



LEBANESE REPUBLIC

General Situation Update for Lebanon's Creditors

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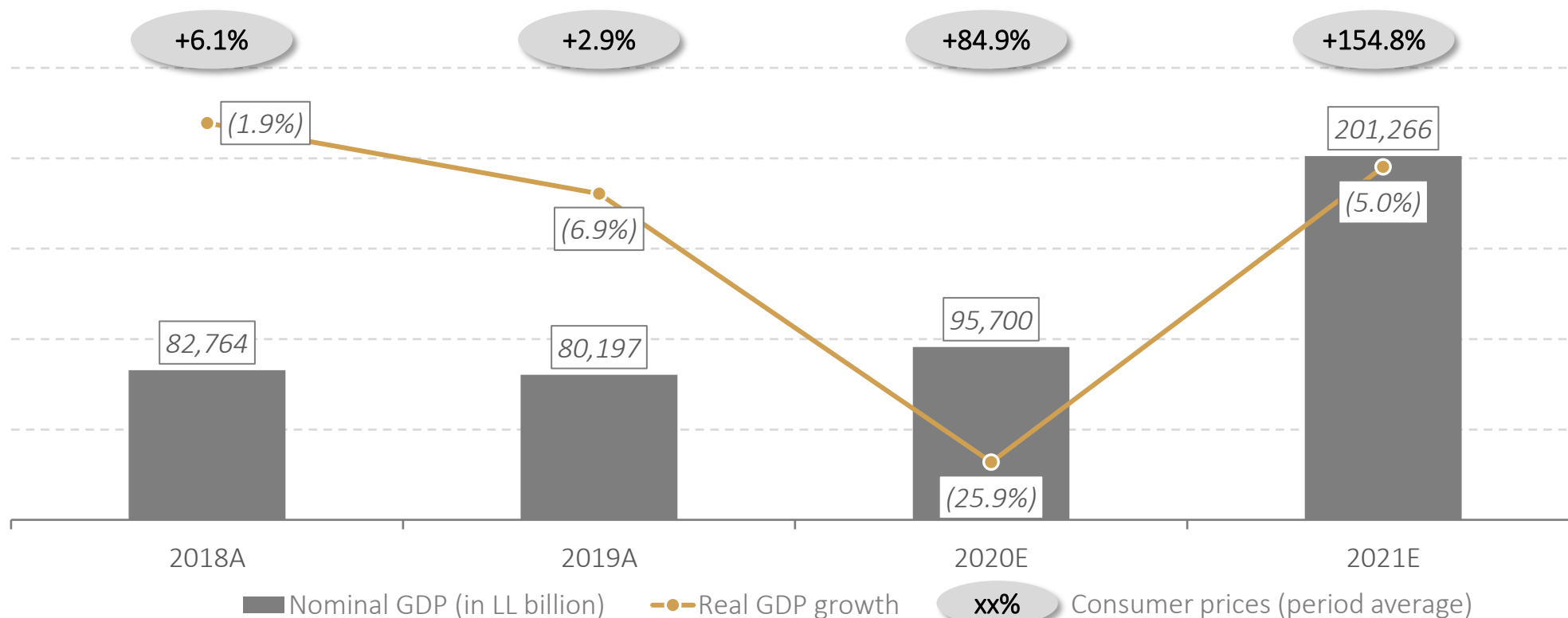
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I Lebanon's Macroeconomic Situation: Where Are We Now?

Since 2019, Lebanon has been facing an unprecedented crisis, with a dramatic economic contraction and a rampant inflation



The crisis has been compounded by the COVID-19 pandemic and the August 2020 explosion of the Port of Beirut. It led to a large increase in poverty, unemployment and emigration as living conditions have deteriorated dramatically.

The lira has lost almost 95% of its value

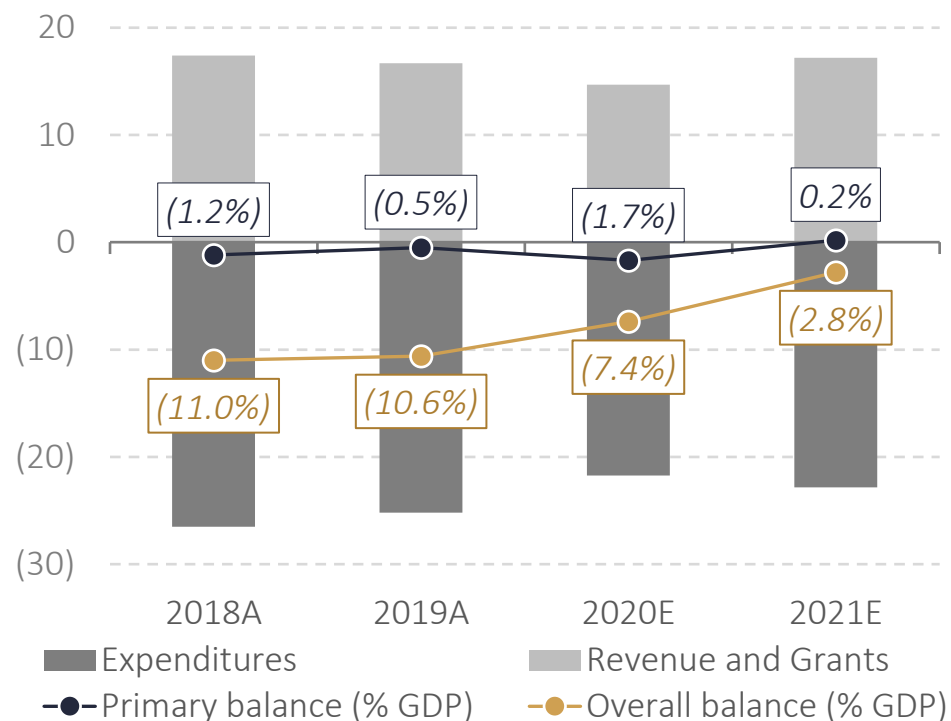


The Lebanese lira lost c. 95% of value since late 2019, currently trading at c. 27,000 to the dollar on the parallel market, and the Lebanese people have been living with a multitude of exchange rates, which have had distortionary effects on the economy.

Fiscal metrics have benefitted from the forced adjustment of budget expenditures in real terms, while public debt has reached c. 360% of GDP

1 Primary and overall budget balance

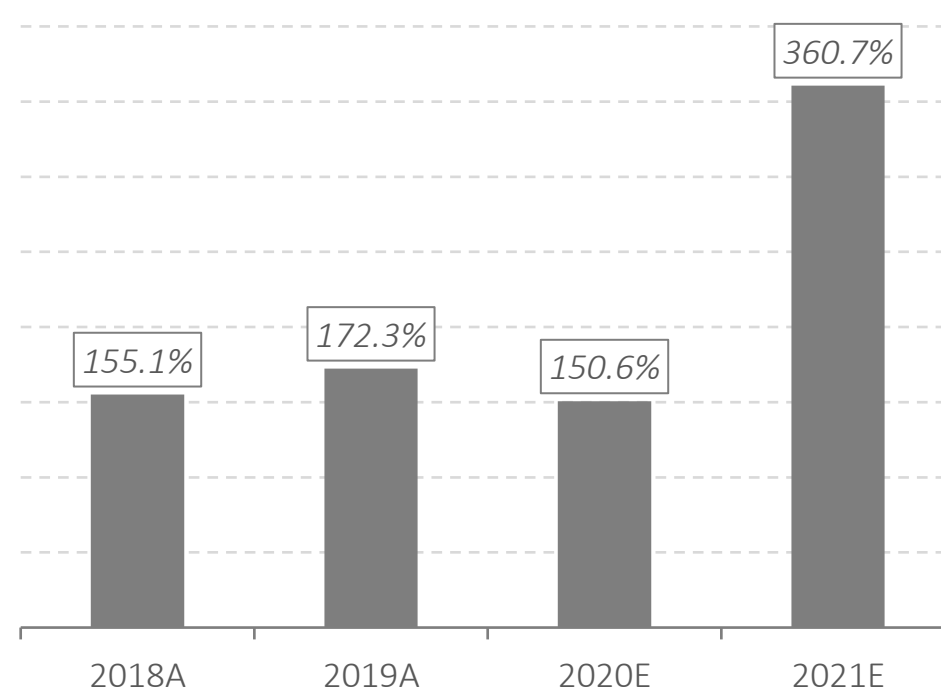
in LBP trillion



The improved fiscal metrics conceal the severe reduction in purchasing power for civil servants resulting from the depreciation.

2 Lebanon outstanding central government debt¹

As of 31 December 2021



The debt-to-GDP ratio has ballooned as a result of the depreciation of the domestic currency.

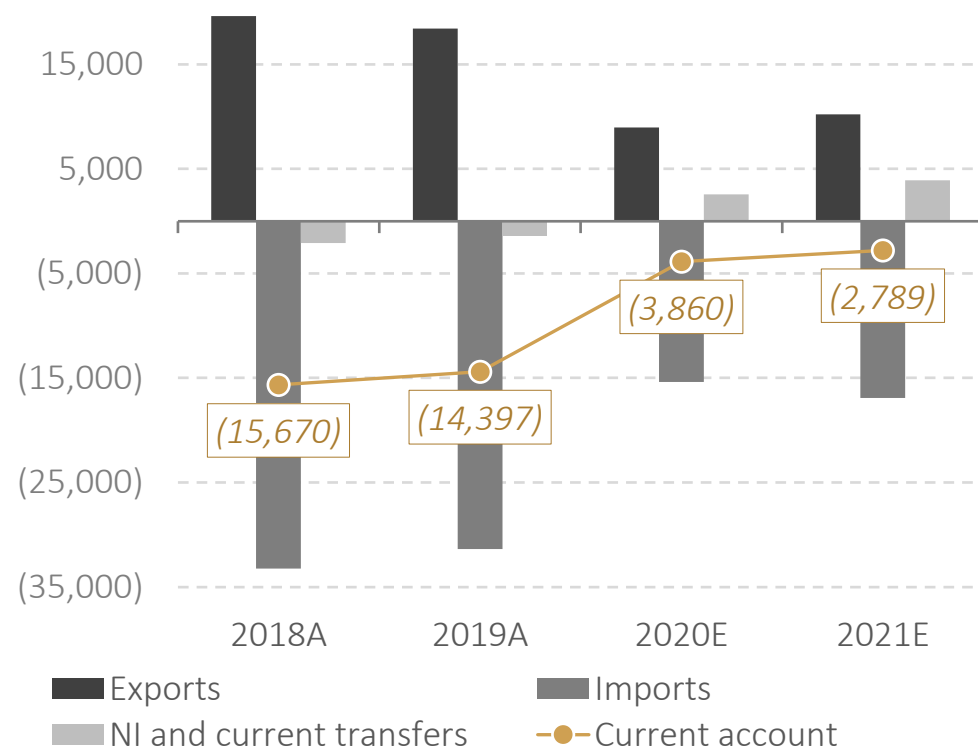
Source(s): Lebanese authorities, IMF staff estimates and calculations

Note(s): (1) At official USD / LL exchange rate, except for 2021 at parallel market rate (weighted average)

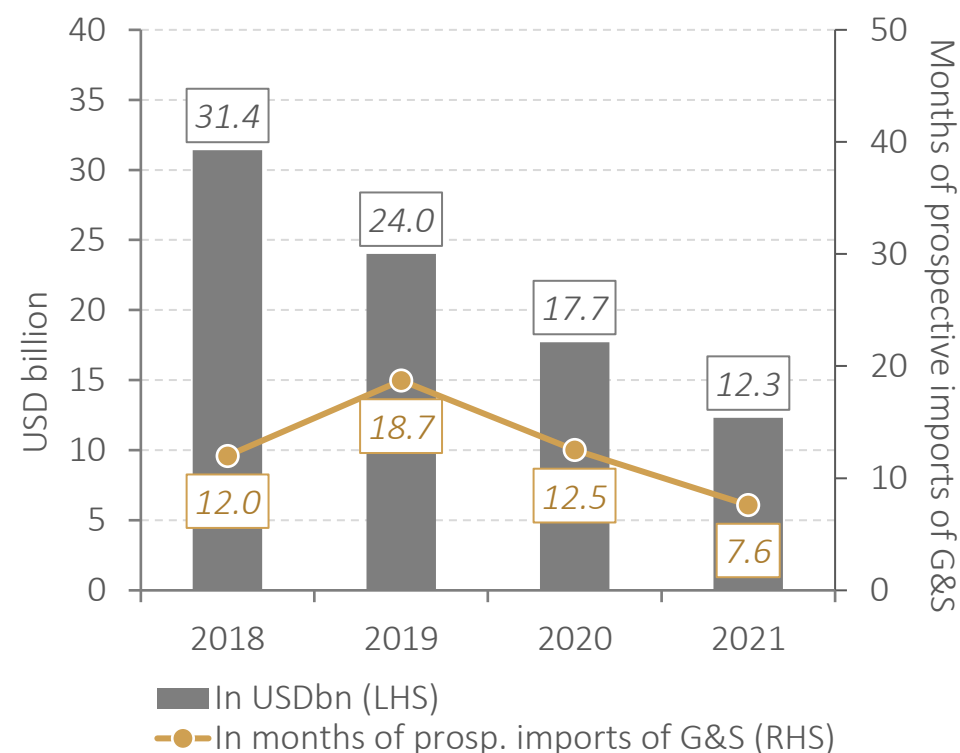
The current account adjustment has largely materialized while FX reserves have reached all-time lows

Current account balance¹

in USD million



The drastic imports contraction has allowed the current account to adjust but at a high cost for the population.

Gross foreign currency reserves²

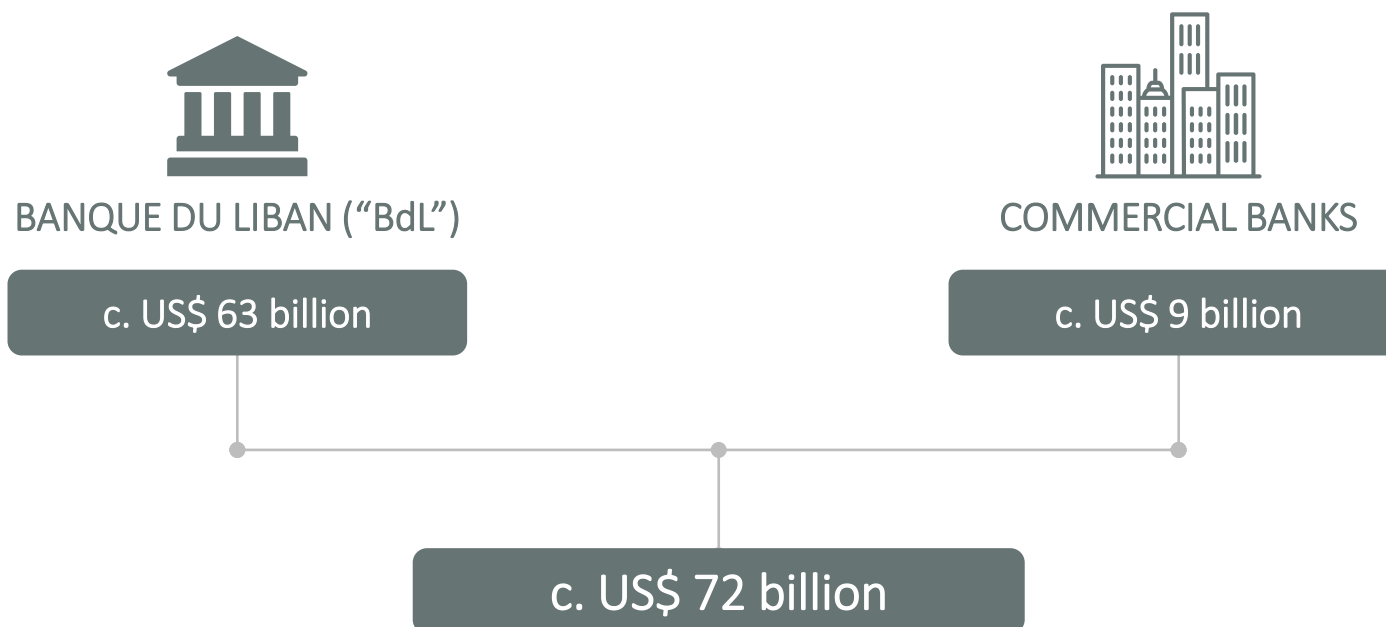
FX reserves (excl. gold) continue to decrease at a very rapid pace, reaching c. USD 12 billion at the end of 2021.

Source(s): Lebanese authorities, IMF staff estimates and calculations

Note(s): (1) As per IMF methodology, excluding official transfers; (2) As per IMF methodology, excluding gold, Eurobonds and encumbered reserves

Losses in the Lebanese financial sector have reached c. US\$72 billion

Estimated losses resulting from the devaluation, the expected sovereign debt restructuring and the restatement of selected BdL and banking sector assets

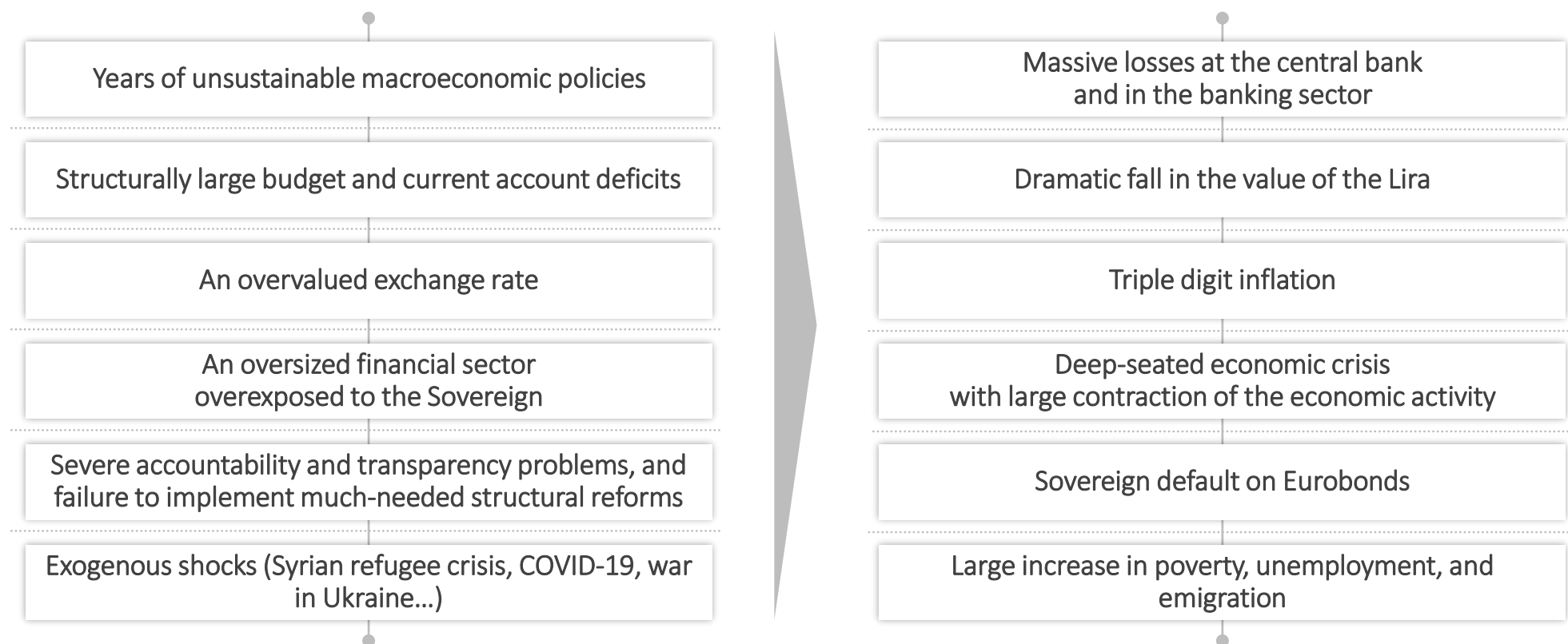


Lebanon's intertwined and oversized financial sector – faced with massive losses resulting mainly from years of financial engineering operations aimed at defending the peg – needs to be recapitalized.



II Overview of the Staff-Level Agreement

The nature and magnitude of the Lebanese crisis requires a comprehensive economic reform package supported by the IMF and Lebanon's international partners



Since its formation in September 2021, the Mikati government has made it its top priority to secure a program with the IMF.

Where do we stand?



On April 7th, after months of negotiations and in a major step towards addressing the country's ongoing crisis, the Lebanese authorities reached a Staff-level Agreement ("SLA") with the IMF Staff on a set of comprehensive economic policies supported by a 4-year US\$3 billion loan facility.



The agreement is subject to approval by IMF management and the Executive Board, after the timely implementation by the authorities of a set of Prior Actions and confirmation of international partners' financial support.



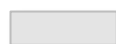
The objectives of the contemplated IMF program are to:

- Backstop the recession, restore macroeconomic stability and spur economic growth
- Consolidate public finances along debt sustainability objectives while enhancing social safety nets and rehabilitating infrastructure
- Ensure fair and equitable burden sharing of financial sector losses
- Allow the banking sector to resume its activity of extending credit to the private sector
- Re-focus monetary policy
- Mend the social fabric torn by rising levels of poverty and growing income disparities
- Improve public sector institutional governance, transparency and accountability

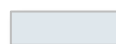
The government has delivered on its promise to reach a preliminary agreement with the IMF ahead of the 2022 elections. This deal provides a clear roadmap in terms of policy implementation and will serve as an anchor for the next political leadership.

The agreement hinges on the completion of the following Prior Actions:

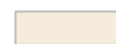
		Responsibility
1	Cabinet approval of a bank restructuring strategy	Government
2	Parliament approval of an appropriate emergency bank resolution legislation	Parliament
3	Initiation of a bank-by-bank assessment of the banking sector by reputable international firms	BCCL / BdL
4	Parliament approval of a reformed bank secrecy law	Parliament
5	Completion of the audit of the BdL's foreign asset position, based on TOR approved by the IMF	BdL
6	Cabinet approval of a medium-term fiscal and debt restructuring strategy	Government
7	Parliament approval of the 2022 budget	Parliament
8	Unification of exchange rates for authorized transactions	Govt / BdL
9	Parliament approval of a capital control and deposit withdrawal legislation	Parliament



Financial sector



Fiscal and debt



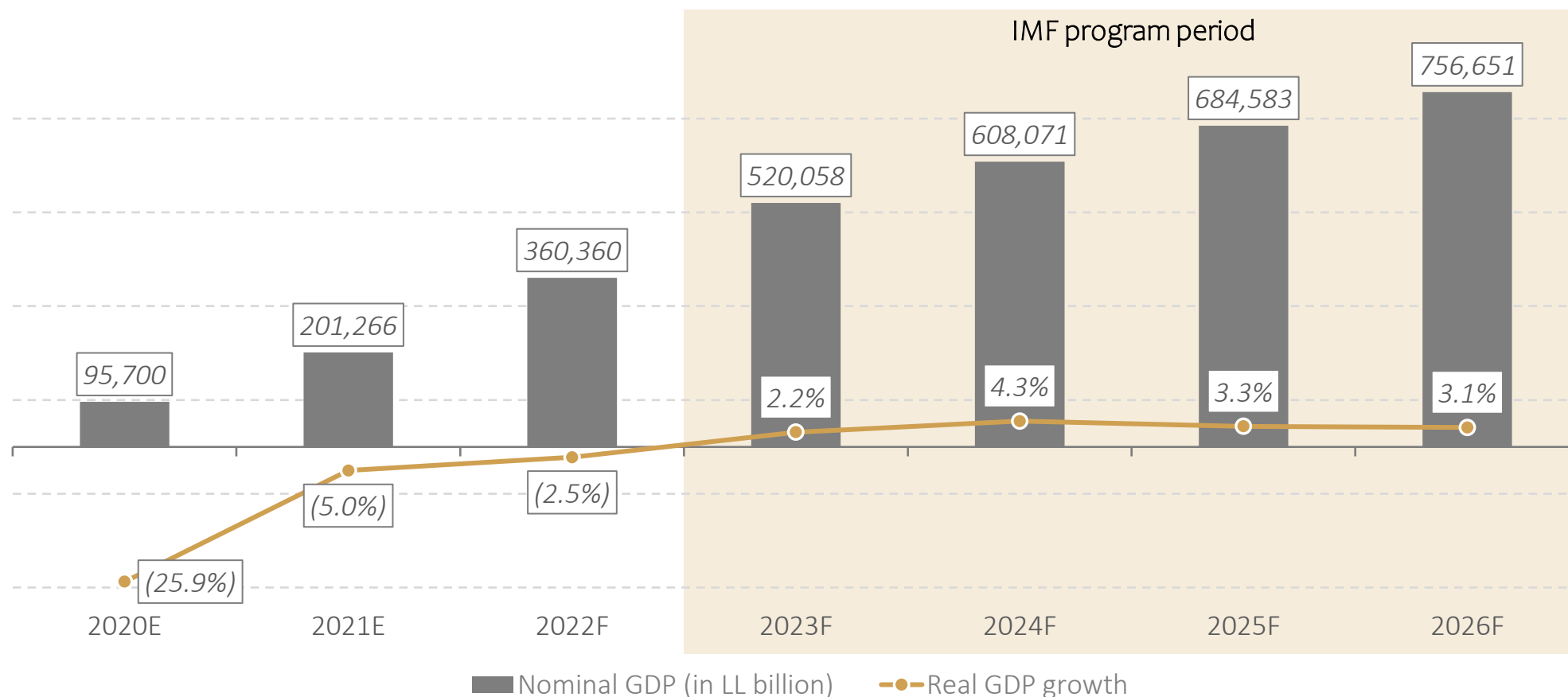
Monetary framework

The implementation of an ambitious set of Prior Actions, with clear responsibilities, has been requested by IMF Staff. Their implementation will lay the groundwork for the successful implementation of the contemplated IMF-supported program.



A The Underlying Macroeconomic Framework

Underlying macro assumptions – *Gross domestic product trajectory*

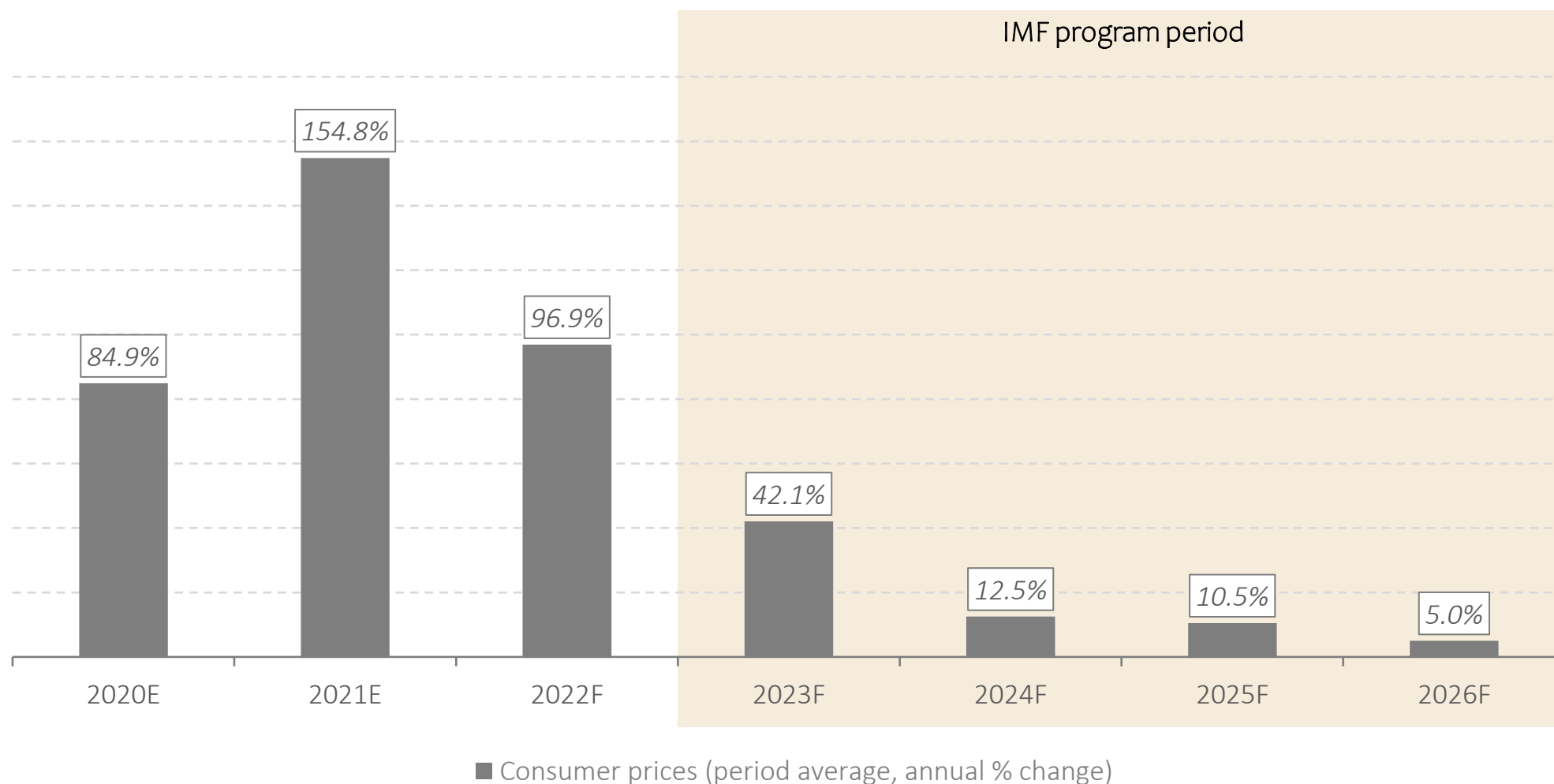


The focus will be on boosting productivity in all economic sectors, with added emphasis on the knowledge economy as a potent driver of growth. The government will provide the right regulatory environment and chart supportive policies for economic activity to thrive¹

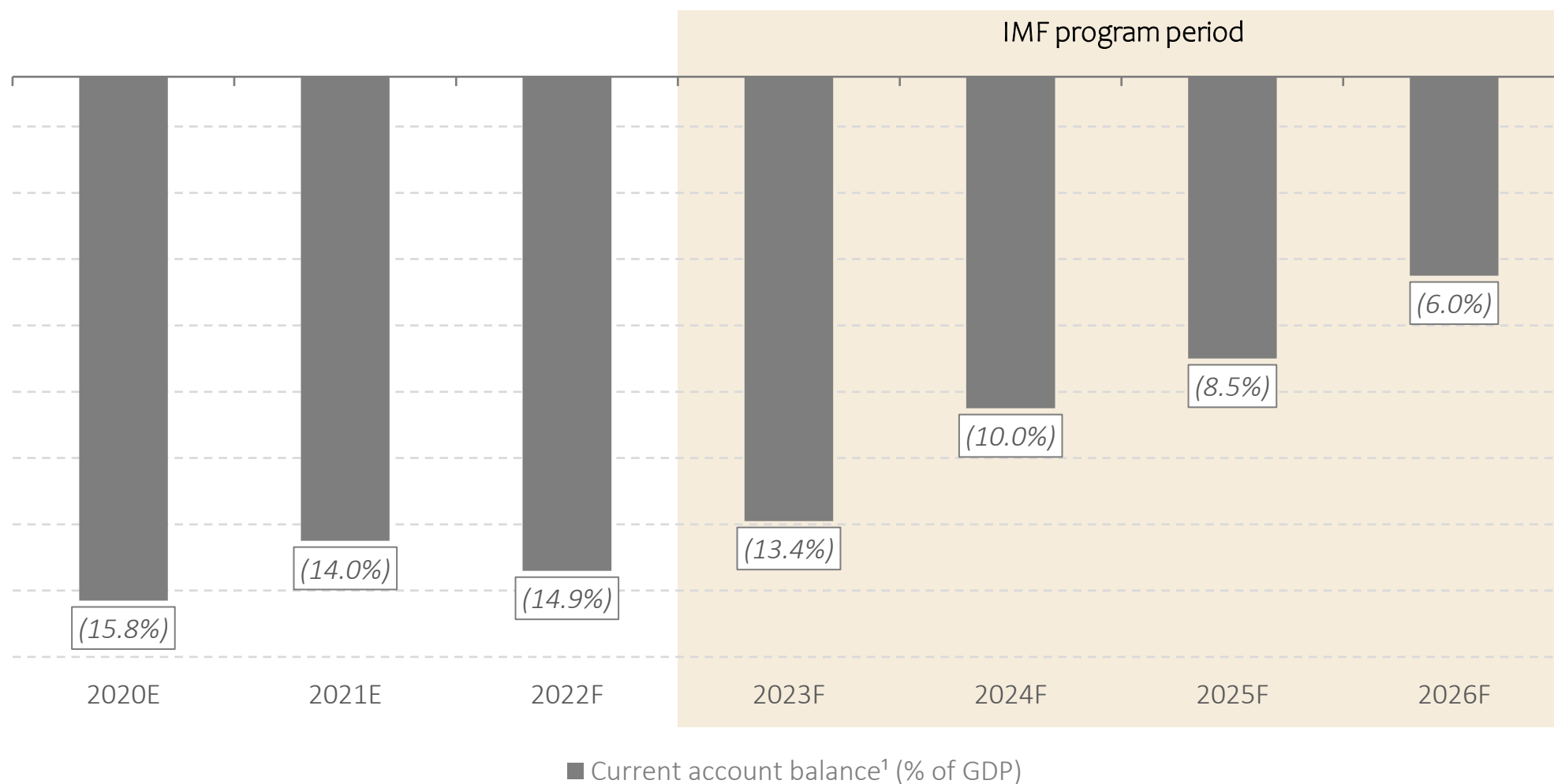
Source(s): Lebanese authorities, IMF staff estimates and calculations

Note(s): (1) In this regard, strengthening digital financial services, enhancing the intellectual property framework, providing affordable and high-speed internet and increasing the supply of electricity will help in building a knowledge and innovation-based economy

Underlying macro assumptions – Inflation path



Underlying macro assumptions – *Current account trajectory*



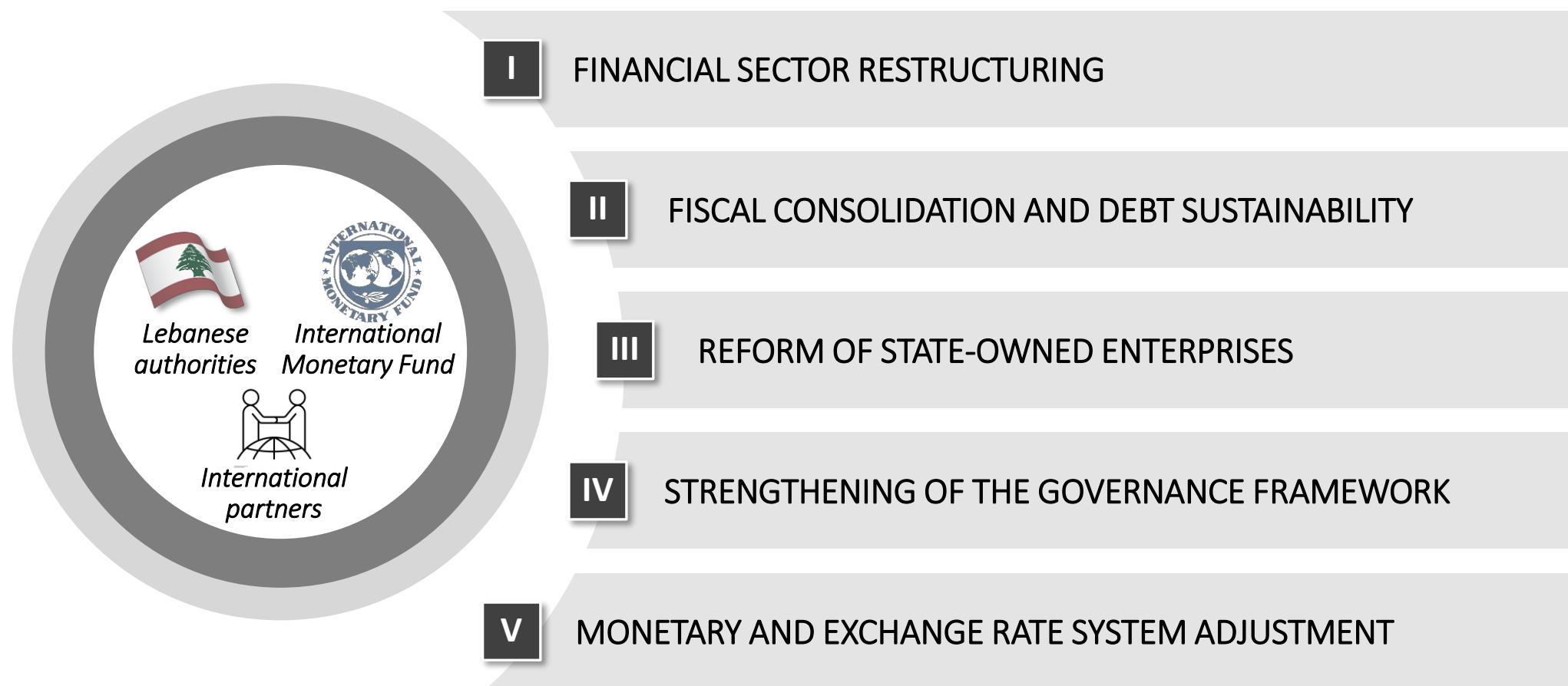
Source(s): Lebanese authorities, IMF staff estimates and calculations

Note(s): (1) Excluding official transfers



B The Building Blocks of the Reform Program

Pillars of the contemplated economic reform program



Building blocks of our financial sector rehabilitation strategy

Pre-requisites to a successful financial sector restructuring

- Finalize BdL audit
 - Financial statements restatement with an upfront recognition of losses
- Draft and enact an emergency banking sector resolution law to support the rehabilitation strategy
- Conduct a bank-by-bank AQR
 - Performed by the Banking Control Commission (“BCC”) with the assistance from reputable international firms based on terms of reference agreed upon with the IMF
 - Derive a bank-by-bank “button up” quantification of losses

Fair and equitable management of the losses

- Respect the hierarchy of claims in dealing with the losses
 - Main parties involved in the build-up of the losses will be asked to contribute first
- Protect small depositors (e.g., up to \$100,000 per depositor per bank)
- Perform restructuring of accounts
 - Bail-in of large depositors and some lira-fication of FX deposits
 - Remaining deposits may be returned in USD and/or lira at market-determined rate for liquidity purposes
- Any credible scheme that could bring additional recovery to depositors will be considered

Recapitalization of viable banks / resolution of unviable banks

- Determine which banks need to go into resolution or be combined with other banking institutions
- Assign gradual capital increase targets for the others
 - Based on a forward-looking analysis of their business plans after restructuring
- Inject fresh capital in viable banks
 - Former and/or new shareholders to commit to invest fresh capital in banks deemed viable by the BCC
- Resolve all unviable banks in line with the new emergency bank resolution framework (no pre-conceived notion about the number of banks that should remain in the system)

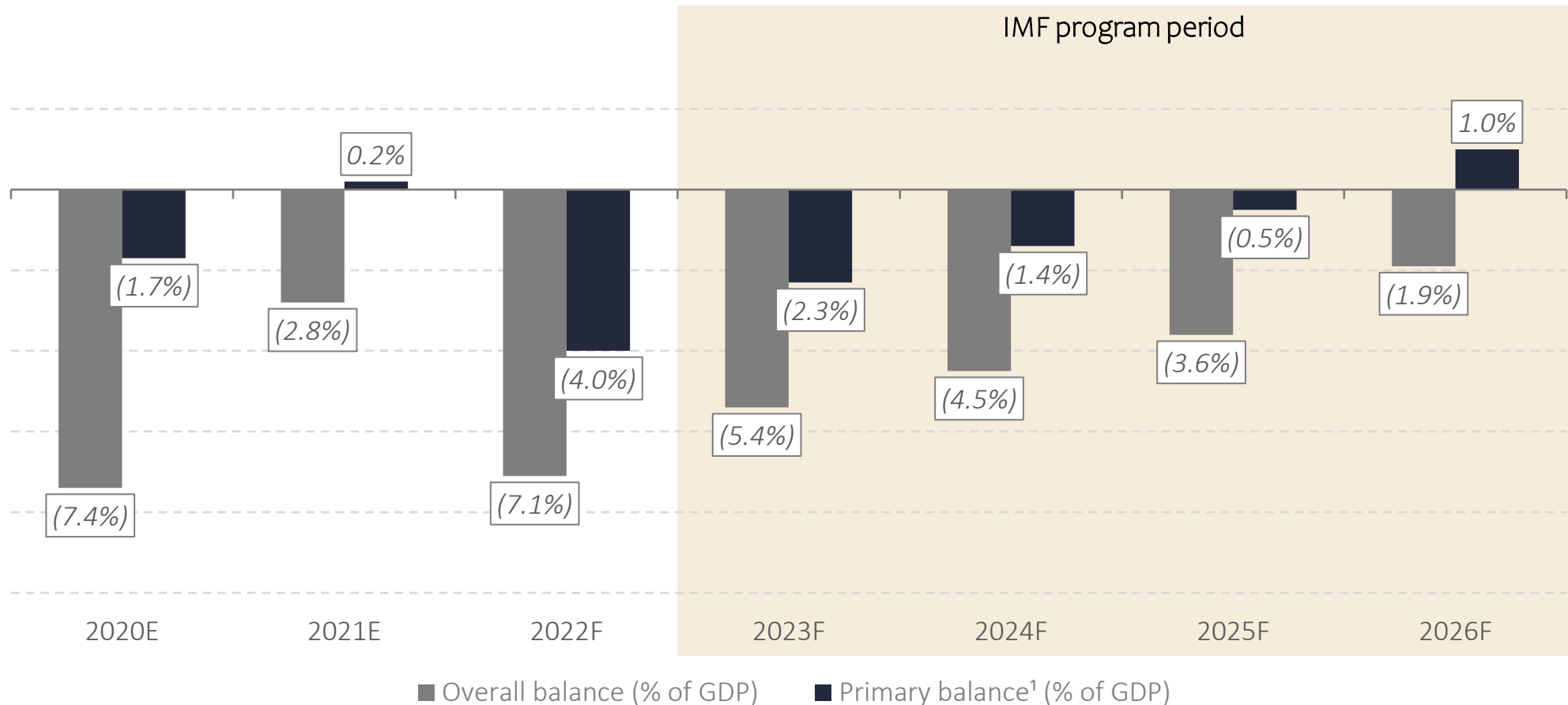
We are committed to (i) restoring the health and viability of our financial sector, and (ii) strengthening the whole banking regulatory framework.

General principles for dealing with the losses

#	Principle	Description	Implication
1	PROTECT THE MOST VULNERABLE	Safeguard the most vulnerable segments of society by guaranteeing the value of their deposits.	We will protect small depositors (e.g., up to \$100,000 per depositor per bank, depending on the banking sector viability assessment, which could lead to changes in the protection level, hopefully upwards)
2	FAIR AND EQUITABLE TREATMENT	<u>Respect the hierarchy of claim.</u>	<u>Banks' shareholders and debtors will be asked to contribute before depositors</u>
3	ENSURE PROMPT ECONOMIC RECOVERY	Ensure that initiatives do not hamper the banking sector, BdL and government from fulfilling their duties.	- Ensure the financial sector's (i.e., banks and BdL) return to solvency and appropriate path to restore liquidity - Manage LBP money supply and USD liabilities, <u>avoid inflation</u> and reduce value discrepancy between USD cash and USD deposits <u>Restore public debt sustainability</u>

We will insist on respecting the most equitable guiding principles for dealing with losses, including the hierarchy of claims.

Our fiscal plan aims at consolidating public finances along debt sustainability objectives



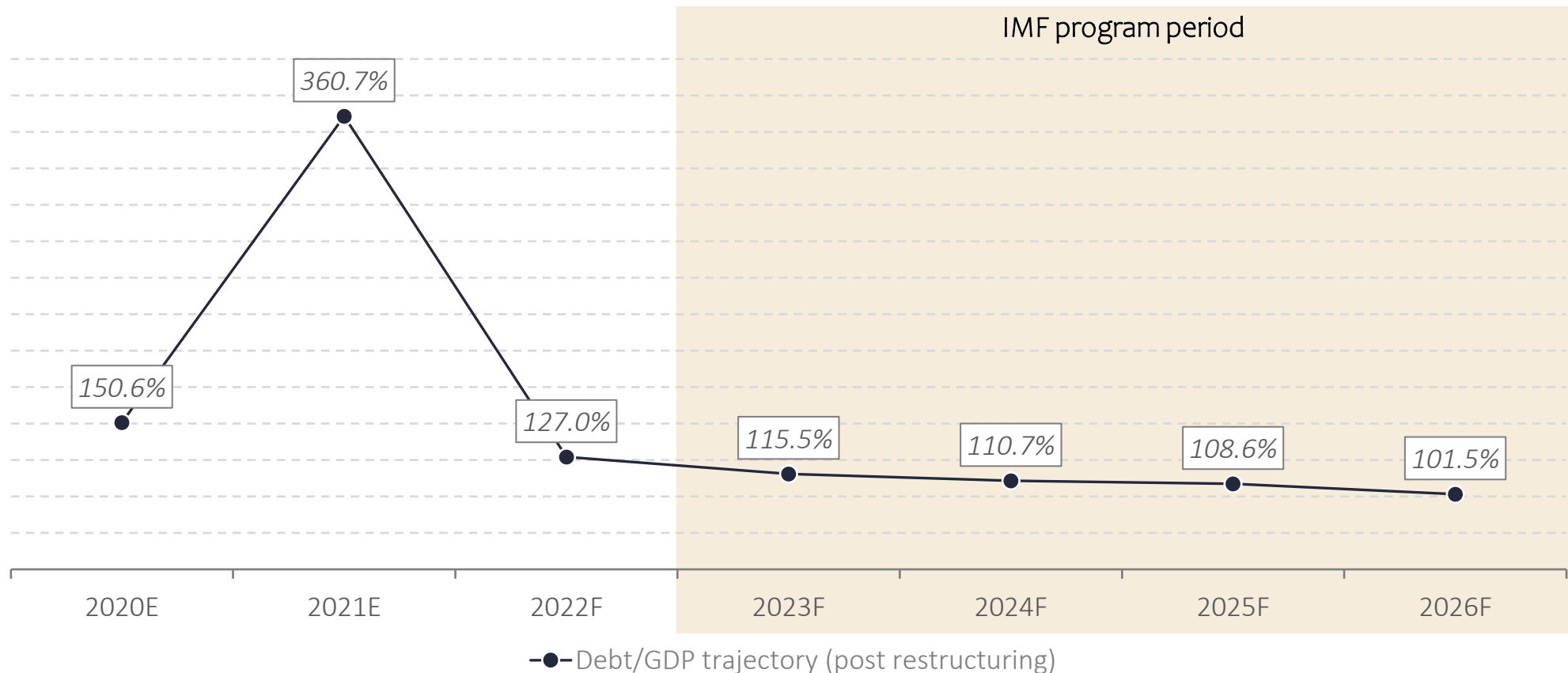
The program will target a cumulative adjustment in primary balance (excl. foreign financed capex) of around 6% of GDP and achieving a primary surplus of 1% of GDP by 2026.

General principles of our ambitious fiscal reform plan

	REVENUE-ENHANCING INITIATIVES	EXPENDITURE RATIONALIZATION INITIATIVES
SHORT-TERM	- Rebuilding the tax and customs collection capacity - Adapting the collection of all taxes and fees on the unified exchange rate, including import valuation base - Adjustment of selected fees along the new unified exchange rate	Support higher social spending. Our immediate commitments include (i) the ESSN¹ project, (ii) the BCCT² program, and (iii) the development of an integrated national social registry Consolidate the various education and health spending schemes for more effective public social expenditures Accommodate partial recovery of personnel and other spending that were significantly eroded in last two years due to high inflation Revamp capital spending to rehabilitate failing infrastructure and enhance growth
MEDIUM-TERM	Revenue administration measures to improve compliance and support consolidation Tax policy measures will focus on broadening the tax base and gradually increasing statutory rates	Public expenditure review to help improve efficiency and effectiveness of public expenditure and identify possible avenues for spending prioritization and streamlining Reducing the size of the public sector by attrition and hiring freeze

To enhance the credibility of the public sector adjustment, we will also undertake wide-ranging public financial management (PFM) reforms.

The government is committed to putting public debt on a sustainable path

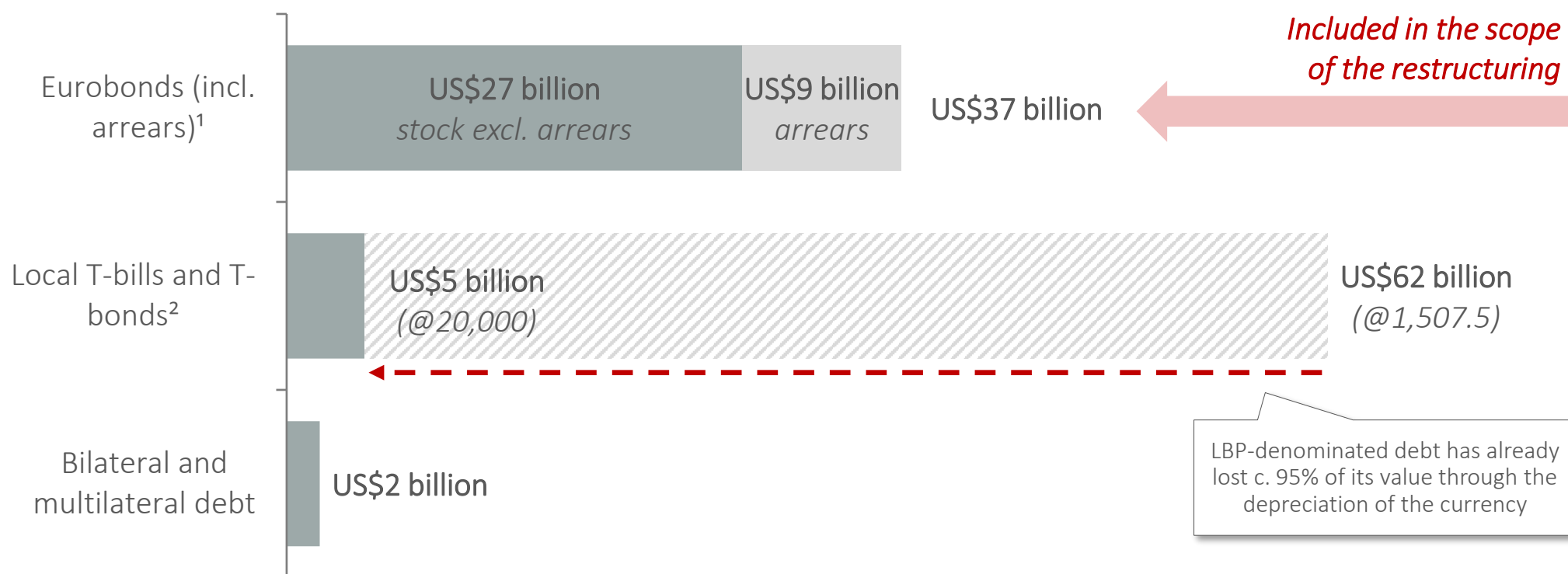


We will reduce public debt to c. 100% of GDP by 2026 and, further, to c. 75% of GDP by 2032. This will be achieved through a combination of (i) fiscal consolidation, (ii) policies to boost growth, and (iii) a restructuring of our public debt.

Contemplated perimeter of the public debt restructuring

Lebanese public debt stock as of December 2021

USD BN



- Local currency-denominated debt and bilateral debt will, to the extent possible, be excluded from the perimeter of the sovereign debt restructuring
- The government will remain current on debt service payments to multilateral partners

Source(s): Lebanese authorities

Note(s): (1) As of April 2022, Banque du Liban held US\$5.03 billion worth of Eurobonds; as of June 2021, the Lebanese banking sector held c. US\$11.1 billion worth of Eurobonds; (2) As of December 2021, Banque du Liban and the Lebanese banking sector held respectively c. 62% and c. 23% of the local T-bills and T-bonds

General principles for the prospective engagement with bondholders

1

Transparency

2

Good faith efforts
for a collaborative
process to restore
debt sustainability

3

Fair treatment
so as to ensure, to
the extent possible,
a fair burden-
sharing between all
stakeholders

4

Consistency with
IMF debt
sustainability
analysis constraints
and program targets

5

Need for a **credible,
sustainable and
lasting solution** to
Lebanon's structural
debt and
macroeconomic
problems

The program objective will be to reform state-owned enterprises, particularly in the energy sector, to provide quality services without draining public resources

1 INCREASING SOE TRANSPARENCY AND OVERSIGHT

2 ENHANCING THE SOE LEGAL FRAMEWORK AND OWNERSHIP ARRANGEMENTS

ELECTRICITÉ DU LIBAN

3 IN THE SHORT TERM, IMPROVE ELECTRICITY SUPPLY HOURS AND IMPLEMENT COST RECOVERY TARIFFICATION

4 INCREASE AND DIVERSIFY POWER SUPPLY

5 IMPROVE FINANCE PERFORMANCE AND TRANSPARENCY

6 REDUCE TRANSMISSION AND DISTRIBUTION LOSSES

7 ENHANCE GOVERNANCE

The reform of the electricity sector is of the utmost importance: today, electricity is a major threat to the livelihood of a large segment of the Lebanese population and a significant impediment to growth. The government has already approved an electricity reform plan.

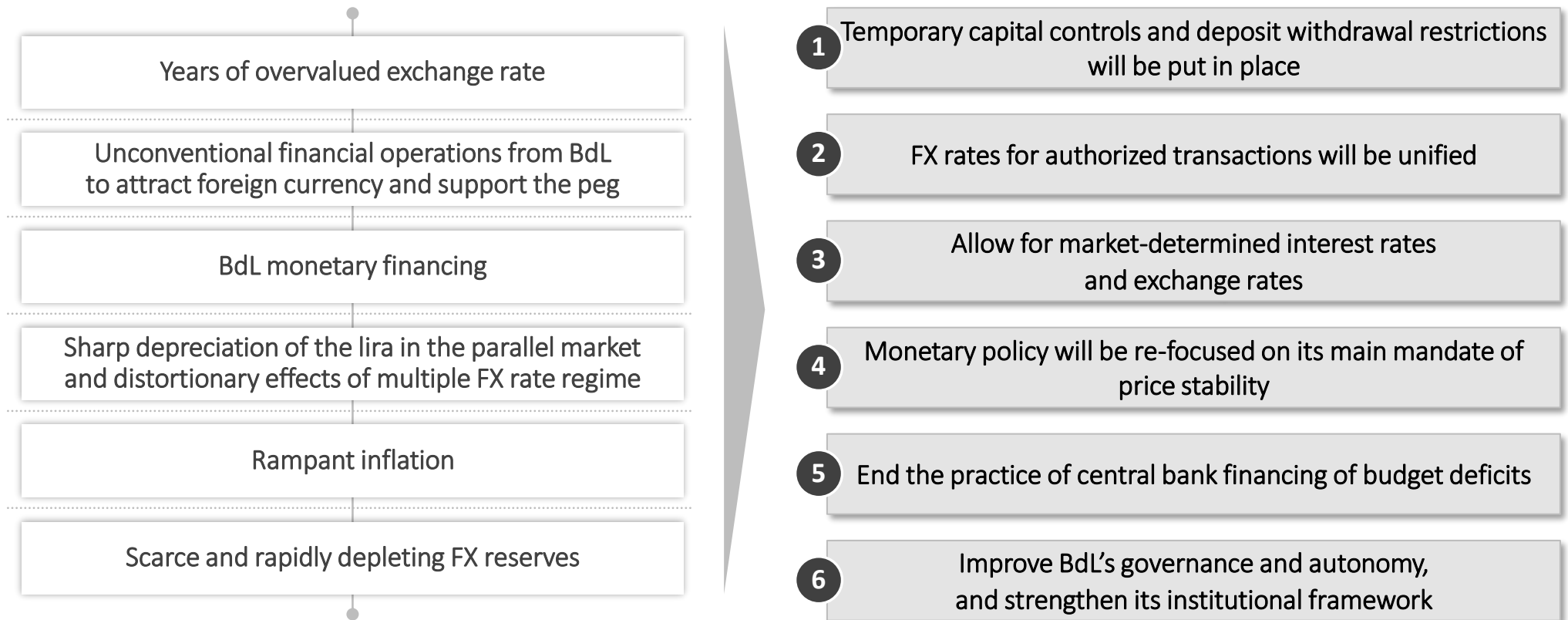
We are determined to intensify our efforts to strengthen governance, the AML/CFT regime and the control of corruption

The priorities are:

- 1 CONDUCTING AND PUBLISHING A COMPREHENSIVE GOVERNANCE DIAGNOSTIC WITH THE SUPPORT OF THE IMF
- 2 STRENGTHENING THE EFFECTIVENESS OF ANTICORRUPTION LEGAL FRAMEWORK AND INSTITUTIONS
- 3 REFORMING BANK SECRECY LEGISLATION IN LINE WITH INTERNATIONAL STANDARDS
- 4 ENHANCING AML/CFT EFFECTIVENESS AND THE AML/CFT LEGAL FRAMEWORK

The government has made the improvement of public sector institutional governance, transparency and accountability one of its top priorities and has already approved an anti-corruption strategy and appointed the members of the anti-corruption committee.

Years of exchange rate peg proved costly and unsustainable. The foreign exchange and monetary framework will be adjusted



11 MAY 2022

GENERAL SITUATION UPDATE FOR LEBANON'S CREDITORS



III Next Steps

Envisaged next steps

Pre-Board Phase

- Lebanese parliamentary elections
- New political leadership to resume the implementation of the program Prior Actions
- Refresh bondholder identification exercise
- Start exchanging materials with bondholders and/or their advisors on the DSA, and publish updated data on debt and debtholder structure
- Provide regular updates to bondholders on (i) the developments of the macroeconomic and political situation on the ground, and (ii) the Prior Actions implementation status
- IMF Executive Board to approve the program

Active Negotiation Phase

- Conduct discussion with bondholders in view of reaching an agreement on the restructuring terms
- Agree with bondholders on the key principles of the restructuring and sign term sheets
- Execution and closing of transactions