KULLUNAIRADA

QUESTIONING THE 2019 BUDGET

June 2019

The Council of Ministers has forwarded to Parliament a draft budget for the 2019 fiscal year. This draft is presented as a sign of the Government's willingness to tackle and initiate the economic reform process and respect its commitment to reduce the size of public deficit, as stated during the CEDRE donor conference.

Our concerns are three-fold:

First, we are concerned about the **fiscal health of the 2019 draft budget,** notably the budget exercise's sincerity and its underlying assumptions and calculations.

• There seems to be ample signs that GDP growth this year will not reach the budget's estimates of 1.2% growth. The IMF has similarly estimated growth projections for 2019, as of April 2019, at 1.3%.

• 2019's budget entails a **15.67% rise in government revenues** to be achieved through introducing new taxes and public service fees in addition to raising rates on existing measures. Given **the weak economic backdrop** that these measures are being introduced in and the fact they have **not been applied over a full year** we don't see that they will achieve their targeted returns.

• **BDL has been monetizing government debt** for years now in stark contrast to conventional monetary policy guidelines leading to a **quasi-fiscal deficit**. BDL has communicated through its balance sheet that it has **paid USD 2.152Bn on behalf of the Treasury in Eurobond coupon payments and maturities** since the start of 2019. Furthermore, an **additional LBP 11,000 Bn issuance at a cost of 1%** is planned in which banks have not agreed upon yet and if they fail to do so BDL has to subscribe to leading to a continuation of the quasi-fiscal deficit transfer; this will also entail the need for BDL to supply the Treasury with USD 1.5Bn to finance Eurobonds maturing in November 2019 excluding coupons. Taking the specificity of Lebanese sovereign debt, **we are concerned by the moral hazard these operations create**.

Our second concern revolves around **the country's monetary environment.**

• The Lebanese monetary model is **dependent on dollar inflows in order to maintain the currency peg**; however, these **inflows have reversed** over the past two years. This raises the question of the sustainability of the peg as **BDL burns through its dollars** to defend it. As such we question **this allocation of BDL's reserves** given that the cost of maintaining the peg is rising as the balance of payments deficit grows.

Our third concern is focused on the **health of Lebanon's banking sector.**

• Lebanon's **sovereign credit rating has already been downgraded** by one of the three major rating agencies to CCC. Upon further downgrade by another agency, and knowing that the Lebanese banking system has **vowed to comply with the Basel Accords**, the **levels and availability of the capital injections needed** to maintain compliance should be very hard to meet.

• The Lebanese **commercial banking sector** has been **reliant on BDL's unconventional polices** to generate a big part of their profits. Given that this has **disincentivized the sector from seeking other sources of profits** we ask about the risk of a sharp drop in banks' profitability when BDL ceases these policies and the possibility of **banks acquiring riskier assets** to cover up for that loss when It materializes.

Kulluna Irada is a civic organization for political reform, engaged in setting the foundations for a modern, secure, efficient, sustainable and just state. It is funded exclusively by Lebanese citizens in Lebanon and abroad. Kulluna Irada believes transparency, accountability and citizen participation as major constituents of good governance. The organization's goal is to raise awareness on public issues and engage constituencies of the Lebanese society: citizens, NGOs, experts, municipalities, and members of Parliament and Government in order to find and implement sustainable solutions.

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