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Economists: Lifting subsidies will cause hyperinflation and further devaluation of pound

Osama Habib|

BEIRUT: Completely lifting subsidies on all commodities coupled with the expected $400 cash withdrawals from the banks will trigger unprecedented hyperinflation and sharp devaluation of the Lebanese pound if the government fails to come up with an alternative plan to cushion the initial shock.

This was the general impression of most economists and bankers who were interviewed by The Daily Star.

The caretaker government, Parliament and the Central Bank have so far declined to work together to devise a stratgey to alleviate the suffering of the Lebanese once the subsidies are totally removed.

Most Lebanese are concerned that their entire monthly income will not cover even the cost gasoline, electricity bills and the bare essentials once the subsidies are lifted.

There is growing talk that the price of 20 liters of gasoline will surpass LL200,000 if the Central Bank decides to end the subsidy program, as it argues that BDL is not authorized to touch the remaining $14 billion in foreign currency reserves,

Furthermore, the patients will be deprived of basic medical services and treatment if subsidies on pharmaceuticals and hospital equipment are lifted.

The government and Parliament have yet to agree on the size of cash disbursements to needy families in Lebanon or even on the source or mechanism of funding the program.

The Lebanese pound has already lost 90 percent of its value against the US dollar and the purchasing power of the residents has reached its lowest point, according to all international studies.

The minimum wage of LL675,000 is now equal to only $45 based on the new exchange rate of LL15,000 to the dollar.

The consumer price index in Lebanon for the month of May 2021 recorded an increase of 119.83 percent compared to May of 2020.

The consumer price inflation during the first five months of the year amounted to 33.2 percent, according to the Central Administration of Statistics.

Rock Antoine Mehanna, an economist and financial analyst, gave a bleak picture of the Lebanese economy if subsidies were lifted without a sound program to ease the pain of the Lebanese consumers.

“We will definitely end up with hyperinflation that's never been seen in the country, accompnaied by further devaluation of the pound once the subsidy program is halted by the Central Bank. Unfortunately, the caretaker government, Parliament and Central Bank are throwing the responsibility of lifting subsidies on each other,” Mehanna told The Daily Star.

He added that BDL’s circular 158 will not have a primary effect on inflation despite some concern that printing more Lebanese banknotes may have affect consumer prices and pound's devaluation.

“I believe that lifting the subsidies will be the main cause of hyperinflation and this could lead to social upheaval in the country if the authorities do not come up with a sound solution to substitute the removal of the support program,” Mehanna explained.

Mehanna said he supported lifting subsidies as they are squandering BDL’s resources, but underlined the need to provide some kind of cash assistance to citizens.

“Nearly 60 percent of the subsidized gasoline and other basic items are either smuggled to Syria or hoarded by some merchants and exclusive dealers in Lebanon,” he added.

Mehanna believes that the caretaker government can negotiate with the International Monetary Fund in a bid to secure some assistance from the IMF.

“Under extremely difficult situations in Lebanon, the caretaker government can resort to a clause in the law to negotiate with the IMF. The government can’t just sit idle,” he added.

The economist advised the authorities to use scanners, GPS and drones to trace the smugglers to Syria and also supported the idea of Parliament creating a temporary currency board.

“We need to get firm with some of the exclusive dealers and merchants who are hoarding the basic items in order to make a quick profit. There is a list of measures the authorities can take before the formation of the government,” Mehanna stressed.

But another economist did not rule out a higher inflation due to BDL’s circular 158.

“The danger of the circular also lies elsewhere, which is its catastrophic impact on the appreciation of the exchange rate, as the press release issued by the Central Bank which preceded the issuance of the circular indicated the size of the monetary cash that will be offered to fund the alternative payment, which will be calculated on the basis of the exchange rate,” he said.

The economist said $400 paid in Lebanese pounds at the LL12,000 exchange rate represents half of the assumed value of the $800, as it is divided into $400 in cash and the rest in Lebanese pounds, and therefore the volume of printing money and comparing it with the volume of pound banknotes printed since 1990 and even before the crisis, will lead to high inflation.

Makram Sader, the secretary-general of the Association of Banks in Lebanon, admitted that BDL’s circular would lead to sharp inflation in Lebanon as the Central Bank is expected to print more pounds to finance half of the $800 which will be paid in local currency.

“The Lebanese pound will be set at rate of LL12,000 per dollar. This requirement creates, within a year, approximately LL30 trillion, which increases the volume of cash and could lead to inflationary pressures that are difficult to calculate in advance. The money supply in circulation will be at 80 percent, but it will weaken the purchasing power of the national currency.”