Banking industry 2019: an analysis of activity performance, risk profile and return indicators

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Since its first edition in 1983, Bankdata publishes periodic reports monitoring on a quarterly and yearly basis the financial standing of Lebanese banks. Bankdata compiles these reports from company data provided by each individual bank in the form of detailed consolidated statements of financial position and income statements. Annual company data encompass audited financial statements that banks formally confirm, while quarterly data is based on unaudited financial statements also formally confirmed by banks. From the outset, it was Bankdata's policy to refrain from commenting on audit reports and financial statements since our methodology is solely based on a single common matrix applied equally to all banks without any additional commentary. Its broad scope and level of details allows users to form a relatively precise idea of the market background and positioning of each bank, its asset utilization policy, risk profile and key elements of its financial standing, including asset quality and liquidity, solvency and regulatory capital as well as elements of cost efficiency and profitability. The analysis is completed by relevant rankings according to all these criteria.

The year 2019 under analysis is a pivotal one in the recent history of Lebanese banks, representing a material turning point. Further to the buildup of massive socio-economic and financial pressures over the previous years, 2019 was the year of monetary collapse after 22 years of currency stability facilitated by a peg implemented by Banque du Liban (Central Bank of Lebanon).

Since the beginning of the year, the drop in capital inflows and the rapid rise in deposit rates, particularly in foreign currencies, had signaled the beginning of a monetary and foreign exchange crisis. However, the incidents of Kabrechmoun in June 2019, the prolonged intentional withdrawal of the Prime Minister from state affairs, followed by the outbreak of unprecedented protests (Revolt of October 17) leading to the resignation of the government uncovered the extent of the damage to the currency, with massive withdrawals generating an acute foreign currency cash liquidity imposing a month-long forced bank holidays followed, at reopening, by the establishment of a de facto capital control. These developments have certainly had a material impact on the financial standing of banks, as evidenced in the analysis that follows.

Banking aggregates are driven and impacted by macroeconomic aggregates. In this regard, the economic context that characterized 2019 was very gloomy. In terms of economic activity, GDP declined by 6.7% in real terms according to the World Bank, as evidenced by the evolution of real sector's main indicators: 12% drop in the Central Bank's coincident indicator, 33% drop in cement deliveries, 13% decline in cleared checks, 3% decrease in the production of electricity and 4% decline in passengers' arrivals at the airport. The impact of this politico-economic imbroglio on the financial and monetary situation was very negative: increase in public debt by USD 6.5 billion, deficit in the balance of payments of USD 5.9 billion, decline in the gross foreign exchange reserves of the Central Bank of USD 3 billion within increasing foreign currency liabilities towards the banking sector by close to USD 15.5 billion; currency in circulation almost doubled, increasing by USD 3.1 billion equivalent in Lebanese Pounds, while intangible assets on the Central Bank's balance sheet increased by USD 12.5 billion! In short, accumulating all the ingredients of the subsequent currency collapse witnessed in 2020.

Banking activity, measured by the consolidated assets of Lebanese banks, decreased by USD 31 billion, from USD 278 billion as at end-December 2018 to USD 247 billion as at end-December 2019. By geography, this evolution stems predominantly from the domestic activity, within a stable asset level for foreign entities across the period, standing at USD 36.8 billion. Nonetheless, in relative terms, the share of foreign entities' assets in total assets rose from 13% as at end-December 2018 to 15% as at end-December 2019. In parallel, deposits of foreign entities increased by circa USD 2 billion, from USD 25.5 billion as at end-December 2018 to USD 27.5 billion as at end-December 2019, most likely driven by massive outflows from Lebanon during the year, while loans of those entities dropped by USD 600 million, from USD 15.9 billion as at end-December 2018 to USD 15.3 billion as at end-December 2019. Foreign entities reported USD 92 million in net profits in 2019, down from USD 225 million in 2018.

The reduction in consolidated assets by USD 31 billion was driven at the liabilities side by consolidated customer deposits (USD -13.5 billion) and consolidated liabilities to Central Banks (USD -9.5 billion) mainly in Lebanon as a result of either netting operations or termination of financial engineering soft loans vs. foreign currency loans granted to banks. The drop in deposits is attributed to a USD 13.7 billion contraction in term and saving accounts within the context of an increase in sight deposits of USD 5.1 billion. In parallel, margin deposits and cash collateral decreased by USD 4.3 billion and related parties' deposits decreased by USD 0.6 billion. Total shareholders' equity decreased by USD 3.1 billion during the year, mainly due to a registered operating loss of USD 1.9 billion in 2019 compared to a profit of USD 2.5 billion in 2018.

The decline in liabilities was met on the asset side with a USD 12 billion decrease in loans to customers, a USD 4 billion decline in placements with banks and a USD 13.7 billion drop in portfolio securities (comprising CDs, TBs and Eurobonds). The decrease in loans was mainly registered at the level of Corporate loans (USD -7.5 billion), Retail and SME loans (USD -2.5 billion) and other loans (USD -2 billion).

By currency, deposits denominated in LL led the decline with a contraction of USD -12.6 billion equivalent to be added to a decrease in dues to Central Banks denominated in LL by USD -13.4 billion equivalent. In foreign currencies, customer deposits decreased by USD 1 billion (increase of USD 2 billion in foreign entities and decrease of USD 2.9 billion in Lebanon).

On the asset side, the contraction in LL liabilities was met by a parallel decrease in deposits with central banks of USD 15.2 billion equivalent, in portfolio securities (principally CDs and TBs) of USD 8 billion equivalent, and in loans and acceptances of USD 4.6 billion equivalent. In foreign currencies, deposits in Central Banks increased by USD 15.5 billion, within the context of a decline in liquidity placed with correspondents of USD 4.2 billion and in portfolio securities (mainly Lebanese eurobonds) of USD 5.7 billion.

This operating environment obviously led banks to implement restrictions and austerity measures, especially towards the end of the year, as evidenced by the closure of 24 domestic branches down to 1,071 and the contraction of domestic staff count by 1,150 to 26,308 employees. This was the start of a process that will develop and intensify in 2020.

In terms of loan quality, gross credit impaired loans increased by USD 2.2 billion despite the contraction in gross loans, resulting in a 4.8% increase in the ratio of doubtful loans to gross loans from 10.4% as at end-December 2018 to 15.1% as at end-December 2019. Loan loss reserves on credit impaired loans allocations reached just USD 1 billion in 2019, explaining the decline in the coverage ratio from 62% as at end-December 2018 to 59% as at end-December 2019. Consequently, net credit impaired loans represented 20.6% of shareholders' equity, up from 12.6% as at end-December 2018.

With respect to off-balance sheet commitments, financing and guarantees issued to banks (net of financing and guarantees received) decreased by USD 2.6 billion in 2019 following the derisking strategies swiftly implemented to face adverse developments. Financing and guarantees issued to customers (net of those received) declined in parallel by USD 6.6 billion in the wake of the decline in activity and credits.
The fact remains that according to audited financial statements, guarantees received from customers (in coverage of on/off-balance sheet loans) still aggregate to USD 113 billion as at end-December 2019. It is obvious that the value of monetary, financial and real collaterals require revaluation in the light of adverse financial and economic developments affecting asset prices, but their level seems to remain adequate.

Subsequent to the adverse market conditions, banks disposed of their securities portfolios that contracted by USD 13.8 billion in 2019, of which USD 3 billion equivalent of Treasury Bills in LL, USD 4.4 billion of Lebanese Eurobonds, USD 4.9 billion equivalent of BDL CDs in LL, nearly USD 1 billion of BDL CDs in US dollars, with the balance accounted for by equity and other instruments. But more importantly, primary liquidity in foreign currencies placed with correspondent banks dropped by USD 5.2 billion during the year to USD 10.5 billion as at end-December 2019 while Lebanese banks' liabilities towards correspondent banks amounted to USD 7.9 billion. These developments foretell the aggravated tensions on real liquidity in foreign currency that followed in 2020 and 2021.

As a result, capitalization was impacted on the one hand by the decrease in regulatory capital caused by operating losses, and on the other hand by the increase in risk weighted assets subsequent to the deterioration of ratings and risk profiles. In fact, despite the decrease in assets of USD 31 billion, risk weighted assets increased by USD 70 billion underscoring a surge in the RWAs density from 49.4% of assets as at end-December 2018 to 84.1 % as at end-December 2019, corresponding to a 34.7% increase. Lower ratings generally entail an increase in the weighting of assets at risk. Consequently, the Tier 1 ratio fell by 5.8%, from 12.8% as at end-December 2018 to 6.9% as at end-December 2019 while the Total Tier 1 ratio dropped by 6.8% from 15.6% to 8.9% and the total capital adequacy ratio deteriorated by 7.6% from 17.9% to 10.4% over the same period. This marks a significant turn in the financial flexibility of Lebanese banks.

In light of the above, it is not surprising that operating results showed a net loss of nearly USD 2 billion in 2019 compared to a profit of USD 2.5 billion in 2018. This loss was principally originated at the top line, with consolidated spread losing 25 basis points from 2% in 2018 to 1.75% in 2019 driven by a decline in spread in foreign currencies by nearly 1% triggered by a faster increase in the cost of foreign currency deposits than in the yield on foreign currency loans, bearing witness to the liquidity pressures and cost. The most tangible contribution to the negative results was the sliding of the net operating margin into negative territory because of the rocketing rise in credit cost and other provisions. Allowances for ECLs totaled USD 4.4 billion (specific and general provisions on stages 1,2 and 3), which represented 73% of the total operating income of banks. In this context, despite the decline in both operating expenses (USD -229 million) and taxes (USD -172 million), banks posted losses of USD 2 billion translating into a negative ROACE of -10%. The 2019 activity and results of Lebanese banks point to even more negative developments in 2020.

The analyses of individual banks grouped according to the categories established by Bankdata; Alpha, Beta and Gamma are detailed in the pages hereafter.

All figures are stated in US dollars at the still applied rate by Banque du Liban (1 USD = 1,507.5 LL).