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Is External Default in Lebanon Inevitable?

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- The political and economic crisis in Lebanon has raised market expectations of a sovereign default in the medium term, with yields on the 2025 government Eurobonds spiking to around 25% in recent weeks, and 5-year CDS spreads currently trading in excess of 2200bp. In the past six weeks, all three major rating agencies have lowered their ratings on Lebanon's foreign currency debt deeper into 'junk' (CC for Moody's and Fitch, CCC for S&P).
- In this note, we argue that default on Lebanon's Eurobonds is not inevitable, and that the government's ability to pay is likely higher than perceived by markets. We show that a combination of fiscal reforms and a restructuring of the domestic debt could be enough to put public finances on a sustainable footing without having to resort to an external default.
- We also argue that the external debt could be sustainable from a balance of payments perspective, and that, should it become necessary, a devaluation/depreciation of the Lebanese Pound should not materially affect the government's capacity to repay.
- That said, we believe the government's ability to avoid external default will be contingent on its having the political will to implement and sustain necessary economic reforms in the long run, despite the risks to social stability that these reforms may entail. What's more, given these risks, we believe that popular pressure to extend burden-sharing to 'foreign' investors could well rise over time. The uncertain political outlook thus raises questions regarding willingness to repay in the long run.

Is External Default in Lebanon Inevitable?

Putting Debt Restructuring in the Context of Broader Reforms

Lebanon has long suffered from persistent twin current account and fiscal deficits (Exhibit 1) that we believe lie at the heart of the current economic crisis. On the external side, sustained net capital outflows in the balance of payments have led to a sharp deterioration in the FX liquidity position of the monetary sector over the past few years (Exhibit 2). This has eroded already weakening depositor confidence and necessitated the implementation of *de facto* capital controls which are seriously harming medium-term economic prospects.

Exhibit 1: Lebanon Has a Long Track Record of Running Large Twin Deficits

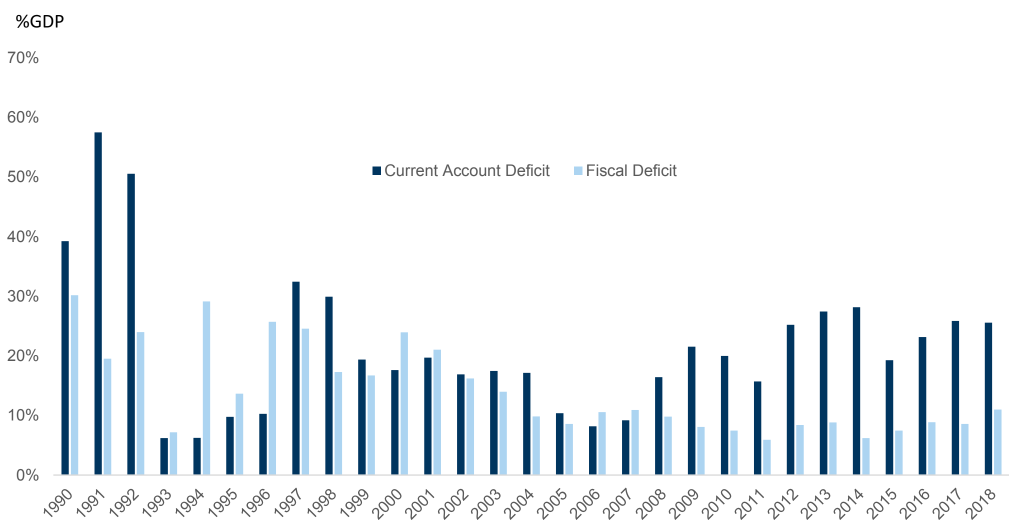


Exhibit 2: FX Liquidity in Monetary Sector Has Declined Sharply Over the Past Decade

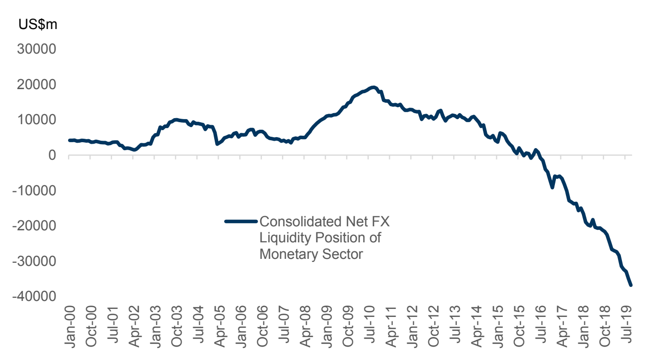
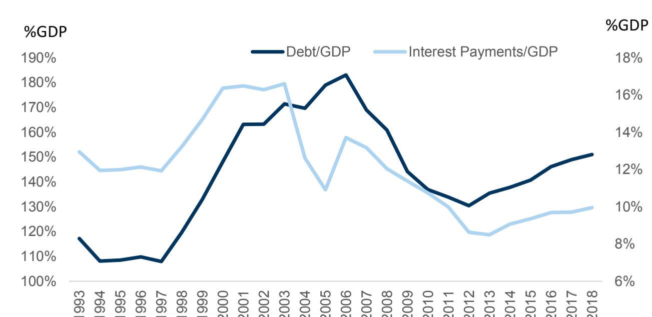


Exhibit 3: Public Debt Rose Sharply During the Post-War Reconstruction



Meanwhile, persistent fiscal deficits have resulted in a large debt overhang. Public debt, already hovering around 100% of GDP, rose sharply in the years following the end of the Lebanese civil war, mainly due to the cost of reconstruction (Exhibit 3). Peaking at 180% of GDP in 2006, it now stands at over 150% (and rising), with interest payments consuming around 10% of GDP. This raises concerns about the sustainability of the public finances.

Despite a budget earlier this year promising to reduce the deficit to under 7% of GDP, caretaker Finance Minister Ali Hassan Khalil recently warned that the 2019 deficit would be 'much bigger' than expected, without giving any further details. The persistence of Lebanon's fiscal imbalances is adding to depositor and investor concerns regarding the economic outlook and reducing growth prospects. Importantly, we think it is also aggravating external imbalances. There are two reasons why this may be the case:

- First, high levels of government spending have directly contributed to the current account deficit by reducing national savings.
- Second, the debt overhang has contributed to public under-investment and weak productivity growth, with negative consequences for competitiveness and the tradable sector.

The inter-linkages between the fiscal and external imbalances in Lebanon argue for broad-based reforms that tackle both. We believe that any debt restructuring should therefore be carried out as part of a wider set of economic reforms generally, and in support of a sustained fiscal consolidation effort, specifically.

Some Scope for Fiscal Consolidation Despite Political Challenges

Tax revenues, at 14% of GDP, are low by international standards. Part of this is down to low tax rates, even compared with regional peers (Exhibit 4). We think that closing the gap could provide significant benefits to the public finances. By way of example, let's assume that the VAT rate were raised to the regional average of 17%, from 11% currently. According to our estimates, this could increase budget revenues by as much as 2.5pp of GDP, all else equal. That said, the political (and economic) consequences of any attempt to raise taxes on the general population would likely preclude such action in the near term. The fact that the current protests were sparked by a proposed modest social media tax is evidence of this.

Better revenue collection, however, could be more feasible, politically. Both VAT and income tax compliance is low. Improving tax administration, clamping down on tax evasion and other illicit activities could provide significant upsides to the budget, in our view, without the political costs. Indeed, Bank Audi, Lebanon's largest bank, has estimated that losses to the budget from such activities amount to $5bn (9% of GDP) per year.

Exhibit 4: Lebanon's Average Tax Rate is Low by International Standards

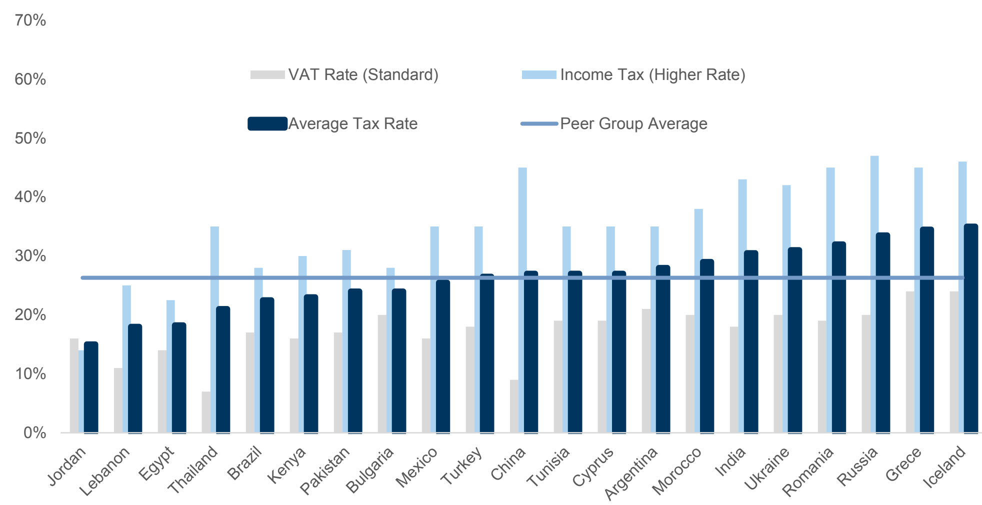


Exhibit 5: Debt Servicing, Wages and EdL Consumed 120% of Government Revenues Last Year

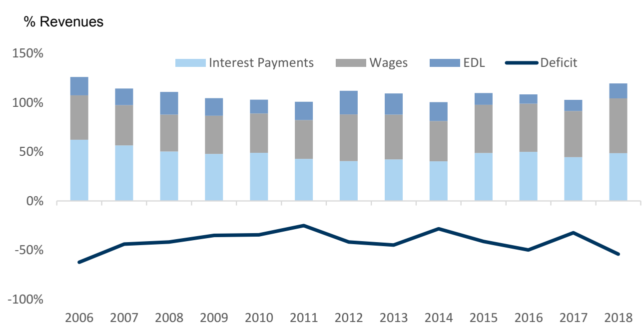
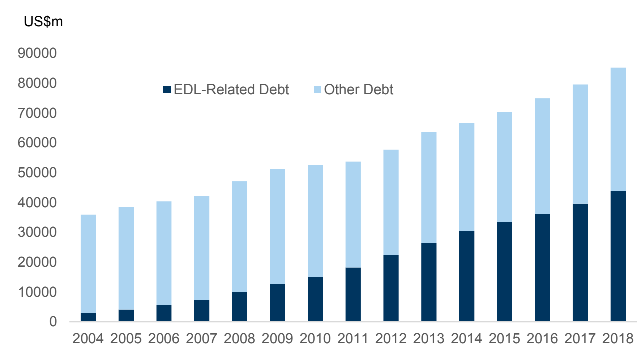


Exhibit 6: We Estimate that Losses at EdL Are Responsible for Half of Lebanon's Debt Pile



Turning to the expenditure side, three main items together accounted for 120% of government revenues last year: losses at the state power company, Electricité de Liban (EdL), wages and interest payments (Exhibit 5). This suggests that rationalisation of state spending should focus on three key areas:

- **Energy reforms**: We estimate that losses at EdL are responsible for around 50% of the government debt burden (Exhibit 6). Implementation of the energy reforms agreed by the cabinet in April could curb the losses at EdL in the medium term, saving the budget around 3pp of GDP per year.
- **Civil service reform**: Consuming 50% of public revenues, public-sector wages (including pensions and benefits) are a serious fiscal drag. In our view, addressing this through wage measures and deeper civil service reform will be important in the long run, but is likely to prove highly politically sensitive in the near term.
- **Debt restructuring**: The other 50% of revenues are consumed by interest

payments. Under current conditions, even if Lebanon were to reduce its deficit by 5pp of GDP through some combination of the measures discussed above, debt would still be well over 200% of GDP by the end of the next decade, and interest payments would consume two-thirds of government revenues. These worrying debt dynamics justify some form of debt restructuring in the medium term, in our view.

In Principle, Local Debt Restructuring is Preferable to External Default

We believe a number of factors would make a local currency restructuring preferable to a foreign currency default from the Lebanese government's perspective. These include:

- **Materiality** - almost two-thirds of Lebanon's debt stock (and 60% of the interest burden) is denominated in local currency.
- **Composition of holding** - 100% of the local currency debt stock is held by residents. Moreover, the BdL holds over half the local debt, with the rest mainly held by the local banks. By contrast, non-resident investors hold around 25% of total traded Eurobonds.
- **Lower workout cost** - the composition of domestic holdings increases the ease of implementing a restructuring and reduces the risk of litigation and hold-outs.
- **Reputational costs** - resident holders of debt represent a more static investor base, while international investors are more fluid. External default could have greater implications for future pricing and market access than a domestic restructuring (although the evidence suggests that these costs are low in the long term).[1] Moreover, Lebanese policy-makers have emphasised Lebanon's track record of never having defaulted, despite the challenges the country has faced in the past.

In our opinion, limiting restructuring to the local currency debt would be possible to the extent that a) this is sufficient to achieve the government's fiscal objectives, and b) continued servicing of the foreign currency debt is sustainable from a balance of payments perspective. We believe that it is likely that both of these conditions can be met.

A Local Debt Restructuring Could be Sufficient to Achieve Fiscal Objectives

In our view, the primary objective of any debt restructuring should be to place public finances on a sustainable footing in the long term. We think that a local currency debt restructuring on its own could achieve this. To demonstrate this, we consider a scenario in which the government carries out an exchange of all outstanding local currency debt. In return for the existing t-bills, the government issues long-term notes to domestic debt holders with 1% coupon.[2] We do not believe that this scenario is unrealistic: the government has recently issued the BdL with LBP3trn in 1% coupon treasury bills, and had earlier this year announced plans to issue LBP12trn in 1% bills to the banking

[1] Borensztein, E. and U. Panizza (2008), 'The Costs of Sovereign Default', IMF Working Papers 08/238, International Monetary Fund.

[2] The BdL and the banks each own approximately half of the outstanding local government debt.

sector.

Under this scenario, we calculate that interest payments on domestic debt would fall by 5pp of GDP, to just 0.5%. This would lower the average real rate of interest paid on total government debt from 4.1% to 0.9% (assuming a constant long-term rate of inflation of 2%), reducing the interest-growth differential in a standard debt sustainability analysis. Recall that the primary balance required to maintain debt at a given level, b^*_t, is a function of the interest-growth differential (r_t-g_t), where r is the real interest rate and g is the growth rate, such that:

$$b_t^* = \left(\frac{r_t - g_t}{1 + g_t}\right) d_{t-1}$$

Where d_{t-1} is the debt/GDP ratio. A lower interest-growth differential would thus, all else equal, reduce the debt-sustaining primary balance.

In our scenario, the reduction in the interest-growth differential would lower the required primary balance by as much as 5pp of GDP for any given level of economic growth (Exhibit 7). Assuming a long-term real growth rate of 1%yoy, this would mean that the Lebanese government would have to run a primary balance of 0% of GDP to stabilise the debt following a local debt restructuring. Given that the actual primary balance last year was around -1% of GDP, this suggests that very little fiscal effort would be required to maintain the government debt stable (a primary consolidation of 1pp of GDP, to be precise).

Exhibit 7: Domestic Debt Re-profiling Would Reduce the Required Debt-Sustaining Primary Balance by over 5pp of GDP

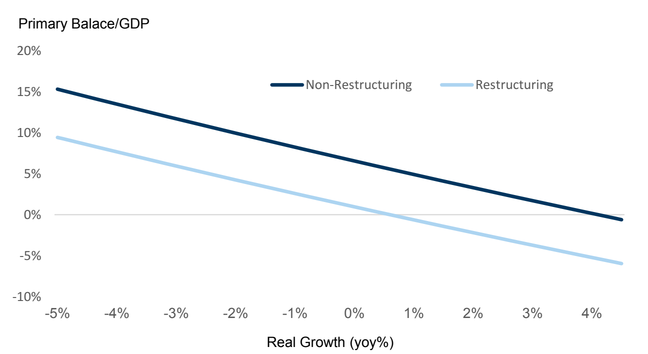
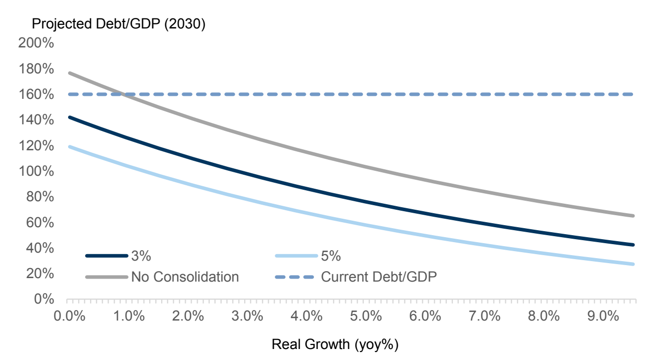


Exhibit 8: Domestic Debt Restructuring Combined with Some Fiscal Adjustment Would Put Debt on a More Sustainable Footing

Projected Debt/GDP in 2030 post domestic restructuring under various fiscal consolidation scenarios



It follows that any fiscal effort greater than 1pp of GDP would put the debt on a downward trajectory post-restructuring. Exhibit 8 plots our forecast debt/GDP level (y-axis) for a given level of economic growth (x-axis) under three fiscal scenarios: a minimal consolidation (0% primary surplus, grey), a moderate consolidation (3% primary surplus, dark blue) and a substantial consolidation (5% primary surplus, light blue). The results suggest that, even at modest levels of long-term growth and with a moderate fiscal effort, a local debt alone restructuring could contribute to a substantial reduction in the debt burden over the long term.

BoP could be Sustainable Without External Default

Fiscal sustainability is a necessary but insufficient condition for limiting any restructuring to the local debt. Continued servicing of the external debt must also be sustainable from a balance of payments perspective. We believe there are three main reasons why this is likely to be the case for Lebanon:

1. **Burden on BoP relatively minor owing to limited non-resident holdings of external debt**: the extent of non-resident ownership of the Eurobonds, rather than the volume outstanding, is the most relevant factor in determining their impact on the BoP. Only $1.5bn of the $6.5bn of principal repayments falling due over the next three years, for example, will actually result in an outflow of capital in the BoP. Indeed, the total cost of debt servicing (principal and coupons) over the next decade is unlikely to exceed $4.6bn in NPV terms according to our estimates (Exhibit 9).
2. **The current account is likely to adjust sharply in the near term** - Lebanon is experiencing a sharp contraction in domestic demand, and importers are struggling to source currency with which to purchase foreign goods. This suggests that a sharp compression in imports is likely in the near term. We forecast that the current account deficit will narrow to around $8bn next year, from $12.5bn last year, and stabilise at that level over the medium term (Exhibit 10). Including principal repayments, this implies a gross external financing requirement of around $8.5bn a year over the next three years. Against current FX reserves of $28bn, this implies external buffers could be sufficient to weather balance of payments pressures for some time.
3. **Capital inflows will be supported near current levels** - we do not necessarily share widely held concerns that capital inflows into Lebanon are likely to decline substantially in the medium term. In our view, one of the drivers of the current liquidity crisis is that capital inflows had already fallen to historically low levels (Exhibit 11). Sticky remittance inflows are likely to continue, and capital controls should limit the risk of capital flight.

Taken together, we believe these factors will limit the drain on the balance of payments in the coming years. Our estimates suggest that, in our base case, FX reserves are likely to decline gradually, and will remain in excess of $10bn by end-2023 (Exhibit 12).

Exhibit 9: Total External Debt Servicing to Non-Resident Investors Will Cost $4.6bn in NPV Terms Over the Next Decade
Based on Bloomberg Data of Non-Resident Holdings of Lebanese Eurobonds

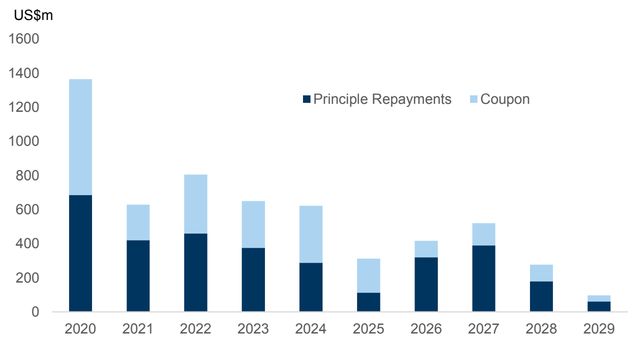


Exhibit 10: Our Base Case is that the Current Account Deficit Will Shrink by 25% Next Year

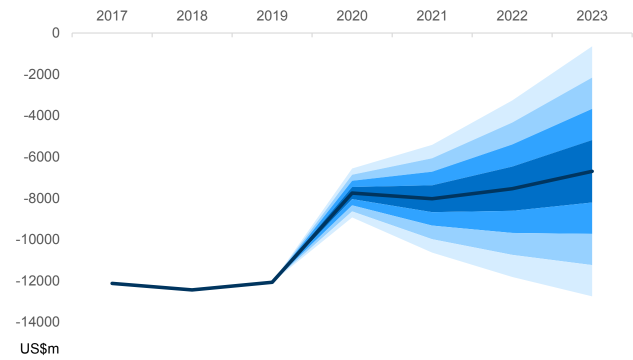


Exhibit 11: We assume Net Inflows in the Capital Account are Likely to Remain Low by Historical Standards, But do not Decrease

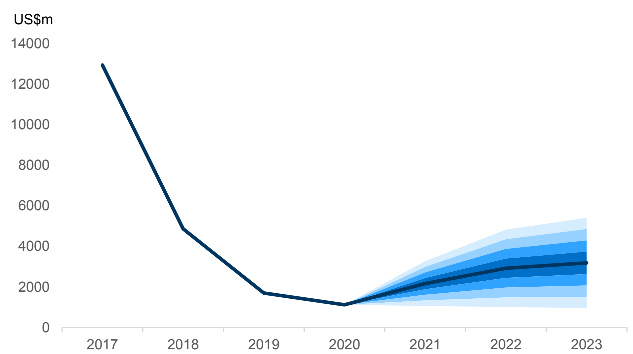
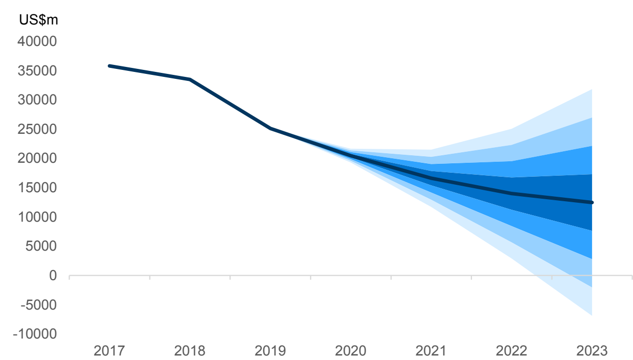


Exhibit 12: In Our Base Case, FX Reserves Are Sufficient to Cover the External Financing Gap While Servicing the External Sovereign Debt



Devaluation/Depreciation of the Pound Does not Increase Risk of External Default Materially

A concern often raised by investors is that a devaluation/depreciation of the Lebanese Pound would be negative for the sovereign balance sheet and increase the likelihood of a sovereign default. We do not share this concern.

To be clear, we do believe that the risk of a devaluation/depreciation of the Pound has increased. This is due to the emergence of a parallel market in foreign exchange, where the Lebanese Pound is currently trading at levels 30% lower than the official rate against the US Dollar. There are three main reasons for this:

1. **Inflation likely even if official rate unchanged** - we believe that domestic prices will be priced off the parallel rate and that the official rate will become infra-marginal. Inflation would rise regardless of whether the official rate is maintained at current levels, in our view. This undermines one of the key arguments in favour of maintaining the peg at current levels.
2. **Risk of diversion of FX flows to parallel market** - we think Lebanon is likely to

continue attracting remittance inflows in the future, given the large diaspora and the sticky nature of these flows. An overvalued official rate is likely to divert future FX inflows away from the official financial sector and into the parallel market, to the detriment of FX reserves.

3. **Parallel market will act as a tax on exports** - parallel exchange rates act as an implicit tax on exports as exporters have to relinquish a premium equivalent to the spread between the parallel rate and the official rate when converting their earnings to local currency. This discourages exports and complicates the adjustment of the current account.

While these factors argue for a weakening of the official Pound rate in the medium term, we believe that the impact on the sovereign balance sheet will be manageable. To demonstrate this, we have carried out an analysis of the likely budgetary outcomes of a devaluation/depreciation of the Pound. We test the sensitivity of our results under two hypothetical scenarios: an alignment of the official rate with the current parallel rate, implying a 30% devaluation of the Pound, and the extreme case of a hypothetical halving of the value of the Pound against the US Dollar (i.e., 100% appreciation of the value of the USD against the Lebanese Pound). Exhibit 13 summarises the results - methodology set out in the footnote below.[3]

Exhibit 13: The Sovereign Balance Sheet Impact of a Devaluation is Small, Although We Would Expect a Composition Shift Between LC and FX Liabilities

Trillion LBP unless otherwise indicated	Status Quo	Scenario A -30% Devaluation	Scenario B - 100% Devaluation
FX Rate (LBP/US$)	1,508	2,000	3,015
GDP	82,878	93,709	116,030
GDP (USD, bn)	55	47	38
Domestic Debt	81,090	81,090	81,090
(% GDP)	97.8%	87.4%	69.9%
External Debt	48,994	65,000	97,988
(% GDP)	59.1%	68.6%	84.5%
Total Debt	130,084	146,090	179,078
(% GDP)	157%	156%	154%
Domestic Debt Servicing	4,541	4,541	4,541
(% GDP)	5.5%	4.8%	3.9%
External Debt Servicing	3,332	4,420	6,663
(% GDP)	4.0%	4.7%	5.7%
Total Debt Servicing	7,873	8,961	11,204
(% GDP)	9.5%	9.6%	9.7%
Budget Deficit (%GDP)	*10.6%*	*10.7%*	*10.8%*

Our analysis suggests that a devaluation would actually lower the debt/GDP ratio, all else equal, albeit marginally. However, there would be a composition shift in the debt burden, with domestic debt falling and external debt rising as a share of GDP. This would result in an increase in external debt servicing costs. Overall debt servicing, however, would remain relatively flat, according to our estimates.

The impact on the overall budget deficit is also likely to be small. This is due to the fact

[3] Based on 2018 fiscal outturns. For the economy as a whole (GDP), we assume that the pass-through to domestic prices from a devaluation would be in the order of 40%. For the budget, we have assigned our own estimates of the elasticity of individual line items in expenditures and revenues to moves in the currency. For example, we assume that a depreciation in the Pound will be reflected in a rise in spending in LBP on external debt servicing and energy subsidies, but not on wages and domestic debt servicing. We consider two scenarios: a 30% appreciation of the USD against LBP, and a 100% appreciation.

that the impact of increases in import-related government spending is likely to be offset by a deflation of Pound-based spending and a small rise in tax and customs revenues (as price increases would likely be greater than volume declines post devaluation).

All Said and Done, Avoiding External Default in Long Run will Require Political Will

Above, we have set out our arguments as to why an external default may be avoidable from both a fiscal and balance of payments sustainability perspective. However, political considerations will inevitably come into play, keeping the risk of such a default elevated, in our view. There are two key risks that we think are important to highlight:

1. **Policy risk**: our analysis on debt sustainability is contingent in large part on a sustained fiscal effort being made by the government. More generally, we have argued that addressing Lebanon's twin deficits is key to long-term economic sustainability, and will require broader economic reforms. In the near term, in the absence of a government, it is difficult to assess the political will to undertake such reforms. In the longer term, even if such reforms are adopted, we think sustaining them in the face of likely popular resistance and economic costs would be a major challenge.
2. **Equity concerns**: although most of Lebanon's Eurobonds are held by local banks, the perception that 'foreign investors' are getting a free ride, by receiving full recompense while the general population bears the weight of the adjustment, may place pressure on the government to be seen to distribute the burden more evenly by 'bailing in' holders of external debt.

Finally, we note that the level of violence surrounding the ongoing protests has increased sharply in recent days. The sectarian dynamics of this violence pose threats to Lebanon's near-term political outlook, and could also have ramifications for the external debt, in our view.

A Footnote on Recovery Values

While we argue that a default on Lebanon's Eurobonds is avoidable, we continue to monitor likely recovery values in the event of a comprehensive restructuring of the sovereign debt. In January of this year, we published our views on likely recovery values (see CEEMEA Economics Analyst: An analysis of Lebanese debt recovery values). We employed a simple fiscal sustainability analysis to calculate recovery values based on the premise that any possible restructuring would be carried out with the goal of placing the public finances on a sustainable footing. In Lebanon's case, we showed that this would require the application of a haircut of approximately 65% to the sovereign debt in our base case, implying a recovery value of 35 cents in the Dollar (Exhibit 14). Our view on this has not changed since then.

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	Current	Base	A	B	C
a) Assumptions					
Primary surplus (%GDP)	0.3%	2.0%	3.0%	2.0%	2.0%
Real interest rate	10.0%	6.5%	6.5%	5.5%	6.5%
Real Growth rate (yoy)	1.2%	2.6%	2.6%	2.6%	4.0%
Debt/GDP (2018)	150%	150%	150%	150%	150%
Exchange rate (LBP/US$)	1507	1507	1507	1507	1507
b) Fiscal adjustment (equation 2)					
Stabilising primary surplus (%GDP)	13.1%	5.7%	5.7%	4.2%	3.6%
c) Debt restructuring (equation 3)					
Stabilising debt level (%GDP)	3.5%	52.6%	78.9%	70.8%	83.2%
Implied haircut (% Principle)	98%	65%	47%	53%	45%
Implied recovery value (cents in dollar)	2	35	53	47	55

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Conviction Macro Views

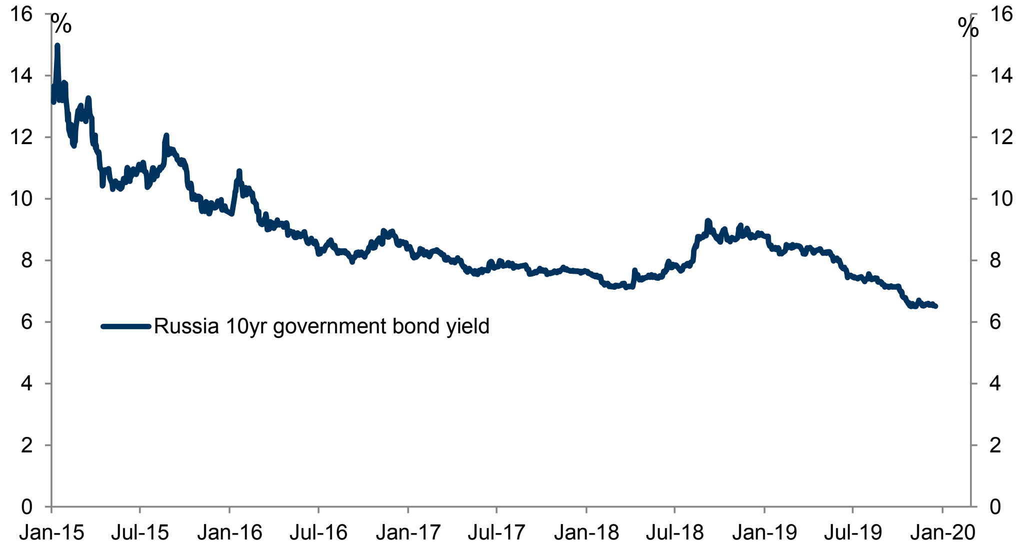
Turkey: Curve Steepeners

We recently argued that the authorities will once again prioritise growth over stability and are continuing to reduce interest rates to support economic activity. Our near-term inflation forecasts are also below that of the consensus, suggesting that the TCMB may have more room to reduce interest rates. We also think that achieving a higher growth rate will require fiscal support and the state to attract foreign funding in local currency. The government has refrained from issuing at the long end of the government bond curve year-to-date, historically one of the avenues for attracting external funding, but plans to do so in the coming months. We think this will be needed to finance the high growth rate being targeted, and that the government will need to accept market yields. This, combined with our view that the fall in inflation will not be sustained in the long run and that the push for growth comes with risks, leads us to think that the long end of the yield curve will reprice higher. Given this combination of lower rates in the near term but our view that the long end of the curve will reprice higher, we hold a 'Conviction View' in favour of curve steepeners in Turkey.

Russia: Inflation as well as a Well-Supported Ruble to Allow Deeper and Faster Cutting Cycle despite an Acceleration in Growth

We expect inflation to be persistently below the CBR's target of 4% throughout 2021 as the economy accelerates towards its trend growth of 2.5-3% without reducing the output gap. We recently wrote about the reaction function of the CBR and, going forward, we expect (i) more weight on the output gap, (ii) a more symmetrical interpretation of the inflation target (i.e., with the CBR reacting more strongly to below-target inflation), (iii) a reduced focus on FX developments and (iv) a decline in the mid-point of the CBR's estimate of the neutral rate. We believe that Russia has one of the largest output gaps among the countries we cover and, as fiscal policy struggles to pick up and support activity, weak sequential economic growth adds to the list of arguments for the CBR to cut rates faster. Against this, real rates have been rising once again despite the recent 50bp cut as persistently weak sequential price growth drives down inflation towards +2.5-3.0% in 2020H1 and well below the CBR's 4% inflation target. We also think that, with accelerating growth driven by exports and fiscal policy, the Ruble will be even better supported than in the recent past and cease to be a risk factor for the CBR. We believe the CBR will accelerate its cutting cycle, cutting rates to +6.0% by year-end, with a further 50bp in cuts in 2020H1. We think this should support Russian equity prices. With regard to rates, we think our view is now broadly priced into the front end of the curve, but we think the level of rates in the belly and in the long end remains too high.

Russia: 10-Year Government Bond Zero Coupon Yield



Romania: Negative on the Romanian Leu (RON)

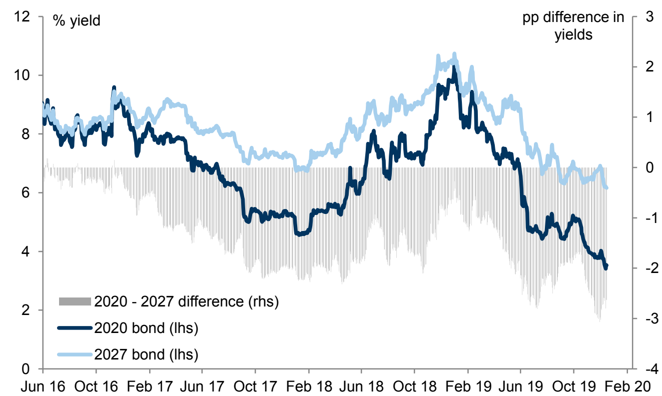
Romania's internal and external imbalances have risen significantly in recent years, exposing the economy to the risk of a painful adjustment. Output is operating significantly above potential, wage costs are rising sharply and the current account deficit has risen to 5%-6% of GDP. Fiscal and political risks have also increased. Despite strong growth in recent years and amid signs of overheating, the government struggled to meet the 3% of GDP Excessive Deficit Procedure (EDP) in 2018. Reflecting our concerns over Romania's external and fiscal imbalances, and the high levels of policy uncertainty, we have maintained a negative 'Conviction View' on the Romanian Leu (RON) since last July. The NBR operates a managed float in the RON but, given a deterioration in Romania's economic fundamentals and the ongoing loss of competitiveness from rapid unit labour cost growth, we expect that it will want to manage the currency weaker over time. This view is consistent with the forecasts of our EM and FX strategists who, among the CEE currencies, are most negative about RON on a 12-month basis.

South Africa: Bullish on Duration

After a series of downside surprises to South African inflation in 2017, 2018 and 2019H1, we expect underlying inflationary pressure to remain subdued over the coming year, given fading supply shocks and the presence of a large disinflationary output gap. We forecast average headline inflation at 3.9% in 2020, down from 4.1% in 2019, with core inflation remaining well below the 4.5% midpoint of the SARB's inflation target band. With inflation undershooting the mid-point of the target range and the outlook increasingly benign, output below potential and growth subdued, we see a strong economic case for monetary policy easing. Following the MPC's 25bp cut in July, we forecast a further 50bp of easing in 2020H1. Given that domestic factors could weigh on the Rand, our conviction in the depth of the cutting cycle is higher than in the timing of cuts, and risks to our forecast are tilted towards a more protracted but potentially deeper cutting cycle. Additionally, we believe there is more fiscal-related term premium (related to Eskom and credit rating concerns) built into the local curve than is warranted by fundamentals, the recent deterioration in the fiscal outlook notwithstanding. For these reasons, we remain bullish on duration and expect the local curve to bull-flatten. The yield curve offers significant value owing to its steepness and high yields in real terms.

South Africa: 10-Year Treasury Bond Yield

Ukraine: 20s vs. 27s



Ukraine: Bullish on Sovereign Credit and on Local-currency Fixed Income

Ukraine saw major political change in 2019, with political newcomer Volodymyr Zelensky's surprise ascent to the presidency and securing of an outright majority in parliamentary elections. Sovereign credit has subsequently outperformed Ukraine's peers by a large margin and, accompanied by large private capital inflows into USD and UAH debt, this has led to the Hryvnia becoming one of the best-performing currencies of the year. As reforms progress and macroeconomic and credit indicators continue to improve, we expect similar dynamics to continue to play out. More specifically, we anticipate that capital inflows will exceed debt redemptions and the current account deficit financing, and therefore will enable the NBU to accumulate FX reserves. As fiscal policy remains prudent and growth remains reasonably strong, debt ratios should continue to improve, supporting sovereign credit and ultimately the credit rating. With disinflationary dynamics becoming more entrenched, the NBU now has space to front-load rate cuts, and we forecast a front-loaded pace of monetary easing to a 10.5% policy rate at end-2020 and a terminal rate of 9% in 2021. With foreign participation in UkrGBs still low relative to peers, we see scope for a further US$3-4bn of inflows into this market. Along with likely GBI-EM index inclusion, we see local-currency fixed income and specifically duration as attractive. We continue to argue that all of these developments remain underpriced by both sovereign credit and local fixed-income markets, leaving attractive opportunities for investment in 2020.

Disclosure Appendix

Reg AC

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