



Tagging Info

Fitch Affirms Lebanon at 'B'; Outlook Negative Ratings Endorsement Policy

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Fitch Ratings-Paris/London-13 June 2014: Fitch Ratings has affirmed Lebanon's Long-term foreign and local currency Issuer Default Ratings (IDRs) at 'B'. The issue ratings on Lebanon's senior unsecured foreign and local currency bonds were also affirmed at 'B'. The Outlooks on the Long-term IDRs are Negative. The Country Ceiling has been affirmed at 'B' and the Short-term foreign currency IDR at 'B'.

KEY RATING DRIVERS

Lebanon's ratings balance a large and rising public debt burden and government financing needs in the context of high political risk with high GDP per capita and human development, a large well-run banking system and credible exchange rate policy. More specifically, the ratings reflect the following key rating drivers:

-Political risk is particularly high. The Syrian conflict has reignited the deep political and sectarian divisions over the past two years and has triggered a wave of terrorist attacks in Lebanon. The steady arrival of Syrian refugees in the country (more than 1 million at end-2013, or around 25% of the population) also tests the cohesion of the population.

-Although tensions have somewhat eased since February 2014, when a national unity government was formed, political uncertainty remains high. The Parliament was not able to agree on a new President before the 25 May deadline and the government's cohesion will be tested in the run-up to the legislative elections in November 2014. Fitch does not expect the political and security environment to materially improve until the end of the Syrian war.

-The Syrian conflict is taking a heavy toll on economic activity, with real GDP estimated to have grown only 1.5% in 2013. Fitch expects only a modest pick-up in 2014-2015 to around 1.8%.

-Public finances remain a key rating weakness. Lebanon is the third most heavily indebted sovereign rated by Fitch (after Japan and Greece): public debt was 141.1% of GDP at end-2013, and the government dedicated 40.2% of its revenues to interest payments. Due to declining revenues, the government posted a primary deficit in 2013 for the second consecutive year, pushing the budget deficit to 9.3% of GDP and reversing public debt trends. Fitch expects budget deficit and public debt to deteriorate further in 2014 as the impact of the refugees on public infrastructure will likely be felt; also there remains uncertainty on the potential upward adjustment of public wages yet to be approved by the Parliament.

-However, sovereign creditworthiness is supported by the large, liquid and well-regulated banking sector, which channels large deposits from the diaspora into financing the government. Total deposit growth has slowed slightly (7.9% yoy at end-April 2014 against 9% in 2013) but banks remain willing to finance the government's large financing needs: at end-April 2014, 58.2% of public debt was held by the banking sector, up from 54% at end-2012.

-The sovereign is also a net external creditor, due to domestic banks' holdings of public debt and the steady accumulation of foreign exchange reserves (USD45.6bn including gold at end-April 2014). Reserves are a crucial support to the longstanding peg of the LBP to the US dollar, given the high dollarisation of the economy and a structural current account deficit. Confidence in the peg has remained strong despite the political deterioration: deposit dollarisation remained broadly stable at 65.7% at end-April 2014 (end 2012: 64.8%).

-GDP per capita and broader human development indicators are in line with 'BBB' medians and are well above 'B' category peers. The government has an unblemished track record of public debt repayment and continues to have access to bond markets.

RATING SENSITIVITIES

The Negative Outlook reflects the following risk factors that may, individually or collectively, result in a downgrade of the ratings:

- A major destabilisation of Lebanon induced by more intense sectarian tensions or spill-overs from the Syrian conflict
- A significant decline in the overall deposit base
- A continued deterioration in public debt dynamics

The current Outlook is Negative. Consequently, Fitch's sensitivity analysis does not currently anticipate developments with a material likelihood, individually or collectively, of leading to an upgrade. However, future developments that may, individually or collectively, lead to a revision of the Outlook to Stable include:

- A significant improvement in overall political and sectarian tensions, eg in relation to the start of peace negotiations in Syria
- Projections of a reversal in public debt dynamics
- A pick-up in real GDP growth

KEY ASSUMPTIONS

The ratings and Outlooks are sensitive to a number of assumptions:

- Fitch assumes that insecurity and political uncertainty will prevail until the end of the Syrian war, but that violence will fall short of escalating into a full-scale civil conflict
- Fitch assumes that international oil prices will on average be lower in 2014 and 2015 than in 2012 and 2013, therefore benefitting the current account deficit and limiting budget transfers to the state electricity company EDL
- Domestic banks continue to be willing to finance government needs

Contact:

Primary Analyst

Amelie Roux

Director

+33 144 299 282

Fitch France SAS

60 rue de Monceau 75008 Paris

Secondary Analyst

Richard Fox

Senior Director

+44 20 3530 1444

Committee Chairperson

Andrew Colquhoun

Senior Director

+852 2263 9938

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable criteria, 'Sovereign Rating Criteria' dated 13 August 2012 and 'Country Ceilings' dated 09 August

2013, are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Sovereign Rating Criteria
Country Ceilings

Additional Disclosure

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