



Tagging Info

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

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Fitch Ratings-London-01 July 2013: Fitch Ratings has affirmed Lebanon's Long-term foreign and local currency Issuer Default Ratings (IDRs) at 'B' with a Stable Outlook. It has simultaneously affirmed the Short-term foreign currency IDR and the Country Ceiling at 'B'.

KEY RATING DRIVERS

Lebanon's ratings reflect the balance between rating strengths including high GDP per capita and human development, a large well-run banking system and credible exchange rate policy on the one hand, and heavy public debt burden and government financing needs in the context of high political risk on the other hand.

GDP per capita and broader human development indicators are in line with 'BBB' rated peers and are well above 'B' category peers.

The large, liquid and well-regulated banking sector supports sovereign creditworthiness through the intermediation of large deposits from the wealthy Lebanese diaspora into public debt. At end-2012, 54% of public debt was held by the domestic banking system, comprising 21% of their aggregate balance sheet. Lebanon's ratings are also supported by a lower share of foreign currency debt than peers and an unblemished track record of public debt repayment.

The sovereign is also a net external creditor, thanks to banks' holdings of foreign currency public debt and the steady accumulation of foreign exchange reserves (USD45.3bn including gold at end-2012, accounting for 73% of GDP). Reserves are a crucial support to the longstanding peg to the US dollar, given the high dollarization of the economy (65.1% at April 2013).

Despite this higher public debt tolerance than peers, 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 139.5% of GDP at end-2012, and the government dedicated 38.5% of its revenues to interest payments in 2012. The budget deficit rose to 9.5% of GDP in 2012, due to weakening real GDP growth (1.5% in 2012), rising public sector wages and budgetary transfers to the loss-making electricity utility EDL. Given that growth is likely to remain subdued due to the spill-over effects of the Syrian conflict, public debt is unlikely to fall significantly in the coming years in the absence of significant fiscal and structural reforms.

The government's large rollover and new financing needs (38% of GDP in 2012) are financed to a large extent by the domestic banks, rendering it extremely reliant on the continuous rise in deposits in the banking sector, itself a function of the diaspora's confidence in the country's political situation and in the credibility of the peg. But the country's political situation is highly vulnerable, as illustrated by the World Bank's political stability indicator (one of the lowest in the world) as well as by the fall of the government in March 2013, and the inability so far to form a new one. The Syrian civil conflict has taken a heavy toll on domestic political stability over the past two years, with more than 500,000 refugees arriving in the country, sectarian tensions sharply rising and military clashes becoming regular in some parts of the country.

In this context, the affirmation of the rating reflects the continuous, albeit decelerating, growth in bank deposits in 2012 and early 2013 despite stalling growth and rising political uncertainty over the past two years due to spillovers from the Syrian crisis.

RATING SENSITIVITIES

The Stable Outlook reflects the fact that the current rating level incorporates a substantial degree of political risk, as has been observed in the past. Heightened political and regional instability induced by the Syrian conflict, as well as its macroeconomic consequences, especially slower GDP growth, have not so far been reflected in any flight of deposits from the banking system or any impact on the ability of the domestic banking system to finance government needs.

In this context, the following factors would, individually or collectively, exert pressure on the rating:

- Deposit flights from the banking system for a sustained period,
- A deterioration in public debt dynamics, leading to heightened risk of debt unsustainability,
- The materialisation of political and geopolitical risk into large-scale violence in the country.

The main elements that could lead to a positive rating action over the medium term are:

- A sustained decline in gross general government debt, associated with fiscal and structural reforms,
- an alleviation of political tensions.

KEY ASSUMPTIONS

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

- Fitch assumes that, even though the current level of turbulence in Lebanon is most likely to persist, the civil war in Syria will not draw Lebanon into a full-scale civil conflict.
- Fitch expects public spending to remain constrained by the lack of budget approval. Therefore, Fitch assumes that budget deficits will not significantly widen over the rating horizon, and that public debt dynamics will not significantly worsen over the forecast period.
- Fitch assumes that international oil prices will on average be lower in 2013 and 2014 than in 2012, therefore limiting budget transfer needs to EDL.

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Additional information is available at www.fitchratings.com.

Applicable criteria, 'Sovereign Rating Criteria', dated 13 August 2012 and 'Country Ceilings' dated 13 August 2012 are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Sovereign Rating Methodology

Additional Disclosure

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