Fitch Affirms Lebanon at 'B-'; Outlook Stable

Fitch Ratings-London-12 September 2008: Fitch Ratings has today affirmed the Republic of Lebanon's Long-term foreign and local currency Issuer Default ratings (IDR) at 'B-' (B minus). The Outlooks on both ratings remain Stable. The Short-term foreign currency IDR is affirmed at 'B' and the Country Ceiling is affirmed at 'B-' (B minus).

"May's Doha Accord, followed by the election of a new president and formation of a new government, holds out the prospect of long overdue implementation of critical reforms," says Richard Fox, Head of Middle East and Africa Sovereign Ratings at Fitch. "However, reform implementation will remain challenging, with parliamentary elections scheduled in May. Lebanon's public finances are the weakest of any sovereign rated by Fitch."

Progress towards reducing Lebanon's heavy debt burden has been stymied since 2005 by a number of political shocks: the assassination of former Prime Minister Rafik Hariri in early 2005; the war with Israel in 2006 and the subsequent political standoff between government and opposition that left Lebanon without an effective government for 18 months and without a president since November 2007. Political tensions came to a head in May and prompted the Doha Accord, brokered by the government of Qatar. In the following three months parliament reconvened and elected a new president, a new government was agreed and won a vote of confidence in August. It now has a window of opportunity to implement key reforms agreed at the Paris III donor conference in 2007 and reaffirmed by the government in August.

The authorities have done well to contain the budget deficit and debt burden in the face of severe shocks - not just political but also the increase in oil prices, which has required higher transfers to heavily loss-making Electricite du Liban. Both the debt burden and deficit improved last year, after swelling under the impact of the 2006 war. Nevertheless, government debt of 170% of GDP and a deficit of 11% of GDP are both amongst the highest of Fitch-rated sovereigns and must be significantly reduced before positive rating action is warranted. Fitch will review the 2009 budget and monitor its implementation, as well as progress towards the intended privatisation of the mobile telecom network that could have a material impact on the debt burden.

Lebanon's creditworthiness is supported by the Lebanese diaspora, which provides substantial transfers and investment, and deposits in Lebanon's banks. International reserves - a key barometer of confidence - have risen to new highs this year. Meanwhile, banks own 60% of government debt and have been willing to maintain their exposure in difficult circumstances. Foreign governments have also provided support at critical times, most recently at the Paris III conference. This combination of support factors has been critical in helping Lebanon retain its unblemished debt service record. As well as the high debt burden and turbulent politics, Lebanon's ratings are also constrained by the systemic risk inherent in a monetary system featuring a pegged exchange rate, a highly dollarised banking system and potentially volatile non-resident deposits. Shocks that triggered sustained falls in non-resident deposits and reserves would likely bring negative rating action.

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