

**Rating Action: Moody's changes outlook on Lebanon's government bond rating to negative from stable**

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Global Credit Research - 14 May 2013

New York, May 14, 2013 -- Moody's Investors Service has today changed the outlook on Lebanon's B1 government bond rating to negative from stable. The B1 rating itself has been affirmed. The outlook change reflects:

1. The impact on Lebanon of Syria's ongoing civil war, which will suppress economic growth and increase fiscal deficits, and in turn lead to an increase in the sovereign's already high debt burden in 2013 and 2014.
2. The risk that a deepening of the Syrian crisis will also lead to political instability in Lebanon.

**RATINGS RATIONALE**

The main driver underlying Moody's decision to change the outlook on Lebanon's sovereign rating to negative is the marked slowdown in Lebanon's economy following the prolonged civil conflict in neighbouring Syria, which is adversely affecting investment, trade and tourism.

After four consecutive years of high GDP growth between 2007 and 2010, growth prospects have slowed to just 1%-2% annually, which is below the growth rate among rating peers. This low growth rate is not enough to sustain public-sector deleveraging, which has consequently come to a halt: in 2012 the public debt burden increased for the first time since 2006, while the fiscal deficit will average at 9%-10% of GDP in 2013 and 2014. Moody's expects the country's debt-to-GDP ratio, which had fallen to 126% in 2011 from 172% in 2006, to continue to rise and reach 133% next year. Lebanon's debt burden is currently the third-highest among rated sovereigns after Japan and Greece.

Moody's decision to affirm Lebanon's B1 rating is supported by the abundant foreign-exchange liquidity in the Lebanese banking system and the proven resilience of domestic banks, which continue to finance the government deficit. Unlike many B-rated governments, Lebanon benefits from a sound creditor base, fostered by the intermediation of resident and non-resident Lebanese nationals' savings into government debt securities.

Key to the country's financial architecture is the dollar peg, which Banque du Liban, the country's central bank, has consolidated over the past decade by increasing its foreign reserves. Even though current account deficits have averaged at 11.9% of GDP since 2006, remittances and foreign investments have bolstered Lebanon's foreign reserves, which had more than tripled to \$33 billion by year-end 2012. However, Moody's notes that Lebanon's external position relies heavily on the risk perception of non-resident depositors, and a sudden deterioration in domestic politics could spill over into the financial sector.

The second driver of Moody's negative outlook for Lebanon's sovereign rating is the threat posed by the Syrian conflict to the country's precarious balance of power. The country's institutions have long been undermined by sectarian divides, with sectors such as telecoms and energy suffering from the governments' inability to approve capital expenditures. Moody's expects decision-making to remain paralyzed while political blocks negotiate a new electoral law ahead of parliamentary elections scheduled for June.

**WHAT COULD MOVE THE RATING UP OR DOWN?**

Moody's would downgrade Lebanon's B1 government bond rating in the event of a further deterioration of the country's main debt metrics or an intensification of domestic political turmoil.

Given the negative outlook, an upgrade of Lebanon's sovereign rating is unlikely over the medium term. However, Moody's would return the rating outlook to stable in the event that the country's debt metrics stop rising and the risk of political spill-over from Syria's conflict diminishes.

**RATINGS RATIONALE**

The principal methodology used in this rating was Sovereign Bond Ratings published on 9-Sep-2008. Please see the Credit Policy page on [www.moody's.com](http://www.moody's.com) for a copy of this methodology.

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Gabriel Torres  
VP - Senior Credit Officer  
Financial Institutions Group  
Moody's Investors Service, Inc.  
250 Greenwich Street  
New York, NY 10007  
U.S.A.  
JOURNALISTS: 212-553-0376  
SUBSCRIBERS: 212-553-1653

Bart Jan Sebastian Oosterveld  
MD - Sovereign Risk  
Financial Institutions Group  
JOURNALISTS: 212-553-0376  
SUBSCRIBERS: 212-553-1653

Releasing Office:  
Moody's Investors Service, Inc.  
250 Greenwich Street  
New York, NY 10007  
U.S.A.  
JOURNALISTS: 212-553-0376  
SUBSCRIBERS: 212-553-1653

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