

Announcement: Lebanon

Moody's says Lebanon's B3 rating already encapsulates severe political turmoil

DIFC, May 09, 2008 -- In response to the heightened political tension affecting Lebanon, Moody's Investors Service today said that Lebanon's foreign and local currency government bond ratings remain at B3 with a stable outlook.

"B3 is typically the lowest rating possible for governments that are not in default, or at imminent risk of default, and denote very poor creditworthiness and a high probability of repayment difficulties," explains Tristan Cooper, Vice President - Senior Analyst in Moody's Sovereign Risk Unit. "Given that the government of Lebanon is not in default, Moody's believes that the country's low ratings already encapsulate the risk of severe political turmoil," says Mr Cooper.

While Moody's notes the very poor state of the country's public finances and the rapidly deteriorating political environment, it also recognizes the following points:

- Lebanon's government has never defaulted on its debt, despite experiencing many destabilising political shocks. These include a 15-year civil war between 1975 and 1990 and a devastating month-long war between Hezbollah and Israel in 2006.
- The central bank still has a large stock of foreign currency reserves with which to bolster confidence, offset potential capital outflows and protect the exchange rate. The central bank's foreign exchange reserves amounted to \$10.8 billion in February or around 45% of GDP. In addition, the central bank held gold reserves worth \$8.9 billion in February. Although the gold's liquidity is legally constrained, it does act as a source of reassurance for bank depositors.
- Depositors in Lebanese banks, which ultimately act as the primary source of government financing, have historically been highly tolerant of domestic political turmoil. This is because they include members of the widely dispersed Lebanese diaspora and wealthy Gulf residents with long-standing ties to Lebanon.
- Perhaps most importantly, the Lebanese government benefits from the committed support of powerful donors that include the US, major EU countries and Saudi Arabia. These donors have provided substantial financial support during previous periods of political distress.

According to Moody's, these unique characteristics have made Lebanon's government finances resistant to political shocks.

Nevertheless, Moody's remains concerned about current developments and will be monitoring the situation carefully. "We would be particularly concerned if political chaos or a change in the composition of the government deterred donor support or altered the government's willingness to service its obligations," cautions Mr Cooper.

However, even then, Moody's says that a downgrade would only be necessary if the rating agency believed that a default were imminent and that it would result in a significant loss for creditors.

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