

Rating Action: Lebanon

Moody's upgrades Lebanon's sovereign ratings

DIFC, April 01, 2009 -- Moody's Investors Service has today upgraded Lebanon's local and foreign currency government bond ratings to B2 from B3. The primary reasons for this rating action are the substantial improvement in external liquidity, the proven resistance of the public finances to shocks, and the willingness and ability of the country's resilient banking system to finance fiscal deficits. Moody's has also upgraded Lebanon's country ceiling for foreign currency bank deposits to B2 from B3, while its country ceiling for foreign currency bonds has been raised to B1 from B2. Lebanon's local currency country ceilings remain at Ba1. The outlook on Lebanon's sovereign ratings is stable.

"Lebanon's public finances have proven remarkably resistant to serious political and economic shocks in recent years. This is due to the resilience of the country's banking system, which is the government's primary creditor," explains Mr. Tristan Cooper, lead sovereign analyst for Lebanon within Moody's Sovereign Risk Group. "Confidence in Lebanon's financial system has been bolstered by the central bank's large cushion of foreign exchange reserves, which protects the exchange rate peg, and its effective regulation of domestic banks."

Moody's notes that the central bank's foreign exchange reserves rose to US\$17.6 billion in January 2009, up from US\$9.8 billion at the end of 2007. This places the country's External Vulnerability Index (the ratio of residual maturity short-term debt to official foreign exchange reserves) in a more favorable position to serve as a buffer to shocks while also providing ample cover for the government's maturing foreign currency debt. Following a debt exchange in March 2009, the government does not face a significant Eurobond maturity until March 2010. In 2010 as a whole, the government's Eurobond maturities amount to around US\$2 billion. Moreover, the central bank also holds a large amount of gold, worth US\$8.5 billion in January, although the liquidity of the gold could potentially be constrained given that parliament must approve its sale.

Lebanon's commercial banks also remain liquid, are well-capitalised and have continued to attract deposits from abroad. Total bank deposits increased by around 14% in the 12 months to January. Moody's notes that Lebanon's banks have not been exposed to toxic financial assets or failed western financial institutions, partly because of rigorous central bank regulations. While there is a risk that bank deposits could fall in the event of a serious political or economic upheaval, Moody's observes that they have displayed a high level of stability during previous crises. The bulk of deposits are sourced from the country's wide and loyal diaspora.

"Moody's is well aware of Lebanon's significant political and economic vulnerabilities. These include wide twin deficits, a very high public debt overhang, a fractious domestic political environment, and a precarious geopolitical location," says Mr. Cooper. The rating agency cautions that the country's heated politics could be stirred up by the elections in June, and that there is no guarantee that the government's weak effectiveness will improve thereafter. Moody's remains concerned by the sluggish progress in implementing much-needed economic reforms. Lebanon's economy is expected to suffer this year as the real sector and the balance of payments are hit by falling external demand and lower inward remittances, symptoms of the global economic slump.

"However, Moody's believes that such risks are adequately encapsulated in a B2 rating, which is low on Moody's global scale," says Mr Cooper. Moody's also derives reassurance from Lebanon's history of financial support from committed external donors.

The last rating action on Lebanon was implemented by Moody's on 11 December 2009, when Moody's changed the outlook on the country's ratings to positive from stable.

The principal methodology used in rating the Government of Lebanon is Moody's Sovereign Bond Methodology, published in September 2008 and available on www.moody.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Credit Policy & Methodologies directory on Moody's website.

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