

Rating Action: Moody's upgrades Lebanon's sovereign ratings to B1

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DIFC, April 13, 2010 -- Moody's Investors Service has today upgraded Lebanon's government bond ratings to B1 from B2. Today's rating action reflects a continuation of the trends that led Moody's to place Lebanon's sovereign ratings on positive outlook in December 2009: namely, the sustained improvement in external liquidity, the strengthened ability of the country's resilient banking system to finance fiscal deficits, and an amelioration of the domestic political situation following the formation of a consensus government last November.

Moody's has today also upgraded Lebanon's country ceiling for foreign currency bank deposits to B1 from B2 and its country ceiling for foreign currency bonds to Ba3 from B1. Lebanon's local currency country ceilings remain at Ba1. The outlook on Lebanon's sovereign ratings is now stable.

"Lebanon's public finances have proven resistant to serious political and economic shocks in recent years. This is due to the strengthened resilience of the country's banking system, which is the government's primary creditor," explains Tristan Cooper, Vice President and Senior Credit Officer in 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 and its effective regulation of domestic banks."

Moody's notes that the central bank's foreign exchange reserves rose to US\$26.9 billion in February 2010, up from US\$9.8 billion at the end of 2007. This places the country in a more favourable position to absorb financial shocks (including any potential rise in deposit dollarisation), while also providing ample cover for the government's maturing foreign currency debt. Moreover, the central bank holds a large amount of gold, worth US\$10.1 billion in February. Although the liquidity of the gold could potentially be constrained given that parliament must approve its sale, its value is a further prop to confidence.

The country's commercial banks remain liquid, are well-capitalised and have continued to attract deposits from abroad. Total bank deposits increased by around 20% in the 12 months to February. Moody's notes that Lebanon's banks were not exposed to toxic financial assets or failed western financial institutions during the global financial crisis, partly because of stringent 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 large and loyal diaspora. Moody's outlook for Lebanon's five rated banks is stable, as announced on 17 March 2010.

"Despite the recent improving trends, Moody's notes Lebanon's significant political and economic vulnerabilities. These include wide twin deficits, a very high public debt overhang, a tense domestic political environment, and the persistent threat of an escalation with Israel," says Mr. Cooper. The rating agency cautions that there is no guarantee that the government's weak policy effectiveness will improve despite the formation of a consensus government in November and relative political stability since. Moody's also remains concerned by the sluggish progress in implementing much-needed economic reforms.

"Moody's believes that such downside risks are adequately encapsulated in Lebanon's low ratings and are offset to some extent by the country's large buffer of external liquidity," says Mr. Cooper. Moody's derives reassurance from Lebanon's history of financial support from committed external donors.

Nonetheless, absent significant further improvement in government finances which also lessens dependence on domestic bank funding and a reduction in political event risk, Lebanon's government ratings will remain bound in the B rating category.

The last rating action on Lebanon was implemented on 18 December 2009, when Moody's changed the outlook on Lebanon's sovereign 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, which can be found at www.moody.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's web site.

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