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**Research Update:**

## Republic of Lebanon Outlook Revised To Stable From Positive On Political Uncertainty; 'B/B' Ratings Affirmed

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### Table Of Contents

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Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

## Research Update:

# Republic of Lebanon Outlook Revised To Stable From Positive On Political Uncertainty; 'B/B' Ratings Affirmed

## Overview

- The collapse of the unity government in Lebanon, following the withdrawal of Hizbollah and its allies, has severely weakened prospects for structural adjustment and the achievement of sustainable economic growth over the medium term, in our view.
- We are revising the outlook on Lebanon to stable from positive and affirming the 'B/B' sovereign credit ratings.
- The stable outlook reflects our view that while the government's control over the economic and political agenda has been diminished, outbreaks of civil unrest in the country will be avoided.

## Rating Action

On Jan. 18, 2011, Standard & Poor's Ratings Services revised the outlook on the Republic of Lebanon to stable from positive. The 'B/B' long- and short-term sovereign credit ratings were affirmed. We maintained the transfer and convertibility (T&C) assessment at 'BB-'. The recovery rating of '4' was also unchanged.

## Rationale

Our outlook revision to stable from positive reflects our view that the political impasse caused by Hizbollah and its March 8 Coalition allies' withdrawal from the unity government will be difficult to overcome, and that the incumbent administration, which is to be a caretaker government, will struggle to govern. Hizbollah and its allies have withdrawn from the government in opposition to a United Nations (UN) special international tribunal's investigation into the circumstances surrounding the assassination in 2005 of former Prime Minister Rafik Hariri, the father of the current Prime Minister Saad Hariri. Political tensions over the UN tribunal are likely to intensify in coming weeks, in our view, because the tribunal is reportedly expected to soon announce indictments of Hizbollah members. We therefore consider that the risks of civil unrest are increasing.

We believe that Hizbollah's return to government would require its acceptance of the UN special tribunal's indictments, which we consider looks unlikely over the medium term. We consider it possible that Hizbollah and its allies may put pressure on any new government to reject the tribunal through public demonstrations. However, with strong support of the U.S. and Western allies,

Prime Minister Hariri is unlikely to accede to these demands, in our opinion.

We note that news of the unity government's collapse has already raised tensions in Lebanon, and we believe a new government will take time to assemble. In the near term, we therefore consider that it will be difficult for Lebanon to make much headway on the achievement of much needed structural reform, especially in the public sector. This, together with political stability, would in our view be required to put the Lebanese economy on a sustainable growth path over the medium term, to support a sustained improvement in the fiscal deficit, and maintain confidence in the banking system.

Lebanon's political crisis occurs at a time when we had already expected large fiscal and current account deficits, forecast at 7.5% and 19% of GDP, respectively, in 2011. We project this year's public debt burden at more than 120% of GDP, although it has been on a declining trend over the past few years due to declining deficits and rapid growth in GDP. This ratio remains among the highest in the world and a major constraint on fiscal flexibility.

## Outlook

The stable outlook on Lebanon reflects our view that following the collapse of the unity government, political consensus in any new government will take time to forge, and progress on structural reform will be hard to achieve. We believe that if the government is unable to move forward on reform, this would in turn preclude an improvement in the sovereign's creditworthiness.

We believe creditworthiness could improve if Prime Minister Hariri could re-engage the defectors and form a new government, underpinned by a workable consensus for structural and fiscal reform. However, we do not expect this to emerge in the short term. Conversely, we consider that the ratings could come under further downward pressure if there was an outbreak of intense or prolonged civil unrest and entrenched political instability, reducing the government's effectiveness to formulate and implement stability-oriented economic policies.

## Related Criteria And Research

- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009.
- Rating Sovereign-Guaranteed Debt, April 6, 2009.
- Sovereign Credit Ratings: A Primer, May 29, 2008.
- Introduction Of Sovereign Recovery Ratings, June 14, 2007.

## Ratings List

Outlook/CreditWatch Action

To

From

Lebanon (Republic of)  
Sovereign Credit Rating                      B/Stable/B                      B/Positive/B

**Affirmed**

Transfer & Convertibility Assessment

Local Currency                                      BB-

Senior Unsecured                                      B

Recovery Rating                                      4

Short-Term Debt                                      B

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Complete ratings information is available to RatingsDirect subscribers on the Global Credit Portal at [www.globalcreditportal.com](http://www.globalcreditportal.com) and RatingsDirect subscribers at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow (7) 495-783-4011.

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