Lebanon Sovereign Ratings Raised To 'B/B' On Greater Political Stability And Fiscal Reform Prospects; Outlook Positive

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-- We are raising the long- and short-term sovereign credit ratings on the Republic of Lebanon to 'B/B', from 'B-/C'.

-- The upgrade and positive outlook reflect our view that Lebanon's public finances, and in particular the banking system, have proven resilient in the face of the political turmoil over the past three years, and that recent developments in Lebanon may provide a greater measure of political stability in the medium term.

DUBAI (Standard & Poor's) Dec. 22, 2009--Standard & Poor's Ratings Services today said it had raised its long- and short-term sovereign credit ratings on the Republic of Lebanon to 'B/B', from 'B-/C'. The outlook is positive.

Standard & Poor's has also raised its transfer and convertibility assessment on Lebanon to 'BB-' from 'B+', and affirmed the '4' recovery rating on Lebanon's foreign currency senior unsecured debt (average recovery of 30%-50%).

The upgrade and positive outlook reflect our view that Lebanon's public finances, and in particular the banking system, have proven resilient in the face of the political turmoil over the past three years, and that recent developments in Lebanon may provide a greater measure of political stability in the medium term.

Most significant among these developments is the new cross-party consensus that allowed Prime Minister Saad al-Hariri to form a National Unity government in November 2009. We believe that the new government is prioritizing structural reforms in line with IMF and Paris III recommendations, which include privatization of the telecom and electricity industries, expenditure cuts, and revenue-boosting measures. If successful, these reforms could lower fiscal deficits, cut government debt-to-GDP, and reduce Lebanon's contingent liabilities. Based on steady progress on public sector reforms, we conservatively estimate that the central government fiscal deficit could fall from 9.9% of GDP in 2008 to 6.3% of GDP in 2012.

The creation of the new government has also coincided with a steady improvement in Lebanon's overall balance of payments' position.

The ratings on Lebanon are supported by a large and stable resident and non-resident depositor base, which allows its banking sector to cover the government's financing requirements. Lebanon also benefits from substantial and ongoing financial support from wealthy Gulf Arab states.

The positive outlook balances the challenges Prime Minister Saad al-Hariri faces in maintaining working consensus among opposing factions in his new government against the opportunity that a stronger political consensus creates to push ahead with much-needed structural reform.

Further improvement in the ratings will depend upon the new government establishing a solid track record on enacting public sector adjustment measures. Fiscal adjustment is crucial for putting Lebanon's public sector accounts on a sounder footing, as the country's large public debt stock (which we forecast at 142% of GDP in 2010) is a major constraint on the government's fiscal flexibility. In our view, the recent improvement in deposits and reserves can only be sustained over the medium term by fiscal reforms.

Conversely, the outlook could come under downward pressure if there is any renewed outbreak of civil unrest, or if the new government's appetite for economic reform as promised at the Paris III conference dissipates. Political uncertainties remain the chief risk to the ratings: factionalism may impede progress on approving the key economic reforms laid down in the Paris III donor conference held in January 2007. This, in turn, could undermine confidence in the financial sector and thus compromise the ability of local banks to lend to the government.

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Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Introduction Of Sovereign Recovery Ratings, June 14, 2007

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