FITCH CHANGES LEBANON’S OUTLOOK TO STABLE

Fitch Ratings-London-14 July 2006: Fitch Ratings has today changed the Republic of Lebanon’s Outlook to Stable from Positive. At the same time, the foreign and local currency Issuer Default ratings are affirmed at ‘B-’
(B minus) and the Short-term foreign currency rating is affirmed at ‘B’.

“Recent attacks on Lebanon’s infrastructure will hurt economic activity and especially tourism. Tax revenues will suffer, public debt dynamics could take a turn for the worse and the political focus will once again be diverted away from long overdue economic reforms,” says Richard Fox, Head of Middle East and Africa sovereign ratings at Fitch.

Fitch placed the Republic of Lebanon’s ratings on Positive Outlook last November after the election of a new government had increased the prospect of implementation of comprehensive economic and structural reforms, which would revitalise growth, reduce Lebanon’s huge debt burden and attract international donor support. However, although a reform programme has been devised, its agreement and implementation has been stymied by political wrangling. The authorities have nevertheless succeeded in stabilising public debt dynamics, helped by tight spending control and buoyant revenues accompanying the recovering economy. Pressure of debt amortisation has also been relieved by successful debt management operations.

Booming tourism has played an important part in Lebanon’s economic recovery, with the bulk of tourists from the Gulf region. Coming at the height of the tourist season the attacks on Beirut airport will therefore have a more damaging impact on the sector than last year’s slump that had followed the assassination of former Prime Minister Rafik Hariri. Economic activity will also be hit by the severing of the main road to Syria, which carries a large part of Lebanon’s external trade. Key ports are also under blockade. Confidence will be damaged, which will affect construction activity — another key growth sector. The severity of the disruption will depend on how long the Israeli attacks continue and how long it takes for damage to be repaired, all of which is currently uncertain.

Tourism makes an important contribution to government revenues through VAT receipts and these will inevitably suffer. Although the authorities may be
able to contain the fiscal damage with spending restraint, fiscal
flexibility is limited. The budget deficit could increase and debt dynamics could take a turn for the worse, at least in the short term. Meanwhile, political attention will inevitably shift away from the economic reform programme towards resolving the security crisis. However, the fractious nature of Lebanese politics and the sensitivity and complexity of the issues which will have to be addressed before a resolution is possible, including the international dimension, all make quick resolution unlikely.

The response of the authorities and the economy to the shock of last year’s assassination demonstrated the resilience of Lebanon’s financial system.

Central bank reserves have since risen to over USD12 billion and provided non-resident deposits remain stable, financing difficulties should be avoided. The risks are encapsulated in the current ‘B-’ (B minus) rating.
Fitch will closely monitor financial market developments and public finance indicators in the coming weeks and months in order to assess the longer-term impact of recent events.

Contact: Richard Fox, London, Tel: +44 20 7417 4357
