RatingsDirect®

Research Update:

Lebanon 'B-/B' Ratings Affirmed As Bank Deposit Inflows Remain Resilient; Outlook Stable

Primary Credit Analyst:
Ana Jelenkovic, London (44) 20-7176-7116; ana.jelenkovic@standardandpoors.com

Secondary Contact:
Trevor Cullinan, Dubai (971) 4-372-7113; trevor.cullinan@standardandpoors.com

Table Of Contents

Research Update:

Lebanon 'B-/B' Ratings Affirmed As Bank Deposit Inflows Remain Resilient; Outlook Stable

Overview

- Lower oil prices will have a positive impact on Lebanon’s economy and will ease pressure on twin fiscal and current account deficits.
- Despite ongoing internal and external political pressures on the economy, we expect deposit flows into Lebanon's banking system to remain resilient and continue to facilitate the government's debt servicing capacity.
- We expect public finances to remain under pressure and that the already high government debt stock will continue to rise.
- We are affirming our 'B-/B' long- and short-term foreign and local currency sovereign credit ratings on Lebanon.
- The stable outlook reflects our expectation that continued deposit inflows will support Lebanon's ability to meet financing needs.

Rating Action

On March 27, 2015, Standard & Poor's Ratings Services affirmed its 'B-/B' long- and short-term foreign and local currency sovereign credit ratings on the Republic of Lebanon. The outlook is stable.

Rationale

The Lebanese government's debt servicing capacity is to a significant extent determined by the domestic financial sector's willingness and ability to continue buying government debt, directly or indirectly, and by the strength of deposit flows into the financial system. In our view, confidence in the Lebanese financial system remains strong, supported by the Banque du Liban (BdL, the central bank) policy of maintaining high foreign currency reserves that cover almost 80% of local currency money supplies, as well as stable prices and a favorable interest rate differential. This confidence is not likely to be significantly affected by domestic political developments, in our view, short of a major escalation of local unrest. The banking system's funding features a high proportion of retail deposits that have shown resilience through various crises. Resident and nonresident private-sector deposit growth was 6% in 2014, and we expect similar levels in 2015. In our view, this should be sufficient to enable the domestic financial sector to finance the large government deficit and demand for private-sector credit.

We expect lower oil prices to have a positive impact on Lebanon’s economy. The cost of oil imports is a source of pressure on economic growth (adding to the high cost of doing business) and Lebanon's fiscal and external positions. However, the net benefits for Lebanon of lower oil prices could be partly offset by the ongoing conflicts in the region, particularly in Syria, as well as by an internal political environment that is not conducive to implementing structural reforms.

In 2015, we expect a modest acceleration in real GDP growth to over 2% from an estimated 1.5% in 2014. We estimate that GDP per capita will reach just below $10,000 in 2015 (though our population figures do not take into account the influx of Syrian refugees). Higher disposable incomes due to lower oil prices will support growth, as will a third BdL stimulus package of $1 billion for 2015 aimed at supporting private sector growth and small and midsize enterprises. The BdL will continue to proactively seek to maintain financial stability and stimulate the economy.

Our growth forecast assumes relative stability in the political environment, with neither a major breakthrough in the deadlocked political system nor a significant deterioration in security. We anticipate that regional crises will continue to suppress growth, and we do not anticipate a significant rebound in tourism, financial and trade services, or foreign direct investment (FDI) in 2015. The Lebanese economy, traditionally services-driven, is highly sensitive to swings in consumer and investment confidence. If the parliament elects a president this year, followed by the formation of a new government, this would likely lead to a pickup in consumer and investor confidence and therefore stronger growth. A prolonged and significant deterioration in the security situation would put pressure on growth. We do not expect that in the current internal and geopolitical contexts the government will use the lower oil price environment and the fiscal space this gives to pursue the structural reforms that would promote longer-term sustainable economic growth.

Lebanon’s large current account deficits, estimated at 22% of GDP in 2014, are financed by capital inflows (deposits) into the banking system, as well as FDI, which allows the BdL to continue to accumulate foreign exchange reserves. Central bank foreign assets reached $43 billion as of end-2014 (including $11 billion in gold). The BdL keeps substantial foreign assets to maintain confidence in the financial system. We expect the current account deficit to narrow in 2015, primarily due to a lower import bill stemming from lower oil prices. The strengthening U.S. dollar will also reduce import prices from the eurozone, which account for 34% of Lebanese imports. Lebanon’s foreign currency inflows are highly dependent on remittances. A significant portion of remittances are estimated to come from the Gulf, but we do not expect their inflow to decrease. Stock-flow discrepancies between the country's balance of payments and international investment position continue to make the analysis of Lebanon's external position difficult, in our view.

The general government deficit narrowed to 6% of GDP in 2014 due to one-off factors, including a larger-than-expected transfer from the Ministry of Telecommunications, improvement in tax collection, and a decline in capital expenditure. As a result, the primary balance returned to a surplus of over 2% of GDP in 2014 and general government debt as a percentage of GDP remained relatively flat, contrary to our expectations--though the debt-to-GDP ratio remains one of the highest among rated sovereigns at 135% of GDP. We expect the general government deficit to widen in 2015 to above 8% of GDP, despite expected savings of around 1.5%-2% of GDP from lower transfers to the electricity company Electricite du Liban (EdL)--which have averaged over 4% of GDP in recent years--due to lower oil prices. Lower transfers to EdL will be offset to an extent by a reduction in VAT and customs duties. We expect 2015 revenues to fall short of 2014, when they were supported by one-off developments, and we expect debt to increase to 138% of GDP in 2015.

Public finances and fiscal flexibility will remain constrained by structural expenditure pressures, including transfers to EdL, as well as high interest payments, which account for around 40% of general government revenue. We do not expect any major progress on structural reforms that would lead to a sustained fiscal adjustment, which would reduce the high debt-to-GDP ratio. The Ministry of Finance, which is targeting lengthening maturities and increasing foreign currency borrowing as part of its public debt strategy, has used up nearly all of the $2.5 billion in additional foreign currency borrowing sanctioned by the parliament after issuing $2.2 billion in Eurobonds in February.

As of end-2014, 62% of gross debt was denominated in local currency. Domestic banks support the government debt market by buying government debt directly or by purchasing certificates of deposit issued by the BdL, which in turn buys government debt. At end-2014, banking sector claims on the public sector accounted for 21% of total banking system assets, and bank creditors held 51% of the government's outstanding local currency debt. We view the concentration of government financing from these sources as a structural weakness that leaves Lebanon more vulnerable to adverse business, financial, and economic conditions.

Recently, the Lebanese parliament failed for the 20th time to elect a president. There has been a presidential vacuum since President Sleiman's term ended in May 2014. The parliament, whose term was due to end in June 2013, voted a second time to extend its term in November 2014. A national unity government comprises both the March 14 and March 8 political alliances, the former led by former Prime Minister Hariri, who opposes the Assad regime in Syria, and the latter by Hezbollah, whose military arm is actively fighting in support of the Assad regime.

The Syrian crisis has displaced millions of people, both inside and outside Syria. Lebanon is the neighboring country by far the most affected by the crisis and the flow of refugees. The UN High Commissioner for Refugees reports that 1.2 million Syrian refugees are registered in Lebanon. Unlike neighboring Jordan, the Lebanese government has not benefited from substantial foreign aid to address the refugee crisis, although Lebanon has received donations through UN agencies and non-governmental organizations to assist Syrian refugees. In the medium term, the impact of the increasing number of Syrian refugees on Lebanese politics and society--as well as on the economy, as pressure increases on public spending, services, infrastructure, and the labor market--will become a greater and greater concern for the Lebanese government.

Outlook

The stable outlook reflects our view that deposit inflows into the financial system will continue over 2015, despite the difficult internal and external political environments, and that consequently the domestic financial sector will continue to enable the government to meet its financing needs.

If the political and economic situation deteriorates such that deposit growth becomes impaired, or if public finances worsen significantly, we could consider lowering the ratings.

We could consider raising the ratings if public finances became more sustainable, which would be supported either by a political breakthrough in Syria--potentially improving economic growth prospects in Lebanon--or an improvement in domestic policymaking that could translate into fiscal reforms.

Key Statistics

Table 1

Republic of Lebanon Selected Indicators

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Nominal GDP (bil. US$)	29.23	35.48	38.42	40.08	44.10	47.22	49.37	51.46	54.73	58.63	62.80
GDP per capita (US$)	6,982	8,354	8,850	8,949	9,490	9,793	9,844	9,867	10,288	10,804	11,347
Real GDP growth (%)	9.2	10.1	8.0	0.9	2.8	3.0	1.5	2.2	2.8	3.5	3.5
Real GDP per capita growth (%)	8.0	8.5	5.7	(2.2)	(1.0)	(0.7)	(2.4)	(1.7)	0.7	1.5	1.5
Change in general government debt/GDP (%)	17.2	11.5	3.8	2.6	9.1	12.3	6.2	8.3	8.0	7.5	7.0
General government balance/GDP (%)	(10.0)	(8.3)	(7.5)	(5.8)	(8.9)	(8.9)	(6.2)	(8.2)	(8.0)	(7.5)	(7.0)
General government debt/GDP (%)	161.0	144.2	136.9	133.9	130.8	134.5	134.8	137.6	137.4	135.8	133.7
Net general government debt/GDP (%)	142.1	124.5	117.2	115.7	111.4	112.7	114.0	117.6	118.6	118.2	117.4
General government interest expenditure/revenues (%)	47.0	45.5	46.5	40.2	38.5	40.2	38.5	43.2	43.1	42.8	42.2
Other dc claims on resident nongovernment sector/GDP (%)	72.1	68.4	78.9	85.4	85.8	87.9	91.9	96.1	101.2	105.8	110.6
CPI growth (%)	5.5	3.4	4.6	7.2	5.9	3.2	2.5	1.0	3.0	3.0	3.0
Gross external financing needs/CARs plus usable reserves (%)	118.3	110.5	100.6	92.2	99.9	100.9	111.1	106.0	102.3	101.6	100.9
Current account balance/GDP (%)	(14.2)	(19.9)	(18.3)	(12.9)	(22.3)	(25.0)	(22.0)	(14.0)	(14.1)	(13.8)	(14.3)
Current account balance/CARs (%)	(13.1)	(23.3)	(23.7)	(15.4)	(32.4)	(37.8)	(32.5)	(20.7)	(21.2)	(20.7)	(21.2)
Narrow net external debt/CARs (%)	(55.2)	(88.9)	(115.0)	(99.9)	(116.6)	(89.6)	(76.4)	(74.2)	(75.9)	(75.5)	(75.0)
Net external liabilities/CARs (%)	21.1	10.6	1.4	8.4	16.2	44.3	57.0	59.7	62.5	62.9	64.1

Table 1

Republic of Lebanon Selected Indicators (cont.)											
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018

Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. CARs--Current account receipts. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Republic of Lebanon Ratings Score Snapshot	
Key rating factors	
Institutional assessment	Weakness
Economic assessment	Neutral
External assessment	Neutral
Fiscal assessment: flexibility and performance	Weakness
Fiscal assessment: debt burden	Weakness
Monetary assessment	Weakness

Standard & Poor's analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of Standard & Poor's "Sovereign Rating Methodology," published on Dec. 23, 2014, summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with Standard & Poor's sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria And Research

Related Criteria

- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 23, 2014
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 07, 2013
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments - May 18, 2009

Related Research

- Sovereign Defaults And Rating Transition Data, 2013 Update, April 18, 2014
- Sovereign Risk Indicators, Dec. 15, 2014 (interactive version at

spratings.com/sri)

- Middle East And North Africa Sovereign Rating Trends 2015, Feb. 24, 2015
- MENA Sovereign Debt Report 2015: Borrowing To Decrease Moderately To $68 Billion, March 5, 2015

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision. After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that all key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria and Research').

Ratings List

	Ratings	
	To	From
Lebanon (Republic of)		
Sovereign credit rating		
Foreign and Local Currency	B-/Stable/B	B-/Stable/B
Transfer & Convertibility Assessment		
T&C Assessment	B+	B+
Senior Unsecured		
Foreign Currency	B-	B-
Short-Term Debt		
Local Currency	B	B

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at

1391218 | 301551771

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) 783-4009.