



بنك الإمارات دبي الوطني  
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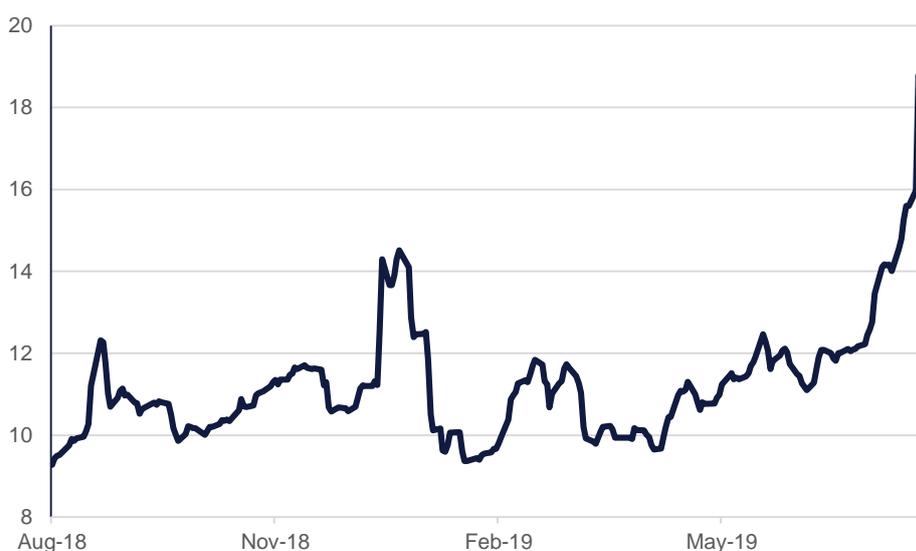
## Lebanon suffers ratings downgrade

The urgency for Lebanon to implement stringent reforms and begin to curb its budget deficit – and its escalating debt load – is becoming ever more paramount, as the country suffered a ratings downgrade at the end of last week. Fitch Ratings moved Lebanon's long-term foreign currency debt issuer rating down a notch, from B- to CCC. Although S&P on the same day held Lebanon's long- and short-term foreign debt issuer rating at B-, it was kept on a negative outlook.

The political paralysis which has stymied fiscal reform in Lebanon over the past several years has begun to weigh ever more heavily on the country's economy, with fears regarding credit defaults and an abandonment of the currency peg to the dollar rising. This increased risk aversion is readily apparent in the spiking CDS spreads and yields on its dollar-denominated debt. Lebanon's five-year CDS has hit 1,125, almost double the 611 it stood at a year ago, while yields on its 2021 eurobond have spiked to 18.3%, compared to 9.3% at this time last year. Crucially, inflows of diaspora deposits have slowed despite ongoing high interest rates and financial engineering by the central bank, as Lebanon's ability to weather the latest storm comes into question.

Failure to reduce the budget deficit to date – largely owing to unproductive spending on debt servicing and supporting the loss-making electricity board EdL – has led to Lebanon having one of the highest debt/GDP ratios in the world at some 160%. With GDP growth little more than flat over the past 18 months, and unlikely to see any significant acceleration over the remainder of the year, cutting the nominal fiscal deficit will be crucial to reducing this, but there are questions regarding the government's ability to do this. Certainly, the deficit target of -6.6% of GDP agreed by parliament – even lower than the -7.6% government target – is unlikely to be reached, and we see somewhere in the region of -9.0%, from -11.2% last year, as a far more likely scenario.

### Lebanon 2021 eurobond % yield spikes



Source: Emirates NBD Research, Bloomberg

All of this being said, there remain some positives, and the fact that the government is at least focusing on the deficit and setting ambitious targets is something to be welcomed, even if their unrealistic nature mars their credibility. The latest downgrade prompted statements from the President, Michel Aoun, and other leading politicians that they recognised their responsibility and were taking the dangers seriously. While the fractious nature of Lebanese politics and the vested parochial interests threatened by any cuts to expenditure make fiscal consolidation challenging, there does at least seem to be greater will than seen over recent years. Concerted, tangible, advancements in this regard will open the door for the gradual release of CEDRE funding, which would provide a much-needed shot in the arm to the Lebanese economy.

Another positive is the ongoing pledges of support from regional powers. Lebanese Prime Minister Saad Hariri said earlier in the month that both Saudi Arabia and the UAE are looking to invest in infrastructure in the country as relations have thawed once more. This is alongside support from Qatar, which has been buying Lebanese bonds, and Turkey, as Foreign Minister Mevlut Cavusoglu said on Friday that his country was interested in supporting the Lebanese economy in the wake of the latest downgrade.

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