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Farah-Silvana Kanaan

Moody's Lebanon downgrade is sudden, hasty: experts

Moody's downgrade of Lebanon's long-term investment rating is surprising and hasty, Byblos Bank's chief economist Nassib Ghobril told The Daily Star. "The downgrade by Moody's comes as a surprise. It was very sudden, especially considering the motivation they provided or, rather, the lack thereof," Ghobril said. Moody's Investor Service announced Monday night that it had downgraded Lebanon's long-term investment rating to reflect an increased likelihood that the country would undertake debt rescheduling or other measures that Moody's may consider a default. "Moody's decision to downgrade the ratings to Caa1 reflects the heightened risk that the government's response to increased liquidity and financial stability risks will include a debt rescheduling or other liability management exercise that may constitute a default under Moody's definition," the investor service said in a report. The Caa1 rating indicates poor quality and very high credit risk. Lebanon's rating is now on par with countries including Iraq, Gabon and Zambia. Its outlook, meanwhile, has been shifted from negative to stable, indicating the expectation that no further shift in the rating - negative or positive - is imminent. But "only a few weeks ago they changed the outlook from stable to negative. Now they suddenly gave a higher outlook and might downgrade it again soon," Ghobril said, referring to a separate report Moody's released last month that announced Lebanon's outlook had changed from stable to negative, but that its B3 rating remained the same. "Their recent rationale, only weeks before the downgrade, was the fact that obstructions and delays to forming a government would soon be resolved and measures would be implemented to reduce debt and service costs so this, if anything, should be a positive development," he added. "Besides," he said, "none of details of these measures have even been disclosed yet." Moody's at the time said the decision to preserve the B3 rating indicated the assumption that a Cabinet would be formed in the short term, and that the government would take steps to implement fiscal reforms that would help unlock the funds pledged at last April's CEDRE conference. These measures would in turn bolster GDP growth and ease the risk of liquidity. "Moody's is clearly behind the curve when it comes to the current developments in Lebanon as they haven't mentioned anything about the Central Bank, ABL [Association of Banks in Lebanon] and the Finance Ministry hav[ing] agreed to cover all financial liabilities in their entirety for 2019. They have confirmed that all obligations for foreign

investments are covered for 2019,” Ghobril said. “And two Sundays ago the Central Bank met with the president, with [caretaker Prime Minister Saad] Hariri and the [finance minister] to reaffirm that the state will pay all obligations and that there will be no restructuring of debt.” In fact, caretaker Finance Minister Ali Hasan Khalil tweeted Tuesday that, despite the report, Lebanon’s financial and monetary situations were stable and the Treasury’s needs were insured. The Treasury “is able to pay all the liabilities, especially the debts,” Khalil wrote. Despite his reservations about the rationale behind the Moody’s downgrade, Ghobril stressed that this did not mean he was understating the urgent need for financial reforms and the imminent formation of a government. “This ongoing obstruction amounts to a huge loss for the economy, financial institutions and many other sectors,” he said. Marwan Barakat, head of research at Bank Audi, agreed. This downgrade is a clear signal for the state of Lebanon that it needs to improve its public finances, fiscal reforms and contain its public debt,” Barakat said. Despite the fairly miserable state of Lebanon’s economy, he saw no reason not to have a positive outlook, provided the government commits to certain reforms as soon as it is formed. “There is still room for a soft landing. If the country actively works on improving the debt-deficit ratio, adopts new fiscal measures and increases public revenue, it will put its financial trajectory on a virtuous path,” he said. The government formation entered its ninth month of deadlock this week. A Cabinet is needed to fully implement reforms that would release the CEDRE funds, which amount to over \$11 billion in investments and soft loans. At the same time, Lebanon’s public debt has soared to the third-highest in the world, at about 150 percent of GDP in 2018, excluding domestic liabilities of public entities, and the cost of servicing it is equivalent to almost half of government revenue, Moody’s estimates. Lebanon’s five-year credit-default swaps have climbed 15 percent this year, the most among contracts tracked by Bloomberg globally. According to Bloomberg, while Eurobonds rallied Monday after Qatar’s announcement that it would subscribe to \$500 million in Lebanese government bonds, the relief was short-lived. The yield on Lebanon’s dollar debt due 2021 jumped 17 basis points to 14.21 percent as of 10:59 a.m. in Beirut Tuesday. It reached 14.86 percent on Jan. 18, the highest on a closing basis since the bonds were issued in 2006. Generally, ratings agencies tend to wait for six to nine months after a negative outlook warning to actually issue a downgrade. It is unclear why Lebanon was not awarded this grace period. Ghobril ventured the opinion that there was “an unnamed reason for this for this rash decision.” “Moody is a competitive business, after all,” he added. “After the financial crisis of 2008, during which they received enormous backlash for their ratings on financial institutions and services, with many saying their rating contributed to the financial crisis, they weathered myriad accusations about misleading the financial markets and investors. And now, 10 years after the financial crisis, they adjusted their model, which led to this hasty decision.” - *Additional reporting by Sahar Houri*