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Economists shrug off Moody's warning

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BEIRUT: Economists brushed off Moody's warning that Lebanon may risk debt rescheduling in the future due to slowing capital inflows and weaker deposit growth. "Lebanon has never defaulted in the payment of its external debt and probably never will thanks to the measures adopted by the Central Bank," economist Ghazi Wazni told The Daily Star.
He added that Moody's made the same warning in February of this year and nothing has happened since then.
Finance Minister Ali Hassan Khalil responded to Moody's report by giving assurances that "everything is under control." He did not elaborate further.

In its report, Moody's expressed deep concern that the Lebanese government may not be able to meet its 7.6 percent deficit to GDP target.

"Despite the inclusion of fiscal consolidation measures in the draft 2019 budget, slowing capital inflows and weaker deposit growth increase the risk that the government's response will include a debt rescheduling or another liability management exercise that may constitute a default under our definition," Moody's said.

It is worth noting that Khalil told a daily Arabic language newspaper last year that the Treasury might consider debt rescheduling, a message that led to a drop in the prices of Lebanese sovereign Eurobonds and criticism from commercial banks.

But Khalil quickly backtracked from this statement, asserting that he was misquoted.
Another economist said that the government may not be able to cut the deficit to 7.6 percent at the end of this year because the time was too short to implement the reforms.
However, the economist ruled out the possibility that the government would reschedule the debt in the future.

Wazni said that in the first five months of this year, the Central Bank paid all the government's outstanding Eurobonds on time.
"In the first five months, BDL paid $500 million in Eurobonds, $650 million, $1.150 billion and $1 billion in interest rate," Wazni said.

He added that the BDL has secured the money to pay for the last maturing Eurobond valued at $1.250 billion in 2019.

BDL has also secured funds for $2.5 billion in Eurobond in 2020.

According to Wazni, 51 percent of the Lebanese Eurobonds are held by the commercial banks, 20 percent by BDL and 27 percent by the international financial markets.
Moody's said in its report that the credit profile of Lebanon reflects challenges stemming from a very large public debt burden, which at 138.8 percent of GDP in 2018 (excluding domestic debt holdings by public entities worth 11.6 percent of GDP) is one of the largest among the sovereigns we rate.

It added that Lebanon's interest to revenue ratio of 46.9 percent was the highest of all the sovereigns it rates.
"Lebanon's credit strengths include a historically resilient bank deposit base supported by remittances and cross-border transfers from the Lebanese diaspora.

Lebanon also has a track record of full and timely debt repayment despite economic and political turmoil both domestically and at the regional level," the report said.

At the CEDRE1 conference in April 2018, the government secured investment commitments from the international community of $11.8 billion for its capital investment program to boost below-trend growth, though disbursements are conditional on fiscal reforms.

The government of Prime Minister Saad Hariri is keen to speed up the approval of the 2019 draft budget to unlock the funds committed by CEDRE.
But there is doubt even among the most optimistic financial analysts that Lebanon has the means and the strong political will to cut the expenses drastically.
But despite the relatively negative report by Moody's, the rating agency refrained from downgrading the outlook of Lebanon.

“The stable outlook reflects a balance of risks between the possibility that an event of default is avoided and that, should a default occur, investors’ losses are larger than consistent with a Caa1 rating. We would downgrade the rating if Lebanon’s fiscal and external metrics weaken further and jeopardize its financial stability,” Moody’s warned.

The report stressed that the rating agency would be likely to upgrade the rating if the likelihood diminished that the government could pursue a liability management exercise that would trigger a default under Moody’s definition in the next few years.

“This would be likely to involve significant fiscal reforms that support macroeconomic stability and offer the prospect of eventually reducing the debt ratio. Such prospects would in turn foster sustained financial inflows, including foreign deposits at Lebanese banks, that secure the financing of Lebanon’s fiscal and external deficit,” the report said.

Moody’s determination of a sovereign’s government bond rating is based on consideration of four rating factors: economic strength, institutional strength, fiscal strength and susceptibility to event risk.

“GDP peaked in 2010 before declining in the wake of the regional Arab Spring uprisings. Growth fell sharply due to declining tourism, with net travel service exports halving to 4 percent of GDP in 2017 from 8 percent in 2010; the closure of trade routes to Syria, one of Lebanon’s main trading partners; and the collapse in oil prices, which have weakened transfers from Gulf cooperation Council (GCC) countries, particularly Saudi Arabia (A1 stable), an important host country for Lebanese expatriates,” the report said.

The report drew attention to the negative impact of the Syrian refugees on the Lebanese economy.
“A large influx of Syrian refugees amounting to 25 percent of the population has also weighed on the labor market and infrastructure provision,” Moody’s added.

It said the resilience of remittances and transfers from abroad to Lebanon’s real estate, construction and financial services sectors has historically helped sustain wealth and consumption levels in an economy that lacks domestic savings and depends entirely on foreign inflows to sustain investment activity.

“These financial inflows have traditionally sustained growth . We expect only a slow recovery to 0.8 percent in 2019 from 0.6 percent in 2018 in anticipation of CEDRE investment funds once the 2019 budget is approved.
Lebanon is one of the weaker performers among upper-middle-income countries in terms of public investment efficiency, underscoring its very low competitiveness performance in the global comparison,” the report said.
It said that the Lebanese expatriates, especially in the Gulf region, play a paramount role in financing the Lebanese economy through the massive remittances each year.
The report said the Gulf region hosts around 330,000 Lebanese expatriates out of a total 885,000 (around 40 percent of all Lebanese expatriates) and accounts for around 30 to 40 percent of remittances to Lebanon.

“Remittances were equivalent to 15 percent of GDP in 2017, down from a peak of almost 25 percent in 2004, and are a key source of income for Lebanese households (the majority are transferred in the form of cash).

The GCC region’s contribution to tourist arrivals is comparable to the distribution of remittances,” the report said.

It added that Arab countries are the source of the vast majority of FDI inflows into Lebanon, underscoring the importance of Lebanon’s economic ties with the GCC and Saudi Arabia in particular.

“FDI as a percentage of GDP has declined following the prolonged political instability triggered by the assassination of former Prime Minister Rafik Hariri in 2005 and the war between [Shiite group] Hezbollah and Israel in 2006. However, at around 5 percent of GDP, Lebanon continues to attract one of the largest shares of FDI inflows among regional peers,” Moody’s said.

The main sources of FDI inflows are the UAE, Kuwait and Saudi Arabia, which combined accounted for 76 percent of total FDI inflows between 2003 and 2015, according to the FDI Markets database, followed by the U.S., Spain and Canada.
Moody’s also commented on the government’s plan to explore gas in its maritime border.
“Lebanon is the last country in the Eastern Mediterranean to explore its hydrocarbon reserves. After passing a hydrocarbon law in 2010, it fell behind neighboring countries in exploring the Levant Basin because of internal political unrest. Egypt, Cyprus and Israel have discovered significant gas reserves in their respective offshore waters in the Mediterranean in the meantime,” the report said.

It added that the government’s proven willingness to prioritize debt payments is an important factor supporting Moody’s assessment of Lebanon’s institutional strength