

Lebanese banks brace for possible downgrade

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BEIRUT: Lebanese banks are bracing themselves for any possible downgrade by rating agencies this month as the country's main political blocs fail to hold Cabinet sessions to implement the measures in the 2019 budget. International rating agencies Fitch and Standards & Poor's are expected to give their assessment of Lebanon's fiscal deficit and other financial indicators, which are not very encouraging.

Experts and analysts say the worst-case scenario is a possible downgrade by S&P from B- to CCC+ but keeping a stable outlook.

Commercial banks have been beefing up their capitals and provisions to face any negative ramifications from the possible downgrade.

Bankers told The Daily Star that they had prepared for all scenarios, brushing off claims that any downgrade could lead to the devaluation of the Lebanese pound and a run on the dollar. They say they have met and even exceeded the requirements of Basil III, noting that their banks' capital adequacy ratio is 15 percent or better.

The Central Bank has also managed to increase its gross foreign currency reserves to \$37 billion thanks to the recent financial engineering.

"Lebanon is classified as B- by S&P and if there is downgrade then it will drop to CCC+. But I don't think the impact will be significant because the agency will look carefully into the indicators," Nassib Ghobril, head of economic research at Byblos Bank, told The Daily Star.

"It is true that the balance of payment recorded a deficit of \$5.3 billion up to June, but it is worth remembering that the Central Bank settled around \$3 billion for maturing Eurobonds, and this was one of the main factors which led to this deficit," he added.

He stressed that rating agencies don't take political factors into considerations when they assess the country's fiscal deficit and other economic indicators.

Ghobril did not expect any serious negative impact on Lebanon in the event of a downgrade.

Economist Ghazi Wazni said the Central Bank had raised between \$1 billion and \$1.5 billion from the latest financial engineering.

Wazni and other economists argued that despite the negative atmosphere in the country and the government paralysis, it was very unlikely that the Cabinet and Prime Minister Saad Hariri would seek financial assistance from the International Monetary Fund because they were aware of the heavy price Lebanon would pay if it opted for this step.

Wazni recommended some measures to improve the assessment of rating agencies. "There should be substantial reforms in the 2020 budget in terms of restructuring the public sector, reforming the pension system, containing the growing debt and its cost, improving the collection of public revenues, combating corruption and waste, in addition to real and effective reduction of the budget deficit through correct estimates of public revenues and public spending," he said.

Wazni underlined the need to benefit from last year's CEDRE conference pledges to implement infrastructure projects, stimulate the economy, attract investors, create jobs and improve social and living conditions.

He also cited the need to implement "the electricity plan, as this would reduce one-third of the deficit and would reflect positively on the economy and citizens through increasing production capacity and tariffs and reduce technical and technical waste."

Wazni said exploration for oil and gas would send a positive message abroad, enhancing confidence in Lebanon and its economy among major investors, businesspeople and international companies and reassuring global financial markets. He said it would also help stabilize interest rates and the issuance of state bonds in foreign currencies, especially with the possibility of reaching an agreement soon with Israel to demarcate the maritime and land borders.

But this week's report by Bank Audi's Lebanon Weekly Monitor noted that the prices of Lebanese bonds had decreased due to the political situation in the country.

“Elevated domestic political tensions and Cabinet sessions’ paralysis left their imprints on the Lebanese Eurobond market over this week, and triggered net international selling operations. Under these conditions, Lebanese sovereigns registered weekly price declines ranging between 0.13 points and 3.0 pts, despite a widely expected 25 basis point rate cut by the U.S. Federal Reserve at end-July 2019, which marked its first rate cut since 2008,” the report said.

It added that this triggered price gains across emerging debt markets (as reflected by a 4.4 percent contraction in the JPMorgan EMBIG Z-spread). “Within this context, the weighted average bond yield increased by 62 bps week-on-week, moving from 10.31 percent at the end of last week to 10.93 percent at the end of this week. Also, the weighted average bid Z-spread expanded from 882 bps last week to 965 bps this week, up by 83 bps. As to the cost of insuring debt, Lebanon’s five-year CDS [credit default swap] spreads expanded from 915-945 bps last week to 960-980 bps this week, in a sign of reduced market perception of sovereign risks at large,” it said.

In January year, Moody’s expressed fear that Lebanon could risk debt rescheduling or another liability management exercise if the fiscal situation did not improve.

But despite the relatively negative report, the rating agency refrained from downgrading Lebanon’s outlook.

“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 the 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.