

Can new Cabinet revive Lebanese economy?

Reuters

BEIRUT After three months of political paralysis, Lebanon has finally formed a government under Prime Minister Hassan Diab. Now comes the task of saving the country from a biting financial crisis and winning over investors and foreign donors.

HOW LIKELY IS A DEBT DEFAULT OR RESTRUCTURING?

Lebanon's public debt burden, equivalent to around 150 percent of GDP, and its twin current account and fiscal deficits looked unsustainable even before anti-government protesters took to the streets three months ago. With many of the international sovereign bonds trading at less than half their face value, market observers see an increasing likelihood of Lebanon struggling to repay some of its obligations and seek a restructuring with creditors at some point.

One of the first tasks of the government will be to decide whether to proceed with a Banque du Liban proposal to ask local holders of some of this year's bonds, including a \$1.2 billion issue maturing in March, to swap them for longer-dated ones to ease pressure on state finances.

Any move to delay bond repayments could constitute a default in the eyes of credit rating agencies and risk pushing its credit rating further into junk territory.

IS A CURRENCY DEVALUATION A GIVEN?

The Lebanese pound's 22-year-old peg to the U.S. dollar has been strained to near breaking point by the country's political and banking crisis.

With the pound losing a third of its official value on the black market as dollars have dried up, a devaluation has loomed increasingly large.

Central Bank Gov. Riad Salameh has previously ruled out any such move, saying the government has the means to maintain the peg. But without a revival in sagging capital flows and a recovery in Lebanon's external balance sheet, BDL's ability to defend the peg will diminish.

HOW CAN THE BANKING SYSTEM BE REVIVED? Banks have long served as a vital cog in keeping Lebanon's economy moving. By taking deposits from Lebanon's millions of scattered diaspora and snapping up the government's local debt, banks helped prop up the state's finances. But that system has broken as foreign deposits dry up in the face of a collapse in confidence in the banking system.

Non-resident private sector deposits in the banking sector fell by 11.3 percent on an annual basis in November, while Lebanon faces a hard currency shortage - leaving Lebanese at home and abroad with restricted access to their bank funds. Some financial experts believe banks will require a deeper injection of cash than the 20 percent of capital they've been told by the Central Bank to raise.

WHAT ABOUT SECURING FOREIGN FINANCIAL SUPPORT?

Lebanon is mired in recession and its recovery remains largely dependent on the government's ability to make reforms needed to secure international financial support.

Lebanon needs a \$20 billion-\$25 billion bailout including International Monetary Fund support to emerge from its financial crisis, according to former Economy Minister Nasser Saidi. But assistance appears uncertain given Diab's support from the Iranian-backed Hezbollah and its allies.

Diab has said his first trip abroad would be to the Arab region, particularly Gulf states.

But Saudi Arabia and the United Arab Emirates, which have provided financial aid to Lebanon in the past, have appeared more circumspect during the latest crisis and may be even less willing to stump up with Diab in power.

Instead, Lebanon may look to Qatar, accused by its Gulf neighbors of more closely aligning itself with Iran.

It is unclear whether Diab will try to pursue an IMF bailout. Some observers warn the United States, the largest financial backer of those institutions, could oppose any such deal due to the government's Hezbollah ties. The United States regards Hezbollah as a terrorist group.