

Moody's expects firm Lebanon deposit inflows

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BEIRUT: International rating agency Moody's expects deposit inflows to Lebanon to remain sustainable despite recent U.S. sanctions against Hezbollah senior officials.

"In our central scenario, we expect deposit inflows to remain resilient despite the latest political headwinds – partly because of the central bank's stabilizing policies and higher deposit rates. Following the political crisis in November, deposit dollarization reached a decade peak of 68.7 percent in December, and banks hiked interest rates for deposits in Lebanese Pounds (LBP) by 2-3 percentage points to attract and maintain LBP deposits," Moody's said in its latest report on Lebanon.

The U.S. Treasury added more names of individuals and institutions connected to Hezbollah and suggested that more names will be added in the future.

Moody's noted that the Central Bank has recently introduced a new operation increasing the interest rate on existing BDL instruments that banks hold by 2-3 percentage points for banks.

The purpose of this new operation was mainly intended to attract more deposits in Lebanese pounds.

"But signs of a sustained slowdown in deposits with emerging funding constraints for the sovereign would be credit negative," Moody's said, adding that the Association of Banks in Lebanon acted swiftly even before the U.S. Treasury released new sanctions against Hezbollah.

"Following the most recent announcements of new sanctions, the Association of Banks in Lebanon reiterated the commitment of the Lebanese banking sector, in all circumstances, to implement the rules of compliance and transparency under the umbrella of the official monetary and supervisory authorities, and to ensure its proper performance, particularly American and European rules, to ensure Lebanon's secure sustainable engagement in the international financial system," Moody's said.

It did not rule out the possibility that Lebanese banks would come under stricter scrutiny once the U.S. announces new measures targeting Hezbollah and all its associates.

"In previous instances of US legislation targeting Hezbollah, most recently the Hezbollah International Financing Prevention Amendments Act of 2017 (HIFPA) passed by the US Congress in October 2017, the banking system has remained largely unaffected, reflecting the fact that Hezbollah has long been cut off from the financial system. That said, the adjustment to a broadening set of sanctions could introduce a period of uncertainty that may increase the

risk premia banks pay on their deposits, and we expect domestic banks to face higher monitoring and reporting standards,” the agency warned.

It noted that U.S. correspondent banks will probably be more cautious in dealing with Lebanese banks in the future if Washington adopted extra measures.

“Highly dollarized banking systems, such as that of Lebanon, require US banks to clear dollars. Moreover, for such systems, fines or sanctions resulting from non-compliance with anti-money laundering (AML) and combating the financing of terrorism (CFT) requirements can be particularly damaging. Furthermore, heightened scrutiny for banks to comply with AML and CFT regulations has been driving international correspondent banks to retrench from cross-border activities in recent years and to end relationships with banks that are regarded as potentially higher risk,” the agency said.

It cautioned that any loss of confidence in the Lebanese banking system could lead to a significant slowdown in private sector deposit growth or outright outflows over an extended period would be credit negative.

“This would exacerbate government liquidity risks given its dependence on domestic banks to fund gross borrowing requirements of around 30 percent of GDP in 2018,” Moody’s said.