

Lebanon Macro Flash

Mikati resignation: Stirring muddied waters*

- PM Najib Mikati's surprise resignation on Friday has added further uncertainty over Lebanon's immediate future. In reality, however, we think the situation was already very unclear, and the PM's resignation has only acted to stir already very muddied waters. Yes, the upcoming parliamentary elections now look in doubt and yes, this raises the spectre of a constitutional vacuum when parliament's mandate ends on 20 June. But significant doubt already existed over whether the elections could go ahead on time, and, in our view, they were unlikely to do so, given ongoing squabbling over the electoral law. In this sense, the situation is little changed for us.
- Mr. Mikati will now lead a caretaker government until a new one can be formed. This is not unusual: Saad Hariri led one for the first five months of 2011. Until this takes place, optimists are hopeful that there will be an opportunity for a resumed national dialogue to address the grievances that have led to deepening sectarian divisions in Lebanese politics. We remain cautious, however, – without Syria and other outside powers applying pressure to broker a deal, there seems little chance of a Doha-type agreement to break the deadlock. Moreover, developments are unfolding rapidly in Syria, and Lebanese political factions may be waiting to see where the chips fall there before entering a binding long-term agreement at home. This is likely to take some time.
- One difference, of course, between now and early 2011 is that sectarian tensions are much higher in Lebanon today, as evidenced by the outbreak of violence in the northern city of Tripoli last week (for the 15th time in 2 years) between pro- and anti-Assad militia. However, we maintain our view that Hizbollah's military dominance within Lebanon makes a military challenge highly unlikely in the medium term. This could change, depending in large part on what happens in Syria and the will (or not) of external powers to provide material support to anti-Hizbollah factions, but there is no evidence of this for the time being. We consequently do not expect a descent into civil strife at this stage.
- Our base-case scenario is the caretaker government muddles along, 'keeping Lebanon going', as previous caretaker governments have done. But the prospect for a grand agreement looks low, and the likelihood of a credible Sunni candidate agreeing to form a government in the current circumstances looks equally so. We think we are therefore looking at a long period of drift, perhaps longer than the first five months of 2011.
- The economic consequences are not clear. In the immediate term, it seems unlikely that the salary scale rise, which would have cost the government over \$1bn this year alone, is unlikely to go through despite cabinet's approval last week. We also see significant delays to the gas exploration tendering process launched last month. In terms of domestic demand, this is mostly subdued due to external factors and is unlikely to be affected significantly by domestic political developments (short of civil strife). The same goes for confidence in the Lebanese banks, which are ultimately the cornerstone of the country's fiscal sustainability.
- *Correction: The salary scale rise is unlikely to go through. We originally said likely.

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