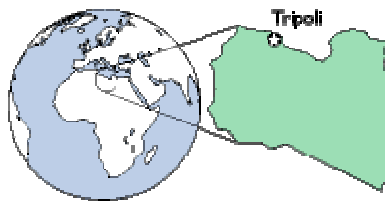


# COUNTRY REVIEW

## Libya



5 June 2009

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**EULER HERMES COUNTRY RISK GRADE: C**

Country Risk Grades are on a scale of AA, A, BB, B, C, D  
where AA is the lowest and D the highest risk.

## Strengths

- Libya is being re-assimilated into the global community and in October 2007 was elected unopposed to the UN Security Council for a two-year period
- Lifting of UN, EU and US sanctions has promoted trade and inward investment flows
- Libya possesses the world's eighth largest oil reserves and these will last for almost 62 years at current rates of extraction
- Large fiscal and current account surpluses from a sustained period of high oil prices
- External liquidity and solvency ratios are stronger than the grade median and import cover is in excess of 25 months
- Net external creditor overall

## Weaknesses

- There is no constitutional provision for succession and Qadhafi has been in power since 1969
- Track record of quixotic, erratic and controversial policymaking may re-emerge
- Exposure to oil price and output cycles engenders export volatility and an economic dependence on international oil markets
- Poor data transparency despite IMF Article IV acceptance
- Although improving, the structural business environment remains weak, including a state-dominated banking sector

## Key Risks

- If oil prices collapse to around USD10-20/barrel for a prolonged period fiscal and current accounts will turn negative and weak GDP growth and high unemployment could result in social dissent and perhaps violent opposition to the ruling regime (low risk)
- Qadhafi could reverse recent policies and Libya could be again ostracised (or sanctioned) by the international community (low risk)

## Country Risk Assessment

Ratings	Libya		Median Grade C	Turkey	Peers Ghana	Botswana
	Latest	Previous				
<b>Systemic Political Risk:</b>	<b>P3-</b>	<b>P3+</b>	<b>P2-</b>	<b>P3-</b>	<b>P2+</b>	<b>P2+</b>
<b>Systemic Economic Risk:</b>	<b>E4</b>	<b>E5</b>	<b>E5</b>	<b>E5</b>	<b>E5</b>	<b>E4</b>
ME rating:	ME3	ME3	ME5	ME5	ME5	ME4
<i>Structure</i>	6.0	6.0	5.7	3.3	6.0	4.7
<i>Policy</i>	6.0	4.3	5.2	4.6	5.6	5.6
<i>Solvency</i>	1.0	2.3	3.0	4.8	3.0	1.6
<i>External Liquidity</i>	1.9	1.3	4.6	6.0	5.6	3.8
SBE rating:	SBE4	SBE5	SBE4	SBE3	SBE4	SBE2
<b>COUNTRY GRADE:</b>	<b>C</b>	<b>C</b>	<b>C</b>	<b>C</b>	<b>C</b>	<b>B</b>

**Nomenclature:**

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

## ECONOMIC STRUCTURE

### Country Profile

Capital city:	Tripoli
Population:	6.16 mn (2007)
GDP:	USD 56427 mn (2007)
Currency:	Dinar (LYD)
Form of state:	Jamahiriya (Republic of the masses)
Head of government:	Colonel Muammar Qadhafi (Supreme Leader)
Next elections:	None

Major Industries (% of GDP at market prices, 2008e)		Global Assumptions	2008	2009f
Agriculture	2.0%	Real GDP grth (% yr/yr) *	0.7	-3.0
Industry	70.0%	Inflation (% , av) *	3.4	1.0
Services	28.0%	Dated brent (USD/b)	98.0	55.0
		* Major economies		

Main Exports (% of total, 2008e)		Main Imports (% of total, 2008e)	
Crude oil	98.0%	Not available	
<b>Lead Export Markets (% of total exports, 2006)</b>		<b>Lead Import Markets (% of total imports, 2006)</b>	
Italy	37.1%	Italy	18.9%
Germany	14.6%	Germany	7.8%
Spain	7.7%	China	7.6%
US	6.1%	Tunisia	6.3%

## Basic indicators

Selected economic indicators	2005	2006	2007	2008	2009f
Nominal GDP (USD mn)	41,500	53,717	56,428	66,959	40,000
Population (mn)	5.92	6.04	6.16	6.28	6.41
GDP per capita (USD)	7,010	8,894	9,160	10,662	6,241
Real GDP growth (% yr/yr)	5.5	6.0	7.0	6.0	2.0
Inflation (% , average)	3.0	2.0	6.0	10.0	5.0
Fiscal balance (% of GDP)	44.6	46.5	42.5	44.8	6.3
Current account balance (% of GDP)	36.0	41.3	50.4	53.0	5.0
External debt/GDP (%)	10.8	8.6	8.9	9.0	15.5
External debt/Exports of goods & services (%)	14.4	11.5	9.7	8.4	20.7
Debt-service ratio (%)	3.2	2.7	2.3	1.7	4.7
Foreign exchange reserves (USD mn)	38,235	57,907	77,897	90,803	75,000
Import cover (months)	29.3	37.4	40.9	33.4	29.1
Exchange rate assumption, LYD:USD (eop)	1.35	1.28	1.22	1.25	1.30
f: CRU central forecast					

Sources: Central Bank, IMF, World Bank, Euler Hermes Country Risk Unit

## Political Stability

Sufficient time has now elapsed to make a judgement that Colonel Muammar Qadhafi is genuine in his aspirations that Libya wishes to engage with the international community. Indeed, in 2007, Libya secured a non-permanent seat on the UN Security Council, thereby signalling that, in turn, the world is willing to restore full diplomatic relations with Tripoli. Qadhafi has overseen **reversals in policy** that encompass renunciation of weapons of mass destruction, co-operation in the war on terrorism and compensation for previous bomb campaigns. This resulted in UN trade **sanctions being lifted** in September 2003 and, in 2004, the United States (September) and the EU (October) lifted most economic and commercial sanctions, following Libya's abandonment of weapons of mass destruction.

For almost 40 years, Qadhafi has stamped his highly personalised mark on Libyan politics and has created a political system based on a combination of socialist and Islamic theories inspired by tribal traditions. In theory, the system establishes direct representation by the people through local committees that appoint representatives to the country's highest legislative authority, the General People's Congress (GPC). However, in practice, Qadhafi—also known as 'the Leader'—has been able to **keep a tight grip on power through the influence of his revolutionary committees**, a kind of political police force that pervades society, and family and tribal supporters. While he has kept a small number of close aides within his inner circle for a long time, he is keenly aware of potential threats to his rule and uses frequent **cabinet reshuffles to prevent rivals building a powerbase**. Oil and gas wealth has generated relatively high living standards, education levels and health care provision and this has minimised the spread of internal dissent. Outright opposition to the regime is discouraged—partly through use of the security apparatus—and has proved ineffective and divided.

**A formal (constitutional) process for succession does not exist** and there are some lingering concerns as to the future development of policies in the post-Qadhafi period. Despite one of Qadhafi's sons, **Sayf al-Islam Qadhafi**, declaring in August 2008 his intention to pursue business and not political interests, it still **appears that he is being groomed for leadership**. Sayf continues to adopt a high media profile and has made pronouncements on constitutional change to enshrine individual and corporate liberties and on independence for the central bank. If he succeeds to the leadership, Sayf appears likely to continue the current trend towards political and economic openness, with the promotion of the private business sector.

Although relatively wealthy, Libya needs to project a more business-friendly image to the wider international investor community. This will allow the import of technology and human capital that will improve oil and gas exploration and production, as well as assist in the country's USD80bn development plan to improve infrastructure, including upgrades of water, sanitation and transport systems. Private sector involvement will be required to ensure an efficient allocation of resources in meeting the development plan and there **are periodic statements signifying that the private sector will be given more business freedoms**. Qadhafi has devolved a significant amount of decision-making authority to the 26 municipal councils that make up the GPC and reformers have been given a greater voice within the inner power base.

Little progress has been made in extending regional co-operation through the Arab Maghreb Union, largely because two of the member states, Morocco and Algeria, have yet to resolve long-standing differences over the status of the Western Sahara. Moreover, with other potent forces vying for leadership in the pan-Arab world, Libya periodically turns to Sub-Saharan Africa to further its foreign policy goals. This it does through provision of financial and military support, exporting subsidised fuel supplies, by high-profile involvement in peace negotiations (including Sudan) and, sometimes, through direct action as in incursions into Chad.

## Economic Stability

Libya is an upper-middle income economy, according to the World Bank's country classification, with **per capita income over USD10,500 in 2008, one of the highest in Africa**. However, the state remains all-pervasive, despite official claims that privatisation is an entrenched policy consideration, and the private sector tends to be both restricted and crowded out of most markets. The economy is heavily dependent on the hydrocarbons sector and the country **possesses 3.3% of the world's known reserves of crude oil (eighth largest), which will last for almost 62 further years at current rates of extraction**. In addition, the country's extensive natural gas reserves are projected to last for around 98 years. The **hydrocarbons sector accounts for an estimated 32% of GDP, over 75% of government revenues and 98% of export earnings**. This exposes the country to international oil price and output cycles (as a member of OPEC, Libya agrees to production quotas in

order to help achieve overall price goals) and associated growth volatility. Sustained high oil prices in 2004-08 improved macro-economic data and these provides a financial comfort zone during the current period of recession-induced lower oil prices. However, with oil and gas playing such a pivotal role in the economy, **real GDP growth will be around 2% in 2009, following an average of over 6% in 2005-08**. Growth at this lower rate will be supported by continuing high domestic consumption and by inward FDI, particularly into the hydrocarbons sector, but also into infrastructural development.

Dependence on the fuel sector leaves **public finances vulnerable to changing trends in world oil markets** and fiscal balances can fluctuate between +5% and +50% of GDP. Indeed, we forecast a surplus of 6% of GDP in 2009 after over 40% in each of the four previous years. Such variation makes planning difficult, given that expenditure plans are formulated with a medium-term outlook. **Foreign assets at end-December 2008 are estimated at around USD150bn**, of which the Libyan Investment Authority (LIA, sovereign wealth fund) accounted for approximately USD60-70bn and the remaining amount is held in FX reserves and is controlled by the central bank, providing an import cover of over 30 months. In need, the LIA and FX reserves can be drawn down when oil revenues dip and the fiscal balance is not sufficient, in itself, to finance large scale capital spending projects. Accordingly, **over the period to end-2010, external liquidity is unlikely to be compromised** even if, as expected, oil prices remain below the (high) average of 2008.

Libya does not pursue an active monetary policy, despite recommendations to do so from the IMF. Interest rate changes are very rare. The exchange rate is pegged to the IMF's Special Drawing Rights (SDR) and was unified on 1 January 2002 following a sharp devaluation that brought the official rate in line with the parallel market at SDR0.608. The currency then appreciated gradually in dollar terms and, following IMF recommendations, the authorities devalued the exchange rate again, by 15% to SDR0.517 in June 2003 in order to boost external competitiveness in the non-oil sector, in particular. **We do not expect another change in the exchange rate peg in the short term.**

Oil revenues dominate Libya's external accounts, contributing around 98% of the receipts from exports of goods. **A surplus on the current account is regularly recorded**. An annual surplus equivalent to around 40% of GDP was recorded in 2005-08 but weaker international oil prices since Q4 2008 will reduce the surplus this year—our forecast is for a current account surplus equivalent to 5% of GDP in 2009. The large surpluses in years of high oil prices have helped generate large foreign exchange reserves, which at almost USD90bn at end-2008 provided **import cover of over 30 months**. An external crisis is therefore highly unlikely. Standard foreign debt indicators are also very favourable, with total external debt only 9% of GDP and 8% of exports and an estimated debt service ratio—official figures are not available—of under 2% in 2008. Libya is a net external creditor and, in March 2009, it received **investment grade status in its first sovereign rating by an international agency**.

## Structural Business Environment

The structural business environment remains well below average for the economies we assess, despite indications of reforms and the need for inward investment. Indeed, the Heritage Foundation's 2009 Index of Economic Freedom (IEF) categorises the economy as "repressed" and assigns it a ranking of 171 out of 179 countries, above Democratic Republic of Congo, Venezuela and Cuba but below Belarus, Iran and Turkmenistan. Non-tariff barriers impede trade and foreign investment. A lack of judicial independence means that property rights cannot be protected formally. The IEF also notes that the government remains the largest source of employment and the **state dominates the all-important energy sector**. Transparency International's 2008 Corruption Perceptions Index ranks Libya as 126= (with Ethiopia, Indonesia and Mozambique) out of 180 countries, below Nigeria, Togo and Vietnam but above Uganda, Nicaragua and Pakistan. However, human development, reflecting oil revenue expenditure in sectors such as education and health, is one area in which Libya compares favourably with other North African states, with a ranking of 52 out of 179 in the UN's Human Development Index 2008, above Oman, Seychelles and Saudi Arabia. Adult literacy is 86% and life expectancy at birth is 74 years.

The banking sector remains highly centralised and under state control, although banking laws have been liberalised—foreign banks can now open branches—and there are periodic statements that it is official policy to pursue privatisation in this sector. As recently as March 2009, the central bank announced imminent sales via the local stock exchange of a stake in one leading bank. Some improvements in regulation and supervision have been observed but the sector is still reported to have heavy debt burdens.

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## Charts

