Country report **LIBYA**

Summary

Libya has been successful in rebuilding the oil fields that were damaged during the revolution and subsequent civil war. As a result, economic recovery will be more rapid than previously anticipated. However, building political institutions and unifying the nation is proving more difficult. Although the recent parliamentary elections were a first step in the right direction, many issues remain unresolved. The new government (which is yet to be formed) is saddled with the almost impossible task of centralizing power, without alienating regional councils that have been lobbying for greater autonomy. In addition, the various militias that helped oust Gadaffi will have to be absorbed in the national army. A failure to do so will increase political instability, as the abundance of arms and manpower means that tribal rivalries can quickly ignite violent conflict.

Things to watch:

- Position of the militias
- Rebuilding of the oil fields
- Ability of the new government to centralize power

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Libya

National facts		
Type of government	n.a.	
Capital	Tripoli	
Surface area (thousand sq km)	1,760	
Population (millions)	6.5	
Main languages	Arabic and Berber (97%)	
	Italian and English	
Main religions	Sunni Muslim (97%)	
	Other (3%)	
Head of State (president)	Mohammed al-Magariaf	
Head of Government (prime-minister)	Abdel-Raheem al-Keib	
Monetary unit	LYD (Libyan dinar)	
Economy		**2011**
Economic size	*bn USD*	*% world total*
Nominal GDP	59	0.09
Nominal GDP at PPP	91	0.11
Export value of goods and services	17	0.08
IMF quotum (in mln SDR)	1124	0.52
Economic structure	*2011*	*5-year av.*
Real GDP growth	-27.9	3.2
Industry (% of GDP)	62	76
Services (% of GDP)	35	22
Agriculture (% of GDP)	3	2
Standards of living	*USD*	*% world av.*
Nominal GDP per head	9971	92
Nominal GDP per head at PPP	15273	123
Real GDP per head	7210	89

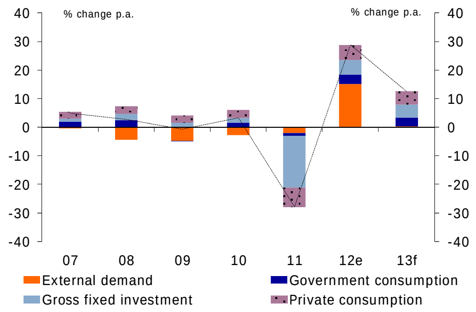
Social and governance indicators			rank / total
Human Development Index (rank)			53 / 169
Ease of doing business (rank)			n.a. / 183
Economic freedom index (rank)			173 / 179
Corruption perceptions index (rank)			146 / 178
Press freedom index (rank)			160 / 178
Gini index (income distribution)			n.a.
Population below $1.25 a day (PPP)			n.a.
Foreign trade			**2011**
Main export partners (%)		*Main import partners (%)*	
Italy	27	Germany	9
France	14	Turkey	9
Spain	10	Italy	6
France	9	China	4
Main export products (%)			
Hydrocarbon products (% share)			97
Main import products (%)			*2006*
Machinery & transport equipment (% share)			49
Foodstuffs & livestock (% share)			13
Miscellaneous products (% share)			7
Chemical materials (% share)			7
Openness of the economy			*2009*
Export value of G&S (% of GDP)			28
Import value of G&S (% of GDP)			18
Inward FDI (% of GDP)			0.2

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economic structure and growth

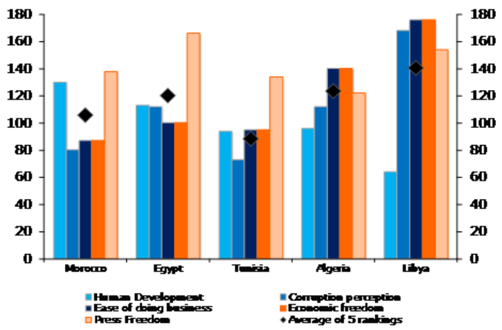
Libya's economy is quickly recovering from the revolution and civil war that ended in October 2011. Despite ongoing political struggles, especially the rebuilding of Libya's oil sector looks promising. Recently published data shows a rapid increase in oil output, with production levels exceeding our expectations. In May 2012, oil output reached 90% of pre-war production levels (roughly 1.5mln barrels a day). This result was achieved under less than perfect conditions. Libya relies heavily on foreign labor, but so far only 45% of the pre-war foreign laborers have returned. Still, the National Oil Council (NOC) expects oil production to be up to pre-war levels by September 2012. As the sector is the main source of growth and traditionally makes up around 75% of GDP, a rapid recovery will go a long way towards the country's overall economic recovery.

Figure 1: Growth performance



Source: EIU

Figure 2: Social indicators



Source: EIU

Economic recovery will further be aided by the return of foreign investors. Now that international sanctions have been lifted, especially construction companies are returning to Libya. In light of these developments and assuming that political stability can be achieved in the short term (which remains highly doubtful), we expect GDP growth to exceed 28% in 2012 (from a 27% contraction in 2011). Beyond 2013, the economy has the potential to grow by more than 8% annually, in the next five years. These upbeat expectations are motivated by the fact that Libya has suffered decades of underinvestment, leaving plenty of room for catching up. In addition, a relatively educated work force should help this process along.

Political and social situation

The most pronounced risk to Libya's immediate and medium term outlook is the risk of war, or, at the very least, prolonged political instability. So far, the creation of a united Libya remains an illusion and it should be asked whether this is even a realistic goal. Libya is still very much a collection of relatively independent regions, each with their own leadership. In addition, the National Transition Council (NTC), which came into power during the revolution, has been unable to gain control over the various militias that helped oust Gadaffi. Although some militias have been merged with the national army, many remain unconvinced that a central government would serve their interests. As a result, arms are widely employed to settle conflicts fuelled by local grievances. Especially in the southern and eastern regions, violence flares up on a regular basis. Whether the newly elected National Congress will prove more successful in building a strong state remains to be seen.

The chance of achieving political stability in the short term was further reduced when a council of local leaders in Benghazi declared the eastern-region Cyrenaica (of which Benghazi is the capital) a semi-autonomous state. Although this declaration caries no legal weight, the political implications are noteworthy. For one, the announcement may well have destroyed any chance of Libya becoming a federal state. A federal system, in which each region maintains some level of independence, could have provided an optimal solution to Libya's fragmentation. However, with the Benghazi council threatening the NTC's (and future government's) position, the latter may see itself forced to opt against the creation of a federal state. The widespread protests against federalism, which broke out after the declaration of semi-independence, provides another argument for the NTC to reject the idea of federalism. In light of these unresolved questions and ongoing tensions, political stability is unlikely to be achieved in the short run.

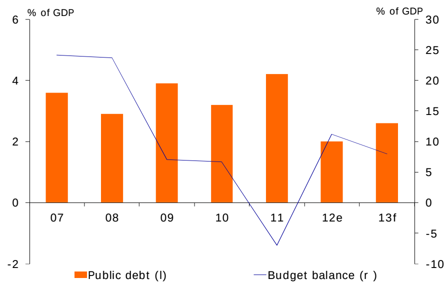
Given this level of fractionalization it is promising that the parliamentary elections in July (2012) were won by the secular National Alliance (NA), led by Jibril. Unlike other parties, NA's campaign was not based on a shared identity (such as religion), but instead focused on broader economic and political issues. This places the party in a better position to unify the nation. Still, as 120 of 200 seats will be allocated to independent candidates, whose alliance is hard to predict, it is not at all certain that the National Alliance will be able to build a coalition.

In light of these many uncertainties, the future remains hard to predict. The next step will be for NA to build a coalition and elect a president. In addition, a new round of elections are needed to establish a council tasked with drafting the country's new constitution. However, the most challenging task will not be the creation of laws, but the formation of democratic institutions. In this respect, centralizing power and convincing Libya's many tribes that a central government acts in their best interest is vital. In contrast, a failure to create a national identity could imply prolonged conflict, or even war.

Economic policy

Given that a new government is still to be formed, it is hard to predict the direction of economic policy. Although the focus on economic liberalization and social investment of NA is promising, their ability to implement these campaign promises remains uncertain. Fortunately, Libya's public finances are in excellent shape, with an expected public debt of only 2% of GDP in 2012. And, as oil exports are picking up, we expect the government to report a budget surplus of 11% of GDP in 2012, from a deficit of 7% of GDP in 2011. Finally, the recovery of economic activity should also help reduce inflation, which came in as a high as 15% in 2011, on account of the severe, war-induced, commodity shortages. With most of these issues resolved we expect inflation to come down to an average of 3% in 2012.

Figure 3: Public finances



Source: EIU

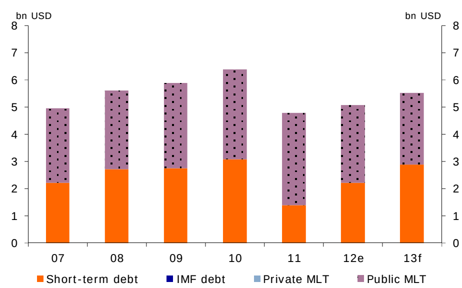
Figure 4: Current account balance

Source: EcoWin

Balance of Payments

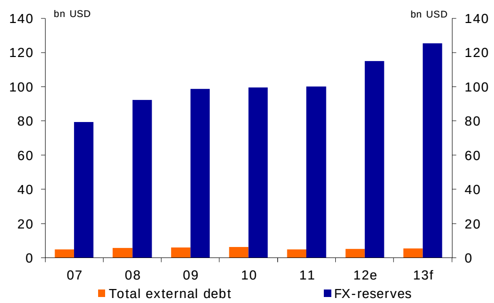
Recovering oil exports, combined with rising oil prices will push exports above their 2010-level. As a result, the trade surplus is expected to come in at 39% of GDP in 2012, from 10% of GDP in 2011 and 30% of GDP in 2010. A large surplus is further driven by subdued domestic demand. At the same time, the return of foreign companies will translate into a somewhat wider deficit on the services balance. The deficit on the income balance is also expected to widen as a result of increased repatriation of profits. Finally, as foreign workers return to Libya, the deficit on the transfer balance should widen as well, due to an increase in worker remittances. All in all, we expect the current account to report a surplus of 36% of GDP in 2012, from 8.5% of GDP in 2011. For 2013, a similar surplus is expected, although much still depends on the government's ability to secure political and social stability.

Figure 7: Foreign debt



Source: EIU

Figure 8: FX Reserves



Source: EIU

The return of foreign construction companies will drive up foreign direct investment. For 2012, we expect FDI to increase to 1% of GDP, from 0.2% of GDP in 2011. If the government succeeds in stabilizing the country, inward FDI could further increase to just below 3% of GDP in 2013. Meanwhile, Libya's large stock of FX reserves covers 67 months of imports.

External position

Given the large current account surplus and low public debt, it is no surprise that Libya maintains very low levels of external debt. In fact, external debt stood at 8% of GDP in 2011 and is expected to fall to 5% of GDP in 2012, mainly due to the anticipated rise in GDP.

Libya

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	5.0	2.7	-0.7	3.3	-27.9	28.8	12.6
Consumer prices (average % change pa)	6.3	10.4	2.4	2.5	15.9	2.8	-3.6
Current account balance (% of GDP)	38.8	37.5	13.6	20.5	8.5	36.4	31.3
Total foreign exchange reserves (mln USD)	79405	92313	98725	99645	100059	115070	125420
Economic growth							
GDP (% real change pa)	5.0	2.7	-0.7	3.3	-27.9	28.8	12.6
Gross fixed investment (% real change pa)	7.5	13.1	9.0	8.6	-86.5	130.0	65.0
Private consumption (real % change pa)	3.8	4.2	4.1	4.4	-10.3	6.5	7.0
Government consumption (% real change pa)	10.5	13.0	-0.4	7.0	-4.0	11.0	12.0
Exports of G&S (% real change pa)	6.3	-7.0	-12.0	0.9	-76.0	288.2	15.4
Imports of G&S (% real change pa)	9.0	8.2	4.5	9.3	-50.0	36.7	14.3
Economic policy							
Budget balance (% of GDP)	24.1	23.7	7.1	6.7	-7.0	11.2	8.0
Public debt (% of GDP)	4	3	4	3	4	2	3
Money market interest rate (%)	4.0	4.0	5.0	5.0	5.0	5.5	5.5
M2 growth (% change pa)	38	49	17	-1	16	-5	22
Consumer prices (average % change pa)	6.3	10.4	2.4	2.5	15.9	2.8	-3.6
Exchange rate LCU to USD (average)	1.3	1.2	1.3	1.3	1.2	1.2	1.3
Recorded unemployment (%)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Balance of payments (mln USD)							
Current account balance	28511	35702	9381	16801	5054	35500	31610
Trade balance	29269	40292	15053	24376	6139	38230	36370
Export value of goods	46970	61950	37055	48935	16454	54730	57830
Import value of goods	17701	21658	22002	24559	10315	16500	21460
Services balance	-2556	-4136	-4678	-5717	-531	-1230	-2440
Income balance	2017	586	578	-30	-6	-670	-1040
Transfer balance	-219	-1040	-1572	-1828	-548	-820	-1280
Net direct investment flows	756	-1777	206	-938	-47	620	1860
Net portfolio investment flows	-1440	-10964	-3352	-4396	-440	-840	-1850
Change in international reserves	20116	12909	6412	920	414	15010	10360
External position (mln USD)							
Total foreign debt	4957	5607	5884	6375	4774	5080	5530
Short-term debt	2213	2707	2750	3070	1389	2220	2890
Total debt service due, incl. short-term debt	2822	3460	4034	4358	4760	2720	3300
Total foreign exchange reserves	79405	92313	98725	99645	100059	115070	125420
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	39.9	42.3	21.9	29.8	10.3	39.2	36.0
Current account balance (% of GDP)	38.8	37.5	13.6	20.5	8.5	36.4	31.3
Inward FDI (% of GDP)	6.4	4.3	2.0	2.2	0.2	0.9	2.6
Foreign debt (% of GDP)	7	6	9	8	8	5	5
Foreign debt (% of XGSIT)	9	8	15	12	28	9	9
Debt service ratio (% of XGSIT)	5	5	10	8	28	5	6
Interest service ratio incl. arrears (% of XGSIT)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
FX-reserves import cover (months)	34.9	36.6	40.9	38.6	109.4	67.3	57.3
FX-reserves debt service cover (%)	2813	2668	2448	2287	2102	4232	3802
Liquidity ratio	432	434	395	395	730	705	581

Source: EIU