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Algeria: 2011 Article IV Consultation—Staff Report; Public Information Notice

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2011 Article IV consultation with Algeria, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 25, 2011, with the officials of Algeria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 22, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

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ALGERIA

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

December 22, 2011

KEY ISSUES

Algeria continues to record solid growth, but the fiscal position has weakened and long-term challenges persist. In 2011, a year of global economic uncertainty and regional sociopolitical instability, nonhydrocarbon growth is projected at 5 percent. To cope with social demands, the authorities raised expenditure, especially on basic food support, employment creation, support for SMEs, and higher salaries. High hydrocarbon prices have improved the current account and the already large international reserves position. However, the economy remains very dependent on hydrocarbon wealth, and youth and women unemployment is high, despite a decline in total unemployment.

The substantial expansion in public expenditure, if not moderated, could lead to strong inflationary pressures and an appreciation of the real exchange rate. Large increases in real wages and other transfers have not yet translated into higher inflation, but the authorities should consider tightening monetary policy early to contain inflationary pressures. An appreciation of the real exchange rate would undermine competitiveness and economic diversification.

Expenditure expansion could also jeopardize medium-term sustainability and constrain the fiscal space needed to implement policies to support economic diversification. Despite high foreign exchange reserves (US$178 billion, equivalent to three years of imports), current expenditure growth makes Algeria's budget more vulnerable to the risk of prolonged lower hydrocarbon revenues. It may also constrain other types of growth-enhancing expenditure such as capital outlays.

More ambitious structural reforms are necessary to achieve sustainable, inclusive, and private investment-led growth, and to reduce unemployment. Reforms should aim at enhancing the business climate, improving competitiveness, increasing financial sector intermediation, and making the labor market more flexible. Without ambitious reforms, medium-term growth prospects will become weaker. The good news is that authorities have adopted new measures to support SMEs and employment.

Focus of the consultation. Discussions centered on the policies needed to support medium-term fiscal sustainability and prudent macroeconomic management while promoting diversified economic growth and employment creation.

Exchange rate regime. The exchange rate regime is classified as "other managed arrangement." Algeria has accepted the obligations of Article VIII Sections 2(a), 3, and 4.

Approved By
Adnan Mazarei and David Marston

A staff team comprising Messrs. Toujas-Bernaté (head), Gijón, Crivelli, and Furceri (all MCD) conducted the discussions in Algiers during October 13th–25th, 2011. Mr. Maherzi (OED) also participated in the discussions.

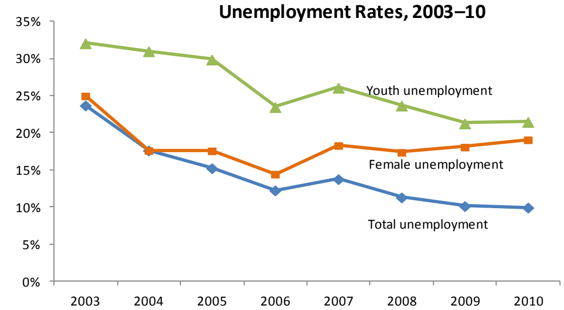
CONTENTS

INTRODUCTION

1. **Algeria has had solid economic growth during the past decade owing to increasing oil revenues and generally prudent macroeconomic policies.** The fiscal and monetary policies adopted since the late 1990s, in the context of increasing hydrocarbon revenues, ensured a decade of robust economic growth while creating a solid financial position with large external reserves, important budgetary savings in an oil stabilization fund (i.e., *Fonds de regulation de recettes*, *FRR*), and a substantial reduction in public and external debt levels.

2. **Nonetheless, Algeria continues to face important challenges, especially the need to diversify the economy, reduce youth and female unemployment, and meet other social demands.** Algeria remains extremely dependent on its hydrocarbon wealth. Despite past efforts, 98 percent of exports and more than two-thirds of budgetary revenues still come from the hydrocarbon sector. Moreover, although total unemployment has declined significantly over the last decade, important social demands remain, as illustrated by the wave of violent unrest in early 2011, including demands for more jobs for the youth. The slow pace and scope of structural reforms so far, and a poor business climate, remain significant barriers to the diversification of the economy and to the private investment–led growth that generates sustainable employment.

Text Figure 1. Algeria: Total, Female, and Youth Unemployment Rates, 2003–10



Source: Algerian authorities.

ECONOMIC CONTEXT

3. **Algeria's growth remains relatively strong, but potential inflationary pressures are emerging.**

Nonhydrocarbon GDP (NHGDP) growth has remained solid, but overall GDP growth could slow in 2011. In 2010, GDP growth was led by an NHGDP growth rate of 6.0 percent, reflecting strong performance in the sectors supported by the Public Investment Program (PIP) (construction and public works, and services). Oil and gas output fell again (by 2.6 percent) bringing overall growth to 3.3 percent. In 2011, a further decline in the oil and gas sector, and restraint in PIP expenditures, could bring overall GDP growth to about 2.5 percent.

Inflation remains moderate but is rising. After declining from 5.7 percent in 2009 to 3.5 percent in mid-2011 thanks to subdued increases in fresh food prices, average inflation has increased through October 2011 to 4.2 percent. In year-on-year terms, inflation rose from 2.7 percent in end-2010 to

5.5 percent in October 2011, partly because of a new surge in fresh food prices.

Banks' deposit growth accelerated in the first half of 2011, further increasing bank liquidity. Civil service pay increases likely contributed to an acceleration in deposit growth (excluding deposits of the public oil company, SONATRACH) to 16 percent (year-on-year) at end-June 2011, while growth in credit to the economy remained steady at 15 percent (year-on-year, excluding buyback of public companies' debt by the treasury). In this context, the Bank of Algeria (BA) continued to absorb excess liquidity generated by government expenditure and the hydrocarbon sector, with liquidity absorption through two deposit windows amounting to 17 percent of GDP at end-August 2011.

4. The fiscal stance has been very expansionary, on the back of higher hydrocarbon revenues. In 2011, Algeria will record a new budget deficit of about 4 percent of GDP, with a significant increase in total revenues (22 percent in nominal terms) more than offset by the growth in total expenditure (32 percent). Current expenditure is projected to grow by 50 percent as a result of (i) civil service pay increases resulting from the ongoing implementation of higher salary structures and back payments for 2008 and 2009, and (ii) the implementation of various measures to support employment, SMEs, and food prices. In turn, capital expenditure is expected to increase by 7 percent reflecting the final phase of the 2005–09 PIP. While nonhydrocarbon revenues are expected to increase by 13 percent, consolidating their upward trend of past years owing to tax administration reform, they will only cover 41 percent of current expenditures (49 percent excluding salary back payments), the lowest level in a decade. In all, following two years of decline, the nonhydrocarbon primary deficit is expected to increase to 49 percent of NHGDP in 2011. Thanks to still large nonbank and non-debt-creating financing from public entities, gross government debt and budgetary savings in the FRR are expected to remain stable at 10 percent and 40 percent of GDP, respectively.

5. With higher oil prices, the external current account surplus continues to improve, despite strong import growth. Oil and gas revenues increased by 30 percent during the first nine months of 2011 owing to higher oil and gas prices. Imports have been rising again after holding steady during the previous two years, with a 19 percent increase during the first eight months of 2011. This rise reflects an increase of 67 percent in food products and a 40 percent increase in consumer goods. Official reserves increased by US$14.6 billion during the first eight months of 2011, to US$178.3 billion at end-August 2011 (the equivalent of nearly three years of imports of goods and services).

6. The real effective exchange rate (REER) depreciated by 1.5 percent during the first eight months of 2011. This reflects a depreciation of 2.2 percent in the nominal effective exchange rate in 2011, while the inflation differential vis-à-vis Algeria's main partners was 0.7 percent. The REER remains broadly in line with its medium-term equilibrium level, which is linked to fundamental factors including oil prices and government expenditure.

THEME 1: COPING WITH SOCIAL DEMANDS WHILE FENDING OFF INFLATIONARY PRESSURES

Near-term outlook

7. The world economic outlook has become more uncertain in 2011 and 2012, and could affect Algeria's hydrocarbon revenues. Economic recovery is now much slower in the advanced economies than was expected at the start of the year. Slower growth in advanced and, in turn, in emerging economies could affect global demand and prices of hydrocarbon products, with spillover effects on Algeria's hydrocarbon revenues. Moreover, many countries of the Middle East and North Africa (MENA) have been immersed in important sociopolitical transitions, which could further affect the whole MENA region.

8. In 2011–12, growth should remain solid and still-high oil prices should support Algeria's external balance and budgetary revenues, but risks of higher inflation have increased. In 2011 and 2012, the growth-supporting effect of the multiyear PIP is expected to maintain nonhydrocarbon growth at about 5 percent, and to bring overall real GDP growth to 2 ½–3 percent. Higher international prices for food staples and civil service pay rises have so far not led to a significant pickup in inflation, because of increased subsidies for basic food products, a higher level of household savings, greater demand for imports, and active absorption of bank liquidity by BA. Assuming these will hold, inflation could stay at about 4–4½ percent in 2011–12, but the risk of rising inflation fueled by more buoyant domestic demand has increased. Oil prices still forecasted at high levels (the Fall 2011 WEO projected oil prices at US$103/barrel in 2011 and US$100/barrel in 2012), would help sustain a current account surplus of 9.5 percent of GDP in 2011 and 5.4 percent in 2012, and hydrocarbon fiscal revenues 25–30 percent above their 2010 level.

Background and staff views

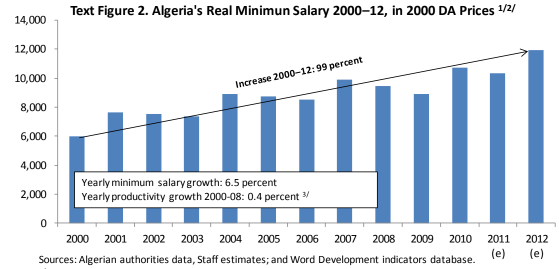
Fiscal and income policies

9. Fiscal policy in 2012 will center on implementing the higher civil service salary scale and social and job-support policies. The authorities will pursue the civil service pay structure revision that began in 2010, which raises civil service salaries, on average, by about 50 percent from 2008, the year when the new salary scale was adopted. The draft 2012 budget also calls for the extension of socioeconomic measures adopted in 2011 to assist low-income groups and support employment, at a cost equivalent to 4 percent of GDP. These measures include price support for certain food staples (cereals, powdered milk, soybean oil, and sugar), expansion of the program to facilitate civil servants' access to housing, and increased support for mechanisms to reduce youth unemployment. The budget will also cover the cost of subsidizing lending rates for investments by SMEs, and the rescheduling of the debt of heavily indebted but viable SMEs. These measures, largely designed to maintain social cohesion, will contribute to keeping current incompressible expenditure at an elevated level of about 45 percent of NHGDP in 2012. Flat oil tax revenues would not make it possible for the still-high levels of expenditure to be covered fully by overall revenues, and the budget would record a deficit for the fourth year in a row in 2012, equivalent to 6 percent of GDP.

10. The rising trend in expenditure should be broken and its composition rebalanced. While the large available fiscal savings can allow the maintenance of relatively high levels of budget expenditures in the short term, the recent sharp increase could push aggregate demand up excessively and have detrimental effects on inflation and competitiveness. The authorities should ensure that public spending is of good quality and effective, and benefits the population in an equitable way. In particular, policies for better targeting of current expenditure, including subsidies and social transfers, should be developed. While current spending is rising, the 2012 budget calls for a significant decrease in capital expenditures, a major change from past years. It will be important, however, to maintain investment expenditure actually executed in 2012 at a level similar to the 2011 outcome in order to support higher potential output in the future, provided that efforts to strengthen the efficiency and control of capital spending continue.

11. The impact of substantial increases in wage earners' income on domestic demand will need to be contained to avoid a pick-up in inflation. Substantial increases in civil servants' salaries are being extended to public companies, and will be accompanied by a further increase in the minimum wage (20 percent in January 2012) and pensions. These increases will likely generate pressure for additional wage hikes in the private sector. These increases in real wages appear to substantially exceed productivity gains. Moreover, back payments of salary increases for 2008–09, which are planned to be spread over only two years, will provide substantial additional income for civil servants (8 percent of NHGDP in 2011 and 7 percent in 2012). If this additional income translates entirely into additional demand for domestic goods and services, inflationary pressures would intensify. In such an event, monetary policy would need to be tightened and imports increased to cover excess demand.

Text Figure 2. Algeria's Real Minimun Salary 2000–12, in 2000 DA Prices [1/2/]



Sources: Algerian authorities data, Staff estimates; and Word Development indicators database.
[1/] The authorities have approved a new minimum salary increase effective 1/1/2012.
[2/] For 2011 and 2012 inflation estimated at 4 percent.
[3/] Latest available data.

Monetary and exchange rate policy

12. The authorities should continue to pursue a monetary policy aimed at controlling excess liquidity and inflationary pressures. The BA continues to absorb, through two short-term repurchase and deposit facilities, the growing liquidity in the banking system generated by oil and gas revenues and government expenditures, to limit their impact on inflation while keeping interest rates unchanged. So far, the salary increase for civil servants does not seem to have led to inflationary pressures for prices of goods and services measured by the CPI, but price data for other sorts of assets, such as real estate, are not available. Banking deposit data suggest that private savings have increased while the growth in private consumption has been covered in part by increased imports. Besides these factors, the emergence of additional inflationary pressures will also depend on how companies in the goods and service sectors will pass through higher labor costs. In this context, the authorities should exercise the greatest vigilance and consider tightening monetary policy early to prevent inflationary pressures from materializing and credit from expanding too quickly. To this end, the BA could increase interest rates to give a strong signal about the cost of credit in the economy and for returns on savings.

13. The authorities can continue to align the REER close to its equilibrium level, but exchange rate fundamentals should be strengthened. The BA continues to conduct an active exchange rate policy of managed float, with the objective of stabilizing the REER close to its equilibrium level (Appendix 1). The equilibrium exchange rate is estimated to have appreciated in the last few years, reflecting the increases in government spending and oil prices, entailing the risk of "Dutch disease" welfare-reducing effects. However, in the staff's baseline medium-term scenario, which assumes fiscal consolidation and structural reforms, this increase will be reversed by 2016.

Authorities' views

14. Fiscal prudence remains a priority, but maintaining social cohesion is a key objective in the short term. The authorities are aware of the need to curb expenditure growth–especially current expenditure– to reinforce medium-term fiscal sustainability. They agreed that a large share of the increase in expenditure is due to salary increases for public servants in 2011 and 2012, which was decided in 2008. However, they consider that these increases and their extension to other sectors, as well as the socioeconomic support measures aimed at job creation, social housing, and private investment, were necessary to improve the standard of living of large parts of the population, in the context of pressing social demands. Drawing on Algeria's past experience, as well as recent regional developments, maintaining social stability is of paramount importance to the preservation of medium-term macroeconomic stability.

15. The authorities are committed to ensuring good quality and efficiency of public expenditures. They will continue to protect the implementation of the PIP, which is viewed as essential to improving Algeria's competitiveness and growth potential. In this respect, they aim at better project selection to improve expenditure quality and effectiveness. The authorities also believe that the new socioeconomic support measures—especially employment and SME support—will help to support Algeria's economic activity, and broaden the nonhydrocarbon tax base.

16. The authorities remain vigilant about inflationary pressures and consider their policy of absorbing liquidity to be fully effective. The monetary authorities' key objective is to contain inflationary pressures. They believe that the objective has been achieved during the last two years with inflation falling to around 4 percent, a level that the authorities are comfortable with. Moreover, they consider that the large increase in wage earners' incomes and public spending did not generate inflationary pressures because most of the additional income has been devoted to purchasing imported goods or saved for acquiring real estate. Nonetheless, they remain firmly committed to changing gears should inflationary pressures arise. The authorities also reiterated their commitment to keeping the real exchange rate close to its equilibrium level and consistent with external stability.

THEME 2: ENSURING MEDIUM-TERM FISCAL SUSTAINABILITY

Background and Staff views

17. Higher oil prices have improved the medium-term financial outlook but it has also been seriously weakened by the steep rise in current public expenditure. The baseline scenario below shows that, if government expenditure increases on the basis of the envisaged measures (including civil service pay rises and other support measures adopted in 2011 and the 2012 budget), in 2016, the oil savings fund (FRR), as a percentage of GDP, will be reduced to almost half of its 2010 level, that is, to 16 percent of GDP. The oil price that would balance the 2011 budget (excluding salary backpayments) would rise to US$100/barrel from US$44/barrel in 2006, and would increase further to about US$110 by 2016, leaving the fiscal position highly vulnerable to a major slump in oil prices. The current account surplus would fall to roughly 5 percent of GDP, while reserves would be equal to four years' worth of goods and services imports.

18. Public finances are vulnerable to a worsening of international conditions, which could lead to a prolonged period of lower oil prices. An alternative scenario, which assumes lower international oil prices (US$55/barrel in 2012 and US$70/barrel thereafter), shows a major deterioration in Algeria's macroeconomic balances over the medium term. By 2016, the FRR would be down to its legal minimum level of 740 billion dinars (about US$10 billion), and fiscal deficits would be financed by increasing government borrowing, which could exceed 26 percent of GDP. The current account balance would be in deficit, reducing reserves to the equivalent of 2½ years of goods and services imports in 2016. In this alternative scenario, it is likely that public investment expenditure would be cut, leading to slower growth and higher unemployment.

Medium-Term Baseline and Alternative Scenarios 2012–16

Base scenario	2012	2013	2014	2015	2016
International oil price (US$/bbl)	100.0	99.5	97.5	96.5	95.5
International gas price (US$/BTU)	8.2	8.1	8.0	7.9	7.8
Overal budget balance (percent of GDP)	-6.0	-3.3	-3.3	-3.3	-3.0
FRR (percent of GDP)	28.6	25.0	21.7	18.6	15.6
Reserves (US$ billion)	193.4	204.9	216.6	229.1	242.7
Primary budget deficit (percent of NHGDP)	-46.4	-39.3	-36.4	-34.0	-32.3
Current account balance (percent of GDP)	5.4	4.6	4.5	4.8	5.0
Government net assets (percent of GDP)(*)	19.2	16.1	13.3	10.6	8.1

(*) FRR minus government debt

Alternative scenario 1/	2012	2013	2014	2015	2016
International oil price (US$/bbl)	55.0	70.0	70.0	70.0	70.0
International gas price (US$/BTU)	4.5	5.7	5.7	5.7	5.7
FRR (percent of GDP) 2/	17.9	8.3	4.5	4.3	4.0
Reserves (US$ billion)	165.7	159.1	153.6	148.9	145.0
Primary budget deficit (percent of NHGDP)	-46.4	-39.3	-36.4	-34.0	-32.3
Current account balance (percent of GDP)	-8.9	-4.3	-3.6	-3.1	-2.7
Government net assets (percent of GDP) 3/	8.5	-0.7	-8.6	-15.6	-21.5

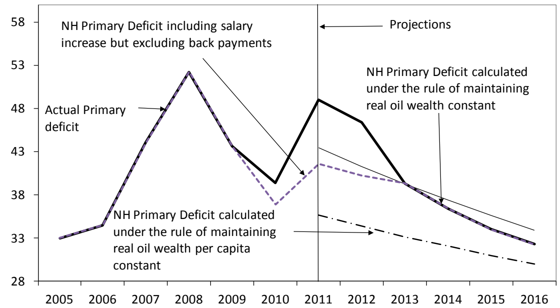
1/ The alternative scenario is based on IMF staff crisis scenario estimates starting in the first quarter of 2012.

2/ The FRR balance is maintained above 740 billion DA as required by Algerian law.

3/ FRR minus government debt.

19. **A medium-term fiscal framework based on the principle of permanent income also underscores the financial vulnerabilities resulting from the sharp expansion in current expenditure.** An analysis based on a permanent income framework (with nonrenewable hydrocarbon resources) suggests that fiscal consolidation will be needed to bring the fiscal position back to a sustainable level in the medium term. This medium-term fiscal framework, based on the principle of maintaining a constant level of income after hydrocarbon reserves are depleted, provides useful benchmarks for ensuring medium-term fiscal sustainability and for efforts to strengthen control and effectiveness of expenditure. In this framework, the goal of maintaining hydrocarbon wealth per capita constant over the long term is more cautious and preferable. In this context, the recent substantial increase in operating expenses, if not progressively reversed, could force the authorities to proceed more cautiously in executing the new PIP for 2010–14.

Text Figure 3. Sustainable Nonhydrocarbon (NH) Primary Deficits and Actual Projections, in Percent of NHGDP



Source: staff estimates.

20. The authorities should formulate and adopt fiscal consolidation measures over the medium term.

Rationalizing current expenditure. While investment spending was the main driver of expenditure expansion in 2006–08, current spending has put more pressure on total spending since last year. As a proportion of total expenditure, current expenditure will reach 64 percent in 2011 (excluding salary back-payments) from 54 percent in 2008–09. Certain expenditures will increase even more quickly in the medium term, as socioeconomic support measures are carried out and new infrastructure is built. This increase will further constrain implementation of fiscal policy because current expenditures are more difficult to compress. Hence, it is imperative to assess the effectiveness of additional expenditures to decide whether or not they should be continued. Moreover, following the substantial pay rises, it will be important to keep tight control on wage bill growth in the years to come by restricting new hiring and future salary increases. The targeting of transfers and subsidies needs to improve, so that these can better serve vulnerable population groups. To that end, the authorities should accelerate the work under way, with the support of the World Bank, on social transfer targeting.

Better controlling high-priority capital expenditure. Capital expenditure will represent 36 percent of total expenditures in 2011, down from 47 percent in 2009–10. This relative decline will likely continue in 2012. Maintaining existing levels of expenditure will require a higher pace of execution than in the past. In view of future pressures to contain capital expenditure, the authorities must ensure sound selection of projects to improve the overall effectiveness of expenditure. In this context, the authorities' efforts, since the creation of the national commission to monitor the implementation of the PIP (*CNED* in French), in better overseeing the implementation of major infrastructure projects, have enabled budget savings and more effective project execution, and should be pursued.

Increasing nonhydrocarbon resources. Major tax administration reforms implemented by the Directorate General of Taxation (DGI) have resulted in an increase of nonhydrocarbon revenues by 15 percent a year over the past five years. Nevertheless, the ratio of current expenditures covered by nonhydrocarbon revenues is expected to further decline in 2012, and to reach its lowest level since 2000. Further efforts to achieve key objectives of the tax administration reform will be required, in particular, implementing the DGI's information system (a project which has been delayed) and strengthening the direction and oversight of tax administration (a project launched in 2010 in cooperation with the French tax administration).

21. Accelerating the process of modernizing budget systems and assuring greater transparency in public financial management are essential to controlling the rapid increase of expenditures. The authorities intend to develop a system of fiscal management based on outcome objectives, so that the performance of various programs can be assessed and, hence, the control and effectiveness of government expenditure can be measured. To that end, better fiscal planning needs to be developed. The authorities have made efforts in a number of areas to develop new tools such as the macroeconomic forecasting models within the Ministry of Finance. However, the implementation of the medium-term fiscal framework being developed by the Budget Department, with World Bank support, is experiencing delays. The authorities thus need to take all necessary actions to speed up the full implementation of fiscal reforms. Drafting and adopting budget review laws since last year represent important steps toward greater transparency in government finance. Additional efforts will be needed to improve the public availability of government finance statistics, including statistics on budget execution.

Authorities' views

22. **The authorities are committed to medium-term fiscal sustainability.** They have recognized that the current expenditure path is not sustainable, and are concerned about the greater reliance on hydrocarbon fiscal revenues to finance the budget. In order to ensure medium-term sustainability, the authorities intend to develop budget consolidation measures such as targeting of social transfers, a project currently under way with World Bank support, and will continue their efforts to increase nonhydrocarbon revenues. Moreover, they started to implement more market-based mechanisms for financing autonomous public entities, including hospitals.

23. **The authorities consider that sustained budget reform efforts will also strengthen medium-term fiscal sustainability.** The authorities are committed to improving the quality and the efficiency of expenditure through the reform of budgetary process and better coordination for developing better budgetary planning tools. In particular, the increased role of the CNED with the new 2010–14 PIP, for which no new large project receives a budget allocation without CNED's approval based on transparent evaluation, will contribute to enhancing the effectiveness of public investment. Efforts to further enhance budget transparency will also be pursued, building on the finance organic law and the renewed practice of adopting budget execution review laws.

THEME 3: PREPARING FOR A NEW GROWTH MODEL TO ADDRESS YOUTH UNEMPLOYMENT

24. **Algeria's main challenge remains to ensure sustainable, diversified, and private investment-led growth to reduce unemployment, especially for the youth, and provide opportunities for all.** Addressing this challenge will require improving financial sector intermediation, and implementing more ambitious structural reforms to improve the business environment, the labor market, and Algeria's integration into the global economy.

Medium-term outlook

25. The medium-term growth outlook remains stable, provided that a more ambitious program of structural reforms is implemented. The prospects for NHGDP growth remain favorable, provided that deeper structural reforms lead to increased and more productive private investment. This will be needed to compensate for the expected decline in the growth-supporting effect of the public investment program, which has reached a plateau in terms of execution of large projects. Under this assumption, nonhydrocarbon growth could average about 5 percent a year during the period 2012 to 2016. Without reform and strong development of the private sector, nonhydrocarbon growth could be 2 percentage points lower. After declining in the last few years, growth in the oil and gas sector is expected to be moderate and restrained by global demand and market conditions for natural gas. As a result, total GDP growth could hover around 3½ percent during the same period.

26. Under this scenario, unemployment would decline only slightly, at best. Unemployment has decreased significantly during the past 10 years, but remains high for the youth, in particular young graduates (21.5 percent), and women (19 percent). This overall decrease was the combined result of moderating growth of the working-age population, broadly stable participation rates (around 42 percent for total population, but only 14 percent for women), and sustained NHGDP growth. However, the job content of growth has been declining recently—the flip side of slightly improving labor productivity growth—and fewer than 38 percent of the working-age population (11 percent of women) have a declared job. Based on the medium-term baseline scenario, and depending on the assumption for employment-growth elasticity (either stable or continuing its recent declining trend), total unemployment in 2016 would be between 8 percent and 11 percent, and youth unemployment between 19 percent and 21 percent.

Background and Staff views

Structural reforms

27. Developing the private sector is of paramount importance to supporting diversified growth and reducing unemployment. The private sector remains relatively narrow and fragmented, and has limited capacity for innovation. In recent years, the authorities have undertaken initiatives to support the development of SMEs, but with limited effect. Additional measures have been adopted following the tripartite consultations in 2011, including investment loan subsidies and debt rescheduling for SMEs. Although these measures seem to be moving in the right direction, it is still too early to assess their impact. Sustained efforts need to be devoted to improving the perception of the business climate, which is still viewed negatively (Appendix 3). More ambitious reforms are needed to boost private-sector growth. In this respect, foreign direct investment (FDI) should play a larger role in the nonhydrocarbon sectors. The level of nonhydrocarbon FDI remains low and the measures introduced in 2009 appear to be having an adverse impact on foreign investors' perceptions, particularly for SMEs. The authorities should assess the impact of these measures and consider introducing more flexibility in order to create a more attractive environment for foreign direct investors, who are critical for transferring technology and knowhow.

28. Besides aiming at higher growth, labor market reforms could help to reduce unemployment. On average, unemployed people have a higher level of education than the economically active population as a whole, which indicates that graduates of secondary schools and institutions of advanced education have particular difficulties in finding jobs. In recent years, the authorities have launched a number of initiatives to reduce youth unemployment, in particular by supporting the creation of microenterprises and subsidizing young people's salaries. These measures need to be supplemented by reforms to make the labor market more flexible and to reduce recruitment costs. The tax measures that the authorities have adopted to reduce employers' contributions for social benefits go in the right direction; however, more reforms are needed to ensure that young people have jobs that will last, including a reform to align minimum-wage increases with productivity gains, lowering payroll taxes and other mandated costs, and incentives for part-time work and flexible working arrangements.

29. The authorities should strengthen their efforts to integrate Algeria into the regional and global economies. Algeria has been a member of the Arab Free Trade Area (ZALE) since 2009, and is undertaking initiatives to develop trade and cooperation with other African countries, including the initiation of discussions with the West Africa Economic and Monetary Union (WAEMU) to conclude trade and investment agreements. These initiatives should be complemented with moving forward into new phases of integration within the framework of the Association Agreement with the European Union and continued efforts to join the World Trade Organization.

30. The authorities should continue their efforts to improve governance. These will include further improvements on fighting corruption and combating money laundering and the financing of terrorism (AML/CFT), taking into account the recommendations of the Financial Action Task Force.

Financial sector

31. Financial intermediation and the depth of financial markets remain fairly limited. Despite being highly liquid, banks are very prudent in extending credit due to difficulty of assessing credit risks. The lack of a reliable credit reporting system in Algeria, compared with other Middle East and North Africa (MENA) countries, is considered to be one of the main factors hindering access to finance. Also, the financial performance of state-owned banks (representing about 90 percent of banking system assets) has been weaker than that of private banks.[1] As a result, financial intermediation in Algeria is weak, with a credit ratio of 39 percent of NHGDP. The level of nonperforming loans (NPLs) continues to decline, reflecting better management of new risks and the increase in outstanding credit, but it remains high for public banks at around 19 percent in June 2011, compared with 24 percent at end-2009. Overall, the banks have an appropriate level of capital and do not represent a risk for macroeconomic stability. The stock exchange remains underdeveloped, with only seven companies listed as of September 2011. Given that the

[1] World Bank, 2011, *Financial Access and Stability—A Road Map for the Middle East and North Africa—MENA Development Report* (Washington: The World Bank).

banks' resources are based entirely on domestic deposits, including those of foreign banks, the risks of the euro zone's financial sector crisis should not be a source of vulnerability for Algeria's financial sector.

Financial Soundness Indicators, 2006–11

(In percent)

	2006	2007	2008	2009	2010	June-11
Capital adequacy ratio	15.2	12.9	16.5	22.1	23.3	20.9
Public banks 1/	14.4	12.1	16.0	19.6	21.8	19.4
Foreign banks 2/	21.6	18.1	20.2	34.9	29.2	27.0
Classified loans/total loans	34.8	35.5	25.4	21.8	19.1	16.6
Public banks	37.5	38.7	28.5	24.3	21.4	19.0
Of which, to private sector	22.0	24.3	20.0	16.9	13.9	13.7
Foreign banks	8.8	11.5	3.9	4.0	4.1	3.6
NPLs/total loans 3/	17.5	22.1	15.7	14.8	13.3	11.2
Public banks	19.2	23.8	17.6	16.5	15.0	12.8
Of which, to private sector	11.7	18.7	15.9	13.0	10.7	10.5
Foreign banks	2.9	9.2	2.2	2.4	2.6	2.3
Other class./total loans 4/	17.3	13.4	9.8	7.1	5.8	5.4
Public banks	18.4	14.9	10.9	7.8	6.4	6.2
Of which, to private sector	10.3	5.7	4.1	3.9	3.2	3.2
Foreign banks	5.9	2.3	1.7	1.6	1.5	1.3
Provisions/classified loans	54.0	56.1	57.7	68.3	74.1	71.8
Public banks	54.2	55.0	57.4	68.0	74.3	71.6
Foreign banks	48.7	85.2	68.7	78.9	69.3	75.7
Return on equity	18.8	24.6	25.2	25.7	20.7	…
Public banks	17.4	23.6	25.0	25.5	22.7	…
Foreign banks	23.4	28.0	25.6	26.3	16.8	…

Source: Algerian authorities.

1/ 90 percent of system assets.

2/ Nonpublic banks are all foreign.

3/ Loans in arrears (100 percent provisioning requirement).

4/ Loans performing but at risk (30 percent or 50 percent provisioning).

32. The authorities should accelerate financial sector modernization and reform efforts, including following up on the recommendations of the 2007 FSAP update. Public banks should continue modernizing their risk information and assessment operating systems, particularly to ensure that new incentives to grant loans to SMEs will not create additional default risks. Substantial efforts have been made to reduce NPLs, but more is needed to identify solutions to deal with the legacy of old loans in default. All possible ways should continue to be explored to bring public banks (90 percent of banking sector assets) to the highest international standards, and to improve their control, management, and governance. As the ban on consumer lending (excluding mortgages) in effect since 2009 has affected the deepening of banking activity, the authorities should accelerate efforts to establish a centralized household credit registry, which should enable this ban to be lifted. As the requirement of using bank cards or checks for all payments of 500,000 dinars or more has been deferred indefinitely, the authorities should pursue their efforts to modernize the country's payment system to reduce the high level of currency in circulation (26 percent of NHGDP).

33. The authorities continue to strengthen banking supervision. The gradual introduction of a new bank rating system, with a pilot to begin by the end of 2011, and the adoption of a new banking accounting plan in 2010, will help to improve credit risk management and banking supervision. Improved banking supervision regulations were prepared with IMF technical assistance. With these new tools, the authorities should aim at ensuring that measures to encourage loans to SMEs and mortgage credit, and the debt rescheduling plans for viable SMEs, will not lead to a deterioration of bank portfolios. The authorities have also prepared preliminary financial stability reports, which it will be useful to publish.

Authorities' views

34. The authorities' main medium-term objective remains to reduce Algeria's dependence on the hydrocarbon sector and develop the private sector to create more jobs and offer better opportunities for all. The authorities believe that many of the socioeconomic support measures adopted in 2011 should help to boost economic diversification. Moreover, the new infrastructure being built with the PIP should enhance Algeria's competitiveness in the medium term. Efforts to enable private sector development will also include support by the National Investment Fund for public-private partnerships in strategic sectors important for innovation. These policies are complemented with others aimed at facilitating access to the labor market for new entrants and creation of microenterprises.

35. The authorities are concerned by the relatively unfavorable perception of Algeria's business climate and have reinforced their focus on improving it. The government launched a series of political and economic initiatives in early 2011 to improve citizen participation, reinforce government accountability, and boost nonhydrocarbon growth. In terms of economic reforms, the authorities have organized cross-sector tripartite consultations to identify measures required to improve the business climate, which should be translated into an array of business climate improvement reforms.

36. The authorities remain cautious about full-fledged trade openness. They are concerned that trade openness has not brought the expected results for Algeria, which has seen imports growing substantially but has not experienced any boost in the export diversification. For this reason, authorities are negotiating more gradual trade integration with multilateral partners.

37. Financial sector reform remains a cornerstone for supporting private investment growth. The BA has continued its efforts to modernize and reinforce the financial system through regulatory reform and improved supervision. Adoption of the new accounting rules in 2010 has helped to improve reporting and transparency in reporting. Regarding NPLs, the authorities have supported the banks' implementation of a distressed-assets-management company and will request banks to write off their oldest NPLs. The authorities recognized unexpected delays in important projects such as the household credit registry, but they are hoping to finalize it in 2012.

STAFF APPRAISAL

38. Algeria has recorded satisfactory growth, but it may be reaching a tipping point. During the past decade, generally prudent macroeconomic management in the context of increasing international oil prices has resulted in robust growth, low inflation, the accumulation of large international reserves and budgetary savings, and a substantial reduction of debt levels. However, the efforts to reduce the dependence on hydrocarbon wealth and to promote the diversification of the economy have been disappointing. With the spillover effects of the public investment program on the nonhydrocarbon sectors of the Algerian economy decelerating, growth is likely to slow down without a more ambitious structural reform agenda.

39. High hydrocarbon revenues and budgetary savings provide scope for addressing pressing social demands and maintaining social stability, but the substantial expansion in current public expenditure in 2011 should be moderated to avoid excessive inflationary pressures. The growing systemic liquidity resulting from higher hydrocarbon revenue, substantial public salary increases, and larger social transfers have not yet translated into higher inflation, but the risk of an inflationary spike has increased. Growth in income transfers and wages will need to be moderated and spread over time as far as possible. In addition to moderating current public spending, the authorities should consider early action to tighten monetary policy to avoid inflationary pressures, through an interest rate hike and larger liquidity absorption.

40. Algeria's long-term fiscal sustainability and its capacity to withstand prolonged negative oil price shocks will be seriously challenged by the substantial expansion in current public spending. The significant growth in current expenditure in 2011 poses substantial challenges to Algeria's budget sustainability as these types of expenses are less compressible. This expenditure growth is making Algeria's fiscal position vulnerable to the risk of prolonged lower international oil prices, which could result from a weaker global economy, despite the large budget savings accumulated so far. A fiscal sustainability analysis based on a permanent income framework points to the need for medium-term fiscal consolidation. Since upward pressures on expenditure growth will continue in the near future, the authorities should adopt fiscal consolidation measures which could include limits to wage increases and new hires, and better targeting of transfers, by means testing social benefits. The increased mobilization of nonhydrocarbon resources and the continuation of tax administration reforms will also contribute to reducing the budget's dependency on volatile hydrocarbon revenues.

41. Delays in budgetary reform could hamper efforts to improve the quality and efficiency of public expenditure. While the budget is the key lever in using and redistributing hydrocarbon wealth, the relatively modest gains recorded by Algeria in real GDP per capita or other social indicators, in view of very large public spending, as well as the lack of progress toward a more diversified and productive economy, point to the need to enhance spending quality and efficiency. Staff welcomes the progress made in budgetary reform and planning but considers that the delays in certain key areas, such as medium-term budgetary planning, could damage the efforts to enhance the control and quality of expenditure. Initiatives such as the creation of the CNED to monitor the quality of capital expenditure have been successful and should be extended to other areas.

42. The BA can continue its exchange rate policy consistent with long-term equilibrium level, but exchange rate fundamentals should be strengthened. Staff concurs with the authorities' policy of intervening in the exchange rate market to avoid misalignments. Exchange rate fundamentals, including the fiscal position and productivity gains, should be strengthened to avoid a real appreciation, which would result in "Dutch disease effects" common to many commodity exporters.

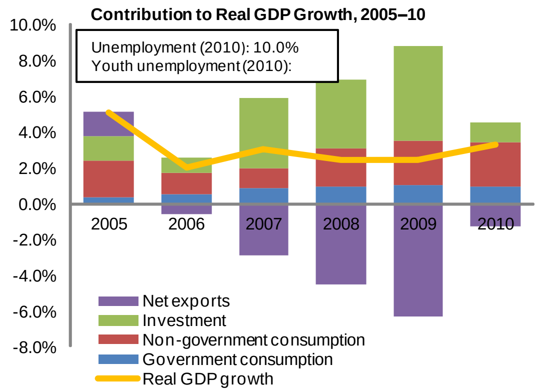
43. To make a significant dent in unemployment, a more ambitious structural reform agenda should be implemented to enhance the business climate and competitiveness. With public investment expected to play a less dynamic role in economic growth, the private sector will need to become a stronger engine for growth and job creation. Without ambitious reforms, medium-term growth prospects will become weaker. The recent measures to support SME financing and the consultations with social partners to improve the business environment should have a positive, albeit small, impact on private investment and economic diversification. Moreover, advances in financial reform should facilitate the private sector's access to credit. However, despite certain advances, important constraints remain to be addressed. Labor cost increases out of line with productivity gains will negatively affect competitiveness. The rules for FDI implemented since 2009, and heavy bureaucratic procedures, discourage foreign investors and could prevent much-needed foreign technology transfers. Similarly, more decisive measures to expose the public financial sector to more competition through the expansion of private banks and to further improve public banks' operations and governance would enhance financial intermediation. The authorities should also persevere in their efforts to further integrate Algeria into regional and global trade. Growth-enhancing policies could usefully be complemented with active labor market policies, aimed at enhancing matching of skills and reducing hiring rigidities.

44. Staff welcomes Algeria's cancellation of US$702 million in loans under the Enhanced HIPC initiative.

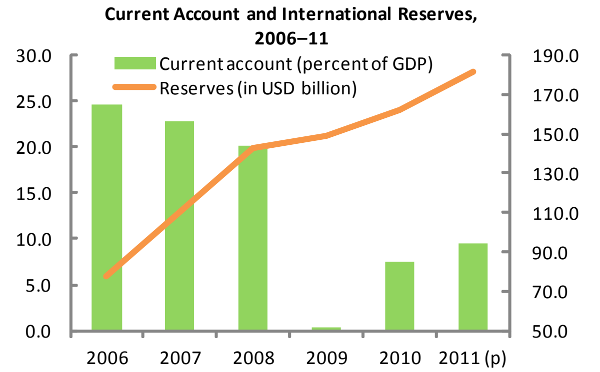
45. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Algeria: Selected Macroeconomic Indicators

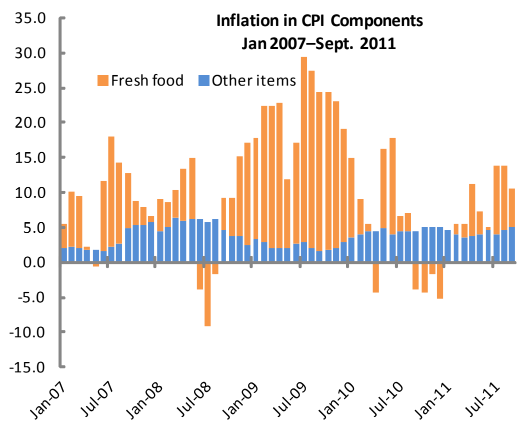
Algeria weathered the crisis well and the 2011 outlook remains positive; however, unemployment remains high, especially among the youth.



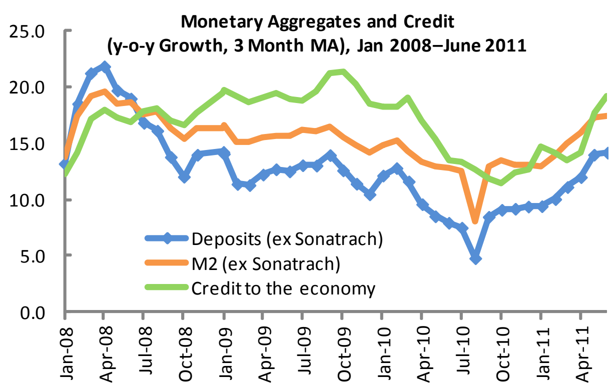
The recovery in oil prices has improved the external balance while reserves are expected to reach US$186 billion by end-2011.



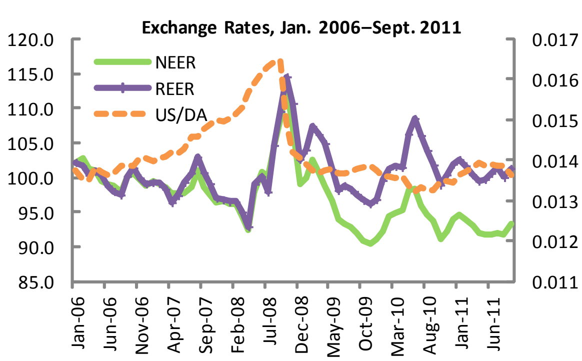
Inflation fell in 2010 due to fresh food products and remained subdued for the non-fresh food component. However, there was a spike in fresh food in early 2011 which was subdued in the second quarter of the year.



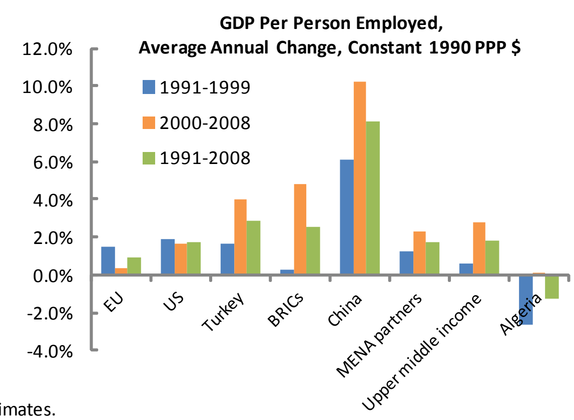
Credit and monetary aggregates have been growning at a healthy rate in 2011 and have recovered from a relative slowdown in late 2010.



In 2011 the real exchange rate depreciated slightly due to a fall in inflation differentials with Algeria's main trade partners.



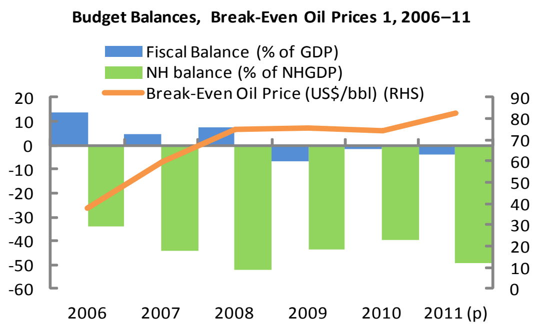
Algeria suffers from a weak business climate and has been slow in implementing structural reforms to diversify the economy.



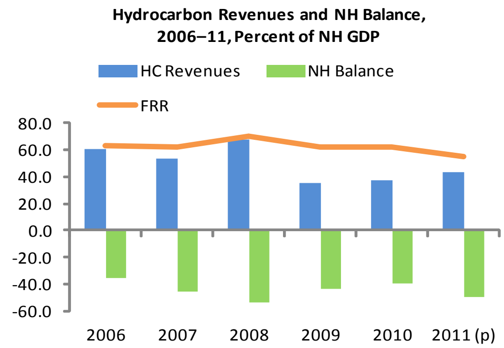
Sources: Algerian authorities; Doing business database; and IMF staff estimates.

Figure 2. Algeria: Fiscal Indicators

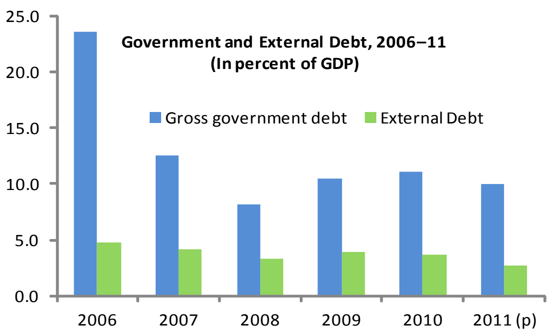
In 2011, Algeria will record another fiscal deficit.



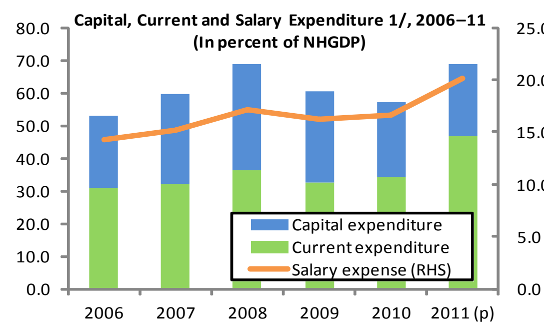
The level of fiscal savings accumulated in the FRR remains strong but will decrease in 2011.



Past savings have also helped to repay debt, keeping government debt levels low.



Expenditure has been growing during the last five years due to PIP expenses and higher salaries for public employees.



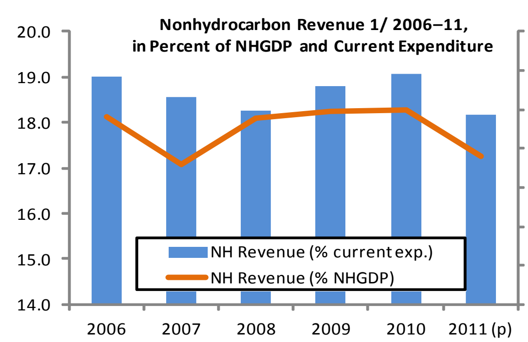
[1] Salary expense includes hospitals and autonomous administrative agencies and excludes back payments to public employees. in 2010 and 2011.

In 2010, the authorities increased salaries by 34 percent, making Algeria one of the MENA countries with the highest public salary burden. However, average salary remains at levels similar to those in neighboring countries.

(*) Wages in percent of NHGDP

1/ Excludes salaries of autonomous agencies

The authorities have been making efforts to reduce the reliance on hydrocarbon revenues by implementing the FRR and increasing nonhydrocarbon revenues, through more efficient tax administration.



[1] Tax revenues in 2010 and 2011 are adjusted to exclude back payments to public employees.

Sources: Algerian authorities; and IMF staff estimates.

Table 1. Algeria: Selected Economic and Financial Indicators, 2008–16

	2008	2009	2010	Projections 2011	2012	2013	2014	2015	2016
	(Annual percentage change; unless otherwise indicated)								
Oil and gas sector									
Liquid petroleum exports (in millions of barrels/day)	1.6	1.5	1.4	1.3	1.3	1.3	1.3	1.3	1.3
Natural gas exports (in billions of m3)	59.5	53.7	56.1	54.6	54.1	54.1	54.1	54.3	54.8
Crude oil export unit value (US$/bbl)	99.0	61.8	79.0	103.2	100.0	99.5	97.5	96.5	95.5
Share of hydrocarbons in total exports (in percent)	98.2	98.3	98.3	98.6	98.4	98.3	98.1	98.0	97.8
National income and prices									
GDP at constant prices	2.4	2.4	3.3	2.5	3.1	3.5	3.5	3.5	3.8
Hydrocarbon sector	-2.3	-6.0	-2.6	-2.1	-0.7	0.3	0.4	0.4	1.0
Other sectors	6.1	9.3	5.9	4.9	5.3	5.2	5.0	5.0	5.0
Consumer price index (period average)	4.9	5.7	3.9	3.9	4.3	4.0	3.7	3.7	3.7
External sector 1/									
Exports, f.o.b.	29.7	-42.5	26.4	25.9	-6.4	-0.6	-2.0	-0.8	0.7
Hydrocarbons	29.5	-42.5	26.4	26.3	-6.6	-0.8	-2.1	-1.0	0.5
Nonhydrocarbons	42.9	-45.0	26.0	5.5	5.8	6.6	6.8	6.9	8.0
Imports, f.o.b.	44.2	-1.6	4.0	16.0	2.9	1.5	0.2	-0.5	0.8
Current account balance (in percent of GDP)	20.1	0.3	7.5	9.5	5.4	4.6	4.5	4.8	5.0
Money and credit									
Net foreign assets	38.2	5.0	11.6	…	…	…	…	…	…
Domestic credit 2/	-17.6	7.3	-0.3	…	…	…	…	…	…
Credit to the government (net) 2/ 3/	-25.2	0.2	-2.5	…	…	…	…	…	…
Credit to the economy 3/	20.4	18.5	5.1	…	…	…	…	…	…
Money and quasi-money	16.1	3.1	13.8	…	…	…	…	…	…
Velocity of broad money (GDP/M2)	1.6	1.4	1.5	…	…	…	…	…	…
Idem, in percent of nonhydrocarbon GDP	0.9	1.0	1.0	…	…	…	…	…	…
Liquidity ratio (M2/GDP)	62.7	71.5	67.7	…	…	…	…	…	…
	(In percent of GDP)								
Savings-investment balance	20.1	0.3	7.5	9.5	5.4	4.6	4.5	4.8	5.0
National savings	57.5	47.0	48.9	49.7	46.8	46.4	45.9	45.2	45.0
Of which: Nongovernment	32.1	34.2	35.8	39.7	39.5	36.4	36.0	35.3	34.7
Investment	37.4	46.7	41.4	40.2	41.4	41.7	41.4	40.5	40.0
Of which: Nongovernment	19.6	27.5	26.4	26.2	28.2	28.5	28.1	27.2	26.7
Central government finance									
Overall budget balance (deficit-)	7.6	-6.4	-1.9	-4.0	-6.0	-3.3	-3.3	-3.3	-3.0
Total revenue	46.8	36.6	36.4	39.5	36.8	34.8	33.6	32.9	32.3
Total expenditure	39.2	43.0	38.2	43.4	42.8	38.2	37.0	36.1	35.3
	(In percent of nonhydrocarbon GDP)								
Central government finance									
Total revenue	85.2	53.1	55.7	62.6	56.3	52.1	49.0	46.9	45.5
Hydrocarbon	67.1	34.8	36.9	43.5	38.0	34.7	31.9	29.7	28.4
Nonhydrocarbon	18.1	18.2	18.8	19.1	18.3	17.4	17.1	17.2	17.1
Total expenditure	71.3	62.4	58.5	68.9	65.5	57.1	53.9	51.6	49.7
Current expenditure	36.4	32.6	34.2	46.6	45.2	37.2	34.6	32.7	31.1
Capital expenditure	34.9	29.7	24.3	22.2	20.3	19.8	19.3	18.9	18.7
Nonhydrocarbon primary balance	-52.2	-43.6	-39.3	-49.0	-46.4	-39.3	-36.4	-34.0	-32.3
Nonhydrocarbon balance	-53.2	-44.1	-39.8	-49.7	-47.1	-39.7	-36.8	-34.3	-32.6
Memorandum items:									
GDP (in billions of dinars at current prices)	11,090	10,034	12,049	13,762	14,520	15,479	16,368	17,358	18,633
NHGDP (in billions of dinars at current prices)	6,092	6,925	7,869	8,681	9,492	10,350	11,230	12,164	13,226
GDP (in billions of US$ at current prices)	171.7	138.0	160.8	189.3	194.6	203.0	210.9	219.8	227.7
Per capita GDP (in US$)	4,996	3,954	4,539	5,265	5,334	5,481	5,609	5,761	5,878
Crude oil exports (in millions of barrels/day)	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Nonhydrocarbon exports (percent of total exports)	1.6	1.5	1.5	1.3	1.5	1.6	1.7	1.8	1.9
Gross official reserves (in billions of US$, end of period)	143.1	148.9	162.2	181.5	193.4	204.9	216.6	229.1	242.7
In months of next year's imports of goods and services	35.4	35.2	33.9	36.9	38.7	41.0	43.6	46.0	48.7
Gross government debt (in percent of GDP)	8.2	10.4	11.1	10.0	9.4	8.9	8.5	8.0	7.5
External debt (in percent of GDP)	3.3	3.9	3.6	2.6	2.5	2.4	2.3	2.2	2.1

Sources: Algerian authorities; and Fund staff estimates and projections.

1/ In U.S. dollar terms.

2/ In percent of beginning money stock.

Table 2. Algeria: Balance of Payments, 2008–16

	2008	2009	2010	Projections 2011	2012	2013	2014	2015	2016
	(In billions of U.S. dollars; unless otherwise indicated)								
Current account	34.5	0.4	12.1	18.0	10.5	9.4	9.6	10.5	11.4
Trade balance	40.6	7.8	18.2	26.8	20.9	19.8	18.4	18.1	18.2
Exports, f.o.b.	78.6	45.2	57.1	71.9	67.3	66.9	65.6	65.0	65.5
Hydrocarbons	77.2	44.4	56.1	70.9	66.2	65.7	64.3	63.7	64.0
Volume change (in percent)	-3.4	-10.2	-2.8	-2.7	-1.5	-0.3	-0.1	0.0	0.8
Price change (in percent)	34.2	-36.0	30.0	28.0	-2.9	-0.5	-2.0	-1.0	-0.6
Other	1.4	0.8	1.0	1.0	1.1	1.2	1.2	1.3	1.4
Imports, f.o.b.	-38.0	-37.4	-38.9	-45.1	-46.4	-47.1	-47.2	-46.9	-47.3
Volume change (in percent)	34.6	12.6	-2.4	2.7	3.1	1.2	-0.2	-0.1	1.2
Price change (in percent)	7.1	-12.6	5.8	13.6	-0.3	0.3	0.4	-0.4	-0.4
Services and income (net)	-8.9	-10.0	-8.7	-11.6	-13.3	-13.2	-11.6	-10.5	-9.6
Services (net)	-7.6	-8.7	-8.3	-8.3	-8.9	-9.1	-9.2	-9.0	-8.9
Credit	3.5	3.0	3.6	4.0	3.8	3.7	3.7	3.6	3.6
Debit	-11.1	-11.7	-11.9	-12.3	-12.7	-12.8	-12.9	-12.6	-12.5
Income (net)	-1.3	-1.3	-0.4	-3.3	-4.4	-4.1	-2.4	-1.5	-0.8
Credit	5.1	4.7	4.6	3.1	1.4	1.8	3.4	4.4	5.3
Debit	-6.5	-6.1	-5.0	-6.4	-5.8	-5.9	-5.8	-5.9	-6.1
Interest payments	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other, including profit repatriation	-6.3	-5.9	-4.9	-6.2	-5.7	-5.8	-5.7	-5.8	-6.0
Transfers (net)	2.8	2.6	2.7	2.8	2.9	2.8	2.8	2.8	2.9
Capital account	1.2	3.5	3.4	1.2	1.5	2.0	2.1	2.1	2.2
Medium- and long-term capital	1.9	3.8	2.3	1.2	1.5	2.0	2.1	2.1	2.2
Direct investment (net)	2.3	2.5	1.9	1.7	1.7	2.0	2.1	2.1	2.2
Loans (net)	-0.4	1.3	0.4	-0.4	-0.2	0.0	0.0	0.0	0.0
Drawings	0.8	2.2	0.6	0.7	0.7	0.7	0.6	0.6	0.6
Amortization	-1.3	-0.9	-0.1	-1.1	-0.8	-0.7	-0.6	-0.7	-0.6
Short-term capital and errors and omissions	-0.7	-0.4	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	35.7	3.9	15.6	19.3	12.0	11.4	11.7	12.5	13.6
Financing	-35.7	-3.9	-15.6	-19.3	-12.0	-11.4	-11.7	-12.5	-13.6
Official reserves (increases -)	-35.7	-3.9	-15.6	-19.3	-12.0	-11.4	-11.7	-12.5	-13.6
Memorandum items:									
Current account balance (in percent of GDP)									
Algerian crude oil price (US$/barrel) 1/	99.2	61.8	79.0	103.2	100.0	99.5	97.5	96.5	95.5
Gross official reserves (in billions of US$) 2/	143.1	148.9	162.2	181.5	193.4	204.9	216.6	229.1	242.7
Idem, in months of next year's imports	35.0	35.2	33.9	36.9	38.7	41.0	43.6	46.0	48.7
Gross external debt (in billions of US$)	5.6	5.4	5.8	5.0	4.8	4.8	4.8	4.7	4.7

Sources: Algerian authorities; and Fund staff estimates and projections.
1/ Weighted average of quarterly data.
2/ Including SDR allocation (US$1.7 billion).

Table 3a. Algeria: Statement of Central Government Operations, 2008–16 1/

				Projections					
	2008	2009	2010	2011	2012	2013	2014	2015	2016
				(In billions of Algerian dinars)					
Revenue (a)	5,191	3,675	4,382	5,434	5,347	5,389	5,503	5,702	6,022
Taxes	965	1,147	1,287	1,456	1,615	1,660	1,781	1,949	2,115
Taxes on income, profits and capital gains	332	462	562	645	718	752	831	939	1,058
Taxes on goods and services	435	478	504	547	629	662	709	768	818
Taxes on international trade and transactions	165	170	182	220	225	198	190	186	177
Other revenue	4,225	2,529	3,095	3,978	3,732	3,729	3,722	3,753	3,906
Rents (Oil revenue), *of which* 2/	4,089	2,413	2,905	3,774	3,608	3,593	3,581	3,607	3,755
Stabilization fund	2,288	401	1,319	2,217	1,986	2,036	2,024	2,049	2,197
Expenditure (b)	4,191	4,185	4,502	5,978	6,214	5,906	6,050	6,273	6,578
Expense (b.1)	2,218	2,259	2,694	4,049	4,290	3,855	3,881	3,973	4,108
Compensation of employees	827	880	1,193	1,742	1,732	1,500	1,598	1,701	1,812
Goods and services	112	113	122	161	173	195	189	190	199
Interest payments	61	37	33	62	69	39	39	39	39
Subsidies	3	3	3	8	8	8	9	9	9
Grants	466	503	608	1,166	1,176	952	952	971	1,032
Social benefits (Mudjahidins' pensions)	160	183	210	178	198	200	203	205	207
Other expense (subsidies public enterprises)	589	541	527	731	935	960	893	857	810
Net acquisition of nonfinancial assets (b.2)	1,973	1,926	1,808	1,929	1,924	2,051	2,169	2,300	2,469
Gross operating balance (a-b.1)	2,973	1,416	1,688	1,384	1,057	1,534	1,623	1,729	1,913
Net lending/borrowing (a-b) (Overall balance)	999	-510	-120	-544	-867	-517	-547	-571	-556
Net acquisition of financial assets	1,133	124	540	-59	-632	-282	-311	-334	-319
Domestic	155	134	104	0	0	0	0	0	0
Currency and deposits	31	-4	-35	0	0	0	0	0	0
Loans (net lending by the treasury)	124	138	139	0	0	0	0	0	0
Foreign	978	-11	435	-59	-632	-282	-311	-334	-319
Currency and deposits	978	-11	435	-59	-632	-282	-311	-334	-319
Net incurrence of liabilities	134	634	659	485	235	235	236	237	237
Domestic	157	655	674	500	250	250	251	252	252
Currency and deposits (public entities)	199	673	699	500	250	250	250	250	250
Loans	-42	-18	-25	0	0	0	1	2	2
Foreign	-23	-22	-15	-15	-15	-15	-15	-15	-15
Loans	-23	-22	-15	-15	-15	-15	-15	-15	-15
Memorandum items:									
Nonhydrocarbon primary balance	-3,028	-2,885	-2,992	-4,256	-4,406	-4,071	-4,089	-4,139	-4,272
Primary balance	1,061	-473	-87	-482	-798	-478	-508	-532	-517
Nonhydrocarbon balance	-3,089	-2,923	-3,025	-4,318	-4,475	-4,110	-4,128	-4,178	-4,310
Oil stabilization fund (in billions of Algerian dinars)	4280.0	4316.5	4842.8	4783.4	4150.9	3868.5	3556.4	3221.0	2900.6
				(In percent of GDP)					
Revenue (a)	47.2	36.6	36.4	39.5	36.8	34.8	33.6	32.9	32.3
Taxes	8.8	11.4	10.7	10.6	11.1	10.7	10.9	11.2	11.4
Other revenue, of which	38.4	25.2	25.7	28.9	25.7	24.1	22.7	21.6	21.0
Rents (Oil revenue) 2/	37.2	24.0	24.1	27.4	24.8	23.2	21.9	20.8	20.2
Expenditure (b)	38.1	41.7	37.4	43.4	42.8	38.2	37.0	36.1	35.3
Expense (b.1)	20.2	22.5	22.4	29.4	29.5	24.9	23.7	22.9	22.0
Compensation of employees	7.5	8.8	9.9	12.7	11.9	9.7	9.8	9.8	9.7
Social benefits (Mudjahidins' pensions)	1.5	1.8	1.7	1.3	1.4	1.3	1.2	1.2	1.1
Goods and services	1.0	1.1	1.0	1.2	1.2	1.3	1.2	1.1	1.1
Grants	4.2	5.0	5.0	8.5	8.1	6.1	5.8	5.6	5.5
Interest payments	0.6	0.4	0.3	0.5	0.5	0.3	0.2	0.2	0.2
Net acquisition of nonfinancial assets (b.2)	17.9	19.2	15.0	14.0	13.3	13.3	13.3	13.3	13.3
Gross operating balance (a-b.1)	27.0	14.1	14.0	10.1	7.3	9.9	9.9	10.0	10.3
Net lending/borrowing (a-b) (Overall balance)	9.1	-5.1	-1.0	-4.0	-6.0	-3.3	-3.3	-3.3	-3.0
Primary balance	9.6	-4.7	-0.7	-3.5	-5.5	-3.1	-3.1	-3.1	-2.8
Oil stabilization fund	38.9	43.0	40.2	34.8	28.6	25.0	21.7	18.6	15.6
				(In percent of nonhydrocarbon GDP)					
Revenue (a)	86.6	53.1	55.7	62.6	56.3	52.1	49.0	46.9	45.5
Taxes	16.1	16.6	16.4	16.8	17.0	16.0	15.9	16.0	16.0
Other revenue, of which	70.5	36.5	39.3	45.8	39.3	36.0	33.1	30.9	29.5
Rents (Oil revenue) 2/	68.2	34.8	36.9	43.5	38.0	34.7	31.9	29.7	28.4
Expenditure (b)	69.9	60.4	57.2	68.9	65.5	57.1	53.9	51.6	49.7
Expense (b.1), of which	37.0	32.6	34.2	46.6	45.2	37.2	34.6	32.7	31.1
Personnel expenditure	*13.8*	*12.7*	*15.2*	*20.1*	*18.2*	*14.5*	*14.2*	*14.0*	*13.7*
Net acquisition of nonfinancial assets (b.2)	32.9	27.8	23.0	22.2	20.3	19.8	19.3	18.9	18.7
Nonhydrocarbon primary balance	-50.5	-41.7	-38.0	-49.0	-46.4	-39.3	-36.4	-34.0	-32.3
Nonhydrocarbon overall balance	-51.5	-42.2	-38.4	-49.7	-47.1	-39.7	-36.8	-34.3	-32.6

Sources: Algerian authorities; and Fund staff estimates and projections.
1/ On cash basis.
2/ Including dividends of Sonatrach.

Table 3b. Algeria: Balance sheet for the Central Government Based on GFSM 2001, 2008–10 1/

	2008				2009			Est. 2010		
	Closing Opening balance	Transaction	Other economic flows 2/	Closing Opening balance	Transaction	Other economic flows 2/	Closing Opening balance	Transaction	Other economic flows 2/	Closing Opening balance
	(In billions of Algerian dinars)									
Financial assets	3,871	1,133		5,004	124		5,128	540		5,668
Domestic	447	155		602	134		736	104		840
Currency and deposits	168	31		199	-4		195	-35		160
Loans	279	124		403	138		541	139		680
Foreign	3,424	978		4,402	-11		4,392	435		4,827
Currency and deposits	3,424	978		4,402	-11		4,392	435		4,827
Liabilities	2,231	-194	30	2,066	634	191	2,891	659	235	3,786
Domestic	2,079	-171		1,907	655	178	2,741	674	212	3,627
Currency and deposits	974	199		1,173	673		1,846	699		2,545
Loans	1,104	-370		734	-18	178	895	-25	212	1,082
Foreign	152	-23	30	159	-22	13	151	-15	23	159
Loans	153	-23	30	160	-22	13	151	-15	23	159
Memorandum items:										
Net financial worth (in percent of GDP)	17.6			26.7			22.3			15.6
Financial assets (in percent of GDP)	41.6			45.5			51.1			47.0
Liabilities (in percent of GDP)	24.0			18.8			28.8			31.4
Change in Net financial worth (in percentage)	312.9			79.1			-23.9			-15.9
Liabilities/Assets	0.21			0.15			0.18			0.21
Liabilities/Financial Assets ratio	0.58			0.41			0.56			0.67

Sources: Algerian authorities; and Fund staff estimates and projections.

1/ Includes Central Government and special accounts.

2/ Other economic flows record holding gains and losses and other changes in the volume of assets and liabilities.

Table 4. Algeria: Monetary Survey, 2008–12

	2008	2009	2010	Projections 2011	2012
	(In billions of Algerian dinars; at end of period)				
Net foreign assets	10,247	10,758	12,008	13,298	14,548
Of which: Bank of Algeria (BA)	10,230	10,746	12,023	13,314	14,564
Net domestic assets	-3,291	-3,585	-3,845	-3,368	-3,537
Domestic credit	-1,402	-892	-913	-738	53
Credit to government (net) 1/	-4,092	-4,079	-4,261	-4,415	-4,003
Credit to the economy	2,689	3,187	3,348	3,677	4,056
Of which: Private sector	1,413	1,621	1,824	2,041	2,351
Other items net	-1,888	-2,693	-2,933	-2,630	-3,590
Money and quasi-money (M2)	6,956	7,173	8,163	9,931	11,011
Excluding Sonatrach deposits	5,654	6,399	7,172	8,731	10,077
Money	4,965	4,944	5,639	7,016	8,501
Quasi-money	1,991	2,229	2,524	2,915	2,510
	(Percent change over 12-month period)				
Money and quasi-money (M2)	16.1	3.1	13.8	21.7	10.9
Excluding Sonatrach deposits	19.9	13.2	12.1	21.7	15.4
Of which: Money	17.4	-0.4	14.0	24.4	21.2
Credit to the economy 2/	20.4	18.5	5.1	9.8	16.5
Of which: Private sector 3/	16.9	14.7	12.5	11.9	15.2
Memorandum items:					
Liquidity ratio (e.o.p. M2/GDP)	62.7	71.5	67.7	72.2	75.8
Liquidity ratio (e.o.p. M2/NHGDP)	114.2	103.6	108.4	114.4	116.0
Idem, excluding deposits of Sonatrach	92.8	92.4	91.1	100.6	106.2
Sonatrach deposits	1,302	774	991	1,200	934
M2 velocity	1.6	1.4	1.5	1.4	1.3
Credit to the economy/GDP	24.3	31.8	27.8	26.7	27.9
Credit to the economy/NHGDP	44.1	46.0	42.5	42.4	42.7
Credit to private sector/NHGDP	23.2	23.4	23.2	23.5	24.8

Sources: Bank of Algeria; and Fund staff estimates and projections.

1/ Net credit to government excludes Treasury postal accounts ("dépôts CCP") deposited at the BA.
2/ The projections including the loans to the public sector bought back by the Treasury in 2010 and 2011 are 14.4 percent and 15.1 percent for 2010 and 2011, respectively.
3/ The projection including loans to the private sector bought back by the Treasury in 2011 is 14.7 percent.

Appendix 1. Exchange Rate Assessment

An analysis using the CGER methodology suggests that the current level of the REER is broadly in line with medium-term fundamentals, provided these fundamentals will be strengthened in line with staff projections. Using estimated coefficients for an oil producer like Algeria, the REER misalignment was calculated under the Macroeconomic Balance (MB), the External Sustainability (ES), and the Equilibrium Real Exchange Rate (ERER) approaches. While the current account (CA) projected surplus in 2011 is above the medium-term norm, as estimated by the MB approach, it is projected to decline slightly below the norm by 2016, suggesting that the REER would converge to its medium-term equilibrium.[1] Also under the ES approach, projection of the underlying CA (consistent with this approach) is in line with the CA norm, suggesting again convergence of the REER to its medium-term equilibrium in the staff baseline scenario.

Results of CGER-type Analysis
(In percent of GDP)

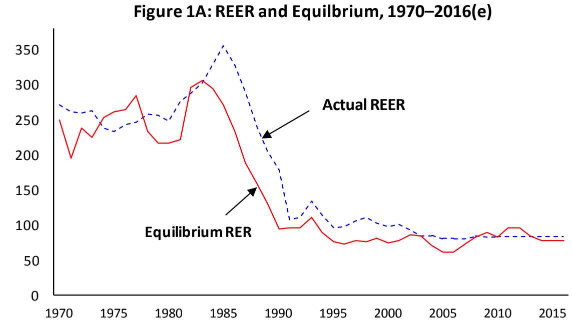
	2011	2016
Projected CA	9.5	5.0
CA norm (MB approach)		6.8
Underlying CA (ES approach)		3.5
CA norm (ES approach)		2.7

A country-specific long-run co-integration relationship was also estimated for the reduced form Equilibrium Real Effective Exchange Rate (EREER). Under this specification, the EREER is determined by Algeria's terms of trade (ToT), the differential of output per worker in Algeria vis-a-vis trade partners (prod), and government spending as a percentage of GDP (G) (*t*-stats between parentheses):

$$\ln(EREER) = -0.38 + \underset{(1.84)}{0.17}\ln(ToT) + \underset{(14.84)}{1.85}\ln(prod) + \underset{(3.76)}{1.20}\ln(G)$$

Calculating the EREER using the medium-term WEO projections for the explanatory variables implies an undervaluation of 13.3 percent in 2011. The EREER has appreciated in the past few years under the effect of increased government spending and oil prices, entailing the risk of the "Dutch disease" phenomenon. The projection of the EREER over the medium term points to a gradual depreciation reflecting lower public spending in percentage of GDP and a wider productivity gap vis-a-vis the trading partners. The REER has slightly depreciated since end-2010.

Figure 1A: REER and Equilbrium, 1970–2016(e)

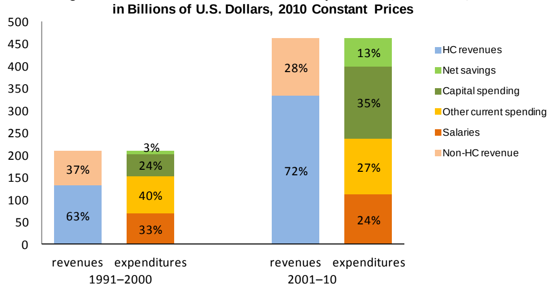


Source: staff estimates.

[1] We compute the CA norm based on Specification 1 in S. Beidas-Strom and P. Cashin, 2011, "Are Middle Eastern Current Account Imbalances Excessive?" IMF Working Paper 11/195.

Appendix 2. Public Spending Composition and Potential Effects on Growth

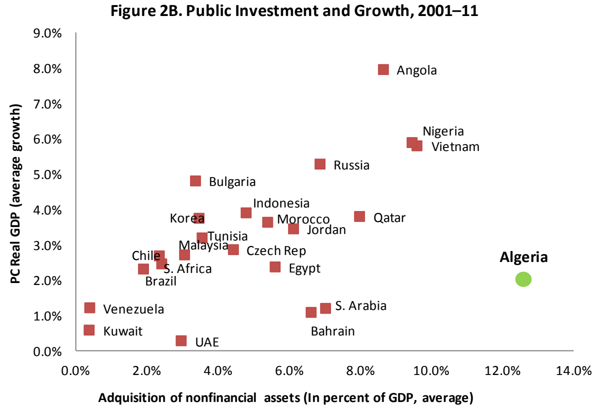
Figure 2A: Accumulated Revenues and Expenditures, 1991–2010, in Billions of U.S. Dollars, 2010 Constant Prices



1/ Salaries include hospitals and EPAs.

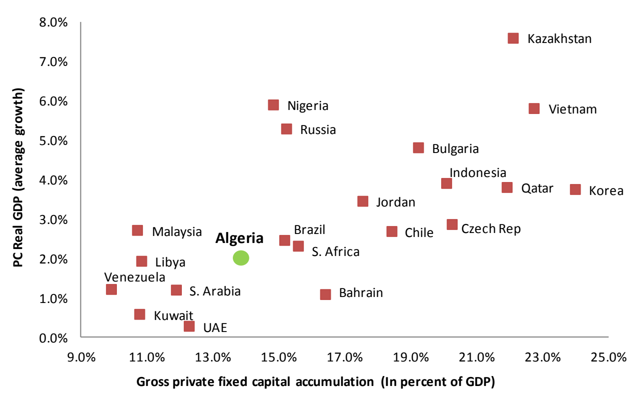
Revenues from exhaustible natural resources are intrinsically temporary because they are derived from a depleting stock of resources and they are unreliable, due to the volatility of commodity prices. Consequently, some significant proportion of the revenues they generate should be saved, so that increases in consumption over time can be sustained. Figure 2A shows the composition of accumulated revenues and spending categories in Algeria during 1991–2010. Hydrocarbon revenues more than doubled (in constant dollar terms) in the 2000s from the previous decade, and their share in total revenues increased from 63 percent to 72 percent, making the Algerian budget more dependent on oil prices. In terms of expenses, Algeria has been devoting a larger share of revenues to capital expenditure and savings, which is consistent with the implementation of the PIP, the creation of the oil savings fund, and the sharp reduction in government debt. Nonhydrocarbon revenues barely cover the cost of public salaries. While countries rich in natural resources have the capacity to engage in significant infrastructure investment programs, this does not always translate into sustained levels of economic growth. Figure 2B shows the interaction between public capital spending and real per capita GDP growth during the period 2001–11. Algeria has the largest public investment share of GDP in the sample but it has not generated higher growth. One reason could be that public policies (and public spending programs) have not attracted enough private capital to boost the diversification of the economy needed to achieve faster growth. Figure 2C shows that private investment contributes significantly to economic growth but remains low in Algeria relative to other countries in the sample.

Figure 2B. Public Investment and Growth, 2001–11



Source: International financial statistics database.

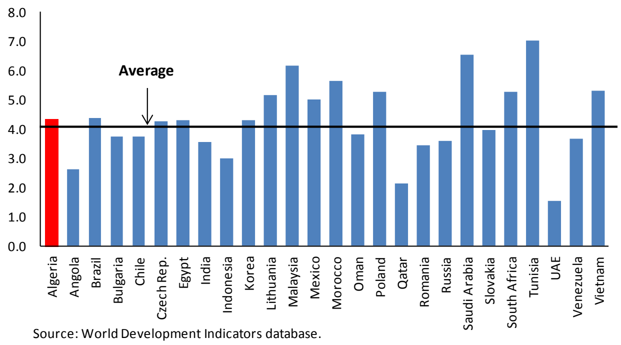
Figure 2C. Private Investment and Growth, 2001–11



Source: International financial statistics database.

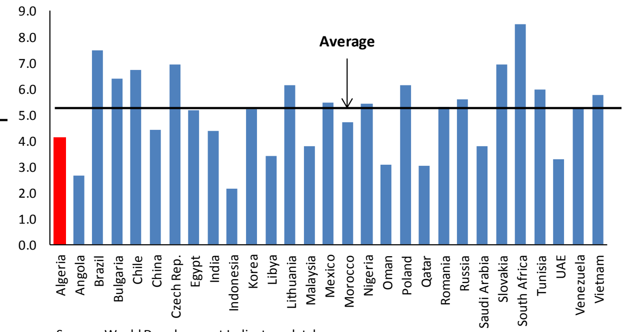
Despite the recent efforts to make the tax system more efficient and to reform public banks and enterprises, the Algerian economy still faces poor business climate indicators, and declining productivity, which likely reduce the potential leverage of public investment on private investment and growth potential. Moreover, Algeria has lower levels of public spending on key areas such as education (Figure 2D) and healthcare (Figure 2E), pointing to room for improvement in spending composition.

Figure 2D. Public Spending on Education, Average 2000–08, in percent of GDP



Source: World Development Indicators database.

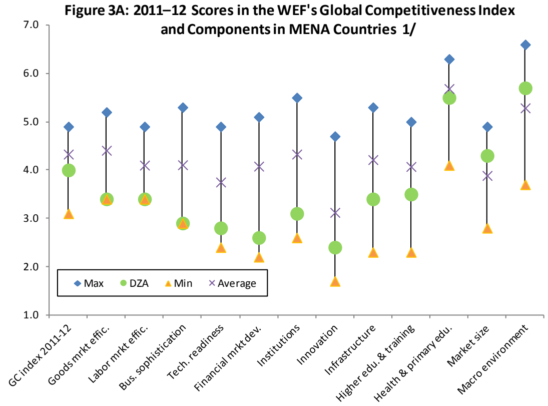
Figure 2E. Public Spending on Health, Average 2005–09, in percent of GDP



Source: World Development Indicators database.

Appendix 3. Algeria's Low Competitiveness and Weak Business Climate

Figure 3A: 2011–12 Scores in the WEF's Global Competitiveness Index and Components in MENA Countries 1/

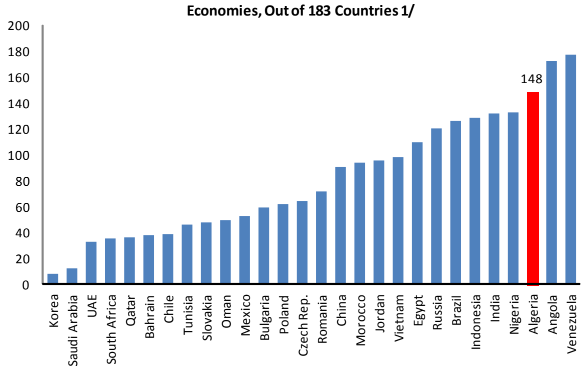


Source: World economic forum database.

1/ Algeria, Barhain, Egypt, Jordan, Kuwait, Lebanon, Morocco, Qatar, Saudi Arabia, Syria, Tunisia, UAE, and Yemen.

One key explanation for disappointing results of the authorities' efforts to diversify the economy is its low competitiveness and weak business climate. Figure 3A presents the World Economic Forum (WEF) *Global Competitiveness Index* and its components for MENA countries. It plots Algeria in comparison with the best and worst performers in each category. The MENA countries have an average low ranking with respect to other regions (e.g., Asia or Emerging Europe) and Algeria ranks low within MENA countries considered in the WEF index. Algeria has the worst rankings for all MENA in three important categories: goods markets efficiency, labor market efficiency, and business sophistication. Moreover, it ranks well below the average in all the other WEF index components with the exception of market size and the macroeconomic environment.

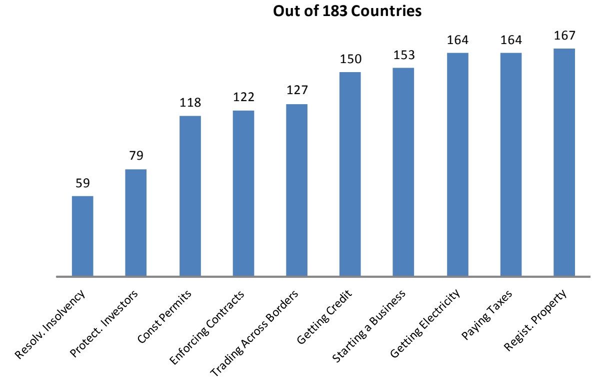
Figure 3B: 2011 *Doing Business* Ranking in Selected Emerging Economies, Out of 183 Countries 1/



Source: *Doing Business* indicators database.

1/ A higher ranking means a worse position.

Figure 3C. Algeria's Ranking in 2012 *Doing Business* Indicators, Out of 183 Countries



Source: *Doing Business* database.

The three lowest rankings in the WEF index components are also good indications of Algeria's weak business climate. In figure 3B, we present Algeria's 2011 *Doing Business* ranking in a group of 28 emerging and oil-producing countries. Algeria's ranking is third lowest, a fall from the previous year. *Doing Business* outlines that one of the key issues that explain Algeria's low ranking is, among others, the excessive and inefficient regulatory burden which, for example, makes it very complicated to incorporate a business (153rd out of 183 countries), pay taxes (164th out of 183 countries) or register property (167th out of 183 countries). Figure 3C presents Algeria's ranking for all the *Doing Business* components in the 2012 *Doing Business* ranking.

INTERNATIONAL MONETARY FUND

ALGERIA

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 22, 2011

Prepared By	The Middle East and Central Asia Department (in Consultation with Other Department)

CONTENTS

ALGERIA: RELATIONS WITH THE FUND

(As of October 31, 2011)

A. Financial Relations

Membership Status

Joined: April 25, 1958; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	1,254.70	100.00
Fund holdings of currency	882.62	70.35
Reserve position in Fund	372.08	29.66

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	1,198.18	100.00
Holdings	1,073.34	89.58

Outstanding Purchases and Loans

None

Financial Arrangements

In millions of SDR, (mm/dd/yyyy)

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	5/22/95	5/21/98	1,169.28	1,169.28
Stand-by	5/27/94	5/22/95	457.20	385.20
Stand-By	6/03/91	3/31/92	300.00	225.00

Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
		2011	2012	2013	2014
Principal	0.00	0.00	0.00	0.00	0.00
Charges/interest	0.00	0.11	0.40	0.40	0.40
Total	**0.00**	**0.11**	**0.40**	**0.40**	**0.40**

Implementation of HIPC Initiative: Not Applicable.

B. Nonfinancial Relations

Exchange Rate Arrangement

1. From January 21, 1974 to October 1, 1994, the exchange rate of the dinar was determined on the basis of a fixed relationship with a basket of currencies, adjusted from time to time. On October 1, 1994, the Bank of Algeria introduced a managed float for the dinar through daily fixing sessions that included six commercial banks. This system has been replaced by an interbank foreign exchange market as of January 2, 1996. On December 15, 2011, the average of the buying and selling rates for the U.S. dollar was $1 = DA 74.6, equivalent to SDR 1 = DA 114.6. No margin limits are imposed on the buying and selling exchange rates in the interbank foreign exchange market, except for a margin of DA 0.017 between the buying and selling rates of the Bank of Algeria for the dinar against the U.S. dollar.

2. The exchange regime is classified as other managed arrangement with no preannounced path for the exchange rate. Full surrender requirements are in effect on hydrocarbon export proceeds. Limits on the making of payments for invisible transactions and current transfers, which have remained in place since Algeria accepted the obligations of Article VIII, sections 2(a), 3, and 4, in 1997, are indicative according to the authorities. Inward direct investment is generally free of restrictions; controls are maintained on other capital account payments and transfers.

Latest Article IV Consultation

3. The discussions for the 2011 Article IV consultation with Algeria were held in Algiers during October 20–November 2, 2010. The Staff Report (IMF Country Report No. 11/39) was discussed and approved by the Executive Board on January 14, 2011 and published on February 03, 2011.

Technical Assistance

- An MFD mission visited Algiers in September 2005, December 2005, and in May 2006 to advise on bank restructuring.

- An MFD experts visited Algiers several times from February through September 2006 to assist the Bank of Algeria to develop its bank supervision and regulation capability.

- An MFD expert visited Algiers in January–February 2006 to advise on monetary and foreign exchange operations.

- An MFD expert visited Algiers in February and May 2006 to advise on foreign exchange reserve management.

- An STA mission visited Algiers in May 2006 to advise on monetary and financial statistics.

- An MFD expert visited Algiers in May 2006 to advise on payment systems.

- An STA mission visited Algiers in May 2006 to advise on consumer price statistics.

- MFDs expert visited Algiers several times from February through October 2007 to assist the Bank of Algeria in banking supervision.

- Two FAD missions visited Algiers in February 2007 to review tax policy and advise on customs administration.

- A multisector STA mission visited Algiers in February 2007 to prepare Algeria's participation in the GDDS.

- An FAD mission visited Algiers in April 2007 to continue the program of assistance in tax administration.

- An FAD mission visited Algiers in May 2008 to continue the program of assistance in tax administration.

- An MCM mission visited Algiers in May 2009 to advise on strengthening banking supervision and regulation.

- An MCM mission visited Algiers in June 2009 to prepare the program for harmonizing financial sector infrastructure in the Maghreb.

- An MCM expert is visiting Algiers for a long-term banking supervision TA from December 2010 to December 2011.

- An FAD mission visited Algiers in October 2011 to provide assistance on tax administration.

Financial Sector Assessment Program

4. Algeria participated in the FSAP in 2003. The Executive Board discussed the Financial System Stability Assessment on

January 14, 2004, (see IMF Country Report No. 04/138). The FSAP was updated in 2007.

Resident Representative/Advisor

None.

ALGERIA: RELATION WITH THE WORLD BANK GROUP

JMAP Implementation, FY11

As of December 11th, 2011

Title	Products	Provisional timing of missions	Expected delivery date
A. Mutual Information on Relevant Work Programs			
Bank work program in next 12 months	a. Country Partnership Strategy FY11-FY14 for delivery in FY11, including Analytical and Technical Assistance activities on a reimbursable basis, no lending in line with government's policy. b. <u>Sector work</u> on: • State-owned Banks for Ministry of Finance • Subsidy targeting • Reviewing Social Protection Programs • Energy Demand • Environment and Tourism • Climate change c. <u>Technical assistance</u> on • Credit Registry with Central Bank • Financial Crisis simulation (FIRST) • RAMP • Social Programs Evaluation • Support to analysis and evaluation of the Household Survey • Agricultural Program • Competitiveness Poles • Agricultural Statistical Capacity	Ongoing activities with multiple missions throughout the year	FY11-FY14 activities

IMF work program in next 12 months	2011 Article IV Consultation Preparing analytical work on labor market issues and the level of optimal reserves in Algeria. Staff visit 2012 Article IV consultation Technical assistance missions on: MCM: banking supervision on-site expert	October 13-25, 2011 Ongoing April 2012 October 2012 December 2010-December 2011	January 2011 January 2011 January 2013 January 2012
B. Requests for Work Program Inputs			
Fund request to Bank	Developments on the subsidy reform Sectoral analysis	As needed As needed	
Bank request to Fund	Assessment of macroeconomic stance and prospects Data sharing	Semiannual (and on ad hoc basis if requested) At least 1 operation predicted Ongoing	Following Article IV and staff visits
C. Agreement on Joint Products and Missions			
Joint products in next 12 months	Continuous close coordination on the reform agenda	Ongoing	

ALGERIA: STATISTICAL ISSUES APPENDIX

I. Assessment of Data Adequacy for Surveillance	
General: Data provision has some shortcomings, but is broadly adequate for surveillance. Government finance statistics, national accounts, and prices have several shortcomings that hamper analysis.	
National Accounts: Key shortcomings in national accounts include an outdated base year for constant price GDP estimates, long lags for publication of data, and incomplete application of the *1993 System of National Accounts*. STA has recommended giving priority to compiling GDP at constant prices (including quarterly accounts) and to rebasing the GDP series. In the second semester of 2011 authorities have started to prepare quarterly accounts. **Price Statistics:** Data are published with a delay of about three months.	
Government finance statistics: Key shortcomings include insufficient institutional coverage (coverage is limited to Budgetary Central Government, albeit in a wide sense, including the general budget, the annexed budget, and the special treasury accounts), classification problems, long lags for production of statistics, and lack of reconciliation of financing with the monetary accounts. Key factors behind these weaknesses include the lack of financial resources allocated to the compilation of statistics, insufficient interagency coordination, and concerns about accuracy that give rise to reluctance to publish provisional data.	
Monetary statistics: The authorities need to ensure the data consistency with the methodology in the Monetary and Financial Statistics Manual, 2000. Timely reporting of balance sheet data by some state-owned commercial banks remains problematic, and most commercial banks do not report all data needed to compile the monetary survey. Prudential data reported by state-owned banks are unreliable and not timely.	
Balance of payments: Although balance of payments statistics are generally of good quality, they could benefit from a survey for direct investment data.	
II. Data Standards and Quality	
Algeria began participation in the General Data Dissemination System (GDDS) on April 21, 2009.	No data ROSC is available.

ALGERIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
As of December 7, 2009

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	09/11	10/25/11	D	M	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	08/11	10/25/11	D	M	M
Reserve/Base Money	08/11	10/25/11	M	M	M
Broad Money	08/11	10/25/11	M	M	M
Central Bank Balance Sheet	08/11	10/25/11	M	M	A
Consolidated Balance Sheet of the Banking System	08/11	10/25/11	M	M	A
Interest Rates[2]	09/11	10/25/11	M	M	M
Consumer Price Index	09/11	10/25/11	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	...	...	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[4]	08/11	10/25/11	Q	I	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	09/11	10/25/11	Q	I	A
External Current Account Balance	06/11	10/25/11	Q	Q	A
Exports and Imports of Goods and Services	09/11	10/25/11	Q	Q	A
GDP/GNP	2010	10/25/11	A	A	A
Gross External Debt	09/11	10/25/11	A	A	A
International Investment Position[6]	...	...	PA	PA	PA

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents. Data are partial, because of shortcomings in the compilation of FDI.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA), Partially available (PA).

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IMF Executive Board Concludes 2011 Article IV Consultation with Algeria

On January 11, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Algeria on a lapse of time basis.[1]

Background

Despite an uncertain international economic environment, the Algerian economy has been doing relatively well. Real nonhydrocarbon GDP growth in 2010 reached 6 percent and total GDP growth was 3 percent. Overall inflation fell to 3.9 percent in 2010 due to a fall in fresh food prices, while nonfood inflation remained low. Unemployment continued to decline slightly to 10 percent at end-2010, but youth and female unemployment remain high. The generally prudent macroeconomic management during 2000–10 has enabled large external reserves to be accumulated and sizable budgetary savings to be built up in the oil stabilization fund, while substantially reducing debt levels.

In 2011, growth is estimated to have remained solid and higher oil prices are strengthening Algeria's external balance and boosting fiscal revenues. The ripple effects of the Public Investment Program (PIP) are expected to maintain nonhydrocarbon growth at about 5 percent, and to bring overall GDP growth to about 2.5 percent. Higher international prices

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This year's Article IV consultation was concluded on a lapse of time basis. Under the IMF's lapse of time procedures, the Executive Board completes Article IV consultations without convening formal discussions.

for food and substantial civil service pay rises have so far not led to significantly higher inflation, because of increased subsidies for basic food products, a higher level of household savings, greater demand for imports, and a vigilant monetary policy. Overall, inflation is expected to have stayed at about 4 percent in 2011. With higher oil prices, the current account surplus will increase to 9.5 percent of GDP in 2011 and hydrocarbon fiscal revenues rise by 30 percent. Official reserves have grown by US$16 billion since end-2010, reaching US$178 billion at end-August 2011 (three years of imports). The budget will remain in deficit at around 4 percent of GDP as a 32 percent increase in total expenditure, in particular higher public salaries and transfers, will more than offset higher fiscal revenues.

The outlook remains favorable in the short term, but fiscal sustainability and financial stability over the medium term have become more dependent on volatile oil prices. Growth will continue to be supported in the short term by public investment and the national hydrocarbon company's investment program. Nonhydrocarbon GDP could grow by 5 percent in 2012, but hydrocarbon output would continue to decline because of weak global demand, constraining overall growth to about 3–3½ percent. Inflation would remain at about 4 percent if fresh food prices remain subdued and inflationary pressures from increased wages are contained. Over the medium term, the relatively high projected oil prices would sustain a positive external balance and large fiscal revenues, but the budget balance will remain in deficit.

Nevertheless, the expansionary fiscal stance of recent years has made the fiscal position vulnerable to oil price swings as the break-even price that balances the budget now slightly exceeds US$100/barrel. Important downside risks will arise in the event of a worsening in the international economic environment and a prolonged decline in oil prices. The external and fiscal positions would be seriously weakened, likely forcing scaling down public investment and leading to slower growth and higher unemployment. Also, much smaller resources in the oil stabilization fund would be left over for future generations.

Important challenges persist, including the need for diversification of the economy, improving the business climate, reducing unemployment, as well as curtailing medium-term vulnerabilities. With public investment expected to play a less dynamic role in the economy, the private sector will need to become a stronger engine for growth and employment creation. To achieve this objective, in 2011 the authorities launched a series of consultations with social partners to improve the business environment, which is central to improving long-term growth prospects.

Executive Board Assessment

Executive Directors welcomed Algeria's overall good economic performance in recent years amid a difficult international economic environment. Nevertheless, they noted that significant challenges persist, and encouraged the authorities to renew their efforts to preserve macroeconomic stability, restore fiscal prudence, and diversify the economy with a stronger private sector. Further reducing unemployment, especially among the young, and enhancing economic opportunities for all remain pressing needs. More decisive structural reforms are vital to achieving these goals.

Directors stressed that while high oil prices provide scope for addressing pressing social demands and maintaining social stability, this should be managed carefully to avoid inflationary pressures and preserve medium-term fiscal sustainability. They noted that the significant growth in current expenditure in 2011 has made the fiscal position vulnerable to the risk of prolonged lower oil prices. Directors encouraged the authorities to adopt fiscal consolidation measures, which could include limits on wage increases and new hires, and a better targeting of transfers and subsidies. The continuation of greater mobilization of nonhydrocarbon fiscal resources and tax administration reforms should also help reduce the budget's dependency on hydrocarbon revenues.

Directors emphasized the importance of ensuring good quality and efficiency of public expenditure. As the budget is the main lever in using and redistributing hydrocarbon wealth, they encouraged the authorities to build on recent progress in controlling the quality of public investment and to advance more forcefully in key areas of budgetary reform.

Directors commended the Bank of Algeria for containing inflationary pressures and effectively absorbing greater systemic liquidity from higher hydrocarbon revenues and large public spending. The significant growth in liquidity has not translated into higher inflation, but the risk of inflation has increased. In addition to the moderation of current spending, Directors noted that the authorities should consider tightening monetary policy early to prevent inflationary pressures from materializing. Directors considered that the exchange rate regime has served Algeria well. They welcomed the authorities' commitment to maintaining the real exchange rate close to equilibrium, but emphasized the need to strengthen exchange rate fundamentals, including the fiscal position and productivity gains.

Directors stressed that, to make a significant dent in unemployment, a more ambitious structural reform agenda should be implemented. While welcoming the authorities' efforts to support SMEs financing and improve the business environment, in consultation with social partners, they emphasized that stronger measures will be necessary for diversification of the economy, improving competitiveness, and boosting growth and employment. Directors also considered that the advances in financial sector reform should continue in order to address key constraints that limit financial intermediation and access to financing for the private sector. Moreover, they noted that increases in labor costs well above productivity gains, and constraints to private investment, such as the limitations to FDI adopted in 2009, hamper competitiveness and growth prospects. Directors encouraged the authorities to ensure a better synergy between macroeconomic policies and the structural reform agenda. They also encouraged the authorities to continue to seek better integration of Algeria into the regional and global economy.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Algeria: Selected Macroeconomic Indicators, 2007–12
(Quota: SDR 1,254.7 million)
(Population: 35.6 million; 2009)
(Per capita GDP: US$ 4,435; 2010)
(Poverty rate: 12.1; 2000)

	2007	2008	2009	2010	2011 Proj.	2012 Proj.
Oil and gas sector						
Total exports of oil and gas products (in billions of U.S. dollars)	59.6	77.2	44.4	56.1	70.9	66.2
Average crude oil export price (in U.S. dollar/barrel)	74.7	99.0	61.8	79.0	103.2	100.0
Crude oil production (in millions of barrels/day)	1.4	1.3	1.3	1.2	1.2	1.2
Output and prices						
Real GDP	3.0	2.4	2.4	3.3	2.5	3.1
Nonhydrocarbon real GDP	6.3	6.1	9.3	5.9	4.9	5.3
Consumer prices (end of period)	4.8	4.9	5.8	4.5	4.5	4.1
Consumer prices (period average)	3.6	4.9	5.7	3.9	3.9	4.3
	(In percent of GDP)					
Investment and Saving						
Gross capital formation	34.4	37.4	46.7	41.4	40.2	41.4
Of which: Nongovernment	18.9	19.6	27.5	26.4	26.2	28.2
Gross national savings	57.2	57.5	47.0	48.9	49.7	46.8
Of which: Nongovernment	37.3	32.1	34.2	35.8	39.7	39.5
	(In percent of GDP)					
Public finances						
Revenue	39.6	46.8	36.6	36.4	39.5	36.8
Hydrocarbon	30.1	36.9	24.0	24.1	27.4	24.8
Expenditure and net lending	35.2	39.2	43.0	38.2	43.4	42.8
Current	18.0	20.0	22.5	22.4	29.4	29.5
Capital	15.5	17.8	19.2	15.0	14.0	13.3
Budget balance	4.4	7.6	-6.4	-1.9	-4.0	-6.0
Nonhydrocarbon primary balance (in percent of nonhydrocarbon GDP)	-44.1	-52.2	-43.6	-39.3	-49.0	-46.4
Total government debt	12.5	8.2	10.4	11.1	10.0	9.4
	(Annual percentage change, unless otherwise indicated)					
Monetary sector						
Credit to the economy 1/	17.2	20.4	18.5	5.1	9.8	10.3
Broad money	24.1	16.1	3.1	13.8	21.7	10.9
Velocity of broad money (level)	1.6	1.6	1.4	1.5	1.4	1.3
Three-month treasury bill rate (end of period, in percent)	0.2	0.2	0.3	0.3	...	...
	(In percent of GDP, unless otherwise indicated)					
External sector						
Hydrocarbon exports of goods (in US$, percentage change)	11.2	29.5	-42.5	26.4	26.3	-6.6
Hydrocarbon exports of goods (in percent of total exports of goods)	98.4	98.2	98.3	98.3	98.6	98.4
Imports of goods (in US$, percentage change)	27.4	44.2	-1.6	4.0	16.0	2.9
Merchandise trade balance	25.5	23.6	5.6	11.3	14.2	10.7
Current account including official transfers	22.8	20.1	0.3	7.5	9.5	5.4
Foreign direct investment	22.8	20.1	0.3	7.5	9.5	5.4
Total external debt	1.0	1.4	1.8	1.2	0.9	0.9
Gross reserves (in billions of U.S. dollars)	4.2	3.3	3.9	3.6	2.6	2.5
In months of next year's imports of goods and services	110.2	143.1	148.9	162.2	181.5	193.4
Memorandum Items:						
Nominal GDP (in billions of U.S. dollars)	134.3	171.7	138.0	160.8	189.3	194.6
Unemployment rate (in percent)	13.8	11.3	10.2	10.0	...	...
Local currency per U.S. dollar (period average)	69.3	64.6	72.6	74.4	...	...
Real effective exchange rate (2005 = 100)	99.0	102.1	102.2	102.7	...	...

Sources: Algerian authorities; and Fund staff estimates and projections.
1/ Credit to the private sector and public enterprises.