

**Algeria: 2018 Article IV Consultation—Press Release; Staff Report; and Statement by the Executive Director for Algeria**



# ALGERIA

June 2018

## 2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ALGERIA

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 2018 Article IV consultation with Algeria, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 30, 2018 consideration of the staff report that concluded the Article IV consultation with Algeria.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 30, 2018, following discussions that ended on March 12, 2018, 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 May 15, 2018
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Algeria.

The document listed below has been or will be separately released.

### Selected Issues

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## **IMF Executive Board Concludes 2018 Article IV Consultation with Algeria**

On May 30, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation<sup>1</sup> with Algeria.

Algeria continues to face important challenges posed by the fall in oil prices four years ago. Despite a sizeable fiscal consolidation in 2017, the fiscal and current account deficits remain large. Real GDP growth slowed sharply, mainly driven by a contraction in hydrocarbon production, although growth in the nonhydrocarbon sector was stable. Unemployment increased to 11.7 percent in September 2017 from 10.5 in September 2016 and remains particularly high among the youth (28.3 percent) and women (20.7 percent). Average inflation declined from 6.4 percent in 2016 to 5.6 percent due to slowing inflation for manufactured goods and services, and stood at 3.4 percent year-on-year in April 2018. Reserves, while still ample, fell by US\$17 billion to US\$96 billion (excluding SDRs). External debt remains negligible, while domestic public debt has increased significantly since 2016 but remains moderate.

### **Executive Board Assessment<sup>2</sup>**

Executive Directors noted that Algeria has faced significant challenges related to lower oil prices since 2014 and slower economic activity. While welcoming the authorities' efforts to manage the adjustment process, Directors encouraged sustained fiscal consolidation and wide-ranging structural reforms to facilitate a more diversified growth model and support private sector development.

Directors noted that the authorities' policy mix includes increased fiscal spending in 2018 followed by a resumption of fiscal consolidation over the medium term, monetary financing of

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<sup>1</sup> 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.

<sup>2</sup> 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. An explanation of any qualifiers used in summing up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

fiscal deficits, and temporary restrictions on imports as well as structural reforms aimed at diversifying the economy. While a few Directors were sympathetic to the authorities' approach, most Directors considered that it may bring short-term respite for the economy, but may entail significant risks to the economic outlook. These Directors emphasized that it will likely exacerbate fiscal and external imbalances, raise inflation, accelerate the loss of international reserves, heighten financial stability risks and, eventually, lower growth.

Directors recommended an approach that would likely achieve better outcomes while being more sustainable. They generally agreed that a gradual fiscal consolidation starting in 2018 could be achieved without central bank financing, relying on a broader range of financing options, including external borrowing to finance well-chosen investment projects. A gradual exchange rate depreciation, combined with efforts to eliminate the parallel foreign exchange market would support the adjustment efforts.

Directors concurred that monetary policy should be independent and aimed at containing inflation. In this regard, they encouraged the authorities to stand ready to tighten the monetary stance if inflationary pressures arise. While discouraging monetary financing of the deficit, Directors underlined the need to put in place safeguards, including time and quantity limits, to contain its negative impact should such financing continue. In this context, they welcomed the central bank's commitment to sterilizing liquidity resulting from monetary financing as needed.

Directors supported the efforts to raise more nonhydrocarbon revenue, improve public spending efficiency and management, and expand the subsidy reform while protecting the poor. They welcomed the authorities' intention to advance reforms to foster private sector development by improving the business environment, enhancing access to finance, and strengthening governance, transparency, and competition. Directors also saw merit in taking steps to reduce skills mismatches, improve the functioning of the labor market, foster greater labor market participation of women, and further open the economy to trade and foreign direct investment.

Directors noted that the banking sector continues to perform relatively well. They highlighted that, given macroeconomic risks and financial linkages in the public sector, the macroprudential framework should be strengthened, including through more frequent stress tests, and development of a crisis management framework.

### Algeria: Selected Macroeconomic Indicators, 2016–19

Population: 40.4 million; 2016

Per capita GDP: US\$ 4,102 (2017)

Quota: SDR 1,959.9 million

Gini coefficient: 0.28 (2015)

Key export markets: EU

Main exports: oil and gas

	2016	2017 Prel.	2018	2019
<b>Output</b>				
Real GDP growth (percent)	3.3	1.6	3.0	2.7
Nonhydrocarbon GDP growth (percent)	2.3	2.6	3.4	2.9
<b>Employment</b>				
Unemployment (percent, end of period)	10.5	12.3	...	...
<b>Prices</b>				
Inflation (percent, average)	6.4	5.6	7.4	7.6
<b>Central government finances (percent of GDP)</b>				
Total revenue	28.8	32.7	30.6	28.2
<i>Of which, hydrocarbon</i>	9.7	12.5	12.4	11.2
Total expenditure	42.3	41.5	39.5	33.0
Overall budget balance (deficit-)	-13.5	-8.8	-9.0	-4.8
Gross government debt	20.6	27.0	34.8	39.9
<b>Money and credit</b>				
Broad money (percent change)	0.8	8.3	11.4	5.0
Credit to the economy (percent change)	9.0	11.8	12.7	7.7
<b>Balance of payments</b>				
Current account balance (percent of GDP)	-16.6	-12.9	-9.7	-10.1
FDI (percent of GDP)	1.0	0.7	0.8	0.8
Gross reserves (months of imports) 1/	22.6	19.1	16.2	13.5
External debt (percent GDP)	2.4	2.4	2.1	1.9
<b>Exchange rate</b>				
REER average (percent change)	-1.7	0.6	...	...

Sources: Algerian authorities; and IMF staff estimates.

1/ In months of next year's imports of goods and services.



# ALGERIA

## STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

May 15, 2018

### KEY ISSUES

**Context.** To adjust to lower oil prices since 2014, Algeria initially relied solely on exchange rate policy before putting most of the burden on fiscal consolidation. In parallel, the government initiated several structural reforms and started designing a long-term plan to reshape the country's growth model, while the central bank was modernizing its monetary policy framework. However, confronted with slowing growth, increasing unemployment, and financing difficulties, the authorities recently chose to boost activity through increased spending in 2018, to be followed by a steep fiscal consolidation from 2019 onward. With fiscal savings depleted and reluctant to borrow externally, they turned to monetary financing. To reduce the trade deficit and foster import substitution, they hardened import barriers.

**Outlook and risks.** In the short term, the authorities' new strategy will likely improve growth but also exacerbate fiscal and external imbalances. In the medium term, it risks increasing inflation, accelerating the loss of international reserves, and lowering growth. Hence, the environment may become less conducive to reforms and private sector development. Importantly, the new policies are likely to reduce the economy's resilience to shocks, externally (e.g., lower oil prices) or domestically (e.g., from higher-than-planned fiscal spending or contingent liabilities).

**Policy recommendations.** Staff shares the authorities' dual objectives of economic stabilization and promotion of more inclusive growth. However, staff considers that there still is some space to pursue a less risky strategy that would achieve better outcomes. Fiscal consolidation should continue in 2018. It should be sustained in the medium term, but implemented at a gradual pace made possible by tapping a broad range of financing options excluding monetary financing. A gradual exchange rate depreciation combined with efforts to eliminate the parallel foreign exchange market would support the adjustment. The central bank should mop up enough of the liquidity already injected through monetary financing operations, and stand ready to tighten the monetary policy stance if inflationary pressures emerge. If the choice is to continue monetizing the deficit, robust safeguards to contain associated risks should include strict quantitative and time limits to monetary financing, and the pricing of such financing at market rates. Irrespective of the policy mix pursued, key structural reforms should be implemented in a timely manner to foster a more diversified, private-sector led economy, and the policy framework should be strengthened.

Approved By  
**Adnan Mazarei and  
 Kevin Fletcher**

The discussions took place in Algiers from February 27 to March 12. The staff team comprised Jean-François Dauphin (head), Gaëlle Pierre, and Moez Souissi (all MCD), and Joelle El Gemayel and Jad Khallouf (both MCM). Greg Auclair, Ramzy Al Amine, Ravaka Prevost, and Geraldine Cruz (all MCD) assisted in the preparation of this report.

The team met with the Governor of Bank of Algeria, Mohamed Loukal; Prime Minister Mr. Ouyahia, Finance Minister, Mr. Raouia; Training and Vocational Education Minister, Mr. Mebarki; Industry and Mines Minister, Mr. Yousfi; Trade Minister, Mr. Benmeradi; Public Works and Transports Minister, Mr. Zaâlâne; Labor, Employment, and Social Security Minister, Mr. Zemali. The mission also held discussions with other senior government and central bank officials as well as with representatives of the economic and financial sectors and trade union. Mr. Badsî (OED) participated in most of the meetings.

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## INTRODUCTION

1. **Since 2014, lower oil prices have hit hard an economy overly dependent on hydrocarbons.** Algeria's growth model, based on the redistribution of oil and gas wealth by a large public sector, was already in need of change before the fall in oil prices as proven oil and gas reserves (excluding shale) are expected to last only one or two generations. The fall in oil prices added urgency to diversifying the economy while reducing the financial means to support its transformation.
2. **Algeria took action to adjust to lower oil prices.** Until 2016, the authorities responded mostly through exchange rate depreciation, drawing on their savings to maintain spending. In 2016, with buffers declining rapidly, they embarked on a steep fiscal consolidation within, for the first time, a medium-term budget framework (MTBF) but stopped the exchange rate depreciation, which they resumed at a significantly lower pace in mid-2017. Also, they have been working on a long-term plan to reshape the growth model, and have taken measures to improve the business climate, reform energy subsidies, and modernize their monetary policy framework.
3. **The authorities recently changed their economic strategy.** Facing economic slowdown, increased unemployment, and increasing financing difficulties, the authorities adopted an expansionary budget for 2018 aimed to clear arrears and support public investment. Reluctant to borrow externally or let the exchange rate depreciate at a faster pace, they decided to monetize their financing needs and harden import barriers.
4. **The consultation focused on how best to restore macroeconomic balances and foster sustainable and inclusive growth.** The discussion centered on the risks associated with the new strategy, alternative policies to stabilize the economy in a less costly and less risky way, and reforms to promote a more diversified, private-sector led economy.

## RECENT MACRO-FINANCIAL DEVELOPMENTS

5. **Some fiscal adjustment was achieved in 2017, but much smaller than planned.** The nonhydrocarbon deficit is estimated to have declined by less than 2 percent of nonhydrocarbon GDP on a cash basis to 26.4 percent of nonhydrocarbon GDP. Overall spending was cut by about 1.3 percent in nominal terms, less than the 5.8 percent initially budgeted. The decrease in capital expenditures (3 percent in nominal terms) offset a nominal increase in current expenditures (3.8 percent). Although sizeable dividends from BA (4.9 percent of GDP) helped reduce the overall deficit from 13.5 percent of GDP to 8.8 percent of GDP, the government faced financing difficulties following the depletion of savings in the oil stabilization fund (FRR) early in the year and incurred domestic payment arrears. Since November, it has resorted to central bank borrowing to finance the deficit (equivalent to 3 percent of GDP for 2017). BA financing was also used to buy back public enterprise debt and finance the National Investment Fund (FNI), for an equivalent of 8.6 percent of GDP. With the depletion of fiscal savings and the materialization of fiscal risks (including support to

public enterprises), central government debt has increased significantly since 2016, but remains relatively low at 27 percent of GDP at end-2017 and is expected to remain sustainable (Annex IV).

**6. Real GDP growth slowed sharply.** Lower OPEC quotas and weak external demand for gas from Europe led to a contraction in hydrocarbon production (-3 percent). Meanwhile, fiscal consolidation continued to weigh on nonhydrocarbon growth (2.6 percent), although it accelerated later in the year (notably in construction and services) as the fiscal constraint was relaxed. In total, growth slowed to 1.6 percent from 3.3 percent in 2016. Unemployment, which had risen from 10.5 percent in September 2016 to 12.3 percent in April 2017, receded somewhat to 11.7 percent in September. It remains particularly high among the youth (28.3 percent) and women (20.7 percent). Average inflation declined from 6.4 percent in 2016 to 5.6 percent, as inflation for manufactured goods and services slowed, but remained above BA's target of 4 percent.<sup>1</sup>

**7. The current account deficit remained high** (Annex V). It narrowed slightly owing to higher oil prices and a minor dip in capital goods imports, but nonetheless remained wide at an estimated 12.9 percent of GDP. The external position in 2017 was substantially weaker than the level warranted by medium-term economic fundamentals and desirable policies, which signals that the real effective exchange rate (REER) remains significantly overvalued, notwithstanding an 8-percent depreciation in 2017. The depreciation of the REER mainly reflected movements of the dollar against the currencies of Algeria's major trading partners. The parallel exchange market rate premium stands at about 50 percent.

**8. External buffers are diminishing rapidly but remain ample.** International reserves fell by US\$17 billion to US\$96 billion (half their 2013 peak), but remain comfortable at 19 months of imports and above 400 percent of the adjusted IMF metric for assessing reserve adequacy (ARA metric).<sup>2</sup> Total external debt remains negligible at 2.4 percent of GDP.

**9. Broad money growth accelerated.** The growth rate of 8.3 percent reflected a rapid growth in net credit to central government, which more than offset the continued decline in net foreign assets. Growth in credit to the economy, particularly to the private sector, was robust at 12.8 percent, owing to large liquidity injections in the banking system stemming from government's drawdown of the FRR early in the year, BA's refinancing operations, and lower reserve requirements (from 8 to 4 percent). Monetary financing operations late in the year seem to have contributed little to the growth of credit in 2017. Tighter liquidity conditions caused interest rates in the interbank market to increase until monetary financing started.

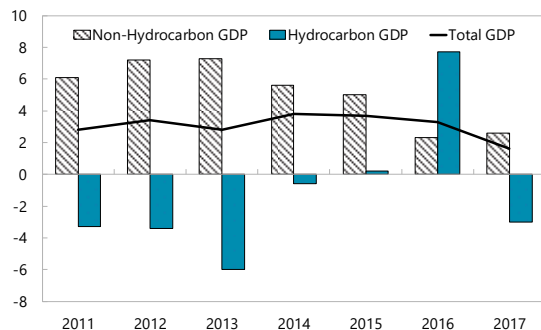
<sup>1</sup> Since February 2018, non-food inflation has started rising. The 12-month moving average inflation slowed to 4.6 percent due to a significant drop in food inflation.

<sup>2</sup> See "Assessing Reserve Adequacy—Specific Proposal," April 2015 (SM/14/334).

**Figure 1. Algeria: Selected Macroeconomic Indicators**

Growth slowed in 2017 due to a significant contraction in hydrocarbon production.

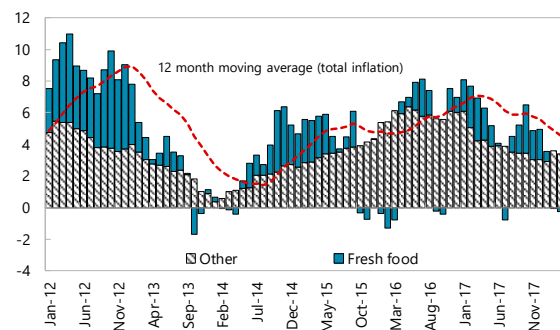
### Hydrocarbon and Non-Hydrocarbon GDP Growth (Percent)



Sources: Algerian authorities; and IMF staff calculations.

Non-food items inflation receded in 2017, but food prices remained very volatile.

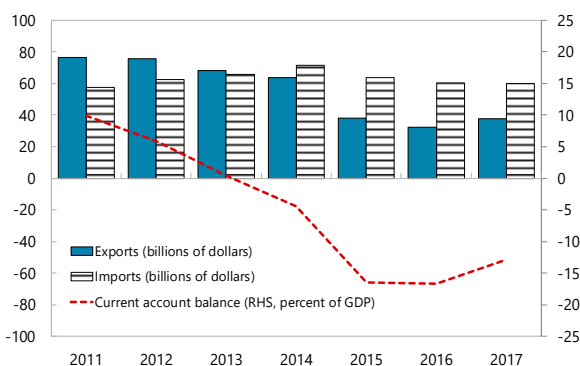
### CPI Inflation (Contribution to year-on-year growth rate)



Sources: Algerian authorities; and IMF staff calculations.

The current account deficit decreased but remained large.

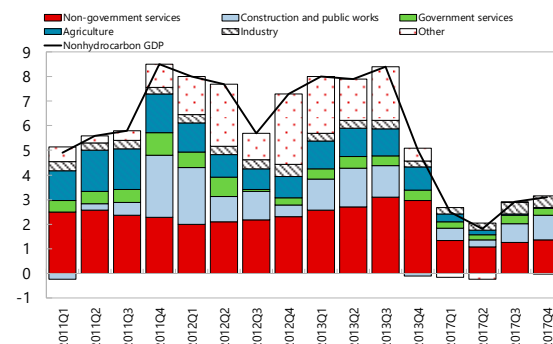
### Current Account Balance



Sources: Algerian authorities; and IMF staff calculations.

Nonhydrocarbon growth improved in the last two quarters, especially in construction and manufacturing.

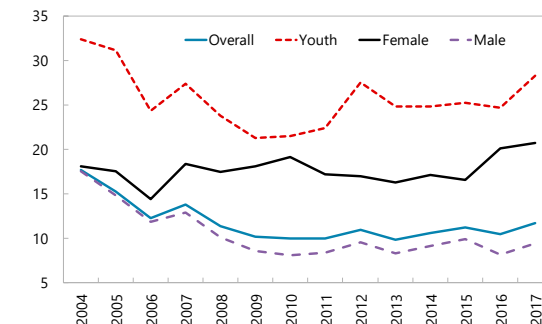
### Contribution to Non-Hydrocarbon Growth (Year-on-year, percent)



Sources: Algerian authorities; and IMF staff calculations.

The unemployment rate increased between 2016 and 2017, especially for young people.

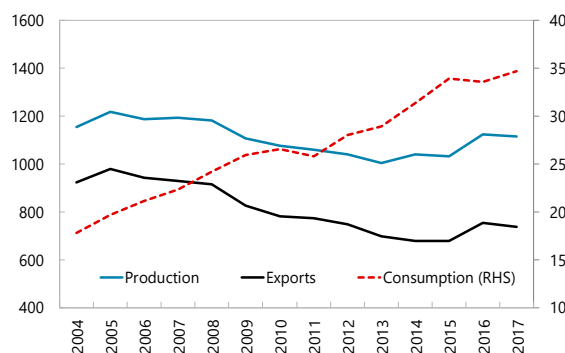
### Unemployment (Percent)



Source: Algerian authorities.

Hydrocarbon exports decreased due to a drop-in production.

### Hydrocarbon Production, Consumption, and Exports (Millions of barrels)



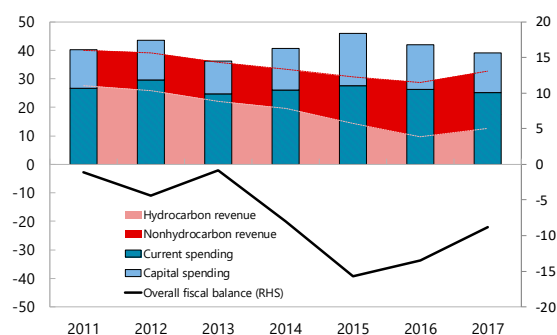
Sources: Algerian authorities; and IMF staff calculations.

**Figure 2. Algeria: Fiscal Indicators**

The budget deficit was significantly reduced in percent of GDP, due to lower spending and higher revenue...

**Overall Fiscal Balance**

(Percent of GDP, 2011–17)

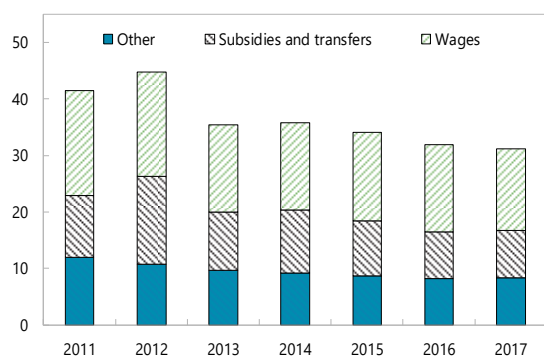


Sources: Algerian authorities; and IMF staff calculations.

Current spending as percent of nonhydrocarbon GDP continued to decline.

**Current Spending**

(Percent of nonhydrocarbon GDP)

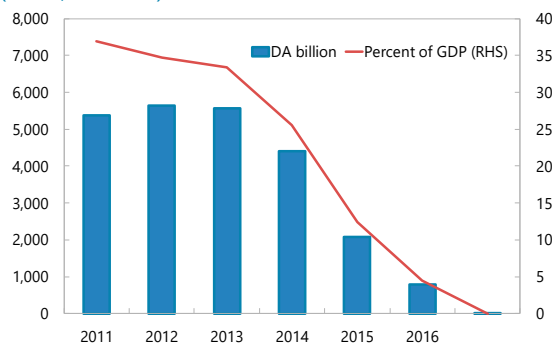


Sources: Algerian authorities; and IMF staff calculations.

Deficits were financed largely by drawing on savings in the oil fund, which was depleted in 2017.

**Oil Stabilization Fund**

(Stock, 2011–17)

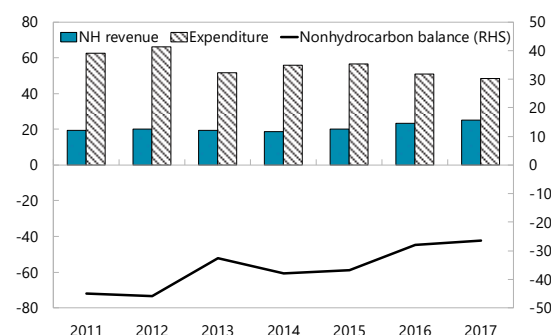


Sources: Algerian authorities; and IMF staff calculations.

...But the decline in nonhydrocarbon deficit was more moderate.

**Nonhydrocarbon Fiscal Balance**

(Percent of NHGDP)

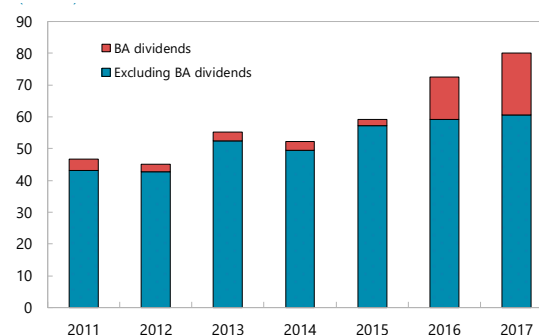


Sources: Algerian authorities; and IMF staff calculations.

Increase in nonhydrocarbon revenues was mostly driven by BA dividends.

**Share of Nonhydrocarbon Revenue to Current Spending**

(Percent)

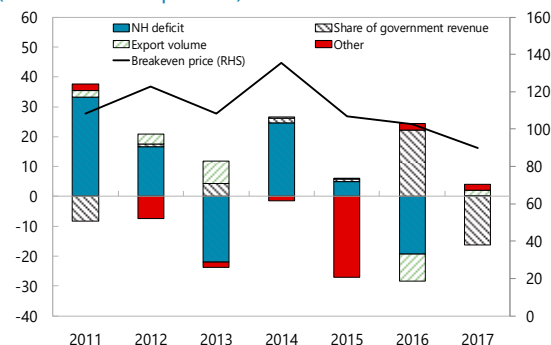


Sources: Algerian authorities; and IMF staff calculations.

The breakeven oil price continued to decline in 2017, but remained above market prices.

**Change in the Fiscal Breakeven Price**

(Contribution in percent)



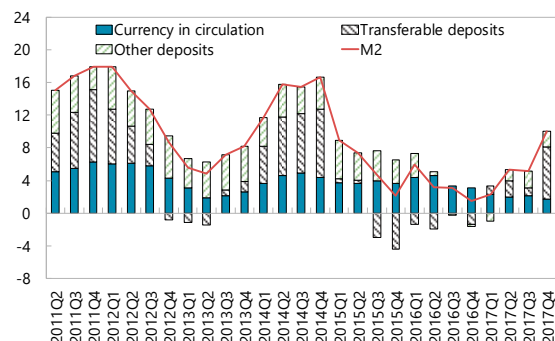
Sources: Algerian authorities; and IMF staff calculations.

**Figure 3. Algeria: Monetary Indicators**

Broad money growth started accelerating in 2017: Q2, partly driven by a higher growth in deposits...

### M2 Growth and Determinants

(Percent)

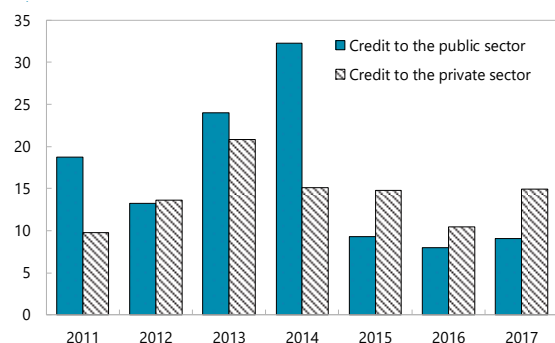


Sources: Algerian authorities; and IMF staff calculations.

Credit growth to the economy accelerated in 2017.

### Credit Growth

(Percent)

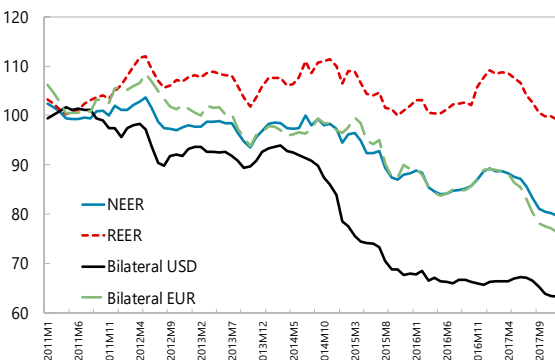


Sources: Algerian authorities; and IMF staff calculations.

Both the NEER and REER depreciated in 2017.

### Exchange Rate Developments

(Index, 2010=100)

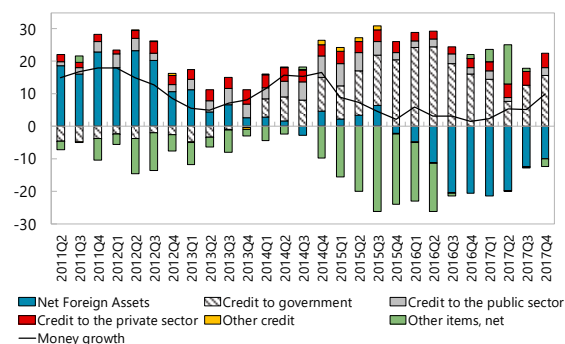


Sources: Algerian authorities; and IMF staff calculations.

...it reflected a slower decline in net foreign assets and a rapid growth in credit to the government.

### Contributions to M2 Growth

(Percent)

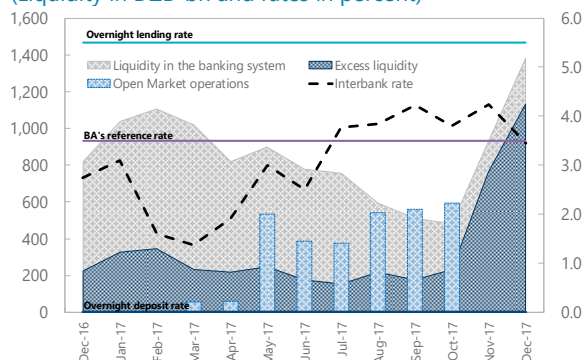


Sources: Algerian authorities; and IMF staff calculations.

Liquidity conditions tightened, causing interest rates to increase, until central bank financing started in Q4.

### Liquidity and interest rates

(Liquidity in DZD bn and rates in percent)

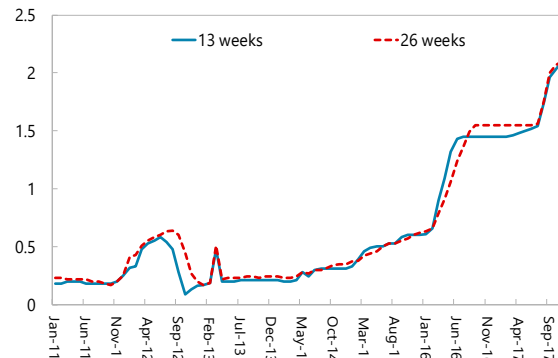


Sources: Algerian authorities; and IMF staff calculations.

Government bond yields rose sharply before the introduction of central bank financing.

### Treasury Note Yields

(Percent)



Source: Algerian authorities.

**10. Overall, the banking system remained adequately capitalized and profitable, but bank liquidity continued to decline until monetary financing started.** Preliminary data at end-December 2017 suggest that the banking sector remained adequately capitalized, with an overall solvency ratio of 19.6 percent. The ratio of solvency to Tier 1 capital declined slightly from 16.3 percent at end-2016 to 15.2 percent owing to the growth of credit to the economy. Banks remained profitable with an overall return on assets of 2 percent. Gross nonperforming loans increased slightly from 11.9 percent to 12.3 percent of total loans at end-2017, partly reflecting the ripple effect of the government's arrears to its suppliers. Banking sector liquidity declined, but remained sufficient to cover about half of the banks' short-term liabilities (Table 5).

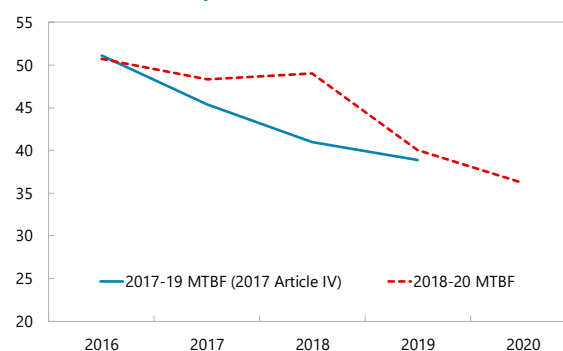
## POLICY DISCUSSIONS<sup>3</sup>

### A. Risks from the New Economic Strategy

**11. The authorities' new strategy aims to preserve growth and employment.** Faced with rising unemployment, concerned with repaying domestic arrears, and reluctant to borrow externally or let the exchange rate depreciate further, the authorities saw their policy options limited to two possibilities: continuing with an abrupt fiscal consolidation in 2018, which would further dampen activity, or creating fiscal space for higher spending through monetary financing. Confident that the risks from monetary financing could be contained, they chose the latter. Their new strategy entails:

- Increased fiscal spending in 2018.* The budget includes a significant increase in spending, which will result in a deficit more than 6 percent of GDP higher than originally planned under the 2017–19 MTBF. Capital expenditures would increase by 21.2 percent in nominal terms from 2017, including to repay arrears, and current expenditures by 6.9 percent, including a significant transfer to the National Social Insurance Fund.<sup>4</sup> The wage bill is kept virtually flat in nominal terms. The government intends to resume consolidation in 2019, with sharp cuts in spending, and to restore fiscal balance by 2022.

**Total Expenditure**  
(Percent of nonhydrocarbon GDP)



Sources: Algerian authorities; and IMF staff calculations.

- Central bank financing.* The banking law was changed in October 2017 to allow for five years BA to finance directly, among others, the budget deficit, public-sector debt buy-back and the FNI. Monetary financing occurs through BA buying ad hoc issuances of sovereign securities with long

<sup>3</sup> See Annex I. Authorities' Response to Past IMF Recommendations.

<sup>4</sup> *Caisse Nationale d'Assurance Sociale* (CNAS). The transfer, equivalent to 2.5 percent of GDP, aims to repay part of the debt of the public pension fund, which had financed its recent deficits by borrowing from CNAS.

maturities, and at a 0.5 percent interest rate. Staff estimates that by end-2018 monetary financing may amount to the equivalent of about 23 percent of 2017 GDP. To mop up part of the liquidity injected through monetary financing, BA raised the reserve requirement ratio from 4 percent to 8 percent in January 2018 and resumed its absorption operations by taking seven-day bank deposits. It is also considering a moderate increase in the policy rate.

- *Tighter import barriers.* To slow the loss of international reserves and promote import-substitution, Algeria replaced its import license system with a temporary ban on the import of about 850 categories of goods.<sup>5</sup> It also extended the list of goods subject to a 30 percent excise tax and significantly increased customs duties (up to 60 percent) for other products.
- *Structural reforms.* The 2018 budget advanced the energy subsidy reform by raising fuel and electricity taxes. The government is working with the World Bank to deepen the reform and better target its support to vulnerable households, with the view to start implementation in 2019. It also adopted an ambitious structural reform plan that aims at simplifying business regulations, improving governance and transparency, reforming the pension system, and modernizing the financial sector. This builds on previous efforts to improve the business climate among other measures, such as opening the sea and air freight industry to the private sector. The authorities are working to strengthen public financial management (PFM), modernize monetary policy instruments, and foster the development of a forward exchange market. A recent decree mandates BA to periodically assess the implementation of the government's reform program and report on its evaluation to the President.

**12. The new strategy entails serious risks.** In an environment where external risks remain tilted to the downside (Box 1), the new strategy may further exacerbate macroeconomic imbalances and, possibly, social tensions, as it risks to:

- *Complicate macroeconomic management.* If interest rates remain low and insensitive to changes in debt level, the amount of monetary financing will be less bound by budget constraints than market financing would be. This risks further weakening fiscal discipline, which would require additional monetary financing. Repeated government demands for liquidity injections would undermine BA's capacity to control monetary conditions and achieve price stability, and weaken its balance sheet. This, and its newly assigned role on monitoring structural reforms, would further challenge its de facto independence.
- *Increase inflationary pressures.* If not adequately sterilized, the increased liquidity would raise perceived or actual nominal wealth and stimulate demand, causing prices to rise in the short term due to insufficient domestic supply or saving opportunities. At the same time, hardened import barriers may fuel inflationary pressure by decreasing supply (or possibly creating product shortages). Wage and price expectations could rapidly adjust and become self-reinforcing.

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<sup>5</sup> The ban covers mainly food and household goods, but also some industrial machines and construction materials. Automobile imports remain subject to licensing.



The government may then need to further resort to monetary financing in the subsequent years, which would risk plunging the economy into an inflationary spiral.

- *Put further pressures on foreign reserves.* With largely inflexible domestic supply, at least in the short run, liquidity injections will fuel import demand. The extent to which this demand is met will depend on the effectiveness of the new trade barriers, but pressures that cannot leak through the balance of payments (resulting in greater reserve loss) will further fuel inflation instead. As foreign reserves decline, pressure on the exchange rate will increase. Expectations of a significant exchange rate depreciation would intensify the demand for foreign exchange (FX) on the parallel market, which would further incentivize rent-seeking behaviors.<sup>6</sup> If sustained, these pressures may eventually force a disorderly exchange rate adjustment.
- *Lower growth.* Fiscal expansion will initially give a boost to activity. However, this will likely be short-lived not only because of the planned subsequent fiscal consolidation, but also because, given significant impediments to private sector development, liquidity injections would primarily support consumption rather than investment. Rising inflation may gradually reduce economic efficiency and discourage investment.
- *Increase financial stability risks in the medium term.* In the short term, better liquidity conditions, the repayment of the government's domestic arrears and higher growth will improve banks' soundness indicators, but risks in the banking system could increase subsequently. Abundant bank liquidity may fuel credit growth and loosen lending standards. Credit risk may then increase if economic growth slows, especially if sterilization efforts and inflationary pressures increase interest rates.

**13. In staff's baseline scenario, based on the authorities' planned policies, the economy moves along a narrow path with weak growth and high inflation.** Quantifying the implications of the new strategy is difficult because of the unknown effectiveness of some measures (e.g., how much will trade restrictions shave off imports?) and uncertainties about how fast and how widely inflationary expectations may adjust. The scenario is based on the 2018–20 MTBF fiscal path. It assumes a moderate nominal exchange rate depreciation and some progress on reforms. Growth accelerates in 2018 and then slows as fiscal consolidation resumes. The fall in reserves is somewhat curtailed initially by higher oil prices than in 2017 and by import restrictions. Inflation, however, accelerates.

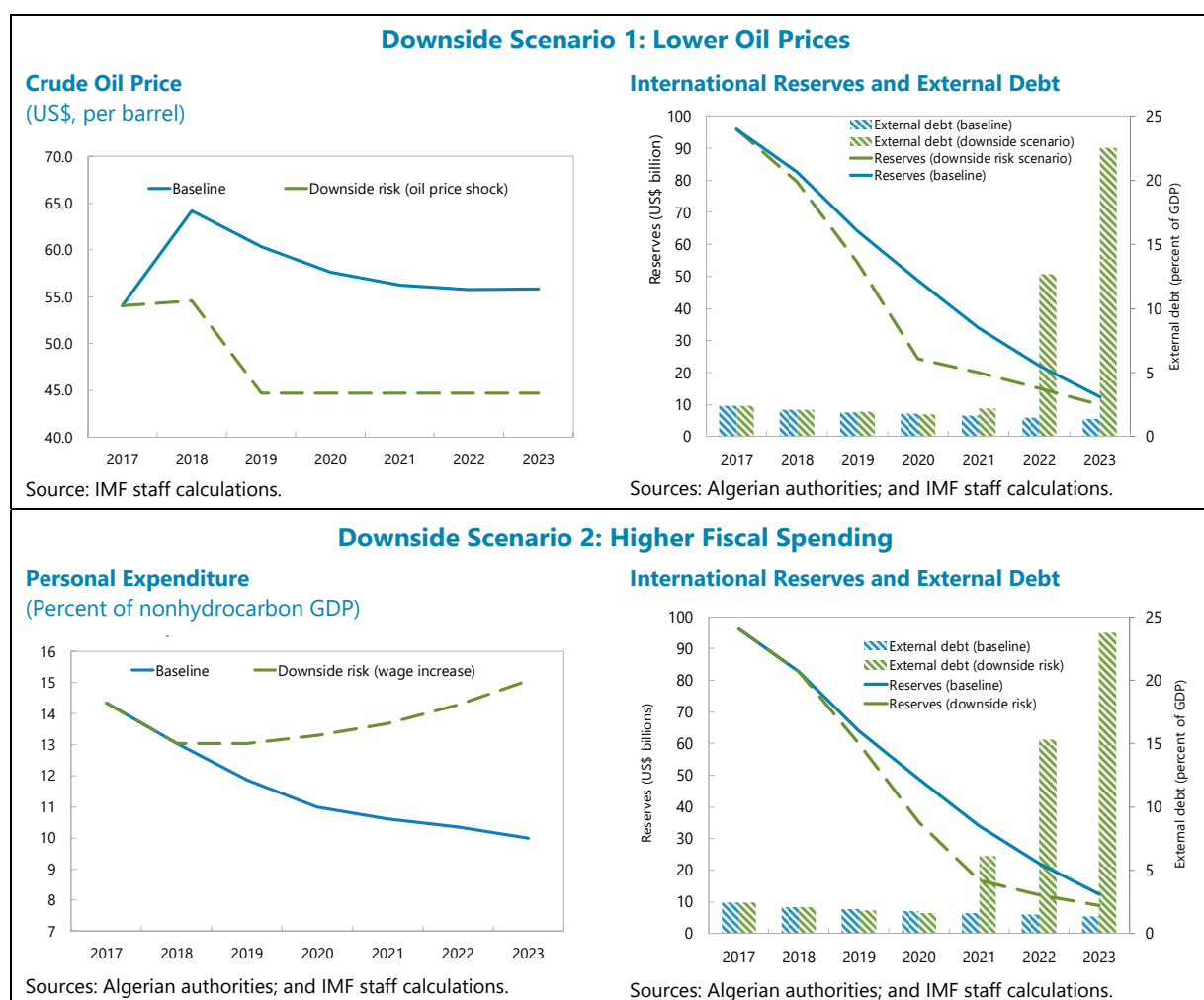
**14. This narrow path is subject to major adverse risks.** Although the potential exploitation of shale gas and shale oil would improve the medium-term outlook, serious downward risks could instead quickly materialize. In particular, if oil prices are lower than projected (possibly because of a weakening OPEC/Russia cartel cohesion and/or a recovery of oil production in the African continent) or if the very ambitious fiscal consolidation intended for 2019 onward does not happen as planned, the imbalances could quickly become unsustainable, as current policies weaken, rather than

<sup>6</sup> For instance, over-invoicing imports to access forex on the official market for resale on the parallel market. See Box 4.



strengthen, the economy's resilience. Indeed, the return to fiscal consolidation could be undermined by the availability of monetary financing, weaknesses in PFM, and difficulties in keeping to the planned reduction in public wages in percent of GDP due to rising inflation. Furthermore, fiscal risks remain significant, including the financial difficulties of the public pension fund (*Caisse Nationale de Retraites*, CNR).<sup>7</sup> More broadly, macro-financial linkages between public entities and the central government could exacerbate their impact (Box 2).

**15. To illustrate vulnerabilities, staff prepared two downside scenarios** (Annex III). The first scenario assumes oil prices fall to US\$45 per barrel starting in 2019.<sup>8</sup> The second scenario illustrates what could be the impact of higher fiscal spending triggered by a wage-price inflationary dynamic. It assumes that wages adjust for inflation and that, absent a significant parametric reform of CNR, additional government transfers are needed to clear outstanding debt of CNR to CNAS and cover future annual losses.



<sup>7</sup> See "[Fiscal Risks in Algeria](#)", IMF Country Report No. 17/142.

<sup>8</sup> The shock is calibrated to be plausible given recent history and serves to its channels of transmission.

Box 1. Risk Assessment Matrix<sup>1,2</sup>

Source of Risks	Relative Likelihood	Expected Impact	Transmission channels	Policy Response
<b>Lower energy prices</b> , driven by weakening OPEC/Russia cartel cohesion and/or recovery of oil production in the African continent.	Low	High	Lower oil and gas prices would exacerbate current macroeconomic imbalances as the economy remains heavily dependent on hydrocarbons. Furthermore, under the authorities' intended policies, Algeria's external buffers would not be sufficient to mitigate the negative effects of a further decline in hydrocarbon prices.	The authorities should sustain gradual fiscal consolidation starting 2018, supported by further exchange rate depreciation, and implement wide-ranging structural reforms to help diversify the economy.
<b>Weaker-than-expected global growth</b> . Structurally weak growth in key advanced economies.	High	High	A weaker-than-expected global growth would primarily affect Algeria negatively to the extent it would lower oil prices. Slower growth in Europe could also negatively affect the demand for Algeria's gas. Weaker demand for nonhydrocarbon exports would have little impact, as nonhydrocarbon exports represent a small fraction of total exports.	See above.
<b>Tighter global financial conditions</b> . An abrupt change in global risk appetite could lead to sudden, sharp increases in interest rates and associated tightening of financial conditions.	High	Low / High	In the short term, financial market spillovers would be limited given Algeria's very limited global financial integration. Nonetheless, tighter global financial conditions would complicate Algeria's access to international debt markets if it eventually chooses to do so.	See above.
<b>Policy and geopolitical uncertainties</b> . Intensification of the risks of fragmentation/ security dislocation in part of the Middle East, Africa, and Europe, leading to socio-economic disruptions.	High	Medium/ High	Increased risks of insecurity in the Middle East could lead to higher oil prices, which would indirectly benefit Algeria's economy. However, regional instability would increase pressure on the government to maintain high levels of spending (in particular, security and social spending and wages), and to delay reforms.	Reforms should be designed and sequenced to distribute the burden of adjustment equitably. Anti-corruption efforts should be strengthened. The authorities need to mount an effective communication campaign to raise awareness about the need for sustained fiscal consolidation, the benefits of reforms, and the cost of inaction.
<b>Idiosyncratic risks</b> . In the context of looming presidential elections in 2019, heightened macroeconomic instability risking to increased resistance to reforms and possible social tensions.	High	High	Heightened uncertainty combined with unsound macroeconomic policies increases the risk of macroeconomic and social instability, which could hamper structural reforms, and ultimately lead to a disorderly economic adjustment.	See above.

<sup>1</sup> The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

<sup>2</sup> Based on the January 2018 G-RAM.

### Box 2. Macro-Financial Linkages from Within the Public Sector

The public sector dominates the economy with numerous and often large state-owned enterprises (SOEs) and public banks. Financial ties between SOEs, other public-sector entities (PSEs), and public banks are multiple and constitute channels of systemic interaction, often intermediated by the central government.<sup>1</sup> For example, the central government reimburses SOEs for the cost of subsidized prices it imposes on them (e.g., for energy products) and public banks for the interest rate subsidies they are mandated to provide. Separately, the government occasionally assumes their debt and may support their capacity to increase capital by refraining from claiming dividends.

Macro-financial linkages within the public sector may exacerbate the impact of fiscal or liquidity risks that may originate in any part of public sector. For instance, troubles in a particular SOE can transmit, directly or through other entities, to public banks and/or the government. In particular, claims on some large SOEs are risk nodes for some public banks. This concentration risk is somewhat mitigated by the fact that public banks remain well-capitalized and profitable and most claims are guaranteed by the government.

The possible persistence of large budget deficits could result in recurring liquidity pressures in the financial sector as was the case in 2016 and 2017 when the decline in oil revenue resulted in arrears to enterprises and banks, which eroded their cash buffers and had repercussions throughout the economy. If higher government financing needs continue to be met by borrowing from BA, fiscal risks may ultimately translate into macro-instability by draining reserves and pushing inflation up, as discussed in paragraph 12.

Systemic supervision should therefore be upgraded to monitor structural imbalances and risk transmission channels, while the government should build the capacity to monitor closely fiscal risks, including the debt of the consolidated public sector and stand-alone imbalances in large SOEs or PSEs.

<sup>1</sup> For an in-depth analysis of interaction within the public sector and associated fiscal risk, see "[Fiscal Risks in Algeria](#)", IMF Country Report No. 17/142.

### Authorities' Views

**16. The authorities recognize that their policy mix entails risks, but are confident that the use of monetary financing can be limited and the associated risks managed.** With the difficult adjustment that followed the early-1990s external debt crisis in mind, they believe their financing strategy is less risky than borrowing externally. They consider that the central bank will be able to sterilize enough of the liquidity injected through monetary financing, and hence both credit growth and inflation are unlikely to accelerate. They are committed to their consolidation plan starting 2019 and therefore trust that external and fiscal imbalances will be restored in a timely manner, which will also limit the use of monetary financing. They view the decree requiring the central bank to assess progress with the government's plans as a tool to strengthen their commitment.

### B. Alternative Policy Mix

**17. It remains possible to smooth the unavoidable adjustment to lower oil prices without recourse to monetary financing.** Thanks to its remaining ample buffers, Algeria still has a window to adopt a policy mix that would minimize the impact of adjustment on growth, while facilitating private sector development. In addition to structural reforms, the policy mix should consist of:

- *Starting in 2018, sustained but gradual fiscal consolidation using available fiscal space.* With a relatively low public debt and negligible external debt, Algeria still has some space for a gradual consolidation. Fiscal consolidation should be resumed in 2018 and sustained in the medium term, following the efforts undertaken in 2016–17. It remains possible to reduce the fiscal deficit this year while clearing domestic arrears and making the planned one-off transfer to the public pension fund. Fiscal consolidation should be conducted through a broad-based approach including: raising more nonhydrocarbon revenues by widening the tax base (reducing exemptions and strengthening tax collection—which is also a matter of fairness), gradually reducing current expenditure as a share of GDP, and reducing investment costs while increasing its efficiency.
- *Tapping a broad range of financing options, but excluding direct borrowing from BA.* Domestic issuance of sovereign debt securities at market rates is necessary to finance the deficit and promote the development of the bond market. More frequent use of public-private partnerships (PPPs) and the sale of government assets offer additional financing options if carefully and transparently carried out. Relaxing the 51–49 partnership rule governing foreign direct investment (FDI) could facilitate privatizations. External borrowing would help shore up foreign reserves and minimize crowding out. Issuance of domestic or international sovereign sukuk is another option.
- *Gradual exchange rate depreciation.* This would help address external imbalances, support private sector development, and increase hydrocarbon revenues thereby creating additional fiscal space.
- *Independent monetary policy aimed at containing inflationary pressures.* Even if fiscal adjustment resumed in 2018, BA should continue to sterilize liquidity created so far by monetary financing of the fiscal deficit. It should stand ready to tighten monetary policy (including by increasing its policy rate) should inflationary pressures emerge.

**18. This policy-mix would likely lead to better economic outcome in the medium term.**

Staff's alternative scenario (Annex II) illustrates the impact of its recommended policy mix. It assumes a steady reduction of the nonhydrocarbon deficit starting in 2018, calibrated such that the public debt stabilizes in the medium term at a level sufficiently low to absorb plausible fiscal risks that may materialize. Compared with the baseline scenario, inflation reverts to a level close to BA's central target, the current account deficit is reduced by the end of the period (and is not dependent on distortionary import barriers), and the decline in international reserves slows. Nonhydrocarbon growth is slower in 2018 but gradually increases above the level of the baseline scenario because fiscal consolidation is less abrupt and more ambitious structural reforms gradually start yielding results.<sup>9</sup>

<sup>9</sup> The impact of structural reforms remains modest over the projection period as international experience show that the payoff typically takes time to materialize.

**19. Some underlying measures could be adapted to the authorities' strategic policy preferences.** Foreign borrowing may become more acceptable to the authorities if it is used to finance well-chosen investment projects. It is also possible to progressively increase the participation of foreign investors in public-private partnerships (PPP). The more rigid the limits, the greater the trade-offs between costly adjustment and risky policies.

**20. If the deficit continues to be monetized, safeguards should be put in place to contain associated risks.** These include strict quantitative limits (for example, capping monetary financing at a reasonable proportion of the average annual nonhydrocarbon tax revenue in the previous three years, excluding BA dividends), time limits (shorter than the five years provided in the law), and financing at market rates. It will be important to sterilize adequate quantities of injected money, and monetary conditions should be tightened to dampen inflationary pressure. Staff emphasized that these safeguards, which are currently lacking, would not substitute for sound macroeconomic policies and may reduce, but not eliminate, the risks.

### ***Authorities' Views***

**21. The authorities appreciate the benefits of a gradual fiscal adjustment, but remain reluctant to make space for it by borrowing externally or allowing greater exchange rate depreciation.** They showed openness to consider external borrowing to finance carefully chosen investment projects with strong expected impact on growth. They do not plan to relax the 51-49 rule at this stage as they believe it does not significantly discourage foreign investment. They concur with staff that fiscal consolidation should rely on reducing tax exemptions, strengthening collection, and increasing the efficiency of spending. They consider that the recent decree on monetary financing provides a strong safeguard to limit the associated risks.

## **C. Reforms for Sustainable and Inclusive Growth**

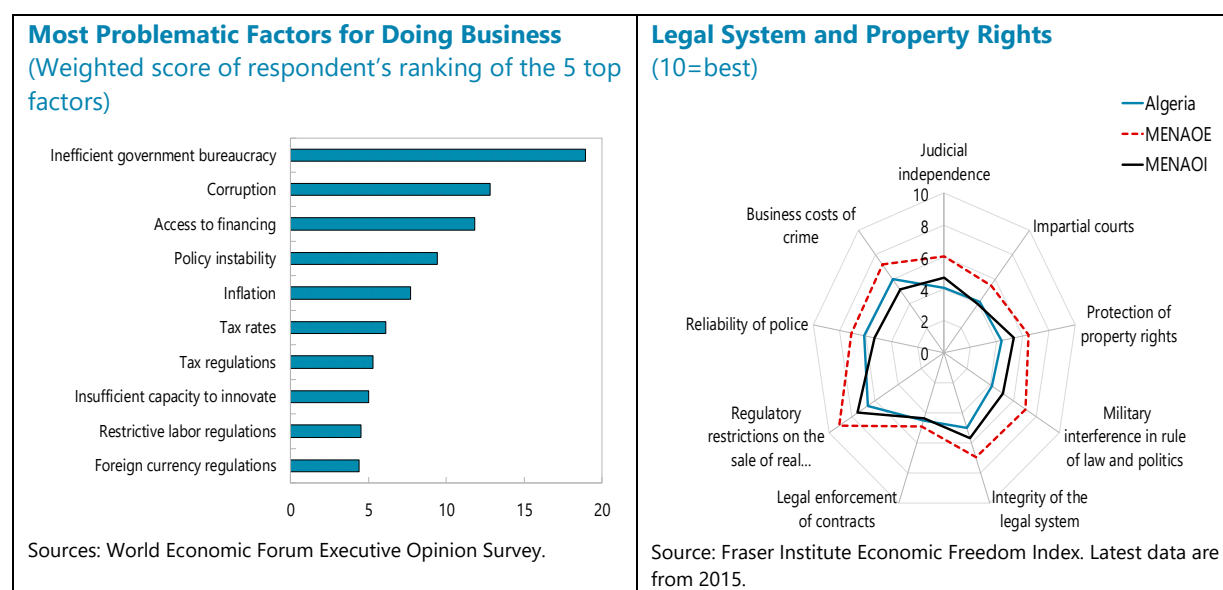
**22. Key structural reforms, carefully sequenced and timely implemented, are needed to reshape the country's growth model.**<sup>10</sup> Irrespective of the policy mix adopted by the authorities, deep reforms are needed to diversify the economy and foster private sector development. Because impediments to private investment are manifold, action will be needed on several fronts.<sup>11</sup> Not all reforms can be implemented at the same time; they thus need to be carefully sequenced taking account of the interactions between different reforms. It will be crucial to start implementing measures as early as possible, within a clearly established timetable, because reforms generally take

<sup>10</sup> For an in-depth analysis of constraints to private sector development, and considerations for planning and sequencing the reform agenda, see "Structural Reforms: Strategies and Possible Payoffs", IMF Country Report No. 17/142.

<sup>11</sup> Algeria performed below the emerging market average in the 2017 Fraser Economic Freedom Index for the effectiveness of its judicial systems, the 2018 doing business report, and the WEF 2017 Global Competitiveness report for the intensity of local competition. See 2017 Selected Issue Paper on "Structural Reforms: Strategies and Possible Payoffs" for an in-depth analysis of constraints to private sector development and considerations for planning and sequencing the reform agenda.

time to bear fruit, while remaining buffers to cushion the adjustment are eroding rapidly. Reforms should be designed to ensure a fair distribution of the burden of adjustment and to reduce inequalities. Priorities include:

- *Strengthening governance and transparency, and reducing red tape.* International surveys show that red tape and corruption are among the top obstacles to private sector activity, while some institutional and legal structures lack capacity, especially those that protect contractual and ownership rights. Recent indicators also suggest that there is a lack of transparency.<sup>12</sup> For example, Algeria is among the countries that disclose the least fiscal information to the public.<sup>13</sup> Addressing these issues would facilitate reforms, enforce regulations in a more equitable manner, and build trust between the public and institutions. To that end, current efforts to develop information systems in administrations are welcome and should help improve transparency and facilitate administrative procedures.



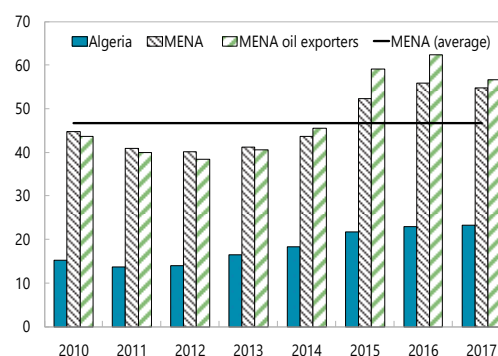
- *Improving access to finance.* In addition to limited access to bank credit and a nascent capital market, alternative sources of financing, such as venture capital, are far less accessible in Algeria than elsewhere in the region. Efforts are needed to diversify the sources of financing, in particular by developing financial instruments that cater to the needs of SMEs and mobilizing

<sup>12</sup> These indicators have not been produced by Algeria's statistical office. Caution is needed when comparing survey-based structural indicators across countries. Although these indicators are updated yearly and survey methodologies are revised frequently, they are partly constrained by the data that can realistically be collected and are based on perceptions.

<sup>13</sup> Algeria had an Open Budget Index (OBI) score of 3 out of 100 in 2017. A country's OBI score shows the extent to which the country makes the eight key budget documents available to the public on its website in a timely manner and the extent to which the budget information available to the public is comprehensive. Algeria publishes the budget after it is approved every year. However, it does not publish timely high-frequency (e.g., monthly) data on budget execution. Algeria could also consider preparing "citizens' budget" that present a simplified version of the budget.

private saving. In this context, the government's intention to modernize the banking sector, which is dominated by the public sector, is welcome.<sup>14</sup> To promote entrepreneurship and risk-taking, it will also be important to uphold creditor rights, simplify bankruptcy procedures, and improve procedures for resolving nonperforming loans. In addition, gradually phasing out interest rate subsidies would increase the attractiveness of capital markets, curtail budget expenditure, and promote better selection of investment projects.

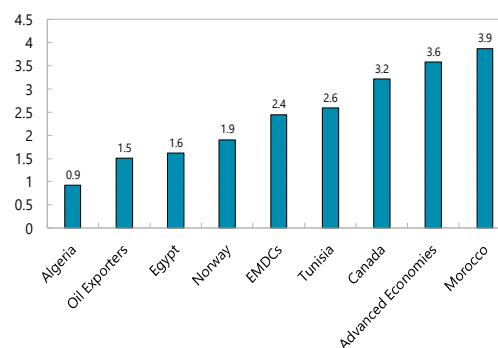
### Credit to the Private Sector (Percent of GDP)



Sources: Country authorities; and IMF staff calculations.

- Opening the economy to more foreign investment and trade.* The recent hardening of import barriers creates distortions, will contribute to higher prices, and will likely drive more activities underground. Instead, it would be preferable to promote exports and develop domestic production by improving the competitiveness of enterprises, in particular through simplified product market regulations and expanded powers for the competition authorities. Moreover, there is scope for Algeria to attract more FDI. Relaxing the 51-49 rule could help increase production capacity, improve domestic competition, and help technology transfers.

### Inward FDI, 2012–16 Average (Percent of GDP)



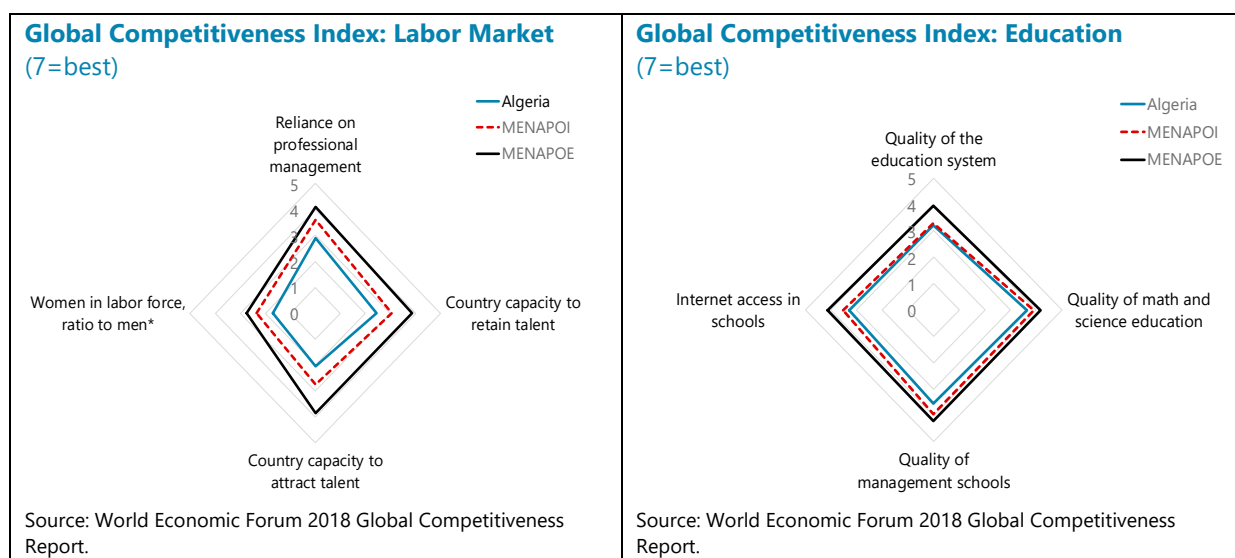
Sources: WEO; IMF staff calculations.

- Improving the functioning of the labor market and reducing skills mismatch.*<sup>15</sup> The revision of the labor code, which is being discussed as part of a broad-based social dialogue, is an opportunity to ensure that workers' mobility is facilitated through less costly hiring and firing regulations, while ensuring their adequate protection, for instance through an unemployment insurance system with expanded coverage. These improvements will reduce incentives for informal employment, and there is also a need to develop better social protection for informal workers. Progress has been made in improving the attractiveness of vocational training streams, in particular by better tailoring the curricula to private sector needs. The academic education streams should provide students with the skills needed to adapt to the jobs of tomorrow and succeed in the private sector, including managerial and "soft" skills.

<sup>14</sup> At end-2017, public banks held 87 percent of total loans to the economy (74.5 percent of loans to the private sector and 99.8 percent of loans to the public sector).

<sup>15</sup> See the previous two Article IV consultations and above-referenced Selected Issue Paper for specific measures in each area.





- *Promoting greater inclusion of women in the labor market* (Annex VII). While women in Algeria are well educated, their participation in the labor market is very low. Fostering it could significantly increase potential growth over time. Regulations give equal rights to women and certain benefits, such as maternity leave, but other impediments need to be removed. For example, increasing flexibility in work schedules and location, improving public transportation, and increasing childcare capacity would help.

## 23. Strengthening the policy framework is also needed to increase policy effectiveness.

Priorities include:<sup>16</sup>

- *Strengthening the PFM system.* The 2018 budget expansion, at odds with the 2017–19 MTBF, undermined the usefulness of the MTBF as a fiscal planning instrument. It is therefore necessary to continue efforts to strengthen the credibility and efficiency of the MTBF. The forthcoming introduction of a medium-term expenditure framework is welcome. Strengthening the capacity to monitor budget execution in real time and control spending commitments will be critical to prevent the reoccurrence of payment arrears. Fiscal risks should also be monitored closely. The planned adoption of a new organic budget law, which should be based on best international practices, will provide a legal basis for multiyear budgeting. The authorities' efforts to improve capacity to produce government finance statistics following international standards and in a timely manner is welcome.
- *Improving the efficiency of public spending.* Improving public wage bill management and investment efficiency would help increase the quality and reach of public service delivery, improve the return on investment in human capital and infrastructure, and foster private sector development. It would also free fiscal space. To that end, the long-term evolution of the wage

<sup>16</sup> The IMF's Fiscal Affairs Department and Monetary and Capital Markets Department are providing technical assistance in many of these areas.



bill should be better controlled, including by better linking wage increases to productivity. Investment projects' selection, budgeting, implementation, and ex post evaluation also need to be improved.<sup>17</sup>

- *Enhancing liquidity management.* BA's toolbox for managing bank liquidity includes reserve requirements and open market operations. BA currently mops up liquidity by taking seven-day bank deposits and it injects liquidity by refinancing banks who provide sovereign securities as a collateral. Both mechanisms occur through competitive auctions. To enhance liquidity sterilization, BA could sell debt securities instead of taking deposits, which would also allow interbank repo transactions. If the issuance of T-bills continues to be limited in Algeria, BA could consider issuing its own negotiable certificates of deposit (CDN). These CDNs would be issued on short maturities (seven days and one month) and would usefully extend the short-term leg of the yield curve.
- *Curbing the parallel foreign exchange market* (Box 3). Efforts to diversify the supply of FX on the interbank market and streamline rules governing FX transactions should be pursued. In this context, BA's recent initiative to clarify the requirements for surrendering nonhydrocarbon export revenue in FX was welcome. BA could consider a wider bid-ask spread on the official exchange rate to increase the volume of transactions. This could be accompanied by the relaxation of the indicative ceilings on allowances for medical expenses, study, and travel abroad.
- *Continuing efforts to strengthen the prudential framework.* The rollout of the Basel II prudential framework, risk-based supervision and tighter public bank governance rules has improved the banking sector's resilience. Bank supervisors are monitoring banks closely and running stress tests to assess their resilience, which has been deemed adequate barring a major adverse exogenous shock. Nonetheless, given existing risks, more frequent stress tests are needed. If ample liquidity boosts credit expansion, the authorities could introduce a countercyclical capital buffer to moderate risk-taking and consider macroprudential measures (such as loan-to-value limits). In any case, they should develop a systemic-risk analysis and containment framework.
- *Improving crisis preparedness.* The authorities need to develop crisis management processes and a bank resolution framework that clearly define the roles and responsibilities of the various parties involved.

### **Authorities' Views**

**24.** *The authorities agree with the need to advance structural reforms, which is a crucial element of their adjustment strategy. The recent decree on monetary financing refers, among others, to reforms to: modernize and strengthen PFM; raise more nonhydrocarbon revenue; increase spending efficiency through better wage management, rationalization of subsidies, and improved investment projects selection; combat over-pricing of imports; modernize the banking sector; promote e-administration*

<sup>17</sup> See companion Selected Issue Paper on "Improving Public Spending Efficiency to Foster More Inclusive Growth."

*and the use of information technologies; improve the functioning of the labor market and unemployment schemes; facilitate nonhydrocarbon exports; and improve the business climate (for which they set up a task force with World Bank assistance). However, they remain convinced of the usefulness of temporary hardened import barriers to preserve reserves and foster import substitution. They appreciate the IMF technical assistance they receive in a number of areas to strengthen their policy framework.*

### Box 3. The Parallel Exchange Market

The interbank spot exchange market is asymmetrical as the central bank is *de facto* the main supplier. This is because the bulk of FX supply is generated by hydrocarbon exports that must be sold exclusively to BA. Other exports provide a minor supply of FX, half of which may be retained by exporters. Over the years, an illegal parallel exchange market has emerged, which seems to have become larger and more sophisticated. The parallel market premium is currently reportedly about 50 percent of the official exchange rate.

The supply of FX on the parallel market is likely mostly sourced by (i) the repatriation of pensions of former Algerian expatriates; (ii) remittances from current Algerian expatriates; (iii) overbilling of imports; and (iv) tourism revenue that is not captured by the banking sector. The demand likely stems from: (i) FX transactions for the purchase of imports that are restricted or for other purchases where the bona fide nature of the transaction cannot be established; (ii) capital flight to invest abroad or evade tax, and/or as a store of value; and (iii) speculation based on the expected fluctuations of the official and parallel exchange rates.

The existence of the parallel market complicates macroeconomic management by fueling inflationary expectations, distorting price formation, and weakening the channels of monetary policy transmission. The recourse to monetary financing, which risks exacerbating inflationary pressures, may increase the demand on the parallel market, raise exchange rate premiums, and incentivize behaviors that are themselves inflationary (for example, the overbilling of imports).

Gradually adjusting the official exchange rate, increasing indicative ceilings for travel allowances, and relaxing import restrictions could reduce the size of the parallel market, but not eliminate it. Unification of the two markets will only be possible through the gradual liberalization of capital transactions, which can only be envisaged in when macroeconomic conditions are more favorable.

## STAFF APPRAISAL

**25. Algeria continues to face important challenges dealing with the legacy of lower oil prices.** Despite some fiscal consolidation in 2017, the fiscal and current account deficits remained large. Savings in the FRR were depleted, financing conditions became more difficult, and domestic payment arrears occurred. Some fiscal risks materialized in the form of support to public enterprises and the national pension scheme. The external position remained substantially weaker than warranted by medium-term fundamentals and desirable policies, and reserves, while still ample, continued to decline. Overall economic activity slowed. Unemployment increased and remains particularly high among the youth and women. Inflation receded but remained above BA's target.

**26. The authorities have shifted their adjustment strategy.** Faced with payment arrears, higher unemployment and slowing growth, they resorted to fiscal expansion in 2018. They intend to resume fiscal consolidation starting 2019 to reach budget balance by 2022. Reluctant to borrow

externally or to allow a greater exchange rate depreciation, they allowed BA to lend directly to the treasury. They also hardened import barriers, including by replacing import licenses with a temporary ban on the imports of many goods and higher tariffs.

**27. This approach may allow some short-term gains in growth, but it is risky.** In the short term, it will improve growth but will exacerbate fiscal and external imbalances. In the medium term, it risks increasing inflation, accelerating the loss of international reserves, and lowering growth. Furthermore, the new policies will reduce the economy's resilience to shocks, externally (e.g., lower oil prices) and domestically (e.g., from higher-than-planned fiscal spending or contingent liabilities).

**28. There still is a window to pursue a less risky strategy that would likely achieve better outcomes in the medium term.** Relatively low public debt and little external debt provide space for a sustained, but gradual fiscal consolidation without recourse to monetary financing. This would require tapping a broad range of financing options, including domestic debt issuance at market rates, public-private partnerships, sale of assets and, external borrowing (e.g., to finance well-chosen investment projects). A gradual exchange rate depreciation combined with efforts to eliminate the parallel foreign exchange market would support the adjustment. The central bank should be allowed to carry out monetary policy independently and stand ready to tighten the monetary policy stance pending an assessment of whether fiscal consolidation sufficiently dampens inflationary pressures.

**29. Robust safeguards to contain associated risks should be put in place, were monetary financing to continue.** These include strict quantitative and time limits to central bank borrowing, and the pricing of such financing at market rates. Money creation should be adequately sterilized. The BA should increase the reserve requirement. It could continue to take bank deposits through auctions, but it may be more effective, in the absence of a deep sovereign bond market, to issue tradable BA deposit certificates, which banks could use to exchange short-term liquidity among themselves. Those safeguards may reduce but would not eliminate the risks and cannot substitute sounder macroeconomic policies.

**30. Timely progress on structural reforms is crucial.** To foster private sector development and reduce the dependence on oil and gas, action is needed to remove key constraints to private sector development. Priorities include reducing red tape, improving access to finance, strengthening governance, transparency and competition, further opening the economy to trade and foreign investment, improving the functioning of the labor markets, and fostering greater female labor force participation. To increase the effectiveness of economic policies, Algeria also needs to strengthen its economic policy framework, including to improve PFM and the efficiency of public spending.

**31. While bank regulation and supervision are satisfactory, the authorities should strengthen their prudential framework.** Complex macro-financial linkages in the public sector are a significant source of fiscal and macroeconomic risks and should be analyzed and monitored closely. Given macroeconomic risks, more frequent stress tests are needed and the authorities should develop a systemic-risk analysis and containment framework. The prudential framework could be strengthened with the introduction of a countercyclical capital buffer and macroprudential

measures such as loan-to-value limits. The authorities also need to develop crisis management processes and a clear bank resolution framework.

**32. Staff recommends that the next Article IV consultation be held on the standard 12-month cycle.**

Table 1. Algeria: Selected Economic and Financial Indicators 2014–23

				Prel.			Proj.			
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Output and prices</b>										
	(Annual percentage change)									
Real GDP	3.8	3.7	3.3	1.6	3.0	2.7	1.8	1.1	0.6	0.5
Hydrocarbon sector	-0.6	0.2	7.7	-3.0	1.3	2.0	2.1	2.4	2.4	2.4
Nonhydrocarbon sector	5.6	5.0	2.3	2.6	3.4	2.9	1.8	0.8	0.3	0.1
Per capita	1.6	1.5	1.3	-0.3	1.1	0.9	0.0	-0.6	-0.9	-1.1
Consumer price index (period average)	2.9	4.8	6.4	5.6	7.4	7.6	7.0	9.1	10.9	13.9
<b>Investment and savings</b>										
	(In percent of GDP)									
Savings-investment balance	-4.4	-16.5	-16.6	-12.9	-9.7	-10.1	-8.2	-6.9	-5.2	-4.3
National savings	43.1	36.3	37.2	37.4	42.0	36.6	33.2	30.8	29.8	29.1
Central government	6.5	2.5	2.1	5.1	6.0	7.3	7.6	7.5	7.8	7.8
Nongovernment 1/	36.6	33.8	35.1	32.3	36.0	29.3	25.6	23.3	22.0	21.3
Investment	47.5	52.8	53.9	50.3	51.7	46.8	41.5	37.7	35.0	33.5
Central government	14.5	18.2	15.6	13.9	15.0	12.2	10.6	9.2	7.8	7.8
Nongovernment 1/	33.0	34.6	38.3	36.4	36.7	34.6	30.9	28.5	27.2	25.7
Of which: Nongovernment nonhydrocarbon	28.6	28.8	33.9	30.3	31.6	28.6	25.9	24.8	24.9	23.5
<b>Central government finances</b>										
	(In percent of GDP)									
Overall budget balance	-8.0	-15.7	-13.5	-8.8	-9.0	-4.8	-3.0	-1.7	-0.1	0.0
Revenue	33.3	30.6	28.8	32.7	30.6	28.2	27.0	26.3	25.9	25.3
Expenditure (incl. net lending)	41.3	46.3	42.3	41.5	39.5	33.0	30.1	28.0	25.9	25.3
Gross government debt (excluding guarantees)	7.7	8.8	20.6	27.0	34.8	39.9	40.6	39.1	35.8	32.1
Central bank financing 2/	0.0	0.0	0.0	11.6	9.9	5.1	3.1	1.7	0.1	0.0
<b>Nonhydrocarbon primary balance</b>										
	(In percent of nonhydrocarbon GDP)									
Nonhydrocarbon primary balance	-37.6	-36.5	-27.7	-25.4	-26.4	-19.2	-15.5	-13.4	-11.0	-10.5
Nonhydrocarbon balance (excluding Bank of Algeria dividends)	-38.9	-37.5	-32.2	-32.4	-31.1	-22.2	-18.2	-15.3	-12.5	-11.3
Nonhydrocarbon balance	-37.9	-36.8	-28.0	-26.4	-26.9	-19.8	-16.3	-14.1	-11.7	-11.1
Revenue	45.6	37.6	34.8	40.4	38.6	34.7	32.8	31.7	31.0	30.1
Hydrocarbon	27.0	17.5	11.7	15.5	15.6	13.8	12.6	12.1	11.6	11.2
Nonhydrocarbon	18.7	20.1	23.1	24.9	23.0	20.9	20.2	19.6	19.4	18.9
Expenditure	55.7	56.4	50.7	48.3	49.1	40.1	36.2	33.5	31.0	30.0
Current expenditure	35.8	34.0	31.9	31.1	30.1	25.1	23.3	22.5	21.7	20.8
Capital expenditure	19.9	22.4	18.9	17.2	18.9	15.0	12.9	11.1	9.3	9.2
<b>External sector 3/</b>										
Current account balance (percent of GDP)	-4.4	-16.5	-16.6	-12.9	-9.7	-10.1	-8.2	-6.9	-5.2	-4.3
Exports, f.o.b. (percent change)	-6.8	-42.4	-15.9	18.5	14.8	-4.3	-3.0	-0.3	0.9	1.3
Hydrocarbons	-7.8	-43.3	-16.4	19.5	14.5	-4.6	-2.9	-0.3	1.3	2.3
Nonhydrocarbons	55.4	-9.1	-6.2	-1.9	20.0	1.9	-5.1	0.5	-8.0	-24.2
Imports, f.o.b. (percent change)	8.5	-11.8	-6.1	-1.4	0.4	1.0	-6.5	-4.6	-5.7	-2.3
Export volume (hydrocarbons, percent change)	-0.6	0.1	7.3	-2.1	-3.7	1.6	1.7	2.2	2.2	2.2
Import volume (percent change)	9.6	-7.7	-2.3	-2.8	-1.4	-0.5	-7.2	-5.7	-6.1	-2.4
Terms of trade (percent change, "-" = deterioration)	-6.3	-40.7	-18.9	20.4	16.8	-7.5	-5.2	-3.5	-1.2	0.1
Nonhydrocarbon exports (percent of total exports)	2.7	4.3	4.8	4.0	4.1	4.4	4.3	4.4	4.0	3.0
Gross official reserves										
In US\$ billions	177	143	113	96	83	64	49	34	22	12
In months of next year's imports of goods and services	33	28	23	19	16	13	11	8	5	3
Gross external debt (in percent of GDP)	1.7	1.8	2.4	2.4	2.1	1.9	1.8	1.6	1.5	1.4
<b>Oil and gas sector</b>										
Hydrocarbon production (in ton oil equivalent)	142	141	153	152	154	157	160	164	168	173
Hydrocarbon exports										
Of which: liquid petroleum exports (in millions of barrels/day)	1.2	1.2	1.2	1.2	1.1	1.1	1.2	1.2	1.2	1.2
natural gas exports (in billions of m3)	44.3	43.1	53.1	53.4	54.2	55.1	56.2	57.6	59.0	60.5
Crude oil exports (in millions of barrels/day)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Crude oil export unit value (US\$/bbl)	99.4	52.9	45.5	54.0	64.2	60.3	57.6	56.2	55.8	55.9
Share of hydrocarbons in total exports (in percent)	97.3	95.7	95.2	96.0	95.9	95.6	95.7	95.6	96.0	97.0
<b>Money and credit</b>										
	(Annual percentage change unless otherwise indicated)									
Net foreign assets	3.3	-2.4	-18.3	-11.1	-14.7	-21.5	-23.2	-27.3	-33.3	-42.7
Credit to the economy	26.0	11.3	9.0	11.8	12.7	7.7	6.6	9.8	9.3	8.8
Money and quasi-money	14.4	0.3	0.8	8.3	11.4	5.0	4.1	5.5	6.3	7.9
Velocity of broad money (GDP/M2)	1.3	1.2	1.3	1.3	1.3	1.3	1.3	1.4	1.4	1.5
<b>Memorandum items:</b>										
GDP (in billions of dinars at current prices)	17,229	16,702	17,407	18,907	21,277	22,807	24,232	26,316	28,826	32,133
NHGD (in billions of dinars at current prices)	12,571	13,568	14,381	15,298	16,865	18,517	19,985	21,859	24,071	27,010
GDP (in billions of US\$ current prices)	214	166	159	170	189	199	209	216	225	239
GDP capita per (in US\$)	5,466	4,151	3,902	4,102	4,463	4,630	4,761	4,842	4,971	5,195
Exchange rate (DA per US\$)	80.6	100.7	109.4	111.0	...	...	...	...	...	...
REER (percent change, annual average)	2.1	-4.2	-1.7	0.6	...	...	...	...	...	...

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

1/ Including public enterprises.

2/ Including public enterprises debt buy-back.

3/ In U.S. dollars.

Table 2. Algeria: Balance of Payments, 2014–23

	Prel.			Proj.						
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
(In billions of U.S. dollars; unless otherwise indicated)										
Current account	-9.4	-27.3	-26.5	-21.9	-18.3	-20.2	-17.2	-14.9	-11.8	-10.4
Trade balance	0.3	-18.1	-20.4	-14.3	-9.4	-11.6	-9.5	-7.5	-4.7	-3.2
Exports, f.o.b.	60.0	34.6	29.1	34.4	39.5	37.8	36.7	36.6	36.9	37.4
Hydrocarbons	58.4	33.1	27.7	33.1	37.9	36.1	35.1	35.0	35.4	36.3
Volume change (in percent)	-0.6	0.1	7.3	-2.1	-3.7	1.6	1.7	2.2	2.2	2.2
Price change (in percent)	-7.2	-43.4	-22.1	22.1	18.9	-6.1	-4.5	-2.4	-0.8	0.2
Other	1.6	1.5	1.4	1.4	1.6	1.7	1.6	1.6	1.5	1.1
Imports, f.o.b.	-59.7	-52.6	-49.4	-48.7	-48.9	-49.4	-46.2	-44.1	-41.6	-40.6
Volume change (in percent)	9.6	-7.7	-2.3	-2.8	-1.4	-0.5	-7.2	-5.7	-6.1	-2.4
Price change (in percent)	-1.0	-4.5	-3.9	1.4	1.8	1.5	0.7	1.1	0.4	0.1
Services and income (net)	-13.0	-12.0	-8.9	-10.7	-11.9	-11.8	-11.0	-10.9	-10.7	-10.9
Services (net)	-8.2	-7.5	-7.3	-8.1	-7.9	-8.3	-7.6	-7.1	-6.5	-6.3
Credit	3.5	3.5	3.4	3.1	3.5	3.4	3.4	3.4	3.3	3.3
Debit	-11.7	-11.0	-10.8	-11.2	-11.4	-11.8	-11.0	-10.5	-9.9	-9.7
Income (net)	-4.9	-4.5	-1.6	-2.5	-4.0	-3.5	-3.4	-3.7	-4.2	-4.6
Credit	3.2	2.2	2.4	2.2	1.5	1.7	1.7	1.3	0.9	0.6
Debit	-8.1	-6.6	-4.0	-4.8	-5.5	-5.2	-5.1	-5.0	-5.1	-5.2
Interest payments	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other, including profit repatriation	-8.0	-6.5	-4.0	-4.7	-5.4	-5.2	-5.0	-5.0	-5.1	-5.2
Transfers (net)	3.3	2.8	2.8	3.0	3.1	3.2	3.3	3.4	3.6	3.7
Capital account	3.6	-0.2	0.2	0.2	1.3	1.4	1.5	0.1	-0.3	0.9
Medium- and long-term capital	1.3	-1.1	2.0	1.0	1.3	1.4	1.5	1.6	1.7	1.9
Direct investment (net)	1.5	-0.7	1.6	1.2	1.5	1.6	1.7	1.8	1.8	2.0
Loans (net)	-0.2	-0.4	0.4	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1
Drawings	0.0	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-0.2	-0.4	-0.5	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1
Short-term capital and errors and omissions	2.3	0.8	-1.8	-0.8	0.0	0.0	0.0	-1.5	-2.0	-1.0
Overall balance	-5.9	-27.5	-26.3	-21.8	-17.0	-18.9	-15.7	-14.8	-12.1	-9.5
Financing	5.9	27.5	26.3	21.8	17.0	18.9	15.7	14.8	12.1	9.5
Official reserves (increases -)	5.9	27.5	26.3	21.8	17.0	18.9	15.7	14.8	12.1	9.5
Memorandum items:										
Current account balance (in percent of GDP)	-4.4	-16.5	-16.6	-12.9	-9.7	-10.1	-8.2	-6.9	-5.2	-4.3
Algerian crude oil price (US\$/barrel) 1/	99.4	52.9	45.5	54.0	64.2	60.3	57.6	56.2	55.8	55.9
Gross official reserves (in billions of US\$) 2/	177.4	142.6	112.9	96.1	82.6	64.1	48.7	34.0	22.0	12.5
Idem, in months of next year's imports	33.4	28.4	22.6	19.1	16.2	13.5	10.7	7.9	5.2	3.0
Reserves (in percent of ARA EM metric) 3/	783.1	832.9	692.7	402.3	240.0	187.0	142.0	100.8	64.5	50.0
Net international investment position (in billions of US\$)	141.7	107.1	72.5	52.0	33.6	10.8	-7.6	-25.1	-39.3	-51.2
Net international investment position (in percent of GDP)	66.3	64.5	45.6	30.5	17.8	5.4	-3.7	-11.6	-17.5	-21.4
Gross external debt (in billions of US\$)	3.6	3.0	3.8	4.1	4.0	3.8	3.7	3.5	3.4	3.2

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

1/ Weighted average of quarterly data.

2/ Excluding SDR holdings.

3/ ARA EM metric includes additional buffer for commodity intensive countries (projection period only).

**Table 3. Algeria: Summary of Central Government Operations, 2014–23<sup>1</sup>**  
(In billions of Algerian Dinars)

	Prel.						Proj.			
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
	(In billions of Algerian dinars)									
Budget revenue and grants	5,738	5,105	5,012	6,183	6,504	6,433	6,553	6,921	7,462	8,117
Hydrocarbon revenue 2/	3,388	2,375	1,683	2,372	2,634	2,561	2,524	2,637	2,804	3,012
Nonhydrocarbon revenue	2,350	2,730	3,329	3,810	3,871	3,872	4,029	4,284	4,659	5,105
Tax revenue	2,091	2,355	2,482	2,663	2,927	3,169	3,353	3,719	4,132	4,665
Taxes on income and profits	881	1,034	1,109	1,236	1,341	1,485	1,631	1,818	2,054	2,365
Taxes on goods and services	769	824	888	976	1,097	1,166	1,206	1,347	1,483	1,686
Customs duties	371	411	389	356	384	403	391	419	445	446
Registration and stamps	71	85	96	95	105	115	124	136	149	168
Nontax revenues	258	375	847	1,147	944	703	676	566	527	439
Fees	76	247	177	179	193	207	222	242	268	306
Bank of Algeria dividends and interests	123	89	611	920	700	440	392	257	185	53
Other	60	39	59	48	51	56	62	67	73	81
Grants	0	0	0	0	0	0	0	0	0	0
Total expenditure	6,996	7,656	7,297	7,389	8,273	7,418	7,225	7,334	7,463	8,115
Current expenditure	4,494	4,617	4,586	4,758	5,085	4,645	4,655	4,915	5,213	5,621
Personnel expenditure	1,941	2,127	2,219	2,193	2,198	2,198	2,199	2,320	2,492	2,700
Mujahidins' pensions	218	223	226	216	224	232	249	271	301	343
Material and supplies	162	180	186	120	112	105	117	133	154	181
Current transfers 3/	2,136	2,044	1,909	2,075	2,467	1,995	1,939	2,040	2,107	2,223
Interest payments	38	43	47	154	84	116	151	151	159	174
Capital expenditure	2,501	3,039	2,712	2,631	3,189	2,773	2,570	2,418	2,250	2,494
Budget balance	-1,258	-2,552	-2,286	-1,207	-1,769	-985	-672	-413	0	2
Overall balance	-1,376	-2,620	-2,344	-1,662	-1,910	-1,102	-731	-442	-15	2
Primary overall balance	-1,338	-2,578	-2,297	-1,508	-1,826	-986	-579	-291	144	176
Nonhydrocarbon balance	-4,764	-4,995	-4,026	-4,035	-4,543	-3,663	-3,255	-3,078	-2,819	-3,010
Financing	1,376	2,620	2,344	1,662	1,910	1,102	731	442	15	-2
Domestic	1,378	2,623	2,243	1,665	1,922	1,314	740	455	31	21
Bank 4/	1,174	2,487	2,178	1,389	2,674	1,314	740	455	31	21
o/w central bank	0	0	0	2,185	2,108	1,164	740	455	31	21
Nonbank 5/	204	137	65	276	-752	0	0	0	0	0
Foreign	-2	-3	101	-3	-13	-12	-10	-13	-16	-15
Memorandum items										
Central bank financing 6/	0.0	0.0	0.0	11.6	9.9	5.1	3.1	1.7	0.1	0.0
Oil stabilization fund										
in billions of Algerian dinars	4,408	2,074	784	0	0	0	0	0	0	0
in percent of GDP	25.6	12.4	4.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross government debt (in percent of GDP)	7.7	8.8	20.6	27.0	34.8	39.9	40.6	39.1	35.8	32.1
Of which, owed to central bank	...	...	...	13.0	22.9	28.0	31.0	32.7	32.9	32.9
Net savings (in percent of GDP)	17.9	3.7	-16.1	-27.0	-34.8	-39.9	-40.6	-39.1	-35.8	-32.1

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

1/ On cash basis.

2/ Including Sonatrach dividends.

3/ Includes 500 billion dinars of transfers to pension fund in 2018.

4/ Bank financing includes domestic debt issuance and a drawdown of the oil stabilization fund and other government deposits at the central bank.

5/ Includes proceeds from sales of state-owned assets.

6/ Including public enterprises debt buy-back.

**Table 4. Algeria: Summary of Central Government Operations, 2014–23<sup>1</sup>**  
(In percent of GDP unless otherwise indicated)

	Prel.					Proj.				
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
(In percent of GDP)										
Budget revenue and grants	33.3	30.6	28.8	32.7	30.6	28.2	27.0	26.3	25.9	25.3
Hydrocarbon revenue 2/	19.7	14.2	9.7	12.5	12.4	11.2	10.4	10.0	9.7	9.4
Nonhydrocarbon revenue	13.6	16.3	19.1	20.2	18.2	17.0	16.6	16.3	16.2	15.9
Tax revenue	12.1	14.1	14.3	14.1	13.8	13.9	13.8	14.1	14.3	14.5
Nontax revenues	1.5	2.2	4.9	6.1	4.4	3.1	2.8	2.1	1.8	1.4
o/w Bank of Algeria dividends and interests	0.7	0.5	3.5	4.9	3.3	1.9	1.6	1.0	0.6	0.2
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	40.6	45.8	41.9	39.1	38.9	32.5	29.8	27.9	25.9	25.3
Current expenditure	26.1	27.6	26.3	25.2	23.9	20.4	19.2	18.7	18.1	17.5
Personnel expenditure	11.3	12.7	12.7	11.6	10.3	9.6	9.1	8.8	8.6	8.4
Current transfers	12.4	12.2	11.0	11.0	11.6	8.7	8.0	7.8	7.3	6.9
Capital expenditure	14.5	18.2	15.6	13.9	15.0	12.2	10.6	9.2	7.8	7.8
Budget balance	-7.3	-15.3	-13.1	-6.4	-8.3	-4.3	-2.8	-1.6	0.0	0.0
Overall balance	-8.0	-15.7	-13.5	-8.8	-9.0	-4.8	-3.0	-1.7	-0.1	0.0
Overall balance (excluding Bank of Algeria dividends)	-8.7	-16.2	-17.0	-13.7	-12.3	-6.8	-4.6	-2.7	-0.7	-0.2
Primary overall balance	-7.8	-15.4	-13.2	-8.0	-8.6	-4.3	-2.4	-1.1	0.5	0.5
Nonhydrocarbon balance	-27.7	-29.9	-23.1	-21.3	-21.4	-16.1	-13.4	-11.7	-9.8	-9.4
Financing	8.0	15.7	13.5	8.8	9.0	4.8	3.0	1.7	0.1	0.0
Domestic	8.0	15.7	12.9	8.8	9.0	5.8	3.1	1.7	0.1	0.1
Bank 3/	6.8	14.9	12.5	7.3	12.6	5.8	3.1	1.7	0.1	0.1
o/w central bank	0.0	0.0	0.0	11.6	9.9	5.1	3.1	1.7	0.1	0.1
Nonbank	1.2	0.8	0.4	1.5	-3.5	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.6	0.0	-0.1	-0.1	0.0	0.0	-0.1	0.0
(In percent of non-oil GDP)										
Budget revenue and grants	45.6	37.6	34.8	40.4	38.6	34.7	32.8	31.7	31.0	30.1
Hydrocarbon revenue 2/	27.0	17.5	11.7	15.5	15.6	13.8	12.6	12.1	11.6	11.2
Nonhydrocarbon revenue	18.7	20.1	23.1	24.9	23.0	20.9	20.2	19.6	19.4	18.9
Tax revenue	16.6	17.4	17.3	17.4	17.4	17.1	16.8	17.0	17.2	17.3
Nontax revenues	2.1	2.8	5.9	7.5	5.6	3.8	3.4	2.6	2.2	1.6
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	55.7	56.4	50.7	48.3	49.1	40.1	36.2	33.5	31.0	30.0
Current expenditure	35.8	34.0	31.9	31.1	30.1	25.1	23.3	22.5	21.7	20.8
Capital expenditure	19.9	22.4	18.9	17.2	18.9	15.0	12.9	11.1	9.3	9.2
Budget balance	-10.0	-18.8	-15.9	-7.9	-10.5	-5.3	-3.4	-1.9	0.0	0.0
Overall balance	-10.9	-19.3	-16.3	-10.9	-11.3	-6.0	-3.7	-2.0	-0.1	0.0
Primary overall balance	-10.6	-19.0	-16.0	-9.9	-10.8	-5.3	-2.9	-1.3	0.6	0.7
Nonhydrocarbon balance	-37.9	-36.8	-28.0	-26.4	-26.9	-19.8	-16.3	-14.1	-11.7	-11.1
Nonhydrocarbon balance (excluding Bank of Algeria dividends)	-38.9	-37.5	-32.2	-32.4	-31.1	-22.2	-18.2	-15.3	-12.5	-11.3
Financing	10.9	19.3	16.3	10.9	11.3	6.0	3.7	2.0	0.1	0.0
Domestic	11.0	19.3	15.6	10.9	11.4	7.1	3.7	2.1	0.1	0.1
Bank 3/	9.3	18.3	15.1	9.1	15.9	7.1	3.7	2.1	0.1	0.1
o/w central bank	0.0	0.0	0.0	14.3	12.5	6.3	3.7	2.1	0.1	0.1
Nonbank 4/	1.6	1.0	0.4	1.8	-4.5	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.7	0.0	-0.1	-0.1	0.0	-0.1	-0.1	-0.1

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

1/ On cash basis.

2/ Including Sonatrach dividends.

3/ Bank financing includes domestic debt issuance and a drawdown of the oil stabilization fund and other government deposits at the central bank.

4/ Includes proceeds from sales of state-owned assets.



Table 5. Algeria: Monetary Survey, 2014–23

	2014	2015	2016	2017	Proj.					
					2018	2019	2020	2021	2022	2023
(In billions of Algerian dinars; at end of period)										
Net foreign assets	15,602	15,222	12,443	11,058	9,438	7,413	5,691	4,135	2,757	1,580
<i>Of which: Bank of Algeria</i>	15,695	15,373	12,544	11,155	9,495	7,440	5,694	4,120	2,726	1,536
Foreign assets (BA)	15,850	15,553	12,725	11,354	9,697	7,644	5,902	4,338	2,955	1,777
Foreign liabilities (BA)	155	181	181	199	202	205	208	218	229	241
Foreign assets (comm. banks)	45	57	62	65	66	67	68	72	75	79
Foreign liabilities (comm. banks)	138	208	164	163	124	94	72	56	44	35
Net domestic assets	-1,938	-1,517	1,374	3,900	7,226	10,078	12,512	15,067	17,662	20,448
Domestic credit	3,102	6,648	9,510	12,606	15,852	17,792	19,250	20,841	22,055	23,298
Credit to government (net) 1/	-3,503	-702	1,499	3,653	5,761	6,925	7,665	8,120	8,151	8,171
Credit to the economy	6,604	7,350	8,011	8,953	10,090	10,867	11,585	12,721	13,905	15,126
<i>Of which: Private sector</i>	3,162	3,629	4,007	4,606	5,286	5,694	6,013	6,478	7,080	7,694
Other items net	-5,039	-8,165	-8,137	-8,706	-8,626	-7,714	-6,738	-5,774	-4,393	-2,850
Money and quasi-money (M2)	13,664	13,705	13,816	14,958	16,664	17,491	18,203	19,202	20,419	22,028
Excluding Sonatrach deposits	12,839	13,218	13,318	13,967	15,398	16,334	17,033	17,914	18,968	20,465
Money	9,580	9,261	9,407	10,250	11,300	11,987	12,500	13,147	13,920	15,019
Quasi-money	4,084	4,443	4,409	4,708	5,363	5,504	5,703	6,055	6,499	7,009
(In percent change over 12-month period)										
Money and quasi-money (M2)	14.4	0.3	0.8	8.3	11.4	5.0	4.1	5.5	6.3	7.9
<i>Of which: Money</i>	16.1	-3.3	1.6	9.0	10.2	6.1	4.3	5.2	5.9	7.9
Credit to the economy	26.0	11.3	9.0	11.8	12.7	7.7	6.6	9.8	9.3	8.8
<i>Of which: Private sector</i>	15.1	14.8	10.4	15.0	14.8	7.7	5.6	7.7	9.3	8.7
Memorandum items:										
Liquidity ratio (average M2/GDP)	79.3	82.1	79.4	79.1	78.3	76.7	75.1	73.0	70.8	68.6
Liquidity ratio (e.o.p. M2/NHGDGP)	108.7	101.0	96.1	97.8	98.8	94.5	91.1	87.8	84.8	81.6
M2 velocity	1.261	1.219	1.260	1.264	1.277	1.304	1.331	1.371	1.412	1.459
Credit to the economy/GDP	38.3	44.0	46.0	47.4	47.4	47.6	47.8	48.3	48.2	47.1
Credit to the economy/NHGDGP	52.5	54.2	55.7	58.5	59.8	58.7	58.0	58.2	57.8	56.0
Credit to private sector/NHGDGP	25.2	26.7	27.9	30.1	31.3	30.8	30.1	29.6	29.4	28.5
Sources: Bank of Algeria; and IMF staff estimates and projections.										
1/ Net credit to government excludes Treasury postal accounts ("dépôts CCP") deposited at the BA.										

**Table 6. Algeria: Financial Soundness Indicators, 2009–17**  
(In percent)

	2009	2010	2011	2012	2013	2014	2015	2016	2017 Prel.
Capital adequacy ratio	26.2	23.6	23.7	23.4	21.5	16.0	18.4	18.9	19.6
- Public banks	23.9	21.7	21.9	21.6	19.9	14.9	17.7	18.5	19.8
- Private banks	35.2	31.6	31.2	31.9	28.5	20.9	21.1	20.4	18.7
Tier I capital adequacy ratio	19.1	17.7	16.9	17.5	15.5	13.3	15.8	16.3	15.2
- Public banks	15.6	14.8	14.1	14.8	13.1	11.7	14.6	15.5	14.6
- Private banks	32.9	29.3	28.8	29.7	26.3	20.2	20.4	19.6	17.9
NPLs net of provisions/Regulatory capital	33.9	21.1	19.4	16.1	17.1	21.4	27.0	34.3	34.4
- Public banks	46.0	27.5	25.1	20.3	21.7	26.8	30.5	39.1	38.2
- Private banks	1.5	3.0	2.3	3.2	2.6	4.6	16.1	16.6	16.2
NPLs/total loans	21.1	18.3	14.5	11.5	10.6	9.2	9.8	11.9	12.3
- Public banks	23.6	20.5	16.1	12.4	11.4	9.7	9.9	12.4	12.9
- Private banks	3.8	4.1	4.0	5.2	4.8	5.1	8.7	8.2	7.9
NPLs net of provisions/total loans	7.3	4.9	4.4	3.5	3.4	3.2	4.0	5.4	6.0
- Public banks	8.3	5.4	4.9	3.9	3.7	3.4	3.9	5.5	6.3
- Private banks	0.7	1.4	1.0	1.3	0.9	1.4	4.8	4.4	3.9
Provisions/classified loans	65.4	76.5	69.8	69.5	68.2	65.2	59.2	54.5	51.4
- Public banks	65.0	73.7	69.6	69.4	67.4	64.8	60.9	55.3	51.5
- Private banks	82.0	66.7	75.9	71.7	80.3	71.9	44.7	46.1	50.3
Return on equity	26.0	16.7	24.7	23.3	19.0	23.6	20.3	18.1	17.8
- Public banks	27.9	29.8	26.1	22.7	18.0	25.1	21.8	19.0	18.7
- Private banks	20.9	20.3	21.4	24.8	21.5	19.6	16.3	15.2	14.7
Return on assets	1.8	2.2	2.1	1.9	1.7	2.0	1.8	1.9	2.0
- Public banks	1.5	1.8	1.8	1.5	1.3	1.8	1.6	1.7	1.9
- Private banks	3.7	4.6	4.5	4.5	3.7	3.3	3.2	2.8	2.6
Interest margin/gross revenues	58.4	63.8	64.9	64.2	69.5	68.5	66.8	72.6	72.7
- Public banks	60.4	71.6	73.6	72.1	73.3	68.4	65.8	72.4	72.2
- Private banks	52.5	44.2	44.4	45.2	59.1	69.1	71.5	73.7	74.4
Non-interest expenses/earnings before tax	32.2	31.4	33.6	35.6	33.5	40.7	40.0	34.1	37.0
- Public banks	33.7	31.6	34.8	38.1	34.0	40.3	39.2	31.3	34.5
- Private banks	31.0	31.0	30.8	29.8	32.3	42.0	43.4	46.5	46.3
Liquid assets/total assets	51.8	53.0	50.2	45.9	40.5	38.0	27.2	23.5	23.7
- Public banks	52.8	54.2	51.1	45.1	39.4	37.0	25.9	22.6	22.1
- Private banks	44.7	43.7	43.2	50.9	46.5	44.0	35.9	29.1	33.1
Liquid assets/short-term debt	114.5	114.3	103.7	107.5	93.5	82.1	61.6	58.4	53.9
- Public banks	118.4	118.1	106.6	110.5	95.7	83.4	60.2	58.8	52.2
- Private banks	89.0	88.5	84.6	93.5	84.1	75.4	69.8	56.2	61.6

Source: Bank of Algeria

## Annex I. Authorities' Response to Past IMF Recommendations

Recommendation	Implementation status
<b>Pursue fiscal consolidation</b>	
Pursue sustained consolidation efforts	The government achieved a significant consolidation in 2017, but plans a large expansion in 2018.
Create fiscal space by tapping a broad range of financial instrument	The government's financing strategy was limited to using fiscal savings in the FRR and issuing some domestic debt. To meet its financing constraint, the government borrowed from the central bank.
Contain the wage bill	The 2018 budget virtually freezes wages in nominal terms. Measures to contain the wage bill also include freezing hiring except for strategic sectors and replacing only one out five new retirees.
Gradually reduce fuel subsidies and introduce a targeted cash-transfer system	The government raised fuel and electricity taxes in 2018, and intends to deepen subsidy reform. It is working with the WB on a communication strategy and the introduction of a targeting system.
Mobilize more nonhydrocarbon revenues by widening the tax base rather than tax increases	The 2018 budget increased taxes on tobacco, wines and alcohol, raised taxes and customs duties on several imported products. The government took steps to modernize tax administration processes, including its IT systems.
Reduce public investment spending and improve its efficiency	Public investment spending was cut significantly in 2017, albeit less than envisaged in the budget. However, the 2018 budget calls for a significant increase in capital expenditures.
Strengthen public financial management	A weak capacity to monitor budget commitments led to renewed arrears in 2017. The government issued a new regulation aiming to ensure that payment ceilings will not be exceeded in 2018. FAD has provided significant TA in this area.
<b>Implement wide-ranging structural reforms</b>	
Implement wide-ranging and well-sequenced structural reforms without delay	The authorities have been drawing a strategy to reshape Algeria' growth model with World Bank support. The government announced an ambitious reform plan and recently published a decree listing reforms, but significant concrete actions are yet to be taken.
<b>Adopt market-oriented exchange rate, monetary, and financial policies</b>	
Consider a gradual depreciation of the dinar to ease pressure on the balance of payments and external reserves	The NEER and REER depreciated by 10 and 8 percent, respectively in 2017, mostly reflecting euro/dollar fluctuations.
Adjust open market operations to changing liquidity conditions while guarding against inflation	Open market operations were introduced in 2017. BA is now adapting to counter the impact of monetary financing.
Strengthen the prudential framework and improve crisis preparedness and management	BA introduced new regulations, including to strengthen banks' corporate governance.

## Annex II. Alternative Scenario

*Staff discussed an alternative scenario consistent with its recommended policy mix. The scenario assumes a sustained but gradual fiscal consolidation, starting in 2018. The gradual pace is made possible by tapping a broad range of financing options but excluding monetary financing, combined with further exchange rate depreciation and ambitious structural reforms. The scenario shows that the authorities still have a window to achieve their dual objectives of macro-stabilization and fostering more sustainable growth without resorting to risky policies.*

The alternative scenario assumes that the government pursues fiscal consolidation in 2018, and aims to gradually bring the deficit close to zero in the medium term, while stabilizing public debt below 40 percent of GDP. The medium-term debt anchor is moderate enough (by EM standards) to leave sufficient buffers should fiscal risks related to the price of oil or contingent liabilities in the public sector materialize. Specific key assumptions are as follows:

- Both current and capital expenditures decline more slowly than in the baseline scenario starting in 2019. Current spending falls to 23.7 percent of nonhydrocarbon GDP in 2023 (compared to 20.8 percent in the baseline scenario). Both wage and non-wage current spending decline gradually as a share of GDP. Investment spending decreases to 13.8 percent of nonhydrocarbon GDP in 2023 (versus 9.2 percent in the baseline scenario) allowing for a greater buildup of capital. The consolidation assumed in 2018 still leaves space to clear the domestic arrears and make the one-off transfer to the public pension fund.
- Tax revenues rise to 18.8 percent of nonhydrocarbon GDP in 2023 (compared to 17.3 percent in the baseline scenario), reflecting a greater reduction in tax exemptions and improved tax administration and collection.
- To finance larger deficits, the government borrows domestically, finances selected investment projects with borrowing from official bilateral creditors (starting in 2019), and issues bonds in international capital markets (starting in 2020).
- The REER is assumed to depreciate by 26 percent over the projection period compared to a real appreciation in the baseline scenario (due to high inflation and limited nominal depreciation of the dinar).
- Efforts to diversify and liberalize the economy gradually result in slightly more nonhydrocarbon exports, FDI, and tourism receipts toward the end of the projection period.

**Table 1. Algeria: Selected Economic and Financial Indicators (alternative scenario), 2014–23**

	Prel.					Proj.				
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Output and prices</b>	(Annual percentage change)									
Real GDP	3.8	3.7	3.3	1.6	2.5	2.3	2.0	1.8	1.6	1.8
Hydrocarbon sector	-0.6	0.2	7.7	-3.0	1.3	1.7	1.7	1.9	2.2	2.6
Nonhydrocarbon sector	5.6	5.0	2.3	2.6	2.8	2.5	2.0	1.7	1.5	1.7
Per capita	1.6	1.5	1.3	-0.3	0.6	0.5	0.2	0.1	0.0	0.2
Consumer price index (period average)	2.9	4.8	6.4	5.6	6.5	6.2	5.8	5.4	4.9	4.0
<b>Investment and savings</b>	(In percent of GDP)									
Savings-investment balance	-4.4	-16.5	-16.6	-12.9	-7.3	-8.6	-6.8	-5.5	-3.3	-0.5
National savings	43.1	36.3	37.2	37.4	40.2	36.7	38.7	41.0	44.1	48.7
Central government	6.5	2.5	2.1	5.1	6.2	6.9	7.2	7.4	8.7	10.0
Nongovernment 1/	36.6	33.8	35.1	32.3	34.0	29.9	31.4	33.7	35.4	38.6
Investment	47.5	52.8	53.9	50.3	47.6	45.3	45.5	46.5	47.4	49.2
Central government	14.5	18.2	15.6	13.9	13.1	12.7	12.3	11.9	11.5	11.1
Nongovernment 1/	33.0	34.6	38.3	36.4	34.5	32.6	33.2	34.6	35.9	38.1
Of which: Nongovernment nonhydrocarbon	28.6	28.8	33.9	30.3	29.3	26.2	27.7	30.4	33.2	35.4
<b>Central government finances</b>	(In percent of GDP)									
Overall budget balance	-8.0	-15.7	-13.5	-8.8	-6.8	-5.8	-5.1	-4.5	-2.8	-1.1
Revenue	33.3	30.6	28.8	32.7	30.7	27.7	27.3	27.2	28.1	29.1
Expenditure (incl. net lending)	41.3	46.3	42.3	41.5	37.6	33.5	32.4	31.7	30.9	30.1
Gross government debt (excluding guarantees)	7.7	8.8	20.6	27.0	30.0	35.7	38.5	40.3	40.3	38.0
Central bank financing 2/	0.0	0.0	0.0	11.6	4.2	0.0	0.0	0.0	0.0	0.0
<b>Nonhydrocarbon primary balance</b>	(In percent of nonhydrocarbon GDP)									
Nonhydrocarbon primary balance	-37.6	-36.5	-27.7	-25.4	-24.4	-21.6	-19.6	-18.4	-16.2	-14.5
Nonhydrocarbon balance (excluding Bank of Algeria dividends)	-38.9	-37.5	-32.2	-32.4	-29.1	-24.2	-22.2	-20.5	-18.2	-16.2
Nonhydrocarbon balance	-37.9	-36.8	-28.0	-26.4	-24.9	-22.3	-20.6	-19.6	-17.7	-16.1
Revenue	45.6	37.6	34.8	40.4	39.1	34.7	33.8	33.6	34.8	36.2
Hydrocarbon	27.0	17.5	11.7	15.5	16.2	15.0	14.3	14.0	14.2	14.8
Nonhydrocarbon	18.7	20.1	23.1	24.9	22.8	19.7	19.5	19.6	20.5	21.4
Expenditure	55.7	56.4	50.7	48.3	47.0	41.3	39.8	39.0	38.1	37.5
Current expenditure	35.8	34.0	31.9	31.1	30.3	25.4	24.5	24.3	23.9	23.7
Capital expenditure	19.9	22.4	18.9	17.2	16.6	15.9	15.3	14.7	14.2	13.8
<b>External sector 3/</b>										
Current account balance (percent of GDP)	-4.4	-16.5	-16.6	-12.9	-7.3	-8.6	-6.8	-5.5	-3.3	-0.5
Exports, f.o.b. (percent change)	-6.8	-42.4	-15.9	18.5	14.5	-3.9	-1.6	1.1	3.5	5.3
Hydrocarbons	-7.8	-43.3	-16.4	19.5	14.5	-4.6	-2.9	-0.3	1.8	3.3
Nonhydrocarbons	55.4	-9.1	-6.2	-1.9	12.8	14.2	23.7	23.6	25.3	26.1
Imports, f.o.b. (percent change)	8.5	-11.8	-6.1	-1.4	-7.9	3.4	-5.5	-3.2	-4.4	-4.2
Export volume (hydrocarbons, percent change)	-0.6	0.1	7.3	-2.1	-3.7	1.6	1.7	2.2	2.7	3.2
Import volume (percent change)	9.6	-7.7	-2.3	-2.8	-9.5	1.9	-6.1	-4.2	-4.8	-4.3
Terms of trade (percent change, "-" = deterioration)	-6.3	-40.7	-18.9	20.4	16.8	-7.5	-5.1	-3.5	-1.2	0.1
Nonhydrocarbon exports (percent of total exports)	2.7	4.3	4.8	4.0	3.9	4.6	5.8	7.1	8.7	10.4
Gross official reserves										
In US\$ billions	177	143	113	96	87	75	66	62	63	69
In months of next year's imports of goods and services	33	28	23	21	18	16	15	15	16	17
Gross external debt (in percent of GDP)	1.7	1.8	2.4	2.4	2.2	2.6	3.5	5.0	7.2	8.9
<b>Oil and gas sector</b>										
Hydrocarbon production (in ton oil equivalent)	142	141	153	152	154	157	159	162	166	170
Hydrocarbon exports										
Of which: liquid petroleum exports (in millions of barrels/day)	1.2	1.2	1.2	1.2	1.1	1.1	1.2	1.2	1.2	1.2
natural gas exports (in billions of m3)	44.3	43.1	53.1	53.4	54.2	55.1	56.2	57.6	59.3	61.4
Crude oil exports (in millions of barrels/day)	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Crude oil export unit value (US\$/bbl)	99.4	52.9	45.5	54.0	64.2	60.3	57.6	56.2	55.8	55.9
Share of hydrocarbons in total exports (in percent)	97.3	95.7	95.2	96.0	96.1	95.4	94.2	92.9	91.3	89.6
<b>Money and credit</b>	(Annual percentage change unless otherwise indicated)									
Net foreign assets	3.3	-2.4	-18.3	-11.1	-6.5	-10.4	-5.8	-1.4	9.2	17.5
Credit to the economy	26.0	11.3	9.0	11.8	11.9	9.5	8.2	9.2	9.5	9.5
Money and quasi-money	14.4	0.3	0.8	8.3	10.5	7.3	6.8	7.4	8.0	8.4
Velocity of broad money (GDP/M2)	1.3	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
<b>Memorandum items:</b>										
GDP (in billions of dinars at current prices)	17,229	16,702	17,407	18,907	21,322	22,837	24,459	26,206	28,107	30,089
NHGD (in billions of dinars at current prices)	12,571	13,568	14,381	15,298	16,758	18,259	19,745	21,238	22,718	24,164
GDP (in billions of US\$ current prices)	214	166	159	170	183	187	189	191	191	191
GDP capita per (in US\$)	5,466	4,151	3,902	4,102	4,323	4,332	4,300	4,273	4,216	4,152
Exchange rate (DA per US\$)	80.6	100.7	109.4	111.0	...	...	...	...	...	...
REER (percent change, annual average)	2.1	-4.2	-1.7	0.6	...	...	...	...	...	...

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

1/ Including public enterprises.

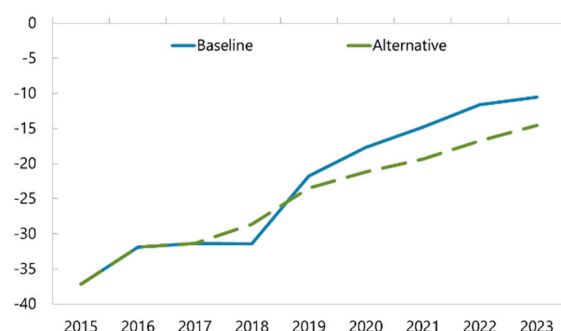
2/ Including public enterprises debt buy-back.

3/ In U.S. dollars.

The following charts compare the main outcomes of the alternative scenario versus the baseline scenario.

**Figure 1. Alternative and Baseline Scenarios**

**Nonhydrocarbon Fiscal Balance<sup>1</sup>**  
(Percent of nonhydrocarbon GDP)



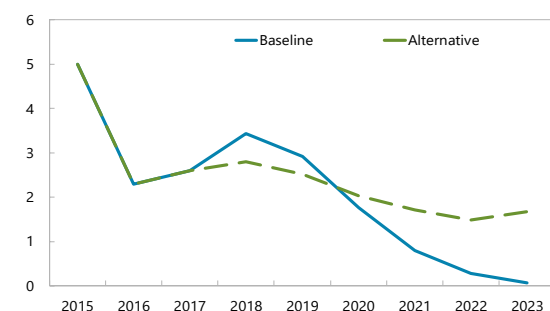
Sources: Algerian authorities; and IMF staff calculations.  
1/ Excluding BA's dividends.

**Fiscal balance**

**Baseline:** In 2018, the deficit widens because of the planned increase in spending. Per the 2018-20 MTBF, the deficit is brought to zero by 2022, implying a steep fiscal consolidation in 2019. Thereafter, fiscal consolidation continues at a slower pace.

**Alternative:** The fiscal deficit declines more gradually over the medium term, reaching close to zero in the medium term.

**Nonhydrocarbon Growth**  
(Percent)



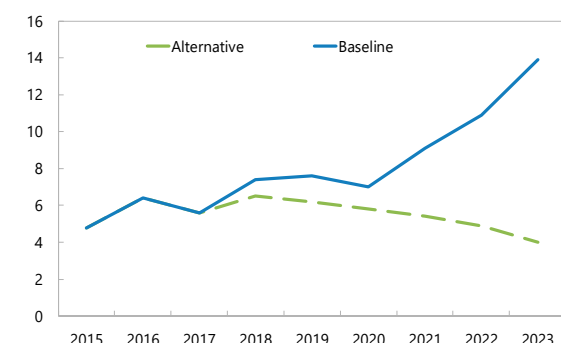
Sources: Algerian authorities; and IMF staff calculations.

**Nonhydrocarbon growth**

**Baseline:** Nonhydrocarbon growth accelerates in 2018 due to the fiscal expansion in 2018, but slows rapidly thereafter, as fiscal consolidation resumes and accelerating inflation discourages investment.

**Alternative:** Growth increases slightly in 2018 and slows down more gradually than in the base scenario thereafter. This is explained by a more gradual pace of fiscal consolidation, structural reforms gradually start paying off toward the end of the projection period, and investors' confidence increases.

**Headline Inflation**  
(Percent)

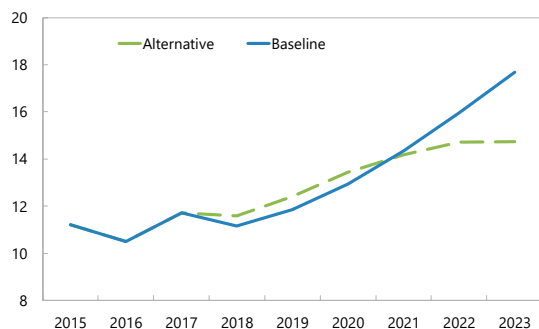


Sources: Algerian authorities; and IMF staff calculations.

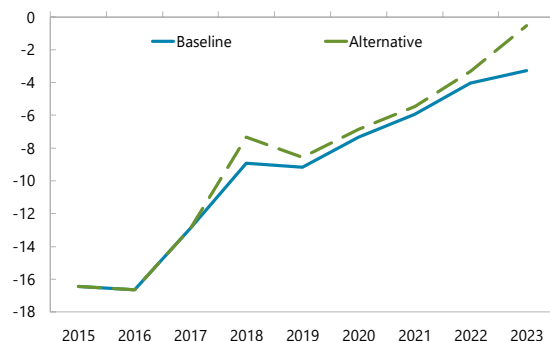
**Inflation**

**Baseline:** Fiscal expansion in 2018, monetary financing and stringent import restrictions increase inflationary pressures and raise inflation expectations. As a result, inflation accelerates rapidly past the impact of the sharp fiscal consolidation in 2019.

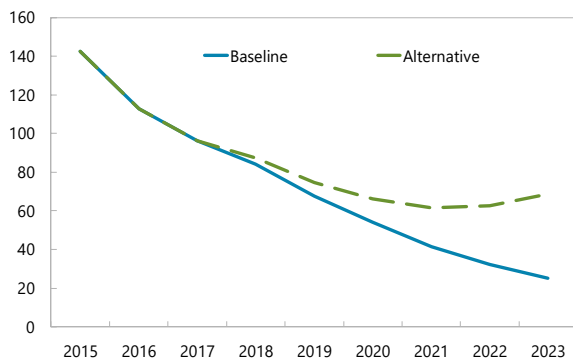
**Alternative:** Inflation converges towards BA's central target because of sustained adjustment efforts and prudent monetary policy.

**Figure 1. Alternative and Baseline Scenarios (concluded)****Unemployment**  
(Percent)

Sources: Algerian authorities; and IMF staff calculations.

**Current Account**  
(Percent of GDP)

Sources: Algerian authorities; and IMF staff calculations.

**International Reserves**  
(US\$ billion)

Sources: Algerian authorities; and IMF staff calculations.

**Unemployment**

**Baseline:** Unemployment falls in 2018 as growth recovers, but subsequently accelerates rapidly as growth slows again.

**Alternative:** Unemployment increases slightly until 2021 due to sustained fiscal adjustment efforts. As growth accelerates, the trend in unemployment rate starts reversing in the medium term.

**Current account balance**

**Baseline:** The current account deficit declines significantly in 2018 mostly due to higher oil prices. It continues to gradually narrow over the medium term as the government resumes fiscal consolidation.

**Alternative:** In the medium term, the deficit declines more than in the baseline scenario, thanks to a greater exchange rate depreciation and more ambitious structural reforms that help diversify exports in the medium term.

**International reserves**

**Baseline:** Reserves decline rapidly to about 3 months of imports by 2023.

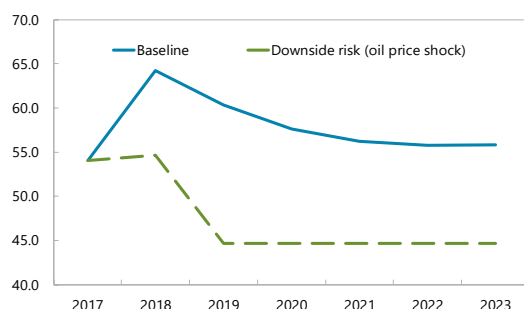
**Alternative:** Reserves decline to about 17 months of imports by 2023 and their level stabilizes.

## Annex III. Downside Risks Scenarios

Staff prepared two scenarios that illustrate the risks around the baseline scenario. The scenarios show that the authorities' policy-mix undermines its resilience to domestic and external shocks.

Figure 1. Lower Oil Prices

### Crude Oil Price (US\$, per barrel)



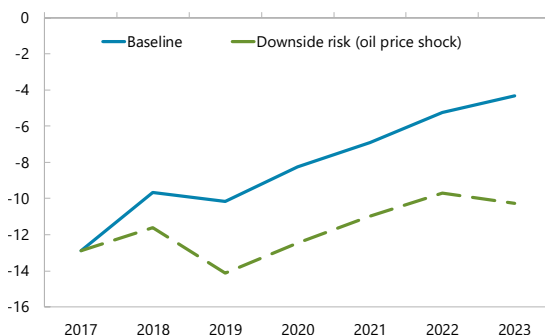
Source: IMF staff calculations.

### Oil price assumptions

**Baseline scenario:** Oil prices increase significantly in 2018, then decrease gradually to stabilize around US\$56 per barrel.

**Downside scenario I:** Oil prices decrease significantly to US\$45 per barrel starting in 2019 and remain at that level over the medium term.

### Current Account (Percent of GDP)



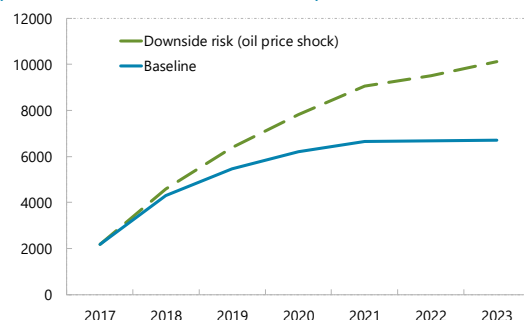
Sources: Algerian authorities; and IMF staff calculations.

### Current account balance

**Baseline scenario:** The current account deficit decreases significantly in 2018 mostly thanks to higher oil prices. The resumption of significant fiscal consolidation in 2019 further reduces the deficit, which reaches 4 percent of GDP in the medium term.

**Downside scenario I:** Lower oil prices significantly worsen the external balance compared to the baseline.

### Monetary Financing (Billions of dinars cumulative)



Source: IMF staff calculations.

### Monetary financing

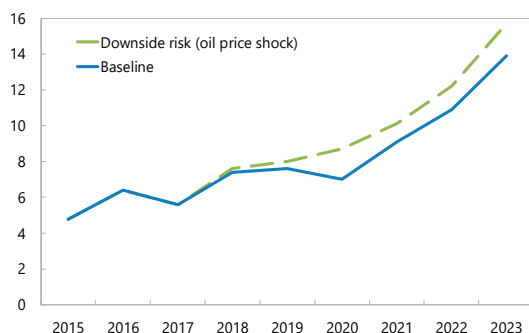
**Baseline scenario:** The use of monetary financing decreases as the fiscal consolidation reduces financing needs. In the medium term, the monetary financing would amount to a total of around DZD 7,000 billion.

**Downside scenario I:** Lower hydrocarbon revenues leads to larger budget deficits. The total amount of monetary financing would be over DZD10,000 billion by 2023.



Figure 1. Lower Oil Prices (concluded)

### Headline Inflation (Percent)



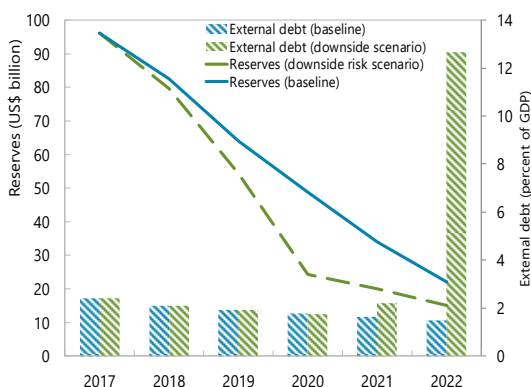
Sources: Algerian authorities; and IMF staff calculations.

### Headline inflation

**Baseline scenario:** Fiscal expansion in 2018 and stringent import restrictions increase inflationary pressures and expectations. Hence, inflation quickly accelerates and reaches 14 percent in the medium term.

**Downside scenario I:** A larger use of monetary financing leads to greater inflationary pressures.

### International Reserves and External Debt



Sources: Algerian authorities; and IMF staff calculations.

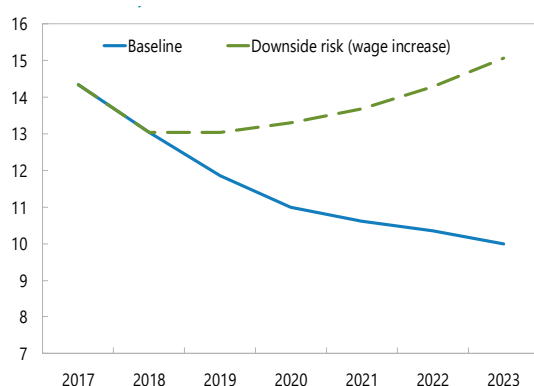
### International reserves

**Baseline scenario:** Reserves decrease to 3 months of imports by 2023.

**Downside scenario I:** It becomes necessary to resort to external borrowing starting in 2021 to avoid the depletion of reserves.

**Figure 2. Higher Fiscal Spending****Personal Expenditure**

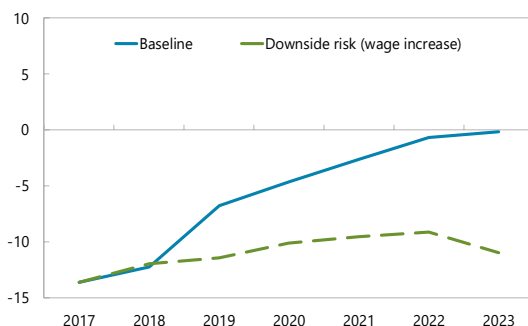
(Percent of nonhydrocarbon GDP)



Sources: Algerian authorities; and IMF staff calculations.

**Nonhydrocarbon Fiscal Balance<sup>1</sup>**

(Percent of GDP)

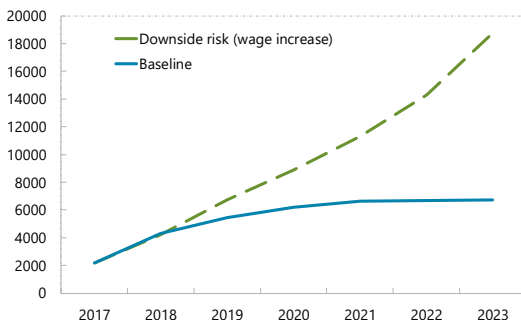


Sources: Algerian authorities; and IMF staff calculations.

1/ Excluding BA's dividends.

**Monetary Financing**

(Billions of dinars, cumulative)



Sources: Algerian authorities; and IMF staff calculations.

**Wage bill assumptions**

**Baseline scenario:** The wage bill is significantly reduced in the medium term (per the 2018–20 MTBF).

**Downside scenario II:** This scenario assumes that wages remain constant in percent of GDP, allowing for some real increases. Total personnel expenditure increase in person of GDP as repeated transfers to the public pension fund are also assumed, absent a significant parametric reform of the pension system.

**Budget balance**

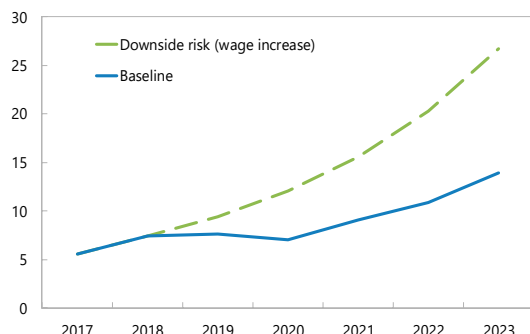
**Baseline scenario:** The budget deficit is eliminated by 2022.

**Downside scenario II:** Higher personnel expenditure worsen the budget deficit in the medium term.

**Monetary financing**

**Baseline scenario:** The use of monetary financing decreases as the fiscal consolidation reduces financing needs.

**Downside scenario II:** The use of monetary financing increases with higher financing needs. In the medium term, the total amount of monetary financing is more than double the amount in the baseline scenario.

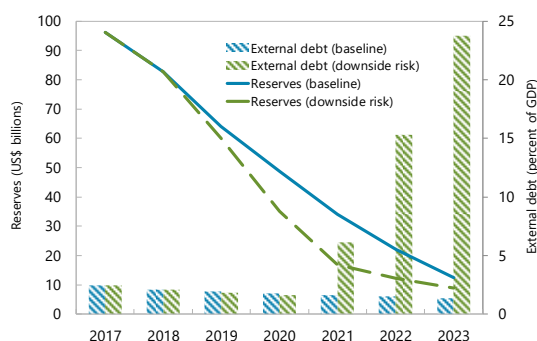
**Figure 2. Higher Fiscal Spending (concluded)****Headline Inflation**  
(Percent)

Sources: Algerian authorities; and IMF staff calculations.

**Headline inflation**

**Baseline scenario:** Fiscal expansion in 2018 and stringent import restrictions increase inflationary pressures and expectations. Inflation reaches 14 percent in the medium term.

**Downside scenario II:** A wage-price inflationary spiral quickly starts, driving a rapid and significant increase in inflation.

**International Reserves and External Debt**

Sources: Algerian authorities; and IMF staff calculations.

**International reserves**

**Baseline scenario:** Reserves decrease to 3 months of imports by 2023.

**Downside scenario II:** Without external borrowing, foreign exchange reserves are depleted by 2022.

## Annex IV. Public Debt Sustainability Analysis

*Public debt currently stands at 27 percent of GDP (48 percent of GDP including guarantees) and is expected to remain sustainable under the authorities' current policy plans. Until recently, debt levels remained low as the fiscal balance was positive (until 2013) or deficits were mainly financed drawing down savings (2014–15, after oil prices fell). Since 2016, however, government debt has increased significantly, reflecting the materialization of fiscal risks and (starting 2017) the depletion of fiscal savings. The government's recent decision to monetize the deficit is (artificially) keeping the cost of debt low. Assuming sustained fiscal consolidation from 2019 onwards, per the authorities' plan, debt levels are projected to remain manageable, and stress tests suggest that financing needs are not very sensitive to shocks.*

### 1. Domestic public debt has increased significantly since 2016 but remains moderate.

During 2014–15, domestic public debt, excluding guarantees, remained relatively low at around 8 percent of GDP, as large budget deficits were mainly financed by drawing on savings in the oil stabilization fund (FRR). In 2016, government debt increased to about 20.6 percent of GDP, mainly reflecting the materialization of fiscal risks in the form of support to public enterprises.<sup>1</sup> In 2017, the government's debt increased further, to 27 percent of GDP, as funds in the FRR were insufficient to cover the fiscal deficit and buy back additional debt of public enterprises occurred.<sup>2</sup> Debt figures including central government guarantees of 48 percent of GDP in 2017. Government guarantees consisted of guarantees of public enterprises' borrowing from state-owned banks (21 percent of GDP in 2017).<sup>3</sup>

### 2. The government started borrowing directly from the central bank in late 2017.

Consolidation efforts combined with higher oil prices contributed to reducing the deficit (on cash basis) from 13.5 percent of GDP in 2016 to 8.8 percent in 2017. With savings in the FRR depleted and domestic liquidity declining, the government, reluctant to borrow externally, changed the banking law and borrowed directly from the central bank about 3 percent of GDP to finance its deficit. It also used monetary financing to buy back some of its own debt to public enterprises and debt owed by public enterprises to public banks, and as well as to finance the National Investment Fund. In total, monetary financing represented 11.6 percent of GDP, backed by securities with long maturities (up to 30 years), and at a low interest rate (0.5 percent).

<sup>1</sup> The government issued bonds for about 9 percent of GDP to finance the purchase of debt owed by a utility company to a public bank and to compensate the state-owned oil company for losses incurred from selling imported refined fuel in the domestic market at subsidized prices.

<sup>2</sup> The FRR was depleted in February 2017.

<sup>3</sup> Guarantees could become a burden for the central government budget if the financial position of public enterprises deteriorates significantly during the consolidation phase.

**3. Algeria's domestic public debt consists of treasury securities and restructured debt purchased from public enterprises.** Domestic debt consists of Treasury bills and bonds, as well as outstanding debt purchased from state-owned enterprises. At end-2017, about 53 percent of outstanding Treasury securities were held by the central bank, and the remaining by banks (mostly public) and insurance companies.<sup>4</sup>

**4. External debt has continued to decline.** After its last disbursement from the IMF in 1999, Algeria did not borrow externally until 2016, when the African Development Bank (AfDB) provided a €900 million budget support loan. At end-2017, public external debt represented only 2.4 percent of GDP. In addition to the AfDB loan, remaining external debt is mostly on concessional terms and owed to bilateral creditors.

**5. Under the authorities' budget plan, debt would decline over the medium term.** The 2018-20 medium-term budget plan calls for fiscal expansion in 2018, followed by very ambitious consolidation aiming to bring the deficit to zero in 2022.<sup>5</sup> The government intends to continue monetizing the deficit for the next three to five years. Staff estimates that it could borrow from the central bank up to 23.8 percent of 2017 GDP during 2018–22 (9.9 percent of 2018 GDP in 2018 alone). Starting in 2019, gross financing needs would decline rapidly, averaging about 4.8 percent of GDP over the period, and government debt is projected to fall to about 31 percent of GDP by 2023 (43 percent of GDP including guarantees).

**6. Alternative scenarios and stress tests indicate that projected debt levels remain manageable and gross financing needs remain limited.** Assuming no change in the primary balance (i.e., no fiscal adjustment) beginning in 2018, public debt (including guarantees) would increase to 49 percent by 2023—higher than in the baseline scenario, but still below the 70 percent benchmark for emerging market countries. Gross financing needs are not sensitive to shocks, and would remain limited even under the scenario of combined macro-fiscal shocks.

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<sup>4</sup> The central government also finances part of its deficit by using deposits from other public entities in the single treasury account ("circuit du Trésor".) The government does not include such financing as public debt although, in essence, it incurs a liability. (See 2017 Selected Issue Papers: "Financing Fiscal Deficits" and "Fiscal Risks in Algeria") for a discussion of this issue.

<sup>5</sup> The planned fiscal consolidation over the next three years has a percentile rank of 2 percent.

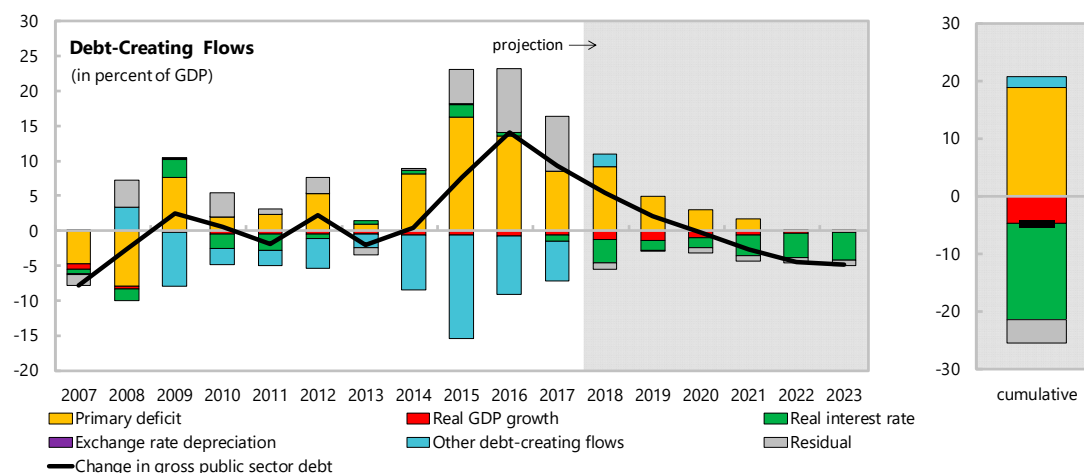
**Figure 1. Algeria: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario**  
(In percent of GDP unless otherwise indicated)

**Debt, Economic and Market Indicators**<sup>1/</sup>

	Actual			Projections						As of April 08, 2016
	2007-2015 <sup>2/</sup>	2016	2017	2018	2019	2020	2021	2022	2023	
Nominal gross public debt	18.1	38.8	48.0	53.5	55.6	55.4	52.7	48.2	43.3	Sovereign Spreads EMBIG (bp) 3/ n.a. 5Y CDS (bp) n.a.
Of which: guarantees	8.7	18.2	21.0	18.7	17.4	16.4	15.1	13.8	12.4	
Public gross financing needs	7.6	14.9	18.1	12.0	8.1	6.3	5.0	2.4	2.0	
Real GDP growth (in percent)	3.1	3.3	1.6	3.0	2.7	1.8	1.1	0.6	0.5	Ratings Foreign Local Moody's n.a. n.a. S&P's n.a. n.a. Fitch n.a. n.a.
Inflation (GDP deflator, in percent)	5.1	0.9	6.9	9.2	4.4	4.3	7.4	8.8	11.0	
Nominal GDP growth (in percent)	8.3	4.2	8.6	12.5	7.2	6.2	8.6	9.5	11.5	
Effective interest rate (in percent) <sup>4/</sup>	3.5	3.2	4.3	1.6	1.6	1.7	1.6	1.6	1.8	

**Contribution to Changes in Public Debt**

	Actual			Projections						cumulative	debt-stabilizing primary balance <sup>9/</sup>
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023		
Change in gross public sector debt	-0.1	14.1	9.3	5.5	2.1	-0.2	-2.7	-4.5	-4.9	-4.8	
Identified debt-creating flows	-1.6	5.0	1.4	6.4	2.2	0.6	-1.9	-3.8	-4.2	-0.7	
Primary deficit	3.3	13.5	8.5	9.2	5.0	3.0	1.7	0.1	0.0	18.9	-4.2
Primary (noninterest) revenue and grants	37.0	28.5	32.2	30.0	27.6	26.4	25.7	25.3	24.7	159.7	
Primary (noninterest) expenditure	40.3	42.0	40.7	39.2	32.5	29.4	27.4	25.4	24.7	178.6	
Automatic debt dynamics <sup>5/</sup>	-0.7	-0.2	-1.5	-4.7	-2.8	-2.4	-3.6	-3.8	-4.2	-21.4	
Interest rate/growth differential <sup>6/</sup>	-0.7	-0.2	-1.5	-4.7	-2.8	-2.4	-3.6	-3.8	-4.2	-21.4	
Of which: real interest rate	-0.2	0.5	-1.0	-3.4	-1.4	-1.4	-3.0	-3.5	-4.0	-16.7	
Of which: real GDP growth	-0.5	-0.8	-0.6	-1.3	-1.4	-1.0	-0.6	-0.3	-0.2	-4.7	
Exchange rate depreciation <sup>7/</sup>	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	-4.2	-8.3	-5.6	1.8	0.0	0.0	0.0	0.0	0.0	1.8	
FRR withdrawal (+) or accumulation (-)	-0.4	-8.0	-4.1	-2.1	0.0	0.0	0.0	0.0	0.0	-2.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Deposits of public entities (- reduces)	-3.8	-0.4	-1.5	3.9	0.0	0.0	0.0	0.0	0.0	3.9	
Residual, including asset changes <sup>8/</sup>	1.4	9.1	7.9	-0.9	0.0	-0.9	-0.8	-0.8	-0.7	-4.1	



Source: IMF staff.

1/ Public sector is defined as general government and includes public guarantees, defined as Debt guarantees.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as  $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+gr)]$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;

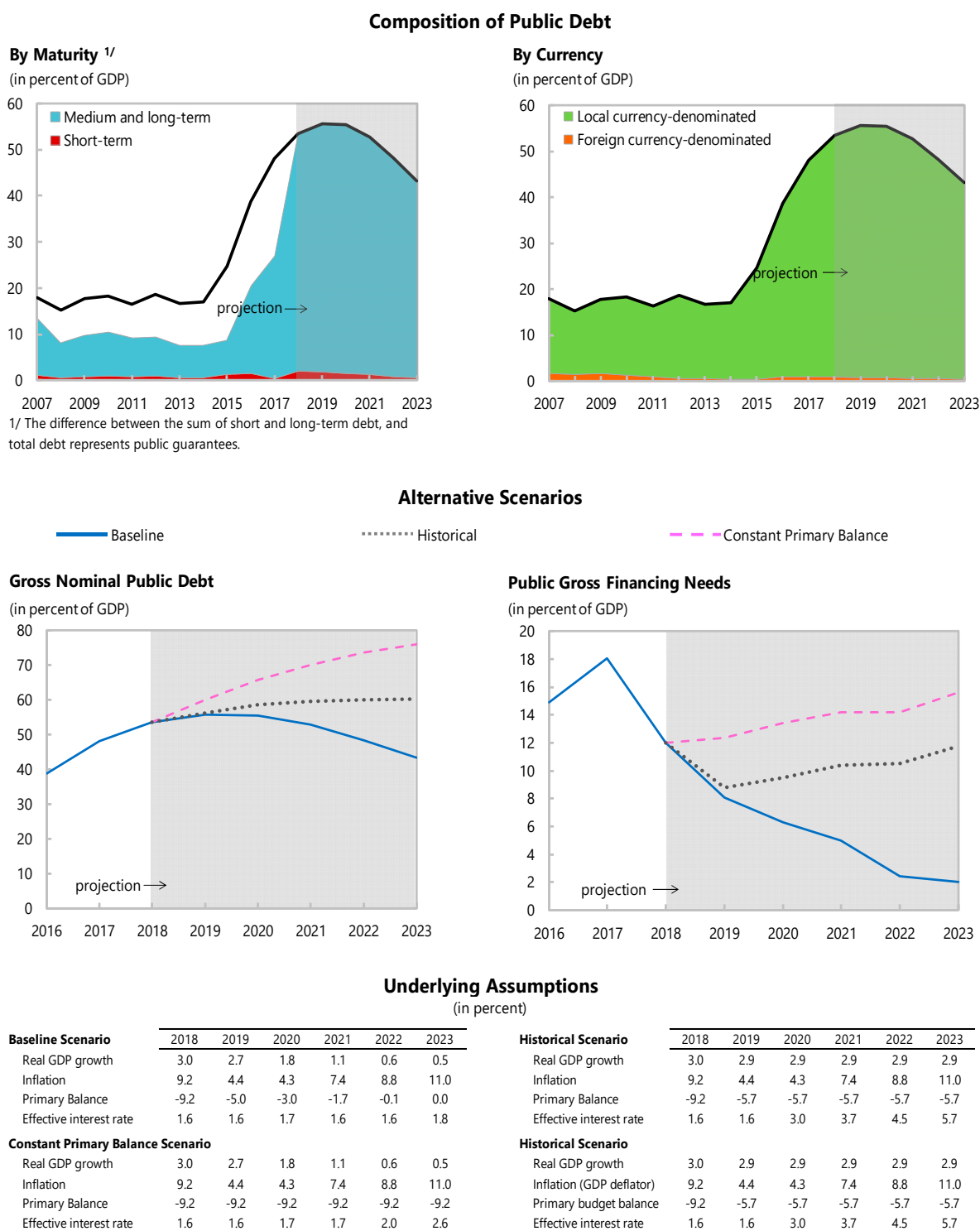
$a$  = share of foreign-currency denominated debt; and  $e$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

7/ The exchange rate contribution is derived from the numerator in footnote 5 as  $ae(1+r)$ .

8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

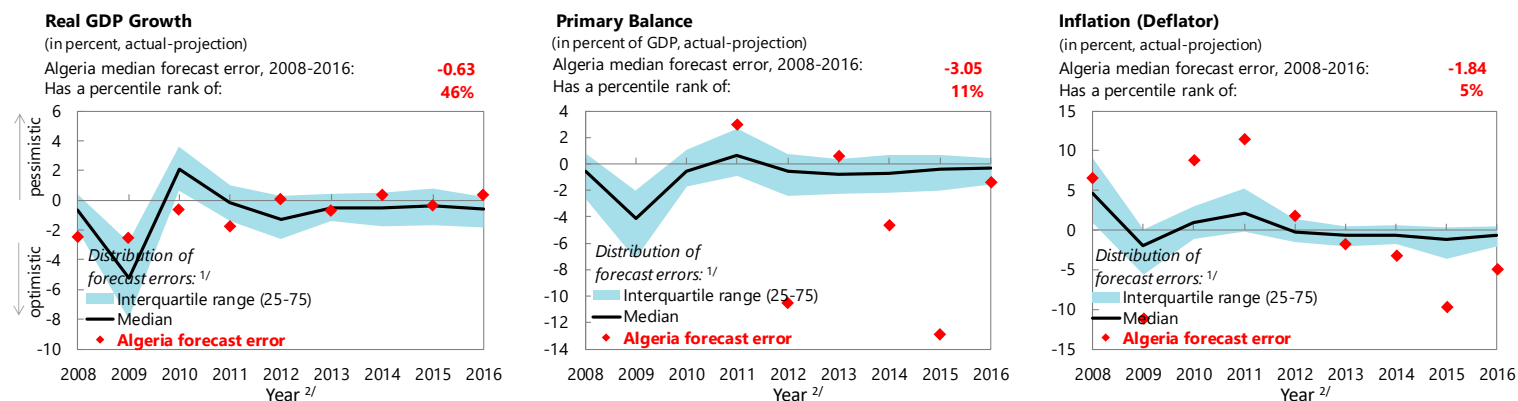
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

**Figure 2. Algeria: Public DSA—Composition of Public Debt and Alternative Scenarios**

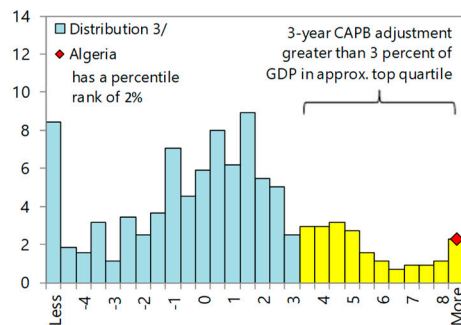
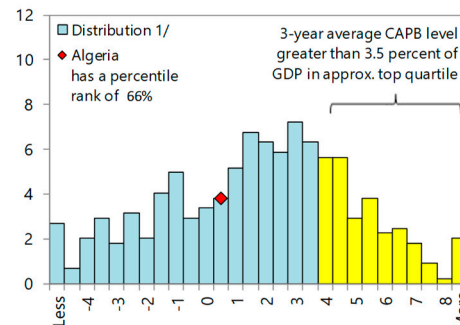
Source: IMF staff.

Figure 3. Algeria: Public DSA—Realism of Baseline Assumptions

## Forecast Track Record, versus all countries



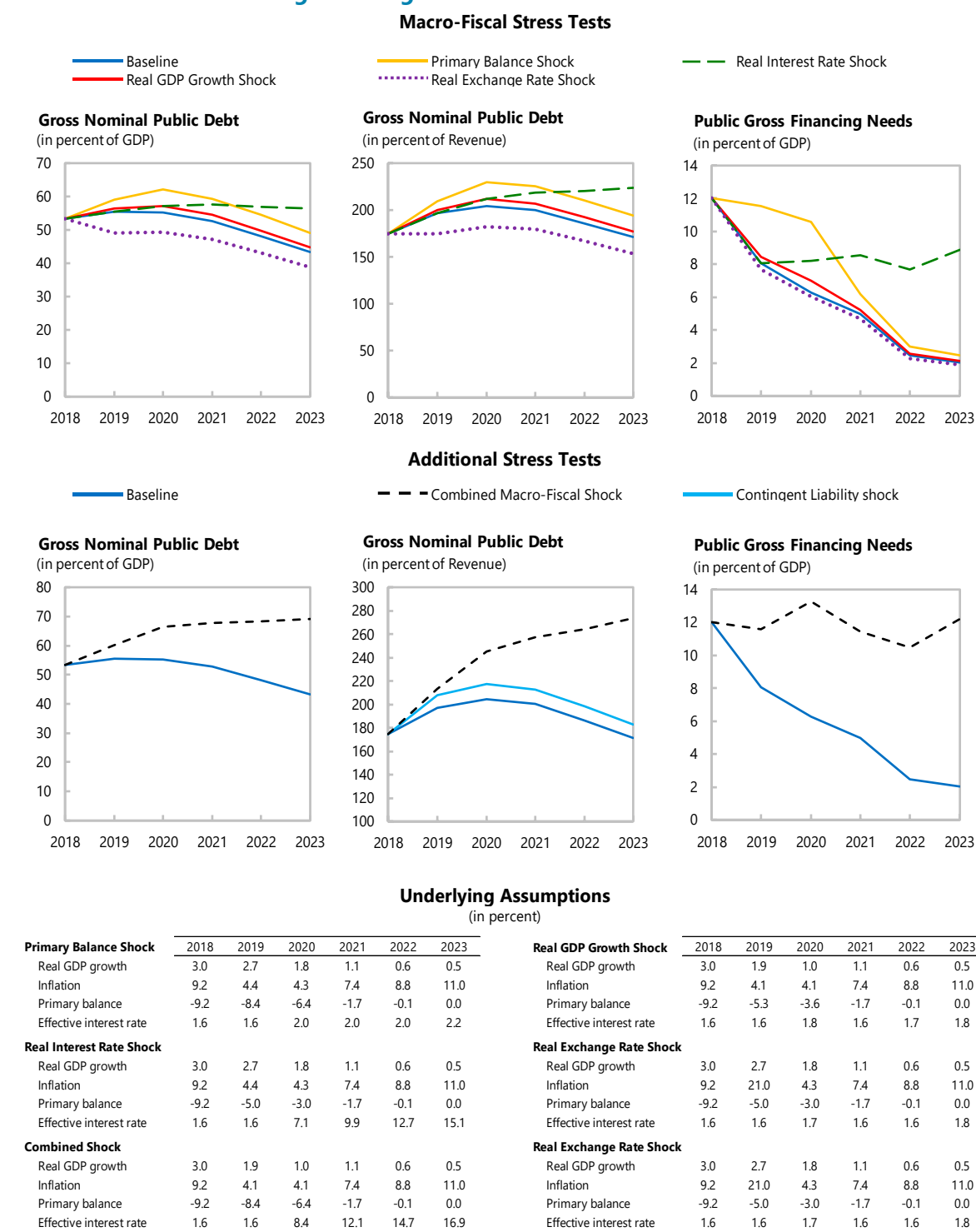
## Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)  
(Percent of GDP)3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)  
(Percent of GDP)

Source : IMF Staff.

<sup>1/</sup> Plotted distribution includes all countries, percentile rank refers to all countries.<sup>2/</sup> Projections made in the spring WEO vintage of the preceding year.<sup>3/</sup> Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.



**Figure 4. Algeria: Public DSA—Stress Tests**

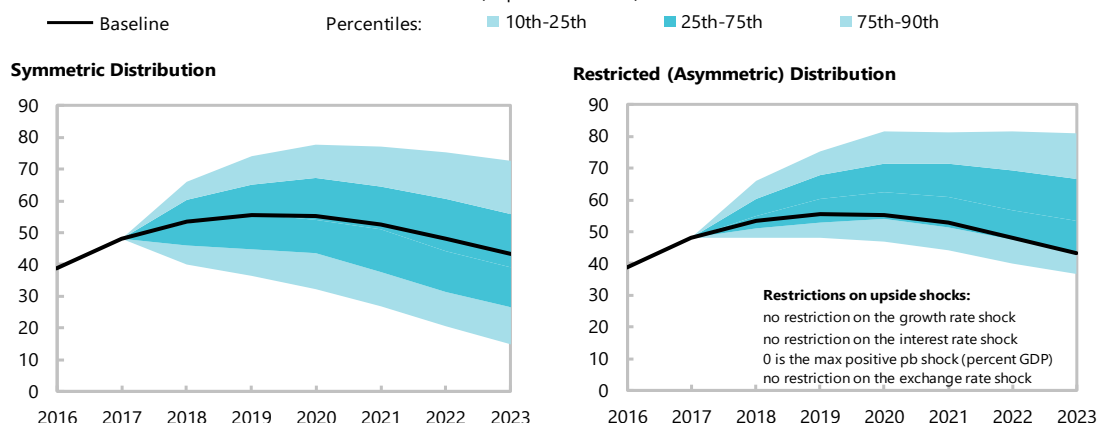
Source: IMF staff.

**Figure 5. Algeria: Public DSA Risk Assessment****Heat Map**

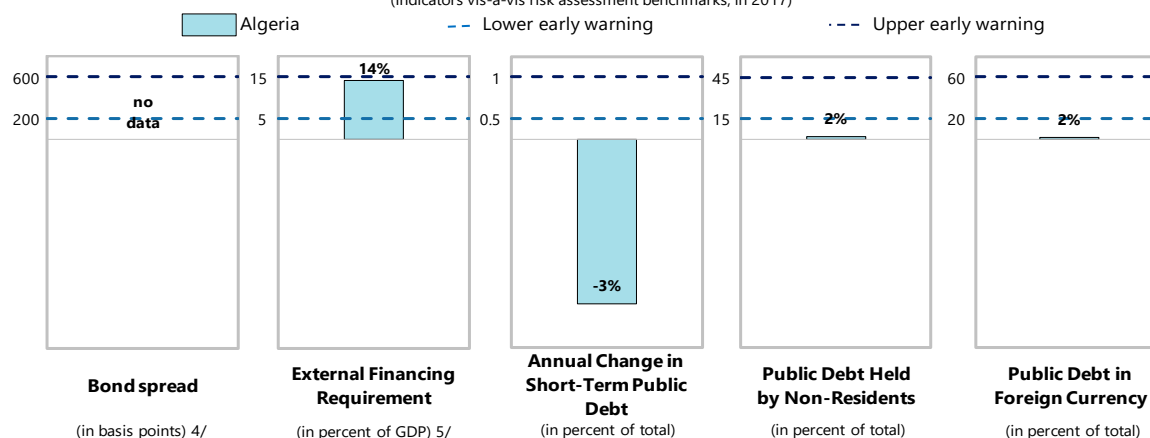
Debt level <sup>1/</sup>	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs <sup>2/</sup>	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile <sup>3/</sup>	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

**Evolution of Predictive Densities of Gross Nominal Public Debt**

(in percent of GDP)

**Debt Profile Vulnerabilities**

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cells are highlighted in red because gross financing needs are estimated to have exceeded the benchmark of 15% in 2017.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 09-Jan-16 through 08-Apr-16.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

**Table 1. Algeria: External Debt Sustainability Framework, 2013–23**  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -1.1
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	
<b>Baseline: External debt</b>	1.6	1.7	1.8	2.4	2.4	<b>2.1</b>	<b>1.9</b>	<b>1.8</b>	<b>1.6</b>	<b>1.5</b>	<b>1.4</b>	
Change in external debt	-0.1	0.1	0.1	0.6	0.0	-0.3	-0.2	-0.1	-0.1	-0.1	-0.1	
Identified external debt-creating flows (4+8+9)	-1.3	3.7	17.4	15.7	14.9	8.3	6.6	4.9	4.0	3.5	3.0	
Current account deficit, excluding interest payments	-0.4	4.4	16.4	16.6	15.9	9.2	7.5	5.8	4.9	4.5	4.0	
Deficit in balance of goods and services	-1.2	3.7	15.5	17.4	15.2	10.6	9.1	7.3	6.3	5.7	5.1	
Exports	32.6	29.7	22.9	20.4	22.0	22.8	20.7	19.2	18.5	17.9	17.0	
Imports	31.3	33.4	38.4	37.9	37.2	33.3	29.7	26.5	24.8	23.6	22.1	
Net non-debt creating capital inflows (negative)	-0.9	-0.7	0.4	-1.0	-0.8	-0.9	-0.9	-0.9	-0.9	-1.0	-1.0	
Automatic debt dynamics 1/	0.0	0.0	0.5	0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	
Contribution from nominal interest rate	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contribution from real GDP growth	0.0	-0.1	-0.1	-0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	
Contribution from price and exchange rate changes 2/	0.0	0.0	0.6	0.1	-0.2	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.2	-3.5	-17.2	-15.1	-14.8	-8.6	-6.7	-5.0	-4.1	-3.7	-3.1	
External debt-to-exports ratio (in percent)	4.8	5.7	7.9	11.8	11.0	9.2	9.3	9.2	8.8	8.3	8.0	
<b>Gross external financing need (in billions of US dollars) 4</b>	0.8	11.0	29.6	28.8	29.3	19.5	18.3	15.5	13.8	13.1	12.2	
in percent of GDP	0.4	5.1	17.9	18.1	17.2	10.3	9.2	7.4	6.4	5.8	5.1	
<b>Scenario with key variables at their historical averages 5/</b>						<b>2.1</b>	<b>-4.8</b>	<b>-9.7</b>	<b>-13.5</b>	<b>-16.6</b>	<b>-19.0</b>	<b>-0.1</b>
<b>Key Macroeconomic Assumptions Underlying Baseline</b>						Historical Average	Standard Deviation					
Real GDP growth (in percent)	2.8	3.8	3.7	3.3	1.6	2.9	0.8	3.0	2.7	1.8	1.1	0.5
GDP deflator in US dollars (change in percent)	-2.4	-1.8	-25.2	-7.2	9.9	1.1	16.4	7.6	2.8	2.8	2.3	5.7
Nominal external interest rate (in percent)	0.7	0.4	0.9	0.4	0.4	1.1	0.8	0.4	0.4	0.3	0.3	0.3
Growth of exports (US dollar terms, in percent)	-9.8	-7.0	-40.1	-14.6	15.5	-1.7	26.1	14.6	-4.2	-2.8	-0.3	1.2
Growth of imports (US dollar terms, in percent)	4.9	8.6	-10.8	-5.4	5.1	7.6	15.8	-0.6	-5.7	-6.6	-3.4	-0.4
Current account balance, excluding interest payments	0.4	-4.4	-16.4	-16.6	-15.9	-0.9	12.5	-9.2	-7.5	-5.8	-4.9	-4.0
Net non-debt creating capital inflows	0.9	0.7	-0.4	1.0	0.8	0.9	0.6	0.9	0.9	0.9	1.0	1.0

1/ Derived as  $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$  times previous period debt stock, with  $r$  = nominal effective interest rate on external debt;  $r$  = change in domestic GDP deflator in US dollar terms,  $g$  = real GDP growth rate,  $e$  = nominal appreciation (increase in dollar value of domestic currency), and  $a$  = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as  $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$  times previous period debt stock.  $r$  increases with an appreciating domestic currency ( $e > 0$ ) and rising inflation (based on GDP deflator).

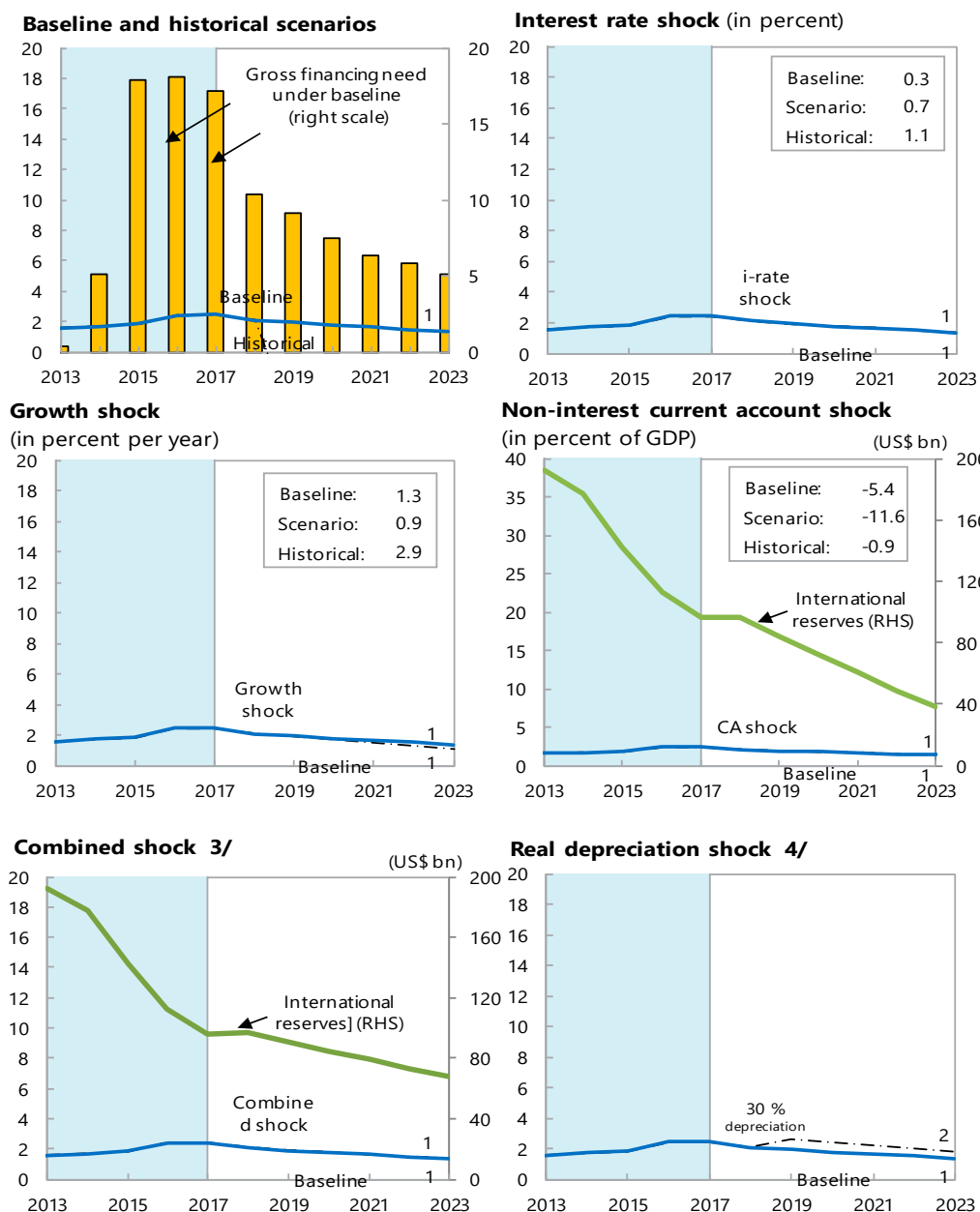
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

**Figure 6. Algeria: External Debt Sustainability: Bounds Tests 1/ 2/**  
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

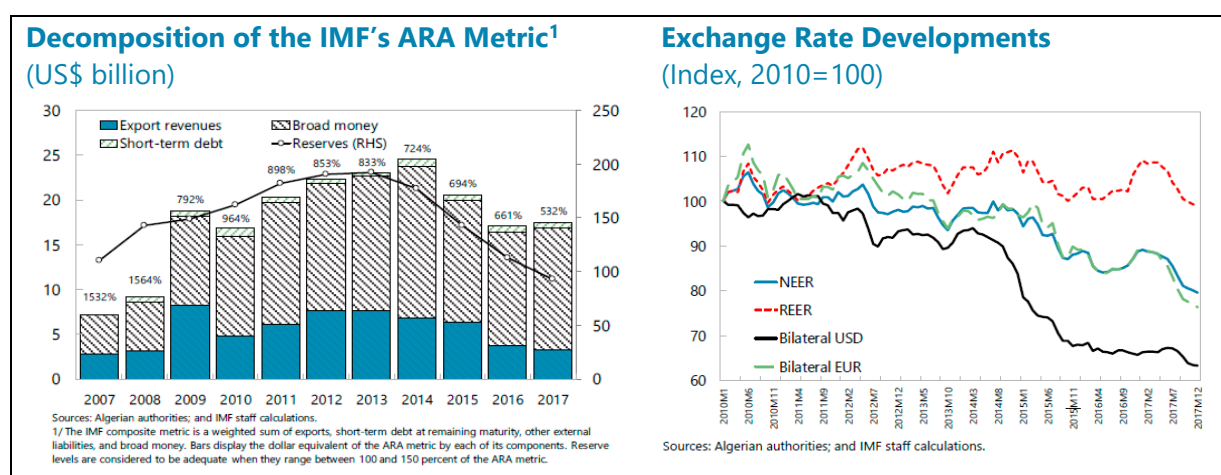
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2010.

## Annex V. External Sector Assessment

*The external position in 2017 was substantially weaker than warranted by medium-term fundamentals and desirable policies, but stock variables remain comfortable. External debt is negligible, and reserves are still well above adequacy ratios, although they are rapidly declining. The exchange rate has depreciated somewhat but remains overvalued and the current account deficit is significantly larger than warranted by medium-term fundamentals and desirable policies.*

- 1. The current account deficit remains large, dented only by a recent small hike in oil prices.** The large drop in oil prices in 2014 and declining hydrocarbon production turned large positive current account surpluses into large deficits. Since then, Algeria has not been able to redress the balance through fostering nonhydrocarbon exports or sufficiently reducing import demand. The recent increase in oil prices has somewhat helped reduce the current account deficit, which is estimated at 12.3 percent of GDP for 2017, down from 16.6 percent in 2016. In the baseline scenario, the current account deficit is projected to narrow significantly in the medium term, reflecting the impact of fiscal consolidation as well as hardened tariff and nontariff trade barriers.
- 2. Algeria's external buffers remain sizeable but are declining rapidly.** International reserves stood at about US\$96 billion at end-2017 (excluding SDRs), equal to 19 months of imports and 402 percent of the IMF's adjusted ARA metric. But reserves are now about half of their peak value in 2013 and are projected to decline over the medium term in the baseline scenario (US\$13 billion in 2023, equal to about 3 months of imports). Total external debt stood at just 2.3 percent of GDP in 2017 and is unlikely to increase in the foreseeable future as the government remains averse to external borrowing and given restrictions on nongovernment external borrowing.



- 3. Since the onset of the oil price shock, the dinar has significantly depreciated on a nominal basis, while real depreciation was smaller.** Since mid-2014, the dinar has depreciated by 31 percent against the dollar, helping to cushion the impact of lower oil prices. Over the same period, however, the REER has depreciated only by 8 percent because of higher inflation in Algeria than in its trading partners. In 2017, both the nominal and real effective exchange rates depreciated

(by 10 and 8 percent, respectively), mainly reflecting the movements of the dollar against major trading partners' currencies. The foreign exchange premium on the parallel exchange market stands at about 50 percent. Despite recent efforts to clarify the surrender requirements of nonhydrocarbon export receipts, more remains to be done to deepen the official FX market.

#### 4. EBA-lite methodologies suggest that the actual current account is well below its norm.

Both the current account and the external sustainability approaches suggest that the current account balance remained far from its norm in 2017, indicating a significant overvaluation of the REER. Staff estimates the overvaluation to be in the 13–51 percent range (consistent with a current account gap in the range of -3 to -10 percent), which is lower than in previous assessments. This reflects the recovery in oil prices as well as the impact of more restrictive trade policies. These estimates are subject to significant uncertainty as the magnitude and persistence of the terms-of-trade shock make the results of standard methodologies unstable: minor changes in underlying assumptions (e.g., regarding trade elasticities, desirable policies, or target NIIP) lead to significant variations in the degree of estimated overvaluation. The existence of a parallel exchange market also complicates the interpretation of the model's results. For these reasons, the EBA-REER method did not yield reliable results.

- The current account approach indicates that the external position in 2017 was substantially weaker than warranted by medium-term fundamentals and desirable policies, resulting in a difference (gap) of -9.9 percent of GDP in 2017. Closing the current account gap requires pursuing sustained fiscal consolidation, fostering export diversification through structural reforms and further nominal depreciation of the dinar.
- The external sustainability approach also points to a large current account gap. Assuming the international investment position (IIP) remains stable at its initial level of 37.6 percent of GDP, the current account norm would be 2.3 percent of GDP, implying a gap of -6.5 percent over the medium term.<sup>1</sup> If the IIP is stabilized at its projected value in 2023, the current account norm would be -1.1 percent of GDP, yielding a smaller gap of -3.1 percent of GDP.

**Text table 1. EBA-Lite Estimates of CA Gap 1/**  
(In percent of GDP)

	Current account norm	Current account actual	Current account gap
EBA-lite current account approach	-3.1	-13.0	-9.9
EBA-lite external sustainability approach		Underlying current account	
Scenario 1: Stabilizing net IIP at current level	2.3	-4.2	-6.5
Scenario 2: Stabilizing net IIP at 2022 projected level	-1.1	-4.2	-3.1
1/ Estimates based on staff's recommended policy mix, as captured in the alternative scenario (Annex II)			

<sup>1</sup> Algeria's IIP consists mostly of international reserves. External debt and FDI are negligible compared to the size of international reserves. Valuation changes are not taken into account in the government's estimate of the IIP.

Table 1. Algeria: External Sustainability Assessment

<b>Current account</b>	<p><b>Background:</b> Despite a 15 percent improvement in the terms of trade on the back of a 17 percent increase in oil prices, the current account deficit narrowed by 3.8 percentage points of GDP in 2017 as imports remained high. The current account deficit is expected to narrow significantly over the medium term, as a result of further terms-of-trade improvement (in 2018), stringent import restrictions, and planned fiscal consolidation (starting 2019).</p> <p><b>Assessment:</b> The EBA-lite CA model yields a current account gap of -9.9 percent of GDP at end-2017, while the ES approach suggests a current account gap between -6.5 percent and -3.1 percent of GDP.</p>	<p><b>Overall assessment:</b> Algeria's net international investment position remains comfortable. External debt is nearly nonexistent, and reserves, though declining, are still well above adequacy ratios. However, the external position in 2017 was substantially weaker than warranted by medium-term fundamentals and desirable policy settings, and the REER remains significantly overvalued.</p> <p><b>Potential policy responses:</b> Sustained fiscal consolidation would help restore external balances. Structural reforms are needed to foster export diversification. To help bring the REER in line with its equilibrium value, further exchange rate depreciation is needed. Independent monetary policy aimed at curbing inflationary pressures has also a key role to play.</p>
<b>Real effective exchange rate (REER)</b>	<p><b>Background:</b> The REER depreciated by 8.2 percent in 2017, mainly reflecting the movements of the dollar against the currencies of Algeria's major trading partners.</p> <p><b>Assessment:</b> Both the EBA CA and ES approaches suggest that the REER remains significantly overvalued.</p>	
<b>Capital and financial accounts</b>	Capital flows are minimal due to multiple restrictions. FDI is small and is concentrated in the hydrocarbon sector.	
<b>Reserve Position</b>	<p><b>Background:</b> International reserves peaked at US\$192 billion in 2013. Since then, they were halved and stood at US\$96 billion at end-2017 (excluding SDRs), equal to 19 months of imports.</p> <p><b>Assessment:</b> Despite their rapid decline, reserves remain comfortable, equal to 402 percent of the IMF's ARA metric adjusted for oil exporters.</p>	
<b>Foreign assets and liabilities position and trajectory</b>	<p><b>Background:</b> Algeria's NIIP at end-2017 was 37.6 percent of GDP. Liabilities are negligible compared to assets, which are dominated by foreign reserves. Portfolio investment does not exist as either assets or liabilities.</p> <p><b>Assessment:</b> Since the stock of external debt and FDI is small, the NIIP trajectory is similar to the path of foreign reserves. Under the baseline scenario, the NIIP is projected to turn negative over the medium term, reaching - 6.7 percent of GDP by 2023.</p>	

## Annex VI. Implementation of 2014 FSAP Recommendations 1/

Recommendation	Responsible <sup>2</sup>	Timeline	Implementation
<b>Leverage hydrocarbon revenue for financial sector development:</b> Improve intergenerational smoothing of hydrocarbon revenue (full-fledged fiscal rule, sovereign wealth fund (SWF)).	BA/MoF	MT-LT	Partial progress. A new organic budget law introducing a fiscal rule tying current spending to nonhydrocarbon revenues is expected to be adopted in 2018. However, the oil stabilization fund revenue (FRR) has been depleted to fund the budget during 2015-2017. No SWF was created.
<b>Exchange controls:</b> Gradually reduce restrictive measures on foreign exchange transactions.	BA/MoF	MT-LT	Partial progress. An MCM technical assistance (TA) mission on foreign exchange (FX) market issues recommended to relax current FX regulations, and harmonizing the repatriation and surrender requirements of nonhydrocarbon export receipts. The BA extended the deadline for repatriating the proceeds of nonhydrocarbon exports from 180 to 360 days.
<b>FX market:</b> Allow nonhydrocarbon exporters to sell directly into the foreign exchange market, to stimulate its development, including for forward contracts.	BA	ST	Partial progress. An MCM TA mission in 2017 assisted the authorities with the design and testing of an FX forward market.
<b>Liquidity management:</b> Create a structural liquidity shortage to facilitate monetary policy implementation.	BA	ST	To be updated. The fall in hydrocarbon revenue, and continued efforts by the BA to absorb excess liquidity, led to liquidity shortages at some banks in 2016 and 2017. The BA built the framework for open market operations and the marginal lending facility in September 2016 and started using OMOs in 2017, while ceasing to use its discount window to supply liquidity to banks. Monetary funding of the fiscal deficit in late 2017 generated excess liquidity, which BA is mopping up by taking bank deposits. Staff recommended an enhancement to this mechanism.
<b>Emergency liquidity facility assistance (ELA).</b> Clarify the emergency liquidity assistance framework.	BA	ST	Not done yet.
<b>State-owned bank reform:</b> Complete corporate governance reform agenda.	BA/MoF	ST-MT	Partial progress. The BA has drafted regulations on bank governance, with IMF and World Bank technical assistance
<sup>1</sup> An FSAP update is scheduled for 2019. <sup>2</sup> BA: Bank of Algeria; MoF: Ministry of Finance; MoJ: Ministry of Justice; COSOB: <i>Commission d'Organisation et de Surveillance des Opérations de Bourse</i> (financial market regulation and supervisory agency).			



Recommendation	Responsible	Timeline	Implementation
<b>State-owned bank reform:</b> Complete corporate governance reform agenda.	BA/MoF	ST-MT	Partial progress. The BA has drafted regulations on bank governance, with IMF and World Bank technical assistance
<b>Consumer lending:</b> Replace consumer lending restrictions with prudential measures; introduce an effective public credit registry for households, and introduce a personal bankruptcy framework.	BA	MT	Partial progress. The credit registry was technically upgraded and extended to individual borrowers. The ban on consumer lending was lifted. No progress on personal bankruptcy as the concept is not defined in national law and raises legal implementation issues.
<b>Banking supervision:</b> Facilitate the write-off of NPLs; improve the operational framework for supervision; continue moving toward Basel II/III standards; improve macroprudential oversight; develop stress-test expertise; introduce consolidated supervision.	BA	ST-MT	Partial progress. New capital adequacy requirements reflecting Pillar I of Basel II and elements of Basel III were introduced in 2014, as well as some liquidity metrics (minimum liquidity and transformation ratios). Loan classification requirements were strengthened and cover overdraft and restructured loans. New rules allow fully-provisioned small NPLs to be written off, but no progress has been made on writing off a historic NPL stock. The BA has been performing bank stress testing. A TA mission in March 2017 provided advice on enhancing banks' governance and implementing consolidated supervision. The BA has also required banks to produce consolidated financial statements. But a systemic risk framework and full resolution powers are still missing.
<b>Small and medium-sized enterprise (SME) lending:</b> Revisit existing government support programs for microenterprises and SMEs, including partial credit guarantee funds.	MoF	MT	Not done yet.
<b>Insurance:</b> Adapt motor third-party liability (MTPL) premiums and reduce compulsory reinsurance.	Insurance Directorate.	MT	No progress.
<b>Insolvency regime:</b> Modernize the insolvency regime to mitigate risk and strengthen the credit environment.	MoJ, MoF	MT	No progress.
<b>Collateral regime:</b> Improve debt enforcement procedures.	MoJ, MoF	ST-MT	No progress.

Recommendation	Responsible	Timeline	Implementation
<b>Criminal sanctions:</b> Clarify Criminal Code sanctions on mismanagement of funds in state-owned enterprises, with judicial training on implementation.	MoJ	ST	No progress. However, at the September 2014 tripartite meeting of trade unions, employers, and the government, there was agreement on the principle of lifting the criminal sanctions for management errors.
<b>Payment systems:</b> Set up a payment system council to monitor the modernization of payment systems and formalize a plan to decrease the proportion of fiduciary money in M2.	BA	MT	Partial progress. A draft law on electronic certification has been adopted. A system is in place for the development of electronic payments that allowed a number of financial institutions to offer electronic payment services.
<b>Capital market development:</b> Finance budget deficits through the issuance of T-bonds along the yield curve and revisit the issuance policy at the MoF to foster liquidity.	MoF	ST-MT	Partial progress. Net T-bill and T-bond issuance was negative in 2016. However, the government did issue an ad-hoc, 5-year local-currency bond (the National Bond for Economic Growth) aimed at retail investors.
<b>Stock exchange:</b> Implement the modernization program set up by the Algerian Securities Commission (COSOB) in 2012.	COSOB/MoF	LT	Limited progress. Training programs were set up for employees. New rules were introduced on trading. Information systems have been upgraded. In 2016, the COSOB approved the IPO of one SOE, but the operation was canceled for lack of investor interest.
<b>Crisis management:</b> Establish (i) special resolution regime (SRR) for failing financial institutions; (ii) memorandum of understanding (MoU) outlining principles for financial crisis management; and (iii) MoU between safety net participants on information exchange and decision-making processes.	BA, MoF	LT ST	No progress.
<b>AML/CFT:</b> Implement action plan established with the FATF International Cooperative Review Group.	BA, MoF, MoJ	ST	Fully implemented. Algeria is no longer subject to the FATF's monitoring process under its ongoing global AML/CFT compliance process.

## Annex VII. Promoting Greater Female Participation in the Labor Market

*Algeria has one of the lowest female labor participation rates in the world. As women are more and more educated, this leaves a large share of potential productive workforce untapped and represents a significant loss of potential output. Even though women's labor force participation is likely to increase over time as the economy develops, proactive policy action can enable the country to leverage this opportunity faster.*

- 1. Fostering women's place in the labor market is a focus of the government.** The government has committed in its 2018 action plan to advance the role of women in the labor market, especially by promoting them to jobs with greater responsibilities in public and private sector jobs. However, the plan needs concrete proposals. Moreover, the government considers that women's participation in the labor market will continue to increase on its own, spurred by the progress made in women's educational attainment.
- 2. Despite strong progress in education, women have not made commensurate progress in employment.** Women's educational attainment has improved and caught up with men's: women are more likely to complete secondary education and perform better than men in international tests scores. However, nearly half of young women (aged 15–24) are not in education, employment or training. Improvements in education have not translated into a significant improvement in women's labor market outcomes: Algerian women fare worse than both men in Algeria and women in peer countries. Only 17 percent of women participate in the labor force (versus an average of 25 percent in the Middle East and North Africa region). When they are active, they face much higher unemployment rates (20.7 percent) than their male counterparts (9.4 percent), and the gender gap in unemployment increases with the level of education.
- 3. The gender wage gap appears insignificant, reflecting strong selection.** Among employed women, a recent survey shows a positive overall wage gap in favor of women and no significant difference between men and women's wages by level of education.<sup>1</sup> The positive wage gap is due to the strong selection effect of women into employment: the few women who are employed tend to be on average more educated than working men. While over 40 percent of female employees have a tertiary education, only 10 percent of male employees do. Moreover, women who work tend to have better quality jobs: they are more likely to be employed in permanent salaried jobs, and in the public sector, and to be affiliated with social security. However, these statistics are likely to exclude informal workers, for which there are no available data.
- 4. While Algerian regulations support gender equality and non-discrimination, practical and cultural barriers partly explain the low participation of women in the labor market.** There is some evidence that women drop out from the labor market once they reach their late thirties. Despite a slow increase in women's labor force participation over time, there is a sharp drop in

<sup>1</sup> Enquête sur les dépenses de consommation et le niveau de vie des ménages—2011 (ONS, 2014).

participation starting in the 30–34 age group. This suggests that once they start a family (average age at marriage ranges between 25 to 30 for Algerian women, and the average age at first birth is 32), their expected role in the household may limit their ability to seek suitable outside work. There are several concrete impediments that may explain this, such as the absence of quality child care and limited provision of early education, inadequate lunch options in schools, inflexible work hours, and long commute without adequate public transportation. However, family formation only partly explains the gender gap since the labor force participation of even young single women remains well below their male counterparts.

**5. By enlarging the pool of talent available to employers, increased female labor market participation would enhance growth.** Simple estimates show that bringing the female employment rate to male levels (which could only happen gradually over a long period of time in practice) could raise GDP per capita in Japan by 9 percent, the United Arab Emirates by 12 percent, and Egypt by 34 percent.<sup>2</sup> Under similar assumptions, the GDP boost in Algeria would be around 40 percent. Recent literature (Cuberes, Newiak and Teigner 2016), points to similar estimates. Using a more elaborate model, the paper suggests that countries in the Middle East and North Africa could see large increases in GDP were they to eliminate labor market frictions that prevent women from joining the labor force.<sup>3</sup> For Algeria, reducing gender gaps over a fifty-year period would see increases in GDP of around 40 percent by 2040.

**6. To support women's inclusion in the labor market, the government should lead by example.** Fostering private sector job creation, which is part of the goals of the government, will contribute to increasing opportunities for women. But attention should also be given to the gender dimension of policies. The commitment of the government to uphold the principles set out in the constitution will help. Progress has been made in some areas, for example the number of women in parliament has increased significantly. Public sector employment already guarantees equal treatment to women, which found it an attractive form of employment. Specific measures could be designed with women in mind, for example providing more flexible work hours and improving the reliability of child care and public transportation. In addition, some existing measures, which may discourage female labor should be reviewed, as part of a more general review of the net impact active labor market policies. For example, women benefit from allowances—including micro-credit for stay-at-home women—that may discourage them from joining the formal labor market. The social and economic costs and benefits of such measures would need to be assessed carefully. More generally, normalizing women's work in the public discourse may help change attitudes.

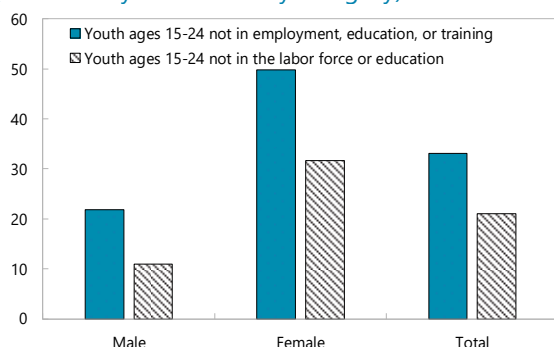
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<sup>2</sup> Aguirre and others (2012).

<sup>3</sup> The model used for this estimate is a general equilibrium occupational choice model in which agents are endowed with a random entrepreneurship skill that determines their optimal occupation. Agents choose to work as either employers, self-employed, or employees. Female labor market frictions prevent an optimal choice of women between these activities.

**Figure 1. Indicators on Female Education and Labor Market Outcomes****Youth Ages 15–24 Not in Employment, Education, or Training, 2017**

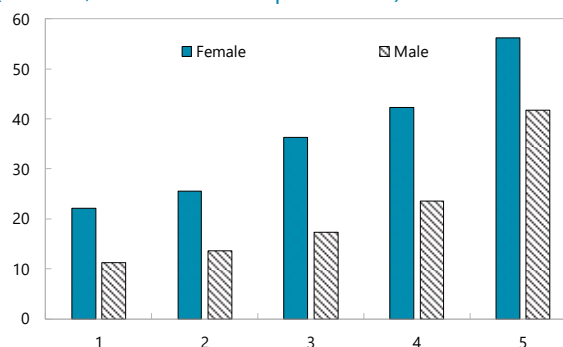
(Percent of youth 15-24 by category)



Source: Algerian authorities.

**Secondary School Completion Rates by Family Income Quintile, 2013**

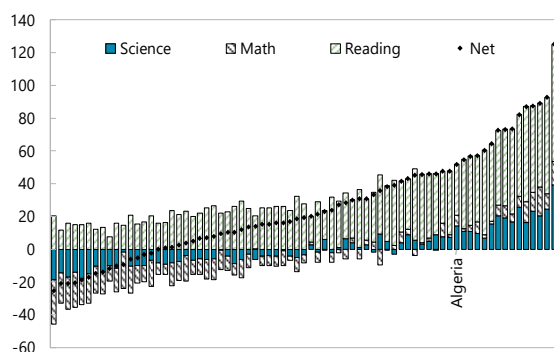
(Percent, lowest income quintile = 1)



Sources: UNESCO.

**Gap between Female and Male PISA Scores, 2015**

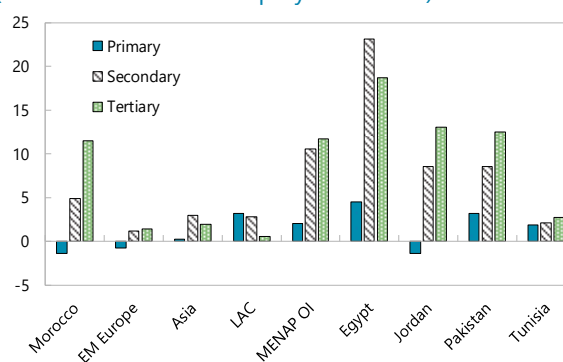
(Female - male by subject; test scale = 0 to 1000)



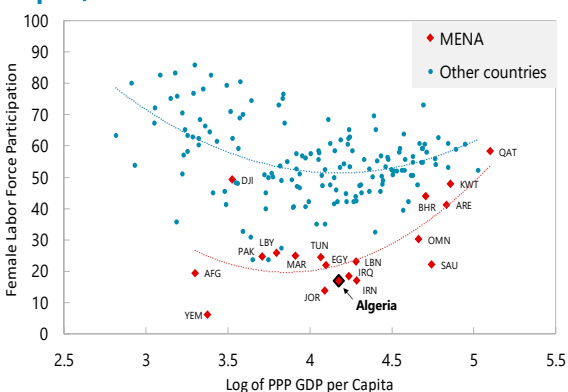
Sources: OECD. PISA = Program for International Student Assessment.

**Gap between Female and Male Unemployment by Education Level**

(Female minus male employment rates)



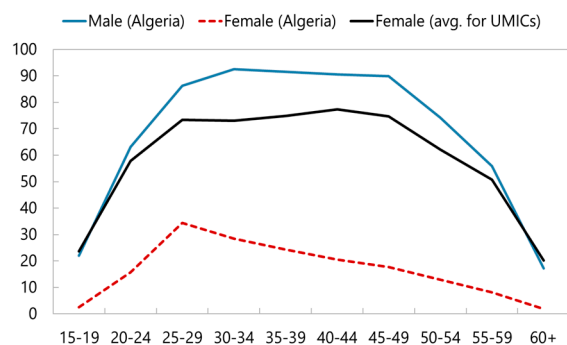
Sources: ILO; and IMF staff estimates.

**Figure 1. Indicators on Female Education and Labor Market Outcomes (concluded)****Female Labor Force Participation and GDP per Capita, 2017**

Sources: World Bank; and IMF staff estimates.

**Labor Force Participation by Gender and Age, 2017**

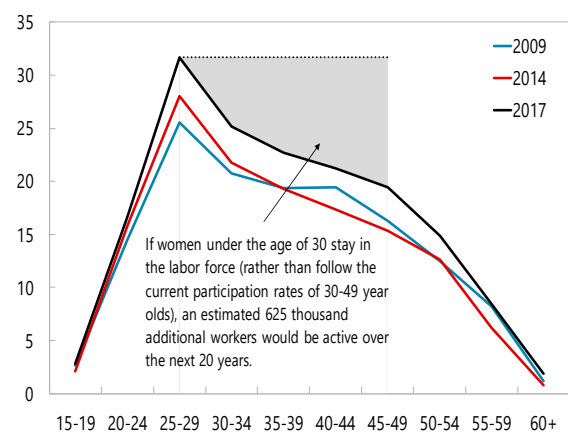
(Percent of age-band in labor force)



Sources: ILO modeled estimates. LMIC = Lower middle-income countries.

**Female Labor Force Participation Rates by Age Group**

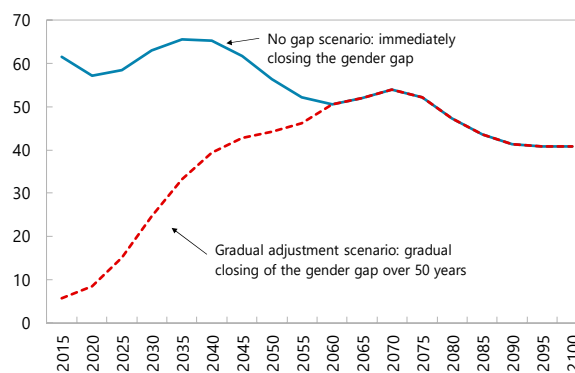
(Percent of female population; participation rates for each year)



Source: Algerian authorities.

**Projected Income Gain if the Gender Gap is Closed, 2015-2100**

(Percent, baseline assumes current gender gap and medium fertility)

Source: IMF staff estimates. See Cuberes, D., and M. Teignier. "Aggregate Effects of Gender Gaps in the Labor Market: A Quantitative Estimate." *Journal of Human Capital* 10 (1): 1–32, 2016.



# ALGERIA

## STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 15, 2018

Prepared By

The Middle East and Central Asia Department  
(In collaboration with other departments)

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## RELATIONS WITH THE FUND

(As of May 4, 2018)

**Membership Status:** Joined: September 26, 1963; Article VIII.

### General Resources Account

	SDR Million	Percent Quota
Quota	1,959.90	100.00
IMF's holding of currency (holdings rate)	1,761.82	89.89
Reserve tranche position	198.08	10.11

### SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	1,198.18	100.00
Holdings	897.54	74.91

### Outstanding Purchases and Loans

None

### Financial Arrangements (In millions of SDR)

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	5/22/1995	5/21/1998	1,169.28	1,169.28
Stand-by	5/27/1994	5/22/1995	457.20	385.20
Stand-By	6/03/1991	3/31/1992	300.00	225.00

### Projected Obligations to Fund

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

	Forthcoming				
	2018	2019	2020	2021	2022
Principal	0.00	0.00	0.00	0.00	0.00
Charges/interest	1.93	2.59	2.59	2.59	2.59
Total	1.93	2.59	2.59	2.59	2.59

**Implementation of HIPC Initiative: Not Applicable.**



## Exchange Rate Arrangement

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 occasionally. 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 May 5, 2018, the average of the buying and selling rates for the U.S. dollar was US\$ 1 = DZD 115.33, equivalent to SDR 1 = DZD 165.09. No margin limits are imposed on the buying and selling exchange rates in the interbank foreign exchange market, except for a margin of DA 0.015 between the buying and selling rates of the Bank of Algeria for the dinar against the U.S. dollar.

The *de jure* exchange rate arrangement is managed floating and the *de facto* exchange regime is classified as other managed arrangement with no preannounced path for the exchange rate. Algeria maintains an exchange system free from restrictions on the making of payments and transfers for current international transactions.

## Article IV Consultation

Algeria is on a 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on May 11, 2017 (IMF Country Report 17/141). The discussions for the 2018 Article IV consultation were held in Algiers from February 27 to March 12, 2018.

## Technical Assistance

STA	Monetary and financial statistics and financial stability indicators	April 2012
MCM	Banking supervision, macro-prudential policy and monetary policy	September 2012
FAD	Public financial management	September 2012
FAD	Subsidy reform	March 2013
FAD	Tax policy	November 2013
MCM	Bank supervision	December 2013
FAD	Tax administration	April 2014
STA	International investment position statistics	September 2014
MCM	Foreign exchange market development	September 2014
FAD	Multiyear budgeting	September 2014
FAD	Tax policy	January 2015
MCM	Interbank financial market development	February 2015
FAD	Organic budget law	April 2015
FAD	Tax administration	April 2015
MCM	Management of foreign exchange reserves	April 2015
RES	Macro-modeling	May 2015
MCM	Macroprudential policies and financial stability	July 2015
MCM	Liquidity management, monetary operations, and interbank market developments	September 2015

MCM	Enhancing bank regulation and supervision	November 2015
FAD	Tax and customs administration	November 2015
MCM	Setting up a liquidity committee	December 2015
FAD	Tax administration	February 2016
MCM	Financial stability and macroprudential policy framework	April 2016
MCM	Liquidity management	May 2016
FAD	Public financial management	July 2016
FAD	Tax administration	October 2016
MCM	Debt market development	October 2016
FAD	Tax administration	November 2016
MCM	Upgrading banking regulations	March 2017
MCM	Forward market development	March 2017
FAD	Tax administration	April 2017
MCM	Collateral framework	July 2017
METAC	Banking supervision	October 2017
FAD	Tax administration	November 2017
FAD	Medium-term budget framework and fiscal risk management	November 2017
MCM	Forward market development (workshop)	November 2017
FAD	Custom administration	December 2017
STA	External sector statistics	January 2018
FAD	Tax policy (local government)	March 2018
METAC	National accounts	March 2018
MCM	Monetary policy and risks to financial stability	March 2018
MCM	Monetary policy operations and liquidity management (long-term expert resident)	October 2016-

### Financial Sector Assessment Program

Algeria first participated in the FSAP in 2003. The FSAP was updated in 2007 and in 2013. The Executive Board discussed the Financial System Stability Assessment on January 24, 2014 (IMF Country Report No. 14/161). An FSAP update is scheduled for 2019.

### Resident Representative

None.

## RELATIONS WITH THE WORLD BANK GROUP

<b>JMAP Implementation, FY18</b> (As of Feb 26, 2018)			
Title	Products	Provisional timing of missions	Expected delivery date
A. Mutual Information on Relevant Work Programs			
Bank work program in next 12 months	<b>a. Sector work</b> <ul style="list-style-type: none"> <li>Algeria Vision 2035</li> <li>Subsidies Reform TA</li> </ul> <b>b. Technical assistance</b> <ul style="list-style-type: none"> <li>AGID: Capacity Building in Integrated Desert Management</li> <li>MADR: Integrated Value Chain in Agriculture</li> <li>Addressing Barriers to increased Exports in Algeria</li> </ul>	March-June 2018 March-June 2018        March-June 2018	Sept. 2018 Dec. 2019    April 2018 June 2018 October 2019
IMF work program in next 12 months	Staff visit Staff visit 2019 Article IV consultation Continued technical assistance expected in the following areas: <ul style="list-style-type: none"> <li>Liquidity management</li> <li>FOREX regulation</li> <li>Public financial management</li> <li>Tax policy and tax administration</li> <li>Macroprudential policy</li> <li>Bank supervision and regulation</li> <li>Government statistics</li> <li>FSAP update</li> </ul>	July 2018 November 2018 March 2019        FY 2019	May 2019
B. Requests for Work Program Inputs			
Fund request to Bank	Analysis related to 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) Ongoing	Following Article IV and staff visits

Title	Products	Provisional timing of missions	Expected delivery date
<b>C. Agreement on Joint Products and Missions</b>			
Joint products in next 12 months	Continuous close coordination on the reform agenda	Ongoing	

# STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance	
<b>General:</b> Data provision has some shortcomings, but is broadly adequate for surveillance.	
<p><b>National Accounts:</b> National accounts broadly follow the 1993 SNA recommendations. However, nonprofit institutions serving households are not included in the estimates and the coverage of the non-financial corporations and household sectors is weak. Annual national accounts are available since 2001 and quarterly national accounts since 2011. Volume measures are derived at prices of the previous year, then chain linked. Quarterly GDP by expenditure components is not calculated.</p> <p><b>Price Statistics:</b> The monthly consumer price index is published with a delay of less than one month. The index reference period is 2001 with weights from 2000. The quarterly producer price index is published with a delay of less than one quarter. The index base period is 1989.</p>	
<p><b>Government finance statistics:</b> Key shortcomings include insufficient institutional coverage (coverage is limited to the central government), 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. The authorities have not reported GFS data for publication in the Government Finance Statistics Yearbook since 2011.</p>	
<p><b>Monetary statistics:</b> The central bank of Algeria (BA) submits the monetary statistics for the central bank, other depository corporations (ODCs), and other financial corporations to STA on a timely basis. Monetary statistics are published in the International Financial Statistics. The monetary data are based on the Standardized Report Form (SRF) following the methodology of the Monetary and Financial Statistics Manual and Compilation Guide (MFSMG).</p>	
<p><b>Financial Sector Surveillance:</b> BA reports Financial Soundness Indicators (FSI), which are published on the IMF's FSI website. However, the periodicity of the data needs to be improved as the FSIs are currently reported only on a yearly basis.</p>	
<p><b>Balance of payments:</b> Balance of payments statistics are of relatively good quality. The data collection system appears comprehensive in terms of payments measurement, but has incomplete coverage of transactions other than settlements (e.g. reinvested earnings) and some position data. A January 2018 TA mission worked with the compilers to address several weak areas, including (i) recording of construction projects as FDI vs. services; (ii) trade statistics; and (iii) FDI position data. Balance of payments and IIP statistics are disseminated regularly on the national website and transmitted to the IMF for re-dissemination in the IFS (2016 are the latest IFS data).</p>	
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 March 28, 2018

	Date of latest observation	Date received	Frequency of Data <sup>7</sup>	Frequency of Reporting <sup>7</sup>	Frequency of publication <sup>7</sup>
Exchange Rates	04/18	04/24/18	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	03/18	05/01/18	D	M	Q
Reserve/Base Money	03/18	05/01/18	D	M	Q
Broad Money	12/17	02/13/18	D	M	Q
Central Bank Balance Sheet	03/18	05/01/18	D	M	Q
Consolidated Balance Sheet of the Banking System	02/18	05/01/18	M	M	Q
Interest Rates <sup>2</sup>	02/18	03/11/18	M	M	Q
Consumer Price Index	03/18	04/11/18	M	M	M
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —Central Government <sup>4</sup>	12/17	04/24/18	M	I	A
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	12/17	04/24/18	I	I	A
External Current Account Balance	Q4, 2017	03/07/18	Q	I	Q
Exports and Imports of Goods and Services	Q4, 2017	03/07/18	Q	I	Q
GDP/GNP	Q4, 2017	04/12/18	A	A	A
Gross External Debt	Q4, 2017	03/07/18	Q	I	Q
International Investment Position <sup>6</sup>	2016	10/11/17	I	I	NA

<sup>1</sup>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.

<sup>2</sup>Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

<sup>3</sup>Foreign domestic bank, and domestic nonbank financing.

<sup>4</sup>The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup>Including currency and maturity composition.

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

<sup>7</sup>Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA), Partially available (PA)

**Statement by Mr. Jafar Mojarrad, Executive Director for Algeria,  
and Mr. Kamel Badsì, Advisor  
May 30, 2018**

Our Algerian authorities thank staff for a set of informative papers and appreciate their high value advice in support of policy reforms. They are grateful to the Board and management for their continuous support.

**Economic Overview**

Algeria's economy has had a timid recovery since the onset of the decline in oil and gas prices in mid-2014. The initial policy response of a significant fiscal tightening and exchange rate depreciation dampened non-hydrocarbon activity, particularly in 2015-16, while oil production restraint in effect since 2016, in compliance with the OPEC agreement, limited hydrocarbon GDP growth. The impact of declining oil and gas prices and oil production restraint was more visible in the twin deficits: despite the REER depreciation, the current account deteriorated by 12 percent of GDP and hydrocarbon revenue fell by 10 percent of GDP between 2014 and 2016. By 2017, there was a significant erosion of internal and external buffers, growth had remained anemic, and unemployment was on the rise. Fiscal adjustment continued in 2017, albeit at a slower pace, essentially through spending cuts, and the deficit was financed by depleting the savings in the oil stabilization fund (FRR) and, late in the year, by borrowing from the Bank of Algeria (BA). Fiscal restraint has continued under the 2018 budget by capping nominal current expenditure and raising taxes and cutting subsidies, even though the headline deficit increased. The recent firming of energy prices is providing welcome space. Non-hydrocarbon (NHC) GDP growth and inflation are expected to tick up in 2018.

Staff policy discussion center on what they see as Algeria's "new economic strategy". The policy approach adopted this year, combining limited exchange rate flexibility; higher capital spending and improved control of current spending; no external borrowing; are in fact continuation of standing policies and do not signify a material shift in policy approach. Import ban on some products to preserve foreign reserves and the resort to central bank financing, following the depletion of FRR resources, are exceptional and temporary measures.

The Algerian authorities are fully aware of risks ahead, some of which are reflected in staff's Risk Assessment Matrix. However, the authorities believe that the staff presentation is too alarmist in its tone. They agree with staff that the relative likelihood of a prolonged period of weak energy prices is low and its likely impact on the Algerian economy is high. However, staff attaches a high likelihood to weaker-than-expected growth in advanced economies and to security and geopolitical risks, with both factors having a high but probably opposite impact on the Algerian economy through oil prices. In fact, three of the five risk factors essentially work through the same channel: oil prices. The oil market channel is the main

source of potential direct and indirect external risks to the Algerian economy, but it is important to remember that Algeria has faced periods of oil market volatility and geopolitical risks before, and has always managed to pull through, thanks to the authorities' pragmatic policies and the support of citizens and international partners. Algeria's large public sector, its low public debt, its virtually non-existent external debt, and its still sizable large external buffers provide extra layers of protection against external shocks.

### **Fiscal Policy and Transparency**

The authorities are of the view that in assessing the underlying fiscal policy stance in 2018, one-off and exceptional factors should be taken into consideration. On the revenue side, the drop in non-tax revenue in 2018 is entirely due to lower dividend transfers from BA to the budget (by 1.6 percentage points of overall GDP). NHC tax revenues in 2018 are in fact likely to exceed budget estimates (unchanged from 2017 at 17.4 percent NHC GDP) due to tax hikes—in line with past staff recommendations (Annex I)—on mass consumption items such as fuel, electricity, tobacco and alcohol, as well as higher tariffs on imported goods. Further, the import ban is likely to be lifted during the course of the year and replaced by high import tariffs, and some government fees (on passports, ID cards, court procedures) are planned to be raised by 40-50 percent. On the expenditure side, current spending is cut by 1 percent of NHC GDP, despite a significant one-off transfer to a pension fund (CNR) to repay part of its debt. Personnel expenditures were frozen in nominal terms, and the increase in capital expenditure, equivalent to 1.7 percent of NHC GDP, in part reflects repayment of government arrears to suppliers. As such, the NHC deficit (excluding BA dividend transfers) is expected to fall by 1.3 percent of NHC GDP in 2018, continuing a trend that started in 2014 with a cumulative decline of 7.8 percent of NHC GDP over 2014-18. If account is taken of one-off factors (transfer to CNR and repayment of arrears), the underlying NHC deficit would be even lower.

The authorities intend to accelerate fiscal consolidation in 2019, while anchoring fiscal policy on a zero balance in 2023—corresponding to a 20 percent reduction in NHC deficit as a share of NHC GDP. Indeed, tight financing conditions demand strong fiscal tightening in the near term. The fiscal consolidation plans will be based on reducing tax exemptions and strengthening tax collection; containing discretionary current spending; increasing the efficiency of public expenditures and improving PFM; while providing enough fiscal space to accommodate higher social and infrastructure spending, all within a rolling medium-term framework.

The authorities are making every effort to enhance budget clarity and transparency and were surprised to see reference to Algeria scoring an Open Budget Index of 3 out of 100 in 2017 (footnote 13, page 17 of the Staff Report. Comparisons of this nature based on third-party indicators with limited or no independence or credibility are questionable at best, and damaging at worst.



## Monetary and Exchange Rate Policy

Government's unconventional financing through BA since late 2017, as indicated earlier, was prompted by the depletion of FRR savings, but also by the need to finance government buyback of public enterprise debt and make a transfer of DZD 500 billion to the National Investment Fund (FNI) for financing two turnkey projects (harbor expansion and a phosphate plant). The authorities are aware of risks associated with central bank financing, especially at below market rates. While such financing was used in Q4 2017 and in January 2018, no additional exceptional borrowing has been made since then, while at the same time the BA doubled the reserve requirement ratio to 8 percent and began mopping up operations to tighten liquidity conditions.

Staff is of the view that if unconventional financing were to continue, it should be subject to strict quantitative and time limits, and be at market pricing. In fact, Law No 17-10 of October 2017 on exceptional financing stipulates that exceptional financing should be limited to 5 years and undertaken solely for the purpose of financing the treasury (within the confines of annual budget laws), paying down public debt, and funding the FNI (the DZD 500 billion transfer to FNI mentioned earlier was in this context). The Law, however, falls short of imposing a quantitative limit on borrowing. The authorities prefer to move towards market rates at a measured pace and as a part of a broader plan to modernize the monetary framework, including establishing an effective monetary transmission mechanism.

As regards the potential inflationary impact of unconventional financing and liquidity growth, staff study<sup>1</sup> has shown that external factors are the most important driving forces of inflation in the long run. Liquidity growth is also an important contributing factor in the long run, but the impact is muted by the extent of price controls in the economy and the fairly slow speed of adjustment of inflation to its long run rate following a shock. The latest data indicate an average annual inflation rate of 3.4 percent during Q1 2018 (the immediate period following the liquidity injection), less than half the 7.6 percent in Q1 2017.

As regards exchange rate policy, staff recommends more flexibility leading to eventual unification of the official and the parallel rates once capital transactions are sufficiently liberalized. The authorities are of the view that the degree of the exchange rate flexibility should be calibrated with other policy moves, particularly fiscal consolidation, and liquidity conditions. Additionally, with non-hydrocarbon exports accounting for a mere 5 percent of total exports, and being almost entirely foreign currency based, the authorities feel that there are only limited gains in export competitiveness from greater exchange rate flexibility under the current export structure, until diversification takes stronger hold through structural policies. There is also little evidence of a robust exchange rate pass-through to domestic prices, at least in the short run: despite the significant nominal depreciation of the dinar in

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<sup>1</sup> "Determinants of Inflation", Algeria Selected Issues, IMF Country Report No. 17/142, June 2017.

2015-2016, CPI inflation in 2017 remained broadly unchanged. The authorities are determined to curb the informal sector of the economy that has been the main source of supply and demand of foreign exchange to the illegal parallel market.

## **Financial Sector**

Algeria's banking system is well capitalized and profitable despite the low interest rate environment. NPLs are moderate and well-provisioned, and are expected to decline as the government continues to clear its arrears to suppliers. Risk-based bank supervision and tighter bank governance have improved banking sector resilience, as indicated by staff. Cognizant of risks to financial sector stability, the authorities are monitoring the liquidity conditions closely and stand ready to act promptly and appropriately.

## **Structural Reforms**

The authorities agree with staff that Algeria is facing important policy challenges in reducing the economy's exposure to the vagaries of the energy market through diversification. They also realize that the private sector has to play a greater role in income generation and wealth distribution going forward. With that in mind, using the window of opportunity offered by the recovery of the energy market, and in close collaboration with the World Bank, they are designing a long-term strategy to reshape Algeria's growth model that has been reliant for decades on a dominant public sector. The process is expected to be well sequenced and its pace measured; some of the reform areas have been already announced in a recent decree.<sup>2</sup> The key areas include: simplifying business regulations and improving business climate in general; opening new areas of activity to the private sector; rationalizing subsidies; improving the functioning of the labor market; strengthening PFM; modernizing the banking system; and investing in infrastructure—all with the longer-term aim of rebalancing the economy in favor of the private sector and diversifying the economic structure away from hydrocarbons.

## **Conclusions**

The Algerian economy is in a state of transition. The authorities' near- to medium-term objectives are to restore macroeconomic stability, revive non-hydrocarbon GDP growth, and create jobs, particularly for women and youth. In the longer run, the primary goal is to diversify the economy with greater private sector participation. There are major headwinds, but the authorities are committed to advancing their reform agenda in a well-sequenced and moderately-paced manner. Fiscal consolidation is central in the authorities' strategy to reduce

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<sup>2</sup> Executive "Decree on the Mechanism of Monitoring Structural Reform Measures Within the Framework of Implementation of Unconventional Financing", March 2018. The Decree delegates the monitoring of a long list of structural reforms to a committee of the Ministry of Finance that reports to the BA Governor who in turn reports to the President.

the economy's reliance on hydrocarbon revenue. The process started in 2015, is ongoing, and is expected to be the lynchpin of macroeconomic policies going forward. Structural reforms will lend support to encourage private sector activity, improve business climate, modernize the monetary policy framework, and improve the efficiency of the labor market. The thrust of the authorities' reform program is consistent with staff views and the authorities will continue to count on staff policy and technical advice.