INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/47

ALGERIA

2012 ARTICLE IV CONSULTATION

February 2013

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 2012 Article IV consultation with Algeria, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 11, 2012, with the officials of Algeria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 21, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its January 16, 2013 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Algeria.

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

Selected Issues Paper
Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

ALGERIA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

December 21, 2012

KEY ISSUES

Algeria's macroeconomic performance has remained strong, but vulnerabilities are surfacing. Nonhydrocarbon sector growth is buoyant, supported by public spending, and hydrocarbon revenues provide substantial external and fiscal buffers. However, the recent surge in current spending has weakened the fiscal stance and spurred inflation while risks are tilted to the downside. Against this backdrop, discussions focused on policies to curtail inflation, ensure fiscal sustainability and the efficiency of public spending, and foster strong nonhydrocarbon growth, with a view to increasing employment.

Fighting inflation will require coordinated monetary and fiscal policies. Current public spending—notably the wage bill—should be contained. Monetary policy was tightened in May 2012, but more needs to be done, by raising interest rates and mopping up excess bank liquidity, and by increasing government securities issuances to finance the deficit.

Fiscal policy needs to be put on a sustainable path. The fiscal stance remains heavily reliant on hydrocarbon revenues and is vulnerable to a long-lasting drop in hydrocarbon prices. The nonhydrocarbon deficit is not consistent with preserving real wealth per capita over the long term. Nonhydrocarbon revenues need to be bolstered, current expenditures rationalized, and public financial management improved to enhance the quality of public spending.

Structural reforms need to be stepped up to achieve faster and more inclusive growth. These include improving the business climate, opening the FDI regime, and deepening the financial sector. Improving the job/skills match and labor market flexibility is also required to spur employment.

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

Approved By
Daniela Gressani and David Marston

A staff team comprising Mr. Zeidane (head), Ms. Lahreche, and Ms. Albertin (all MCD), and Mr. Ben Naceur (ICD) conducted the discussions in Algiers during October 29–November 11, 2012. Mr. Maherzi (OED) also participated in the discussions.

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APPENDICES

INTRODUCTION

1. **Following a decade of economic growth marked by the buildup of substantial buffers, Algeria weathered both the global financial crisis and regional uncertainties well.** Prudent macroeconomic policies over the past decade, and the cautious management of large hydrocarbon revenues, led to a strong financial position, with comfortable reserves, very low external debt, and sizeable budgetary savings in the oil stabilization fund (*Fonds de Regulation des Recettes*, *FRR*). This allowed the country to undertake countercyclical measures to withstand the global financial crisis, and, more recently, to scale up current spending and support to employment and housing in order to meet pressing social demands and contain social unrest.

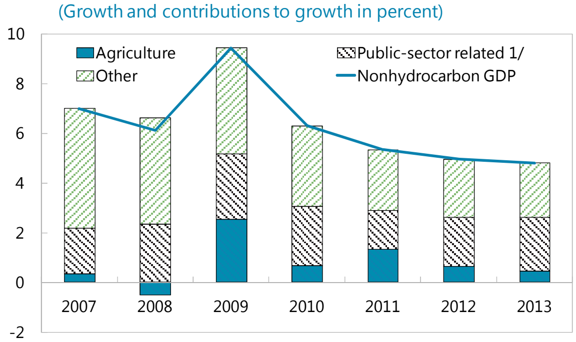
2. **However, new challenges are surfacing along with longer-standing structural issues**. In the short term, the major concern is inflation, which is expected to reach a 15-year high in 2012. The recent fiscal expansion has worsened fiscal sustainability and increased vulnerability vis-à-vis the oil price. More broadly, Algeria's economy is insufficiently diversified and is growing below its potential; it remains heavily reliant on the hydrocarbon sector and public spending, while private-sector growth is lackluster. Although there has been progress in curbing unemployment, it remains high among youth and women; further progress hinges on accelerating private sector-led growth.

RECENT ECONOMIC DEVELOPMENTS

3. **Growth and inflation.** In 2011, growth reached 2.4 percent, held back by the continued decline in hydrocarbon output and the slowdown in the construction sector. In the first months of 2012, the increase in public-sector absorption, good agricultural yields, and a smaller decrease in hydrocarbon production, suggest that growth could be slightly better than in 2011. Inflation rose from 4.5 percent in 2011 to 8.9 percent on average over the first nine months of 2012 (compared with the first nine months of 2011), mostly on account of food (+19.6 percent for fresh food) and manufactured goods prices. Higher prices were spurred by the excess liquidity resulting from the surge in current public spending, and possibly also by inefficiencies in the distribution chain.

Sources of Nonhydrocarbon Growth

(Growth and contributions to growth in percent)

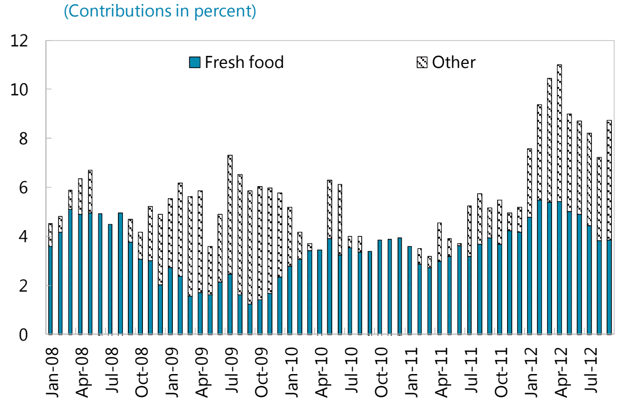


Sources: Algeria authorities; and IMF staff calculations.

1/ Includes construction and public works, and government services.

CPI Inflation

(Contributions in percent)



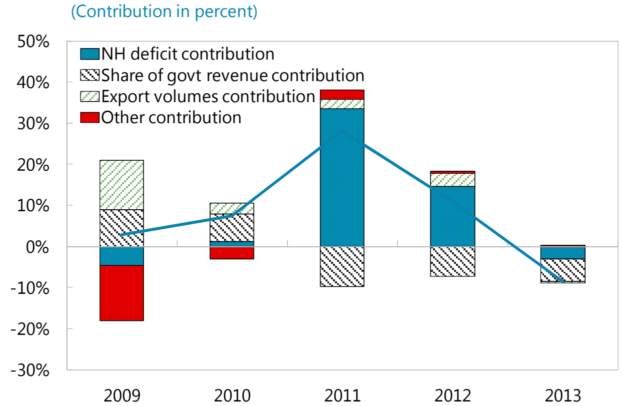
Source: IMF staff calculations using authorities' data.

4. External position. The current account balance improved in 2011, to reach 9.9 percent of GDP. The sharp increase in export revenues (27 percent), driven by the rise in the oil price, exceeded import growth (15 percent), while the volume of hydrocarbon exports continued to fall, reflecting a drop in production as well as an increase in domestic consumption. Algeria's nonhydrocarbon exports declined by about 11 percent in the first half of 2012, reflecting weak external demand. Capital inflows remained limited, with FDI reaching US$2.6 billion (1.3 percent of GDP). Official reserves increased by US$20 billion to reach US$182.2 billion at the end of 2011 (38 months of imports of goods and services) while external debt fell to 2.2 percent of GDP. Over the first nine months of 2012, hydrocarbon export revenues remained stable, with price increases offsetting the impact of a 4 percent (year-on-year) reduction in volumes. Imports declined by 2.8 percent over the same period, as the fall in food products and consumer durables imports surpassed the increase in consumer goods imports. At end-June 2012, the current account surplus reached US$10.8 billion (5.4 percent of GDP), but FDI inflows remained relatively low, at US$1 billion. Official reserves rose to US$188.3 billion at end-September 2012.

5. The real effective exchange rate (REER) remains close to its equilibrium level. Following a slight depreciation (0.6 percent) in 2011, the REER appreciated by 5.8 percent (on a year-to-year basis) over the first nine months of 2012. This appreciation was mainly due to a large inflation differential between Algeria and its main trading partners, offset only in part by a 2 percent nominal effective exchange rate depreciation. Nevertheless, the REER remains in line with its equilibrium level, which appreciated following higher terms of trade and public spending (Appendix I); the latter could entail Dutch disease effects. Despite the convertibility of the dinar for current transactions, the parallel foreign exchange market has shown a substantial premium—about 32 percent at end-2012.

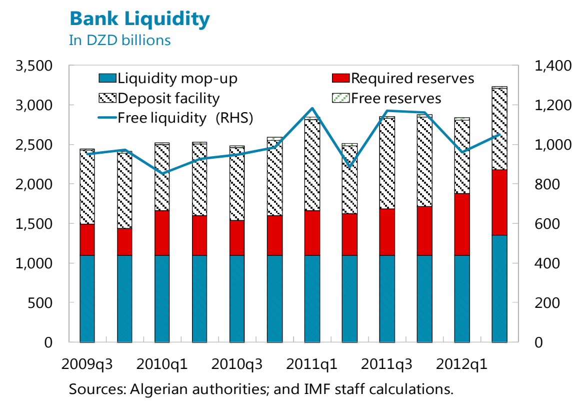
6. Public finances. The fiscal deficit in 2011 stood at 1.3 percent of GDP, compared to 1.8 percent in 2010, as a result of higher hydrocarbon revenues. However, the nonhydrocarbon deficit worsened, rising from 39.8 percent of nonhydrocarbon GDP (NHGDP) in 2010 to 45.1 percent in 2011, reflecting the larger increase in current spending—notably in the wage bill, given substantial back payments—than in nonhydrocarbon revenues. The fiscal breakeven oil price reached US$109 per barrel, up from US$85 in 2010. During the first half of 2012, revenues rose, bolstered by rising oil prices and buoyant personal income taxes following the public sector wage bill increase. However, this rise was more than offset by an increase in current and capital spending. As a result, the fiscal deficit widened to 3.2 percent of GDP in the first half of 2012.

Change in the Fiscal Breakeven Price
(Contribution in percent)



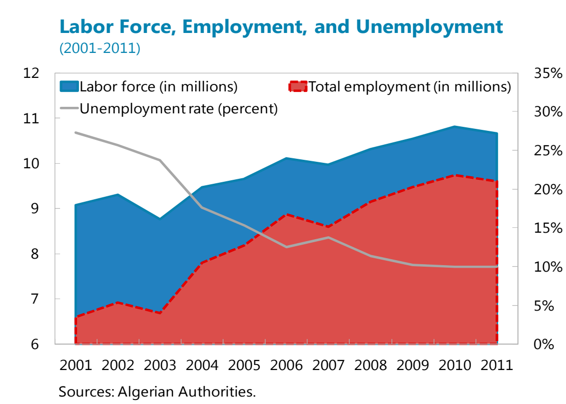
Sources: Fund staff calculations using authorities data.

7. Monetary survey. As a result of public spending and credit to the economy, money supply (excluding deposits of the national hydrocarbon company SONATRACH) increased by 22.3 percent in 2011, and by 21.7 percent in July 2012 (year-to-year basis). Structural bank liquidity (bank reserves and liquidity absorption) increased by 10.6 percent in 2011, following the substantial increase in net foreign assets (NFAs) and a relatively limited improvement in the net government position; it continued to grow over the first quarter of 2012, before falling off. Excess liquidity (free reserves and overnight deposits) also increased in 2011 and during the early months of 2012, but was reduced at the end of the second quarter, thanks to liquidity management measures and the improvement in the net government position. The discount, seven-day and three-month repurchase facility rates of the Central Bank remained stable at 4 percent, 0.75 percent, and 1.25 percent respectively.



8. Financial sector. The banking sector remained sound in 2011. The overall solvency rate was 24 percent, the ratio of nonperforming loans (NPLs) declined to 14 percent (of which 72 percent are provisioned), liquidity was comfortable, and profitability high (Table 6). However, private-sector credit has remained low (22 percent of NHGDP), reflecting the difficult access to financing for both businesses and households. Notably, credit to households was low and accounted for only 8 percent of credit to the economy, hindered by the ban on consumer credit decided in 2009. Notably, credit to households was low and accounted for only 8 percent of credit to the economy, hindered by the ban on consumer credit decided in 2009. The equity market is underdeveloped, with only three listed companies and a capitalization of 0.1 percent of GDP in 2011. There were no issuances on the private bond market in 2011 and 2012, and the volume of outstanding paper in circulation fell by 69.8 percent to 32.4 billion dinars between 2010 and 2011.

9. Employment. The unemployment rate has been steadily decreasing over the past decade; it remained stable at 10 percent in 2011, as the fall in employment was offset by a decline in the labor force. Youth and female unemployment remained high at 21.5 percent and 17.2 percent, respectively.



10. Outlook

- *Growth and inflation*. Growth in 2012 is projected at 2.5 percent, supported by domestic absorption, and could reach 3.4 percent in 2013, spurred by sustained private domestic demand and a recovery in the hydrocarbon sector that is expected to last over the medium term on the back of the national oil company's large investment program. From 2013 onward, however, fiscal consolidation is expected to weigh on growth; absent structural reforms to support private investment and net exports, nonhydrocarbon growth is projected to stay below 5 percent. Inflation is expected to ebb to 5 percent in 2013, as public-sector wage back payments are completed and monetary policy remains prudent.

- *External position*. Algeria's external position is expected to remain solid over the short and medium term, with a current surplus of 8.1 percent of GDP in 2012 and 7 percent in 2013. Hydrocarbon revenues are expected to decline slightly in 2012, as decreasing export volumes (-3.2 percent) are not offset by higher international prices; imports will remain stable in 2012 compared to 2011. Nonhydrocarbon exports are expected to gradually strengthen, supported by an anticipated gain in external competitiveness and a stronger external environment. FDI flows are expected to remain low, at US$1.7 billion (0.9 percent of GDP). Official reserves are projected to reach US$194 billion (40 months of imports of goods and services) while foreign debt will fall further to 1.9 percent of GDP. The current account is projected to remain in surplus in the medium term, despite a slowdown in export revenues (a gradual improvement in export volumes would not offset a lower hydrocarbon prices). The current account is expected to remain close to its norm over the short and medium term (Appendix I).

- *Fiscal*. In 2012, the nonhydrocarbon deficit is expected to deteriorate further to 45.6 percent of NHGDP, as a result of the full effect of wage increases and back payments. Wages and current transfers should reach 26.6 percent of GDP in 2012, compared with 24.5 in 2011. In 2013, wage stability and the phasing out of back payments should contribute to fiscal consolidation, even though the volume of civil service employment will increase by 2.7 percent. High hydrocarbon prices will support the fiscal balance, which should reach 3.6 percent of GDP deficit in 2012 before falling to below 2 percent of GDP in the medium term. Fiscal savings for the stabilization fund are expected to decrease, to 35.8 percent and 34.7 percent of GDP in 2012 and 2013, respectively. The fiscal breakeven oil price should rise to US$121 a barrel in 2012 before falling back to US$110.6 in 2013.

- *Monetary*. Monetary policy tightening and fiscal consolidation should support the slowdown in broad money growth in 2012 (10.6 percent) and in 2013 (9.9 percent), while credit to the economy is expected to grow at 14.9 percent in 2012 and 9 percent in 2013.

11. Risks. Risks are mainly tilted to the downside, as Algeria is vulnerable to the following risks (Box 1):

Box 1. An Assessment of Risks to Algeria's Economy

Rising food prices. Food dependence is a source of vulnerability for Algeria through food price increases. An illustrative scenario shows that the current account balance would worsen by about ½ percent of GDP following a 10 percent rise in food prices. The first-order fiscal impact would be slightly positive as a result of additional import tax revenues, but maintaining food price support would weigh on current spending and result in a negative fiscal impact. Assuming a limited pass-through of world inflation to Algerian inflation (as a result of price subsidies), a limited increase in inflation would be observed.

Impact of a 10 Percent Increase in Food Prices in 2013

On the current account	
Increase in imports value (US$ billion)	0.9
Change in the current account (percent GDP)	-0.58
On the fiscal account (percent GDP)	
Excluding the impact of higher subsidy costs	0.13
Including the cost of higher subsidies	-0.28
On the consumer price index	
Impact of a 3 percent pass-through of price increases, in CPI point	0.13

Source: IMF staff calculations.

Lasting decline in hydrocarbon prices. A scenario assuming a drop in oil prices of one standard deviation (over 1998–2012) from 2013 onwards shows that the current account balance would quickly turn negative. This would result in a slower accumulation of foreign exchange reserves and lower import coverage. Under unchanged fiscal policy, the deficit would worsen and FRR reserves as a percentage of GDP would fall swiftly. Risks related to implicit subsidies would remain high (Appendix II).

Impact of a Lasting Decline in Hydrocarbon Prices

	2012	2013	2014	2015	2016	2017
Baseline scenario						
Spot oil price	106.2	105.1	100.6	96.4	92.8	88.9
Current account (percent GDP)	8.1	7.0	5.2	4.9	4.7	4.5
Foreign exchange reserves						
In US$ billions	193.9	208.6	221.5	233.8	246.1	258.5
In months of imports	40.2	41.7	44.5	46.6	48.4	50.3
Fiscal deficit (percent GDP)	-3.6	-1.3	-1.9	-1.6	-1.7	-1.7
FRR (percent GDP)	35.8	34.7	33.3	32.2	31.2	30.0
Alternative scenario: one standard deviation drop in hydrocarbon prices from 2013 onward						
Spot oil price	106.2	77.1	72.6	68.4	64.8	60.9
Current account (percent GDP)	8.1	-0.4	-2.4	-2.7	-3.2	-3.7
Foreign exchange reserves						
In US$ billions	193.9	193.0	190.3	186.6	182.4	177.3
In months of imports	41.3	39.6	39.3	38.2	36.9	35.4
Fiscal deficit (percent GDP)	-3.6	-7.3	-7.9	-7.6	-7.7	-7.7
FRR (percent GDP)	35.8	32.3	25.3	19.0	13.1	7.2

Source: IMF staff calculations.

Euro area crisis. Algeria is exposed to risks that face the euro area outlook, notably via its gas exports (90 percent of which are directed towards the euro area). Slower European demand—as well as the increase in domestic consumption—have contributed to a 4 percent decline in hydrocarbon exports volumes in the first nine months of 2012, with natural gas exports falling by about 14 percent in the third quarter (year-on-year). This is consistent with simulations based on a multinational GVAR analysis that suggest a strong impact of European growth on Algeria.[1/]

[1/] See Cashin, P., K. Mohaddes, and M. Raissi, (2012), "The Global Impact of the Systemic Economies and MENA Business Cycles," IMF Working Paper WP/12/255, and Cashin, P., K. Mohaddes, and M. Raissi, (2012), "The Differential Effects of Oil Demand and Supply Shocks on the Global Economy," IMF Working Paper WP/12/253.

- *A prolonged fall in oil prices*. Rising expenditure was the main cause of the increase in the fiscal breakeven oil price in 2011 and 2012. In 2013, the breakeven price is expected to remain high and close to projected prices, despite the expected cutback in current spending. A long-lasting decline in hydrocarbon prices would set the country on an unsustainable fiscal trajectory.

- *Rising food prices in international markets* (notably wheat). A rise in food prices would negatively affect the current account balance and weigh on the fiscal balance (given the relatively high level of subsidies), and could fuel inflation.

- *Worsening of the global economy*. A new slowdown in growth (particularly in the euro zone) would worsen the balance of payments, mainly as a result of the ensuing decline in hydrocarbon prices and, to a lesser degree, the reduction of export volumes. Lower hydrocarbon revenues would also worsen the fiscal balance. On the other hand, risks to the financial sector are limited, given Algeria's very limited exposure to international financial markets (e.g., banks are domestically financed, and short-term debt is covered 159 times by reserves).

- *Increasing pressure to use hydrocarbon revenues*. This pressure could intensify as inflation erodes real income, giving rise to a wage-price loop in the public sector that would complicate fiscal consolidation and weigh on the economy's competitiveness.

12. Outward spillovers from Algeria are expected to be limited. Notwithstanding non-measurable informal trade and possible capital flows, Algeria has limited trade and financial integration with its immediate neighbors. Spillover effects from a shock in Algeria would therefore be very limited. This is confirmed by a global vector auto-regression (GVAR) analysis run on MCD countries, which shows that a shock to Algeria's growth would have barely any effect on its neighbors.[1]

13. Against this backdrop, discussions focused on the three main economic policy challenges Algeria will be facing in the years ahead. In the short term, macroeconomic stability will have to be preserved. In the medium term, fiscal sustainability and improved public financial management are needed. Finally, a policy of promoting sustained and diversified growth must be pursued to spur employment.

[1] See Cashin et al., *op. cit*.

Algeria: Risk Assessment Matrix		
Nature/Source of Main Threats	Overall Level of Concern	
	Likelihood of Severe Realization of Threat in the Next 1-3 Years (high, medium or low)	Expected Impact if Threat is Realized (high medium or low)
Lasting decline in oil prices	**Low**	**High**. Algeria's fiscal sector is heavily reliant on oil revenues. A lasting decline in oil prices would risk putting the fiscal stance on an unsustainable path absent significant efforts to curb current spending and prop non-hydrocarbon revenues.
Shocks to food prices (notably wheat)	**Low**	**Low** Food price increases would put further pressure on the fiscal balance through subsidies, and may feed inflation.
Short term: Strong intensification of the euro area crisis	**Medium**	**High.** A further slowdown in growth would negatively affect the balance of payment, mostly through lower oil prices. Effects through declining exports volumes would be limited owing to long-term gas export contracts that stablize external demand, even though this stabilization effect might only kick-in when export volumes are close to the take-or-pay threshold. Spillovers through capital markets would be limited given Algeria's non-exposure to international financial markets.
Medium term: Protracted period of slow European growth	**Medium**	
Further demands on the hydrocarbon rent	**High** - Resources are important and despite large spending in 2011 and 2012 frustration remains elevated in the population (inflation, lack of housing, unemployment) as the next presidential election is looming (2014).	**High**. Additional current spending would further worsen the fiscal stance, increase Algeria's reliance on the hydrocarbon rent, and could fuel inflation.

Box 2. Authorities' Response to Past IMF Policy Recommendations

The authorities have broadly followed staff advice, though the pace and breadth of structural reforms have been less than recommended by staff.

Monetary policy. The Banque d'Algérie (BA) increased liquidity absorption in May and raised the reserve requirement rate, but refrained from raising interest rates.

Fiscal policy and public financial management. The large fiscal stimulus decided in 2010 is phasing out, and the budget law for 2013 provides for a sizeable fiscal consolidation as salary back payments are coming to an end. It has, however, proven difficult to contain the nonhydrocarbon deficit, and fiscal sustainability continues to rely on the hydrocarbon resource. Tax administration and public financial management (PFM) reforms are only slowly making headway, and work to improve the targeting of transfers, while high on the authorities' agenda, has not started.

Structural reforms. There has been some progress in improving the business environment, but the agenda remains large, notably, improving the investment climate, encouraging foreign direct investment, deepening and developing the financial sector, and continuing to support employment.

THEME 1. PRESERVING MACROECONOMIC STABILITY

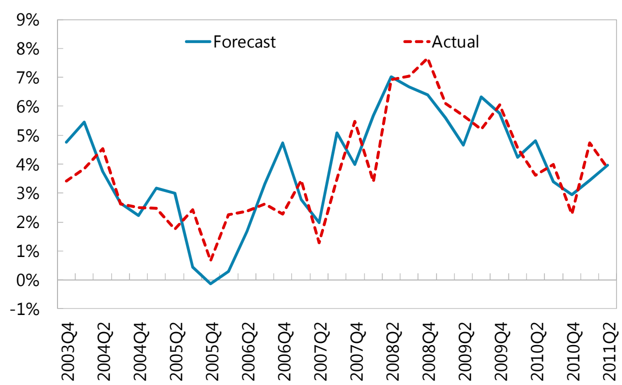
14. **The fiscal consolidation in the 2013 budget law is welcome, and any further wage bill increase should be resisted.** Fiscal policy has a key role in fighting inflation; the large increase in the public wage bill in 2011 and 2012 was the main contributing factor to liquidity expansion, which is the principal determinant of underlying inflation (Box 3). The 2013 budget is marked by the end of public service wage back payments, which should facilitate disinflation. It will be vital to avoid any further wage increases, as these would bring the risk of triggering a wage-price spiral and fueling new inflationary pressures. In the medium term, wage increases should be linked to productivity gains.

Box 3. Determinants of Inflation

An analysis of the determinants of inflation over 2003–11 shows that money supply, non-oil real GDP, and prices of imported consumer goods are the three factors driving inflation in the long run. The analysis looks at the short- and long-run determinants of inflation using quarterly data, and uses a price model that includes both domestic and foreign factors. A vector error correction model (VECM) is used to estimate the price model, given the nonstationarity in the variables and the existence of long-term co-integrating relationships.

The analysis shows that a one percent increase in money supply and in prices of imported goods results in a 0.3 and 0.2 percent increase of the price level, respectively, while a one percent increase of nonhydrocarbon real output results in 0.2 percent decline in the price level. The results also suggest that the speed of adjustment is high, as it only takes one quarter to eliminate one-half of the deviation from the long-run equilibrium. The impulse response functions and the variance decomposition functions show that money supply and imported goods are the driving factors of domestic prices in the short run. The model appears to fit the data and adequately captures the general trend of prices and inflation.

Actual and Forecasted Inflation
(Year-on-year)



Source: IMF staff calculations.

These findings notably underscore the importance of containing liquidity growth and unlocking supply-side constraints to control inflation in the long term.

15. **Further monetary policy tightening is needed to rein in inflation.** The commendable decision by the BA, in May 2012, to raise the required reserves rate from 9 percent to 11 percent and to increase liquidity absorption by 250 billion dinar (23 percent) reduced free liquidity and contributed to slowing inflation. These measures were not, however, sufficient to bring average inflation down to the level targeted by the monetary authorities (4–4.5 percent). Staff recommended

tightening monetary policy. With scarce room left to further increase the reserve requirement rate, mopping up excess bank liquidity should be pursued and supplemented by raising the discount and repurchase facility rates to nudge up savings returns. Delaying action would bear risks, particularly in the event of second-round effects from public wage increases, and should be avoided. Excess liquidity is also fed by the lack of savings instruments and investment opportunities; measures to encourage savings, notably in the housing sector (complemented by policies to address housing shortages), and to deepen financial markets would contribute to reducing consumption and, hence, to easing inflationary pressures.

16. Staff suggested resorting to bond financing of the government deficit to contain liquidity injections. Fiscal financing requirements are currently met by drawings on the FRR, which increases liquidity. Greater resort to the domestic capital market would help liquidity management, with limited risks of crowding out private investment, given the high liquidity and very low interest rates (nominal interest rates on three-month treasury bills and two-year bonds stood at 0.54 percent and 1.27 percent respectively, on June 2012). A more active government securities market would also have the advantage of supporting the necessary development of the financial markets. The authorities argued that a greater reliance on market financing might increase the interest bill for the budget; they expressed a preference for relying on the central bank to absorb liquidity. The authorities felt that monetary and fiscal policy coordination was good; nevertheless, there is room for improvement. In particular, it is important that updated cash-flow plans be shared to support an accurate forecasting of the net government position and appropriate liquidity absorption decisions.

17. Tensions on the supply side that feed inflation need to be addressed. The authorities see inefficiencies in the distribution chain (notably for fresh food) and lack of competition as disrupting price formation. Some of the distribution issues are being addressed by developing market infrastructure, such as storage capacity and regional markets. Staff recommended that the competition authority, provided for in a 2003 ordinance but yet to be established, be set up. Easing FDI restrictions on the retail sector would also help.

18. Staff and the authorities agreed that the exchange rate policy must continue to aim at maintaining the REER in line with its equilibrium level. The foreign exchange regime is a managed float: the rate is determined by the foreign exchange market, with the BA as the main supplier. The exchange rate policy appropriately targets a REER in line with fundamentals. The nominal and real appreciation in the first half of 2012 reflect the improvement in the terms of trade and increase in public spending, and helped to moderate inflation. Stability of the nominal effective exchange rate through end-2012 would support efforts made elsewhere to fight inflation, without the real exchange rate deviating much from its fundamental value. In 2013, fiscal consolidation and a prudent monetary policy would support disinflation, and would bring about some depreciation in the equilibrium real exchange rate. The REER should therefore depreciate to remain in line with its equilibrium value, thereby improving external competitiveness. The reserve adequacy level is high across all measures (Box 4).

19. There was broad agreement between staff and the authorities that the persistent parallel market premium needs to be addressed. The official exchange market provides full access to foreign currencies for current account transactions. However, the high premium on the parallel exchange market points to a demand not satisfied on the official market, and its persistence could be detrimental to stability and growth. Staff recommended unifying the exchange rate market, particularly by implementing the authorities' plan to increase forex ceilings for travelers, as they are very low—by far the lowest in the region (see Table below)—and ensuring that these are set to realistic levels. Easing the obligation that exporters surrender a part of their nonhydrocarbon export revenues to commercial banks and reducing significantly the "de facto" 100 percent reserve requirement on FX deposits, would contribute to developing the forex market and encouraging export diversification. In the longer term, a gradual lifting of capital account restrictions should be envisaged.

Box 4. Reserve Adequacy Analysis

Algeria's level of reserves at end-2011 remains more than adequate, based on traditional metrics. Reserves increased rapidly last year, reaching US$182 billion at end-2011, on the back of a strong current account surplus. Traditional metrics of reserve adequacy indicate that Algeria's reserves at end-2011 are more than adequate buffer against risks emanating from current account shocks, short-term lack of access to the international markets, and risk of capital flight.

Algeria: Reserve Adequacy Measures

	2009	2010	2011	Adequacy Threshold
Reserves in:				
US$ billions	148.9	162.2	182.2	…
Months of imports	35.2	33.9	38.2	3
Percent of short-term debt	111.9	91.2	159.6	1
Percent of broad money	138.3	150.6	169.2	20
Percent of RA indicator	1681.5	847.0	804.1	100-150

Source: IMF staff calculations.

This conclusion is confirmed by using a new and broader-based measure of reserve adequacy. A composite reserve adequacy (RA) metric that combines risks based on short-term debt, other portfolio liabilities, broad money, and export earnings points out that Algeria's current level of reserves is above the range considered safe from a precautionary perspective. A recent IMF study suggests that a level of reserves covering between 100 and 150 percent of the RA ratio provides adequate buffers for crisis prevention or for mitigating the effects of a crisis.[1] Algeria's coverage was at about 800 percent at end-2011, reflecting the high level of reserves as well as limited external liabilities, a relatively closed capital account, and strong export earnings.

1/ Assessing Reserve Adequacy, February 14, 2011 (http://www.imf.org/external/pp/longres.aspx?id=4547).

Controls on Payments for Travel: Algeria in a Cross-Country Perspective

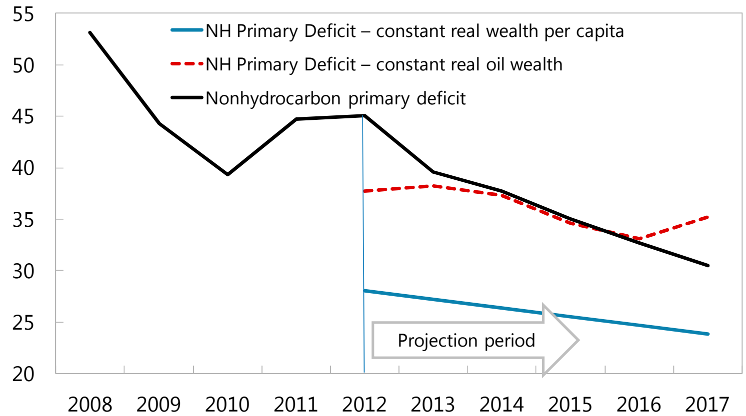
	Controls	Foreign exchange ceilings for travelers
MENA oil exporters		
Algeria	yes	Residents traveling abroad have an annual foreign exchange allowance for travel. The limit for personal travel is DA 15,000 (about US$200) a year. For nonbusiness trips, the BA reviews and approves documented foreign exchange requests that exceed the indicative limits. For business trips, the allowance and the per diem for each trip reach DA 16,000 (about US$220) and DA 10,000 (about US$137), respectively, for senior managers.
Bahrain	no	no
Iraq	yes	There is a US$10,000 limit on the amount in banknotes a traveler may take out of Iraq.
Iran	yes	Effective January 1, 2012, the upper limit on the amount of foreign exchange that travelers may export was reduced from US$2,000 to US$1,000. Amounts in excess of the limit may be approved by the CBI on presentation of satisfactory supporting documents.
Kuwait	no	no
Libya	yes	Residents may purchase foreign exchange for tourism from authorized banks up to the equivalent of US$10,000 in traveler's checks or US$5,000 in cash.
Oman	no	no
Qatar	no	no
Saudi Arabia	no	no
United Arab Emirates	no	no
Yemen	no	no
Other Maghreb countries		
Mauritania	yes	Effective February 22, 2012, the maximum for one trip has been raised from the equivalent of UM2 million to UM3 million (about to US$10,900). An additional allowance, requested via a licensed intermediary, may be granted by the BCM.
Morocco	yes	For tourism travel, authorized banks may provide Moroccans and foreigners the equivalent of DH40,000 (about US$4,700) a person a year. Business travel by exporters may be financed without restriction by debiting foreign exchange or convertible dirham accounts with Moroccan banks. For business travel other than by exporters, the maximum allowance banks can provide is 10 percent of the previous fiscal year turnover, with a minimum entitlement of DH60,000 (about US$7,000) to a maximum of DH200,000 (about US$23,000) a year. Larger allowances may be approved on proof of need.
Tunisia	yes	The annual allowance for tourism travel is TD6,000 (about US$3,800) for an adult and TD3,000 (about US$1,900) for a child under 10. Unused amounts may not be carried forward to subsequent years. The business travel allowance (AVA) for exporters is 25 percent of export proceeds for the current year. Any unused portion of this allowance may be carried forward to subsequent years, provided the cumulative amount does not exceed the annual limit of TD500,000 (about US$319,000). The annual limit for business travel by other professions not included in the negative list is 8 percent of the turnover from the previous year, with an overall limit of TD22,000-30,000 (about US$14,000–19,000).
Other comparator countries		
Egypt	no	no
Jordan	no	no
Lebanon	no	no

Source: *Annual Report on exchange arrangements and exchange restrictions,* International Monetary Fund, 2012.

THEME 2. ENSURING FISCAL SUSTAINABILITY OVER THE MEDIUM TERM

20. Fiscal policy must be set on a sustainable trajectory. A permanent income hypothesis (PIH) analysis suggests that, even with the expected consolidation, the medium-term nonhydrocarbon deficits will fail to maintain real wealth per capita in the long run. In addition, nonhydrocarbon revenues barely cover half of current spending in 2012, raising further sustainability issues, because a large share of the hydrocarbon windfall is used to finance current spending rather than the investment needed to spur growth. These projections do not take into account the downside risks that weigh on Algeria's public finances: the fiscal deficit is sensitive to a lasting drop in hydrocarbon prices (Box 1); the increasing domestic demand for hydrocarbons could reduce the country's exports; large implicit subsidies on the domestic price of hydrocarbon products add risk to the budget; and the social pressure to share the hydrocarbon rent by raising expenditure is high.

Nonhydrocarbon (NH) Primary Deficit
(Projected and sustainable levels in percent of NHGDP)



Source: IMF staff calculations.

21. There was broad agreement on the need to bring the fiscal deficit to a sustainable level, as well as on the measures to achieve this objective.

- *On the spending side*, the consolidation in current spending provided for in the 2013 budget law should continue. Staff recommended limiting net hiring, especially as the large public sector is already in Algeria (Appendix III); aligning wage increases with productivity gains; and containing the real growth of current transfers. The authorities, however, felt that spending restraints needed to be balanced by the need to share the hydrocarbon revenues with the population.

- *On the revenue side*, tax revenues should be diversified to limit the reliance on hydrocarbon revenues. Tax exemptions should be reviewed and rationalized. Steps taken in 2012 to speed up the pace of VAT credit reimbursements would be expected to support progress in phasing out VAT exemptions. A systematic assessment of the cost of tax spending would also support efforts towards rationalization. Finally, improvements in tax administration would also help to expand the tax base and increase the tax yield. While the authorities broadly agreed, they continued to see a need for granting exemptions in order to spur investment and growth.

22. Staff suggested that the rules governing the accumulation of resources in the FRR could be reviewed. Although the FRR still provides a comfortable buffer in the event of a temporary shock, its size as a percent of GDP has diminished with the surge in spending since 2011; under current hydrocarbon price assumptions, this declining trend is expected to continue. The fiscal rule, that involves saving hydrocarbon revenues whenever prices, are above the US$37/barrel reference price, is incomplete, as the annual drawdowns on the FRR are not capped. As a result, the actual oil price at which hydrocarbon revenues are saved is, in effect, closer to US$89 per barrel in 2011. Staff suggested considering an annual cap on drawdowns; this could be set in the budget law, and would be consistent with fiscal sustainability. Additional financing requirements would be met by issuing debt, which would have the advantage of supporting the development of capital markets. While the authorities expressed interest in exploring options for debt issuance, they indicated their determination to keep the flexibility in managing their cash flow that is afforded by drawdowns from the FRR.

23. Algeria's subsidies are large and represent a significant fiscal effort in favor of its population. Budgeted transfers in Algeria are high (13.6 percent of GDP in 2012), and include food, employment, housing and interest subsidies. The authorities are committed to improving the quality and the targeting of these subsidies, and have requested technical assistance from the IMF in this area. In addition to these explicit transfers, the prices of a number of essential products, such as petroleum and gas products or electricity, are set at a level well below international prices, which gives rise to a system of implicit subsidies. Staff estimates suggest that implicit subsidies on hydrocarbon products amounted to 5.7 percent of GDP in 2010 for households' final consumption; the implicit subsidy to the productive sector through subsidized gas prices amounted to an additional 6 percent of 2010 GDP (Appendix II).[2] These implicit subsidies have several adverse consequences. First, they give rise to episodic and costly bailouts of the public companies that supply services at below-market prices; this in turn disrupts the activities of these companies, increases costs, and creates fiscal risks. Second, the actual level of public expenditure and foregone revenues from the national oil company are more difficult to assess. Staff recommended quantifying and disclosing in the budget the actual cost of the implicit subsidies and providing for proper and transparent financing public spending. This approach would strengthen fiscal management, improve the financial situation of public companies, and raise awareness of the support provided by the government to households and businesses. The authorities were in broad agreement with staff's assessment and suggestions, and while they felt it was difficult to fully incorporate implicit subsidy costs into the budget in the short term, they saw a possibility for disclosing them as an appendix to the next budget law.

[2] Electricity is largely produced using low-priced hydrocarbon products. In addition to this implicit subsidy, infrequent repurchases of the national electricity company's debt by the Treasury constitute an additional support to investment and other operating costs.

24. Staff supports the authorities' efforts to improve their budget toolkit as a means of enhancing fiscal sustainability and the efficiency of expenditure.

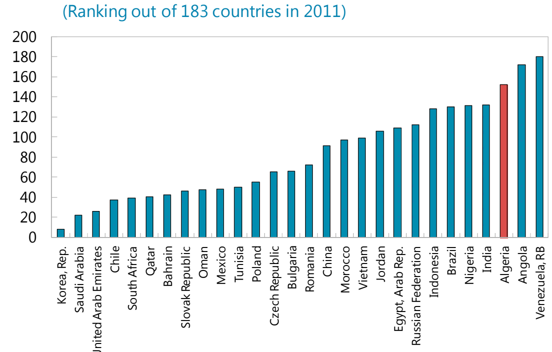
- The authorities' long-standing objective of introducing a consistent medium-term budget framework (MTBF) and multi-annual sector programs linking resources to expected performance is commendable. However, repeated delays are depriving fiscal policy of a crucial tool. Staff recommended interim steps that would support the longer-term objective of setting up a consistent MTBF while making technical headway. In the context of the 2014 budget law, sector-level budget envelopes could be set at the time of the budget memorandum. Sector-level budgeting could be carried out in two or three pilot ministries, for which a programming system is already in place. Such an approach would provide the Ministry of Finance with helpful experience in the implementation of comprehensive and more complex tools. Moreover, the roll-out of the five-year investment plan should be seized as an opportunity to develop the full budgeting kit (MTBF and multi-year sector-level performance-based budgeting).

- The authorities were in broad agreement on a number of areas, identified by a recent FAD TA mission, where progress would increase the efficiency of public financial management. These include (i) rolling out of an integrated financial management IT system; (ii) further improving the monitoring of public capital spending, especially program authorizations; (iii) developing sector-level budget execution plans; (iv) gradually reducing the length of the 3-month-long supplementary budget period; and (v) modernizing the public accounting framework.

THEME 3. PROMOTING MORE INCLUSIVE AND LESS OIL-DEPENDENT GROWTH

25. While maintaining public capital spending is critical to promoting more diversified long-term growth, progress is needed to encourage private investment and improve total factor productivity.

Ease of Doing Business in Selected Countries
(Ranking out of 183 countries in 2011)



Source: Doing Business Report, 2013.

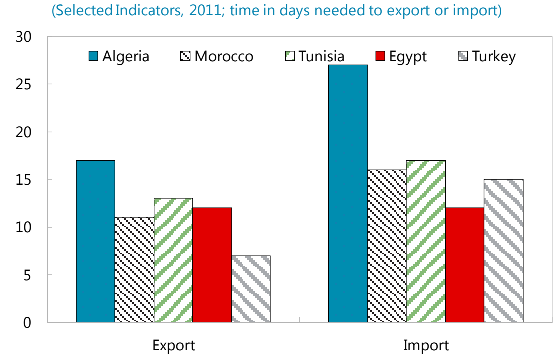
- Public investment has been—and will remain in the short term—an important source of nonhydrocarbon growth and competitiveness gains. Staff therefore recommended that fiscal consolidation should safeguard capital spending. The commendable efforts undertaken to improve the quality of public capital spending through the *Caisse nationale d'équipement pour le développement* (CNED), which have led to better project preparation, should be maintained. Efforts will also need to be geared toward improving execution capacity: these include relaxing conditions for the participation of foreign contractors, simplifying procedures, and reducing payment periods.

- The authorities are well aware that competitiveness indicators point to weaknesses in Algeria's business environment; for instance in starting a business, trading, and paying taxes. The authorities have taken steps to address some issues, but wide-ranging reforms are needed. Staff notably recommended simplifying procedures for starting a business; improving the efficiency of one-stop shops for new businesses; facilitating tax formalities, for example by introducing online filing and payment of taxes for companies; and modernizing taxation by reforming the TAP business tax, while ensuring revenue neutrality.[3] The authorities were in broad agreement with the recommendations; they expressed interest in reviewing the TAP, provided an alternative revenue source could be found.

- Algeria's FDI regime is restrictive and should be opened. A comparative analysis of 88 countries (Table 3) shows that Algeria's general requirement that foreign ownership should not exceed 49 percent of assets stands as an exception: none of the surveyed countries imposes a uniform minority rule on FDI across all sectors. Staff recommended lifting this restriction on FDI or limiting it to a few strategic sectors. The construction sector could, for instance, benefit from a relaxation of the minority rule; this would help the government reach its ambitious housing construction goals, accelerate growth, and ease supply-side tensions to fight inflation. The authorities, however, felt that their regulation did not constitute a severe hindrance to FDI, as evidenced by recently launched or negotiated partnerships. Finally, there is still a significant potential for attracting more FDI in the hydrocarbon sector; passing the new hydrocarbon law approved by the Cabinet and streamlining investment procedures would support larger FDI inflows in this sector.

- An analysis of growth over the two decades shows that it has mostly been driven by factors accumulation and that it could increase by 0.8 percent per year if total factor productivity (TFP) growth were aligned with the international average (Box 5). To improve TFP, staff suggested (i) increasing the country's integration into the world economy by shortening the timetable for WTO accession and, by intensifying foreign trade facilitation and export promotion programs; (ii) increasing openness to FDI through a more favorable environment and the adoption of measures to encourage technology transfer and integration with local sub-contractors; and (iii) pursuing

Ease of Trading
(Selected Indicators, 2011; time in days needed to export or import)



Source: Doing Business 2013.

[3] The TAP (*Taxe sur l'activité professionnelle*) is a tax on turnover accruing to local governments.

infrastructure development, improving education and training, and spurring innovation, in partnership with the private sector.

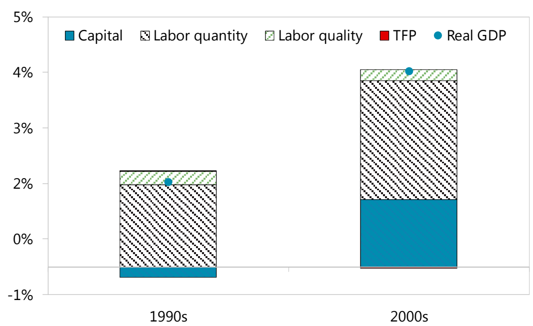
Box 5. Promoting Economic Growth in Algeria

Algeria's growth performance has been modest. Average real GDP growth during the 1990s, a decade marked by internal conflict, barely reached 1.5 percent. Although real growth increased to 3.5 percent in the 2000s, it remained below the average for oil exporters and emerging markets.

Real growth in Algeria has mostly been driven by the accumulation of factors of production, while overall total factor productivity (TFP) growth was negligible. A standard growth accounting approach points out that labor accumulation, mostly reflecting rapid growth in the labor force, was consistently the most important source of growth, while physical capital accumulation only contributed significantly in the 2000s. Meanwhile, TFP growth was, on average, negligible. Significant differences arise across sectors, with TFP growth contributing positively to growth in the nonhydrocarbon sector. Real GDP growth in the hydrocarbon sector was mainly driven by the accumulation of human capital, with a declining contribution of TFP growth. TFP growth contributed positively to the nonhydrocarbon sector during the 2000s.

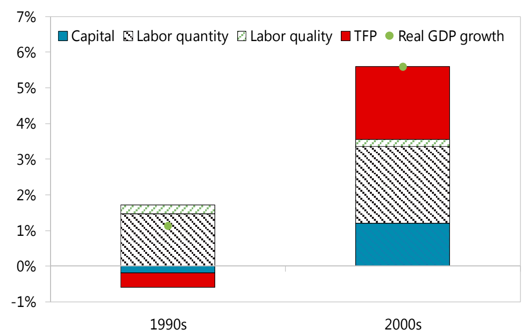
Growth Accounting

Total Growth
(Contributions in percent)



Sources: Staff's calculations.

Nonhydrocarbon
(Contributions in percent)



Sources: IMF Staff calculations.

Box 5. Promoting Economic Growth in Algeria (concluded)

A standard growth equation is also estimated to assess the contribution of various determinants to growth, and to compare Algeria's performance in a cross-country setting. A stable macroeconomic environment and a relatively high investment ratio were the main strengths of the country compared to the average of the 106-country sample. Conversely, a somewhat higher level of current spending, less openness, less R&D, some underperformance in government effectiveness, and slightly more appreciated real exchange rate than the sample average all contributed to slowing growth.

Simulations using both approaches suggest that Algeria's long-term growth potential could be as high as 6 percent per year, which would support higher employment as well as improved fiscal and external positions.

Based on the findings of the analysis, policies to achieve higher growth should

- Target higher investment. Public capital spending should be directed toward projects that generate high economic returns; efforts to improve the quality of spending should be maintained, while private sector participation could be better leveraged. The environment for private investment needs to be improved, in particular by lowering the cost of doing business, improving tax administration, facilitating trade, and improving access to finance, notably for privately-owned SMEs.
- Support an efficient and knowledge-driven economy. A faster accumulation of knowledge would notably require a larger openness to both trade and foreign direct investment. Policies to enable innovation and increase technological absorptive capacity are also needed to increase R&D investment, support the absorption of existing technologies, and nurture innovative enterprises. Similarly, investment in education, training, and health is needed to support knowledge absorption. Institutions are also essential to the optimal allocation and efficiency of factors; in particular, government effectiveness, a business climate supportive of private-sector development, and a sound competitive environment should be encouraged.
- Preserve Algeria's strengths, notably the contribution of labor to growth. This implies increasing employment, notably by enhancing labor quality; improving the jobs/skills match; and improving labor market flexibility.

Table 1. Algeria: Foreign Equity Ownership: A Cross-Country Comparison

(index: 100 = full foreign ownership allowed)

		Mining, oil and gas	Agriculture and forestry	Manufacturing	Telecom	Electricity	Banking	Insurance	Transport	Media	Construction	Health care
Algeria	A new FDI legislation was introduced in 2009 setting, a 49 percent ceiling on foreign investors' stakeholding in any new FDI project. This was extended to foreign participation in investments in the financial sector in 2010.	49	49	49	49	49	49	49	49	49	49	49
Maghreb countries												
Morocco	Most sectors have been fully opened up to foreign investors participation. However, some statutory ownership restrictions remain. Airport and port operation and the electricity sectors are closed to foreign capital participation. Foreign ownership in companies providing domestic or international air transportation services is limited to a maximum of 49 percent. In the oil and gas sector, the National Agency retains a share of 25 percent of any recognition license or exploitation permit.	93.8	100	100	100	0	100	100	39.8	100	100	100
Tunisia	All sectors have been opened up to full foreign capital participation. As the only exception, the electricity transmission and distribution sectors are closed to foreign ownership. Foreign capital participation is not restricted by law in electricity generation, but the public monopoly and difficulty of obtaining the required operating license make it difficult for foreign investors to engage.	100	100	100	100	71.4	100	100	100	100	100	100
MENA oil exporters												
Saudi Arabia	Saudi Arabia has opened up many sectors of its economy to foreign investors. However, sectors such as mining, oil and gas, air and railway transportation, health care, and media are closed to foreign equity ownership. Foreign capital participation in the financial services sectors is allowed up to a maximum share of 60 percent. Unlike most other countries in the Middle East and North Africa region, Saudi Arabia does not impose any legal ownership restrictions on the electricity sector.	0	100	75	70	100	60	60	40	0	91.7	50
Yemen	Many sectors are fully open to foreign equity ownership. However, a number of restrictions remain in service sectors. Foreign ownership in electricity transmission is limited to a maximum of 49 percent. Furthermore, the telecommunications, electricity distribution, airport, and port operation sectors are closed to foreign capital participation.	100	100	100	50	71.1	100	100	60	100	100	100
Other MENAP countries												
Afghanistan	Afghanistan is among the countries with the least statutory restriction on foreign ownership. Among all sectors covered by the indicators no such restrictions were identified.	100	100	100	100	100	100	100	100	100	100	100
Egypt	Most sectors are fully open to foreign investors participation. Statutory ownership restrictions are imposed on some sectors, including the media. In other sectors, such as construction and air transportation, foreign ownership is limited to a minority stake.	100	100	100	100	100	50	100	76	50	83	100
Pakistan	Several sectors are fully open to foreign equity ownership. However, a number of restrictions remain in the service sectors, including the media. Foreign capital participation in such companies is permitted only up to a maximum of 25 percent and is further subject to government approval. Foreign ownership in nationwide television channels is limited to a less-than-50 percent stake. In the financial services sector, a maximum of 49 percent foreign ownership of Pakistani banks is allowed, while foreign capital participation in insurance is allowed up to a 51 percent share.	100	100	100	100	100	49	51	79.6	37	100	100
Regional averages												
Middle East and North Africa		78	100	95	84	68.5	82	92	63.2	70	94.9	90
High-income OECD		100	100	93.8	89.9	88	97.1	100	69.2	73.3	100	91.7
Eastern Europe and Central Asia		96.2	97.5	98.5	96.2	96.4	100	94.9	84	73.1	100	100
Sub-Saharan Africa		95.2	97.6	98.6	84.1	90.5	84.7	87.3	86.6	69.9	97.6	100

Source: World Bank, *Investing Across Borders,* 2010.

26. The financial sector needs to be modernized.

- The commendable improvements in financial stability should be consolidated; banks should particularly be encouraged to set up a mechanism to clear old and fully-provisioned nonperforming loans. Staff welcomed the introduction of a bank rating system based on the CAMELS method,[4] and encouraged the authorities to complete the process on the basis of their own ambitious targets set for end-2013. Staff also supported tightening prudential regulation, in compliance with international standards. With respect to financial stability, staff recommended conducting stress-test exercises with a wider range of shocks on a regular basis, and incorporating them in the upcoming financial stability report, which should be published. The BA's intention to establish a macro-prudential policy framework that draws on international best practices is welcome. BA should also develop a formal early warning system for the financial system.

- Special attention should be paid to improving bank intermediation. Staff recommended stepping up the modernization of the credit bureau. Staff also underscored that the ban on consumer credit should be eliminated and real estate mortgages developed, especially as credit bureau coverage has been extended to households. Currency in circulation is high in Algeria, reflecting the sizeable informal sector and the uneven access to banking services across the country (Appendix III). To reduce currency in circulation, staff recommended that large transactions with the public sector be systematically carried through checks or wire transfers. Moreover, to enhance access to banking services, procedures for branch opening could be simplified. Finally, finance could become more inclusive with the introduction of measures to encourage micro-finance.

- Staff welcomed the authorities' program to reform the financial markets, which focused on increasing stocks listing and securities issuance; developing market infrastructure and investment services; and improving market functioning, including by upgrading the trading platform. To develop the stock market, well-performing public companies should be listed. Current programs to strengthen public companies and offer subsidized interest rates to the private sector reduce the incentive for tapping the bond market. In that context, it would be important to review the framework for supporting companies and expanding government bond issues. In the medium term, opening sovereign debt issuance to the international market would contribute to setting a benchmark.

27. The authorities have implemented some of the recommendations as part of the action plan agreed on with the Financial Action Task Force (FATF). In early 2012, the authorities established regulations providing definitions of "acts of terrorism" and specifying the notion of "politically exposed person (PEP)", although the latter term is limited to persons of foreign nationality. The BA conducts regular inspections of banks to ensure their compliance with the

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[4] CAMELs—a credit worthiness assessment system—stands for Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to market risk.

existing regulations governing money laundering and the financing of terrorism, and shares its findings with the AML/CFT unit. However, deficiencies remain, in particular regarding how terrorist acts are defined, the implementation of United Nations Security Council Resolutions 1267 and 1373, broadening of the definition of PEPs to include nationals, and enlarging the scope of customer due diligence (CDD) obligations in line with the recently revised FATF standard. The authorities are encouraged to tackle these deficiencies and to fully implement the action plan agreed with the FATF.

28. Reforms of the employment market will be necessary to support job creation. Employment is dominated by the public sector, which accounts for 30 percent of total employment and 76.1 percent of those wage earners who have a permanent job. There is also a large informal sector (Appendix III). The mismatch between education and employment results in high unemployment rates among university graduates, and insufficient numbers of skilled workers in professional sectors, such as the construction sector and agriculture. The authorities would do well to introduce an "education for employment" plan. Additionally, labor market rigidities and high payroll taxes may reduce the incentive for companies to create jobs. Finally, active labor market policy measures—such as subsidized hires in the private sector and support for starting individual businesses—have helped to bring down unemployment among university graduates. An independent assessment should be carried out on the efficiency of these measures.

Box 6. Actionable Policy Recommendations for 2013

The following macroeconomic and structural measures could be introduced relatively quickly, and could make a significant difference in both stabilization and growth.

To strengthen macroeconomic stability

- Tighten monetary policy.
- Enhance coordination between the Ministry of Finance and Banque d'Algerie. Updated Treasury cash flows could be discussed at regular intervals.
- Set higher and realistic FX ceilings for travelers.

To support fiscal sustainability

- Cost and disclose the main implicit subsidies—such as energy subsidies—in an appendix to the 2014 budget law.
- Review and rationalize VAT exemptions.
- Set medium-term sector envelopes early in the process for the 2014 budget.

To improve the business environment and spur growth

- Further simplify the procedures for creating and operating a business.
- Revise the FDI ownership rules to lift existing restrictions or limit them to strategic sectors.
- Lift the ban on consumer credit.

STAFF APPRAISAL

29. Algeria's macroeconomic performance has remained strong, but vulnerabilities are surfacing. Nonhydrocarbon sector growth is buoyant, supported by large public spending, and sizeable hydrocarbon revenues provide external and fiscal buffers. However, the recent surge in current spending has worsened the fiscal stance and spurred inflation, which is expected to reach a 15-year high, while nonhydrocarbon growth shows signs of slowing. Policies will have to be geared toward curtailing inflation, ensuring fiscal sustainability and the efficiency of public spending, and fostering strong nonhydrocarbon growth.

30. Fighting inflation will require a coordinated use of monetary, fiscal, and structural policies. The fiscal consolidation envisaged in the 2013 budget law is welcome, and any additional increase in current spending—particularly in the wage bill—should be resisted. The authorities appropriately bolstered liquidity management in May 2012, but the monetary stance will need to be further tightened to bring down inflation to the 4–4.5 percent target. The reliance of the government on drawdowns from the FRR to cover its cash flow needs should be reduced to contain liquidity injections, and market financing should be sought more actively. Finally, structural measures would also help contain demand pressures. The authorities' efforts to reduce tensions on the supply side that distort prices are welcome, but there is room for further action, notably putting in place the long-awaited competition authority.

31. The exchange rate policy appropriately targets a real effective exchange rate in line with fundamentals. The real effective exchange rate is broadly in line with its equilibrium value, and the reserves position is very comfortable. In that context, the parallel market premium on the exchange rate should be addressed, given the importance of a unified exchange rate market, especially for private sector development. Forex ceilings for travelers should be raised significantly to realistic levels, and forex surrender requirements on exporters, as well as the regulation on reserve requirement on forex deposit, should be eased.

32. Fiscal policy needs to be set on a sustainable trajectory. The fiscal stance is vulnerable to a lasting drop in hydrocarbon prices, and large current spending in the recent past has led to an increase in the fiscal breakeven oil price to levels slightly above actual prices. The nonhydrocarbon fiscal deficit is not consistent with maintaining real wealth per capita, and is largely financed by drawdowns from the oil fund. Current spending—notably on the wage bill and subsidies—should be contained, and nonhydrocarbon tax revenues bolstered, notably by discontinuing tax exemptions. The budget law could usefully include an explicit cap on FRR drawings consistent with medium-term sustainability. Moreover, the actual cost of large implicit subsidies, related particularly to the low domestic energy prices, should be disclosed, and financing provided within the budget to strengthen fiscal management, improve the financial management of the public companies that are part of this subsidy framework, and raise awareness of the support provided by the government to households and businesses.

33. The authorities' efforts to enhance their budget toolkit are welcome. Sector-level multi-year budget envelopes could be set for the next exercise, and pilot experiences of sector-level performance-based budgeting carried out. Better monitoring of capital spending authorizations, the development of sector-level budget execution plans, the setting up of an integrated PFM IT system, and a gradual shortening of the supplementary budget period, are all measures that would improve the efficiency of public financial management.

34. Algeria needs a faster and more inclusive growth. Public investment should be safeguarded while improving its quality and the public sector's absorptive capacity. To encourage private investment, wide-ranging reforms to the business climate are needed. The restrictive FDI regime should be reviewed, and ownership restrictions lifted or limited to a few strategic sectors. Finally, to enhance job opportunities for the still-high number of young and female unemployed, policies to improve the jobs/skills match and to increase labor market flexibility are needed.

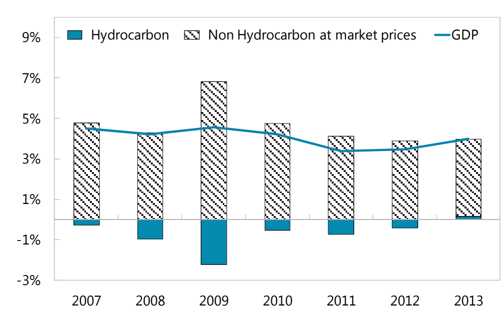
35. A modernized financial sector is needed to foster growth. Improvements in financial stability are welcome and should be consolidated, by enhancing supervision and assessing systemic risk, and by establishing a write-off mechanism for fully provisioned old NPLs. Bank intermediation will need to be strengthened, and the ban on consumer credit lifted. Finally, the authorities' plan to reform the financial market is welcome, and should be supported by the listing of public companies; however, the extended use of subsidized interest rates reduces incentives to rely on financial markets and should be phased out.

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

Figure 1. Algeria: Selected Macroeconomic Indicators

Nonhydrocarbon growth gradually slowed down since 2009, as the impulse from public spending faded on. The hydrocarbon sector has been a drag overall growth since 2006 and is only expected to recover in 2013.

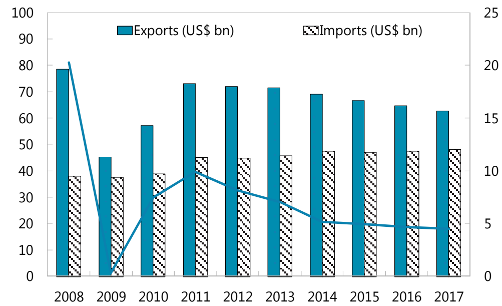
Hydro and Nonhydrocarbon Growth



Sources: Algerian authorities; and IMF staff calculations.

The current account continued to strengthen, on the back of higher oil prices, and is expected to remain positive over the medium term.

Current Account

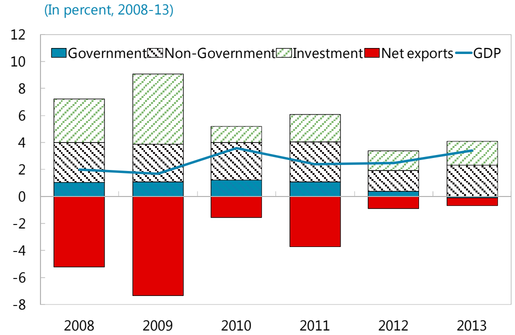


Sources: Algerian authorities.

On the demand side, growth is mostly driven by consumption and investment, while net exports have been weighting down growth.

Algeria: Contribution to GDP Growth

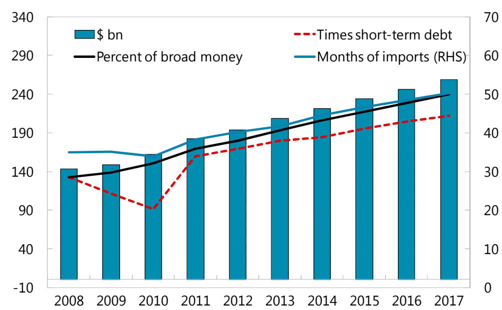
(In percent, 2008-13)



Sources: Algerian authorities; and IMF staff calculations.

The reserves position is expected to strengthen further.

International Reserves

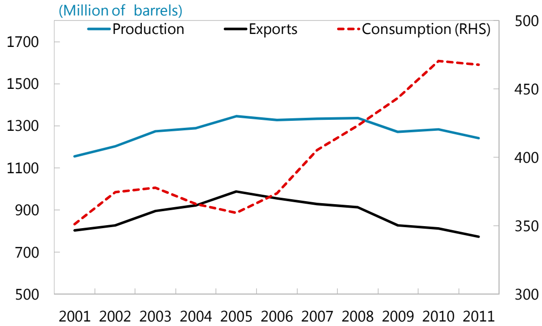


Sources: Algerian authorities; and IMF staff calculations.

The combination of increasing consumption and slowing production resulted in declining hydrocarbon export volumes.

Hydrocarbon Production, Consumption, and Exports

(Million of barrels)

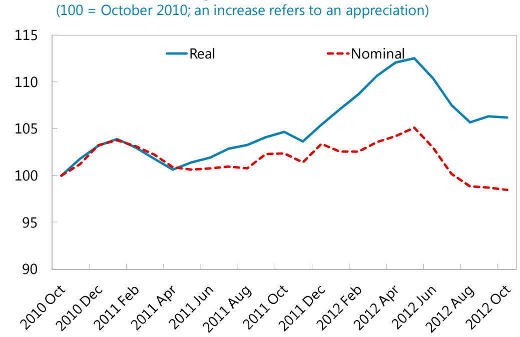


Source: Algerian authorities.

The large price differential with Algeria's partners led to a real effective appreciation in the first months of 2012.

Effective Exchange Rate

(100 = October 2010; an increase refers to an appreciation)



Sources: Algerian authorities; and IMF staff calculations.

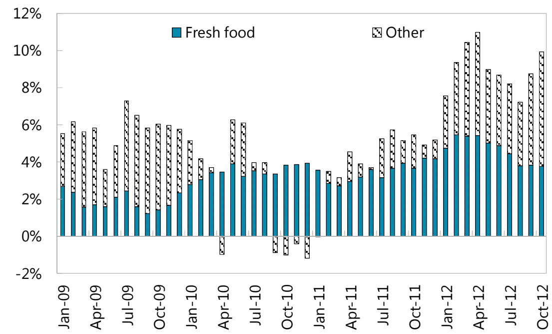
Figure 1. Algeria: Selected Macroeconomic Indicators (concluded)

Inflation accelerated in the first months of 2012. While shocks to fresh food prices contributed, liquidity is the major factor behind the increase in other prices.

The financial sector remains underdeveloped, with low private sector credit to GDP …

CPI Inflation

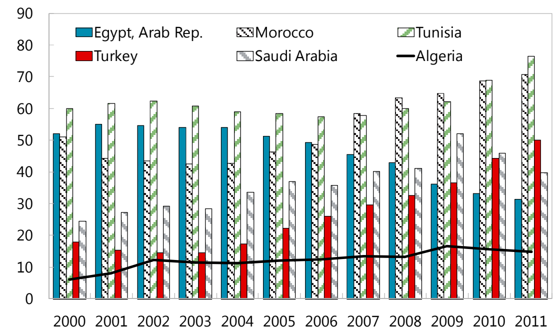
(Contributions in percent)



Sources: Algerian authorities; and IMF staff calculations.

Private Sector Credit

(Percent of GDP)



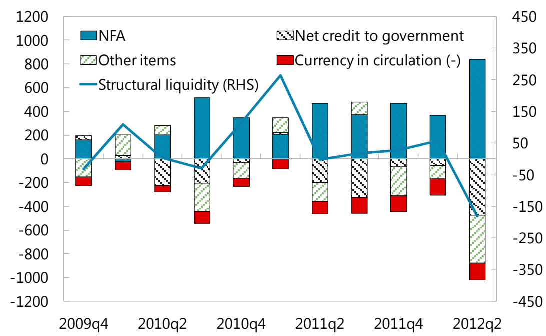
Source: World Bank, World Development Indicators.

NFA and smaller government savings are the main drivers of structural liquidity changes.

… low credit to deposit ratios…

Structural Liquidity and Autonomous Factors

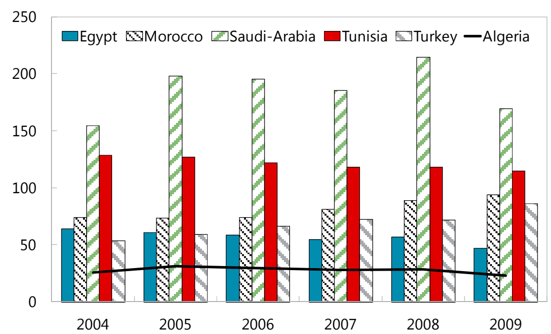
(q-to-q change in DZD billion)



Sources: Algerian authorities; and IMF staff calculations.

Bank Credit to Bank Deposits

(Percent, 2004-10)

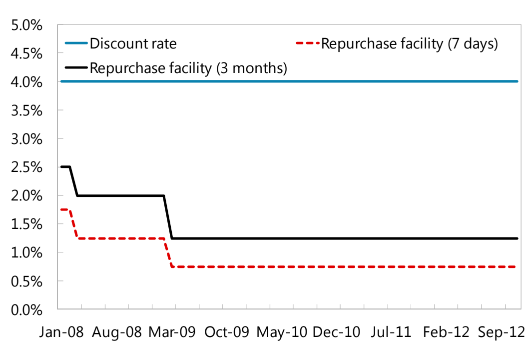


Source: World Bank, Global Development Finance.

Interest rates remain low.

… and a small stock market capitalization.

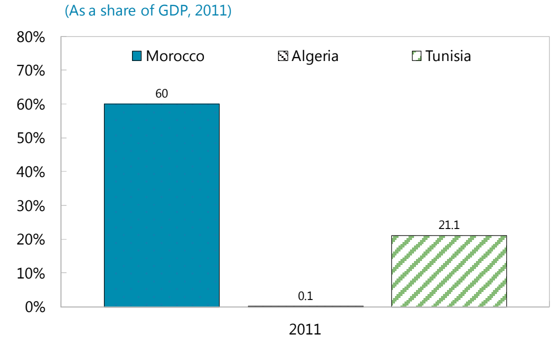
BA Interest Rates



Source: Algerian authorities.

Stock Market Capitalization

(As a share of GDP, 2011)

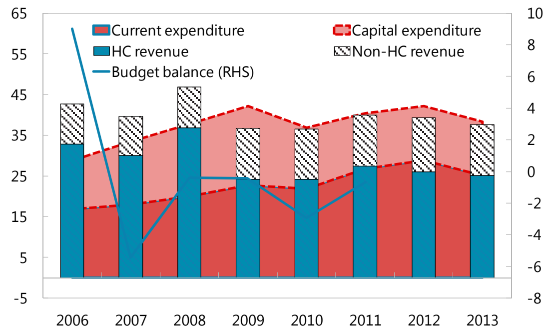


Sources: Algerian authorities; and World Bank, Global Development Finance.

Figure 2. Algeria: Fiscal Indicators

The overall fiscal balance remained contained, as large increases in current expenditure were offset by large hydrocarbon revenues.

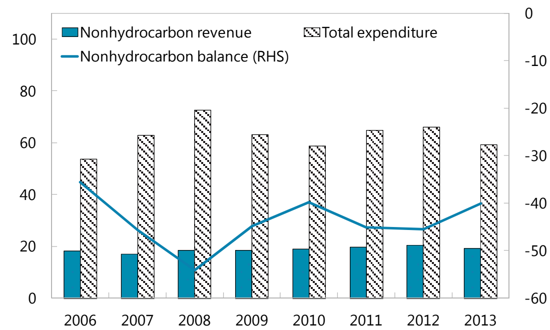
Overall Fiscal Balance
(Percent of GDP)



Sources: Algerian authorities; and IMF staff calculations.

Low nonhydrocarbon revenues combined with large spending lead to a sizeable nonhydrocarbon deficit.

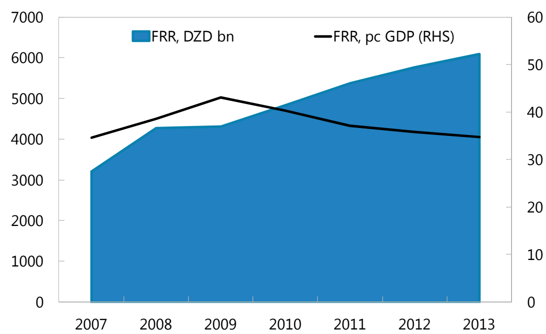
Nonhydrocarbon Fiscal Balance
(In percent of non-HC GDP)



Sources: Algerian authorities; and IMF staff calculations.

Fiscal savings remained sizeable but have stabilized as a share of GDP.

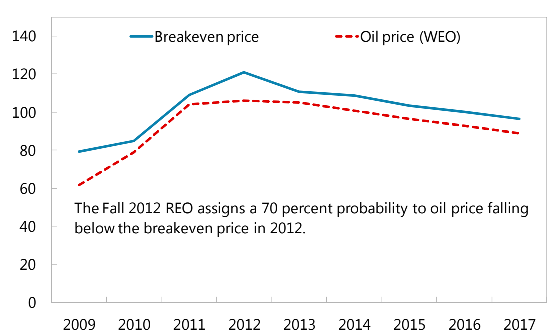
Oil Stabilization Fund



Sources: Algerian authorities; and IMF staff calculations.

In the medium term, fiscal breakeven oil prices are expected to remain close to actual prices, suggesting an important risk if oil prices fell and remained low.

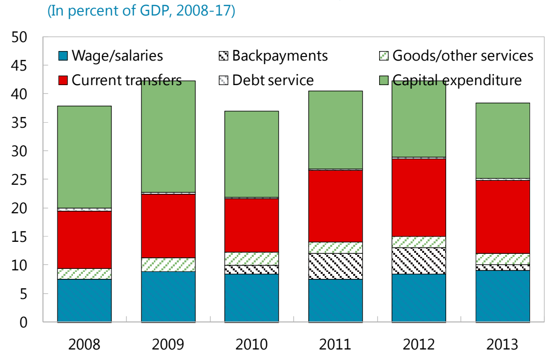
Oil: Actual and Fiscal Breakeven Prices
(In USD)



Source: IMF staff calculations.

Current spending is a growing share of total spending.

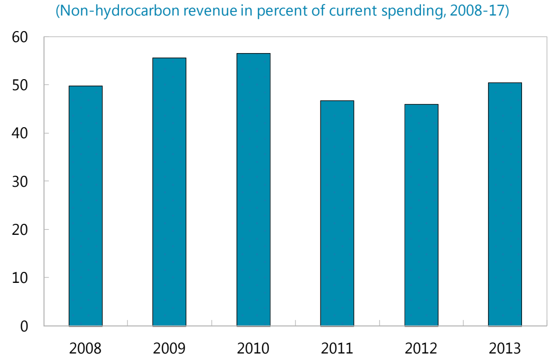
Composition of Public spending
(In percent of GDP, 2008-17)



Sources: Authorities data and IMF staff calculations.

Current spending is high compared to nonhydrocarbon revenue.

Current Spending
(Non-hydrocarbon revenue in percent of current spending, 2008-17)

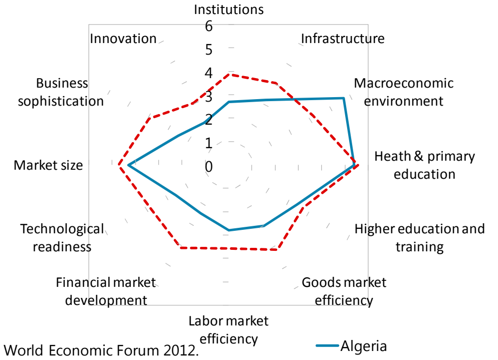


Sources: Algerian authorities; and IMF staff calculations.

Figure 3. Algeria: Structural Issues

A weak business environment hampers private sector investment.

Global Competitiveness Index

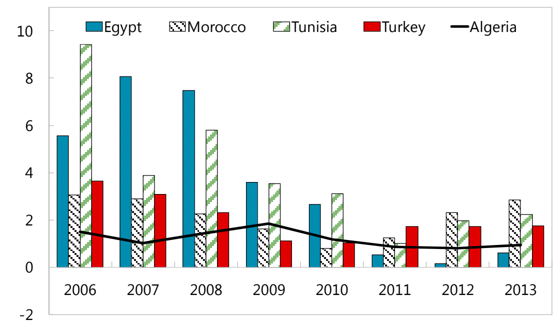


Sources: World Economic Forum 2012.
1/ Comparators: Egypt, Morocco, Turkey.

FDI inflows are low compared to other countries, reflecting the limited attractiveness of Algeria.

FDI in Selected Countries

(In percent of GDP)

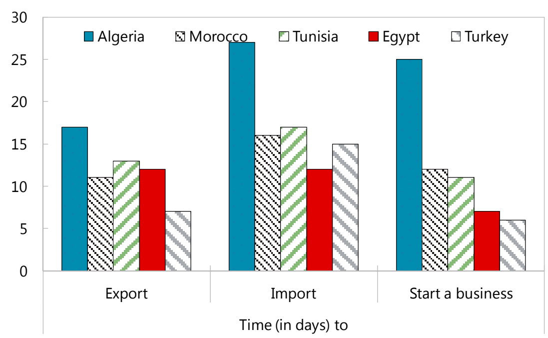


Sources: IMF, WEO.

Trading and starting a business are among the impediments to private sector development.

Ease of Doing Business

(Selected Indicators, 2011)

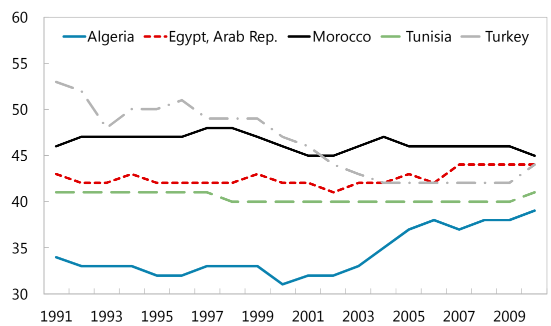


Sources: Doing Business 2012.

Despite recent progress, Algeria's employment rate remains low compared to other countries in the region.

Employment Rate

(In percent of population age 15+)

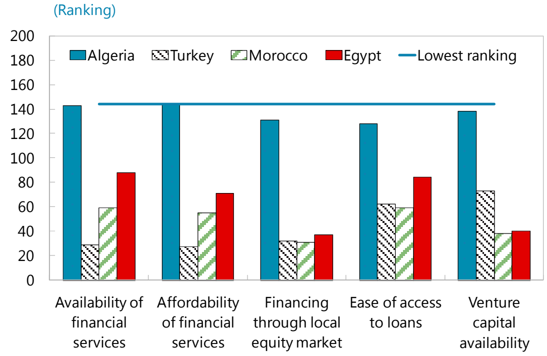


Sources: World Bank, World Development Indicators.

The financial sector remains underdeveloped.

Financial Market Development

(Ranking)

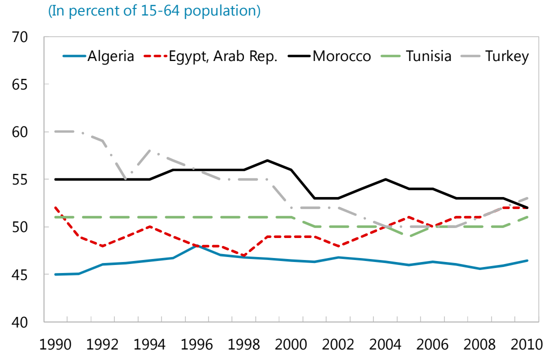


Sources: 2012 WEF Competitiveness Report.

Labor force participation lags the performance of other countries in the region.

Labor Force Participation

(In percent of 15-64 population)



Sources: World Bank, World Development Indicators.

Table 2. Algeria: Selected Economic and Financial Indicators, 2009–17

			Prel.	Proj.					
	2009	2010	2011	2012	2013	2014	2015	2016	2017
	(Annual percentage change; unless otherwise indicated)								
Oil and gas sector									
Liquid petroleum exports (in millions of barrels/day)	1.5	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Natural gas exports (in billions of m3)	53.7	56.1	51.8	50.4	50.5	50.8	51.2	51.6	52.1
Crude oil export unit value (US$/bbl)	61.8	80.1	112.9	115.3	114.1	109.2	104.7	100.7	96.5
Share of hydrocarbons in total exports (in percent)	98.3	98.3	98.3	98.4	98.3	98.1	98.0	97.8	97.5
National income and prices									
GDP at constant prices	1.7	3.6	2.4	2.5	3.4	3.3	3.4	3.5	3.5
Hydrocarbon sector	-8.0	-2.2	-3.2	-1.9	0.8	0.9	0.9	0.9	1.0
Other sectors	9.4	6.3	5.3	5.0	4.8	4.6	4.6	4.6	4.6
Consumer price index (period average)	5.7	3.9	4.5	8.4	5.0	4.5	4.0	4.0	4.0
External sector 1/									
Exports, f.o.b.	-42.5	26.4	27.6	-1.3	-0.6	-3.6	-3.3	-2.9	-3.1
Hydrocarbons	-42.5	26.4	27.6	-1.3	-0.7	-3.8	-3.5	-3.1	-3.3
Nonhydrocarbons	-45.0	26.0	25.8	-7.0	5.8	6.3	6.6	6.7	6.7
Imports, f.o.b.	-1.6	4.0	15.6	-0.2	1.7	3.9	-0.7	0.6	1.5
Current account balance (in percent of GDP)	0.3	7.5	9.9	8.1	7.0	5.2	4.9	4.7	4.5
Money and credit									
Net foreign assets	5.0	10.3	16.2	6.3	…	…	…	…	…
Domestic credit 2/	7.3	4.8	-1.4	1.8	…	…	…	…	…
Credit to the government (net) 2/	0.2	2.6	-6.8	-3.9	…	…	…	…	…
Credit to the economy	18.5	5.1	13.5	14.9	…	…	…	…	…
Money and quasi-money	4.8	13.5	19.9	10.6	…	…	…	…	…
Velocity of broad money (GDP/M2)	1.4	1.5	1.5	1.5	…	…	…	…	…
Idem, in percent of nonhydrocarbon GDP	0.9	0.9	0.9	1.0	…	…	…	…	…
Liquidity ratio (M2/GDP)	72.9	68.8	68.6	68.1	…	…	…	…	…
	(Percent of GDP)								
Saving-investment balance	0.3	7.5	9.9	8.1	7.0	5.2	4.9	4.7	4.5
National savings	47.1	49.2	46.0	43.7	48.6	47.9	47.7	47.6	47.8
Government	12.7	13.2	12.3	10.4	12.6	11.9	12.0	11.8	11.8
Of which: Nongovernment	34.4	36.0	33.7	33.3	36.0	36.1	35.7	35.7	36.0
Investment	46.8	41.7	36.2	35.6	41.6	42.8	42.7	42.9	43.3
Government	19.4	15.0	13.6	14.0	13.9	13.7	13.6	13.6	13.5
Of which: Nongovernment	27.4	26.6	22.5	21.5	27.7	29.0	29.1	29.3	29.8
Central government finance									
Overall budget balance (deficit-)	-6.8	-1.8	-1.3	-3.6	-1.3	-1.9	-1.6	-1.7	-1.7
Total revenue	36.7	36.5	40.0	39.3	37.7	36.6	35.8	35.1	34.4
Total expenditure	43.5	38.3	41.3	42.9	39.0	38.5	37.4	36.8	36.2
	(Percent of nonhydrocarbon GDP)								
Central government finance									
Total revenue	53.3	55.9	62.7	60.4	57.2	54.3	52.1	49.9	47.9
Hydrocarbon	35.0	37.0	43.1	40.0	38.0	35.3	33.1	30.6	28.4
Nonhydrocarbon	18.3	18.9	19.6	20.4	19.2	19.0	19.0	19.3	19.5
Total expenditure	63.1	58.7	64.7	66.0	59.3	57.1	54.4	52.3	50.4
Current expenditure	33.0	33.5	42.0	44.4	38.1	36.7	34.6	33.0	31.5
Capital expenditure	30.2	25.2	22.7	21.6	21.1	20.4	19.8	19.3	18.9
Nonhydrocarbon primary balance	-44.3	-39.3	-44.7	-45.1	-39.5	-37.7	-35.0	-32.7	-30.5
Nonhydrocarbon balance	-44.8	-39.8	-45.1	-45.6	-40.0	-38.1	-35.4	-33.1	-30.8
Memorandum items:									
GDP (in billions of dinars at current prices)	10,007	12,034	14,481	16,124	17,582	18,762	20,031	21,305	22,751
NHGDP (in billions of dinars at current prices)	6,898	7,854	9,239	10,486	11,569	12,634	13,769	14,982	16,339
GDP (in billions of US$ current prices)	137.6	161.8	199.2	206.5	210.5	213.0	215.1	220.0	224.3
GDP capita per (in US$)	3,943	4,567	5,540	5,659	5,684	5,664	5,637	5,680	5,706
Crude oil exports (in millions of barrels/day)	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Nonhydrocarbon exports (percent of total exports)	1.5	1.5	1.5	1.5	1.6	1.7	1.8	2.0	2.1
Gross official reserves (end of period)	148.9	162.2	182.2	193.9	208.6	221.5	233.8	246.1	258.5
In months of next year's imports of goods and services	35.2	33.9	38.2	40.2	41.7	44.5	46.6	48.4	50.3
Gross government debt (percent of GDP)	10.4	11.1	11.0	9.9	8.9	8.3	7.7	7.3	6.8

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

1/ In U.S. dollars terms.

2/ In percent of beginning money stock.

Table 3. Algeria: Balance of Payments, 2009–17

			Prel.	Proj.					
	2009	2010	2011	2012	2013	2014	2015	2016	2017
	(Billions of U.S. dollars; unless otherwise indicated)								
Current account	0.4	12.1	19.7	16.8	14.8	11.0	10.6	10.3	10.1
Trade balance	7.8	18.2	27.9	27.1	25.9	21.5	19.6	17.3	14.6
Exports, f.o.b.	45.2	57.1	72.9	71.9	71.5	68.9	66.6	64.7	62.7
Hydrocarbons	44.4	56.1	71.7	70.8	70.3	67.6	65.2	63.2	61.1
Volume change (percent)	-10.2	-2.8	-3.8	-3.2	0.3	0.5	0.7	0.7	0.8
Price change (percent)	-36.0	30.7	32.4	2.1	-1.0	-4.3	-4.2	-3.8	-4.1
Other	0.8	1.0	1.2	1.1	1.2	1.3	1.4	1.4	1.5
Imports, f.o.b.	-37.4	-38.9	-44.9	-44.8	-45.6	-47.4	-47.1	-47.4	-48.0
Volume change (percent)	12.6	-2.4	4.5	-0.1	2.4	5.4	0.1	0.6	1.0
Price change (percent)	-12.6	5.8	11.4	-0.3	-0.6	-1.4	-0.7	0.1	0.5
Services and income (net)	-10.0	-8.7	-10.8	-12.8	-13.6	-13.0	-11.4	-9.4	-6.9
Services (net)	-8.7	-8.3	-8.8	-9.0	-9.0	-9.3	-9.1	-9.2	-9.2
Credit	3.0	3.6	3.8	3.3	3.4	3.5	3.6	3.7	3.8
Debit	-11.7	-11.9	-12.6	-12.3	-12.3	-12.7	-12.6	-12.9	-13.0
Income (net)	-1.3	-0.4	-2.0	-3.8	-4.6	-3.7	-2.4	-0.3	2.2
Credit	4.7	4.6	4.5	3.0	2.1	2.7	4.0	5.9	8.3
Debit	-6.1	-5.0	-6.5	-6.8	-6.8	-6.4	-6.3	-6.1	-6.1
Interest payments	-0.2	-0.1	-0.2	-0.03	-0.04	-0.03	-0.05	-0.02	-0.02
Other, including profit repatriation	-5.9	-4.9	-6.3	-6.8	-6.7	-6.4	-6.3	-6.1	-6.1
Transfers (net)	2.6	2.7	2.6	2.6	2.5	2.5	2.5	2.4	2.4
Capital account	3.4	3.1	0.4	1.4	1.6	2.2	2.0	2.4	2.6
Medium- and long-term capital	4.1	3.6	1.0	1.4	1.6	2.2	2.0	2.4	2.6
Direct investment (net)	2.5	3.5	2.0	1.7	2.0	2.5	2.6	2.7	2.9
Loans (net)	1.5	0.1	-1.1	-0.3	-0.4	-0.3	-0.6	-0.3	-0.2
Drawings	2.2	0.6	0.1	0.02	0.02	0.02	0.02	0.02	0.02
Amortization	-0.7	-0.4	-1.2	-0.3	-0.4	-0.4	-0.6	-0.3	-0.2
Short-term capital and errors and	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0	0
omissions	-0.6	-0.4	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	3.9	15.3	20.1	18.2	16.4	13.2	12.7	12.7	12.8
Financing	-3.9	-15.3	-20.1	-18.2	-16.4	-13.2	-12.7	-12.7	-12.8
Official reserves (increases -)	-3.9	-15.3	-20.1	-18.2	-16.4	-13.2	-12.7	-12.7	-12.8
Memorandum items:									
Current account balance (percent of GDP)	0.3	7.5	9.9	8.1	7.0	5.2	4.9	4.7	4.5
Algerian crude oil price (US$/barrel) 1/	61.8	80.1	112.9	115.3	114.1	109.2	104.7	100.7	96.5
Gross official reserves (billions of US$)	148.9	162.2	182.2	193.9	208.6	221.5	233.8	246.1	258.5
Idem, in months of next year's imports	35.2	33.9	38.2	40.2	41.7	44.5	46.6	48.4	50.3
Gross external debt (billions of US$)	5.7	5.7	4.4	3.9	3.5	3.1	2.6	2.3	2.1

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

1/ Weighted average of quarterly data.

Table 4a. Algeria: Summary of Central Government Operations, 2009-17 1/

	2009	2010	Prel. 2011	Proj. 2012	2013	2014	2015	2016	2017
	(Billions of Algerian dinars)								
Budget revenue and grants	3,676	4,393	5,790	6,330	6,623	6,863	7,173	7,473	7,833
Hydrocarbon revenue 2/	2,413	2,905	3,980	4,192	4,399	4,465	4,553	4,587	4,643
Nonhydrocarbon revenue	1,263	1,488	1,810	2,138	2,223	2,398	2,620	2,885	3,190
Tax revenue	1,147	1,298	1,527	1,863	1,972	2,156	2,350	2,567	2,803
Taxes on income and profits	462	562	685	917	941	1,037	1,130	1,244	1,378
Taxes on goods and services	478	515	573	620	676	737	804	873	942
Customs duties	170	182	222	271	294	316	343	371	397
Registration and stamps	36	40	47	55	61	66	72	79	86
Nontax revenues	117	190	283	276	251	242	270	318	387
Fees	68	64	79	89	94	98	102	106	110
Bank of Algeria dividends and interests	48	121	137	115	77	55	71	107	162
Dividends from Pes	1	4	67	71	81	89	97	106	115
Total expenditure	4,221	4,440	5,853	6,804	6,743	7,105	7,385	7,729	8,116
Current expenditure	2,275	2,632	3,879	4,651	4,413	4,637	4,770	4,948	5,146
Personnel expenditure	880	1,193	1,740	2,093	1,753	1,878	2,002	2,114	2,231
Mudjahidins' pensions	131	151	163	177	194	203	203	203	203
Material and supplies	113	122	130	138	161	170	179	188	199
Current transfers	1,114	1,130	1,808	2,192	2,248	2,330	2,330	2,388	2,458
Interest payments	37	36	38	51	57	57	56	55	55
Capital expenditure	1,946	1,808	1,974	2,153	2,330	2,468	2,614	2,781	2,969
Budget balance	-545	-47	-63	-474	-120	-241	-212	-257	-283
Nonhydrocarbon primary balance	-3,054	-3,089	-4,133	-4,727	-4,575	-4,762	-4,820	-4,900	-4,982
Primary balance 3/	-642	-184	-153	-535	-175	-297	-267	-312	-339
Nonhydrocarbon balance	-3,092	-3,125	-4,170	-4,778	-4,632	-4,819	-4,876	-4,955	-5,037
Overall balance	-679	-220	-190	-586	-232	-353	-323	-368	-394
Financing	679	220	190	586	232	353	323	368	394
Domestic	701	235	208	605	236	357	328	373	399
Bank	46	-439	-520	-389	-326	-153	-206	-197	-165
Nonbank	655	674	728	994	562	511	535	570	564
Foreign	-22	-15	-17	-19	-4	-4	-4	-4	-4
	(Percent of GDP)								
Total revenue	36.7	36.5	40.0	39.3	37.7	36.6	35.8	35.1	34.4
Hydrocarbon	24.1	24.1	27.5	26.0	25.0	23.8	22.7	21.5	20.4
Nonhydrocarbon	12.6	12.4	12.5	13.3	12.6	12.8	13.1	13.5	14.0
Of which: Tax revenue	11.5	10.8	10.5	11.6	11.2	11.5	11.7	12.0	12.3
Total expenditure	43.5	38.3	41.3	42.9	39.0	38.5	37.4	36.8	36.2
Current expenditure	22.7	21.9	26.8	28.8	25.1	24.7	23.8	23.2	22.6
Wages and salaries	8.8	9.9	12.0	13.0	10.0	10.0	10.0	9.9	9.8
Wages and salaries (excluding backpayments 20	8.8	8.3	7.5	8.4	9.1	10.0	10.0	9.9	9.8
Goods and other services	2.4	2.3	2.0	2.0	2.0	2.0	1.9	1.8	1.8
Current transfers	11.1	9.4	12.5	13.6	12.8	12.4	11.6	11.2	10.8
Debt service	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2
Capital expenditure	19.4	15.0	13.6	13.4	13.3	13.2	13.1	13.1	13.1
Budget balance	-5.4	-0.4	-0.4	-2.9	-0.7	-1.3	-1.1	-1.2	-1.2
Primary balance	-6.4	-1.5	-1.1	-3.3	-1.0	-1.6	-1.3	-1.5	-1.5
Overall balance	-6.8	-1.8	-1.3	-3.6	-1.3	-1.9	-1.6	-1.7	-1.7
	(Percent of nonhydrocarbon GDP)								
Total revenue	53.3	55.9	62.7	60.4	57.2	54.3	52.1	49.9	47.9
Hydrocarbon revenue	35.0	37.0	43.1	40.0	38.0	35.3	33.1	30.6	28.4
Nonhydrocarbon revenue	18.3	18.9	19.6	20.4	19.2	19.0	19.0	19.3	19.5
Of which: Tax revenue	16.6	16.5	16.5	17.8	17.0	17.1	17.1	17.1	17.2
Total expenditure	63.1	58.7	64.7	66.0	59.3	57.1	54.4	52.3	50.4
Current expenditure	33.0	33.5	42.0	44.4	38.1	36.7	34.6	33.0	31.5
Of which: Personnel expenditure	12.8	15.2	18.8	20.0	15.2	14.9	14.5	14.1	13.7
Capital expenditure	28.2	23.0	21.4	20.5	20.1	19.5	19.0	18.6	18.2
Capital expenditure	30.2	25.2	22.7	21.6	21.1	20.4	19.8	19.3	18.9
Nonhydrocarbon primary balance	-44.3	-39.3	-44.7	-45.1	-39.5	-37.7	-35.0	-32.7	-30.5
Nonhydrocarbon overall balance	-44.8	-39.8	-45.1	-45.6	-40.0	-38.1	-35.4	-33.1	-30.8
Oil stabilization fund (in billions of Algerian dinars)	4316.5	4842.8	5381.7	5770.9	6096.8	6249.8	6456.9	6654.9	6820.9
(Percent of GDP)	43.1	40.2	37.2	35.8	34.7	33.3	32.2	31.2	30.0

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

1/ On cash basis.

2/ Including dividends of Sonatrach.

3/ Includes net lending by the Treasury.

Table 4b. Algeria: Statement of Central Government Operations, 2009–17 1/

			Prel.	Proj.					
	2009	2010	2011	2012	2013	2014	2015	2016	2017
	(Billions of Algerian dinars)								
Revenue (a)	3,676	4,393	5,790	6,330	6,623	6,863	7,173	7,473	7,833
Taxes	1,147	1,298	1,527	1,863	1,972	2,156	2,350	2,567	2,803
Taxes on income, profits and capital gains	462	562	685	917	941	1,037	1,130	1,244	1,378
Taxes on goods and services	478	515	573	620	676	737	804	873	942
Taxes on international trade and transactions	170	182	222	271	294	316	343	371	397
Other revenue	2,529	3,095	4,263	4,467	4,651	4,707	4,823	4,906	5,030
Rents (Oil revenue), of which 2/	2,413	2,905	3,980	4,192	4,399	4,465	4,553	4,587	4,643
Stabilization fund	401	1,319	2,300	2,543	2,795	2,861	2,948	2,982	3,038
Expenditure (b)	4,221	4,440	5,853	6,804	6,743	7,105	7,385	7,729	8,116
Expense (b.1)	2,275	2,632	3,879	4,651	4,413	4,637	4,770	4,948	5,146
Compensation of employees	880	1,193	1,740	2,093	1,753	1,878	2,002	2,114	2,231
Goods and services	113	122	130	138	161	170	179	188	199
Interest payments	37	36	38	51	57	57	56	55	55
Subsidies	3	3	3	3	3	3	3	3	3
Grants	503	609	989	1,169	921	969	1,014	1,072	1,155
Social benefits (Mudjahidins' pensions)	183	210	235	255	276	289	292	305	320
Other expense (subsidies public enterprises)	556	460	745	942	1,242	1,272	1,224	1,211	1,183
Net acquisition of nonfinancial assets (b.2)	1,946	1,808	1,974	2,153	2,330	2,468	2,614	2,781	2,969
Gross operating balance (a-b.1)	1,401	1,761	1,911	1,679	2,210	2,226	2,402	2,524	2,687
Net lending/borrowing (a-b) (Overall balance)	-545	-47	-63	-474	-120	-241	-212	-257	-283
Net aquisition of financial assets	88	613	648	501	438	266	320	311	279
Domestic	134	174	127	112	112	112	112	112	112
Currency and deposits	-4	35	0	0	0	0	0	0	0
Loans (net lending by the treasury)	138	139	127	112	112	112	112	112	112
Foreign	-46	439	520	389	326	154	208	199	167
Currency and deposits	-46	439	520	389	326	154	208	199	167
Net incurrence of liabilities	633	660	711	975	558	508	532	568	562
Domestic	655	674	728	994	562	512	537	572	566
Currency and deposits (public entities)	673	699	741	1,001	616	564	588	624	617
Loans	-18	-25	-13	-7	-53	-52	-51	-51	-51
Foreign	-22	-15	-17	-19	-4	-4	-4	-4	-4
Loans	-22	-15	-17	-19	-4	-4	-4	-4	-4
Memorandum items:									
Nonhydrocarbon primary balance	-2,920	-2,916	-4,005	-4,615	-4,463	-4,650	-4,709	-4,788	-4,871
Primary balance	-507	-10	-26	-423	-63	-185	-156	-201	-228
Nonhydrocarbon balance	-2,958	-2,952	-4,043	-4,666	-4,520	-4,707	-4,765	-4,844	-4,925
Overall balance excluding stabilization fund	-946	-1,365	-2,364	-3,017	-2,916	-3,103	-3,160	-3,239	-3,320
Oil stabilization fund (in billions of Algerian dinars)	4,316	4,843	5,382	5,771	6,097	6,250	6,457	6,655	6,821
	(Percent of GDP)								
Revenue (a)	36.7	36.5	40.0	39.3	37.7	36.6	35.8	35.1	34.4
Taxes	11.5	10.8	10.5	11.6	11.2	11.5	11.7	12.0	12.3
Other revenue, of which	25.3	25.7	29.4	27.7	26.5	25.1	24.1	23.0	22.1
Nontax revenues	1.2	1.6	2.0	1.7	1.4	1.3	1.3	1.5	1.7
Rents (Oil revenue) 2/	24.1	24.1	27.5	26.0	25.0	23.8	22.7	21.5	20.4
Expenditure (b)	42.2	36.9	40.4	42.2	38.4	37.9	36.9	36.3	35.7
Expense (b.1)	22.7	21.9	26.8	28.8	25.1	24.7	23.8	23.2	22.6
Compensation of employees	8.8	9.9	12.0	13.0	10.0	10.0	10.0	9.9	9.8
Social benefits (Mudjahidins' pensions)	1.8	1.7	1.6	1.6	1.6	1.5	1.5	1.4	1.4
Goods and services	1.1	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Grants	5.0	5.1	6.8	7.3	5.2	5.2	5.1	5.0	5.1
Interest payments	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2
Net acquisition of nonfinancial assets (b.2)	19.4	15.0	13.6	13.4	13.3	13.2	13.1	13.1	13.1
Gross operating balance (a-b.1)	14.0	14.6	13.2	10.4	12.6	11.9	12.0	11.8	11.8
Net lending/borrowing (a-b) (Overall balance)	-5.4	-0.4	-0.4	-2.9	-0.7	-1.3	-1.1	-1.2	-1.2
Primary balance	-5.1	-0.1	-0.2	-2.6	-0.4	-1.0	-0.8	-0.9	-1.0
Oil stabilization fund	43.1	40.2	37.2	35.8	34.7	33.3	32.2	31.2	30.0
	(Percent of nonhydrocarbon GDP)								
Revenue (a)	53.3	55.9	62.7	60.4	57.2	54.3	52.1	49.9	47.9
Taxes	16.6	16.5	16.5	17.8	17.0	17.1	17.1	17.1	17.2
Other revenue, of which	36.7	39.4	46.1	42.6	40.2	37.3	35.0	32.7	30.8
Rents (Oil revenue) 2/	35.0	37.0	43.1	40.0	38.0	35.3	33.1	30.6	28.4
Expenditure (b)	61.2	56.5	63.4	64.9	58.3	56.2	53.6	51.6	49.7
Expense (b.1), of which	33.0	33.5	42.0	44.4	38.1	36.7	34.6	33.0	31.5
Personnel expenditure	12.8	15.2	18.8	20.0	15.2	14.9	14.5	14.1	13.7
Net acquisition of nonfinancial assets (b.2)	28.2	23.0	21.4	20.5	20.1	19.5	19.0	18.6	18.2
Nonhydrocarbon primary balance	-42.3	-37.1	-43.4	-44.0	-38.6	-36.8	-34.2	-32.0	-29.8
Nonhydrocarbon overall balance	-42.9	-37.6	-43.8	-44.5	-39.1	-37.3	-34.6	-32.3	-30.1

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

1/ On cash basis.

2/ Including dividends of Sonatrach.

Table 4c. Algeria: Balance Sheet for the Central Government based on GFSM 2001, 2009–11 1/

	2009			2010			Prel. 2011		
	Transaction	Other economic flows 2/	Closing Opening balance	Transaction	Other economic flows 2/	Closing Opening balance	Transaction	Other economic flows 2/	Closing Opening balance
				(Billions of Algerian dinars)					
Net worth and its changes:	1,401	-191	13,084	1,761	-235	14,610	1,911	-207	16,314
Nonfinancial assets	1,946		10,882	1,808		12,690	1,974		14,664
Net Financial Worth:	-545	-191	2,202	-47	-235	1,920	-63	-207	1,650
Financial assets	88		5,093	613		5,706	648		6,353
Domestic	134		736	174		910	127		1,037
Currency and deposits	-4		195	35		230	0		230
Loans	138		541	139		680	127		807
Foreign	-46		4,356	439		4,796	520		5,316
Currency and deposits	-46		4,356	439		4,796	520		5,316
Liabilities	633	191	2,891	660	235	3,785	711	207	4,703
Domestic	655	178	2,741	674	212	3,627	728	225	4,580
Currency and deposits	673		1,846	699		2,545	741		3,286
Loans	-18	178	895	-25	212	1,082	-13	225	1,293
Foreign	-22	13	150	-15	23	159	-17	-18	124
Loans	-22	13	151	-15	23	159	-17	-18	124
Memorandum items:									
Net worth (in percent of GDP)			130.7			121.4			112.7
Net financial worth (in percent of GDP)			22.0			16.0			11.4
Financial assets (in percent of GDP)			50.9			47.4			43.9
Liabilities (in percent of GDP)			28.9			31.5			32.5
Change in Net worth (in percentage)			10.2			11.7			11.7
Change in Net financial worth (in percentage)			-25.1			-12.8			-14.1
Liabilities/Assets			0.18			0.21			0.22
Liabilities/Financial Assets ratio			0.57			0.66			0.74

Sources: Algerian authorities; and IMF staff estimates and projections.
1/ Includes Central Government and special accounts.
2/ Other economic flows record holding gains and losses and other changes in the volume of assets and liabilities.

Table 5. Algeria: Monetary Survey, 2009–13

	2009	2010	Prel. 2011	Proj. 2012	Proj. 2013
	(Billions of Algerian dinars; at end of period)				
Net foreign assets	10,758	11,871	13,795	14,665	16,899
Of which: Bank of Algeria	10,746	11,887	13,759	14,628	16,863
Net domestic assets	-3,465	-3,591	-3,866	-3,683	-4,833
Domestic credit	-892	-544	-659	-483	-416
Credit to government (net) 1/	-4,079	-3,892	-4,458	-4,847	-5,173
Credit to the economy 2/	3,187	3,348	3,800	4,364	4,757
Of which: Private sector	1,621	1,824	2,001	2,241	2,488
Other items net	-2,573	-3,047	-3,207	-3,200	-4,417
Money and quasi-money (M2)	7,293	8,281	9,929	10,982	12,066
Excluding Sonatrach deposits	6,518	7,290	8,912	10,332	11,369
Money	5,022	5,756	7,142	7,797	8,446
Quasi-money	2,271	2,524	2,787	3,185	3,620
	(Percent change over 12-month period)				
Money and quasi-money (M2)	4.8	13.5	19.9	10.6	9.9
Excluding Sonatrach deposits	15.3	11.8	22.3	15.9	10.0
Of which: Money	1.1	14.6	24.1	9.2	8.3
Credit to the economy	18.5	5.1	13.5	14.9	9.0
Of which: Private sector 3/	14.7	12.5	9.7	12.0	11.0
Memorandum items:					
Liquidity ratio (e.o.p. M2/GDP)	72.9	68.8	68.6	68.1	68.6
Liquidity ratio (e.o.p. M2/NHGDP)	105.7	105.4	107.5	104.7	104.3
Idem, excluding deposits of Sonatrach	94.5	92.8	96.5	98.5	98.3
Sonatrach deposits	774	991	1,017	650	697
M2 velocity	1.4	1.5	1.5	1.5	1.5
Credit to the economy/GDP	31.8	27.8	26.2	27.1	27.1
Credit to the economy/NHGDP	46.2	42.6	41.1	41.6	41.1
Credit to private sector/NHGDP	23.5	23.2	21.7	21.4	21.5

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.

2/ The projections including the public credit bought by the Treasury in 2010 and 2011 are 14.4 and 15.1 for 2010 and 2011, respectively.

3/ The projections including the private credit bought by the Treasury in 2011 is 14.7.

Table 6. Algeria: Financial Soundness Indicators, 2009–11
(Percent)

	2009	2010	2011
Capital adequacy ratio	26.2	23.6	23.7
- Public Banks	23.9	21.7	22.0
- Private Banks	35.2	31.6	31.2
NPLs/total loans	21.1	18.3	14.4
- Public Banks	23.6	20.5	16.0
- Private Banks	3.8	4.1	4.2
Provisions/classified loans	67.8	74.4	72.0
- Public Banks	67.4	74.5	71.9
- Private Banks	82.6	71.5	75.0
NPLs net of provisions/total loans	6.8	4.7	4.0
- Public Banks	7.7	5.2	4.5
- Private Banks	0.7	1.2	1.0
Return on equity	26.0	26.2	24.6
- Public Banks	27.9	29.3	26.1
- Private Banks	20.9	19.7	21.1
Liquid assets/Short-term debt	114.7	114.4	103.7
- Public Banks	118.5	118.1	106.6
- Private Banks	89.1	88.5	84.6

Source: Bank of Algeria.

Appendix I. Exchange Rate and External Stability Assessment

The analysis, based on the three methods of the Consultative Group on Exchange Rate Issues (CGER), shows that the Algerian dinar remains in line with fundamentals.

A CGER-based assessment and an alternative estimate based on the macroeconomic balance approach (MBA) suggest that the current account surplus is close to the norm. Standard CGER approaches and the alternative MBA estimate indicate that Algeria's projected medium-term current account balance (4.5 percent of GDP in 2017) is close to the norm. The MBA method implies a current account norm at 6 percent of GDP, while the alternative MBA estimate points to a slightly higher current account norm at 8.5 percent of GDP. The sustainability method (ES) implies a current account norm at 4.9 percent.

CGER-type Analysis

	Medium-term Current Account Norm 3/
CGER Approaches	
MBA Approach 1/	6.0
ES Approach 1/	4.9
Alternative MBA calculation 2/	8.5

Sources: IMF staff calculations.

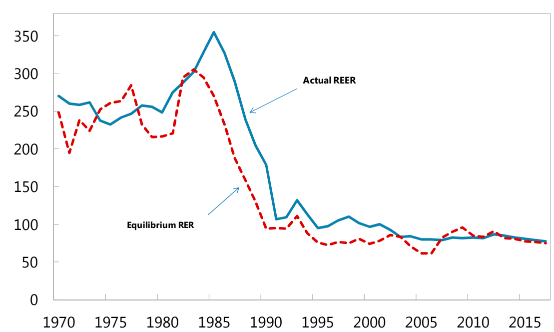
1/ Based on CGER methodologies. Misalignment is defined as the real exchange rate adjustment that would close the gap between the estimated "current account norm" and the underlying current account.

2/ The CA norm is computed based on Specification II in S. Beidas-Strom and P. Cashin, 2011, "Are Middle Eastern Current Account Imbalances Excessive?" IMF Working Paper 11/195.

3/ In 2017 (percentage of GDP).

A country-specific long-run co-integration relationship was also estimated for the reduced form Equilibrium Real Effective Exchange Rate (EREER).[1] Under this specification, the EREER is determined by Algeria's terms of trade (ToT), the differential of output per worker in Algeria vis-a-vis trade partners (prod), and government spending as a percentage of GDP (G).

REER and Equilbrium, 1970-2017



Sources: IMF staff calculations.

$$\ln(\text{REEER}) = -038 + 0.17\ln(\text{ToT}) + 1.85\ln(\text{prod}) + 1.20\ln(G)$$

The medium-term EREER under staff's baseline scenario would be expected to depreciate. This reflects lower government spending in percentage of GDP, and deteriorating terms of trade on the back of declining oil prices which would more than

[1] IMF staff estimates, 2011 Algeria Article IV Staff Report.

offset the slight narrowing of gap in Algeria's productivity with respect to its trading partners. The EREER analysis suggests an overvaluation of the REER of about 3.3 percent in 2017.

However, the results of the analysis should be treated with caution, given the existence of a more depreciated parallel market exchange rate.

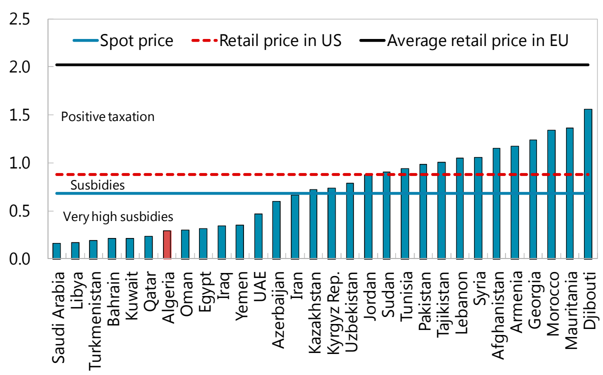
Appendix II. An Estimation of Implicit Subsidies from Low Domestic Hydrocarbon Prices

The domestic price of hydrocarbon products sold in Algeria have been kept stable as part of a policy of sharing the hydrocarbon resource, which involves setting prices that are lower than the international market price. As a result, energy prices are lower than the average European and American prices, and lower than the average price in Middle Eastern and Central Asian countries. Gasoline prices—which are generally below market in oil-exporting countries—are lower in Algeria than in oil-exporting countries such as Iraq, the United Arab Emirates, or Kazakhstan. Algerian diesel oil prices are also among the lowest in the region. These prices expose Algeria to leakages, especially in view of the higher prices in neighboring oil-importing countries in the Maghreb.[1]

Petroleum and Diesel Prices in Middle East and Central Asia (MCD) countries

Petroleum Retail Price in MCD Countries

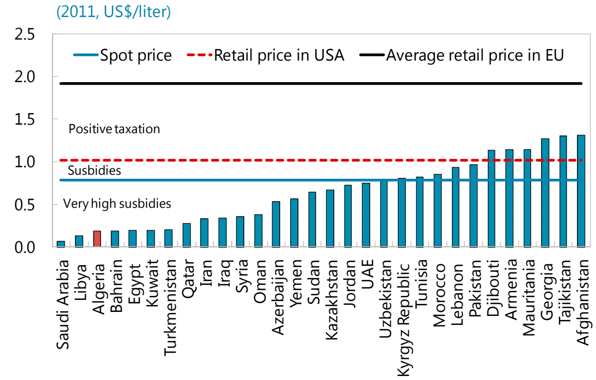
(2011, in US$/liter)



Source : Fund staff calculations

Diesel Retail Price in MCD countries

(2011, US$/liter)



Source : Fund staff calculations

A price policy of this nature represents a considerable effort on the part of Algeria in favor of its consumers. This effort has increased over time, as domestic prices were kept stable in the context of rising world oil prices. Staff estimates for the final consumption of diesel oil, gasoline, and LPG alone suggest that in 2010, the effort, measured on the basis of the difference between the world price and the Algerian price, amounted to 4.1 percent of GDP. Similarly, the policy of low-priced gas represented an effort in favor of final consumption amounting to about 1.6 percent of GDP. This figure is substantially higher when implicit subsidies to intermediate consumption of gas are taken into account, and rises by about 6 percent of GDP, assuming identical pricing of intermediate and final natural gas consumption.

[1] These large price disparities with Algeria's neighbours create a risk of subsidized products being acquired by foreign consumers.

The implicit subsidies on final and intermediate consumption amounted to about 11.8 percent of 2010 GDP, corresponding to US$19 billion, 125 percent of current transfers, or 109 percent of tax revenues in 2010.

Algeria: Estimated Cost of Implicit Subsidies on Hydrocarbon Products, 2010

	Diesel	Petroleum	LPG and natural gas (final consumption)	Natural Gas (intermediate consumption)	Total
In USD bn	3.8	2.0	3.4	9.8	19.0
In percent of 2010 GDP	2.4	1.3	2.1	6.0	11.8

Sources: Algerian authorities; and IMF staff calculations.

Under current consumption growth assumptions, the cost of implicit subsidies would remain high even in the event of a lasting drop in hydrocarbon prices. Total implicit subsidies (including on intermediate gas consumption) would remain at about 10 percent of GDP by the end of the projection period, and would still reach 7.7 percent of GDP in the event of a lasting decline in international hydrocarbon prices.

Implicit Hydrocarbon Subsidies under the Baseline and Alternative Scenarios

(Alternative scenario: lasting decline in international hydrocarbon prices, by one standard deviation)

	2012	2013	2014	2015	2016	2017
Magnitude of implicit subsidies (percent of GDP)						
Baseline	12.5	12.4	11.9	11.5	11.0	10.5
Lasting drop in oil prices	12.5	9.1	8.8	8.4	8.1	7.7
Assumptions						
Assumptions						
Domestic hydrocarbon consumption (growth in percent)	2.0	2.0	2.0	1.5	1.5	1.5
Hydrocarbon price (percent change)						
Baseline	2.1	-1.0	-4.3	-4.2	-3.8	-4.1
Lasting drop in oil prices	2.1	-27.4	-4.3	-4.2	-3.8	-4.1

Source: IMF staff calculations.

Note:Tthe projected growth in domestic hydrocarbon demand is conservative.

The potential cost of these implicit subsidies could increase. Low oil prices continue to foster the rapid growth in the energy intensity of the country (measured in kg of oil equivalent per capita), which was 3.5 percent on average over 2004–09, compared with 2.3 percent in the Middle East and North Africa region, and 3 percent in all middle-income countries.[2] The subsidies thus directly contribute to increasing the pressure of domestic demand on Algeria's export capacity.

Household consumption survey data will be useful for furthering the analysis of the impact of implicit subsidies on poor households, and for designing a strategy for targeting subsidies.

[2] Source: World Bank, *World Development Indicators*.

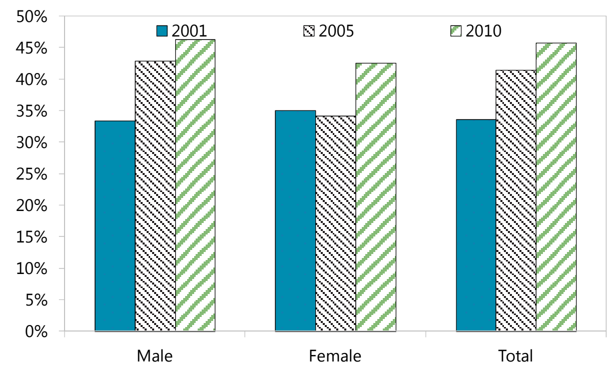
Appendix III. The Informal Sector in Algeria

The informal sector is a source of concern for the authorities, who see it as a major obstacle to the development of economic activity in Algeria.

Despite the lack of statistical monitoring, there are indications that informality is a widespread, and possibly growing, phenomenon.

- The employment survey carried out by the Algerian statistics office (ONS) suggests that the informal sector, proxied by the share of non-registered workers in the wage earner population, accounted for 46 percent of total employment in 2010, up by 12 percentage points since 2001. While informal female employment fell in 2005 compared with 2001, it rose in the second half of the decade, to reach close to 43 percent of total employment, in line with informal male employment.

Informal Employment
(Percent of total employment)

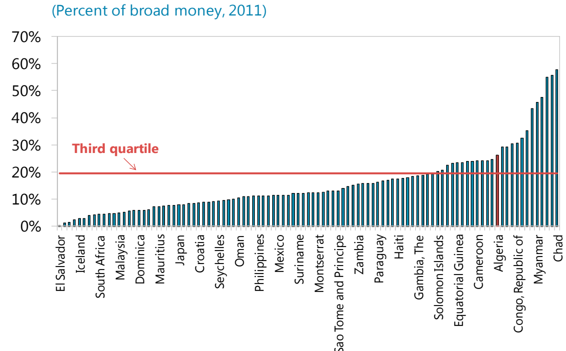


Source: Algerian authorities (ONS).

- Data for the monetary sector also suggest that the informal sector represents a large part of the economy, and increased over the decade starting in 2000. In 2011, the ratio of currency in circulation (relative to M2) in Algeria was higher than in 75 percent of countries in the world, an indicator that not only underlines the insufficient development of the financial sector, but also indicates that a substantial share of transactions are conducted outside formal payment systems. Additionally, while the share of currency in circulation in proportion to the money supply fell for a sample of 101 countries between 2002 and 2011, figures show that this ratio remained stable in Algeria and increased slightly at the end of the period.

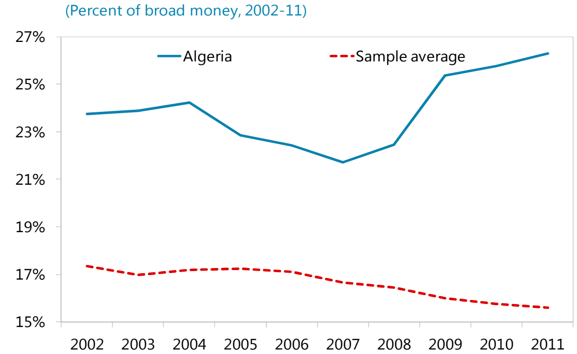
Indicators for the Informal Sector

Currency in Circulation
(Percent of broad money, 2011)



Source: IMF staff calculations using International Financial Statistics.

Currency in Circulation
(Percent of broad money, 2002-11)



Source: IMF, International Financial Statistics.

The factors encouraging the development of the informal sector are generally well-identified and include excessive regulation of the goods and labor markets, and high taxes.[1] Specifically, experience in countries in the Middle East and Central Asia suggests that obstacles to the development of the formal sector include

- high taxes;
- long, expensive, and complex procedures for setting up and managing companies; and
- high employment costs, especially through minimum wages that are higher than employment productivity, or high severance costs.

The quality of institutions also plays a role, notably when it leads to below-standard public services or the failure to implement legislation properly.

Selected Indicators of Performance in the Maghreb and Middle-East

	Algeria	Tunisia	Morocco	Egypt	Turkey
Tax rate (in percent of profit) (a)	72	62.9	49.6	42.6	41.2
Time to create a business (in days) (a)	25	11	12	7	6
Government effectiveness index (b)	-0.56	0.19	0.17	-0.43	0.35
Labor maket efficiency (rank over 144) (c)	144	n/a	122	142	124

Sources: (a) Doing Business 2013; (b) World Bank, 2010; (c) World Economic Forum 2012-13.

[1] See IMF 2011 *Regional Economic Outlook*, Middle East and Central Asia.

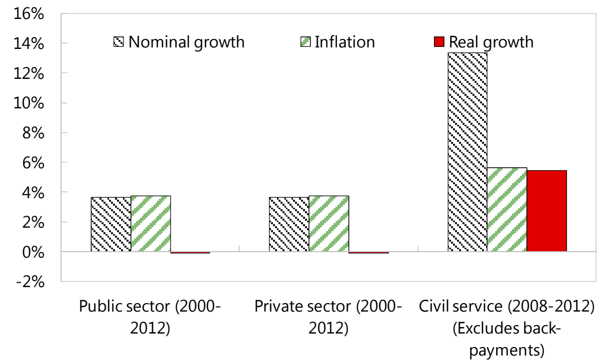
Appendix IV. Public Sector Employment in Algeria. An Inter-Sector and International Comparison

The recent increase in civil servants' wages resulted in a major increase in their purchasing power, which exceeded the growth of real wages in other sectors. The pay rises in the public sector (excluding civil service) and in the private sector were in line with inflation; consequently, real wages remained constant over 2000–12. On the other hand, the increase in civil service wages resulted in an increase in compensation of 5.5 percent in real terms (annualized rate of payment, excluding the back payment) over 2008–12. The average civil service wage appears to be relatively high—about 40 percent higher than the average public-sector wage (excluding civil service) and twice as high as the average private-sector wage (which includes the informal sector).[1]

Public Sector and Civil Service Wages

Nominal and Real Wage Increases

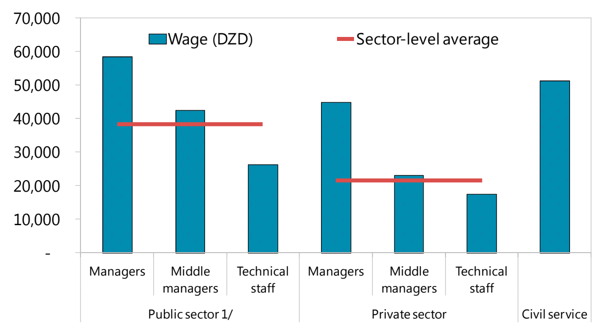
(Annualized growth rate over indicated period)



Sources: Algerian authorities, UGTA and Fund staff calculations.

Average Net Monthly Wage, 2010

(In DZD)



Sources: Algerian authorities and Fund staff calculations.

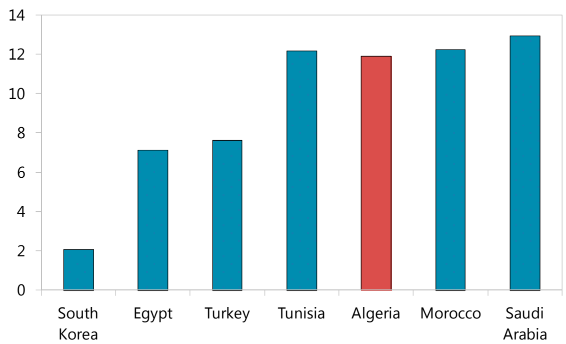
1/ Excludes civil service.

[1] Wage bill figures exclude wages back payments.

Algeria's public-sector wage bill is comparable to those in other Maghreb countries, but higher than those in other selected countries, and considerably higher than in other emerging markets (such as South Korea, for example). Total compensation for the public sector, relative to per capita income, appears to be higher in Algeria.

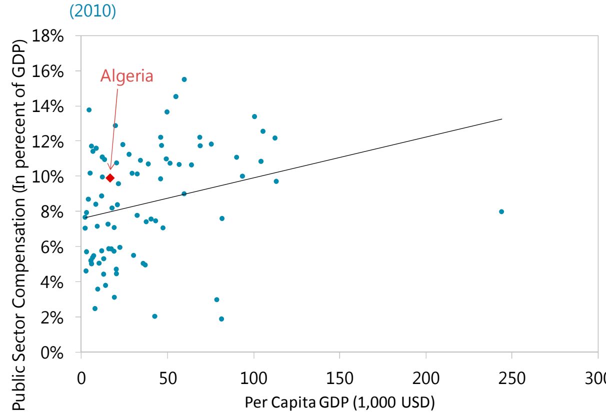
Wage Bill in Algeria and in Other Countries

Wage Bill in 2011
(In percent of GDP)



Sources: Staff's calculations using WEO.

Public Sector Compensation and Per Capita GDP
(2010)

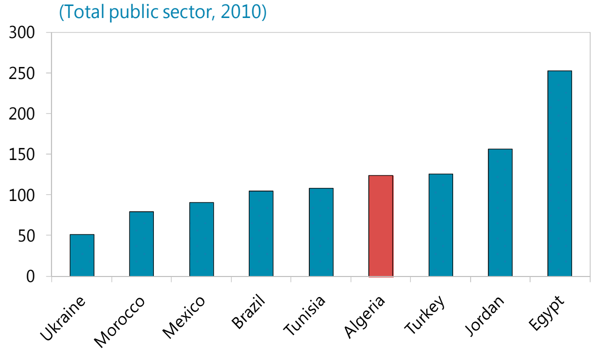


Source: WEO.

Public employment is also relatively high in comparison with emerging markets for which information is available. A stabilization of the volume of employment starting in 2014 would bring it back to ratios per 1,000 inhabitants observed in 2011.

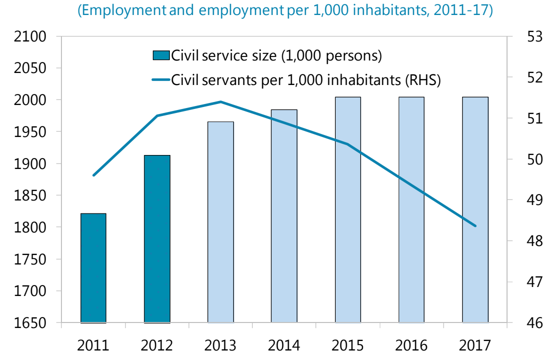
Volume of Public Employment

Public Employees per 1,000 Inhabitants
(Total public sector, 2010)



Sources: Algerian authorities; and ILO.
Note: Public sector employment in Algeria is 4.4 million.

Algeria: Civil Service
(Employment and employment per 1,000 inhabitants, 2011-17)

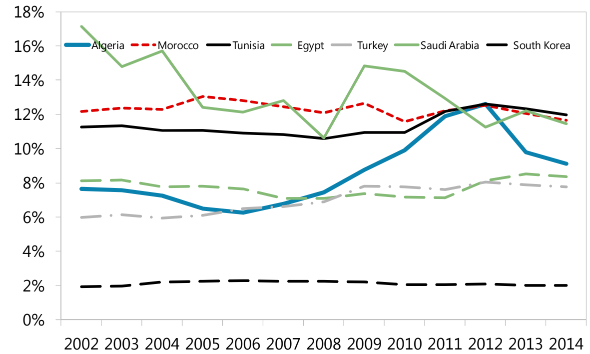


Sources: Algerian authorities; and IMF staff calculations.

Civil service wage increases in 2010 accelerated the already swift progression of the wage bill in the late 2000s. Following the completion of civil service wage back payments, the wage bill is expected to fall in 2013. This movement should be supported by stabilizing employment volumes, in order to avoid an unsustainable increase in the wage bill.

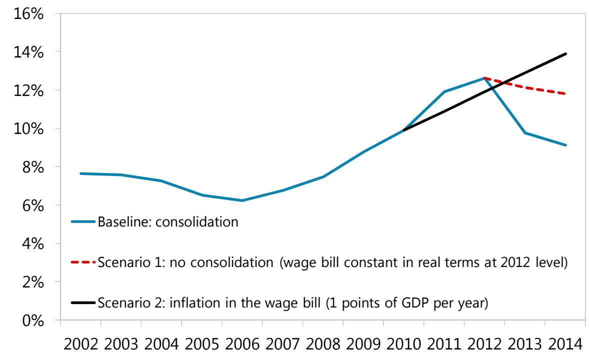
Long-Term Trends in the Wage Bill, and Scenarios

Wage Bill
(Percent of GDP)



Sources: IMF staff calculations using WEO.

Wage bill Scenarios
(Wage bill in percent of GDP)



Source: IMF staff calculations.

Appendix V. Growth and Employment in Algeria

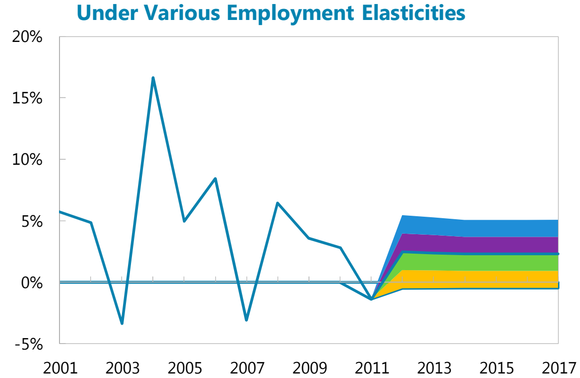
A simulation based on an analysis of the employment content of growth in Algeria suggests that large reforms to the labor market, or significantly faster growth, would be needed to curb unemployment.

Employment growth can be expected to be relatively slow under current nonhydrocarbon growth assumptions.[10] Given the relatively low elasticity of employment to growth, at about 0.5, and slowing nonhydrocarbon growth, employment is expected to increase by only about 2¼ percent a year, compared to 4 percent on average over 2001–10. The elasticity of employment to growth would need to be doubled for employment to grow above its past trend, and would need to be supported by wide-ranging reforms to the labor market.

In the baseline scenario, growth would barely stabilize unemployment at its 2011 level. Reforms to the labor market would increase the elasticity of employment to growth and support some decline in unemployment. However, the most powerful driver of a drop in unemployment would be higher growth. Should growth reach its potential level of 5.7 percent, unemployment would decline rapidly.

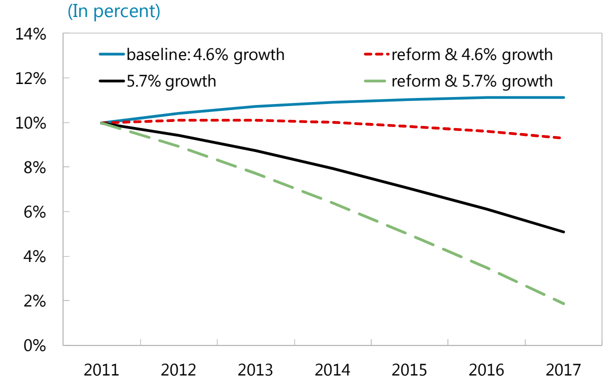
Employment Growth and Unemployment Rates under Various Assumptions

Algeria: Annual Percent Employment Growth Under Various Employment Elasticities



Sources: Algerian authorities and Fund staff calculations.

Unemployment Rate Projections
(In percent)



Sources: Algerian authorities and Fund staff calculations.

[10] The analysis focuses on nonhydrocarbon growth, given the low employment content of hydrocarbon growth.

INTERNATIONAL MONETARY FUND

ALGERIA

December 21, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

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

CONTENTS

ANNEX I. ALGERIA: RELATIONS WITH THE FUND

(As of November 16, 2012)

A. Financial Relations

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

II. General Resources Account

	SDR Million	Percent Quota
Quota	1,254.70	100.00
Fund holdings of currency	840.92	67.02
Reserve position in Fund	413.78	32.98

III. SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	1,198.18	100.00
Holdings	1,074.28	89.66

IV. Outstanding Purchases and Loans

None

V. Financial Arrangements (In millions of SDR)

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

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

	Forthcoming				
	2012	2013	2014	2015	2016
Principal	0.00	0.00	0.00	0.00	0.00
Charges/interest	0.02	0.13	0.13	0.13	0.13
Total	0.02	0.13	0.13	0.13	0.13

Implementation of HIPC Initiative: Not Applicable.

B. Nonfinancial Relations

VII. Exchange Rate Arrangement

1. From January 21, 1974 to October 1, 1994, the exchange rate of the dinar was determined on the basis of a fixed relationship with a basket of currencies, adjusted from time to time. On October 1, 1994, the Bank of Algeria introduced a managed float for the dinar through daily fixing sessions that included six commercial banks. This system has been replaced by an interbank foreign exchange market as of January 2, 1996. On December 12, 2012, the average of the buying and selling rates for the U.S. dollar was US$ 1 = DZD 78.21, equivalent to SDR 1 = DZD 120.15. 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.

2. The de facto exchange regime is classified as other managed arrangement with no preannounced path for the exchange rate. Full surrender requirements are in effect on hydrocarbon export proceeds. Limits on the making of payments for invisible transactions and current transfers, which have remained in place since Algeria accepted the obligations of Article VIII, sections 2(a), 3, and 4, in 1997, are indicative according to the authorities. Inward direct investment is generally free of restrictions but a 49 percent foreign ownership limit has been introduced in December 2009; controls are maintained on other capital account payments and transfers.

VIII. Latest Article IV Consultation

The discussions for the 2012 Article IV consultation with Algeria were held in Algiers during October 29–November 11, 2011. The Staff Report (IMF Country Report 12/20) was discussed and approved by the Executive Board on January 14, 2012 and published on January 31, 2012.

IX. Technical Assistance

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

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

- A multi-sector STA mission visited Algiers in February 2007 to prepare Algeria’s participation in the GDDS.

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

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

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

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

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

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

- An STA mission visited Algiers in April 2012 to provide assistance on monetary and financial statistics and financial stability indicators.

- An MCM mission visited Algiers in September 2012 to provide assistance on banking supervision, macro-prudential policy and monetary policy.

- An FAD mission visited Algiers in September 2012 to provide assistance on public financial management.

X. Financial Sector Assessment Program

Algeria participated in the FSAP in 2003. The Executive Board discussed the Financial System Stability Assessment on January 14, 2004, (see IMF Country Report No. 04/138). The FSAP was updated in 2007.

XI. Resident Representative/Advisor

None.

ANNEX II. ALGERIA: RELATIONS WITH THE WORLD BANK GROUP

JMAP Implementation, FY12

As of December 20, 2012

Title	Products	Provisional timing of missions	Expected delivery date
A. Mutual Information on Relevant Work Programs			
Bank work program in next 12 months	a. **Country Partnership Strategy** FY11-FY14, including Analytical and Technical Assistance activities on a reimbursable basis, no lending in line with government's policy. Progress Report for the FY11-14 CPS b. **Sector work** on: • State-owned Banks for Ministry of Finance • Subsidy targeting • Reviewing Social Protection Programs • Climate change • Integrated desert management, • Support for rural renewal • Agricultural development c. **Technical assistance** on • Credit Registry with Central Bank • Financial Crisis simulation (FIRST) • RAMP • Social Programs Evaluation • Support to analysis and evaluation of the Household Survey • Agricultural Program • Competitiveness Poles • Agricultural Statistical Capacity • Algeria Telecom strategic and operational support	Ongoing activities with multiple missions throughout the year	FY11-FY14 activities FY13/14

	• Broadband Strategy		
IMF work program in next 12 months	2012 Article IV Consultation Preparing analytical work on growth and inflation in Algeria Staff visit 2012 Article IV consultation Technical assistance missions on: MCM: financial supervision FAD: subsidy reform	October 29-November 11, 2012 Ongoing April 2013 October 2013 January 2013 March 2013	January 2013 January 2013 January 2014 January 2013 March 2013
B. Requests for Work Program Inputs			
Fund request to Bank	Developments on the subsidy reform Sectoral analysis	As needed As needed	
Bank request to Fund	Assessment of macroeconomic stance and prospects Data sharing	Semiannual (and on ad hoc basis if requested) At least 1 operation predicted Ongoing	Following Article IV and staff visits
C. Agreement on Joint Products and Missions			
Joint products in next 12 months	Continuous close coordination on the reform agenda	Ongoing	

ANNEX III. ALGERIA: STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance	
General: Data provision has some shortcomings, but is broadly adequate for surveillance.	
National Accounts: Following STA recommendations, the NSO is now compiling annual national accounts (ANA) at prior year prices. The ANA broadly follow the 1993 SNA recommendations, but nonprofit institutions serving households are not taken into account. Work is ongoing to compile QNA. **Price Statistics:** Data are published with a delay of less than one month.	
Government finance statistics: Key shortcomings include insufficient institutional coverage (coverage is limited to Budgetary Central Government, albeit in a wide sense, including the general budget, the annexed budget, and the special treasury accounts), classification problems, long lags for production of statistics, and lack of reconciliation of financing with the monetary accounts. Key factors behind these weaknesses include the lack of financial resources allocated to the compilation of statistics, insufficient interagency coordination, and concern about accuracy that give rise to reluctance to publish provisional data.	
Monetary statistics: Monetary statistics compiled by the authorities are largely in line with the methodology in the Monetary and Financial Statistics Manual, 2000 and its companion Compilation Guide, 2008. Timeliness of reporting by state-owned commercial banks has significantly improved over the last two years; consequently, data on depository corporations—as well as finance companies—are usually available within a period of two to three months. Reporting formats (balance sheet and appendices) applied to commercial banks and finance companies were updated in 2009 and the updated version was enforced in 2010. All respondents now provide all requested data, thus making the monetary statistics more meaningful than before. Data on insurance corporations are not yet collected, but the Banque d'Algérie, with the continuing support of the IMF Statistics Department, launched in 2009 a project to this end.	
Balance of payments: Balance of payments statistics are generally of good quality. International investment position data are not available	
II. Data Standards and Quality	
Algeria began participation in the General Data Dissemination System (GDDS) on April 21, 2009.	No data ROSC is available.

ALGERIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

As of December 20, 2012

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	09/12	10/29/12	D	M	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	08/12	10/29/12	D	M	M
Reserve/Base Money	08/12	10/29/12	M	M	M
Broad Money	08/12	10/29/12	M	M	M
Central Bank Balance Sheet	08/12	10/29/12	M	M	A
Consolidated Balance Sheet of the Banking System	08/12	10/29/12	M	M	A
Interest Rates[2]	09/12	10/29/12	M	M	M
Consumer Price Index	09/12	10/29/12	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[4]	08/12	10/29/12	M	I	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	09/11	10/29/12	Q	I	A
External Current Account Balance	06/12	10/29/12	Q	Q	A
Exports and Imports of Goods and Services	09/12	10/29/12	Q	Q	A
GDP/GNP	2011	10/29/12	A	A	A
Gross External Debt	09/12	10/29/12	A	A	A
International Investment Position[6]	...	...	PA	PA	PA

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

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

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

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

[5] Including currency and maturity composition.

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

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

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 13/10
FOR IMMEDIATE RELEASE
January 25, 2013

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Algeria

On January 16, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the 2012 Article IV consultation with Algeria.[1]

Background

Algeria's economic performance in 2012 is expected to remain solid. Growth is projected at 2.5 percent in 2012, supported by a buoyant nonhydrocarbon sector bolstered by public spending. It is forecast at 3.4 percent in 2013, underpinned by domestic demand and a recovery in the hydrocarbon sector. The current account surplus is expected to reach 8.1 percent of GDP in 2012, as higher hydrocarbon prices offset lower export volumes, and 7.0 percent of GDP in 2013. In 2012 and 2013, foreign exchange reserves will remain comfortable, at about three years of imports, and external debt levels will remain low. The oil stabilization fund, net of public debt, will be hovering at 26 percent of GDP. Risks to the economy are mainly tilted to the downside, as Algeria is vulnerable to a prolonged fall in oil prices, rising food prices on international markets (notably wheat), a worsening of the global economy, particularly in the euro zone, and increasing domestic pressure to use hydrocarbon rents. Outward spillovers from Algeria are expected to be limited.

Inflation surged to 8.4 percent in 2012, reaching a 15-year high, from 4.5 percent in 2011. Price increases were mainly seen in food and manufactured goods, spurred by excess liquidity resulting from the surge in current public spending that was financed by draw-downs from the oil fund, and possibly also by inefficiencies in the distribution chain. In May 2012, Banque d'Algérie

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

raised the required reserves rate from 9 to 11 percent and increased liquidity absorption by 250 billion dinar (23 percent), thereby reducing free liquidity, but this was not sufficient to contain inflation.

Fiscal vulnerability increased as a result of the fiscal expansion of recent years. The fiscal balance is expected to deteriorate to 3.6 percent of GDP in 2012, from 1.3 percent in 2011, as a result of the full effect of increases in civil service wages and current transfers decided in 2011. As a consequence, the breakeven oil price is projected at $121 per barrel in 2012, up from $109 in 2011, reflecting an increased vulnerability to hydrocarbon prices. The new budget law for 2013 phases out the wage back payments, and allows for fiscal consolidation; the fiscal deficit is consequently expected to improve to 1.3 percent of GDP in 2013. Although the nonhydrocarbon deficit is projected to decrease to 40 percent in 2013 from 45.6 percent of nonhydrocarbon GDP in 2012, the real wealth per capita will continue to decline in the long run.

Growth is insufficient to dent unemployment. It is highly dependent on the public sector, funded by the hydrocarbon windfall, and it lacks diversification. Negative growth in the hydrocarbon sector over the past few years dragged down overall growth. Public investment has been growing at a slower pace since 2009, contributing to the slowdown in nonhydrocarbon growth. The real effective exchange rate appreciated in 2012, weighing on the external competitiveness that is needed to foster the contribution of net exports to growth. Despite recent efforts, the business environment remains cumbersome and hampers private investment, both domestic and foreign. Foreign direct investment, in particular, faces severe constraints on ownership. The banking sector is sound, but access to financing remains limited. Financial markets are underdeveloped. Unemployment has declined from a high of almost 30 percent in 2000 to 10 percent in 2011, but youth and female unemployment rates remain high, at 21.5 percent and 17 percent, respectively.

Executive Board Assessment

Executive Directors commended Algeria's continued strong economic performance despite the difficult external environment. Directors noted, however, that rising inflation, continued heavy reliance on the hydrocarbon sector and public spending, and vulnerability to a prolonged decline in the oil price, as well as high unemployment pose significant challenges. Against this background, they encouraged the authorities to take measures to preserve macroeconomic stability, ensure long-term fiscal sustainability, and promote strong nonhydrocarbon growth.

Directors welcomed the authorities' efforts to curb inflation, notably through increased liquidity absorption and higher required reserves by the Banque d'Algérie, and the fiscal consolidation embedded in the 2013 budget. However, to bring average inflation down to the targeted level, they recommended further tightening of monetary policy by mopping up excess liquidity and raising the discount and repurchase facility rates. Avoiding any further increase in public sector wages, and issuing government bonds to cover cash-flow needs, instead of reliance on the oil fund, will also play an important role. In addition, Directors saw scope for structural measures to help contain price pressures stemming from the supply side.

Directors noted staff's assessment that the real effective exchange rate is in line with fundamentals. They welcomed the authorities' intention to address the high parallel market premium. Directors considered that increasing foreign exchange ceilings for travelers will be a step in the right direction. They encouraged the authorities to further develop the interbank foreign exchange market.

Directors emphasized that further fiscal consolidation will be key to ensuring fiscal sustainability. In this context, policy efforts should gear towards containing current spending, especially the wage bill, better targeting subsidies, reviewing tax exemptions, and bolstering nonhydrocarbon tax revenues. Directors noted that explicitly considering an annual cap on drawdowns from the oil fund, set in the budget law, would strengthen the existing oil price fiscal rule. They stressed the need to enhance public financial management and to implement a full-fledged medium-term budget framework.

Directors welcomed the improvements in financial stability and called for steps to consolidate these gains. They encouraged efforts to strengthen bank intermediation by lifting the ban on consumer credit and supported the authorities' plans to deepen the financial markets. Directors called for measures to address the remaining shortcomings in the AML/CFT (Anti-Money Laundering and Combating the Financing of Terrorism) framework and fully implement the action plan agreed with the FATF.

Directors emphasized the need for wide-ranging reforms to diversify the economy, improve the business climate and competitiveness, increase productivity, and boost growth, especially nonhydrocarbon growth. Efforts should also focus on promoting private investment, further liberalizing trade, and supporting a more efficient and knowledge-driven economy. Directors recommended safeguarding public investment and improving its quality and enhancing the public sector's absorptive capacity. They encouraged the authorities to review and amend the restrictive FDI (Foreign Direct Investment) regime. Directors agreed that policies aimed at improving the jobs/skills match and enhancing labor market flexibility, along with effective active labor market interventions, will help increase employment, especially for the young and women.

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

Algeria: Selected Macroeconomic Indicators baseline scenario, 2011–13

Population: 37.1 million; 2012 Main products/exports: Hydrocarbons
Quota: SDR 1,254.7 million Key export markets: EU
Per capita GDP: US$ 5,253; 2011
Poverty rate: 12.1; 2000
Main exports: Oil and Gas

	Prel.	Proj.	Proj.
	2011	2012	2013
Output			
Real GDP	2.4	2.5	3.4
Nonhydrocarbon real GDP	5.3	5.0	4.8
Employment			
Unemployment rate (in percent)	10%	10%	...
Prices			
Consumer prices (end of period)	5.2	6.3	5.0
Consumer prices (period average)	4.5	8.4	5.0
Public finances			
Revenue	40.0	39.3	37.7
Hydrocarbon	27.5	26.0	25.0
Expenditure and net lending	41.3	42.9	39.0
Current	26.8	28.8	25.1
Capital	13.6	13.4	13.3
Budget balance	-1.3	-3.6	-1.3
Nonhydrocarbon primary balance (in percent of nonhydrocarbon GDP)	-44.7	-45.1	-39.5
Total government debt	11.0	9.9	8.9
	(Annual percentage change, unless otherwise indicated)		
Monetary sector			
Credit to the economy 1/	13.5	14.9	...
Broad money	19.9	10.6	...
Three-month treasury bill rate (end of period, in percent)	0.3	1.3	...
	(In percent of GDP, unless otherwise indicated)		
Balance of Payments			
Hydrocarbon exports of goods (in US$, percentage change)	27.6	-1.3	-0.7
Hydrocarbon exports of goods (in percent of total exports of goods)	98.3	98.4	98.3
Imports of goods (in US$, percentage change)	15.6	-0.2	1.7
Merchandise trade balance	14.0	13.1	12.3
Current account	9.9	8.1	7.0
Foreign direct investment	1.0	0.8	0.9
Total external debt	2.2	1.9	1.7
Gross reserves (in billions of U.S. dollars)	182.2	193.9	208.6
In months of next year's imports of goods and services	38.2	40.2	41.7
Exchange rate			
Real effective exchange rate (2005 = 100)	101.8	...	...
Local currency per U.S. dollar (period average)	72.7	...	...
Oil and gas sector			
Total exports of oil and gas products (in billions of U.S. dollars)	71.7	70.8	70.3
Average crude oil export price (in U.S. dollar/barrel)	112.9	115.3	114.1
Crude oil production (in millions of barrels/day)	1.29	1.27	1.28
Gas production (in millions of barrels/day equivalent)	1.34	1.34	1.34
	(In percent of GDP)		
Investment and Saving			
Gross capital formation	36.2	35.6	41.6
Of which: Nongovernment	22.5	21.5	27.7
Gross national savings	46.0	43.7	48.6
Of which: Nongovernment	33.7	33.3	36.0

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

Statement by Jafar Mojarrad, Executive Director for Algeria and Said Maherzi, Advisor to Executive Director for Algeria January 16, 2013

Our Algerian authorities thank staff for a candid report and a useful Selected Issues paper (SIP), and are in broad agreement with the staff's appraisal. They are appreciative of the constructive dialogue with the Fund and highly value its advice, technical assistance, and support to their policies and reforms.

Algeria's economic performance remained strong in 2012. Sustained implementation of the public investment program (PIP) continued to underpin growth in the nonhydrocarbon sector, which remained buoyant. At the same time, despite continued decline in the hydrocarbon sector, overall GDP growth stood at an estimated 2.5 percent. Unemployment rate stabilized at around 10 percent, down from a peak of 30 percent in 2000, although it remains high among the youth. Fueled by excess liquidity and distortions in the distribution chain, inflation surged to 8.4 percent, but is expected to recede to 5 percent in 2013. The external position remained strong, with a current account surplus estimated at more than 8 percent of GDP, international reserves representing more than 3 years of imports, gross external debt further declining to less than 2 percent of GDP, and the stabilization fund (FRR) resources standing at 36 percent of GDP. Growth is projected to strengthen in 2013 onward on account of continued good performance of the nonhydrocarbon sector, supported by the PIP, and a gradual recovery of the hydrocarbon sector, underpinned by the national oil company's ambitious investment program.

Preserving macroeconomic stability is central to the authorities' strategy. The surge in current spending during the past three years, following civil service reform-related wage increases and back payments spread over the 2010-12 period, has impacted the fiscal position. With capital spending under the PIP remaining high, the 2012 overall deficit is expected to increase to 3.6 percent of GDP, even though the nonhydrocarbon balance should remain broadly unchanged at around 44 percent of nonhydrocarbon GDP. Building on the phasing-out of the wage back payments, the 2013 budget initiates a consolidation process, which should bring the fiscal accounts back to sustainable levels, with the deficit declining to 1.3 percent of GDP this year. A review of the subsidy system, soon to be undertaken with Fund assistance, should help identify steps to rationalize and better target spending in this area, thereby further containing current spending, while strengthening the social safety net. Particular attention will also be directed to further improving tax administration and the quality of investment spending, including by strengthening the agency in charge of evaluating and monitoring investment projects.

Significant investment has been made over the past several years, particularly in infrastructure, which remains important to supporting growth. Looking ahead, the authorities will continue to ensure that capital spending is adjusted to available resources to preserve fiscal sustainability while supporting macroeconomic objectives. Stepped-up efforts will be devoted to modernizing the budget framework, including by accelerating the establishment of an integrated public financial management IT system and developing sector-level budgeting, as a step towards introducing a medium-term budget framework.

Monetary policy continues to be geared toward containing inflation. Faced with a surge in excess liquidity, the Bank of Algeria (BA) has substantially increased liquidity absorption and raised the reserves requirement rate. However, these measures were not sufficient to contain inflation, which averaged 8.4 percent in 2012, although it trended downward over the last months of the year. Looking forward, inflation pressures are expected to recede with the phasing-out of the wage back payments, fiscal consolidation efforts, and ongoing measures to address distortions in the distribution chain. This said, BA will continue to closely monitor developments and will take additional actions, as needed, to bring inflation down to the targeted 4-4.5 percent range, including by increasing excess liquidity absorption and raising interest rates. The authorities take positive note of staff suggestion to finance part of the budget deficit through government bonds instead of drawing down on the stabilization fund in order to provide additional instruments for liquidity management. Such direction will be considered in light of inflation developments with due regard to the objective of maintaining public debt at manageable levels.

Staff assessment that the real effective exchange rate (REER) is in line with fundamentals is consistent with BA's flexible exchange rate policy aimed at maintaining the REER close to its equilibrium rate. The authorities intend to effectively address the issue of the parallel exchange rate premium, including in the broader context of gradually reducing the scope of the informal sector.

The banking sector remains well capitalized, liquid, profitable, and adequately provisioned. While the nonperforming loans (NPLs) ratio appears high at 14.4 percent in 2011, although substantially declining over the past several years reflecting much lower NPLs for public banks, the bulk of the NPLs is related to fully provisioned old debts. Net of provisions, the NPL ratio in 2011 stood at 4.0 percent, as shown in table 6 of the staff report. The authorities will give due consideration to staff suggestion to write off fully provisioned NPLs in cases where the scope for recovery is very slim. A credit registry will soon be established, which will help revisit the issue of the ban on consumer lending (mortgages are not subject to the ban). Banking supervision continues to be strengthened, including with Fund assistance, and financial stability reports are now prepared on a regular basis. BA has established a new bank rating system, which will be generalized to all banks, following successful pilot operations. The authorities express interest in an FSAP update to help identify measures aimed at further strengthening the financial system.

The authorities are well aware that promoting economic diversification and private sector development is key to anchor sustainable high growth and promote job creation. Macroeconomic stability and the large-scale infrastructure investment implemented over the past several years should serve this objective well. Progress has also been made in improving the business environment, including facilitating investors' access to land, establishment of one-stop shops, substantial reduction of the tax burden on business, improvement in tax administration and governance of public institutions, modernization of the judiciary system, and introduction of specific measures to facilitate SMEs' establishment and access to credit. However, the authorities are cognizant of the remaining challenges and broadly agree with staff recommendations in this area. They have initiated close and periodic dialogue with the private sector at the Prime Minister level to discuss the needed measures to substantially improve the business environment and take steps towards their implementation. They will review in due course the FDI regulations and act as needed to further encourage effective partnership with foreign investors. To foster employment, particularly among the youth, a number of key steps have been taken over the past several years, including substantial facilitations granted through the national agency for youth employment support (ANSEJ) for small businesses and a program for subsidies for hiring university graduates in the private sector.