INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/141

ALGERIA

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR ALGERIA

June 2017

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 2017 Article IV consultation with Algeria, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 26, 2017 consideration of the staff report that concluded the Article IV consultation with Algeria.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 26, 2017, following discussions that ended on March 20, 2017, with the officials of Algeria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 11, 2017
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Algeria.

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

Selected Issues

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June 1, 2017

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IMF Executive Board Concludes 2017 Article IV Consultation with Algeria

On May 26, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the 2017 Article IV consultation[1] with Algeria.

Algeria continues to face important challenges posed by lower oil prices. Overall economic activity was resilient, but growth in the nonhydrocarbon sector slowed to 2.9 percent in 2016, partly under the effects of spending cuts. Inflation increased from 4.8 percent in 2015 to 6.4 percent in 2016 and stood at 7.7 percent year-on-year in February 2017. Unemployment was 10.5 percent in September 2016 and remains particularly high among the youth (26.7 percent) and women (20.0 percent). Despite fiscal consolidation in 2016, the fiscal and current account deficits remained large, and public debt increased, reflecting in part the assumption of a government-guaranteed debt. International reserves, while still ample, declined rapidly. External debt remains very low.

Executive Board Assessment[2]

Executive Directors noted the significant challenges facing the Algerian economy and commended the authorities' ongoing efforts to adjust to the oil price shock. Directors emphasized that a balanced policy mix along with ambitious structural reforms will be important to ensure fiscal sustainability, narrow external imbalances, reduce reliance on hydrocarbons, and raise potential growth.

Directors welcomed the authorities' commitment to pursue sustained fiscal consolidation, within a clear medium-term budget framework. They supported the steps being taken to reduce the fiscal deficit, namely to raise more nonhydrocarbon revenue, control current spending, expand the subsidy reform while protecting the poor, and increase the efficiency of public investment

[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.

[2] 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.

and reduce its cost. Directors were generally of the view that tapping a broader range of financing options, including prudent external borrowing and the sale of state assets, combined with greater exchange rate flexibility, could provide room for a more gradual and growth-friendly fiscal consolidation than currently envisaged and reduce potential adverse impact on economic activity.

Directors emphasized that wide-ranging structural reforms are needed to diversify the economy and promote a dynamic private sector. They welcomed the steps taken to improve the business environment, and the ongoing work on a long-term strategy to reshape the country's growth model. Directors stressed the need for timely action to reduce red tape, improve access to finance, and strengthen governance and transparency. Attention should also be given to reducing skills mismatches, improving the functioning of the labor market, fostering greater labor participation of women, and further opening the economy to trade and foreign direct investment. Directors underscored that the overall strategy should be carefully designed and sequenced so that reforms reinforce each other and the burden of economic adjustment is shared equitably.

Directors noted that net international reserves remain comfortable, but that the current account balance is significantly weaker than warranted by medium-term fundamentals. They emphasized that greater exchange rate flexibility, along with fiscal consolidation and structural reforms, would help address external imbalances and support private sector development. Directors also called for measures to deepen the official foreign exchange market and curtail parallel market activity.

Directors welcomed the introduction of open market operations by the central bank to manage liquidity. They recommended that the central bank should phase out bank financing via the discount window without delay to encourage banks to manage their liquidity more effectively. Considering inflationary pressures, Directors encouraged the authorities to stand ready to increase the policy rate.

Directors noted that the banking sector as a whole is adequately capitalized and profitable. However, financial sector policies should be further strengthened to address growing financial stability risks resulting from the oil price shock. They encouraged the authorities to accelerate the transition to a risk-based supervisory framework, enhance the role of macroprudential policy, strengthen the governance of public banks, and develop a crisis resolution framework.

Algeria: Selected Macroeconomic Indicators, 2015–18

Population: 40.0 million; 2015

Quota: SDR 1,959.9 million

Key export markets: EU

Main exports: oil and gas

Per capita GDP: US$ 3,966 (2016)

Gini coefficient: 0.38 (2014)

	2015	2016	2017	2018
		Est.		
Output				
Real GDP growth (percent)	3.8	3.5	1.3	0.7
Nonhydrocarbon GDP growth (percent)	5.0	2.9	1.3	0.3
Employment				
Unemployment (percent, end of period)	11.2	…	…	…
Prices				
Inflation (percent, average)	4.8	6.4	4.8	4.3
Central government finances (percent of GDP)				
Total revenue	30.8	29.5	34.3	30.9
Of which, hydrocarbon	14.3	10.4	14.7	14.7
Total expenditure	46.6	43.5	37.3	33.5
Overall budget balance (deficit-)	-15.8	-14.0	-3.0	-2.7
Gross government debt	8.8	21.0	18.3	19.3
Money and credit				
Broad money (percent change)	0.3	1.8	7.2	4.3
Credit to the economy (percent change)	11.3	9.8	6.0	2.0
Balance of payments				
Current account balance (percent of GDP)	-16.6	-16.9	-11.9	-9.7
FDI (percent of GDP)	-0.4	0.9	1.1	1.3
Gross reserves (months of imports) 1/	28.4	22.5	19.5	16.7
External debt (percent GDP)	1.8	2.5	2.5	2.7
Exchange rate				
REER average (percent change)	-4.3	-2.0	…	…

Sources: Algerian authorities; and IMF staff estimates.

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

INTERNATIONAL MONETARY FUND

ALGERIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

May 11, 2017

KEY ISSUES

Context. Algeria continues to deal with the implications of lower oil prices for an economy that is highly dependent on hydrocarbons. Lower hydrocarbon revenues have led to large current account and fiscal deficits, a steep decline in international reserves (although they remain high), and a near depletion of fiscal savings in the oil stabilization fund. After a timid start, reform momentum is building. Last year, the authorities achieved a sizeable reduction in the fiscal deficit. They have adopted, for the first time, a medium-term budget framework that envisages ambitious fiscal consolidation. They have implemented some structural reforms and are working on a long-term strategy to reshape the country's growth model. The central bank is adapting to changing liquidity conditions by reintroducing refinancing instruments.

Outlook and risks. The authorities' resolve to adjust to lower oil prices is encouraging, as the challenges remain significant. Although growth has been resilient, the planned fiscal consolidation stands to weigh on future activity, with implications for unemployment. It could also trigger contingent fiscal liabilities, which are multiple and interrelated. The authorities' wariness to borrow externally and the tighter liquidity in the banking system imply that financing the deficit will be more difficult than in the past. Structural reforms to diversify the economy away from hydrocarbons will take time to bear fruit and could run into public resistance. Inflation is rising, and financial stability risks are growing. These risks remain manageable, but the authorities will need to navigate a difficult path between adjusting too quickly and moving too slowly.

Policy recommendations. Discussions focused on the appropriate policy mix for adjusting to lower prices. Staff supports the authorities' intention to pursue fiscal consolidation and structural reforms. However, it believes that some fiscal space exists to cut spending more gradually than planned if the adjustment were coupled with exchange rate depreciation and increased borrowing—including external borrowing. A more gradual fiscal consolidation would have less impact on growth while still restoring fiscal sustainability. Wide-ranging structural reforms are needed to reduce the economy's reliance on hydrocarbons and transform the private sector into an engine for growth. The reforms need to ensure that the burden of adjustment is shared equitably. Monetary policy should guard against emerging inflationary pressures. Financial sector policies should be further strengthened to address growing financial stability risks.

Approved By
Adnan Mazarei and Daria Zakharova

The discussions took place in Algiers from March 7 to 20. The staff team comprised Jean-François Dauphin (head), Andrew Jewell and Moez Souissi (all MCD), and Racheeda Boukezia (FAD). Greg Auclair and Geraldine Cruz (both MCD) assisted in the preparation of this report.

The team met with the Governor of the Bank of Algeria, Mohamed Loukal; Finance Minister Hadji Baba Ammi; Industry and Mines Minister Abdessalem Bouchouareb; Acting Trade Minister and Housing and Urban Development Minister Abdelmadjid Tebboune; Education Minister Nouria Benghebrit; and Labor, Employment, and Social Security Minister Mohamed El Ghazi. The mission also held discussions with other senior government and central bank officials as well as with representatives of the economic and financial sectors and civil society. Mr. Badsi (OED) participated in most of the meetings.

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INTRODUCTION

1. The collapse of oil prices has exposed the shortcomings of Algeria's growth model. Historically, the economy has relied on government redistribution of hydrocarbon revenues. When oil prices were high, this model allowed Algeria to build infrastructure, achieve social stability, make significant progress toward meeting the Millennium Development Goals, and repay most of its external debt to which the country is averse. Yet even when oil prices were high, this model was unsustainable considering that hydrocarbon reserves may be exhausted in one or two generations' time.[1] Over the past decade, a large share of new job creation has been either in the public sector, which is very large by international standards, or in the construction sector, which is driven largely by public investment. With durably lower oil prices, it has become even more apparent that the government no longer has sufficient resources to sustain high levels of spending and continue creating jobs for a young and fast-growing population.

2. While initially delayed, the adjustment to the oil price shock is now underway. After a slow start in 2014–15, the authorities have taken steps to address the challenges of living with lower oil prices. They have adopted an ambitious medium-term fiscal consolidation plan, implemented some structural reforms, and are working on a long-term vision for reshaping the country's growth model. In response to changing liquidity conditions, the central bank has appropriately reintroduced refinancing instruments. The new reform momentum is welcome. However, staff believes the authorities' policy mix is tighter than necessary, and that there is some fiscal space to conduct a more gradual fiscal consolidation, less costly in terms of growth and employment. The authorities should ensure that the burden of adjustment is borne equitably, even more so to foster wider ownership of the adjustment ahead.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

A. Recent Developments

3. Economic activity was resilient in 2016, but inflation increased. Real GDP growth slowed modestly to 3.5 percent in 2016 from 3.8 percent in 2015. Activity was supported by strong growth in the hydrocarbon sector, which benefited from new fields coming on stream and the return to full production of a major gas plant that was the target of a terrorist attack in 2013.[2] By contrast, growth in the nonhydrocarbon sector—particularly the agriculture and services sectors—slowed, in part because of spending cuts, and reached its lowest level since 1999. Unemployment increased to 10.5 percent in September 2016 and remains particularly high among the youth (26.7 percent) and women (20.0 percent). Average inflation rose from 4.8 percent in 2015 to 6.4 percent in 2016, driven

[1] Algeria's oil reserves are projected to be depleted in 21 years and its gas reserves in 54 years. See BP Statistical Review of World Energy 2016.

[2] Algeria's crude oil production remained below its OPEC quota in 2016.

by higher prices for manufactured and imported goods, and stood at 6.9 percent year-on-year in March 2017. Inflation was particularly volatile in 2016 due to large fluctuations in food prices.

4. The fiscal adjustment in 2016 was sizeable. Overall spending was cut by 3.6 percent in nominal terms, a reduction equivalent to 5.8 percent of nonhydrocarbon GDP. While it was less than built into the budget, which targeted a 9 percent spending cut in nominal terms, this reduction, combined with an exceptional dividend from the Bank of Algeria (BA), helped lower the nonhydrocarbon budget deficit from 37.1 percent of nonhydrocarbon GDP in 2015 to 28.9 percent in 2016 (cash basis).[3] The overall deficit of 14.0 percent of GDP was financed mainly by drawing down savings in the oil stabilization fund,[4] which reached its statutory floor, and by borrowing in the domestic market. Payment delays increased, reflecting financing difficulties. Public debt increased from 8.8 percent of GDP in 2015 to 21.0 percent following government financial operations to support two state-owned enterprises.

5. The current account deficit remained substantial and far from its norm (Annex III). Following a deterioration in the terms of trade for the third year in a row, the trade deficit widened from US$18.1 billion in 2015 to US$20.4 billion in 2016. The wider trade deficit was offset by lower profit repatriation, leading to a slight improvement in the current account deficit in nominal dollar terms. As a percent of GDP, however, the current account deficit widened slightly to 16.9 percent of GDP. By comparison, staff estimates of the current account norm range from a surplus of 1.4 percent of GDP to a deficit of 3.7 percent, indicating an external balance significantly weaker than warranted by medium-term fundamentals and desirable policies. The nominal effective exchange rate (NEER) was broadly stable in 2016 while the real effective exchange rate (REER) appreciated by 5.6 percent because of higher inflation in Algeria than in its trading partners. The REER is significantly overvalued, hurting Algeria's competitiveness.

6. Nevertheless, the net international investment position, though weakened, remains comfortable. International reserves fell by US$30 billion to US$113 billion (excluding SDRs) but remained substantial at 23 months of imports and 686 percent of the Fund's unadjusted metric to assess reserve adequacy (ARA metric).[5] External debt amounted to just 2.5 percent of GDP in 2016. Overall, the net international investment position stood at a comfortable 47 percent of GDP.

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[3] The dividends from the BA paid in 2016 and expected in 2017 reflect a reduction in the level of provisioning following the introduction in the 2017 budget law of a ceiling on the BA's provisions equivalent to three times its capital, as well as valuation gains on the sale of international reserves.

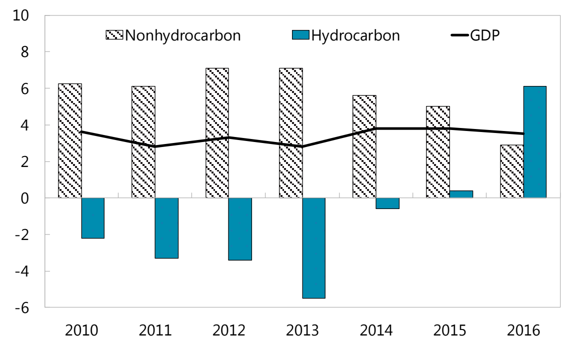
[4] *Fonds de Régulation des Recettes* (FRR).

[5] See "*Assessing Reserve Adequacy—Specific Proposals*," April 2015 (http://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Assessing-Reserve-Adequacy-Specific-Proposals-PP4947).

Figure 1. Algeria: Selected Macroeconomic Indicators

A rebound in hydrocarbon production partly offset the slowdown in nonhydrocarbon growth in 2016.

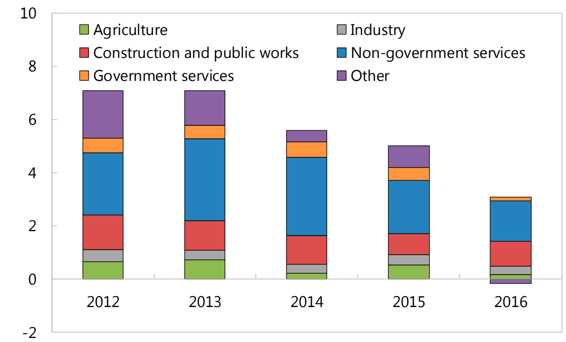
Hydrocarbon and Nonhydrocarbon Growth
(Percent)



Sources: Algerian authorities; and IMF staff calculations.

Weak activity in the agriculture and services sectors weighed on nonhydrocarbon growth.

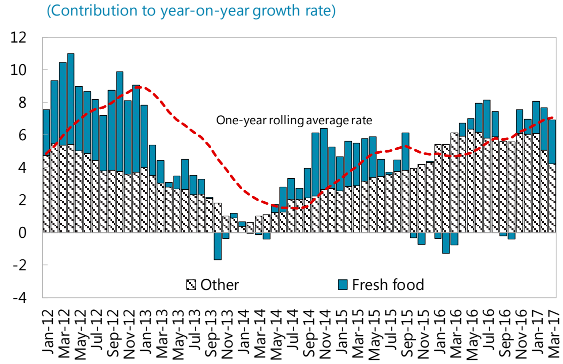
Sources of Nonhydrocarbon Growth
(Percent)



Sources: Algerian authorities; and IMF staff calculations.

Nonfood products continued to push inflation higher.

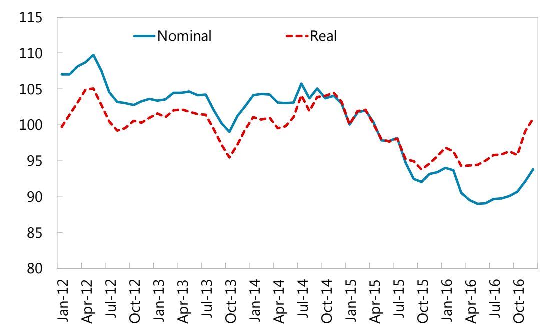
CPI Inflation
(Contribution to year-on-year growth rate)



Sources: Algerian authorities; and IMF staff calculations.

The nominal and real effective exchange rates strengthened in 2016, partly reversing earlier depreciation.

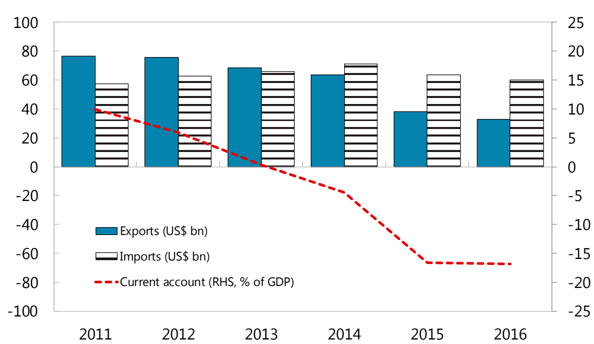
Effective Exchange Rate
(Jan 2012=100)



Sources: Algerian authorities; and IMF staff calculations.

The current account deficit remained large.

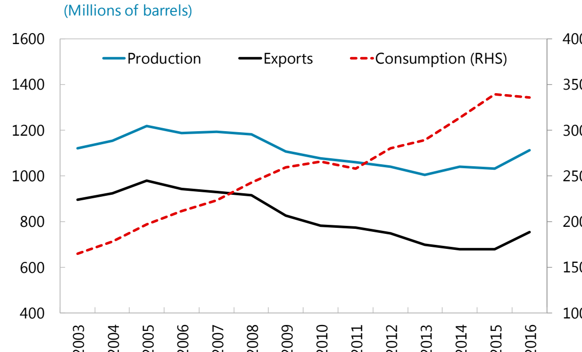
Current Account Balance



Sources: Algerian authorities; and IMF staff calculations.

After a decade of strong growth, domestic consumption of hydrocarbon stabilized in 2016, allowing higher exports.

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

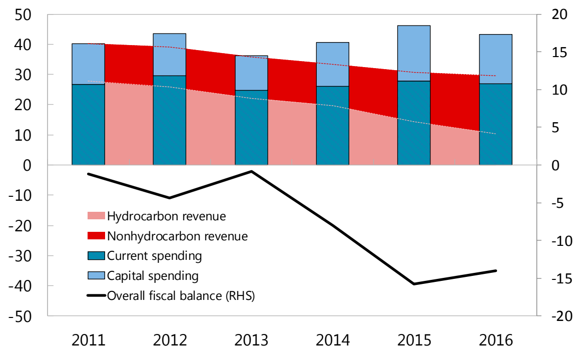


Sources: Algerian authorities; and IMF staff calculations.

Figure 2. Algeria: Fiscal Indicators

The fiscal deficit remained large due to a continued fall in hydrocarbon revenues.

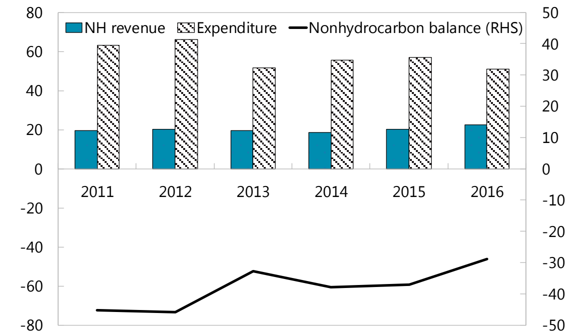
Overall Fiscal Balance
(Percent of GDP, 2011–16)



Sources: Algerian authorities; and IMF staff calculations.

The nonhydrocarbon deficit narrowed significantly in 2016.

Nonhydrocarbon Fiscal Balance
(Percent of NHGDP)



Sources: Algerian authorities; and IMF staff calculations.

Current spending as a percent of nonhydrocarbon GDP declined significantly in 2016.

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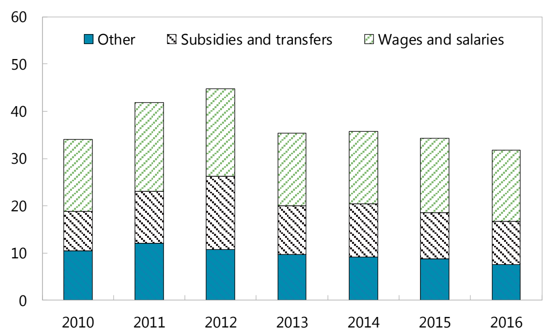
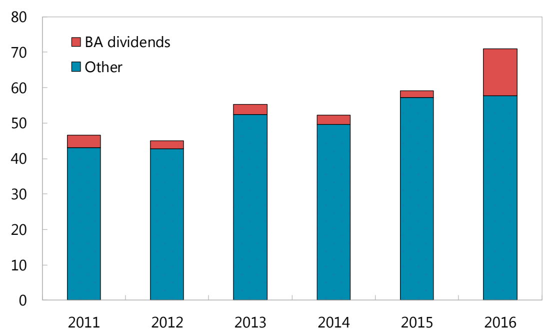
Current Spending
(Percent of nonhydrocarbon GDP)



Sources: Algerian authorities; and IMF staff calculations.

The share of nonhydrocarbon revenues to current expenditure jumped in 2016, thanks to an exceptionally large dividend from the BA.

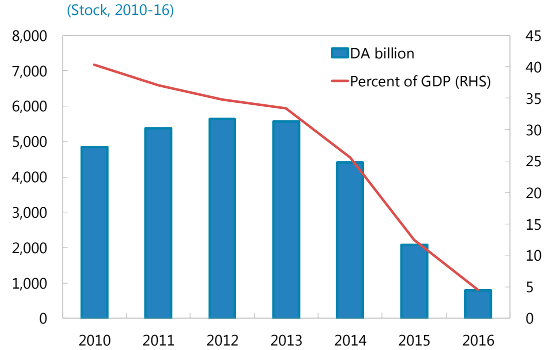
Share of Nonhydrocarbon Revenue to Current Spending
(Percent)



Sources: Algerian authorities; and IMF staff calculations.

The oil stabilization fund reached its statutory floor of 740 billion dinars in 2016.

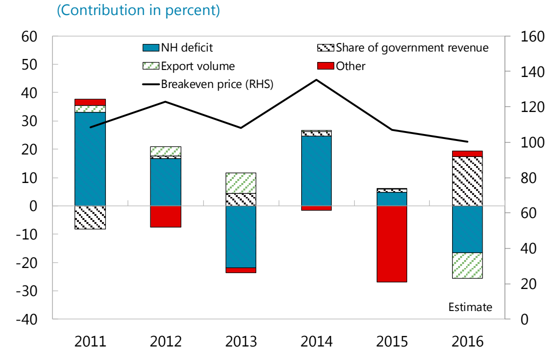
Oil Fund
(Stock, 2010-16)



Sources: Algerian authorities; and IMF staff calculations.

The decline in the breakeven oil price in 2016 was mainly driven by cuts in spending.

Change in the Fiscal Breakeven Price
(Contribution in percent)

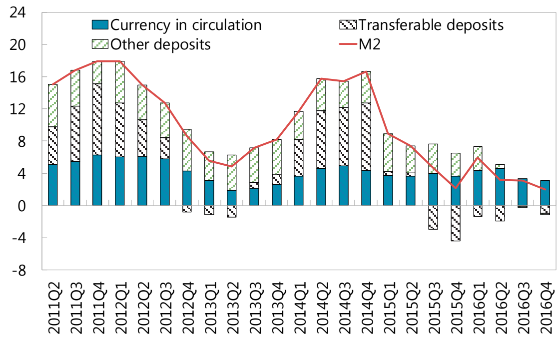


Sources: Algerian authorities; and IMF staff calculations.

Figure 3. Algeria: Monetary Indicators

Broad money growth slowed in 2016, mainly reflecting a drop in bank deposits, and despite lower reserve requirements.

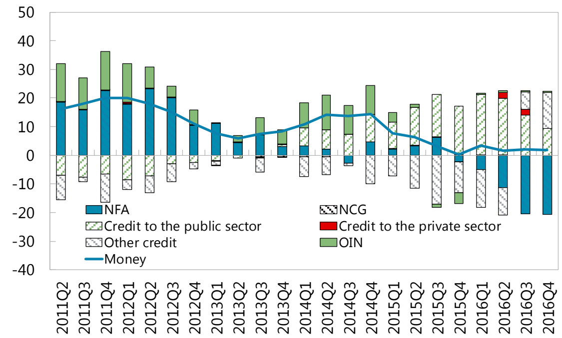
M2 Growth and Determinants
(Percent)



Sources: Algerian authorities; and IMF staff calculations.

On the asset side of the balance sheet, slower broad money growth reflected a significant decline in net foreign assets.

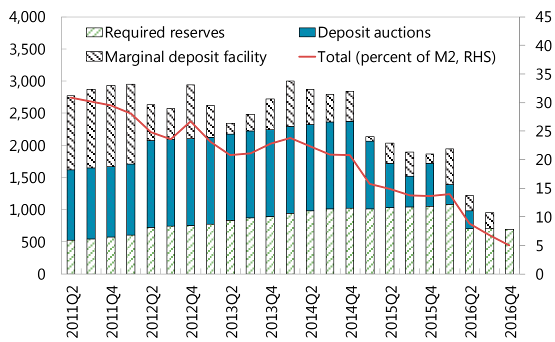
Contribution to M2 Growth
(Percent)



Sources: Algerian authorities; and IMF staff calculations.

Liquidity conditions continued to tighten, inducing the BA to scale back its liquidity absorbing operations.

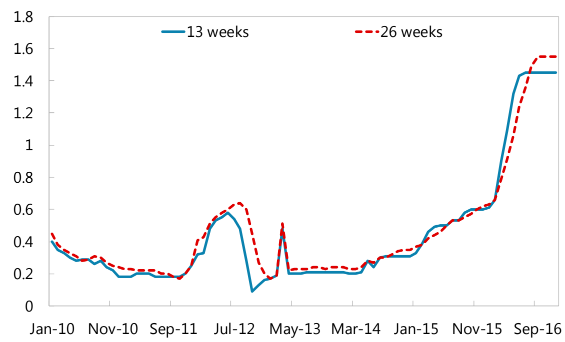
Liquidity Management
(Liquidity management in DZD bn and in percent of M2)



Sources: Algerian authorities; and IMF staff calculations.

Government bond yields rose sharply due to tighter liquidity conditions.

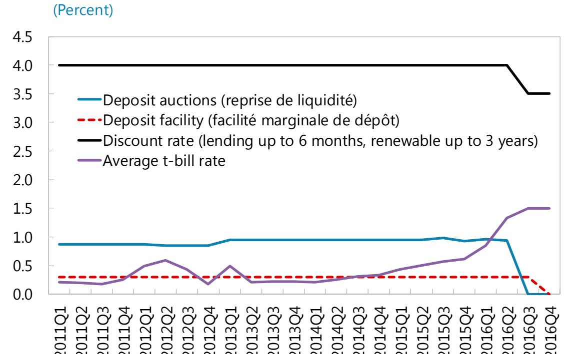
Government Bond Rates
(Percent)



Sources: Algerian authorities.

The BA introduced refinancing instruments and lowered interest rates

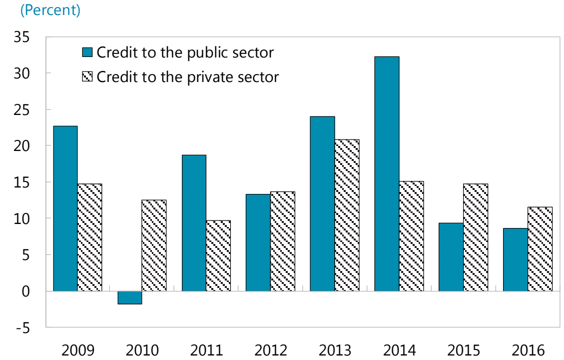
Interest Rates
(Percent)



Sources: Algerian authorities; and IMF staff calculations.

Credit growth to the economy slowed but remained robust.

Credit Growth
(Percent)



Sources: Algerian authorities.

7. Banks' excess reserves with the central bank dried up. Lower oil prices contributed to a sharp reduction in excess liquidity. As a result, some banks returned to BA for financing, interbank lending picked up, and interest rates increased. In an environment of tighter bank liquidity, growth in credit to the economy slowed but nevertheless remained robust at 9.8 percent in 2016. This, combined with the government's drawdown of the oil stabilization fund, helped offset the decline in net foreign assets such that broad money increased by 1.8 percent.

8. The banking system as a whole remained adequately capitalized and profitable, but credit quality deteriorated. Preliminary data at end-2016 suggest that the banking sector was adequately capitalized. The Tier I solvency ratio was up from 15.9 percent in 2015 to 16.4 percent in 2016, mainly due to the recapitalization of a public bank. The ratio of gross nonperforming loans to total loans increased from 9.8 percent to 11.4 percent, partly reflecting delayed payments from the government to its suppliers. However, the ratio of net nonperforming loans was only 5.1 percent thanks to a high level of provisioning (55.4 percent), and banks continued to post a high return on assets (1.9 percent on aggregate). At the system level, 27.5 percent of assets were liquid, roughly unchanged from 2015 and sufficient to cover more than two-thirds of banks' short-term liabilities.

B. Outlook and Risks

9. The growth outlook is tied closely to the policy mix pursued to adjust to lower oil prices. The baseline scenario reflected in Tables 1–4 is based on the fiscal adjustment envisaged in the authorities' 2017 and medium-term budget. It also assumes the continuation of current structural reforms efforts and a nearly stable real effective exchange rate over the medium term. This policy mix would help restore fiscal and external balances, but significant spending cuts would weigh heavily on growth. As detailed below, a more gradual consolidation combined with more ambitious structural reforms and further exchange rate depreciation would likely result in higher growth and would still be consistent with maintaining debt sustainability.

10. Risks are tilted to the downside (Box 1). Persistently lower oil prices would worsen economic imbalances and financial strains. Capital account restrictions insulate Algeria from direct contagion from world market turbulence, but higher global rates or risk aversion could complicate recourse to foreign savings. Fiscal adjustment could lead to social tensions, which have been isolated thus far. With memories of the 1990s' civil war still fresh, the authorities are walking a fine line between too rapid an adjustment that could spark social unrest and insufficient action that ends in a sudden, disorderly adjustment. It will be important to garner a broad political and social consensus to ensure that future electoral cycles do not undermine support for reforms.

Box 1. Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Expected Impact	Source of Impact	Policy Response
Persistently lower energy prices.				
Production cuts by OPEC and other major producers may not materialize as agreed while other sources of supply could increase production.	Low	High	Lower oil and gas prices would worsen the current account and fiscal deficits.	Staff's recommended adjustment path, while less steep than the authorities' intended policy, leaves room to accommodate the materialization of fiscal risks, including the risk of lower oil prices.
Weaker-than-expected global growth				
Significant slowdown in other large EMs/frontier economies.	Medium	High	A sharper-than-expected slowdown in global growth would hurt Algeria through lower oil prices. Slower growth in Europe in particular could negatively affect demand for Algeria's gas exports. Weaker demand for nonhydrocarbon exports would have little impact on the balance of payments, as nonhydrocarbon exports are a small fraction of total exports. Financial market spillovers would be limited given Algeria's very limited global financial integration.	See above.
Structurally weak growth in key advanced and emerging economies.	High/ Medium	High		
Policy and geopolitical uncertainties				
Intensification of the risks of fragmentation/security dislocation in part of the Middle East, Africa, and Europe, leading to a sharp rise in migrant flows, with negative global spillovers.	High	Medium/ High	Heightened security concerns may indirectly benefit Algeria's economy to the extent that they lead to higher oil prices. However, regional instability would increase pressure on the government to maintain security and social spending, thus complicating fiscal consolidation. Low trade and financial flows with the region limit the direct impact of regional instability.	See above.
Algeria-specific risks				
Difficulties garnering a political and social consensus around necessary reforms, particularly in a volatile regional context.	Medium	High	A lack of consensus around reforms could hamper fiscal consolidation and structural reforms, which could lead to a more abrupt adjustment.	The authorities need to mount an effective communications campaign that raises awareness about the benefits of reforms and the cost of inaction. Structural reforms, including fiscal reforms, should be designed to distribute the burden of adjustment equitably and promote inclusive growth. The potential negative impact on the most in need should be mitigated (e.g., a targeted cash-transfer system would mitigate the impact of subsidy reform on the poor). Anti-corruption efforts should be strengthened.

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

POLICY DISCUSSIONS

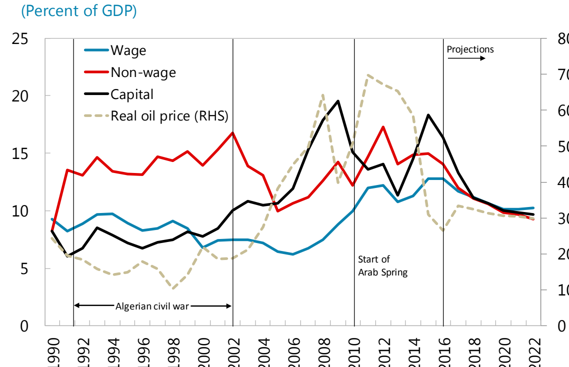
11. Since the 2016 Article IV consultation, the Algerian authorities have taken actions to adjust to lower oil prices. The authorities achieved a sizeable reduction in the fiscal deficit in 2016 and have adopted an ambitious fiscal consolidation plan for 2017–19. They have made progress improving the business environment and are working on a long-term strategy to reshape the country's growth model to foster greater private sector activity and economic diversification. The central bank has adapted its monetary policy instruments to a tighter liquidity environment.

12. The growing reform momentum is welcome, but the policy mix pursued by the authorities appears overly restrictive. Until 2015, adjustment to the oil price shock was borne essentially by exchange rate policy. The government's current policy, which entails financing the deficit with domestic resources only, with no further exchange rate depreciation, runs the risk of excessively shifting the burden of adjustment toward fiscal policy. Staff considers that there is some fiscal space to conduct a more gradual fiscal consolidation, with less impact on growth, if fiscal consolidation were combined with: (i) further exchange rate depreciation, which not only would help address external imbalances and support private sector development, but would also raise oil revenue in local currency; (ii) a less restrictive financing strategy that includes external borrowing; and, (iii) more ambitious structural reforms to raise potential growth.

A. Balancing Fiscal Consolidation and Growth

13. The authorities' fiscal policy plan goes in the right direction and uses levers broadly in line with staff's recommendations (Box 2). After years of expansive fiscal policy (even in the early days of the fall in oil prices), the authorities are now firmly committed to consolidating their fiscal position. Fiscal consolidation is essential for restoring fiscal sustainability, ensuring intergenerational equity, and supporting external rebalancing. The authorities have adopted for the first time a medium-term budget framework (MTBF) with a clear medium-term anchor, which is a significant achievement. Staff welcomed the broad-based approach taken to reduce the deficit, which entails raising nonhydrocarbon revenues, reducing current expenditure (including wages) as a share of GDP, reforming the subsidy system, reducing investment spending while increasing its efficiency, and improving public financial management. The key features of the authorities' plan are as follows:

Expenditures - Baseline Scenario
(Percent of GDP)



Sources: Algerian authorities; and IMF staff calculations.

- *Cut current spending to pre-global financial crisis levels.* Since 2009, current expenditures have averaged 26 percent of GDP. The MTBF aims to reduce current spending to 20 percent of GDP by 2020. The government intends to limit new hiring to strategic sectors and rein in other operating costs while preserving social transfers.

- *Substantially lower capital spending.* Capital spending has averaged 15 percent of GDP since 2009—well above the average in other MENA oil exporters. The authorities aim to reduce it to 10 percent of GDP by 2020 (a return to 2002 levels) while increasing investment efficiency by improving the selection, implementation, and ex-post assessment of projects. Staff stressed the need to preserve investment in health, education, and well-targeted safety nets.

- *Continue subsidy reform.* The government initiated subsidy reform in 2016 by increasing the prices of fuel, natural gas, and electricity for the first time since 2005. The 2017 budget law raised fuel prices further, and the government plans to deepen subsidy reform while introducing a targeted cash transfer system to protect the most vulnerable.[6] Staff emphasized the need to explain the rationale and benefits of subsidy reform to the public.

- *Increase nonhydrocarbon tax revenues.* The 2017 budget raised VAT rates by two points to 9 and 19 percent and increased taxes on tobacco and a range of luxury goods. Staff welcomed the authorities' intention to further increase nonhydrocarbon revenues by focusing henceforth on rationalizing tax exemptions and strengthening tax administration, which will also help promote a more equitable tax system.

14. The degree of fiscal consolidation built into the MTBF is very ambitious and risks damaging growth. The authorities aim to bring the deficit close to zero by 2019. This is a steep (and possibly difficult to achieve) consolidation plan.[7] If the authorities implement the MTBF, staff projects that nonhydrocarbon growth will slow to close to zero in 2018—a sharp deviation from the authorities' own forecast.[8] Such a sharp deceleration in growth would likely worsen unemployment, dampen nonhydrocarbon revenues, increase financial stability risks, and heighten social tensions.

15. In staff's assessment, Algeria has some fiscal space. Fiscal savings have been nearly depleted, but public debt remains low, and external debt is nearly nonexistent. Public sector gross financing needs decline sharply under the MTBF and remain manageable even under more expansionary scenarios simulated by staff. Debt levels decline under the MTBF and remain well below benchmark levels for emerging markets in expansionary scenarios.

[6] The World Bank is providing assistance in this area. Many existing subsidies are highly regressive. See "Subsidy Reform in Algeria," IMF Country Report No. 16/128.

[7] See Public Debt Sustainability Analysis, Annex II.

[8] Staff's growth projections are based on fiscal multipliers estimated using Algeria-specific data. See Annex I.

Box 2. Authorities' Response to Past IMF Recommendations

Recommendation	Implementation status
Pursue fiscal consolidation	The authorities reduced the fiscal deficit in 2016 despite a large drop in hydrocarbon revenues. The medium-term budget framework calls for significant fiscal consolidation over the next three years.
Strengthen public financial management	The authorities adopted a medium-term budget framework and closed special treasury accounts that posed significant fiscal risk.
Mobilize more nonhydrocarbon revenues	The 2017 budget law raised VAT rates and increased taxes on tobacco and a range of luxury goods. The authorities are making efforts to improve tax administration. More needs to be done to reduce tax exemptions.
Reduce public investment spending and improve its efficiency	Public investment pending was cut significantly in 2016. Further cuts are envisioned under the medium-term budget framework.
Contain the wage bill	The authorities have limited new public sector hiring to strategic sectors.
Gradually reduce fuel subsidies and develop a targeted cash-transfer system	The authorities initiated subsidy reform in 2016 by raising the prices of fuel, electricity, and natural gas. They increased fuel prices further in 2017 and intend to expand subsidy reforms to other products while putting in place a cash-transfer system.
Borrow more to meet financing needs, including external borrowing	The government issued a domestic sovereign bond in 2016 and borrowed €900 million from the African Development Bank. However, regular Treasury bill issuance contributed little to the financing of the deficit, and there is reluctance to borrow more externally.
Implement wide-ranging structural reforms	The authorities have taken steps to improve the business environment, as evidenced by Algeria's improvement in the 2017 Doing Business ranking. The government is fleshing out a broad strategy to reshape the country's growth model.
Adopt supportive exchange rate, monetary, and financial policies	
Pursue further real depreciation of the dinar	The real effective exchange rate depreciated 7.4 percent in 2015, but it appreciated 3.7 percent in 2016 and remains significantly overvalued.
Adjust to the changing liquidity environment while guarding against inflation	The central bank has strengthened its liquidity forecasting capabilities and reintroduced refinancing instruments.
Strengthen the prudential framework and improve crisis preparedness and management	A stress test exercise launched at the end of 2015 has yet to be completed.

16. Using the fiscal space to cut spending more gradually than envisaged in the MTBF would help limit the slowdown in growth. The mission prepared an alternative scenario that illustrated policy tradeoffs and highlighted the existence of some fiscal space (Annex I). Compared to the baseline scenario, spending cuts in the alternative scenario are less severe and financing needs are larger, requiring more borrowing. The government is assumed to meet some of these needs through external borrowing. Fiscal policy is anchored by gradually stabilizing public debt at around 30 percent of GDP, a level higher than in the authorities' plan, but moderate enough (by emerging market standards) to leave buffers should some fiscal risks related to the price of oil or contingent liabilities materialize.

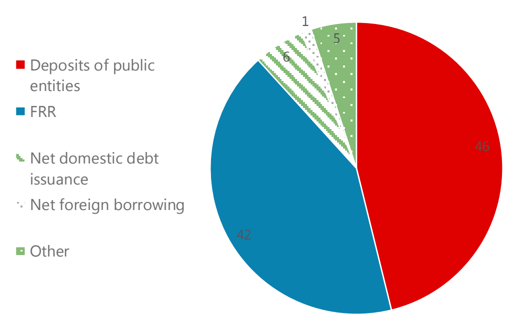
Key Economic Indicators Under the Baseline and Alternative Scenarios

	Baseline scenario				Alternative scenario		
	2016	2017	2018	2022	2017	2018	2022
Total GDP growth (percent)	3.5	1.3	0.7	2.3	2.7	2.2	4.2
Nonhydrocarbon GDP growth (percent)	2.9	1.3	0.3	2.3	3.0	2.2	4.4
International reserves (US$ billion)	112.9	93.3	79.0	37.8	95.5	84.1	58.1
Public debt (percent of GDP)	21.0	18.3	19.3	14.6	21.2	25.9	31.0

Source: IMF staff calculations.

17. Tapping a broader range of financing options would allow for more gradual fiscal consolidation.[9] Since 2009, the government has financed deficits mainly by drawing down fiscal savings and tapping the deposits of public entities held at the Treasury. Staff projects government debt to decline to 14.6 percent of GDP by 2022 under the MTBF. Given its low debt, Algeria can afford to borrow more. An increase in domestic debt issuance would also support the development of the country's incipient financial markets. However, to avoid excessive crowding out effects in an environment of tighter liquidity, and to shore up reserves, the government could also borrow externally. Tapping international markets would require careful preparation and overcoming resistance to external debt. In addition, transparently opening the capital of selected state-owned enterprises, including public banks, could provide financing while helping to develop the stock market and improve corporate governance. In this context, staff encouraged the authorities to relax the 51-49 rule requiring majority Algerian ownership in foreign investments.

Sources of Financing, 2009-16
(Percent of total)



Sources: Algerian authorities; and IMF staff calculations.

[9] See accompanying Selected Issues Paper: "Financing Fiscal Deficits."

18. Further public finance management reforms would support fiscal adjustment and improve governance. Staff encouraged the authorities to prepare sectoral medium-term expenditure frameworks (MTEFs) consistent with an overall MTEF. Staff supported the authorities' intention to adopt a new organic budget law that would provide a legal basis for the multiyear budgeting process and ensure that debt is used only to finance investment spending. The authorities should improve their capacity to monitor budget execution and, if necessary, make adjustments upstream in the expenditure chain, rather than downstream, to minimize the risk of payment arrears. The authorities also need to improve forecasting and cash management to properly anticipate and cover future liquidity requirements. To enhance the effectiveness of monetary policy, the Ministry of Finance should regularly communicate its treasury cash flow projections to the BA. Finally, to better assess the sustainability of the broader public sector, the authorities should develop consolidated public sector flow and stock statistics that include the debt of state-owned enterprises and government guarantees.

19. Some fiscal risks could materialize during the adjustment (Box 3). The authorities reduced an important source of fiscal risk by closing several special treasury accounts that led to spending overruns in the past. However, other sources of fiscal risk have materialized recently and are still present. They include government guarantees of loans to state-owned enterprises, the potential need to recapitalize public banks, implicit commitments given to state-owned enterprises, and the financial difficulties of the state-run pension system. The fiscal consolidation process, although necessary, increases the probability that some fiscal risks could materialize. Staff recommended that the authorities monitor fiscal risks more closely, including by tracking the debt of the consolidated public sector.

Box 3. Fiscal Risks[1]

Fiscal risks in Algeria are multiple and interrelated, and their potential impact on the budget deficit and public debt is considerable. The state plays a dominant role in economic activity through government programs as well as through commercial activities carried out by public institutions and state-owned enterprises. The government frequently recapitalizes public banks, buys back guaranteed debt, and provides financial support to state-owned enterprises to cover the differential between market prices and regulated prices. Other sources of fiscal risk include volatile hydrocarbon revenues, natural disasters, and the financial situation of social safety net programs.

Some of these risks have materialized in the past. Between 1991 and 2012, Treasury operations to support public banks amounted to 14.8 percent of 2012 GDP. In 2016, the materialization of fiscal risks cost an estimated 8.9 percent of GDP, mainly reflecting two operations: the government's purchase of debt owed by a public utility company to a public bank, and the issuance of bonds to the state-owned oil company to compensate for losses incurred from selling imported refined fuel in the domestic market at subsidized prices.

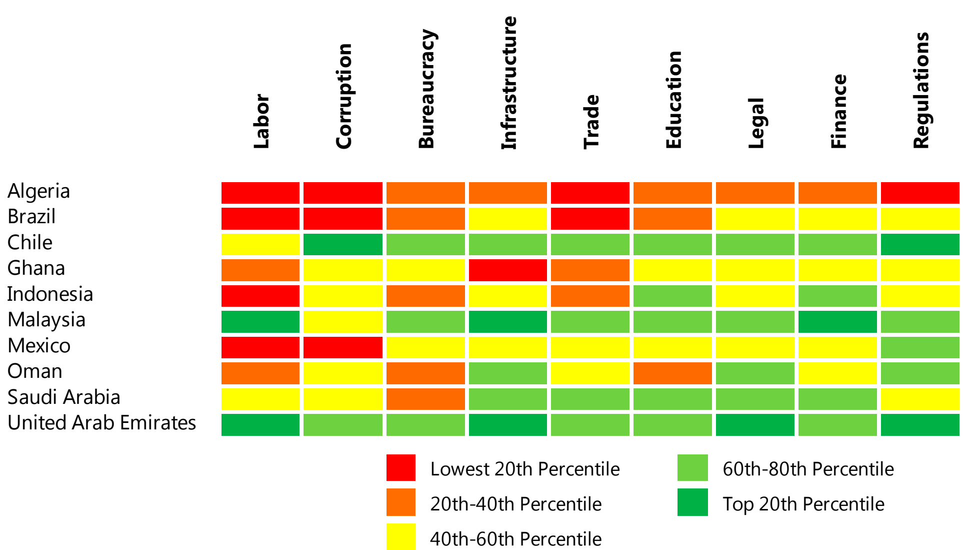
[1]See accompanying Selected Issues Paper: "Fiscal Risks in Algeria."

20. ***Authorities' views.*** *The authorities said they might reconsider the composition of spending over the medium term to ensure the adjustment is as growth-friendly as possible, but they do not intend to raise the overall spending caps in the MTBF. Rather than turn to external borrowing, they argued that significant fiscal consolidation was necessary to reduce financing needs and minimize crowding out effects. They do not plan to relax the 51-49 rule at this stage and noted that previous efforts to sell state-owned assets had not gone well. They were unconvinced that their fiscal consolidation plan would severely damage growth, pointing to large industrial projects in the pipeline that would support activity in the nonhydrocarbon sector. While recognizing the potential for acceleration of growth in the industrial sector, staff noted, however, that its contribution to GDP remains too small to make a significant difference in the short run. The authorities acknowledged the existence of fiscal risks and agreed that they needed to be monitored closely, but said that developing consolidated public sector statistics would take time.*

B. Structural Reforms[10]

21. **Structural impediments are multiple and intertwined.** Algeria ranks behind regional peers and emerging market countries in almost all key structural reform areas in international surveys. Notable deficiencies include a restrictive business environment, difficult access to finance, weak governance and corruption controls, insufficient transparency and competition, high barriers to entry, a rigid labor market, jobs-skills mismatches, and excessive growth in wages with respect to productivity.[11]

Key Structural Impediments



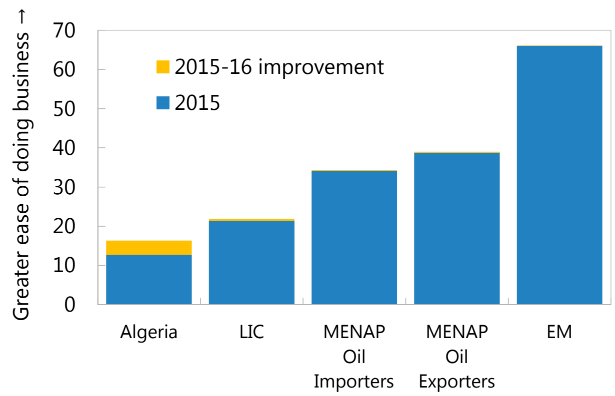
Sources: World Bank; World Economic Forum; PRS Group; and IMF staff calculations. Percentile rank includes all countries with data available.

[10] See accompanying Selected Issues Paper: "Structural Reforms: Strategies and Possible Payoffs."

[11] Caution is needed when comparing survey-based structural indicators across countries. Although these indicators are updated yearly and survey methodologies are revised frequently, they are partly constrained by the data that can realistically be collected.

22. Therefore, structural reforms should be a pillar of Algeria's strategy for adjusting to lower oil prices. In addition to undertaking fiscal consolidation to restore macroeconomic balances, Algeria should implement an ambitious structural reform program to facilitate the emergence of a dynamic private sector. There are some indications that reform momentum is building. Last year the government adopted a broad strategy to reshape the country's growth model. It is now fleshing it out with World Bank support. Staff welcomed the objectives of the new model, namely to reduce dependence on hydrocarbons through investments in high value-added sectors such as agribusiness, renewable energy, services, and industry, and to support private sector development. The authorities also took steps to enhance the business environment, which resulted in an improvement in the World Bank's Doing Business ranking from 163 in 2016 to 156 in 2017, and enacted new laws to foster investment and the development of small and medium-sized enterprises (SMEs).[12]

Ease of Doing Business, 2016

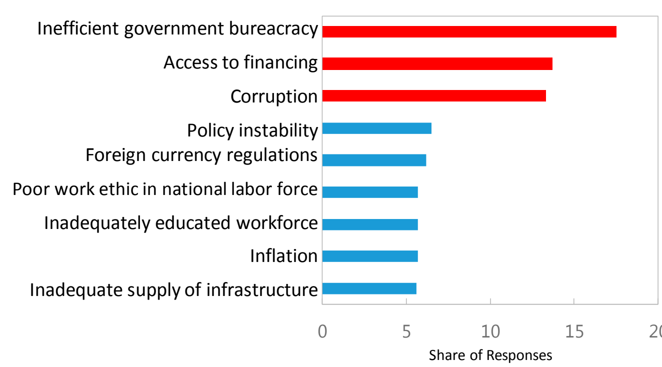


Sources: 2016 World Bank Doing Business Indicators; and IMF staff estimates.

23. Algeria's challenges call for an ambitious reform agenda. Staff encouraged the authorities to:

- *Continue to reduce excessive bureaucracy and strengthen the institutional and legal frameworks.* Opinion surveys indicate that excessive bureaucracy and corruption are major impediments to private investment. Other indicators point to gaps in the institutional and legal frameworks. Simplifying administrative procedures and accelerating the transition to a digital economy should be priorities. The institutional and legal frameworks should be strengthened to better protect property and contractual rights and ensure more rapid settlement of contract disputes and bankruptcy proceedings. International experience suggests that where the rule of law is lacking and corruption is a concern, resistance to reforms is likely to be stronger.

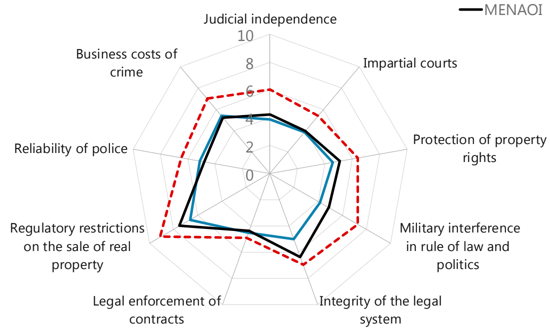
Executive Opinion Survey, 2016



Source: World Economic Forum Executive Opinion Survey,
Note: From a list of 16 factors, respondents are asked to select the five most problematic and rank them from 1 (most problematic) to 5.

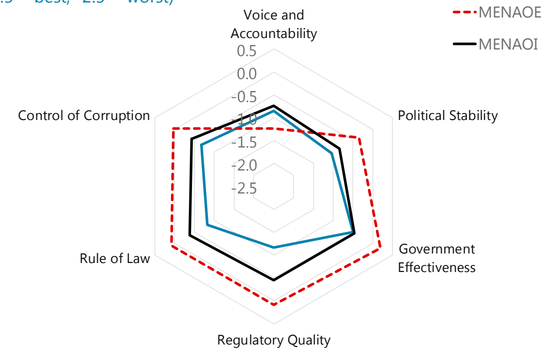
[12] Algeria's improvement in the Doing Business ranking is largely explained by tax reforms, publishing electricity tariffs, and reducing the time needed to obtain a construction permit.

Legal System and Property Rights
(Best = 10)



Source: Fraser Economic Freedom Index.
Note: Latest data are 2014.

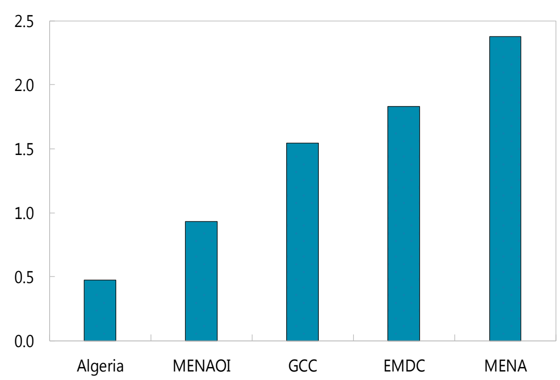
World Governance Indicators, 2015
(2.5 = best, -2.5 = worst)



Source: World Bank World Governance Indicators.

- *Strengthen competition in product markets.* Strengthening competition in product markets requires reducing barriers to the entry of new firms and to the exit of obsolete ones. Privatizing some nonstrategic public enterprises that pose implicit barriers to entry, and further reducing price restrictions by expanding subsidy reform, would create incentives for private entrepreneurs to emerge. To ensure an adequate enforcement of competition rules, the powers of the competition authority should be strengthened.

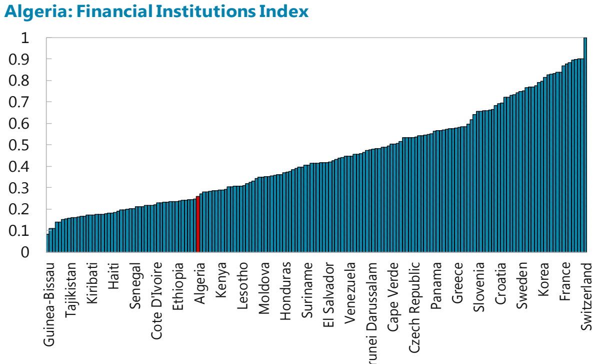
New Business Density, 2008-14
(New registrations per 1000 population ages 15-64, average)



Source: World Bank.

- *Open the economy to more trade and foreign investment.* Relaxing the 51-49 rule could help strengthen competition in the domestic market, lead to technology transfers, and make Algerian businesses more competitive. Staff stressed that import licenses, which the authorities have imposed on selected products to dampen imports, should be avoided because they add to inflationary pressures and introduce distortions and rent-seeking opportunities that are likely to drive more activity underground. Staff also encouraged the authorities to pursue WTO accession.

Algeria: Financial Institutions Index

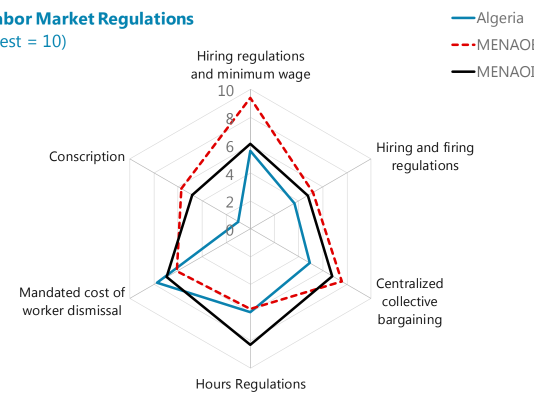


Sources: IMF Financial Development Index.

- *Ensure adequate access to financing for businesses.* Difficult access to credit is a key factor hindering the development of the private sector. Lending to the private sector represents only 24 percent of GDP, one of the lowest ratios in the region. There are substantial collateral requirements for lending to SMEs, and bankruptcy settlement proceedings are lengthy. Moreover, Algerian capital markets are nascent, and market capitalization amounts to less than 1 percent of GDP. A number of factors thwart the development of financial markets, including lengthy administrative procedures and subsidized bank lending that makes market financing unattractive. Staff recommended promoting competition in the banking sector, protecting creditors' rights, modernizing the bankruptcy framework, and improving procedures for resolving nonperforming loans. Reducing widespread interest rate subsidies for investment loans would increase the attractiveness of capital markets, promote better self-selection of investment projects, lessen budget spending, and strengthen the transmission mechanisms of monetary policy. As noted above, the authorities could also consider opening up the capital of certain large public enterprises and banks.

- *Improve the functioning of the labor market.* The labor market is characterized by a lack of flexibility caused by costly hiring and firing regulations, high payroll taxes, mismatches between skills offered by job seekers and those sought by firms, strict eligibility requirements that limit access to the unemployment insurance system, and excessive wage hikes relative to productivity gains.[13] These characteristics reduce the demand for labor and hamper labor mobility across sectors. They also exclude a large part of the population from the labor market, in particular women and youth, and contribute to a large informal sector. Staff welcomed the ongoing dialogue between trade unions, employers, and the government on the labor code, which is an opportunity to increase labor market flexibility while ensuring adequate protection for workers. Staff reiterated the need to thoroughly assess the effectiveness of active labor market policies, improve the unemployment benefit system, develop closer ties between the educational system and the private sector, and consider measures that would support greater labor market participation of women.

Labor Market Regulations
(Best = 10)



Source: Fraser Economic Freedom Index.
Note: Latest data are 2014.

24. Structural reforms should be carefully sequenced and started without delay. International experience suggests that a "big bang" approach, involving many reforms in a short period, would likely fail in Algeria because the institutional and legal frameworks are not sufficiently developed to overcome public resistance. On the other hand, an overly fragmented approach would also likely fail due to the interrelated nature of the multiple binding constraints to private sector development. Staff recommended that the authorities adopt an intermediate approach, gradually implementing reforms across many areas while paying close attention to sequencing. Where reform preconditions exist, certain reforms should precede others. For example, strengthening the legal and governance framework would facilitate privatization efforts. Where complementarities exist, reforms

[13] For more details on Algeria's social protection system, see "Fostering Private Sector Job Creation in Algeria," IMF Country Report No. 14/342.

should be implemented together. For example, product market reforms and reforms to open the economy to more foreign direct investment (FDI) would reinforce each other. Most importantly, reforms should be started without delay and steadily implemented, as they will take time to bear fruit.

25. Structural reforms should be designed to ensure that the burden of adjustment is borne equitably. Reforms should be carefully designed bearing in mind their distributional impacts. Fiscal reforms, in particular, have a key role to play to ensure equity in sharing the potential costs of the adjustment. For example, energy subsidies, which are costly and highly regressive, should be gradually replaced with targeted monetary transfers. Eliminating tax exemptions and strengthening tax administration would help make the tax system more inclusive while increasing nonhydrocarbon revenues. Reforms to increase the flexibility of the labor market and jumpstart private sector growth should be preceded by a review of the current unemployment benefit system to increase its coverage. The authorities should also strengthen anti-corruption efforts, including by mobilizing the framework for anti-money laundering and combating the financing of terrorism (AML/CFT). More broadly, given the currently weak macroeconomic environment and the potential for reform resistance, macroeconomic policies should support reforms, including by using the available fiscal space to cushion transitory costs.

26. ***Authorities' views.*** *The authorities agreed that wide-ranging structural reforms were necessary to change the growth model, and that such reforms should proceed at a gradual but steady pace. They highlighted measures already taken or in train, such as the new investment code, a draft law on private-public partnerships, and a new custom code, which aims at streamlining procedures and reducing administrative delays. They agreed that the institutional and legal frameworks were not well adapted to a market-based economy and needed to be revamped. They recently expanded the system of import licenses to cover twenty new products that are manufactured domestically, and they intend to ensure that imports meet appropriate standards. They argued that access to credit was not a major problem for many SMEs but rather that entrepreneurs often lacked managerial skills, and students, for cultural reasons, tended to seek skills more suitable for the public sector. They expressed wariness about possible tradeoffs between improving the flexibility of the labor market and protecting employee rights, and noted that active labor market policies helped create many jobs and a burgeoning private sector dynamic.*

C. Supportive Exchange Rate, Monetary, and Financial Policies

Exchange rate policy

27. Measures are needed to deepen the official foreign exchange market and curtail the parallel market. Diversifying the supply of foreign currencies on the interbank market, through a relaxation of surrender requirements relating to repatriation of export earnings and a reduction in the *de facto* high compulsory reserve ratio on foreign currency deposits, would support the development of the foreign exchange market. Measures are also needed to reduce the premium on the parallel foreign exchange market, which stands at about 60 percent. In particular, the indicative foreign exchange allocation ceilings for individuals should be raised.[14]

28. Further depreciation of the dinar also has a key role to play to support the fiscal and external adjustment. Various methodologies suggest that the REER remains significantly overvalued (Annex III). While most of the adjustment to correct the overvaluation should come from fiscal consolidation and structural reforms, further depreciation of the nominal exchange rate, combined with efforts to gradually eliminate the parallel market, should also play a role. A weaker currency would increase hydrocarbon revenues in dinars and reduce demand for imports, thus helping to restore fiscal sustainability and external balance while supporting the diversification of the economy in the medium term. Moreover, staff analysis suggests that a gradual nominal depreciation should not cause significant inflationary pressures in the short term.[15]

Monetary policy

29. The BA has appropriately adjusted to changing liquidity conditions by reintroducing refinancing instruments, with open market operations as the main tool. For more than a decade, monetary policy focused exclusively on mopping up structural excess liquidity. Lower oil prices have caused excess liquidity to dry up, which should allow the BA to regain control over liquidity conditions and short-term interest rates. The BA recently reintroduced its refinancing instruments, which consist of open market operations as the main instrument and a marginal lending facility. To support this approach, the BA needs to further strengthen its liquidity forecasting and management capabilities, in coordination with the Treasury, as well as its capacity for evaluating collateral. Access to the discount window, which allows banks to satisfy liquidity needs in amounts and maturities not under direct control of the central bank, should be discouraged, which would reinforce the monetary policy transmission mechanism. To that effect, the discount window rate should rapidly be set higher than the rate of the marginal lending facility.

[14] Algeria's indicative foreign exchange allocation ceilings are the lowest in the region. See IMF Country Report No. 13/47.

[15] See accompanying Selected Issues Paper: "Determinants of Inflation."

30. With inflation rising, the BA should stand ready to increase its policy rate to anchor inflation expectations around its target of 4 percent. The introduction of open market operations allows the BA to establish a new policy rate that will serve as the benchmark rate in the interbank market. Because this transmission channel is new, the effectiveness of monetary policy remains untested. As inflation has been rising, credit growth remains robust, and recent and planned measures (VAT increases, subsidy reform) have inflationary effects, the BA should adopt a tightening bias, pending an assessment of whether the planned fiscal consolidation will sufficiently dampen inflationary pressures in the short term.

Financial sector policy

31. To date, the oil price shock has had only a moderate impact on the stability of the banking system, but financial stability risks are increasing (Table 5). The banking sector is dominated by public banks, which represent 87 percent of total banking assets. The sector as a whole remains adequately capitalized and profitable, but, as expected, the oil price shock has increased liquidity, interest rate, and credit risks.[16] The recent increase in payment delays by the government could translate into a sudden rise in impaired loans. Moreover, an abrupt fiscal consolidation that leads to a significant slowdown in the nonhydrocarbon sector would also increase credit risks.

32. The prudential framework needs to be strengthened (Annex IV). The BA should monitor the evolution of risks within each bank and within the banking system as a whole through more frequent liquidity and solvency stress tests. The stress test launched in 2015 needs to be completed as quickly as possible. Existing regulations should be amended to include more detailed governance requirements for state-owned banks. Creating a level playing field among all banks (public and private) would ensure that government interventions to stabilize the balance sheets of public banks does not amount to regulatory forbearance. Further efforts are needed to strengthen the macroprudential framework, particularly given higher liquidity risks. Staff recommended that the authorities develop a systemic risk analysis framework, improve data quality, and adopt a toolbox of macroprudential instruments to counter the rising trend in systemic risk.

33. Improving crisis preparedness and management is also needed. A crisis resolution framework that clearly defines the roles and responsibilities of the various entities involved is lacking. Currently, bank resolution options are limited to the liquidation of insolvent banks under the general bankruptcy regime. An explicit bank resolution framework should be put in place, and the general business insolvency regime should be strengthened.

34. *Authorities' views.* *The authorities agreed that the dinar was overvalued and that correcting the overvaluation should primarily come from fiscal consolidation and structural reforms, together with some nominal depreciation of the dinar. However, they expressed concerns about allowing further depreciation until a foreign exchange forward market is in place for importers to hedge their exchange rate risk (IMF staff has provided technical assistance in this area). They are open to raising indicative*

[16] See "The Financial Stability Implications of Lasting Low Oil Prices for Algeria," IMF Country Report No. 16/128.

foreign exchange allocation ceilings but are concerned that the additional foreign exchange could end up feeding the parallel market. To help develop the interbank foreign exchange market, they have not excluded the possibility of relaxing surrender requirements. They agreed that inflation developments should be watched closely but stressed that inflation was driven mostly by structural supply factors. Staff agreed but emphasized that supply-driven inflation could feed into inflation expectations, which the central bank needs to anchor around its target. With the introduction of open market operations, they are planning to gradually phase out the discount window. They indicated that strengthening the macroprudential framework would be a priority in 2017.

STAFF APPRAISAL

35. **Nearly three years after the onset of the oil price shock, Algeria continues to face significant challenges.** The fiscal and current account deficits remain large despite sizeable fiscal adjustment in 2016. Savings in the oil stabilization fund have been nearly depleted, financing conditions have become more difficult, and payment delays have increased. International reserves remain comfortable but continue to decline rapidly. Excess liquidity in the banking system has dried up, and inflation is well above the Bank of Algeria's target of 4 percent. Overall growth has been resilient, but activity in the nonhydrocarbon has slowed. Unemployment has increased and remains particularly high among the youth and women.

36. **Algeria must undertake ambitious and sustained fiscal consolidation to restore fiscal sustainability, ensure intergenerational equity, and support external rebalancing.** After several years of expansive fiscal policy, the authorities are now committed to consolidating their fiscal position and have adopted for the first time a medium-term budget framework. They intend to pursue fiscal consolidation by controlling the wage bill, expanding subsidy reform while protecting the poor, mobilizing more nonhydrocarbon revenues, increasing the efficiency of investment, and reducing its cost. This approach is broadly in line with staff's advice.

37. **Nevertheless, there is some fiscal space to pursue a more gradual, growth friendly fiscal adjustment.** The fiscal consolidation built into the medium-term budget framework is extremely ambitious. Given relatively low levels of debt, staff believes Algeria could cut spending more gradually, with less impact on growth and employment. More gradual spending cuts would be possible if Algeria considered tapping a broader range of financing options, including external borrowing and the sale of state assets, and allowed further exchange rate depreciation.

38. **Wide-ranging structural reforms are needed to reduce the economy's reliance on hydrocarbons and transform the private sector into an engine for growth.** The authorities have made some progress improving the business environment and are working on a long-term strategy to reshape the country's growth model. Measures are needed to reduce red tape, improve access to finance, strengthen governance and transparency, make the labor market more effective, ensure that skills produced by the education system and sought by students match the needs of employers, foster greater female participation in the labor market, and further open the economy to foreign investment. The overall strategy should be designed and sequenced so that reforms reinforce each

other and the burden of economic adjustment is shared equitably. Action should be timely, as structural reforms take time to bear fruit.

39. The real effective exchange rate should gradually be brought closer to equilibrium, and efforts are needed to curb the parallel foreign exchange market. Although the net international investment position remains comfortable, the external balance is significantly weaker than warranted by medium-term fundamentals and desirable policy settings. Correcting the dinar's overvaluation will require not only fiscal consolidation and structural reforms but also further nominal depreciation. A weaker dinar would help address external imbalances, support private sector development, and raise hydrocarbon revenues in local currency.

40. Monetary policy should guard against emerging inflationary pressures. Consistent with staff's advice, the Bank of Algeria has appropriately transitioned to open market operations to manage liquidity. Financing via the discount window should be phased out to encourage banks to manage their liquidity more effectively. Considering growing inflationary pressures, the central bank should stand ready to increase its policy rate.

41. Financial sector policies should be further strengthened to address growing financial stability risks. Based on preliminary data, the banking sector as a whole remains adequately capitalized and profitable, but the oil price shock has increased liquidity, interest rate, and credit risks. It is therefore important to accelerate the transition to a risk-based supervisory framework, enhance the role of macroprudential policy, strengthen the governance of public banks, and develop a crisis resolution framework.

42. Staff recommends that the next Article IV consultation for Algeria be held on the standard 12-month cycle.

Table 1. Algeria: Selected Economic and Financial Indicators, 2014–22 1/

			Prel.			Proj.			
	2014	2015	2016	2017	2018	2019	2020	2021	2022
Output and prices	(Annual percentage change)								
Real GDP	3.8	3.8	3.5	1.3	0.7	1.5	1.7	2.2	2.3
Hydrocarbon sector	-0.6	0.4	6.1	1.3	2.2	2.2	2.4	2.4	2.4
Nonhydrocarbon sector	5.6	5.0	2.9	1.3	0.3	1.3	1.5	2.1	2.3
Consumer price index (period average)	2.9	4.8	6.4	4.8	4.3	4.0	4.0	4.0	4.0
Investment and savings	(In percent of GDP)								
Savings-investment balance	-4.4	-16.6	-16.9	-11.9	-9.7	-9.0	-7.7	-6.6	-6.5
National savings	43.4	35.2	34.2	35.3	29.0	30.2	31.6	33.6	35.0
Central government	6.5	2.5	2.4	10.3	8.5	9.1	10.2	10.4	10.7
Nongovernment 1/	36.9	32.6	31.8	25.0	20.5	21.2	21.4	23.2	24.3
Investment	47.8	51.7	51.0	47.2	38.6	39.2	39.2	40.2	41.5
Central government	14.5	18.3	16.3	13.3	11.1	10.6	10.0	9.8	9.7
Nongovernment 1/	33.3	33.4	34.7	33.9	27.5	28.6	29.2	30.4	31.8
Central government finances	(In percent of GDP)								
Overall budget balance	-8.0	-15.8	-14.0	-3.0	-2.7	-1.6	0.2	0.6	1.1
Revenue	33.4	30.8	29.5	34.3	30.9	30.4	30.2	30.2	30.3
Expenditure (incl. net lending)	41.3	46.6	43.5	37.3	33.5	32.0	30.1	29.7	29.2
Gross government debt	7.7	8.8	21.0	18.3	19.3	19.6	18.1	16.3	14.6
	(In percent of nonhydrocarbon GDP)								
Nonhydrocarbon primary balance	-37.7	-36.8	-28.5	-21.3	-20.9	-19.0	-16.5	-15.8	-15.0
Nonhydrocarbon balance	-38.0	-37.1	-28.9	-21.8	-21.3	-19.4	-17.0	-16.3	-15.4
Revenue	45.7	37.9	34.9	42.1	37.8	37.1	36.8	36.8	36.7
Hydrocarbon	27.0	17.6	12.3	18.1	18.0	17.5	17.1	17.0	16.7
Nonhydrocarbon	18.7	20.3	22.6	24.0	19.8	19.6	19.7	19.8	20.0
Expenditure	55.8	56.9	51.1	45.4	41.0	38.9	36.6	36.1	35.4
Current expenditure	35.8	34.3	31.8	29.1	27.3	26.0	24.4	24.1	23.7
Capital expenditure	19.9	22.6	19.3	16.3	13.7	13.0	12.2	12.0	11.7
External sector 2/									
Current account balance (percent of GDP)	-4.4	-16.6	-16.9	-11.9	-9.7	-9.0	-7.7	-6.6	-6.5
Exports, f.o.b. (percent change)	-6.8	-42.4	-15.9	27.4	0.9	0.0	1.7	3.4	2.4
Hydrocarbons	-7.8	-43.3	-16.4	29.0	0.8	-0.2	1.5	3.4	2.2
Nonhydrocarbons	55.4	-9.1	-6.2	-4.3	4.0	5.8	5.7	5.0	8.0
Imports, f.o.b. (percent change)	8.5	-11.8	-6.1	-0.1	-4.6	-1.1	-2.7	-0.6	1.8
Export volume (hydrocarbons, percent change)	-0.6	0.1	7.3	0.9	1.5	1.6	1.7	2.2	2.2
Import volume (percent change)	9.6	-7.5	-1.9	-2.2	-5.7	-2.2	-3.7	-1.7	1.0
Terms of trade (percent change, "-" = deterioration)	-6.3	-40.6	-18.6	25.2	-1.8	-2.8	-1.1	0.0	-0.8
Crude oil exports (in millions of barrels/day)	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Nonhydrocarbon exports (percent of total exports)	2.7	4.3	4.8	3.6	3.7	3.9	4.1	4.1	4.4
Gross official reserves (US$ billions)	177	143	113	93	79	66	55	46	38
In months of next year's imports of goods and services	33	28	23	20	17	14	12	10	8
Oil and gas sector									
Hydrocarbon production (in ton oil equivalent)	142	141	152	154	157	161	164	168	172
Hydrocarbon exports									
Of which: liquid petroleum exports (in millions of barrels/day)	1.2	1.2	1.2	1.2	1.3	1.3	1.3	1.3	1.4
Of which: natural gas exports (in billions of m3)	44.3	43.1	53.1	53.6	54.4	55.3	56.4	57.9	59.3
Crude oil export unit value (US$/bbl)	99.4	52.9	45.5	58.2	57.8	56.8	56.7	57.4	57.4
Share of hydrocarbons in total exports (in percent)	97.3	95.7	95.2	96.4	96.3	96.1	95.9	95.9	95.6
Money and credit	(Annual percentage change unless otherwise indicated)								
Net foreign assets	3.3	-2.4	-18.3	-16.9	-13.7	-15.0	-14.6	-14.5	-17.2
Credit to the economy	26.0	11.3	9.8	6.0	2.0	5.2	7.9	9.2	8.9
Money and quasi-money	14.4	0.3	1.8	7.2	4.3	5.1	5.5	6.2	6.1
Velocity of broad money (GDP/M2)	1.3	1.2	1.2	1.3	1.3	1.3	1.2	1.2	1.2
Memorandum items:									
GDP (in billions of dinars at current prices)	17,205	16,592	17,082	18,808	19,608	20,524	21,587	22,876	24,216
NHGDP (in billions of dinars at current prices)	12,547	13,458	14,440	15,316	15,992	16,818	17,721	18,792	19,952
GDP (in billions of US$ current prices)	214	165	156	168	172	177	182	189	196
GDP capita per (in US$)	5,459	4,123	3,829	4,056	4,069	4,101	4,154	4,244	4,335
Exchange rate (DA per US$)	80.6	100.7	109.4	...	...	...	...	...	...
REER (percent change)	2.0	-4.3	-2.0	...	...	...	...	...	...

Sources: Algerian authorities; and IMF staff estimates and projections.
1/ Including public enterprises.
2/ In U.S. dollars terms.

Table 2. Algeria: Balance of Payments, 2014–22

			Prel.			Proj.			
	2014	2015	2016	2017	2018	2019	2020	2021	2022
	(In billions of U.S. dollars; unless otherwise indicated)								
Current account	-9.4	-27.3	-26.3	-20.0	-16.7	-15.9	-14.0	-12.5	-12.7
Trade balance	0.3	-18.1	-20.4	-12.4	-9.7	-9.2	-7.3	-5.7	-5.6
Exports, f.o.b.	60.0	34.6	29.1	37.0	37.3	37.4	38.0	39.3	40.2
Hydrocarbons	58.4	33.1	27.7	35.7	36.0	35.9	36.4	37.7	38.5
Volume change (in percent)	-0.6	0.1	7.3	0.9	1.5	1.6	1.7	2.2	2.2
Price change (in percent)	-7.2	-43.4	-22.1	27.8	-0.7	-1.7	-0.1	1.2	0.0
Other	1.6	1.5	1.4	1.3	1.4	1.5	1.5	1.6	1.8
Imports, f.o.b.	-59.7	-52.6	-49.4	-49.4	-47.1	-46.6	-45.3	-45.0	-45.9
Volume change (in percent)	9.6	-7.5	-1.9	-2.2	-5.7	-2.2	-3.7	-1.7	1.0
Price change (in percent)	-1.0	-4.6	-4.3	2.1	1.2	1.1	1.0	1.2	0.8
Services and income (net)	-13.0	-12.0	-8.6	-10.4	-9.8	-9.8	-9.8	-10.1	-10.5
Services (net)	-8.2	-7.5	-7.2	-7.0	-6.6	-6.5	-6.2	-6.2	-6.3
Credit	3.5	3.5	3.6	3.7	3.6	3.6	3.6	3.6	3.6
Debit	-11.7	-11.0	-10.7	-10.7	-10.2	-10.1	-9.8	-9.8	-10.0
Income (net)	-4.9	-4.5	-1.5	-3.4	-3.3	-3.2	-3.5	-3.9	-4.2
Credit	3.2	2.2	2.4	1.6	1.8	1.8	1.6	1.5	1.3
Debit	-8.1	-6.6	-3.9	-5.0	-5.0	-5.1	-5.2	-5.3	-5.5
Interest payments	0.0	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other, including profit repatriation	-8.0	-6.5	-3.8	-4.9	-5.0	-5.0	-5.0	-5.2	-5.3
Transfers (net)	3.3	2.8	2.7	2.8	2.9	3.0	3.1	3.3	3.4
Capital account	3.6	-0.2	0.3	2.1	2.4	2.8	3.3	3.7	4.2
Medium- and long-term capital	1.3	-1.1	2.2	2.1	2.4	2.8	3.3	3.7	4.2
Direct investment (net)	1.5	-0.7	1.4	1.8	2.2	2.6	3.1	3.6	4.1
Loans (net)	-0.2	-0.4	0.8	0.2	0.2	0.2	0.2	0.1	0.1
Drawings	0.0	0.0	0.9	0.5	0.5	0.5	0.5	0.5	0.5
Amortization	-0.2	-0.4	-0.2	-0.3	-0.3	-0.3	-0.3	-0.4	-0.4
Short-term capital and errors and omissions	2.3	0.8	-1.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-5.9	-27.5	-26.0	-17.9	-14.2	-13.1	-10.7	-8.8	-8.5
Financing	5.9	27.5	26.0	17.9	14.2	13.1	10.7	8.8	8.5
Official reserves (increases -)	5.9	27.5	26.0	17.9	14.2	13.1	10.7	8.8	8.5
Memorandum items:									
Current account balance (in percent of GDP)	-4.4	-16.6	-16.9	-11.9	-9.7	-9.0	-7.7	-6.6	-6.5
Algerian crude oil price (US$/barrel) 1/	99.4	52.9	45.5	58.2	57.8	56.8	56.7	57.4	57.4
Gross official reserves (in billions of US$) 2/	177.4	142.6	112.9	93.3	79.0	65.9	55.2	46.4	37.8
Idem, in months of next year's imports	33.4	28.4	22.5	19.5	16.7	14.3	12.1	10.0	8.1
Reserves (in percent of ARA EM metric) 3/	783.1	832.9	686.1	345.8	263.9	208.5	164.4	132.3	104.6
Net international investment position (in billions of US$)	141.7	107.1	72.7	51.1	33.7	17.3	3.3	-9.2	-22.0
Net international investment position (in percent of GDP)	66.4	65.0	46.6	30.3	19.6	9.8	1.8	-4.9	-11.2
Gross external debt (in billions of US$)	3.6	3.0	3.9	4.3	4.6	4.8	5.0	5.2	5.3

Sources: Algerian authorities; and IMF staff estimates and projections.
1/ Weighted average of quarterly data.
2/ Excluding SDR holdings.
3/ ARA EM metric includes additional buffer for commodity intensive countries (projection period only).

Table 3. Algeria: Summary of Central Government Operations, 2014–22 1/
(In billions of Algerian dinars)

			Prel.			Proj.			
	2014	2015	2016	2017	2018	2019	2020	2021	2022
Budget revenue and grants	5,738	5,105	5,042	6,451	6,051	6,239	6,521	6,919	7,330
Hydrocarbon revenue 2/	3,388	2,375	1,781	2,771	2,881	2,936	3,039	3,201	3,337
Nonhydrocarbon revenue	2,350	2,730	3,261	3,680	3,170	3,303	3,482	3,717	3,993
Tax revenue	2,091	2,355	2,423	2,674	2,827	3,005	3,200	3,449	3,731
Taxes on income and profits	881	1,034	1,104	1,195	1,279	1,367	1,467	1,598	1,749
Taxes on goods and services	769	824	857	988	1,048	1,125	1,204	1,302	1,410
Customs duties	371	411	368	390	395	404	413	427	442
Registration and stamps	71	85	94	100	104	110	116	123	130
Nontax revenues	258	375	838	1,007	343	298	283	268	261
Fees	76	247	171	106	111	115	120	124	129
Bank of Algeria dividends and interests	123	89	611	840	168	116	92	69	53
Other	60	39	56	61	64	67	71	74	79
Grants	0	0	0	0	0	0	0	0	0
Total expenditure	6,996	7,656	7,384	6,956	6,550	6,550	6,481	6,783	7,069
Current expenditure	4,494	4,617	4,591	4,454	4,365	4,365	4,318	4,533	4,730
Personnel expenditure	1,941	2,127	2,186	2,199	2,195	2,191	2,188	2,321	2,487
Mudjahidins' pensions	218	223	198	207	212	216	225	234	243
Material and supplies	162	180	138	127	118	111	120	130	140
Current transfers	2,136	2,044	2,023	1,858	1,781	1,776	1,699	1,754	1,765
Interest payments	38	43	47	63	59	71	87	95	94
Capital expenditure	2,501	3,039	2,792	2,502	2,185	2,185	2,163	2,250	2,340
Budget balance	-1,258	-2,552	-2,341	-504	-499	-311	39	136	261
Overall balance	-1,376	-2,620	-2,387	-560	-527	-325	32	132	259
Primary overall balance	-1,338	-2,578	-2,340	-498	-468	-254	120	227	353
Nonhydrocarbon balance	-4,764	-4,995	-4,168	-3,332	-3,408	-3,261	-3,006	-3,069	-3,078
Financing	1,376	2,620	2,387	560	527	325	-32	-132	-259
Domestic	1,378	2,623	2,285	573	538	337	-24	-121	-246
Bank 3/	1,174	2,487	1,680	625	288	148	-58	-107	-217
Nonbank 4/	204	137	605	-52	250	189	34	-14	-28
Foreign	-2	-3	102	-12	-11	-12	-9	-11	-13
Memorandum items									
Oil stabilization fund									
in billions of Algerian dinars	4,408	2,074	784	82	0	0	0	0	105
in percent of GDP	25.6	12.5	4.6	0.4	0.0	0.0	0.0	0.0	0.4
Gross government debt (in percent of GDP)	7.7	8.8	21.0	18.3	19.3	19.6	18.1	16.3	14.6
Net savings (in percent of GDP)	17.9	3.7	-16.4	-17.9	-19.3	-19.6	-18.1	-16.3	-14.1

Sources: Algerian authorities; and IMF staff estimates and projections.
1/ On cash basis.
2/ Including Sonatrach dividends.
3/ Bank financing includes domestic debt issuance and a drawdown of the oil stabilization fund and other government deposits at the central bank.
4/ Includes proceeds from sales of state-owned assets.

Table 4. Algeria: Summary of Central Government Operations, 2014–22 1/
(In percent of GDP)

	2014	2015	2016 Prel.	2017	2018	2019 Proj.	2020	2021	2022
Budget revenue and grants	33.4	30.8	29.5	34.3	30.9	30.4	30.2	30.2	30.3
Hydrocarbon revenue 2/	19.7	14.3	10.4	14.7	14.7	14.3	14.1	14.0	13.8
Nonhydrocarbon revenue	13.7	16.5	19.1	19.6	16.2	16.1	16.1	16.2	16.5
Tax revenue	12.2	14.2	14.2	14.2	14.4	14.6	14.8	15.1	15.4
Nontax revenues	1.5	2.3	4.9	5.4	1.8	1.5	1.3	1.2	1.1
o/w Bank of Algeria dividends and interests	0.7	0.5	3.6	4.5	0.9	0.6	0.4	0.3	0.2
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	40.7	46.1	43.2	37.0	33.4	31.9	30.0	29.7	29.2
Current expenditure	26.1	27.8	26.9	23.7	22.3	21.3	20.0	19.8	19.5
Personnel expenditure	11.3	12.8	12.8	11.7	11.2	10.7	10.1	10.1	10.3
Current transfers	12.4	12.3	11.8	9.9	9.1	8.7	7.9	7.7	7.3
Capital expenditure	14.5	18.3	16.3	13.3	11.1	10.6	10.0	9.8	9.7
Budget balance	-7.3	-15.4	-13.7	-2.7	-2.5	-1.5	0.2	0.6	1.1
Overall balance	-8.0	-15.8	-14.0	-3.0	-2.7	-1.6	0.2	0.6	1.1
Overall balance (excluding Bank of Algeria dividends)	-8.7	-16.3	-17.5	-7.4	-3.5	-2.1	-0.3	0.3	0.9
Primary overall balance	-7.8	-15.5	-13.7	-2.6	-2.4	-1.2	0.6	1.0	1.5
Nonhydrocarbon balance	-27.7	-30.1	-24.4	-17.7	-17.4	-15.9	-13.9	-13.4	-12.7
Financing	8.0	15.8	14.0	3.0	2.7	1.6	-0.2	-0.6	-1.1
Domestic	8.0	15.8	13.4	3.0	2.7	1.6	-0.1	-0.5	-1.0
Bank 3/	6.8	15.0	9.8	3.3	1.5	0.7	-0.3	-0.5	-0.9
Nonbank	1.2	0.8	3.5	-0.3	1.3	0.9	0.2	-0.1	-0.1
Foreign	0.0	0.0	0.6	-0.1	-0.1	-0.1	0.0	0.0	-0.1
				(In percent of non-oil GDP)					
Budget revenue and grants	45.7	37.9	34.9	42.1	37.8	37.1	36.8	36.8	36.7
Hydrocarbon revenue 2/	27.0	17.6	12.3	18.1	18.0	17.5	17.1	17.0	16.7
Nonhydrocarbon revenue	18.7	20.3	22.6	24.0	19.8	19.6	19.7	19.8	20.0
Tax revenue	16.7	17.5	16.8	17.5	17.7	17.9	18.1	18.4	18.7
Nontax revenues	2.1	2.8	5.8	6.6	2.1	1.8	1.6	1.4	1.3
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	55.8	56.9	51.1	45.4	41.0	38.9	36.6	36.1	35.4
Current expenditure	35.8	34.3	31.8	29.1	27.3	26.0	24.4	24.1	23.7
Capital expenditure	19.9	22.6	19.3	16.3	13.7	13.0	12.2	12.0	11.7
Budget balance	-10.0	-19.0	-16.2	-3.3	-3.1	-1.9	0.2	0.7	1.3
Overall balance	-11.0	-19.5	-16.5	-3.7	-3.3	-1.9	0.2	0.7	1.3
Primary overall balance	-10.7	-19.2	-16.2	-3.2	-2.9	-1.5	0.7	1.2	1.8
Nonhydrocarbon balance	-38.0	-37.1	-28.9	-21.8	-21.3	-19.4	-17.0	-16.3	-15.4
Nonhydrocarbon balance (excluding Bank of Algeria dividends)	-38.9	-37.8	-33.1	-27.2	-22.4	-20.1	-17.5	-16.7	-15.7
Financing	11.0	19.5	16.5	3.7	3.3	1.9	-0.2	-0.7	-1.3
Domestic	11.0	19.5	15.8	3.7	3.4	2.0	-0.1	-0.6	-1.2
Bank 3/	9.4	18.5	11.6	4.1	1.8	0.9	-0.3	-0.6	-1.1
Nonbank 4/	1.6	1.0	4.2	-0.3	1.6	1.1	0.2	-0.1	-0.1
Foreign	0.0	0.0	0.7	-0.1	-0.1	-0.1	0.0	-0.1	-0.1

Sources: Algerian authorities; and IMF staff estimates and projections.
1/ On cash basis.
2/ Including Sonatrach dividends.
3/ Bank financing includes domestic debt issuance and a drawdown of the oil stabilization fund and other government deposits at the central bank.
4/ Includes proceeds from sales of state-owned assets.

Table 5. Algeria: Monetary Survey, 2014–22

			Prel.			Proj.			
	2014	2015	2016	2017	2018	2019	2020	2021	2022
	(In billions of Algerian dinars; at end of period)								
Net foreign assets	15,602	15,222	12,443	10,336	8,919	7,583	6,476	5,536	4,584
Of which: Bank of Algeria	15,695	15,373	12,544	10,398	8,950	7,590	6,465	5,510	4,547
Foreign assets (BA)	15,850	15,553	12,725	10,582	9,138	7,782	6,660	5,710	4,750
Foreign liabilities (BA)	155	181	181	184	188	192	196	199	203
Foreign assets (comm. banks)	45	57	62	64	65	66	68	69	70
Foreign liabilities (comm. banks)	138	208	164	125	96	73	56	43	33
Net domestic assets	-1,938	-1,517	1,502	4,614	6,673	8,806	10,815	12,825	14,894
Domestic credit	3,102	6,648	9,541	10,651	11,110	11,714	12,383	13,184	13,931
Credit to government (net) 1/	-3,503	-702	1,467	2,092	2,380	2,528	2,471	2,363	2,146
Credit to the economy	6,604	7,350	8,074	8,559	8,731	9,186	9,912	10,821	11,784
Of which: Private sector	3,162	3,629	4,048	4,327	4,452	4,732	5,162	5,697	6,271
Other items net	-5,039	-8,165	-8,039	-6,036	-4,437	-2,908	-1,568	-359	963
Money and quasi-money (M2)	13,664	13,705	13,945	14,950	15,592	16,389	17,291	18,361	19,478
Excluding Sonatrach deposits	12,839	13,218	13,446	14,263	14,892	15,661	16,502	17,500	18,580
Money	9,580	9,261	9,542	10,121	10,568	11,114	11,711	12,418	13,185
Quasi-money	4,084	4,443	4,403	4,829	5,025	5,275	5,581	5,943	6,293
	(In percent change over 12-month period)								
Money and quasi-money (M2)	14.4	0.3	1.8	7.2	4.3	5.1	5.5	6.2	6.1
Of which: Money	16.1	-3.3	3.0	6.1	4.4	5.2	5.4	6.0	6.2
Credit to the economy	26.0	11.3	9.8	6.0	2.0	5.2	7.9	9.2	8.9
Of which: Private sector	15.1	14.8	11.6	6.9	2.9	6.3	9.1	10.4	10.1
Memorandum items:									
Liquidity ratio (average M2/GDP)	79.4	82.6	81.6	79.5	79.5	79.9	80.1	80.3	80.4
Liquidity ratio (e.o.p. M2/NHGDP)	108.9	101.8	96.6	97.6	97.5	97.4	97.6	97.7	97.6
M2 velocity	1.259	1.211	1.225	1.258	1.258	1.252	1.248	1.246	1.243
Credit to the economy/GDP	38.4	44.3	47.3	45.5	44.5	44.8	45.9	47.3	48.7
Credit to the economy/NHGDP	52.6	54.6	55.9	55.9	54.6	54.6	55.9	57.6	59.1
Credit to private sector/NHGDP	25.2	27.0	28.0	28.2	27.8	28.1	29.1	30.3	31.4

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

1/ Net credit to government excludes Treasury postal accounts ("dépôts CCP") deposited at the BA.

Table 6. Algeria: Financial Soundness Indicators, 2009–16

(In percent)

	2009	2010	2011	2012	2013	2014	2015	2016 (Prel.)
Capital adequacy ratio	26.2	23.6	23.7	23.4	21.5	16.0	18.7	18.9
- Public banks	23.9	21.7	21.9	21.6	19.9	14.9	18.0	18.5
- Private banks	35.2	31.6	31.2	31.9	28.5	20.9	21.3	20.4
Tier I capital adequacy ratio	19.1	17.7	16.9	17.3	15.5	13.3	15.9	16.4
- Public banks	15.6	14.8	14.1	14.7	13.1	11.7	14.7	15.6
- Private banks	32.9	29.3	28.8	29.5	26.3	20.2	20.4	19.7
NPLs net of provisions/Tier I capital	33.9	21.1	19.4	16.2	17.1	21.4	25.4	32.9
- Public banks	46.0	27.5	25.1	20.4	21.7	26.8	28.2	37.3
- Private banks	1.5	3.0	2.3	3.4	2.6	4.6	16.0	16.6
NPLs/total loans	21.1	18.3	14.5	11.5	10.6	9.2	9.8	11.4
- Public banks	23.6	20.5	16.1	12.4	11.4	9.7	9.9	12.0
- Private banks	3.8	4.1	4.0	5.2	4.8	5.1	8.8	7.8
NPLs net of provisions/total loans	7.3	4.9	4.4	3.5	3.4	3.2	3.8	5.1
- Public banks	8.3	5.4	4.9	3.8	3.7	3.4	3.7	5.2
- Private banks	0.7	1.4	1.0	1.5	0.9	1.4	4.8	4.2
Provisions/classified loans	65.4	76.5	69.8	69.5	68.2	65.2	61.2	55.4
- Public banks	65.0	73.7	69.6	69.4	67.4	64.8	63.0	56.3
- Private banks	82.0	66.7	75.9	71.7	80.3	71.9	44.9	46.3
Return on equity	26.0	16.7	24.7	23.3	19.0	23.6	21.6	19.4
- Public banks	27.9	29.8	26.1	22.7	17.9	25.1	23.4	20.8
- Private banks	20.9	20.3	21.4	24.8	21.6	19.6	16.3	15.1
Return on assets	1.8	2.2	2.1	2.0	1.7	2.0	1.9	1.9
- Public banks	1.5	1.8	1.8	1.6	1.3	1.8	1.8	1.8
- Private banks	3.7	4.6	4.5	4.6	3.8	3.3	3.2	2.8
Interest margin/gross revenues	58.4	63.8	64.9	67.2	68.2	68.5	66.8	72.4
- Public banks	60.4	71.6	73.6	78.1	71.5	68.4	65.8	72.1
- Private banks	52.5	44.2	44.4	41.6	59.1	69.1	71.5	73.4
Non-interest expenses/earnings before tax	32.2	31.4	33.6	33.2	33.5	28.5	26.2	28.1
- Public banks	33.7	31.6	34.8	34.7	33.9	26.9	24.1	25.4
- Private banks	31.0	31.0	30.8	29.5	32.3	34.4	36.0	38.2
Liquid assets/total assets	51.8	53.0	50.2	45.9	40.5	38.0	27.2	27.5
- Public banks	52.8	54.2	51.1	45.1	39.4	37.0	25.9	27.4
- Private banks	44.7	43.7	43.2	50.9	46.5	44.0	35.9	28.1
Liquid assets/short-term debt	114.5	114.3	103.7	107.5	93.5	82.1	61.6	67.3
- Public banks	118.4	118.1	106.6	110.5	95.7	83.4	60.2	70.4
- Private banks	89.0	88.5	84.6	93.5	84.1	75.4	69.8	52.8

Source: Bank of Algeria

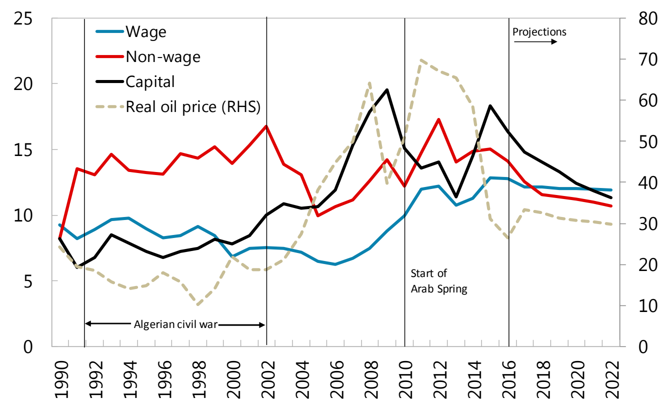
Annex I. Alternative Scenario

Staff discussed an alternative scenario consistent with its recommended policy mix. The scenario assumes the use of available fiscal space for a more gradual fiscal consolidation combined with further exchange rate depreciation and more ambitious structural reforms. The purpose of the scenario is to illustrate that a different policy mix could lead to better macroeconomic outcomes.

In the alternative scenario, fiscal policy is anchored by gradually stabilizing public debt at around 30 percent of GDP, a level higher than the authorities' plan, but moderate enough (by emerging market standards) to leave enough buffers should fiscal risks related to the price of oil or contingent liabilities materialize. Specific key assumptions are as follows:

- Both current and capital expenditures decline more slowly than in the baseline scenario. Current spending falls to 22.6 percent of GDP in 2022 (compared to 19.5 percent in the baseline scenario). Both wage and non-wage current spending decline gradually. Capital spending falls to 11.3 percent of GDP in 2022 (versus 9.7 percent in the baseline scenario).

Expenditures - Alternative Scenario
(Percent of GDP)



Sources: Algerian authorities; and IMF staff calculations.

- Tax revenues rise to 19.5 percent of nonhydrocarbon GDP in 2022 (compared to 18.7 percent in the baseline scenario), reflecting deeper subsidy reform, a greater reduction in tax exemptions, and improved tax administration.

- To finance larger deficits, the government borrows externally as well as domestically.

- The REER is assumed to depreciate by 10 percent over the projection period, whereas it is nearly stable in the baseline scenario.

- Deeper subsidy reform dampens domestic energy consumption, providing a boost to hydrocarbon exports.

- Efforts to diversify and liberalize the economy gradually result in more nonhydrocarbon exports, FDI, and tourism receipts.

Growth projections, both in the baseline and alternative scenarios, are based on fiscal multipliers estimated using Algeria-specific data:

Fiscal Multipliers Used in Staff's Scenarios

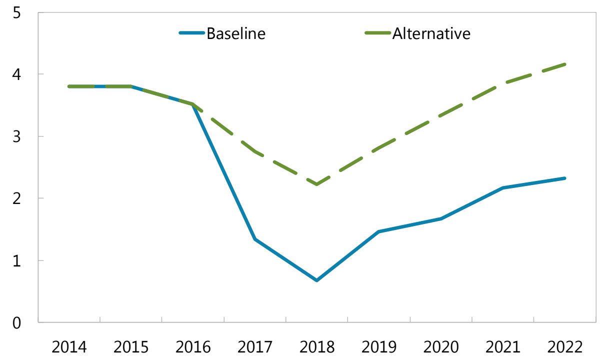
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Government consumption	0.6	0.1	0.1	0.0	0.0	0.0
Subsidies	0.6	0.1	0.1	0.0	0.0	0.0
Capital expenditure	0.4	0.2	0.2	0.4	0.4	0.0
Tax revenue	0.0	0.0	0.0	0.0	0.0	0.0

Source: IMF staff calculations

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

Alternative and Baseline Scenarios

Real GDP Growth
(Percent)



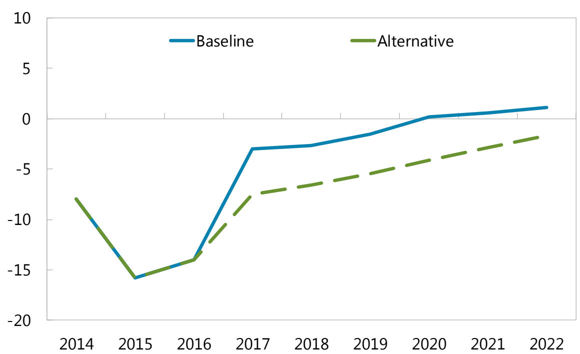
Sources: Algerian authorities; and IMF staff calculations.

Overall growth

Baseline: Growth slows sharply under the effects of the authorities' medium-term fiscal consolidation plan.

Alternative: Growth declines more slowly mainly owing to more gradual fiscal consolidation, supported by greater exchange rate depreciation. More ambitious structural reforms allow for some productivity gains that gradually help increase potential growth toward the end of the projection period.

Fiscal Balance
(Percent of GDP)



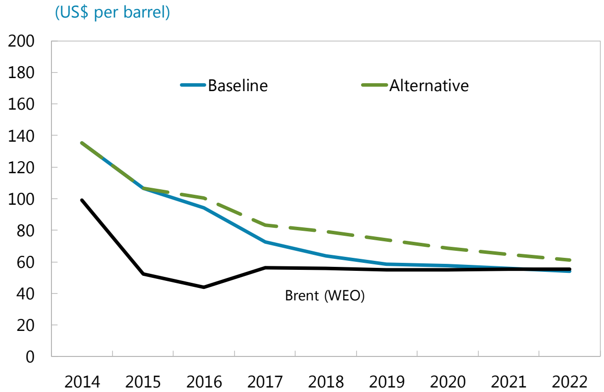
Sources: Algerian authorities; and IMF staff calculations.

Fiscal balance

Baseline: Under the authorities' medium-term fiscal consolidation plan, the deficit reaches equilibrium by 2020.

Alternative: The fiscal deficit declines more gradually over the medium term, approaching equilibrium by 2022.

Fiscal Breakeven Price
(US$ per barrel)



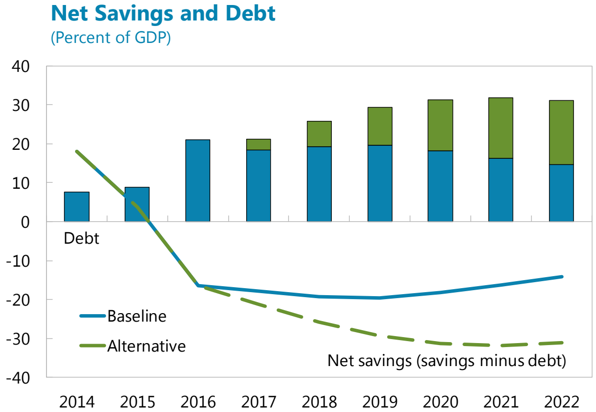
Sources: Algerian authorities; and IMF staff calculations.

Fiscal breakeven price

Baseline: The fiscal breakeven price declines below the WEO oil price forecast in 2022.

Alternative: The fiscal breakeven price declines more gradually over time, approaching the WEO oil price forecast in 2022.

Alternative and Baseline Scenarios (concluded)

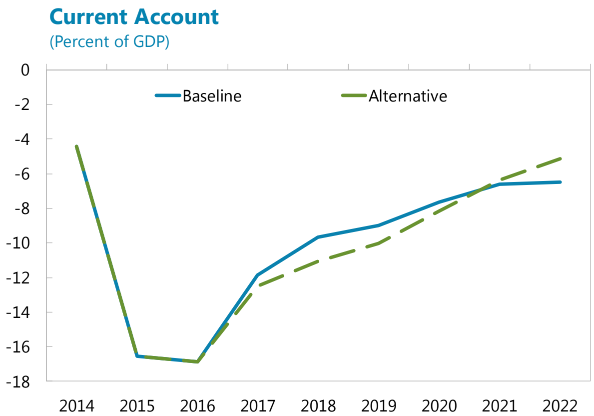


Sources: Algerian authorities; and IMF staff calculations.

Net savings and debt

Baseline: Net savings decline initially as fiscal savings are depleted, but start to increase in 2020 as debt falls. Debt declines to 14.6 percent of GDP by 2022.

Alternative: Net savings decline throughout most of the projection period, but stabilize by 2022. Debt stabilizes at around 30 percent of GDP, reflecting larger budget deficits and more debt financing.

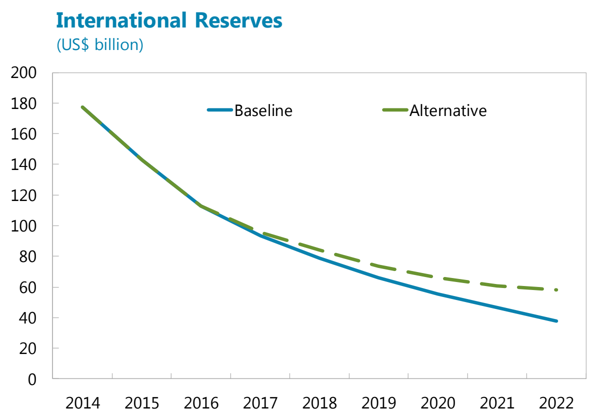


Sources: Algerian authorities; and IMF staff calculations.

Current account balance

Baseline: The current account deficit declines over the medium term as a result of the government's medium-term fiscal consolidation plan.

Alternative: The current account deficit initially declines more slowly than in the baseline scenario, reflecting more gradual fiscal consolidation. However, toward the end of the projection period, the deficit narrows further than in the baseline scenario thanks to greater exchange rate depreciation and more ambitious structural reforms to diversify the economy.



Sources: Algerian authorities; and IMF staff calculations.

International reserves

Baseline: Reserves decline to 8 months of imports by 2022.

Alternative: Reserves also decline but remain above 11 months of imports by 2022.

Algeria: Selected Economic and Financial Indicators, 2014–22 (Alternative Scenario)

			Est.			Proj.			
	2014	2015	2016	2017	2018	2019	2020	2021	2022
Output and prices					(Annual percentage change)				
Real GDP	3.8	3.8	3.5	2.7	2.2	2.8	3.3	3.8	4.2
Hydrocarbon sector	-0.6	0.4	6.1	1.6	2.4	2.5	2.8	2.8	2.9
Nonhydrocarbon sector	5.6	5.0	2.9	3.0	2.2	2.9	3.5	4.1	4.4
Consumer price index (period average)	2.9	4.8	6.4	5.5	5.0	4.5	4.0	4.0	4.0
Investment and savings					(In percent of GDP)				
Savings-investment balance	-4.4	-16.6	-16.9	-12.5	-11.1	-10.0	-8.2	-6.4	-5.1
National savings	43.4	35.2	34.2	37.2	38.1	39.7	41.7	44.0	45.6
Central government	6.5	2.5	2.4	7.3	7.5	7.8	8.3	9.0	9.7
Nongovernment 1/	36.9	32.6	31.8	29.9	30.6	31.9	33.4	35.0	35.9
Investment	47.8	51.7	51.0	49.7	49.2	49.7	49.8	50.4	50.7
Central government	14.5	18.3	16.3	14.8	14.1	13.3	12.4	11.9	11.3
Nongovernment 1/	33.3	33.4	34.7	34.9	35.1	36.4	37.4	38.5	39.4
Central government finances					(In percent of GDP)				
Overall budget balance	-8.0	-15.8	-14.0	-7.5	-6.6	-5.5	-4.1	-2.9	-1.7
Revenue	33.4	30.8	29.5	32.0	31.1	31.3	31.6	32.0	32.3
Expenditure (incl. net lending)	41.3	46.6	43.5	39.5	37.7	36.7	35.7	34.9	34.0
Gross government debt	7.7	8.8	21.0	21.2	25.9	29.3	31.2	31.7	31.0
					(In percent of nonhydrocarbon GDP)				
Nonhydrocarbon primary balance	-37.7	-36.8	-28.5	-27.1	-26.0	-24.2	-22.3	-20.9	-19.4
Nonhydrocarbon balance	-38.0	-37.1	-28.9	-27.5	-26.5	-24.9	-23.3	-22.1	-20.7
Revenue	45.7	37.9	34.9	39.3	38.2	38.2	38.6	39.1	39.5
Hydrocarbon	27.0	17.6	12.3	18.3	18.4	18.2	18.3	18.6	18.7
Nonhydrocarbon	18.7	20.3	22.6	21.0	19.8	20.0	20.4	20.5	20.8
Expenditure	55.8	56.9	51.1	48.5	46.3	44.9	43.7	42.7	41.5
Current expenditure	35.8	34.3	31.8	30.3	29.1	28.7	28.5	28.1	27.7
Capital expenditure	19.9	22.6	19.3	18.2	17.3	16.2	15.2	14.5	13.9
External sector 2/									
Current account balance (percent of GDP)	-4.4	-16.6	-16.9	-12.5	-11.1	-10.0	-8.2	-6.4	-5.1
Exports, f.o.b. (percent change)	-6.8	-42.4	-15.9	28.3	1.9	1.9	4.0	6.3	6.5
Hydrocarbons	-7.8	-43.3	-16.4	29.6	1.3	1.0	2.9	4.9	3.9
Nonhydrocarbons	55.4	-9.1	-6.2	3.5	15.2	20.8	25.1	27.7	38.6
Imports, f.o.b. (percent change)	8.5	-11.8	-6.1	2.5	-1.4	-0.6	-1.9	0.0	2.3
Export volume (hydrocarbons, percent change)	-0.6	0.1	7.3	1.3	2.0	2.8	3.0	3.7	3.9
Import volume (percent change)	-1.0	-4.6	-4.3	2.1	1.2	1.1	1.0	1.2	0.8
Terms of trade (percent change, "-" = deterioration)	-6.3	-40.6	-18.6	25.2	-1.8	-2.8	-1.1	0.0	-0.8
Crude oil exports (in millions of barrels/day)	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.7
Nonhydrocarbon exports (percent of total exports)	2.7	4.3	4.8	3.9	4.4	5.2	6.2	7.5	9.7
Gross official reserves (US$ billions)	177	143	113	95	84	74	66	61	58
In months of next year's imports of goods and services	33	28	22	19	17	15	13	12	11
Oil and gas sector									
Hydrocarbon production (in ton oil equivalent)	142	141	152	154	158	162	166	171	176
Hydrocarbon exports									
Of which: liquid petroleum exports (in millions of barrels/day)	1.2	1.2	1.2	1.3	1.3	1.3	1.4	1.4	1.5
Of which: natural gas exports (in billions of m3)	44.3	43.1	53.1	53.6	54.4	55.3	56.4	57.9	59.3
Crude oil export unit value (US$/bbl)	99.4	52.9	45.5	58.2	57.8	56.8	56.7	57.4	57.4
Share of hydrocarbons in total exports (in percent)	97.3	95.7	95.2	96.1	95.6	94.8	93.8	92.5	90.3
Money and credit					(Annual percentage change unless otherwise indicated)				
Net foreign assets	3.3	-2.4	-18.3	-12.5	-7.4	-8.1	-5.8	-3.1	0.3
Credit to the economy	26.0	11.3	9.8	8.7	4.3	5.5	7.7	9.7	11.5
Money and quasi-money	14.4	0.3	1.8	10.2	7.4	7.9	8.3	8.9	9.0
Velocity of broad money (GDP/M2)	1.3	1.2	1.2	1.3	1.3	1.3	1.3	1.2	1.2
Memorandum items:									
GDP (in billions of dinars at current prices)	17,205	16,592	17,082	19,339	20,771	22,324	24,108	26,227	28,543
NHGDP (in billions of dinars at current prices)	12,547	13,458	14,440	15,737	16,923	18,253	19,718	21,433	23,360
GDP (in billions of US$ current prices)	214	165	156	168	172	176	181	188	195
GDP capita per (in US$)	5,459	4,123	3,829	4,052	4,067	4,089	4,131	4,209	4,294
Exchange rate (DA per US$)	80.6	100.7	109.4	…	…	…	…	…	…
REER (percent change)	2.0	-4.3	-2.0	…	…	…	…	…	…

Sources: Algerian authorities; and IMF staff estimates and projections.
1/ Including public enterprises.
2/ In U.S. dollars terms.

Annex II. Public Debt Sustainability Analysis

During the oil price boom, Algeria repaid most of its debt and accumulated large fiscal savings. Since the onset of the oil price shock, fiscal savings have been nearly depleted to finance large fiscal deficits, allowing debt to remain low. The authorities initially took little fiscal policy action in response to the shock, but they are now planning to undertake substantial fiscal consolidation over the medium term. Under the authorities' medium-term fiscal plan, debt levels are projected to remain low, and stress tests suggest that financing needs are not sensitive to shocks. However, international experience suggests that such a consolidation plan may be difficult to achieve. Moreover, fiscal risks are numerous and could lead to further increases in debt.

The oil price shock, together with an initially timid policy response, led to a rapid deterioration of the fiscal position. The policy response to the shock was initially limited to exchange rate depreciation, while spending remained high. Consequently, lower oil prices translated into large fiscal deficits that Algeria was able to finance by drawing on its fiscal savings. More than two years into the shock, fiscal savings are now almost depleted, having declined from a peak of 43.3 percent of GDP in 2009 to 4.6 percent in 2016. Nevertheless, despite little new borrowing, government debt increased from 8.8 percent of GDP in 2015 to 21.0 percent of GDP in 2016 following the purchase of debt owed by a utility company to a public bank and the issuance of bonds to the state-owned oil company to compensate for losses incurred from selling imported refined fuel in the domestic market at subsidized prices (Box 3).

Algeria's domestic debt consists of Treasury securities and restructured debt purchased from public enterprises. At end-2016, Algeria's domestic debt amounted to DZD 3,407 billion (equivalent to 19.9 percent of GDP). Of this amount, DZD 978 billion consisted of regularly-issued Treasury securities with maturities ranging from 13 weeks to 15 years. Most of this debt is held by banks and insurance companies. The National Bond for Economic Growth, a local-currency bond issued by the government in 2016, accounted for another DZD 569 billion. The remaining DZD 1,861 billion resulted from government operations to support public enterprises. Most of these operations took place between 2009 and 2016. Government-guaranteed domestic debt amounted to DZD 3,163 billion, equal to 18.5 percent of GDP.

External public debt is minimal and mostly owed to official bilateral creditors. At end-2016, Algeria's external public debt was equal to just US$1.6 billion (1.0 percent of GDP). Most of this debt is owed to official bilateral creditors and is on concessional terms. Algeria repaid the last of its debt to the IMF in 2005 and prepaid its outstanding balance to the Paris Club group of creditors in 2006. Since 2006, external debt has remained less than US$3 billion. In 2016, the African Development Bank (AfDB) provided Algeria a €900 million budget support loan—the AfDB's first loan to Algeria in 12 years.

Under the authorities' fiscal consolidation plan, debt would decline over the medium term. In this scenario, gross financing needs decline sharply, averaging 2.3 percent of GDP over the period. The government is assumed to deplete its fiscal savings in 2017. Thereafter, financing needs are met by domestic debt issuance and by using the deposits of public entities. The ratio of debt (including guarantees) to GDP falls from 39.5 percent in 2016 to 27.6 percent in 2022.

Central Government Debt, end-2016

	US$ billion	DZD billion	Percent of GDP
Total debt	32.3	3,582.1	21.0
External debt	1.6	174.8	1.0
Domestic debt	30.7	3,407.3	19.9
Treasury securities	8.8	977.5	5.7
National Bond for Economic Growth	5.1	569.1	3.3
Debt from financial support operations	16.8	1860.7	10.9
Guaranteed domestic debt	28.5	3163.3	18.5

The authorities' fiscal consolidation plan is exceptionally ambitious. The degree of deficit reduction ranks in the top 1 percent of fiscal consolidations recorded between 1990 and 2010 among advanced and emerging economies with debt greater than 60 percent of GDP. The drastic nature of the authorities' fiscal consolidation plan appears to be motivated in part by a reluctance to incur debt (particularly external debt) and allow further exchange rate depreciation.

Under alternative scenarios and stress tests, debt levels are resilient to shocks and gross financing needs remain limited. Assuming that the primary balance remains constant at its 2016 level (i.e., no fiscal adjustment), public debt would increase to 39.4 percent by 2022—much lower than the 70 percent benchmark for emerging market countries. Projected gross financing needs are not sensitive to shocks given the size of the consolidation assumed in the baseline scenario.[1]

[1] The heat map on page 43 indicates that gross financing needs are a risk in the baseline scenario and certain shock scenarios. In fact, gross financing needs exceed the benchmark of 15 percent of GDP only in 2016; over the projection period, they remain well below the benchmark. The government was able to meet its financing needs in 2016 mainly by drawing down savings in the FRR and by borrowing domestically.

Algeria: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP unless otherwise indicated)

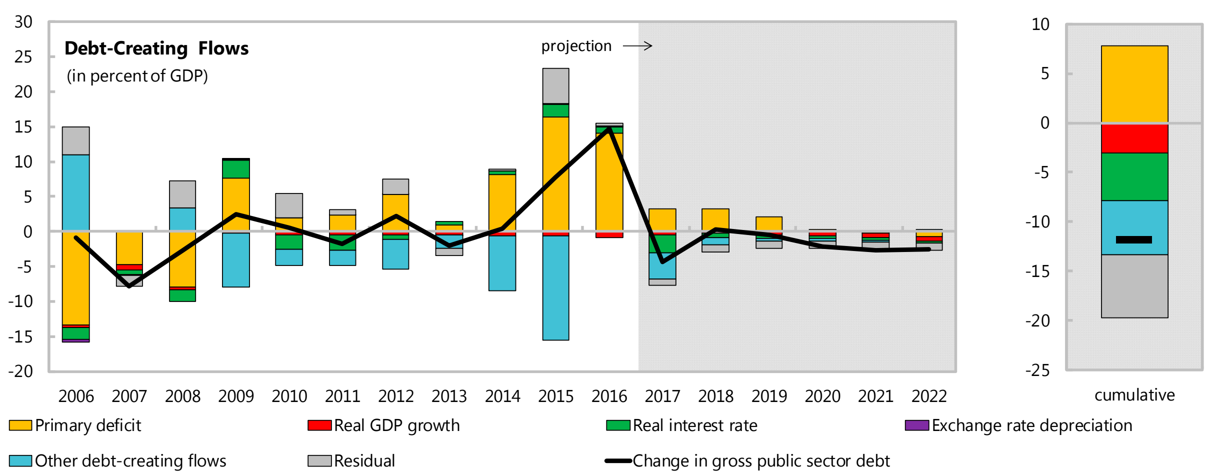
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	18.2	24.8	39.5	35.1	35.4	35.0	32.8	30.1	27.6
Of which: guarantees	7.2	16.0	18.5	16.8	16.1	15.4	14.7	13.8	13.1
Public gross financing needs	6.0	17.4	15.2	4.2	3.3	3.5	2.6	0.7	-0.2
Real GDP growth (in percent)	2.8	3.8	3.5	1.3	0.7	1.5	1.7	2.2	2.3
Inflation (GDP deflator, in percent)	6.9	-7.1	-0.5	8.7	3.6	3.2	3.5	3.7	3.5
Nominal GDP growth (in percent)	10.0	-3.6	3.0	10.1	4.3	4.7	5.2	6.0	5.9
Effective interest rate (in percent) [4/]	3.6	3.2	3.2	1.8	1.7	1.9	2.2	2.4	2.5

As of April 08, 2016		
Sovereign Spreads 3/		
EMBIG (bp)		n.a.
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	n.a.	n.a.
Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-1.1	7.8	14.7	-4.4	0.3	-0.4	-2.2	-2.7	-2.5	-11.8	
Identified debt-creating flows	-2.4	2.8	14.2	-3.4	1.3	0.7	-1.1	-1.6	-1.4	-5.5	
Primary deficit	0.0	16.4	14.0	3.3	3.2	2.0	0.2	-0.2	-0.7	7.8	-0.7
Primary (noninterest) revenue and grants	38.3	29.9	29.2	33.7	30.1	29.6	29.4	29.5	29.5	181.7	
Primary (noninterest) expenditure	38.4	46.3	43.2	36.9	33.2	31.6	29.7	29.2	28.8	189.5	
Automatic debt dynamics [5/]	-1.1	1.3	0.1	-3.0	-0.9	-0.9	-1.0	-1.1	-0.9	-7.8	
Interest rate/growth differential [6/]	-1.1	1.2	0.1	-3.0	-0.9	-0.9	-1.0	-1.1	-0.9	-7.8	
Of which: real interest rate	-0.6	1.9	0.9	-2.5	-0.6	-0.5	-0.4	-0.4	-0.3	-4.7	
Of which: real GDP growth	-0.5	-0.7	-0.8	-0.5	-0.2	-0.5	-0.6	-0.7	-0.7	-3.1	
Exchange rate depreciation [7/]	0.0	0.1	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	-1.3	-14.9	0.1	-3.7	-1.0	-0.4	-0.3	-0.3	0.2	-5.5	
FRR withdrawal (+) or accumulation (-) (negative)	2.6	-14.1	-7.5	-3.7	-0.4	0.0	0.0	0.0	0.4	-3.7	
Contingent liabilities	0.0	0.0	8.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Deposits of public entities (- reduces financing need)	-3.9	-0.8	-1.2	0.0	-0.6	-0.4	-0.3	-0.3	-0.2	-1.8	
Residual, including asset changes [8/]	1.3	5.0	0.5	-0.9	-1.1	-1.1	-1.1	-1.1	-1.1	-6.3	



Source: IMF staff.

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

2/ Based on available data.

3/ Spreads are not available due to the lack of international bonds.

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

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

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

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

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

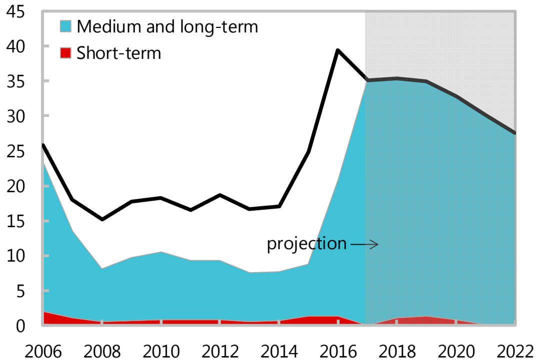
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Algeria: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

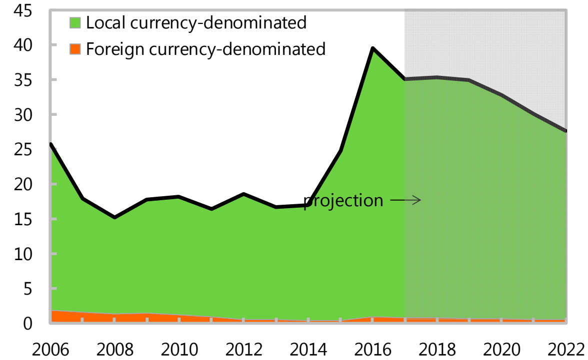
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

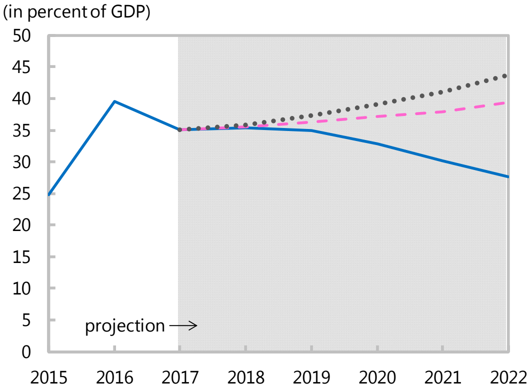


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

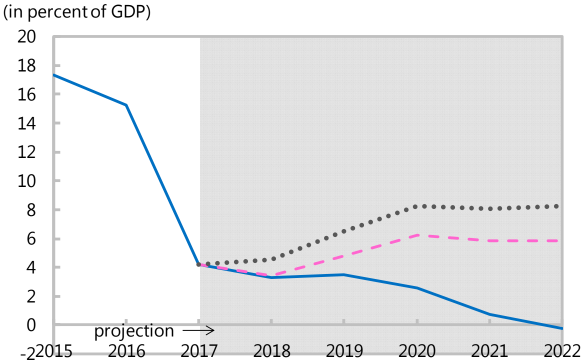
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	1.3	0.7	1.5	1.7	2.2	2.3
Inflation (GDP deflator)	8.7	3.6	3.2	3.5	3.7	3.5
Primary budget balance	-3.3	-3.2	-2.0	-0.2	0.2	0.7
Effective interest rate	1.8	1.7	1.9	2.2	2.4	2.5
Constant Primary Balance Scenario						
Real GDP growth	1.3	0.7	1.5	1.7	2.2	2.3
Inflation (GDP deflator)	8.7	3.6	3.2	3.5	3.7	3.5
Primary budget balance	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3
Effective interest rate	1.8	1.7	1.9	2.3	2.9	3.5

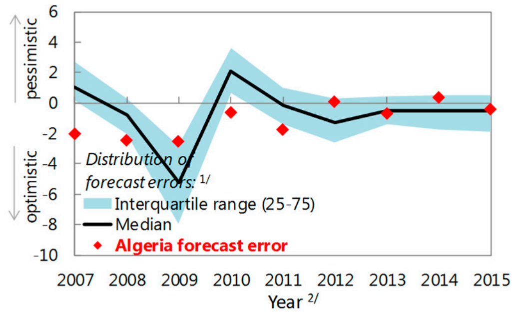
Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	1.3	3.1	3.1	3.1	3.1	3.1
Inflation (GDP deflator)	8.7	3.6	3.2	3.5	3.7	3.5
Primary budget balance	-3.3	-4.4	-4.4	-4.4	-4.4	-4.4
Effective interest rate	1.8	1.7	2.3	3.2	4.2	5.1

Source: IMF staff.

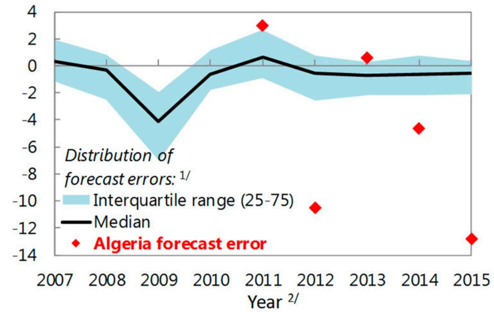
Algeria: Public DSA—Realism of Baseline Assumptions

Forecast Track Record, versus all countries

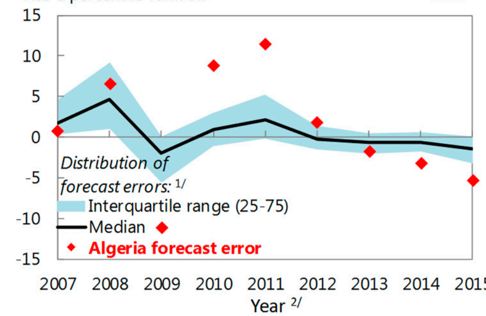
Real GDP Growth
(in percent, actual-projection)
Algeria median forecast error, 2007-2015: -0.66
Has a percentile rank of: 39%



Primary Balance
(in percent of GDP, actual-projection)
Algeria median forecast error, 2007-2015: -4.67
Has a percentile rank of: 7%

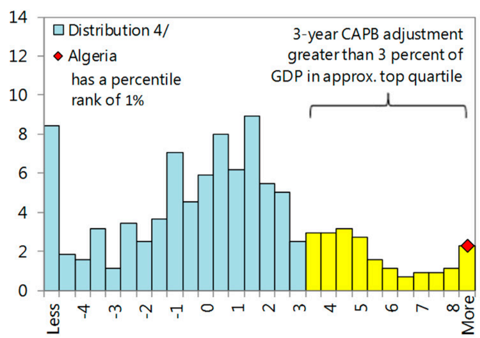


Inflation (Deflator)
(in percent, actual-projection)
Algeria median forecast error, 2007-2015: 0.75
Has a percentile rank of: 64%

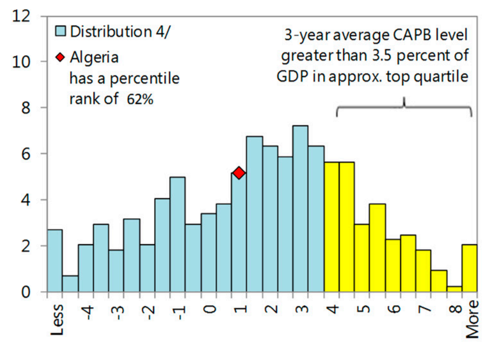


Assessing the Realism of Projected Fiscal Adjustment

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

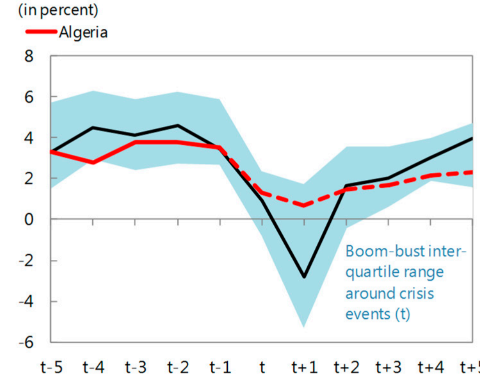


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/

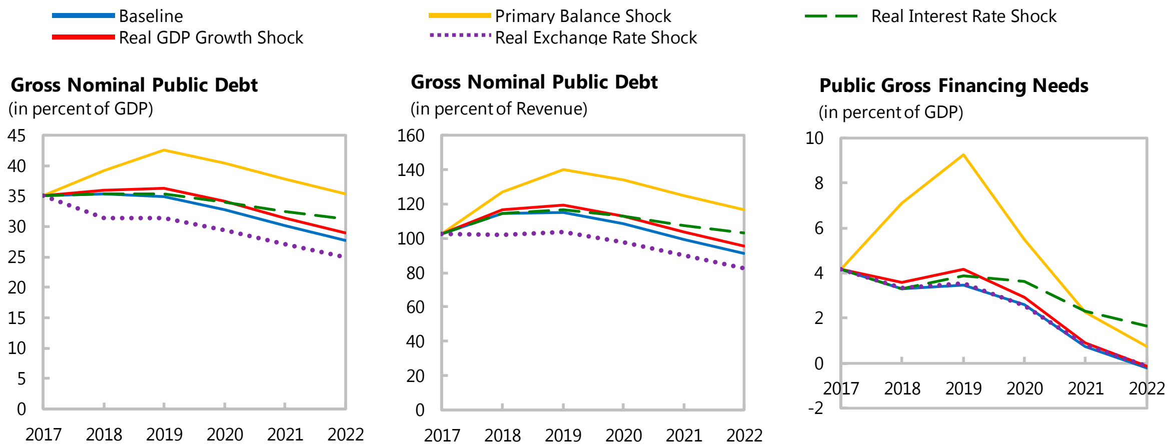
Real GDP growth
(in percent)



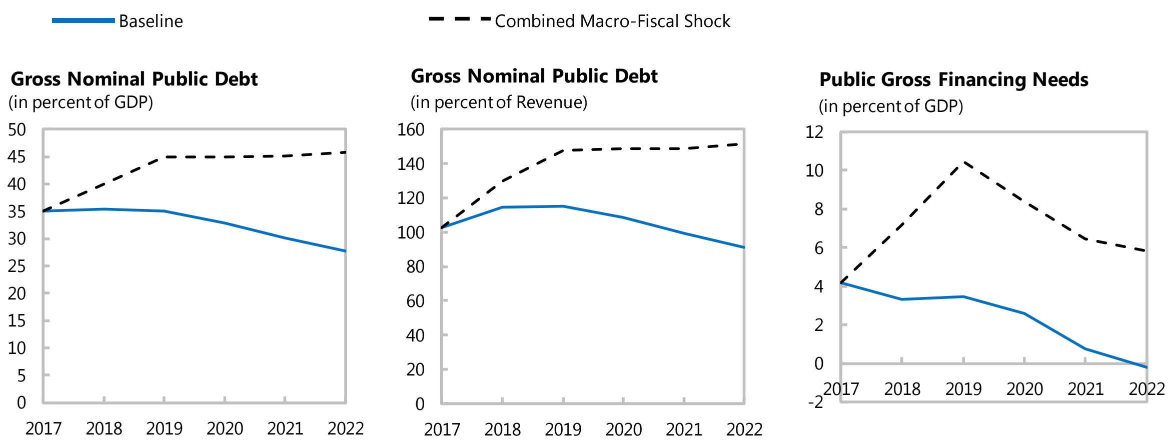
Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Algeria has had a positive output gap for 3 consecutive years, 2014-2016. For Algeria, t corresponds to 2017; for the distribution, t corresponds to the first year of the crisis.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Algeria: Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	1.3	0.7	1.5	1.7	2.2	2.3
Inflation	8.7	3.6	3.2	3.5	3.7	3.5
Primary balance	-3.3	-7.0	-5.8	-0.2	0.2	0.7
Effective interest rate	1.8	1.7	2.4	3.2	3.4	3.7
Real Interest Rate Shock						
Real GDP growth	1.3	0.7	1.5	1.7	2.2	2.3
Inflation	8.7	3.6	3.2	3.5	3.7	3.5
Primary balance	-3.3	-3.2	-2.0	-0.2	0.2	0.7
Effective interest rate	1.8	1.7	4.2	6.7	8.8	9.8
Combined Shock						
Real GDP growth	1.3	0.0	0.8	1.7	2.2	2.3
Inflation	8.7	3.4	3.0	3.5	3.7	3.5
Primary balance	-3.3	-7.0	-5.8	-0.2	0.2	0.7
Effective interest rate	1.8	1.7	7.2	11.4	13.8	15.3

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	1.3	0.0	0.8	1.7	2.2	2.3
Inflation	8.7	3.4	3.0	3.5	3.7	3.5
Primary balance	-3.3	-3.5	-2.6	-0.2	0.2	0.7
Effective interest rate	1.8	1.7	1.9	2.3	2.6	2.7
Real Exchange Rate Shock						
Real GDP growth	1.3	0.7	1.5	1.7	2.2	2.3
Inflation	8.7	20.2	3.2	3.5	3.7	3.5
Primary balance	-3.3	-3.2	-2.0	-0.2	0.2	0.7
Effective interest rate	1.8	1.7	1.9	2.2	2.5	2.6

Source: IMF staff.

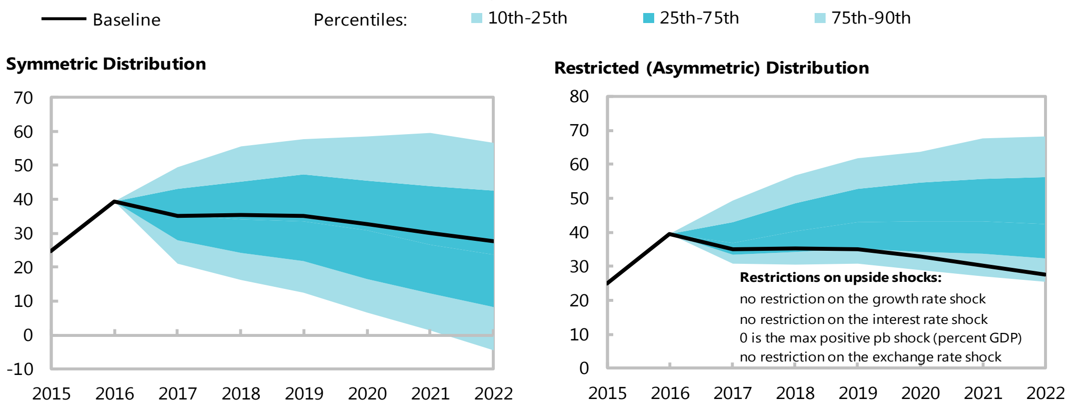
Algeria: Public DSA Risk Assessment

Heat Map

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

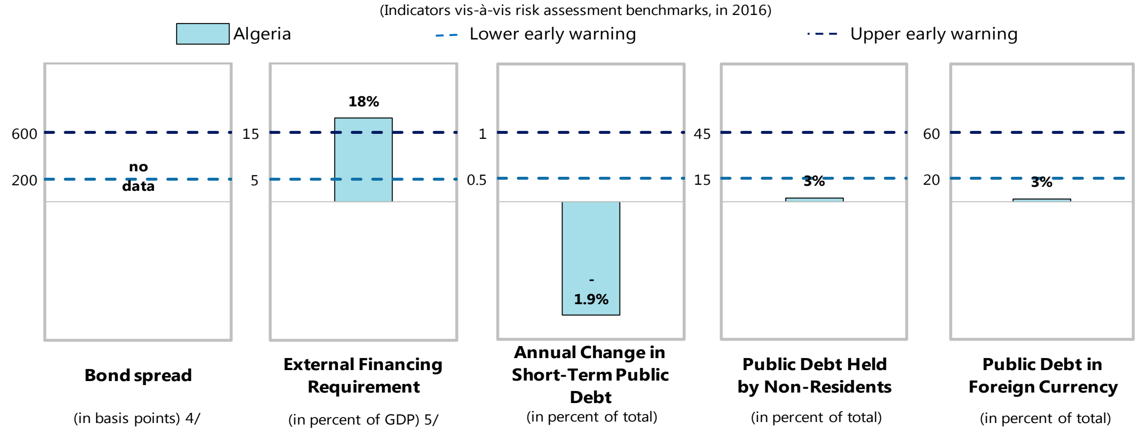
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Source: IMF staff.

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

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

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

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

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

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

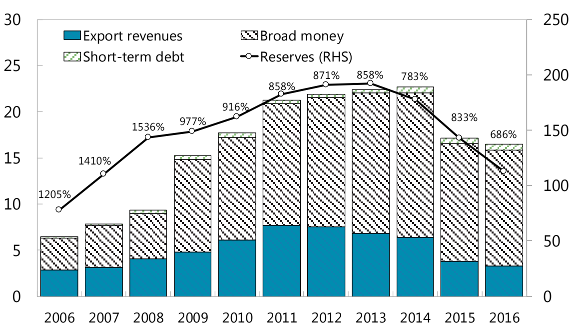
Annex III. External Sector Assessment

Algeria's net international investment position, though significantly weakened by the oil price shock, remains comfortable. External debt is nearly nonexistent, and reserves are still well above adequacy ratios. The EBA-lite methodology points to a substantial current account gap, suggesting that the external balance is significantly weaker than warranted by medium-term fundamentals and desirable policy settings and that the dinar is significantly overvalued.

Following the collapse in oil prices, Algeria's current account has swung from large surpluses to large deficits. Between 2000 and 2013, current account surpluses averaged 12.5 percent of GDP. In 2014, the current account recorded a deficit for the first time in nearly 15 years—a consequence of sharply lower oil prices and declining hydrocarbon production, both of which contributed to lower hydrocarbon exports. Since 2014, current account deficits have exceeded 16 percent of GDP. In the baseline scenario, the current account deficit is projected gradually narrow as oil prices rebound somewhat and fiscal consolidation dampens import demand.

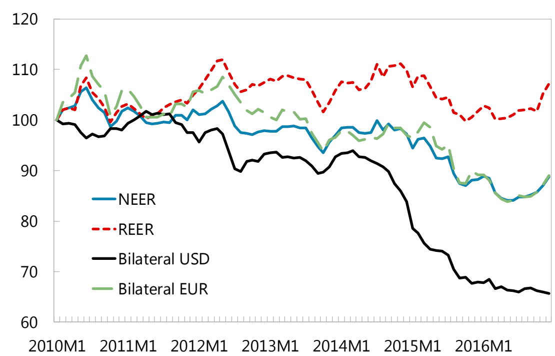
Algeria's external buffers remain sizeable. International reserves stood at about US$113 billion at end-2016 (excluding SDRs), equal to 23 months of imports and 686 percent of the IMF's unadjusted ARA metric. But reserves have declined almost 41 percent from their peak in 2013 and are projected to decline further over the medium term. In the baseline scenario, reserves are projected to fall to 37.8 billion in 2022, equal to 8 months of imports and 105 percent of the ARA metric adjusted to include an additional buffer that captures the risk of lower oil prices. Total external debt stood at just 2.5 percent of GDP in 2016 but could increase if the government decided to rely more on external borrowing to finance future deficits.

Decomposition of the IMF's ARA Metric 1/
(US$ billion)



Sources: Algerian authorities; and IMF staff calculations.
1/ The IMF composite metric is a weighted sum of exports, short-term debt at remaining maturity, other external liabilities, and broad money. Bars display the dollar equivalent of the ARA metric by each of its components. Reserve levels are considered to be adequate when they range between 100 and 150 percent of the ARA metric.

Exchange Rate Developments
(Index, 2010=100)



Sources: Algerian authorities; and IMF staff calculations.

Since the oil price shock, the dinar has significantly depreciated on a nominal basis, but the REER is broadly unchanged owing to relatively high domestic inflation. Since mid-2014, the dinar has depreciated by 29 percent against the dollar, helping to cushion the impact of lower oil prices. Most of the depreciation occurred in the second half of 2014 through 2015. Against the euro, the dinar has depreciated by 8 percent. On a REER basis, however, the dinar is little changed since the oil price shock. In recent months, the REER has been on an upward trend. The foreign exchange premium on the parallel exchange market reportedly stands at close to 60 percent.[1]

EBA-lite methodologies point to large differences between the actual current account and its norm. Both the current account and the external sustainability approaches suggest that the current account balance remains well below the norm for 2016, suggesting a significant overvaluation of the REER.[2]

- The current account approach indicates that the current account deficit is much weaker than the value consistent with medium-term fundamentals and desirable policies, resulting in a current account gap of -13.2 percent of GDP in 2016. Closing the current account gap requires pursuing fiscal consolidation, improving the effectiveness of monetary policy, and fostering export diversification through exchange rate depreciation and structural reforms.

- The external sustainability approach also points to a large current account gap. Assuming the net international investment position (NIIP) remains stable at its initial level of 46.6 percent of GDP, the current account norm would be 1.4 percent of GDP, implying a gap of -7.6 percent over the medium term.[3] If the NIIP was stabilized at -5.4 percent of GDP (the projected value in 2022), the current account norm would be zero percent of GDP, yielding a smaller gap of -6.2 percent of GDP.

EBA-Lite Estimates of CA Gap 1/

(In percent of GDP)

	Current account norm	Current account actual	Current account gap
EBA-lite current account approach	-3.7	-16.9	-13.2
		Underlying current account	
EBA-lite external sustainability approach			
Scenario 1: Stabilizing net NIIP at current level	1.4	-6.2	-7.6
Scenario 2: Stabilizing net NIIP at 2022 projected level	0.0	-6.2	-6.2

1/ Estimates based on staff's recommended policy mix, as captured in the alternative scenario (Annex I).

[1] The parallel market remains illegal, and foreign exchange regulations stipulate that foreign exchange is available for all current international transactions.

[2] Staff estimates the overvaluation to be in the 54-115 percent range. These estimates are subject to significant uncertainty as the magnitude and persistence of the terms-of-trade shock make the results of standard methodologies unstable: minor changes in underlying assumptions (e.g., regarding trade elasticities, desirable policies, or target NIIP) lead to significant variations in the degree of estimated overvaluation. The existence of a parallel exchange market also complicates the interpretation of the model's results. The EBA-REER method did not yield reliable results.

[3] Algeria's NIIP consists mostly of international reserves. External debt and FDI are negligible compared to the size of international reserves. Valuation changes are not taken into account in the estimation of the NIIP.

Table 1. Algeria: External Sustainability Assessment

<table>
<tr><td>Current account</td><td>Background: Despite a 7.3 percent increase in volume terms, hydrocarbon exports declined in in value terms from US$33.1 billion in 2015 to US$27.7 billion in 2016 owing to a 22.1 percent fall in prices. Nevertheless, the current account deficit narrowed slightly (in nominal terms) as imports and profit repatriation declined. The current account deficit is expected to narrow over the medium term as a result of policy action and some recovery in the oil prices.
Assessment: The EBA-lite CA model yields a current account gap of -13.2 percent of GDP at end-2016, while the ES approach suggests a current account gap between -6.2 and -7.6 percent of GDP. Fiscal consolidation combined with structural reforms and further exchange rate depreciation would help close the gap.</td><td rowspan="5">Overall assessment:
Algeria's net international investment position remains comfortable. External debt is nearly nonexistent, and reserves, though declining, are still well above adequacy ratios. The external balance however is significantly weaker than warranted by medium-term fundamentals and desirable policy settings, and the REER is significantly overvalued.

Potential policy responses:
Fiscal consolidation will help mitigate the impact of the oil price shock on the external position. Structural reforms are needed to foster export diversification in the medium and long term. Further exchange rate depreciation would help reduce the current account gap and bring the REER in line with its equilibrium value.</td></tr>
<tr><td>Real effective exchange rate (REER)</td><td>Background: The REER strengthened by 5.6 percent in 2016, despite some depreciation early in the year.
Assessment: Both the EBA CA and ES approaches suggest that the REER remains significantly overvalued.</td></tr>
<tr><td>Capital and financial accounts</td><td>Capital flows are minimal due to multiple restrictions. FDI is small and is concentrated in the hydrocarbon sector.</td></tr>
<tr><td>Reserve Position</td><td>Background: Reserves peaked at US$192 billion in 2013. Since then, reserves have declined by 41 percent and stood at US$113 billion at end-2016 (excluding SDRs), equal to 23 months of imports.
Assessment: Despite their rapid decline, reserves remain comfortable, equal to 686 percent of the IMF's ARA metric.</td></tr>
<tr><td>Foreign assets and liabilities position and trajectory</td><td>Background: Algeria's NIIP at end-2016 was 46.6 percent of GDP. Liabilities are negligible compared to assets, which are dominated by foreign reserves. Portfolio investment does not exist as either assets or liabilities.
Assessment: Since the stock of debt and FDI is small, the NIIP trajectory is similar to the path of foreign reserves. Under the baseline scenario, the NIIP is projected to turn negative over the medium term, reaching -11.2 percent of GDP by 2022.</td></tr>
</table>

Table 2. Algeria: External Debt Sustainability Framework, 2012–22

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	1.7	1.6	1.7	1.8	2.5			**2.5**	**2.7**	**2.7**	**2.8**	**2.7**	**2.7**	**-2.3**
Change in external debt	-0.4	-0.1	0.1	0.1	0.7			0.0	0.1	0.1	0.0	0.0	-0.1	
Identified external debt-creating flows (4+8+9)	-6.7	-1.3	3.7	17.5	16.1			11.6	9.2	8.2	6.8	5.6	5.2	
Current account deficit, excluding interest payments	-5.9	-0.4	4.4	16.5	16.9			12.7	10.5	9.8	8.6	7.6	7.5	
Deficit in balance of goods and services	-6.2	-1.2	3.7	15.6	17.7			12.4	10.3	9.7	8.4	7.2	7.0	
Exports	36.2	32.6	29.8	23.1	20.9			24.2	23.8	23.2	22.8	22.7	22.3	
Imports	30.0	31.4	33.4	38.6	38.6			36.5	34.1	32.9	31.2	29.9	29.3	
Net non-debt creating capital inflows (negative)	-0.7	-0.9	-0.7	0.4	-0.9			-1.1	-1.3	-1.5	-1.7	-2.0	-2.2	
Automatic debt dynamics 1/	0.0	0.0	0.0	0.5	0.1			0.0	0.0	0.0	0.0	-0.1	-0.1	
Contribution from nominal interest rate	0.1	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Contribution from real GDP growth	-0.1	0.0	-0.1	-0.1	-0.1			0.0	0.0	0.0	0.0	-0.1	-0.1	
Contribution from price and exchange rate changes 2/	0.0	0.0	0.0	0.6	0.2			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	6.3	1.2	-3.5	-17.4	-15.4			-11.5	-9.1	-8.2	-6.8	-5.6	-5.3	
External debt-to-exports ratio (in percent)	4.7	4.8	5.7	7.9	12.0			10.5	11.1	11.8	12.1	12.1	12.1	
Gross external financing need (in billions of US dollars) 4/	-10.3	0.8	11.0	29.6	28.3			23.6	20.3	19.3	17.6	16.2	16.5	
in percent of GDP	-4.9	0.4	5.1	18.0	18.1	10-Year	10-Year	14.0	11.8	10.9	9.7	8.6	8.4	
Scenario with key variables at their historical averages 5/								**2.5**	**-10.3**	**-21.7**	**-31.3**	**-39.5**	**-47.1**	**0.6**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	3.3	2.8	3.8	3.8	3.5	3.1	0.7	1.3	0.7	1.5	1.7	2.2	2.3	
GDP deflator in US dollars (change in percent)	0.9	-2.3	-1.5	-25.7	-8.5	1.1	16.6	6.5	1.5	1.1	1.4	1.7	1.4	
Nominal external interest rate (in percent)	2.7	0.7	0.4	0.9	0.4	1.2	0.8	0.5	0.4	0.3	0.3	0.3	0.2	
Growth of exports (US dollar terms, in percent)	-1.2	-9.8	-7.0	-40.1	-14.2	-2.1	25.7	24.7	0.7	-0.1	1.6	3.2	2.2	
Growth of imports (US dollar terms, in percent)	9.1	4.9	8.6	-10.8	-5.4	10.1	17.3	2.3	-4.5	-1.2	-2.1	-0.5	1.8	
Current account balance, excluding interest payments	5.9	0.4	-4.4	-16.5	-16.9	2.9	13.4	-12.7	-10.5	-9.8	-8.6	-7.6	-7.5	
Net non-debt creating capital inflows	0.7	0.9	0.7	-0.4	0.9	1.0	0.6	1.1	1.3	1.5	1.7	2.0	2.2	

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

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

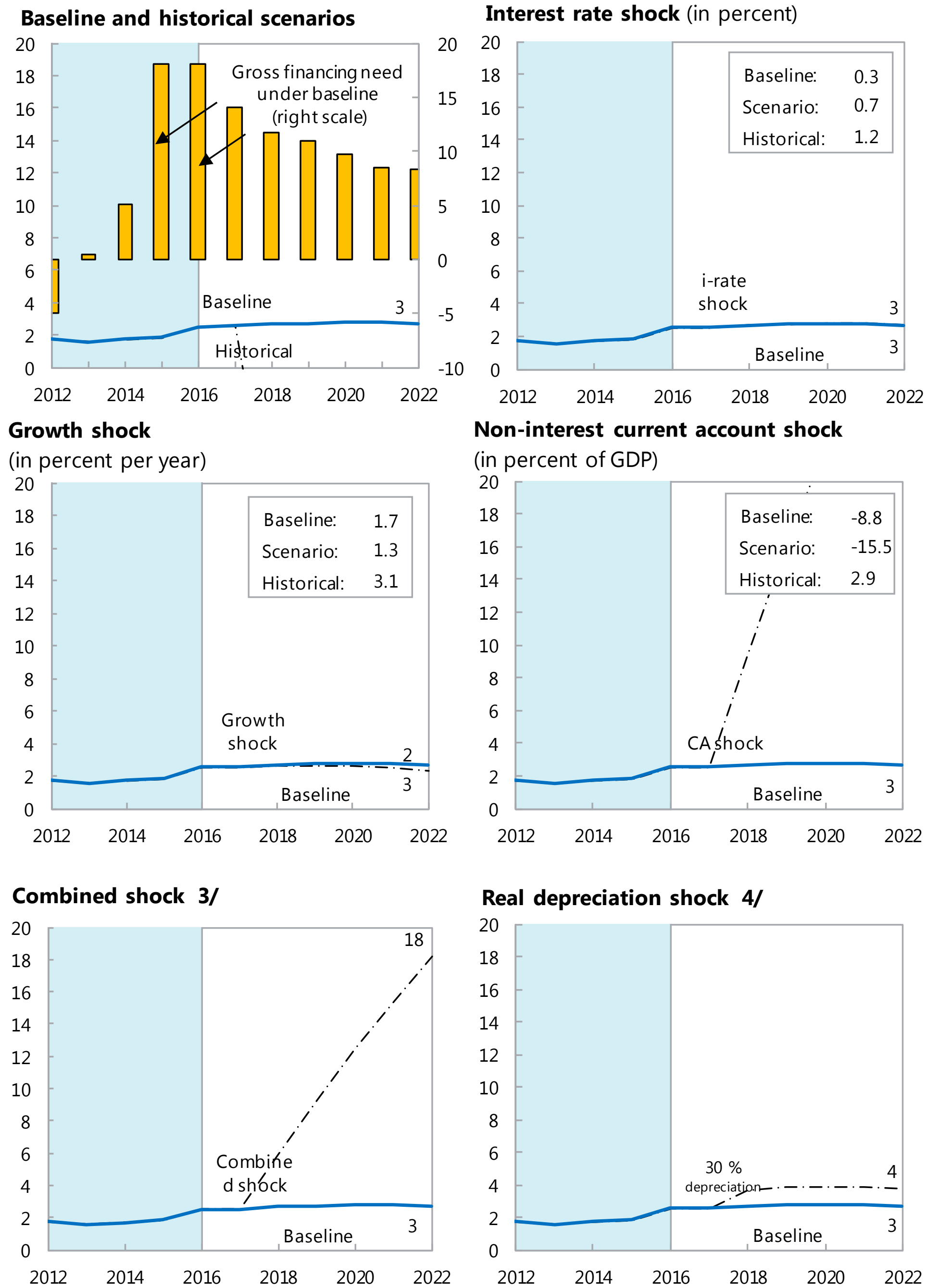
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Figure 1. Algeria: External Debt Sustainability: Bound Tests 1/ 2/



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2010.

Annex IV. Implementation of FSAP Recommendations

Recommendation	Responsible	Timeline	Implementation
Leverage hydrocarbon revenue for financial sector development: Improve intergenerational smoothing of hydrocarbon revenue (full-fledged fiscal rule, sovereign wealth fund (SWF)).	BA/MoF	MT-LT	Partial progress. The authorities are revising the organic budget law which will include a fiscal rule that ties current spending to nonhydrocarbon revenues.
Exchange controls: Gradually reduce restrictive measures on foreign exchange transactions.	BA/MoF	MT-LT	Partial progress. An MCM technical assistance (TA) mission on foreign exchange (FX) market issues made a number of recommendations to relax the current FX regulations, including by harmonizing the repatriation and surrender requirements of nonhydrocarbon export receipts. The BA extended the deadline for repatriating the proceeds of nonhydrocarbon exports from 180 to 360 days.
FX market: Allow nonhydrocarbon exporters to sell directly into the foreign exchange market, to stimulate its development, including for forward contracts.	BA	ST	Partial progress. An MCM TA mission in 2017 assisted the authorities with the implementation of an FX forward market.
Liquidity management: Create a structural liquidity shortage to facilitate monetary policy implementation.	BA	ST	Completed. The fall in oil prices, combined with continued efforts by the BA to absorb excess liquidity, led to the emergence of liquidity shortages at some banks starting in July 2016. The BA published a regulation defining the framework for open market operations and the marginal lending facility in September 2016. The BA used discount operations to supply liquidity to banks, and transitioned to open market operations for the first time in March 2017.
Emergency liquidity facility assistance (ELA). Clarify the emergency liquidity assistance framework.	BA	ST	No progress.
State-owned bank reform: Complete corporate governance reform agenda.	BA/MoF	ST-MT	Partial progress. The BA has drafted regulations on bank governance, with technical assistance from the IMF and World Bank.
Consumer lending: Replace consumer lending restrictions with prudential measures; introduce an effective public credit registry for households, and introduce a personal bankruptcy framework.	BA	MT	Partial progress. The credit registry was extended to individuals. The ban on consumer lending was lifted. No progress on personal bankruptcy.
Banking supervision: Facilitate the write-off of NPLs; improve the operational framework for supervision; continue moving toward Basel II/III standards; improve macroprudential oversight; develop stress-test expertise; introduce consolidated supervision.	BA	ST-MT	Partial progress. New regulations on capital adequacy related to pillar I of Basel II and elements of Basel III were introduced in 2014. The BA introduced a number of liquidity instruments (minimum liquidity and transformation ratios) to manage liquidity risks. Loan classification requirements were strengthened to cover the treatment of overdraft and restructured loans. New regulations allow fully-provisioned small NPLs to be written off, but no progress was made on writing off the current NPL stock. The BA is working on its first macro stress test exercise. The BA has drafted a new regulation on consolidated supervision, but the

			current supervisory assessment is still conducted on a standalone basis. A TA mission in March 2017 provided advice on enhancing banks' corporate governance and implementing consolidated supervision. The BA also drafted new regulation requiring banks to produce consolidated financial statements. No progress has been made on establishing an integrated institutional framework in charge of implementing macroprudential policy due to limited resources and competing priorities.
Small and medium-sized enterprise (SME) lending: Revisit existing government support programs for microenterprises and SMEs, including partial credit guarantee funds.	MoF	MT	No progress.
Insurance: Adapt motor third-party liability (MTPL) premiums and reduce compulsory reinsurance.	Insurance Dir.	MT	No progress.
Insolvency regime: Modernize the insolvency regime to mitigate risk and strengthen the credit environment.	MoJ, MoF	MT	No progress.
Collateral regime: Improve debt enforcement procedures.	MoJ, MoF	ST–MT	No progress.
Criminal sanctions: Clarify Criminal Code sanctions on mismanagement of funds in state-owned enterprises, with judicial training on implementation.	MoJ	ST	No progress. However, at the September 2014 tripartite meeting of trade unions, employers, and the government, there was agreement on the principle of lifting the criminal sanctions for management errors.
Payment systems: Set up a payment system council to monitor the modernization of payment systems and formalize a plan to decrease the proportion of fiduciary money in M2.	BA	MT	Partial progress. A draft law on electronic certification has been adopted. A system is in place for the development of electronic payments that allowed a number of financial institutions to offer electronic payment services.
Capital market development: Finance budget deficits through the issuance of T-bonds along the yield curve and revisit the issuance policy at the MoF to foster liquidity.	MoF	ST-MT	Partial progress. Net T-bill and T-bond issuance was negative in 2016. However, the government did issue an ad-hoc, 5-year local-currency bond (the National Bond for Economic Growth) aimed at retail investors.
Stock exchange: Implement the modernization program set up by the Algerian Securities Commission (COSOB) in 2012.	COSOB/MoF	LT	Partial progress. Training programs were established for professionals hired since 2014. A new regulation governing stock market traders was issued. Information systems are being upgraded. In 2016, the COSOB approved the initial public offering of one SOE, but the operation was canceled due to lack of interest.
Crisis management: Establish (i) special resolution regime (SRR) for failing financial institutions; (ii) memorandum of understanding (MoU) outlining principles for financial crisis management; and (iii) MoU between safety net participants on information exchange and decision-making processes.	BA, MoF	LT ST	No progress.
AML/CFT: Implement action plan established with the FATF International Cooperative Review Group.	BA, MoF, MoJ	ST	Fully implemented. Algeria is no longer subject to the FATF's monitoring process under its ongoing global AML/CFT compliance process.

INTERNATIONAL MONETARY FUND

ALGERIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 11, 2017

Prepared By

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

CONTENTS

RELATIONS WITH THE FUND

(As of March 31, 2017)

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

General Resources Account

	SDR Million	Percent Quota
Quota	1,959.90	100.00
IMF's holding of currency (holdings rate)	1,771.82	90.40
Reserve tranche position	188.08	9.60

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	1,198.18	100.00
Holdings	898.40	74.98

Outstanding Purchases and Loans

None

Financial Arrangements (In millions of SDR)

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

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

	Forthcoming				
	2017	2018	2019	2020	2021
Principal	0.00	0.00	0.00	0.00	0.00
Charges/interest	0.70	0.91	0.91	0.91	0.91
Total	**0.70**	**0.91**	**0.91**	**0.91**	**0.91**

Implementation of HIPC Initiative: Not Applicable.

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 May 10, 2017, the average of the buying and selling rates for the U.S. dollar was US$ 1 = DZD 109.54, equivalent to SDR 1 = DZD 149.63. 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 jure* exchange rate arrangement is managed floating and the *de facto* exchange regime is classified as other managed arrangement with no preannounced path for the exchange rate. Algeria maintains an exchange system free from restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation

The last Article IV consultation was concluded by the Executive Board on a lapse of time basis on May 16, 2016 (IMF Country Report 16/127). The discussions for the 2017 Article IV consultation were held in Algiers from March 7 to March 20, 2017.

Technical Assistance

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

MCM	Enhancing bank regulation and supervision	November 2015
FAD	Tax and customs administration	November 2015
MCM	Setting up a liquidity committee	December 2015
FAD	Tax administration	February 2016
MCM	Financial stability and macroprudential policy framework	April 2016
MCM	Liquidity management	May 2016
FAD	Public financial management	July 2016
FAD	Tax administration	October 2016
MCM	Debt market development	October 2016
FAD	Tax administration	November 2016
MCM	Upgrading banking regulations	March 2017
MCM	Forward market development	March 2017
FAD	Tax administration	April 2017

Financial Sector Assessment Program

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

Resident Representative/Advisor

None.

RELATIONS WITH THE WORLD BANK GROUP

JMAP Implementation, FY17 (As of April 20, 2017)			
Title	**Products**	**Provisional timing of missions**	**Expected delivery date**
A. Mutual Information on Relevant Work Programs			
Bank work program in next 12 months	**a. Sector work** • Algeria Vision 2035 • Policy Notes on Subsidies and Social Programs Reform **b. Technical assistance** • AGID: Capacity Building in Integrated Desert Management • ANGEM: Strengthening capacity for M&E and Impact Evaluation of Programs • ADS: Strengthening capacity for M&E an Impact Evaluation of Programs • BA: Training of On-site Inspectors • MADR: Integrated Value Chain in Agriculture • Addressing Barriers to Increased Exports in Algeria	 May-June 2017 May-June 2017	 March 2018 March 2018 October 2017 June 2019 June 2019 August 2017 June 2018 October 2019
IMF work program in next 12 months	Staff visit Staff visit 2018 Article IV consultation Continued technical assistance expected in the following areas: • Liquidity management • Foreign exchange market development • Tax administration • Debt management • Public financial management • Macroprudential policy • Bank supervision and regulation • Tax policy	June 2017 October 2017 March 2018	 May 2018

B. Requests for Work Program Inputs			
Fund request to Bank	Analysis related to new growth model Sectoral analysis	As needed As needed	
Bank request to Fund	Assessment of macroeconomic stance and prospects Data sharing	Semiannual (and on ad hoc basis if requested) Ongoing	Following Article IV and staff visits
C. Agreement on Joint Products and Missions			
Joint products in next 12 months	Continuous close coordination on the reform agenda	Ongoing	

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 compiles 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. The NSO started publishing quarterly national accounts in 2015. **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 the central government), classification problems, long lags for production of statistics, and lack of reconciliation of financing with the monetary accounts. Key factors behind these weaknesses include the lack of financial resources allocated to the compilation of statistics, insufficient interagency coordination, and 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; consequently, data on depository corporations—as well as finance companies—are usually available within a period of two to three months.	
Balance of payments: Balance of payments statistics are generally of good quality. Estimates of international investment position data are now available for 2011-2013 but have not yet been compiled for more recent years.	
II. Data Standards and Quality	
Algeria began participation in the General Data Dissemination System (GDDS) on April 21, 2009.	No data ROSC is available.

Algeria: Table of Common Indicators Required for Surveillance

(As of March 31, 2017)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	03/31/17	03/31/17	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/16	03/03/17	D	M	Q
Reserve/Base Money	12/16	03/03/17	D	M	Q
Broad Money	12/16	03/03/17	D	M	Q
Central Bank Balance Sheet	12/16	03/03/17	D	M	Q
Consolidated Balance Sheet of the Banking System	12/16	03/16/17	M	M	Q
Interest Rates[2]	12/16	02/21/17	M	M	Q
Consumer Price Index	02/17	03/28/17	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government[4]	11/16	03/08/17	M	I	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/16	03/08/17	I	I	A
External Current Account Balance	Q4, 2016	03/07/17	Q	I	Q
Exports and Imports of Goods and Services	Q4, 2016	03/07/17	Q	I	Q
GDP/GNP	Q3, 2016	01/23/17	Q	Q	Q
Gross External Debt	Q4, 2016	03/08/17	Q	I	Q
International Investment Position[6]	2013	03/03/16	I	I	NA

[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. With technical assistance from the IMF, the authorities have produced IIP statistics for 2010-2013. They are working on producing IIP statistics for more recent years.

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

Statement by Mr. Jafar Mojarrad, Executive Director for Algeria, and Mr. Kamel Badsi, Advisor to the Executive Director
May 26, 2017

Our Algerian authorities thank staff for a comprehensive report and pertinent SIP, appreciate the constructive dialogue with the mission team, and highly value Fund policy advice and technical assistance. They are in broad agreement with staff on the challenges facing Algeria and policies and reforms needed to achieve medium-term objectives.

Background

Algeria's economy continued to deal with the fallout of the oil price shock. The authorities have taken important adjustment measures and are determined to pursue appropriate medium-term policies and implement necessary reforms to restore and preserve macroeconomic stability and diversify the economy with the aim of strengthening growth and promoting job creation.

Growth in 2016 remained resilient, reflecting the hydrocarbon sector's recovery from continued contraction in recent years, while spending cuts and weak agricultural output weighed down on non-hydrocarbon activity. Growth is expected to decelerate in 2017, due to the projected maintenance-related slowdown in the hydrocarbon sector and weaker construction activity. Unemployment picked up to 10 ½ percent and remains high among the youth and women. Inflation rose to 6.4 percent, largely driven by supply factors and distortions in the distribution channels.

The sharp oil price decline resulted in a significant deterioration in the fiscal and external positions, triggering strong adjustment measures, including on the fiscal front, as detailed below. Nevertheless, the still large fiscal deficits entailed significant erosion of the fiscal buffers, which were brought down to their statutory floor in 2016 despite substantial domestic borrowing. International reserves also decreased significantly, on the account of high current account deficits. They remain, however, at comfortable levels, covering more than 23 months of imports at end-2016, and external debt remains very low, at 2.5 percent of GDP. At the same time, the banking sector remained broadly resilient.

The authorities are fully aware of the challenges ahead, and are strongly committed to restoring and preserving macroeconomic stability and supporting growth through a well-calibrated policy mix of pro-growth fiscal consolidation, prudent monetary policy, and comprehensive structural reforms. Work is underway on a long-term strategy to reshape Algeria's growth model to promote economic diversification and strengthen the role of the private sector. Implementation of a medium-term budget framework (MTBF), as of 2017, anchored on substantial medium-term fiscal consolidation, is an important building block of this strategy.

Fiscal Policy

Significant fiscal adjustment has been made in 2016 through a package of measures to raise non-hydrocarbon revenue, reduce current spending, including the wage bill, reform the subsidy system, and scale down investment while enhancing its efficiency. As a result, non-hydrocarbon revenue increased by 2.3 percent of non-hydrocarbon GDP (NHGDP), while public expenditure declined by 5.8 percent, bringing down the non-hydrocarbon fiscal deficit by 8.2 percent of NHGDP. Further fiscal consolidation is envisaged under the 2017 budget, in line with the MTBF, reducing the non-hydrocarbon deficit further by about 7 percent of NHGDP. To this end, the authorities intend to continue with tight expenditure control, including by maintaining the wage bill at about last year's level in nominal terms, which will bring it down to the equivalent of 11.7 percent of GDP (from 12.8 percent). This will be achieved through a freeze of civil service recruitment in non-strategic sectors, with replacement of retirees to be limited to one out of five, while preserving social transfers. On public investment spending, priority will be given to completion of ongoing projects while enhancing spending efficiency. Payment delays observed in 2016 were resolved during the first quarter of 2017.

The authorities are mindful of the potential adverse effects of fiscal consolidation on non-hydrocarbon growth, which should, however, be transitory and could be partly offset by the coming on stream of large industrial projects, as well as by enhanced efficiency of capital spending and greater use of spare capacity in many sectors. Therefore, our authorities expect growth from 2017 onward to be close to recent years' level rather than decline abruptly as shown in the report. Should signs of deep growth deceleration emerge, the authorities will have the option of introducing a supplementary budget law to support growth.

The authorities have embarked on a dynamic process of gradual phasing out of energy subsidies by increasing prices, including for fuel, natural gas, and electricity. To deepen the ongoing reform, work is underway with World Bank technical assistance to set up a well-targeted subsidy system through cash transfers. The authorities are also revisiting the interest rate subsidy scheme. Given the social sensitivity of these issues, they are following a pragmatic approach supported by appropriate outreach.

Steps have also been taken to enhance public financial management, including through the implementation of the MTBF. To reduce fiscal risks, the authorities have permanently closed the open-ended treasury special accounts, whereas government loan guarantees are being limited to a few state-owned, highly strategic enterprises. A study on the viability of the pension system is being carried out recently and will prepare the ground for a reform of the pension system.

Efforts are also being made to strengthen nonoil revenue mobilization. The VAT rate was raised by 2 percent in 2017, and taxes on tobacco and luxury goods were increased. Efforts are focused on strengthening revenue administration, including by improving VAT and customs duties collection and enhancing local tax management.

Monetary, Exchange Rate, and Financial Policies

Bank of Algeria (BoA) remains committed to containing inflation, and stands ready to adjust its policy, as needed. After a long period of excess liquidity, monetary policy has been adapting to the shift to a tighter liquidity situation and its effectiveness should be improved, with banks in need for central bank refinancing. In this regard, BoA reactivated its refinancing instruments, with the introduction of open market operations and a marginal lending facility, while strengthening its liquidity forecasting. Open market operations should facilitate the emergence of a new benchmark interest rate, and allow the central bank to gradually phase out its discount window. A new regulation on securities eligible for central bank refinancing is expected to be implemented over the course of the year.

In 2015, the exchange rate was instrumental in absorbing the impact of the oil price shock, through significant depreciation. The authorities are aware that more exchange rate flexibility is needed, along with strong macroeconomic policies, particularly fiscal consolidation, and structural reforms, to increase competitiveness, promote diversification, and bring the real effective exchange rate close to equilibrium. They look forward to further room for flexibility with the prospective launch of the foreign exchange forward market, for which the Fund is providing valuable technical assistance.

As evidenced by financial soundness indicators, the banking sector is healthy and resilient, with adequate capitalization and profitability. While NPLs have increased recently, partly due to temporary increase in government payment delays, they are well provisioned. The authorities remain committed to preserving financial stability by further strengthening regulation and supervision as well as the macroprudential framework. In this connection, BoA is refining its stress testing framework while launching the first milestones for a systemic risk analysis framework. New regulations on banks' governance have been drafted with technical assistance of the IMF and WB. Moreover, following full implementation of the action plan on AML/CFT with FATF, Algeria is no longer subject to its monitoring process. While all electronic payments platforms are in place, a draft law on electronic certification has been adopted, which should help modernize the payments system and enhance financial inclusion.

Structural Reforms

Structural reforms are a cornerstone of the authorities' economic diversification and private sector promotion strategy. The authorities appreciate staff analysis of structural reform needs in Algeria, as detailed in the SIP. They are determined to lift impediments to investment and growth by improving the business climate, enhancing competitiveness, and attracting foreign direct investment. In this regard, significant strides have been made for the removal of barriers on industrial and real estate activities, and new bills are being prepared on labor market, mining activity, and public-private partnerships, to promote greater private sector participation in the economy. In the context of the preparation of the new growth model, the authorities have also established an ad-hoc committee for investment monitoring, led by the Prime Minister.

In conclusion, our Algerian authorities are determined to use the oil price shock as an opportunity to embark on a comprehensive long-term reform agenda aimed at diversifying the economy and fostering private sector-led, sustainable, and job-rich and inclusive growth. They highly value Fund's readiness to provide continued technical assistance and appropriate policy advice for successful implementation of their reform strategy.