February 2007
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Algeria: 2006 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Algeria.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2006 Article IV consultation with Algeria, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on January 10, 2007, with the officials of Algeria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 18, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 10, 2007, discussion of the staff report that concluded the Article IV consultation; and

- a statement by the Executive Director for Algeria.

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

Selected Issues Paper

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

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INTERNATIONAL MONETARY FUND

ALGERIA

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with Algeria

Approved by Amor Tahari and Scott Brown

December 18, 2006

- The 2006 Article IV consultation discussions were held in Algiers during October 4–18, 2006. The staff team comprised J.E. De Vrijer (head), N. Laframboise, B. Loko, G. Sensenbrenner, and K. Kpodar (EP) (all MCD).

- The mission met with Minister of Finance Mourad Meldeci, Governor of the Bank of Algeria Mohammed Laksaci, Minister of Energy and Mining Chakib Khelil, Delegate Minister for Financial Sector Reform Karim Djoudi, other senior officials, members of parliament, the head of the largest trade union (UGTA), and representatives from the banking and business community. S. Maherzi, Advisor to the Executive Director for Algeria, participated in the discussions. The mission issued a press statement and held a press conference at the end of its stay.

- Algeria accepted the obligations under Article VIII, Sections 2(a), 3, and 4, in September 1997. Algeria's exchange rate regime is a managed float with no preannounced path for the exchange rate.

- Algeria effected in November 2005 the early and full repurchase of its past drawings on the Fund.

- Despite weaknesses, Algeria's statistical base is broadly adequate to conduct surveillance. In February 2006, Algeria decided to participate in the General Data Dissemination System (GDDS).

- The authorities have published the Article IV consultation reports since 2000; they also published the 2003 Financial System Stability Assessment (FSSA) and the 2004 Report on the Observance of Standards and Codes (ROSC)-fiscal module.

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EXECUTIVE SUMMARY

- **A favorable external environment and appropriate macroeconomic policies have contributed to Algeria's encouraging economic performance over the past five years.** Economic growth has been sustained, inflation has remained low, and unemployment has declined steadily, although it remains high. Growth is expected to decrease temporarily in 2006, reflecting lower hydrocarbon production, and inflation is picking up. The strong expansion of hydrocarbon receipts has allowed a considerable increase in public investment and a civil service wage increase. The external debt was largely prepaid in 2006 and the external position has continued to strengthen.

- **Algeria's economic outlook for the medium term is favorable**. With world hydrocarbon prices expected to remain relatively high, the current account surplus would remain large and gross international reserves would rise further. Nonhydrocarbon GDP growth would continue at about 5 percent. However, the planned sizeable increase in public investment for the coming years and the spread of the civil service wage increase to the rest of the economy would be expected to contribute to somewhat higher inflation.

- **Algeria's key challenges are to achieve sustained growth and reduce unemployment, while maintaining macroeconomic stability**. The Article IV consultation discussions focused on the sound management of the hydrocarbon receipts and key structural reforms, in particular in the financial sector.

- **The ambitious public investment program requires sustained efforts to ensure the quality of these expenditures.** The authorities have begun reassessing the projects included in the investment program and are committed to taking into account the recommendations of the public expenditure review conducted in cooperation with the World Bank. The recently concluded National Economic and Social Pact that supports linking real wage increases to productivity growth and economic performance in the nonhydrocarbon sector is an important milestone.

- **In view of the fiscal expansion and wage increases, a tightening of monetary policy and a flexible management of the exchange rate will be required to keep inflation under control.** The authorities indicated that they intend to increase Bank of Algeria's policy interest rate to keep it at a positive level in real terms and to continue their flexible management of the exchange rate.

- **The authorities are aware of the need to accelerate structural reforms aimed at encouraging private investment and job creation**. Moving ahead with the ongoing banking sector reform, in particular the privatization of the first public bank is paramount. The authorities intend to continue liberalizing external trade and to remain engaged in efforts to deepen Maghreb regional cooperation. They also intend to accelerate other structural reforms, in particular streamlining the tax system, completing the ongoing reform of the tax administration, modernizing the customs administration, and to increase the pass-through of word oil prices to domestic energy prices.

I. Background and Key Challenges

1. **A favorable external environment and appropriate macroeconomic policies have contributed to Algeria's encouraging economic performance over the past five years**. Economic growth has been sustained at an average annual rate of 5½ percent in 2001–05, and inflation has remained low. The unemployment rate has declined steadily, although it was still high at 15.3 percent in 2005.[1] Algeria's position as an important hydrocarbon exporter has resulted in marked improvements to the country's fiscal and external positions.[2]

2. **Algeria's political situation is fairly stable**. In May 2006, Prime Minister Ahmed Ouyahia was replaced by Mr. Abdelaziz Belkhadem, general secretary of the main party in the ruling coalition. The new prime minister has indicated that he would support a constitutional amendment that would allow the president to run for a third term. Parliamentary elections are scheduled to take place in 2007 and presidential elections in 2009.

3. **Algeria's key challenges are to achieve sustained growth and reduce unemployment, while maintaining macroeconomic stability**. The government's economic program for 2005–09 addresses these challenges by (a) using part of the hydrocarbon revenues for public investment in key sectors such as infrastructure, housing, education, and healthcare, while continuing appropriate macroeconomic policies; and (b) undertaking structural reforms, particularly in the financial sector, to achieve the transition to an open, market-oriented economy. Fund surveillance in recent years has focused on these areas. The authorities have indicated their appreciation of Fund policy advice and technical assistance, and have drawn on it in their policy making.

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[1] Excluding a sharp increase in work at home/temporary employment in 2004–05, staff estimated the unemployment rate at just below 21 percent in 2005 (See the Selected Issues paper on "The Labor Market and Unemployment in Algeria", forthcoming). The youth unemployment rate stood at 31 percent in 2005.

[2] Algeria is the world's third largest exporter of natural gas, having the eight-largest proven reserves, and the world's tenth largest oil exporter. In 2004, gas production was 225 million cubic meters/day (about 3 percent of world production) and production of liquid petroleum products was 1.9 million barrels/day (about 2½ percent of world production).

Box 1. Priorities of Fund Surveillance

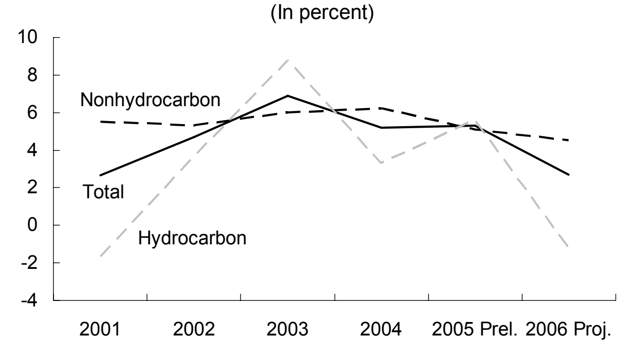
Objective	Instruments	Policy Advice	Fund Input
Improve growth prospects and reduce unemployment	Sound management of hydrocarbon wealth	Setting fiscal policy in a long-term framework and preserving macroeconomic stability	Surveillance
		Careful selection of public expenditures to improve infrastructure, strengthen social sectors, and accompany structural reforms	Coordination with World Bank on public expenditure review and budget management modernization
		Prudent liquidity management and flexible management of the exchange rate	Surveillance
	Structural reforms aimed at promoting private sector activity	Financial sector reform	FSAP update in 2007; MCM technical assistance in bank supervision and restructuring
		Trade liberalization and regional cooperation	Surveillance; regional conferences on trade facilitation in November 2005 and on financial sector reforms and integration in December 2006
		Streamlining of exchange regime for current international transactions	MCM/LEG technical assistance starting in July 2005
		Simplifying the tax and incentive system for private business activity and modernization of the tax administration	FAD technical assistance

II. Recent Economic Developments and Outlook

A. Recent Economic Developments

4. **Economic growth is expected to slow temporarily in 2006.** Reflecting a drop in hydrocarbon output because of maintenance work, real GDP growth is projected to decline to about 3 percent in 2006 from about 5½ percent in 2005. Nonhydrocarbon GDP (NHGDP) growth would continue at 4½ percent, underpinned by sustained activity in the construction sector, resulting from the significant fiscal impulse, and in the agricultural sector.

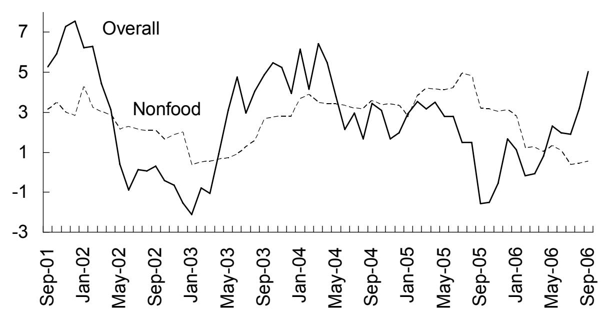
Figure 1. Real GDP Growth, 2001–06
(In percent)



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

5. **Inflation is picking up**. Consumer price inflation remained low through mid-2006 but increased to almost 5 percent (year-on-year) in September, reflecting mainly a rebound in food prices, which had declined with the good 2005 crop.

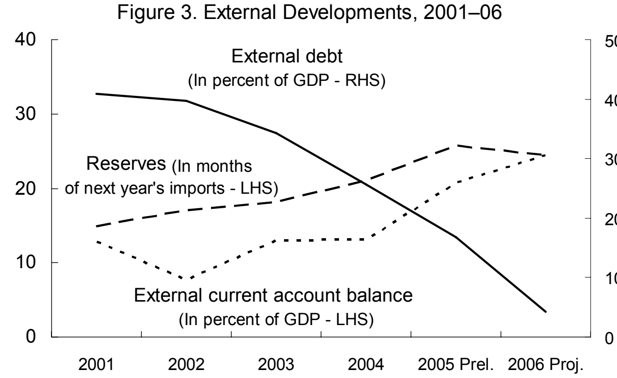
Figure 2. CPI, September 2001–September 2006
(Annual change in percent)



Source: Algerian authorities.

6. **Algeria's external position continued to improve in 2006**. With high world oil prices, the external current account surplus is projected to increase further to 24½ percent of GDP from almost 21 percent in 2005. Gross external reserves reached $70 billion at end-September 2006 (two years of next years' import cover). After early debt repayment of $10½ billion, including to Paris and London Club creditors, the external debt-to-GDP ratio is expected to decline from 17 percent in 2005 to below 4½ percent in 2006.

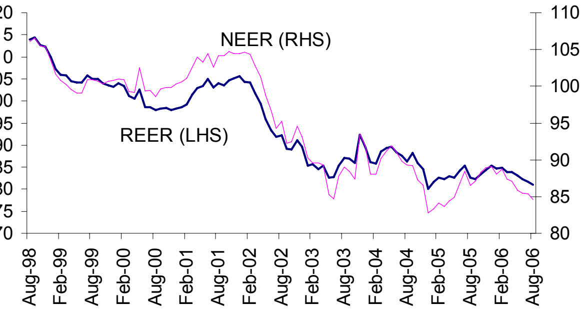
Figure 3. External Developments, 2001–06



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

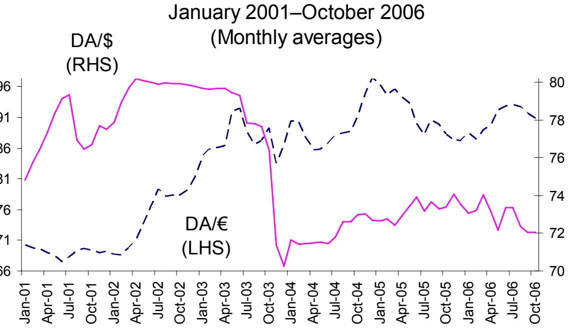
7. **The real effective exchange rate (REER) depreciated by about 5 percent during the first eight months of 2006**, mainly reflecting the appreciation of the euro against the dollar. Algeria's full surrender requirement on hydrocarbon export proceeds makes Bank of Algeria (BA) the dominant seller of foreign exchange to the banks. This position has helped BA to keep the REER broadly in line with its end-2003 level that the authorities considered close to equilibrium. This policy has also resulted in a reduced variability of the dinar/dollar exchange rate since early 2004, given the low inflation differential with Algeria's main trading partners. The spread between the illegal parallel market and the official exchange rates reportedly disappeared in early 2006, following measures to reduce the size of the informal economy (including an increase in the required minimum capital for importers).

Figure 4. Real and Nominal Effective Exchange Rates, August 1998–August 2006 (1995=100)



Source: INS.

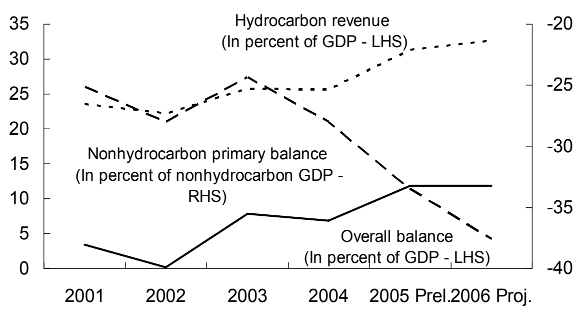
Figure 5. Nominal Exchange Rates, January 2001–October 2006 (Monthly averages)



Source: Algerian authorities.

8. **Buoyant hydrocarbon revenues have financed a strong increase in public spending**. In the 2006 supplementary budget, the 2005–09 public investment program was increased from \$73 billion to \$90 billion. Civil service wages were raised by about 15–16 percent on average as of July 1, 2006, largely in compensation for past inflation.[3] As a result, the nonhydrocarbon primary deficit is expected to widen from about 33½ percent of NHGDP in 2005 to almost 37½ percent in 2006. Nevertheless, the overall budget surplus would remain high at about 12 percent of GDP in 2006.

Figure 6. Overall and Nonhydrocarbon Fiscal Balances, 2001–06



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

[3] The authorities last increased the minimum wage by 25 percent in January 2004 from its level of January 2001, which had only a limited effect on the wage structure.

Box 2. Prepayment of External Debt, 2004–06

In light of large hydrocarbon export receipts, the authorities decided in 2004 to prepay official external debt, and limit nonconcessional borrowing. Since 2004, Algeria has repaid about $14 billion official external debt ahead of schedule.

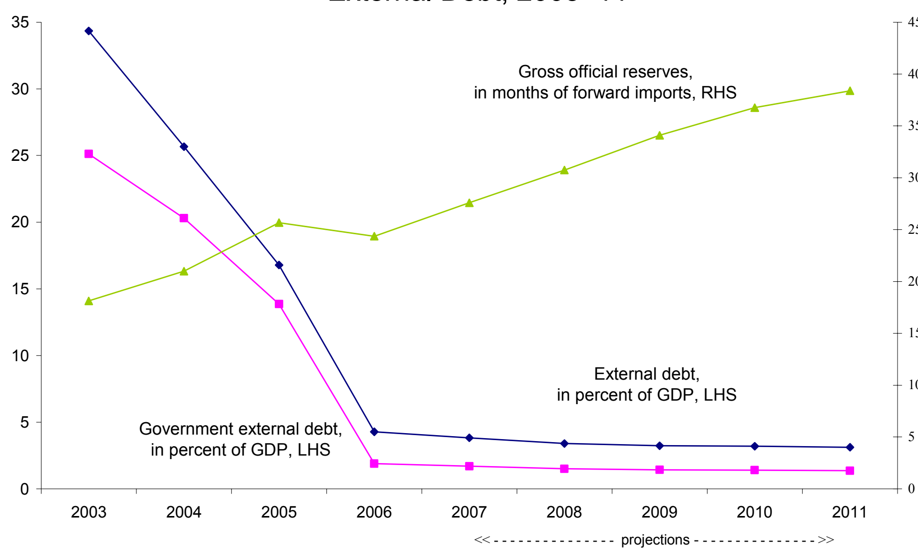
At end-2003, Algeria's external debt of $23.4 billion (excluding Soviet-era debt owed to Russia) included $12.2 billion of rescheduled debt to Paris and London Club creditors and $5 billion to multilateral creditors.

In 2004–05, Algeria prepaid $3.3 billion, particularly to multilateral creditors, including the Fund. In March 2006, Russia cancelled $4.7 billion Soviet-era claims in exchange for Algeria agreeing to import an equivalent amount of Russian goods and services over an unspecified time period. This paved the way for Paris Club approval in May 2006 of Algeria's request to prepay its outstanding debt at par. Following bilateral negotiations, Paris and London Club debt worth $8.5 billion had been prepaid by end-2006. A further $2 billion was also prepaid to multilateral creditors in 2006.

Algeria's external debt-to-GDP ratio has declined from about 34 percent of GDP at end-2003 to less than 4½ percent at end-2006; it is projected to fall to 3 percent by 2011. At the same time, the reserve cover ratio has increased from 18 months in 2003 to almost 25 months in 2006, and is projected to reach 38 months by 2011. Under the circumstances, Algeria's external debt would remain sustainable over the medium term. Building on this, the authorities intend to obtain a sovereign rating.

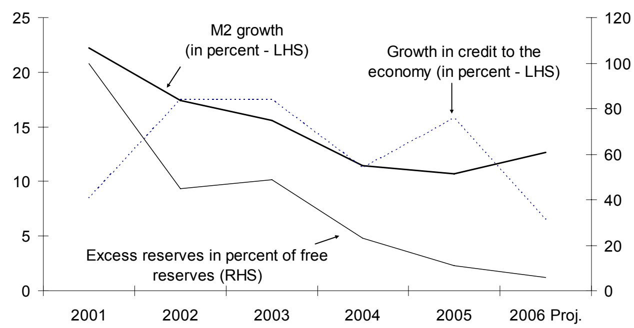
Algeria's participation as a creditor in the Enhanced HIPC Initiative awaits approval by the authorities.

External Debt, 2003–11



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

Figure 7. Monetary Policy Stance, 2001–06

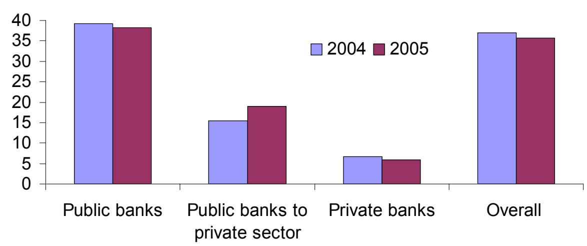


Sources: Algerian authorities; and Fund staff estimates and projections.

9. **Monetary policy has remained prudent, in line with the authorities' objective of containing inflation**. BA continued to absorb most of the excess liquidity of the banking system through deposit auctions in 2006, in reaction to the fiscal stimulus and the rapidly growing bank deposits of the national oil company (Sonatrach). The expansion of credit to the economy slowed.

10. **Some progress was made in structural reforms in 2006**. In the financial sector, the process of privatizing a first public bank and the modernization of the payments system are underway. The governance of the remaining public banks is being strengthened and supervision has become more active, mainly through on-site inspections. However, nonperforming loans of public banks remained high. The corporate profit tax rate was reduced from 30 percent to 25 percent. In addition, the government decided to streamline the taxation of small enterprises by introducing a single presumptive tax.[4] A new hydrocarbon law was adopted in 2005 that, inter alia, further liberalizes investment in this sector; in 2006, the authorities amended the new law to restore Sonatrach's majority stake in all contracts with international hydrocarbon companies. Privatization of public enterprises is proceeding and an anticorruption law was adopted in January 2006.

Figure 8. Ratio of Nonperforming Loans to Total Loans, 2004–05
(In percent)



Source: Algerian authorities.

B. Medium-Term Outlook

11. **Algeria's external position is expected to remain strong over the medium term**. With oil prices projected to remain relatively high and given the authorities' decision to limit the expansion of hydrocarbon output, annual hydrocarbon exports are expected to average \$55½ billion through 2011. Imports would increase significantly, driven by large investments by the government and Sonatrach. The external current account surplus, while gradually declining, would remain sizable and gross external reserves would exceed three years of import cover by 2011. Gross external debt would remain low and sustainable.

[4] The tax rate will be 6 percent of turnover for traders and 12 percent of turnover for other small businesses.

12. **Algeria's economic outlook for the medium term is favorable**. The authorities agreed with staff that medium-term growth prospects depend importantly on the country's ability to address key constraints to growth. Assuming steady implementation of the public investment program and of ongoing structural reforms, real NHGDP growth is projected at 5½ percent in 2007 and about 5 percent thereafter. Achieving a higher growth trend would require more ambitious structural reforms.[5] The planned increase in public investment and the spread of the public sector wage hike to the rest of the economy would contribute to some inflationary pressures in the coming years.

Algeria: Medium-Term Projections 2006–11

(In percent of GDP, unless otherwise indicated)

	2006	2007	2008	2009	2010	2011
Real GDP	2.7	4.5	4.1	4.0	4.0	4.0
Hydrocarbon sector	-1.2	2.5	2.0	2.0	2.0	2.0
Nonhydrocarbon sector	4.5	5.4	5.1	4.9	4.8	4.8
CPI inflation (period average)	2.2	5.5	5.7	5.2	4.6	4.1
Current account balance (in percent of GDP)	24.4	16.6	14.4	11.8	10.1	8.5
Nonhydrocarbon primary balance (in percent of NHGDP)	-37.6	-39.2	-38.3	-36.6	-33.6	-31.3
Overall fiscal balance (in percent of GDP)	11.9	9.9	9.4	8.3	7.8	7.2

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

13. **The draft 2007 budget includes a sizeable increase in public spending over the medium term**. The 2005–09 public investment program would be increased to some $113 billion (equal to 2006 GDP). Taking account of the full-year effect of the civil service wage increase and of current expenditure needs over the medium term, the nonhydrocarbon primary deficit would increase to about 39 percent of NHGDP in 2007; thereafter it would gradually decline to 31 percent of NHGDP by 2011, in line with long-term fiscal sustainability. The overall budget surplus would remain above 7 percent of GDP through 2011.

[5] See the Selected Issues paper on "Growth Prospects in Algeria" (forthcoming).

Box 3. Long-Term Fiscal Sustainability

Staff's long-term fiscal framework for assessing the management of hydrocarbon wealth aims at preserving the permanent per capita income from hydrocarbon wealth (see IMF Country Report No. 04/33; IMF Country Report No. 06/93). This is expressed as a sustainable path for the nonhydrocarbon primary deficit/NHGDP ratio. In this framework, the sustainable nonhydrocarbon primary deficit would decrease from about 37½ percent of NHGDP in 2006 to 32½ percent in 2010 (compared to 26 percent estimated at the time of the 2005 Article IV consultation). Income from financial wealth would entirely finance the deficit that prevails after 2050 when hydrocarbon reserves are assumed to run out. Given the volatility of world oil prices, it is important that the authorities continue to maintain fiscal sustainability over the long term.

Sustainable Nonhydrocarbon Primary Deficit, 2006–11

(In percent of NHGDP)

	2006	2007	2008	2009	2010	2011
Sustainable path (see IMF Country Report No. 06/93)	-30.8	-29.5	-28.3	-27.2	-26.1	...
Memo: Crude oil export unit value (US$/bbl)	*61.7*	*60.0*	*58.0*	*57.3*	*56.5*	...
Sustainable path (September 2006 WEO oil prices)	-37.4	-36.0	-34.8	-33.7	-32.6	-31.6
Staff projections for actual deficit	-37.6	-39.2	-38.3	-36.6	-33.6	-31.3
Memo: Crude oil export unit value ($/bbl)	*67.3*	*65.4*	*65.7*	*63.8*	*62.0*	*60.4*

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

III. Policy Discussions

14. **The discussions were characterized by broad agreement between authorities and staff on the key economic challenges facing Algeria and policies needed to address them**. The authorities concurred that Algeria's strong financial position creates an ideal window of opportunity for accelerating reforms and tackling key impediments to private sector-led growth. The discussions centered on (a) the management of hydrocarbon resources and macroeconomic policies; and (b) key structural reforms, notably in the banking sector.

A. Management of Hydrocarbon Revenue and Macroeconomic Policies

15. **The authorities have enhanced the transparency in the use of hydrocarbon revenue in the budget**. In the 2006 supplementary budget, the rules of the hydrocarbon stabilization fund—*Fonds de Régulation des Recettes* (FRR)—were amended to allow for the direct financing of the nonhydrocarbon deficit (unless the balance of the FRR drops below 10 billion), broadly in line with staff advice (see IMF Country Report No. 06/93).[6] Moreover,

[6] Algeria's hydrocarbon stabilization fund is a sub-account of the government at the central bank, in dinars and with a low interest rate. Inflows into the account are hydrocarbon budgetary receipts above the equivalent of $19 per barrel; outflows are for debt amortization and the financing of the remaining nonhydrocarbon deficit.

the draft 2007 budget informs parliament of the implicit price of a barrel of oil equivalent to the hydrocarbon revenue needed to finance the nonhydrocarbon deficit (2007: $49 per barrel). However, the budget reference price has been kept at $19 per barrel for budget presentation purposes.

Fiscal Policy

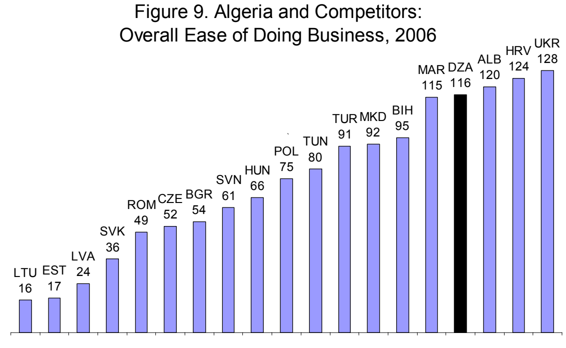
16. **Discussions focused on the 2006–09 public investment program, wage policy, and structural fiscal issues.**

- **The authorities were keenly aware of the challenge of ensuring the high quality of public investment in light of the limited absorption capacity.** They indicated that they have already begun to reevaluate the projects included in the public investment program, in order to focus on projects with a high rate of return, and have strengthened the monitoring and evaluation mechanisms for large investment projects. The authorities were also committed to taking into account the recommendations of the public expenditure review conducted in cooperation with the World Bank in 2005–06.

- **The National Economic and Social Pact—concluded in 2006 between the government, employers' organizations, and trade unions—supports, for the first time, linking real wage increases to productivity and economic performance in the nonhydrocarbon sector**, in line with past staff advice. In addition, the Pact supports efforts to improve the business climate for private enterprise, enhance the productivity of the economy, and privatize public enterprises. Decentralized wage negotiations are underway and will likely result in wage increases broadly in line with that granted to the civil service. The Pact provides that future wage demands will not be based on hydrocarbon revenues and the unions indicated that they have agreed to hold off demands for another general wage increase until 2009–10.

- **The government intends to take advantage of buoyant hydrocarbon revenues to simplify the tax and incentive system for business activity**. The authorities concurred that the development of Algeria's nonhydrocarbon economy requires a significant improvement in the business climate. However, structural reforms will take time to mature. Therefore, the authorities believed that progress can be accelerated by focusing on measures with a more rapid payoff, and have requested FAD technical assistance to streamline further the tax system and assist them in the ongoing modernization of the tax administration.

Figure 9. Algeria and Competitors:
Overall Ease of Doing Business, 2006



Source*:* http:\\www.doingbusiness.org. Country ranking from 1 (best) to 175 (worst).

Box 4. The 2005–06 Public Expenditure Review

The public expenditure review (PER) was conducted between October 2005 and June 2006. It covered four sectors: health, education, water, and transport/public works. The PER also assessed the performance of budgetary management.

Diagnosis

The PER found that Algeria has made important progress in education and public healthcare. However, it found severe shortcomings in the planning and execution of public investment. General, cross-sector concerns included:

- the technical readiness of personnel in charge of executing projects is generally low and unlikely to be improved by large upfront spending authorizations;
- existing weaknesses in absorption capacity entail substantial risks that costs could be excessive;
- project quality is uneven and would only partially achieve the objectives of sectoral strategies;
- several projects fail to meet minimum standards and should not proceed.

Main recommendations

- The pace of implementation of the public investment program should reflect a more realistic assessment of the absorption capacity of line ministries.
- A more even implementation of the investment program than currently planned is proposed starting with the 2007 budget.
- Project selection should be more closely guided by sectoral strategies in the context of a medium-term expenditure framework.
- Management and control systems for public investment and the budget should be urgently modernized.

- **The government is poised to modernize budget management and strengthen fiscal governance**. It intends to submit the draft organic law on public finances to parliament before end-2006 and has prepared a new budget classification system, in line with *Government Finance Statistics* guidelines. The authorities indicated that they envisage implementing other recommendations of the 2004 fiscal ROSC in the period ahead.

Monetary and Exchange Rate Policies

17. **Keeping inflation under control will be the key challenge for BA**. The monetary authorities considered that the fiscal expansion and wage increases will require tightening monetary policy to forestall inflationary pressures. They indicated that they intend to increase BA's policy interest rate to keep it at a positive level in real terms and to continue absorbing excess liquidity in the banking system.[7]

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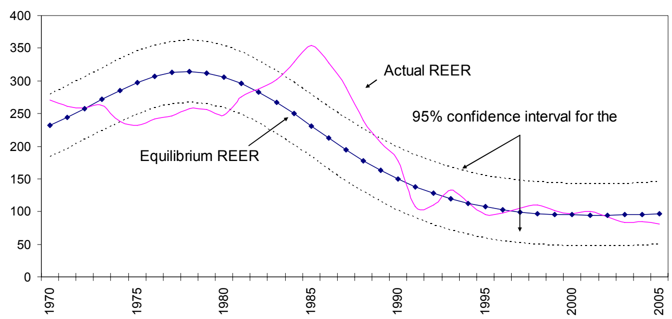
[7] In September 2006, BA's policy interest rate stood at 1.7 percent and average CPI inflation was at 1.3 percent.

18. **The authorities intend to continue managing the exchange rate in a flexible manner, taking account of the inflation objective**. Staff found no evidence of misalignment of the real exchange rate.[8] In the short term, the REER would be subject to offsetting influences. The expansionary fiscal stance and the wage increases imply a real exchange rate appreciation, while the ongoing trade liberalization points in the opposite direction. With the sizable demand stimulus, the authorities believed that an appreciation of the REER is likely in 2007. In this context, they intend to continue their flexible management of the exchange rate. To achieve lasting gains in competitiveness, given prevailing wage levels in Algeria, it is essential to implement structural reforms aimed at increasing the productivity of the economy.

Figure 10. Real Effective Exchange Rate (REER) and Equilibrium REER,1970–2005



Sources: INS; and Fund staff estimates.

B. Structural Reforms

Reform of the Financial Sector

19. **The authorities considered that further progress on financial sector reform aimed at improving the soundness of the banking system and strengthening financial intermediation is a priority to sustain growth in the nonhydrocarbon sector**. They have requested a Financial Sector Assessment Program (FSAP) update, which is scheduled for early 2007. Discussions focused on the ongoing banking sector reform and the financial relationship between public banks and public enterprises.

- **The privatization of the first public bank is proceeding as planned**. The sale of a majority share in *Crédit Populaire d'Algérie* is expected to be completed in early 2007. Subsequently, other public banks may also be privatized. The objective of the government is to select banks with an internationally established reputation as majority shareholders, in order to inject modern know-how into the sector.

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[8] The fundamentals of the equilibrium real effective exchange rate are Algeria's labor productivity differential with trading partners and the real oil price (See IMF County Report No. 05/52). The impact of the recent oil price increase is offset by the relatively low labor productivity growth in Algeria, leaving the equilibrium real effective exchange rate almost flat in recent years.

- **Steps are also being taken to strengthen the governance of the remaining public banks**. Performance contracts for public banks have been strengthened and the authorities are focusing their efforts in particular on improving risk management and internal controls.

- **The authorities agreed that greater competition in the banking sector and further improving the operational framework will strengthen financial intermediation**. Steadfast progress is being made through the ongoing modernization of the payment system, sustained political support of the banking commission in enforcing prudential regulations, and improving banking supervision, with Fund technical assistance. However, the directive prohibiting public entities from dealing with private banks remains an obstacle to better promoting a level playing field.

- **There is a need to establish a more sound and transparent relationship between public banks and public enterprises**. The government is in the process of taking over nonperforming loans of public banks to public enterprises in an amount equivalent to 4 percent of GDP. It is determined to avoid new nonperforming loans from arising by strictly limiting bank financing of nonviable public enterprises, but has not yet decided on the measures needed to achieve this.

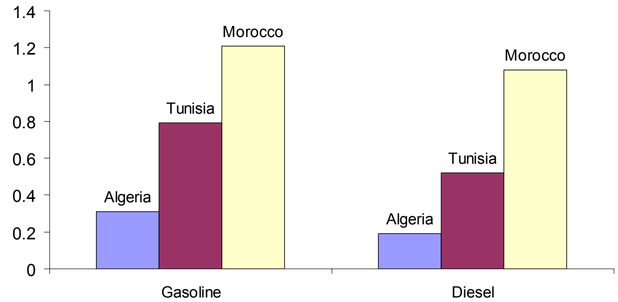
Other Structural Reforms

20. **The authorities intend to continue liberalizing external trade and to remain engaged in regional integration efforts**. Following the coming into effect of the Association Agreement with the European Union in 2005, the authorities are now focusing on Algeria's accession to the World Trade Organization (WTO). The government has also decided to modernize and streamline the customs administration, with Fund technical assistance. Gradually enhancing regional cooperation and eventually establishing a large regional market will help Algeria to better harness the benefits of multilateral liberalization. In this context, the authorities intend to implement the action plan resulting from the 2005 Maghreb trade facilitation conference to: (a) set up a website with comprehensive information on trade regulations and taxation; (b) work toward mutual recognition of norms and controls; (c) reduce trade distortions and informal trade; (d) develop a one-stop document-processing system; and (e) establish a private sector-led monitoring unit on Maghreb foreign trade. The forthcoming conference on financial sector reform and prospects for financial integration in the Maghreb will also help to intensify regional cooperation.

21. **Although the authorities acknowledged that improving the legal framework for foreign exchange transactions would help Algeria benefit from its opening up to the rest of the world, they have not yet followed through on their intention to promulgate a new draft foreign exchange regulation that implements the recommendations of Fund technical assistance in this regard** (IMF Country Report No. 06/93). The authorities have indicated that this regulation, that will clearly establish the current convertibility of the dinar, will be promulgated shortly.

22. **Rigidities in domestic energy pricing are giving rise to inefficiencies and large implicit subsidies**.[9] The authorities agreed that these subsidies favor energy-intensive activities at the expense of labor-intensive ones, discourage energy conservation, and give rise to smuggling to neighboring countries. They indicated that the subsidies would be reduced gradually by raising domestic energy prices after 2007. However, the authorities were concerned about the social impact of such increases and asked staff to advise in the coming months on the modalities of such price increases and on targeted measures to protect the most vulnerable groups.

Figure 11. Fuel Prices, end–June 2006
(in $/liter)



Source: Authorities.

IV. Staff Appraisal

23. In recent years, Algeria has succeeded in using its ample hydrocarbon revenues to sustain economic growth and bring down the still high unemployment, while keeping inflation low. The external position has improved significantly with the build-up of international reserves and prepayment of most of the external debt. Progress continued to be made in structural reforms.

24. Algeria's external position is expected to remain strong and growth prospects are favorable. However, as the temporary slowdown in 2006 has shown, growth remains fragile and mainly driven by government investment. Also, the envisaged fiscal expansion and the impact of wage increases would result in some inflationary pressures.

25. The country's increased political stability and favorable financial situation present an excellent opportunity for achieving high, sustainable growth and reducing unemployment, while maintaining macroeconomic stability. This requires: (a) ensuring sound management of hydrocarbon resources, notably the high quality of the large public investment program; and (b) pressing ahead with the modernization of financial intermediation and other structural reforms to increase productivity and improve the business climate.

26. The ambitious public investment program requires sustained efforts to ensure its quality. In addition to the steps being taken by the government, staff recommends that the authorities focus on the execution and monitoring of existing projects. It is also important to

[9] For 2005, staff estimated that the government's and Sonatrach's loss of revenue resulting from the gap between prices of hydrocarbon products on the domestic and world markets amounted to 7½ percent of GDP.

prepare comprehensive medium-term budget projections, taking into account the implication of public investment on current expenditures, to accelerate budget modernization, and to strengthen fiscal governance by implementing the recommendations of the 2004 fiscal ROSC.

27. Staff welcomes the new rules governing the hydrocarbon stabilization fund and, in view of the expected large increase in its balance, recommends aiming at a higher investment return.

28. The National Economic and Social Pact is an important milestone. Staff recommends that real wages be adjusted more gradually than in the past, in line with productivity growth and economic performance in the nonhydrocarbon sector.

29. Given the need to tighten monetary policy, staff welcomes the authorities' intention to bring BA's policy interest rate to a positive level in real terms. It reiterates that handling Sonatrach's large deposits outside the banking system would strengthen BA's control over base money. It is important that BA continue its flexible management of the exchange rate.

30. Pushing ahead decisively with the privatization of public banks, strengthening the governance of remaining public banks, and promoting competition in the sector are paramount. Staff also emphasizes the need to strictly limit bank lending to nonviable public enterprises and, if necessary, provide assistance through direct government subsidies accompanied by enterprise restructuring and acceleration of privatization.

31. Following the coming into effect of the Association Agreement with the European Union, it is important to pursue the negotiations for Algeria's accession to the WTO. Staff welcomes the authorities' decision to modernize the customs administration. Enhanced regional integration will also help Algeria realize its full economic potential and enhance its attractiveness to foreign investors. As a first step, staff welcomes the authorities' intention to implement the action plan to reduce obstacles to regional trade that resulted from the 2005 conference on trade facilitation in the Maghreb.

32. Staff urges the authorities to promulgate as soon as possible the new draft exchange regulation, which should remove remaining ambiguities regarding the current convertibility of the dinar.

33. It is important to continue to improve the business climate, including by simplifying the tax system for business activity. Staff also welcomes the intention of the government to gradually increase the pass-through of world oil prices to domestic energy prices.

34. Staff strongly encourages the authorities to intensify their efforts to upgrade the production and dissemination of economic and financial statistics, including by benefiting from the needed technical assistance under the GDDS.

35. Staff encourages Algeria to participate as a creditor in the Enhanced HIPC Initiative, and to obtain a sovereign rating.

36. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Table 1. Algeria: Selected Economic and Financial Indicators, 2003–11

	2003	2004	Est. 2005	Projections 2006	2007	2008	2009	2010	2011
				(Annual percentage change)					
National income and prices									
GDP at constant prices 1/	6.9	5.2	5.3	2.7	4.5	4.1	4.0	4.0	4.0
Hydrocarbon sector	8.8	3.3	5.6	-1.2	2.5	2.0	2.0	2.0	2.0
Other sectors	6.0	6.2	5.1	4.5	5.4	5.1	4.9	4.8	4.8
GDP deflator	8.3	10.6	16.5	9.0	3.2	6.4	3.5	2.3	2.0
Hydrocarbon	16.3	20.7	38.0	18.1	2.5	5.8	0.6	-1.3	-1.4
Nonhydrocarbon	4.4	5.3	3.4	3.5	6.9	8.4	7.0	5.9	5.1
Consumer price index (average)	2.6	3.6	1.6	2.2	5.5	5.7	5.2	4.6	4.1
Consumer price index (end of period)	4.0	2.0	1.7	3.1	6.0	5.5	4.9	4.3	4.0
External sector 2/									
Exports, f.o.b.	30.7	31.7	43.8	16.8	2.3	4.7	-0.1	-1.4	-1.1
Hydrocarbons	32.5	31.5	44.5	17.0	2.3	4.7	-0.2	-1.6	-1.3
Nonhydrocarbons	-21.7	42.6	10.4	6.2	6.0	5.9	5.8	5.9	5.8
Imports, f.o.b.	11.2	34.5	10.6	6.6	39.9	12.0	7.4	3.4	3.6
Terms of trade	9.7	13.6	30.0	9.4	-0.2	6.2	0.4	-1.9	-2.4
Nominal effective exchange rate 3/	-8.9	-0.1	-2.8	0.3	...	...	...	...	...
Real effective exchange rate 3/	-9.5	0.6	-3.9	-0.1	...	...	...	...	...
Money and credit									
Net foreign assets	33.4	33.1	34.0	33.7	31.2	...	...	...	...
Domestic credit 4/	-1.4	-8.6	-18.2	-19.4	-14.7	...	...	...	...
Credit to the government (net) 4/ 5/	-5.3	-13.2	-24.7	-17.0	-18.6	...	...	...	...
Credit to the economy 5/	8.9	11.2	15.8	-5.5	10.8	...	...	...	...
In real terms	*4.8*	*9.1*	*13.9*	*-8.3*	*4.5*	...	...	...	...
Money and quasi-money	15.6	11.5	10.7	12.7	17.9	...	...	...	...
Velocity of broad money (GDP/M2)	1.6	1.6	1.8	1.8	1.6	...	...	...	...
Liquidity ratio (M2/nonhydrocarbon GDP)	98.9	98.6	100.4	105.5	112.8	...	...	...	...
Liquidity ratio (M2/GDP)	63.8	61.1	55.1	55.7	60.9	...	...	...	...
				(In percent of GDP)					
Saving-investment balance	13.0	13.1	20.7	24.4	16.6	14.4	11.8	10.1	8.5
National savings	43.5	46.3	51.6	56.3	52.5	51.7	49.9	47.4	44.5
Government	15.9	14.7	22.7	25.3	24.6	24.1	22.6	20.9	19.4
Nongovernment	27.5	31.6	28.9	31.1	27.8	27.6	27.4	26.5	25.2
Investment	30.5	33.3	30.9	31.9	35.9	37.3	38.1	37.3	36.0
Government	8.1	7.9	10.8	13.4	14.7	14.7	14.3	13.1	12.1
Nongovernment	22.4	25.4	20.1	18.6	21.1	22.6	23.8	24.2	23.9
Central government finance									
Overall budget balance (deficit -)	7.8	6.9	11.9	11.9	9.9	9.4	8.3	7.8	7.2
Revenue and grants	37.0	36.2	41.0	41.9	42.2	41.6	40.4	39.0	37.8
Hydrocarbon 6/	25.6	25.6	31.3	32.6	31.9	31.2	29.8	28.3	27.0
Nonhydrocarbon	11.3	10.5	9.7	9.2	10.2	10.4	10.5	10.6	10.9
Grants	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	29.2	29.3	29.1	30.0	32.3	32.2	32.1	31.2	30.6
Current expenditure	21.3	20.3	16.5	16.6	17.6	17.5	17.8	18.1	18.4
Capital expenditure 7/	8.1	7.9	10.8	13.4	14.7	14.7	14.3	13.1	12.1
Other 8/	-0.2	1.1	1.8	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing	-6.1	-6.0	-10.4	-10.9	-9.6	-9.1	-8.1	-7.6	-7.1
External financing	-1.7	-0.9	-1.5	-1.0	-0.3	-0.3	-0.2	-0.2	-0.1
				(In percent of nonhydrocarbon GDP)					
Central government finance									
Total revenue	57.3	58.3	74.7	79.4	78.2	75.4	70.5	65.5	61.4
Hydrocarbon	39.8	41.4	57.0	61.8	59.2	56.6	52.1	47.6	43.8
Nonhydrocarbon	17.5	17.0	17.7	17.5	19.0	18.8	18.3	17.9	17.6
Total expenditure	45.3	47.2	53.0	56.8	59.8	58.4	56.0	52.4	49.6
Current expenditure	33.0	32.8	30.1	31.5	32.5	31.7	31.1	30.4	29.9
Capital expenditure 7/	12.6	12.7	19.7	25.3	27.3	26.7	24.9	22.0	19.7
Other 8/	-0.3	1.8	3.3	0.0	0.0	0.0	0.0	0.0	0.0
Nonhydrocarbon primary balance	-24.3	-28.0	-33.5	-37.6	-39.2	-38.3	-36.6	-33.6	-31.3
Nonhydrocarbon balance	-27.7	-30.3	-35.3	-39.3	-40.9	-39.6	-37.7	-34.5	-32.0

Table 1 (concluded). Algeria: Selected Economic and Financial Indicators, 2003–11

			Est.	Projections					
	2003	2004	2005	2006	2007	2008	2009	2010	2011
	(In billions of U.S. dollars; unless otherwise specified)								
External sector									
Exports, f.o.b.	24.5	32.2	46.3	54.1	55.4	58.0	57.9	57.1	56.5
Hydrocarbon	24.0	31.6	45.6	53.3	54.6	57.1	57.0	56.1	55.4
Nonhydrocarbon	0.5	0.7	0.7	0.8	0.8	0.9	0.9	1.0	1.0
Imports, f.o.b.	13.4	18.0	19.9	21.2	29.6	33.2	35.6	36.8	38.1
Interest payments	1.2	1.3	1.0	0.6	0.2	0.2	0.2	0.2	0.2
Current account balance (deficit -)	8.8	11.1	21.2	27.9	19.7	18.3	15.7	13.9	12.2
Idem, in percent of GDP	13.0	13.1	20.7	24.4	16.6	14.4	11.8	10.1	8.5
Overall balance (deficit -)	7.4	9.3	16.9	16.7	19.9	18.4	16.3	14.9	13.1
Gross official reserves (end-period)	32.9	43.1	56.2	74.6	94.6	113.2	129.7	144.9	158.5
In months of next year's imports of G&S	18.1	21.0	25.7	24.4	27.6	30.7	34.1	36.8	38.4
External debt	23.4	21.8	17.2	4.9	4.6	4.3	4.3	4.4	4.5
External debt (in percent of GDP)	34.3	25.7	16.8	4.3	3.8	3.4	3.2	3.2	3.1
External debt service (in percent of exports)	17.9	17.6	12.5	22.6	2.9	2.9	2.7	2.7	2.8
	(In billions of Algerian dinars; unless otherwise indicated)								
Memorandum items:									
GDP (current prices)	5,264	6,127	7,519	8,384	9,039	10,015	10,783	11,465	12,156
NHGDP (current prices)	3,395	3,797	4,125	4,425	4,879	5,526	6,177	6,826	7,488
GDP (current prices, in billions of $)	68.0	85.0	102.4	114.2	119.2	127.4	132.9	137.7	142.9
Per capita GDP (in $)	2,136	2,627	3,097	3,403	3,499	3,684	3,787	3,866	3,953
Population (in millions)	31.8	32.4	33.1	...	...	...	...	...	...
Unemployment rate (in percent) 9/	23.7	17.7	15.3	...	...	...	...	...	...
Crude oil export unit value ($/bbl)	29.0	38.5	54.6	67.3	65.4	65.7	63.8	62.0	60.4
Crude oil exports (in millions of barrels/day)	0.7	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Gross government debt (in percent of GDP)	43.8	36.6	28.4	22.6	19.5	17.1	14.5	12.9	11.3
Of which: Domestic	18.7	16.3	14.6	20.7	17.8	15.6	13.1	11.5	9.9
External	25.1	20.3	13.9	1.9	1.7	1.5	1.4	1.4	1.4
Exchange rate (DA/$) (end of period) 10/	72.6	72.6	73.4	72.1	...	...	...	...	...
Exchange rate (DA/$) (average) 10/	77.4	72.1	73.4	72.9	...	...	...	...	...

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

1/ Starting in 2004, in constant 2001 prices.
2/ In U.S. dollars terms.
3/ Annual average changes in trade-weighted INS index. A decrease implies a depreciation. For 2006, as of August.
4/ In percent of beginning money stock.
5/ Including the impact of the financial restructuring in 2001–02 and end-2006 involving the swap of government bonds for bank claims on public enterprises.
6/ Including dividends of Sonatrach.
7/ Including special accounts related to capital spending.
8/ Including special accounts (not related to capital spending) and net lending.
9/ Derived from a survey conducted once a year in September. In 2004, reflects a sharp increase in work at home and temporary employment.
10/ For 2006, as of October.

Table 2. Algeria: Balance of Payments, 2003–11

				Projections					
	2003	2004	2005	2006	2007	2008	2009	2010	2011
	(In billions of U.S. dollars; unless otherwise indicated)								
Current account	8.81	11.12	21.18	27.90	19.75	18.28	15.70	13.94	12.17
Trade balance	11.11	14.27	26.47	32.95	25.77	24.84	22.33	20.29	18.33
Exports, f.o.b.	24.46	32.22	46.33	54.13	55.39	58.01	57.95	57.11	56.46
Hydrocarbons	23.99	31.55	45.59	53.34	54.55	57.13	57.01	56.12	55.41
Volume change (in percent)	*9.2*	*2.8*	*5.7*	*-2.7*	*1.9*	*1.3*	*1.3*	*1.3*	*1.2*
Price change (in percent)	*21.9*	*27.4*	*36.6*	*20.1*	*0.3*	*3.4*	*-1.5*	*-2.8*	*-2.5*
Other	0.47	0.67	0.74	0.79	0.83	0.88	0.93	0.99	1.04
Imports, f.o.b.	-13.35	-17.95	-19.86	-21.17	-29.61	-33.16	-35.62	-36.82	-38.13
Volume change (in percent)	*-9.4*	*21.9*	*7.5*	*-0.5*	*40.0*	*14.8*	*9.8*	*4.8*	*3.3*
Price change (in percent)	*22.7*	*10.3*	*2.8*	*7.2*	*-0.1*	*-2.5*	*-2.2*	*-1.3*	*0.3*
Services and income (net)	-4.05	-5.61	-7.35	-6.34	-7.37	-7.95	-8.07	-7.84	-7.70
Services (net)	-1.35	-2.01	-2.27	-2.22	-4.15	-4.86	-5.38	-5.62	-5.87
Credit	1.57	1.85	2.51	2.88	2.98	3.12	3.20	3.25	3.30
Debit	-2.92	-3.86	-4.78	-5.10	-7.13	-7.98	-8.57	-8.86	-9.18
Income (net)	-2.70	-3.60	-5.08	-4.13	-3.22	-3.09	-2.69	-2.23	-1.83
Credit	0.76	0.99	1.43	2.90	4.17	5.19	6.14	7.03	7.87
Debit	-3.46	-4.59	-6.51	-7.03	-7.39	-8.28	-8.83	-9.26	-9.70
Interest payments	-1.18	-1.29	-1.03	-0.58	-0.25	-0.24	-0.23	-0.23	-0.23
other, including profit repatriation	-2.28	-3.30	-5.48	-6.45	-7.14	-8.05	-8.60	-9.03	-9.47
Transfers (net)	1.75	2.46	2.06	1.29	1.34	1.39	1.44	1.49	1.54
Capital account	-1.37	-1.87	-4.23	-11.19	0.11	0.16	0.65	0.93	0.96
Medium- and long-term capital	-0.76	-1.61	-1.99	-10.05	0.71	0.88	1.14	1.35	1.40
Direct investment (net)	0.62	0.62	1.06	1.37	1.04	1.11	1.19	1.27	1.35
Loans (net)	-1.38	-2.23	-3.05	-11.42	-0.33	-0.23	-0.05	0.09	0.05
Drawings	1.65	2.12	1.41	0.88	1.10	1.28	1.40	1.46	1.51
Amortization	-3.03	-4.35	-4.46	-12.30	-1.43	-1.51	-1.45	-1.38	-1.46
Short-term capital and errors and omissions	-0.61	-0.26	-2.24	-1.15	-0.60	-0.71	-0.49	-0.43	-0.44
Overall balance	7.44	9.25	16.95	16.71	19.85	18.44	16.35	14.86	13.13
Financing	-7.44	-9.25	-16.95	-16.71	-19.85	-18.44	-16.35	-14.86	-13.13
Official reserves (increases -)	-7.00	-8.88	-16.32	-16.71	-19.85	-18.44	-16.35	-14.86	-13.13
Fund repurchases	-0.44	-0.37	-0.63	0.00	0.00	0.00	0.00	0.00	0.00
Memorandum items:									
Current account balance (in percent of GDP)	13.0	13.1	20.7	24.4	16.6	14.4	11.8	10.1	8.5
Crude oil export unit value ($/barrel) 1/	29.0	38.5	54.6	67.3	65.4	65.7	63.8	62.0	60.4
Gross official reserves (in billions of $)	32.9	43.1	56.2	74.6	94.6	113.2	129.7	144.9	158.5
Idem, in months of next year's imports	18.1	21.0	25.7	24.4	27.6	30.7	34.1	36.8	38.4
Gross external debt (in billions of $)	23.4	21.8	17.2	4.9	4.6	4.3	4.3	4.4	4.5
Of which: Short-term	0.2	0.4	0.7	...	...	...	...	...	...
External debt/exports (in percent)	89.7	64.0	35.2	8.6	7.8	7.1	7.0	7.3	7.5
External debt/GDP (in percent)	34.3	25.7	16.8	4.3	3.8	3.4	3.2	3.2	3.1

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

1/ Weighted average of quarterly data through the third quarter of 2006; projections based on the August 2006 WEO oil price projections.

Table 3. Algeria: Summary of Central Government Operations, 2003–11 1/

		Est.	Prel.	Projections					
	2003	2004	2005	2006	2007	2008	2009	2010	2011
	(In billions of Algerian dinars)								
Budget revenue and grants	1,947	2,215	3,083	3,512	3,813	4,165	4,352	4,470	4,596
Hydrocarbon revenue 2/	1,350	1,571	2,353	2,737	2,887	3,128	3,219	3,250	3,277
Nonhydrocarbon revenue	595	644	730	775	926	1,037	1,133	1,220	1,319
Tax revenue	525	580	640	686	835	943	1,037	1,122	1,219
Taxes on income and profits	128	148	168	208	236	275	307	339	372
Taxes on goods and services	234	274	309	342	415	464	508	548	594
Customs duties	144	139	144	111	157	175	189	199	213
Registration and stamps	19	20	20	24	26	30	33	37	40
Nontax revenues	70	64	90	89	91	94	96	98	100
Fees	24	27	35	40	43	45	47	49	52
Bank of Algeria dividends and interests	42	30	49	49	49	49	49	49	49
Grants	2.9	0	0	0	0	0	0	0	0
Total expenditure	1,691	1,892	2,052	2,514	2,920	3,227	3,460	3,576	3,716
Current expenditure	1,121	1,245	1,241	1,394	1,587	1,751	1,919	2,076	2,241
Personnel expenditure	398	447	492	548	627	708	797	888	976
Mudjahidins' pensions	63	69	80	96	103	103	103	102	101
Material and supplies	59	72	76	88	104	129	155	172	190
Current transfers	488	573	520	588	674	737	795	852	917
Interest payments	114	85	73	74	80	75	70	62	57
Capital expenditure	570	646	811	1,120	1,333	1,476	1,541	1,500	1,475
Budget balance	256	323	1,031	997	893	937	891	894	880
Special accounts	187	110	-129	0	0	0	0	0	0
Nonhydrocarbon primary balance	-826	-1,064	-1,383	-1,665	-1,914	-2,116	-2,258	-2,294	-2,340
Primary balance	524	507	970	1,072	973	1,012	961	956	937
Nonhydrocarbon balance	-940	-1,149	-1,456	-1,740	-1,994	-2,190	-2,327	-2,356	-2,397
Overall balance	410	421	897	997	893	937	891	894	880
Financing	-410	-421	-897	-997	-893	-937	-891	-894	-880
Bank 3/	-267	-435	-1,002	-918	-866	-910	-870	-877	-864
Borrowing	-100	-3	65	-64	-128	-147	-168	-98	-103
Change in cash balances	-168	-432	-1,067	-854	-738	-763	-702	-779	-760
Nonbank 4/	-52	67	221	7	0	0	0	0	0
Foreign	-91	-53	-116	-87	-27	-28	-21	-17	-16
	(In percent of GDP)								
Total revenue	37.0	36.2	41.0	41.9	42.2	41.6	40.4	39.0	37.8
Hydrocarbon	25.6	25.6	31.3	32.6	31.9	31.2	29.8	28.3	27.0
Nonhydrocarbon	11.3	10.5	9.7	9.2	10.2	10.4	10.5	10.6	10.9
Of which: Tax revenue	10.0	9.5	8.5	8.2	9.2	9.4	9.6	9.8	10.0
Total expenditure	29.2	29.3	29.1	30.0	32.3	32.2	32.1	31.2	30.6
Current expenditure	21.3	20.3	16.5	16.6	17.6	17.5	17.8	18.1	18.4
Capital expenditure/5	8.1	7.9	10.8	13.4	14.7	14.7	14.3	13.1	12.1
Other 6/	-0.2	1.1	1.8	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	10.0	8.3	12.9	12.8	10.8	10.1	8.9	8.3	7.7
Overall balance	7.8	6.9	11.9	11.9	9.9	9.4	8.3	7.8	7.2

Table 3 (concluded). Algeria: Summary of Central Government Operations, 2003–11 1/

		Est.	Prel.	Projections					
	2003	2004	2005	2006	2007	2008	2009	2010	2011
	(In percent of nonhydrocarbon GDP)								
Total revenue	57.3	58.3	74.7	79.4	78.2	75.4	70.5	65.5	61.4
Hydrocarbon revenue	39.8	41.4	57.0	61.8	59.2	56.6	52.1	47.6	43.8
Nonhydrocarbon revenue	17.5	17.0	17.7	17.5	19.0	18.8	18.3	17.9	17.6
Of which: Tax revenue	15.5	15.3	15.5	15.5	17.1	17.1	16.8	16.4	16.3
Total expenditure	45.3	47.2	53.0	56.8	59.8	58.4	56.0	52.4	49.6
Current expenditure	33.0	32.8	30.1	31.5	32.5	31.7	31.1	30.4	29.9
Of which: Personnel expenditure	*11.7*	*11.8*	*11.9*	*12.4*	*12.8*	*12.8*	*12.9*	*13.0*	*13.0*
Capital expenditure/5	12.6	12.7	19.7	25.3	27.3	26.7	24.9	22.0	19.7
Other 6/	-0.3	1.8	3.3	0.0	0.0	0.0	0.0	0.0	0.0
Nonhydrocarbon primary balance	-24.3	-28.0	-33.5	-37.6	-39.2	-38.3	-36.6	-33.6	-31.3
Nonhydrocarbon overall balance	-27.7	-30.3	-35.3	-39.3	-40.9	-39.6	-37.7	-34.5	-32.0
Gross government debt									
(in percent of GDP)	43.8	36.6	28.4	22.6	19.5	17.1	14.5	12.9	11.3
Of which: Domestic	18.7	16.3	14.6	20.7	17.8	15.6	13.1	11.5	9.9
External	25.1	20.3	13.9	1.9	1.7	1.5	1.4	1.4	1.4
Oil stabilization fund (in billions									
of dinars)	568	722	1,843	2,716	3,282	4,048	4,522	5,233	5,622
Inflow	...	...	...	2,728	2,868	3,108	3,198	3,229	3,256
Outflow	...	...	...	1,848	2,334	2,407	2,829	2,656	3,043
Pension Fund	...	...	...	9	29	49	69	90	111

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

1/ Cash basis.
2/ Including dividends of Sonatrach.
3/ Starting in 2002, includes the savings/housing bank CNEP.
4/ Including privatization receipts.
5/ Including special accounts related to capital spending.
6/ Including special accounts (not related to capital spending) and net lending.

Table 4. Algeria: Monetary Survey, 2003–07

(In billions of Algerian dinars; at end of period)

				Projections	
	2003	2004	2005	2006	2007
	(In billions of Algerian dinars; at end of period)				
Net foreign assets	2,342.7	3,119.2	4,179.4	5,589.7	7,332.4
Of which : Bank of Algeria	2,325.9	3,109.1	4,151.5	5,561.3	7,303.0
Net domestic assets	1,015.2	623.4	-37.0	-921.0	-1,828.5
Domestic credit	1,803.6	1,514.4	833.7	31.4	-654.1
Credit to government (net) 1/ 2/	423.4	-20.6	-944.5	-1,649.6	-2,515.8
Idem , excluding treasury advance 3/	...	...	...	-2,249.3	-2,994.9
Credit to the economy 1/	1,380.2	1,535.0	1,778.3	1,680.9	1,861.7
Of which: Private sector	587.8	676.4	882.2	...	...
Other items net 4/	-788.4	-891.0	-870.8	-952.4	-1,174.5
Money and quasi-money (M2) 5/	3,357.9	3,742.6	4,142.4	4,668.6	5,503.8
Money	1,630.4	2,160.6	2,417.4	2,801.2	3,247.3
Quasi-money	1,727.5	1,582.0	1,724.9	1,867.5	2,256.6
	(Percent change over 12-month period)				
Money and quasi-money (M2) 5/	15.6	11.5	10.7	12.7	17.9
Of which : Money	15.1	32.5	11.9	15.9	15.9
Credit to the economy 1/	8.9	11.2	15.8	-5.5	10.8
Idem, in real terms 1/	*4.8*	*9.1*	*13.9*	*-8.3*	*4.5*
Memorandum items:					
Liquidity ratio (e.o.p. M2/GDP)	63.8	61.1	55.1	55.7	60.9
Liquidity ratio (e.o.p. M2/NHGDP)	98.9	98.6	100.4	105.5	112.8
Idem, excluding deposits of Sonatrach	91.4	89.6	88.3	90.6	92.4
M2 velocity	1.6	1.6	1.8	1.8	1.6
Credit to the economy/GDP	26.2	25.1	23.7	20.0	20.6
Credit to the economy/NHGDP	40.7	40.4	43.1	38.0	38.2
Credit to private sector/NHGDP	17.3	17.8	21.4	…	…

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

1/ Includes impact of public banks' restructuring packages. The conversion of public banks' claims on public enterprises into claims on the government results in a decrease in credit to the economy and an equal increase in credit to government. The adjustment amounted to DA 213 billion in 2006. The flow of new credits to the economy in 2003 (17.5 percent annual growth) exceeded the stock difference between 2002 and 2003, because of the liquidation of two private banks. The flow of new credits to the economy in 2006 (6.5 percent annual growth) exceeded the stock difference between 2005 and 2006.

2/ Net credit to government excludes postal accounts (CCP) at the treasury deposited at the BA.

3/ The advance of BA to the treasury is in respect of early payments by the government of rescheduled debt to the Paris and London Clubs in 2006. The external payment is reflected in NFA in 2006; the additional claim of BA on the government (the treasury advance) will be drawn down in accordance with the original Paris/ London Club rescheduling terms over 2007–11.

4/ Includes the debt rescheduling proceeds blocked in special accounts at the Bank of Algeria.

5/ Includes postal accounts (CCP) and deposits of non-bank financial institutions (DA 3.4 billion in 2003; DA 4.6 billion in 2004; DA 0.8 billion in 2005).

Table 5. Algeria: Summary Balance Sheet of Bank of Algeria, 2003–07

(In billions of Algerian dinars; at end of period)

				Projections	
	2003	2004	2005	2006	2007
Net foreign assets	2,325.9	3,109.1	4,151.5	5,561.3	7,303.0
Assets	2,419.7	3,173.2	4,171.8	5,564.5	7,306.4
Liabilities	93.7	64.1	20.4	3.3	3.4
Net domestic assets	-923.7	-1,549.0	-2,488.4	-3,392.8	-4,480.2
Credit to government (net)	-464.1	-915.8	-1,986.5	-2,763.4	-3,629.6
Claims on government	142.0	122.1	118.1	717.8	590.0
*Of which: T*reasury advance 1/	...	...	...	599.7	479.1
Government deposits 1/	606.1	1,037.9	2,104.6	3,481.2	4,219.6
Credit to banks	0.0	0.0	0.0	0.0	0.0
Other credit	0.7	0.6	0.8	1.6	1.6
Other items net	-460.3	-633.8	-502.7	-631.1	-852.2
Deposit auction (- = liquidity injection)	250.0	400.0	499.8	891.2	1,313.3
Reserve money 2/	1,152.3	1,160.1	1,163.3	1,277.2	1,509.5
Currency in circulation	787.7	882.5	930.3	1,037.5	1,223.1
Banks' deposits	364.6	277.6	233.1	239.8	286.4
Memorandum items:					
Reserve money growth (in percent)	36.1	0.7	0.3	9.8	18.2
M2 money multiplier	2.9	3.2	3.6	3.7	3.6
Reserve ratio 2/	15.2	10.3	7.9	7.5	7.5
Of which: Required	5.3	5.8	5.8	6.3	6.3
Currency ratio	32.5	32.5	31.3	30.6	30.2
Rediscount rate (in percent) 3/	4.5	4.0	4.0	4.0	...
Deposit auction rate (in percent) 4/	1.75	0.75	1.68	1.63	...

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

1/ The advance of BA to the treasury is in respect of early payments by the government of rescheduled debt to the Paris and London Clubs in 2006. The external payment is reflected in NFA in 2006; the additional claim of BA on the government (the treasury advance) will be drawn down in accordance with the original Paris/London Club rescheduling terms over 2007–11.

2/ Reserve money in the International Finance Statistics (IFS) includes deposit auctions.

3/ For 2006, as of October.

4/ For 2006, as of October. Average of one-week and three-month facilities. Excludes marginal deposit facility (rate: 0.3 percent as of October 2006).

Table 6. Algeria: Summary Balance Sheet of Deposit Money Banks, 2003–07

(In billions of Algerian dinars; at end of period)

				Projections	
	2003	2004	2005	2006	2007
Net foreign assets	16.7	10.1	27.9	28.4	29.4
Assets	55.5	76.6	91.6	93.1	96.4
Liabilities	38.8	66.5	63.6	64.7	67.0
Net domestic assets	2,426.2	2,695.3	2,916.6	3,329.1	3,979.5
Domestic credit	2,136.9	2,271.3	2,543.3	2,509.1	2,689.9
Credit to government (net)	757.4	736.9	765.9	829.8	829.8
Credit to the economy 1/	1,379.5	1,534.4	1,777.4	1,679.3	1,860.1
Of which: Private sector	587.8	674.7	881.6	...	...
Other items (net)	-328.1	-257.2	-368.0	-321.3	-322.3
Deposit auction	250.0	400.0	499.8	891.2	1,313.3
Reserves	373.8	280.6	194.3	250.1	298.5
Cash in vault	6.3	8.1	9.2	10.3	12.2
Deposits at BA	367.4	272.5	185.1	239.8	286.4
Of which: Required reserves	126.7	157.3	171.5	209.5	250.3
Deposits at BA/Required reserves	2.9	1.7	1.1	1.1	1.1
Demand deposits	718.9	1,127.9	1,220.4	1,490.0	1,752.3
Time deposits 2/	1,724.0	1,577.5	1,724.2	1,867.5	2,256.6

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

1/ Includes impact of public banks' restructuring packages. The conversion of public banks' claims on public enterprises into claims on the government results in a decrease in credit to the economy and an equal increase in credit to government. The adjustment amounted to DA 213 billion in 2006. The flow of new credits to the economy in 2003 (17.5 percent annual growth) exceeded the stock difference between 2002 and 2003, because of the liquidation of two private banks. The flow of new credits to the economy in 2006 (6.5 percent annual growth) exceeded the stock difference between 2005 and 2006.

2/ In the IFS, time deposits exclude deposits to be used for imports.

Table 7. Algeria: Selected Vulnerability Indicators, 2003–06

(In percent of GDP, unless otherwise indicated)

	2003	2004	Est. 2005	Proj. 2006
Financial Indicators				
Central government identified debt	43.8	36.6	28.4	22.6
Broad money (percent change, 12-month basis)	15.6	11.5	10.7	12.7
13 weeks T-bill yield (in percent per annum) 1/	1.1	0.1	0.8	2.1
13 weeks T-bill yield (real; in percent per annum) 2/	-3.0	-2.0	-0.9	-1.0
External Indicators				
Exports (percent change, 12-month basis in $)	30.7	31.7	43.8	16.8
Imports (percent change, 12-month basis in $)	11.2	34.5	10.6	6.6
Terms of Trade (percent change, 12 month basis)	9.7	13.6	30.0	9.4
Current account balance	13.0	13.1	20.7	24.4
Capital and financial account balance	-2.0	-2.2	-4.1	-9.8
Gross official reserves (in $ billions)	32.9	43.1	56.2	74.6
Central Bank short-term foreign liabilities (in $ billion)	0.3	0.3	0.3	...
Central Bank foreign currency exposure (in $ billion)	n.a.	n.a.	n.a.	n.a.
Short term foreign assets of the financial sector (in $ billion)	<0.1	<0.1	<0.1	<0.1
Short term foreign liabilities of the financial sector (in $ billion)	<0.1	<0.1	<0.1	<0.1
Foreign currency exposure of the financial sector (in $ billion)	n.a.	n.a.	n.a.	n.a.
Official reserves (in months of imports GNFS)	18.1	21.0	25.7	24.4
Broad money to reserves (in percent)	140.4	119.6	99.9	86.8
Total external debt	34.3	25.7	16.8	4.3
Total external debt to exports GNFS (in percent)	89.7	64.0	35.2	8.6
External interest payments to exports GNFS (in percent)	4.5	3.8	2.1	1.0
External amortization payments to exports GNFS (in percent) 3/	11.6	12.8	9.1	21.6
Exchange rate (per $, period average) 4/	77.4	72.1	73.4	72.9
REER appreciation (12 month basis) 5/	-9.5	0.6	-3.9	-0.1
Financial Soundness Indicators				
Capital adequacy ratio (in percent of risk-weighted assets)	14.4	14.4	12.9	...
Public banks	14.0	13.9	12.0	...
Private banks	19.4	21.2	23.7	...
Gross nonperforming loans (in percent of total loans)	...	37.0	35.7	...
Public banks	...	39.2	38.2	...
Of which: To private sector	...	15.5	19.0	...
Private banks	...	6.7	5.8	...
Provisions (in percent of nonperforming loans)	...	46.3	49.3	...
Public banks	...	45.9	49.2	...
Private banks	...	82.2	62.3	...
Return on assets (in percent)	0.4	0.3	0.4	...
Public banks	0.4	0.2	0.3	...
Private banks	0.9	1.6	2.2	...
Return on equity (in percent)	6.7	5.2	8.1	...
Public banks	6.2	3.4	5.6	...
Private banks	12.6	23.5	25.4	...

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

1/As of end-December. For 2006, as of September.
2/ Using CPI (end of period).
3/ Includes prepayment
4/ For 2006, as of October.
5/ For 2006, as of August.

Table 8. Algeria: Millennium Development Goals, 1990–2005

	1990	1994	1997	2000	2003	2005
Eradicate extreme poverty and hunger						
Percentage share of income or consumption held by poorest 20%	...	7.0	...	...	...	...
Population below $1 a day (%)	...	2.0	...	...	...	...
Population below minimum level of dietary energy consumption (%)	...	...	6.0	...	5.0	
Poverty gap ratio at $1 a day (incidence x depth of poverty)	...	0.5	...	...	...	...
Poverty headcount, national (% of population)	...	22.6	12.2	...	...	...
Prevalence of underweight in children (under five years of age)	...	12.8	...	6.0	...	...
Achieve universal primary education						
Net primary enrollment ratio (% of relevant age group)	93.2	...	92.1	94.2	96.0	97.0
Primary completion rate, total (% of relevant age group)	80.8	79.7	84.0	82.5	92.8	94.3
Proportion of pupils starting grade 1 who reach grade 5	94.5	...	95.0	97.0	96.0	
Youth literacy rate (% ages 15–24)	...	...	...	...	90.1	90.0
Promote gender equality and empower women						
Proportion of seats held by women in national parliament (%)	2.0	...	7.0	3.0	6.0	6.2
Ratio of girls to boys in primary and secondary education (%)	83.3	...	...	97.7	98.6	98.9
Ratio of young literate females to males (% ages 15–24)	...	...	...	...	...	91.6
Share of women employed in the nonagricultural sector (%)	8.0	10.8	15.6	12.2	15.5	...
Reduce child mortality						
Immunization, measles (% of children ages 12–23 months)	83.0	88.0	92.0	80.0	84.0	81.0
Infant mortality rate (per 1,000 live births)	54.0	43.0	...	37.0	...	35.0
Under 5 mortality rate (per 1,000)	69.0	55.0	...	44.0	...	40.0
Improve maternal health						
Births attended by skilled health staff (% of total)	...	...	...	92.0	96.0	...
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	...	140.0	...	...
Combat HIV/AIDS, malaria, and other diseases						
Contraceptive prevalence rate (% of women ages 15–49)	...	...	...	...	57.0	...
Incidence of tuberculosis (per 100,000 people)	36.6	...	...	...	...	54.0
Number of children orphaned by HIV/AIDS	...	...	...	...	...	...
Prevalence of HIV, total (% of population aged 15–49)	...	...	...	0.1	0.1	...
Tuberculosis cases detected under DOTS (%)	...	...	132.6	125.8	113.6	105.5
Ensure environmental sustainability						
Access to an improved water source (% of population)	94.0	...	...	...	...	85.0
Access to improved sanitation (% of population)	88.0	...	...	...	...	92.0
Access to secure tenure (% of population)	...	...	...	...	...	...
CO2 emissions (metric tons per capita)	3.0	3.1	`	2.8	2.9	...
Forest area (% of total land area)	1.0	...	...	1.0	...	1.0
GDP per unit of energy use (2000 PPP $ per kg oil equivalent)	5.7	5.4	5.7	5.6	5.6	...
Nationally protected areas (% of total land area)	...	...	...	...	5.0	5.0
Develop a global partnership for development						
Aid per capita (current $)	5.2	10.6	8.6	6.6	7.4	9.7
Fixed line and mobile phone subscribers (per 1,000 people)	32.1	40.5	48.6	60.6	114.3	215.4
Internet users (per 1,000 people)	...	0.0	0.1	4.9	20.4	26.1
Personal computers (per 1,000 people)	1.0	2.6	4.8	6.6	8.3	9.0
Unemployment, youth total (% of total labor force ages 15–24)	38.7	...	...	54.9	45.5	31.0

Source: World Development Indicators Database, April 2006.

Appendix I. Algeria: Relations with the Fund

(As of October 31, 2006)

A. Financial Relations

Membership Status Joined 9/26/63; Article VIII

General Resources Account	**SDR Million**	**Percent of Quota**
Quota	1,254.70	100.00
Fund holdings of currency	1,169.62	93.22
Reserve position in Fund	85.08	6.78

SDR Department	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	128.64	100.00
Holdings	3.92	3.05

Outstanding Purchases and Loans: None.

Financial Arrangements

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

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

	Overdue	Forthcoming				
		2006	2007	2008	2009	2010
Principal	0.00	0.00	0.00	0.00	0.00	0.00
Charges/interest	0.00	1.23	5.05	5.06	5.05	5.05
Total	0.00	1.23	5.05	5.06	5.05	5.05

Implementation of HIPC Initiative: Not Applicable.

B. Nonfinancial Relations

Exchange Rate Arrangement

From January 21, 1974 to October 1, 1994, the exchange rate of the dinar was determined on the basis of a fixed relationship with a basket of currencies, adjusted 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. At the end of September 2006, the average of the buying and selling rates for the U.S. dollar was $1 = DA 72.12, equivalent to SDR 1 = DA 106.47. No margin limits are imposed on the buying and selling exchange rates in the interbank foreign exchange market, except for a margin of DA 0.017 between the buying and selling rates of the Bank of Algeria for the dinar against the U.S. dollar.

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

Latest Article IV Consultation

The discussions for the 2005 Article IV consultation with Algeria were held in Algiers during October 1–16, 2005. The staff report (IMF Country Report No 06/93) was discussed by the Executive Board on February 13, 2006 and published on March 9, 2006.

Technical Assistance

- An MAE consultant visited Algiers in February and April 2003 to assist the Bank of Algeria to develop its bank supervision and regulation capability.
- An FAD consultant visited Algiers in September–October 2003 to advise on the ongoing process of customs modernization.
- MFD experts visited Algiers in 2003–04 to advise on bank liquidation, bank supervision and inspection, reserve management, and information systems for bank oversight.
- An FAD mission visited Algiers in March 2004 to advise on tax administration.
- An STA expert visited Algiers in March 2004 to advise on national accounts.
- An MFD expert visited Algiers in May 2004 to advise on foreign exchange reserves management.
- An MFD mission visited Algiers in July 2004 to advise on liquidity management and instruments of monetary policy.
- An STA expert visited Algiers in November–December 2004 to advise on national accounts.

- An MFD expert visited Algiers in January–February 2005 to advise on bank inspection.
- An STA expert visited Algiers in June–July 2005 to advise on the development of quarterly national accounts statistics.
- An MFD mission visited Algiers in July 2005 to advise on liquidity management and monetary operations.
- An MFD/LEG mission visited Algiers in July 2005 to advise on the exchange regime and the development of the foreign exchange market.
- An MFD expert visited Algiers in October 2005 to advise on foreign exchange reserve management.
- An MFD mission visited Algiers in September 2005, December 2005, and in May 2006 to advise on bank restructuring.
- An MFD expert visited Algiers several times from February through September 2006 to assist the Bank of Algeria to develop its bank supervision and regulation capability.
- An MFD expert visited Algiers in January–February 2006 to advise on monetary and foreign exchange operations.
- An MFD expert visited Algiers in February and May 2006 to advise on foreign exchange reserve management.
- An STA mission visited Algiers in May 2006 to advise on monetary and financial statistics.
- An MFD expert visited Algiers in May 2006 to advise on payment systems.
- An STA mission visited Algiers in May 2006 to advise on consumer price statistics.

Financial Sector Assessment Program

Algeria participated in the FSAP in 2003. Missions were conducted in March and June 2003. Conclusions were discussed with the authorities in October 2003. The Executive Board discussed the Financial System Stability Assessment on January 14, 2004, (see IMF Country Report No. 04/138). The FSSA was published on May 17, 2004.

Resident Representative/Advisor

None.

Appendix II. Algeria: Relations with the World Bank

(As of October 31, 2006)

The Algeria Country Assistance Strategy was discussed by the World Bank Board on June 12, 2003, and a Country Assistance Strategy Progress Report was distributed to the Board on August 9, 2005. The proposed support of the Bank Group for 2004–06 aims at: (a) strengthening fiscal sustainability and hydrocarbon revenue management to build the basis for sustained growth; (b) removing the constraints to private sector-led growth, particularly those affecting the business environment, SMEs, the financial sector, and infrastructure development; and (c) supporting the government's efforts to articulate and implement a strategy for better service delivery, particularly in water supply, transport, housing, environmental services and human development to meet the critical needs of the population. The Bank Group's support is guided by three principles: (a) selectivity through engagement in a limited number of areas and a selective use of Bank instruments; (b) programmatic approaches focused on transfer of knowledge and capacity building; and (c) partnerships, outreach and knowledge sharing.

The World Bank portfolio in Algeria comprises 7 active operations and 67 closed loans, with cumulative net commitments of $4.3 billion, of which $4.1 billion have been repaid. Net commitments for the 7 current operations amount to $83.5 million. Of the 7 operations, 4 will be closed by end of FY07, leaving only 3 operations with a total net commitment of $45.1million, of which $17.2 million have been disbursed. No new loans have been approved since FY03. In FY06 the Government prepaid $637 million of 22 IBRD loans, and cancelled $176.9 million of loans for active operations.

Recent analytical work includes policy notes on poverty, the transport sector, and the legal and business environment (FY05). A Public Expenditure Review was prepared in FY06 (in close collaboration with the IMF) and the findings presented to the authorities during a high level workshop held in Algiers during July 2006. During FY07, the Bank projects to develop further analytical work on the macroeconomic impact of the public investment program, trade and labor market issues, as well as to explore potential for capacity building activities on poverty and the statistical system. Other ongoing analytical work includes an Education Sector Note, Financial Sector TA, Health Sector TA, Doing Business TA, and policy notes on the macroeconomic impact of the public investment program, trade, and the labor market.

The authorities have expressed interest in Reimbursable Technical Assistance (RTA) from the World Bank. Ongoing RTA activities include preparations for private management of water services in three cities, and capacity building for the *Caisse Nationale d'Equipement et de Développement* (CNED). New RTA programs are expected to start soon in the environment sector and with Sonatrach.

Algeria: Financial Relations with the World Bank
(As of October 31, 2006)

	Total Net Commitments				Undisbursed Balance	
	(In millions of U.S. dollars)					
IBRD lending operations 1/						
67 loans closed 2/	4,252.8					
7 active loans:						
-Telecommunications postal sector	8.7				1.2	
-Budget system Modernization	18.4				15.3	
-Energy and mining TA	18.0				6.6	
-Transport technical assistance	8.7				6.1	
-Mortgage finance TA	5.5				1.4	
-Urban natural hazard vulnerability	10.8				5.2	
-Second rural employment	13.4				5.8	
Total active loans	83.5				41.6	
Repayments	4,140.2					
Debt outstanding	117.1					

	2001	2002	2003	2004	2005	2006	2007
Net lending by the World Bank (by fiscal year) 3/							
Commitments	42	31	183	0	0	0	0
Disbursements	57	90	51	51	27	28.6	2.0
Debt service	286	306	296	270	224	788.7	8.7
Principal	162	194	201	197	174	748	5.5
Interest 4/	124	112	95	73	50	40.7	3.2
Net transfer 5/	-229	-216	-245	-219	-197	-760.1	-6.7

1/ IDA has no operations in Algeria.
2/ Less cancellations, includes adjustment lending.
3/ Fiscal years start July 1 and end June 30.
4/ Includes charges.
5/ Equal to disbursements minus debt service.

Appendix III. Algeria: Statistical Issues

Algeria's data provision to the Fund is broadly adequate for effective surveillance, but there are serious weaknesses particularly in government finance statistics. The lack of financial resources allocated to the compilation of statistics, insufficient interagency coordination, as well as concerns about accuracy and subsequent reluctance to publish provisional data, are partly responsible for this situation.

Algeria has decided to participate in the GDDS in February 2006. The authorities have nominated a national coordinator and are in the process of producing GDDS metadata. GDDS participation and technical issues will be discussed during the STA multisector statistics mission scheduled for early 2007.

Real Sector

Real sector data is reported to STA on an irregular basis and with substantial lags. The latest national accounts information published in the *International Financial Statistics (IFS)* pertains to partial data reported for 2003. IFS import trade data at current prices are derived from Direction of Trade Statistics. The September 2002 multisector statistics mission recommended that priority be given to move the compilation of national accounts to *1993 SNA*. STA missions visited Algiers during 2004–05 to assist the National Statistical Office with the development of quarterly national accounts.

Government Finance

Algeria reported government finance statistics (GFS) for the period 1994–2002 for publication in the *GFS Yearbook*. However, the institutional coverage of the data reported is limited to Budgetary Central Government, albeit in a wide sense, including the general budget, the annexed budget, and the special treasury accounts. Clarification has been sought from the authorities regarding the recording of the latter (net versus gross recording). No sub-annual data are submitted for *IFS* publication.

The September 2002 multisector statistics mission recommended the designation of a coordinator and the assignment of at least one economist for the compilation of GFS data. The authorities have not yet followed up on their initial intention to assign GFS leadership to the General Directorate of Accounting in the ministry of finance. A first step would be the establishment of an automated bridge table between the detailed monthly Treasury ledger (*Balance générale*), regularly produced by the latter, and the GFS table (*Situation Résumée des Opérations du Trésor—SROT*) in order to ensure a more timely production of quarterly and monthly GFS, as well as a more timely report to the Fund of quarterly data that fully reconcile the SROT presentation of government finances with the budget presentation. The ongoing changeover to an enhanced chart of accounts of the Treasury would offer an ideal opportunity to revamp the way GFS compilation is organized and carried out in Algeria.

The mission further recommended (a) that proceeds of the oil stabilization fund (FRR) be shown as revenue (rather than financing); (b) the compilation of more detailed breakdowns, in particular relating to the item "other transfers"; (c) a more appropriate reporting of the three large debt assumption operations carried out over the past decade; and (d) further work on the financing and the reconciliation with monetary statistics. The mission noted that meeting the GDDS and eventually the SDDS standards would require substantial efforts in terms of extension of coverage (consolidating the operations of social security and Wilayate, and subsequently of other administrative bodies and municipalities).

Monetary Accounts

Monetary data are broadly adequate for policy formulation and monitoring of economic developments. In particular, coverage has improved with the consolidation of data from the national savings bank (CNEP) beginning December 1998 and banking operations conducted by the National Mutual Fund for Agriculture (CNMA-banque) beginning January 2002. However, reporting of balance sheet data by some state-owned commercial banks is very untimely, and most commercial banks do not report the complete data needed to compile the monetary survey. Prudential data reported by banks are untimely and unreliable on the part of state-owned banks. The May 2006 monetary and financial statistics mission reiterated a long standing recommendation to strictly enforce the reporting obligations of banks by introducing high penalties. The mission also recommended to further extend the coverage of monetary statistics to include operations of finance companies and undertake a major revision of the outdated chart of accounts and accounting guidelines applied to banks and finance companies.

Balance of Payments

The September 2002 multisector statistics mission noted the following: (a) the Bank of Algeria's legal authority to collect data is limited to banking and financial institutions only; (b) data sources need to be expanded by conducting enterprise surveys in addition to traditional exchange-based records; (c) a more rigorous and uniform application of the residency criterion should be followed; (d) quarterly data are compiled but not regularly disseminated; and (e) international investment position data are not compiled. Algeria does not report Balance of Payments data to STA, and there are no BOP data in *IFS* or in the BOPSY. These issues will be examined during the forthcoming multisector statistics mission.

ALGERIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
As of November 14, 2006

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	10/31/06	11/12/06	D	M	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	10/30/06	11/12/06	D	M	M
Reserve/Base Money	10/06	11/12/06	M	M	M
Broad Money	06/06	11/12/06	M	M	M
Central Bank Balance Sheet	10/06	11/12/06	M	M	A
Consolidated Balance Sheet of the Banking System	06/06	11/12/06	M	M	A
Interest Rates[2]	08/06	09/25/06	M	M	M
Consumer Price Index	08/06	09/25/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	06/05	10/01/05	Q	I	A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	06/05	10/01/05	Q	I	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	06/05	10/01/05	Q	I	A
External Current Account Balance	06/05	08/31/05	Q	Q	A
Exports and Imports of Goods and Services	06/05	08/31/05	Q	Q	A
GDP/GNP	12/04	04/27/05	A	A	A
Gross External Debt	12/04	04/27/05	A	A	A

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[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] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).

INTERNATIONAL MONETARY FUND

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EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 07/16
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February 7, 2007

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

IMF Executive Board Concludes 2006 Article IV Consultation with Algeria

On January 10, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Algeria.[1]

Background

Real GDP growth temporarily declined to about 3 percent in 2006, largely because of a drop in hydrocarbon output for technical reasons. Nonhydrocarbon GDP (NHGDP) growth would continue at 4½ percent, underpinned by sustained activity in the construction sector, resulting from the significant fiscal impulse, and agriculture. Inflation remained low through mid-year but is picking up, reflecting a rebound in food prices.

Favorable hydrocarbon prices on international markets further strengthened Algeria's external position. The current account surplus is projected to increase to 24½ percent of GDP from almost 21 percent in 2005. Gross external reserves reached US$70 billion at end-September 2006 (2 years of import cover). After early debt repayment, in particular to the Paris and London Clubs, the external debt-to-GDP ratio would decline from 17 percent in 2005 to below 4½ percent in 2006.

Buoyant hydrocarbon revenues have enabled a strong increase in public spending. The 2005–09 public investment program was increased considerably, and civil service wages were raised by about 15–16 percent on average. As a result, the nonhydrocarbon primary deficit is expected to widen from about 33½ percent of NHGDP in 2005 to

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

almost 37½ percent in 2006, but the overall budget surplus would remain at about 12 percent of GDP in 2006.

Monetary policy remained prudent, in line with the authorities' objective of containing inflation. The Bank of Algeria continued to absorb most of the excess liquidity of the banking system through deposit auctions in 2006 and the expansion of credit to the economy slowed.

Some progress was made in structural reforms. The privatization of one public bank and the modernization of the payments system are underway. The governance of the remaining public banks is being strengthened and supervision has become more active, mainly through on-site inspections. However, nonperforming loans of public banks remained high. The corporate profit tax rate was reduced from 30 percent to 25 percent, and the taxation of small enterprises was streamlined by introducing a single presumptive tax. Privatization of public enterprises is proceeding and an anticorruption law was adopted in January 2006.

Executive Board Assessment

Executive Directors commended the authorities for their prudent macroeconomic policies and welcomed Algeria's encouraging economic performance in recent years, noting the decline in the unemployment rate, sustained economic growth, low inflation, and comfortable external and fiscal positions in the wake of high world energy prices.

Looking forward, Directors agreed that the country's increased political stability and favorable financial situation present an invaluable window of opportunity for achieving high growth and further reducing unemployment, while maintaining macroeconomic stability. They underscored the importance of ensuring sound management of hydrocarbon resources and pressing ahead vigorously with structural reforms to increase productivity and improve the business climate.

Directors welcomed the authorities' ongoing reassessment of projects included in the public investment program and the commitment to take into account the recommendations of the public expenditure review conducted in cooperation with the World Bank. They cautioned that, given the limited absorptive capacity, a slower pace of project implementation may be desirable to ensure a high quality of the public investment program and avoid undue strain on monetary policy. In addition, they encouraged the authorities to focus on the execution and monitoring of existing projects, accelerate budget modernization, and strengthen fiscal governance by implementing the recommendations of the 2004 fiscal Reports on the Observance of Standards and Codes.

Directors noted the authorities' intention to maintain fiscal sustainability over the medium term. In this context, they welcomed the new rules governing the hydrocarbon stabilization fund and recommended aiming at a higher investment return. They were also encouraged by the recently concluded National Economic and Social Pact, which supports linking real wage increases to productivity growth and economic performance in the nonhydrocarbon sector, noting that it would help preserve Algeria's competitiveness as the economy opens up further.

Directors commended the authorities for the prudent conduct of monetary policy that has kept inflation under control. In light of the expected external inflows, the planned increase in public investment, and the wage increases, Directors welcomed the authorities' intention to pursue a tight monetary policy stance. In this respect, they supported the authorities' intentions to maintain the Bank of Algeria's policy interest rate positive in real terms and to continue managing the exchange rate in a flexible manner.

Directors were of the view that financial sector reform and a significant deepening of financial intermediation will be necessary to foster private sector activity. In this respect, they pointed to the need to push ahead decisively with the privatization of public banks, strengthen the governance of the remaining public banks, and promote competition in the banking sector, while avoiding bank lending to nonviable public enterprises. Directors also looked forward to the update of the 2003 Financial Sector Assessment Program.

Directors welcomed the authorities' pursuit of WTO accession and their intention to implement the action plan to reduce obstacles to regional trade following the 2005 conference on trade facilitation in the Maghreb. They welcomed the recent promulgation of the new exchange regulation that is aimed at removing the remaining ambiguities regarding the current convertibility of the dinar.

Directors urged the authorities to accelerate other structural reforms, in particular streamlining the tax system, completing the ongoing reform of the tax administration, and modernizing the customs administration. They also welcomed the authorities' intention to gradually increase the pass-through of world oil prices to domestic energy prices.

Directors praised the authorities' policy to prepay external debt and encouraged Algeria to participate as a creditor in the enhanced Heavily Indebted Poor Countries Initiative, and obtain a sovereign rating.

Directors encouraged the authorities to intensify their efforts to upgrade the production and dissemination of economic and financial statistics, including by benefiting from technical assistance under the General Data Dissemination System.

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

Algeria: Selected Economic Indicators

	2002	2003	2004	Est. 2005	Proj. 2006
	(Annual percentage change, unless otherwise indicated)				
Domestic Economy					
Real GDP	4.7	6.9	5.2	5.3	2.7
Real Nonhydrocarbon GDP	5.3	6.0	6.2	5.1	4.5
GDP deflator	1.9	8.3	10.6	16.5	9.0
Consumer price index (average)	1.4	2.6	3.6	1.6	2.2
Gross national savings (in percent of GDP)	38.8	43.5	46.3	51.2	56.3
Gross national investment (in percent of GDP)	31.2	30.5	33.3	30.5	31.9
	(In billions of US dollars; unless otherwise indicated)				
External sector					
Exports, f.o.b.	18.7	24.5	32.2	46.3	54.1
Imports, f.o.b.	12.0	13.4	18.0	19.9	21.2
Current account (in percent of GDP)	7.6	13.0	13.1	20.7	24.4
Capital account balance	-0.7	-1.4	-1.9	-4.2	-11.2
Gross official reserves	23.1	32.9	43.1	56.2	74.6
Idem, in months of next year's imports	17.0	18.1	21.0	25.7	24.4
External debt (in percent of GDP)	39.7	34.3	25.7	16.8	4.3
Debt service ratio (in percent of exports)	22.6	17.9	17.6	12.5	22.6
Terms of trade (deterioration -)	-8.6	9.7	13.6	30.0	9.4
Real effective exchange rate (depreciation -) 1/	-7.6	-9.5	0.6	-3.9	-0.1
	(In percent of GDP)				
Central government finance					
Total revenue	35.3	37.0	36.2	41.0	41.9
Total expenditure and net lending	35.0	29.2	29.3	29.1	30.0
Overall budget balance (deficit-)	0.2	7.8	6.9	11.9	11.9
	(Annual percentage change, unless otherwise indicated)				
Money and credit					
Net foreign assets	33.9	33.4	33.1	34.0	33.7
Domestic credit	8.0	-1.4	-8.6	-18.2	-19.4
Credit to the government (net)	0.4	-5.3	-13.2	-24.7	-17.0
Credit to the economy 2/	17.5	8.9	11.2	15.8	-5.5
Broad money	17.4	15.6	11.5	10.7	12.7
Interest rate (central bank rediscount rate, in percent) 3/	5.5	4.5	4.0	4.0	4.0

Sources: Algerian authorities; and IMF staff estimates and projections.
1/ For 2006, as of August.
2/ Excluding the impact of public banks' restructuring, credit to the economy increases by 6.5 percent in 2006.
3/ For 2006, as of October.

Statement by Abbas Mirakhor, Executive Director for Algeria
January 10, 2007

My authorities thank staff for the well-focused report and helpful Selected Issues (SI) paper. They appreciate the high-quality Fund policy dialogue, advice, and technical assistance, and highly value management and the Executive Board's support for Algeria's sustained reform efforts. They broadly agree with staff's assessment of the recent economic developments, challenges ahead, and policies required for growth acceleration.

Prudent macroeconomic policies and continued structural reforms, supported by higher oil prices and improved political and security situations, have underpinned recent favorable economic developments. Following high growth rates, low inflation, and strong fiscal and external positions in 2001–05, the economy continued to perform well in 2006. While hydrocarbon output declined due to the need to improve maintenance and upgrade production facilities, nonhydrocarbon sector continued to expand at a healthy rate, underpinned by strong activity in the construction sector, nongovernment services, and agriculture, leading to a reduction in unemployment. Prudent monetary policy kept inflation under control, fiscal position strengthened further, with the overall surplus reaching 12 percent of GDP on account of higher revenues, and the external position improved significantly, with the current account surplus exceeding 24 percent of GDP, allowing for further accumulation of international reserves. As indicated in the staff report (Box 2), with the settlement of the Russian debt issue, the government accelerated the early repayment of the external obligations, including to Paris Club and London Club creditors, bringing the debt-to-GDP ratio down to less than 4.5 percent from 34 percent at end-2003.

The authorities remain strongly committed to their reform agenda to strengthen private sector participation in the economy, further reduce unemployment, and improve the living conditions of the population while maintaining macroeconomic stability. Priority actions include continued implementation of the 2005–09 Growth Consolidation Plan (GCP), strengthening financial intermediation, and improving the business climate. Fiscal sustainability remains the anchor of the authorities' strategy. The substantial accumulation of savings in the hydrocarbon stabilization fund over the past years reflects the prudent management of oil revenue and provides room for investment in infrastructure and social spending. The former is set to increase over the medium term, in line with the GCP's objectives while the latter will focus on housing, education, and health. The authorities are determined to enhance the quality of public investment, therefore, they are carefully considering the recommendations of the public expenditure review recently conducted with the assistance of the World Bank. Particular attention is paid to keeping the pace of implementation in line with the economy's absorptive capacity. Sustained efforts will also be devoted to contain current spending. As staff note, the recent wage increase was meant largely to compensate for past large compression of real wages. Looking forward, the principles set forth in the National Economic and Social Pact (NESP), recently concluded between the government, employers, and trade unions, will govern wage setting policy. In addition to supporting efforts to improve the business climate, enhance productivity, and privatize public enterprises, the NESP ensures that wage increases are linked to productivity and economic performance in the nonhydrocarbon sector. Furthermore, the trade unions have indicated that no general wage increase will be requested over the next four years.

The authorities intend to continue to enhance nonhydrocarbon revenue. Building on progress achieved thus far in improving tax administration, including the establishment of a Large Taxpayers Unit, the restructuring and modernization of the regional and local tax agencies are progressing. In addition, the authorities plan to simplify the tax and incentive system and to modernize customs administration and have requested Fund technical assistance in these areas. They also intend to gradually increase domestic energy prices while mitigating the impact on vulnerable segments of the population.

Progress is being made in modernizing budget management and strengthening fiscal transparency. In this regard, a new budget classification, in line with the Government Finance Statistics guidelines, has been prepared and a draft organic law will be submitted soon to the Parliament. The rules governing the use of the hydrocarbon stabilization fund have been amended to allow for direct financing of the nonhydrocarbon deficit, in line with staff's advice. The authorities intend to proceed with implementation of the remaining recommendations of the 2004 fiscal ROSC, including the introduction of a medium-term budget framework by 2009.

Prudent monetary policy has kept inflation under control. In view of the potential inflationary pressures stemming from higher external flows as well as additional spending, the central bank will continue to absorb excess liquidity in the banking system, while keeping its policy interest rate positive in real terms. At the same time, it will maintain its flexible exchange rate policy. In line with staff's recommendations, the authorities have prepared a draft new unified regulatory framework to improve the exchange and payments systems, which will be issued shortly.

Financial sector reforms are advancing, in line with the FSAP recommendations. Banking supervision continues to be strengthened with Fund technical assistance, mainly through enhanced on-site inspections. Tighter bank licensing requirements are contributing to improving the soundness of the sector. With strong political support, the role of the Banking Commission has been strengthened. Governance of the public banks is being improved, with close monitoring of the performance contracts and elimination of quasi-fiscal deficits. Efforts are also focused on improving risk management and internal controls, and plans are being developed to address the nonperforming loans issue. Competition in the sector will be further enhanced with the privatization of a first public bank, expected to be completed in early 2007 with the assistance of a reputable foreign investment bank. Significant progress has been made in modernizing the payment system with the launch in 2006 of the Real Time Gross Settlement and the Retail Payments systems. The authorities are determined to sustain these efforts to further strengthen and deepen financial intermediation. The upcoming FSAP update should contribute to identifying helpful directions in this regard.

The SI paper on growth prospects in Algeria provides useful advice on improving the country's growth potential. The paper concludes that "[the] results support the authorities' reform priorities," including modernizing the banking and financial system, further liberalizing trade, and improving the business climate. Sustained efforts are being made to improve governance, prevent corruption, strengthen the judiciary system, and reduce the cost of doing business. A number of measures have already been taken, including lowering employers' social contributions, facilitating the issuance of property titles, and streamlining the procedures for establishing businesses. Improved financial intermediation, along with strengthened confidence, should allow raising the quality and the level of credit to the private sector. The authorities are also advancing the agenda of restructuring and privatization of public enterprises and have taken important strides in recent years to liberalize trade. They remain focused on the steadfast implementation of the Association Agreement with the European Union and making continued progress toward accession to the World Trade Organization. Ongoing efforts to promote regional cooperation within the Maghreb countries, including in the areas of trade and finance, should also help improve economic prospects. In this context, the authorities appreciate highly the Managing Director's efforts in this process.