

Algeria: 2010 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 2010 Article IV consultation with Algeria, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 2, 2010, 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 23, 2010. 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 14, 2011 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Algeria.

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**International Monetary Fund
Washington, D.C.**



ALGERIA

Staff Report for the 2010 Article IV Consultation

Prepared by the Staff Representatives for the 2010 Consultation with Algeria

Approved by Patricia Alonso-Gamo and David Marston

December 23, 2010

Algeria remains in a relatively strong position but continues to face important challenges. Algeria weathered the crisis well owing to the prudent policies of the past decade. The authorities maintained the expansionary fiscal stance and took additional policy actions to reduce the impact of lower hydrocarbon exports in 2009. Since mid-2009, the recovery of hydrocarbon demand has improved the current account and the international reserves, which are extremely high (3 years of imports of goods and services in September 2010). However, the recent crisis shows that Algeria remains highly dependent on fluctuations of hydrocarbon prices and on public expenditure. Algeria's main challenge remains to ensure sustainable, diversified and private investment-led growth to reduce unemployment, which is still high among the youth.

Focus of the consultation. Discussions centered on policies needed to maintain prudent macroeconomic management while supporting economic growth in an uncertain international environment, and to promote the diversification of the economy in the medium term.

Key policy issues. Staff considered that the current expansionary fiscal stance will need to be contained. While public infrastructure investment efforts continue to be important for growth and the ample fiscal savings could support high spending, a gradual fiscal consolidation will be needed to ensure fiscal sustainability over the medium term. Monetary and exchange rate policies should be geared toward absorbing excess liquidity from hydrocarbon revenues and fending off inflationary pressures which may arise from the recent significant increase in public wages. Medium-term prospects will largely depend on the authorities' structural reform agenda to further strengthen and develop the financial sector, enhance the business climate and competitiveness, promote private investment and support economic diversification.

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

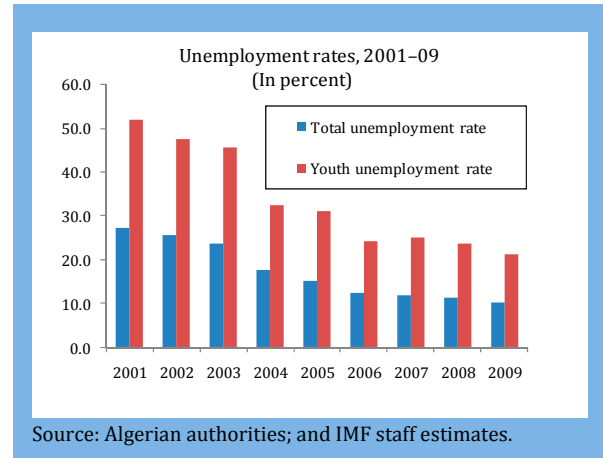
Mission. A staff team comprising Mr. Toujas-Bernaté (head), Mr. Gijón, Ms. Sab, and Ms. Albertin (all MCD) conducted the discussions in Algiers during October 20th–November 2nd, 2010. Mr. Maherzi (OED) also participated in the discussions.

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I. BACKGROUND: FAVORABLE DEVELOPMENTS BUT KEY CHALLENGES REMAIN

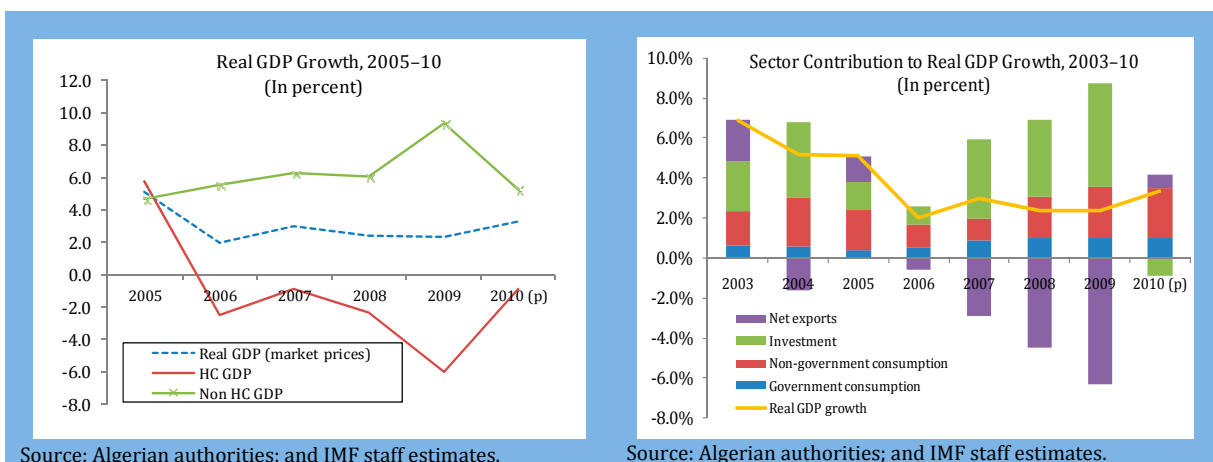
1. After the political and socio-economic crisis of the 1990s, Algeria has enjoyed more than 10 years of economic development but remains as dependent on hydrocarbons and public spending.

Prudent fiscal and monetary policies contributed to maintaining inflation low, and, combined with a period of increasing oil prices, allowed Algeria to build a solid financial position, with large external reserves, sizable budgetary savings in an oil stabilization fund, and low public and external debts. Despite efforts to diversify the economy, hydrocarbon revenues still represent 98 percent of exports and two-thirds of budgetary revenues. The nonhydrocarbon sector is inward-oriented and largely sustained by public spending. On the back of solid nonhydrocarbon growth (about 6 percent over the past decade), unemployment has fallen continuously, reaching 10.2 percent at end-2009, but remains high among the youth.

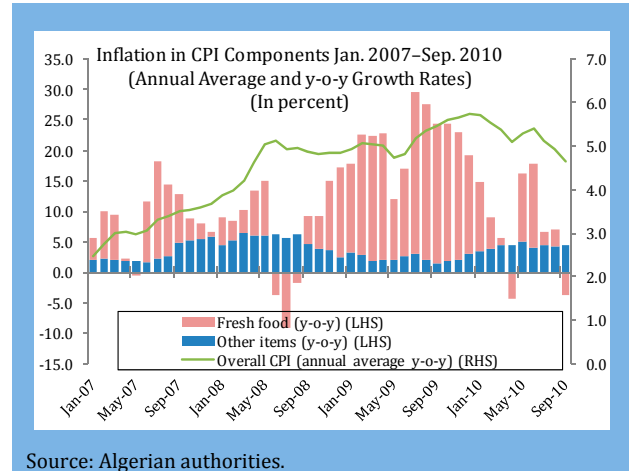


2. Algeria weathered the international crisis relatively well.

The very strong growth in nonhydrocarbon GDP was partially offset by the decline in hydrocarbon production. NHGDP growth reached 9.3 percent in 2009, driven by an excellent cereal harvest and good performance in the Public Investment Program (PIP)-led service and construction sectors. However, the substantial drop in hydrocarbon output (-6.0 percent) lowered overall growth to about 2½ percent, a little lower than in 2008. The stabilization of the hydrocarbon sector and the dynamic performance of the PIP-related sectors should lead to overall growth of 3–3½ percent in 2010.

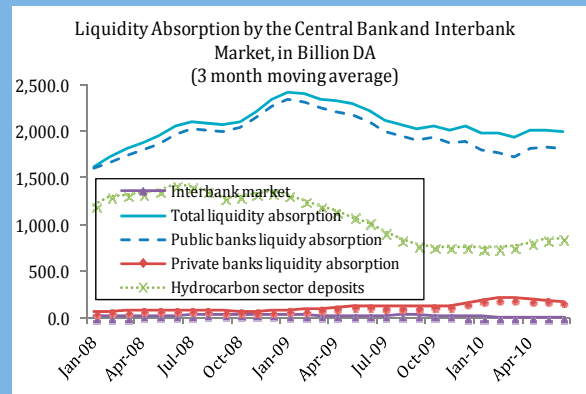
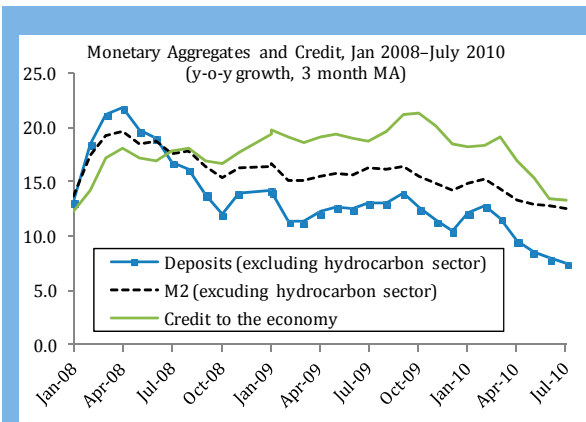


After rising in 2009, inflation has declined. Average total inflation rose to 5.7 percent in 2009, the highest level of the past decade, due to substantial fresh food price inflation. Nonfresh food inflation remained low in 2009 at 2.3 percent on average. In 2010, the increase in fresh food prices slowed down considerably but the rate of nonfresh food inflation is trending upward. Overall, inflation is projected at just over 4 percent in 2010 on average.



Growth in deposits and credit to the economy has remained strong. Algerian

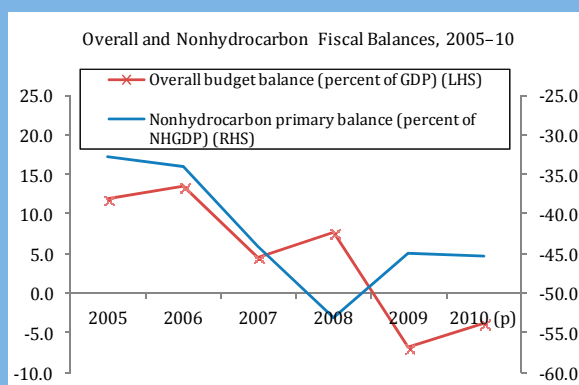
banks do not rely on external financing and continue to benefit from a healthy growth in deposits, although it slowed down a little since end-2009 (8.3 percent y-o-y in August 2010). The Bank of Algeria (BA) has continued its policy of absorbing excess liquidity generated by the PIP expenditure and the hydrocarbon sector. Overall, credit to the economy has increased by 12.5 percent (August 2010, y-o-y). The growth in credit to the public sector has remained at a high level (excluding debt repurchase by the Treasury) while growth in credit to the private sector (enterprises and households) slowed slightly as a result of a reduction in credit to households following the ban on consumer lending since August 2009.



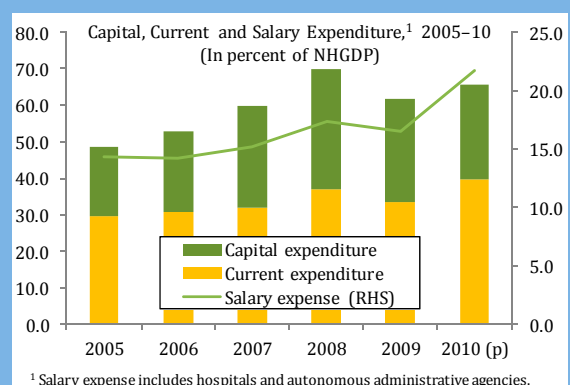
3. Algeria has continued to maintain its expansionary fiscal stance, supporting the NH sector.

The budget will remain in deficit despite the rise in hydrocarbon revenues. Algeria is expected to post in 2010 its second consecutive budget deficit of the decade, which could reach 4 percent of GDP following a deficit of about 7 percent in 2009. The increase in hydrocarbon revenues will be more than offset by a 17 percent increase in total expenditures. Reflecting the substantial increase in expenditures in recent years, the breakeven oil price that would correspond to a balanced budget increased from US\$34/bbl in 2005 to US\$88/bbl in 2010. A reform of civil service wages and salaries, to rationalize their structure, has led to a 34 percent rise in the wage

bill with effect from 2008. As a result, current expenditure is projected to grow by 31 percent (including salary back payments for 2008–09 in the education sector). Capital expenditure is expected to stabilize at its 2008–09 level with the continued implementation of the 2005–09 PIP. Nonhydrocarbon revenue will record a further 19 percent increase but yet will cover only half of current expenditure. In total, the primary nonhydrocarbon deficit in 2010 would remain broadly unchanged from last year at about 45 percent of NHGDP, indicating a continued support of fiscal policy to NH growth which has decelerated from 2009. The overall deficit should be fully covered by nonbank financing, while the level of resources in the FRR could grow by about US\$1½ billion and be equivalent to 38 percent of GDP.



Source: Algerian authorities; and IMF staff estimates.



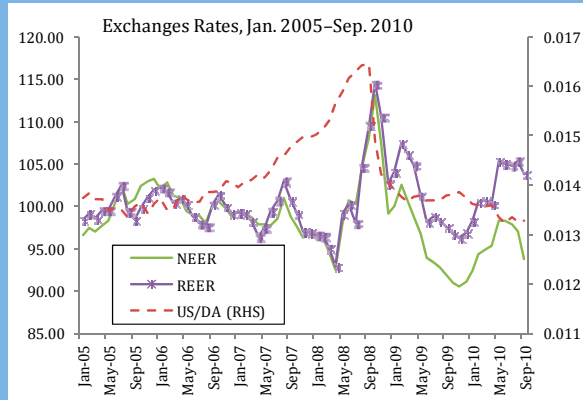
¹ Salary expense includes hospitals and autonomous administrative agencies.
Source: Algerian authorities; and IMF staff estimates.

4. Nominal and real effective exchanges rates have been rising in 2010.

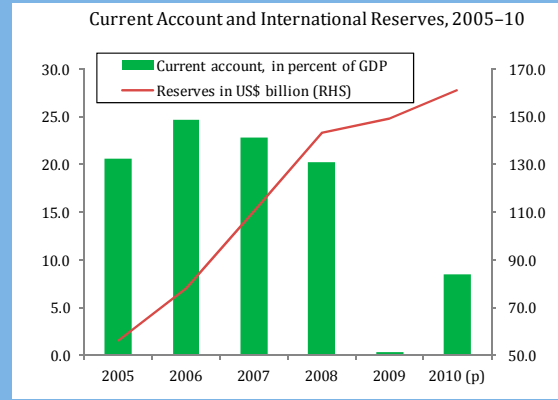
The real effective exchange rate rose by 6.5 percent in the first seven months of 2010, after declining by 7 percent in 2009. This reflects the increase in the nominal effective exchange rate over the course of 2010 of around 6 percent. The real effective exchange rate remains close to its equilibrium level, reflecting the development of underlying factors, in particular rising oil prices and public expenditures.

5. The current account surplus is improving significantly in 2010 due to higher hydrocarbon exports.

The external balance was negatively affected during 2009 by the fall in the price of hydrocarbons, with the current account surplus falling to 0.3 percent of GDP from 20 percent in 2008. Nevertheless, official reserves increased by US\$4 billion to US\$149 billion at end-2009 (almost 3 years of imports of goods and services). During the first nine months of 2010, hydrocarbon export revenues increased by about 32 percent, due to the steady rise in the oil prices, while export volumes (in particular of gas) fell by 1.4 percent. Imports decreased slightly from last year, contributing also to the improvement in the current account balance. Accordingly, official reserves rose by about US\$8 billion since end-2009 to US\$157 billion by end-September 2010.



Source: Algerian authorities; and IMF staff estimates.



Source: Algerian authorities; and IMF staff estimates.

Past Consultations

In recent consultations, the authorities and the staff agreed on the broad macroeconomic policies stance, which have contributed to maintain a very comfortable financial position, but structural reforms have not been as ambitious as suggested by staff. The authorities continued the implementation of a large PIP to improve infrastructure and enhance growth potential. However, the recent substantial increase in civil service wages will push back the fiscal consolidation needed in the medium term to protect Algeria's capacity to weather negative oil price shocks. Control over the quality of large PIP projects has improved, and modernization of budget systems is advancing slowly. The BA continued to effectively absorb the abundant liquidity of banks to contain inflationary pressures, while maintaining interest rates at their reduced levels since early 2009. The authorities continued to state their objective of economic diversification, but progress in structural reforms, including in the financial sector, remains slow. The new regulations for FDI adopted in 2009 may further deteriorate the unfavorable perception of business climate.

II. SHORT-TERM OUTLOOK AND POLICIES: SUPPORTING GROWTH WHILE FENDING OFF INFLATIONARY PRESSURES

6. The global recovery will support the Algerian hydrocarbon sector while public expenditure will continue to boost the nonhydrocarbon sector.

The global recovery has gone hand in hand with a rise in the demand and price of hydrocarbons. As a result, following several years of declining production, the hydrocarbon sector in Algeria should stabilize, but would make only a small contribution to overall growth. Nonhydrocarbon growth is likely to remain strong with the continuation of PIP spending and the ongoing hydrocarbon sector investment program. Accordingly, NHGDP could grow by about 5.3 percent in 2010–11, and contribute to an overall growth of 3.7 percent in 2011. The rises in civil service and public enterprises' wages could put upward pressure on inflation, which could reach about 5 percent in 2011.

7. Higher oil prices should improve the external and the fiscal balances significantly.

The rise in oil prices projected by the WEO would contribute to an improvement in the current account surplus to 8–9 percent of GDP in 2010–11. The budget balance is expected to remain in negative territory in 2011 at 3.3 percent of GDP, due to continuously large current expenditure.

8. Against the need to further reduce unemployment and uncertainties in Algeria's main hydrocarbon export markets, policies should aim at continuing to support growth while initiating actions to ensure fiscal sustainability.

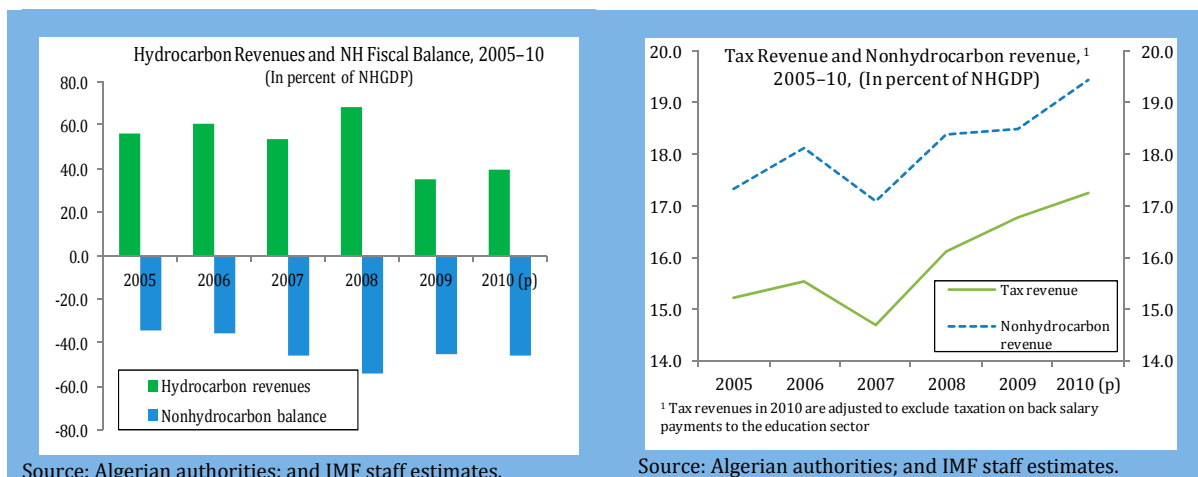
The support to economic growth, which helped to weather the impact of the global crisis in 2009, should not be withdrawn too quickly. The prudent macroeconomic management of the past decade has given Algeria an important margin to face external shocks and absorb sharp falls in hydrocarbon prices. However, the global crisis also showed Algeria's financial vulnerability to prolonged periods of low oil prices. At the same time, the authorities should remain vigilant about risks of potential inflationary pressures.

Fiscal policy

9. The fiscal policy priorities in 2011 should be to break the rising trend of expenditure, while improving its efficiency and targeting.

With public spending playing a dominant role for growth, key policy goals include the continuation of the PIP and complementing and supporting private investment. Thanks to large available fiscal savings, the authorities could maintain the relatively high levels of budget expenditures in the short term. However, as the sharp increase in current expenditures in the past few years could have had detrimental effects via exacerbating "Dutch disease"-type real appreciation of the exchange rate which would undermine NH sector competitiveness, it will be important to stop and reverse this rising trend, develop policies for better targeting of current expenditure (current transfers, in particular), and continue strengthening the efficiency of control over capital expenditure. Moreover, to minimize its impact on aggregate demand,

implementation of the reform of public wages and salaries, including back payments, should be spread as much as possible over time.



10. The fiscal balance should improve but will remain in deficit in 2011.

The fiscal position will remain in deficit in 2011. The preliminary 2011 Budget Law provides for the continued implementation of pay scale reforms for the civil service and the increase in recurring charges of new public infrastructures. Current expenditures (on a cash basis) would thus increase by 13 percent to close to 41 percent of NHGDP. However, when excluding salary back payments, the ratio of current expenditures would decline from 37 percent of NHGDP in 2010 to 35 percent in 2011, which should mark the start of a reversal in their trend following the peak reached this year. Capital expenditures are expected to remain stable in real terms. Total revenues will continue to rise thanks to the increase in hydrocarbon prices and greater efficiency of tax administration in the collection of direct taxes.

Authorities' views

11. Fiscal prudence remains a priority for the authorities. *The authorities agreed that the recent substantial growth of expenditure needs to be halted—especially for current expenditure. The salary increase to civil servants in the context of the pay scale reform was a necessary step, nevertheless, to compensate for the loss of purchasing power of public employees due to the absence of adjustments in the last few years. Moreover, the authorities consider that the increase will bring public salaries closer to average salaries in the region. To minimize the potential negative effect on inflation and the external current account, back salary payments will be spread over 2010–12. At the same time, a review of current transfers, in particular of food subsidies, is being launched with World Bank assistance to improve its targeting.*

12. The authorities see the continued implementation of large public investments as key to enhance nonhydrocarbon growth potential. *Therefore, overall capital expenditure will be kept at their 2009–10 levels in real terms in order to complete the execution of the 2005–09 PIP and start executing the new 2010–14 PIP. Nevertheless, should a deterioration of the international environment occur and hydrocarbon fiscal revenue fall, the authorities stand ready to adjust investment spending according to the availability of resources.*

Monetary and exchange rate policies

13. The prevailing orientation of monetary policy for 2010 and 2011 should be to continue to absorb excess liquidity and fend off inflationary pressures.

The BA continues to absorb effectively excess banking liquidity arising from hydrocarbon sector resources and public expenditures, thereby limiting the impact of abundant liquidity on inflation. The authorities should maintain a watchful stance given the current context of rising hydrocarbon revenues fueling the economy with liquidity, the sharp increase in remuneration of civil servants and other employees, as well as the uncertainties relating to the direction of fresh food prices. If inflationary pressures become apparent, the BA should promptly increase interest rates, preferably including the refinancing rate, in order to give a more definite signal for the cost of credit in the economy than the more indirect indication given by liquidity absorption rates. The BA should also maintain effective information exchange with the Ministry of Finance on future spending, and continue to enhance its analytical capacity to better inform monetary policy decisions.

14. Exchange rate policy continues to aim at stabilizing the real effective exchange rate of the dinar close to its equilibrium rate.

The BA continues to conduct an active exchange rate policy of managed float, aimed at maintaining the real effective exchange rate close to its equilibrium level and minimizing the risks of misalignment stemming from volatility in oil prices and of the Euro/US\$ exchange rate (Appendix 1). The equilibrium real exchange rate has appreciated in the last few years, essentially reflecting the increase in government spending, entailing the risks of “Dutch disease” welfare-reducing effects.

Authorities’ views

15. The authorities consider that the liquidity absorption has been effective in containing inflation and remain vigilant about any new build up of inflationary pressures.

The authorities are mindful of the continuous need to fend off inflationary pressures following the peak of inflation in 2009. They noted, however, that the substantial increase in fresh food prices in 2008–09 was mainly due to market imperfections. These prices have stabilized since early 2010, but the rising inflation in nonfood products is a source of concern. The authorities are monitoring developments closely and stand ready to act to contain any surge in inflation pressures. They face difficulties created by the abundant liquidity to achieve effective monetary transmission but consider that current monetary intervention mechanisms are working well in this context.

16. The authorities remain committed to maintaining the real effective exchange rate close to its equilibrium level and consistent with external stability. *During 2010, the exchange rate policy allowed for an appreciation of the real effective exchange rate in line with the recovery of hydrocarbon prices and larger public expenditure. The authorities will pursue their efforts to enhance their exchange rate analysis capacity.*

III. MEDIUM-TERM CHALLENGES AND REFORMS: NEED TO PROMOTE ECONOMIC DIVERSIFICATION

Medium-term outlook

17. The medium-term growth outlook remains stable, with risks of a slowdown in some sectors.

Over the medium term, the hydrocarbon sector may be affected by a drop in gas exports—stemming from the possible development of alternative gas production in Algeria’s export markets—which could weigh on growth and total hydrocarbon revenues (see selected issues paper on oil and gas prices). The growth of NHGDP of approximately 5 percent would be supported by the new PIP and the continuation of the hydrocarbon sector investment program. The growth potential of the private sector will critically depend on a forceful structural reform program, in particular in the financial sector and for improving the business climate. A more ambitious program of structural reforms is needed to avoid a slowdown in medium-term NHGDP growth, given that PIP expenditure would remain stable in real terms and should give way to other private sector-led sources of growth.

18. The medium-term financial outlook is positive, given the projected steady increase in hydrocarbon prices.

The medium-term financial outlook is positive overall, thanks to the gradual increase expected in hydrocarbon prices, but it remains dependent on fluctuations in these prices. If public expenditures are contained in the medium term, FRR resources could increase further, albeit at a lower rate of growth than nominal GDP, thus reaching 32 percent of GDP in 2015. With current account surpluses remaining at about 9 percent of GDP over the period, reserves would increase to the equivalent of over four years of imports of goods and services in 2015. In an alternative scenario, with a drop of 30 percent in the price of natural gas, due to the development of unconventional gas production in Algeria's export markets, the resources in the FRR would fall substantially, by about 10 percentage points of GDP by 2015.

Medium-Term Baseline Scenario, 2009–15

Base scenario	2009	2010	2011	2012	2013	2014	2015
International oil price (US\$/bbl)	61.8	76.2	78.8	82.3	84.8	86.0	87.5
International gas price (US\$/BTU)	6.6	7.6	7.9	8.3	8.6	8.7	8.9
Overall budget balance (percent of GDP)	-6.8	-3.9	-3.3	-1.1	1.7	2.6	3.2
FRR (percent of GDP)	42.6	37.9	32.1	28.9	28.9	30.1	31.8
Reserves (US\$ billion)	148.9	161.0	171.4	188.3	206.9	226.4	247.4
Primary budget deficit (percent of NHGDP)	-44.9	-45.3	-45.8	-41.6	-36.1	-33.1	-30.8
Current account balance (percent of GDP)	0.3	8.5	9.3	9.6	9.7	9.8	10.1
Government net assets (percent of GDP)(*)	32.2	27.6	20.8	17.9	18.1	19.5	21.4

(*) FRR minus government debt

Authorities’ views

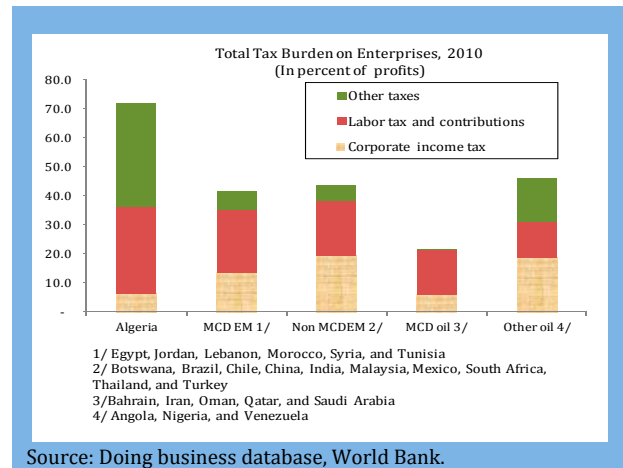
19. The authorities realize the challenges lying ahead and continue to aim at reducing the reliance of the Algerian economy on the hydrocarbon sector. Their key objective remains

to promote a more diversified and private investment-led growing economy in order to reduce unemployment further and improve the living standards of the population. This will continue to guide their policies and structural reforms. The authorities agreed that new developments in international gas markets, with the potential rise of alternative gas production, could affect Algerian gas exports over the medium term.

Medium-term fiscal consolidation and fiscal reforms

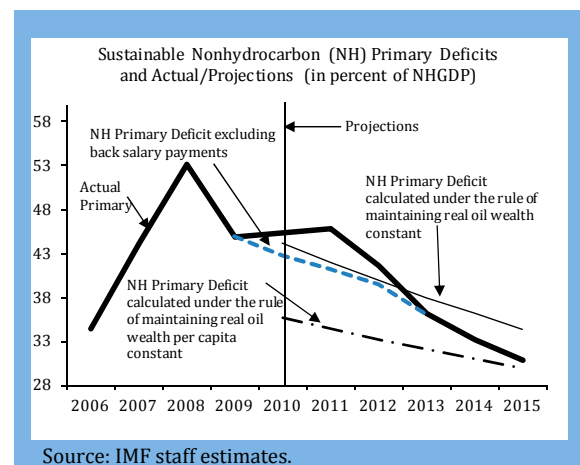
20. Nonhydrocarbon budget revenues should be further enhanced, but the tax burden on businesses should decline.

Good progress was achieved in the last few years—with IMF technical assistance—in increasing nonhydrocarbon revenues, including through combating tax fraud, coordinating efforts among the various collecting organizations, and efforts to widen the tax base by creating tax centers. However, in 2010 hydrocarbon revenues still represent about two-third of total revenues. Although the authorities successfully set up the FRR to reduce the budget vulnerability to hydrocarbon revenues, this is not necessarily sufficient in the medium to long term to face oil price volatility. The authorities could aim at covering all current expenditure with nonhydrocarbon revenues in the longer term. At the same time, comparisons with other emerging market economies show that the tax burden on businesses is very high in Algeria. Reducing this burden would ease doing business and support the fight against the informal sector.



21. Adopting a medium-term budget framework, based on the principle of permanent income, would provide a useful benchmark to ensure fiscal sustainability in the medium term.

This analysis is based on the principle of nonrenewable hydrocarbon resources and the establishment of policies to ensure the availability of hydrocarbon resources in the long term. Accordingly, the government would set itself the goal of spending only part of the hydrocarbon income in order to maintain constant overall wealth—or wealth per capita—over the long term. Applying this framework to Algeria indicates that fiscal consolidation will be necessary to bring the fiscal position back to a



sustainable level in the medium term.

22. Following several years of substantial expenditure increase, control and prioritization of expenditure should improve to protect Algeria's capacity to weather a prolonged fall in oil prices.

Current expenditure has increased on average by 20 percent per year over the past five years. This rise is mainly due to the increase in the wage bill from 11.6 percent of NHGDP in 2006 to 15.6 percent in 2010 (excluding back payments). Wage back payments and rising recurring costs of new infrastructures will put upward pressures on expenditure. Moreover, potential fiscal risks, such as capital project cost overruns, or the need to restructure and further support public enterprises, could add to those pressures. Against this backdrop, containing expenditure more strictly will be necessary to ensure long-term fiscal sustainability. It could be achieved through limiting annual wage increases below inflation, improving the targeting of transfers and subsidies, and prioritizing and adjusting investment projects within available resources. Furthermore, establishing mechanisms to make partial and more regular adjustments to civil service wages would help to avoid destabilizing effects of the very sharp periodic increases as seen in recent past.

23. Close attention should be given to the quality and effectiveness of expenditures.

The creation of the national commission (*Caisse Nationale d'Equipements et de Développement, CNED*) to monitor the implementation of PIP projects has been a positive development, and it should play an increasingly important role in prioritizing the PIP. That said, for the PIP to have the hoped for positive effect on potential growth, it should also be accompanied by forceful structural reforms aimed at facilitating private economic activity. Modernization of the budget systems is continuing, but requires further significant efforts in some areas. Target-based budget management with performance assessment of the various programs will, over time, bring about improved control and greater efficiency of public expenditure. The preparation for the first time in many years of the 2008 Budget Review Law is a step toward improved transparency.

Authorities' views

24. *The authorities are committed to ensure medium-term fiscal sustainability. They aim at reducing the dependence on hydrocarbon revenues in the medium term and protect the fiscal savings under normal circumstances. Continued modernization of tax administration and strengthened tax collection procedures will help further increasing nonhydrocarbon revenues. The authorities are also exploring measures to curb current expenditure growth over the medium term, including devising a system of targeted income support to replace general subsidies, and establishing market-based pricing mechanisms for some energy product and services.*

25. *The continuation of fiscal reforms is a key component of the authorities' growth strategy. They attach great importance to the quality and efficiency of public spending. The role of the CNED will increase with the new 2010–14 PIP for which no new large project will be*

included in the budget without the CNED's approval based on transparent procedures. The authorities also pursue their efforts to improve medium-term budgeting and forecasting.

Further strengthening the financial system

26. Financial sector indicators continued to improve in 2009.

Banks are well capitalized overall—especially following the quadrupling of minimum capital requirements in 2009—and profitable. The nonperforming loans (NPLs) ratio decreased further in 2009 to 14.5 percent and loans' provisioning increased, reflecting tighter risk assessment by both regulators and banks. However, the NPLs ratio in public banks remains too high and further actions are needed to improve the resolution of public banks' NPLs with public enterprises and the private sector.

27. Banking intermediation remains relatively low.

The banking sector is very liquid, but lending remains relatively low mainly because of credit risk. The establishment of a central credit register for risk of individuals planned for 2011 will help enhance risk assessment and promote lending. Other measures aim to develop lending for small and medium-sized enterprises (SMEs), and mortgage loans to individuals. Some banks are also modernizing their operations and means of payment, to reduce the widespread practice of payment in cash. Similarly, further development of bank branch networks remains essential to improve the use of banks by the general public.

28. Some recent measures may hamper the efforts to modernize the financial system.

New rules for FDI (see below) will prevent the entry of new foreign majority-owned banks or the takeover of public banks by foreign banks as part of any privatization. Moreover, the presence of a nonvoting government representative on the boards of private banks has become mandatory. It will be essential that this does not affect the normal operations of these institutions but fosters a better dialog with the public authorities. Furthermore, the ban on consumer lending (except mortgages) in force since 2009 has affected the deepening of banking activity and should be reviewed once the credit registry becomes operational.

Financial Soundness Indicators, 2005–10
(In percent)

	2005	2006	2007	2008	2009	Jun-10
Capital adequacy ratio	12.3	15.2	12.9	16.5	21.8	18.4
Public banks 1/	11.7	14.4	12.1	16.0	19.1	15.9
Foreign banks 2/	19.0	21.6	18.1	20.2	35.3	29.7
Classified loans/total loans	35.7	34.8	35.5	25.4	21.6	22.1
Public banks	38.2	37.5	38.7	28.5	24.4	24.9
<i>Off which</i> , to private sector	19.0	22.0	24.3	20.0	16.9	17.4
Foreign banks	5.7	8.8	11.5	3.9	4.0	4.0
NPLs/total loans 3/	19.2	17.5	22.1	15.7	14.5	14.9
Public banks	20.4	19.2	23.8	17.6	16.5	16.8
<i>Off which</i> , to private sector	10.1	11.7	18.7	15.9	13.0	13.3
Foreign banks	3.2	2.9	9.2	2.2	2.4	2.6
Other class./total loans 4/	16.5	17.3	13.4	9.8	7.1	7.2
Public banks	17.8	18.4	14.9	10.9	7.8	8.1
<i>Off which</i> , to private sector	8.9	10.3	5.7	4.1	3.9	4.1
Foreign banks	2.5	5.9	2.3	1.7	1.6	1.4
Provisions/classified loans	49.3	54.0	56.1	57.7	68.3	67.8
Public banks	49.2	54.2	55.0	57.4	68.0	67.8
Foreign banks	62.3	48.7	85.2	68.7	78.9	70.0
Return on equity	7.8	18.8	24.6	25.2	25.7	...
Public banks	5.6	17.4	23.6	25.0	25.5	...
Foreign banks	25.4	23.4	28.0	25.6	26.3	...

Source: Algerian authorities.

1/ 90 percent of system assets.

2/ Nonpublic banks are all foreign.

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

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

29. More forceful implementation of the 2007 FSAP update recommendations will support the modernization of the financial system.

These measures include: (a) clarifying the role of the public banks; (b) improving further the operational environment; and (c) developing nonbank financing through the bond market. The control, management, and governance of public banks (90 percent of banking sector assets) should be enhanced, considering all possible ways forward to bring them to the highest international standards, including through partnerships with foreign financial institutions.

30. Efforts to strengthen banking supervision are underway.

The BA will establish a new bank rating system planned for 2011 as part of ongoing actions to improve the assessment, management, and control of credit risk. The authorities are also preparing the first report on financial stability, to help identify potential risks in the financial sector. This work is part of the responsibility explicitly assigned to the central bank by the 2010 amendment of the Law on Money and Credit (LMC) to ensure financial stability.

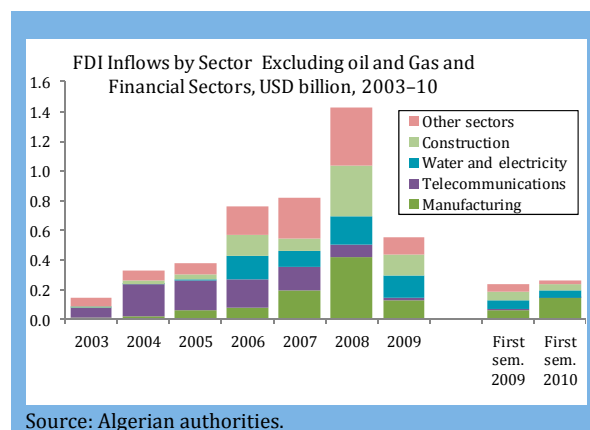
Authorities' views

31. Modernizing and strengthening the financial sector is a key pillar of the authorities' strategy to support private investment. The BA will continue with its efforts to improve supervision and reinforce the strength of financial institutions. Recent measures such as the new banking accounting system based on IAS/IFRS principles contribute to better disclosure of financial information. The authorities consider that the relatively high NPLs levels are due to the legacy of old debts, and that accumulation of new NPLs is small. They will continue to explore ways to enhance operations of public banks, including through possible partnerships with foreign financial institutions. They see the presence of government representatives at private banks' boards as helping the communication with the authorities.

Efforts needed to diversify the economy

32. Some measures of the 2009 Supplementary Budget Law may have contributed to deter FDI and could hamper the diversification of the Algerian economy.

Algeria has traditionally received little FDI outside the hydrocarbon sector, although it was on an upward trend until 2008. The new measures imposing (a) a 49 percent ceiling for foreign participation in any new FDI; (b) a positive foreign currency balance for new FDI projects; or (c) the reaffirmation of the preemptive right of the public authorities over the sale of foreign investments could deter foreign investors. In 2009, FDI (excluding hydrocarbons and the financial sector) fell by about 60 percent and has not recovered in 2010. Algerian authorities should continue to review the impact of these measures and identify any necessary adjustments that would ensure an attractive, but well controlled FDI regime. For example, the foreign participation limit could apply only for strategic sectors, and the mandatory review of FDI project authorizations by the National Investment Council (CNI) be limited to the largest projects.



33. A more assertive structural reform agenda would boost business climate and private investment-led growth.

The private sector remains weak and fragmented, in particular in the industrial sector, and has limited capacity for innovation and improving competitiveness. The support program for SMEs should be accelerated, with efficient targeting and consistent objectives, which should be devised in cooperation with private sector representatives. The public enterprise restructuring programs, recently decentralized to sector ministries, should gain momentum to give greater scope for private initiative and reduce the fiscal burden. More generally, the authorities should explore any other reform to improve business climate.

34. More efforts are needed to foster Algeria's integration in regional and world trade.

The growth in imports of the past years demonstrates Algeria's gradual trade openness, but some recent measures—including the ban on consumer lending—aimed at reining in import growth which was perceived as excessive. Moreover, Algeria still has high average tariff rates which should be reduced starting by cutting the highest rates. In 2009, Algeria joined the Arab Free Trade Zone (AFTZ) and imports from regional partners increased significantly—albeit from low levels—prompting the authorities to seek a more gradual implementation of this trade agreement. The authorities have pursued their efforts to join the World Trade Organization, which they hope in the near future. The negotiations on the new phase in the Association agreement with the European Union (EU) are continuing but have been somehow slowed due to Algerian concerns on the nonhydrocarbon exports access to EU markets.

Authorities' views

35. *The authorities are concerned by the relatively unfavorable perception of Algeria's business climate but consider that the new measures will help to support investments more beneficial for the local economy.* They consider that the new infrastructure will boost Algeria's competitiveness. Moreover, they believe that the measures taken in 2009 and 2010 to promote greater participation of Algerian private investment and the public sector will help to create better investment opportunities.

36. *The authorities consider that certain trade agreements did not meet Algeria's expectations.* In their view, the AFTZ and the Association Agreement with the EU led to excessive import growth with no sufficient benefits for Algerian exports. The authorities are negotiating the restoration of certain duty rights with the AFTZ and the EU in order to smooth the integration process for certain sectors.

IV. STAFF APPRAISAL

37. Algeria has recorded favorable macroeconomic developments but continues to face important challenges.

Algeria has enjoyed a decade of solid nonhydrocarbon growth and low inflation after the political and socio-economic crisis of the 1990s. Prudent fiscal and monetary policies, combined with a period of high oil prices, contributed to build a comfortable financial position, with large external reserves, substantial savings in an oil stabilization fund, and very low public and external debt. However, despite repeated efforts to diversify the economy and strengthen the private sector, Algeria is still as dependent on hydrocarbons and public spending, with productivity and business climate lagging behind trading partners. While having fallen, youth unemployment remains high, highlighting the pressing need to accelerate structural reforms to diversify the economy and promote new sources of sustainable growth.

38. The very expansionary fiscal stance of the last few years will need to be contained over the medium term to protect Algeria's capacity to withstand negative and prolonged hydrocarbon revenue shocks.

Given the dominant role of public spending for growth, continued implementation of the infrastructure component of the PIP and support to SMEs is desirable in the short term and the large fiscal savings could be used to that end if needed. While upward pressures on expenditure will likely continue, strict containment of spending will be necessary to ensure long-term fiscal sustainability. Wage increases should be limited below inflation, and targeting of transfers and subsidies should improve in order to make room for increased recurring costs of new infrastructures. Investments projects will also need to be prioritized and adjusted within available resources. Similarly, ongoing advances in tax administration should continue to boost nonhydrocarbon revenues. The need for these policies will become more pressing if risks on gas revenue related to the development of nonconventional gas in Algeria's export markets materialize.

39. Ensuring the quality and efficiency of public expenditure and pursuing budgetary reform are essential to strengthen growth potential.

Ongoing efforts to modernize budget systems should continue, in particular to achieve a medium-term budget programming system, develop tools to evaluate programs performance, and enhance budget control. The role of the commission in charge of monitoring the implementation of large PIP projects has been positive and should become even more important for prioritizing PIP expenditure in the near future.

40. The central bank has been able to contain inflationary pressures, but should stand ready to tighten monetary policy promptly if these pressures were to increase.

The BA has successfully absorbed the abundant liquidity from high oil revenues and large public spending. To avoid that the significant increase in public wages would push inflation up, the BA should reverse the rate cuts of 2009 and consider increasing the refinancing rate if

a stronger signal is needed. Ongoing efforts to refine the instruments for monitoring, assessing and absorbing the abundant liquidity should continue.

41. The central bank should continue to pursue an exchange rate policy consistent with external stability.

The BA should closely monitor developments to minimize the risks of misalignment of the real effective exchange rate, which has remained close to its equilibrium level. The containment of government spending would contribute to reduce pressures for a real appreciation and potential “Dutch disease” effects.

42. Structural reforms, including in the financial sector, should be implemented more forcefully to improve the business climate.

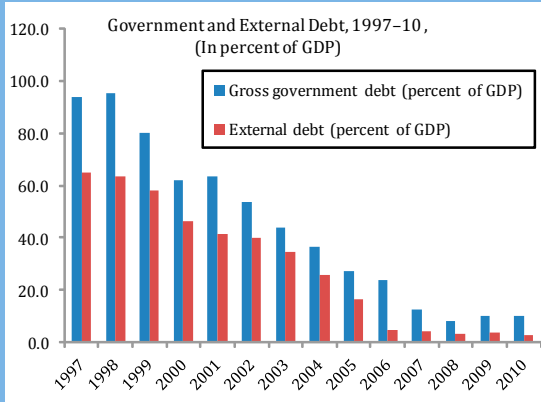
The commendable efforts to enhance infrastructures are not sufficient to improve investment climate. New rules for FDI adopted in 2009 and some bureaucratic burden seem to discourage foreign direct investors, which deprives Algeria of needed transfer of technology and know-how. These measures could be reviewed to ensure a well regulated but yet attractive investment framework. Public banks need to improve their governance and further modernize their operational framework to enhance financial intermediation. All possible ways should be explored to bring them to the highest international standards, including through partnerships with foreign institutions and opening up of their capital to the private sector. Recommendations of the 2007 FSAP Update of the financial sector should be implemented forcefully, and ongoing efforts to reduce NPLs should continue to bring their level closer to comparable countries. Moreover, the authorities should continue to seek a better integration of Algeria in the regional and global economy.

43. The authorities should expedite Algeria’s participation as a creditor in the Enhanced HIPC Initiative.

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

Panel 1. Algeria: Selected Economic Indicators

Prudent macroeconomic policies and high oil prices have allowed Algeria to reduce very significantly domestic and external indebtedness.



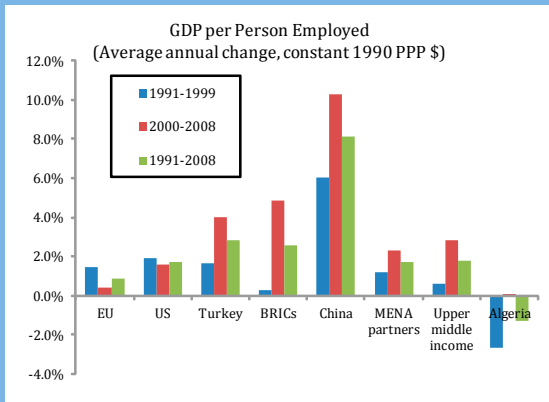
Sources: Algerian authorities; and IMF staff estimates.

Algeria ranks poorly in terms of business climate with respect to its main regional partners...



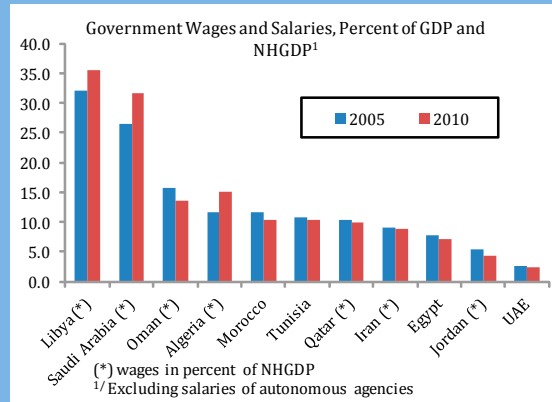
Source: World Development Indicators database, World Bank.

Productivity in Algeria has been declining over the past decades and may have affected its competitiveness.



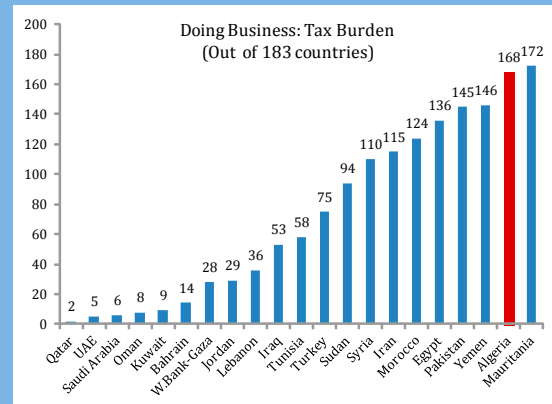
Source: World Development Indicators database, World Bank.

In 2010, 34 percent public service wage increase places Algeria at higher public wage levels compared to neighboring countries.



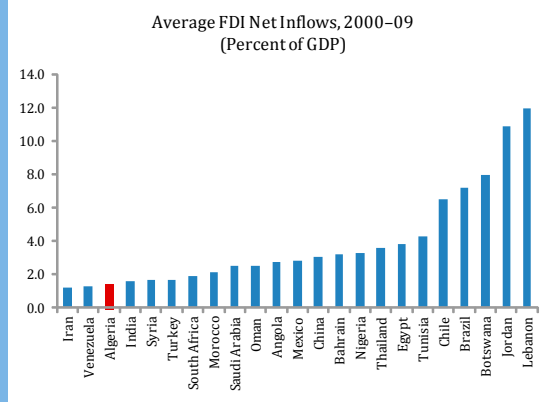
Sources: Algerian authorities; and IMF staff estimates.

... and ranks even lower in terms of the tax burden.



Source: Doing Business Indicators database, World Bank.

Algeria has failed to attract FDI during the last decade with the exception of the hydrocarbon sector.



Source: World Development Indicators database, World Bank.

Table 1. Algeria: Selected Economic and Financial Indicators, 2007–15

	2007	2008	Est. 2009	Projections					
				2010	2011	2012	2013	2014	2015
(Annual percentage change; unless otherwise indicated)									
Oil and gas sector									
Liquid petroleum exports (in millions of barrels/day)	1.7	1.6	1.5	1.4	1.4	1.4	1.4	1.4	1.4
Natural gas exports (in billions of m3)	59.4	59.5	53.7	53.8	53.8	53.8	53.8	53.8	53.9
Crude oil export unit value (US\$/bbl)	74.7	99.0	61.8	76.2	78.8	82.3	84.8	86.0	87.5
Share of hydrocarbons in total exports (in percent)	98.4	98.2	98.3	98.0	98.0	98.0	98.1	98.0	98.1
National income and prices									
GDP at constant prices	3.0	2.4	2.4	3.3	3.7	3.6	3.5	3.4	3.4
Hydrocarbon sector	-0.9	-2.3	-6.0	-0.9	0.8	0.6	0.6	0.6	0.5
Other sectors	6.3	6.1	9.3	5.3	5.3	5.3	5.2	5.0	5.0
Consumer price index (period average)	3.7	4.9	5.7	4.3	5.0	4.3	4.0	3.7	3.7
External sector 1/									
Exports, f.o.b.	10.7	29.7	-42.5	27.5	8.6	4.6	3.1	1.7	1.8
Hydrocarbons	11.2	29.5	-42.5	27.0	8.6	4.6	3.1	1.6	1.9
Nonhydrocarbons	-13.3	42.9	-45.0	51.8	5.8	6.1	-1.4	6.2	-1.0
Imports, f.o.b.	27.4	44.2	-1.6	1.3	4.7	3.2	3.7	3.4	2.1
Current account balance (in percent of GDP)	22.8	20.2	0.3	8.5	9.3	9.6	9.7	9.8	10.1
Money and credit									
Net foreign assets	34.5	38.2	5.0	10.5	...	...	...	...	...
Domestic credit 2/	-19.7	-17.6	7.3	0.9	...	...	...	...	...
Credit to the government (net) 2/ 3/	-26.5	-25.2	0.2	-4.7	...	...	...	...	...
Credit to the economy 3/	17.2	20.4	18.5	12.5	...	...	...	...	...
Money and quasi-money	24.1	16.1	3.1	14.1	...	...	...	...	...
Velocity of broad money (GDP/M2)	1.6	1.6	1.4	1.4	...	...	...	...	...
Idem, in percent of nonhydrocarbon GDP	0.9	0.9	1.0	0.9	...	...	...	...	...
Liquidity ratio (M2/GDP)	64.4	63.3	70.8	69.8	...	...	...	...	...
(In percent of GDP)									
Saving-investment balance	22.8	20.2	0.3	8.5	9.3	9.6	9.7	9.8	10.1
National savings	57.2	58.6	50.3	53.0	53.7	54.0	53.7	53.5	53.2
Of which: Nongovernment	37.3	32.9	38.1	40.3	41.0	39.0	37.1	36.8	36.4
Investment	34.4	38.3	50.0	44.5	44.4	44.4	44.0	43.8	43.1
Of which: Nongovernment	18.9	20.4	31.0	28.0	28.4	28.2	29.0	29.7	29.6
Central government finance									
Overall budget balance (deficit-)	4.4	7.7	-6.8	-3.9	-3.3	-1.1	1.7	2.6	3.2
Total revenue	39.6	47.2	36.3	38.4	38.4	37.8	37.5	37.1	36.6
Total expenditure	35.2	39.5	43.1	42.2	41.8	38.9	35.8	34.4	33.4
(In percent of nonhydrocarbon GDP)									
Central government finance									
Total revenue	70.7	86.6	53.8	59.6	60.6	59.5	58.4	57.0	55.7
Hydrocarbon	53.6	68.2	35.3	39.8	41.1	40.4	39.3	37.6	36.2
Nonhydrocarbon	17.1	18.4	18.5	19.8	19.5	19.0	19.1	19.4	19.5
Total expenditure	62.8	72.5	63.9	65.6	65.8	61.2	55.8	53.0	50.8
Current expenditure	32.0	37.0	33.7	39.9	40.6	35.9	32.4	31.3	30.2
Capital expenditure	30.7	35.5	30.3	25.7	25.2	25.3	23.4	21.7	20.6
Nonhydrocarbon primary balance	-44.1	-53.1	-44.9	-45.3	-45.8	-41.6	-36.1	-33.1	-30.8
Nonhydrocarbon balance	-45.7	-54.1	-45.4	-45.8	-46.3	-42.2	-36.7	-33.6	-31.3
Memorandum items:									
GDP (in billions of dinars at current prices)	9,306	10,994	10,136	11,733	13,205	14,414	15,614	16,747	17,953
NHGD (in billions of dinars at current prices)	5,217	5,994	6,831	7,554	8,376	9,172	10,016	10,885	11,809
GDP (in billions of US\$ current prices)	134.3	170.2	139.8	158.6	168.8	178.4	187.6	196.2	205.2
Per capita GDP (in US\$)	3,904	4,940	3,926	4,389	4,603	4,793	4,966	5,115	5,270
Crude oil exports (in millions of barrels/day)	0.9	0.8	0.7	0.7	0.7	0.8	0.8	0.8	0.8
Nonhydrocarbon exports (percent of total exports)	1.5	1.6	1.5	1.8	1.8	1.8	1.7	1.7	1.6
Gross official reserves (in billions of US\$, end of period)	110.2	143.1	148.9	161.0	171.4	188.3	206.9	226.4	247.4
In months of next year's imports of goods and services	26.9	35.4	35.6	36.7	37.9	40.1	42.7	45.9	49.9
Gross government debt (in percent of GDP)	12.5	8.2	10.4	10.3	11.4	11.1	10.8	10.6	10.4
External debt (in percent of GDP)	4.2	3.3	3.8	2.8	2.2	1.9	1.7	1.5	1.1

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

1/ In U.S. dollars terms.

2/ In percent of beginning money stock.

3/ Including the impact of the financial restructuring in 2006 involving the swap of government bonds for bank claims on public enterprises.

Table 2. Algeria: Balance of Payments, 2007–15

	2007	2008	Est. 2009	Projections					
				2010	2011	2012	2013	2014	2015
(In billions of U.S. dollars; unless otherwise indicated)									
Current account	30.6	34.5	0.4	13.4	15.7	17.2	18.2	19.2	20.7
Trade balance	34.2	40.6	7.8	19.7	22.8	24.4	24.9	24.6	24.9
Exports, f.o.b.	60.6	78.6	45.2	57.6	62.5	65.4	67.4	68.5	69.8
Hydrocarbons	59.6	77.2	44.4	56.4	61.3	64.1	66.1	67.2	68.4
Volume change (in percent)	-1.6	-3.4	-10.2	-1.6	0.1	0.1	0.1	0.1	0.1
Price change (in percent)	12.9	34.2	-36.0	29.5	8.4	4.5	3.1	1.5	1.7
Other	1.0	1.4	0.8	1.2	1.2	1.3	1.3	1.4	1.4
Imports, f.o.b.	-26.4	-38.0	-37.4	-37.9	-39.7	-41.0	-42.5	-43.9	-44.8
Volume change (in percent)	14.8	34.6	12.6	-4.3	3.7	3.5	3.4	3.0	2.5
Price change (in percent)	11.0	7.1	-12.6	5.8	1.0	-0.3	0.3	0.4	-0.4
Services and income (net)	-5.9	-8.9	-10.0	-8.8	-9.6	-9.8	-9.2	-7.9	-6.8
Services (net)	-4.0	-7.6	-8.7	-8.4	-8.8	-9.2	-9.7	-10.1	-10.2
Credit	2.9	3.5	3.0	4.0	4.1	4.1	4.2	4.2	4.2
Debit	-6.9	-11.1	-11.7	-12.3	-12.9	-13.3	-13.8	-14.3	-14.4
Income (net)	-1.8	-1.3	-1.3	-0.4	-0.8	-0.6	0.4	2.2	3.4
Credit	3.8	5.1	4.7	4.0	4.0	4.2	5.5	7.4	8.9
Debit	-5.6	-6.5	-6.1	-4.4	-4.8	-4.8	-5.1	-5.2	-5.5
Interest payments	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Other, including profit repatriation	-5.4	-6.3	-5.9	-4.2	-4.6	-4.7	-5.0	-5.1	-5.4
Transfers (net)	2.2	2.8	2.6	2.5	2.5	2.5	2.5	2.5	2.5
Capital account	-1.1	1.2	3.5	1.2	0.2	0.2	0.7	0.8	0.8
Medium- and long-term capital	0.6	1.9	3.8	2.6	1.6	1.6	2.1	2.2	2.2
Direct investment (net)	1.4	2.3	2.5	2.4	1.7	1.7	2.0	2.1	2.1
Loans (net)	-0.8	-0.4	1.3	0.2	-0.1	-0.1	0.1	0.1	0.1
Drawings	0.5	0.8	2.2	0.8	0.8	0.8	0.8	0.8	0.8
Amortization	-1.3	-1.3	-0.9	-0.6	-0.9	-0.9	-0.8	-0.6	-0.7
Short-term capital and errors and omissions	-1.7	-0.7	-0.4	-1.4	-1.4	-1.4	-1.4	-1.4	-1.4
Overall balance	29.6	35.7	3.9	14.6	16.0	17.3	18.9	20.0	21.4
Financing	-29.6	-35.7	-3.9	-14.6	-16.0	-17.3	-18.9	-20.0	-21.4
Official reserves (increases -)	-29.6	-35.7	-3.9	-14.6	-16.0	-17.3	-18.9	-20.0	-21.4
Memorandum items:									
Current account balance (in percent of GDP)	22.8	20.2	0.3	8.5	9.3	9.6	9.7	9.8	10.1
Algerian crude oil price (US\$/barrel) 1/	74.7	99.2	61.8	76.2	78.8	82.3	84.8	86.0	87.5
Gross official reserves (in billions of US\$)	110.2	143.1	148.9	161.0	171.4	188.3	206.9	226.4	247.4
Idem, in months of next year's imports	26.9	35.0	35.6	36.7	37.9	40.1	42.7	45.9	49.9
Gross external debt (in billions of US\$)	5.7	6.0	5.3	4.5	3.7	3.4	3.2	2.9	2.3
Of which: Short term	0.6	1.3	1.3	0.9	1.0	1.2	1.1	1.1	1.1
External debt/exports (in percent)	8.9	7.3	10.9	7.3	5.5	4.8	4.4	3.9	3.1
External debt/GDP (in percent)	4.2	3.5	3.8	2.8	2.2	1.9	1.7	1.5	1.1

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

1/ Weighted average of quarterly data.

2/ Including SDR allocation (\$1.7 billion).

Table 3. Algeria: Summary of Central Government Operations, 2007–15 1/

	2007	2008	2009	Projections					
				2010	2011	2012	2013	2014	2015
	(In billions of Algerian dinars)								
Budget revenue and grants	3,688	5,191	3,675	4,503	5,075	5,455	5,852	6,206	6,578
Hydrocarbon revenue 2/	2,797	4,089	2,413	3,006	3,440	3,709	3,935	4,098	4,278
Nonhydrocarbon revenue	891	1,102	1,262	1,497	1,635	1,745	1,917	2,108	2,301
Tax revenue	767	965	1,146	1,331	1,451	1,549	1,705	1,888	2,074
Taxes on income and profits	258	332	462	625	705	783	871	960	1,055
Taxes on goods and services	347	435	478	489	532	562	623	706	791
Customs duties	133	165	170	176	170	155	157	164	164
Registration and stamps	28	34	36	40	45	49	54	58	63
Nontax revenues	124	137	116	166	184	196	212	219	227
Grants	0	0	0	0	0	0	0	0	0
Total expenditure	3,114	4,191	4,225	4,956	5,514	5,612	5,589	5,766	6,001
Current expenditure	1,672	2,218	2,299	3,013	3,403	3,290	3,248	3,405	3,571
Personnel expenditure	629	827	880	1,330	1,502	1,368	1,303	1,372	1,447
Mudjahidins' pensions	102	103	131	147	147	147	147	147	147
Material and supplies	94	112	113	159	168	177	186	197	210
Current transfers	763	1,115	1,138	1,339	1,544	1,550	1,561	1,636	1,711
Interest payments	85	61	37	38	42	48	51	54	57
Capital expenditure	1,442	1,973	1,926	1,943	2,111	2,322	2,341	2,360	2,430
Budget balance	574	999	-550	-453	-439	-157	264	440	578
Special accounts	-19	-31	-7	0	0	0	0	0	0
Net lending by the treasury	141	124	135	0	0	0	0	0	0
Nonhydrocarbon primary balance	-2,298	-3,183	-3,067	-3,421	-3,837	-3,818	-3,621	-3,604	-3,642
Primary balance	498	906	-654	-414	-397	-109	314	494	636
Nonhydrocarbon balance	-2,383	-3,244	-3,104	-3,459	-3,879	-3,866	-3,672	-3,658	-3,699
Overall balance	413	844	-692	-453	-439	-157	264	440	579
Financing	-413	-844	692	453	439	157	-264	-440	-579
Domestic	-303	-822	713	468	455	174	-247	-423	-561
Bank	-516	-978	76	-132	205	74	-347	-523	-661
Nonbank	214	157	638	600	250	100	100	100	100
Foreign	-111	-23	-22	-15	-16	-17	-17	-17	-17
	(In percent of GDP)								
Total revenue	39.6	47.2	36.3	38.4	38.4	37.8	37.5	37.1	36.6
Hydrocarbon	30.1	37.2	23.8	25.6	26.0	25.7	25.2	24.5	23.8
Nonhydrocarbon	9.6	10.0	12.5	12.8	12.4	12.1	12.3	12.6	12.8
Of which: Tax revenue	8.2	8.8	11.3	11.3	11.0	10.7	10.9	11.3	11.6
Total expenditure	35.2	39.5	43.1	42.2	41.8	38.9	35.8	34.4	33.4
Current expenditure	18.0	20.2	22.7	25.7	25.8	22.8	20.8	20.3	19.9
Wages and salaries	6.8	7.5	8.7	11.3	11.4	9.5	8.3	8.2	8.1
Goods and other services	2.1	2.0	2.4	2.6	2.4	2.2	2.1	2.1	2.0
Current transfers	8.2	10.1	11.2	11.4	11.7	10.8	10.0	9.8	9.5
Debt service	0.9	0.6	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Capital expenditure	15.5	17.9	19.0	16.6	16.0	16.1	15.0	14.1	13.5
Overall balance	4.4	7.7	-6.8	-3.9	-3.3	-1.1	1.7	2.6	3.2
	(In percent of nonhydrocarbon GDP)								
Total revenue	70.7	86.6	53.8	59.6	60.6	59.5	58.4	57.0	55.7
Hydrocarbon revenue	53.6	68.2	35.3	39.8	41.1	40.4	39.3	37.6	36.2
Nonhydrocarbon revenue	17.1	18.4	18.5	19.8	19.5	19.0	19.1	19.4	19.5
Of which: Tax revenue	14.7	16.1	16.8	17.6	17.3	16.9	17.0	17.3	17.6
Total expenditure	62.8	72.5	63.9	65.6	65.8	61.2	55.8	53.0	50.8
Current expenditure	32.0	37.0	33.7	39.9	40.6	35.9	32.4	31.3	30.2
Of which: Personnel expenditure	12.1	13.8	12.9	17.6	17.9	14.9	13.0	12.6	12.2
Capital expenditure	27.6	32.9	28.2	25.7	25.2	25.3	23.4	21.7	20.6
Nonhydrocarbon primary balance	-44.1	-53.1	-44.9	-45.3	-45.8	-41.6	-36.1	-33.1	-30.8
Nonhydrocarbon overall balance	-45.7	-54.1	-45.4	-45.8	-46.3	-42.2	-36.7	-33.6	-31.3
Oil stabilization fund (in billions of Algerian dinars)	3215.5	4280.0	4316.5	4448.9	4243.9	4170.3	4517.5	5040.9	5703.2
(in percent of GDP)	34.6	38.9	42.6	37.9	32.1	28.9	28.9	30.1	31.8

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

1/ On cash basis.

2/ Including dividends of Sonatrach.

Table 4. Algeria: Monetary Survey, 2007–11

	2007	2008	Est.	Projections	
			2009	2010	2011
(In billions of Algerian dinars; at end of period)					
Net foreign assets	7,416	10,247	10,758	11,890	13,385
<i>Of which</i> : Bank of Algeria (BA)	7,399	10,230	10,746	11,878	13,372
Net domestic assets	-1,424	-3,291	-3,585	-3,702	-4,004
Domestic credit	-350	-1,402	-892	-831	-416
Credit to government (net) 1/	-2,583	-4,092	-4,079	-4,416	-4,432
Credit to the economy	2,233	2,689	3,187	3,585	4,016
<i>Of which</i> : Private sector	1,209	1,413	1,621	1,824	2,052
Other items net	-1,075	-1,888	-2,693	-2,871	-3,588
Money and quasi-money (M2)	5,991	6,956	7,173	8,188	9,381
Excluding Sonatrach deposits	4,716	5,654	6,399	7,188	7,981
Money	4,230	4,965	4,944	5,776	6,414
Quasi-money	1,761	1,991	2,229	2,412	2,967
(Percent change over 12-month period)					
Money and quasi-money (M2)	24.1	16.1	3.1	14.1	14.6
Excluding Sonatrach deposits	12.1	19.9	13.2	12.3	11.0
<i>Of which</i> : Money	33.1	17.4	-0.4	16.8	11.0
Credit to the economy	17.2	20.4	18.5	12.5	12.0
<i>Of which</i> : Private sector	14.4	16.9	14.7	12.5	12.5
Memorandum items:					
Liquidity ratio (e.o.p. M2/GDP)	64.4	63.3	70.8	69.8	71.0
Liquidity ratio (e.o.p. M2/NHGDP)	114.8	116.1	105.0	108.4	112.0
<i>Idem</i> , excluding deposits of Sonatrach	90.4	94.3	93.7	95.2	95.3
Sonatrach deposits	1,275	1,302	774	1,000	1,400
M2 velocity	1.6	1.6	1.4	1.4	1.4
Credit to the economy/GDP	24.0	24.5	31.4	30.6	30.4
Credit to the economy/NHGDP	42.8	44.9	46.7	47.5	47.9
Credit to private sector/NHGDP	23.2	23.6	23.7	24.1	24.5

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

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



INTERNATIONAL MONETARY FUND

ALGERIA

Staff Report for the 2010 Article IV Consultation

Appendix

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APPENDIX 1: EXCHANGE RATE ASSESSMENT

An analysis using the CGER methodology suggests that the current level of the real effective exchange rate (REER) is broadly in line with fundamentals. Using estimated coefficients for an oil producer like Algeria, the REER misalignment was calculated under the Equilibrium Real Exchange Rate (ERER) and the Macroeconomic Balance (MB) approaches.

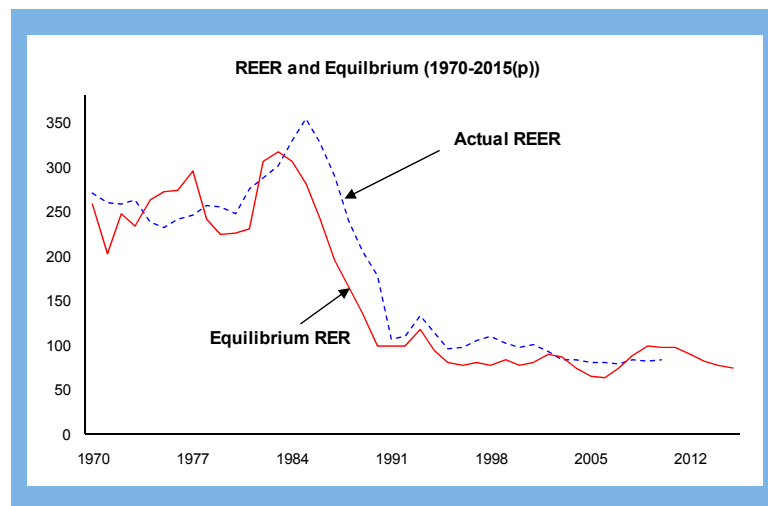
The MB approach implies a current account (CA) norm lower than the projected CA balance in 2010, implying an undervaluation of about 23 percent. The gap between the current account and its norm is expected to decrease by about half over the period until 2015.

	Results of CGER-type Analysis (In percent of GDP)	
	Projected CA	CA norm
2010	8.5	2.2
2015	10.1	7.1

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

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

Calculating the EREER using the WEO projections for the explanatory variables implies an undervaluation of 14.5 percent in 2010. The EREER has appreciated in the last few years mainly under the effect of increasing government spending. This development entails the risks of a "Dutch disease" phenomenon. The projection of the EREER over the medium term points to a gradual depreciation reflecting the projected lower public spending in percentage of GDP and increased productivity gap vis-a-vis the trading partners which more than balance the impact of higher oil prices. The effective real exchange rate has slightly appreciated since end-2009.





ALGERIA

Staff Report for the 2010 Article IV Consultation

Informational Annex

Prepared by the Staff Representatives for the 2010 Consultation with Algeria

December 23, 2010

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ANNEX I. RELATIONS WITH THE FUND

(As of November 30, 2010)

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	1,198.18	93.22
Reserve position in Fund	85.08	6.78

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

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				
		2010	2011	2012	2013	2014
Principal	0.00	0.00	0.00	0.00	0.00	0.00
Charges/interest	0.00	0.00	0.47	0.47	0.47	0.47
Total	0.00	0.00	0.47	0.47	0.47	0.47

Implementation of HIPC Initiative: Not Applicable.

B. Nonfinancial Relations

Exchange Rate Arrangement

45. From January 21, 1974 to October 1, 1994, the exchange rate of the dinar was determined on the basis of a fixed relationship with a basket of currencies, adjusted from time to time. On October 1, 1994, the Bank of Algeria introduced a managed float for the dinar through daily fixing sessions that included six commercial banks. This system has been replaced by an interbank foreign exchange market as of January 2, 1996. On December 15, 2010, the average of the buying and selling rates for the U.S. dollar was \$1 = DA 74.6, equivalent to SDR 1 = DA 114.9. 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.

46. The exchange regime is classified as other managed arrangement with no preannounced path for the exchange rate. Full surrender requirements are in effect on hydrocarbon export proceeds. Limits on the making of payments for invisible transactions and current transfers, which have remained 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

47. The discussions for the 2009 Article IV consultation with Algeria were held in Algiers during October 21–November 3, 2009. The staff report (IMF Country Report No. 10/57) was considered by the Executive Board on January 5, 2010 on a lapse of time basis and published on March 02, 2010.

Technical Assistance

- 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.
- A 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.
- A STA mission visited Algiers in May 2006 to advise on consumer price statistics.
- MFDs expert visited Algiers several times from February through October 2007 to assist the Bank of Algeria in banking supervision.
- Two FAD missions visited Algiers in February 2007 to review tax policy and advise on customs administration.
- A multisector STA mission visited Algiers in February 2007 to prepare Algeria's participation in the GDDS.
- An FAD mission visited Algiers in April 2007 to continue the program of assistance in tax administration.
- An FAD mission visited Algiers in May 2008 to continue the program of assistance in tax administration.
- An MCM mission visited Algiers in May 2009 to advise on strengthening banking supervision and regulation.
- An MCM mission visited Algiers in June 2009 to prepare the program for harmonizing financial sector infrastructure in the Maghreb.
- An MCM expert is planned to start a long-term banking supervision TA in December 2010.

Financial Sector Assessment Program

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

Resident Representative/Advisor

None.

ANNEX II. ALGERIA: RELATIONS WITH THE WORLD BANK GROUP

JMAP Implementation, FY11

As of December 10th, 2010

Title	Products	Provisional timing of missions	Expected delivery date
A. Mutual Information on Relevant Work Programs			
Bank work program in next 12 months	<p>a. Country Partnership Strategy FY11-FY14 for delivery in FY11, including Analytical and Technical Assistance activities on a reimbursable basis, no lending in line with government's policy.</p> <p>b. <u>Sector work</u> on:</p> <ul style="list-style-type: none"> • State-owned Banks for Ministry of Finance • Subsidy targeting • Reviewing Social Protection Programs • Energy Demand • Environment and Tourism • Climate change <p>c. <u>Technical assistance</u> on</p> <ul style="list-style-type: none"> • Credit Registry with Central Bank • Financial Crisis simulation (FIRST) • RAMP • Social Programs Evaluation • Support to analysis and evaluation of the Household Survey • Agricultural Program • Competitiveness Poles • Agricultural Statistical Capacity 	Ongoing activities with multiple missions throughout the year	FY11-FY14 activities
IMF work program in next 12 months	<p>2010 Article IV Consultation</p> <p>Preparing analytical work on new FDI regulation and the structural links between gas and oil prices in Algeria</p> <p>Staff visit</p> <p>2011 Article IV consultation</p>	<p>October 20- November 2 2010</p> <p>Ongoing</p> <p>April 2011</p> <p>October 2011</p>	<p>January 2011</p> <p>January 2011</p> <p>January 2012</p>

	Technical assistance missions on: MCM: banking supervision on-site expert STA: GDP quarterly statistics	Ongoing November 2011	ongoing
B. Requests for Work Program Inputs			
Fund request to Bank	Developments on the subsidy reform Sectoral analysis	As needed As needed	
Bank request to Fund	Assessment of macroeconomic stance and prospects Data sharing	Semiannual (and on ad hoc basis if requested) At least 1 operation predicted Ongoing	Following Article IV and staff visits
C. Agreement on Joint Products and Missions			
Joint products in next 12 months	Continuous close coordination on the reform agenda	Ongoing	

Algeria—Statistical Issues Appendix

I. Assessment of Data Adequacy for Surveillance	
<p>General: Data provision has some shortcomings, but is broadly adequate for surveillance. Government finance statistics, national accounts, and prices have several shortcomings that hamper analysis.</p>	
<p>National Accounts: Key shortcomings in national accounts include an outdated base year for constant price GDP estimates, long lags for publication of data, and incomplete application of the <i>1993 System of National Accounts</i>. STA has recommended giving priority to compiling GDP at constant prices (including quarterly accounts) and to rebasing the GDP series.</p>	
<p>Price Statistics: Data are published with a delay of about 3 months.</p>	
<p>Government finance statistics: Key shortcomings include insufficient institutional coverage (coverage is limited to Budgetary Central Government, albeit in a wide sense, including the general budget, the annexed budget, and the special treasury accounts), classification problems, long lags for production of statistics, and lack of reconciliation of financing with the monetary accounts. Key factors behind these weaknesses include the lack of financial resources allocated to the compilation of statistics, insufficient interagency coordination, as well as concerns about accuracy that give rise to reluctance to publish provisional data.</p>	
<p>Monetary statistics: The authorities need to ensure the data consistency with the methodology in the Monetary and Financial Statistics Manuel, 2000. Timely reporting of balance sheet data by some state-owned commercial banks remains problematic, and most commercial banks do not report all data needed to compile the monetary survey. Prudential data reported by state-owned banks are unreliable and not timely.</p>	
<p>Balance of payments: Although balance of payments statistics are generally of good quality, they could benefit from a survey for direct investment data.</p>	
II. Data Standards and Quality	
<p>Algeria began participation in the General Data Dissemination System (GDDS) on April 21, 2009.</p>	<p>No data ROSC is available.</p>

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

	Date of latest observation	Date received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of publication ⁷
Exchange Rates	10/09	11/02/10	D	M	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	09/09	11/02/10	D	M	M
Reserve/Base Money	09/10	11/30/10	M	M	M
Broad Money	09/10	11/02/10	M	M	M
Central Bank Balance Sheet	09/10	11/02/10	M	M	A
Consolidated Balance Sheet of the Banking System	09/10	11/02/10	M	M	A
Interest Rates ²	09/10	11/02/10	M	M	M
Consumer Price Index	09/10	11/20/09	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	...	...	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	03/10	11/02/10	Q	I	A
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	03/10	11/02/10	Q	I	A
External Current Account Balance	06/10	10/20/10	Q	Q	A
Exports and Imports of Goods and Services	09/10	10/20/10	Q	Q	A
GDP/GNP	2009	11/02/10	A	A	A
Gross External Debt	09/10	11/02/10	A	A	A
International Investment Position ⁶	...	...	PA	PA	PA

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

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

³Foreign, domestic bank, and domestic nonbank financing.

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

⁵Including currency and maturity composition.

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



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 11/10
FOR IMMEDIATE RELEASE
January 26, 2011

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

IMF Executive Board Concludes 2010 Article IV Consultation with Algeria

On January 14, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Algeria.¹

Background

Despite the effects of the international crisis, real nonhydrocarbon GDP (NHGDP) growth in 2009 exceeded the average of 6 percent seen over the past decade. The overall inflation rate rose in 2009 due to a surge in fresh food prices, but nonfood inflation remained low. Unemployment continued to fall, reaching 10.2 percent at end-2009, although youth unemployment remained high. The prudent macroeconomic management of the last ten years also enabled large external reserves to be accumulated and sizable budgetary savings to be built up in the oil stabilization fund, while maintaining a very low level of debt.

Executive Directors welcomed Algeria's good economic performance supported by the authorities' prudent fiscal and monetary policies and the favorable external environment. Directors noted that notwithstanding the favorable developments, the country faces important challenges of preserving macroeconomic stability, restoring fiscal prudence and diversifying the economy. They encouraged the authorities to build on the progress thus far. A more assertive structural reform agenda would improve the business climate and boost private investment-led growth, creating job opportunities. Further reducing

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

unemployment, especially among the young, remains a pressing need. Modernizing and strengthening the financial sector would be vital for supporting private investment.

Directors emphasized that the expansionary fiscal stance of recent years needs to be contained over the medium term to protect Algeria's capacity to withstand negative and prolonged hydrocarbon revenue shocks. They welcomed the authorities' commitment to undertake fiscal consolidation, starting with the 2011 budget. Continued fiscal reform will be critical for increasing nonhydrocarbon revenues and containing public spending, including greater control of the public sector wage bill, better targeting of transfers and subsidies, and prioritizing public investment projects. Directors also welcomed the efforts being made to improve the quality and efficiency of public expenditure as well as pursue budget system reforms.

Directors commended the Bank of Algeria for successfully containing inflationary pressures through sterilizing excess liquidity associated with high oil revenues and large public spending. They encouraged the authorities to tighten the stance of monetary policy in case these pressures were to increase.

Directors noted that the current exchange rate regime has served Algeria well. They welcomed the authorities' policy to maintain the real effective exchange rate close to equilibrium which is consistent with external stability. Containing government spending would contribute to reducing pressures for real exchange appreciation and potential "Dutch disease" effects.

Directors stressed that a more forceful implementation of structural reforms will be crucial for diversification of the economy, improving the business climate and competitiveness, as well as boosting growth and employment. Welcoming the authorities' efforts to enhance the infrastructure, they emphasized that stronger measures will be necessary to improve the investment climate. Directors considered that the new rules on foreign direct investment could discourage foreign investors and hamper growth. They encouraged the authorities to continue to seek a better integration of Algeria in the regional and global economy.

Directors emphasized the importance of accelerating financial sector reform. Effective implementation of the recommendations of the 2007 FSAP Update would strengthen financial supervision and monitoring. Noting the recent decline in NPLs, Directors stressed that efforts were also needed to further reduce the high level of NPLs in public banks. Improving the governance of public banks and further modernizing their operational framework would help enhance financial intermediation. Efforts should also be made to bring these banks to the highest international standards, including through partnerships with foreign institutions.

Executive Board Assessment

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

Algeria: Selected Macroeconomic Indicators, 2006–11

(Quota: SDR 1,254.7 million)

(Population: 35.6 million; 2009)

(Per capita GDP: US\$ 3,926; 2009)

(Poverty rate: 12.1; 2000)

	2006	2007	2008	2009	2010 Proj.	2011 Proj.
Oil and gas sector						
Total exports of oil and gas products (in billions of U.S. dollars)	53.6	59.6	77.2	44.4	56.4	61.3
Average crude oil export price (in U.S. dollar/barrel)	65.7	74.7	99.0	61.8	76.2	78.8
Crude oil production (in millions of barrels/day)	1.4	1.4	1.3	1.3	1.2	1.3
Output and prices						
Real GDP	2.0	3.0	2.4	2.4	3.3	3.7
Nonhydrocarbon real GDP	5.6	6.3	6.1	9.3	5.3	5.3
Consumer prices (end of period)	3.8	4.8	4.9	5.8	4.5	4.5
Consumer prices (period average)	2.3	3.6	4.9	5.7	4.3	5.0
	(In percent of GDP)					
Investment and Saving						
Gross capital formation	30.0	34.4	38.3	50.0	44.5	44.4
Of which: Nongovernment	18.0	18.9	20.4	31.0	28.0	28.4
Gross national savings	54.7	57.2	58.6	50.3	53.0	53.7
Of which: Nongovernment	29.2	37.3	32.9	38.1	40.3	41.0
	(In percent of GDP)					
Public finances						
Revenue	42.7	39.6	47.2	36.3	38.4	38.4
Hydrocarbon	32.8	30.1	37.2	23.8	25.6	26.0
Expenditure and net lending	29.2	35.2	39.5	43.1	42.2	41.8
Current	16.8	18.0	20.2	22.7	25.7	25.8
Capital	12.0	15.5	17.9	19.0	16.6	16.0
Budget balance	13.5	4.4	7.7	-6.8	-3.9	-3.3
Nonhydrocarbon primary balance (in percent of nonhydrocarbon GDP)	-34.1	-44.1	-53.1	-44.9	-45.3	-45.8
Total government debt	23.6	12.5	8.2	10.4	10.3	11.4
	(Annual percentage change, unless otherwise indicated)					
Monetary sector						
Credit to the economy 1/	7.1	17.2	20.4	18.5	12.5	12.0
Broad money	18.6	24.1	16.1	3.1	14.1	14.6
Velocity of broad money (level)	1.8	1.6	1.6	1.4	1.4	1.4
Three-month treasury bill rate (end of period, in percent)	2.1	0.2	0.2	0.3	...	...
	(In percent of GDP, unless otherwise indicated)					
External sector						
Hydrocarbon exports of goods (in US\$, percentage change)	43.0	11.2	29.5	-42.5	27.0	8.6
Hydrocarbon exports of goods (in percent of total exports of goods)	97.9	98.4	98.2	98.3	98.0	98.0
Imports of goods (in US\$, percentage change)	4.1	27.4	44.2	-1.6	1.3	4.7
Merchandise trade balance	29.0	25.5	23.9	5.6	12.4	13.5
Current account including official transfers	24.7	22.8	20.2	0.3	8.5	9.3
Foreign direct investment	1.5	1.0	1.4	1.8	1.5	1.0
Total external debt	4.8	4.2	3.3	3.8	2.8	2.2
Gross reserves (in billions of U.S. dollars)	77.8	110.2	143.1	148.9	161.0	171.4
In months of next year's imports of goods and services	28.0	26.9	35.4	35.6	36.7	37.9
Memorandum Items:						
Nominal GDP (in billions of U.S. dollars)	117.3	134.3	170.2	139.8	158.6	168.8
Unemployment rate (in percent)	12.3	11.8	11.3	10.2	...	...
Local currency per U.S. dollar (period average)	72.6	69.3	64.6	72.5	...	...
Real effective exchange rate (2005 = 100)	100.0	99.0	102.1	100.0	...	...

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

1/ credit to the private sector and public enterprises.

**Statement by Mohammad Mojarrad, Executive Director for Algeria
and Said Maherzi, Advisor to the Executive Director
January 14, 2011**

Our Algerian authorities thank staff for a well-balanced report and a useful Selected Issues paper (SIP). They highly value the constructive dialogue with the Fund and reiterate their appreciation for Fund's advice, technical assistance, and support to their policies and reforms.

The Algerian economy continued to perform strongly in 2010, underpinned by sustained implementation of the public investment program (PIP). Growth in the nonhydrocarbon sector exceeded 5 percent, while a slight decline in the hydrocarbon sector held overall GDP growth at 3.3 percent. Sound policies helped to bring down inflation to 4 percent and unemployment continued to decline, although it remains high among the youth. Despite continued high imports, mainly in connection with the PIP, a recovery in oil prices contributed to a significant strengthening in the current account surplus following its sharp decline in 2009. International reserves stood at a very comfortable level, further cushioning the economy against external shocks, and external debt declined further to less than 3 percent of GDP. With continued strong performance in the nonhydrocarbon sector, supported by the PIP, and a recovery in oil and gas production, real GDP growth is projected to strengthen in 2011.

The authorities are committed to preserving macroeconomic stability as an essential pillar of their growth and social development strategy. Prudent fiscal policy over several years has helped build significant savings in the revenue stabilization fund, contributing to a sustainable financing of the PIP. Despite increased hydrocarbon revenue in 2010 and substantially strengthened nonhydrocarbon revenue on account of buoyant activity and further improvement in customs and tax administration, the budget recorded a deficit, although at a significantly lower level than in the previous year, reflecting higher expenditure. While capital spending remained high, in line with PIP implementation, current spending increased significantly, largely reflecting the impact of the reform of the civil service aimed at rationalizing the wage and salary structure, the total impact of which will be spread over 3 years. However, with the reform taking effect from 2008, the budgetary cost in 2010-12 includes salary back payments in 2008-09, and after peaking at 11.4 percent of GDP in 2011, the wage bill is projected to decline gradually and to return to a more sustainable level of 8.3 percent of GDP in 2013.

Looking ahead, the authorities are committed to rationalizing and containing current spending, including through a comprehensive review of the subsidies system, which is being launched with World Bank assistance, to improve its targeting and efficiency. Ensuring quality capital spending remains a key focus. In this regard, the agency in charge of evaluating and monitoring investment projects under the PIP, CNED, is being strengthened and its prior approval is now required for a project to be included in the budget. To preserve medium-term fiscal sustainability, the authorities stand ready to adjust capital spending to available resources, should external conditions turn out to be less favorable than projected. Continued efforts are being made to modernize the budget systems and improve fiscal governance, transparency and accountability. In this regard, the 2008 Budget Review Law has recently been submitted to Parliament.

Monetary policy continues to be geared toward containing inflation. The Bank of Algeria (BA) continues to absorb effectively excess liquidity in the banking sector resulting from hydrocarbon resources and public spending. Looking forward, BA will continue to closely monitor developments

and stands ready to take further actions as needed to contain inflation, including in view of the recent wage increase. The authorities share the staff's assessment that the current level of the real effective exchange rate (REER) is broadly in line with fundamentals, consistent with BA's flexible exchange rate policy aiming at stabilizing the REER close to its equilibrium rate.

The financial system remains sound, with a well-capitalized, liquid, and profitable banking sector. While overall nonperforming loans have declined and provisioning has increased, reflecting tighter risk assessment, efforts continue to be made to address remaining NPLs in public banks' portfolios, the bulk of which is related to old debts. The establishment of a credit registry is scheduled for late 2011. As it becomes operational, the ban on consumer lending (excluding mortgages) will be reviewed. Banking supervision continues to be strengthened, including with Fund assistance. A new bank rating system is being developed by BA with external assistance and a first report on financial stability is being prepared, in line with the newly amended Law on Money and Credit which assigns to BA explicit responsibility to ensure financial stability. The authorities will continue to explore ways to enhance operations of the public banks, including through possible partnerships with foreign financial institutions, in line with FSAP recommendations.

The authorities agree with staff on the need to reduce the reliance of the economy on the hydrocarbon sector through sustained economic diversification efforts. Substantial infrastructure development under the PIP will be instrumental in this regard. At the same time, attention remains focused on improving the business environment, including by further modernizing the judiciary, improving governance of public institutions and fighting corruption, streamlining the tax system, strengthening the financial system, and promoting SMEs.

The interesting SIP on economic diversification includes useful advice and suggestions which should serve the authorities' objectives well. While Algeria should be able to develop a successful non-oil export strategy based on strong public participation as recognized by staff, the authorities believe that private sector development and FDI will have a major role to play. In this regard, the new FDI regulations, setting a ceiling of 49 percent on foreign partners' participation in new investment projects, do not exclude granting the management of the project to the foreign partner. They are meant to encourage joint ventures with local public and/or private investors. The authorities believe that such joint ventures would serve the development of the domestic private sector well by promoting dynamic entrepreneurs. In this connection, it is encouraging that a number of joint ventures are being finalized with foreign partners from diverse origins and in various sectors, including the financial sector, construction, building materials, construction of industrial vehicles, rails production and maintenance, and food processing.