

**Algeria: 2005 Article IV Consultation—Staff Report; Staff Statement; 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 2005 Article IV consultation with Algeria, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 16, 2005, 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 January 9, 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 staff statement of February 10, 2006 updating information on recent developments.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its February 13, 2006 discussion of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Algeria.

The documents listed below have been or will be separately released.

Statistical Appendix  
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 2005 Article IV Consultation**

Prepared by the Staff Representatives for the 2005 Consultation with Algeria

Approved by Amor Tahari and John Hicklin

January 9, 2006

- The 2005 Article IV consultation discussions were held in Algiers during October 1–16, 2005. The mission comprised J.E. De Vrijer (head), T. Koranchelian, G. Sensenbrenner, L. Söderling, and J. Wiczorek (all MCD). S. Maherzi, Advisor to the Executive Director for Algeria, participated in the discussions.
- The mission met with the Minister of Finance, the Governor of the Bank of Algeria, the Minister of Energy, the Minister of Labor and Social Security, the Delegate Minister for Financial Sector Reform, other senior officials, members of parliament, and representatives from the business community. A press conference was held at the end of the mission.
- 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 pre-announced path for the exchange rate.
- Algeria effected in November 2005 the early and full repurchase of its past drawings on the Fund. Relations with the Fund and the World Bank are summarized in Appendices I and II.
- Despite a number of weaknesses, Algeria's statistical base is broadly adequate to conduct surveillance. Statistical issues are addressed in Appendix III.
- 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

### Background

Algeria's economic developments and prospects are encouraging. Real GDP growth moderated somewhat to about 5 percent in 2004–05, mainly due to a slowdown in agriculture following the 2003 bumper crop. Boosted by high world oil prices and expanding oil output, the external position strengthened further. Inflation was low and the unemployment rate continued to decline, although youth unemployment remains very high.

In light of increasing hydrocarbon revenue and the need to address infrastructure bottlenecks, the government decided in 2005 to boost public investment. Monetary policy remained prudent with the Bank of Algeria (BA) mopping up most excess liquidity in the banking sector. Credit to the economy accelerated, while nonperforming loans remained high. Progress was achieved in structural reforms, mainly in external trade and energy sector liberalization.

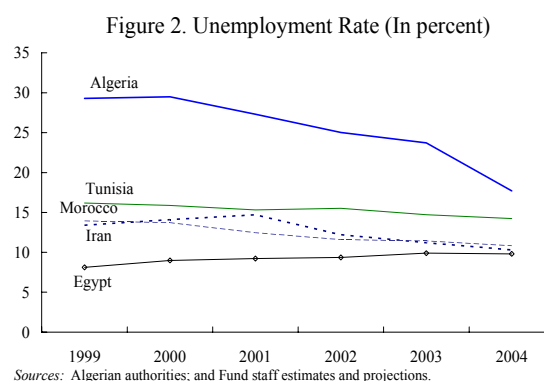
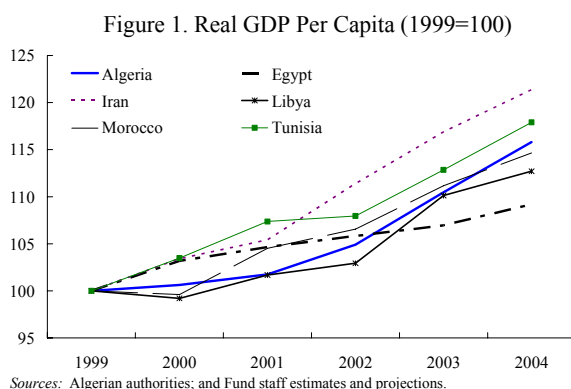
### Policy discussions

Discussions focused on how to sustain growth and reduce unemployment in the context of large hydrocarbon revenues and increasing openness.

- The draft 2006 budget envisages a considerable increase in public investment. In light of the limited absorption capacity and the need to ensure high quality spending, staff recommended a more even implementation of the investment program, taking into account the recommendations of the public expenditure review being undertaken with the World Bank. The authorities agreed on the need for a wage policy that would preserve the competitiveness of the economy. It is also important to use part of the fiscal space to support priority structural reforms.
- The authorities were interested in staff's advice to formulate fiscal policy in the context of a long-term framework and to replace the present oil stabilization fund by a savings/financing account that is fully integrated into the budget.
- In light of the envisaged fiscal expansion, staff recommended tightening the monetary policy stance by bringing the BA's policy interest rate to a positive level in real terms to keep inflation under control. The authorities intend to pursue their current policy of gradual appreciation of the real effective exchange rate.
- The authorities agreed that the opening of the Algerian economy increases the need to step up priority reforms aimed at encouraging private investment and creating jobs. This requires implementation of a coherent strategy that includes accelerated banking reform, further external trade liberalization, ensuring the free current convertibility of the dinar, improving the business climate, and public enterprise restructuring/privatization.

## I. BACKGROUND AND KEY CHALLENGES

1. **Algeria, an important hydrocarbon exporter, has benefited from abundant and increasing hydrocarbon revenues in recent years.** In the context of sharply increasing oil prices, the external and fiscal positions have strengthened markedly. The significant fiscal impulse created by the government's Economic Recovery Program underpinned growth in the nonhydrocarbon sector (annual average rate of 5.7 percent in 2001–04), while inflation remained under control.<sup>1</sup> Consequently, real per capita GDP increased considerably and the unemployment rate has declined, although this partly reflected an increase in temporary employment and youth unemployment remains high (Figures 1 and 2).



2. **The authorities have made progress in economic liberalization but other reforms have trailed, delaying Algeria's transition to a market economy.** A comprehensive tariff reform has been implemented since 2001, when the number of non-zero tariffs was cut to three, reducing the simple average tariff rate from 26 percent to 19 percent. The 2001–05 temporary additional duty on some imports is being phased out as planned. Important steps have also been taken to liberalize the hydrocarbon and telecommunications sectors. However, economic activity continues to rely heavily on the state. State-owned banks, which account for 90 percent of banking system assets, lack basic risk management capacity and are burdened by nonperforming loans. Following the privatization of more than 400 public enterprises in the 1990s, some 1,200 public entities remain. These and other factors, including the violence during the 1990s, explain Algeria's difficult business climate which contributed to the low diversification of exports and high unemployment.<sup>2</sup>

<sup>1</sup> The Economy Recovery Program was a public investment program covering the period 2001–04. It supplemented the budget and amounted to about US\$7 billion (almost 13 percent of 2001 GDP).

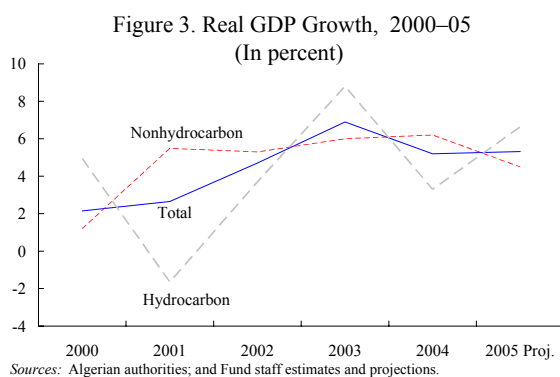
<sup>2</sup> For a review of business climate indicators, see the selected issues paper on "Algeria's Business Climate: Tax Reforms for Faster Job Creation," (forthcoming).

3. **Algeria’s challenge is to improve growth prospects and create jobs for its young and growing labor force in an increasingly open environment.** With the external trade liberalization, Algeria has committed to a course that can be completed successfully only by managing carefully the large hydrocarbon-related inflows and speeding up reforms aimed at private sector development. Fund surveillance in recent years has focused on these areas (Box 1).

4. **On the political front, President Bouteflika has taken a number of initiatives that have strengthened Algeria’s political stability.** The President’s election as head of the *Front de Libération National* party in February 2005 has cemented his political power. The Charter for Peace and National Reconciliation, which offers broad amnesty for acts committed during the 1990s, won strong support (97 percent of the votes) in a referendum held in September 2005.

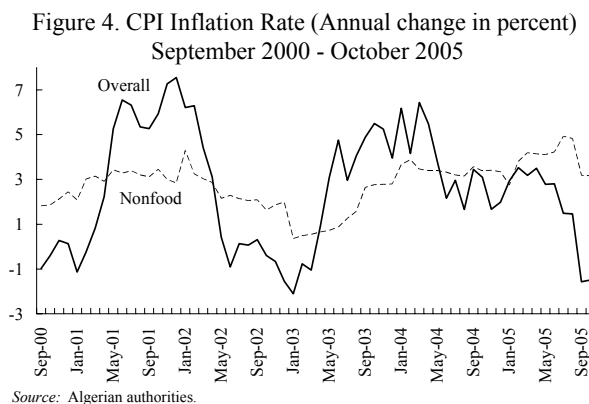
## II. RECENT ECONOMIC DEVELOPMENTS

5. **Growth performance in 2004–05 continued to be encouraging.** Real GDP growth moderated to about 5¼ percent in 2004 from 7 percent in 2003, due to a slowdown in agriculture following the 2003 bumper crop and in hydrocarbon output (Figure 3 and Table 1).



Growth is projected to continue at about 5½ percent in 2005, led by increased output in the hydrocarbon sector and sustained activity in the construction and services sectors. However, agricultural output is projected to decline somewhat, while the inefficiency of public enterprises continues to depress industrial output. The unemployment rate declined further in 2005 to 15.3 percent; the youth unemployment rate, however, remained very high at 31 percent.

6. **Inflation remained low in 2005.** Consumer prices fell by some 1½ percent (year-on-year) in October 2005, mainly owing to a drop in food prices (Figure 4). At the same time, annual nonfood-CPI inflation remained above 3 percent through October, reflecting the impact of the fiscal stimulus and increases in administered prices for transportation and energy products.





**Box 1. Fund Surveillance in Algeria**

**Since 1998, Fund surveillance has focused on policies to improve growth performance and reduce unemployment.** In the wake of abundant hydrocarbon revenue, staff recommended prudent fiscal and monetary policies. It also called for the acceleration of structural reforms to encourage private sector-led growth, in particular liberalizing external trade, reforming the banking system, privatizing/restructuring public enterprises, and improving the business climate.

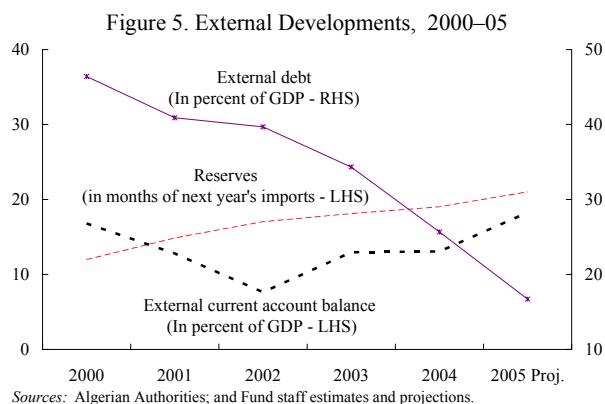
**The macroeconomic policy mix has been largely in line with staff's advice.** BA's prudent monetary policy and flexible management of the exchange rate helped maintain macroeconomic stability. The authorities have also started reducing their external debt through early repayments. At the same time, they considered that an expansionary fiscal policy has a role to play in creating jobs and improving living standards.

**Progress in structural reforms has been mixed.** Important steps have been taken in some areas, including economic and trade liberalization, but implementation of other reforms, in particular in the public bank and enterprise sectors, has been slow.

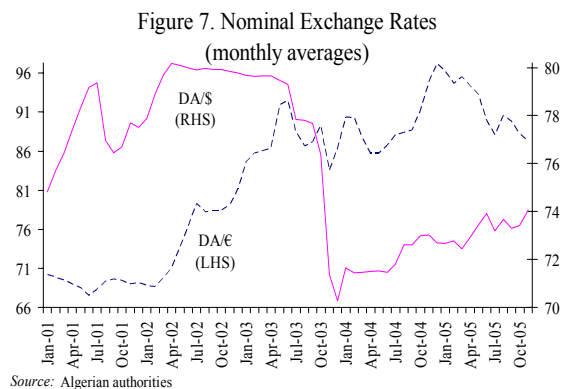
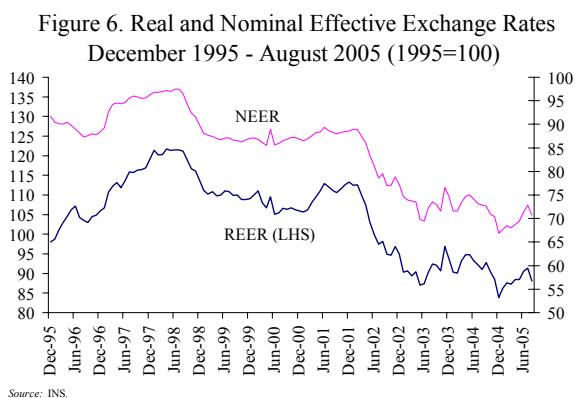
**Current Fund strategy focuses on sound management of hydrocarbon wealth and structural reforms, notably in the banking sector.** As agreed during the Managing Director's visit to Algiers in March 2005, the Fund is providing technical assistance in the areas of banking reform; banking supervision; tax administration; and statistics. Fund staff liaised with a World Bank public expenditure review mission and is intensifying training of Algerian officials. The Fund also helped organize a conference on trade facilitation in the Maghreb in November 2005.

<b>Fund Policy Advice for Algeria</b>			
<b>Objective</b>	<b>Instruments</b>	<b>Policy Advice</b>	<b>Fund Input</b>
Improve growth prospects and reduce unemployment	Sound management of hydrocarbon wealth	Long-term fiscal framework with hydrocarbon savings/financing account	Surveillance
		Careful selection of public expenditures to improve infrastructure, strengthen social sectors, and accompany structural reforms	Participation in World Bank public expenditure review in October 2005
		Active debt management	Surveillance
		Liquidity management through appropriate monetary instruments	Surveillance; technical assistance in monetary policy
	Structural reforms aimed at promoting private sector activity	Banking sector reform	FSAP follow-up; technical assistance in bank supervision and restructuring
		Trade liberalization	Surveillance; conference on regional trade facilitation in November 2005
		Streamlining of exchange regime for current international transactions	Technical assistance starting in July 2005
		Modernization of tax administration	Technical assistance resuming in January 2006

7. **Boosted by high hydrocarbon export prices, Algeria’s external position strengthened further in 2004–05** (Figure 5 and Table 2). The external current account surplus remained at 13 percent of GDP in 2004, as higher hydrocarbon exports were accompanied by a surge in imports, partly reflecting the ongoing trade liberalization. The hike in world oil prices, together with an expansion of hydrocarbon production, is expected to increase the external current account surplus to 18½ percent of GDP in 2005. After early debt repayment of US\$1.1 billion, including to the European Investment Bank and the African Development Bank, the external debt-to-GDP ratio is expected to decline further from 26 percent in 2004 to 16½ percent in 2005. Gross external reserves grew by US\$20 billion since end-2003 to reach US\$53 billion at end-September 2005 (more than 1½ years of import cover). In light of the significantly improved balance of payments and external reserves position, Algeria effected the early and full repurchase of its past drawings on the Fund in November.



8. **The nominal effective exchange rate appreciated during the first eight months of 2005** (Figures 6 and 7). This followed the depreciation of the real effective exchange rate (REER) by some 10 percent during the last quarter of 2004, mainly reflecting the appreciation of the euro against the dollar. The appreciation in 2005 was intended to minimize the deviation of the REER from its end-2003 level, which the authorities considered an equilibrium level<sup>3</sup>. The spread between the illegal parallel market and the official exchange rates remained large at about 20 percent, partly reflecting problems in the implementation of the free current convertibility of the dinar (see paragraph 30 below).

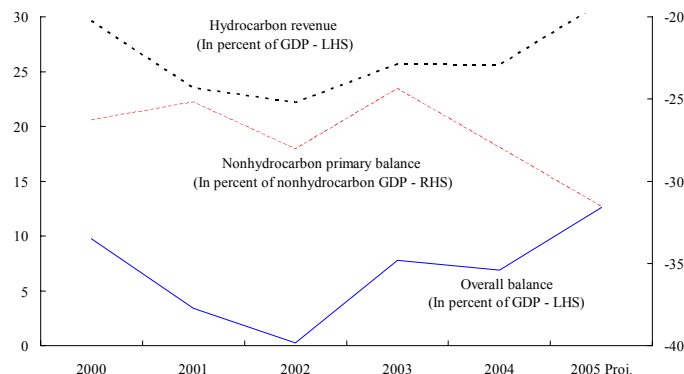


<sup>3</sup> This was in line with the staff finding at the time of the 2004 Article IV consultation that there were no signs of misalignment of the exchange rate in early 2004 (IMF Country Report No. 05/50).

**9. In light of Algeria’s buoyant hydrocarbon revenue, the government decided to boost public spending in 2005.**

In 2004, the authorities had launched the Growth Consolidation Plan (GCP), a public investment program for 2005–09 that amounted to US\$50 billion. In June 2005, the program was revised upward to US\$57 billion (55 percent of 2005 GDP), with considerable frontloading. As a result, government spending in 2005 is expected to increase by 4 percentage points of nonhydrocarbon GDP (NHGDP), with the nonhydrocarbon primary deficit widening from 28 percent of NHGDP in 2004 to 31½ percent in 2005 (Figure 8 and Table 3). Nevertheless, higher hydrocarbon revenue would almost double the overall budget surplus.

Figure 8. Overall and Nonhydrocarbon Fiscal Balances, 2000–05



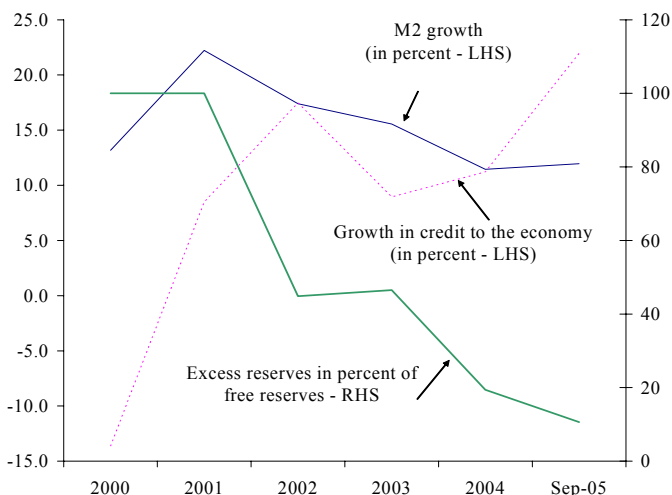
Sources: Algerian authorities and Fund staff estimates and projections.

**10. Monetary policy remained prudent, in line with the authorities’ objective to keep inflation low.**

The central bank implemented several measures to absorb the rapidly increasing liquidity in the banking sector. In particular, it (a) increased the amount of deposit auctions in 2004 and early 2005; (b) raised its policy interest rate from ¾ percent in 2004 to 1¼ percent in

July 2005 (however, this rate remained negative in real terms relative to nonfood inflation);<sup>4</sup> (c) extended the maturities of a large portion of the deposit auctions from one week to three months in July 2005; and (d) introduced a 24-hour deposit facility in September 2005. As a result, BA was able to mop up most excess bank liquidity (Figure 9 and Tables 4–6). Annual broad money growth continued at about 12 percent through September 2005. At the same time, credit to the economy accelerated in the first part of 2005, while nonperforming loans remained high (Box 2).

Figure 9. Monetary Policy Stance



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

<sup>4</sup> Given Algeria’s ample liquidity situation and the extensive controls on the capital account, the link between domestic and foreign interest rates is weak.

### Box 2. Nonperforming Loans

**Nonperforming loans in Algeria's banking sector are concentrated in public banks**, which had an aggregate nonperforming loan ratio of 40 percent at end-2004. Nonperforming loans of private banks stood at 4 percent of total loans at end-2004.

**The continued provision of credit to large loss-making public enterprises has been the main factor behind the fragility of public banks.** Between 1991 and 2002, the Treasury repeatedly bailed out public banks to enable them to meet prudential ratios. On average, these interventions amounted to about 4 percent of GDP per year over 1991–2002. The Ministry of Finance estimated public banks' nonperforming loans to insolvent or dissolved public enterprises at approximately DA 290 billion (or almost 4 percent of GDP) at end-June 2005.

**Nonperforming loans of public banks to the private sector have also been growing recently.** A BA audit of five (out of six) public banks found that these banks' nonperforming loans to the private sector represented 33 percent of their total loans to the private sector at end-2003. This is mainly due to the rapid expansion of public banks credits to the private sector in the wake of abundant liquidity and these banks' weak risk assessment capacity.

Algeria. Financial Soundness Indicators  
(in percent)

	2003	2004
Regulatory equity (in percent of risk-weighted assets)	10.1	10.4
Public banks	9.3	9.5
Private banks	19.5	21.2
Nonperforming loans (in percent of total loans)	37.1	37.4
Public banks	40.7	40.5
Private banks	3.2	4.2
Nonperforming loans (in percent of equity)	323.8	297.6
Public banks	378.7	353.6
Private banks	17.3	17.3
Provisioning (in percent of nonperforming loans)	43.1	44.6
Public banks	42.8	44.3
Private banks	86.1	73.2
Average return on assets (in percent)	0.4	0.4
Public banks	0.3	0.2
Private banks	1.2	1.7
Average return on equity	6.4	6.2
Public banks	5.3	3.9
Private banks	16.7	23.6
Liquid assets (in percent of total assets)	10.8	10.0

Source: Bank of Algeria

11. **The authorities have taken several actions in line with the recommendations of the 2003 FSSA.** They strengthened performance contracts of public bank managers and shareholder oversight, retained an investment advisor for the sale of the first of three public banks designated for privatization, and made important progress in modernizing the payments system.<sup>5</sup> The Banking Commission instructed all public banks to submit external audits of their end-2004 financial accounts by end-2005.

12. **Several other important structural reforms were also implemented in 2005.** The Association Agreement with the European Union (AAEU) became effective as of September 2005, and WTO negotiations are entering their final stages. A new hydrocarbon law was adopted that further liberalizes investment in this sector (Box 3). The government has also submitted to parliament an anti-corruption law following Algeria's adoption of the 2003 United Nations' Convention against Corruption. The law contains a broad definition of corruption, institutes a code of conduct for public servants, protects whistle-blowers, and provides for international cooperation.

### III. POLICY DISCUSSIONS

13. **The policy discussions focused on Algeria's main challenges of improving growth prospects and creating jobs for its young and growing labor force in an increasingly open environment.** The success of Algeria's external trade liberalization envisaged under the AAEU requires speeding up interrelated structural and institutional reforms aimed at private sector development. The authorities recognized that the considerable increase in hydrocarbon revenue provides an excellent opportunity to step up the pace of economic and social development in Algeria. Staff underscored that sound management of hydrocarbon receipts is crucial to maintaining macroeconomic stability and enhancing the competitiveness of the nonhydrocarbon sector. The authorities are aware of the importance to ensure that the ample availability of hydrocarbon resources does not weaken the resolve to undertake economic reforms but is used to facilitate costly and difficult reforms such as of public banks and enterprises. Over the medium term, a strategy aimed at efficient use of hydrocarbon resources and accelerating growth-enhancing structural reforms would also contribute to the alleviation of global imbalances.

#### A. Medium-Term Outlook

14. **Algeria's external position is projected to strengthen further over the medium term.** With world market oil prices expected to remain high, annual hydrocarbon exports are projected to average US\$57 billion through 2010. Imports are likely to increase significantly with the envisaged large public investment, Sonatrach's investment plans, and the implementation of the AAEU. The external current account surplus, while gradually declining after 2006, is expected to remain large and gross international reserves are forecast at above two years of import cover from 2006. Gross external debt is projected to fall below 5 percent of GDP by 2010, partly reflecting the authorities' policy of limiting nonconcessional borrowing.

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<sup>5</sup> The Real Time Gross Settlement system is expected to be effective as of January 1, 2006.

### Box 3. The Hydrocarbon Sector

**Algeria is an important hydrocarbon (oil and gas) exporter.** It is the world's 14<sup>th</sup> largest oil exporter and supplies some 20 percent of Europe's natural gas. Oil production in 2004 was 1.9 million barrels/day (about 2½ percent of world production) and marketed gas production was 225 million cubic meters/day (about 3 percent of world production).

**The hydrocarbon sector dominates the economy,** accounting for 38 percent of GDP, 98 percent of exports of goods, and 71 percent of budgetary revenue in 2004.

**Algeria is still considered to be relatively under-explored.** Proven crude oil reserves are estimated at 11.8 billion barrels. However, recoverable crude oil reserves may range as high as 28 billion barrels according to the 2005 U.S. Geological Survey. Algeria has also proven natural gas reserves of about 4.5 trillion cubic meters, ranking seventh in the world, while significant discoveries of additional reserves are expected in the coming years.

**The hydrocarbon sector has been open for almost 20 years.** In 2004, foreign partners accounted for slightly less than half of Algeria's crude oil output (14 percent for gas). However, each foreign investor was required to partner with the state-owned hydrocarbon company, Sonatrach. The complex contractual arrangements imposed by law increasingly hampered the financing of Algeria's investment needs in the upstream hydrocarbon sector (estimated at US\$70 billion for 2005–15).

**In March 2005, Parliament adopted a new law,** which:

- Simplifies the contractual framework for upstream activities (exploration, production, and transportation);
- Introduces free entry in transportation and downstream activities;
- Replaces the existing production-sharing regime by a tax and royalty system;
- Establishes investors' rights and obligations, including Sonatrach's;
- Creates a regulatory agency to tender upstream contracts, set reference gas prices, and collect royalties and taxes, and an agency that would issue permits for downstream activities.

**The law should lead to more investment upstream,** through foreign investment and by freeing Sonatrach from the obligation to own and operate all oil and gas infrastructure, finance new pipelines, and fulfill noncommercial roles, such as regulation, tendering, and collection of taxes and royalties.

**On domestic pricing,** the law states that the price of crude oil for domestic refineries is set at the beginning of each year on the basis of the moving 10-year average of Algerian export prices. Domestic gas prices are set by regulation each year.

15. **The fiscal policy stance envisaged in the draft 2006 budget law implies a sizable increase in public spending.** In particular, government investment in 2006 is programmed to double compared to its 2004 level.<sup>6</sup> At the same time, amid abundant hydrocarbon revenues, there is mounting pressure for a large wage increase.<sup>7</sup> Staff

<sup>6</sup> The public investment program for 2005–09 comprises the GCP, as well as US\$16 billion representing other projects under way. In total, the public investment program amounts to US\$74 billion (72 percent of 2005 GDP).

<sup>7</sup> In January 2004, the authorities granted an increase in the minimum wage of 25 percent.

projections assume a 10 percent increase in public sector wages in 2006 and also take account of the government investment program's implications on current expenditure needs over the medium term, both of which are not included in the draft budget. On this basis, the nonhydrocarbon primary deficit would increase from 31½ percent of NHGDP in 2005 to 36½ percent in 2006; thereafter it would decline to about 26½ percent by 2010. However, the overall budget surplus is expected to remain above 10 percent of GDP over the period.

16. **The economic outlook would remain favorable over the medium term.** Average annual real NHGDP growth is projected at about 5½ percent, and the unemployment rate would continue to decline. However, the envisaged sharp increase in public investment and a likely public sector wage hike would contribute to higher inflation. The entry into effect of the AAEU and the ensuing increased international competition may have a negative impact on the industrial sector starting in 2007, but this could be short-lived if enterprises take the necessary measures to improve their competitiveness. The increased openness of the economy would also help local producers to improve their efficiency via technology transfers from abroad and better access to imports and capital goods.

17. **The debt sustainability analyses show that external and public debt will remain sustainable over the medium term** (Tables 7 and 8). The standardized stress tests for external debt sustainability show that the external debt ratio is expected to drop sharply under all circumstances. The public debt sustainability analysis indicates that although the public debt-to-GDP ratio may increase under various scenarios, it will likely remain sustainable.<sup>8</sup> Domestic public debt would increase, due to the constraints imposed by the current rules of the hydrocarbon stabilization fund—*Fonds de Régulation des Recettes* (FRR)—that do not allow the FRR to finance the nonhydrocarbon budget deficit directly, but only to repay public debt. To finance the nonhydrocarbon budget deficits in the coming years, the government will need to issue new debt and use the FRR to repay this debt when falling due. In view of the economy's high dependency on hydrocarbon revenue, staff also analyzed the impact of a drop in oil prices to US\$19 per barrel starting in 2006, resulting in lower growth. Under this scenario and with no policy changes, international reserves would decline and the government would run budget deficits starting in 2006. Nevertheless, given Algeria's strong financial position, external and public debt would remain sustainable.

## **B. Management of Hydrocarbon Revenue**

18. **Sound long-term management of hydrocarbon revenue is the basis for successful macroeconomic policy in Algeria.** The authorities were interested in a long-term framework for setting fiscal policy presented by staff (IMF Country Report No. 05/50). Such management does not preclude significant government expenditure, but delinks it from fluctuations in oil prices. The authorities agreed that the current rules governing the FRR are likely to generate additional interest expenditures and may create bottlenecks in financing future budget deficits.

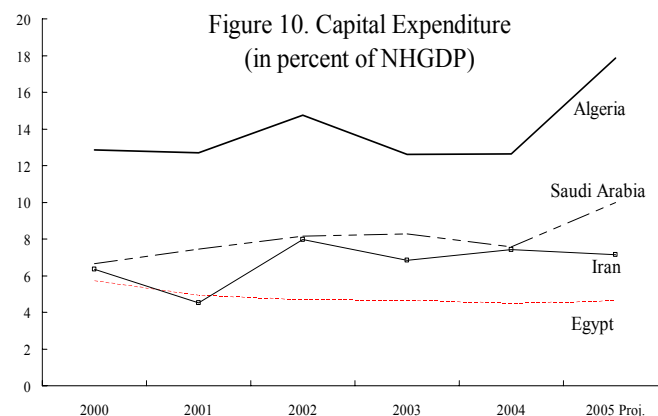
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<sup>8</sup> Public debt includes the quasi-fiscal debt arising from public banks' nonperforming loans to public enterprises.

Therefore, they plan to reconsider the role of the FRR, including transforming it into a savings/financing account as proposed by staff. This account would be fully integrated into the budget and be used to finance the sustainable nonhydrocarbon primary deficit and to repay public debt, including prepayments. The sound management of hydrocarbon resources also requires coordination between fiscal and monetary policies, as well as the transparent use of hydrocarbon revenues to avoid problems of governance and waste.

## Fiscal policy

19. **The authorities decided to use part of the fiscal space created by high hydrocarbon revenues to increase public investment** (Figure 10). In the current low inflation environment, there is room to increase government expenditure. The government investment program appropriately envisages building much-needed public infrastructure, developing human capital, improving public services (mainly the judiciary), supporting economic activity, and expanding housing.



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

20. **The authorities agreed with staff on the need to pay attention to the quality of spending**, including by taking into account the recommendations of the public expenditure review being conducted in cooperation with the World Bank that, inter alia, aims to help increase the authorities' capacity in selecting projects on efficiency grounds. Staff underscored that the sizable front-loading of spending, despite its high import content, could run into absorption capacity constraints. It advised, therefore, a more even implementation of the investment program. The authorities agreed that their public investment plans are very ambitious in the short term. They indicated that the draft 2006 budget was meant to send a strong signal that multi-year funding for the public investment program is assured.

21. **At the same time, it is important to maintain macroeconomic stability and adopt a wage policy that the economy can support.** While the higher world market oil prices allow for higher nonhydrocarbon primary deficits, the envisaged fiscal expansion would likely contribute to higher inflation, given domestic supply rigidities. The authorities were determined to adhere to their objective of achieving fiscal sustainability over the medium term (Box 4). In this connection, it would be important for the government to start preparing comprehensive medium-term budget projections that take account of the implications for current spending of the government investment program. The authorities agreed with the need to limit any increase in real wages to the real growth rate of nonhydrocarbon GDP, in order to preserve competitiveness as Algeria's economy opens up.



**Box 4. Management of Hydrocarbon Revenues and Fiscal Sustainability**

**Staff's long-term fiscal framework aims at preserving the permanent per capita income from hydrocarbon wealth on the basis of a sustainable path for the nonhydrocarbon primary deficit/nonhydrocarbon GDP ratio** (IMF Country Report No. 05/50). The updated assumptions are: depletion of probable reserves by 2050; population growth of 1.5 percent per annum; real NHGDP growth of 4 percent per annum after 2010; a 5 percent real interest rate; a gradual decline of oil prices to a long-term level of US\$30/bbl from 2015; and a ratio of \$/Km<sup>3</sup> gas to \$/bbl oil of 3.8. All prices are expressed in 2003 dollars.

**In this framework, the sustainable nonhydrocarbon primary deficit decreases from 32 percent in 2005 to 27 percent of NHGDP by 2009** (compared to 21 percent estimated at the time of the 2004 Article IV consultation which was based on a long-term oil price of US\$25/bbl). Income from financial wealth entirely finances the deficit that prevails after 2050.

Algeria: Sustainable Nonhydrocarbon Primary Deficit, 2005-10  
(In Percent of NHGDP, in 2003 Dollars)

	2005	2006	2007	2008	2009	2010
Sustainable path in SM/04/425	-23.4	-22.8	-22.3	-21.8	-21.2	...
<i>Memo: Crude oil export unit value (US\$/bbl)</i>	42.7	38.2	36.0	35.0	34.5	...
Latest sustainable path (Summer 2005 WEO oil prices)	-32.1	-30.8	-29.5	-28.3	-27.2	-26.1
Staff projections for actual deficit	-31.6	-36.4	-33.4	-29.6	-27.3	-26.7
<i>Memo: Crude oil export unit value (US\$/bbl)</i>	55.3	61.7	60.0	58.0	57.3	56.5

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

22. **The authorities agreed with the importance of allocating resources in support of market-based reforms**, including to limit the social cost of priority reforms in the public banking and enterprise sectors, and to bring the quasi-fiscal deficits related to public bank losses into the budget. Staff suggested streamlining the tax system by eliminating exemptions and using part of the additional fiscal space to reduce the tax burden on businesses, and to further reduce employer contributions to stimulate job creation.

### Monetary and Exchange Rate Policies

23. **The monetary policy stance should be tightened to keep inflation under control.** The BA's response to the rapidly changing liquidity environment and the absorption of excess liquidity helped maintain low inflation. Staff underscored, however, that the anticipated fiscal expansion and the current strong growth of credit to the economy would complicate monetary management and the development of a sound banking sector. The monetary stance needs tightening through: (a) raising BA's policy interest rate to a positive level in real terms; and (b) handling the national hydrocarbon company's large deposits outside the money market to strengthen BA's control over base money. These measures would allow BA to restore the signaling role of its policy interest rate and establish more effective control over the system's liquidity. The authorities considered that the existing monetary instruments were adequate to contain money growth, but indicated that they would carefully consider staff's

recommendations. BA's monetary program aims to limit broad money growth to 16½ percent in 2006 by controlling base money growth.

24. **The authorities intend to continue to manage the exchange rate in a flexible manner, taking account of the inflation objective.** They indicated that in managing the float they take account of fundamental developments of the real effective exchange rate. The increase in real oil prices and the current economic growth suggest a tendency for the equilibrium REER to appreciate. The expansionary fiscal stance also implies a real exchange rate appreciation, while the trade liberalization envisaged under the AAEU points in the opposite direction. However, with the increased openness of the economy, the link between changes in the exchange rate and the inflation rate would be strengthened. Against this backdrop, staff recommended allowing the REER to appreciate through a nominal appreciation of the dinar rather than higher inflation. The authorities agreed, and indicated that the flexibility with which they manage the float would be maintained. Since early 2005 they have been appreciating the nominal effective exchange rate, but declining inflation has thus far prevented the REER from appreciating as much as expected.

### C. Structural Reforms

25. **The authorities are aware that opening of the Algerian economy reinforces the need to step up priority reforms aimed at encouraging private investment and creating jobs.** To maximize the benefits and minimize the inevitable costs of the greater competition entailed by establishment of a free trade zone with the European Union (Box 5), staff encouraged the authorities to accelerate banking sector reform, further liberalize external trade, and ensure full implementation of the current convertibility of the dinar.

#### Box 5. The Association Agreement with the European Union

**Algeria's AAEU became effective on September 1, 2005.** The agreement provides a major impetus toward an open trade regime over the next 12 years.

**The economic impact of this agreement includes both costs and benefits,** with costs likely to occur in the short run while benefits accruing over the longer term. The potential benefits would consist of welfare gains, increased foreign direct investment, technology and knowledge transfer, higher productivity, and increased growth. Costs include a limited fiscal revenue impact, trade diversion, transitional unemployment, and enterprise restructuring/closure.

**Maximizing the benefits depends to a large extent on Algeria's commitment to reforms.** Other countries' experiences show that the Barcelona Process positively affected mainly countries that manifested serious commitment to reform.

**The required policy actions comprise:** (a) maintaining sound macroeconomic policies; (b) undertaking deep structural reforms aimed at diversifying the economy and achieving a transition to a market economy; and (c) liberalizing trade more generally.

<sup>1</sup> See the selected issues paper on "The Association Agreement between Algeria and the European Union: Economic Implications and Challenges," (forthcoming).

## Reform of the Financial Sector

26. **The strategy for reforming the financial system in Algeria should focus on banking sector reform.** In discussing the authorities' comprehensive approach to financial sector reform, including the nonbank financial sector, staff stressed that financial intermediation would be bank-based in the near future.

27. **The weak financial situation of public banks confirms the need to adopt a coherent strategy that aims to gradually reduce the State's role in the sector.** The authorities' reform program aims at strengthening the governance of public banks and accelerating privatization. Key actions include:

- **Successfully privatizing the first of three designated public banks.** Building on the preparatory work for opening up the majority of the capital of a first public bank to a reputable strategic investor, it is now important to issue the call for bids as soon as possible.
- **Preparing for the privatization of the other two public banks,** to take advantage of the momentum created by the privatization of the first public bank as soon as it is completed.
- **Improving the governance of public banks.** The strengthening of performance contracts for public banks is a welcome step. Staff recommended that these contracts require banks to grant loans only to solvent clients and be published with their ex-post assessments. Although the 2005 budget law included explicit government subsidies to replace part of public banks' credit to loss-making public enterprises, the implementation of this reform was delayed. The authorities are endeavoring to speed up the process, including by developing an enterprise restructuring program aimed at phasing out the subsidies over the medium term. Staff advised establishing a code of conduct for the financial relations between public banks and public enterprises.
- **Promoting competition in the banking sector,** in order to ensure the success of the privatization and facilitate efficient intermediation. In this regard, staff recommended replacing the directive prohibiting public entities from dealing with private banks with a directive instructing these entities to deal solely with sound banks. It also encouraged the authorities to avoid any discretionary measures aimed at increasing credit to the economy, such as interest subsidies.

28. **Continued improvement of the operational framework for financial intermediation should accompany this strategy.** Key actions are the ongoing modernization of the payments system, as well as the authorities' capacity-building efforts in banking supervision, with Fund technical assistance. To ensure the success of these efforts, the political support for the banking commission in enforcing prudential regulations needs to be sustained.

## Other Structural Reforms

29. **Staff welcomed the authorities' continued efforts toward external trade liberalization.** It is now important to step up the negotiations for Algeria's accession to the WTO. In this context, staff encouraged the authorities to liberalize rights of establishment to attract more foreign investment. Regional integration is also an important factor in enhancing the positive impact of the AAEU and attracting more foreign direct investment. The work program agreed upon at the conference on trade facilitation in Algeria, Morocco and Tunisia, which took place in Algiers in November, provides a good basis to make progress in this direction. Regarding customs reform, the ongoing development of the risk management system should be continued to shorten customs clearance times.

30. **The free current convertibility of the dinar is essential to enable Algeria to benefit from its opening up to the rest of the world.** A recent Fund technical assistance mission noted some problems in the implementation of the free convertibility of the dinar for payments and transfers relating to *bona fide* current international transactions, particularly those relating to invisible transactions and imports of some services; it also noted problems in the communication of this free convertibility to the banks and the Algerian public. The authorities acknowledged that the exchange system needs to be improved and indicated that they have started work to implement the preliminary recommendations of the Fund technical assistance mission (Box 6).

### Box 6. Improving the Exchange System

**Algeria's exchange system was found to be complicated and bureaucratic.** Despite the publication of a BA note in 1997, the public was generally unaware that BA allows the purchase of *bona fide* amounts exceeding annual limits, which cover many invisible payments. The foreign exchange authority should:

- Issue a new instruction confirming the free convertibility of the dinar for the payment of invisible transactions (i.e. for healthcare, education, and travel) and disseminate widely and immediately the policy of free convertibility for all *bona fide* current account payments and transfers;
- Significantly increase or abolish the current indicative limits on conversion for current international invisible transactions; and
- Launch a general overhaul and streamlining of the regulatory framework.

31. **Other structural reforms should be targeted at improving the business climate in Algeria.** In this regard, the authorities were determined to push ahead with the ongoing judicial reform aimed at implementing the legislation in a transparent and predictable fashion.

They were also interested in exploring possibilities to improve the incentives for enterprise and job creation through the tax system as proposed by staff (Box 7).

**Box 7. Algeria's Business Climate**

**Algeria's business climate lags behind that of countries on the rim of the European Union.**<sup>1</sup> The authorities are pursuing a number of structural reforms to improve the business climate, but these will take time to mature.

**The fiscal space created by higher hydrocarbon revenues could be used to achieve a faster improvement in the business climate through the tax system.** The gap between Algeria and its competitors is largest in business taxes. While Algeria has lowered its corporate income tax (CIT) rate to 30 percent, the average maximum CIT rate in the EU10 accession countries dropped from 30½ percent in 1995 to 21½ percent in 2004.

**The subsidy implicit in the pricing of domestic energy could also partly be redirected away from energy-intensive to labor-intensive activities.** A reduction in taxes and mandatory charges on labor could be considered in this context to make its tax system more conducive to job creation.

<sup>1</sup> See the selected issues paper on "Algeria's Business Climate: Tax Reforms for Faster Job Creation," (forthcoming).

32. **Staff encouraged the government to step up its efforts to reduce its involvement in the productive sector.** It advised against subjecting privatization to the maintenance of employment and activity, but rather to accompany this process with appropriate social measures. Staff also encouraged the government to subject remaining public enterprises to annual external audits in line with international standards, and to publish the results.

33. **Further strengthening fiscal governance and transparency is key to ensuring the proper use of the large hydrocarbon revenues.** Staff welcomed the progress made with regard to anti-corruption legislation, and encouraged the authorities to accelerate budget modernization and establish an action plan to implement the recommendations of the fiscal ROSC. Priorities include (a) finalizing the draft organic law on public finances; (b) improving information disseminated to Parliament and the public; (c) modernizing the budget nomenclature and accounting framework; (d) reducing the number of special accounts; and (e) reforming the financing of local governments. Staff also encouraged the authorities to participate in the Extractive Industries Transparency Initiative (EITI).

#### IV. STATISTICAL AND OTHER ISSUES

34. **Despite the authorities' efforts to improve the statistical base, serious weaknesses remain,** particularly in government finance statistics and prudential data on the financial sector, as well as in the timeliness of data dissemination.<sup>9</sup> Staff recommended that Algeria

<sup>9</sup> For example, the 2003 nonhydrocarbon overall deficit is presently estimated at 27.7 percent of NHGDP compared to 33.1 percent in IMF Country Report No. 05/50.

participate in the GDDS to develop and modernize its statistical system in a structured framework, while obtaining the needed technical assistance.

35. **The authorities intend to pursue their active external debt management.** Staff encouraged them to continue their efforts to seek early settlement of issues related to the debt with Russia, which would facilitate a more ambitious approach in prepaying external debt to Paris Club creditors.

36. **The authorities expressed satisfaction with Fund technical assistance** on tax administration, monetary policy, and banking supervision. Staff welcomed the authorities' efforts to accelerate the reform of the tax administration, including the start-up of the Large Enterprise Unit, and expressed Fund readiness to continue to provide technical assistance in this area. Near-term Fund technical assistance also includes bank restructuring and banking supervision, as well as organizing a course on financial markets analysis in Algeria in early 2006.

## V. STAFF APPRAISAL

37. **Since 2001, the Algerian economy has successfully used abundant hydrocarbon revenues to boost economic growth while keeping inflation low.** Growth benefited from a sizable fiscal impulse and buoyant activity in the hydrocarbon sector. The unemployment rate declined considerably, but this also reflected an increase in temporary employment and youth unemployment remains high. Monetary policy adequately managed the large external inflows by absorbing most of the excess liquidity in the banking system. However, the strong expansion of credit to the economy remains a cause for concern in light of the very large share of nonperforming loans in the public banks. Several major structural reforms were accomplished in 2005, including the entry into effect of the AAEU, but much remains to be done to achieve the transition to a market economy.

38. **The key challenge for Algeria is to strengthen the prospects for sustainable growth in the nonhydrocarbon sector and increase employment in an increasingly open environment.** With greater competition resulting from the external trade liberalization, it is imperative to speed up priority reforms aimed at encouraging private investment and creating jobs. The prospect of continued high hydrocarbon revenues would provide the fiscal space to accelerate these reforms. In managing the large hydrocarbon-related inflows, it is important to coordinate fiscal and monetary policies to maintain macroeconomic stability.

39. **The progress made in consolidating political stability and the encouraging outlook for Algeria's already strong financial position provide an excellent opportunity to decisively advance the government's economic agenda.** The government's program focuses on (a) using part of the hydrocarbon revenues for investment in infrastructure, education, health, and housing; and (b) accelerating structural reforms aimed at moving toward an open and diversified market economy. While this orientation is appropriate, it is also important to ensure that the program is implemented in such a way as to ensure that its objectives are achieved.

40. **With the rise in world oil prices, the sustainable level of public spending for 2006 and beyond has increased significantly, but the government's investment plans are very ambitious in the short term.** Given limited absorption capacity, the front-loading of investment could jeopardize the quality of these expenditures and increase inflation. Staff recommends a more even implementation of the public investment program, taking into account the recommendations of the public expenditure review being conducted in cooperation with the World Bank.

41. **It is also important to use part of the increased fiscal space to accelerate reforms and to adopt a wage policy that the economy is able to support.** Allocating adequate resources to support reforms in the public bank and enterprise sectors, including to mitigate the inevitable social costs, would help to accelerate the transformation of the economy. To achieve an immediate improvement in the business climate, the authorities should consider streamlining the tax system, and lowering the tax and other charges on enterprise and employment. In view of the need to preserve the competitiveness of the economy, real public sector wage increases should not exceed the real growth in the nonhydrocarbon sector.

42. **Staff encourages the authorities to transform the current hydrocarbon stabilization fund into a savings/financing account that is fully integrated into the budget.** It also underscores the importance of setting the fiscal management of hydrocarbon revenue in a long-term framework and to start preparing medium-term budget projections that take account of the current spending implications of public investment.

43. **Inflation will likely be more difficult to control in the period ahead, owing to the envisaged fiscal expansion and the strong credit expansion to the economy.** This requires tightening monetary policy by further strengthening BA's control over system liquidity and increasing its policy interest rate to a positive level in real terms. The latter would also lead banks to better assess prevailing credit risks. Staff reiterates its recommendation that the large structural liquidity of Sonatrach be deposited directly at BA.

44. **The authorities should continue to implement the managed exchange rate float in a flexible manner.** The rise in oil prices, together with the fiscal expansion and the current growth momentum, suggest a tendency for the equilibrium real exchange rate to appreciate. The current policy of gradually appreciating the dinar should be pursued in the period ahead, which would help keep inflation under control.

45. **To enable Algeria to benefit as much as possible from establishing a free trade zone with the European Union, the implementation of market-based structural reforms needs to be accelerated.** Banking reform remains a priority. Staff emphasizes the need to push ahead with the privatization of several public banks, strengthen governance of the remaining public banks, and promote competition in the sector on a level playing field. In addition, stepping up efforts to join the WTO and to strengthen regional integration are important, including to attract more foreign direct investment. Staff also encourages the authorities to decisively execute their privatization program.

46. **In order to ensure free convertibility for international current transactions, staff urges the authorities to implement the recommendations of the recent Fund technical assistance mission without delay.**

47. **The progress made with regard to enacting anti-corruption legislation and strengthening banking supervision is welcome**, but further efforts are needed to implement the recommendations of the 2004 fiscal ROSC report and to undertake financial audits of public enterprises.

48. **Staff urges the authorities to step up their efforts to improve the statistical base.** Although data provision to the Fund is still broadly adequate for effective surveillance, there are serious weaknesses, including in the government finance statistics. Staff recommends that Algeria participate in the GDDS.

49. **The authorities' policy to prepay external debt is appropriate and Algeria's voluntary advance repurchase to the Fund was a positive step.** Staff encourages the authorities to continue their efforts to seek a settlement of bilateral debt issues with Russia.

50. It is proposed that the next Article IV consultation with Algeria take place on the standard 12-month cycle.



Table 1. Algeria: Selected Economic and Financial Indicators, 2002–10

	2002	Est. 2003	Prel. 2004	Projections					
				2005	2006	2007	2008	2009	2010
(Annual percentage change)									
National income and prices									
GDP at constant prices 1/	4.7	6.9	5.2	5.3	4.7	5.1	4.9	4.8	4.8
Hydrocarbon sector	3.7	8.8	3.3	6.6	3.0	3.0	3.0	3.0	3.0
Other sectors	5.3	6.0	6.2	4.5	5.6	6.1	5.8	5.6	5.6
GDP deflator	1.9	8.3	10.6	14.9	15.0	5.1	3.7	4.9	4.7
Hydrocarbon	-1.4	16.6	19.8	33.8	26.9	4.2	1.1	3.2	3.0
Nonhydrocarbon	3.5	4.2	5.7	3.1	6.2	6.9	6.7	6.9	6.6
Consumer price index (average)	1.4	2.6	3.6	2.7	6.0	7.0	6.8	6.6	6.4
Consumer price index (end of period)	-1.5	4.0	2.0	3.1	6.5	6.9	6.7	6.5	6.4
External sector 2/									
Exports, f.o.b.	-2.0	30.7	31.7	42.1	22.2	2.4	-0.4	1.7	1.7
Hydrocarbons	-2.3	32.5	31.5	42.8	22.5	2.3	-0.5	1.7	1.7
Nonhydrocarbons	7.1	-21.7	42.6	5.4	5.5	5.4	5.4	5.3	5.3
Imports, f.o.b.	26.7	11.2	34.5	24.1	16.7	12.9	12.4	12.2	12.5
Terms of trade	-8.8	9.3	13.0	26.3	18.7	-0.1	-2.8	-1.0	-1.7
Nominal effective exchange rate 3/	-6.9	-10.9	-1.1	-2.2	...	...	...	...	...
Real effective exchange rate 3/	-7.8	-10.7	0.4	-3.6	...	...	...	...	...
Money and credit									
Net foreign assets	33.9	33.4	33.1	33.1	45.1	...	...	...	...
Domestic credit 4/	8.0	-1.4	-8.6	-14.5	-20.9	...	...	...	...
Credit to the government (net) 4/ 5/	0.4	-5.3	-13.2	-23.2	-28.1	...	...	...	...
Credit to the economy 5/	17.5	8.9	11.2	21.1	16.6	...	...	...	...
<i>in real terms</i>	19.3	4.8	9.1	17.5	9.5	...	...	...	...
Money and quasi-money	17.4	15.6	11.5	13.4	16.5	...	...	...	...
Velocity of broad money (GDP/M2)	1.6	1.6	1.6	1.7	1.8	...	...	...	...
Liquidity ratio (M2/nonhydrocarbon GDP)	94.7	99.0	98.3	103.4	107.5	...	...	...	...
Liquidity ratio (M2/GDP)	63.9	63.8	61.1	57.2	55.4	...	...	...	...
(In percent of GDP)									
Saving-investment balance	7.6	13.0	13.1	18.3	19.7	16.8	12.8	9.9	6.8
National savings	38.8	43.5	46.3	51.6	53.1	49.5	44.6	41.4	38.7
Government	10.2	15.9	14.7	22.5	25.4	24.3	22.4	21.1	20.0
Nongovernment	28.6	27.5	31.6	29.0	27.7	25.3	22.2	20.2	18.7
Investment	31.2	30.5	33.3	33.3	33.4	32.7	31.8	31.4	31.9
Government	10.0	8.1	7.9	9.9	11.3	10.2	8.5	7.6	7.6
Nongovernment	21.2	22.4	25.4	23.4	22.0	22.5	23.3	23.8	24.3
Central government finance									
Overall budget balance (deficit-)	0.2	7.8	6.9	12.6	14.1	14.0	13.8	13.6	12.4
Revenue and grants	35.3	37.0	36.2	40.8	42.5	41.7	40.6	39.8	39.0
Hydrocarbons 6/	22.2	25.6	25.6	31.3	33.7	32.7	31.2	30.2	29.1
Nonhydrocarbons	13.1	11.3	10.5	9.5	8.8	9.1	9.4	9.6	10.0
Grants	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure 7/	35.0	29.2	29.3	28.2	28.4	27.7	26.8	26.2	26.6
Current expenditure	24.1	21.3	20.3	18.3	17.1	17.5	18.3	18.7	19.0
Capital expenditure	10.0	8.1	7.9	9.9	11.3	10.2	8.5	7.6	7.6
Other 7/	0.9	-0.2	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing	1.4	-6.1	-6.0	-11.6	-13.3	-13.3	-13.1	-12.9	-12.1
External financing	-1.6	-1.7	-0.9	-1.0	-0.8	-0.8	-0.7	-0.6	-0.3
(In percent of nonhydrocarbon GDP)									
Central government finance									
Total revenue	52.2	57.4	58.2	73.7	82.4	78.9	74.0	70.6	67.5
Hydrocarbon revenue	32.8	39.8	41.3	56.5	65.3	61.7	56.9	53.5	50.3
Nonhydrocarbon revenue	19.4	17.5	16.9	17.2	17.1	17.2	17.1	17.1	17.2
Total expenditure 7/	51.9	45.3	47.1	50.9	55.1	52.4	48.8	46.5	46.0
Current expenditure	35.8	33.1	32.7	33.0	33.1	33.0	33.3	33.1	32.9
Capital expenditure	14.8	12.6	12.7	17.9	22.0	19.3	15.5	13.4	13.1
Other 7/	1.4	-0.3	1.7	0.0	0.0	0.0	0.0	0.0	0.0
Nonhydrocarbon primary balance	-28.0	-24.3	-27.9	-31.6	-36.4	-33.4	-29.6	-27.3	-26.7
Nonhydrocarbon balance	-32.5	-27.7	-30.2	-33.7	-38.0	-35.2	-31.7	-29.4	-28.8

Table 1. Algeria: Selected Economic and Financial Indicators, 2002–10 (continued)

	2002	Est.	Prel.	Projections					
		2003	2004	2005	2006	2007	2008	2009	2010
(In billions of US dollars; unless otherwise specified)									
External sector									
Exports, f.o.b.	18.7	24.5	32.2	45.8	56.0	57.3	57.1	58.0	59.0
Hydrocarbons	18.1	24.0	31.6	45.1	55.2	56.5	56.2	57.2	58.1
Nonhydrocarbons	0.6	0.5	0.7	0.7	0.7	0.8	0.8	0.9	0.9
Imports, f.o.b.	12.0	13.4	18.0	22.3	26.0	29.4	33.0	37.0	41.7
Interest payments	1.3	1.2	1.3	0.9	0.8	0.7	0.6	0.4	0.3
Current account balance (deficit -)	4.4	8.8	11.1	18.8	22.8	20.5	16.2	13.3	9.5
Idem, in percent of GDP	7.6	13.0	13.1	18.3	19.7	16.8	12.8	9.9	6.8
Overall balance (deficit -)	3.6	7.4	9.2	14.8	20.6	19.1	14.6	11.5	8.9
Gross official reserves (end-period)	23.1	32.9	43.1	55.6	76.3	95.4	110.1	121.7	130.6
In months of next year's imports of goods and service	17.0	18.1	19.0	21.0	25.5	28.4	29.2	28.7	27.4
External debt	22.6	23.4	21.8	16.8	14.8	12.7	10.2	7.6	6.2
External debt (in percent of GDP)	39.7	34.3	25.7	16.4	12.8	10.4	8.1	5.7	4.4
External debt service (in percent of exports)	22.6	17.9	17.6	12.1	7.0	7.1	7.7	7.8	6.0
(In billions of Algerian dinars; unless otherwise indicated)									
Memorandum items:									
GDP (current prices)	4,546	5,264	6,127	7,412	8,925	9,859	10,721	11,783	12,934
NHGD (current prices)	3,069	3,391	3,808	4,103	4,599	5,215	5,886	6,645	7,485
GDP (current prices, in billions of US\$)	57.1	68.0	85.0	102.8	116.0	122.1	127.0	133.5	140.5
Per capita GDP (in US\$)	1,819	2,136	2,627	3,109	3,457	3,586	3,673	3,805	3,944
Population (in millions)	31.4	31.8	32.4	33.1	...	...	...	...	...
Unemployment rate (in percent) 8/	25.7	23.7	17.7	15.3	...	...	...	...	...
Crude oil export unit value (US\$/bbl)	25.2	29.0	38.5	55.3	61.7	60.0	58.0	57.3	56.5
Crude oil exports (in millions of barrels/day)	0.5	0.7	0.9	1.0	1.0	1.0	1.1	1.1	1.1
Gross government debt (in percent of GDP)	53.5	43.8	36.6	29.0	25.6	25.2	23.9	22.0	21.3
<i>Of which:</i> Domestic	21.6	18.7	16.3	12.7	13.5	15.6	16.6	16.8	17.4
External	31.9	25.1	20.3	16.3	12.1	9.5	7.3	5.2	3.9
Exchange rate (DA/US\$) (end of period) 9/	79.7	72.6	72.6	73.8	...	...	...	...	...
Exchange rate (DA/US\$) (average) 9/	79.7	77.4	72.1	73.1	...	...	...	...	...

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 2005, as of August.

4/ In percent of beginning money stock.

5/ Including the impact of the financial restructuring in 2001-02 involving the swap of government bonds for bank claims on public enterprises.

6/ Including dividends of Sonatrach.

7/ Including special accounts and net lending.

8/ Derived from a household survey conducted once a year in September. In 2004, reflects a sharp increase in "work at home," possibly in relation to the occurrence of Ramadan shortly after the survey was conducted.

9/ For 2005, as of September.

Table 2. Algeria: Balance of Payments, 2002–10

	2002	2003	2004	Projections					
				2005	2006	2007	2008	2009	2010
(In billions of U.S. dollars; unless otherwise indicated)									
Current account	4.36	8.81	11.12	18.79	22.83	20.48	16.22	13.28	9.52
Trade balance	6.70	11.11	14.27	23.49	29.94	27.91	24.05	20.99	17.33
Exports, f.o.b.	18.71	24.46	32.22	45.77	55.95	57.27	57.05	58.04	59.03
Hydrocarbons	18.11	23.99	31.55	45.06	55.21	56.48	56.23	57.16	58.11
% Volume change	3.2	9.3	3.4	6.6	3.0	3.0	3.0	3.0	3.0
% Price change	-5.4	21.8	26.8	33.7	18.9	-0.7	-3.4	-1.3	-1.3
Other	0.60	0.47	0.67	0.71	0.75	0.79	0.83	0.87	0.92
Imports, f.o.b.	-12.01	-13.35	-17.95	-22.28	-26.01	-29.36	-33.01	-37.04	-41.69
% Volume change	24.3	0.1	21.3	17.8	16.4	12.2	11.5	11.3	11.3
% Price change	1.9	11.0	10.8	5.4	0.3	0.6	0.8	0.8	1.1
Services and income (net)	-3.41	-4.05	-5.61	-7.45	-9.95	-10.35	-10.85	-10.84	-11.03
Services (net)	-1.18	-1.35	-2.01	-2.38	-2.86	-3.51	-4.25	-5.06	-5.99
Credit	1.30	1.57	1.85	2.54	2.88	2.97	3.03	3.12	3.21
Debit	-2.48	-2.92	-3.86	-4.92	-5.74	-6.48	-7.29	-8.18	-9.20
Income (net)	-2.23	-2.70	-3.60	-5.07	-7.08	-6.85	-6.59	-5.78	-5.04
Credit	0.68	0.76	0.99	1.44	2.47	3.43	4.30	5.16	5.98
Debit	-2.91	-3.46	-4.59	-6.51	-9.55	-10.28	-10.89	-10.94	-11.02
Interest payments	-1.31	-1.18	-1.29	-0.93	-0.76	-0.66	-0.55	-0.43	-0.33
Profit repatriation	-1.60	-2.28	-3.30	-5.58	-8.79	-9.62	-10.34	-10.51	-10.69
Transfers (net)	1.07	1.75	2.46	2.75	2.84	2.93	3.02	3.12	3.22
Capital account	-0.71	-1.37	-1.87	-4.00	-2.19	-1.43	-1.61	-1.80	-0.64
Medium- and long-term capital	-0.35	-0.76	-1.61	-2.27	-1.08	-1.02	-1.30	-1.34	-0.14
Direct investment (net)	0.97	0.62	0.62	0.94	0.99	1.16	1.18	1.26	1.34
Loans (net)	-1.32	-1.38	-2.23	-3.21	-2.07	-2.18	-2.48	-2.60	-1.48
Drawings	1.60	1.65	2.12	1.08	1.26	1.41	1.57	1.75	1.95
Amortization	-2.92	-3.03	-4.35	-4.29	-3.33	-3.59	-4.05	-4.36	-3.43
Short-term capital and errors and omissions	-0.36	-0.61	-0.26	-1.72	-1.11	-0.41	-0.32	-0.45	-0.50
Overall balance	3.65	7.44	9.25	14.79	20.64	19.05	14.61	11.48	8.88
Financing	-3.65	-7.44	-9.25	-14.79	-20.64	-19.05	-14.61	-11.48	-8.88
Official reserves (increases -)	-3.39	-7.00	-8.88	-14.16	-20.64	-19.05	-14.61	-11.48	-8.88
Fund repurchases	-0.30	-0.44	-0.37	-0.63	0.00	0.00	0.00	0.00	0.00
Memorandum items:									
Current account balance (in percent of GDP)	7.6	13.0	13.1	18.3	19.7	16.8	12.8	9.9	6.8
Algerian crude oil price (US\$/barrel) 1/	25.2	29.0	38.5	55.3	61.7	60.0	58.0	57.3	56.5
Gross official reserves (in billions of US\$)	23.1	32.9	43.1	55.6	76.3	95.4	110.1	121.7	130.6
Idem, in months of next year's imports	17.0	18.1	19.0	21.0	25.5	28.4	29.2	28.7	27.4
Gross external debt (in billions of US\$)	22.6	23.4	21.8	16.8	14.8	12.7	10.2	7.6	6.2
Of which: Short-term	0.1	0.2	0.4	...	...	...	...	...	...
External debt/exports (in percent)	113.2	89.7	64.0	34.8	25.2	21.0	17.0	12.5	9.9
External debt/GDP (in percent)	39.7	34.3	25.7	16.4	12.8	10.4	8.1	5.7	4.4
Debt service (in billions of US\$)	4.5	4.7	6.0	5.9	4.1	4.3	4.6	4.8	3.8
Debt service/exports (in percent)	22.6	17.9	17.6	12.1	7.0	7.1	7.7	7.8	6.0

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

1/ Weighted average of quarterly data.

Table 3. Algeria: Summary of Central Government Operations, 2002–10 1/

	2002	Est. 2003	Prel. 2004	Projections					
				2005	2006	2007	2008	2009	2010
(In billions of Algerian dinars)									
Budget revenue and grants	1,603	1,948	2,215	3,023	3,789	4,115	4,356	4,689	5,050
Hydrocarbon revenue 2/	1,008	1,350	1,571	2,319	3,005	3,219	3,348	3,553	3,763
Nonhydrocarbon revenue	595	595	644	704	785	895	1,007	1,136	1,287
Tax revenue	483	525	580	650	730	840	951	1,078	1,227
Taxes on income and profits	112	128	148	159	179	203	229	258	291
Taxes on goods and services	223	234	274	319	371	429	493	565	650
Customs duties	128	144	139	151	157	182	200	221	249
Registration and stamps	19	19	20	21	23	26	30	33	38
Nontax revenues	112	70	64	54	54	55	56	58	60
Fees	75	24	27	22	23	23	25	26	28
Bank of Algeria dividends and interests	38	42	30	30	30	30	30	30	30
Dividends from Pes	0	4	7	2	2	2	2	2	2
Grants	0	2.9	0	0	0	0	0	0	0
Total expenditure	1,551	1,691	1,892	2,401	2,870	2,844	2,973	3,090	3,414
Current expenditure	1,098	1,121	1,245	1,353	1,522	1,724	1,957	2,199	2,460
Personnel expenditure	346	398	447	469	537	609	694	784	882
Mudjahidins' pensions	74	63	69	73	81	86	94	101	109
Material and supplies	69	59	72	79	89	101	114	128	145
Current transfers	472	488	573	645	741	834	935	1,047	1,169
Interest payments	137	114	85	87	74	93	121	138	155
Capital expenditure	453	570	646	1,048	1,348	1,120	1,016	891	953
Budget balance	53	256	323	622	919	1,271	1,383	1,599	1,637
Special accounts balance	-11	187	110	314	337	112	102	0	-27
Net lending by the treasury	31	33	12	0	0	0	0	0	0
Nonhydrocarbon primary balance	-860	-826	-1,064	-1,295	-1,674	-1,743	-1,743	-1,816	-1,998
Primary balance	148	525	507	1,023	1,330	1,476	1,605	1,737	1,765
Nonhydrocarbon balance	-997	-940	-1,149	-1,383	-1,749	-1,836	-1,864	-1,954	-2,153
Overall balance	10	411	421	936	1,256	1,383	1,484	1,599	1,610
Financing	-10	-411	-421	-936	-1,256	-1,383	-1,484	-1,599	-1,610
Bank 3/	7	-267	-435	-869	-1,192	-1,308	-1,407	-1,524	-1,569
Borrowing	25	-100	-3	-63	263	338	238	203	263
Change in cash balances	-18	-168	-432	-806	-1,455	-1,646	-1,645	-1,727	-1,831
Nonbank 4/	57	-52	67	8	7	0	0	0	0
Foreign	-75	-91	-53	-75	-71	-75	-77	-75	-41
(In percent of GDP)									
Total revenue	35.3	37.0	36.2	40.8	42.5	41.7	40.6	39.8	39.0
Hydrocarbon	22.2	25.6	25.6	31.3	33.7	32.7	31.2	30.2	29.1
Nonhydrocarbon	13.1	11.3	10.5	9.5	8.8	9.1	9.4	9.6	10.0
Of which: Tax revenue	10.6	10.0	9.5	8.8	8.2	8.5	8.9	9.1	9.5
Total expenditure	35.0	29.2	29.3	28.2	28.4	27.7	26.8	26.2	26.6
Current expenditure	24.1	21.3	20.3	18.3	17.1	17.5	18.3	18.7	19.0
Capital expenditure	10.0	8.1	7.9	9.9	11.3	10.2	8.5	7.6	7.6
Other 5/	0.9	-0.2	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Primary balance	3.2	10.0	8.3	13.8	14.9	15.0	15.0	14.7	13.6
Overall balance	0.2	7.8	6.9	12.6	14.1	14.0	13.8	13.6	12.4
(In percent of nonhydrocarbon GDP)									
Total revenue	52.2	57.4	58.2	73.7	82.4	78.9	74.0	70.6	67.5
Hydrocarbon revenue	32.8	39.8	41.3	56.5	65.3	61.7	56.9	53.5	50.3
Nonhydrocarbon revenue	19.4	17.5	16.9	17.2	17.1	17.2	17.1	17.1	17.2
Of which: Tax revenue	15.7	15.5	15.2	15.8	15.9	16.1	16.2	16.2	16.4
Total expenditure	51.9	45.3	47.1	50.9	55.1	52.4	48.8	46.5	46.0
Current expenditure	35.8	33.1	32.7	33.0	33.1	33.0	33.3	33.1	32.9
Capital expenditure	14.8	12.6	12.7	17.9	22.0	19.3	15.5	13.4	13.1
Other 5/	1.4	-0.3	1.7	0.0	0.0	0.0	0.0	0.0	0.0
Nonhydrocarbon primary balance	-28.0	-24.3	-27.9	-31.6	-36.4	-33.4	-29.6	-27.3	-26.7
Nonhydrocarbon overall balance	-32.5	-27.7	-30.2	-33.7	-38.0	-35.2	-31.7	-29.4	-28.8

Table 3. Algeria: Summary of Central Government Operations, 2002–10 (continued)

	2002	Est. 2003	Prel. 2004	Projections					
				2005	2006	2007	2008	2009	2010
Gross government debt (in percent of GDP)	53.5	43.8	36.6	29.0	25.6	25.2	23.9	22.0	21.3
<i>Of which:</i> Domestic	21.6	18.7	16.3	12.7	13.5	15.6	16.6	16.8	17.4
External	31.9	25.1	20.3	16.3	12.1	9.5	7.3	5.2	3.9
Gross government debt including identified cumulative quasi-fiscal deficits (in percent of GDP) 6/	56.5	50.3	43.0	35.1	31.4	31.2	30.3	28.6	28.1
Oil stabilization fund (in billions of Algerian dinars)	276	568	722	...	...	...	...	...	...
Accumulation	27	449	623	...	...	...	...	...	...
Utilization	0	156	470	...	...	...	...	...	...

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

1/ On 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 (not related to capital spending) and net lending.

6/ The quasi-fiscal deficit comprises the losses of public enterprises net of government subsidies.

Table 4. Algeria: Monetary Survey, 2002–06

	2002	2003	Prel. 2004	Proj.	
				2005	2006
(In billions of Algerian dinars; at the end of the period)					
Net foreign assets	1,755.7	2,342.7	3,119.2	4,151.4	6,021.6
<i>Of which</i> : Bank of Algeria	1,742.7	2,325.9	3,109.1	4,141.0	6,010.6
Net domestic assets	1,150.1	1,015.2	623.4	91.3	-1,077.9
Domestic credit	1,845.5	1,803.6	1,514.4	973.4	86.2
Credit to government (net) 1/	578.7	423.4	-20.6	-889.5	-2,081.8
Credit to the economy 1/	1,266.8	1,380.2	1,535.0	1,859.0	2,168.0
<i>Of which</i> : Private sector	550.2	587.8	676.4	923.0	...
Other items net 2/	-695.4	-788.4	-891.0	-882.1	-1,164.1
Money and quasi-money (M2)	2,905.8	3,357.9	3,742.6	4,242.7	4,943.7
Money	1,416.3	1,630.4	2,160.6	2,534.3	3,027.3
Quasi-money	1,489.5	1,727.5	1,582.0	1,708.3	1,916.5
(Percent change over 12-month period)					
Money and quasi-money (M2)	17.4	15.6	11.5	13.4	16.5
<i>Of which</i> : Money	14.4	15.1	32.5	17.3	19.4
Credit to the economy	17.5	8.9	11.2	21.1	16.6
<i>Idem, in real terms</i>	19.3	4.8	9.1	17.5	9.5
(Changes as a percent of beginning money stock)					
Money and quasi-money (M2)	17.4	15.6	11.5	13.4	16.5
Net foreign assets	18.0	20.2	23.1	27.6	44.1
Net domestic assets	-0.6	-4.6	-11.7	-14.2	-27.6
Domestic credit	8.0	-1.4	-8.6	-14.6	-20.8
Net credit to government	0.4	-5.3	-13.2	-23.2	-28.1
Credit to the economy	7.6	3.9	4.6	8.7	7.3
Memorandum items:					
Liquidity ratio (e.o.p. M2/GDP)	63.9	63.8	61.1	57.2	55.4
Liquidity ratio (e.o.p. M2/NHGDP)	94.7	99.0	98.3	103.4	107.5
Idem, excl. deposits of Sonatrach	89.1	91.5	89.4	90.8	...
M2 velocity	1.6	1.6	1.6	1.7	1.8
Credit to the economy/GDP	27.9	26.2	25.1	25.1	24.3
Credit to the economy/NHGDP	41.3	40.7	40.3	45.3	47.1
Credit to private sector/NHGDP	17.9	17.3	17.8	...	...

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

1/ This includes the impact of banks' restructuring packages. The conversion of bank claims on public enterprises in bank claims on the government results, other things being equal, in a decrease of credit to the economy and an equal increase in credit to the government. The adjustment amounted to about DA 216 billion in 2000, DA 311.6 billion in 2001, and DA 297 billion in 2002. 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.

2/ This includes the debt-rescheduling proceeds blocked in special accounts at the Bank of Algeria.

Table 5. Algeria: Summary Balance Sheet of Bank of Algeria, 2002–06  
(In billions of Algerian dinars; at the end of the period)

	2002	2003	Prel. 2004	Proj. 2005	2006
Net foreign assets	1,742.7	2,325.9	3,109.1	4,141.0	6,010.6
Assets	1,868.5	2,419.7	3,173.2	4,144.1	6,013.9
Liabilities	125.8	93.7	64.1	3.1	3.2
Net domestic assets	-766.4	-923.7	-1,549.0	-2,311.8	-4,055.5
Credit to government (net)	-304.8	-464.1	-915.8	-1,729.2	-3,191.5
Claims on government	133.8	142.0	122.1	114.8	107.5
Government deposits	438.5	606.1	1,037.9	1,844.1	3,299.0
Credit to banks	0.0	0.0	0.0	0.0	0.0
Other credit	0.8	0.7	0.6	0.6	0.6
Other items net	-462.4	-460.3	-633.8	-583.2	-864.6
Deposit auction	129.7	250.0	400.0	657.1	602.0
Reserve money 1/	846.7	1,152.3	1,160.1	1,172.1	1,353.1
Currency in circulation	673.7	787.7	882.5	935.9	1,074.7
Banks' deposits	172.9	364.6	277.6	236.1	278.4
Memorandum items:					
Reserve money growth (in percent)	8.8	36.1	0.7	1.0	15.4
M2 money multiplier	3.4	2.9	3.2	3.6	3.7
Reserve ratio	9.7	15.5	10.4	7.8	7.8
<i>Of which</i> : Required	4.3	6.3	6.6	6.5	6.5
Currency ratio	31.6	32.5	32.5	29.5	28.7
Rediscount rate (in percent) 1/ 2/	5.5	4.5	4.0	4.0	...
Deposit auction rate (in percent) 1/ 3/	2.75	1.75	0.75	1.81	...

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

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

2/ For 2005, as of May.

3/ For 2005, as of September.

Table 6. Algeria: Summary Balance Sheet of Deposit Money Banks, 2002–06  
(In billions of Algerian dinars; at the end of the period)

	2002	2003	Prel.	Proj.	
			2004	2005	2006
Net foreign assets	13.0	16.7	10.1	10.4	11.0
Assets	49.7	55.5	76.6	78.6	83.2
Liabilities	36.7	38.8	66.5	68.3	72.2
Net domestic assets	2,114.4	2,426.2	2,695.3	3,142.8	3,709.6
Domestic credit	2,040.0	2,136.9	2,271.3	2,540.5	3,119.4
Credit to government (net)	774.0	757.4	736.9	681.4	951.4
Credit to the economy	1,266.0	1,379.5	1,534.4	1,859.0	2,168.0
<i>Of which:</i> Private sector	550.2	587.8	674.7	923.0	...
Other items (net)	-259.2	-334.4	-256.6	-299.6	-300.2
Deposit auction	129.7	250.0	400.0	657.1	602.0
Reserves	203.9	373.8	280.6	244.7	288.3
Cash in vault	9.0	6.3	8.1	8.6	9.9
Deposits at BA	194.8	367.4	272.5	236.1	278.4
<i>Of which:</i> Required reserves	89.3	150.3	176.2	204.6	241.2
Deposits at BA/Required reserves	2.2	2.4	1.5	1.2	1.2
Demand deposits	642.2	718.9	1,127.9	1,448.7	1,804.1
Time deposits 1/	1,485.2	1,724.0	1,577.5	1,708.3	1,916.5

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

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



Table 7. Algeria: External Debt Sustainability Framework, 2000-2010  
(in percent of GDP, unless otherwise indicated)

	Actual					Projections					Debt-stabilizing non-interest current account 8/	
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009		2010
<b>1 Baseline: External debt</b>	46.4	41.1	39.8	34.3	25.7	16.4	12.8	10.4	8.1	5.7	4.4	-1.0
2 Change in external debt	-11.6	-5.3	-1.3	-5.4	-8.6	-9.4	-3.6	-2.4	-2.3	-2.3	-1.3	-1.3
3 Identified external debt-creating flows (4+8+9)	-23.5	-15.4	-10.8	-20.4	-20.6	-20.3	-21.2	-18.3	-14.2	-11.3	-8.0	-8.0
4 Current account deficit, excluding interest payments	-20.0	-15.6	-10.0	-14.7	-14.6	-19.2	-20.3	-17.3	-13.2	-10.3	-7.0	-7.0
5 Deficit in balance of goods and services	-20.0	-14.7	-9.7	-14.4	-14.5	-20.5	-23.3	-20.0	-15.6	-11.9	-8.1	-8.1
6 Exports	41.5	36.4	35.1	38.3	40.2	47.0	50.7	49.3	47.3	45.8	44.3	44.3
7 Imports	21.5	21.7	25.4	23.9	25.7	26.5	27.4	29.3	31.7	33.9	36.2	36.2
8 Net non-debt creating capital inflows (negative)	-0.8	-2.1	-1.7	-0.9	-0.7	-0.9	-0.9	-1.0	-0.9	-0.9	-1.0	-1.0
9 Automatic debt dynamics 1/	-2.8	2.3	0.8	-4.7	-5.3	-0.2	0.0	-0.1	-0.1	0.0	0.0	0.0
10 Contribution from nominal interest rate	3.2	2.8	2.3	1.7	1.5	0.9	0.7	0.5	0.4	0.3	0.2	0.2
11 Contribution from real GDP growth	-1.1	-1.2	-1.9	-2.3	-1.4	-1.1	-0.7	-0.6	-0.5	-0.4	-0.3	-0.3
12 Contribution from price and exchange rate changes 2/	-4.8	0.8	0.4	-4.2	-5.4	...	...	...	...	...	...	...
13 Residual, incl. change in gross foreign assets (2-3)/3/	12.0	10.1	9.5	15.0	12.0	11.0	2.8	3.3	4.5	6.4	7.0	7.0
External debt-to-exports ratio (in percent)	112.0	112.8	113.2	89.7	64.0	34.8	25.2	21.0	17.0	12.5	9.9	9.9
<b>Gross external financing need (in billions of US dollars) 4/</b>	-6.1	-3.8	-0.9	-5.3	-6.3	-13.5	-19.1	-16.5	-11.8	-8.5	-5.7	-5.7
in percent of GDP	-11.2	-7.0	-1.5	-7.7	-7.4	-13.1	-16.5	-13.5	-9.3	-6.4	-4.0	-4.0
<b>Scenario with key variables at their historical averages 5/ 6/</b>												
<b>Scenario with oil prices dropping to \$19 per barrel starting in 2006 7/</b>						16.4	10.1	7.4	4.5	2.4	0.0	-0.8
						16.4	16.7	18.3	21.2	25.4	31.7	-1.6
<b>Key Macroeconomic Assumptions Underlying Baseline</b>												
Real GDP growth (in percent)	2.2	2.6	4.7	6.9	5.2	5.3	4.7	5.1	4.9	4.8	4.8	4.8
GDP deflator in US dollars (change in percent)	9.1	-1.7	-1.0	11.7	18.5	15.1	7.8	0.2	-0.9	0.3	0.4	0.4
Nominal external interest rate (in percent)	6.1	6.0	5.8	5.2	5.5	4.3	4.5	4.5	4.4	4.2	4.4	4.4
Growth of exports (US dollar terms, in percent)	73.0	-11.3	0.0	30.1	30.9	41.8	21.8	2.4	-0.3	1.8	1.8	1.8
Growth of imports (US dollar terms, in percent)	1.6	1.8	21.6	12.1	34.3	24.7	16.7	12.9	12.4	12.2	12.5	12.5
Current account balance, excluding interest payments	20.0	15.6	10.0	14.7	14.6	19.2	20.3	17.3	13.2	10.3	7.0	7.0
Net non-debt creating capital inflows	0.8	2.1	1.7	0.9	0.7	0.9	0.9	1.0	0.9	0.9	1.0	1.0

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

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

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

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

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

6/ Assuming that the authorities seek to maintain the reserve cover of next year's imports at its 2005 level throughout the projection period.

7/ Assuming that the reserve cover of next year's imports does not drop below 3 months by 2010.

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

Table 8. Algeria: Public Sector Debt Sustainability Framework, 2000-2010  
(In percent of GDP, unless otherwise indicated)

	Actual										Projections					Debt-stabilizing primary balance % -0.3
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010					
<b>1 Baseline: Public sector debt 1/ o/w foreign-currency denominated</b>	70.8	65.0	56.5	50.3	43.0	<b>35.1</b>	<b>31.4</b>	<b>31.2</b>	<b>30.3</b>	<b>28.6</b>	<b>28.1</b>					
2 Change in public sector debt	-18.5	-5.9	-8.5	-6.2	-7.3	-8.0	-3.7	-0.2	-0.9	-1.7	-0.5					
3 Identified debt-creating flows (4+7+12)	-21.0	-2.9	-2.2	-10.8	-12.9	-19.2	-19.1	-16.2	-15.5	-15.4	-14.1					
4 Primary deficit	-13.7	-6.9	-3.2	-10.0	-8.3	-13.8	-14.9	-15.0	-15.0	-14.7	-13.6					
5 Revenue and grants	38.5	34.7	35.3	37.0	36.2	40.8	42.5	41.7	40.6	39.8	39.0					
6 Primary (noninterest) expenditure	24.8	27.9	32.0	27.0	27.9	27.0	27.6	26.8	25.7	25.1	25.4					
7 Automatic debt dynamics 2/	-10.5	2.3	-0.1	-8.1	-5.7	-6.3	-5.1	-2.0	-1.4	-1.6	-1.4					
8 Contribution from interest rate/growth differential 3/	-14.6	0.8	-1.1	-5.5	-5.7	-6.3	-5.1	-2.0	-1.4	-1.6	-1.4					
9 Of which contribution from real interest rate	-13.1	2.9	1.8	-2.2	-3.4	-4.4	-3.7	-0.6	0.0	-0.2	-0.1					
10 Of which contribution from real GDP growth	-1.5	-2.1	-2.9	-3.4	-2.2	-1.9	-1.4	-1.4	-1.4	-1.3	-1.3					
11 Contribution from exchange rate depreciation 4/	4.1	1.5	0.9	-2.6	0.0	...	...	...	...	...	...					
12 Other identified debt-creating flows	3.2	1.7	1.2	7.2	1.1	0.9	0.9	0.8	0.9	0.9	0.9					
13 Privatization receipts (negative)	0.0	0.6	0.0	0.5	0.2	0.1	0.1	0.0	0.0	0.0	0.0					
14 Recognition of implicit or contingent liabilities	1.1	1.1	1.2	6.7	0.9	0.8	0.8	0.8	0.9	0.9	0.9					
15 Bank recapitalization	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0					
16 Residual, including asset changes (2-3) 5/	2.5	-3.0	-6.3	4.7	5.6	11.2	15.4	16.0	14.6	13.8	13.6					
Public sector debt-to-revenue ratio 1/	183.9	187.2	160.1	135.9	119.0	86.0	73.9	74.8	74.5	71.9	72.1					
<b>Gross financing need 6/ in billions of U.S. dollars</b>	-2.3	3.4	5.4	-2.6	-2.8	-9.0	-10.3	-9.5	-7.1	-4.5	-4.2					
	-1.3	1.9	3.1	-1.8	-2.4	-9.3	-11.9	-11.7	-9.0	-6.0	-5.9					
<b>Scenario with key variables at their historical averages 7/</b>																
<b>Scenario with no policy change (constant primary balance) in 2005-2010</b>																
<b>Scenario with oil prices dropping to US\$19 per barrel starting in 2006</b>																
						<b>35.1</b>	<b>28.3</b>	<b>21.5</b>	<b>15.2</b>	<b>9.4</b>	<b>4.2</b>				<b>0.5</b>	
						<b>35.1</b>	<b>32.5</b>	<b>33.4</b>	<b>33.6</b>	<b>32.7</b>	<b>31.9</b>				<b>-0.4</b>	
						<b>35.1</b>	<b>49.7</b>	<b>48.5</b>	<b>45.6</b>	<b>42.2</b>	<b>40.7</b>				<b>-1.3</b>	
<b>Key Macroeconomic and Fiscal Assumptions Underlying Baseline</b>																
Real GDP growth (in percent)	2.2	3.1	4.7	6.9	5.2	5.3	4.7	5.1	4.9	4.8	4.8					
Average nominal interest rate on public debt (in percent) 8/	5.6	5.1	5.0	4.4	3.2	3.3	2.9	3.3	3.9	4.3	4.6					
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-17.9	4.3	3.0	-3.9	-7.4	-11.6	-12.2	-1.8	0.2	-0.6	-0.2					
Nominal appreciation (increase in US dollar value of local currency, in percent)	-8.0	-3.2	-2.4	9.8	0.0	...	...	...	...	...	...					
Inflation rate (GDP deflator, in percent)	23.5	0.8	1.9	8.3	10.6	14.9	15.0	5.1	3.7	4.9	4.7					
Growth of real primary spending (deflated by GDP deflator, in percent)	-9.9	15.8	20.3	-9.7	8.5	1.9	6.9	2.1	0.5	2.3	6.3					
Primary deficit	-13.7	-6.9	-3.2	-10.0	-8.3	-13.8	-14.9	-15.0	-15.0	-14.7	-13.6					

1/ Public sector debt covers central government and is in gross terms.  
2/ Derived as  $[(r - \pi(1+g)) - g + \alpha\epsilon(1+g)] / (1+g+\pi+g\pi)$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $\alpha$  = share of foreign-currency denominated debt; and  $\epsilon$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).  
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .  
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $\alpha\epsilon(1+g)$ .  
5/ For projections, this line includes exchange rate changes.  
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.  
7/ The key variables include real GDP growth; real interest rate; accumulation of government deposits at the central bank in percent of GDP; and primary balance in percent of GDP.  
8/ Derived as nominal interest expenditure divided by previous period debt stock.  
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 9. Algeria: Indicators of External Vulnerability, 2001–05  
(In percent of GDP, unless otherwise indicated)

	2001	2002	2003	Est. 2004	Proj. 2005
<b>Financial indicators</b>					
Central government identified debt	65.0	56.5	50.3	43.0	35.1
Broad money (percent change, 12-month basis)	22.2	17.4	15.6	11.5	13.4
13 weeks T-bill yield (in percent per annum) 1/	5.6	2.7	1.5	0.3	0.3
13 weeks T-bill yield (real; in percent per annum) 2/	1.4	1.3	-1.1	-3.3	-2.4
<b>External Indicators</b>					
Exports (percent change, 12-month basis in US\$)	-11.8	-2.0	30.7	31.7	42.1
Imports (percent change, 12-month basis in US\$)	1.5	26.7	11.2	34.5	24.1
Terms of Trade (percent change, 12 month basis)	-7.8	-8.8	9.3	13.0	26.3
Current account balance	12.8	7.6	13.0	13.1	18.3
Capital and financial account balance	-1.3	-1.2	-2.0	-2.2	-3.9
Gross official reserves (in US\$ billions)	18.0	23.1	32.9	43.1	55.6
Central Bank short-term foreign liabilities (in US\$ billion)	0.2	0.2	0.3	...	...
Central Bank foreign currency exposure (in US\$ billion)	n.a.	n.a.	n.a.	n.a.	n.a.
Short term foreign assets of the financial sector (in US\$ billion)	<0.1	<0.1	<0.1	<0.1	<0.1
Short term foreign liabilities of the financial sector (in US\$ billion)	<0.1	<0.1	<0.1	<0.1	<0.1
Foreign currency exposure of the financial sector (in US\$ billion)	n.a.	n.a.	n.a.	n.a.	n.a.
Official reserves (in months of imports GNFS)	14.9	17.0	18.1	19.0	21.0
Broad money to reserves (in percent)	177.1	157.7	140.4	119.6	102.4
Total external debt	40.9	39.7	34.3	25.7	16.4
Total external debt to exports GNFS (in percent)	112.8	113.2	89.7	64.0	36.8
External interest payments to exports GNFS (in percent)	7.6	6.5	4.5	3.8	2.0
External amortization payments to exports GNFS (in percent)	14.5	14.6	11.6	12.8	9.4
Exchange rate (per US\$, period average) 3/	77.2	79.7	77.4	72.1	73.1
REER appreciation (12 month basis) 4/	2.9	-7.8	-10.7	0.4	-3.6
<b>Financial Market Indicators</b>					
	n.a.	n.a.	n.a.	n.a.	n.a.

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

1/ For 2005, as of September.

2/ Using actual CPI.

3/ For 2005, as of September.

4/ For 2005, as of August.

Table 10. Algeria: Millennium Development Goals, 1990–2003

	1990	1994	1997	2000	2003
<b>Eradicate extreme poverty and hunger</b>					
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	..
<b>Achieve universal primary education</b>					
Net primary enrollment ratio (% of relevant age group)	93.2	..	92.1	94.2	94.9
Primary completion rate, total (% of relevant age group)	80.4	85.9	91.1	95.5	95.5
Proportion of pupils starting grade 1 who reach grade 5	94.5	..	95.0	96.0	..
Youth literacy rate (% ages 15-24)	..	..	..	..	90.1
<b>Promote gender equality and empower women</b>					
Proportion of seats held by women in national parliament (%)	2.0	..	7.0	3.0	6.0
Ratio of girls to boys in primary and secondary education (%)	83.3	..	..	97.7	98.6
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
<b>Reduce child mortality</b>					
Immunization, measles (% of children ages 12-23 months)	83.0	88.0	92.0	80.0	84.0
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	..	45.0	41.0
<b>Improve maternal health</b>					
Births attended by skilled health staff (% of total)	..	..	..	92.0	..
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	140.0	..
<b>Combat HIV/AIDS, malaria, and other diseases</b>					
Contraceptive prevalence rate (% of women ages 15-49)	..	..	..	..	57.0
Incidence of tuberculosis (per 100,000 people)	36.4	40.8	44.4	48.4	52.8
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 (%)	..	..	134.2	126.4	113.2
<b>Ensure environmental sustainability</b>					
Access to an improved water source (% of population)	95.0	..	..	..	87.0
Access to improved sanitation (% of population)	88.0	..	..	..	92.0
Access to secure tenure (% of population)	..	..	..	..	..
CO2 emissions (metric tons per capita)	3.2	3.1	3.4	2.9	..
Forest area (% of total land area)	0.8	..	..	0.9	..
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
<b>Develop a global partnership for development</b>					
Aid per capita (current US\$)	5.3	10.7	8.6	6.6	7.3
Fixed line and mobile phone subscribers (per 1,000 people)	32.5	40.9	48.8	60.8	114.8
Internet users (per 1,000 people)	..	0.0	0.1	4.9	16.0
Personal computers (per 1,000 people)	1.0	2.6	4.8	6.6	7.7
Unemployment, youth total (% of total labor force ages 15-24)	38.7	..	..	54.9	45.0

Source: World Development Indicators Database, April 2005.

**Algeria: Relations with the Fund**

As of November 30, 2005

**A. Financial Relations**

**Membership Status** Joined 9/26/63; Article VIII

<b>General Resources Account</b>	<b>SDR Million</b>	<b>Percent of Quota</b>
Quota	1,254.70	100.00
Fund holdings of currency	1,169.02	93.22
Reserve position in Fund	85.08	6.78

<b>SDR Department</b>	<b>SDR Million</b>	<b>Percent of Allocation</b>
Net cumulative allocation	128.64	100.00
Holdings	2.44	1.89

**Outstanding Purchases and Loans:** None

**Financial Arrangements**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
CCFF	5/07/99	--	223.50	223.50
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 Payments to Fund**

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

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	0.00	0.00	0.00	0.00	0.00
Charges/interest	0.00	4.42	3.80	3.81	3.80
Total	0.00	4.42	3.80	3.81	3.80

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

## **B. Nonfinancial Relations**

### **Exchange Rate Arrangement**

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 November 2005, the average of the buying and selling rates for the U.S. dollar was \$1 = DA 73.76, equivalent to SDR 1 = DA 105.04. 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 pre-announced 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 are still in effect since Algeria accepted the obligations of Article VIII, Sections 2(a), 3, and 4, in 1997, are indicative according to the authorities, although this information is not commonly known by the public, despite the publication of a BA note in 1997. In addition, some difficulties arise with regard to the making of payments for other current international transactions (such as the payment of certain services).

### **Latest Article IV Consultation**

The discussions for the 2004 Article IV consultation with Algeria were held in Algiers during October 7–24, 2004. The staff report (IMF Country Report No. 05/50) was discussed by the Executive Board on January 12, 2005 and published on February 15, 2005.

### **Technical Assistance**

- MAE consultants visited Algiers in January, March, July, and December 2002 to advise on insurance supervision.
- MAE consultants visited Algiers in February–May 2002 to assist the Bank of Algeria to develop its bank supervision capability.
- An MAE mission on monetary policy visited Algiers in March 2002.
- MAE consultants visited Algiers in March, June, and October 2002 to advise on foreign reserve management.
- An FAD mission visited Algiers in June–July 2002 to advise on the process of customs modernization.
- An MAE consultant visited Algiers in July, September, October, and December 2002 to assist the Bank of Algeria to develop its bank supervision and regulation capability.

- An STA multisector mission visited Algiers during September 4–17, 2002 to assess the system of macroeconomic statistics, including monetary, balance of payments, public finance and national accounts statistics, and price indices.
- 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 2003–2004 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 mission visited Algiers in September and December 2005 to advise on bank restructuring.

### **Financial Sector Assessment Program (FSAP)**

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 (IMF Country Report No. 04/138) on January 14, 2004. The FSSA was published on May 17, 2004.

### **Resident Representative/Advisor**

None.

## **Algeria: Relations with the World Bank**

(As of November 8, 2005)

The World Bank portfolio in Algeria comprises 9 active operations and 64 closed loans, with cumulative net commitments of US\$4.5 billion, of which US\$3.67 billion have been repaid. Net commitments for the 9 current operations amount to US\$337 million.

The Algeria Country Assistance Strategy was discussed by the World Bank Board on June 12, 2003 and a Country Assistance Strategy Progress Report was discussed by the Board on August 30, 2005. The proposed support of the Bank Group to Algeria 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 approach focused on transfer of knowledge and capacity building; and (c) partnerships, outreach and knowledge sharing.

Recent analytical work includes policy notes on poverty, the transport sector, and the legal and business environment (FY05). A Public Expenditure Review is scheduled for FY06 (in collaboration with the IMF). The Bank is seeking to expand its analytic and advisory work in Algeria.

Given high oil revenues and the decision to reduce external borrowing, the authorities have expressed interest in Reimbursable Technical Assistance (RTA) from the World Bank. Agreement has been reached on an RTA program in the water and sanitation sector and another is under preparation in the information and communication technology sector.

The quality of the Algeria portfolio deteriorated in FY04 and FY05. The percentage of projects at risk rose from 8 percent in FY03 to above 20 percent in FY04–05, and is currently at 22 percent. Slow implementation continues to affect most projects, partly because of insufficient institutional capacity and procurement problems. The average disbursement ratio was 11 percent in FY04 and dropped to 8.9 percent in FY05. No new loans have been approved since FY03.



**Algeria: Financial Relations with the World Bank**

(As of November 1, 2005)

	Total Net Commitments		Undisbursed Balance				
	(In millions of U.S. dollars)						
IBRD lending operations 1/ 64 loans closed 2/ 9 active loans:							
-Telecommunications & postal sector		9.0		1.5			
-TEERP (Ain Temouchent)		83.5		15.1			
-Budget system Modernization		23.7		21.9			
-Energy and mining TA		18.0		8.2			
-Financial system Infrastructure		5.2		3.4			
-Transport technical Assistance		8.7		6.7			
-Mortgage finance TA		5.5		1.9			
-Urban natural hazard Vulnerability		88.5		83.0			
-Second rural Employment		95		90.4			
Total active loans		337.0		232.1			
Repayments 3/ Debt outstanding 3/		3,671.8 822.4					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Net lending by the World Bank (by fiscal year) 4/							
Commitments	98	42	31	183	0	0	0
Disbursements	69	57	90	51	51	27	10.6
Debt service	316	286	306	296	270	224	53.3
Principal	188	162	194	201	197	174	41.0
Interest 5/	128	124	112	95	73	50	12.3
Net transfer 6/	-247	-229	-216	-245	-219	-197	-42.7

1/ IDA has no operations in Algeria.

2/ Less cancellations, includes adjustment lending.

3/ As of November 1, 2005.

4/ Fiscal years start July 1 and end June 30.

5/ Includes charges.

6/ Equal to disbursements minus debt service.

### **Algeria: Statistical Issues**

Algeria's data provision to the Fund is still broadly adequate for effective surveillance, but there are serious weaknesses particularly in government finance statistics. Since the late 1990s, the reporting of statistics to the Fund has generally deteriorated, particularly with respect to overall quality and timeliness. The lack of financial resources allocated to the compilation of statistics, insufficient inter-agency coordination, as well as concerns about accuracy and subsequent reluctance to publish provisional data, are partly responsible for this situation.

The September 2002 multisector statistics mission designed an action plan to facilitate Algeria's eventual subscription to the Special Data Dissemination Standard (SDDS). STA believes that the optimal strategy is participation in the General Data Dissemination System (GDDS) as an interim step. The GDDS would provide a comprehensive and consistent framework for improving Algeria's statistics, attract the required technical assistance from the Fund and other donors, and serve to signal to the world Algeria's commitment to improving statistics. The authorities have stated that they aim for Algeria to participate in the GDDS in the near future.

#### **Real Sector**

Real sector data is reported to STA on an irregular basis and with substantial lags. The latest national accounts information in 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). However, reporting of balance sheet data by some 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 public banks. The September 2002 STA multisector statistics mission recommended expanding further the coverage of the monetary survey to include banking operations of the National Mutual Fund for Agriculture (CNMA) and strictly enforcing the reporting obligations of banks by introducing high penalties.

### **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.

**ALGERIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE**  
**As of December 19, 2005**

	Date of latest observation	Date received	Frequency of Data <sup>6</sup>	Frequency of Reporting <sup>6</sup>	Frequency of publication <sup>6</sup>
Exchange Rates	10/31/05	10/31/05	D	M	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	9/30/05	10/05/05	D	M	M
Reserve/Base Money	10/2005	11/14/05	M	M	M
Broad Money	7/31/05	10/3/05	M	M	M
Central Bank Balance Sheet	10/2005	11/14/05	M	M	A
Consolidated Balance Sheet of the Banking System	7/31/05	10/03/05	M	M	A
Interest Rates <sup>2</sup>	9/30/05	10/3/05	M	M	M
Consumer Price Index	08/05	09/25/05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	06/05	10/01/05	Q	I	A
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	06/05	10/01/05	Q	I	A
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	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

<sup>1</sup>Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

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

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

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

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

<sup>6</sup>Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).

**Statement by the IMF Staff Representative on Algeria**  
**February 13, 2006**

Since the issuance of the staff report, the following information has become available. This information does not alter the thrust of the staff appraisal.

**Inflation in 2005 was lower than projected.** The consumer price index rose on average by 1.6 percent in 2005 as compared with the projected 2.7 percent, mainly reflecting a stronger-than-foreseen decline in food prices.

**International reserves at end-2005 were slightly higher than expected.** Gross official reserves reached US\$ 56.2 billion at end-2005 as compared to the projected level of US\$55.6 billion.

**Free current convertibility of the dinar.** Staff has assessed the jurisdictional implications under Article VIII of certain limits on the making of payments for current international invisible transactions and has concluded that such limits do not give rise to an exchange restriction subject to Fund jurisdiction. However, staff urges the authorities to make the public more aware of the indicative nature of those limits. The authorities have sent staff for comments a new draft regulation on payments and transfers relating to current international transactions, in response to the recommendations of the Fund technical assistance. This draft is currently being reviewed by staff.

**Progress continued on the structural reform front with the parliamentary approval of the anti-corruption law on January 24, 2006.** The law contains a broad definition of corruption, institutes a code of conduct for public servants, and provides for international cooperation.

**Participation in GDDS.** In a letter to the Director of the Statistics Department dated February 6, 2006, the authorities announced Algeria's participation in the General Data Dissemination System (GDDS).



INTERNATIONAL MONETARY FUND

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FOR IMMEDIATE RELEASE  
March 9, 2006

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Executive Board Concludes 2005 Article IV Consultation with Algeria**

On February 13, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Algeria.<sup>1</sup>

### **Background**

The Algerian economy continues to benefit from abundant and increasing hydrocarbon revenues. Real GDP growth is expected to continue at about 5 percent in 2005, led by increased output in the hydrocarbon sector and sustained activity in the construction and services sectors. Inflation is projected to remain low, mainly due to a decline in food prices, and the unemployment rate continued to decline.

Boosted by high oil prices, the external position strengthened further. Despite a continued surge in imports, the external current account surplus is projected to increase further in 2005, reflecting a rapid increase in oil prices as well as an expansion of oil production. Gross external reserves grew by US\$20 billion since end-2003 to US\$53 billion at end-September 2005, covering more than 1½ year of imports. With continued early debt repayment, the external debt-to-GDP ratio is expected to decline further from 26 percent in 2004 to 16½ percent in 2005.

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. 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.

In the context of buoyant hydrocarbon revenue and the need to address infrastructural bottlenecks, the government decided in 2005 to boost public spending and launched a Growth Consolidation Plan for 2005–09 amounting to US\$50 billion. In June 2005, the program was revised upward to US\$57 billion. As a result, the nonhydrocarbon primary deficit is expected to widen from 28 percent of nonhydrocarbon GDP in 2004 to 31½ percent in 2005. Nevertheless, higher oil prices would allow for a stronger overall fiscal position, with the overall surplus increasing almost twofold from 6.9 percent to 12.6 percent of GDP.

Monetary policy remained prudent with the Bank of Algeria (BA) adopting several measures to mop up the rapidly increasing liquidity in the banking sector. As a result, BA was able to absorb most excess bank liquidity. However, BA's policy interest rate remains negative in real terms, despite an increase from ¾ percent in 2004 to 1¼ percent in July 2005. Annual broad money growth continued at about 12 percent through September 2005. Credit to the economy accelerated in the first half of 2005, while the level of nonperforming loans remained high.

Important progress was achieved in structural reforms. The Association Agreement with the European Union (AAEU) became effective in September 2005, and negotiations towards Algeria's accession to the World Trade Organization are in their final stages. The authorities strengthened performance contracts of public bank managers and shareholder oversight, initiated the privatization of a public bank, and made progress in modernizing the payments system. A new hydrocarbon law was adopted that further liberalizes investment in this sector. The government has also submitted an anti-corruption law to parliament.

### **Executive Board Assessment**

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

Looking forward, Directors agreed that prospects are favorable for sustaining strong economic growth and further reducing unemployment, especially among the young. In view of the greater competition resulting from further external trade liberalization, Directors underlined the importance of speeding up priority reforms aimed at encouraging private sector investment and job creation, and accelerating the transition to a market economy. The considerable increase in hydrocarbon revenue provides an excellent opportunity to step up the pace of economic and social development.

Directors noted the authorities' decision to use part of the fiscal space created by the higher hydrocarbon revenues to increase public investment. The investment program appropriately envisages building much-needed public infrastructure, developing human capital, improving public services, supporting economic activity, and expanding housing. While some caution was expressed concerning the somewhat front-loaded distribution of investments in light of constraints on absorptive capacity, Directors generally

supported the authorities' strategy of making upfront expenditure authorizations as a signal to economic agents that investment resources will be available over a longer time horizon. At the same time, Directors stressed that the high quality of public spending needs to be assured. In this context, they welcomed the authorities' intention to take into account the recommendations of the ongoing public expenditure review undertaken in cooperation with the World Bank.

Directors welcomed the authorities' resolve to maintain fiscal sustainability over the medium term. They stressed the importance of preparing comprehensive medium-term budget projections, and limiting increases in real wages to increases in productivity in the non-hydrocarbon sector in order to preserve Algeria's competitiveness as the economy opens up further.

Directors emphasized that sound management of hydrocarbon wealth will be critical to maintaining macroeconomic stability and enhancing the competitiveness of the nonhydrocarbon sector, and advised setting fiscal policy within a long-term framework. Appropriate coordination between fiscal and monetary policies and the continued transparent use of hydrocarbon revenues will also be needed. Directors welcomed the authorities' intention to reconsider the role of the oil stabilization fund—the *Fonds de régulation des recettes* (FRR)—including transforming it into a savings/financing account; such an account should be fully integrated into the budget. Some Directors encouraged Algeria to participate in the Extractive Industries Transparency Initiative.

Directors commended the authorities for the prudent conduct of monetary policy that has kept inflation under control. However, the planned increase in public investment and the current strong growth of credit to the economy could complicate monetary management. Directors encouraged the authorities to consider tightening the monetary stance by raising the Bank of Algeria's (BA) policy interest rate to a positive level in real terms, and to strengthen the BA control over base money.

Directors welcomed the authorities' commitment to continue implementing the managed float of the exchange rate of the dinar in a flexible manner. They noted the pressures for a real appreciation resulting from the increase in oil prices and the current economic growth. Directors encouraged the authorities to continue their commendable work toward ensuring the free convertibility of the dinar for international current transactions, in line with recent Fund technical assistance recommendations.

Directors welcomed the authorities' reform program to develop a stronger and more efficient banking system. They urged the authorities to push ahead with the privatization of several public banks, improve the management and governance of the remaining public banks, and promote competition in the sector. Continued improvement of the operational framework for financial intermediation, including by ensuring that the banking commission can enforce prudential regulations effectively, will be critical. Directors encouraged the authorities to continue the ongoing modernization of the payments system, as well as their capacity building efforts in banking supervision, with Fund technical assistance.



Directors welcomed Algeria's commitment to trade liberalization and the ratification of the AAEU in 2005. They encouraged the authorities to step up the negotiations for the country's accession to the World Trade Organization. They considered that regional trade facilitation and integration would enhance the positive impact of the AAEU and help attract foreign direct investment.

Directors urged the authorities to take advantage of the current favorable economic conditions to accelerate their efforts at improving the business environment to support private sector-led growth. Adequate resources need to be mobilized in support of further market-based reforms, including to limit the social cost of priority reforms in the public banking and public enterprise sectors. The tax system should be streamlined by eliminating exemptions, and the tax burden on businesses should be reduced in order to stimulate investment and job creation. Directors recommended reducing further the state's direct involvement in the productive sectors, and subjecting all remaining public enterprises to annual external audits in line with international standards, and publishing the results.

Directors praised the authorities' policy to prepay external debt, and welcomed Algeria's voluntary advance repurchase to the Fund. They encouraged the authorities to continue their efforts to seek a settlement of bilateral debt issues with Russia.

Directors welcomed the authorities' support for the HIPC Initiative, but encouraged their full participation in the Initiative.

Directors welcomed the authorities' decision for Algeria to participate in the General Data Dissemination System (GDDS). They encouraged them to continue their efforts to improve data coverage, quality, and timeliness, in order to support effective policy making.

**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. The staff report for the 2005 Article IV Consultation with Algeria is also available.

Algeria: Selected Economic Indicators

	2001	2002	2003	<u>Est.</u> 2004	<u>Proj.</u> 2005
(Annual percentage change, unless otherwise indicated)					
Domestic Economy					
Real GDP	2.6	4.7	6.9	5.2	5.3
GDP deflator	0.7	1.9	8.3	10.6	14.9
Consumer price index (average)	4.2	1.4	2.6	3.6	2.7
Gross national savings (in percent of GDP)	40.1	38.8	43.5	46.3	51.6
Gross national investment (in percent of GDP)	27.3	31.2	30.5	33.3	33.3
(In billions of US dollars, unless otherwise indicated)					
External sector					
Exports, f.o.b.	19.1	18.7	24.5	32.2	45.8
Imports, f.o.b.	9.5	12.0	13.4	18.0	22.3
Current account (in percent of GDP)	12.8	7.6	13.0	13.1	18.3
Capital account balance	-0.7	-0.7	-1.4	-1.9	-4.0
Gross official reserves	18.0	23.1	32.9	43.1	55.6
Idem, in months of next year's imports	14.9	17.0	18.1	19.0	21.0
External debt (in percent of GDP)	40.9	39.7	34.3	25.7	16.4
Debt service ratio (in percent of exports)	22.8	22.6	17.9	17.6	12.1
Terms of trade (deterioration -)	-7.8	-8.8	9.3	13.0	26.3
Real effective exchange rate (depreciation -) 1/	2.9	-7.8	-10.7	0.4	-3.6
(In percent of GDP)					
Central government finance					
Total revenue	34.7	35.3	37.0	36.2	40.8
Total expenditure and net lending	31.3	35.0	29.2	29.3	28.2
Overall budget balance (deficit-)	3.4	0.2	7.8	6.9	12.6
(Annual percentage change, unless otherwise indicated)					
Money and credit					
Net foreign assets	68.9	33.9	33.4	33.1	33.1
Domestic credit	-1.1	8.0	-1.4	-8.6	-14.5
Credit to the government (net)	-5.3	0.4	-5.3	-13.2	-23.2
Credit to the economy	8.5	17.5	8.9	11.2	21.1
Broad money	22.2	17.4	15.6	11.5	13.4
Interest rate (central bank rediscount rate, in percent) 2/	6.0	5.5	4.5	4.0	4.0

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

1/ For 2005, as of August.

2/ For 2005, as of September.

**Statement by Abbas Mirakhor, Executive Director for Algeria**  
**February 13, 2006**

As underscored in the staff report and in previous Board meetings, Algeria has progressively strengthened macroeconomic stability in recent years, and has taken important strides in reforming and liberalizing its economy. As a result, the country has achieved high growth, significant reduction in unemployment, and substantial improvement in the living standard of the population. To fully consolidate macro stability and achieve sustainable higher growth, reform efforts will be enhanced with greater reliance on an expanded role for the private sector as the engine of growth. The authorities have seized the opportunity of the increase in international hydrocarbon prices to accelerate the pace of fiscal consolidation, saving most of the additional revenue, maintaining control over current spending, and using part of the available fiscal space to increase the much needed capital expenditure.

Underpinned by the 2003-05 Economic Recovery Program, growth averaged more than 5 percent, real per capita GDP increased by 4 percent a year on average, and the unemployment rate fell from 23.7 percent to 15.3 percent. The central government's fiscal position recorded a surplus of more than 9 percent of GDP on average over the past three years, as against virtual balance in 2002. Additional hydrocarbon revenues and prudent fiscal stance, combined with active debt management policy, led to a decline in gross government debt-to-GDP ratio by half over the period—on a net basis, the government debt-to-GDP ratio decreased from 38 percent to 4 percent. Over the same period, the current account recorded an annual surplus of more than 14 percent on average, while the ratio of international reserves to external debt increased from 1.0 in 2002 to 3.4 in 2005.

The authorities remain cognizant of the considerable challenges that still lie ahead: high unemployment, with youth unemployment of 32.5 percent; infrastructure in need of considerable further attention; public enterprise restructuring process yet to be completed; and the role of the private sector to be strengthened.

**Recent economic developments**

Real GDP expanded by 5.3 percent in 2005, led by buoyant activity in the construction and services sectors, steady agricultural growth, and higher hydrocarbon production and export. Reflecting prudent fiscal and monetary policies, inflation slowed to 1.6 percent from 4 percent in 2004. Strengthened hydrocarbon and nonhydrocarbon revenues, careful selection and monitoring of capital expenditure, and prudent current spending contributed to further improvement in the fiscal position; overall budget surplus was about 12 percent of GDP despite larger infrastructural investment.

Building on recommendations of a technical assistance mission on liquidity management, the central bank (BA) took additional measures to mop up excess liquidity, including increasing the amount of deposit auctions, extending maturity of a large part of these deposits, raising its policy interest rate, and introducing a 24-hour deposit facility. Despite these actions, credit to the private sector continued to support buoyant activity in the nonhydrocarbon economy leading to further decline in unemployment.

On the external front, strong export revenues offset higher imports due, in part, to the public investment program and the entry into force of the Association Agreement with the European Union (AAEU). The current account surplus strengthened further, exceeding 18 percent of GDP, thus allowing additional accumulation of international reserves. The authorities continued advanced repayment of external debt, including early repurchase of the outstanding financial obligations to the Fund, bringing the external debt-to-GDP ratio to 16.5 percent and the debt service ratio to 12 percent and substantially strengthening external viability. The authorities intend to accelerate early debt repayments in 2006, including to other multilateral creditors.

### **Short- and medium-term policies**

As detailed in the 2005-09 Growth Consolidation Plan (GCP), the authorities reiterate their commitment to address the remaining agenda of reforms. The ongoing and planned policies and reform actions, described below, attest to the strength and seriousness of this commitment. The considerable progress achieved in consolidating political stability and improving the security environment, as well as the strong financial position, provide a fortuitous opportunity for successful implementation of the reform agenda.

Fiscal sustainability remains the centerpiece of the medium-term strategy. The strong fiscal performance over the past several years has allowed for a sizable accumulation of savings, thus providing resources for the implementation of the public investment program under the GCP. The authorities are carefully considering staff's recommendation for the management of the hydrocarbon revenues in the context of a longer-term fiscal framework. They look forward to further consultation with the staff on this issue as well as on the possibility of transforming the stabilization fund into a savings/financing account that would be fully integrated into the budget.

The authorities remain vigilant to the need to balance accumulation of financial savings for intergenerational equity and the more urgent demands for infrastructure, education, health, and other social spendings. While acknowledging the appropriateness of the authorities' investment program, staff raise concerns regarding the front-loading of the planned spending. However, it should be noted that the budgeted capital spending is more evenly distributed over the 2005-09 period (Table 3 of the staff report) than implied in paragraph 15 of the staff report.

The front-loading of the program authorizations reflects identified programs that are scheduled to be completed over the period of several years. The authorities view the process of upfront expenditure authorizations as a signal of the assurance to economic agents of the

availability of the necessary resources over the horizon of the investment period. Actual annual appropriations will be allocated in the future budgets, with due consideration to the selection and monitoring of the projects, their macroeconomic implications as well as to the absorptive capacity constraints. They are fully cognizant of the latter limitation and the potential risk of adverse impact of an unsustainably rapid pace of implementation on the quality of spending. The ongoing public expenditure review with World Bank assistance should lead to adoption of measures that would mitigate against such risk. Along with the rationalization of capital expenditure, efforts to contain current spending will be sustained, including through a prudent wage policy to preserve the competitiveness of the economy.

In view of the volatility of hydrocarbon prices, priority is attached to enhancing nonhydrocarbon revenues; important progress is being made to improve tax administration. Particularly noteworthy is the launching of operations of the large taxpayers department, the transfer of remaining non-tax functions to the treasury, the simplification of identification procedures, and progress in restructuring the tax office network for the remaining taxpayers. Along with Fund technical assistance, the tax modernization strategy is benefiting from other multilateral (World Bank and the European Union) and bilateral assistance. Further, the authorities are considering staff's recommendation for a tax policy review.

The flexible exchange rate regime continues to serve the economy well, and BA remains committed to monitoring developments in line with its objective of minimizing deviations of the real effective exchange rate from its equilibrium level. In view of increased trade liberalization in the context of the AAEU and the expected WTO membership, a recent Fund technical assistance mission has suggested a number of useful recommendations aimed at improving the exchange rate and payments systems. The authorities are taking steps to implement these recommendations: they have already drafted a new, unified regulatory framework and have requested the mission's comments on the draft before its final approval. They look forward to receiving the TA mission's final report to take further actions as needed.

Financial sector reform has received strong political support as a priority in the authorities' agenda, and important progress is being made in this area. In addition to strengthening banking supervision, the authorities have articulated a reform strategy based on the FSAP recommendations. Accordingly, the privatization of one public bank is well advanced; a contract has been signed recently with a foreign investment bank to assist in implementing the process in 2006. Preliminary indications suggest strong interest from reputable foreign strategic investors. The authorities attach high importance to the success of this process as it will have a positive demonstration effect on the envisaged privatization of two other public banks already slated for divestiture. Other ongoing reforms in the sector include:

- modernization of the payment system, entailing improved information and accounting systems. The new Real Time Gross Settlements system will be launched shortly, and the Retail Payments system will be established later this year. In addition to improving financial intermediation, this will contribute to enhancing the quality and timeliness of data reporting, including in the area of public finances and further facilitating enhanced supervision;

- improving governance in the banking sector, particularly through strengthened performance contracts and the replacement of quasi-fiscal activities with direct budget support in line with FSAP recommendations. These and other steps in the context of the ongoing MFD technical assistance should address decisively the issue of nonperforming loans in public banks; and
- consideration of options to improve performance of the remaining public banks, including through corporatization and the use of management contracts.

It is worth noting that, as required by the Banking Commission, all public banks are currently being audited by reputable international auditing firms. The audit reports should provide further guidance in improving the institutional capacity and financial performance of these banks.

To strengthen the insurance sector, the parliament has passed a new law that establishes an independent supervisory commission and a guaranty fund, and allows participation of foreign insurance companies in this sector. The parliament has also adopted a law on the securitization of mortgages that should further encourage the development of this market. This effort will be enhanced through measures that would facilitate the issuance of property titles. Moreover, a draft law on establishment of investment funds has been submitted to parliament for approval. To further deepen the domestic financial market, the authorities are preparing legislation that would allow creation of credit unions.

Sustained efforts have been made thus far to reduce the role of the public sector in the economy, with this sector now representing only 20 percent of nonhydrocarbon value-added. As can be viewed from the table below, important privatization efforts in various sectors have been made over the past three years.

	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>Total</b>
Total privatization	6	9	52	67
Partial privatization	1	4	17	22
Divestment for workers	8	23	29	60
Partnership	4	10	4	18
<b>Total</b>	<b>19</b>	<b>46</b>	<b>102</b>	<b>167</b>

In addition, contracts with foreign companies to manage water distribution are either signed or are under consideration. Strong efforts are being made to advance further the divestiture process.

In March 2005, the parliament approved a new law to strengthen competition in the hydrocarbon sector. As summarized in Box 3 of the staff report, the law introduces major developments in the sector. Particularly noteworthy aspects of the law are:

- elimination of the obligation for foreign investors to enter into partnership with Sonatrach, the national oil company;
- liberalization of transportation and downstream activities in the hydrocarbon sector;
- establishment of two regulatory agencies, one responsible for tendering upstream contracts and the other for issuing downstream permits; and
- establishment of investors' rights and obligations.

The authorities are committed to further improvements of the business climate to support expansion of private investment and accelerate growth. To this end, a high-level, multi-sector task force, assisted by the World Bank, has been established recently to propose policies. Based on the recommendations of the task force, concrete actions would be taken in the course of the year. Efforts are also directed to improving governance, e.g., adoption of a new law on combating corruption and the strengthening of the judiciary system. Moreover, an organic law governing public finances is drafted for submission to the parliament.

There has been considerable improvement over the past years in data provision, and the authorities are determined to address the remaining weaknesses, consistent with Fund advice. To this end, they have subscribed to the Fund's General Data Dissemination System.

As in the past, my Algerian authorities look forward to the Board discussion of this year's Article IV report and to the views and guidance of Executive Directors. They appreciate the participation of the Managing Director in the ongoing trade facilitation process among the Maghreb countries.