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IMF Executive Board Concludes 2008 Article IV Consultation with Algeria

On January, 21, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Algeria.[1]

Background

Algeria has enjoyed several years of strong economic performance, but continues to face important challenges. Non-hydrocarbon growth has been solid, inflation low, and the fiscal and external positions strong, thanks to high hydrocarbon prices. External debt has been virtually eliminated, and the government has accumulated large savings in the oil stabilization fund (FRR). However, youth unemployment remains high, the economy is highly dependent on hydrocarbon exports, the non-hydrocarbon private sector is mainly inward oriented, and productivity and business climate are lagging compared to trading partners. The global financial crisis and declining oil prices highlight the pressing need to accelerate structural reforms to diversify the economy and ensure sustained non-hydrocarbon growth and job creation.

Economic performance remained relatively favorable in 2008. Growth in the non-hydrocarbon sector, which represents 55 percent of total GDP, reached about 6 percent, as the large public investment program (PIP) continued to pull activity in services and construction. Overall growth is projected at below 3 percent, as hydrocarbon exports remained sluggish. Inflation is among the lowest in the region. Boosted by increasing oil prices until mid-2008, international reserves stood at US$135 billion in October (2 ½ years of imports). The fiscal

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

stance has been expansionary, but large hydrocarbon revenues translated into an overall budget surplus of 8 percent of GDP. Additional savings were accumulated in the oil stabilization fund, which reached 37 percent of GDP. The real effective exchange rate continued to be close to its equilibrium level.

The outlook remains encouraging despite the challenging international environment, but medium-term risks may become significant. Algeria appears insulated from direct financial contagion given the predominantly public financial sector, minimal external indebtedness, and prudent management of international reserves. Non-hydrocarbon GDP growth is projected at about 6 percent in 2009, provided the government and the national hydrocarbon company, Sonatrach, draw down their savings to continue their substantial investments. Reflecting a slowdown of growth in Europe, staff projects a drop in the volume of hydrocarbon exports, bringing overall growth down to 2 ½ percent. Inflation would stay below 4 percent. The significant decline in oil prices and high imports induced by PIP and Sonatrach investments would shift the current account balance from a surplus of 20 percent of GDP in 2008 to a deficit of 3 percent in 2009, but the reserve cover would remain above 2 years of imports. The most important risk in the medium term would be continued low international oil prices, which would significantly weaken the external and fiscal positions, force a slow down of the PIP and other investments, and depress growth.

There was some progress in structural reforms, but the business climate needs to improve. The authorities have launched various initiatives aimed at increasing the banking system's lending capacity, including budget appropriations for public bank capital and some financial restructuring of public enterprises. Loan syndication and project finance techniques have been used for large investments, as well as further corporate bond issues. Longer maturity government bonds have been listed on the Algiers stock exchange to improve price dissemination. The central bank's credit bureau is being extended to household loans. Efforts are also ongoing to deepen Algeria's integration into the regional and world economies. Nevertheless, these reforms have not yet translated into an improvement in the perception of the business climate, which continues to be ranked behind most regional competitors.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They welcomed Algeria's strong economic performance in recent years, with solid non-hydrocarbon growth and low inflation. In particular, they commended the authorities for their sound policy stance that has enabled the accumulation of large external reserves and resources in the oil stabilization fund.

Directors observed that the immediate priority is to adopt adequate policies in response to the global crisis. They noted that Algeria's economy and financial system are relatively insulated from the global financial turmoil. However, the significant decline in oil prices, if sustained, will shift the external and fiscal positions into deficits, and, together with a prolonged recession in major trading partners, could eventually weigh on growth. Algeria also continues to face important medium-term challenges. Sustained efforts are needed to diversify the economy and reduce dependence on the hydrocarbon sector, improve productivity and the business climate, both of which are lagging relative to trading partners, and reduce high youth unemployment.

Directors endorsed the authorities’ decision to maintain the high level of public spending in the short term to provide support to the economy and mitigate the impact of the global economic downturn. They observed that continuing the implementation of the Public Investment Program would improve infrastructure, enhance human capital, and help reduce unemployment. Directors noted that the fiscal deficits can be covered in the short term by drawing on the significant savings accumulated in recent years through prudent financial policies.

Directors welcomed the authorities’ commitment to preserving competitiveness and long-term fiscal sustainability by containing current outlays, in particular the wage bill and subsidies. In that light, they supported plans to link future wage increases to productivity and economic performance. Directors stressed the need to continue ensuring the quality and efficiency of public spending, enhancing non-hydrocarbon tax collection, modernizing the budget process, and strengthening fiscal governance. Directors also welcomed the authorities’ readiness to further prioritize the public investment program and their commitment to contain current expenditure and strengthen non-hydrocarbon revenues if risks of durably low oil prices materialize.

Directors commended the authorities’ prudent monetary policy, which has succeeded in absorbing the banking system’s structural liquidity surplus, and keeping inflation under control. They saw room for reducing interest rates, if needed, to help sustain domestic demand.

Directors considered that Algeria’s exchange rate policy is consistent with external stability. They generally agreed with the staff’s assessment that the exchange rate is broadly aligned with fundamentals, though noting that the assessment was sensitive to oil price volatility. Directors believed that the needed improvement in external competitiveness hinges on advancing structural reform.

Directors viewed financial sector reform as key to improving productivity, diversifying the economy, and sustaining non-hydrocarbon growth. They observed that the banking sector has coped well with the global financial crisis. Directors noted the importance of pursuing the implementation of the recommendations of the 2007 Financial Sector Assessment Program Update. In particular, it is important to continue strengthening banking supervision and regulation, reducing state involvement in the banking sector, improving the operational environment for financial intermediation, and encouraging non-bank financing.

Selected Economic Indicators

	2004	2005	2006	Prel. 2007	Proj. 2008
(Annual percentage change, unless otherwise indicated)					
Domestic Economy					
Real GDP	5.2	5.1	2.0	3.0	3.0
Hydrocarbon sector	3.3	5.8	-2.5	-0.9	-0.6
Other sectors	6.2	4.7	5.6	6.3	5.8
Consumer price index (average)	3.6	1.6	2.5	3.5	3.9
Gross national savings (in percent of GDP)	46.2	51.8	54.9	57.2	55.5
Gross national investment (in percent of GDP)	33.2	31.2	29.7	34.6	35.2
(In billions of US dollars; unless otherwise indicated)					
External sector					
Exports, f.o.b.	32.2	46.3	54.7	60.6	78.2
Imports, f.o.b.	18.0	19.9	20.7	26.4	36.3
Current account (in percent of GDP)	13.1	20.6	25.2	22.6	20.2
Gross official reserves	43.1	56.2	77.8	110.2	138.9
Idem, in months of next year's imports	21.0	26.5	28.0	27.4	31.0
External debt (in percent of GDP)	25.6	16.7	4.8	3.8	3.0
Debt service ratio (in percent of exports)	17.6	12.5	23.8	2.4	1.7
Terms of trade (deterioration -) (annual percent change)	15.5	33.0	12.4	1.0	15.2
Real effective exchange rate (depreciation -) (annual percent change) 1/	0.6	-4.0	0.0	-1.0	-1.2
(In percent of GDP)					
Central government finance					
Total revenue	36.1	40.9	43.0	39.6	45.0
Total expenditure and net lending	29.2	29.0	29.4	35.1	36.7
Overall budget balance (deficit-)	6.9	11.9	13.6	4.5	8.2
(Annual percentage change, unless otherwise indicated)					
Money and credit					
Net foreign assets	33.1	34.0	31.9	34.5	19.6
Domestic credit	-8.6	-17.8	-5.9	-11.9	-17.0
Credit to the government (net)	-13.2	-24.4	-8.9	-18.0	-23.0
Credit to the economy	11.2	15.9	7.1	15.7	16.1
Broad money	11.5	11.1	18.6	24.2	13.2
Interest rate (central bank rediscount rate, in percent)	4.0	4.0	4.0	4.0	4.0

Sources: Algerian authorities; and IMFstaff estimates and projections.
1/ For 2008, as of September.