

ALGERIA

In the first half of 2016, Algeria's economy grew at 3.6 percent compared to 3.9 percent in 2015. The sharp drop in oil prices was compensated by an increase in hydrocarbon production and a high level of public spending. Inflation and unemployment rose and double-digit fiscal and external current deficits deepened. Over the next two or three years, growth is expected to decelerate as the government implements fiscal consolidation measures.

Recent developments

Despite a sharp decline in oil prices and unfavorable weather, Algeria was able to maintain respectable economic growth in 2015 and in the first semester of 2016. In 2015, growth picked up to 3.9 percent due to the first increase of hydrocarbon output in a decade and a stable non-hydrocarbon growth despite the economy being hit by a falling oil price. During the first half of 2016, Algeria sustained fairly strong growth of 3.6 percent (yoy), underpinned by ongoing hydrocarbon production recovering which mitigated slower non-hydrocarbon growth. Hydrocarbon production grew at 3.2 percent during the first semester of 2016 up from -0.8 percent in the same period of 2015. Non-hydrocarbon output eased to 3.8 percent from 5.1 percent in the first semester of 2015. This slowdown was led by a weaker growth in agriculture (due to poor weather), in water and energy, and in other industries. On the demand side, government consumption increased its contribution to growth in 2015 and during the first half of 2016, while the contribution of private consumption and investment declined, see figure 1.

Sustained growth has been achieved at the cost of a widening fiscal deficit, which more than doubled to 16.2 percent in 2015 as the government delayed fiscal consolidation. The deficit widened further in the first semester of 2016, as the government had difficulty implementing the fiscal measures contemplated in the 2016 Budget

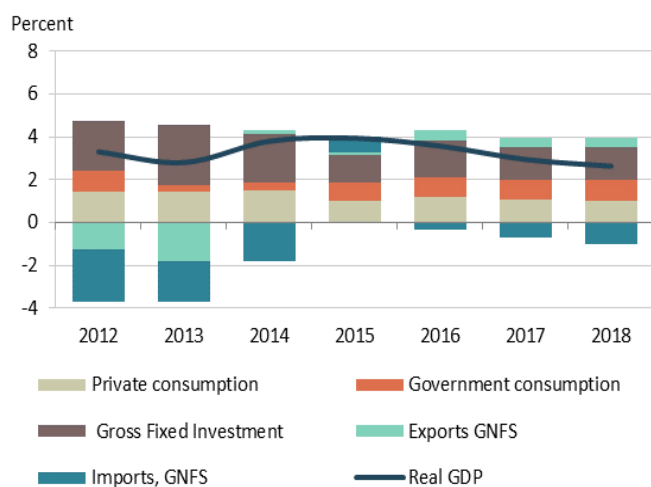
law. The latter calls for a 9 percent cut in expenditure (mostly investment) and a 4 percent increase in tax revenue, based on a 36 percent hike in gasoline prices and higher taxes on electricity and on car registrations. The budget also empowers finance authorities to approve further cuts if oil prices fall lower than its average oil price assumption, and to engage in external borrowing if needed. However, in Q1 2016, government spending skyrocketed (up roughly 60 percent yoy), indicating difficulties in implementing fiscal consolidation.

The current account deficit remained stable at 16.5 percent of GDP in 2015 but worsened during the first semester of 2016. The value of imports decreased by 11.8 percent in 2015 and 8.7 percent (yoy) in Q1 2016, too little to compensate for the 42.3 percent and 36.6 percent (yoy) fall in exports in 2015 and in Q1 2016 respectively. In 2016, new import licenses were introduced to further curb the current account deficit.

Despite tight monetary policy, inflation rose to 4.8 percent in 2015, in part reflecting pass-through from a roughly 20 percent nominal depreciation of the dinar, aims at correcting the external imbalance. In the H1 2016, monetary authorities allowed the dinar to further depreciate as the authorities tried to avoid a sharp drop in foreign exchange reserves and maintain reserves at US\$100 million or above. The depreciation of the dinar should keep inflation pressures high, with inflation projected at 5.9 percent in 2016.

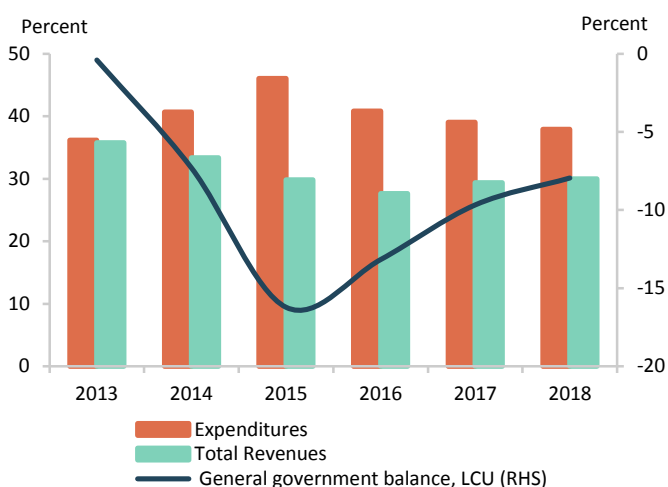
Persistently high youth unemployment hampered poverty and inequality reduc-

FIGURE 1 Algeria / Contributions to annual GDP growth



Sources: IMF and World Bank Staff estimates and projections.

FIGURE 2 Algeria / Fiscal position



Sources: IMF and World Bank Staff estimates and projections.

tion. In 2015, unemployment rose to double digits (11.2 percent), has not significantly changed in the first half of 2016 and is acute among women (16.6 percent) and youth (29.9 percent). The poor rely heavily on subsistence agriculture for income generation. In urban areas, informal jobs are predominant among the poor. The formal sector is dominated by civil servants and employees of state-owned enterprises.

Outlook

Real GDP growth is expected to slow to 3.6 percent in 2016 and to ease further to 2.6 percent in 2018. In 2017 and 2018, a substantial increase in hydrocarbon output, as new oil wells start to produce, will mitigate the negative effect of the projected oil price decline on the real non-oil sectors. High unemployment is expected to weigh on household spending. The baseline assumes that the government will make some progress in fiscal consolidation. Still, the fiscal deficit is expected to remain large at about 13.2 percent of GDP in 2016 (albeit gradually, narrowing to 8.0 percent in 2018) as low oil prices weigh on fiscal receipts. With fiscal savings (Fonds de Régulation des Recettes, FRR) depleted, the deficit is expected to be financed by the issuance of new debts with the debt

-to-GDP ratio projected to rise from 13.6 percent of GDP in 2016 to 25.1 percent in 2018. The current account deficit is projected to slightly narrow from 15.5 percent of GDP in 2016 to 10.4 percent in 2018.

Risks and challenges

This outlook is subject to at least two key downside risks: oil price volatility and social discontent. Reliance on hydrocarbon revenues makes Algeria still highly vulnerable to volatility in global oil prices in the face of substantial global oil inventories, and weaker than anticipated recovery in demand. A fall in oil prices may also impact investment in the hydrocarbon sector. Mounting social discontent from government spending cuts, tax hikes and high youth unemployment levels also pose a risk. The political will and national consensus to rationalize inefficient, inequitable and costly subsidies is emerging, but such reform requires improved safety nets, a cash transfer system reaching the needy, a solid media campaign facing opposition during its implementation, and, a stronger statistical system that allows monitoring of households' living conditions more frequently. None of these accompanying measures are, or expected to be, in place in the short run.

TABLE 1 Algeria / Macro outlook indicators

(annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
Real GDP growth, at constant market prices	2.8	3.8	3.9	3.6	2.9	2.6
Private Consumption	5.0	4.4	3.3	4.1	3.5	3.5
Government Consumption	0.8	1.1	2.6	2.7	2.8	2.8
Gross Fixed Capital Investment	8.6	6.4	3.0	4.7	4.3	4.3
Exports, Goods and Services	-5.7	0.2	0.5	1.9	1.5	1.7
Imports, Goods and Services	10.0	8.6	-3.3	1.6	3.6	5.1
Real GDP growth, at constant factor prices	2.3	4.0	4.5	4.2	3.4	3.1
Agriculture	8.2	2.5	7.6	4.8	4.9	4.5
Industry	2.3	3.4	4.1	4.5	3.2	3.2
Services	-0.3	5.6	3.7	3.4	3.0	2.4
Inflation (Consumer Price Index)	3.3	2.9	4.8	5.9	4.8	4.3
Current Account Balance (% of GDP)	0.4	-4.4	-16.5	-15.5	-14.3	-10.4
Fiscal Balance (% of GDP)	-0.4	-7.3	-16.2	-13.2	-9.7	-7.9
Debt (% of GDP)	7.7	8.0	9.2	13.6	18.1	25.1
Primary Balance (% of GDP)	-0.1	-7.0	-15.9	-12.8	-9.2	-7.4

Sources: World Bank. Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Note: f = forecast.