NOOZZ.com
bringing business closer

Algeria:

Risk

January 2019

ALGERIA

Summary

Algeria faces an era of economic and political stagnation and concerns over its fiscal management as it embarks on consolidation under an ageing leader.

Economic risk (MEDIUM): The economy is likely to endure a slowdown as the government reverts to fiscal consolidation.

Political risk (HIGH): President Abdelaziz Bouteflika's age and ill health have raised concerns over the succession process. There are concerns that he will remain in power until 2024 when he will be 87.

Financial risk (LOW): With its closed financial system Algeria is largely immune to global volatility. Falling oil prices increased risks of financial instability so a rebound has eased pressure.

Commercial risk (MEDIUM): The government has worked with the World Bank on business law reforms and Algeria has its poor ranking in the Bank's Doing Business Report.

Vital Statistics

GDP (2016)	US$159.0bn
GDP growth (year, 2016)	3.5%
Current account balance (% GDP, 2016)	-16.5%
Population (2016)	40.0%
Poverty rate (2015)	5.5%
Income level	Upper middle income
GNI per capita (2016)	US$4,220

Source: World Bank Global Economic Prospects database, 2019

ALGERIA

Economic risk

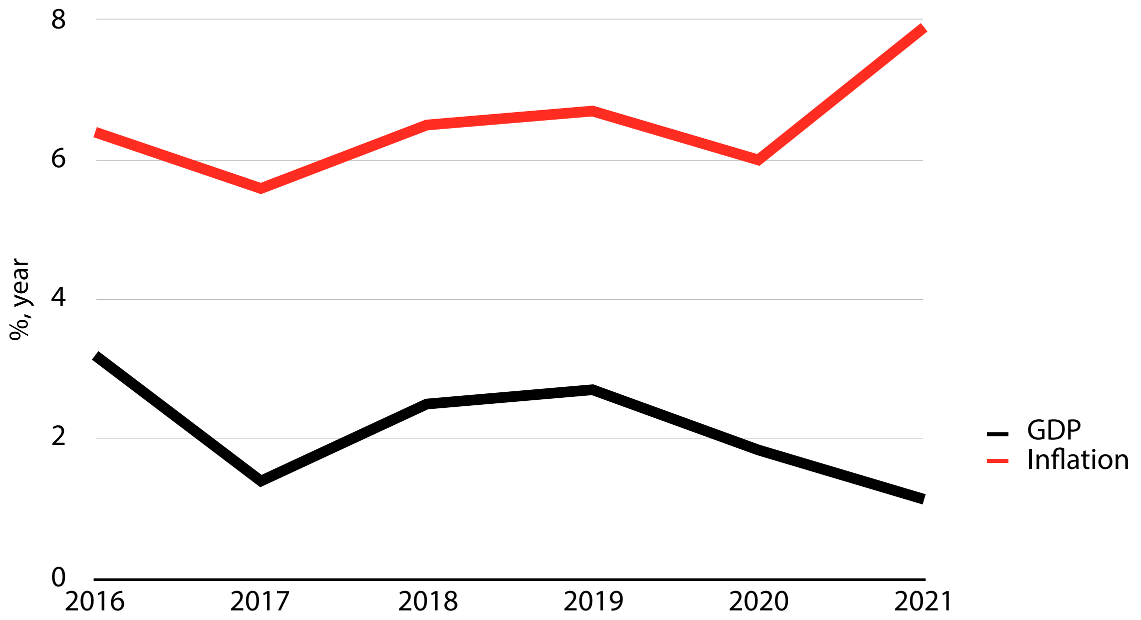
The fiscal consolidation package set out in the draft 2019 budget will lead to a major slowdown as the government recoups the lost ground in terms of deficit reduction after its decision to pump up growth in 2018. The aim to reduce the budget deficit to 9.2% of GDP in 2019 from a likely 10.2% in 2018 will see a cut in government spending that will filter through to lower growth. Its decision to rule out privatisations will require savings to be made elsewhere. A mild decrease in oil and gas production under the Opec agreement will compound a slowdown in non-hydrocarbon sector which most likely will bear the brunt of the programmed fiscal consolidation. The economy is heavily reliant on hydrocarbons for its exports and government revenues, standing at 95% and 75% respectively. Given the succession of downgrades by major forecasters, the risk is weighted towards further disappointment. The growth in the size and output of the non-oil sectors has offset the impact on headline growth although there are signs that its contribution is slowing down. Sustained fiscal deficits are likely to require significant monetary finance, the government's chosen alternative to external borrowing. Inflationary pressures will therefore continue.

The 2019 budget envisages a 1.5% cut to spending, which will help the public finances after 2018's spending spree will entail a return to austerity seen in the previous two years: spending was cut 14% in 2017 after 9% in 2016. The IMF, which backed the fiscal consolidation, criticised the stimulus for exacerbating imbalances, fuelling inflation and accelerating the loss of international reserves. It has hailed the plans under the medium term budget framework (MTBF) to bring the deficit close to zero. If the authorities had implemented the MTBF immediately, non-hydrocarbon growth would have slowed to close to zero in 2018 — a sharp deviation from the likely outturn. On the other hand, such a sharp deceleration in growth would have worsened unemployment, dampened non-hydrocarbon revenues, increased financial stability risks, and heightened social tensions. Those risks will become more a concern now that fiscal expansion has been reversed.

Failure in the government's efforts to diversify the economy away from hydrocarbons raise the risk of lower growth and higher fiscal and current account deficits. In the short term revenues from non-hydrocarbon sectors are holding up and the government can call on the oil stabilisation fund, which currently contains funds worth 32% of GDP. The fall in the oil price from 2014 to 2016 eroded its finances, trade balance and international reserves although the price rebound following the September 2016 OPEC deal has relieved the pressure. While large current account deficits cannot be sustained over the long-term, the country has sufficient official reserves to pay for 25 months of imports. However reserves have already shrunk from $194bn in 2013 to $88.6bn at the end of July 2018, and are projected by the World Bank to decline further to $60bn during 2018. The current account deficit should shrink as a result of lower imports. The government's plan targets 7% growth and focuses on industrial sectors such as automobiles, mining and processing sectors. A two percentage point hike in VAT is likely to push up inflation, which is still above the central bank's 4% target after a few months of contained price pressures and could breach 15% a year by 2020. The ousting of the central bank governor, who had been criticised over the depreciation of the dinar and its impact on inflation, appears not to have unsettled markets although the dinar is showing worrying signs of being a long term depreciation. For now, forecasts for Noozz indicate a further 23% depreciation by 2021.

ALGERIA

GDP growth and inflation



Source: IMF World Economic Outlook database, October 2018

Political risk

Political succession remains an issue. President Abdelaziz Bouteflika, 81, has been dogged by health problems since 2005. He suffered a stroke in 2013 that has limited his public appearances to a handful of largely ceremonial occasions. Confirmation that he will contest his fifth successive election in April 2019 means that if he serves his full five years, he will be 87 at the end of his term. In a rare public appearance in November 2018 at a ceremony to honour fighters in the country's independence war, Bouteflika looked frail and hunched in a wheelchair. The decision indicates that Algeria's political and military power brokers have been unable to agree on a successor. The president's brother Said Bouteflika is understood to be well connected to the heads of leading companies that have benefited from the economic boom. In September 2018 the president was flown to Geneva for what his office said was for "periodic medical checks". He is now back in the country. He won a fourth term in office in 2014 with 81% of the vote. In April 2018 Prime Minister Ahmed Ouyahia confirmed he will not run in the elections, leaving the political succession uncertain. In June 2018 one possible successor, national police chief Abdelghani Hamel, was ejected from the president's inner circle. The new constitution, which limits the number of successive terms to two, should prevent such a political monopoly in the future although Bouteflika will be allowed to run for a fifth term. The last presidential election saw a 50% abstention rate and it could reach a record high in 2019. Bouteflika's decision earlier in 2016 to dissolve the country's state intelligence service and replace it with three security departments indicated that the presidency was still proceeding to absorb authority away from the intelligence services. Bouteflika's eventual passing could be the trigger for a renewed power struggle within the ruling regime. The succession is likely to happen behind closed doors, with the military and the political establishment coming to an agreement on

ALGERIA

the candidate. In July 2018 General Ahmed Gaid Salah, Algeria's army chief, told political parties to keep the military out of next year's presidential election, vigorously pushing back against calls for the army to oversee a transition period. Although it is a democracy, the country has been categorised as an authoritarian regime by the Democracy Index compiled by the Economist Intelligence Unit.

Algeria's ruling parties retained their majority in the November 2017 local elections, taking more than 50% of the vote. The two ruling parties, the National Liberation Front (FLN) and the National Rally for Democracy (RND), got 30.56% and 23.21% respectively. The smooth passage of the poll and of elections in May 2017 were seen as partial affirmation of the regime's commitment to greater democracy. Bouteflika's National Liberation Front (FLN) won 164 of the national assembly's 462 seats. However it lost a quarter of the seats it won in 2012 polls but preserved its majority thanks to its ally, the Rally for National Democracy, which won 97 seats, up from 68 in the last election. The poll was overshadowed by a low turnout, public disillusionment over a tepid economy and allegations of political corruption. Algeria was not directly affected by the Arab Spring revolutions.

The continuing high level of unemployment, which broke through the 10% mark in 2016 risks fuelling social unrest, power struggles, and political violence. The jobless total is forecast to rise to 20% among the university workforce; youth unemployment has already hit 30%. Rising inflation, weaker domestic demand, and growing unemployment could be potent triggers for renewed civil unrest. There is little sign of dissent at the moment, and the extra government spending in 2018 will lessen the risk of an outbreak of tensions. Algeria appears vulnerable to political unrest and large scale labour strikes because of complaints over inadequate housing, high unemployment rates and inadequate utilities. The slowdown has put into question the government's ability to maintain its high level of spending that has been a key component to maintaining domestic security. In late 2016, the International Crisis Group issued a report to sound the alarm bell over the situation and the consequences of growing popular resentment.

The crash of a military plane in April 2018 killing 257 people has left the country in shock. Bouteflika ordered three days of mourning for what was the country's worst aviation disaster. Most of the dead were army personnel and their families. The National Liberation Army — which grew out of the fighting force which freed Algeria from French colonial rule — is revered by Algerians. The plane crashed in Algeria's Blida Province, 30km southwest of the capital Algiers just moments after it took off from Boufarik military airport.

Algeria has not been immune to Islamic-related terrorist attack and is likely to remain vulnerable. However the number of events has declined as Islamic State (IS) has been driven out of Iraq and Syria. In April 2017 the Ministry of Defence claimed to have killed two terrorists including Noureddine Laouira, leader of the el-Ghoraba militia. In July 2017 police claimed to have broken up an IS militant cell led by a former al Qaeda commander convicted in France more than a decade ago. Officers captured Mohamed Yacine Aknouche, near Tipaza, a coastal city 50 km west of the capital Algiers where officials charge he had been planning to carry out attacks on security forces. Al-Qaeda in the Islamic Maghreb (AQIM) may be a greater threat. AQIM has intensified its military operations in Algeria. In March 2016 it launched a series of homemade mortars at Algeria's Krechba gas plant. The concern is that future attacks are likely to focus on energy infrastructure assets and targets that attract Western tourists.

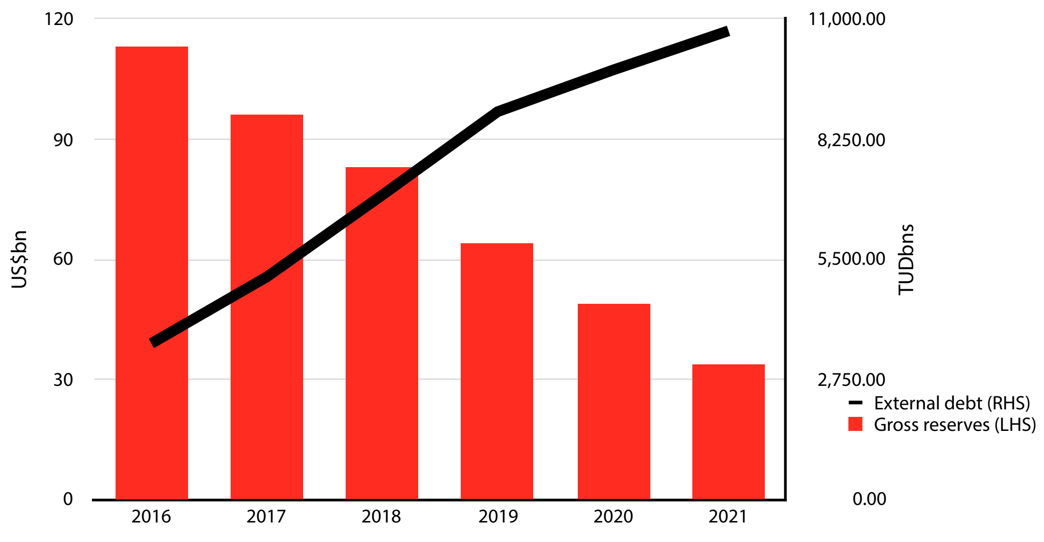
ALGERIA

Financial system risk

Algeria's exposure to global financial instability is limited by its closed capital account that prevents national institutions borrowing abroad. However the drop in oil prices fed through to deposits by hydrocarbon companies. The strong links between the financial, hydrocarbon, and public sectors have increased the vulnerability of banks to systemic risks. Algeria has a relatively underdeveloped banking sector, which has limited the country's ability to provide domestic lending to promote the private sector. The banking sector is dominated by public banks, which represent 87% of total banking assets, and which have to absorb losses from public sector companies. The main domestic risk is the growth in domestic credit in the banking system. So far government intervention has transferred losses from the banks to the government's balance sheet. The authorities have implemented regulations related to capital adequacy, lending classification and provisioning, and concentration risk as recommended by the IMF.

The IMF has said that the banking sector remains adequately capitalised and profitable, but it warns that the oil price shock had affected liquidity, interest rate, and credit risks. The overall liquidity of banks has contracted sharply due to the impact of lower oil prices on bank deposits and to rapid growth in credit. It has fallen to DZD1.8trn at the end September 2015, down 34% from DZD2.7trn a year earlier. Tier I solvency ratio declined slightly from 16.3% at the end of 2016 to 15.2% in December 2017 owing to the growth of credit to the economy. In an environment of tighter bank liquidity, growth in credit to the economy slowed but nevertheless remained robust at 9.8% in 2016. The ratio of gross nonperforming loans to total loans increased from 11.9% to 12.3% over the same period. Bank supervisors are monitoring banks closely and running stress tests to assess their resilience, which has been deemed adequate barring a major adverse exogenous shock. The government has ample liquid reserves to protect its domestic banking system, which is mainly state owned, although those reserves are being run down. (chart 2). This protection also reduces the risk to the public banks that are highly exposed to large state-owned manufacturing, construction, and commerce companies. Any acceleration in the pace of currency depreciation will alarm markets.

Government debt and reserves



Source: IMF World Economic Outlook database October 2018; Article IV assessment. August 2018

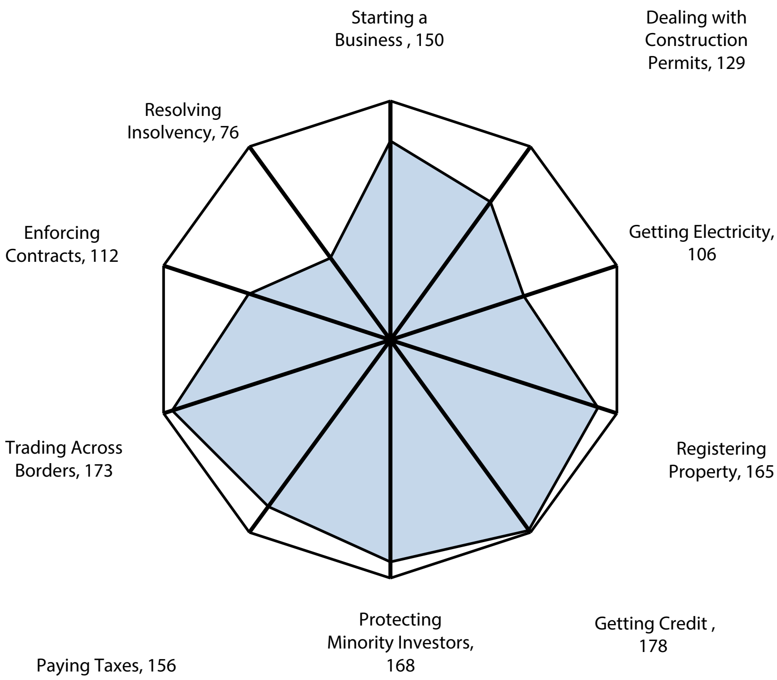
RISK

ALGERIA

Commercial risk

Algeria is a stable country, albeit in a highly authoritarian and centralised way. Its business climate is marked by difficult access to credit, a complex regulatory environment, and time-consuming procedures to set up a business. Doing business can be difficult as the bureaucracy can be complex and lead to delays. Concerns over the political succession and the security situation concerns, combined with a poor business environment, have prompted foreign investors to take flight since the start of 2015. The government is trying to attract more foreign investment and technology and has started to adopt policy reforms. Algeria attracted $1.2bn in FDI inflows in 2017 and $310m in the first quarter of 2018. It has begun collaboration with the World Bank on a range of areas including: simplifying business regulations; opening new areas of activity to the private sector; rationalising subsidies; improving the functioning of the labour market; modernising the banking system; and investing in infrastructure. In March 2018 it issued a decree delegating the monitoring of structural reforms to the Ministry of Finance. Difficult access to credit is a key factor hindering the development of the private sector. Lending to the private sector represents only 24% of GDP, one of the lowest ratios in the region. In July 2016 parliament passed a new investment law to spur economic growth in the country. It includes tax breaks and measures to ease bureaucratic procedures that have been one of the main hurdles to investment. Investors will get 10-year exemptions from tax on property needed for a project and a three-year tax break on profits on a new project. The IMF says that it should attract a much-needed flow of foreign direct investment.

The World Bank's 2019 Doing Business Report ranks it towards the bottom of its 190 countries, at 157 slightly up from 166 in 2018. It rose in five sub-categories and fell in none. This is one of the worst ratings amongst its MENA peers, with only Iraq. Sudan Syria, Yemen, and Libya scoring worse. It scores best on measures such as resolving insolvency (76th) and enforcing contracts (112th).



Source: World Bank, Doing Business Report, 2019
Rank 190 bottom, Rank 1 top of scale

RISK

ALGERIA

There are substantial delays for entrepreneurs wishing to obtain official approvals (with ranking of the best-performing nation, New Zealand, in brackets)

- Start a business: 17.5 days (0.5)
- Obtain construction permits: 136 days (93)
- Gain electricity supply: 93 days (58)

Algeria ranked 112 out of 180 countries in Transparency International's 2017 Corruption Perceptions Index, down from 108 in 2016. According to the UK Government's business risk analysis most businesses report successful business operations in Algeria free of corrupt practices. However, there are still some isolated anecdotal reports of low-level corruption.