Euler Hermes Economic Research

Country Report

Algeria

Heightened uncertainties relating to leadership

General Information

GDP	USD214.1bn (World ranking 48, World Bank 2014)
Population	39.9mn (World ranking 33, World Bank 2014)
Form of state	Republic
Head of government	Abdelaziz BOUTEFLIKA
Next elections	2019, presidential

Strengths

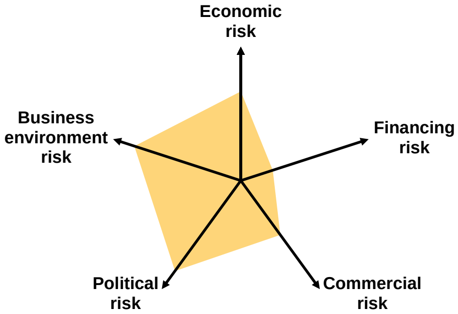
- Strong hydrocarbon resources, with gas reserves estimated to last a further 54 years at current rates of extraction (and crude oil almost 22 years).
- Strong liquidity indicators, supported by a period of sustained high oil prices, now provide a financial cushion to withstand the impact of current weak commodity prices.
- External debt management is much improved following repayment concerns in the 1990s and debt ratios and obligations are now low, providing scope for increasing debt to cover FX shortfalls resulting from low oil and gas prices.

Weaknesses

- Uncertain political succession, with the health of President Abdelaziz Bouteflika a major concern.
- High unemployment and underemployment.
- Lack of economic diversification. Over-dependence on oil and gas (99% of export earnings).
- Banking sector remains dominated by state enterprises that have to absorb losses from public sector companies.
- Limited private sector opportunities and perceptions that the business environment (including regulations) is restrictive.
- Regional dynamics are affected by continuing friction between Algeria and Morocco.
- Oil and gas installations are vulnerable to periodic (but localised) attacks by terrorist groups.

Country Rating

C2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Italy	16%	1	13%	France
United States	15%	2	12%	China
Spain	11%	3	10%	Italy
France	9%	4	9%	Spain
Netherlands	7%	5	5%	Germany

By product (% of total)

Exports		Rank		Imports
Petroleum, petroleum products and related materials	61%	1	15%	Road vehicles
Gas, natural and manufactured	38%	2	9%	Petroleum, petroleum products and
Inorganic chemicals	1%	3	8%	Iron and steel
Sugar, sugar preparations and honey	0%	4	7%	Cereals and cereal preparations
Crude fertilizers other than division 56, and crude minerals	0%	5	5%	Other industrial machinery and parts

Source: UNCTAD

Economic Overview

GDP growth, already low, further impacted by weak oil prices

Hydrocarbons (oil but particularly gas) remain pivotal for economic development as the sector accounts directly for around 40% of GDP and 99% of exports. Accordingly, current low oil prices (benchmark Brent -45% y/y and -74% from a peak in April 2011) are limiting GDP to below potential rates of growth. EH expects GDP will expand by around +2.5% in 2016 and +3% in 2017 but with downside risks. Over a ten-year period to end-2015, annual average growth was +2.9%, suggesting that other factors were already limiting the economy's development. Indeed, growth was markedly below that of Africa as a whole through most of that period (see chart). A protracted period of subdued growth and recession in some European markets (that region accounts for at least 40% of exports, by value) was one such factor and another was the Algerian economic model, which relies heavily on state-run enterprises. Even programmes to boost public spending (including increased subsidies and investment in infrastructure), partly reflecting an initial official response to prevent contagion from the Arab Spring, did not raise growth rates markedly above annual population expansion.

The general outlook increases risks of commercial disruption and insolvencies

A weak economic background and accompanying financial pressures stemming from relatively large fiscal and current account deficits result in the government adopting countervailing measures. These include project delays and some cancellations, which impact heavily on private sector suppliers. EH expects associated commercial disruptions and higher rates of corporate failure.

Inflationary pressures monitored closely

Monetary policy is not exercised actively through interest rate changes and the key policy rate has been unchanged at 4% since 2004. EH expects this policy will continue over the forecast period. Policymakers in Algiers seek to limit inflation as it is a primary cause of social discontent, so they will attempt to limit upward price pressures from DZD depreciation. EH expects inflation will end 2016 at around 3.4% but some action to ease subsidy costs will push inflation towards 4.9% by end-2017.

Although Algerian financial markets are relatively illiquid to foreign investors, the country has not been immune to the general emerging market sell-off. The exchange rate ended 2015 at DZD107:USD1, compared with DZD78 and DZD88 in 2013 and 2014, respectively.

Fiscal deficits have deteriorated. Weak revenue generation and public spending patterns prevent marked improvements

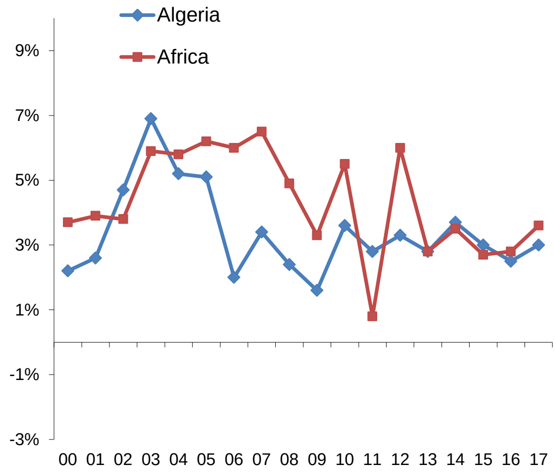
Strong government revenues in periods of high oil prices resulted in fiscal surpluses or low deficits. Strong receipts enabled the state to increase public expenditure in attempts to limit any contagion from the Arab Spring. In early 2012, the government increased the national guaranteed minimum wage, increased subsidies for the purchase of consumer goods, introduced tax breaks for SMEs and started new job creation schemes. Since then weak oil prices (see above) have reduced earnings but the social needs have not diminished. Large fiscal deficits (-10.9% of GDP in 2015) require careful management.

Key economic forecasts

	2014	2015	2016f	2017f
GDP growth (% change)	3.7	3.0	2.5	3.0
Inflation (%, end-year)	5.3	5.1	3.4	4.9
Fiscal balance (% of GDP)	-8.7	-10.9	-7.5	-6.0
Public debt (% of GDP)	8.5	12.0	11.5	11.0
Current account (% of GDP)	-4.1	-6.3	-5.5	-1.5
External debt (% of GDP)	2.5	3.3	3.3	3.1

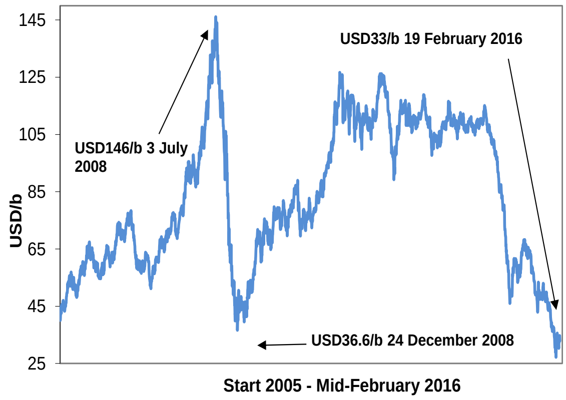
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Oil Prices (Benchmark Brent, USD/barrel)



Sources: FT, Euler Hermes

Public debt levels are comfortable…

The general government debt-GDP ratio has been reduced significantly since 2000 and at current levels of around 12% is comfortable.

…but external accounts are under pressure

Output of crude oil is the third largest in Africa (after Nigeria and Angola) and known reserves are projected to provide almost 22 years of additional supply at existing rates of extraction. However, Algeria's hydrocarbon wealth also stems from its gas sector. Reserves of natural gas are the 10th largest in the world and will provide output for a further 54 years. Annual gas output is equivalent to 2.4% of global supply and Algeria is the 9th largest world producer. The external accounts depend heavily on oil and gas sales and therefore on internationally-determined oil prices.

Large annual current account surpluses (>20% of GDP in 2005-08) allowed FX reserves to be accumulated and external debt to be reduced markedly. With the onset of the Arab Spring, heightened spending was used to limit social discontent but the current account remained in surplus. Since the oil price collapse from Q4 2014, however, the current account has been in deficit (-6.3% of GDP in 2015). Oil prices are forecast to remain low this year, so a further large shortfall in the current account is expected in 2016 (-5.5%).

External debt obligations are comfortable

Following significant pressures in relation to debt repayments in the 1990s, a revised external debt policy was adopted that targeted a marked reduction in the country's dependence on external borrowings. The policy has been noticeably successful, with external debt-GDP currently <3.5% and servicing of external obligations is very comfortable (annual external debt servicing equivalent to only 2% of total foreign exchange earnings).

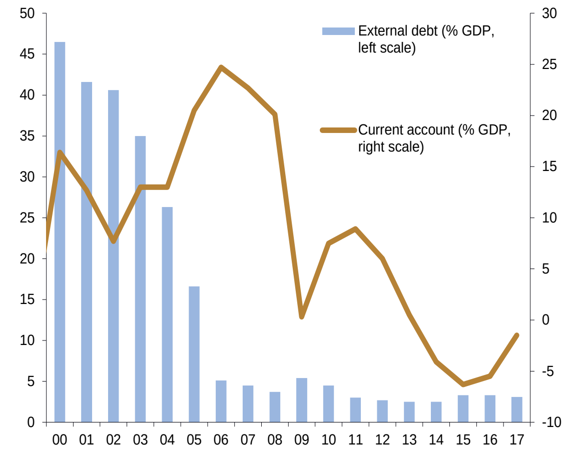
High FX reserves and import cover

Official foreign exchange reserves (excluding gold) are currently around USD150bn and cover around 29 months of imports of goods and services, compared with an international benchmark comfort level of three months. An oil stabilisation fund of around USD50bn provides further support.

Political uncertainties heighten risks

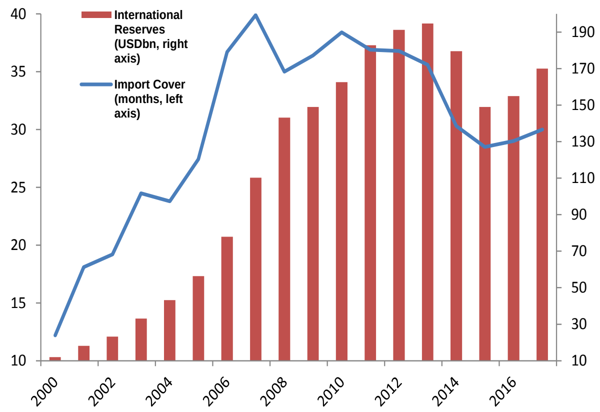
A large financial cushion provides a buttress during the current period of low oil prices but political risk is a key concern. Until the leadership succession process is clarified significant uncertainties will weigh against investment and consumption decisions, with negative knock-on effects for commerce and trade transactions.

Current account and external debt (% of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign Exchange Reserves and Import Cover



Sources: IHS, Euler Hermes

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