WINDFALL EFFECT

The Algerian economy has enjoyed almost unprecedented favourable conditions for a decade. 2022 saw twin surpluses return thanks to soaring global hydrocarbon prices and a lower than expected fiscal support. Despite the fragile international environment, the outlook for 2023 is positive and macroeconomic risks are limited. Nevertheless, the persistently high inflation poses a risk that must be monitored. Above all, soaring public spending planned in the budget could contribute to further medium-term macroeconomic imbalances, without providing a major boost to economic activity, however.

EXTERNAL ACCOUNTS: BACK INTO SURPLUS

The rebalancing of external accounts that began in 2021 accelerated significantly last year. Over the first nine months of 2022, Algeria ran a current account surplus of more than USD 10 billion, compared to the deficit of USD 4.8 billion in 2021. At a time of high energy demand from Europe, hydrocarbon exports rose to USD 43.2 billion from USD 24.1 billion over the same period in 2021. This strong performance has been mainly fuelled by soaring global oil and gas prices. Hydrocarbon export volumes were down 4% year-on-year over the first nine months of 2022. This was due to the fall in gas exports by more than 10% (both pipeline and liquefied natural gas), whereas oil exports grew by 7%. Export growth momentum seemingly increased further during the past quarter: according to the national hydrocarbon company Sonatrach, oil and gas exports totalled USD 60 billion over 2022, a figure that Algeria had not hit since 2013/2014.

The non-hydrocarbon export performance was also solid, with a 43% year-on-year increase over the first nine months of 2022. They stood at USD 4.4 billion over this period, meaning that the USD 7 billion target for the whole year should be achieved. By contrast, they were only USD 2 billion in 2019. Even though this non-hydrocarbon export figure is still low, non-hydrocarbon exports now account for 10% of total exports, more than double the pre-pandemic figure.

More surprisingly, import value growth remained at just 3% over the first nine months of 2022. The 20% rise in food and raw material imports was offset by the fall in industrial capital goods imports. In addition to the measures to reduce imports that have been introduced in recent years, the monetary authorities have sought to limit the impact of the rising global commodity prices on imports through the appreciation of the Algerian dinar (DZD). The nominal effective exchange rate rose by 6.6% in 2022, driven largely by the appreciation of the DZD against the euro (more than half of Algerian imports come from Europe). However, this is not the only reason. In fact, capital good imports fell below the USD 4 billion mark over the first nine months of 2022, vs. USD 6.3 billion in 2019, which is also a clear reflection of the currently sluggish state of the economy and weak dynamism of investment.

In the end, with a current account surplus of close to 8% of GDP during 2022, Algeria was able to accumulate FX reserves, for the first time in nearly a decade (Chart 1). After bottoming out at USD 46.6 billion at the end of 2021, FX reserves now exceed USD 60 billion, which is equivalent to more than 15 months of goods and services imports. Even though reserves are still nowhere near their USD 195 billion peak at the end of 2013, the recovery of external liquidity is making a balance of payments crisis far less likely. Moreover, external debt is negligible and the Algerian economy is expected to continue recording current account surpluses provided that the Brent price remains above 80 dollars per barrel. This is expected to be the case once again in 2023.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth (%)	-5.1	3.5	3.0	3.3	2.7
Inflation (CPI, year average, %)	2.4	7.2	9.2	8.2	7.0
Gen. Gov. balance / GDP (%)	-11.9	-7.2	2.3	-5.1	-5.9
Central. Gov. debt / GDP (%)	50.3	62.3	59.4	60.0	62.3
Current account balance / GDP (%)	-12.6	-3.2	7.5	2.9	1.2
External debt / GDP (%)	2.4	1.9	1.7	1.6	1.6
Forex reserves (USD bn)	49	47	62	69	74
Forex reserves, in months of imports	13.8	12.4	15.7	16.7	17.0

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

ALGERIA: FX RESERVES

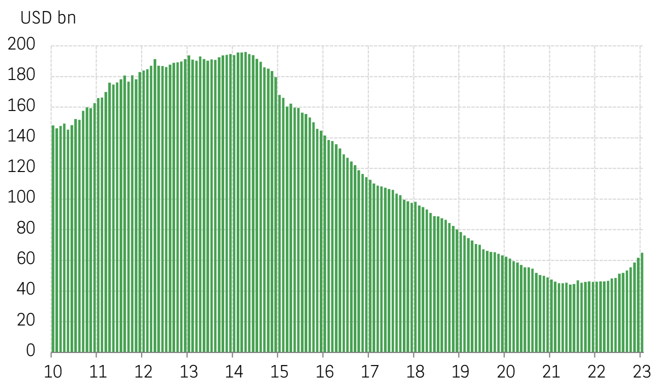

CHART 1 SOURCE: IMF, BNP PARIBAS

PUBLIC FINANCES: A TEMPORARY UPTURN

By contrast, the improvement in public finances may not last. According to the IMF, Algeria ran a budget surplus in 2022, which is estimated at just over 2% of GDP. This came as a surprise. This was the first surplus since 2008 and was a sign of the significant recovery from the deficits accumulated since 2014 (which averaged 10% of GDP and still stood at 7.2% in 2021). Above all, the 56% increase in public spending included in the 2022 Supplementary Financing Law (approved in July) suggested that the budget balance would remain in the red despite the surge in hydrocarbon revenue (around 40% of the government's revenue). However, the increase in spending was kept below 10% in 2022, illustrating the significant under-execution on current expenditures and, in particular, on public investment. Public investment declined further, even though it was supposed to double in 2022. When expressed in GDP points, capital expenditure therefore fell to 7%, compared with 14% in 2019. The figures published by the central bank on the budgetary situation at the end of August are in line with the IMF's estimates.

The situation of public finances is expected to deteriorate in 2023. The deferral of some spending not yet implemented in 2022, the 20% increase in civil servants' salaries (as a result of the salary scale being raised), and rising unemployment benefits and pensions will contribute to increase spending by 7% of GDP. Despite the strong performance of hydrocarbon revenues (although they should fall compared to 2022), Algeria is expected to once again run a budget deficit of around 5% of GDP in 2023. The financial situation will still be manageable. According to the IMF, the budget surplus in 2022 helped to rebuild partially the Algerian Government's fiscal reserve within the Fonds de Régulation des Recettes (Revenue Regulation Fund - FRR). The FRR is estimated to be worth 7.2% of GDP and could theoretically cover all of the Treasury's needs. In addition, even though government debt stands at 60% of GDP, it is financed by captive creditors on the local currency market, as it is held by the central bank (46%) and commercial banks (56%) at negative real interest rates and on long maturities, as a result of direct or indirect monetisation programmes since 2017. Furthermore, there are no guarantees that the authorities will be able to resolve budgetary execution problems. As a result, spending could increase less than expected, like in 2022. At the same time, however, the social aspects of the main measures are reducing the likelihood of this occurring.

Looking beyond the size of fiscal imbalances, the growing burden of current expenditures in public finances is cause for concern. Current spending increased from 64% of total spending in 2014 to 76% in 2022, as adjustment efforts focused on public investment and social benefit mechanisms were maintained (the subsidy system in particular). They could account for 80% of the budget this year. However, with an increasingly rigid spending structure, public finances are becoming increasingly vulnerable to fluctuations in oil and gas revenues.

ECONOMIC GROWTH: A MODEST RECOVERY TAKES HOLD

After a 5.1% recession in 2020, growth rebounded to 3.5% in 2021 and stood at 2.9% year-on-year over the first nine months of 2022. The driving forces of economic activity have changed. While the post-pandemic recovery had been fuelled by gas production bouncing back, non-hydrocarbon GDP now underpins Algeria's growth. It posted an average growth of 3.7% year-on-year in the first three quarters of 2022, compared to just 2.4% in 2021. This momentum is expected to grow further thanks to the country's expansionary fiscal policy. Despite virtually flat hydrocarbon real GDP, economic growth is expected to go above 3% in 2023.

However, the recovery in economic activity is modest in view of the Algerian economy's favourable conditions. Above all, it is still fragile. In particular, measures to support household purchasing power could be counter-productive, as they could be neutralised by the inflationary pressures they could create. Inflation has fallen slightly since its 10.8% year-on-year peak in June 2022, but is still very high at 9.3% (Chart 2).

ALGERIA: INFLATION RATE

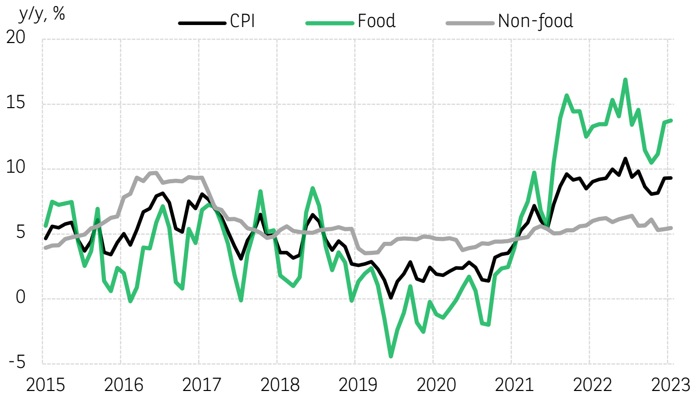

CHART 2

SOURCE: CENTRAL BANK, BNP PARIBAS

In January 2023, food prices were up more than 10% year-on-year for the 19th consecutive month. Non-food inflation stood at 5.5%. In fact, the acceleration in inflation started before the shock caused by the war in Ukraine, highlighting its partially endogenous nature. In view of this situation, the central bank has seemingly decided to maintain its accommodative stance (its policy rate has stayed at 3% since May 2020). This is a risky strategy, in view of the already strong growth in money supply (+14.2% in September 2022) and the forthcoming fiscal stimulus.

The new investment law adopted in June 2022 builds on a set of measures that have been in place since 2019 to boost private-sector development. These measures are positive but with limited results so far. For example, bank lending to the private sector is still growing sluggishly (+3.9% year-on-year in nominal terms in January 2023).

Assuming a lower support from fiscal policy, continued low levels of private investment and a still fragile international environment, economic growth is expected to slow down starting from 2024. Algeria's macroeconomic vulnerabilities could then increase again.

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