ALGERIA

SOME RESPITE BUT NO RALLY

Algeria has not pulled out of the crisis yet, but it is no longer in the danger zone. Real GDP growth swung back into positive territory in Q1 2021, and external pressures have eased considerably. The factors behind these improvements are essentially cyclical, however, starting with the upturn in oil prices and strong European demand for natural gas. But this will not be enough to balance public finances. The vaccination campaign has not advanced enough to rule out the emergence of a new wave of contaminations. Against this backdrop, parliament just adopted the new government's action plan. Although diversification efforts are highlighted once again, the lack of quantified targets and a precise timetable throws doubts on their implementation. Moreover, some economic policy decisions suggest that the authorities are still caught up in emergency management at the risk of putting off much-needed adjustments and even aggravating imbalances (notably monetary).

EXTERNAL ACCOUNTS: PRESSURES EASE

For the first time since April 2015, forex reserves increased by USD 2.4 bn in August (chart 1). Granted, this is largely due to the IMF's allocation of USD 2.7 bn in special drawing rights (SDR). Yet this stabilization also comes from the current improvement in external trade dynamics. The trade deficit was slashed to less than USD 1 bn in the first eight months of 2021, compared to USD 7.6 bn in the year-earlier period. In addition to soaring oil prices, Europe's strong demand for natural gas is also driving hydrocarbon exports at a time when several development projects are reaching completion. According to JODI statistics, natural gas production and exports rose 28% and 76% YoY, respectively, at the end of July. Although it is difficult to extrapolate these trends, notably due to seasonal factors, natural gas export volumes could reach a record high for the decade. This would help offset some of the shortfall imposed by the OPEC+ oil production quotas, assuming the latter are regularly raised. All in all, hydrocarbon exports are expected to rise to more than USD 33 bn in 2021, up from USD 20 bn in 2020. Excluding hydrocarbons, exports more than doubled during the first eight months of the year, a performance that is worth pointing out, even though it must be kept in perspective given their low weighting as a share of foreign trade (12% of total exports).

At the same time, imports are holding at a low level. Although they rose 8% at the end of August compared to the same period in 2020, they were still 20% lower than in 2019. Reducing imports is a top priority of the government's policy, whether by tightening non-tariff measures or through the depreciation of the exchange rate. Since the beginning of 2020, the dinar has lost 13% in value against the dollar and 17% against the euro. Yet the spread with the exchange rate on parallel market is still higher than 30%, which suggests that the overvaluation of the dinar is far from being corrected. The reduction in imports is due above all to sluggish economic activity. The fall in imports of machinery and equipment accounted for more than half of the decline in 2020.

All in all, the current account deficit should narrow to less than 5% of GDP this year, after swelling to nearly 13% of GDP in 2020. External liquidity will continue to erode, albeit at a much slower pace. Forex reserves fell to USD 49 bn at year-end 2020, compared to USD 180 bn at year-end 2014, and they should shrink by another USD 6 bn in 2021. That is three times less than during the past four years. Moreover, FX reserves are still comfortable at 14 months of imports of goods and services, and should remain so in the short term, assuming that oil prices hold above USD 70 a barrel. In other words, the risk of a balance of payments crisis in the short term has reduced.

FORECASTS

	2019	2020	2021e	2022e
Real GDP growth (%)	0.8	-4.9	3.5	2.4
Inflation (CPI, year average, %)	2.0	2.4	5.2	4.8
Gen. Gov. balance / GDP (%)	-9.8	-14.4	-9.6	-9.7
Central. Gov. debt / GDP (%)	45.8	53.4	58.7	64.8
Current account balance / GDP (%)	-9.9	-12.8	-4.9	-5.7
External debt / GDP (%)	2.7	3.5	3.5	3.8
Forex reserves (USD bn)	62	49	43	36
Forex reserves, in months of imports	13.8	13.8	11.0	8.8

TABLE 1

e: ESTIMATES & FORECASTS

SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

FOREX RESERVES

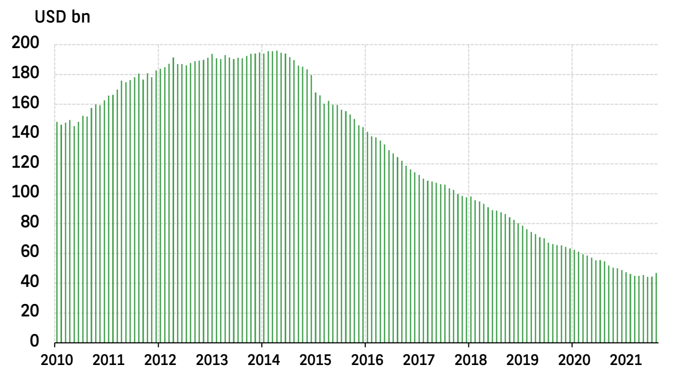

CHART 1

SOURCE: IMF

PUBLIC FINANCES: STILL A LONG WAY TO GO

The public finances situation, in contrast, continues to be worrisome. Despite adjustment efforts to face up to the drop in oil revenue (40% of total revenue before the crisis), the budget deficit widened considerably in 2020 to more than 14% of GDP (according to our estimates). Yet given the orientations of the 2021 finance bill, we do not foresee a major rebalancing. Based on the hypothesis of oil prices of USD 45 a barrel, the government can obviously count on extra revenues (about 4% of GDP). But with spending up 10%, three quarters of which is due to higher current expenditures, the budget deficit is estimated at more than 5% of GDP. We must also add 4 points of GDP for net transfers and loans to support ailing state-owned companies and to cover the financing needs of the National Pension Fund. All in all, public finances are expected to report a deficit of about 10% of GDP in 2021, whereas most of the region's other oil-exporting countries are expected to virtually balance their accounts.

Consequently, debt will swell rapidly again. The increase in debt ratios in 2020 was mainly due to the contraction of GDP. About two thirds of financing needs were covered by transfers from the Treasury's current account with the central bank, a large part of which came from the 2017-2019 direct monetary financing programme. Since this account dried up, the authorities decided to proceed with a new, more indirect monetary financing mechanism starting on 1 July 2021, via open market operations amounting to DZD 2,100 bn (about 10% of GDP) spread over 12 months. At first sight, that should suffice to finance the deficit, but that does not solve the problem of the shallowness of the capital market, nor the structural imbalance of public finances. Government debt is expected to approach 60% of GDP at the end of this year, compared to only 7% of GDP in 2014. However, the debt is still fundamentally captive in so far as the central bank finances the State at real negative rates with long maturities. Moreover, there is virtually no foreign currency debt.

OUTLOOK: TOWARDS A SLUGGISH RECOVERY

Despite the expected increase in public spending and a more favourable external environment, the economic recovery will be slow. After four quarters of contraction, the Q1 rebound is certainly good news, but it must be kept in perspective. First, it was very moderate at only 2.4% year-on-year (chart 2). Second, it is largely due to the increase in natural gas production. Excluding hydrocarbons, GDP rose only 1.4%.

There are still major headwinds. Although the vaccination campaign has accelerated in recent weeks, it has not advanced enough to rule out another wave of Covid-19 cases like the one that swept the country last summer. At the end of September, only 20% of the population had received a first dose of the vaccine. Moreover, inflationary pressures have intensified since year-end 2020 and peaked at 7.2% in March 2021 due to surging food prices (+9.7%; 43% of the consumer basket). Although they have eased somewhat since, inflation still averaged 5.7% in the first six months of the year (compared to 2.4% in 2020), and sources of risk are numerous. In addition to the impact of the dinar's depreciation, monetary factors could come into play (acceleration of money supply growth since the beginning of the year to 12% at the end of July due notably to the upturn in oil and gas revenues, liquidity injections by the central bank since mid-2021).

Above all, the Covid-19 shock triggered a 4.9% recession in 2020, hitting an economy that was already weakened. Since 2017, the growth of real GDP per capita is negative and investment rate of the private sector has continued to fall. The efficiency of public spending to stimulate growth is now weak. The same can be said about the central bank's support measures, which the authorities just announced will be extended until year-end 2021. The easing of monetary policy and prudential constraints will undoubtedly help preserve the stability of the financing system, although it will not boost lending activity. At the end of July, bank lending to the private sector and to state-owned companies was still growing at a slower pace than inflation.

SECTORAL CONTRIBUTION TO GROWTH

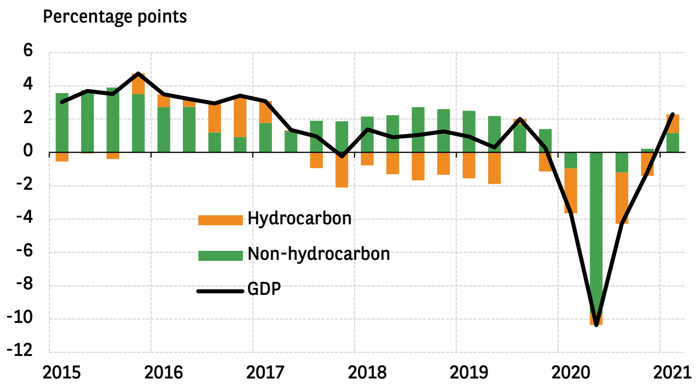

CHART 2

SOURCE: ONS, BNP PARIBAS

Under this environment, we expect economic growth to reach only 3.5% in 2021 before slowing to 2.4% in 2022. Thereafter, the dynamics of growth will be closely correlated with the authorities' ability to reform a system with severe imbalances. Parliament has just adopted the action plan presented by the new government. Once again, it highlights diversification efforts, but the lack of quantified targets and a precise timetable throws doubts on their implementation. At a time when oil prices are rising again, there is also a big risk that the authorities will postpone much-needed fiscal adjustments.

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