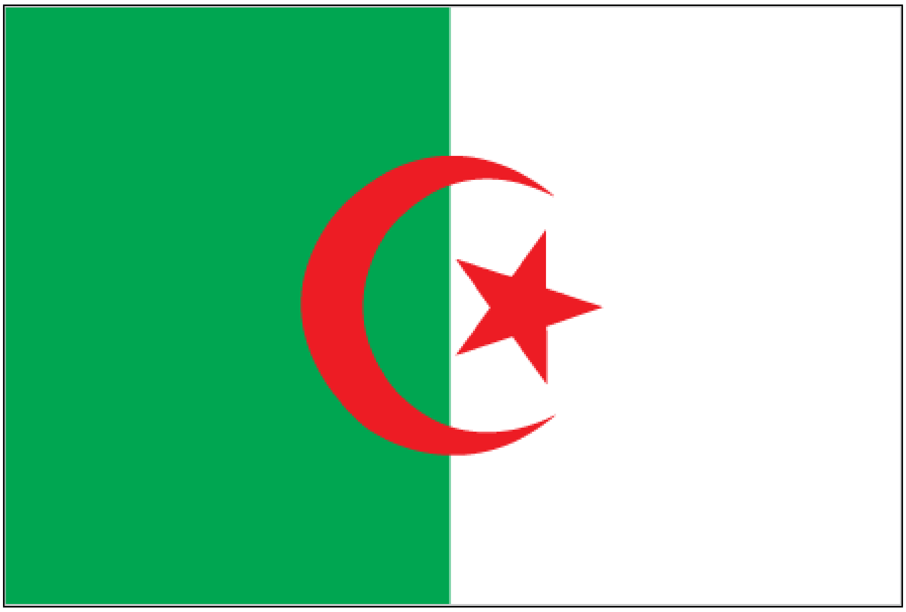
Country update **ALGERIA**



Summary

Algeria is experiencing continuing social unrest sparked by grievances over escalating food prices, high unemployment and restricted political expression. The army successfully suppresses the riots each time, while the government increased public sector wages and introduced higher food subsidies. Despite the unrest, the economy continues to grow at about 4% of GDP a year. High oil and gas prices account for a lower budget deficit in 2010 and 2011 than forecasted in last year's report. For the same reason, foreign exchange reserves and current account surpluses in 2010 and 2011 have been adjusted upward. The economy's growth and the current account surplus in 2012 are likely to be somewhat lower than in 2011, as fuel prices are expected to ease due to an expected slowdown of the global economy.

Things to watch:

- Social unrest
- Attitude towards foreign investment
- Continuation of the flow of revenues from the hydrocarbon industry

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Algeria

National facts	
Type of government	Parliamentary republic
Capital	Algiers
Surface area (thousand sq km)	2,382
Population (millions)	35.4
Main languages	Arabic
	French, Berber dialects
Main religions	Sunni Muslims (99%)
	Christian, Jewish (1%)
Head of State (president)	Abdelaziz Boutéflika
Head of Government (prime-minister)	Ahmed Ouyahia
Monetary unit	Algerian Dinar (DZD)

Social and governance indicators	rank / total
Human Development Index (rank)	84 / 169
Ease of doing business (rank)	148 / 183
Economic freedom index (rank)	132 / 179
Corruption perceptions index (rank)	105 / 178
Press freedom index (rank)	133 / 178
Gini index (income distribution)	35.3
Population below $1.25 per day (PPP)	n.a.

Economy		2010
Economic size	*bn USD*	*% world total*
Nominal GDP	152	0.24
Nominal GDP at PPP	295	0.40
Export value of goods and services	61	0.33
IMF quotum (in mln SDR)	1255	0.58
Economic structure	*2010*	*5-year av.*
Real GDP growth	4.1	3.0
Agriculture (% of GDP)	8	8
Industry (% of GDP)	62	62
Services (% of GDP)	30	30
Standards of living	*USD*	*% world av.*
Nominal GDP per head	4174	42
Nominal GDP per head at PPP	8138	69
Real GDP per head	3262	41

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
US	24	France	19
Italy	17	Italy	11
Spain	10	China	10
France	6	Spain	7
Main export products (%)			
Hydrocarbons			97
Semi-finished goods			2
Raw materials			0
Capital goods			0
Main import products (%)			
Capital goods			39
Semi-finished goods			25
Food			15
Consumer goods			15
Openness of the economy			
Export value of G&S (% of GDP)			40
Import value of G&S (% of GDP)			33
Inward FDI (% of GDP)			2.4

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Introduction and update

In this country risk update about Algeria, we analyze the Arab Spring Uprising and the deteriorated business climate for foreign investment and trade. However, first of all, we review the developments since our report of November 2010. Algeria remains a country that heavily relies on its hydrocarbon industry, the output of which is structured around gas and oil-based products. The industry hardly employs any people, but generates a lot of revenues for the government. Economic growth and government revenues have benefitted from higher than expected oil and gas prices, resulting in a growth expectation of 4.6% for 2011 (up from our previous estimate of 4%). Growth and the current account surplus in 2012 are likely to be somewhat lower than this year, as oil and gas prices are expected to ease due to an expected slowdown of the global economy. For 2012, growth is expected to ease to 4%.

As the country received more revenues and new forecasts became available, the budget deficit in 2011 has been revised from 9% of GDP, to 2% of GDP. The deficit is expected to stay just above 1% of GDP in 2012, but lower oil and gas prices could put downward pressures on the revenues and thereby the deficit. In addition to the lower deficit, the current account position in 2010 was also notably better than expected. Higher exports, lower imports and higher receipts on the income account boosted the current account surplus to 8.4% of GDP, from a forecasted 2.9% of GDP. This year’s current account shows a slightly higher surplus of about 10% of GDP, due to further rising exports, although it will ease somewhat to about 7% of GDP next year.

Arab Spring Uprising

Social unrest is not uncommon in Algeria. In the 1990s the country experienced a very violent and bloody type of social unrest: a decade-long civil war. The civil war was an armed conflict between the Algerian government and Islamist rebel groups, after an Islamist party gained popularity in an electoral campaign, but elections were cancelled by the ruling party and the military took control of the government. More than 150,000 people died out of a population of about 28 million people during the war. The war ended in victory for the military government. Although the civil war has ended, protests, strikes and riots have continued to sweep the country. This is illustrated by the fact that in 2010, the police registered more than 10,000 disturbances. However, in January and February 2011, the country experienced an Arab Spring Uprising with protests and riots that were more intense and more geographically spread. Several protestors were killed and according to media reports, up to 800 were injured. The protests were comparable to protests in other Arab countries (Egypt, Tunisia and Libya), as they were sparked by grievances over escalating food prices, high unemployment and restricted political expression. Unlike neighboring Arab countries, the protests in Algeria have not succeeded in destabilizing the country, as the army successfully repressed the uprising. Owing to this, the unrest was short-lived and without significant adverse impact on the economy.

To fight the unrest the government increased its spending in 2011 with 25% by rising public sector wages, introducing higher subsidies on flour, milk, cooking oil and sugar, creating work for young, unemployed people and building new houses. Furthermore, the government suspended customs duties and VAT on sugar imports. However, the government did not address the biggest problem of the economy, the weakness of the economic structure, reflected by the large dependence of the country on the hydrocarbon industry

Apart from the measures above, the government promised constitutional reforms. In February 2011, a first measure was the lifting of the state of emergency, which was introduced in 1992 to restore public order after cancelled elections in 1991 erupted in a decade-long civil war. However, along with the lifting of the state of emergency, the government adopted a decree that confirms that the army remains responsible for the co-ordination of operations in the fight against terrorism and subversion. So, actually the situation has not changed. More recently, the government approved draft laws on political reform, but their impact falls short. A new media law would prohibit imprisoning journalists, but still allow them to be fined if they report outside the "rules and ethics" of the media. Also the radio and television sector will be opened up, although the regulations are not yet clear. Another law entails that new political parties may be formed, but they will be accountable to the cabinet in case of suspicions of disrupting social order or the law.

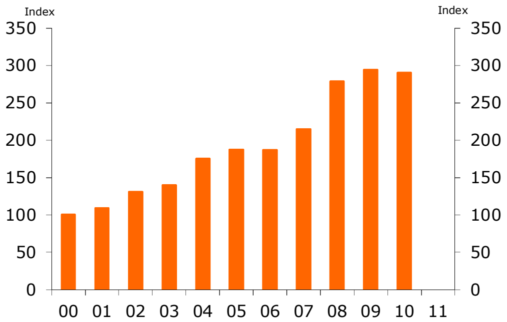
Isolated protests and scattered unrest have continued up till now, although they seem to be focused on wages and unemployment, and not too much on politics. The relatively small scale of the unrest may indicate that many Algerians do not want to participate as they fear a similar situation as in the 1990s. Additionally, the small scale may be explained by the strength of the army, which has succeeded in suppressing the revolt, and the government that generally meets claims of strikers, using its wealth derived from oil en gas revenues. We expect the simmering unrest to go on, as the authorities are expected to continue crushing the unrest and the weakness of the economic structure is not tackled.

Weak business environment for foreign investment and trade

Algeria has a mediocre business environment, reflected by the country's low FDI inflows, averaging to about 2% of GDP a year, but also revealed by the country's low rank on the World Bank's Ease of Doing Business Index. In this index, Algeria has dropped from place 136 out of 183 in 2010 (revised after new data to place 143), to 148 in 2011. This is notably lower than neighboring

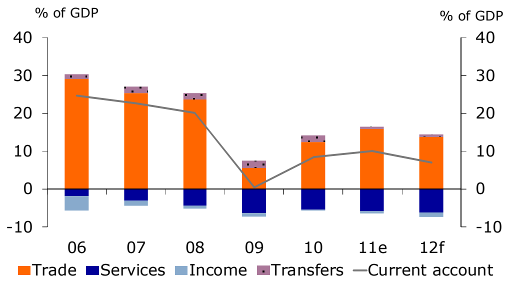
countries Tunisia (46) and Morocco (94), and far below the Middle East and North Africa average (93). In particular, bureaucracy, a high tax burden and a large informal sector make the business climate unfavorable.
Since 2009, the government has introduced economic policies that discourage foreign investment and trade. The most important measures affecting investment are the following two. (i) Foreign investors are forced to associate themselves with Algerian partners, with foreign investors not permitted to hold more than a 49% stake in any company. (ii) The state is assigned the right of first refusal for any sale of assets held by foreign investors. Especially the first measure is intended to stimulate the Algerian private sector. The government also introduced measures aimed at reducing the level of imports of goods and services, because rising commodity prices and expansionary fiscal policy had boosted imports in the last years: from USD 12mln in 2001 to USD 49mln in 2009, when imports surpassed exports. Firstly, consumer credit has been banned, with the exception of property credit. Furthermore, the use of documentary credit as the method of financing imports was obliged, but in May 2011 this measure has been transformed into a documentary remittance system after complaints from the business owners' organization. In this system, payments are required at arrival of the goods instead of two or three months before, as was the case under documentary credit.
Algeria has been a candidate to join the World Trade Organization (WTO) since 1987. However, due to its adherence to protectionist energy pricing and its reluctance to allow international companies to its energy sector, its candidacy has been undermined for years. From 2002 to 2008, negations have taken place, although results were not reached. This year, the WTO has urged the country to increase its efforts.

Chart 1: Import volume (2000=100)



Source: World bank WDI

Chart 2: Current account



Source: EIU

Algeria

Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
Key country risk indicators							
GDP (% real change pa)	1.8	3.1	2.9	2.0	4.1	4.6	4.0
Consumer prices (average % change pa)	2.5	3.5	6.7	5.7	3.9	4.0	3.9
Current account balance (% of GDP)	24.7	22.6	20.1	0.4	8.4	10.0	7.0
Total foreign exchange reserves (mln USD)	77914	110318	143243	149041	162614	185640	199410
Economic growth							
GDP (% real change pa)	1.8	3.1	2.9	2.0	4.1	4.6	4.0
Gross fixed investment (% real change)	7.2	9.8	8.1	5.0	7.0	6.5	6.0
Private consumption (% real change)	4.0	5.7	7.3	3.5	4.1	5.7	4.3
Government consumption (% real change)	4.8	7.1	8.8	10.4	11.2	15.0	10.0
Exports of G&S (% real change)	-2.4	-0.6	3.9	0.1	0.5	1.4	1.1
Imports of G&S (% real change)	-1.8	7.6	13.7	8.4	7.7	10.6	9.0
Economic policy							
Budget balance (% of GDP)	13.9	6.1	9.0	-5.5	-1.2	-2.1	-1.3
Public debt (% of GDP)	22	12	7	8	7	7	6
Money market interest rate (%)	2.3	3.4	3.4	3.8	1.2	3.3	3.5
M2 growth (% change pa)	20	20	16	3	14	18	14
Consumer prices (average % change pa)	2.5	3.5	6.7	5.7	3.9	4.0	3.9
Exchange rate LCU to USD (average)	72.6	69.3	64.6	72.6	74.4	72.5	75.3
Recorded unemployment (%)	12.3	13.8	11.3	10.2	10.0	9.7	9.6
Balance of payments (mln USD)							
Current account balance	28950	30540	34450	520	12760	18120	12730
Trade balance	34060	34240	40600	7780	18810	28670	25150
Export value of goods	54740	60590	78590	45180	57190	78510	80430
Import value of goods	20680	26350	37990	37400	38380	49840	55270
Services balance	-2200	-4090	-7590	-8690	-8250	-10540	-11440
Income balance	-4520	-1830	-1340	-1310	-440	-1160	-2050
Transfer balance	1610	2220	2780	2630	2630	1150	1070
Net direct investment flows	1760	1367	2328	2538	3490	3400	3550
Net portfolio investment flows	13	13	10	10	12	10	20
Net debt flows	-3914	1057	1073	-504	-796	-140	-180
Other capital flows (negative is flight)	-5184	-558	-4944	3240	-1898	1640	-2340
Change in international reserves	21625	32419	32917	5803	13568	23030	13780
External position (mln USD)							
Total foreign debt	5722	5794	5825	5345	4344	4420	4220
Short-term debt	541	750	1304	1493	1556	2100	2390
Total debt service due, incl. short-term debt	5933	386	1002	2331	3047	2960	3400
Total foreign exchange reserves	77914	110318	143243	149041	162614	185640	199410
International investment position	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	29.1	25.3	23.7	5.6	12.4	15.8	13.8
Current account balance (% of GDP)	24.7	22.6	20.1	0.4	8.4	10.0	7.0
Inward FDI (% of GDP)	1.5	1.2	1.5	2.1	2.4	1.9	2.1
Foreign debt (% of GDP)	5	4	3	4	3	2	2
Foreign debt (% of XGSIT)	9	8	6	10	6	5	5
International investment position (% of GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	9	1	1	4	4	3	4
Interest service ratio incl. arrears (% of XGSIT)	1	0	0	0	0	0	0
FX-reserves import cover (months)	36.7	39.8	35.0	36.4	38.8	34.9	34.2
FX-reserves debt service cover (%)	1313	28550	14303	6395	5338	6263	5859
Liquidity ratio	366	452	407	351	387	373	352

Source: EIU