

AFRICA RISK CONSULTING

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Algeria Summary 29 August 2015

Algeria gains Iran as an ally in the Organisation of the Petroleum Exporting Countries (OPEC) as both put pressure on other members to regulate the supply of oil in order to raise its price. The commodity fell to a new low of \$47 per barrel in August. The government introduces measures to diversify its revenue. The central bank, the Banque d'Algérie (BA), lets the dinar slide to a historic low against the United States (US) dollar of 105.6/S. Tax authority Direction Générale des Impôts (DGI) introduces a tax amnesty for traders in the \$40 billion black economy to encourage them to move into mainstream taxation. Clashes between militants and the army in the coastal Skikda and Jijel provinces continue in August.

Algeria gradually gains allies in OPEC lobby...

Algeria has gained **Iran** as an ally in its continuing efforts to lobby other members of the **Organization of the Petroleum Exporting Countries (OPEC)** to reduce the supply of oil in order to raise its price. Algerian oil minister **Salah Khebri** wrote to OPEC on 20 August to urge the organisation to take action following further falls in the price of oil.¹ The price of crude oil dropped to \$47 per barrel at time of writing, down from \$62 per barrel at OPEC's last meeting in June.² Khebri's letter called for an emergency meeting and action to decrease the supply of oil in order to artificially raise the price, and cooperation with non-OPEC members to help manage the global supply of oil.³ So far OPEC has kept levels of production stable and has resisted Algeria's repeated calls for an emergency meeting. Iran has also made public statements about the long-term non-viability of taking no action to regulate the oil price in the current market.⁴ Iranian oil minister **Bijan Zanganeh** said on 23 August that an emergency meeting could mitigate the current circumstances.⁵ Iran could act as an ally to Algeria in persuading the **Gulf States** to back an emergency meeting.

*"Iran itself will not be sufficient to sway **Saudi [Arabia]** and the Gulf States... Algeria will need to concentrate on **Angola**, which is now the fourth largest producer in OPEC, in order to sway Saudi [Arabia] or **Iraq** to reduce outputs."⁶*

Algeria is part of the so-called 'fragile five' OPEC members which include Angola, **Libya**, **Nigeria**, and **Venezuela** who all lack the cash reserves that allow larger **Middle East** members to ride out the decrease in price.⁷ Algeria has lobbied OPEC to cut its oil production since late 2014. Algeria and its allies were unable to convince the major players in OPEC at its June meeting to do so.⁸ The move is not without precedent – OPEC has reduced supply in the past to increase the price of oil. However, OPEC's two largest producers, Saudi Arabia and Iraq, both increased their output over the first half of 2015.⁹

¹ Liberté, 20 Aug 2015

² Oil Price.net

³ Liberté, 20 Aug 2015

⁴ CNBC, 24 Aug 2015

⁵ CNBC, 24 Aug 2015

⁶ Source, risk analyst, Dubai

⁷ Wall Street Journal, 25 Aug 2015

⁸ Liberté, 20 Aug 2015

⁹ FT, 11 Aug 2015

This led OPEC countries to produce a record 31.5m barrels per day (bpd) in July 2015, above estimated demand of 29.6m bpd.¹⁰

Pressure is mounting on OPEC to take action before its next meeting in December 2015. However, no unilateral action by OPEC will happen without the consent of Saudi Arabia which, so far, has resisted any calls to reduce production. Analysts believe that this is unlikely to happen while other oil markets remain decentralised:

*“Saudi Arabia is not going to make a move on reducing supply while decentralised markets like the **United States (US)** are still producing as much oil as possible... in their eyes it would unnecessarily reduce OPEC’s market share.”¹¹*

However, Saudi Arabia is looking to cut \$10 billion from its annual budget due to the falling price of oil. There were indications of a slight contraction in the country’s output from 10.6m bpd in July to 10.4 bpd in August. If the slump continues it may be forced to take action.¹²

...as the government seeks increased revenues

The government of Algeria is trying to increase revenue and stimulate economic growth as the further decrease in the price of oil adds pressure to the economy. It is doing this through currency devaluation and a tax amnesty. Algeria has foreign currency reserves of \$158 billion that will allow it to continue its current spending plan until 2017. However, with analysts predicting a lower oil price for the short and medium term, the government is looking to diversify funding sources immediately. According to finance minister **Abderrahmane Benkhalfa**:

“The government is counting on these funds to diversify its extra-budgetary sources of finance.”¹³

The central bank, **Banque d’Algérie (BA)**, allowed the dinar to slide to a historic low against the US dollar on 17 August.¹⁴ The move is an attempt to curb the costs of imports that are expected to reach \$53.7 billion across 2015.¹⁵ The BA allowed the currency to devalue from 94.5 to the dollar to 105.6 dollar at time of writing in August – a fall of 12.4%.¹⁶ The currency has fallen 21% across 2015 from 87.8 to the dollar on 1 January 2015.¹⁷ Rapid currency devaluation eases pressure on the public purse, but comes with a risk of inflation. The latest available official figures show that consumer price index (CPI) inflation rose to 4.5% in May from 4.1% in April.¹⁸ According to local sources, the increased cost of imported goods is beginning to affect the quality of life:

“The price of bread has already gone up by a third and some of the smaller supermarkets are no longer stocking international brands of food and other products like shampoo... if this continues they will move out of many people’s price range.”¹⁹

The cabinet launched a tax amnesty programme on 10 August in an attempt to recoup government revenue.²⁰ The **Direction Générale des Impôts (DGI)**, which manages the country’s taxation, will offer a flat rate of 7% taxation on income for Algerian citizens that meet their criteria until 31 December 2016.²¹ The amnesty is part of the **Complementary Finance Act (2015)** adopted in July

¹⁰ FT, 11 Aug 2015

¹¹ Source, oil analyst, Geneva

¹² Wall Street Journal, 25 Aug 2015

¹³ APS, 24 Aug 2015

¹⁴ BA press release, 17 Aug 2015

¹⁵ Reuters, 17 Aug 2015

¹⁶ XE.com

¹⁷ XE.com

¹⁸ BA website, 2015

¹⁹ Source, journalist, Algiers

²⁰ DGI website 10 Aug 2015

²¹ DGI website, 10 Aug 2015

that is designed to recoup income to the public purse. The latest projections show Algeria's imports could rise as high as \$57.3 billion in 2015.²²

*"The tax amnesty is clever...more effective and less costly in the long run than trying to prosecute tax avoiders...but there is a long running mistrust of the central government, especially in rural areas [so] the informal economy will remain important."*²³

According to the DGI, Algeria loses on average \$4 billion through tax fraud, much of which is carried out by small and medium business owners.²⁴ The so-called 'black economy' has an estimated value of \$40 billion and is mainly comprised of smaller traders and import/export businesses that operate out of the country's many bazaars.²⁵ The complementary finance law is designed to move this sector into the mainstream banking and taxation circuit.²⁶ However, the government faces a significant challenge to bring traders out of the black economy:

*"The government isn't offering them anything...they tried to clamp down on them in 2010 but didn't have the resources to do so, now they have even fewer resources."*²⁷

Part of the reason for the tax amnesty is that it is a more politically palatable solution than decreasing public spending. This is particularly the case with Algeria's generous subsidy scheme on staples including grain, which cost the equivalent of 30% of gross domestic product (GDP).²⁸ However in order to address the budget deficit in the long term the government may have to reduce this spending:

*"The administration will have to cut subsidies eventually but they are concerned with the security situation...they don't want to risk sparking anti-state sentiment in rural areas [which rely heavily on subsidies] so it will happen gradually."*²⁹

Some other factors may help the government make up the shortfall for 2015. Grain production increased 14.6% in 2015 from last year.³⁰ Grain imports are a large government cost and a good harvest will go a little way to easing the pressure on state finances. Grain regulator **Office Algérien Interprofessionnel des Céréales (OAIC)** released figures on 25 August that show that grain production reached 4 billion tonnes.³¹ The figures place agricultural output back on track; the 2014 harvest was lower than usual due to heavy rain.³² The country will always rely on imports as its unfavourable climate makes widespread agricultural cultivation difficult. Algeria imports over 90% of its soft grains.³³

Security situation remains unstable in coastal provinces

Skirmishes between militants and the military in the coastal provinces of Algeria have continued throughout August. Two soldiers died in an ambush in **Skikda** province on 16 August that is linked to **Al Qaeda in the Islamic Magrheb (AQIM)**.³⁴ This is the second attack against Algerian soldiers in as many months. Militants ambushed soldiers in woodlands near **Colo** killing a soldier and a

²² Reuters, 10 Aug 2015

²³ Source, journalist, Algiers

²⁴ DGI website, 10 Aug 2015

²⁵ Bloomberg, 27 Aug 2015

²⁶ El Watan, 11 Aug 2015

²⁷ Source, journalist, Algiers

²⁸ Bloomberg, 27 Aug 2015

²⁹ Source, academic with government connections, Algiers

³⁰ Reuters, 26 Aug 2015

³¹ Reuters, 26 Aug 2015

³² Reuters, 26 Aug 2015

³³ Reuters, 26 Aug 2015

³⁴ UPI, 16 Aug 2015

commander.³⁵ The casualties occurred during a military operation against a group of up to 30 militants that the media reported were operating out of Skikda province earlier in August.³⁶

The army has retaliated by carrying out operations across Skikda province and neighbouring **Jijel** province. They have issued press releases claiming they had killed seven militants between 18 and 24 August who were linked to the 16 August ambush.³⁷ The declining security situation in Algeria currently appears to be limited to military targets.

“The military are actively pursuing targets linked to AQIM and other anti-government and Islamist movements...the latest casualties are part of their operations...however, more militant activity increases the risk of more attacks.”³⁸

The landscape of Algerian Islamist militants is continuing to shift. Local media reported on 19 August that **Al-Murabitoun**, a group which has carried out some of the highest profile terrorist attacks in Algeria including the January 2013 **In Amenas** gas plant attack, has merged with **Al-Qaeda**.³⁹ Al-Murabitoun’s Algerian leader **Mokhtar Belmokhtar** released a video rebranding the group **Qaeda al-Jihad in West Africa**.⁴⁰ Belmokhtar originally split from AQIM in May 2012. His return bolsters AQIM’s forces after **Jund al-Khilafah fi Ard al-Jazayer** (*Soldiers of the Caliphate in Algeria*) split from AQIM and declared allegiance to **Islamic State** leader **Abu Bakr al-Baghdadi** in September 2014.⁴¹

Implications

Algeria has been a lone voice against OPEC’s more powerful members for almost a year so Iran adding its voice to theirs helps move the agenda forward. However, Iran itself comes with limited influence due to continuing geopolitical tensions with the majority of Middle East members. Iraq and Saudi Arabia will only be swayed by a significant threat to their own financial stability. If the oil price continues to fall this may yet happen.

In the meantime the government will need to address its budget deficit. Spending foreign cash reserves for two years will help to soften the transition from an oil-dependent economy. However, this will leave the economy highly exposed to further commodity fluctuations. The political environment compounds the lack of will to reduce subsidies. The administration is worried about destabilising rural areas, but the significant vested interests of the *pouvoir* – the businessmen and military figures around President **Abdelaziz Bouteflika** (1999-present) – also prevent wide-reaching reforms. The new ministerial team that Bouteflika put in place in May will struggle to take on these interests.

The security risk remains confined to specific areas of the country and to military targets. It will not have an immediate effect on businesses or investors’ interests. However, given Algeria’s recent history of instability, and the considerable support that militant organisations received in the 1990s, investors would be wise to observe the situation, which has the potential to escalate quickly.

³⁵ UPI, 16 Aug 2015

³⁶ Xinhua, 12 Aug 2015

³⁷ Algérie Presse Service, 24 Aug 2015

³⁸ Source, security consultant, Rabat

³⁹ AFP, 15 Aug 2015

⁴⁰ AFP, 15 Aug 2015

⁴¹ UPI, 16 Aug 2015

About Africa Risk Consulting:

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