Mohammed Laksaci: Financial system developments in Algeria – resilience and risks in the face of the international financial crisis and its spillover effects

Speech by Dr Mohammed Laksaci, Governor of the Bank of Algeria, at a Meeting with the Algerian Bankers Association, Algiers, 22 January 2009.

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Algeria's strong macroeconomic performance over the past nine years and the gradual strengthening of the banking sector's stability have contributed to establishing a relative resilience to external shocks. Key achievements include:

- sound management of international reserves (no investments in risky assets), paying due attention to the strategic objective of safeguarding asset portfolios against any loss of capital;
- significantly reducing external debt, in 2005 and 2006, after strictly limiting external borrowing since early 2000. By end 2008, total medium and long term debt stood at only $4 billion (less than 3% of GDP). Furthermore, banks' external liabilities represent less than 1% of their total liabilities, and banks are required to deposit their end-of-day foreign exchange balances at the central bank which manages the country's overall exchange position;
- saving part of the fiscal revenue windfalls, with an annual budget saving averaging 23% of GDP during the period 2005-2008. By end 2008, savings in the stabilization fund (FRR) , totaled DA 4113 billion (equivalent to $57,8 billion);
- domestically financing the economy's large investments, in the context of excess saving rates over investment rates;
- developing the bond segment of the financial market, with access limited to domestic investors;
- Advancing the restructuring of the banking sector following failure and bankruptcy of small private banks which resulted in withdrawing their licences over 2003-2006 while compensating depositors through the Deposits Guarantee Fund.

The strengthened macroeconomic stability, as evidenced by subdued inflation (4.4 % in 2008 despite the surge in world commodity prices) and a real exchange rate of the Dinar near its equilibrium level, as well as important foreign exchange reserves ($143 billion, by end 2008) and low external debt, have constituted sound safeguards against the inherent shocks of the current international financial crisis. In addition, indirect monetary policy instruments (deposit auctions, marginal deposit facility, …) have been successfully used to limit the impact of structural excess liquidity on inflation.

Although the direct contagion impact of the international financial crisis on the Algerian banking system is limited, in view of its small exposure to international financial markets, increased attention is directed to further strengthening and preserving its soundness. In this regard, the required minimum capital for banks and financial institutions have recently been substantially increased to strengthen their resilience and increase their lending capacity.

Despite the structural nature of the excess liquidity since 2002, growth of credit to the economy has been relatively moderate (14% in 2008). For a better contribution to the diversification of the economy, banks are expected to enhance their efforts in financing the development of SMEs while further improving credit and operational risk management.

The role of banks in investment financing is crucial given the limited development of the financial markets. The 2009 government budget provides for appropriations to strengthen public banks' capital base. Government financial support to the public banks (bailing out of public banks' portfolios and strengthening of their capital assets) averaged 2.6% of GDP for the period 1991-2002 and 1.7% for the period 2005-2006.

The Bank of Algeria will continue to pay due attention to potential risks arising from the deepening international financial and economic crisis, particularly risks to the banking sector. In this respect, particular attention will be attached to the flexible use of available monetary policy instruments and to maintaining a flexible exchange rate policy to reflect the economy's fundamentals.

At the same time, banking supervision will continue to be strengthened, in accordance with the ongoing initiatives of the Basel Committee. Following the modernization and consolidation of banks' reporting system and the recent increase in required minimum capital, sustained efforts are being devoted to strengthen the operational and regulatory frameworks of the banking sector over the first half of 2009 (conformity of bank assets, liquidity and credit risks management, …), in accordance with international standards. In this regard, a stress testing system, introduced in 2007, already contributes to better assessing banks' risk management and evaluating adequacy of capital assets to potential risks. In view of the large number of foreign banks presently operating in Algeria, continued efforts are being made to develop bilateral cooperation on their supervision.

In conclusion, prudent management of resources and continued strengthening of the financial and banking system stability allow Algeria to consider its medium term economic objectives with a relative confidence. However, the deepening of the international financial crisis and its drastic spillover effects on the world economy is already affecting the country through a number of channels, notably:

- a reduction in its savings capacity. The sharp decline in oil prices is drastically reducing hydrocarbon export receipts and consequently government's savings capacity. A prolonged weakness of oil prices would inevitably erode the financial wealth accumulated in the stabilization fund with a correlative reduction in international reserves;
- a reduction in the yields on the investment of international reserves, as a consequence of low interest rates in international markets.