Mohammed Laksaci: Investment financing in Algeria

Speech by Dr Mohammed Laksaci, Governor of the Bank of Algeria, at the Japan-Arab Economic Forum, Tokyo, 7–8 December 2009.

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1. Recent economic and financial developments

The deep and synchronized recession in advanced economies, which resulted from the deepening financial crisis during 2008 and which rapidly spread to many emerging and developing countries, appears to recede. Indeed, the second and third quarters of 2009 recorded the first signs of stabilization and even some signs of improvement in the global financial situation. The massive public interventions in many countries have contributed to reducing systemic risks and uncertainties in the financial markets.

However, signs of malfunctioning in the financial sector remain and commercial banks are still dependent on exceptional budgetary support and central banks, in the context of gradual recovery in some advanced countries. Ensuring sustainable growth anchored to financial stability remains a major challenge.

The spill over of the impact of the global financial crisis and recession to emerging and developing countries is well established in the first half of 2009, especially in countries affected by sudden capital outflows in the context of high exposure of their banking sector to international financial markets. In response, recovery plans focussed on supporting domestic demand have been implemented in a number of emerging countries, particularly in Asia, thereby contributing to stimulating commodity export recovery in Latin America and the Middle-East.

With limited exposure to international financial markets, Algeria has not been directly affected by the global financial turmoil. However, the sharp decline in oil prices over the second half of 2008 significantly impacted export and budget revenues. Despite this external shock, macroeconomic performance remained robust in 2009 with:

– strong external financial position with comfortable international reserves (US$ billion146, end September 2009) equivalent to 3 years imports of goods and services, and low external debt;

– the real effective exchange rate around its equilibrium level;

– continued high growth in the non-oil sector, expected to exceed 9% in 2009 against 6.1% in 2008;

– sizeable savings in the stabilization fund despite the expected first budget deficit for several years;

– contained inflation, notably on account of continued absorption by the Bank of Algeria of the excess liquidity.

The strong economic performance in 2009, in line with the performance of the past several years, reflects continued prudent financial policies, sustained efforts to anchor monetary stability, and progress in strengthening the resilience of the banking sector, which have supported macroeconomic stability since 2000.

2. Savings and investment financing structure

Following a period of external financial imbalances and related adjustment programs during the nineties, Algeria has entered, since 2000, a period of sustained increase in savings, leading to a situation of excess savings over investment. Despite a situation of increasing investment rates, the ratio of total savings to GDP reached 57% in 2008 against 48% in 2004, leading to a context of excess saving rates of 13% to 24,7% over the period. These developments have allowed sizeable reserve accumulation, particularly from 2004 (US$ billion 43) to 2008 (US$ billion 143) as a cushion against possible external shocks, including shocks of a "sudden stop" nature.

Anchored to regained macroeconomic stability, a large public investment program was launched in 2001 (2001–04) followed by a larger one in 2005 (2005–09). Implementation of the two public investment programs significantly stimulated gross fixed capital formation, with public investments representing 56.5% of total investment in 2008 up from 40.8% in 2004. Over the past five years, public investments (economic and social infrastructure, housing, agriculture and water, others) amounted to US$ billion 80 (representing 51% of a total of US$ billion 156). It should be noted that foreign companies, particularly from Asia, hold a significant position in terms of implementation of the public investment programs.

In parallel, the national oil company (Sonatrach) implemented ambitious annual investment plans over the past 3 years, increasing the annual investment envelope from US$ billion 4.8 in 2006 to US$ billion 8.5 in 2008. For the past 5 years, the ratio of Sonatrach's investment to total investment reached 17.6% (17.1% in 2008). For 2009, Sonatrach's investment program amounts to US$ billion 16.5.

Investment of the remaining sectors of the economy represented 31% of total investment over the period 2004–08. In 2008, this ratio was 26.4%, although investment in these sectors increased sharply during this year (+37.4%).

In the context of structural excess savings over investments, the structure of investment financing in Algeria over the past 5 years reflects the predominance of self-financing (82.5%) on account of the budgetary financing of the public investment programs.

Indeed, with significantly increased financing capacity, domestic financing has been the sole source of public investments financing, at a time where external debt was significantly reduced, notably through advanced repayments of nearly all public external debt (which amounted to US$ billion 13.9 by end 2003). Domestic public debt has also been significantly reduced to a level representing 6.6% of GDP in 2008, down from 18.7% of GDP in 2003. In addition, available resources in the stabilization fund amounted to US$ billion 59 by end 2008, representing a sizeable self-financing capacity which allows continued implementation of the investment program (2009–10) in the context of external shocks.

While Sonatrach's investments were partly – although to a large extent – financed on the company's own resources over the period 2001–04, accumulated savings (reaching US$ billion 18 by end 2008) have since allowed for total self-financing of the oil company's investments, with investments in 2009 upstream and downstream significantly increasing, in view of the important opportunities in the sector and in line with the objective of achieving potential capacity.

Investment in the remaining sectors of the economy have also been, to a large extent, self-financed (44.2% during the period 2004–08) while financial savings of private enterprises and households increased. The share of bank financing, mainly domestic, represented 50.5% while bond issuance covered 5.3% of financing needs.

Domestic medium and long term bank loans, which have been substantially increasing over the past 5 years, have been oriented to investments in productive non-oil sectors, notably energy and water sectors where investments have significantly increased.

Anchored to relatively stable and sustainable resources, the development of credit allocation has been notable, with credit to the economy increasing by 15.7% in 2007 and 18.6% in 2008. Growth in the credit to the economy in 2009 remained strong (19.4%, twelve months increase by June 2009) at a time where many emerging economies faced bank credit contractions. Credit to private enterprises and households represents a large share of total allocated credit (54 to 55% over the past 3 years). Medium and long term (investment) credit increased by 20.9% in 2008 and 12.9% in the first half of 2009, reflecting favorable domestic bank financing conditions.

In this favorable financing context, additional measures have been introduced in the Supplementary Budget Law of July 2009, aimed at further promoting credit to small and medium size enterprises (SMEs), including increasing the maximum government guaranteed credit amount. In the same vein, banks are allowed to extend credit to their affiliates up to 25% of their tier 1 capital. In addition, additional cleaning of past nonperforming loans (NPLs) to public enterprises is being completed by the Treasury.

Increased capital of the banks in 2009, in the context of abundant liquidity and sustained efforts to improve credit evaluation and risk management, should stimulate further improvement in banks' credit allocation to productive investment in support of sustained growth. In particular, domestic financing available for companies established in partnership, as encouraged through measures introduced in the Supplementary Budget Law, should provide further opportunities to banks operating in Algeria. Finally, banks' financial soundness, as reflected in their global capital adequacy ratio (16.54% in 2008), which is key to ensuring adequate financing of productive investment, should contribute to achieving growth potential in the non-oil sectors over the period 2010–14.

3. Exchange rate regime stability and foreign investment

In the context of the liberalization of the exchange rate regime, as part of the 1994–98 structural adjustments, the process of convertibility of the dinar for international current transactions was completed in September 1997 when Algeria accepted the terms of Article VIII of the International Monetary Fund's (IMF) Articles. In parallel, the monetary authority promulgated in 1995 the regulation on interbank exchange market and related exchange rate hedging mechanisms. The operational framework was put in place by the Bank of Algeria and exchange market operations effectively started in 1996.

The current convertibility of the dinar relates to all current transactions of the balance of payments (goods, services and transfers). Regulation 07–01 of February 3, 2007 on rules applicable to current transactions with the rest of the world has clearly confirmed this convertibility through its Article 3, which stipulates that: "... payments and transfers related to international current transactions are free. They take place through licensed intermediaries".

Regarding foreign direct investments, transfers of revenues, profits, and dividends are included in the scope of current convertibility. In case of asset sale or liquidation, transfer of the proceeds takes place through licensed intermediaries without delay, commensurate with Regulation 05–03 of June 6, 2005 on foreign investments, promulgated in implementation of Article 31 of the Ordinance on investment development.

It should be noted that the measures introduced in the Supplementary Budget Law of July 2009 do not affect the current convertibility regime nor do they affect capital transfers related to foreign direct investments (FDIs). The measures do not give rise to any exchange restriction. The objective of the measures is to ensure the traceability of payments related to good faith transactions, hence contributing to combating the parallel sector and ensuring that banks operating in Algeria effectively fulfil their responsibility in terms of first-level control of the transactions with the rest of the world, in line with the terms of their license.

Algeria remains committed to the stability of its exchange rate regime, commensurate with its commitments in the context of Article VIII of the IMF's Articles and the Association agreement with the European Union (EU), notably regarding current payments and capital movements.

Foreign direct investment in Algeria is a relatively recent development and has notably followed the achievement of balance of payments viability. For the past six years (2003–2008), total FDIs amounted US$ billion 8.7, of which 47.3% from EU countries and

25.2% from Asian and Middle-Eastern and North African countries. The share of FDIs in the hydrocarbon sector in total FDIs, which reached 55% in 2005, has gradually declined to 42% on average during the recent years. Non-hydrocarbon sectors which attracted FDIs include the banking sector, chemical industry, food industry, electricity sector, water desalination, and construction material.

The exchange rate policy is conducted by the Bank of Algeria in the context of a managed float regime of the dinar vis-à-vis the currencies of Algeria's main trade partners.

Since 2004, with a real effective exchange rate (REER) around the equilibrium level as determined by the economy's fundamentals, exchange rate policy is well in line with external stability, the latter being anchored to a notably strong net external financial position. In operational terms, the Bank of Algeria intervenes in the interbank market to ensure that movements in the nominal exchange rate do not affect the long term equilibrium of the real effective exchange rate of the dinar.

In this context, despite high volatility of consumer prices and exchange rates in trading partners, including the sharp decline in oil prices in the second half of 2008 (one of the main fundamentals in Algeria's economy), the REER has remained near its equilibrium level and the external financial position remains comfortable.