Algeria's banking system struggles in the face of political upheavals

Six months after a series of demonstrations on the streets of Algeria forced the resignation of former President Bouteflika, the country remains in crisis. Some of Algeria's most prominent politicians and businessmen have been arrested, opposition groups struggle to present a unified front, and economic activity is slowing. Meanwhile, the army, led by General Gaid Saleh, monitors and tries to direct events from above.

Algeria's archaic banking and financial system is not well placed to cope with this upheaval and uncertainty. In the following article, *Arab Banker's* Editor, Andrew Cunningham, presents a profile of the Algerian banking system and considers the challenges that it will face if the political crisis continues.

According to official figures, Algeria's banks are well placed to cope with the political upheavals that began in February this year and look set to continue well after this edition of *Arab Banke*r is published.

Across the system as a whole, capital adequacy ratios averaged nearly 20%, of which about 16% was Tier 1. Return on assets was running at 2–3% and return on equity around 18%. The public-sector banks were showing non-performing loan (NPL) ratios of 13% and the private banks were showing 8%. Those are high NPL ratios, but the picture improves when provisions and the high levels of capital are taken into account.

Furthermore, those estimates, which come from the Banque d'Algérie (the central bank), are for 2017, three years after the Algerian economy had begun to slow down in response to lower oil and gas prices.

However, it would be unwise to take those official figures at face value. In economies such as Algeria's, NPLs are routinely understated, especially when they are due from public-sector companies; and loans to the public sector account for about 50% of all loans made by banks. (See Table 1.)

Equity-to-net loan ratios provide some perspective on this issue: if Banque Extérieure d'Algérie and Crédit Populaire d'Algérie were understating their NPLs by 12% at the end of

Table 1: Agregate balance sheet indicators of deposit taking banks, 2014–September 2018

In Billions of Algerian Dinars	Sep 18	End 2017	End 2016	End 2015	End 2014
Assets	15,362.4	14,098.4	12,881.0	12,506.7	11,976.4
Credit to domestic private sector	*4,861.9*	*4,565.5*	*3,954.5*	*3,586.1*	*3,119.7*
Credit to state-owned companies (non-financial)	*4,769.5*	*4,153.6*	*3,794.5*	*3,530.2*	*3,224.6*
*Placements with Government**	*2,057.4*	*2,105.8*	*2,641.8*	*1,929.9*	*1,472.0*
Deposits from demestic private sector	5,483.8	5,121.7	4,884.2	4,667.3	4,376.3
Deposits from the public sector	3,945.6	3,448.2	2,741.4	3,037.6	3,197.9
Capital and reserves	1,161.1	1,059.9	963.4	863.9	744.4
Memo item: Assets in $bn, using end of period exchange rate	133.7	122.7	112.1	108.9	104.2

** includes government bonds, placements with the Treasury, and other placements*
Source: Banque d'Algérie, Bulletin Statistique Trimestriel

2017 then, with realistic accounting treatment, they would not be able to show any capital funds. The equivalent figure for Banque Nationale d'Algérie was 13.6%. (See Table 2.)

Looking beyond NPLs, capital ratios of Algerian banks are flattered by the zero risk weighting that is applied to government-related entities. Although consistent with current international standards – and routine practice in emerging markets – such zero risk weights hardly reflect the true likelihood that interest and principal will be repaid on the due dates.

The sharp fall in oil prices, which began in the second half of 2014, greatly reduced the Algerian government's revenues. Hydrocarbon revenues (which include sales of gas, whose price is linked to that of oil) halved from 2014 to 2016. Initially, the government relied on exchange rate depreciation, and on the drawdown of financial reserves that had reached high levels during the previous years of high oil prices; but as reserves dwindled, the government changed course and moved to stimulate the economy through increased spending that was funded by monetary operations. Simply put, during 2017 the Banque d'Algérie paid dividends to the government, and when that became untenable it lent money to the government.

By early 2017, the Oil Stabilisation Fund (which accumulates funds during good times with the aim of using them during bad times) had been run down to zero, having stood at $56bn at the end of 2014. International reserves had been cut in half, although at around $80 bn at the end of 2018 they were still equivalent to 16 months of imports, according to IMF figures.

It is in this uncertain fiscal and budgetary environment that Algerian banks have faced the political upheavals that began in February with protests against the candidacy of President Bouteflika in the elections that had been scheduled for 18 April.

Bouteflika's candidacy was withdrawn on 11 March and his office announced that he would resign the Presidency by 28 April. In late May, Presidential elections that had been rescheduled to 4 July were postponed *sine die* by the Constitutional Council. As *Arab Banker* was going to press, Abdel Kader Bensaleh remained in place as a caretaker President, and Nouredin Bedoui the caretaker Prime Minister.

Throughout the summer, senior officials from the Bouteflika era and prominent businessmen were arrested as army and security forces fought for influence and settled old scores and grievances.

Those arrested and temporarily detained included the former President's younger brother, Said, who had been *de facto* ruler in recent years; and two former heads of the Direction du Renseignement et de la Sécurité (DRS – the internal intelligence service): Tewfiq Mediene; and the man who controversially replaced him in 2015, Bachir Tartag.

Two former Prime Ministers, Ahmed Ouyahia and Abdel Malik Sellal, and eight former cabinet ministers were arrested, along with Issad Rebrab, reputed to be Algeria's richest man, and Ali Haddad, the former head of the Algerian Business Leaders' Forum and owner of one of the country's biggest construction firms.

Table 2: Key financial figures for leading Algerian banks: end-2017*

$ mn	Banque Extérieure d'Algérie	Banque Nationale d'Algérie	Crédit Populaire d'Algérie
Assets	27,244	24,683	16,776
Loans to clients	15,930	14,155	10,528
Deposits from clients	21,877	16,007	11,615
Capital and reserves	1,905	1,925	1,261
Net profit	501	262	287
Capital and reserves % assets (unweighted)	7.0	7.8	7.5
Capital and reserves % net loans to clients	12.0	13.6	12.0

** Recent figures for Algerian banks are hard to find from publicly available information, such as banks' own websites. The three banks cited here were the only large local banks to have published their 2017 financial statements on their websites at the time this article was being prepared. Original figures in Algerian Dirhams have been converted to US$ at the end-2017 exchange rate: $1 = AD 114.6*

Financial soundness indicators of Algerian banks, preliminary for 2017*

Total capital ratio	
Public banks	19.8
Private Banks	18.7
NPLs/Total loans	
Public banks	12.9
Private Banks	7.9
NPLs net of provisions/regulatory capital	
Public banks	38.2
Private banks	16.2
Return on assets	
Public banks	1.9
Private Banks	2.6
Return on equity	
Public banks	18.7
Private Banks	14.7

** Source: Bank of Algeria, cited in IMF Article IV report, July 2018*

In June, local press reported that Aboud Achour, the head of Banque Nationale d'Algérie and of the Association of Banks and Financial Institutions, had been taken into detention alongside Omar Boudib, the former head of Crédit Populaire d'Algérie.

Boudib was reportedly investigated for extending loans "without due care" and for abuse of power. Such charges have implications for the future of Algeria's banking system that go beyond the high-level political vendettas that were being played out over the summer.

If bankers are afraid that their credit decisions will be used by political rivals to frame charges against them, they will stop lending.

It is hard to doubt that some loans made by banks, and particularly by state-owned banks, to those close to the Bouteflika regime were not made with the sole intention of financing business activities and stimulating economic growth; but business does depend on credit and working capital facilities, and when banks do not lend, economic activity stagnates.

In the short term, credit demand is likely to be subdued as businesses postpone investment decisions, but over the medium term, bank lending will be essential to re-start economic activity.

The longer-term issue is that of the modernisation of the banking sector. State-owned banks dominate the system: at the end of 2017, they accounted for 99.8% of loans to the public sector and 74.5% of loans to the private sector, according to IMF figures. These banks are essentially arms of the government and are used to fund government projects. Commitment to the broader community – ordinary Algerians who want to deposit money, borrow to buy a car or a house – is not part of their ethos, and as other emerging market banking systems have shown, that is something that takes many years to change.

The private banks provide better service – both to corporate and to retail clients – but they are focussed on the most profitable customer segments and are hemmed in by regulations that favour the state-owned banks.

Some progress has been made. Steps have been taken to improve governance at the state-owned banks, although the practical effects of this are hard to discern. Banque d'Algérie has strengthened banking supervision and required banks to conform to the Basel II standards.

Once a new political regime is established in Algeria, it will have to decide whether it wishes to maintain a banking system that exists to finance government projects or whether it wants to create a more open and competitive banking system that can stimulate private-sector growth, including small and medium-sized enterprises, and improve the lives of ordinary Algerians by enabling them to conduct their financial transactions efficiently and quickly.

For decades, Algeria has been ruled by a group of people whose instincts have always been to retain control of economic activity, to take advantage of cyclical phases of high oil and gas revenue to boost spending and reserves, and to use political and security institutions to depress popular dissatisfaction during times of economic strain.

If Algeria is to move beyond this model, a radically different group of leaders will have to emerge from the current upheavals. Whether that will happen is unlikely to be known for some time. ■

Banks listed on the website of Banque d'Algérie, July 2019

State-owned banks

Banque Extérieure d'Algérie
Banque Nationale d'Algérie
Banque de l'Agriculture et du Développement Rural
Banque de Développement Local
Crédit Populaire d'Algérie
Caisse Nationale d'Epargne et de Prévoyance

Foreign banks

Banque Al Baraka
Arab Banking Corporation
Natixis
Société Générale
BNP Paribas
Trust Bank
Gulf Bank
The Housing Bank for Trade and Finance
Fransabank
Crédit Agricole Corporate & Investissement Bank
Al Salam Bank

Foreign branches

Arab Bank Algeria
Citibank Algeria
HSBC