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The Effect of the Financial Depth of the Monetary Stability in Algeria: Econometric Study from 1994 to 2024

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Abstract:

This study analyses the effect of the financial depth of the monetary stability in Algeria from 1994 to 2024 by testing the relation between the financial depth FD indicators, namely the monetary supply MS to the GDP, the private credit PC to the GDP, and the monetary stability indicator (the inflation). In so doing, we used ARDL model to analyse the short and long term relations between the variables. Findings showed complicated and non-linear dynamic relations between FD and the monetary stability. In the long term, MS to the GDP positively and significantly affects inflation, showing that the monetary policy in Algeria had been expansionist during the study period. In addition, PC to GDP negatively affects inflation, confirming that granting credits to the private sector decreases inflation in the long term. As for the short-term, findings showed an immediate negative and significant effect for CP to GDP and a positive significant effect after three lags, confirming the effect of the credit policies on the general level of prices.

Keywords: financial depth; monetary stability; monetary policy; inflation.

Jel Classification Codes : E42

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1. INTRODUCTION

The financial stability is a key point in the economic policies for its role in boosting the purchasing power, fostering trust in the financial system, and limiting inflation and market fluctuations. In this regard, FD highly mirrors the development of the financial sector compared to the macro economy. Governments have to achieve FD, as it facilitates resources mobilization and direction towards productive investments, supports liquidity, and fosters the economic growth in the long-term. Besides, a deep financial system provides more efficient channels to empower the monetary policy to affect economy, consolidate local liquidity, absorb external shocks, and achieve goals. Thus, FD is crucial for increasing the efficiency of the momentary policy and achieving the monetary stability.

Based on what was said, this study discusses the effect of FD of the monetary stability in Algeria by analysing the relation between FD as an independent variable and inflation INF as a dependent one that reflects the monetary stability. In addition, we shall measure FD using the ratio of PC to the GDP and MS to GDP. Moreover, we raise the following problematic, "Is there a cointegration between FD and monetary stability in Algeria during the study period?". From this question, sub-questions arise, as follows:

- Is there a statistically significant effect in the short and long terms between FD through PC to GDP and Inf?
- Is there a statistically significant effect in the short and long terms between FD through MS to GDP and Inf?

2. Literature Review:

- The study of Sato Ryoji (2025): It aims at showing the role of FD and the banking indicators as factors of developing the financial sector in identifying the economic growth in the Arab Gulf states during 2000 and 2018 using Generalized Moments Method. Findings show that PC highly contributes to the economic growth and that the bank cost and the assets negatively affect the economic growth. Since the negative effect of the credit provided to the government and the governmental institutions reflects crowding out, governments had better foster private credit instead of borrowing themselves.

- The study of Quoc Hoi Lea (2019): It discusses the relation between the states of the League of East Southern Asia+3 from 2000 to 2014 based on Coup Douglas model. Findings show that FD that is measured with PC to

GDP, MS, and stock market capital affects the economic growth. The study recommends developing the financial growth to achieve long-term economic growth in those states.

- The study of (Adeniyi O. Adenuga and Babatunde S. Omotosho, 2013): It aims at studying the long-term relation between FD, access to financial services, and economic growth in Nigeria using error correction model. Findings show that the increase of FD (measured with MS to GDP or PC to GDP) increased GDP in Nigeria during 1975-2012. However, the population per each bank negatively affects the economic growth and confirms that access to the financial services is key for development. Therefore, the study supports the financial inclusive program adopted by the Nigerian Central Bank to foster development.

- The study of (Thuraya Abdul Rahim Al-Khazraji, 2020): It aims at studying the effect of FD on the monetary policy in Iraq. It tests the relation between FD and the efficiency of the monetary policy in Iraq using auto regression models, which measure the regression model when the values of the independent variable (Y) are slow for a previous lag (Yt-1) as an interpretative variable, in addition to other interpretative variables (Xt). Findings show that the decrease of FD, namely MS to GDP, PC to GDP, and deposits to GDP had a negative effect on the channels of monetary policy transmission to economy.

- The study of (Mohamed, 2021): It aims at measuring and analysing the effect of FD on the economic development in Algeria during 1980 and 2019 using ARDL model. It used MS to GDP to measure FD, the GDP per capita to measure economic growth, and the commercial openness indicators, the stock capital, and the exchange rate as control variables. Findings showed a long-term relation between FD and the economic growth in Algeria.

- The study of (Derdour, 2022): It aims at measuring the effect of FD on the efficiency of the monetary policy in Algeria during 1990-2019 using ARDL model. It used FD indicators as independent variables and GDP as a dependent variable. Long-term findings denied the hypothesis that stated that FD to GDP and PC to GDP support the monetary policy.

3. The Financial Depth:

3.1 The Concept of Financial Depth:

It reflects an increase in the delivery of financial services with multiple choices. According to the World Bank, it is the increase in the stock of assets. Thus, it is the ability of the financial institutions to mobilize the financial resources for development (Derdour; 2022, p. 194).

Traditionally speaking, it is the ratio of banking deposits to GDP (al Saadi, 2011, p. 219).

3.2 The Aims of Financial Depth:

- The efficient exchange of goods and services.
- Taking rational decisions regarding saving and investment.
- The good coverage of risks, as the financial sector creates a wide synthesis of assets that allow for distributing risks.
- Decrease of information incompatibility by issuing regulations that govern the financial sector (Abd al Rahman, 2024, p. 1767).

3.3 The Indicators of Measuring the Financial Depth:

Table 1. The Indicators of Measuring the Financial Depth

FD indicators on a bank basis	FD indicators on financial market basis
PC to GDP	PC to GDP
Financial assets to GDP	Public debts to GDP
Monetary sums to GDP	International debts to GDP
Overall deposits to GDP	Capitalization of stock market to GDP
Value added to the financial sector to GDP	Traded stocks to GDP

Source: (Derdour, 2022, p. 195)

4. The Financial Stability:

4.1 The Concept of Financial Stability:

It is the stability in the value of money and is seen in the stability of inflation rates. It does not negate inflation, but, rather, means a relative stability in prices with predictable fluctuations (al Zahra, 2021, p. 467).

4.2 The Importance of Financial Stability (Mahfoudi, 2024, p. 167):

- The achievement of harmony between the ratio of MS and the requirements of public expenditures, mainly consumption expenditure.
- A relative balance between goods flows and the monetary flows because any increase in MS is not faced with increase in goods flows.
- The efficiency of banking credits to all sectors.
- The stability of prices in the local market.
- Maintaining an exchange rate that suits the needs of the national economy.

5. Methodology:

The study aims at analysing the effect of FD on the monetary stability in Algeria. Therefore, we shall rely on ARDL model, as it helps estimate the long and short term relations between variables in time-series.

5.1 Variables and Basic Model Formulas:

Independent Variable:

Inflation: it is used as an indicator of the financial stability.

Dependent variable (interpretative variables):

Financial depth: it is measured with PC to GDP and MS to GDP.

The general formula of ARDL model is $(p, q_1, q_2, \ldots, q_k)$, where p is the number of lags of the dependent variable and q is the number of lags of the independent variable:

$$\mathrm{INF}_t = \alpha_0 + \sum_{i=1}^{p} \alpha_i \mathrm{INF}_{t-i} + \sum_{j=1}^{q_1} \beta_{1,j} \mathrm{CP}_{t-j} + \sum_{k=1}^{q_2} \beta_{2,k} \mathrm{MS}_{t-k} + \grave{o}_t$$

Where:

INF_t is the inflation ratio in t.

CP_{t-j} is CP to GDP in lag $t-j$

MS_{t-k} is MS to GDP in $t-k$

α_0 is the constant.

$\alpha_i, \beta_{1,j}, \beta_{2,k}$ are regression coefficients of different lags.

$\grave{o}_t$ is the random error limit.

6. Results:

6.1 The Results of the Descriptive Study:

Table 2. The descriptive statistics of the study variables

	INF	MS	CP
Mean	6.23	59.90	13.59
Median	4.30	62.40	12.60
Maximum	29.80	84.90	26.10
Minimum	0.30	33.00	3.90
Std. Dev.	6.18	13.87	6.35
Skewness	2.46	-0.38	0.17
Kurtosis	8.90	2.19	1.95
Jarque-Bera	76.34	1.58	1.57
Probability	0.00	0.45	0.46

Source: by the author based on the outputs of the statistical program

The descriptive statistics show that the mean of Inf in Algeria during the study period is 6.23%, showing that statistically speaking all the values

lean to concentration at relatively lower levels than the mean due to extended lags marked with relative stability of prices. However, the minimum limit 0.30% and the maximum limit 29.80% show wide fluctuations in time series, confirming strong price shocks and inflation factors in some years, such as the high increases in exchange rates and imports prices, or internal financial and monetary effects. In addition, the standard deviation 6.18% is in harmony with the big dispersion in values. Skewness is estimated at 2.46 and reflects a strong positive deviation in the variable distribution, showing that the high values of inflation are more frequent than the very low values. Besides, Kurtosis value is 8.90, showing fat tails and significant deviation than the normal distribution, as confirmed by Jarque-Bera test, whose value is 76.34, and probabilistic value that is estimated at 0.00. Thus, we refuse the hypothesis on the normal distribution of inflation. These statistical characteristics are important for the standard modelling because they show the need for models, which can represent the non-linearity and dispersion, such as ARDL and error correction models.

Table 3. Taxonomy of linear correlation between the study variables

Correlation	INF	MS	CP
INF	1		
MS	-0.368	1	
CP	-0.300	0.953	1

Source: by the author based on the outputs of the statistical program

The table shows an average reverse relation between inflation, MS to GDP, and PC to GDP, as the correlation between inflation and MS to GDP is 0.368, and inflation and PC to GDP is 0.300, what primarily means that the increase of liquidity and expansion of credit in Algeria does not depend on inflation; rather, it is related to stability or decrease of general prices, mainly when the state was able to absorb the effect of the monetary expansion by funding the imports with oil surplus. In return, we find a very strong correlation between MS to GDP and PC to GDP estimated at 0.953, as the expansion of MS is usually faced with an increase in the banks' ability to fund the private sector. Thus, the credit dynamics is highly related to the prevailing monetary policies and the liquidity level. In general, these results show that the interpretation of the relation between inflation and FD in the Algerian context is not understood by the simple correlations; rather, it requires a dynamic model like ARDL to find out whether the effects appears in the long or short terms and how the relation power and direction change with the changes in the economic environment, mainly after the big changes in the oil exports.

6.2 Results of the Econometric Study:

6.2.1 Testing the Stationarity of Time Series:

Table 4. Stationarity test with developed Fuller-Locker test:

Variable	(At level)			(First Difference)		
INF	0.00001	0.06154	0.01420	0.04063	0.00344	0.00010
MS	0.30432	0.73073	0.87128	0.01950	0.00787	0.00000
CP	0.54626	0.77801	0.88165	0.00395	0.00068	0.00006

Source: by the author based on the outputs of the statistical program

Findings show that the three variables are not stationary at level, as P-values of all variables are higher than 1%, 5%, and 10%, meaning that we refuse the hypothesis about the unit root. Thus, the inflation time series, MS, and PC are non-stationary series at level. In return, all variables are stationary at first difference, as the values decrease to lower than the critical, where the values of (p) for inflation at first difference are 0.00344 and 0.00010, for MS are 0.01950, 0.00787, and 0.00000, and for PC are 0.00395, 0.00068, and 0.00006. Therefore, we refuse the unit root at first difference and confirm that the time series are stationary at first difference I(1).

These results reflect the changing nature of the Algerian economy in time, as the three variables are affected by internal and external variables, such as the oil prices fluctuation, the changes in the credit and liquidity policies, the issues in offer and supply, and the changes in the financial and monetary policies; making the current levels non-stationary, but they turn into stationary series after differences. These findings have high methodological importance because they support the use of ARDL model, which is suitable when the changes are a mixture of I (0) and I (1) and allows for testing the existence of a long-term balance relation by testing bounds to provide a suitable analytical frame that helps deduce the short and long terms effects between FD and inflation in Algeria.

6.2.2 Bounds Test for Cointegration:

Table 5. Bounds Test for Cointegration

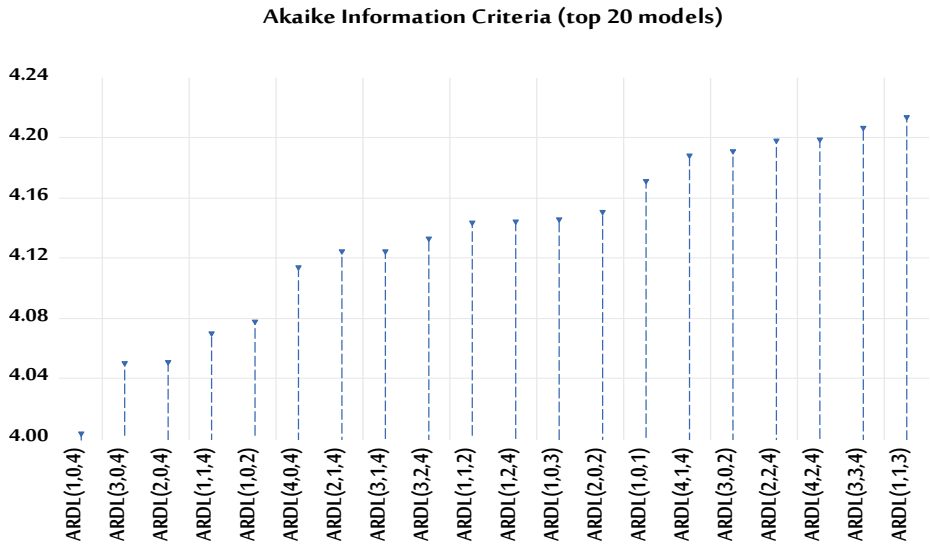
Null hypothesis: No levels relationship	
Number of cointegrating variables: 2	
Trend type: Rest. constant (Case 2)	
Sample size: 27	
Test Statistic	**Value**
F-statistic	**7.5879117**

Source: by the author based on the outputs of the statistical program

The results show a complementary relation between the variables, as the value of F-statistics is 7.5879 and is very higher than the suggested critical values in Pesaran tables. Thus, we refuse the null hypothesis about the absence of a long-term balance relation between all the variables and accept the alternative about the cointegration between inflation, MS, and PC during the study period. In this regard, despite the non-stationarity of the variables at level and their being I(1), the variables move in the long-term according to a common path that links them, making them correct their temporary deviations with time.

Moreover, the changes in FD, either expansion in liquidity or PC, have permanent effects on the price level in the Algerian economy. Therefore, the results of ARDL model are reliable and can be used to deduce the long-term coefficients, derivate the error correction model, and analyse the dynamics of the movement of FD effects on inflation in the long and short terms. This provides a strong experimental basis to understand the relation between the monetary policy and the financial sector in the Algerian economy.

Fig. 1. Choosing the best model using Akaike information criteria



Source: by the author based on the outputs of the statistical program

The figure shows that the choice of the optimal model was exact and methodological, as 100 models were compared. In addition, the chosen model, ARDL (1, 0, 4), achieved the lowest value of AIC model, as AIC values for the first 20 models are between 4.00 and 4.22, with a clear outperformance for the chosen one, which had a value of 4.003. In addition, the differences between the models are slight, as AIC values are gradually

convergent, reflecting the existence of many good models. In this regard, the used model is not a random choice; rather, it is the outcome of an automatic and regular selection process to get the best representation of the dynamic relation between FD and inflation in Algeria, making sure to avoid the number of over-fitting variables that may weaken the predictive ability and statistical efficiency of the model. This fosters the reliability of results and conclusions.

6.2.3 Estimating the Long- and Short-Term Relations:

Table 6. The results of short-term model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
COINTEQ*	-0.75701	0.12770	-5.92824	0.00001
D(CP)	-0.92358	0.17260	-5.35113	0.00002
D(CP(-1))	-0.25822	0.16864	-1.53124	0.13996
D(CP(-2))	0.06626	0.16725	0.39618	0.69579
D(CP(-3))	0.46836	0.17736	2.64074	0.01493
R-squared	0.73160	Mean dependent var		-0.06296
Adjusted R-squared	0.68280	S.D. dependent var		2.61944
S.E. of regression	1.47529	Akaike info criterion		3.78116
Sum squared resid	47.88255	Schwarz criterion		4.02113
Log likelihood	-46.04568	Hannan-Quinn criter.		3.85252
F-statistic	14.99157	Durbin-Watson stat		1.76723
Prob(F-statistic)	4.71E-06			

Source: by the author based on the outputs of the statistical program

COINTEQ* is the main item in the short-term model, as it represents the speed of the model's return to its long-term balance after a temporary shock or deviation. It has a negative value estimated at -0.75701 and a strong statistical significance at 1 (0.00001), confirming cointegration between the variables and the previous results of bounds test. In addition, almost 76% of disturbances in inflation is corrected in one year, which is a relatively fast average that reflects the ability of the financial and economic system to correct the short-term disturbances and re-establish long-term balance between inflation and FD. Thus, the short-term shocks on prices are handled to gradually go with the financial and monetary factors, including the increase of PC and liquidity.

The Effect of Changes in PC on Inflation in the Short-term:

The results of differences in PC in the short-term show an important significant effect on inflation, as D (PC) is -0.92358 with a very high

significance degree of 0.00002, meaning that any immediate increase in PC decreases inflation in the same period. From an economic perspective, the credit expansion in Algeria may be related to funding the productive or investment activity instead of consumption expansion; this reduces price pressures, mainly with the state's ability to support imports and absorb the increasing demand. Moreover, some lag differences, such as in D(PC) (-3) have a statistically significant and positive effect (p=0.01493), showing some lagging effects for credit that appear after many lags. This goes with the nature of the monetary policy that usually needs time before completely moving to the prices level. On the other hand, other differences, such as D (PC) (-1) and D (PC) (-2), show no statistical significance, confirming that the effect is non-linear and varying in time in all phases of time series.

The Strength of the Statistical Model and the Reliability of Estimation:

The indices of estimation quality reflect the short-term model's force and analytical ability, as R^2 is 0.7316, meaning that 79% of changes in inflation can be interpreted with the changes listed in the model while the adjusted R^2 is high (0.6828), showing a good interpretational ability despite the limited number of variables. In addition, F statistics has a high statistical value of 4.71, confirming the model's significance and ability to interpret the short-term relations between inflation and FD. Furthermore, Durbin-Watson value is 1.767, which is close to neutral value (2), reflecting the absence of a big problem in serial correlation of residuals; this is important to ensure the validity of ARDL model results. Besides, the values of AIC information are relatively low at SC and HQ, confirming the suitability of lags choice and that the model has balanced efficiency and interpretability. Together, these indicators give trust in the model's ability to interpret the inflation dynamics in the short-term in the light of PC movements and allow for a wider analysis when merging their results with long-term estimates and error correction model.

Table 7. The equation of the long-term balance in ARDL model

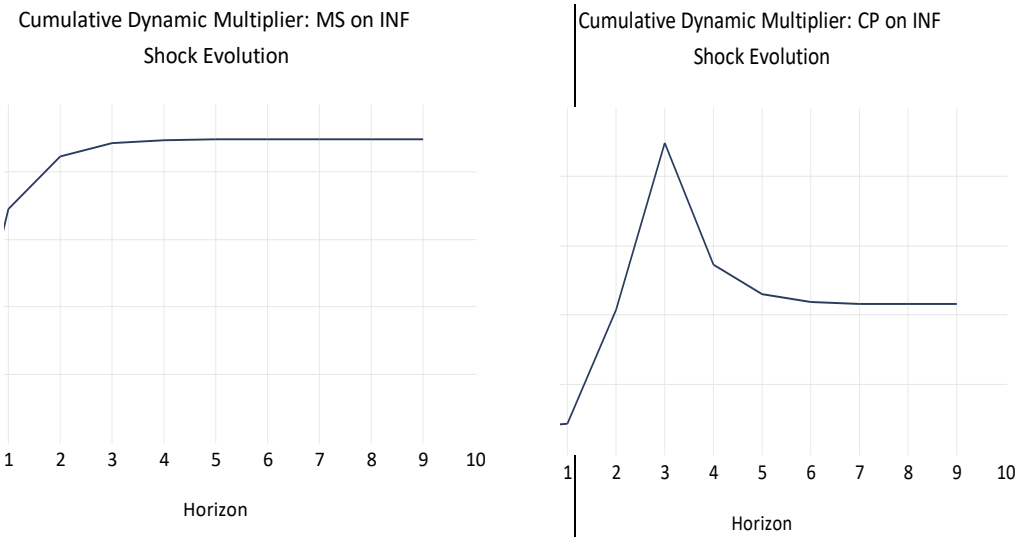
Variable *	Coefficient	Std. Error	t-Statistic	Prob.
MS	0.34967	0.15697	2.22766	0.03554
CP(-1)	-0.56831	0.31600	-1.79847	0.08469
C	-9.15846	5.64492	-1.62242	0.11778
Note: * Coefficients derived from the CEC regression.				

Source: by the author based on the outputs of the statistical program

Rest. Constant shows the existence of a restricted constant in the long-term balance relation between the variables without a time trend. In

addition, the error correction equation shows that Infl-1 is linear and correlated with MS and PC (-1), as the values between brackets represent the long-term balance relation. In this regard, any deviation from this balance is corrected in the short-term by the error correction coefficient in ARDL.

Fig. 2. The cumulative dynamic multipliers of the independent variables on inflation



Source: by the author based on the outputs of the statistical program

Based on the cumulative dynamic multipliers, we can analyse the development of inflation response to the shocks in the independent variables throughout time. The 1st figure shows the effect of MS shock on inflation, as the shock starts with a cumulative positive effect of 0.26 in Horizon 0 and, then, rapidly increases in Horizons 1 and 2 to reach 0.35 and 0.34, and, later, turns stable in Horizons 03 and what follows, meaning that a sudden increase in MS leads to a cumulative increase in inflation with about 0.35 points in the long-term; this reflects the positive relation between liquidity and the price level in the Algerian economy.

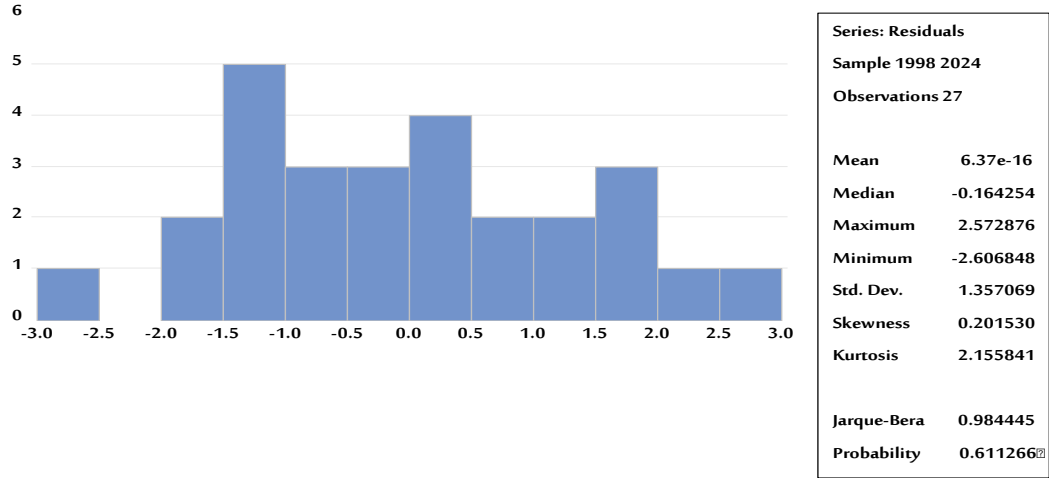
In addition, figure 02 shows the effect of a shock in PC on inflation. In this regard, we see a more complicated and non-linear behaviour, as the cumulative effect starts negative at about -0.92 in Horizon 0 (it is in line with D (PC) in the short-term model) and, then, gradually improves to be less negative in horizons 1 and 2, reaching a slight positive peak at about -0.12 in Horizon 3 before it decreases and turns stationary at -0.57, starting from Horizon 4 and on. This means that the increase of PC leads, first, to a sharp decrease in inflation (due to the productive funding); however, this

gradually vanishes in the middle-term before getting stationary at a long-term negative effect, meaning that the expansion of credit in Algeria decreases inflation in the long-term with 0.57 percentage points thanks to improved supply and increased productivity. Together, these curves confirm that the effects of FD on inflation are dynamic and changing in time, not immediate or constant, and that the credit and monetary policies need enough time to show the full effects on FS. Therefore, the Algerian decision makers must consider the policy transmission lags when designing anti-inflation strategies.

6.2.4 Diagnosis Test:

Normality Test:

Fig. 3. Normality Test



Source: by the author based on the outputs of the statistical program

Jarque-Bera results show that the model residuals follow the normal distribution, as the test statistics is estimated at 0.984445 with a probability of 0.611266, which is very high and greater than 1%, 5%, and 10%. Thus, we accept the null hypothesis about the normal distribution of residuals. Besides, Skewness is 0.201530 and Kurtosis is 2.155841; values that are close to the optimal values of normal distribution. Thus, the errors distribution has no affective odd values. These results are very important for the validity of the model, as they ensure the reliability of the statistical tests used in estimating the coefficients and testing the statistical significance. In addition, they confirm that ARDL conclusions on the relation between FD and inflation in Algeria are correct and reliable for economic analysis and policy making, with no need for alternative estimation methods.

Table 8. Serial correlation of residuals

Breusch-Godfrey Serial Correlation LM Test:			
Null hypothesis: No serial correlation at up to 2 lags			
F-statistic	0.4535	Prob. F(2,17)	0.6429
Obs*R-squared	1.3676	Prob. Chi-Square(2)	0.5047

Source: by the author based on the outputs of the statistical program

Breusch-Godfrey tests show that F statistics is 0.4535 with a probability of 0.6429, and that R^2 statistics is 1.3676 with a probability of 0.5047 and are higher than 1%, 5%, and 10%, reflecting failure in refusing the null hypothesis about the lack of serial correlation in residuals even at two lags. Thus, we can say that the model's errors are independent and not correlated in time. This fosters the model's validity and ability to give unbiased estimates, and confirms that ARDL conclusions are not affected by errors accumulation.

Table 9. Heteroskedasticity test

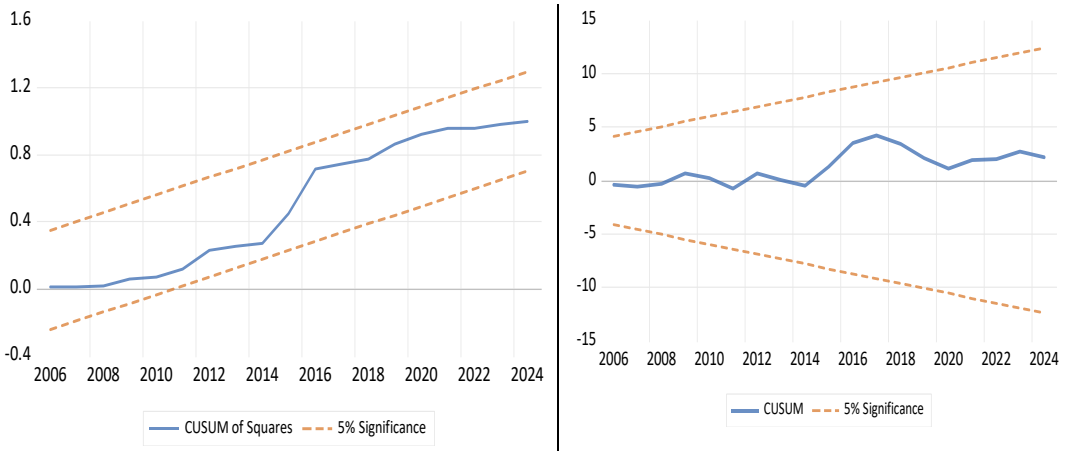
Heteroskedasticity Test: ARCH			
F-statistic	0.4776	Prob. F(1,24)	0.4962
Obs*R-squared	0.5073	Prob. Chi-Square(1)	0.4763

Source: by the author based on the outputs of the statistical program

The table shows that the model's residuals show no heteroskedasticity, as F statistics is 0.4776 with a probability of 0.4962 while Obs*R-squared is 0.5073 with a probability of 0.4763. All these values are greater than 1%, 5%, and 10%. Therefore, we refuse the null hypothesis about the heterogeneity of residuals in time. This means that the residuals show no ARCH effect and that the variance in the random errors is stationary and does not change with time. Thus, we confirm the validity of the conclusions of the short and long-terms coefficients and statistical significance tests with no need for additional models, such as GARCH. In addition, the model is suitable for analysing the effect of FD on the monetary stability in Algeria during the study period.

The Structural Stability:

Fig. 4. The model stability



Source: by the author based on the outputs of the statistical program

The figure shows that the estimated model has a strong structural stability during the study period, as in CUSUM test, the blue line that represents the standard residuals is moving inside the critical range with the red dashed line at significance level 5%, except a slight and short term deviation in 2022-2024, which rapidly returns to stability without exceeding the critical limits. Thus, the model coefficients are stable with no structural changes in the relation between the variables in time. Besides, the economic fluctuations or shocks in the period do not lead to a radical change in the relation between FD and inflation. Regarding CUSUMSQ, the blue line is fully inside the dashed critical limits throughout the study period and moves regularly and smoothly around 0 without penetrating the maximum or minimum limits. This confirms the variance in residuals in time and lack of any sudden or irregular changes in the model behaviour, and confirms the results of ARCH model on heteroskedasticity. These results confirm the validity and reliability of ARDL model, as the statistical estimates in the short and long terms are unbiased, and the relation between the variables was not subject to structural fractures due to economic crises, such as oil prices decrease in 2014-2014, Covid-19, and the last economic fluctuations. Therefore, our findings are generalizable and can be used in designing monetary and economic policies in Algeria.

7. CONCLUSION

Our findings show that all the study variables are non-stationary at level and stationary at first difference, as shown in ADF model. This justifies the use of ARDL model and fosters its methodological suitability. In addition, bounds test revealed a long-term balanced relation between the variables and the econometric analysis showed non-linear and complicated dynamic relations between FD and the monetary stability in Algeria. In the long term, MS has a positive and significant effect on inflation, showing that the monetary policy was expansionist during the study period. On the other hand, PC to GDP showed a negative effect on inflation, confirming that the development of the financial mediation and of the credit to the private sector decreases inflation in the long-term by funding the productive investments and improving the supply. As for the short-term, the error correction model showed a significant and negative relation. It is relatively fast and reflects the flexibility of the economic model in dealing with shocks.

Furthermore, the short-term dynamics revealed an immediate significant negative effect for PC, followed by a significant positive effect after three lags, confirming the time complexity in the transmission of the credit policies. In addition, the diverse diagnostic tests confirm the model's reliability, as Jarque-Bera test showed that the residuals follow a natural distribution and Breusch-Godfrey test revealed no serial correlation issues. In addition, CUSUM and CUSUMSQ tests confirmed the structural stability of the model in time without any structural fractures. Together, these results mirror the development of the financial sector in Algeria despite its relative limitedness. In this regard, the expansion of liquidity contributes to inflation when there is no growth in production or import in return. On the other side, the depth of the financial mediation through PC can foster the financial stability by boosting production and improving resources allocation.

Based on these findings, we recommend developing an integrated strategy that regulates the growth of MS according to the real economic development rates, encouraging credit provided to productive investments instead of consumption, and fostering the depth of the financial sector by developing the financial markets and improving the regulations to ensure sustainable balance between the financial expansion and the financial stability in the Algerian economy.

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