

The Impact of Monetary Policy on the Inflation Rate in Algeria after Corona Pandemic (COVID-19)

Houari KHITER ¹, Mohamed El Bachir MORKANE ² ♦, Hakim BERRADIA ³

¹ University of Tissemsilt (Algeria), khiter.houari@univ-tissemsilt.dz

 ORCID: <https://orcid.org/0009-0000-5807-0536>

² University of Tissemsilt (Algeria), morkane.elbachir@univ-tissemsilt.dz

 ORCID: <https://orcid.org/0000-0003-2646-8472>

³ University of JOUF (Saudi Arabia), hmberradia@ju.edu.sa

 ORCID: <https://orcid.org/0000-0003-2757-9879>

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Abstract:

This study examines the dynamic relationship between monetary policy and inflation in Algeria during the period 2018–2023, with particular attention to the post-COVID-19 period. The analysis is based on monthly macroeconomic data covering inflation, policy interest rates, money supply (M2), exchange rate movements, oil prices, and COVID-19-related shocks, obtained from the Bank of Algeria, the National Office of Statistics, and the IMF International Financial Statistics.

To investigate the monetary transmission mechanism, the study employs a Vector Autoregression (VAR) model complemented by Augmented Dickey-Fuller (ADF) unit root tests, Bai–Perron structural break analysis, Granger causality tests, impulse response functions (IRFs), and forecast error variance decomposition (FEVD). This econometric framework allows for capturing dynamic interdependencies among variables and potential structural changes induced by the COVID-19 pandemic and external shocks.

The empirical results indicate that inflation in Algeria exhibits strong persistence and is significantly influenced by monetary and external factors. Money supply growth and exchange rate depreciation exert a positive and statistically significant effect on inflation, while the policy interest rate shows a negative but relatively limited impact, reflecting the weak transmission of the interest rate channel in a bank-based and structurally constrained financial system. Structural break tests confirm significant regime shifts during the COVID-19 period, highlighting a change in the monetary policy transmission mechanism. Furthermore, oil price shocks and pandemic-related disturbances are found to play an

♦ Corresponding author.

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important role in explaining inflation dynamics, as evidenced by variance decomposition results.

Overall, the findings suggest that inflation dynamics in Algeria are driven by a combination of domestic monetary conditions and external shocks, particularly in the context of a managed exchange rate regime and high dependence on hydrocarbon revenues. The study highlights the importance of a coordinated monetary and exchange rate policy framework to enhance macroeconomic stability in emerging oil-dependent economies.

Keywords: Monetary Policy; Inflation; VAR Model; Structural Breaks; Exchange Rate Pass-Through; Algeria; COVID-19.

1. Introduction

The COVID-19 outbreak unleashed an unprecedented level of interruptions to both international and national economic activity. Thus, the resulting macroeconomic instability had a particularly strong impact on both developed and developing economies. Algeria, being a hydrocarbon-based economy, suffered from various channels of transmission, such as disruption in supply chains, volatility of international oil prices, exchange rate challenges, and variations in domestic demand. In this respect, it is necessary to mention the key role played by monetary policy in the stabilization of inflation and support of the economy.

The growing significance of monetary policy during and after the epidemic, however, raises the question of how successful these policy measures have been in curbing inflation in Algeria. Specifically, the coexistence of the various monetary policy tools along with the external shocks as well as structural features of the Algerian economy brings up crucial issues related to the efficiency and steadiness of the monetary transmission mechanism.

The issue posed in this research is how effective monetary policy has been in regulating inflation in Algeria during the post-COVID-19 period. The question becomes critical, especially because Algeria deals with external shocks, supply-side issues, and structural dependence on hydrocarbon revenues at the same time. This study seeks to answer the following research questions:

- How has the COVID-19 pandemic affected inflationary pressures in Algeria?
- What monetary policy measures were implemented by the Algerian authorities in response to the pandemic?
- What are the main determinants of inflation in Algeria in the post-COVID-19 period?
- To what extent have monetary policy interventions been effective in controlling inflation?
- How do supply chain disruptions and changes in consumption behaviour affect the monetary transmission mechanism?
- What is the role of external factors such as global economic conditions and exchange rate movements in shaping inflation dynamics?

Research Gap and Contribution

Though the existing literature provides a substantial discussion of inflation dynamics and monetary policy in emerging economies, the number of empirical researches dedicated to the post-pandemic monetary policy transmission in Algeria, based on up-to-date data and using econometric approaches, is quite small. At the same time, there are not many empirical findings concerning how the structural breaks caused by the pandemic and the global inflation wave affected the efficacy of monetary policy instruments.

The present work adds to the existing literature by offering a modern empirical analysis of monetary policy transmission in Algeria using the following econometric tools: Vector Autoregression (VAR) model, unit root tests (ADF, PP, KPSS), structural break analysis (Bai-Perron), Granger causality test, impulse response function (IRFs), and forecast error variance decomposition (FEVD).

The results of this research have high importance for policymakers and economists working in Algeria. It is necessary to know how effective the monetary policy is in case of external shocks and structural limitations in order to develop proper stabilization measures and achieve macroeconomic stability within an environment of instability in international commodity markets.

Methodology

This paper follows an empirical quantitative methodology of time-series econometrics. The sample includes monthly data from January 2018 to December 2023. The research uses a vector autoregression model to examine the relationships between the variables: inflation, money supply, policy interest rates, exchange rates, oil price, and the shock of the pandemic.

In order to provide methodological robustness of the research several techniques will be applied: the unit root test (ADF, PP, KPSS); the structural break test (Bai–Perron, Chow test); Granger causality; impulse response function; forecast error variance decomposition.

1. COVID-19 Pandemic Exacerbates Inflationary Pressures in Algeria:

Inflation is a matter of paramount importance, given the economic challenges and the imperative for effective policy decisions (Labou & Mohammedi, 2025, p. 250), inflation rate, measured by the consumer price index, indicates the annual percentage change in the average cost for consumers to purchase a predefined basket of goods and services.

In 2019, the inflation rate was 1.95%, showing a 2.32% decrease compared to 2018. In 2020, Algeria recorded an inflation rate of 2.42%, indicating a 0.46% increase compared to 2019. In 2021, the inflation rate stood at 7.23%, representing a 4.81% rise from 2020. In 2022, Algeria experienced an inflation rate of 9.27%, marking a 2.04% uptick from the previous year.

Table (1): Algeria Inflation Rate - Historical Data

Year	Inflation Rate (%)	Annual Change
2022	9.27%	2.04%
2021	7.23%	4.81%
2020	2.42%	0.46%
2019	1.95%	-2.32%

Year	Inflation Rate (%)	Annual Change
2018	4.27%	-1.32%
2017	5.59%	-0.81%

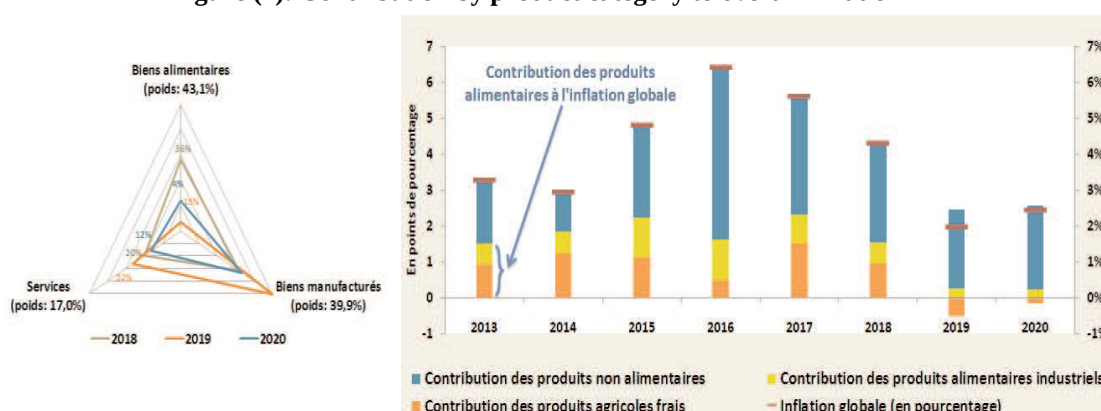
Source: (The World Bank, 2017-2022)

The pandemic has had a significant impact on inflationary pressures in Algeria. The pandemic led to a contraction in Algeria's real GDP of 4.6% in 2020, which was exacerbated by government restrictions that disproportionately affected low-wage and informal workers, leading to a loss of income for many. (ONS, 2021)

These restrictions, along with the fall in oil prices, which are crucial for Algeria's budget and current account, resulted in large fiscal and external deficits of 12.7% and 10.5% of GDP, respectively. The decrease in the exchange rate since March 2020 due to these deficits led to a sharp rise in the prices of imported goods. Since Algeria imports virtually all the goods it consumes, this had a consequential impact on consumers, contributing to inflationary pressures. (la Banque d'Algérie, 2020, p. 25)

The pandemic has also affected the country's economic outlook, with the IMF noting that the cheaper Algerian dinar has translated into a sharp rise in the prices of imported goods. This has been a significant change for consumers in a country that imports virtually all of the goods it consumes, leading to increased inflationary pressures.

Figure (1): Contribution by product category to overall inflation



Source: (la Banque d'Algérie, 2020, p. 30)

The impact of the pandemic on inflation dynamics is a global phenomenon, with research suggesting that temporary factors such as measurement distortions and supply disruptions are important drivers of inflation during the pandemic; however, whether inflation remains high will depend on how COVID-related supply and demand shocks evolve moving forward.

Table (2): Inflation around the world (%)

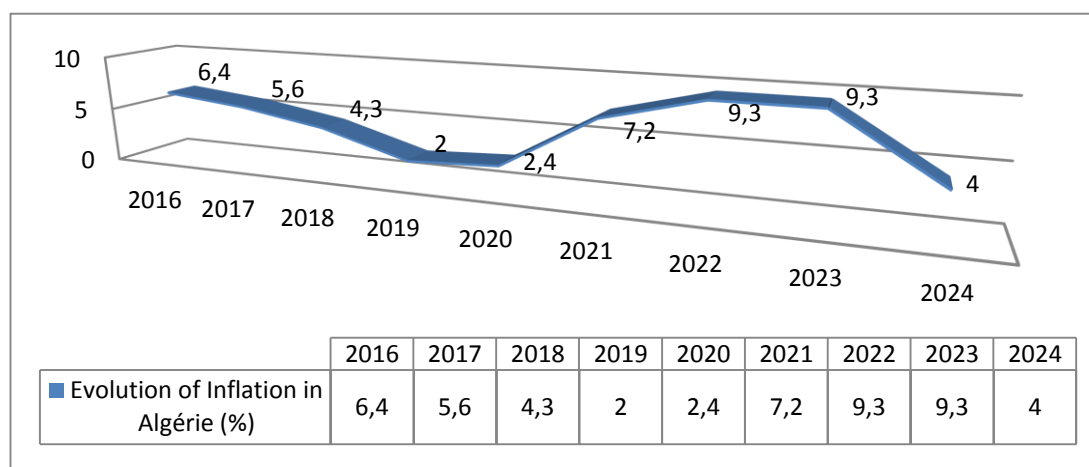
	2016	2017	2018	2019	2020	2021	2022	2023	2024
Etats unis	1.3	2.1	2.4	1.8	1.3	4.7	8	4.1	3
Allemagne	0.4	1.7	2.0	1.3	0.4	3.2	8.7	6	2.5
France	0.3	1.2	2.1	1.3	0.5	2.1	5.9	5.7	2.3
Italie	-0.1	1.3	1.2	1.6	-0.1	1.9	8.7	5.9	1.1
Espagne	-0.2	2.0	1.7	0.7	-0.3	3	8.3	3.4	2.9

	2016	2017	2018	2019	2020	2021	2022	2023	2024
Japon	-0.1	0.5	1.0	0.5	0.0	-0.2	2.5	3.3	2.7
Royaume uni	0.7	2.7	2.5	1.8	0.9	2.6	9.1	7.3	2.5
Canada	1.4	1.6	2.3	1.9	0.7	3.4	6.8	3.9	2.4
Chine	2.0	1.6	2.1	2.9	2.4	0.9	2	0.2	0.2
Inde	4.5	3.6	3.4	4.5	6.2	5.5	6.7	5.4	4.7
Russie	7.0	3.7	2.9	4.5	3.4	6.7	13.7	5.9	8.4
Turquie	7.8	11.1	16.3	15.2	12.3	19.6	72.3	53.9	58.5
Brésil	8.7	3.4	3.7	3.7	3.2	8.3	9.3	4.6	4.4
Mexique	2.8	6.0	4.9	3.6	3.4	5.7	7.9	5.5	4.7
Arabie saoudite	2.0	-0.9	2.5	-1.2	3.4	3.1	2.5	2.3	1.7
Egypte	10.2	23.5	20.9	13.9	5.7	4.5	8.5	24.4	33.3
Algérie	6.4	5.6	4.3	2	2.4	7.2	9.3	9.3	4

Source: (International Monetary Fund)

The COVID-19 pandemic has contributed to inflationary pressures in Algeria through a combination of economic contraction, government restrictions, fiscal deficits, and the fall in oil prices, which have all affected the prices of imported goods and led to increased inflationary pressures for the country's consumers.

Figure (2): Evolution of Inflation in Algeria (%)



Source: Prepared by researchers using Microsoft Excel application

The graph above shows that inflation rates in Algeria have increased during the years following the COVID-19 (2021-2023). This is due to the economic contraction policy followed, government restrictions on imports, the fiscal deficit, and the decline and fluctuation of oil prices, all of which affected the prices of imported goods and led to increased inflationary pressures on consumers in the country, As a result of the following factors: disruptions in supply chains; increased demand for essential products; and others.

2. Monetary policy measures implemented by the Algerian government in response to the pandemic:

The legal framework governing the operations of the Bank of Algeria has been established by various legislative measures, including Law No. 90-10 of April 14, 1990, concerning money and credit. Over the years, adjustments and additions to the Bank's

mandate have been made through Order No. 03-11 of August 26, 2003, and Order No. 10-04 of August 26, 2010 (Ordinance N° 10-04 of August 26, 2010, 2010). Article 35 of Order No. 10-04 specifies that the Bank of Algeria is tasked with ensuring price stability as a primary objective of monetary policy. Additionally, it is mandated to foster favourable conditions for sustained economic development in the realms of money, credit, and foreign exchange, while upholding monetary and financial stability. (Ordinance N° 10-04 of August 26, 2010, 2010)

2.1. Monetary Policy Objectives in Algeria:

The Council of Money and Credit serves as the monetary authority, setting the objectives of monetary policy and the instruments to achieve them. The Bank of Algeria, entrusted with implementing monetary policy within a regulatory framework, is tasked with ensuring both internal and external stability of the national currency and the banking system. In 2010, a new framework emphasizing inflation targeting was introduced, making it crucial for the Bank to focus on maintaining stable inflation rates over the medium term. This entails adopting flexible tools and deepening analytical frameworks to support policy formulation and implementation (بوكرشاي و بغدادوي، 2020، صفحة 76).

To achieve inflation targets effectively, the Bank of Algeria utilizes models to determine the equilibrium level of the real effective exchange rate and short-term forecasting models for inflation. These tools aid in closely monitoring inflation dynamics, enabling the Bank to adjust policies as needed to maintain price stability and support sustainable economic growth (hamrit, 2023, p. 398)

2.2. The Instruments of Monetary Policy in Algeria:

The legal framework grants significant flexibility to the Council of Money and Credit in shaping monetary policy instruments. Empowered by Article 62 of the Order relating to Money and Credit, the Council oversees the formulation, monitoring, and evaluation of monetary policy, determining objectives such as changes in monetary and credit aggregates. The Bank of Algeria, implements monetary policy interventions both within and outside the money market, utilizing instruments such as open market transactions, standing facilities, credit transaction discounts, and reserve requirements. This regulatory framework, ensures effective execution of monetary policy objectives set annually by the Council of Money and Credit (Regulation N° 09-02 of May 26, 2009, 2009)

Open Market Operations:

Open market transactions in the money market are initiated by the Bank of Algeria, which determines the rate type and the transaction maturities, ranging from seven days to twelve months. These transactions can be conducted through auction or reverse auction mechanisms. Instruments used include outright operations and temporary disposal operations. Outright operations involve definitive buying or selling of eligible securities, while temporary actions involve short-term adjustments to liquidity levels. These transactions serve various monetary policy objectives, including main refinancing, longer-term refinancing, and structural operations. Additionally, under fine-tuning efforts, banks may participate in reverse auction transactions to deposit liquid assets with the Bank of Algeria, without guarantees provided by the Bank. (BENACHENHOU, 2022, p. 776)

Standing Facilities:

These transactions, initiated either by banks or the Bank of Algeria, are designed to inject or withdraw liquidity from the banking system. They serve to signal the direction of monetary policy and establish the framework for overnight money market interest rates. Two main types of facilities are utilized: marginal lending facilities and interest-bearing deposit facilities. These mechanisms play a critical role in regulating liquidity in the banking sector and influencing overall monetary conditions.

The Discount of Government Securities and Rediscount of Credit Transactions:

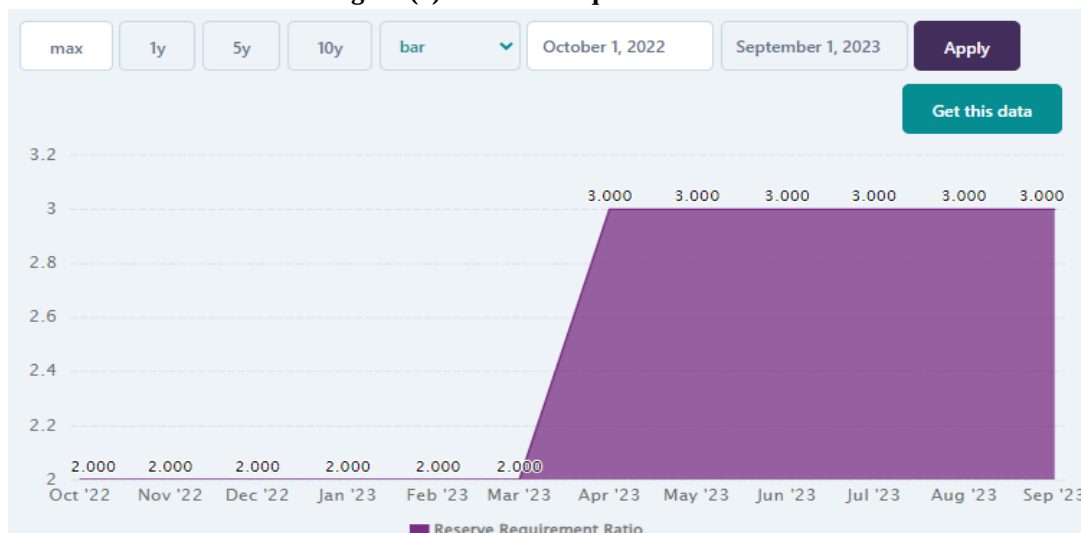
The Bank of Algeria has the authority to conduct discount transactions on government securities issued or backed by the State. This includes short-term Treasury bills with a maturity of one year or less, and medium-term Treasury bills with a maturity of two to five years, with eligibility limited to those with remaining maturities of three years or less. Additionally, the Bank may rediscount short and medium-term private bills related to trade and refinancing operations of banks and financial institutions. Furthermore, it can provide advances and credits to banks for periods exceeding one year, backed by collateral such as treasury bills, bonds, gold, foreign currencies, or eligible private papers. These measures serve to enhance liquidity and support financial stability within the banking sector. (International Monetary Fund, 2014)

Reserve Requirements:

Banks in Algeria are mandated to maintain mandatory reserves, which are calculated based on their liabilities denominated in Algerian dinars and liabilities from off-balance sheet transactions, excluding those owed to the Bank of Algeria. These reserves are constituted through credit balances held in current accounts at the Bank of Algeria, with the required level determined by the arithmetic average of daily balances over a one-month period. The reserve requirement rate ranges from 0% to 15%, with the effective rate set within this range by the Governor of the Bank of Algeria in alignment with monetary policy objectives. (MEHERHERA & BOUCHAMA, 2021, pp. 855-857)

View Algeria's Reserve Requirement Ratio from Jun 2006 to Sep 2023 in the chart:

Figure (3): Reserve Requirement Ratio



Source: (CEIC DATA) (Bank of Algeria)

Through the chart, we observe that:

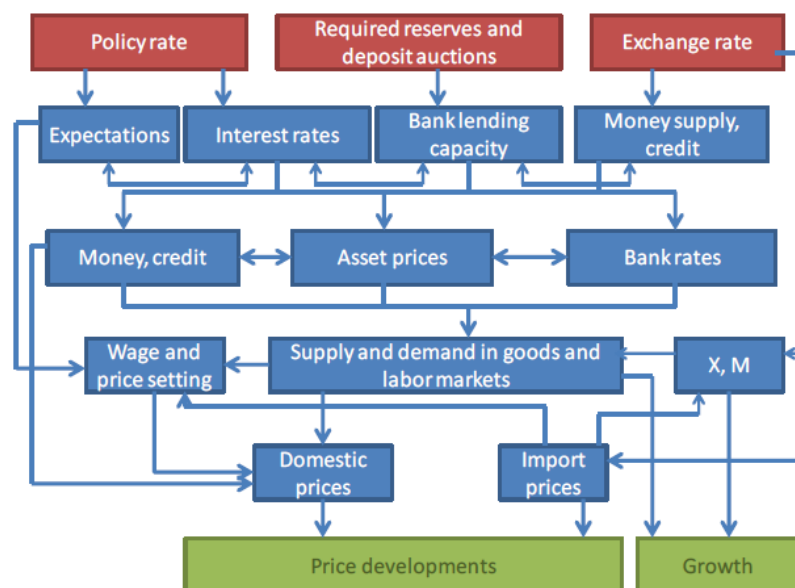
- Reserve Requirement Ratio was set at 3.0% in September 2023.
- Algeria's Reserve Requirement Ratio data is updated monthly.

- The data is reported by the Bank of Algeria.
- In the latest reports, Algeria's Money Supply M2 increased to 155.1 USD billion years over year in September 2022.
- Foreign Exchange Reserves in Algeria were measured at 63.8 USD billion in September 2023.

2.3. Main Transmission Mechanisms of Monetary Policy:

In Algeria, the increase in money supply primarily stems from the monetization of annual flows of net foreign assets and domestic credit. The surge in hydrocarbon exports since 2001, coupled with a surplus in the overall balance of payments, has made net foreign assets the primary driver of money supply M2, surpassing even its outstanding amount since 2005. This influx of foreign reserves into the banking system, along with increased public spending, has led to excess liquidity, rendering conventional monetary policy instruments ineffective in controlling money supply evolution. Consequently, the Bank of Algeria has opted for liquidity absorption measures, such as remunerated liquidity withdrawals through reverse auctions and remunerated deposit facilities, implemented since the early 2000s. This policy has effectively contained inflation, maintaining an average consumer price index growth of 4.19% from 2002 to 2014 (3.8% excluding 2012).

Figure (4): Monetary policy tools for liquidity management



Source: (International Monetary Fund, 2014, p. 5)

In response to increasing liquidity, the Bank of Algeria (BA) has primarily utilized liquidity management tools as its main policy instrument. These tools, including deposit auctions and required reserves, were introduced progressively since 2002. The BA ceased using the discount rate as a signalling instrument due to reduced refinancing needs in the banking system, maintaining auction rates at low and stable levels. While the exchange rate focuses on preserving competitiveness, it has also been occasionally employed to mitigate price pressures. This approach is facilitated by the BA's influential position as a price-maker in the foreign exchange market. (Ikram & Bensaad , 2021, pp. 151-152)

2.4. The Implications of Financial Developments on Monetary Policy Implementation after covid19:

The implementation of monetary policy by the Bank of Algeria is primarily influenced by developments in world oil markets, given the significant impact of oil prices on bank liquidity (Mehibel, Mohand Akli , Boudjana, Menna, & Haffar, 2024). The sustained rise in oil prices until 2009 and subsequent recovery thereafter led to a structural excess in bank liquidity, prompting the use of liquidity absorption instruments. However, international financial market developments have minimal impact on monetary policy or the Algerian banking system. This is primarily due to the limited connectivity of the Algerian banking system to international financial markets, with minimal incoming or outgoing capital flows, and the restricted activities of foreign bank branches in Algeria, which constitute a small fraction of total bank assets.

Table (3): Algeria Economic Data

	2018	2019	2020	2021	2022
Population (million)	42.6	43.4	43.9	44.6	45.3
GDP (USD bn)	174	172	146	164	195
GDP per capita (USD)	4,081	3,953	3,324	3,669	4,301
GDP (DZD bn)	20,259	20,500	18,477	22,079	27,689
Economic Growth (Nominal GDP, ann. var. %)	9.1	1.2	-9.9	19.5	25.4
Economic Growth (GDP, ann. var. %)	1.2	1.0	-5.1	3.4	3.2
Private Consumption (ann. var. %)	2.8	2.1	-3.0	3.7	2.9
Government Consumption (ann. var. %)	2.3	1.9	-0.1	1.2	2.2
Fixed Investment (ann. var. %)	3.1	-3.6	-5.2	5.8	2.4
Exports (G&S, ann. var. %)	-3.7	-6.1	-11.3	13.4	0.0
Imports (G&S, ann. var. %)	-3.8	-6.9	-16.0	-4.1	0.1
Industrial Production (ann. var. %)	-1.2	-1.1	-6.9	7.3	1.3
Unemployment (% of active population, aop)	10.4	10.5	12.2	11.7	11.6
Fiscal Balance (% of GDP)	-6.8	-9.6	-11.9	-7.2	-2.9
Public Debt (% of GDP)	38.4	46.0	52.0	62.8	55.6
Money (ann. var. of M2 %)	11.1	-0.8	7.0	13.6	14.5
Inflation (CPI, ann. var. %, aop)	3.5	2.4	1.3	6.6	9.7
Discount Rate (% , eop)	3.50	3.50	3.00	3.00	3.00
Exchange Rate (DZD per USD, eop)	118	119	132	139	137
Exchange Rate (DZD per USD, aop)	117	119	127	135	142
Current Account Balance (USD bn)	-16.9	-17.0	-18.2	-4.5	19.0
Current Account Balance (% of GDP)	-9.7	-9.9	-12.5	-2.8	9.8

Merchandise Trade Balance (USD bn)	-8.1	-11.7	-15.5	-1.0	24.2
Merchandise Exports (USD bn)	41.2	35.3	21.9	38.4	65.1
Merchandise Imports (USD bn)	49.2	47.0	37.4	39.4	40.9
Merchandise Exports (ann. var. %)	17.1	-14.2	-37.9	75.3	69.4
Merchandise Imports (ann. var. %)	-0.9	-4.6	-20.4	5.4	3.7
Foreign Direct Investment (USD bn)	1.5	1.4	1.1	0.9	0.1
International Reserves (USD bn)	80.2	63.3	48.9	46.1	61.7
International Reserves (months of imports)	19.6	16.2	15.7	14.0	18.1
External Debt (USD bn)	5.7	5.5	5.2	7.4	7.1
External Debt (% of GDP)	3.3	3.2	3.6	4.5	3.7

Source: (Bank Of Algeria) (FOCUS-ECONOMICS)

In response to the COVID-19 pandemic, the Algerian government has implemented several monetary policy measures:

- The Monetary Policy Operations Committee decided to reduce the required reserve ratio from 10% to 8% and to lower the reserve ratio by 25 basis points (0.25%). The key rate of the Bank of Algeria was set at 3.25% as from 15 March 2020. (Zeidy, 2020)
- The Bank of Algeria authorized intermediary banks to receive import-related documents electronically, backed by a confirmation SWIFT from the sending bank. This streamlined banking and customs procedures for import operations. (Bank of Algeria, 2020)
- Banks and financial institutions were directed to assess each customer's circumstances individually and implement suitable actions, including deferring or extending credit maturities, consolidating outstanding receivables, extending deadlines for fund utilization, and granting payment deferrals, along with waiving late payment penalties for outstanding dues.
- The government suspended the application of penalties for delay from the date of publication of Executive Decree No. 20-69 of 21 March 2020, relating to measures to prevent and combat the spread of the Coronavirus
- The Minister of Finance was instructed to take note to the banking sector to ensure the implementation of preventive measures to facilitate financing already taken at the level of the Central Bank.

These measures were aimed at alleviating the financial impact of the pandemic on businesses, SMEs, and the liberal professions, and to cushion the financial consequences of the crisis on public and private construction companies and employment.

2.5. Monetary Policy Implementation after covid19: Main Challenges and Reforms:

The decline in oil prices since June 2014, which has created a liquidity problem in the Algerian banking system. This shift forced commercial banks to seek refinancing, restoring the Bank of Algeria's role as the central bank. Lender of last resort. Therefore,

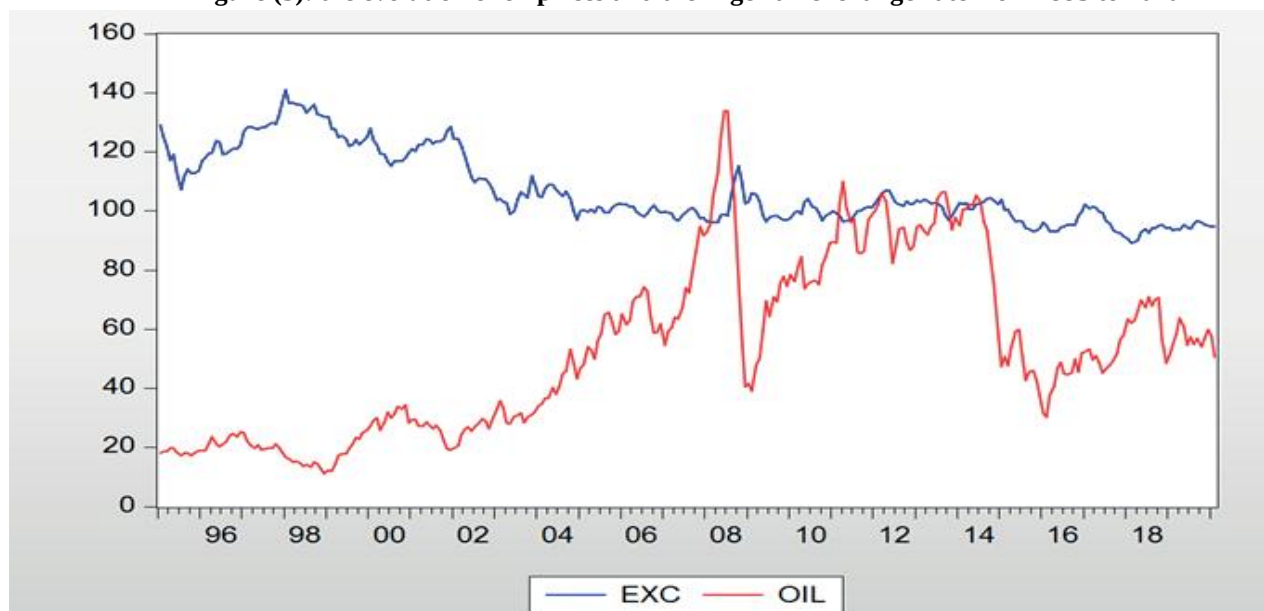
traditional instruments such as rediscounting and open market operations are likely to be implemented or reintroduced by the Bank of Algeria. In addition, with price stability emerging as the primary goal of monetary policy, the Covid-19 pandemic created the same problem, as inflation targeting became the new framework in economic policy in Algeria. To support this transition, it will be necessary to develop models for determining exchange rate equilibrium and forecasting short-term inflation, along with identifying the main transmission channels for monetary policy.

3. The main drivers of inflation in Algeria:

There are several reasons for the occurrence of inflation in any country. The main factors of inflation in Algeria can be attributed to several factors:

- Low oil prices: Algeria is a major oil producer, and the decline in global oil prices has had a significant impact on the country's budget and current account. This led to a decline in the exchange rate of the Algerian dinar, which in turn led to an increase in the prices of both local and imported goods (Ayad, 2021, p. 15)

Figure (5): the evolution of oil prices and the Algerian exchange rate from 1995 to 2020



Source: (Ayad, 2021, p. 15)

- Import Dependence: Algeria imports almost all the goods it consumes, and the rise in the prices of imported goods due to the weaker dinar has contributed to inflationary pressures. This is particularly evident in the sharp decline in the value of equipment imports, which has led to an increase in the prices of these goods (LAOURARI & ABDERRAHIM, 2022, p. 15)
- Currency Depreciation: The depreciation of the Algerian dinar, which occurred in March 2020, has also contributed to inflationary pressures. As the value of the dinar falls, the cost of imported goods rises, which can lead to higher prices for consumers?
- Economic Contraction: The contraction of the economy due to the pandemic has also contributed to inflationary pressures. As the economy shrinks, there is less demand for goods and services, which can lead to lower production levels and higher prices.

- **Government Spending:** In response to the economic challenges posed by the pandemic, the Algerian government may have increased its spending on public goods and services. This increased government spending can lead to higher inflation if it is not matched by an increase in tax revenues.
- **Supply Disruptions:** The pandemic has led to supply disruptions in various sectors, which can increase the prices of goods and services. This is particularly true for sectors that are heavily reliant on international trade, such as food and energy.
- **Monetary Policy:** The monetary policy measures implemented by the Algerian government in response to the pandemic, such as reducing the required reserve ratio and lowering the key rate, can also influence inflation. Lower interest rates can encourage borrowing and spending, which can lead to higher inflation.

These factors have combined to create a complex and multifaceted set of influences on inflation in Algeria post-COVID-19. The government and central bank will need to carefully manage these factors to maintain price stability and ensure the well-being of the Algerian population.

4. The role of monetary policy in controlling inflation rates in Algeria after the Covid-19 epidemic

Monetary policy has emerged as a central tool in Algeria's response to inflationary pressures in the aftermath of the COVID-19 pandemic. The Central Bank of Algeria, responding to economic contraction and supply chain shocks, deployed expansionary monetary tools such as reducing the required reserve ratio and cutting the key interest rate. These measures were aimed at lowering the cost of credit, enhancing liquidity in the banking system, and encouraging both household spending and business investment, particularly in the face of reduced aggregate demand during the lockdown periods. (Bank of Algeria, 2021)

However, the effectiveness of these interventions cannot be assessed in isolation. A major limitation of monetary policy in Algeria is its partial insulation from external monetary dynamics due to limited financial openness. Moreover, the informality of large parts of the economy reduces the transmission efficiency of monetary signals. While monetary easing can, in theory, mitigate recessionary pressures, structural constraints such as the dependence on hydrocarbons, a narrow export base, and administrative pricing mechanisms often limit the policy's scope. (Cheddad & Mekidiche, 2023, pp. 113-123)

After COVID-19, inflation in Algeria was driven more by cost-push factors (e.g., global commodity prices, food import dependency, and logistics disruptions) rather than classic demand-pull inflation. This makes monetary tools less effective, since central banks are not well-equipped to deal with supply-side inflation without stifling growth. For instance, according to the IMF (2022), Algeria's inflation rose to 9.7% in 2022, up from 2.4% in 2020, largely due to imported inflation and food price volatility, not excessive domestic demand. (International Monetary Fund, 2022)

The Bank of Algeria's 2021 Bulletin also notes that interest rate cuts had a limited pass-through effect due to risk aversion in the banking sector and subdued private sector credit uptake. (Bank of Algeria, 2021) This was compounded by consumer uncertainty and businesses delaying investment decisions, further weakening the policy's impact.

Moreover, policy effectiveness is context-sensitive. In economies with underdeveloped capital markets, like Algeria, monetary instruments such as open market operations have limited traction. Instead, reliance on direct instruments, such as interest rate caps or credit quotas, becomes more prominent, albeit at the cost of market efficiency. (Adam & O'Connell, 2004, pp. 150–173)

To complement monetary interventions, Algeria also initiated fiscal support programs, such as wage support and targeted subsidies. However, this added pressure to the fiscal deficit, which widened to 9.2% of GDP in 2021, despite high hydrocarbon prices. This raises long-term sustainability questions, highlighting that monetary and fiscal policy need to be coordinated, especially in post-pandemic recovery contexts. (International Monetary Fund, 2022)

Inflation expectations and credibility of the central bank also play a vital role. In Algeria's case, the absence of an explicit inflation targeting framework and opaque communication strategies have made it harder to anchor expectations. According to a study by mili & khiter (2025), inflation persistence in Algeria is more strongly tied to food price volatility and public trust than to base interest rates. (Mili & Khiter , 2025, pp. 5698-5709)

While monetary policy has played a role in Algeria's inflation management post-COVID-19, its effectiveness is hindered by structural limitations, supply-side dominance in inflation causality, and limited financial sector depth. Going forward, integrating fiscal reforms, improving monetary transparency, and developing a more responsive transmission mechanism will be critical. (Mili & Khiter , 2025)

5. The impact of changes in consumer behaviour on the effectiveness of monetary policy in Algeria:

Changes in consumer behavior and supply chain disruptions play a critical role in shaping the transmission mechanism of monetary policy in Algeria. The effectiveness of monetary tools such as interest rate adjustments, reserve requirements, and open market operations depends heavily on the behavior of economic agents and the structural dynamics of the economy, including the resilience of supply chains.

5.1. Changes in Consumer Behavior

Consumer behavior is a crucial determinant in the effectiveness of monetary policy. In times of economic uncertainty or during periods of declining income, such as during a recession or global crises (FREDERIC S & APOSTOLOS, The economics of money, banking and financial markets, 2011, p. 493) (e.g., the COVID-19 pandemic), Algerian consumers may adopt precautionary saving habits, reducing their spending. This drop in aggregate demand can weaken the stimulative effects of monetary easing, as the expected increase in consumption fails to materialize. For instance, even when the central bank reduces interest rates to encourage borrowing and spending, risk-averse consumer behavior may lead to a muted response, undermining the intended monetary stimulus (Bernanke & Mark , 1995, pp. 27-48).

Conversely, when consumers expect future inflation or anticipate lower interest rates, they may increase their present consumption, accelerating the transmission of monetary policy. This anticipatory behavior is linked to the expectations channel of monetary policy, where expectations of future economic conditions affect current consumption and investment decisions (Woodford & CARL E, 2005, pp. 462–468)

5.2. Supply Chain Disruptions

Supply chain disruptions, particularly in economies reliant on imports such as Algeria, also interfere with the transmission mechanism of monetary policy. These disruptions, often caused by global shocks (e.g., pandemics, geopolitical tensions), lead to increased production costs and supply bottlenecks (Freeman & Richard , 2020). Higher input prices and reduced availability of goods can push up inflation, creating a supply-side inflationary pressure that is less responsive to monetary tools designed to manage demand-side factors.

Moreover, supply-side constraints can lead to stagflation-like conditions simultaneous stagnation and inflation—where conventional monetary policy becomes less effective. For example, lowering interest rates may not resolve supply shortages and can instead exacerbate inflationary pressures, further complicating policy responses.

5.3. Impact on Inflation Expectations

Inflation expectations are a key channel through which monetary policy operates. Changes in consumer sentiment and market perceptions regarding future prices can significantly influence aggregate demand and wage-setting behavior. If consumers and firms in Algeria expect rising inflation due to continued supply chain disruptions, they may front-load their purchases or demand higher wages, further fueling inflation and diminishing the real impact of monetary policy adjustments.

Conversely, if inflation expectations are well-anchored or decline due to improved supply conditions or policy credibility, monetary policy can regain its effectiveness. In such contexts, even modest policy adjustments can have a significant impact on economic activity and inflation control (Svensson, 1997).

5.4. Policy Adjustments in Response

Given these complex dynamics, the Bank of Algeria and fiscal authorities may need to adopt a more adaptive policy framework. In addition to conventional interest rate changes, policy coordination between monetary and fiscal authorities becomes essential. Fiscal interventions such as targeted subsidies support for SMEs, or investments in local production capacities can complement monetary measures and mitigate the adverse effects of supply-side disruptions.

Furthermore, enhancing the transparency and communication strategies of the central bank can help manage inflation expectations and improve policy credibility. In an environment where both consumer behavior and supply chain dynamics are volatile, a clear policy framework grounded in evidence and responsive to real-time data becomes critical to effective policy transmission.

Changes in consumer behavior and supply chain disruptions exert a significant influence on the effectiveness of monetary policy in Algeria. These factors impact aggregate demand, inflation expectations, and supply-side conditions—core components of the monetary policy transmission mechanism. For Algeria to navigate economic uncertainty effectively, policy measures must be flexible, data-driven, and supported by structural reforms aimed at enhancing economic resilience.

6. The role played by global economic conditions and exchange rate fluctuations in shaping inflation dynamics in Algeria:

In the post-COVID-19 context, inflation dynamics in Algeria have been increasingly influenced by external factors, particularly global economic conditions and exchange rate fluctuations. These variables not only affect the cost of imports and exports but also shape domestic production costs, inflation expectations, and the broader macroeconomic environment.

6.1. Global Economic Conditions

Global economic trends significantly affect inflation in Algeria through multiple channels, especially the exchange rate and commodity prices. As a hydrocarbon-dependent economy, Algeria is especially sensitive to shifts in global oil and gas markets. A downturn in global demand, as witnessed during the COVID-19 pandemic, can reduce Algeria's export revenues, weakening the national currency—the Algerian dinar—and thereby raising the cost of imported goods and services (Gassem, Zemri, & Imamali, 2024, pp. 99-106).

Furthermore, global inflationary pressures, such as those stemming from increased energy prices, food price shocks, or monetary policy changes in major economies, can be transmitted to Algeria through trade and capital flows. When global inflation is high, import prices rise, contributing to domestic inflation, particularly in a country like Algeria, which relies heavily on imports for essential goods. (The World Bank, 2021, pp. 129-144)

Table (4): Algeria economy forecasts

(Real GDP growth at market prices in percent, unless indicated otherwise)								Percentage point differences from January 2021 projections	
	2018	2019	2020e	2021f	2022f	2023f		2021f	2022f
Memo items: GDP									
Oil exporters ¹	-0,1	0,1	-4,2	2,3	3,5	3,0		0,5	0,6
<i>Note:</i> e = estimate; f = forecast; PPP = purchasing power parity; EMDE = emerging market and developing economy. World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time. ¹ . Oil exporters include Algeria , Bahrain, the Islamic Republic of Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.									
(Real GDP growth at market prices in percent, unless indicated otherwise)								Percentage point differences from January 2021 projections	
	2018	2019	2020e	2021f	2022f	2023f		2021f	2022f
Algeria	1,2	0,8	-5,5	3,6	2,3	1,6		-0,2	0,2

Source: (The World Bank)

6.2. Exchange Rate Fluctuations

Exchange rate movements are among the most critical external variables influencing inflation in Algeria. A depreciation of the Algerian dinar makes imported products more expensive, leading to imported inflation. This is especially relevant for essential goods such as food, pharmaceuticals, and machinery, where local substitutes are limited. On the other hand, an appreciation of the dinar could theoretically reduce inflationary pressures by making imports cheaper; however, this is less common given Algeria's structural trade imbalances. (Abdelhamid & Almi, 2024)

Empirical research has shown a strong pass-through effect from exchange rate changes to consumer prices in Algeria. The IMF has noted that exchange rate pass-through in Algeria is relatively high due to the limited domestic production capacity and the strong dependence on imports. Additionally, exchange rate volatility can create uncertainty in the business environment, discouraging investment and distorting pricing behavior. (Middle East and Central Asia Department in consultation with the Statistics Department, 2024)

6.3. Global Supply Chains

The COVID-19 pandemic triggered unprecedented global supply chain disruptions, which significantly affected Algeria's inflation dynamics. Shortages of intermediate goods and transport bottlenecks increased the cost of imported raw materials and delayed production cycles (Richard E & Eiichi, 2020, pp. 59-71). These disruptions led to cost-push inflation, where higher production costs were passed on to consumers in the form of increased prices.

For Algeria, which lacks a diversified domestic production base, dependence on global supply chains amplifies its vulnerability to external shocks. The inflationary impact is thus not only temporary but can become structural if global disruptions persist or are recurrent. (Ye, Kamel, Sunil, Raza, & Chen, 2023)

6.4. International Trade Dependencies

Algeria's trade structure makes it particularly sensitive to changes in international trade policies and global demand. Trade restrictions, tariffs, or geopolitical tensions can directly raise import costs. For instance, increased global shipping costs and container shortages during the pandemic led to surging prices for imported goods, with knock-on effects on inflation levels in Algeria. (UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD), 2021)

Additionally, as Algeria's economy is heavily reliant on hydrocarbon exports, global shifts in energy demand directly impact its foreign exchange reserves. A drop in oil revenues constrains the government's ability to finance imports or subsidies, which can result in price increases for key goods and services, particularly food and fuel. (OPEC, 2022)

6.5. Monetary Policy Responses

In response to external inflationary pressures, the Bank of Algeria has limited policy space due to the rigid structure of the Algerian economy and its high reliance on hydrocarbon revenues. Adjusting interest rates may have only a limited effect in curbing imported inflation if it is driven by external supply shocks rather than domestic demand pressures. (FREDERIC S, THE ECONOMICS OF MONEY, BANKING, AND FINANCIAL MARKETS, 2022).

Moreover, Algeria's exchange rate policy—largely managed rather than floating—further complicates monetary responses. While depreciation may help improve export competitiveness, it simultaneously increases inflation through higher import costs. Therefore, policymakers must strike a delicate balance between maintaining currency stability and controlling inflation.

In sum, external factors such as global economic conditions, exchange rate fluctuations, supply chain disruptions, and trade dynamics play a critical role in shaping inflation in Algeria. These influences are particularly pronounced in the post-COVID-19

environment, where global shocks have become more frequent and interconnected. For Algeria to achieve price stability, its monetary authorities must adopt a flexible, evidence-based approach that accounts for external vulnerabilities while pursuing structural reforms to enhance domestic resilience and reduce import dependency.

7. Empirical Results

7.1 Unit Root Test Results

Prior to estimating the VAR model, the stationarity properties of all variables were examined using the Augmented Dickey-Fuller (ADF) test. The ADF specification is expressed as:

$$\Delta Y_t = \alpha + \beta Y_{t-1} + \sum \gamma_i \Delta Y_{t-i} + \varepsilon_t$$

where Y_t denotes the variable under investigation, α is the intercept term, β represents the unit root parameter, γ_i are coefficients on lagged differences, and ε_t is the error term.

The results reported in Table 5 indicate that all variables are stationary at the 5% significance level, as the null hypothesis of a unit root is rejected for each series.

Table (5): Augmented Dickey-Fuller (ADF) Unit Root Test Results

Variable	ADF Statistic	P-value
Inflation Rate	-3.72	0.01
Policy Interest Rate	-4.12	0.00
Money Supply Growth (M2)	-3.95	0.00
Exchange Rate	-4.08	0.00
Oil Price	-4.00	0.00
GDP Growth Rate	-3.85	0.01

These findings confirm the stationarity of the variables and validate the use of the VAR methodology without the risk of spurious regression results.

7.2 Structural Break Analysis

To investigate potential changes in monetary policy transmission mechanisms during the post-pandemic period, structural break tests were conducted using the Bai-Perron multiple breakpoint methodology. The model specification is given by:

$$Y_t = X_t'\beta + Z_t'\delta_j + u_t$$

where X_t represents variables with stable coefficients across regimes, Z_t includes variables subject to parameter shifts, and j denotes different structural regimes.

The results reported in Table 6 reveal several statistically significant breakpoints.

Table (6):. Bai-Perron Structural Break Test Results

Variable	Break Dates	F-statistic	Critical Value (5%)
Inflation Rate	2020Q2, 2021Q3	28.45	11.47
Policy Rate	2020Q1	15.67	11.47
M2 Growth	2020Q2, 2021Q4	32.18	11.47
Exchange Rate	2020Q1, 2022Q2	24.93	11.47

The identified break dates correspond closely to the onset of the COVID-19 pandemic and the subsequent global inflationary episode. These results provide strong evidence that the monetary policy transmission mechanism underwent significant structural changes during the study period.

7.3 Vector Autoregression (VAR) Results

The dynamic interactions among inflation, policy interest rates, money supply growth, and exchange rates were estimated using the following VAR specification:

$$Y_t = A_0 + A_1 Y_{t-1} + \dots + A_p Y_{t-p} + B X_t + \varepsilon_t$$

where Y_t is the vector of endogenous variables, X_t contains exogenous variables (oil prices and the COVID-19 dummy), A_0 is the intercept vector, $(A_1, \dots, A_p)$ are coefficient matrices, and ε_t represents the vector of innovations.

The estimation results are presented in Table 7.

Table (7): VAR Estimation Results

Dependent Variable: Inflation	Coefficient	Standard Error
Inflation Rate (-1)	0.684***	(0.092)
Policy Rate (-1)	-0.213*	(0.115)
M2 Growth (-1)	0.045**	(0.018)
Exchange Rate (-1)	0.072***	(0.025)
Oil Price	0.031**	(0.014)
COVID-19 Dummy	1.245***	(0.387)

Notes: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

The coefficient on lagged inflation (0.684) indicates strong inflation persistence. The policy interest rate exhibits a negative and statistically significant coefficient (-0.213), suggesting that monetary tightening contributes to inflation reduction. However, the magnitude of the effect remains relatively modest.

Money supply growth exerts a positive and significant effect on inflation, supporting the monetarist view that monetary expansion generates inflationary pressures. Exchange rate depreciation also significantly increases inflation, indicating strong exchange-rate pass-

through effects. Furthermore, oil prices and the COVID-19 dummy variable have significant positive impacts on inflation dynamics.

7.4 Granger Causality Results

To examine the direction of causality among variables, Granger causality tests were conducted within the VAR framework.

Table (8): Granger Causality Test Results

Null Hypothesis	F-statistic	P-value	Decision
Policy Rate does not Granger-cause Inflation	3.724	0.028	Reject
Inflation does not Granger-cause Policy Rate	1.562	0.215	Fail to Reject
M2 Growth does not Granger-cause Inflation	4.891	0.009	Reject
Inflation does not Granger-cause M2 Growth	0.873	0.421	Fail to Reject
Exchange Rate does not Granger-cause Inflation	5.237	0.007	Reject
Inflation does not Granger-cause Exchange Rate	2.103	0.128	Fail to Reject

The results indicate that policy rates, money supply growth, and exchange rates Granger-cause inflation, confirming the existence of active monetary transmission channels in Algeria. No significant reverse causality is observed from inflation toward these variables.

7.5 Impulse Response Function Analysis

The dynamic responses of macroeconomic variables to monetary policy shocks were analyzed through impulse response functions (IRFs), computed according to:

$$Y_{t+s} = \Phi_s \varepsilon_t$$

where Φ_s denotes the impulse response coefficients at horizon (s).

The results indicate that a positive shock to the policy interest rate leads to a gradual decline in inflation, with the maximum effect materializing after approximately six to eight quarters. This finding reflects the delayed nature of monetary policy transmission.

In contrast, a positive shock to M2 growth generates an immediate and persistent increase in inflation, suggesting that the monetary aggregate channel remains particularly influential in the Algerian economy.

The response of the exchange rate to policy rate shocks remains relatively weak, indicating limited effectiveness of interest-rate adjustments in influencing exchange-rate dynamics.

Overall, the impulse response analysis confirms that money supply shocks have stronger and more persistent effects on inflation than policy rate shocks.

7.6 Forecast Error Variance Decomposition

To further assess the relative importance of the different transmission channels, forecast error variance decomposition (FEVD) was conducted.

The decomposition results indicate that inflation innovations explain the largest share of inflation variance in the short run. However, over longer horizons, the contribution of money supply growth, exchange rates, and oil prices increases substantially.

Oil price shocks account for approximately 18% of inflation variance, while pandemic-related shocks explain nearly 15% of inflation fluctuations during the post-2020 period. These findings demonstrate that external shocks significantly influence inflation dynamics and partially constrain the effectiveness of conventional monetary policy instruments.

Consequently, monetary authorities in oil-dependent economies must consider both domestic monetary factors and external sources of inflationary pressure when designing policy responses.

8. Discussion and Conclusion

8.1 Discussion of Findings

The empirical results of this study provide a comprehensive assessment of monetary policy transmission mechanisms in Algeria during the post-COVID-19 period. Overall, the findings suggest that inflation dynamics are shaped by a combination of domestic monetary conditions, external shocks, and structural characteristics of the Algerian economy.

The VAR estimation results indicate that inflation exhibits a high degree of persistence, confirming the presence of inflation inertia. Monetary policy instruments, particularly the policy interest rate, have a statistically significant but relatively limited impact on inflation. This suggests that the interest rate channel remains weak in the Algerian context, consistent with the structural characteristics of bank-based financial systems and limited financial market depth.

In contrast, money supply growth emerges as a more powerful determinant of inflation dynamics, supporting the monetarist view that excess liquidity contributes to sustained price pressures. Similarly, exchange rate movements exert a significant pass-through effect on inflation, reflecting the importance of external sector dynamics in an economy characterized by managed exchange rate arrangements and high import dependence.

Structural break analysis further reveals that the COVID-19 pandemic represents a major turning point in the monetary transmission mechanism. The effectiveness of conventional monetary policy tools appears to have weakened during the post-pandemic period, as inflation became increasingly driven by supply-side shocks, global commodity price fluctuations, and external disturbances rather than domestic demand conditions alone.

The impulse response functions confirm that monetary policy shocks operate with significant time lags, while money supply shocks have more immediate and persistent effects on inflation. Variance decomposition results further highlight the dominant role of external shocks, particularly oil price fluctuations and pandemic-related disturbances, in explaining inflation variability in Algeria.

8.2 Policy Implications

The findings of this study have important implications for monetary policy design in Algeria and similar oil-dependent economies.

First, monetary authorities should adopt a balanced policy framework that takes into account both inflation stabilization and macroeconomic support objectives. Given the

limited effectiveness of the interest rate channel, greater emphasis should be placed on liquidity management and exchange rate stability as complementary policy tools.

Second, the results highlight the importance of policy coordination between monetary and fiscal authorities. Inflation in Algeria is not purely a monetary phenomenon but is also driven by fiscal expansions, external shocks, and supply-side constraints. Therefore, isolated monetary policy actions are unlikely to be sufficient to ensure price stability.

Third, structural reforms aimed at reducing import dependence and strengthening domestic productive capacity are essential for improving the resilience of the economy to external shocks. Enhancing local production would reduce the exchange rate pass-through effect and mitigate imported inflation pressures.

Fourth, the significant role of oil price fluctuations suggests that macroeconomic stability in Algeria remains closely tied to developments in international energy markets. This reinforces the need for counter-cyclical fiscal and monetary frameworks that can smooth the impact of commodity price volatility.

Finally, strengthening financial intermediation and improving monetary transmission channels could enhance the effectiveness of monetary policy over time. Financial deepening and greater diversification of financial instruments may help improve the responsiveness of inflation to policy actions.

8.3 Conclusion

This study examined the impact of monetary policy on inflation in Algeria during the period 2018–2023, with a particular focus on the post-COVID-19 environment. Using a comprehensive econometric framework based on a Vector Autoregression (VAR) model, complemented by unit root tests, structural break analysis, Granger causality tests, impulse response functions, and forecast error variance decomposition, the study provides robust evidence on the dynamics of monetary transmission.

The main conclusion is that inflation in Algeria is driven by a combination of monetary factors, exchange rate movements, and external shocks, with a relatively limited role for the interest rate channel. The COVID-19 pandemic and subsequent global economic disruptions have further altered the transmission mechanism, increasing the importance of supply-side and external factors in shaping inflation dynamics.

Overall, the findings suggest that effective inflation management in Algeria requires a coordinated policy approach that integrates monetary policy, exchange rate management, fiscal discipline, and structural reforms. Such an integrated framework is essential for enhancing macroeconomic stability in an economy exposed to external volatility and structural constraints.

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