

# **Sources of Inflation in Algeria; 1970-2009**

**By  
Boubekeur BABA**

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By  
Boubekeur BABA

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## ABSTRACT

Inflation is regarded as regressive taxation against the poor. The most visible impact of inflation in recent times is its effect on real output and relative prices. The study focuses on investigating determinants of inflation in Algeria. For that purpose, this study has undertaken annual time series data for the period from 1970 to 2009. This study used the variables Gross Domestic Product (GDP), government expenditures, money supply and exchange rate as determinants of inflation in Algeria. The test for the unit roots has been performed by employing the Augmented Dickey Fuller test and Phillip Perron test. Long run and short run estimation have been investigated using Johansen Cointegration and Error Correction approach. The findings of the study reveal that in the long run inflation in Algeria is positively influenced by money supply, government expenditures and exchange rate. On the other hand the GDP reduces the overall price level in Algeria. Long run elasticities of price level with respect to money supply, GDP, government expenditures, money supply and exchange rate are -88.99, 51.41, 33.19 and 12.18, respectively. In the short run, the lagged GDP and the lagged exchange rate directly affect the inflation of current year. Therefore improvement in GDP, reducing government expenditures and controlling the monetary mass are necessary to stabilize the price level.

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## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 INTRODUCTION**

This chapter provides a general introduction of the study. Section 1.2 introduces the background of the study. The problem statement, objectives, significance and organization of study are discussed in sections 1.3, 1.4, 1.5 and 1.6, respectively.

#### **1.2 BACKGROUND OF STUDY**

Algeria is an oil-exporting developing country. The domestic economy is lacked for the variation of resources. Around two decades have passed since the transition process from the socialism economy to the open market economy. Yet the domestic economy is still dominated by the public sector in which the state sector dominant in controlling over 80 percent of the country's economic activity (Belatas and Jones, 1993). The fact that the state own the most part of the enterprise sector generates additional difficulties for the direction toward trade liberalization.

Inflation appears as one of the main problems of Algeria's economy. It is considered as an important indicator for the soundness of the economy. Usually inflation in Algeria is led by the fluctuation in the food prices. In fact the movements of food prices dominate the consumer price index (CPI) movements where the food and beverages represent around 44 percent from the CPI basket. With attention to that the food prices frequently affected by factors such as wages, import prices and exchange rate. But the inflation shows a downward trend since the economic liberalization. In spite of Algeria has achieved relative price stability in the last decade. But the macroeconomic environment has been always carries inflationary risks. The ongoing growth of money strengthened by high hydrocarbon

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