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ALTHOUGH THE [ANGOLAN BANKING] MARKET IS VERY ATTRACTIVE, IT'S VERY COMPETITIVE ***Emídio Pinheiro, page 12***

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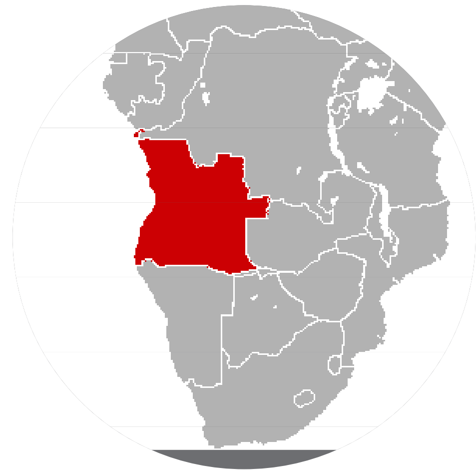
INTRODUCTION

CHANGES LOOM FOR BOOMING ANGOLA
Introduction



Angola has recovered quickly from its slump four years ago and regained its position as one of the world's most buoyant economies. But despite that, the country's ruling party will have to adapt to the changing expectations of Angolans, for many of whom peace is no longer enough. Paul Wallace reports.

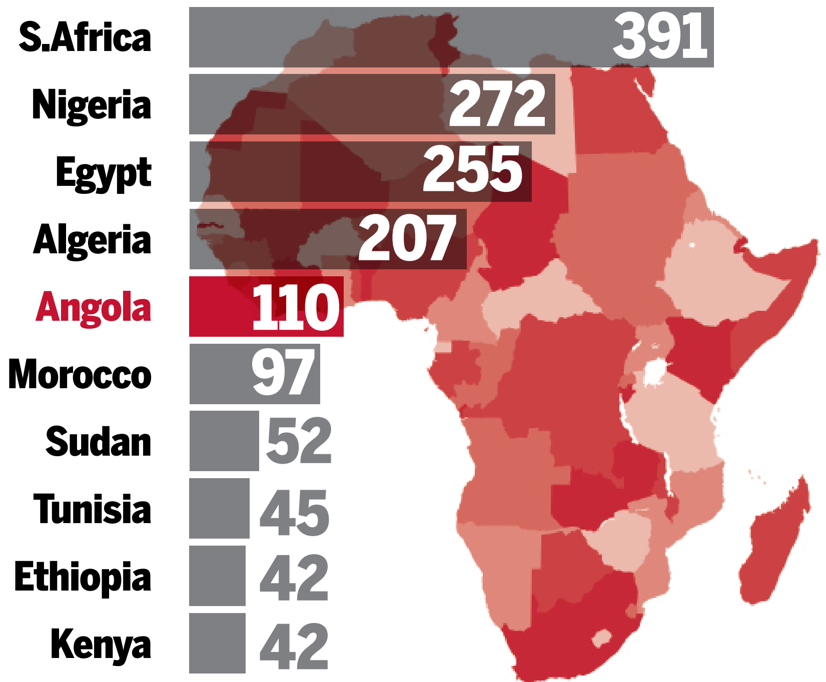
ANGOLA'S RISE AS A MAJOR AFRICAN ECONOMY has continued unabated in the past two years. Since its downturn in late 2008 and 2009, the Lusophone country has recovered its position as one of the world's most buoyant economies. Gross domestic product (GDP) rose almost 8% in real terms in 2012 and could do so by even more this year, according to Standard Bank.

Angolan policy-makers have, moreover, learnt from the financial slump of four years ago and since rectified some of the oil-rich country's most glaring macroeconomic weaknesses. The problems during that period, while caused by a fall in crude prices, were exacerbated by high inflation and a lack of foreign exchange (FX) reserves to counter a balance of payments crisis. After signing a standby facility with the International Monetary Fund (IMF) in 2009 and completing an adjustment programme last year, Angola's financial situation has improved. Inflation fell to single digits for the first time on record in August 2012, while FX reserves stood at an all time high of $33bn at the end of last year.

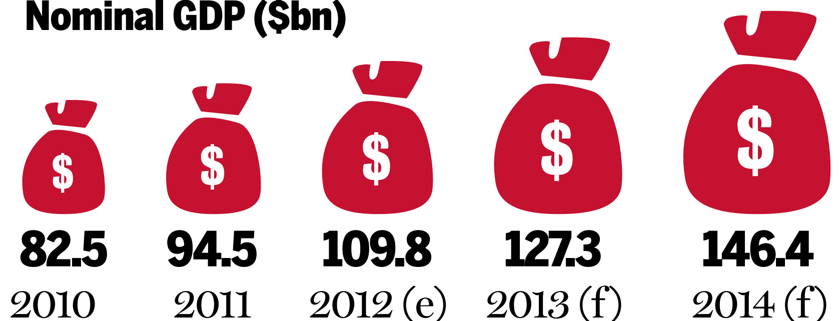
IMPROVING PICTURE

The government has also carried out many of the IMF's recommendations to increase fiscal transparency, thus bolstering its position should there be further external shocks. Spending controls have been tightened to stop ministries signing contracts without having the necessary funds, something which contributed to the country accruing $7bn of arrears during the crisis. And the billions of dollars-worth of quasi-fiscal activities carried out by Sonangol, the state oil company, were incorporated into the »

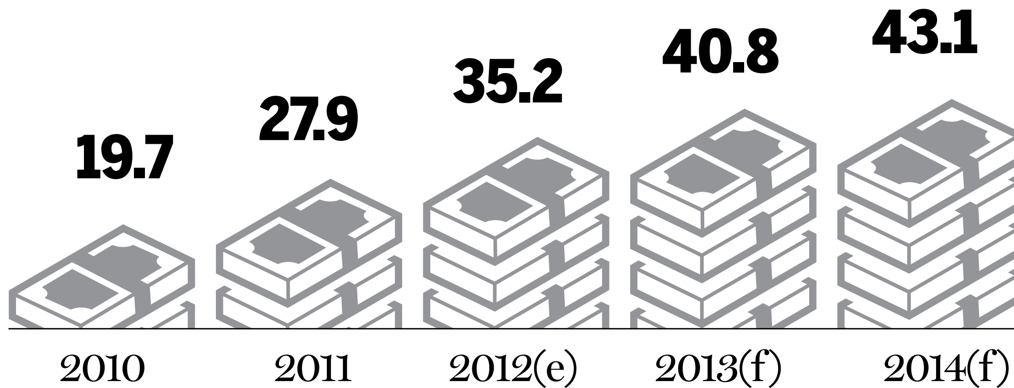
Africa's major economies (2012 GDP $bn)

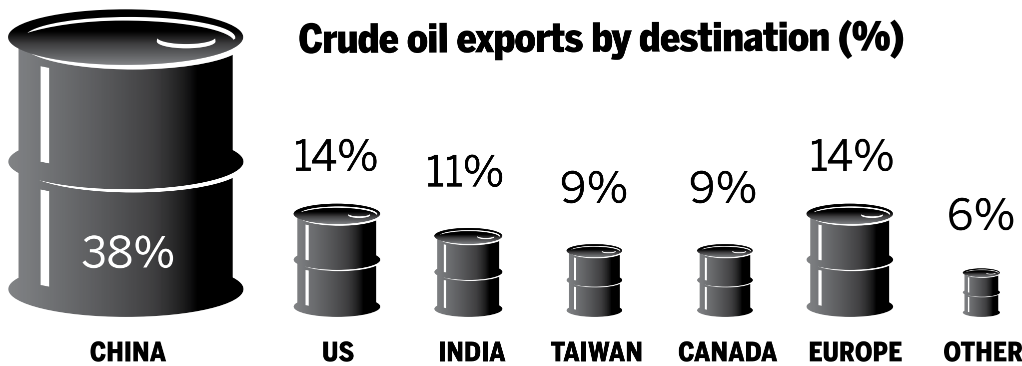


Nominal GDP ($bn)

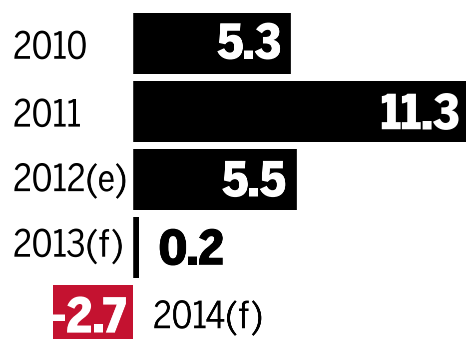


Foreign exchange reserves ($bn)

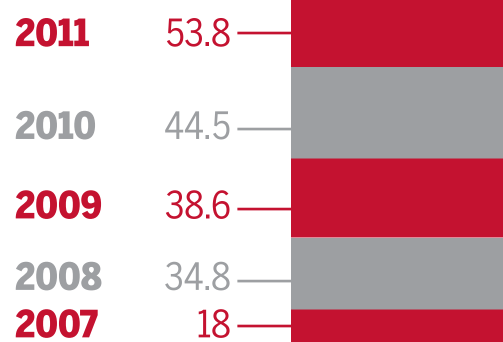




Budget balance/GDP (%)



Total banking sector assets ($bn)



Average consumer price inflation

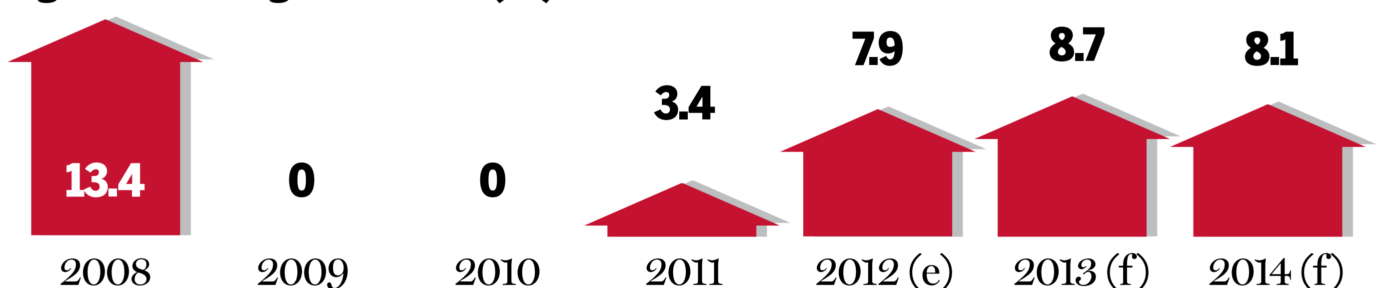
Year	Inflation
2010	14.4
2011	13.5
2012(e)	10.3
2013(f)	9.4
2013(f)	10

$/kwanza average exchange rate

Year	Rate
2010	91.9
2011	93.7
2012(e)	95.4
2013(f)	97.2
2014(f)	99.8

Sources: Banco Espirito Santo Angola, Ecobank, Standard Bank, The Banker Database
Note: e = estimate and f = forecast

Angola real GDP growth rates (%)



budget for the first time earlier this year.

The latter development was particularly significant, not least because the IMF, soon after signing the standby agreement, disclosed a $32bn hole in Angola's public finances, chiefly a result of Sonangol's spending on behalf of the government not being accounted for properly.

"[It has] done well," says Nicholas Staines, the IMF's resident representative in Angola, referring to the government's performance since 2009. "It restored macroeconomic stability, which wasn't a pain-free process, and completed a standby agreement. [The government has] bitten the bullet when it comes to important macroeconomic institutional reforms. It needs to be given credit for that."

Although the country, Africa's second biggest oil exporter, remains highly dependent on the commodity, those changes have resulted in a more balanced economy developing. The financial sector is generally thriving, while Angola's breweries and telecommunications companies are among the most lucrative on the continent. "The non-oil sector is growing faster than the oil industry, which is a very good sign," says José de Lima Massano, Angola's central bank governor. "It shows that the country is achieving some results in terms of diversifying the economy."

VOTING SHIFTS

Reforms and economic robustness have been accompanied by political stability. Parliamentary elections were held in August last year, marking only the second time Angolans have gone to the polls since 1992. They were easily won by the ruling Popular Movement for the Liberation of Angola (known by its Portuguese acronym MPLA), which garnered 72% of the votes, thus extending the 33-year rule of president José Eduardo dos Santos.

The run-up to the polls was marked by sporadic street protests, including by young Angolans irked by perceived corruption among business and government elites and the widespread prevalence, despite the country's huge oil riches, of poverty. Few analysts believe, however, that they presage any major changes in Angola's political structure. "The risk of political instability in Angola has sometimes been overstated," says Victor Lopes, an economist at Standard Chartered. "At this stage, I don't see any major risks."

Nonetheless, the elections did suggest a rise in apathy towards the government. The abstention rate was 37%, higher than that of 13% in the previous polls in 2008. In the capital of Luanda, for a long time an MPLA stronghold, the party garnered about 60% of votes, well below the national average. Several analysts say that while the overall result was good for the MPLA, the fairly low turnout hinted at a cooling of enthusiasm for the party, which likely resulted in part from its failure to fulfil previous election pledges, not least one in 2008 to build 1 million low-cost homes.

[THE ANGOLAN GOVERNMENT HAS] BITTEN THE BULLET WHEN IT COMES TO IMPORTANT MACROECONOMIC INSTITUTIONAL REFORMS. IT NEEDS TO BE GIVEN CREDIT FOR THAT

Nicholas Staines

"The MPLA is relentless in its use of developmental language," says Ricardo Soares de Oliveira, a lecturer in African politics at the University of Oxford. "This language puts a lot of emphasis on service delivery. You could argue it's the government itself that increases the expectations of the population."

SUCCESSOR UNDECIDED

Still, the MPLA, which dominates access to the media and tightly restricts political freedom, faces little competition from other parties. The National Union for the Total Independence of Angola, the main opposition group and which took 19% of the vote in the latest elections, up from 10% previously, remains weak. And a newly formed party, known as Casa-CE, which came third, lacks experience or a nationwide network of activists.

Mr dos Santos is eligible to run for one more five-year term in 2017. Yet there is speculation that the 70-year-old will step down at the next elections or even before then. Many Angolans take it for granted he will be succeeded by Manuel Vicente, who became vice-president in September shortly after finishing a 13-year stint as head of Sonangol.

However, several foreign analysts doubt that Mr dos Santos has made up his mind about who will follow him as head of state. Some even suggest he could try to manoeuvre his son, José Filomeno de Sousa dos Santos, who sits on the three-man board of Angola's recently launched sovereign wealth fund, into the position.

But whatever the outcome, most experienced Angola-watchers doubt the transition will lead to volatility. "The handover will be pretty smooth because power will stay within the ruling elite," says Paul Collier, an economics professor at the University of Oxford. "It is in everybody's interests to keep the show on the road with a new president who keeps the structure of power largely unaltered."

GENERATIONAL CHANGE

It is difficult to overstate how far Angola has come since it ushered in peace in 2002 after 27 years of civil war. One banker describes the country in the late 1990s, when he made his first visit, as chaotic. "Pretty much every city was blown up and people were dying in their thousands each week," he says.

Such has been the progress in the meantime that Angola has evolved from a basket case to the third largest economy in sub-Saharan Africa. Nonetheless, the MPLA can scarcely afford to rest on its laurels. It is likely to face growing pressure from younger Angolans (more than 60% of the population is under the age of 25) who judge it by different standards to their parents. "Those above the age of 35 or 40 compare their current life to that during the civil war," says Mr Soares de Oliveira. "In that context, the comparison is always positive. For the younger people, the war is not a reference point."

Keeping them satisfied in the coming years will hinge to a large extent on how well the government manages to diversify the economy and increase employment, both of which will be crucial to reducing poverty and boosting standards of living. Further reforms to modernise what is still viewed as a highly opaque and corrupt economic system will also be needed.

Angola has plenty going for it. It has an abundance of natural resources and a manageable population of just 20 million. And, unlike Nigeria, another African powerhouse, it lacks deep religious and tribal tensions. "It is a huge opportunity," says Mr Collier. "Angola has got a lot of land without too many people. There's a trajectory of rising oil revenues pretty well regardless. So, it's really quite an easy situation to manage. But it doesn't necessarily mean they will manage it well." TB

Good reflection: construction is taking place right across the Angolan capital of Luanda (pictured), reflective of the growth in the country's economy

AN ECONOMY IN PROGRESS

Economy

Angola's government has won plaudits for its macroeconomic reforms since the 2009 crisis, but plenty more are needed to lure foreign investment and modernise what is still one of the world's toughest business environments. Paul Wallace reports.

The skyline in Luanda seemingly never stops changing. Those who are away from the booming Angolan capital for more than a few weeks have become used to seeing the start of new skyscrapers, hotels or highways on their return.

The frenzied activity in the city reflects what is happening in the wider economy. Since ending a devastating civil war in 2002, Angola has turned itself from a flailing economy with a gross domestic product (GDP) of less than $7bn to one with annual economic output of $110bn. Its economy is now the third biggest in sub-Saharan Africa, after South Africa and Nigeria, and more than twice the size of that of Ghana or Kenya.

Angola has huge offshore oil reserves to thank for its gains. The Portuguese-speaking country produces about 1.8 million barrels per day (bpd) of crude, most of it exported to China and the US.

The commodity dominates the economy, accounting for 50% of overall output, 95% of export earnings and three-quarters of government revenues. That is unlikely to change much before the end of the decade, and perhaps even beyond then. David Thomson, an analyst at energy consultancy Wood Mackenzie, says that oil production, most of it coming from known reserves, could climb to 2.4 million or 2.5 million bpd by 2019.

From that point, it could rise even faster, should the most optimistic projections about Angola's so-called 'pre-salt' reserves in ultra-deep water prove correct. The first major discovery of those was made early in 2012 by US firm Cobalt. How lucrative they become will depend on their quantity and on oil prices once they are on stream. But Mr Thomson believes they would be economically viable to drill at today's prices.

"While it's not the most straightforward of drilling, the technology and knowledge are improving all the time," he says. "Three or four years ago, it was absolutely at the limit of what could be done. Now, while it's not for every company, it is not by any means impossible."

VULNERABILITY EXPOSED

Regardless of whether crude production keeps going up, Angolan policy-makers realise the country is far too exposed to oil. They were made painfully aware of this when prices crashed in the second half of 2008 from $140 a barrel to just $40. Angola's overheating economy went into freefall. Between 2008 and 2009, growth plummeted from 13% to barely more than zero, the currency depreciated heavily and the current account swung from a surplus of 8.5% of GDP to a deficit of 10%. The public finances were in tatters, with a fiscal surplus in 2008 turning in to a 7% deficit in 2009. Government arrears ballooned to more than $7bn.

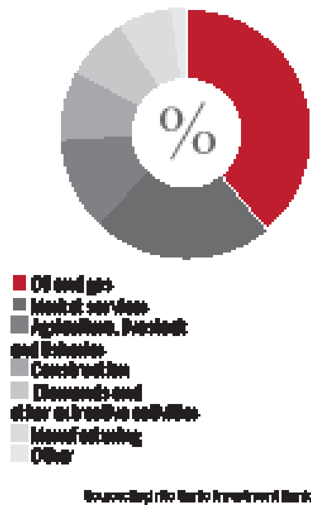
It was clear that Angola's buffers against external shocks were shoddy. Foreign exchange (FX) reserves had been inadequate to deal with the balance-of-payments crisis and the government had little grip on its expenditure due to carefree spending by ministries and the huge quasi-fiscal activities of state oil giant Sonangol not being accounted for properly.

"It's very difficult for the government to implement fiscal policies when it doesn't have a clear picture of what the numbers are," says Nicholas Staines, the resident representative in Luanda of the International Monetary Fund (IMF).

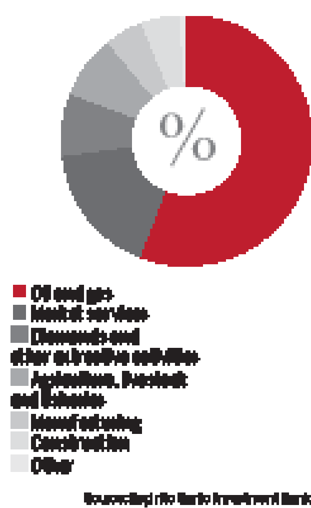
The start of the clean-up came when the ruling Popular Movement for the Liberation of Angola, or MPLA, signed a 27-month standby loan and adjustment programme with the IMF. Since then, plenty of macroeconomic reforms have been carried out. Spending was quickly brought under control (the government ran big fiscal surpluses in 2011 and 2012) and Sonangol's activities on behalf of the state were incorporated into the budget for the first time earlier in 2013, greatly boosting fiscal transparency.

FX reserves were rebuilt, too. Having fallen to $14bn in 2009, they stood at an all-time high of $33bn at the end of 2012, equivalent to almost nine months of import cover. "That's a substantial buffer and should help cushion against any further »

Angola's gross domestic product composition, 2012
(%)



Angola's gross domestic product composition, 2007
(%)



external shocks in the short to medium term," says Gaimin Nonyane, an economist at Ecobank.

The government also managed to tame inflation, which had long blighted Angola. It fell from 15% in 2010 to less than 10% for the first time on record in August last year, which analysts say was no mean feat given the country's still-feeble infrastructure and its need, owing to a lack of manufacturing, to import most finished goods. "Bringing inflation down to single digits was a huge challenge given the structural problems," says Victor Lopes, a strategist at Standard Chartered.

NEW MONETARY TOOLS

José Massano, governor of the Banco Nacional de Angola (BNA), the country's central bank, says that the government's target is to reduce inflation to 7% by 2017. His confidence in achieving this stems, in part, from the new monetary instruments introduced under his tenure, which began in 2010. Before, the BNA had little way of influencing prices other than through keeping the exchange rate stable. But in 2011, a monetary policy committee, base interest rate and interbank rate were launched to give the authorities more ways to manage liquidity.

For now, the exchange rate probably remains the BNA's single most important monetary tool, particularly given the interbank market's illiquidity. But Mr Massano says that this will change in the coming years and that the extra instruments, together with a greater use of overnight repurchase agreements (repos) by the central bank, are leading to the establishment of market-based interest rates for the first time.

"In the past, commercial banks struggled to set interest rates," he says. "Some would use inflation as a reference, some would use government securities, while others would use prudential regulations set by the BNA. It was very confusing. Now, most banks are using repo rates or the BNA's base rate as a reference for loans."

These moves are being implemented alongside attempts to de-dollarise an economy in which transactions and loans in the US currency are commonplace. Among the main measures is a new FX law for the hydrocarbon sector, which is currently being phased in and will lead to more payments to oil suppliers being made in kwanza. Mr Massano says that strengthening the local currency's role in the economy is crucial if the BNA is to conduct its monetary duties effectively.

Analysts largely praise the efforts of policy-makers since 2009 and say their reforms have strengthened the Angolan economy, which with the GDP rising 8% in 2012 and on course for a similar outcome this year, is once again one of the world's most buoyant. "Another collapse in oil prices would obviously have an impact, given the weight of oil on fiscal receipts and GDP," says Mr Lopes. "But it probably wouldn't be as bad as in 2008. At that time, the budget management and monetary policy were much less consistent than they are today."

DILUTING OIL

The government still has plenty to do to address structural deficiencies in the economy. Widening its revenue base beyond the oil sector and cutting expensive fuel subsidies, even if that proves politically unpopular, are a must in the medium term, say most analysts. They add that without diversifying the economy from oil, the extraction of which provides few jobs for Angolans, the MPLA will struggle to create the levels of employment needed to reduce widespread poverty.

There have been improvements in the past five years, and much of the non-oil sector is thriving. Banks are highly profitable, while the country's breweries and telecommunications companies are among the most lucrative in Africa. Tiago Laranjeiro, head of Angola Capital Partners, which runs a private equity fund looking at firms involved in anything from fishing to advertising, says even small businesses are growing quickly. "If an Angolan company is competent and can serve its market, it will find customers," he says.

Non-oil export earnings should be boosted later this year when a long-delayed $9bn liquefied natural gas terminal in the north of the country is expected to start operating. And a new mining code was ratified in late 2012, which officials hope will increase Angola's already substantial output of diamonds and revive investment in its large reserves of other minerals, including iron ore and copper.

Further progress towards a more sophisticated economy will require heavy investments in infrastructure. Angola's main roads, railways and ports are in a far better state today than after the civil war, thanks to billions of dollars-worth of public spending, much of it funded by oil-backed loans from China. But secondary roads generally remain dire, electricity supply is nowhere near sufficient to meet the needs of businesses and water shortages are frequent in the major cities.

"Angola's infrastructure was entirely done away with during the civil war," says Ricardo Soares de Oliveira, a politics lecturer at the University of Oxford in the UK. "No one should underestimate the seriousness of »

rectifying this. There could be a heavy infrastructure agenda for the next 25 years."

The manufacturing and agricultural sectors suffer particularly badly. The latter has yet to recover its glory days under Portuguese rule, when the country was one of the world's largest coffee and cotton producers. Today, its farming industry, hobbled by an inability to get produce to markets quickly and a lack of food processing businesses, is able to meet just half the national demand for food. "Resolving the infrastructural issues will go a long way to helping diversify the economy," says Mr Staines of the IMF. "That's when you'll get the possibility of local producers competing with imports, especially in agriculture."

BARRIERS TO ENTRY

More investment from abroad would also help. The vast majority of foreign direct investment goes to the oil industry. The MPLA is slowly opening up the rest of the economy. But the process of setting up a new business is often arduous and involves getting permission from the national agency for private investment, the BNA (which needs to approve the importation of capital) and the relevant ministry. Moreover, pressure is sometimes put on foreign-owned companies to give or sell stakes to opaque entities thought to be controlled by members of the ruling elite, a factor which puts off many would-be investors.

Bureaucracy and corruption are a large part of the reason Angola ranked 172 out of 185 countries in the World Bank's latest Doing Business report, far below Nigeria and in equal place with Zimbabwe. "Angola is one of the strongest economies in Africa and it is full of potential and fast-growing business opportunities," says Geoffrey White, chief executive of conglomerate Lonrho, which has several investments in the country. "[But] operating costs are high, it is a difficult business environment and there are significant challenges involved in getting set up from a bureaucracy perspective."

Emerging market portfolio investors crave access to Angola. The country, rated BB- by Standard & Poor's, issued a $1bn loan participation note (a similar instrument to a bond) in August last year, the yield on which tightened from 7% at launch to 3.6% in January thanks to heavy demand. And the government is considering a debut Eurobond in the coming 12 months.

Yet it remains difficult for outsiders to buy kwanza-denominated securities. Not only do strict capital controls exist, but there is no equity market and Angolan banks hoard virtually all the government bonds that are issued.

THERE COULD BE A HEAVY INFRASTRUCTURE AGENDA FOR THE NEXT 25 YEARS

Ricardo Soares de Oliveira

The launch of a stock exchange, which will be called the Bolsa de Valores e Derivados de Angola, has been constantly delayed since the 2009 crisis. Some bankers say there are scarcely any local firms with the auditing or governance standards needed to go public. But Anthony Lopes-Pinto, head of Imara Securities Angola, claims otherwise. "There are enough companies to list," he says. "It's political will that will decide when it happens. It is unfathomable that much smaller economies, such as Botswana, Malawi and Zimbabwe, can have deep, well-developed capital markets, while Angola, which boasts some of the largest banks, telecoms and beverages players in Africa, is deemed not ready."

IN THE OFFING

For now, however, policy-makers seem more interested in establishing a proper bond market. The Capital Market Commission, the securities regulator, recently set out plans for a secondary debt market that would involve market makers, a government issuance calendar and more frequent sales of long-dated sovereign bonds.

Some investors, pointing to the buy-and-hold nature of bond markets in most sub-Saharan countries other than South Africa, are sceptical a liquid market can be created.

Others disagree, saying the establishment of a regulated debt market will, in time, lead to a vibrant trading environment and the growth of Angola's paltry insurance and pension industries. "This country must start with a debt market," says Jorge Ramos, head of investment banking at Banco Espírito Santo Angola, a big local lender. "It will allow the government to finance itself with fair interest rates, allow the banks to distribute bonds to their clients and encourage the development of a trading mentality."

Whether foreign investors will be allowed full access to that market depends on the government loosening exchange controls. It remains wary of hot money flows, lest they cause exchange rate volatility. Pedro Coelho, managing director of Standard Bank Angola, says that given the country's history of high inflation, the authorities will likely maintain restrictions until they are confident that Angolans themselves would not rush to move money abroad. "The central bank [by keeping inflation stable] is trying to prove that people can trust the currency," he says. "Then, they will slowly go ahead with the process of converting the kwanza into other currencies."

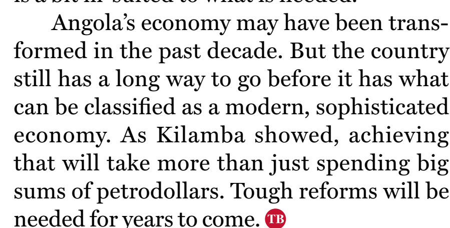
Many local bankers cite Angola's huge future infrastructure needs and say it will have no choice but to open its capital account. "It's impossible for domestic banks or domestic savings to finance that," says Mr Ramos. "They need to open up for international capital, [albeit with] some controls and supervision."

SOCIAL FOCUS

The MPLA is often criticised for focusing too little on social development and too much on large-scale capital projects. Analysts argue that oil riches and rapid economic growth are failing to benefit most Angolans. Despite a GDP per capita of about $6000, one of the highest in Africa, the country's 20 million people largely languish in poverty. Life expectancy is just 51 and the infant mortality rate is one of the worst in the world.

The latest budget, approved in February, signalled a shift in emphasis, allocating a record level of funding to social sectors such as health and education. But boosting expenditure – which the government insists it will anyway carry out prudently given its experiences in 2009 – will not in itself be enough to curtail poverty. One oft-cited example is the vast Kilamba social housing complex outside Luanda. Built and funded by China to house 500,000 people, it lies mostly empty because few Angolans could afford the asking prices for flats.

Paul Collier, an economics professor at the University of Oxford, says that as well as failing to benefit the people it was meant for, the use of foreign labourers during its construction wasted an opportunity to provide locals with formal employment. "The challenge for any oil economy is to engage the population in the production process rather than just as recipients of consumption," he says. "The Chinese are not good at that. Their forte is: 'We build it and then we'll hand it over.' Their mode of operation is a bit ill-suited to what is needed."



Angola's economy may have been transformed in the past decade. But the country still has a long way to go before it has what can be classified as a modern, sophisticated economy. As Kilamba showed, achieving that will take more than just spending big sums of petrodollars. Tough reforms will be needed for years to come.

A NEW LANDSCAPE *Banking*

Life for Angola's banks is getting harder, thanks in no small part to falling interest rates and new taxes. But, as the country's economy continues to perform impressively, growth opportunities will remain. The challenge will be to make sure that this growth is sustainable. Paul Wallace reports.

Angolan banks have benefited handsomely from the country's oil-fuelled economic boom since its 27-year civil war ended in 2002. At this point, they were tiny, with less than $3bn of assets between them. That figure had risen to $54bn by the end of 2011, making Angola's the largest banking sector in sub-Saharan Africa after South Africa and Nigeria.

Yet despite this growth, Angola's banking system was until recently unsophisticated, with lenders making the bulk of their earnings from government bonds rather than growing their loan books, e-payments being all too rare, and the regulatory framework far below international standards.

However, plenty of progress has been made in the past three years towards creating a more mature banking sector. The use of credit and debt cards has climbed sharply, while banks have significantly expanded their networks of ATMs and point-of-sale terminals, which barely existed before 2008.

LEADING THE CHARGE

The Banco Nacional de Angola (BNA), the country's central bank, has implemented many regulatory and monetary reforms in that period. In 2011, it introduced new money-laundering rules, which bankers say was badly needed. It also set up a monetary policy committee, a base interest rate and an interbank rate. These reforms, along with a greater use by the central bank of overnight repurchase agreements (repos), are leading to the establishment of market-based interest rates for the first time, says José Massano, who has been governor of the BNA since 2010.

"In the past, commercial banks struggled to set interest rates," he says. "Some would use inflation as a reference, some would use government securities, while others would use prudential regulations set by the BNA. It was very confusing. Now, most banks are using repo rates or the BNA's base rate as a reference for loans."

The interbank market remains largely inactive, aside from a small amount of overnight lending, while the base rate is not yet a powerful tool for managing liquidity. But bankers say that will change in the coming few years and that the BNA's reforms have done much to strengthen the sector. "In the past three years, you can see that progress has been made," says Pedro Coelho, head of Standard Bank Angola. "The central bank has been laying out rules and instruments that allow the financial system to become more solid."

A BIG PART OF THE BANKS' GROWTH HAS BEEN FINANCING THE REAL ESTATE BUBBLE

António Henriques

TOUGH TIMES LOOMING?

Thanks to their soaring growth over the past decade, Angola's banks have not struggled to make money. Their profitability ratios are among the best in Africa, with returns of equity (ROEs) averaging 33% in 2010 and 25% in 2011, according to a survey published by accountancy group Deloitte.

The days of sky-high earnings may not last, however. Inflation, which had long blighted Angola, fell to less than 10% for the first time on record in August 2012. As a result, interest rates on government bonds, from which banks derive so much of their income, have tightened sharply. Yields on three-month securities, which were 20% in early 2010, had decreased to 3% by the start of this year.

Mr Coelho says this has changed the banking environment significantly. "It's certainly tougher than it was five to seven years ago," he says. "Interest rates are low compared to then, when some of the banks grew very fast without necessarily doing a lot of credit."

The government is, moreover, starting to increase taxes on banks in an effort to widen its revenue base beyond the oil industry. The exemptions they used to enjoy – Angola's biggest six lenders paid effective taxes of 12% in 2010, despite a corporate tax rate of 35% – are being phased out, while a new withholding tax of 5% is being applied to treasury bills. These developments are combining with weaker yields on property assets to put pressure on banks.

"The trend in the banking sector will be of shrinking net interest margins due to the 5% withholding tax introduced on investments in treasury bills, while expense ratios will go up," says Anthony Lopes-Pinto, managing director of investment bank Imara Securities Angola. "There is also significant pressure arising from declining yields on property portfolios, as the high end of the market is oversupplied, and most of the largest banks have invested heavily in real estate. This will ultimately affect banks' bottom lines."

Several analysts say it is no bad thing if the profits of Angola's banks stop rising so quickly. They claim the sector's overall growth is unsustainable and has left regulators struggling to keep up. "Until a few years ago, the major systemic concern people had was the price of oil," says one Africa-focused private equity investor. "Now, the banking sector has become, thanks to its sheer size, a systemic concern. It has grown faster than the regulatory framework."

Others add that a rise in bad assets is a sign that slower growth levels are needed.

Boom times: Angola's banks, including BFA (left) and Millennium Angola (right), have benefited from the country's oil-fuelled economic growth

Net profits at Banco Angolano de Investimentos (BAI), the country's largest lender, fell 15% last year because of extra provisions for non-performing loans, the ratio of which went up from 4.9% to 7.2%.

REAL ESTATE WORRIES

One source of concern is the real estate market. Property prices in Luanda, Angola's capital, remain high, but they are still below their peak of 2008, just before the country's economy was hit by a crisis triggered by a collapse in oil prices. "A big part of the banks' growth has been financing the real estate bubble," says António Henriques, chief executive of Millennium Angola, which is controlled by Portugal's Millennium BCP.

Despite the possibility of banks slowing their property lending, they are likely to start to make more effort to expand their loan books. In part because of the high, tax-free returns they were making on treasuries until recently, credit provision in the country is low. The banking sector's loan-to-deposit ratio was 52% at the end of 2011, compared with 91% in South Africa. Bankers admit that will have to change if they are to maintain their profitability ratios.

"The economic incentive is there," says Emídio Pinheiro, head of BFA, Angola's third largest bank. "If the yield on treasury bills has been reduced to 4% or 5%, obviously we have to look for alternatives and domestic credit is one of the options. We will have to be more active and aggressive in the credit market."

Much of the non-oil sector is thriving, which should provide banks with opportunities to lend. Yet finding good assets is not easy in a country that the World Bank ranks as one of the toughest business environments globally. Bankers say that local companies, none of which are listed because of the absence of a stock exchange, usually lack proper auditing and governance structures. And many struggle to expand because of infrastructural constraints.

The recent creation of credit bureaux and big investments by the government in infrastructure have led to improvements, although bankers say it is a long-term process. "Angolan companies and entrepreneurs are maturing," says Mr Henriques. "But there's still not much information about the businesses. And the quality of information is very poor. Only a few companies are audited, so you never know what you have. It's a big challenge."

FOREIGN EXCHANGE LAW

Perhaps the single biggest change this year for the banking sector is a new foreign exchange (FX) law for the oil and gas industry. It will ensure that all payments to oil suppliers are made through the local banking system, rather than offshore. Since October last year, oil producers have had to pay local suppliers via domestic banks. From July this year, those payments will have to be made in kwanzas (many payments are currently made in US dollars).

The biggest development will happen this October, however, when foreign supply companies, which make up the bulk of those serving the industry, will have to be paid through the local banks, either in kwanzas or in foreign currency.

Upstream oil companies opposed the law, fearing that Angola's banks would not be able to cope efficiently with their billions of dollars-worth of transactions to suppliers. "It will be a test of the maturity of the banking system in Angola," says Jorge Ramos, head of investment banking at Banco Espírito Santo Angola, the second biggest lender in the country. "We know that most of the big oil operators have lobbied against the change, which is understandable. If you are a BP, Chevron or Exxon and you're used to working with a JPMorgan or Citi that guarantees your payments, you get comfortable with that. If you are obliged to go through domestic banks, there will be a degree of uncertainty."

So far, however, the process has seemingly been smooth. Local banks invested heavily in their IT and payments systems in anticipation of the law, particularly to ensure they could guarantee straight-through processing, while some set up corporate desks dedicated to oil companies. BFA's has five people serving about 20 clients. "We are very satisfied with the results, as are the clients," says Mr Pinheiro. "We are moving a lot of money and everything is going according to plan. The initial fears that we would not handle this have been overcome."

The law will be lucrative for those banks that oil companies choose to work with. For one, they will make fees from any transactions made. Most analysts also claim that deposits will soar as oil companies move money into the local banking system. Several say that up to $30bn, equivalent to 50% of today's total deposit base, will be brought onshore.

But others doubt those predictions, arguing that because the majority of oil service companies are foreign, much of the money that flows into the country when they are paid will swiftly move out again. "The new FX law's impact on liquidity in the banking sector is being overplayed," says Mr Lopes-Pinto. "The fact is that oil producers' expenses are typically foreign expenses »

ALTHOUGH THE MARKET IS VERY ATTRACTIVE, IT'S VERY COMPETITIVE. NEW BANKS HAVE TO MAKE HUGE INVESTMENTS

Emídio Pinheiro

related to imported goods and services and expatriate staff. The notion that the new FX law will increase long-term deposits by $20bn to $30bn is exaggerated."

NEW SOURCE OF DOLLARS

Nonetheless, Angolan officials are optimistic that in the long term, the FX law will augment the use of the kwanza in the economy and make it easier for local businesses and entrepreneurs to compete with foreign oil suppliers by more closely linking the upstream sector with the onshore economy.

"We want to see a better connection between the oil companies and the Angolan banking system," says Mr Massano at the BNA. "We want to make sure the process helps us strengthen the role of the kwanza, creates more opportunities for local businesses and provides banks with more resources to finance the economy."

Another consequence of this law will be to open up the FX market to some extent. At the moment, banks access dollars via the BNA at weekly auctions. The new law's requirement for foreign suppliers to be paid locally (many will continue to be paid in dollars, rather than kwanzas) will give them a new source of FX liquidity. It could even be one of the first steps towards Angola liberalising its capital account and allowing for the free convertibility of the kwanza.

"When banks get access to those funds from the oil industry, they will be able to mediate in the buying and selling of dollars outside the BNA," says Mr Henriques. "It will start a new market. That's a major change, and a good one for the banks and the economy."

Angola's unbanked population of roughly 80% remains high, albeit in line with much of the rest of Africa. That figure has, however, come down from 90% just two years ago, partly as a result of banks investing heavily in new branches, especially in areas outside Luanda. "Although the banks have become stronger, they haven't grown apart from society," says Mr Massano, who previously was chief executive of BAI. "They have actually become more inclusive and made a tremendous effort to increase Angolans' access to financial services."

Another factor in the reduction of the unbanked population has been the BNA introducing accounts targeted at low-income Angolans that can be created with deposits of just Kz100 ($1.03). Bankers were initially sceptical as to whether these so-called 'Bankita deposits' – which, so as to encourage banks to offer them, do not count toward compulsory reserve requirements – would catch on. But tens of thousands have been opened. Mr Massano says the growth of these and other deposits in the past two years suggests that Angolans have more trust in the banking system. "In the past, when inflation was very high, people were afraid of losing money by keeping it in the bank," he says. "That's now totally disappeared."

HUNT FOR LICENCES

Foreign banks have long sought access to Angola. Lenders from Portugal, Angola's former colonial ruler, have a heavy presence. But aside from them, South Africa's Standard Bank, which was awarded an Angolan licence in 2009, is the only foreign lender to offer full banking services in the country. Ecobank and Standard Chartered, which both have representative offices in Luanda, and Nigeria's United Bank for Africa are among the many others thought to have applied for licences.

Bankers say that while the licence process takes at least two years to complete, and usually involves a requirement to partner with the government or other entities, the attractions of Angola's big and rapidly growing economy make it worth their while. "There's a long queue coming out the BNA of banks trying to get licences," says one banker in London. "Ultimately, if a bank wants to say it is in sub-Saharan Africa, it has to be present in a place like Angola."

Analysts warn, however, that while Angola might be profitable for established lenders, new ones will have to make hefty investments if they are to gain market share. Standard Bank Angola will probably not break even until next year, mainly because of the cost of building its branch network, which is expected to number about 27 by the end of 2013. "Although the market is very attractive, it's very competitive," says BFA's Mr Pinheiro. "New banks have to make huge investments."

Angola's banking sector has become more sophisticated and complex in the past decade. That process, far from being over, will likely accelerate over the next few years. Not only will lending pick up thanks to low yields on government bonds and a maturing of the non-oil sector, but local capital markets instruments will start to play a greater role. The new FX law could also herald the liberalisation of the capital account, which would give Angolan banks the ability to tap international capital markets. All this, combined with a buoyant economy, means that while they might not expand as quickly as they did a few years ago, their growth is hardly likely to be pedestrian. It will be up to the banks and regulators to make sure that growth is carried out sustainably. TB

OIL AND MINING

Big scoop: four of the five oil 'supermajors' are present in Angola, including BP (pictured)

OIL BONANZA KEEPS FLOWING
Oil and mining

Oil looks set to dominate Angola's economy in the medium term and potentially longer if pre-salt discoveries prove as lucrative as optimists hope. But new regulations in the US and Europe could shake up the industry, while the government hopes to develop gas exports and the mining sector. Louise Redvers reports.

THE 24-STOREY STEEL AND GLASS headquarters of Angola's state oil company, Sonangol, stands tall and proud amid crumbling colonial ruins in central Luanda. The dominance of the building and the brightness of its illuminated logo serve as an indelible marker of the importance of a company that is at once an oil concessionaire, regulator and operator, as well a real estate dealer, global investor, and an aviation and telecoms provider.

The headquarters also serves as a firm reminder of the importance of oil to Angola. Crude accounts for more than 90% of Angola's exports and 50% of its gross domestic product (GDP), and it is because of growing oil output and rising revenues that the country has enjoyed some of the world's most rapid growth rates since the end of its civil war in 2002.

Oil powers the economy in Angola – now sub-Saharan Africa's third largest economy – as well as the country's strategic alliances with China, the US, Brazil and the EU, making it one of the continent's most powerful diplomatic players.

A member of the Organisation of the Petroleum Exporting Countries (OPEC) since 2007, Angola is Africa's second largest oil producer, pumping an average of more than 1.7 million barrels per day (bpd). It hopes to raise this to more than 2 million bpd by 2015.

In April, national reserve estimates were revised upwards from a 2011 OPEC figure of 10.4 billion barrels to more than 12.6 billion barrels, largely due to promising discoveries of oil deposits in so-called 'pre-salt' layers.

Although pre-salt drilling is more time consuming, technically challenging and expensive, given its location beneath thousands of metres of rock in what is usually ultra-deep water, it could offer Angola substantial rewards. Scientists believe the country's pre-salt layers may match formations found off the coast of Brazil, where geological patterns are similar owing to the fact the countries were part of the same continent 156 million years ago. This would mean a lot of oil.

"The pre-salt exploration looks to be promising and could potentially catapult Angola to become Africa's largest oil producer," says Philippe de Pontet, Africa director at political risk consultancy Eurasia Group. He adds that Angola is increasingly more attractive to big oil industry investors than Nigeria, given Angola's greater stability and fewer "regulatory uncertainties" and security challenges.

BIG PLAYERS

Four of the five oil 'supermajors' are present in Angola: Chevron (as Cabinda Gulf Oil Company), ExxonMobil (as Esso Angola), BP and Total. Between them, they run the bulk of Angola's production, as well as holding significant equity stakes in other blocks, both onshore and offshore.

Other operators, such as Norway's Statoil, Italy's Eni, Brazil's Petrobras and Denmark's Maersk, are also growing their interests in Angola, as are leading service companies such as Schlumberger and Halliburton.

Somoil and Sonangol's operating subsidiary Sonangol P&P are the only Angolan operating companies (those that drill as opposed to just owning equity stakes), although this may change with a licensing round set for 2013 offering onshore blocks that are more accessible and require less technology than offshore ones.

Steinar Pollen, Angola country manager for Statoil, which has equity partnerships in eight blocks and has just begun pre-salt exploration in blocks 38 and 39, is buoyant about the opportunities in Angola. "There is a very high level of activity in Angola and »

WE WANT TO RECRUIT, TRAIN AND DEVELOP ANGOLANS TO FILL AND LEAD [BP ANGOLA] AS TIME PROGRESSES, BUT IT IS VERY CHALLENGING TO FIND ENOUGH TALENTED STAFF IN THE LOCAL MARKET

Martyn Morris

a lot of interest. As you can see, all the major companies are here, plus other smaller operators. Our position in Angola is very interesting. We have a good portfolio and in size it is second only to our portfolio in Norway. We have been in Angola for more than 20 years and we hope many more. Angola is a long-term project for us. It is part of our long-term strategy," he says.

For all the buzz, however, working in Angola is not straightforward. The technical requirements of operating in ultra-deep water are vast and expensive, and importing highly specialised equipment into the congested Luanda port can take months, delaying operations and pushing up costs.

But the biggest headache, companies say, is finding suitably skilled English-speaking Angolan personnel to staff their operations and meet tough government 'Angolisation' quotas. In a bid to try to share the benefits of this capital-intensive sector that creates few jobs, as well as secure longer-term control of it, Angola's Ministry of Petroleum enforces strict rules on foreign oil companies. These require 70% of all staff to be from Angola and can include restrictions on the number of annual work permits an individual may apply for, usually no more than three, while visas are often dependent on a guarantee the post will be filled afterwards by a national hire. The intention is not questioned, but it is hard for firms to recruit sufficiently from Angola, with the entire education system devastated by decades of war and very limited professional training options.

"There is a shortage of experienced support to the oil industry, particularly in terms of human resources," says Martyn Morris, general manager of BP Angola, which has invested more than $20bn in the country since 2000 via interests in nine deep and ultra-deep water blocks. "We want to recruit, train and develop Angolans to fill and lead this company as time progresses, but it is very challenging to find enough talented staff in the local market."

LOOMING FX CHANGES

Another challenge for Angola's foreign operators is the new foreign exchange law for the industry. Since October 2012, all oil companies have had to make payments for goods and services from bank accounts domiciled in Angola. From July this year, those payments to locally based companies will have to be in Angolan kwanzas, instead of US dollars, while from October the provision will extend to include payments to non-resident service and goods providers.

The idea is to channel the billions of dollars' worth of industry transactions through Angola's banking system, thus reducing the dollarisation of the economy, boosting national liquidity and stopping the oil sector operating as it has for decades as an 'island economy' offshore.

Angola's central bank, Banco Nacional de Angola, has given strong assurances that banks will be able to cope and has installed new regulatory frameworks, but there are concerns. Asked what impact the new legislation may have on the industry, Mr Morris at BP says cautiously: "It is very early days to say about the law. The principles exposed in the law are sound ones... It will require a rapid growth of the capacity of the local banking environment and it is going to take time to implement."

There are some fears that the Angolan banks will struggle to handle the high volumes of cash and there is insecurity regarding longer-term repatriation of currency. One former offshore manager with a great deal of experience in Angola says: "Angolan banks have limited capacity. Sometimes they have no electricity or there is 'no system'; that is the computers go down. Failure to process a payment could mean equipment doesn't make it in time. Then you're talking whole operations being delayed and that is big money."

DODD-FRANK IMPACT

Other legislation that could also potentially shake up the Angolan oil industry has to do with transparency and disclosure. The US Dodd-Frank Wall Street Reform and Consumer Protection Act dates back to 2010, although it is still being vigorously appealed by the American Petroleum Institute and others. Section 1504 will require all US-listed oil, gas and mining companies that have to report to the US Securities and Exchange Commission (SEC) to disclose payments of more than $100,000 that they make to any government anywhere in the world.

The EU Accounting and Transparency Directives (whose terms have been agreed by the European Parliament, European Council and European Commission, but still faces a vote in parliament) go further, compelling EU-listed privately owned oil, gas, mining and logging firms to disclose all payments of more than €100,000, including taxes, royalties and licence fees.

Sonangol, which insists on strict confidentiality clauses in all its contracts and is renowned for its opacity, is understood to be deeply unhappy about foreign legislation trying to override its own terms and conditions. It is not clear how the new EU and »

ANGOLA IS CLEARLY KEEN TO DIVERSIFY ITS MINING SECTOR BEYOND DIAMONDS AND IT HAS PUT THE PIECES IN PLACE, FROM A REGULATORY AND INFRASTRUCTURE PERSPECTIVE, TO MOVE AGGRESSIVELY IN THAT DIRECTION ***Philippe de Pontet***

US laws will play out, but in 2001 BP was reported to have backed off plans to disclose its Angolan payments under the terms of Publish What You Pay – a social movement advocating financial transparency – after Sonangol allegedly indicated such a move may risk its contracts.

CHINESE DEMAND KEY

Although Western companies dominate Angola's oil industry operationally, it is China that leads consumption of the end product. According to the US Energy Information Administration (EIA), 35% of Angola's 2011 crude exports went to China, 14% to the US, 14% to the EU and 11% to India. Chinese government figures for the same year show Angola was the second largest source of China's oil (12%), behind Saudi Arabia, and for some years Angola has been China's largest trading partner in Africa.

Angola would have a more diversified market and one closer to home in Africa if it could refine more of its crude, but its single refinery in Luanda, which was built by the Portuguese in the 1950s, struggles to process 40,000bpd.

A second refinery will be located in Lobito, strategically close to the country's second port and the Benguela Railway which, thanks to a Chinese makeover (made possible by a credit line paid for with oil), will soon link the Atlantic coast to neighbouring Democratic Republic of Congo. However, construction has been slow, with several potential partners, including the state-owned China Petrochemical Corporation, coming and going, and there is still no completion date for construction. As a result, the country is forced to import more than 80% of its fuel, a frustrating irony given oil is one of the few things that Angola actually produces.

Government subsidies ensure local fuel costs are kept down, fixing pump prices at 40 cents a litre for diesel and 60 cents a litre for petrol, some of the lowest levels in the world. The cost to the wider economy in maintaining these prices is significant. According to the EIA, subsidies account for as much as 7.8% of Angola's GDP.

The International Monetary Fund is urging the government to cut the subsidies. Sonangol announced in February that it would implement this, a decision reinforced by long-serving oil minister José Maria Botelho de Vasconcelos in March. But in April, Sonangol appeared to backtrack, issuing a statement to say petrol prices would not change. This is being read as a political move to protect the country from protests similar to those that occurred in Nigeria when it tried to drop fuel subsidies last year.

OTHER COMMODITIES

The most significant downstream development in Angola is the much-hyped $9bn liquefied natural gas (LNG) plant in Soyo. It is hoped the plant will finally begin exporting this year. Angola's LNG plant was built and is being operated by a consortium of Chevron (36.4%), Sonangol via its gas subsidiary Sonagas (22.8%), Total (13.6%), BP (13.6%) and Eni (13.6%). It will use pipelines to transport waste gas from offshore rigs and compress it into a marketable product.

The repeated delays to shipment have been blamed on technical testing, but insiders say the company has struggled to find a willing buyer, given the recent shale gas developments in the US, to where exports were initially going to be sold. If Angola can find a market, LNG could become a major contributor to its GDP.

In the meantime, Angola continues to be one of the world's leading exporters of diamonds, although output has stagnated in recent years due to the drop in global prices that led to some operators mothballing mines.

The country also has significant reserves of other commodities, including iron ore, copper, gold, manganese, marble and granite. Non-oil receipts came to just 17% of total income in 2012, according to government budget documents released in February 2013. But the hope is that a new mining code ratified in November 2012 will attract investors to the industry to exploit its potential and create jobs, something the oil sector has largely failed to do. Under the new code, mining taxes have been slashed from 35% to 25% and investors are given more rights and guarantees.

A number of colonial-era iron ore mines that were closed during the war are being brought back into commission, and there are manganese and phosphate mining projects under way. In the longer-term, there are plans to build factories producing fertiliser for export, as well as an aluminium smelting plant.

"Angola is clearly keen to diversify its mining sector beyond diamonds and it has put the pieces in place, from a regulatory and infrastructure perspective, to move aggressively in that direction," says Mr de Pontet of Eurasia Group.

He cautions, however, against Angola having too much exposure to falling commodity prices and adds that "infrastructure constraints render most greenfield projects uneconomical at current prices". TB