ANGOLA THINKS BEYOND OIL

Introduction

Angola's impressive post-war development continues apace. But as oil production stagnates, the government is under greater pressure than ever to diversify the economy and create jobs, writes Paul Wallace.

In one of his rare speeches in October last year, Angolan president José Eduardo dos Santos said he expected the country's economy to grow 5.1% in 2013, well below the government's target of more than 7%. To his audience of politicians, it was a signal that the oil-rich south-west African country had reached a turning point in its post-war development.

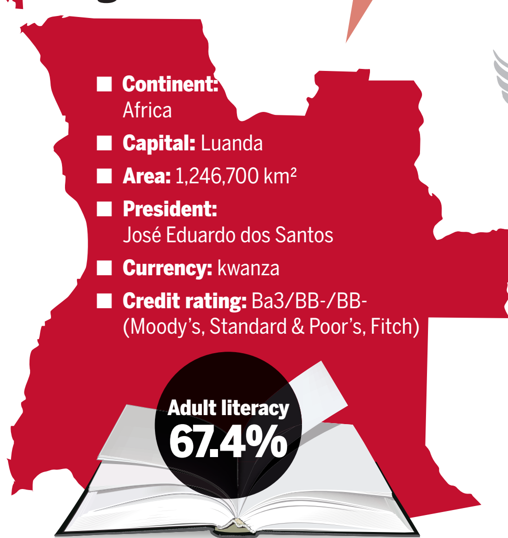
The former Portuguese colony was in a sorry state when it ended a bloody 27-year civil war in 2002. Much of its economy and infrastructure were destroyed and its health and education systems existed in name only.

Since then it has soared thanks to oil exports. Crude production rose from 800,000 barrels per day (bpd) in 2003 to almost 2 million bpd in 2008. The economy expanded at more than 10% annually in real terms, making it one of the fastest growing in the world. Angola's gross domestic product (GDP) of more than $120bn is now the fifth largest in Africa and roughly equal to those of Ghana, Kenya and Ethiopia combined.

In Luanda, the capital, there is a frenzy of investment. Cranes clutter the skyline, putting up high-rise offices, luxury hotels and flats. The first mall in the centre of the city, Sky Gallery, is set to open its doors in July. It will include Armani, Hugo Boss and Prada shops. In the rest of the country, the government is spending billions of dollars on roads, railways, ports and energy projects.

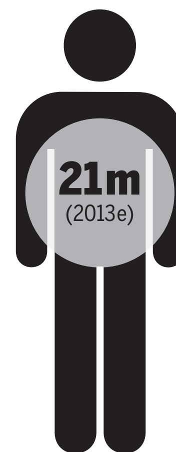
Yet the days of Angola being able to rely on oil to fuel its boom have ended. Following a severe slump in 2009 and 2010, caused by a crash in crude prices, Angolan officials hoped the economy would quickly regain its strength. But oil output has been stagnant since 2009, when it dropped to 1.8 million bpd because of technical problems. As a result, Angola's growth, although still high by sub-Saharan African standards, is a long way off its pre-crisis levels. The Interna- »

Angola overview:



Life expectancy

Population



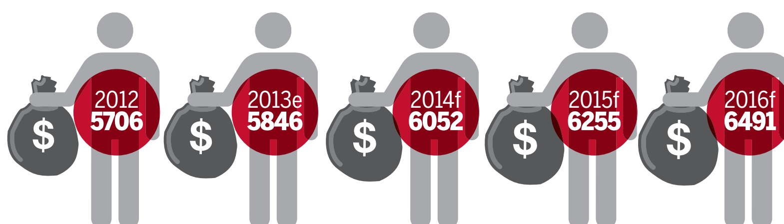
$62bn

Total banking assets (end 2012)

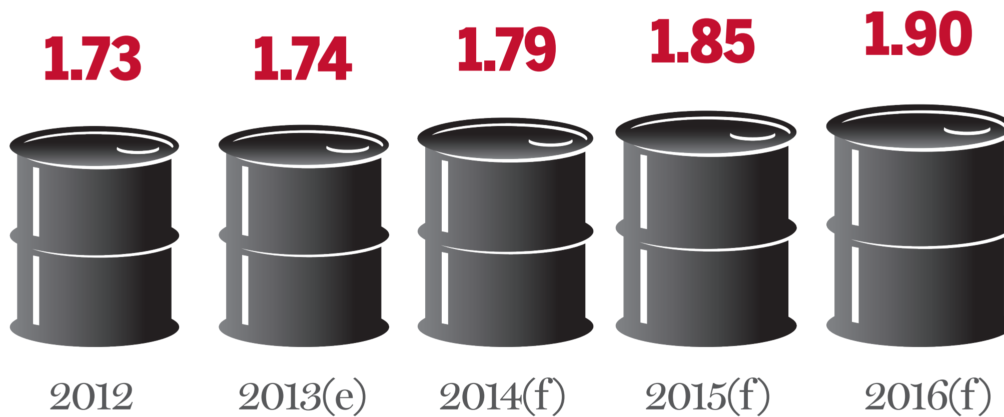
World Bank Ease of Doing Business rank out of 189 countries (2014)

179th

GDP per capita ($)



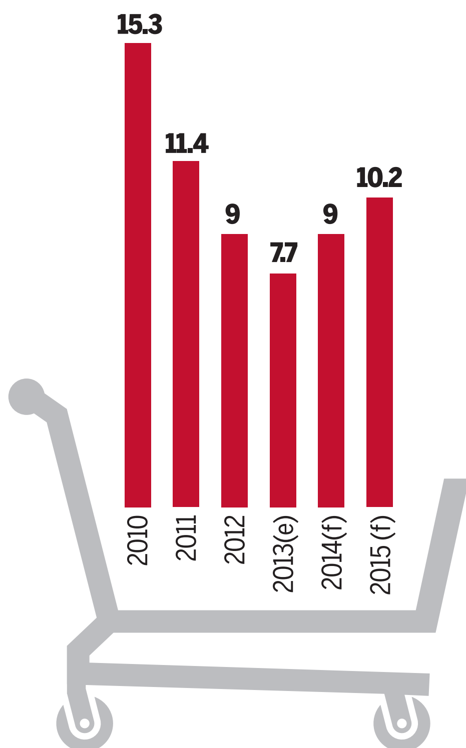
Angola's oil production (million barrels per day)



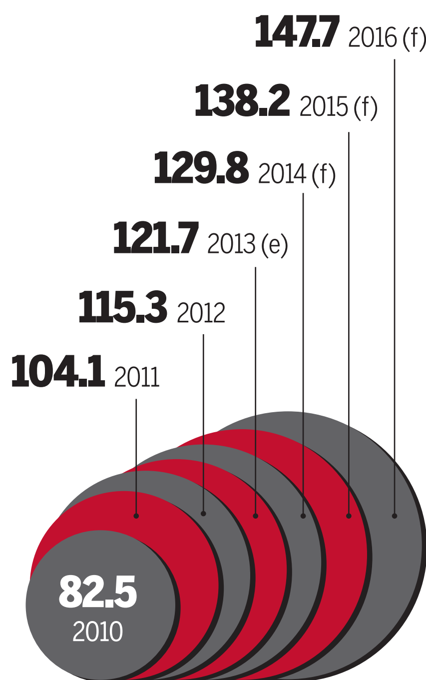
Government debt (% of GDP)

Year	% of GDP
2012	29
2013(e)	27
2014(f)	29
2015(f)	31
2016(f)	32

Consumer inflation (%, period end)



GDP ($ bn)



Fiscal balance (% of GDP)

Year	% of GDP
2012	5.1
2013(e)	-1.5
2014(f)	-2
2015(f)	-2.6
2016(f)	-2.1

Angola real GDP growth rates (%)

Note: e, estimate; f, forecast.
Sources: Deloitte, Espírito Santo Investment Bank, IMF, Standard Bank, World Bank

INTRODUCTION

tional Monetary Fund (IMF) believes GDP actually rose 4.1% last year, even lower than the president's revised forecast.

OIL TARGETS MISSED

GDP growth is unlikely to pick up significantly in the near term. Manuel Alves da Rocha, an economics professor at Luanda's Catholic University, says growth rates could remain about 5% to 6% until 2020. Analysts generally think state oil company Sonangol's prediction that exports will climb to 2 million bpd by 2015 are unrealistic. And even though oil firms are optimistic about the country's largely untapped onshore and deepwater blocks, any finds from them will take a few years to come onstream.

Against this backdrop, policy-makers are under pressure to step up efforts to diversify the economy. Today, oil, which has provided few jobs for Angola's mostly impoverished 21 million people, accounts for 97% of exports and almost 80% of the state's revenues. Moreover, there has seemingly been little progress in the past decade. INE, Angola's national statistics body, recently said that the commodity made up 44% of GDP in 2010, down only a few percentage points from 2002.

Public finances have already come under strain from oil receipts being lower than forecast. Last year, Angola posted its first budget deficit since 2009. The IMF does not expect a surplus until 2019, mainly because the government plans to spend billions of dollars on infrastructure in the next decade, while the first ever local elections, which are meant to be held next year, and an upcoming census, the first since 1973, will be expensive. "The budget is expanding, but income is not increasing at the same rate," says Markus Weimer, an independent consultant and Angola expert. "So, at least in the short term, there will be some pressure on Angola."

The government's low debt-to-GDP ratio of 27% means it will not struggle to borrow more, either locally or abroad, to fund its deficits. Foreign bankers say there will be plenty of demand if the country, rated BB- or its equivalent by Moody's, Standard & Poor's and Fitch, issues its first Eurobond later this year.

SEEKING DIVERSIFICATION

Nonetheless, members of the ruling Popular Movement for the Liberation of Angola (known by its Portuguese abbreviation, MPLA) privately admit that it is vital to boost the non-oil sector. Some parts of it are flourishing. Profitability ratios in the banking industry, now the third largest in sub-Saharan Africa, have dropped in recent years, but they remain high. Telecommunications firms, retailers and drinks companies are benefiting from a rising middle class.

THE PUBLIC SECTOR STILL DOMINATES AND DRIVES THE ECONOMY. PART OF THE SOLUTION TO BUILD THE NON-OIL SECTOR IS TO GET AWAY FROM THE STATE BEING THE MAIN SOURCE OF CONTRACTS AND ENGINE OF GROWTH

Markus Weimer

Manufacturing is picking up, albeit from a very low base. Fewer goods, particularly food items, have to be imported, which is helping to make Luanda, one of the world's costliest cities for expatriates, slightly cheaper. "It is now easy to find local produce in the shops," says Anthony Lopes Pinto, head of Imara Securities Angola. "Previously, it was hard. It's still an expensive city to live in, but not to the same extent as before."

But Angola's reputation for being one of Africa's toughest business environments persists. It ranked 179th out of 189 in the World Bank's latest Ease of Doing Business survey. Its inefficient courts make it hard for companies to enforce contracts. A shortage of power – only about half of Angolans have electricity – leads to high manufacturing costs. "What Angola needs is cheap electricity and water," says Oxford University's Ricardo Soares de Oliveira, author of Magnificent and Beggar Land, a forthcoming book on the country's post-conflict history. "These are basic inputs for industrial production that are not in place right now."

Investors and entrepreneurs are also hampered by rigid bureaucracy and a rentier culture that often forces them to partner with members of the political and ruling elite. Analysts say this hinders the development of the private sector. "The public sector still dominates and drives the economy," says Mr Weimer. "Part of the solution to build the non-oil sector is to get away from the state being the main source of contracts and engine of growth."

POLITICAL CHANGES

Angola's economic outlook is changing at a time of political transition. The 71-year-old president, who has held power since 1979, is widely thought to want to step down before or at the next national elections in 2017, even though the constitution allows him to run for one more term until 2022.

Rumours that his son, José Filomeno dos Santos, who is chairman of Angola's newly created sovereign wealth fund, was being lined up as a successor have died down. Instead, the president is thought to favour his vice-president, Manuel Vicente, who gained a reputation as a savvy businessman when he ran Sonangol between 1999 and 2012, before he joined the cabinet for a brief stint as the minister for economic coordination.

"There would be continuation of policy [if he became president]," says Mr Weimer. "Mr Vicente has already been influential in terms of the direction Angola takes. His efforts when he was a minister were focused on empowering the local private sector. There would probably be more of that." Angola's political and social stability does not seem under threat. The MPLA's grip on power is strong, and it controls most of the media. Occasional street protests are sporadic and usually small. The two main opposition parties lack broad support.

Nonetheless, whoever becomes the next president will take over a country vastly different from what it was in 2002. The economy may continue to grow quickly, but it is slowing. And about 60% of Angolans are under the age of 25, with little or no memory of the war. Peace alone will not be enough to satisfy them. They will want jobs and greater prosperity. For that, economic diversification is badly needed. TB

ANGOLAN BANKS LEARN FROM THEIR EXCESSES

Banking

Angola's banking sector has been hit by a recent rise in non-performing loans, a legacy of reckless lending in the past decade. But bankers are optimistic that the worst is over, finds Paul Wallace.

In the past two years, Angola's banks have been given a sombre reminder of their excesses in the first decade of this century. When the country's civil war ended in 2002, the financial sector was, much like the overall economy, in a bad state. The few banks that existed were mostly state-owned and inefficient. They had barely $3bn of assets between them.

Since then, their growth has been dizzying. At the end of 2012, they had almost $62bn of assets, says consultancy firm Deloitte. The number of lenders has swollen to 24. Only three of them are controlled by the state. The rest are either owned by local investors or by foreign banks, with those from Portugal, the former colonial ruler, having the heaviest presence.

The sector benefited handsomely from Angola's boom that followed the war. As oil production rose from 800,000 barrels per day in 2003 to almost 2 million in 2008, gross domestic product (GDP) grew more than 10% annually, making the country one of the most buoyant economies in the world. Banks' profitability ratios peaked in 2008 when they made a huge aggregate return on equity of 35%, according to Tiago Dionisio, an analyst at Eaglestone, a sub-Saharan-focused investment bank.

But conditions are now a lot tougher for banks. The government has cut tax exemptions they used to enjoy as it seeks to diversify its revenues from oil. Banks have also been hit by a declining interest rate environment. Angolan inflation fell to single digits for the first time on record in mid-2012 and has continued to decrease, measuring 7.5% this February. Yields on government bonds, which banks tend to buy in large quantities, have dropped in tandem. Short-term treasury rates, as high as 20% in 2010, are today just over 3%.

"The industry is facing huge challenges because traditional, safe sources of revenue have decreased," says António Henriques, chief executive of Millennium Angola, which is controlled by Portugal's Millennium BCP. "The decline has severely affected banks' profits."

NON-PERFORMING LOANS UP

Even more worryingly for banks, non-performing loans (NPLs) have gone up significantly. The economy slumped amid a collapse in oil prices in 2008 and 2009 and has not regained its former vigour. GDP increased 4.1% in 2013 and is forecast to increase by just over 5% this year.

Construction and real estate companies, to which banks lent heavily and often recklessly before the crash, have been hit by the slowdown and a build-up of government arrears to contractors. José Massano, governor of the Banco Nacional de Angola, the central bank, says the NPL ratio for the banking sector is about 11% (see interview with the central bank governor, page 10).

Bankers in the capital Luanda are generally confident that the situation is under control, arguing that lenders have put aside big provisions for potential losses. But they admit that the industry needs to learn from its mistakes. "The level of NPLs as a whole is high," says Pedro Coelho, head of Standard Bank Angola, which started operating in 2010. "It's not healthy. The financial system has to be more cautious in the way it lends."

He adds, however, that policy-makers should address inefficiencies in the legal system that make it difficult for banks to recover loans. "The central bank has to help banks recover loans more easily," he says. "Today, that is not a straightforward process."

The problem of NPLs worsened for some banks last year. The net profit of Banco Angolano de Investimentos (BAI), the country's largest lender by assets, fell 31% in 2013 due to loan write-offs and provisioning. Meanwhile, income after tax at Banco Espírito Santo Angola (BESA), the second biggest bank, dipped to $55m. Only two years earlier it earned $313m.

The developments have led to shake- »

The level of non-performing loans as a whole is high. It's not healthy. The financial system has to be more cautious in the way it lends ***Pedro Coelho***

Credit rating: Banco Angolano de Investimentos is the first Angolan bank to get an international credit rating

ups at these institutions. BAI has bolstered its credit recovery department and changed its lending criteria. BESA has replaced some board members, including its chief executive. In December 2013 it increased its share capital by $500m to about $1.6bn, making it by far the highest-capitalised bank in Angola. At the same time, however, it says that because of its recent experience, it wants to lower its loan-to-deposit ratio of roughly 190%.

"We want to continue growing, but not as fast as in the past," says Rui Guerra, its new chief executive. "We have to deleverage. The idea is to get down to a 100% transformation ratio in two or three years."

PRUDENTIAL REFORMS

The changed market environment comes at a time when the central bank has been pushing through a host of regulations to bring bank practices more in line with the rest of the world. It has sought to strengthen anti-money laundering controls and risk management. It has also focused on improving corporate governance and transparency, especially after BAI was criticised in a 2010 US Senate report for not disclosing a list of shareholders. BAI has since done this.

As part of these aims, banks have been given two years to adopt International Financial Reporting Standards, which bankers say are stricter about declaring overdue debts than current Angolan accounting practices.

"The regulations encompass a whole range of things," says Emídio Pinheiro, head of Banco de Fomento Angola (BFA), a subsidiary of Portuguese bank BPI. "There's a lot of pressure on banks and their management to comply in the next two years. It will be very demanding. But it will help the sector be better understood by the international financial community."

Analysts say the prudential reforms have already led to significant improvements. They cite the fact that BAI became the first Angolan bank to get an international credit rating (of Ba3 from Moody's) earlier this year as evidence that the sector is becoming more transparent and sophisticated. "The banks have come a long way in the last few years," says Nuno Alpendre, a financial services partner at Deloitte in Luanda. "Everyone knows it's crucial for them if they hope to bring in foreign investment."

NEW OPPORTUNITIES

Despite all the troubles Angola's banking sector has gone through in the past few years, it remains in a good state. Many lenders seem to have reversed the trend of falling profits. BFA's net earnings rose more than 10% last year to roughly $245m, while those of Banco BIC, which has the largest branch network in the country, climbed 20% to $201m. Standard Bank, meanwhile, broke even for the first time last August, ahead of schedule, and expects to post its first full-year profit in 2014.

Even though the economy is no longer expanding at a double-digit pace, banking opportunities keep on emerging. A new foreign exchange (FX) law for the oil and gas sector has boosted revenues for some lenders. Introduced by the central bank to encourage greater use of the kwanza in what is a heavily dollarised economy, it forces oil producers to pay their suppliers through the Angolan banking system.

Oil companies were worried that local banks would not cope with their billions of dollars of transactions. But the transition has so far been smooth, testifying to banks' efforts in the run up to the law, the final phase of which was implemented last October.

The changes required banks to update their systems to ensure they could provide straight-through processing, and set up dedicated oil and gas desks. "Most [oil firms] are positive about what's happened," says BFA's Mr Pinheiro. "Everyone at the banks – on the commercial side, on the systems side, on the payments and transactions side – committed a lot towards this. They did a good job."

The oil and gas sector will probably come to be dominated by a handful of banks. Bankers say oil firms will only want to work with the biggest local institutions or specialists in the sector such as Standard Bank and Standard Chartered, which got an Angolan licence late last year. "It's not a business for every bank," says Mr Pinheiro. "You need to have a strong balance sheet and lots of liquidity. You have to comply with certain rules and criteria. Not all the banks can participate."

One the main benefits for banks that have won oil business is that they have a new way to access dollars. Previously they had to rely on the central bank's FX auctions. The extra supply of the currency has enabled them to increase their FX sales to companies in need of dollars to pay for imports. "The banks that have managed to attract the oil operators are in a better position than those that haven't," says Standard Bank's Mr Coelho. "It's a strong source of dollars. It's created a bit of an imbal-

ance between banks that deal with the oil sector and those that don't."

DIVERSIFICATION PLAY

The diversification of Angola's economy from oil, which accounts for almost 50% of GDP, has been slow. Businesses struggle because of a poor logistics networks, electricity shortages and red tape. The government's much-touted Angola Investe programme, designed to subsidise and partially guarantee loans to small firms, has seen low uptake from banks, which say too few proposals meet their risk criteria.

But bankers are generally optimistic that the situation is improving. They say that conditions for manufacturers are getting easier as the government invests more in infrastructure.

Some banks are positioning themselves with this in mind. BESA opened 30 branches in 2013 and plans to add another 11 to 14 to its network this year. Mr Guerra says it is doing this as part of a strategy to exploit the growth of companies outside the oil industry. "More and more clients are meeting us to see if we can help them invest in non-oil sectors," he says.

Investment banking is likely to be increasingly important for Angolan lenders. Many are trying to win advisory and structuring mandates on the various large infrastructure and energy projects taking place across the country. A few are preparing for the opening of a secondary debt market, which will be a precursor to a stock market. Angola's capital markets regulator, CMC, has been developing a legal framework to enable trading in government bonds and encourage corporate issuance.

The process has suffered delays, but last October CMC published regulations outlining rules for brokers, banks and investors. Jorge Ramos, head of investment banking at BESA, hopes that trading in government securities, at least on a small scale, will start by the end of 2014. "The regulators are building the market from scratch, but they are doing it properly," he says. "The country needs capital markets. We don't expect them to be very liquid from day one. But the liquidity will come. If in two or three years Angola can create a decent treasury and corporate bond market, that will be a major achievement."

The retail banking market is shallow. The vast majority of Angola's population is unbanked. Bankers say they are trying to work with the government to rectify this, but claim that little progress can be made with so many of the country's 21 million people living in poverty.

They are more excited about services and products targeted at the small but growing middle class in major cities such as Luanda and Lobito. A few banks are looking at introducing mortgages soon. Some have started offering insurance and car leasing loans, while a few have pushed into private banking. Last year Millennium Angola launched prestige banking for its more affluent clients by opening seven branches dedicated to them. "It's been very successful," says Mr Henriques.

CONSOLIDATION LOOMING?

Angola's banking sector is already fairly crowded. Yet it could get even more so in the near future. Togo-based Ecobank and several local investors have applied for banking licences. If they are successful, it would take the number of banks in the country to almost 30.

Analysts argue, however, that some consolidation may be inevitable in the next few years as small lenders find themselves squeezed out of the market by bigger rivals. "I don't think the number of banks is sustainable," says Eaglestone's Mr Dionisio. "Some probably don't have enough capital to compete in the long term."

Takeovers are rare in Angolan banking. But earlier this year VTB of Russia merged its small local subsidiary with Banco Privado Atlantico, the sixth largest bank in the country. Mr Dionisio says the move could encourage more such deals.

Consolidation could be driven by regulators. The central bank recently gave lenders until June this year to meet a minimum capital requirement of Kz2.5bn ($25m), up from Kz600m previously. But some bankers, pointing to Nigeria, which has a minimum capital requirement of $160m, say the new level is still too low and that $100m would be more appropriate for an economy the size of Angola, which has sub-Saharan Africa's third largest GDP.

"Angola needs higher-capitalised banks," says Mr Ramos of BESA, whose own $500m capital-raising last year led to questions about whether its main rivals would follow suit. "It is a country of big numbers and big development needs. The projects require big money."

A lot has changed for Angola's banks in the past four years. Gone are the days of them routinely making returns on equity of 30% by doing little more that piling into treasuries. Today, in what many believe to be a reflection of a maturing financial sector and an economy growing more sustainably, they face an environment in which their margins are shrinking and competition is becoming fiercer.

Some banks will fall by the wayside, unable to adapt to the new market. Those that hope to emerge on top will have to find innovative ways of reaching new clients and developing products. It will also be crucial that they do not repeat the mistakes of the sector's boom years by lending recklessly. TB

TOP ANGOLAN BANKS BY ASSETS (2012 YEAR END)

Bank	Consolidation level	Parent bank	Assets ($m)	Assets (% change)	Tier 1 capital ($m)	Tier 1 capital (% change)	Pre-tax profits ($m)	Pre-tax profits (% change)	Return on capital (% latest)	Loans to assets ratio (%)
Banco Angolano de Investimentos	BHC		10,788	-9.2	669	24.2	185	-7.3	27.7	54.9
Banco Espírito Santo Angola	FOS	Banco Espírito Santo	10,410	17.6	1,022	48.3	56	-84.1	5.6	67.4
Banco de Poupanca e Credito	BHC		9,597	22.0	815	15.6	110	-40.0	13.4	n/a
Banco de Fomento Angola	FOS	BPI	7,933	12.3	553	16.8	219	-12.2	39.6	19.2
Banco BIC	BHC		6,933	25.8	593	20.0	191	8.9	32.3	37.3
Banco Privado Atlantico	BHC		3,063	30.8	277	13.7	78	78.5	28.2	49.7
Banco Sol	BHC		1,865	33.4	96	24.5	42	125.6	43.6	30.4
Millennium Bank Angola	FOS	Millennium BCP	1,832	2.2	208	21.6	65	35.4	31.3	46.6
BNI	BHC		1,693	39.4	165	18.2	43	0.4	26.1	48.1
Caixa Totta Angola	FOS	Caixa Geral de Depositos	1,583	24.5	236	9.4	80	39.9	34.0	34.6
Banco Keve	BHC		896	38.7	81	14.8	21	119.1	25.8	36.1
Standard Bank de Angola	FOS	Standard Bank Group	647	83.0	76	117.1	-17	-6.9	-22.1	15.9

Notes: BHC = bank holding company, FOS = foreign-owned subsidiary. Source: www.thebankerdatabase.com

JOSÉ DE LIMA MASSANO *Profile*

Angola's central bank has carried out a wave of reforms in recent years to improve its monetary policies and modernise the banking sector. And its governor, José de Lima Massano, tells Paul Wallace there is still more to come.

ANGOLA'S FINANCIAL SYSTEM HAS DEVELOPED AT A FRENETIC PACE IN THE PAST DECADE, matching the rise of the oil-fuelled economy following the end of a devastating civil war in 2002. The country's banks have grown from having a paltry $3bn of assets to more than $60bn today, making theirs the third largest banking sector in sub-Saharan Africa after those in South Africa and Nigeria.

The central bank, Banco Nacional de Angola (BNA), has had the tough task of overseeing and regulating this expansion, as well as creating a monetary framework virtually from scratch.

Since José de Lima Massano became governor in late 2010, BNA has launched one reform after another. Among his first moves was to improve the bank's fiscal management by creating a monetary policy committee, a benchmark interest rate and an interbank rate, called the Luanda Interbank Offered Rate (Luibor).

RISING INFLUENCE

These initiatives are still in their infancy. The base rate is not yet a powerful tool on its own for managing liquidity and the interbank market is more or less inactive beyond a small amount of overnight lending. But their influence on the economy is rising and they are, together with BNA's use of cash reserve requirements, starting to affect the decisions of banks and liquidity levels.

"Whenever there's a change in BNA's interest rates, you can see adjustments in Luibor," says Mr Massano in an interview in Angola's capital, Luanda. "To us, it is a sign of the increasing [importance] of our monetary instruments."

Their greater effectiveness is one of the reasons inflation, which had long-blighted Angola, has fallen to single digits, an achievement many believe to be BNA's finest in recent years. Inflation dropped significantly in the immediate post-war period, but was still as high as 15% in 2010. In mid-2012, it fell below 10% for the first time on record and has since carried on slowing. This February it measured 7.5%, well within Mr Massano's target of 7% to 9%.

A stable exchange rate has helped BNA. The kwanza, protected by the country's strict capital controls and current account surplus, has hardly moved against the dollar in the past four years, whereas many African currencies have been volatile. The kwanza's steadiness has anchored the central bank's monetary policy (Angola imports the bulk of its consumer goods and any depreciation would quickly result in higher prices) and enabled foreign exchange (FX) reserves to grow from $14bn in 2009 to $33bn at the end of 2013.

LESS VULNERABLE

Economists have praised the taming of inflation and the building of FX reserves as a major step forward. They believe these give Angola the buffers it lacked in 2008 and 2009 when a crash in crude prices sent its economy and currency plummeting. While the country is still vulnerable to a big slump in oil earnings, it is, they reckon, far better positioned to cope.

BNA, partly to spur lending to the non-oil sector, has loosened its policy in response to falling inflation. It cut its base rate by 100 basis points to 9.25% in 2013 and since last June has lowered reserve requirements for local currency deposits from 20% to 12.5%.

But recent events could force the central bank to change its stance. FX reserves shrunk in the first two months of 2014 by $1bn, reflecting a slight decrease in oil production. And last year the government posted its first budget deficit since 2009. The International Monetary Fund predicts it will be the first of many as spending commitments rise.

Nonetheless, Mr Massano is confident that inflation will stay low and says he wants it to get even closer to 7%, the bottom end of his target range, by 2017. He does not expect a hike in customs tariffs in March, designed to assist local manufacturers, to affect prices much. "Angola is still highly dependent on imported goods," he says. "With the new tariffs, the price of some products may go up. But we don't think it will be a problem beyond the initial adjustment."

He adds, however, that keeping inflationary pressure down in the long term will depend on the government rectifying Angola's structural problems, including its poor

infrastructure. "Although we have a primary role of keeping inflation low, in our case it's not a job the central bank can do on its own," he says. "We try to coordinate as much as we can with other entities, particularly with the fiscal authorities."

REGULATING OIL PAYMENTS

One of the biggest changes to the financial system in the past 18 months has been the implementation of an FX law for the oil and gas sector. Introduced by Mr Massano to increase the use of the kwanza in what remains a heavily dollarised economy, the law makes oil companies pay their suppliers through the domestic banking system, whereas before most transactions happened offshore.

The final part of the legislation came last October, when foreign suppliers started to be paid through Angolan banks (although, unlike local suppliers, they can still receive dollars). Some oil firms feared that the banks' payment and processing systems would be too backward to cope with their billions of dollars-worth of transactions. But so far the transition has been smooth, testifying to the efforts banks made to modernise their systems in the run up to the law.

Mr Massano says kwanza transactions are already more common, which he felt was necessary for BNA to strengthen its monetary policies and better control the currency. In August 2013, the proportion of loans denominated in kwanzas was 65%, up from just 45% in 2010. "The FX law has helped us to maintain the exchange rate, as well as macroeconomic stability," he says.

The FX law could also mark the first phase of Angola opening its capital account and making the kwanza convertible. It has led to the partial liberalisation of the FX market, with banks now able to source dollars from oil companies and not just BNA, as was previously the case.

CAPITAL MARKETS

Alongside this development, Angola's capital markets regulator CMC has been putting in place a legal structure for a secondary debt market. At present treasury bonds are bought and held by banks. But officials hope that within a year banks and other local investors, such as insurance firms, will be trading them. Bankers in Luanda are optimistic the changes will go further and make the government remove curbs on foreigners buying kwanza securities.

Mr Massano confirms BNA will adopt a more flexible regime, but says it will do so slowly and maintain some restrictions. Angola's financial officials have privately expressed concern at the volatility caused by rapid capital flows in emerging markets recently. And they argue that while the government has a fiscal deficit, it can fund it easily using local capital or by issuing Eurobonds.

"With the legal and operational framework being set up by the CMC, the central bank will have to introduce more flexibility to capital controls," says the governor. "But we will need to keep the safeguards... to protect the economy from external shocks."

BANKING REFORMS

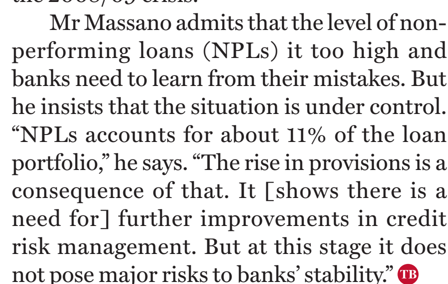
Mr Massano, previously head of the country's largest lender, Banco Angolano de Investimentos, has been no less vigorous with his reforms of the banking sector. Since 2011, BNA has introduced a raft of regulations concerning anti-money laundering, compliance, corporate governance and risk management. Analysts say these measures were vital to bring Angolan practices more in line with international ones, given that the country's financial institutions will have to open up to global markets as they grow.

"It has been very intense in the past two years with new prudential and corporate governance rules," says Mr Massano. "We want to bring the banking sector up to international standards quickly."

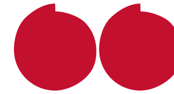
Bankers in Luanda say already there have been significant improvements and that, should Angola's stock exchange launch as planned in 2016, banks will be among the few companies that meet the requirements to list.

Further measures are due in the next two years, including an obligation for lenders to base their accounts on International Financial Reporting Standards. But BNA's priority is to consolidate what rules are in place and to make sure banks comply with them.

The growth of Angolan banks is slowing, which economists generally welcome, saying that their expansion in the past decade was unsustainable and posed dangers to the country's financial stability. Some hangovers from that period linger, however. Provisions have risen fast since 2011, in part because of troubles at construction and real estate companies, which banks lent to heavily before the 2008/09 crisis.



Mr Massano admits that the level of non-performing loans (NPLs) it too high and banks need to learn from their mistakes. But he insists that the situation is under control. "NPLs accounts for about 11% of the loan portfolio," he says. "The rise in provisions is a consequence of that. It [shows there is a need for] further improvements in credit risk management. But at this stage it does not pose major risks to banks' stability." TB



WE WANT TO BRING THE BANKING SECTOR UP TO INTERNATIONAL STANDARDS QUICKLY *José de Lima Massano*

WORK IN PROGRESS
Economy

Angola's government has been praised for its macroeconomic reforms of recent years, but more are needed to accelerate economic diversification, and public financial management still needs to be strengthened, finds Paul Wallace.

Angola suffers many of the problems that come with being a post-conflict and oil-rich country. Having only been at peace since 2002, when its destructive civil war ended, its infrastructure is still weak. With many of its adults having barely had an education, its businesses struggle to find skilled workers. And while oil has propelled the economy from being a basket case 12 years ago to the fifth largest in Africa today, it has left the country with huge inequality and done little to reduce joblessness.

Angola's fragility was revealed when oil prices crashed in the second half of 2008. The country's economic growth plummeted from more than 10% that year to just 2% in 2009. The current account swung from a surplus of 8.5% of gross domestic product (GDP) to a deficit of 10%, while the kwanza depreciated heavily. The government's arrears to contractors soared to more than $8bn.

MAKING PROGRESS

Rectifying these weaknesses has been a priority for policy-makers. Most analysts have praised their efforts, saying that macroeconomic reforms in the past five years have greatly strengthened the country's financial and economic position.

Crucially, inflation has been brought under control. Having been as high as 15% in 2010, it fell to single digits for the first time on record in mid-2012. This February, it measured 7.5%. Manuel Alves da Rocha, an economics professor at Luanda's Catholic University, says this has been one of the country's most important developments since 2002.

Angola's foreign exchange (FX) reserves have also been built up. They grew from $14bn in 2009 to an all-time high of $33bn at the end of 2012. And the government has tightened its spending controls to stop ministries going ahead with contracts when they lack the necessary funds.

Economists say that Angola is better prepared to cope with another short-term fall in oil prices because of the changes it has made. "The major problem in 2008 and 2009 was inadequate policy buffers because of an overextended budget, inadequate foreign reserves and limitations in the government's capacity to formulate and implement policies," says Nicholas Staines, head of the International Monetary Fund (IMF) in Angola. "Now, [the government has] much higher reserves, more fiscal space to manoeuvre and is more prepared because its policy-making coordination is better."

BEFORE THIS [FX] LAW, MOST BANKS DIDN'T HAVE OIL AND GAS DEPARTMENTS. THEY WERE GIVEN THE TIME TO CREATE THEM

Miguel Bartolomeu Miguel

DEEPER FX MARKET

Angolan officials took another step towards bolstering macroeconomic stability last year when they implemented the final phase of an FX law for the oil and gas sector. Designed to increase the use of the kwanza in what is a heavily dollarised economy, the law makes oil firms pay their suppliers through the local banking system, rather than offshore as they tended to do previously.

Despite concerns among oil companies that domestic banks would struggle to process their payments on time, the transition has been smooth so far, with few disruptions to the oil industry. "One thing the central bank did very well was to implement the law in phases," says Miguel Bartolomeu Miguel, head of Standard Chartered Angola, which got a banking licence last year. "That was the secret of its success. Before this law, most banks didn't have oil and gas departments. They were given the time to create them. The oil companies were also given time to plan for the changes, which they knew about well in advance."

The law is leading to more transactions in kwanzas and fewer in dollars, according to Celeste Fauconnier, an Africa analyst at South Africa's Rand Merchant Bank. "It's causing greater demand for the local currency," she says. "The interbank market is functioning more efficiently to meet this demand, which is helping monetary policy become more effective."

She adds that the law has deepened the local FX market by giving banks access to dollars – which they sell to their clients with import needs – from oil companies, whereas before they had to rely almost solely on the central bank.

The FX law comes alongside other measures to boost the country's financial markets. The capital markets regulator, the Comissão do Mercado de Capitais, hopes to launch a secondary debt market later this year, followed by an equities market in 2016. There is plenty of interest in a debt market. Standard Bank Angola held the country's first capital

markets conference in March to bring together potential issuers and investors. Eaglestone, a sub-Saharan Africa-focused investment bank, has already obtained a brokerage licence, while Imara, a Bostwana-listed investment group, has applied for one.

Bankers in Luanda are confident that a market for government bonds will develop and that companies will begin to issue corporate bonds. But they caution that it will take time for liquidity and issuance to pick up, especially given the absence of a big domestic investor base. Anthony Lopes Pinto, head of Imara's Angola office, says the country's insurers, who would normally be expected to invest heavily in a bond market, mostly sell short-term products, meaning they would not necessarily be able to buy long-term assets.

"They need to create more long-term products, such as life insurance," he says. "But that takes time and would entail a paradigm shift among consumers. Angola is a consumption-orientated market. There's very little saving."

A major factor determining the success of the market will be whether foreign investors are allowed access to it. Although they can buy kwanza-denominated securities today, it is a laborious process, owing to Angola's tight capital controls. Bankers hope that the launch of the secondary market will lead to the opening of the country's capital account.

They say this will be done gradually, however, to minimise the fallout from external shocks. "In a country with a non-convertible currency, the opening of the capital account should be controlled," says Jorge Ramos, head of investment banking at Banco Espírito Santo Angola. "But it's very important that some kind of outside investment is allowed given the sheer number of projects under way that need financing."

Yet for all Angola's macroeconomic and financial reforms, plenty more are still needed. The IMF has long urged the government to make plans to enable it to cut fuel subsidies, which cost the equivalent of almost 5% of GDP last year, a hefty figure. "The government is committed to reducing fuel subsidies," says Mr Staines. "The challenge is how to sequence it. You can only do it if you improve electricity provision. You also need some sort of social support system for those who would suffer the most."

Arrears remain a problem, due to poor administration rather than financial difficulties. They totalled $6.1bn between 2010 and 2012. While most have been paid off, the IMF criticised the government in March, saying it "regretted the continued weaknesses in public financial management".

The IMF was encouraged, however, by Angola's 2014 budget, which introduced a definition of arrears and a requirement for ministries to settle them within 90 days. The budget also stated that the minister of finance had to sign off all central government contracts of more than $1.5m and local government ones of more than $1m. "The government wants to solve the problem," says Mr Staines. "In the latest budget, it has taken more measures to improve the system."

TAX REFORMS

Other reforms are under way to diversify the tax base beyond oil, which accounts for 80% of state revenues. Policy-makers have reduced tax exemptions that non-oil companies such as banks used to enjoy before the 2009 crisis. But non-oil revenues only amount to 9% of GDP, which is low by African standards. "The fiscal reforms the government has carried out since 2010 have not achieved the expected results," says Mr Alves da Rocha. "Non-oil revenues have increased a little bit in recent years, but not by enough."

The government will also have to do more to improve Angola's business environment, which ranks as one of the toughest in the world. The country placed 179th out of 189 in the World Bank's latest Ease of Doing Business survey. Companies complain about their high costs thanks to electricity shortages and the existence of a rentier culture, which makes it difficult for them to operate without close ties to members of the political and military elite.

"The government has made enormous strides with its management of the macroeconomy. The past 12 years have been revolutionary," says Ricardo Soares de Oliveira, a lecturer at Oxford University. "But microeconomic reforms, even when they're championed by senior policy-makers, tend to run against vested interests."

For the government, these are increasingly important issues to deal with. The economy has slowed since its boom days. With oil production more or less stagnant, it seems unlikely to grow much faster than 5% or 6% in the next few years.

Worryingly for Angolan policy-makers, analysts say that should oil prices drop anytime soon, it will be difficult for them to fund the reforms and infrastructure improvements needed to diversify the economy. "Angola's future hangs on the price of oil," says Mr de Oliveira. "That's more important than anything else. High oil prices are needed to finance the diversification and industrialisation of the economy." TB

THE NEW LAW IS CAUSING GREATER DEMAND FOR THE LOCAL CURRENCY. THE INTERBANK MARKET IS FUNCTIONING MORE EFFICIENTLY TO MEET THIS DEMAND, WHICH IS HELPING MONETARY POLICY BECOME MORE EFFECTIVE

Celeste Fauconnier

Moving to the fore: Portuguese beverages giant Unicer is one of several foreign firms that, following the announcement of Angola's new import duties, said it would open a factory in the country

A CASE FOR BUSINESS
Business reform

Angola's government has launched several initiatives to boost the country's non-oil sectors. Some of these, including a hike in import tariffs, have proved controversial, while the business environment remains tough by global standards. But investors think the country still has plenty going for it, as Louise Redvers reports.

Economic diversification has long been at the top of Angola's agenda, but so far government plans have delivered little. While the country's non-oil economy is growing, it is not doing so quickly enough to create jobs on a large scale.

It was hoped that a controversial new customs regime introduced on March 1 would change the situation by kick-starting Angola's domestic manufacturing and agricultural output. The new system applies hefty import tariffs of up to 50% on various items and thus encourages them to be produced domestically.

DOMESTIC FOCUS

Analysts say it is a risky strategy that could lead to prices rising or monopolies benefiting from such protectionism. But if it works, it could also radically alter Angola's economic outlook and give it a chance of a future beyond oil. "Theses new tariffs are really punitive but they push companies that want to be in Angola to produce locally," says Anna Rosenberg of London-based consultancy Frontier Strategy Group.

Although admitting that inflationary pressures could rise, Ms Rosenberg says: "I understand why they have put these measures in place and, theoretically, it makes sense. The Angolan government knows that it only has a limited amount of oil left, another 20 or so years, so it has to diversify, for better or for worse. It doesn't have an option not to."

The new customs regime is backed by the country's leading business lobby, the Associação Industrial de Angola (AIA), which says its members need protection to be given a chance to grow.

AIA president Jose Severino says: "Before the war Angola was self-sufficient and an exporter of consumption goods, now we are importing nearby 75% of food and other products, many of which could easily be produced by local businesses here if they had the right stimulus."

If the policy works, Angola may soon start to compete regionally with its more developed neighbours and eventually enter into the Southern African Development Community (SADC) free-trade area, something it has fiercely resisted until now.

Roger Ballard-Tremeer, a former South African ambassador to Luanda and who now heads the Angola and South Africa Chamber of Commerce, disputes that the new tariffs will lead to sudden price rises. "The protectionist intentions of the new tariff regime have been in the Angolan public domain since late 2011, so no one should be expressing surprise at the new import duties," he says.

NEW FACTORIES

Several large firms, including Portuguese beverages giant Unicer (which makes the Cristal and Superbock brands of beer) and Portuguese juice firm Sumol+Compal, have already said they will open up factories in Angola in a bid to beat the tariffs. Others have announced expansion plans for existing operations.

But Mohamed Zin El Abidine, an analyst at Moroccan consultancy Infomineo who visited Angola last year to study its agricultural sector, believes that, particularly in the case of food production, the introduced measures are premature. "I believe [the government] should have waited until it had developed the local agricultural economy more and then slowly increased the tariffs," he says. "You need to have something to protect in the first place."

Neither is Carlos Rosado de Carvalho, a respected Angolan economist and editor of the local Expansão newspaper, convinced that the new tariffs will help the economy. "This is not new protectionism, this is just

more protectionism," he says. "If we couldn't protect local industry with 30% tariffs, what difference will another 20% make? Many local industries in Angola are virtual monopolies, so in fact that is all we are protecting."

He points out that tough operating conditions remain a burden on local businesses. "The big problem that we have is our infrastructure, and in particular the lack of electricity," he says. "Until we resolve our energy deficit I think it will be very difficult to diversify our economy."

Mr Rosado, who writes a popular weekly column on national economic policy, says the government is too stuck on securing big headline projects, and that it should do more to support smaller businesses. "We need to create jobs," he says. "Our government likes these big projects but what is important is not the value of an investment but what it actually delivers, especially in terms of jobs."

TARGETING SMES

One flagship government initiative that is supposed to support small and medium-sized enterprises is Angola Investe. Launched in 2012, it gave government guarantees to commercial bank loans for new business proposals. But 18 months on, only a small amount of credit has been given out.

The government blames the banks, who in turn criticise weak business plans, uncreditworthy clients and a squeeze on credit due to a hike in non-performing loans, something partly attributed to the government's own failure to pay its contractors on time.

Unimpressed by Angola Investe and its custodian, Mr Rosado believes Angola should open up to small overseas companies to allow them to bring their capital and, crucially, their experience to develop a manufacturing and processing sector that Angolan firms can learn from. This goes against the widely held view that Angolans should retain as much control over their economy as possible and that foreign firms should only operate as part of local partnerships.

Although many small overseas companies are interested in Angola, since 2011 their prospects of entering the country have waned because of the adoption of an investment law that requires an initial minimum investment of $1m for them to be eligible for tax breaks and other incentives. This was an increase from $50,000 for local investors and $100,000 for overseas businesses. The move has been highly contentious, even prompting some members of the ruling Movimento Popular de Libertação de Angola to speak up, a rarity in a country where few challenge the status quo.

GREEN SHOOTS IN AGRICULTURE

Angola was once a major exporter of coffee and grain, but now imports nearly all its food. Thanks to a poor road network and weak supply chains, it is in many cases cheaper to do that than grow produce locally. Insecure land rights, a lack of irrigation systems and more recently drought have also held back agricultural development, but there are green shoots emerging.

In Malange, in the north-east of Luanda, the 411,000-hectare Sociedade de Desenvolvimento do Pólo Agroindustrial de Capanda (Sodepac) project is trying to kick-start large-scale farming with concessions for crops, livestock and agri-processing.

Strategically located next to the Capanda Dam, and so in theory guaranteed regular electricity and water supplies, Sodepac already has several farms in operation. One is run by Chinese state-owned construction company Citic and another is managed by Brazil's Odebrecht, which aims to start producing sugar and ethanol later this year.

At the other end of the scale, a government initiative launched in November 2013 aims to tackle local supply chain issues and get more produce from small and subsistence farmers to market. Sites are being set up in all 18 provinces where small-scale farmers can sell their goods, which are then transported in bulk to sales points.

The Programa de Aquisição de Produtos Agro-pecuários, a public-private partnership, also plans to open processing factories to can, freeze and process food so as to extend its shelf life and add value.

The near-compete rehabilitation of the country's century-old rail network should be a boost for small-scale farmers, with lines now running through agricultural heartlands such as Huambo and Malange to coastal cities such as the capital Luanda and Lobito.

There are some positive signs in the mining industry too. Angola is already a major diamond exporter, but it has proven reserves of gold, iron ore, copper and potassium that are largely untapped.

Through a new mining code introduced in 2011, the government is working hard to woo companies to both prospect and develop sites.

Caffeine hit: Angola's coffee exports have declined in recent years

The law's defenders say that it has helped speed up decision making at the government's private investment agency, Agência Nacional Para o Investimento Privado, which was becoming overwhelmed by the volume of applications. According to Mr Ballard-Tremeer, the change allows investors to negotiate specific investment incentives rather than accept one-size-fits-all terms.

IMBALANCED RESULTS

But critics believe the case-by-case system has been highly subjective and has led to inequalities and imbalances because fewer firms have received incentives to set up outside Luanda in less developed parts of the country.

After noisy lobbying from members of the AIA, the law is now up for review and a public consultation took place earlier this year to see how it might be revised, though no date has been given about possible amendments.

The frequency with which legislation changes in Angola is one of the headaches investors face when they try to penetrate what is already a complicated business environment. The country – notorious for its traffic jams, heavy bureaucracy and high business costs – came 179th out of 189 countries in the World Bank's 2014 Doing Business ranking, down one place from 2013.

Ms Rosenberg says the changes and amendments to laws are frustrating for her clients, but adds: "Angola as a country is still in the early stages of development. Everything has to be put in place – new laws, new systems, and often new laws to change ones that they thought were good but had secondary effects they had not bargained for. But this also shows they are learning from mistakes, and that is a good thing."

And while she agrees that corruption was a problem in Angola, there are steps businesses can take to protect themselves, such as properly following legal processes and not "slipping up and needing to expedite something".

"You need to plan," she says. "For instance, don't think goods are going to clear the port in two days, be prepared for it to take months, or you may be tempted to pay a bribe to get them out quicker to meet other deadlines."

Mr Zin El Abidine says that despite Angola's problems, its large and still rapidly growing economy – its gross domestic product, the third biggest in sub-Saharan Africa, is set to expand 5% to 7% this year – means it cannot be ignored by international investors. "Angola is not a country that you can miss," he says. "It's one of the places in Africa that you need to be. Firms are interested now in new frontiers and going into countries such as Angola." TB

TENTATIVE SWF STEPS

Angola's $5bn sovereign wealth fund, the Fundo Soberano de Angola (FSDEA), gained plenty of positive headlines when it launched in October 2012, but it has since come under fire for its slow start and governance structure.

Much of the unease is caused by the decision to give the chairmanship of the fund to José Filomeno dos Santos, the eldest son of Angola's long-serving president José Eduardo dos Santos. He took the job after the first chairman, Armando Manuel, became the country's finance minister in May last year. Mr dos Santos Jr insists he is qualified to run the FSDEA, which stresses its commitment to transparency and auditing.

But not everyone is convinced that the fund will be able to take decisions transparently and independently. Its advisory board is made up of the ministers of finance, economy and planning, all of whom are handpicked by the president.

The FSDEA grew out of an earlier 'Oil for Infrastructure Fund', which pledged to collect revenues equivalent to 100,000 barrels of oil per day and then spend them on development projects. The FSDEA is expected to follow this method of top-up and it is estimated that its base amount could grow by $3.5bn a year. If so, this would soon make it the continent's largest sovereign fund, overtaking Botswana's diamond-fed $6.8bn Pula Fund.

However, some analysts think that smaller sums will be allocated to the FSDEA now that the government has entered what is likely to be a long period of budget deficits, mainly because of stagnant oil production.

The FSDEA says it will allocate 50% of its assets to fixed-income instruments, such as sovereign bonds, and equities in G7 countries. Most of the other half will go on higher yielding bonds from emerging markets, as well as direct investments in commodities, agriculture, mining, infrastructure and property.

Some 7.5% of assets will be placed towards 'social development' and 'socially responsible projects' involving education, income generation, water and healthcare initiatives.

The FSDEA had said it would produce a full audited annual report by the end of the first quarter of this year, but has yet to do so. Speaking at a business summit in April, Mr dos Santos said the fund had so far invested in some "high-grade fixed-income securities" and would "start investing in agriculture, mining, infrastructure and hospitality projects soon".

On governance, he said the FSDEA submitted detailed quarterly reports to the ministry of finance. The International Monetary Fund, which has called for more clarity on the FSDEA's investment policy, suggested that it should submit these quarterly reports to parliament in order to "preserve transparency".

Staying afloat: the Fundo Soberano de Angola was set up to manage the country's oil revenues