Standard Bank

ResearchEconomics

Mid-year Gauge

Angola ● June 2008

Improved transport network benefits agriculture

In line with the reality in the rest of Africa, the majority of the poor in Angola lives in rural areas. In Africa, roughly 80% of the poor are in rural areas. As agricultural producers, 70% of all Africans (and nearly 90% of their poor) work primarily in agriculture. As consumers, all of Africa's rural and urban poor count heavily on the efficiency of the farmers, since farm productivity and production costs are fundamental determinants of the prices of basic foodstuffs which account for 60-70% of total consumption expenditure by low-income groups.

Between 60% and 70% of Angolans earn their living from agriculture, which currently accounts for less than 10% of GDP. The country was once the world's third largest exporter of coffee. Maize was a major export commodity, amounting to more than 400 000 MT a year, almost all of which was produced by smallholders. Cotton, sugar cane, sisal, bananas and wood also used to be important exportable cash crops. Angola has a good climate which is conducive to agriculture. However, after independence, the state confiscated abandoned settler farms and set up inefficient state farms. This and the civil war led to the collapse of commercial agriculture and the successful performance of the country as an exporter of agricultural products. During the war, infrastructure suffered greatly with widespread destruction of roads, bridges and warehouses together with the presence of thousands of land mines in rural areas. As a result, Angola, once self-sufficient in food, except for wheat, has been heavily dependent on food aid and commercial imports since the early 1980s.

With the end of the civil war, the agricultural sector is gradually recovering. Considering the relative weight of transport costs on the final value of farm products and food, the reopening of roads alone provided a major benefit to the agricultural sector. Owing to its importance in employment creation and poverty reduction, the government prioritised the agricultural sector for public investment, particularly irrigation. The investment in irrigation and infrastructure, particularly the transportation network, timely availability of inputs, the resettlement of internally displaced people and improved security in rural areas resulted in a growth rate of more than 9% in 2006/07. This recovery was aided by improved weather and an increase in cultivated area due to the continued removal of land mines from the countryside.

The outlook for the 2007/08 season is for growth of 12.5% and more than 15% in the season thereafter. An agreement was signed between Angola and the International Fund for Agricultural Development to provide a credit line of US$45 million to 200 000 farmers to strengthen agricultural production and investment. Staple crops range from cassava in the humid north and northeast to maize in the central highlands and sorghum in the dryer southern provinces. Potatoes are an important crop in the central plateau and rice is also grown over large areas in the north. Cattle is raised over broad areas in the central plateau but are particularly important in the southern provinces of Cunene, Huila, and Namibe where there are an estimated three million heads of cattle.

Coffee, the most important cash crop during colonial times, grows well in the highlands from Uige and Malange through Kuanza Norte and as far south as Huambo and Bie. Already, the government has initiated steps to revive the coffee sector and bring production back to the levels recorded before the war. It also wants to increase cereals production between 2008 and 2013, on about 4 million hectares of land, to over 15 million tonnes. Between 2008 and 2013 roots and small tuber production are predicted to grow by 11% and vegetable production by 40%.

Despite the country's significant natural wealth, existing social indicators still reflect low living standards. A recovery in the agriculture sector will support the government's efforts to reduce widespread poverty, improve food security, diversify the economy and promote sustainable economic growth.

Anita Last ☎(+27 11) 631 5990 ✉ Anita.Last@standardbank.co.za

Economic development

Angola continues to outperform regional peers as high oil prices and increased production continue to drive high GDP growth rates. According to the Ministry of Finance, GDP growth in 2007 recorded 24.4%, above the IMF's predictions of 23.8% and the government's own forecasts of 19.8%. Angola's economic growth surpassed the rest of the continent, which recorded an average growth rate of 7.6%.

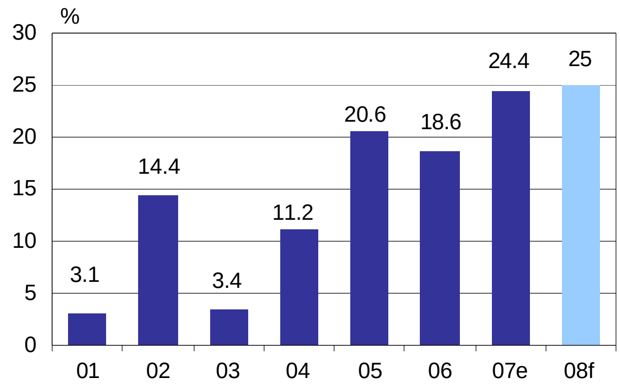
The oil sector grew at 21.8% up from 13.1% in 2006. Oil production increased as new deepwater oilfields came on stream. By the end of 2007, oil production had risen from around 500 000 barrels per day (b/d) in 1993 to 1.7 million b/d. In addition to the rise in oil output, the government also reaped the benefits of high oil prices, which averaged US$72 per barrel in 2007.

The non-oil sector grew at 25.7%. Diamond production rose on the back of increased production from kimberlite mines. Production increased by 16.2% in 2005 and by 42% in 2006 as output at the Catoca mine doubled. The kimberlite mine at Catoca in Lunda Sul province produces 71% of Angola's output by volume, although diamonds from informal mines are of a much higher value per carat, making Catoca's share by value significantly smaller. According to the national diamond company, Endiama, output reached 3.35 million carats in the first five months of 2008, worth US$525 million. Endiama projects output for this year at 10 million carats and 10.5 million carats in 2009.

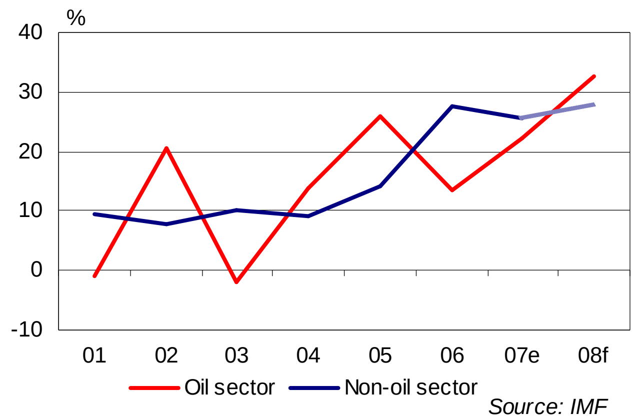
Growth in the construction sector, amid post-war reconstruction efforts, continues to be robust. Ongoing construction to rehabilitate infrastructure has seen the sector expand by 17% in 2005 and more than 60% in 2006. Progress has been made in rehabilitating transport infrastructure, particularly roads, railways, ports and bridges. Chinese contractors completed major projects such as the Keve Bridge and the Luanda-Namibe railway. In Luanda, a number of Portuguese construction firms completed or announced projects involving residential, hotel and office buildings. The hosting of the Africa Cup of Nations football championships in 2010 is expected to sustain growth over the next few years. Although its share in GDP remains small (around 4%), the manufacturing sector grew rapidly at 44.7%, attributed to the demand for intermediate goods used in construction and infrastructure rehabilitation. Government investment in infrastructure - in particular irrigation and the transportation network - timely availability of inputs, the resettlement of internally displaced people, an increase in the cultivated area as well as good weather, supported a recovery in the agricultural sector. Agricultural production rebounded in the 2006/07 season, growing by 9.3%. Output should continue to grow as the government attempts to revitalise the once-dominant sector and continues to further increase land that can be cultivated. The outlook for the 2007/08 season is for growth of 12.5%.

Despite the government's efforts to encourage regional development, boost the country's infrastructure and diversify the economy, the oil sector remains the pillar of the economy. With more oil production scheduled to come on stream from existing discoveries and the price of crude oil predicted to remain high, prospects are promising for continued economic growth.

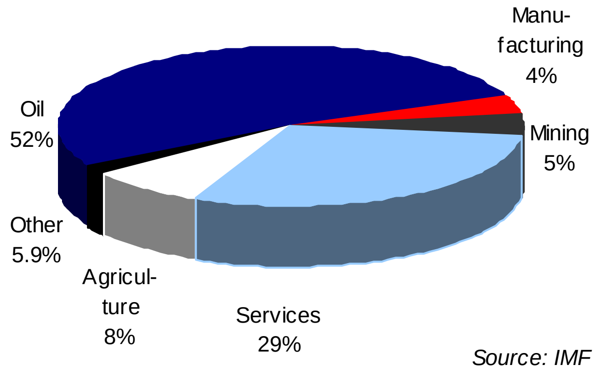
GDP GROWTH



Source: IMF



Source: IMF



Source: IMF

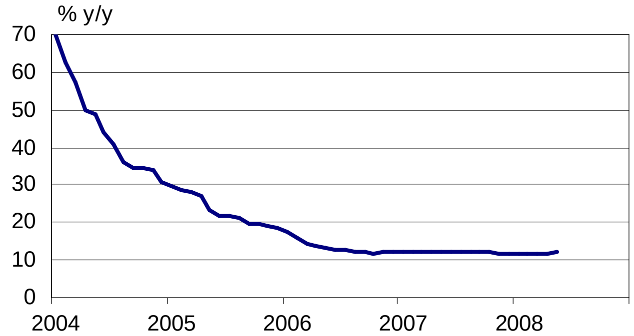
Monetary policy

Following years of hyperinflation, inflation appears to have stabilised at around 12%. Average inflation in 2007 was 12.2%; the lowest ever recorded annual average. In the first five months of 2008, inflation remained at these low double digits, recording 12.05% y/y in May.

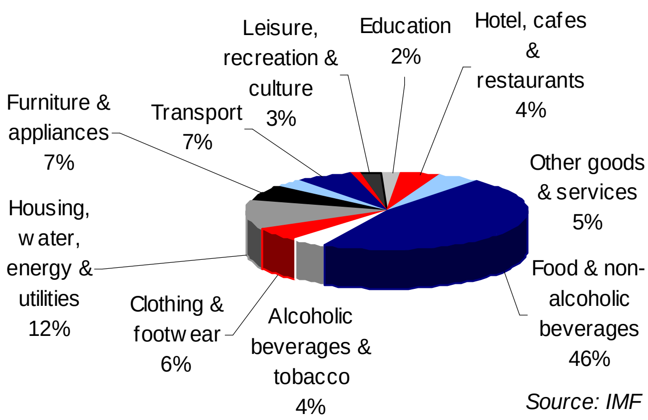
A major factor behind the decline has been the use of foreign exchange earnings, particularly from oil, to support the kwanza through intervention in the foreign exchange market. This policy has kept the price of imports (which represent 90% of domestically consumed goods) low. In addition to this, agricultural production - and consequently food supply - benefited from continued resettlement of displaced farmers, favourable climatic conditions and easier access to markets through improved roads. Increased production helped to alleviate food scarcities, keeping food inflation (46% of the consumer basket) low. (Although agriculture is recovering, supported by government investment in infrastructure, it still has to deal with various obstacles like difficult access to credit and uncertainties over land rights).

Election-related public spending and expanding private consumption expenditures are likely to slow the declining trend. The rising costs of imported building materials and food from the EU are also likely to put pressure on inflation, as the value of the kwanza has weakened relative to the euro, translating into higher import prices. Furthermore, infrastructure bottlenecks, particularly congestion at the Luanda port, are causing constraints in the supply of many goods, pushing retail prices up. We expect inflation to remain above its target of 10%.

INFLATION



Source: BNA

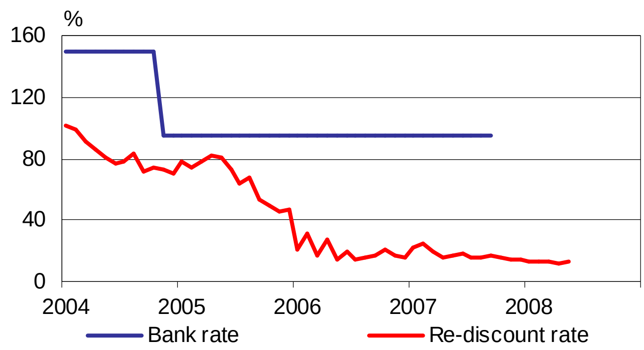


Source: IMF

The declining trend in average inflation presented an opportunity for the BNA (Banco Nacional de Angola - the central bank) to lower its official lending rate from 100% in 2004 to 14% at the beginning of 2007. In May 2007 the BNA revised the assets considered eligible as required reserves, and increased the banks' reserve ratio from 7.5% to 15%, prompting an increase in commercial bank lending rates to 19.6%.

We expect the central bank to keep policy interest rates above inflation in order to maintain the benefits of the monetary stabilisation achieved and keep inflation under control.

INTEREST RATES



Source: Banco Nacional de Angola

Angola is the most dollarised economy in Africa and also among the highest dollarised economies in the world. However, kwanza stability has led to its increasing adoption in the economy: the share of foreign currency deposits has decreased from 85% of total deposits in 2002 to 66% in 2005. This development is expected to increase the effectiveness of interest rate intervention as a policy instrument.

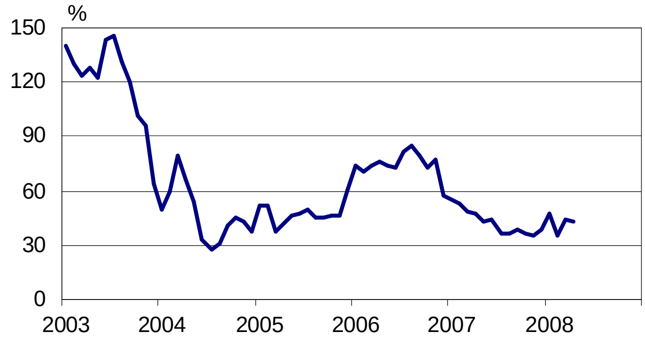
The largely dollarised banking system has limited exposure to the private sector, engaging primarily in foreign exchange operations. Noting high levels of excess liquidity in the banking sector, the IMF, following official discussions with the Angolan authorities that ended in June 2007, suggested that macroeconomic and structural factors, and banks' attitudes towards risk, are more likely to explain the low levels of credit extended to the private sector.

Credit to the economy totalled AON58 billion in December 2003, K104.8 billion in December 2004, and is estimated by the IMF at K173.1 billion in December 2005. Credit is expected to grow at a faster rate as more Angolans obtain access to credit and commercial banks fund more and bigger projects in real estate, construction and agro-processing.

The oil revenue surge has hindered the authorities' efforts to mop-up liquidity. Despite intensified sterilisation efforts in 2006, broad money growth accelerated through the first eight months of 2006. By July 2006, broad money growth exceeded 80% y/y. The last quarter of the year saw money supply growth retreat slightly as overall economic growth slowed.

By the end of 2007, the growth rate of M2 was around 30% y/y. This has been partly achieved by increasing sales of government debt, notably Treasury bills, and containing base money growth.

MONEY SUPPLY GROWTH (M2)



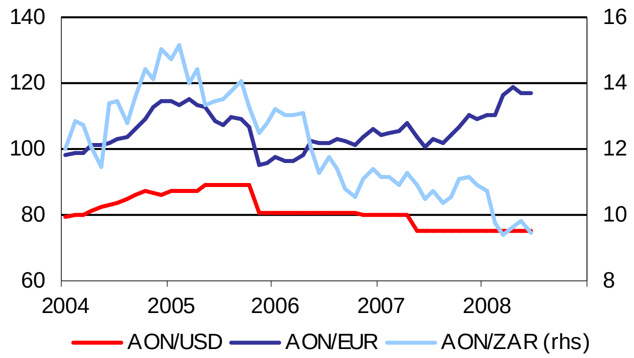
Source: IMF

The ongoing intervention has largely stabilised the nominal exchange rate. In 2005 the currency traded within a range of AON86/USD and AON89/USD, and in 2006 the exchange rate remained constant at AON80/USD. The authorities noted that while they do indeed manage the exchange rate, they do not hold it to a predetermined path, and would allow the rate to adjust if conditions warranted it.

In May 2007, the BNA raised its rediscount rate from 14% to 18% and revised the assets eligible for required reserves, within an unchanged total required reserve target. These measures have increased commercial banks' interest rates, which facilitated a revaluation of the kwanza. The currency appreciated and the exchange rate fell to AON75/USD.

With strong oil export earnings expected to continue and foreign-exchange reserves estimated to remain strong in 2008, the BNA will continue its support for the kwanza, especially in a pre-election context. Although the governor of the BNA, Amadeu Mauricio, has recently reaffirmed the current regime's decision to ensure exchange-rate stability through intervention in the country's foreign-exchange markets, this policy can only be maintained while oil revenues remain buoyant.

EXCHANGE RATE

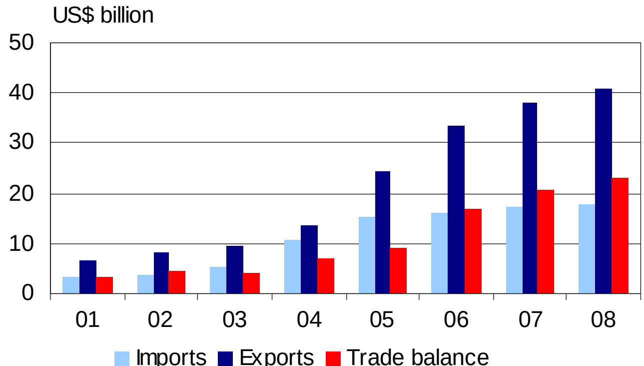


Source: Bloomberg

Balance of payments

Angola has consistently run a large trade surplus owing to its oil exports, with the magnitude dependant on prevailing international oil prices and the level of production. In recent years, the strengthening of the trade balance has been remarkable given that imports have also grown rapidly.

The bulk of imports consist of consumer goods, which make up around 68%, followed by capital goods (22%) and intermediate goods (10%). The most significant requirements are machinery parts, construction materials and petroleum products – given its limited petroleum refining capacity.



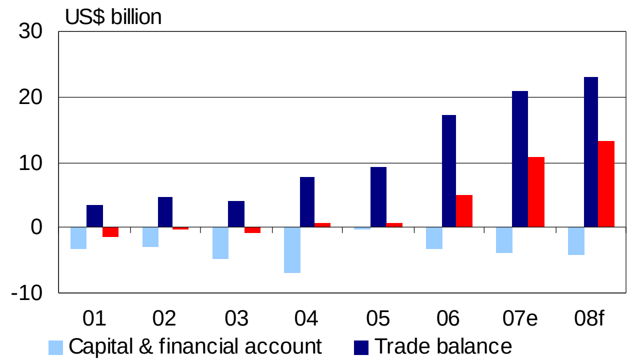
Source: BNA

Portugal remains Angola's largest commercial partner representing 15% of total imports, followed by Brazil (around 9%), China (around 9%), and the US (around 9%). At 8% of Angolan imports, South Africa is Angola's largest commercial partner in Africa. The main export is oil (90% of total merchandise exports) followed by diamonds.

Driven by oil and diamonds, total merchandise exports are estimated to have exceeded US$44 billion in 2007, up from US$30 billion in 2006 and US$24.3 billion in 2005. Exports are expected to expand by more than 40% in 2008 on the back of the rise in diamond and crude oil exports.

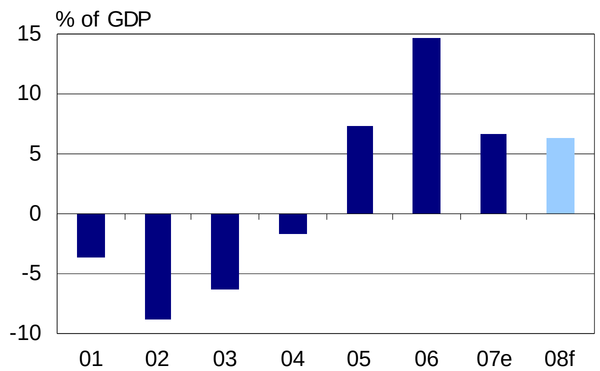
Imports increased to an estimated US$11 billion from US$8.8 billion in 2006 and US$8.4 billion in 2005, led by imports of machinery, electrical equipment, vehicles and consumer durables. Import growth in 2008 is estimated at close to 24% on the back of increased capital investment by both the public and private sectors and surging consumer demand for household goods.

Overall, the trade balance is estimated at above 50% of GDP, for the third consecutive year. The current account surplus has grown to around 25% of GDP in 2007 from 3.4% of GDP in 2004. This trend is expected to continue, with export growth driven by high diamond and oil production and prices, and import growth driven by the importation of increasingly sophisticated equipment as crude oil exploration and exploitation move to ultra-deep fields.



Source: BNA

BUDGET DEFICIT/SURPLUS



Source: IMF

Government finance

Fiscal revenue relies heavily on the oil sector (77.2% of total revenue) and as a result changes in the overall balance of the budget have mirrored movements in the oil price.

In 2005 the fiscal deficit moved to a surplus for the first time in more than a decade, reaching around 7% of GDP, compared with a deficit of 4% in 2004, owing primarily to high oil revenue. In 2006 the fiscal surplus doubled to 14.7%. While security and defence spending constituted the biggest components of the USD20 billion budget, health, education and other social spending also saw significant increases. Government managed to execute just over 50% of the 2006 investment programme, against the 40% executed in 2005 - mainly as a result of limited administrative capacity and lack of skilled labour.

In 2007 social spending received the biggest boost - 30.6% - as the government heeded calls for enhanced social programming and more rapid rural development. Emphasis on infrastructure rebuilding continued, and defence spending and national security also comprised a sizeable share of budgeted expenditures. External debt as a percentage of GDP was dramatically reduced from 73% in 2003 to only 16% of GDP in 2007.

The 2008 budget topped the 2007 budget by 30% at 2.5 trillion kwanza. Social sector spending constitutes 31.7% followed by the economic sector, which will receive 24.6%. Defence, security and public order comprise 14.6%. With high oil prices and production estimated at more than two million b/d, the fiscal surplus will continue.

Summary forecasts

	2003	2004	2005	2006	2007e	2008f
Balance of payments (US$ billion)						
Exports	9.5	13.5	24.11	31.86	38.99	55.92
Imports	-5.48	-5.83	-8.35	-9.59	-15.80	-19.80
Trade balance	4.03	7.64	15.76	22.28	23.95	36.11
Services	-3.1	-4.48	-6.6	-8.5	-11.1	-11.3
Income	-1.7	-2.5	-4.0	-5.5	-11	-17.4
Current transfers	0.1	0	0	-0.2	-0.2	-0.2
Current account	-0.719	0.686	5.138	10.538	3.784	7.339
Capital and Financial account	-0.8	-0.03	-3.7	-3.6	-0.1	-1.5
Errors and omissions	-0.4	0.277-	-3.8-	-	-	-
Overall balance	0.101	0.658	1.445	6.975	3.676	5.836
Net international reserves (-ve: increase)	-0.26	-0.78	-1.82	-5.4	-1.92	-5.84
Debt rescheduling and debt forgiveness	0.297	1.253	0.255	0.04	0	0
Arrears, net (+ increase)	-0.135	-1.13	0.117	-1.608	-1.752	0
Exceptional financing	0.162	0.122	0.372	-1.573	-1.752	0
Government finances (Kwanza billion)						
Tax revenue	382	596.6	1050	1577	1488	1976
Non-tax revenue	4.9	5.6	29.2	107	55.9	72.1
Grants	8.0	7.5	6.4	0	4.6	4.1
Total revenue	394.9	609.7	1085	1684	1549	2052
Current expenditures	378	505	720	823	1099	1263
of which: interest	19	38	49	54	56	61
Capital expenditures	79	81	135	323	408	560
of which: financed by external sources	8.0	7.5	0	185.8	232	215
Other	9	9	20	0	0	0
Total expenditures	462	636	890	1148	1508	1824
Adjustment to cash	59	61	173	240	94	229
Overall balance (accrual basis)	-67	-26	196	538	41	229
Oil bonus (net)	0	17	0	80	0	0
External financing (net)	36	89	-91	-33	-8.8	215
Borrowing (net)	17	-18	-107	-33	-8.8	215
Amortization of parastatal debt	-101	-208	-148	-295	-241	-0.1
Disbursement	118	190	40	262	231	215
Debt relief	20	108	16	0	0	0
Domestic financing (net)	22	-46	-81	-287	103	-433
Total financing	59	61	-172	-239	94	-228
Supplemental indicators						
Real GDP growth (%)	3.3	11.2	20.6	18.6	23.4	22.2
GDP per capita (US$)	959	1383	2118	3092	3979	5587
Nominal GDP (US$ bn)		19.8	30.6	45.2	58.7	83.2
Annual average inflation (%)	100	45.3	23.2	13.4	12	10
Policy interest rate (average)	120	95	95	14	18	13.8
Exchange rate (annual average)	73.3	83.7	87	80.4	75	68
Gross official reserves (US$ bn)	0.8	2.0	4.1	8.8	10.5	16.4
Months of import cover	1.9	3.1	5.6	7.1	6.3	8.6
Current account to GDP (%)	-5.2	3.5	16.8	23.3	6.4	8.7
Total revenue to GDP (%)	38	37	41	46	35	35
Government expenditure to GDP (%)	44	39	33	32	34	34

Source: IMF Country Report no. 07/354 October 2007

Picture Gallery

FIGURE 1: DIAMOND PRODUCTION

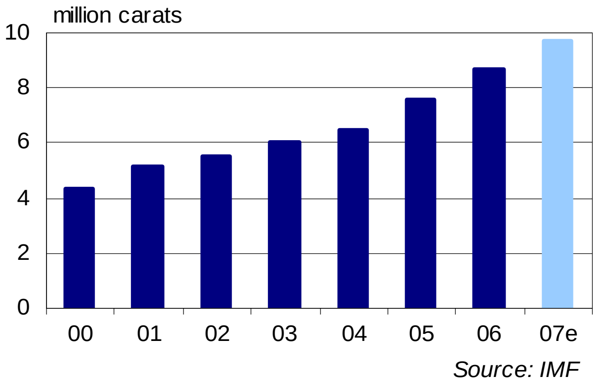


FIGURE 2: OIL PRODUCTION

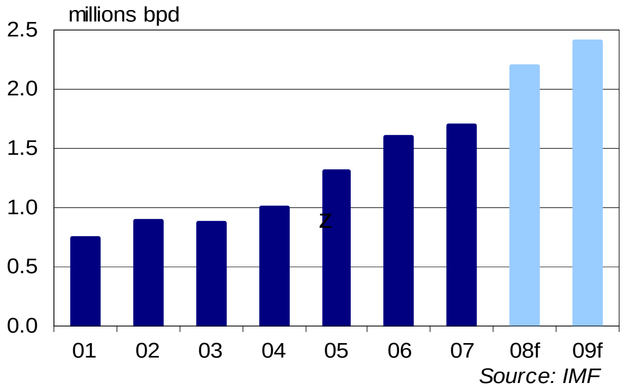


FIGURE 3: EXTERNAL DEBT

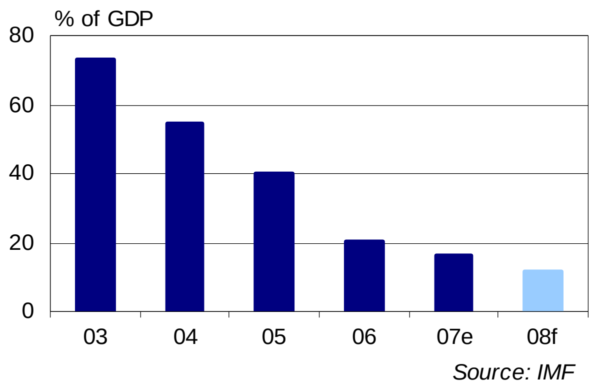


FIGURE 4: GOVERNMENT FINANCE - TAX REVENUE

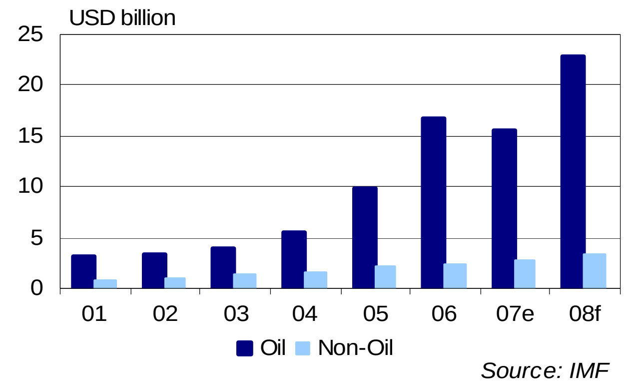


FIGURE 5: EXPORTS.

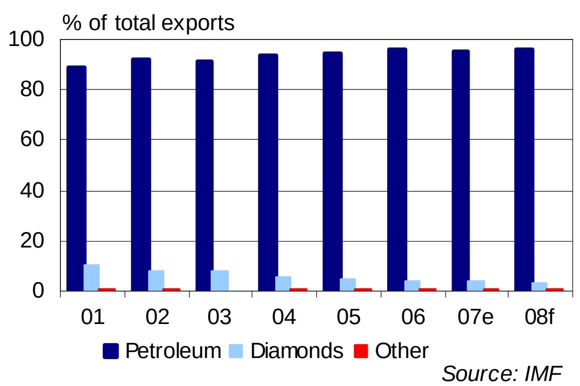
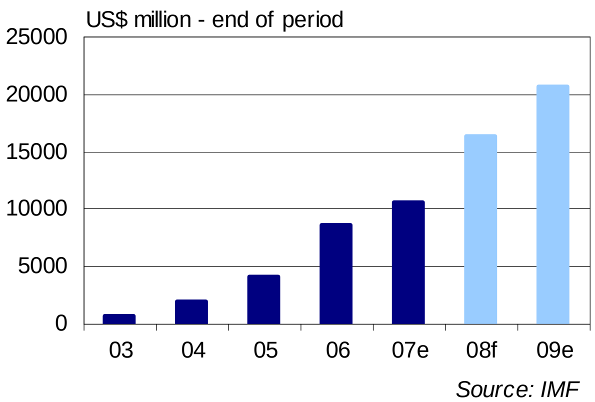


FIGURE 6: FOREIGN RESERVES.



Group Economics

Goolam Ballim – Group Economist
+27-11-636-2910 goolam.ballim@standardbank.co.za

South Africa

Johan Botha
+27-11-636-2463
Johan.botha@standardbank.co.za

Shireen Darmalingam
+27-11-636-2905
Shireen.darmalingam@standardbank.co.za

Sizwe Nxedlana
+27-11-631-2018
Sizwe.Nxedlana@standardbank.co.za

Jeremy Stevens
+27-11-631-7855
Jeremy.Stevens@standardbank.co.za

Danelee van Dyk
+27-11-636-6242
Danelee.vanDyk@standardbank.co.za

Rest of Africa

Jan Duvenage
+27-11-636-4557
Jan.duvenage@standardbank.co.za
Botswana
Lesotho
Namibia
Swaziland

Anita Last
+27-11-631-5990
Anita.last@standardbank.co.za
Angola
Ghana
Malawi
Mauritius

Yvonne Mhango
+27-11-631-2190
Yvonne.Mhango@standardbank.co.za
Kenya
Mozambique
Uganda
Zambia

Victor Munyama
+27 11-631-1279
Victor.Munyama@standardbank.co.za
DRC
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