



World Economic Outlook and Implications for Angola

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The IMF and World Bank held their annual meetings in Tokyo in late October. At the meetings, the IMF released its reports surveying the world economy as well as its regional economic outlook for Sub-Saharan Africa.

World Economic Outlook

Overview

The central theme of the world economic outlook is that the weak global recovery is continuing, but has softened and appears to be weighed down by large uncertainties and elevated risks.

The recovery has indeed softened. Global manufacturing has slowed down sharply. Economic activity has declined in the Euro periphery area and is disappointing in the U.S. and the U.K. And importantly, spillovers are starting to adversely affect emerging market and developing economies through weaker trade and financial channels.

The main forces holding down growth in the advanced economies are fiscal consolidation and weak financial systems. Fiscal consolidation in the advanced economies is generally proceeding as planned but is pressing down on demand more heavily than expected and is likely to last several years. The financial system is not functioning well and banks remain weak so that borrowing conditions remain tight. And emerging market economies, such as China, have had to rein back on their expansionary policies because of overheating. On the positive side, monetary policy has been supportive: interest rates are low, both the US Fed and the ECB are injecting liquidity, and countries are exploring ways to stimulate financial intermediation.

But the recovery seems to be particularly weighed down by two large uncertainties. The first is about whether Europe can contain its financial crisis. The second is whether the U.S. can avoid the fiscal cliff, while adopting a credible medium-term framework to restore fiscal sustainability. The outlook assumes that policy makers make good progress on these challenges.

Looking ahead, no significant improvement seems likely and only a modest acceleration is expected in 2013. This would be helped by less policy uncertainty, continued monetary accommodation, and easier financial conditions. In the advanced economies, healthier balance sheets will encourage private spending. In emerging market and developing economies, monetary and fiscal policy easing will strengthen output growth. But the policy challenges and uncertainties noted above are likely to weigh down growth through the medium term. Fiscal consolidation, in particular, can be prolonged.

As a result, the growth projections for the global economy have been reduced in the short and medium term. Real GDP growth is expected to be 3.3 percent in 2012 and 3.6 percent in 2013 and growth is expected to remain modest through the medium term. Growth in the advanced

economies is now expected to be around 1.5 percent: prospects for the US are broadly unchanged but the economies of the European periphery—including the UK, Spain, Italy, as well as Portugal and Greece—will see their economies contract. The outlook for emerging and developing economies remains robust but has been reduced—including for China, India and Brazil—to around 5.5 percent. For Sub-Saharan Africa in particular the outlook remains positive, with growth projected above 5 percent.

Regional

The regional outlook is dominated by the continued weakness in the advanced economies. But growth in the emerging economies has also slowed down.

The crisis in the Euro area had intensified in recent months because of doubts about the periphery's ability to deliver the fiscal and structural adjustments needed, the readiness of countries to coordinate policies, and the ECB's readiness to respond forcefully if needed. As a result, liquidity moved from the periphery to the core, pushing up spreads in Italy and Spain. In response, Spain adopted a program to address its banking problems, work was launched on a banking union and a single supervisory mechanism, the ECB announced its program for Outright Monetary Transactions, and the European Stability Mechanism was launched.

The U.S. economy has been more sluggish than expected, prompting another stimulus round from the U.S. Feds. On the positive side, the housing market is picking up and private sector credit has continued to expand. But the U.S. faces a large fiscal contraction of about 4 percent of GDP in 2013 when large tax cuts expire and because of automatic spending cuts that will push the economy into a deep recession, unless moderated.

Growth in emerging economies has dropped because of deliberate policy tightening in response to concerns about capacity overheating and inflation, about the quality of bank loan portfolios, and also because of weaker export demand. China's economy slowed sharply, owing to tighter credit conditions (because of worries of a real estate bubble), a return to a more sustainable pace of public investment, and weaker external demand. But China's economy is now expected to receive a boost from higher public infrastructure investment. Growth also decelerated in Brazil because of policy tightening to contain inflation pressures and steps to moderate credit growth, as well as some external drag. The projected acceleration is strong for Brazil because of targeted fiscal measures aimed at boosting demand in the near term and large monetary policy easing.

Prices

Commodity prices are heavily influenced by demand conditions and strong growth in China was an important factor behind the price gains until 2012. But the slowdown in the global recovery, including China, then underpinned weaker commodity prices in early 2012. In particular, oil prices also softened in 2012 and the IMF basket price is projected to rise from \$104 in 2011 to \$106 in 2012, then dipping to \$105 in 2013. In the medium-term, prices are expected to drop back below \$90.

Consumer prices are also affected by global conditions. Global inflation picked along with the global recovery and the food and fuel price gains. But the weaker global recovery and commodity prices in 2012 will reduce inflation in 2012 and 2013. Food prices have moderated from the surge in 2011, but have been affected in 2012 by supply shocks in the U.S., Russia and Latin America. Prices for wheat, soya and maize (but not rice) have risen strongly, but the current food price shock is less severe than the shock in 2007/08 because it has not affected all key crops uniformly and has not been aggravated by trade restrictions and high energy input costs.

Resilience in Emerging Market and Developing Economies

A major theme is the resilience of emerging market and developing economies and whether this is likely to continue. To put this in perspective, for the first time, these economies as a group have spent more time in expansion and have had smaller downturns than the advanced economies. And importantly this has also been the case for most of Sub-Saharan Africa. This has led to suggestions that these economies have decoupled from advanced counterparts.

To some extent, this has been due to fewer domestic and external shocks. During the recent crisis, countries with trade and financial links to the global economy were exposed. But low-income countries in Sub-Saharan Africa and elsewhere benefitted from limited economic linkages to the global economy, while those dependent on commodity exports were helped by China's strong growth. But the resilience is mainly explained by the sustained improvement in macroeconomic policies. Specifically, these countries developed the institutional capacity (data, supervision, coordination, regulations) to develop better policy frameworks (countercyclical policy, inflation targeting, and flexible exchange rate regimes) that enabled them to maintain greater policy space (low inflation, favorable fiscal and external positions, external reserves) needed to respond to shocks

However, these buffers have been somewhat eroded and need to be rebuilt. At the same time the weak external environment will be a drag on growth and downside risks from the uncertain global environment have intensified. In this scenario, countries have less policy space to sustain growth. With a sharper downturn in the global recovery, emerging market and developing economies might become re-coupled again with their advanced economy counterparts.

Implications for Angola

Angola was heavily affected by the recent global economic crisis mainly because of its heavy reliance on oil revenues, but also because the country lacked the adequate macroeconomic policy buffers to implement counter-cyclical policies that could soften the domestic impact. However, since the crisis, Angola has made substantial strides in improving its macroeconomic indicators. It is fair to say that macroeconomic stability has been restored and the economy is now in a better position to face another shock: international reserves are higher than they were before, the budget is in a much healthier condition, and inflation has come down to single digits. But Angola

still remains heavily exposed to international oil prices and prices are projected to fall below US\$90 per barrel over the next few years.

Looking ahead, Angola's key economic policy challenge is to maintain the macroeconomic stability essential for sustained growth, economic diversification, and poverty reduction. For this, Angola needs to sustain the prudent macroeconomic policies of the last few years and rebuild the buffers to help stabilize the economy. Central to this is delinking the non-oil sector from the oil sector and make it less vulnerable to fluctuations in international oil prices. This means further building foreign reserves, pressing against inflation, and strengthening fiscal balances. At the same time, there are also large development needs for spending on infrastructure and social priorities and meeting these needs in the context of weakening oil prices implies some difficult choices. To create fiscal space, the country could raise non-oil tax collections and restrain spending in non-priority areas. Meeting these challenges with resilience will require sound macroeconomic policies. In this regard, if Angola can draw on the example of other developing countries, the country's medium-term prospects will continue to look strong.

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