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Interview with Rumo

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Question 1: What is your view of the current condition of the Angolan economy?

Any discussion of the current condition of the Angolan economy needs to start at the height of the crisis in 2009 as macroeconomic policy over the past three years has been dominated by redressing the impact of the crisis. The economy is clearly now in much better condition than in 2009 and fair to say that stability has been restored. After all, the exchange rate is stable, foreign reserves are now much higher than before whether measured in dollars or in import coverage, inflation has reached single digits, the Government's large domestic arrears have been cleared and its fiscal balances are much healthier. From this perspective, the Angolan economy is in much better shape to face another global crisis and fall in international oil prices. This is a considerable achievement.

But it is also important to put this in perspective. Angola was badly affected by the crisis because of its heavy reliance on oil and also because it did not have any room for macroeconomic policy to respond to the crisis—or policy buffers—in a counter-cyclical manner that would soften the impact on the non-oil sector. Foreign reserves before the crisis were inadequate, inflation was high, and fiscal deficits too high. This was because oil prices and also Government spending before the crisis were high so that Angola had a bubble economy. Angola's experience in recent years has not only been about recovery from the global crisis, but also about unwinding a bubble economy. Indeed, the Government's footprint in the non-oil economy is now smaller than before and this has contributed to the lower growth rates in the non-oil sector as well as lower inflation. This is a positive development as it implies growth in the non-oil sector that is more sustainable.

Question 2: What are economic prospects over the medium term?

Angola's prospects over the medium-term are closely linked to the health of the global economy because of its heavy reliance on oil exports. But the IMF's recent review of the global economy is somber. The weak global recovery has softened further. The advanced economies are weighed down by fiscal consolidation and poorly functioning financial systems and output in much of peripheral Europe is now contracting. Also, emerging market and developing economies—especially China—are now also slowing down because of deliberate policy decisions to avoid them overheating. Looking ahead, the recovery appears to be particularly weighed down by large policy uncertainties revolving around whether the Euro area can address it financial issues and whether the U.S. can side-step the fiscal cliff that will tip it back into recession. Growth is likely to remain weak through the medium term, but could become noticeably weaker if these policy issues are not addressed.

The key implication of this for Angola is that international demand for oil will likely weaken from around US$105 in 2012 to below US$90 per barrel in the medium term. This is a sizeable drop and will obviously have large adverse implications for the Government's budget and for Angola's growth prospects. We are envisaging overall growth in Angola somewhat above 5 percent through the medium term—reflecting modest increases in oil production increases and growth in the non-oil sector somewhat above 6 percent. But on the positive side, it will also make it easier for the BNA to meet its objectives of keeping inflation within single digits.

Question 3: What are the main macroeconomic challenges facing Angola in the medium term?

Angola has an urgent need for more inclusive growth that would benefit the broader population and reduce poverty. In other words Angola needs stronger growth and economic diversification in the non-oil sector. But macroeconomic stability is essential for this to happen and maintaining this stability is Angola's key macroeconomic policy challenge over the medium term—a challenge that will be particularly difficult in the context of softening oil prices. And this needs an overall framework for sound macroeconomic policies.

Maintaining stability in the non-oil sector requires a medium-term macroeconomic policy framework that will delink the non-oil sector from the oil sector and make it less vulnerable to volatility in international oil prices. Most of all, this means smoothing the budget, saving reserves for stabilization purposes when oil prices are high and drawing down on these reserves when oil prices fall.

But at the same time, the Government will need to address the country's large development needs, especially for spending on infrastructure and other social priorities. In the context of stagnant or falling oil revenues, the Government will face difficult policy choices and will have to look elsewhere for the fiscal space to meet these development needs. One possibility is to further increase tax revenues from the non-oil sector by broadening the tax base. Another possibility is to look for savings in non-priority spending. In particular, as in much of sub-Saharan Africa, there are potential savings in Angola's subsidies on fuel and utilities as these are inefficient (they distort economic incentives), costly (about 15 percent of non-oil GDP) and poorly targeted to the vulnerable who need support. Instead, some consideration could be given to strengthening social assistance to protect the vulnerable.

Question 4: What is needed to make sound macroeconomic policies?

Making sounds macroeconomic policies sounds deceptively simple. But it is best thought of as a process rather than a set of specific targets. In this regard, Angola could borrow from other emerging market and developing economies, including some in sub-Saharan Africa, that have shown remarkable resilience to the recent global crisis. IMF studies have concluded that this resilience was mainly because these countries had established a macroeconomic policy framework that enabled them to assess and respond effectively to crises that threatened stability. There appear to be three elements.

The first element is an institutional structure to support the formulation and implementation of sound policies and this entails the collection and dissemination of information, coordination and consultation with stakeholders, and regulation and supervision. The second is a consistent and sustainable medium-term macroeconomic framework for fiscal, monetary and exchange rate policies geared towards maintaining stability. The third is the preservation of adequate policy buffers to implement counter-cyclical policies in the event of another crisis.

Question 5: What should be the Government's priorities for spending?

The Government's spending priorities should be in line with the MPLA's election program on the basis of which it won the recent elections. There are clearly a lot of demands on the budget, but there are also important constraints on Government spending.

From a macroeconomic perspective, financial resources are limited so that the Government will have to carefully select its priorities so as to keep the fiscal deficit at a sustainable level. And there are limits on how much government spending the economy can absorb without crowding out economic resources and pushing up prices for the private sector. This is particularly the case for large infrastructure projects but is also true, for example, for spending that soaks up skilled human capital resources.

There are also significant institutional limitations that could be addressed to improve the effectiveness of government spending. A big push is needed to strengthen the civil service and public expenditure management to ensure that the Government's spending decisions are implemented and that the public gets good value for its money. This is important to improve social services, and it is critical for public infrastructure projects.

Question 6: What can the Government do to help diversify the economy?

Angola has a vibrant entrepreneurial culture that needs a helping hand to unlock the country's large economic potential outside the oil sector. The best way that the Government can assist is to build an enabling environment for the private sector to flourish. For this, maintaining macroeconomic stability is essential.

The key cause for Angola's lack of economic diversification is the non-oil sector's poor competitiveness so that it is cheaper to import than to produce domestically. This is partly due to the oil-driven strength of the national currency, but also reflects the high cost structure associated with poor public infrastructure in energy, water, and transportation as well as the well-known difficulties of doing business in Angola. A sustained Government effort in these areas will go a long way to improving the business environment and unlocking Angola's economic potential.

The Government can also help economy diversify by leaving space for the private sector to operate. High government spending can soak up domestic resources and raise costs making it difficult for the private sector to compete. There is a limit to how much government spending the economy can absorb.

Question 7: Are the BNA's policy goals for inflation sustainable?

The BNA's goal of reducing and maintaining inflation below 10 percent is both achievable and sustainable. After all, inflation, measured by the change in the CPI from a year ago, is already below 10 percent and has been running at a much lower pace in recent months. Inflation is ultimately a monetary phenomenon and the BNA's responsibility, but there are also factors working in the BNA's favor. The winding down of Angola's bubble economy and the steady improvement of Angola's infrastructure have already contributed to reducing prices and holding down the inflation rate. The stability of the exchange and the weak global economic environment have also helped by reducing pressures on imported inflation. These factors will continue to help, but, of course, the BNA will have to continue leaning against inflation to reduce it further and well below the 10 percent ceiling.

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