



# Developing Angola's Capital Markets

Nicholas Staines  
IMF Resident Representative  
23/25 Largo Albano Machado  
Luanda, Angola  
[www.imf.org/luanda](http://www.imf.org/luanda)  
(244) 937-787-670

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To respond to the need for increased sources of financing of the economy, the Angolan Government has created the Capital Market Commission (CMC), which aims open a stock market between 2014 and 2016.

**Q1 - Economy and Markets:** In your opinion, why do firms face so much difficulty to obtain financing in Angola?

**Nicholas Staines:** This is a pervasive problem in the sub-Saharan region and developing countries in general. The broader issue is why is financial intermediation so limited? That is, why is it so difficult to match investors with savings and firms (or households) in need of financing? In my view, the key issues are information, governance and judicial recourse. There are three sides to this: the supplier and the user of funds, the financial architecture, and a fourth is the macroeconomic environment. Similar issues arise for banking financing, or for corporate debt and equity financing. These challenges will take time to address and the establishment of a stock market is one important part.

**Q2 - Economy and Markets:** Why do you emphasize information, governance and judicial recourse?

**Nicholas Staines:** These are the key elements in the 'principal-agency' problem facing investors anywhere, and are particularly challenging in a developing economy like Angola. Information about the Angolan economy is limited and potential investors in a firm know much less about it than do its managers (or owner-managers). This adds considerable uncertainty to the risk of investment. The uncertainty is heightened by weak corporate governance and especially the danger of fraud and exacerbated by the challenges of seeking redress in the judicial system. Banks help overcome these barriers by acting as middlemen between depositors and borrowers, but these challenges are prevalent in corporate debt and equity markets.

**Q3 - Economy and Markets:** How is the macroeconomic environment important?

**Nicholas Staines:** Firms and investors need confidence in Angola's longer-term prospects. Macroeconomic stability is fundamental to Angola's longer-term growth prospects. It is also essential for firms to have viable opportunities and if investors are going to take the risk to part with their savings. And confidence in the country's economic prospects is essential if private investors are to keep their savings in Angola instead of looking for ways to take them out of the country. Economic policies also influence supply and demand. For example, it influences which corporate sectors have the growth opportunities and what sort of financing is needed: construction firms working with government contracts have very different financing needs than retail firms serving the private sector. Equally important is whether the country's savings are generated by the Government, corporate or household sectors as these sectors will use their savings in quite different ways.

**Q4 - Economy and Markets:** What can firms do to make it easier for them to obtain financing?

**Nicholas Staines:** Firms wanting to attract financing can go a long way to addressing investors' concerns by providing information about their operations and prospects and by building strong corporate governance. This would include, for example, having an effective corporate board, sound financial accounts and audited financial statements. This would help reduce the uncertainties facing potential investors and help improve assurances that their investment would be safeguarded.

**Q5 - Economy and Markets:** What can be done to encourage households to invest?

**Nicholas Staines:** Household investors generally lack an understanding of financial markets. A large proportion of households already participate in financial intermediation through their holdings of bank deposits. But their participation in capital markets can be further harnessed through institutional vehicles such as pension and insurance funds and investment funds. These institutions can help the household investor overcome the information gap and spread their risk. But for this to happen, households must also have confidence that these institutions are well-managed and regulated.

**Q6 - Economy and Markets:** Why is the financial architecture so important?

**Nicholas Staines:** Markets may be driven by 'animal spirits', but the 'rules of the game' need to be carefully structured if markets are to function properly. The financial architecture defines the roles of the various financial institutions and regulates how they function. This includes banks, non-bank financial institutions such as pension and insurance firms, and market institutions such as a stock market. It also covers the rules governing the participation of those supplying funds and those seeking financing. Confidence in the architecture and in the regulator, as 'referee', is of paramount importance. As the recent global financial crisis has shown, a weak financial architecture can be very damaging when it fails.

**Q7 - Economy and Markets:** Why is the Government domestic debt market important?

**Nicholas Staines:** The interest rates on Government domestic debt securities provide a benchmark for valuations in private capital markets. To play this role, the Government's domestic debt market needs to be sufficiently deep at the various maturities to generate a term structure. It is also important that prices and yields can move freely to signal market conditions.

**Q8 - Economy and Markets:** Should non-resident be allowed to invest in Angola's stock and debt markets and repatriate the investments on demand?

**Nicholas Staines:** Allowing non-residents to make short-term portfolio investments and repatriate the investment on demand is tantamount to liberalizing capital market balance of payments transactions. The inflow of foreign financial resources would add to Angola's own financial resources. However, the risk of large swings in financial inflows and outflows could be difficult to manage and potentially very destabilizing to the Angolan economy without the

adequate financial architecture and policy framework in place. In my view, Angola is not yet ready for this.