ANGOLA ECONOMIC OUTLOOK FOR 2017: GROWTH PROSPECTS & THREATS

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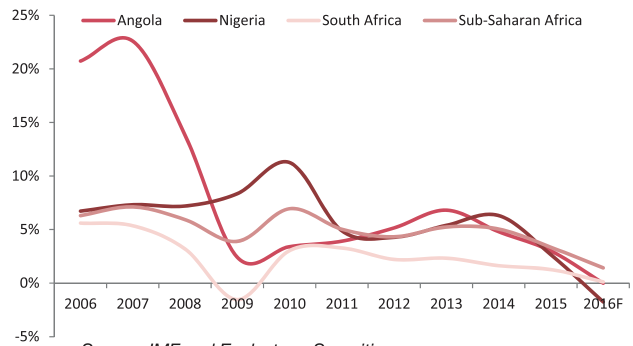
Angola is facing a tough macroeconomic environment, in line with other countries in Sub-Saharan Africa such as Nigeria and South Africa that saw economic growth come to a halt or even turn into negative territory during 2016. Similar to what happened in the oil crisis of 2008-09, the current downturn in Angola has been the result of the sharp and prolonged decline in oil prices that started in the second half of 2014. Economic growth slowed to 4.8% in 2014, 3% in 2015 and is expected to come to a near standstill in 2016, as global economic conditions also became less supportive in recent months. This compares with double-digit average annual growth witnessed during the previous decade that made Angola one of the fastest expanding countries in the world.

REAL GDP GROWTH (2010-16F)



Source: IMF and Eaglestone Securities

Growth has also been hindered by tighter monetary conditions to contain rising inflation levels not seen in over a decade. This largely reflects the pass through effects of the depreciation of the kwanza, but also the reduction in fuel subsidies and higher food costs. The BNA, the country's central bank, raised interest rates five times in 2015 and two times last year for a combined increase of 700bps, lifting its benchmark interest rate to 16%, an all-time high. Overall, the current long-lasting low oil price environment has also led to increased imbalances, with a widening of the fiscal and external deficits in recent years.

The government assumes that growth will recover somewhat in 2017 based on an improved contribution from both the oil and non-oil sectors. Agriculture, manufacturing and energy are all expected to be the main drivers of economic activity. The budget proposal recently approved by Parliament includes a real GDP growth forecast estimate of 2.1%, well above the IMF's latest projection of 1.25% for 2017 as the Fund sees risks from potential delays in the implementation of the needed structural reforms to promote economic diversification.

Despite the recovery, growth in 2017 is expected to remain below population growth of around 3%, which means that GDP per capita is once again anticipated to decline this year.

The 2017 budget proposal also incorporates an average oil price assumption of US$ 46 per barrel, 12% higher than in the US$ 40.9 projected in the 2016 revised budget, while oil production is expected to recover to 1.82 million barrels per day (bpd), up from 1.79 million (bpd) in 2016.

Consumer prices are expected to remain elevated in 2017, but they should gradually trend downwards due to continued tight monetary conditions and the introduction of price control measures on some goods. That said, the decline in prices is unlikely to be rapid since the local currency's expected continued weakness against the dollar will push up the cost of imported goods. On the other hand, the months leading up to the next general elections (scheduled for August 2017) are likely to see increased government spending while a partial recovery of global food and non-food commodity prices could also lead to further inflationary pressures. All in all, the inflation rate is expected to drop to 15.8% from 38.5% in 2016.

BUDGET PROPOSAL - 2017

Forecasts	2012	2013	2014	2015	2016 (1)	2016 (2)	2017 (3)
Inflation	9.0%	7.7%	7.5%	14.3%	11.0%	38.5%	15.8%
Annual oil production (mn barrels)	631.9	626.3	610.2	649.5	689.4	654.6	664.7
Daily oil production (million bpd)	1.73	1.72	1.67	1.78	1.89	1.79	1.82
Average oil price (US$ per barrel)	111.6	107.7	96.9	50.0	45.0	40.9	46.0
Gross domestic product:							
Nominal value (AOA billion)	10,876	12,056	12,462	12,321	14,218	16,880	19,746
Oil sector	4,981	4,818	4,304	2,884	3,302	3,659	3,753
% of total	45.8%	40.0%	34.5%	23.4%	23.2%	21.7%	19.0%
Non-oil sector	5,895	7,239	8,158	9,436	10,916	13,220	15,993
% of total	54.2%	60.0%	65.5%	76.6%	76.8%	78.3%	81.0%
Real GDP growth	5.2%	6.8%	4.8%	3.0%	3.4%	1.1%	2.1%
Oil sector	4.3%	-0.9%	-2.6%	6.5%	4.8%	0.8%	1.8%
Non-oil sector	5.6%	10.9%	8.2%	1.5%	2.7%	1.2%	2.3%
Exchange rate (US$/AOA)	95.4	96.6	98.3	120.1	143.8	-	-

(1) Initial Budget; (2) Revised Budget; (3) Budget Proposal.

Source: Angolan authorities.

Meanwhile, in terms of fiscal accounts, higher oil prices are expected to support oil related revenue growth in 2017 and help offset a lower contribution from income taxes and non-tax revenues. The government will need to continue to intensify its efforts to broaden the tax base, including the planned introduction of a VAT scheduled to take place in 2019. Regarding expenditures, the anticipated rise in spending levels will be driven by higher current expenditures such as wages and spending on goods and services, as they still account for nearly 80% of total spending. The local authorities also plan to increase investment levels, but only moderately, and continue to cut fuel related subsidies.

Overall, total revenues and expenditures are projected to increase 5.3% and 7.2%, respectively, from the 2016 revised budget estimates. They are also expected to represent 18.6% and 24.3% of GDP, respectively. This puts the 2017 budget deficit forecast at 5.8% of GDP, slightly below the 5.9% estimated by the government for 2016. However, we believe that the executed figure for 2016 may turn out to be lower than the 5.9% due to the strong increase in oil prices in the last few months of the year. Indeed, the average price turned out to be around US$ 45 per barrel in 2016, well above the US$ 40.9 projected in the 2016 revised budget. Still, public debt levels are anticipated to remain relatively high, reflecting the depreciation of the exchange rate in addition to the fiscal deficit.

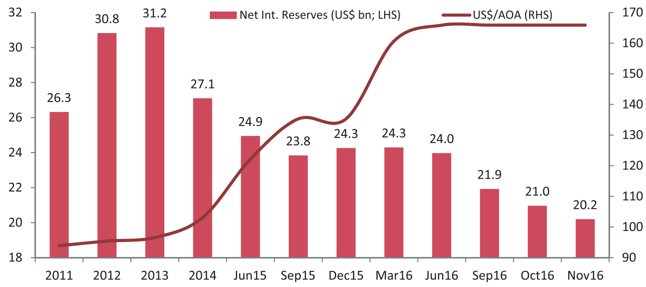
GOVERNMENT ACCOUNTS

	% of GDP						
	2012	2013	2014	2015 (1)	2016 (2)	2016 (3)	2017 (4)
Revenues	**46.5%**	**40.2%**	**35.3%**	**27.3%**	**24.7%**	**20.6%**	**18.6%**
Tax Revenues	44.4%	38.2%	32.9%	24.7%	22.8%	18.3%	17.2%
Oil Revenues	37.7%	30.1%	23.8%	15.4%	11.9%	9.1%	8.6%
Non-oil Revenues	6.6%	8.1%	9.1%	9.3%	10.9%	9.2%	8.7%
Of which: Income Taxes	3.0%	4.2%	4.4%	5.4%	4.9%	5.4%	4.4%
Non-tax Revenues	2.1%	2.0%	2.4%	2.6%	2.0%	2.3%	1.3%
Expenditures	**39.8%**	**39.9%**	**41.9%**	**30.6%**	**30.2%**	**26.6%**	**24.3%**
Current Expenditures	29.3%	28.5%	29.4%	24.7%	24.5%	20.9%	19.3%
Wages	9.5%	9.6%	10.6%	11.3%	10.5%	9.3%	8.2%
Goods and Services	11.9%	10.2%	10.0%	6.4%	7.0%	5.0%	5.2%
Interests	1.0%	0.8%	1.2%	2.0%	2.2%	2.6%	2.5%
Transfers	6.9%	7.9%	7.6%	5.0%	4.8%	4.0%	3.4%
Subsidies	5.0%	5.9%	5.4%	2.3%	2.6%	2.1%	1.5%
Capital Expenditure	10.5%	11.4%	12.5%	6.0%	5.7%	5.7%	5.0%
Public Investment	10.5%	11.4%	12.4%	5.8%	5.7%	5.7%	5.0%
Primary Fiscal Balance	**17.2%**	**11.7%**	**5.9%**	**2.7%**	**0.2%**	**-0.2%**	**-0.7%**
Overall Fiscal Balance	**6.7%**	**0.3%**	**-6.6%**	**-3.3%**	**-5.5%**	**-5.9%**	**-5.8%**

(1) Preliminary; (2) Initial Budget; (3) Revised Budget and (4) Budget Proposal.
Sources: Angolan authorities and Eaglestone Securities.

We expect the kwanza to continue to depreciate against the dollar in 2017, although at a slower pace than recently witnessed. Larger export receipts, namely from the oil sector, are expected to ease some of the near-term pressure on the local currency. However, the ability of the BNA to defend the kwanza through market interventions going forward will depend on the level of foreign exchange reserves. We note that these stood at nearly US$ 20.2 billion in November 2016 (the latest available data), which is equivalent to about eight months of imports. Although this is considered to be a relatively comfortable level, international reserves currently stand well below the US$ 31 billion level recorded at the end of 2013.

NET INTERNATIONAL RESERVES AND EXCHANGE RATE



Source: BNA

The BNA will also continue to have a critical role in not only improving bank regulation and supervision, but also in strengthening the country's financial system, which has recently been under increased pressure largely due to the tougher economic backdrop. We believe the Angolan banking sector could see some M&A activity this year, as the nearly 30 banks with a license to operate in the country is likely to prove to be unsustainable over the medium-term in an increasingly competitive and tougher regulatory business environment.

Moreover, the central bank is expected to maintain its efforts to attenuate the negative impacts from the loss of correspondent banking relations and its effects on the local economy, something that has affected many other countries. The BNA has stopped selling dollars to the commercial banks, selling only euros throughout most of 2016. The persistently large and volatile spread between the official and parallel market exchange rates is evidence that a large imbalance in the foreign exchange market still exists and needs to be resolved.

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In sum, 2017 should prove to be another challenging year for Angola. After recently coming to a near standstill, economic activity is likely to recover on the back of an improved performance in both the oil and non-oil sectors. A moderate increase in oil prices should also help support both private and public consumption levels as well as partly reduce macroeconomic imbalances. Still, real GDP growth this year should once again remain below projected population growth of about 3%.

We think the government's oil price assumption of US$ 46 per barrel currently looks to be conservative bearing in mind the impact that the latest oil output cut agreements by OPEC and non-OPEC members has recently had on oil prices. As an example, according to our calculations, if Brent prices remain at the current level of around US$ 55 and assuming all else equal, then total revenues would increase 9% (or US$ 2 billion at the current exchange rate) from the government's current budget forecast. That said, Angola's long-term growth prospects remain largely dependent on the local authorities' implementation of structural reforms to diversify the economy as well as improve the business environment and competitiveness.

Contributor's Profile

Tiago joined EAGLESTONE in 2013. He has over 15 years' experience in investment banking, namely at Banco Português de Investimento (BPI) and later at Espírito Santo Investment Bank (ESIB).

Before joining EAGLESTONE, Tiago was part of ESIB's Project Finance team for two years. Prior to that, Tiago was a sell-side analyst covering the main listed Iberian banks for eight years both at ESIB and BPI. Before that, he was a macro research analyst at BPI for three years responsible for covering Portugal, Spain and several Latin America countries, including Brazil and Argentina.