ANGOLA: FUNDING THE BUDGET DEFICIT AMIDST THE OIL PRICE SLUMP

By **Tiago Bossa Dionisio,** Chief Economist, Eaglestone Advisory, S.A.

Government revises macro scenario for 2016

Economic activity in Angola has slowed considerably in recent years. Real GDP advanced by only 4.8% in 2014 (from 6.8% in the previous year) and 3% in 2015. This is considerably slower than the 10.4% average recorded in the previous decade. The deceleration was particularly reflected in the oil sector, which saw a contraction in activity in 2014 after a strong decline in production and oil prices started their free fall in the second half of the year. The year 2015 saw an improved performance in the oil sector (despite the continued decline in prices), but a sharp slowdown in other sectors like manufacturing, construction, retail and agriculture resulted in a modest economic expansion.

Angola continues to face a rather challenging economic environment in 2016. In its initial budget proposal for 2016 presented at the end of last year, the government predicted that real GDP would expand at a rate of 3.3% this year based on higher oil production and stronger growth in the non-oil sector. However, these assumptions have proved to be too optimistic. The local authorities have recently presented to the country's Parliament a revised budget proposal for 2016 whereby they include an amended macroeconomic scenario.

In this new macroeconomic scenario, the forecast for average daily oil production was cut to 1.79 million barrels per day (bpd) this year from a previous estimate of 1.89 million bpd (and 1.72 million bpd in 2015). On the other hand, the government lowered its average oil price assumption to US$ 40.9 per barrel (from US$ 45 previously), as prices remain at multi-year lows. This is lower than the average oil price of US$ 50 recorded last year and US$ 96.9 in 2014.

Overall, growth in the oil sector is now only expected to reach 0.8% in 2016 (vs. 6.3% in 2015) and activity in the non-oil sector to advance 1.2% after an already depressed increase of 1.5% last year. These figures compare with previous forecasts of 4.8% in the oil sector and 2.7% in the non-oil sector in the initial budget proposal. This means that the government now expects economic activity to expand at only 1.1% in 2016, a rate that is unseen in the post-civil war period.

Moreover, inflation has picked up in recent months mostly as a result of the reduction in fuel subsidies earlier in January as well as the pass-through effects of the continued depreciation of the kwanza this year. We note that Angola continues to import a very large part of the food that it consumes while the ongoing investments in infrastructure mean that about 40% of its imports are related to machinery and metals. This lifted the inflation rate to 31.8% in June, a multi-year high and well above the government's initial target of 11% for the year.

Consumer prices are expected to remain under pressure in the foreseeable future as the local authorities are reportedly expected to announce two additional depreciation moves of the local currency before the end of the year. Specifically, the local press suggests that the kwanza could depreciate to 199 kwanzas to the dollar in Q3 and to 215.5 in Q4, which represents a further devaluation of 23% until year-end. Overall, the government now expects inflation to reach 38.5% in December, a level not seen in over 12 years.

Lower prices continue to hit oil export receipts…

The latest figures for the Angolan oil market show that oil exports have slightly increased in the first half of this year when compared with the same period of 2015. Total exports reached 322.5 million barrels during this period, representing an increase of 1.3% YoY. In other words,

MACRO FORECASTS

	2012	2013	2014	2015	2016(1)	2016(2)
Inflation	9.0%	7.7%	7.5%	14.3%	11.0%	38.5%
Annual oil production (million barrels)	631.9	626.3	610.2	628.3	689.4	654.6
Daily oil production (million bpd)	1.73	1.72	1.67	1.72	1.89	1.79
A verage oil price (US$ per barrel)	111.6	107.7	96.9	50.0	45.0	40.9
Gross domestic prouct:						
Nominal value (AOA billion)	10,876	12,056	12,462	12,537	14,218	16,880
Oil sector	4,981	4,818	4,304	3,098	3,302	3,659
% of total	45.8%	40.0%	34.5%	24.7%	23.2%	21.7%
Non-oil sector	5,895	7,239	8,158	9,439	10,916	13,220
% of total	54.2%	60.0%	65.5%	75.3%	76.8%	78.3%
Real GDP growth	5.2%	6.8%	4.8%	3.0%	3.3%	1.1%
Oil sector	4.3%	-0.9%	-2.6%	6.3%	4.8%	0.8%
Non-oil sector	5.6%	10.9%	8.2%	1.5%	2.7%	1.2%
Exchange rate (US$/AOA)	95.4	96.6	98.3	120.1	143.8	n.a

(1) Initial budget; (2) Revised budget;
Source: Angolan authorities.

ANGOLAN OIL MARKET						
				YoY Change		
	Exports (mn BBLs)	Avg.Price (US$/BBL)	Receipts (mnUS$)	Exports	Average Price	Export Receipts
2015						
January	52.6	63.2	3,320	6.7%	-42.2%	-38.3%
February	57.0	49.2	2,808	18.4%	-53.8%	-45.3%
March	47.6	55.0	2,619	4.5%	-47.9%	-45.6%
April	53.1	50.3	2,671	8.5%	-48.4%	-44.0%
May	53.5	57.4	3,072	17.6%	-45.3%	-35.7%
June	54.5	61.9	3,375	-2.9%	-41.9%	-43.6%
Accumulated	**318.4**	**56.2**	**17,864**	**8.4%**	**-46.5%**	-42.1%
2016						
January	54.7	35.2	1,924	4.1%	-44.3%	-42.1%
February	57.2	30.9	1,765	0.3%	-37.3%	-37.1%
March	48.2	30.4	1,467	1.2%	-44.6%	-44.0%
April	56.3	36.6	2,060	6.0%	-27.2%	-22.9%
May	52.0	37.6	1,952	-2.8%	-34.6%	-36.5%
June	54.1	45.3	2,448	-0.8%	-26.9%	-27.5%
Accumulated	**322.5**	**36.0**	**11,616**	**1.3%**	**-35.9%**	-35.0%

Source: Angolan authorities and Eaglestone Securities

Angola exported an average of 1.79 million bpd until June of 2016 compared with 1.77 million bpd exported in the same period of 2015. Meanwhile, oil prices averaged US$ 36 per barrel in the first six months of 2016. This is nearly 36% lower than the average price of US$ 56.2 recorded in the homologous period. All in all, this means that export receipts stood at US$ 11.6 billion year-to-date, falling 35% YoY. It also means that when looking at the newly revised figures for the whole of 2016 the government is foreseeing a recovery in oil prices in the second half of the year, but it expects oil production to remain at the same levels of around 1.79 million bpd.

…and also fiscal revenues

The lower oil price environment has unsurprisingly had a major impact on the government's fiscal accounts in the last couple of years. The latest figures show that total taxes fell 13.3% YoY to AOA 586,483 million in the first half of 2016. The biggest decline occurred in income taxes (-17.7% YoY), which represented 28.5% of the total taxes collected from the oil sector. The largest share of oil revenues came from concessionary taxes. These accounted for 62.5% of the total oil proceeds and fell 12.9% YoY.

Government presents revised budget for 2016

Against this backdrop, the Angolan government recently presented a revised budget for the current year to the country's Parliament. According to the new budget, total revenues are expected to amount to AOA 3,485 billion in 2016. This is a modest reduction of 0.9% from the initial estimate of AOA 3,515 billion. This was largely due to a reduction of 9.1% in expected oil revenues, which are expected to account for less than half of tax revenues (vs. 62.1% in 2015).

However, in terms of expenditures, the government now expects to spend 4.4% more than initially planned, with

OIL REVENUES								
	Taxes				YoY Change			
Million AOA	Income (IRP)	Production (IPP)	Conces-sionary	Total	Income Tax (IRP)	Production Tax (IPP)	Concessio-nary Tax	Total Taxes
2015								
January	48,460	10,529	80,527	139,515	-0.1%	-57.0%	-65.3%	-57.1%
February	18,954	2,479	78,943	100,377	-69.1%	-68.4%	-43.8%	-53.7%
March	24,980	6,364	69,938	101,282	-52.8%	-73.0%	-51.9%	-57.2%
April	33,331	10,031	47,175	90,537	-43.9%	-46.2%	-73.4%	-66.3%
May	37,222	10,835	43,640	91,697	-36.6%	26.0%	-65.0%	-53.9%
June	40,094	11,738	100,993	152,825	-37.6%	-37.6%	-45.5%	-46.0%
Accumulated	**203,041**	**51,976**	**421,216**	**676,232**	**-41.2%**	**-49.0%**	**-58.1%**	**-55.8%**
% of the Total	**30.0%**	**7.7%**	**62.3%**	**100.0%**				
2016								
January	39,979	8,550	54,039	102,568	-17.5%	-18.8%	-32.9%	-26.5%
February	18,722	8,861	59,014	86,596	-1.2%	257.4%	-25.2%	-13.7%
March	18,516	7,096	45,723	71,334	-25.9%	11.5%	-34.6%	-29.6%
April	29,249	7,983	65,016	102,247	-12.2%	-20.4%	37.8%	12.9%
May	28,699	9,553	58,393	96,645	-22.9%	-11.8%	33.8%	5.4%
June	31,984	10,448	84,659	127,091	-20.2%	-11.0%	-16.2%	-16.8%
Accumulated	**167,149**	**52,490**	**366,844**	**586,483**	**-17.7%**	**1.0%**	**-12.9%**	**-13.3%**
% of the Total	**28.5%**	**9.0%**	**62.5%**	**100.0%**				

Source: Angolan authorities and Eaglestone Securities

GOVERNMENT ACCOUNTS						
				Change		
AOA BILLION	2015	2016 (Initial)	2016 (Revised)	2016(Init.) / 2015	2016(Rev.) / 2015	2016(Rev.) / 2016(Init.)
Revenues	**3,381**	**3,515**	**3,485**	**3.9%**	**3.1%**	**-0.9%**
% of GDP	27.4%	24.7%	20.6%			
Tax Revenues	3,056	3,235	3,092	5.9%	1.2%	-4.4%
Oil Revenues	1,898	1,690	1,536	-11.0%	-19.1%	-9.1%
% of Total Tax Revenues	62.1%	52.2%	49.7%			
Concessionary Rights	1,306	1,163	968	-10.9%	-25.9%	-16.8%
Non - Tax Revenues	326	279	393	-14.2%	20.5%	40.5%
Expenditures	**3,858**	**4,296**	**4,485**	**11.3%**	**16.2%**	**4.4%**
% of GDP	31.3%	30.2%	26.6%			
Current Expenditure	3,045	3,480	3,524	14.3%	15.7%	1.2%
Capital Expenditure	813	816	961	0.3%	18.2%	17.8%
Primary Fiscal Balance	**337**	**34**	**-39**	**-89.8%**	**-111.6%**	**-213.1%**
% of GDP	2.7%	0.2%	-0.2%			
Overall Fiscal Balance	**-477**	**-78.1**	**-1,000**	**63.9%**	**109.8%**	**28.0%**
% of GDP	-3.9%	-5.5%	-5.9%			

Source: Angolan authorities and Eaglestone Securities

total expenditures forecasted to amount to AOA 4,485 billion. This came after a slight increase in expected current expenditures, namely on wages and interest payments, but more importantly a significant 17.8% increase in capital spending. The local authorities stated that they hope to use the proceeds from external financing already secured to increase public investment levels for the remainder of the year in the hope of restarting economic activity to more robust growth levels. Overall, this means that the budget deficit forecast was revised upwards to 5.9% of GDP this year from an initial forecast of 5.5%.

Angola has relied mostly on international funding sources. From a funding perspective, Angola continues to show that it has access to diversified sources of international funding. According to the government, the country has raised US$ 11.46 billion in international markets since the successful issue of its US$ 1.5 billion Eurobond in November 2015. The external funding facilities raised since then and until June 2016 include funding from (1) the China Development Bank (US$ 5 billion); (2) the Industrial and Commercial Bank of China, China Development Bank and Exim Bank (US$ 1.98 billion); (3) various international export credit agencies already concluded or to be concluded before year-end (US$ 1.18 billion) and (4) framework agreement and budget support concluded and to be concluded before year-end (US$ 3.3 billion). The local authorities have also issued securities in the domestic market amounting to AOA 512.6 billion so far in 2016.

All in all, government debt (excluding debt at state-owned enterprises) amounted to US$ 47.9 billion at the end of June, of which US$ 25.5 billion was external debt (or 53% of the total). This means that government debt is expected to increase to about 50% of GDP this year from 46.6% in 2015 and 32.8% in 2014. Moreover, external debt payments foreseen in the next 12 months amount to US$ 4.4 billion, which represents around 22% of the total government revenues budgeted for 2016.

In sum, Angola believes that it continues to have access to sufficient funding, which we believe is more likely to come from international sources. The government stated that this was the main reason for not requiring funding from the IMF, although the country will continue its program of technical assistance with the Fund. However, it is clear that Angola's debt level continues to rise at a very rapid pace and so careful monitoring is required. This is particularly relevant bearing in mind the growing debt levels denominated in foreign currency as well as the possibility of the kwanza depreciating further in the near-term, which could make it more challenging for the country to fulfill its debt commitments.

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.

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Deal Value **R2.6 Billion**
Financial Advisor to Lesedi Power Company
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Letsatsi POWER COMPANY
75MW$_{DC}$ Solar Photovoltaic Power Plant in the Free state
Deal Value **R2.5 Billion**
Financial Advisor to Letsatsi Power Company
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www.eaglestone.eu
eaglestone@eaglestone.eu

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