

# INTO AFRICA

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# ANGOLA: CHALLENGING ECONOMIC ENVIRONMENT CONTINUES

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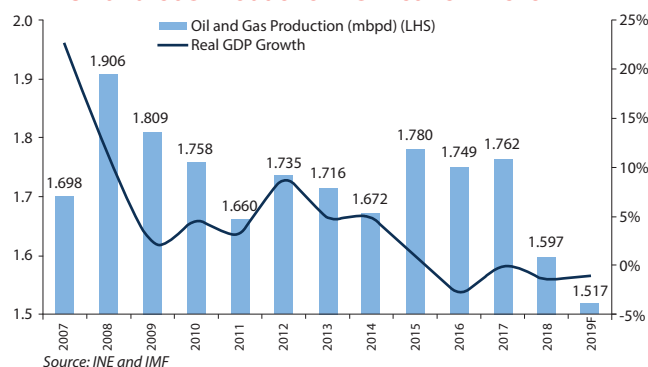


## Review of 2019

Economic activity in Angola contracted for a fourth straight year in 2019 mainly due to a strong decline in oil and gas production that reflects recent underinvestment in the sector following the sharp fall in oil prices at the end of 2014. The lower oil proceeds and the need to secure some fiscal deficit adjustment led to a marked decline in capex levels in recent years. This strategy only exacerbated the downturn in economic activity, as public investment remains a key source of growth of the non-oil sector, which now represents more than 65% of the country's GDP (vs. less than 45% a decade ago).

Current forecasts suggest that real GDP declined 1.1% in 2019 after falling 1.2% in the previous year. In particular, activity in the oil and gas sector continued to see a material decline (estimated at 5% YoY after already tumbling 9.5% in 2018) while growth in the non-oil sector remained quite modest (forecast of 0.6% vs. 1% in the previous year).

**Oil and Gas Production vs. Real GDP Growth**



Meanwhile, inflation kept a downward trajectory thanks to a persistently tight monetary policy adopted by the BNA (the central bank) and the implementation of price control measures for some goods. Recall that inflation peaked above the 40% level at end-2016 due to the gradual elimination of fuel subsidies and some depreciation of the local currency (18%).

In 2019, yearly inflation reached 16.9% (below the government's forecast of 17.5% and the lowest level since 2015) and average inflation stood at 17.08%. This despite consumer prices being affected by (1) adjustments in some administered prices, including electricity tariffs, (2) the introduction of the VAT and (3) the sharp depreciation of the

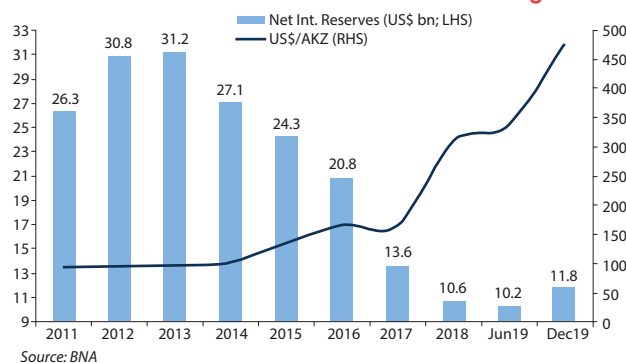
kwanza (36% in 2019 vs. 46% in the previous year).

Moreover, the measures introduced by the BNA in the foreign exchange market led to a significant improvement in the access to foreign currency by local market participants as well as a reduction in the differential between the kwanza exchange rate in the official and parallel markets. Specifically, this differential narrowed from a peak of 150% before the introduction of a new foreign exchange regime in January 2018 to around 23% in December 2019.

On the fiscal front, the years 2018 and 2019 marked an inflection point in terms of the budget deficit trajectory of the recent past as both the primary and total fiscal balances stood in positive territory. This notwithstanding, public debt levels continued to climb to nearly 90% of GDP (from below 40% in 2014 before the oil crisis commenced), standing well above the 60% level considered a reasonable threshold.

Angola's external position weakened relatively to 2018 on the back of lower oil prices and production, but remained in surplus, while international reserves saw a sharp increase towards the end of the year. This was due to the Eurobond issue of US\$ 3 billion in November, which lifted net reserves to close the year at US\$ 11.84 billion (+11.2% YoY), equivalent to about seven months of imports.

**Net International Reserves and Kwanza Exchange Rate**

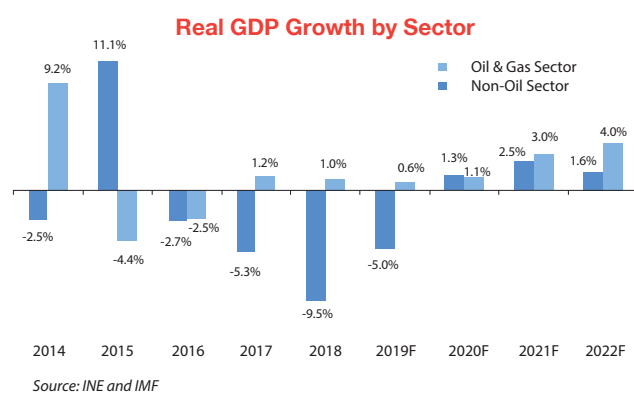


## Economic Outlook

Angola continues to face a challenging economic environment, as persistent oil price volatility coupled with the need to continue to adopt tight fiscal and monetary policies likely impact the country's growth trajectory in the foreseeable future. Economic activity is expected to gradually recover, neverthe-

less, albeit very modestly.

Real GDP growth is projected to stand at close to 1% this year and increase to 2.5%-3% in 2021-22. Activity in the oil and gas sector is expected to recoup from a very weak performance in the recent past while growth in the non-oil sector gradually advances at a faster pace. Higher growth in the non-oil sector is also likely to reflect the positive effects of greater exchange rate liberalization and, in part, the government’s structural reforms aimed at diversifying the local economy.



The government’s 2020 budget assumes that oil production will recover from the levels recorded in recent years based on the stabilization in the output from France’s Total oil project at the Kaombo Sul area, which is currently Angola’s biggest deep-water offshore development, and the start of production in other oil fields. Oil prices are also expected to average US\$ 55 (the same assumption as in the 2019 budget). This may prove to be on the conservative side bearing in mind current consensus forecasts for oil prices. The 2020 budget assumes a fiscal surplus of 1.2% and primary surplus of 7.1% of GDP, meaning that public accounts could be in positive territory for a third consecutive year.

Inflation is expected to increase to about 25% largely as a result of the gradual adjustment in fuel prices and the rapid depreciation of the kwanza. This goes against the government’s goal for inflation not to increase after 2018 and for consumer prices to gradually decline toward single-digits by end-2022.

Angola’s long-term growth outlook will depend on the implementation of structural reforms. These reforms will be very relevant in order to correct the imbalances that persist and also improve the business environment to attract more foreign direct investment to the country.

It is worth noting the new Private Investment Law introduced in June 2018 that establishes the guidelines for private investment. This law is applicable to all investments in the country and, contrary to the prior legislation, it does not include any minimum required amount or demand for a local partner. Incentives will be granted depending on the sectors that the investment is made (namely those activity sectors that contribute to import substitution, increase in exports and economic diversification) and its location.

The government also recently launched a Privatization Program (PROPRIV) that aims to restart activity in the private sector and reform public finances. In particular, the government plans to start the privatization of 195 entities/assets in the period 2019-22 through the stock market or a tender. The aims of the PROPRIV include (1) promoting macroeconomic stability, (2) improving the productivity of the local economy and (3) distributing in a more equitable manner the income of the country.

Moreover, the BNA introduced some key legislation aimed at increasing the amount of credit granted to investment projects that contribute directly and indirectly to the national production and, as a result, reduce the large import dependency. First, the central bank announced that the banks operating in Angola will have to grant credit specifically for these types of projects in an amount equivalent to 2% of their total assets (at the end of the previous year) at a total cost (interest plus commissions) no greater than 7.5%. And, second, the Credit Support Programme (PAC) for the period 2019-22 aims to make it easier to grant credit to the companies operating in the production and commercialization of 54 essential goods for the local population.

In sum, the Angolan authorities are expected to remain strongly committed to addressing existing imbalances, together with the assistance of the current IMF program. Economic diversification remains a key priority for the government in its strategic objective to gradually replace imports with local production. The evolution of economic activity will depend on the improvement in crude production and a faster expansion in the non-oil sector. The continued implementation of reforms to bolster business environment should help to improve activity in the non-oil sector, lowering Angola’s persistently high dependence on oil and reducing the risks to its economic outlook.