ANGOLA: TURNING THE CORNER IN 2019

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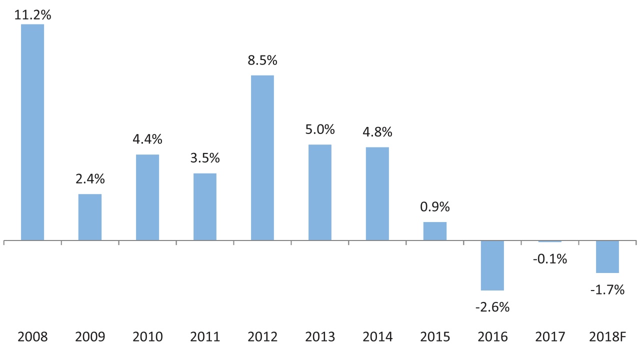
Economic Activity and Inflation

The Angolan economy likely contracted for a third straight year in 2018 mainly due to a sharp decline in oil and gas production that reflects recent underinvestment in the sector. The latest figures disclosed by the country's National Statistics Institute (INE) showed that real GDP fell by 2.7% in the first nine months of 2018 from a year earlier. The oil industry, which still represents over a third of the country's GDP, recorded a contraction of 8.7% while activity in the agriculture, manufacturing, construction and retail sectors all declined in the period until September.

Overall, current projections indicate that real GDP probably contracted 1.7% last year after falling 0.1% in 2017 and 2.6% in 2016. The existing downturn in activity also followed the freefall in oil prices since the second half of 2014 and has had major repercussions in the country's fiscal and external accounts, foreign exchange market and real economy.

REAL GDP GROWTH (2008-18F)

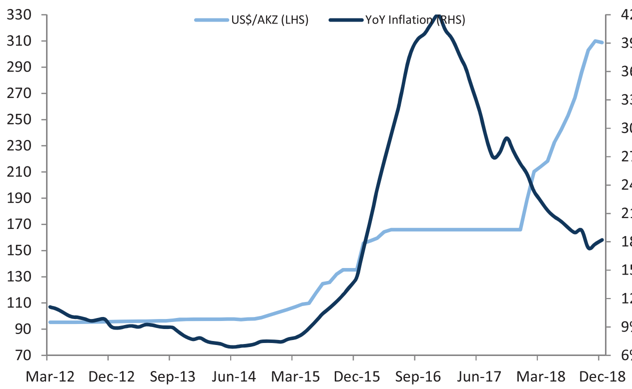


Sources: INE and IMF.

The INE also recently announced that annual inflation stood at 18.6% in December 2018, standing near the government's latest forecast of 18%, but clearly below its initial projection of 28.8% made in the 2018 budget proposal. This figure compares with 23.7% recorded in December 2017. Moreover, INE stated that the 12-month average inflation rate declined further to 19.6% last month (from 29.9% in December 2017).

Despite small increases in the last three months of 2018, the annual inflation rate has kept a downward trajectory from a peak above 40% at the end of 2016. We note that inflation reached multi-year highs at the time due to a gradual elimination of fuel subsidies and a significant depreciation of the kwanza. More recently, inflation levels have been more contained, reflecting for the most part a persistently tight monetary policy adopted by the central bank and the implementation of price control measures for some goods.

KWANZA EXCHANGE RATE AND ANNUAL INFLATION



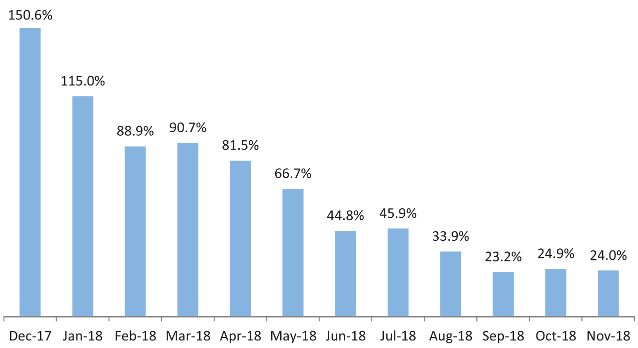
Sources: BNA and INE.

Monetary Policy and Exchange Rate

The Banco Nacional de Angola (BNA), the central bank, introduced a new foreign exchange regime in early-2018. It states that the kwanza will fluctuate within a range against the euro determined at central bank currency auctions and that the other exchange rates will result from how the euro trades against those currencies. The introduction of this new regime led to a sharp (but gradual) depreciation of the kwanza throughout 2018, with the local currency stabilizing later in the year at around 310 against the dollar and 355 against the euro. This corresponds to a depreciation of slightly more than 45% against both currencies from end-2017 levels.

Meanwhile, the gap in the exchange rate quoted in the parallel and official markets clearly diminished in recent months, narrowing from 150% at the end of 2017 (from a peak above 180%) to about 20-25% currently. This is due to the greater availability of foreign currency from the BNA and commercial banks as well as the lower demand for foreign currency under the new exchange rate regime. It is worth noting though that central bank data shows that the euro is the only foreign currency being sold at its weekly auctions since October 2016.

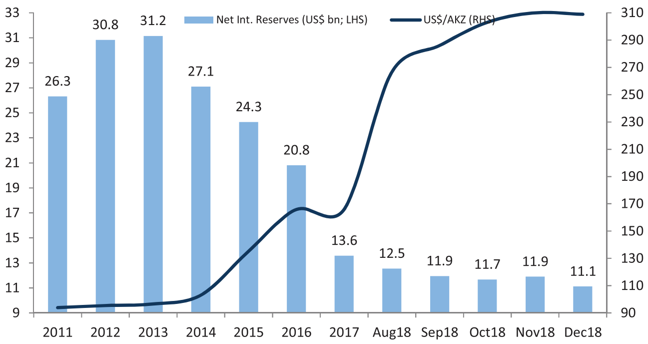
GAP FOR PARALLEL AND OFFICAL MARKETS (US$/AKZ)



Source: BNA.

In recent years, the BNA has had to intervene in the foreign exchange market in order to defend the kwanza. This has been reflected in the level of international reserves at the central bank, which fell from US$ 31.2 billion in 2013 (before the start of the oil crisis) to the current level of around US$ 11 billion.

NET FOREIGN RESERVES AND EXCHANGE RATE (US$/AKZ)

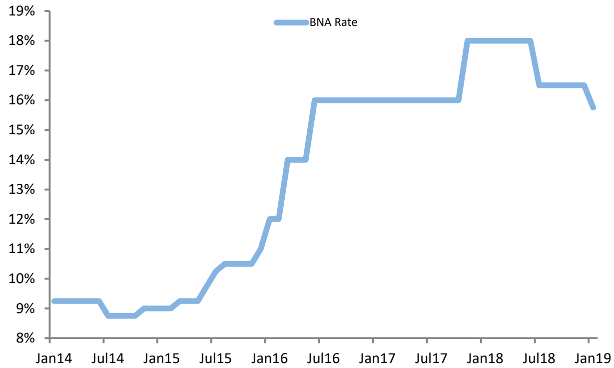


Source: BNA.

The BNA significantly tightened liquidity conditions and raised its reference rate by 925bps (in a total of ten rate increases) since the end of 2014 in order to contain the depreciation of the kwanza and its subsequent impact on inflation levels. As a result, the BNA rate peaked at 18%, a multi-year high, in November 2017. The BNA also increased the banks' mandatory reserve requirements in local currency three times since the end of 2014, lifting the required level from 15% to 30%.

Inflation levels have gradually receded, which allowed the central bank to lower interest rates by 150bps (to 16.5%) in July 2018. This was the first cut in interest rates in four years. The BNA also gradually lowered the reserve requirements in local currency from 30% to 17% currently, while reserve requirements in foreign currency remained unchanged at 15%. More recently, the central bank lowered the BNA rate once again by an additional 75bps to 15.75% in January, stating that this decision was due to inflation keeping a downward trajectory in 2018.

EVOLUTION OF THE BNA RATE



Source: BNA.

Fiscal Accounts

The Angolan government expects to reach a fiscal surplus of AKZ 175 billion (0.6% of GDP) in 2018, as a significantly larger than previously forecasted contribution from revenues more than offsets slightly higher expenditures in the period. The revised fiscal balance projection compares with an earlier forecast for a deficit of AKZ 805 billion (-3.4% of GDP) included in the initial budget proposal. If confirmed, it would be the first time since 2012 that Angola achieves a fiscal surplus.

The new revenue projection for 2018 assumes a much larger contribution from oil tax receipts (+62% deviation) than previously anticipated. This is due to a revised average oil price forecast of US$ 71.9 per barrel for 2018 (vs. US$ 50 initially projected) that followed a much better oil price evolution since the start of the year. This pricing effect is expected to more than offset the impact from lower oil production in the year, namely 1.52 million barrels per day (bpd) (vs. 1.70 million bpd expected earlier).

Prospects for 2019

The macroeconomic projections included in the government's 2019 budget proposal suggest that the economic recession of the past three years (2016-18) will end in 2019. The government fore-casts that real GDP will expand by 2.8% this year as the oil and gas sector recoups from a very weak

GOVERNMENT ACCOUNTS			
AKZ BILLION	2018 Budget	2018 Forecast	Forecast vs. Budget
Revenues	**4,404**	**5,625**	**27.7%**
% of GDP	*18.4%*	*19.9%*	
Tax Revenues	4,139	5,257	27.0%
Oil Revenues	2,399	3,886	62.0%
Non-oil Revenues	1,740	1,372	-21.2%
Of which: Income Taxes	834	834	0.0%
Non-tax Revenues	265	368	38.8%
Expenditures	**5,209**	**5,450**	**4.6%**
% of GDP	*21.8%*	*19.3%*	
Current Expenditures	4,230	4,370	3.3%
Wages	1,690	1,692	0.1%
Goods and Services	972	972	0.0%
Interests	968	1,182	22.1%
Transfers	600	524	-12.6%
Subsidies	225	0	-100.0%
Capital Expenditure	979	1,080	10.3%
Public Investment	939	939	0.0%
Primary Fiscal Balance	**164**	**1,357**	**729.6%**
% of GDP	*0.7%*	*4.8%*	
Overall Fiscal Balance	**-805**	**175**	**n.m.**
% of GDP	*-3.4%*	*0.6%*	

Sources: Angolan authorities and Eaglestone Securities.

BUDGET PROPOSAL 2019				
Macroeconomic Projections	2016	2017	2018 (1)	2019 (2)
Real GDP Growth	-2.6%	-0.1%	-1.1%	2.8%
- Oil and Gas	-2.7%	-5.3%	-8.2%	3.1%
Oil	-2.7%	-5.3%	-6.9%	3.0%
Gas	0.0%	0.0%	-25.4%	4.1%
- Non-oil	-2.5%	1.2%	1.0%	2.6%
Agriculture	1.8%	1.4%	3.1%	6.8%
Fishing	7.5%	-1.1%	1.3%	3.0%
Extractive Industry	0.0%	-0.8%	0.8%	15.5%
Manufacturing	11.6%	1.2%	0.1%	2.1%
Construction	2.5%	2.5%	2.1%	2.0%
Energy	8.8%	-1.7%	30.0%	0.0%
Commerce	-5.2%	1.5%	1.0%	1.4%
Other	-16.5%	0.3%	2.0%	2.0%
Inflation	41.1%	23.7%	18.0%	15.0%
Daily Oil Production (MBbl)	1.726	1.637	1.524	1.570
Average Oil Price (US$/Bbl)	40.9	53.9	71.9	68.0

(1) Forecast; (2) Budget Proposal. Source: Angolan authorities.

performance in the recent past and activity in the non-oil sector advances a slightly faster pace. The budget proposal also assumes that average daily oil production will increase to 1.570 million barrels (from a revised estimate of 1.524 million bpd in 2018) and that oil prices will average US$68. Meanwhile, inflation is expected to continue its downward trend and reach 15% in the period. Consumer prices are expected to remain contained due to a persistently tight monetary policy followed by the BNA and also some stabilization in the kwanza exchange rate.

Angola recently secured a three-year arrangement with the IMF under an Extended Fund Facility. The program mainly aims to (1) support the implementation of the government's reform plan, (2) help restore external and fiscal sustainability and (3) promote economic diversification. It also consists of a financial aid package of US$ 3.7 billion for the three years, with US$ 990.7 million to be immediately made available. The program's key policy commitments include (1) the implementation of fiscal consolidation measures, (2) the liberalization of the exchange rate regime, (3) strengthening the local financial sector and (4) improving governance and business environment.

The IMF program is expected to help the Angolan economy recover in the next three years. Current IMF projections point to real GDP growth of 2.5% this year and 3.2% in 2020-21, more in line with population growth in the country. An improvement in activity in the oil sector, as new oil fields come on stream, is expected to boost GDP growth, while the implementation of reforms to bolster business environment should lead to a stronger pickup in activity in the non-oil sector. A combination of tighter monetary and fiscal policies is expected to help keep inflation levels on a downward trajectory. However, monetary policy should also remain supportive of much needed economic growth. On the fiscal front, a continued retrenchment will help reduce the public debt burden from above 90% of GDP in 2018 to a level more in line with the 65% target during the forecast period.

Together with the assistance of the current IMF program, the Angolan authorities are expected to remain highly committed to addressing the country's imbalances built in recent years. A Macroeconomic Stabilization Program has helped strengthen fiscal accounts, lower inflation, reduce distortions in the foreign exchange market and is also expected to improve financial sector stability. At the same time, the government hopes the implementation of a National Development Plan for 2018-22 aimed at tackling structural bottlenecks and promoting economic diversification and inclusive growth will help the economy exit this prolonged recession. It remains to be seen if 2019 will be the year when Angolan turns the corner and economic growth returns.

Contributor's Profile

Tiago Dionisio is Chief Economist at Eaglestone since 2013 where he covers Portuguese- speaking countries in Africa such as Angola and Mozambique both as a macro and banking sector research analyst. He has over 17 years' experience in investment banking, namely at Portugal's 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 BPI and ESIB. 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.