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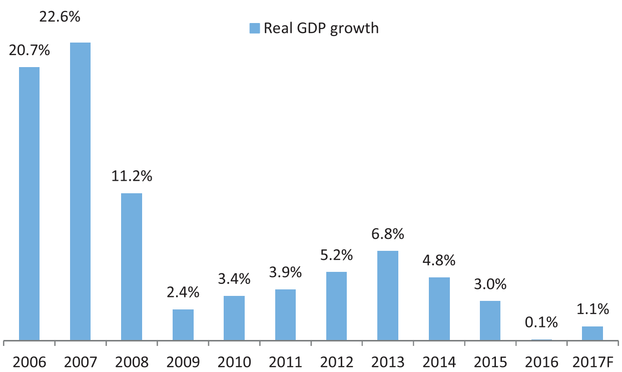
ANGOLA: THE BEGINNING OF A NEW CHAPTER

By **Tiago Dionisio,** Chief Economist, Eaglestone Advisory

Economic activity in Angola has decelerated markedly since the second half of 2014 mainly as a result of the significant decline in oil prices during this period. The freefall in oil prices (from a peak above US$ 110 in early-2014 to as low as US$ 28 in 1Q2016) had major implications in the country's fiscal and external accounts, foreign exchange market and the real economy. Real GDP growth stood at only 4.8% in 2014, 3% in 2015 and stagnated to 0.1% in 2016. This is well below the 6.8% in 2013 and the double-digit growth average recorded in the previous decade.



Source: Angolan authorities and IMF

Specifically, the oil price shock had a major impact on: (1) oil related exports and fiscal receipts, with the latter falling almost 30% since 2014; (2) inflation, which in 2016 surged to levels unseen since 2004 and has reduced the purchasing power of a large part of the local population; (3) foreign exchange market, as a lower availability of foreign currency led to a devaluation of the kwanza and a widening of the gap between the exchange rates in the official and parallel markets; (4) net international reserves, which have kept a downward trend since 2014; and (5) liquidity, leading to higher interest rates that have impacted debt service levels and hurt private investment.

The Angolan authorities have implemented several measures in recent years, both on the fiscal and monetary fronts, in order to try to attenuate the impact of sharply lower oil prices. On the fiscal front, the government lowered spending levels, namely capital expenditures (down nearly 45% in the period 2014-17), and gradually reduced the level of subsidies, eliminating fuel subsidies almost entirely. It also introduced programs to re-register public sector employees as well as to improve tax collection. On the monetary front, the central bank adjusted the foreign exchange rate, allowing the kwanza to depreciate by nearly 70% during 2014-16. The BNA intervened in the foreign exchange market in order to defend the local currency and help stabilize the kwanza, but not without sacrificing the level of reserves, which have fallen almost 50% since 2014 (to US$ 14 billion at end-2017). The central bank also raised the BNA rate nine times (a combined 900bps) since end-2014, lifting its benchmark rate to a multi-year high of 18%. Moreover, the BNA raised restrictions on hard foreign currency supplied to commercial banks, which led to a widening of the gap between the official exchange rate and the parallel market rate. The unofficial rate reached a level above 600 kwanzas to the dollar in 2016 and a spread of over 180% to the official rate (the kwanza currently trades at around 450 to the dollar on the streets).

On the political front, José Eduardo dos Santos' last term in office ended at the end of September 2017 after he was president of Angola for nearly four decades. Mr. dos Santos remains the head of the ruling MPLA party for now. The new president, João Lourenço, hopes to change Angola's fortunes and quickly address its more acute challenges, including (1) reaching economic stability, (2) relaunching vigorous economic growth to create more jobs and (3) mitigating the more pressing social problems. Since taking office, Mr. Lourenço replaced the heads of the central bank, Sonangol, Endiama (the government-backed diamond company), the boards of all three state-run media companies and, more recently, the head of the country's sovereign wealth fund. The new president's greater than anticipated appetite for reform could face some headwinds this year, but for now it has been generally well received at home and abroad.

The new government believes that economic activity will improve significantly in 2018 from the performance in recent years. Its real GDP growth forecast of 4.9% incorporated in the budget proposal recently presented to the country's parliament is broken down by projections of 6.1% for the oil sector and 4.4% for the non-oil sector. This compares with estimates of -0.5% and 1.9%, respectively, for 2017 and overall real GDP growth of 1.1% last year. The 4.4% growth forecast for the non-oil sector incorporates a 5.9% expansion in agriculture, 4.3% in commerce, 3.1% in construction, 1.8% in manufacturing, 4.4% in extractive industry and 60.6% in energy.

We believe the growth forecasts for 2018 are likely to be somewhat optimistic bearing in mind Angola's current macroeconomic situation and immediate challenges. The growth outlook in the longer-term will depend on the commitment to implement major structural reforms in the country. These will be fundamental to a rebalancing of the local economy away from its dependence on the oil sector and also improve the business environment in order to attract higher foreign investment in the country.

Besides the acute challenges aforementioned, the local authorities will be faced this year with (1) the need to implement additional fiscal consolidation measures, (2) a persistently tight monetary policy stance and (3) the likely impact of further adjustments to the newly announced exchange rate regime. On the latter, we note that this new mechanism states that the kwanza will fluctuate within a range against the euro determined at central bank currency auctions, with the other rates resulting from how the euro trades against those currencies. At the first auction in early-2018, the kwanza depreciated roughly 10% against the dollar, but a stronger euro expected this year would put further pressure on the dollar/kwanza rate.

Meanwhile, consumer price inflation is expected to remain elevated in 2018 after peaking at 42% in late 2016 and gradually declining to an estimated 23% last year. This assumption comes despite significantly tighter monetary and fiscal policies as well as the implementation of several measures aimed at combating inflation, including the introduction of price controls and the replacement of the supply of some essential goods. A new customs tariff regime due to come into effect is also expected to lower import duties on a number of food and other items. That said, the government's 28.7% inflation forecast likely incorporates the impact from the adjustment(s) to the kwanza exchange rate in 2018, which will push up the prices of imported goods.

MACRO FORECASTS

	2013	2014	2015	2016	2017 (1)	2017 (2)	2018 (1)
Inflation	7.7%	7.5%	14.3%	42.0%	15.8%	22.9%	28.7%
Annual oil production (mn barrels)	626.3	610.2	648.5	611.2	664.7	610.6	620.2
Daily oil production (million bpd)	1.716	1.672	1.777	1.675	1.821	1.673	1.699
Average oil price (US$ per barrel)	107.7	96.9	53.7	41.8	46.0	48.4	50.0
Gross domestic product:							
Nominal value (AKZ billion)	12,056	12,462	12,321	16,662	19,746	18,350	23,872
Oil sector	4,818	4,304	2,884	3,149	3,753	3,573	5,017
% of total	40.0%	34.5%	23.4%	18.9%	19.0%	19.5%	21.0%
Non-oil sector	7,239	8,158	9,436	13,513	15,993	14,778	18,855
% of total	60.0%	65.5%	76.6%	81.1%	81.0%	80.5%	79.0%
Real GDP growth	6.8%	4.8%	3.0%	0.1%	2.1%	1.1%	4.9%
Oil sector	-0.9%	-2.6%	6.3%	-2.3%	1.8%	-0.5%	6.1%
Non-oil sector	10.9%	8.2%	1.5%	1.2%	2.3%	1.9%	4.4%
Exchange rate (US$/AKZ)	96.6	98.3	120.1	164.0	165.9	165.9	-

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

On the fiscal front, the government anticipates in this year's budget proposal that a significant improvement in oil-related receipts (40.9% YoY), boosted by slightly higher oil prices and production, will help to reduce the fiscal deficit further in 2018. The current budget proposal foresees average daily oil production increasing 1.5% to 1.699 million barrels per day while the oil price is expected to average US$ 50, slightly higher than the US$ 48.4 in 2017. We believe this oil price assumption is rather conservative, standing at the bottom-end of current consensus estimates for Brent crude oil. Non-oil revenues are also projected to see a (likely optimistic) rise of 39.9% YoY, reflecting the continued efforts by the local authorities to improve tax collection outside of the oil sector. In terms of expenditures, it is worth noting the surge in interest payments (36.2% YoY and double the amount projected in 2017), which come as a result of the large increase in debt levels in recent years. Indeed, public debt represented less than 30% of GDP in 2013, but rapidly surpassed 70% of GDP in 2016. As a result, spending on interest payments is expected to represent 18.9% of total spending and 4.1% of GDP (vs. 2.8% and 1.2%, respectively, in 2014). Overall, the 2018 budget proposal foresees a deficit of 3% of GDP (down from an estimated 5.3% of GDP in 2017). It is also worth noting that the primary fiscal balance (which excludes interest payments) is projected to reach a surplus for the first time since 2013. This is an ambitious target aimed at continuing the fiscal consolidation efforts of the Angolan authorities that will ideally place public debt back on a downward trajectory and below the debt ceiling of 60% of GDP.

GOVERNMENT ACCOUNTS

AKZ BILLION	2012	2013	2014	2015	2016	2017 (1)	2017 (2)	2018 (1)	Change 2018 (1) / 2017 (1)	Change 2018 (1) / 2017 (2)
Revenues	**5,054**	**4,849**	**4,403**	**3,367**	**2,900**	**3,668**	**3,254**	**4,404**	**20.1%**	**35.4%**
% of GDP	*46.5%*	*40.2%*	*35.3%*	*27.3%*	*17.4%*	*18.6%*	*17.7%*	*18.4%*		
Tax Revenues	4,826	4,602	4,098	3,042	2,599	3,404	2,947	4,139	21.6%	40.5%
Oil Revenues	4,103	3,630	2,970	1,898	1,373	1,696	1,703	2,399	41.5%	40.9%
% of Total Tax Revenues	*85.0%*	*78.9%*	*72.5%*	*62.4%*	*52.8%*	*49.8%*	*57.8%*	*58.0%*		
Non-oil Revenues	723	972	1,128	1,144	1,227	1,709	1,244	1,740	1.8%	39.9%
Of which: Income Taxes	325	502	545	664	720	862	697	834	-3.3%	19.6%
Non-tax Revenues	228	247	305	325	301	264	307	265	0.5%	-13.7%
Expenditures	**4,329**	**4,816**	**5,221**	**3,774**	**3,648**	**4,808**	**4,222**	**5,129**	**6.7%**	**21.5%**
% of GDP	*39.8%*	*39.9%*	*41.9%*	*30.6%*	*21.9%*	*24.3%*	*23.0%*	*21.5%*		
Current Expenditures	3,184	3,437	3,666	3,038	3,003	3,813	3,373	4,190	9.9%	24.2%
Wages	1,031	1,155	1,319	1,390	1,397	1,614	1,493	1,647	2.1%	10.3%
Goods and Services	1,297	1,228	1,249	787	624	1,035	718	975	-5.8%	35.6%
Interests	105	99	147	249	470	484	711	968	100.0%	36.2%
Transfers	752	955	950	612	512	680	451	600	-11.8%	33.0%
Subsidies	548	710	668	279	161	292	112	225	-22.9%	100.4%
Capital Expenditure	1,145	1,379	1,555	736	645	995	849	939	-5.6%	10.6%
Public Investment	1,145	1,376	1,547	719	634	995	839	939	-5.6%	11.9%
Primary Fiscal Balance	**830**	**131**	**-672**	**-159**	**-278**	**-656**	**-258**	**244**	**n.m.**	**n.m.**
% of GDP	*7.6%*	*1.1%*	*-5.4%*	*-1.3%*	*-1.7%*	*-3.3%*	*-1.4%*	*1.0%*		
Overall Fiscal Balance	**725**	**32**	**-819**	**-407**	**-748**	**-1,140**	**-968**	**-725**	**-36.4%**	**-25.2%**
% of GDP	*6.7%*	*0.3%*	*-6.6%*	*-3.3%*	*-4.5%*	*-5.8%*	*-5.3%*	*-3.0%*		

(1) Budget Proposal; (2) Forecast. Sources: Angolan authorities and Eaglestone Securities.

The government is likely to give high priority to continuing to consolidate relations with key strategic partners (like China and Portuguese-speaking countries) and to diversifying the country's access to international finance. There are increasing talks about a new Eurobond deal reaching as much as US$ 2 billion taking place as early as 1Q2018. Moreover, the government confirmed last October that it was looking at a new IMF program, although it had not yet been decided if it would include financial assistance. The new president also seems to be looking to increase Angola's regional presence and economic links with Africa, as recently demonstrated by the lifting of visa restrictions with South Africa on traveling between both countries.

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.