Angola: State Budget expects a 5.8% budget deficit in 2017

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EXPECTATIONS ARE THAT AN INCREASE IN SPENDING IS COMPENSATED BY NOMINAL GROWTH

The Angolan economic situation is now very fragile, with high frequency economic data pointing towards further worsening in comparison with 2015. The decrease in imports mirrors the economic decline since 2014 (a reduction of around 60% in economic activity), being likely that this adjustment period has not ended yet.

Angola's fiscal strategy for next year will imply a relatively large deficit (5.8% of the GDP), although the Government has expressed its will to contain spending further (namely in investment) if this is deemed necessary to sustain the solidity of the public accounts. We highlight also the Government's aim to stimulate the economy, always restricted by a balanced path for public finances and public debt.

Despite the still considerable level of international reserves held by Angola, its clear negative trend could trigger the need of further devaluation of the Kwanza. Yet, it is likely that this pressure is less severe if the scenario of higher oil prices (due to the OPEC & non-OPEC deal) is confirmed.

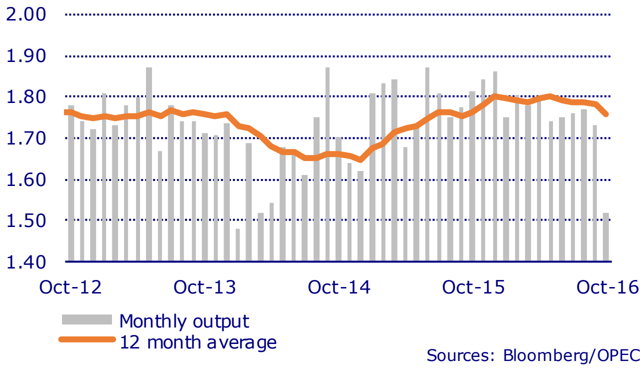
1. Data shows further economic deterioration during 2016

▫ **While actual GDP data are still lacking (the latest official data regards the year of 2013), various economic indicators are pointing towards an economy which is either stagnated or possibly in an actual recession, both in the oil sector as in other industries.**

▫ **In this scenario of low prices, oil output (which accounts for almost all of Angolan exports) is still relatively modest.** On the one hand, until October, 2016 has seen output growth in comparison with the previous year, as seen in monthly output numbers reported by the Angolan authorities. Notwithstanding, such growth is limited: a weaker performance in the second half of the year is likely to make average output stay at a similar magnitude to the output in 2015, and below the Executive's revised prediction of 1.79 million barrels per day (mbd). Yet, the largest impact to the country is in the effect of the low price per barrel in oil revenues, and which were 26.4% below the previous year until October.

Oil output

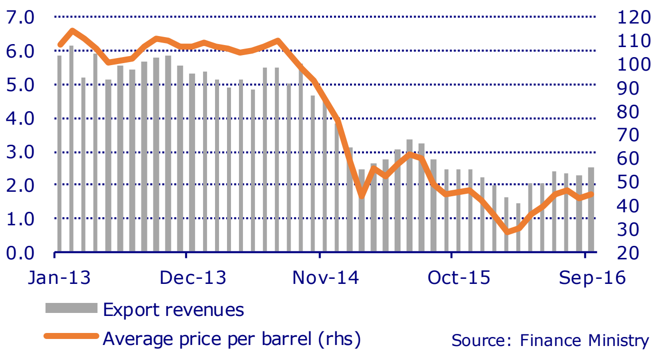
million barrels per day



Sources: Bloomberg/OPEC

Oil revenues

% of the GDP



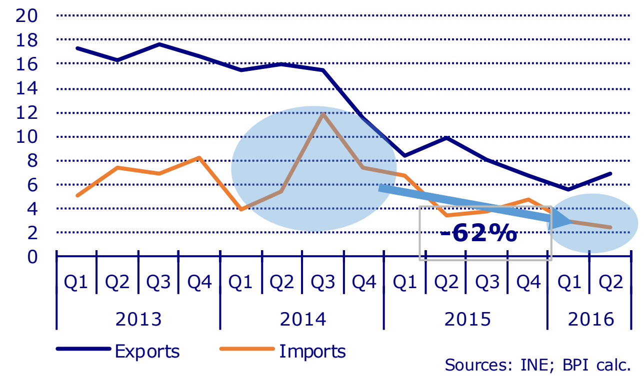
Source: Finance Ministry

▫ **On its turn, the lower revenues are decisively impacting on the performance of the non-oil economy.** The lack of public revenues is being reflected on a lower spending capacity by the part of the Government, shrinking the aggregate demand through multiple channels. On the other hand, the scarcity of foreign currency (which is partially caused by the maintenance of the exchange rate at artificially high levels) is posing challenges to the payment of imports, whether these are related to consumption, raw materials, or investment.

▫ **The influence of these factors should reflect in the behavior of private consumption.** International trade data shows a clear tumble in imports, across various sectors. As seen in the figure below, **the level of imports is now at a minimum,** with food imports decreasing 47.3% yoy in the first half of 2016. Fuel imports, on the other hand, decreased 56.5% in the same period, while other imports declined 55.9%. Taking into account the cumulative value of imports, and using these as a proxy for the behavior of the internal demand, the data point at a decline in economic activity of more than 60% in about 3 years, in a phenomenon likely to have prolonged itself in the rest of 2016. Other indicators, like credit growth and money growth, by being clearly below inflation levels, are also a hint that the Angolan economy could well be in a recession, particularly in the second half of the year.

International trade

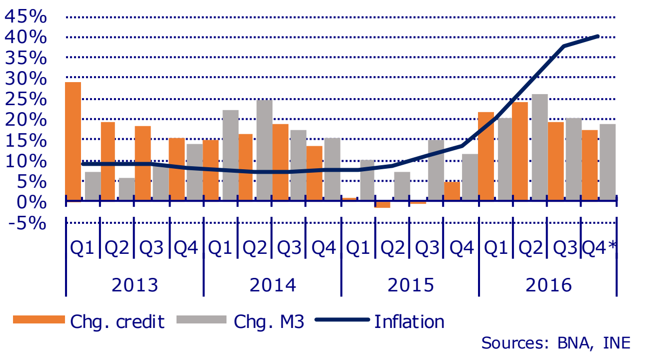
USD billion



Sources: INE; BPI calc.

Inflation, credit, and money growth

% yoy



Sources: BNA, INE
*October value only

2. Fiscal strategy relies on a large budget deficit, containing investment if necessary

- **As expressed in USD, the Executive is expecting a 5.5% increase in revenues, while spending should rise 7.5%, countering the decreasing trend in these variables, present until 2016. Nevertheless, the increase in the nominal GDP (largely due to the still high inflation to persist in 2017) will mean that these rises will translate into relative drops in revenue and expenditure, as expressed in terms of the country's GDP – thus, the budget deficit will actually be 0.1 percentage points lower, at 5.8% of the GDP.**

- **In terms of revenue, we highlight the prediction of oil revenues, where an absolute increase is expected for the first time in the last few years.** A rise of 10.7% is expected, a number which will however, still mean a slight decrease of oil revenues as percentage of the GDP, from 9.1% to 8.6%. The same behavior is expected of non-oil taxes, although the past performance of these is much less negative, when accounted in USD. Furthermore, if the Government predictions for 2016 and 2017 regarding taxes are correct, for the first time non-oil taxes will account for a larger share of revenue than oil taxes, albeit only slightly more.

- **Regarding expenditure, the most remarkable feature of this State Budget is the 22.4% increase in purchases of goods and services, which is the only component in spending whose share of the GDP will increase in 2017 – which is a likely indicator of a will by the Executive of propping up the private part of the economy.** This should be read together with the fact that General Elections will occur in 2017, an event which will (both directly and indirectly) lead to higher public spending. Money spent on debt interest payments is another component of spending also rising significantly, already representing about 2.5% of the GDP – it should be noted that these expenses have almost doubled in comparison with 2014, when expressed in USD.

- **Other expenses should remain at similar levels in absolute value. Also, part of this remaining expenditure, particularly investment spending, should be dependent on the actual financing funds available.** Capital spending should increase 3.8%, lingering still at significantly depressed values, when comparing with 2014, for example: the amount to be spent in 2017 is about 1/3 of what was invested in that year. Moreover, the Government explicitly states that the "capacity to take in external disbursements" could restrict the pace of execution of some expenses, a strategy already put in practice in the first half of 2016 with public investment spending, at the time as a way to reinforce the reliability of Angolan public finances.

- **Another important issue to consider is the actual reliability of the Government's predictions in terms of revenues and expenditures.** In the recent past, and for several times, the actual execution of the Budget has differed significantly from the predictions. Also, this fact has been true not only in the years where oil revenues have been low, but also in other years, with more "standard" conditions. For example, the Government had predicted in 2013 a budget deficit of 3.8%, while the actual execution saw a 0.3% surplus, due to an excess in revenues and fewer spending than expected in the State Budget for that year. In fact, between 2010 and 2015, there was only one year (2014) when the budget balance was worse than initially, when expressed in percentage of the GDP. **Even in the previous year of general elections (2012), where spending was significantly**

State Budget

	2014	2015 Prel.	2016 ASB	2017 SB	Change %	2016 ASB	2017 SB
		(million USD)			(%)	(% of the GDP)	
Revenue	**44.79**	**28.15**	**20.98**	**22.13**	**5.5%**	**20.6**	**18.6**
Current revenue	44.78	28.15	20.98	22.13	5.5%	20.6	18.6
Taxes	41.69	25.44	18.62	20.54	10.4%	18.3	17.2
Oil taxes	30.21	15.80	9.24	10.24	10.7%	9.1	8.6
from which: Sonangol revenue	20.28	10.87	5.83	7.34	26.0%	5.7	6.2
Non-oil taxes	11.48	9.64	9.37	10.31	10.0%	9.2	8.7
Social contributions	0.88	1.25	0.92	1.04	13.3%	0.9	0.9
Donations	0.02	0.01	0.00	0.00	-	0.0	0.0
Other revenue	2.19	1.44	1.44	0.55	-62.0%	1.4	0.5
Capital revenue	0.01	0.01	0.00	0.00	-	0.0	0.0
Expenditure	**53.12**	**32.12**	**27.00**	**29.01**	**7.5%**	**26.6**	**24.3**
Current expenditure	37.30	25.35	21.21	23.01	8.5%	20.9	19.3
Wages	13.42	11.58	9.41	9.74	3.5%	9.3	8.2
Goods and services	12.69	6.48	5.10	6.24	22.4%	5.0	5.2
Interest	1.52	2.07	2.66	2.92	9.9%	2.6	2.5
Current transfers	9.67	5.60	4.04	4.10	1.5%	4.0	3.4
Capital expenditure	15.82	6.77	5.79	6.00	3.8%	5.7	5.0
Current fiscal balance	**7.48**	**2.79**	**-0.23**	**-0.88**		**-0.2**	**-0.7**
Primary balance	**-6.81**	**-1.90**	**-3.36**	**-3.96**		**-3.3**	**-3.3**
Budget balance	**-8.34**	**-3.97**	**-6.02**	**-6.88**		**-5.9**	**-5.8**
in % of the GDP	**-6.6%**	**-3.9%**	**-5.9%**	**-5.8%**			
Non-oil budget balance	**-38.55**	**-19.77**	**-15.26**	**-17.11**		**-15.0**	**-14.4**
Exchange rate (USD/AOA)	**98.3**	**120.1**	**166.1**	**165.7**			
Oil prices (USD/barrel)	**96.9**	**50.0**	**40.9**	**46.0**			

larger than expected, this was compensated by higher oil revenues than predicted in the Budget. The fiscal stance in the first half of 2016 was another token of this fiscal prudence, where the need to strengthen the credibility of the Angolan public finances (with oil prices at historical minima) drove the execution rate of expenditure down to 28% of the planned expenses for the whole year in the State Budget for 2016.

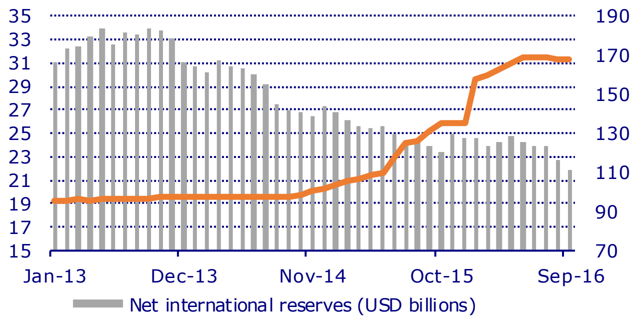
3. The drop in international reserves could put pressure in the current exchange rate

▫ **Despite the maintenance of the exchange rate at a fairly artificial level (in relation to the implicit rate seen in parallel markets), the Government has managed to keep international reserves at a relatively safe level. Still, the decreasing trend seen in the last few months is worrying and could lead to a scenario where devaluation is inevitable.**

▫ **Between June 2015 and April 2016, net international reserves have been kept around USD 24 billion.** However, these have been gradually decreasing since May this year, putting the October reserves at USD 21 billion, which account for around 7 months of imports of goods and services, a number mentioned by the Angolan authorities as a benchmark for stability. Although this ratio is still well above the 3 months typically considered by the IMF as the threshold of sustainability for emerging economies, the permanence of this decrease that started in May (since the last devaluation) would mean that it would only take one year and a half to reach such level (assuming that

Exchange rate and international reserves

USD billions; USD



Source: BNA

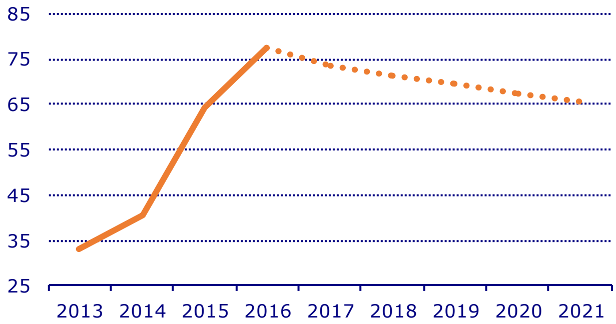
imports of goods and services remain at the current amount, which is very low). Thus, a continued decline could press the authorities into further moves in the exchange rate.

- **Still, the Angolan intention is to keep with the current foreign exchange level, as pointed in the last monetary policy meeting by the BNA (where there were no monetary policy changes).** Other than that, the recent oil output reduction deal by both OPEC and non-OPEC member should, with its price-rising effects, support this strategy, as the level of reserves will certainly benefit from a scenario of higher oil prices. Surely, even if there is the need to devaluate, this will not take place until the inflationary pressures are weaker (an already ongoing process).

- **Additionally, one should note the current level of public debt, which, according to the IMF, will end 2016 above 75% of the GDP (including Sonangol debt).** This is surely a risky rate of public debt for a country like Angola, a fact clearly shown by the very gradual decrease predicted by the Fund, most likely due to the proportion of interest payments in total spending in the future.

Public debt

% of the GDP



Source: FMI

- **Thus, both the fiscal and economic future of the country will be highly dependent of the evolution of oil prices: if the recent rise is sustained and translates into average oil prices above USD 60 in 2017, the whole scenario is more positive and the stability of the exchange rate is more likely.** We do, however, still believe that even with those prices in international oil markets, the seriousness of the Angolan economic situation will necessary imply some relief, and part of it could come from a weaker Kwanza.

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