Angola
Economic Perspectives and Report on 2nd PPM

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All data taken from published sources: BNA and MinFin websites, 2014 budget document and IMF staff reports.

Outline

Reminders

External Environment

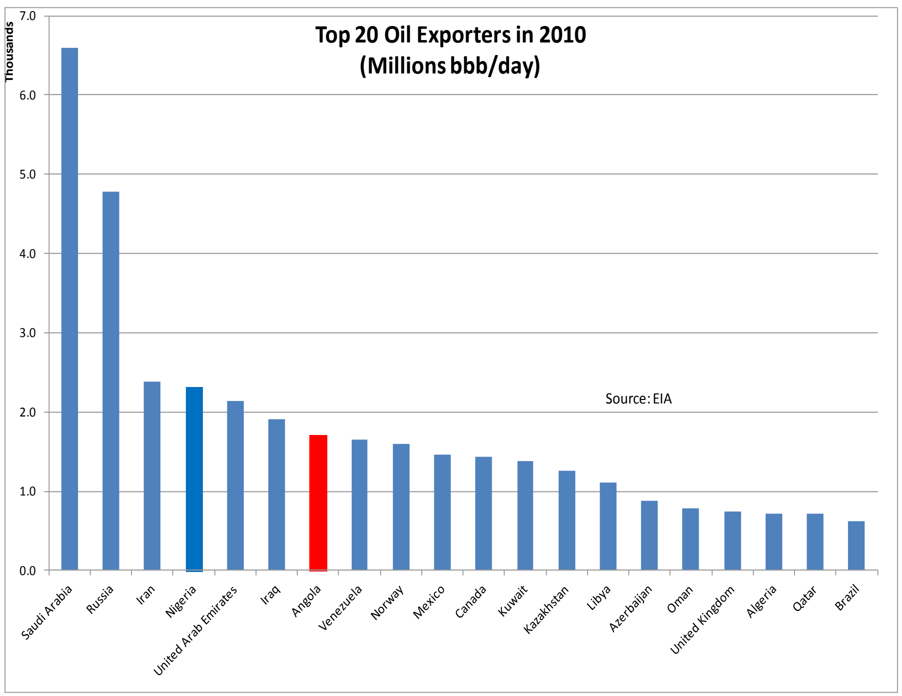
Output and Prices

Fiscal

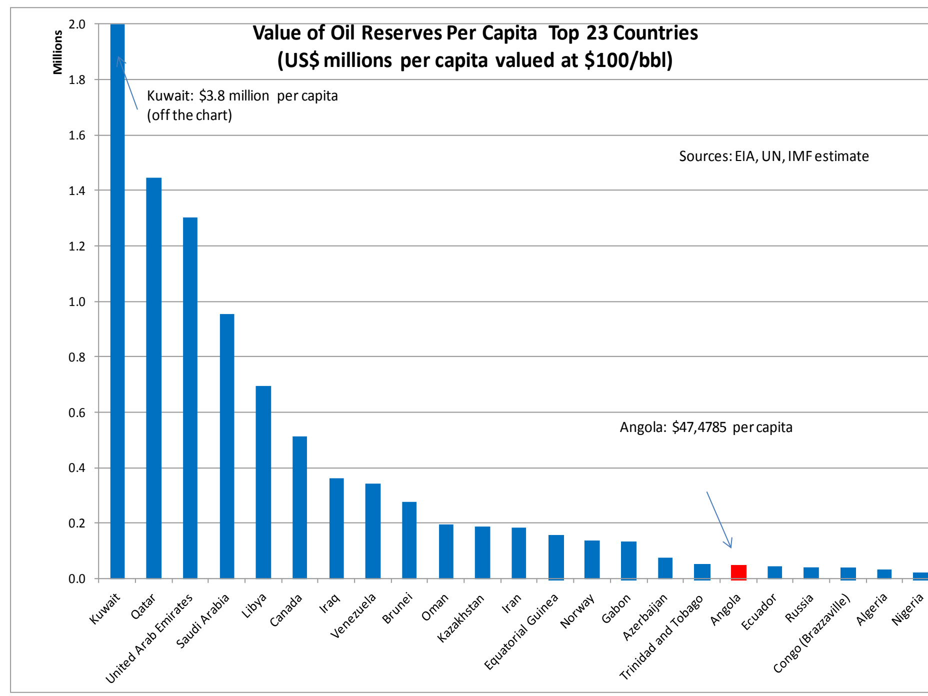
Monetary

Reminder: Angola is not rich

Angola is a major oil producer…..



……but per capita oil wealth is low



Reminder: Angola's policy challenges

Angola is a post-conflict country that produces a lot of oil
It faces the challenges of both

Save and invest for the future

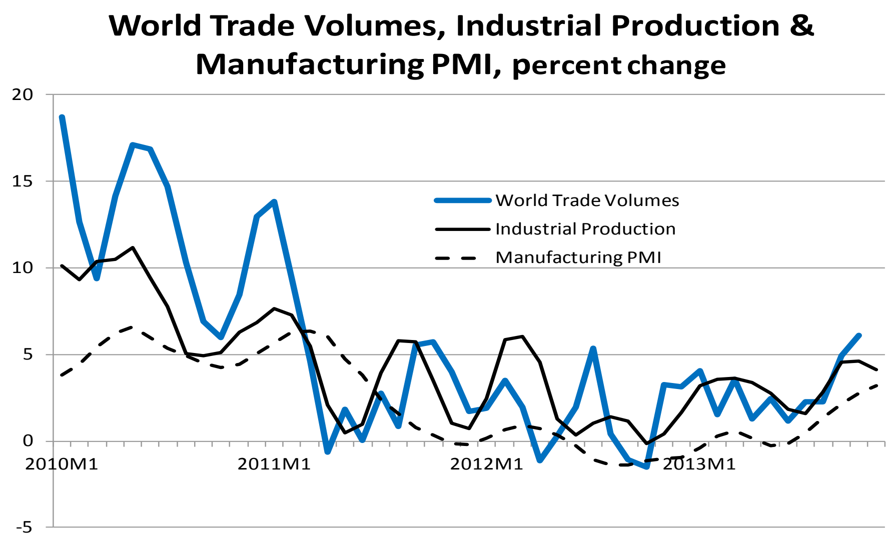
Reduce volatility from oil sector

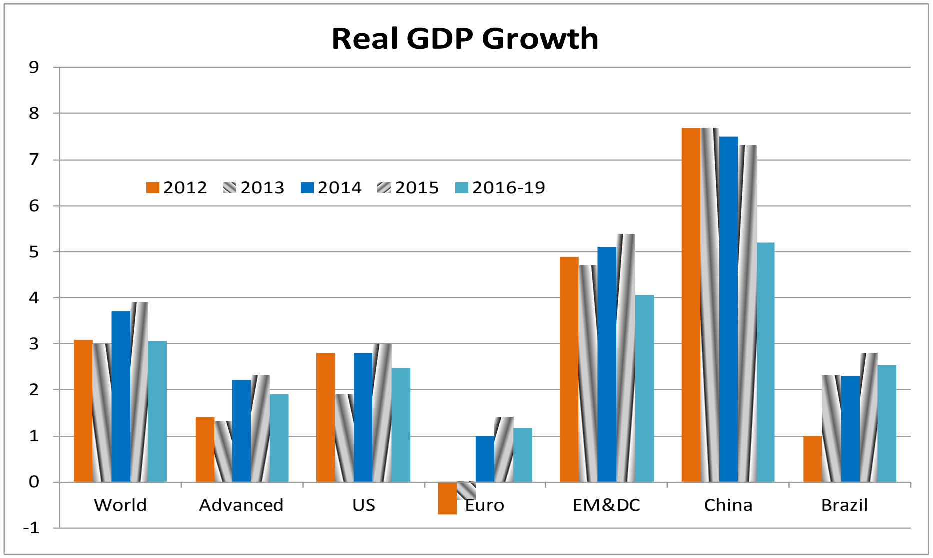
Public expenditure and financial management

Diversification and inclusive growth

External environment
WEO Update, Jan 2014

Is the tide rising?





Trade volumes, ind.prod. & manuf. Indices now rising. Is the tide turning?

World growth strengthening in 2014 and 2015, esp. AEs. Growth for 2014 revised upwards from WEO Oct 2013

Solid US recovery supported by budget agreement but cuts postponed to FY15. Monetary policy tightening?

Euro area recovery fragile because of debt and financial difficulties.

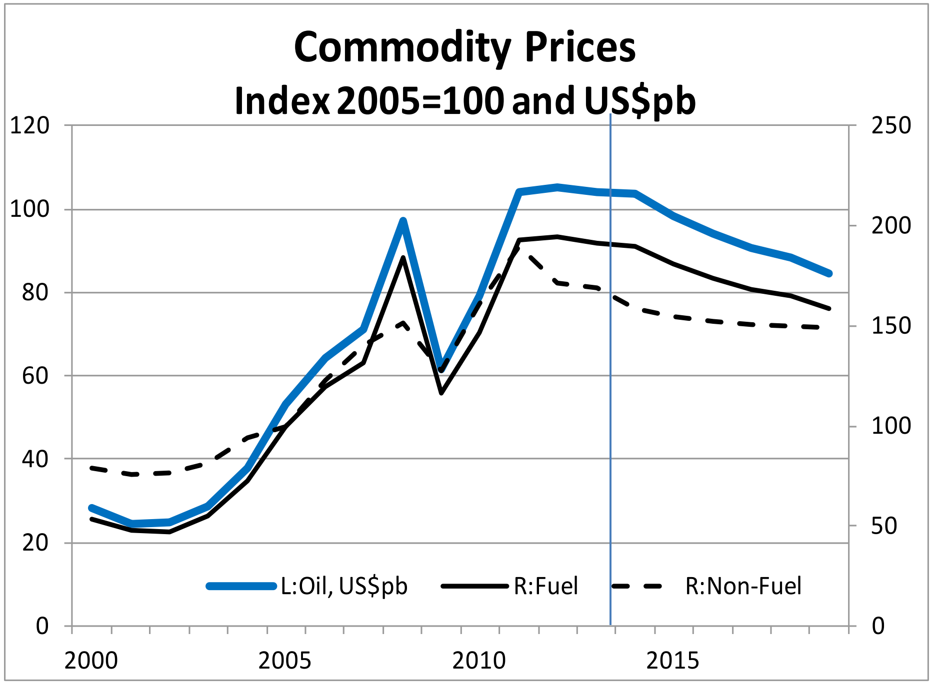
EM&DCs will benefit from recovery in AEs but fragile, especially China.

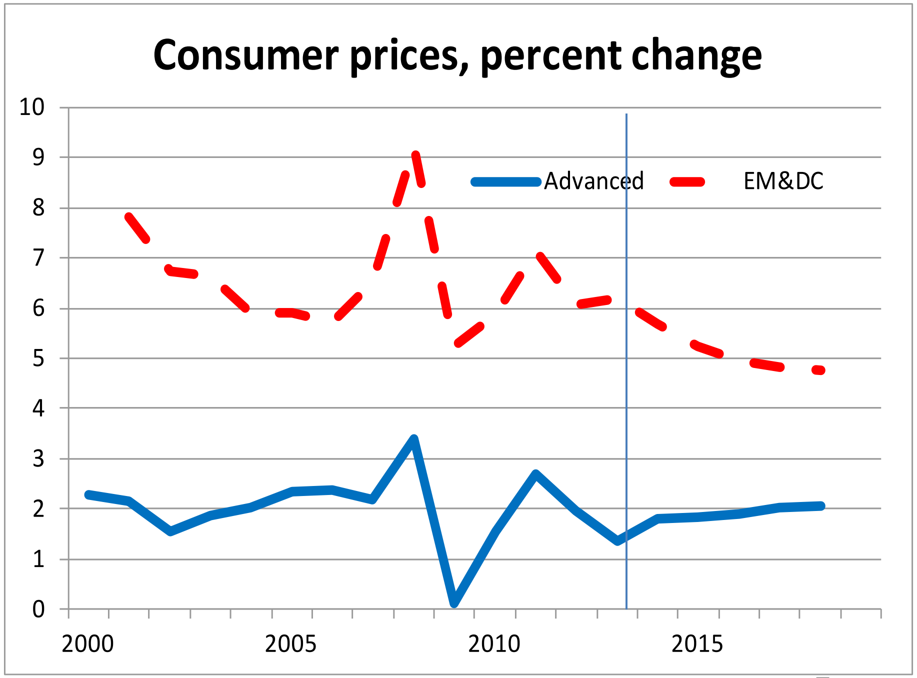
Commodity prices and inflation

Commodity prices – both fuel and non-fuel (including food) - expected to weaken (subject to developments in Ukraine).

APSP oil price pb: 2013 $104; 2014 US$99; 2015 $94; then down towards US$80 in medium term.

Inflation expected to pick up in AEs (US) towards 2 percent, but danger of deflation in Euro area. Weakening inflation in EMs&DCs converging towards 5 percent

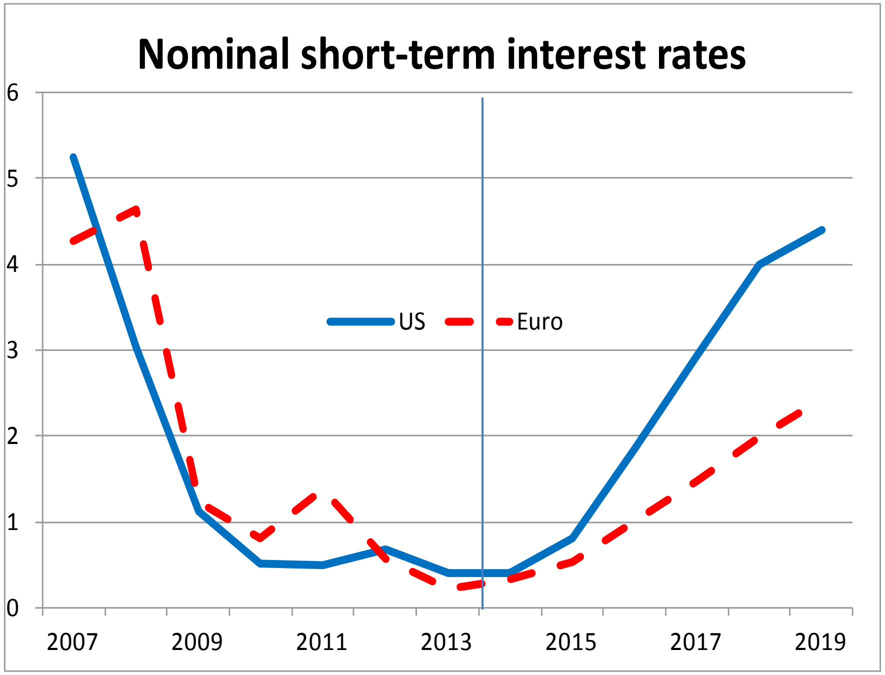


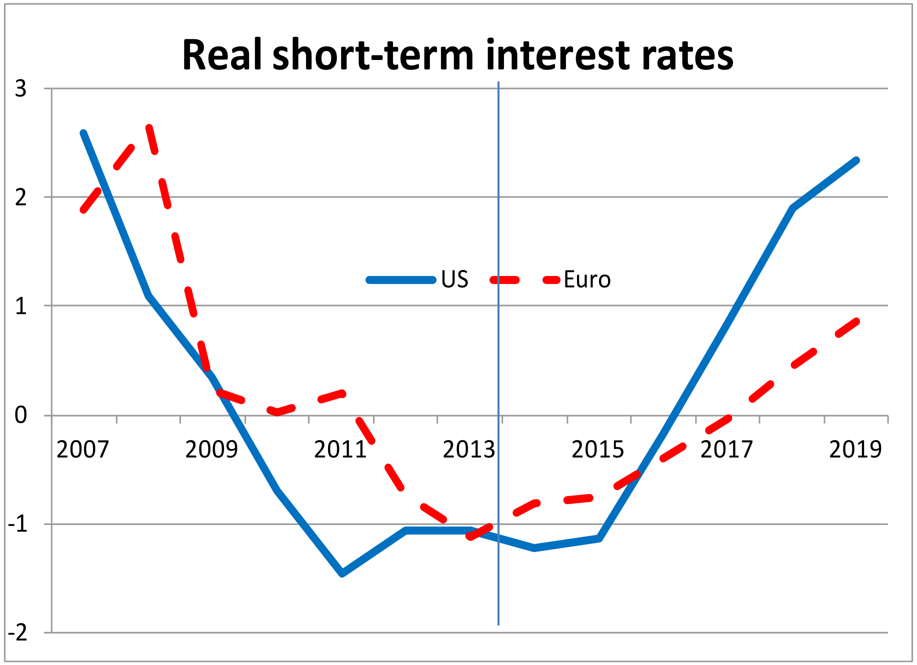


Interest rate increase not yet

US Fed tapering security purchases and tightening policy as economy recovers. Anticipated increase in LIBOR rates affecting global markets, capital flows and FX rates for EMs&DCs. Euro tightening somewhat later.

But LIBOR rates expected to remain negative through near term.





Upsides and risks

Possible deflation in advanced economies

Weak domestic demand in emerging markets

Stagnation in euro area

Capital flow volatility to some emerging markets

Strengthening global activity in 2013H2

Euro area moving from recession to recovery

Higher export demand in emerging markets

US budget deal to boost demand in 2014

Policy challenges

Advanced	Avoid premature monetary policy tightening Repair balance sheets Implement structural reforms to boost growth
Emerging and Developing	Manage vulnerabilities from capital flow volatility Safeguard financial stability after rapid credit growth Implement structural reforms to boost growth

Output and prices

Macro assumptions

Macro Assumption, 2013-14

	2014 Budget		IMF	
	2013	2014	2013	2014
Real GDP, percent change	5.1	8.8	4.1	5.3
Oil	2.6	6.5	0.6	3.0
Non-Oil	6.5	9.9	5.8	6.4
Nominal GDP (billions of Kwz)	11,764	12,823	11,745	12,767
Oil	4,851	4,362	4,937	5,056
Non-Oil	6,913	8,461	6,808	7,711
Nominal GDP, percent change	8.2	9.0	6.7	8.7
Oil	-2.6	-10.1	-1.6	2.4
Non-Oil	17.3	22.4	13.6	13.3
Oil production, mbpd	1.78	1.79	1.74	1.79
Percent change	2.6	1.0	0.6	3.0
Oil production, mb	648	655	636	655
Average oil price US$pb	101	98	107	105
Percent change	-10	-2.5	-3.3	-2.5
CPI, percent change, eop	9.0	8.0	7.7	8.0
FX rate AKZ/USD, average	96.3	98	96.5	….
Net foreign reserves, US$bn	30.6	33.7	30.9	32.0

IMF growth projections more cautious than OGE and NPD

OGE has tendency to:

- under-project oil prices
- over-project
  - oil production
  - non-oil revenues
  - capital spending
  - non-oil GDP growth

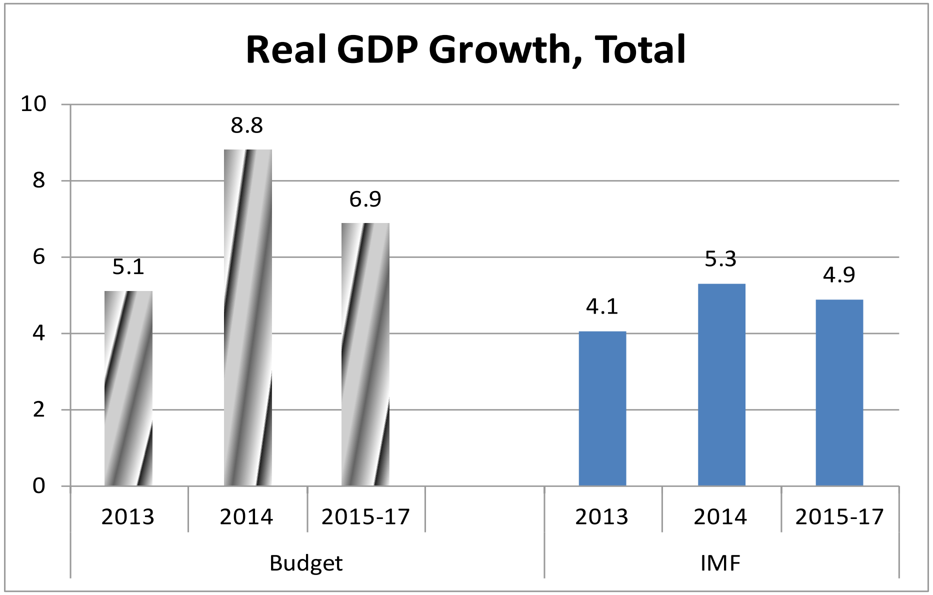
This implies large difference in projected nominal non-oil GDP (NOGDP) over medium-term.

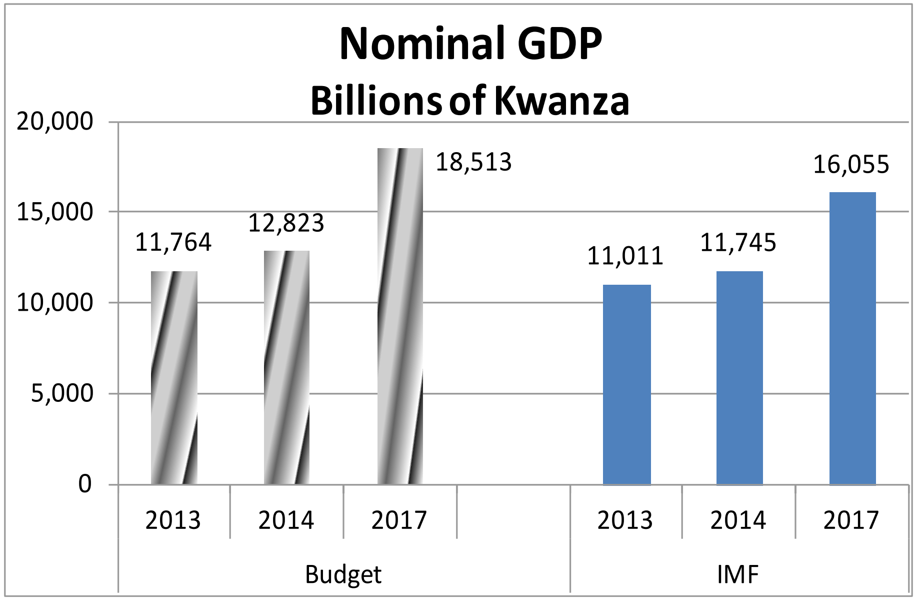
GDP growth

IMF growth estimates for 2013 lower than OGE and IMF projections more cautious for 2014 and medium term.

IMF also projects lower nominal GDP.

Over medium term, the main difference is for NOGDP. By 2017, the difference is 15 percent.

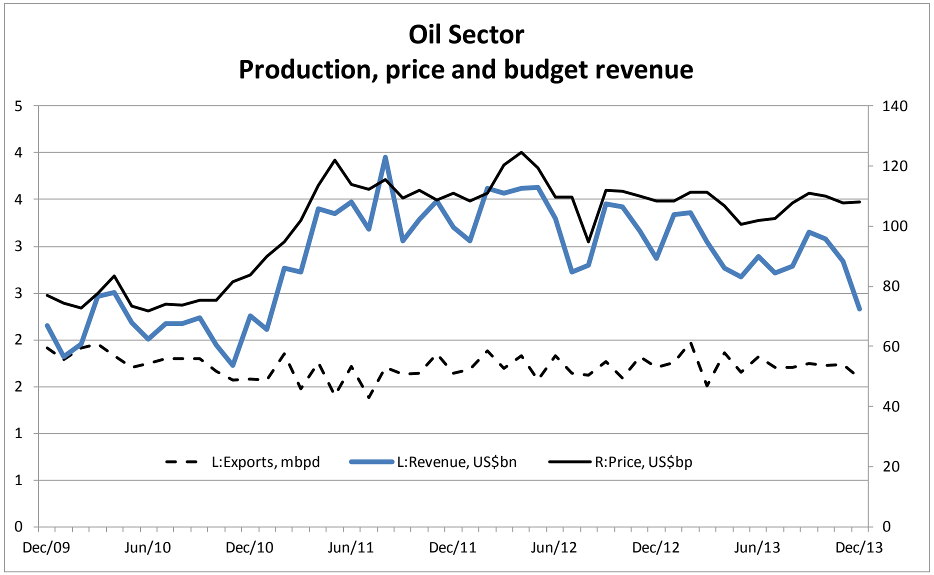


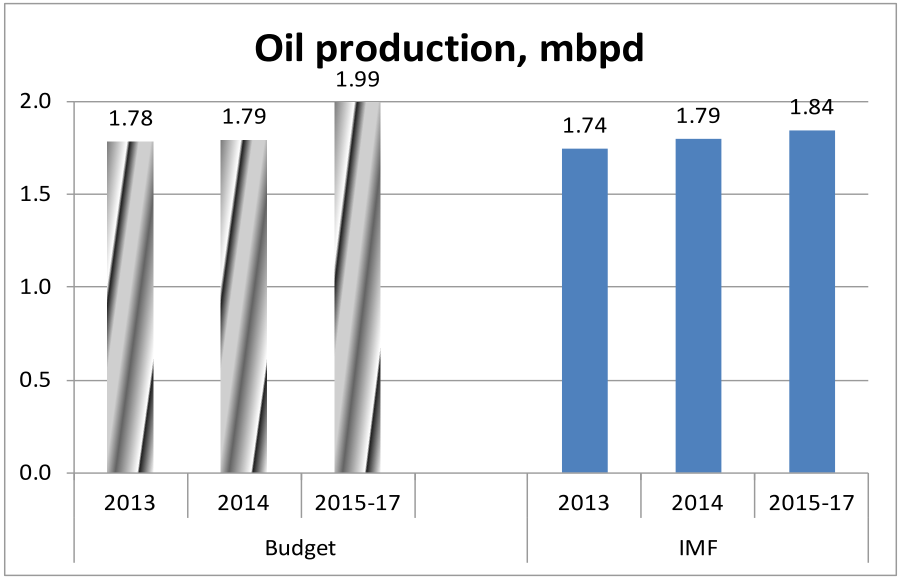


Oil production

MinFin monthly data indicates oil exports in 2013 were 631 mb, or 1.74 mbpd. Price averaged $107 pb. Budget oil revenues totaled US$35 billion. Figures preliminary likely to be reduced.

OGE projects oil production topping 2mbpd in medium term. IMF output forecast more cautious.

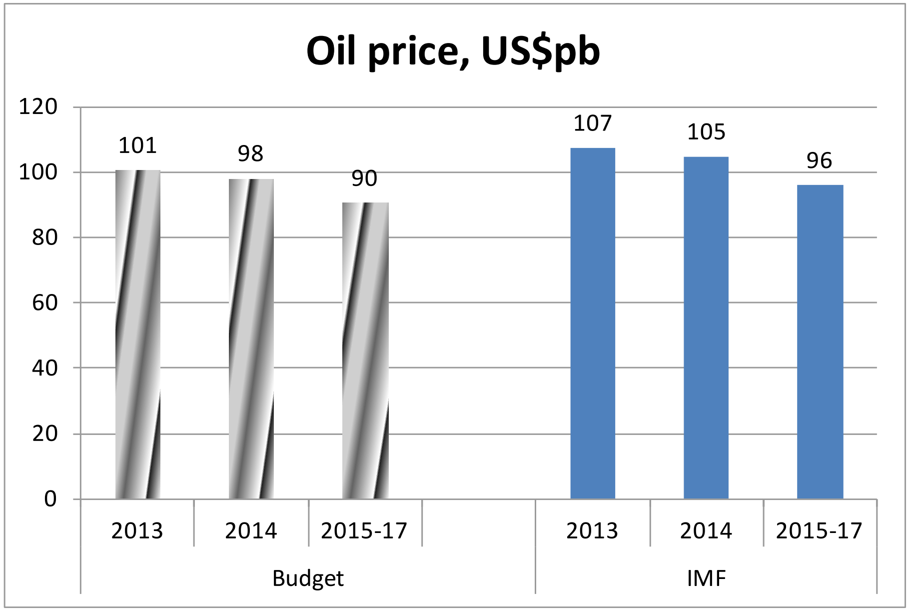


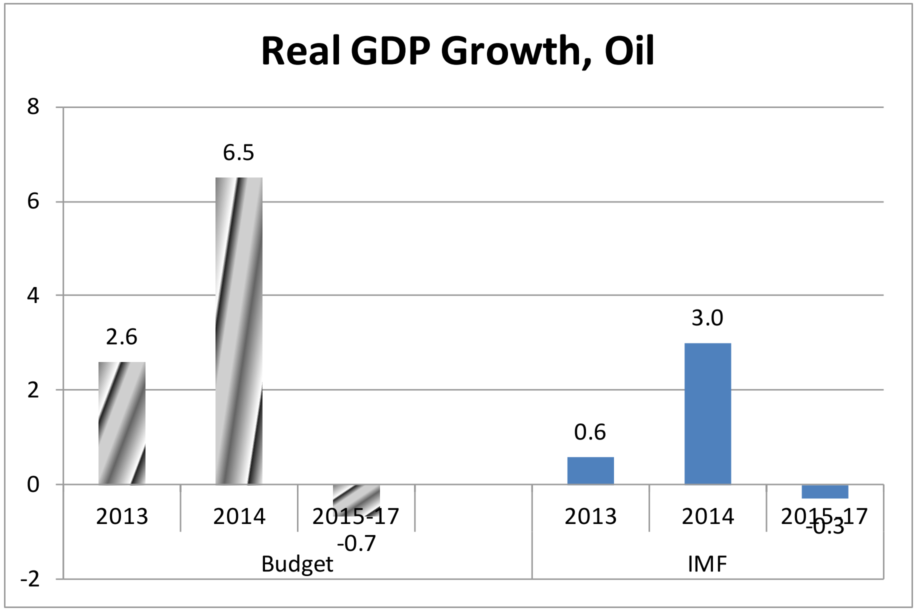


Oil price and GDP

OGE forecast is well below comparator Brent price projections. IMF projections more in line with Brent comparator.

Both OGE and IMF project declining oil GDP in medium term – mainly because of drop in 2017.





Non-oil sector GDP

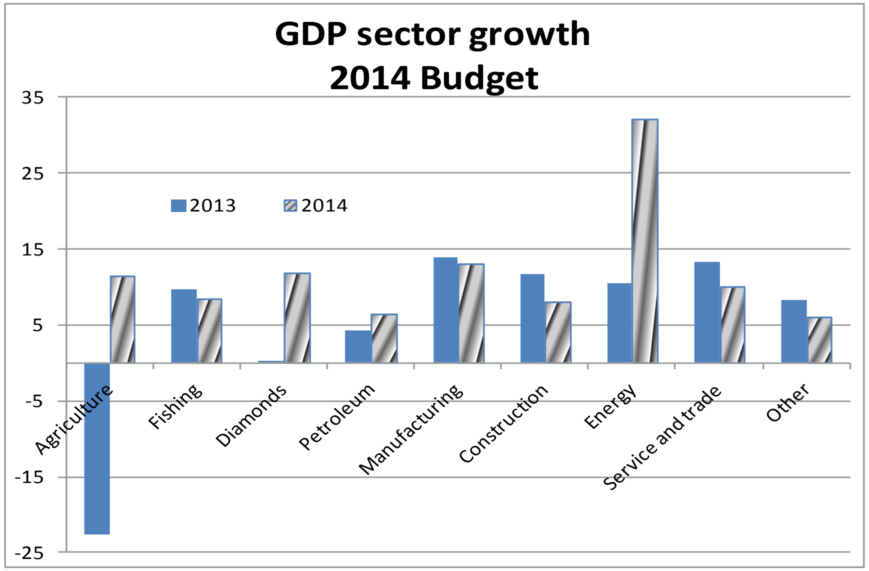
2013 and 2014 NOGDP sector figures dominated by agriculture and energy.

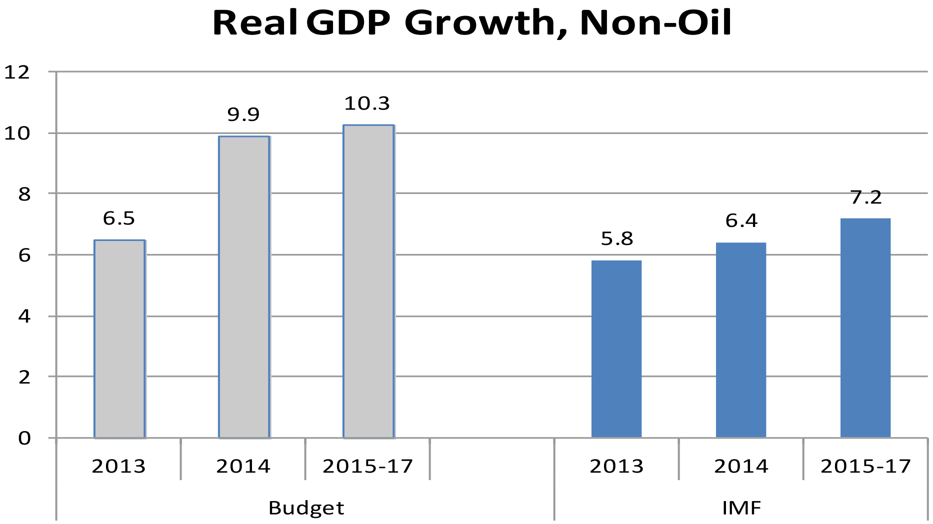
IMF 2013 estimates weaker because of impact of 2012 drought and slow budget implementation.

IMF 2014 projections more cautious on energy sector, budget implementation, and capex impact.

IMF real NOGDP growth projections weaker than OGE in medium term.

Over 2012-17, real NOGDP projected to increase 60 percent (OGE) v 50 percent (IMF).

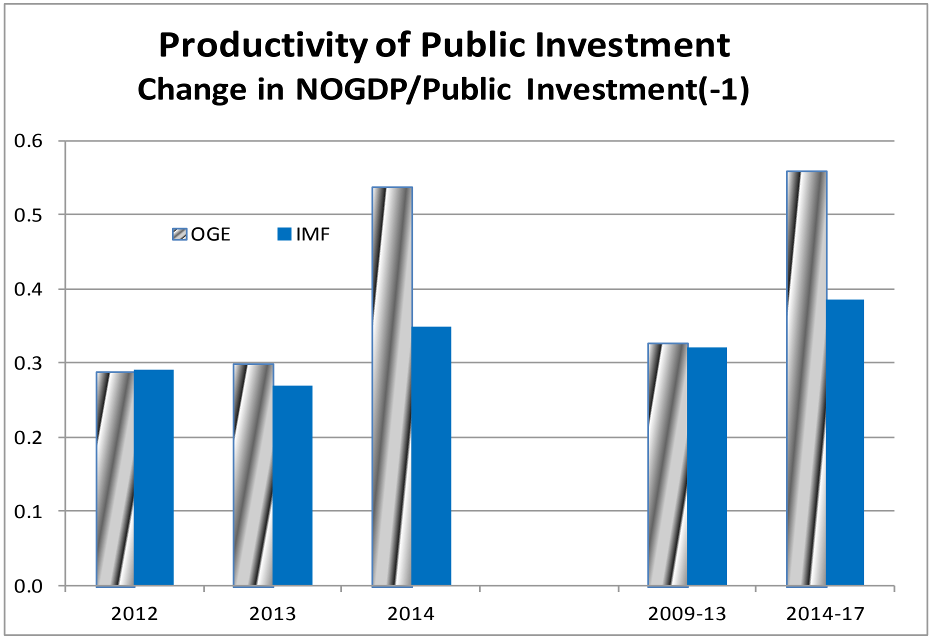




Investment and growth

OGE projects high NOGDP growth to 2017. This is central to macro projections and sustainability. This assumes high productivity of investment. How reasonable is this?

Look at marginal product of public capital: change in real NOGDP divided by change in real public capital stock (i.e. public investment). This excludes private investment because of lack of data. OGE assumes large increase in MPK reflecting spillovers. IMF projections more cautious.



Inflation

Food and non-food

CPI 12-month inflation fell below 8 percent in late 2013.

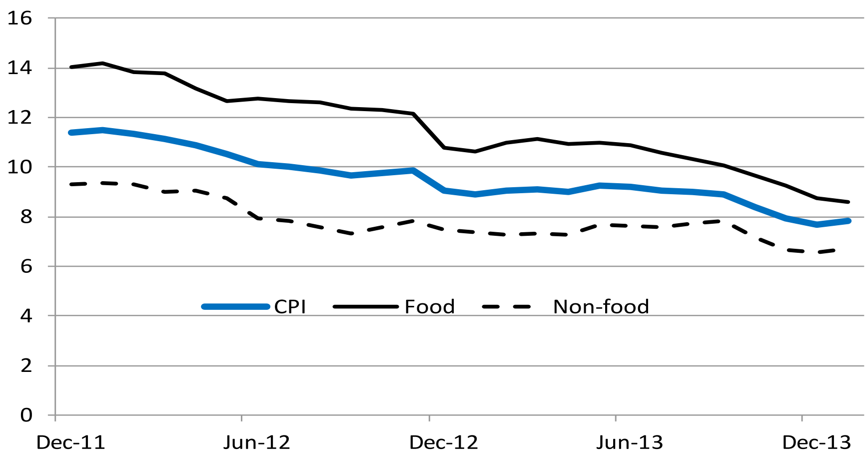
Inflation pressures falling fast and

Seasonally adjusted monthly inflation now around 6.5 percent. Without budget and tariff pressures, 12-month inflation could near 7 percent by end-2014.

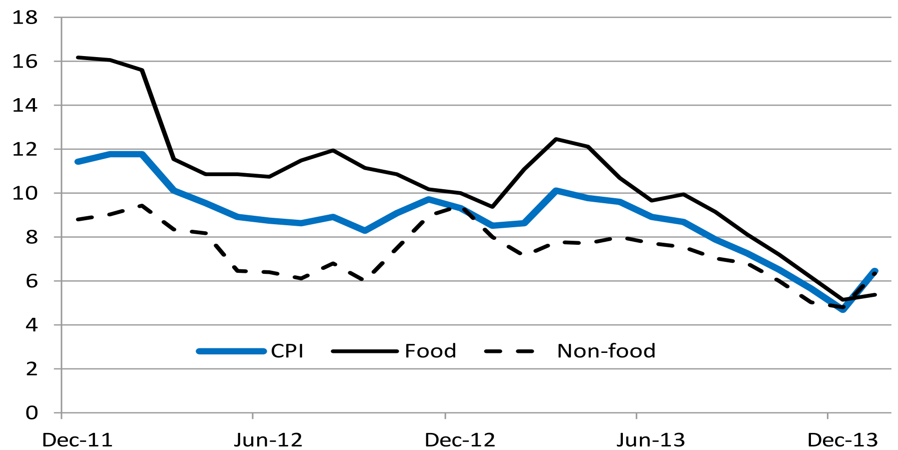
Shift in sources of inflation.

Inflation previously held up by food prices. Food inflation falling rapidly and s.adj. monthly inflation now below non-food inflation.

Consumer price index
12-month percent change



Consumer price index
3-m avg seasonally adj. annualized



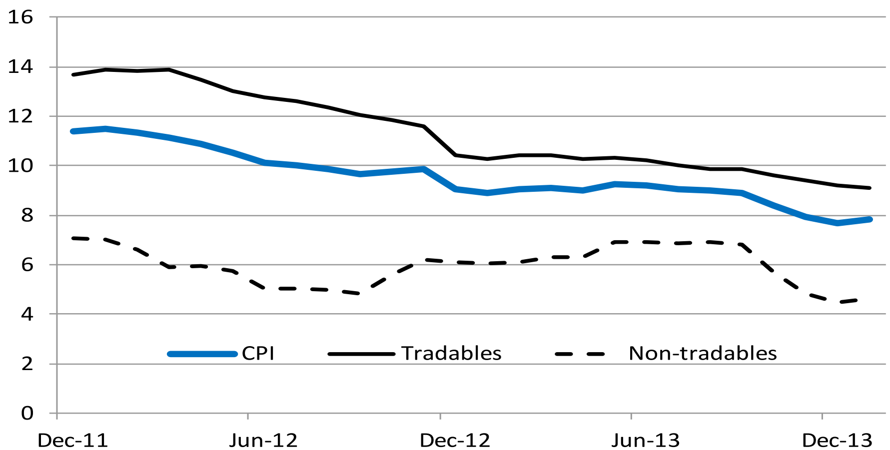
Inflation

Tariffs and non-tradables

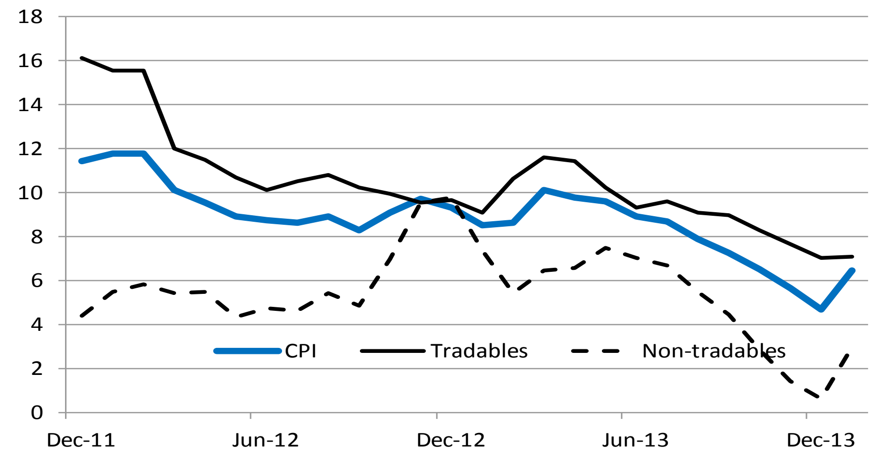
Budget and tariffs will exert prices pressures. Tariffs imply 'one shot' price increase, raising monthly inflation for several months and raising 12-month inflation for a year. BNA expected to contain spillovers to other sectors. 12-month inflation expected to top 8.5 percent within months and then down to 8 percent.

Wide gap between inflation for tradables and non-tradables. S.adj monthly inflation for tradables now only 2 percent. Suggests room to absorb spillovers from tariffs.

Consumer price index
12-month percent change



Consumer price index
3-m avg seasonally adj. annualized



Fiscal

Budget implementation

Preliminary, Jan 2014

Preliminary estimates/projections for 2013H2:

Oil revenues lower than H1 because of lower prices. Non-oil revenues unchanged.

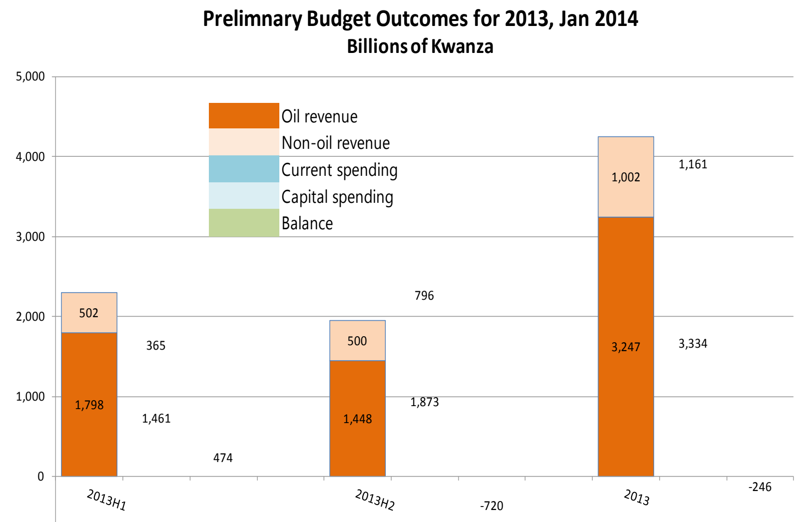
Large increases in current and capital spending.

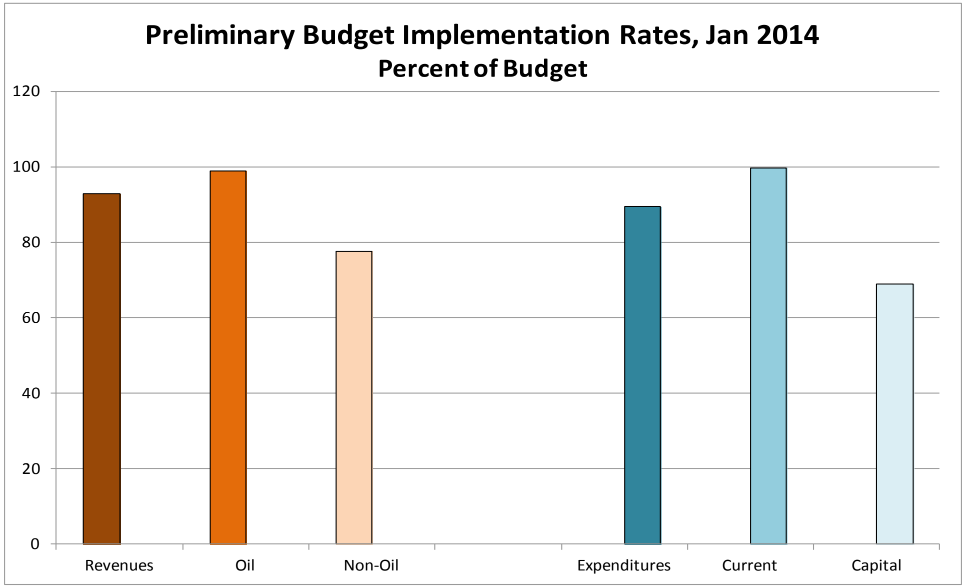
Fiscal balance in 2013 probably in deficit.

2013 oil revenues modestly weaker than budgeted. Non-oil revenue performance below 80 percent.

Current spending as budgeted. Capital spending around 70 percent of budget.

But figures very preliminary.





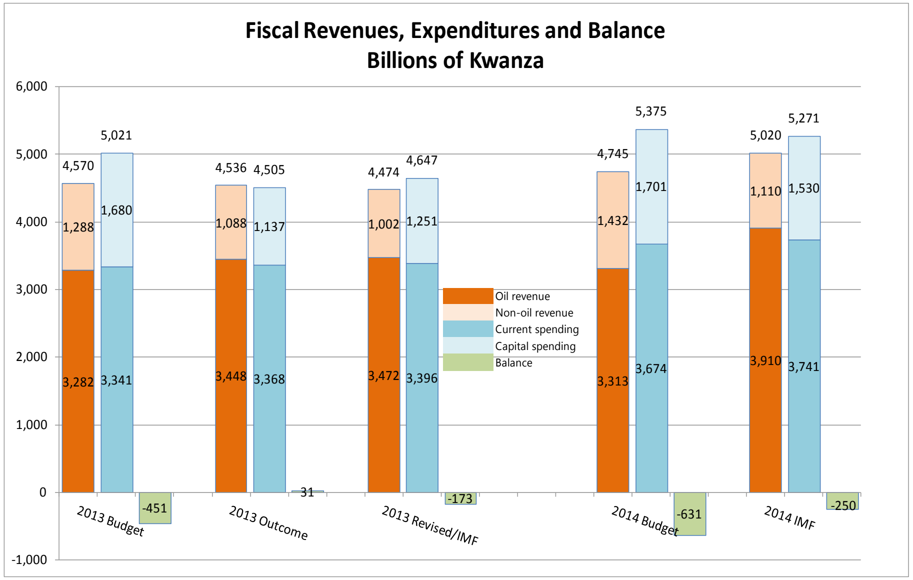
Budget evolution

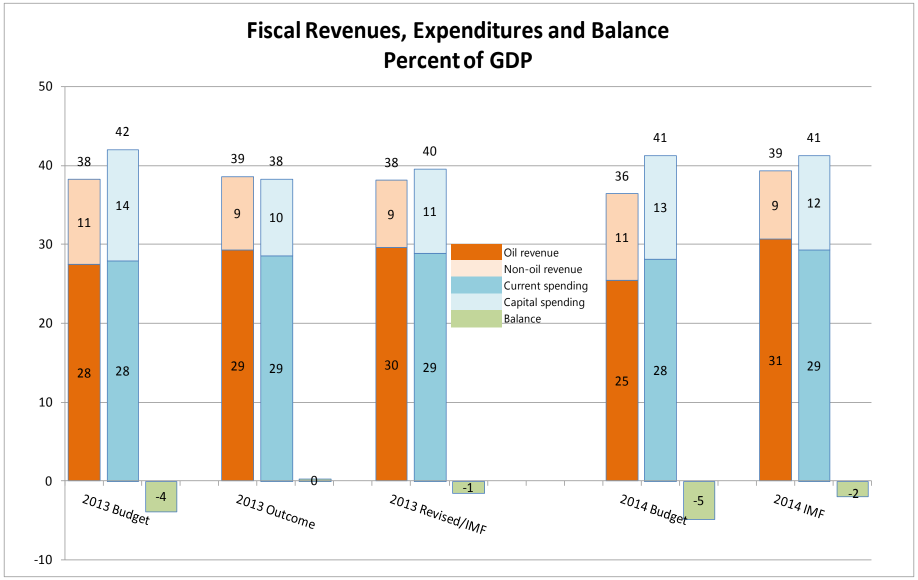
2013:

Compared to 2014 OGE document, IMF more cautious on non-oil revenues and more optimistic on spending. IMF estimate of fiscal deficit.

2014:

Compared to OGE, IMF more optimistic on oil revenues but more cautious on non-oil revenue and capital spending.



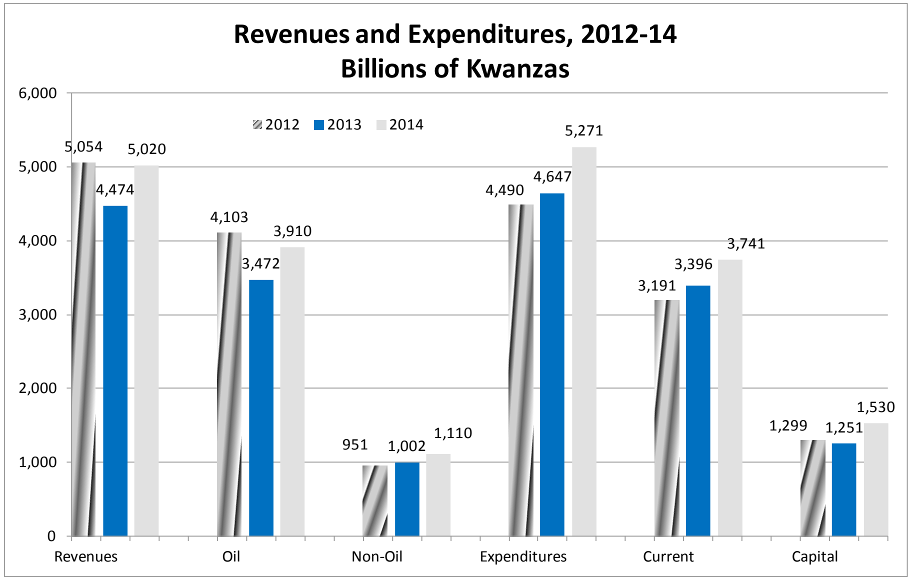


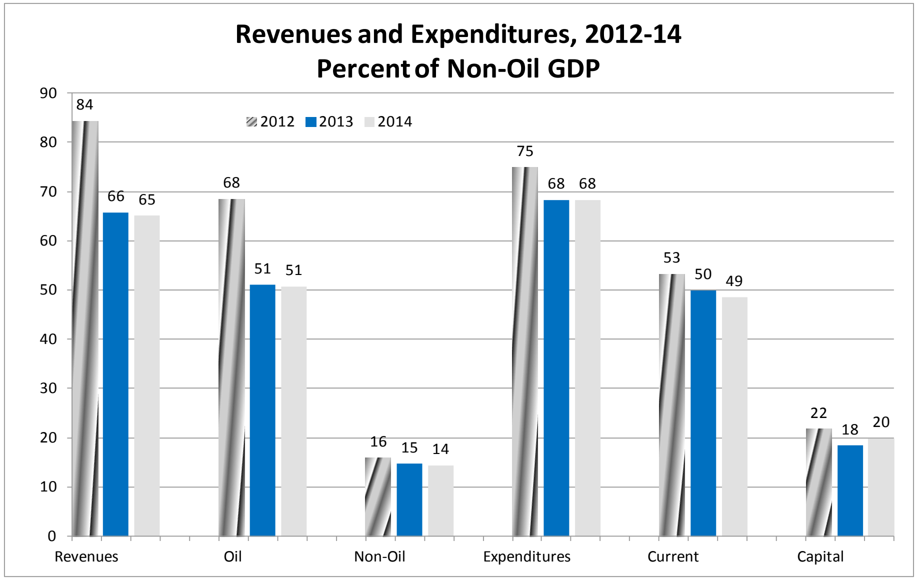
Revenues and expenditures
IMF projections

Kwanza revenues and spending projected to rise in 2014.

But both are flat or declining relative to IMF projections of NOGDP - except for capital spending.

Modest shift in spending composition.





Source of savings
Saving for the future

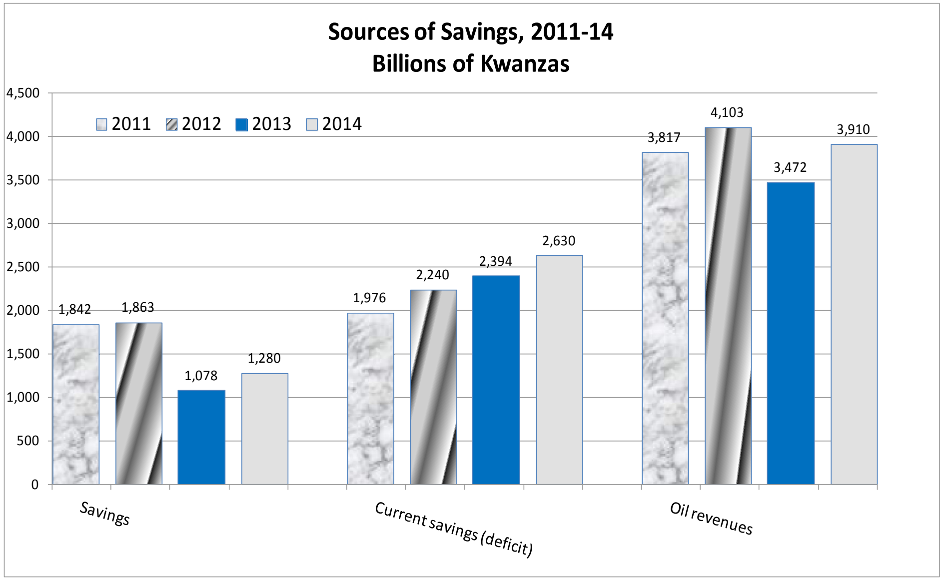
Angola is making a modest discretionary policy effort to save for the future.

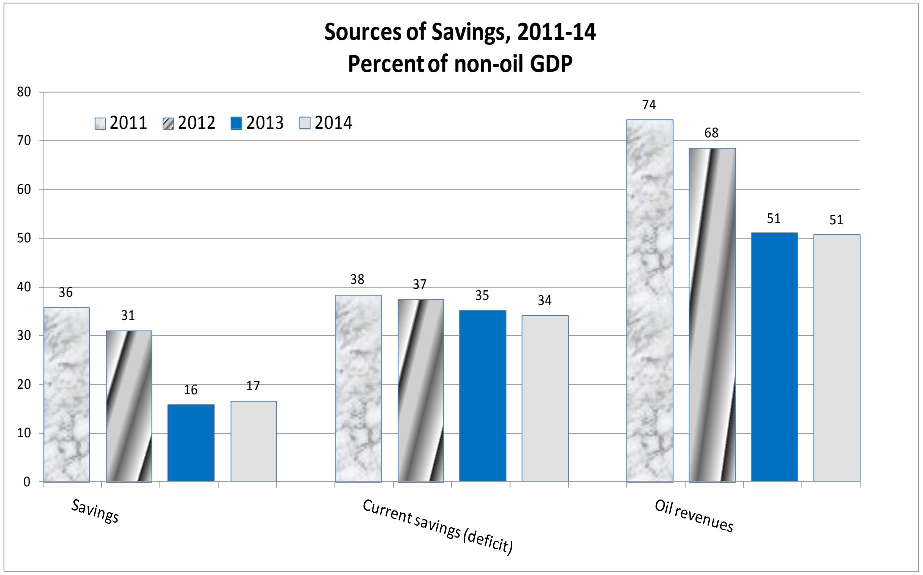
Government savings weakened considerably in 2013 because of weaker oil revenues. But current savings deficit continues to decline relative to NOGDP. In other words,

Note:

Government savings = oil and non-oil revenues less current spending

Current savings = non-oil revenues less current spending.



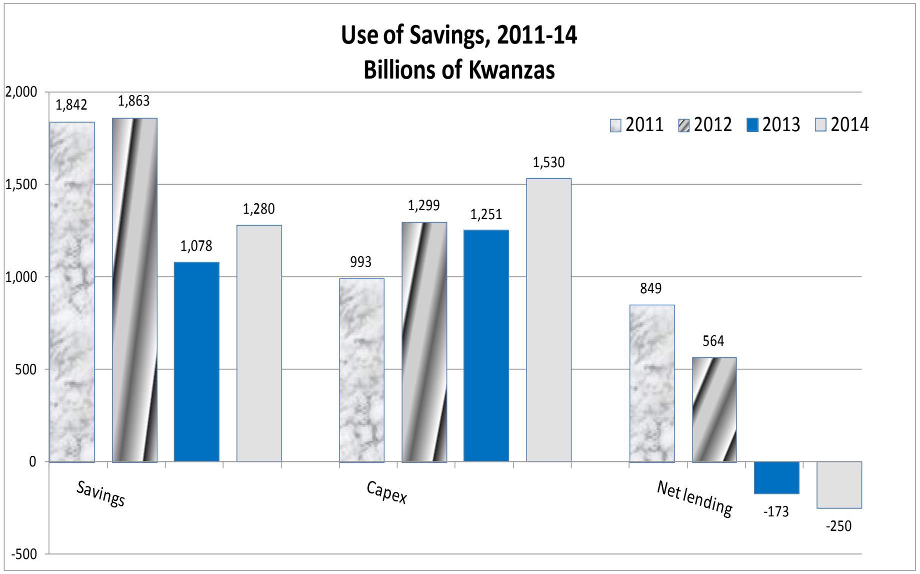


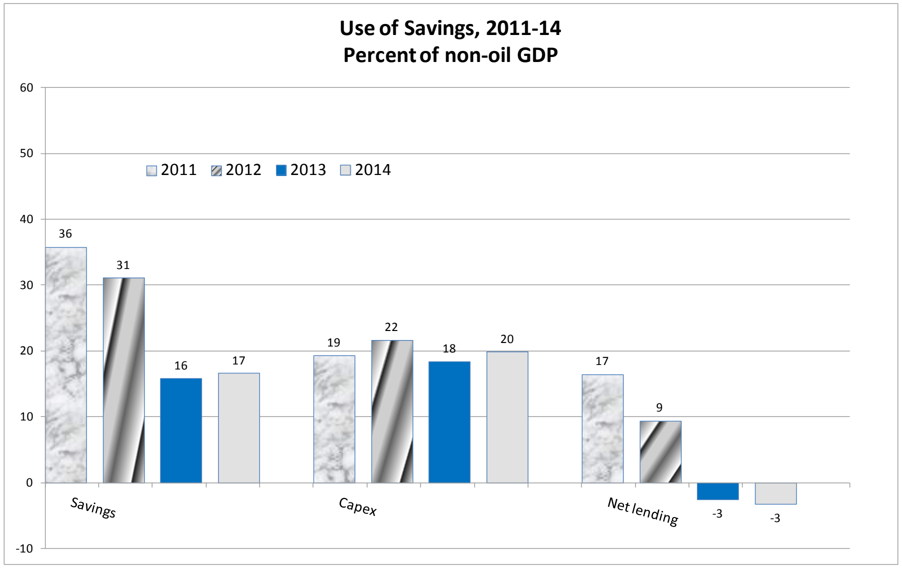
Use of savings
Investing for future

Angola investing in capital formation for the future, but also reducing net investment in financial assets.

Relative to NOGDP, declining public savings means lower domestic budget resources to finance both higher capital spending and accumulation of financial assets (incl. foreign reserves & FSDEA).

Reduced public savings (because of oil revenues) underpins large decline in the fiscal balance (net lending) by 12 percent of NOGDP in 2013 and by 20 percent of NOGDP between 2011-2014.





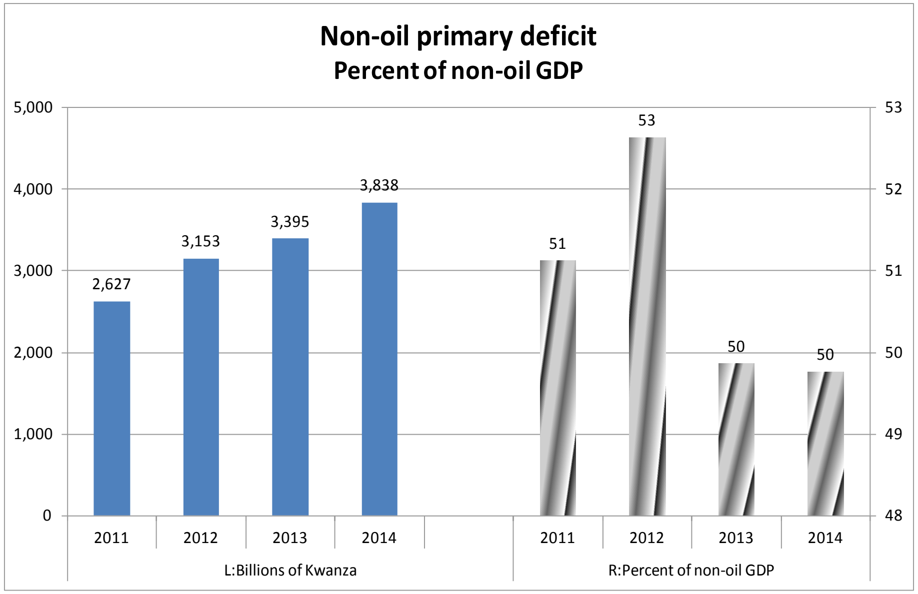
Policy buffers

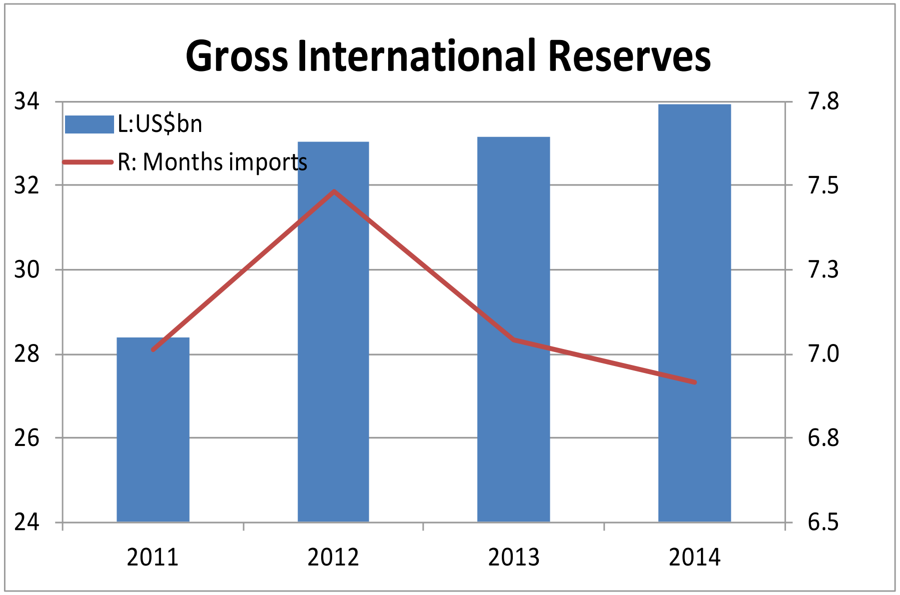
The non-oil primary deficit measures discretionary fiscal policy.

The deficit improved 3 percent of NOGDP in 2013 because of slow budget implementation. But only limited improvement is expected in 2014 because of higher capital spending.

Note: NOPD equals non-oil revenues less spending excluding interest and oil-related spending

Gross foreign reserves in USD were flat in 2013 and only a modest increase is projected in 2014. Months of import cover declined in 2013 and will fall below 7 months in 2014. But this is still about 14 months of non-oil imports.





FSDEA

Sources of funding: FSDEA funded by oil revenue-sharing arrangement. A surplus-sharing rule would be preferable to avoid diverting revenue from Treasury when oil revenue is low and deficit financing needed.

Impact on fiscal buffers: The OIF played a stabilization role as its assets were included in the GoA Treasury account and earmarked for domestic investment. The assets of the FSDEA are outside the Treasury account and earmarked for purposes outside the budget. The FSDEA's assets are therefore not readily available to the Treasury for stabilization purposes.

Financing: The revenue-sharing rule to fund the FSDEA will put larger pressure on budget finances to meet obligation on spending, accumulation of liquid assets for stabilization purposes and to fund the FSDEA. OGE incorporates substantial domestic and foreign borrowing in 2014 to meet these financing needs.

Domestic arrears

Expenditure chain

Budget formulation in concordance with National Development Plan & (MT fiscal framework).

Financial allocation: Budget units receive *quotas financieras* (QF) in response to their quarterly funding requests. MinFin withholds 20% of allocation to prevent units from spending their annual budget allocation before end-year.

Commitment: Tribunal de Contas gives certification, Nota de Cabimentação (NC), that sufficient budget allocation is available to place contracts. The NC identifies nature of the expenditure according to budget classification and amount to be paid.

Verification: The confirmation that the creditor is entitled to receive payment for the services provided and goods delivered according to the contract that gave rise to the transaction. The spending unit issues a Nota de Liquidação (NL) to complete the verification.

Payment order: The spending unit issues a payment order for the government's fiscal agent to pay the creditor.

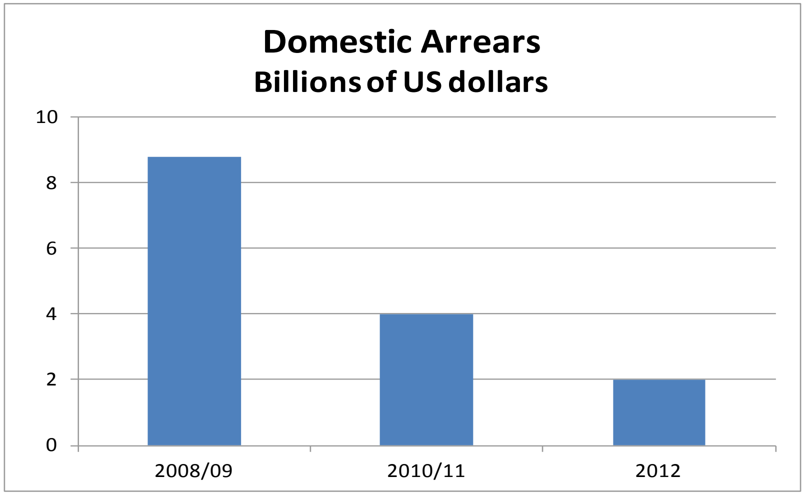
Payment: The actual payment is made by Banco de Poupança (BPC), the government's fiscal agent. Until 2014 OGE accounts payable or arrears accumulated if payment not made by April 1 of new fiscal year.

Domestic arrears

Causes and measures

Angola: Domestic Arrears, Billions of US dollars

	Initial End-2012	New Mid-2013	Total	Settled	Residual End-2013
Total domestic arrears	4.0	2.0	6.1	4.4	1.6
Min. Construction, Verified	2.9	1.6	4.5	4.4	0.0
2010-2011	2.9	0.0	2.9	2.9	0.0
2012	0.0	1.6	1.6	1.6	0.0
Other Budget Units, Unverified	1.1	0.5	1.6	0.0	1.6



New domestic arrears for 2010/11 & 12 totaling US$6.1bn. Mostly settled by end-2013 with cash or securities. Arrears for 2013 not yet known.

Causes

(i) Insufficient consensus on role of budget as key instrument for GoA objectives (ii) weak enforcement of budget legislation – unbudgeted contracts, (iii) difficulties in budgeting multi-year contracts, (iv) lack of clear definition of arrears.

Measures

Verification and settlement of arrears

2013 OGE: defines operational aspects of multi-year budgeting and includes Sonangol QFOs

2014 OGE: (i) definition of arrears, (ii) co-signature of MoF for contracts above $1.5 for central GoA and above $1 for local GoA (iii) accounts payable monitoring system.

Other: Medium term strategy to strengthen PFM supported by IMF TA, incl. MT fiscal framework.

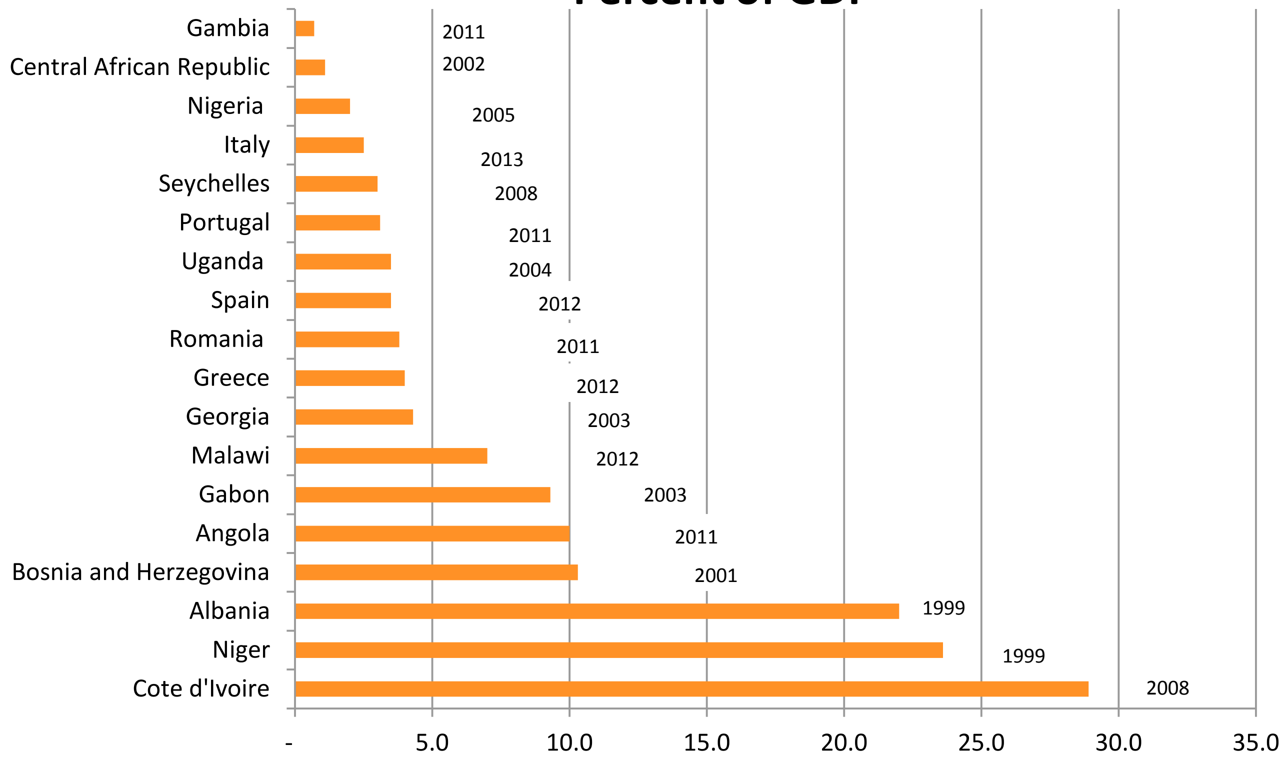
Resolution will take time and political will.

Domestic arrears

A resolvable problem

Periods of high domestic arrears accumulation are not rare and can and have been resolved. The key is political will and commitment.

Episodes of high accumulation of domestic arrears
Percent of GDP



Monetary

Banks' portfolio choices

Source of funds
Deposits, LC and FC

Use of funds

Required LC and FC reserves at BNA
Cash Holdings

Net FX purchases
Net lending to BNA

Net credit to GoA (NCG)
Credit to Economy, LC and FC

Excess bank reserves incl. facilities

Proportion of deposits required (LRR) to be held in reserve at BNA. AKZ requirement reduced in June.

BNA monetary policy instruments. BNA FX sales affected by oil FX law in June

NCG driven by budget requirement
Credit to Economy depends on liquidity and bankable projects.

Some excess reserves held as precaution; remainder as residual portfolio allocation.

Money growth picks up

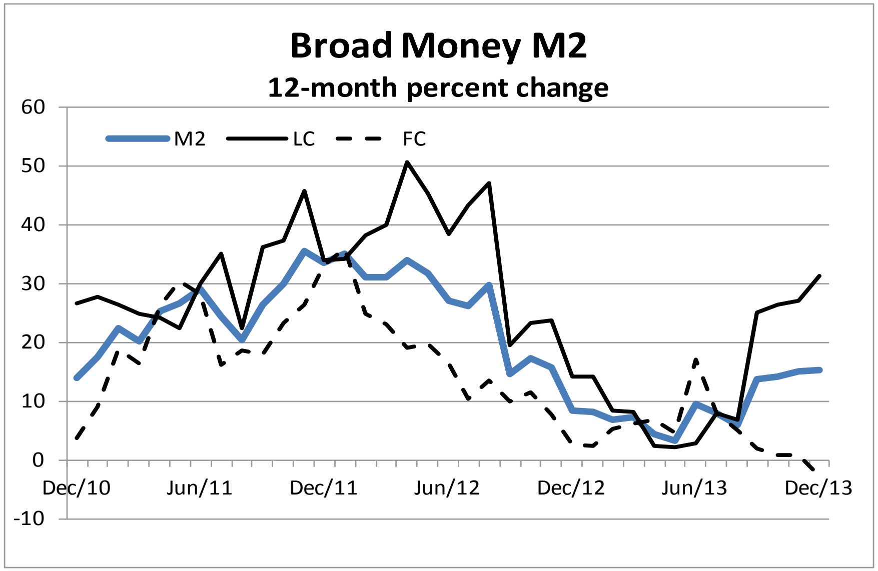
M2 growth slowed from mid-2012 to mid-2013, because of slow budget implementation.

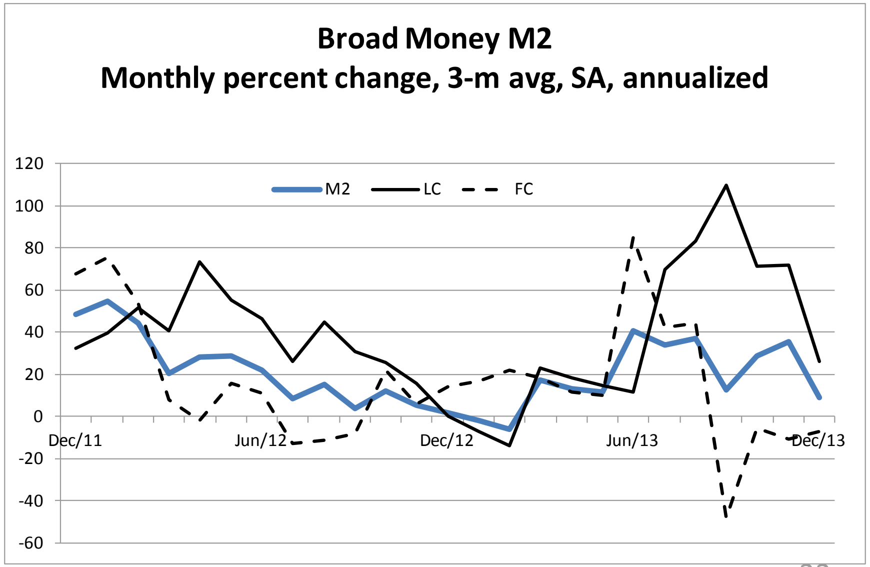
But M2 growth picked up sharply in 2013H2.

The expansion was particularly large in AKZ deposits, while USD deposits fell.

Three factors :

- Stronger H2 budget implementation
- Implementation of the oil FX law
- Reduction in the AKZ LRR in June.





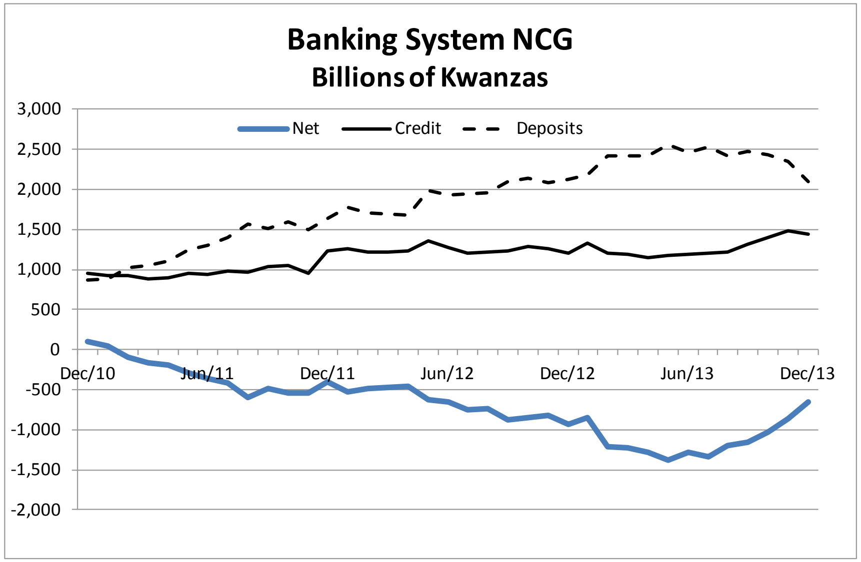
Net credit to government rises

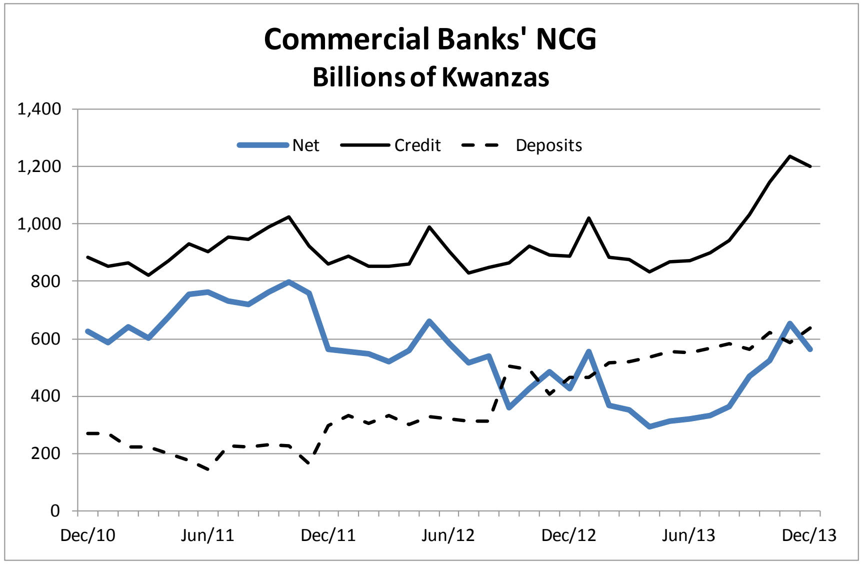
Excess of Government deposits over credit falls

Government spending increased in 2013H2, including repayment of domestic arrears.

Banking system (BNA + banks) NCG rose. This included a big decline in government deposits at BNA.

Higher government spending was accompanied by increase in government deposits in banks as well as government borrowing.

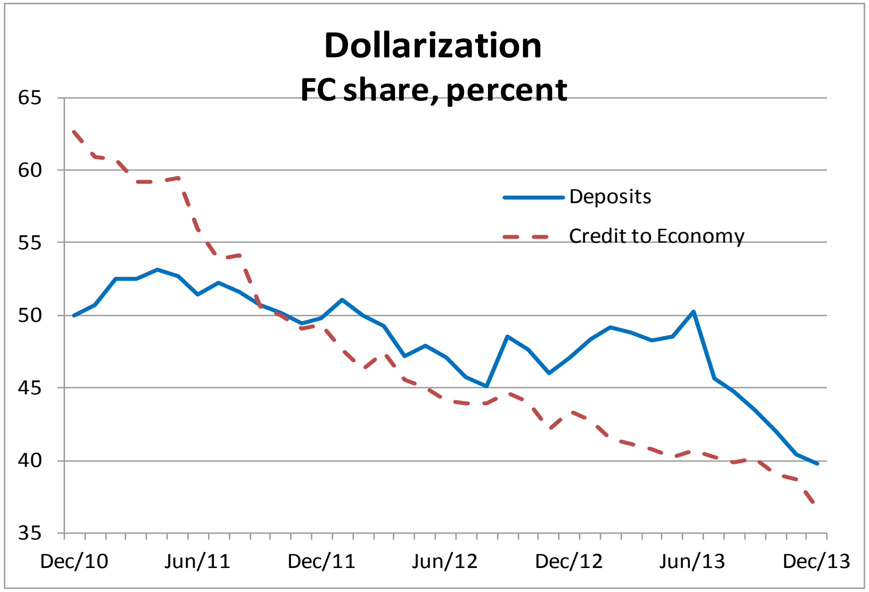




Oil FX law and dollarization

Dollar hoarding and increase in dollar share of deposits in 2013H1 followed by declining share after June.

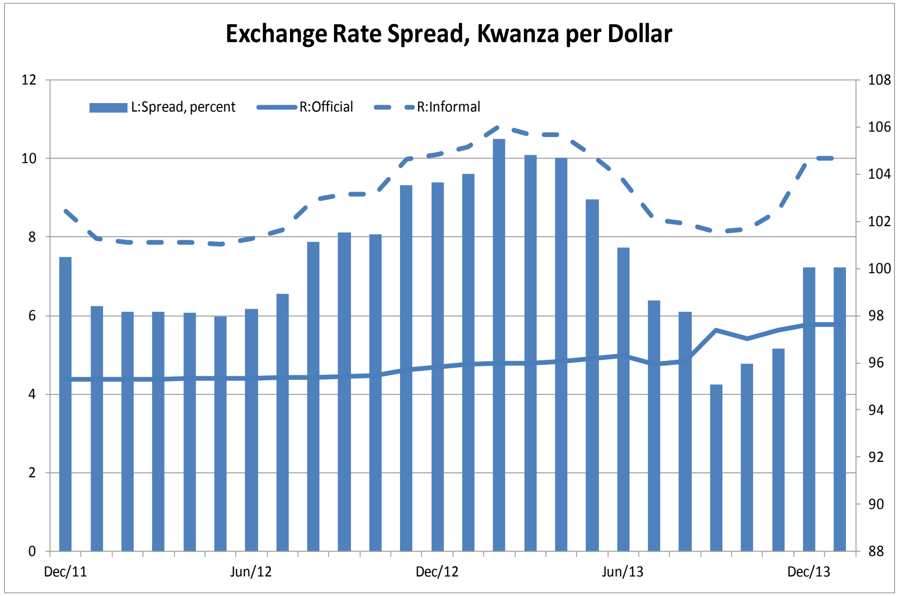
Change in currency composition of deposits also affects money expansion because of differential reserve requirement after June.



Parallel market FX spread has seasonal cycle, normally widening over Xmas.

Dollar hoarding in 2013H1 widened the FX spread into mid-2013.

Spread narrowed after June.

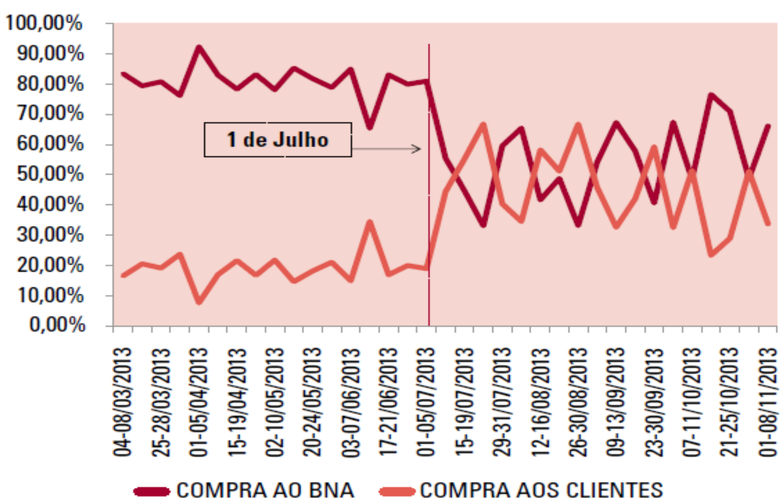


FX law and BNA FX sales

Prior to June phase of oil FX law, banks met 20 percent of dollar needs from private sector. The BNA supplied 80 percent of banks needs.

Since June, the BNA supplies about 50 of banks' dollar requirements.

Gráfico 7 - Compra de Divisas pelos Bancos Comerciais



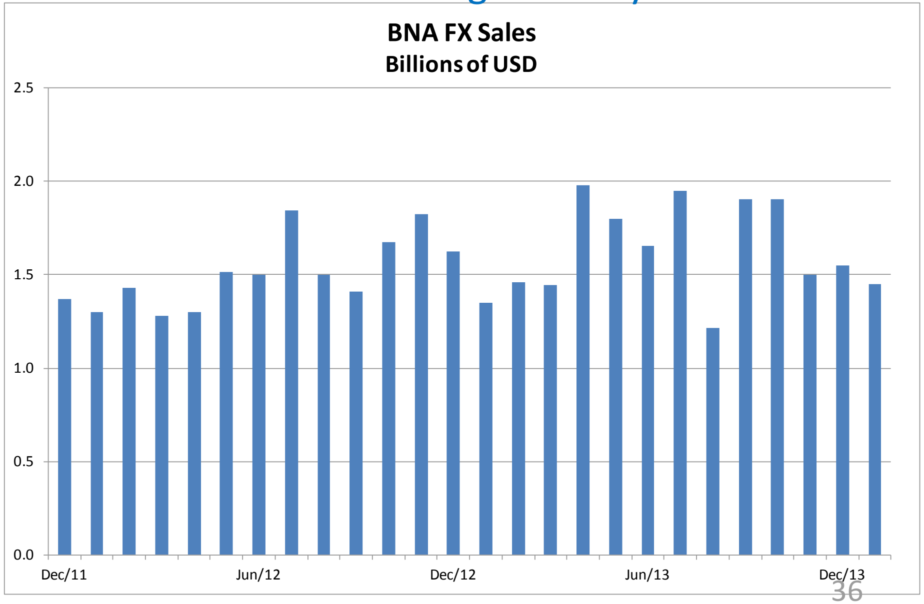
Fonte: BNA

BNA FX sales key to impact of oil FX law.

BNA has maintained FX sales, helping reduce market shortages and hold down parallel market spread.

What happens if BNA reduces FX sales further to offset private sector supply to banks?

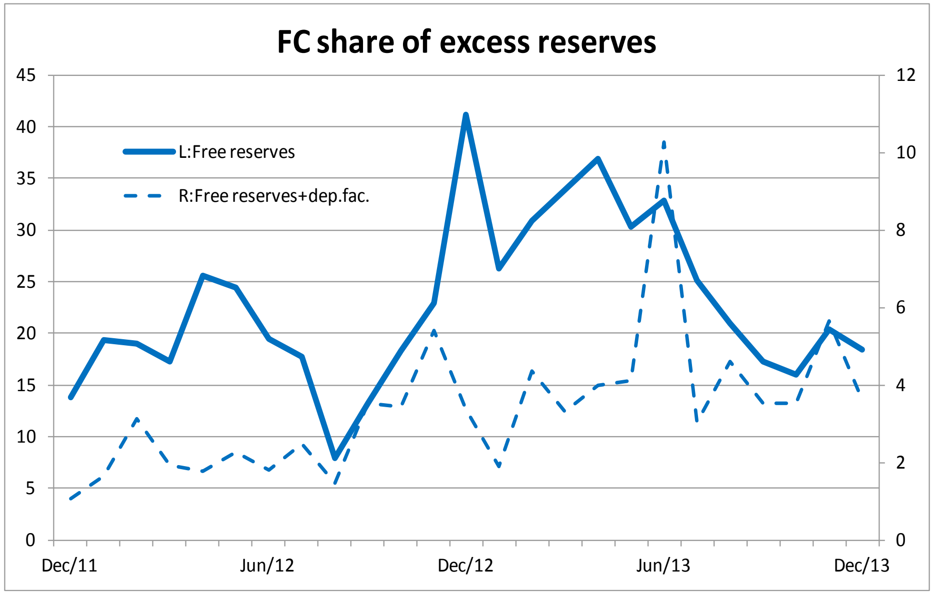
Sustained de-dollarization needs not only administrative measures but also reducing incentives to hold dollars – i.e. removing one-way bet on FX rate.

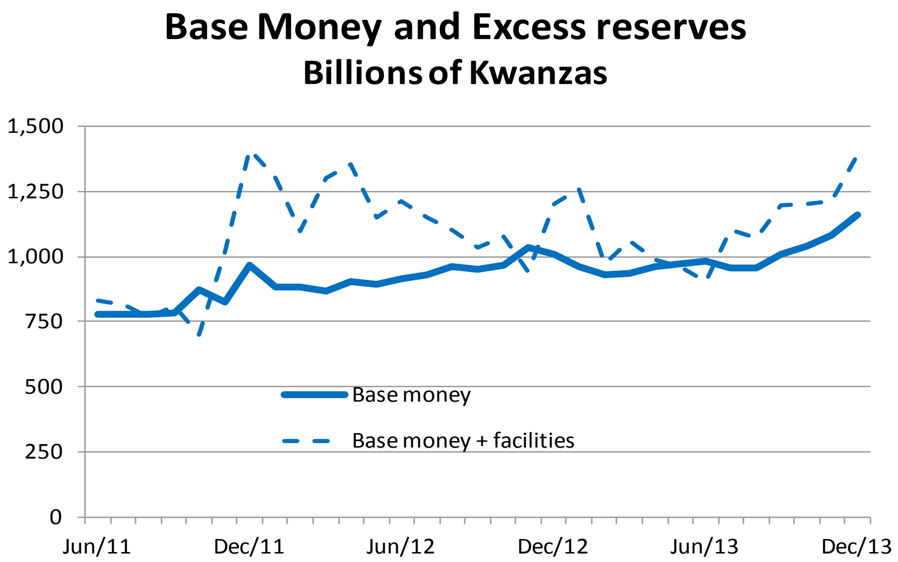


Excess bank reserves

History of chronic excess reserves reflects shortage of worthwhile uses for bank deposits. BNA tightened liquidity in 2012 to reduce excess reserves.

Excess reserves increased again in 2013H2. This reflects higher government spending and deposits in banks, the reduction in the kwanza liquidity reserve requirement in June from 20% to 15%, and the shift from dollar to kwanza deposits because of the oil FX law.



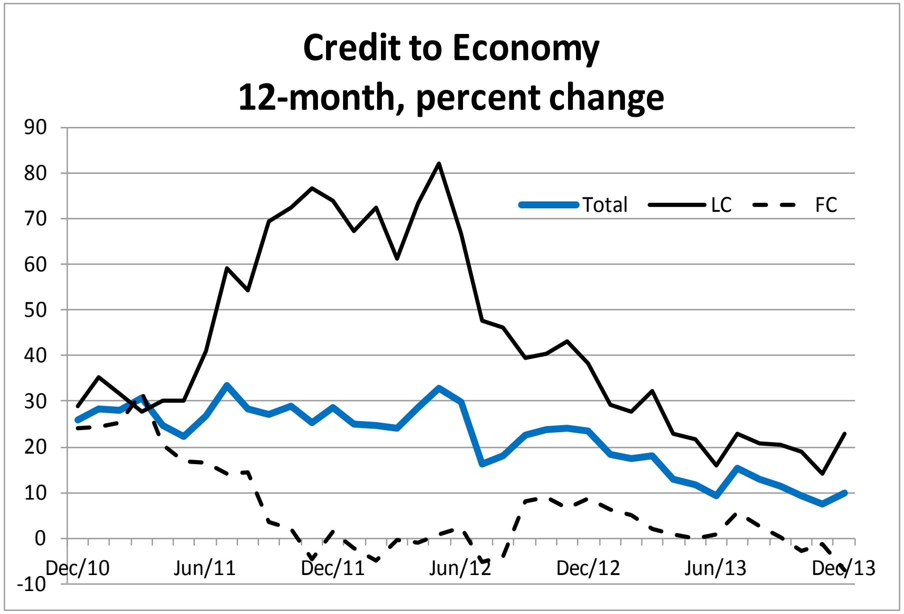


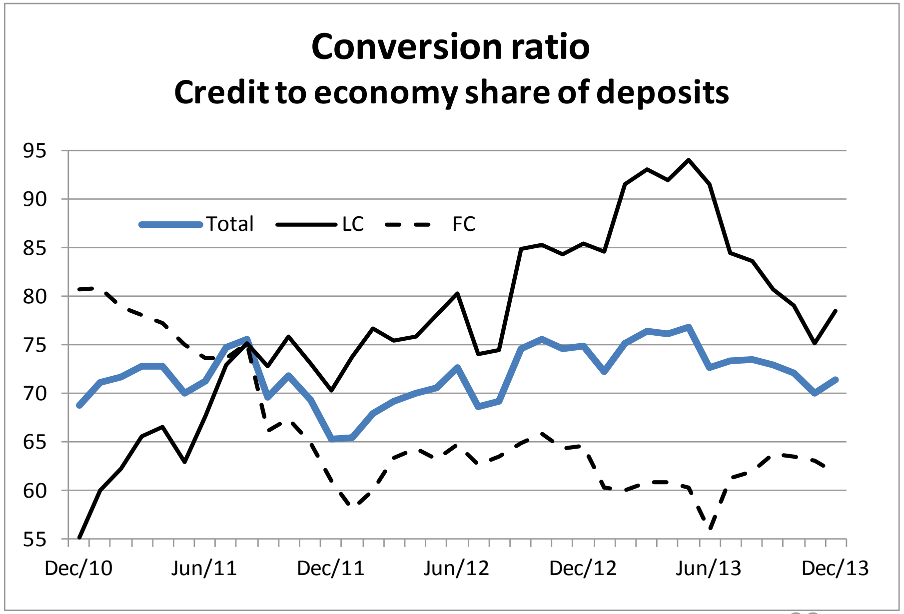
Credit to the economy

Growth in credit to the economy has trended down since mid-2012 in line with M2.

The 2013H2 rebound in M2 was not reflected in credit growth. Banks accumulated excess reserves.

As a result, the conversion ratio of deposits into credit has fallen since June, especially for kwanza deposits and credit.

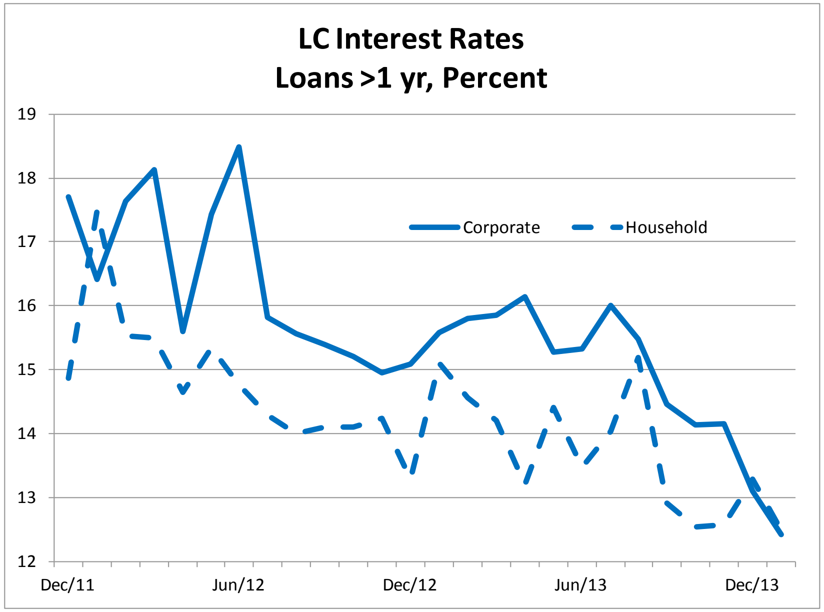


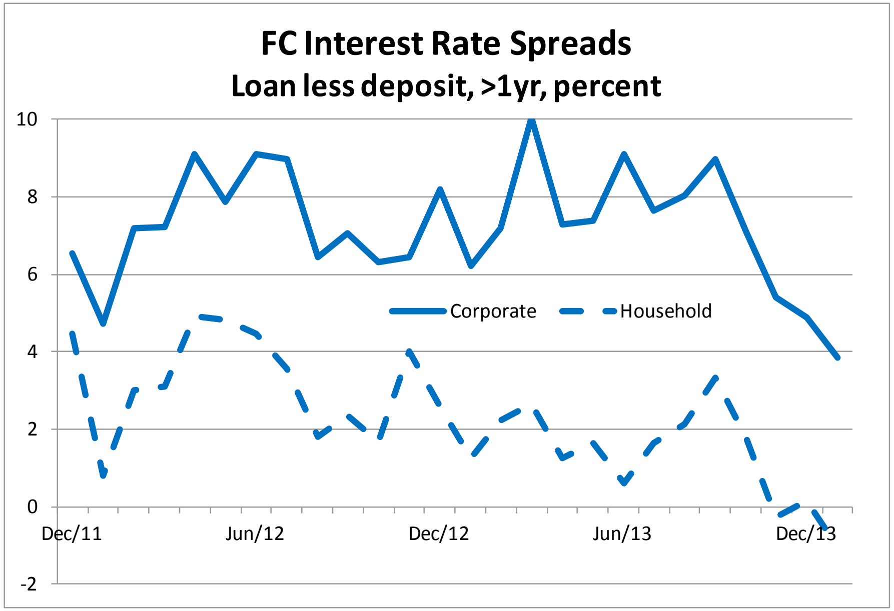


Interest rates

The lower kwanza LRR reduces the bank costs of holding kwanza deposits and should lead to lower kwanza loan-deposit spreads.

The oil FX law reduces the demand for dollar loans and has been accompanied by lower dollar loan-deposit spreads.





Thank you