Angola Country Brief

December 2018

Introduction

The Republic of Angola is located on the west coast of south-central Africa. It shares borders with Namibia to the south, the Democratic Republic of the Congo to the north, Zambia to the east, and the Atlantic Ocean to the west. Angola has an exclave province, the province of Cabinda that borders the Republic of the Congo and the Democratic Republic of the Congo. The capital and largest city of Angola is Luanda.

The country has an area size of roughly 1,246,700 square kilometers, making it the 7th largest country in the continent. With a population of about 25.4 million inhabitants, Angola is the 14th most populous nation in Africa. Like most countries in the region several different languages are spoken in Angola. Portuguese is the official language with Umbundu, Kimbundu and Kikongoe the most widely spoken indigenous languages.

Angola's economy is overwhelmingly driven by its oil sector as the second largest oil-exporting country on the continent. Oil production and its supporting activities contribute about 50 percent of GDP, more than 70 percent of government revenue, and more than 90 percent of the country's export earnings. Diamonds contribute an additional 5 percent to export earnings. Subsistence agriculture provides the main livelihood for most of the people, but half of the country's food is still imported. A postwar reconstruction boom and resettlement of displaced persons led to high rates of growth particularly supported by infrastructure development.

Political Environment

Angola changed from a one-party system ruled by the Popular Movement for the Liberation of Angola (MPLA), in place since independence in 1975, to a multiparty democracy based on a new constitution adopted in 1992—the same year the first parliamentary and presidential election was held. The MPLA won an absolute majority in the parliamentary elections, with President José Eduardo dos Santos elected as President.

Since the adoption of a new constitution which initiated a presidential system in 2010, the President is both head of state and head of government. Executive power is exercised by the government. Legislative power is vested in the President, the government and parliament.

General João Manuel Gonçalves Lourenço took the leadership position of the ruling MPLA after legislative elections held in August 2017. As the MPLA won a majority of 150 seats, Lourenço automatically became the President of Angola, succeeding José Eduardo dos Santos who had ruled the country for 38 years. Lourenço was officially sworn into office on 26 September 2017.

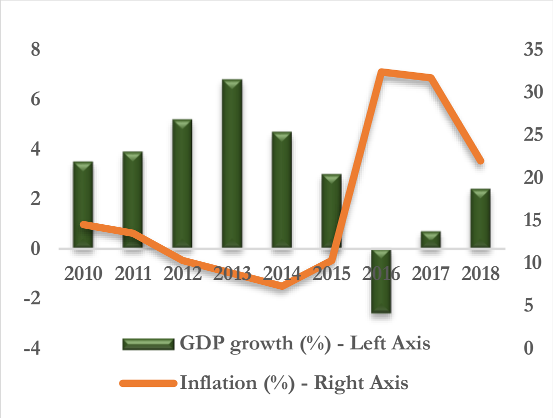
Economic Overview

GDP: After averaging a growth rate of over 8 percent from 2000-2014, the economy of Angola contracted by 2.6 percent in 2016 following the collapse of oil prices in the aftermath of the end of the commodity super-cycle. However, it recovered in 2017 with output expanding by 0.7 percent, partly on the back of a slight recovery in global oil prices, strong performance in agriculture and energy. The recovery also reflects, the improving macroeconomic environment anchored on the Macroeconomic Stabilization Programme (MSP) launched by the Government in January 2018.

The recovery is expected to continue in the short-to-medium-term, with growth projected to remain modest, at 2.4 percent in 2018 and about 2.5 percent in 2019, supported by the recovery in oil prices and increasing oil production; increasing foreign direct investment in a context of improving competitiveness and foreign currency supply following reform of monetary policy and diversification of sources of growth.

Prepared by the Research and International Cooperation Department.

Figure 1. Angola GDP Growth and Inflation (%)



Source: IMF World Economic Outlook (2017)

However, the country continues to face a number of structural challenges on its growth path. These include the deficits of economic diversification, unequal distribution of growth, weak agricultural productivity, inadequate infrastructure, shortage of human resources (in particular, in business management, science and technology, construction, and manufacturing), weak trade facilitation and export support systems, and an onerous business environment that impedes private sector development.

Inflation: Food imports are a major component of Angola's consumption basket and as a result consumer-price inflation is highly sensitive to changes in global food prices. After peaking in 2010 inflation trended downwards to a record low of 7.3 percent in 2014. However, owing to liquidity challenges and exchange rate volatility associated with the end of commodity super-cycle, inflation rose to 10.3 percent in 2015 and accelerated to 32.4 percent in 2016 before declining marginally at 31.7 percent in 2017.

An improving macroeconomic environment, among other factors, has contributed to the easing of inflation from 23.5 percent in August 2018 to 21.6 percent in September 2018 and is expected at 22 percent in December 2018, a 9.7 percent decline over the last 12 months.

Given the large share of imported goods in the consumer basket the National Bank of Angola (BNA) has focused its policies on stabilizing the nominal exchange rate to reduce inflationary pressures. While conservative monetary and fiscal policies have mitigated against higher inflation, structural inflation remains high due to the country's reliance on imports, bottlenecks in basic infrastructure including transportation and energy, uncompetitive and geographically truncated markets, and other factors that constrain the flow of goods.

Exchange Rate: After the tumultuous economic experience in recent years, Angola is gradually moving towards a more market-based, floating exchange rate regime with a nominal monetary anchor. BNA carried out policies that led to a large currency devaluation early in 2018 and has been promoting small monthly devaluations since then. It has eased currency controls, increased transparency in foreign exchange allocations through regular auctions and improved communication, in a move towards a more market-based and floating exchange rate regime. Since January 2018 the local currency has depreciated by 56.7 percent against the US dollar.

Fiscal balance: The overall fiscal deficit worsened to 6 percent of GDP in 2017 after the deterioration of the fiscal account following the end of the commodity super-cycle and exchange rate adjustment. The government plans to restructure its debt to reduce the burden on its public finances. At 76 percent in 2017, total debt service to export revenues is becoming hard to sustain and limiting investments in social sectors and infrastructure projects. Consistent with declining fiscal revenues, the fiscal policy is likely to remain restrictive as the authorities further reduce the public-sector wage bill as a percentage of fiscal receipts. Similarly, public investment financed from domestic resources as percentage of fiscal revenues is set to decline to 21.2 percent in 2018.

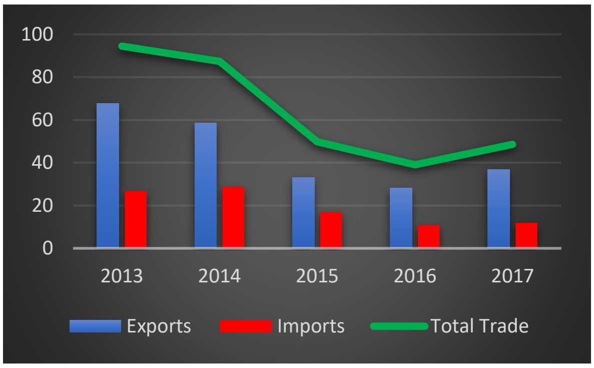
The government has also prioritized clearance of arrears in 2018 and is targeting a fiscal deficit below 3.6 percent of GDP in 2018/19. The fiscal reforms also include the introduction of Value-Added Taxes (VAT) and other measures to enhance domestic revenue mobilization.

Overview of trade, reserves and financial sector

Trade: Angola is the 65th largest export economy in the world and was the 3rd largest export economy in Africa in 2017. It exported US$36.73 billion and imported US$11.91 billion of goods and services in 2017, resulting in a trade surplus of US$24.8 billion. This large trade surplus is on account of improved oil prices in a context of recovery in the natural resources and commodity markets.

Angola mainly exports oil and diamonds. Its top export destinations are China, India, the US, and South Africa, which together accounted for more than 82 percent of total exports in 2017. Angola's top imports include capital goods such as machinery, electrical equipment and vehicles, but also plastics, iron and steel, and meat. Its top import origins are China, Portugal, the US, Brazil, and South Africa, which together accounted for more than 53 percent of total imports in 2017.

Figure 2: Angola's total trade, US$ billion



Source: ITC Trademap, Afreximbank Research

Intra-African Trade: Angola's total intra-African trade amounted to approximately U$2.31 billion in 2017, accounting for around 4.8 percent of its total trade, significantly below the regional average of 15 percent. South Africa is the top destination for Angola's exports within the region. It accounts for over 95 percent of Angola's total intra-African exports. The main exports to South Africa are oil and diamonds. Other export markets include the Congo Republic and Egypt.

Angola's largest African import partners are South Africa, and the Republic of Congo, which together accounts for over 95 percent of Angola's total intra-African imports. It imports machinery, refined petroleum products, beverages, and cereals from South Africa, and imports mainly fish and meat from the Republic of Congo.

Reserves: Angola's reserve position has been trending down and reached US$17.3 billion as of December 2017 significantly down from the level of US$28.1 billion at the end of 2014 that was built up during the commodity super-cycle. The decline in foreign reserves is largely on account of falling oil prices and large outflow of foreign reserves to honor external debt service payments by the National Bank of Angola.

International reserves at the end of 2017 remained at comfortable levels, with coverage above the Southern Africa Development Community (SADC) convergence target of six-months for imports of goods and services. The devaluation and floating of the currency in January 2018 along with the recovery in oil prices should help ease pressure on demand for foreign reserves and incentivize FDI flows which in recent years have helped sustain the reserve position.

Current and capital account balance: Since the end of the commodity super-cycle in 2014, Angola's current account position has slipped into deficits, peaking at 8.8 percent of GDP in 2015 before narrowing to 0.9 percent of GDP in 2017, supported by improved terms of trade. After widening to 2.1 percent of GDP in 2018 the current account is expected to improve during 2019-21 and is forecast to average below 2 percent of GDP, on account of a stronger oil price and ongoing efforts by the Government to accelerate the process of structural transformation and diversification of sources of growth.

The capital account was also under pressure as foreign direct investment (FDI) continued to be adversely affected by declining terms of trade. Lower oil prices led to a standstill in upstream investment since reserves and developments in deep and ultradeep waters would require a higher oil price for oil companies to break even. A large share of FDI flows to Angola reflects liquidity management by oil companies in the context of lack of local capital markets.

Overall, Angola's risk of reversal of capital flows is very limited. Other financial flows, such as portfolio investment, trade credits, and currency and deposits mostly reflect investments of public sector funds abroad and banking sector activities for facilitating international trade. Non-residents' investment in Angola is limited to FDI and more recently purchases of long-term government securities issued abroad as it has a closed capital account for other flows.

Financial sector: The IMF notes that while the banking system is generally stable, lingering vulnerabilities persist. Banks have generally been supported and benefitted from greater exchange rate flexibility, but a few banks are struggling with forex liquidity mismatches. The BNA introduced a new liquidity requirement for banks that curtails their daily net forex liquid position around 20 percent of regulatory capital by March 2018 and around 10 percent by June 2018. This reform has negatively impacted a few banks. The BNA also increased threefold the minimum regulatory capital requirement for commercial banks to be met by end-2018, which could lead to some consolidation in the sector. In addition, banks continue to suffer from subdued lending and, in the case of state-owned banks, very high NPLs. A state funded asset management company, Recredit, has agreed to acquire about one-third (Kz300 billion) of Banco de Poupança e Crédito S.A.R.L. (BPC) distressed assets and is working with other banks to acquire an additional Kz180 billion NPLs.

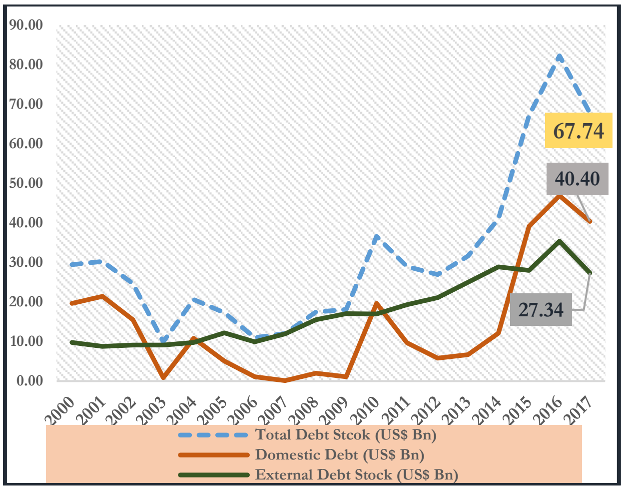
Of the 28 commercial banks registered to operate in Angola, five—Banco Angolano de Investimentos (BAI), Banco Economico, Banco de Fomento Angola (BFA), Banco BIC Angola (BIC) and Banco de Poupança e Crédito S.A.R.L. (BPC) —control over 80 percent of total banking assets, deposits and loans.

Debt Sustainability Analysis

Angola's total debt has grown by some 230.25 percent over the last 17 years from US$29.42 billion in 2000 to US$67.74 billion in 2017 with the total debt stock peaking during 2016 at US$82.25 billion (Figure 3). Even though Angola's total debt has largely been driven by external borrowing, there has been a shift towards increasing reliance on domestic borrowing since 2015.

At US$40.4 billion domestic borrowing now accounts for about 60 percent of Angola's total debt. The adverse effects of the end of commodity super-cycle saw debt levels rise even more dramatically during the period 2014-17, with total debt reaching US$67.74 billion from US$41.03 billion in 2014. As a ratio of GDP, total debt increased from 40.68 percent to 65.27 percent over the same period, well above the 40 percent debt sustainability threshold.

Figure 3: Trend in Angola's Total Debt Stock



Source: World Bank, WDI Database, 2018

Angola scored 3.4 in the 2017 World Bank Country and Policy Institutional Assessment (CPIA) index[1]—up from 3.2 in 2016 and marginally above the middle-income country average of 3.3, perhaps pointing to improving macroeconomic management.

With an overall CPIA score of 3.4, the indicative thresholds for the country's debt sustainability are as follows: Present value (PV) of external debt/GDP at 40%; PV of total debt/GDP at 55%; PV of external debt/exports at 180%; PV of external debt service/revenue at 18%. Angola's debt sustainability is assessed against the aforementioned benchmarks.

(i) PV of external debt/GDP

External public debt has increased at a more moderate pace with the debt ratios generally around the policy-dependent threshold of 40%,

1(1=lowest, 6=highest); Debt thresholds corresponding to strong performers are highest, indicating that countries with good macroeconomic performance and policies, can generally handle greater debt accumulation.

except for 2017 which posted 35.2%. Accordingly, Angola's external debt is projected to remain stable at around 40 percent of GDP over the medium term on the back of increasing reliance on domestic borrowings and effective implementation of economic reforms.

(ii) *PV of total debt/GDP*

The PV of Angola's total debt to GDP has been rising and exceeded the threshold of 55% in 2015, largely driven by increasing domestic debt in a context of widening fiscal deficits, exchange rate depreciation, and recapitalization of state-owned enterprises and banks. It is forecast to peak at 72.9% in 2018 followed by a marginal but steady decline in the medium-term as the authorities implement fiscal consolidation and structural reforms to improve governance and the business climate.

(iii) *PV of external debt/exports*

The PV of external debt to exports is forecast at 115.4% in 2018 (down from 130.3% in 2017), and below debt the sustainability threshold of 180%. This ratio, which is sensitive to dynamics in the world oil market, is expected to increase over the medium-term peaking at 144% in 2021. Overall, even though the dynamics in external debt-to-exports ratio are consistent with a moderate risk of debt distress, it highlights vulnerability of Angola's debt profile to global volatility and adverse terms of trade shocks.

(iv) *External debt service/Government revenue*

At 13.4% in 2017, the ratio of external debt service to revenue is below the DSF threshold of 18% and is projected to marginally decline in 2018 at 13.2% and forecast to continue the downward trend over the medium-term. The impact of external debt servicing costs on total revenue could nonetheless be improved through ongoing efforts by the government to broaden the tax base to increase domestic resource mobilization, increasing reliance on semi-concessional loans and continuing implementation of structural reforms. The government is also pursuing a prudent debt management strategy and developing the domestic debt market which would allow the gradual replacement of government domestic securities denominated in foreign currency with local currency government bonds with longer maturities thereby improving the country's debt profile and mitigating risks to debt sustainability.

Table 1: Debt Sustainability Framework

DSF and (threshold)	2017	2018F	2019F	2020F	2021F
PV external debt/GDP (40%)	35.2	39.8	40.5	40.1	39.6
PV total debt/GDP (55%)	64.1	72.9	69.9	67.3	65.4
PV of external debt/exports (180%)	130.3	115.4	126.2	135.2	144
External debt service/revenue (18%)	13.4	13.2	12.7	11.8	11.2

Source: IMF and World Bank, 2018

Overall, Angola's public debt remains vulnerable to growth and exchange rate volatility, and global volatility, adverse commodity terms of trade, and contingent liability shocks. However, risks to debt sustainability are mitigated by the availability of buffers (government deposits and international reserves), financing on semi-concessional terms, and strong ownership of ongoing reforms.

On balance and in light of the foregoing, the risk of debt distress in Angola is deemed moderate even though vulnerable.

Opportunities for Bank Support

Even though the oil sector has dominated the Angolan economy and has attracted foreign investment with competitive returns, investment opportunities in Angola do not begin and end with oil, especially given the commitment by the government to diversify the economy away from over-reliance on oil.

The favourable climatic conditions and government commitment to diversifying sources of growth of the country offer a number of opportunities in the agricultural sector which could be significant, especially for a country that has seen its food import bill increase steadily over the last decades. In addition to boosting agricultural growth and productivity there are also opportunities to develop agro-processing facilities and manufacturing and industrial activities to promote value addition and diversification of the country's export basket. Within the context of the National Development Plan 2018–2022, other areas that offer opportunities include (i) Offshore Oil and Gas

Technologies, (ii) Electrical Power Equipment, (iii) Transportation and Logistics-Aviation and Rail; (iv) Marine Technologies (Fisheries and Ports infrastructure); and (v) Mining.

Table 2. Angola Selected Macroeconomic and Financial Indicators

	2010	2011	2012	2013	2014	2015	2016	2017	2018(f)	2019(f)
Real GDP, %	3.5	3.9	5.2	6.8	4.7	3	-2.6	0.7	2.4	2.5
Inflation, %, Annual average	14.5	13.5	10.3	8.8	**7.3**	10.3	32.4	31.7	22.0	17.1
Exports of Goods and Services % y/y	-19.5	-5.4	3.8	0.1	-2.1	6.7	2.0	0.6	2.8	
Current Account (% of GDP)	9	11.7	10.8	6.1	-2.6	-8.8	-4.8	-0.9	-2.1	-1.9
Total Reserves (US$ billion)	19.8	28.8	33.4	32.8	28.1	23.8	23.7	17.3	24.1	25.8
Gross Reserves (months of imports)	5.4	6.4	7.1	6.5	5.4	6.5	9.1	6.0	5.2	5.8

Sources: IMF, World Bank: WDI; EIU (various issues), 2018.