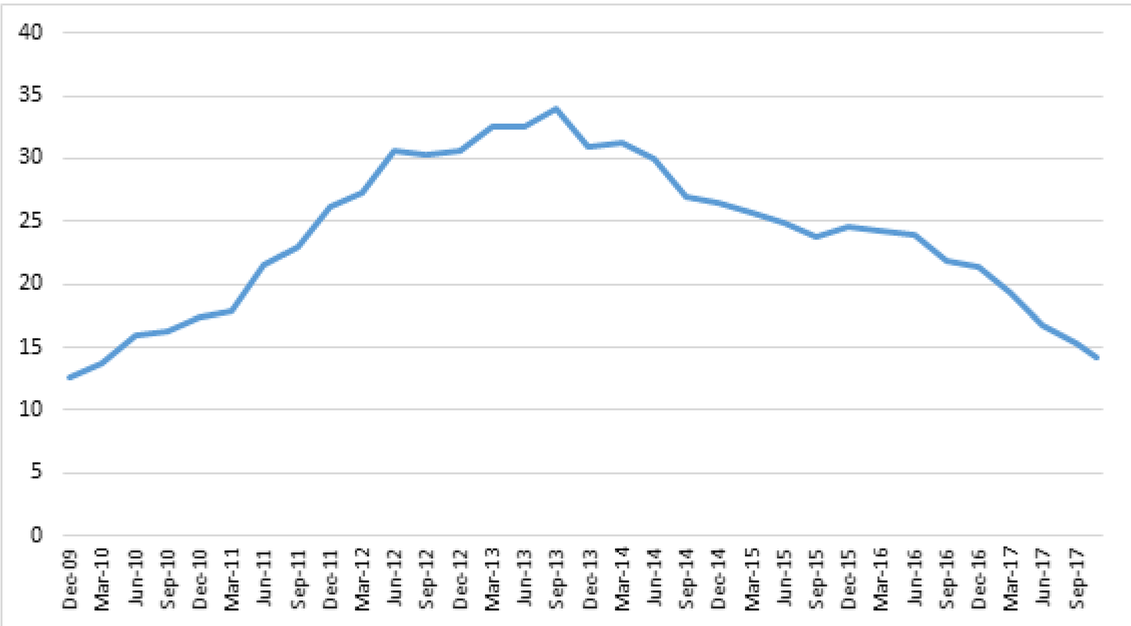
Afreximbank Research–Trade Update
January 2018

Angola Adopts a New Currency Regime

Angola, Africa's second largest oil exporter, has ended its two-year currency peg to the US Dollar. This follows a recent statement from the National Bank of Angola (Banco Nacional de Angola, BNA) indicating that the exchange rate would henceforth be determined at currency auctions. The first auction held on January 9, 2018, resulted in a de-facto 10.1% devaluation against the euro and 13.4% against the USD. The change in policy was widely anticipated as the new government of President Joao Lourenco had indicated its commitment to fiscal and foreign exchange adjustments.

Both the internal and external adjustments were prompted by sharp currency depreciation and rapid declines in foreign exchange reserves following the collapse in oil prices in a country where oil exports are the main source of growth and foreign exchange earnings, accounting for more than 50% of GDP and 75% of government revenues. The weakening of foreign reserves, which shrank by more than 50% to US$14.3 billion, was exacerbated by the withdrawal of correspondent banking relationships by large international banks as part of their de-risking strategy.

Central Bank of Angola Net International Reserves (USD billion)

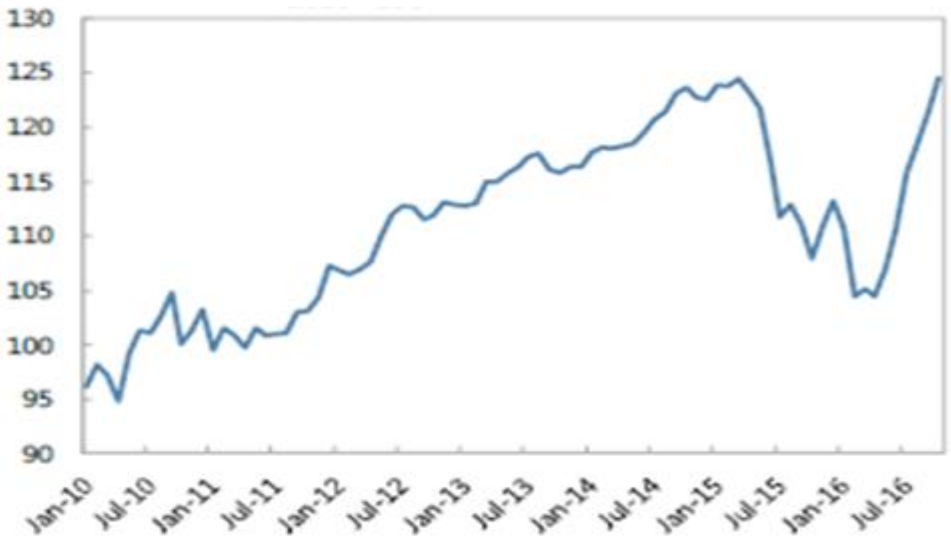


Source: Bloomberg, Afreximbank Research

The sharp drawdown in the foreign reserve position had undermined the central bank's ability to support the kwanza through market interventions, a constraint which contributed to the adoption of a number of policy measures as part of the adjustment to low commodity prices, including drastic cuts in government expenditure and public investment, currency controls and more recently the shift towards a more flexible exchange rate regime. The adoption of exchange controls by government authorities as the first measure to defend the currency did not stem the reduction of foreign reserves, but instead created import bottlenecks due to limited access to foreign exchange and declining investment flows in a context of increasing exchange risks and challenges faced by investors in repatriating funds. To some certain extent parallel markets allow for some degree of business continuity, but at a rate well above the official rate. The Angolan Kwanza (AOA) had been pegged to the USD at a rate of around AOA166:USD1 since April 2016, against AOA360:USD1 in the parallel market.

In this context the Central Bank of Angola recently announced its plans to shift from a currency peg to a trading band which would keep the kwanza's value against the US dollar within a range. Although the new monetary arrangement is set to become fully operational in January 2018, the range within which the exchange rate will be allowed to fluctuate is yet to be defined. However, what is certain under the new monetary arrangement is that the exchange rate will be determined by supply and demand of foreign reserves via a primary market auction. The move which was accompanied by the government decision to ease currency controls had been advocated by the International Monetary Fund, in part reflecting the fact that countries with floating exchange rate regimes have enjoyed more flexibility and have done a better job at stabilizing their reserves even though at an initial cost of sharp currency depreciations.

Angola Real Effective Exchange rate, 2010=100



Source: IMF

The change in Angola's currency regime is by no means unprecedented. The country joins a long list of commodity exporters, and especially oil-exporters, on the continent and globally, including Nigeria, Russia and Kazakhstan, which have either floated or devalued their currencies in a bid to improve foreign exchange liquidity and stem pressures on foreign reserves associated with the end of the commodity price boom. For these countries the shift towards a flexible exchange rate regime has led to improvements in economic output, greater currency stability (including a convergence between the official and parallel market rates), and a return of investor confidence.

In this regard, and all things being equal, the reforms undertaken by the Government of Angola—the shift towards a more flexible exchange rate and easing of capital controls—should bring some level of transparency and predictability to exchange rate management, and in the process strengthen investors' confidence. In addition the adjustment could enhance the external competitiveness of the economy.

The Expected Effects

The sharp depreciation associated with the shift towards a more flexible exchange rate regime is likely to raise a number of challenges in the short term, including inflationary pressures and costs to debt servicing. In a country which relies almost exclusively on imports for both basic consumption and manufactured goods the risks of inflation for growth are significant. In particular the rise in the cost of imports could induce a fall in domestic output in the short run. In the fiscal space, the shift towards a more flexible exchange rate regime could have a direct effect on the domestic currency costs of foreign debt servicing although this risk is mitigated by resilient oil output and firmer oil prices. The debt-service to revenue ratio has deteriorated on account of higher borrowing and higher yields—primarily on domestic debt which accounts for over 95% of short-term debt. Although a weaker currency could potentially ease domestic debt servicing costs, this will be limited by the fact that a large share is indexed to the USD. For a country where total public debt currently stands at US$76 billion, with more than 60% denominated in foreign currency the government should be rightly concerned that a sharp fall in exchange rates could raise the debt-to-GDP ratio, a view similarly expressed by rating agency Moody’s. Measures to extend the maturity profile of the debt could decrease debt-servicing costs and reduce the risks of default and public sector crowding out.

After consecutive years of surpluses, Angola’s current account plummeted in 2014, reaching -10.3% of GDP according to consensus forecasts, on account of the sharp and sustained decline in oil prices between 2014 and 2016. This adverse change in Angola’s terms of trade was exacerbated by still-firm imports, comparable with the oil boom years and facilitated by a relatively strong currency and robust foreign reserves. To a large extent, the improvement in the current account in 2016 is attributable to the decline in imports, occasioned by the devaluation of the kwanza in January 2016 with the current account improving to -6.0% of GDP in 2016 even as oil receipts fell. The current account balance is forecast to further improve and the recent devaluation of the kwanza could, within the context of firming oil prices, lead to a stronger-than-previously-anticipated improvement and strengthen the foreign reserve position. According to data from Banco Nacional de Angola, Angola’s net international reserves stood at around US$14.3 billion in November 2017, significantly down from the level of US$26.5 billion at the end of 2014 that was built up during the previous oil boom period.

After contracting by 0.66% in 2016 following the collapse of oil prices, economic activity expanded in 2017, leading to 1.5% economic growth. Consensus forecasts point to strengthening economic activities with real GDP growth expanding by 2.6% in 2018, on the back of firming commodity prices, a moderate expansion in government and private consumption and an increase in non-oil activity as the industrial, construction, and services sectors recover.

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