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FLASH NOTE
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New Eurobond issue expands Angolan treasury yield curve

Bond was costly comparing to African peers, but cheaper than in 2015

A. DESCRIPTION

1 - Angola returned to international markets, following its maiden 10-year Eurobond in late 2015.
The issue occurred last week – settlement date today, May 9th. Goldman Sachs, ICBC Standard and Deutsche Bank were the bookrunners for this dual-tranche issue, comprising of a 10-year and a 30-year bond. The 10-year issue amounted to USD 1.75 bn at 8.25%. The longer term bond saw an issue of USD 1.25 bn, costing 9.375% in interest to Angola. The operation drew USD 9 bn in demand (with a bias towards the 10-year issue) - bid-to-cover ratio of 3.

B. ANALYSIS

1 - The 10-year interest rate agreed was 1.25 percentage points (p.p.) below the previous issue in November 2015. Thus, even though the cost was above what was publicly expected by the Finance Ministry, the Government effectively financed itself on cheaper terms than two-and-a-half years ago. Moreover, the spread against US treasuries was significantly lower: the 8.25% interest rate implies a spread of 529 basis points (b.p.), compared to 726 b.p. at the 2015 issue. As a measure of Angolan risk, **this shows that the market now considers somewhat less risky to invest in Angolan debt, relative to 2015.**

2 - Looking at international peers, the interest rate on this issue is relatively high.
Particularly in the case of the 30-year issue, Angola is to pay the highest interest rate of all Sub-Saharan issuers: South Africa (5.65%), Senegal (6.75%), Nigeria (7.625%) and Kenya (8.25%). Notably, one should compare with Nigeria, also an oil producer; the main difference allowing this country to get cheaper financing is related to its lesser dependency on food imports, among other factors. Nevertheless, the previous analysis could be somewhat deceiving: while it is true that Angola pays the highest cost for 30-year debt among its peers, **it is also particularly relevant to note that there was market demand for a 30-year issue, which translates into a relatively significant degree of trust in the country.** In other words, among all African issuers of such long term debt, Angola is the riskiest – but the country is still on that lot; moreover, Senegal and Kenya have likewise issued their 30-year bonds for the first time this year. **Thus, this is indeed a relative milestone, expanding the Angolan Treasury Yield curve, in a somewhat surprising fashion - a single 10-year issue was considered to be the most likely scenario by market participants.**

The risk spread of the previous Eurobond has decreased against the US but also Nigeria

Source: Bloomberg

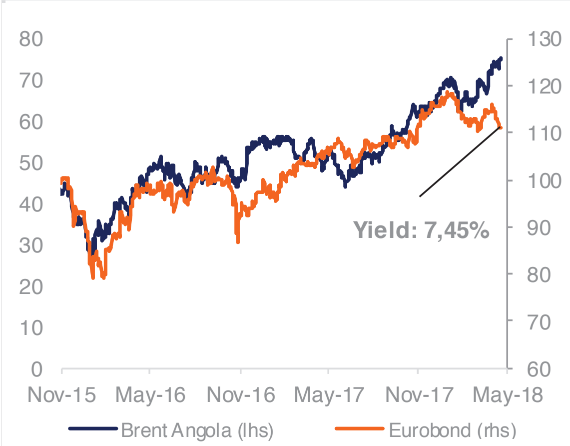
3 - **These USD 3 bn are quite significant for the Executive's financing needs this year.** According to macroeconomic data available at the Finance Ministry's website, external debt issuance this year should amount to USD 9 bn. Thus, this issue ensures on itself 1/3 of planned external debt; adding USD 2 bn agreed with the Brazilian Development Bank (BNDES), plus USD 500 million from Gemcorp, and some other USD 500 million from UK Export Finance, 2/3 of external financing are already assured. Finally, credit lines are still being negotiated, namely with ICBC Standard and China Exim Bank, among others.

Box– In the secondary market, with the exception of recent divergence, the yields of the Eurobond issued in November 2015 have followed kept with oil prices

1- Brent and the Eurobond maturing in 2025 have been positively correlated from the issue date. After trading at a minimum price of USD 26.74 per barrel in January 2016, the Brent price has been appreciating, reaching a maximum value of USD 75.21 per barrel May this year, the highest level since November 2014. Similarly, in January 2016, the Eurobond traded at USD 78.96, the lowest price seen since the issue; thus, since price and yield move inversely, the bond presented the highest yield-to- maturity (YTM) at that date (13.24%). On the other hand, the lowest YTM was seen January this year, of 6.35%, while the obligation was quoted at the highest price since it was issued (USD 118.75). However, after the start of the roadshow, there was a divergence in the behaviour between the Brent and Eurobond prices; in fact, while Brent appreciated, the Eurobond fell. This was probably due to the selling position of some debt holders, who may have sold some of their 2025 holdings in order to participate in new issue that occurred this month.

The 2025 Eurobond has fluctuated in price according to the evolution of oil prices

USD per barrel; index

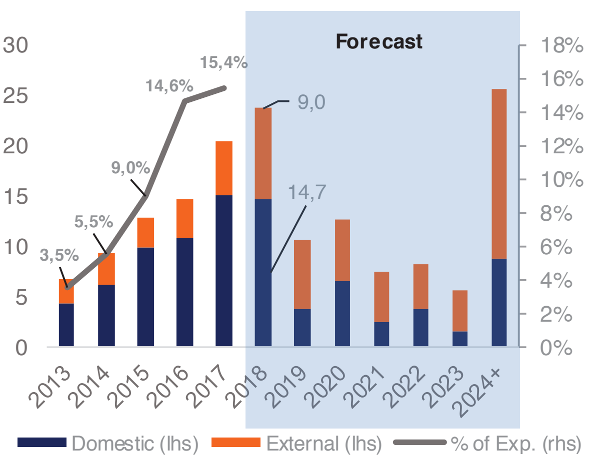


Source: Bloomberg

4 - **Despite the success of this issue, debt refinancing issues will remain pressing during this year and the next.** Although the funds obtained will grant the Government some degree of planning, and a little less navigation in sight, the benefit is limited. There are still very high funding needs for this year, and these are expected to remain in 2019, and they are not necessarily going to be lower. In fact, it all depends on the success of the Government in extending the maturity of debt to be issued. Moreover, fiscal consolidation will continue to be the key factor for solving the debt problem (in addition to economic growth). Therefore, it is essential that the Government complies with the Budget approved (particularly regarding expenditure), using any margin that arises from oil revenues (given current oil prices well above the USD 50 which were assumed by the Executive in the Budget) to pay arrears to suppliers or as a financial cushion, as it has already been discussed.

Angola faces significant debt repayments in the next years, even without short-term refinancing

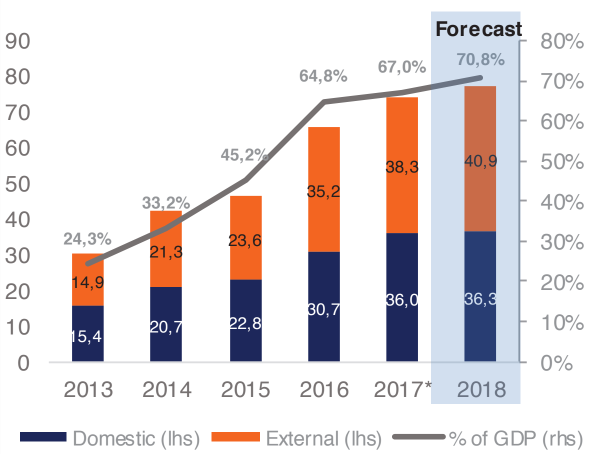
USD billion; percentage



Source: MinFin

Public debt has been on the rise, albeit at a slower rate since 2016

USD billion; percentage



*Preliminary

Source: MinFin

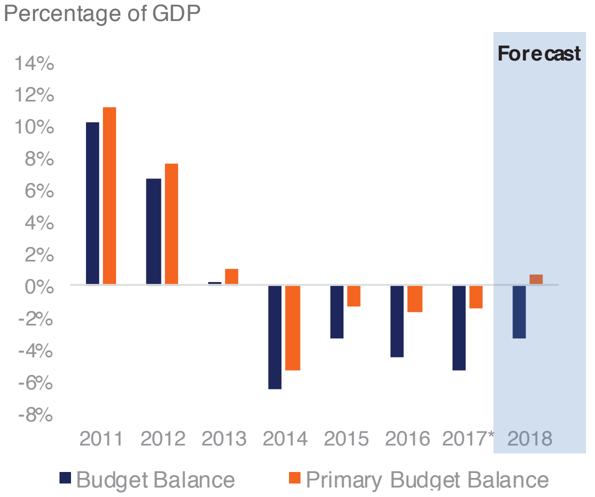
5 - Investor geography was not too concentrated, according to sources close to the deal. The origin of the funding came mainly from the United States and the United Kingdom, probably due to the Government pushing the operation in these geographical areas, but there was also investment from other European countries. **The presence of a few more conservative investors, including insurers and pension funds, is a positive sign.** Even though their share was small (as usually expected in high-risk assets), the fact that some of these institutions have made this investment is a good indicator of the credibility amassed by the Angolan authorities. **Sources close to investors on the roadshow indicate that the authorities' responses to the doubts of the possible buyers were detailed and assertive, in particular regarding short-term policies and issues related to existing high levels of public debt.**

CI CONCLUSION

1 - This was a significant debt issue for the country, albeit at a relatively high cost. One should note that, for a country such as Angola, ensuring financing at such long maturities (like 30 years) is an important step towards establishing a deeper interaction with international markets; in fact, it allows the country to showcase itself in more appealing conditions in the face of investors. **Indeed the broadening of the treasury curve is going to establish a relatively solid indicator of market perceptions on the country, which is useful for decision making for the Government, investors and businessmen alike.**

Debt will only be reduced if the budget deficit is put well under control

Percentage of GDP



*Preliminary

Source: MinFin

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2 - Equally relevant (aside from the increase in maturity) is the decrease in dependency from bilateral financing. For example, while it is true that Chinese funds were important for Angola, particularly when other funds were not available, tapping a more diverse range of financing sources is quite necessary for the country, in order to increase its bargaining power when looking for money abroad.

3- As previously mentioned, there is still need for renewed and constant fiscal consolidation, broadening the tax base and keeping expenditure under control. Angolan debt is close to a threshold where sustainability questions are already arising; the future of such debt will mostly depend on the actions of the Angolan Government (and oil prices). Investors have raised their doubts on that same sustainability, with the replies of Angolan authorities keeping them content enough that there was an eager demand for this debt issue. The issue now lies with executing the Government's plans; in that sense, the upcoming IMF Policy Cooperation Instrument could be an important source of pressure, seeing as the previous pressure (the need to get this Eurobond issue through) exists no longer.

4 - Finally, despite the high cost, we do not consider this additional debt raising unwise; in fact, these funds were necessary. The country is taking on new debt because of previously existing needs; the alternative would entail either: cutting public expenditure further (or increase revenue); or selling public assets. The former solution is the one to go for, but it will take some time; the latter can produce quick results, albeit having effects only in the short term, leaving future commitments unaccounted. **We thus disagree from an argument that further indebtedness is not the path to pursue because of possible misuse of funds.** These are two separate issues: as mentioned above, liabilities towards suppliers, creditors, civil servants and the Angolan people in general, these are previous to the debt issue: if they are left unattended, there is then indeed a risk of default or of adding fuel to an already fiery environment of social problems. On the other hand, it is indeed essential to use up any eventual financial slack to - as already mulled by the Executive - pay up arrears, and to continue in a path of fiscal responsibility, ever more demanding. **As a matter of fact, in the sense that this step will lead to an increased level of interaction with financial markets (instead of bilateral lenders), the Eurobond issue could well be an important incentive for the reforms currently under way to be actually implemented - as long as the stakeholders involved wish it.**