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FLASH NOTE
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State Budget 2019 continues fiscal consolidation path

Brent's price decline may lead to additional spending constraints

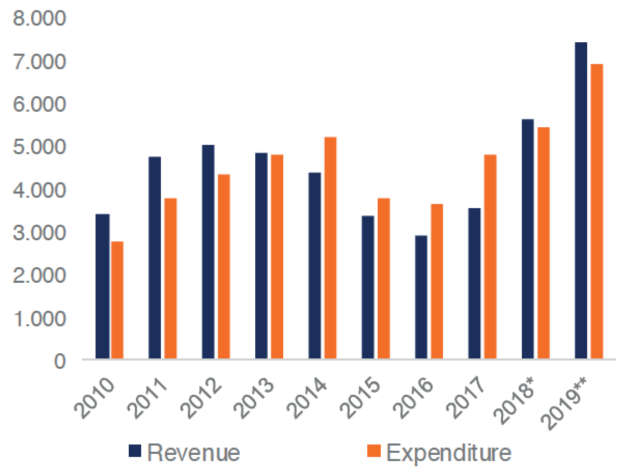
A. DESCRIPTION

1- The State Budget for 2019, approved in Parliament on 14th of December, provides for a budget revenue of AOA 7423.8 billion (bn) and budgetary expenditure of AOA 6917.8 bn of Kwanzas. The analyses are under the preliminary version of the OGE. However, the differences to the final 2019 budget are not expected to be material.

2- On the revenue side, there is an increase of 32.0% compared to the year-end projections for 2018, which is equivalent to an increase of AOA 1798.8 bn. This increase is mainly due to a foreseen growth of oil taxes, forecast for 2019, in the amount of AOA 1433.4 bn (+36.9%). On the other hand, there is also an increase in non-oil tax revenue by AOA 342.3 bn (+25.0%).

Revenue and expenditure are both to grow significantly in nominal terms...

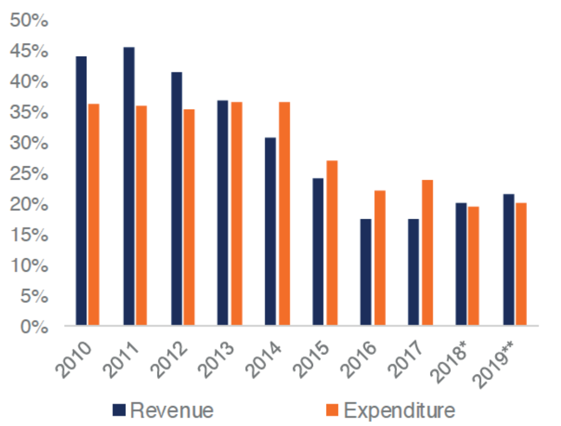
Billion Kwanza



*Closing projections **Forecast Source: Finance Ministry

...while in percentage of GDP revenue will grow and spending will remain stagnant

Percentage of GDP



*Closing projections **Forecast Source: Finance Ministry

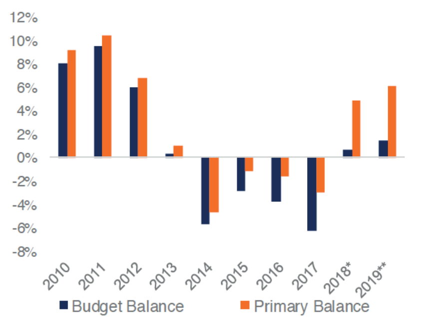
3- 3I The current economic context – with the drastic depreciation of the currency and the still high inflation – makes this analysis in nominal terms somewhat deceiving, demanding a more detailed analysis in percentage of GDP terms. In this case, when analysing the revenue as a percentage of GDP, there is a clear increase in revenue by 1.39 percentage points (p.p.) to 21.3% of GDP (19.9% in the closing projections for 2018). This will be the second consecutive year of revenue growth as a percentage of GDP, although this is far from the beginning of the decade (44.1% of GDP in 2010). This medium-term decline is mainly due to the decrease in importance of oil tax revenues; in 2010, these were worth four times the value of other tax revenues; by 2015, oil taxes almost matched the other taxes in amount. Whereas, currently, oil prices are at levels slightly above the lows of 2015 and 2016, oil revenues for 2019 stand out again against the other revenues: 15.3% of GDP in oil tax revenues, versus 4.9% in other taxes.

4-Expenditure should also increase by AOA 1467.9 bn (+26.9%), this growth is observed in several of the components, with interest payments and purchases of goods and services expected to have the highest increases, respectively AOA 444.2 bn (+37.6%) and AOA 403.9 bn (+41.6%); transfers also increase in nominal terms (particularly for the subsidies - +AOA 274.6 bn), as well as public investment (+AOA 234.6 bn) and wages (+AOA 104.6 bn). **As a percentage of GDP,**

however, spending should almost stagnate, rising by only 56 basis points (bps) to 19.9% of GDP. Excluding wages and public investment (84 bps and 5 bps), the remaining expenditure shows growth when expressed as a percentage of GDP. Current expenditures will represent 16.1% of GDP (+61 bps compared to 2018), while capital expenditure (investment) is expected to amount to 3.8% of GDP (- 5 bps than in 2018).

Budget balance and primary budget balance are to improve for second year in a row…

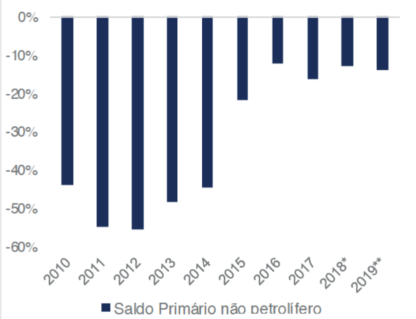
Percentage of GDP



*Closing projections **Forecast Source: Finance Ministry

…while the non-oil budget deficit has been lower in the las few years

Percentage of non-oil GDP



*Closing projections **Forecast Source: Finance Ministry

5- The projection for 2019 should result in a budget surplus of AOA 505.9 bn, AOA 330.9 bn above the closing projection for 2018 - AOA 175 bn. **As a percentage of GDP, this is an increase from 0.6% to 1.5% of GDP.** Therefore, according to Government forecasts, Angola will again have a positive primary balance for the second consecutive year of AOA 2132.4 bn – an increase of AOA 775.1 compared to 2018. **On the other hand, the primary non-oil deficit is expected to increase (+AOA 658.3 bn), falling marginally as percentage of nonoil GDP, from 13.0% to 13.8%.**

Box – 2018 State Budget performance

1- Looking at year-end figures for the 2018 State Budget 2018, although we only have the closing projections, it is clear that the main difference from expectations in March (when the OGE was approved) is in the price of Brent that has been much higher than expected. The cumulative selling price of Angolan oil exports stood at USD 71.1, for sales until November; which compares to the Budget hypothesis of USD 50 per barrel. Thus, despite the much lower production volume than expected (the latest data point to a production volume close to 1.51-1.52 million barrels per day, far from the 1.70 forecast by the Executive), the revenues in oil taxes will probably reach AOA 3886 bn, well above the forecasted in the state budget 2018 (AOA 2399 billion). It should be noted that non-oil taxes are expected to be well below projected value, and even below our own projection in March, as presented in the table below.

2- On the expenditure side, these will amount to AOA 5450 bn, slightly above the estimated (forecast of AOA 5209 bn). Here, the main factor of increase comparing to the planned spending had already been signalled by our research piece back in March: interest payments, which were 22% higher than expected, totalling AOA 1182 bn (forecast of AOA 0.968 bn). Public investment should also be higher than expected, although we have some doubts about the conclusion of several investments by the end of the year. Despite some of these investments being likely accounted for in 2018 - budgetary allocations for various investments have been made in recent months-, their effective implementation is expected to continue throughout 2019.

3- As a result of this Budget performance, the Executive expects 0.6% of GDP in surplus this year, not anticipated by any predicting institution. This is a positive development, especially given the 6.3% deficit in 2017. Moreover, this consolidation is also visible in the primary balance indicator, which has also returned to a surplus, something which had not occurred since 2013 (the same year in which a budget surplus had occurred). To finalise, it is worth mentioning that, excluding the effects in the oil price, and looking at the non-oil primary balance (as a percentage of non-oil GDP), a lower deficit was also achieved, from 16.3% to -13.0%.

Forecast Scenario	Fin. Min.	BFA	Execution
Hypotheses			
Oil barrel price (USD)	50	57,5	71,9
Oil output (mbd)	1,70	1,55	1,52
GDP growth (%)	4,9	1,8	-1,1
AOA Billion			
Revenue	4404	4258	5625
Oil taxes	2399	2361	3886
Non-oil taxes	1740	1547	1372
Expenditure	5209	5287	5450
Budget Balance	-805	-1029	175
in % of GDP	-3,4	-4,4	0,6

B. ANALYSIS

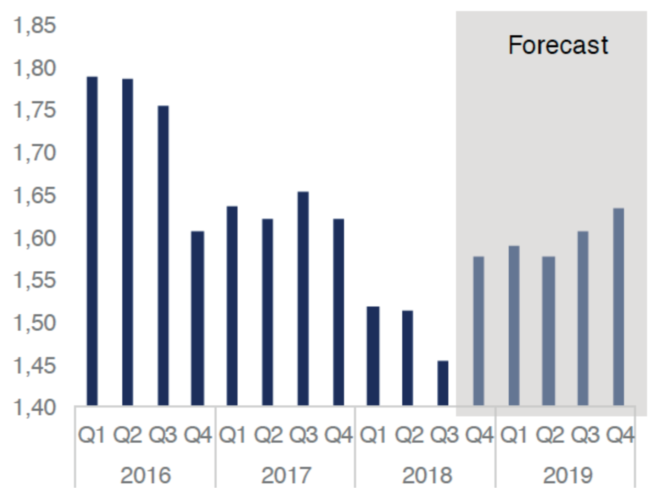
1-While the 2019 state budget looks conservative, it does have some vulnerability regarding oil revenue forecasts, even if the Brent average USD 68 per barrel.

2- Looking into the oil price hypothesis, the authorities expect an average Brent price of USD 68 per barrel. By the time we wrote this note, Brent traded close to USD 50 per barrel. On the one hand, this behaviour is a reflection of fears surrounding the supply, as investors are sceptical that declines in output agreed by OPEC + Russia will be sufficient to reduce market availability - while US output continuing to reach new highs. On the other hand, the impacts of the trade dispute between the US and China and the Federal Reserve's interest rate policy, as well as the momentum of market failure, obscure the prospects for growth in the commodity market. **However, a significant part of the analysts expect a recovery close to USD 70 per barrel. In particular, Bloomberg's composite forecast index also points to an average price of USD 72.5 in 2019.** Taking a perspective a little closer to current levels, like Commerzbank, we could expect an average Brent price of USD 65 next year. Although the Government's hypothesis is somewhat vulnerable at the moment, it is somehow a supported vision in the market. It is worth considering that the authorities anticipate the possibility of carrying out a revision of the budgetary assumptions after the end of the first quarter of 2019, if Brent prices remain close to current levels.

3- Regarding the expected oil volume produced, the Finance Minister forecast a rise, from 1.52 million barrels per day (mbd) this year, to 1.57 mbd in 2019. This forecast is supported by developments in 2 oil blocks: on the one hand, in Block 32, the output at Kaombo North is almost reaching full capacity, while Kaombo South is expected to start up in mid-2019, totalling an additional 0.23 mbd at full capacity; on the other hand, in Block 15.06, the Vandumbu field should lead production from 0.14 mbd to 0.17 mbd in Q1 2019. Our analysis, taking into account these new additions and the natural decline of the remaining Blocks, deems the Government's expectation achievable and even somewhat conservative; we feel that these forecasts may be surpassed, possibly reaching an average output of 1.60 mbd in 2019. This hypothesis is, thus, reasonable.

Crude exports are to increase in 2019, coming close to 1.60 mbd

Million barrels per day



Sources: Finance Ministry, BFA calc.

4- 4I Regarding the economy, the State Budget works assuming 2.8% growth in GDP, with 3.1% increase in the oil economy (including LNG), and 2.6% in the non-oil sector. This forecast is only slightly optimistic when compared with the average Bloomberg forecast (2.4%) or the latest IMF prediction (2.5%), divulged in the EFF programme documents. Our own estimates are relatively similar to what the Government expects regarding total GDP. However, we expect growth to be much more supported in the oil economy (which is consistent with our expectation of larger oil volume output compared to the Government), with the non-oil economy growing at a more modest pace.

5- According to the analysis above, our projection for the public accounts in 2019 takes the form of occurred depreciation in 2018; 2.9% in GDP growth;

1. Scenario A: Brent at USD 65; Oil volume produced at 1.60 mbd; Depreciation of about 1/3 of the occurred depreciation in 2018; 2.9% in GDP growth;

2. Scenario B: Brent at USD 58.5; Oil volume produced at 1.60 mbd; Depreciation of about ½ of the occurred depreciation in 2018; 2.3% in GDP growth.

Forecast Scenario	Fin. Min.	Scenario A	Scenario B	IMF
Hypotheses				
Oil barrel price (USD)	68	65	58,5	72,3
Oil output (mbd)	1,57	1,60	1,60	1,57
GDP growth (%)	2,8	2,9	2,3	2,5
Forecasts				
AOA Billion				
Revenue	7424	6978	6467	7424
Oil taxes	5319	4946	4426	5319
Non-oil taxes	1714	1667	1676	1648

6- Thus, in Scenario A, our forecast points towards a budget surplus of 0.3% of GDP; one should note, however, that these projections comprise a certain degree of uncertainty – using a reasonable margin of error, a budget surplus close to 1.5% of GDP is within range, if the assumptions remain the same. Still, it is worthwhile to take this forecast and explain the differences against the State Budget.

7-The main difference lies on a lower tax collection, both in oil and non-oil taxes. **In the case of oil taxes, we expect revenue to amount to AOA 4967.7 billion, about AOA 350 billion below the Executive's expectation.** This gap results, on the one hand, from a lower Brent price; aside from that, our estimates predict lower revenue even when assuming the Budget's hypotheses; in part, our estimate of a higher volume of oil production mitigates this gap. Looking at non-oil taxes, the difference comes from a different estimate of nominal GDP growth, which in turn leads to a lower amount of tax collected, in about AOA 50 billion, if we assume the Government's forecast expressed as a percentage of non-oil GDP. Although the Executive's forecast is slightly more optimistic than the normal performance of non-oil taxes – these are almost always considerably lower than expected -, this year's forecast looks somewhat more conservative. **Furthermore, one must take into consideration the pledge from the Government to the IMF of applying a package of contingency measures (non-oil taxes) worth about 0.3% of GDP in case the VAT implementation does not proceed according to the planned schedule (July 2019).** In total, revenue should come short of the Budget forecast in about AOA 424 billion.

8- On the expenditure side, we do not expect a scenario which is significantly different from the Executive's expectations, estimating spending to be around AOA 44 billion lower than the Budget's forecast. We base our estimates on the historic of execution of budgeted expenditure: for example, public investment and wages are normally executed below 100%, while transfers normally show an execution above 100%.

9- In Scenario B, a budget deficit of 1.3% of the GDP is expected, if no correcting measures are taken. One must note that, to illustrate the impact of a lower oil price, this Scenario assumes that only revenues change, while expenditure is executed in the same way as in Scenario A. Yet, it is likely that, if the Brent remains significantly below the initial expected level throughout 2019, the Executive will adjust spending levels (namely public investment and purchases of goods and services). Thus, we deem likely that, in this Scenario, a reduced level of spending could bring this deficit closer to a balanced budget.

10- Assuming Scenario A for our analysis, it seems to us that, if these assumptions are broadly verified, this Budget should ensure that the Angolan fiscal situation improves (or at least remains the same).
Namely, even if the budget surplus does not improve significantly from 2019's expectation of 0.6% GDP,

it is highly likely that Angola posts again a surplus, and that the primary budget balance is higher than the one in 2018.
As for public debt, although our estimates do not reach the same numbers as the IMF for 2018 (91.0%), as the Fund, we also expect a reduction in public debt in percentage of GDP, from 81.9% in 2018 to 77.9% in 2019.

C. CONCLUSION

1- The Angolan fiscal situation remains fragile, both regarding the level of public debt (which has significantly increased due to the currency depreciation) and the reliance on oil taxes. However, we can state that this State Budget is, as last year's, relatively prudent, even if its oil price assumption is now at stake. If the Brent recovers to levels close to USD 65-68 per barrel, it will be surely possible to achieve budget consolidation, with economic growth and an increase in public investment, while also ensuring a reduction of public debt in percentage of GDP. **Nevertheless, if prices remain at the current level or only marginally above, not all these goals can be attained. Most likely, the Executive will adjust its spending level, in order to ensure balanced books and ensure that the public debt level (at least) remains broadly the same.** Alas, this effort should prevent a significant increase of public investment, and will in turn cause the growth of the nonoil economy to remain at very modest levels.

D. ANNEX

State Budget	2018		2019	
(Kz billion)	Budget	Execution	Budget	Chg. %
Revenue	4404	5625	7424	32,0%
Current revenue	4404	5625	7424	32,0%
Tax	4139	5257	7033	33,8%
Oil taxes	2399	3886	5319	36,9%
Non-oil taxes	1740	1372	1714	25,0%
Social contributions	173	174	181	3,8%
Donations	0	1	0	-
Other current revenue	92	193	210	8,9%
Capital income	0	0	0	-
Expenditure	5209	5450	6918	26,9%
Current expenditure	4230	4370	5604	28,2%
Employee wages	1690	1692	1796	6,2%
Goods and services	972	972	1376	41,6%
Interest	968	1182	1627	37,6%
External	517	553	808	46,0%
Internal	451	629	819	30,1%
Current transfers	600	524	805	53,5%
Capital expenditures	979	1080	1314	21,7%
Current balance	174	1255	1820	
Primary balance	164	1357	2132	
Non-oil primary balance	-2235	-2528	-3187	
As % of non-oil GDP	-11,3%	-13,0%	-13,8%	
Overall budget balance	-805	175	506	
As % of GDP	-3,4%	0,6%	1,5%	

Source: Fin. Min.