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# FLASH NOTE

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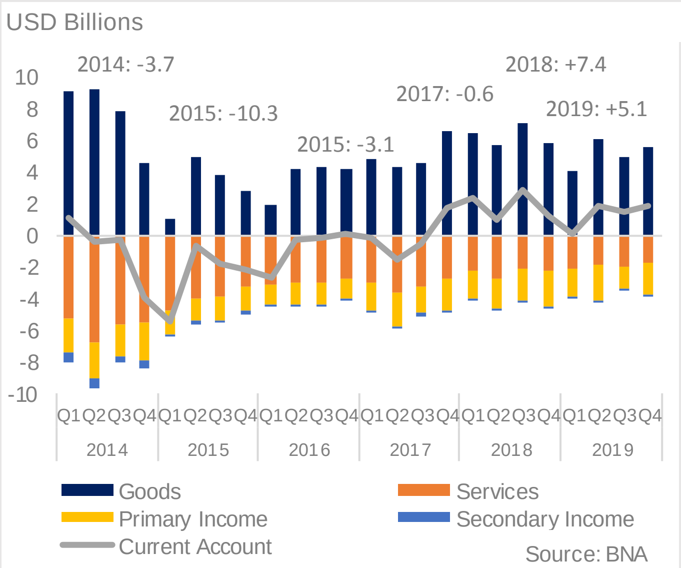
# External balance reached in 2018-19 at risk of reversing

## Halving in exports will demand additional measures to support reserves

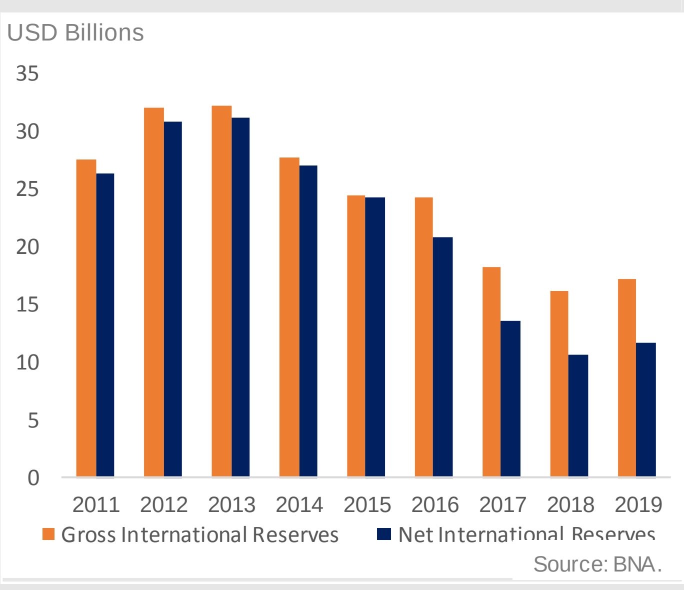
## A. DESCRIPTION

**1| Up until the pandemic outbreak and its effects on oil prices, we expected Angola to keep an external surplus, with the current account showing positive balances in 2020 and probably still in 2021, returning to a deficit in 2022.** In fact, the current account surplus in 2019 was higher than expected, indicating a sharp drop in imports, in goods and services, confirming the previous trajectory. **However, the current prospects for the oil market will certainly cause a new deficit in 2020, leading to a renewed decline of international reserves, since on the Financial Balance side the news are also not positive.** Furthermore, the new prospect of a drop comes at a time when the level of reserves is already quite low; thus, imports will have to show a similarly strong correction, either by market or administrative mechanisms. **Nevertheless, we expect the first quarter current account to go in the opposite direction as the rest of the year, with imports already falling and the export value still stable, since oil exports in the first quarter were negotiated with pre-pandemic prices.**

**Current account show surplus for 9th consecutive quarter**




**International reserves saw a sharp decline between 2014 and 2018**




## B. ANALYSIS

**1| Between 2014 and 2017, Angola recorded current account deficits in an accumulated total of USD 17.7 billion (Bn) – if we sum 2018, the accumulated drop is less severe, USD 10.3Bn.** In 2015, the year with the largest imbalance, the deficit reached USD 10.3Bn: exports (goods and services) amounted to USD 34.4Bn, with USD 38.0Bn being imported; the remaining deficit came from the primary income account, due to USD 1.3Bn paid in interest abroad and USD 4.3Bn repatriated in profits. **On the other hand, between 2014 and 2018, Gross International Reserves fell by approximately USD 16.0Bn, which roughly reflects the deficits in the Balance of Payments (Current Account + Financial Account);** that is, in the same period, the Financial Account has also likely recorded a

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deficit, which we estimate in the order of USD 5.0-7.0 Bn.

**2| In 2018 and 2019, the situation was reversed on the current account side, with a significant drop in imports of goods and services (-21.1% in 2019 compared to 2017) which offset the downward trend in export earnings.** In 2018, this result was not yet sufficient to lead to an increase in International Reserves, although they fell much less than in the previous year (USD -2.0Bn vs -6.1Bn in 2017); it is quite likely that, on the Financial Account, there was also a negative effect due to payment backlog clearing from previous years. **However, in 2019, reserves rose again, by USD 1.0Bn.**

**Box 1 –** Current Account performance in 2019

**The Angolan Current Account closed 2019 with a USD 5.1Bn surplus, on the positive side for the 2nd year in a row, following 4 consecutive years of deficits from 2014 to 2017.** Notwithstanding, this was a lower surplus than in 2018, by less USD 2.3Bn. As a percentage of GDP, the surplus represents 6.1% of GDP (6.9% in 2018), and is somewhat above market forecasts, and also above our own forecast - we expected a surplus which would "surely be above USD 3.0Bn"; however, we did not anticipate it to be in the vicinity of USD 5.0Bn. **On the other hand, the external accounts, as mentioned above, have likely posted their first surplus since 2013, with an increase of approximately USD 1.0Bn in International Reserves.**

| Balance of Payments | 2017 | 2018 | 2019 | |
|---|---|---|---|---|
| USD Bilions | Total | Total | Total | yoy chg. |
| **Current Account** | **-0.6** | **7.4** | **5.1** | **-31%** |
| **Goods** | **20.2** | **25.0** | **20.6** | **-17%** |
| **Exports** | 34.6 | 40.8 | 34.7 | -15% |
| Oil sector | 33.3 | 39.4 | 33.4 | -15% |
| Diamond sector | 1.1 | 1.2 | 1.2 | 5% |
| Others | 0.2 | 0.2 | 0.1 | -26% |
| **Imports** | **14.5** | **15.8** | **14.1** | **-11%** |
| Consumer goods | 9.6 | 9.3 | 8.0 | -13% |
| **Services** | **-12.8** | **-9.5** | **-7.7** | **-18%** |
| Imports | 13.8 | 10.1 | 8.2 | -19% |
| **Primary Income** | **-7.5** | **-7.8** | **-7.5** | **-4%** |
| Outflow | 7.7 | 8.3 | 8.2 | -1% |
| **Secondary Income** | -0.5 | -0.3 | **-0.2** | **-16%** |

Source: BNA, calc. BFA

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**Compared to 2018, the main change was a drop of USD 6.0Bn (-15.3%) in oil exports, as crude exports dropped both in volume (-7.8%) and average export prices (-10, 8%), according to data from the Ministry of Finance.** On the other hand, this decrease was partially offset by a drop in imports of goods and services, totaling USD 3.6Bn (-13.9%): imports of goods fell by USD 1.7Bn (-10.6%), while service imports tumbled by USD 1.9Bn (-19.0%). The largest drop in purchases of foreign goods was seen in consumption goods (-13.2%), with intermediate goods purchases declining only 3.6%. The primary income account saw a less negative balance, of USD -7.5Bn: the deficit was smaller by USD 0.3Bn: there were an additional USD 0.2Bn in interest received from abroad; regarding payments to other countries, there was a mixed performance – an increase of USD 0.4Bn in interest paid, but less USD 0.4Bn in profits were repatriated, and USD 0.1Bn less transferred in non-resident wages.

**One should note the extent of the adjustment which occurred already in imports of goods and services – these are well below the highs recorded in 2014.** In that year, USD 28.6Bn were imported in goods, which compares with imports of less than half that amount in 2019. In services, USD 25.0Bn were purchased from abroad in the same year - last year, the country imported only USD 7Bn in services, less than 1/3 of the value in 2014.

**Imports of Goods and Services dropped below USD 5.0 Bn in Q4 2019**


Source: BNA.

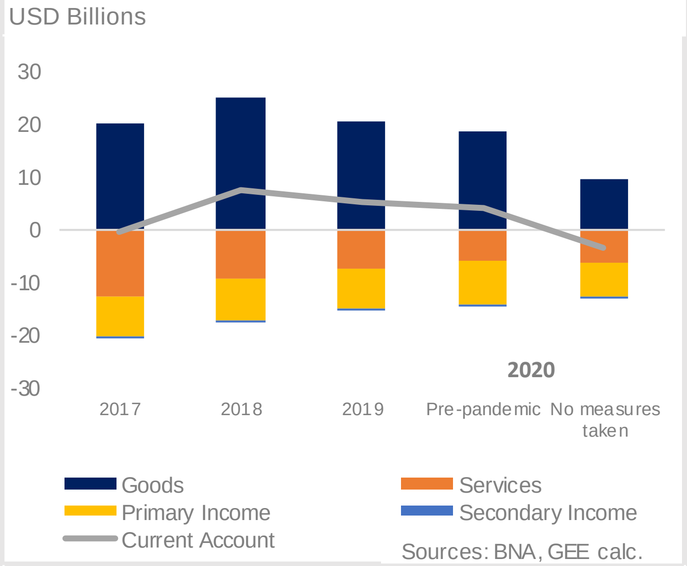
**3| Before the pandemic, we expected a USD 4Bn surplus in the current account in 2020, with a slight drop in oil exports being almost entirely offset by a decrease in imports.** Furthermore, we expected a modest increase in international reserves, between USD 1-3Bn. In particular, this result would not imply a very significant depreciation: it would likely be lower than the expected rate of inflation.

**4| The impact of the Covid-19 pandemic and the consequent confinement in many countries has led to a huge drop in demand for oil products;** this factor, coupled with the impossibility of storing all the resulting excess demand, and the inability to reduce production in the same proportion as the drop in demand, led to a sharp drop in prices, with Brent trading below USD 20 and WTI hitting negative prices for the first time in mid-April - Brent's price is now close to USD 35. On average, Brent is expected to be between USD 35 and USD 40 during this year, according to most forecasters.

**5| The impact of the fall in oil prices is devastating for Angolan external accounts.** Oil exports in 2020, which would yield around USD 30Bn, should be worth only around USD 17Bn, a reduction which is larger greater than the amount held by Angola in Net International Reserves. Expectedly, imports would also decline, due to the enormous economic difficulties caused by the situation: we would have previously expected purchases from abroad (in goods and services) to stay close to USD 20Bn this year (USD 22.3Bn in 2019) - now, depending on the level of depreciation observed, we expect imports to range between USD 14-16Bn. **As a result of these changes, instead of a surplus close to USD 3Bn, we would now expect a deficit between USD 2-4 Bn, a difference of USD 5-7 Bn.** On the other hand, in the Financial Account, expectations included receipts worth USD 3Bn in Eurobonds, which are not likely at all in the current situation. **If no measures had been taken, this scenario would potentially wipe out the country's international reserves in about 2 years.**

**6| So far, the measures taken will allow modest relief; taken at face value, the withdrawal of USD 1.5Bn from the Sovereign Fund (probably by selling foreign currency assets) is the measure with the greatest impact.** On the other hand, restrictions on public expenditure on goods & services will contribute to a decrease in imports. Still, the main causes for a decline in imports will be the significant decrease in economic activity (which will decrease disposable income), coupled with additional depreciation (which makes imports substantially more expensive).

**The impact of the oil price drop on the Current Account is very significant**




Sources: BNA, GEE calc.

**7| A significant part of the problem remains to be resolved; the country will not necessarily have to achieve a balance in external accounts this year, but it needs to smoothen the blow as much as possible.** Part of the solution could come from the renegotiation of the external debt, which will certainly be underway at least with part of the creditors which are owed principle tranches this year. It is likely that, among the approximately USD 8Bn to be paid in external public debt this year, some amount will be rescheduled for future years; this would entail a relevant amount of Balance of Payments outflows that would thus be avoided this year. On the other hand, there is also a high probability that Angola will obtain additional aid from multilateral institutions (IMF, World Bank, African Development Bank), for a total of between USD 1.0-1.5Bn. Apart from these two sources of support, decreasing imports will be the most immediate way to “solve” the issue; the larger the imbalance in the external accounts (due to a lower Brent price, or for lack of help from creditors or multilaterals), the greater the adjustment will have to be, whether by letting the currency freely depreciate, or enacting harder restrictions (informal or formal) on imports and other currency outflows.

**8| The Q1 numbers may be a very misleading indicator; due to the way in which oil sales prices are agreed (1-2 months in advance), it is likely that almost all sales until March were made at prices still around USD 60.** At the same time, the reduction in imports was already occurring in that period - even though there was still not an absence of foreign currency, the Kwanza was already quite depreciated compared to Q1 2019, and the economic uncertainty and fears of entrepreneurs and consumers were already relevant enough to lead to a fall in economic activity, and in turn, imports. Thus, we expect imports to be around USD 4.1Bn (goods and services), and a surplus between USD 2.0-3.0Bn in the current account.

## C. CONCLUSION

**1| Angola had managed to improve its external accounts in 2/3 years, reaching a surplus in 2019, which was reflected in a modest increase in International Reserves compared to the end of 2018.** In 2020, our expectation until a few months ago was that there would be a new Balance of Payments surplus, with a continued fall in imports and a depreciation below (or at the level of) inflation, partially offsetting the persistent decline in oil exports - the decline of oil production in 2020 was also supposed to be marginal. **However, the shock in oil prices due to the drop in world demand in the context of the pandemic makes for a much harder situation.**

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**2| The impact of the shock on the Balance of Payments, if no measures had been taken, could be greater than USD 8Bn, in lost oil revenues and debt not issued, net of import drops.** This translates to a true Balance of Payments crisis; International Reserves could possibly be wiped out in a relatively short period (either that or a default - the issue of State financial needs is also in question at this point, a sort of fiscal mirror of the external imbalance problem, which is not dealt with in detail here).

**3| The measures already taken by the Government are impactful on fiscal front (although far from sorting out the problem), but are insufficient to sort out he external problem.** Both the renegotiation of debt, along with some additional multilateral loans, will be instrumental in alleviating this year's external imbalance - as well as being part of the solution to the State's financing issue.

**4| Angola's problems (on both fiscal and external balance) are so dire in 2020 that none of the solutions will be sufficient on an individual basis:** additional expenditure consolidation is necessary, but the Sovereign Fund withdrawal is fundamental for liquidity this year; additional multilateral loans could yield another USD 1.5Bn this year, but the gap to be covered still is much larger, so a significant portion of the external debt to be repaid this year (USD 8Bn) this year must be rescheduled; the fall in imports resulting from the huge decrease in economic activity will help to balance the accounts, but some degree of further depreciation will be necessary.

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Figures are expressed using the comma as thousands separator and the point as decimal separator and using the term "billion" to signify 10^9