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FLASH NOTE

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IMF remains pleased with Programme implementation

GDP continued downward trend in the third quarter of 2020

A. DESCRIPTION

1|On the 12th of January, the IMF approved the 4th Review under the Extended Fund Facility (EFF) Arrangement for Angola, thus freeing an additional USD 0.49 billion (bn). The institution reinforced its praise to the authorities' commitment by employing responsible policies under the programme, being particularly positive on the Government's fiscal stance.

2|Although there structural targets were left unmet, mostly were postponed to the 1st semester of this year, including two new structural goals. The rest of the performance criteria were broadly met.

3|The growth outlook for 2021 has been subdued, with the Fund now expecting 0.4% GDP growth this year (up from 3.2% from the last review). The Fund's economic forecast is aligned with the Angolan Government: in fact, the IMF is also assuming Brent prices not to exceed USD 50 until 2023, in rather conservative forecast, and in a similar tone to the Angola Executive.

B. ANALYSIS

1|In general, the review is again positive, with no major news since the previous one in September. From the performance criteria as of June 2020, 5 were met, while the non-accumulation of external arrears criteria was missed due to issues with correspondence banking; however, in July 2020, the situation was corrected, and an escrow account was created to deposit the amounts due at a local bank. On the other hand, all the indicative targets have been met. In the case of structural targets, there were clear delays:

- Payment of all arrears accumulated until 2018; deadline: end of December 2020 - not met, having been paid about 80% of arrears, with the Government expecting to complete payments by the end of the first half of 2021;
- Allocation of at least 45% of eligible public contracts through public tender; deadline: end of December 2020 - fulfilled, with 88% of eligible projects awarded through public tender;
- Publication of a strategy on the role of the State in the banking sector; deadline: end of February 2020 - not met, depending on the completion of the BCI restructuring plan; new deadline at the end of March 2021;
- Approve new Financial Institutions Law; deadline: end of September 2020 - not met, although it is now being considered by the National Assembly; new deadline at the end of March 2021;
- Submit a new BNA Law to the Council of Ministers; deadline: end of September 2020 - not met, having been submitted only in December 2020;
- Complete the recapitalisation of the banking sector, requiring the necessary levels of regulatory funds; deadline: end of June 2020 - not met, depending on the implementation of the BCI restructuring plan; new deadline: end of March 2021;
- Reinforcement of Recredit governance; deadline: end of August 2020 - not met, dependent on the appointment of an independent board member, which should occur by the end of February 2021;
- Submit new SOE Law; deadline: end of December 2020 - fulfilled.

Two new structural goals were also defined: the submission of the new BNA Law to the National Assembly (by the end of January) for approval, and the approval of new amendments to the SOE, namely regarding segregation of the compliance function (until end of June this year).

2|With regard to the outlook for the Angolan economy, the Fund remains optimistic about the impact of structural reforms on the performance of the non-oil economy, forecasting 2.5% growth in 2021, accelerating to 4.7% in 2023, even assuming that oil prices remain below USD 50. Inflation is expected to slow down again (with the help of tightening monetary policy), towards close to 9% in 2023.

3|The fiscal front shows the Angolan Government's best results, with the Fund praising the Executive's efforts in times of pandemic. One should not the extraordinary consolidation looking at the non-oil primary budget deficit (NOPD) as a percentage of GDP; it is a trustworthy measure of the success of fiscal restraint, a metric that allows to purge effects of both interest payments and oil tax revenues, beyond current budgetary control. Accordingly, in 2020, the NOPD likely stood at 4.3% of GDP, a historical low, and even below the medium-term operational objective set out in the new Public Finance Sustainability Law (5%). The IMF expects this balance to remain below 5% in the coming years; looking at the budget balance as a whole, the IMF expects the Executive to spend less than its revenues over the next 3 years, even though the forecast for this year is of only a slight surplus of 0.3% of GDP.

At the end of last year, due to the exchange rate effect, public reached a historical high as a percentage of GDP according to the IMF, around 134.2%; it is expected to fall to 97.2% at the end of 2023.

It is also worth noticing the renewed reference to fuel subsidy reform, again listed as conditional on the development of the Kwenda Program, which entails direct cash transfers to low-income households. The Fund explains that "the authorities plan to proceed with fuel subsidy reforms gradually, once the cash transfer program reaches a critical mass of families". Our interpretation is that this will surely mean an implementation later than the first semester, but fundamentally dependent on the evolution of the Kwenda Program, which faced several delays due to the pandemic.

Box 1 – Q3 2020 GDP

1|The Angolan economy posted a 5.8% yoy decline between July and September last year, representing the 5th consecutive quarter of decline. The decrease is due, on one hand, to the -5.1% yoy drop in the oil sector, and on the other hand, to a very significant decline in the construction (-35.9% yoy) and transport (-81.3% yoy) sectors. From January through September 2020, Angolan economic activity decreased by 5.0% compared to the same period in 2019. **In quarterly terms, there was an increase of 2.7% in Q3 2020 following decreases of 1.7% and 6.8% in the 1st and 2nd quarter, respectively.** It is important to note that with the application of Covid-19 containment measures in the 2nd quarter, economic activity was significantly affected. Given these circumstances, the gradual resumption of the economy in Q3 (with less restrictions) explains this quarterly growth. Still, this increase is shadowed by the rate of decline of the previous quarter (-6.8%).

Data from previous quarters has undergone slight revisions related to the introduction of seasonality controls, with the Angolan statistics office (INE) showing a slightly smaller

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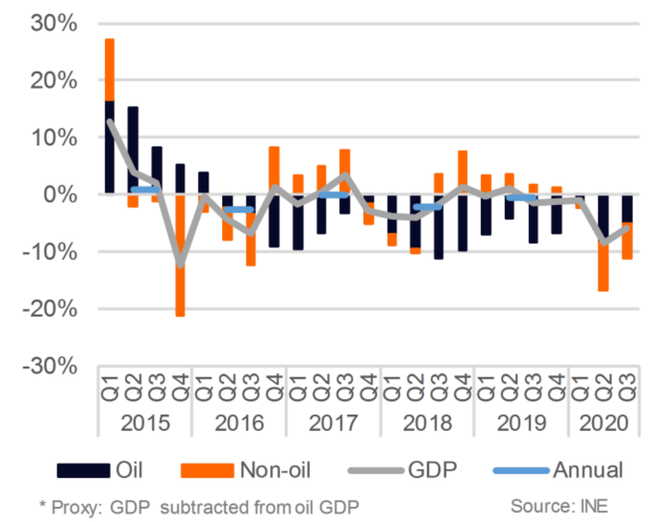
economic decline than previously estimated. In the first two quarters of 2020, there were revisions upwards of 0.9pp and 0.5pp, respectively showing a 0.9% yoy drop in Q1 and a 8.3% yoy tumble in Q2.

2|For the 18th consecutive quarter, the oil economy recorded a negative year-on-year change, having contracted around 5.1% in the third quarter of 2020. In the first 9 months of 2020, the oil economy contracted 5.1%, 1.4 percentage points (pp) below the fall registered in the same period of 2019. The decrease continues to show the effect of the suspension of new investments planned for 2020 and the natural decline of some wells, together with the production restriction imposed by OPEC quotas. The data collected independently by the cartel indicates a year-on-year drop of 12.8% yoy with average annual production at around 1.21mbd for 2020: at the moment, Angola continues to produce oil below the quota stipulated by the OPEC+ agreement (1.25 mbd).

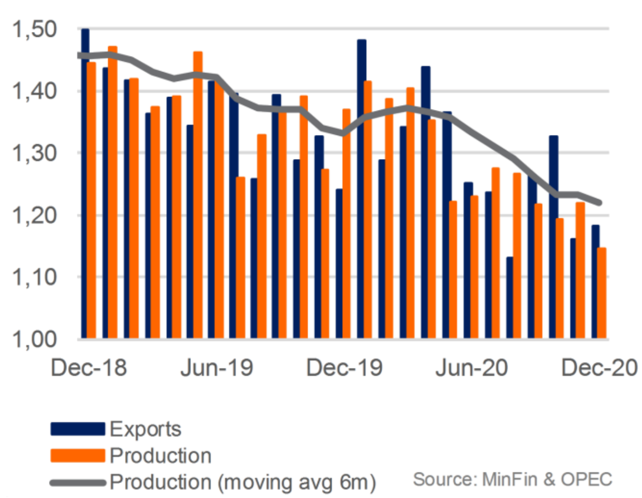
Angolan GDP continues to fall for the 5th consecutive quarter

Variation yoy; Contribution to homologous variation



Production decreasing to lowest values in recent years;

Millions of barrels per day



3|The non-oil sector is likely to have contracted in the third quarter of 2020, due on one hand to the impact of the measures applied to tackle the Covid-19 pandemic and on the other to the effect of the drop in oil revenues that impacted Government ability to invest and otherwise support the economy. With the seasonality controls of the quarterly GDP data, adjustments were made to the performance measures of various sectors of the economy. The construction sector data was updated for the first 6 months of 2020, with Q1 data being revised downwards (from + 2.9% yoy to -14.1% yoy) and upwards for Q2 (from -41.0% yoy to -26.7% yoy). In the third quarter, the construction sector recorded a year-on-year drop of 35.9%, having had the largest negative contribution the economic growth in the quarter (-1.3pp in total GDP growth rate). Data for the Diamond sector was revised downwards, as the sector's activity declined in the first semester (from a 3.0% yoy decrease to an 89.5% decrease). In the 3rd Quarter, the diamond sector contracted 24.5% yoy, having contributed negatively by 0.2pp to GDP growth. According to MinFin data, in Q3 2020, revenue from diamond sales decreased by just over 50% yoy, to USD 148.2 million. On the other hand, the Retail sector (2nd sector with the greatest weight in the Angolan GDP) posted year-on-year growth for the 2nd consecutive quarter, having expanded 5.8% (previous data pointed to a decrease of 0.3%). This sector contributed 1.6pp to GDP growth. The agriculture sector recorded a year-on-year growth of 3.1%, contributing 0.2pp to GDP growth. **For the full year, the non-oil economy is expected to contract around 2.9% according to IMF forecasts.**

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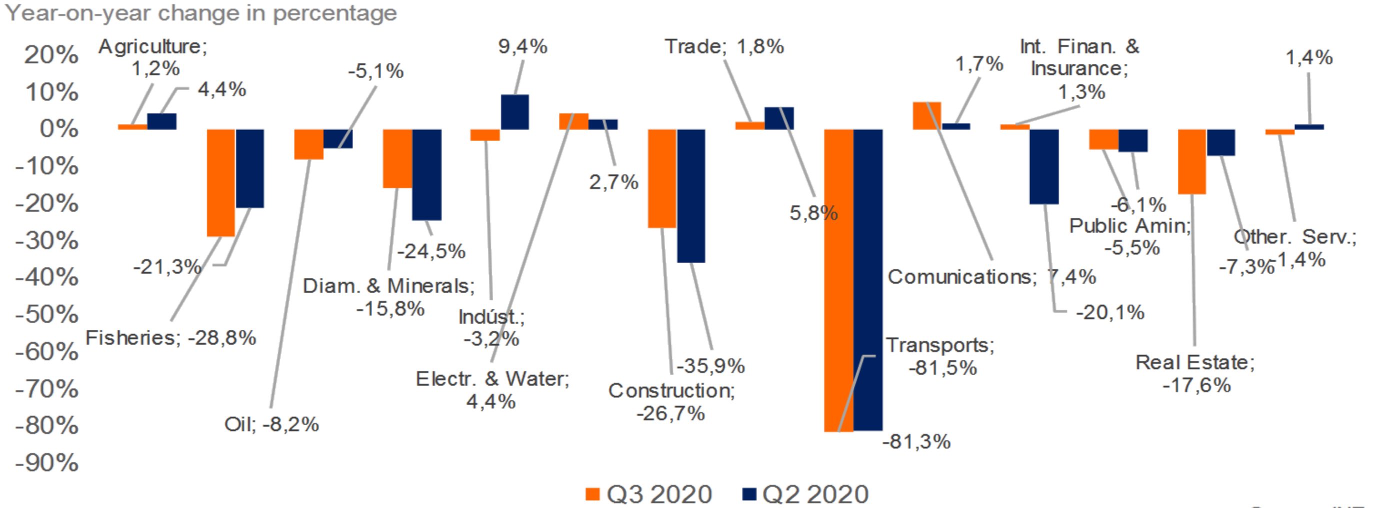
In 2021, economic recovery will be conditional on the evolution of the pandemic and the speed with which the vaccine can be distributed worldwide, and particularly by the effects of the former on the oil market; we expect growth of around 1-2% in 2021 with the oil economy contracting significantly and the non-oil economy starting to show a more solid recovery.

Economic activity in the Construction and Transport sector with a big drop in Q3 2020; Industry recovered after Q2 2020 crashes



Source: INE

4| In the banking sector, the Fund warns of the still existing pressure on the quality of banks' assets, with non-performing loans at 20.2% of total credit in September last year - well below the 35.8% maximum in March, after a major credit transfer from BPC to Recredit in the middle of the year. On the other hand, the institution refers to the various issues pending in the sector, with particular emphasis on the restructuring of BCI (a small state-owned bank), which will then allow the completion of the strategy for the role of the State in the banking sector; however, the restructuring itself is dependent on the approval of the new Financial Institutions Law, which brings with it a new bank resolution framework.

5|Monetary policy is another emphasis; the IMF recognizes the importance of supporting economic activity during 2020, alleviating liquidity pressures, through the direct purchase of assets (public debt) held by companies. At the present time, the institution prefers to emphasize the need to control inflation, having agreed a reduction monetary aggregate targets with the Angolan central bank, which will translate into a tightening of monetary policy in 2020 to fulfil those goals; the IMF also suggested taking into account the possibility of increasing the BNA's reference rate, as a signal to the market (in the current context, the BNA Rate is not the central banks's main policy instrument) - the authorities agreed with the need to raise real interest rates, but expressed concern about the risks to economic activity in hastily raising rates.

6|With regard to the external balance of the economy, the Fund is, for now, satisfied with the level of existing international reserves, but intends to see a recovery in the near future. In fact, Angola's external balance deteriorated significantly in 2020, with a huge decline in exports bringing the current account into a small deficit, in the IMF's perspective, and the financial account maintaining a significant deficit. The deterioration was nevertheless quite contained compared to what it could have been, due to two main factors, among others: the debt restructuring with Chinese creditors, which allowed fewer outflows in the financial account, and the very significant depreciation of the Kwanza, which led to a huge drop in imports, also allowing less outflows in the current account. **The IMF expects reserves to rise again in 2021, reflecting a positive balance of payments as a whole, with**

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relative stability over the next two years. This forecast, like others, is also dependent on the conservative premise of lower oil prices, and could be exceeded, in our view. In particular, our expectation is for significant surpluses in the current account in the coming years, starting already in 2021.

C. CONCLUSION

1|The IMF continues to support the Executive's reform agenda, and it is obvious that some extraordinary margin has been given when it comes to meeting structural targets, taking into account the impact of the pandemic.

2|The hope for a return to economic growth remains, this time supported by a scenario of oil price recovery (from a very low point in 2020). On the non-oil economy side, there is hope that the reforms already made (which will enable a significant improvement in the business environment) bring new growth, in different sectors, such as mining and agriculture.

3|External equilibrium in the coming years seems to be possible, mainly due to the very demanding correction that occurred in the import of goods and services in the recent past, due to the depreciation. We agree with the Fund that there are already some initial signs of price-driven import substitution, but it will be necessary to monitor whether these small increases are consolidated in the coming years, allowing for greater economic sustainability for the country.

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