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FLASH NOTE

Nº 05.2021 | July 20 2021

IMF pleased with measures, cautious about the economy

Country should return to budget and external surpluses this year

A. DESCRIPTION

1| On June 9, Angola merited a new positive assessment from the IMF, allowing a further disbursement of USD 772 million. Only one more review remains, expected to take place in the last quarter of the year, and it is still uncertain, as assumed by the authorities themselves, whether the country will resort to a new program after the end of the current arrangement.

2| The IMF continues to positively assess the performance of the authorities, despite the delay of some structural reforms. However, the institution is still somewhat cautious (perhaps too much, in our view) regarding the growth that these reforms may cause in the short term.

B. ANALYSIS

1| Overall, the IMF considered Angola's performance broadly positive, emphasizing that program implementation has been adequate since the previous review. Of the performance criteria objectives set for the end of 2020, all were met, except for BNA claims on the Central Government whose waiver of non-compliance was granted during the 4th Review. This pertains to a technical interpretation rather than a material breach, as the IMF considered BNA purchases of Government bonds from firms (to support the economy) as indirect financing to the Treasury; however, it also considered that this was a fully justified technical non-compliance. With regard to the indicative targets, 4 were met, with the central Government & Sonangol debt stock ceiling unmet.

In the case of structural benchmarks, the assessment is positive; however, there were several delays in complying with the measures aligned with the IMF:

- Payment of all arrears accumulated until 2018; deadline: end of December 2020 - not met, the Government expected at the time of the assessment to complete this process by the end of June this year;
- Award at least 45% of eligible public contracts through public tender; deadline: end of December 2020 – fulfilled, 54% of public contracts have been awarded through public tender;
- Elaboration of a strategy for the future involvement of the State in the banking sector; deadline: end of March 2021 – not met, depending on Banco Económico's restructuring plan, which according to the deputy governor of the BNA, will be completed and publicized before September 2021;
- Approval of the new Law on Financial Institutions; deadline: end of March 2021 – not met, having been completed late and published as law in May 2021;
- Restructuring and recapitalization of the banking sector; deadline: end of March 2021 – not met, pending the implementation of the restructuring of Banco Económico; new deadline: end of September 2021;
- Reinforcement of Recredit's governance; deadline: end of August 2020 – not met, having been completed late with to the appointment of an independent board member in January 2021;
- Submit an amendment to the State Owned Enterprises (SOE) Law; was implemented in August 2020, however without elements on the functions of internal and external audits; it was replaced by the goal of submitting amendments to the SOE Law, whose deadline was, at the time of the assessment, the end of June this year;

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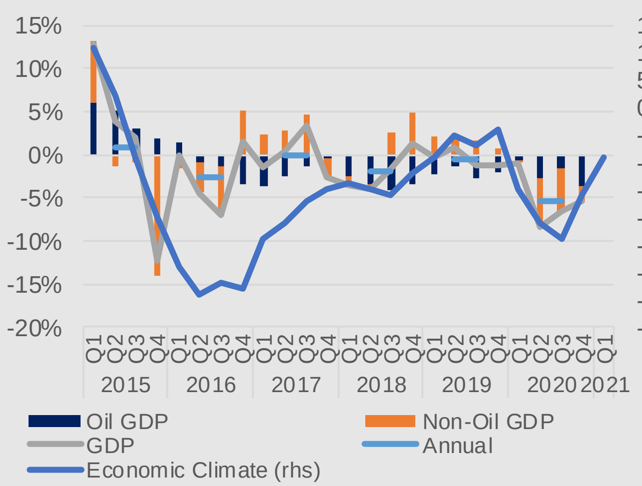
- Submit a new BNA law to the council of ministers; deadline: end of September 2020 – not met, having been submitted late in December 2020;
- Submit a new BNA law to the National Assembly; deadline: end of January 2021 – met, submitted in the same month;

The Fund added 2 new structural benchmarks: approval via presidential decree of the roadmap for the reform of SOEs (by the end of September 2021) and adoption of the revised BNA Law, with a precise mandate to focus on price stability, limit government funding, increase operational autonomy, strengthen oversight and improve governance (end November 2021).

2| Regarding the country's economic outlook, the Fund adjusted expectations for 2021 slightly downwards, forecasting a 0.1% decrease in GDP, dragged down by a 7.0% drop in oil GDP, with non-oil GDP increasing 2.3%.

Sentiment notes a possible slight break in Q1, with improvement in the non-oil economy

Percentage; contribution to growth; index

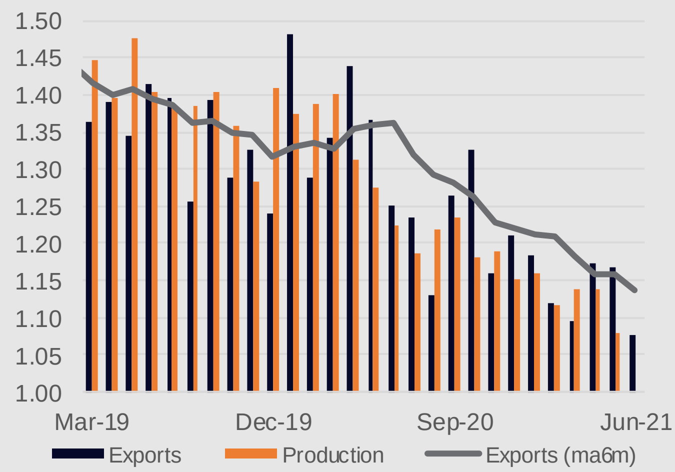


* Proxy: GDP subtracted from oil GDP

Source: INE

Decrease in oil production volume leads oil economy to decline despite price rise

Millions of barrels per day

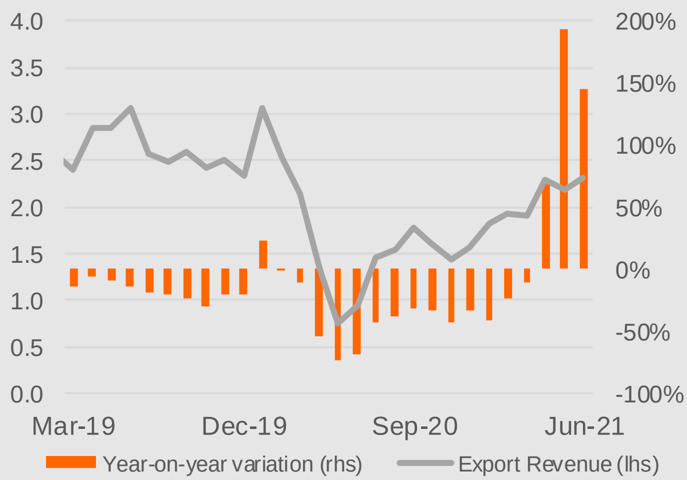


Source: MinFin e OPEC

The forecast for the oil economy derives from the continuous decrease in production, which the Government now expects to stand at around 1.19 million barrels per day (mbd) - compared to the initial forecast of 1.22 mbd. Existing data confirms the downward trend, with exports falling significantly in Q1 2021: -18.2% yoy. In the first 5 months, there was a 17.5% yoy decrease, and forecasted shipment data up to August points to a 12.3% decrease; we expect a negative variation below 10% for the whole year, which is consistent with slightly more pessimistic decrease in oil GDP than expected by the IMF. In intra-annual terms, we expected a drop of more than 15% in the Q1 – it came at -18.6% -, around 10% in Q2, and decreases of less than 5% in the 3rd and 4th quarters. However, despite the decrease in oil GDP – which derives solely from changes in volume produced – the oil economy will have a positive spillover effect in the remaining economic

Oil export revenues are growing very significantly since April

USD Billion; percentage



Source: MinFin

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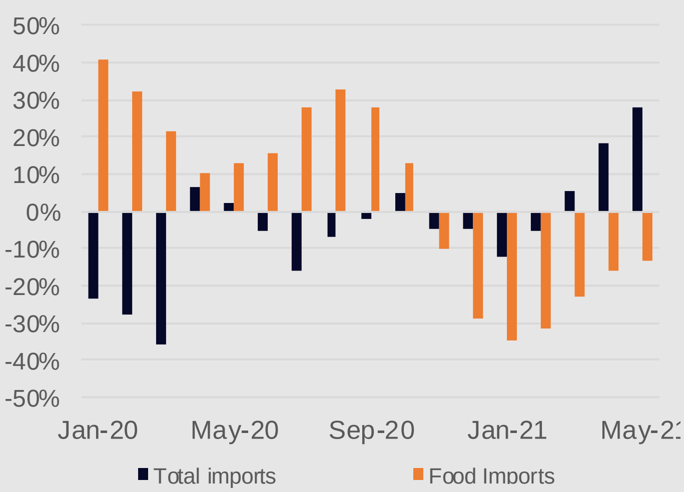
activity, due to higher prices, which will allow for greater revenues. On the one hand, export revenue will be significantly higher than in 2020, which will translate to a greater availability of foreign currency: until May, export earnings rose by 3.5% yoy, measured in Dollars, but the rise will be particularly relevant in the 2nd semester, possibly higher than 40%. For the entire year, we expect an increase of more than 35%, largely supported by current oil prices in international markets, which could even cause some appreciation of the Kwanza. Additionally, the State's leeway for investments will also be greater: until May, oil tax revenues were falling 9.2% yoy, but for the whole year they are expected to grow above 60% in Kwanzas, ie, close to 40% in real terms. In the same sense, our expectation is of an increase close to 40% in Government spending on Goods and Services, Current Transfers, and Investment, which results in a real increase (discounting inflation) of close to 15-20%.

In this sense, non-oil GDP may experience a more robust growth acceleration than predicted by the IMF. The Fund expects a "gradual" recovery, hampered by adverse conditions (drought, followed by heavy rains) in agricultural regions and by the constraints of the restrictive measures related to the pandemic.

Regarding the 1st factor, the data do not fully support this explanation; although it is difficult to obtain data on agricultural production in 2021, note the following facts: despite the real increase in imports until May (+37.0% yoy in nominal terms, +12.3% in real terms, according to data from the BNA and our calculations), food imports are down (+7.0% yoy in nominal terms, -17.7% in real terms); on the other hand, according to data from the tax authority, exports of goods under PRODESI (composed mostly of agricultural goods) increased 27.6% yoy until June, measured in Dollars, although they represent only a small amount (USD 31.7 million in the 1st half of this year); exports of goods outside the oil and diamond sector increased by around 20.0% in real terms, measured in Kwanzas, according to BNA data and BFA calculations, which points to the same trend. For example, banana exports tripled in this period, to an amount of USD 2.2 million.

Despite the growth in total imports, food imports continue to fall

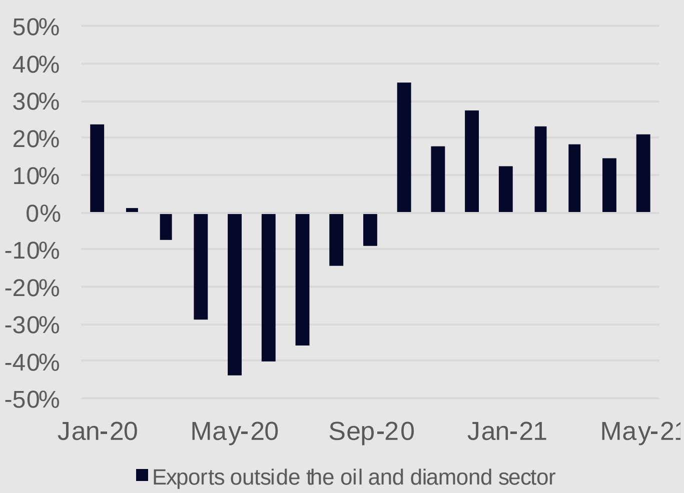
Real year-on-year change in 3-month moving average



Source: BNA

On the other hand, exports of food and other goods have increased since October

Real year-on-year change in 3-month moving average



Source: BNA

With regard to the impact of the pandemic, the situation is relatively more complex, although there is currently no significant deterioration in expectations. On the one hand, official statistics point to the existence of a peak in deaths and cases in May this year, although very far from other countries in the region. Angola's very young demographic profile, combined with its scarce connection with other African countries, may provide some explanation for these numbers. Still, the possibility that these data may not reflect the full impact of the pandemic should be considered. Using the intensity of Google searches for some words related to Covid-19 cases ("cough", "fever", "smell", "throat"), 2 peaks

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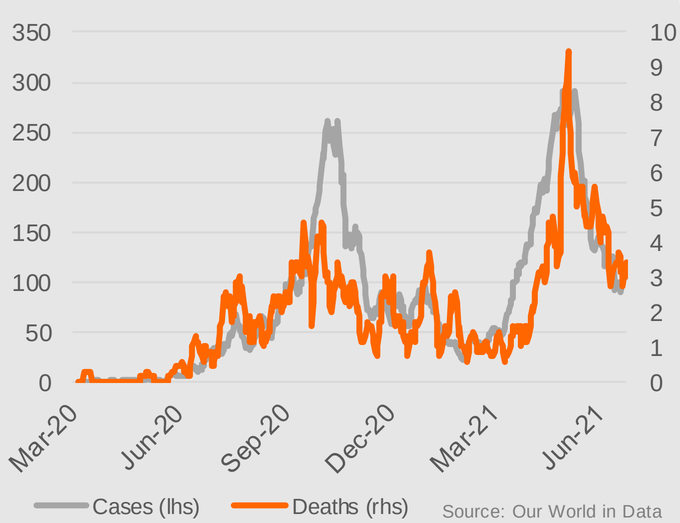
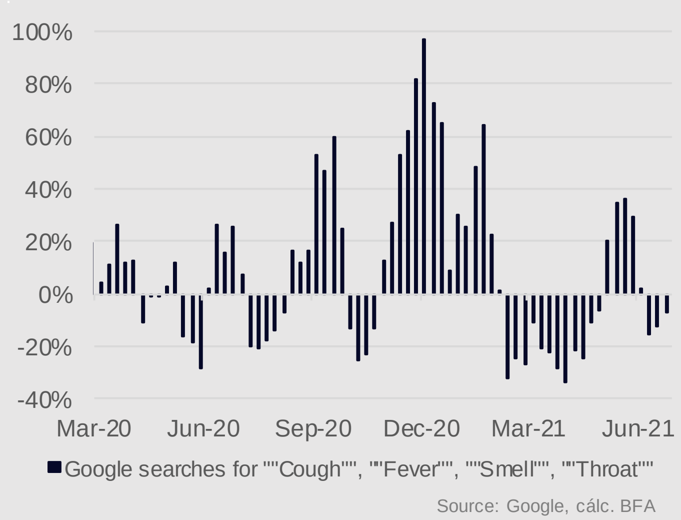
Deaths and cases recently peaked in May but are declining again

Moving average 7 days



Google searches show concern in the end of 2020, in addition to the identified Covid peaks

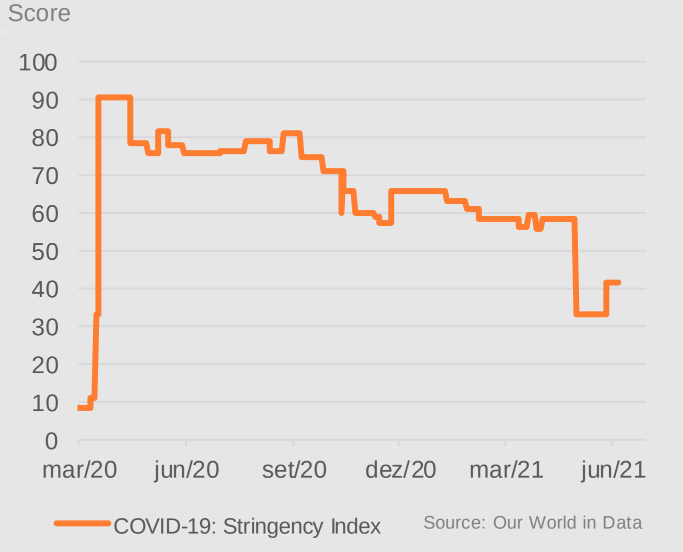
Change vs. average for the period 2018-19



are noted in mid-December and late January, in which there were twice as many searches for these terms compared to the 2018-19 average, which points to a more serious impact than the data shows. At the same time, the main economic impact comes from the necessary restrictions imposed. In this context, according to the Stringency Index of the restriction measures calculated by the University of Oxford, the measures applied at this moment are already less burdensome than the restrictions in the same period of the previous year; in fact, between May 10th and June 4th, the index registered its lowest value since March 2020, at 33.3 points, having increased to 41.7 points on June 5th. **In addition, although the numbers point to a low vaccination rate (2.9% of the population with 1 dose, 1.8% fully vaccinated), it should be noted that the population over 65 accounts for only 2.2% of the population Angola.** In this sense, since there are no data on the age distribution of vaccination, it is possible that it is already having some effects on the protection of the most vulnerable.

Measures are now less burdensome than in 2020, for example, with regard to travel

Score



In fact, there are already two indicators that could illustrate a recovery in non-oil economic activity. EMIS (the Angolan payments firm collectively owned by banks) data point to real year-on-year growth in monthly amounts in the sum of cash withdrawals & payments, from March onwards; on the 3-month moving average, real growth in May was 12.9% (the last month with real year-on-year growth in this series was March 2020). On the other hand, imports (which tend to grow/decrease coinciding with demand) have been increasing in real year-on-year terms since February; on the 3-month moving average, real growth in May was 28.0%.

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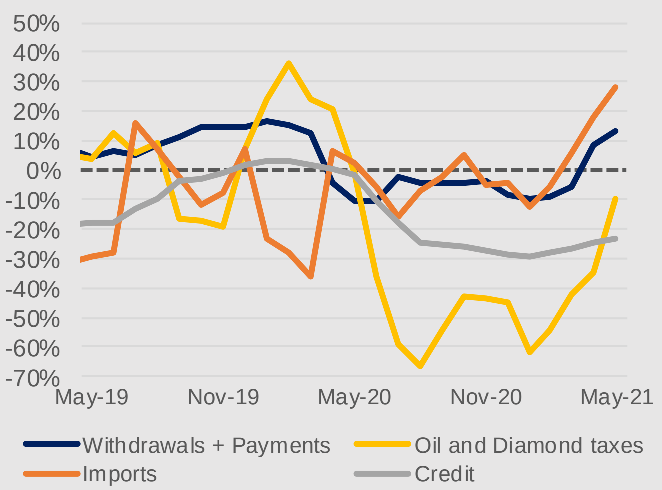
From our point of view, growth in the non-oil economy may thus have already started in Q2 2021, and could become more robust in the 2nd half, benefitted by the stability or appreciation of the Kwanza and increased government spending.

3| In fiscal terms, the IMF once again praises the Executive's commitment, describing the fiscal consolidation (largely supported by non-oil taxes) which ensured a relatively modest deficit (1.9% of GDP) and a new low in the non-oil primary deficit, which the Fund estimates at 5.5% of GDP. In fact, according to our calculations, non-oil tax revenue represented 8.8% of GDP in 2020, a maximum since at least 2010, representing 42.4% of budget revenues, also a high of the last decade. In particular, the implementation of VAT is proceeding in a very favorable way to the tax authorities. The Fund also reports that the same likely occurred in the 1st quarter of this year. Thus, the IMF expects a non-oil primary deficit of 4.8% of GDP.

Imports, withdrawals and payments show growth; credit decreases

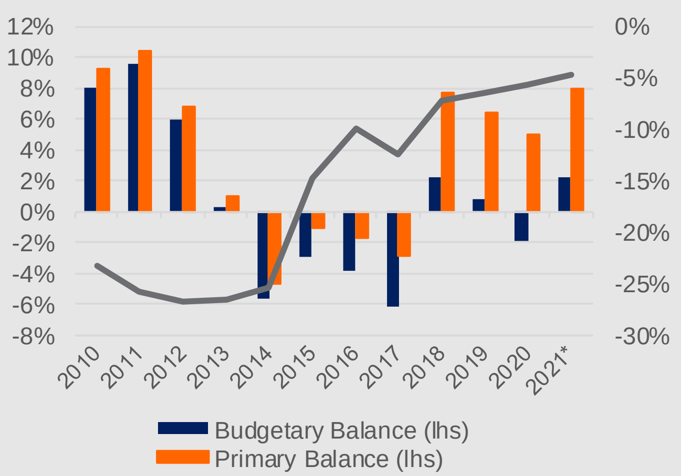
Real year-on-year change in 3-month moving average



Fonte: Emis, BNA, MinFin

Budget consolidation continues at a good pace, with considerable resilience

Percentage of GDP

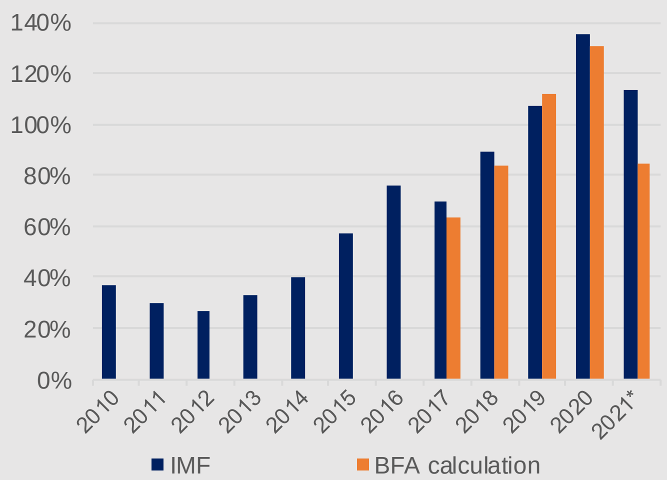


*IMF forecast

Source: MinFin, FMI

Public debtis all but certain to decline in 2021, with a more stable Kwanza

Percentage of GDP



* Forecasts

Sources: FMI, Cálc. BFA

Primary expenditure rose to 15.9% of GDP (compared to 14.8% in 2019), as some savings in interest allowed for this to happen, but the Fund hopes it will return to 2019 levels this year. Our expectation is relatively more optimistic, supported by the more positive outlook on GDP data. With regard to the overall balance, we are in line with the IMF, also expecting a surplus slightly above 2% of GDP. It should be noted that this expectation is based on the premise that Brent prices remain at an average of USD 70 for the rest of the year (it trades today close to USD 69).

Regarding public debt, the IMF points to a ratio of 135.1% of GDP at the end of 2020, expecting it to drop to 113.3% by the end of this year. As it is not possible to fully replicate the

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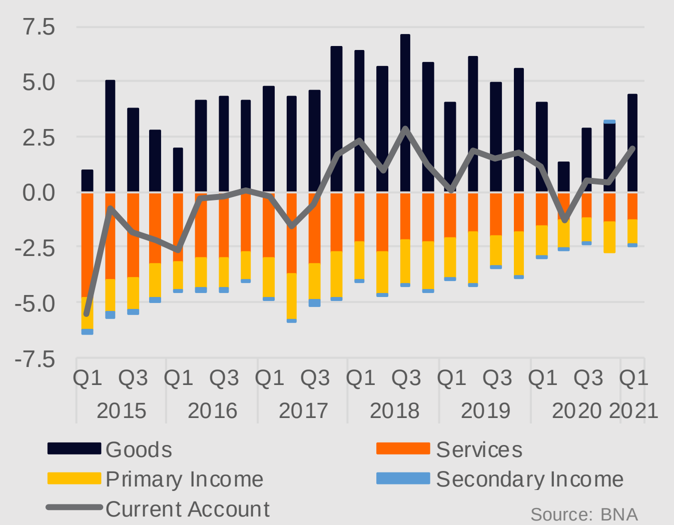
Fund's calculations, the figures calculated by BFA point to a public debt of around USD 68.0Bn at the end of last year (130.6% of GDP), well below the USD 79.3Bn in December 2017. From our point of view, it is quite realistic to expect a very significant decline in debt as a percentage of GDP, even to below 100%; note that, with no depreciation until the end of the year (which appears likely for BFA), the Angolan GDP should return to USD 70-72Bn – at the same time, the debt likely declined already in Q1, to USD 67.6Bn, according to our calculations.

Current account should continue to record significant surpluses during the year

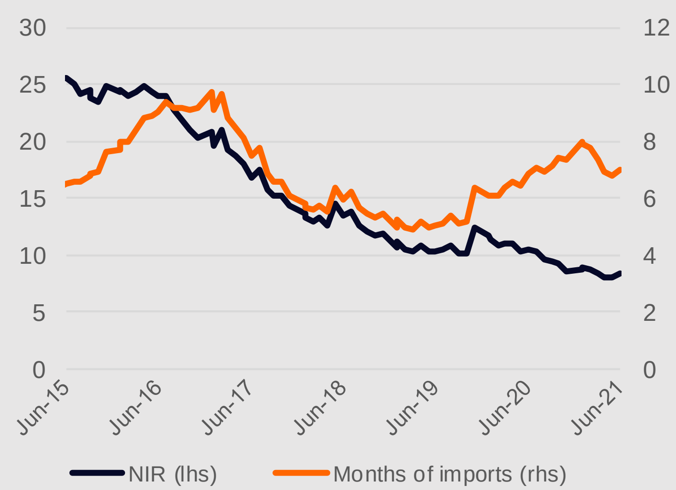
USD Billion



Source: BNA

Net International Reserves are finally stagnating again, expected to rise by the end of the year

USD Billion; Months

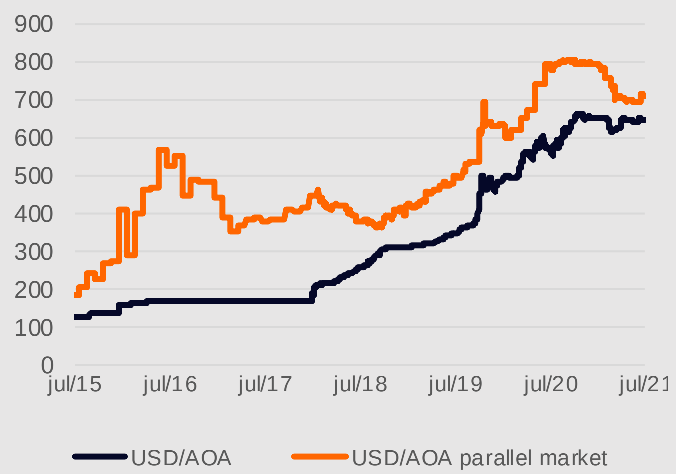


Source: BNA, calc. BFA

4| With regard to the external balance, the Fund expects a current account surplus of 5.2% of GDP, with a slight increase in net reserves (around USD 0.5Bn). In our view, the surplus will be relatively larger, possibly close to 9% of GDP, mainly due to a more moderate outlook on the growth of service imports (facing constrains while international travel remains difficult), but also considering a continuation of the decline in profit repatriation started in 2019. Even so, it is difficult to predict whether the accumulation of reserves could be greater than predicted by the IMF, since the financial balance remains a black box, making forecasts unwise. However, it is unlikely that reserves will end the year in decline. **It should be noted that, at first sight, Angola would have missed the target for Net International Reserves in June, since the amount stood at USD 8.3Bn and the target was USD 8.8Bn;** however, this target was adjusted downwards, as previously dictated by the IMF, due to the delay in the disbursement of the World Bank's budget support loan of USD 0.7Bn (approved in March of this year)– presumably there has been a new step towards unlocking this process last week. In other words, with this amount, with the sale of oil at higher prices, with imports still at very low levels, the external accounts will show resilience and cause growth in reserves during the second half of the year. **In fact, the Balance of Payments likely posted a small surplus in the 1st**

After a huge adjustment since 2018, and a new depreciation with the pandemic, Kwanza stabilized

USD/AOA



Source: BNA, Kinguila Hoje, AngolaForex, Rokesanteiro

semester, of around USD 0.27Bn, as growth in Gross International Reserves by that amount shows.

Looking specifically at the foreign exchange market, the IMF highlights the fact that exchange rate liberalization and flexibility facilitated adjustments to last year's shocks. It is mentioned that the Kwanza should continue to be determined by the market and that the Central Bank should only use local currency instruments for monetary policy operations. The authorities and the institution agreed that the intervention of the BNA should only occur in cases of excessive volatility. In fact, the BNA's interventions in the foreign exchange market have been quite limited in 2021, with no foreign exchange being sold by the BNA to the market since April.

5| The Fund emphasizes that the banking sector has been resilient, but that continued monitoring will be critical to avoid deterioration in asset quality resulting from the pandemic. The non-performing loan (NPL) ratio continued its downward trend, closing the year at 18.4%; however, it remains at a high level, according to the IMF. The implementation of the new Law on Financial Institutions will, according to the Fund, allow the establishment of a more robust supervision framework. In order for this to be done, the BNA requested technical assistance so that the institution itself can be in line with the best international practices and ensure the proper performance of its job in functions of supervision, resolution and macro-prudential authority. With regard to the new BNA Law, the IMF expects it to be approved at the end of November 2021, after some changes to the Constitution, which should further strengthen the Central Bank's independence. The institution also states that the restructuring of Banco Económico, which is still being prepared, will allow the completion of two structural benchmarks. As far as BCI is concerned, the Fund expects the privatization process to be completed in September; at the moment the process has 6 contenders with effective proposals, both local and foreign. Regarding NPLs transferred from BPC to Recredit, the IMF expects the credit recovery process to accelerate.

NPL adjusted in 2020 with asset sales towards outside the banking system

Percentage

Source: BNA,

6| On the issue of monetary policy, the Fund highlights the efforts made by the Central Bank in helping the economy during the 2020 shock; among these efforts, the BNA operated by providing liquidity to companies through the purchase of public debt. At the moment, the IMF points out that the BNA has turned its attention to controlling inflation so that they can contain the increase in prices, which has been quite persistent, as shown by the year-on-year inflation rate in June of 25.3% (highest value since October 2017). In this sense, the institution encouraged the BNA to increase the reference rate (in order to signal the tightening of policy, actually conducted through open market operations) and to abandon the custody rate, stressing that it reduces overnight interbank rates, and that liquidity-absorbing instruments would be a better means of reducing excess market liquidity.

The BNA seems to have taken into account the Fund's recommendations - at the Monetary Policy Committee held on July 2nd, one month earlier than initially planned, the Central Bank increased the BNA rate by 4.5 percentage points (pp) to 20%, the Standing Facility for Liquidity Lending interest rate by 5.12pp to 25% and the 7-day Standing Facility for Liquidity Absorption interest rate by 3pp to 15%. With these measures, the Central Bank intends to encourage

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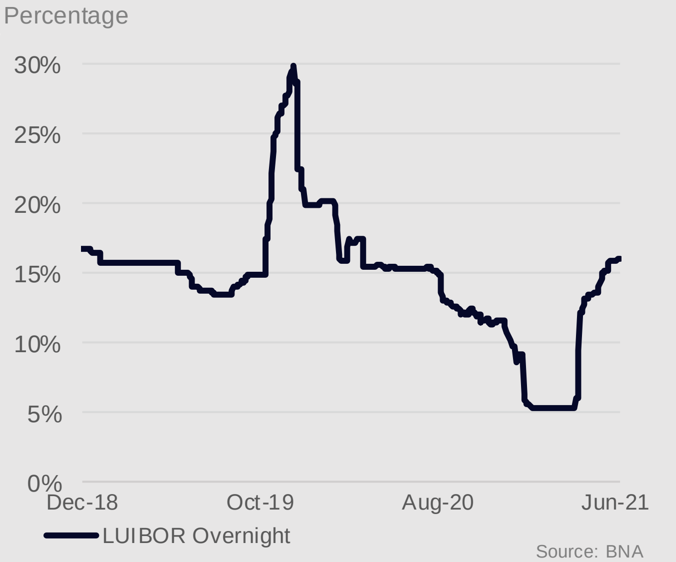
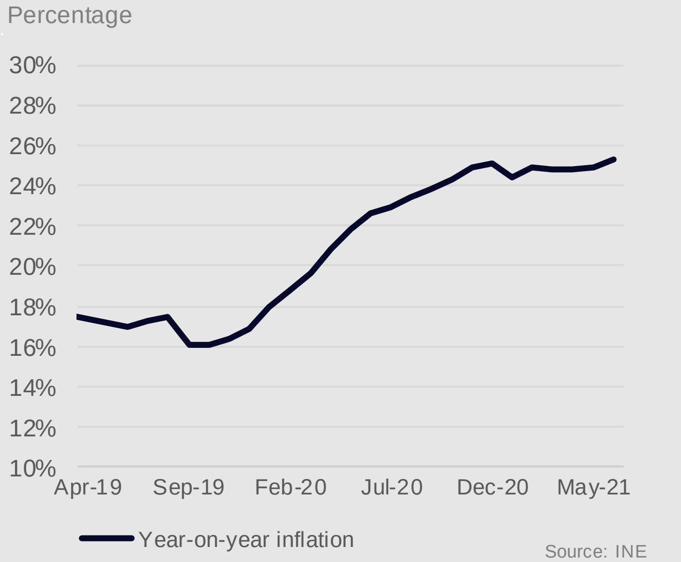
savings by economic agents and aims to reverse the trajectory of inflation, so that it can reach the goal of 19.5% by the end of 2021. For this to be possible, we estimate that the monthly average inflation between July and December will have to be around 1.08%, that is, 0.84pp below the average of the first semester, which justifies the sharp rise in rates. In fact, we expect the measures to have a less pronounced impact than necessary, with year-end inflation certainly above 20%, possibly around 23-24%. Even so, the impact of monetary policy on economic activity cannot be ignored, since inflation control will only be achieved with some effective liquidity restriction.

Liquidity abounded in late 2020, pushing LUIBOR to multi-year lows



Source: BNA

Inflation accelerated again from the beginning of the pandemic, remaining at high levels



Source: INE

The Fund also recognizes the efforts made to improve the BNA's Governance structure, namely with submission of the new BNA Law to parliament in last December. This law was drafted on the basis of IMF recommendations and is one of the main objectives of the government's reform program. It is expected to be adopted by the end of November 2021 (new structural benchmark). In their memorandum of economic and financial policies, Angolan authorities emphasized their commitment to safeguarding the stability of the financial system, by being ready to create legislation that can improve the regulatory framework of BNA as a lender of last resort. Among the most recent measures, the BNA recently issued a new regulation aiming to regulate external audit activity in financial institutions, and additional legislation regulating some requirements that financial institutions must comply with regarding governance and limits to large risks, liquidity requirements, reporting and capital requirements.

7| The IMF also raised some other structural reform themes in this report, such as fighting corruption, improving governance and business conditions. In particular, the institution welcomed Angola's various efforts to combat corruption, such as the Government's adherence to the Extractive Industries Transparency Initiative in early June, and the intention to align practices with the US Foreign Corrupt Practices Act and UK Bribery Act. Additionally, the IMF says that the authorities are coordinating with the United Nations an anti-corruption strategy that could include the opening of a delegation in Luanda of the UN agency to combat corruption, drug trafficking, crime and terrorism. The IMF also points to the authorities' commitment to the implementation of the new AML/CFT Law, supporting investigations into corruption and money laundering, which should benefit the country in Angola's next AML/CFT assessment, which is scheduled for mid-2022.

In the case of transparency in public finances, the Fund refers to the fulfillment of one of the structural benchmark related to the share of public contracts to be allocated via public tender (54% vs. target of 45%). Additionally, the institution mentions that the authorities will expand the use of the electronic auction platform and have committed to the publication of the annual purchase plan. Another important measure mentioned in the document on transparency is the detailed publication of expenditures made in the context of combating the pandemic. In the budget execution report for the 1st quarter 2021, the Government reported disbursing a little more than AOA 36Bn, with a good part of this amount being allocated to specialized current consumption material.

C. CONCLUSION

1| The IMF remains satisfied with the degree of compliance with the measures by the authorities, despite delays in meeting the structural targets. The current status of the Program and the alignment of perspective between the authorities and the Institution make an approval of the final review more than certain at the end of the year; it would not be surprising if the country decides to maintain some more formal monitoring framework with the Fund following the end of the Program. This should add to several Technical Assistance missions in various areas initiated throughout the Program.

2|The prospects for the Angolan economy continue to be conditioned by the decrease in oil production, as well as the restrictions imposed by the pandemic, and some impact of climatic adversities. However, it seems to us that the Fund may be too pessimistic in its assessment of the non-oil economy: in particular, the indications we have about food production are positive, and the effects of the rise in oil prices will be more impactful in the 2nd semester; additionally, there are already some year-on-year growth indicators.

3| Fiscal consolidation continues to be the aspect in which the authorities achieve better results, this year; non-oil primary deficit is expected to reach just 4.8% of GDP this year, according to the IMF. Furthermore, the Fund expects the debt-to-GDP ratio to decline for the first time this year; we also expect this, likely with a stronger decline than expected by the Fun, given the likely stabilization and possible appreciation of the Kwanza.

4| The external balance is, for now, assured for 2021, Reserves should grow somewhat in the 2nd half of the year. The current account will show a significant surplus, forecasted by the Fund at 5.2% of GDP; BFA expects it to be higher, perhaps close to 9%.

5| The banking sector is showing signs of resilience, with the restructuring of BPC underway, and there is finally a concrete prospect in the short term for the start of the restructuring of Banco Económico, and a plan should be known and implemented before September. The existence of several privatization processes in the near future should open doors to the possibility of consolidation movements.

6| The focus given by the Fund to various measures to combat corruption by the Government is interesting, and it is clear that the IMF intends to certify the recent efforts of the Angolan authorities as well-intentioned. Still, it remains to be seen whether there will be a positive assessment next year with regard to AML/CFT practices.

7| A note to the sparse discussion and evaluation of some very important themes by the Fund: Privatization Program, attraction of new investments; Kwenda program and other social expenditures; development of the agricultural sector. It is true that all these issues are being dealt primarily in cooperation with the World Bank; the fact is that information about these issues is much scarcer, so a greater emphasis on them would be positive.

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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.