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FLASH NOTE

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2023 State Budget conservative again, albeit slightly

Fuel subsidy reform likely to start gradually this year

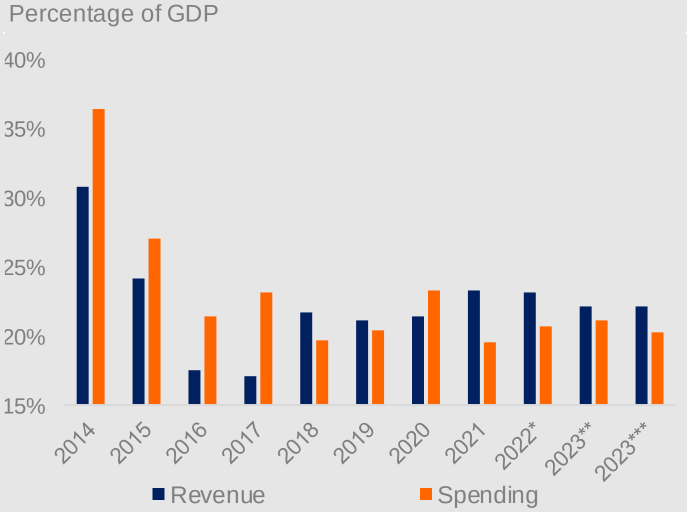
A. DESRIPTION

1| The State Budget (OGE) for 2023, which was approved in the Angolan parliament last Monday, February 13th, foresees budget revenues of AOA 13.5 trillion and budgeted expenditures of AOA 12.9Tn. According to our calculations, in Dollars, the Executive expects revenue of 26.1 billion and budget expenditure of around USD 25.1Bn, which will result in a positive budget balance. The balance should be positive for the 3rd consecutive year: excluding 2020, the year the pandemic began, budget accounts have been in surplus since 2018.

2| With regard to revenues, a slight increase of 0.7% is expected compared to the expected execution for 2022 (AOA +0.91Tn). As a percentage of GDP, revenues are expected to decline, from 23.2% to 22.1%. On the side of oil tax revenues (including concessionaire's rights), a reduction of AOA 0.77Tn (-9.8% yoy) to AOA 7.2Tn is expected. According to the Government forecast and BFA calculations, when expressed in Dollars, the drop is 19.3% to USD 14.0Bn, compared to USD 17.3Bn in 2022. This evolution is due to an assumption of the price of Brent lower compared to the average export price in the previous year (USD 98.0 in the 2022 fiscal year against the USD 75 proposed in the 2023 OGE); With regard to production, the Government expects an increase of around 2% to 1.18 million barrels per day (mbd).

Non-oil tax revenue is expected to increase by AOA 0.42Tn to AOA 4.8Tn, according to the Executive. This is an increase of 9.6% compared to the execution forecast by the Government for 2022. As a percentage of GDP, the collection of non-oil taxes should represent 7.9%, 0.2pp below 2022, and also the recent maximum recorded in 2020 (8.7% of GDP).

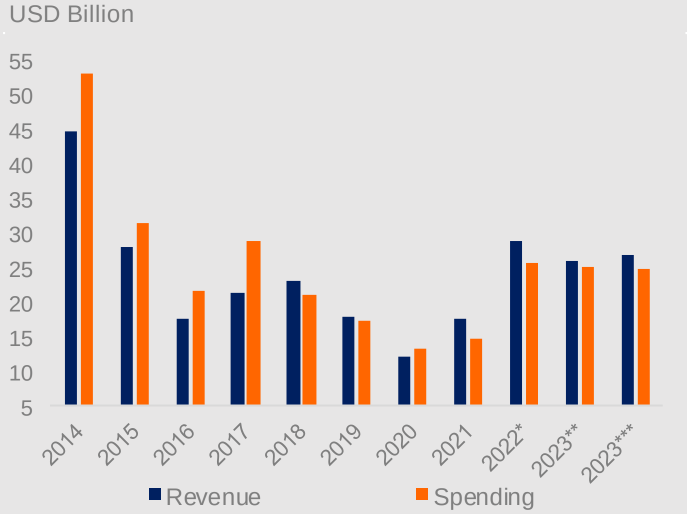
In percentage of GDP, revenue should decreasce in 2023 compared to last year



*Estimate **Budget ***BFA

Sources: Fin. Min., BFA calc.

As measured in Dollars, revenue is expected to decline slightly in 2023



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State Budget (AOA Billion)	**2022** Budget	**2022** Execution	**2023** Budget	**2023** BFA est.	**Change 2023/22** Budget	**Change 2023/22** BFA
Revenue	**11 637**	**13 371**	**13 462**	**14 116**	**0.7%**	**5.6%**
Current Revenue	11 637	13 332	13 462	14 116	1.0%	5.9%
Taxes	10 730	12 355	11 999	12 754	-2.9%	3.2%
Oil Taxes	6 118	7 973	7 196	7 824	-9.8%	-1.9%
Non-oil Taxes	4 612	4 382	4 804	4 929	9.6%	12.5%
Social Contributions	336	390	311	361	-20.2%	-7.5%
Donations	1	0	7	7	1625.0%	1625.0%
Other current revenue	571	587	1 145	995	95.2%	69.7%
Capital Revenue	0	39	0	0	-100.0%	-100.0%
Expenditure	**11 636**	**11 900**	**12 902**	**12 991**	**8.4%**	**9.2%**
Current Expenditure	9 623	8 730	9 808	9 897	12.4%	13.4%
Wages	2 675	2 392	2 825	2 621	18.1%	9.6%
Goods & Services	2 392	2 112	2 885	2 885	36.6%	36.6%
Interest	3 021	2 135	2 441	2 462	14.3%	15.3%
External	1 753	989	1 296	1 317	31.0%	33.2%
Internal	1 268	1 146	1 145	1 145	0.0%	0.0%
Current Transfers	1 536	2 091	1 657	1 929	-20.7%	-7.7%
Capital Expenditure	2 013	3 171	3 094	3 094	-2.4%	-2.4%
Current Balance	**2 015**	**4 602**	**3 654**	**4 220**	**-948**	**-383**
Primary Balance	3 022	3 606	3 001	3 588	-605	-18
in % of GDP	5.5%	6.2%	4.9%	5.6%	-1.33	-0.64
Non-oil Primary Balance	**-3 096**	**-4 367**	**-4 195**	**-4 237**	**172**	**131**
in % of non-oil GDP	-5.7%	-7.6%	-6.9%	-6.6%	0.69	0.95
Budget Balance	**2**	**1 471**	**560**	**1 125**	**-911**	**-345**
in % of GDP	0.0%	2.5%	0.9%	1.8%	-1.63	-0.79

Source: Min. Fin.,BFA calc

3| On the expenditure side, an increase of 8.4% is expected, which represents AOA 0.99Tn compared to the execution forecast for 2022. As a percentage of GDP, this is a reduction of 0.8pp to 21.1% (21.9% in 2022); excluding the pandemic year (in which the much lower GDP statistically raised the ratio), expenditure stood at an average of 19.4% of GDP in the years 2018, 2019 and 2021.

Comparing with the 2022 execution, the largest increase in absolute value of current expenditures should be on the side of goods and services, which should increase 37%. At the same time, interest expenses should rise by 14% and represent around 19% of total expenses, while employee compensation should rise by 18%, which, by the way, should grow above the average inflation forecast for this year (11%). **The most relevant decline is in current transfers (which includes**

spending on subsidies), at around 20.7%. Investment spending is expected to decline by 2.4% to AOA 3.1Tn, the second likely drop since 2021.

4| In general, the 2023 OGE forecasts a positive budget balance in the order of AOA 0.59Tn, which for us is slightly conservative. Our expectation is for a positive balance of AOA 0.62-1.62Tn, mainly based on a higher Brent price than the Executive's assumption, although we expect a lower level of oil production.

Box 1 – Budget execution in 2022 better than expected due to oil prices

1| In 2022, the General State Budget forecast budget revenues of AOA 11.6 Tn and budgeted expenditures of the same amount. On the side of oil tax revenues, there was a drop compared to 2021 of 7.5% to AOA 6.1Tn was expected. These expectations were based on a Brent price of around USD 59 and an average daily production of 1.14 million barrels per day (mbd). On the non-oil fiscal revenue side for 2022, the Budget forecast a 26% increase to AOA 5.5Tn. According to preliminary data published by Minfin, budget execution for 2022 will have performed better than initially estimated. Total revenue will have been around AOA 13.4Tn, above the Government's expectation (+1.7Tn) and above our own expectation (+1.1Tn); expenditure was AOA 263 billion higher than initially expected, standing at AOA 11.9T – in line with our expectations.

The State accounts had a budget surplus of AOA 1.47Tn, much higher than the expected balanced accounts, but also higher than the surplus of 0.3Tn forecast by the BFA. When we evaluate budget execution data as a percentage of GDP, revenues represented around 23.2% while on the expenditure side, these represented around 21.1%. In Dollars, according to our calculations, revenues stood at USD 29.04Bn, with expenses of USD 25.84Bn, making a positive budget balance of USD 3.19Bn.

2| Revenues collected by the Government were 15% higher than forecast in the Budget for 2022 with higher tax collection than projected (AOA +1.6Tn). On the side of oil taxes, there was a collection 30% higher than expected; non-oil taxes were 5% lower than projected in the Budget. In both cases, the BFA forecast expected higher values than projected, but not as high. These significant increases in tax revenue are related to two factors: on the one hand, the positive effect of oil prices on international markets – USD 101 compared to USD 59 of the Budget 2022; and on the other hand, the exchange rate appreciation in 2022 (10% against the Dollar and 17% against the Euro) which resulted from a greater supply of currencies in the national market, and brought growth in the non-oil sector. With regard to social contributions, they increased by 16% to AOA 389Bn, while other current revenues grew slightly to AOA 586Bn (+2.7%).

3| With regard to expenditure, the Government almost complied with the expenditure limit, spending 2.2% more than it had foreseen. As a percentage of GDP, expenditure in 2022 will have represented around 20.6%. In view of the forecast, the deviations were in line with our perspective. There was 29% less interest expense (AOA 3.0Tn vs AOA 2.1Tn). This drop was essentially due to the 44% reduction in interest payments to external entities, which has to do with a more appreciated currency than expected by the Government. And on the other hand, expenditure on current transfers was well above the forecast by the Government. On the other hand, but less relevant, expenditure on goods and services was 12.4% lower than planned, representing 3.7% of GDP, the highest value since 2017. Capital expenditure also exceeded expectations, having grown by 60% to AOA 3.2Tn, corresponding to a typical movement in an election year.

4| As a result of this execution, the Ministry of Finance expects to have recorded a budget surplus of 2.7% of GDP, a lower value compared to 2021. The primary balance reduced, having gone from AOA 4.2Tn in 2021 to AOA 3.6Tn in 2022, expected to be around 6.3% of GDP. When we

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analyze the non-oil primary balance (which corresponds to the balance without taking into account expenditure on interest and oil revenue), in 2022 it stood at AOA -4.3Tn, around -7.6% of GDP – it deteriorated in compared to 2021 and interrupted a downward cycle that started in 2018, being above the medium-term limit of -5%.

B. ANALYSIS

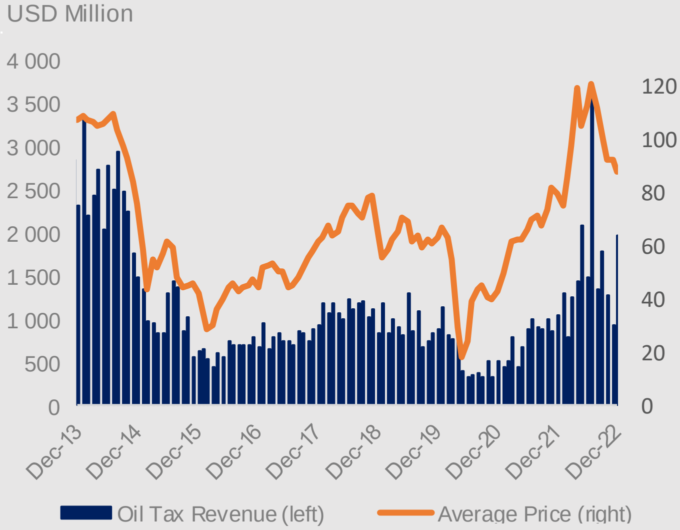
1| From our perspective, this Budget is, again, a moderately conservative exercise. Taking into account what the main forecasting houses have said and expected, it is quite possible that the price of oil could again be around USD 80 or 90; in fact, the current consensus of forecasts for the Bloomberg platform points to USD 87.8 in 2023, which compares with USD 75 by the Government. For our part, we assume for now an average of around USD 85.

Forecast Scenario	OGE	Est. BFA
Hypotheses		
Oil price (USD)	75.0	85.0
Oil production (mbd)	1.17	1.10
GDP growth (%)	3.3	1.3
Forecasts		
AOA Billion		
Revenue	**13 462**	**14 116**
Oil taxes	7 196	7 824
Non-oil taxes	4 804	4 929
Expenditure	**12 902**	**12 991**
Budget Balance	**560**	**1 125**
as a % of GDP	0.9%	1.8%

Source: Min. Fin.,BFA calc

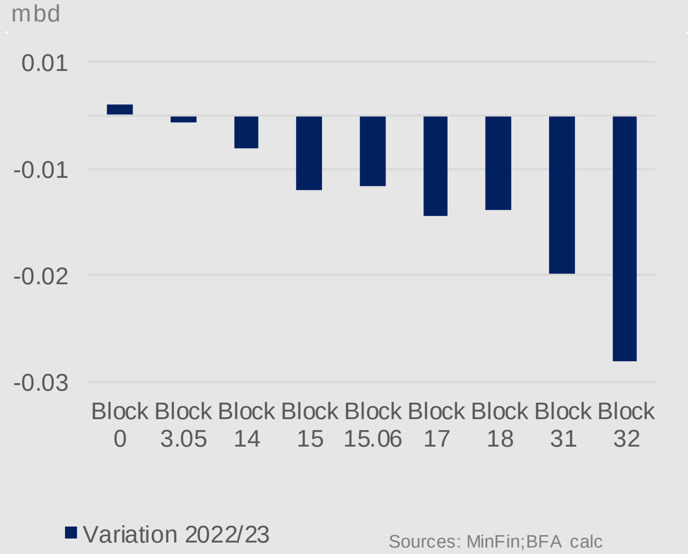
2| With regard to production volume, the Government's forecast for 2023 seems very optimistic. In 2023 there should be few new production projects in the sector, these being concentrated in Block 0 (with some result still from the installation of the Lifua A platform and possible advances on platforms B and C) and in block 15/06 (with a possible impact on last quarter of the full Agogo field development project). Even in these 2 blocks, the new production should not prevent decreases, and the only block with production to increase should be Block 18 (+2%), due to a favorable effect on the comparison since, according to the observed export figures, there likely was a temporary stoppage of production sometime in the last quarter of 2022. In this sense, we expect oil production close to 1.10mbd, well below the 1.18mbd expected by the Budget.

Oil tax revenues expected to fall from 2022 peaks



Source: Min. Fin.

Only Block 18 will see a slight increase in production in 2023



Sources: MinFin;BFA calc

3| As for the Government's macroeconomic scenario, it anticipates economic growth, both in the non-oil and non-oil economy. The Executive expects economic activity in general to grow by 3.3%. On the side of the oil economy, the Government expects a 3.0% increase in activity (an acceleration compared to growth in 2022), which contrasts with the drop that BFA predicts, between -6.6% and -6.0%; the more pessimistic perspective we assume derives directly from the differences in forecasting the evolution of crude oil production. In the case of the non-oil economy, the Executive expects growth of 3.4% in 2023, which represents a slowdown compared to preliminary data for 2022 – in this case, our expectation is slightly more positive, pointing to an increase between 3.8%-4.3%, similarly to the performance in 2022. For the economy as a whole, the Budget assumes a growth of 3.3%, while the BFA expects an increase in activity between 1.0-1.5%.

4| Despite forecasting negative growth in oil production, we believe there will be some budgetary slack. We anticipate oil tax revenue to be about AOA 0.6Tn above Treasury expectations. This more optimistic view results mainly from a positive effect of higher Brent, more than offsetting the negative effect of lower than expected production. **In isolation, between USD 75 and USD 90, each Dollar more in the average price of Brent in 2023 results in an additional AOA 0.15Tn of oil tax revenues.**

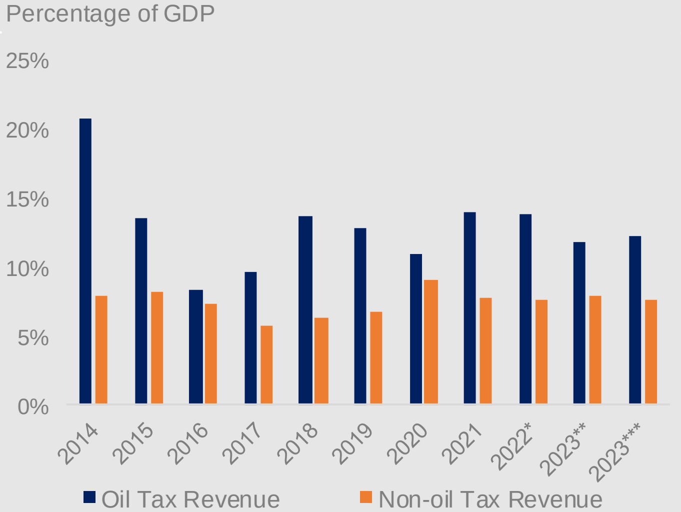
Oil Revenue for each Price Level

Brent price (USD)	Est. Revenue (AOA Bn)
75	7 206.8
79	7 757.4
83	8 340.0
87	8 956.9
91	9 610.3
95	10 303.0

Source: Min. Fin.,BFA calc

5| With regard to non-oil revenues (taxes, social contributions and other current revenues), the Executive expects an overall increase of around 16.8%. Our expectations for the total amount of revenue does not diverge, although we expect that the forecast will be exceeded in the case of taxes and social contributions, and that it will come short in the case of other current revenues. In the first two cases, we expect an increase that should be between AOA 0.1-0.2Tn – especially with regard to revenue in social contributions, we believe that the Executive is being very conservative; these could be 10-20% above the foreseen. However, this is a small component of revenue. With regard to other current revenues, which the Executive expects to almost double compared to 2022 (+95.2%), most of the impact is due to the reclassification of revenues that were previously classified as taxes or social contributions, but there is also a positive impact that derives from an expectation of a doubling of revenues in fees and charges, from AOA 0.03Tn to 0.06Tn, which does not seem entirely justified by the economic reality or legislative changes. In this sense, our expectation is that revenue in this component will be lower than expected by the Executive, also by around AOA 0.1-0.2Tn.

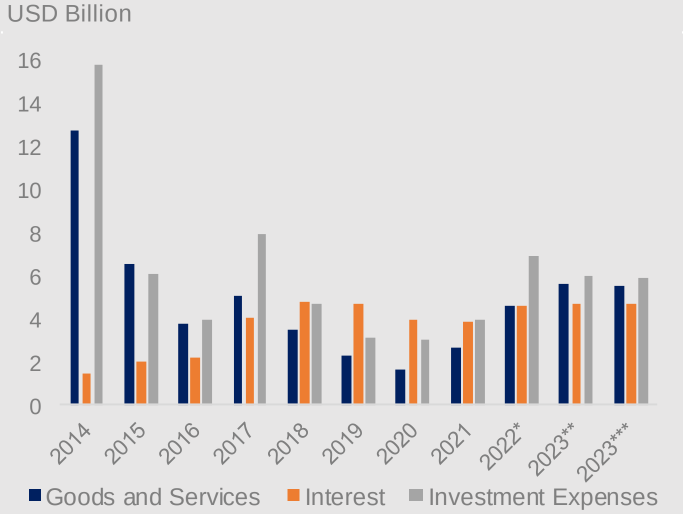
Oil tax revenue expected to fall again, as % of GDP



*Estimate **OGE ***BFA

Sources: Min. Fin.,BFA calc

Interest spending will stabilize in 2023; investment will be less; purchases of goods & services will rise



*Estimate **Budget ***BFA

Sources: Min. Fin.,BFA calc

6| Total revenues are estimated at AOA 13.4Tn by the Executive, corresponding to a year-on-year increase of 0.67% (below the expected average inflation for 2023). Based on our calculations, we estimate a higher level of revenue, around AOA 14.1Tn, essentially due to higher oil tax collections, as explained above.

7| On the expenditure side, the Government foresees an increase of 8.4% to AOA 12.9Tn; representing 21.1% of GDP. Our estimate of the expense is slightly higher than the executive's, at around AOA 13.0Tn. Excluding interest, primary expenditure will grow by 7.1%, below the inflation assumed by the Budget – that is, expenditure will decline in real terms.

8| Within the various components of expenditure, the largest increase will be registered in goods and services, while current transfers are expected to register the largest drop. In the case of purchases of goods and services, the increase is 36.6% - as a percentage of GDP, it would be 4.6%, the highest value since the 5.6% recorded in 2015. Current transfers should fall by more than 20.7% to AOA 1.6Tn and this drop is likely to signal the partial removal of fuel price subsidies that have been supported off-budget by Sonangol (though offset through tax credits).

The Treasury expects to spend AOA 0.6Tn less on fuel subsidies, according to our calculations using OGE and IGAPE data. We estimate that MinFin expects that much of this decrease in spending is due to lower fuel prices in international markets – possibly around AOA 0.4Tn. The remaining savings, around AOA 0.2Tn, would be achieved with the start of the withdrawal of price subsidies: according to our calculations, the average annual price increase would always be less than 30%.

From our point of view, the savings from falling prices will be slightly lower, possibly closer to AOA 0.2Tn. At the same time, we also expect an average increase in prices lower than that calculated above – the possible impact on inflation and the complexity of the mechanism for gradually increasing prices should mean that the withdrawal of the subsidy will only take place sometime in the 2nd half of this year, which should lead this reform to span for several budgetary years.

Spending on employee compensation should rise by around 18% according to the Budget. It should be noted that, according to data from the INE Employment Survey, the population employed in the Public Administration sector rose by 20.5% yoy in Q3 2022 - assuming a continuation of these levels of year-on-year growth for most of 2023 (which is quite possible), the numbers are consistent with a stagnation of civil servant salaries during this year.

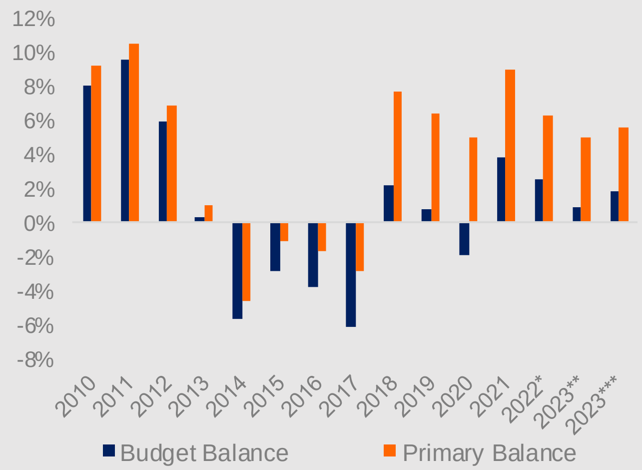
9| With regard to investment spending, the Government forecasts a reduction of 2.4% compared to the 2021 budget execution. In Dollars, the amount to be disbursed in investment should represent around USD 5.9Bn. As a percentage of GDP, investment is around 5.1%, which represents a reduction compared to the 5.5% estimated in 2022.

10| Finally, interest expenditures are expected to increase by around 14%, mainly due to a 31% increase in interest expenditures owed abroad. Even so, it should be noted that they should remain around 4.0% of GDP, according to the Budget, slightly above the 3.7% in 2022, but well below the average of 5.9% between 2019-21.

11| Thus, the Executive forecasts a positive budget balance of 0.57Tn, around 0.9% of GDP, while the BFA forecasts a higher positive budget balance, between 1.5-2.0% of GDP. It cannot be ruled out, however, that if there is a gap similar to or greater than what we are estimating, the Executive will choose to increase investment spending by the corresponding amount, maintaining a surplus similar to that budgeted. Looking at the primary balance (which excludes interest expenditures), the Executive anticipates a surplus of 4.9% of GDP, representing a decrease of 1.3pp compared to 2022 values; the BFA estimates that the primary balance will be around 5.4-5.9% – since 2018 the Executive has presented consecutive positive primary balances, something that did not occur between 2014-2017.

Primary balance will remain positive, but lower than normal in recent years

Percentage of GDP

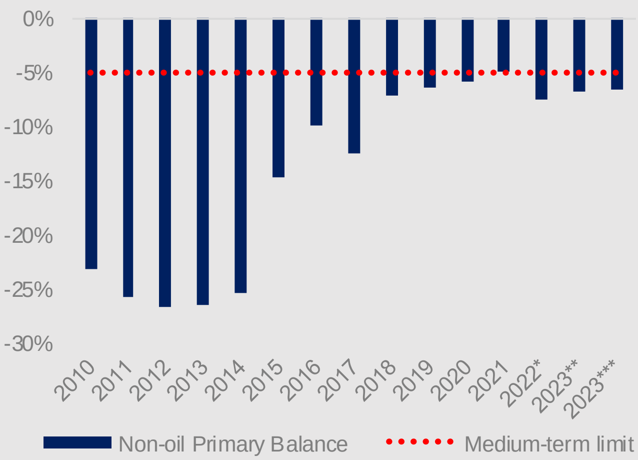


*Estimate **Budget ***BFA

Sources: Min. Fin.,BFA calc

Non-oil Primary Balance remains larger than the medium-term limit

Percentage of Non-oil Primary Balance



*Estimate **Budget ***BFA

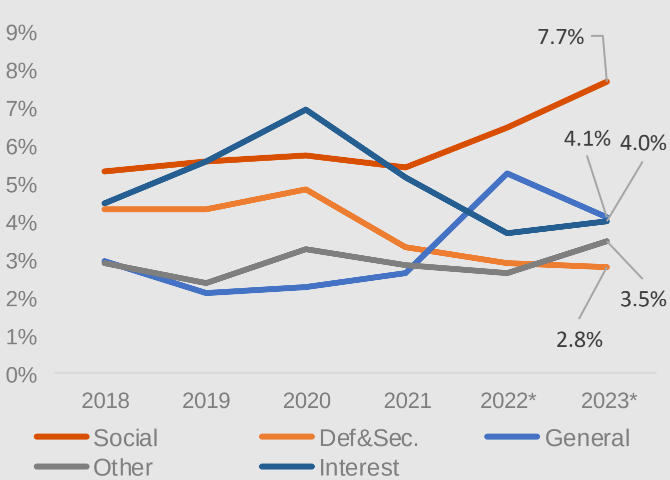
Sources: Min. Fin.,BFA calc

12| In the case of the non-oil Primary Balance, the Government expects it to deteriorate to -6.9% of GDP; this is an improvement compared to the 7.6% of the preliminary Execution for 2022. BFA expects a possibly better non-oil primary balance, between -6.4% and -6.9%. Even so, the balance will still be above the medium-term limit of -5.0% of GDP.

13| With regard to expenditure by sector, it is worth mentioning a further decrease in expenditure on Defense & Security, to 15.6% of total budgetary expenditure, below the remaining expenditure components. On the other hand, social expenditure (Education, Health, Social Protection, Housing) concentrates 42.5% of budgetary expenditure, a maximum since at least 2018, when it totaled 41.9% of expenditure. In fact, looking at expenditure as a percentage of GDP, and accounting for data from the State Account up to 2021, the 2022 Provisional Execution, and the 2023 Budget, spending on social expenditure is on an upward trend, predictably representing 7.7% of GDP in 2023.

Interest expenses are making budget expenditure less conditional on 2020

% of GDP

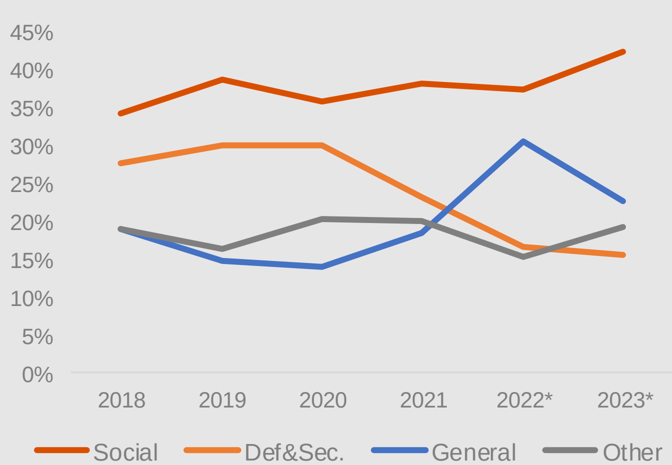


*Budget

Sources: Min. Fin.,BFA calc

Excluding financial expenditures, the share of social expenditure has increased slightly

% of primary expenditure



*Budget

Sources: Min. Fin.,BFA calc

Looking at the graph below, it is possible to detect that this rise was possible in recent years due to the decrease in public debt interest expenditure, as a result of fiscal consolidation. On the other hand, there has actually been a decrease in the weight of public expenditure on defense & security, in relation to GDP. Still, compared to other sub-Saharan African economies, spending on social spending remains low. World Bank data pointed to Namibia spending 17.4% of GDP on Education & Health alone in 2019; the same data pointed to 9.6% in Kenya and similar levels in Rwanda. Although Angola compares favorably with an economy similar in structure, such as Nigeria (3.5% of GDP in 2019, 4.4% in the same source for Angola), these were, at the time, numbers far below the economies taken as examples in the field.

In this sense, it is still necessary to increase spending in these sectors. Part of these gains could come from a continued fiscal consolidation that could save another 1% of GDP in interest within 2-3 years, which can be allocated to these expenditures; another part may come from the reform of spending on fuel subsidies – in 2022, they were 2.5% of GDP, in 2023, even with the reduction, they should be 1.8% of GDP; finally, the continued growth of the economy may be accompanied by a broadening of the tax collection base, which may open space for greater expenditure.

C. CONCLUSION

1| The 2023 Budget is relatively conservative, as has been the case in recent fiscal years, but the margin we identified is modest. In summary, despite a forecast for increased production that seems optimistic to us, the price assumed in the budget is below our expectations (and market expectations) for 2023 – thus, oil revenues will be slightly higher than expected, which justifies our perspective of a surplus greater than the 0.9% of GDP forecast by the Government. Despite the surplus, the non-oil primary deficit remains more serious than the medium-term limit established at -5% of GDP: it should be -6.9% according to the Budget, a little more favorable, but also in the vicinity of -6% according to our perspective.

2| In terms of fiscal policy direction, this is a slightly contractionary Budget, both due to the effect of lower oil revenues and excluding this effect, which is seen by the improvement in the non-oil primary deficit, from -7.6% to - 6.9%. The impact is visible in the evolution of primary expenditure (which excludes interest), which will rise 7.1%, clearly below inflation. More specifically, investment spending will decline by 2.4%, unlike all other primary expenditure items which will record increases at or above inflation. A note on the issue of fuel subsidy reform, which should start in 2023. It seems to us that the adjustment assumed in this Budget is, for the time being, relatively light, which is supported by the good overall budgetary situation and by Sonangol's comfort with the solution of tax credits, which makes the resolution of this matter less urgent in terms of the State's treasury and the public oil company. However, these are relevant amounts that could be spent on Education, Health, among others, which makes the subject more important in the medium and long term.

3| Our analysis points to a gradual increase in social sector spending in recent years, as a percentage of GDP and as a share of total spending. In fact, the decrease in expenditure on interest, as a result of fiscal consolidation, and some containment in expenditure on Defense & Security, have allowed for an increase in expenditure on Education, Health, Housing and Social Protection. Even so, comparisons with other sub-Saharan countries whose development has taken place in a healthy and sustained manner show us that current levels of spending, measured as a percentage of the economy, are insufficient, and need to continue to increase. As stated above, fuel subsidy reform is therefore essential to release funds in this regard.

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D. ANNEX

State Budget (USD Billion)	2022 Budget	2022 Execution	2023 Budget	2023 BFA est.	Variation 2023/22 OGE	Variation 2023/22 BFA
Revenue	**16.33**	**29.04**	**26.15**	**26.97**	**-9.9%**	**-7.1%**
Current Revenue	16.33	28.95	26.15	26.97	-9.7%	-6.8%
Taxes	15.05	26.83	23.31	24.37	-13.1%	-9.2%
Oil Taxes	8.58	17.31	13.98	14.95	-19.3%	-13.6%
Non-oil Taxes	6.47	9.52	9.33	9.42	-1.9%	-1.0%
Social Contributions	0.47	0.85	0.60	0.69	-28.7%	-18.6%
Donations	0.00	0.00	0.01	0.01	-	-
Other current revenue	0.80	1.27	2.22	1.90	74.6%	49.3%
Capital Revenue	0	0	0	0	-	-
Expenditure	**13.34**	**25.84**	**25.06**	**24.82**	**-3.0%**	**-3.9%**
Current Expenditure	10.70	18.96	19.05	18.91	0.5%	-0.2%
Wages	3.94	5.19	5.49	5.01	5.7%	-3.6%
Goods & Services	1.86	4.59	5.60	5.51	22.2%	20.2%
Interest	3.55	4.64	4.74	4.70	2.3%	1.5%
External	2.46	2.15	2.52	2.52	17.2%	17.2%
Internal	1.78	2.49	2.22	2.19	-10.6%	-12.0%
Current Transfers	2.15	4.54	3.22	3.69	-29.1%	-18.8%
Capital Expenditure	2.82	6.88	6.01	5.91	-12.7%	-14.1%
Current Balance	**2.83**	**9.99**	**7.10**	**8.06**	**-2.90**	**-1.93**
Primary Balance	4.24	7.83	5.83	6.86	-0.26	-0.12
in % of GDP	5.5%	6.2%	4.9%	5.6%	-1.33	-0.64
Non-oil Primary Balance	**-4.34**	**-9.48**	**-8.15**	**-8.10**	**1.34**	**1.39**
in % of non-oil GDP	-5.7%	-7.6%	-6.9%	-6.6%	0.7%	0.9%
Budget Balance	**0.00**	**3.19**	**1.09**	**2.15**	**(2.11)**	**(1.04)**
in % of GDP	0.0%	2.5%	0.9%	1.8%	-1.63	-0.79

Source: Min. Fin.,BFA calc

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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