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FLASH NOTE

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Economy likely to suffer from exchange rate uncertainty

Exchange rate crisis and subsidy reform broke the confidence environment

A. DESCRIPTION

1| The macroeconomic scenario today is significantly different from previous expectations of most economic agents; likewise, our perspective at this moment is different from what we anticipated at the beginning of this year. The economy grew in 2022, with the oil and non-oil sectors contributing 0.7 percentage points (pp) and 2.4 pp to the overall GDP growth rate. The performance of 2022 greatly influenced the formation of expectations in 2023 and until the beginning of that year it was not thought that the exchange rate would sink by more than 50% by June and that new challenges regarding inflation would emerge in the 1st half of the year.

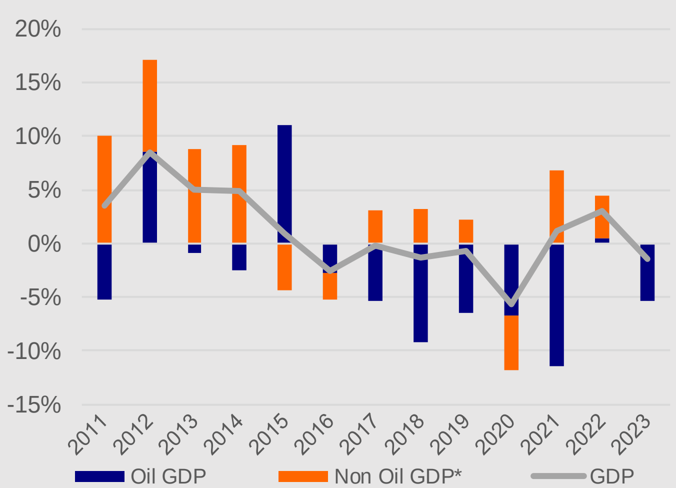
2| These headwinds have led to revised forecasts by several institutions, from Fitch Solutions, Oxford Economics, IMF and the Government itself – we present our analysis in this document. Below are two alternative economic growth scenarios, illustrating how economic performance is at the mercy of the exchange rate, not only from the point of view of price stabilization, but as a variable that can curb the growth of the non-oil economy.

B. THE EXCHANGE RATE REMAINS AT CURRENT LEVELS OR RECOVERS SLIGHTLY

1| In this scenario we are predicting that the exchange rate will stay close to the current level or correct very slightly; even if the movement stabilizes, the depreciation that has already occurred will continue to impact prices. Data from the Angolan statistics office (INE) indicate that inflation has already accelerated in June and July, to 1.41% and 1.61%, respectively. Our perspective

If non-oil GDP stagnates, the overall economy will contract by 1.4%

yoy variation

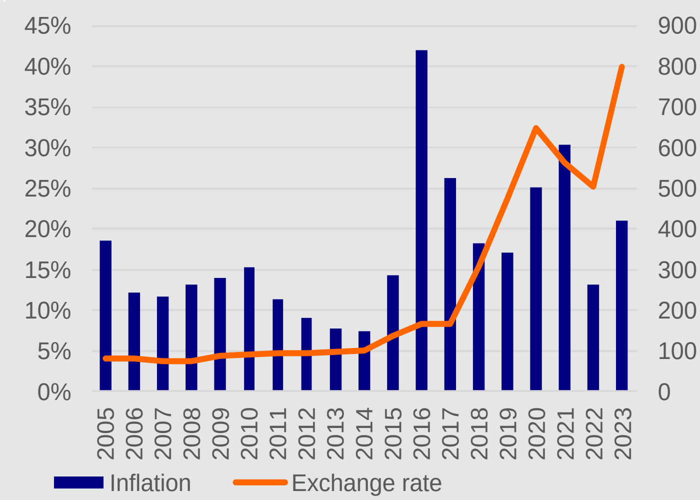


* Proxy: GDP subtracted from oil GDP

Source: INE and BFA calculations

If the exchange rate remains at current levels, inflation will end the year above the BNA target

yoy variation; USD/AOA



Source: INE and BFA calculations

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was that it would rise to higher levels and then slowly begin to fall. However, we believe that inflation will possibly end the year close to or above 20% if there is not a strong monetary policy reaction and some Kwanza recovery. However, a reaction strong enough to contain price growth could further damage economic growth, particularly in the non-oil sector. As such, we expect inflation to be well above the BNA's target.

We estimate a 27% yoy contraction in export earnings in 2023

Values in mbd; Amounts in bilions USD

Sources: MinFin; OPEC and BFA Calculations

Our estimate of higher inflation until the end of the year is consistent with a tighter monetary policy throughout the year and increases in interest rates that will condition the financing capacity of economic agents, from families, companies and even the State.

The impact of the partial removal of fuel subsidies together with the abrupt depreciation of the Kwanza is being very strong for the non-oil economy: the prices of imported goods and goods in general have increased, purchasing power has fallen and, as a consequence, consumption shall also fall; at the same time, this situation caused an environment of uncertainty and deterioration in consumer confidence, which had been growing since last year. The impact of removing fuel subsidies is transitory; in fact, the exchange rate will play a very important role: if it ends the year close to current levels or even corrects a little, the economy as a whole will contract. More significantly for citizens' lives, the non-oil GDP will stagnate, and, in this sense, it is expected that there will be no additional job gains, and thus the unemployment rate should remain close to 30% or even increase slightly.

2| In the case of oil production, our perspective is negative, but it has not worsened compared to the beginning of the year. Production likely dropped by 6.7% in the 1st semester of the year based on OPEC data, which indicates a drop of the same magnitude as oil GDP. More recently, production began to rise in monthly terms and in July reached 1.17 million barrels a day, the highest value since August last year. The result of the recent growth in production must be linked to a few investments that already seem to be having an impact and should be reflected even more in the Q4 of the year, concentrated mainly in block 15/06. Despite this, it is still clear that Angola continues to face capacity constraints and based on this, oil production will not evolve in 2nd semester 2023 to the point of offsetting the 6.7% loss that occurred in 1st semester 2023, which is why we consider a contraction in the sector. Overall, our outlook on oil GDP has not changed, so we are forecasting an oil sector recession of around 5.4%.

3| As for the non-oil sector, which grew 3.1% yoy in Q1 2023, it will probably still grow in Q2, albeit more slowly, already including the effect of the exchange rate crisis from the end of May, and it should still observe homologous contractions in Q3 and Q4. Our estimates point to a drop in at least 2 quarters, but which will certainly occur in Q3 2023, more intensely. Altogether, we expect stagnation in the non-oil sector, which is equivalent to saying that activity will interrupt a sequence of growth that has been going on since Q1 2021. The stagnation of the sector will be associated with the various factors listed above, with emphasis on the depreciation of the exchange rate - which is making many investments unfeasible -, a drop in consumption and a real contraction in credit growth, contributing to a total GDP contraction of close to 1.0%-1.4% yoy.

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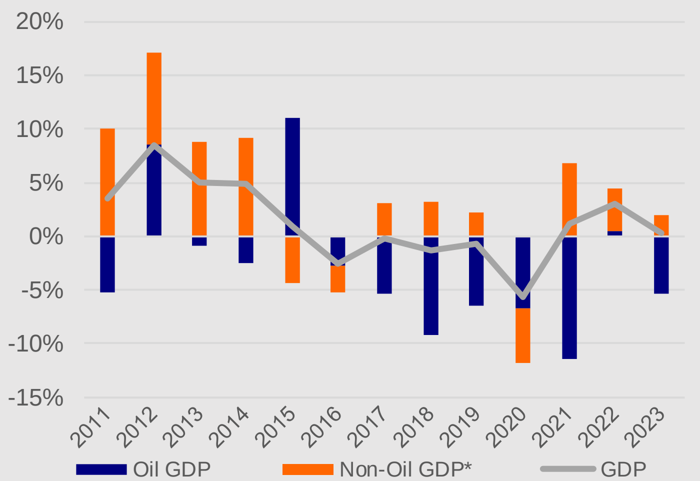
C. SUBSTANTIAL REVERSAL OF THE EXCHANGE MOVEMENT

1| After having accelerated depreciation in May and June, the exchange rate appears more stable now, although currency market conditions remain tight. The late approval of the OGE 2023, which culminated in a delay in disclosing the Annual Debt Plan (PAE), will have impacted the State's external financing capacity until close to Q2 2023. In calculations made to measure the pressure of the State Treasury, the Preliminary results point to simultaneous deficits in EM and MN in Q1 2023, which was also confirmed by the March debt bulletin released by the Debt Management Unit (UGD), which presents external disbursements valued at USD 0.35 billion (B) and debt service of USD 2.5 B, which makes a negative deficit or net external indebtedness (disbursements minus debt service) of USD 2.1 B up to March. It should be noted that the total amount amortized up to March represents 61 % of the forecast in the PAE for that date, while the amounts disbursed represent only 17% of the forecast in the Q1 2023.

If non-oil GDP grows by 2% the overall economy will stagnate

Variation yoy

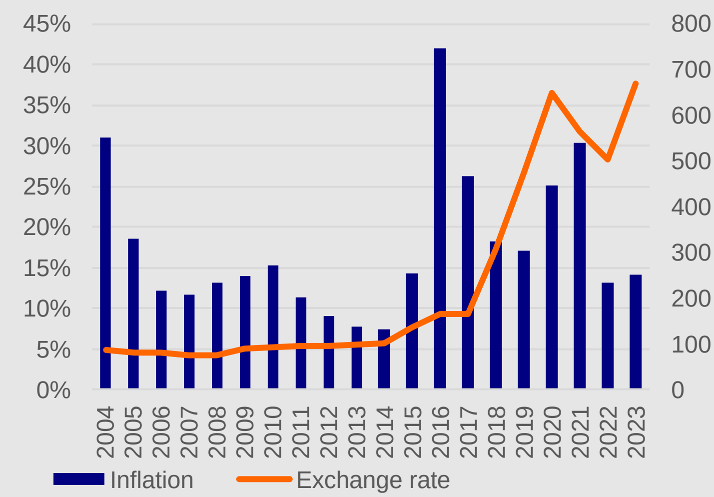


* Proxy: GDP subtracted from oil GDP Source: INE and BFA calculations

Linking this fact to the deterioration of export earnings (we estimate that it will fall by 27% yoy in 2023), the result will have contributed to the absence of the Treasury in the foreign exchange market. It is possible that, if the PAE is fully complied with, in particular with regard to external disbursements that were forecast, the scenario will be reversed in the 2nd half, with very positive net external debt. Effectively, there are signed agreements whose disbursements should only occur in the 2nd semester (in particular with the World Bank), and other agreements that are foreseen, but not yet signed, at least publicly. In a scenario where the PAE is complied with in terms of external debt, Minfin will certainly have more room to allow it to participate in the sale of currencies again, a scenario that can be further boosted by a Brent at a much more favorable level.

If the exchange rate reverses at least 2/3 of the movement, inflation will be close to the BNA target

yoy variation; USD/AOA



Source: INE and BFA calculations

In this alternative scenario, which we consider unlikely, in which the Kwanza would substantially reverse part of the loss movement, inflationary pressures would be alleviated, and inflation would be closer to the target defined by the BNA, between 11%-14%. In this sense, the Central Bank would not adopt such a restrictive position as expected, easing monetary policy a little further. Furthermore, this scenario would result in an increase in consumption with positive impacts on non-oil economic activity. Here, the non-oil GDP would avoid a contraction and

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would have a modest annual growth, that is, 2% yoy. This growth should result in slight gains in employment, with particular emphasis on the formal sector. Assuming the same variations for oil GDP, in general, global GDP would stagnate, growing only 0.1-0.3% in 2023.

We reinforce that this is a less likely scenario, but it serves to illustrate the impact of the exchange rate variable on the performance of the Angolan economy.

D. CONCLUSION

1| In general, the probability of occurrence of the first scenario presented is higher, although both are conditioned to more favorable movements in the exchange rate. The exchange rate will play a key role on several fronts, both in terms of inflation and GDP growth. As for the general level of prices, we believe that the partial removal of fuel subsidies is just a factor that generates transitory inflation, while the effect of the exchange rate is more permanent since it affects prices with lag, and therefore its course a determining factor for price stability and the achievement of the BNA target.

In relation to GDP, the positive evolution of the non-oil sector is essential to guarantee economic growth in 2023, as we have no doubt that the oil sector will contract this year. The stability of the exchange rate and the eventual partial reversal of the downturn will be crucial for the growth of non-oil economic activity, with some of the largest sectors of the economy, such as Commerce (18%), Construction (8.9%) and the Real Estate sector (5.8%) have a very high exchange rate risk. Testimonials from businessmen report projects in the construction and real estate sectors being discontinued due to the exchange rate depreciation, and Commerce, the second largest sector of the economy, essentially dependent on imports, should feel a very strong impact throughout the year and eventually contract.

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