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Angola: a vital but constrained transformation of the economic model in the run-up to the 2022 elections

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Executive summary

In recent years, Angola has undergone several major changes that have had a significant impact on its economic and financial model. The first and most significant of these arose from the oil shock of 2014–2015, which prompted a rethink of the development model the country had been following since the end of the civil war, and which put a halt to the high growth regime that had prevailed up till then. The fall in oil prices highlighted the constraints of Angola's heavy dependence on hydrocarbons. It also led to a long period of instability at the macroeconomic level. This instability has been compounded more recently by the COVID-19 pandemic and its economic consequences. The period from 2015 to 2020 was marked by a continuous recession, as well as an increase in fiscal and external deficits, a rise in public debt, and a significant depreciation of the kwanza. The second significant development over the last few years is linked to political succession in the country, especially now that José Eduardo dos Santos passed away. Dos Santos, who ruled the country continuously from 1979 to 2017, died at the beginning of July 2022. His successor, João Lourenço, has since sought to distance himself from the practices that had previously prevailed, which had fostered a political and economic system that benefited only the ruling elite.

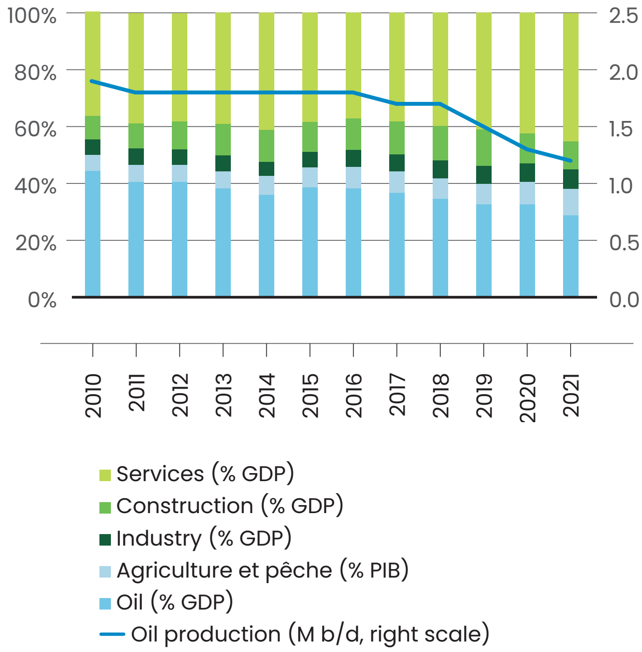
The country is therefore approaching the general elections of August 24, 2022 in a changing economic and political environment. Lourenço, who is running for president, will be able to claim that the economic situation has improved during his term. Indeed, 2021 was marked by a return to growth and comfortable external and fiscal surpluses, and it is expected that this performance will be consolidated in 2022. This improvement is mainly due to the rise in oil prices but also, in part, to the incipient transformation of the Angolan economic model. Between the end of 2018 and the end of 2021, Lourenço's government brought in many reforms with the support of the International Monetary Fund (IMF). These measures are as much about improving the business climate and fighting corruption as they are about increasing the proportion of national revenue that does not come from oil, controlling public spending, and making the exchange rate more flexible.

However, the Angolan economic model still has many weaknesses. Efforts to reduce the country's dependence on oil are not, at this stage, enough to protect the country if the price of oil falls again. Governance indicators remain well below those of countries with comparable income levels, the result of decades of an opaque and rentier political and economic system. Finally, the policies put in place do not yet allow for the promotion of inclusive and more egalitarian growth, by means of which the dividends of oil exploitation would be redistributed to the entire population. Many social, economic, and financial issues await the winners of the August elections, whoever they may be. The race for power seems more open than ever between the Movimento Popular de Libertação de Angola (MPLA), which has governed the country since 1975, and the União Nacional para a Independência Total de Angola (UNITA), its historic opponent, which has rallied a united opposition under its banner. The transformation of the business model, which has been ongoing since 2017, will need to be continued. As numerous and profound as the obstacles are, this paradigm shift appears necessary for the country to develop in a more robust and sustainable manner.

1. An economic model struggling to generate inclusive and sustainable growth: constraints and the beginnings of a transformation

1.1 – Major constraints on the diversification of a fragile economic model that is highly dependent on the oil sector

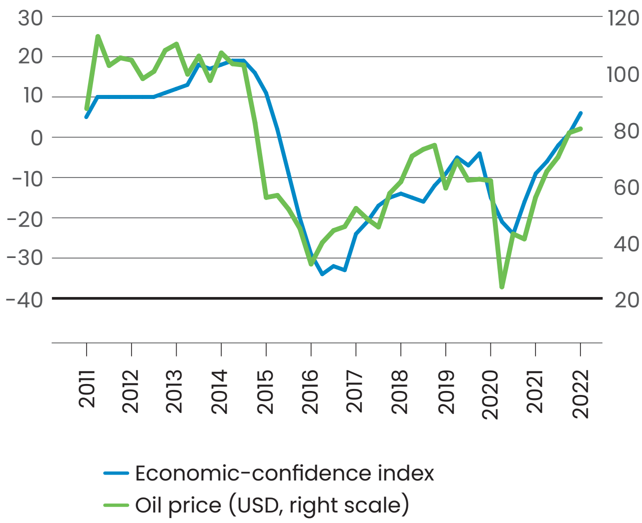
Figure 1 – Breakdown of GDP and oil production by sector



Sources: World Bank (World Development Indicator), INE, BNA, BP, and calculations by the author

All aspects of the Angolan economic model depend directly or indirectly on the oil sector. Angola is a major oil-producing country—Africa's second largest—and the amount of oil it produces has risen sharply since the end of the civil war in 2002. Production rose from just under a million barrels a day in 2002 to 1.9 million barrels a day in 2009. From 2010 to 2014 it held steady at just under 1.8 million barrels a day. Because the production of oil makes up such a large part of economic activity, the sector accounted for about 40% of gross domestic product (GDP) between 2010 and 2013 (see Figure 1). This share has declined in line with falling prices and lower production, which dropped from 1.8 million barrels a day in 2015 to just under 1.2 million in 2021—at which time oil production still accounted for 30% of GDP. The oil sector is also crucial to the external balance of payments (hydrocarbons account for 95% of exports) and to public finances (hydrocarbons accounted for 80% of government revenue up to 2014, and has continued to account for a yearly average of 60% from 2015 on). For these reasons, IMF officials see a close correlation between the oil and non-oil sectors, particularly services and construction. This dependence is reflected, for example, in the economic-confidence index that is measured each quarter by the Central Bank of Angola (BNA), which is almost perfectly correlated with oil prices (Figure 2). Finally, the banking and financial systems depend on the performance of the oil sector, either because of their direct exposure to it or because of the effects on public finances, on foreign-currency liquidity, and more generally on the economy as a whole (and thus on asset quality and bank liquidity).

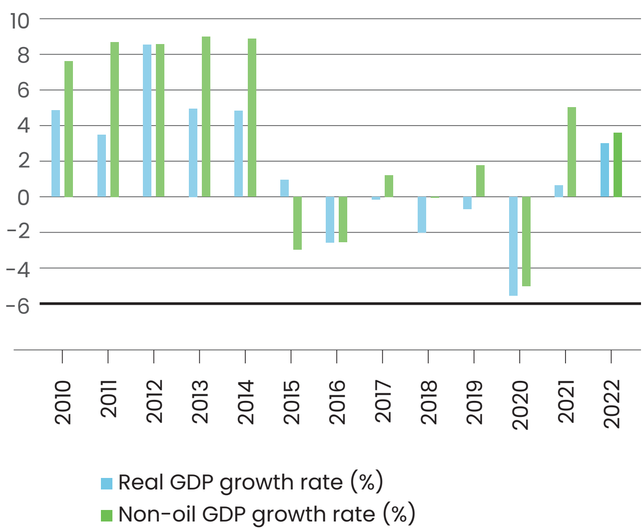
Figure 2 – Oil prices and the economic environment



Sources: BNA, Angolan Ministry of Finance, and calculations by the author

For this reason, economic growth is extremely volatile and is still constrained by the outlook for the oil sector. The actual GDP growth rate averaged more than 8% between 2004 and 2013, driven by both rising output and the commodities super-cycle. Following the drop in oil prices in 2014–2015, the growth rate collapsed (see Figure 3) and the economy experienced five consecutive years of recession, from 2016 to 2020. The economic consequences of the COVID-19 crisis struck in 2020, with the country's economy contracting by 5.6%. Macroeconomic imbalances have also had their effect on the overall economy, and non-oil GDP declined in real terms between 2015 and 2020 by an average of -1.3% a year. Thanks to a "rebound" effect following the crisis of 2020 and due, above all, to the recovery of oil prices, the Angolan economy returned to positive growth in 2021 (at a rate of 0.7%), and the IMF estimates that this trend will continue, with growth of around 3% in 2022. However, the prospects for growth beyond that are uncertain, and the risks involved are high due to declining production in the oil sector, caused by aging infrastructure, the maturing of existing fields, and a lack of significant investment by international oil companies; deep-water exploration is particularly costly in Angola. However, production could rebound slightly in 2022, since new projects from Total and Eni entered the production phase in the second half of 2021.

Figure 3 – GDP growth rate



Source: IMF (World Economic Outlook, Regional Economic Outlook), and calculations by the author

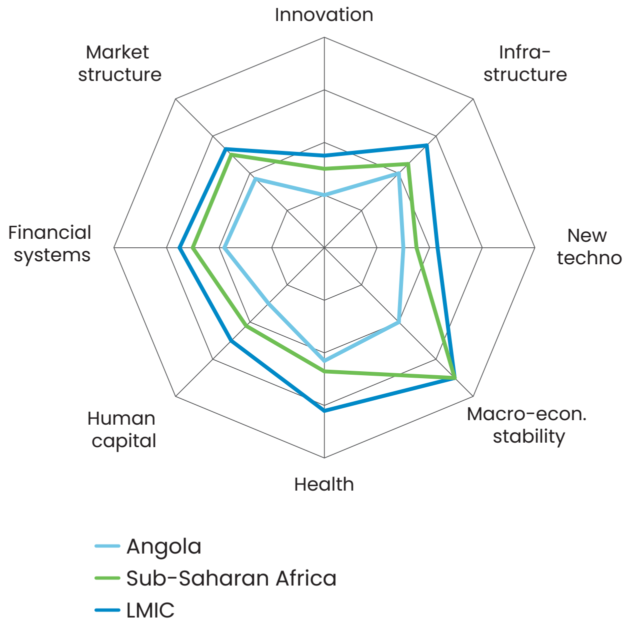
There are many major obstacles to economic diversification, and these have the potential to hinder growth. Because of both the declining trend in production and the volatility of oil prices, Angola needs to develop growth drivers to increase its potential for growth and make it more resilient to exogenous shocks. However, there are many structural obstacles to any efforts at diversification. This is because of the country's low competitiveness—regularly ranked among the bottom ten in the world, according to the World Economic Forum's *Global Competitiveness Report*—, the business environment,[1] and how the country is governed. In terms of competitiveness, the country's performance is weak due to macroeconomic instability, the business climate, the quality of infrastructure, and human capital (Figure 4).

Prior to 2019, Dutch disease had an impact both on the construction of the economic model, which was entirely devoted to the oil sector, and on the country's external competitiveness (until the exchange rate was made flexible, it was considerably overvalued.) Weak governance is another impediment to economic diversification, and the World Bank's World Governance Indicator also places the country well below the average for sub-Saharan Africa and for countries with similar income levels. Between 2018 and 2021, some progress was made, under the IMF program and with the support of the World Bank and other donors—particularly with regard to management of public finances—but there are still challenges related to the regulatory framework, the quality of the judicial system, and corruption. In addition, the economy suffers from the lack of a favorable competitive environment, especially given the high barriers to entry and competition from an omnipresent public and semi-public sector (especially public enterprises). Finally, the level of human capital is also among the lowest in sub-Saharan Africa: the rate of participation in higher education is no higher than 45% and the literacy rate declined from 67% of the population in 2001 to 66% in 2015. For all these reasons, the prospects for the development of a dynamic non-oil private sector are poor.[2]

1 The World Bank's "Doing Business" ranking is no longer being updated, but the country ranked 177th out of 190 in 2019, with unfavorable scores in all measures of the index.

2 In addition, the combined legacy of a communist and then a command economy, a predatory elite, and an omnipresent oil sector have not favored the emergence of a dynamic private sector.

Figure 4 – Competitiveness and the business environment



Sources: IMF, World Economic Forum (Global Competitiveness Index), and calculations by the author

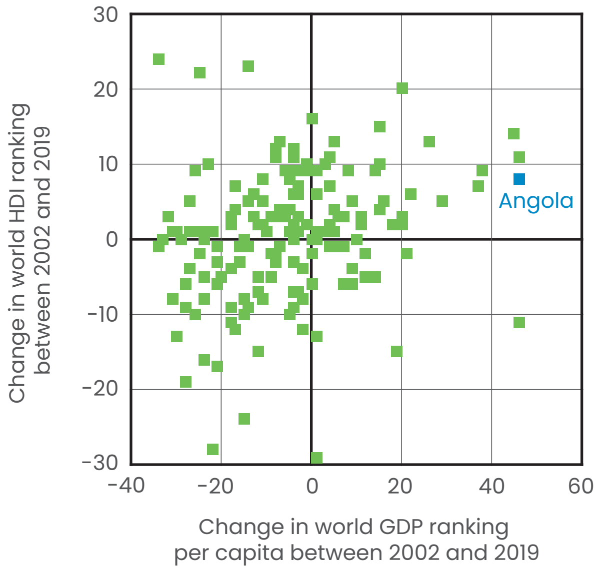
Yet this sector must be developed if a stable growth rate is to be maintained at a minimum level: in 2021, the IMF estimated that growth could, in the best-case scenario, average 4% by 2030, assuming that it is accompanied by a significant increase in investment. However, investments have fallen sharply with the drop in oil prices (from 34% of GDP in 2015 to 23% in 2021), while public investment is constrained by fiscal adjustments and debt-sustainability issues.

The initiatives taken by the authorities to respond to these challenges are in the very early stages. The country has begun putting measures in place to address issues around the country's reputation and the business climate there. Despite the apparently ambitious character of these measures, some have been implemented effectively. For example, as the fight against corruption was one of Lourenço's priorities upon taking office, an anti-corruption strategy was quickly put in place by the Public Prosecutor's Office for the period 2018–2022, while in January 2019 the National Assembly reformed the penal code to include provisions on economic and financial crimes as well as tougher penalties for corruption. In particular, the administration has targeted beneficiaries of the dos Santos regime's wealth-capture scheme; the Public Prosecutor's Office estimated that, by September 2021, it had recovered more than USD 7 billion in ill-gotten gains—both tangible and financial assets. President Lourenço was also quick to dismiss some of the former president's close associates, the most prominent example being the dos Santos children, the daughter having left the country and the son having been convicted of fraud and influence-peddling. However, he had to keep on some figures from the previous regime, both for political reasons and to maintain the balance within the MPLA. The oil and gas sector is another area where corruption has been particularly pronounced in recent decades, but it may now be cleaned up and made more transparent after Angola joined the Extractive Industries Transparency Initiative in June 2022. The ranking awarded by Transparency International regarding the perception of corruption rose from 167th (out of 180 countries) in 2017 to 136th in 2021, one of the strongest increases in the world in recent years. In addition to the fight against corruption, many reforms have been undertaken to improve governance, particularly in economic and financial terms. In addition to establishing a program with the IMF in late 2018, which likely led to the flexibilization of the exchange rate and better management of public finances, the government has strengthened the country's legislative and regulatory framework by, for example, passing legislation on the Central Bank, financial institutions, and competition. Two other national initiatives are worth mentioning. The first is the Production Support, Export Diversification, and Import Substitution Program *(Programa de Apoio à Produção, Diversificação das Exportações e Substituição das Importações, PRODESI).* The program, set up in 2018, aims to (i) increase domestic production, (ii) reduce imported essential goods, (iii) increase non-oil foreign-exchange earnings, and (iv) attract more foreign investment. Part of the National Development Plan 2018–2022, it offers training programs, organizes events such as fairs, exhibitions, and markets, and helps secure funding for projects. Funding for approximately 850 projects has reportedly led to the creation of 67,000 jobs and raised GDP by 2% since 2018. However, the IMF believes that the program lacks a holistic approach, and that it has focused primarily on supporting project financing without making the link to improving the business climate. The second initiative is the privatization program known as PROPRIV, which was launched in 2019 and aims to dispose of assets and to privatize a set of state assets either fully or in part. In 2018 the government set up the Institute for the Management of State Assets and Equity *(Instituto de Gestão de Activos e Participações do Estado, IGAPE)*, which aims to improve the management of the state's assets and holdings, but also to pave the way for some of them to be privatized. A law on the steering, management, and reform of public enterprises was also passed in August 2020. At the end of 2021, IGAPE presented an updated roadmap that took stock of the state's assets and holdings, and presented a way forward for privatization, particularly in terms of due diligence and management. At this stage, the privatizations that have been carried out are minimal when the initial objective is considered: the 2019–2022 program set a target of 195 asset sales, but just 89 have been carried out to date. Other factors point to inadequate progress in this area: the number of sectors of activity in which public companies are still involved, and the notable size of Sonangol and its assets. Without commenting on the number of privatizations planned, the IMF estimates that privatization revenues will not exceed USD 100 to 150 million per year in the coming years, while IGAPE estimates that public assets and shareholdings represent more than USD 75 billion and that the amount brought in by the 89 privatizations carried out thus far is only around USD 1 billion.

1.2 – Persistent socioeconomic challenges, to which neither the political nor the economic sphere has been able to respond up till now

Despite the country's rapid enrichment, socioeconomic indicators remain far below those of countries with comparable incomes. The country's strong growth since 2002 has made it the third-largest economy in sub-Saharan Africa, and increased per capita annual income from less than USD 1,000 in 2002 to nearly USD 5,600 in 2015. The five consecutive years of recession and the depreciation of the kwanza then brought it down to USD 1,900 in 2020, but it is expected to return to somewhere between USD 3,500 and 4,000 in 2022.

Figure 5 – Growth in HDI and GDP per capita between 2002 and 2019

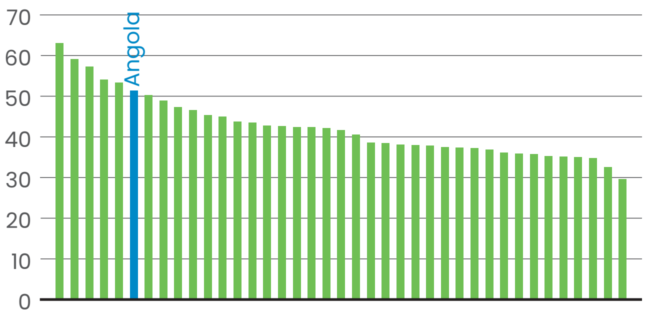


Sources: IMF (World Economic Outlook), UNDP (Human Development Report 2021), and calculations by the author

Although between 2002 and 2015, Angola moved up nearly 45 places in country rankings in terms of per capita income, it rose only eight places on the Human Development Index, from 156th place in 2002 to 148th in 2019 (see Figure 5). All the social- and human-development indicators are indeed deeply troubling. They are the result of a growth model that is not very inclusive and that is driven by hydrocarbons, by high levels of inequality, and by inefficient public spending that for many years has been oriented either not at all or only minimally toward the social sector. In 2020, 56% of the population were living below the poverty line (USD 1.90 per capita per day, adjusted for purchasing power parity). Multidimensional poverty, as defined by the World Bank, affects nine out of ten people in rural areas, where only 35% of the population has regular access to drinking water. Life expectancy is only 61 years, and other public-health indicators such as malnutrition, undernutrition, and infant mortality are below the average for middle-income countries.

The economic outlook is also gloomy, due to the weakness of the private sector and a lack of diversified activity. Informal employment predominates (making up 80% of all employment, according to the World Bank), and the unemployment rate reached 30.8% of the active population at the end of the first quarter of 2022, and 57.2% among 15-to-24-year-olds. Inequality has increased since the end of the civil war, and the Gini coefficient rose from 43 in 2008 to 51 in 2018, making Angola one of the most unequal countries in sub-Saharan Africa (see Figure 6). According to the World Bank, the wealthiest 20% of individuals account for 63% of the national income; the poorest 20%, for just 2%. All of these socioeconomic challenges are expected to intensify in the medium term because of high population growth (3.5% per year on average over the past decade), and a high number of children for each woman compared to other countries in the region (5.44 children per woman in 2019 compared to 4.78 for Mozambique, for example).

Figure 6 – Gini coefficient in sub-Saharan Africa



Source: World Bank (World Development Index), and calculations by the author

Prospects for improving the socioeconomic situation are constrained by a growth model that is still not diverse enough, by limited budgetary scope, and by weak public policies. While the lack of economic diversification is a primary obstacle to economic and human development (the hydrocarbon sector employs less than 10% of the workforce in the formal sector), the lack of an ambitious public policy is almost as important. The drop in oil prices in 2014 and 2015 had a major impact on government revenues, which fell from an average of just over 40% of GDP between 2005 and 2014 to an average of 20% since 2016, thus limiting the means available to finance new social policies. And although the proportion of spending on health and education went up from 2018 to 2021 under the IMF program, (spending in these sectors was an indicative program target) it remains below the average for countries with comparable incomes. Moreover, spending on social programs declined from 11% of total government spending in 2015 to 5% in 2019, and it is mostly quite unequal (targeting, for example, very specific populations such as veterans or civil-service retirees): less than 10% of workers are covered by a social-protection mechanism. An extensive social-assistance program, initiated as a cash transfer program implemented by the Fundo de Apoio Social (Social Support Fund) and supported by the World Bank, has been put in place progressively since early 2020. This program, known as "Kwenda," was initially designed to compensate for the loss of subsidies to the poorest households, but it has become the main instrument for fighting poverty (and one of the most ambitious in sub-Saharan Africa, with a target of benefiting 1.6 million families by the end of 2023). Although the program has been a success thus far, its objective of eventually reducing the poverty rate by about five percentage points is too modest: the country's socioeconomic vulnerabilities mean that a truly ambitious national strategy will be required if the aspirations of the population are to be met.

1.3 – Major challenges in terms of exposure to climate risk and the low-carbon transition

To transform Angola's economic model, it will thus be necessary to develop more-inclusive and less-volatile drivers of growth in the short term, but also to take into account the challenges related to climate change and the low-carbon transition. Although Angola is a low emitter at the global level, these two issues are of particular importance in the country.

First, Angola is exposed to the physical consequences of climate change, particularly in terms of bouts of climatic stress (floods, droughts, and rising temperatures), which have an impact on production in the agricultural sector (which itself depends on rain-fed agriculture) and therefore on growth and food security. After several years of low rainfall between 2012 and 2019, which caused cumulative losses of around USD 750 million, according to the World Bank, the country experienced its worst drought in 40 years between November 2020 and January 2021. It impacted production and pushed more than 1.3 million people into food insecurity, according to the United Nations. More-frequent and larger-scale episodes are forecast, and the Intergovernmental Panel on

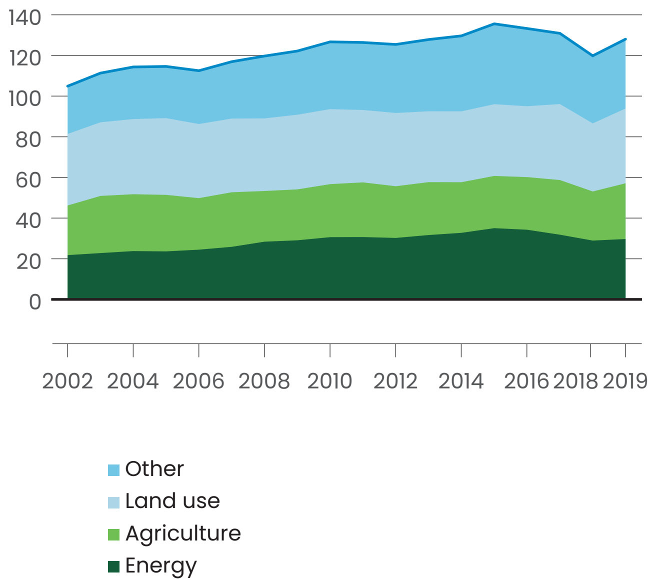
Climate Change's central scenario suggests the annual mean temperature could increase by 1.2°C to 3.2°C between now and 2060. There could also be pressures in the Angolan coastal zone, which comprises 10% of the country's territory. Incidents could include severe flooding, and may impact both the population and the economy (since the majority of the population, cities, and infrastructures are concentrated in the coastal zone), but also biodiversity, particularly mangroves.

Second, Angola is also exposed to the risks involved in transitioning to a low-carbon economy, given its heavy dependence on hydrocarbons. The country has one of the least diversified economies in Africa: oil accounts for 30% of GDP, 95% of exports, and 60% of government revenues. At this point, the steps taken toward diversification are inadequate and the country is therefore highly exposed, across the board, to the risk of lower global demand for hydrocarbons, which will depress the economy. This vulnerability is compounded by already declining oil production. Moreover, the production of oil in Angola gives off, itself, some of the heaviest emissions of any oil-producing operation in the world, particularly because of gas flaring, and the investments of oil companies (in particular those from Europe) will be concentrated in the short term on reducing the emissions produced by these operations so they can meet their commitments to their shareholders on this score.

The policies that have been put in place by the authorities on mitigation and adaptation are inadequate. Angola aims to reduce its greenhouse-gas emissions by 14% by 2025, and by an additional 10% if it secures international financing for this, according to nationally determined contributions (NDCs) that were revised in 2021. It is a small emitter, giving off just under 130 million metric tons of CO_2eq, or 0.2% of global emissions. However, the country has not presented a strong and holistic national strategy for mitigation and adaptation. The Ministry of Culture, Tourism and Environment, which oversees the implementation of the NDCs, has only very limited political and financial means at its disposal. Angola ranks very low on the ND-GAIN index,[3] at 160th place, and it is particularly poorly prepared for future changes (173rd place out of 192 countries).

3 The ND-GAIN index measures the performance of all countries in the world in terms of exposure to climate change and preparedness for it, with regard to public policies.

Figure 7 – Greenhouse-gas emissions by sector (millions of metric tons of CO_2eq)



Source: Climate Watch Data, and calculations by the author

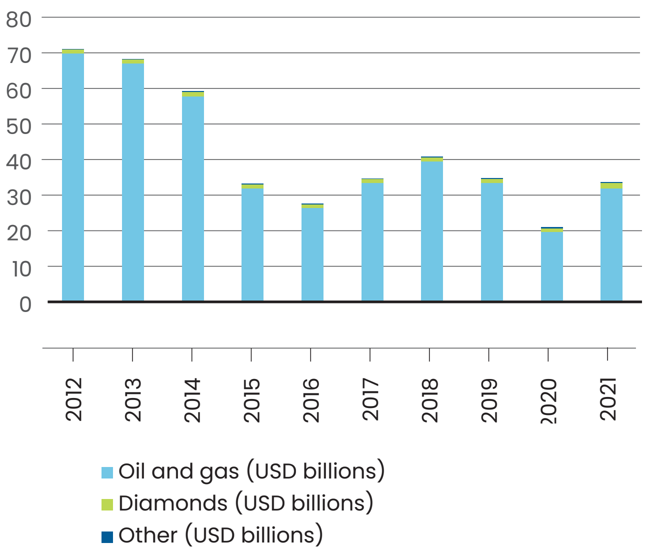
The agricultural sector, by way of illustration, brings together all the challenges related to these points. Agriculture accounts for just under 8% of added value but nearly 50% of employment. Agriculture is the main source of income for 90% of the 10 million people living in rural areas, and small-scale producers account for 80% of agricultural production and 90% of the land used for agriculture (International Finance Corporation, 2019). Up until the civil war, agriculture was one of the main drivers of the economy. In the 1970s, for instance, Angola was the world's third-largest producer of coffee, and exported 250,000 metric tons of coffee a year, compared to just 1,200 metric tons in 2017. With the development of the oil sector, agriculture has declined because of a lack of investment and declining productivity. Although, the authorities and international partners are now working to revitalize agriculture, both as a contributor to growth and as a factor for mitigating exogenous shocks, it is not an simple solution. Land use (deforestation and slash-and-burn methods) and agriculture account for 50% of greenhouse-gas emissions in Angola (Figure 7), and agriculture is highly vulnerable to the consequences of climate change (droughts and rising temperatures). Revitalizing the agricultural sector will therefore require a high level of investment to develop both practices that result in lower emissions and production models that are more resilient to climate change.

2. External finances heavily dependent on hydrocarbons: the cause of volatility in Angola's external position

2.1 – External finances highly exposed to hydrocarbon prices

The importance of hydrocarbons plays a predominant role in any analysis of Angola's external finances, just as it does in the economic model. In structural terms, oil and gas account for the vast majority of the country's exports (between 90% and 95% of total exports, depending on the year and the price of a barrel of oil—see Figure 8). Non-hydrocarbon exports are limited, due to the low level of diversification in the economic model (as discussed above). Diamonds dominate this group—Angola is the third-largest diamond producer in Africa—but on average these accounted for only 3% of the country's total exports in the 2012–2021 period.

Figure 8 – Breakdown of exports



Source: BNA and calculations by the author

The level of exports is therefore almost entirely correlated to oil prices on international markets, which it has followed since the price drop in 2014. As a result, total exports have fallen from around USD 70 billion in 2012– 2013 to an all-time low of just over USD 20 billion in 2020, a decline exacerbated by falling production. They recovered to USD 34 billion in 2021, and are expected to rise further in 2022, based on the prices seen in the first half of the year. This dependence goes hand in hand with the development of a growing trade relationship with China (which took 70% of Angola's exports in 2021), characterized by China's collateralized (i.e., oil-backed) investments and financing projects in the country. China has thus become the world's largest buyer of Angolan oil.[4]

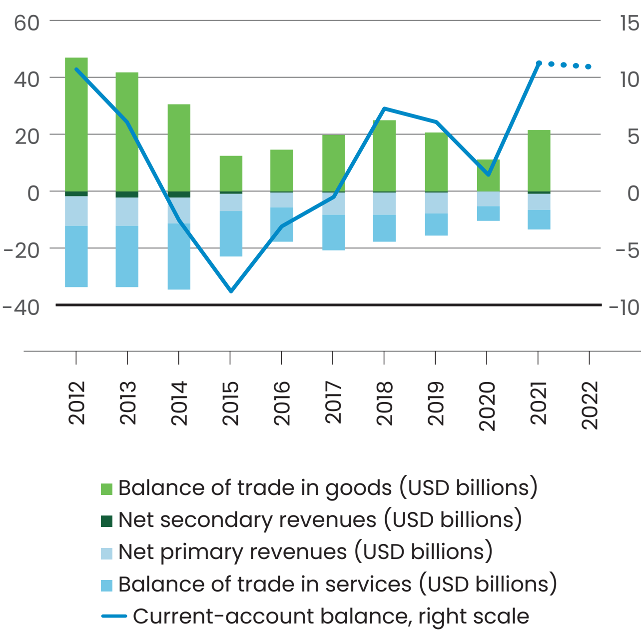
This dependence on hydrocarbons is reflected throughout the analysis of Angola's current account, the price of oil per barrel being the main determining factor. The balance of services is structurally in deficit due to imports of services related to the oil sector (particularly in the construction, transportation, and maintenance sectors), while exports of services are almost nil. Similarly, 95% of the primary-income deficit is explained by the repatriation of the profits of international oil companies, whose cash management decisions are determined by the price per barrel. It should be noted, however, that the inverse correlation between the oil price on the one hand and the services deficit and primary-income deficit on the other helped mitigate the impact of the contraction in the trade balance on the current account balance.

Changes in the current account balance since 2014 show its extreme volatility (Figure 9). After experiencing very high surpluses between 2004 and 2013 (9.5% of GDP on average), it was in deficit between 2014 and 2017, reaching a record current account deficit of 9% of GDP in 2015, when oil prices were at their lowest and imports remained at a high level. The country imports the majority of consumer and capital goods because of the low diversification of the economy and the demand for imported goods is less elastic, especially because the exchange rate was fixed up until 2018. The current account balance has been in surplus again since 2018 thanks to the recovery of oil prices (and despite the decline in production), but also because of the flexibilization of the exchange rate regime. This has made it possible to adjust the real effective exchange rate, which was previously overvalued. It remained in surplus in 2020 (at 1.5% of GDP) despite the further fall in oil prices and the COVID-19 pandemic. The contraction in imports of goods and services—itself caused in part by the introduction of import restrictions—partly offset the

4 In turn, between 2005 and 2014, Angola was China's second-largest oil supplier, and its third-largest between 2015 and 2019.

decline in oil exports. Thanks to higher oil prices,[5] the current account balance reached 11.3% of GDP in 2021 and the IMF expects it to remain at 11% of GDP in 2022—a figure that corresponds, however, to a current account surplus of USD 14 billion in 2022, as against USD 8 billion in 2021.

Figure 9 – Current account balance



Sources: BNA, World Bank (World Development Indicator), and calculations by the author.

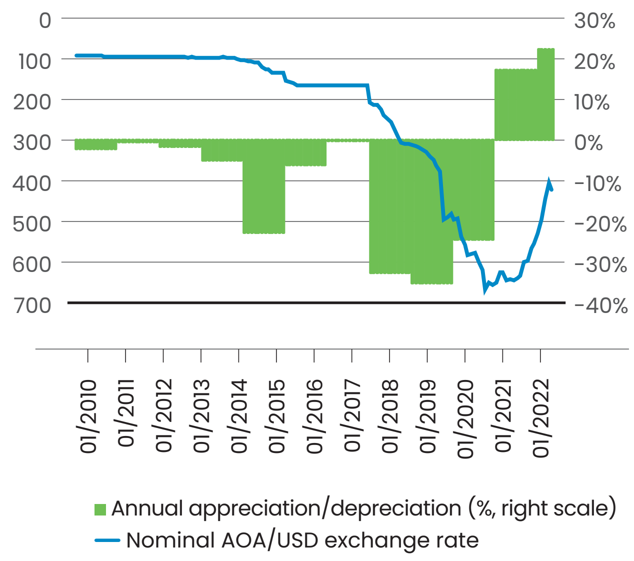
The IMF projects a gradual decline in the current account surplus starting in 2023, and a deficit from 2027. However, these projections depend on oil-price forecasts, and the price volatility seen since 2014 should invite caution. While it is difficult to establish a break-even price for Angola, it is certain that a more rapid decline in oil prices could result in a current account deficit before 2027. Exchange rate flexibility and the expected results of the PRODESI export-diversification program could partially mitigate future exogenous shocks, at least more so than in the past, but without significantly protecting the country.

2.2 – The country's external solvency has been restored in the medium term thanks to exchange rate flexibility, the recovery of oil prices, and the rescheduling of external debt

Falling oil prices and current account deficits between 2014 and 2017 have severely and persistently worsened Angola's external position and caused significant external-liquidity pressures. Foreign-exchange reserves shrank rapidly, from USD 32 billion in 2013 to USD 24 billion in 2015, following the decline in oil prices, prompting the BNA to devalue the kwanza, which had previously been pegged to the US dollar, by nearly 60% between January 2015 and June 2016. The BNA subsequently decided to peg the kwanza to the dollar again with effect from June 2016, particularly because of the effects of devaluations on inflation (which rose from 12% year-on-year at the end of 2015 to more than 30% in mid-2016). However, this could be done only at the cost of a further rapid decline in foreign-exchange reserves, from USD 24 billion in January 2016 to USD 17 billion in January 2018, as well as significant capital controls, which led to the creation of a parallel foreign-exchange market (whose spread with the official exchange rate reached 250% in 2016).

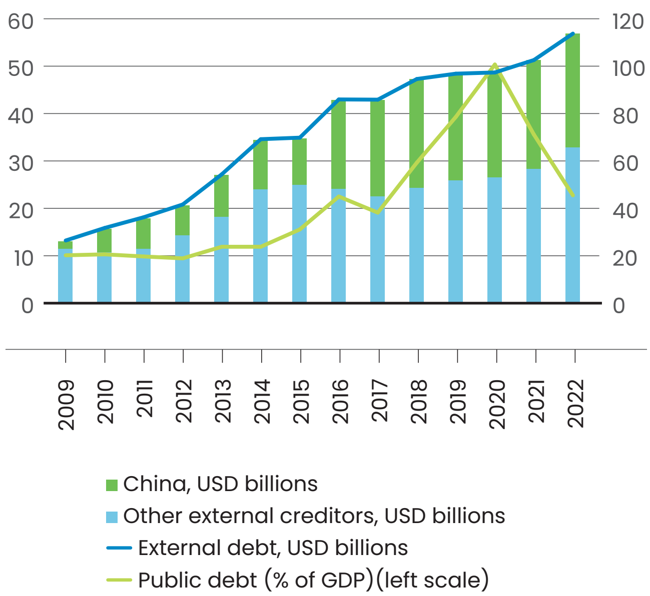
5 In 2022, however, Angola may not benefit fully from higher oil prices, especially as China is the largest buyer of its oil. Chinese demand for Angolan oil could drop because of restrictions and lockdowns put in place in China at the beginning of 2022, and because of competition from Russian oil as a result of international sanctions against Russia (in 2022, Russia has become China's largest oil supplier).

Figure 10 – Exchange rates



Source: BNA and calculations by the author

Figure 11 – External debt



Source: BNA, IMF, World Bank (International Debt Statistics), and calculations by the author

Starting in January 2018, the authorities had to make the exchange rate regime more flexible, first by setting up controlled fluctuation bands, and then, from January 2019, by reducing the BNA's interventions in the foreign-exchange market. The IMF takes the view that the de facto exchange-ate regime has been floating since March 2020, while the parallel market has narrowed sharply and the spread with the official rate was reduced to just under 5% by the end of 2021. This flexibilization led the kwanza to drop sharply against the dollar—by about 70%—between January 2018 and the end of 2020 (Figure 10). In December 2018, the IMF introduced a program[6] to accompany this period of adjustment, which also encompassed the authorities' fiscal reform and economic diversification program.

Moreover, **this period of turbulence around external accounts has been accompanied by an increase in both the amount and the impact of external debt.**[7] The increase in external debt had preceded the deterioration of the current account in 2013: the debt rose from USD 13 billion (20% of GDP) in 2009 to USD 27 billion (24% of GDP) in 2013, notably as a result of financing from private creditors (banks, suppliers, and financiers of hydrocarbon development projects) and from China, through its state-owned and semi-state financial institutions (Exim Bank of China, the China Development Bank (CDB), and the Industrial and Commercial Bank of China (ICBC)). The amount of external debt owed to China would thus have risen from just under USD 2 billion in 2009 to USD 9 billion in 2013. Chinese receivables in Angola (China's largest debtor in Africa) may be as high as USD 24 billion, although some estimates actually put them much higher.[8] From 2014 onward, indebtedness was driven mainly by Chinese financing (particularly in 2016 and 2018)

6 The three-year Extended Fund Facility of USD 3.75 billion (increased to USD 4.5 billion in September 2020). All the reviews were validated, and the program ended in December 2021 to general satisfaction, with the achievement of quantitative targets and structural reforms, including exchange rate flexibility and the improvement of public accounts.

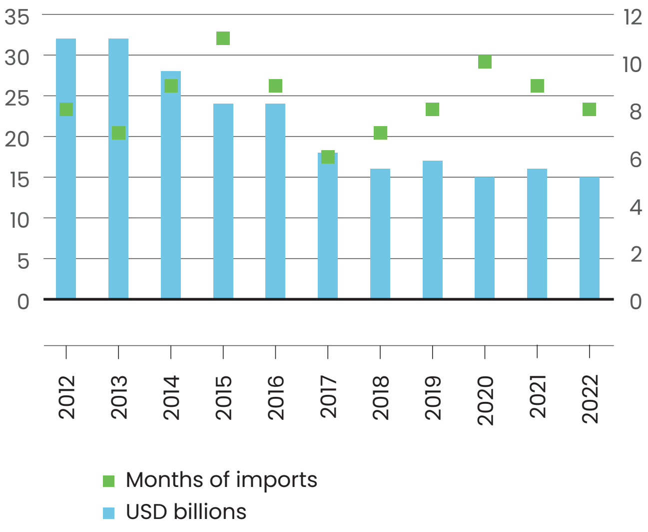
7 The scope of external debt discussed here is public external debt (central government, Sonangol, the Angolan airline TAAG, and public guarantees). The IMF believes that the data collected by the authorities on private external debt at this stage is patchy and unreliable, although the IMF is providing technical assistance in this area.

8 The Chinese Africa Research Initiative (CARI) estimates that total Chinese lending to Angola between 2002 and 2019 amounted to USD 42.6 billion, including USD 10 billion from the CDB to refinance Sonangol's debt to China and prepayment of oil exports.

as well as by the issuance of Eurobonds (USD 3.5 billion in 2018 and USD 3 billion in 2019). The relative weight of external debt in relation to GDP has increased exponentially as a result of successive devaluations and then the floating of the kwanza (Figure 11), which raised the ratio of external debt to GDP from 24% in 2014 to 101% in 2020, while the stock of external debt rose by just 40% (+USD 14 billion) over the same period.

This deterioration in the country's external position between 2014 and 2019 meant that Angola found itself in an extremely delicate situation in 2020. As a result of the COVID-19 pandemic and the further fall in oil prices, the current account surplus fell from 6.1% of GDP in 2019 to 1.5% of GDP in 2020. At the same time, external debt service stood ex ante at nearly 15% of GDP, as against 9.4% in 2019, thus contributing to a high external-financing requirement (EFR). However, this was not covered a priori, for two reasons: first, the tightening of conditions on international financial markets. While the country had issued Eurobonds in 2018 and 2019, sovereign spreads exceeded 1,500 basis points in 2020. The second reason was capital outflows, in particular foreign-currency deposits, which had been declining since the lifting of capital controls.

Figure 12 – Foreign exchange reserves



Sources: BNA, IMF, World Bank (International Financial Statistics), and calculations by the author

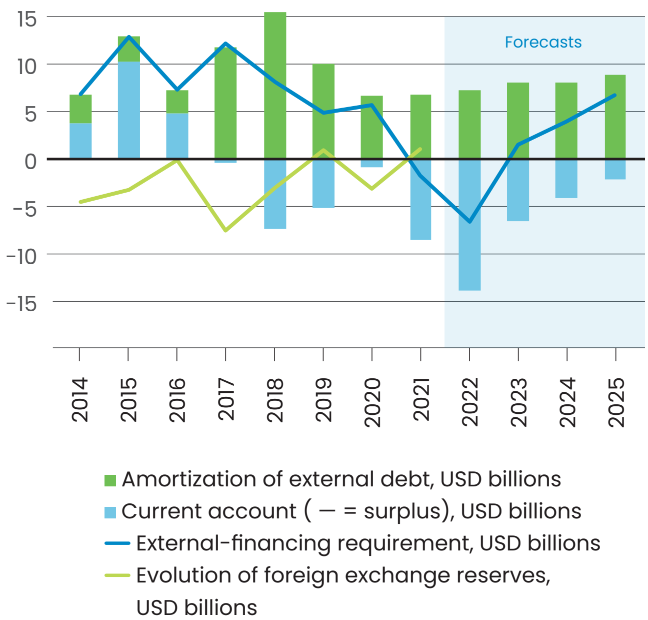
Against the backdrop of historically low foreign-exchange reserves, which reached an all-time low of USD 13.5 billion in August 2020, the country was at risk of approaching external default. This risk was acknowledged by the rating agencies: Moody's, Fitch, and S&P downgraded Angola's rating to the equivalent of CCC in 2020. However, the authorities were able to benefit from the Debt Service Suspension Initiative (DSSI[9]), and negotiated a rescheduling of the debts owed to the country's Chinese creditors.[10] The DSSI agreements and the restructuring have led to a reduction in debt service of around USD 5.5 to 6.5 billion in the period from 2020 to 2023, most of it from the agreement with Chinese creditors (the amount suspended by the Paris Club under the DSSI is no more than USD 295 million). In terms of additional financing, Angola also benefited from a further increase in the amount of the IMF program in September 2020 of about USD 750 million (from USD 3.75 billion to USD 4.5 billion), which was disbursed

9 Angola would not normally have been eligible for this program, because it is the only country that does not have standard access to the World Bank's International Development Association window.

10 Exim Bank, the CDB, and the ICBC. The agreements include a deferral of principal maturities from 2020 to 2023, and a smoothing of frozen amounts over the period from 2023 to 2030. Interest over the period will be covered by a dedicated escrow account that is expected to be gradually depleted by 2023.

in 2020 and 2021, while the World Bank[11] and the African Development Bank have expanded their operations in the country (especially in terms of budget support).

Figure 13 – External financing requirements



Source: BNA and calculations by the author

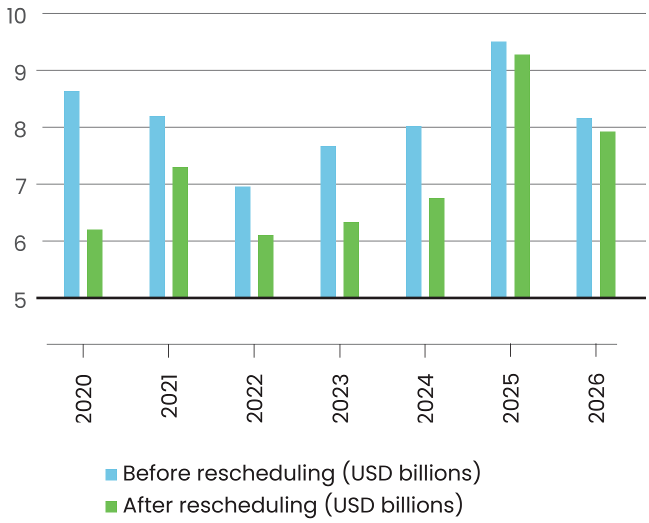
The country's solvency and external-liquidity pressures have lessened significantly since 2021, thanks to the rescheduling of external debt service and higher oil prices. The combination of debt rescheduling and current account surpluses is allowing the country to post a near-zero EFR over the cumulative period from 2021 to 2023. This will limit external-liquidity pressures despite continued capital outflows at this stage, thanks to declining foreign-currency deposits and negative net flows of foreign direct investment (FDI), which are linked to higher oil prices. The higher prices are leading to outward investment flows on the part of foreign oil companies operating in Angola. Foreign-exchange reserves should also stabilize around their current level, which is now comfortable thanks to exchange rate flexibility and the contraction of imports: they covered just under nine months of imports at the end of 2021, a level that the IMF regards as adequate (Figure 12). Finally, external debt is benefiting in 2021 and 2022 from the very strong appreciation of the kwanza (+50% against the US dollar between June 2021 and June 2022), which should bring its proportion down to between 45% and 50% of GDP by the end of 2022.

However, two vulnerabilities remain in the medium term—even though, here too, there are factors that mitigate the risks. The first vulnerability is the current account's exposure to oil prices: a further drop could increase the need for financing (Figure 13). The second is the gradual resumption of capital repayments to Chinese creditors from 2023 on: according to the IMF, external debt servicing would reach USD 9.3 billion in 2025, higher than in 2020, before the rescheduling. This will therefore weigh on the country's EFR—and it cannot be predicted with any certainty what oil prices or the level of production will be at that point. Whether EFRs can be met is also uncertain, and depends mostly on FDI in the hydrocarbon sector—which has been negative in terms of net value since 2016—and on the level of government indebtedness: Eurobonds make up the lion's share of portfolio flows; external government financing, the bulk of other investments. Non-FDI inflows are tightly limited, due to the capital controls that were in place up until 2020 (and some that are still in place). They are also constrained by the lack of investment options in Angola: non-oil private-sector prospects are limited, and domestic securities have little appeal for foreign investors: non-resident holders of local currency debt account for less than 2% of the total according to the Ministry of Finance's Unidad de Gestão da Dívida (debt-management unit).

11 The World Bank's annual commitments have increased from an average of less than USD 200 million a year between 2010 and 2018 to more than USD 1.2 billion a year starting in 2019–2020.

One primary factor that mitigates these risks and that could smooth out the financing requirement in the period from 2022 to 2025 is that, although the terms of the rescheduling with the Chinese creditors are not precisely known, a clause linked to the price of oil should have triggered an early repayment of the capital maturities that had been frozen. Indeed, a public statement by the minister of finance in early 2022 suggested that prepayments had begun in late 2021 because of a change in oil prices. This suggests the existence of a trigger—probably around USD 70 to 80 a barrel, according to the IMF—that would act as a counter-cyclical buffer.

Figure 14 – External debt service 2020–2026



Source: IMF and calculations by the author

In this context, the increase in external debt staggered repayment from 2023 on could be lower than what the IMF has forecast (see Figure 14), at the cost of diverting the gains from 2022 to debt service. On the other hand, in early April 2022, Angola issued a ten-year Eurobond[12] for USD 1.75 billion, some of which will be used to partially refinance the 2015 and 2018 Eurobonds that will mature in 2025 and 2028, for USD 1.5 billion and USD 1.75 billion, respectively. In addition, this Eurobond issuance was done at lower rates than those of 2015 and 2018, a move that improves the country's debt profile. Finally, significant financing from the IMF and multilateral institutions between 2019 and 2021 have likely improved the degree of external debt concessionality compared with that provided by previous private and Chinese financing.

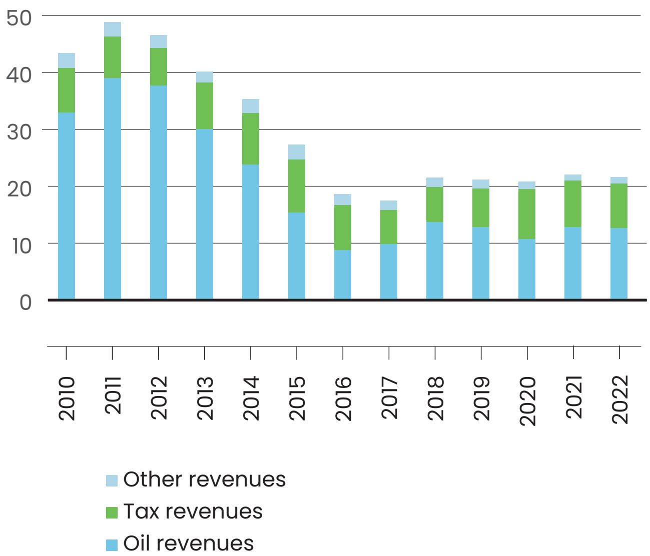
12 Against the backdrop of the successful completion of the IMF program and the recovery of oil prices, all three major rating agencies upgraded Angola's credit ratings to the equivalent of B- between September 2021 and February 2022.

3. Public finances that have been under strain since the 2014 oil shock are now being cleaned up thanks to the extended reforms

3.1 – Fiscal consolidation and rising oil revenues are allowing the government to return to fiscal surpluses

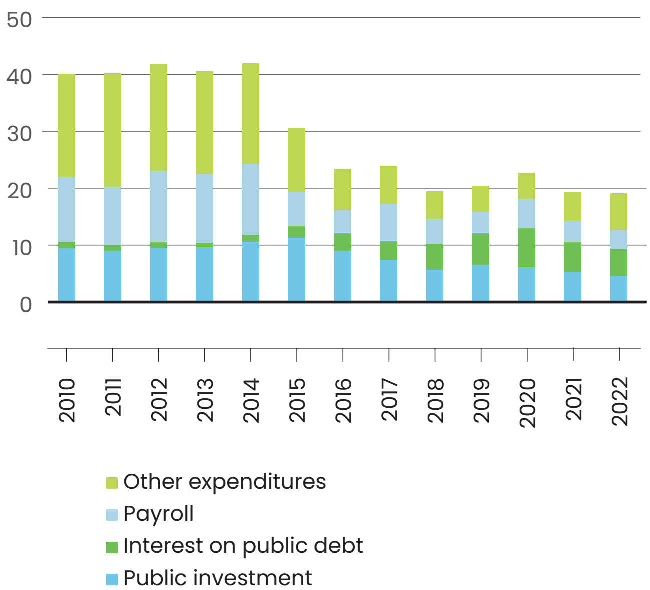
The state budget is closely linked to oil revenues, which in turn depend on the price of oil on international markets. This has led to a sharp fiscal contraction and the emergence of public deficits since 2014. Due to low economic diversification, a high level of oil production, and a very low tax base, oil revenues accounted for an average of 78% of budgetary revenues between 2010 and 2013 (Figure 15), while non-oil revenues accounted for no more than 10% of GDP. The high level of production and high oil prices have thus enabled the country to post a substantial budget (40% of GDP on average between 2005 and 2015) without threatening the primary balance, which, except for 2009, was positive each year from 2004 to 2013. All budgetary-expense items were at high levels in 2014, particularly in public investment, the wage bill, and operating expenses (Figure 16). Falling oil prices have, however, reduced government revenues sharply: from nearly 40% of GDP in 2013 to a low of 17.5% of GDP in 2017. Because of the rigidity and lower elasticity of public spending, public deficits have emerged, averaging 5.3% of GDP between 2014 and 2017.

Figure 15 – Fiscal revenues (% of GDP)



Source: BNA and calculations by the author

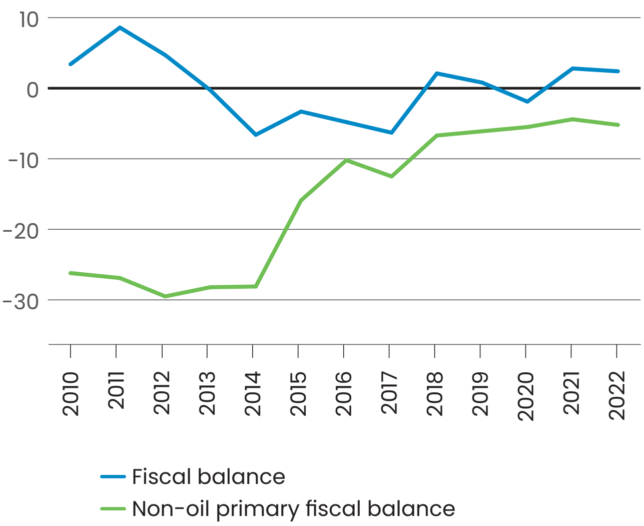
Figure 16 – Breakdown of public spending (% of GDP)



Source: IMF and calculations by the author

The reforms undertaken by the new authorities under the IMF program have led to a structural improvement in Angola's fiscal position, while higher oil prices are expected to increase the government surplus. The recovery of oil prices contributed to the return of budget surpluses in 2018 and 2019. Around the same time, President Lourenço announced a large fiscal-adjustment initiative supported by the IMF program that had been put in place in late 2018. This initiative included measures to improve spending control and tax collection. On the revenue side, the signature reform was the introduction of VAT in October 2019, accompanied by the implementation of a package of measures designed to broaden the tax base and improve tax collection. While the level of spending has fallen sharply as a result of the decline in oil revenues, attention has focused on the efficiency and transparency of public spending and investment, with the IMF and the World Bank supporting the authorities in this area. Public investment has been regulated: it fell from 6.5% of GDP in 2017 to 4.4% in 2018, and has since remained at comparable levels. The budget-planning exercise has also made it possible to begin reducing the accumulation of arrears. These were caused both by declining revenues and a lack of multi- and intra-year programming of budget allocations to ministries and public bodies. This decline is expected to continue in the coming years, and to make it possible to clear the stock of arrears. Finally, improvements in procurement and contracting procedures (especially in terms of transparency) have been a positive factor in reducing current expenditures.

Figure 17 – Fiscal balance (as a % of GDP)



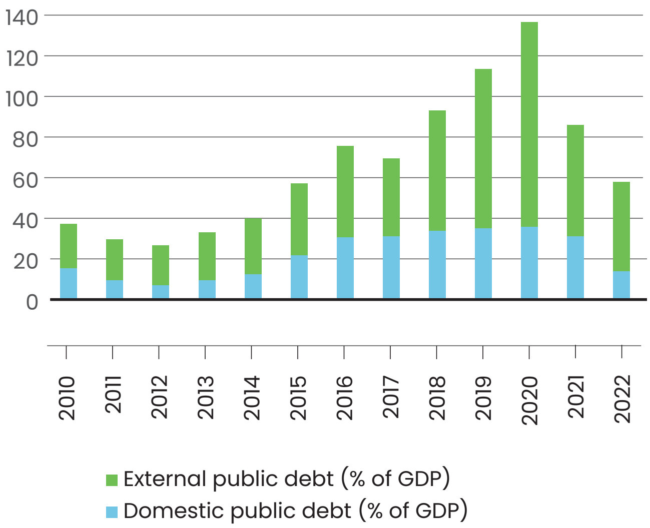
Source: IMF and calculations by the author

All of these measures represent a significant break from the management of public finances during the dos Santos era, when the political and economic authorities were responsible for capturing oil revenues and spending was opaque, with no budgetary planning. As a result of these reforms, the non-oil primary fiscal balance (a metric monitored by the IMF in particular, under the 2018–2021 program—see Figure 17) has been strengthened significantly from, growing from -15.9%of GDP in 2015 to 4.4% of GDP in 2021. This will be a mitigating factor in the event of a decline in oil prices. It is one of the reasons why the public deficit did not exceed 1.9% of GDP in 2020—the primary surplus remaining at 4.9% of GDP—despite the significant drop in oil prices and the increase in spending in response to the health and economic crises. Against the backdrop of a rise in oil prices that started in mid-2021, the public accounts were again in surplus (2.8% of GDP). They are also expected to be balanced in 2022 for the same reason: the Angolan budget for 2022 assumes a balanced budget based on USD 59 per barrel, while the IMF projected at the end of 2021 that Angola would be able to achieve a surplus of around 2.4% of GDP based on USD 78 per barrel of Brent crude. Prices seen since the beginning of 2022 suggest that this level will be exceeded. Part of the additional oil revenues should, however, be diverted to early repayment of the principal installments that were frozen in 2020 by agreement with Chinese creditors (see Chapter II).

3.2 – A combination of favorable factors are benefiting dynamics around public debt, helping to make it more sustainable

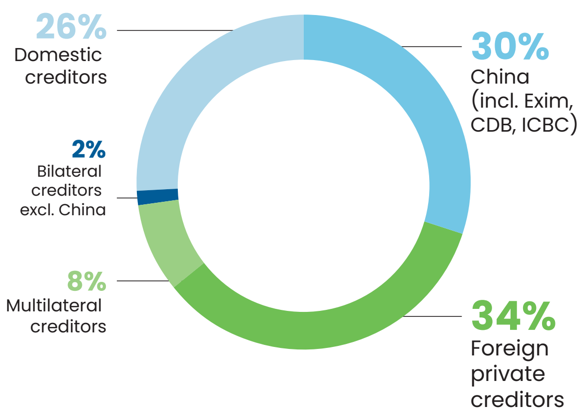
Between 2014 and 2020, public debt increased from 40% of GDP to 137% of GDP, a result of successive public deficits, the recession between 2016 and 2020, and periods in which the kwanza was devalued and depreciated (Figure 18). Analysis of this rapid increase in Angola's public-debt ratio must, however, take into account the contemporaneous evolution of several factors. The four consecutive years of primary budget deficits from 2014 to 2017 (see above) have contributed to an increase in government financing needs (GFNs) to an average of 16% of GDP a year from 2014 to 2019, whereas there were virtually no such needs up until 2013. These needs have largely been covered by recourse to external debt (see Section 2 above). Angola has also tapped the local market, thus increasing domestic public debt from 12% of GDP in 2014 to 36% in 2020. Angolan banks' holdings of government securities increased from 17% of their consolidated assets in 2014 to 34% in 2020. Moreover, nearly half of the domestic debt is directly denominated in foreign currencies or pegged to the dollar.

Figure 18 – Public debt



Source: IMF and calculations by the author

Figure 19 – State creditors at the end of 2020

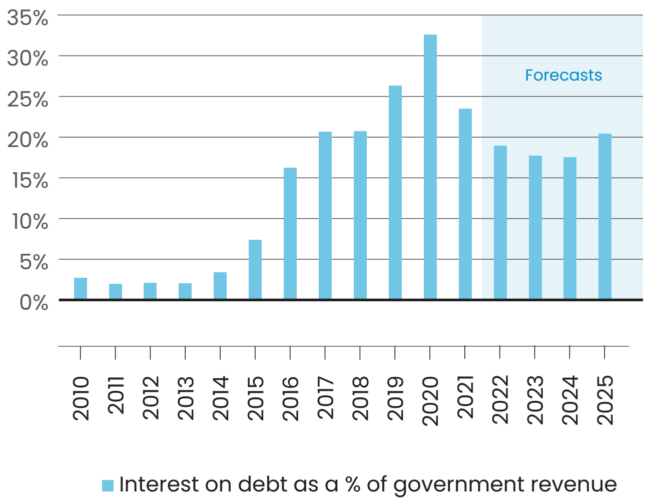


Source: IMF and calculations by the author

These developments have led to a change in the profile of the public debt, and increased the risk to its sustainability[13] for several reasons. The first is exposure to the risks associated with foreign-exchange rates, as reflected in the evolution of the ratio of external debt to GDP. The second comes from the rising cost and level of public-debt service, amid a sharp decline in state revenues since 2015. The interest burden on the public debt increased from an average of 3% of budgetary revenues between 2010 and 2014 to more than 26% in 2019 and 33% in 2020 (Figure 20). Meanwhile, public-debt service has averaged more than 14% of GDP since 2015. The third reason is the risks associated with refinancing, on both the domestic and international markets. Against the backdrop of a decline in foreign-exchange reserves since 2014, maintaining access to the international capital market or to lines of credit or financing from donors has become an indispensable condition for ensuring the refinancing of public debt. In addition, the gradual saturation of the domestic market is another potential source of pressure (as demonstrated by the necessary recourse to an advance from the BNA in 2017 for almost 1.5% of GDP, or 6.5% of the bank's total assets). Finally, the diversity of the profiles of external creditors (Figure 19) and of the terms of indebtedness is a cause for concern. In 2020, 40% of external public debt was held by China, 30% by private creditors (excluding Eurobonds: banks, suppliers, private financiers), and 16% by Eurobond holders. External debt owed to official bilateral creditors is not more than 3% of the total, while that owed to multilateral donors accounts for only 11%. Moreover, Chinese financing has been accompanied by a widespread practice of collateralization (with oil), and that complicates debt-service management whenever there is pressure on the government's liquidity. However, the IMF has made the reduction of the stock of collateralized debt a focus point of the program that was put in place at the end of 2018; that stock has not increased since 2019, but still accounted for more than one-third of external public debt at the end of 2020.

After the difficulties encountered in 2020, the sustainability of public debt is gradually improving as a result of a combination of favorable but still-volatile factors. As noted earlier, the state found itself close to an external-liquidity crisis in 2020 because falling oil prices and rising debt-service levels. This also resulted in GFNs reaching a peak of around 26% of GDP in 2020 (as against 16% in 2019). These needs could be met only by rescheduling part of the external public debt (which brought them down to 20% of GDP), by the provision of additional IMF financing, and by drawing on the public purse. In 2020, the debt-to-GDP ratio also reached an all-time high of 137% of GDP as a result of the recession and the depreciation of the kwanza.

Figure 20 – Public debt interests



Source: IMF and calculations by the author

13 As suggested by the debt-sustainability analyzes conducted by the IMF, which note a rapid and marked downward trend in all sustainability indicators on public debt since 2014. Angola was still rated BB- on average until 2014 by the main rating agencies, but reached B- on average at the end of 2019 before being downgraded to CCC in the course of 2020.

However, the debt ratio is expected to improve very significantly in 2022 thanks to the favorable evolution of all the factors contributing to its dynamics: a return to real growth of 3% (accompanied by a very high nominal growth rate), negative real interest rates (in line with persistent inflation), a high primary surplus (7.2% of GDP), and an unprecedented appreciation of the kwanza (+50% against the dollar between June 2021 and June 2022). Public debt would thus be reduced from 137% of GDP in 2020 to 86% at the end of 2021 and 58% at the end of 2022, especially if the early repayment of principal to Chinese creditors contributes to the reduction of the debt stock. The modernization of active debt management by the Ministry of Finance's debt-management unit, along with the introduction of multi-year strategies and regular reporting, also suggests that public-debt management will be made more robust than in previous years.

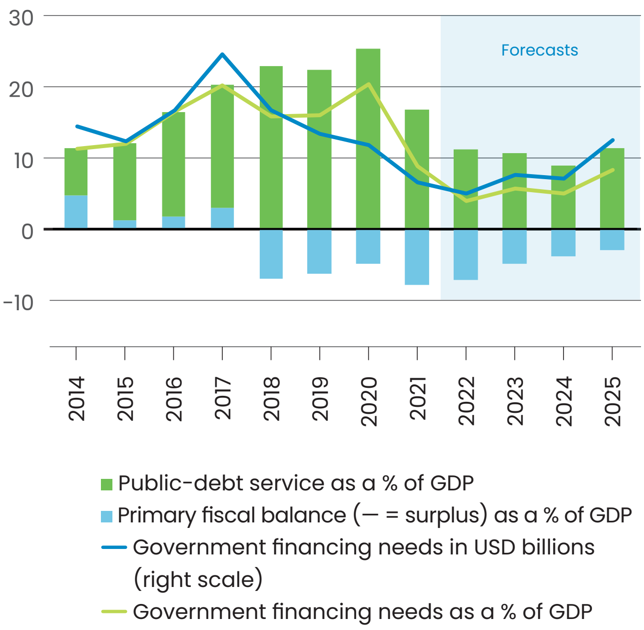
This improvement is accompanied by a decline in financing needs and pressures on liquidity, but there are still vulnerabilities. In particular, the volatility of macroeconomic indicators could further deteriorate the debt profile. The concern here is the exposure of growth and the budgetary position to the level of the oil price, the volatility of the exchange rate (in a context where the exchange rate regime has recently been made more flexible), and the cost of debt, in terms both of rate rises on the international markets and of the BNA's desire to target inflation, which could lead to an increase in the cost of domestic debt. The IMF estimated in its previous debt-sustainability analysis at the end of 2021 that the risks to debt sustainability were still significant, although it should be noted that this analysis was conducted before the rise in oil prices in 2022.

3.3 – Pressures on government liquidity have eased in the short-to-medium term, but fiscal discipline will need to continue

GFNs and the burden of public debt should diminish significantly over the next few years, provided that budgetary rigor is maintained. GFNs should be kept below 10% of GDP at least until 2025 (see Figure 21) if the government can maintain a primary surplus. Most GFNs can still be met in 2022, in particular through the use of external debt (the World Bank and donors, new Chinese financing, and the issuance of Eurobonds) and by leveraging the local banking sector to refinance domestic debt. The government could also take advantage of unbudgeted-for windfall oil revenues to replenish the public purse that it has drawn on since 2015, in particular to provide preventive liquidity cover for the payment of public salaries and current expenditures, and to avoid the accumulation of new arrears.[14]

14 The IMF put the stock of arrears (mostly domestic) at 4% of GDP in June 2021. Some of that was cleared in the second half of 2021 and in the first quarter of 2022. However, about USD 600 million (0.8% of GDP) in new arrears has accumulated in the first half of 2021. The IMF considers that this is primarily because of cash-management problems.

Figure 21 – External financing requirements



Source: IMF and calculations by the author

From 2023 on, the extent of GFNs will be determined mainly by how the budget is implemented. While fiscal-consolidation efforts (see above) are encouraging, the authorities still face challenges moving forward. Among these, the most important will be the reduction of hydrocarbon subsidies[15] (which the IMF estimated at the end of 2021 at 1.8% of GDP for 2022, but which could be higher in view of oil prices). Achieving this depends in part on the full operationalization of the social-protection Kwenda program (see Section 1), which is supposed to mitigate the impact on the poorest households. Among other challenges to fiscal discipline, the reduction of extra-budgetary public investment,[16] a practice inherited from previous governments, is a major focus. Finally, the development of tax revenues will have to be an important axis of reform, particularly in terms of broadening the tax base and strengthening tax collection. The decision in October 2021 to lower the VAT rate on a range of "essential" goods is a wake-up call, bearing in mind that this tax was introduced as a flagship measure two years earlier.

Further fiscal adjustment may be even more difficult, given the continuing socioeconomic challenges, the upcoming elections in August 2022, and the fact that the IMF program has come to an end (with no need or desire for a successor program, given that there are no financing needs).[17] The modalities for meeting GFNs will also be decisive, as these have increasingly been met by international financial institutions from 2019 to 2021 (and to a lesser extent in 2022). The increase in prices on international financial markets already seen in 2022 could affect the cost of external debt and the amounts likely to be issued, while the domestic market is already highly exposed and the authorities' objective is to promote credit to the private sector.

15 In December 2021, petrol and diesel prices at the pump were the fourth and sixth lowest in the world, respectively.

16 Essentially dictated by a political agenda and decided by the highest courts. These investments are officially communicated, but they do not appear in the state budget, their financing remains opaque, and they are often made without a call for tenders. This practice was publicly denounced by the minister of finance in early 2022, and the IMF and the World Bank are working to reconcile the list of projects, amounts, and financing awarded under this framework.

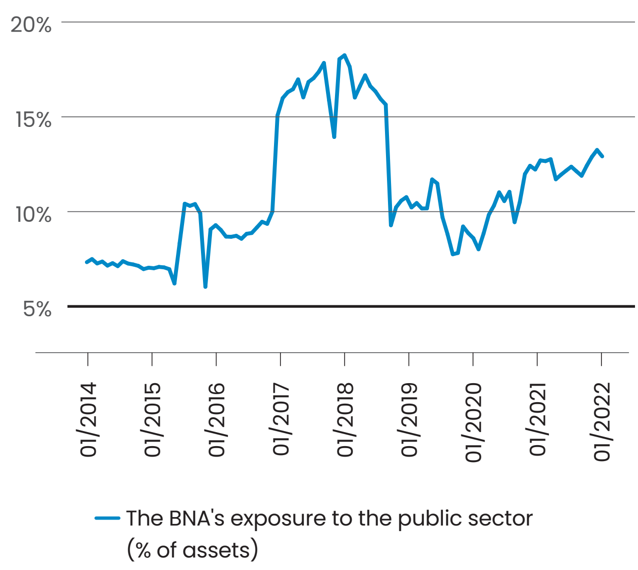
17 A strengthened post-program monitoring initiative is planned and will be carried out in parallel with the Article IV Angola mission, which should take place in the last quarter of 2022.

4.
A new monetary paradigm to add to the ongoing challenges of the banking and financial sectors

4.1 – Significant changes in the monetary and financial environment

Exchange rate flexibility and the increased independence of the BNA represent a paradigm shift in Angola's monetary and financial environment. The transition from a fixed to a floating exchange rate regime (see Section 2) represents an unprecedented reform of the monetary environment. According to the IMF, the channels for the transmission of the exchange rate at the level of pricing have not been significantly modified by this measure (the transmission at the level of pricing was previously carried out by the parallel market)—but it does require a credible monetary policy to set the expectations of economic operators properly. For this reason, the IMF program made strengthening the independence of the BNA one of its objectives, resulting in a law on the Central Bank being passed by the Assembly in 2021. This law aims, among other things, to (i) clarify the BNA's mandate on the price level; (ii) limit the state's use of monetary financing; (iii) increase the operational autonomy and independence of the BNA; and (iv) improve the governance of the Central Bank, in line with international standards.

Figure 22 – The BNA's exposure to the public sector

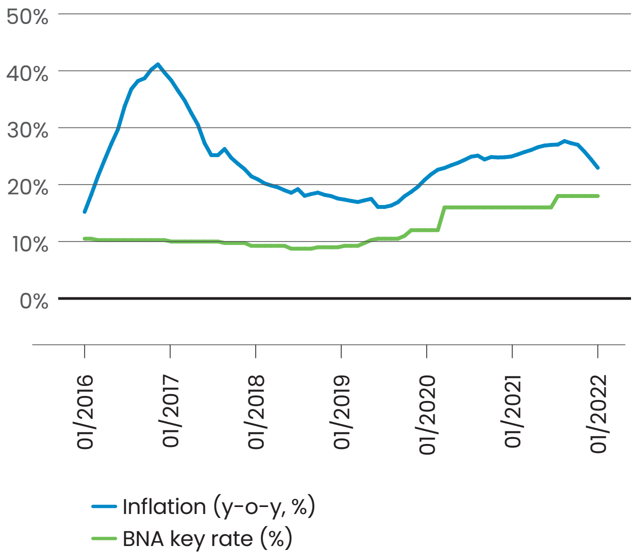


Source: BNA and calculations by the author

The first objective (on the price-level mandate) has resulted, among other things, in an initiative within the BNA to define the structures and instruments that will enable the progressive implementation (by 2023) of an explicit inflation-targeting policy. Under the IMF program, monetary financing of deficits by the Central Bank (Figure 22) had begun to decline before the law on the BNA was enacted. Previously, it had increased slightly with the fall in oil prices between 2014 and 2017, and had risen again in February 2017 when the BNA had advanced the state, as an exceptional matter, an amount equivalent to about 1.5 GDP points to help it meet its financing needs. As a result, BNA's exposure to the government had increased from just under 7% of its assets in 2014 to nearly 18% between 2017 and 2019. Repayment of the advance, together with a moderate policy of buying government securities (encouraged by the IMF under the program), brought exposure back to 8% in early 2020. However, BNA's sovereign exposure increased again starting in April 2020 due to the COVID-19 crisis, and at the beginning of 2022 it represented about 13% of its assets. It seems, though, that the independence of the BNA is now being respected. This independence is crucial to ensure the credibility of its decisions on monetary policy under the new exchange rate regime, especially since these decisions may have contradictory effects on the price level, interest rates, the cost of public debt, and the exchange rate, resulting in the involvement of various actors in the Angolan political economy.

Persistent inflation remains the most important challenge for monetary policy-makers. After rising rapidly in 2016 and 2017 (due to a delayed impact from the successive devaluations of 2015 and 2016), inflation fell below 20% between June 2018 and early 2020 (Figure 23). It has, however, been on the rise since late 2019 and has remained above the 25% mark since the beginning of 2021. This is essentially the consequence of the combination of monetary (quantitative) easing that was introduced in the spring of 2020 in response to the crisis, and supply factors that the IMF believes to be temporary (in particular, import restrictions that were introduced in 2020, and supply and transport problems). The tightening of monetary policy in July 2020 (+450 basis points, bringing the BNA's key rate to 20%) and the appreciation of the kwanza should help stabilize prices. Inflation thus began to slow in early 2022, from 27.7% year-on-year in January 2022 to 23% in June 2022. Nevertheless, inflation remains high and helps maintain a negative real rate environment. Beyond the short-term response, which could consist of a further increase in BNA rates, the Central Bank's objective is to pursue explicit inflation targeting (with IMF technical assistance), particularly in relation to the Central Bank Act of 2021. This will be another important paradigm shift for monetary policy-makers.

Figure 23 – Inflation and policy rates



Sources: INE, BNA, and calculations by the author

4.2 – A banking sector undergoing improvements but highly exposed to the public and oil sectors

The banking sector, weakened since 2015 by the fall in oil prices, has been undergoing a process of clean-up and stabilization since the end of 2019, thanks to measures taken by the authorities under the IMF program. The country's economic growth since the early 2000s has led to marked growth in the banking sector, from just under 20% of GDP in 2003 to over 60% in 2015 (although this share has since been declining, averaging 55% of GDP over the past three years). However, the banking sector has developed mainly in order to support the oil sector, while remaining highly dependent, in terms of both shareholding and financing, on the political elite and state-owned enterprises. The banking business model was supported by economic growth and oil revenues, allowing for comfortable levels of profitability until the oil shock of 2014–2015. Since then, the banking sector has experienced numerous disruptions because of the recession, macroeconomic destabilization, and inadequate safety nets. In particular, this has resulted in a decrease in liquidity and, more importantly, in an increase in bad loans from 6.3% of gross loans in 2013 to 32.4% in 2019 (Table 1).

The IMF program made stabilization of the banking sector one of its priorities, and that has resulted since 2018 in (i) a clean-up of the sector through recapitalizations or license withdrawals; (ii) a reduction in non-performing loans through the creation of a bad bank (named "Recredit"); (iii) the promotion of a modernized regulatory framework through a new law on financial institutions, passed in May 2021; and (iv) improvements to the Anti-Money Laundering/Combating the Financing of Terrorism framework, including better international standards. In 2019, a review of the quality of the banking sector's asset portfolio, conducted jointly by the IMF and the BNA, led to the conclusion that seven institutions had insufficient levels of capitalization. By the end of 2021, that number was down to one. Moreover, the still-high proportion of non-performing loans at the end of 2021 (18.2% of gross loans) is explained by a high concentration of the stock of bad loans in two troubled public banks, Banco de Poupança e Crédito and Banco Económico. These have been in the process of recapitalization since 2019 and are expected to be fully and effectively recapitalized by the end of 2022 or early 2023. However, the strategy for clearing bad debts will have to be given particular attention in view of the low profitability of the banks.

Table 1 – Financial soundness indicators

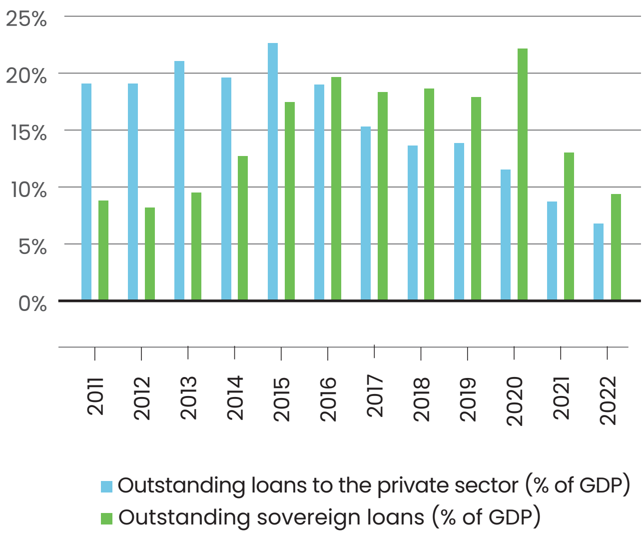
	2013	2014	2015	2016	2017	2018	2019	2020	2021
Consolidated balance sheet of the banking sector (% of GDP)	52.7	52.6	61.5	6.2	51.8	53.5	59.6	64.5	43.6
Private-sector credit (% of GDP)	21.0	19.6	22.6	19.0	15.3	13.6	13.9	11.5	8.7
Sovereign exposure (% of GDP)	9.5	12.7	17.4	19.6	18.3	18.6	17.9	22.1	13.0
Credit growth rate (%)	12.2	4.7	-4.5	3.8	3.5	20.7	26.9	-2.7	5.5
Deposit growth rate (%)	16.8	15.2	15.7	16.4	-0.3	31.1	28.1	19.6	-4.0
Loan-to-deposit ratio (%)	77.0	70.0	57.8	51.5	53.5	49.2	48.7	39.6	43.6
Capital-adequacy ratio (%)	18.0	19.9	19.8	19.2	18.9	24.2	23.2	2.3	19.1
Non-performing loans (% of gross loans)	6.3	11.7	11.6	13.1	15.3	28.3	32.4	18.4	18.2
Return on assets (%)	n.d.	0.6	1.7	2.2	2.1	4.4	-1.3	-2.9	1.1
Return on equity (%)	n.d.	5.0	12.9	15.6	14.5	26.6	-10.0	-29.8	13.4

Sources: IMF, BNA, and calculations by the author.

Note: n.d. (no data)

The banking system provides little financing to the real economy and—its major vulnerability—remains highly exposed to the state and to the performance of the oil sector. Because of the weak diversification of the economy and structural obstacles to private-sector development (see Section I), banking activity finances little of the real economy, and this trend has worsened and accelerated since the oil shock of 2014–2015. The amount of outstanding loans to the private sector has thus been reduced from an already-low level in 2015—23% of GDP—to just 7% in April 2022 (Figure 24). Even though a number of measures have been taken since 2018 to promote private-sector financing (financial incentives, BNA guidelines, and a PRODESI-type framework), credit to the private sector is struggling to grow both because demand is still limited (notably by structural locks that have been put on the economy) and because the offer is subject to competition from government securities ownership, which is more profitable and more secure.

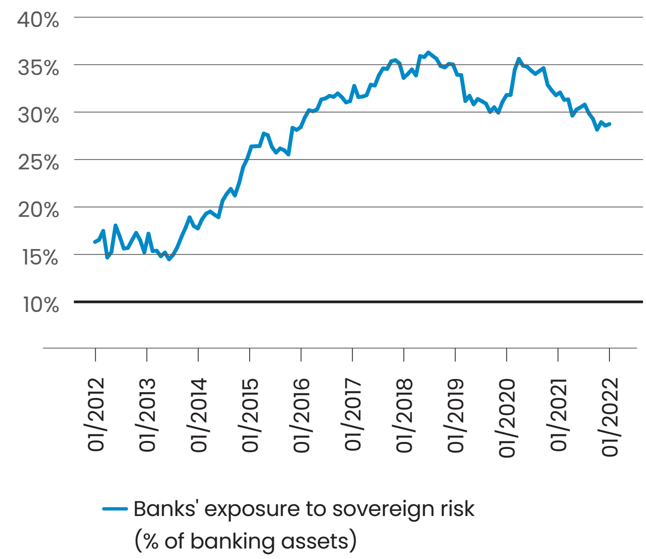
Figure 24 – Banks' outstanding loans to the private sector and outstanding sovereign loans



Source: BNA and calculations by the author

The increase in GFNs has in fact contributed to an increase in the stock of domestic public debt, the majority of which has been underwritten by the banking sector (Figure 25). The banks' exposure to sovereign risk has thus risen from 15% of their assets before the fall in oil prices, to more than 35% of their assets at the beginning of 2019, or 19% of GDP (as against 14% of GDP for outstanding credit to the private sector in the same period). Their exposure to sovereign risk increased again in 2020 because of the COVID-19 crisis, but it has been declining since the beginning of 2021. It thus fell back below 30% of banking assets in early 2022 for the first time since 2016, and represents less than 10% of GDP (down from over 20% of GDP in mid-2020). However, the level of exposure remains high (for all major banks, both public and private) and is likely to remain so in view of the government's financing strategy, even as banks continue to operate in an environment of negative real rates.

Figure 25 – Banks' sovereign exposure



Source: BNA and calculations by the author

Finally, the nexus between the performance of the oil sector and that of the banking sector is particularly pronounced in Angola. In 2018, IMF officials conducted a study on the transmission channels for the macroeconomic situation regarding the banking sector, and concluded that the degree of correlation was particularly strong, especially when the price of oil is included as a variable. This vulnerability persists due to the absence of major changes in the structure of the Angolan economy since 2018—particularly in terms of diversifying activity and reducing the presence of the state in the economy and the banking sector.

The development of a non-bank financial sector and of a stock market could help support economic diversification and the private sector, but efforts in this direction are still at the embryonic stage. The financial sector is made up almost entirely of banking (90% in terms of assets; insurance, pension funds, and microcredit institutions are either underdeveloped or not very active), while the capital market has so far been limited to the public debt market. The Angolan stock exchange *(Bolsa de Dívida e Valores de Angola, BODIVA)* was only established in December 2014, and has since served only to facilitate the trading of government bonds. The first initial public offering (IPO) was not made until June 2022, when the state sold off its shares in BAI Bank for USD 94 million (10% of the capital, held by the oil company Sonangol and the diamond company Endiama). This is therefore a new stage in the PROPRIV process (see Section 1), as the state intends to carry out further privatizations through IPO mechanisms (BODIVA itself being one of the assets that the state wants to privatize). These sales could catalyze the revitalization of the private capital market and, in the long run, support and diversify the financing of companies, especially private ones.

List of acronyms and other abbreviations

BNA	*Banco Nacional de Angola*
BODIVA	Bolsa de Dívida e Valores de Angola
BPC	Banco de Poupança e Crédito
CDB	China Development Bank
DSSI	Debt Service Suspension Initiative
EFR	External-financing requirement
FDI	Foreign direct investment
GDP	Gross domestic product
GFNs	Government financing needs
HDI	Human Development Index
ICBC	Industrial and Commercial Bank of China
IGAPE	*Instituto de Gestão de Activos e Participações do Estado* (Institute for the Management of State Assets and Equity)
IMF	International Monetary Fund
INE	*Instituto Nacional de Estatísticas* (National Statistics Institute)
IPO	Initial public offering
MPLA	*Movimento Popular de Libertação de Angola* (People's Movement for the Liberation of Angola)
NDC	Nationally determined contributions
PRODESI	*Programa de Apoio à Produção, Diversificação das Exportações e Substituição das Importações* (Support Program for National Production, the Diversification of Exports, and the Substitution of Imports)
PROPRIV	*Programa de Privatizações*

List of figures and tables

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