Angola and the oil price shock

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Remember

Angola is not rich

It is a post-conflict country that is rapidly extracting its limited (known) oil reserves

It faces the challenges of both
External environment
World growth slower than expected

- US economy stronger than expected, but Euro area remains weak and China slowing down.
- Global growth projected to accelerate, but more slowly than expected.
- Growth projections keep being reduced.

### Real GDP Growth

<table>
<thead>
<tr>
<th>Region</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>4.0</td>
<td>3.9</td>
<td>3.8</td>
</tr>
<tr>
<td>USA</td>
<td>3.6</td>
<td>3.3</td>
<td>3.5</td>
</tr>
<tr>
<td>Euro</td>
<td>3.3</td>
<td>3.8</td>
<td>3.8</td>
</tr>
<tr>
<td>Japan</td>
<td>3.3</td>
<td>3.5</td>
<td>3.8</td>
</tr>
</tbody>
</table>

### World real GDP growth projections

<table>
<thead>
<tr>
<th>Date</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr-13</td>
<td>4.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oct-13</td>
<td>3.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Apr-14</td>
<td>3.6</td>
<td>3.9</td>
<td></td>
</tr>
<tr>
<td>Oct-14</td>
<td>3.3</td>
<td>3.8</td>
<td></td>
</tr>
<tr>
<td>Jan-15</td>
<td>3.3</td>
<td>3.5</td>
<td>3.8</td>
</tr>
</tbody>
</table>
Pushing down commodity prices

- **Demand**: Slow global growth is pushing down commodity prices.
- **Supply**: Fuel prices also affected by expansion of US fuel production and cycle of geopolitical tensions.
- **Price**: Oil price fell to $45 p/b. IMF projects $60 p/b in 2015 rising to $75-$80 p/b in medium term.
Current shock differs from 2009 demand shock because of structural supply shock. But price rebound after 2009 was unexpected.

Oil supply price shocks persist longer than demand shocks. Large explanatory residual suggests market over-reaction.

Oil prices have probably overshot:
--Decline in ‘normal’ from, say, $90 to $75-$80 p/b.
--Temporary decline below new ‘normal’.
Oil flows
Absorbing oil resources

- USD oil earnings are a claim on foreign resources – these resources are either consumed via imports of goods and services or saved as foreign reserves/deposits.

- Oil resources preferably used to import productive capital rather than consumer goods.

- Domestic AKZ spending is not a use of USD oil resources until it generates imports.

- Government receives USD oil revenues. But Government spending is only a use of USD oil resources when used to finance imports.
Financial flows

- Oil resources enter non-oil sector through spending by GoA and oil firms. BNA now sole supplier of USD to non-oil sector.
- Two ‘USD cycles’ – budget cycle via GoA and FX market cycle via BNA.

Net exports - USD

Oil sector

- Oil FX Law: resident suppliers paid in AKZ

RoW

Imports & other - USD

Non-oil sector

Oil revenues - USD

Government

- GoA spending - AKZ

Central Bank

- FX sales for resident payments - USD

- FX sales USD/AKZ
Impact of lower oil price
Impact on exports and revenues

- Price shock is foremost a shock to **external balance**: fall in 2015 export receipts by around $27 billion.

- Also **fiscal shock** because of lower oil revenues and financing constraints: fall in 2015 budget oil revenues by about $17 billion.

### Direct impact of oil price decline
Assuming 2014 oil production

<table>
<thead>
<tr>
<th></th>
<th>2014 price</th>
<th>Rev</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil price</td>
<td>104</td>
<td>60</td>
<td>44</td>
</tr>
<tr>
<td>Oil production</td>
<td>1.66</td>
<td>1.66</td>
<td>0</td>
</tr>
<tr>
<td>Oil export receipts</td>
<td>63</td>
<td>36</td>
<td>27</td>
</tr>
<tr>
<td>Oil budget revenues</td>
<td>31</td>
<td>14</td>
<td>17</td>
</tr>
</tbody>
</table>
Angola better prepared to face oil price shock in 2014/15 than in 2008/09

---Higher foreign reserves
---Lower inflation
---Stronger fiscal balance ??
And stronger policy coordination

Policy buffers 2008/9 and 2014

Note: fiscal balance for 2008 includes unaccounted residual and for 2014 taken from 2015 OGE
Policy options

Foreign reserves (savings) can and should be used to smooth the adjustment, but only temporarily.

**External imbalance**: need to cut use of foreign exchange (imports) by:
- Price adjustment: depreciate FX rate plus higher interest rates.
- Demand adjustment: cut fiscal spending or raise taxes to suppress import demand.

**Fiscal adjustment**: need to restrain fiscal deficit by:
- Lower spending or higher taxes.
- Adjustment constrained by availability of domestic and foreign financing
- Impact on economic activity.

What is the residual adjustment?
**External**: quantity constraints on access to FX and import quotas
**Fiscal**: delayed payments.
Impact on FX market

- FX shortages already evident: FX rationing and import quotas. Widening FX spreads.

- FX depreciation about 7 percent since September. Further depreciation constrained by impact on inflation, fiscal costs, and banks’ balance sheets. Need for higher interest rates?

- Fiscal adjustment needed.

**BNA FX sales and Reserves**

<table>
<thead>
<tr>
<th>US$ billion</th>
<th>Oil FX law revised</th>
<th>Oil production falls</th>
<th>Oil FX law</th>
<th>Oil production falls</th>
</tr>
</thead>
<tbody>
<tr>
<td>L: Sales</td>
<td>R: Reserves</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Official FX rate & parallel market spread**

<table>
<thead>
<tr>
<th>R: Spread, %</th>
<th>L: Middle Kw/USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>5</td>
<td>25</td>
</tr>
<tr>
<td>10</td>
<td>20</td>
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<tr>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>25</td>
<td>5</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Dec-11</th>
<th>Jun-12</th>
<th>Dec-12</th>
<th>Jun-13</th>
<th>Dec-13</th>
<th>Jun-14</th>
<th>Dec-14</th>
</tr>
</thead>
<tbody>
<tr>
<td>L: Sales</td>
<td>R: Reserves</td>
<td>Official FX rate</td>
<td>Parallel market spread</td>
<td></td>
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</tbody>
</table>
BoP trends

- Sizeable current account deficit projected in 2015.
- Longer-term BoP squeeze: Oil sector already trending down relative to non-oil GDP with current account deficit already in medium term.
- Oil shock accentuates over-valuation of FX rate.
Fiscal adjustment

Increase in 2015 OGE fiscal deficit due to both lower oil price and higher spending.

- Total spending: +19%
- Nominal non-oil GDP: +16%
- CPI inflation: +7%

Options

- Stronger revenue effort. Non-oil revenues 14% NOGDP, compared to 20+% for SSA.
- Lower spending on salaries and G&S: 56% 2015 OGE.
- Eliminate fuel subsidies: costly, regressive, and inefficient. Introduce social income support?
- Slower capital spending: need higher efficiency.

Adjustment constrained by availability of financing for fiscal deficit.

- Foreign borrowing difficult in current global environment, concerns about future fiscal deficits and debt sustainability, and prospects for sub-salt.
- Domestic borrowing can crowd out private sector despite excess bank liquidity.
- Delayed payments already evident.

Budget expenditure commitments

<table>
<thead>
<tr>
<th>Year</th>
<th>Salaries</th>
<th>G&amp;S</th>
<th>Interest</th>
<th>Transfers</th>
<th>Capital</th>
<th>Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>60%</td>
</tr>
<tr>
<td>2014</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>50%</td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>40%</td>
</tr>
</tbody>
</table>

Loan financing of 2015 OGE

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross</th>
<th>Amortization</th>
<th>Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015</td>
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</tbody>
</table>
Fiscal trends

Angola already faces a longer term fiscal squeeze accentuated by the oil price shock

- Trend deterioration in fiscal balance due to falling oil revenues/NOGDP: 2015 OGE – deficit 7.5% of GDP, 10.8% of NOGDP.
- Oil revenue share of total revenues declining, now nearing 50%. Reinforcing longer-term trend of declining revenues share of NOGDP.
- Despite tightening fiscal policy stance: declining non-oil primary deficit (discretionary fiscal stance) and non-oil current deficit (discretionary budget savings).

![Revenues Graph](chart1)

![Fiscal balances Graph](chart2)
Medium-term policy objectives

Angola is not rich
It is a post-conflict country that is rapidly extracting its limited oil reserves
It faces the challenges of both

Save and invest for the future

Higher capex and restore fiscal surplus

Reduce volatility from oil sector

Smooth spending (stabilization fund) around the new ‘normal’ oil price

Diversified and inclusive growth

Shift from consumption to capex. Social income transfers
Thank you