Angola and the oil price shock

Angola Field Group, February 5, 2015
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Remember

Angola is not rich

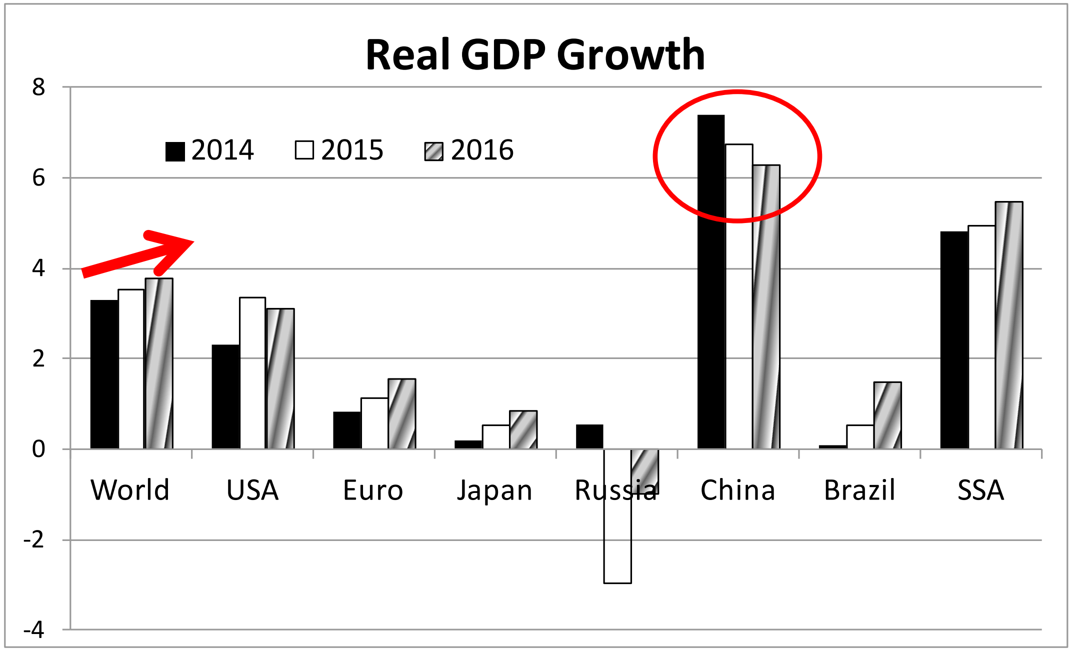
It is a post-conflict country that is rapidly extracting its limited (known) oil reserves

It faces the challenges of both

External environment

World growth slower than expected

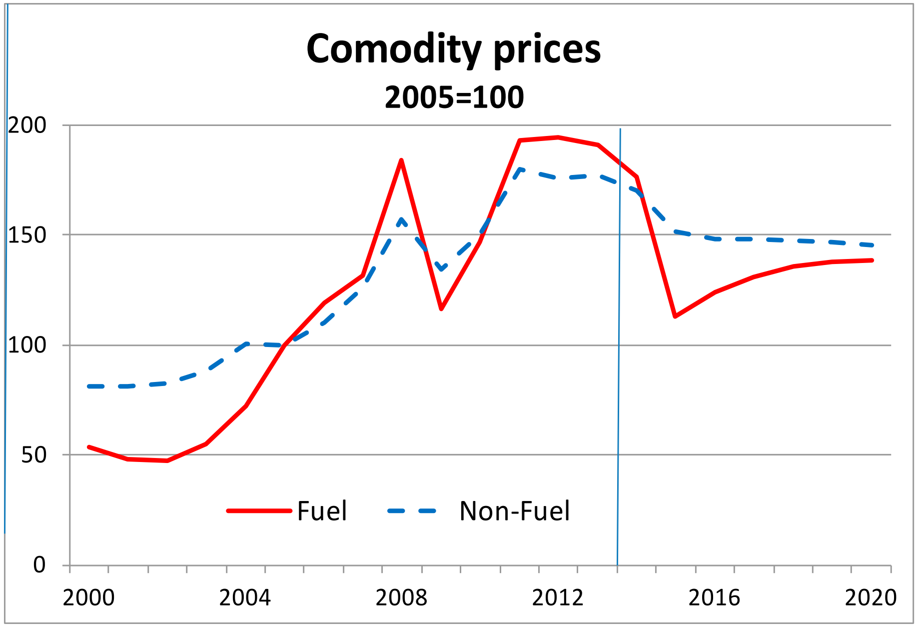
- US economy stronger than expected, but Euro area remains weak and China slowing down.
- Global growth projected to accelerate, but more slowly than expected.
- Growth projections keeps being reduced.

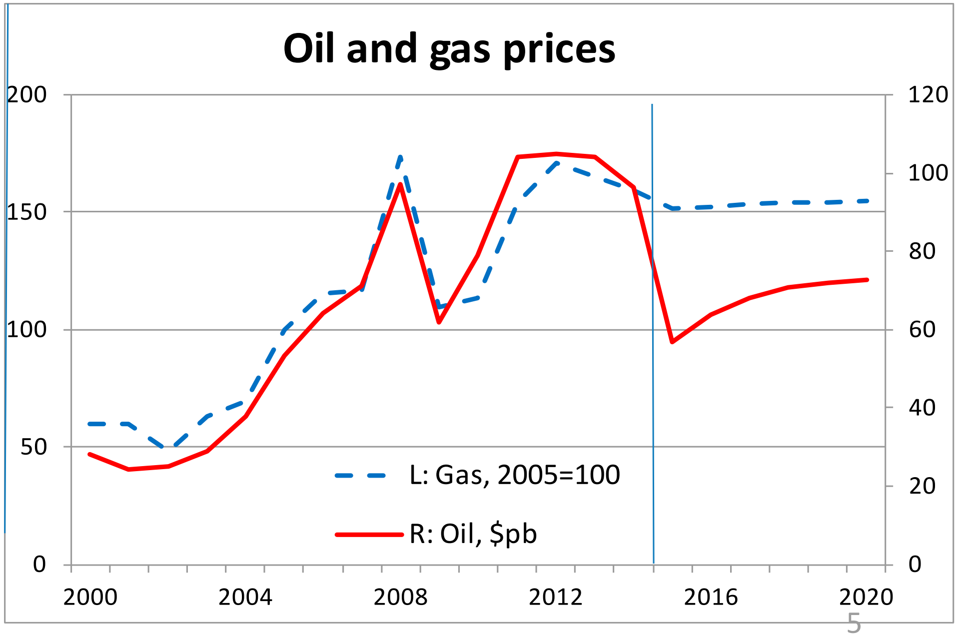


World real GDP growth projections			
	2014	2015	2016
Apr-13	4.0		
Oct-13	3.6		
Apr-14	3.6	3.9	
Oct-14	3.3	3.8	
Jan-15	3.3	3.5	3.8

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.



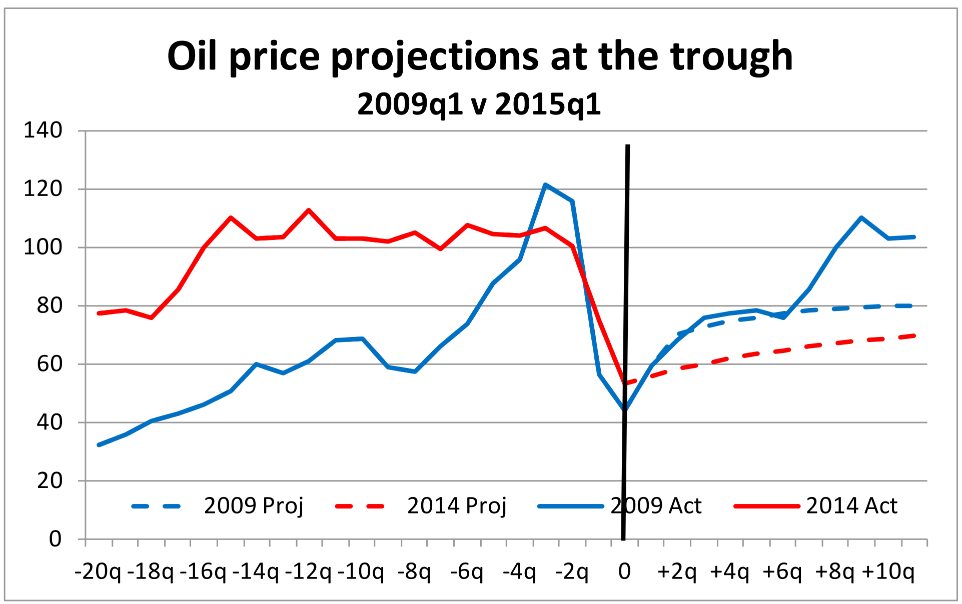


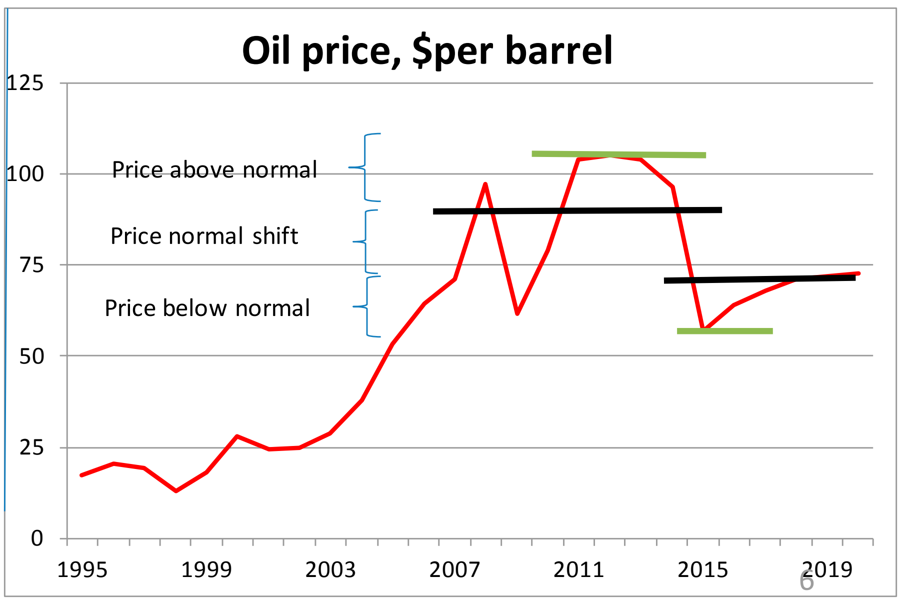
Short v long term price shock

- ❑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.

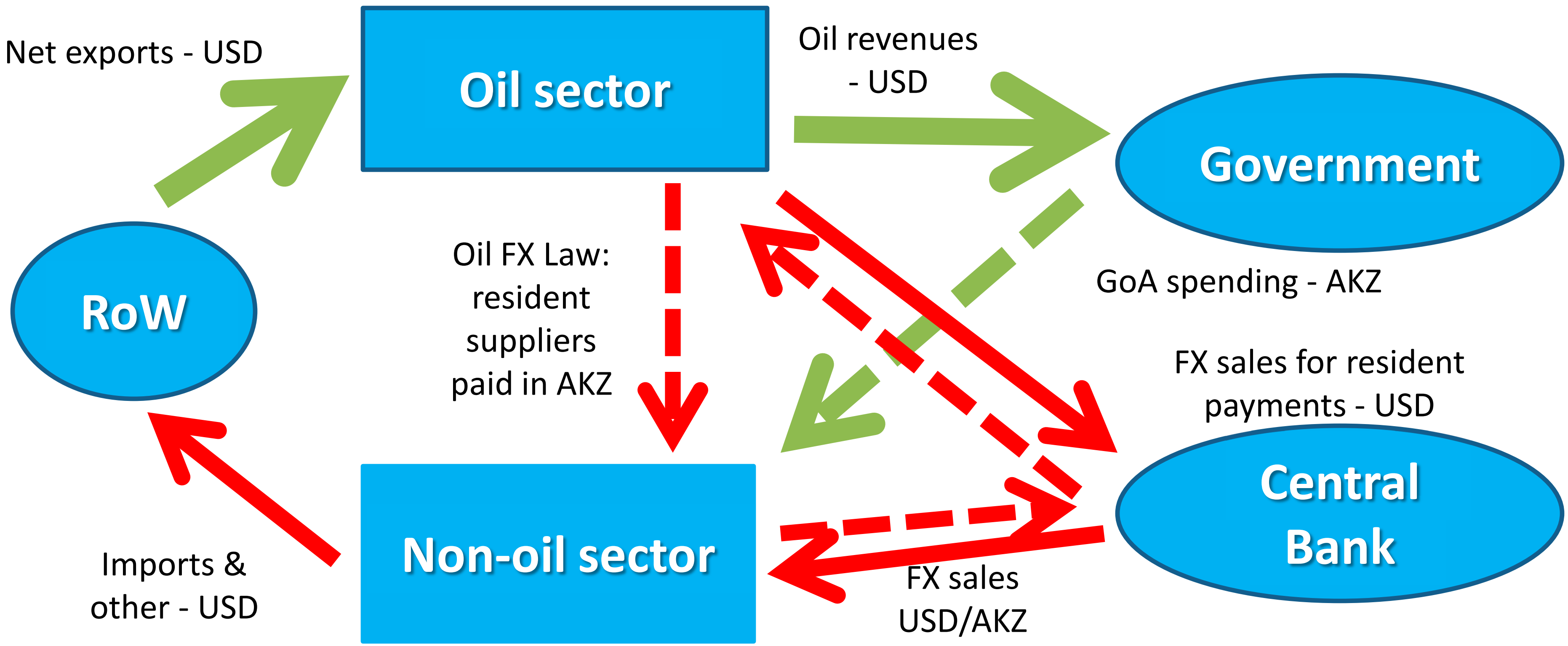
❑Oil resources preferably used to import productive capital rather than consumer goods.

❑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.



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

	2014 price	Rev	Difference
Oil price	104	60	44
Oil production	1.66	1.66	0
Oil export receipts	63	36	27
Oil budget revenues	31	14	17

Policy buffers

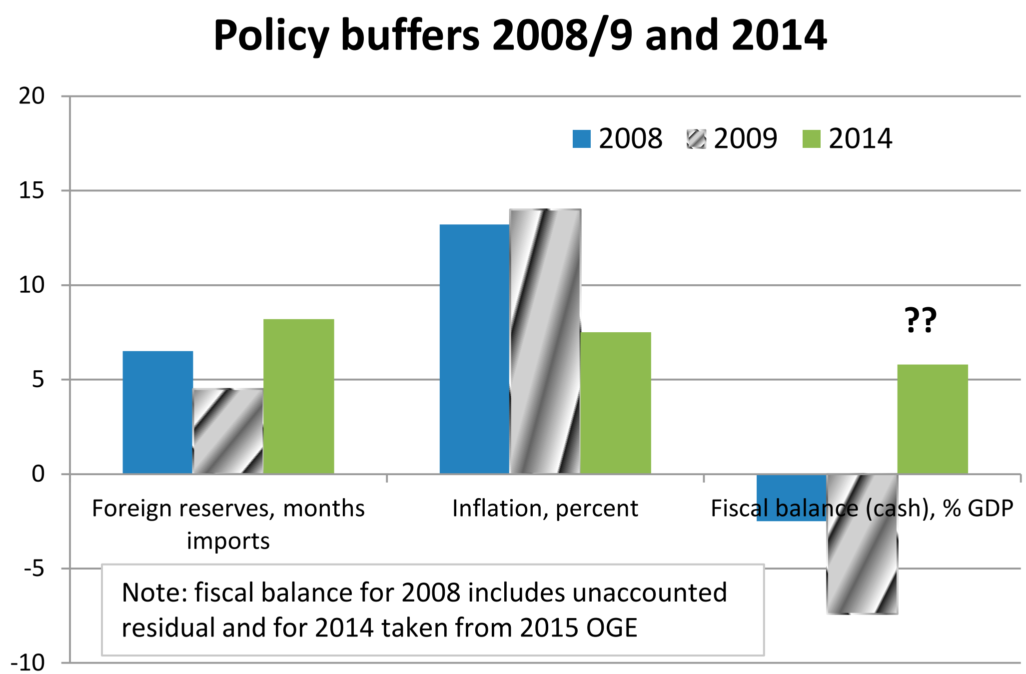
Angola better prepared to face oil price shock in 2014/15 than in 2008/09

---Higher foreign reserves

---Lower inflation

---Stronger fiscal balance ??

And stronger policy coordination



Policy 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.

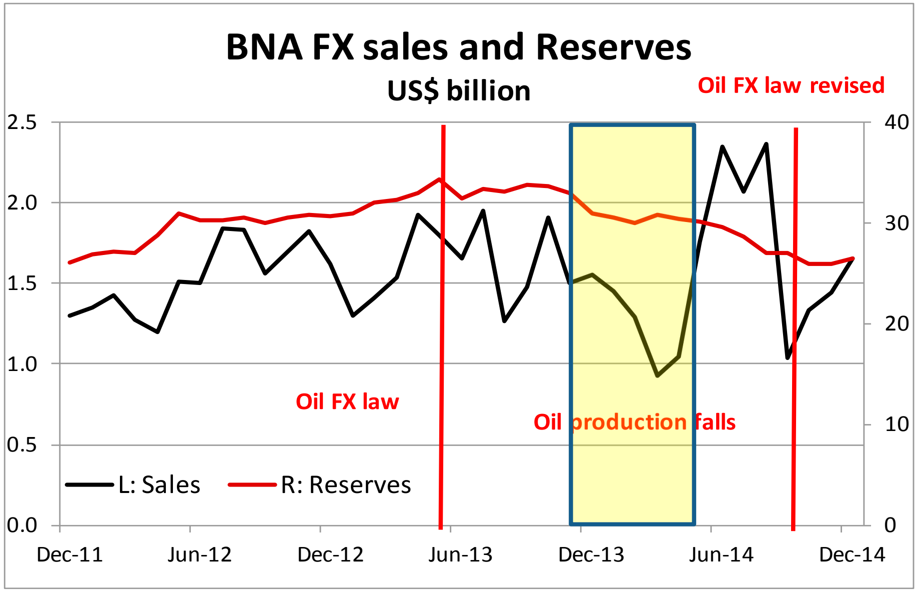
What is the residual adjustment?

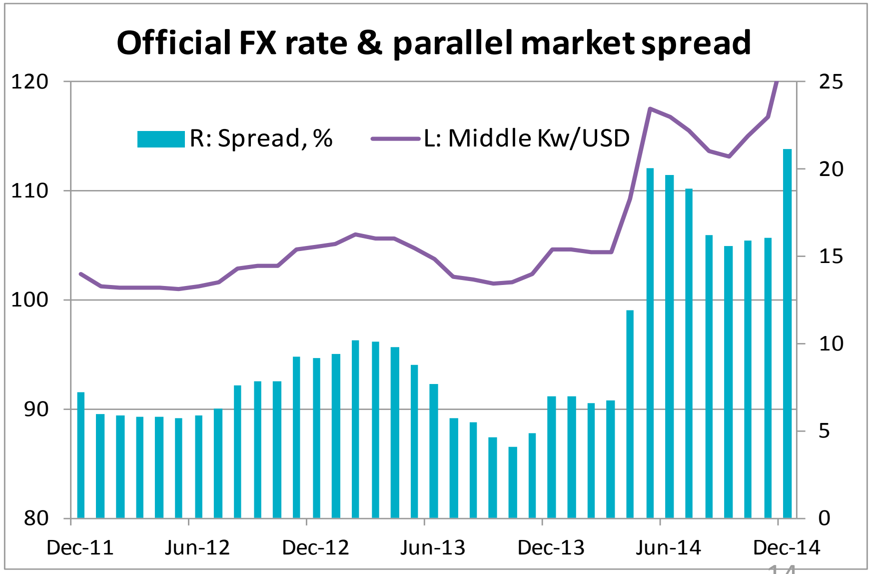
External: quantity constraints on access to FX and import quotas

Fiscal: delayed payments.

Impact on FX market

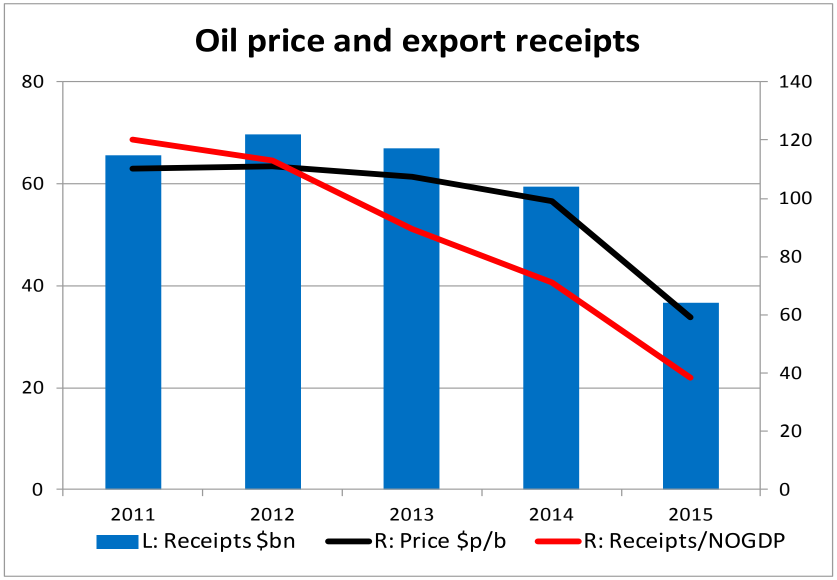
- ❑FX shortages already evident: FX rationing and import quotas. Widening FX spreads.
- ❑FX depreciation about 7 percent since September. Further depreciation constrained by impact on inflation, fiscal costs, and banks' balance sheets. Need for higher interest rates?
- ❑Fiscal adjustment needed.

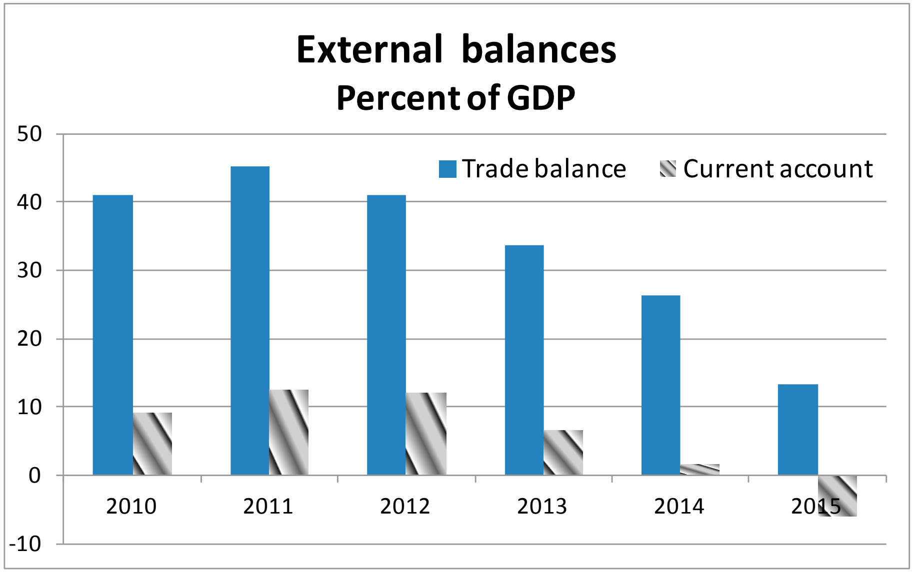




BoP trends

- 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.

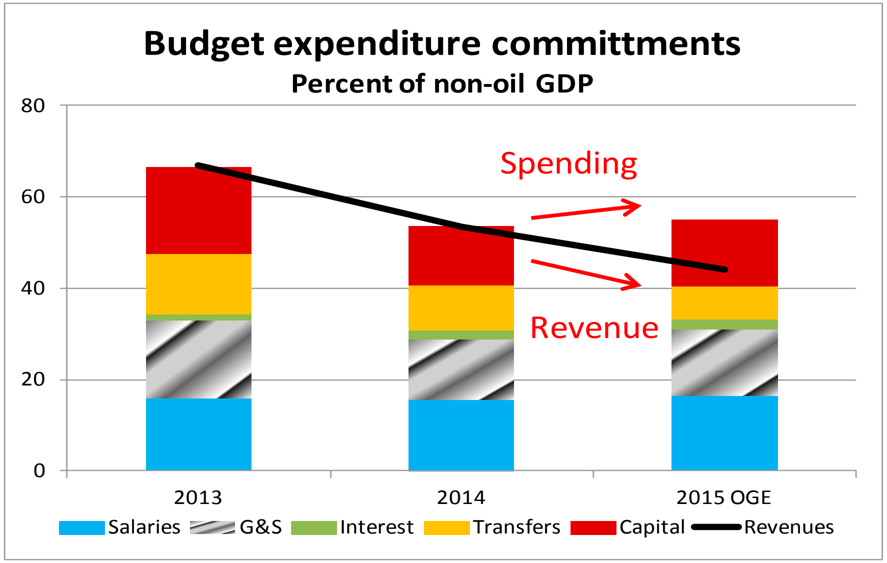
- Total spending +19%
- Nominal non-oil GDP +16%
- CPI inflation +7%

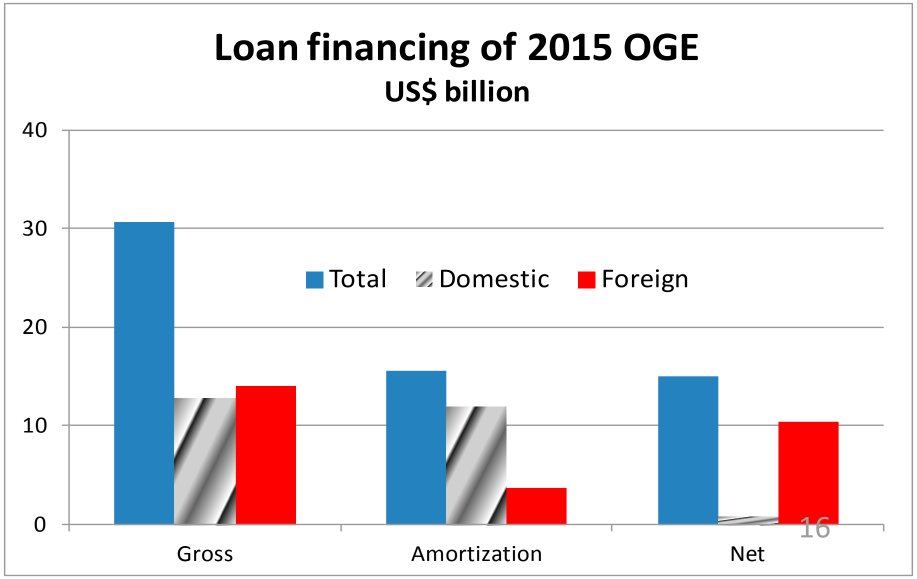
Options

- 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.





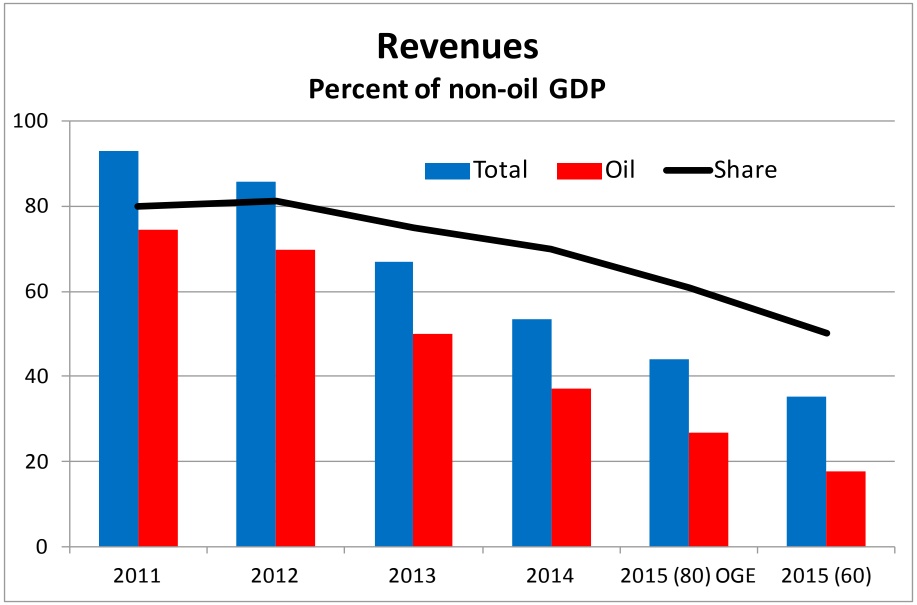
Fiscal trends

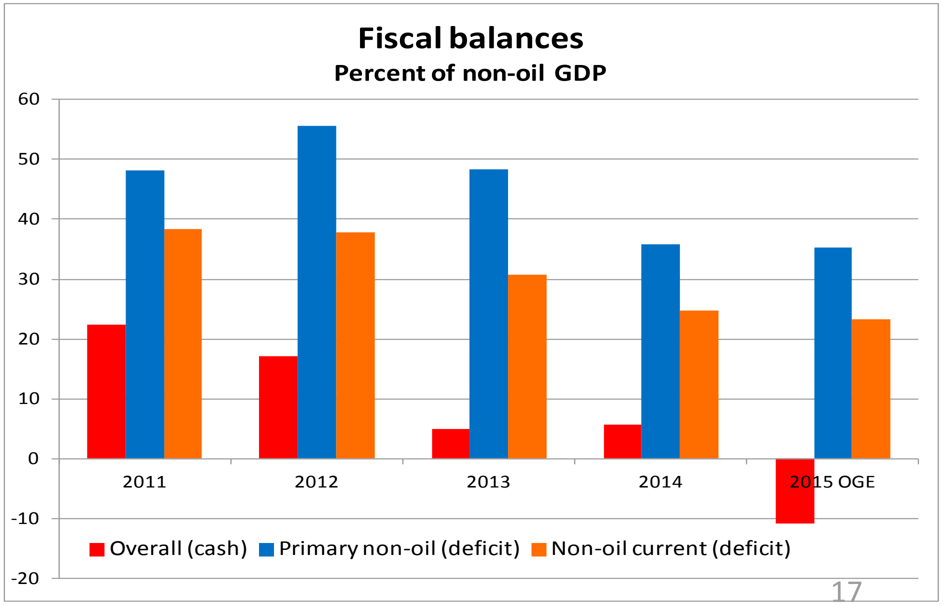
Angola already faces a longer term fiscal squeeze accentuated by the oil price shock

- ❑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).





Medium-term policy objectives

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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