Angola: adjusting to the oil price shock

AIPN, March 25, 2015
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Remember

Angola is not rich

It is a post-conflict country with high oil revenues but rapidly declining reserves

It faces the challenges of both

Absorbing oil resources

- USD oil earnings are a claim on foreign resources – transferred via imports or saved as foreign financial assets.

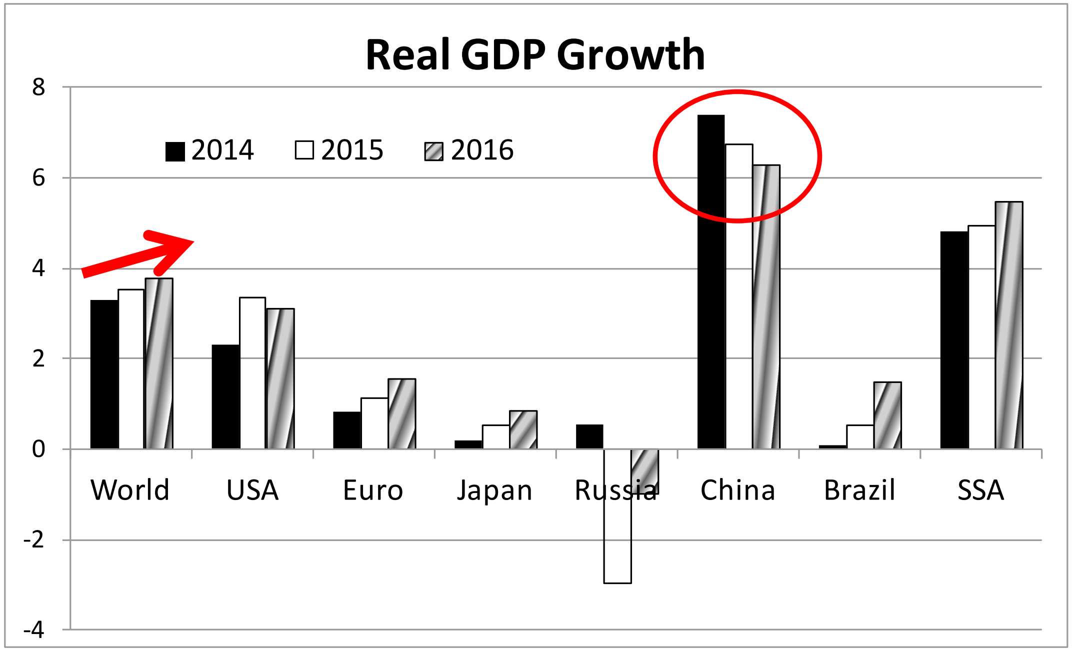
- Domestic AKZ spending, including government spending, is NOT a use of USD oil resources – unless it generates imports.

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

External environment

World growth slower than expected

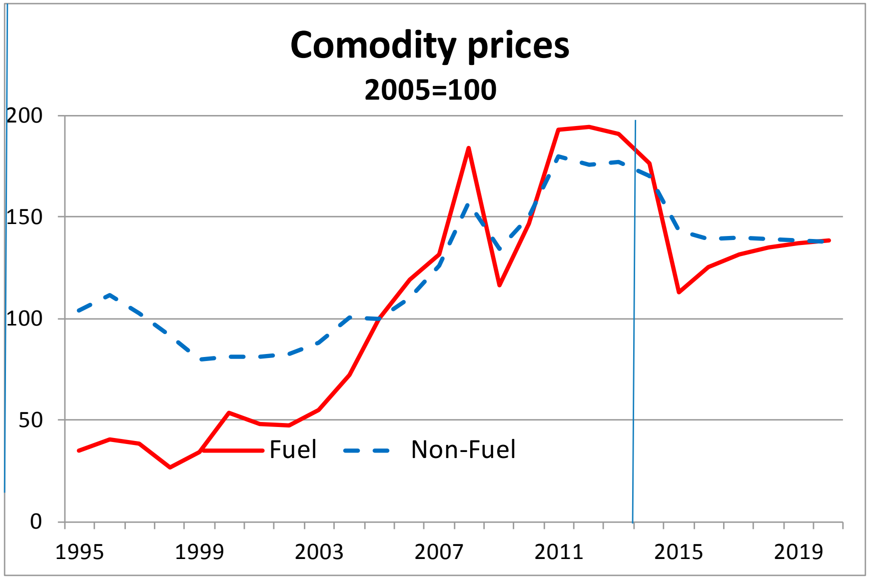
- US economy stronger than expected, but Euro area remains weak and China slowing down.
- Global growth projected to accelerate, but more slowly than expected.
- Growth projections keep being reduced.

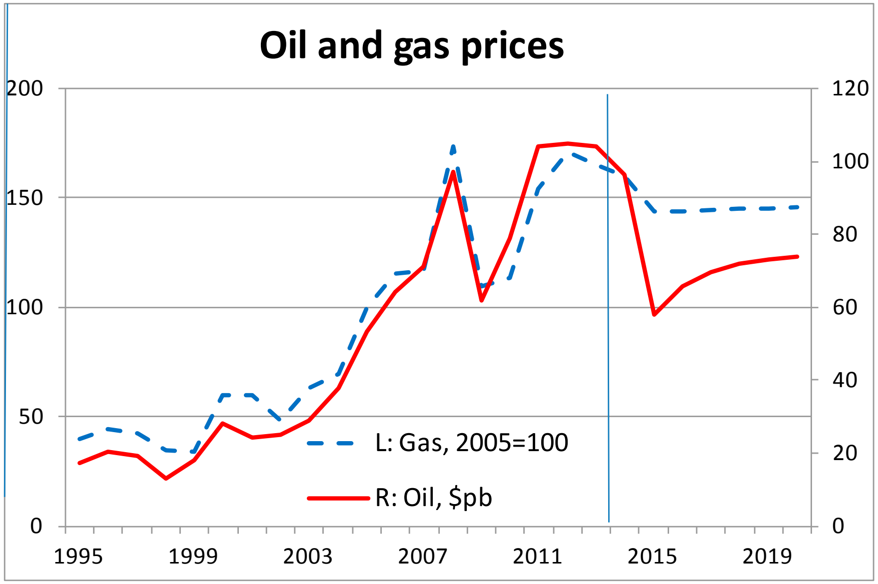


World real GDP growth projections			
	2014	2015	2016
Apr-13	4.0		
Oct-13	3.6		
Apr-14	3.6	3.9	
Oct-14	3.3	3.8	
Jan-15	3.3	3.5	3.8

Pushing down commodity prices

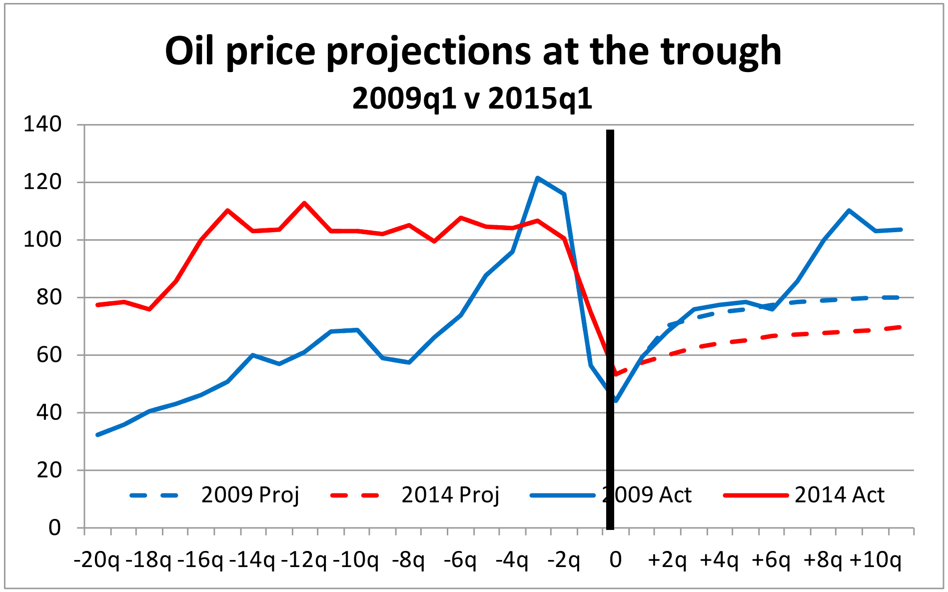
- ❑**Demand**: Slow global growth is pushing down commodity prices.
- ❑**Supply**: Fuel prices also affected by expansion of US fuel production and cycle of geopolitical tensions.
- ❑**Price**: Oil price (APSP) fell to $45 p/b. IMF projects $58 p/b in 2015 rising to around $75 p/b within the decade.





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.
- ❑What is the new normal?



Impact of lower oil price

Impact on exports and revenues

- ❑Oil price fall is foremost a shock to **external balance**: fall in 2015 export receipts by about $30 billion.

- ❑Also shock to **fiscal balance** because of lower oil revenues. Oil revenues in 2015 fall by around $20 billion - lower price and lower revenue/export share partially offset by higher oil output.

Estimated direct impact of oil price decline
Assuming 2014 oil production

	2014	2015				
	Est.	High	Middle	Low	OGE Rev	Change
Oil price, US$ bp	104	81	50	40	40	-64
Oil production, mbpd	1.66	1.66	1.66	1.66	1.83	0.2
Oil export receipts, US$bn	63	49	30	24	27	-36
Oil budget revenues, US$bn	31	23	12	8	9	-22
Oil revenues/exports, %	50	48	41	35	35	-15

Policy buffers

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

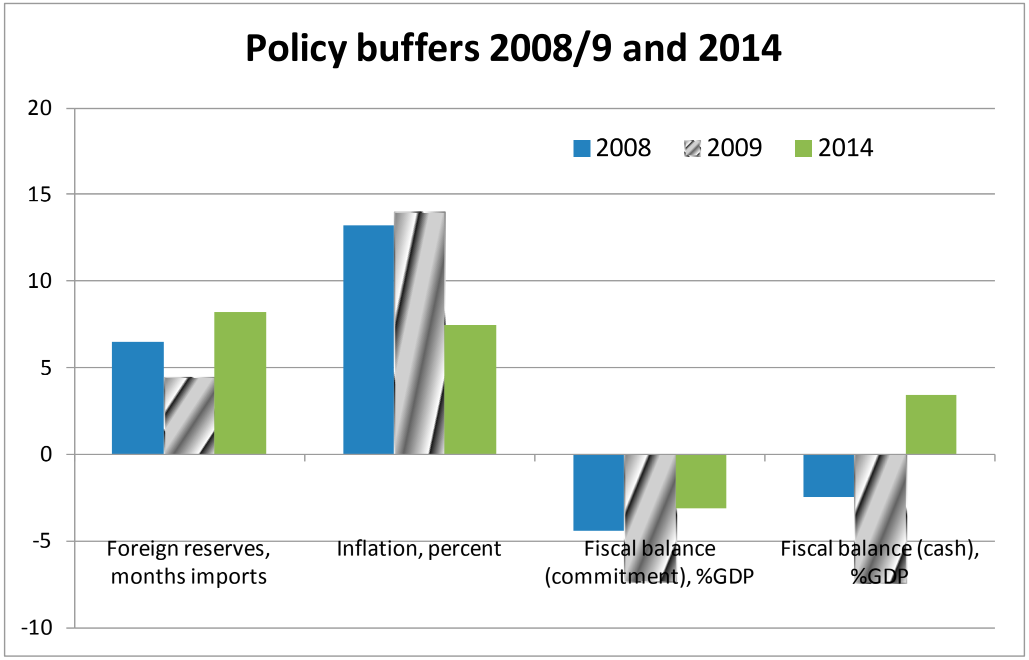
Policy buffers:

---Higher foreign reserves

---Lower inflation

---Stronger fiscal balance (commitment and cash basis)

Policy coordination: Stronger and faster response than in 2009. Adjustment plan took 3 months in 2014/05 versus one year in 2008/09.



Policy options

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

External imbalance: cut foreign exchange demand by:

- Price adjustment: depreciate FX rate and raise interest rates.
- Demand adjustment: cut fiscal spending or raise taxes to suppress import demand.

Fiscal imbalance: restrain deficit by:

- Lower spending and higher taxes.
- Adjustment constrained by availability of deficit financing.
- Impact of 'austerity' on economic activity.

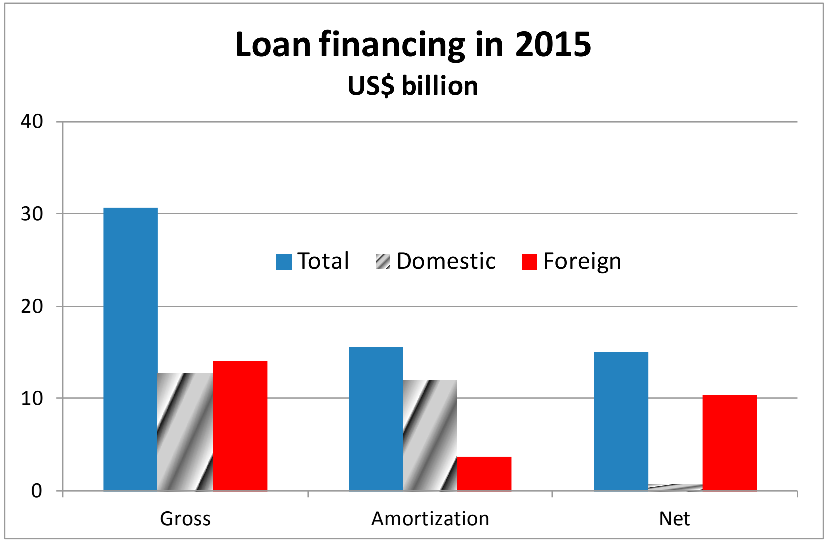
What is the residual adjustment?

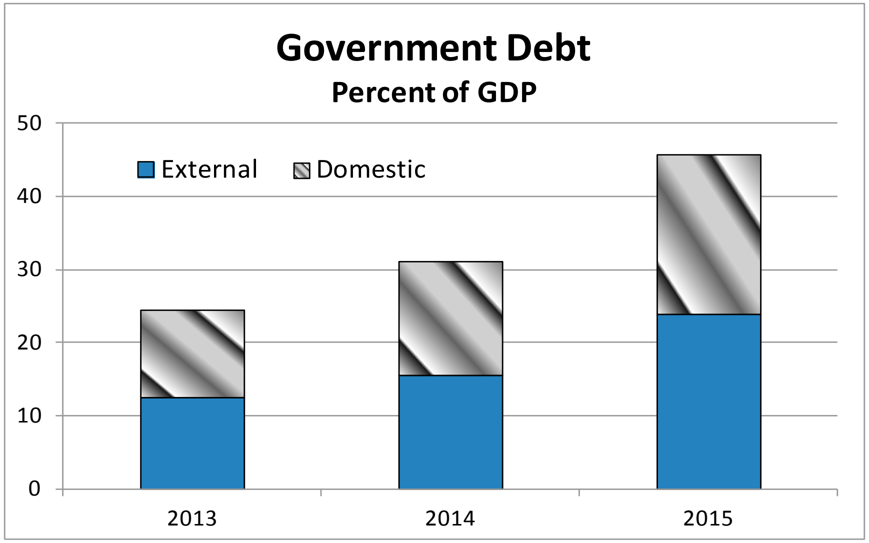
- **External**: restricted access to FX
- **Fiscal**: delayed payments.

Fiscal impact

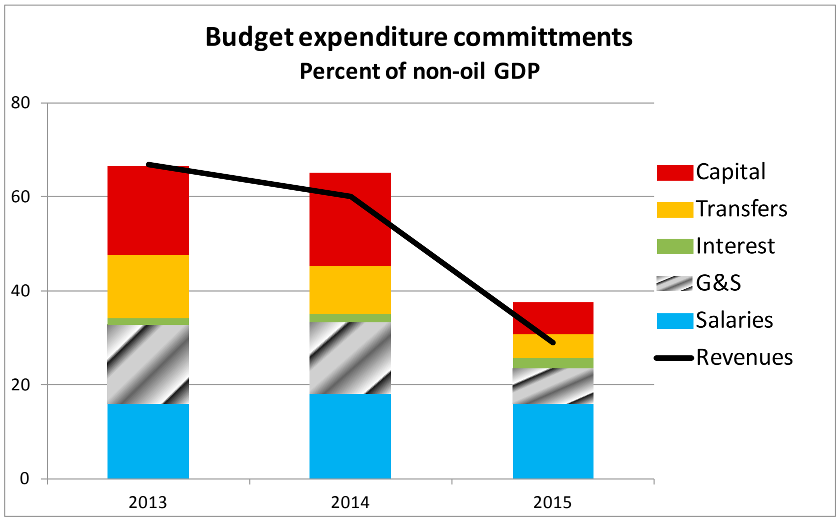
Fiscal adjustment to repress imports and adjust to financing constraints.

- Delayed payments already evident.
- Fiscal deficit would be over 20 percent of GDP without adjustment. OGE brings it down to 7 percent of GDP.
- 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.





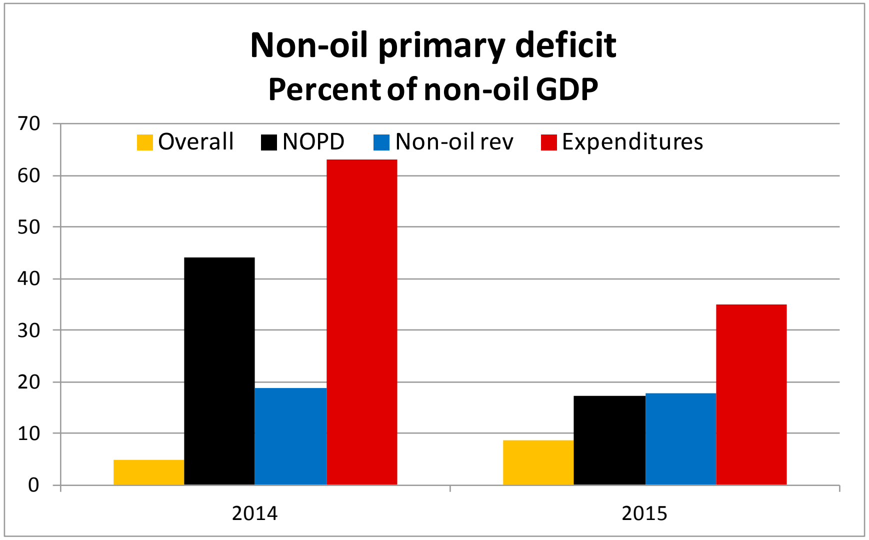
Fiscal adjustment



Spending in 2015 is ¼ lower than 2014 – ⅓ lower in real terms or as % of NOGDP.

- Stronger revenue effort. Non-oil revenues 12% of GDP in 2014 rising to 14% in 2015. Compared to 20+% for SSA.
- Lower spending on salaries plus G&S.
- Eliminating subsidies: fuel subsidies costly, regressive, and inefficient. Move to reduce SOE subsidies (electricity).
- Much lower capital spending: need higher efficiency. This will test budget discipline.

Fiscal contraction



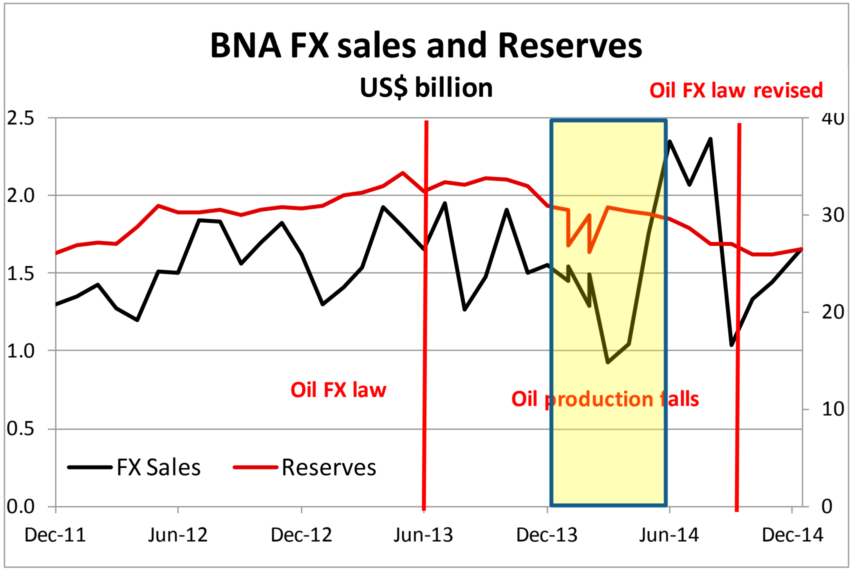
The fiscal adjustment implies large fiscal contraction.

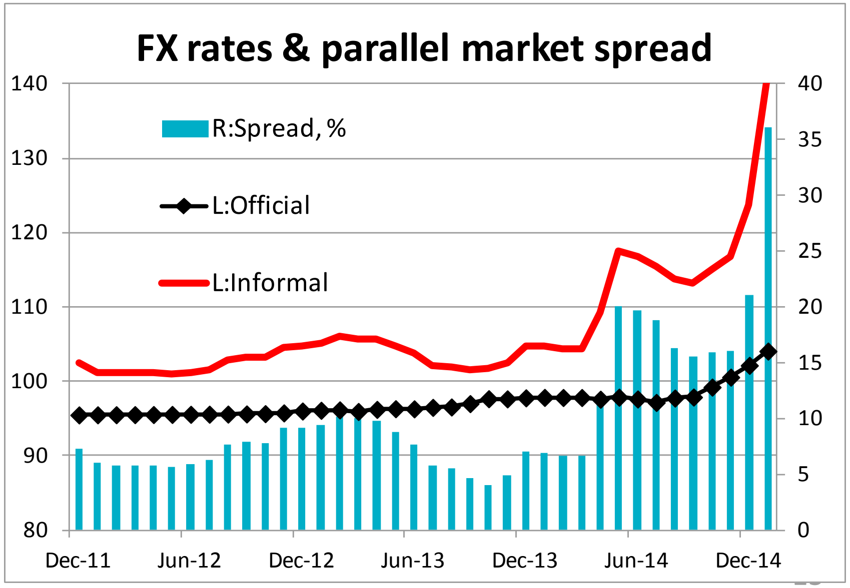
- Higher **overall deficit** (total revenues minus spending) normally associated with expansionary fiscal policy. But this is because of lower oil revenues.

- Non-oil deficit (non-oil revenues minus spending) is better measure of **discretionary fiscal policy**. This deficit declines from 44 to 17 percent of NOGDP because of lower spending, implying large fiscal contraction.

Impact on FX market

- ➢BNA dominates FX market following November revision to oil FX rules.
- ➢ FX shortages evident: FX rationing and wide informal market spread.
- ➢Foreign reserves around US$26 bn, down from US$33 bn in late 2013.
- ➢FX depreciated 12 percent since September.





External adjustment

Large fiscal adjustment signals that much of the import repression will come from fiscal contraction rather than FX adjustment.

- OGE aims to maintain **foreign reserves** around US$20 billion – around 5-6 months of imports.

- FX depreciation constrained by **concerns for inflation.** Also concerns about impact on fiscal costs and banks' balance sheets.

- Policy of **gradual FX depreciation** calibrated to evolving market conditions. Need to avoid large destabilizing step depreciation.

- Meanwhile, **administrative measures** such as restricting access to FX to priority imports and use of import quotas.

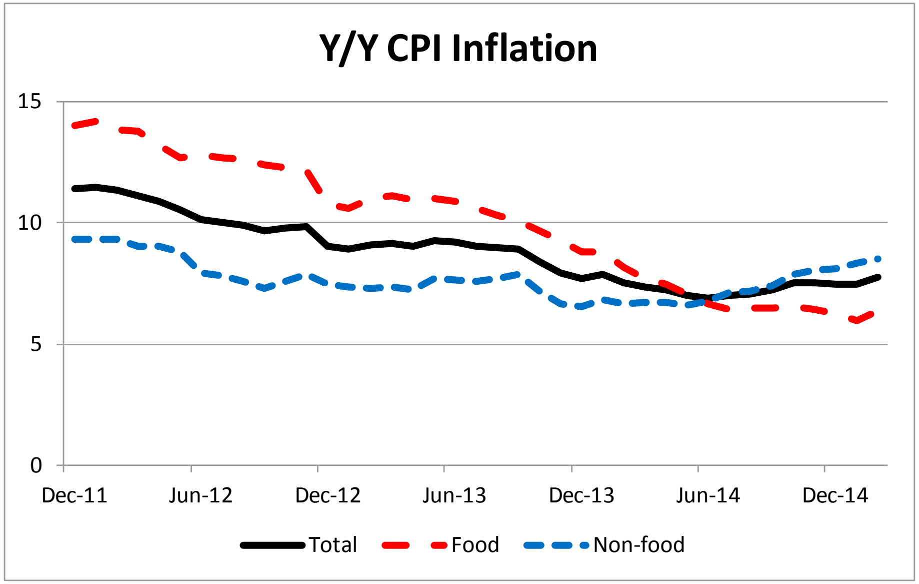
Inflation

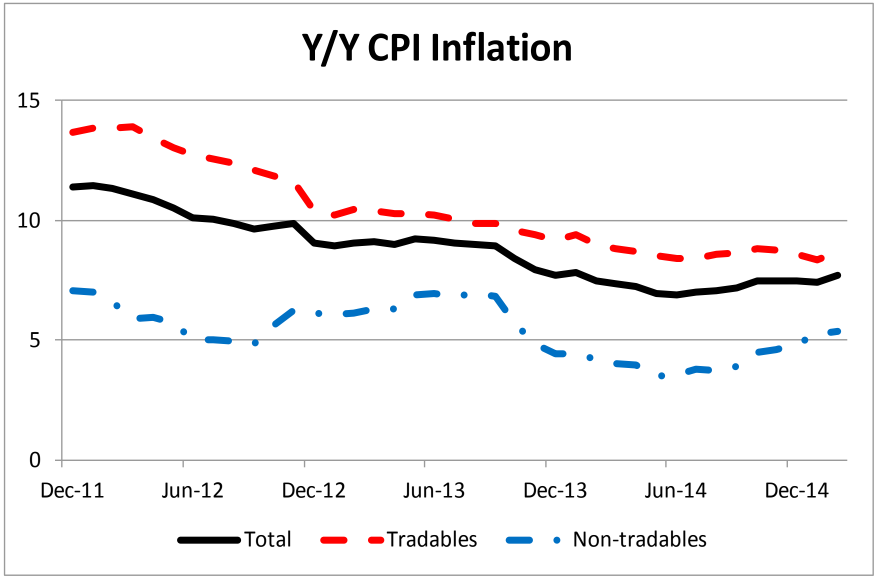
➢**Inflation is key policy objective**.

➢**Inflation bottomed out and rising again** – because of non-food and non-tradables.

➢**Inflation faces offsetting pressures**: (i) low international inflation and falling commodity prices, including food; (ii) appreciation of USD v Euro and of AKZ v Euro & rand; (iii) weakening domestic demand because of oil price shock and fiscal contraction.

➢**OGE target** of 9 percent inflation is doable.





Medium-term challenges

Economic growth

Real GDP

- ❑Ambitious OGE growth projections
- ❑Oil sector: OGE 1.83 mbpd & 9.8% real GDP growth doable but ambitious
- ❑Non-oil sector: OGE 5.3% real GDP growth ambitious: sector hit by lower oil-sector spending, fiscal contraction and supply import constraints.

Nominal GDP

- ❑OGE projects flat nominal GDP. Decline more likely.
- ❑Nominal oil GDP falls by ½ because of oil price.
- ❑Nominal non-oil GDP unlikely to grow by ⅓, unless inflation rises.

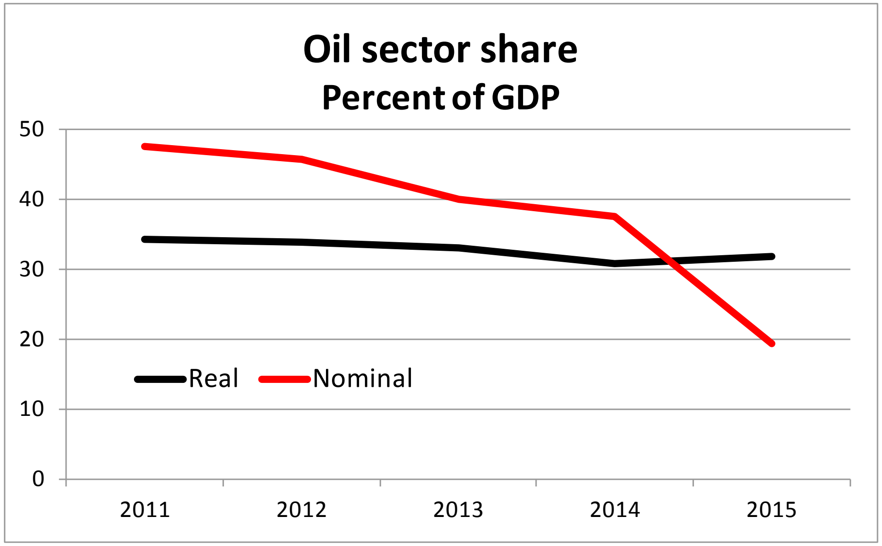
	Real GDP		Nominal GDP		
	2015 %chg		2014	2015	%chg
Total	6.6		11,495	11,535	0
Oil	9.8		4,304	2,230	-48
Non-oil	5.3		7,191	9,304	29

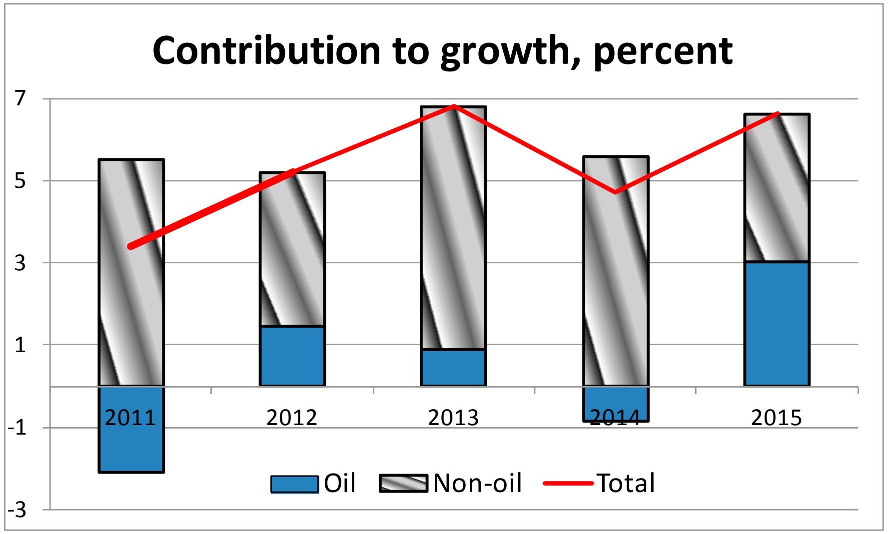
GDP trends

❑**Economy is diversifying**. Oil sector remains about ⅓ of real GDP, but is a declining share of nominal GDP – down to ⅕ in 2015.

❑**Economy still reliant on oil**: The oil sector not the main source of growth, but remains the dominant source of export receipts and budget revenues.

❑**BUT** oil sector source of financing is declining relative to the economy.

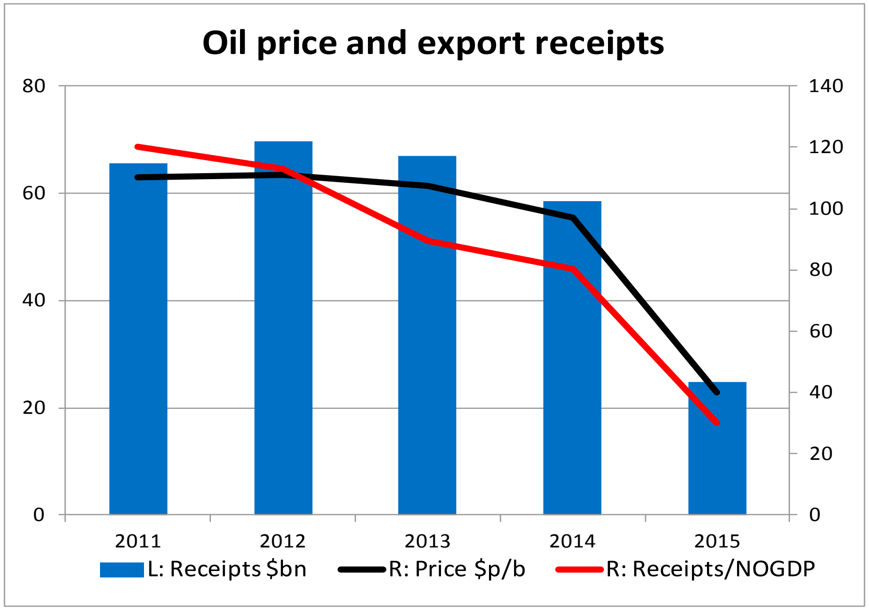


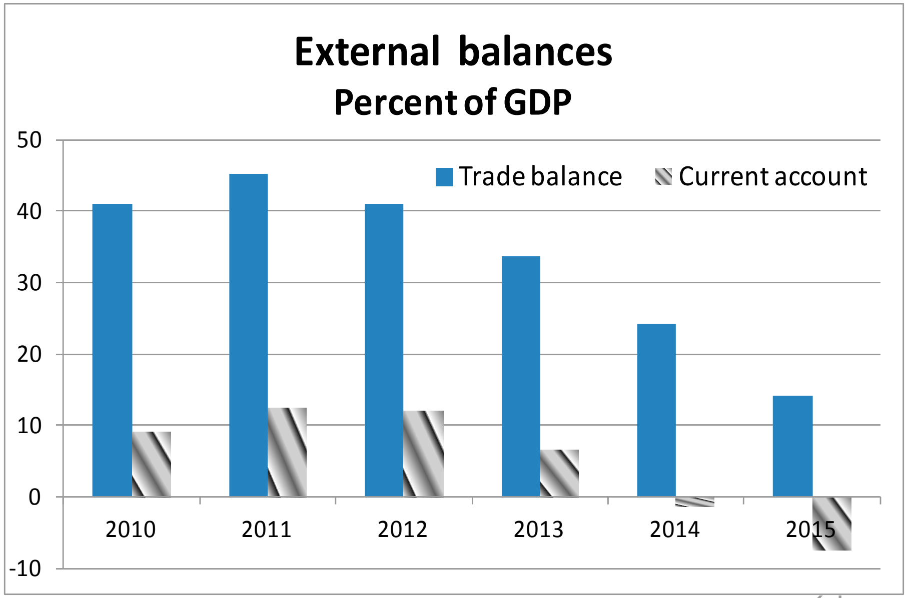


BoP trends

Oil shock accentuates trend BoP squeeze

- ❑**Trend deterioration in trade and current account balances** due to lower oil export receipts relative to NOGDP. Trend accentuated by oil shock. Large external deficit in 2015.
- ❑**FX rate already 15% overvalued** in mid-2014 - accentuated by oil shock.

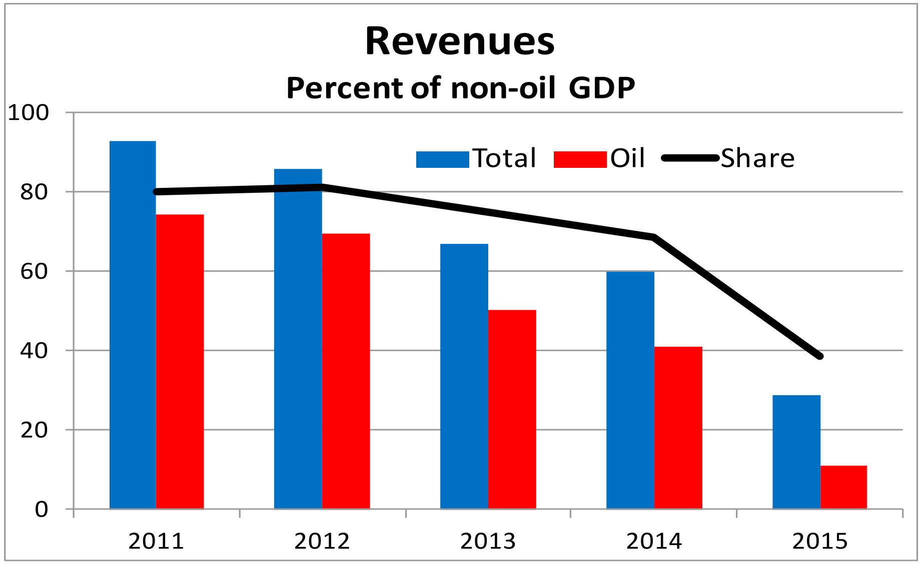


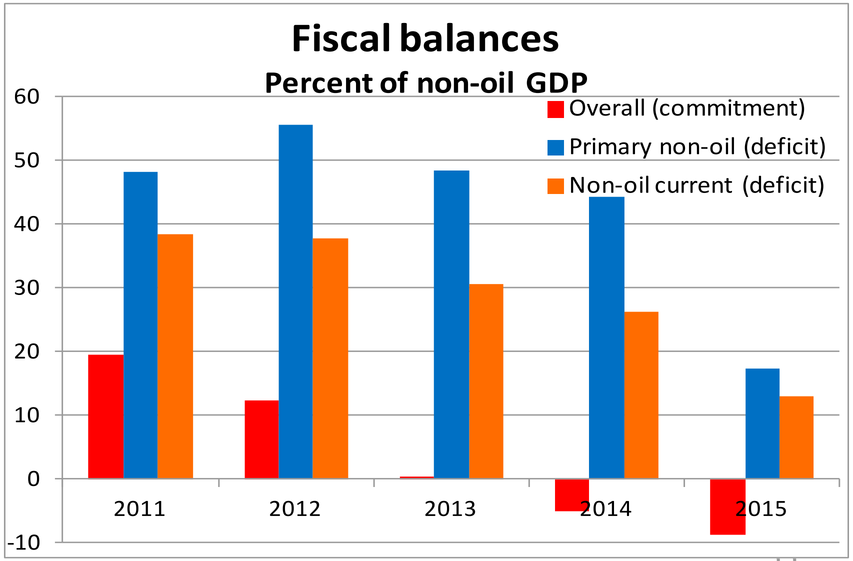


Fiscal trends

Trend fiscal deterioration despite fiscal effort due to lower oil revenue.

- **Trend fiscal deterioration** due to decline in total revenues relative to NOGDP – due to lower oil share of total revenues and relative to NOGDP.
- **Stronger non-oil revenue effort** needed to mobilize domestic resources.
- **Despite** tighter discretionary policy stance (lower non-oil primary deficit) lower discretionary budget dis-savings (lower non-oil current deficit).

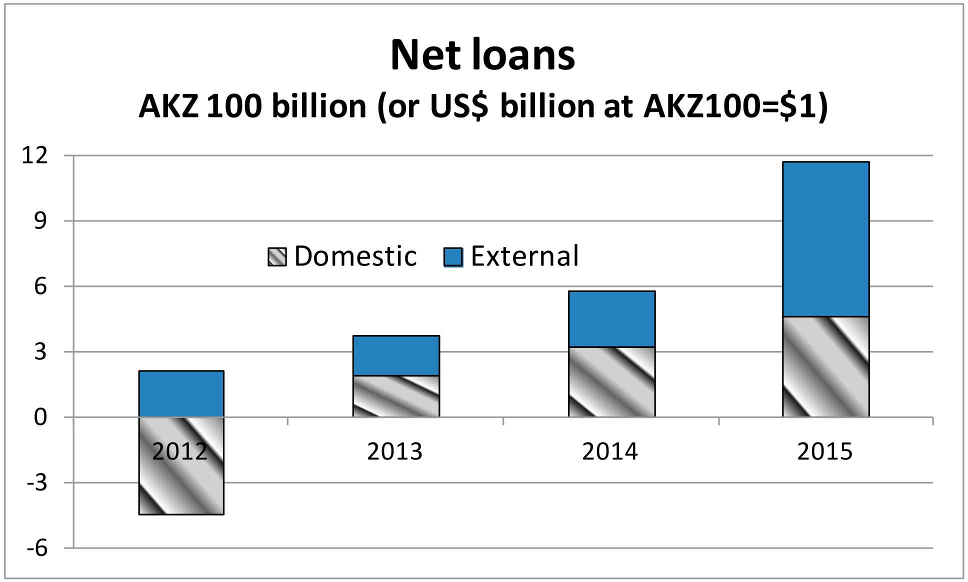


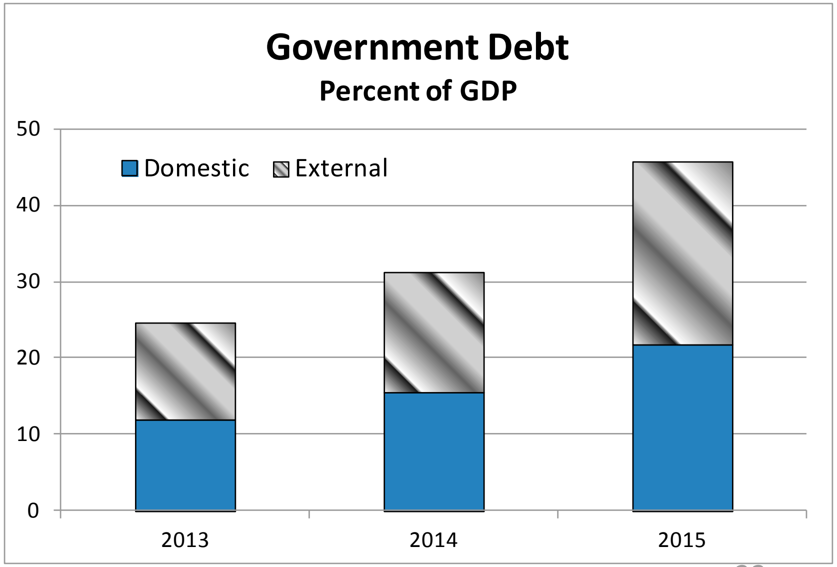


Shift from oil to loan financing

Angola shifting from using oil resources towards debt financing.

- ❑Trend fiscal deterioration reflected in higher borrowing and debt.
- ❑Debt levels currently sustainable, but not if high deficits continue.
- ❑Need to mobilize domestic revenue resources and ensure high growth payoff from costly public investment.





Medium-term policy objectives

Angola is not rich
It is a post-conflict country but is rapidly extracting its finite 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 investment. Need for social income transfers

Need for medium-term fiscal framework, esp. to guide oil revenue management

Thank you