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FLASH NOTE
Nº 2.2024 | 09 January 2024

2024 Budget will imply reduced investment spending

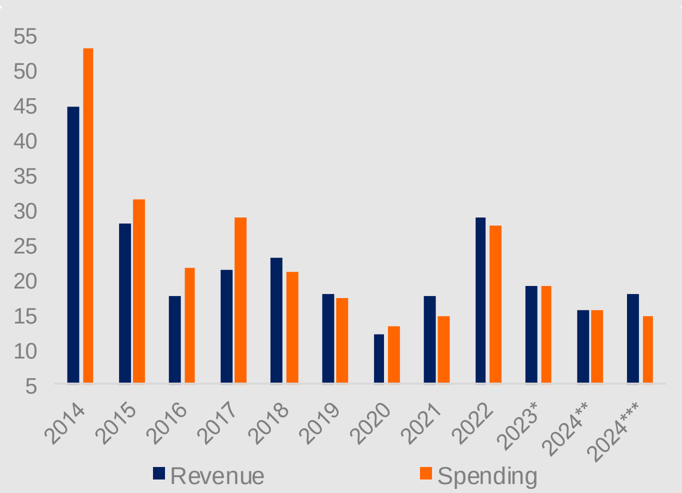
Budget surplus will be a necessity given less external financing

A. DESCRIPTION

1| The State Budget for 2024, approved by the National Assembly on December 13, foresees budget revenues of AOA 14.7 trillion (T) and budgeted expenditures of AOA 14.7T. If fulfilled, it will be a repeat of the scenario expected this year, in which the balance should end close to zero; It should be noted that, excluding 2020, the year the pandemic began, the budget accounts have been in surplus since 2018.

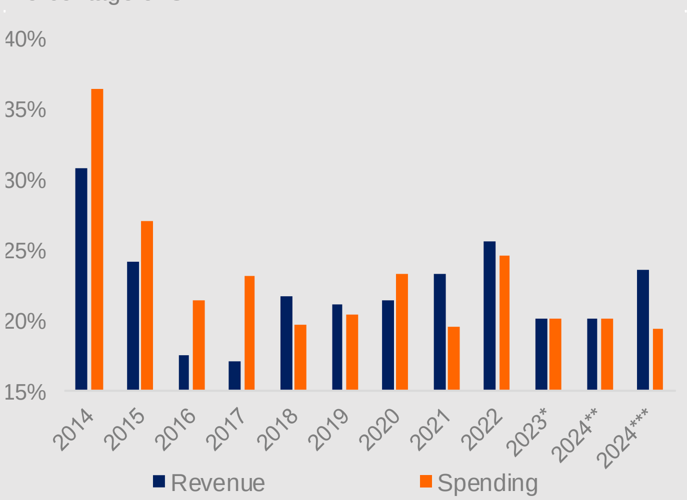
2| In general, the 2024 Budget forecasts a fiscal balance near zero, maintaining some prudence in the year, looking only at fiscal revenues and expenditures. On our end, we expect a surplus of between AOA 3.0-3.6T, resulting from a higher Brent price and oil production levels, combined with a continued constraint on the financing situation that will mean that this revenue slack does not translate into a slack in spending.

As measured in Dollars, revenue is expected to decline slightly in 2023



*Estimate **Budget ***BFA Sources: Fin. Min., BFA calc.

In percentage of GDP, revenue should decreasce in 2023 compared to last year



*Estimate **Budget ***BFA Sources: Fin. Min., BFA calc.

Box 1 – Budget execution in 2023 needed a brake on expenditure.

1| In 2023, the General State Budget foresaw budget revenues of AOA 13.5 trillion (T) and budgeted expenditures of AOA 12.9T. On the oil tax revenue side, a drop compared to 2022 of 6.6% to AOA 7.2T was expected. These expectations were based on the price of Brent being around USD 75 and an average daily production of 1.18 million barrels per day (mbd). On the side of the non-oil tax revenue for 2023, the State Budget forecast an increase of 6.6% to AOA 4.9T. According to preliminary data published by Minfin, revenue execution will have been significantly lower than initially estimated.

Total revenue will have been around AOA 12.6T, below the Government's expectation (-0.8T) and our own expectation (-1.5T); the AOA expenditure was 0.2T lower than expected, settling at AOA 12.7T – also, AOA 0.3T below our expectation. However, these seemingly simple variations do not fully explain the scenario. In fact, the depreciation that occurred in the middle of the year influenced all fiscal variables. On the petroleum tax side, lower-than-expected production led to lower revenues, but depreciation led to an appreciation of these revenues when evaluated in Kwanzas, bringing the revenue collected (AOA 7.5T) very close to our initial forecast (AOA 7.8T); with regard to other revenues, they were greatly affected by the economic downturn: the collection of non-petroleum taxes was only AOA 4.3T (compared to AOA 4.8T expected), while other current revenues were only AOA 0.5T (compared to AOA 1.1T expected). At the same time, external interest payments were AOA 1.9T (compared to the expected 1.3T) and subsidy spending almost doubled compared to expected despite the start of the reform in fuel subsidies (AOA 1.9T compared to the expected 1.0T) – in both cases the increase was due to the impact of depreciation in values whose amount is calculated in Dollars. With these reductions in revenues and unwanted increases in some expenses, it was necessary to cut other expenses: spending on Goods & Services totaled AOA 1.8T (compared to AOA 2.8T forecast) and expenditure on Investment was AOA 2.4T (compared to AOA 3.1T forecast). The State's accounts will have had a budget balance close to zero, compared to an expected surplus of AOA 0.6T.

B. ANALYSIS

1| Our outlook on the 2024 budget year needs to be contextualized by explaining what happened in 2023.

Usually, looking at tax revenues and expenditures (excluding financing), the Angolan state has in practice a **fiscal deficit in Kwanzas** and a **fiscal surplus in Dollars**; that is, in Kwanzas, the State spends more than it receives, in Dollars it receives more than it spends.

In addition to these expenses and revenues, there is the financial balance, the income that comes from new debt, and the expense to pay back previous debts and the corresponding interest.

Financial revenues and expenditures in Kwanzas are added to the rest of the State's accounts, for management purposes: to a large extent, the revenue in new financing is through securities, and the State can apply these revenues wherever it sees fit. New debt can be used to pay off previous debts and interest, or to cover the fiscal deficit in Kwanzas.

However, the same is not true of the financial balance in foreign currency: most of the new financing in foreign currency is in loans for specific purposes for investment projects. That is, except for Eurobonds, IMF financing, and some World Bank financing instruments, the amounts in new external financing cannot be allocated to the payment of external public debt. **The payment of foreign debt depends mainly on the fiscal surplus in Dollars mentioned above, that is, on revenues from petroleum taxes and concessionaire rights.** Alternatively, it relies on Eurobond issuances, or direct financing to the treasury such as that of the IMF.

The remaining financing, being allocated to investment projects, is analyzed separately, serving only to cover most of the State's investment expenses; thus, we also assume that this majority of investment expenses does not have to be covered by revenues in Kwanzas, but is already covered by financing in Dollars.

In a scenario in which this total foreign currency balance is positive, there is an excess of Dollars to sell to the market by the Ministry of Finance, which finances part of the total deficit in Kwanzas.

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In the scenario between 2018 and 2022, there was a consistently positive total balance in Dollars, significantly, making the Treasury an important participant in the supply of foreign exchange to the market. This is no longer true as of March/April 2023: an increase in foreign repayments, a decrease in oil tax revenues, and almost no direct financing to the State's cash balance, led to the Treasury ceasing to sell foreign exchange, which is the main factor of imbalance in the foreign exchange market.

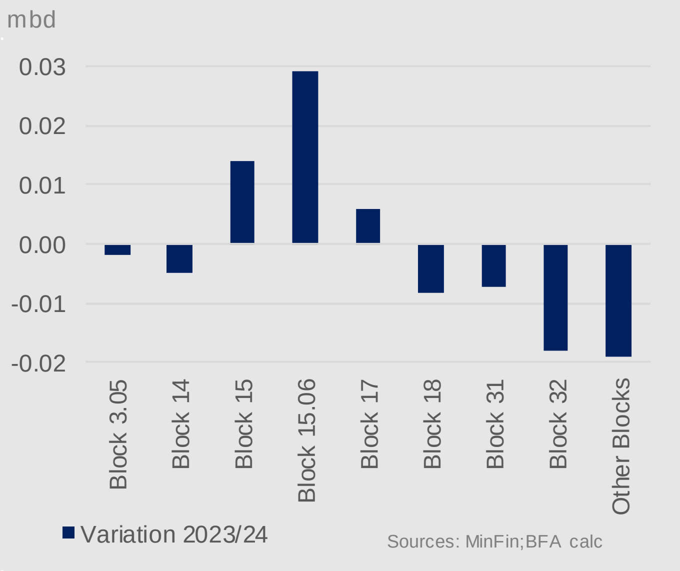
2| So let's look at the scenario in 2024, with this same lens of interpretation. We start by assuming some assumptions – our expectation for the price of Brent is more optimistic than that of the Government (average price of USD 76.9), still below the average market expectations, which are at this point at USD 85.8 according to the composite average of forecasts on the Bloomberg platform.

Regarding production volume, the Government's forecast for 2024 seems pessimistic to us, considering the data we have on some sources of new production that should occur next year. In Block 15, we expect some impact from the Redevelopment Plan, which started with a 1st well at the end of 2022, with an increase in production being possible with other steps in the plan, including the development of the Bavuca-Sul discovery in November 2022; in Block 15/06 some new

Forecast Scenario	Budget	Est. BFA
Hypotheses		
Oil price (USD)	65.0	77.0
Oil production (mbd)	1.06	1.12
GDP growth (%)	2.8	2.1
Forecasts		
AOA Billion		
Revenue	**14 710**	**18 283**
Oil taxes	7 859	11 273
Non-oil taxes	5 191	5 339
Expenditure	**14 689**	**14 989**
Budget Balance	**21**	**3 294**
as a % of GDP	0.0%	4.2%

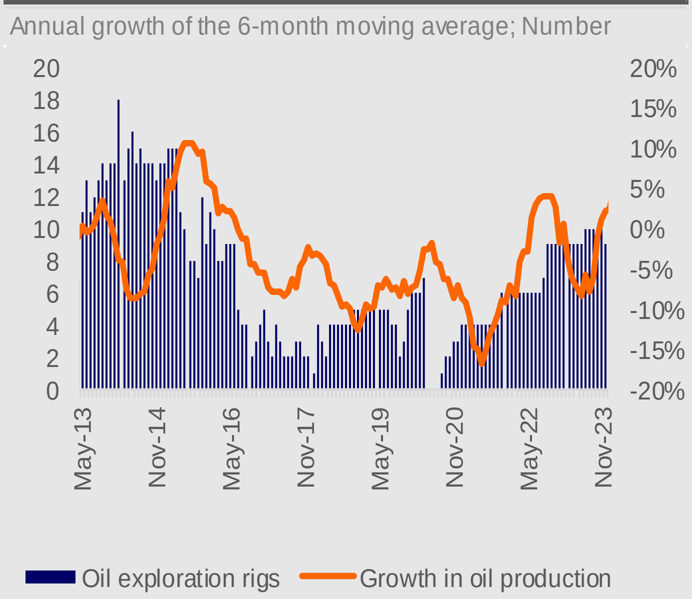
Source: Min. Fin.,BFA calc

Scenario will be balanced between increases and decreases in production in the blocks



Sources: MinFin;BFA calc

An increase in the number of rigs points to a possible increase in production in the future



State Budget (AOA Billion)	2023 Budget	2023 Execution	2024 Budget	2024 BFA est.	Change 2023/24 Budget	Change 2023/24 BFA
Revenue	**13 462**	**12 641**	**14 710**	**18 283**	**16.4%**	**44.6%**
Current Revenue	13 462	12 641	14 697	18 270	16.3%	44.5%
Taxes	11 999	11 855	13 050	16 613	10.1%	40.1%
Oil Taxes	7 196	7 544	7 859	11 273	4.2%	49.4%
Non-oil Taxes	4 804	4 311	5 191	5 339	20.4%	23.9%
Social Contributions	311	311	568	578	82.6%	86.0%
Donations	7	1	4	4	500.0%	500.0%
Other current revenue	1 145	475	1 075	1 075	126.4%	126.4%
Capital Revenue	0	0	13	13		
Expenditure	**12 902**	**12 691**	**14 689**	**14 989**	**15.7%**	**18.1%**
Current Expenditure	9 808	10 255	12 089	12 388	17.9%	20.8%
Wages	2 825	2 702	3 062	3 062	13.3%	13.3%
Goods & Services	2 885	1 787	2 659	2 260	48.8%	26.4%
Interest	2 441	3 272	4 555	4 810	39.2%	47.0%
External	1 296	1 901	2 806	3 060	47.5%	60.9%
Internal	1 145	1 370	1 750	1 750	27.7%	27.7%
Current Transfers	1 657	2 494	1 813	2 257	-27.3%	-9.5%
Capital Expenditure	3 094	2 436	2 600	2 600	6.7%	6.7%
Current Balance	**3 654**	**2 387**	**2 608**	**5 882**	**221**	**3495**
Primary Balance	3 001	3 222	4 576	8 104	1354	4882
in % of GDP	4.9%	5.1%	6.2%	10.4%	1.14	5.33
Non-oil Primary Balance	**-4 195**	**-4 322**	**-3 283**	**-3 169**	**1039**	**1153**
in % of non-oil GDP	-6.9%	-6.9%	-4.5%	-4.1%	2.37	2.77
Budget Balance	**560**	**-49**	**21**	**3 294**	**70**	**3 343**
in % of GDP	0.9%	-0.1%	0.0%	4.2%	0.11	4.32

Source: Min. Fin.,BFA calc

production of the Agogo West Hub development is also expected – the biggest impact is expected to be in 2025/26 with the entry of the new FPSO Agogo vessel, but for now there will be investments taking advantage of the FPSO Ngoma, which already operates in the area; finally, in Block 17 the impact of the new production due to the CLOV Phase 3 project is more certain, and some impact of the new Block 17/06 is also expected, with the Begonia field, also using some existing infrastructures in Block 17. It is also possible that 2024 will benefit from some impact from investments at the end of 2023 in Block 0, but the information is more uncertain. Thus, our average production expectation in 2024 is close to 1.11mbd, which compares with the 1.06 forecast by the 2024 State Budget.

3| As for the Government's macroeconomic scenario, it anticipates economic growth only on the non-oil side. As we said, in the non-oil economy, the Government expects an increase in activity of 4.6% (a very significant acceleration compared to growth in 2023), which contrasts with the slower pace expected by us, a growth between 2.4%-2.9%; The more pessimistic outlook we assume derives from the impact on the expectations of economic agents of the current environment in the foreign exchange market, with some impact of a new slight adjustment during the 1st quarter of the year, which we will explain below.

In the case of the oil economy, the Executive expects a decrease of 2.5% in activity; Our outlook is for growth and is directly related to the differences in the production volume forecast: we expect a slight growth between 0.3%-0.8%.

For the economy, the State Budget assumes a growth of 2.8%, while the BFA expects an increase in activity between 1.9%-2.4%.

4| Considering these assumptions, and our expectation for the foreign exchange market, we then look at the cash balance in foreign currency. Note that this is an exercise that is not entirely accurate, as access to some information is limited. Still, we think it allows us to draw several interesting conclusions.

Valued in USD, we estimate the expenses on amortizations and interest on external debt at close to USD 8.9B. At the same time, we estimate oil tax revenues (including concessionaire rights) to be close to USD 11.1B. As external financing revenues not allocated to investment projects, we safely have only USD 0.5B from the World Bank, the 2nd of 2 tranches of the budget support program. That is, a total revenue of USD 11.6B, and a total positive balance of USD 2.6B. This balance serves: to finance the total deficit in Kwanzas, with the Treasury selling Dollars in the foreign exchange market; or for necessary expenditures on goods & services purchased abroad.

It should be noted, for context, that in the unlikely scenario that the Treasury were to sell all this USD 2.6B in the market, it would be lower than the one sold in 2021 (USD 3.1B) and much lower than the one sold in 2022 (USD 5.3B).

5| In Kwanzas, looking at the fiscal balance, we add up, as expenses, all expenditure on Salaries, Goods & Services and Transfers, as well as a minority of expenditure on Investment (15%, since it is common for many of the projects to assume some payments borne by the State). In the case of Transfers, we expect a higher amount than the Executive – the costs are in AOA but valued in USD, and we expect a higher depreciation than what is implied in the 2024 State Budget; On the other hand, we have only assumed part of the reform planned for 2024. In total, AOA is 8.0T in budget expenditure, excluding interest and 85% of investment expenditure. On the revenue side, we have AOA 7.0T in non-oil revenues. This results in a deficit of AOA 1.0T.

We add the needs for amortizations, interest and capitalizations, for a total of AOA 6.2B. They remain uncovered AOA 7.2T. Part of it would be covered by AOA 2.7B, which corresponds to a positive balance of USD 2.6B, when sold in the foreign exchange market. That leaves AOA 4.5T that will have to be financed in the domestic debt market, only slightly above the AOA 3.8T provided for in the 2024 State Budget.

It should be noted that this scenario assumes that much of the new foreign currency funding will not occur. While the 2024 State Budget expects new external debt totaling USD 6.6 million, on our side we expect that there will be just enough to finance 85% of investment spending (USD 2.2B), together with USD 0.5B from the World Bank for treasury financing and an amount of around USD 1.5B for other project financing whose expenses are executed directly by the financing entities. such as the World Bank and other similar institutions; In other words, the new disbursements could total around USD 4.2B, which would mean a further decrease in the external public debt, around USD 1.8B. In the first 3 quarters of 2023, external public debt has already fallen by USD 2.7B.

This is, in practice, a scenario with a relevant gap in the budget balance, which we estimate between 4.0%-4.5%, but which is not, in practice, the result of the Executive's choice, but

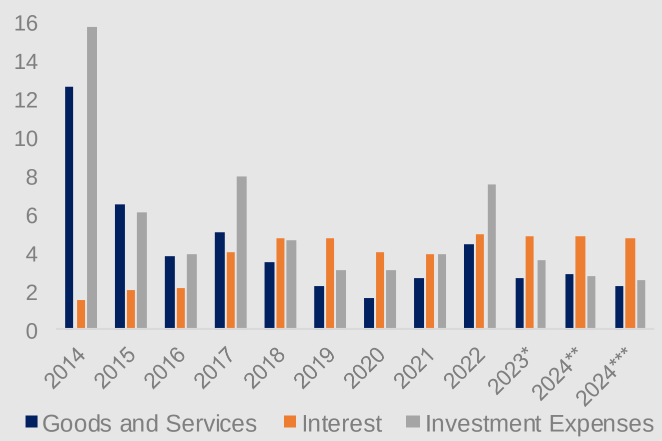
rather the result of the lack of access to the markets for external debt, which is forcing the country to pay the external public debt faster than desirable by the authorities. We say that it is faster than desirable because it requires a rather abrupt level of fiscal consolidation, and with less margin than desirable.

Without access to more financing (in international bond markets, or through the IMF), the Angolan state will need to carry out much of the reform of fuel subsidies and/or maintain restrictions on spending on Goods & Services. The alternative would be even more indebtedness in the domestic market but given the commitment so far to a significant decline in public debt yields in the medium term, it seems to us that the Treasury, to a large extent, will not opt for this path.

6| Thus, total revenues are estimated at AOA 14.7T by the executive, corresponding to a year-on-year increase of 16.4% (in line with the inflation expected by the Executive, of 15.6% at the end of the period). By our calculations, we estimate a higher level of revenue, around AOA 18.3T, essentially due to higher oil tax collection, explained by higher Brent than the Executive expects, higher production level and a more depreciated exchange rate than expected – the exchange rate that we estimate to be implicit in the 2023 State Budget is close to USD/AOA 920-930.

Public investment is expected to be the lowest ever, when measured in dollars

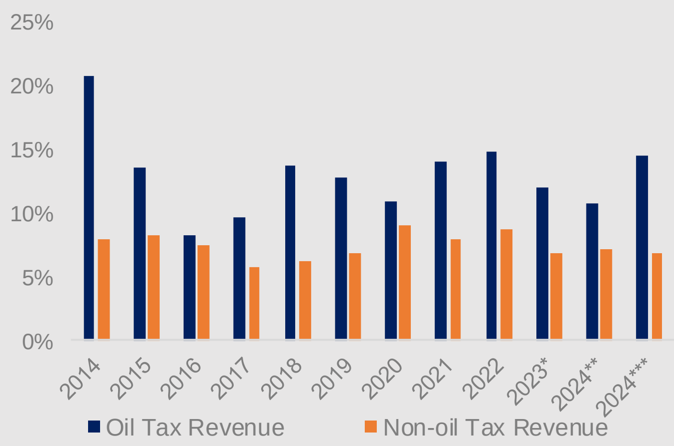
USD Billion



*Estimate **Budget ***BFA Sources: Min. Fin.,BFA calc

As a percentage of GDP, oil revenues are expected to grow again

Percentage of GDP



*Estimate **OGE ***BFA Sources: Min. Fin.,BFA calc

7| On the expenditure side, the Government foresees an increase of 15.7% to AOA 14.7B; representing 20.1% of GDP. Our estimate of expenditure is slightly higher than the executive's, at around AOA 15.0T. Excluding interest, primary expenditure will grow by 7.6%, below the inflation assumed by the State Budget – that is, expenditure will fall in real terms.

8| Within the various components of expenditure, the largest increase will be in goods and services, while current transfers are expected to record the largest decrease. In the case of purchases of goods and services, the increase is 48.8% - as a percentage of GDP, it would be 3.6%, slightly above the average of 3.2% recorded since 2018. In our forecast, the constraints explained above will imply a containment of these expenditures closer to AOA 2.3T. Current transfers are expected to fall by 27.3% to AOA 1.8T and this drop signals a continuation of fuel subsidy reform. As explained above, in our perspective these expenses will be higher – we estimate a total of AOA 2.3T in transfers.

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Spending on employee compensation is expected to rise about 13.3%, according to the State Budget. According to the 2024 State Budget itself, there will be a 5% increase in the remuneration of civil servants, which means that this forecast of an increase in spending above this amount is consistent with the hiring of more civil servants, which according to the document, should be concentrated in the Health and Education sectors.

9| With regard to investment spending, the Government forecasts an increase of 6.7% compared to the 2022 budget execution. In U.S. dollars, the amount to be disbursed in investment should represent about USD 2.6 million. As a percentage of GDP, investment stands at around 3.6%, an all-time low since at least 2010.

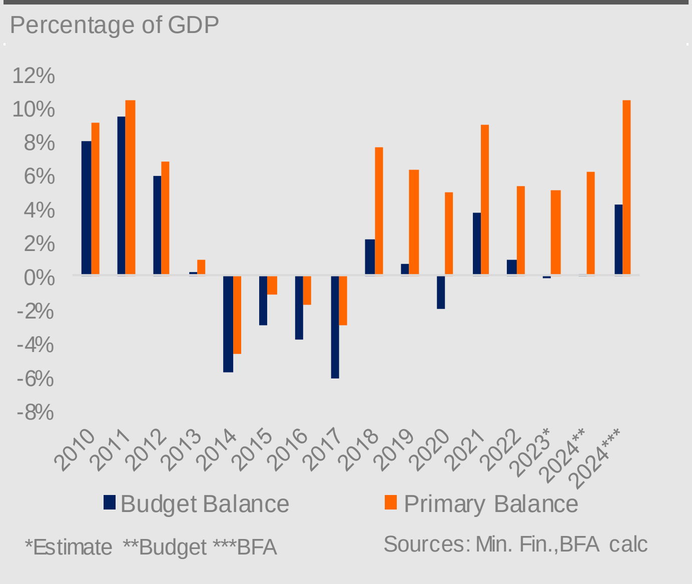
10| Finally, interest expenses are expected to increase by about 39.2 percent, mainly due to a 47.5 percent increase in interest expenses owed abroad. As a percentage of GDP, it will be 6.2% according to the 2024 State Budget, the highest value since the 7.0% recorded in 2020.

11| Thus, the Executive forecasts a zero-budget balance, 0.0% of GDP, while the BFA forecasts a positive budget balance, between 4.0%-4.5% of GDP. We remind you of what we explained above: although it seems like a loose execution, it is not due to the difficulty in obtaining external financing.

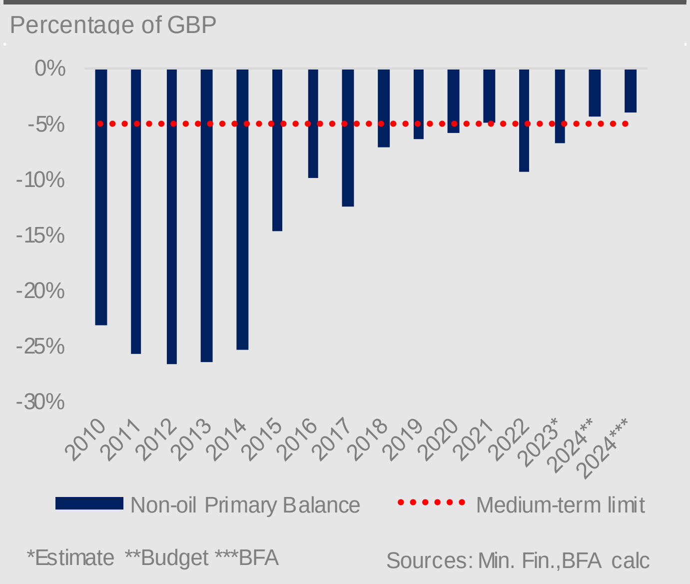
12| If there is more financing (an IMF financial package, significantly higher oil prices, improved market access conditions that would allow the issuance of Eurobonds), it is possible to assume a scenario with more Treasury sales to the foreign exchange market, which would mean a more supported exchange rate, and possibly more government spending on Goods & Services, or even slower progress on fuel price reform. In the most likely scenario, there will be no such slack.

13| On the other hand, if the price of oil materializes at the level predicted by the Executive, the calculations we made above are tighter, and will imply a combination of more spending cuts in Goods & Services, more debt issuances in the domestic market (leading to more significant increases in public

Primary balance will remain positive and reach 2011 highs



Non-oil primary balance will remain in deficit, but slightly above the medium-term limit



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debt yields); at the same time, they will put even more pressure on the exchange rate, by reducing the slack that the State will have to sell dollars in the foreign exchange market.

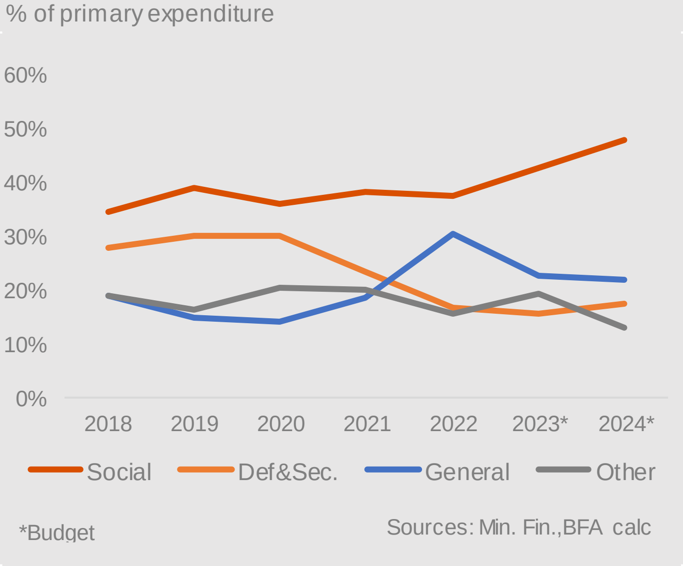
As an alternative, it cannot be ruled out that the Angolan state will show a new openness to talks with the IMF. And given the current path of de-indebtedness externally, the sufficient fulfilment of the previous programme, and the close relations with the Bretton Woods institutions, our expectation is that the Washington-based institution would also be open to this possibility.

14| Looking at the primary balance (which excludes interest expenses), the Executive anticipates a surplus of 6.2% of GDP, representing an increase of 2.4pp compared to 2023 values; BFA estimates that the primary balance will be between 10.2%-10.7% – since 2018 the Executive has presented consecutive positive primary balances, something that did not occur between 2014-2017.

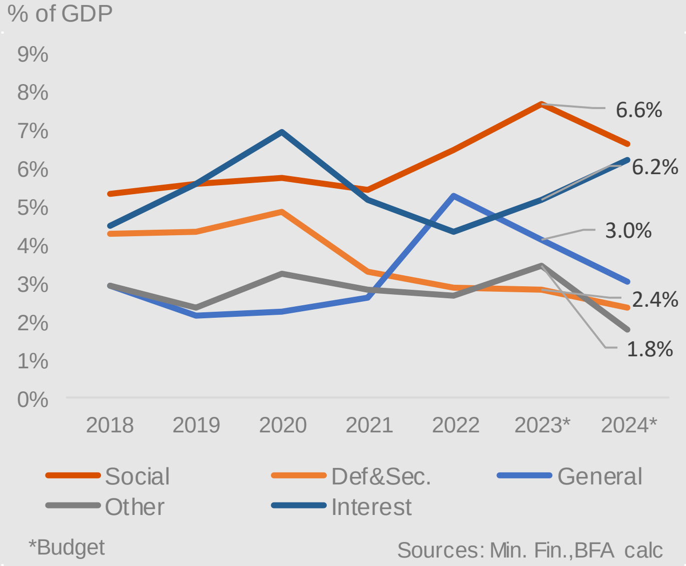
15| In the case of the non-oil Primary Balance, the Government expects it to improve to -4.5% of GDP, compared to -6.9% this year. BFA expects a possibly better non-oil primary balance, between -4.3% and -3.8%. It would be the first year in which the Angolan government would comply with the medium-term fiscal anchor, the 5% limit for the non-oil primary balance.

16| With regard to expenditure by sector, the State expects to spend much less on the set that encompasses Economic Affairs, Environmental Protection and Culture, and less on General Expenditure. In the first case, expenditure falls by 37.5% compared to what had been budgeted in the previous year (representing 13.1% of primary expenditure), and in the second case it is a decrease of 11.8% compared to what was budgeted for 2023, with general expenditure representing 21.9% of total primary expenditure. On the other hand, social expenditure (Education, Health, Social Protection, Housing) will concentrate, according to the 2024 State Budget, 47.9% of primary expenditure, a maximum since at least 2018, when it totaled 41.9% of expenditure – it is expected to grow by 3.4% compared to the budgeted in 2023.

Excluding financial expenditures, the share of social expenditure has increased slightly



Interest expenditures are once again conditioning the remaining expenditures on the functions of the State



Expenditure on Defense and Security will grow by 1.4% compared to the budget in 2023, representing 17.2% of total planned expenditure. Looking at expenditure as a percentage of GDP, and accounting for data from the State Account until 2021, the 2022 Provisional Execution, and the 2023 State Budget, spending on social expenditure falls by a the upward trend in recent years, falling from 7.7% of GDP forecast in 2023 to 6.6% forecast in 2024; all components of expenditure as a percentage of GDP are falling this year, with the exception of interest rates, which rise again from 5.2% to 6.2% of GDP. As we have reported in previous years, spending on Education and Health is insufficient when compared to other African economies that are investing more: the percentage in the 2024 State Budget for the sum of these 2 sectors is only 4.0% of GDP – in Namibia the levels are around 17-18%, while in Kenya and Rwanda, Levels are close to 10%. Thus, the need for expenditure reform, with accelerated debt repayment and reform of fuel subsidies, to free up resources to spend in these sectors, remains clear.

C. CONCLUSION

1| Although at first glance it points to a conservative budget, as has been the habit of the Ministry of Finance, the execution of the financial component leads us to take a very cautious perspective. In 2023, the unavailability of external resources to support external debt amortizations, together with a growth in these same needs, led to the absence of the Treasury in the foreign exchange market, which in turn greatly increased the need to resort to financing in Kwanzas. Nothing indicates to us that this scenario will be different, so it seems to us that it will be another year of difficult execution, with very tight control in spending, even with figures that point to a fiscal surplus.

2| It should be noted, however, that the scenario is also consistent with improvements in fiscal terms, which will come out of necessity in an environment of little availability for new financing to emerging economies. External public debt fell by almost USD 3 billion in the first 3 quarters of the year, and our calculations indicate that the same will happen next year. This will not only be the case if financing conditions improve considerably, allowing for new issuances on international markets, or if additional treasury support from multilateral institutions. In that case, we would have a smoother adjustment in fiscal policies and spending.

3| Our analysis points to a gradual increase in social sector spending in recent years, as a percentage of GDP and as a share of total expenditure, but interest spending has again constrained remaining expenditure for 2024. In fact, the decrease in interest spending, as a result of fiscal consolidation, and some restraint in spending on Defense & Security, allowed an increase in spending on Education, Health, Housing and Social Protection in previous years. Still, comparisons with other sub-Saharan countries whose development have been healthy and sustained show that current spending levels, measured as a percentage of the economy, are insufficient, and need to continue to rise. In this sense, it is imperative to reform the remaining expenditure, such as fuel subsidies, but also in areas such as Defense and Public Security.

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