



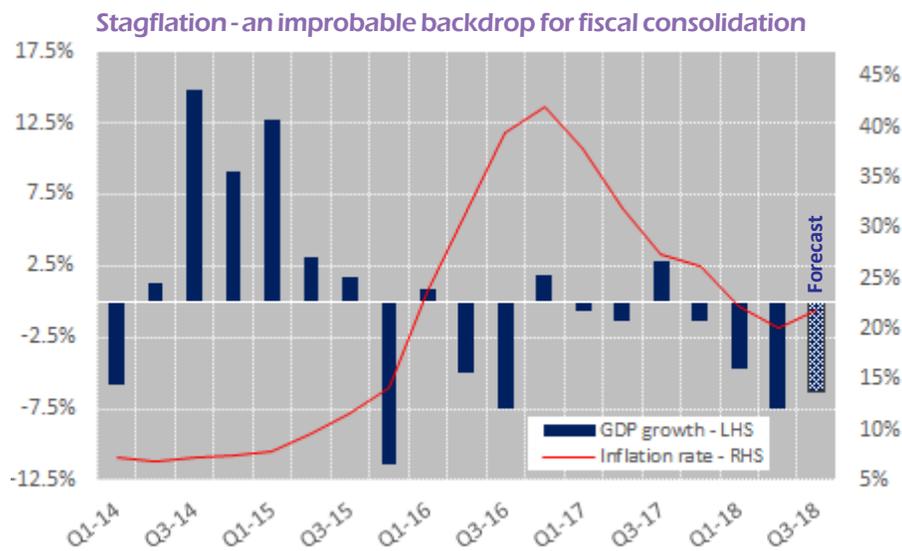
ANGOLA RESEARCH NOTE [REV]

### Inflation, growth and the fiscal consolidation effort - a bit of a puzzle

The shock inflation print reported for September has shone *an unwelcome spotlight on inconsistencies in the time-series.*

1) After inflation’s relative quiescence over the first eight months of the year, it was natural to assume that the sharp acceleration in September marked a delayed reaction to the Kwanza’s year-to-date depreciation of almost 40%. Instead, it turns out that fully **3.6% of the index’s 4.98%<sup>1</sup> monthly gain was attributable to a single item** in the CPI basket: a 450% spike in the water tariff<sup>2</sup>.

2) This means that there has still been no explanation for the **suspiciously disinflationary price trend reported through August<sup>3</sup>**. As will be recalled, the period was marked by consistently negative real interest rates as well as a major currency shock under whose weight **the economy contracted by a cumulative 6% during the first two quarters alone.**



3) Nevertheless, the steep hike in the water tariff does mark an important follow-through on the Lourenço administration’s pledge to reduce the generous– if poorly targeted - subsidies that have been a significant drag on the budget. This apparent **commitment to fiscal reform<sup>4</sup> would appear to bode well for Luanda’s ongoing programme negotiations** with the IMF.

<sup>1</sup> I.e. the highest monthly print since Aug. 2003, when annual inflation was running at 99.69%.

<sup>2</sup> This led to a 43.33% increase in the index’s *Housing, water, Electricity & Fuel* component.

<sup>3</sup> In a note last month, we expressed surprise at the fact that, given Angola’s high import-dependency, inflation could have decelerated by a cumulative 728 b.p. from its 26.26% level in Dec. 2017. At the time we noted, in particular:

- the pass-through effect of the 15% devaluation in Jan 2016, which triggered a CPI spike of 3.33% that month; and,
- the complaint voiced by a cross-section of local businesses surveyed by the Luanda daily *Expansão*, that sales had collapsed under the weight of the surge in prices since January, crippling the economy.

<sup>4</sup> On its face, such stagflationary conditions would seem to challenge the reports of an ongoing fiscal consolidation on the basis of which the authorities are now projecting a full-year deficit equivalent to 1% of GDP, down from 7.1% in 2017.

4) In the interim, even as the authorities strive to turn the page on 2017's the fiscal debacle, they will have to confront two additional budget challenges. First, the **unanticipated costs of combatting an emerging Zika outbreak** that has seen a total of 72 cases of microcephaly identified in the *favelas* of Luanda<sup>5</sup> since February (even though there has still been no official mention of this epidemiological cluster).

5) The second constraint relates to the **question of financing**. As recently as four weeks ago, the Angolan government sounded convinced that a new, **USD 11.25 billion credit line** from China was **a fait accompli** that would be formalized during J-Lo's working visit to Beijing in early October. Instead, he returned with **a total package of just USD 2 billion**, only a portion of which represents 'new money'<sup>6</sup>.

*In other words, in view of its enormous financing requirements over the next few years, Luanda now has **more riding on the early materialization of an IMF support programme** than ever.*

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<sup>5</sup> Yet there has still been no official mention of this disturbing cluster. It is also worth recalling that the same neighbourhoods formed the epicenter of the 2016/17 epidemic of yellow fever, a disease transmitted by the same species of mosquito (*Aedes aegypti*) as Zika.

<sup>6</sup> This is because an unspecified portion of the headline figure is earmarked for "regularizing Angola's position" with various Chinese creditors, viz.: '*Parte [dos 2 mil milhões de dólares que serão financiados pelo Governo da China] servirá para a regularização da dívida com os credores chineses*'. Remarks by finance minister Mangueira, as quoted in "*PR regressa de China com empréstimo de 2 mil milhões na bagagem*", by Novo Jornal, Oct. 10. 2018.

<sup>7</sup> The authorities have indicated that they are seeking a 3-year financing package of USD 4.5 billion under the Extended Financing Facility. Under the EFF's *Normal access* ceiling of 435% of quota, this is in fact the maximum available to Angola, whose quota is USD 1.03 billion.

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