International Monetary Fund

Angola and the IMF

Press Release:
IMF Executive Board Completes Sixth and Final Review Under Stand-By Arrangement with Angola and Approves Final US$ 132.9 Million Disbursement
March 28, 2012

Angola: Letter of Intent

March 14, 2012

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ANGOLA: LETTER OF INTENT

March 14, 2012

Madam Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street N.W.
Washington, D.C. 20431
USA

Dear Madam Lagarde:

1. **The Government's stabilization program, supported by the Stand-by Arrangement (SBA), has achieved its key objectives.** The economy has recovered from the severe disruptions linked to the collapse of world oil prices in late 2008: international reserves have been rebuilt, the fiscal position has improved sharply, all domestic arrears have been settled with a positive impact on economic activity, the exchange rate has stabilized, and inflation is now nearing single digits. Angola's economic outlook for 2012 is relatively favorable, thanks to the resumption of growth in the oil sector. However, we intend to remain vigilant given the increasingly uncertain global environment. Further strengthening our foreign exchange reserves remains a priority.

2. **Performance under the program at end-September was mixed.** It improved to some extent by year-end due to corrective efforts.

- Three performance criteria (PCs) on *net international reserves* (NIR), *net domestic credit extended by the BNA* (NDC), and *banking system credit to the government* (NCG) were missed, the latter two by wide margins (Table 1). The nonobservance of these PCs was mainly caused by the recurrent problem of delays in the transfer to the treasury of oil revenues collected by Sonangol in its capacity as concessionaire. An external financing shortfall related to priority investment projects financed by European credit lines was also compensated for by additional domestic bank financing. The indicative target (IT) on the *non-oil primary fiscal deficit* (NOPD) was missed but by a small margin (Kz. 2 billion, or 0.04 percent of the non-oil GDP), confirming that fiscal policies remained on track. In addition, we have kept accounts payable within the program target, fulfilling the commitment to avoid a recurrence of domestic arrears.

- Based on information available as of mid-January, performance improved relative to the end-December ITs. Two transfers of oil revenue by Sonangol to the budget in November and December (cumulatively, US$3.3 billion) helped improve the international reserve position, but the ITs on NCG and NDC were again missed while budget implementation was accelerating. In addition, the shortfall in external financing from European banks continued. Despite Sonangol's transfers, a part of the 2011 oil revenue receivables remained pending at end-2011. All other ITs were met.

3. **Program performance in the second half of 2011 highlighted the need for more predictable and regular transfers of oil revenue from Sonangol**. Given the significance of oil revenues, recurrent delays and unpredictability of these transfers poses a major problem for macroeconomic management, since it impacts negatively the ability to attain our fiscal and monetary policy objectives.

4. **To address the root causes of this problem and increase transparency and accountability of fiscal operations, the Government is implementing important reforms**.

- *Phasing-out Sonangol's quasi-fiscal operations (QFOs)*. Sonangol's transfers are lower than oil revenues due to the treasury mainly because it retains large amounts of profit oil to finance QFOs. Strengthening efforts to phase out QFOs and to incorporate them into the budget, Presidential Decree No. 320/11 (published in the Official Gazette on December 30, 2011, and regulating the execution of the 2012 budget) mandates the gradual assumption of the payments by the budget units, except for two specific categories, for which Sonangol will be allowed to retain profit oil resources for budgetary obligations: (i) the provision of fuel subsidies; and (ii) the provisioning of escrow accounts for the service external credit lines. This is a milestone in improving fiscal management and the coverage of fiscal accounts.

- *Reforming the information system for oil sector activities*. Presidential Decree No. 58/11 established a new regime of statistical reporting and analysis for oil sector activities, aimed at improving the planning, coordination, and execution of the government economic and financial policies. This decree sets the institutional framework for interagency working groups (respectively, at the policy making and technical levels) including the Ministry of Finance, Ministry of Petroleum, and Sonangol. These working groups are responsible for ensuring regular monitoring and reconciliation of oil revenues due and transferred to the treasury. To date, an important outcome from this effort has been the first Reconciliation Report (prepared in December 2011 and covering the period January-October 2011). This report was discussed with the mission, meeting a structural benchmark for the sixth SBA review.

5. **Moreover, the government has brought the program fully back on track and is committed to pursuing a complete oil revenue reconciliation effort.** To this end, we intend to:

- *Limit, to the extent possible, the additional accumulation of receivables from Sonangol*. To complete the review, we significantly reduced the remaining 2011 outstanding receivables. Based on information available from the reconciliation effort, the accumulated receivables as of end-October 2011 were about US$4.8 billion. Of these, we ensured the transfer from Sonangol to the treasury of US$4.2 billion (US$3.3 billion in November-December 2011 and US$0.9 billion in February 2012). The remainder US$0.6 billion was deducted from the receivables in compensation for the estimated cost of fuel subsidies incurred in late 2011. We firmly intend to adhere to the principle of avoiding the accumulation of new receivables starting in 2012.

- *Provide a full reconciliation of oil revenue and related transfers for the 2007–2010 period*. To this end have provided the mission with preliminary data to inform the IMF Executive Board discussion for the sixth review about the ongoing efforts to explain the large cumulative residual in the fiscal accounts. Our preliminary assessment is that about ¾ of this residual is due to 2007–08 QFOs paid by Sonangol for housing, railway rehabilitation, and various infrastructure projects, including for special economic zones. We intend to discuss with IMF staff a fuller report for the 2007–2010 period in the course of the forthcoming Article IV Consultation.

- *Conclude the ringfencing of Sonangol's functions as concessionaire from its corporate commercial activities*. In particular, we intend to pursue a separate income and balance sheet accounting and reporting for the concessionaire function, to further promote proper audit and accountability, once the legal framework related to the consolidation of public companies' financial statements is fully established.

- *Improve the quality of fiscal policy and public financial management*. To this end, the Minister of Finance requests technical assistance from the Fund in the areas of medium-term fiscal and debt management framework, oil revenue administration, treasury management, and budget accounts.

6. **In other areas the structural reform agenda is progressing well**. The third quarterly budget execution report was published on the Ministry of Finance website in November, continuing efforts to promote fiscal transparency. The BNA has posted on its website the 2010 annual statement and the independent auditors' report. The tax reform plan is being implemented, contributing to a steady increase in non-oil tax revenue. Furthermore, the Debt Management Unit is operational and we have prepared a first draft of our National Debt Strategy. In regard to avoiding the recurrence of domestic arrears, our ability to keep accounts payable consistently below the agreed program ceiling throughout 2011 is evidence that our efforts since last year are producing the expected results.

7. **Our main economic objectives for 2012 remain further reducing inflation, strengthening our international reserve buffers, and addressing infrastructure bottlenecks to promote economic diversification and poverty reduction.** In particular:

- *Fiscal policy*: The 2012 budget has been prudently prepared on the basis of a conservative oil price assumption (US$77 per barrel), as a cushion against oil revenue volatility. We intend to keep current spending unchanged as a share of GDP, while continuing to improve the non-oil tax revenue collection, so as to make room for a further significant reduction in the NOPD. We are committed to a sustained improvement in our project selection, implementation, and monitoring capacity.
- *Monetary and exchange rate policies*: Our monetary program aims at further disinflating the economy, while boosting the international reserves buffer. We are actively pursuing de-dollarization, including through a revision of the foreign exchange regime for oil companies and prudential regulation of short-term credit denominated in foreign currency. The recent overhaul of BNA's monetary policy improves the operational framework for central bank operations, the instruments available to manage liquidity, and the setting for interbank activity.

8. **The government has put together a strong package of corrective measures to address the institutional weaknesses leading to the recurrent problems of uncertain oil revenue transfers.** In light of the corrective measures already adopted, and the prudent policies we intend to pursue going forward, we request waivers for the non-observance of the PCs at the end-September 2011 on NIR, NDC, and NCG.

9. **The program of reforms supported by the SBA has helped us overcome the 2008–09 crisis.** The government is committed to maintaining close policy dialogue with the IMF and is prepared to take the necessary measures to maintain macroeconomic stability, further reduce inflation, and reduce vulnerabilities to oil revenue fluctuations. We are also committed to fulfill the Executive Board expectations regarding post-program monitoring and to continue to promote transparency and good communication of economic policies to the public. We authorize the IMF to publish this Letter of Intent and the related staff report.

Sincerely yours,

/s/	/s/
Ana Dias Lourenço Minister of Planning	Carlos Alberto Lopes Minister of Finance

Table 1. Angola: Quantitative Performance Criteria (PC) and Indicative Targets (ITs), 2011

	2011																			
	March					June					September					December				
	PC	Adjustors	Adj. PC	Actual	Margin [1]	IT	Adjustors	Adj. IT	Actual	Margin	PC	Adjustors	Adj. PC	Actual	Margin	IT	Adjustors	Adj. IT	Actual	Margin
Performance criteria [2]																				
Net international reserves, floor (millions of U.S. dollars)	12,834	801	13,635	15,866	2,231	13,511	3,833	17,344	19,327	1,983	16,944	4,200	21,144	20,566	-578	17,889	4,365	22,254	23,543	1,288
Net domestic credit extended by the BNA, ceiling (billions of kwanzas) [3]	-518	-75	-593	-786	193	-564	-355	-919	-1075	156	-1056	-389	-1,445	-1214	-230	-1165	-404	-1,569	-1487	-82
Net credit to the government extended by the banking system, ceiling (billions of kwanzas)	373	-75	298	-69	367	277	-355	-78	-250	172	-469	-389	-858	-376	-482	-560	-404	-964	-763	-201
Accounts payable, ceiling (billions of kwanzas)	100		100	21	79	100		100	18	82	100		100	25	75	100		100	22	78
Nonaccumulation of external arrears (billions of U.S. dollars) [3]	0		0	0	0	0		0	0	0	0		0	0	0	0		0	0	0
External borrowing, ceiling (billions of U.S. dollars) [3]	4.0		4.0	0.4	3.6	4.0		4.0	0.8	3.2	4.0		4.0	0.9	3.1	4.0		4.0	1.2	2.8
Indicative targets																				
Social spending, floor (billions of kwanzas) [4]	185		185	224	39	424		424	557	133	630		630	820	190	997		997	1,158	161
Non-oil primary fiscal deficit (on budget basis), ceiling (billions of kwanzas) [4]	378		378	377	1	803		803	880	-76	1,399		1,399	1,401	-2	2,284		2,284	2,270	14
Memorandum items:																				
Program assumptions (billions of kwanzas)																				
Oil revenue, less oil-related expenditures	635			712		1,294			1,660		2,219			2,616		3,111			3,529	
External debt service by the central government	29			32		66			77		138			95		185			145	
Non-project medium and long-term central government external borrowing	0			0		0			0		51			0		53			0	

[1] Margin in red indicates that the PC or IT was missed.
[2] Performance criteria and indicative targets evaluated at exchange rates defined in the TMU.
[3] Continuous.
[4] Cumulative from January 1, 2011.

Table 2. Angola: Structural Reform Measures under the Stand-By Arrangement

Area	Structural Benchmark	Timing	Status
Public finance management			
	Development of the project appraisal and monitoring framework, for use in evaluating new projects on a pilot basis during the 2012 budget process.	September 2010, reset to May 2011	Not met. Due to delays in signing terms of reference with AfDB. Training program started with international consultant. Technical assistance program to start by end-March 2012. Goal to pilot framework in 2013 budget preparation.
	Complete the settlement of all verified central government domestic arrears incurred prior to end-December 2010.	March 2011	Met, with delay. Verification process completed in February 2011. Most arrears settled by end-March 2011. Agreement with creditors reached by end-August 2011 to clear all outstanding 2008-09 arrears.
	Submit for consideration to the National Assembly the new Public Enterprise Law.	March 2011	Met.
	Complete the settlement of all verified central government domestic arrears incurred prior to end-December 2010 .	March 2011	Met, with delay. Verification process completed in February 2011. Most arrears settled by end-March 2011. Agreement with creditors reached by end-August 2011 to clear all outstanding 2008-09 arrears by end-2011.
	Cabinet approval of National Debt Strategy.	March 2011, reset to November 2011	[Met, with delay.] Draft debt strategy including sustainability analysis completed in January 2012. [Cabinet approval expected before end-March.]
	Define a time-bound action plan and an early warning system to improve monitoring of accounts payable and their duration.	November 2011	Met, in part. Accounts payable levels consistently below agreed program ceiling shows that additional efforts and reforms by the authorities are producing results.
	Completion of a reconciliation report, reconciling the Ministry of Finance's and Sonangol's data on receivables and payables.	November 2011	Met. Report covering January-October 2011 period completed in December 2011. Work ongoing to complete 2011 and 2007-2010 period.
Fiscal transparency			
	Begin quarterly publication of reports of central government budget execution on the Ministry of Finance website, including coverage of the expenditures undertaken by Sonangol on behalf of the central government.	June 2010, reset to June 2011	Met.
	Publication of Sonangol's 2010 audited financial statements including quasifiscal operations.	September 2011	Met.
Tax reform			
	Submission of the draft laws of the General Tax Code, the Code of Tax Procedure and the Tax Collection Enforcement Code as well as the draft tax code on Stamp Duty to the National Assembly.	October 2010	Met, except for the draft tax code on Stamp Duty.
	Submission to the cabinet of a time-bound action plan for the government's tax reform program.	June 2011	Met.
Financial sector stability			
	Amend the regulation on capital adequacy to reflect the credit risk of foreign currency loans.	March 2011	Met, with delay. Delayed due to the need to allow for additional consultation with market participants.
Central bank safeguards measures			
	Issuance of semiannual reports by the Internal Audit Office of the BNA to the Board on compliance with the foreign reserve investment guidelines.	September 2010, reset to March 2011	Met, with delay. Issued in May 2011.
	Reconstituting the Audit Board by: (i) replacing the member who has a conflict of interest; (ii) adopting a Charter to define all statutory responsibilities; and (iii) assuming oversight of the external audit and financial reporting process.	June 2010, reset to January 2011	Met.
Central Bank transparency			
	Complete the audit of the BNA's 2010 financial statements.	June 2011	Met.