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FLASH NOTE

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Inflation should reach BNA target as early as October

MPC may ease conditions further even with slight inflationary pressures

A. DESCRIPTION

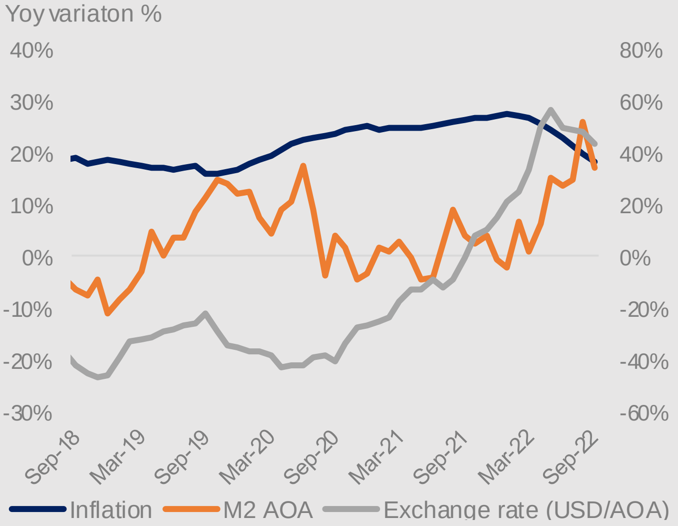
1| Year-on-year inflation in September stood at 18.16%, maintaining the trend of deceleration (the eighth consecutive month of decline in 2022), despite the slight monthly increase of 0.03 percentage points (pp) to 0.79%, compared to August.

2| The deceleration of price increases supports the recent action of the BNA: at the meeting of the Monetary Policy Committee (MPC) held on the 26th of September, the central bank decided to reduce two of the three main interest rates. The basic interest rate (BNA rate) was reduced to 19.5% (-50bps) and the interest rate of the Permanent Liquidity Lending Facility (PLLF) to 21% (-200bps), while the remaining monetary policy instruments remained unchanged.

B. ANALYSIS

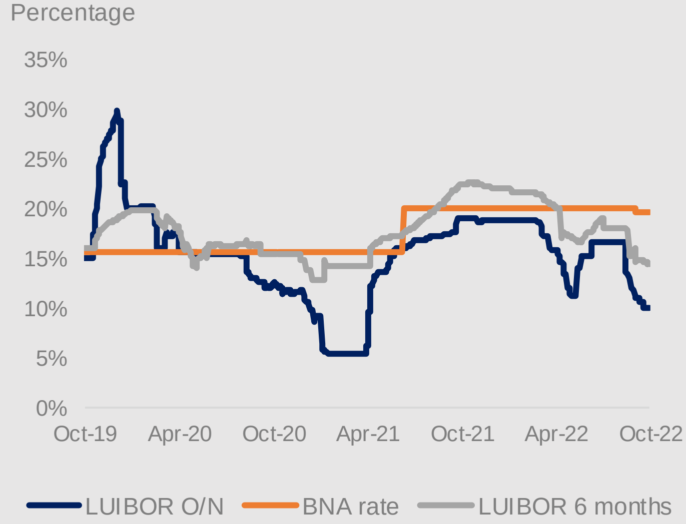
1| Year-on-year inflation in September reached the lowest level since January 2020 and is now only 0.16pp above the BNA's short-term target and is certain to reach it as early as October. Monthly inflation, which was on its way to the ninth consecutive drop, interrupted its trajectory, largely due to the increase in education costs, which, according to INE, registered the largest monthly increase, +3.15% (+1.75pp than the increase in Sep/2021), still affected by the resumption of the school period. In addition, other significant increases were recorded in the Clothing & Footwear and Health classes, which increased by 1.77% (-0.01pp) and 1.54% (-0.43pp), respectively. In the opposite direction, the Transport class stands out, showing a change of 0.17%, followed by Housing, Water & Electricity, which rose 0.55%, the smallest increase since June 2020, and 0.32pp less than than in the same month of 2021.

BNA is allowing an increase in liquidity in Kwanzas, reassured by the drop in inflation



Sources:INE, BNA, BFA calc.

Overnight LUIBOR dropped sharply, signaling solid levels of liquidity in the market



Sources: BNA

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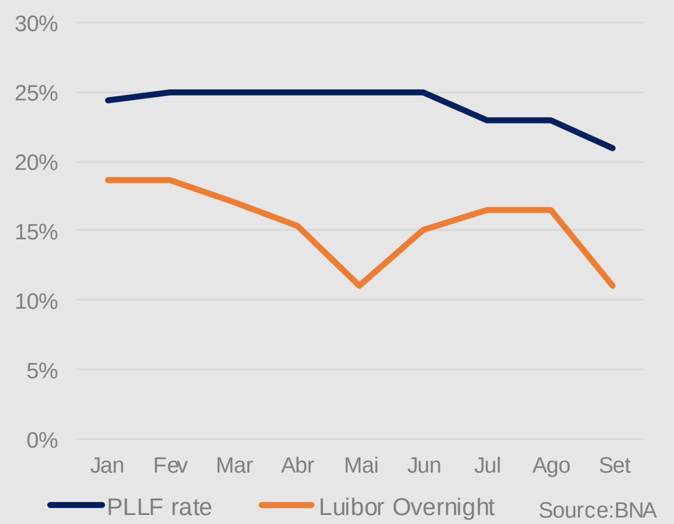
2| The decrease of inflation allowed the BNA to begin the easing movement in May, when the MPC lowered the mandatory reserve ratio to 19% (-3pp). In the subsequent MPC, in July, the BNA further reduced the mandatory reserve ratio to 17% (-2pp). In the most recent one, carried out in September, the BNA reduced the basic interest rate and the PLLF interest rate.

It is important to note that, in the case of Angola, the mandatory reserve ratio and open market operations (OMO) are the most relevant and effective tools in determining monetary policy. In other economies, there is an effective monetary policy corridor, a gap between the rate at which the central bank is willing to lend and the rate at which the central bank is willing to hold money from banks; in turn, banks lend money to each other (overnight) only between these rates, which in the case of Angola would be the Permanent Liquidity Lending Facility (21%) and the Permanent Liquidity Absorption Facility (15%).

Permanent Liquidity Lending Facility and LUIBOR falling in an environment of monetary easing

Percentage (amount at the end of each month)



In theory, no bank would lend to another for less than 15% - because it could rather lend its liquidity to the BNA itself by earning that 15% -, no bank would borrow at more than 21% - because it could first borrow from the BNA being charged by 21%. Due to the influence that interbank rates later have on the rates charged for loans to clients, changes in lending and absorption rates lead to increases and decreases in rates on loans to the economy, which in turn impact liquidity and economic activity. However, for various regulatory reasons, this is not the case in Angola and, now, the overnight LUIBOR rate (and other maturities) is well below 15%. On the other hand, in addition to the absence of this link, the percentage of credit in the Angolan economy is much lower than in other economies. Thus, the BNA impacts liquidity levels and economic activity through the levels of mandatory reserves (higher reserves imply less liquidity, a contractionary monetary policy, and vice versa) and the use of Open Market Operations (the provision of greater or lesser amounts to banks implies greater or lesser liquidity, and directly influences rate levels in the interbank market).

In particular, OMO are the most effective instrument of liquidity management, and almost immediately impact on the liquidity levels of the market, as well as the interest rates of the interbank market, and by extension, also the rates of Treasury Bills, and consequently, those of credit. In the most recent period, auctions for liquidity absorbing OMO have resulted in rates consistently below 10% on several maturities, which in turn is the main factor causing the significant drop in the overnight LUIBOR rate, which is now around 10%.

That is, unlike the decisions taken at the MPC in May and July, the decisions taken at the committee in September result more in the effect of signaling more clearly the easing of monetary policy, which was already taking place in effect through the previous measures.

3| The money supply, measured by M2 in national currency, rose by 22.68% compared to the same month of 2021, being the second consecutive month that it grows above inflation. Except for February 2020, the local currency in circulation has always grown below inflation in recent years; this containment of currency growth reflects the contractionary monetary policy of the BNA, with the intention of reducing inflation.

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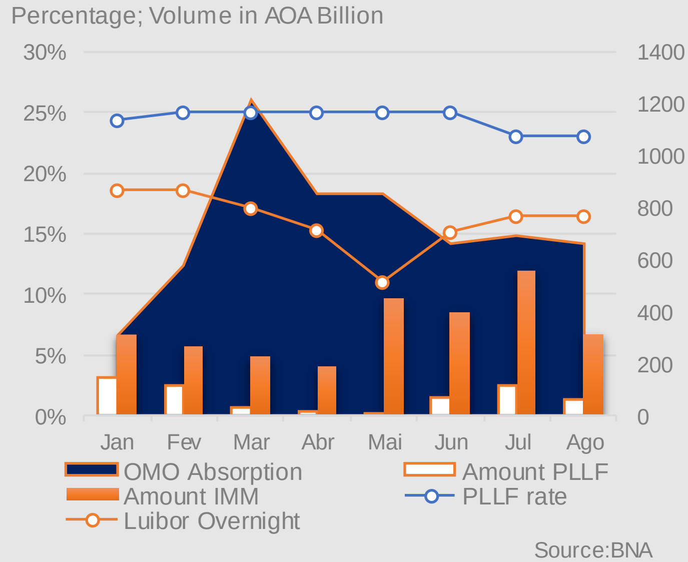
In particular, the BNA reinforced this movement between March 2021 and mid-2022 - for example, in December 2021, inflation was 27%, while M2 in Kwanzas grew by 1% yoy, a differential of 26pp, the highest of the last 3 years. With the deceleration in the growth rate of the general price level becoming clearer from Q2 2022 onwards, the BNA started to allow higher M2 growth, growing above inflation from August onwards. The expansion of M2 is consistent with the increase in liquidity in the market, which has also been reflected in the greater intensity of the use of Open Market Operations to absorb liquidity by banks: on average, banks have provided an average of AOA 727 billion a month to the BNA.

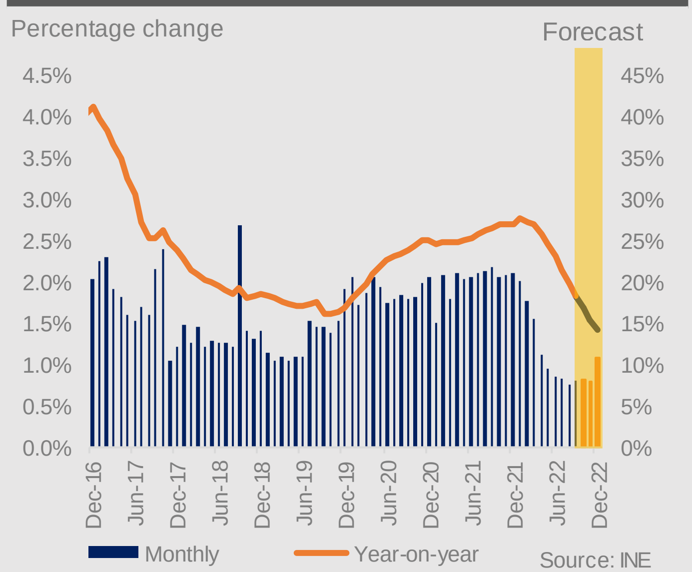
Volumes on the interbank market recorded in July a maximum since January 2021



4| In anticipation of the MPC meeting, the Governor of the Central Bank had previously signaled a possible reduction in interest rates. Therefore, by reducing them, the BNA is contributing to the credibility of monetary policy, in a process that is commonly called forward guidance – guiding the market on future actions by the central bank, providing predictability to economic agents. In this way, greater confidence is transmitted, and investors can more easily anticipate monetary policy decisions and incorporate them into their investment plans, in addition to the fact that the more credibility the BNA has, the more easily it can influence the future of the economy in the present and reduce the inflationary inertia effect. If agents believe in the power of the BNA to control inflation, they will not raise prices in the future just because of past price increases. Even so, despite the reductions in the policy rates, the BNA still has immense challenges in relation to the transmission channels of monetary policy, especially in influencing the rates of credit to the economy.

5| Regarding our outlook for the near future, despite a slight increase in monthly inflation, year-on-year inflation continued to decline, and our estimate indicates that it will end the year between 14-15%. Therefore, we believe that there is still room for monetary policy flexibility that the BNA can take advantage of. Although monthly inflation will continue to accelerate slightly in the coming months, the acceleration that we anticipate as possible and realistic will not interrupt the downward trend in year-on-year inflation. The latest inflation figure of 18.16% confirms the trend we had estimated for September, and for October we expect year-on-year inflation to be between 16.6-16.8%. For 2023, our forecast for now indicates a slight acceleration of monthly inflation values compared to the 2nd half of 2022, which could cause year-on-year inflation to stop falling somewhere between the 1st and 2nd quarter of the year, and may even rise somewhat, to levels around or

Inflation will meet BNA target as early as October and should end the year below 15%



above 15%. The reason is related to a gradual but real depreciation of the Kwanza, which will occur due to the decrease in oil production and in the price of the commodity in international markets**.**

C. CONCLUSION

1| The BNA should continue to maintain a delicate balance between exchange rate policy and monetary policy, given that at this time of year there will be greater inflationary pressures, consistent with travel and imports of goods during the festive period. For this reason, even with room for monetary easing, the BNA needs to monitor all inflation drivers and exercise extreme caution. Thus, it is not entirely certain that the next monetary policy easing will take place as early as November, although it cannot be ruled out. If not, we expect the BNA to relax the policy in January 2023. On the other hand, the situation of the foreign exchange market will play a very important role, at a time when the Kwanza is already starting to show signs of depreciation, and an economic stimulus via monetary policy could lead to a worsening of this trend.

2| The BNA's monetary policy options will always depend on the performance of inflation, and this should start to show signs of stopping its decline sometime in the 1st half of 2023, partly because of the gradual depreciation of the Kwanza, and as a result of the impacts of imported inflation. Even so, it is not to be ruled out that the central bank will be able to counter this trend; in our opinion, if the BNA keeps its credible and orthodox strategy, the path to 1-digit inflation may be delayed, but it will not be reversed.

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