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FLASH NOTE

Nº 02.2023 |January 30, 2023

BNA cuts all key interest rates

Less inflationary pressures justify the first relief of the year

A. DESCRIPTION

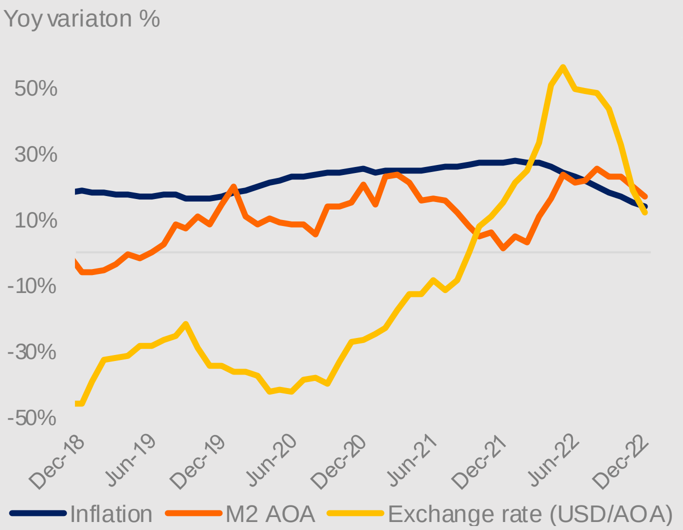
1| The reductions in inflationary pressures led the BNA, at the Monetary Policy Committee (CPM) meeting held on 20 January, to reduce the main interest rates that guide the economy. The Basic Interest Rate was reduced by 50 basis points (bp) to 18%, the Permanent Absorption Facility to 14% (-100bp) and the Liquidity Supply to 18% (-300bp), while the mandatory reserve ratios, both in local currency and in foreign currency, remain at the same levels as in July 2022.

2| Year-on-year inflation in December stood at 13.86%, a drop of 1.38 percentage points (p.p) compared to November, the tenth consecutive month of decline in 2022. According to INE data, monthly inflation stood at 0.87%, representing acceleration compared to the average between September and November (0.8%), with the categories "Clothing & Footwear", "Health" and "Miscellaneous Goods & Services", being the ones that recorded the highest variations of the National Consumer Price Index (IPCN), with 1.98%, 1.85% and 1.47%, respectively.

B. ANALYSIS

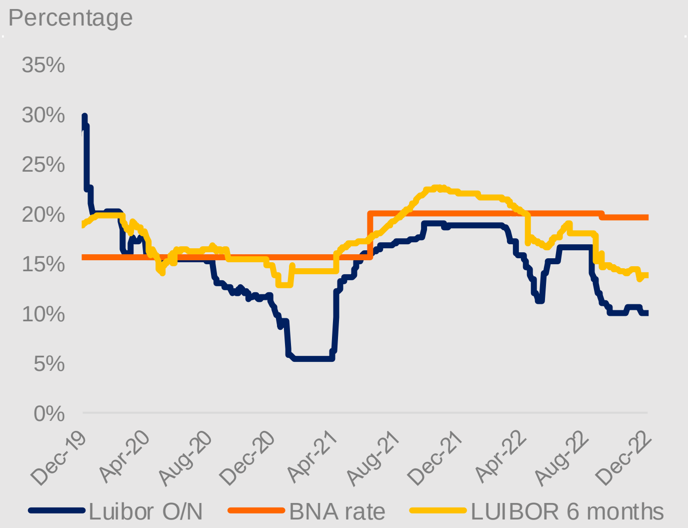
1| Even with year-on-year inflation reaching the lowest levels of 2015 in December 2022 and closing more than 4pp below the target for that year, the BNA remained very cautious about the easing of monetary policy. The reduction in inflation further widened the scope for flexibility, but the BNA still preferred to act with some caution. The central bank expects inflation between 9-11% at the end of the year, a plausible but optimistic expectation in our opinion, even if the effects of the depreciation that occurred in Q4 2022 are more severe than we expect.

BNA allowing increased liquidity in local currency, reassured by the drop in inflation



Sources: INE, BNA, and BFA Calcs

Luibor overnight drops to 9.05% in context of monetary easing

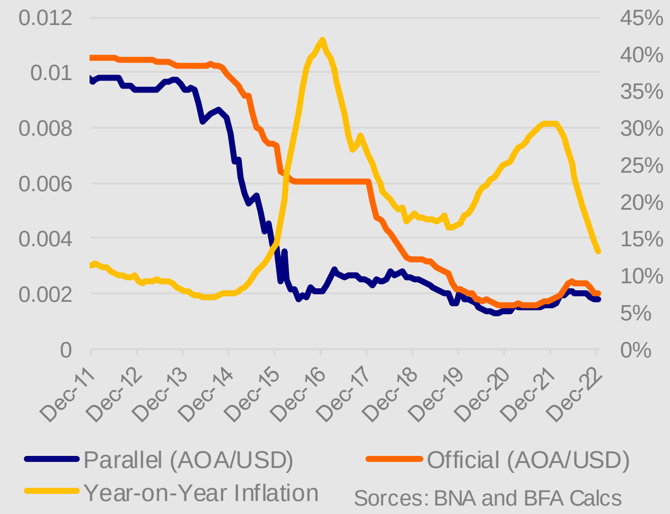


Source: BNA

2| The deceleration of inflation in recent months allowed the BNA to start its first monetary easing movement of the year. Monthly inflation accelerated slightly in November and December, but below our expectations (it accelerated less than the 0.2pp we expected, standing at 0.9%), especially in December, due to the weak seasonal effect and the impact of the depreciation lag exchange rate between October and November.

The exchange rate depreciation in the Q4 shortened the spread between the parallel and the official

Absolute value; Percentage



Sorces: BNA and BFA Calcs

Of the four expense classes that most influenced the IPNC, three of them, i.e. "Clothing & Footwear", "Leisure, Recreation & Culture", as well as "Miscellaneous Goods & Services" increased slightly more than the respective averages for the entire year , which indicates some slight seasonal effect between November and December; however, the increases in those categories were almost dampened by reductions in the classes "Housing, Water, Electricity & Fuels" and "Communications", which minimized the impact on the overall index.

Regarding the pass-through effects, they probably haven't been reflected yet; not knowing the size of the temporal lag between the depreciation and its impact on domestic prices, we do not rule out possible impacts until we analyze the February numbers.

3| It should be noted that, with a relatively non-functional monetary policy corridor, open market operations (OMA) with repurchase agreements (Repo) are, at the moment (together with reserve requirements rates), the main monetary policy tool of the BNA. The reduction of the basic interest rate, of the permanent facilities for lending and absorbing liquidity are relevant in the context of transmitting monetary policy via forward guidance – that is, indicating to the market what to expect in the future of monetary policy -, given that the decision taken last Friday is a clear signal that the BNA is giving to the market that it expects to see inflation continuing its decelerating path. In this way, the same expectation is passed on to economic agents and, above all, to banks, that they will be able to count on lower interest rates in the near future, which could potentially influence investment decisions. In terms of short-term monetary policy effectiveness, OMAs are much more relevant. On Monday of last week, the BNA lowered OMA rates (absorption) by another 0.5% for the 2 maturities, settling at 7.5% for 6 months and 8.0% for 12 months.

In this sense, the alternative to deposit liquidity, in a scenario of relative excess of currency in the banking system, is effectively this range of rates between 7.5-8.0%, at this point. Therefore, as there is no direct and immediate impact on the decisions of the first meeting of the MPC, what effectively the central bank is doing consists of creating an environment that should lead to a decrease in interbank interest rates and, by extension, the interest rates charged by banks on credit to customers. For a clearer demonstration, just note the relationship between OMA rates and interbank market rates, as seen in the graph below: average repo rates fell by around 75bps between December 2022 and January 2023, and in the same time horizon, the main interest rate of the interbank market, the Luibor Overnight, fell 79 bp.

4| Money supply, measured by M2 in local currency, rose 16.9% in December, compared to the same month of 2021, being the sixth consecutive month that it grows more than inflation. Apart from February 2020, the local currency in circulation has always grown below inflation in recent

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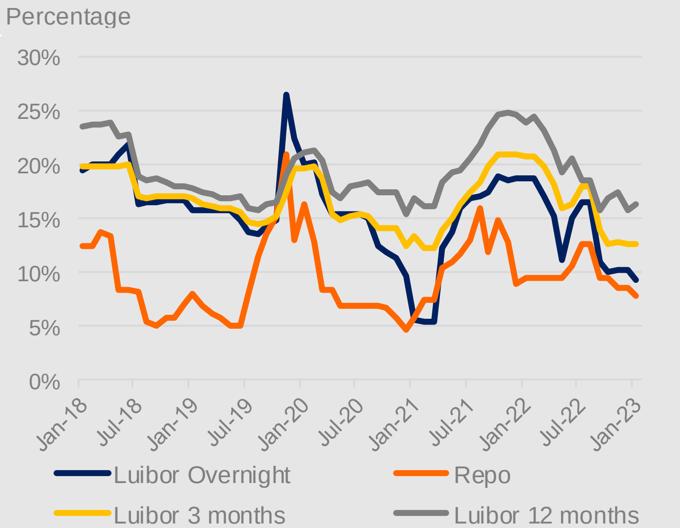
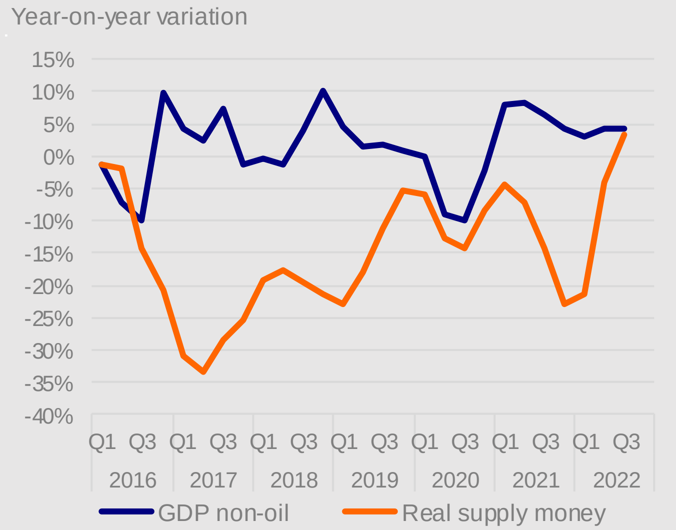
Repo interest rates continue to drive Luibor Overnight down



Source: BNA and BFA Calcs

Real money supply grows in Q3 signaling net wealth creation in the economy

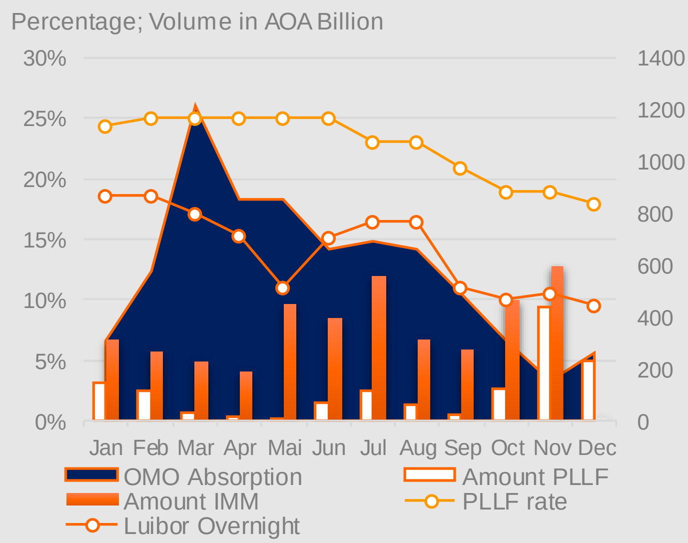


Sorces: BNA and BFA calcs

years; this containment of currency growth reflected the contractionary monetary policy of the BNA, with the intention of reducing inflation. In particular, the BNA reinforced this movement between March 2021 and mid-2022 - for example, in December 2021, inflation was 27%, while M2 in local currency grew by 1% yoy, in a spread of 26pp, the highest high over the past 3 years. With the decline in inflation becoming clearer from Q2 2022 onwards, the BNA began to allow greater M2 growth, growing above inflation from July onwards.

According to the statistical series that we are following, the real money supply, measured by the differential between the nominal money supply and inflation, grew by 3.4% in Q3 2022 after years in negative territory, which signals the creation of net wealth in the economy, confidence, positive real interest rates, inflation steadily decreasing and liquidity levels in line with market needs, as the BNA continues to be very active in the money market, regulating the amount of money in the system. It should be noted that the total volume of overnight lending facilities reached AOA 1.4 billion, the highest figure in the last 2 years, while total OMAs (absorption) stood at around AOA 4.2 billion. In the interbank market, until November the accumulated volume of operations in 2022 amounted to more than AOA 4 billion, a value already higher than that recorded in 2021.

Volumes in the interbank market recorded the highest value of 2022 in November



Source: BNA

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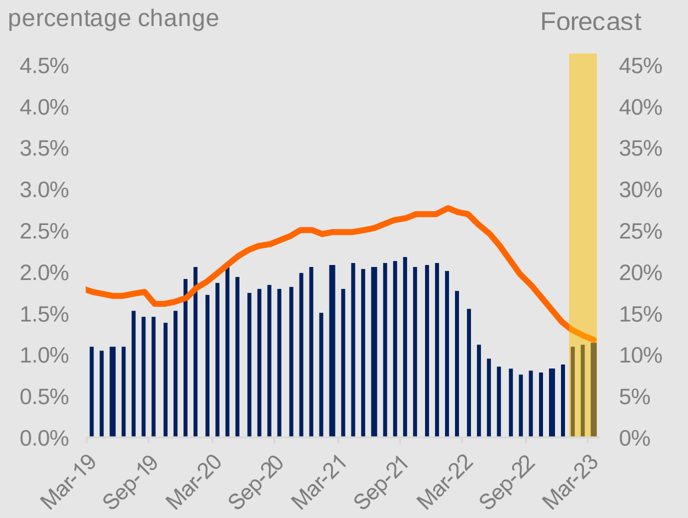
Inflation should stop falling at the end of 1Q2023, to start rising slightly from 2Q



Sources: INE and BFA Calcs

5| For the near future, our perspective is that monthly inflation accelerates again in January and February, standing at around 0.9%-1.1%, but yearly inflation should clearly continue to decelerate until the Q1 of the year, reversing the trend from the beginning of the Q2. In homologous terms, we maintain our forecast for now, according to the last note we published in which we said that inflation should end 2023 at around 16-17%. On the one hand, we still expect some impact of the depreciation that occurred at the end of last year; at the same time, we expect a continued slight and gradual depreciation of the Kwanza, which will occur due to the decrease in oil export revenues, with a decrease in production and price, in average terms; finally, we are also counting on the start of a process of increasing fuel prices this year. Even so, this forecast involves risks, which at this point are mainly positive, which could lead to a downward revision of the forecast: in fact, if the impact of the depreciation that occurred in October/November is not as significant as expected in this Q1, the scenario for inflation will be more benign; on the other hand, the effect of accelerating inflation through the reduction of fuel subsidies could be more serious than we expected, although we attribute a lower probability to this second risk. As for the next MPC, scheduled for March 21st, we think that the central bank may take more flexibility measures, because according to our forecast, by then the year-on-year inflation should be between 11%-12%, giving greater margin to the monetary authority.

C. CONCLUSION

1| The binomial of inflation and exchange rate will continue to be a decisive factor for defining and conducting monetary policy. To determine the exchange rate, factors such as the evolution of Brent and oil production are crucial variables since the final effect ends up being more or less supply in the exchange market. In recent months, we have observed a new balance for the Kwanza around 500-510 USD/AOA, with the regular presence of the National Treasury and other suppliers, generating stability in the Kwanza. We are forecasting a reduction in oil production this year and slightly less revenue than last year; thus, we already anticipate some exchange rate and inflationary pressures, but that will not prevent the BNA from proceeding with the course of monetary easing, at least until the end of the Q2.

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 also through the impacts of imported inflation. In our opinion, with the continuation of the good management of the monetary policy by the BNA, it cannot be ruled out that the central bank will be able to counteract this trend, but the objective of inflation below 2 digits could be achieved later than expected by both the BNA (2023/24) and the IMF (2024), even though we consider that the inflation path will remain in a downward direction in the medium term. Our forecast for this year is between 16-17%, but this could be revised downwards in the near future.

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