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FLASH NOTE

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Inflation registers a further slowdown, to 10.8%

BNA should continue to ease monetary policy gradually

A. DESCRIPTION

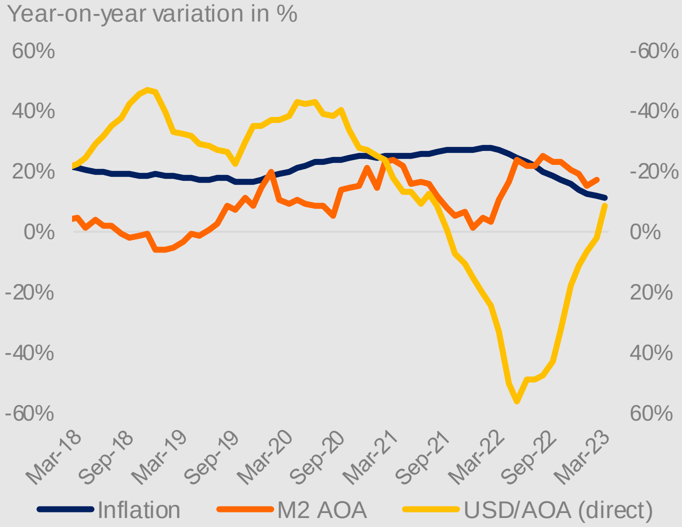
1|Year-on-year inflation in March stood at 10.8%, a drop of 0.7 percentage points compared to January, the fourteenth consecutive month of decline. According to INE data, monthly inflation stood at 0.9%, stable compared to the previous month, with the categories "Health", "Clothing & Footwear" and "Miscellaneous Goods & Services" registering the lowest higher variations of the CPI, with 1.9%, 1.6% and 1.4%, respectively.

2| The Monetary Policy Committee (MPC) of March 21 advanced to the second interest rate cut of the year and adjusted the time period for compliance with reserve requirements by commercial banks, moving from the current daily fixed basis to a fortnightly average compliance. The MPC cut the basic interest rate by 100 basis points (bp) to 17%, the permanent absorption facility to 13.5% (-50bp) and the liquidity-providing facility to 17% (-100bp), while the Required reserve coefficients, both in national currency and in foreign currency, remain at the same levels as in July 2022.

B. ANALYSIS

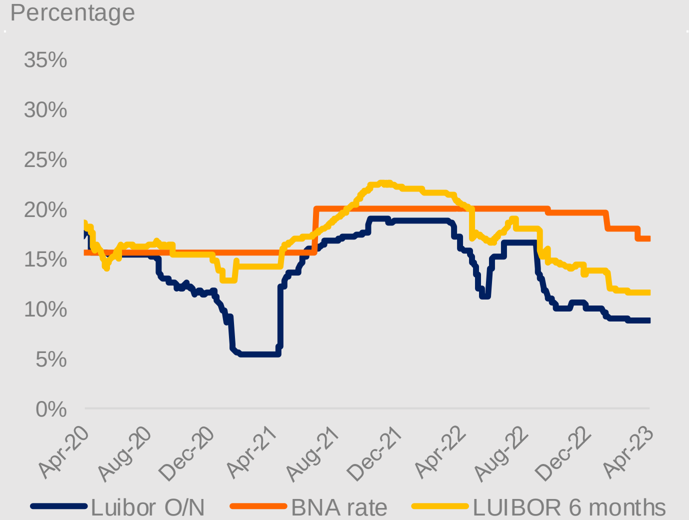
1| After a few months of the depreciation that occurred between October and November last year, the inflationary impact is not being as strong as we had expected – it is possible that the BNA had similar fears, so the continued decline in inflation justifies the further decrease in the rate base rate last month. At the end of last year, the MPC had not changed the course of monetary policy due to the fact that the Kwanza had depreciated 15% against the dollar and 21% against

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



Sorces: BNA, INE and BFA Calcs

Luibor overnight drops to 8.7% in context of monetary easing



Sources: BNA

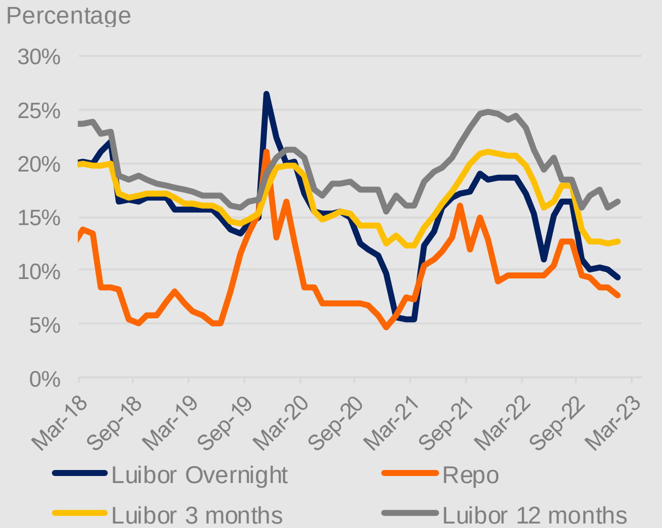
the EUR, between October and November. However, the BNA's fears did not end there, since at the first meeting, in January, the MPC maintained a very conservative posture, having reduced the basic interest rate by only 50pbs, which, according to our understanding, was a reflection of that the Central Bank had not yet ruled out a possible pass-through effect (effect of depreciation on inflation). With inflation in the first quarter showing strong resistance to the rise, having settled at a monthly average of 0.9% (below our initial expectation, more around 1.1%), it became clearer that the pressure coming from the depreciation will have run out, justifying the less conservative position of the MPC in this last meeting.

2| The consistent trajectory of inflation seems to be making the BNA more and more comfortable with regard to the easing of monetary policy. Year-on-year inflation continues on its downward path, having dropped 16.2pp in about 12 months and should continue at this pace until the middle of the year.

The “Food and Non-Alcoholic Beverages” class, which contributes the most to the CPI, has remained very stable since May, fluctuating around 0.8%, rising slightly to 0.9% in March. The rest of the classes that contribute to the CPI, such as the “Clothing & Footwear” class as well as “Health” have been quite volatile, which indicates transitory pressures on the general price level, which are not worrying.

3|The reduction of key interest rates in a context of continuous drop in inflation is positive because it contributes to greater credibility of monetary policy and allows anticipation of MPC decisions by economic agents. However, we reiterate that open market operations with repurchase agreements (Repo) are, at this moment (together with mandatory reserve rates), the main monetary policy tool. The OMOs are much more relevant, on the one hand for allowing the fine management of short-term liquidity, on the other hand, for directly impacting Luibor's movement, and, by extension, the interest rates charged by banks on credit to customers.

Repo interest rates continue to drive Luibor Overnight down



Source: BNA and BFA Calcs

In February and March, the overnight Luibor stabilized around 8.9%, with some slight rises and falls. According to what we have seen, these variations are in line with the movement of the OMOs rates, which fell 50bps to 7.50% in February, having reached a minimum of 7.21% somewhere in March to then rise again around the 7.50%. Repos interest rates are stable, and the BNA gradually seems to be reducing the frequency with which it makes Repos at longer terms, which for us indicates some comfort on the part of the BNA in relation to the current level of interest rates on the Interbank Monetary Market and that there is no excess liquidity to worry about. Therefore, it must have been in this sense that the MPC, along with the reduction in interest rates, also decided to make liquidity conditions more flexible in the financial system, adjusting the time period for compliance with mandatory reserves by commercial banks, moving from the current basis fixed daily to a fortnightly compliance average. Although this regulation is not yet very clear, the understanding is that it could bring some more flexibility in liquidity management by banks, which is equivalent to a slight easing of financial conditions.

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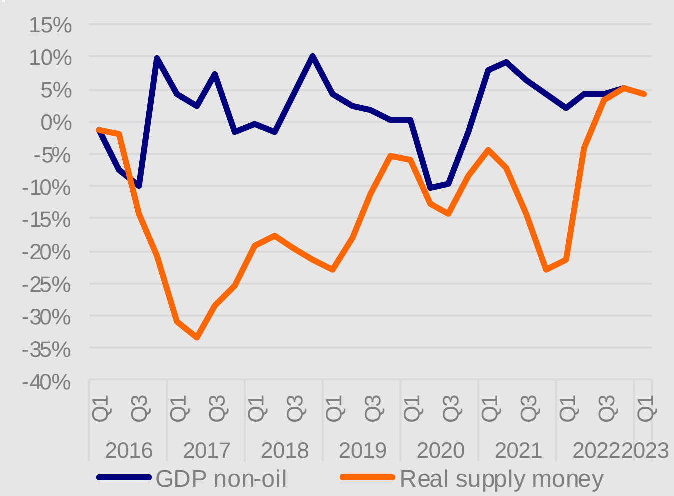
4| Despite the relief in interest rates, the BNA continues to closely monitor the evolution of currency in circulation, in order to avoid future inflationary pressures on the currency side and not jeopardize the short-term objective. Money supply, measured by M2 in national currency, rose 17.17% in February, compared to the same month of 2022, being the eighth consecutive month that it grows more than inflation. 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 again, that is, 5.1% in Q4 2022 after years in negative territory.

Real money supply grew again in Q1, consistent with continued economic growth

Yoy variation



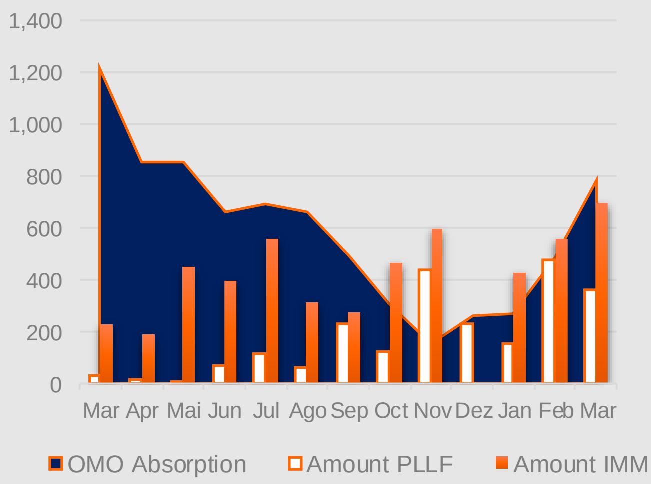
Sorces: BNA and BFA Calcs

Note that the operational variable of monetary policy (M0), which most visibly measures the position (contraction or expansionist) of the policy, continues in a negative direction, having contracted, according to our calculations, around 3.7% yoy. Despite this, the money market is liquid, OMOs (absorption) reached around AOA 480.9 billion (MM) in February, permanent lending facilities with a maturity of 63 days stood at close to AOA 479 MM, while the swap volume for liquidity on the IMM stood at AOA 553 MM.

5| We are confident that, for the time being, there are no inflationary pressures that should significantly change the course of inflation in the 1st semester. We believe that inflation should continue to fluctuate at around 0.8-0.9% in the coming months, with the corresponding trend continuing to fall very gradually to a low of around 10% somewhere in the middle of the year. The scenario in the 2nd half of the year is contingent on the existence of some removal of fuel price subsidies. If this adaptation does not start this year, which seems possible at this point, inflation could end the year between 11-12%, with monthly inflation accelerating in the 2nd half, due to some depreciation and a less significant decrease of food prices worldwide. Based on a scenario of a gradual start to the removal of subsidies, according to our estimates on the reform that is implicit in the 2023 State Budget, we would expect an acceleration of monthly inflation in the 2nd semester, to values progressively closer to 2%, with the possibility of ending the year between 15-16%, continuing to rise in 2024.

Open market operations continue to grow

Percentage; Volume in AOA Billions



Sources: BNA

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Currency spread and inflation close to the minimums, signaling exchange rate balance

Percentage

Sorces: BNA and BFA Calcs

Year-on-year inflation should register minimum values in the 2Q, and rise again later

Percentage change

Sources: INE

As for the next MPC, scheduled for May 19, we think that the central bank may take more easing measures, because according to our forecast, until then, year-on-year inflation should continue to fall, giving greater margin to the monetary authority.

C. CONCLUSION

1| The binomial inflation and exchange rate will continue to be a decisive factor for defining and conducting monetary policy. Since there are, as of now, no inflationary pressures that we can contemplate for the coming months, we believe that the BNA should continue to proceed with cuts in interest rates, with its room for easing becoming greater as year-on-year inflation remains stubbornly resistant to the ascent. We are forecasting a reduction in oil production this year and slightly less revenue than last year; thus, we already anticipate some slight inflationary pressure from the exchange rate, but that will not prevent the BNA from continuing with the course of monetary easing, at least until the end of the Q2.

2| The course of inflation in the 2nd half of the year is conditioned by the beginning of an increase in fuel prices. In a scenario where this increase begins, even if it is quite gradual as we expect, inflation would tend to accelerate significantly, possibly returning to close to 16% at the end of the year and continuing to rise significantly in 2024. reform is postponed until after the end of 2023, our expectation is that the current world food price environment, together with a slight depreciation, will allow inflation to maintain a downward trend until the end of the 1st half, accelerating only rather slightly to levels around 11-12% at the end of 2023.

3| We have noticed that the BNA has managed to balance its monetary policy easing movements while at the same time trying to avoid the appearance of inflationary pressures on the currency side. While interest rates are falling and facilities have been used to inject liquidity into the system, repos have been used to drain liquidity. For this reason, the change in base money has been negative for the last 4 months, while M2 is now growing a little more than inflation.

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