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FLASH NOTE

Nº 07.2023 | May 30, 2023

BNA keeps the course of monetary policy unchanged

Pressure on the local currency weighed more than inflation

A. DESCRIPTION

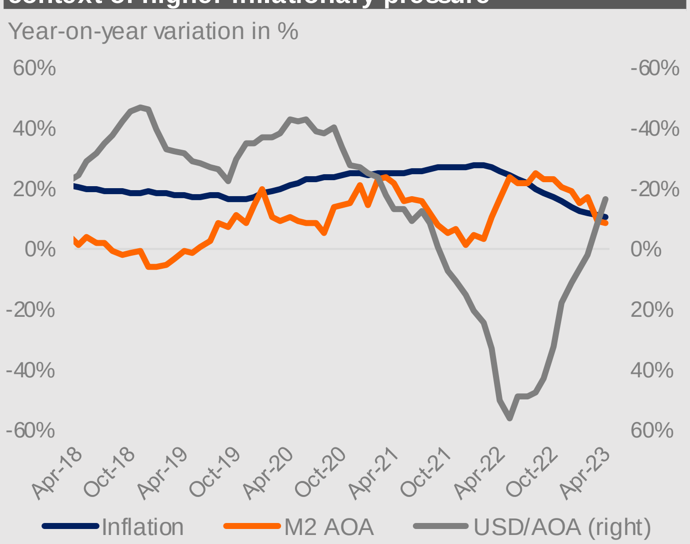
1| At the meeting of the Monetary Policy Committee (CPM), held last Friday, May 19, the BNA decided to keep the instruments for conducting monetary policy unchanged. The Basic Interest Rate remains at 17%, the Permanent Facility Lending and Absorbing Liquidity situated at 17% and 13.5%, respectively, while the mandatory reserve ratios, both in local currency and in foreign currency, remain at same levels as July 2022.

2| Year-on-year inflation in April stood at 10.59%, a drop of 0.22 percentage points (p.p) compared to March, the fifteenth consecutive month of decline. According to data from the National Institute of Statistics (INE), monthly inflation stood at 0.92%, representing a slight acceleration of 0.02pp compared to the previous month, with the categories "Health", "Clothing & Footwear" and "Miscellaneous Goods and Services" were the ones that recorded the highest variations in the National Consumer Price Index (IPCN), with 1.91%, 1.55% and 1.45%, respectively. In geographic terms, the provinces that registered the greatest variations were Namibe, with 1.12%, Cunene and Zaire with 1.08%.

B. ANALYSIS

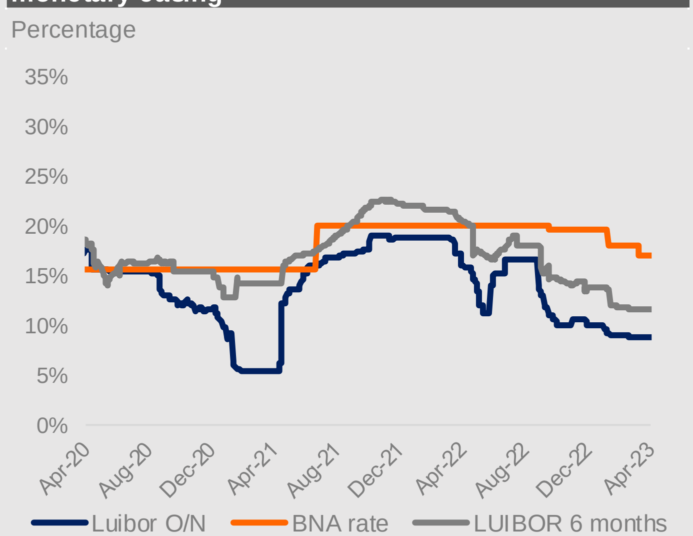
1| This decision was consistent with our expectations at a time when the foreign exchange market is under strong pressure with the Kwanza showing clear signs of a break and with monthly inflation accelerating, albeit slightly. The Kwanza recently broke the period of stability observed since the first half of December, between USD/AOA 503-507 and is now situated close to USD/AOA 578, making a depreciation of around 14.6% so far, with the highest part of the fall in the

M2 achieves lowest growth since March 2022 in a context of higher inflationary pressure



Sorces: BNA, INE and BFA Calcs

Luibor overnight continues to decline in context of monetary easing



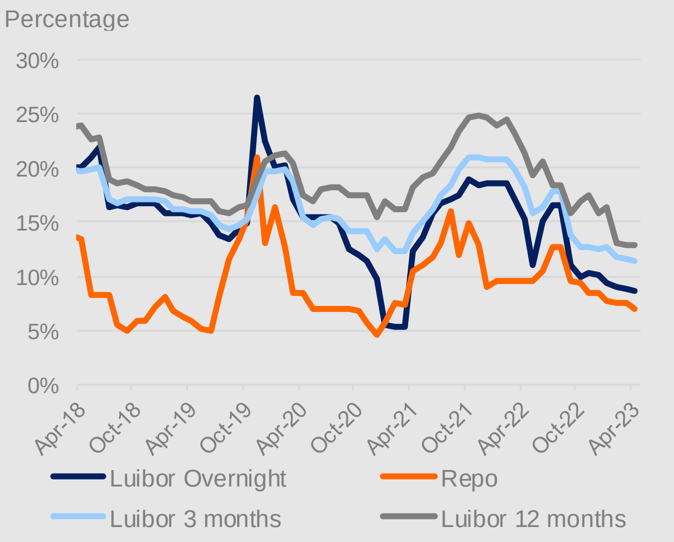
Sources: BNA

value of the local currency (13.9%) occurred in May. The current pressure of the local currency had already been alerted by us in past notes since the biggest supplier of currency in the market, the Treasury, practically did not sell in April and in May it placed only USD 100 million. In Q1 2023, the inflow of foreign exchange resources into the country reduced substantially due to the drop in the Goods account balance, according to BNA data: oil exports totaled USD 6.6 billion (Bn), a 35% drop against USD 10.1Bn registered in the same period in the previous year. This movement was mainly caused by the contraction in oil production, in line with the stoppage of production at the Dália field, in Block 17 in March, and by the reduction in export prices. In this context, the reduction in the trade balance with an impact on the supply of foreign exchange resources to economic operators and consequently the pressure on the local currency, motivated the CPM's more conservative stance in this last meeting.

2| We have followed the path of year-on-year inflation, which slowed down in April for the fifteenth consecutive month, in line with the BNA's policy measures, but mainly due to the performance of the oil economy in the recent past: in the first three months of the year, the average rate of monthly inflation was 0.9% compared to 1.8% in the same period of the previous year. However, with a closer look, it appears that the monthly rate has accelerated since January at an average pace of 0.03pp and for this reason it is expected that year-on-year inflation will already start to accelerate slightly from May or June.

3| Long before the May depreciation, we expected the BNA to continue easing monetary policy. However, with the exchange rate imbalance, our expectations were adjusted. The CPM adopted a more conservative position, opting for a period of observation of the impacts of decisions taken in previous meetings. As we stated in the last note by way of conclusion, the inflation-exchange rate pair will continue to be a decisive factor for defining the monetary policy guidance mechanisms, considering that the exchange rate is one of the main reflectors of inflation in Angola, with high *pass-through* effects justified by weak economic diversification. Although there are no changes in the instruments for conducting monetary policy, the effects of short-term liquidity management through open market operations (OMA) with repurchase agreements (*Repo*) are felt. Repo interest rates continue to fall and directly impact the other interbank money market interest rates, primarily LUIBOR Overnight, which therefore affects the cost of credit to the economy in the same direction.

Repo interest rates continue to drive Luibor Overnight down



Source: BNA and BFA Calcs

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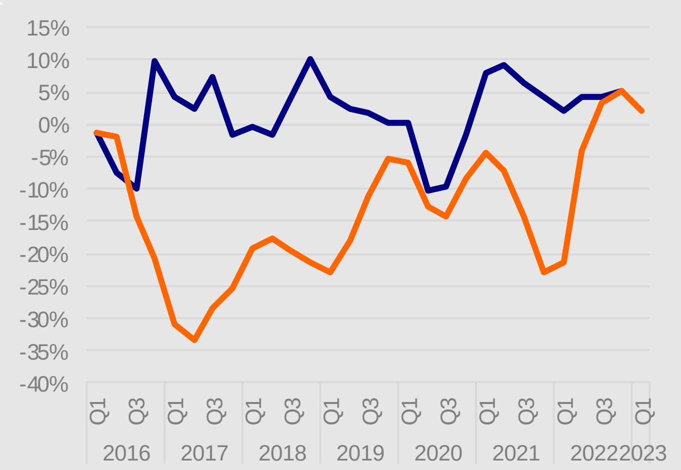
4| The real money supply, in Q1 2023, grew more slowly, consistent with our expectations of softer economic growth in this period. Money supply, measured by M2 in local currency rose 7.97% in April, the lowest growth since March 2022. After having grown for 8 consecutive months above Inflation, this pace was interrupted in March, and is now growing by around 2pp below the general price level, which indicates a more conservative position by the BNA, as monthly inflation has accelerated slightly. It can be noted that the operational variable of monetary policy (M0), which most visibly measures the position (contractionist or expansionist) of the policy, continues in a negative direction and, according to our calculations, fell again more sharply, around 10.3% yoy. In spite of this, the money market remains liquid, OMAs (absorption) reached around AOA 860.1 Bn in April, standing lending facilities for a period of 63 days stood at close to AOA 240 Bn, while the volume of swaps for liquidity on the IMM stood at AOA 721 Bn.

Real money supply grew slower in Q1

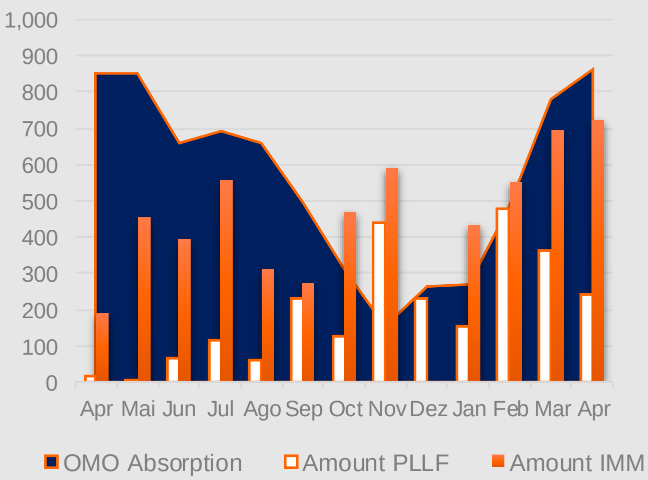
Yoy variation



Sorces: BNA and BFA Calcs

Volume of open market operations rises slightly

Percentage; Volume in AOA Billions



Sources: BNA

5| In order to mitigate the instability in the exchange market and the associated risk, the BNA decided to put USD 350 million in Treasury Bonds in circulation, available on the Angolan Stock Exchange and Debts (BODIVA). This decision is similar to the one taken at the end of 2022, during the depreciation that took place between October and November, and by the way it is the same title.

This intervention would allow the growth of the flow of operations, the growth of instruments such as forwards or speculative investors to raise expectations for the value of the Kwanza in the short term. However, given the amounts involved, this will have a very limited effect.

As for the next meeting scheduled for July 14, the CPM's decisions will depend on the course of monthly inflation, which seems to be accelerating slightly, on the evolution of the monetary base in Local currency, which is likely to contract more sharply and on the evolution of the exchange market, which is currently one of the main challenges for the BNA.

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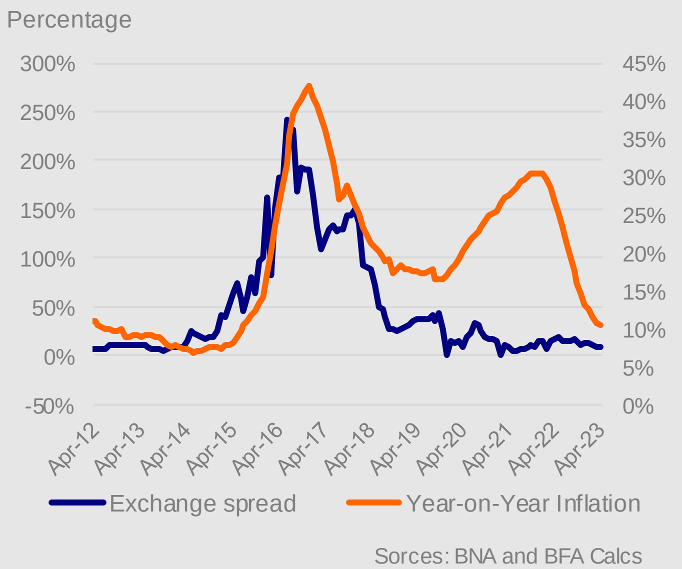
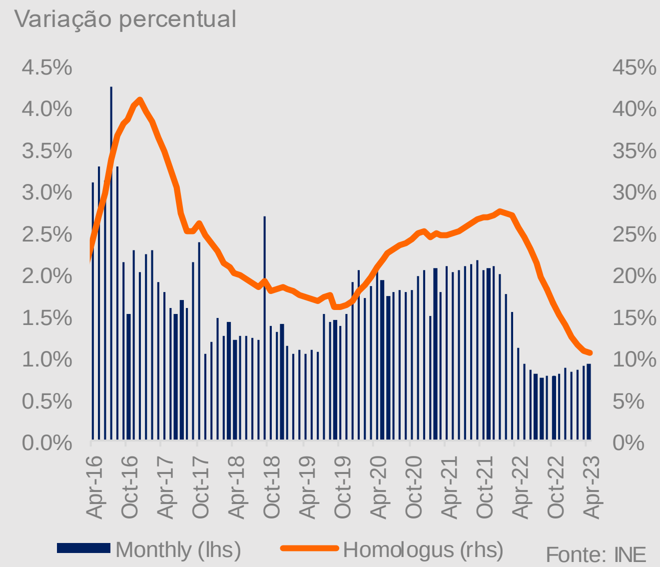
Exchange spread and inflation both close to minimums until April 2023



Inflation should stop dropping in Q2 2023



C. CONCLUSION

1| In pursuit of the objectives of price stability and the value of the local currency, the BNA must continue to ensure the balance between monetary policy and exchange rate policy: at a time when there is visible pressure on the exchange market consistent with the reduction in the balance of the trade balance, the Central Bank should continue to assess the situation very closely. Additionally, despite year-on-year inflation being at historic levels, it is crucial to analyze the pace of monthly inflation, which has been accelerating slightly.

2| We have observed that the BNA has been achieving its objectives linked to the easing of monetary policy, adopting a prudent position: while interest rates continue to fall and facilities have been used to inject liquidity into the system, repos have been used to dry up liquidity. Our expectation is that year-on-year inflation has already stopped decelerating and may start to rise very slightly to a level just above 12% at the end of this year.

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