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FLASH NOTE

Nº 10.2023 | July 28, 2023

BNA signals change in the course of monetary policy

Inflation accelerated in July less than we expected

A. DESCRIPTION

1| At the Monetary Policy Committee (CPM) meeting held on 14 July, the BNA decided to increase the interest rate on the marginal lending facility (FPCL) to 17.50% (+50bps). The CPM opted to maintain the basic interest rate and the deposit facility (FPAL) at 17% and 13.5%, respectively. Additionally, the CPM decided to make the custody fee mechanism more flexible on the excess liquidity of commercial banks with the BNA.

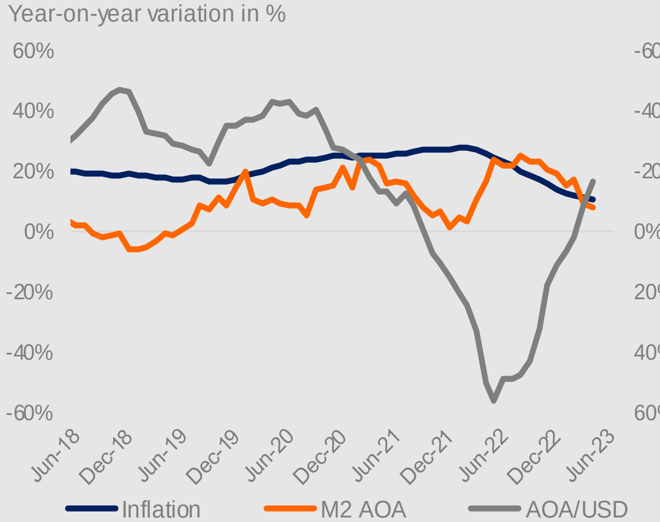
2| Year-on-year inflation accelerated to 11.23%, (+0.6 p.p) compared to May, signaling its second consecutive month of increases after registering the lowest levels since August 2015 in the first quarter of this year. According to date from the National Institute of Statistics (INE), monthly inflation stood at 1.41%, with the categories "Transport", "Health" and "Miscellaneous goods and services" registering the highest variations in the National Consumer Price Index (IPCN), with 2.71%, 2.08% and 1.70%, respectively.

B. ANALYSIS

1| The adjustment of the FPCL interest rate to 17.50% (+50bps) is a clear sign of a tighter monetary policy that the BNA has been adopting since the beginning of the Kwanza break. M0, the operational variable of monetary policy, has been contracting since November, with more intense year-on-year drops between April (-10.33% yoy) and May (-12.45% yoy), when it became clear that increases in monthly inflation were already persistent.

M2 grows less and less in the context of higher inflationary pressures

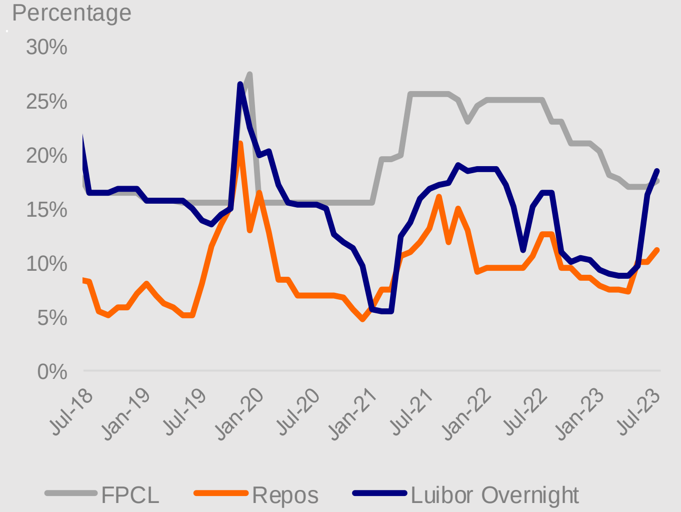
Year-on-year variation in %



Sources: INE, BNA and BFA calculations

The rise in the FPCL interest rate is a sign of a monetary tightening that has already been adopted

Percentage



Source: BNA

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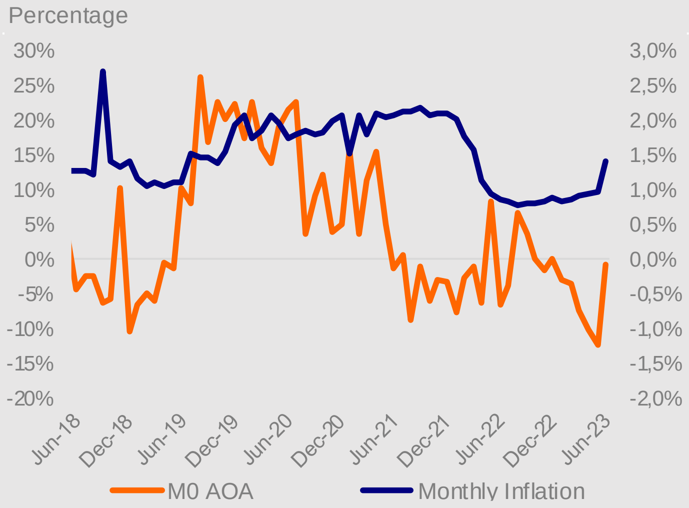
M0 started to fall in November reflecting BNA concerns about inflation



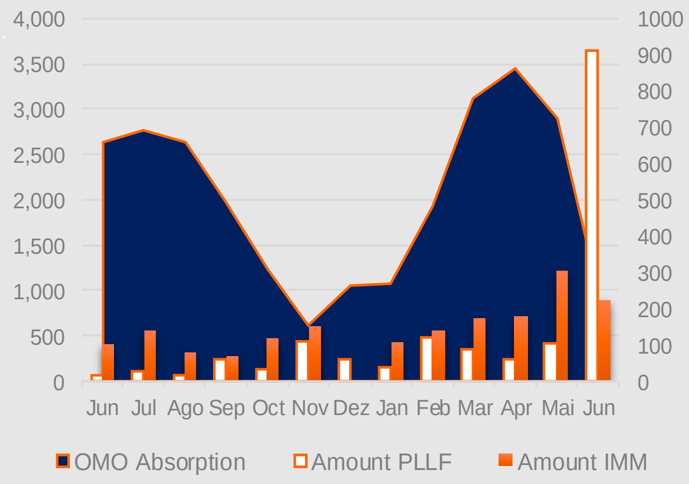
Sources: INE, BNA and BFA calculations

From the graph, the movement of M0 is very much in line with the trajectory of monthly inflation, which started to rise slightly from November onwards. Although the monetary base had already started to fall since Q4 2022, overall monetary policy was being accommodative, with the BNA regulating short-term liquidity needs, at the same time influencing the economy's interest rates lower.

In our opinion, the BNA changed the course of monetary policy from the end of May when the Kwanza began to fall sharply. According to our calculations, at that time the rates on the interbank money market (IMM) were already rising, the overnight Luibor which rose around 102 bp that month, rose again in June to another 651 bp. This movement is the result of the rise in repo rates and overnight marginal loan facilities.

The BNA, in pursuit of its objective of stabilizing the local currency (LC) and with the commitment to continue to maintain reserves at adequate levels, has prudently preferred to act on the demand side, contracting liquidity in LC through a more intense use of open market operations (OMO) with higher rates and wiping Kwanzas equivalent to USD 300 million through the sale of treasury bonds in foreign currency (FC). The BNA's more aggressive stance towards contracting liquidity in LC in order to curb demand for FC, moved the money market: in the interbank exchange for liquidity in May reached AOA 1.2 billion, making December 2020 peaks, while in June, the overnight liquidity facility reached the highest value since September 2020, which reflects an unbridled demand for Kwanzas, as the facilities are executed on the initiative of commercial banks, unlike OMOs.

Marginal lending facilities reached September 2020 highs

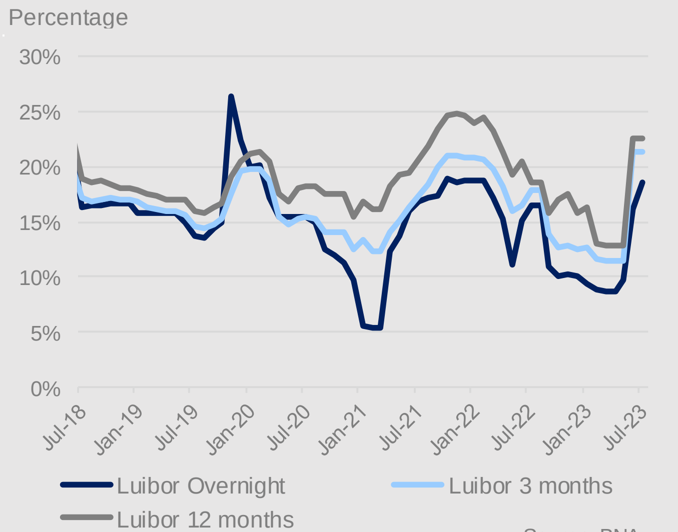


Source: BNA

In fact, marginal lending facilities operations reached historic highs, which would have partly justified the BNA communiqué of 23 June, informing banks that access to these operations would be restricted in terms of amounts. Now, we understand that this is an effective measure from the point of view of contracting demand for foreign exchange, since some banks, after purchasing FC, can resort to facilities to regularize their positions in LC. We believe that the current exchange rate, which is around 830 per dollar, is not the equilibrium rate and that part of the depreciation stems from speculative behavior. Therefore, now more restricted access to facilities may contribute to reducing speculation.

2| We think interest rates on the IMM and Treasury bonds will rise a little more as a result of reduced liquidity in the market. The IMM interest rates are growing: the overnight rate that signals the degree of liquidity in the economy is now close to 18.54% (+850Pbs ytd) and the remaining IMM rates that serve as indexes for a large part of credits to the economy, from housing loans and credit cards, increased by an average of 772bps since the beginning of the year, which is equivalent to saying that the cost of loans to the economy increased at least in the same proportion and eventually this should already have been reflected in the level credit whose stock contracted to AOA 4.6 trillion (-11% mom) in June.

IMM interest rates continue to rise, evidencing an increase in the cost of credit



Source: BNA

The liquidity pressure on the money market is notorious and this situation should prevail throughout the second half of 2023. With the BNA restricting access to facilities and directing banks only to the IMM as a way to obtain liquidity to meet the demands of In the short term, this is expected to impact the Treasury's ability to finance itself from banks, which may result in an increase in interest rates on sovereign bonds.

3| At a time when the market is very tight in terms of liquidity and the current macroeconomic environment demands higher levels of financial intermediation, the easing of the custody fee is opportune. The free reserves of banking financial institutions that represent the surplus of mandatory reserves deposited at the BNA, for the purpose of paying the custody fee, are classified in levels 1 and 2, the first being exempt and the second subject to the custody fee. According to the latest legislation of February 02, 2021, banks could maintain a minimum surplus of AOA 3 billion (level 1) not subject to the custody fee, while amounts above (level 2) were subject to a fee that ranged from 0.1% to 0.2%, depending on the excess. The new legislation makes it more flexible because it increases the minimum limit to AOA 4 billion and also sets 0.1% as the sole custody fee, regardless of the amount.

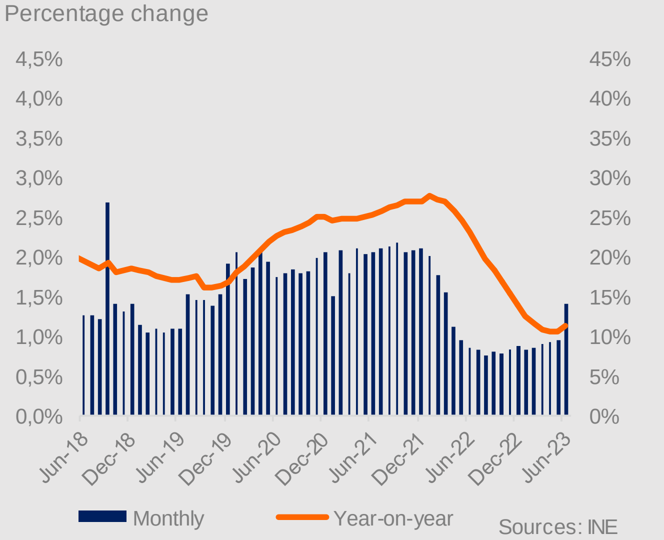
4| Monthly inflation accelerated noticeably, but below our expectations - our analysis pointed to a higher rise in June, and more moderate in the following months. We have been following the trajectory of monthly inflation, which in June increased for the ninth consecutive time, being mainly driven by the "Food and non-alcoholic beverages", "Miscellaneous goods and services" and "Health" classes, with a contribution to the IPCN which is around an average of 53%, 10% and 8%, respectively. Of all the classes, "Health" has registered the greatest price variations: prices have consistently increased and, according to our calculations, inflation in the sector in June grew by around 23.45% yoy. In addition to "Health", "Clothing and Footwear" and "Hotels and Restaurants" increased by 22% yoy and 14% yoy, respectively.

Health inflation has been growing persistently and in June it stood at 23.45% yoy

Sources: Bloomberg and BFA calculations

As we stated in the last note by way of conclusion, the inflation-exchange rate pair will continue to be the most decisive factor since the impacts of removing fuel subsidies are transitory and therefore their effects should remain for another 2 to 3 months, while pass-through effects should generate more persistent inflation. Thus, the key to controlling inflation in the coming months is the stability of the exchange rate, which still seems very challenging, although it is already clear that the exchange rate is depreciating less and less – against the Dollar, the Kwanza fell 14% in May, 34% in June and until the beginning of the third week of July it fell by only 1%.

Monthly inflation accelerates less than we expected and the year-on-year rate is close to 11.23%



Sources: INE

5| As for the next meeting scheduled for September 15, the CPM's decisions that go beyond the definition of the interest rate will depend on the course of monthly inflation, the evolution of the monetary base in LC and the evolution of the exchange market, which is in this This is the biggest challenge for the Central Bank. The BNA reset the short-term inflation target to a range of 12-14%. The impact of the exchange rate should pose a challenge regarding meeting the target. In this sense, we expect new measures to restrict monetary policy during the rest of the year, however, as the key interest rates are already high, it is possible that the BNA will resort to other measures, such as adjustment in the ratios of mandatory reserves and continuation of the restriction the use of standing liquidity facilities.

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: Until now, the efforts of the BNA to stabilize the Kwanza without compromising the proper functioning of the market are notable, but in order to meet the new inflation target, either a very noticeable inversion or immediate stability in the exchange rate is needed. At the beginning of this year, we expected inflation close to 12% at the end of the year, with this change in scenario we are also revising our expectations.

2| We have observed that the BNA has been draining liquidity to curb the demand for the local currency and soften the impact of its value against foreign currencies. However, we understand that the reduction in imports and an eventual return of the Treasury to consistent sales will be a crucial factor for the exchange rate, cooperating to reach the BNA's short-term target.

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