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FLASH NOTE

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BNA keeps the course of monetary policy unchanged

There are still 4 more months to go, but inflation is already close to the BNA target

A. DESCRIPTION

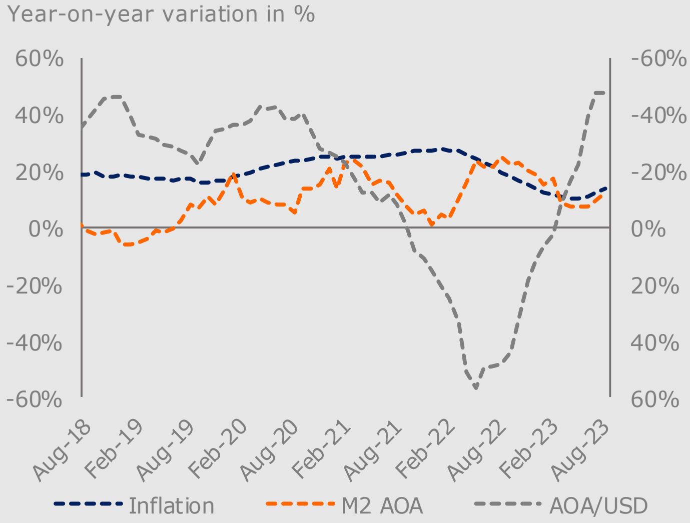
1| At the meeting of the Monetary Policy Committee (MPC), held on September 15th, the Central Bank of Angola (BNA) decided to keep key interest rates unchanged. The MPC chose to maintain the basic interest rate (BNA rate), the marginal lending facility (MLF) and the deposit facility (DF) at 17%, 17.5% and 13.5%, respectively.

2| Annual inflation accelerated to 13.53%, +1.4 percentage points (pp) compared to July, signaling the fourth consecutive month of increases and reaching levels close to the December 2022 highs, 13.86%. According to date from the National Institute of Statistics (INE), monthly inflation stood at 2.04%, with the categories "Education", "Health" and "Food and non-alcoholic drinks" being those that recorded the biggest variations in the Price Index to the National Consumer (IPCN), with 6.19%, 2.08% and 1.70%, respectively.

B. ANALYSIS

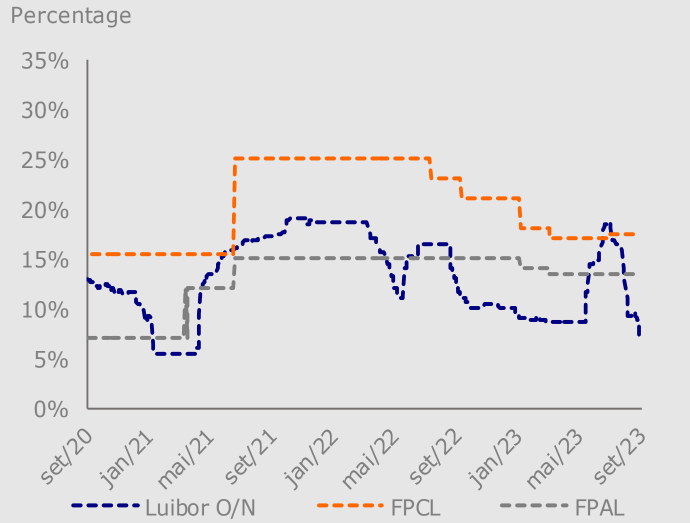
1| At a time when the exchange rate appears stable, inflation rising but still below reference interest rates, the MPC has not changed the main instruments for conducting monetary policy. The foreign exchange market does not show significant variations as the USD/AOA exchange rate has been around 825 since mid-July, after having depreciated by more than 45% in the last semester. We believe that there are some factors that underlie this movement, as issues linked to the structure of the market itself and regulation. Looking specifically at regulation, the BNA changed the procedures for the sale of foreign currency by companies in the oil and diamond sector with the aim of ensuring greater

M2 grows again despite inflationary pressures



Sources: INE, BNA and BFA calculations

Overnight Luibor falls signaling increase in liquidity in the Interbank Money Market



Source: BNA

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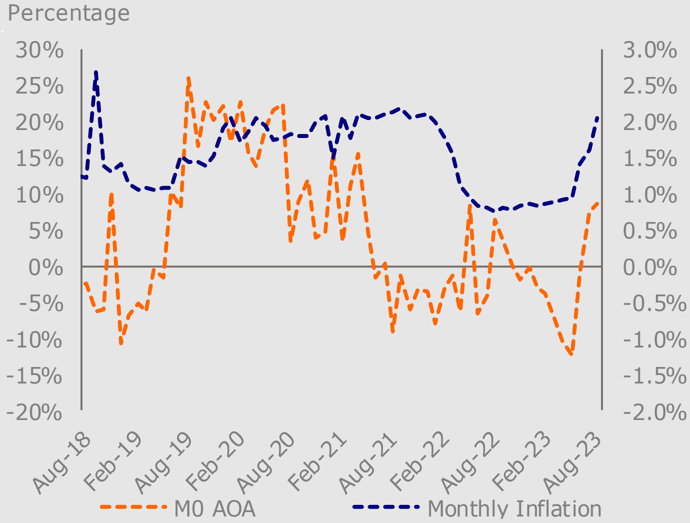
transparency in foreign currency sales operations. Following the entry into force of this directive, we noticed a reduction in the volume of transactions by oil companies, which is linked to the adaptation by operators to this regulation, and which culminated in the transfer made by the BNA at the end of August of USD 100 million to Commercial Banks, acquired from participants on the Bloomberg FXGO platform.

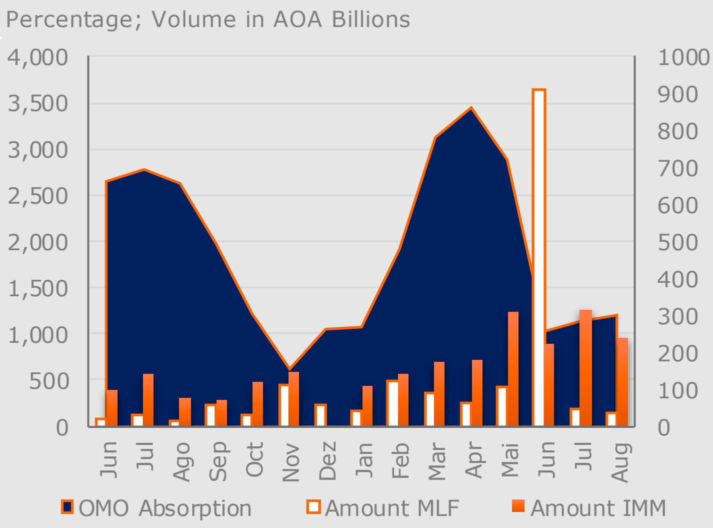
2|The Monetary Base (M0) in local currency, the main operational variable of monetary policy, interrupted in the previous month the sequence of consecutive year-on-year declines seen since October 2022, fundamentally influenced by the excess reserves of the banking system which grew by around 170.45% in July. The movement of M0 converges with the trajectory of monthly inflation, which began to rise since the end of 2022 due to seasonal factors and the beginning of the depreciation of the domestic currency from mid-October. In monthly terms, there was a contraction of around 0.13% to around 1.6 billion, after having reached the biggest monthly expansion in the last three years in July, 10.95%. The monetary aggregate M2 registered a monthly expansion of around 3.72% (AOA +279 million compared to AOA 7.5 billion in July). In year-on-year terms, there was an expansion of 12.37%:

M0 grows year-on-year, influenced by the rise in excess reserves



Sources: INE, BNA and BFA calculations

Marginal lending facility falls after growing significantly in June



Source: BNA

this movement was strongly influenced by the very sharp growth of the indicators that make up this aggregate, with emphasis on quasi-currency, notes and coins held by the public and transferable deposits, which achieved growth of 13.87%, 25.05% and 9.58 %, respectively. Removing the effect of inflation, this monetary aggregate recorded the sixth month of consecutive year-on-year falls, amounting, on average, to a drop of 2.54%. In general, we believe that the BNA has not changed the instruments for conducting monetary policy as it is still evaluating the effects of past measures in order to maintain balance in the money market.

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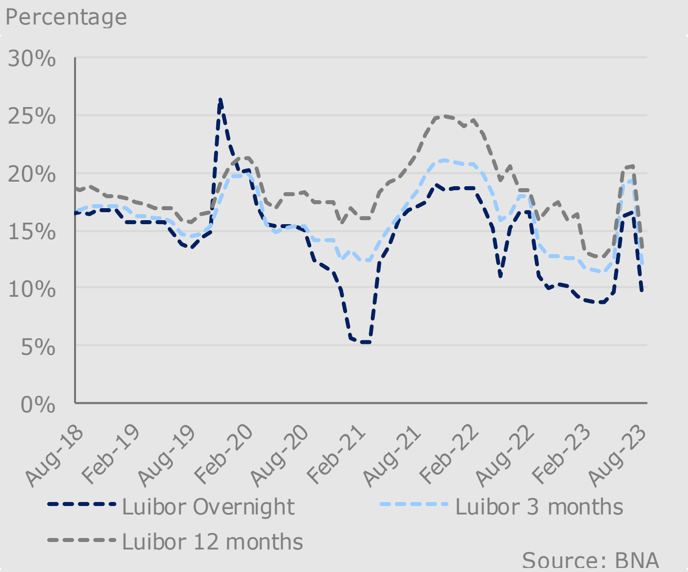
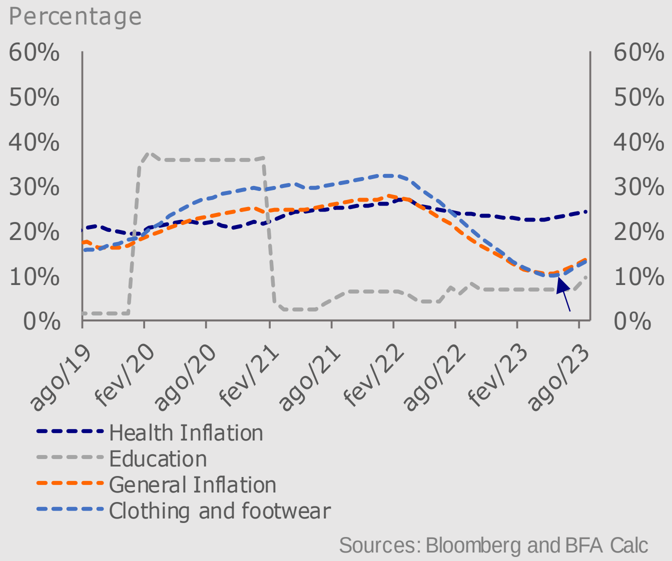
Interest rates fall in line with greater liquidity in the IMM



Food inflation grows again in line with general inflation



3| We believe that the BNA changed the course of monetary policy from the end of May when the Kwanza began to fall abruptly, directly affecting liquidity due to the amounts and rates offered in repo instruments but the trend appears to have completely reversed in recent weeks. Luibor rates are now falling and Overnight rates are at 7.20%, 280 basis points below the levels recorded at the beginning of the year, 10%. It should be noted that in the period immediately following the depreciation, between June and mid-August, they grew significantly and reached close to the March 2022 highs of 16.68%: the rise in Luibor rates reflected a more restrictive monetary policy and with the liquidity tightening, it became possible for banks to retain liquidity in the BNA with higher rates. At this point, there is clearly an inflection in the trajectory of Luibor rates, strongly impacted by the maturity of a very significant volume of debt securities and this event is contributing to the extra liquidity seen in the market: the foreign exchange market is unable to absorb this liquidity, which pushes Luibor rates down.

However, we think that this market positioning will not be maintained for long - if inflation continues to grow, as we expect, the BNA will have to intervene more strongly to restrict liquidity again.

4| The MPC's decision is justified by the fact that it considers that the increase in prices was due to seasonal factors and the insufficient supply of goods and services: monthly inflation accelerated again, reaching 2.04% in August, the highest level since December 2021. Taking a closer look, it appears that the "Education", "Health" and "Food and non-alcoholic beverages" classes were those that recorded the greatest variations for the IPCN, around 6.19%, 2.08% and 1.70%, respectively. In Luanda, the IPCN was 2.82% compared to July, however, it represents the biggest monthly increase since October 2017. The "Education" class recorded the biggest variation in prices: this increase is consistent with the increase in goods related to teaching, which generally takes place in August and September, such as registration, enrollment and teaching material. It is expected that in the coming months this category will again register increases both due to seasonal factors and also as a result of the measures imposed by the executive in Decree nº 187/23 which approves the rules and procedures for setting and changing the value of tuition fees and emoluments: According to this legal diploma, "the values of tuition fees and emoluments can be adjusted annually up to the limit of the annual inflation rate for the month of May of each calendar year published by INE".

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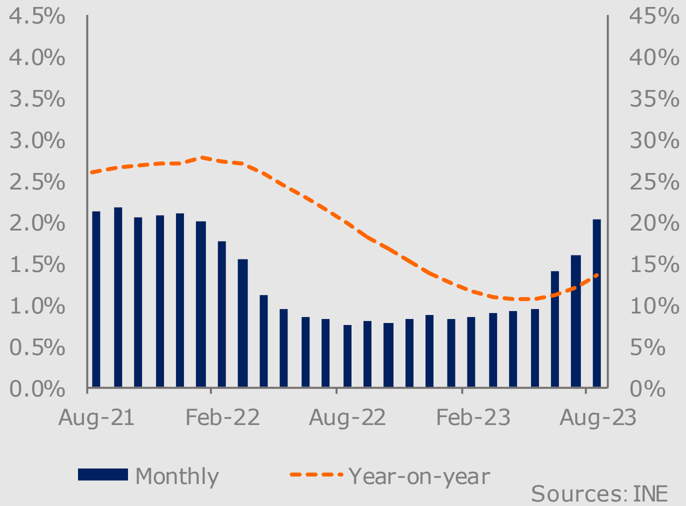
Year-on-year inflation accelerates to December 2022 highs

Percentage change



Sources: INE

From our perspective, we believe that the increase in prices was not solely due to seasonal factors: more than half of general inflation depends on price variations in the "Food and non-alcoholic beverages" category; When we look at the variation in food prices, they are rising at the same pace or even slightly higher than the general inflation trend. In this sense, the data are not compatible with the argument that the increase was mainly due to seasonal issues. As a result, the path of monthly (and year-on-year) inflation is expected to continue to rise in the coming months.

We believe that annual inflation will end the year at around 20% or above if there is no recovery in the Kwanza and a strong tightening of monetary policy, taking into account that with current data relating to the money market, the BNA has stopped making restrictive monetary policy. As for the next meeting scheduled for November 20th and 21st, the MPC's decisions, which extend to defining the instruments for conducting monetary policy, will depend on the trajectory of inflation and the evolution of the foreign exchange market. Therefore, we predict that inflation could be above the short-term target defined by the BNA, between 12-14%, in September, fundamentally influenced by the lack of an inversion in the exchange rate. Therefore, we expect other measures to restrict monetary policy to be used, such as, for example, adjustments to mandatory reserve ratios and continued tightening of the use of permanent liquidity facilities.

C. CONCLUSION

1| Monetary policy options depend mainly on the inflation-exchange rate binomial: Looking at the inflationary pressures of recent months, we believe that the BNA should use other monetary policy instruments since the key interest rates are already high. On the exchange side, in a scenario in which there is no reversal of its movement, it is expected that monetary policy will again become "tighter".

2| The reductions in the trade balance in the last six months, consistent with the pressure on the foreign exchange market, are indicators that the BNA continues to analyze the type and measures it intends to use in order to maintain exchange rate stability.

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