Economic Research Unit
Contacts: +244 222 696 462
E-mail: dfi.gee@bfa.ao

FLASH NOTE

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Better late than never, inflation forces BNA to tighten

Mandatory reserves coefficient in local currency changed after several months

A. DESCRIPTION

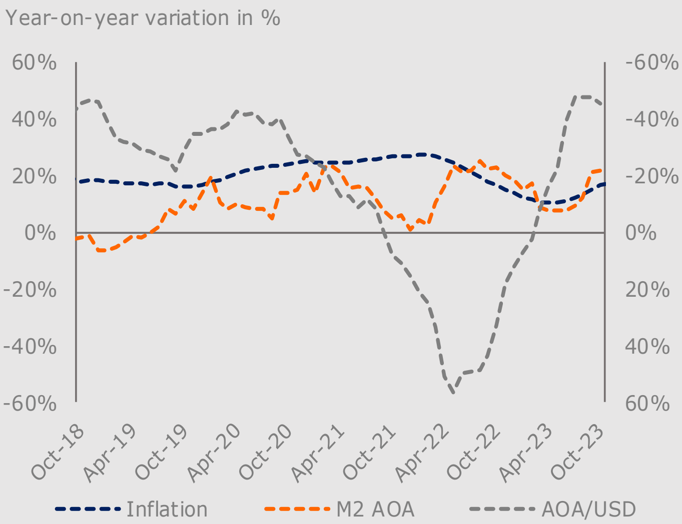
1| At the Monetary Policy Committee (MPC) meeting, held between the 20th and 21st of November, the BNA decided to increase the main interest rates. The basic interest rate (BNA Rate) was raised by +100bps to 18%, the marginal lending facility and deposit facility were raised to 18.5% (+100bps) and 17.5% (+400bps), respectively. The MPC also decided to increase the coefficient of mandatory reserves in local currency (LC) to 18% (+1pp) and eliminate the custody fee on the excess free reserves of banking financial institutions, deposited at the Central Bank.

2| Year-on-year inflation in October accelerated to 16.56%, +1.6pp compared to September, the sixth consecutive month of increases, reaching highs of the last 12 months. According to data released by INE, monthly inflation stood at 2.15%, with the categories "Health", "Transport" and "Food and non-alcoholic drinks" being those that recorded the biggest variations in the Price Index to the Local Consumer (IPCN), with 2.66%, 2.54% and 2.42%, respectively.

B. ANALYSIS

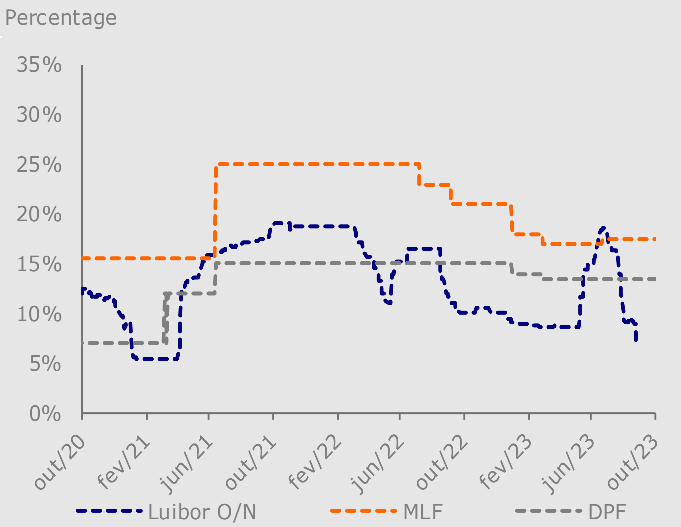
1| At the previous MPC meeting, in September, the BNA had decided not to change the course of monetary policy, expecting the impacts of exchange rate depreciation and the partial removal of fuel subsidies to last approximately three months. However, we note that liquidity in the monetary system has grown dramatically: in the last three months the monetary base (M0) in LC increased by an average of 18% yoy - this is the period with the highest growth since that observed in July 2020, a period in which relief measures were underway for the domestic economy while trying to

M2 grows again despite inflationary pressures



Sources: INE, BNA and BFA calculations

Overnight Luibor falls signaling increase in liquidity in the IMM



Source: BNA

combat the harmful effects caused by Covid-19. The main example of these measures is the purchase of bonds from companies by the BNA, for a total value of AOA 100 BN.

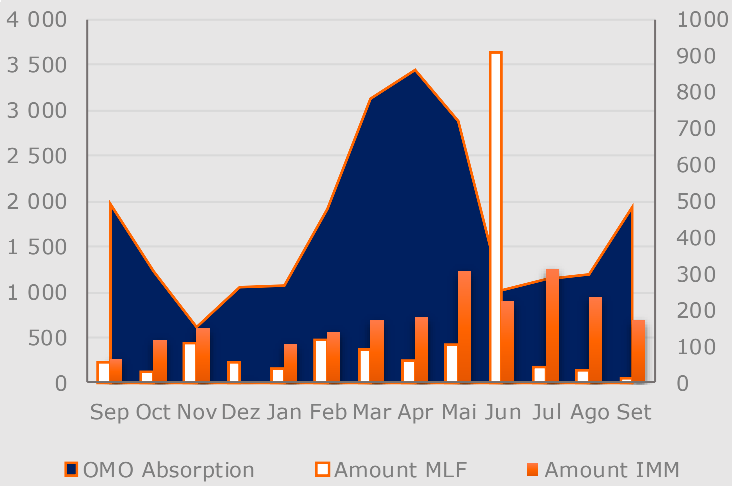
According to our understanding, there are some factors that justify the amount of liquidity that exists in the market now: This year we have seen a movement towards paying public debt arrears more in the form of liquidity than in sovereign bonds; volumes of bond maturities have been high; the banks have maintained high levels of liquidity to ensure capacity and purchase of foreign currency; primary market interest rates have not been high enough to counter this banking preference for liquidity.

Looking at the M2 variable, which is a more comprehensive measure of liquidity, it grew almost 19% yoy in the last three months. In view of this, interest rates on the interbank money market (IMM) fell significantly, overnight Luibor reached 2014 lows, around 4.7%. In other words, in this season between the previous MPC and this decision, the central bank ended up allowing a very significant expansion of the nominal currency stock, which could contribute to further stimulating inflation soon. In fact, at the last meeting the BNA attributed the growth of monetary aggregates to an expansionary effect of fiscal policy. However, a bond sale or purchase operation carried out by the Treasury is ultimately a monetary policy operation. Therefore, the expansionary effect of fiscal policy is also an expansionary effect of monetary policy.

2| The increase in the mandatory reserve coefficient and the elimination of the custody fee are measures consistent with the current situation. As stated in the paragraph above, the level of liquidity in the market has increased significantly, with particular emphasis on banks' free reserves, which have grown on average by almost 68% yoy in the last 4 months. The volumes of marginal lending facility operations contracted 76% yoy in September, with limitations on access to the line in June. Open market operations reached almost AOA 481 BN in September, the highest value since May; Still, a year-on-year contraction of close to 3%. Liquidity swap operations reached AOA 679 BN, more than doubling compared to the same period last year. Despite the restriction on MLF and a now more intense use of OMO in September, the market remains quite liquid.

Marginal lending facility falls after growing significantly in June

Percentage; Volume in AOA Billions



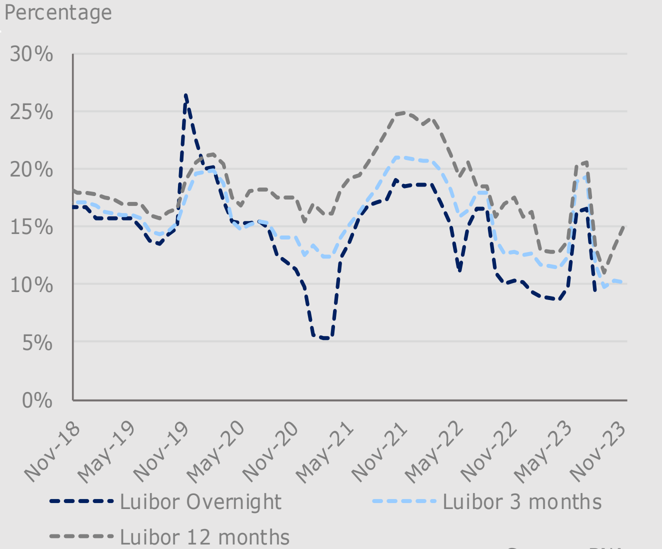
Source: BNA

Therefore, increasing the mandatory reserve coefficient, a more structural instrument with a strong potential to restrict short-term liquidity, seems to us to be an appropriate tool to reduce excess liquidity. Regarding the elimination of the custody fee, implemented in August 2020 - with the underlying objective of stimulating economic activity by encouraging an increase in the level of intermediation of financial resources between Commercial Banking and other economic agents -, the MPC says it has already achieved the intended objective.

3| Headline inflation will end the year close to 20%, at a time when Luanda's inflation in October was already at 20.4%, 3.82pp above headline inflation. Taking into account the capital's nature in economic activity and the huge difference compared to other provinces in current inflation levels, our expectation is that inflation in the remaining provinces will accelerate in the coming months. For 2024, our perspective is that inflation will continue above 20%, still accelerating for part of the year, before slowing down again. On the one hand, we expect that there may still be some depreciation movement in the 1st quarter of 2024, a factor that will contribute to higher inflation; on the other hand, it is possible that there will be more movements to remove fuel subsidies and that energy costs will increase, according to the 2024 Budget. Therefore, the general effect of these factors, combined with some inertia in inflation, should maintain the above variable in 20% for most of the year; Our estimate points to inflation ending 2024 at close to 24%. In this sense, interest rates in the economy (interbank, credit to customers, public debt yields) should also register an upward movement. In fact, the MPC's decision at the last meeting is a prelude to this movement. It remains to be seen how the BNA will act regarding the amounts and rates of repo operations, which directly influence liquidity. Interest rates on longer terms in the interbank market have already started to rise and reversed the trend around mid-October.

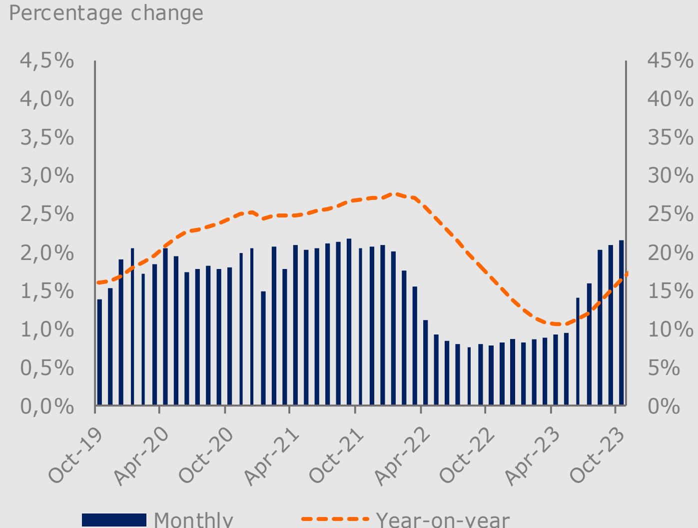
As for the next meeting, which should take place in January next year, the MPC's decisions will depend on the trajectory of inflation and the evolution of the foreign exchange market, which is currently a major challenge for the monetary authority.

Interest rates in the IMM have already started to rise, with the exception of overnight rates



Source: BNA

Year-on-year inflation accelerates to October 2022 highs



Sources: INE

C. CONCLUSION

1| We believe that the fight against inflation will continue for a long period and the objective of single-digit inflation will again not be achieved for at least the next 2 years: between oil prices not returning to levels above USD 90, a growth in limited oil production, but above all the Ministry of Finance is under pressure with high foreign currency amortizations in the short and medium term, there will continue to be pressure on the foreign exchange market which will be reflected in equally pressured inflation. In this sense, we do not expect an easing of monetary policy soon, and it is even possible that it will worsen in the 1st half of 2024.

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