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FLASH NOTE

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More reserves, less liquidity

Inflationary pressures force a new increase in mandatory reserve ratio

A. DESCRIPTION

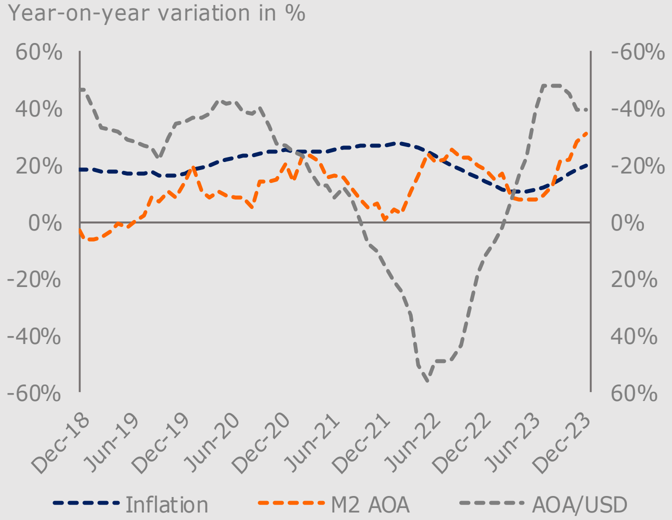
1| The Monetary Policy Committee (MPC) met on 18 and 19 January and decided to tighten monetary policy again. The Angolan central bank (BNA) opted to increase, for the second consecutive time, the mandatory reserve ratio by 2 percentage points (p.p.) to 20% and kept the other instruments for conducting monetary policy unchanged.

2| Year-on-year inflation in December stood at 20%, an expansion of 1.8pp compared to November, the seventh consecutive month of increases in 2023. According to INE data, monthly inflation stood at 2.4%, the highest since October 2018. In particular, the highlights were the increases in the classes of "Health", "Miscellaneous Goods and Services" and "Food and Non-alcoholic Beverages", with 3.1%, 3.0% and 2.8%, respectively. On the other hand, the classes of "Education", "Communication" and "Transportation" had the smallest increases, with 0.0%, 0.8% and 0.9%, respectively.

B. ANALYSIS

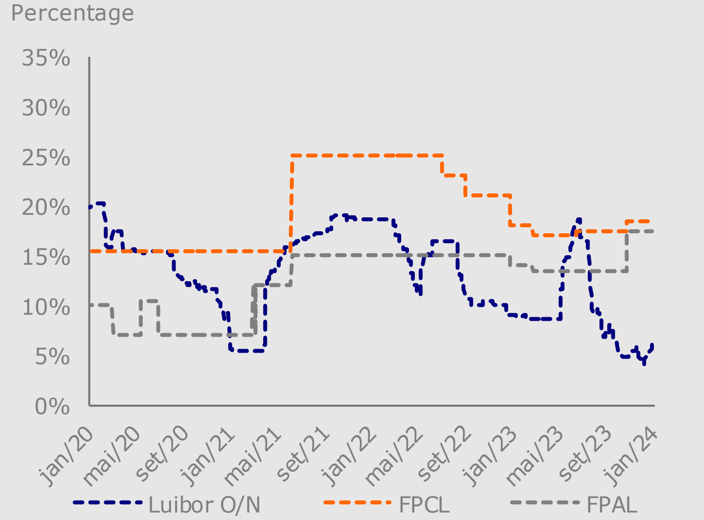
1| The MPC began the monetary tightening cycle in November last year, having decided on that date to raise key interest rates, as well as to raise the reserve requirement ratio. Since September, M2 has been growing comfortably above inflation and therefore tightening monetary policy seemed to us to be the most appropriate decision since then. However, we note that despite the BNA's more restrictive stance in November, the growth of liquidity in the market did not stop, with M2

M2 grows a lot, pushing inflation upwards



Sources: INE, BNA and BFA calculations

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



Source: BNA

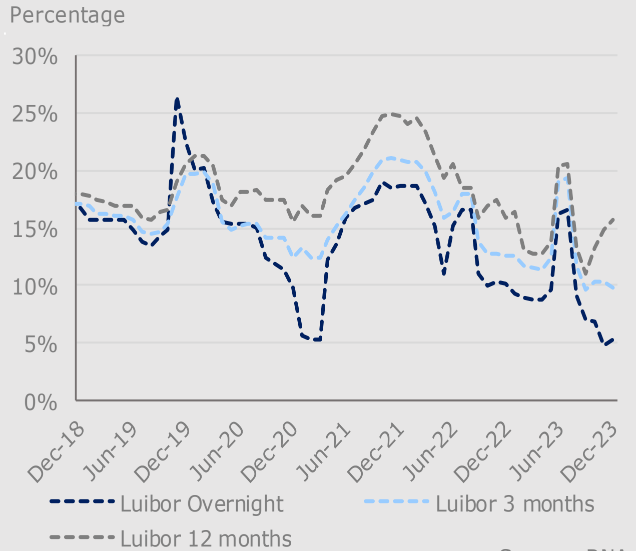
continuing to grow above inflation and the money market still showing signs of plenty of liquidity. It is important to understand how the variables behaved in the face of these November changes:

- M2 has grown 26% yoy on average in the last 4 months and by extending 31% yoy in December, it reached October 2014 highs. We also note that M0, the operational variable of monetary policy, grew by 27% in November and by another 34% in December, the largest increase since January 2016. According to our analysis, the monetary base expanded mainly on the side of free reserves, which grew by 68% in the last two months of last year, probably due to the removal of the custody rate; In other words, monetary tightening is not being effective so far, despite the measures.

- As a result of this low effectiveness, the rates in the MMI have not reacted so far. Luibor Overnigth (O/N) recorded mixed movements, with very slow increases and in all, it rose only 116 basis points (bps) to 5.89%, remaining quite close to historical lows. The longest maturities, i.e. 9 and 12 months, saw increases of +29 bps and +83 bps respectively. The 1, 3 and 6 month maturities had the opposite behavior, with drops around 143 bps, 104 bps and 55 bps, respectively.

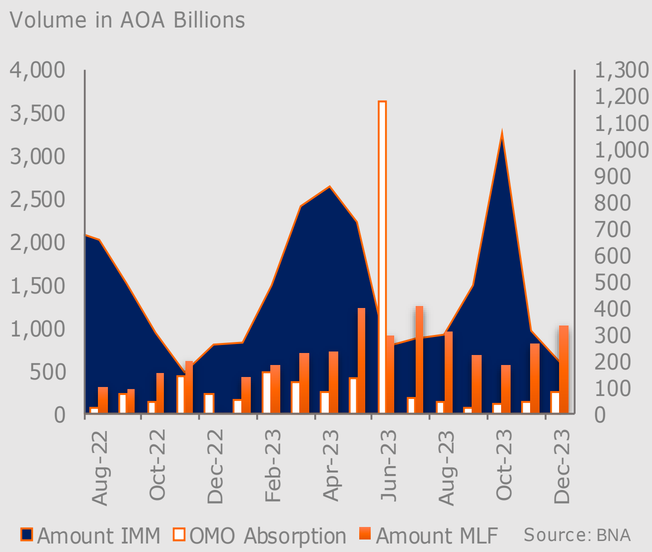
- On the other hand, another sign of liquidity: the volume of exchange transactions for liquidity between banks reached AOA 806 billion (B) in November (+47% mom) and another A0A 1.0 trillion in December (+25% mom), which makes an average monthly growth of more than 35%. In the money market, we saw that the BNA absorbed almost AOA 1.1 trillion via open market reduced the number of repos to AOA 309 million and in December it reduced it even further to AOA 191 operations (OMA) in October. In November, it million, which means that the BNA withdrew more liquidity before November – when monetary policy tightening began – than after.

Luibor growing on the longer timeframes and recording lows on the shorter timeframes



Source: BNA

Marginal lending facility falls after growing significantly in June



Source: BNA

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According to our understanding, the high volume of securities maturities, the increasingly noticeable loosening in the volume of transactions in the foreign exchange market and especially the removal of custody, will be contributing even more to the expansion of liquidity, competing with the effect of depreciation to increase inflation, which justifies new monetary tightening measures. the increase in the reserve requirement ratio.

2| Increasing the reserve ratio coefficient is appropriate to reduce liquidity levels in the market, although we believe that +2pp may not be enough to withdraw all excess liquidity consistent with fighting inflation. According to our calculations, with the increase in the coefficient in November, about 1.53B Kwanzas were withdrawn from there. By raising the coefficient by +2pp to 20%, the BNA would be withdrawing approximately AOA 179B more and in total AOA 1.79 trillion as of February. We estimate that by the end of March, the date of the next MPC meeting, a sum of AOA 1.84 trillion will be withdrawn from the market**. It is possible that it is also necessary to strengthen the liquidity constraint by offering more attractive interest rates to banks for the absorption of liquidity by the BNA, through repos and with Ease of Absorption.**

3| The MPC set this year's inflation target at 19% based on the continued slowdown in the terms of trade, the insufficiency of the supply of goods and services in the short term, the vulnerability of the domestic supply chain, and the persistence of constraints in the international supply chain. We found that the gap between Luanda's inflation and National inflation increased again in December to close to 6pp, the highest value since records began. Considering the capital's character 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 outlook is for inflation to remain 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 State Budget. Thus, the general effect of these factors, combined with some inertia of inflation, should keep the variable above 20% for much of the year; our estimate points to inflation ending 2024 close to 24%, 5pp above the BNA's current target.

Year-on-year inflation in December accelerates to August 2022 highs

Percentage change

Source:INE

The BNA once again assumed that part of the growth in liquidity in the market is linked to the expansionary effect of fiscal policy and the high level of credit granted to the private sector. Although it seems to us that the fiscal situation should lead to higher issuances than expected in the annual debt plan, both factors cited by the BNA should continue to be relevant, continuing to provide a stimulating environment for inflation. In this sense, it seems likely that a further tightening of monetary policy will be in March: however, it will be important to wait to see the effect of these measures on monetary aggregates in the next 2 months. The BNA itself should be aware of these variables.

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C. CONCLUSION

1| The BNA's monetary policy options depend on the performance of inflation and inflation shows no signs of stopping its increase in the short term. In our opinion, the increasing trend of inflation, the increasing pressures on the foreign exchange market, the removal of the custody fee, the maturities of several securities, among other occurrences, may represent obstacles to the BNA's intention to reduce liquidity in the market. Thus, it is necessary to use other tools to deal with liquidity management. We expect further worsening of monetary policy throughout the year, due to the use of more attractive rates in the BNA's liquidity-absorbing instruments, especially repos.

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