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FLASH NOTE
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Angolan Central Bank lowers reference rate, cuts reserve ratio

Decelerating inflation allows for slight easing of monetary policy

A. DESCRIPTION

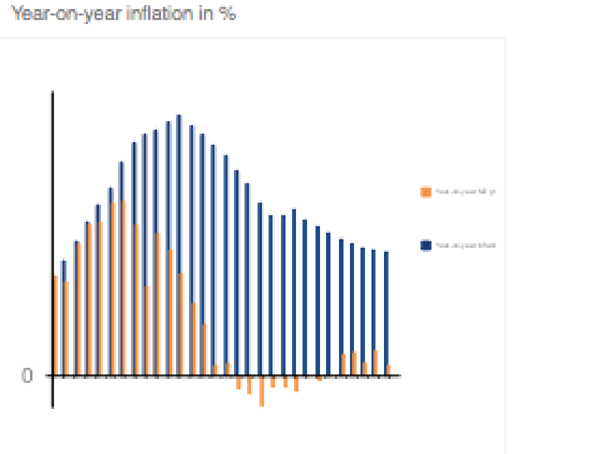
1 - The Angolan central bank's (BNA) Monetary Policy Committee (CPM) decided to reduce its reference rate (BNA rate) from 18% to 16.5%, the second consecutive drop – in May, the CPM merged its liquidity provision rate (then at 20%), with the reference rate, then at 18%, de facto easing monetary policy. Moreover, it was likewise announced that the mandatory reserves ratio in local currency would drop, from 19% to 17% (it had also been reduced from 21% to 19% in May).

B. ANALYSIS

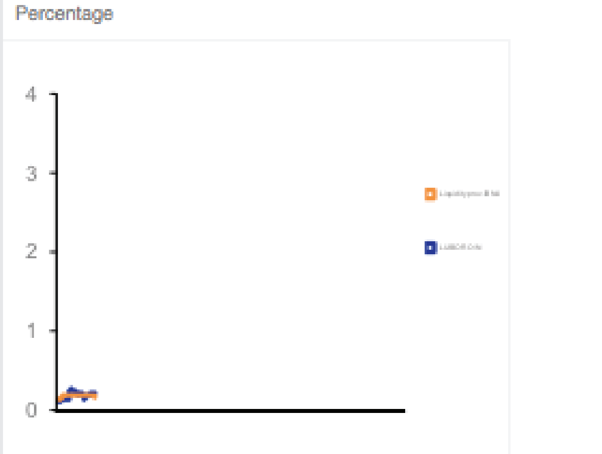
1 - These two decisions reflect a slightly more flexible monetary policy, somewhat slowing the tightening put in place since mid-2016. Looking at the M2 in local currency (physical currency together with deposits in the banking system), money supply has grown at a lower rate than the year-on-year rise in prices, as shown by the Luanda CPI. In this sense, as the growth in money supply is not keeping up with inflation, the real money supply is actually decreasing, even though it shows nominal increases. **Indeed, for some months, the money supply has seen actual nominal declines year-on-year.**

2 - The tightening in monetary policy aimed precisely to control inflation: the scarcity in local currency is driving up the liquidity needs of the Angolan banks, which in turn pushes the interbank offer rate (LUIBOR) upwards; consequently this increase hinders consumption and investment - LUIBOR influences (and indexes) the rates practiced by banks in the market. **In the last few months, the continued deceleration of inflation (while the currency depreciation would point the other way) has reflected a relative success in the applied monetary policy.** In fact, the larger availability of foreign exchange (at a weaker exchange rate) has probably reinforced this effect: in making foreign exchange more readily available, addressing a significant amount of pending requests, the BNA caused bank depositors and companies to move Kwanzas to cover for these operations.

M2 in local currency has grown significantly less than year-on-year inflation



Interbank rates remain high despite the start of monetary flexibilization



3 - This reduction in liquidity is translating into a dire scenario for firms, which are likely to have seen private consumption drop in the first half of the year. Although there are no available statistics for GDP for 2018, industrial production in Q1 showed a year-on-year fall (the 8th consecutive quarter of decreases), hinted at a still shrinking economic activity.

4 - Thus, this slight easing should allow for larger liquidity in the system, albeit only marginally. In fact, although there are now more funds available in the banking system (which, in turn, could be available to the real economy), interest rates are likely to react slowly, being at the same time at still relatively high levels. In particular, one should note that the impact of the changes in the mandatory reserve rate will be larger, in comparison with the change in the reference rate; this results from the fact that, while liquidity provision operations occur (the central bank providing overnight liquidity to local banks) relatively often, for various reasons, this is not an instrument as broadly used as would be deemed optimal – a fact that is reflected on the significant premium of the LUIBOR against the reference rate.

Box - Angola taps 30-year Eurobond issued in May with USD 500 million

1 - Angola will issue USD 500 million on its May issue of 30-year Eurobonds, maturing in 2048, totaling an outstanding amount of USD 1.25 billion. The issue will settle on July 23, and pricing was agreed above par (102.76), translating into an implicit yield of 9.1%, 27.5 basis point below the cost in the original USD 1.25 billion in May.

2 - Although these news do not constitute a significant change, they are a sign that investors remain confident in a slightly more complicated environment for emerging markets. Moreover, in our opinion, debt issuing in the market will surely be more transparent, and possibly cheaper than bilateral debt agreements with several commercial entities, which remains a cornerstone of the financing of the Angolan government.

C. CONCLUSION

1 - The drop in the reference rate and the mandatory reserves rate in local currency will allow for a more loose environment in the banking system. However, the climate will remain one of scarce liquidity, exacerbated by the central bank's need to address pending foreign currency requests. Therefore, it is likely that the apex bank will proceed to further easing in 2018, possibly in the CPM's next meeting, on September 24. One should note that the mandatory reserves ratio in local currency saw a low of 12.5% in the previous tenure of the current BNA head, José de Lima Massano, at a time when inflation posted historical minima in Angola (6.9% in May 2014).

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