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FLASH NOTE
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Rates unchanged, but monetary policy tightens nonetheless
Inflation should accelerate in 2020, as a result of October's depreciation

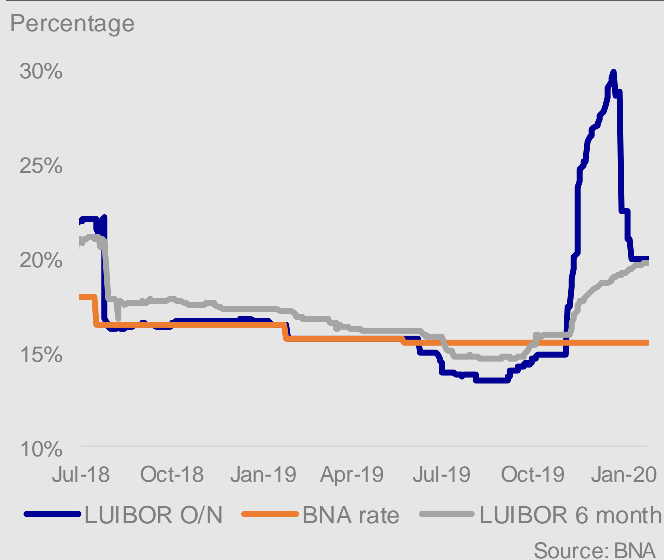
A. DESCRIPTION

1| At Monday's Monetary Policy Committee meeting, the Angolan central bank decided to keep the various monetary policy instruments unchanged. At the moment, the BNA Rate (reference rate) remains at 15.5%; the mandatory reserves coefficient in Kwanza is 17%, 15% for foreign currency deposits. However, the use of other tools still translates into a rather tight monetary policy, with a view to containing inflation and, at the same time, also resulting in a restricted demand for foreign exchange from the banking system, preventing a further depreciation of the Kwanza. The next meeting is expected to take place on March 27 this year.

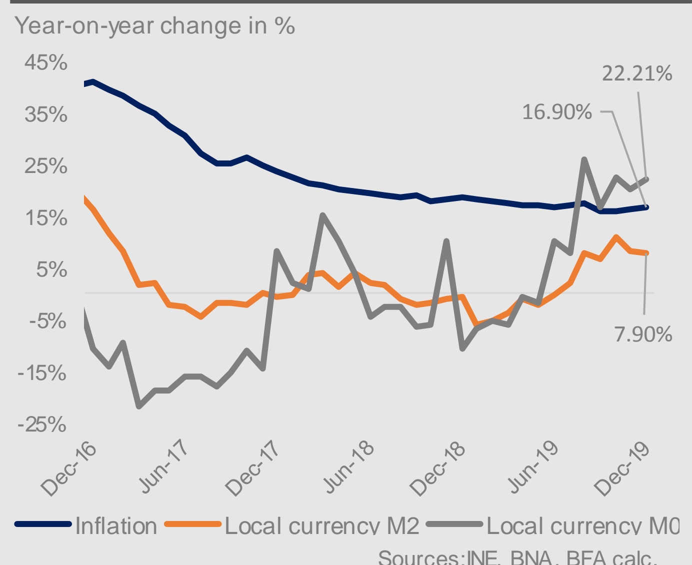
B. ANALYSIS

1| This decision reflects a steady course of action by BNA, in maintaining a restrictive monetary policy, both pausing the reference rate's lowering path and using more direct (and effective) tools to restrict liquidity. From the decision to increase local currency mandatory reserves (from 17% to 22%), a large portion of liquidity has been withdrawn from the market. This caused a halt in the depreciation occurring at that time, even leading to a temporary appreciation of the Kwanza. At the same time, to mitigate the effects of this decision, the central bank provided liquidity through open market operations (BNA does repo operations with banks at 7 days maturity); the interventions mentioned above (rise in mandatory reserves, and liquidity providing through repos), together with the liquidity effects of foreign currency purchases (which are a heavier burden with a weaker Kwanza) are truly what has weighed on liquidity in the economy, opposed to the more conventional tool of the reference interest rate. The effects on liquidity have been quite clear in the interbank market: the LUIBOR overnight rate gradually increased from the beginning of September and then shot up after the increase

The rise in the overnight interbank rate reflected the scarce liquidity in the system



Monetary base increased sharply towards the end of the year

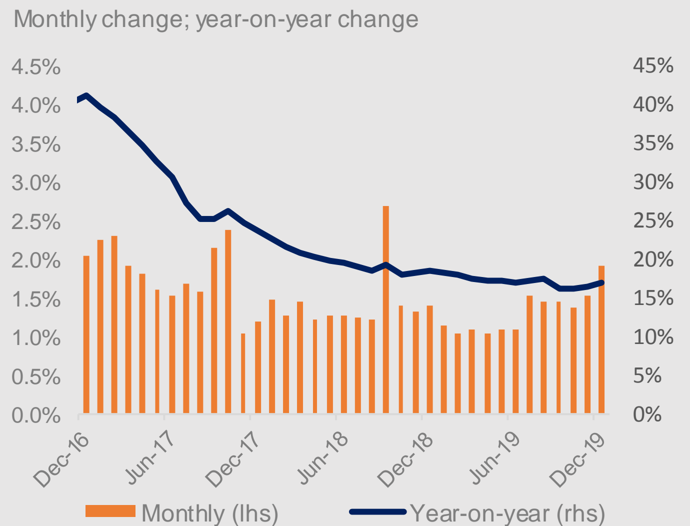


in mandatory reserves, reaching 29.9% at December 26th. At the moment, the rate has moderated somewhat, to a level slightly below 20% - it had reached a multi-year low in August (13.5%).

2| Monthly inflation has crept up since July 2019; December saw the highest inflation since September 2018, at 1.91%. In the first half of the year, average monthly inflation rate was 1.1%, from 1.5% between July and December. This had an impact on year-on-year inflation as of October, showing a gradual increase, from 16.1% in that month to 16.9% in December. Our expectation is that annual inflation will steadily rise as a result of the lagged effects of the significant depreciation in October, likely reaching close to 24% at the end of 2020.

Monthly inflation accelerated significantly in the last few months

Monthly change; year-on-year change



Source: INE

3| Consequently, we expect monetary policy to remain tight, although we see no need for further changes in the next MPCs. It is worth noting that, according to the Governor's perspective conveyed at the press conference that followed the MPC, monetary policy should serve to provide stability to the foreign exchange market. In fact, by liberalizing the exchange rate, the central bank will only be able to contain sudden depreciation pressures by withdrawing Kwanza liquidity, with the accompanying contractionary effect on the economy. In the current scenario, there is also an aim to tame inflation, implying a similar policy response. **If the need arises to further restrict monetary policy (with a higher-than-expected acceleration of inflation), our expectation is for an adjustment in local currency mandatory reserves, instead of changes in the reference rate. Furthermore, an expectedly gradual rise in fuel prices could be further watered down in view of the current situation.**

CONCLUSION

1| BNA continues to strive for a delicate balance between exchange rate and monetary policy; inflation prospects for the coming months are worrisome, giving no room for any relief in the monetary stance. On the other hand, we believe that, for now, the current tools are adequate to achieve the necessary liquidity management. If the outlook turns out to be more negative than expected, further tightening could come in the form of a mandatory reserve rate rise, but this does not seem likely for now.

2| The next Monetary policy Committee should occur on March 27th.

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