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FLASH NOTE

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BNA tightens monetary policy: rates and reserve coefficient

At a time when inflationary pressure is strong, it may still be insufficient

A. DESCRIPTION

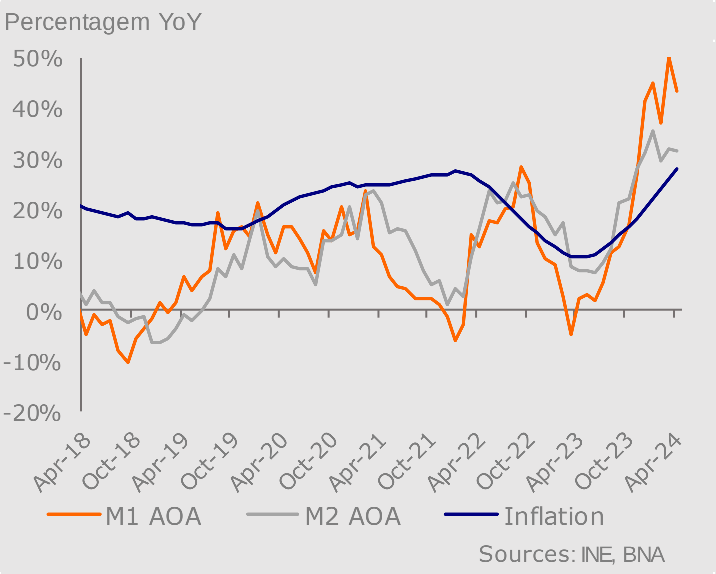
1|At the meeting of the Monetary Policy Committee (MPC) held on the 16th and 17th of last week, in Luanda, the BNA decided to increase the basic interest rate by 50 basis points (bp) to 19.5%, the marginal lending facility to 20.5% (+100bp) and the coefficient of mandatory reserves (CROs) in local currency to 21.0%, +1 percentage point (pp). According to the MPC, the decisions were motivated by the persistence of inflationary pressures in the economy and aim to contribute to the control of liquidity in circulation.

2| Year-on-year inflation in April stood at 28.2%, an increase of 2.1pp compared to the previous month. Monthly inflation accelerated again, standing at 2.6%, +0.07pp, contradicting the slight slowdown that occurred in March. The classes with the greatest variation were "Health", "Food and Non-Alcoholic Beverages" and "Clothing and Footwear" with 3.3%, 3.1% and 2.8%, respectively.

B. ANALYSIS

1| At a time when inflation shows no signs of slowing down, the latest PMC's decisions are in line with market expectations. However, as inflation is now more likely to continue to rise due to greater inflationary pressures and as there continues to be high growth in the money supply, we believe that a worsening of the already restrictive monetary policy position will be necessary.

The money supply continues to rise persistently more than inflation



Since inflation began to rise and the BNA decided to change the course of monetary policy, basic interest rates increased to 19.5% (+250bps), the marginal lending facility increased by 20.5% (+300bps) and the mandatory reserve ratio increased to 21.0% (+5pp). During this period, the money supply did not fall, on the contrary, it continued to rise even more - before the change in the monetary policy cycle began, M1 in local currency was growing 27% YoY, but now the growth has almost doubled to 43% YoY. As M1 represents the amount of currency directly available for immediate spending, this growth indicates a direct stimulus to aggregate demand in the short term and, therefore, causes price growth. M2, a more comprehensive measure, which indicates medium-term inflationary trends, is also increasing - between January and November 2023 it grew 14% YoY on average, but from Nov/23 to April/2024 it grew on average 31% YoY. This growth shows that a more restrictive approach may be necessary and for which simply increasing reference interest rates and CRO may not be enough. By increasing the coefficient by 1pp, the BNA will withdraw from June +AOA 93.6 billion (B), which makes a total of AOA 1.97 trillion (T).

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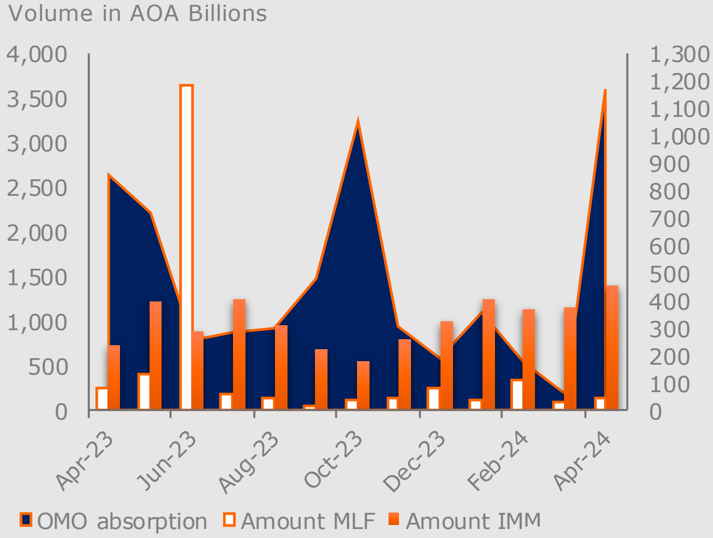
On the other hand, the withdrawal of liquidity also occurs with the use of open market operations (OMAs): in the last three months, the BNA withdrew close to AOA 1.2T using OMAs absorption; However, the results in terms of liquidity evolution clearly indicate that it may be through a more intensive use of this tool that the necessary liquidity will be removed to maintain M2 growth consistent with the fight against inflation.

Liquidity Swap Operations reached October/2020 highs, AOA 1.4T



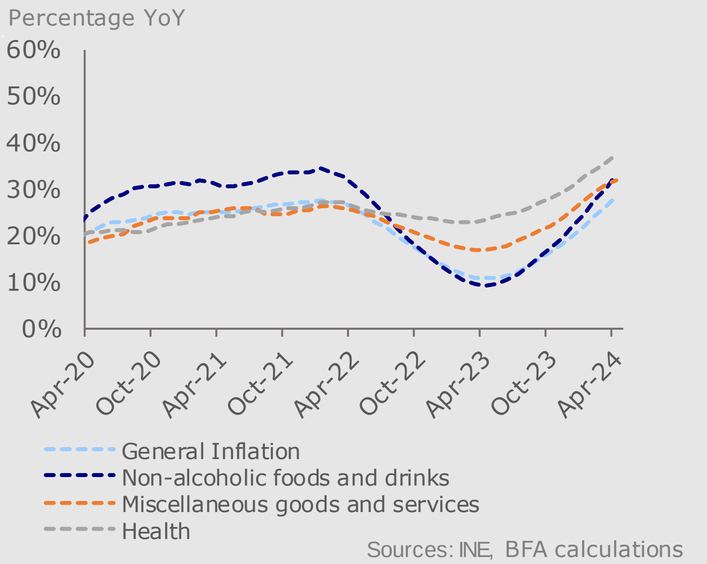
Source: BNA

Another factor influencing liquidity must be considered, linked to the management of the State's debt, mainly related to bond maturities. In July, liquidity will grow significantly again as around AOA 1.0T will mature in accordance with the 2024 Annual Debt Plan. As the Treasury's bond sales operations add more liquidity to the banking system, so as not to compromise to combat inflation, it would be recommended to intensify the use of OMAs during this period, possibly with an increase in rates to attract this excess liquidity.

Looking at Luibor Overnight, which in April reached 2013 highs, 25%, is now falling, standing close to 21%. This movement indicates a slight relief in liquidity on the part of banks, in a very active interbank market at this time - liquidity swap operations in April grew 95% YoY and in absolute values reached AOA 1.4T, which represents a maximum of October 2020.

2|The monetary authority also decided to revise the inflation target upwards to 23.4% (+4pp), at a time when there was an increase in the prices of diesel and public urban passenger transport. Thus, the BNA predicts that inflation will begin to fall from the second half of the year. Even with the revised target, for inflation to reach the BNA's objective, the monthly growth in the general price level in accumulated terms from June to December must be at least equal to or less than 8.9%, which gives us seems quite challenging, mainly because of the inflationary inertia that will take longer to fade – that is, inflation expectations could support the continuation of an accelerated rise in prices.

The "Food and non-alcoholic beverages" class is growing faster than general inflation



Sources: INE, BFA calculations

We believe that at that time there are many more forces that could put upward pressure on prices – in addition to the factors mentioned above, customs duties have increased slightly; the exchange rate could still depreciate, having already shown signs last week, falling 1.6% after months on stable ground; The Minister of Finance, Vera Daves, in an interview in the Financial Times, reported that the USD 150-200 million to be released from the Escrow Account will be used to pay interest on a crucial debt. In this case, the market's hopes regarding the relief of the backlog fade and the already existing

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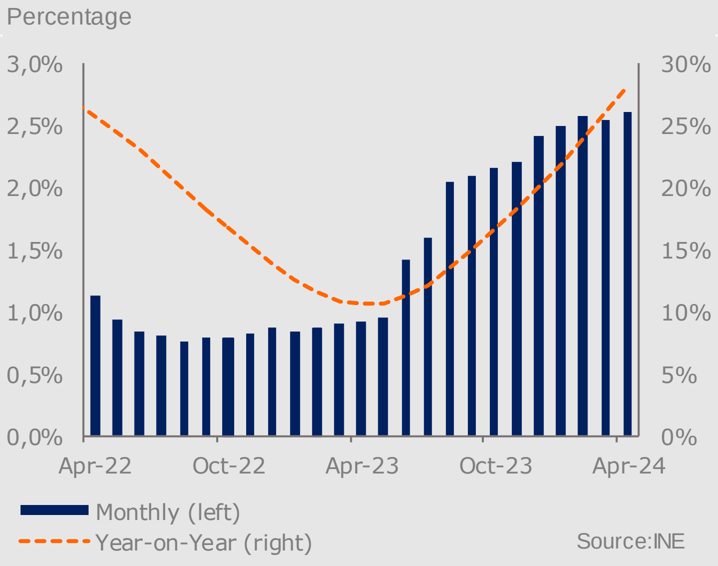
pressure on the supply side on the exchange rate should, therefore, continue to put pressure on the availability of goods and services in the economy. Our perspective is that inflation will continue to rise in the coming months and end the year close to 32.7%.

Inflation in April reached the highs of July/2017, 28.18%



Additionally, on the one hand, at that time, there was faster growth in the "Food and non-alcoholic beverages" class – 33% YoY, +5pp than general inflation – which contributed more than 60% to the general index. On the other hand, taking into account the importance of the capital in the country's economic activity and the enormous difference compared to other provinces in relation to current inflation levels - the gap has once again reached new highs since records have been recorded, 10.7pp -, it is possible that inflation in the remaining provinces also accelerates in the coming months. Therefore, there is clear evidence that there is still a lot of inflationary pressure, which makes the decline in annual inflation this year challenging.

C. CONCLUSION

1| As inflation now has more comfort to continue rising, we believe that the BNA should further reinforce the already restrictive monetary policy position, further increasing interest rates and the mandatory reserve ratio. However, as liquidity continues to grow precipitously, more intense use of OMAs and facilities will be necessary so that the growth of currency in circulation can actually begin to slow down.

2| The target of 23.4% seems challenging to reach by the end of 2024. Therefore, from our perspective it will make sense to pay extra attention to the maturity dates of securities during this year, and their effect on liquidity. These amounts have significantly impacted liquidity and, therefore, the interest rates in force in the money market. More vigorous coordination and communication will therefore be necessary between the management of monetary policy by BNA and the management of treasury and debt by MINFIN.

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