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FLASH NOTE

Nº 14.2024 | July 30, 2024

BNA keeps the course of monetary policy unchanged

Monthly inflation slows down again, and BNA opts for a cautious approach

A. DESCRIPTION

1|At the meeting of the Monetary Policy Committee (MPC) held on 18 and 19 July in the city of Menongue, the BNA decided to keep the instruments for conducting monetary policy unchanged. The key interest rate remains at 19.5%, the Marginal Lending Facility and the Deposit Facility interest rate at 20.5% and 18.5% respectively. The BNA also maintained the coefficient of reserve requirements in local currency at 21.0%.

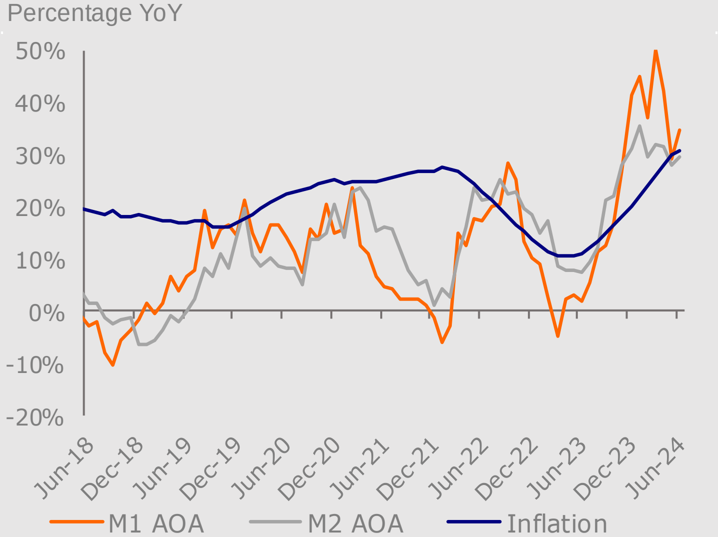
2| Year-on-year inflation in June stood at 31.0%, an increase of 0.8pp compared to the previous month. According to INE data, monthly inflation stood at 2.1%, a slowdown of 0.42pp, which corresponds to the first consecutive monthly deceleration. The Health class recorded the highest price increase, with a change of 2.7%, followed by the classes of "Clothing and Footwear", "Miscellaneous Goods and Services" and "Hotels, cafes and restaurants", with 2.7%, 2.6% and 2.5%, respectively.

B. ANALYSIS

1| At the previous meeting, held in May, the CPM had tightened monetary policy again, raising the BNA rate, the interest rate on the marginal lending facility and the reserve requirement ratio in local currency. Such a move was in line with market expectations, as inflation showed no signs of slowing down and the money supply was growing rapidly. However, at the last meeting, the BNA preferred to be more cautious motivated by the monthly slowdown in the pace of price growth in the economy, resulting from the relative improvement in the supply of essential consumer goods and some perception of liquidity control in the market.

In fact, the analysis of the data partially confirms the BNA's premise: the money supply has fallen in recent months - M0, the operational variable of monetary policy, contracted by almost 3% between April and May and registered a slight acceleration in June, 0.2%; M1 in local currency follows the same pace and has fallen by 4% since April. M2, a more comprehensive measure of liquidity, whose variation signals medium-term inflationary trends, is also slowing down – 1% since April. At the moment, the change in the real money supply, measured by the differential between nominal money supply and inflation, is in negative territory, -1.5%, which has not been seen since August 2023. It is also clear that this movement is clearly in line with the recent trajectory of monthly inflation that began to decelerate in the same period. Despite these monthly declines, liquidity continues to grow

M2 maintains growth trend, but now below inflation



Sources: INE, BNA

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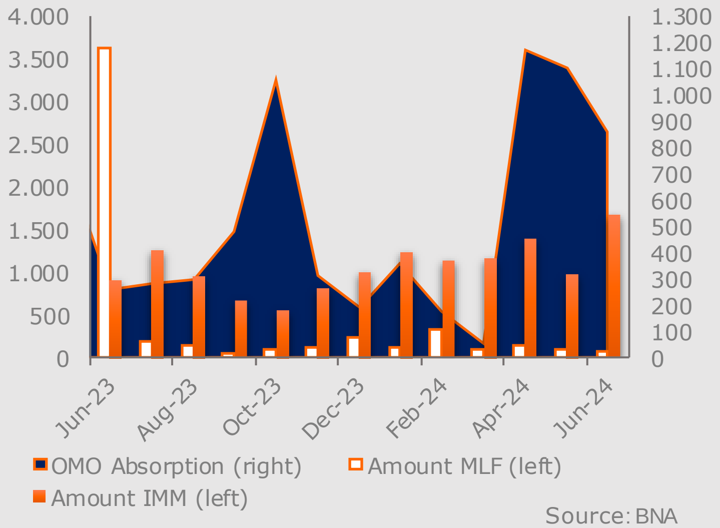
significantly when assessed on a year-on-year basis – in June, M1 and M2 grew by 29% and 34%, respectively.

We have noted that Luibor current moves may not necessarily be signaling a tighter market, with a few banks circumstantially looking for liquidity while others trying to monetize. BNA data indicate that the volume of liquidity exchange in the interbank money market (IMM) stood at AOA 2.6B, between May and June, an increase of 4% compared to the previous two months. LUIBOR has recorded mixed movements since the last meeting: Overnight (O/N) accelerated between May and June, until it reached a peak of 24.4% in early July and is now at 21%. Rates for longer maturities have also been growing – the Luibor at 6, 9 and 12 months are now at 21.0%, 22.3% and 23.5%, respectively. We believe that the launch of Luibor-indexed 6M Treasury Bonds should have boosted the expansion of interbank money market rates – this movement is making the cost of credit higher, since, except for O/N, IMM rates serve as indexes for credit rates to the economy.

Open Market Operations totaled AOA 3.4T in Q2

Volume in AOA Billions



Source: BNA

The Central Bank has also intensified the use of Open Market Operations, having reduced the market by about AOA 3.1T in the last three months, which will have impacted the evolution of liquidity, as we can see from the recent movements of monetary aggregates.

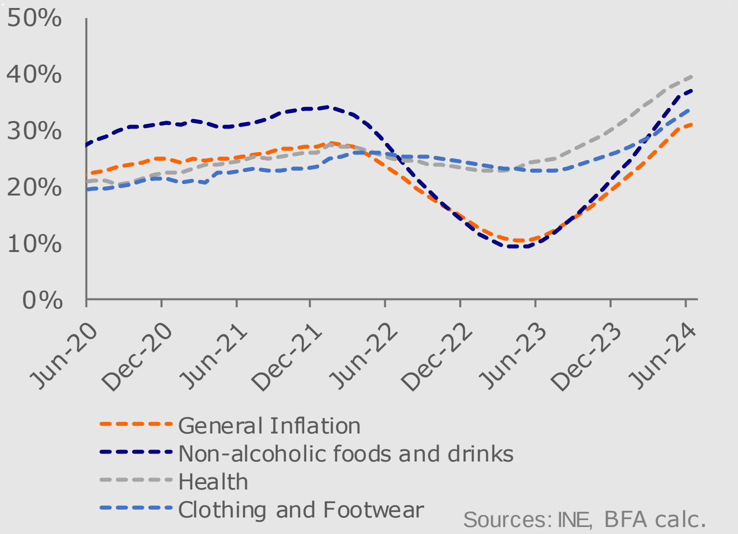
2| We are concerned that there will not be enough indicators for the time being to make monetary policy more flexible or less restrictive, at least until the end of the year:

- Some classes with the greatest weight in the general index continue to grow much more than the general inflation - "Food and Alcoholic Beverages", "Health" and "Clothing and Footwear" grew about 37.1%, 39.4% and 30.9% when compared to the same period in 2023, respectively; In addition, prices in the province of Luanda continue to show no respite, with the year-on-year rate standing at 42.8%, +12pp than general inflation.

- **We continue to notice that demand for foreign exchange remains significantly higher than current supply levels – the system *backlog* that fell in May, has risen again and we estimate it to be close to USD 1.5B:** according to our data, around USD

Food, Health and Clothing classes grow above national inflation

Percentage YoY



Sources: INE, BFA calc.

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4.7B was made available in 1S 2024, a drop of 19% YoY. MinFin recently released the National Treasury sale operations, where we can see that around USD 1.1B were made available to commercial banks in 1S, which accounts for a drop of 19% compared to the AOA 1.3B placed in the same period of 2023. Even with the strong depreciation of the Kwanza last year and the recent movements – the USD/AOA exchange rate is currently close to USD/AOA 873, making a depreciation of around 5.0% YTD, imports are not falling enough. In our view, this is because imports are inelastic to changes in exchange rates – according to our calculations, the correlation coefficient between imports and the exchange rate is -0.3%, which indicates a very weak relationship. This occurs, naturally, because the Angolan economy imports a large part of the products it consumes.

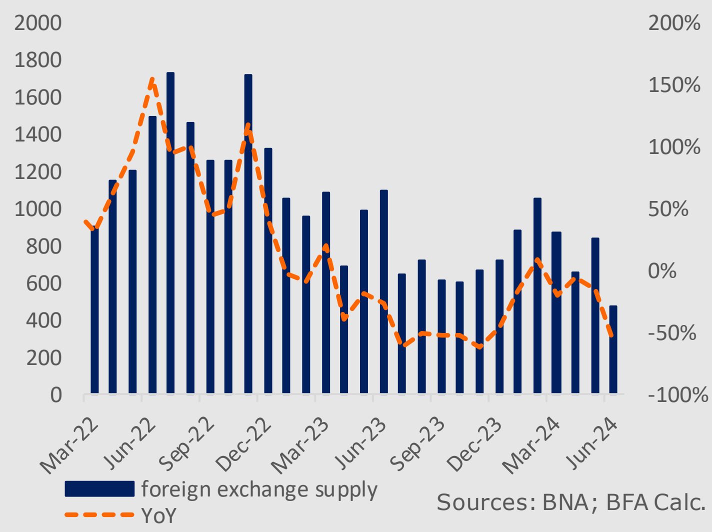
- Considering seasonality effects, the second half of the year tends to be one of more inflationary pressure – the festive season period that usually generates a greater stimulus to demand, tends to cause inflationary pressures between December and January, especially in the food category. In addition, the return to school also puts pressure on prices in August and September in the Education and Transport category. In addition, an adjustment in the prices of school fees is expected in the order of 30%, considering Presidential Decree No. 181/23 of 1 September 2023, which allows the annual update of tuition fees and fees charged by Educational Institutions based on the year-on-year inflation of May of the current year - which will further pressure inflation.

- The adjustment to the national minimum wage to AOA 70 thousand was approved via Presidential Decree No. 152/24 of July 17 thousand (an increase of more than 40% compared to the previous one) and, in our view, this is also an event that has the potential to put pressure on prices: on the one hand because it tends to increase demand, on the other hand because it can generate speculative behavior on the part of some economic agents. Here, the impact may eventually be felt, above all, in the food class.

Adding all the effects, including the money supply that is still growing year-on-year and finally the phenomenon of inflationary inertia, we continue to believe that monthly inflation should fluctuate for a few months close to around 2%, making the year-on-year inflation end closer to 32%. **Overall, the scenario in the 2nd half is still challenging and suggests a lot of caution in the conduct of monetary policy.**

Supply of FX resources to economic operators registers a sharp reduction compared to 2023

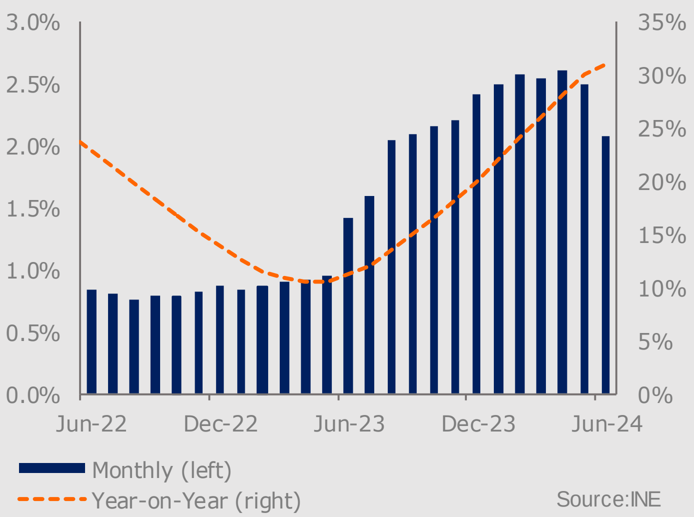
Monthly values; YoY variation in %



Sources: BNA; BFA Calc.

Monthly inflation decelerating in June while the same period reaches May 2017 highs, 31.0%

Percentage



Source:INE

C. CONCLUSION

1| We see that there is a slowdown in liquidity in monthly terms, however, if we look at it year-on-year, growth is still quite relevant, which indicates that in the medium term, there may still be inflationary pressure coming from the demand side. We saw a deceleration in inflation in the months of May and June and this movement is in line with the reduction in monetary expansion.

2| In pursuit of the objectives of price stability and the value of the local currency, the BNA must continue to ensure the balance between monetary policy and exchange rate policy. With inflationary pressures that we can contemplate for the coming months, we believe that the BNA should continue to adopt a restrictive monetary policy – mainly using Repos and Deposit Facilities – and annual inflation remains stubbornly resistant to the downside. We are observing the challenging situation in the foreign exchange market, and for now, we anticipate inflationary pressure from foreign exchange, which may prevent the BNA from maintaining an optimistic approach, at least until the beginning of next year.

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