NATIONAL BANK OF RWANDA
BANKI NKURU Y'U RWANDA

MONETARY POLICY REPORT

FEBRUARY 2022

CONTENTS

The statutory quarterly Monetary Policy Committee (MPC) meeting held on 15th February 2022 reviewed the impact of its previous decisions and assessed recent economic developments at the global and domestic level and the outlook. The analysis indicates that, in line with the global economic recovery, commodity prices are increasing significantly, prompting central banks to consider a tightening path of monetary policy to contain inflation. In Rwanda, inflation is projected to be above the NBR inflation benchmark of 5.0 percent in 2022 on average but not exceeding the upper bound of 8 percent. Given the recent economic developments and the outlook at the global and national level, the MPC decided to raise the Central Bank Rate (CBR) by 50 basis points from 4.5 percent to 5.0 percent to ensure that inflation is contained at an adequate level while continuing to support economic recovery.

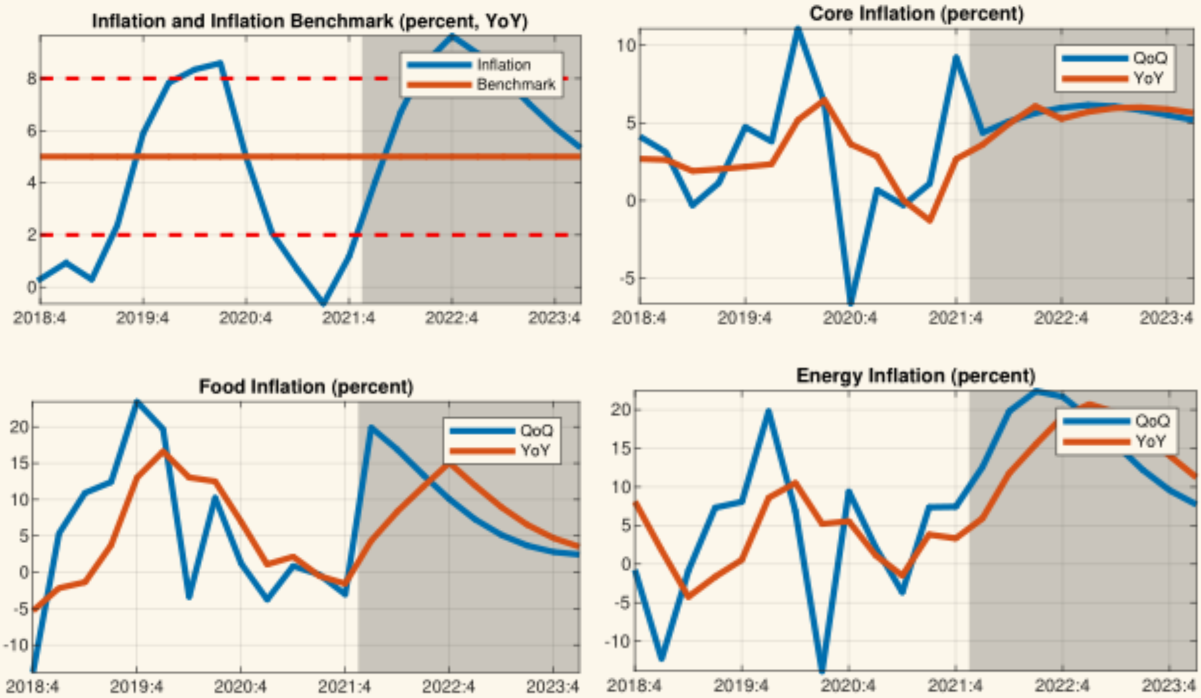
In 2021, inflation evolved below the lower bound but has started rising in January 2022. This uptick results from concurrent core and food inflation pickups, reflecting the recent domestic and global economic developments.

NBR reaffirms its assessment of November 2021 about future trends. In February 2022, projections continue to indicate an increase in core inflation, which is in line with the continued global and domestic economic recoveries. With the ongoing recovery in the global economy, projections of commodity prices and foreign inflation remain high, maintaining the current inflationary pressures from imported production costs. Though slower than in the previous forecasts, the expected global economic growth remains supportive of domestic economic recovery efforts. The latter reflects fiscal sector plans to raise domestic demand, adding to the recovery in private consumption relating to the re-opening of domestic economic activities following the easing of restrictions measures and vaccine rollout.

The decision to raise the CBR at 5.0 percent is twofold. The increase by 50 basis points allows maintaining the accommodative monetary conditions to continue supporting the economic recovery momentum. It also helps to contain inflation within the band- below 8 percent.

Although food and non-alcoholic beverages inflation eased in 2021Q4, higher international food prices and lower domestic food production kept exerting pressures upward. As supply conditions improve, global food prices will gradually decline in 2022 and 2023. However, in 2022 supply constraints may persist for some food imports such as edible oils despite government support to curb pressures. With higher global food prices and the expected slowdown in domestic food supply during the planting period of Season B 2022, food inflation is expected to pick up in 2022H1.

In Q-o-Q terms, energy inflation increased in 2021Q4, following pressures from international oil prices. In early 2022, the country started to regulate cooking gas prices to reduce volatility. In 2022, however, global energy prices are expected to remain high, and maintain pressures on energy inflation.



I. GLOBAL ECONOMIC DEVELOPMENTS AND OUTLOOK

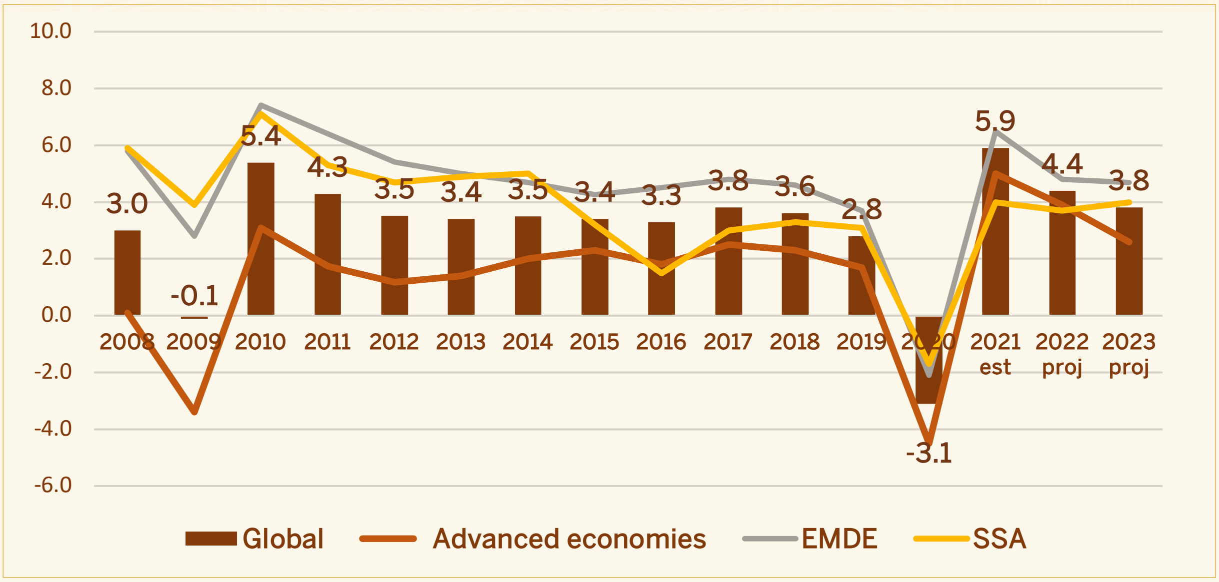
According to the International Monetary Fund's (IMF) World Economic Outlook (WEO) update published in January 2022, the world economy is projected to grow by 4.4 percent in 2022 from an estimated growth of 5.9 percent in 2021. Growth projections for 2022 were revised down by 0.5 percentage points relative to October 2021 WEO projections, reflecting forecast downgrades to the advanced economies and emerging markets and developing economies.

Global economic recovery continues at a slow pace with multiple challenges

According to the International Monetary Fund's (IMF) World Economic Outlook (WEO) update published in January 2022, the world economy is projected to grow by 4.4 percent in 2022 from an estimated growth of 5.9 percent in 2021. Growth projections for 2022 were revised down by 0.5 percentage points relative to October 2021 WEO projections, reflecting forecast downgrades to the advanced economies and emerging markets and developing economies.

Economic growth in advanced economies is projected at 3.9 percent in 2022 after an estimated growth of 5.0 percent in 2021, revised down by 0.6 percentage points relative to October 2021 WEO projections, largely reflecting downgrades to the United States, Eurozone and United Kingdom.

Chart 1: GDP growth and projections across regional blocks (% change)



Source: IMF WEO update, January 2022

Relative to October 2021 WEO projections, the US economic growth projections are revised down by 1.2 percentage points to 4.0 percent in 2022 after 5.6 percent in 2021. The downward revision for growth projections in 2022 was largely due to earlier withdrawal of monetary accommodation, continued supply shortage as well as a revised assumption removing fiscal package.

Eurozone's economy is projected to grow by 3.9 percent in 2022 from 5.2 percent in 2021, growth projections revised down by 0.4 percentage points in 2022 relative to October 2021 projections, largely due mobility restrictions imposed towards the end of 2021 as well as prolonged supply constraints and COVID disruptions led by a markdown of 0.8 percentage points for Germany due to the economy's exposure to supply chain shocks.

The United Kingdom's economy is projected to slow down to 4.7 percent in 2022 from 7.2 percent in 2021, and growth projections are revised down by 0.3 percentage points relative to October projections. The downward revision reflects disruptions related to Omicron and supply constraints, particularly in labor and energy markets. The UK's economy will still be the fastest growing economy of all the G7 countries.

Japan's economy is projected to grow by 3.3 percent in 2022 from 1.6 percent in 2021, and growth projections for 2022 were revised up by 0.1 percentage points relative to October 2021 projections. The Japan's 2023 outlook is also revised up by 0.4 percentage points, reflecting anticipated improvements in external demand and continued fiscal support.

Emerging market and developing economies are projected to grow by 4.8 percent in 2022, after 6.5 percent in 2021. The forecast for the group is marked down by 0.3 percentage points relative to October 2021 WEO projections, largely attributed to downgrades across almost all regions, despite growth upgrades for Middle East and central Asian economies. In China, growth is projected to moderate at 4.8 percent in 2022, from 8.1 percent in 2021, as growth projections were revised down by 0.8 percentage points, relative to October projections. The downgrade revision was largely due to pandemic-induced disruptions related to the zero-tolerance COVID-19 policy (a strict zero-Covid strategy) leading to recurrent mobility restrictions, protracted financial stress among property developers (deteriorating prospects for construction sector employment), as private consumption is likely to be lower than anticipated. Growth forecast for 2022 is revised down with negative implications for trading partners' prospects.

India's economy is projected to grow by 9.0 percent in 2022, the same as an estimated growth of 9.0 percent in 2021, and growth projections for 2022 were revised up by 0.5 percentage points relative to October projections. India's prospects are marked up on expected improvements to credit growth and, subsequently, investment and consumption, building on better-than-anticipated performance of the financial sector.

The Sub-Saharan African economy is projected to grow by 3.7 percent in 2022, 0.1 percentage points lower relative to October 2021 WEO projections, compared to an estimated growth of 4.0 percent in 2021. Growth projections for 2022 are above the pre-pandemic level of 3.1 percent in 2019, and growth for 2021 was the highest growth since 2015. Growth projection's downgrade reflects markdown growth for South Africa as growth prospects for Nigeria remained unchanged. South Africa's growth forecasts were revised down by 0.3 percentage points relative to October projections, downgraded in light of a softer-than-expected second half of 2021 and a weaker outlook for investment as business sentiment remains subdued.

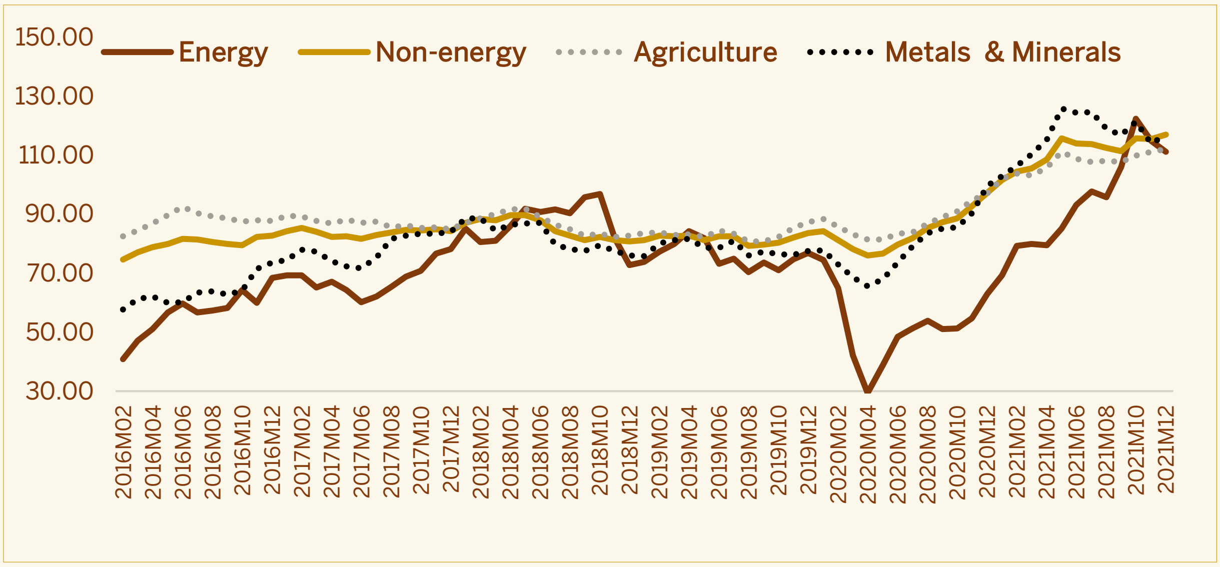
The global economy enters 2022 in a weaker position than previously expected, as the new Omicron COVID-19 variant spreads. Rising energy prices and supply disruptions have resulted in higher and more broad-based inflation than anticipated, notably in the United States and many Emerging market and developing economies. The ongoing retrenchment of China's real estate sector and slower-than-expected recovery of private consumption also have limited growth prospects.

However, worldwide access to vaccines, tests, and treatments is essential to reduce the risk of further dangerous COVID-19 variants. This requires increased production of supplies, as well as better in-country delivery systems and fairer international distribution.

Higher global commodity prices induced by a rising global demand

In 2021Q4 (y-o-y), global commodity prices increased, reflecting a rebound in global demand. Energy prices rose highly by 106.2 percent from a drop of 24.1 percent in 2020Q4, attributed mainly to the rise in crude oil prices and natural gas. Non-energy commodity prices increased by 24.9 percent in 2021Q4, from 13.2 percent in 2020Q4, owing largely to higher prices for fertilizers and metals.

Chart 2 - Commodity Prices Index in Nominal US Dollar (2010=100)



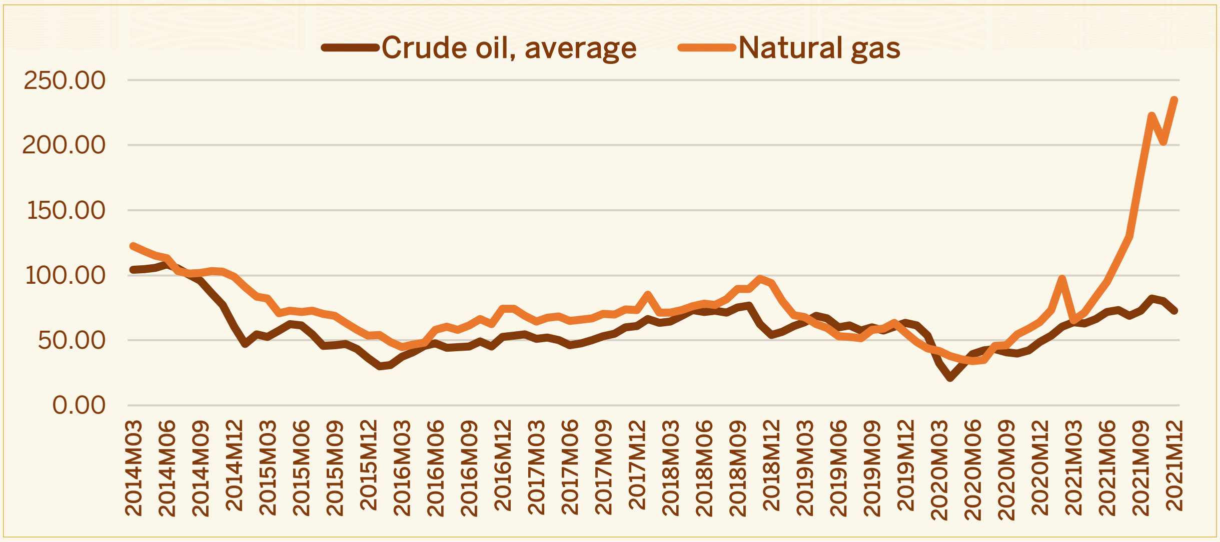
Source: World Bank Commodity Prices, January 2022

In 2021Q4, crude oil prices increased by 79.4 percent on average compared to a decline of 27.7 percent in 2020Q4, following supply disruptions and production constraints. Oil prices have also been supported by higher natural gas prices as it is becoming more competitive in heating and electricity generation. In January 2022, IMF projects oil prices to increase by 11.9 percent in 2022, from USD 69.07/barrel in 2021 to USD 77.31/barrel in 2022, and later drop by 7.8 percent in 2023.

Natural gas prices surged by 271.5 percent in 2021Q4 compared to a decline of 0.5 percent in 2020Q4. The surge reflects a sharp increase in demand, especially from China and constrained supply exacerbated by some disruptions, with adverse weather events playing a key role. As the global economy started to recover from the pandemic, demand for natural gas and coal rebounded, both for electricity generation as well as for industrial purposes. Hotter-than-normal weather boosted demand for electricity for cooling in major economies including China and the United States.

On the supply side, electricity production from renewable sources declined in several countries due to drought (Brazil, China, Turkey and US), and low wind speeds reduced power generation in Europe. In January 2022, IMF projects natural gas prices to increase by 58 percent in 2022.

Chart 3: **Crude Oil and Natural gas Developments (USD/barrel)**



Source: World Bank commodity prices, January 2022

In 2021Q4, average prices for agricultural commodities increased by 17.8 percent from 10.9 percent in 2020Q4, reflecting supply shortfalls, input cost increases (especially fertilizers and natural gas), and strong demand for animal feed commodities in China. Food prices increased by 20.6 percent in 2021Q4 compared to 13.7 percent in 2020Q4, of which oils & meals (20.3 percent compared to 33.6 percent), grains, (15.3 percent after 11.7 percent), and other foods (26.2 percent against -6.0 percent). Local food prices have surged in response to the ongoing spike in energy and fertilizers prices as well as Covid-induced supply-chain constraints.

Beverages prices increased by 30.2 percent in 2021Q4 from 2.6 percent in 2020Q4 mainly led by coffee prices due to weather-related production shortfalls in Brazil following a frost that affected the country's coffee production regions. Tea prices (Mombasa) increased by 27.3 percent in 2021Q4 after dropping by 13.9 percent in 2020Q4, as tea production reflects weather-related production shortfalls in East Africa, especially in Kenya, the world's largest tea exporter.

Metals & mineral prices went up by 27.8 percent in 2021Q4, from 19.7 percent in 2020Q4, reflecting the impact of rising demand that favored industrial production activities. Tin prices increased highly by 106.1 percent in 2021Q4 from 12.7 percent in 2020Q4, as growth in electronics and photovoltaic installations significantly increased the demand for tin. Metal prices continued to climb in early 2021, driven by strong demand in China, the ongoing global economic recovery, and supply disruptions.

Most base metal prices continued to rise due to supply curtailments, electricity shortages and China's policies to reduce energy consumption from metal processing. Demand for base metals has continued to increase drown by the global economic recovery while production has been disrupted by energy shortages and lockdowns.

Precious metals dropped by 4.1 percent in 2021Q4 after rising by 28.3 percent in 2020Q4, due to declining investor sentiment stemming from higher real interest rates and a stronger US dollar. Precious metals fell amid a rise in US 10-year treasury bills with large falls for gold and silver. Gold prices fell by 4.2 percent in 2021Q4 after rising by 26.6 percent in 2020Q4, partly driven by a slump in investment demand amid a rise in interest rates, as well as central banks, which have reduced gold purchases in recent months. Silver prices also dropped by 4.3 percent in 2021Q4 after rising by 41.1 percent in 2020Q4, driven by decline in investment amid rising interest rates.

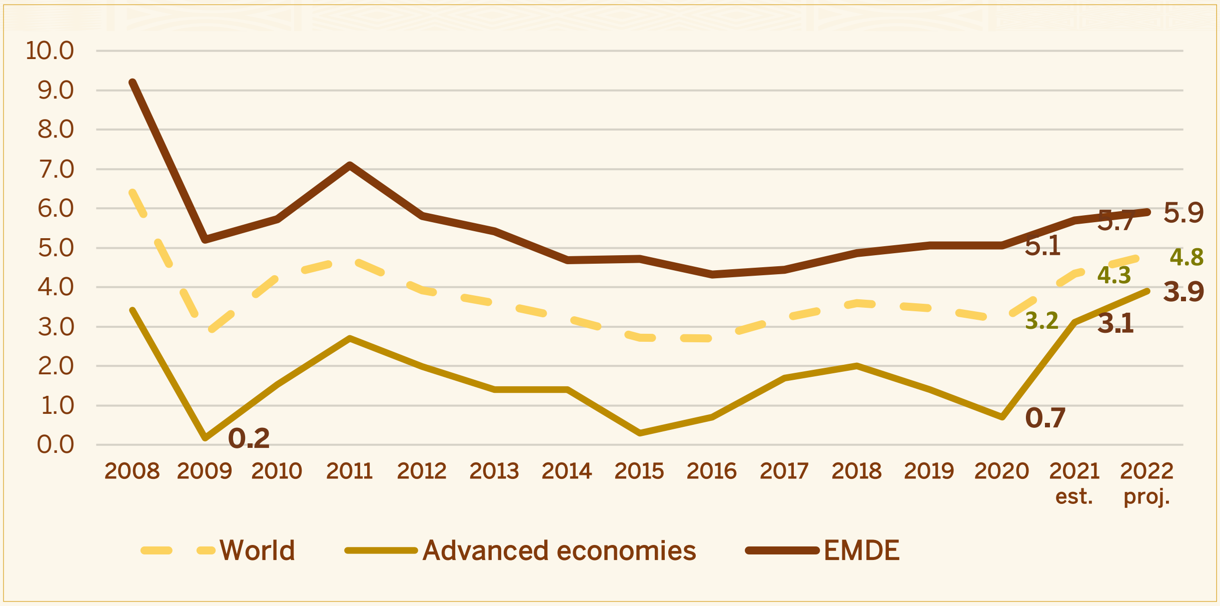
Prices for fertilizers increased highly by 151.1 percent in 2021Q4 from a drop of 3.2 percent in 2020Q4, driven by strong demand in US and Brazil, production restrictions as several fertilizer manufacturers stopped or reduced production capacity, rising input costs in China and Europe and adverse weather in the United States, as well as trade policies, of which China's recent suspension of phosphate exports until June 2022 putting more pressure on DAP fertilizers. The World Bank projects fertilizers to increase by 6.5 percent in 2022 and a drop of 19.2 percent in 2023.

Global inflation forecast upgraded for many advanced economies as well as emerging market and developing economies for 2022

World annual average inflation is projected to increase around 4.8 percent in 2022 from 4.3 percent in 2021, following the persistent global supply chain disruptions. Inflation is expected to remain elevated in the near term, leading to upgraded forecasts in many advanced and emerging market and developing economies. In some countries, exchange rate depreciations have also contributed to higher import goods prices.

However, assuming medium-term inflation expectations remain well anchored and the pandemic eases its grip, higher inflation should fade as supply chain disruptions ease, monetary policy tightens, and demand rebalances away from goods-intensive consumption towards services. The rapid increase in fuel prices is also expected to moderate during 2022–2023, which will help contain headline inflation. Similarly, food prices are expected to increase at a more moderate pace of about 4.5 percent in 2022 and decline in 2023.

Chart 4- Global inflation and projections across regional blocks (% change)



Source: IMF WEO update, January 2022

In advanced economies, consumer price inflation is expected to increase to 3.9 percent in 2022 from 3.1 percent in 2021, reflecting persistent supply chain disruptions and increasing commodity prices. In the emerging market and developing economies, inflation is projected to increase to 5.9 percent in 2022, from 5.7 percent in 2021.

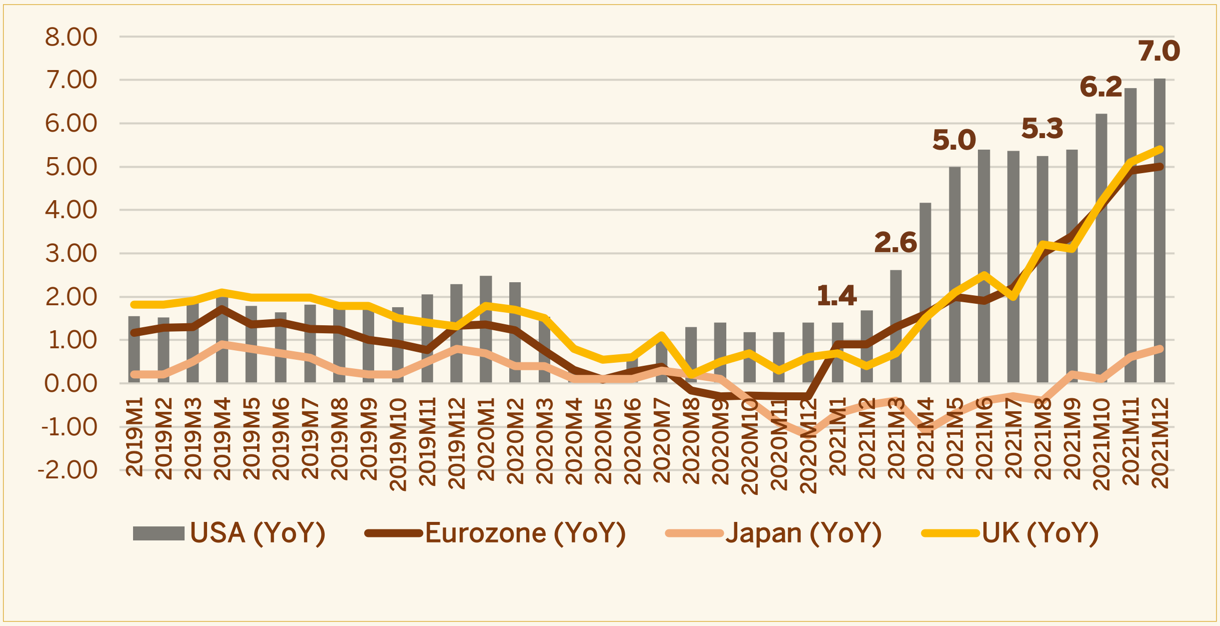
The US annual headline inflation increased to 7.0 percent in December 2021 from 6.8 percent in the previous month, the highest inflation rate since June 1982, the 10th consecutive month above the Fed's 2 percent target. Prices are pushed up by pandemic-induced supply constraints, soaring energy prices, increasing demand, labor shortages, and low base effect from 2020. The big contributors came from gasoline prices, used cars & trucks, new vehicles, shelter, and food at home. Inflationary pressures are likely to last well into the middle of 2022 and Fed Chair recently pledged to do what is necessary to contain an inflation surge including increasing interest rates.

The annual headline inflation in the Eurozone increased to 5.0 percent in December 2021, from 4.9 percent in the previous month, due mainly to the rising energy and food prices, the 6th consecutive month as headline inflation stays above the ECB's 2 percent target, pushed up by supply chain disruptions, and high-energy prices. The annual core inflation, which excludes volatile prices of energy, food, alcohol & tobacco, increased to 2.6 percent.

The annual headline inflation in the United Kingdom increased to 5.4 percent in December 2021, from 5.1 percent in the previous month, the highest inflation rate since March 1992. The observed increase was due to the rising energy prices, supply chain disruptions as well as low base effect from last year. The main upward pressure came from food prices, and transport prices, principally motor fuels, followed by second hard cars, and housing and household services.

Japan's annual headline inflation increased to 0.8 percent in December 2021 from 0.6 percent in November 2021, pointing to the 4th consecutive months of increase. It was the highest annual inflation rate since December 2019, boosted by a sharp pickup in food prices and a further increase in housing prices. The core consumer prices, which excludes fresh food, went up by 0.5 percent (y-o-y), in December, staying at their highest in almost 2 years, amid high-energy prices, but remaining well below the Bank of Japan's 2 percent target.

Chart 5- Annual headline Inflation developments (percent change)

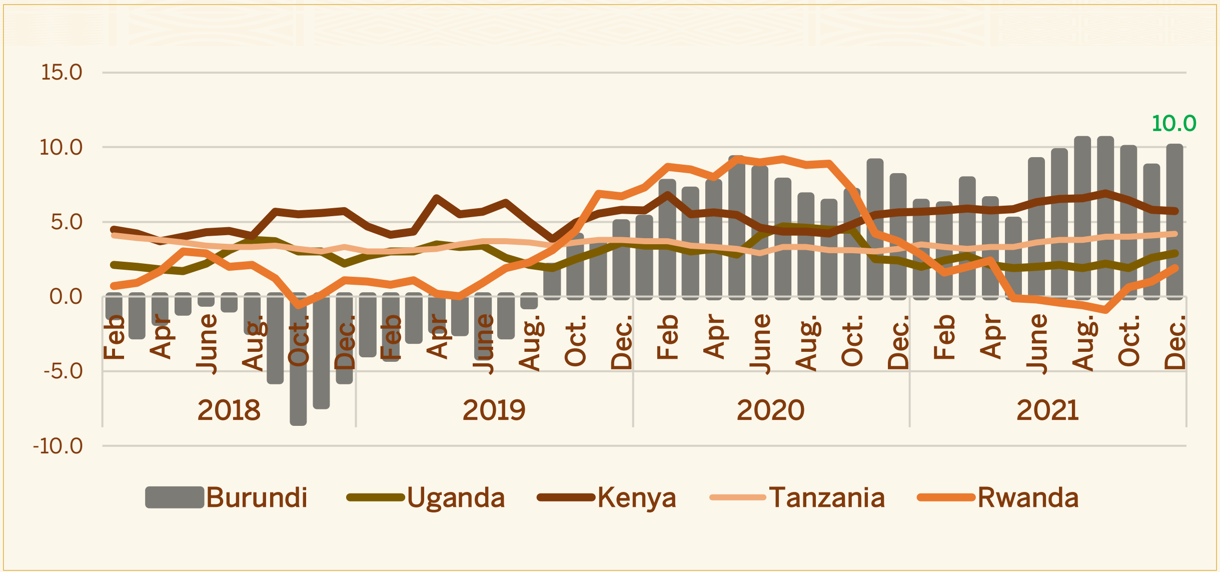


Source: Country Bureau of statistics

In Sub-Saharan Africa (SSA), annual headline inflation is projected at 8.6 percent in 2022, from 10.7 percent in 2021, following the projected falling inflation rates in Zimbabwe, Angola, Nigeria and Zambia. In some Sub-Saharan African countries, food prices have increased significantly, amid local shortages and the rise in global food prices. Exchange rate depreciations have also contributed to higher prices of imported goods in many Sub-Saharan African countries.

With regard to price developments in the EAC-5 countries, the annual headline inflation in Kenya eased to 5.73 percent in December 2021 from 5.80 percent in the previous month, reaching its lowest rate since January 2021, mainly due to a slowdown in prices of food & non-alcoholic beverages, namely tomatoes. However, transport prices rose, as gasoline and diesel prices remained steady due to the fuel subsidies. The annual average inflation increased to 6.1 percent in 2021 from 5.2 percent in 2020. Rwanda's headline inflation increased to 1.9 percent in December 2021 from 1.0 percent in the previous month, and this was mainly pushed up by increase in prices of education (19.2 percent), energy (5.5 percent), and transport (4.7 percent), despite decreases in food prices (-2.0 percent). The annual average inflation eased to 0.8 percent in 2021 from 7.7 percent in 2020.

Chart 6- Annual headline Inflation developments (percent change)



Source: Country Bureau of statistics

The annual headline inflation in Tanzania increased to 4.2 percent in December 2021, from 4.1 percent in the previous month, the highest inflation rate since November 2018, amid rising prices for food & non-alcoholic beverages, transport, housing & utilities as well as restaurants & hotels. The annual average inflation increased to 3.7 percent in 2021 from 3.3 percent in 2020. Uganda's annual headline inflation increased to 2.9 percent in December 2021, from 2.6 percent in the previous month, the highest inflation rate since November 2020, as prices increased mostly for food & non-alcoholic beverages, health, furnishings, and transport. The annual average inflation eased to 2.2 percent in 2021 from 3.6 percent in 2020.

Monetary conditions tighten globally amid heightened inflation risks

Global financial conditions have remained broadly accommodative since October 2021, despite some recent tightening driven by rising interest rates and spread of Omicron variant. Emerging market assets have remained under pressure due to concerns about inflation, the policy outlook and expected Fed policy tightening.

The Bank of England increased the Bank rate by 25 basis points, to 0.50 percent, following the monetary policy meeting held on 2nd January 2022. However, the MPC members in the minority preferred to increase the Bank rate by 50 basis points to 0.75 percent.

The US Federal Reserve decided to keep the target range for the federal funds rate at 0 to 0.25 percent, following the FOMC statement issued on 26th January 2022. With inflation well above 2 percent and a strong labor market, the economy no longer needs sustainable high levels of monetary policy support, and the committee expects that it will soon be appropriate to raise the target range for the federal funds rate.

At its monetary policy meeting held on 3rd February 2022, the ECB Governing Council confirmed the decisions taken at its monetary policy meeting of 15thDecember 2021. The Council decide that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 0.00 percent, 0.25 percent and -0.50 percent, respectively.

In December 2021, the three-month deposit rates remained negative in the Eurozone and Japan, standing at -0.515 percent and -0.045 percent, respectively, affecting banks' deposits in the Central Bank and encouraging economic financing. In the US, deposit rates decreased to 0.220 percent from 0.340 percent in December 2020, while increasing for UK to 0.315 percent from 0.101 percent in December 2020.

The 10 Year government bond rate increased in the United States, Japan and United Kingdom to 1.5101 percent, 0.065 percent and 0.971 percent, respectively, from 0.913 percent, 0.017 percent and 0.197 percent in December 2020. In the United States, this increase reflected bullish economic recovery amid stronger fiscal stimulus, higher inflation expectations and the Federal Reserve's intention to keep easy monetary stance to achieve its objectives of full employment and price stability. The 10-Year government bond rate however decreased in the Eurozone to -0.177 percent in December 2021 from -0.207 percent in December 2020.

On the foreign exchange market, the US dollar is appreciating against major currencies, notably the Japanese Yen, Euro, and the British Pound, while weakening against the Chinese Yuan.

By end December 2021 (y-o-y), the US dollar appreciated by 11.46 percent against the Japanese Yen, by 7.42 percent against the Euro, and by 1.01 percent against the British pound, reflecting optimism about the US growth outlook, but weakened by 2.66 percent against the Chinese Yuan.

II. EXTERNAL SECTOR DEVELOPMENTS

Rwanda's trade recovery continued in the fourth quarter of 2021.

In 2021Q4, merchandise exports[1] rose by 62.6 percent amounting to USD 353.1 million, up from USD 287.6 million recorded in the same quarter of 2020. The increase is owed to the continued recovery of external demand, supported by rising commodity prices and domestic economic activities as COVID-19 containment measures ease.

Traditional exports revenues grew by 56.7 percent, year -on- year, in 2021Q4 amounting to USD 111.7 million, up from USD 71.3 million in 2020Q4, due to increased receipts from coffee exports (+79.2 percent), tea (+7.9percent) and minerals (+84.0 percent), reflecting improving global commodity prices and value addition in minerals. In addition, exports quantities in the period under review went up significantly (+13.2 percent) compared to the same period of last year (-2.8 percent) as the supply disruptions caused by the pandemic have reduced.

Moreover, non-traditional exports rebounded in 2021Q4, registering USD 82.5 million from USD 45.1 million a year ago, an increase of 82.8 percent, mainly attributed to increased exports of horticulture products to European market as well as manufacturing exports mainly composed of construction materials to neighboring countries. Lastly, receipts from re-exported products soared by 43.5 percent year-on-year in the fourth quarter of 2021, standing at USD 129.4 million from USD 90.1 million recorded in 2020Q4, largely driven by re-exports of food products. Exports revenues from Informal Cross-Border Trade (ICBT)[2] amounted to USD 29.5 million in 2021Q4, following the opening of some borders with DRC as COVID-19 infections decreased.

Merchandise imports rose by 26.2 percent mainly driven by higher demand of consumer goods (+22.9 percent) largely food products that also reflected higher international prices, capital goods (+7.4 percent) driven by machines, devices & tools, intermediary goods (+22.3 percent) in large part driven by industrial products, and lastly energy (+79.1 percent) driven by increasing global oil prices. The increase in imports reflected the rebound of domestic economic activities in the period under review. Imports revenues from Informal Cross-Border Trade (ICBT) amounted to USD 1.2 million in 2021Q4.

Considering the cumulative twelve months of 2021, Rwanda's merchandise exports amounted to USD 1,167.8 million, up from USD 761.3 million a year earlier, an increase of 53.4 percent. On the other hand, merchandise imports value grew by 16.5 percent, to USD 3,201.0 million in 2021, up from USD 2,746.7 million in 2020. As result, Rwanda's annual trade deficit amounted to USD 2,033.1 million in 2021 from USD 1,985.3 million in 2020, representing an increase of 2.4 percent."

[1] Merchandise exports/ imports refers to exports/imports excluding gold. It includes formal exports and informal cross-border trade (ICBT).
[2] ICBT trade was suspended during April-October 2020 due to closure of borders in order to reduce the spread of the pandemic. However, at the end of November some borders with DRC resumed.

Projections for 2021 show that the external position will improve compared to last year, buoyed by continued recovery of external demand as well as Rwandan economy as Covid-19 restrictions decrease supported by the vaccine rollout. However, there are risks to these projections. Downside risks include renewed waves, virus mutations, and difficulties in accessing the vaccine in many developing countries which might delay the recovery in trade, travel, and tourism. Projections indicate that the current account deficit (CAD) is estimated to grow by 11.1 percent in 2021 from 11.9 percent in 2020 before widening in 2022 driven by higher oil prices and increased imports of capital and intermediate goods as the recovery of domestic economic activities continues. On the financing side, FDI and private borrowing are likely to remain subdued, but Rwanda could attract additional donor inflows and disbursements for the existing projects, notably Bugesera airport. However, Rwanda's external vulnerability remains marginal as the gross international official reserves remain adequate. The coverage of foreign reserves is 5.3 months of imports as of end December 2021. It will stay at above the desired level of 4.0 months of imports in the medium term.

III. DOMESTIC ECONOMIC DEVELOPMENTS

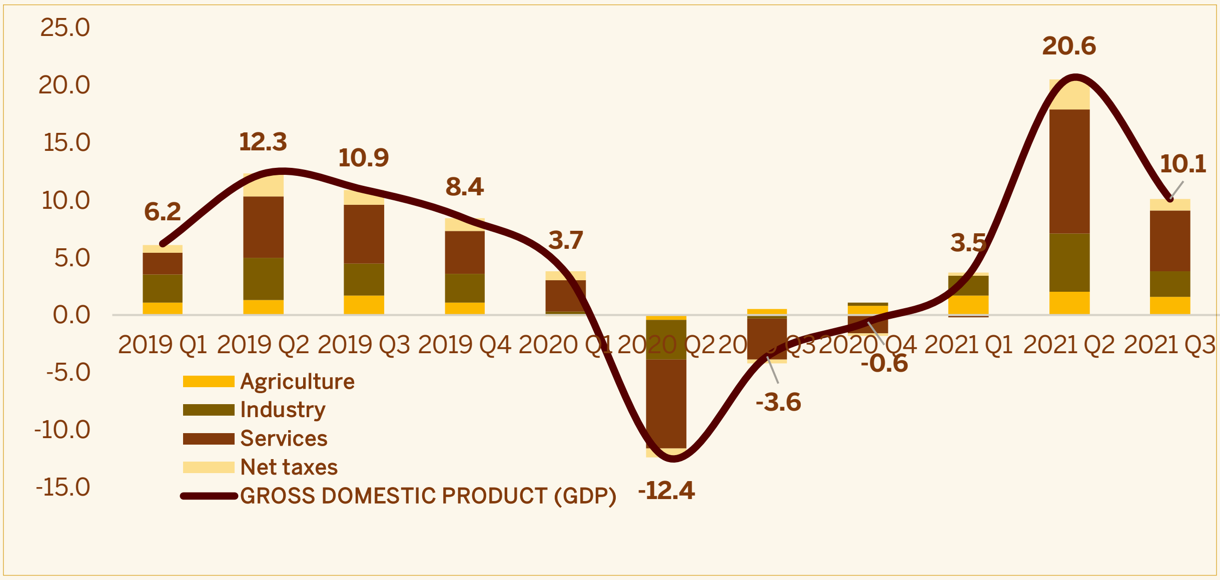
3.1 Economic growth in the third quarter of 2021

RWANDA's economy has been steadily improving after the adverse consequences of COVID-19, supported by effective vaccination campaign, government support and growing external demand. The real GDP grew by 11.4 percent in the first three quarters of 2021 and this strong growth is widespread across all sectors.

Strong economic recovery in 2021.

In 2021, Rwanda's economy achieved a broad-based recovery from the adverse effects of COVID-19 pandemic with an average real GDP growth of 11.4 percent during the first three quarters following the 3.4 percent contraction in 2020.

Chart 7: Real Gross Domestic Product (percentage change)



Source: National Institute of Statistics of Rwanda

The strong rebound was underpinned by sizeable policy support measures and the successful vaccination agenda which prompted the easing of Covid-19 restrictions, in addition to good weather conditions.

The latter, together with increased use of fertilizers and improved seeds have led to good harvest of food crops during the 2021 agricultural season A and B. Hence, food production increased by 6.4 percent in 2021Q3 after 7.0 percent in 2021Q2 and was the main contributor to the 6.3 percent growth of agricultural output in 2021Q3. Agriculture growth was driven also by good performance in other sub-sectors: exports crops (2.3 percent), forest products (5.3 percent), livestock and livestock products (8.2 percent) and fishing (30.1 percent).

Recovery policies, including the infrastructure projects, have primarily affected the industry sector. Industrial production grew by 11.6 percent in 2021Q3 and recorded an average of 17.1 percent during the first three quarters of 2021. The strong demand for construction activities as well as domestically manufactured related materials were the main contributors to the 14.5 percent growth in the construction sub-sector in 2021Q3 and a significant contribution to the 6.9 percent growth of manufacturing industries. Building on materials, specifically cement (+43.1 percent), paints and vanishes (+18.1 percent) to name a few, expanded at a faster pace.

Growth in the manufacturing industry is also associated with good progress in the recovery of wood, paper and printing (+16.3 percent), textiles (+11.7 percent), food processing (+5.6 percent) as well as beverages (+3.3 percent). The sector's performance has also been supported by the global economic recovery, mainly through the increased demand for minerals which led to the increase of their prices on international market. This is why mining and quarrying subsector registered a growth of 29.5 percent in 2021Q3 consistent with the increase in metal and minerals prices by 45.5 percent over the same period.

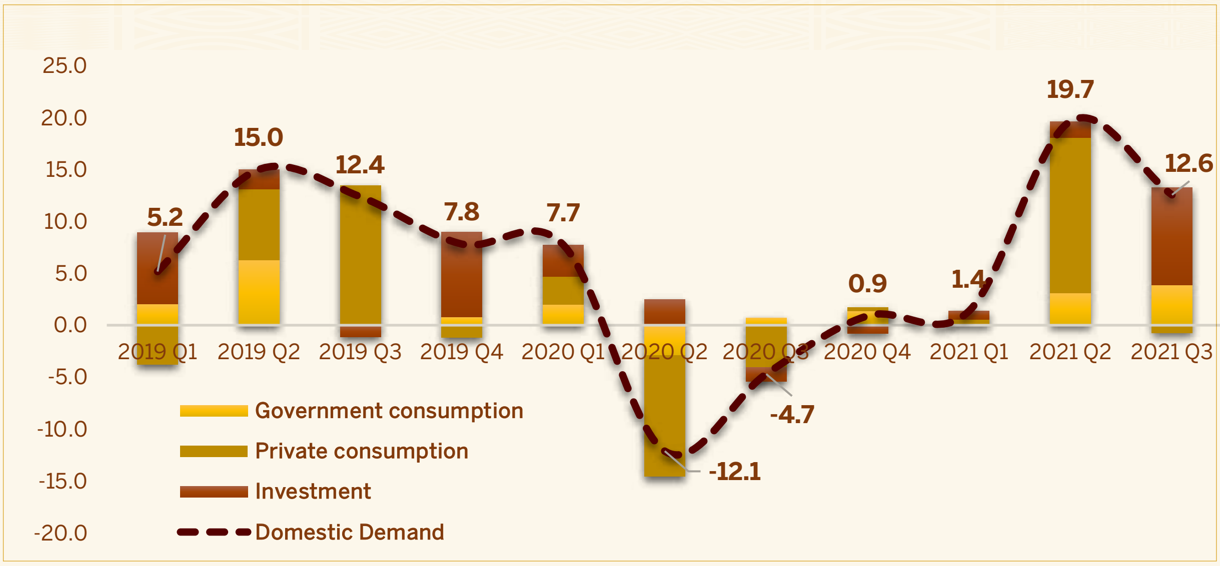
The services sector continued to recover despite the impact of delta coronavirus variant, which prompted a partial lockdown in July 2021 and that has mainly constrained services delivery. The sector recorded a growth of 11.3 percent in 2021Q3 and averaged 11.6 percent in the first three quarters of 2021. The performance of services sector in 2021Q3 was linked to the resilience of trade services (+3.8 percent); outstanding performance of information and communication (+14.1 percent), financial services (+10.6 percent) and architectural & engineering services (+12.0 percent), and finally, the robust recovery of tourism related services such as hotels and restaurants (+62.2 percent), air transport (+59.9 percent) and Travel agents & tour operators (+169.6 percent) as well as the strong recovery of education sector (+140.5 percent).

Strong investment demand backed the recovering of the domestic demand.

The domestic demand increased by 12.6 percent in 2021Q3, mainly driven by robust investment demand (+54.5 percent), including investment in construction (+15.1 percent), that were boosted by public and private infrastructure projects, part of the recovery plan. The domestic demand was reflected in the reduction of inventories (-95.2 percent) following the easing of COVID-19 restriction measures that supported progressively the resumption of economic activities.

The growth in domestic demand also depended on government consumption (+28.0 percent) while the private consumption declined by 1.0 percent, partly due to the July 2021 containment measures amid the delta variant crisis.

Chart 8: Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

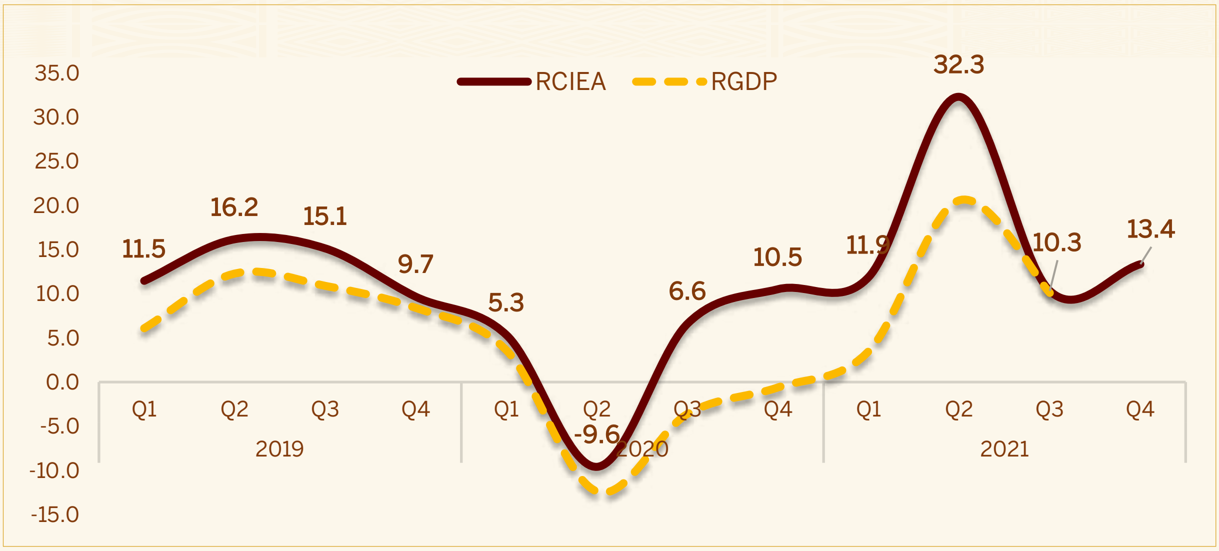
3.2 High frequency indicators in the fourth quarter of 2021

The economic recovery from COVID-19 adverse economic effects continued in 2021Q4, fueled by fiscal and monetary stimulus, the ease of containment measures as well as the successful vaccine campaign. This is evidenced by the composite index of economic activities (CIEA), that increased by 13.4 percent in 2021Q4 after 10.3 percent in 2021Q3.

High-frequency indicators evidence continuous economic recovery in 2021Q4.

Supported by the economic recovery plan, manufacturing and build to recover program, accommodative monetary policy, easing of restriction measures as well as the Covid-19 vaccine campaign, economic activity continued to recover in 2021Q4 despite the omicron wave. The latter led to tight restriction measures from the second half of December. The Composite Index of Economic Activities (CIEA) increased by 13.4 percent year-on-year in 2021Q4, suggesting solid economic momentum in the last quarter of 2021 as well as good progress towards the achievement of the 2021 projected economic growth of 10.2 percent.

Chart 9: Quarterly Real GDP growth vs CIEA (% change, y-o-y)

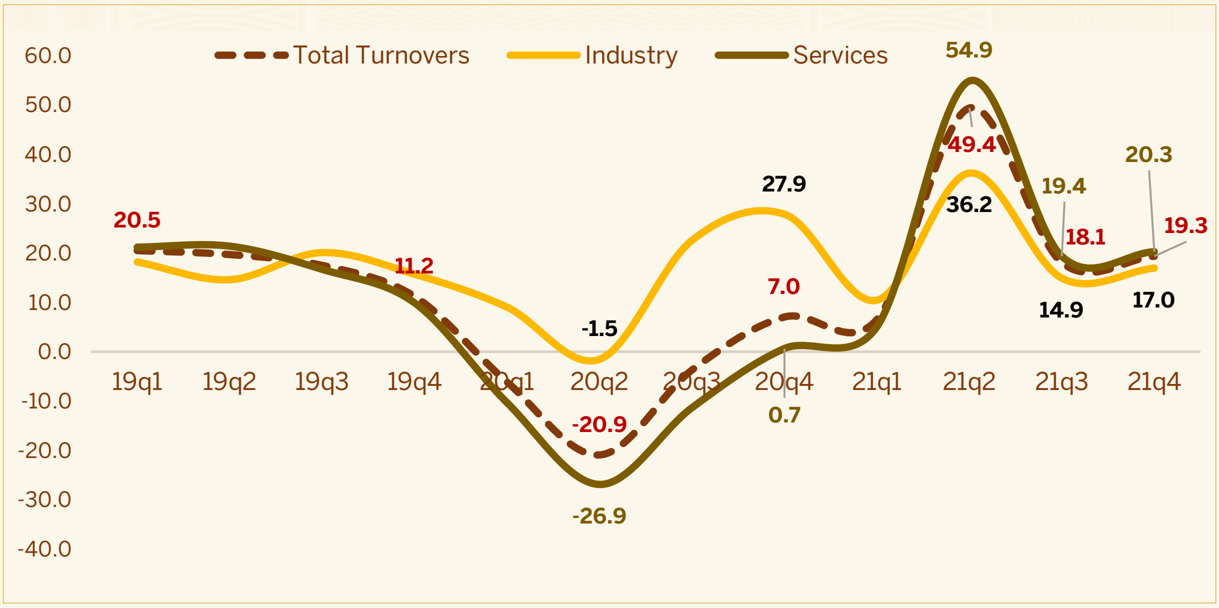


Source: NBR, Monetary Policy Department

The robust economic recovery is further evidenced by the continuous increase in turnovers of the industry and services sectors (+19.3 percent in 2021Q4, year-on-year). The industrial sector has maintained a rapid recovery path, with improvement in manufacturing, construction playing a crucial role. The construction subsector grew by 11.3 percent in 2021Q4, backed by on-going infrastructure projects; of which KIVU 56 and Rwanda urban development project. These projects boosted the demand for construction materials, which contributed to the good performance of local manufacturing industries (+15.4 percent in 2021Q4). In addition, food processing, beverages, textile, wood, paper, chemical, and furniture industries have expanded in line with the relaxation of restriction measures and growing regional export demand. As indicated also by the index of total manufacturing industrial production, the volume of industrial production grew by 6.0 percent in 2021Q4 after 10.6 percent in the corresponding period of 2020.

The mining and quarrying sector's turnovers increased by 54.4 percent in 2021Q4, supported by the increasing metal and mineral prices which grew by 27.8 percent.

Chart 10: Turnovers of industry & services sectors (% change, y-o-y)



Source: NBR, Monetary Policy Department

The services sector's turnovers that increased by 20.3 percent, indicate sustained recovery of the sector backed by vaccination campaign and relaxation of restriction measures. The growth in services sales is reflected in the good performance of trade services (+21.5 percent), transport and storage (+17.5 percent), hotels and restaurants (+73.4 percent), financial services (+10.2 percent) and information and communication (+15.2 percent).

Overall, Rwanda's economy rebounded significantly in 2021, fueled by economic recovery policies and effective vaccination campaign. Developments in the economic sector indicate a progress towards the achievement of the 10.2 percent real GDP growth projected for 2021. The recovery is expected to continue through 2022, with a projected growth of 7.2 percent and supported by accommodative macroeconomic policies, manufacturing build to recover program, continuity in vaccine campaign and the improvement of global and regional economy.

4.1 INFLATION DEVELOPMENTS

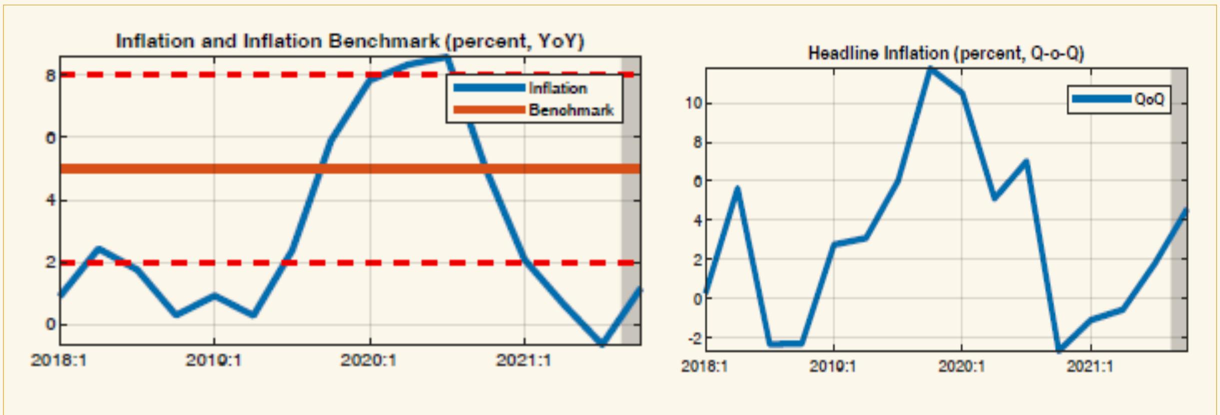
In line with the projections, headline inflation (y-o-y) increased to 1.2 percent in 2021Q4 from -0.6 percent recorded in the previous quarter. This uptick reflects mainly the increase in core components attributed to the rise in import costs. Unlike core inflation, fresh food and energy inflation rates slowed down due to the ample food supply on markets and the base effect, respectively.

Headline inflation accelerated in 2021Q4, reflecting mainly the rise in core inflation components.

Headline inflation in y-o-y and q-o-q terms picked up, and the increase mainly reflects core inflation components. In 2021Q4, core inflation (y-o-y) rose to 3.5 percent from 0.3 percent following the upticks in import costs that started over the past four quarters. Over the same period, energy inflation (y-o-y) slightly reduced to 3.4 percent from 3.9 percent due to base effect, while fresh food inflation (y-o-y) decelerated to -8.6 percent from -5.8 percent following ample food supply on the markets, adding to the base effect.

However, in January 2022, all the components recorded increases. Headline inflation accelerated to 4.3 percent, from 1.9 percent recorded in the previous month. Core inflation rose from 4.1 percent to 4.6 percent. Fresh food and energy inflation rose from -8.2 percent and 5.5 percent in December 2021 to 2.2 percent and 6.6 percent in January 2022, respectively.

Chart-11: Developments in headline inflation (y-o-y, q-o-q, percentage change)



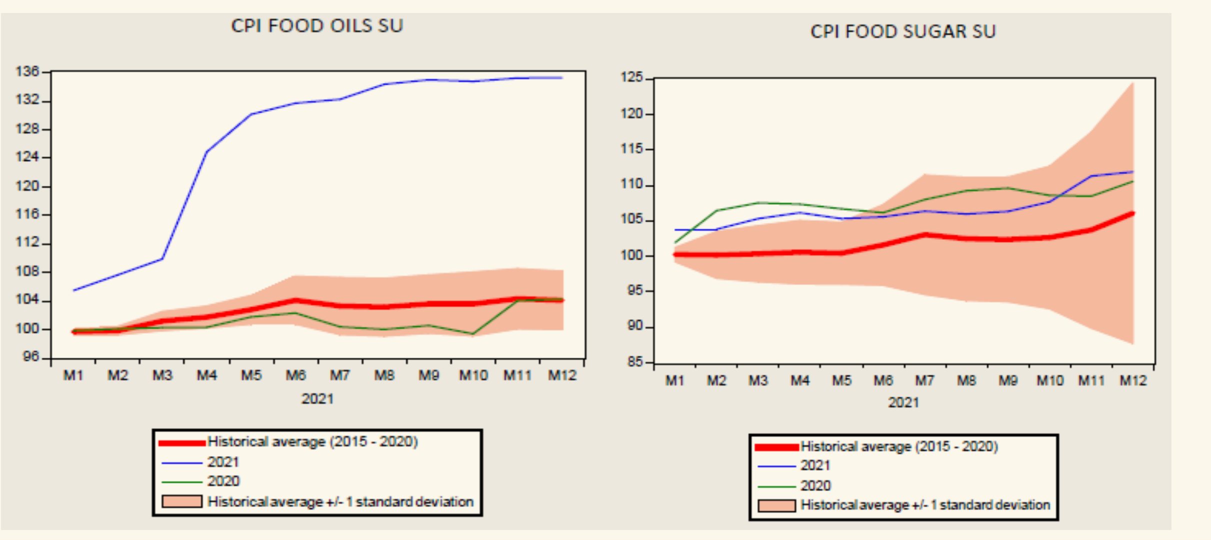
Source: NBR, Monetary Policy, and Research Directorate

Core inflation accelerated in 2021Q4 following the rise in import costs of core goods and the upward revision of school fees.

The upward trend in core inflation (y-o-y) is mainly reflected in core food inflation (from 5.0 percent to 6.6 percent), education inflation (from 10.8 percent to 19.2 percent), transport inflation (from -15.3 percent to -0.4 percent), and hotels and restaurants (from 2.0 percent to 3.5 percent). In 2021Q4, some imported core goods prices (processed foods such as sugar and cooking oils, motorcycles, clothing, and furnishing items) rose following the increase in container freight rates from the global markets. Core education inflation increased due to the upward revision of parental contributions (school fees and registration fees) for the nursery, primary and secondary schools. Hotels and restaurant inflation picked following the changes in menu costs.

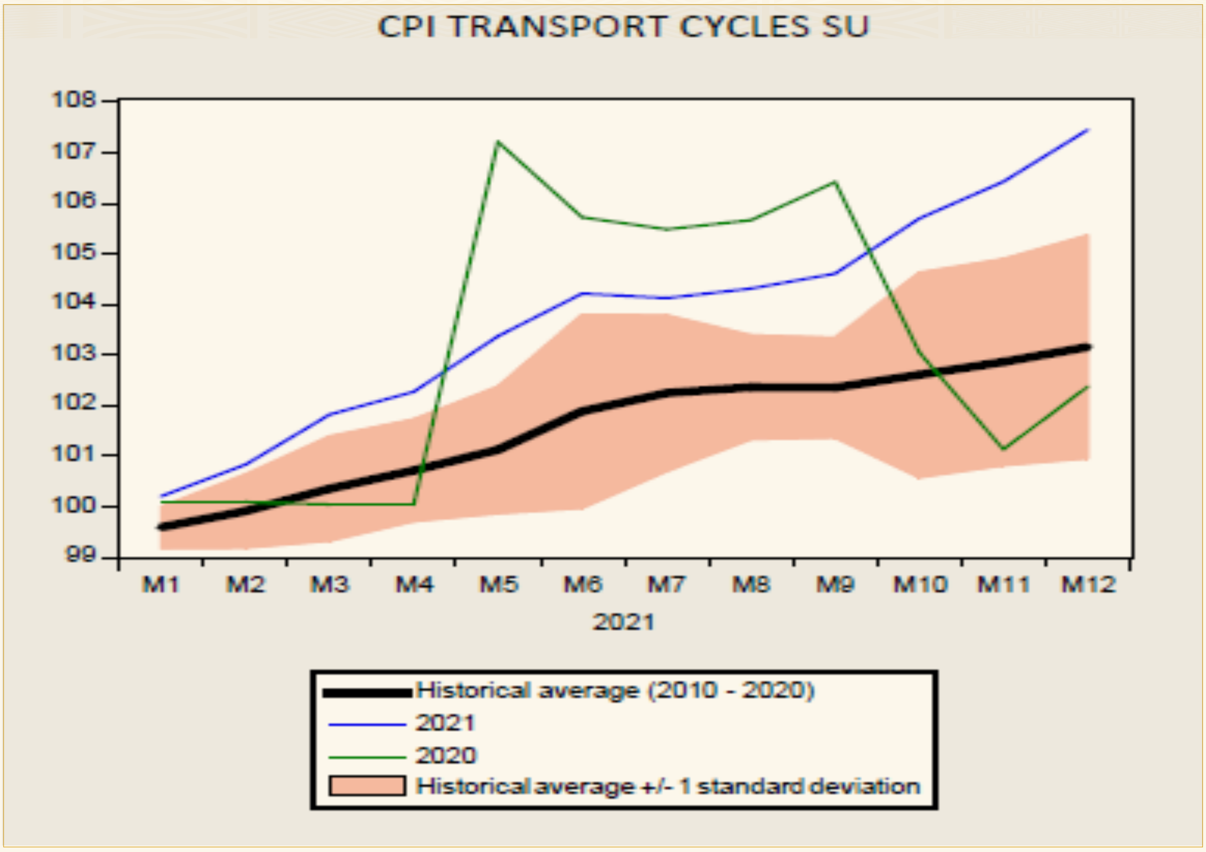
The continuous rise in prices of some processed foods (cooking oils and sugar) is on the back of the upsurge in international prices. Generally, prices of some processed foods increased much more in 2021 than 2020 due to the increase in demand and tighter supply conditions.

Chart-12: Cooking oils and sugar prices



Core transport inflation (q-o-q) increased in 2021Q4 due to the rising trend in purchase of vehicles inflation. The purchase of vehicles' inflation rose from 2.0 percent in 2021Q3 to 2.7 percent in 2021Q4, mainly reflecting the upticks observed in motorcycles (from 1.0 percent to 2.1 percent). The surge in motorcycle inflation reflects the increase in import costs as a result of the rise in shipment costs.

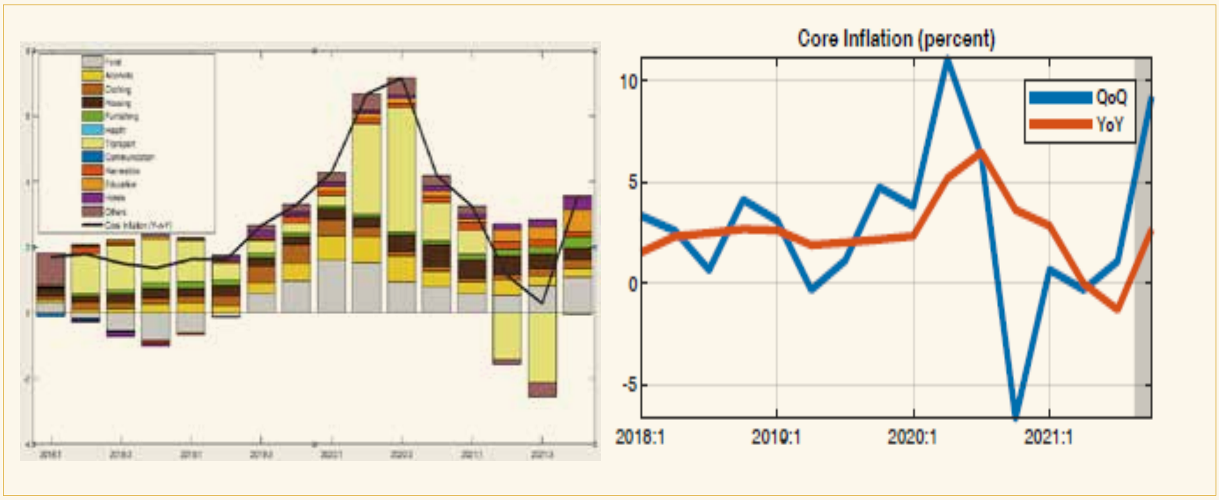
Chart-13: Transport motocycles index



Source: NBR, Monetary Policy, and Research Directorate

From 2021Q3, core inflation (core excluding food and energy components) in q-o-q terms recorded successive increases, reflecting the rise of the cost pressures from import costs of core goods.

Chart- 14: Core inflation (percentage change)



Source: NBR, Monetary Policy, and Research Directorate

Fresh food inflation eased on the back of ample food supply, adding to a base effect.

The drop in fresh food inflation (y-o-y) since 2021 mainly reflects vegetables' inflation. Vegetables' inflation (y-o-y) decreased to -18.3 percent in 2021Q4 from -11.8 percent, while it stood at -6.9 percent in 2021Q2. Vegetables' prices evolved below the 2020 price levels and the typical patterns of the historical prices (2015-2020). The recent developments in vegetables' inflation (y-o-y) are attributed to ample food supply on the market, coupled with the base effect.
In q-o-q terms, the decline in vegetables' inflation in 2021Q4 resulted from an early harvest of season A-2021/2022.

Chart-15: Fresh food inflation (y-o-y)

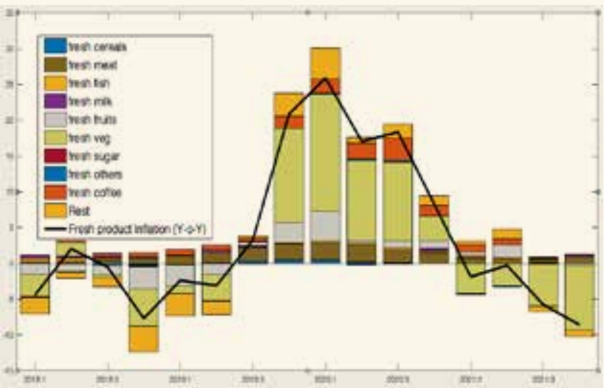
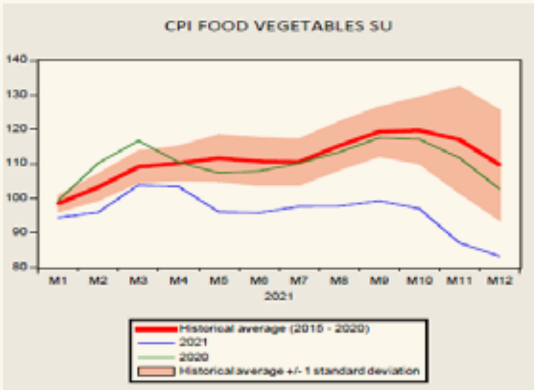


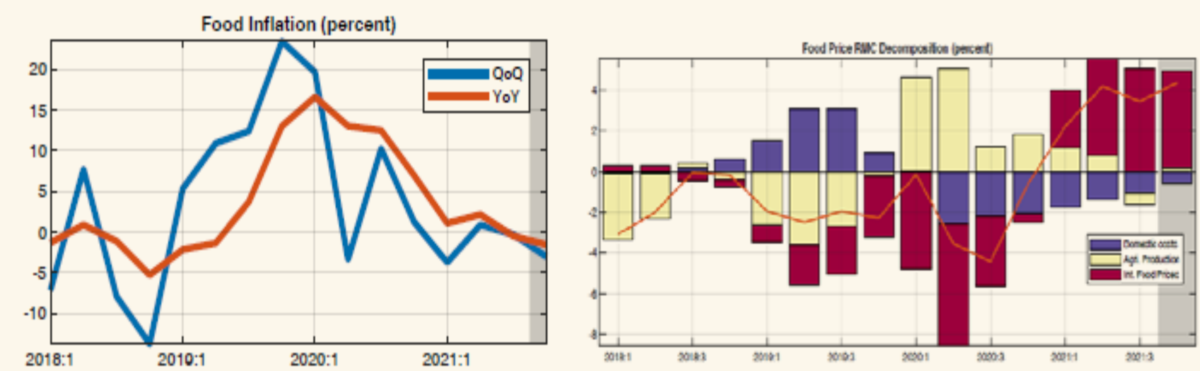
Chart-16: Vegetables CPI



Source: NBR, Monetary Policy, and Research Directorate

Food and beverages inflation (q-o-q) also declined in 2021, reflecting the subdued domestic prices pressures despite the increasing trend in international food prices.

Chart-17: Food and beverages inflation



Source: NBR, Monetary Policy, and Research Directorate

Energy inflation rose quarter on quarter, but slightly declined year on year terms following the base effect

The slight decrease observed in energy inflation (y-o-y) mainly reflects the drop in solid fuels inflation. Solid fuels inflation eased from 1.4 percent to 0.4 percent due to the base effect. However, energy inflation picked up in q-o-q terms from -1.1 percent in 2021Q3 to 1.8 percent in 2021Q4. These upticks reflected liquid fuels inflation that increased from 0.0 percent to 4.0 percent due to global oil prices. Over the same period, solid fuels inflation rose from -0.3 percent to 1.7 percent. This surge followed the increase in propane prices, whose price picked up following the recent prices in the international markets of liquefied petroleum gas.

Chart-18: Energy inflation (y-o-y)

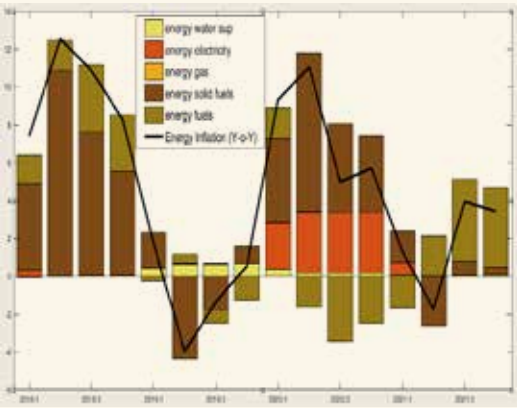
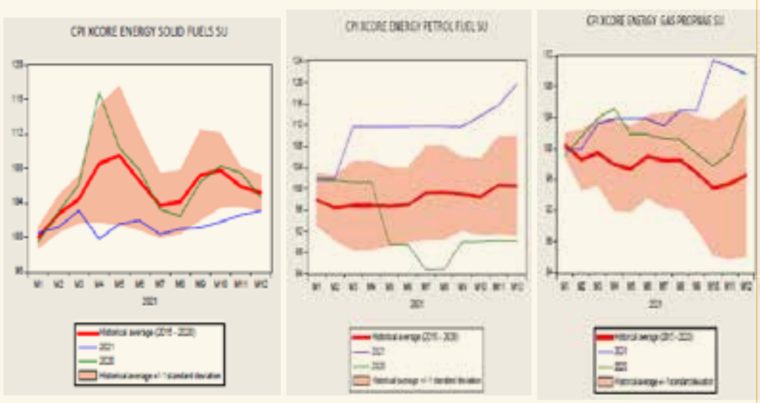


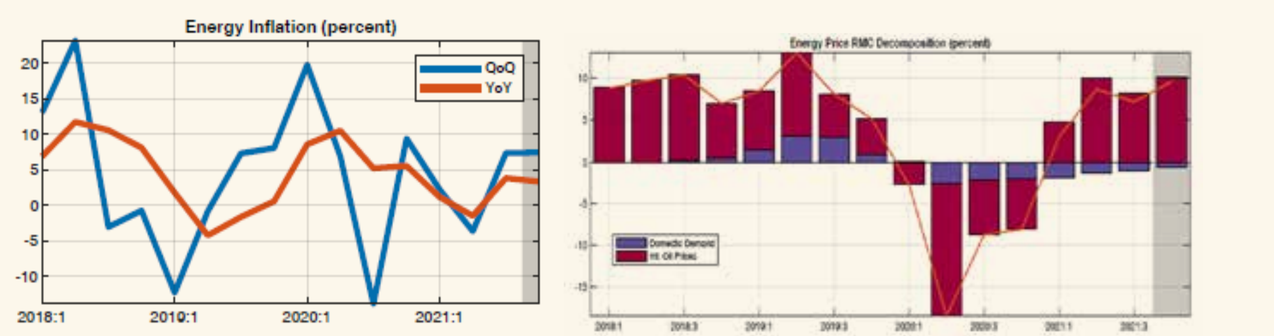
Chart-19: Solid, liquid fuels, Gas CPI



Source: NBR, Monetary Policy, and Research Directorate

Over the last two quarters of 2021, energy inflation recorded an upward trend, mainly following increased international oil prices.

Chart-20: Energy inflation (y-o-y)

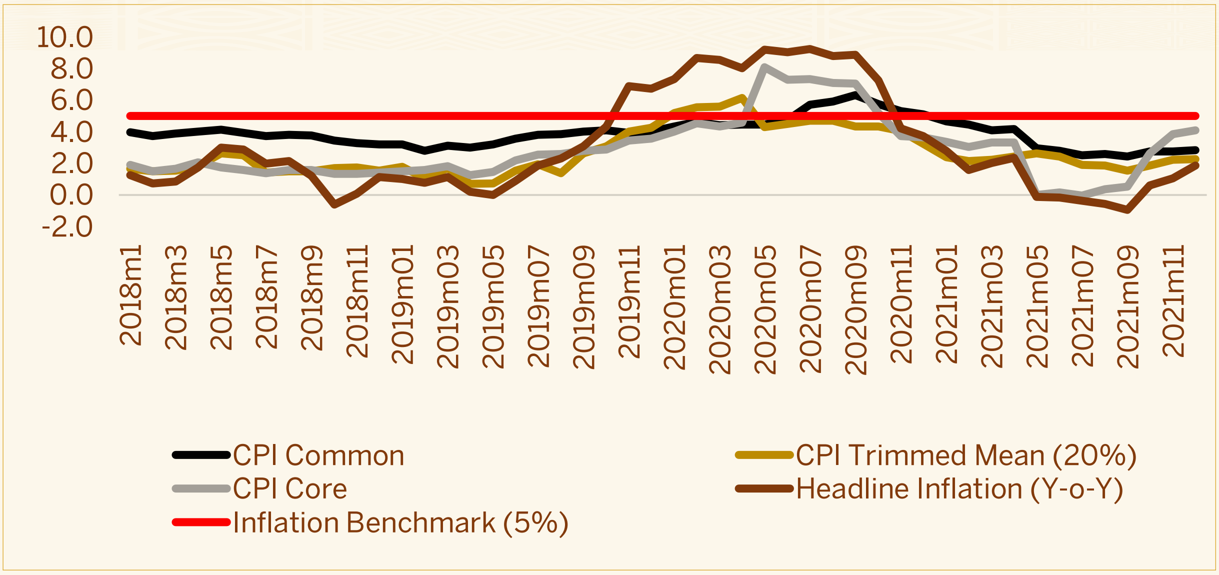


Source: NBR, Monetary Policy, and Research Directorate

Underlying inflation indicators evolved slightly above the lower bound of 2.0 percent in 2021Q4

CPI Trimmed Mean (20%) slightly picked up to 2.1 percent in 2021Q4 from 1.8 percent in 2021Q3, while CPI Common surged to 2.8 percent in 2021Q4 from 2.5 percent in 2021Q3. Generally, these underlying measures of inflation suggest a slight but broad-based increase in inflation in line with macroeconomic fundamentals.

Chart-21: Indicators of underlying inflation vs headline inflation (y-o-y)



Source: NBR, Monetary Policy and Research Directorate

4.2 INFLATION OUTLOOK

4.2.1 Forecast assumptions

Though at a slower pace, the global economy's strengthening will positively impact domestic economic recovery over the forecasting horizon.

The most recent IMF projections (WEO -January 2022) suggest a continued increase in global economic growth though at a slower pace, standing at 4.4 percent in 2022 from 5.9 percent recorded in 2021. The projections revised down the growth for the advanced economies, but they remain positive. For instance, the forecast of 2022 in the USA was revised down mainly following the revised fiscal policy package, earlier withdrawal of monetary accommodation, and continued supply chain disruptions. Similarly, the downward revision of the growth outlook for the Eurozone relates to the prolonged supply constraints and COVID-19 disruptions.

Over the forecasting period, inflation rates in the advanced economies are projected to remain higher than previous estimates of October 2021. The continuous rise in global inflation rates in 2022 followed the ongoing supply chain disruptions and high energy prices. Assuming that inflation expectations remain well-anchored, global inflation is expected to gradually drop as supply-demand imbalances disappear in 2022 and monetary policy in major economies responds accordingly. The projected paths of global economic growth and inflation rates support domestic economic recovery through export earnings.

The international commodity prices (mainly energy and food) are expected to remain at high levels in 2022, maintaining observed pressures on imported inflation.

In 2021, energy and food prices continued to rise on the back of supply chain disruptions and high demand for goods. In 2022, energy and food prices are projected to remain high due to the ongoing mismatch between demand and supply capacity of goods. However, pressures on energy and foods costs are projected to recede in 2023 as supply-demand imbalances reduce slightly.

Consistent with the projections of energy and food prices, pressures from imported food and energy products on the local markets are likely to persist over 2022 but ease in 2023.

4.2.2 Baseline projections of key macroeconomic variables

4.2.2.1. Drivers of inflation projections

The recovery in the domestic economy will continue throughout 2022 and allow the economy to operate above full production capacity in 2023, hence exerting inflation pressures.

By 2021, the domestic economy recorded positive growth as the lockdown measures and other restrictions associated with Covid-19 were eased and activities re-opened. Going forward, projections of the domestic economy indicate a continuous recovery, which will be mainly supported by global demand and accommodative monetary conditions. Consistent with the expected path of the domestic economic recovery, the cyclical position of the non-agricultural economy is expected to evolve above the normal capacity of production over the forecasting horizon. However, the recovery in economic activity is likely to lead to the rise in the domestic costs of production, exerting inflationary pressures upward on core inflation from 2022H2 onwards.

The imported production costs will remain high in 2022H1 but are expected to become non-inflationary afterward.

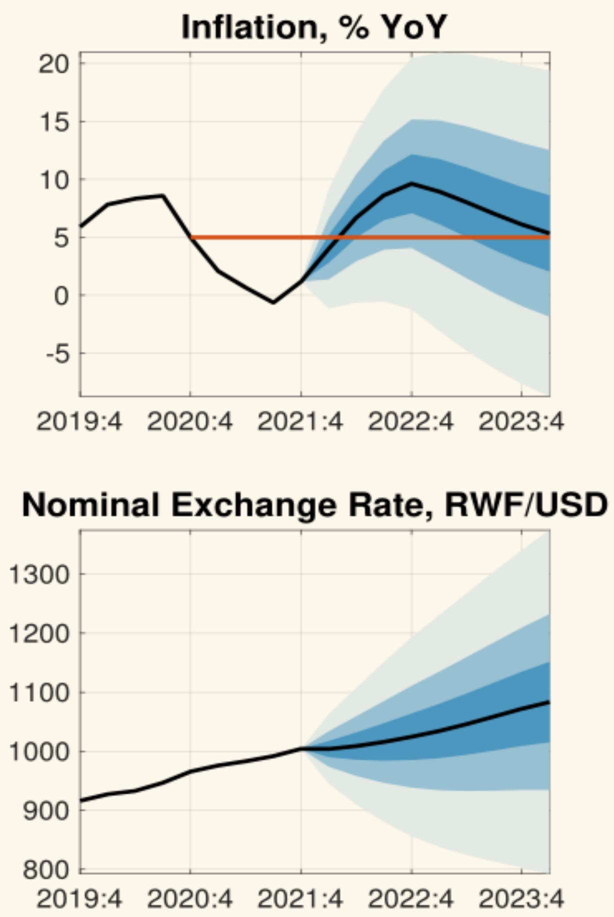
Since the beginning of 2021, imported production costs have been picking up due to the rise in global inflation. Over the next two quarters of 2022, imported costs are projected to remain high but decelerating. The price of foreign goods and services in the domestic currency is expected to reduce on the back of lowering global inflation, easing nominal exchange rate depreciation in 2022, and the expected increase in domestic inflation. Once these materialize, pressures on inflation from imported costs will be non-inflationary.

4.2.2.2. Projections of key macroeconomic indicators

Consistent with initial economic conditions, assumptions on the global economy and other macroeconomic variables, headline inflation is projected to evolve around 7.5 percent in 2022 and 7.8 percent in 2023. Core inflation is expected to increase throughout 2022H1, mainly due to the increase in the imported costs of production. Pressures on core inflation are projected to start decelerating after 2022H2 as imported costs normalize.

Upward pressures from imported costs will continue to push up food inflation in 2022, but will fade away afterward. International food prices exerted inflationary pressures in 2021, which is expected to continue in 2022H1. In 2023, pressures on food prices will dissipate as global food prices moderate and offset the increase in domestic costs of production. Similarly, prices of imported energy products are projected to continue creating upward pressures on energy inflation in 2022. Such pressures will be mainly driven by the expected upticks in the international oil prices.

The figure below indicates the outlook for key macroeconomic variables over the medium-term horizon.

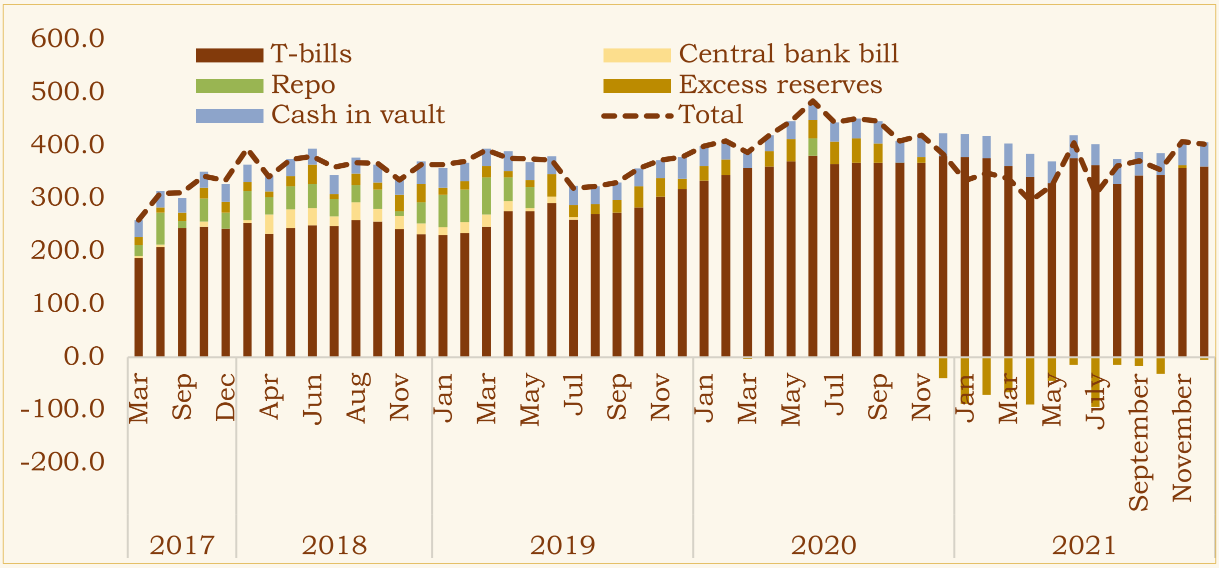


Banking system liquidity rebounded and as result, money market rates remained steered around the central bank rate with the interbank reducing by 17 basis points to 5.18 percent in 2021 compared to the previous year. Regarding market rates, in 2021, the average lending rate declined by 17 basis points to 16.18 percent. During the same period, broad money and outstanding credit to private sector picked up by 17.8 percent and 14.7 percent (y-o-y), respectively. The growth in credit to private sector (CPS) was explained by the increase in new authorized loans (NALs) by 15.4 percent compared with a contraction of 8.2 percent registered in 2020.

The growth of banking system liquidity resulted from the rebound in excess reserves.

In December 2021, the banking system liquidity grew at slow pace of 4.9 percent to FRW402.1 billion, from FRW383.4 billion in 2020, compared to a growth of 30.0 percent recorded in 2020. This growth is mostly attributed to both the rebound in excess reserves and accelerated T-bills investment on the back of increased government spending recorded in 2021Q4.

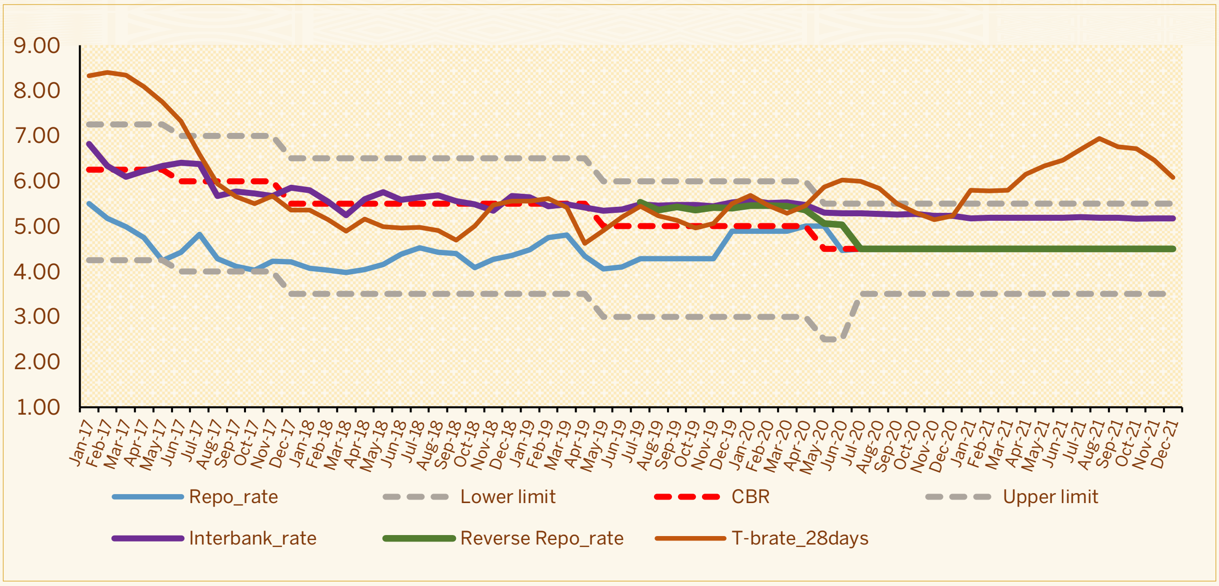
Chart 22: Most liquid assets of commercial banks (FRW billion)



Money Market rates were largely steered close to the central bank rate.

The Monetary Policy Committee (MPC) decided in November 2021 to maintain an accommodative monetary policy stance by keeping the central bank rate (CBR) at 4.5 percent to support economic recovery during the COVID-19 pandemic. Money market rates were steered around the central bank rate as a result of prudent monetary policy implementation. The interbank rate dropped by 17 basis points to 5.18 percent in 2021 from 5.35 percent in 2020 and lessened by 8 basis points in 2021Q4 to 5.17 percent on average, year-on-year. The repo and reverse repo rates were steered at the CBR since July 2020, in a bid to enhance the monetary policy transmission mechanism.

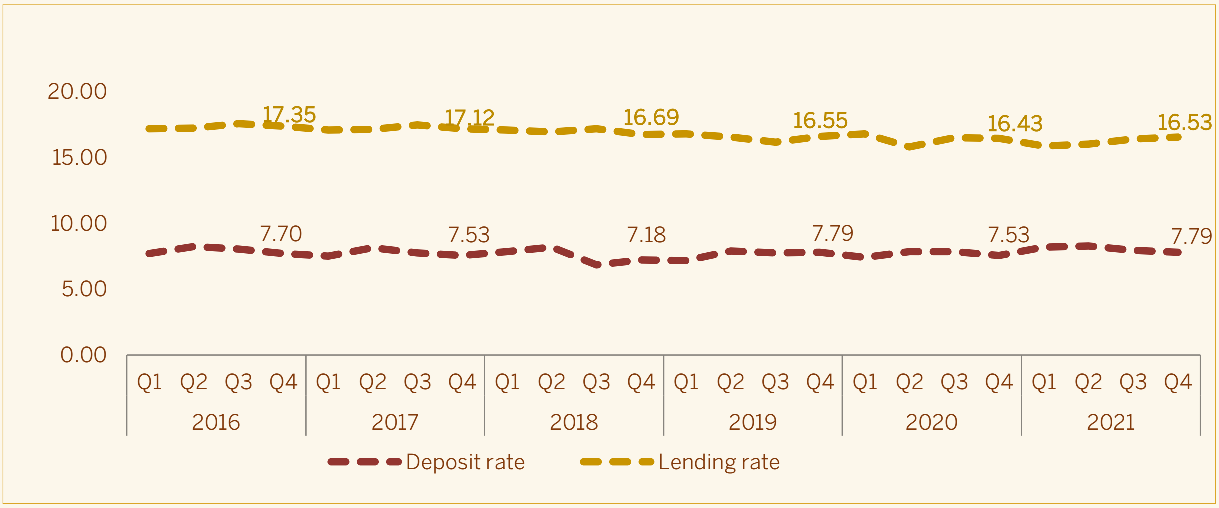
Chart 23: Money market rates developments



Source: NBR, Monetary Policy and Research Directorate

Regarding market rates, the lending rate declined by 17 basis points to 16.18 percent in 2021 from 16.35 percent in 2020, and this decline is partially linked to the increase in long-term loans which are priced at lower rates. Looking at y-o-y changes, lending rate rose by 10 basis points to 16.53 percent in 2021Q4, reflecting a growth in short term loans which were priced at high rates for both corporate and individual customers. During the same period, deposit rate increased by 39 basis points to 8.03 percent in 2021 from 7.64 percent in 2020; while it rose by 26 basis points to 7.79 percent in 2021Q4 (y-o-y changes), this increase is mostly attributed to the rise in deposits by corporates that have bargaining power. As a result, the spread between the lending rate and the deposit rate lessened by 56 basis points to 8.15 in 2021 from 8.71 in 2020 while it dropped by 16 basis points to 8.74 percent on average in 2021Q4, down from 8.90 percent in 2020Q4.

Chart 24: Market interest rates (percent average)



Source: NBR, Monetary Policy and Research Directorate

Foreign exchange market remains stable.

In 2021Q4, the franc kept depreciating against the USD, reflecting the growing need for imports to supporting the economic recovery and the continuous effort to contain the COVID-19 pandemic. Compared to December 2020, the FRW depreciated by 3.82 percent versus the US dollar end December 2021, slower than 5.42 percent in the similar period last year, partly reflecting a gradual improvement in foreign inflows.

The franc depreciated also by 2.94 percent against the Pound, relative to a depreciation of 9.42 percent end December 2020. It however advanced by 4.39 percent and 6.96 percent versus the Euro and the Yen against respective decline of 15.71 percent and 11.43 percent in the corresponding period last year.

Table 1: Appreciation/Depreciation rate of FRW against selected currencies

	FRW/USD	FRW/GBP	FRW/EUR	FRW/JPY	FRW/KES	FRW/TZS	FRW/UGS	FRW/BIF
Dec-18	4.04	-1.96	-0.07	6.20	5.46	1.24	1.77	1.93
Dec-19	4.94	8.48	2.81	6.25	4.53	3.73	5.13	-0.24
Dec-20	5.42	9.42	15.71	11.43	-1.34	5.66	7.17	2.53
Jan-21	0.28	0.94	-1.29	-1.00	-0.49	0.40	-0.82	0.18
Feb-21	0.46	2.94	-0.69	-2.39	-0.04	0.46	-0.27	0.27
Mar-21	0.70	1.52	-4.09	-6.29	0.42	0.70	0.15	0.31
Apr-21	0.99	3.48	-0.43	-4.25	2.31	0.99	2.83	0.50
May-21	1.22	5.54	0.45	-4.78	2.76	1.22	3.98	-0.45
Jun-21	1.51	3.26	-1.73	-5.23	2.83	1.51	4.10	-0.56
Jul-21	1.80	4.31	-1.61	-4.09	2.41	1.80	4.40	-0.37
Aug-21	2.13	3.38	-1.81	-4.13	1.53	2.13	5.30	-0.15
Sep-21	2.58	1.33	-3.17	-5.47	1.45	3.05	5.57	0.09
Oct-21	3.09	4.43	-2.11	-6.43	1.28	4.05	5.72	0.49
Nov-21	3.49	1.25	-4.88	-6.00	0.46	4.21	5.76	0.78
Dec-21	3.82	2.94	-4.39	-6.96	0.24	4.78	6.85	1.00
Dec-20	5.42	9.42	15.71	11.43	-1.34	5.66	7.17	2.53

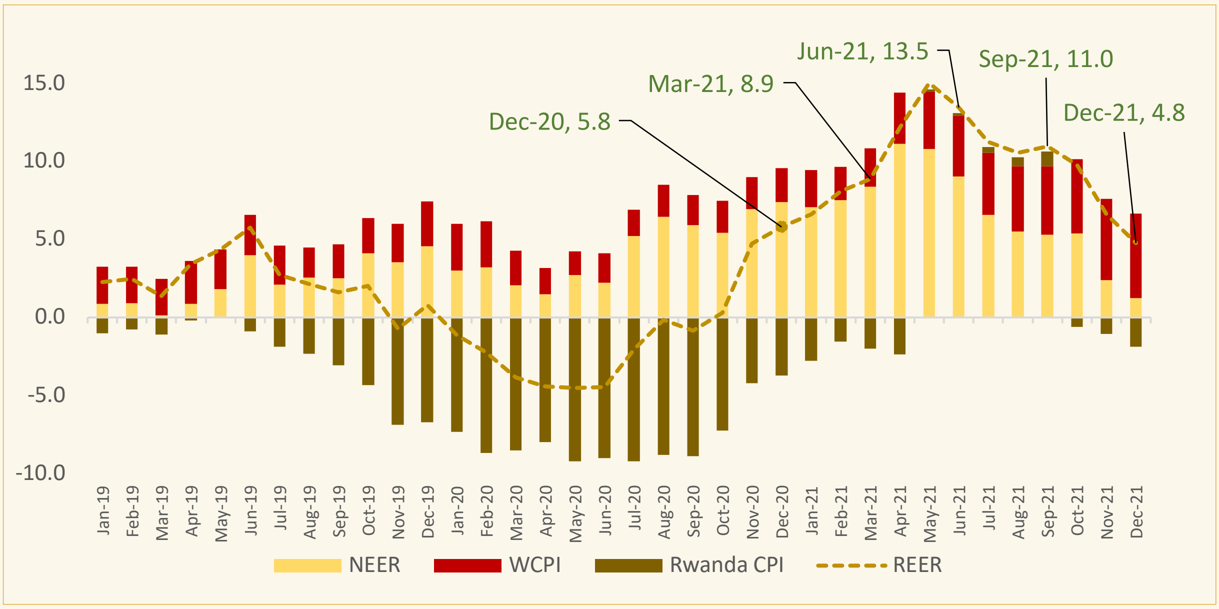
Source: NBR, Monetary Policy Department

Relative to regional currencies, the FRW slightly weakened against the Kenyan Shilling, losing 0.24 percent after an appreciation of 1.34 percent end December 2020. It curbed losses against the TZS, UGS and BIF, losing 4.78 percent, 6.85 percent and 1.00 percent.

Compared to a basket of currencies of Rwanda's main trading partners, the FRW continued to erase some previous losses in real terms, depreciating by 4.8 percent (y-o-y) end December 2021, slower than 11.0 percent depreciation recorded in September 2021, and against a 5.8 percent appreciation recorded during the corresponding period of the year 2020.

This lower depreciation mostly reflected slower than the previous year's nominal effective depreciation and subdued domestic inflation amid higher foreign inflation. In nominal effective terms, the franc depreciated by 1.3 percent in December 2021 compared to a depreciation of 7.4 percent in December 2020. Weighted foreign inflation rose to 5.4 percent from 2.2 percent end December 2020, while domestic inflation stood at 1.9 percent compared to 3.7 percent in the corresponding period of 2020.

Chart 25: Drivers of REER movement



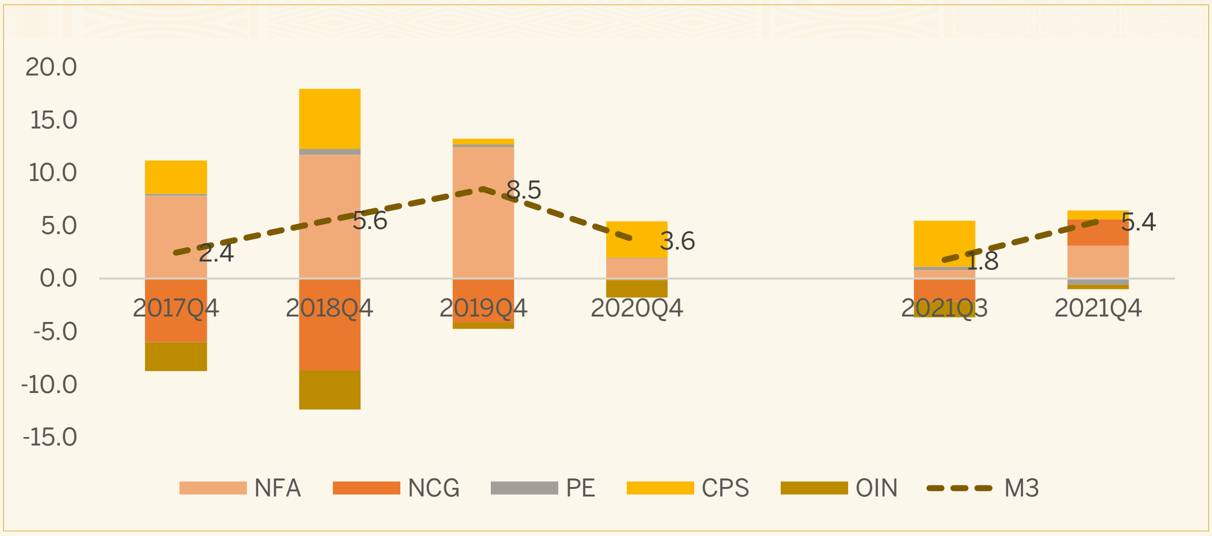
Source: NBR, Monetary Policy Department

Broad money M3 kept increasing, in line with the accommodative monetary policy stance.

Broad money M3 picked up by 17.8 percent in 2021Q4, year-on-year, mainly attributed to the growth in outstanding Credit to the Private Sector (CPS) by 14.7 percent, reflecting a high increase in new authorized loans in 2021.

Looking at q-o-q changes, the broad money M3 increased by 5.4 percent in 2021Q4 against a growth of 1.8 percent recorded in 2021Q3. This growth emanated from the increase in Net Foreign Assets (NFA), Net Credit to Government (NCG) and outstanding Credit to Private Sector (CPS) by 7.3 percent, 33.9 percent, and 1.1 percent respectively. However, the Credit to Private Enterprises and the Other Items Net (OIN) pulled down the growth of M3 with a contraction of 13.3 percent and 1.3 percent respectively in 2021Q4 (q-o-q).

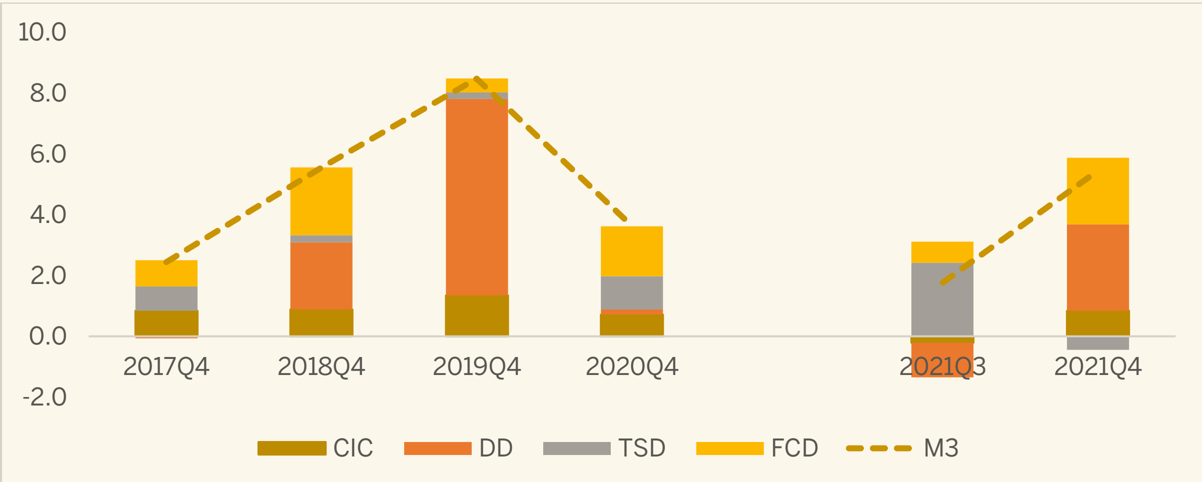
Chart 26: Contributors to M3 growth from assets side



Source: NBR, Monetary Policy and Research Department

With regard to the broad money M3 components, its increase of 5.4 percent in 2021Q4 (q-o-q), was mainly attributed to the growth in Demand Deposits (DD) of 8.7 percent, Foreign Currency Deposits (FCD) of 8.9 percent and Currency in Circulation (CIC) of 10.8 percent. Considering the y-o-y changes, the increase of 17.8 percent in M3 was mainly reflected in the growth of TSD of 17.0 percent, followed by a growth in FCD of 27.9 percent, in demand deposits (13.3 percent), and in CIC (12.3 percent).

Chart 27: Contributors to M3 growth from liabilities side



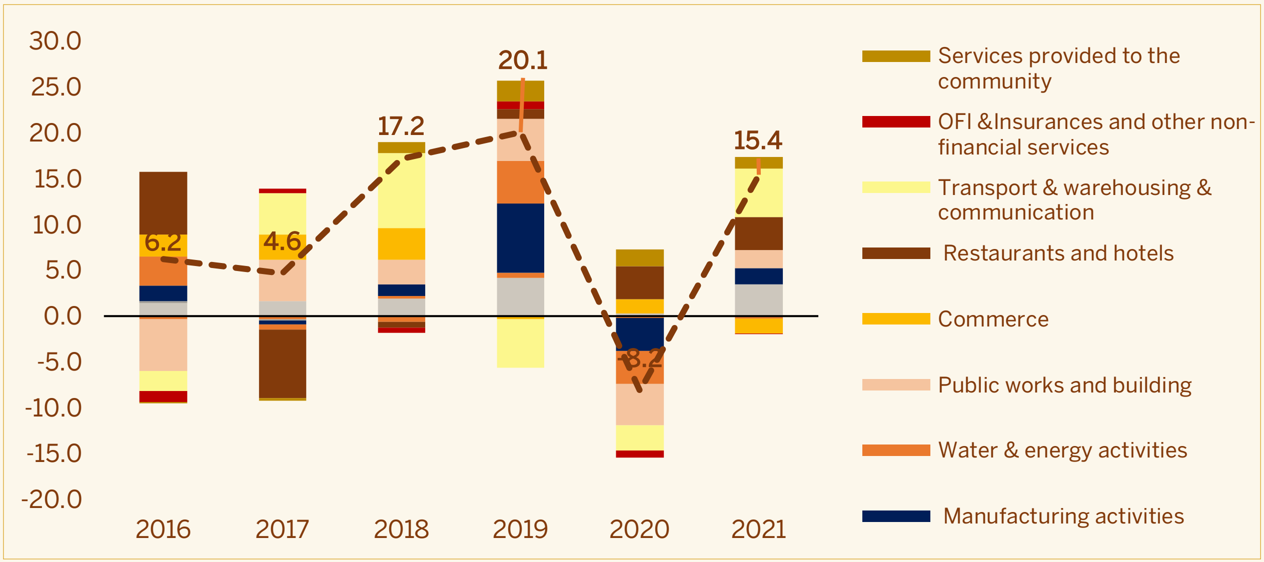
Source: NBR, Monetary Policy and Research Directorate

Sound credit to the private sector owing to continuous supportive policy measures, including the accomodative monetary policy.

The outstanding Credit to the Private Sector (CPS) increased by 14.7 percent in 2021Q4 (Y-o-Y) compared to 21.8 percent growth in 2020Q4, due to new disbursed loans in 2021.

New Authorized loans (NALs) picked up in 2021 as a result of improving economic outlook compared to the previous year and continuous economic recovery measures. In 2021, NALs grew by 15.4 percent compared with a contraction of 8.2 percent registered in 2020. The top four sectors that were mostly financed in 2021 are commerce, which was granted 25.7 percent of the total NALs, public works & buildings (21.6 percent), personal loans (15.2 percent), and Transport, warehousing & communication (9.3 percent).

Chart 28: Contributions of Sectors to the Change in New Authorized Loans (% changes)



Source: NBR, Monetary Policy Department

The increase in NALs was in line with the rise in loan demand in both value and volume, induced by the relaxation of the tight Covid-19 restrictions and improving economic outlook that followed the vaccination program. According to the latest credit survey, loan demand increased by 18.0 percent in terms of value compared with 12.7 percent contraction recorded in the first nine months of 2020, whereas it rose by 14.9 percent in terms of number of applications, against 0.7 percent increase recorded last year during the period under consideration.

Looking at quarter-on-quarter changes, NALs slowed down by 9.2 percent in 2021Q4 compared with a growth of 4.8 percent registered in 2021Q3 due to base effect.

- End -

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