NATIONAL BANK OF RWANDA
BANKI NKURU Y'U RWANDA

MONETARY POLICY REPORT

May 2023

NBR IDENTITY STATEMENT

The National Bank of Rwanda strives to be a World class Central Bank contributing to economic growth & development, by using robust monetary policy tools to maintain stable market prices. The Bank ensures financial stability in a free market economy as it embraces innovation, inclusiveness, and economic integration.

VISION

To become a World Class Central Bank

MISSION

To ensure Price Stability and a Sound Financial System

OUR CORE VALUES

INTEGRITY

We uphold high moral, ethical and professional standards for our people, systems and data

ACCOUNTABILITY

We are result-focused and transparent, and we reward according to performance

MUTUAL-RESPECT AND TEAM-WORK

We keep ourselves in high spirit, committed to each other for success

EXCELLENCE

We passionately strive to deliver quality services in a timely and cost effective manner. We continuously seek improvement by encouraging new ideas and welcoming feedback that adds value to customer services.

NBR
Key Strategic Focus
(2017/18-2023/24)

The National Bank of Rwanda strategic plan sets out six strategic focus areas in which the Bank must excel to achieve its mission and vision. The strategy was designed based on Rwanda's aspirations for economic transformation in line with the National Strategy for Transformation (NST1).

SUMMARY OF NBR's MONETARY POLICY STRATEGY

OBJECTIVE

Monetary Policy shall maintain price stability by keeping headline consumer price inflation within the band of 2% and 8%, with a focus of having it close to 5% in the medium term. In line with best practices, price stability is the primary and overriding objective of the NBR's monetary policy.

NBR shall also ensure financial stability as well as support other general objectives for economic development. NBR will set the Central Bank Rate (CBR) to stabilize inflation in the medium term.

The monetary policy framework is forward looking, therefore relying on the projections of inflation, taking into account economic developments.

DECISION-MAKING PROCESS

The Monetary Policy Committee (MPC) usually holds four quarterly meetings per year, where it decides on the monetary policy stance by setting the CBR to stabilize medium term inflation. Before the MPC decision, there is extensive assessment and economic analysis to guide discussions.

COMMUNICATION

A press release with the monetary policy decision and its main rationales is always published the day after the MPC decision and the Governor holds a press conference. The monetary policy report, detailing recent economic developments, projections, and reasons behind the decision is also published at the same time as the press release.

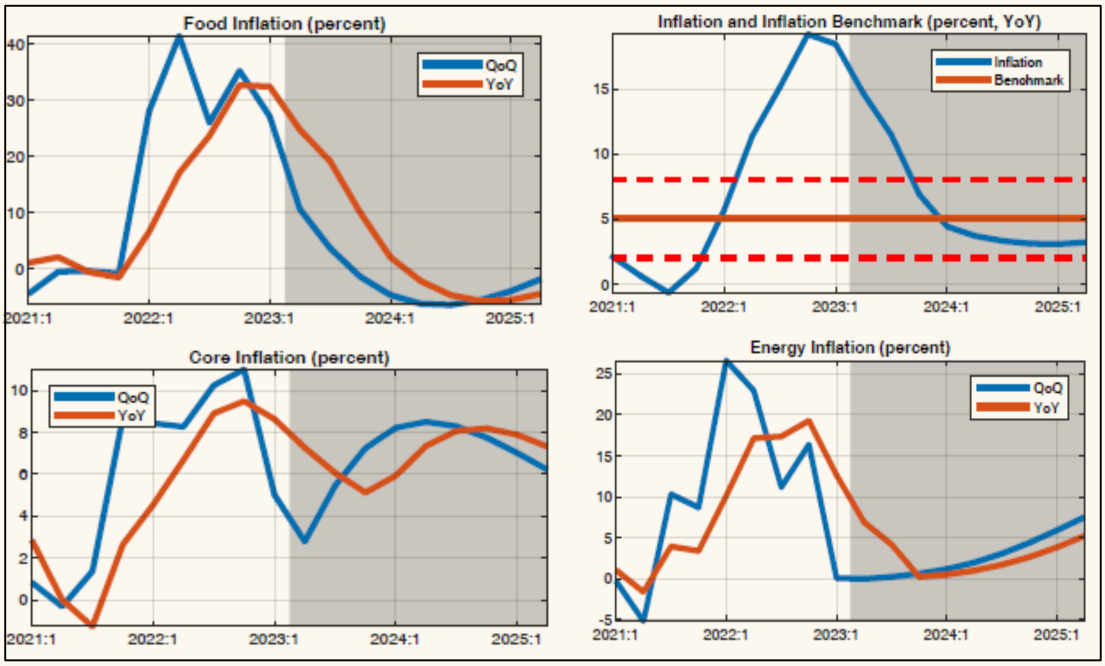
CONTENTS

MONETARY POLICY COMMITTEE DECISION, CURRENT OUTLOOK, AND RISKS

The Monetary Policy Committee (MPC) met on 10th May 2023 to review the impact of its previous decisions, evaluate recent global and domestic economic developments, and decide on the Central Bank Rate (CBR) for the next quarter. Analysis shows that inflationary pressures are declining, although still high, following the continued global economic challenges as well as less supply of domestic agricultural production. The downward pressures observed in core inflation reflect the drop noted from both imported and domestic processed food inflation. Similarly, energy inflation reduced as a result of an increased supply of charcoal and firewood, coupled with the downward revisions in local pump prices throughout 2023Q1. Conversely, the rising trend observed in fresh foods inflation is attributed to the shortage in the food supply, in line with the lower-than-expected 2023 Season A agricultural production.

Though headline inflation remains high, going forward, it is expected to fall within the target band towards the end of 2023, reflecting the effect of NBR monetary policy, Government policy measures, and continued ease in global pressures. This decline is expected for all main components of headline inflation, namely core, energy, and fresh food inflation. This inflation outlook assumes the improved performance of the agriculture sector for the second half of this year. However, risks may come from weather-related challenges.

Based on the projected ease in inflation, the MPC decided to maintain the Central Bank Rate (CBR) at 7.0 percent. The MPC remains committed to bringing back inflation within the target band (2 percent to 8 percent) and will continue to monitor macroeconomic developments and take appropriate action when necessary.



I. GLOBAL ECONOMIC DEVELOPMENTS AND OUTLOOK

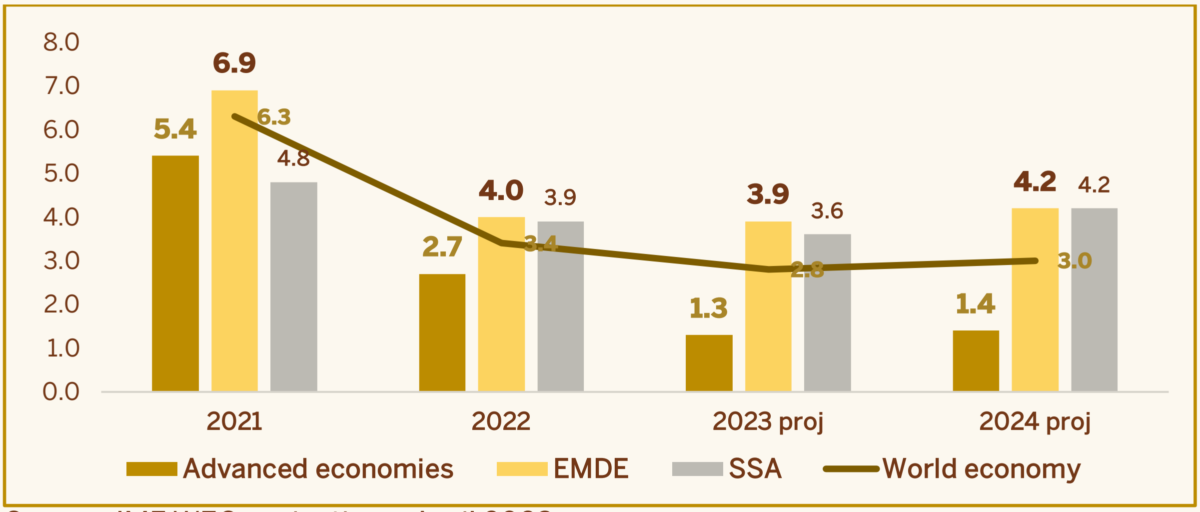
According to the International Monetary Fund (IMF)'s World Economic Outlook (WEO) projections published in April 2023, the world economic growth is projected to slow to 2.8 percent in 2023, from 3.4 percent in 2022. Growth projections for 2023 are revised down by 0.1 percentage points relative to January 2023 update, reflecting downward revision for emerging market and developing economies.

The global economy is projected to slow in 2023.

According to the International Monetary Fund (IMF)'s World Economic Outlook (WEO) projections in April 2023, the world economic growth is projected to slow to 2.8 percent in 2023 from 3.4 percent in 2022. Growth projections for 2023 are revised down by 0.1 percentage points relative to January 2023 update, reflecting downward revision for emerging market and developing economies.

Economic growth in advanced economies is projected to decelerate from 2.7 percent in 2022 to 1.3 percent in 2023, forecasted to decline by half, before increasing slightly to 1.4 percent in 2024. Although the forecast for 2023 is modestly higher by 0.1 percentage point than in the January WEO update, it is well below 2.6 percent forecast of January 2022. In 2023, about 90 percent of advanced economies are projected to see a decline in growth. With the sharp slowdown, advanced economies are expected to see higher unemployment.

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



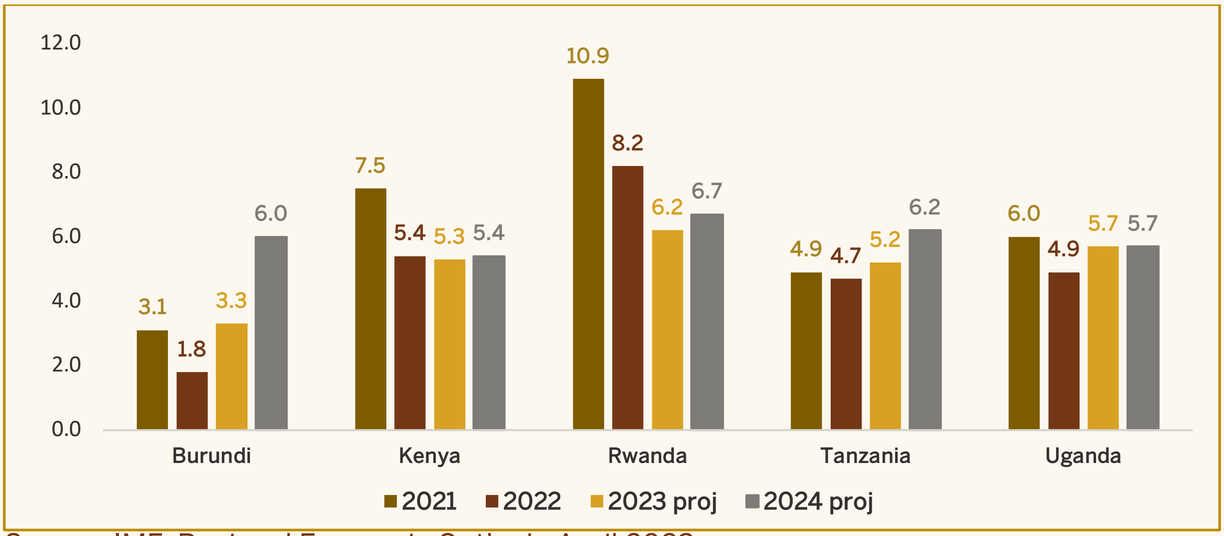
Source: IMF WEO projections, April 2023

Emerging market and developing economies are projected to grow moderately from 4.0 percent in 2022 to 3.9 percent in 2023, with a downward revision of 0.1 percent point relative to January 2023 update, and significantly below the 4.7 percent forecast of January 2022.

Economic prospects for emerging markets and developing economies are on average stronger than for advanced economies, but these prospects vary widely across regions. Growth outlook for Sub-Saharan Africa is slightly weaker than predicted in January 2023 update. The Sub-Saharan African economy is projected to slow from 3.9 percent in 2022 to 3.6 percent in 2023, revised downward by 0.2 percentage point relative to January 2023 update, amid prolonged fallout from the Covid-19 pandemic. The weaker output reflects lower trading partner growth, tighter financial and monetary conditions, and a negative shift in the commodity terms of trade. Sub-Saharan Africa is expected to rebound to 4.2 percent in 2024.

The economic performance in the East African Community (EAC[1]-5) countries is projected at 5.4 percent in 2023, from 5.1 percent in 2022, following projected upgrades for the majority of member countries compared to the previous year.

Chart 2 - Economic growth in EAC-5 countries (% change)



Source: IMF, Regional Economic Outlook, April 2023

Commodity prices continued to decline in 2023 due to the slowing global demand.

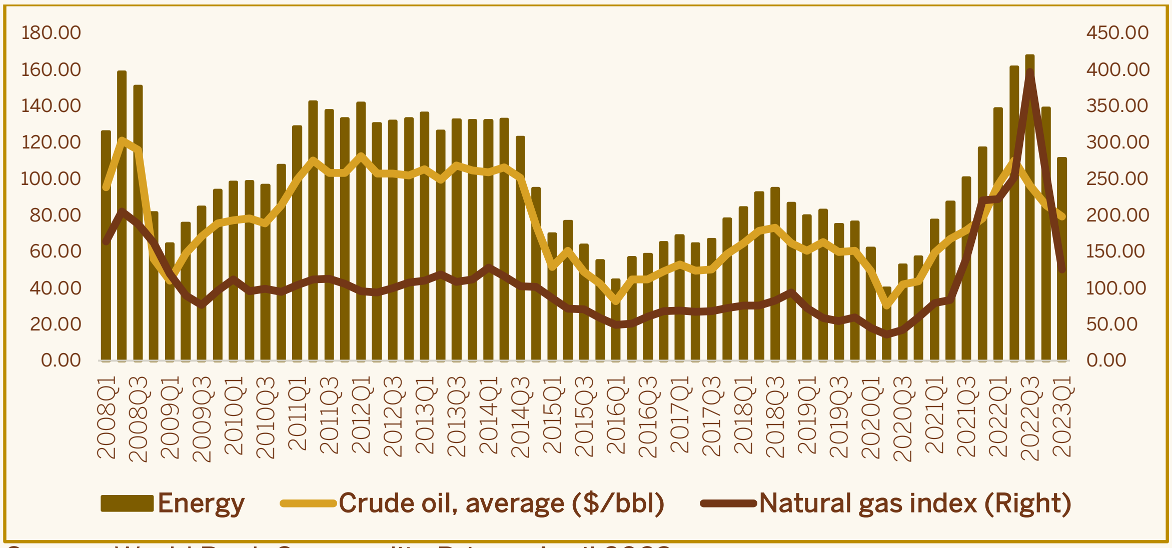
Global commodity prices decreased in 2023Q1 and are projected to drop by 21.2 percent in 2023 after increasing by 41.9 percent in 2022, and remain mostly stable in 2024, amid slowing global demand.

Energy prices dropped by 20.9 percent in 2023Q1, after surging by 82.4 percent in 2022Q1, reflecting falling prices for crude oil and natural gas. The decline in energy prices in the first

[1] EAC-5 members are Burundi, Kenya, Rwanda, Tanzania and Uganda

quarter of 2023 is expected to fade and be followed by stable prices over the remainder of 2023 and a slight uptick in 2024, as markets are expected to tighten amid supply pressures. Global energy prices are projected to drop by 25.8 percent in 2023 after rising by 60.0 percent in 2022, but slightly recover by 0.1 percent in 2024.

Chart 3 – Energy commodity prices index in nominal US dollar (2010=100)



Source: World Bank Commodity Prices, April 2023

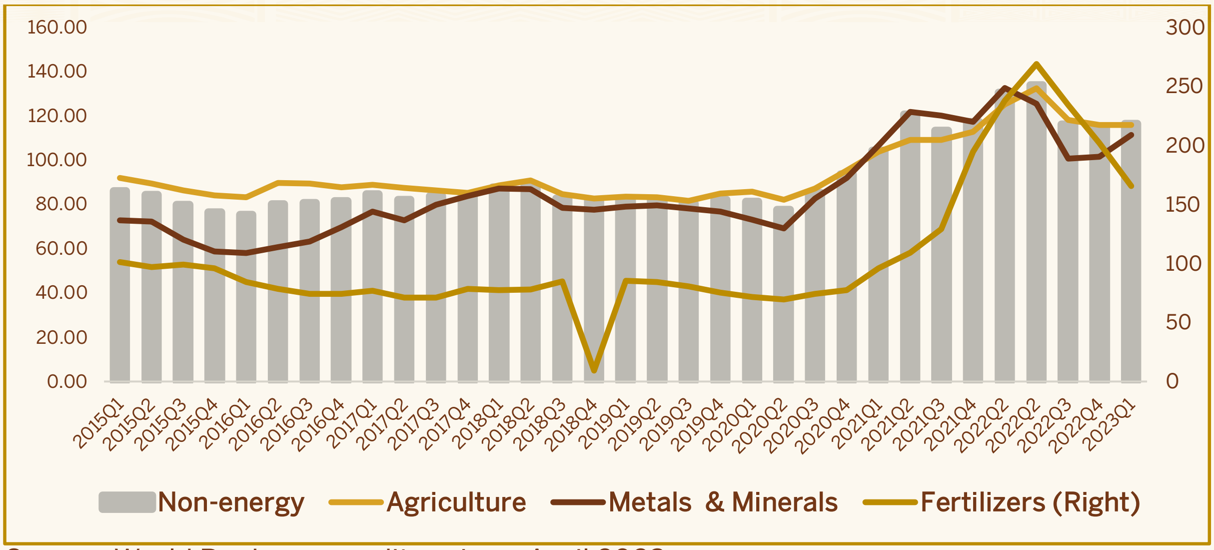
In 2023Q1, crude oil prices dropped by 18.2 percent compared to a surge of 62.9 percent in 2022Q1. In April 2023, IMF projects oil average prices to drop by 24.1 percent in 2023, from USD 96.36/barrel in 2022 to USD 73.13/barrel in 2023, amid slowing global growth.

Natural gas prices dropped by 43.6 percent in 2023Q1 compared to a surge of 181.9 percent in 2022Q1, following a mild winter in Europe which kept energy prices down. The World Bank projects natural gas average prices to drop by 39.2 percent in 2023, after surging by 110.7 percent in 2022, and projected to drop further by 7.6 percent in 2024.

Non-energy commodity prices dropped by 11.4 percent in 2023Q1, after increasing by 26.3 percent in 2022Q1, owing largely to declining prices of all non-energy commodity prices.

World Bank projects non- energy commodity prices to drop by 9.6 percent in 2023 after increasing by 10.6 percent in 2022 and drop further by 2.7 percent in 2024. The downward trend reflects the projected falling prices of all non-energy commodities.

Chart 4: Non-energy commodity price developments (USD/barrel)



Source: World Bank commodity prices, April 2023

In 2023Q1, average prices for agricultural commodities dropped by 7.1 percent after an increase of 21.3 percent in 2022Q1, attributed to decreasing beverages and food prices. Agricultural commodities prices are projected to drop by 7.2 percent in 2023 and drop further by 2.0 percent in 2024 after increasing by 13.3 percent in 2022, reflecting longer-than-expected edible and oilseed global supplies.

Food prices dropped by 5.6 percent in 2023Q1 compared to an increase of 24.7 percent in 2022Q1, of which, oils & meals (-17.8 percent), and grains (-0.1 percent). Global food prices are projected to drop by 7.9 percent in 2023 and drop further by 2.8 percent in 2024 after increasing by 18.0 percent in 2022, assuming that grain and oilseed exports from the Black Sea region will remain stable.

Beverages prices dropped by 7.3 percent in 2023Q1 compared to an increase of 30.9 percent in 2022Q1, and projected to drop by 5.0 percent in 2023, and drop further by 3.4 percent in 2024, after increasing by 13.7 percent in 2022. Coffee (Arabica) prices are projected to drop by 14.7 percent in 2023 after increasing by 24.8 percent in 2022.

Tea average prices are projected to drop by 11.5 percent in 2023 after increasing by 13.4 percent in 2022, and are projected to slightly increase by 1.9 percent in 2024.

Metals & minerals prices went down by 15.9 percent in 2023Q1, after increasing by 24.5 percent in 2022Q1, reflecting slowing global demand. Tin prices dropped by 39.1 percent in 2023Q1 compared to a surge of 72.3 percent in 2022Q1, undermined by a reduced demand from the electronics sector. The World Bank projects metals and mineral prices to drop by

8.4 percent in 2023 after a slight decline of 1.2 percent in 2022, and projected to drop further by 3.3 percent in 2024 attributed mainly to the slowing global demand.

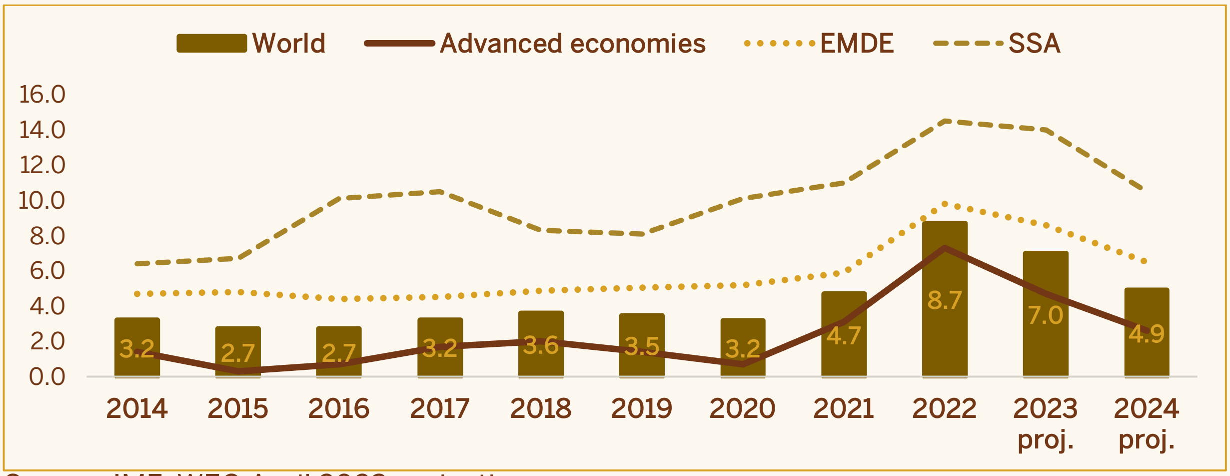
Precious metals slightly dropped by 0.4 percent in 2023Q1 compared to an increase of 1.7 percent in 2022Q1, and projected to increase by 5.5 percent in 2023 after dropping by 2.4 percent in 2022. In 2024, the prices for precious metals are projected to drop by 7.1 percent.

Prices for fertilizers dropped by 30.3 percent in 2023Q1 after a surge of 135.4 percent in 2022Q1, following easing supply disruptions. The World Bank projects fertilizers to drop by 36.9 percent in 2023 after increasing by 54.8 percent in 2022, and drop further by 7.1 percent in 2024, as supply disruptions ease gradually.

Global inflation is expected to ease in 2023 after rising in 2022

World annual average inflation is projected to ease to 7.0 percent in 2023 and 4.9 percent in 2024 from 8.7 percent in 2022. The forecast for 2023 is higher by 0.4 percentage point than January 2023 WEO update, but nearly double the January 2022 forecast. Disinflation is expected in major country groups, with about 76 percent of economies expected to experience lower headline inflation in 2023. The projected disnflation reflects declining fuel and nonfuel commodity prices as well as the expected cooling effects of monetary tigtening on economic activity.

Chart 5- Global inflation and projections across regional blocks (% change)

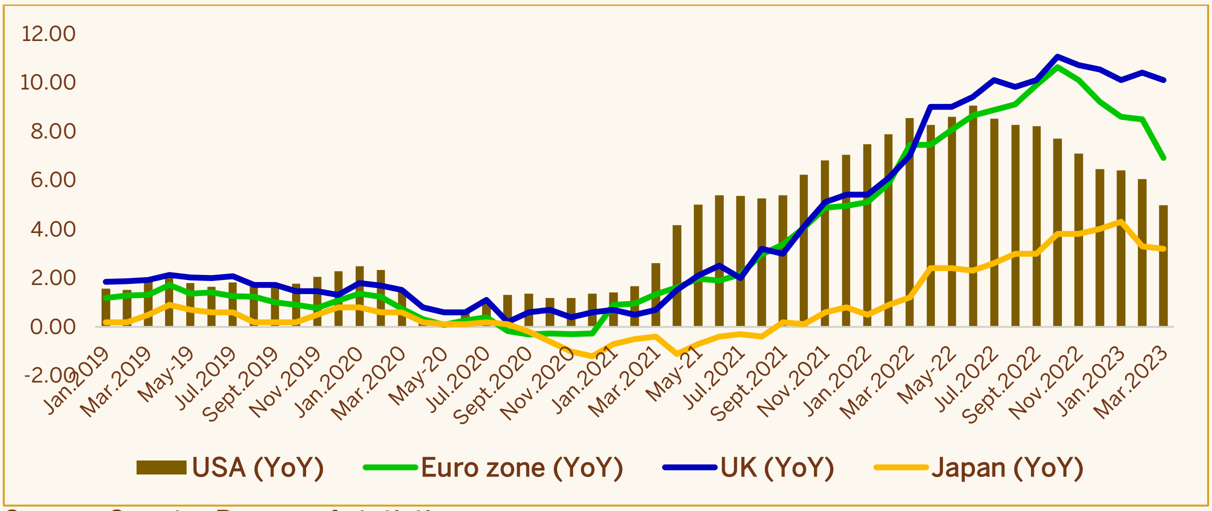


Source: IMF, WEO April 2023 projections

In advanced economies, consumer price inflation is expected to ease to 4.7 percent in 2023 and ease further to 2.6 percent in 2024 from 7.3 percent in 2022, reflecting falling energy and food prices.

In emerging market and developing economies, annual headline inflation is expected to slightly ease to 8.6 percent in 2023 and ease further to 6.5 percent in 2024 from close to a double digit of 9.8 percent in 2022, reflecting falling energy and food prices.

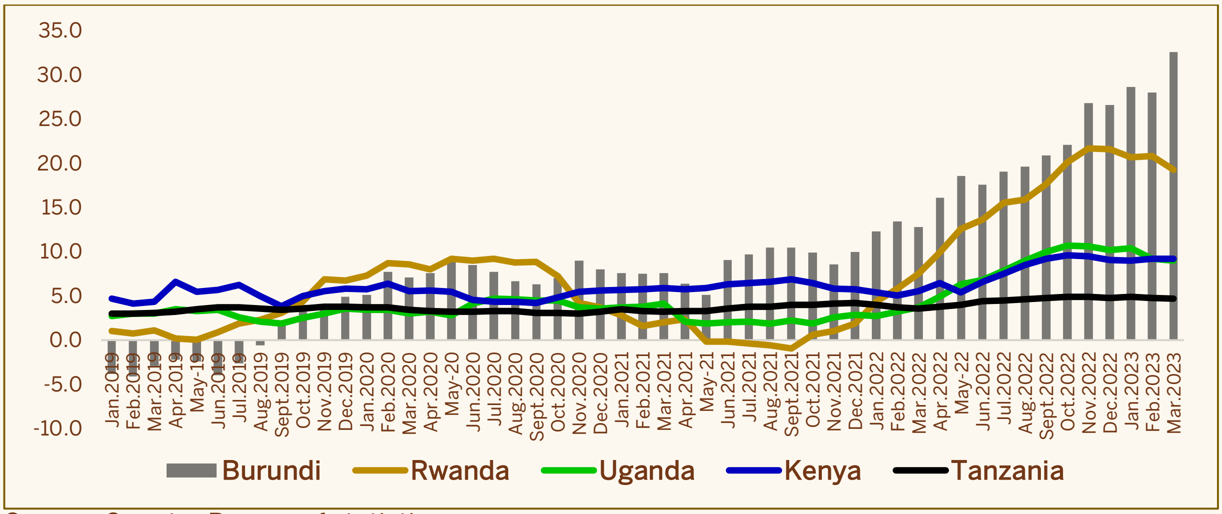
Chart 6- Annual headline inflation developments (percent change)



Source: Country Bureau of statistics

In Sub-Saharan Africa, annual headline inflation is projected to remain in double digits and ease from 14.5 percent in 2022 to 14.0 percent in 2023. and ease further to 10.5 percent in 2024, reflecting falling energy and food prices. In the EAC-5 countries, annual average inflation is projected to remain unchanged at 7.0 percent in 2023 and ease to 5.4 percent in 2024.

Chart 7- Annual Headline Inflation developments (percent change)



Source: Country Bureau of statistics

Monetary conditions tighten globally amid heightened inflation risks

At the beginning of 2022 till today most advanced economies as well as some emerging market and developing economies continued monetary policy tightening to help inflation return to central bank targets.

The US Federal Reserve hiked interest rate by 25 basis points, on 3rd May 2023, tightening global financial conditions and tempting investors, having raised the benchmark rate by a total of 75 basis points in three consecutive meetings since January 2023. On 10th May 2023, the Bank of England increased the Bank rate by 25 basis points, increasing the benchmark rate by a total of 100 basis points in three consecutive meetings since January this year. The European Central Bank decided to raise the three key ECB interest rates by 25 basis points on 4th May 2023, raising the benchmark rate by a total of 125 basis points in three consecutive meetings since January 2023.

On the foreign exchange market, the US dollar is depreciating against all major currencies, partly reflecting the cooling monetary policy tightening by the FED.

By end March 2023, the US dollar depreciated by 3.43 percent (y-o-y), against the British pound, by 2.88 percent against the Euro, by 0.41 percent against the Japanese Yen, and by 0.15 percent against the Chinese Yuan.

II. EXTERNAL SECTOR DEVELOPMENTS

Exports continued to grow in 2023Q1 driven by non-traditional exports.

In 2023Q1, merchandise exports[2] rose by 17.4 percent amounting to USD 401.6 million, up from USD 342.1 million recorded in 2022Q1. The increase is mainly owed to good performance of manufacturing exports and higher export quantities for traditional exports that outweighed the negative effect of the reduction in prices.

Specifically, receipts from the traditional exports grew by 8.9 percent (y-o-y) in 2023Q1, amounting to USD 97.1 million, up from USD 89.1 million in 2022Q1, driven by increased receipts from coffee (+105.5 percent) and tea (+5.1 percent), offsetting the decrease in traditional mineral[3] export revenues (-2.7 percent). The increase of revenues from coffee and tea is attributable to higher exported volumes that rose by 103.8 percent and 16.8 percent respectively, as the prices for tea reduced. Tea prices dropped by 10 percent while coffee prices remained relatively stable, rising by 0.8 percent in 2023Q1 compared to the same period of last year. Besides, the average price for Rwanda's traditional minerals declined by 12.9 percent in 2023Q1, owing to significant decreases of cassiterite (-37.0 percent) and wolfram (-31.5 percent). The decline in the global commodity prices is attributable to weakening global demand and improved supply prospects.

Furthermore, non-traditional exports[4] remain strong, rising by 45.2 percent in 2023Q1, registering USD 108.3 million from USD 74.6 million a year ago, mainly attributed to the rise in manufactured and agro-processed exports, reflecting the good performance of domestic manufacturing activities and stable regional demand.

In particular, export receipts from cement rose by 70.0 percent followed by milling products and food preparation of cereals (+65.1 percent). Receipts from horticulture exports increased by 51.6 percent.

Lastly, receipts from re-exported products increased by 3.8 percent year-on-year in 2023Q1, standing at USD 156.2 million from USD 150.5 million recorded in 2022Q1, on soared revenues from non-fuel products.

Besides, exports revenues from Informal Cross-Border Trade (ICBT) increased by 43.4 percent, amounting to USD 40.0 million in 2023Q1 from USD 27.9 million in 2022Q1, reflecting the resumption of cross-border movements in the aftermath of Covid-19.

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[2] Merchandise exports/ imports refer to exports/imports excluding gold. It includes formal exports and informal cross-border trade (ICBT).
[3] Rwanda's traditional minerals are cassiterite, coltan, and wolfram.
[4] Non-traditional exports refer to domestic exports other than those in traditional exports (coffee, tea, minerals, hides and skins and pyrethrum).

Increasing trend of Imports, mainly coming from the growth in consumer goods.

On the other hand, merchandise imports rose by 27.6 percent, amounting to USD 1,023.9 million in 2023Q1 up from USD 802.3 million a year earlier, reflecting the still elevated oil and food prices combined with strong domestic demand. Specifically, consumer goods imports rose by 46.4 percent due to high imports of food products, especially cereals, vegetables, fruits & spices, and sugar. Besides, imports of oil, capital, and intermediate goods rose by 31 percent, 25.9 percent, and 13.6 percent respectively.

The trade deficit widened in the first quarter of 2023.

In 2023Q1, the value of imported merchandise outpaced that of exported goods. As a result, Rwanda's merchandise trade deficit amounted to USD 622.3 million in 2023Q1, up from USD 460.2 million in 2022Q1, representing an increase of 35.2 percent.

III. DOMESTIC ECONOMIC DEVELOPMENTS

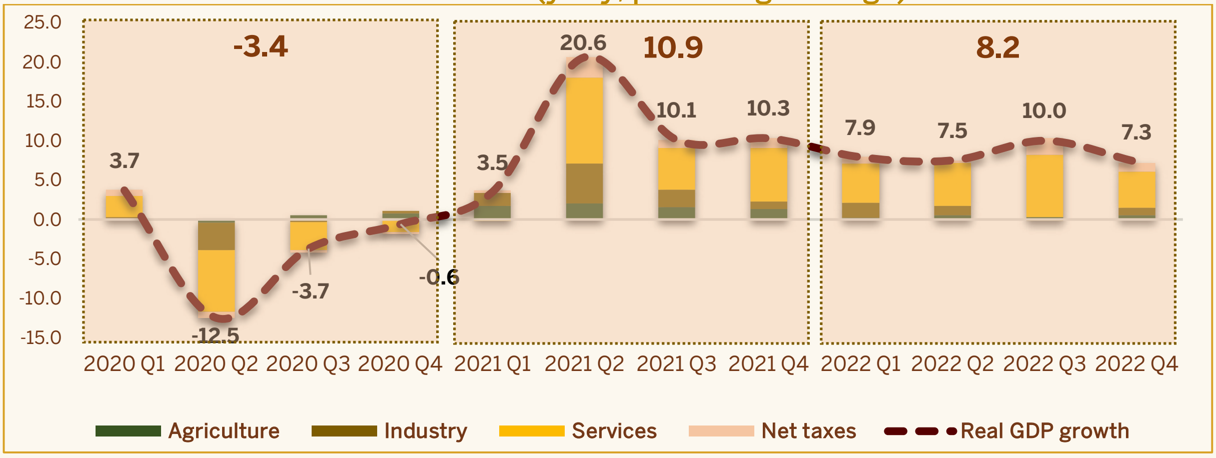
3.1 Economic growth in 2022

Rwanda's economy performed well in 2022, despite external and domestic shocks. Real GDP growth was 8.2 percent, following a 10.9 percent increase in 2021 and a 3.4 percent contraction in 2020.

Strong economic growth in 2022 despite weak agricultural production.

Rwanda's economy grew by 8.2 percent in 2022 from 10.9 percent recorded in the previous year, supported by strong performance of the service sector.

Chart 8: Real Gross Domestic Product (y-o-y, percentage change)



Source: National Institute of Statistics of Rwanda

The strong recovery of the tourism industry in 2022 was the main driver of the services sector performance. This recovery is evidenced by high growth of output of tourism related services such as hotels and restaurants (+86.9%), transport services (+21.7%) and travel agents and tour operators (+23.9%). Tourism revenues increased by 171.3% between 2021 and 2022, reaching US$445 million, representing 89.3% recovery from the pre-pandemic period[5]. In addition, the services sector was supported by trade services (+13.9 percent), information and communication (+19.7 percent), financial services (+10.3 percent) and education (+17.4 percent).

The industry sector's output increased by 5.0 percent in 2022 as the contraction of the construction subsector (-5.7 percent) partly offset the good performance of mining and quarrying (+14.1 percent) as well as manufacturing (+11.0 percent). The performance of the construction subsector declined, following the completion of large infrastructure projects that supported the economic recovery in 2021.

[5] RDB, Annual Report 2022: https://rdb.rw/reports/RDB-Annual-Report-2022.pdf

Mining and quarrying have continued to benefit from high metal and mineral prices on the international market. Following a 1.2 percent decrease in metal and mineral prices on the international market, the sector grew by 14.1 percent in 2022, lower than 26.7 percent recorded a year before.

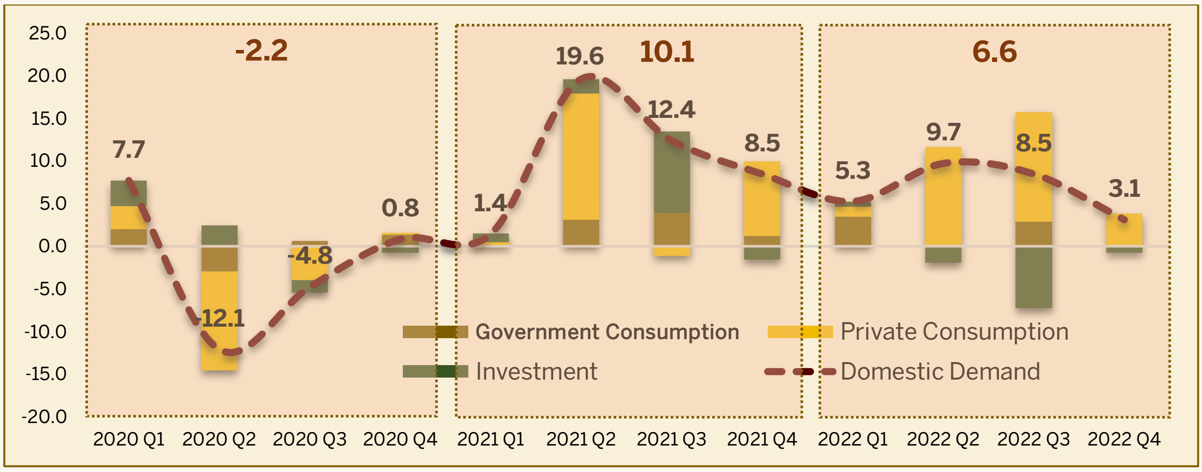
However, the sector's growth remained strong, as prices remained high compared to the pre-pandemic period (+46.8 percent compared to 2019 levels), supporting the sector's recovery.

The agriculture sector's growth slowed down from 6.4 percent in 2021 to 1.6 percent in 2022, following the decline in food production (-0.9 percent) due to unfavorable weather conditions. This bad harvest outweighed the good performance of the livestock (+8.7 percent), forest (+4.8 percent), exports crops (+3.5 percent), and fishing (+3.3 percent).

Moderate growth of the domestic demand.

Domestic demand expanded moderately in 2022 (+6.6 percent from +10.1 percent in 2021) boosted by the growth of private consumption (+11.9 percent after +8.9 percent) while investment declined (-10.1 percent against +11.4 percent). Following a sustained economic recovery and extensive relaxation of COVID-19 restriction measures, consumer confidence increased, supporting private consumption. Furthermore, government consumption increased by 10.5 percent on top of the previous 13.8 percent. As a result, total consumption increased by 11.6 percent in 2022, up from 9.7 percent in 2021.

Chart 9: Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

The investments in the construction subsector, which accounted for 70.6% of all investments, was crucial to Rwandan economy's recovery from COVID-19 in 2021. After experiencing a boom in 2021, construction investment started to slow down in 2022. In this context, the growth of construction investment decreased by 4.2% in the third quarter of 2022 from an increase of 16.5% in the same quarter of 2021.

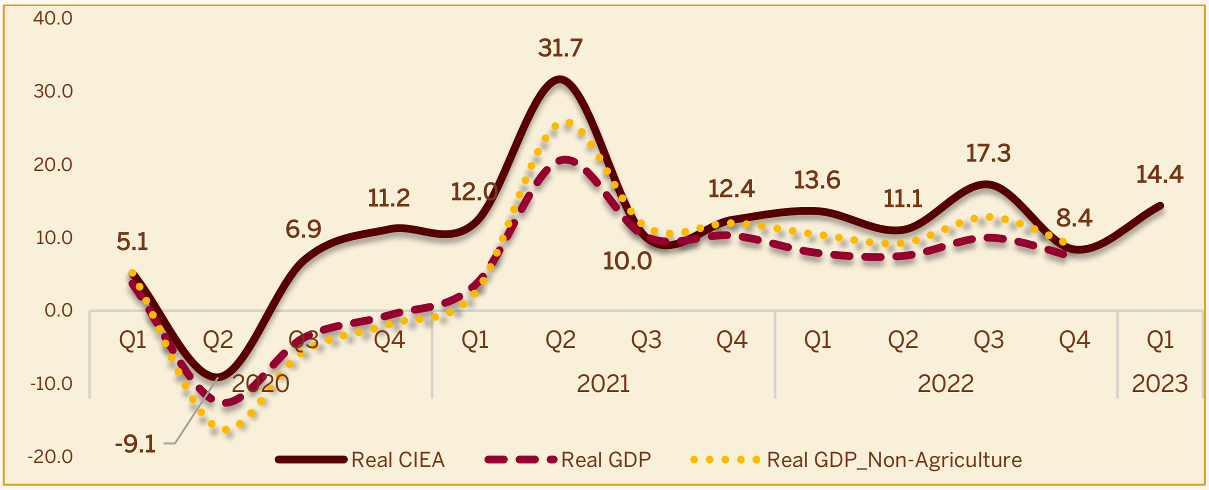
3.2 High-frequency indicators in the first quarter of 2023

The trend in high frequency indicators suggests a strong economic growth momentum in 2023Q1, despite a poor agricultural performance.

The first quarter of 2023 saw an improvement in economic activity overall.

The Composite Index of Economic Activities (CIEA) increased by 14.4 percent in 2023Q1 year-on-year, and 3.9 percent when compared to 2022Q4, indicating growing economic activities during the first quarter of 2023 and signaling a robust real GDP growth.

Chart 10: Quarterly real GDP growth vs CIEA (% change, y-o-y)



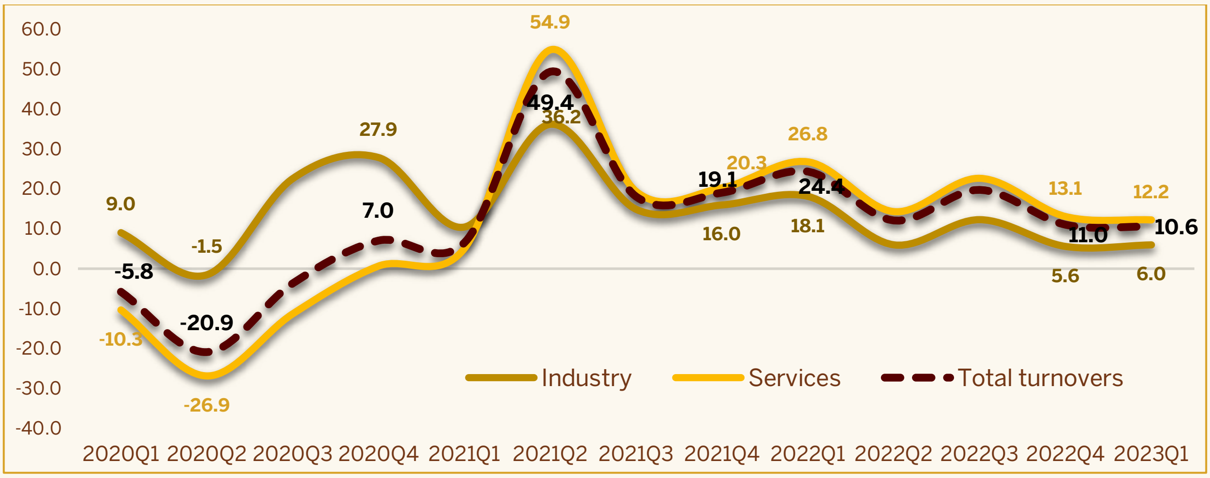
Source: NBR, Monetary Policy Department

The Good economic performance in 2023Q1 was mainly driven by continuous robust recovery of the tourism industry as well as the improvement of trade (+10.7 percent) and telecommunication (+25.9 percent) services. Tourism related services like hotels and restaurants as well as transport saw a continuous increase of their turnovers, recording 54.6 percent and 8.9 percent respectively in 2023Q1.

This recovery is further evidenced by a rising number of MICE delegates, which increased by 415.7 percent during this quarter, from 2.4 percent in 2022Q1. Additionally, other services rose by 16.3 percent in 2023Q1 and the overall services sector expanded by 12.2 in 2023Q1, from 26.8 percent in 2022Q1.

The industry sector recorded a moderate performance, as the sector's total turnover grew by 6.0 percent in 2023Q1, against 18.1 percent in 2022Q1. The industry sector was supported by manufacturing activities. Manufacturing industries' turnover growth stood at 12.8 percent during this quarter and the index of industrial production (IIP) for manufacturers indicates that the output expanded by 4.3 percent. Manufacturing activities were buoyed by the improvement of domestic and foreign demand, as evidenced by the increase of industrial non-traditional exports (+32.3 percent in 2023Q1).

Chart 11: Turnovers of industry & services sectors (% change, y-o-y)



Source: NBR, Monetary Policy Department

The impact of the good performance of the manufacturing industries on industry sector was moderated by the slowdown in construction and mining and quarrying subsectors. Due to a softening of construction investments, construction companies' turnovers growth decelerated from 17.9 percent in 2022Q1 to 6.0 percent in 2022Q4 and contracted by 12.2 percent in 2023Q1. On the other hand, rising domestic demand for cement signals a recovery in the near future. In 2023Q1, it increased by 26.6 percent after slowing down from 42.7 percent in 2022Q1 to 1.9 percent in 2022Q4.

Regarding mining and quarrying, the subsector's turnovers dropped by 0.6 percent in 2023Q1 from 67.7 percent in 2022Q1 mainly influenced by the metal and minerals prices on international market, which declined by 15.9 percent from 25.5 percent over the same period of the previous year.

The agriculture sector performed badly due to unfavorable weather conditions that led to a bad harvest of food crops, representing 64 percent of the sector. The 2023 season A agricultural survey indicates that the production of all types of food crops fell during the season compared to the season A 2022, with the exception of cereals, banana, and fruits. Their increase has a little weight (35 percent of food crop value added) in comparison to the decline of roots and tubers as well vegetables, which are important staple foods for Rwandans with a share of 64 percent of food production value added.

Table 1: 2023 Season A production by crop

Crop/Groups	Production (% change)	
	2022 A	2023 A
Cereals	-5.2	8.4
o.w. Maize	-7.9	12.0
Tubers and Roots	4.2	-4.6
o.w. Irish potato	4.9	-6.5
Banana	3.5	2.3
Legumes and Pulses	-8.6	-16.2
o.w. Beans	-8.9	-16.4
Vegetables and Fruits	-11.4	-5.3
o.w. Vegetables	-10.7	-6.9

Source: National Institute of Statistics of Rwanda

Overall, despite the poor performance of the agriculture sector, the real GDP growth for 2023Q1 is expected to be strong, supported by the good performance of the services sector combined with the moderate growth of the industry sector.

IV. INFLATION DEVELOPMENTS AND OUTLOOK

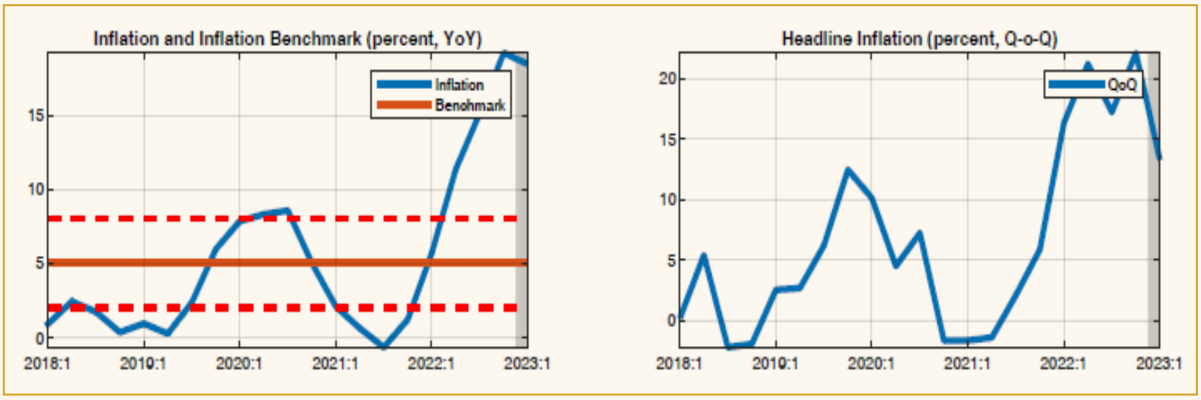
4.1 INFLATION DEVELOPMENTS

In 2023Q1, headline inflation (y-o-y) decelerated to 20.2 percent from 21.1 percent recorded in the previous quarter, following the decrease in core and energy inflation that offset a slight increase recorded in fresh foods inflation. The slight decrease in core inflation is consistent with developments in global and domestic prices, while a decrease in energy inflation is associated with a decline in prices for solid fuels, coupled with the downward revisions in local pump prices throughout 2023Q1. Conversely, the rising trend observed in fresh foods inflation is attributed to the shortage in food supply, in line with the lower-than-expected 2023 Season A agricultural production.

Headline inflation decelerated in 2023Q1, reflecting a decline in core and energy inflation.

Headline inflation decelerated in both y-o-y and q-o-q terms. This decrease was mainly reflected in core and energy CPI components. Core inflation (y-o-y) decelerated to 14.0 percent in 2023Q1 from 14.9 percent recorded in 2022Q4, while energy inflation decreased to 13.6 percent from 21.3 percent, during the same period. On the contrary, fresh foods inflation slightly increased to 48.8 percent in 2023Q1 from 48.2 percent recorded in 2022Q4. The decrease in core inflation reflected easing price pressures for some processed foods, while the drop in energy inflation reflected the drop in the prices for both solid and liquid fuels, consistent with the ease in prices for both charcoal and firewood and the continued fall in international oil prices, respectively. The slight increase in fresh foods inflation mainly reflected an increase in fresh fruit inflation, coupled with the base effect.

Chart 12: Developments in headline inflation

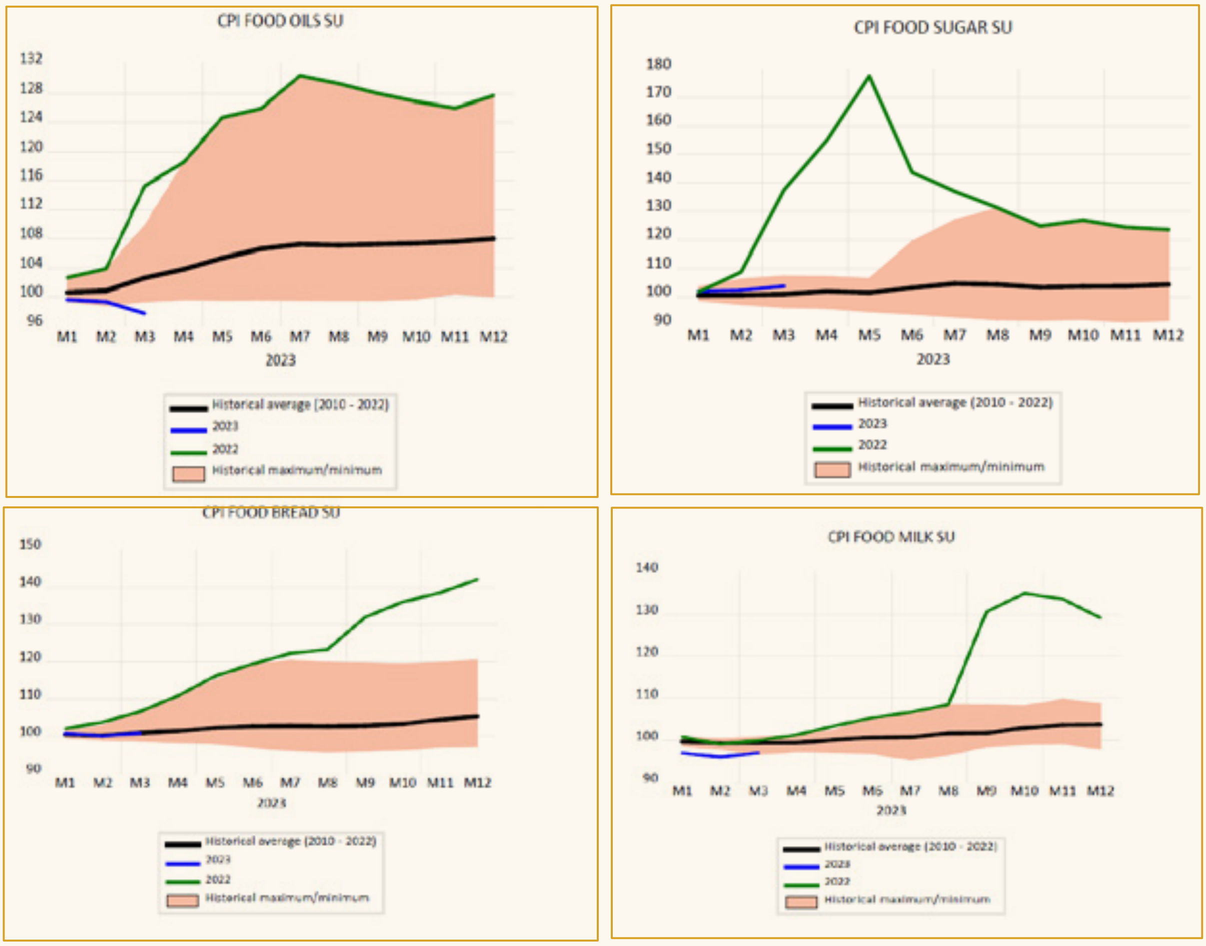


Source: NBR, Monetary Policy and Research Directorate

Core inflation, in y-o-y and q-o-q terms, eased in 2023Q1 on the back of the decrease recorded in both domestic and imported costs.

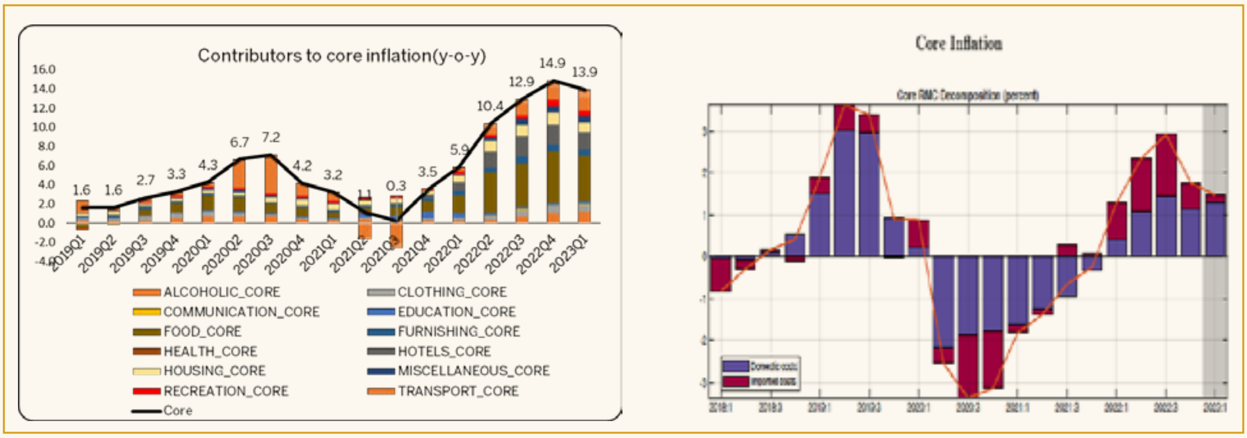
The drop observed in core inflation reflects mainly a deceleration in core foods inflation (from 32.2 percent to 29.2 percent), following a slight moderation in the prices of some processed food items (cooking oils and rice), consistent with the ease in international food prices.

Chart-13: Evolution in consumer price indices of some core food items



Source: NBR, Monetary Policy and Research Directorate

Chart-14: Core inflation, (percentage change)

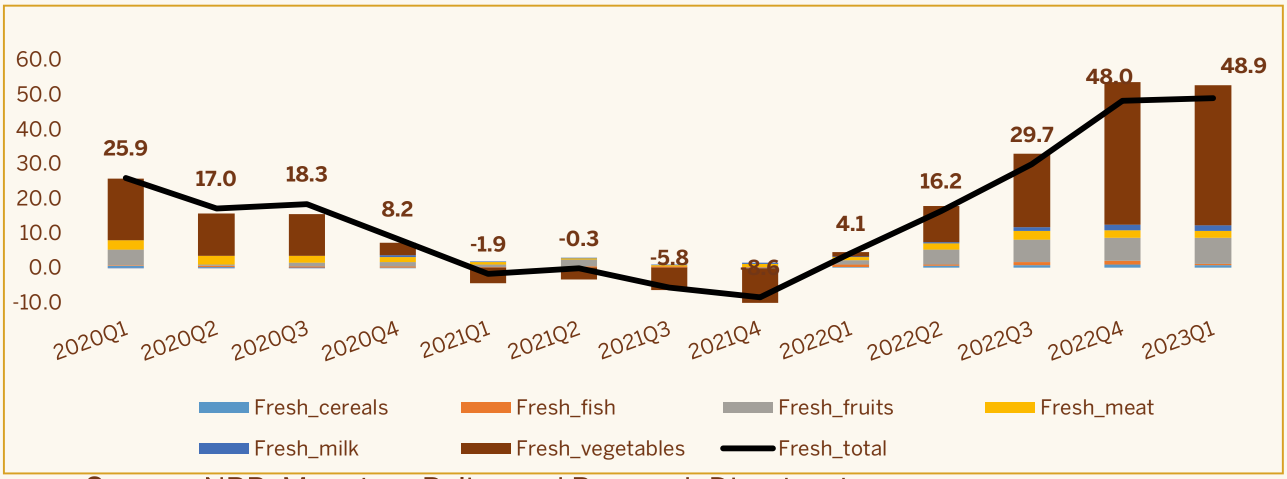


Source: NBR, Monetary Policy and Research Directorate

Fresh food inflation (y-o-y and q-o-q) slightly increased on the back of the reduction in the supply of fresh foods on the domestic market, coupled with the base effect.

The increasing trend in fresh foods inflation, in y-o-y terms, for 2023Q1 was mainly reflected in an increase in prices for fruits. Fruits inflation (y-o-y) rose to 35.4 percent in 2023Q1 from 31.0 percent recorded in the previous quarter as a result of reduced supply of fruits, coupled with the base effect. Over the same period, vegetables inflation (y-o-y) increased to 75.6 percent in 2023Q1 from 74.5 percent recorded in 2022Q4, on the back of reduced supply.

Chart-15: Contribution to fresh foods inflation (y-o-y)

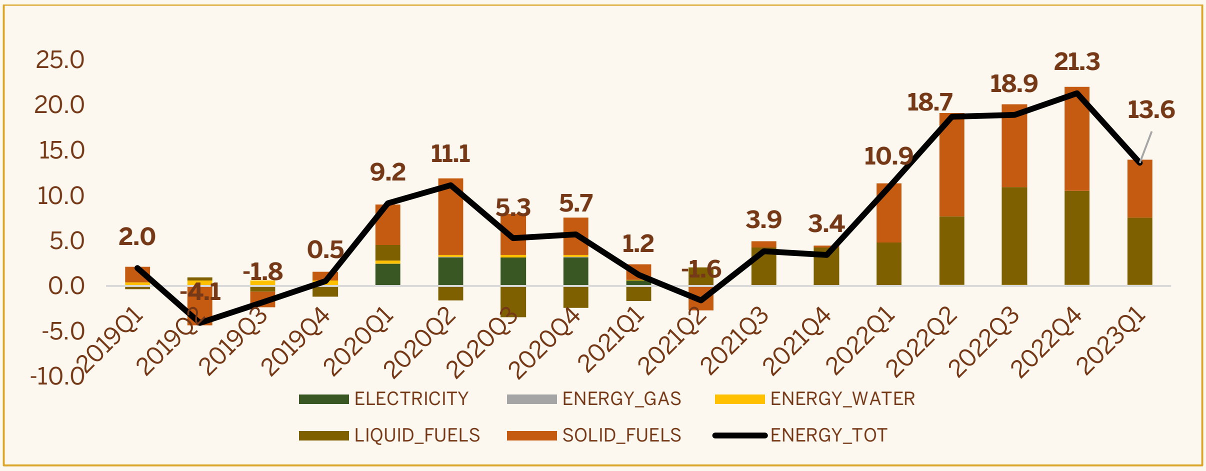


Source: NBR, Monetary Policy and Research Directorate

In 2023Q1, Energy inflation (y-o-y) decreased, reflecting the decline recorded in both liquid and solid fuels.

In 2023Q1, energy inflation (y-o-y) decreased to 13.6 percent from 21.3 percent recorded in the previous quarter. Liquid fuels inflation decreased to 29.4 percent from 40.9 percent, while solid fuels inflation decelerated to 13.0 percent from 22.4 percent, during the same period. The deceleration in liquid fuels inflation is attributed to downward revisions in local pump prices, while the decrease in solid fuels inflation reflects ease in firewood prices, coupled with the base effect, given that prices for charcoal were high during the same period of last year.

Chart-16: Contribution to energy inflation (y-o-y)

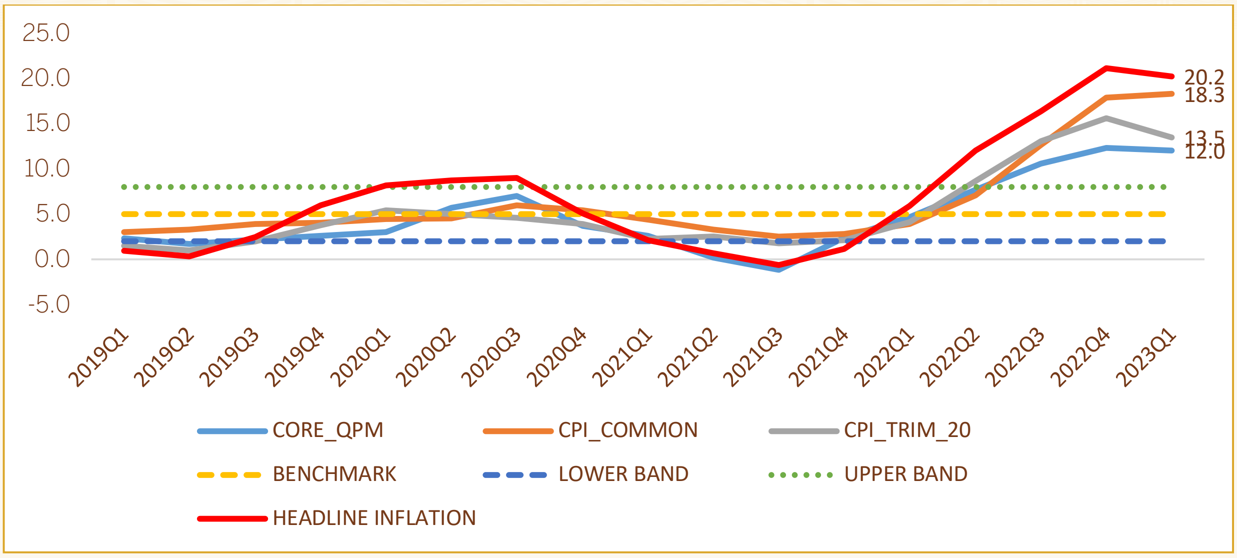


Source: NBR, Monetary Policy and Research Directorate

Underlying inflation measures indicate a broad-based increase in inflation.

In 2023Q1, the underlying measures of inflation indicate a slight decline in prices, though above the upper bound, following the developments recorded in both domestic and imported CPI components. CPI Trimmed mean decreased to 13.5 percent in 2023Q1 from 14.7 percent recorded in 2022Q4, CPI Common increased to 18.3 percent in 2023Q1 from 17.5 percent in 2022Q4, and CPI core (excluding food and beverages) eased to 12.0 percent in 2023Q1 from 12.3 percent noted in 2022Q4.

Chart-17: 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

In 2023, the global economy is projected to slow down, and may evolve below potential in 2024, limiting the stimulus to the domestic economy.

From the IMF projections released in April 2023, global growth is estimated to stand at 2.8 percent in 2023, before rising to 3.0 percent in 2024. The 2023 projection is 0.1 percentage point lower than predicted in the January 2023 projections. Some of the factors behind the slight decline in global growth projections in 2023 comprise the hikes recorded in the central bank rates to fight against high levels of inflation, and the spillover effects from the war between Russia and Ukraine that continues to weigh on economic activities.

More specifically, the USA economic growth is projected to stand at 1.6 percent in 2023 and 1.1 percent in 2024. The projected trend in USA economic growth is more driven by the uncertainties in the financial sector. Similarly, the Euro zone's economy is projected to evolve at 0.8 percent before rising to 1.4 percent in 2024, reflecting tighter financing conditions that are expected to have a negative impact on growth.

Despite the above positive trends in economic growth from USA and Eurozone, growth will be evolving below their potential levels.

Consistently, the impact from global economic growth to the domestic economy is expected to be moderate. Although the domestic economy will continue to grow, it is anticipated that the pace will be slower in the medium term.

Global inflation and international commodity prices (food and energy) are expected to drop significantly over the policy horizon, exerting downward pressures on imported inflation.

In the beginning months of 2022, inflation rates were on the upward trend across the world following the war between Russia and Ukraine that constrained the supply chains of food and energy to reach the markets. However, due to some economic policy measures taken by countries, inflation started to reduce in 2023Q1. Throughout 2023, global inflation will remain above targets, evolving around 7.0 percent in 2023 from 8.7 percent recorded in 2022, and the declining trend will continue in 2024. Though core inflation is expected to remain high as a result of high labor costs, it will be on a gradually easing trend over the medium term. Headline inflation is expected to fall significantly in 2023, mainly driven by the expected drop in energy-related items (transport fuels, gas and electricity prices) and food prices. In advanced economies such as USA and Eurozone, inflation is expected to evolve closer to the target levels towards the beginning of 2025.

Over the policy horizon, international energy and food prices are expected to drop significantly, exerting downward pressures on imported inflation. Energy related items are projected to slow down on the back of new fossils of fuels and slowing down of the global economy that is expected to weaken demand for energy. Over the same period, food prices will be falling as a result of the anticipated ample food supply and the pass-through of energy-related items to food prices. Consistent with the current projected path in global inflation and less demand for international commodity over the medium term, imported prices are projected to reduce, hence less pressure on domestic inflation.

4.2.2 Baseline projections of key macroeconomic variables

In 2023, headline inflation (y-o-y) is projected to decelerate and fall below the upper bound of 8 percent towards the end of the year, and below 5 percent in 2024. Pressures on food and energy prices are projected to reduce significantly, consistent with the expected decline in international food and energy prices and the anticipated improvement in domestic food production. Similarly, pressures from the domestic economy on core inflation are projected to ease.

4.2.2.1 Drivers of inflation projections

Pressures from the domestic economy are projected to slightly reduce and be contained over the medium term.

Since the beginning of 2022 until the end of the year, core inflation picked up, as a result of the upward pressures from both domestic and imported costs of production. Going forward, current projections indicate that pressures on both imported and domestic costs of production will decelerate. Domestic demand pressures are currently mild and are expected to progressively decline in the medium term.

Imported costs that started in 2022 are projected to ease throughout 2023 and 2024, consistent with the projected decline in both international commodity prices and foreign demand.

Energy inflation is expected to be subdued over the medium term. High cost pressures on energy prices that pushed up energy inflation in 2022 are projected to fade away and become neutral throughout the forecasting horizon, on the back of falling international oil prices.

Food inflation (including processed food and beverages) is expected to decline. Recent upward pressures on food inflation are reducing. Pressures from domestic food production are expected to dissipate as food production is projected to normalize towards the beginning of 2024. Indeed, the projected downward trend in food inflation will be supplemented by the expected slowdown in international food prices on the back of ample global food supply.

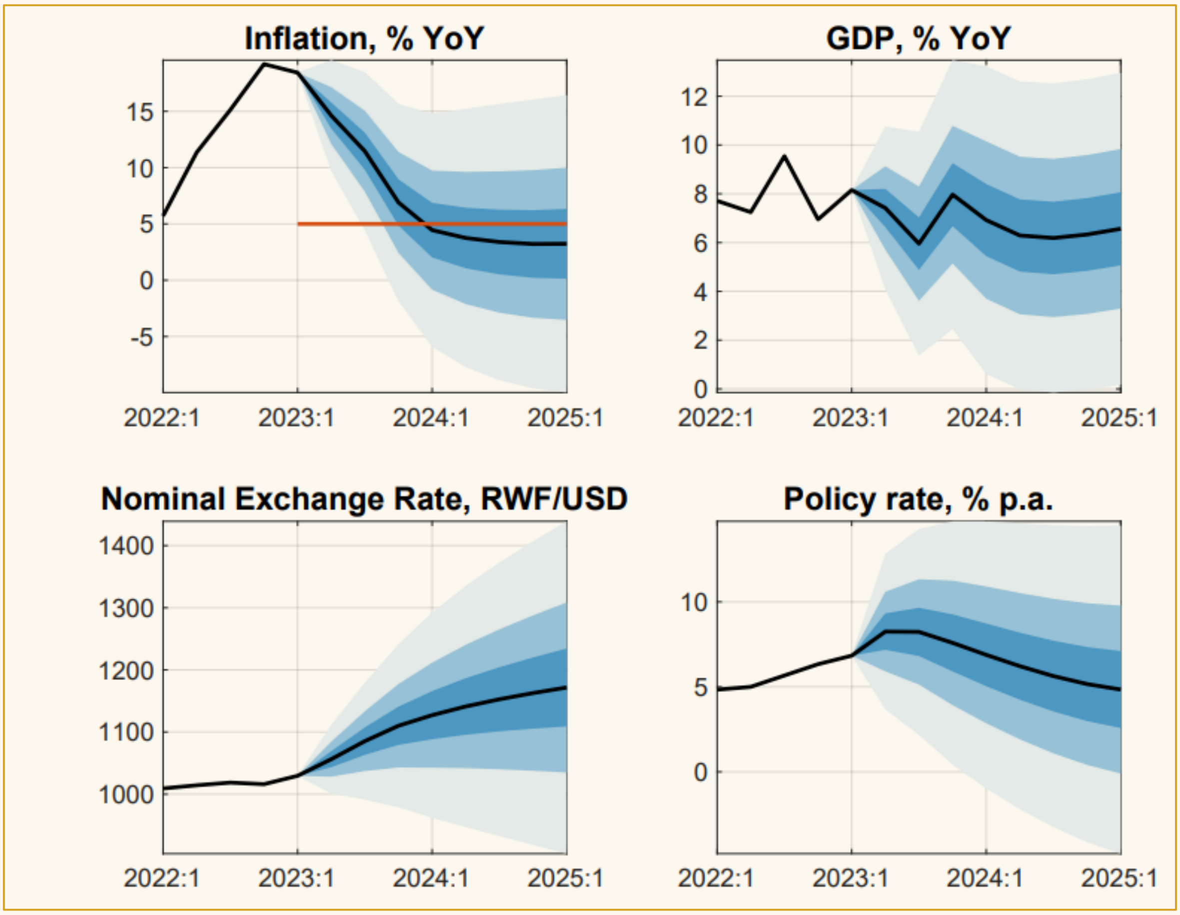
4.2.2.2 Projections of key macroeconomic indicators

In line with the recent domestic economic developments, assumptions on the global economy (GDP growth, inflations and commodity prices), and other macroeconomic variables, domestic headline inflation is projected to decelerate and fall within the benchmark band in the last quarter of 2023.

Core inflation is expected to progressively decelerate in the short term, whereas pressures will be fading away over the policy horizon, in line with the projected ease in both domestic and imported costs.

Pressures on food inflation are projected to decline, following the expected deceleration in international food prices and the normalization of domestic agricultural production. Similarly, energy inflation is expected to ease, reflecting mainly the deceleration in international oil prices.

The figure below presents the projections for key domestic macroeconomic variables over the policy horizon.



Source: NBR, Monetary Policy, and Research Directorate

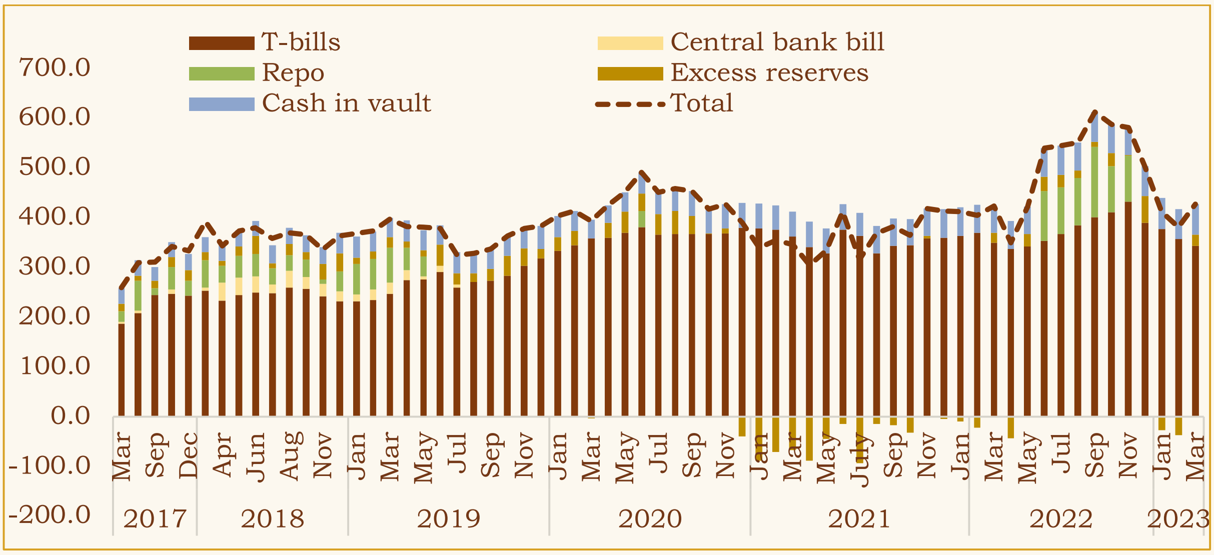
V. FINANCIAL AND MONETARY DEVELOPMENTS

The liquidity in the banking system increased, and money market rates remained steered around the central bank rate. The interbank rate increased by 207 basis points to 7.36 percent year-on-year in 2023Q1, following the central bank rate hikes recorded between February 2022 and February 2023. In terms of market rates, the average lending rate fell by 60 basis points to 15.92 percent in 2023Q1. During the same period, the outstanding credit to the private sector rose by 12.92 percent, lower than the 14.69 percent growth recorded in the corresponding period of 2022.

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

In March 2023, the bank's most liquid assets grew by 1 percent to FRW 427 billion, from FRW 423 billion recorded in March 2022. This growth resulted from increased government spending in 2023Q1, which led to rebounded excess reserves and increased T-bills investment.

Chart 18: Most liquid assets of commercial banks (FRW billion)



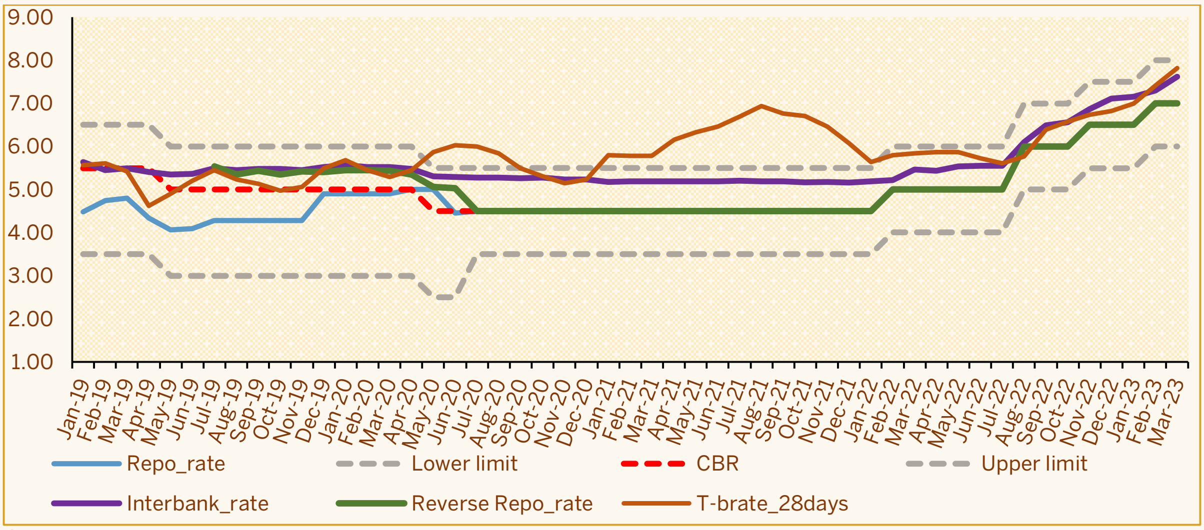
Source: NBR, Monetary Policy Department

Money market interest rates remained close to the central bank rate.

The Monetary Policy Committee (MPC) meeting held on February 14th, 2023, raised the Central Bank Rate (CBR) by 50 basis points to 7 percent. This is in addition to the 200 basis points increase that occurred in the February, August, and November 2022 MPC rounds, aiming to fight the inflationary pressures.

Consequently, money market rates were steered around the central bank rate, and the interbank rate increased by 207 basis points to 7.36 percent on average in 2023Q1 from 5.29 percent in 2022Q1.

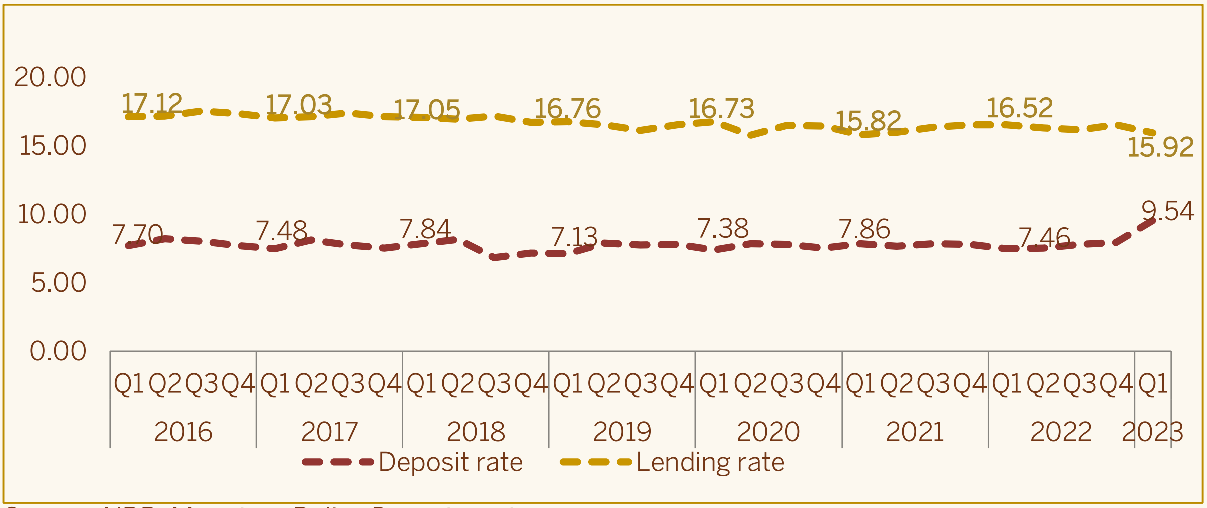
Chart 19: Money market rates developments



Source: NBR, Monetary Policy Department

The lending rate fell by 60 basis points to 15.92 percent in 2023 Q1 from 16.52 percent in 2022 Q1. This was due to an increased share of large loans with short-term maturity, which were priced at relatively lower rates. During the same period, the deposit rate increased by 208 basis points to 9.54 percent in 2023Q1 from 7.46 percent in 2022Q1, which was a result of an increased share of long-term deposits.

Chart 20: Market interest rates (percent average)



Source: NBR, Monetary Policy Department

The foreign exchange market remains stable.

In 2023Q1, the franc remained weak, reflecting widening current account deficit and the dollar shortage on slowing external financing. Higher international commodity prices continued to drive up the import bill and the dollar kept strengthening against most currencies. Compared to December 2022, the FRW depreciated against the USD by 3.07 percent end of March 2023.

Tab.2: Exchange rate of FRW against selected currencies (% changes compared to Dec. previous year)

	FRW/USD	FRW/GBP	FRW/EUR	FRW/JPY	FRW/KES	FRW/TZS	FRW/UGX	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
Dec-21	3.82	2.94	-4.39	-6.96	0.24	4.78	6.85	1.00
Dec-21	3.82	2.94	-4.39	-6.96	0.24	4.78	6.85	1.00
Dec-22	6.05	-5.30	-0.04	-7.90	-2.80	4.47	1.17	2.03
Mar-22	0.89	-1.98	-0.51	-4.99	-0.69	-0.04	-0.54	-1.93
Mar-23	3.07	5.97	5.31	2.89	-3.86	2.71	1.16	2.65

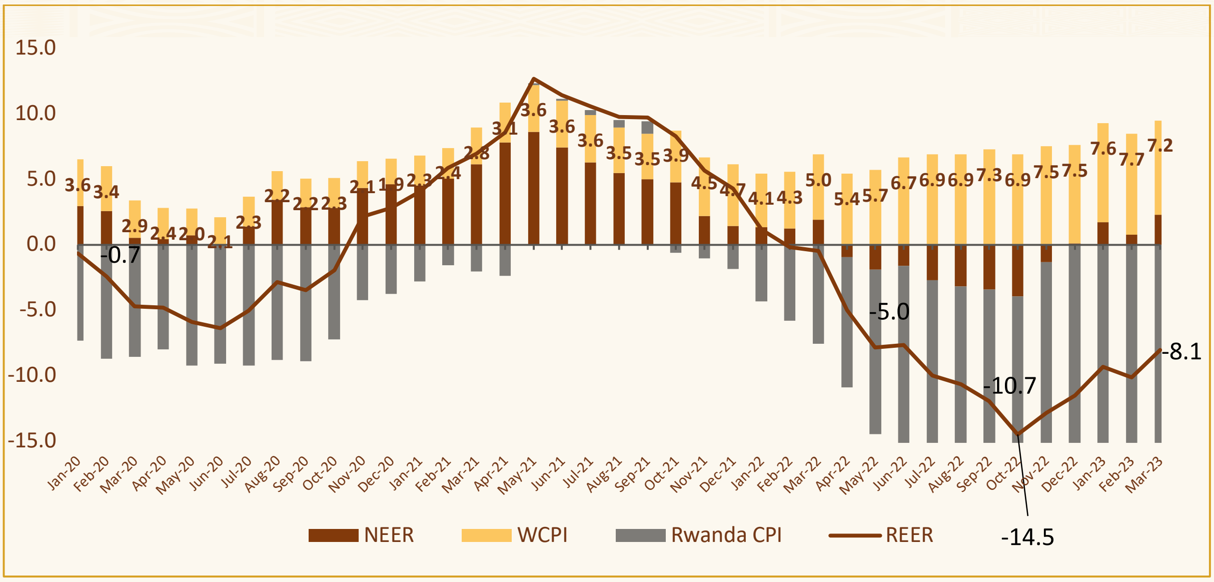
Source: NBR, Monetary Policy Department

Relative to regional currencies, the FRW continued to gain against the Kenyan shilling while it weakened against the TZS, the BIF and UGS. The FRW rose by 3.86 percent vis-⁜vis the KES in 2023Q1 faster than an appreciation of 0.69 percent in the corresponding quarter of 2022. The franc weakened by 2.71 percent, 1.16 percent and 2.65 percent respectively versus the TZS, Uganda shilling and the BIF, faster than in the similar period last year.

In the medium term, the FRW is foreseen to remain stable, with the level of international reserves equivalent to 4 months of prospective imports of goods and services as of end March 2023.

In nominal effective terms, the FRW depreciated by 2.3 percent year-on-year against a weighted average of 31 currencies of most important trading partners as of end March 2023, faster than 1.9 percent depreciation in March 2022. In real terms, the FRW appreciated by 8.1 percent as high domestic inflation continues to outpace the combination of weighted foreign inflation and the nominal effective depreciation, slower than 11.5 percent appreciation recorded end December 2022.

Chart 21: Drivers of REER movement



Source: NBR, Monetary Policy Department

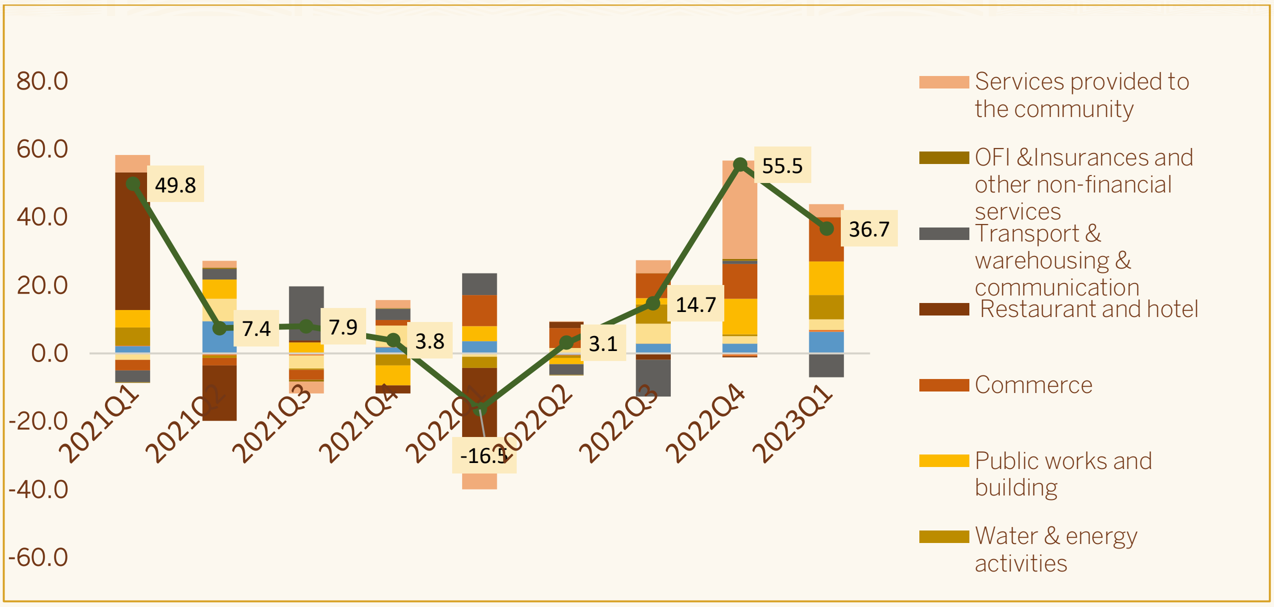
As implications, domestic products remain less competitive compared to foreign goods, but the monetary policy tightening decisions previously implemented by the NBR are expected to provide some relief to the FRW in real terms.

Broad money (M3) kept increasing, indicating a very long monetary policy transmission lag.

Broad money (M3) grew by 13.44 percent in March, year-on-year, mainly attributed to the growth in outstanding Credit to the Private Sector (CPS) which contributed by 10.6 percent.

As of end March 2023, CPS rose by 12.92 percent, lower than the 14.69 percent growth observed during the same period in 2022, in line with newly approved loans. During the first quarter of 2023, there was a notable increase of 36.7 percent in newly authorized loans (NALs) compared to the same period in the previous year, which had experienced a contraction of 16.5 percent. This suggests that there is still a significant delay in transmission. The growth in NALs for 2023Q1 is predominantly reflected in four sectors, namely commerce, public works and buildings, water and energy activities, and personal loans. However, on a quarterly basis, NALs plunged by 14.7 percent in 2023Q1 compared to a rise of 23.1 percent experienced in 2022Q4. This drop was merely the result of a sizable sum of money granted to services provided to the community in 2022Q4.

Chart 22: Contributions of sectors to the change in NALs (Y-o-Y % changes)



Source: NBR, Monetary Policy Department.

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