National Bank of Rwanda

Banki Nkuru y'u Rwanda

MONETARY POLICY REPORT

May 2020

CONTENTS

MPC PRESS RELEASE

National Bank of Rwanda reduces the Central Bank Rate (CBR) to 4.5 percent.

The quarterly Monetary Policy Committee (MPC) meeting, was held on April 29th, 2020 to assess recent economic developments at global and national level. The meeting was held amidst global economic challenges caused by the Covid-19 pandemic and the implementation of various measures to contain its spread.

The MPC assessed recent negative economic developments, the unfolding impact of previous policy measures and the outlook of the economy. Considering that inflation is projected to decelerate in the second half of 2020, owed to a significant drop in aggregate demand, the MPC decided to cut the Central Bank Rate (CBR) from 5.0 percent to 4.5 percent. This decision, along with other implemented policy measures taken in March will support commercial banks to continue financing the economy.

Previous measures by NBR to mitigate the economic impact caused by COVID-19:

The measures put in place by the National Bank of Rwanda (NBR) on 18th March 2020, to ease liquidity conditions in the banking sector, yielded immediate impact. FRW 23.4 billion was injected into the system on April 1st, 2020, through a reduction of the reserve requirement ratio from 5 percent to 4 percent. A FRW 50 billion lending facility is also available to banks at the Central Bank Rate (CBR).

The NBR also eased prudential requirements to exceptionally allow banks to restructure outstanding loans of borrowers facing temporary cash flow challenges arising from the COVID-19 pandemic. In response, as at April 10th 2020, banks had restructured 7,952 loans (out of 8,667 applications), worth FRW 255 billion.

The global economic outlook adversely affected by the COVID-19 outbreak:

The Committee noted that global economic growth is projected to decline sharply by -3 percent in 2020, a downward revision from a 3.3 percent growth previously projected by IMF in January. This severe economic downturn is a result of the effect of the COVID-19 pandemic that has claimed over 200,000 lives, with more than 3 million cases reported globally to date, leaving many economic activities restricted and countries in a lock down over the past few weeks. Across the world, this outbreak has caused major disruptions in supply chains, uncertainties and high volatilities in financial markets, contraction in economic activities, high unemployment rates, and a sharp decline in commodity prices.

Domestic economic performance and outlook remained strong until COVID-19 outbreak:

The global economic disruptions caused by the COVID-19 pandemic are weighing on Rwanda's economy. Leading indicators suggest that the performance of the domestic economy was strong in the first two months of 2020, with the composite index of economic activities growing by 5.1 percent in the first quarter of 2020. However, the outbreak of COVID-19 in mid-March 2020 led to a significant slowdown, mainly in the services and industry sectors.

While the outstanding credit to the private sector increased by 4.3 percent in 2020Q1, the demand for loans reduced due to the decline in economic activities. This led to a reduction in new authorized loans by 10.6 percent in 2020Q1. On the external sector, the trade deficit deteriorated by 18.8 percent in 2020Q1 due to higher imports compared to exports. However, policy measures being taken by the government aiming at supporting the recovery of the economy after COVID 19 are expected to increase the demand for credit by the private sector. This expected recovery will also contribute to a reduction in the trade deficit and maintain a stable foreign exchange market.

Headline inflation projected to reduce from the second half of 2020:

The average quarterly headline inflation for 2020Q1 stood at 8.2 percent, mainly attributed to increased food and energy inflation. However, due to a significant drop in aggregate demand that resulted from COVID19, headline inflation is projected to decelerate, leading to an average of 6.0 percent and 1.0 percent for 2020 and 2021, respectively pointing out the need for policy measures to support aggregate demand in the economy.

After assessing the negative effect of the outbreak of COVID-19, in effort to mitigate the shock on the Rwandan economy, the MPC decided to further accommodate the monetary conditions, to ease liquidity conditions in the banking sector and support economic recovery efforts in 2020 and onwards.

In view of the above, the MPC will continue to closely monitor domestic and global economic conditions, and stands ready to take appropriate measures.

April 30th, 2020

RWANGOMBWA John
Governor, Chairperson of the MPC

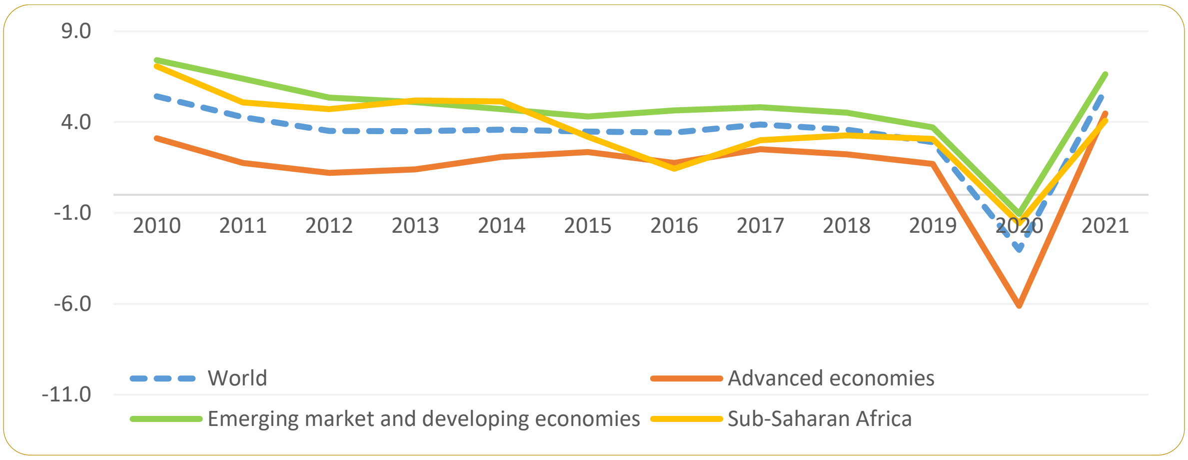
I. GLOBAL ECONOMIC AND FINANCIAL DEVELOPMENTS

1.1 Economic Growth

According to the International Monetary Fund's (IMF) publication of April 2020, global growth was estimated at 2.9 percent in 2019, the weakest growth since the 2008-2009 global financial crisis owing to uncertainties over US-China trade tensions, Brexit, geopolitical tensions among other factors. In 2020, the world economy is expected to sharply decline by 3.0 percent, a downgrade of 6.3 percentage points from January 2020 projections. The drastic changes in the projections reflected the impact of the Covid-19 outbreak, which has led to human fatalities, strains in global trade, decline in international commodity prices as well as uncertainties in financial markets. However, this recession is assumed to be temporary and the global growth is anticipated to recover by 5.8 percent in 2021, conditional to effective containment and a fading out of the pandemic in the second half 2020.

According to International Monetary Fund, this global growth outlook is however overshadowed by a set of downside risks including high uncertainty about the pandemic pathway, the intensity and efficiency of containment measures, the extent of the supply disruptions, and repercussions from tightening global financial market conditions as well as volatilities in commodity prices, among others.

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



Source: IMF WEO, April 2020

The current global situation seems uniquely dismal as for the first time since the great depression, all economic blocks are in a recession. Recent data from IMF shows that growth in advanced economies, is foreseen to plunge by 6.1 percent in 2020 from 1.7 percent in 2019, mostly reflecting contraction in major economies including the United States (-5.9 percent), United Kingdom (-6.5 percent), Japan (-5.2 percent), Germany (-7.0 percent), France (-7.2 percent), Italy (-9.1 percent) and Spain (-8.0 percent). Similarly, in the emerging markets and developing economies, growth is anticipated to drop by 1.0 percent in 2020, from 3.7 percent in 2019.

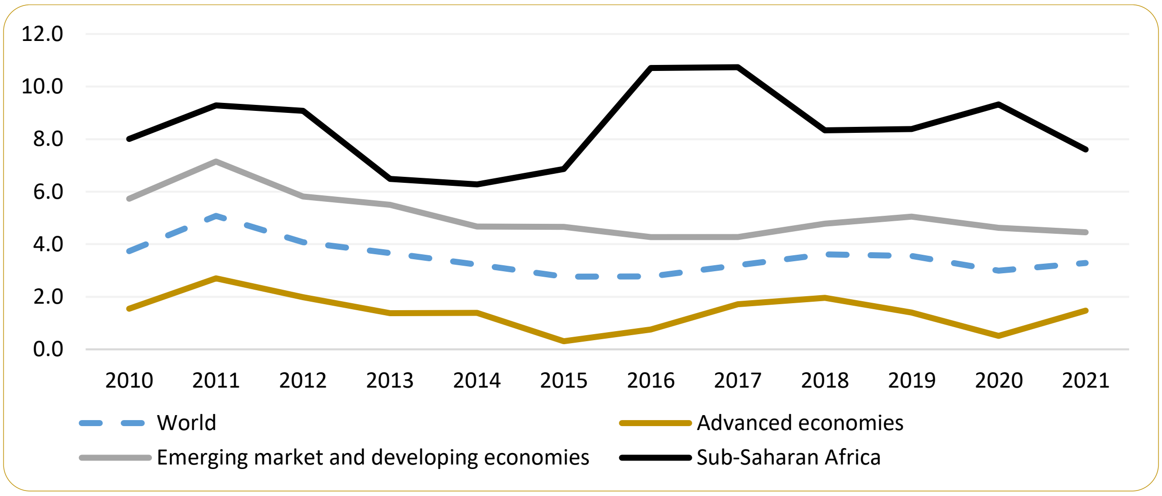
In Sub-Saharan Africa, growth is projected at -1.6 percent in 2020 compared to 3.1 percent recorded in 2019, the first recession in the region for the last 25 years. Compared with January 2020 WEO update, growth for 2020 has been revised down by 5.1 percentage points. This downward growth revision reflects macroeconomic risks arising from the sharp decline in output growth among the region's key trading partners, including China and the euro area, the fall in commodity prices, reduced tourism activity, as well as the effects of measures to contain the COVID-19 global pandemic. The COVID-19 shock is mainly hitting the region's three largest economies, Nigeria, South Africa, and Angola, in a context of persistently weak growth and investment, and declining commodity prices. The region's growth is however projected to recover to 4.1 percent in 2021, 0.6 percentage points higher compared to the January 2020 WEO forecast.

In the EAC countries, the economic growth is projected at 2.0 percent in 2020 from 5.9 percent recorded in 2019, following projected slowdown for all EAC countries and a projected recession in Burundi. Compared with October 2019 Regional Economic Outlook for Sub-Saharan Africa, growth for 2020 was revised down by 4.0 percentage points, reflecting the negative impact of COVID-19 pandemic outbreak. The projected deceleration in growth is mainly due to the weak external demand and disruptions to supply chains and domestic production. In addition, activity in tourist-dependent countries is expected to contract sharply in response to severe disruptions to travel and tourism activities.

1.2 Inflation Developments

Following a sharp drop in global demand and falling commodity prices, world annual average inflation is projected to decelerate from 3.6 percent in 2019 to 3.0 percent in 2020 before picking up to 3.3 percent in 2021. In advanced economies, consumer price inflation is projected to ease to 0.5 percent in 2020 from 1.4 percent in 2019, following projected falling inflation in the United States (0.6 percent from 1.8 percent in 2019), Eurozone (0.2 percent from 1.2 percent), United Kingdom (1.2 percent after 1.8 percent), and Japan (0.2 percent compared to 0.5 percent), giving room to Central Banks for further monetary easing.

Chart 2: Global inflation and projections across regional blocks (% change)



Source: IMF, April 2020

In the emerging markets and developing economies, inflation is projected to ease to 4.6 percent in 2020 from 5.0 percent in 2019, and edge down to 4.5 percent in 2021.

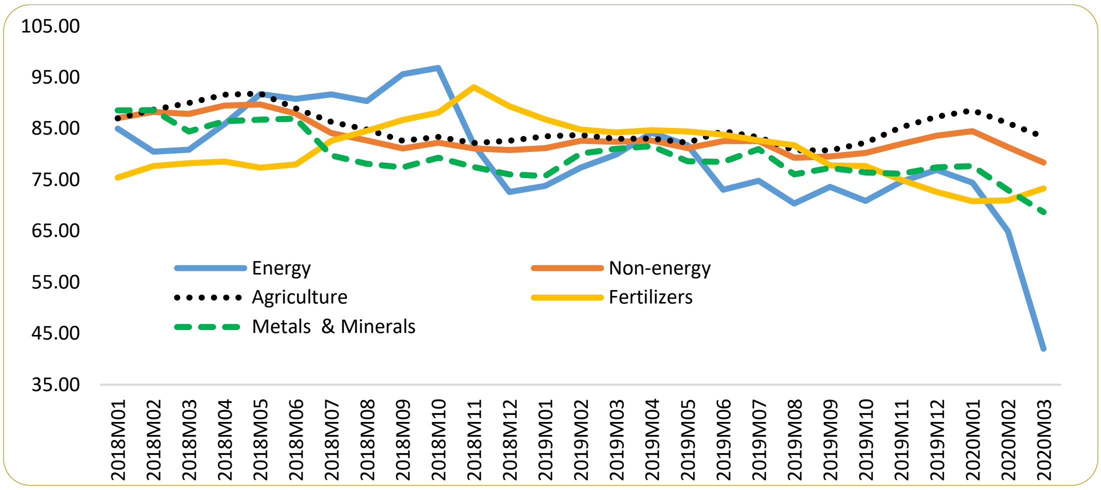
In Sub-Saharan Africa, annual headline inflation is projected to rise to 9.3 percent in 2020, from 8.4 percent in 2019. This part of the continent has been facing multiple weatherrelated shocks, including cyclones, droughts in southern and eastern Africa (especially in Mozambique, Zambia, Lesotho and Zimbabwe), exchange rate pressures and severe locust swarms in the horn of Africa. In 2021, Sub-Saharan annual average inflation is projected to ease to 7.6 percent.

In the EAC_5 countries, annual headline inflation is projected to average 4.5 percent in 2020, from 3.8 percent in 2019, following projected rise in inflation in Burundi (8.0 percent from -0.7 percent in 2019), Rwanda (6.9 percent from 2.4 percent), Tanzania (3.9 percent after 3.4 percent), and Uganda (3.9 percent compared to 2.9 percent). Kenya inflation is expected to stand at 5.1 percent in 2020 from 5.2 percent in the year 2019.

1.3 Global commodity prices

On commodity market, global commodity prices decreased in the first three months of 2020, reflecting a slowdown in global demand. Energy prices declined by 21.5 percent from a decline of 6.2 percent in the same period of 2019 due to uncertainty about the potential impact of COVID-19 and the warm winter that reduced demand for heating fuels.

Chart 3: Commodity Prices Index in Nominal US Dollar (2010=100)



Source: World Bank, March 2020

In the first three months of 2020, crude oil prices decreased by 18.9 percent on average compared to a decrease of 6.4 percent in the same period of 2019. In March 2020, crude oil prices decreased by 49.5 percent compared to a decline of 0.6 percent in March 2019, reflecting the impact of the COVID-19 pandemic on the global demand. In addition to low demand caused by the COVID-19 pandemic, oil prices will also be impacted negatively by the collapse of the OPEC and non-OPEC agreement. According to April 2020 IMF report, oil prices are projected to decrease further by 42 percent to USD 35.6/barrel from USD 61.4/barrel in 2019.

Non-energy commodity prices slightly decreased by 0.8 percent on average for the first three months of 2020, reflecting falling prices of fertilizers and metals & mineral commodities. Metals & mineral prices decreased by 7.4 percent after a decrease of 9.4 percent in the same period of 2019, reflecting the impact of the measures undertaken by the Chinese government to contain the spread of the COVID-19 that limited industrial production activities. However, prices increased for precious metals presumed to be safe heaven, with gold prices rising by 21.4 percent after a decline of 1.9 percent in the same period of 2019, amid expectation that the ongoing virus outbreak will result into lower US interest rates.

Average prices for agriculture commodities increased by 3.1 percent due to the rising prices of beverages (6.5 percent); of which Coffee Arabica increased by 11.8 percent. During the same period, food prices increased by 4.6 percent; of which oils & meals (8.1 percent), grains (4.5 percent), and other foods (0.9 percent).

Prices for fertilizers declined by 15.9 percent in the first three months of 2020, compared to an increase of 10.6 percent in the same period of 2019.

Going forward, IMF projections published in April 2020 anticipates the prices of metals to drop by 15.0 percent in 2020, but this sharp drop should ease to -5.6 percent in 2021. Food and beverages prices are projected to reduce by 1.3 percent before a recovery of 0.6 percent in 2021.

1.4 Monetary policy and financial markets

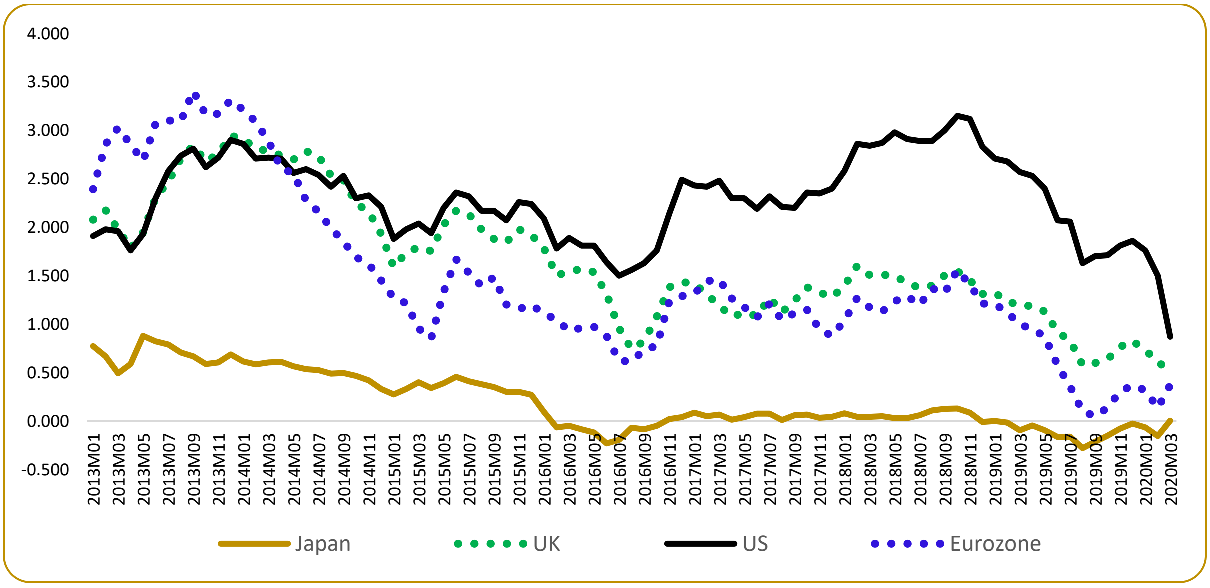
1.4.1 Monetary policy

Monetary policy remained accommodative in most advanced economies. A decline in global demand & falling business confidence derived from the Covid-19 pandemic lead many Central Banks across the World (including the Federal Reserve, and Bank of England), and Governments to take targeted policy measures in order to support their economies.

The US Federal reserve cut the Federal Funds rate twice in March 2020, (3rd and 15th March by 50, 100 basis points, respectively), while the Bank of England (BoE) also cut its policy rate twice in March (11th and 19th by 50 and 15 basis points, respectively). They further eased monetary policies and started implementing other quantitative easing to restore confidence and support their economies. The European Central Bank rate (ECB) was maintained at zero percent since March 2016, and the Bank of Japan continued to apply a negative interest rate since January 2016. By end March 2020, 42 countries had cut their policy rates, and from January 2020, 90 countries had cut their policy rates.

In March 2020, the ten- year government bond rate decreased in US and UK to 0.870 percent and 0.461 percent respectively reflecting flight-to-safety assets amid high market volatilities compared to 1.860 percent and 0.831 percent in December 2019. In Eurozone and Japan, the ten-year government rates slightly went up to 0.372 percent and 0.005 percent from 0.369 percent and -0.025 percent respectively in December last year.

Chart 4: 10-Year Government Bond Yield (p.a)



Source: https://fred.stlouisfed.org

The three-month deposit rates remained negative in the Eurozone and Japan, standing at -0.255 percent and -0.049 percent in March 2020, respectively, affecting banks' deposits in the Central Banks while encouraging economic financing. In US and UK, the three-month deposit rates decreased to 1.451 percent and 0.596 percent from 1.908 percent and 0.792 percent respectively in December 2019.

1.4.2 Foreign Exchange Markets

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

Compared to December 2019, in March 2020, the US dollar appreciated by 4.44 percent against the British Pound, 1.89 percent against the Euro, and by 5.51 against the Chinese Yuan. However, the dollar depreciated by 2.85 percent against the Japanese Yen.

II. DOMESTIC ECONOMY

2.1 Domestic Demand and Output

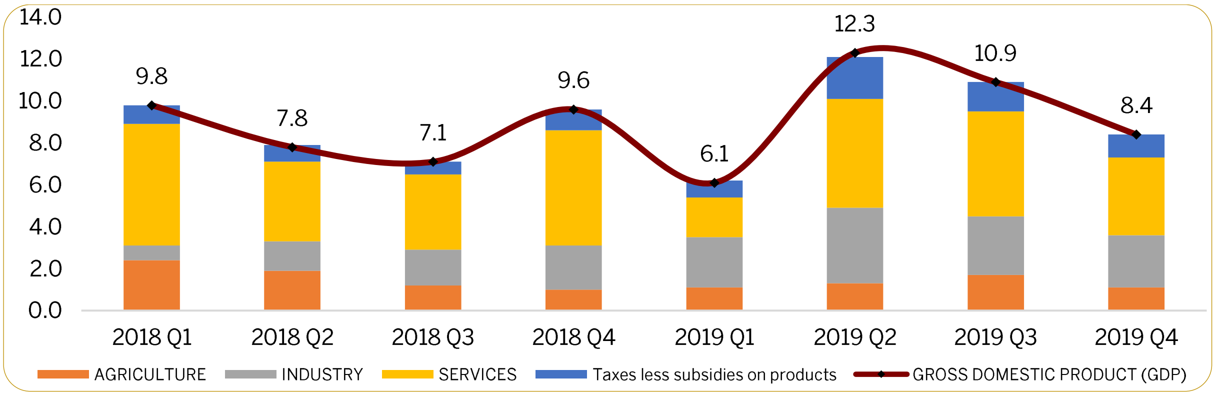
Rwandan economy is expected to slow down significantly in 2020, after a strong performance in 2019. The real GDP growth in 2019 was 9.4 percent from 8.6 percent in 2018 and is likely to hover around 2.0% in 2020, due to the negative effect of the COVID-19 pandemic.

This coronavirus outbreak has plunged economic activities from a combination of factors, including the disruption in trade and value chains affecting commodity exports and imports; reduction in foreign financing inflows including foreign direct investments, foreign aid, remittances, tourism revenues and also repercussions from imposed lockdown.

2.1.1 Economic performance by sector

Rwanda's strong growth in 2019 reflected broad-based increases in the three sectors of the economy. The industry sector grew by 16.5 percent from 8.7 percent in 2018, largely driven by a growth in construction sector (+ 33.8 percent) and in manufacturing industries (+11.0 percent). The service sector expanded by 8.2 percent in 2019, after 9.7 percent previously, following the increase in trade and transport services (+15.6 percent) and other services (+5.8 percent). The agriculture sector grew by 5.0 percent slightly lower than 6.1 percent recorded in 2018.

Chart 5: Real Gross Domestic Product (percentage change)

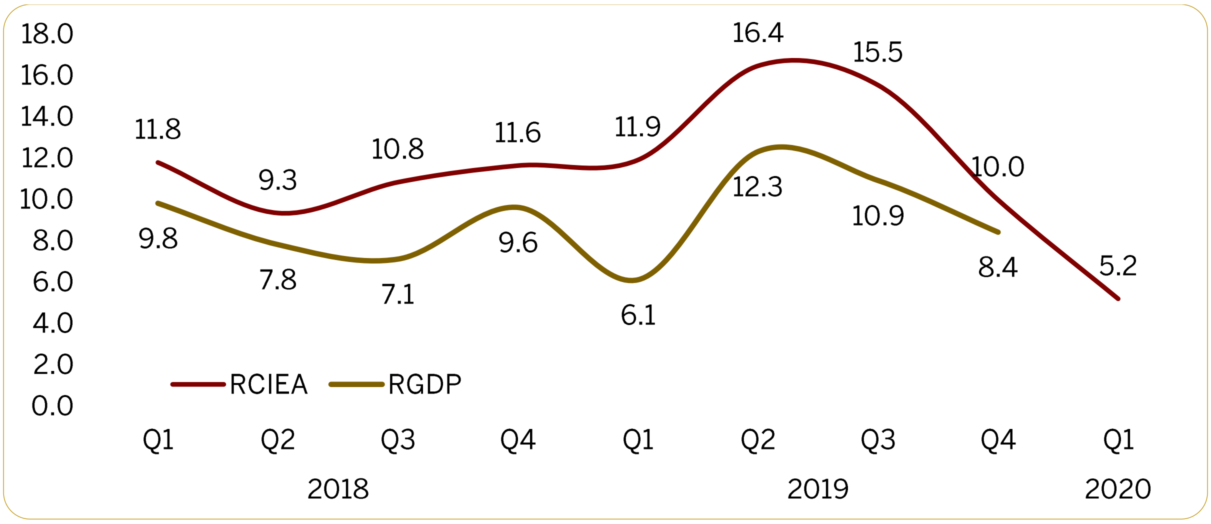


Source: National Institute of Statistics of Rwanda

Prior to the COVID-19 outbreak, the real GDP was expected to keep growing at high pace. However, with the virus outbreak in China, Rwanda was impacted even before the first confirmed case domestically, due to strong trade links between the two countries. Real GDP growth initially projected to grow at 8.0 percent in 2020, has been revised significantly down to 5.1 percent, and may be revised down further.

In 2020Q1, high frequency indicators point to an economic slowdown to a level well below the long term average. During the first quarter, the composite index for economic activities (CIEA) grew by 5.2 percent against an increase of 11.9 percent recorded in the corresponding period last year, suggesting a slowdown in the economic growth in the near term.

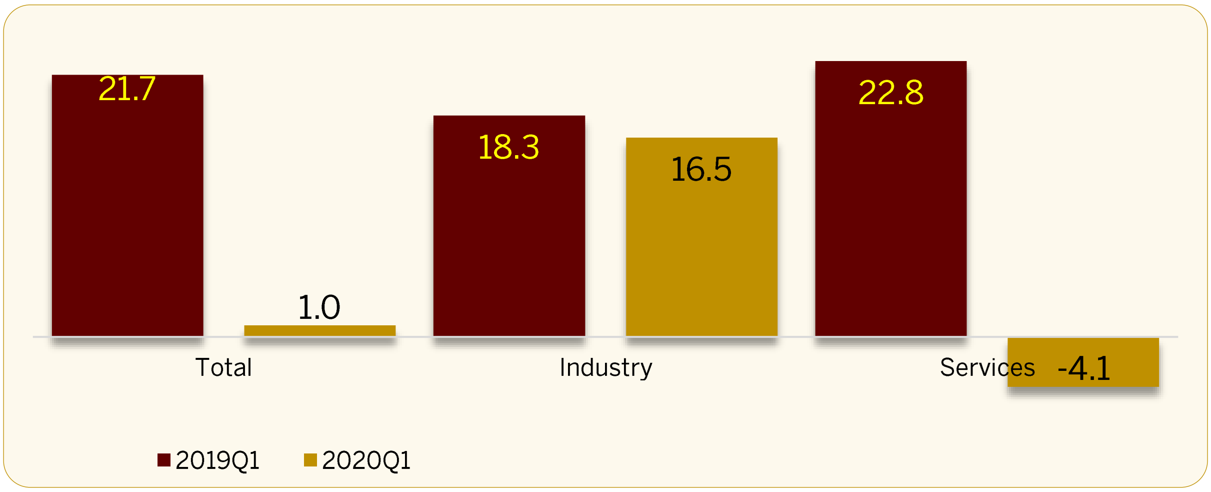
Chart 6: Quarterly Real GDP growth vs CIEA (% change, y-o-y)



Source: NBR, Monetary Policy Department

The total turnovers, one of important components in the CIEA computation, registered an unprecedented low growth of 1.0 percent from 21.7 percent, mainly undermined by the decline in turnovers of service sector by 4.1 percent. The latter represented 71.6 percent of the total turnovers.

Chart 7: Turnovers of industry & services sectors (% change, y-o-y)



Source: NBR, Monetary Policy Department

The services sector has been heavily affected by the pandemic. Business activities weakened due to restricted supply after COVID-19 cases multiplied in and outside China, resulting into stocks shortage for domestic traders and manufacturers, travel restrictions and lockdown of most businesses since mid-March 2020.

Wholesale and retail trade sales fell by 5.8 percent in March 2020 against an increase of 5.7 percent in the same period of 2019 and recorded an overall quarterly growth of 1.9 percent from 8.8 percent in 2019Q1.

The tourism industry was badly hit through events cancellations since mid-March 2020 and low demand for catering services following temporary shutdown of businesses and after private and government institutions' employees started working remotely from home. This resulted in a decline of 32.6 percent in March turnovers of hotels and restaurants against an increase of 3.5 percent in March 2019. Despite the sharp decline recorded in March, the overall quarterly performance was positive with a growth of 8.0 percent from 10.6 percent in the same period last year.

Transport services gained by 21.1 percent in 2020Q1 from 25.5 percent in 2019Q1, supported by land transport and logistics services while air transport slowed down following travel restrictions around the world.

Furthermore, the slump in services sector's turnovers reflected the decline in turnovers of financial services (-5.3 percent from +13.9 percent) and petroleum distribution services (-33.2 percent from +66.9 percent). The fall in sales of petroleum was mainly due to the slowdown in sub-sector's turnovers after having recorded a strong uptick in the corresponding period last year, as result of the spillover effect from booming construction activities.

The industry sector, was quite resilient with its turnovers growing by 16.5 percent in 2020Q1, mainly supported by manufacturing industries, whose sales increased by 27.9 percent from 9.0 percent in the corresponding period of 2019. This performance outweighed the slowdown in turnovers growth of construction (2.7 percent from 36.4 percent) and negative growth in mining and quarrying (-20.5 percent from 5.7 percent).

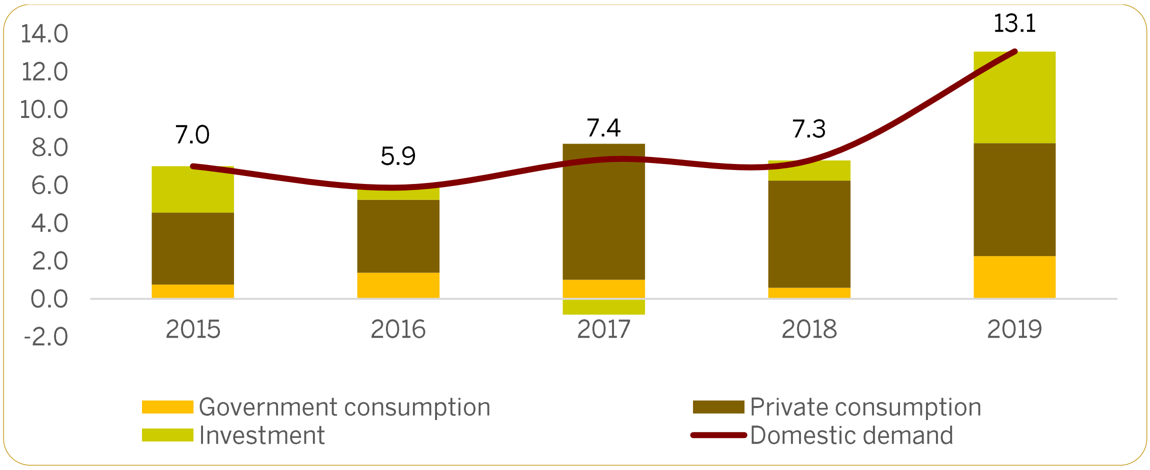
The construction subsector slowed down after the completion of some construction projects including KIGALI ARENA, but also due to covid-19 containment measures. Mining and quarrying fell partly as results of the decline in commodity prices, owing to trade tensions coupled with substantial impact of COVID-19. The international prices of metal and minerals fell by 7.4 percent in 2020Q1 after a decline of 9.4 percent recorded in 2019Q1.

Positive developments in manufacturing industries resulted mainly from food processing, which sales increased by 36.2 percent in 2020Q1 from a decline of 5.7 percent in 2019Q1 and from breweries which recorded an increase of 7.6 percent after 10.4 percent over the same period.

2.1.2 Domestic Demand

The domestic demand in 2019 was mainly driven by investment and consumption expenditures. Investment expenditures increased by 23.3 percent from 5.0 percent in 2018 mainly buoyed by investments in construction which grew by 32.8 percent and other fixed investment that increased by 26.5 percent from 4.8 percent and 6.5 percent respectively in 2018. The total final consumption augmented by 10.4 percent from 7.9 percent, mainly led by Government consumption which increased by 17.4 percent from 4.5 percent previously. The rise in Government consumption reflects a growth in wages and salaries (+16.6 percent) as well as expenditures in goods and services (+17.8 percent).

Chart 8: Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

Developments in the total turnovers of industry and services sectors, reflects a slowdown in domestic demand is expected in 2020Q1, driven by poor performance of the services and construction subsectors. These two sectors employ 49.7 percent of the labor force, of which 71 percent are informal. The negative impact of COVID-19 to these sectors translated into loss of income for most of these workers, and will weaken household consumption expenditure. The latter represents 63.9 percent of the total domestic demand. Furthermore, the slowdown in construction turnovers signals a slump in construction investment that significantly boosted 2019's growth as it represented 70.7 percent of total investment expenditure.

The COVID-19's pandemic negatively affected the services sector which represented 47.8 percent of real GDP in 2019 and had significant spillovers to other sectors. The agricultural sector is expected to record weak growth in 2020Q2 adding to poor performance in the 2020Q1 due to heavy rains in season A which destroyed some crops such as beans, Irish potatoes and sweet potatoes. Overall, the economy is anticipated to experience a recession in 2020Q2.

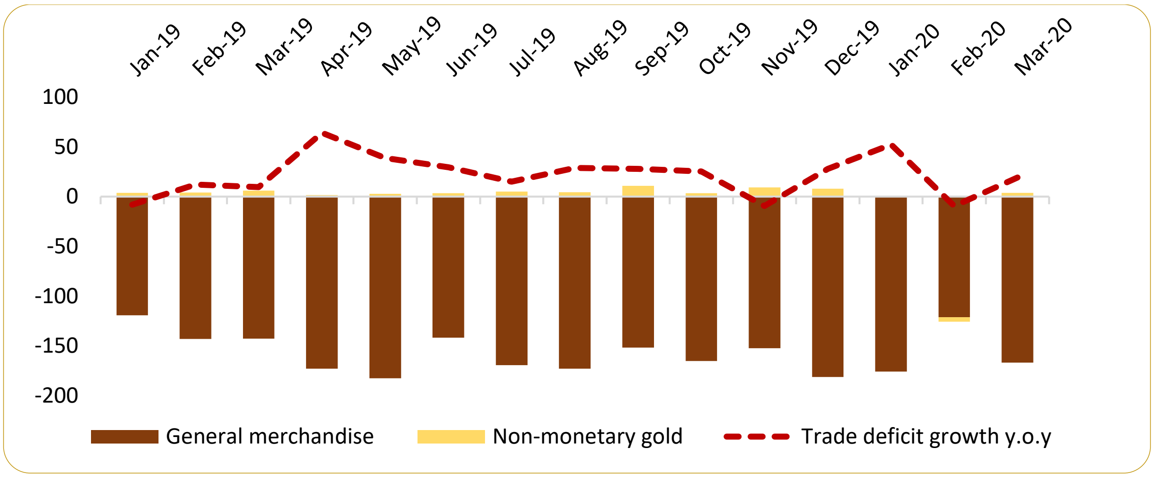
2.2 External Sector Developments

Rwanda's exports revenues rose by 22.6 percent year-on-year in 2020Q1 to 314.7 million (from USD 256.6 million a year earlier). The increase was mainly driven by receipts from gold that fetched USD 107.2 million in 2020Q1 compared to USD 13.9 million in the same period a year before. In contrast, the COVID-19 containment efforts including lockdowns across the world weighed on external demand which hit exports of traditional exports. In 2020Q1, exports of traditional exports plunged by 15.6 percent mainly undermined by low earnings from minerals (-33.7 percent) and coffee (-32.9 percent). Similarly, confinements and restrictions affected cross-border movements and weighted on other exports categories. Non-traditional exports, re-exports, and informal cross-border trade (ICBT) decreased by 25.9 percent, 6.7 percent and 9.7 percent respectively.

On the other hand, imports grew by 20.3 percent amounting to USD 779.2 million in the 2020Q1 (from USD 647.6 million of last year) largely driven by high gold import bill (USD 107.6 million). In addition, imports of consumer goods increased mainly driven by high purchase of food products (+22.2 percent). Imports of capital and intermediary goods rose by 1.9 percent and 6.2 percent respectively, despite the slowdown in their imports during February-March period, partly as result of weakening domestic demand following the COVID-19 containment measures. Rwanda imports bill on energy products decreased by 4.4 percent, owing to declining global oil prices.

Overall, Rwanda's trade deficit rose by 18.8 percent or USD 73.4 million to USD 464.4 million in 2020Q1.

Chart 9: Trade deficit (USD million except otherwise indicated)



Source: Statistics Department

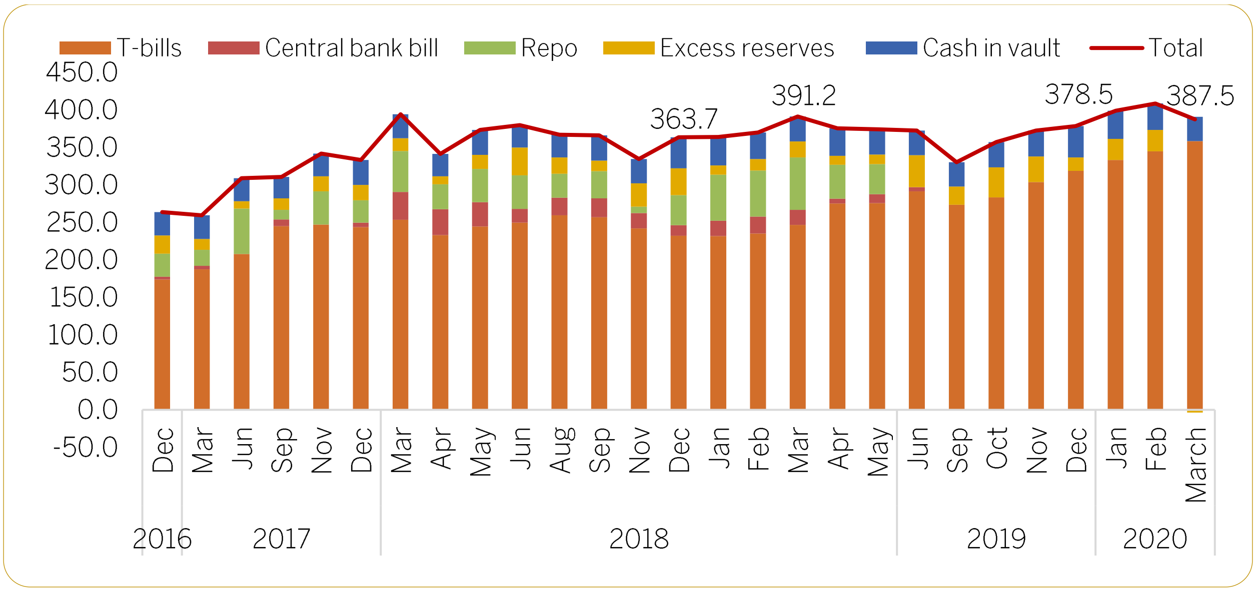
Looking ahead, the outlook for external sector in 2020 turned negative compared to the October outlook, following increased risks caused by COVID-19 pandemic which is expected to heavily affect the global demand. The sluggish global economic outlook is expected to weigh on exports revenues from goods and services, reduce inflows of remittances and foreign aid, widening the current account deficit. The business sentiment is falling due to projected slowdown in domestic activity which will weigh on private inflows (FDI and loans) widening the financing gap. The latter is expected to be financed by government foreign inflows including external borrowings and use of international reserves.

III. FINANCIAL AND MONETARY DEVELOPMENTS

3.1 Banking System Liquidity Conditions

In 2020Q1, the most-liquid assets grew at slow pace by 2.4 percent, to FRW 387.5 billion from FRW 378.5 billion in December 2019, compared to the growth of 7.6 percent recorded in 2019Q1.

Chart 10: Most liquid assets of commercial banks (FRW billion)



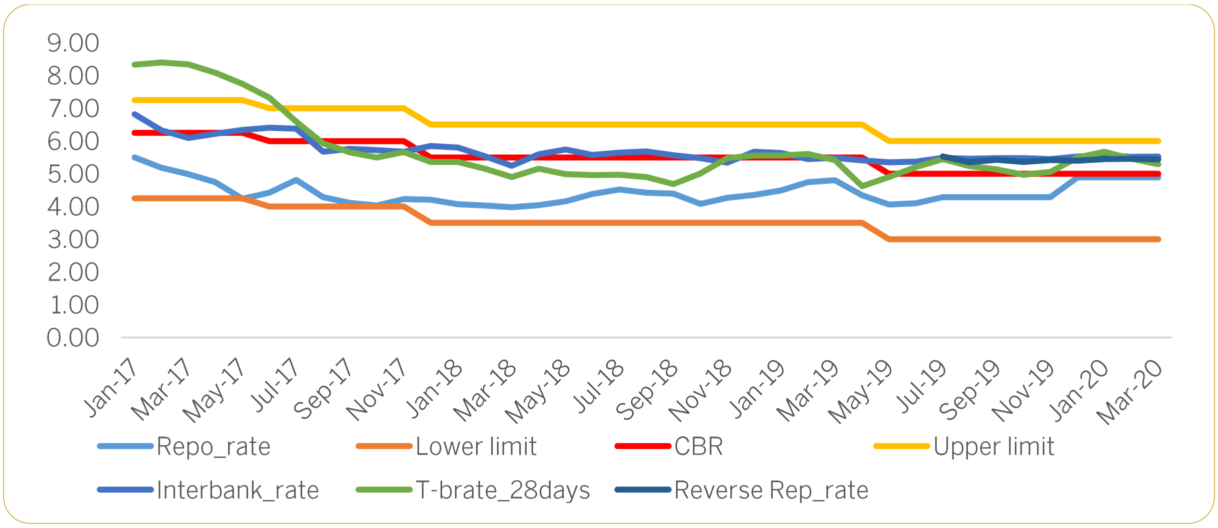
Source: NBR, Monetary Policy and Research Directorate

3.2 Monetary Policy and Interest Rates

In May 2019, Monetary Policy Committee revised once the central bank rate to 5 percent from 5.5 percent, and kept it unchanged in a bid to pursue the accommodative monetary policy. Money market interest rates remained close to the CBR, pointing out a continuous improvement in the Monetary Policy Transmission Mechanism.

Interbank rate slightly rose by 2 basis points to 5.54 percent in 2020Q1, from 5.52 percent in 2019Q1. The 28 days T- bill rate moved consistently closer to the CBR and stood at 5.48 percent on average in 2020Q1, from 5.53 percent in 2019Q1. Reverse repo rate averaged 5.45 percent in 2020Q1, a quarter during which the central bank injected liquidity while there was no reverse repo operations in 2019Q1.

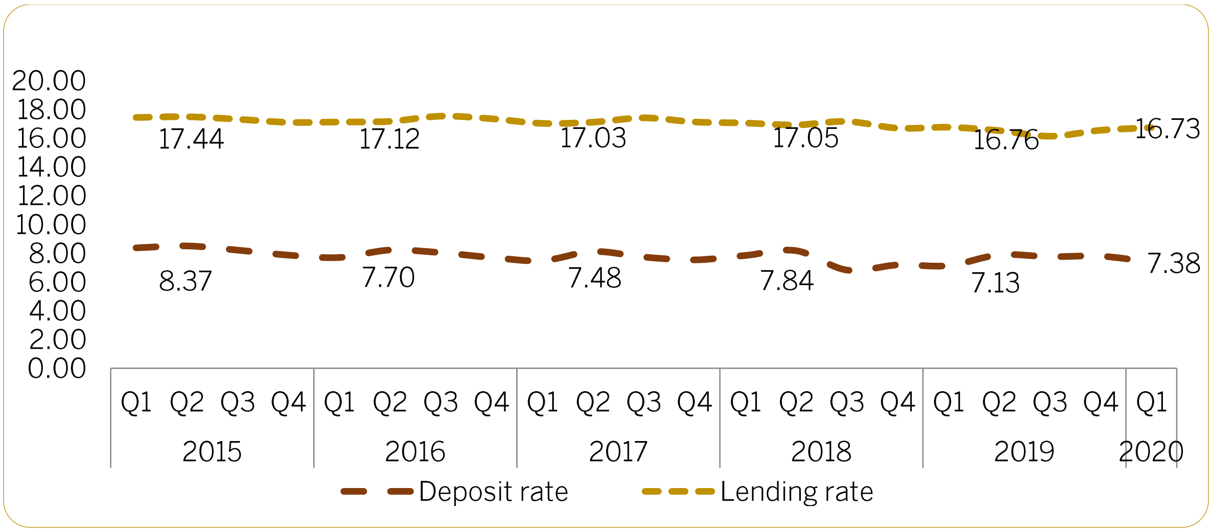
Chart 11: Money market rates developments



Source: NBR, Monetary Policy and Research Directorate

Deposit rate increased by 25 basis points to reach 7.38 percent on average in 2020Q1, from 7.13 percent in 2019Q1, while lending rate slightly decreased by 3 basis points to 16.73 percent in 2020Q1, from 16.76 percent in 2019Q1. As a result, the spread between lending rate and deposit rate dropped significantly by 28 basis points to reach 9.35 percent on average in 2020Q1, from 9.63 percent in 2019Q1 respectively.

Chart 12: Market interest rates (percent average)



Source: NBR, Monetary Policy and Research Directorate

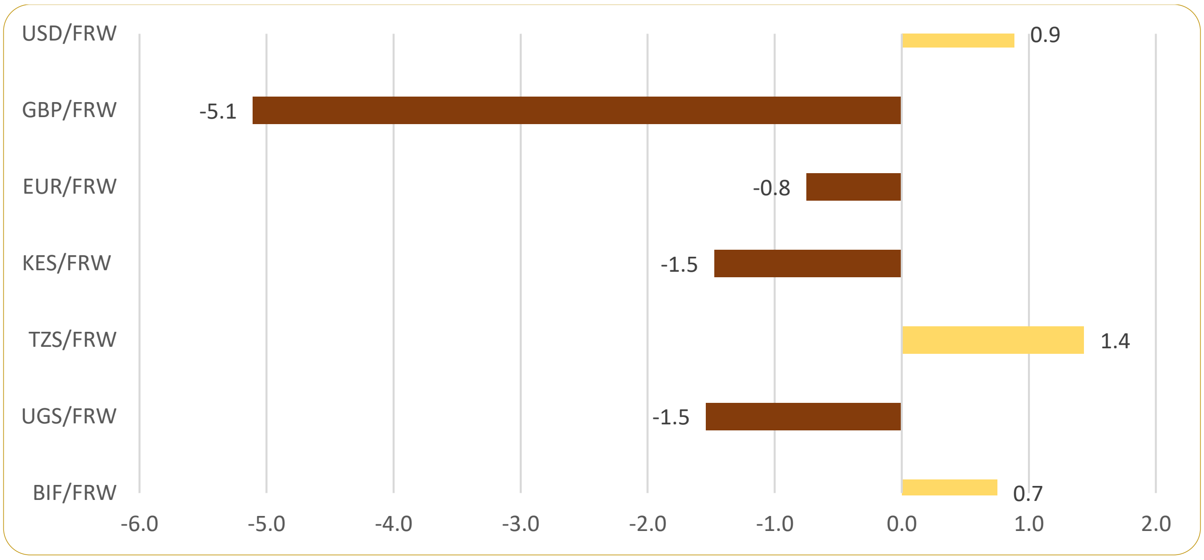
3.3 The exchange rate: bilateral and effective

In the beginning of the year 2020, the Rwandan franc was stronger compared to the same period last year, reflecting a relatively low demand of foreign currencies as result of the COVID-19 pandemic.

Relative to December 2019, by end March 2020, Rwandan franc depreciated by 0.9 percent against the USD, slower than 1.1 percent recorded in the same period last year. Inversely, the FRW appreciated by 0.8 percent versus the Euro, faster than 0.6 percent appreciation in March 2019, and rose by 5.1 percent vis-à-vis the British Pound after a depreciation of 4.2 percent during the same period of 2019.

Compared to regional currencies, the FRW appreciated by 1.5 percent against both Kenyan and Uganda shillings, from a depreciation of 2.2 percent and 0.7 percent respectively in the corresponding period of 2019. The Rwandan franc weakened by 1.4 percent against the Tanzanian shilling from an appreciation of 0.1 percent in the same period a year before while it depreciated by 0.7 percent against the Burundian franc from 0.5 percent during the same period of 2019.

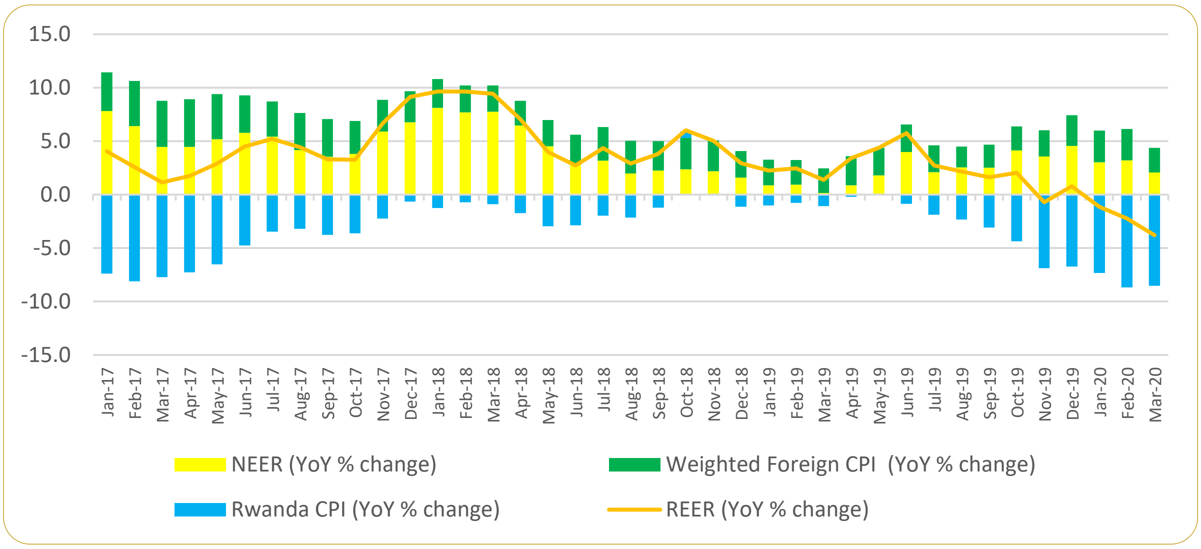
Chart 13: The FRW exchange rate (in % change compared to December 2019)



Source: NBR, Monetary Policy Department

Looking at a basket of currencies of Rwanda's main trading partners, the FRW real effective exchange rate appreciated by 3.8 percent (y-o-y) end March 2020 against a depreciation of 1.4 percent recorded during the corresponding period in 2019. This was mostly attributable to higher domestic inflation than foreign inflation which outweighed the slight depreciation of the nominal effective exchange rate of the FRW (2.1 percent compared to a depreciation of 0.1 percent end March 2019).

Chart 14: Drivers of Real Effective Exchange Rate



Source: NBR, Monetary Policy Department

3.4 Credit

The outstanding credit to the private sector increased by 4.3 percent in 2020Q1 compared to 3.3 percent in 2019Q1, however new authorized loans slowed down to -10.6 percent in the Q1 2020, in the wake of the covid-19 global pandemic that hit credit demand across business sectors, compared to an increase of 24.9 percent recorded in the same period of

2019. Much of the slowdown in Q1 NALs was mainly observed in three sectors namely water & energy (-97.9 percent), public works & buildings (-14.9percent) and Manufacturing activities (-22.9 percent).

With regard to distribution of the NAL by economic sector, the main financed sectors remained Commerce (32.3%), Public works & building (20.3%), Personal loans (15.6%), and Manufacturing activities (10.6%).

Table 1: Distribution of NALs by economic sector in % share

	Amount in billions of FRW			SHARES in%		
Economic Sector	2018Q1	2019Q1	2020Q1	2018Q1	2019Q1	2020Q1
Commerce	64.4	63.5	71.4	32.5	25.3	32.3
Public works and building	51.0	51.9	45.1	25.8	21.4	20.3
Personal loans	25.2	34.0	34.2	12.7	13.8	15.6
Manufacturing activities	10.3	30.5	23.5	5.2	12.3	10.6
Transport & warehousing & communication	10.1	10.4	20.2	16.7	9.1	7.4
Water & energy activities	33.0	22.6	16.4	0.1	7.5	0.2
Services provided to the community	0.7	9.7	6.1	5.1	4.2	9.1
Restaurant and hotel	2.6	2.8	2.9	0.3	3.9	2.9
OFI &Insurances and other non-financial services	0.4	3.2	0.8	0.2	1.3	0.3
Agricultural, fisheries& livestock	0.2	18.6	0.4	1.3	1.1	1.3
Mining activities	0.0	0.0	0.0	0.0	0.0	0.0
Total	197.9	247.3	221.1	100.0	100.0	100.0

Source: Financial Stability Monitoring Department

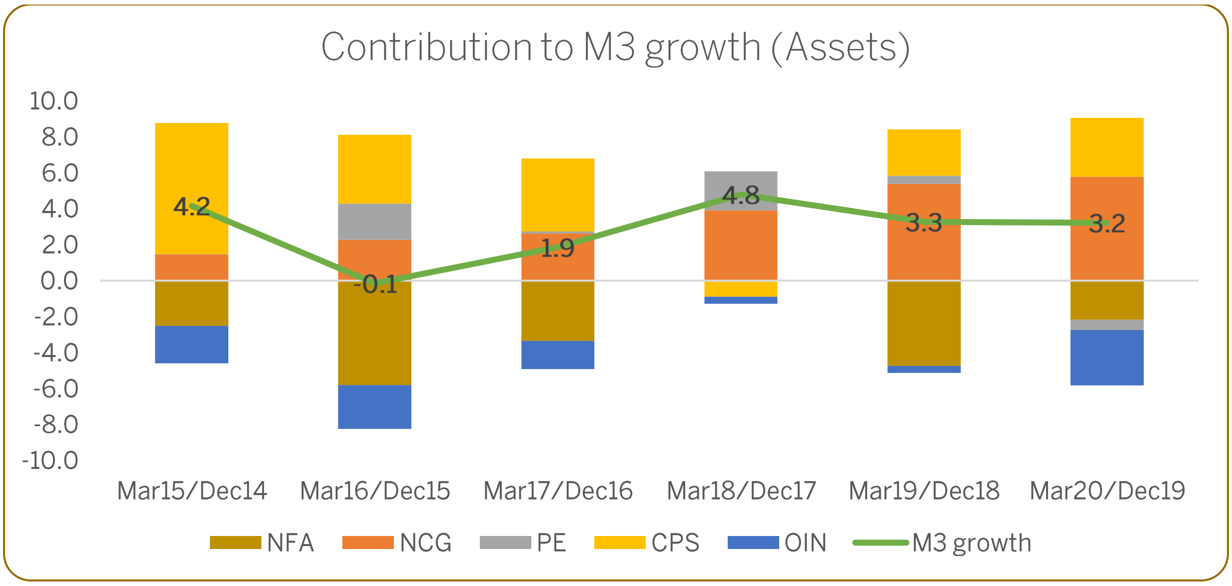
3.5 Money

In March 2020, broad money M3 picked up by 3.2 percent cumulatively from December 2019, versus 3.3 percent recorded in the corresponding period of the year before. That growth was primarily driven by net credit to government (NCG) with a contribution of 5.8 percent, followed by the stock of credit to the private sector (CPS) [+3.3 percent]. However, the net foreign assets (NFA), credit to public enterprise (PE) and other items nets (OIN) weighed on the growth of M3 with a contribution of – 2.2 percent and - 0.6 percent and -3.1 percent respectively.

The higher contribution of NCG in the growth of M3 in March 2020 was attributed to the increased government borrowing by 17.1 percent from 6.6 percent last year, while the moderate contribution of CPS was explained by the contraction in NALs in 2020Q1.

The contraction of NFA mainly came from a reduction in commercial banks' NFA of 13.6 percent in March 2020 resulting from more foreign transfers abroad.

Chart 15: Contributors to M3 growth on assets side



Source: NBR, Monetary Policy and Research Directorate

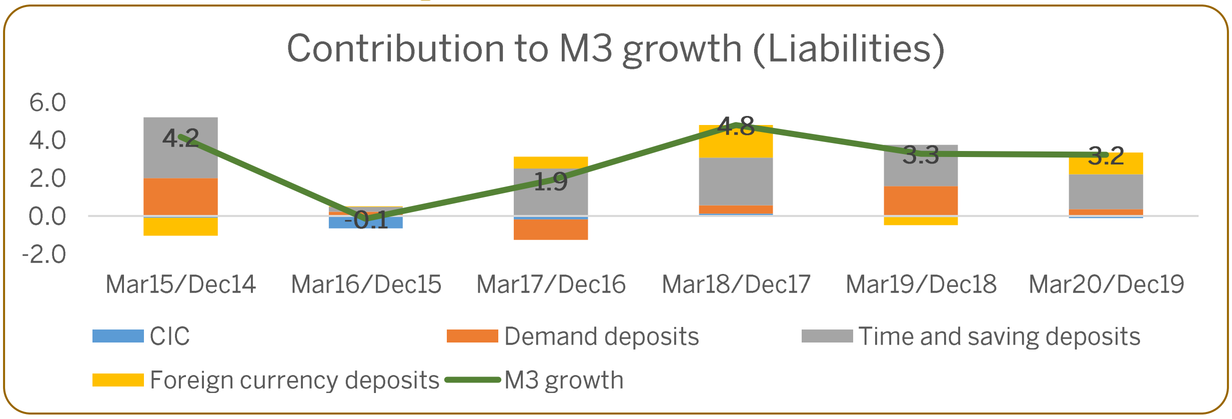
From the liabilities side, M3 growth was driven by time and savings deposits, which contributed by 1.8 percent in March 2020, foreign currency deposits with 1.2 percent and demand deposits with 0.4 percent.

The increase of time and savings deposits came from some big depositors, which increased their deposits during 2020Q1.

The rise in foreign currency deposits was attributed to more foreign inflows especially in February 2020. This has been eased by some foreign transfers abroad occurred in March 2020.

However, the currency in circulation (CIC) pulled down the growth of M3 by 0.1 percent.

Chart 16: Contributors to M3 growth on liabilities side

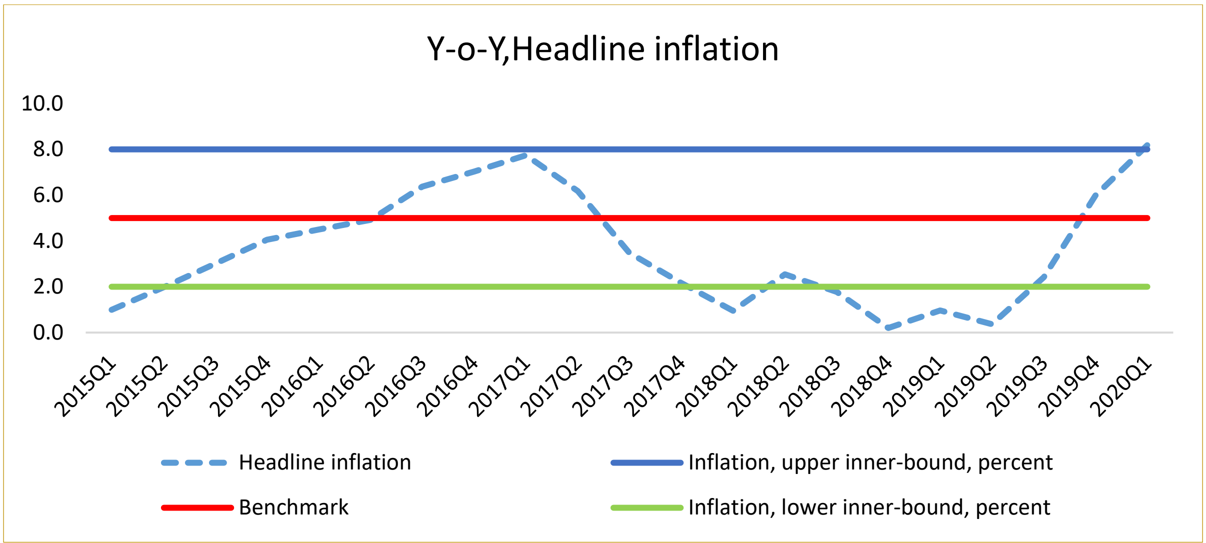


Source: NBR, Monetary Policy and Research Directorate

IV. INFLATION DEVELOPMENTS

In 2020Q1, headline inflation surged to 8.2 percent from 6.0 percent recorded in 2019Q4. The higher outturn of headline inflation reflects upticks in food inflation (from 13.7 percent to 18.2 percent) and energy inflation (from 0.6 percent to 9.2 percent). During the same period, core inflation increased from 3.3 percent to 4.3 percent.

Chart 17: Developments in headline inflation (% change)



Source: NBR, Monetary Policy and Research Directorate

4.1 Contributors to headline inflation

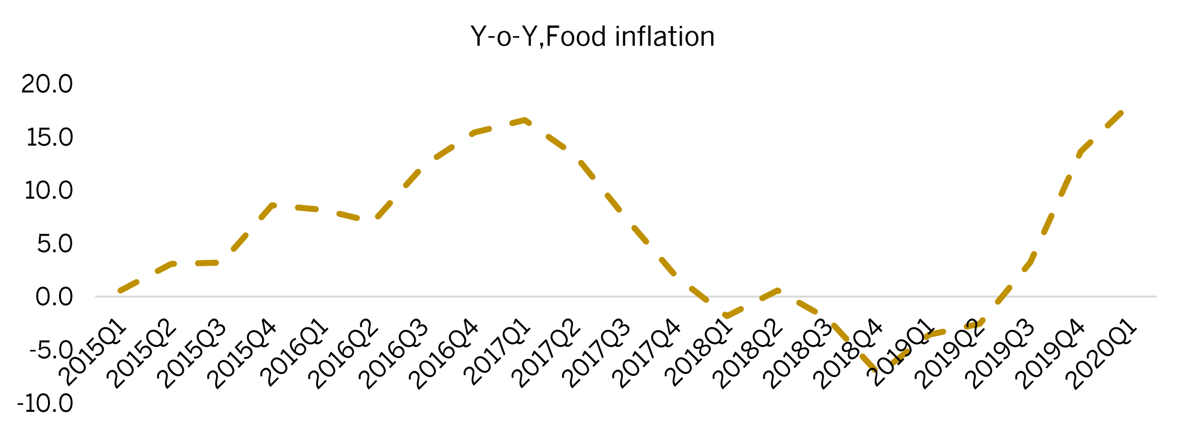
4.1.1 Food and alcoholic beverages inflation

The rise in food inflation from 2019Q4 to 2020Q1 as depicted in chart 18 reflects increases in fresh and processed food inflations. Vegetables and bread &cereals inflations increased respectively from 23.6 and 9.4 percent to 31.4 and 12.7 percent, while alcoholic beverages and tobacco inflation hiked from 11.4 percent to 15.4 percent.

The upward trend in food inflation resulted mainly from a declining trend in food prices recorded last year in 2019Q1, coupled with unfavorable weather conditions that affected negatively agricultural production of Season A. After a long cycle of increasing prices of fresh food that underlain the upward trend in food inflation since 2019Q3 (mainly driven by poor performance of Season C 2019 and Season A 2020), pressures on fresh food prices eased and reversed in 2020Q1 (particularly in March 2020) at the outset of the harvesting period of Season A 2020.In addition to base effects, the unfavorable weather conditions (including hailstorms and wind gusts in some parts of the country) during Season A, the rising food prices on international markets affected domestic food prices over the same periods.

In addition to the increase in international prices, upward pressures in core alcoholic beverages and tobacco inflation originated respectively from tax law enforcement (specifically on wines and liquors imports) and an increase in excise duty on tobacco.

Chart 18: Development of food inflation (%, Y-o-Y)

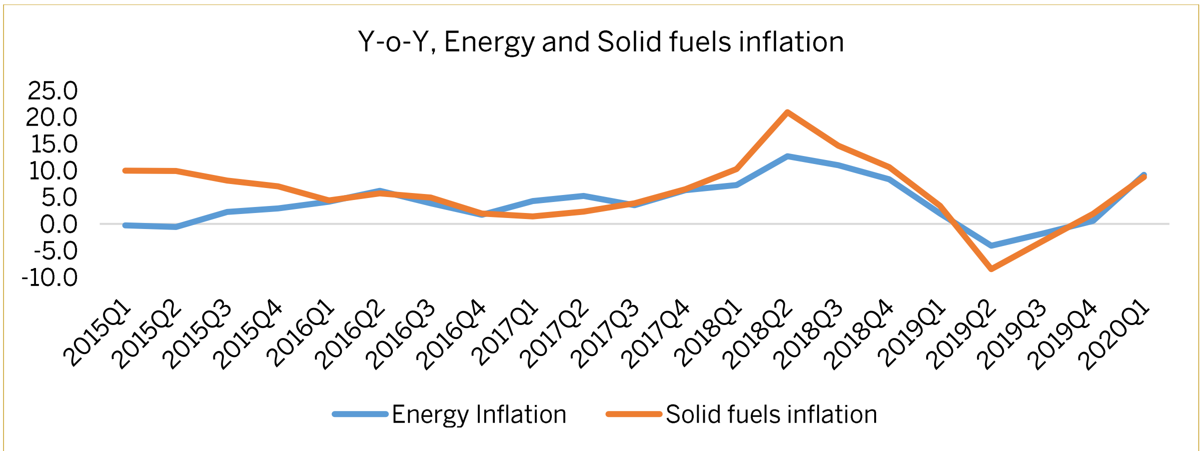


Source: NBR, Monetary Policy and Research Directorate

4.1.2 Energy inflation

The rising trend in energy inflation observed in Chart 19 reflects electricity inflation that hiked to 19.6 percent in 2020Q1 from 0.0 percent in the previous quarter. The increase in electricity inflation is mainly attributed to the upward revision in electricity tariffs effective from January 2020, adding to the Y-o-Y declining trend in prices recorded last year during the same period. Other upward pressures in energy inflation resulted from solid fuels and gas inflations that picked up to 8.8 and 4.6 percent in 2020Q1, respectively from 2.0 and 2.8 percent. The recent pressures recorded in solid fuel prices also reflects consumers' rush to build stocks in relation to the outbreak of COVID-19 in Rwanda.

Chart 19: Energy inflation (%, Y-o-Y)

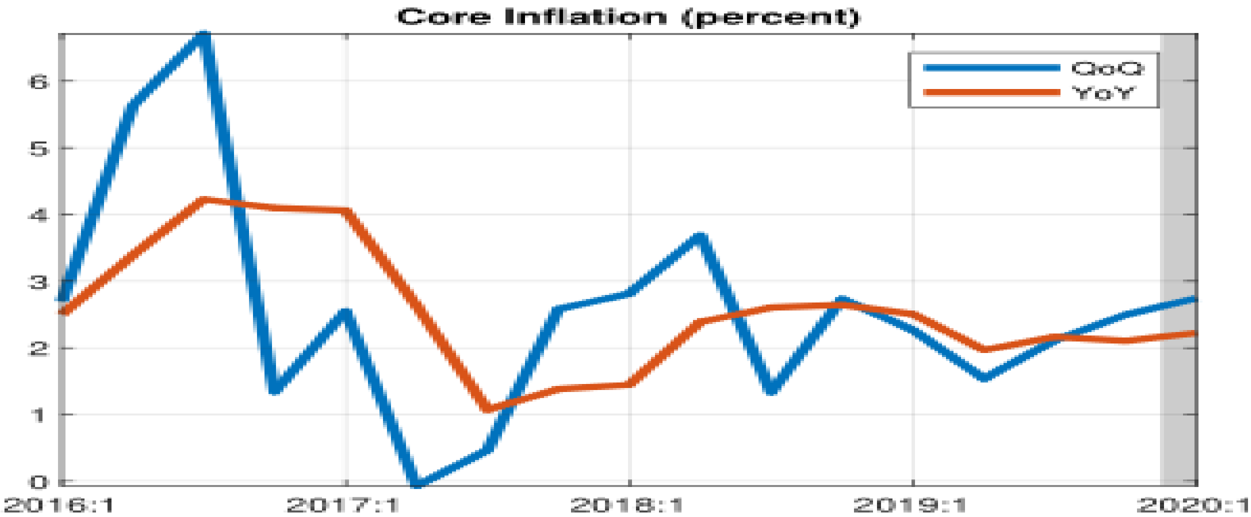


Source: NBR, Monetary Policy and Research Directorate

4.1.3 Core inflation

The increase in processed (especially imported) food inflation mentioned in Section 4.1.1 above contributed to the rise in core inflation (from 3.3 percent to 4.3 percent, in Y-o-Y terms). Other core items recorded a relatively stable inflation rate in year-on-year terms. However, in Q-o-Q terms, the increasing pressures recorded since 2019Q3 continued through to 2020Q1, reflecting the increase in food prices on international markets coupled with decreased domestic production of core foodstuffs such as sugar and rice (due to flooded marshlands that destroyed sugarcane and rice plantations).

Chart 20: Core inflation (excluding core food items)

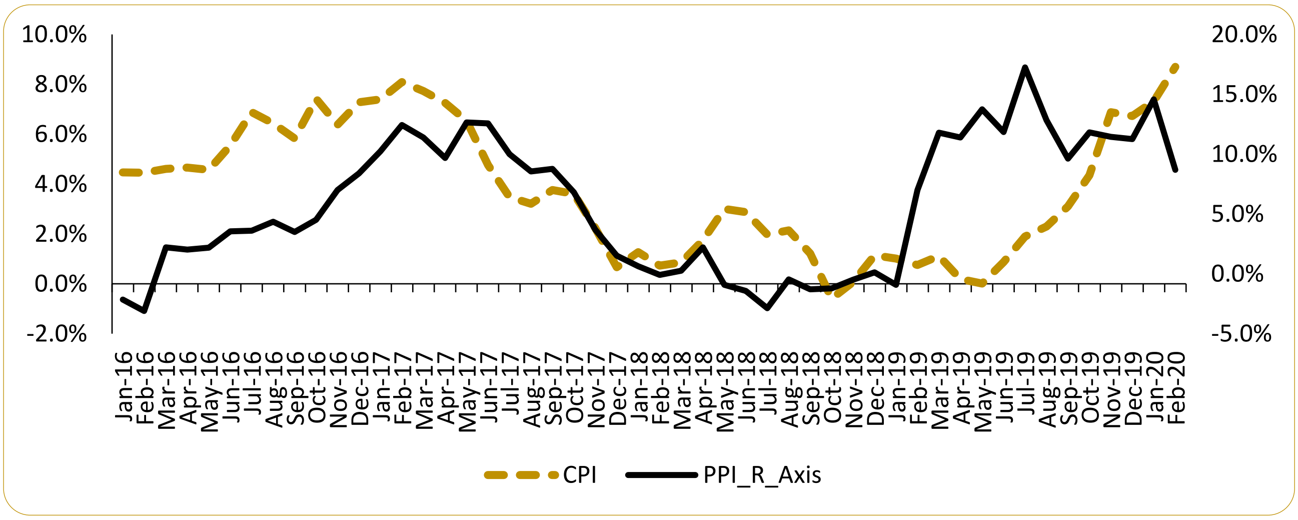


Source: NBR, Monetary Policy and Research Directorate

The slight deceleration in Q-o-Q terms is attributable to decreasing domestic and imported cost pressures (starting from February 2020). Domestic cost pressures eased on the back of a significant slowdown in economic activity that resulted from the outbreak of Covid-19 in Rwanda and elsewhere in the world. Imported cost pressures subsided following a deceleration in FRW depreciation and domestic inflation that led to an over-valuation of real exchange rate.

The trend of the Producer Price Index (PPI) during the same period (as depicted in Chart 21) is consistent with the hypothesis of easing cost pressures.

Chart 21: PPI - CPI inflation (%, Y-o-Y)



Source: NBR, Monetary Policy and Research Directorate

V. OUTLOOK

5.1 External assumptions of baseline projections

Assumption 1: The contraction in global demand will drag on domestic economy. Unlike the previous projections, the global economy is projected to contract significantly in 2020, in relation to the negative effects of Covid-19 that pushed a big number of advanced and emerging economies to adopt strict measures to limit the spreading of the pandemic, including social distancing, closure of non-essential businesses and restrictions on international travels. With these measures, most cities remained under lockdown for several weeks. Based on the IMF projections released in April 2020, global economy is expected to decelerate by -3.0 percent in 2020 but rebounding to 5.8 percent in 2021, supported by the normalization of the economy as well as the impact of remedial policies put in place.

Assumption 2: Global commodity prices that started to fall in the first three months of 2020 as the Covid-19 pandemic worsened, will reduce further throughout the year in line with the decline in global demand. Since the beginning of 2020, commodity prices were affected by the Covid-19 pandemic. The supply and demand of oil and food commodities reduced on the back of some mitigation measures to stop the spread of COVID-19 that affected transport and trade. In line with the falling global demand, both oil and food prices will decline much further over the forecasting horizon. In this regard, international commodity prices will exert downward pressures on inflation. The projections indicate that the recovery is expected in 2022, but this will mostly depend on the policies and measures put in place to boost aggregate demand.

Assumption 3: Expansionary fiscal policy is expected but it will remain non-inflationary. In relation to COVID-19 lockdown, government total revenues are projected to drop more than the projections of January 2020, especially from tax revenues. To support economic recovery post-Covid19, the fiscal sector plans to increase spending in 2020. Subsequently, the overall deficit is projected to pick up during the same year. This implies that fiscal stimulus on the economy will go up in 2020, but the impulse will remain non-inflationary.

5.2 Baseline projections of key macroeconomic variables

5.2.1 The economy is projected to operate below potential throughout 2020

Easy monetary conditions and favorable global environment maintained the economy above potential since 2019Q1. In 2020Q1, however, authorities adopted various measures to contain the outbreak of Covid-19 in the country, including restrictions of international travels and the practice of social distancing. A major portion of labor-intensive sectors (especially services and manufacturing) were negatively affected, and most of their businesses were closed down. The lockdown and disruptions in supply chains that followed COVID-19 contributed to slowing economic activity especially in March 2020. High frequency indicators of economic activities (CIEA) point to an economic downturn since mid-March 2020, especially in service and industry sectors. Consequently, the economy has operated below potential, thereby exerting downward pressures on marginal costs.

Going forward, the lockdown and other mitigation measures that continued through in April 2020 (and partially in May 2020) will continue to drag on GDP growth in 2020Q2 and thereafter. Baseline projections indicate a contraction of output in 2020 and a rebound to in 2021. The non-agricultural economy will be the most affected sector and it will continue to operate below potential over the medium term trajectory.

Under such circumstances, projections indicate that monetary conditions should remain accommodative, although it will not be enough to bring the economy to the potential level. Consequently, unmuted downward pressures on core inflation are expected over the forecasting horizon.

5.2.2 Pressures from domestic food production are expected to be subdued

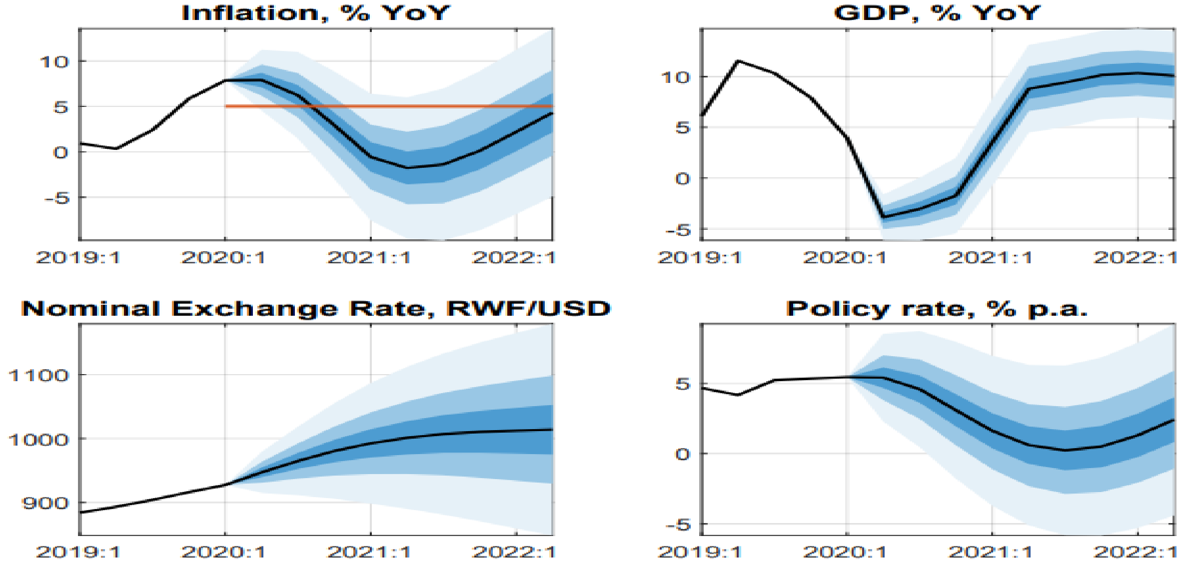
The rainstorms experienced since 2019H2 have contributed to the poor performance of agricultural Season A 2020, resulting into upward pressures in food prices in 2019Q4 and during the first month of 2020Q1. Going forward, data from Rwanda Meteorology Agency point to favorable weather conditions throughout 2020Q2, which could signify good performance of Season B 2020. Under such an environment, pressures in fresh food inflation are projected to be subdued.

5.2.3 Key macroeconomic projections

As stated earlier, the non-agricultural economy will continue to operate below potential over the medium term, dragged down by both global demand and slowdown of economic activity in relation to COVID-19. Consequently, cost pressures are projected to remain subdued throughout 2020, yielding downward pressures on core inflation. Pressures on food inflation are also tilted downwards, given the projected performance of agricultural Season B, coupled with the expected fall in international food prices. Similarly, energy inflation is expected to decline in line with the subdued domestic demand conditions and the expected fall in international oil prices.

Overall, headline inflation will remain high in the next two quarters (mainly as a base effect of the low inflation experienced last year during the same period) and fall afterwards. On average, headline inflation is projected at 6.4 percent in 2020 and at -0.9 percent in 2021.

Chart 22-Headline inflation projection



Source: NBR, Monetary Policy and Research Directorate