National Bank of Rwanda

Banki Nkuru y'u Rwanda

MONETARY POLICY REPORT

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The National Bank of Rwanda's Monetary Policy Report was called Inflation Report until February 2019. It is published four times a year, consistent with the quarterly Monetary Policy Committee meetings.

EXECUTIVE SUMMARY

The National Bank of Rwanda maintains the Central Bank Rate (CBR) at 5.0 percent.

The quarterly Monetary Policy Committee (MPC) meeting convened on August 14, 2019 to review the outcome of its previous decisions, recent economic developments and outlook. The Committee observed that the first half of 2019 (2019H1) ended with positive macroeconomic conditions, that are expected to continue throughout the year, with modest inflation rates, and moderate exchange rate pressures. The MPC decided to maintain the Central Bank Rate (CBR) at 5.0 percent, to continue supporting the financing of the economy and improvement in aggregate demand.

Headline inflation decelerated to 0.7% in 2019H1, from 1.8% in 2018H1, following a food deflation and a decline in energy inflation. Core inflation slightly dropped to 1.6 percent in 2019H1, from 1.8 percent in 2018H1, consistent with the aggregate demand that remains non-inflationary. Average headline inflation for 2019 is projected to be around 2.0 percent, in line with the prevailing accommodative monetary policy stance.

The outstanding credit to the private sector rose by 8.2 percent in 2019H1, compared to 1.8 percent growth in the corresponding period of 2018. During the same period, new authorized loans increased by 36.8 percent, from -3.3 percent, owed to an increased demand for loans reflecting a good economic performance.

The FRW depreciated by 2.2 percent against the USD by end June 2019, compared to 1.7 percent recorded in June 2018, in line with external sector developments. Growth of exports (7.5 percent) was outweighed by growth of imports (18.2 percent) which led to a wider trade deficit. High growth of imports was mainly observed in intermediate and capital goods, reflecting ongoing investments. Growth of exports was constrained by low international commodity prices. However, the foreign exchange market is expected to remain stable, with adequate foreign exchange reserves buffer.

Money market interest rates remained close to the central bank rate, on account of a continued proactive liquidity forecasting and management. In commercial banks, average lending and deposit rates slightly declined to 16.64 percent and 7.63 percent in 2019H1, from 16.98 percent 8.01 percent in 2018H1, respectively.

Real GDP grew by 8.4 percent in 2019Q1, as a result of good performance in industry sector (+18.1 percent), followed by services (+7.6 percent) and agriculture (+4.3 percent) sectors.

The Composite index of Economic Activities, points to a sustained economic performance in 2019Q2, consistent with the projection of 7.8 percent growth in 2019.

Going forward, Rwanda's aggregate demand in 2019 is expected to continue improving, supported by the accommodative monetary policy and a fiscal stimulus. Downward risks could potentially come from the Global economy, owing to intensified US-China trade tensions and prolonged uncertainties around Brexit. As result of these developments, global economic growth is projected to slow down from 3.6 percent in 2018 to 3.2 percent in 2019, before picking up to 3.5 percent in 2020.

The committee will continue monitoring developments in domestic and global economic conditions, and stands ready to take appropriate measures. The next MPC meeting is scheduled in November 2019.

I. GLOBAL ECONOMIC AND FINANCIAL DEVELOPMENTS

1.1 Economic Growth

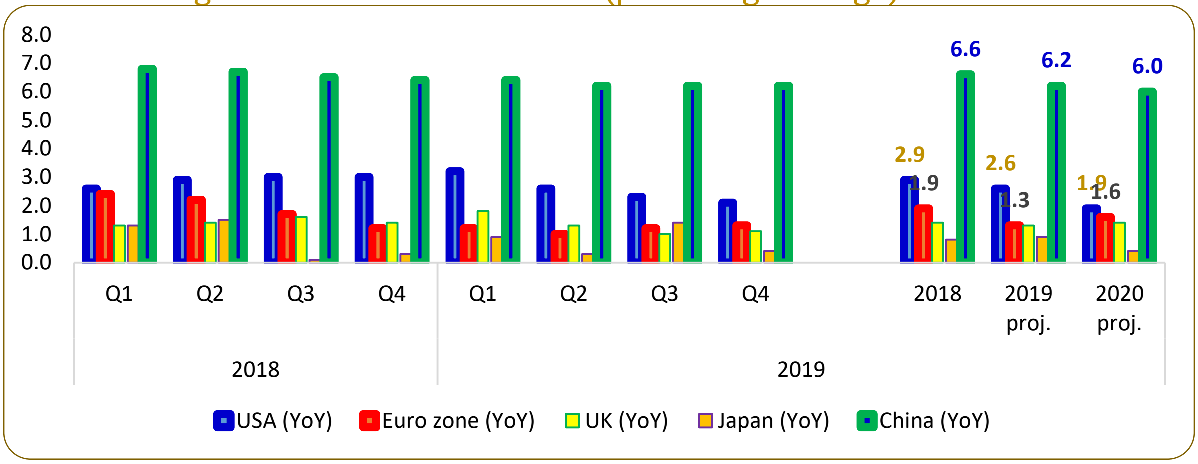
According to the IMF's July 2019 estimates, global growth is projected to slow down from 3.6 percent in 2018 to 3.2 percent in 2019 and to later pickup to 3.5 percent in 2020. Projected growth for 2019 and 2020 was revised down by 0.1 percentage point each, relative to April forecast.

In the first half of 2019, momentum in the global activity remained low, as a result of intensified US-China trade tensions, prolonged uncertainties on Brexit, and weaker than expected growth in emerging and developing economies, despite positive growth in advanced economies.

The projected pickup in global growth in 2020 will depend on supportive reactions from financial markets; continuous fading of temporary drags in the euro area; stabilization in some stressed emerging market economies, and avoidance of worse collapse in others.

Growth in advanced economies is projected at 1.9 percent in 2019 (0.1 percentage point higher than in April WEO), mostly reflecting an upward revision for the United States. Real GDP growth is projected to slow down to 1.7 percent in 2020 for advanced economies, despite an upward revision for the United States and Euro area.

Chart 1- GDP growth in selected countries (percentage change)



Source: BLOOMBERG and IMF, WEO, July 2019

In 2019Q1, the US economy grew by 3.2 percent (y-o-y), following high growth in exports (+3.7 percent) and contraction in imports (-3.7 percent), as well as strong investments (+8.6 percent). Growth is projected at 2.6 percent in 2019 (0.3 percentage point higher than in April forecast), reflecting stronger than anticipated first quarter performance. Real GDP growth is projected to moderate to 1.9 percent in 2020 as the fiscal stimulus unwinds.

After decelerating to 1.2 percent (y-o-y) in 2018Q4 from 1.7 percent in 2018Q3, GDP growth in Euro area stabilized at 1.2 percent in 2019Q1 and projected to decelerate to 1.0 percent in 2019Q2. Growth is expected to pick up in the second half of this year and into 2020, as external demand is projected to recover and temporary factors continue to fade. Therefore, the annual growth is projected at 1.3 percent in 2019 and 1.6 percent in 2020 (0.1 percentage point higher than in April forecast).

The United Kingdom's economy is set to grow at 1.3 percent in 2019 (0.1 percentage point higher than in April forecast), reflecting stronger than anticipated growth in the first quarter, boosted by pre-Brexit inventory accumulation and stockpiling. In 2019Q1, real GDP grew by 1.8 percent (y-o-y) from 1.4 percent in 2018Q4, driven by private and government consumption, and gross capital formation. The UK's economy is projected to grow at 1.4 percent in 2020.

Japan's economy is set to grow by 0.9 percent in 2019, from 0.8 percent in 2018, reflecting additional fiscal support that includes measures to mitigate the effects of the planned increase of the consumption tax rate in October 2019. However, growth is projected to decline to 0.4 percent in 2020.

In emerging and developing economies, growth is expected to slow down to 4.1 percent in 2019 (0.3 percentage point lower than in April forecast), before improving to 4.7 percent in 2020 (0.1 percentage point lower than in April forecast), reflecting downward revisions for major economies in that category such as China and India.

In China, the negative effects of escalating tariffs and weakening external demand have added pressure to an economy already amid a structural slowdown. In 2019Q2, the Chinese economy grew by 6.2 percent (y-o-y), lower than 6.4 percent in 2019Q1. Despite policy stimulus expected to support activity in the face of the adverse external shock, the Chinese economy is projected to slow down to 6.2 percent in 2019 and decelerate further to 6.0 percent in 2020.

India's economy is projected to grow by 7.0 percent in 2019 , picking up to 7.2 percent in 2020. The downward revision of 0.3 percentage point for both years, relative to April forecast, reflects a weaker than expected outlook for domestic demand.

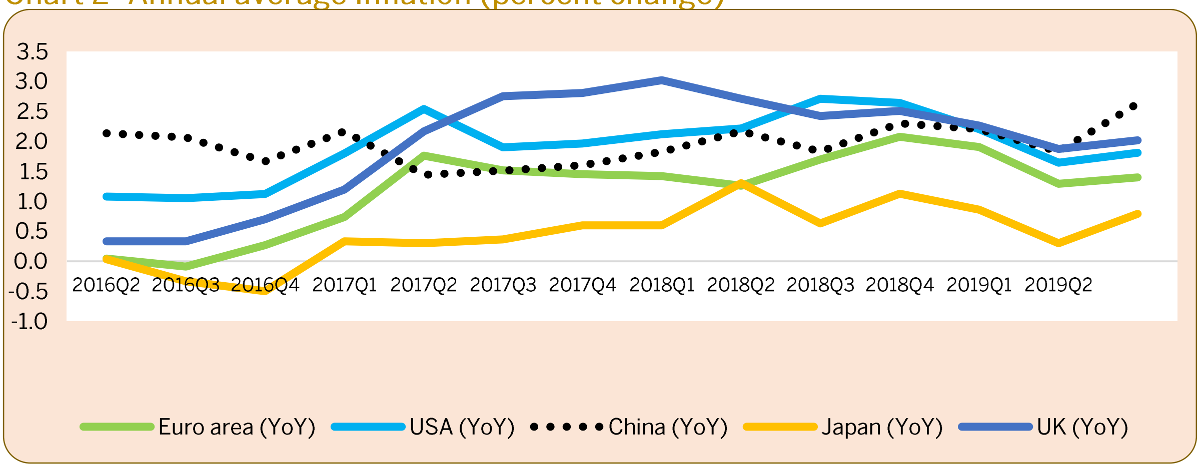
In Sub-Saharan Africa, growth is expected to increase from 3.1% in 2018 to 3.4 percent in 2019, and 3.6 percent in 2020 (0.1 percentage point lower for, both years than the April forecast). This improving performance is reflected in non-resource intensive and oil-exporting countries. However, growth in South Africa is expected to slightly decline in 2019 than projected in April forecast, following a weak first quarter, owing to a larger than anticipated impact of energy supply issues in mining and weak agricultural production.

In the East African Community (EAC), GDP growth is projected at 5.3 percent in 2019 and 5.4 percent in 2020, after 6.3 percent in 2018. Rwanda's economic growth stood at 8.4 percent in 2019Q1 from 9.6 percent in 2018Q4, and projected at 7.8 percent in 2019. In Uganda, GDP growth stood at 5.6 percent in 2019Q1 from 6.8 percent in 2018Q4, and projected at 6.3 percent in 2019. During the same period, Kenya's real GDP grew from 6.0 percent in 2018Q4 to 5.6 percent in 2019Q1, and projected at 5.8 percent in 2019. Tanzania's economic growth stood at 6.6 percent in 2019Q1 from 6.3 percent in 2018Q4, and projected at 4.0 percent in 2019. In Burundi, growth is projected to remain subdued at 0.4 percent in 2019, from 0.1 percent in 2018.

1.2 Inflation Developments

World annual average inflation is projected at 3.58 percent in 2019 and at 3.62 percent in 2020, from 3.64 percent in 2018, in line with falling commodity prices and softening global demand. Headline inflation has been subdued across most advanced and emerging market economies. Core inflation in most advanced economies has been below the target, and has dropped further below historical averages in many emerging and developing economies. In the first six months of 2019, monetary policy stayed accommodative in most advanced economies, with central bank rates remaining unchanged in the Eurozone, Japan and UK.

Chart 2- Annual average Inflation (percent change)



Source: National statistics offices

The US annual average inflation fell to 1.6 percent in June 2019 from 1.8 percent in the previous month, mainly due to a decline in energy prices. The core inflation edged up to 2.1 percent in June 2019, from 2.0 percent in the previous month.

The annual inflation rate in the Eurozone rose to 1.3 percent in June 2019 from 1.2 percent in the previous month, due to rising prices of food, alcohol & tobacco and services. The highest annual inflation rate was recorded in Germany (1.5 percent), followed by France (1.4 percent), Italy (0.8 percent), and Spain (0.6 percent). The annual core inflation was up to 1.1 percent in June 2019 from 0.8 percent in the previous month. The annual average inflation eased to 1.3 percent in 2019H1, after 1.5 percent in 2018H1.

The annual inflation rate in the United Kingdom was 2.0 percent in June 2019, unchanged from the previous month, as prices for transport, and housing & utilities declined, while food prices rose further. The annual core inflation rose to 1.8 percent in June 2019, from 1.7 percent the previous month.

Japan's annual inflation eased to 0.7 percent in June 2019, from 0.8 percent in the previous month, with a faster rise in food prices, offset by a steeper decline in transport and communication prices. The annual core inflation fell to 0.6 percent in June, from 0.8 percent in the previous month.

In China, inflation (y-o-y) stood at 2.7 percent in June 2019, unchanged from the previous month, with food prices rising the most since January 2012. The annual core inflation stabilized at 1.6 percent in June 2019. The annual average inflation slightly rose to 2.2 percent in 2019H1 compared to 2.0 percent in 2018H1.

In Sub-Saharan Africa, annual average inflation is projected to decline to 8.1 percent in 2019 from 8.5 percent in 2018, reflecting large decline in global energy prices.

In EAC, annual average inflation is projected at 3.9 percent in 2019, a slight increase from 3.6 percent in 2018. The stable and low inflation in the region results from good agriculture production due to favorable weather conditions.

Burundi’s annual average inflation was - 4.0 percent in June 2019, from a deflation of 2.4 percent in the previous month, as transport, food and, non-alcoholic beverages prices went down.

The annual average inflation in Kenya slightly rose to 5.7 percent in June 2019, from 5.5 percent in the previous month, mainly pushed up by food prices. Food inflation accelerated, while housing, transport and clothing prices increased at a slower pace. Transport inflation increased because of an increase in petrol and diesel pump prices. The annual average inflation increased to 5.2 percent in 2019H1, from 4.3 percent in 2018H1.

In Rwanda inflation eased to 0.7 percent in the first half of 2019 from 1.8 percent recorded in the same period of 2018, though it increased to 0.9 percent in June 2019 from 0.0 percent of the previous month. The decline in inflation was mainly reflected in food and energy deflation.

The annual average inflation in Tanzania increased to 3.7 percent in June 2019, from 3.5 percent in the previous month, amid rising prices of food, transport, and housing & utilities. Core inflation, which excludes food and energy, eased to 3.4 percent in June 2019, from 3.5 percent in the previous month. The annual average inflation eased at 3.3 percent in 2019H1, from 3.8 percent in 2018H1.

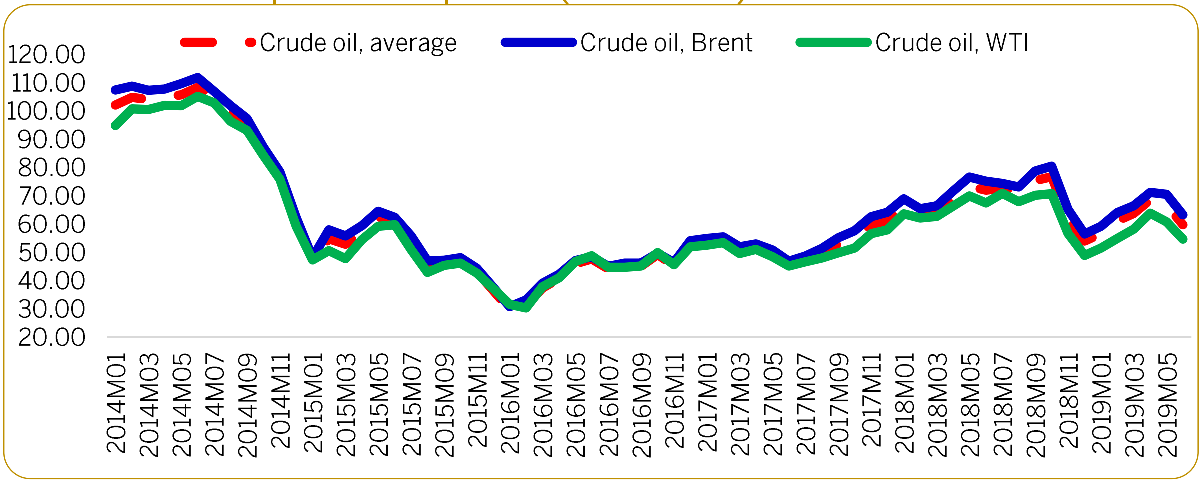
Uganda's headline inflation (y-o-y) edged up to 3.4 percent in June 2019, from 3.3 percent in the previous month, with an upward pressure mainly coming from communication and education, while prices eased for transport, and rebounded for food & non-alcoholic beverages. The core annual inflation rose to 4.9 percent in June, from 4.6 percent registered in the previous month. The annual average inflation in Uganda rose to 3.2 percent in 2019H1, from 2.1 percent in 2018H1.

1.3 Global Commodity Prices

In the first half of 2019, global commodity prices decreased, reflecting supply effects and softening global demand. Energy prices fell by 8.7 percent in the first half of 2019, compared to an increase of 30.3 percent in the corresponding period of 2018, while, non-energy commodity prices decreased by 7.0 percent, following a decline in prices of agricultural commodities, and metals & minerals.

In the first half of 2019, crude oil prices decreased by 7.7 percent on average, compared to an increase of 32.9 percent in the corresponding period of 2018. On a monthly basis, crude oil prices dropped by 10.6 percent in June 2019. Going forward, crude oil prices are projected to decrease by 4.1 percent in 2019, and decline further by 2.5 percent in 2020.

Chart 3 - Crude oil price developments (USD/barrel)



Source: World Bank commodity prices, July 2019

The decrease in non-energy commodity prices was attributed to agricultural commodities, and metals & minerals prices. Since August 2018, non-energy commodity prices slightly softened, partially due to subdued demand from China. In the first half of 2019, average prices for agriculture commodities decreased (-7.0 percent), due to the falling prices of beverages (-8.6 percent), of which Coffee Arabica (-7.6 percent), Coffee Robusta (-14.5 percent), and tea average auctions (-14.2 percent). During the same period, prices decreased by 7.8 percent for food, of which oils & meals (-15.8 percent) and other foods (-4.3 percent). Agricultural commodity prices are projected to decrease by 2.7 percent in 2019, attributed mainly to the projected falling prices of beverages by 4.6 percent; with Coffee Arabica, Coffee Robusta and tea average auction prices expected to decrease by 2.7 percent, 6.4 percent and 14.0 percent, respectively.

Metals & mineral prices decreased by 8.8 percent in the first half of 2019, compared to an increase of 16.5 percent in 2018H1, attributed to softening global demand, a strengthening US dollar, and growing trade tensions between US and China. Metals & mineral prices are projected to further decrease by 1.8 percent in 2019, a deeper decline than anticipated in the October 2018 forecast, but to slightly increase by 0.7 percent in 2020.

Prices for fertilizers went up by 9.9 percent in the first half of 2019, compared to an increase of 5.2 percent in the corresponding period of 2018, as a result of high import demand from Brazil and India. Prices for fertilizers are projected to decelerate, increasing by 4.7 percent in 2019, and 1.7 percent in 2020, due to modest global demand growth.

1.4 Monetary policy and financial markets

Monetary policy remained accommodative in most advanced economies, with central bank rates remaining unchanged in major economies. The US Federal Reserve has cut interest rates by 0.25 basis points on 31st July 2019, and signaled willingness to provide more support amid slower economic growth. The European Central Bank confirmed that monetary policy would remain amply accommodative, with no increase in policy rates in 2019.

In June 2019, the ten- year government bond rates decreased in USA, UK, Japan and Eurozone to 2.01 percent, 0.83 percent, -0.16 percent, and -0.33 percent, respectively, from 2.86 percent, 1.28 percent, 0.30 percent, and 0.04 percent in June 2018.

The three-month deposit rates remained negative in the Eurozone and Japan, standing at -0.385 percent and -0.245 percent in June 2019, respectively. In the USA and UK, deposit rates decreased to 2.3 percent and 0.8 percent, respectively, from 2.8 percent and 0.9 percent in December 2018.

1.5 Foreign Exchange Markets

On the foreign exchange market, the US dollar is appreciating against major currencies, notably the Euro and British Pound, while weakening against the Japanese Yen. Compared to December 2018, the US dollar appreciated by 0.81 percent against the Euro, and by 0.46 percent against the British Pound in June 2019, from respective appreciation of 2.74 percent and 2.30 percent in June 2018. However, the dollar depreciated by 1.68 percent against the Japanese Yen, from a depreciation of 1.71 percent in June 2018.

II. DOMESTIC ECONOMY

2.1 Domestic Demand and Output

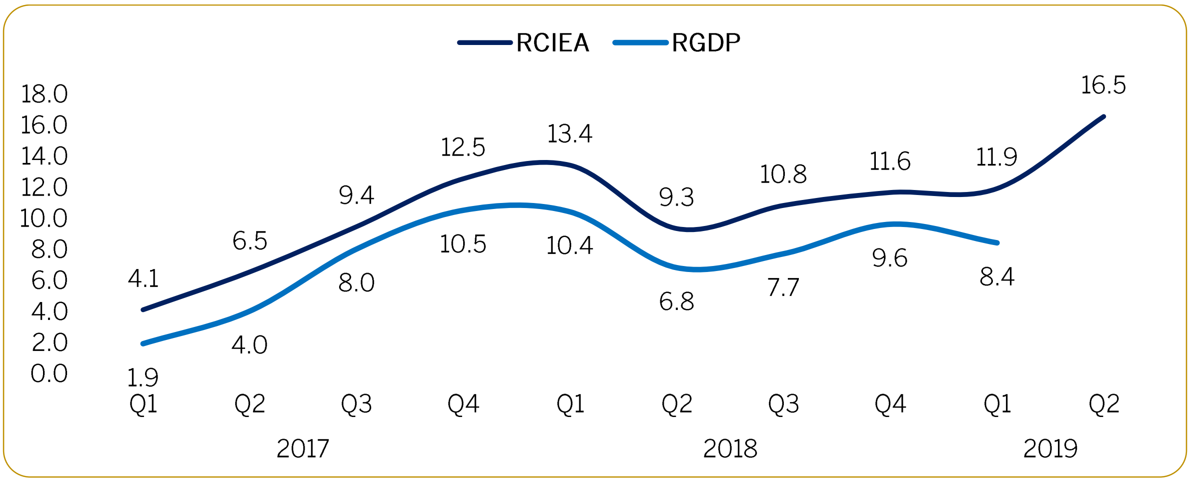
The Rwandan economy recorded a growth of 8.4 percent in 2019Q1, from 10.4 percent registered in 2018Q1. The Composite Index of Economic Activities (CIEA) points to a sustained good economic performance in 2019Q2, consistent with the initial projection of 7.8 percent GDP growth in 2019.

2.1.1 Output and the Near-Term Outlook

The real GDP growth recorded in 2019Q1 resulted from the good performance in industry sector (+18.1 percent), followed by services (+7.6 percent) and agriculture (+4.3 percent) sectors.

The high performance recorded by the industry sector in 2019Q1, was mostly reflected in the construction sub-sector, which increased by 30.5 percent on the back of on-going infrastructure projects. Moreover, the industry sector was supported by manufacturing industries, especially industries producing construction materials. Non-metallic mineral products (including cement) increased by 21.1 percent, Metal products, machinery and equipment by 11.0 percent and Chemicals, rubber & plastic products by 10.2 percent. Additionally, Textiles, clothing & leather sub-sector continued to improve, recording a growth of 15.1 percent in 2019Q1 on top of 24.5 percent of 2018Q1.

Chart 4- Quarterly real GDP growth vs CIEA (% change, y-o-y)



Source: NBR, Monetary Policy Department

The good performance of services sector was mainly driven by Trade and Transport services (+8.8 percent), Financial services (+13.7 percent), Administrative and Support service activities (+15.2 percent), and Professional, Scientific and Technical activities (+25.4 percent). Administrative & Support services were boosted by the performance of

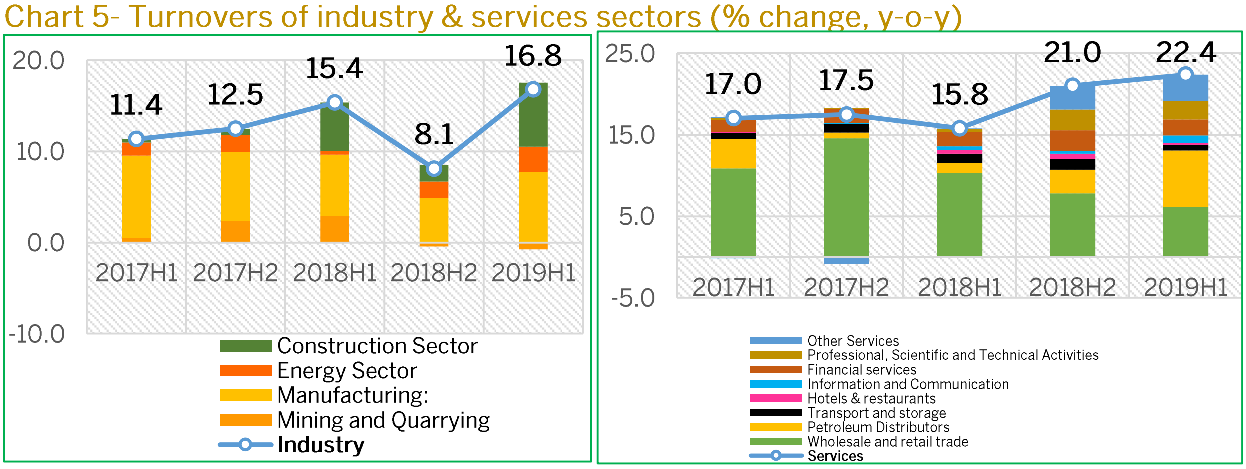
Travel agents and Tour operators that increased by 14.3 percent in 2019Q1. Professional, Scientific and Technical activities expansion was led by Architectural and Engineering services, with a growth of 63.0 percent in 2019Q1, from 48.1 percent in 2018Q1, consistent with the surge in construction activities.

The agriculture sector recorded a growth of 4.3 percent in 2019Q1, from 8.5 percent in 2018Q1, supported by good weather conditions. However, the sector's growth was limited by the decline in export crops, mainly due to the production of tea, which decreased by 7.2 percent in 2019Q1, from an increase of 22.8 percent in 2018Q1. Tea represents 24.9 percent of total exports crops, and its production fell as tea trees were cut for rejuvenation.

During 2019Q2, the CIEA in real term increased by 16.5 percent, from 11.9 in 2019Q1 and 9.3 percent in 2018Q2; signaling good economic performance over this period. The growth over the first half of 2019 stood at 14.3 percent, against 10.5 percent in the corresponding period of 2018.

The total turnovers of industry and service sectors increased by 21.0 percent in 2019H1, from 15.7 percent during the same period of 2018, and construction activities and related services remain the main drivers.

Chart 5- Turnovers of industry & services sectors (% change, y-o-y)



Source: NBR, Monetary Policy Department

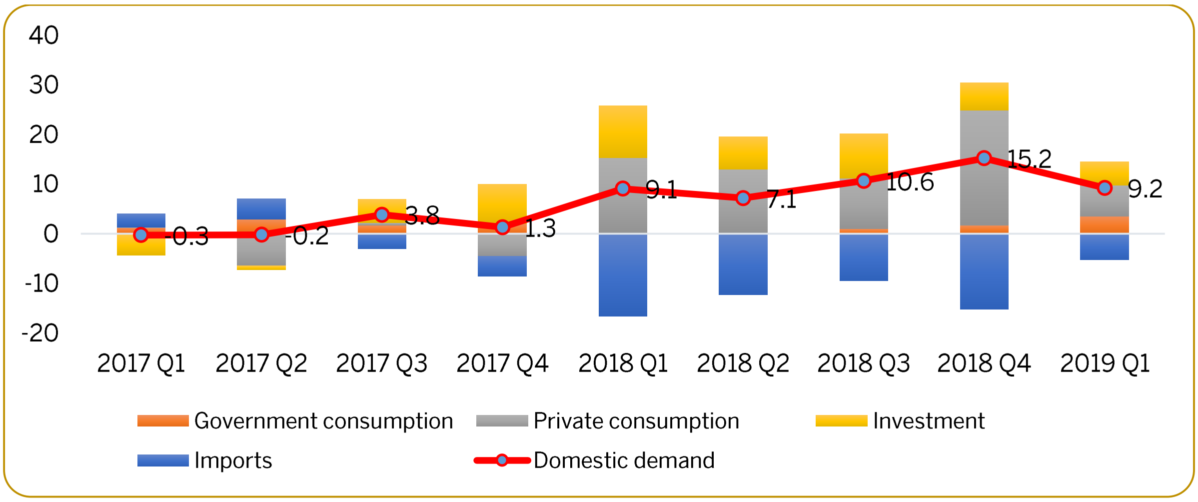
Industry sector's turnovers grew by 16.8 percent in 2019H1, supported mainly by construction and manufacturing sub-sectors. Construction activities related turnovers expanded by 23.5 percent in the first half of 2019, supported by construction projects, such as Kigali Arena stadium and road network upgrade in Kigali and upcountry. Moreover, sales of metal and cement industries increased by 20.4 percent and 50.4 percent respectively. This supported the manufacturing sub-sector (+14.9 percent), outweighing the decline of 17.5 percent and 1.3 percent in coffee and tea companies as well as milling industries respectively, from a growth of 19.2 percent and 28.5 percent.

The service sector's performance (+22.4 percent) was mainly led by petroleum distributors (+52.1 percent), financial services (+14.7 percent), as well as trade and transport services (+11.7 percent).

2.1.2 Domestic demand

Domestic demand remained strong in 2019Q1, growing by 9.2 percent mainly driven by high growth in investment and improvement in total final consumption.

Chart 6- Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

Gross capital formation increased by 12.5 percent in 2019Q1, mainly supported by the increase in construction investment (+30.6 percent in 2019Q1 from 8.2 percent in 2018Q1), representing 61.9 percent of total investment. The high growth in construction investment was underpinned by on-going construction projects.

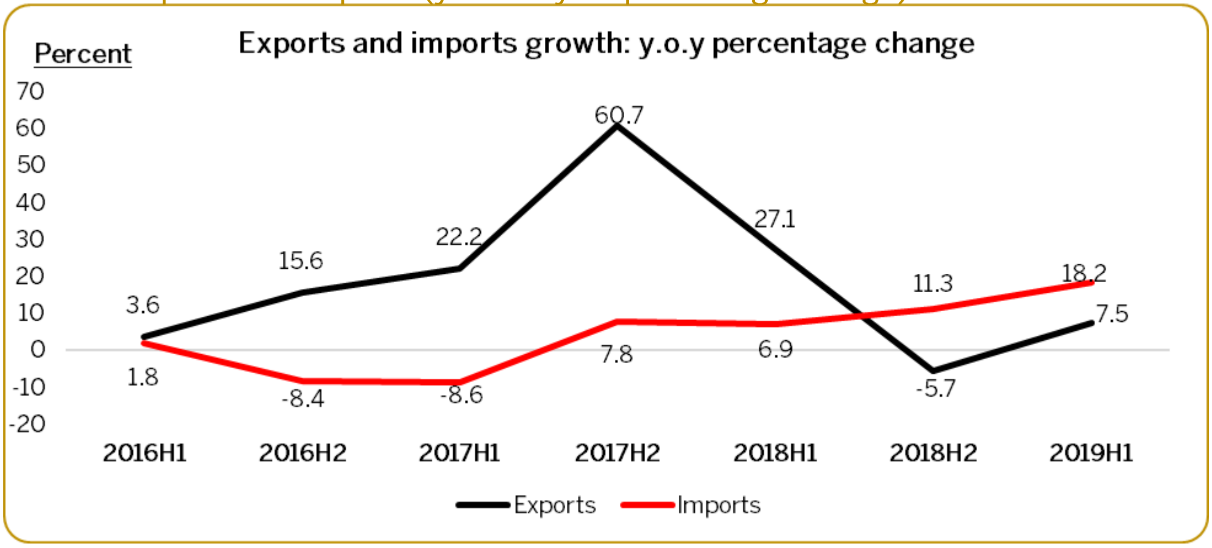
The growth of total final consumption reached 8.8 percent in 2019Q1, supported by government consumption, which increased by 20.6 percent from a decline on 0.4 percent in 2018Q1.

2.2 External Sector Developments

Rwanda's exports continue to grow, rising by 7.5 percent to USD 577.8 million in the first half of 2019. This increase was mainly driven by good performance of non-traditional exports (+25.2 percent), and re-exports (+18.9 percent), which offset the fall in traditional exports that resulted from weakening external demand. On the other hand, imports grew by 18.2 percent, mainly explained by high domestic demand of capital goods, from ongoing projects, and intermediary goods. As a result, Rwanda's trade deficit increased from USD

601.4 million in 2018H1 to USD 767.9 million in 2019H1. These developments produced mild pressures on the depreciation of the Rwandan Francs (FRW) against the US dollar.

Chart 7- Exports and imports (year-on-year percentage change)



Source: Statistics Department

In 2019, the current account deficit is expected to widen to 9.6 percent of GDP from 7.9 percent of GDP in 2018, partly due to continued higher imports reflecting the rise of domestic demand and a lower exports growth due to slowdown in external demand.

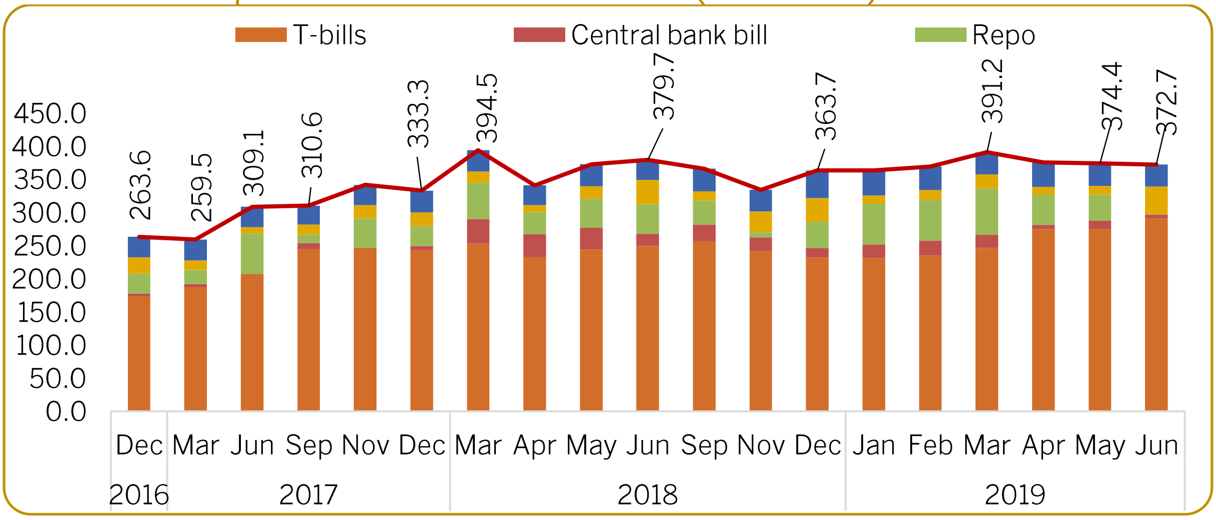
The Rwanda's current account deficit will continue to be financed by steady rise of capital inflows, including Foreign Direct Investment (FDI) and external borrowings. As a result, Rwanda will continue to build-up its forex exchange reserves, with the reserves in months of imports of goods and services expected to remain above 4 months.

III. FINANCIAL AND MONETARY DEVELOPMENTS

3.1 Banking System Liquidity Conditions

In June 2019, the growth of the most liquid assets slowed down to 2.4 percent, from FRW 363.7 billion in December 2018 to FRW 372.7 billion, compared to the growth of 13.9 percent recorded during the same period of the previous year. This is attributed to more demand of foreign currency consistent with the increase of imports of capital and intermediary goods and low increase in net fiscal injection. Comparing 2019H1 to 2018H1, net fiscal injection increased by 0.6 percent. During the same period, commercial banks purchased more foreign currency from NBR, equivalent to USD 143.7 million (FRW 127.6 billion) from USD 96.6 million (FRW 82.4 billion).

Chart 8- Most liquid assets of commercial banks (FRW billion)



Source: NBR, Financial Markets Department

3.2 Monetary Policy and Interest Rates

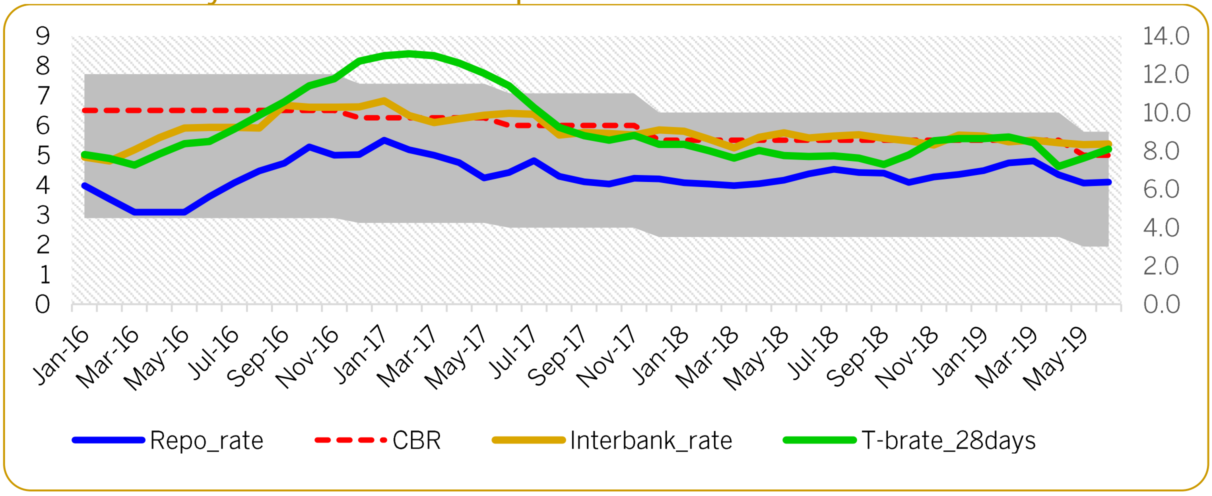
After NBR cut its monetary policy rate from 6.0 percent to 5.5 percent in December 2017, the central bank rate (CBR) was kept unchanged until the MPC decided to cut it further to 5.0 percent in May 2019. As a result, nominal short-term interest rates continued to move gradually around the CBR.

3.2.1 Money market rates converged towards the CBR

Money market interest rates continued to stabilize around the central bank rate. Interbank rate declined to 5.45 percent on average in 2019H1, from 5.64 percent on average in 2018H1. However, average repo and T- bill rates grew to 4.42 percent and 5.22 percent in 2019H1, from 4.11 percent and 5.09 percent in 2018H1 respectively.

It is important to highlight that, in 2019Q2, the repo, interbank and T- bill rates declined by 3, 27 and 13 basis points, respectively, following the MPC's decision to cut the CBR by 50 basis points in May 2019.

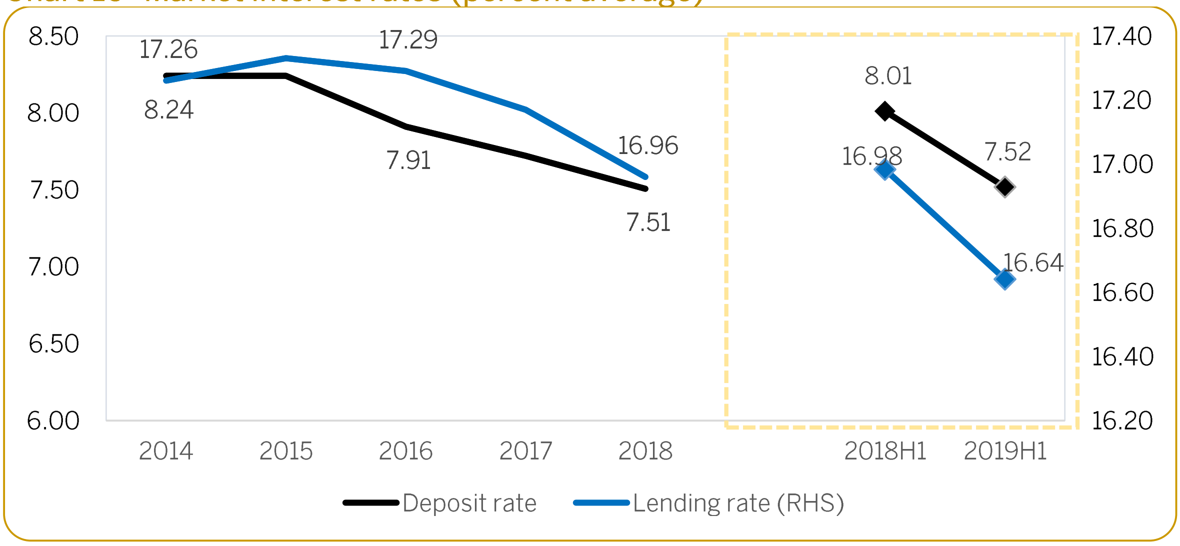
Chart 9- Money market rates developments



Source: NBR, Financial Markets Department

The market rates followed the downturn trend in money market rates. Deposit rate declined by 49 basis points, decreasing to 7.52 percent on average in 2019H1, from 8.01 percent in 2018H1. Similarly, lending rate dropped by 34 basis points, to 16.64 percent, from 16.98 percent during the same period.

Chart 10- Market interest rates (percent average)



Source: NBR, Financial Stability Directorate

3.3 Exchange Rate Developments

Relative to December 2018, the FRW depreciated by 2.2 percent against the USD by end June 2019, higher than a depreciation of 1.7 percent registered in the same period of 2018, following the relatively high import bill from ongoing infrastructure projects. However, this depreciation remains moderate and consistent with the revised projection of around 4.8 percent for the whole year 2019, but higher than 4.0 percent recorded in 2018.

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

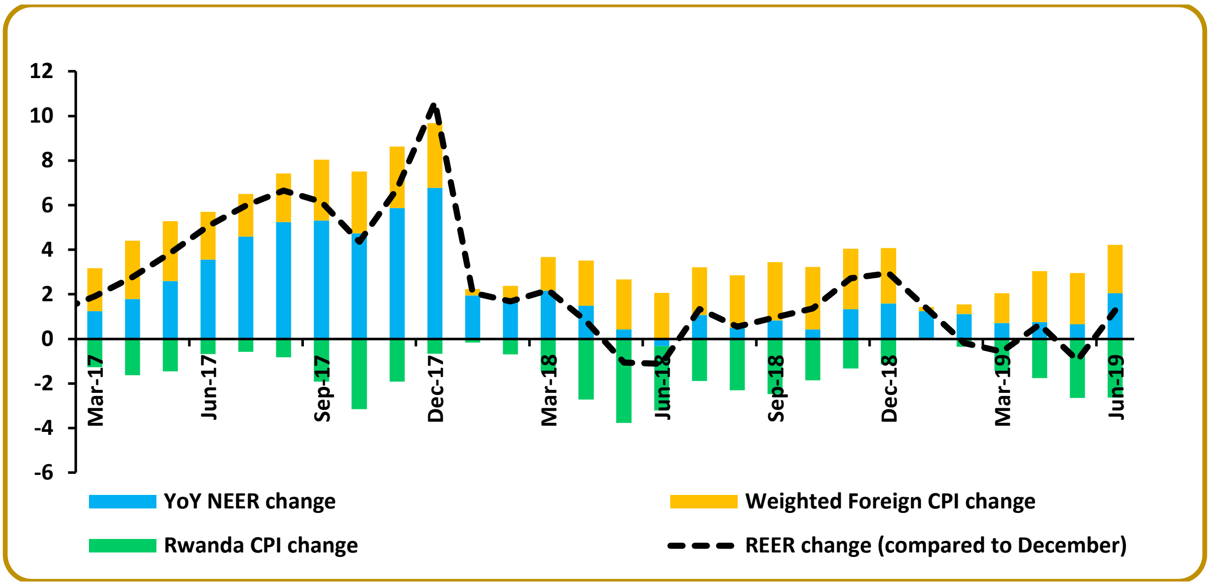
	FRW/USD	FRW/GBP	FRW/EUR	FRW/JPY	FRW/KES	FRW/TZS	FRW/UGS	FRW/BIF
Dec-2011	1.6	1.5	-0.4	7.3	-2.0	-5.8	-3.9	-2.2
Dec-2012	4.5	10.0	7.7	-5.2	3.4	4.7	-2.6	-11.5
Dec-2013	6.1	8.0	10.2	-13.4	5.3	6.2	11.7	4.9
Dec-2014	3.6	-2.4	-8.5	-9.7	-2.8	-7.0	-6.7	1.0
Dec-2015	7.6	2.8	-3.2	7.8	-4.6	-13.5	-11.6	10.0
Dec-2016	9.7	-9.2	5.3	13.4	9.6	8.6	2.3	-0.2
Jun-2017	1.3	7.5	10.4	5.4	0.0	-1.4	2.0	-1.0
Dec-2017	3.1	13.2	16.9	6.6	2.3	0.4	2.7	-1.0
Jun-2018	1.7	-0.9	-0.4	3.6	4.0	-0.1	-4.7	1.5
Sep-2018	2.9	-0.1	0.6	2.1	5.2	0.6	-2.4	2.0
Dec-2018	4.0	-2.0	-0.1	6.2	5.5	1.2	1.8	1.9
May-2019	1.8	1.2	-0.9	3.1	2.3	1.8	0.2	-0.4
Jun-2019	2.2	2.0	1.6	4.8	1.8	2.2	2.6	-0.2

Source: NBR, Monetary Policy and Research Directorate

Compared to the British pound, Euro and Japanese yen, the FRW depreciated by 2.0 percent, 1.6 percent and 4.8 percent respectively. Compared to the regional currencies, it depreciated by 1.8 percent, 2.2 percent and 2.6 percent against the Kenyan, Tanzanian and Ugandan shillings, respectively, while it appreciated by 0.2 percent against the Burundian franc.

In real effective terms, compared to December 2018, the FRW depreciated by 1.3 percent by end June 2019, from an appreciation of 1.1 percent registered in June 2018. This is mostly attributed to the depreciation of the nominal value of the FRW against most currencies of major trading partners. In nominal effective terms, it depreciated by 2.0 percent compared to an appreciation of 0.3 percent at the end of June 2018.

Chart 11- Drivers of REER movement



Source: NBR, Monetary Policy and Research Directorate

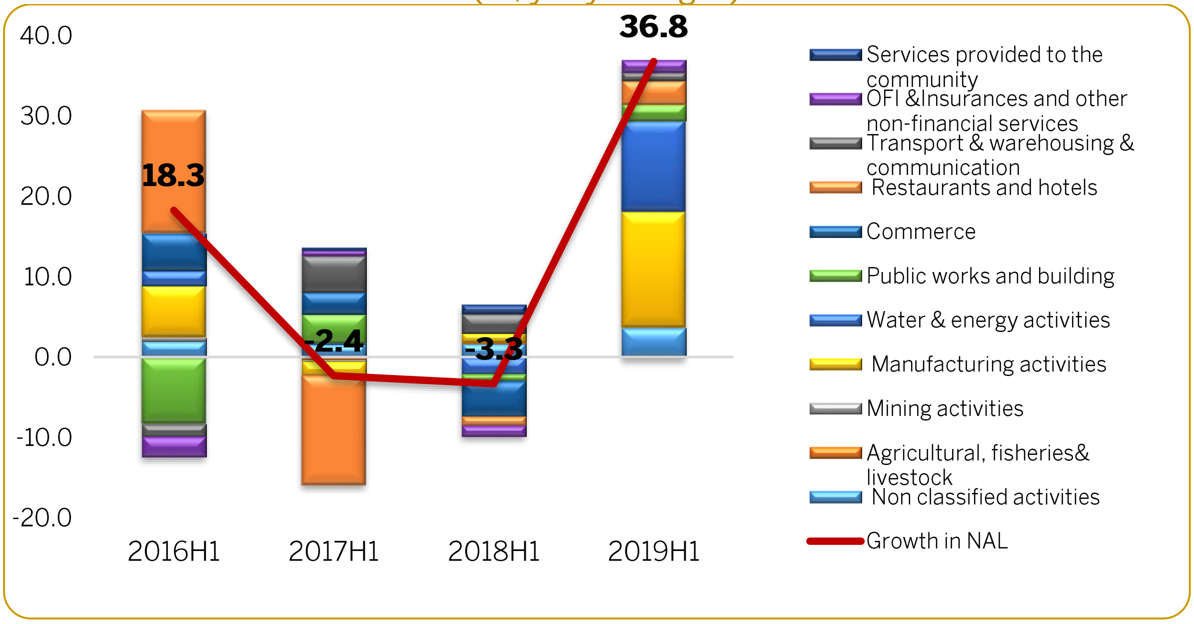
3.3.1 Foreign Exchange Market Developments

By end June 2019, net foreign assets of commercial banks decreased by FRW 1.6 billion, to a stock of FRW 80.6 billion from FRW 82.2 billion accumulated end June 2018. Consequently, due to the high demand of dollars from ongoing big projects, NBR increased its sales of US dollars to commercial banks by 48.6 percent in 2019H1, from USD 96.6 million end June 2018 to USD 143.5 million end June 2019.

3.4 Credit

The outstanding credit to the private sector increased by 8.2 percent in 2019H1, compared to 1.8 percent increase in 2018H1. New authorized loans (NALs) picked up by 36.8 percent in 2019H1, from -3.3 percent in 2018H1, due to an increase in demand for loans (52.4 percent in number and 28.3 percent in value), and a reduction in loan's rejection rate (12.1 percent from 27.9 percent). The growth observed in NALs is mainly reflected in Manufacturing (176.3 percent in 2019H1 from 16.4 percent in 2018H1), restaurants and hotels (385.0 percent in 2019H1 from -60.0 percent in 2018H1), and Water & Energy sectors (23,602.0 percent in 2019H1 from -97.8 percent in 2018H1).

Chart 12- Contributions of sectors of activity to the growth of new authorized loans (%, y-o-y changes)



Source: NBR, Financial Stability Directorate

3.5 Money

During the first six months of 2019, M3 rose by 6.8 percent, with demand deposits contributing the most. In 2019H1, total deposits increased by 6.5 percent from a growth of 8.1 percent in 2018H1, while the currency in circulation grew by 9.7 percent from a growth of 11.6 percent in 2018H1.

Table 2: Deposits (FRW million)

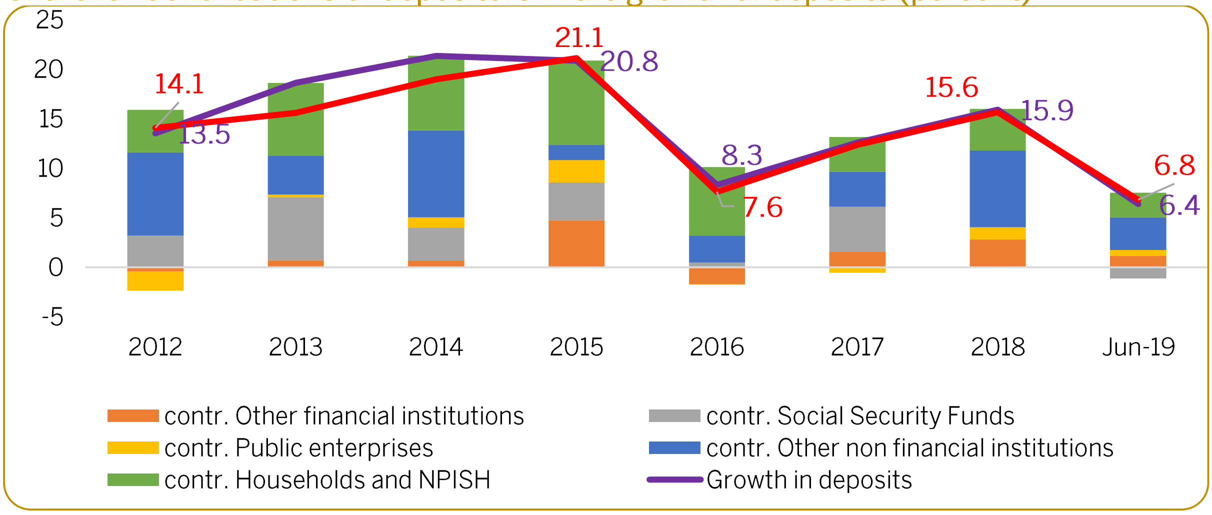
	2015	2016	2017	2018	Jun-19
Demand Deposits	614.6	587.9	647.3	770.9	825.1
Term Deposits	469.0	532.4	583.1	603.3	695.2
Foreign Deposits	255.9	328.5	398.5	514.0	491.4
Total Deposits	1339.5	1448.8	1628.9	1888.2	2011.7

Source: NBR, Statistics Department

Turning to the depositors' breakdown, the biggest contribution came from other non-financial corporations, with a growth of 11.1 percent. Deposits from social security funds decreased by 7.7 percent, reflecting their preference to invest in government securities. In this regard, non-banks investment grew in both T-bills (FRW 127.3 billion in June 2019 from

FRW 111.1 billion in December 2018), and T-bonds (FRW 204.4 billion in June 2019 from FRW 153.9 billion in December 2018).

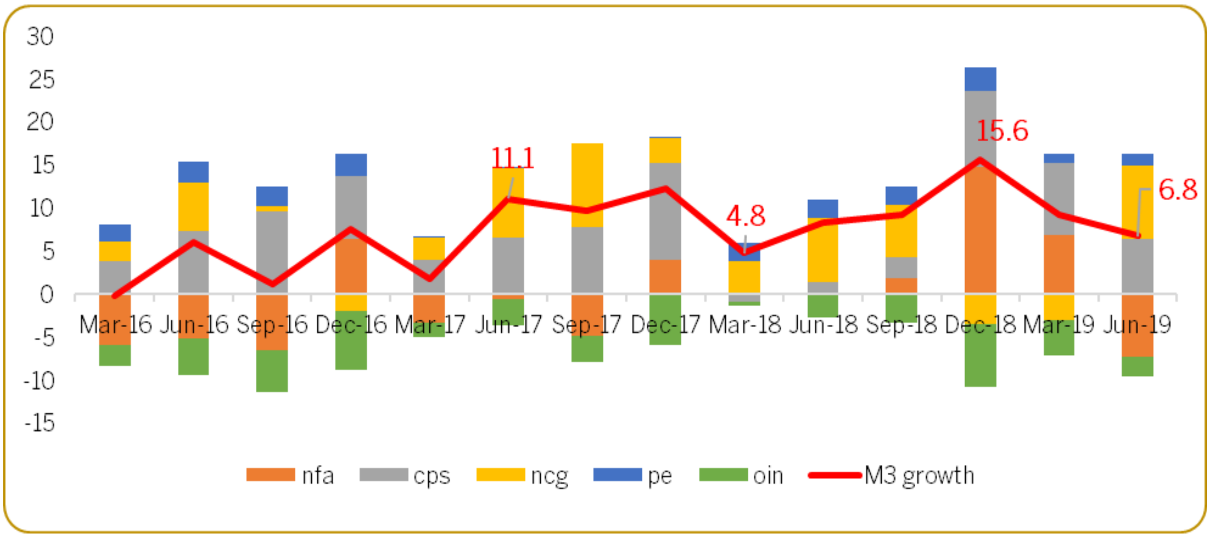
Chart 13- Contributions of depositors in the growth of deposits (percent)



Source: NBR, Monetary Policy and Research Directorate

Looking at M3 counterparts, Net domestic assets (NDA) was the main driver behind M3 growth, increasing by 28.9 percent. In 2019H1, Net credit to government (NCG) grew significantly, from a combination of an increase in domestic debt and a drawdown in deposits. Thus, making NCG the main contributor to NDA growth, followed by the credit to private sector (CPS) with a growth of 8.2 percent.

Chart 14 - M3 growth (percent)

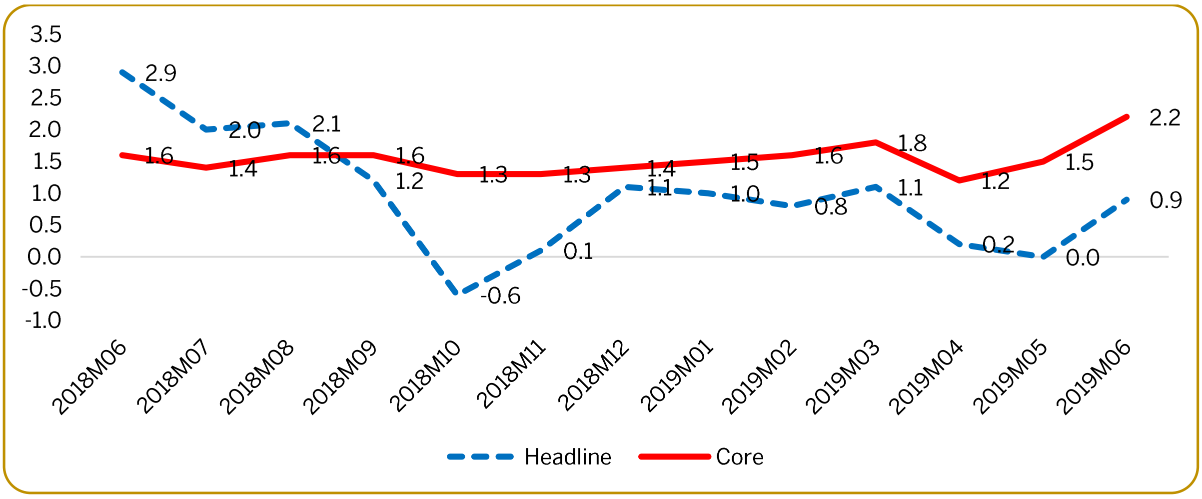


Source: NBR, Monetary Policy and Research Directorate

IV. INFLATION DEVELOPMENTS AND OUTLOOK

Headline inflation eased to 0.7 percent in 2019H1, from 1.8 percent recorded in the same period of 2018, though it increased to 0.9 percent in June 2019, from 0.0 percent in the previous month. The decline in headline inflation was mainly reflected in food, and energy deflation. Core inflation picked up in May and June 2019, but it relatively stabilized at 1.6 percent in 2019H1, from 1.8 percent in 2018H1.

Chart 15-Headline and core Inflation developments (%, Y-o-Y)



Source: NBR, Monetary Policy and Research Directorate

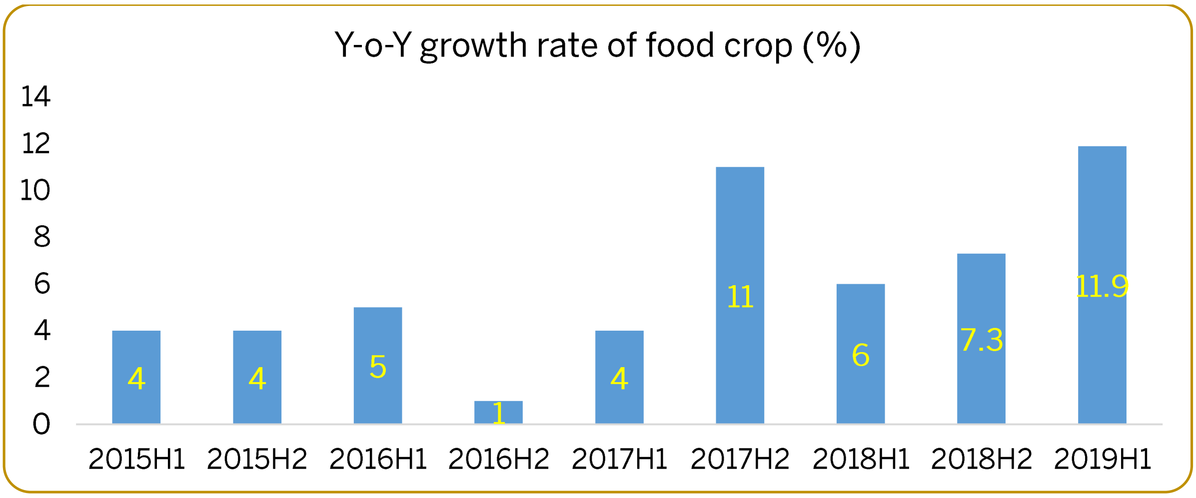
4.1 Drivers of inflation

4.1.1 Food inflation

In 2019H1, on average, food inflation continued to decelerate up to -3.1 percent, from -0.6 percent in 2018H1. The decline in food inflation was observed in vegetables inflation, which dropped from -1.5 percent to -7.9 percent, and fruits inflation that fell from -0.6 percent to -11.4 percent during the same period.

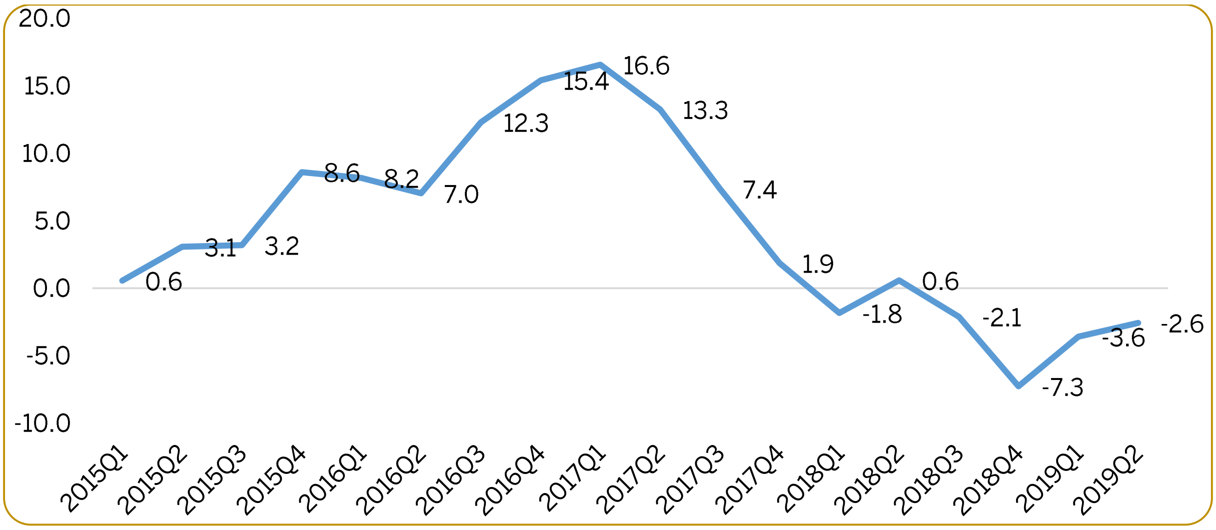
The drop-in vegetables inflation was caused by good agricultural production recorded in season A (Sept 2018-Feb 2019), where by the growth in food crops was 11.9 percent in 2019H1, from 6.0 percent recorded in 2018H1. Market survey organized by the National Bank of Rwanda in June 2019, on food prices, indicated that vegetable prices may gradually rise in the next months, as the dry season sets in.

Chart 16-Food crop production



Source: NBR, Monetary Policy and Research Directorate

Chart 17-Food prices inflation



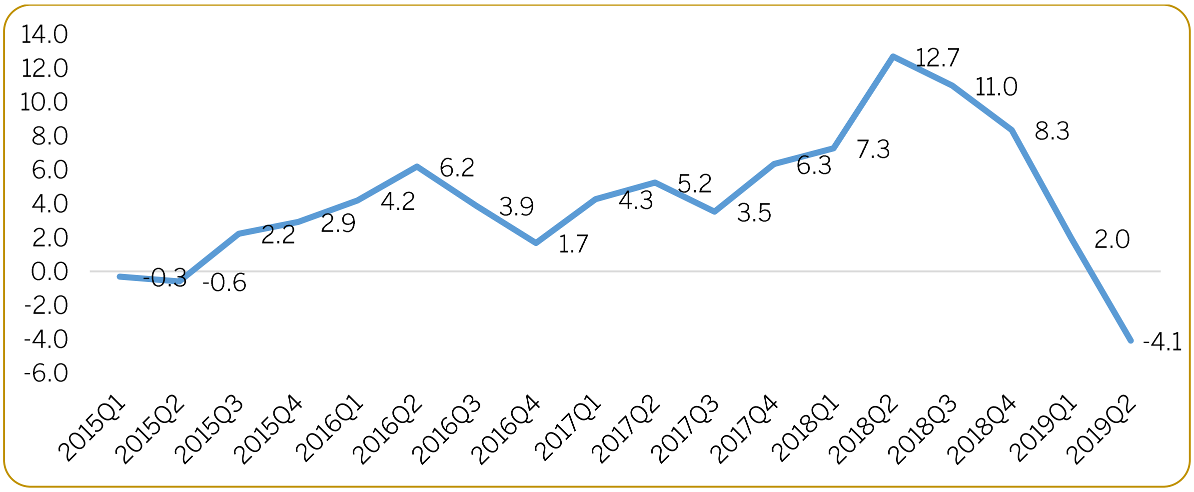
Source: NBR, Monetary Policy and Research Directorate

4.1.2 Energy inflation

Energy inflation eased to -1.0 percent in 2019H1, from 10.0 percent recorded in 2018H1, mainly reflecting a decline in charcoal and firewood prices which account for roughly 50 percent in energy. This decline observed in energy inflation was also reflected in housing inflation that dropped from 3.4 percent to 0.6 percent during the same period.

The downward trend observed in solid fuels (charcoal and firewood) prices started from 2018Q2 (20.9 percent), 2018Q3 (14.7 percent), 2018Q4 (10.6 percent), 2019Q1 (3.4 percent) and ended at (-8.5 percent) in 2019Q2. This persistent decline in solid fuels' inflation resulted from an increase in the issuance of forests harvesting permits. The increase in permit issuance was in line with weather conditions that were favorable for environmental protection in the process of charcoal burning. The market survey reveals that prices of charcoal and firewood are likely to increase in 2019Q3, due to fewer harvesting permits issued during the dry season. Regarding other energy components, fuels & lubricants that cover 26 percent in energy inflation, caused no pressures on local pump prices, reducing from FRW 1055 per liter in 2018H1 to FRW 1040 per liter in 2019H1 on average.

Chart 18-Energy inflation

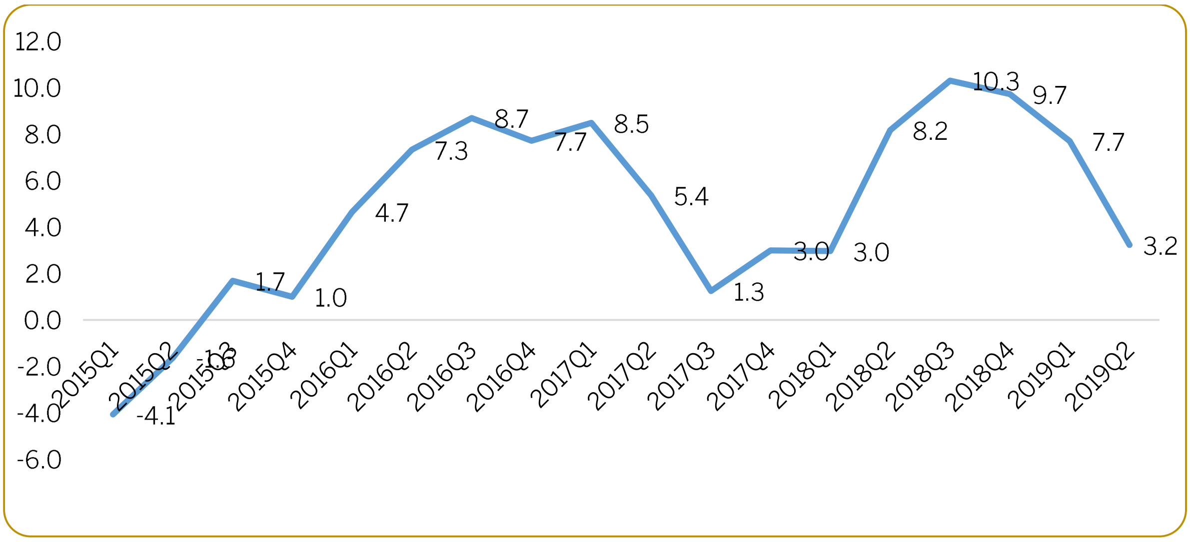


Source: NBR, Monetary Policy and Research Directorate

4.1.3 Transport inflation

In 2019H1, transport inflation remained stable at 5.5 percent compared to 2018H1, unlike other main components of headline inflation. The stability in transport inflation resulted from the phasing out of the increase in public transport fares that occurred in April 2018.

Chart 19-Transport inflation

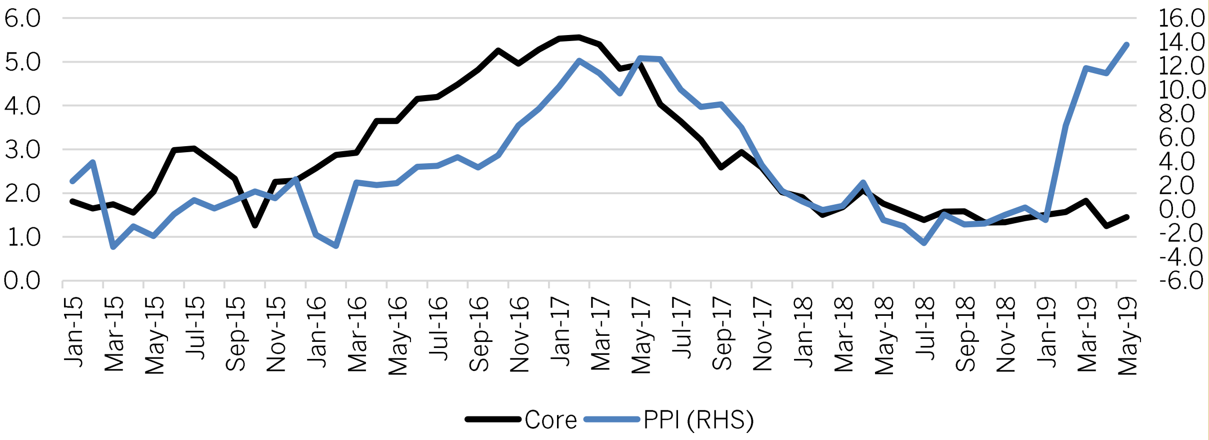


Source: NBR, Monetary Policy and Research Directorate

4.2 Core inflation

The relative stability recorded in core inflation (1.6 percent in 2019H1 from 1.8 percent in 2018H1), is in line with the trend observed in costs of production as evidenced by the Producer Price Index (PPI), which measures the costs of producing domestic consumer goods. It directly affects retail prices, and therefore serves as a good leading indicator of pressures, especially on core inflation. The upward revision in water tariffs in Feb-March 2019, led to a hike in PPI observed during the same period. However, this hike did not fully transmit into a higher increase in core inflation, because water does not have significant weight in CPI basket, as it does in PPI.

Chart 20-Core inflation and PPI (Y-o-Y, % change)



Source: NBR, Monetary Policy and Research Directorate

Table 3: Developments in inflation (Y-o-Y, % change)

	2018		2019						
	2018H1	2018H2	Jan	Feb	Mar	Apr	May	June	2019H1
Headline	1.8	1.0	1.0	0.8	1.1	0.2	0.0	0.9	0.7
Domestic	0.9	0.1	0.5	0.2	0.8	-0.4	-0.7	0.0	0.1
Food	-0.6	-4.6	-4.3	-4.1	-2.4	-3.1	-3.0	-1.6	-3.1
Vegetables	-1.5	-8.1	-7.1	-7.0	-4.4	-7.1	-10.8	-10.8	-7.9
Meat	1.5	4.3	6.7	7.8	10.4	9.0	13.6	14.8	10.4
Fruits	-6.1	-11.5	-15.7	-15.1	-14.6	-12.8	-6.4	-4.0	-11.4
Bread & Cereal	3.1	-2.1	-1.8	-1.4	0.3	1.1	1.9	2.9	0.5
Housing	3.4	3.3	2.6	1.2	1.1	0.0	-1.3	0.0	0.6
Transport	5.6	10.0	8.2	8.2	6.8	3.0	3.5	3.2	5.5
Imported	4.7	4.1	2.7	2.6	2.2	2.0	2.5	3.7	2.6
Core	1.8	1.4	1.5	1.6	1.8	1.2	1.5	2.2	1.6
Energy	10.0	9.7	4.7	1.1	0.2	-3.3	-6.0	-2.9	-1.0

Source: NBR, Monetary Policy and Research Directorate

4.3 Inflation Outlook

4.3.1 Assumptions and risks

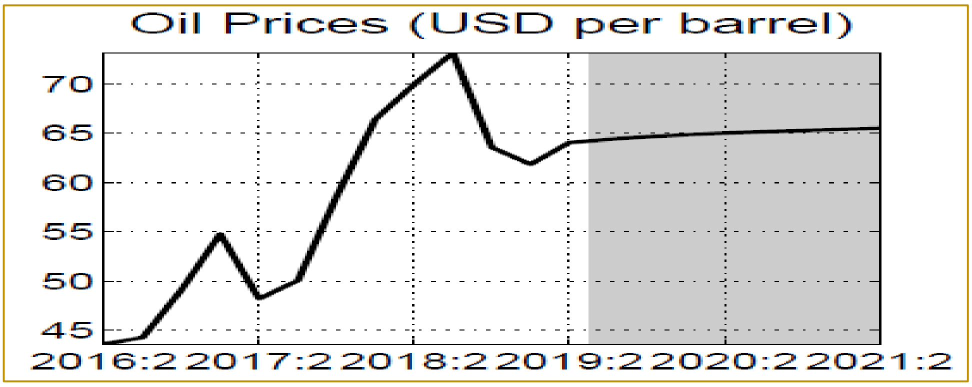
Assumption 1: Near-term Forecasts for food and solid fuels prices

Price expectation surveys indicated that the climate changes will continue to affect agricultural performance and forests harvesting (charcoal burning and firewood). Surveys revealed that rainfall in 2019Q3 will be below normal. Therefore, food production is expected to reduce, leading to a slight increase in food prices. Exception may come from horticulture and food items produced in marshlands. Similarly, solid fuels (charcoals and firewood) production is expected to decline following the above-mentioned dry season as forests extraction permits reduce, pushing prices up.

Assumption 2: International oil prices remain non-inflationary for 2019

Global oil prices dropped in May and June 2019, leading to the decline of local pump prices effective July 2, 2019. In July 2019, International Monetary Fund (IMF) reassessed markets prospects for oil prices. Despite geopolitical tensions and continued uncertainty around Brexit, having an effect on oil prices, the new projections indicated that oil prices are likely to remain stable around the current levels for the rest of 2019, evolving around $65.52 per barrel in 2019 and $63.88 in 2020. Consistently, inflationary pressures from global oil prices may be subdued.

Chart 21-Global oil prices



Source: Research Department

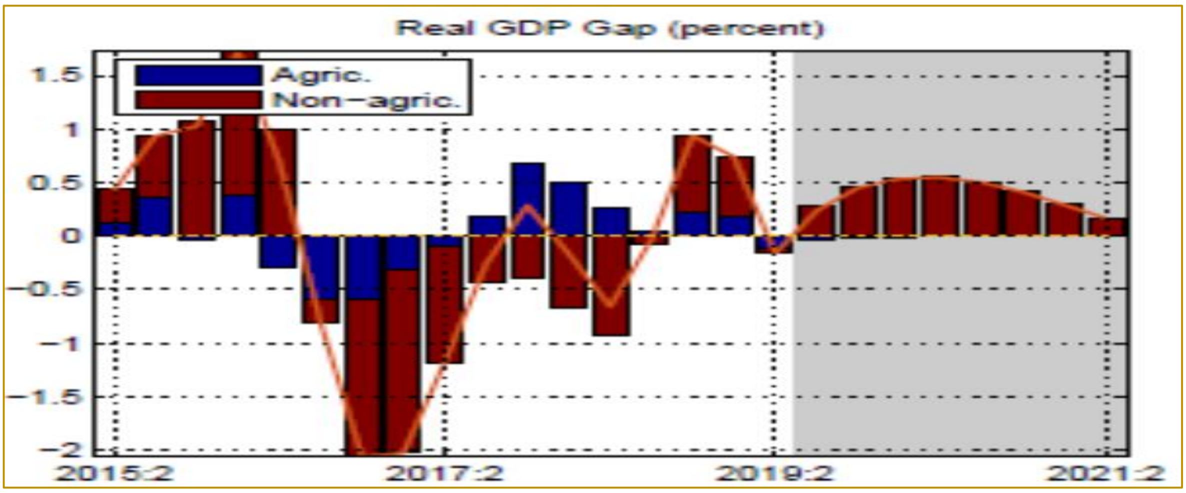
Assumption 3: Exchange rate depreciation will continue to reflect external sector developments for 2019

In June 2019, projections for exchange rate depreciation was revised down to 4.78 percent by the end of 2019 from 5.1 percent projected in the beginning of 2019. The implication is that downward pressures of exchange rate depreciation might lessen pressures to inflation in the remaining quarters of 2019. However, recent external developments (July-Aug 2019) point to possible exchange rate pressures following the expected sluggish global economy and projected international commodity prices by the end 2019. In this context, the export revenues may continue to grow at slower pace, compared to the import bill which is expected to reflect high demand for capital and intermediary goods.

Assumption 4: The recent credit growth may contribute to the rise in aggregate demand going forward

Since September 2018, following the increase in demand for loans, bank lending to economic activities intensified. The growth in credit to private sector will strengthen the economy, and subsequently boost aggregate demand. This effect is likely to remain mild in short-term because more loans were oriented to construction and mortgage sectors, whose contributions to aggregate demand are moderate. However, the rise of loans to sectors such as personal loans, manufacturing, restaurant and hotels is likely to have an increased effect on aggregate demand if maintained for the medium-term.

Chart 22-Real GDP gap

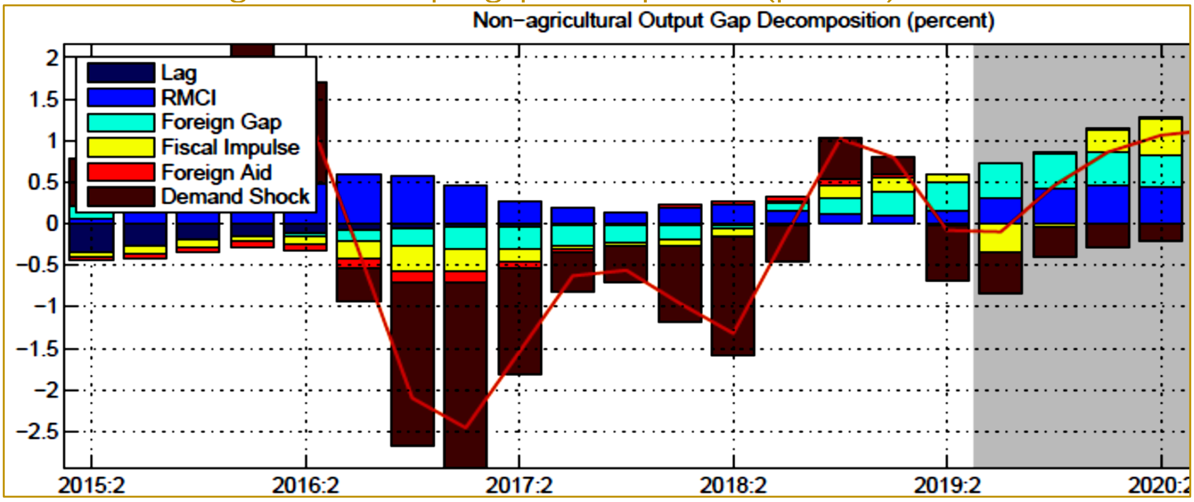


Source: Research Department

Assumption 5: Limited fiscal stimulus in the context of continued accommodative monetary policy

Even though global economic growth projections point to a slowdown, domestic economy will remain solid as evidenced by the real composite index of economic activities (CIEA). The positive trend in domestic economy will be on the back of the continued accommodative monetary policy and the expected expansionary fiscal policy as figured in the 2019/20 fiscal budget.

Chart 23- Non-agricultural output gap decomposition (percent)



Source: NBR, Monetary Policy and Research Directorate

Assumption 6: The Base Effect

Since 2018Q3, favorable weather conditions supported high food production that led to food deflation, and therefore low headline inflation until 2019Q2. This situation of low inflation developments created a low base for inflation computation in the same period. Subsequently, in 2019H2 and 2020H1, inflation may have an upward trend, owing to the base effect.

4.3.2 Risks to the Baseline Projections

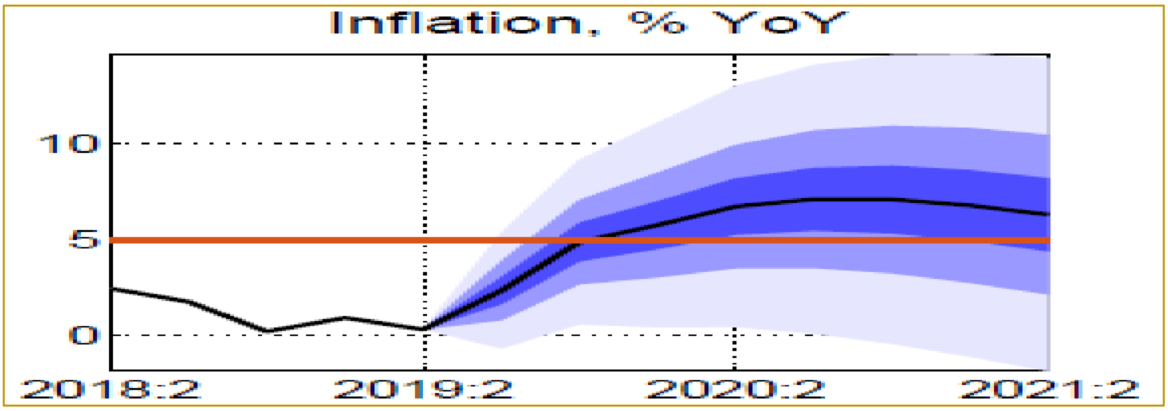
For the past 2 years, most downward inflationary pressures came from agricultural production. While the Monetary Policy Committee (MPC) judges that the agricultural production will normalize in the coming seasons, the MPC also assesses that the main downward risk to the projections can arise from the good performance of the agriculture sector. In a case agricultural production in season A 2019/20 attains the level recorded in season A 2018/19, inflationary pressures will ease and the average headline inflation for 2019 will likely evolve below 2.0 percent.

Other slight risks to the inflation projections may result from the depreciation of USD against the Yen. The MPC assumed the current projections of exchange rate depreciation would prevail going forward. However, the MPC reassessed the prospects for the global economy and Rwandan external trade, and judged that if the USD continues to depreciate against the Yen, mild upward pressures will emerge.

4.3.3 Projections for inflation in 2019

Judgements based on the mentioned assumptions and risks, and conditioned on the path of the Central Bank Rate (CBR), the Monetary Policy Committee of NBR estimates the August projections to be below the last projections of May 2019. MPC assesses the GDP growth of 7.8 percent as projected by MINECOFIN for 2019 to remain consistent. The MPC expects fiscal spending to pick up in the second half of the budget year and back the growth in domestic demand. Corollary, the MPC revised down inflation projection to around 2.0 percent in 2019 on average, compared to 3.0 percent projected in May 2019. This projection assumes a CBR maintained at 5.0 percent and a Frw depreciation of 4.78 percent by end December 2019.

Chart 24-Inflation Forecasts



Source: NBR, Research Department