National Bank of Rwanda

Banki Nkuru y'u Rwanda

MONETARY POLICY REPORT

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Contents

EXECUTIVE SUMMARY

Global economic outlook adversely affected by the COVID-19 outbreak.

According to estimates published by IMF in January 2021, the global economy contracted by 3.5 percent in 2020, owing to a negative impact of COVID-19. In 2021, the global economy is projected to recover and grow by 5.5 percent. However, the strength of the recovery is expected to be uneven and unequal across countries depending on factors like; access to the COVID-19 vaccine, the effectiveness of policy support, exposure to cross-country spillovers, and preexisting economic conditions. On quarterly basis, global economic growth slowed in 2020Q4, weighed by new surge in COVID-19 and subsequent measures to curb the spread of the virus. Estimates show that the growth for the third and fourth quarters beat market expectations in advanced economies owing to the reopening of economic activities after full lockdown. Inflation remained low, reflecting this year's subdued aggregate demand and lower energy prices.

The domestic economy is recovering from the negative impact of COVID-19.

Rwanda's real GDP contracted by 4.1 percent in the first three quarters of 2020 compared to a growth of 8.3 percent registered in the corresponding period of 2019. However, the second half of 2020 recorded a gradual recovery, on the back of supportive policy measures and easing COVID-19 containment measures. The real GDP decreased by 3.6 percent in 2020Q3, a lower fall than the -12.4 percent recoded in 2020Q2. This recovery is evidenced by the rising trend of the real Composite Index of Economic Activities (CIEA), which increased by 9.4 percent in the second half of 2020 from a contraction of 2.1 percent recorded in the first half of 2020. On quarterly basis, the CIEA recorded an increase of 11.7 percent in 2020Q4 after 7.1 percent in 2020Q3. This domestic economic recovery is expected to continue in 2021, supported by policy interventions to revive business activities, despite the uncertainty around COVID-19 and its containment measures. The roll-out of the COVID-19 vaccine globally and in the country will also enhance private-sector optimism, hence stimulating the recovery in economic activities.

Banking system liquidity conditions remained sound, owing to economic policy measures.

The banking system liquidity remained resilient to the COVID-19 pandemic impact, supported by the different measures taken by NBR and the Government of Rwanda, amid subdued demand for loans by the private sector during the lockdown. By end December 2020, broad money and outstanding credit to private sector grew by 18.0 percent and 21.8 percent year on year respectively. In line with the continuing NBR accommodative monetary policy stance, market interest rates in the economy reduced further. In 2020, the average lending rate reduced by 14 basis points to 16.35 percent, favorable to continue supporting the economic recovery.

Headline inflation projected to ease in 2021.

As initially projected, headline inflation dropped to 5.0 percent in 2020Q4 from 9.0 percent recorded in 2020Q3. This decline reflects a significant drop in core inflation, following the downward revision of public transport fares in October 2020, and a deceleration in prices of fresh food products reflecting favorable agricultural production in season A/2021. In 2021, headline inflation is projected to evolve around the lower bound of 2.0 percent owing to subdued inflationary pressures. Risks that may divert the headline inflation from the projected baseline path include the performance of agriculture in seasons B and C 2021.

Based on these prospects, on 18th February 2021, the Monetary Policy Committee decided to maintain an accommodative monetary policy stance, by keeping the CBR at 4.5 percent to continue supporting the financing of the economy by the banking sector.

I. RECENT DEVELOPMENTS AND OUTLOOK

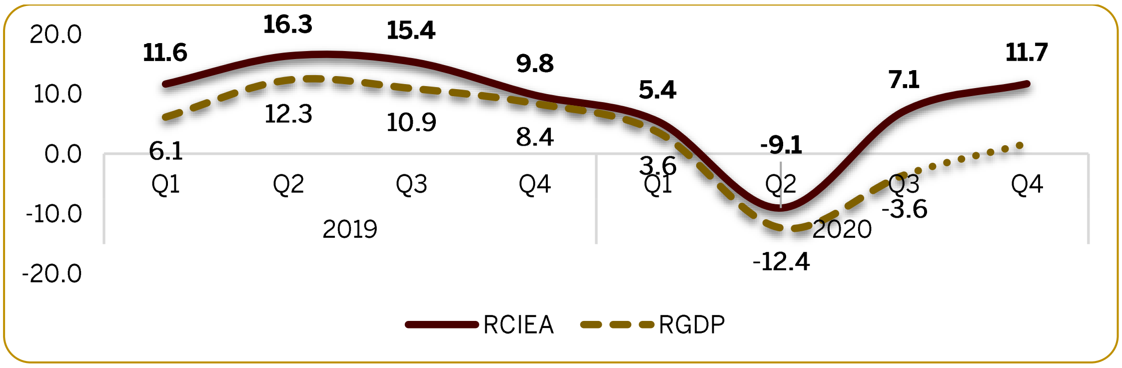
1.1 Recent developments

The Composite Index of Economic Activities (CIEA) increased by 9.4 percent in the second half of 2020 from a contraction of 2.1 percent recorded in the first half of 2020. On quarterly basis, the CIEA recorded an increase of 11.7 percent in 2020Q4 after 7.1 percent in 2020Q3. This domestic economic recovery is expected to continue in 2021, supported by policy interventions to revive business activities, despite the uncertainty around COVID-19 and its containment measures. The roll-out of the COVID-19 vaccine globally and in the country will also enhance private-sector optimism, hence stimulating the recovery in economic activities.

High frequency indicators point to continuous economic recovery in 2020Q4.

Helped by supportive Government measures together with easing of COVID-19 containment measures, the Rwandan economy has been recovering since May 2020. In 2020Q4, the composite index of economic activities (CIEA) increased by 11.7 percent from 7.1 percent in 2020Q3, signaling an improvement in economic activities. The increase in the CIEA was driven by an uptick in credit to private sector (21.8 percent), in cement demand (36.8 percent), as well as improving turnovers of industry and services sectors (7.2 percent). The increase in credit to private sector was partly linked to the loan restructuring decision to ease loan repayment conditions for borrowers affected by the COVID-19 pandemic. On the other hand, the expansion in domestic demand for cement was related to Government recent infrastructure projects.

Chart 1: Quarterly Real GDP growth vs CIEA (% change, y-o-y)

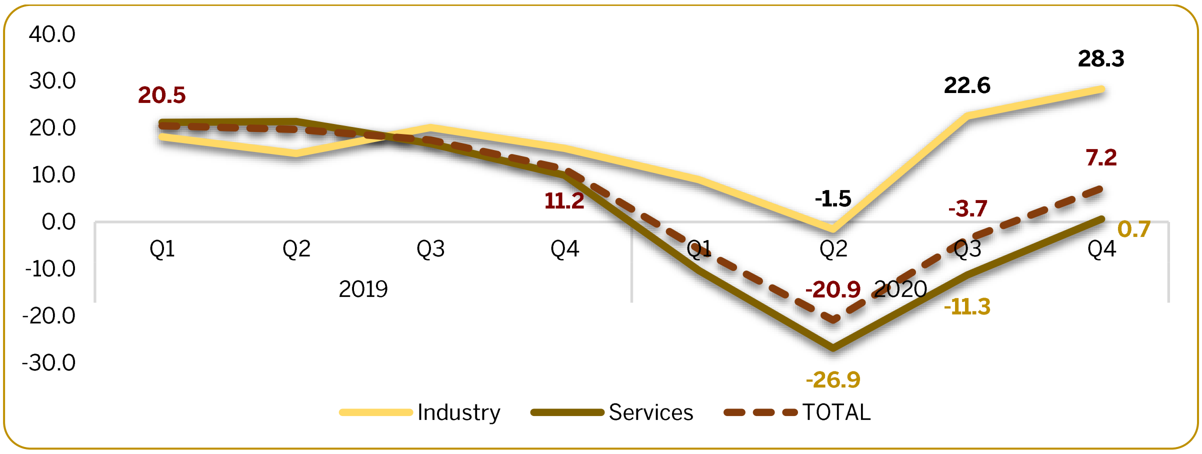


Source: NBR, Monetary Policy Department

The overall performance of the industry and services sector was dominated by the developments in the industry sector which grew by 28.3 percent in 2020Q4 with continuous support from Government infrastructure projects that have spillover effects on domestic production of construction materials such as cement, metals, and iron sheets among others. Hence, construction and manufacturing subsectors turnovers increased by

14.1 percent and 40.5 percent in 2020Q4 from 5.5 percent and 25.2 percent in 2019Q4, respectively. With regard to the manufacturing subsector, the recovery was also supported by breweries whose turnovers increased by 11.3 percent in 2020Q4 from 0.2 percent in the previous quarter and 10.4 percent in 2019Q4. Furthermore, the industry sector's good performance was underpinned by the recovery of the mining sector, whose turnovers grew by 6.8 percent in 2020Q4 from a decline of 3.9 percent in 2020Q3, owing to a rise in prices of metals and minerals on international markets.

Chart 2: Turnovers of industry & services sectors (% change, y-o-y)



Source: NBR, Monetary Policy Department

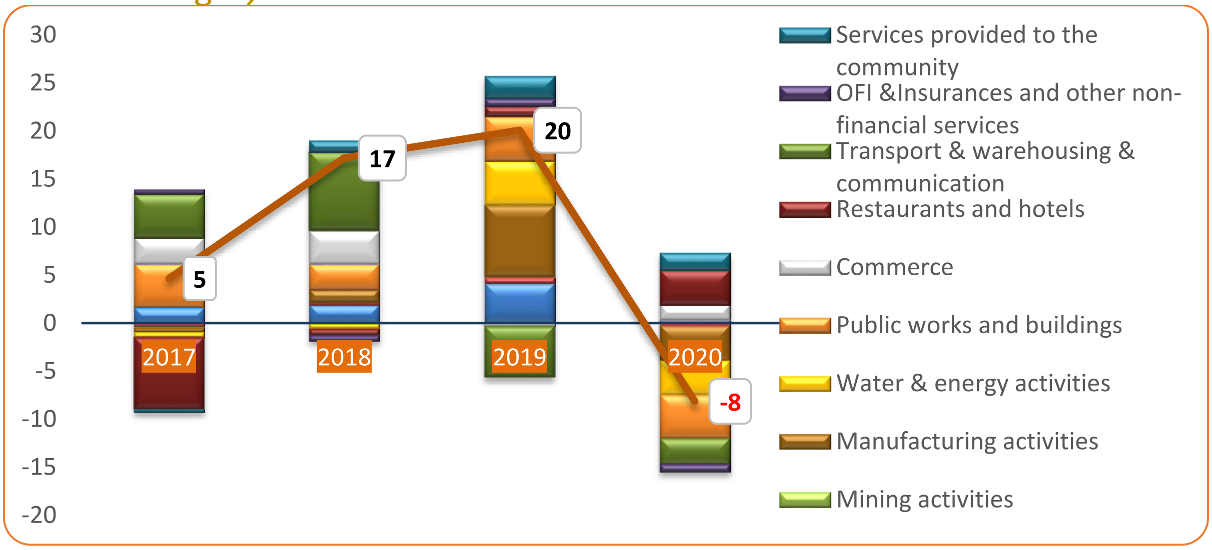
The services sector registered notable progress in 2020Q4, recording a positive growth after three quarters of declines. The overall improvement in services sector is mainly rooted in the upward trend in turnovers of trade services and financial services as well as the good performance of information and communication. Trade services recovered by 0.5 percent in 2020Q4 from a decline of 7.2 percent in 2020Q3, helped by the improving domestic consumption and rising investment, particularly spill over services from government construction projects, amid the eased virus containment measures. This had positive implications on the performance of the financial services (16.9 percent from -7.1 percent), transport services (5.6 percent from -43.0 percent) as well as information and communication sector (+24.8 percent from 27.5 percent). However, tourism related services such as hotels (-46.5 percent) continued to perform poorly as tourism industry has been severely affected by the pandemic control measures. The recovery of this industry is foreseen to be slow. According to World Tourism Organization (UNWTO), the return to pre-COVID-19 performance is not expected before 2023.

Sound credit to the private sector owing to supportive policy measures.

The outstanding credit to the private sector (CPS) rose by 21.8 percent in 2020, higher than the 12.6 percent growth in 2019. The hike in the stock of CPS in 2020 was due to the restructuring of some loans for affected borrowers and new disbursed loans in 2020.

NALs amounted to 1,066 billion in 2020, an 8 percent fall from 2019's level. The decline in NALs reflects the demand and supply shocks linked to the uncertainties around the COVID-19 pandemic, coupled with measures to contain its spread. As expected, the total loan application in terms of value decreased by 10.5 percent in 2020 after previously growing by 20.5 percent in 2019. On the other hand, the rejection rate was 20. 1 percent, slightly lower than that of 2019(22.1 percent). The declines in NALs were experienced in all sectors except those of hotels and restaurants, services provided to the community and commerce, whose loans increased significantly by 161%, 41% and 6% respectively. Resultantly, these three sectors are the main positive contributors to the 2020 NAL development.

Chart 3: Contributions of Sectors to the Change in New Authorized Loans (y-o-y % changes)



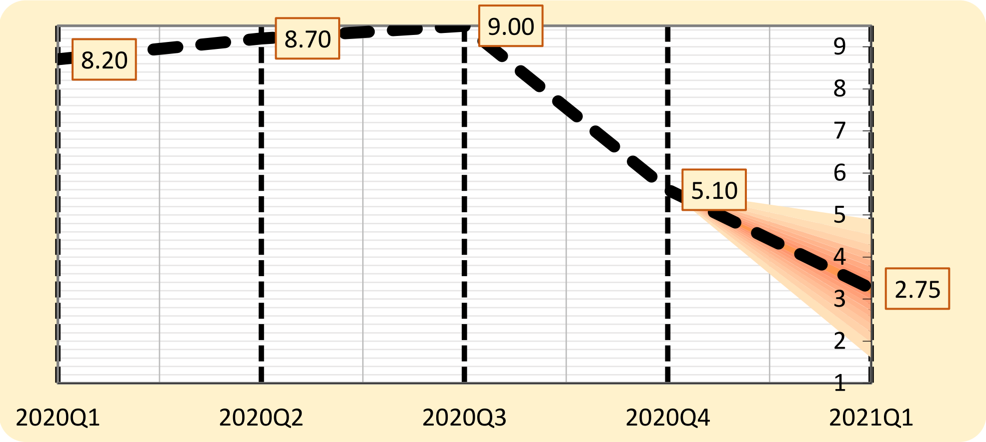
Source: NBR, Monetary Policy Department

Headline inflation is expected to ease further in the first quarter of 2021.

In 2021Q1, headline inflation is projected to decline as a result of muted pressures on food and core inflation. On the food CPI component, some downward pressures are expected to originate from the good performance of the agricultural sector during Season A- 021 that led to stable food prices in 2021Q1. The removal of transport price shock in 2020Q3 is expected to drive core inflation in 2021Q1 further down. Pressures on core inflation will also remain muted on the back of the expected slowdown in the recovery strengths in 2021Q1. The disinflationary trend will be further stressed by a base effect of the food, alcoholic beverages, and energy price increases recorded in the previous year during the corresponding period.

Some upward pressures are likely to result from the increase in prices of imported commodities such as oil and foodstuffs.

Chart 4: Quarterly Inflation (%, Y-o-Y), Fan chart



1.2 Global economic outlook

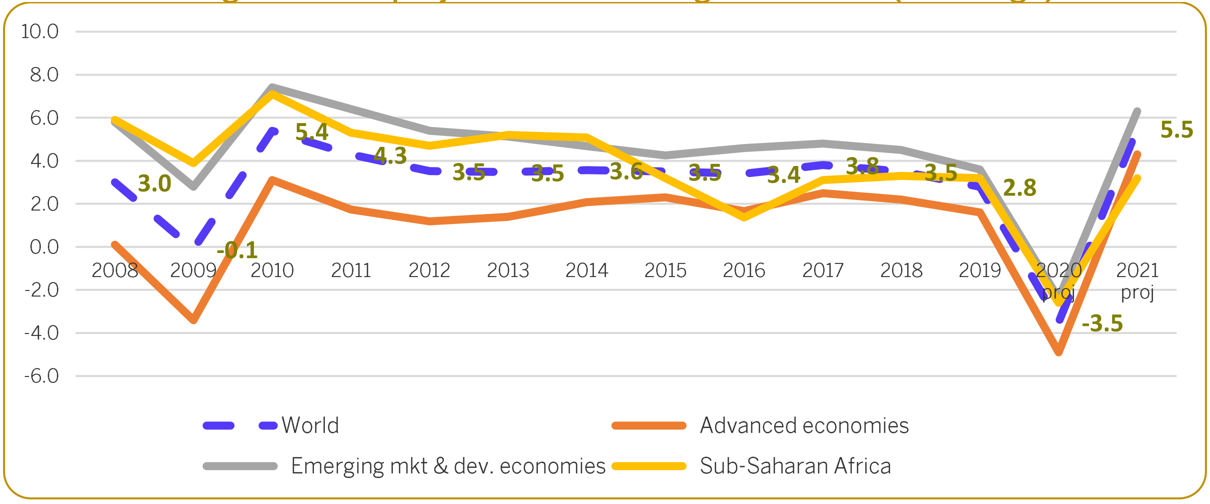
According to the International Monetary Fund's (IMF) World Economic Outlook (WEO) update published in January 2021, the world economic growth is estimated at -3.5 percent in 2020 from 2.8 percent recorded in 2019, the worst contraction since the global financial crisis, owing to the COVID-19 pandemic outbreak. In 2021, the global economy is projected to recover by 5.5 percent. However, the strength of the recovery is expected to be uneven and unequal across countries depending on factors like; access to the COVID-19 vaccine, the effectiveness of policy support, exposure to cross-country spillovers, and preexisting economic conditions.

Global growth hit hard in 2020 but expected to recover in 2021.

The world economy is expected to contract by 3.5 percent in 2020 from an increase of 2.8 percent in 2019, according to the International Monetary Fund's (IMF) World Economic Outlook (WEO). This was the worst contraction since the global financial crisis, owing to the COVID-19 pandemic outbreak. This economic contraction in 2020 was 0.9 percentage points lower than the October 2020 projections, reflecting a stronger than expected recovery on average in the second half of 2020.

A recovery by 5.5 percent is projected in 2021, a 0.3 percentage point increase relative to the October 2020 projections, reflecting additional policy support in a few large economies and expectations of a vaccine-powered strengthening of activity later in 2021, outweighing the effect of rising infections. However, the magnitude of the recovery is projected to vary significantly across countries. That will depend on the access to medical interventions, the effectiveness of policy support, exposure to foreign spillovers, and preexisting economic conditions.

Chart 5: GDP growth and projections across regional blocks (% change)



Source: IMF WEO, Jan. 2021

In advanced economies, growth is estimated at -4.9 percent in 2020 from 1.6 percent recorded in 2019, mostly reflecting contraction in all major economies. These economies include the United States (-3.4 percent), Eurozone (-7.2 percent), United Kingdom (-10.0 percent), Japan (-5.1 percent), Germany (-5.4 percent), France (-9.0 percent), Italy (-9.2 percent) and Spain (-11.1 percent).

In 2021, economic growth in advanced economies is projected to recover to 4.3 percent, following the expected improvement in performance for all major economies. The sizable fiscal support announced for 2021 in some countries, including most recently in the US and Japan, together with the unlocking of Next Generation EU funds, will help lift economic activity in this group with favorable spillovers to trading partners. Projections for most countries point to a decline of fiscal deficit in 2021, as revenues rise and expenditures decline during the recovery period.

Relative to the IMF forecasts of October 2020, the US growth projections for 2021 is revised up by two percentage points, reflecting carryover from the strong momentum in the second half of 2020 and the fiscal package of December 2020. Similarly, the 0.8 percentage points upward revision to Japan's 2021 projections mostly reflects the additional fiscal measures introduced at the end of 2020. However, these forecasts for 2021 are partially offset by downward revisions for the Euro area (one percentage point), reflecting an observed softening of activity towards the end of 2020, which is anticipated to continue in early 2021 amid rising infections and renewed lockdowns.

Emerging market and developing economies are estimated to contract by 2.4 percent in 2020, from 3.6 percent growth recorded in 2019, but projected to grow by 6.3 percent in 2021. Oil exporters and tourism-based economies within the group face particular difficult prospects considering the expected slow normalization of cross-border travel and the subdued outlook for oil prices.

In China, GDP growth is estimated at 2.3 percent in 2020, from 6.0 percent recorded in 2019. Compared to the projected growth of 1.9 percent in October 2020, the estimated growth for 2020 reflects the effective containment measures, a significant public investment response, and central bank liquidity support. In 2021, the Chinese economic growth is projected to recover with 8.1 percent growth.

According to the IMF estimates, India's economy contracted by 8.0 percent in 2020, from a growth of 4.2 percent recorded in 2019, and is expected to grow by 11.5 percent in 2021. The projections for 2021 have been revised up by 2.7 percentage points, reflecting carryover from a stronger than expected recovery after the ease of lockdowns.

On aggregate, Sub-Saharan African economy is expected to have contracted by 2.6 percent in 2020, the first recession in the region in the last 25 years, after a 3.2 percent growth recorded in 2019. The severe contraction in 2020 reflects macroeconomic risks arising from the sharp decline in output growth among the region's key trading partners, including the euro area; the fall in commodity prices; reduced tourism activity in several countries; as well as the effects of measures taken to contain the COVID-19 global pandemic.

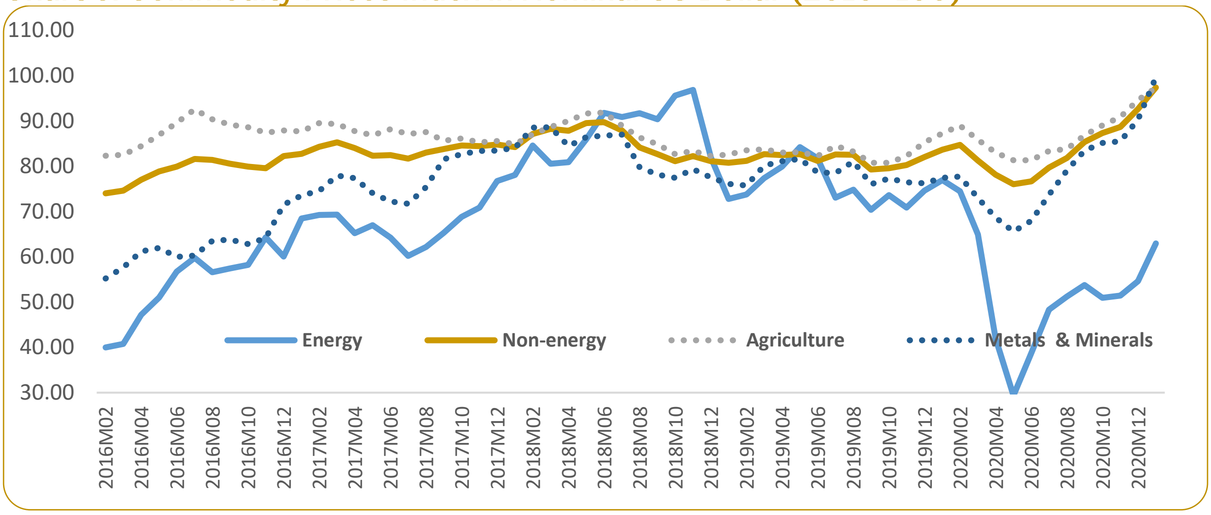
In the Sub-Saharan region, the pandemic shock has mostly hit the region's three largest economies; notably Nigeria, South Africa, and Angola, in a context of already weak growth and declining commodity prices. However, economic growth for the region is projected to recover to 3.2 percent in 2021, reflecting economic recovery mainly in Nigeria (1.5 percent) and South Africa (2.8 percent).

The economic performance in the East African Community (EAC) countries is projected at 1.0 percent in 2020 from 6.2 percent recorded in 2019. The projected deceleration in growth is mainly due to the weak external demand and disruptions to supply chains and domestic production. Activity in tourist-dependent countries is expected to contract sharply in response to severe disruptions to travel and tourism activities.

Lower global commodity prices induced by sluggish global demand.

In 2020, global commodity prices decreased, reflecting a slowdown in global demand. Energy prices fell by 31.6 percent from a decline of 12.7 percent in 2019; due to uncertainties about the COVID-19 pandemic and the warm winter that reduced demand for heating fuels. Non-energy commodity prices increased by 2.9 percent in 2020, after a decline of 4.1 percent in 2019, owing to higher prices for agricultural commodities; and metals & minerals. In 2020Q4, non-energy commodity prices increased by 13.3 percent in 2020Q4 compared to 0.7 percent in the same quarter of the previous year.

Chart 6: Commodity Prices Index in Nominal US Dollar (2010=100)



Source: World Bank, February 2021

In 2020, crude oil prices decreased by 32.8 percent on average compared to a decline of 10.2 percent in 2019, following the impact of the COVID-19 pandemic on the global demand. In 2020Q4, crude oil prices decreased by 27.7 percent compared to a decline of 6.2 percent in the same period of the previous year. In 2021, IMF projects oil prices to increase by 21.2 percent, from USD 41.26/barrel in 2020 to USD 50.02/barrel in 2021, reflecting an expected rise in oil consumption.

Agricultural commodities' average prices increased by 4.5 percent in 2020 after a decrease of 3.8 percent in 2019, driven by supply shortfalls and stronger-than-expected demand in some oils and meals, as well as the depreciation of the US dollar. In 2020Q4, agriculture commodities advanced by 10.9 percent due to the rising prices of beverages (2.6 percent); of which Coffee Arabica and tea prices rose by 8.2 percent and 8.8 percent, respectively. During the same period, prices surged by 13.3 percent for food; of which grains (11.7 percent) and oils & meals (32.8 percent). Agricultural commodity prices are projected to further increase by 1.4 percent in 2021, attributed mainly to the projected rising prices of beverages (1.0 percent), and food prices (1.4 percent).

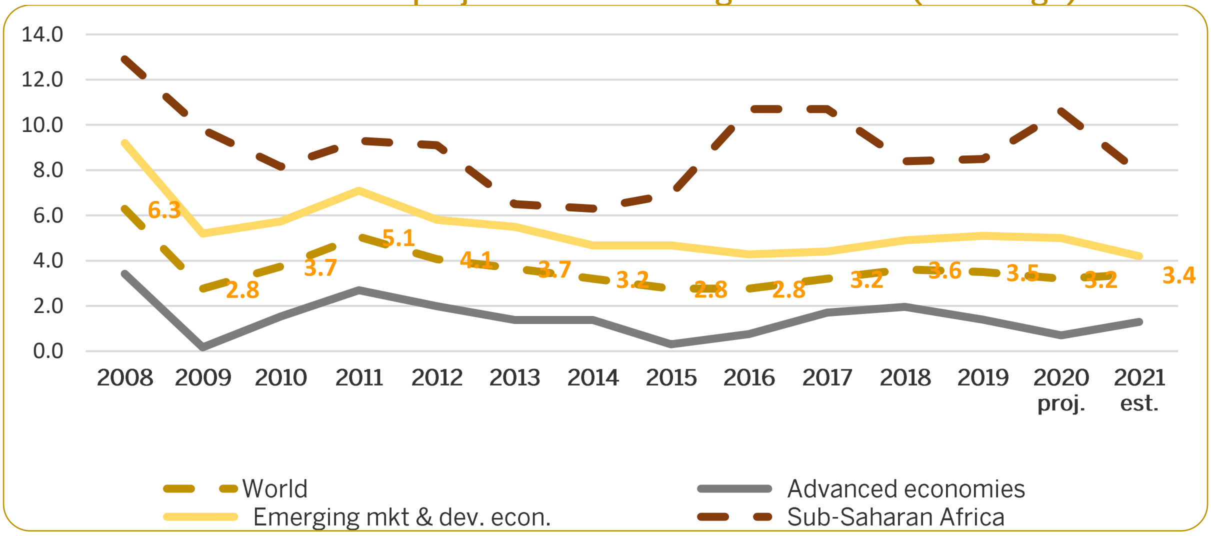
Metals & mineral prices were slightly up by 1.0 percent in 2020, compared to a contraction of 5.0 percent in 2019, reflecting the impact of the COVID-19 pandemic outbreak that limited industrial production activities. Prices increased for precious metals as uncertainties overshadowed prospects for the global economy and increased the demand for safe-haven assets. Gold prices rose by 27.1 percent after an increase of 9.7 percent in 2019. Metals & mineral prices are projected to increase by 2.1 percent in 2021 and by 1.3 percent in 2022.

Prices for fertilizers went down by 10.1 percent in 2020 from a decrease of 1.4 percent in 2019. In 2020Q4, prices increased by 3.2 percent, after a drop of 16.7 percent in the corresponding quarter of 2019. The World Bank projects an increase of 3.2 percent for the next two consecutive years.

Global inflation expected to remain subdued untill 2022

World annual average inflation is expected at 3.2 percent in 2020 from 3.5 percent in 2019, following a sharp drop in global demand and falling commodity prices, while projected to increase to 3.4 percent in 2021. Consistent with persistent negative output gaps, inflation is expected to remain subdued until 2022.

Chart 7: Global inflation and projections across regional blocks (% change)



Source: IMF, Jan. 2021 and Oct. 2020

In advanced economies, consumer price inflation is expected to ease to 0.7 percent in 2020 from 1.4 percent in 2019, reflecting weaker economic activities and lower commodity prices. In line with the expected recovery in economic activities, the projections for inflation points to an increase but below central bank targets at 1.3 percent in 2021 and 1.5 percent in 2022.

The annual average inflation eased to 1.2 percent in 2020 from 1.8 percent in 2019 in the United States, at 0.3 percent from 1.2 percent in the Euro zone, and at 0.9 percent after 1.8 percent in the United Kingdom, giving room to Central Banks for further monetary easing.

In the emerging market and developing economies, inflation is estimated to slightly ease to 5.0 percent in 2020 from 5.1 percent in 2019. In 2021, it is projected to decelerate at a historical low level of 4.2 percent. The Chinese annual average inflation is estimated at 2.7 percent in 2020, from 2.9 percent in 2019, and projected to remain unchanged to 2.7 percent in 2021.

In Sub-Saharan Africa (SSA), annual headline inflation is projected to rise to 10.6 percent in 2020, from 8.5 percent in 2019, following projected rising inflation rates in Nigeria (12.9 percent from 11.4 percent in 2019), Angola (21.0 percent from 17.1 percent), DRC (11.5 percent after 4.7 percent), and Zimbabwe (622.8 percent compared to 255.8 percent). Headline inflation is projected to ease to 7.9 percent in 2021. The SSA region has been facing multiple shocks, including cyclones, droughts in southern and eastern Africa (especially in Mozambique, Zambia, Lesotho, and Zimbabwe), exchange rate pressures and severe locust swarms (particularly in Ethiopia, Kenya, South Sudan, and Uganda) as well as COVID-19 related disruptions to the local and imported food supply.

In the five countries of the East African Community (EAC), average annual headline inflation is estimated to rise at 5.5 percent in 2020, from 4.0 percent in 2019, reflecting higher inflation in Burundi (7.5 percent from -0.7 percent in 2019), Rwanda (7.7 percent from 2.4 percent), and Uganda (3.8 percent compared to 2.9 percent). The EAC's stable and low inflation is attributed to good agriculture production owing to favorable weather conditions, and effective monetary policies implemented by its central banks.

1.3 Key macroeconomic projections

In 2020Q4, headline inflation largely decelerated and stood at 5.1 percent, mostly reflecting the drop observed in both core and food inflations. Going forward, the declining trend is expected to continue throughout 2021Q1 and headline inflation is projected to evolve around 2.75 percent. In line with baseline projections, core and food inflations will ease further, reflecting a non-inflationary economic recovery and low effects of domestic costs, respectively. As an upshot, headline inflation is anticipated to evolve around the lower bound of 2.0 percent in 2021 and will then slightly pick up to 3.2 percent in 2022.

1.3.1 Assumptions

Though global economy is recovering from the contractions recorded in 2020, the projected global growth in 2021-2022 will remain fragile to support the domestic economy.

The global economy picked up in 2020H2 reflecting stronger than expected momentum of the recovery. The projections for the global economy in 2021 and 2022 assume a turnaround in the COVID-19 pandemic this year. However, some downside risks to the projected global economy include the renewed waves and new variants of the coronavirus and difficulties around the logistical distribution of effective vaccines, coupled with financial stress among higher debt levels. Under these circumstances, the global demand will remain sluggish and will continue to drag on Rwandan export receipts. The persistent travel difficulties will keep weighing on the tourism sector and negatively affect imports in general.

International commodities are expected to have mixed effects on domestic economy.

Following the recovery in global demand, oil prices are projected to increase much faster than previously forecasted. This expected upward trend in oil prices will create pressures on local pump prices and inflation. Unlike oil prices, international food prices are expected to record a downward trend in the first three quarters of 2021 but rising from 2021Q4 onwards. The World Bank projections point to an overall drop in prices throughout 2021. This is consistent with Food and Agricultural Organization (FAO) projections indicating that some cereals production recorded an uptick in 2020/2021 though stocks are subject to fall over the same period. However, the projections show a recovery in international food prices in 2022. If this projection unfolds, it will exert mild upward pressures on food inflation over the medium term.

The fiscal support and improved pandemic management will remain non-inflationary over the medium-term.

The fiscal deficit increased in 2020Q3 and Q4, but fiscal authorities made some revisions in 2021. On the revenues side, the changes include a rise in domestic revenues following the projected upsurge in taxes resulting from the recovery of economic activities. On the expenditure side, the government expects to increase recurrent spending to cater for COVID-19 related costs and increase net lending outlays to support businesses (through the Economic Recovery Fund) as well as state corporations. Nevertheless, these interventions will not create pressures on inflation over the medium term.

Despite the ongoing recovery in domestic economic activity, aggregate demand (GDP) will remain below the potential level over the medium term.

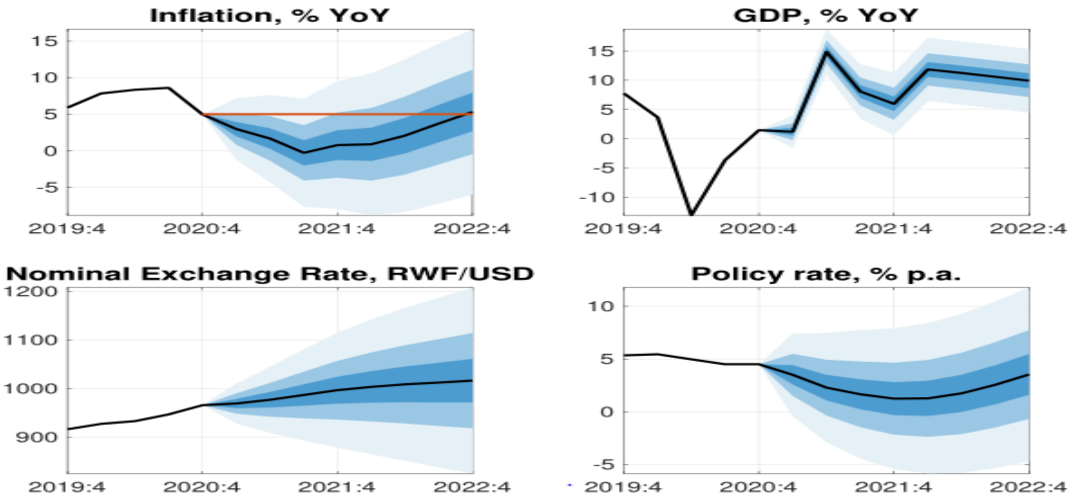
Just like many other economies in the region and overseas, the domestic economy has been steadily recovering from the sharp contraction recorded in 2020Q2. The recovery continued throughout 2020Q4 thanks to the ease in COVID-19 containment measures that allowed the resumption of economic activities. This thrust, however, was bogged down by the second wave of infections that led to movement restrictions and partial lockdown towards the end of 2020 and the beginning of 2021Q1.

Going forward, the baseline projections point to a reduction in GDP in 2021Q1, and a rebound in growth for subsequent quarters. The assessment indicates that the rebound will be supported by accommodative monetary conditions, the fiscal stimulus and recoveries in global economies. However, the economy is likely to continue operating below potential levels over the medium term.

1.3.2 Projection of key macroeconomic indicators

Consistent with initial economic conditions, assumptions on the global economy, domestic fiscal policy and other macroeconomic variables, headline inflation is projected to evolve around the lower bound of 2.0 percent in 2021 and pick up to 3.2 percent in 2022.

Chart 8: Projections



Source: NBR, Monetary Policy and Research Directorate

The projections indicate that core inflation will be driven by both imported and domestic costs factors. Pressures on core inflation resulting from the costs of producing core domestic goods and services are projected to be muted in 2021. However, they will start to increase and create mild inflationary pressures on core inflation towards the second half of 2022, following the expected increase in costs of imported factors of production. Domestic costs will remain non-inflationary, despite the increasing trend that is consistent with the recovery in economic activities.

The projections show that food inflation will be subdued in the near-term driven by ample food supply on the local markets. In the second half of 2022, mild pressures will pile up as domestic demand strengthens, and as international food prices recover.

Unlike food inflation, energy inflation is projected to start increasing in 2021Q3 following a pickup in solid fuel prices. Over the forecasting period (2021-2022), the upward trend in international oil prices is expected to exert upward pressures on energy inflation, despite subdued domestic demand.

II. DOMESTIC ECONOMIC DEVELOPMENTS

2.1 Economic growth

Rwanda's real GDP contracted by 4.1 percent in the first three quarters of 2020 compared to a growth of 8.3 percent registered in the corresponding period of 2019. However, the second half of 2020 recorded a gradual recovery, on the back of supportive policy measures and easing COVID-19 containment measures. This recovery is evidenced by the rising trend of the real Composite Index of Economic Activities (CIEA), which increased by 9.4 percent in the second half of 2020 from a contraction of 2.1 percent recorded in the first half of 2020.

Domestic economy is recovering from the contraction caused by the COVID-19 pandemic.

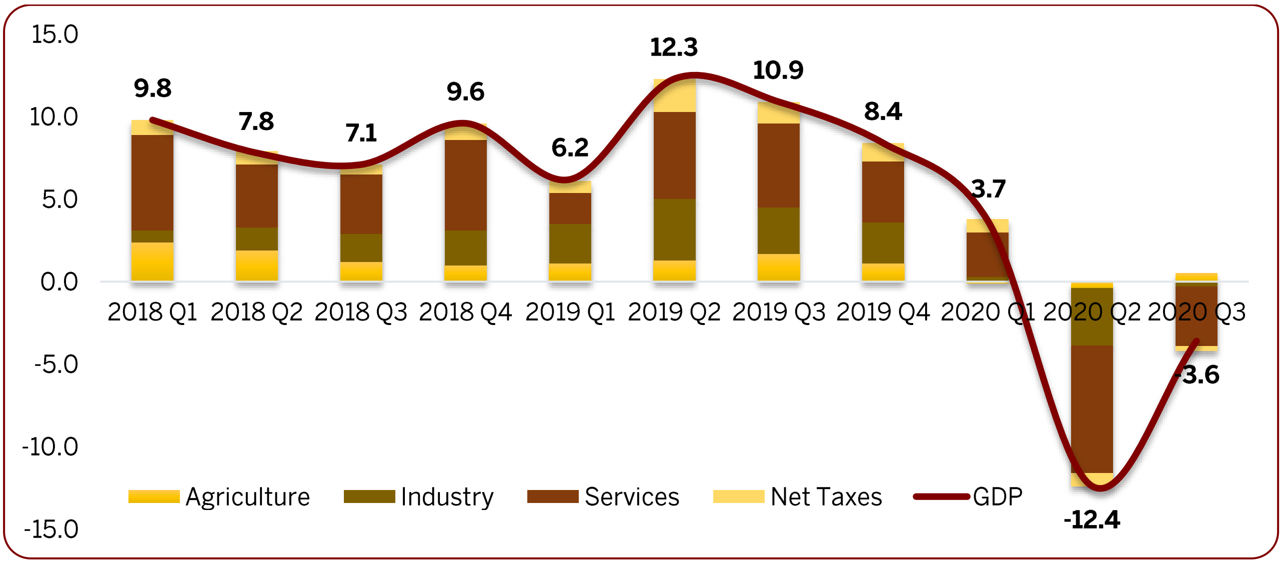
Rwanda's real GDP contracted by 4.1 percent in the first three quarters of 2020 compared to a growth of 8.3 percent registered in the corresponding period of 2019. However, the second half of 2020 recorded a gradual recovery, on the back of supportive policy measures and easing COVID-19 containment measures. In 2020Q3, the real GDP decreased by 3.6 percent, better than -12.4 percent recorded in 2020Q2. Despite the recovery, the economic growth remained negative as the country continued to face the negative effects of the COVID-19 pandemic, particularly the services sector (47 percent of real GDP, in 2020Q3).

The services sector decreased by 7.4 percent in 2020Q3, as tourism-related services continued to be severely affected by imposed travel restrictions aimed to limit the spread of the pandemic. This is reflected mainly in the decline of air transport services (-76.9 percent), Hotels & restaurants (-54.7 percent), as well as Travel agents & tour operators (-70.6 percent). Despite the overall poor performance, the services sector output improved compared to 2020Q2 performance (-7.4 percent after -16.3 percent). This improvement reflected the strong demand for telecommunication services (+63.0 percent) to support teleworking, the recovery of the wholesale & retail trade (0.0 percent from -21.7 percent in 2020Q2), as well as the demand for construction materials originating from private and government construction projects, and the easing of COVID-19 containment measures. These projects have also supported the Architectural & engineering services, which grew by 34.9 percent in 2020Q3 from 12.5 percent in 2020Q2 and a decline of 3.3 in 2019Q3.

Construction projects, again, were the key driver of the recovery of the industry sector, with a contraction of 1.4 percent in 2020Q3 compared to a decline of 18.9 percent in 2020Q2. This trend was associated with a high demand for construction materials reflected in both the manufacturing industries (+6.5 percent after -12.7 percent) and the construction subsector (-5.5 percent after -19.9 percent).

The economic performance of 2020Q3 was further supported by the outcome from agriculture sector, which recorded a growth of 2.2 percent after two quarters of contraction (-0.5 percent in 2020Q1 and -1.8 percent in 2020Q2). This achievement was mainly linked with a good performance in food crops production (64 percent of agriculture sector) which, supported by favorable weather conditions, grew by 2.6 percent in 2020Q3 after declining by 1.8 percent in 2020Q2 and Q1.

Chart 9: Real Gross Domestic Product (percentage change)

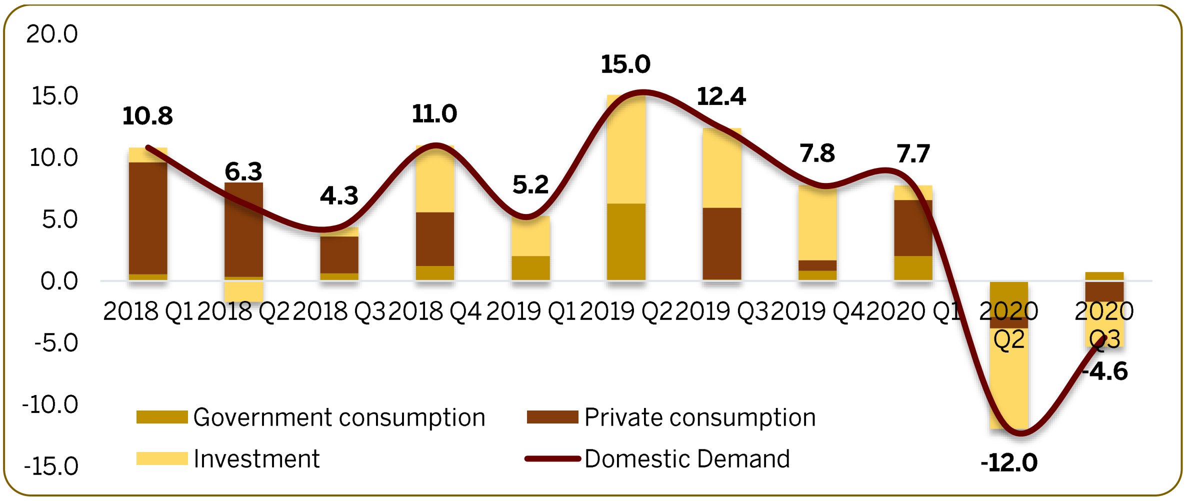


Source: National Institute of Statistics of Rwanda

The domestic demand remains subdued though recovering.

Domestic demand was improving in 2020Q3, mainly helped by Government consumption and investment expenditure. Government consumption expenditure increased by 5.9 percent in 2020Q3, consistent with Government measures to support the economic recovery. Investment expenditure decreased by 14.3 percent, improving from a decline of 34.2 percent recorded in 2020Q2, as fixed investment fell less than previously recorded (-0.7 percent compared to -25.3 percent). These fixed investments included construction (-5.5 percent from -20.0 percent) as well as machine and equipment (+10.6 percent from -33.7 percent).

Chart 10: Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

Rwanda's merchandise trade slightly declined after a sharp increase in the previous quarter.

Rwanda's merchandise trade decreased from the sharp increase recorded in the third quarter of 2020, following the COVID-19 effect. In 2020Q4, non-gold exports decreased by 1.4 percent, y-o-y, while imports fell by 1.8 percent from an increase of 21.4 percent in the previous quarter. Exports of services are expected to remain low, partly due to lower receipts from tourism and air passenger transports amid massive fall of international tourist arrivals. The external sector prospects of 2021 remain weak and uncertain amidst global travel restrictions and the resurgence of infections in many countries.

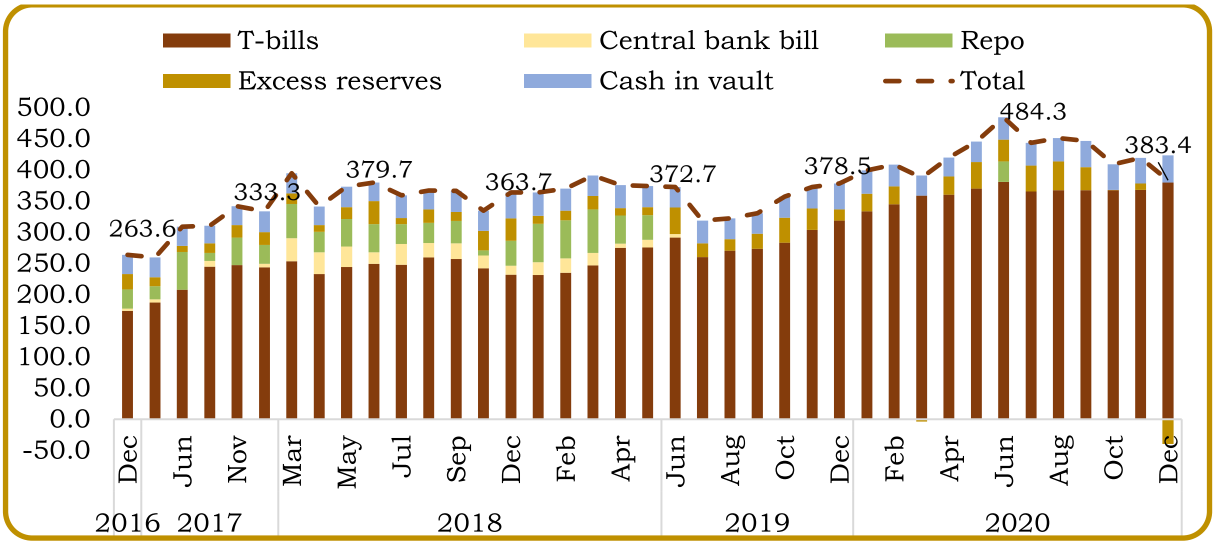
2.2 Financial and monetary developments

The banking system liquidity remained resilient to the COVID-19 pandemic impact. The increase in liquidity resulted from supportive measures taken by NBR and the Government of Rwanda, amid subdued demand for loans by the private sector during the lockdown. By end December 2020, broad money and outstanding credit to private sector grew by 18.0 percent and 21.8 percent year on year, respectively. In line with the ongoing NBR accommodative monetary policy stance, market interest rates in the economy reduced further. In 2020, the average lending rate reduced by 14 basis points to 16.35 percent,, which is favorable to continue supporting the economic recovery.

Banking system liquidity conditions remained sound, owing to economic policy measures.

In 2020, the most liquid assets grew at a slow pace of 1.3 percent, to FRW 383.4 billion, from FRW 378.5 billion in 2019, compared to an increase of 4.0 percent recorded in 2019. The observed growth in most liquid assets is credited to the increase in T-bills investments which offset the decline in excess reserves experienced in 2020. As of December 2020, investment in T-bills rose by FRW 61.3 billion, while it had recorded an increase of 86.5 billion in 2019. Despite the NBR's decision to reduce the reserve requirement ratio from 5 to 4 percent in March 2020, excess reserves dropped to FRW -3.0 billion on average in 2020Q4, from FRW 16.0 billion in 2019Q4, mostly credited to the reduction of net fiscal injection in 2020Q4.

Chart 11: Most liquid assets of commercial banks (FRW billion)



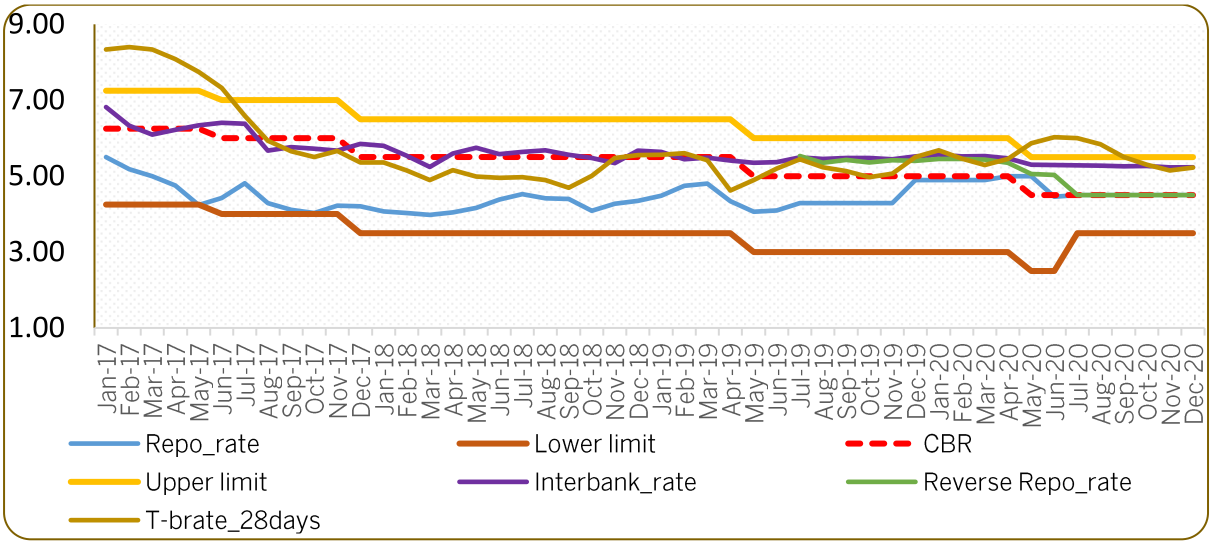
Source: NBR, Monetary Policy and Research Directorate

Money market rates generally sustained their stability around the Central Bank Rate.

In 2020, the Monetary Policy Committee revised down the central bank rate from 5.0 percent to 4.5 percent on 29th April, aiming to continue supporting the economy during the challenging period of the COVID-19 pandemic. This NBR's historically low rate was kept unchanged during the August and November meetings. During that period, money market interest rates continued to evolve closer to the CBR, in the symmetric corridor of ±1 percent.

Money market rates were steered around the central bank rate, in the symmetric corridor of ±1 percent since July 2020. The interbank rate dropped by 11 basis points to 5.35 percent in 2020, from 5.46 percent in 2019. Also, reverse repo declined to 4.90 percent on average in 2020 from 5.41 percent in 2019. However, repo rate and 28 days T-bill rates rose to 4.74 percent and 5.57 percent on average in 2020, from 4.40 percent and 5.22 percent in 2019 respectively. The shift of repo and reverse repo rates towards the CBR were attributed to the revised monetary policy implementation, which set these rates at the policy rate since July 2020. The decision is expected to continue strengthening the monetary policy transmission mechanism by steering the interbank rate close to CBR.

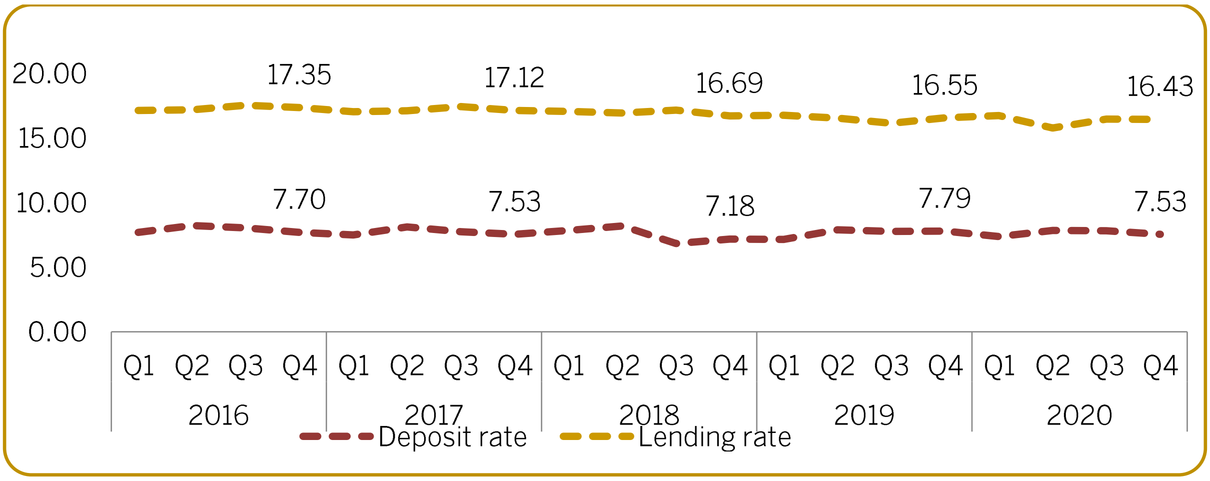
Chart 12: Money market rates developments



Source: NBR, Monetary Policy and Research Directorate

The lending rate decreased by 14 basis points to 16.35 percent in 2020 from 16.49 percent in 2019, reflecting a descending trend in lending rates for both corporate and individual borrowers. The deposit rate remained stable at 7.64 percent on average in 2020 compared to the previous year. As a result, the spread between the lending rate and the deposit rate dropped by 14 basis points to reach 8.71 percent on average in 2020, from 8.85 percent in 2019, which is beneficial for the clients of banks.

Chart 13: Market interest rates (percent average)



Source: NBR, Monetary Policy and Research Directorate

Foreign exchange market remains stable.

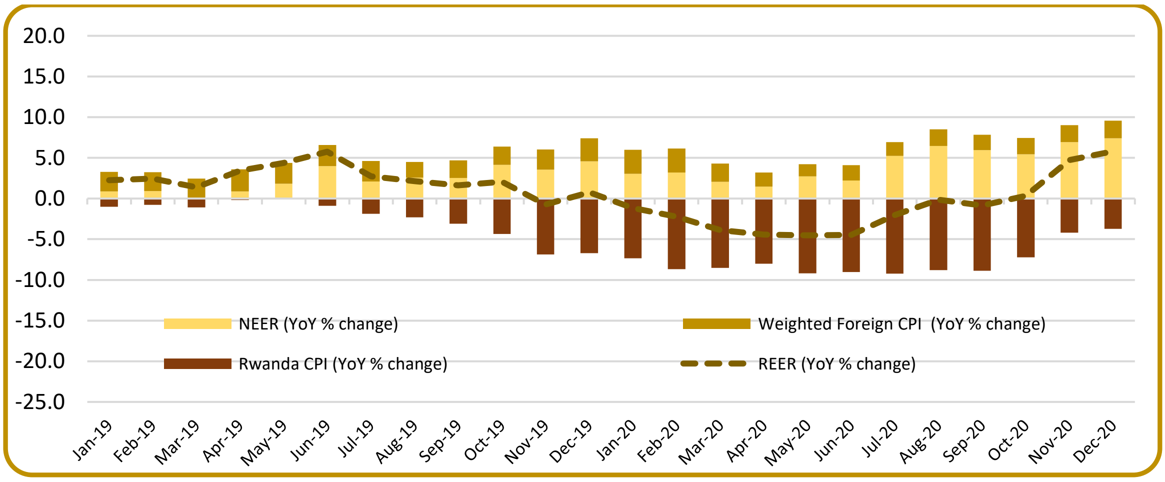
On account of higher foreign exchange demand linked to the resumption of economic activities in 2020H2, NBR forex sales to banks rose by 35.2% in 2020, to USD 381.80 million from USD 282.5 million in 2019. However, despite this increase in forex sales, foreign exchange reserves held by NBR remained adequate, covering 5.9 months of imports as of December 2020.

In the first half of the year 2020, the depreciation of the Rwandan franc was relatively gentle compared to the same period of 2019. This was from a significant lower demand for foreign exchange following COVID-19 related contraction in economic activities, and the supply-chain disruptions that constrained transactions with the rest of the World. End June 2020, the FRW depreciated by 1.6 percent against the USD, as the country kept on importing essential goods and healthcare products, but slower than 2.2 percent observed in the same period in 2019.

The Rwandan franc came under increased pressures during the second half of the year, with the resumption of economic activities and the rise in the demand for foreign currencies amid low foreign inflows. Compared to December 2019, relatively to the US dollar, the FRW depreciated by 5.4 percent end December 2020, the fastest since 2017, against a depreciation of 4.9 percent in December 2019.

In real effective terms, the FRW depreciated by 5.8 percent (y-o-y) end December 2020, against a depreciation of 0.8 percent recorded during the corresponding period of 2019. This depreciation of the FRW was mostly attributable to high nominal depreciation of the franc compared to a basket of currencies of the main trading partners. Higher domestic inflation (3.7 percent) than weighted foreign inflation (2.2 percent) contributed to moderate the depreciation. In nominal effective terms, the franc depreciated by 7.4 percent in December 2020 compared to a depreciation of 4.6 percent end December 2019.

Chart 14: Drivers of REER movement



Source: BNR, Monetary Policy and Research Department

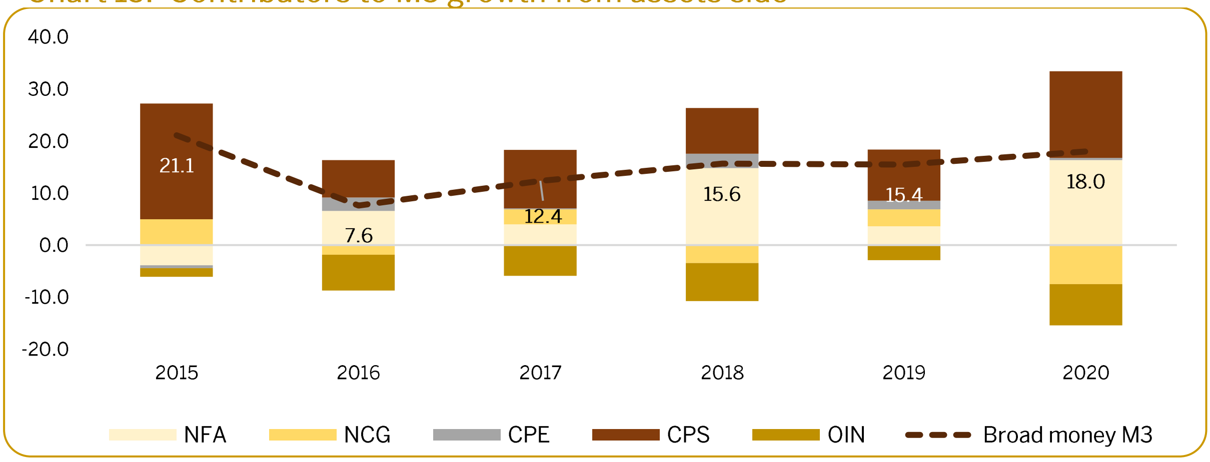
Broad money M3 picked up regardless a challenging macro-economic environment.

In 2020, money supply recorded the highest growth in four years, boosted by different measures put in place by NBR and the Government of Rwanda to contain the negative economic impact of the pandemic. Broad money (M3) picked up by 18.0 percent in 2020 compared to a growth of 15.4 percent recorded in the previous year. Credit to the Private Sector (CPS) was the main positive contributor [+16.7 percent] to that growth in M3, followed by Net Foreign Assets (NFA) [+16.3 percent] and Credit to Public Enterprises (CPE) [+0.5 percent]. Conversely, Other Items Net (OIN) and Net Credit to Government (NCG) recorded negative contributions of 8.0 percent and 7.5 percent respectively.

The credit to the private sector (CPS) rose by 21.8 percent in 2020, higher than a growth of 12.6 percent in 2019. The hike in the stock of CPS in 2020 was due to the restructuring of some loans for affected borrowers and new disbursed loans in 2020. The upturn in M3 was also attributed to the rise of 34.6 percent in net foreign assets (NFA), originating from an accumulation of more revenues in foreign currencies (amounting to USD 2,386.5 million in 2020 from USD 1377.6 million received in the year before). The negative contribution of OIN to M3 was due to an increase in equity for both NBR and commercial banks, while the negative contribution of NCG to M3, was due to low government borrowing from the banking sector.

On a quarterly basis, the broad money M3 grew by 3.6 percent in December 2020 compared to September 2020, against a growth of 8.5 percent recorded in the same period of the year before. Similar to annual drivers of M3, the stock of CPS and NFA largely contributed to the growth in M3, with a contribution of 3.5 percent and 2.0 percent respectively. Net credit to government (NCG), and other items nets (OIN) reduced the growth of M3, with negative contributions of 0.2 percent and 1.7 percent respectively, while the stock of credit to public enterprises remained stable.

Chart 15: Contributors to M3 growth from assets side

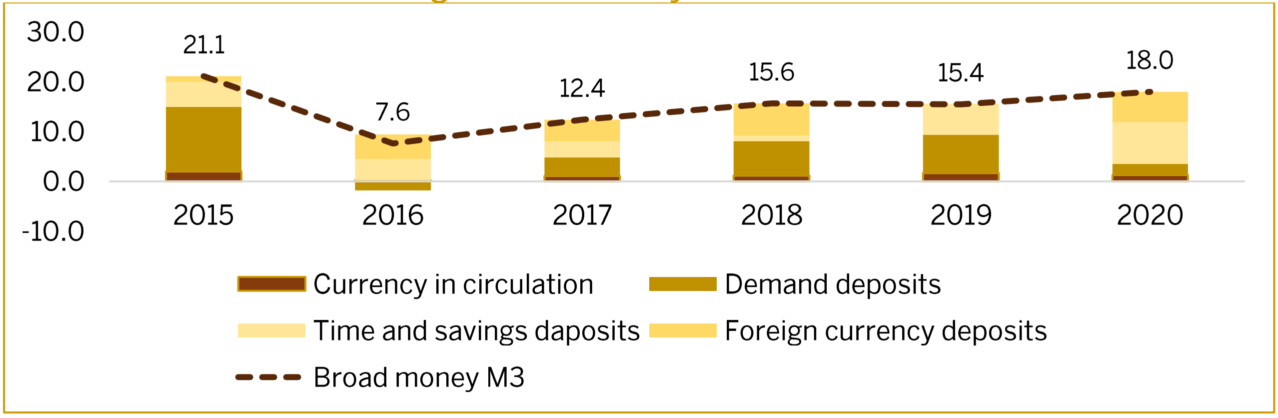


Source: NBR, Monetary Policy and Research Department

From the liability side, time & saving deposits have been the main contributors to M3 growth with a contribution of 8.3 percent in 2020, followed by foreign currency deposits with 6.1 percent, demand deposits with 2.3 percent, and Currency in Circulation (CIC) with 1.2 percent.

The hike in time and saving deposits reflects increased term deposits for some big depositors. The growth in foreign currency deposits was mainly driven by an accumulation of foreign exchange inflows by public and private corporations, aiming to finance their future imports and investment abroad. A low contribution of currency in circulation is observed over the period under review, owing to the expansion of the banking industry across the country and the development of Microfinance institutions. Besides, the improved technology in the operations of banks and MFIs (pull and push operations using mobile phones between economic agents and their banks or MFIs) is another way of increasing cashless in the economy. The increased use of digital payments since the outbreak of COVID-19 also explains the low contribution of currency in circulation in the year 2020.

Chart 16: Contributors to M3 growth on liability side



Source: NBR, Monetary Policy and Research Directorate

On quarterly basis, the growth of 3.6 percent in broad money M3 between September and December 2020 resulted mainly from foreign currency deposits (FCD) which contributed 1.7 percent, followed by time and savings deposits (TSD) [1.1 percent], currency in circulation (CIC) [0.7 percent] and demand deposits (DD) [0.2 percent].

The contribution of FCD to M3 growth resulted from an accumulation of FCD by economic agents for imports, especially consumer goods and intermediary goods, whose demand normally increases during the festive season. The positive contributions of TSD and CIC to M3 growth reflect the increased term deposits for some big depositors, such as pension, development funds and seasonal patterns of CIC reflecting its increase towards the end of the year. The low contribution of DD to M3 growth resulted from increased investments of economic agents in government securities.

III. INFLATION DEVELOPMENTS

In line with the projections, headline inflation dropped to 5.0 percent in 2020Q4 from 9.0 percent recorded in 2020Q3. This decline reflects a significant drop in core inflation, following the downward revision of public transport fares in October 2020, and a deceleration in prices of fresh food products reflecting favorable agricultural production in season A/2021. Energy inflation picked up on the back of the rise in the international prices, during the same period.

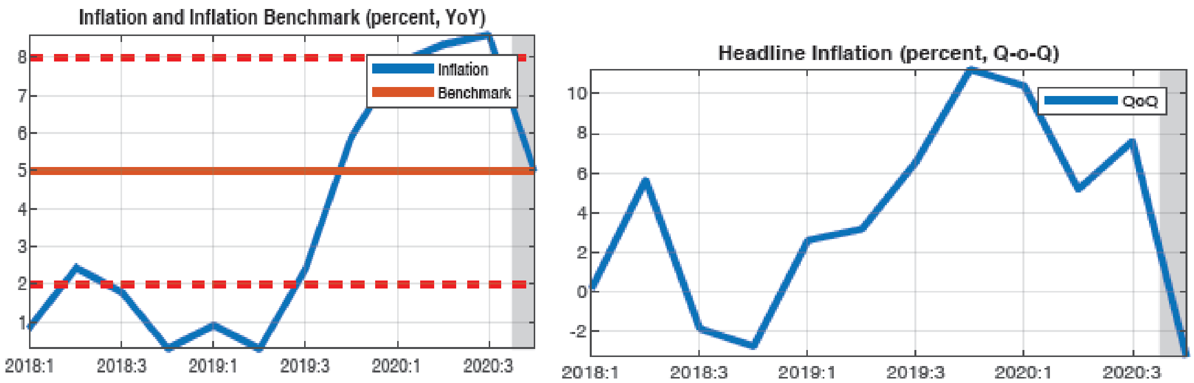
On average headline inflation stood within its benchmark band in 2020.

In 2020, headline inflation increased to 7.7 percent on average from 2.4 percent recorded in 2019. The rise in headline inflation was reflected in its main components; food inflation picked to 12.1 percent from 2.7 percent, core inflation rose to 5.6 percent from 2.3 percent, while energy inflation surged to 7.8 percent from a deflation of 0.8 percent.

In line with projections, headline inflation dropped in the last quarter of 2020.

In 2020Q4, headline inflation decelerated to 5.1 percent from 9.0 percent recorded in the previous quarter. The slowdown in headline inflation mostly reflected core and food inflation. Core inflation reduced to 4.2 percent from 7.2 percent, while food inflation declined to 6.2 percent from 11.3 percent. The easing trend in both core and food inflation offset the slight hike in energy inflation from 5.2 percent to 5.7 percent, over the same period.

Chart 17: Developments in headline inflation (Y-o-Y, % change)



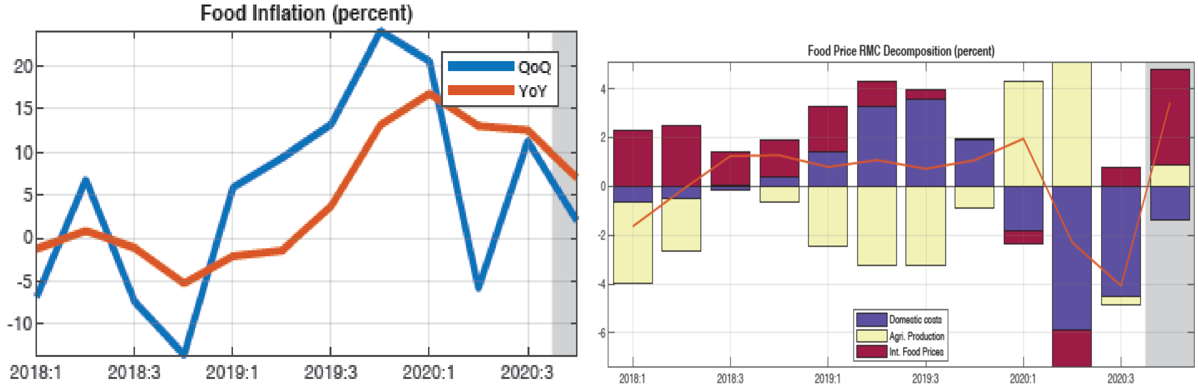
Source: NBR, Monetary Policy and Research Directorate

Food inflation declined on the back of domestic downward pressures.

In 2020Q4, food and alcoholic beverages inflation dropped in both y-o-y and q-o-q terms. The declining trend in food inflation mainly resulted from good agricultural production in season A/2021. The drop in domestic food pressures offset the surge in the international food prices during the same period, partly reflecting the difficulties in the supply chains.

The decline in food and alcoholic beverages inflation also reflected the base effect, particularly for alcoholic beverages.

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

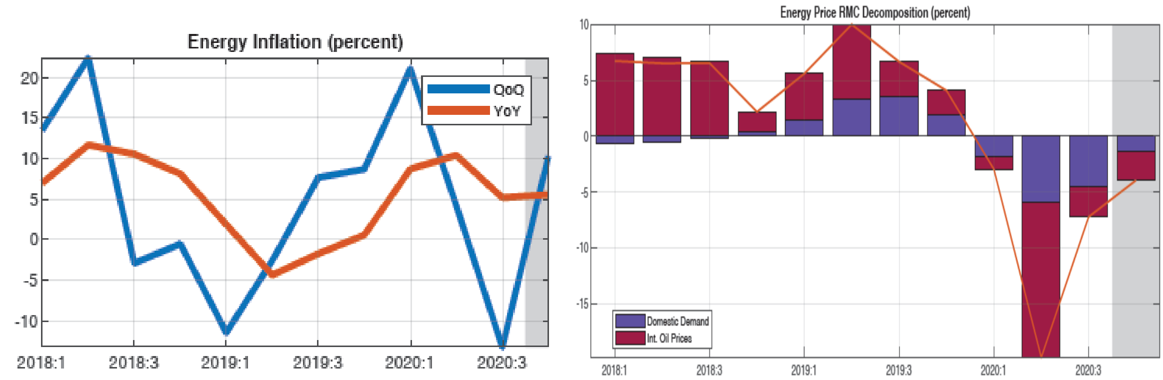


Source: NBR, Monetary Policy and Research Directorate

The trend in international oil prices created mild upward pressures on energy inflation.

In 2020Q4, energy inflation picked up in both y-o-y and q-o-q terms. The rise in international oil prices that started in October 2020, was transmitted into local pump prices, pushing up energy inflation. Other upward pressures in energy inflation were attributed to the increase in prices for energy components like solid fuels especially in October 2020.

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

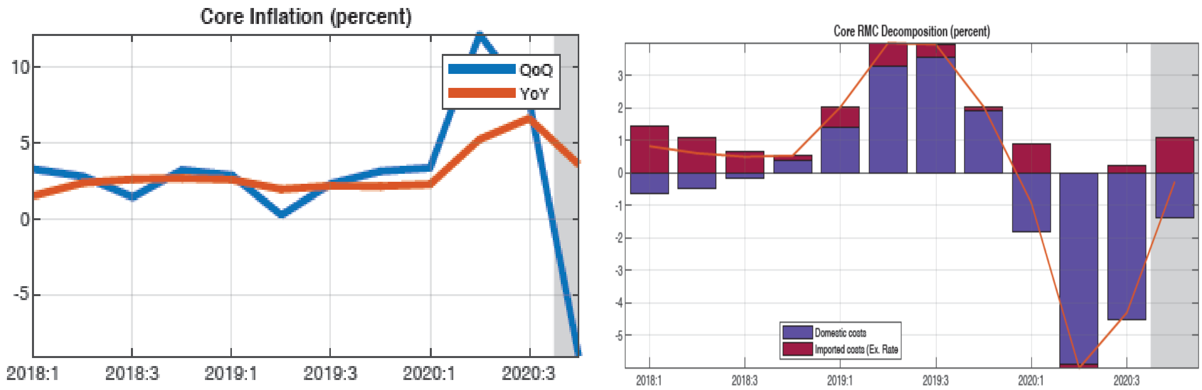


Source: NBR, Monetary Policy and Research Directorate

Core inflation recorded a downward trend in 2020Q4, reflecting the subsidy for public transport.

The drop of core inflation in 2020Q4 mainly resulted from the downward revision of public transport tariffs, after the introduction of a subsidy in the sector. This drop outweighed upward pressures from increasing prices of construction wood and supplies for building repairs that picked up, due to disruption in cross border supply chains.

Chart 20: Core inflation (excluding core food items)



Source: NBR, Monetary Policy and Research Directorate

It is worth mentioning that despite the mild economic recovery in 2020H2, the domestic economy continued to operate below the full capacity utilization and the costs of producing core domestic products remained subdued, therefore exerting no pressures on core inflation.

- End -