National Bank of Rwanda

Banki Nkuru y'u Rwanda

MONETARY POLICY REPORT

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CONTENTS

EXECUTIVE SUMMARY

Global economic outlook projected to rebound in 2021 after being hit hard in 2020.

According to the International Monetary Fund's (IMF) World Economic Outlook (WEO) update published in July 2021, the world economic growth is projected to recover from a contraction of 3.2 percent in 2020, growing by 6.0 percent in 2021, and 4.9 percent in 2022. Although the 2021 forecasts is unchanged from April projections, there are offsetting revisions across advanced economies and emerging market and developing economies reflecting differences in pandemic developments and policy shifts. The 0.5 percentage points higher for 2022 than in the April forecasts, derives largely from the forecast upgrade for advanced economies, particularly the United States, reflecting the anticipated legislation of additional fiscal support in the second half of 2021 and improved health metrics more broadly across the advanced economies group.

The domestic economy expected to further improve in 2021Q2 despite the 2nd wave of the pandemic.

Rwanda's economy continues to recover from adverse effects of the COVID-19 pandemic. Despite the second wave of the COVID-19 pandemic that led to movement restrictions between December 2020 and February 2021, the real GDP growth stood at 3.5 percent in 2021Q1 after three consecutive quarters in recession. The Composite Index of Economic Activities (CIEA) increased by 32.4 percent against a decline of 9.4 percent in 2020Q2, pointing to a strong economic performance in 2021Q2. These developments have been supported mainly by fiscal and monetary policy measures as well as the ease of COVID-19 containment measures.

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

In 2021Q2, merchandise exports[1] more than doubled to USD 286.7 million, up from USD 142.2 million recorded in the corresponding quarter of 2020 and USD 239.3 million a quarter earlier. The increase is owed to the continued recovery of external demand and domestic economic activities. The bigger increase is also due to the sharp decline in the same quarter a year ago.

The foreign exchange market remains stable.

In 2021Q2, the Rwandan franc (FRW) depreciated by 1.51 percent versus the US dollar end June 2021 slower than 1.58 percent in the similar period last year.

[1] Merchandise exports/ imports refers to exports/imports excluding gold. It includes formal exports and informal cross-border trade (ICBT).

The interbank rate remains steered around the Central Bank Rate.

The continuing accommodative monetary policy stance together with good liquidity management contributed to maintaining money market rates within the interest rate corridor. In line with the Central Bank Rate path, the interbank rates dropped by 26 basis points in the first half of 2021, to 5.19 percent on average compared to the corresponding period of 2020. The repo and reverse repo rates were set at the CBR since July 2020, in an effort to further strengthen the monetary policy transmission mechanism.

In 2021H1, the lending rate reduced by 34 basis points to 15.91 percent, reflecting a decline for both corporate and individual loans. In the same period, the deposit rate increased by 12 basis points to 7.73 percent on average compared to the corresponding period of 2020.

Monetary aggregates remained resilient to the impact of COVID -19.

The monetary sector remains resilient owing to the accommodative monetary policy and different measures that were put in place to support banks in need of liquidity and the financing of the economy.

The broad money M3 expanded by 5.3 percent in 2021Q2 (Q-o-Q) higher than a growth of 4.3 percent recorded in 2021Q1 (Q-o-Q), while growing by 17.3 percent in 2021Q2 (Y-o-Y) compared to 18.9 percent growth in 2020Q2 (Y-o-Y).

The outstanding Credit to the Private Sector (CPS) grew by 19.1 percent in 2021Q2 (Y-o-Y), compared to 14.4 percent growth in 2020Q2 (Y-o-Y). This growth emanated from new disbursed loans in the first half of 2021.

Headline inflation will evolve below 2.0 percent in 2021 and is projected to be around the 5.0 percent inflation benchmark in 2022.

In 2021Q2, headline inflation decelerated to 0.7 percent from 2.1 percent recorded in 2021Q1. The deceleration in headline inflation was reflected in its key components, mostly due to the base effect. The new projections indicate a headline inflation standing at around 0.7 percent in 2021 and then surging to 5.6 percent in 2022. The expected trend of headline inflation is backed by the projected increase in imported and domestic costs of production as both global and domestic economies are recovering from COVID-19 effects. However, the risks associated with the forecasts relate to food prices that depend on weather conditions.

I. RECENT DEVELOPMENTS AND OUTLOOK

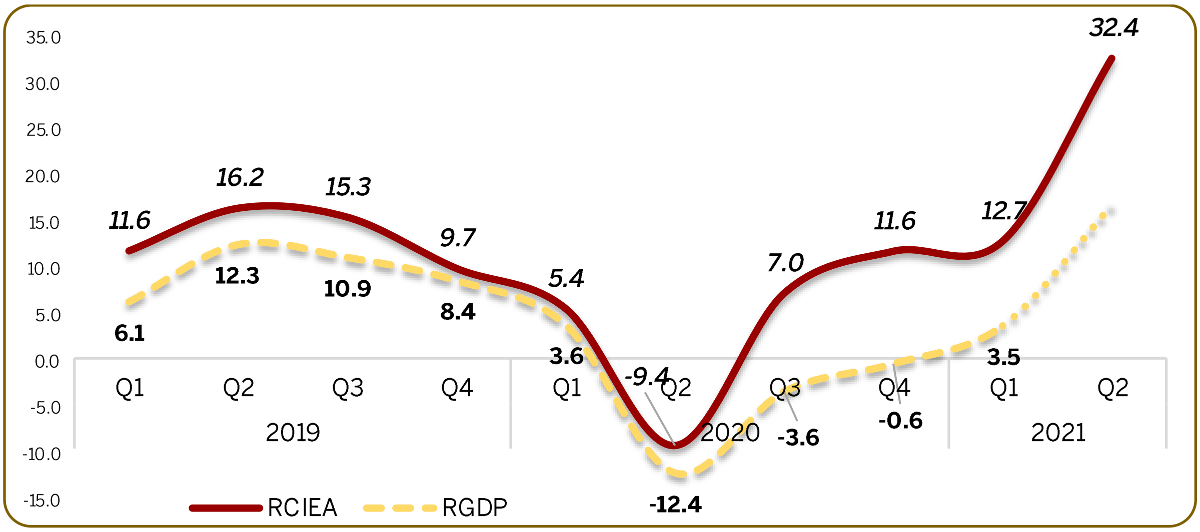
1.1 Recent developments

The economic recovery from COVID-19 related contraction has accelerated in 2021Q2 supported by fiscal and monetary stimulus, as well as the ease of containment measures. This is confirmed by the composite index of economic activities (CIEA), that increased by 32.4 percent in 2021Q2 from 12.7 percent in 2021Q1 and a decline of 9.4 percent in 2020Q2.

High-frequency indicators evidence continuous economic recovery in 2021Q2.

Rwanda's economic recovery from the COVID-19 pandemic fallout continued to gain momentum in the first half of 2021, despite the effect of the second wave of the pandemic between December 2020 and February 2021. Supported by the economic recovery plan, manufacturing and build to recover program, monetary accommodation as well as easing of restriction measures, economic activities expanded in 2021Q2 as signaled by the Composite Index of Economic Activities (CIEA). The later increased by 32.4 percent year-on-year in 2021Q2 from 12.7 percent in 2021Q1 and a decline of 9.4 percent in 2020Q2. Compared to the pre-Covid era, the CIEA rose by 19.9 percent, suggesting a return to the pre-crisis levels.

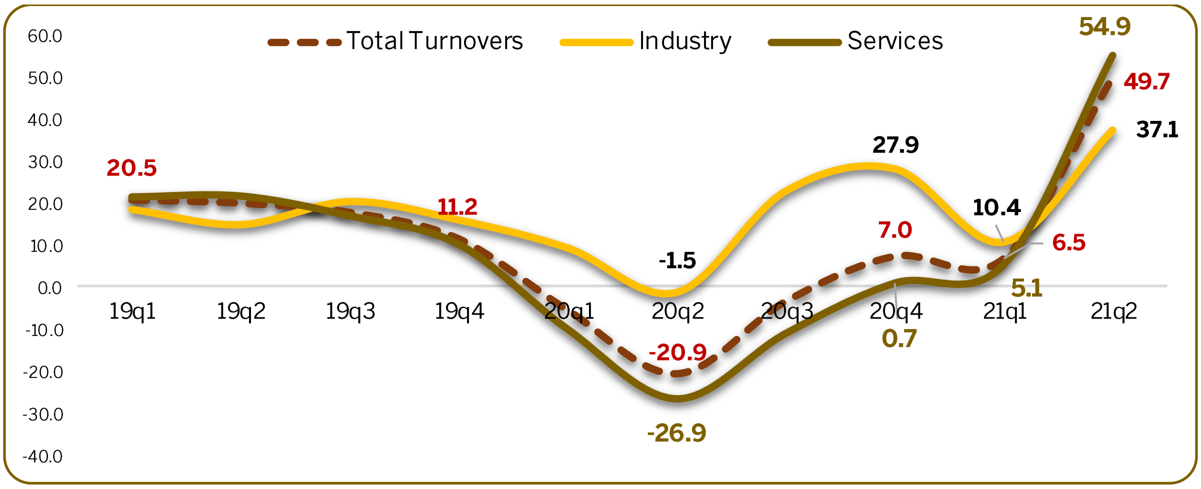
Chart 1: Quarterly Real GDP growth vs CIEA (% change, y-o-y)



Source: NBR, Monetary Policy Department

Among key components of the CIEA, the total turnovers of the industry and services sectors expanded by 49.7 percent year-on-year, against a decline of 26.9 percent in 2020Q2 and, were 18.4 percent higher compared to pre-COVID-19.

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



Source: NBR, Monetary Policy Department

The industry sector total sales increased by 37.1 percent in 2021Q2 (35.0 percent compared to the pre-COVID-19 period), supported by the economic recovery plan that included infrastructure projects, and the manufacturing and build to recover program. These projects have positive spillovers to all industrial subsectors which recorded high growth. Specifically, construction grew by 22.9 percent in 2021Q2 from a decline of 8.1 percent, while manufacturing expanded by 31.7 percent from 7.6 percent. The Manufacturing subsector benefited from increased demand for locally produced construction materials needed by on-going public and private infrastructure projects. In addition the subsector, was supported by improving foreign demand, as evidenced by increased exports of manufactured products; namely milling products (+55.7 percent), cement (+95.6 percent) and metals (+87.9 percent). The mining and quarrying subsector recorded tremendous improvement, growing by 185.8 percent in 2021Q2 against a decrease of 39.8 percent in 2020Q2, partly underpinned by rising metal and mineral prices on international market (+76.3 percent in 2021Q2 after – 13.2 percent in 2020Q2). The recovery continued in the energy and water subsector as well (+71.3 percent in 2021Q2 from -13.3 percent in 2020Q2).

Similarly, the services sector recorded a strong performance in 2021Q2, with a total turnover growth of 54.9 percent (13.2 percent compared to pre-COVID-19 period) compared to a contraction of 26.9 percent in 2020Q2.

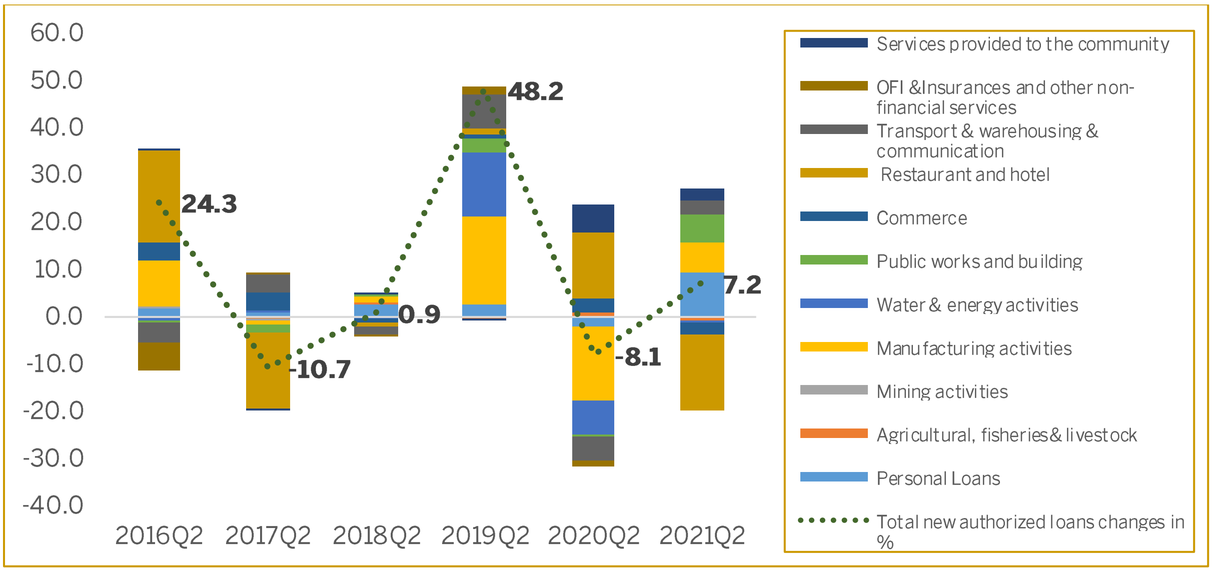
This positive trend is mainly associated with the good performance of trade services (+53.6 percent), transport and storage (+188.3 percent), hotels and restaurants (+138.8 percent), Information and communication (+46.0 percent) as well as financial services (+31.6 percent). Although these high growth rates are partly associated to the base effect, most subsectors of industry and services sectors performed well as they recorded double digit growth rates when compared to corresponding period before COVID-19. However, the performance of hotels remain below the pre-COVID-19 levels, reflecting sluggish recovery of tourism industry worldwide. Indeed, global hotel bookings fell by 25.7 percent in 2021Q2 against a drop of 72.0 percent in 2020Q2. In Africa, they fell by 55.0 percent from a decline of 92.7 percent in the corresponding period of 2020. UNWTO indicated that the devastating impact of the COVID-19 pandemic on global tourism has been carried on into 2021 such that the international tourist arrivals would fall by 55 percent up to 67 percent.

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

The outstanding Credit to the Private Sector (CPS) rose by 3.9 percent in 2021Q2 (Q-o-Q) and 19.1 percent in 2021Q2 (YoY), due to new disbursed loans in 2021.

In 2021H1, new authorized loans (NALs) picked up by 26.0 percent, compared to the contraction of 9.2 percent recorded 2020H1. Looking at Y-o-Y growth, NALs grew by 7.2 percent in 2021Q2, compared to the contraction of 8.1 percent in 2020Q2, due to the base effect related to the first lockdown (March-April 2020) to contain the spread of Covid-19.

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



Source: NBR, Monetary Policy Department

Headline inflation (y-o-y) is projected to evolve below 2.0 percent in 2021Q3

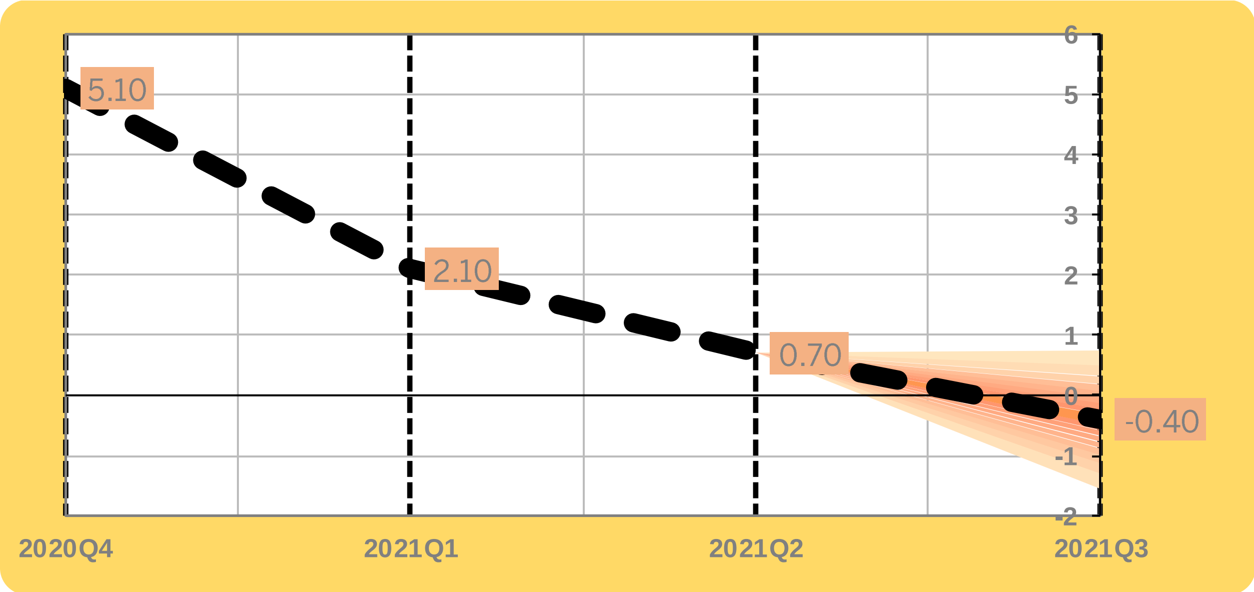
In 2021Q3, headline inflation is expected to remain below the lower bound (2.0 percent) of the 5.0 percent inflation benchmark. The projected headline inflation mostly reflects the developments in both domestic and global economy. In y-o-y terms, core inflation slightly eased in 2021Q2 and this trend is expected to continue in 2021Q3 as a result of the base effect in transport services inflation. However, domestic and imported costs of production are likely to exert upward pressures on core inflation during 2021Q3.

The upticks observed from food and non-alcoholic beverage prices in 2021Q2 are expected to continue in 2021Q3, in line with observed developments in international food prices. These pressures from international prices are likely to be eased by lower food prices following good agricultural production.

Energy inflation is projected to surge slightly in 2021Q3 and this rise is attributed to the continuous hike observed in the international oil prices as global economies are recovering from the Covid-19 pandemic. Unlike liquid fuels, solid fuels are expected to remain stable despite the dry season that sets in.

Despite the pressures observed, the 12-months moving average headline inflation is projected to evolve below the 5.0 percent inflation benchmark in 2021Q3.

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



Source: NBR, Monetary Policy and Research Directorate

1.2 Global economic outlook

According to the International Monetary Fund's (IMF) World Economic Outlook (WEO) update published in July 2021, the world economic growth is projected to recover from a contraction of 3.2 percent in 2020, growing by 6.0 percent in 2021, and 4.9 percent in 2022. Growth projections for 2021 is unchanged from April forecast while projections for 2022 are 0.5 percentage points stronger than in April forecast, reflecting US anticipated legislation of additional fiscal support in the second half of 2021 as well as improved health metrics more broadly across the advanced economies group.

Global growth projected to recover in 2021 after being hit hard in 2020.

According to the International Monetary Fund's (IMF) World Economic Outlook (WEO update) published in July 2021, the world economic growth is projected to recover from a contraction of 3.2 percent in 2020, growing by 6.0 percent in 2021, and 4.9 percent in 2022. The contraction for 2020 was the worst contraction since the global financial crisis, owing to the COVID-19 pandemic outbreak. Even though the 2021 forecasts are unchanged from April projections, there are offsetting revisions across advanced economies and emerging market and developing economies reflecting differences in pandemic developments and policy shifts.

The projected growth for 2022 is 0.5 percentage points higher than in the April forecasts, resulting largely from the forecast upgrade for advanced economies, particularly the United States, reflecting the anticipated legislation of additional fiscal support in the second half of 2021 and improved health metrics more broadly across the advanced economies group. However, uncertainty surrounding the global projections remains high, primarily related to the prospects of emerging market and developing economies.

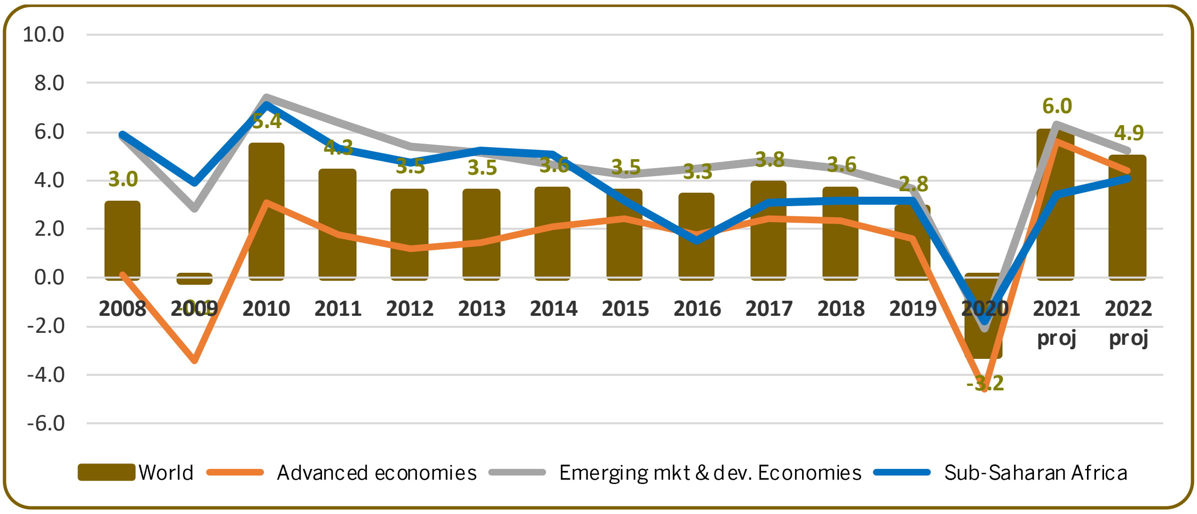
With regard to pandemic related downside factors, global growth would be weaker than projected if logistical hurdles in procuring and distributing vaccines in emerging market and developing economies lead to an even slower pace of vaccination than assumed. Such delays would allow new variants to spread, with possibly higher risks of breakthrough infections among vaccinated populations.

In addition to the downside factors but beyond pandemic –related factors, social unrest, geopolitical tensions, cyberattacks on critical infrastructure, or weather-related natural disasters could further weigh on the global recovery.

Furthermore, the assumed fiscal impulse in the United States may be weaker than expected if legislated infrastructure and family support packages turn out smaller than announced or if the multiplier effect on activity is weaker than assumed. This would lead to lower US growth than in the baseline, with smaller spillovers to trading partners. Growth could also disappoint relative to the forecast if financial conditions were to tighten abruptly, for instance if inflationary pressures persist longer than expected and lead to another reassessment of the monetary policy outlook.

On the upside, better global cooperation on vaccines could help prevent renewed waves of infection and the emergence of new variants, end the health crisis sooner than assumed, and allow for faster normalization of activity, particularly among emerging market and developing economies. Moreover, a sooner-than-anticipated end to the health crisis could lead to a faster-than-expected release of excess savings by households, higher confidence, and more front-loaded investment spending by firms.

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



Source: IMF WEO update, July 2021

In 2021, economic growth in advanced economies is projected to recover by 5.6 percent after a contraction of 4.6 percent in 2020, reflecting recovery in all major economies. These economies include the United States (7.0 percent after -3.5 percent), Eurozone (4.6 percent after -6.5 percent), United Kingdom (7.0 percent from -9.8 percent), and Japan (2.8 percent from -4.7 percent). GDP growth prospects for 2021-2022 have been revised up by 0.5 and 0.8 percentage points respectively, from expected further normalization in the second half of 2021 as vaccine rollout proceeds and with additional fiscal support.

Relative to the April WEO projections, the US growth projections are revised up by 0.6 percentage points in 2021 and 1.4 percentage points in 2022, reflecting anticipated further fiscal support. The significantly improved outlook for the US economy derives from the impact of anticipated legislation boosting infrastructure investment and strengthening the social safety net in the second half of 2021. The additional support is expected to lift US GDP growth by 0.3 percentage points in 2021 and by 1.1 percentage points in 2022, with positive spillovers to trading partners.

Contrary, Japan's 2021 projections are revised down by 0.5 percentage points, mostly reflecting tighter restrictions in the first half of the year as caseloads picked up, but anticipated to see a stronger rebound in the second half of 2021, as vaccination proceeds and the economy fully reopens, improving its growth forecast for 2022 to 3.0 percent.

Emerging market and developing economies are projected to recover by 6.3 percent in 2021, after contracting by 2.1 percent in 2020, and projected to grow by 5.2 percent in 2022. The forecast for the group was revised down by 0.4 percentage points in 2021 compared with the April WEO projections, largely attributed to growth markdowns for emerging Asian economies, while growth forecasts for other regions have generally been revised up for 2021, largely reflecting the stronger-than-anticipated outturns in the first quarter.

In China, GDP growth is projected at 8.1 percent in 2021, from 2.3 percent recorded in 2020. Compared to the projected growth of 8.4 percent in April 2021 WEO forecast, the projected growth for 2021 was revised down by 0.3 percentage points on scaling back of public investment and overall fiscal support. In 2022, the Chinese economic growth is projected at 5.7 percent.

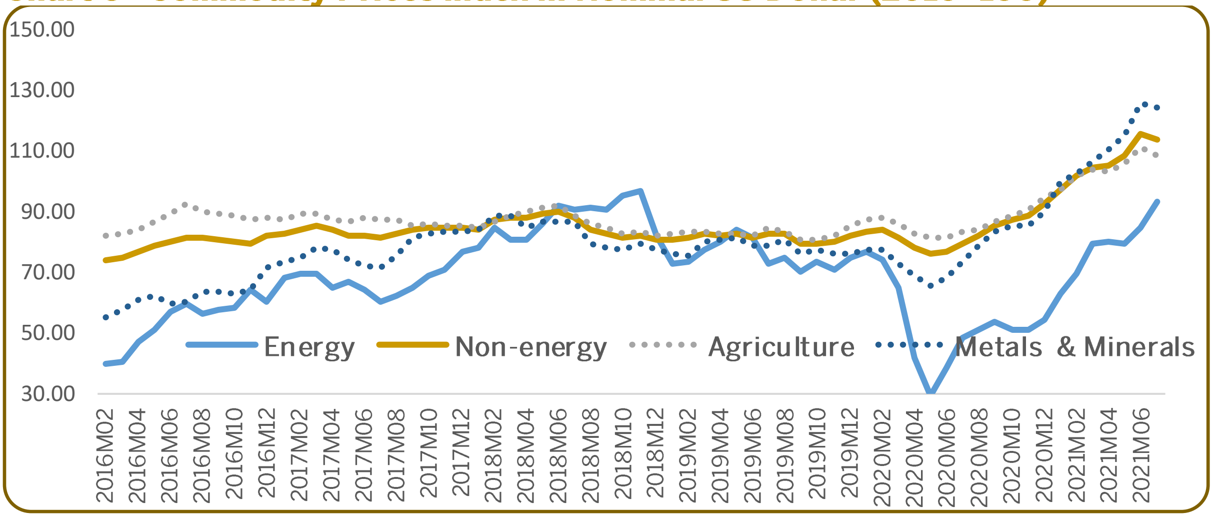
According to the IMF July 2021 WEO update, India's economy is projected to recover by 9.5 percent in 2021, from a contraction of 7.3 percent recorded in 2020, and projected to grow by 8.5 percent in 2022. The projections for 2021 have been revised down by three percentage points, following the severe second COVID-19 wave during March–May 2021.

The Sub-Saharan African economy is unchanged relative to April WEO forecast of 3.4 percent in 2021, compared to a contraction of 1.8 percent in 2020, reflecting economic recovery mainly in Nigeria (2.5 percent) and South Africa (4.0 percent). The unchanged revision reflects an upgrade for South Africa following a strong positive surprise in the first quarter of 2021 offset by downward revisions in other countries. The worsening pandemic developments in Sub-Saharan Africa are expected to weigh on the region's recovery, and tourism-reliant economies will likely be the most affected. However, projections for 2022 were slightly revised up by 0.1 percentage point to 4.1 percent.

Higher global commodity prices induced by a rebound in global demand.

In 2021Q2 (y-o-y), global commodity prices increased, reflecting a rebound in global demand. Energy prices rose highly by 121.1 percent from a drop of 51.3 percent in 2020Q2, attributed mainly to the rise in crude oil prices. Non-energy commodity prices increased by 45.6 percent in 2021Q2, after a decline of 5.7 percent in 2020Q2, owing to higher prices for metals & minerals, agricultural commodities, and fertilizers. In the first half of 2021, global commodity prices increased, reflecting a rebound in global demand. Energy prices rose by 63.1 percent from a drop of 36.6 percent in the first half of 2020, attributed mainly to the rise in crude oil prices. Non-energy commodity prices increased by 36.5 percent in 2021H1, after a decline of 3.4 percent in 2020H1, owing to higher prices for metals & minerals, agricultural commodities, and fertilizers.

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

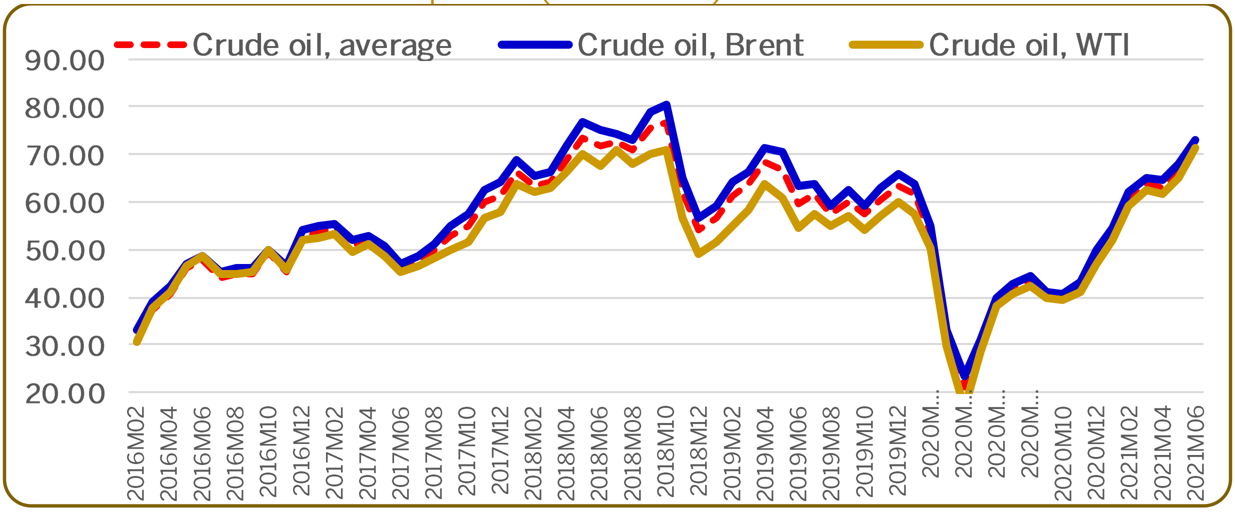


Source: World Bank, June 2021

Global energy prices are projected to further increase by 36.2 percent in 2021 and by 6.1 percent in 2022, attributed mainly to the projected rising crude oil prices. Non-energy prices are projected to increase by 26.5 percent, following the projected increase for metals & minerals, and agricultural commodities mostly food prices.

In 2021Q2, crude oil prices increased sensitively by 121.3 percent on average compared to a decline of 53.4 percent in 2020Q2, following the rebound in global demand. In the first half of 2021, crude oil prices increased by 59.2 percent on average compared to a decline of 36.8 percent in the first half of 2020. In July 2021, IMF projected oil prices to increase by 56.6 percent, from USD 41.30/barrel in 2020 to USD 64.68/barrel in 2021, reflecting an expected rise in oil consumption.

Chart 7: Crude Oil Price Developments (USD/barrel)



Source: World Bank commodity prices, July 2021

In 2021Q2, average prices for agricultural commodities increased by 32.4 percent from a decline of 1.5 percent in 2020Q2, driven by supply shortfalls and stronger-than-expected demand in some oils and meals. In the first half of 2021, average prices for agricultural commodities increased by 26.1 percent from 0.6 percent in the first half of 2020, due to the rising prices of food (33.7 percent); of which oils & meals, grains, and other foods prices rose by 55.4 percent, 31.5 percent and 11.5 percent, respectively. Agricultural commodity prices are projected to further increase by 13.5 percent in 2021, attributed mainly to the projected rising food prices (17.1 percent), and beverages (1.4 percent), of which coffee Arabica (5.4 percent), and coffee Robusta (5.3 percent).

Metals & mineral prices went up highly by 76.3 percent in 2021Q2, compared to a decline of 13.2 percent in 2020Q2, reflecting the impact of rising demand that favored industrial production activities. Prices increased for precious metals as uncertainties overshadowed prospects for the global economy and increased the demand for safe-haven assets. Precious metals rose by 13.7 percent after an increase of 27.0 percent in 2020Q2. In the first half of 2021, metals & mineral prices rose by 60.5 percent compared to a drop of 10.3 percent in the first half of 2020, reflecting the impact of rising demand that favored industrial production activities. Metals & mineral prices are projected to increase further by 30.5 percent in 2021, attributed mainly to the projected increase of tin prices by 46.0 percent, but will later drop by 12.1 percent in 2022.

Prices for fertilizers increased by 57.4 percent in 2021Q2 from a drop of 17.8 percent in 2020Q2. In the first half of 2021, prices increased (y-o-y), by 45.2 percent, after a decline of 16.8 percent in the corresponding half of 2020. The World Bank projects an increase of 27.0 percent in 2021 and a decrease of 4.9 percent in 2022.

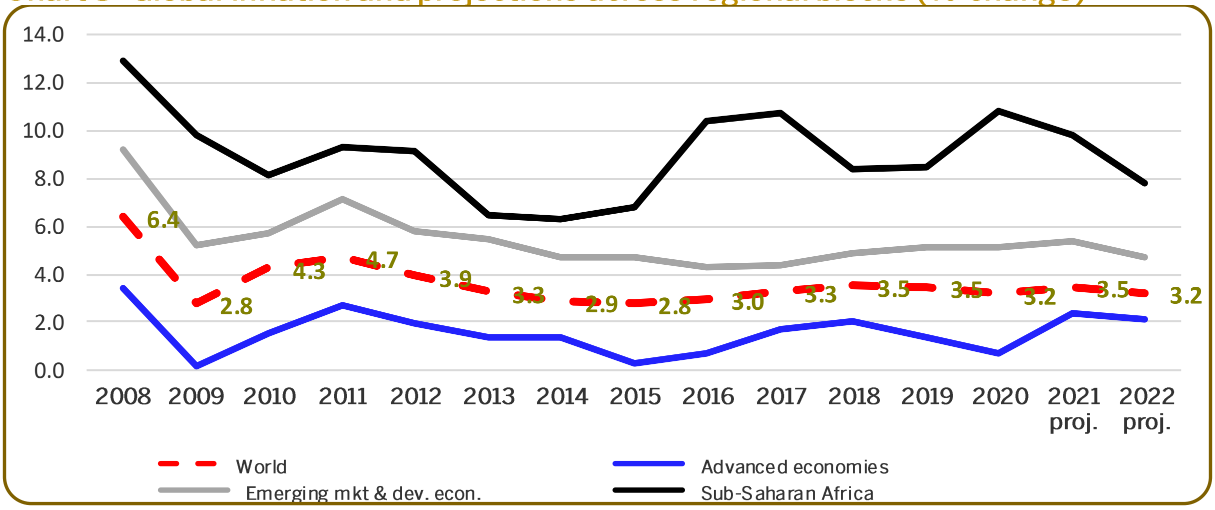
Global inflation expected to remain subdued untill 2022.

World annual average inflation is projected at 3.5 percent in 2021 from 3.2 percent in 2020, following a rebound in global demand and rising commodity prices. In some emerging market and developing economies (Sub-Saharan Africa and the Middle East and Central Asia), food prices have increased significantly amid shortages and the rise in global food prices. Currency depreciation has also lifted prices of imported goods, further adding to overall inflation. Global inflation is projected to ease to 3.2 percent in 2022.

In advanced economies, consumer price inflation is expected to increase to 2.4 percent in 2021 from 0.7 percent in 2020, reflecting stronger economic activities and higher commodity prices. The annual average inflation is projected to rise to 2.3 percent in 2021 from 1.2 percent in 2020 in the United States, at 1.4 percent from 0.3 percent in the Euro zone, and at 1.5 percent after 0.9 percent in the United Kingdom, over the same period, leaving room to Central Banks for further monetary easing.

In the emerging market and developing economies, inflation is projected to rise to 5.4 percent in 2021, from 5.1 percent in 2020, but projected to ease to 4.7 percent in 2022. The Chinese annual average inflation is projected to ease at 1.2 percent in 2021, from 2.4 percent in 2020, and projected at 1.9 percent in 2022.

Chart 8- Global inflation and projections across regional blocks (% change)



Source: IMF, April 2021 and July 2021 WEO update

In Sub-Saharan Africa (SSA), annual headline inflation is projected to ease to 9.8 percent in 2021, from 10.8 percent in 2020, following projected falling inflation rates in Zimbabwe (99.3 percent from 557.2 percent), Ethiopia (13.1 percent from 20.4 percent), Democratic Republic of Congo (10.9 percent after 11.3 percent), and Senegal (2.0 percent from 2.5 percent). Sub-Saharan Africa's inflation is projected to ease further to 7.8 percent in 2022.

In the five countries of the East African Community (EAC-5), annual headline inflation is estimated to ease at 4.4 percent in 2021, from 4.5 percent in 2020, reflecting the projected lower inflation rate in Burundi (4.1 percent from 7.3 percent in 2020), Rwanda[2] (2.5 percent from 7.7 percent), and Kenya (5.0 percent compared to 5.3 percent). The EAC-5 stable and low inflation is attributed to the good agriculture production owing to favorable weather conditions, and effective monetary policies implemented by Central Banks.

1.3 Key macroeconomic projections

Headline inflation stood at 2.1 percent in 2021Q2 and it is projected to evolve below 2.0 percent in the coming months, averaging at 0.7 percent in 2021. Over the policy horizon, core inflation is expected to slightly hike in 2022 and 2023, reflecting the increase in domestic and imported costs of factors of production following the recovery in economic activities. International food prices are expected to create upward pressures on food inflation but this trend is projected to be reversed towards the end of 2022 as the international food prices stabilize. Similarly, the costs of producing energy items are expected to exert upward pressures on energy inflation following the rise in the international oil prices. In view of the above, headline inflation is projected to increase to 5.6 percent in 2022.

1.3.1 Forecast assumptions

The recovery in global economy is expected to have positive effect on domestic economy in the medium term.

IMF's projections of global economy in 2021 remained at 6.0 percent as published by World Economic Outlook in July 2021. The projections in July 2021 also indicate a growth of 4.9 percent in 2022 (from 4.4 percent forecasted back in April 2021). The expected upward trend in global economy for 2021-2022 reflects mainly the positive impact from the vaccination campaigns, the continuous fiscal support and the rebounding demand. For some regions such as USA and the Eurozone, the economies are likely to produce above their full capacity in the medium-term. However, inflation remains globally well-anchored especially in advanced economies, with monetary authorities maintaining accommodative monetary policy stance.

[2] In this paragraph, we use IMF projections published in April 2021 for consistency with other EAC countries. In subsequent sections, inflation projection has been revised downward in NBR August 2021 forecast round.

The increasing trend of the global commodity prices is projected to continue and will continue to exert pressures on imported inflation.

Since 2021, commodity prices surged on the back of the global recovery from the recession recorded in 2020, improved growth prospects and commodity-specific supply factors for crude oils and food stuffs. Going forward, the World Economic Outlook report of July 2021 indicated that commodity prices are projected to increase significantly at faster pace than previously projected in April 2021. With this upward trend, oil prices in 2022 and 2023 are expected to reach above the levels recorded in 2020, as the global demand continues to steadily hike.

In 2021, non-oil commodity prices are also expected to rise to nearly 30 percent above 2020 levels, reflecting particularly strong increases in the price of metals and food items. The expected rise in food prices is explained by excess demand for food stuffs though this trend may reverse going forward (2022 and 2023). Some risks vis-à-vis the trend in commodity prices include the developments of the pandemic (for industrial commodities) and weather shocks (for agriculture production). The projected increase in global commodity prices will push up imported inflation through imported food and energy items.

The rise in fiscal spending is expected to continue over the medium term but it will not create pressures on inflation.

Since the beginning of the pandemic of COVID-19 in 2020, the Government of Rwanda intervened to limit its negative impact through fiscal policy measures to support the economy. Going forward, annual budget deficits are projected to rise following the additional spending over FY20/21-FY22/23, reflecting the measures to first truck the rollout of COVID-19 vaccines and other initiatives that are linked to government's priorities to boost domestic economic activities. Despite the expected increase in fiscal deficit to support the economic recovery, this path will not create pressures on inflation going forward.

1.3.2 Baseline projections of key macroeconomic variables

The domestic economic growth is projected to continue recovering and may return to its pre-pandemic trend over the policy horizon.

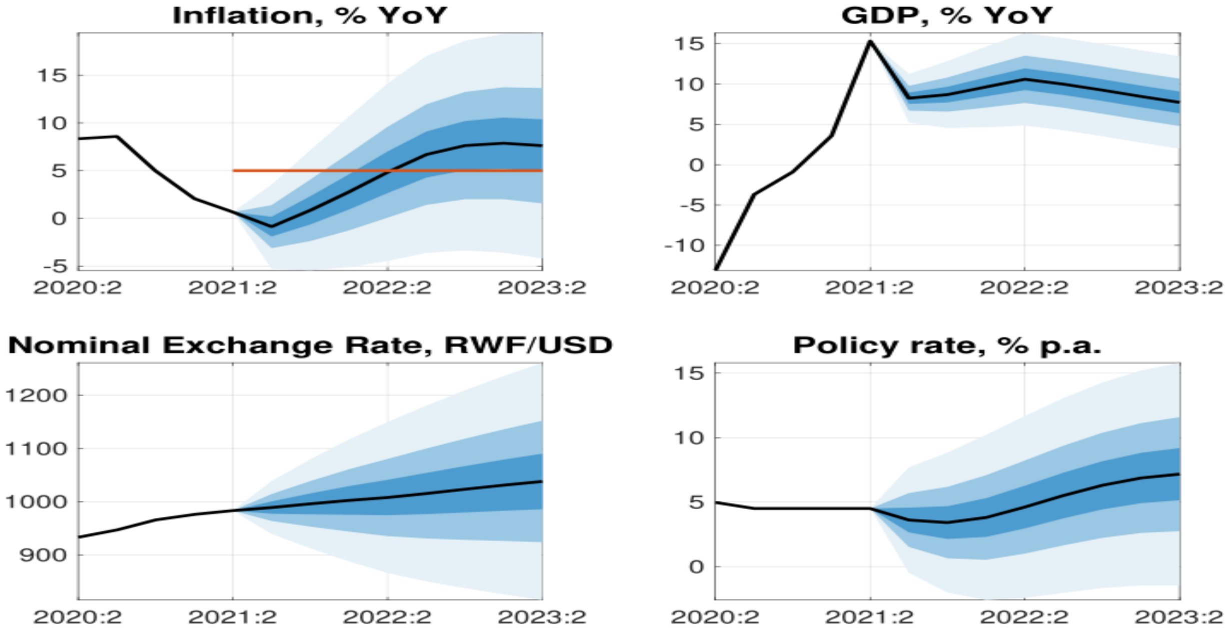
In the past two quarters, the domestic economy recorded positive growth from the 2020 recession. In 2022 and 2023, projections point to continued recovery of domestic economy supported by rising global demand and domestic policies put in place to stimulate demand in non-agricultural sectors. With the expected systematic reopening of economic activities, the recovery in output is likely to evolve around the pre-pandemic levels (for 2019Q2) by

2022Q2, though uncertainties remain, depending on the developments in outbreak of COVID-19.

1.3.3 Projections of key macroeconomic indicators

Taking into account the projected developments in the global economy and commodity prices, domestic fiscal spending and other key macroeconomic variables, headline inflation is projected to stand around 0.7 percent in 2021. Headline inflation will then increase to 5.6 percent in 2022. Other key macroeconomic indicators are projected to evolve as shown in figure 2 below.

Chart 9-Projections of key macroeconomic variables



Source: NBR, Monetary Policy and Research Directorate

II. DOMESTIC ECONOMIC DEVELOPMENTS

2.1 Economic growth

The Rwandan economy has been gradually recovering from the adverse effects of COVID-19, on the back of sizeable fiscal and monetary support. The real GDP increased by 3.5 percent in 2021Q1 after -0.6 percent in 2020Q4, -3.6 percent in 2020Q3 and -12.4 percent in 2020Q2.

Gradual recovery of domestic economy from the recession caused by the COVID-19 pandemic.

Rwandan economy has been gradually recovering from the adverse effects of COVID-19 pandemic, which led to a contraction of economic growth of 3.4 percent in 2020. Despite the second wave of infections that prompted a partial lockdown, real GDP growth stood at 3.5 percent in 2021Q1 mainly due to good performance in agriculture and industry sectors, following three consecutive quarters of contraction.

The agriculture sector grew by 6.8 percent in 2021Q1, from a decline of 0.5 percent in 2020Q1. This improved performance was led by good harvest of food crops during 2021 agricultural season A, supported by favorable weather conditions and increased use of agricultural inputs, notably fertilizers and improved seeds. Food production increased by 7.0 percent and represented 64.8 percent of 2021Q1 agriculture's value added. Moreover, export crops production rose by 7.0 percent from a decrease of 15.7 percent, led by coffee that represented 42.3 percent of the subsector and which production grew by 30.3 percent against a contraction of 37.7 percent in 2020Q1.

Industrial production recorded a growth of 9.7 percent in 2021Q1 from 1.9 percent in 2020Q1, supported by fiscal and monetary policy measures to help the economy to recover from the adverse effects of COVID-19. The recovery process is observed across all industrial sub-sectors. Mining and quarrying grew by 3.3 percent from a decline of 26.3 percent, mainly supported by increasing mineral prices on international markets. The price index for metals and minerals increased by 45.6 percent in 2021Q1 from a contraction of 7.4 percent in 2020Q1.

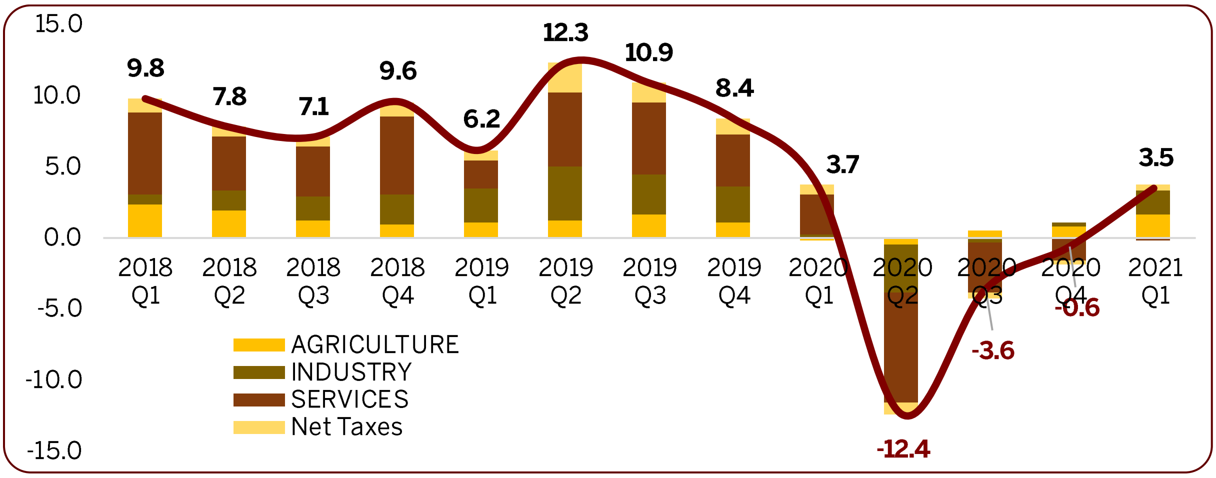
Manufacturing and construction grew by 8.3 percent and 14.4 percent in 2021Q1 respectively, benefiting from aforementioned measures which included infrastructure projects that led to increased demand for locally produced construction materials such as metal products (+28.8 percent) together with paints and varnishes (+63.1 percent), therefore contributing to a fast recovery of industry sector. The good performance of manufacturing industries was also linked to positive contribution from food processing

(+7.2 percent), beverages (+4.1 percent) and furniture as well as other manufactured products (+15.6 percent).

The services sector, though recovering (-0.4 percent in 2021Q1 from -3.3 percent in 2020Q4), remained constrained by adverse effect of COVID-19, especially tourism related services. The global evolution of the pandemic as well as related containment measures have led to a decline of 83 percent in international tourist arrivals in 2021Q1. This led to poor performance of air transport (-54.6 percent in 2021Q1 from -15.3 percent in 2020Q1), travel agents and tour (-43.3 percent in 2021Q1 from +24.4 percent in 2020Q1) as well as hotel and restaurant (-34.4 percent in 2021Q1 from +3.3 percent in 2020Q1) subsectors. In 2021Q1, overall transport services contracted by 13.9 percent as the poor performance of air transport added to the impact of the partial lockdown that caused a decline of 1.3 percent in land transport outcome. The domestic partial lockdown has also contributed to the poor performance of hotel and restaurants subsector.

The recovery of services sector was associated with the good performance of information and communication (+18.2 percent), financial services (+10.4 percent), real estate (+3.0 percent), education (+5.3 percent) and professional, scientific & technical services (+10.1 percent).

Chart 10: Real Gross Domestic Product (percentage change)



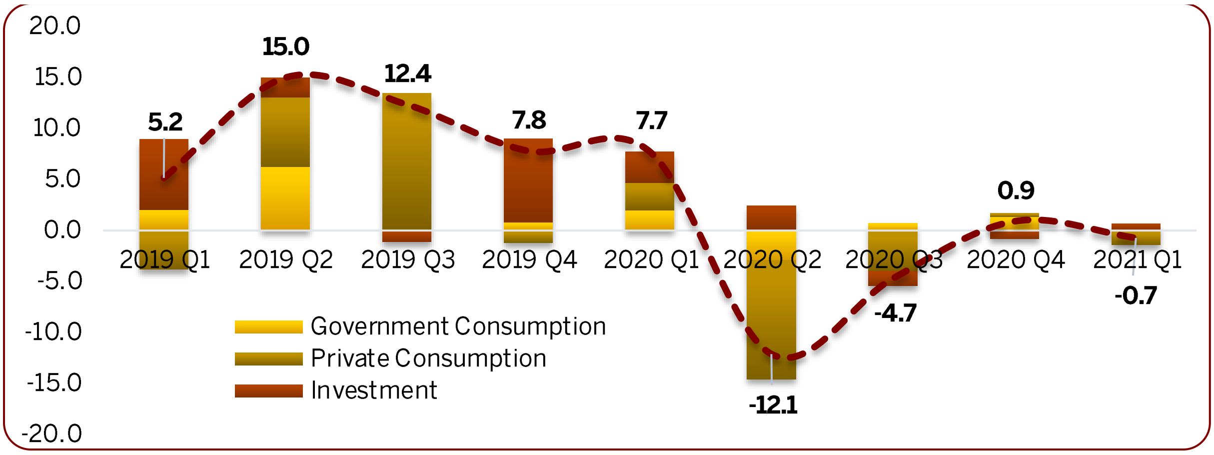
Source: National Institute of Statistics of Rwanda

The domestic demand slowed down amid partial lockdown

The domestic demand has been recovering from COVID-19 induced shock helped by resumption in economic activities as well as government supportive measures. From a contraction of 12.1 percent in 2020Q2, it grew by 0.9 percent in 2020Q4 before a decline by 0.7 percent in 2021Q1.

The slowdown in recovery of domestic demand emanates mainly from a decline in private consumption. The later decreased by 2.1 percent in 2021Q1 while it grew by 0.6 percent and 4.1 percent in 2020Q4 and 2020Q1 respectively. This trend reflected mainly the partial lockdown imposed between January and February 2021 to contain the spread of the virus amid the second wave of infection that started in mid-December 2020. However, this negative contribution from private consumption was partly offset by an increase in investment (+3.1 percent in 2021Q1 after a decline of 2.9 percent and 7.9 percent in 2020Q4 and 2020Q3 respectively), of which investment in gross fixed capital formation grew by 15.8 percent in 2021Q1 from 0.0 percent and -0.7 percent, respectively in 2020Q4 and 2020Q3.. Construction investment, representing 61.6 percent of gross capital formation in 2021Q1, grew by 14.3 percent in 2021Q1 against 5.4 percent in 2020Q1. The expansion of fixed investment is linked to the aforementioned infrastructure projects that played a notable role in the current observed Rwanda's economic recovery.

Chart 11: Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

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

In 2021Q2, merchandise exports[3] more than doubled to USD 286.7 million, up from USD 142.2 million recorded in the same quarter of 2020 and USD 239.3 million a quarter earlier. The increase is owed to the continued recovery of external demand and domestic economic activities. The bigger increase is also due to the steep decline in the same quarter a year ago.

Traditional exports revenues grew by 47.8 percent, year -on- year, in 2021Q2 amounting to USD 67.0 million, up from USD 45.3 million in 2020Q2, due to increased receipts from

[3] Merchandise exports/ imports refers to exports/imports excluding gold. It includes formal exports and informal cross-border trade (ICBT).

coffee exports (+39.3 percent), tea (+2.7 percent) and minerals (+139.4 percent), reflecting improving global commodity prices and value addition in minerals. In addition, exports quantities in the period under review went up significantly compared to the same period of last year as the supply disruptions caused by the pandemic reduce.

Moreover, non-traditional exports rebounded in 2021Q2, registering USD 84.3 million from USD 34.0 million a year ago, an increase of 148.7 percent, mainly attributed to increased exports of horticulture products to European market as well as manufacturing exports mainly composed of construction materials to neighboring countries. Lastly, receipts from re-exported products soared by 83.6 percent year-on-year in the second quarter of 2020, standing at USD 115.0 million from USD 62.6 million recorded in 2020Q2, largely driven by re-exports of food products while revenues from Informal Cross-Border Trade (ICBT)[4] amounted to USD 19.5 million.

Merchandise imports rose by 43.2 percent mainly driven by higher demand of consumer goods (+42 percent) largely food products, capital goods (+35 percent) mainly industrial and electrical equipment, intermediary goods (+48.1 percent) in large part driven by industrial products; and lastly energy (+29.4 percent). The increase in imports reflected the rebound of domestic economic activities in the period under review.

By including gold, total exports amounted to USD 382.4 million in the second quarter of 2021, up from USD 263.8 million, representing an increase of 45 percent year-on-year. Total imports increased by 32.6 percent, year-on-year, amounting to USD 892.3 million, up from USD 672.8 million recorder in the corresponding period of last year. As a result, total trade deficit widened by 24.7 percent amounting to USD 509.9 million in 2021Q2 from USD 409.0 million recorded a year earlier.

Projections for 2021 show that the external position will improve compared to last year, buoyed by the Rwandan plan to roll out the vaccine for COVID-19 and improved therapies. However, there are risks to these projections. Downside risks include renewed waves, virus mutations, and difficulties in accessing the vaccine in many developing countries might delay the recovery in trade, travel, and tourism. On the financing side, FDI and private borrowing are likely to remain subdued, but Rwanda could attract additional donor inflows and disbursements for the existing project, notably Bugesera airport. Projections indicate that the CAD will widen to 13.4 percent of GDP in 2021, up from 12.2 percent estimated in 2020. However, Rwanda's external vulnerability remains marginal as the gross international official reserves remain adequate. The coverage of foreign reserves is

[4] ICBT trade was suspended during April-October 2020 due to closure of borders in order to reduce the spread of the pandemic. However, at the end of November some borders with DRC resumed.

estimated at 5.1 future months of imports in 2021, before decelerating towards 4.0 in the medium term.

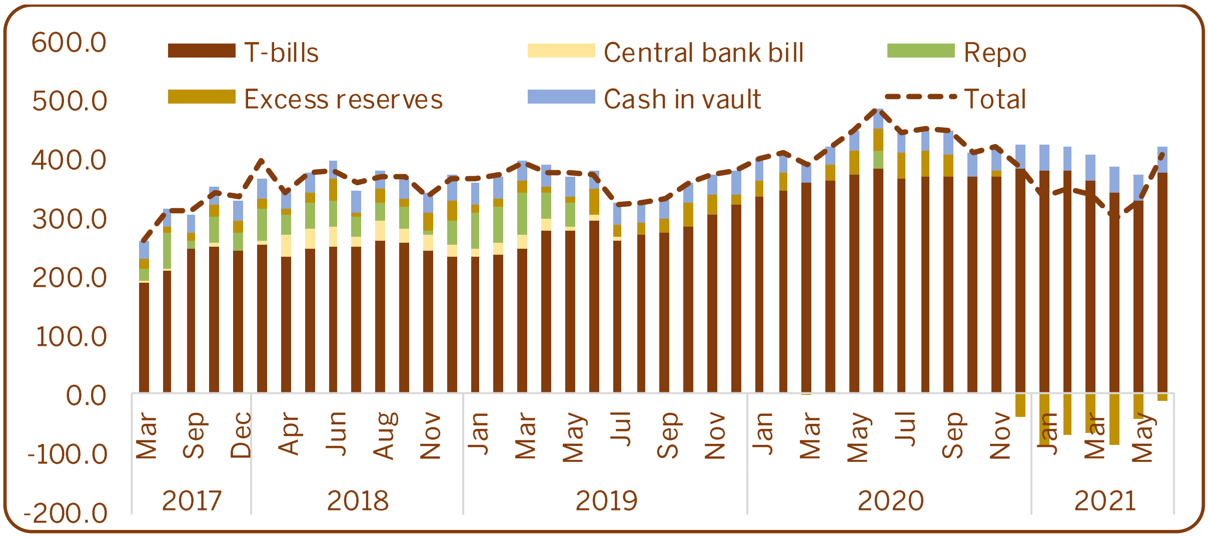
2.2 Financial and monetary developments

In May 2021, the Monetary Policy Committee (MPC) decided to maintain an accommodative monetary policy stance by keeping the Central Bank Rate (CBR) at 4.5 percent. In addition, the increase of NBR's liquidity injection through reverse repo and the rise in government spending contributed to the stability of liquidity in the banking system. As a result, excess reserves by banks which is the surplus on the regulatory reserve requirement has rebounded. In 2021Q2, broad money and outstanding credit to private sector grew by 17.3 percent and 19.1 percent (y-o-y), respectively.
Money market rates remained steered around the central bank rate. Regarding market rates, in 2021H1 (y-o-y), the average lending rate reduced by 34 basis points to 15.91 percent, reflecting a decline for both corporate and individual loans.

The growth of banking system liquidity owing to the rebound in excess reserves.

In June 2021, the banking system liquidity has rebounded with a growth pace of 19.9 percent to FRW 404.7 billion, from FRW 337.5bn recorded in March 2021. This growth is entirely attributed to the rebound in excess reserves on the back of increase in government spending recorded in June.

Chart 12: Excess reserves in the Banking System (FRW billion)



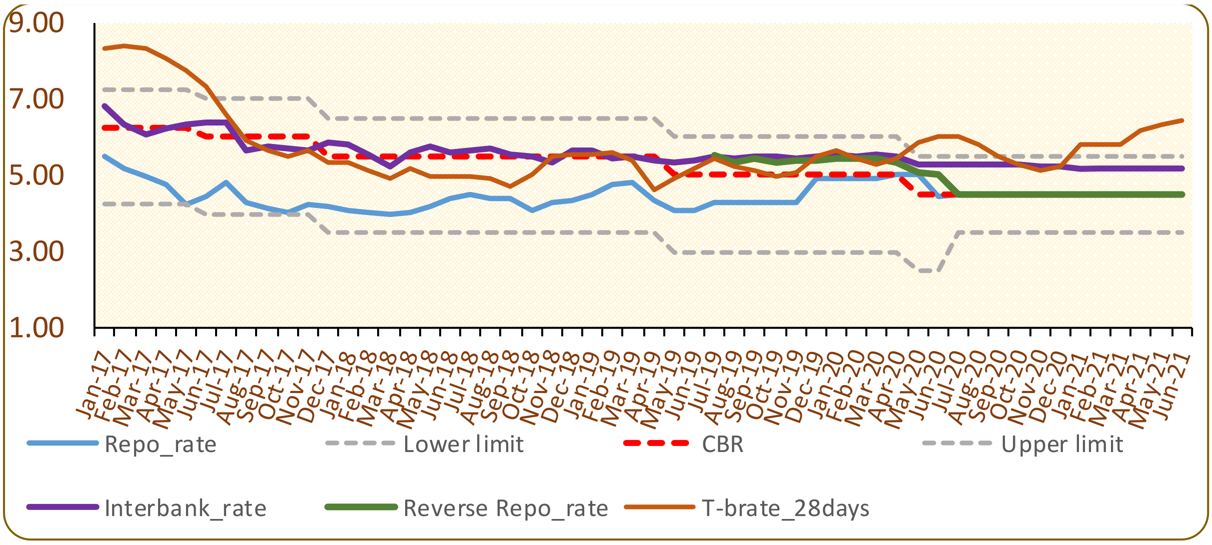
Source: NBR, Monetary Policy and Research Directorate

Money Market rates were largely steered around the central bank rate.

The Monetary Policy Committee (MPC) decided in May 2021 to maintain an accommodative monetary policy stance by maintaining the central bank rate (CBR) at 4.5 percent to assist the economy during the COVID-19 epidemic. Money market rates were steered around the central bank rate as a result of prudent monetary policy implementation.

The interbank rates dropped by 26 basis points in the first half of 2021, to 5.19 percent on average compared to the corresponding period of 2020.The repo and reverse repo rates were steered at the CBR since July 2020, in an effort to further strengthen the monetary policy transmission mechanism.

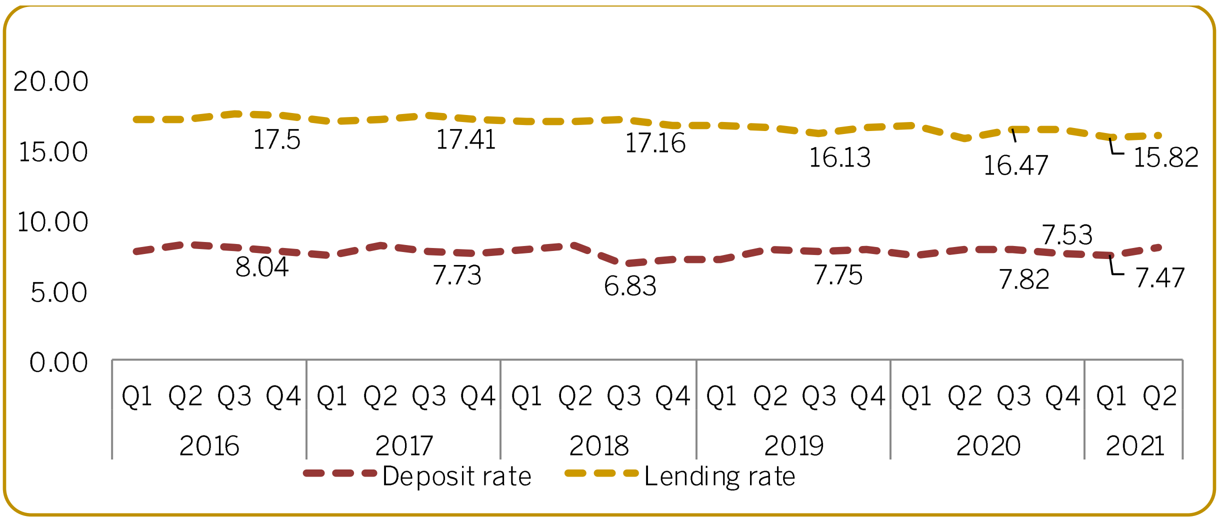
Chart 13: Money market rates developments



Source: NBR, Monetary Policy and Research Directorate

As regards market rates, the lending rate reduced by 34 basis points to 15.91 percent, reflecting a decline for both corporate and individual loans. Conversely, the deposit rate increased by 12 basis points to 7.73 percent on average compared to the corresponding period of 2020. As a result, the spread between the lending rate and the deposit rate fell by 46 basis points to 8.18 percent on average in 2021H1, down from 8.64 percent in 2020H1.

Chart 14: Market interest rates (percent average)



Source: NBR, Monetary Policy and Research Directorate

The foreign exchange market remains stable.

Compared to the same period of last year, the depreciation of the FRW was relatively muted in 2021Q2, owing to improvement in foreign inflows despite higher demand for forex compelled by recovering economic activities and rising imports to cater for Covid-19 related needs. The Rwandan franc depreciated by 1.51 percent versus the US dollar end June 2021 slower than 1.58 percent in the similar period last year. This slow depreciation rate reflects a gradual improvement in foreign inflows despite high demand for forex to cater for growing imports.

End June 2021, the local currency depreciated also by 3.26 percent against the Pound after a gain of 4.74 percent end June 2020. The franc advanced by 1.73 percent and 5.23 percent versus the Euro and the Yen respectively, against respective decline of 1.94 percent and 2.84 percent in the corresponding period last year.

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

	FRW/USD	FRW/GBP	FRW/EUR	FRW/JPY	FRW/KES	FRW/TZS	FRW/UGS	FRW/BIF
Dec-18	4.04	-1.96	-0.07	6.20	5.46	1.24	1.77	1.93
Dec-19	4.94	8.48	2.81	6.25	4.53	3.73	5.13	-0.24
Dec-20	5.42	9.42	15.71	11.43	-1.34	5.66	7.17	2.53
Jan-21	0.28	0.94	-1.29	-1.00	-0.49	0.40	-0.82	0.18
Feb-21	0.46	2.94	-0.69	-2.39	-0.04	0.46	-0.27	0.27
Mar-21	0.70	1.52	-4.09	-6.29	0.42	0.70	0.15	0.31
Apr-21	0.99	3.48	-0.43	-4.25	2.31	0.99	2.83	0.50
May-21	1.22	5.54	0.45	-4.78	2.76	1.22	3.98	-0.45
Jun-21	1.51	3.26	-1.73	-5.23	2.83	1.51	4.10	-0.56
Jun-20	1.58	-4.74	1.94	2.84	-2.52	1.81	0.64	0.24

Source: NBR, Monetary Policy Department

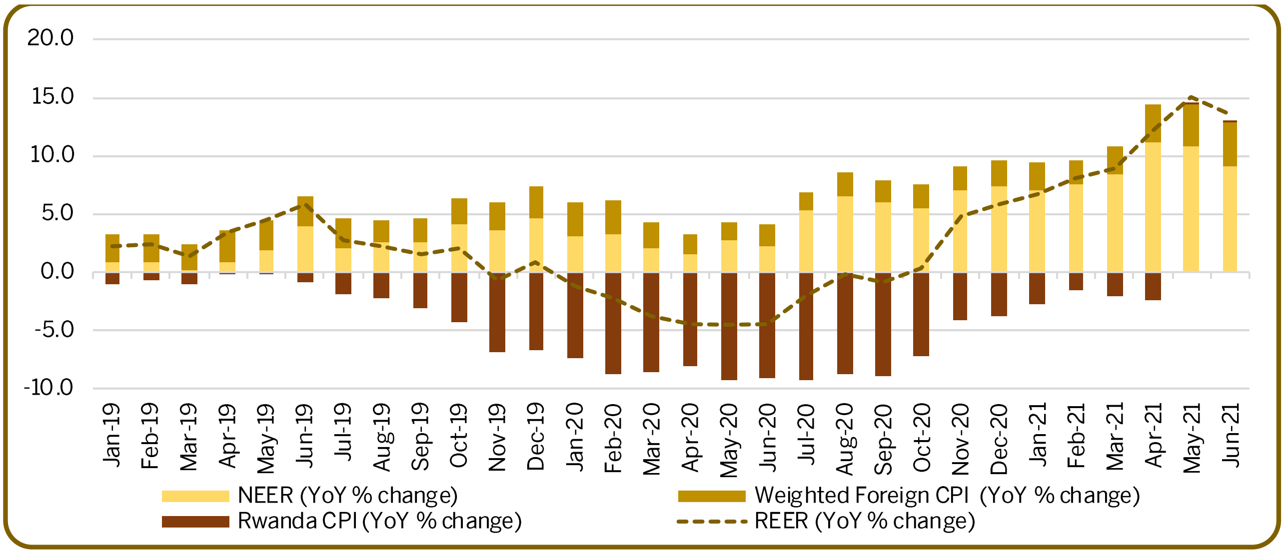
Compared to regional currencies, the FRW lost ground against the Kenyan Shilling, depreciating by 2.83 percent against an appreciation of 2.52 percent end June 2020. It depreciated further versus the UGS, losing 4.10 percent after 0.64 percent recorded in the previous year. The national currency erased some previous losses versus the Tanzanian shilling and gained against the Burundian franc. The franc lost 1.51 percent compared to the TZS and added 0.56 percent vis-à-vis the Burundian Franc while it lost 1.81 percent and 0.24 percent in the corresponding period last year.

Compared to a basket of currencies of Rwanda's main trading partners, the FRW depreciated in real terms by 13.5 percent (y-o-y) end June 2021, against a 4.5 percent appreciation recorded during the corresponding period in 2020.

This was mostly attributable to higher nominal depreciation of the franc against the currencies of some major trading partners, and higher prices of foreign goods than domestic ones. In nominal effective terms, the FRW depreciated by 9.0 percent end June

2021, compared to a depreciation of 2.2 percent end June 2020. Weighted foreign inflation rose to 3.9 percent from 1.9 percent end June 2020 while domestic inflation stood at negative 0.2 percent compared to 9.0 percent in the corresponding period 2020.

Chart 15: Drivers of REER movement



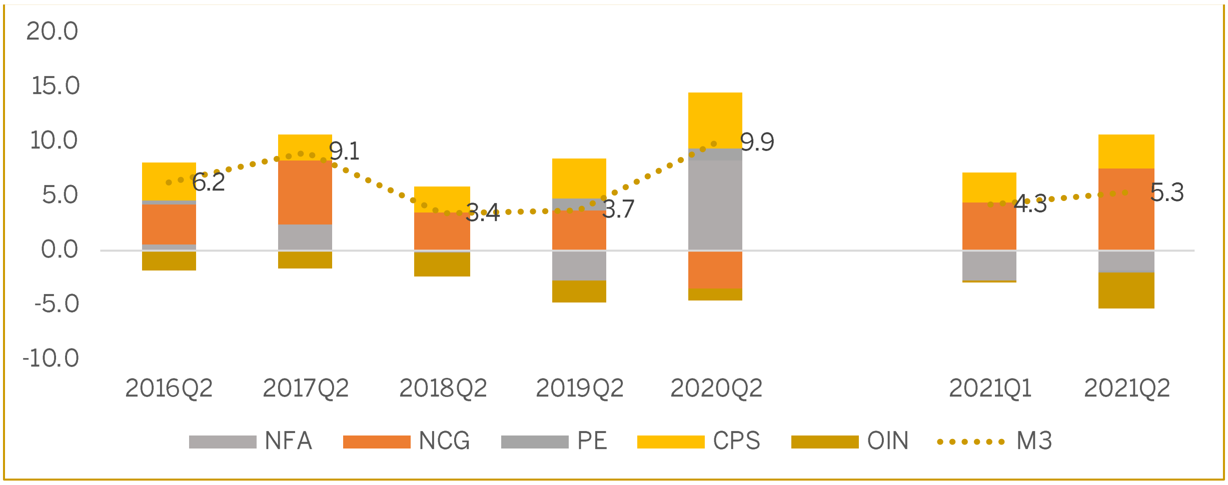
Source: NBR, Monetary Policy Department

Broad money M3 kept increasing in 2021Q2, in line with the accommodative monetary policy stance.

Broad money M3 grew by 17.3 percent in 2021Q2 (y-o-y) compared to 18.9 percent in 2020Q2. This high growth was mainly driven by a growth in Credit to Private Sector of 19.1 percent, followed by a growth in Net Credit to Government (138.4 percent) and a growth in Net Foreign Assets (7.3 percent).

Looking at q-o-q changes, the broad money M3 expanded by 5.3 percent in 2021Q2 (q-o-q) higher than a growth of 4.3 percent recorded in 2021Q1 (q-o-q). The main driver of this growth was observed in the Net Credit to Government (NCG) with a growth of 1224.9 percent, followed by a growth in the Credit to the Private Sector (CPS) of 3.9 percent. The higher contribution of NCG to the growth of M3 in 2021Q2 was attributed to the growth in government borrowing by 8.8 percent and the drawdown in government deposits by 19.4 percent during the same period. This drawdown in government deposits is reflected in an increased government spending which improved the net fiscal injection of liquidity in the banking industry by 19.8 percent in 2021Q2, as it is the normal seasonal patterns at end of the fiscal year. The contribution of outstanding CPS remained explained by the restructured loans in addition to the new authorized loans in the second quarter of 2021. However, the decline in the Net Foreign Assets (NFA), the Credit to the Public Enterprises (CPE) and Other Items Net (OIN) of –3.5 percent, –5.6 percent and –10.0 percent negatively impacted the growth of M3. The negative contribution of NFA mainly resulted from the contraction of both NBR and commercial banks' NFA on the delay of foreign inflows for budget support and projects, amid import bill expansion by 18.3 percent in 2021Q2.

Chart 16: Contributors to M3 growth from assets side

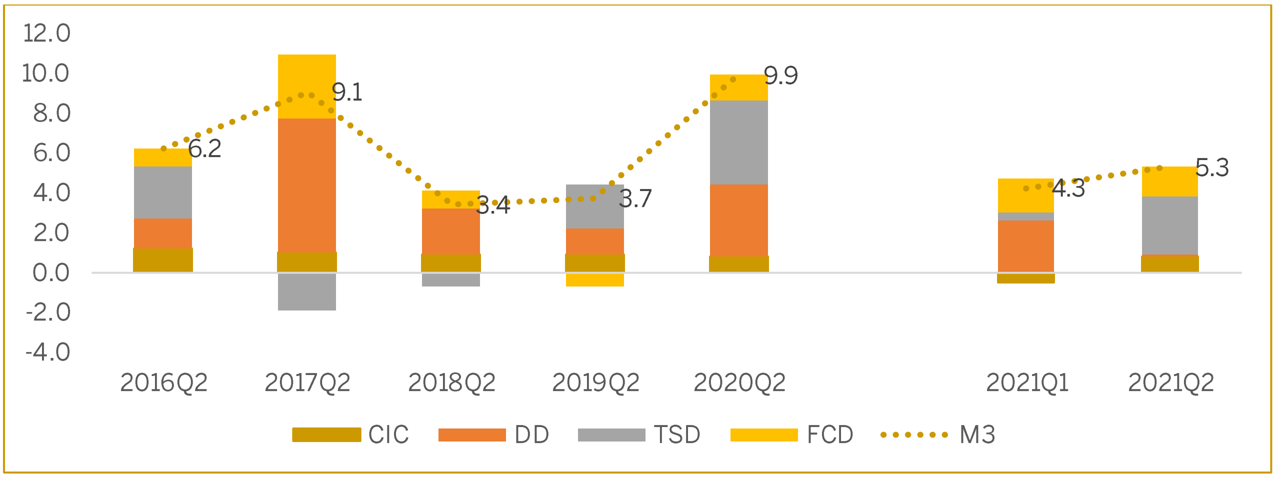


Source: NBR, Monetary Policy and Research Department

Concerning the broad money M3 components, its increase of 5.3 percent in 2021Q2 mainly resulted from the growth of time and savings deposits (9.0 percent), foreign currency deposits (6.1 percent) and demand deposits (0.4 percent). Furthermore, the currency in circulation (CIC) also positively contributed to the expansion in M3 with a growth of 10.7 percent on the back of its increasing normal trend related to higher government expenditures in the last quarter of the fiscal year.

Considering the y-o-y changes, the high growth in M3 (17.3 percent) was mainly driven by a growth in Foreign currency deposits (31.8 percent), followed by a growth in time and saving deposits (17.1 percent), demand deposits (10.5 percent), and finally CIC (10.4 percent).

Chart 17: Contributors to M3 growth from liabilities side



Source: NBR, Monetary Policy and Research Directorate

In the first half of 2021, new authorized loans (NALs) picked up by 26.0 percent, compared to the contraction of 9.2 percent recorded in the first half of 2020. The major sectors that contributed to the growth in NALs in 2021H1 are restaurants and hotels (+8.7 percent), personal loans (+6.4 percent), public works and buildings (+5.3 percent), and services provided to the community (+3.6 percent). It is worth noting that the base effect also explains the experienced growth in NALs in 2021H1 due to the first lockdown that occurred in March and April of last year to contain the covid-19 spread in the country.

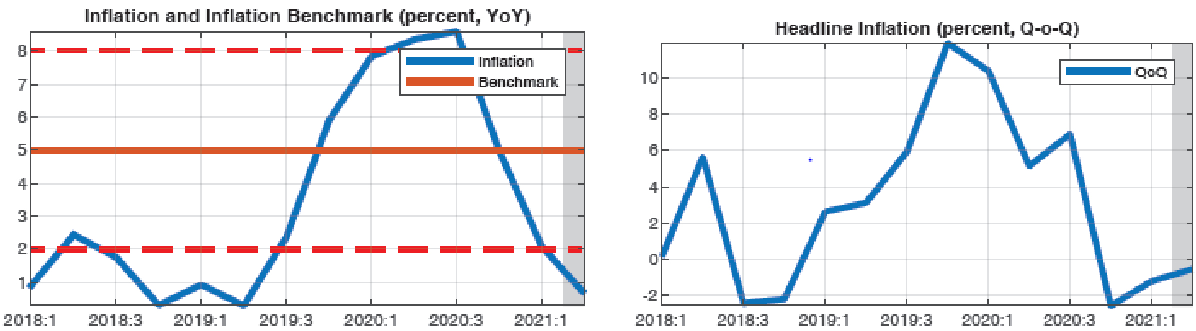
III. INFLATION DEVELOPMENTS

In 2021Q2, headline inflation decelerated to 0.7 percent from 2.1 percent recorded in the previous quarter. The decelerations in headline inflation were mainly reflected in core and energy CPI components. This declining trend observed in headline inflation resulted mostly from the higher prices recorded last year in the corresponding period.

Headline inflation slowed down in 2021Q2 on the back of the base effect.

The drop in headline inflation was reflected in core and energy components. In 2021Q2, core inflation reduced to 1.2 percent from 3.2 percent, while energy inflation eased to -1.5 percent from 1.3 percent. Unlike core and energy inflation, food inflation slightly surged to 0.6 percent from a deflation of 0.4 percent recorded the previous quarter.

Chart 18: Developments in headline inflation (y-o-y, q-o-q, percentage change)

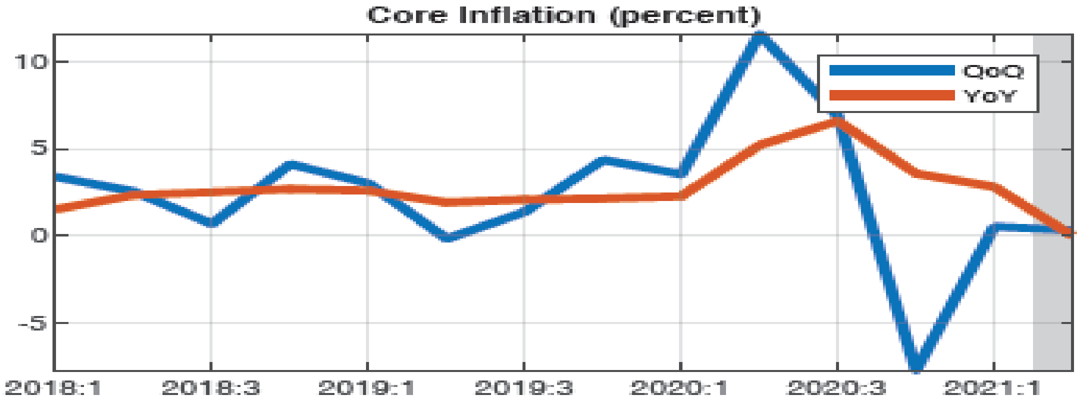


Source: NBR, Monetary Policy and Research Directorate

Core inflation (y-o-y) eased in 2021Q2 following the higher prices recorded last year in transport services component.

The downward trend observed in core inflation (y-o-y) was mostly reflected in transport component. The decline recorded in core transport is on account of the base effect with the hike of public transport fares in May 2020.

Chart 19 : Core inflation (y-o-y, q-o-q, parentage change)

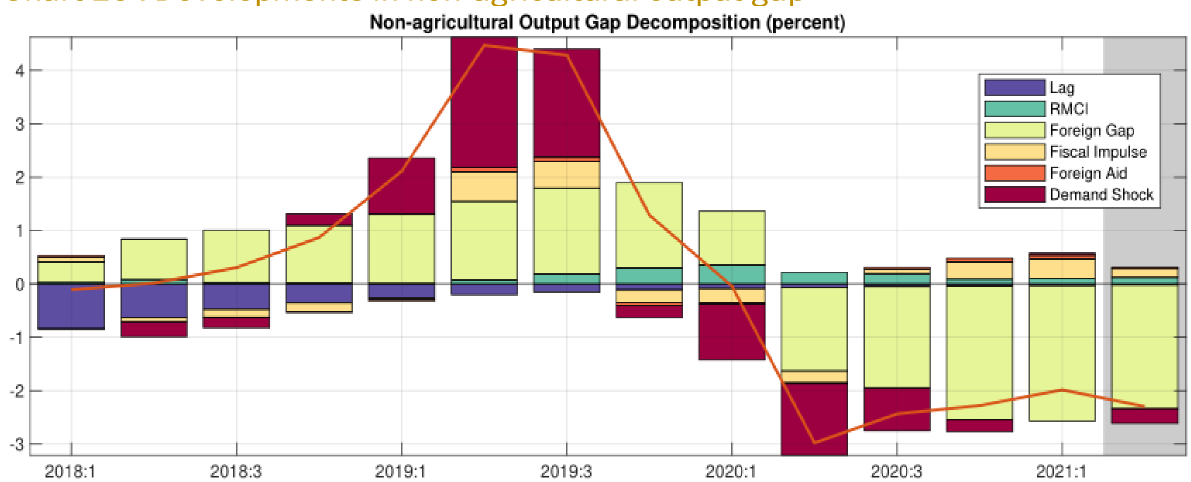


Source: NBR, Monetary Policy and Research Directorate

Subdued economic activities in non-agriculture sectors exert low pressures on core inflation (y-o-y) in 2021Q2.

Though the country put in place measures and policies to help domestic economy recover from the Covid-19 negative shock, economic activities in non-agriculture sectors remain moderate to create pressures on core inflation. Over the same period, the global environment continued to weigh on the economic recovery, hence low current pressures on core inflation.

Chart 20 : Developments in non-agricultural output gap

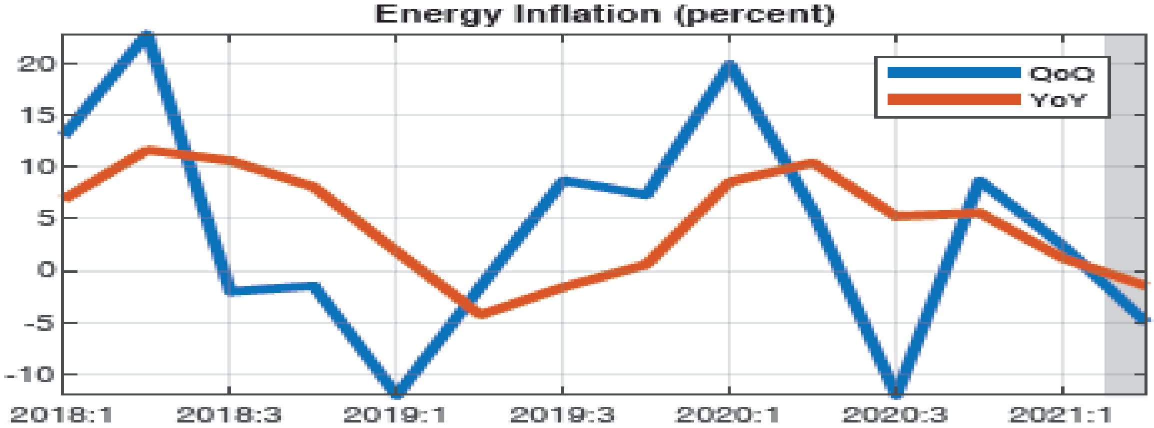


Source: NBR, Monetary Policy and Research Directorate

Energy inflation decelerated as a result of the base effect.

Energy inflation decreased in both y-o-y and q-o-q terms in 2021Q2. The drop in energy inflation that started in 2021Q1 and continued in 2021Q2, reflected the declines observed in solid fuels and electricity inflations during the same period. Solid fuels inflation reduced to -5.3 percent from 3.3 percent, while electricity inflation dropped to 0.0 percent from 4.9 percent. These decelerations were mostly attributed to higher prices recorded last year in the corresponding period. On one hand, the prices of solid fuels remained high in 2020Q2 as consumers were buying more solid fuels to make stocks on the onset of Covid-19. On the other hand, electricity tariffs were revised up and these effects faded away in 2021Q2.

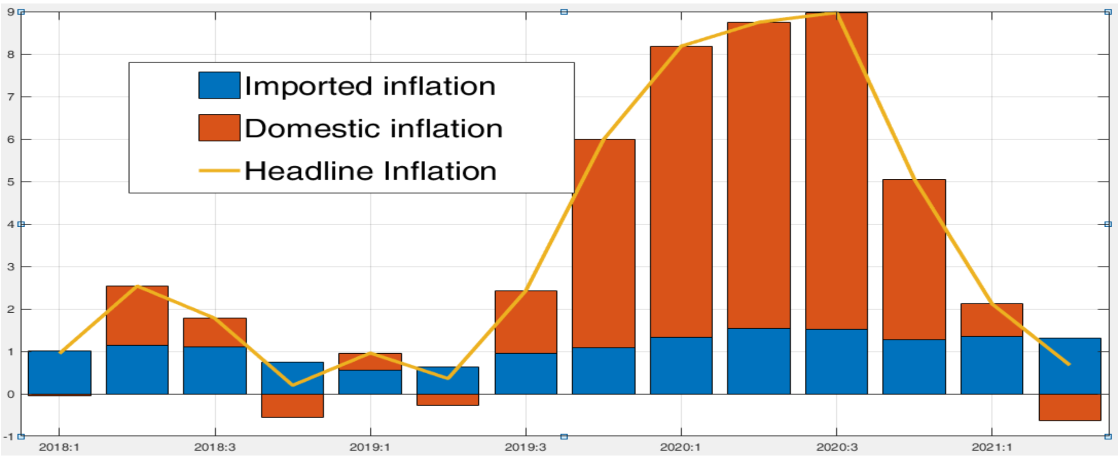
Chart 21 : Energy inflation (y-o-y, q-o-q, parentage change)



Source: NBR, Monetary Policy and Research Directorate

Regarding imported and domestic inflation, the decline observed in headline inflation in 2021Q2, resulted more from domestic than external factors. Domestic inflation declined to -0.8 percent from 1.0 percent, while imported inflation stabilized at 5.8 percent. The decreasing trend in domestic inflation was attributed to the higher prices recorded last year the corresponding period.

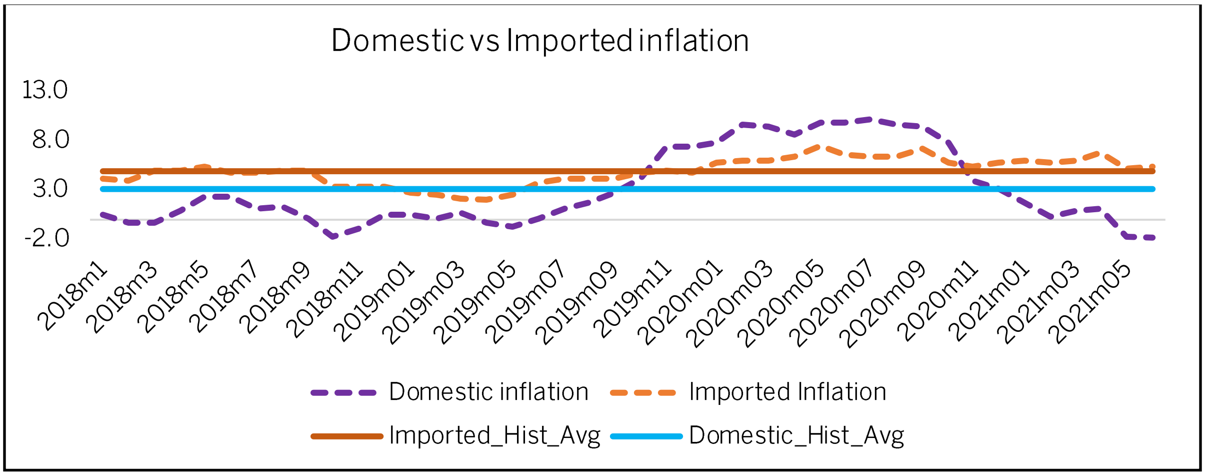
Chart 22 : Contribution to headline inflation by source (y-o-y, percentage change)



Source: NBR, Monetary Policy and Research Directorate

Since 2018 until 2021M06, imported inflation (y-o-y) on average stood at 4.9 percent while domestic inflation (y-o-y) mounted at 3.1 percent, meaning that some upward pressures are more concerted from imported side than domestic side for the specified period. These upticks in imported inflation are partly associated with the international food prices, coupled with the difficulties in the supply chains. However, the recent decline observed in domestic inflation for 2021Q2 reflects only the drops in transport services which is part of domestic CPI component.

Chart 23: Developments of domestic vs imported inflations (y-o-y, percentage change)

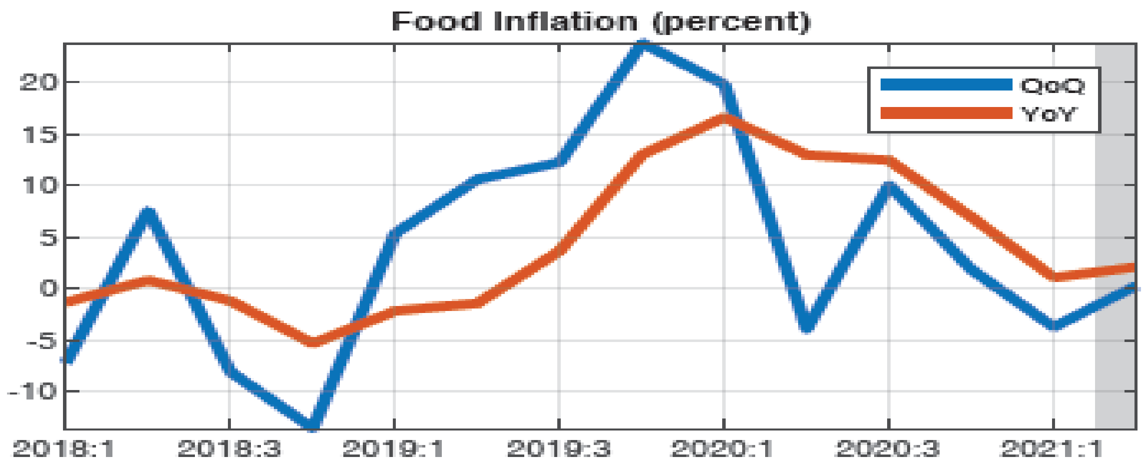


Source: NBR, Monetary Policy and Research Directorate

Unlike core and energy inflations, food inflation hiked following the increase in prices of some non-harvest dependent food items.

In 2021Q2, food and non-alcoholic beverages inflation picked up both y-o-y and q-o-q terms. The upward trend in food and non-alcoholic beverages inflation was reflected mainly in some non-harvest dependent foods such as cooking oils and fish. During the same period, oils inflation increased to 32.4 percent from 12.2 percent, while fish inflation surged to 11.0 percent from 5.9 percent. This upward trend in the aforementioned food items are in line with the fall in supply on the local markets. Over the same period, some imported food items reduced followed by the difficulties in supply chains, coupled with the rise in international food prices.

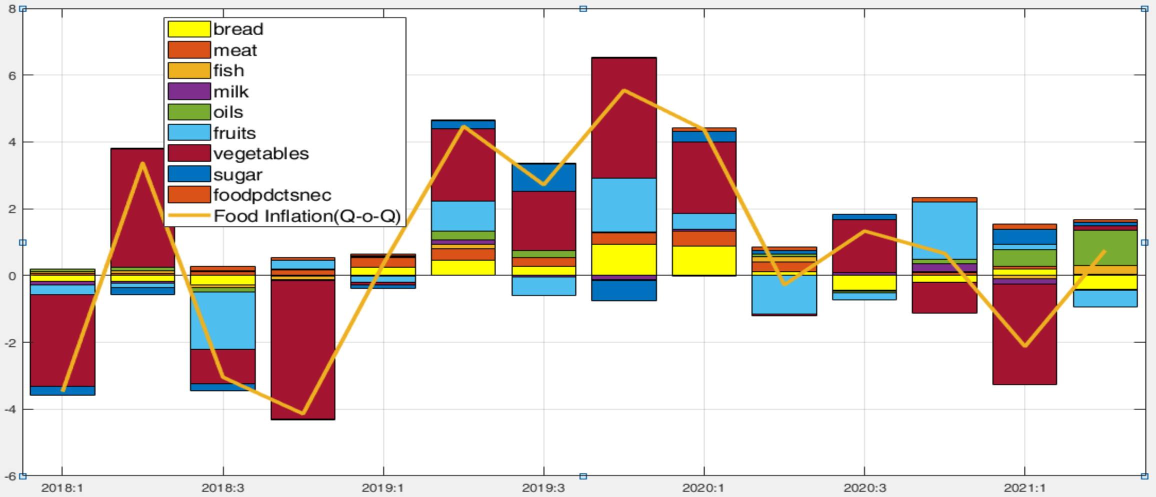
Chart 24 : Development of food inflation (y-o-y, q-o-q, percentage change)



Source: NBR, Monetary Policy and Research Directorate

In q-o-q terms, food inflation rose from -1.1 percent to 0.8 percent on the back of the rise in prices recorded in oils and fish food items.

Chart 25: Contributors to food inflation (q-o-q, percentage change)



Source: NBR, Monetary Policy and Research Directorate

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