National Bank of Rwanda

Banki Nkuru y'u Rwanda

MONETARY POLICY REPORT

August 2020

CONTENTS

MPC PRESS RELEASE

National Bank of Rwanda maintains the Central Bank Rate (CBR) at 4.5 percent.

The statutory quarterly Monetary Policy Committee (MPC) meeting was held on 12th August 2020, to decide on the monetary policy stance. During the meeting, the committee assessed recent economic developments at the global and national level and noted the economic impact of COVID-19, as well as the unfolding effect of previous policy measures, and the outlook.

Considering that inflation is projected to decelerate in the last quarter of 2020, the MPC has decided to maintain an accommodative monetary policy stance, by keeping the Central Bank Rate at 4.5 percent. This decision, along with other policy measures implemented by the government, will support commercial banks to continue financing businesses and households.

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

According to IMF projections in June 2020, global economic growth is projected at -4.9 percent in 2020, the worst since the Great depression, against 2.9 percent recorded in 2019. Across the world, this outbreak has claimed many lives and has caused major disruptions in supply chains, uncertainties and high volatilities in financial markets, contraction in economic activities, high unemployment rates, and a sharp decline in commodity prices. However, the global economy is expected to recover from this deep recession in 2021.

Domestic economy expected to recover from the negative impact of COVID-19:

The real GDP growth decelerated to 3.6 percent in quarter one of 2020 compared to 6.1 percent recorded in quarter one of 2019. High-frequency indicators point to a negative impact of COVID-19 in the second quarter of 2020. The Composite Index of Economic Activities (CIEA) which is the Central Bank measure that provides an early direction of economic performance, decreased by 8.8 percent in quarter two of 2020 compared to an increase of 16.5% recorded in the same period of 2019. With the opening of more economic activities in the country, supported by several government economic initiatives as well as opening up of other economies across the world, the Rwandan economy is expected to pick up in the second half of 2020. This is evidenced by an upward trend of CIEA, with an increase of 8.4 percent in June.

CBR transmission to market rates continues to improve:

The continuing accommodative monetary policy stance has contributed to a further reduction in market interest rates in the economy. In the first half of 2020, the lending rate reduced to 16.14 percent from 16.64 percent in the same period of 2019, and this is expected to support the economic recovery.

Foreign exchange market remains stable:

The FRW depreciated by 2.3 percent against the USD by end July 2020, slightly lower than 2.6 percent recorded in the same period of 2019. The foreign exchange market is expected to remain stable, with adequate foreign exchange reserves covering 6.3 months of imports as of end July 2020.

Headline inflation projected to reduce from the third quarter of 2020:

In the second quarter of 2020, headline inflation stood at 8.7 percent (year-on-year) from 8.2 percent in quarter one of 2020. The uptick in headline inflation was mainly driven by the upward revision of public transport fares. However, baseline projections of inflation suggest that headline inflation is projected to start reducing gradually to below the NBR benchmark of 5.0 percent in the last quarter of 2020. As a result of the aforementioned increase in transport inflation, the average inflation for 2020 is revised to 6.9 percent, from 6.0 percent projected in April 2020.

Measures to mitigate the economic impact caused by COVID-19:

The measures put in place by the National Bank of Rwanda (NBR) in March 2020, to ease liquidity conditions in the banking sector, yielded immediate impact. FRW 23.4 billion was injected into the system in April 2020, through a reduction of the reserve requirement ratio from 5 percent to 4 percent. A FRW 50 billion lending facility is also available to banks at the Central Bank Rate (CBR). In addition, the Government of Rwanda has put in place an Economic Recovery Fund (ERF) of FRW 101 billion to cushion businesses affected by the COVID-19 pandemic to resume operation and safeguard employment. All these measures have contributed to increasing liquidity in the economy.

The MPC will continue to closely monitor domestic and global economic conditions and stands ready to take appropriate measures if and when necessary.

August 12th, 2020

RWANGOMBWA John

Governor, Chairperson of the MPC

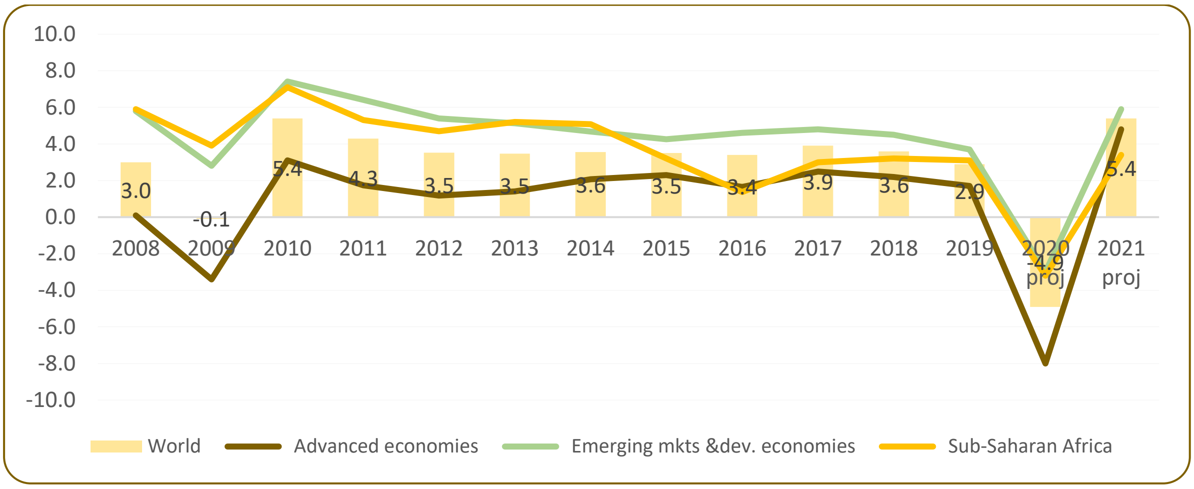
I. GLOBAL ECONOMIC AND FINANCIAL DEVELOPMENTS

1.1 Economic Growth

According to the International Monetary Fund's (IMF) projections published in June 2020, global growth is projected to contract at -4.9 percent in 2020 from 2.9 percent recorded in 2019, worse than during the 2008-09 global financial crisis, owing to the COVID-19 pandemic outbreak. The growth projection is marked down by 1.9 percentage points relative to April 2020 projections, an extraordinary revision over such a short period of time.

The global economy is projected to recover by 5.4 percent in 2021 as economic activity normalizes, helped by policy support, as the baseline scenario assumes that the pandemic fades in the second half of 2020 and containment efforts can be gradually unwound. Growth projection has been revised down by 0.4 percentage points relative to April 2020 projections.

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



Source: IMF WEO, June 2020

In advanced economies, growth is projected to contract by -8.0 percent in 2020 from 1.7 percent in 2019, mostly reflecting contraction in all economies including the United States (-8.0 percent), Eurozone (-10.2 percent), United Kingdom (-10.2 percent), Japan (-5.8 percent), Germany (-7.8 percent), France (-12.5 percent), Italy (-12.8 percent) and Spain (-12.8 percent).

Following COVID-19 containment measures across the world, in 2020Q1, GDP in the G20 area decreased by 3.4 percent, the largest contraction since 1998. The decline was deeper in the second quarter in countries that were mostly affected by the outbreak. In USA, GDP declined by 9.5 percent year-on-year from -5.0 percent in 2020Q1 reflecting the response to COVID-19, as "stay-at-home" orders were issued in March and April to contain the spread of the virus.

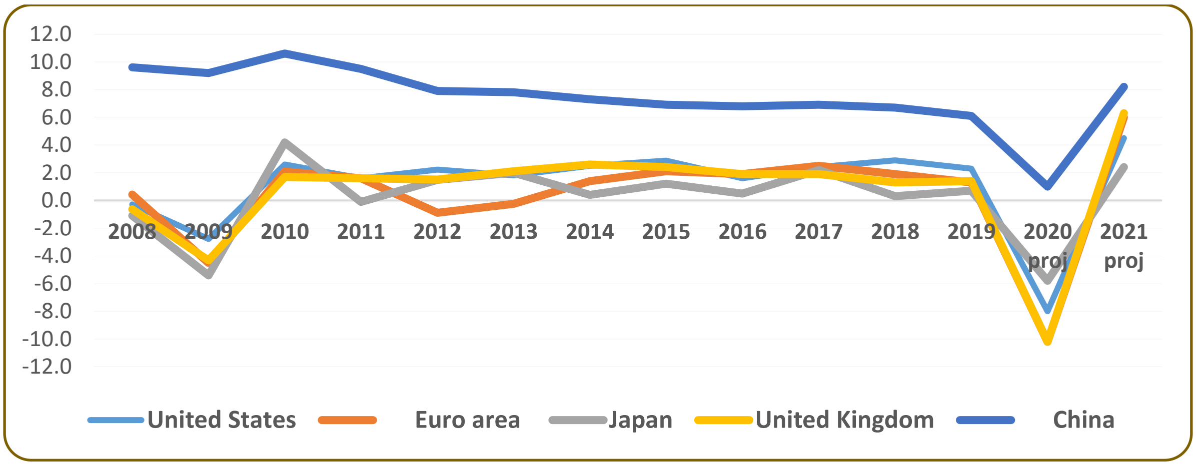
In the Euro area, preliminary estimates showed that growth contracted by 15.0 percent in 2020Q2, the sharpest decline since 1995, after -3.1 percent in 2020Q1. Most affected member countries included Spain (-22.1 percent after -4.1 percent in 2020Q1), Italy (-17.3 percent after -5.5 percent), Portugal (-16.5 percent after -2.3 percent), France (-19.0

percent from -5.7 percent), Belgium (-14.5 percent after -2.4 percent), German (-11.7 percent after -2.2 percent), Austria (-13.3 percent against -2.8 percent), among others.

In United Kingdom, GDP fell, for the second straight quarter, by 21.7 percent year-on-year in 2020Q2, reflecting the direct impact of the COVID-19 after a slowdown of 1.7 percent in 2020Q1. During this quarter, service, production and construction sectors were severely affected and this negatively impacted output, with the services output falling by 19.9 percent following a decline of 2.3 percent in the 2020Q1.

In Japan, the contraction was less pronounced reaching -1.7 percent year-on-year in 2020Q1 but deteriorated to -9.9 percent in the following quarter as economic activity was restricted under a state of emergency during the coronavirus outbreak.

Chart 2- GDP growth in selected countries (percentage change)



Source: IMF WEO, June 2020

In the emerging markets and developing economies, growth is projected to contract by -3.0 percent in 2020, from 3.7 percent in 2019, but projected to recover by 5.9 percent in 2021.

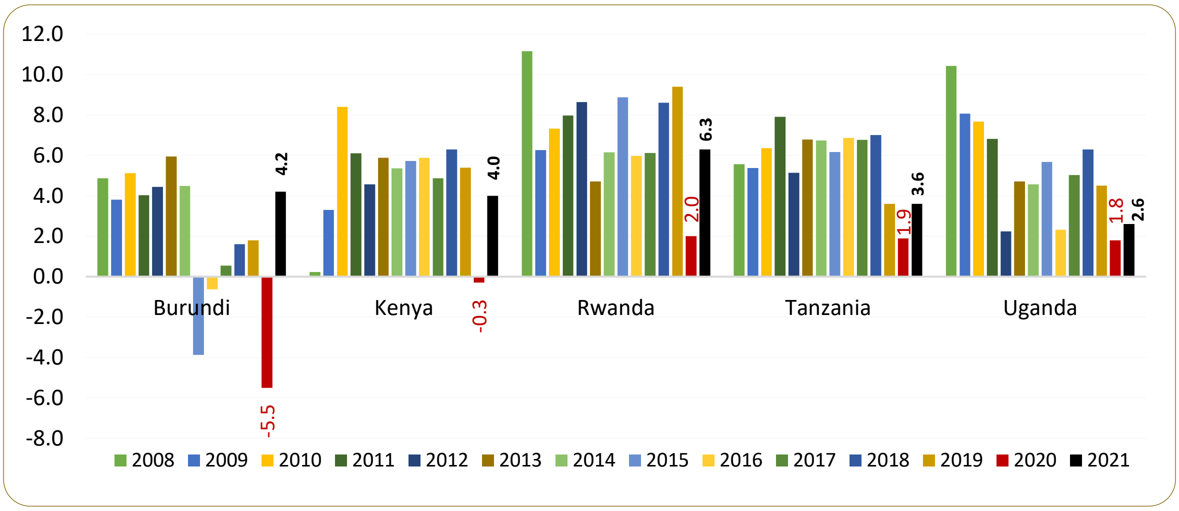
In China, GDP growth is projected to decelerate to 1.0 percent in 2020, from 6.1 percent in 2019, while expected to recover at 8.2 percent in 2021. The slowdown in Chinese economy, the top global consumer of raw materials and top exporter to the rest of the world, is anticipated to trigger further downward risks worldwide given its share in global GDP (closer to 19.2 percent in 2019) and role in supply chains and commodity markets. Already in 2020Q1, due to stringent lockdown measures introduced to curb the transmission of the virus, Chinese GDP sharply fell by 6.8 percent in the 2020Q1 but quickly recovered by 3.2 percent in the following quarter as economic activities resumed and lockdown measures eased.

India and Turkey were the only G20 countries to report positive growth in the 2020Q1. India's GDP increased by 4.1 and 3.1 percent respectively in 2020Q1 and 2020Q2. It is however expected to decline by 4.5 percent in 2020 from 4.2 percent in 2019, following a longer period of lockdown and slower recovery than anticipated in April. However, in 2021, growth is expected to improve to 6.0 percent though, the speed of recovery in 2021, will depend on several factors, including, the impact of the pandemic on local health systems, effectiveness of national containment efforts, and support from the international community.

In Sub-Saharan Africa, growth is projected to contract to -3.2 percent in 2020 compared to 3.1 percent recorded in 2019, and this is the first recession in the region for the last 25 years. The downward revision for 2020 growth reflects macroeconomic risks arising from the sharp decline in output growth among the region's key trading partners, including China and the euro area, the fall in commodity prices, reduced tourism activity in several countries, as well as the effects of measures to contain the COVID-19 global pandemic. The COVID-19 shock is hitting the region's three largest economies, Nigeria, South Africa, and Angola, in a context of persistently weak growth and investment, and declining commodity prices. The region's growth is however projected to recover to 3.4 percent in 2021, revised down slightly by 0.7 percentage points compared with April 2020 WEO update.

The economic performance in the East African Community (EAC) countries is projected at 1.0 percent in 2020 from 5.7 percent recorded in 2019, following a projected slowdown for all member countries compared to the previous year and a projected recession in Kenya and Burundi. 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 disruption to travel and tourism activities.

Chart 3 - Economic growth in EAC countries (% change)



Source: IMF WEO, April 2020 & June 2020

Particularly in Kenya, where the tourism constitutes the second-largest source of foreign exchange revenue, real GDP is projected to contract by 0.3 percent in 2020. The decline in Kenya's real GDP, which accounts for more than 40 percent of the total community's output, will negatively affect the growth of EAC in general.

On quarterly basis, Kenya real GDP grew by 4.9 percent in 2020Q1 compared to 5.5 percent growth in the first quarter of 2019. The growth was driven by strong growths in transportation and storage (+6.2 percent), financial and insurance activities (+6.0 percent), construction (+5.3 percent), information and communication (+9.8 percent) and wholesale and retail trade (+6.4 percent) as well as the agriculture (+4.9 percent) which offset the decline of 9.3 percent in accommodation and food service activities that were heavily weighed on by the COVID-19 containment measures.

Uganda GDP grew year-on-year by 1.8 percent in 2020Q1 compared to 7.3 percent registered in 2019Q1. Agriculture sector rose by 1.3 percent compared to 8.1 percent in the corresponding period last year. The services sector grew by 2.5 percent after 6.1 percent in 2019Q1 while industry output declined by 1.5 percent after a growth of 10.7 percent the same quarter last year.

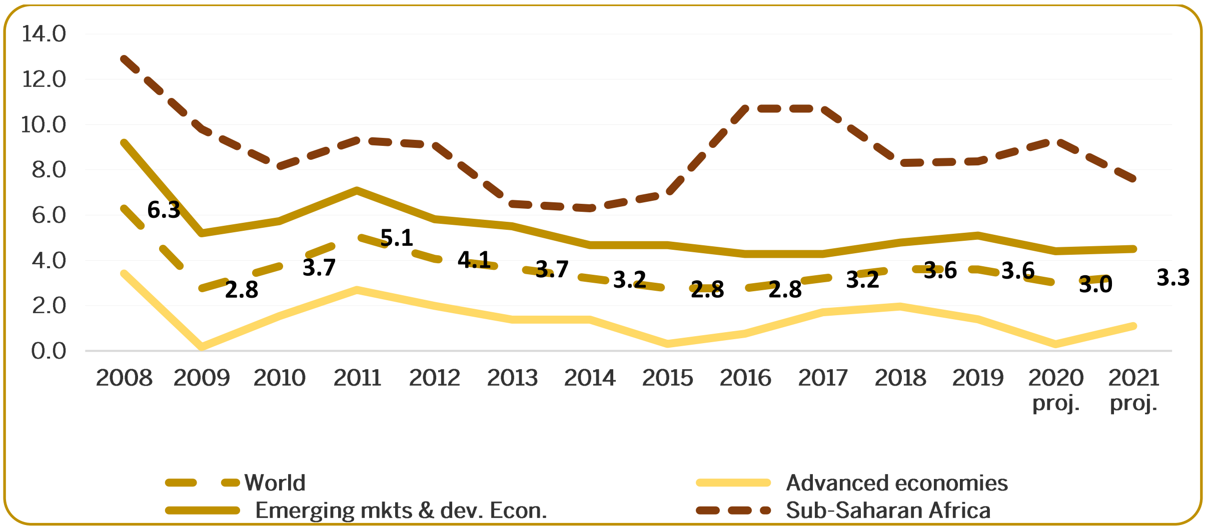
In 2020Q1, Rwanda real GDP growth stood at 3.6 percent as a result of the poor performance in agriculture and industry sectors. Agricultural production fell by 0.5 percent against an increase of 4.0 percent in 2019Q1 due to unfavorable weather conditions that led to low harvest. The industry sector grew by 1.9 percent in 2020Q1 against 14.8 percent in 2019Q1, following weak performance in all its sub-sectors. The services sector grew by 5.6 percent in 2020Q1 from 3.9 percent in 2019Q1.

Tanzania GDP increased by 5.7 percent in the 2020Q1 from 6.3 percent in the corresponding quarter 2019 supported by services sector activities which accounted for 42.0 percent, followed by agriculture 33.2 percent and industry sector with a share of 24.7 percent.

1.2 Inflation Developments

World annual average inflation is projected to decelerate to 3.0 percent in 2020 from 3.6 percent in 2019, following a sharp drop in global demand and falling commodity prices, while projected to increase to 3.3 percent in 2021.

Chart 4- Global inflation and projections across regional blocks (% change)



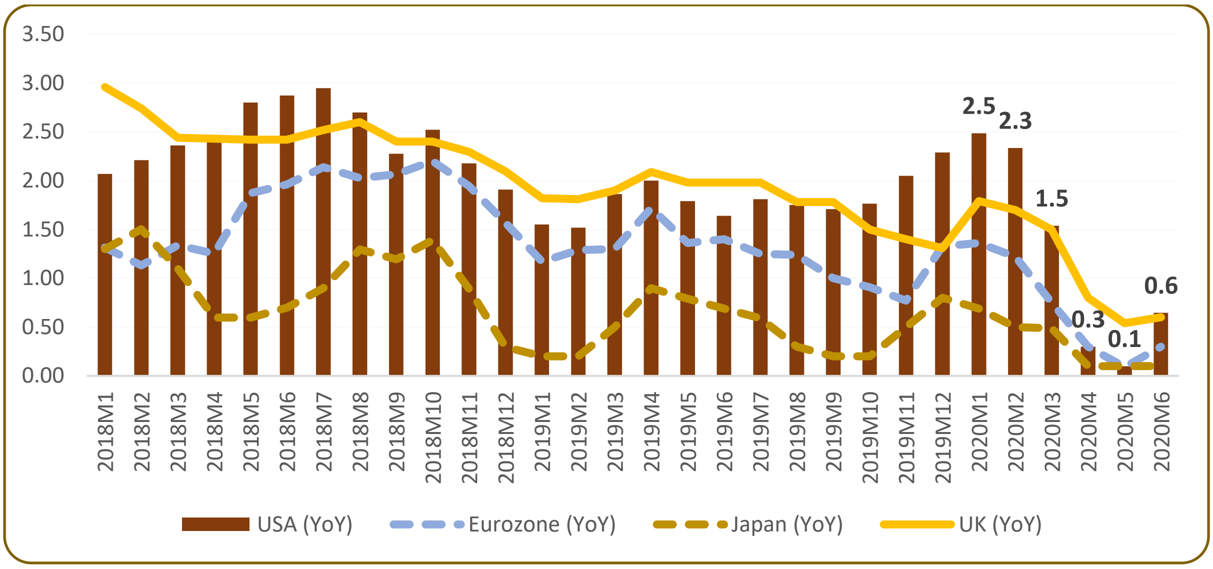
Source: IMF, April 2020

In advanced economies, consumer price inflation is projected to ease to 0.3 percent in 2020 reflecting weaker economic activity and lower commodity prices from 1.4 percent in 2019 and, to later pickup to 1.3 percent in 2021 in line with expected recovery in economic activities.

Inflation is projected to decrease in the United States (0.6 percent in 2020 from 1.8 percent in 2019), Eurozone (0.2 percent from 1.2 percent), and United Kingdom (1.2 percent after

1.8 percent), and Japan (0.2 percent compared to 0.5 percent) over the same period, giving room to Central Banks for further monetary easing.

Chart 5- Annual headline Inflation (percent change)



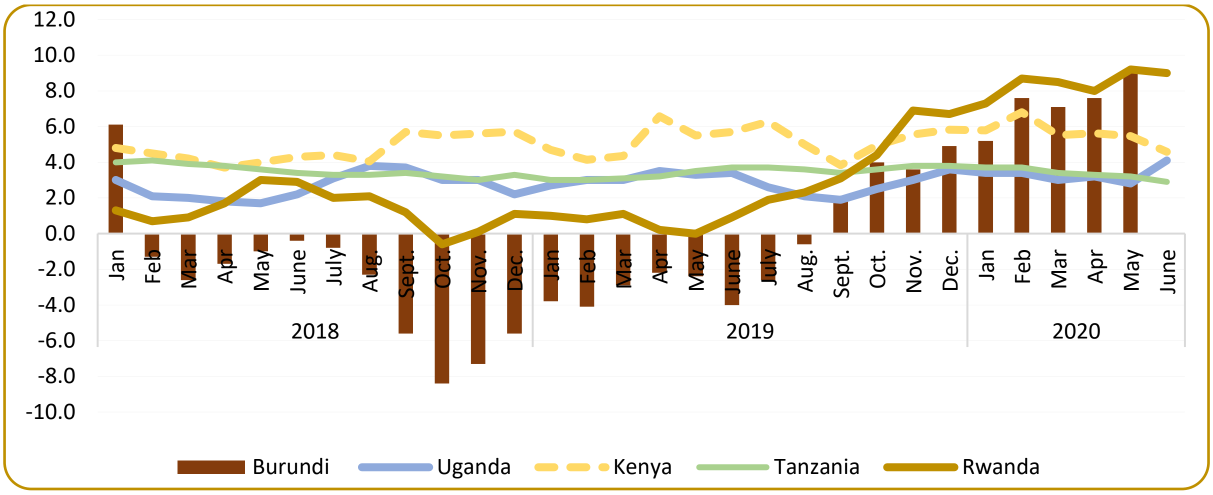
Source: National statistics offices

In the emerging markets and developing economies, inflation is projected to ease to 4.4 percent in 2020 from 5.1 percent in 2019, and to slightly increase to 4.5 percent in 2021. The Chinese annual average inflation is projected to gradually rise to 3.0 percent in 2020, from 2.9 percent in 2019, and projected to ease to 2.6 percent in 2021.

In Sub-Saharan Africa, annual headline inflation is projected to rise to 9.3 percent in 2020, from 8.4 percent in 2019, following projected high rising inflation rates in Nigeria (13.4 percent from 11.4 percent in 2019), Angola (20.7 percent from 17.1 percent), Democratic Republic of Congo (11.0 percent after 4.8 percent), and Zimbabwe (319.0 percent compared to 255.3 percent). Headline inflation is projected to ease to 7.6 percent in 2021. The SSA region has been facing multiple weather-related 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).

In the EAC countries, annual headline inflation is projected to average at 4.5 percent in 2020, from 3.8 percent in 2019, following projected rising inflation in Burundi (8.0 percent from -0.7 percent in 2019), Rwanda (6.9 percent from 2.4 percent), Tanzania (3.9 percent after 3.4 percent), and Uganda (3.9 percent compared to 2.9 percent). The stable and low inflation in the region is attributed to good agriculture production owing to favorable weather conditions, and monetary policies implemented by Central Banks.

Chart 6- Annual headline Inflation (percent change)



Source: Country Bureau of statistics

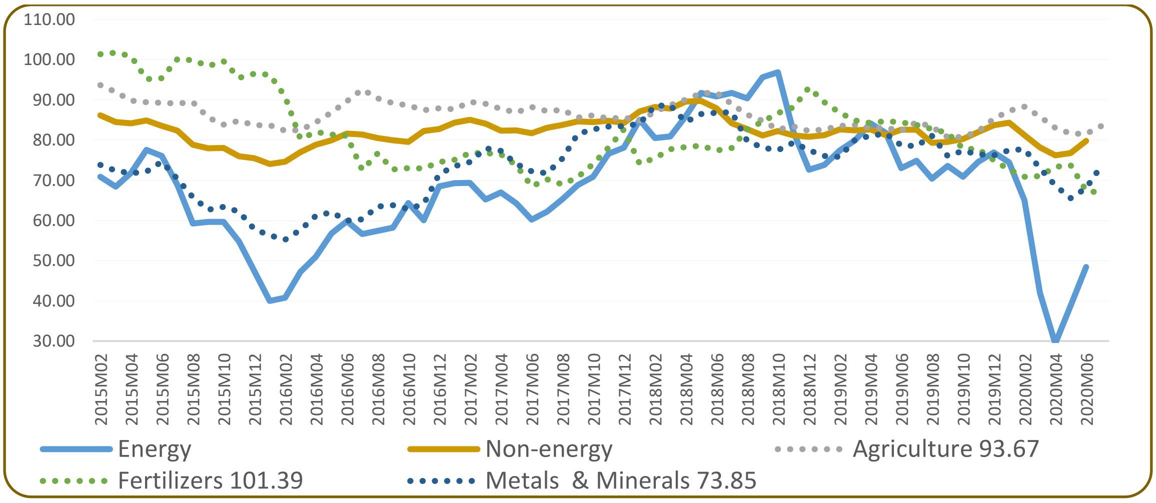
In June 2020, annual headline inflation in Kenya eased to 4.59 percent from 5.47 percent in May, as prices slowed further for food & non-alcoholic prices, housing & utilities, and alcoholic beverages & tobacco. The annual headline inflation in Tanzania eased to 2.9 percent in June 2020, from 3.2 percent in the previous month, reaching its lowest level since April 2019, as prices slowed mostly for food & non-alcoholic beverages, falling transport prices, and recreation & culture.

Rwanda's headline inflation increased to 9.0 percent in June 2020 from 9.2 percent in May, and this was mainly reflected in food & non-alcoholic beverages, alcoholic beverages & tobacco, transport as well as housing, water, electricity, gas & other fuels. Uganda's annual headline inflation rose to 4.1 percent in June 2020, from 2.8 percent in the previous month, the highest inflation rate since October 2017, mainly pushed up by transport prices, in particular transport services, as taxi and bus operators have raised fares after the ban on transport in border districts was lifted.

1.3 Global commodity prices

On commodity market, global commodity prices decreased in the 2020Q2, reflecting slowdown in global demand. Energy prices declined due to Covid-19 impact and the warm winter that reduced demand for heating fuels. In the 2020Q2, energy prices fell by 51.3 percent from a decline of 11.0 percent in the same period of 2019.

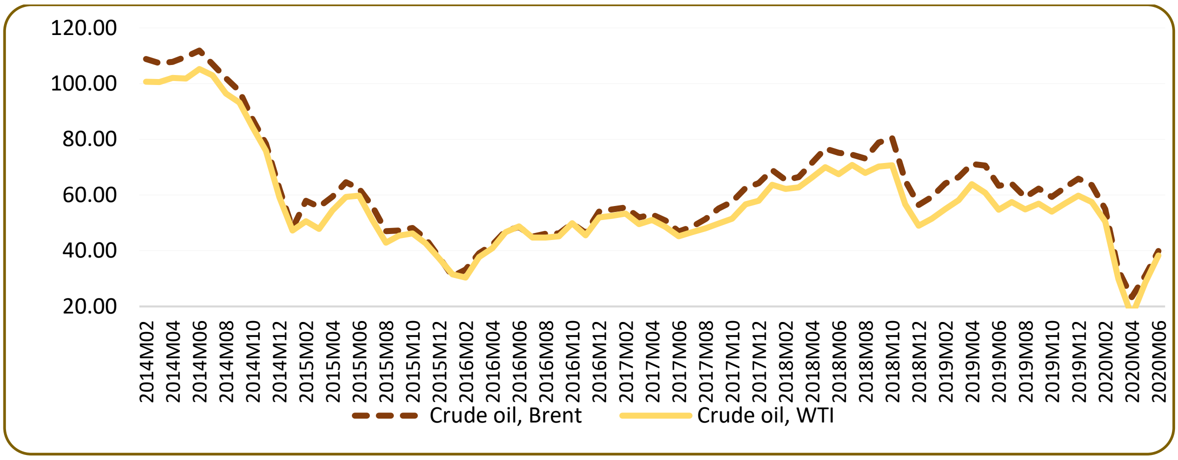
Chart 7 - Commodity Prices Index in Nominal US Dollar (2010=100)



Source: World Bank, June 2020

In 2020Q2, crude oil prices decreased by 53.4 percent on average compared to a decrease of 8.9 percent in the same period of 2019. In June 2020, crude oil prices decreased by 34.0 percent compared to a decline of 17.0 percent in June 2019, reflecting the impact of the COVID-19 pandemic on the global demand. In addition to low demand caused by COVID-19 pandemic, oil prices were also impacted negatively by the collapse of the OPEC and non-OPEC agreement. In June 2020, IMF projected oil prices to decrease further by 41.1 percent, from USD 61.4/barrel in 2019 to USD 36.1/barrel in 2020.

Chart 8 - Crude Oil Price Developments (USD/barrel)



Source: World Bank, June 2020.

Non-energy commodity prices decreased by 5.7 percent on average in 2020Q2, reflecting falling prices of fertilizers as well as metals & mineral commodities. In 2020Q2, metals & mineral prices decreased by 13.2 percent after a decrease of 8.2 percent in the same period of 2019, reflecting the impact of the measures undertaken by governments to control the COVID-19 pandemic outbreak that limited industrial production activities. However, prices increased for precious metals presumed to be safe heaven, with gold prices rising by 30.6 percent after a slight increase of 0.2 percent in the same period of 2019, amid expectation that the ongoing virus outbreak will result into lower US interest rates. Metals & mineral prices are projected to further decrease by 13.3 percent in 2020, but later increase by 4.1 percent in 2021.

Average prices for agriculture commodities slightly decreased by 1.5 percent in 2020Q2 owing to the decline in raw materials (-7.6 percent) which offset the increase in prices of beverages (2.8 percent). Prices for Coffee Arabica increased by 20.1 percent and declined by 11.6 percent for Robusta coffee. During the same period, prices increased by 0.1 percent for food; of which grains (0.2 percent) and oils & meals (3.5 percent). In 2020, agricultural commodity prices are projected to decline by 1.1 percent, attributed mainly to the projected fall in prices of beverages (-5.4 percent); with Coffee Arabica, Coffee Robusta and Tea average auction prices projected to fall by 2.8 percent, 7.4 percent and 10.5 percent, respectively.

Prices for fertilizers declined by 17.8 percent in 2020Q2 compared to an increase of 8.1 percent in the same period of 2019, and projected to drop by 10.0 percent in 2020, before increasing by 3.1 percent in 2021.

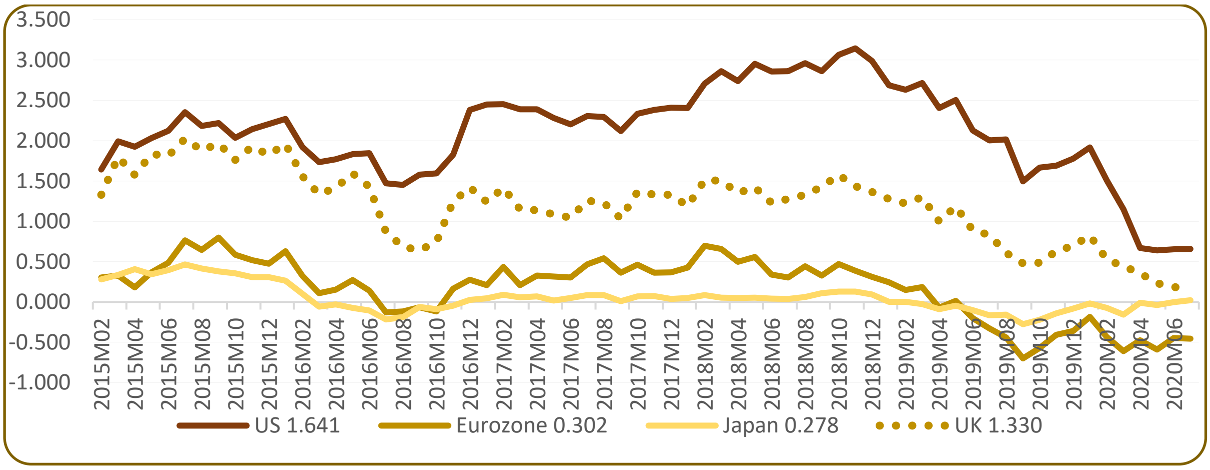
1.4 Monetary policy and financial markets

1.4.1 Monetary policy

Monetary policy remained accommodative across the world, in response to the decline in global demand & falling business confidence due to Covid-19 pandemic. Moreover, many Central Banks and Governments across the World undertook unprecedented policy measures to limit the economic impact of the COVID-19 pandemic and restore the business confidence. Central banks measures include the use of unconventional monetary policy tools as well as enhanced asset purchase programs and targeted interventions in financial market segments under extreme stress.

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

Chart 9- 10-Year Government Bond Yield (p.a)



Source: Bloomberg database, June 2020

In June 2020, the three-month deposit rates remained negative in the Eurozone and Japan, standing at -0.445 percent and -0.080 percent in June 2020, respectively, affecting banks' deposits in the Central Bank and encouraging economic financing. In the US deposit rate decreased to 0.237 percent from 1.855 percent, and decreased for UK to 0.125 percent from 0.822 percent in December 2019.

The ten- year government bond rate decreased in US, Eurozone and UK to 0.656 percent, -0.456 percent, and 0.172 percent, respectively, from 1.918 percent, -0.185 percent, and 0.822 percent in December 2019. However, the 10-year bond increased for Japan to 0.020 percent in June 2020 from -0.020 percent in December 2019.

1.4.2 Foreign Exchange Markets

On the foreign exchange market, the US dollar is appreciating against the British Pound and Chinese Yuan, while weakening against the Euro and Japanese Yen.

Compared to December 2019, the US dollar appreciated by 6.91 percent against the British Pound and by 1.47 percent against the Chinese Yuan in June 2020. However, the dollar depreciated by 0.63 percent against the Japanese Yen and by 0.19 percent against the Euro.

Table 1: Units Currency per 1 US Dollar

	2019					2020		
	Jan	Mar	Jun	Sept	Dec	Jan	Mar	Jun
USD/GBP	0.763	0.767	0.788	0.814	0.754	0.757	0.806	0.806
USD/EUR	0.874	0.891	0.879	0.918	0.892	0.902	0.906	0.890
USD/JPY	108.89	110.86	107.85	108.08	108.61	108.35	107.54	107.93
USD/CNY	6.709	6.723	6.868	7.141	6.962	6.998	6.999	7.065

Source: Bloomberg, June 2020

II. DOMESTIC ECONOMY

2.1 Domestic Demand and Output

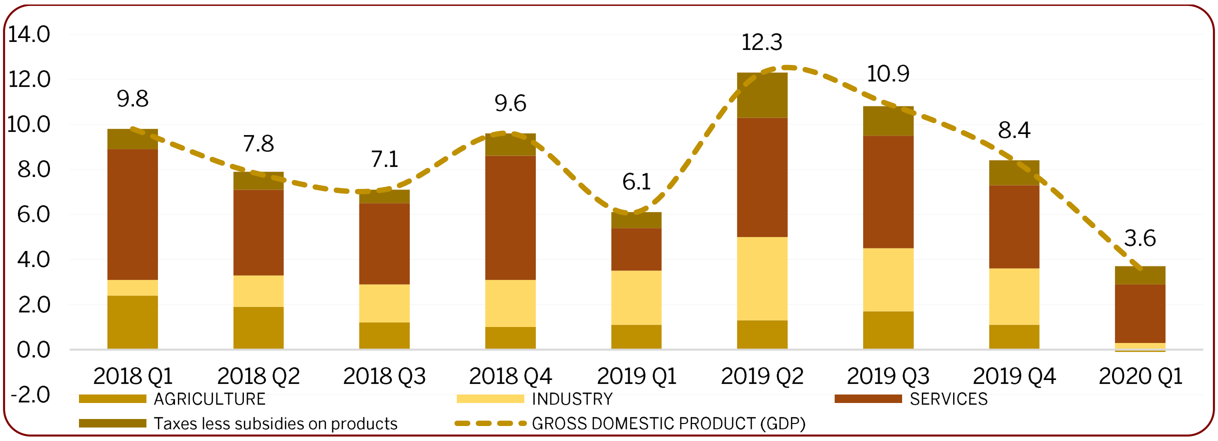
Rwandan economy, like other countries worldwide, have been severely affected by the COVID-19 pandemic. This pandemic has plunged economic activities through the disruption in trade and value chains; reduction in foreign financing inflows including foreign direct investments, foreign aid, remittances, tourism revenues and containment measures. Consequently, the real GDP growth is projected to be around 2.0% in 2020, well below the past five year average of 7.2 percent.

2.1.1 Economic performance by sector

In 2020Q1, real GDP growth slid to 3.6 percent from 6.1 percent recorded in 2019Q1 mainly due to the bad performance in agriculture and industry sectors. Agriculture production fell by 0.5 percent against an increase of 4.0 percent, owing to unfavorable weather conditions that led to bad harvest. Food crops production contracted by 1.8 percent from +3.7 percent in 2019Q1 and exports crops fell by 15.7 percent on top of a decrease of 6.8 percent over the same period last year.

The industry sector grew by 1.9 percent in 2020Q1, slower than 14.8 percent in 2019Q1, following weak performance in all its sub-sectors. Construction subsector's performance slid (+5.3 percent from +28.2 percent) after the completion of mega projects including Kigali Arena. This had spillover effects on manufacturing subsector which growth slowed to +5.5 percent from 7.0 percent in 2019Q1. Manufacturing industries were affected also by early negative effects of the COVID-19, through supply chain disruptions that imposed constraints to imports of inputs. The slack in the industry sector also resulted from the fall in mining and quarrying's production (-26.3 percent from +15.9 percent) due to the decrease of commodity prices on the international markets.

Chart 10- Real Gross Domestic Product (percentage change)

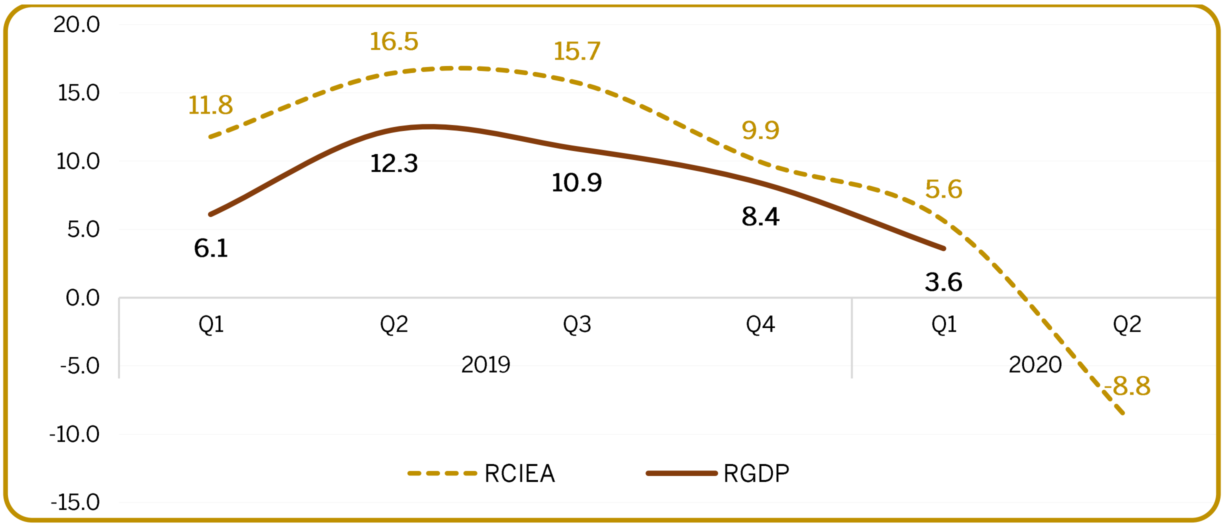


Source: National Institute of Statistics of Rwanda

The services sector, representing 48.1 percent of real GDP, grew by 5.6 percent in 2020Q1 from 3.9 percent in 2019Q1, mainly supported by wholesale & retail trade (+11.4 percent from +4.6 percent) and Information & communication (+33.7 percent from +2.2 percent) and Public administration (+14.5 percent from -3.5 percent). As a result of early negative effect of the COVID-19, other sub-sectors performed poorly, notably transport (+0.2 percent from 8.2 percent), hotel and restaurant (+3.3 percent from 6.5 percent) and financial services (-5.0 percent from 6.1 percent). The slowdown in transport and hotel and restaurant services was due to travel and tourism restrictions as the pandemic spread around the world. Air transport fell by 15.5 percent in 2020Q1 from an increase of 2.1 percent in 2019Q1, while accommodation services declined by 0.7 percent from an increase of 2.4 percent during the same period.

The leading indicators of economic activities indicate that the slowdown in economic activities worsened further during the second quarter of 2020. The composite index of economic activities (CIEA) decreased by 8.8 percent in 2020Q2, against an increase of 16.5 percent in the corresponding period of 2019, pointing to a contraction of economic activities. This period was marked by policies and measures to curb the spread of COVID-19 after its first case in Rwanda in mid-March 2020. These measures included a full lockdown of majority of businesses from Mid-March 2020 to the end of April and the partial lockdown that started in May 2020.

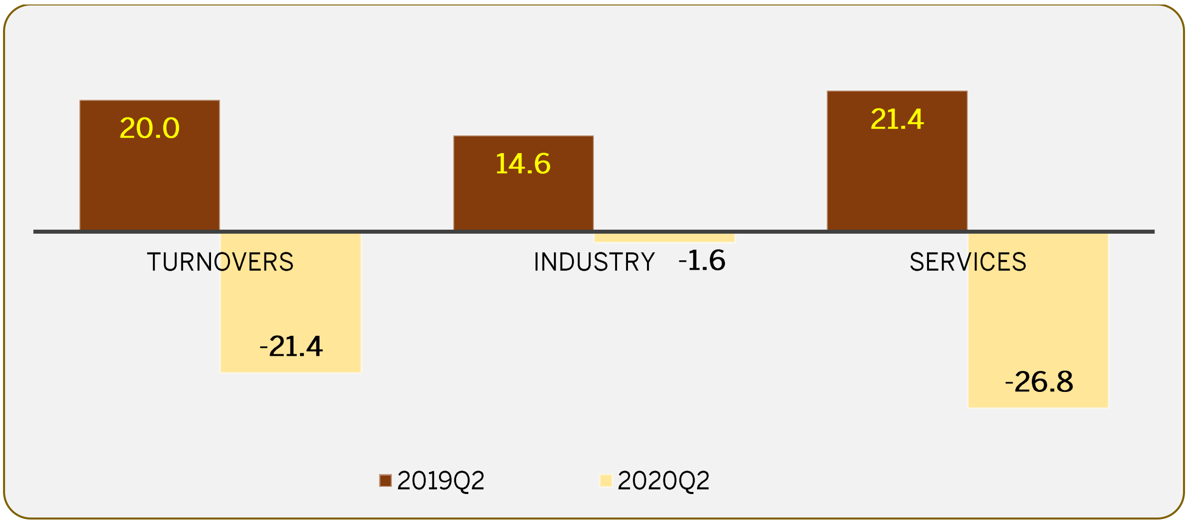
Chart 11- Quarterly Real GDP growth vs CIEA (% change, y-o-y)



Source: NBR, Monetary Policy Department

The contraction recorded in 2020Q2 is observed in important components of the CIEA such as turnovers of industry and services sector (-22.2 percent from 20.0 percent); electricity (-6.3 percent from 9.4 percent); imports (-25.1 percent from 35.4 percent); cement (-14.9 percent from 10.5 percent) and value added tax -VAT (-20.2 percent and 19.1 percent). The decline in total turnovers of industry and services sectors was mainly spurred by the slowdown in turnovers of service sector that represented 71.9 percent of the total turnovers.

Chart 12- Turnovers of industry & services sectors (% change, y-o-y)



Source: NBR, Monetary Policy Department

The services sector, which sales represent 63.4 percent of total services turnovers, was heavily affected by the pandemic. Transport services, hotel and restaurants' sales fell by 13.1 percent and 25.3 percent respectively from respective increase of 7.7 percent and 8.0 percent during the same period last year. Trade sales decreased by 20.1 percent in 2020Q2 against an increase of 18.9 percent in the same period of 2019.

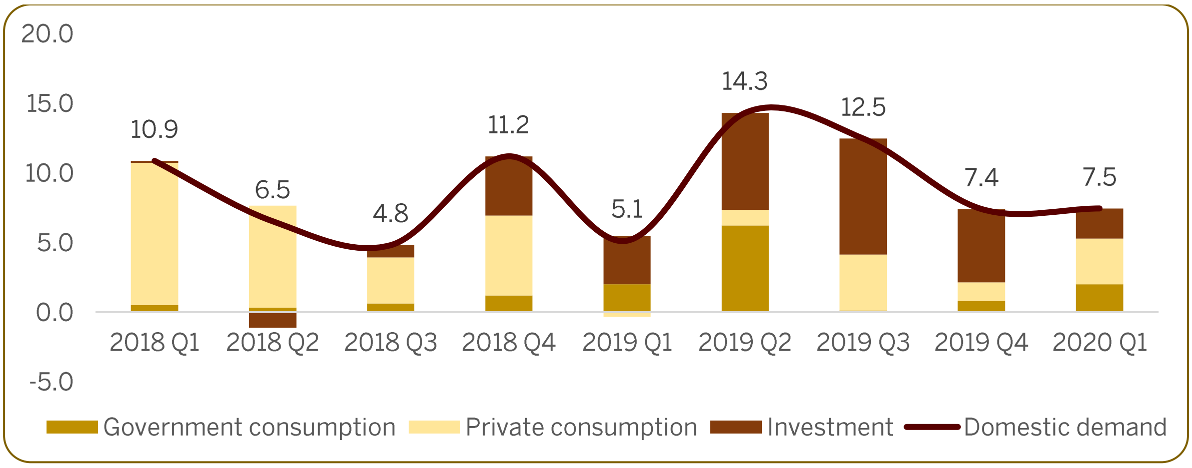
The decline of industrial sector was mainly driven by construction subsector (30.3 percent of total turnovers of industry sector) that decreased by 8.1 percent in 2020Q2 from 11.1 percent in 2019Q2. As a result of decreasing minerals prices on international market and COVID-19 containment measures, mining and quarrying fell sharply by 41.3 percent after a decline of 15.6 percent, hence weighing down further the performance of industry sector. However, positive performance in manufacturing offset the aforementioned downward trend as it grew by 7.5 percent after 26.1 percent in the same period 2019. This positive performance results from the opportunity of continuing operations during the lockdown period for some industries, especially food processing. Food processing industries' sales increased by 6.2 percent in 2020Q2 from 16.0 percent in the corresponding period of 2019.

2.1.2 Domestic Demand

The domestic demand remained resilient in 2020Q1, growing by 7.5 percent mainly driven by private consumption as it increased by 5.1 percent from a decline of 0.5 percent in 2019Q1 and represents 63.7 percent of domestic demand. The increase in private consumption together with government consumption (14.9 percent from 16.9 percent) resulted in the total final consumption that rose by 6.7 percent from a moderate growth of 2.0 percent.

Domestic demand was boosted also by a continuous increase in investment. Total capital formation increased by 10.2 percent in 2020Q1 on top of 18.2 percent registered in the corresponding period of 2019. This resulted mainly from other fixed investment, such as machine and equipment, which grew by 19.7 percent from 13.8 percent last year.

Chart 13- Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

The trend in total turnovers of industry and services sectors as well imports indicate a decline of domestic demand in 2020Q2. Total turnovers of industry and services sectors fell by 21.4 percent in 2020Q2 due to the negative effect of COVID-19 pandemic. Likewise, total imports decreased by 20.4 percent from an increase of 37.7 percent during the same period.

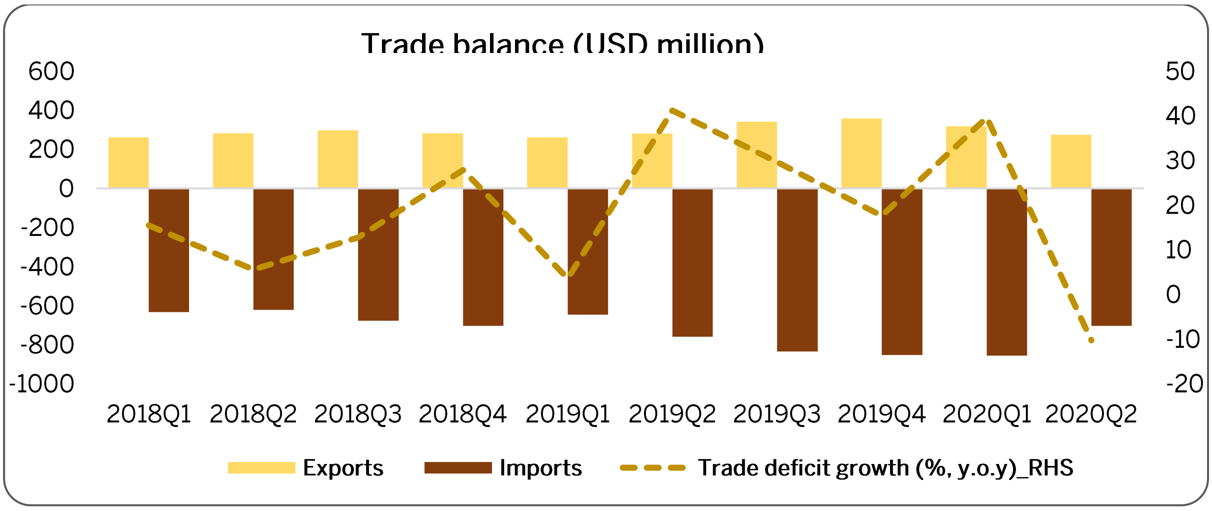
However, the economy is expected to recover amid eased COVID-19 lockdown measures. This is evidenced by the CIEA and total turnovers of industry and services sectors that reversed the trend since May. The CIEA decline of 19.1 percent in April 2020, eased to negative 15.1 percent in May and recorded a positive growth of 8.4 percent in June. The total turnovers evolved from negative 36.8 percent in April to negative 23.7 percent and negative 1.2 percent in May and June respectively. The recovery of economic activities will be also supported by resumption of tourism and commercial flights in August 2020, along with the support of the Economic recovery fund and other government interventions to revive the business activities.

2.2 External Sector Developments

In the second quarter of 2020, Rwanda's trade deficit improved by 10.3 percent standing at USD 430.1 million compared to USD 479.5 million recorded in 2019Q2. The improvement in the trade deficit is on account of higher decline in imports that outpace the decrease in exports.

Imports dropped by 7.4 percent Y.o.Y in 2020Q2, while exports reduced by 2.4 percent in the same period. Capital and intermediary goods imports fell by 40.9 percent and 24.9 percent respectively, partly reflecting slowing domestic economic activities. Similarly, imports of energy dropped by 43.9 percent driven in part by lower global oil prices but also on lower mobility due to COVID-19 containment measures. Imports of consumer goods were the least affected due to high imports of food products and critical medical supplies to deal with the pandemic. On the other hand, weakening external demand, which weighed on commodity prices, and trade disruptions brought by the pandemic have negatively affected Rwanda's exports receipts. Non-traditional and traditional exports categories are the hardest hit, decreasing by 64.2 percent and 32.9 percent respectively.

Chart 14: Trade deficit (USD million except otherwise indicated)



Source: Statistics Department

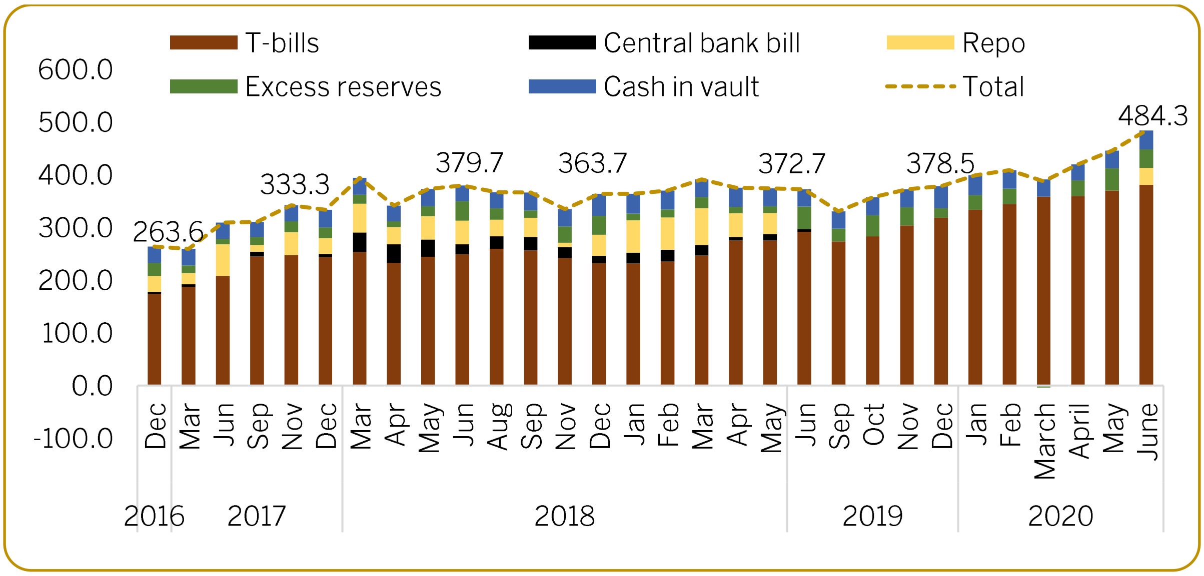
The external position is projected to deteriorate further driven by the adverse consequences of the COVID-19 pandemic, which are foreseen to weigh on the flow of international trade, travel and tourism, air transports, remittances, official transfers and FDI as well as private loan disbursements as investors risks sentiments worsen. The Current Account Deficit (CAD) is projected to widen to 16.7 percent of GDP in 2020, up from 12.4 percent of GDP registered in 2019. Despite the expected reduction in financial inflows to finance the widening CAD, Rwanda's external vulnerability remains marginal, partly owing to the increase in international official reserves in preceding periods. As of end July 2020, foreign exchange reserves covered 6.3 months of future imports and they are projected to remain adequate throughout 2020.

III. FINANCIAL AND MONETARY DEVELOPMENTS

3.1 Banking System Liquidity Conditions

In 2020Q2, the most liquid assets grew by 25.0 percent, to FRW 484.3 billion, from FRW 387.5 billion in 2020Q1, compared to a decline of 4.7 percent recorded in 2019Q2. This reflects improvement in banking liquidity. The growth in most liquidity assets is entirely credited to the surge in T-bills investments and excess reserves. By the end of June 2020, investment in T-bills increased by FRW 89.5 billion, while it recorded an increase of 41.9 billion in June 2019.That growth is related to subdued demand in loans to the private sector during the period of COVID-19. In addition, excess reserves rose to FRW 35.8 billion on average in 2020Q2 from FRW 22.5 billion in 2019Q2, partly because of increased net fiscal injection in 2020Q2.

Chart 15: Most liquid assets of commercial banks (FRW billion)



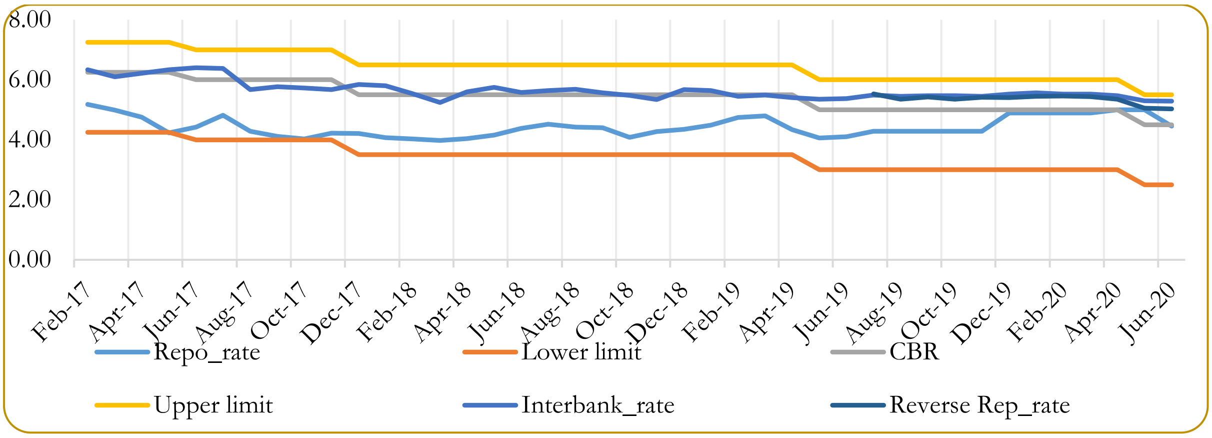
Source: NBR, Monetary Policy and Research Directorate

3.2 Monetary Policy and Interest Rates

On 29th April 2020, Monetary Policy Committee revised down the central bank rate to 4.5 percent from 5.0 percent, in order to continue supporting the economy during the period of COVID-19 pandemic. As result, interbank rates and repo rates remained within the interest rate corridor, pointing out a continuous improvement in liquidity management and in Monetary Policy Transmission Mechanism.

Interbank rate slightly dropped by 2 basis points to 5.35 percent in 2020Q2, from 5.37 percent in 2019Q2. However, repo and 28 days T- bill rate rose to 4.73 percent and 5.78 percent on average in 2020Q2, from 4.17 percent and 4.91 percent in 2019Q2 respectively. The increase in repo rates was explained by the improvement in liquidity management leading short-term interest rates to converge toward the CBR, while the rise in 28 days T-bill rate, similarly to other maturities, mirrored a sharp increase in government borrowing. In addition, reverse repo stood at 5.15 percent on average in 2020Q2.

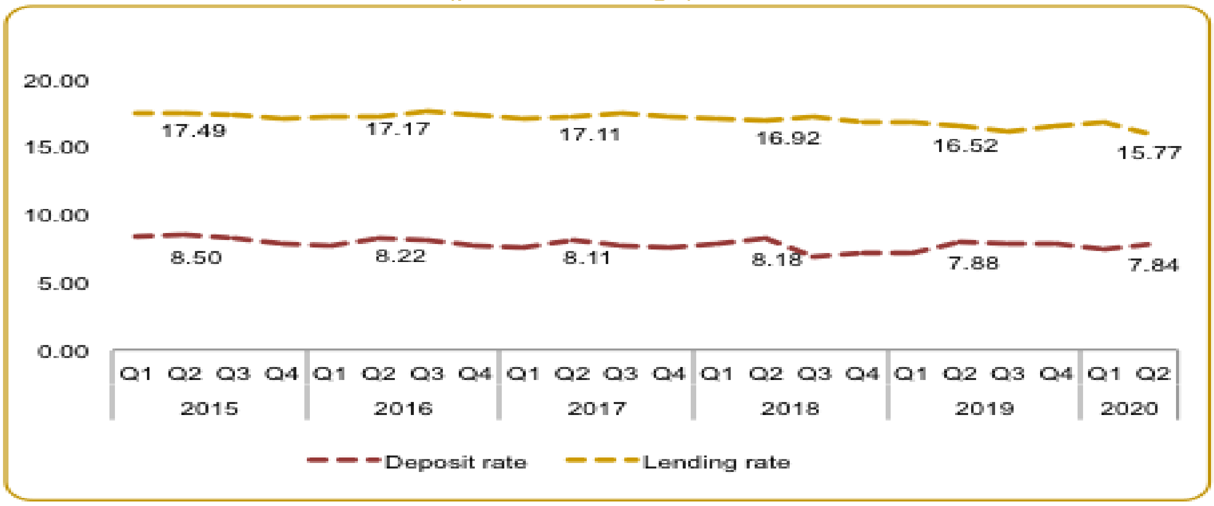
Chart 16: Money market rates developments



Source: NBR, Monetary Policy and Research Directorate

Lending rate decreased by 75 basis points to 15.77 percent in 2020Q2 from 16.52 percent in 2019Q2, resulting from a declining trend of lending rates in both corporates and individuals. Similarly, deposit rate slightly decreased by 4 basis points to 7.84 percent on average in 2020Q2 from 7.88 percent in 2019Q2. As a result, the spread between lending rate and deposit rate dropped by 71 basis points to reach 7.93 percent on average in 2020Q2, from 8.64 percent in 2019Q2.

Chart 17: Market interest rates (percent average)

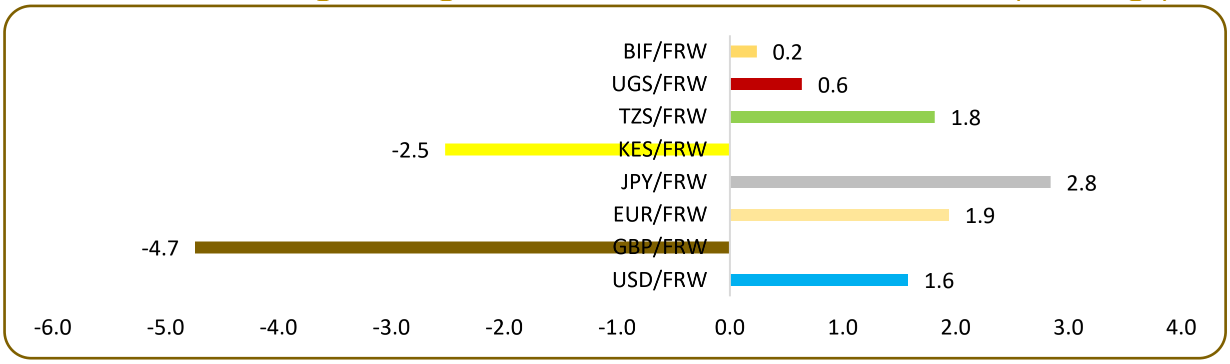


Source: NBR, Monetary Policy and Research Directorate

3.3 The exchange rate: bilateral and effective

The Rwandan franc depreciation was relatively subdued in the beginning of 2020, compared to the corresponding period of last year due to lower economic activities caused by COVID-19. In June 2020, compared to the US dollar, the franc weakened by 1.6 percent slower than 2.2 percent depreciation recorded in June last year. The local currency depreciated by 1.9 percent and 2.8 percent against the Euro and the Yen while it appreciated by 4.7 percent versus the British pound compared to previous falls of 1.6 percent, 4.8 percent and 2.0 percent the same period last year.

Chart 18: FRW exchange rate against selected currencies in June 2020 (% change)

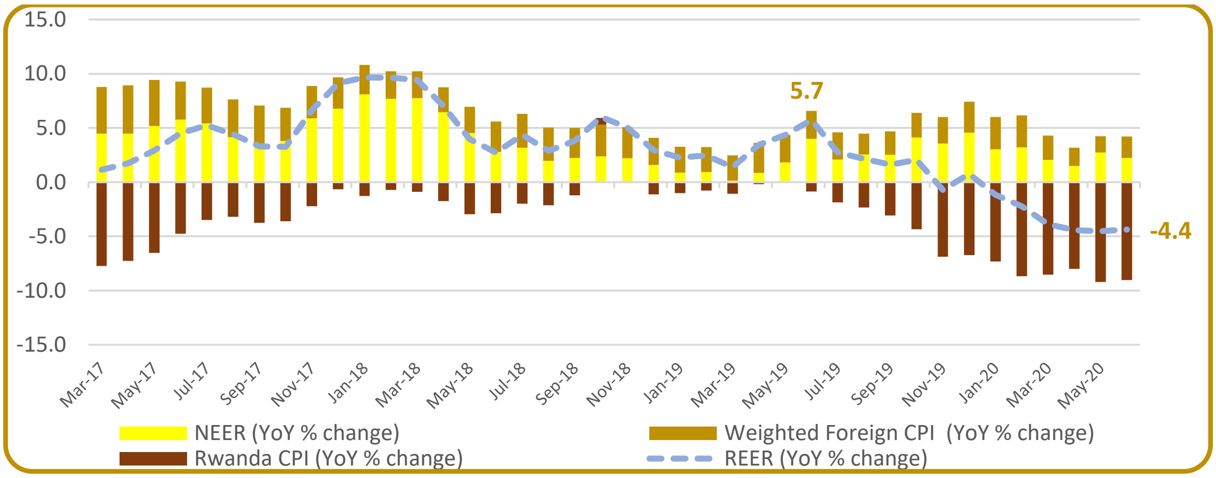


Source: NBR, Monetary Policy Department

In June 2020, the FRW strengthened by 2.5 percent versus the KES against a depreciation of 1.8 percent in the corresponding period last year. Compared to the TZS, the UGS and the BIF, the FRW depreciated by 1.8 percent, 0.6 percent and 0.2 percent from previous slips of 2.2 percent, 2.6 percent and a slight appreciation of 0.2 percent in June 2019 respectively.

Compared to a basket of currencies of Rwanda's main trading partners, the FRW appreciated in real terms by 4.4 percent (y-o-y) end June 2020, against a 5.7 percent depreciation recorded during the corresponding period in 2019.

Chart 19: Drivers of REER movement



Source: NBR, Monetary Policy Department

This was mostly attributable to higher domestic inflation relative to foreign inflation and a lower nominal depreciation of the FRW against currencies of some of the major trading partners. In nominal effective terms, the FRW depreciated by 2.2 percent, compared to a depreciation of 4.0 percent end June 2019.

3.4 Credit

Outstanding credit to the private sector picked up by 9.7 percent in June 2020 cumulatively from December 2019, up from a growth of 8.2 percent in the same period of the year before. That growth in outstanding CPS reflects the restructured loans for some sectors affected by Covid-19 (principal not repaid amounting to FRW 34.9 billion) in addition to new authorized loans (NALs) equivalent to FRW 500.1 billion distributed in 2020H1.

In the first half of 2020, new authorized loans declined by 9.2 percent, compared to the high growth of 36.8 percent recorded in the first half of 2019. The major sectors that contributed to the reduction in NALs in 2020H1, are manufacturing activities (-9.8 percent), water and energy (-7.5 percent), transport warehousing and communication (-4.0 percent) and public works and buildings (-1.6 percent).

It is important to highlight that the experienced contraction in NALs mainly happened in March, April and May of 2020 due to the lockdown, while a recovery was recorded in June 2020, where banks authorized FRW 155.0 billion equivalent to 30.9 percent of total NALs in 2020H1.

Considering the distribution of the NALs by economic sector, the main financed sectors remained Commerce (32.4%), Public works & building (20.3%), Personal loans (11.9%), and Restaurant and hotel (10.7%).

Table 2: Distribution of NALs by economic sector in % share

Economic sector	Amount in FRW billion			% share		
	2018 H1	2019 H1	2020 H1	2018 H1	2019 H1	2020 H1
Commerce	143.2	143.2	162.1	35.5	26.0	32.4
Public works and building	101.8	110.1	101.3	25.3	20.0	20.3
Personal loans	51.4	65.8	59.4	12.8	11.9	11.9
Transport & warehousing & communication	48.4	52.5	30.5	12.0	9.5	6.1
Manufacturing activities	33.1	91.5	37.6	8.2	16.6	7.5
Services provided to the community	14.7	14.8	42.1	3.7	2.7	8.4
Agricultural, fisheries& livestock	5.7	5.2	8.1	1.4	0.9	1.6
Restaurant and hotel	3.1	14.9	53.5	0.8	2.7	10.7
OFI &Insurances and other non-financial services	1.0	7.1	1.0	0.2	1.3	0.2
Mining activities	0.3	0.0	0.0	0.1	0.0	0.0
Water & energy activities	0.2	45.8	4.5	0.0	8.3	0.9
Total	**402.7**	**550.8**	**500.1**	**100.0**	**100.0**	**100.0**

Source: NBR, Financial Stability Monitoring Department

3.5 Money

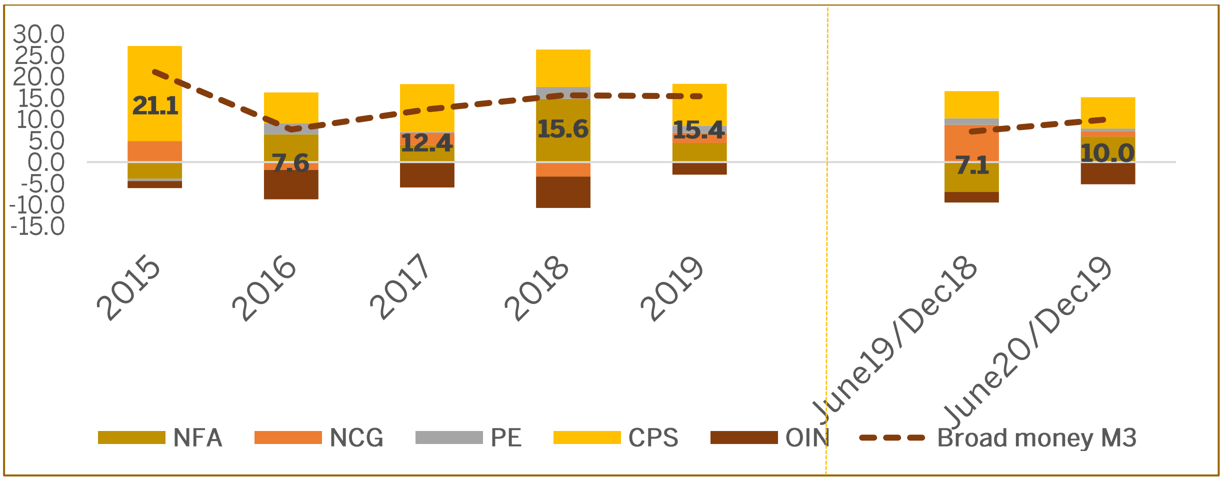
In the first half of 2020, Broad money M3 grew by 10.0 percent against a growth of 7.1 percent recorded in the same period of the year before. Credit to private sector mostly contributed to that growth in M3, with a contribution of 7.4 percent, followed by net foreign assets (+6.0 percent), net credit to government (1.3 percent) and public enterprises (+0.6 percent). However, other items net pulled down the growth of M3 with a negative contribution of 5.2 percent.

The increase in outstanding credit to the private sector was mainly driven by the restructuring of loans granted to some borrowers facing the problems caused by COVID-19 pandemic, and new authorized credit distributed in the first half of 2020. The NBR's NFA have been the driver of the growth of total net foreign assets, resulting from accumulated budget loans in 2020H1 worth USD 389.0 million (especially IMF disbursement of RCF for covid-19, World Bank loans and AFD) from USD 70.3 million recorded in 2019H1.

The growth in net credit to government was attributed to increased government domestic borrowing despite the accumulation of deposits. In this respect, credit to government from the banking system picked up by 31.6 percent in the first half of 2020 from a rise of 23.0 percent in the corresponding period of the previous year. Government deposits grew by 28.4 percent in 2020H1 (high accumulation was experienced in June 2020) from a contraction of 22.9 percent in 2019H1.

The negative contribution of other items net was attributed to the increase in equity in both NBR and Commercial banks and suspense accounts, which increased especially in June 2020.

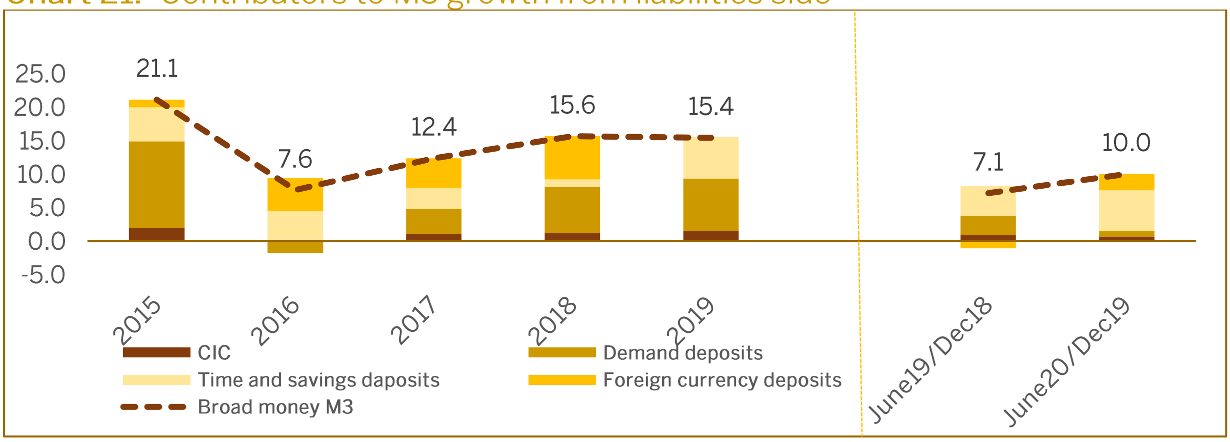
Chart 20: Contributors to M3 growth from assets side



Source: NBR, Monetary Policy and Research Department

From the liabilities side, M3 growth was mainly attributed to the time and saving deposits that contributed 6.1 percent in the first half of 2020 from 4.4 percent recorded in the corresponding period of the year earlier. Foreign currency deposits followed with 2.4 percent from – 1.1 percent, demand deposits with 0.8 percent from 2.9 percent and currency in circulation with 0.7 percent from 0.9 percent.

Chart 21: Contributors to M3 growth from liabilities side



Source: NBR, Monetary Policy and Research Directorate

The high increase in time and saving deposits reflects increased term deposits for some big depositors such as RSSB, BDF, Agaciro Development Fund and Ultimate Developers limited. The rise in foreign currency deposits was driven by foreign exchange inflows accumulated by private corporations, NGO and individuals.

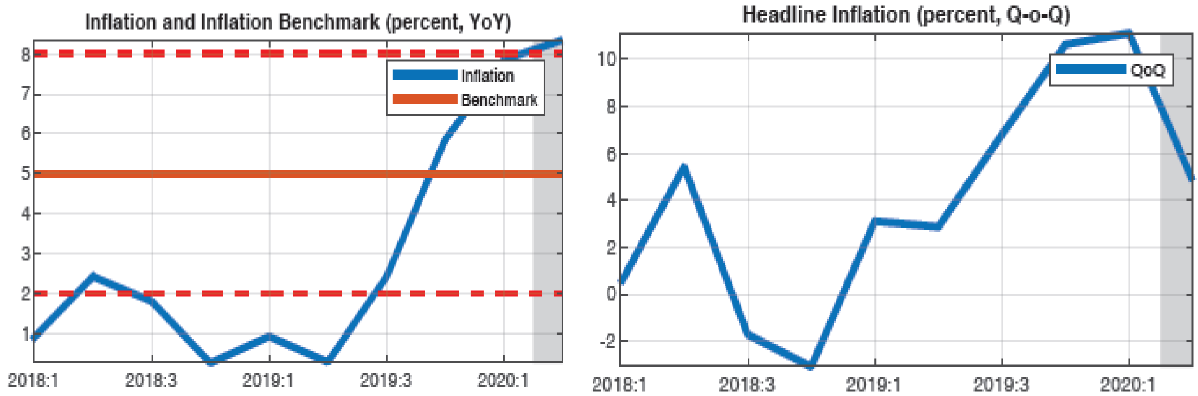
A low contribution in currency in circulation is witnessed over the period under review, due to extension of the banking industry across the country and the development of Micro finance institutions. In addition, measures taken during the COVID-19 pandemic lockdown to use digital payments explain the low contribution of currency in circulation during 2020H1.

IV INFLATION DEVELOPMENTS

4.1 Inflation developments

In 2020Q2, headline inflation surged to 8.7 percent from 8.2 percent recorded in 2020Q1. The slight increase in headline inflation reflects upticks in core and energy inflation from 2.2 percent to 5.2 percent and from 8.8 percent to 10.8 percent, respectively. The upward pressures from core and energy inflation outweighed downward trend in food inflation (from 16.8 percent to 12.9 percent), over the same period. On one hand, an increasing trend in overall prices was recorded in annual terms (2020Q2 versus 2019Q2), while on the other hand, a declining trend was recorded on Q-o-Q basis (2020Q2 versus 2020Q1).

Figure 22: Developments in headline inflation (% change)



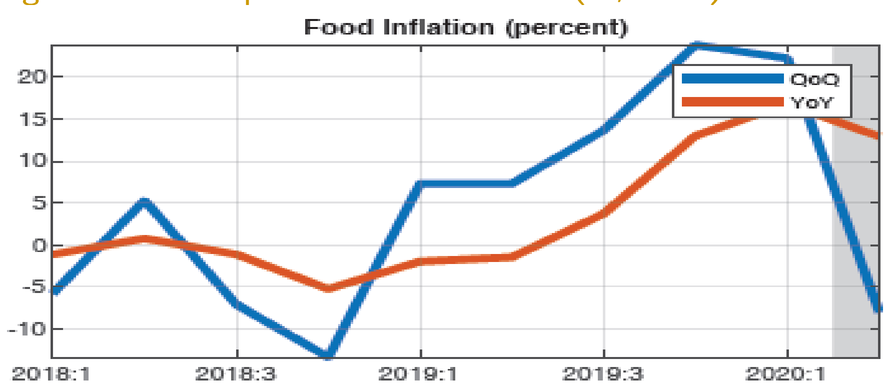
Source: NBR, Monetary Policy and Research Directorate

4.2 Contributors to headline inflation

4.2.1 Food and alcoholic beverages inflation

In 2020Q2, food inflation and price pressures eased. On Q-o-Q basis food inflation fell to -8% in 2020Q2 from 22.3% in 2020Q1, whereas on Y-o-Y basis it fell at 12.9% in 2020Q2 from 16.8% in 2020Q1. The current downward trend in food inflation is related to early harvest for season B 2020 and subdued aggregate demand. In addition, falling international food prices contributed to the downward trend in food inflation

Figure 23: Development of food inflation (%, Y-o-Y)

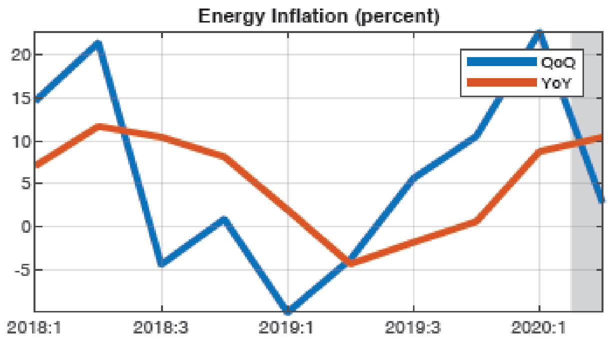


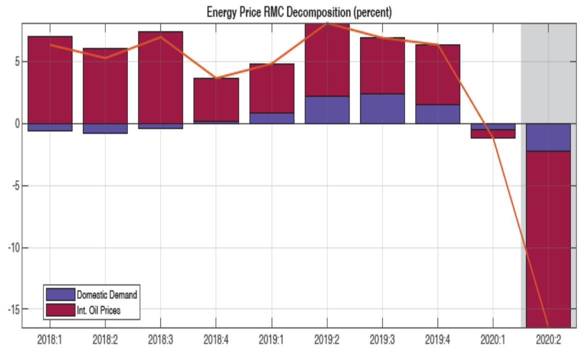
Source: NBR, Monetary Policy and Research Directorate

4.2.2 Energy inflation

Energy inflation picked up in 2020Q2 on Y-o-Y basis, on the back of the increase in prices of electricity tariffs since in January 2020. However, energy inflation eased on Q-o-Q basis (from 22.7 percent to 2.0 percent). The recent drop in energy inflation was attributed to the sharp decline in international oil prices. Other downward pressures came from solid fuels prices that eased following the covid-19 outbreak. In fact, the demand for solid fuels used by businesses and schools reduced during the lockdown.

Figure 24: Energy inflation (%, Y-o-Y)



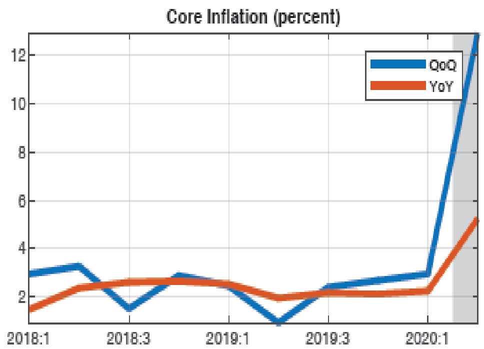


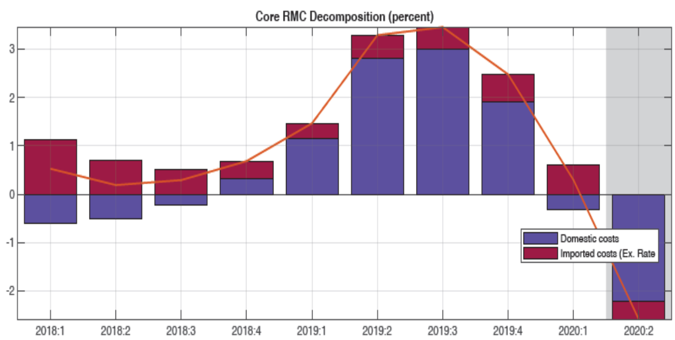
Source: NBR, Monetary Policy and Research Directorate

4.2.3. Core inflation

The surge observed in core inflation in 2020Q2, was mostly reflected in core transport inflation. Core transport inflation increased to 19.8 percent from 2.3 percent, mainly following the upward revision of public transport fares that took effect in May 2020, as part of measures to open public transportation with limited passenger turnovers to continue fighting the spread of Covid-19. In addition, purchase of vehicles inflation increased to 12.9 percent from 3.5 percent, during the same period. The upward trend reflects the surge in prices of imported vehicles as a result of Covid-19 effects that include the increase in the costs of shipments (some delays that incurred additional costs), coupled with exchange rate depreciation (USD/Yen). However, the marginal costs of production are falling for the past 3 quarters, reflecting both domestic costs (slowing economic activity) and imported costs (over-appreciation of real exchange rate), signaling downward pressures on core inflation going forward

Figure 25: Core inflation (excluding core food items)

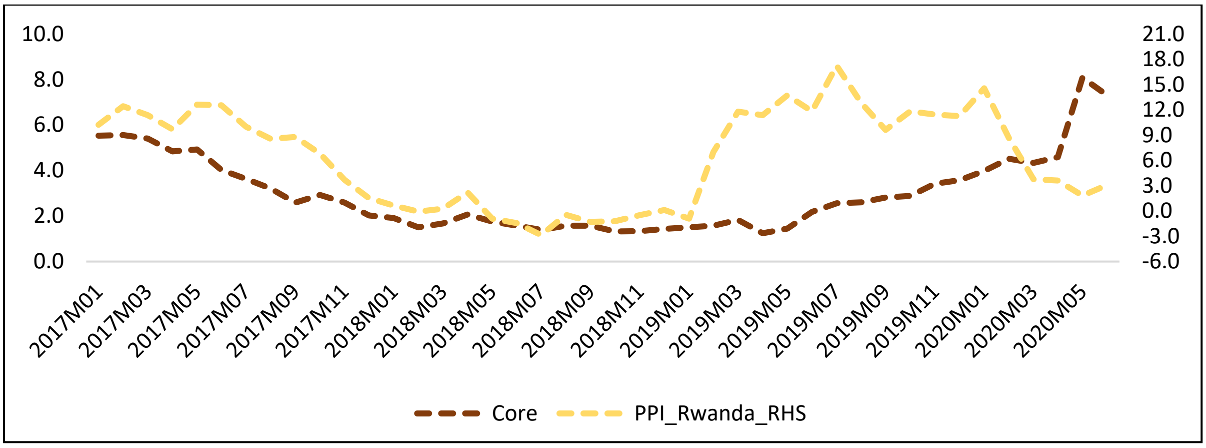




Source: NBR, Monetary Policy and Research Directorate

The aforementioned decline in marginal costs of production is also observed in the falling trend of the producer price index which is the proxy of inputs prices for firms.

Figure 26: Core inflation and PPI-Rwanda (%, Y-o-Y)



Source: NBR, Monetary Policy and Research Directorate

V. OUTLOOK

5.1. External assumptions of baseline projections

Assumption 1: The contraction in global demand will negatively affect the domestic economy.

The Covid-19 affected more negatively economic activities than expected especially in the first half of 2020. Going forward, contraction in global economy is expected to continue following the persistent social distancing as well as the prolonged lockdowns in different countries. This trend in global economy is likely to lead to a slowdown in domestic demand now and in the near future, on the back of lower domestic exports, fewer remittances and reduced foreign direct investments.

Assumption 2: The increase in both oil and food prices is expected to start earlier in 2020Q3 even though they will remain subdued in line with global demand.

In comparison with the World Economic Outlook projections of April 2020, the prices on fuels remained unchanged in regard to the projections of June 2020. Though the current economic conditions point to an increase in oil prices starting in 2020Q3, the prices will remain low, projected at $ 36.20 per barrel in 2020 and $ 37.50 per barrel in 2021. The highest oil prices per barrel expected in 2020 is around $46 per barrel, which is about 25 percent below the 2019 average. Over the forecasting horizon, the non-fuels items including food prices are expected to rise faster than previously projected, while oil prices are expected to remain non-inflationary. The length of the pandemic, the lockdowns and disruptions in supply chains coupled with other government's measures to limit Covid-19 effects will be among other factors determining the trend in food prices.

Assumption 3: Expansionary fiscal policy is anticipated throughout the forecasting horizon but it will remain non-inflationary.

In relation to Covid-19 lockdown, both government total revenues and expenditures are projected to drop slightly with June 2020 projections compared to April 2020 projections. Thus, tax revenues are expected to slightly decelerate to 14 percent of GDP from 16 percent while total spending are projected at 32 percent of GDP from 34 percent. Over the same horizon, fiscal deficit will remain at 12 percent.

5.2. Baseline projections of key macroeconomic variables

Domestic GDP growth is projected to slowdown in 2020 but recover in 2021:

The recent developments and new projections indicate a contraction in domestic output in 2020 with a rebound in 2021. The country measures to limit the spread of COVID-19 are maintained in 2020H2, some businesses remain closed, some areas are in lockdown and land frontiers are yet to be opened for usual businesses. The non-agricultural economy will be the most affected, operating below potential over the medium term and dragged down by both global demand and slowdown of economic activity in relation to COVID-19 as evidenced by the trend in CIEA. The agricultural economy remains uncertain. Food production in season B may have not perform well based on the current trend in domestic fresh food prices. The meteorology Agency does not indicate any abnormalities in rainfall in the upcoming season.

The accommodative monetary policy will continue supporting the economy:

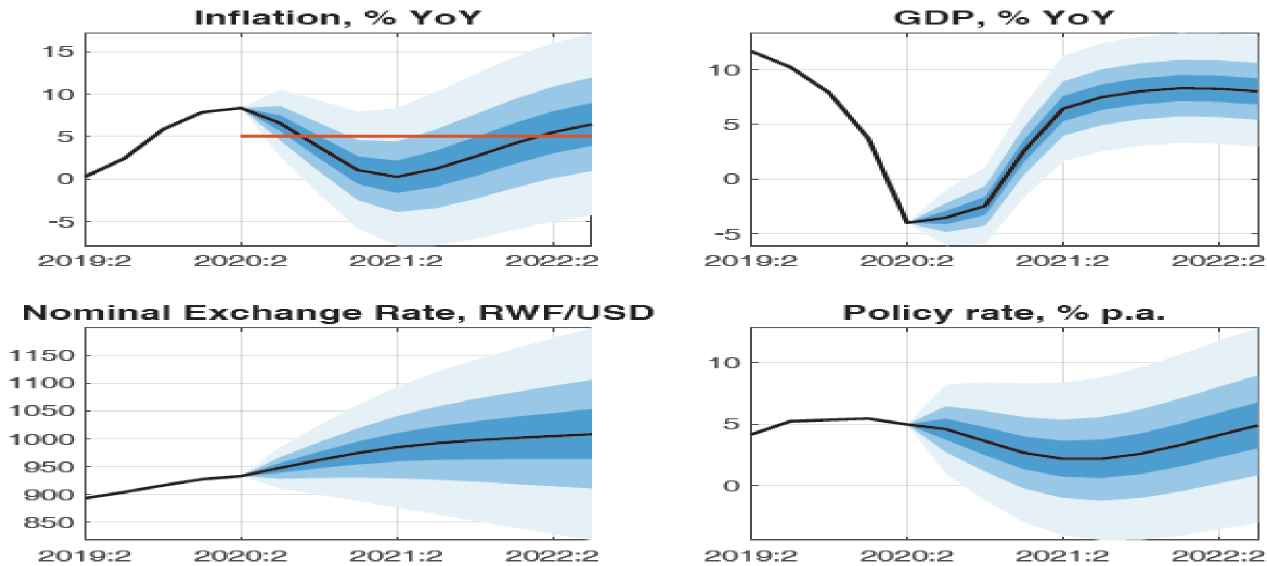
Generally, new projections put forward that monetary conditions should remain accommodative to support the economy, mainly on the back of real exchange rate depreciation. This is consistent with the expected uptick in imports as part of the economic recovery and the increase in international commodity prices that both push up the need for more foreign exchange. Going forward, ease in policy rate will support the exchange rate depreciation not to be outweighed by the increase in real interest rate following the expected inflation.

Inflation projections

From the baseline projections, domestic demand will remain subdued over the medium term, reflecting the drop in global economy, slowdown in domestic economic activities as a consequence of Covid-19. However, some mild upward pressures on core inflation are expected to resume in 2021, backed by the resumption of economic activities, exchange rate depreciation and conducive real interest rate conditions. Similarly, food price levels are expected to increase in 2021Q1, following the uptick in international food prices and the increase in domestic food prices in the near term. Energy inflation is projected to marginally increase in 2021Q1 as a result of the expected slight recovery in oil prices.

Consistent with the initial economic conditions and forecast assumptions, headline inflation will lie within the benchmark band at 6.9 percent in 2020 but fall below the lower bound at 1.3 percent in 2021.

Figure 27: Headline inflation projection



Source: NBR, Monetary Policy and Research Directorate