National Bank of Rwanda

Banki Nkuru y'u Rwanda

MONETARY POLICY REPORT

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Contents

EXECUTIVE SUMMARY

The domestic economy is expected to recover from the negative impact of COVID-19

Following COVID-19 induced shutdown, real GDP decreased by 12.4 percent in the second quarter of 2020. However, high-frequency indicators point to an improvement in the third quarter of 2020. The Composite Index of Economic Activities (CIEA), a measure that provides an early indication of economic performance, increased by 6.3 percent in quarter three of 2020 compared to a contraction of 9.1 percent recorded in the second quarter of 2020. Similarly, total turnovers of industry and services sectors improved, but still below last year's levels. The industry sector turnovers for the third quarter of 2020 grew in line with the increased government demand for construction materials to build schools, roads and health facilities. Though COVID-19 related risks continue to weigh in on the performance of the services sector, the contraction in the sector's turnovers eased in 2020Q3, after a deeper decline recorded in the previous quarter.

Global economic outlook adversely affected by the COVID-19 outbreak

According to October 2020 IMF projections, global economic growth is projected at - 4.4 percent in 2020, a less severe contraction compared to June forecasts. The revision was mainly due to the resumption of economic activities in May and June, though the second wave of the pandemic is compelling countries to opt for another lockdown. In 2021, the global economy is expected to recover from this deep recession, with a growth projected at 5.2 percent despite the medium-term downside risks related to containment measures and rising sovereign debt in many countries around the world.

Easy liquidity conditions recorded in the banking sector

The banking system liquidity remained resilient to the COVID-19 pandemic impact. The increase in liquidity resulted from supportive measures taken by NBR and the Government of Rwanda, amid subdued demand for loans by the private sector during the lockdown. By end September 2020, broad money and outstanding credit to private sector grew by 23.1 percent and 17.4 percent year on year respectively. In line with the continuing NBR accommodative monetary policy stance, market interest rates in the economy reduced further. In the first three quarters of 2020, the average lending rate reduced by 18 basis points year on year to 16.31 percent, which is favorable to continue supporting the economic recovery.

Headline inflation projected to ease from the fourth quarter of 2020

Despite receding inflationary pressures from the core and energy CPI components, headline inflation remained above the upper bound of the benchmark band, standing at 9.0 percent in the third quarter of 2020, mainly reflecting the effect of the transport price shock. Nevertheless, the outcome of those easing pressures is expected to unfold in 2020Q4 with a headline CPI inflation revolving around 6 percent. Baseline projections of inflation point to further easing of core inflationary pressures in 2021, resulting from subdued domestic and global demand, coupled with the effect of the removal of transport price shock. As a result, headline inflation is projected to lie below the benchmark of 5 percent in 2021.

Based on these prospects, on 11th November 2020, the Monetary Policy Committee decided to maintain an accommodative monetary policy stance, by keeping the CBR at 4.5 percent to continue supporting the financing of the economy by the banking sector.

I. ECONOMIC OUTLOOK

The COVID-19 pandemic is taking a toll on both global and domestic economies. Near term developments are highly uncertain and significantly depend on future evolution of the infection. Central Banks and governments across the world took targeted measures to limit COVID-19 economic fallout and restore the waning business confidence. The world GDP sharply decreased in the first half of the year 2020 and this slowdown was broadly based across the globe.

On the domestic front, the pandemic has clouded Rwanda's economic growth outlook for 2020 through both demand and supply shocks. Particularly in the second quarter of 2020, the economy fell by a record 12.4 percent but leading indicators are pointing to recovery since the third quarter 2020, following the ease of COVID-19 containment measures, coupled with supportive policy actions.

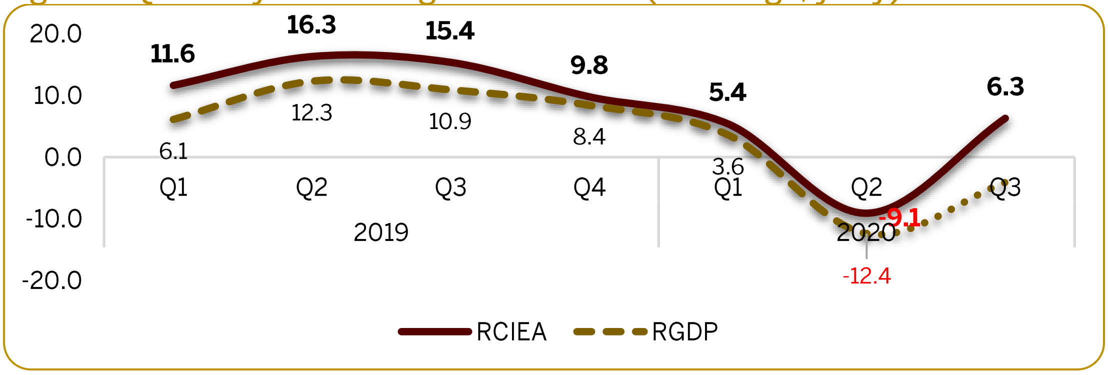
1.1 Recent developments

High-frequency indicators point to an improvement in the third quarter of 2020. The Composite Index of Economic Activities (CIEA), a measure that provides an early indication of economic performance, increased by 6.3 percent in quarter three of 2020 compared to a contraction of 9.1 percent recorded in the second quarter of 2020. Similarly, total turnovers of industry and services sectors improved, but still below last year's levels. The industry sector turnovers for the third quarter of 2020 grew in line with the increased government demand for construction materials to build schools, roads and health facilities. Though COVID-19 related risks continue to weigh in on the performance of the services sector, the contraction in the sector's turnovers eased in 2020Q3, after a deeper decline recorded in the previous quarter.

High frequency indicators point to an economic recovery in 2020Q3, consistent with the resumption of economic activities.

The composite index of economic activities (CIEA) increased by 6.3 percent in 2020Q3, from a decline of 9.1 percent in 2020Q2; the biggest contributor to this growth being credit to private sector and cement. The expansion in credit to private sector was partly driven by the loan restructuring that aimed at easing loan repayment conditions to borrowers affected by the COVID-19 pandemic. The high domestic demand of cement reflects the ongoing government infrastructure projects of which schools, roads upgrade and rehabilitation of health facilities.

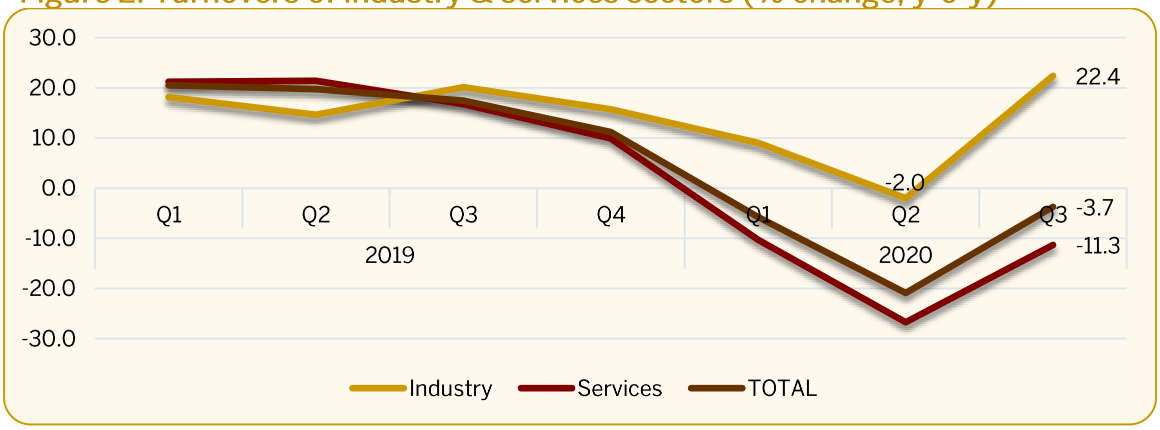
Figure 1: Quarterly Real GDP growth vs CIEA (% change, y-o-y)



Source: NBR, Monetary Policy Department

The total turnovers of industry and services sector also signal the recovery in economic activities. Though still negative in real term, total turnovers growth improved to negative 3.7 percent in 2020Q3 against a drop of 20.9 percent in 2020Q2, mainly led by industry sector. The aforementioned infrastructure projects were the main drivers of the rebound recorded by the industry sector, which resulted in good performance of manufacturing industries. Furthermore, this outcome was underpinned by the production of a new cement factory (Prime Cement) with a capacity of 0.6 megatons a year as well as the continuous increase of production by food processing industries.

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



Source: NBR, Monetary Policy Department

While improving, the services sector remains weak due to heavy negative impact of COVID-19 on this sector. In particular, all services related to travel and tourism continue to record high contraction, between -20% and -40% in 2020Q3, from a range of -30% to -60% in 2020Q2. The poor performance of services sector outweighed the successful achievement of industry sector as it represents a bigger share of total turnovers.

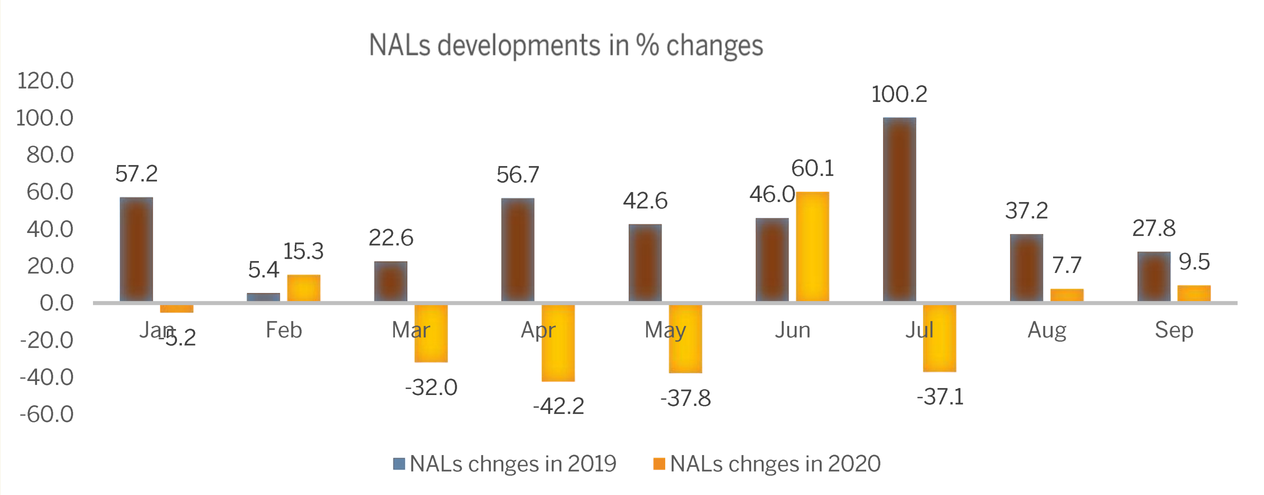
The recovery observed in 2020Q3 is expected to continue in the fourth quarter, reflecting the growing private sector optimism and government spending through ongoing infrastructure projects. The promising development of domestic demand will continue to be the main driver of the economic recovery as the external demand is likely to be impeded by growing COVID-19 cases in advanced countries. The accommodative monetary policy stance and the increasing disbursement of the Economic Recovery Fund (ERF) established by the Government of Rwanda are expected to revive the growth momentum. However, the economic performance this year is expected to remain low compared to 2019, with a growth rate projected at negative 0.2 percent.

Sound credit to the private sector owing to supportive policy measures

Outstanding credit to the private sector picked up by 6.3 percent in September 2020 cumulatively from June 2020, up from a growth of 3.4 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 in addition to new authorized loans (NALs) amounting to FRW 290.98 billion distributed in 2020Q3.

However, New authorized loans (NALs) have declined by 6.5% in 2020Q3, down from a 2spike of 49.6% in corresponding period of the year 2019. The downturn was observed mainly in OFI insurances and non- financial services, public works and building, agriculture, fisheries, livestock and Commerce. The demand for credit contracted by 2.8% in the nine months of 2020 from a pick of 24.2% of the same period previous year.

Figure 3: New authorized loans developments in % change



Source: NBR, Financial Stability Monitoring Department

Considering the distribution of the NALs by economic sector, the main financed sectors remained Commerce, Public works & building, Personal loans and manufacturing activities.

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

Economic sector	Amount in FRW billion			% share		
	2018Q3	2019Q3	2020Q3	2018Q3	2019Q3	2020Q3
Commerce	75.9	94.0	87.9	36.5	30.2	30.2
Public works and building	55.1	95.4	67.3	26.5	30.7	23.1
Person loans	26.8	46.0	47.0	12.9	14.8	16.1
Water & energy activities	15.1	5.8	3.4	7.3	1.9	1.2
Manufacturing activities	11.4	30.3	39.3	5.5	9.7	13.5
Transport & warehousing & communication	10.6	13.4	18.0	5.1	4.3	6.2
Services provided to the community	5.0	12.4	17.8	2.4	4.0	6.1
Restaurants and hotels	3.4	5.0	5.3	1.6	1.6	1.8
Agricultural, fisheries& livestock	3.4	4.6	3.0	1.6	1.5	1.0
OFI &Insurances and other non-financial services	1.4	4.3	2.1	0.7	1.4	0.7
Mining activities	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	208.0	311.1	291.0	100.0	100.0	100.0

Source: NBR, Financial Stability Monitoring Department

The growth in credit supply is expected to continue in the fourth quarter of 2020. This growth will be supported by ample liquidity in the banking system, amid an economic recovery which is foreseen to boost the demand for loans.

Headline inflation projected to ease from the fourth quarter of 2020

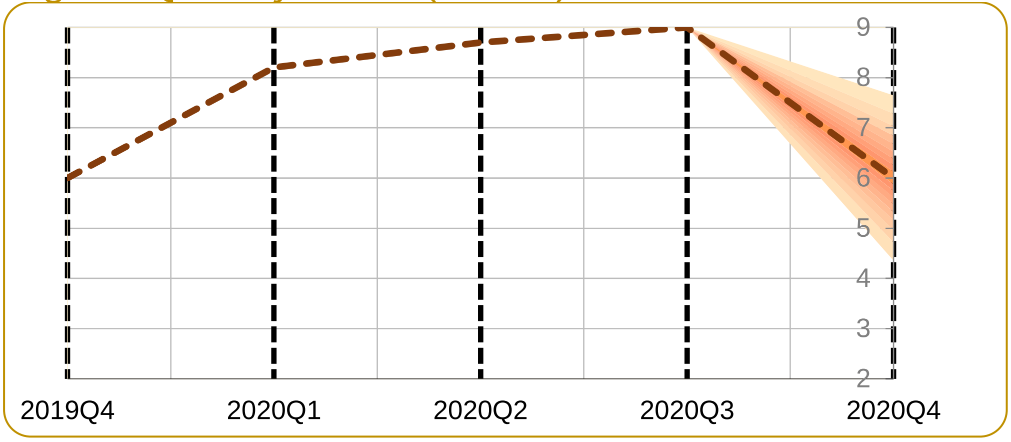
Consistent with the near term inflation forecasts, quarterly price expectations survey findings, coupled with expert judgements, headline inflation is expected to ease from the fourth quarter of 2020.

In the coming quarter (2020Q4), both downward and upward pressures are expected to emanate mainly from the supply side. Food inflation is expected to record a moderate deceleration in comparison with the previous quarter (2020Q3), reflecting the anticipated good production of some vegetables (fresh products) over the same period. Other downward pressures will be resulting from the downward revision of public transport tariffs, pushing down core (excluding food) inflation.

Unlike fresh food inflation and core (excluding food) inflation, energy inflation is expected to stabilize despite the increase in permits of forest extraction. The trend in energy inflation is mainly driven by solid fuels inflation and in the next quarter the effect of higher prices recorded last year during the same period will be dragging down the expected inflation. Stability in energy inflation will be resulting from the stable demand for solid fuels coupled with government's regulations vis-à-vis the changes in solid fuels prices.

On the upside, prices of some core food items are expected to record a mild increase following tighter supply conditions (delays in supply), adding to the uncertainties around seasonal patterns.

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



1.2 Global economic outlook

According to October 2020 IMF projections, global economic growth is projected at - 4.4 percent in 2020, a less severe contraction compared to June forecasts. The revision was mainly due to the resumption of economic activities in May and June, though the second wave of the pandemic is compelling countries to opt for another lockdown. In 2021, the global economy is expected to recover from this deep recession, with a growth projected at 5.2 percent despite the medium-term downside risks related to containment measures and rising sovereign debt in many countries around the world.

The world economic outlook remains overshadowed by COVID-19-related developments. New cases of infections are significantly rising mainly in Eurozone, United States, United Kingdom, and India among others, negatively impacting on developments in 2020Q4 and onwards. Advanced economies, emerging markets and developing economies are operating below their potential capacity in 2020 and going forward in 2021. Unemployment rate stays high globally and aggregate demand remains subdued.

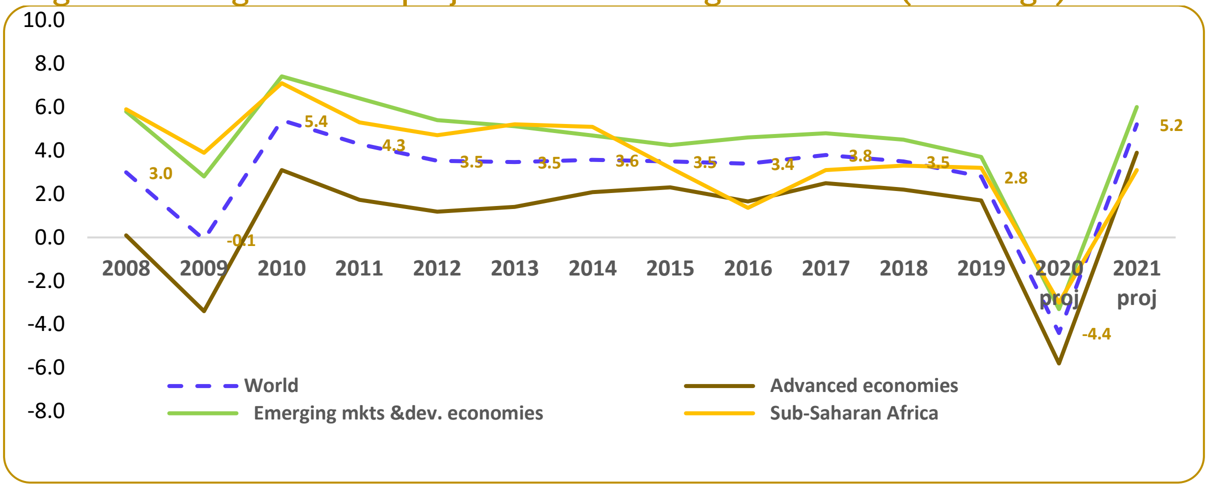
This section provides key highlights on global economic outlook that are likely to impact on domestic economy through direct or indirect channels. It analyses developments in commodity prices and their spillover effect on consumer prices.

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

According to the IMF projections published in October 2020, global economic growth is projected to contract to -4.4 percent in 2020, slightly better than -4.9 percent forecast in June 2020. With easing lockdown restrictions in May and June, the 2020Q2 growth was better than anticipated, particularly in advanced economies and, available indicators point to further improvement in the third quarter 2020. In 2021, the global growth is expected to recover by 5.2 percent on easy monetary policy, fiscal stimulus and hope for an effective and widely distributable COVID-19 vaccine.

However, the global outlook remains highly uncertain as COVID-19 cases rose again across the globe mainly in advanced economies. Emerging and developing economies are faced with domestic COVID-19 related challenges in addition to a slowdown in foreign demand.

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



Source: IMF WEO, Oct. 2020

In advanced economies, growth is projected at -5.8 percent in 2020, reflecting recessions in all economies. Growth in United States is projected at -4.3 percent in 2020 before recovering to 3.1 percent in 2021. The Eurozone recession will be more pronounced at -8.3 percent in 2020, reflecting first half of the year poor performance. The Eurozone economy is foreseen to recover by around 5.2 percent in 2021. Real GDP in the United Kingdom is forecasted at -9.8 percent in 2020, and will rebound back by 5.9 percent in 2021. The Japanese growth is projected at -5.3 percent in 2020, before strengthening by 2.3 percent in 2021.

In the emerging markets and developing economies, activity is projected to contract by -3.3 percent in 2020, but expected to recover by 6.0 percent in 2021. In China, GDP is projected to slightly increase by 1.9 percent in 2020. India's economy is estimated to contract by 10.3 percent in 2020, following a longer period of lockdown and slower recovery than anticipated in April.

In Sub-Saharan Africa, growth is expected to contract to -3.0 percent in 2020, reflecting risks arising from the sharp decline in output growth among the region's key trading partners, the fall in commodity prices, reduced tourism activity in several countries, as well as the effects of COVID-19 containment measures. The region's growth is however projected to recover to 3.1 percent in 2021, slower than historical average as most of countries lack policy space to sustain more fiscal stance.

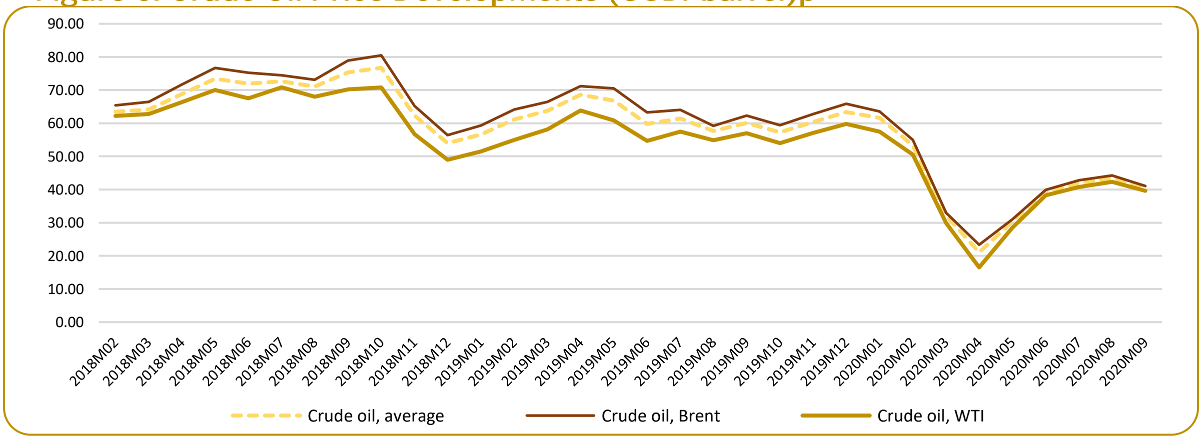
The real GDP in the EAC is projected at 1.0 percent in 2020 due to weak external demand and disruptions to supply chains and domestic production. Activity in tourist-dependent countries is expected to contract sharply in response to severe disruptions to travel and tourism activities.

Overall, the world economy is subject to downside risks that may worsen the recession in 2020 and derail the projected recovery in 2021. These risks include the outcome of the Brexit, rising geopolitical tensions in some regions, increasing global debt burden, COVID-19 related impediments as well as trade related challenges. Upside factors, may stem from effective COVID-19 containment measures such as vaccine, powerful treatment or natural end of the disease.

Lower Global commodity prices backed by sluggish global demand

On commodity markets, prices decreased in the first nine months of 2020, reflecting slowdown in global demand due to the COVID-19 pandemic. According to World Bank commodity outlook report published in October 2020, crude oil prices are gradually recovering from extremely low level (US $21.04/barrel in April 2020) and expected to average US $41/barrel in 2020 and US$44/barrel in 2021, against US $61.4/barrel in 2019.

Figure 6: Crude Oil Price Developments (USD/barrel)p



Source: World Bank, Sept. 2020

The slowdown in oil demand is anticipated to be offset by easing supply conditions. Additional stimulus measures are expected to boost the economic activity and increase the oil demand.

In 2020Q3, non-fuel commodity prices recovered from strong shock caused by the COVID-19 pandemic but remained below the pre-pandemic levels. In 2020, metals & mineral prices are projected to decrease by 1.1 percent, less negative than -5.0% in 2019 following a rebound in Chinese industrial production and a slight recovery in global demand. In 2021, prices of metals and minerals are foreseen to recover by 2.1 percent. Boosted by the US dollar depreciation and lower interest rates, prices soared for precious metals and projected to be 27.3 percent higher in 2020 than in 2019, before dropping by 3.7 percent later in 2021.

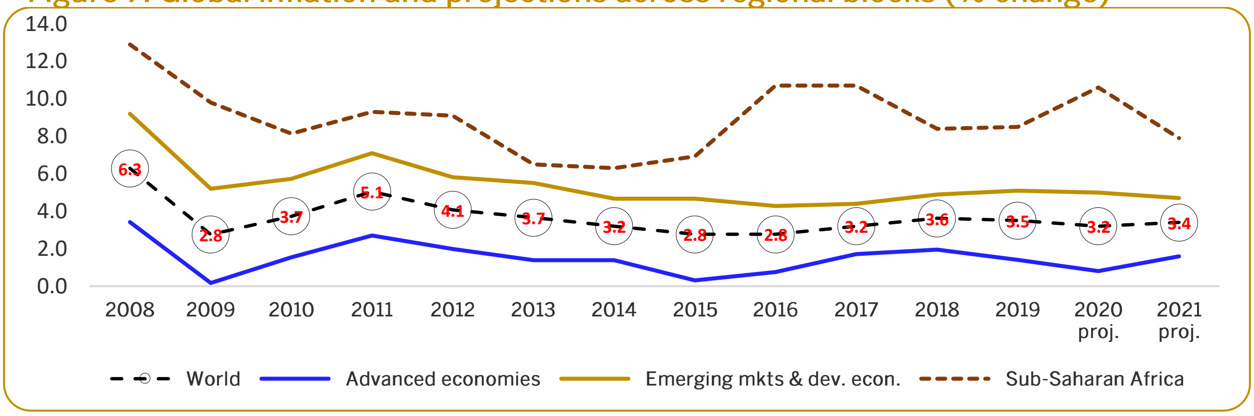
Agricultural commodity prices are projected to increase by 2.8 percent in 2020, as prices are expected to rise for beverages (6.7 percent); of which coffee Arabica (17.0 percent) and tea average (8.2 percent) and for food items by 3.4 percent in 2020. Prices for fertilizers are projected to drop by 10.3 percent in 2020, before increasing by 3.2 percent in 2021.

Global inflationary pressures projected to ease, owing to low aggregate demand and declining commodity prices

World inflation is expected to remain low, following a sharp drop in global demand, a projected decline in commodity prices adding to persistently high unemployment rate. However, upward risks may arise from higher fiscal deficit and further depreciations of regional currencies.

World annual average inflation is projected to decelerate to 3.2 percent in 2020 while foreseen to slightly go up to 3.4 percent in 2021. In advanced economies, inflation is projected to ease to 0.8 percent in 2020, giving room for Central Banks' further monetary policy easing. Inflation is anticipated to later pick up to 1.6 percent in 2021 in line with expected recovery in economic activities but still below the benchmark target.

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



Source: IMF, Oct. 2020

US annual average inflation is projected to ease to 1.5 percent in 2020 but expected to rise to 2.8 percent in 2021. In the Eurozone, the annual average inflation is projected to reduce to 0.4 percent in 2020 and to rise gradually to 0.9 percent in 2021.

In the emerging markets and developing economies, inflation is projected to ease to 5.0 percent in 2020 and decelerate to 4.7 percent in 2021. In China, inflation is anticipated to gradually rise to 2.9 percent in 2020 while foreseen to recede to 2.7 percent in 2021 against the Central Bank target of 3 percent.

Inversely, in Sub-Saharan Africa, annual headline inflation is projected to rise to 10.6 percent in 2020, reflecting higher food prices following multiple weather-related shocks, including cyclones, droughts in southern and eastern Africa, exchange rate pressures together with supply disruptions for imported products as well as severe locust swarms in the horn of Africa and nearest countries. However, Sub-Saharan African headline inflation is projected to ease to 7.9 percent in 2021.

In five countries of the East African Community (EAC), inflation is expected to remain moderate due to low aggregate demand, low energy prices as well as slowing food prices. Headline inflation is projected to average 4.7 percent in 2020 and will continue to go up in 2021 but will remain below the EAC ceiling of 8.0 percent.

1.3 Key macroeconomic projections

Despite receding inflationary pressures from the core and energy CPI components, headline inflation remained above the upper bound of the benchmark band, standing at 9.0 percent in the third quarter of 2020, mainly reflecting the effect of the transport price shock. Nevertheless, the outcome of those easing pressures is expected to unfold in 2020Q4 with a headline CPI inflation revolving around 6 percent. Baseline projections of inflation point to further easing of core inflationary pressures in 2021, resulting from subdued domestic and global demand, coupled with the effect of the removal of transport price shock. As a result, headline inflation is projected to lie below the benchmark of 5 percent in 2021.

Uncertainties around the global economic recovery, may weigh on Rwanda's external sector.

Since the beginning of 2020, economies around the world were negatively affected by Covid-19 outbreak, leading to contraction in GDP for most countries. Even though the global economy started to pick up from the contractions recorded in 2020Q2, uncertainties remain. In effect, the global economy's recovery back to pre-pandemic levels of activity remains prone to setbacks of the second wave of coronavirus. In case it becomes more severe, the domestic economy will be affected through the drop in exports revenues emerging from less global demand.

The rising trend in oil prices will be offset by the downward trend in food prices.

In line with the recovery in global demand, global projections indicate that oil prices will record an upward trend than previously projected while food prices are likely to fall over the medium term. During the first months of the COVID-19 pandemic, global assessments highlighted that international oil prices decelerated to around 60 percent from February to April 2020, on the back of the slowdown in global demand for oil. Over that time, countries set different measures including lockdowns where the unnecessary travels were restricted, hence easing pressures on the demand for oils and other related items. However, recent global baseline assumptions published by IMF (Oct, 2020) illustrate the existence of uncertainties around the path of COVID-19 but confirm the upside risks on the trajectory of oil prices, linked to the usual geopolitical tensions in the Middle East. However, the upside risks will be moderated by downside risks that may result from the subdued global economic recovery. Hence, oil prices may exert moderate pressures on inflation going forward.

Regarding food prices, most of foodstuffs recorded an upward trend since the beginning of the pandemic as a consequence of tighter food supply conditions, coupled with the consumer's stockpiling. With the new measures set by countries to curb the COVID-19 pandemic, food prices are predicted to be stable or even decline. However, there are risks to the projected ease in global food prices. Upward pressures might come from the continued disruptions in food supply chains, export restrictions, and tensions between China and US regarding export of food items.

Fiscal policy is expected to effectively support domestic aggregate demand without exerting pressures on inflation.

Government total revenues are projected to increase higher than previously projected and this will be reflected in both tax revenues and grants. The end of full lockdown period, marking a progressive reopening of economic activities since May 2020 affected positively the accumulation of tax revenues. During the economic recovery and in line with boosting domestic demand, the fiscal authority is keen to hasten current expenditure while decreasing its capital spending in subsequent quarters, compared to the levels previously projected. The fiscal policy stimulus on domestic economy increased, however, its effects on aggregate demand will remain non-inflationary over the medium term.

The economy will continue to operate below full capacity in 2021 amidst ample liquidity in the banking sector.

In the economic recovery perspectives, macroeconomic fundamentals indicate that over the medium term the economy will continue operating below potential levels despite measures taken by the Government and the National Bank of Rwanda to support the boost of economic activities. To prevent the plunge of the economy following the pandemic of COVID-19, easy monetary and liquidity conditions were created through cutting the Central Bank Rate and reducing the required reserves ratio. In addition, other measures including the establishment of the Economic Recovery Fund (ERF) by the government were initiated. However, the uptake of these conditions is still timid with the credit market that is taking more time to recover consistent with a rather low activity is some key sectors of the economy. Developments of these aspects in next two to three quarters will be critical and indicative of the next policy actions.

The slowdown in aggregate demand (GDP) in 2020 and a rebound in 2021

Domestic economy in the first two quarters of 2020 recorded a contraction, as a result of COVID-19 outbreak. However, following the gradual resumption of economic activities since 2020Q2, the economy started to recover progressively from 2020Q3. This is evidenced by the increase in turnovers mainly in the construction sector during the same period. However, the economy will continue to operate below full capacity of production, weighed down by a subdued global demand. In addition, the current low uptake of liquidity facilities aimed to revive the economy will delay the full recovery. Furthermore, projections indicate that the accommodative monetary policy stance will also support aggregate demand though it will not be enough to bring the economy to potential level. In this regard, initial conditions adding to the projections revealed that the slowdown in demand will continue towards the end of 2020, before recovering slowly in 2021.

Projection of key macroeconomic indicators

Mild pressures on core inflation are expected over the medium term as a result of the continuous real exchange rate depreciation. Once this materializes, it will exert upward pressures on imported inflation.

Additionally, other mild pressures on core inflation are expected to upshot from domestic costs. As the economy is rebounding from COVID-19 effects, domestic demand for raw materials and labor are expected to create minor upward pressures, especially in service and industry sectors.

Out of the upsides pressures, the downsides pressures on core inflation will continue to lie around the removal of transport shock though its effects are disposed to fade away in the short run.

During the same period, pressures from food prices are expected to stabilize. Food production is going to remain non-inflationary driven by the expected increase in food supply, adding to the projected slight drop in international food prices, ceteris paribus.

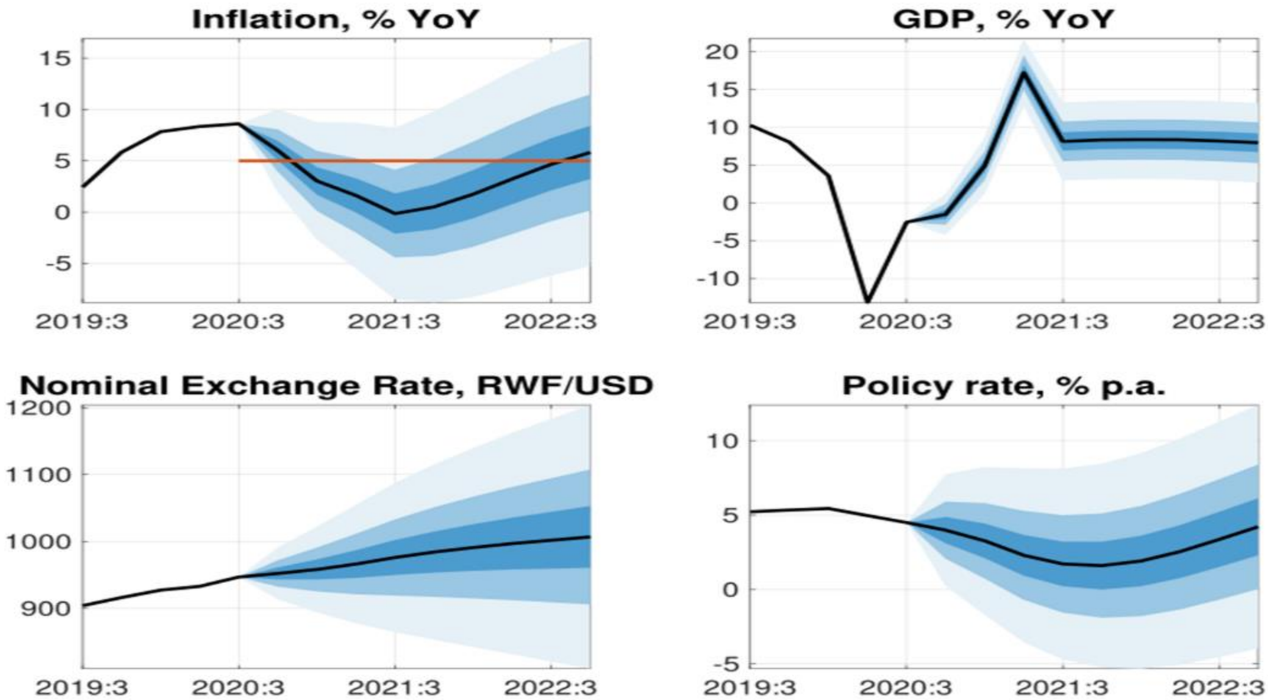
In terms of costs of producing and transport food items, pressures over the forecasting horizon are expected to record a declining trend and this will be supported by the availability of domestic factors at low costs, coupled with the ease in the supply chains. On this, the projections do figure out that the trend in food prices will depend on the type of food item, the origin of food imports, as well as the agricultural seasonal patterns.

Similarly, pressures in energy will be non-inflationary till 2021H1 on the back of decreasing trend in domestic demand though the trend will be offset by the increase in international oil prices that might exert mild upward pressures on energy inflation over the forecasting period.

Still, pressures that may determine the future trajectory of energy inflation will depend on the duration of COVID-19 pandemic, meaning that the demand for energy components is subject to surge or decline following the containment measures put in place by the governments.

Consistent with Initial economic conditions, assumptions on global economy, domestic fiscal policy and other macroeconomic variables, headline inflation is projected to remain above the benchmark at 8.0 percent in 2020. Headline inflation will then drop at 1.3 percent in 2021.

Figure 8: Projections



Source: NBR, Monetary Policy and Research Directorate

II. ECONOMIC DEVELOPMENTS

The recent global economic developments have continued to be shaped by the negative effects of COVID-19. Advanced economies have been drastically affected, particularly the USA and Eurozone. Nonetheless, the second and third quarters were better than expected in advanced economies, as countries started reopening economies in May and June 2020, amidst significant stimulus measures.

In 2020Q1, following COVID-19 containment measures across the world, GDP in the G20 area contracted by 3.4%, the largest recession since 1998. The decline was deeper in the second quarter in countries that were mostly affected by the outbreak.

On the domestic side, Rwanda's economic growth has also weakened, owing to both demand and supply shocks. In the second quarter of 2020, the economy contracted to -12.4 percent as the period was marked by more pronounced COVID-19 containment measures. Afterward, high frequency indicators signal gradual and sustained recovering economic activities during the third quarter of 2020, which is expected to continue in the last quarter of the year.

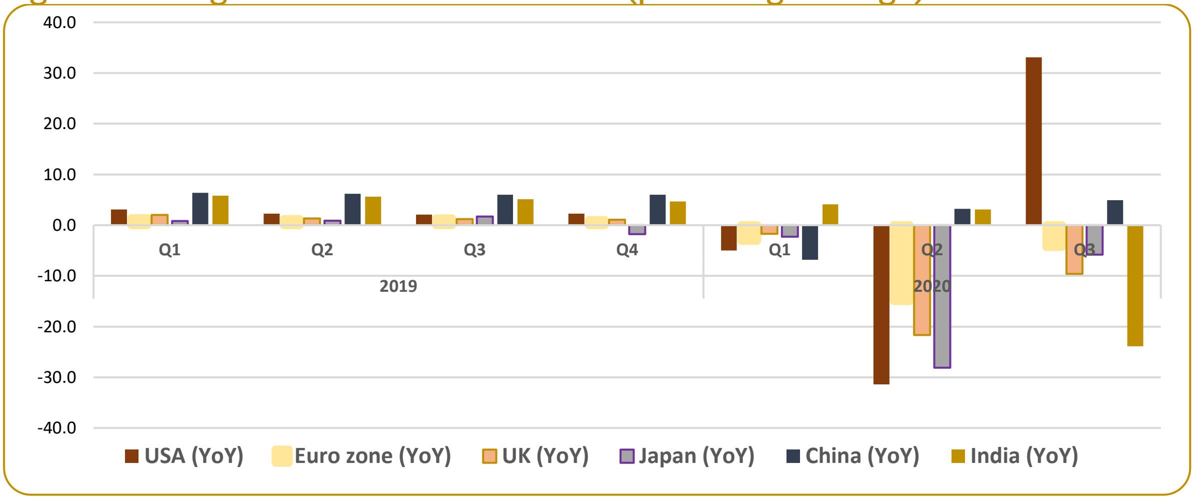
The following sections will detail out the recent past developments for global and domestic economy with emphasis on the impact of the COVID-19 pandemic.

2.1 Global environment

Estimates show that the growth for the second and third quarters beat market expectations in advanced economies owing to the reopening of economic activities after full lockdown. Inflation remained low, reflecting this year's subdued aggregate demand and lower energy prices.

In 2020Q3, USA GDP rebounded by 33.1 percent year-on-year, from negative 31.4 percent in 2020Q2 and -5.0 percent in 2020Q1, thanks to continuous effort to re-open activities after COVID-19 related lockdowns together with a pickup in consumer spending. In the Euro area, preliminary estimates show that quarter-on-quarter growth increased by 12.7 percent in 2020Q3 from -11.8 percent in 2020Q2. Compared to the same quarter 2019, Eurozone GDP declined by 4.3 percent recovering from -14.8 percent previously.

Figure 9: GDP growth in selected countries (percentage change)

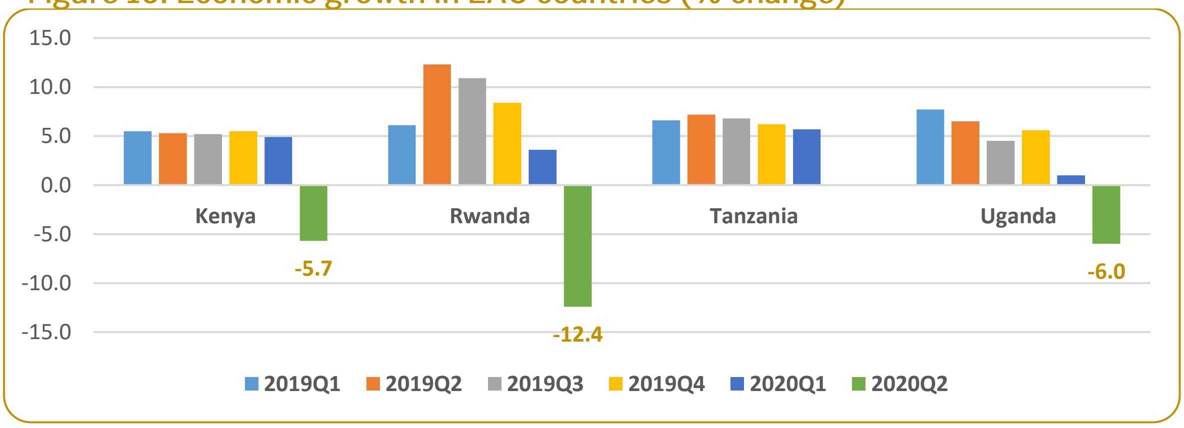


Source: Country Bureau of Statistics

In the United Kingdom, GDP grew by 15.5 percent, Q-o-Q in 2020Q3 from negative 19.8 percent in 2020Q2 on easing lockdown measures. Year-on-year, GDP fell by 9.6 percent in 2020Q3, as output from services, industrial production and construction sectors were lower than the levels in the year before. In Japan, y-o-y, real GDP fell by 5.8 percent in 2020Q3 against -10.2 percent in 2020Q2 as government stimulus resulted into increased consumer spending and a pickup in trade. Driven by a recovery in exports and investments, Chinese GDP increased by 4.9 percent in 2020Q3 after 3.2 percent and -6.8 percent respectively in 2020Q2 and 2020Q1. Indian GDP dropped sharply by 23.9 percent in 2020Q3 after growing by 3.1 and 4.1 percent in 2020Q2 and 2020Q1 as the COVID-19 continue to significantly affect the economy.

In EAC countries, already in 2020Q2, all EAC countries entered recession mostly due to the impact of COVID-19 and subsequent lockdowns.

Figure 10: Economic growth in EAC countries (% change)



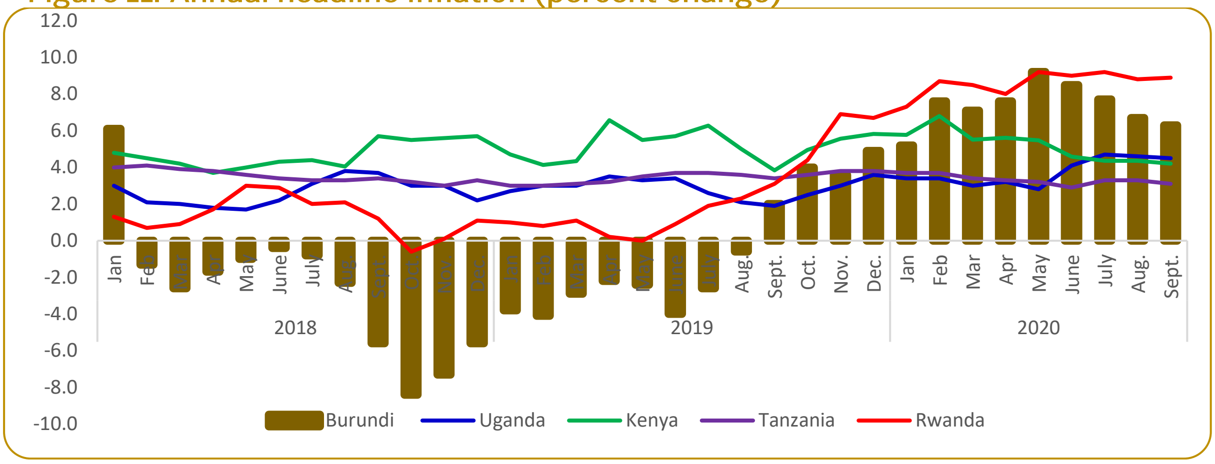
Source: Country bureau of statistics

Subdued inflationary pressures, reflecting relatively high food supply and lower energy prices.

In United States, inflation increased to 1.4 percent in September 2020, from 1.3 percent in August 2020 against the central Bank target of 2.0%. In the Eurozone, inflation dropped to -0.3 percent in September 2020 from -0.2 percent in the previous month. In China, inflation eased to 1.7 percent in September 2020, from 2.4 percent in the previous month.

In EAC, inflation eased in Kenya, Tanzania and Uganda to 4.2 percent, 3.1 percent and 4.5 percent respectively in September 2020 from 4.4 percent, 3.3 percent and 4.6 percent in August 2020 mostly driven by a slowdown in prices of food. Rwanda's headline inflation increased to 8.9 percent in September 2020 up from 8.8 percent in August.

Figure 11: Annual headline Inflation (percent change)



Source: Country Bureau of statistics

Financial conditions remained accommodative and continue to ease.

Monetary policy remained accommodative in most advanced economies to support the economy and restore the business confidence undermined by the COVID-19 pandemic. Central Banks and Governments across the world have taken targeted policy measures to support their economies.

The Federal Reserve and the Bank of England cut their rates twice in March 2020 by 150 and 65 basis points respectively. They further eased monetary policies and started implementing other quantitative easing to stem the impact of partial lockdown in their countries. The European Central Bank rate was unchanged at zero percent, and the Bank of Japan continued to apply a negative interest rate.

Subsequently, in September 2020, the three-month deposit rates remained negative in the Eurozone and Japan and slowed down in US and England. Following increasing concerns about the global slowdown following the coronavirus outbreak, ten-year government bond rate decreased in US, UK and the Eurozone reflecting flight to safe government bonds.

The US dollar is losing weight versus major currencies

On the foreign exchange market, the US dollar is appreciating against major currencies, notably the British Pound, while weakening against the Euro, the Chinese Yuan and Japanese Yen. The dollar fell following growing impression that the rest of the world was handling the coronavirus pandemic better than the United States and growth expectations in Europe have started to outperform the U.S.

Compared to December 2019, the US dollar appreciated by 2.59 percent against the British Pound in September 2020. However, the dollar depreciated by 4.34 percent against the Euro, by 2.88 percent against the Japanese Yen and by 2.47 percent against the Chinese Yuan.

2.2 Domestic economy

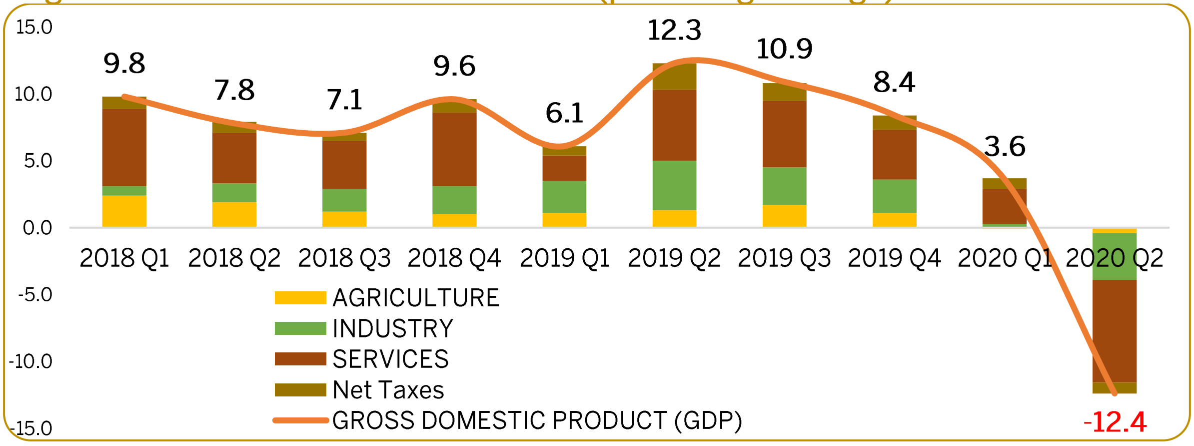
The Rwandan economy has been adversely affected by the COVID-19 pandemic. In 2020Q2, economic activities contracted significantly across industry and services sectors with the only exception of information and communication, human health and social work. Agriculture sector was hit by unfavorable weather conditions.

The COVID-19 pandemic has had a dramatic impact on Rwandan economy. Real GDP growth plunged by 12.4 percent in 2020Q2, owing to demand and supply shocks caused by the COVID-19 pandemic together with poor performance in agriculture sector. The decrease in economic performance was broad-based. Agriculture fell by 1.6 percent in 2020Q2 from an increase of 5.1 percent in 2019Q2 mainly due to unfavorable weather condition which led to bad harvest of food crop in 2020 Agriculture season A. In addition, other agriculture sub-sectors were also constrained by the supply chain disruptions caused by the pandemic. Export crops and fish farming dropped, while a slowdown was observed in livestock and livestock products.

The industry sector fell by 18.9 percent from 21.4 percent following weak performance in construction, manufacturing, electricity, water, as well as mining & quarrying. The services sector, representing 45.3 percent of real GDP of 2020Q2, shrank by 16.3 percent from an increase of 11.0 percent following a decrease in all subsectors except information and communication and human health & social work. Wholesale & retail trade fell by 21.7

percent, transport by 41.0 percent, hotel and restaurant by 62.5 percent, financial services by 8.4 percent and real estate by 7.5 percent.

Figure 12: Real Gross Domestic Product (percentage change)

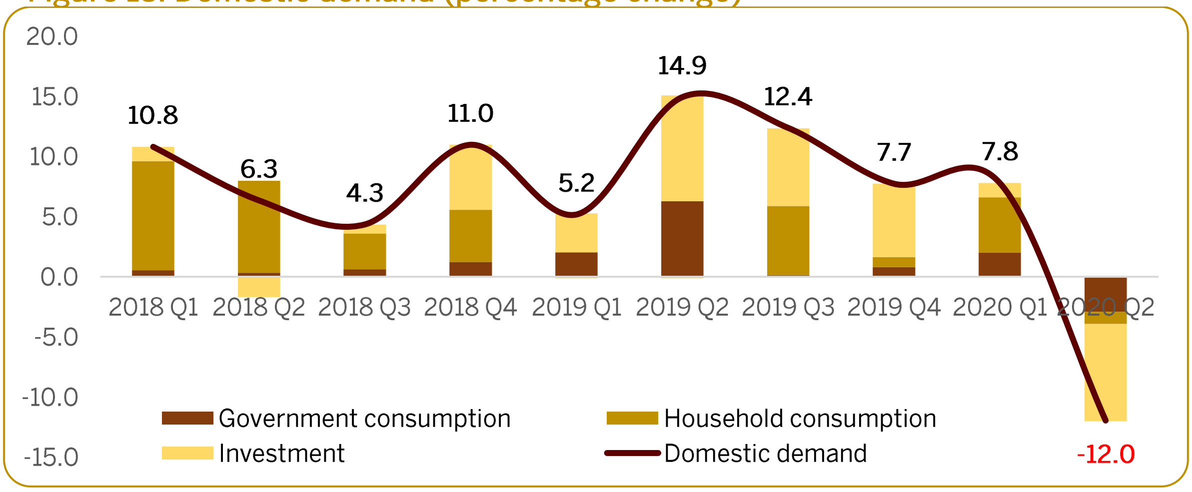


Source: National Institute of Statistics of Rwanda

The domestic demand also hit by COVID-19

The domestic demand fell dramatically in 2020Q2. The decline in investment was the major driver, not only due to COVID-19 containment measures but also linked to a base effect reflecting a high growth recorded in 2019Q2, thanks to important infrastructure projects, mainly Kigali Arena.

Figure 13: Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

Rwanda's merchandise trade has started to recover after a sharp decline.

Rwanda's merchandise trade is recovering from the sharp decline recorded in the second quarter of 2020, as measures to curb the spread of COVID-19 continue to ease. In

2020Q3, non-gold exports decreased by 13.8 percent, y-o-y, while imports remained unchanged improving from respective contractions of 47.9 percent and 27.0 percent in the previous quarter. The recovery is expected to continue in the fourth quarter driven by resuming economic activities and improving global trade. However, exports of services are expected to remain low partly due to lower receipts from tourism and air passenger transports amid massive fall of international tourist arrivals. The external sector prospects of the reminder of 2020 remain weak and uncertain amid global travel restrictions and the resurgence of infections in many countries.

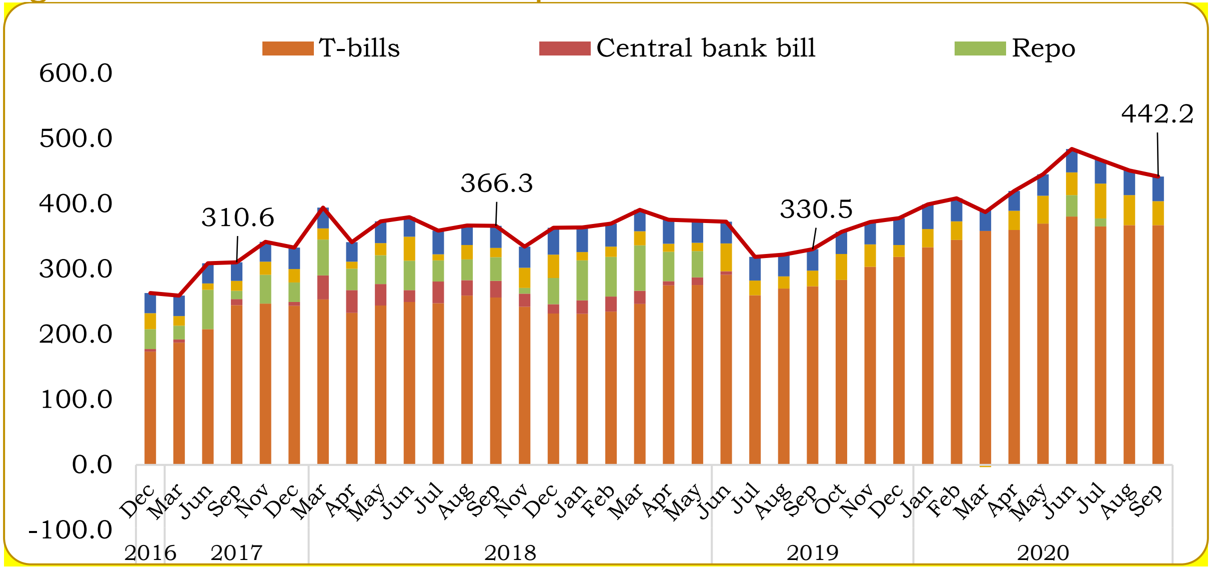
2.3 Financial and monetary developments

The banking system liquidity remained resilient to the COVID-19 pandemic impact. The increase in liquidity resulted from supportive measures taken by NBR and the Government of Rwanda, amid subdued demand for loans by the private sector during the lockdown. By end September 2020, broad money and outstanding credit to private sector grew by 23.1 percent and 17.4 percent year on year respectively. In line with the continuing NBR accommodative monetary policy stance, market interest rates in the economy reduced further. In the first three quarters of 2020, the average lending rate reduced by 18 basis points year on year to 16.31 percent, which is favorable to continue supporting the economic recovery.

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

The banking system liquidity conditions remained strong on the back of economic policy measures put in place by both the National Bank of Rwanda and the Government of Rwanda to mitigate the negative economic impact of the COVID-19 pandemic. To that end, most liquid assets of banks increased significantly by 33.8 percent, y-o-y, in the third quarter of 2020. Measures put in place to curb the negative effects of COVID-19 include the reduction of reserve requirement ratio by 100 basis points and the launch of an Economic Recovery Fund, among others. Additionally, Net fiscal injection also contributed to high liquidity in the banking system, as the government spent more in COVID-19 related expenditures and capital spending mainly for the construction of schools.

Figure 14: Commercial banks most liquid assets

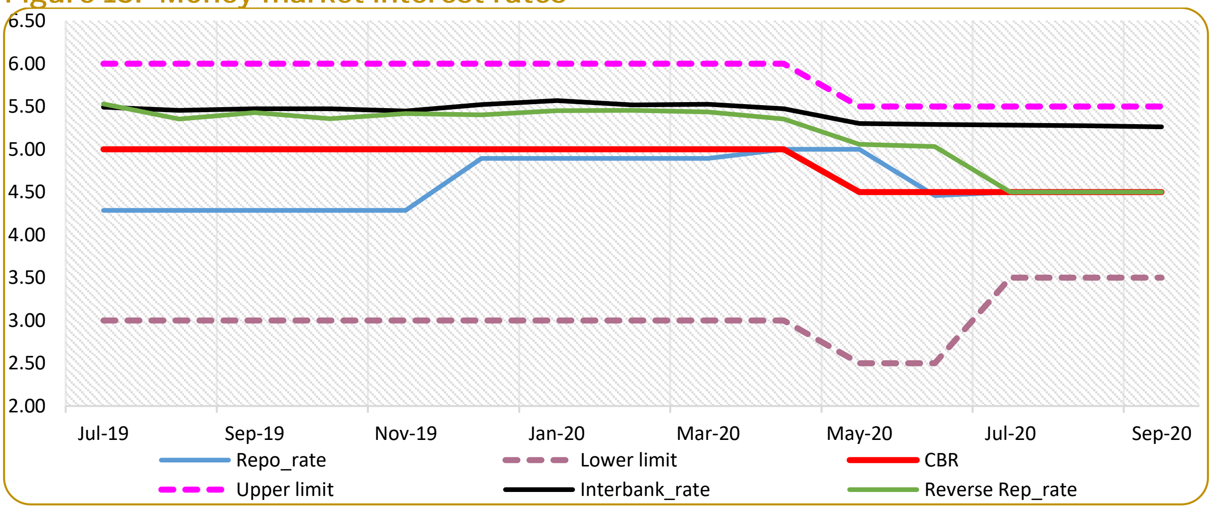


Source: NBR, Monetary Policy and Research Directorate

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

The central bank rate (CBR) was maintained at 4.5 percent in August 2020, its lowest level ever, which led to the continued reduction in the interbank market rate (see chart 16). The average interbank market rate for 2020Q3 was 5.273 percent, a drop from 5.473 in 2019Q3. Importantly, reverse repo and repo rates, which are the main monetary policy instruments, were set at the CBR rate since July 2020, while the CBR lower corridor was reduced from 2 percentage points to 1 percentage point. The corridor was narrowed with the aim to increase effectiveness of the monetary policy through an improved transmission of the CBR to money markets and interest rates.

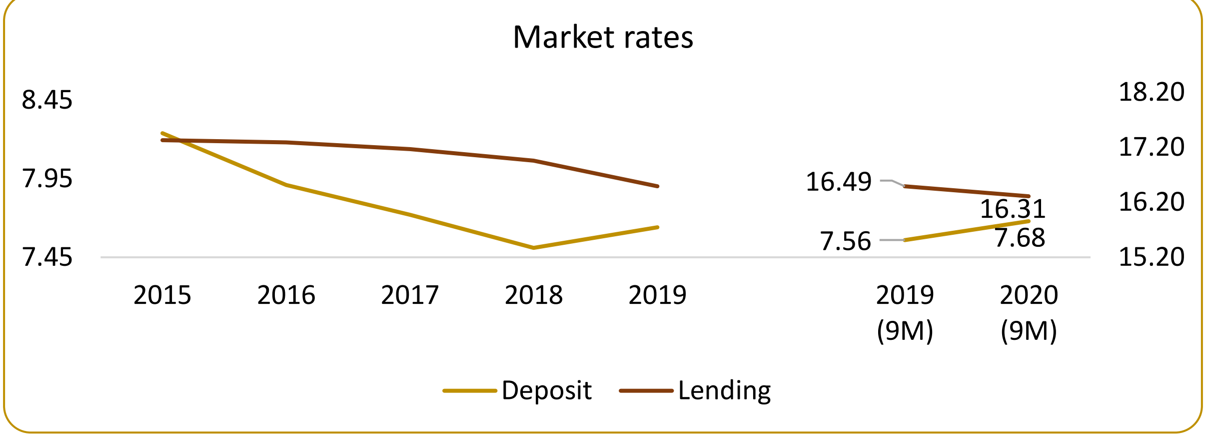
Figure 15: Money market interest rates



Source: NBR, Monetary Policy and Research Directorate

Market lending rates declined in the first three quarters of 2020 by 18 basis points (see chart 17) which is in line with the eased monetary policy to support the economy during and after the COVID-19 crisis. Deposit rates increased in the same period, causing a decline in the spread between them and lending rates.

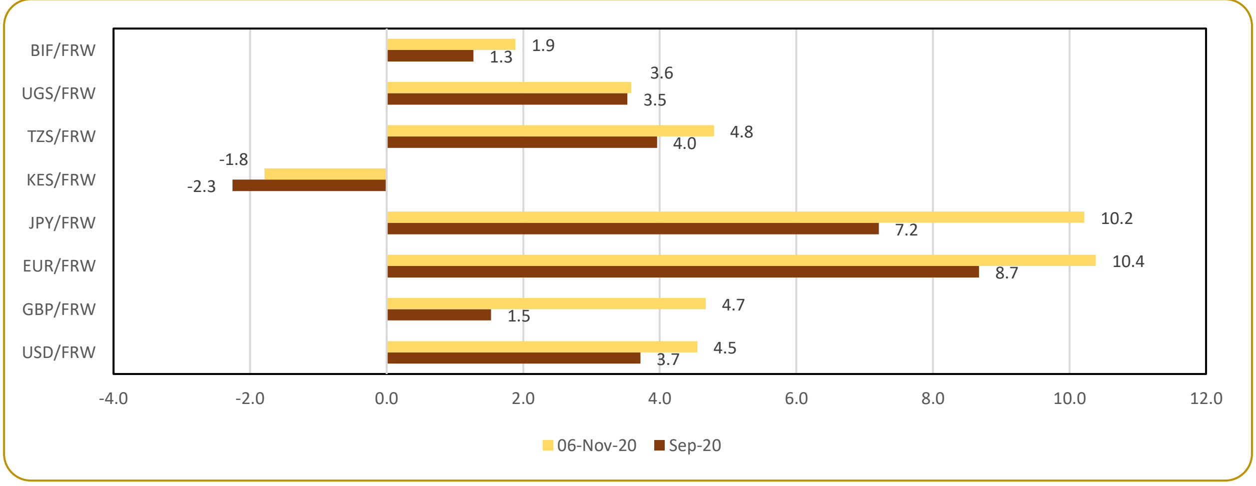
Figure 16: Market lending and Deposit rates



Foreign exchange market remains stable

The demand for foreign currencies increased following the reopening of economic activities. As a result, in the first nine months ending in September 2020, the FRW depreciated by 3.7 percent against the USD, slightly higher than 3.5 percent depreciation observed in the same period of 2019. However, the foreign exchange market is expected to remain stable, with adequate foreign exchange reserves covering more than 4 months of imports in the medium term.

Figure 17: Depreciation rate of selected currencies against the FRW (in % compared to December 2019)

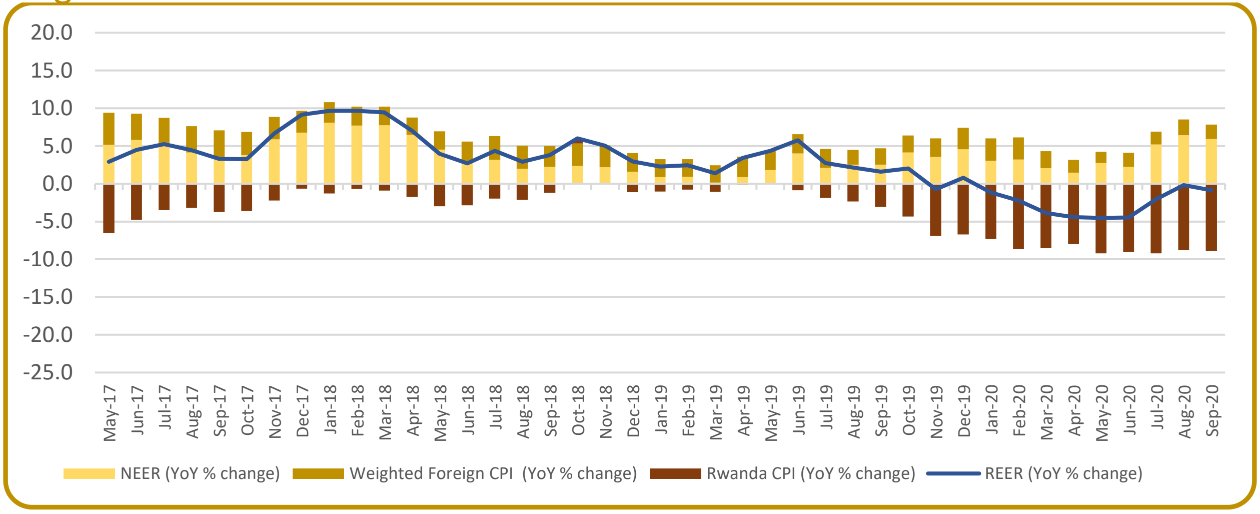


Source: BNR, Monetary Policy and Research Department

During the same period, the Rwandan franc weakened by 1.5 percent against the British Pound, 8.7 percent against the Euro and by 7.2 percent compared to the Japanese Yen. With regard to regional currencies, the FRW appreciated by 2.3 percent against the Kenyan shilling while it depreciated by 4.0 percent, 3.5 percent and 1.3 percent vis-à-vis the Tanzanian shilling, Ugandan shilling and the Burundian franc respectively.

In real effective terms, the FRW appreciated by 0.9 percent (y-o-y) end September 2020, against a depreciation of 1.6 percent recorded during the corresponding period in 2019. This was mostly attributable to higher level of domestic inflation than foreign inflation and a depreciation of the nominal value of the FRW against currencies of some of the major trading partners. In nominal effective terms, it depreciated by 5.9 percent compared to a depreciation of 2.5 percent end September 2019.

Figure 18: Drivers of REER movement



Source: BNR, Monetary Policy and Research Department

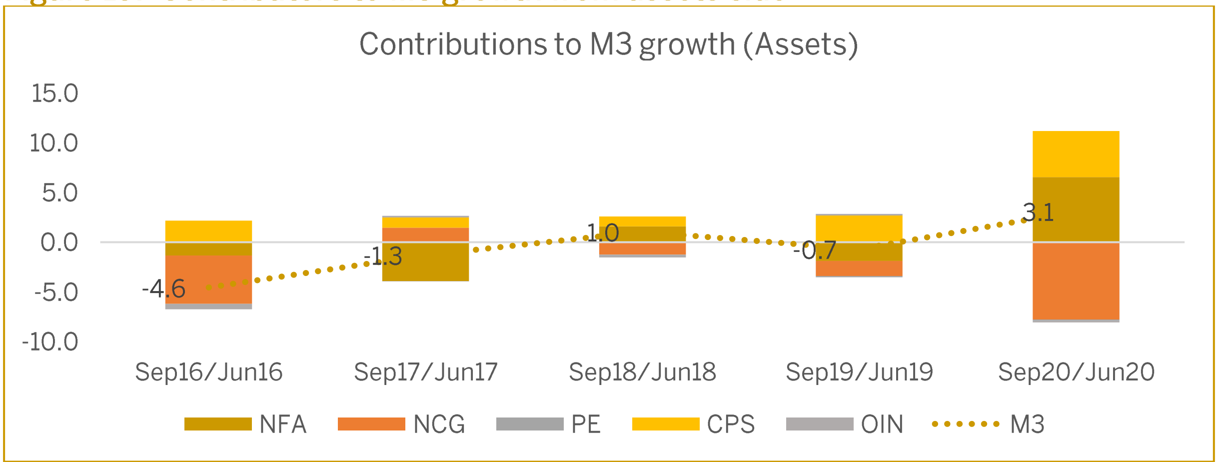
Broad money M3 rose despite a challenging macro-economic environment

Broad money M3 rose by 23.5 percent y-o-y in September 2020 from a growth of 12.3 percent recorded in September 2019. That growth in M3 was mainly driven by an increase of 71.0 percent in net foreign assets (NFA) in September 2020, resulting from an accumulation of more foreign inflows especially budgetary loans (amounting to USD 478.6 million in the first nine months of 2020 from USD 94.4 million received in the same period of the year before). The stock of credit to the private sector (CPS) grew by 17.4 percent y-o-y in September 2020, lower than a growth of 20.1 percent in September 2019 due to COVID-19 effects that has been eased by the restructuring of some loans for affected borrowers. The CPS is expected to improve in 2020Q4 as the economy continues to recover and end of year celebrations which increase demand for loans.

The broad money M3 also grew by 3.1 percent in September 2020 compared to June 2020 against a contraction of 0.7 percent recorded in the same period of the year before. The net foreign assets largely contributed to that growth in M3, with a contribution of 6.5 percent, followed by CPS (+4.6 percent). However, net credit to government (NCG), credit to public enterprises and other items nets weighed on the growth of M3, with a negative contribution of 7.8 percent, 0.1 percent and 0.2 percent respectively.

The greater contribution of NFA to Broad money M3 was credited to accumulated budget loans in 2020Q3, equivalent to USD 145.0 million (from World Bank, Japan International Cooperation Agency and "Agence Française de Development") compared to USD 24.0 million recorded in 2019Q3. The positive contribution of credit to the private sector to broad money M3, was mainly attributed to the restructuring of loans granted to borrowers affected by the COVID-19 pandemic, and new authorized loans distributed in 2020Q3. The high negative contribution of NCG to M3 resulted from the accumulation of government deposits between June and September 2020, picking up by 39.3 percent from 13.6 percent in the corresponding period of the year earlier.

Figure 19: Contributors to M3 growth from assets side



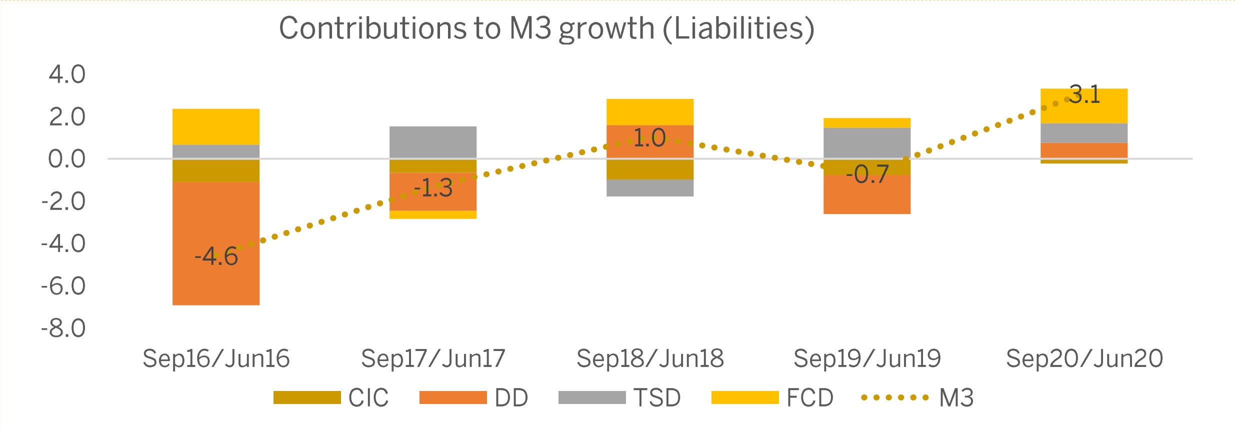
Source: NBR, Monetary Policy and Research Department

From the liabilities side, the growth of 3.1 percent in broad money M3 between June and September 2020 was mainly attributed to the foreign currency deposits (FCD) which contributed 1.6 percent followed by time and savings deposits (0.9 percent) and demand deposits (0.8 percent). However, currency in circulation reduced the growth of M3 by 0.2 percent.

The bigger contribution of FCD to M3 growth resulted from an accumulation of FCD by economic agents for imports, especially consumer goods and intermediary goods whose demand is expected to increase during the festive season and the continuing economic recovery. The positive contribution of time and savings deposits to M3 growth reflects the increased term deposits for some big depositors such as pension and development funds. The positive contribution of demand deposits to M3 growth emanated from the frequent uses of electronic payment methods especially during this period of COVID-19.

The currency in circulation (CIC) contributed negatively to the M3 growth between June and September 2020 owing to its seasonal trend. Normally, CIC is lower in September compared to June which reflects higher government spending towards the end of the fiscal year.

Figure 20: Contributors to M3 growth from liabilities side



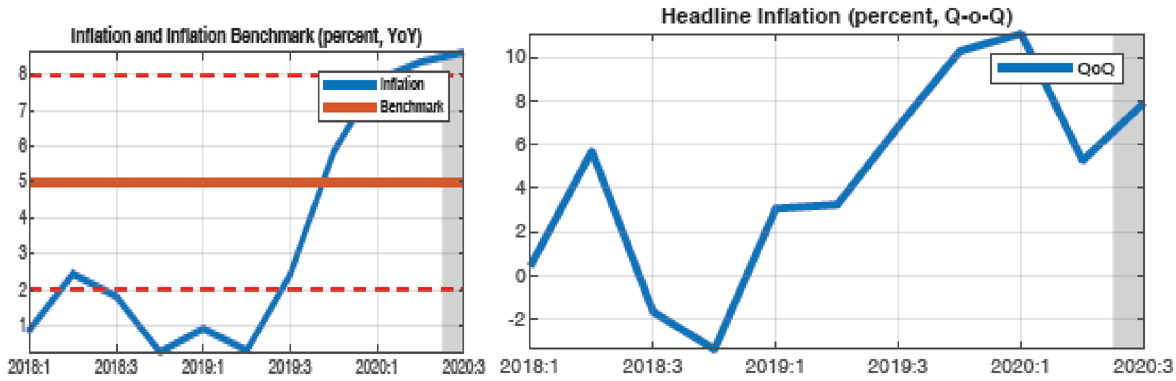
Source: NBR, Monetary Policy and Research Directorate

III. INFLATION DEVELOPMENTS

In the third quarter of 2020, food and energy prices slightly declined, but headline inflation remained above the upper bound of its benchmark, standing at 9.0 percent (year-on-year) from 8.7 percent in 2020Q2. The uptick in headline inflation was reflected in core inflation that hiked, mostly following the upward revision of public transport fares.

In 2020Q3, headline inflation slightly surged to 9.0 percent from 8.7 percent recorded in the previous quarter. The slight upsurge in headline inflation reflects mainly the upticks in core inflation from 6.7 percent to 7.2 percent. The rising trend in core inflation outweighed the drop in energy inflation (from 11.1 percent to 5.2 percent) and food inflation (from 12.8 percent to 11.3 percent), during the same period.

Figure 21: Developments in headline inflation (Y-o-Y, % change)

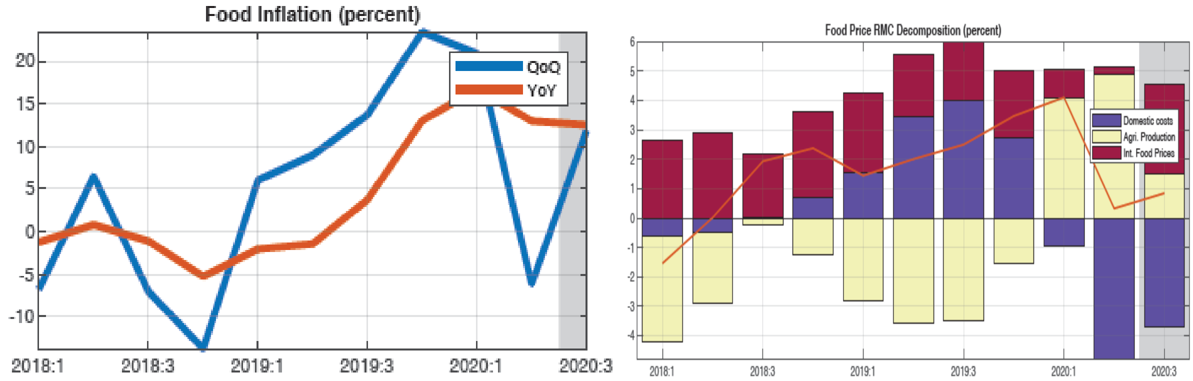


Source: NBR, Monetary Policy and Research Directorate

Domestic and external factors put pressures on food and alcoholic beverages inflation.

In 2020Q3, though food and alcoholic beverages inflation slightly decelerated in y-o-y terms, it picked up q-o-q (from -0.3 percent to 1.3 percent), reflecting the upward pressures in the international food prices, coupled with the shortage in some food products on the local markets in relation to the poor performance of agricultural season C.

Figure 22: Development of food inflation (%, Y-o-Y)

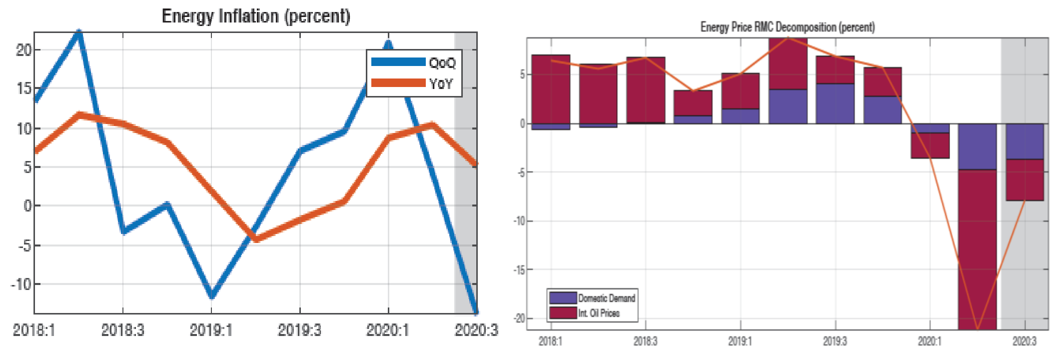


Source: NBR, Monetary Policy and Research Directorate

Government regulations eased pressures on energy inflation despite the pick in global oil prices.

Unlike food inflation, energy inflation decelerated in both y-o-y and q-o-q terms. Much declining pressures were observed between 2020Q2 and 2020Q3. It dropped to -5.4 percent in 2020Q3 from 3.8 percent recorded in the previous quarter. The downward pressures in energy component was mainly from solid fuels reflecting the increasing trend in prices recorded last year (base effect), adding to the government's measures regulating solid fuels prices. Though international oil prices picked up during the same period, the shock was not transmitted into the observed trend in energy inflation due to the lag effect.

Figure 23: Energy inflation (%, Y-o-Y)



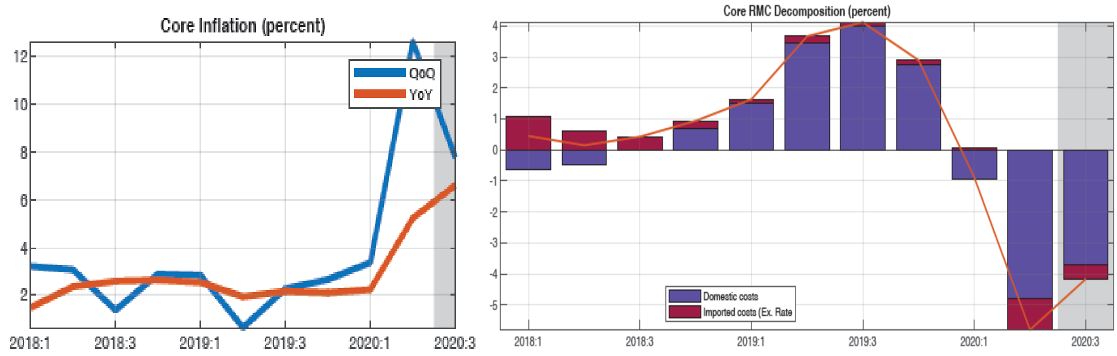
Source: NBR, Monetary Policy and Research Directorate

Downward pressures on core inflation prevail, reflecting the ease in transport fares and the slow economic recovery

Even though core inflation surged in y-o-y terms due to the shock on transport prices, it eased in q-o-q terms. The easing pressures in core inflation reflects the current cyclical position of the economy, especially the non-agricultural sectors that are operating below full capacity utilization, which implies subdued demand pressures. In addition, the fiscal sector increased its stimulus to the economy, but this will take some time to boost aggregate demand and bring up upward pressures. Therefore, the fiscal impulse will remain non-inflationary.

The downward pressures in core inflation resulting from the domestic demand are moderated by the rising pressures coming from external trade in 2020Q3. Over the past few quarters, pressures from the rest of the world remained muted, but they have started to rise through nominal exchange rate depreciation and increasing inflation in trading partners.

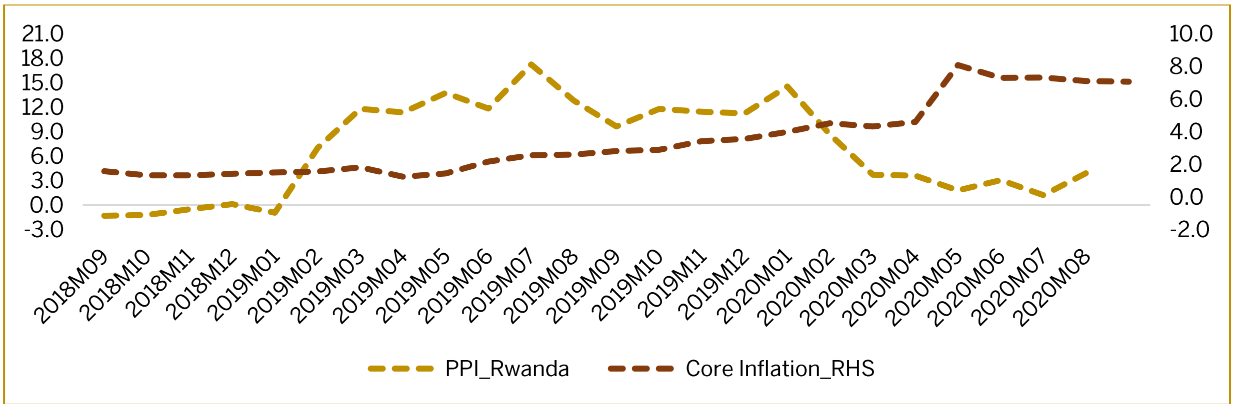
Figure 24: Core inflation (excluding core food items)



Source: NBR, Monetary Policy and Research Directorate

Another economic indicator that captures pressures on core inflation is the Producer Price Index (PPI) or a measure of the inputs costs. This index measures the prices of goods and services at the firm's gate. As the economy recovers from the negative effects of full lockdown period, slight upward pressures started to pile up especially in July and August 2020, following the surge in demand for the factors of production.

Figure 25: Core inflation and PPI-Rwanda (%, Y-o-Y)



Source: NBR, Monetary Policy and Research Directorate