National Bank of Rwanda

Banki Nkuru y'u Rwanda

MONETARY POLICY REPORT

February 2020

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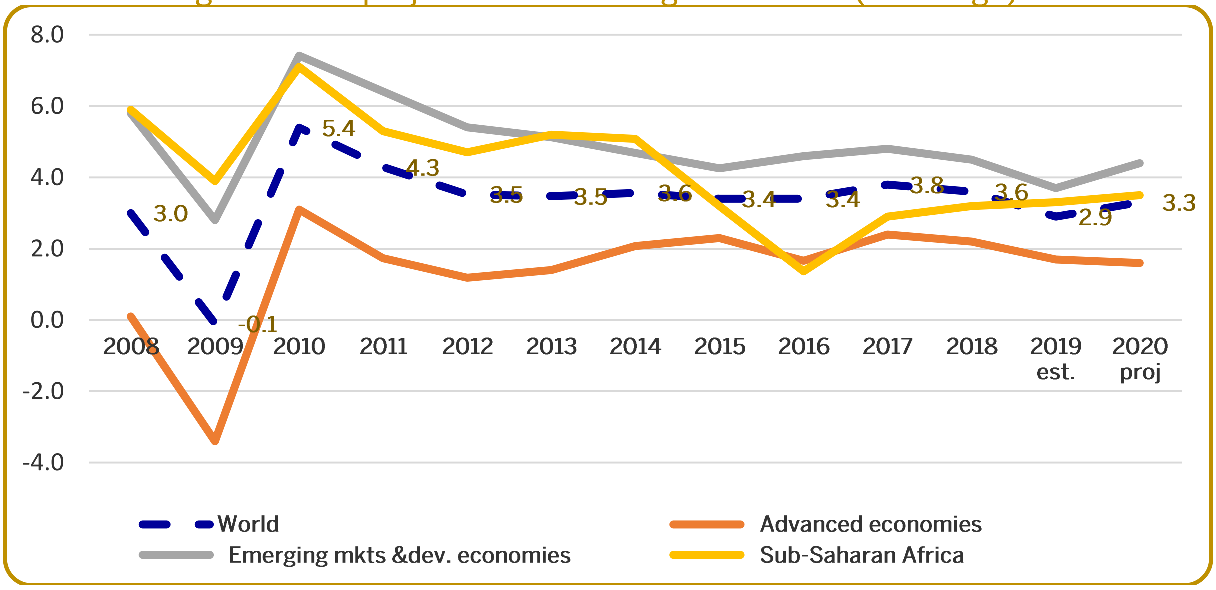
I. GLOBAL ECONOMIC AND FINANCIAL DEVELOPMENTS

1.1 Economic Growth

According to the International Monetary Fund's (IMF) estimates published in January 2020, global growth is estimated at 2.9 percent in 2019 from 3.6 percent recorded in 2018. This is the weakest growth since 2008-09 global financial crisis, following uncertainties of US-China trade tensions & Brexit, geopolitical tensions (US & Iran), effects from climate change, and slowed domestic demand in India. In 2020, global growth is expected to pick up to 3.3 percent.

Growth in advanced economies is estimated at 1.7 percent in 2019, and projected to soften to 1.6 percent in 2020 and 2021, mostly reflecting downward revision for the United States, Euro area and United Kingdom.

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

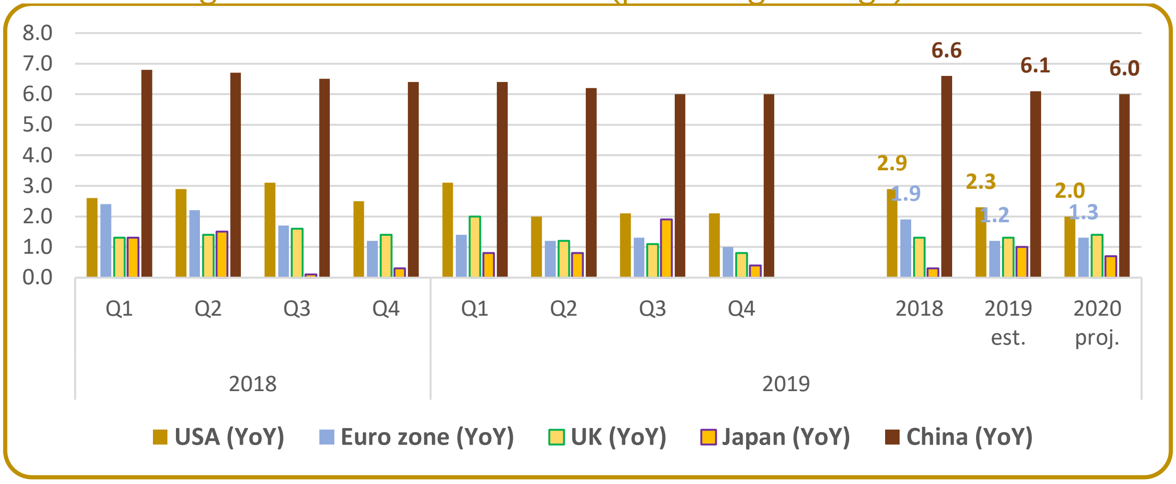


Source: IMF, January 2020

The United States (US) growth is expected to moderately decrease to 2.3 percent in 2019 from 2.9 percent in 2018, and decelerate further to 2.0 percent in 2020. This projected growth reflects a return to a neutral fiscal stance and anticipated waning support from further loosening of financial conditions.

GDP growth in the Eurozone is estimated at 1.2 percent in 2019 from 1.9 percent recorded in 2018, and projected to pick up to 1.3 percent in 2020. The United Kingdom's economy is estimated to stabilize at 1.3 percent in 2019, and projected at 1.4 percent in 2020. Relative to October 2019 forecast, projections were revised by 0.1 percentage point higher for 2019 and unchanged projections for 2020. This growth forecast assumes an orderly exit from the European Union at the end of January, followed by a gradual transition to a new economic relationship.

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



Source: IMF, January 2020 & Bloomberg

In emerging markets and developing economies, growth is estimated at 3.7 percent in 2019, from 4.5 percent in 2018, before improving to 4.4 percent in 2020. This growth reflects a recovery from deep downturns in underperforming emerging economies.

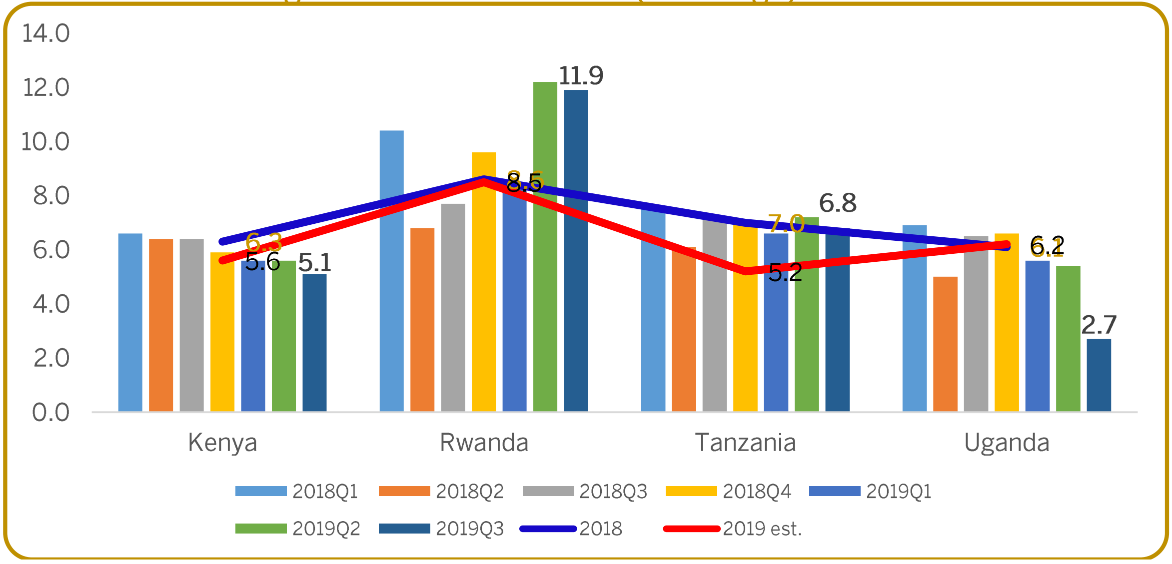
Growth in China is projected to inch down from an estimated 6.1 percent in 2019 to 6.0 percent in 2020. The envisaged partial rollback of past tariffs and pause in additional tariff hikes as part of ''phase one'' trade deal with the United States is likely to alleviate near-term cyclical weakness. However, unresolved disputes on broader US-China economic relations, needed domestic financial regulatory strengthening, as well as the outbreak of the coronavirus that is estimated to lower China's growth, are expected to weigh down the economic activity.

India's economic growth is estimated at 4.8 percent in 2019, from 6.8 percent in 2018, where domestic demand has slowed more sharply than expected amid stress in the nonbank financial sector and a decline in credit growth. In 2020, growth is projected at 5.8 percent (1.2 percentage point lower than the October 2019 forecast), supported by monetary and fiscal stimulus as well as subdued oil prices.

In Sub-Saharan Africa, growth is expected to slightly increase to 3.3 percent in 2019, from 3.2 percent in 2018, and strengthen to 3.5 percent in 2020 (0.1 percentage point lower than October 2019 forecasts), reflecting downward revision for South Africa, where structural constraints and deteriorating public finances are holding back business confidence and private investment.

The economic performance in the East Africa community countries (EAC) is expected to decelerate in 2019. Real GDP growth is estimated at 5.6 percent in 2019 after 6.5 percent in 2018, following projected slowdown for some EAC countries compared to the previous year. However, Real GDP growth is projected to pick up to 6.0 percent in 2020, following a high estimated growth for Rwanda, Kenya and Tanzania.

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



Source: IMF, October 2019 & Country Bureau of Statistics websites

Kenya's economy is expected to grow by 5.6 percent in 2019, from 6.3 percent in 2018, and projected to pick up to 6.0 percent in 2020. Rwanda's economy grew by 10.9 percent in the first three quarters of 2019 from 8.3 percent in the corresponding period of 2018. According to IMF January projections, Rwanda's economy is expected to grow by 8.5 percent in 2019. Following double-digit growth recorded in the first three quarters of 2019, on average, growth is expected to surpass the IMF projections and remain strong in 2020.

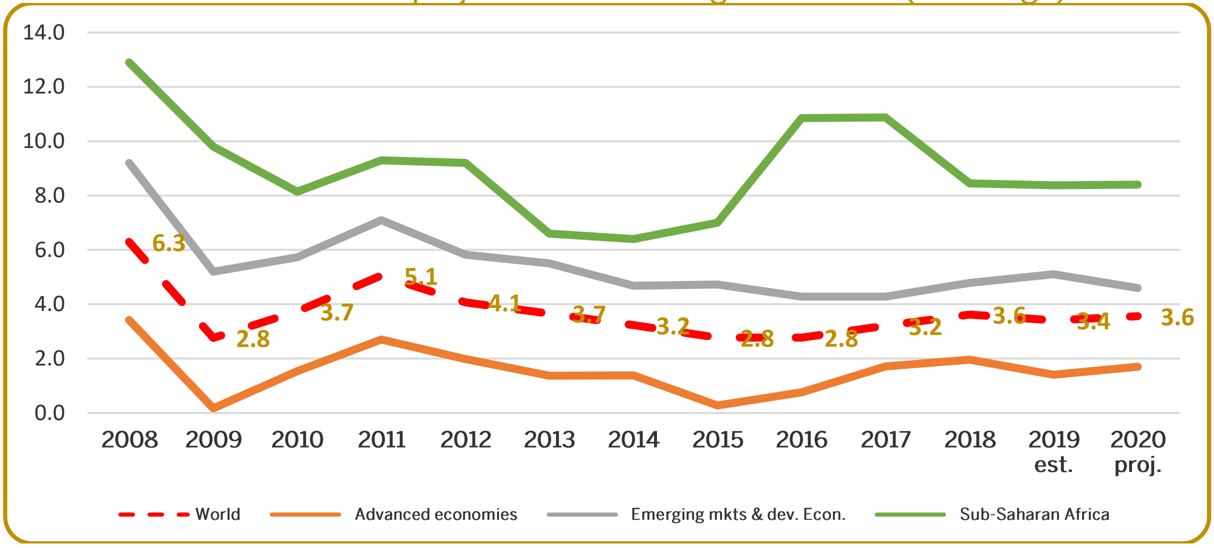
In Uganda, GDP growth is expected at 6.2 percent in 2019 after 6.1 percent recorded in 2018, and projected to remain stable in 2020. Tanzania's economy is expected to grow by 5.2 percent in 2019, lower than 7.0 percent recorded in 2018, and projected to pick up to 5.7 percent in 2020. In Burundi, growth is projected to remain subdued at 0.4 percent in 2019 and slightly pick up to 0.5 percent in 2020, from 0.1 percent in 2018.

1.2 Inflation Developments

World annual average inflation is expected at 3.4 percent in 2019 from 3.6 percent in 2018, in line with falling commodity prices and softening global demand, and projected to increase at 3.6 percent in 2020.

In advanced economies, consumer price inflation is expected to average 1.4 percent in 2019 and projected to rise to 1.7 percent in 2020, from 2.0 percent in 2018, consistent with the softening of energy prices and the decline in the economic growth.

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

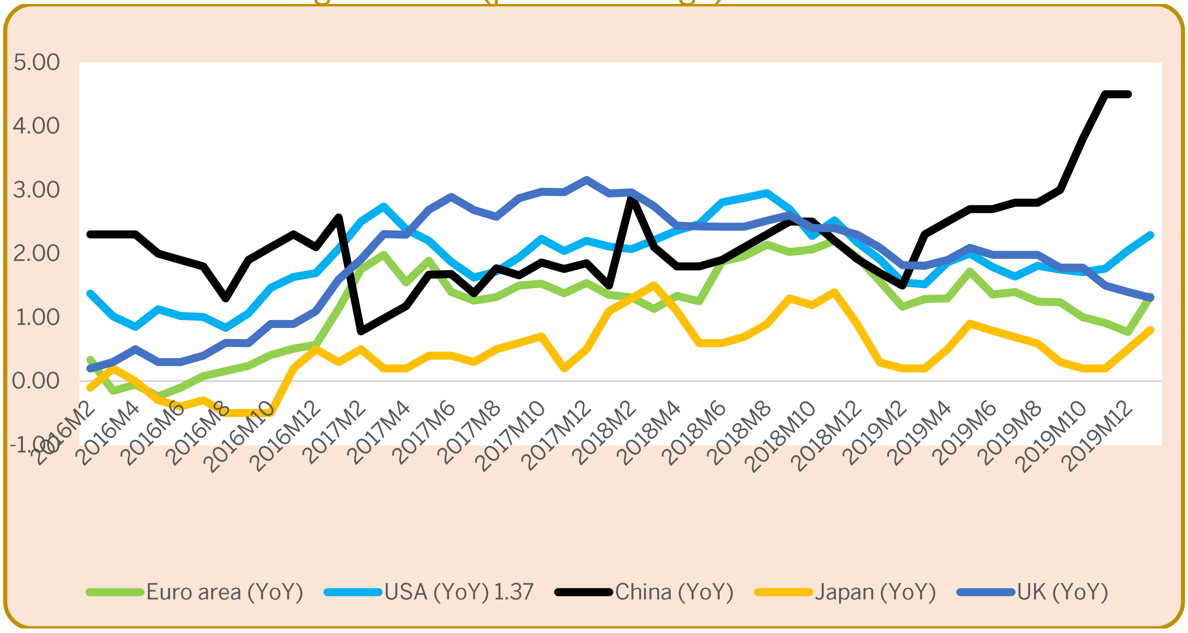


Source: IMF, January 2020

The US annual average inflation eased to 1.8 percent in 2019, from 2.4 percent in the previous year, and projected at 2.3 percent in 2020. With the US economy operating above potential, core consumer price inflation is projected at about 2.6 percent in 2020-2021, higher than its medium-term level of 2.2 percent (consistent with the medium-term target of 2.0 percent for personal consumption expenditure inflation).

The annual average inflation in the Eurozone eased to 1.2 percent in 2019, from 1.8 percent in 2018, and expected to rise gradually to 1.4 percent in 2020. The annual average inflation in the United Kingdom eased to 1.8 percent in 2019, from 2.5 percent in the previous year, and projected to slightly increase to 1.9 percent in 2020.

Chart 5- Annual average Inflation (percent change)



Source: National statistics offices

In the emerging markets and developing economies, inflation is expected to increase to 5.1 percent in 2019, from 4.8 percent in 2018, and edge down to 4.6 percent in 2020. In China, annual average inflation rose to 2.9 percent in 2019, from 2.1 percent in the previous year, but projected to ease to 2.4 percent in 2020.

In Sub-Saharan Africa, annual average inflation is projected to ease to 8.4 percent in 2019, and 8.0 percent in 2020, from 8.5 percent in 2018, reflecting a large decline in global energy prices.

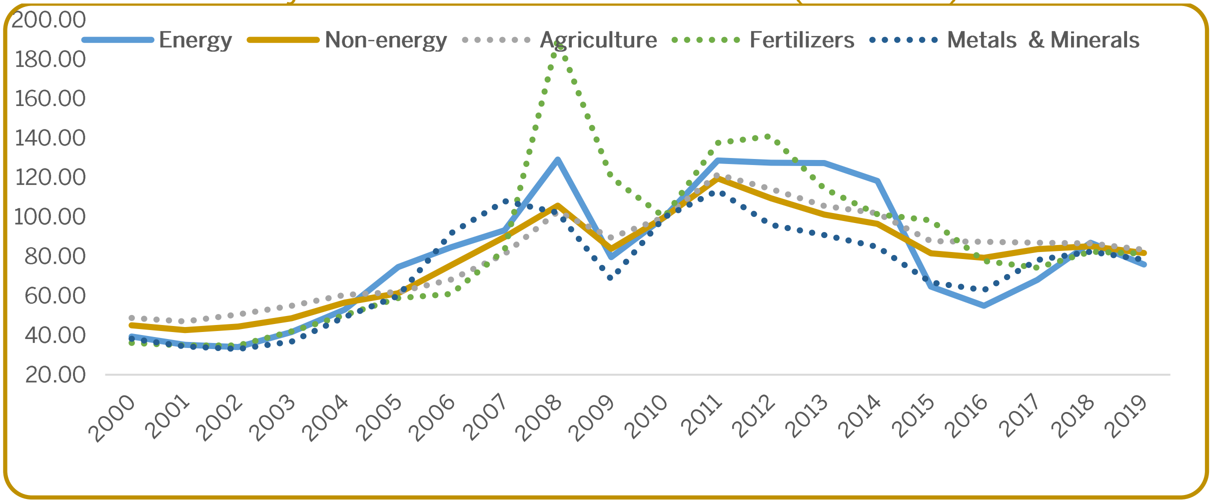
In EAC, annual average inflation is estimated at 4.3 percent in 2019 and 4.6 percent in 2020, from 3.6 percent in 2018. The stable and low inflation in the region is attributed to good agriculture production due to favorable weather conditions, and monetary policies implemented by Central Banks.

The annual average inflation in Kenya rose to 5.2 percent in 2019 from 4.7 percent in 2018, and projected to rise further to 5.3 percent in 2020. In Rwanda, the annual average inflation rose to 2.4 percent in 2019, from 1.4 percent in 2018, and projected to be slightly above the medium term benchmark of 5 percent in 2020. In Tanzania, annual average inflation remained stable at 3.5 percent in 2019, and projected to increase to 4.2 percent in 2020. The annual average inflation in Uganda rose to 2.9 percent in 2019, from 2.6 percent in 2018, and projected to increase to 3.8 percent in 2020. The annual average inflation in Burundi was -0.7 percent in 2019 from 1.2 percent in 2018, and projected to rise to 9.0 percent in 2020.

1.3 Global commodity prices

In 2019, global commodity prices decreased, reflecting supply influences and softening global demand and projected to continue falling in 2020. Energy prices fell by 12.7 percent in 2019 compared to an increase of 27.8 percent in 2018, and non-energy commodity prices decreased by 4.1 percent after an increase of 1.7 percent in 2018. Non-energy prices decreased following a decline in all three major components, namely agriculture, metals & minerals and fertilizers.

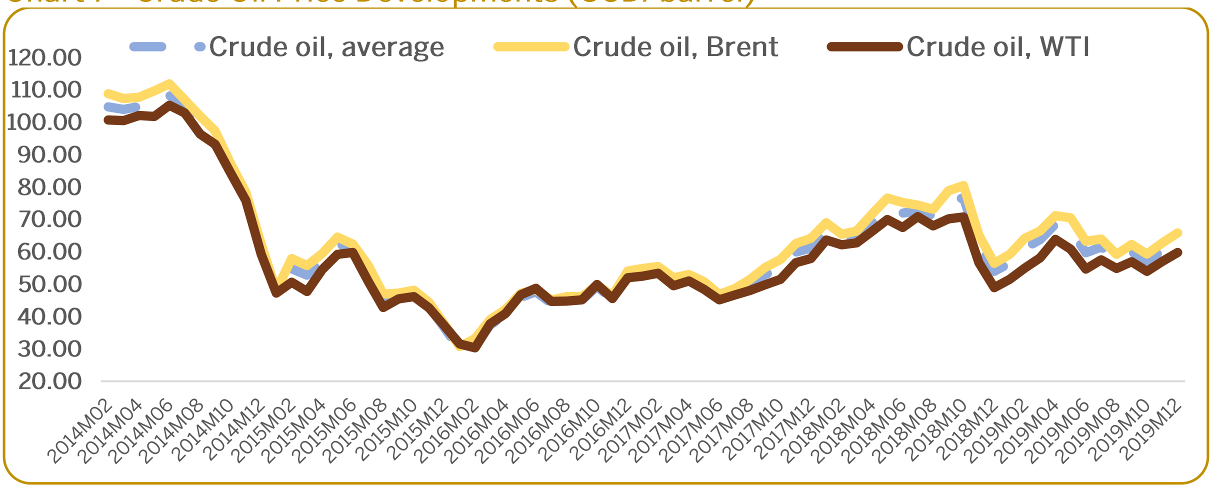
Chart 6 - Commodity Prices Index in Nominal US Dollar (2010=100)



Source: World Bank, December 2019 & IMF, January 2020

On the back of softening global demand, crude oil prices decreased by 11.3 percent on average, in 2019, compared to an increase of 29.4 percent in 2018. In 2020, crude oil prices will continue to decrease, but deceleration rate will be lower than in the previous year, as oil consumption is expected to increase slightly. According to the IMF January projections, crude oil prices are projected to decrease further by 4.3 percent in 2020.

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



Source: World Bank, December 2019

In 2019, average prices for agriculture commodities declined (-3.8 percent) due to the falling prices of beverages (-3.7 percent); of which Coffee Arabica (-1.6 percent), Coffee Robusta (-13.2 percent), and tea (-9.8 percent). During the same year, food prices decreased by 3.8 percent; oils & meals (-8.9 percent) and other foods (-1.4 percent). In 2020, agricultural prices are projected to slightly increase by 0.6 percent, mainly attributed to the projected rising prices of beverages by 2.3 percent; Coffee Arabica, Coffee Robusta and Tea prices increasing by 1.8 percent, 3.1 percent and 2.0 percent, respectively.

In 2019, metals & mineral prices decreased by 5.0 percent, compared to an increase of 5.5 percent in 2018, attributed to softening global demand. Metals & mineral prices are projected to further decline by 1.4 percent in 2020, on expectations of subdued global industrial demand.

Prices for fertilizers declined by 1.4 percent in 2019 compared to an increase of 11.1 percent in 2018, and projected to increase by 2.2 percent in 2020, on continued acreage expansion.

1.4 Monetary policy and financial markets

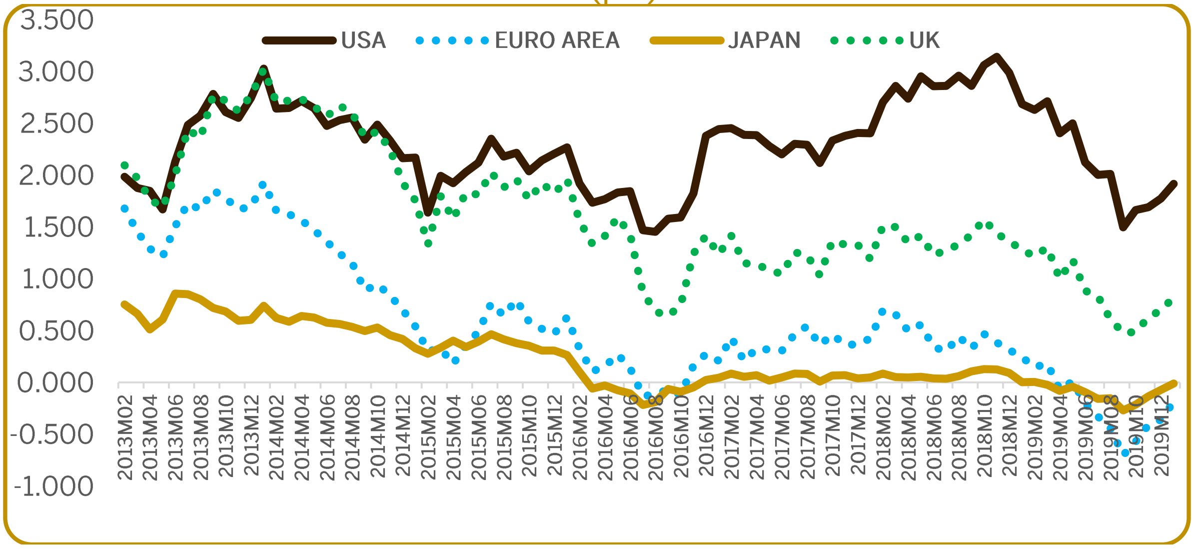
1.4.1 Monetary policy

Monetary policy remained accommodative in most advanced economies. The US Federal reserve cut the Federal Funds rate three times in 2019, while the Bank of England (BoE) has maintained its policy rate at 0.75 percent, following the last increase by 25 basis points in August 2018. The European Central Bank rate (ECB) was maintained at zero percent since March 2016, and the Bank of Japan continued to apply a negative interest rate since January 2016.

In December 2019, the three-month deposit rates remained negative in the Eurozone and Japan, standing at -0.420 percent and -0.115 percent, respectively. In the US and UK, deposit rates decreased to 1.855 percent and 0.765 percent, respectively, from 2.770 percent and 0.900 percent in December 2018.

The ten- year government bond rate decreased in US, Eurozone, UK and Japan to 1.918 percent, -0.185 percent, 0.822 percent and -0.011 percent, respectively, from 2.685 percent, 0.242 percent, 1.277 percent and 0.003 percent in December 2018.

Chart 8- 10-Year Government Bond Yield (p.a)



Source: Bloomberg database, 2019

1.4.2 Foreign Exchange Markets

On the foreign exchange market, the US dollar is weakening against major currencies, notably the British Pound and Japanese Yen, mainly due to the slowdown in the US economy, while appreciating against the Euro.

In December 2019, the US dollar depreciated by 3.8 percent against the British Pound, and by 0.1 percent against the Japanese Yen, from an appreciation of 5.9 percent and a depreciation of 2.70 percent in December 2018, respectively. However, the dollar appreciated by 2.3 percent against the Euro, compared to an appreciation of 4.7 percent in December 2018.

II. DOMESTIC ECONOMY AND FINANCIAL DEVELOPMENTS

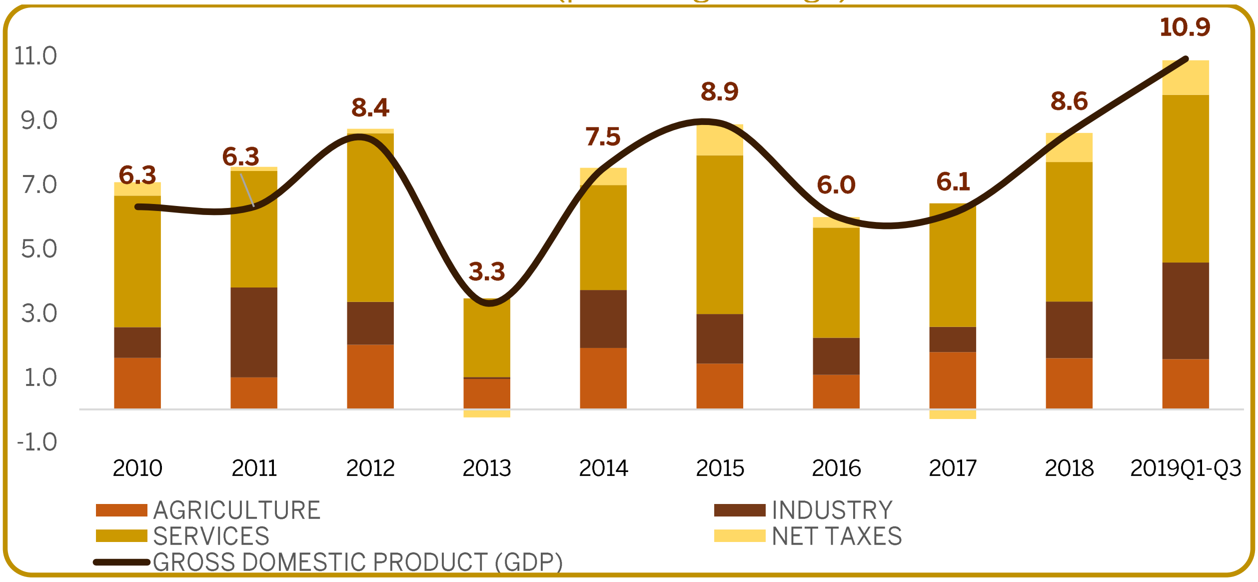
2.1 Domestic demand and output

The Rwandan real GDP grew by 10.9 percent on average in the first three quarters of 2019, driven by all the sectors. The services sector grew by 10.6 percent on average, the industrial sector by 17.7 percent and the agricultural sector by 5.8 percent. Quarter 4 is expected to slow down as indicated by high frequency indicators but the year's overall growth will remain high, surpassing the predicted 8.5 growth. This robust growth is expected to continue in 2020, with the services and industrial sectors as the key drivers.

2.1.1 Economic performance by sector

The services sector was the highest contributor to growth in the first three quarters of 2019, owing to its high growth and high share of GDP (49.1 percent). Its growth was mainly driven by the good performance in trade services (+18.5 percent), transport services (+15.4 percent), hotel industry (+11.6 percent), financial services (+12.1 percent) as well as architectural & engineering activities (+29.1 percent). The services sector continues to thrive because of the emphasis on the MICE initiative that has led Rwanda to increase efforts in becoming a conference destination. In 2019, international meetings hosted by Rwanda grew by 9.5 percent while the delegates received increased by 117.8 percent. Transport services were partly led by Air transport; which, among other factors, was boosted by Rwandair's new destinations within the course of the year. Architectural and engineering services are benefitting from the blossoming industrial sector.

Chart 9- Real Gross Domestic Product (percentage change)



Source: National Institute of Statistics of Rwanda

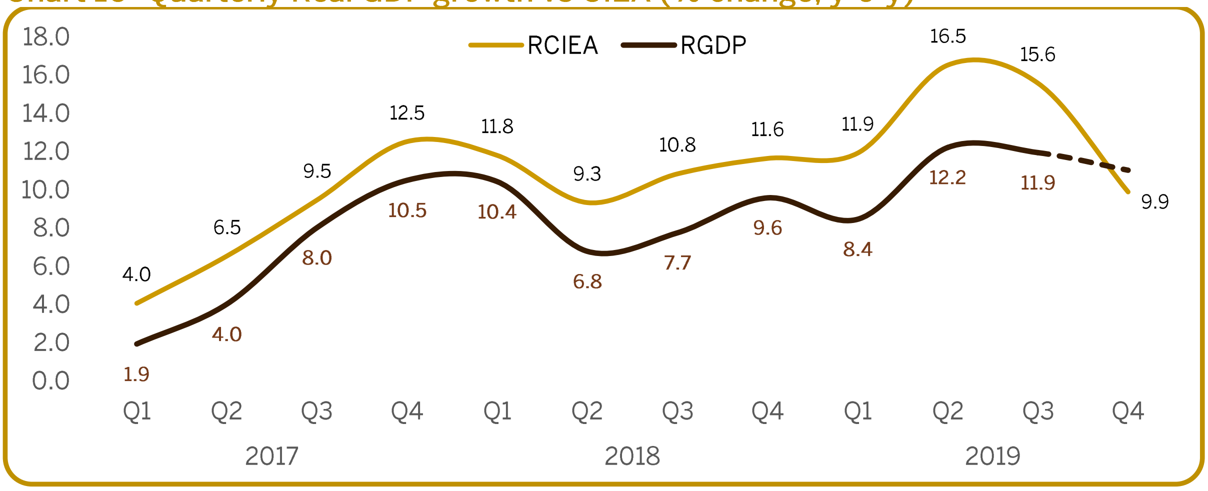
The industrial sector had the highest growth despite having the lowest share of GDP (18.2 percent). As a result, it was the second contributor to growth after the services sector. Its growth was mainly driven by the construction sub-sector which has the sector's highest share of 49.1 percent, and which grew by 30.5 percent in 2019Q1-Q3 compared to 11.9 percent growth in the same period of 2018. Major construction activities that were conducted, of which some are still ongoing, include the Kigali Arena, Gisagara peat plant, and multiple road-networks across the country among others. The manufacturing subsector, which had a share of 33.9 percent, grew by 12.5 percent from 10.0 percent recorded previously. The mining and quarrying subsector suffered from the decline in mineral prices and its growth average was at 3.0 percent.

The agriculture sector's growth in 2019Q1-Q3 (5.8 percent) was a bit lower than the growth recorded in the same period of 2018 (6.5 percent). Food crop production, which accounted for 57.6 percent of the sector, increased by 4.5 percent in 2019 from 4.3 percent in 2018; Livestock & livestock products grew by 14.1 percent in the first three quarters of 2019 against 13.0 percent in the same period of 2018; and export crops' production increased by 6.2 percent. The slowdown in export crops resulted from the cut tea plantations for rejuvenation purposes, exacerbated by low international coffee prices that discouraged coffee farmers.

Overall 2019 GDP outlook

High frequency indicators showed better performance in 2019 than 2018. The overall year's composite index for economic activities (CIEA) grew by 13.4 percent versus 10.9 percent in 2018, indicating a better performance of 2019 than 2018 and that could possibly exceed the projected GDP growth of 8.5 percent. In 2019Q4, the CIEA grew by 9.9 percent, a slower pace compared to 15.6 percent recorded in 2019Q3, pointing to a slowing GDP growth in the last quarter of 2019.

Chart 10- Quarterly Real GDP growth vs CIEA (% change, y-o-y)

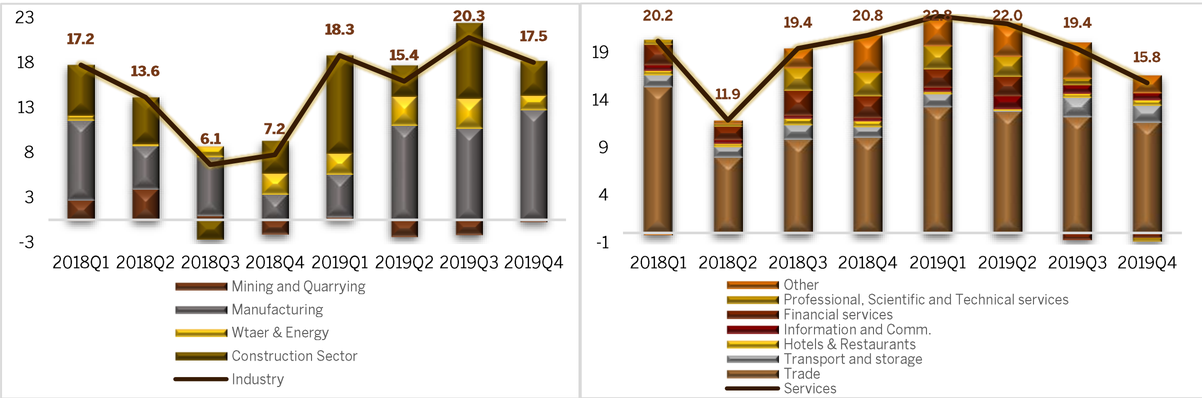


Source: NBR, Monetary Policy Department

The total turnovers, which are part of the CIEA computation, had an overall growth of 19.3 percent versus 16.2 in the previous year. The services sector, with a share of 75.6 percent of total turnovers, was leading by a growth of 19.8 percent while those of the industrial sector grew by 17.8 percent. The key driver of growth in the services sector was wholesale and retail trade which grew by 16.1 percent, while that of the industrial sector was manufacturing turnovers which grew by 18.2 percent as a result of the good performance in food processing (13.2 percent from 10.4 percent) and construction materials industries (14.8 percent from 15.6 percent).

The trend in turnovers also reveals a slower paced GDP growth in 2019Q4. The services turnovers, grew by 15.8 percent from a growth of 19.4 in 2019Q3 and 20.8 in 2018Q4. The industrial sector turnovers grew by 17.5 percent, lower than the 20.3 percent growth in 2019Q3 but higher than the 7.2 percent growth in 2018Q4.

Chart 11- Turnovers of industry & services sectors (% change, y-o-y)

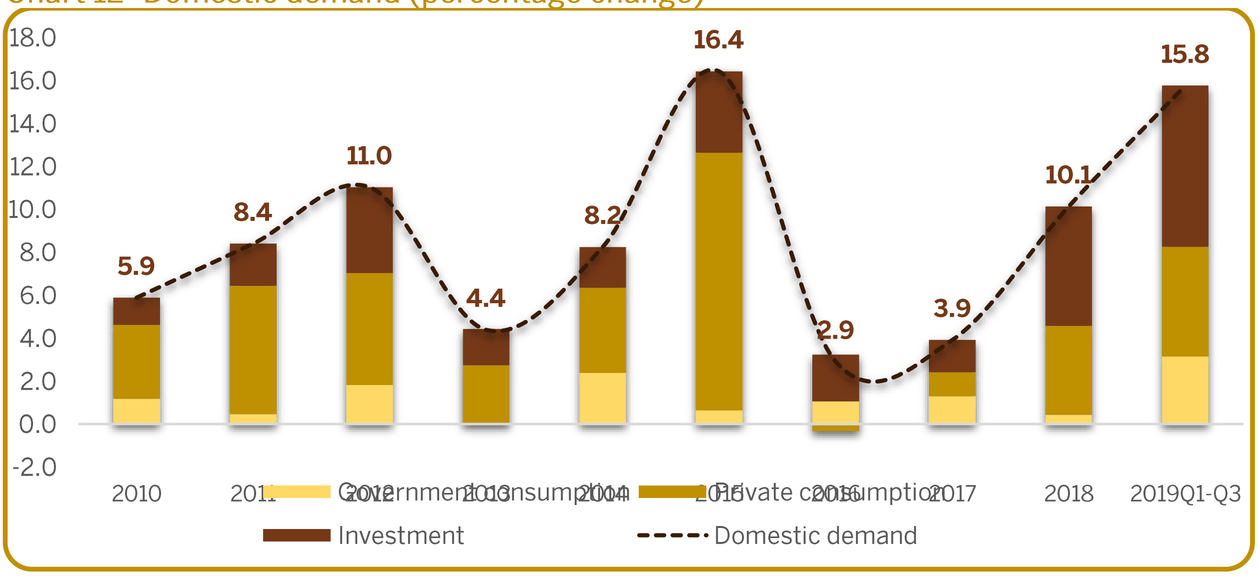


Source: NBR, Monetary Policy Department

2.1.2 Domestic Demand

Aggregate demand in the first three quarters of 2019 was mainly driven by investment and consumption expenditures. Investment expenditures grew by 28.4 percent, up from 26 percent in 2018, mainly due to investments for construction purposes that grew by 30.4 percent from 11.9 percent recorded previously.

Chart 12- Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

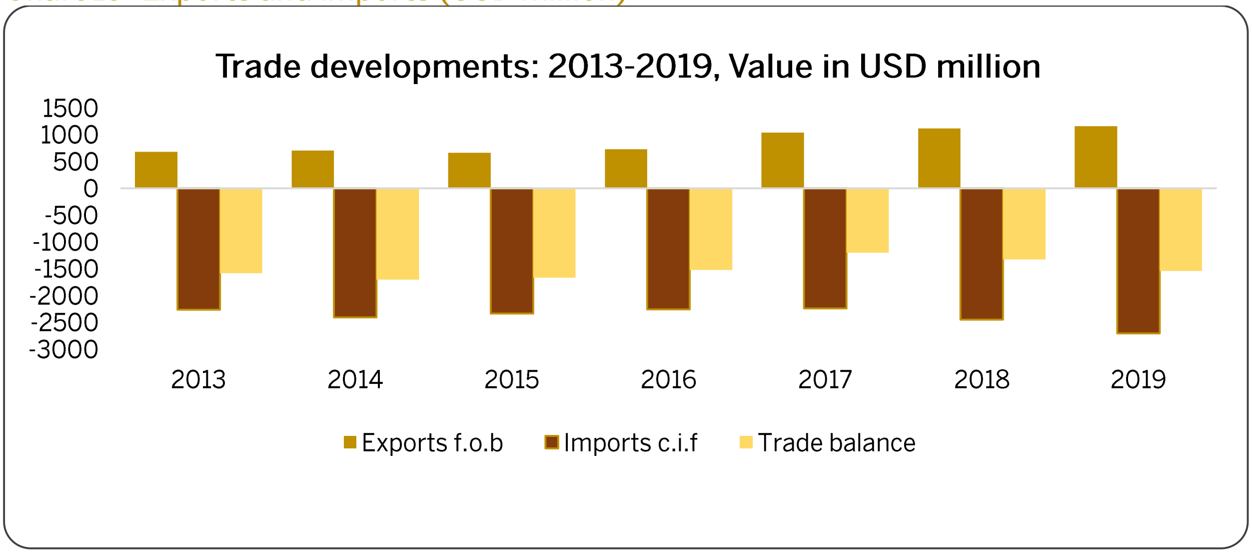
Government consumption grew by 26.3 percent from a previous growth of 3.4 percent mainly as a result of the growth in wages and salaries (+23.0 percent) as well as expenditures in goods and services (+9.0 percent).

2.2 External Sector Developments

Rwanda's exports revenues rose by 3.8 percent in 2019 year-on-year to 1,164.5 million in 2019 from USD 1,121.9 million recorded in 2018. The increase was mainly driven by good performance of re-exports (+22.4 percent) and non-traditional exports (+10.1 percent), albeit a fall in traditional exports (-15.9 percent). The decline in traditional exports resulted largely from a weakening external demand of mineral exports due to a slowdown of global manufacturing activity and prolonged stall in the trade war between United States and China. On the other hand, imports grew by 10.6 percent mainly explained by high domestic demand of capital goods (+17.8 percent), linked to ongoing developmental projects and intermediary goods (+16.0 percent) on the back of a booming construction sector and increasing output from manufacturing sector.

As a result, Rwanda's trade deficit increased by USD 215.5 million (16.3 percent) to USD 1,538.9 million in 2019.

Chart 13- Exports and imports (USD million)



Source: Statistics Department

Rwanda's external sector outlook is expected to improve in 2020 driven by increasing inflows from services, remittances and decreasing trade deficit. The current account deficit is projected to improve to 9.9 percent of GDP in 2020 from the estimated 10.5 percent of GDP in 2019. The projected recovery of global demand is expected to affect positively the prices of traditional exports (minerals, coffee and tea) following sharp drop in 2019. In addition, raising Rwanda's attractiveness to international meetings & conferences and tourism is expected to boost receipts from services, contributing to the slowdown in the current account imbalance. On the other hand, increasing domestic demand of intermediate and capital goods mainly to support the growing manufacturing sector and investment spending will continue to weigh down the improvement in current account imbalance. On the downside, covid-19 risks on global trade and market sentiment could derail the recovery of global economic growth, pushing down prices for traditional exports and reducing exports receipts.

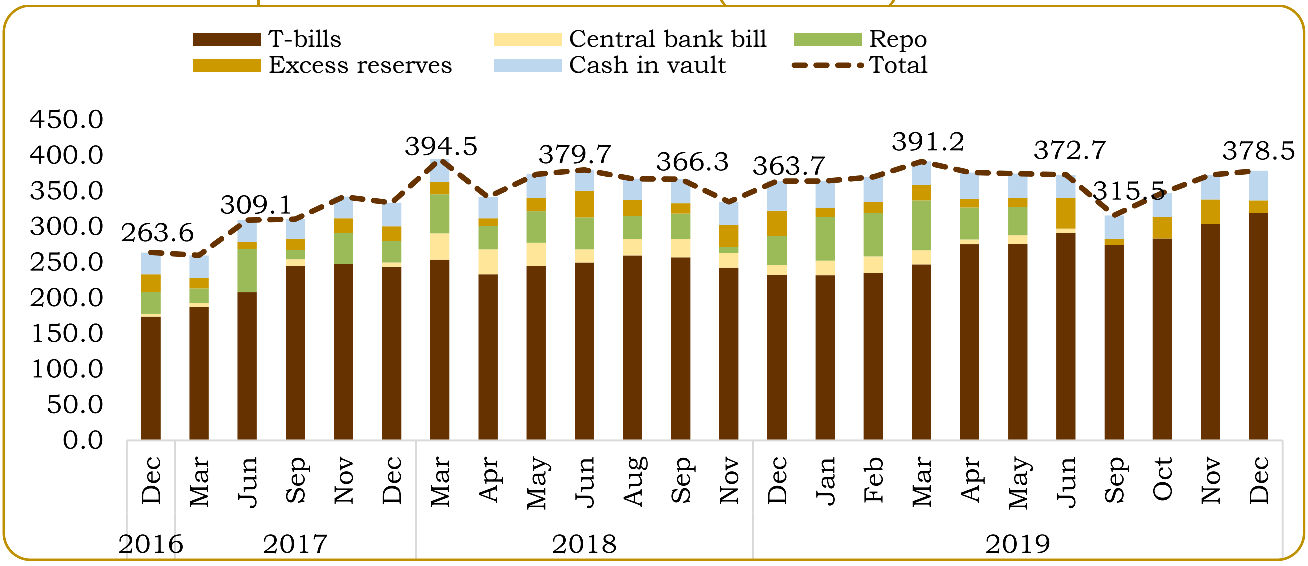
The current account deficit will continue to be financed by steady inflows from FDI and other investments. Rwanda's attractiveness to investors due to its ease of doing business and stable domestic macroeconomic environment (high economic growth, stable inflation and moderate exchange depreciation) will drive the increase in FDI, averaging 3.2 percent of GDP in 2020. Together with a gradual increase in financial flows, these current account improvements should support a continued growth in external buffers: gross official reserves are projected to reach 4.6 of prospective imports by 2020.

III. FINANCIAL AND MONETARY DEVELOPMENTS

3.1 Banking System Liquidity Conditions

In 2019, the most-liquid assets of the banking sector grew at a slow pace by 4.0 percent, to FRW 378.5 billion from FRW 363.7 billion in 2018, compared to the growth of 9.1 percent in 2018. This slow growth was explained by the synergy of more loans to the private sector as new approved loans increased by 20.1 percent from 17.2 percent in 2018, and interbank market development that waved away the need of keeping huge amount of excess reserves for banks.

Chart 14 - Most liquid assets of commercial banks (FRW billion)



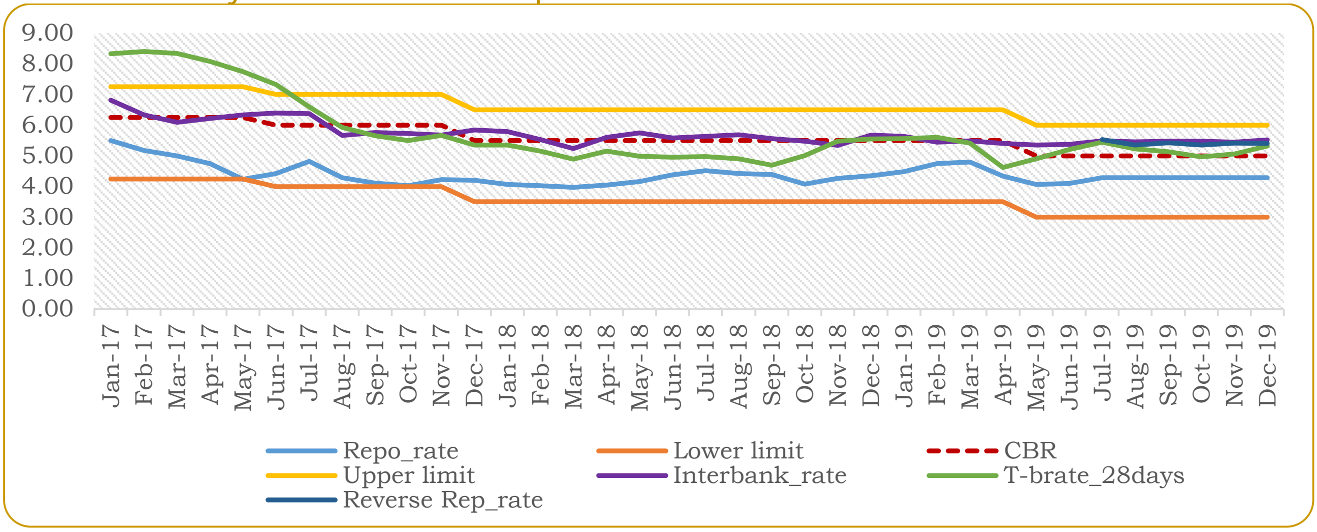
Source: NBR, Financial Markets Department

3.2.2 Monetary Policy and Interest Rates

In 2019, Monetary Policy Committee revised the central bank rate from 5.5 percent to 5.0 percent in May, and kept it unchanged during the August and November meetings. During that period, money market interest rates continued to evolve closely to the CBR.

Money market interest rates were steered around the central bank rate, in the corridor of + 1 /- 2 percent. In fact, Interbank rate averaged to 5.46 percent in 2019, from 5.57 percent in 2018. Similarly, repo and 28 days T- bill rates stood at 4.40 percent and 5.22 percent on average in 2019, from 4.22 percent and 5.09 percent in 2018 respectively. In addition, reverse repo rate averaged 5.41 percent in the last six months of 2019 as the central bank injected money to support commercial banks in their management of short-term liquidity.

Chart 15 - Money market rates developments

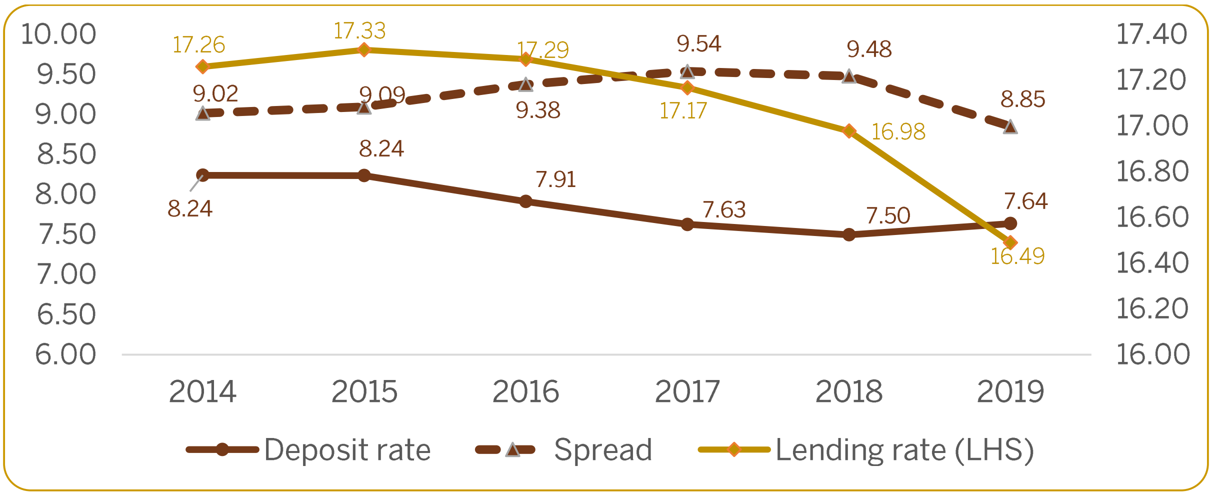


Source: NBR, Financial Markets Department

Compared to 2018, lending rate declined by 49 basis points in 2019 to stand at 16.49 percent on average, while deposit rate increased by 14 basis points, standing at 7.64 percent on average.

As a result, the spread between lending rate and deposit rate dropped by 63 basis points to reach 8.85 percent on average in 2019, thanks to increased competition and improved efficiency in the banking sector.

Chart 16 - Market interest rates (percent average)

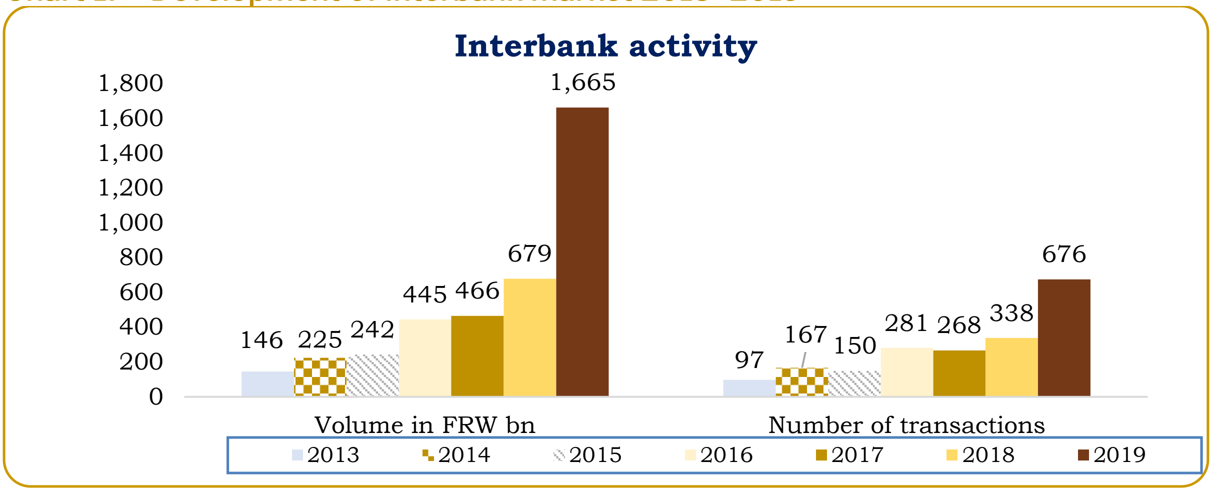


Source: Financial Markets Department

3.2.3 Money market developments

In 2019, the interbank market recorded significant increase both in number of transactions and amount exchanged as compared to 2018. In volume, the market recorded Frw 1,665 billion versus Frw 679 billion in 2018, which is an increase of 145 percent while the number of transactions doubled to 676 from 338 in 2018.

Chart 17 - Development of interbank market 2013- 2019



Source: Financial Markets Department

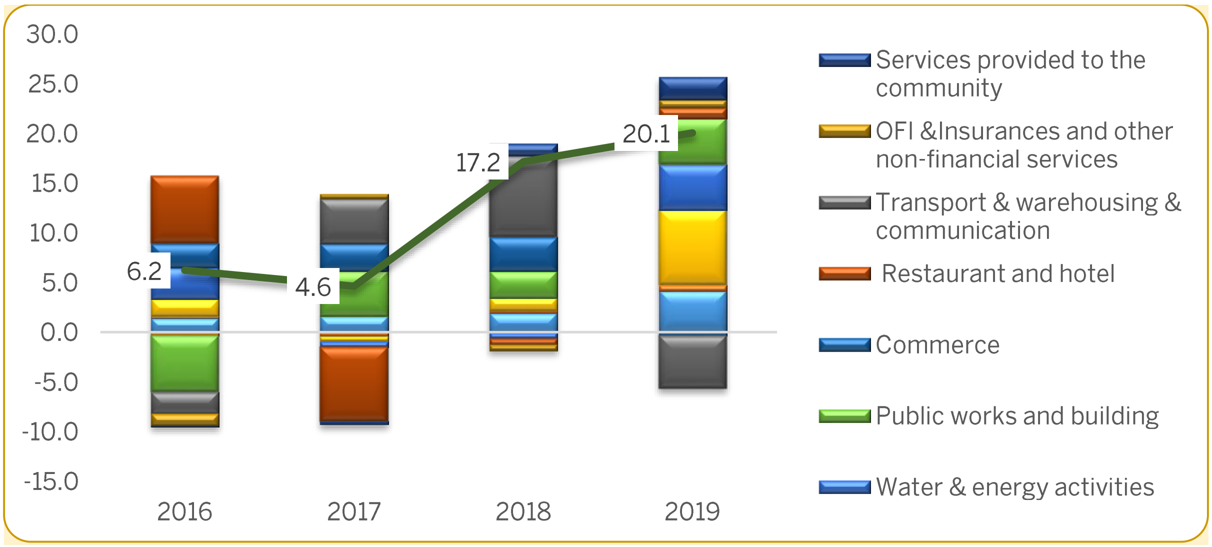
The significant increase in volume and number of transactions in the interbank market is explained by the continuous improvement in liquidity forecasting and management by NBR in the wake of a price-based monetary policy framework adopted since January 2019. Moreover, regular awareness meetings between NBR and commercial bank treasurers have played a role to increase trust among banks, hence an improvement of interbank market activities. This interconnectedness through interbank market is key for an effective transmission of monetary policy impulse and makes financial institutions more capable of absorbing idiosyncratic shocks.

3.2 Credit

The outstanding credit to the private sector rose by 12.6 percent in 2019, compared to 10.8 percent growth in 2018, resulting from a high increase in New authorized loans (20.1 percent in 2019, from 17.2 percent in 2018) amounting to FRW 1.1 trillion FRW in 2019 compared with FRW 966.5 billion in 2018.

The main sectors, which highly contributed to this growth, were manufacturing activities (7.5 percent), Public works & building (4.6 percent), water & energy (4.6 percent), and personal loans (4.2 percent).

Chart 18 - Contributions of sectors of activity to the growth of new authorized loans (%, y-o-y changes)



Source: Financial Stability Monitoring Department

With regard to share by sector, the more financed sectors remained commerce (27.2 percent), public works & building (25.6 percent), personal loans (12.7 percent), and manufacturing activities (12.4 percent).

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

Economic Sector	2015	2016	2017	2018	2019
Commerce	33.8	34.1	35.2	32.9	27.2
Public works and building	32.0	24.7	28.0	26.2	25.6
Personal loans	9.0	9.9	11.0	11.0	12.7
Manufacturing activities	6.9	8.1	7.3	7.3	12.4
Transport & warehousing & communication	7.3	4.8	8.9	14.6	7.7
Water & energy activities	0.2	3.1	2.4	1.6	5.2
Services provided to the community	3.0	2.8	2.4	3.1	4.5
Restaurants and hotels	3.9	10.1	2.5	1.6	2.2
Agricultural, fisheries& livestock	1.9	1.5	1.1	1.2	1.5
OFI &Insurances and other non-financial services	2.0	0.7	1.1	0.5	1.1
Mining activities	0.0	0.2	0.1	0.0	0.0
TOTAL	100	100	100	100	100

Source: NBR, Monetary Policy and Research Directorate

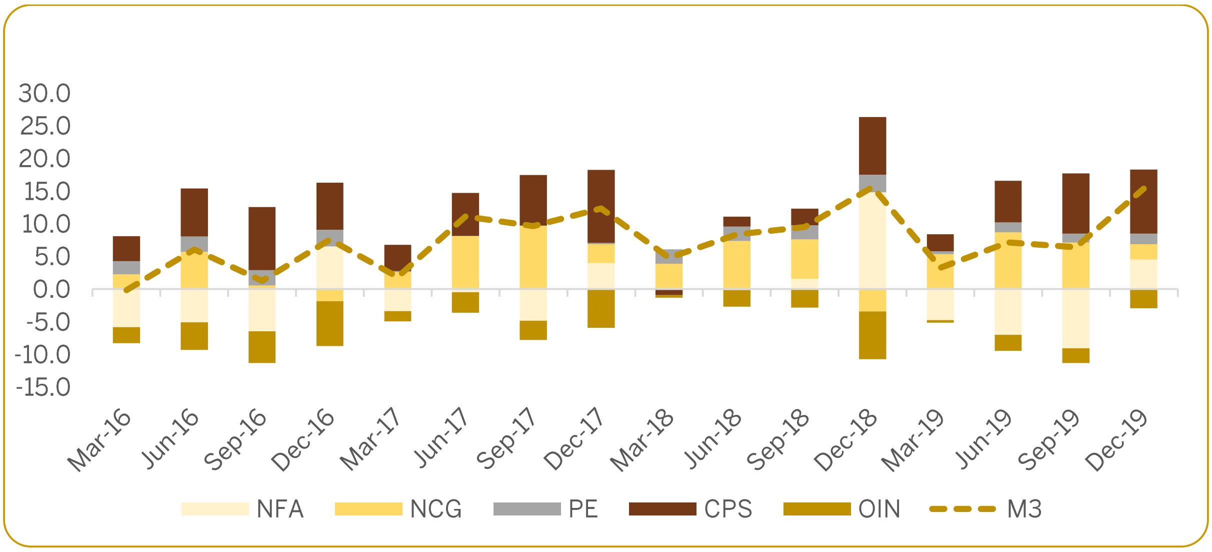
3.3 Money

In 2019, broad money M3 grew by 15.4 percent versus 15.6 percent recorded in 2018. The growth was predominantly driven by credit to the private sector with a contribution of 9.8 percent, followed by net foreign assets (+4.5 percent), net credit to government (+2.4 percent) and credit to public enterprises (+1.6 percent). However, other items net (OIN) partially weighed down on M3 growth, with negative contributions of -2.9 percent.

The growth in the stock of credit to the private sector was attributed to increased new authorized loans in 2019, thanks to high demand for loans in line with increased economic activities and a decline in loan rejection. The demand for loans increased by 20.4 percent in 2019 in value from an increase of 3.4 percent recorded in 2018, and the overall loan rejection rate in volume declined to 3.9 percent in 2019 from 7.2 percent in 2018.

The increase in net foreign assets mainly came from an expansion of NBR's NFAs by 15.4 percent in 2019, from 20.3 percent in 2018, owing to an accumulation of inflows, which outweighed the outflows. However, NFAs of commercial banks reduced by 27.3 percent in 2019 standing at FRW 278.5 billion from FRW 324.6 billion.

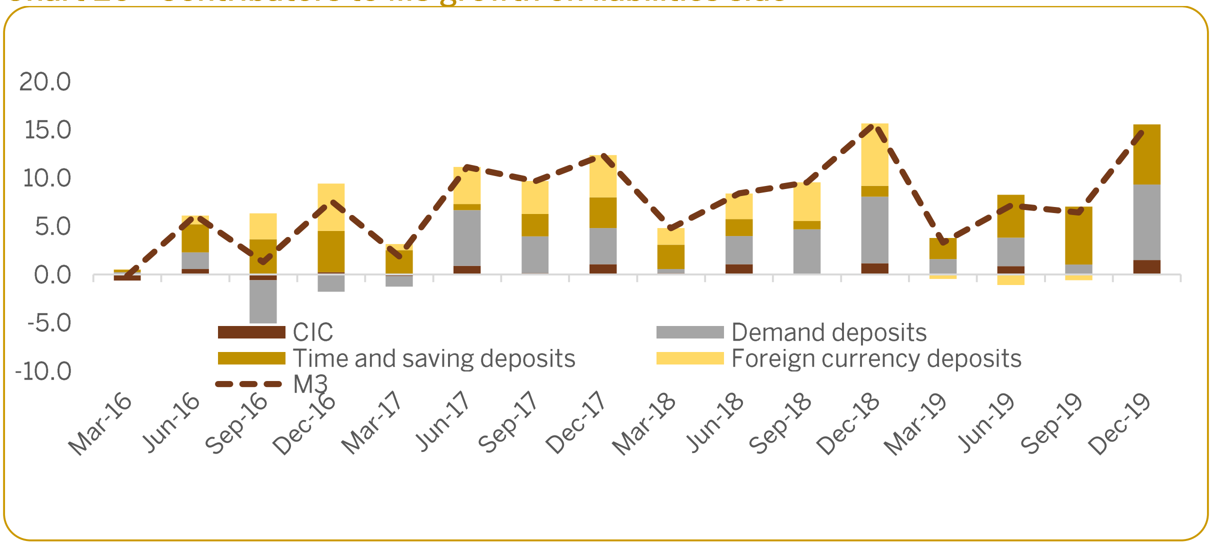
Chart 19 - Contributors to M3 growth on assets side



Source: NBR, Monetary Policy and Research Directorate

From the liabilities side, M3 growth was mainly driven by demand deposits, which contributed 7.8 percent in 2019 from 6.9 percent in 2018, followed by time and saving deposits with 6.2 percent from 1.1 percent, and currency in circulation with 1.5 percent from 1.2 percent. The high uptick in time and saving deposits reflects increased term deposits by big depositors. Nevertheless, foreign currency deposits pulled back the growth with a negative contribution of 0.1 percent from a positive contribution of 6.4 percent in 2018. This negative contribution resulted from an increase in import bill amid low growth in export receipts.

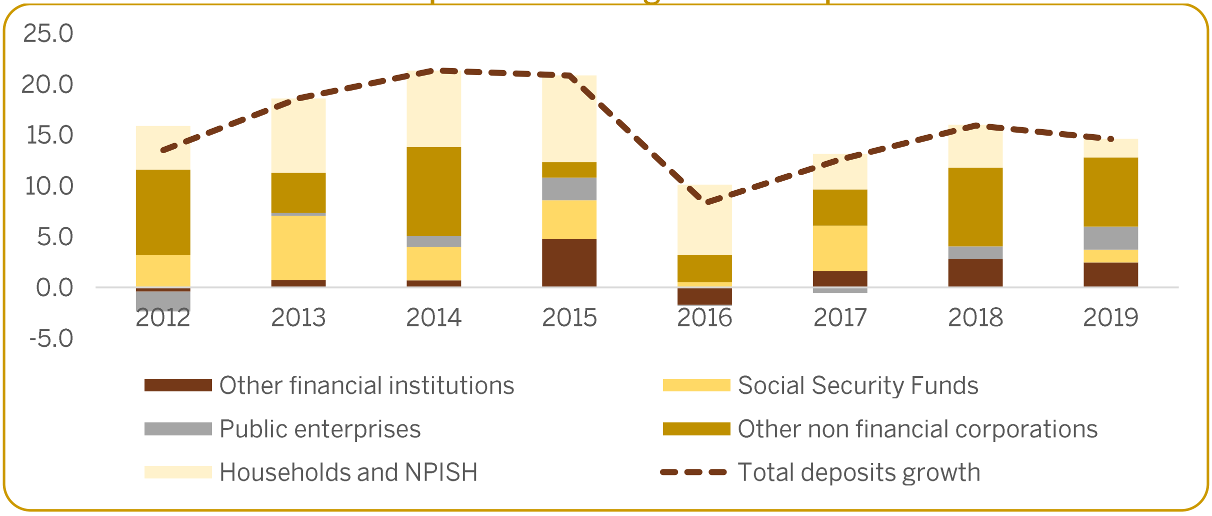
Chart 20 - Contributors to M3 growth on liabilities side



Source: NBR, Monetary Policy and Research Directorate

Banks' deposits - the main component of M3 rose by 14.6 percent in 2019, down from 15.9 percent in 2018. The primary contribution to the growth in deposits was from other non-financial corporations with 6.8 percent, followed by other financial institutions (2.4 percent), public enterprises (2.3 percent), households and NPISH (1.8 percent), and social security fund (1.3 percent).

Chart 21 - Contributions of depositors in the growth of deposits



Source: NBR, Monetary Policy and Research Directorate

IV. INFLATION DEVELOPMENTS AND OUTLOOK

4.1 Inflation developments

In 2019Q4, headline inflation accelerated to 6.0 percent from 2.4 percent recorded in 2019Q3. This uptick observed in headline inflation was mainly attributed to the base effect and the rising trend in food prices that started from the second half of 2019. Following the upward trend in demand pressures adding to the domestic and imported costs, core inflation surged to 3.3 percent in 2019Q4 from 2.7 percent recorded in the previous quarter.

Table 2: Developments in headline inflation on quarterly basis (Y-o-Y, % change)

	2017				2018				2019			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Headline	7.7	6.2	3.5	2.2	0.9	2.5	1.8	0.2	1.0	0.4	2.4	6.0
Domestic	7.4	6.0	3.4	1.4	-0.1	1.8	0.9	-0.7	0.5	-0.4	1.9	6.4
Food:	16.6	13.3	7.4	1.9	-1.8	0.6	-2.1	-7.3	-3.6	-2.6	3.2	13.7
- Vegetables	21.0	13.3	4.6	-0.5	-5.4	2.3	-3.3	-13.5	-6.2	-9.6	-1.9	23.6
Housing	2.0	1.8	1.7	2.3	2.4	4.4	3.6	3.0	1.7	-0.5	0.4	1.4
Transport	8.5	5.4	1.2	3.0	3.0	8.2	10.3	9.7	7.7	3.2	1.9	1.3
Imported	8.8	6.9	3.9	4.7	4.4	5.0	4.9	3.3	2.5	2.8	4.2	4.8
Core	5.5	4.6	3.1	2.5	1.7	1.8	1.5	1.4	1.6	1.6	2.7	3.3
Energy	4.3	5.2	3.5	6.3	7.3	12.7	11.0	8.3	2.0	-4.1	-1.8	0.6

Source: NBR, Statistics Department

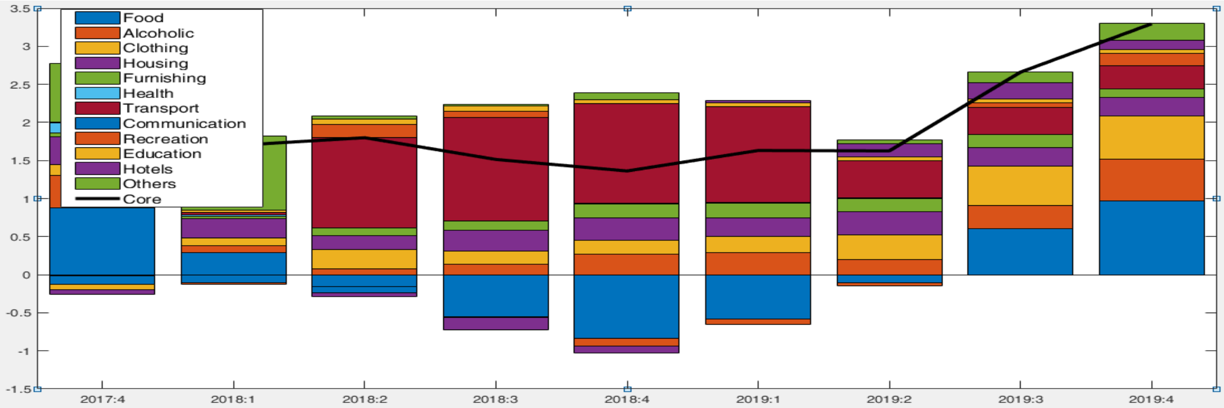
4.1.1. Contributors to headline inflation

a. Core inflation

The increase in core inflation was reflected in core food inflation, alcoholic beverages & tobacco inflation and clothing inflation, outweighing the decrease in transport inflation. Core food inflation picked to 5.9 percent in 2019Q4 from 3.7 percent in 2019Q3, following an increase in international prices of some imported food products such as rice and sugar. Clothing inflation surged to 8.3 percent in 2019Q4 from 7.5 percent in 2019Q3 as a result of an increase in prices of imported clothes. Alcoholic beverages and tobacco inflation hiked to 11.4 percent from 6.4 percent and this was in line with the increase in excise duty on tobacco and the enforcement of tax law that resulted in increased prices for imported wines and liquors. Transport inflation slowed down to 2.2 percent from 2.6 percent during the same period.

This increase in core inflation is in line with monetary conditions that prevailed since 2018Q1. As core inflation remained lower since 2018, NBR maintained an accommodative monetary policy stance that supported high economic growth recorded in 2018 and 2019.

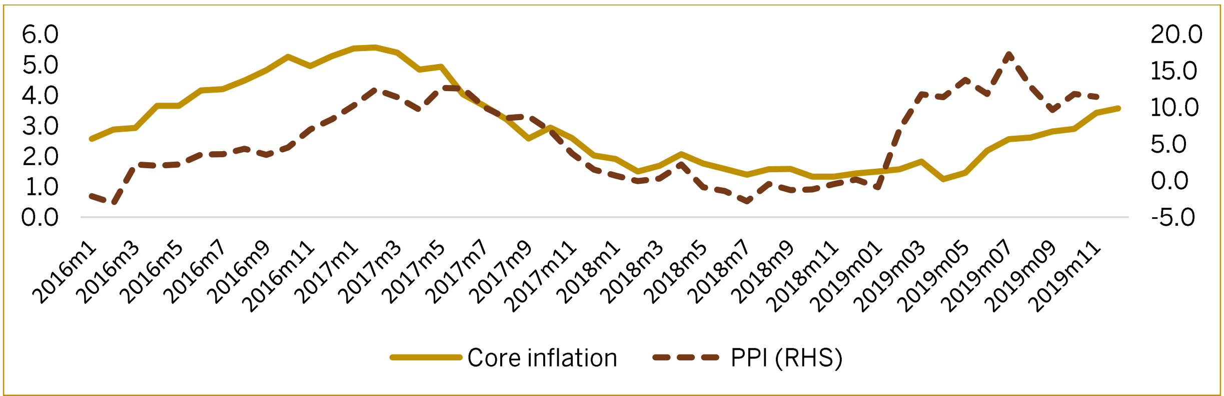
Chart 22 - Development of core inflation (%, Y-o-Y)



Source: NBR, Monetary Policy and Research Directorate

The aforementioned rise in core inflation is also evidenced by the positive trend observed in producer price index, which is an indicator of domestic cost of production. For the first two months of 2019Q4, the general producer price index increased by 11.8 percent in October and by 11.44 percent in November, from 9.6 recorded in September 2019. The recent upward trend in general producer price index was on the back of the rise in cost of manufacturing furniture (especially mattresses), metals and food products.

Chart 23 - Development of core inflation and PPI

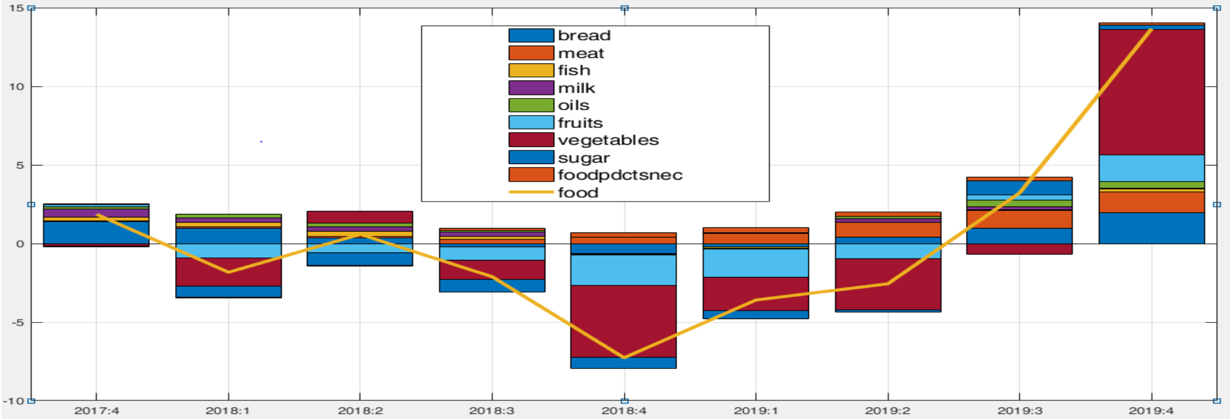


Source: NBR, Monetary Policy and Research Directorate

b. Food inflation

In 2019Q4, food inflation accelerated to 13.7 percent from 3.2 percent in 2019Q3. This upsurge in food inflation was reflected in different components, notably vegetables inflation that surged to 23.6 percent from -1.9 percent, bread & cereals inflation that pick up to 9.9 percent from 4.6 percent, and fruits inflation that increased to 14.2 percent from 2.6 percent during the same period.

Chart 24 - Development of food inflation (%, Y-o-Y)



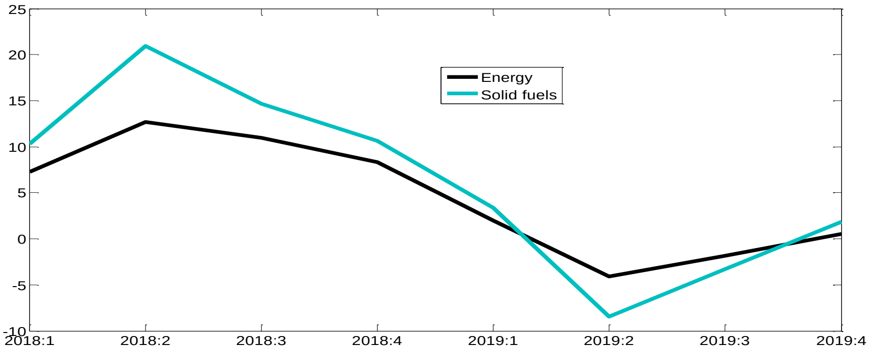
Source: NBR, Monetary Policy and Research Directorate

These upward pressures on food inflation were observed mainly since the second half of 2019. The pressures came from the lower food prices recorded the same period in 2018 (base effect) as well as upward pressures resulting from unfavorable weather conditions in Season A 2019/2020 in some regions of the country.

c. Energy inflation

Energy inflation surged to 0.6 percent in 2019Q4 from a deflation of 1.8 percent in the previous quarter, reflecting an increase in solid fuels inflation from -3.3 percent to 2.0 percent during the same period. The recent rise in charcoals and firewood prices, mainly resulted from the base effect and the heavy rains that disturbed production and transportation of charcoals and firewood. Other mild pressures came from global oil prices.

Chart 25 - Energy inflation (%,Y-o-Y)



Source: NBR, Monetary Policy and Research Directorate

4.2. Inflation outlook

4.2.1. Assumptions of baseline projections

Assumption 1: Fiscal policy stance is expected to be non-inflationary

The structural fiscal deficit recorded an upward trend since 2018 and this was in line with the previous MPC projections. Government allocated more spending on capital and current expenditures to boost domestic economy. However, the stimulus from an additional fiscal spending declined over 2018/2019 and will continue throughout 2019/2020. Though fiscal deficit in 2019/2020 is expected to pick up to 6.2 percent of GDP from 5.5 percent of GDP recorded in 2018/2019, it will remain non-inflationary, hence pressures on domestic demand are expected to be trivial.

Assumption 2: Global aggregate demand will remain moderate and non-inflationary

In 2020, global growth is projected to pick up to 3.3 percent, from 2.9 percent in 2019, mostly reflecting a recovery from deep downturns in underperforming emerging economies. On the downside, the effect of the novel coronavirus outbreak on global trade and market sentiment could derail the recovery of global economic growth.

Assumption 3: Pressures from international food prices will be moderated by a decline in oil prices

In 2019, international food prices recorded an upward trend with a high speed compared to the previous forecasts. Over the forecasting horizon, increase in food prices will remain, but its effect on Rwanda's economy will be moderated by the expected drop in global oil prices. Though global oil prices will continue to reduce over the forecasting horizon, the deceleration will be lower than previously projected.

4.2.2. Inflation projections

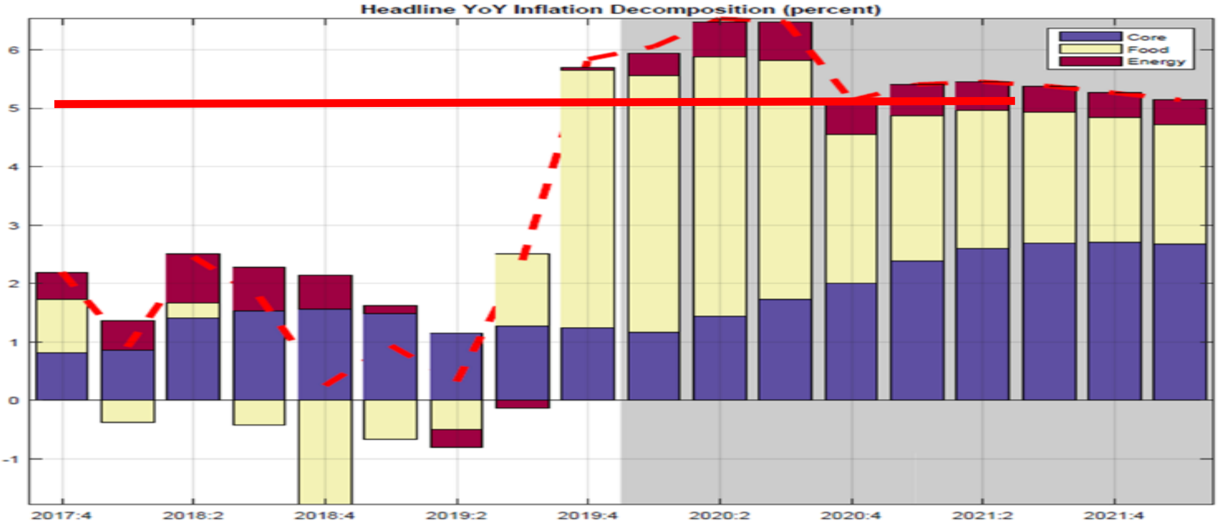
As a result of the deflationary pressures in food prices observed in the first half of 2019, upward pressures in food inflation are projected during the first half of 2020. During the second half of the year, the base effect will dissipate, easing the pressures on food inflation.

By contrast, core inflation is projected to pick up during the second half of 2020, as a result of upward pressures in international food prices.

On energy inflation, the increase in electricity tariffs that took effect in January 2020 coupled with the deflationary pressures in solid fuels observed in 2019Q2 and 2019Q3 are projected to exert upward pressures throughout Year 2020. The upward pressures in energy inflation are projected to be eased by the downward drag from global oil prices.

Consistent with the assumptions above, average headline inflation in 2020 is projected to hover around 6.2 percent. Upward pressures in headline inflation are expected to ease during the last quarter of the year.

Chart 26 - Headline inflation projection



Source: NBR, Monetary Policy and Research Directorate

Based on the above-mentioned assessment of the current economic performance as well as the macroeconomic projections indicating that headline inflation will remain within the inflation benchmark bands, NBR's Monetary Policy Committee held on February 5, 2020 maintained the Central Bank Rate at 5.0 percent. The Committee will continue to closely monitor developments in domestic and global economic conditions, and stands ready to respond appropriately.