National Bank of Rwanda

Banki Nkuru y'u Rwanda

MONETARY POLICY REPORT

May 2019

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The National Bank of Rwanda's Monetary Policy Report was called Inflation Report until February 2019. It is published four times a year, consistent with the quarterly Monetary Policy Committee meetings.

EXECUTIVE SUMMARY

The National Bank of Rwanda cut the Central Bank Rate by 50 basis points.

The quarterly Monetary Policy Committee (MPC) meeting convened on May 6, 2019 to review the outcome of its previous decisions, recent economic developments and outlook. After assessment, the Committee observed that domestic demand continued to improve in 2019Q1 supported by growing credit to the private sector. With regard to the low inflation environment, the MPC decided to cut the Central Bank Rate (CBR) by 50 basis points (from 5.5 percent to 5.0 percent), to sustain growing domestic demand.

Annual headline inflation increased to 1.0 percent in 2019Q1 (from 0.2 percent in 2018Q4), following an easing food deflation, that outweighed a drop in energy inflation. The low level of inflation experienced since 2018 originates from good performance in the agriculture sector. Core inflation slightly picked up, to 1.6 percent in 2019Q1 from 1.4 percent in 2018Q4. The improvement in domestic demand supported by the new monetary policy stance will drive inflation towards 3.0 percent in 2019, from 1.4 percent recorded in 2018.

Outstanding credit to private sector and new authorized loans increased at a higher pace, growing at 16.2 percent and 24.9 percent in 2019Q1, respectively, from 7.3 percent and -7.4 percent recorded in 2018Q1. The trend is expected to continue throughout 2019, supported by the more accommodative policy stance.

In 2019Q1, money market interest rates remained stable, in line with the CBR. Commercial banks' lending rate decreased by 29 basis points, y-o-y, to 16.76 percent on average. The decline in lending rate is partially reflected in the reduction of deposit rates (cost of money) by 69 basis points to 7.15 percent.

Exchange rate depreciation was moderate in 2019Q1, consistent with initial projection of 5% for the whole year 2019, higher than 4.0% recorded in 2018. The FRW depreciation will slightly increase due to a wider trade deficit. The latter is due to a high import bill coming from ongoing infrastructure projects, and a slowdown of the global economy. However, the foreign exchange market will remain stable, with adequate foreign exchange reserves to serve as a buffer against external shocks.

Real GDP grew by 8.6 percent in 2018, resulting from the good performance in agriculture (6 percent), service (9 percent) and industry (10 percent) sectors. The composite index of economic activities points to sustained good economic performance in 2019Q1, consistent with the projection of 7.8 percent growth in 2019.

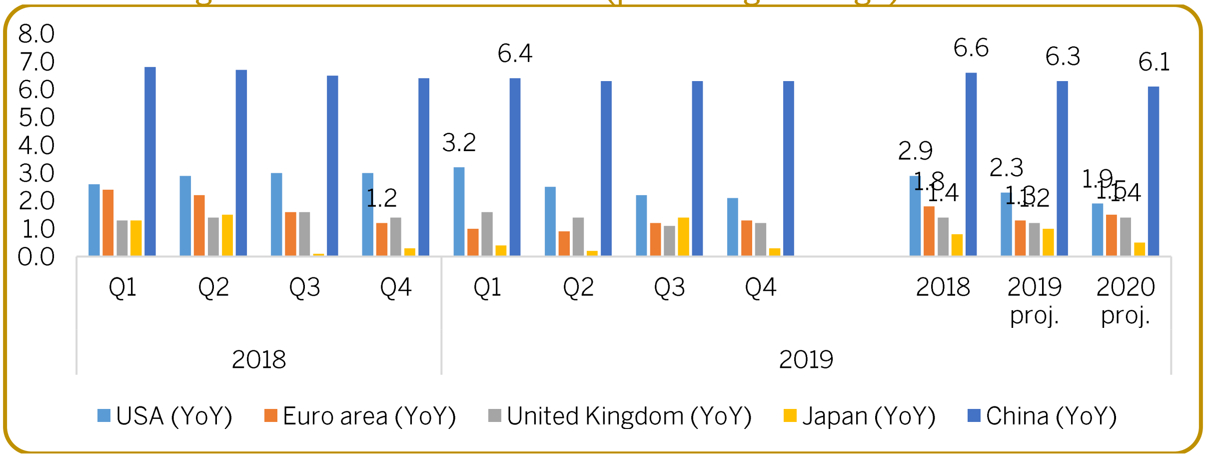
Going forward, aggregate demand in 2019 is expected to improve, supported by a more accommodative monetary policy and increased fiscal stimulus. Global economic performance is projected to slow down, and commodity prices are expected to decline in 2019, with uncertainties around Brexit deal and trade tensions. In line with the domestic and global economic outlook, headline inflation rate is projected to pick up towards 3.0 percent in 2019.

I. GLOBAL ECONOMIC AND FINANCIAL DEVELOPMENTS

1.1 Economic Growth

According to the IMF World Economic Outlook (WEO), global growth is projected to slow from 3.6 percent in 2018 to 3.3 percent in 2019, before bouncing back to 3.6 percent in 2020. The current forecast envisages that global growth will level off in the first half of 2019 and firm up after that. The projected pickup in the second half of 2019 is predicted on an ongoing buildup of policy stimulus in China, recent improvements in the global financial market sentiment, the waning of some temporary drags on growth in the Euro Area, and gradual stabilisation of conditions in stressed emerging market and developing economies. Growth in advanced economies is projected to slow from 2.2 percent in 2018 to 1.8 percent in 2019, mostly due to downward revisions for the Euro area.

Chart 1- GDP growth in selected countries (percentage change)



Source: BLOOMBERG and IMF, World Economic Outlook, April 2019

In 2019Q1, the US economy grew by 3.2 percent (y-o-y), and projected to decline to 2.3 percent in 2019, from 2.9 percent in 2018, and soften further to 1.9 percent in 2020 with the unwinding of fiscal stimulus. Growth in the Euro area is set to moderate from 1.8 percent in 2018 to 1.3 percent in 2019 and 1.5 percent in 2020. Growth rates have been marked down for many economies notably Germany, Italy and France. Growing concerns about a no-deal Brexit also likely weighed on investment spending within the euro area.

The UK economy decelerated to 1.4 percent (y-o-y) in 2018 from 1.8 percent in 2017, and projected to decelerate further to 1.2 percent in 2019 before picking to 1.4 percent in 2020.

In the emerging market & developing economies, growth is expected to slow down to 4.4 percent in 2019, from 4.5 percent in 2018, before improving to 4.8 percent in 2020. The decline in 2019 relative to 2018 reflects lower growth in China and the recession in Turkey. The Chinese economy grew by 6.4 percent (y-o-y) in 2019Q1, same as in 2018Q4, and projected to slow to 6.3 percent in 2019, and decelerate further to 6.1 percent in 2020.

The macroeconomic outlook for Sub-Saharan Africa economies continues to strengthen as economic growth is projected to pick up from 3.0 percent in 2018 to 3.5 percent in 2019 and 3.7 percent in 2020, despite downward revisions for Angola and Nigeria, in line with the softening of oil prices.

In 2018, growth in the EAC countries was strong, reaching 6.3 percent up from 5.6 percent in 2017, following favorable weather conditions and public infrastructure investments. However, growth is projected to slow down in both 2019 and 2020, respectively, to stand at 5.3 percent and 5.4 percent, partly due to the growing current account deficits following low export earnings.

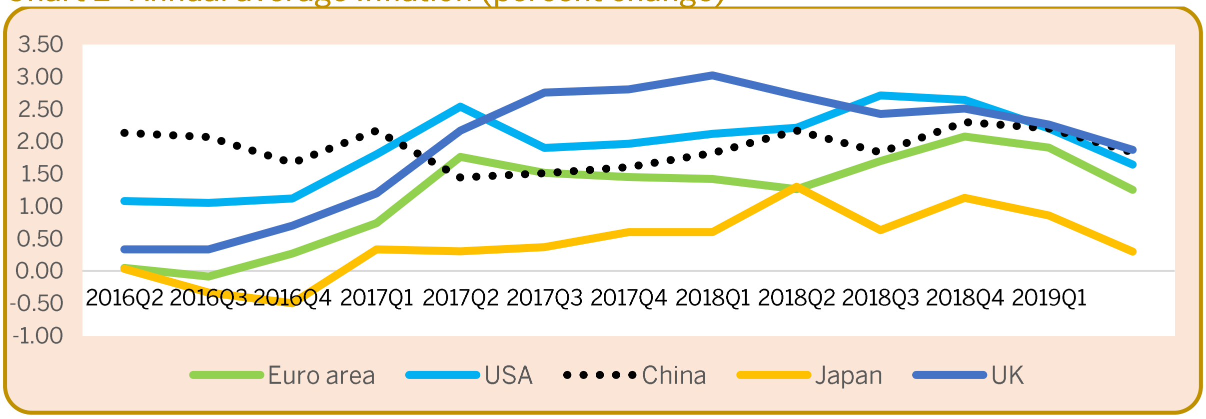
Rwanda's economic growth stood at 8.6 percent in 2018, and projected at 7.8 percent in 2019. Kenya's real GDP growth stood at 6.0 percent in 2018, and projected to slow to 5.8 percent in 2019 due to the expected poor harvest following the drought that has delayed planting. In Tanzania, GDP growth increased to 6.6 percent in 2018, and projected at 4.0 percent in 2019, due to growing private sector concerns about economic uncertainty and increased domestic arrears that could disrupt the government's fiscal consolidation and harm the private sector. Uganda's economy grew by 6.2 percent in 2018, and projected to grow by 6.3 percent in 2019, due to increased infrastructure investment, foreign direct investment in the oil and mining subsectors, and reforms to improve business environment.

1.2 Inflation Developments

World annual average inflation is projected at 3.58 percent in 2019 from 3.64 percent in 2018, following softening global demand, and it is projected at 3.62 percent in 2020. Monetary policy remained accommodative in most advanced economies with Central Bank rates remaining unchanged in the Eurozone and Japan. The European Central Bank rate was maintained at zero percent since March 2016, and the Bank of Japan continued to apply a negative interest rate since February 2016. The US Federal Reserve Bank increased its policy rate on 19^{th} December 2018, following three other increases in September, June and March 2018, and does not expect interest rates hike for the rest of 2019.

Consistent with the softer outlook for commodity prices and the expected moderation in growth, inflation in advanced economies is expected to decline to 1.6 percent in 2019, from 2.0 percent in 2018. The US annual average inflation (y-o-y) is projected to ease at 2.0 percent in 2019 from 2.4 percent in 2018. In 2019Q1, inflation decelerated to 1.6 percent from 2.2 percent the previous quarter, due mainly to fall in prices for food, gasoline and new vehicles. The core inflation rate, which excludes volatile items such as food and energy, edged down to 2.0 percent in 2019Q1, staying below forecasts of 2.1 percent.

Chart 2- Annual average Inflation (percent change)



Source: Country Bureau of Statistics

The annual average inflation (y-o-y) in Eurozone is projected to decelerate to 1.3 percent in 2019 from 1.8 percent in 2018, and inflation has eased to 1.3 percent in 2019Q1 from 1.9 percent in 2018Q4, due to a slowdown in food, alcohol & tobacco, services and non-energy industrial goods. Core inflation, which excludes volatile prices of energy, food, alcohol & tobacco, slowed to 0.8 percent. In the United Kingdom, annual average inflation (y-o-y) is projected to ease to 1.8 percent in 2019 from 2.5 percent in 2018. In 2019Q1, inflation eased to 1.9 percent in 2019Q1 from 2.3 percent, the previous quarter, as prices slowed for food and-non-alcoholic beverages, and transport.

Inflation in emerging market and developing economies, excluding Venezuela, expected to firm to 4.9 percent in 2019 from 4.8 percent in 2018. In China, the annual average inflation (y-o-y) eased to 1.8 percent in 2019Q1 from 2.2 percent in 2018Q4, while annual core inflation, stood at 1.8 percent in March 2019. For 2019, average inflation is projected at 2.3 percent from 2.1 percent in 2018.

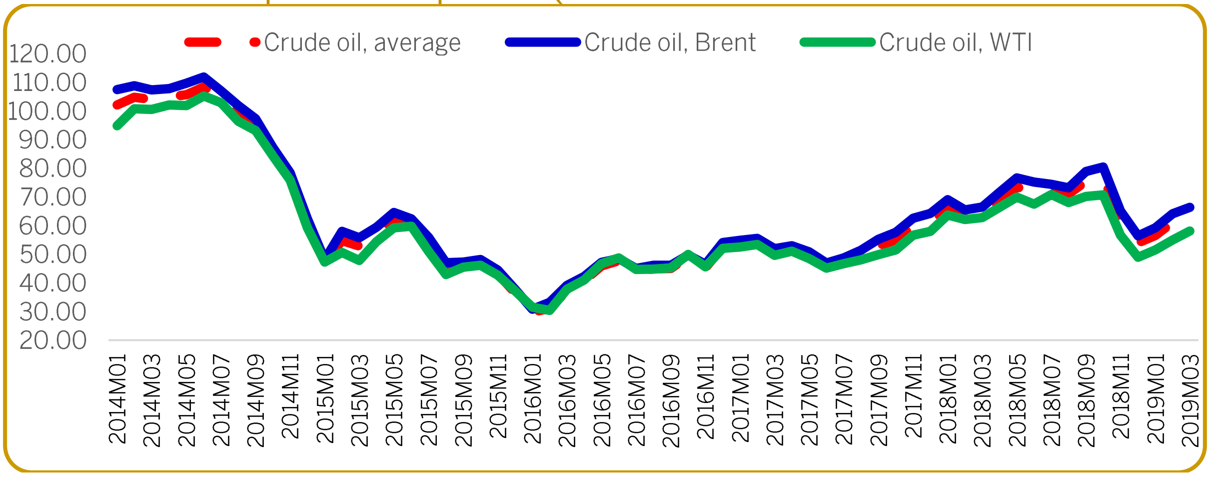
In Sub-Saharan Africa, annual average inflation is projected to decline to 8.1 percent in 2019 from 8.5 percent in 2018, reflecting decline in global energy prices. In EAC, annual average inflation is projected at 3.9 percent in 2019 and 4.8 percent in 2020 from 3.6 percent in 2018, following unfavorable weather conditions due to experienced drought that has led to late planting in some countries.

In Kenya, annual average inflation (y-o-y) eased to 4.4 percent in 2019Q1 from 5.6 percent in 2018Q4, due mainly to food and non-alcoholic beverages, and projected at 4.4 percent in 2019, down from 4.7 percent in 2018. Rwanda's annual average inflation (y-o-y) rose to 1.0 percent in 2019Q1, from 0.2 percent in the previous quarter. The annual average inflation (y-o-y) in Tanzania eased to 3.0 percent in 2019Q1 from 3.2 percent in the previous quarter, mainly due to falling prices of alcoholic beverages & tobacco, and miscellaneous goods & services, and projected at 3.5 percent in 2019, same as in 2018. Uganda's annual average inflation (y-o-y) slightly rose to 2.9 percent in 2019Q1, from 2.7 percent in 2018Q4, due to rising transport prices, recreation & culture and communication, and projected to increase to 3.6 percent in 2019, from 2.6 percent in 2018.

1.3 Global Commodity Prices

In 2019Q1, global commodity prices decreased, reflecting ample supply and softening global demand. Energy prices fell by 6.2 percent in 2019Q1 compared to an increase of 20.9 percent in 2018Q1, while non-energy commodity prices decreased by 6.4 percent, following a decline in prices of agricultural commodities and metals & minerals. Crude oil prices decreased by 6.4 percent on average in 2019Q1, compared to an increase of 22.0 percent in 2018Q1, on the back of softening global demand. Going forward, crude oil prices are projected to decrease by 3.4 percent in 2019 and further by 1.5 percent in 2020.

Chart 3- Crude oil price developments (USD/barrel



Source: World Bank commodity prices, April 2019 .

Agricultural commodity prices are projected to decrease by 2.7 percent in 2019 from -0.3 percent in 2018, attributed mainly to falling prices of food (-3.2 percent) and beverages (-4.6 percent). Auction prices for Coffee Arabica, Coffee Robusta and Tea are expected to decrease by 2.7 percent, 6.4 percent and 14.0 percent, respectively. Metals & mineral prices are projected to further decrease by 1.8 percent (y-o- y) in 2019, a deeper decline than anticipated in the October 2018 WEO, but will slightly increase by 0.7 percent in 2020. Prices for fertilizers are projected to increase by 4.7 percent in 2019 and by 1.7 percent in 2020.

1.4 Foreign Exchange Markets

On the foreign exchange market, the US dollar is weakening against major currencies, notably the Euro and Japanese Yen, while appreciating against the British Pound. Compared to December 2018, the US dollar depreciated by 2.20 percent against the Euro, and by 1.07 percent against the Japanese Yen, while appreciating by 2.14 percent against the British Pound in March 2019, after respective depreciation of 3.62 percent, 2.59 percent and 5.69 percent in March 2018.

II. DOMESTIC ECONOMY AND FINANCIAL DEVELOPMENTS

2.1 Domestic Demand and Output

The Rwandan Real GDP grew by 8.6 percent in 2018, resulting from the good performance in agriculture (5.9 percent), service (8.8 percent) and industry (10.3 percent) sectors. The composite index of economic activities points to sustained good economic performance in 2019Q1, consistent with the projection of 7.8 percent growth in 2019.

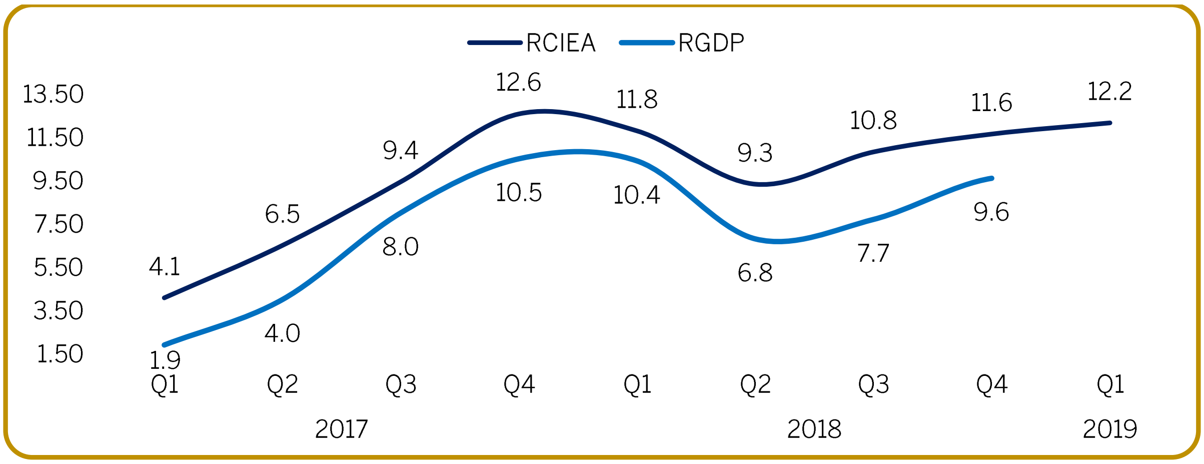
2.1.1 Output and the Near-Term Outlook

The high economic growth in 2018 resulted mainly from the good performance of the construction sector, improvement in manufacturing and services sector, in addition to the favorable weather conditions that supported the agriculture sector.

The observed favorable weather condition backed the 2019 agricultural season A, which harvest was positive (4.3 percent) as evidenced by NISR Seasonal Agricultural Survey Report. In addition to the good performance in agriculture, the leading indicators of economic activities point to the continuity of good economic performance in 2019Q1.

Consistent with the projection of 7.8 percent growth in 2019; the composite index of economic activities (CIEA) grew by 12.2 percent in 2019Q1 after 11.8 percent in the corresponding period of 2018, with the total turnovers of industry and service sectors increasing by 21.7 percent from 19.4 percent in the same period.

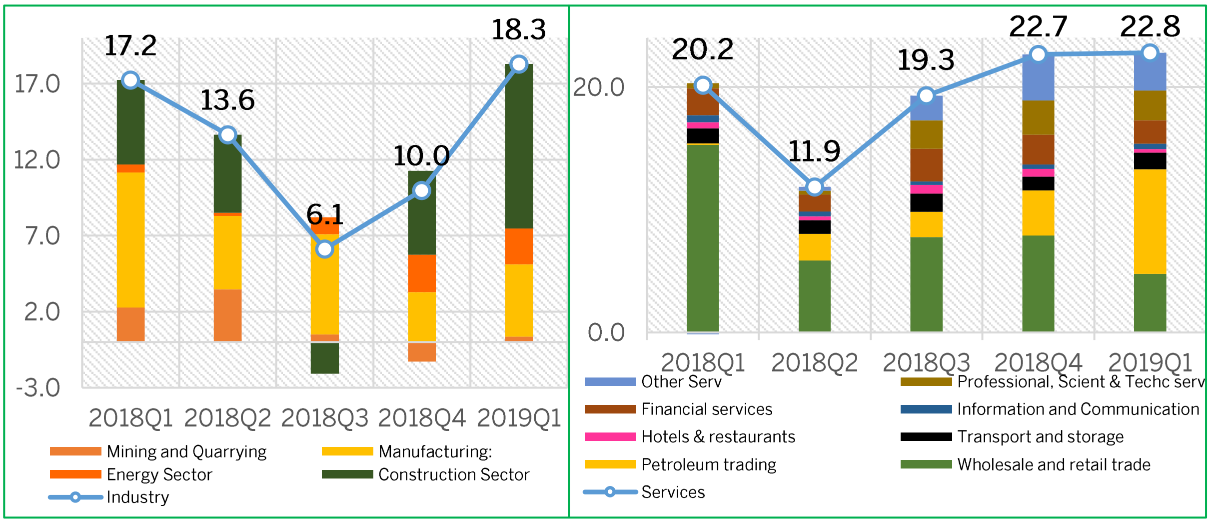
Chart 4- Quarterly Real GDP growth vs CIEA (% change, y-o-y)



Source: NBR, Monetary Policy Department

The 2019Q1 growth of total turnovers of industry and service sectors emanated from industry sector' sales gaining by 18.3 percent and the services sector's turnovers accelerating by 22.8 percent.

Chart 5- Turnovers of industry & services sectors (% change, y-o-y)



Source: NBR, Monetary Policy Department

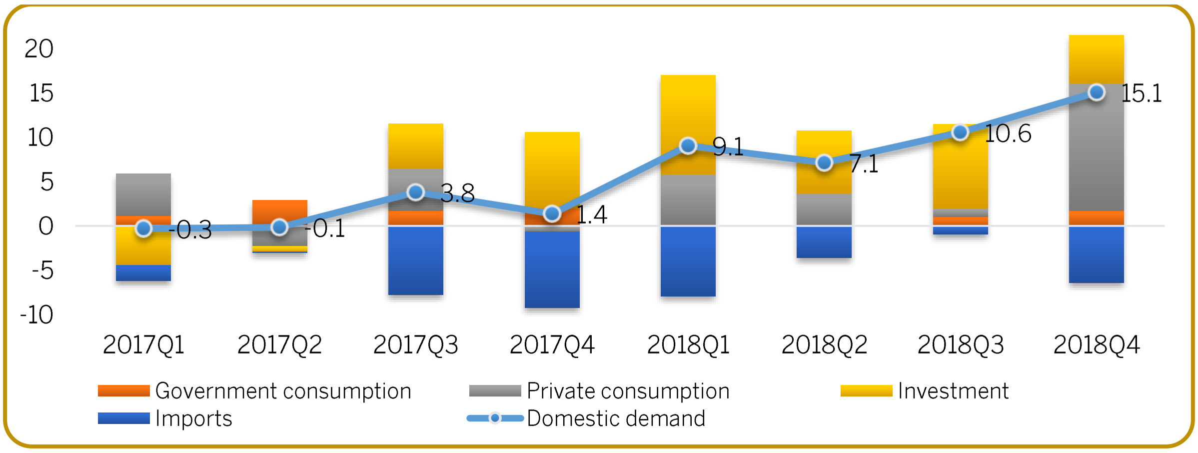
The industry sector's performance was mainly led by booming construction sector, following ongoing infrastructure projects; of which Bugesera airport, Kigali arena stadium and road network upgrade across the country. Manufacturing activities continued to improve in line with construction activities, as indicated by increasing turnovers of metal (+26.2 percent) and cement industries (+36.5 percent). However, manufacturing sector performance was moderate due to subdued activities in milling, tea and coffee industries. Milling industries have adversely been affected by the inadequate and delay in raw materials supply, tea and coffee companies have been weighed down by lower international prices.

The good performance of services sector was led mainly by trade services (+19.9 percent), representing 65.2 percent of total services sector turnovers. Furthermore, the services sector was supported by the developments in air transport reflected in Rwandair business expansion; the improvement in tourism industry and professional, scientific and technical services. The transport and storage sub-sector turnovers increased by 25.5 percent in 2019Q1 against 23.9 percent in 2018Q1 whereas the hotels' turnovers recorded a growth of 11.9 percent from 26.7 percent in the same period. Professional, scientific and technical services' sales accelerated at high rate (+151.5 percent in 2019Q1 vs +28.6 in 2018Q1) supported by the developments in construction sector.

2.1.2 Domestic demand

Domestic demand grew at a higher pace throughout 2018 as compared to 2017, mainly driven by strong investment and improvement in total final consumption.

Chart 6- Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

In 2018, gross capital formation evolved beyond 5 years average (+23.4 percent vs 13.3 percent over past 5 years), mainly supported by the increase in construction investment (+14.1 percent in 2018 from -3.1 percent in 2017). Construction investment, representing 65.7 percent of total investment, increased thanks to the on-going big infrastructure projects. These projects continued to bolster the construction sector in 2019Q1 as reflected in the increase of turnovers of construction companies as well as domestic demand of cement. Construction companies' turnovers increased by 36.4 percent in 2019Q1 from 19.0 percent in 2018Q1, while the domestic demand for cement gained by 27.6 percent after 10.7 percent in the same period.

The total final consumption growth doubled in 2018 from 3.2 percent in 2017 and it increased further in 2019Q1. Government consumption contributed positively to the total final consumption, with a growth of 5.0 and 9.0 percent in 2018Q3 and Q4 respectively, and the recorded fiscal injection indicates that this trend continued in 2019Q1. The net fiscal injection increased to FRW 74.7 billion in 2019Q1 from a net fiscal absorption of FRW 23.5 billion in 2018Q4 signals that private consumption would be supported by spillover effect from rising public consumption and investment.

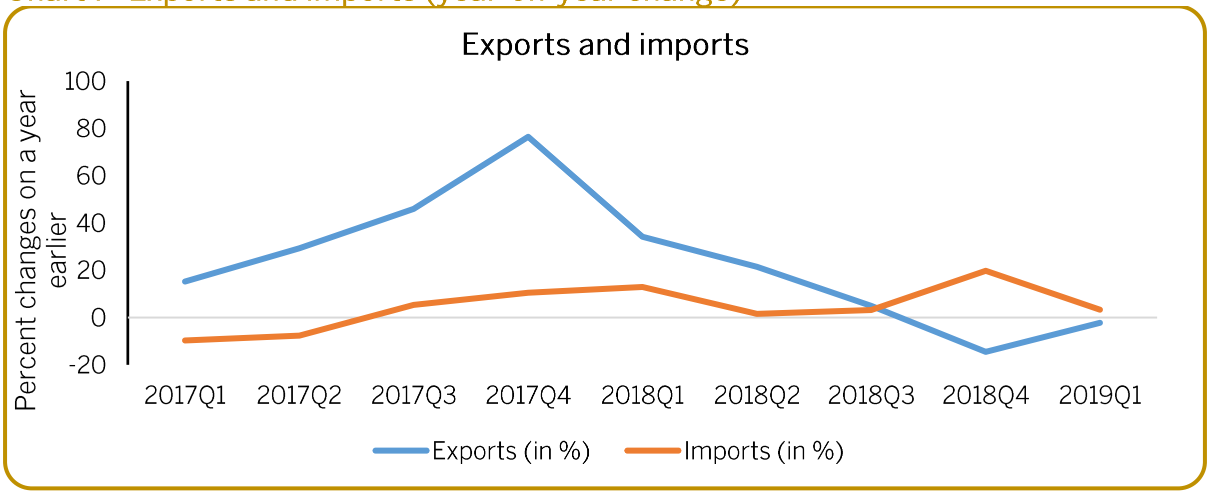
2.2 External Sector Developments

In 2019Q1, trade deficit widened by 7.5 percent compared to the same period of last year, amounting to USD 351.8 million from USD 327.3 million. That reflected increase in imports by 3.2 percent coupled with a fall in exports (-2.2 percent).

The increase in imports is due to increase in domestic demand on intermediate goods, as input in production process in manufacturing sector. Favorable weather conditions throughout 2018 yielded good harvest across the country, which lessened the growth in imports of food products. During 2019Q1, imports of food products went up slightly by 0.4 percent.

On the other hand, falling exports growth is largely explained by higher global supplies of agricultural produce and a softer global demand that weighed on prices of Rwanda's traditional exports mainly coffee, tea and minerals. However, the decline in Rwanda's traditional exports was lessened by continued gains of other exports categories notably the non-traditional exports–mainly composed of manufactured exports and agricultural products with exception of coffee, tea and pyrethrum. In 2019Q1, receipts from non-traditional exports and re-exports went up by 2.3 percent and 6.6 percent, respectively. These developments produced mild pressures on the depreciation of the domestic currency against the dollar. In the first quarter of 2019, Rwandan francs (FRW) depreciated by 1.1 percent against the dollar compared to depreciation of 0.9 percent recorded in 2018Q1.

Chart 7- Exports and imports (year-on-year change)



Source: Statistics Department

In 2019, the current account deficit is expected to widen to 9.6 percent partly due to continued higher imports –supporting the rise of domestic demand– and a lower exports growth due to slowdown in external demand.

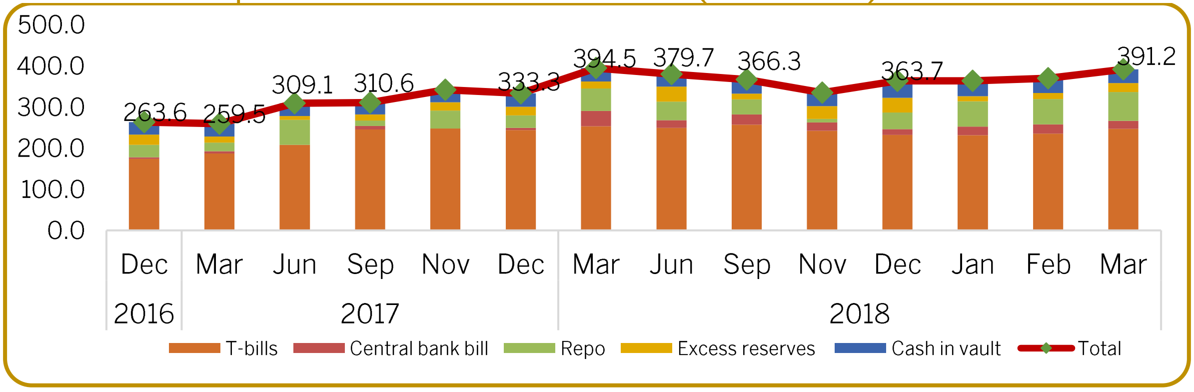
The Rwanda's current account deficit will continue to be financed by steady rise of capital inflows, including foreign direct investment (FDI), external borrowings, tourism receipts and remittances.

III. FINANCIAL AND MONETARY DEVELOPMENTS

3.1 Banking System Liquidity Conditions

Total most liquid assets increased to 7.6 percent, standing at FRW 391.2 billion in March 2019 compared to FRW 363.7 billion in December 2018, reflecting good liquidity conditions in banking system in 2019Q1. This increase was mainly attributed to the expansionary fiscal policy during the period under review, as the net credit to government increased by 29.1 percent. However, banks purchased more foreign currency from NBR, amounting to USD 74.0 million (equivalent to FRW 65.5 billion) in 2019Q1, against USD 50.9 million (equivalent to FRW 43.2 billion) in 2018Q1 indicating a slight contraction in liquidity conditions by 0.8 percent.

Chart 8- Most liquid assets of commercial banks (FRW billion)



Source: NBR, Financial Markets Department

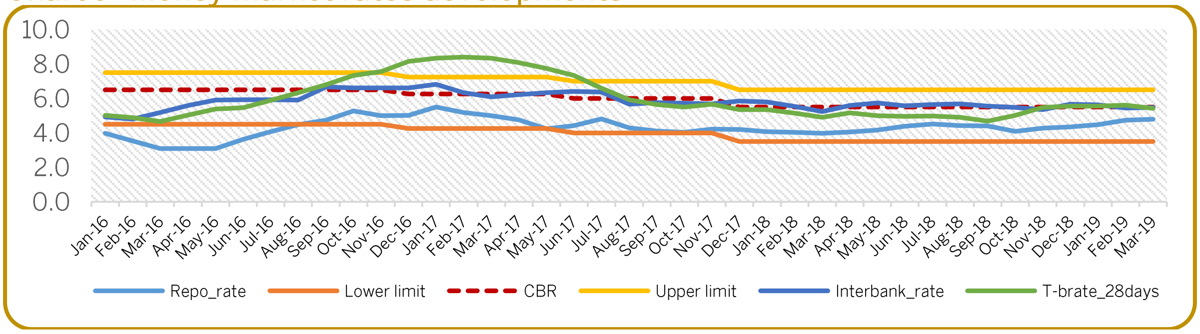
3.2 Monetary Policy and Interest Rates

After cutting its monetary policy rate from 6.0 percent to 5.5 percent in December 2017, the central bank rate (CBR) was kept unchanged till May 2019 MPC meeting. Thus, nominal interest rates continued to move gradually around the CBR.

Money market rates converged towards the CBR.

Money market interest rates remained stable, and around the central bank rate. Interbank rate stood at 5.52 percent on average in 2019Q1, compared to 5.53 percent during the same quarter of last year. The repo rate increased to 4.86 percent on average from 4.03 percent, as the central bank had to deal with a huge liquidity from fiscal expansion during the 2019Q1. Therefore, the T-bills rate registered a temporary upward trend, standing at 5.53 percent from 5.14 percent on average.

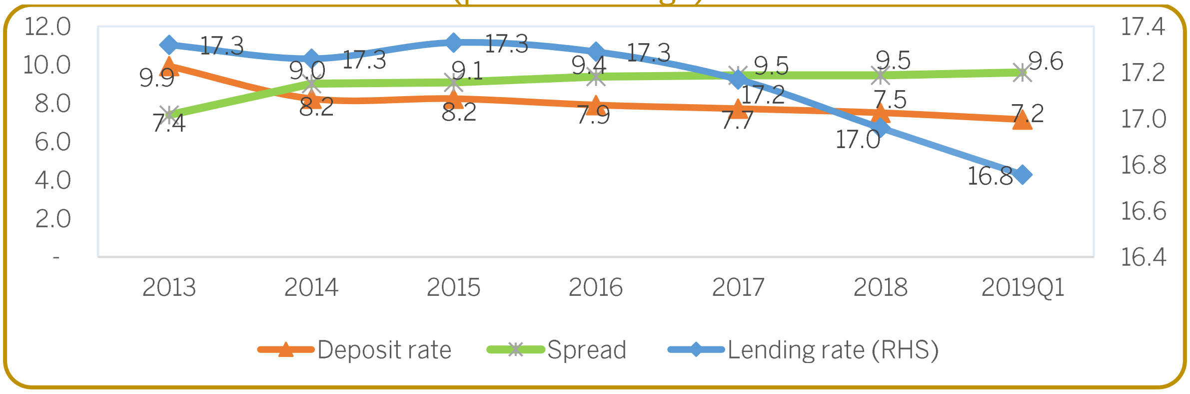
Chart 9- Money market rates developments



Source: NBR, Financial Markets Department

Following an improving transmission mechanism, the decline in the money market rates was therefore transferred into lower market rates. Deposit rate declined by 69 basis points, decreasing to 7.15 percent on average in 2019Q1, from 7.84 percent in 2018Q1. Similarly, lending rate declined by 29 basis points, to 16.76 percent from 17.05 percent during the same period.

Chart 10- Market interest rates (percent average)

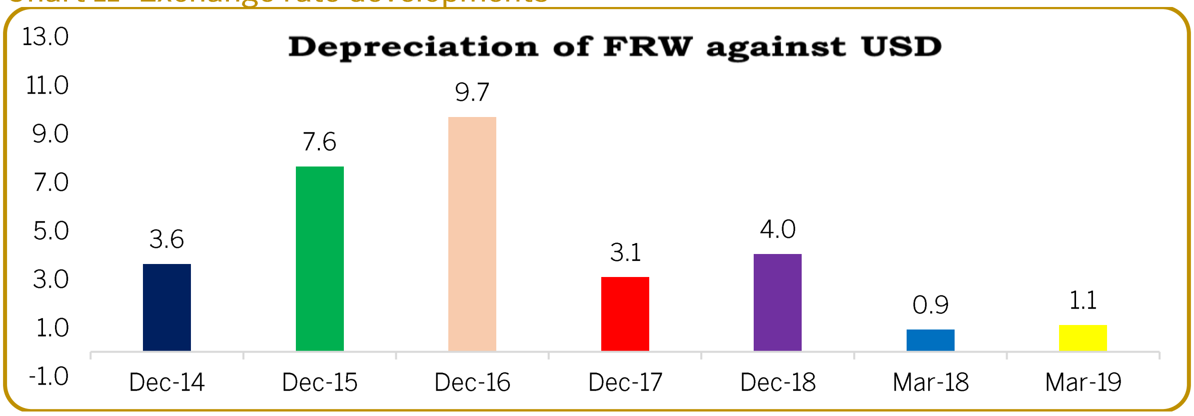


Source: Financial Markets Department

3.3 Exchange Rate Developments

Relative to December 2018, the FRW depreciated against the USD by 1.1 percent end March 2019, slightly higher than 0.9 percent in March 2018. The depreciation was due to low exports earnings and relatively high import bill from ongoing infrastructure projects. This depreciation was moderate and consistent with initial projection of 5.0 percent for the whole year 2019, higher that 4.0 percent recorded in 2018.

Chart 11- Exchange rate developments

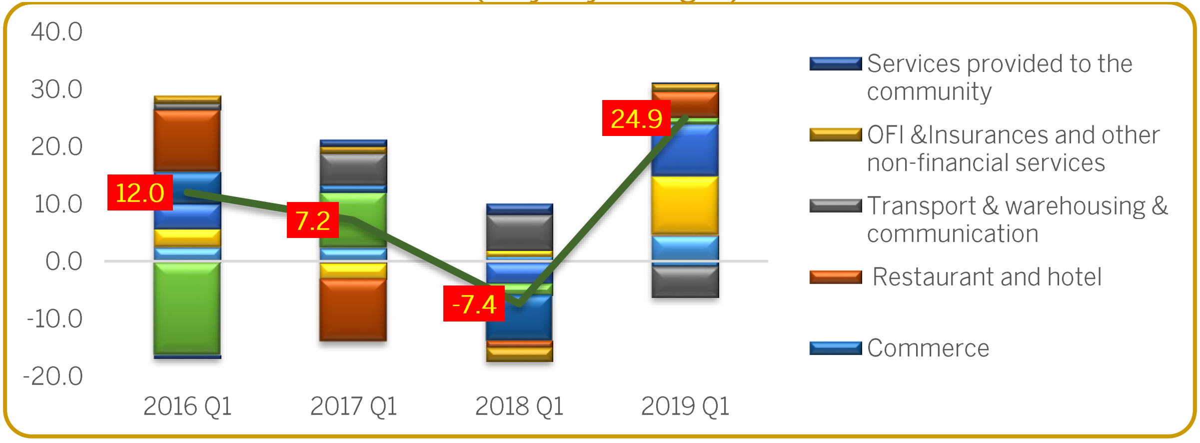


Source: Monetary Policy Department

3.4 Credit

The outstanding credit to the private sector picked up by 3.8 percent in the first quarter of 2019, compared to a decline of 1.0 percent in the same period of 2018, on account of increased new authorized loans (NALs). The annual growth rate of NALs was 24.9 percent (y-o-y) in 2019Q1, due to an increase in demand for loans (17.6 percent) and a reduction in loan's rejection rate (16.7 percent from 21.5 percent). This growth is mainly reflected in the Manufacturing, Restaurants & Hotels, and Water & Energy sectors.

Chart 12- Contributions of sectors of activity to the growth of new authorized loans (%, y-o-y changes)

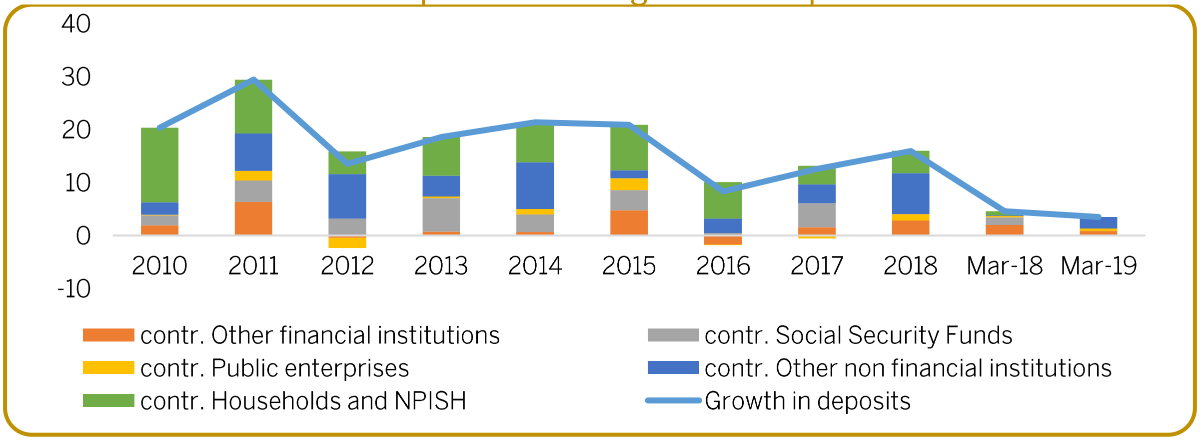


Source: NBR, Financial Stability Directorate

3.5 Money

In 2019Q1, M3 growth rose to 13.9 percent (y-o-y). The demand deposits remain the biggest contributor to M3 growth. Turning to the depositors' breakdown, the biggest contribution came from other non-financial corporations, whose rate of growth increased, reaching 7.4 percent. Growth in deposits of other financial corporation also accelerated to stand at 9.0 percent.

Chart 13- Contributions of Depositors in the growth of deposits

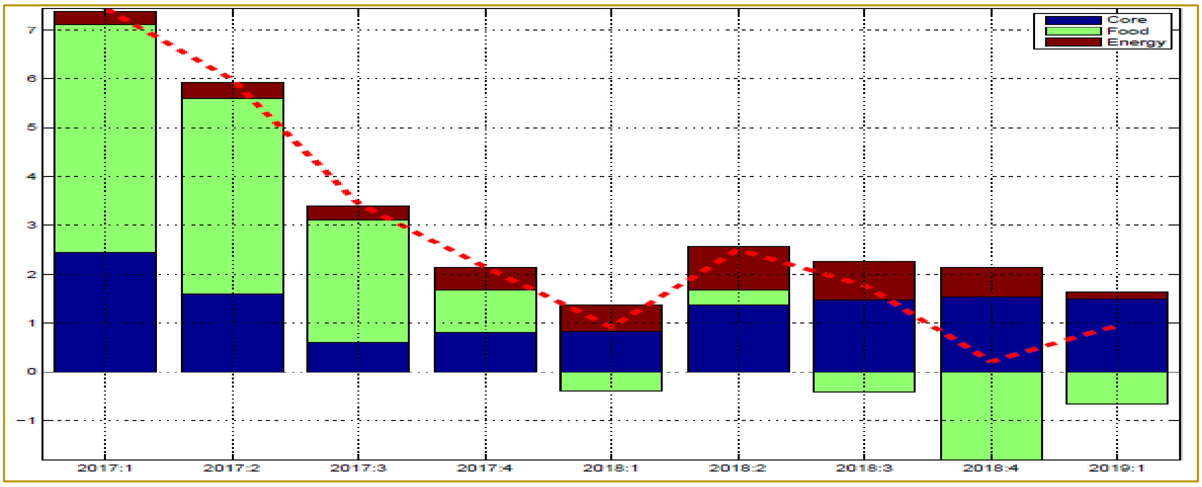


Source: NBR, Statistics Department

IV. INFLATION DEVELOPMENTS AND OUTLOOK

Annual headline inflation increased to 1.0 percent in 2019Q1 from 0.2 percent in 2018Q4, following an ease in food deflation, that outweighed a drop in energy inflation. Core inflation slightly picked up to 1.6 percent in 2019Q1 from 1.4 percent in 2018Q4. Consistent with previous forecasts, inflation is projected to increase towards 3.0 percent in 2019 on average.

Chart 14- Inflation developments (headline[1], core, food and energy)



Source: NBR, Research Department

4.1 Drivers of Inflation

4.1.1 Energy Prices

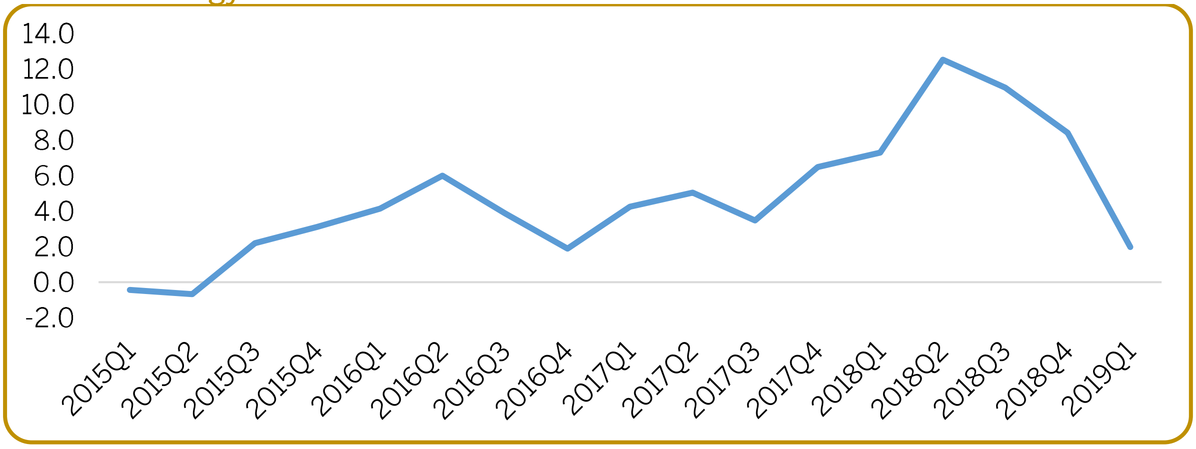
Energy covered in CPI basket consists of imported liquid fuels and locally produced solid fuels. Imported energy includes oil, gas, and diesel, fuel for generator, petrol, and vehicle lubricants. The fluctuations of energy prices on the international market are reflected in the prices of the highlighted items on the domestic market. Since 2018Q3, the trend in global oil prices pushed down energy inflation.

Starting in January 2019, global oil prices resurged; and the local pump prices were revised up from 1013 FRW to 1096 FRW and from 1039 FRW to 1091 FRW per litter on gasoline and diesel respectively, effective from 4 May 2019. This implies that the upward revision of local pump prices may have a direct effect on headline inflation for 2019Q2 and will be reflected in energy and transport inflation.

In 2019Q1, the prices of locally produced energy components that include charcoals and firewood decelerated to 3.4 percent from 10.6 percent in 2018Q4, due to the increase in forest extraction permits issuance. The market expectation survey conducted on energy prices in April 2019 indicated that prices of charcoal and firewood are expected to slightly increase in 2019Q2 due to the rainy season, despite the increase in extraction permits.

[1] Headline: Y-o-Y headline inflation is shown in the dashed points with red color on the chart

Chart 15- Energy Inflation

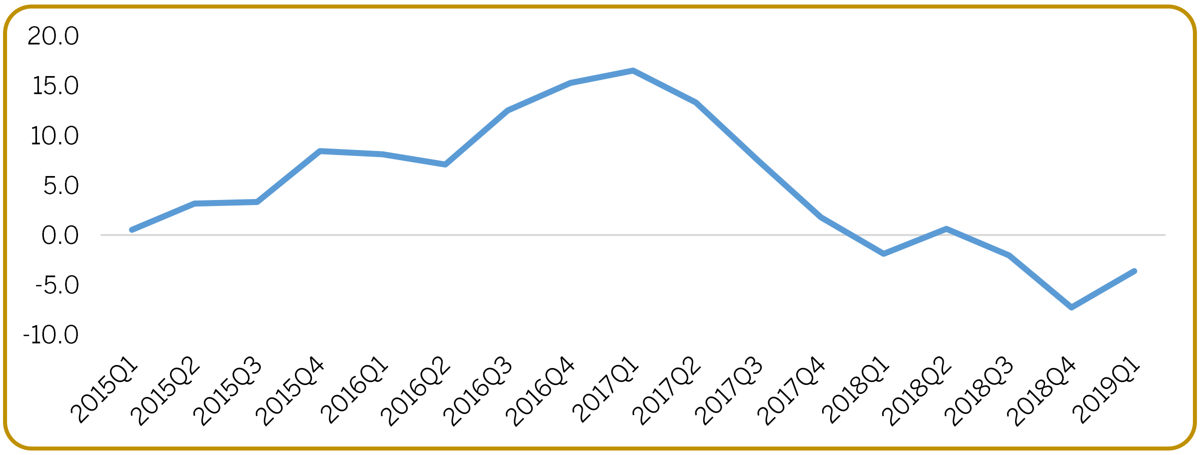


Source: NBR, Research Department

4.1.2 Food Prices

Since 2018Q1, food inflation remains negative on the back of good agricultural production. In 2019Q1, negative inflation continued though it eased from -7.3% in 2018Q4 to -3.6% driven by the reduction in supply of vegetables, fruits, bread and cereals that was recorded in March 2019. The findings from market expectations survey showed that food prices are expected to slight increase in the next quarter, however, negative inflation might continue till May 2019.

Chart 16- Food inflation

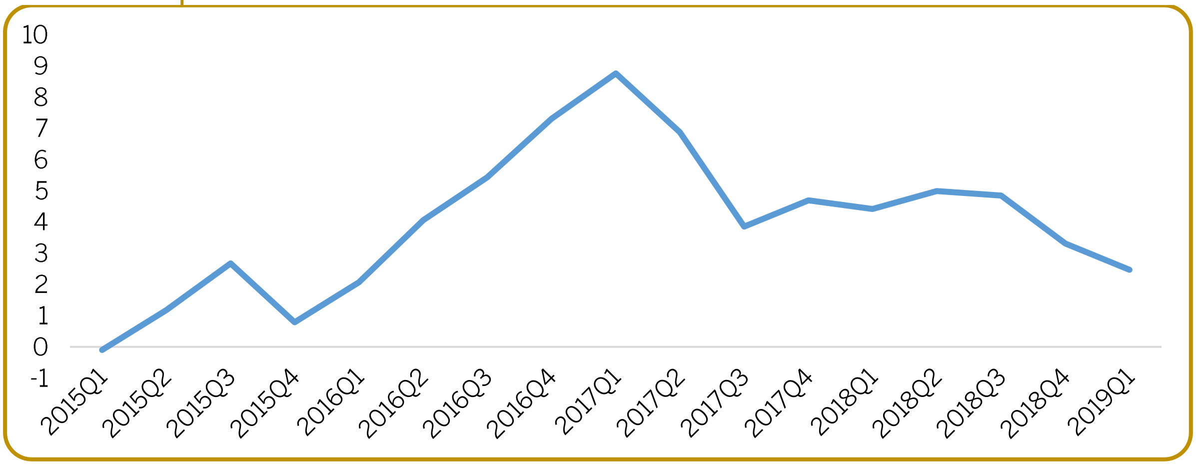


Source: NBR, Research Department

4.1.3 Imported Prices

Imported inflation eased from 3.3% in 2018Q4 to 2.5% in 2019Q1 with the main contributors being the aforementioned decline in global oil prices as well as imported food prices. Prices of food products imported from the EAC region dropped as neighboring countries recorded good agricultural production, following favorable weather conditions. In April 2019, food prices have started to pick up in the region and some EAC countries expect droughts in the second half of 2019. This may create some upward pressures on imported food prices.

Chart 17- Imported inflation



Source: NBR, Research Department

4.1.4 Domestic Demand

The composite index of economic activities indicates that the good performance in economic growth recorded in 2018Q4 is expected to continue in 2019Q1. If the current pace in economic growth is maintained in next quarters, it will further strength domestic demand and create some inflationary pressures.

4.1.5 Inflation Expectations

The National Bank of Rwanda (NBR) carries out surveys on price-setting behavior and expectations of Rwandan firms and on prices of locally produced food. The surveys carried out in April 2019 revealed that about 73 percent of the companies raised the prices, while 26 percent did not. Firms indicated that prices are expected to remain stable in 2019Q2.

The food prices expectations survey and other information from the Agricultural Forecasting Group revealed that season B 2018 rainfall was above normal and resulted in floods. Season B 2019 rainfall is projected to be normal in all parts of the country, except in the eastern region. These results suggested that food prices might slight increase in 2019Q2.

4.2 Inflation Outlook

4.2.1 Assumptions and Risks

Assumption 1: Domestic aggregate demand is rising

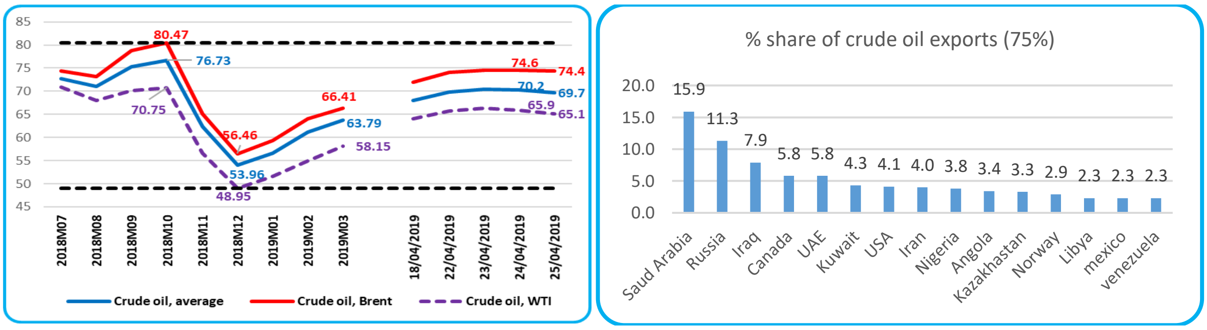
The GDP growth picked momentum in 2018 and is expected to remain high in 2019Q1, thrusting domestic demand upwards. The current trend in domestic demand reflects a positive fiscal impulse in the last two quarters in support of the accommodative monetary policy implemented since 2017Q4. The buoyant economic activity may continue for the whole 2019, reflecting the good performance in the credit market since 2019Q1. Interest rates remain stable and the demand for loans is expected to continue growing in 2019Q2. The increase in loans is likely to be reflected in consumer loans, loans in manufacturing, hotels and energy sectors. The fiscal spending is projected to be higher in 2019, supporting the economic activities more.

Assumption 2: Global oil prices continue to reflect geo-political tensions and will have an effect on local pump prices

The decline in global oil prices in December and November 2018 entailed a reduction in domestic prices in January 2019. However, the recent raise in local pump prices came from the re-surge in global oil prices since January 2019.

In 2018Q4 and 2019Q1, World Bank and IMF respectively projected a reduction in global oil prices for 2019 compared to 2018. In April 2019, they revised the projections upwards but maintained lower prices compared to 2018. The recent geo-political developments between US and Iran brought about some risks to the initial projections. US put sanctions on Iranian oil with a waiver for some importing countries. Iran contributes only 4% of crude oil exports, and 3/8 Iranian oil importers exploiting alternative markets, however, five countries have requested extension of the waiver. Saudi Arabia is likely to increase production to cover any eventual shortage. Since the recent increase in global oil prices has already been incorporated in domestic prices, it is unlikely to have a persistent increase for the rest of 2019.

Chart 18- Global oil Prices



Source: NBR, Monetary Policy Department

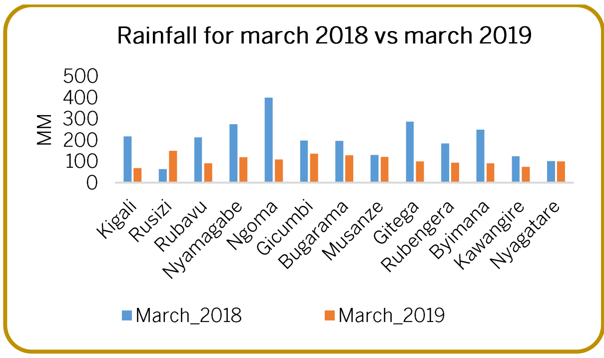
Assumption 3: External trade and exchange rate may support CPI inflation

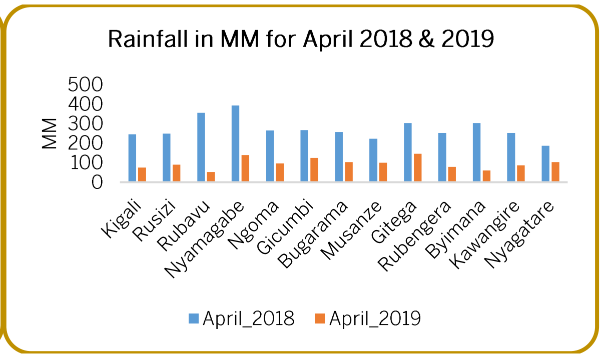
The trade deficit is projected to widen in 2019. The import bill will increase because of the planned big projects such as Bugesera Airport that necessitate big amount of foreign currency to import. In addition, the export sector may not perform well due to downward trends in international commodity prices (including coffee prices). Besides, the recovery in new authorized loans is likely to lead to high demand for foreign currency. Therefore, the FRW is likely to depreciate to around 5.0% by end of 2019, which might create inflationary pressures through imported prices.

Assumption 4: The performance of agriculture in Season B 2019 will have an effect on food prices

According to the Rwanda Meteorology Agency, season B 2019 recorded lower rainfall, compared to same period in 2018. In fact, season B 2018 rainfall was above normal and resulted in floods. However, season B 2019 rainfall was normal, except in the eastern region. This might result in a reduction in food supply in East in the second half of 2019 and subsequently cause a hike in food prices. The survey conducted by NBR staff on food prices expectations in April 2019, indicates that food prices might rise between June and August 2019.

Chart 19- Rainfall





Source: Meteo Rwanda

4.2.2 Projections for Inflation in 2019

Judgements based on the mentioned assumptions and risks and conditioned on the path of the Central Bank Rate (CBR), the Monetary Policy Committee of NBR estimates the May projections to be broadly in line with the last projections of February 2019. The MPC expects fiscal policy expansion to back the growth in domestic demand. Corollary, the MPC projects inflation to rise around 3.0% in 2019 on average, which will be supported by the decision to reduce the CBR to 5% and the depreciation of the FRW that is projected to reach 5.0% by end December 2019.

Chart 8- Inflation forecasts