



National Bank of Rwanda

QUARTERLY INFLATION REPORT



WP02/2015Q2

Kigali, August 2015

LIST OF ACCRONYMS

IMF	International Monetary Fund
OECD	Organization for Economic Co-operation and Development
EIU	Economists Intelligence Unit
WEO	World Economic Outlook
WB	World Bank

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EXECUTIVE SUMMARY

The quarterly Inflation report presents the National Bank of Rwanda's assessment of the current and future macroeconomic developments influencing inflation. The inflation forecasts are one of the inputs to the Monetary Policy Committee decision making process.

The Rwandan economy has gained momentum in 2015, with real GDP growing by 7.6% y-o-y in 2015Q1 after 6.5% of 2014Q4 and 7.5% of 2014Q1. Following the BNR accommodative monetary policy, domestic demand increased from 3% in 2014Q4 to 6% in 2015Q1 helping to offset the contraction in external demand. All sectors of the economy performed fairly well, notably the subsectors of construction and manufacturing whereas the mining sub-sector contracted. Generally, the economy continued with its growth trajectory in 2015Q2 albeit at a slow pace as indicated by the trend of the composite index of economic activities, turnovers for the services and industry sector as well as credit to the private sector .

The current macroeconomic environment is characterized by the low level of inflation, the decline in international commodity prices, good agricultural harvests, weak aggregate demand as well as the emerging exchange rate, resulting from the strengthening of the US dollar and amplified by the pressures from the already existing structural problem of a persistent trade deficit. Despite edging up in May and June 2015, on the back of rising food inflation, headline inflation stood at 2.8% in June 2015 as had been projected in the inflation report for 2015Q1.

The main risks to watch in the coming months are exchange rate developments and the performance of the agriculture sector. However, the already existing good coordination between fiscal and monetary policies will continue to keep inflationary pressures under control. In view of the above mentioned developments and risks, inflation is projected to stand at around 2.6% in 2015Q3 while the forecast for 2015Q4 remain unchanged at 3.5%.

ACKNOWLEDGEMENTS

A team from the Monetary Policy & Research Department, spearheaded by the Modeling and forecasting division, prepared the 2015Q2 inflation report with notable contribution from Mr. Mathias KARANGWA (Manager, Modeling & forecasting division) & Mr. MWENESE Bruno (Senior Economist, Modeling & forecasting division) whereas Prof. Kasai NDAHIRIWE (Director, Monetary policy and Research Department) and Prof. Thomas Kigabo RUSUHUZWA (Chief Economist and DG-Monetary Policy Directorate) edited and reviewed the report. Other contributors include Mr. NUWAGIRA Wilberforce (Manager, Balance of payments division) and Mr. Ananias GICHONDO (Manager, Economic Research and Financial Stability Analysis division).

1. EXTERNAL ENVIRONMENT

1.1. Global economic activities

The global economic growth was revised down in July 2015 to 3.3% from 3.5% following the poor performance in 2015Q1 mainly caused by a bad winter in North America and an increase in oil prices in 2015Q2. However, the world economy is expected to get back on track soon as the main drivers of growth still show positive sign in advanced countries. As initially projected, emerging markets and developing economies continue to record decelerated growth mainly on the back of contraction in financing conditions and low commodity prices.

Table 1: Economic growth developments (in %)

	Quarterly(SAAR) ¹						Annual	
	2014				2015		2014	2015 Jul Proj.
	Q1	Q2	Q3	Q4	Q1	Q2		
World (YoY)	1.9	2.4	2.8	2.3	1.4	2.7	3.4	3.3
USA (QoQ)	-2.1	4.6	4.3	2.1	0.6	2.3	2.4	2.5
Euro area (YoY)	1.1	0.8	0.8	0.9	1.0	1.2	0.8	1.5
Japan (QoQ)	4.9	-6.8	-2.0	1.4	4.5	-1.6	-0.1	0.8
UK (YoY)	2.7	3.0	3.0	3.4	2.9	2.6	2.9	2.4
China (YoY)	7.4	7.5	7.3	7.3	7.0	7.0	7.4	6.8
India (YoY)	4.6	6.7	8.4	6.6	7.5	7.5	7.3	7.5

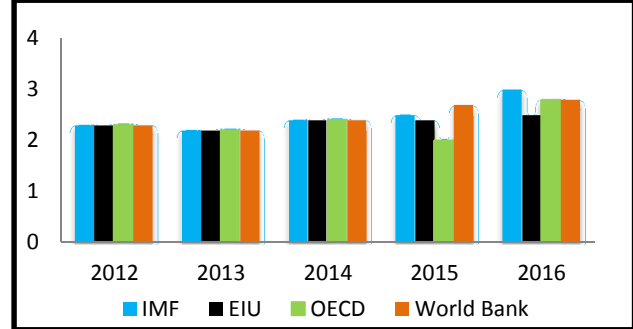
Source: BLOOMBERG & IMF, World economic Outlook, 2015.

The U.S economy is expected to grow by 2.5% in 2015, below the April projection of 3.1%, due to the shortfall in 2015Q1. After slowing to 0.6% in 2015Q1, the U.S economic growth is estimated to rebound to 2.3% in 2015Q2 following the expected decline in the unemployment rate to 5.5% in 2015 from 6.2%

¹ SAAR is “Seasonally Adjusted Annualized Rate”

in 2014, which will continue to support consumption and investment.

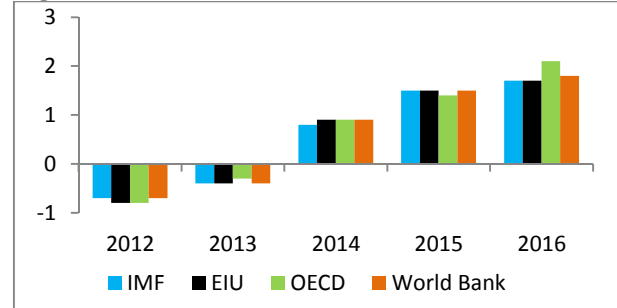
Figure 1: Growth forecasts for the US (% YoY)



Source: IMF, OECD & EIU, WB (July. 2015)

The Euro zone economic growth is still maintained at 1.5% for 2015 mainly because of strengthening domestic demand and an uptick in inflation. The increase in demand was supported by improving financial conditions, accommodative fiscal policy, lower oil prices and increased net exports due to the depreciating Euro. In Japan, despite stronger than expected growth recorded in 2015Q1, the growth outlook remains modest for 2015 mainly because consumption is still weak.

Figure 2: Growth forecasts for the Eurozone (% Y-O-Y)

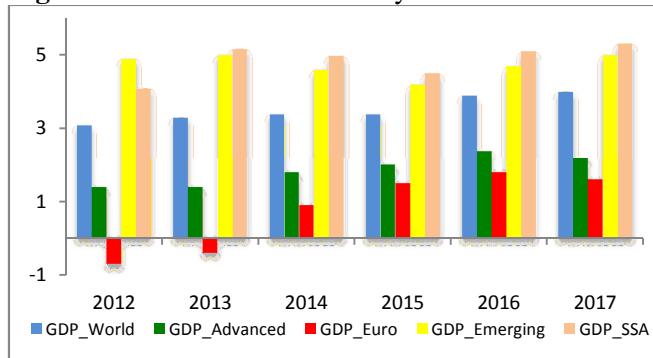


Source: IMF, OECD & EIU, WB (July 2015)

Structural problems and falling international commodity prices continue to weigh on the economic growth of emerging markets and developing economies since 2014 until 2015 but a rebound is expected in 2016.

The growth in these economies is projected to drop from 4.6% in 2014 to 4.2% in 2015 dominated by the Chinese economy which stagnated at 7% in 2015Q1 and Q2 whereas the Brazilian economy shrank by -0.2% in 2015Q1, but it is expected to expand by 0.34% in 2015Q2.

Figure 3: Growth outlook for key economies



Source: IMF & World Bank (July, 2015)

The global economic growth is expected to be lower in 2015 owing to the impact of the weaker first-quarter growth in advanced economies. The global economic growth outlook for 2016 is still maintained at the same level, with growth projections of 3.8%. To achieve this growth, it is argued that monetary policies need to be accommodative in a majority of countries. In addition, economies need to strike a balance between fiscal consolidation and less restrictive fiscal policies meant to boost long run growth. The global economic growth will still be influenced by oil prices movements, volatility in financial markets, global inflation developments, the US dollar appreciation, consumption and policy effectiveness.

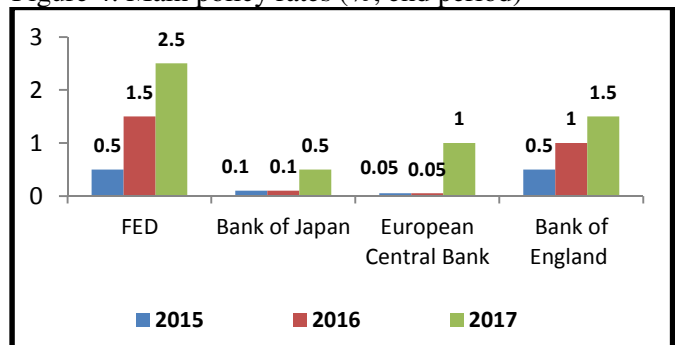
1.2. Monetary policy and international financial markets

Monetary policies are expected to remain accommodative in many economies to support economic growth and bring inflation to medium term targets.

The U.S Federal Reserve has kept the interest rate at 0.25%; the Fed is likely to raise interest rate towards the end of this year. This decision is supported by the IMF, which advised the FED in July 2015 to wait for clear signs on wage and inflation, and sufficiently strong economic growth before initiating an interest rate increase.

The EU refinancing rate will remain unchanged throughout 2015 and the quantitative easing program is planned to continue even in 2016. In China, recent developments and the outlook made the People’s Bank of China to revise down the benchmark interest rate to a record of 4.85% and to reduce the required reserve ratio by 50 basis points in June 2015.

Figure 4: Main policy rates (% , end period)



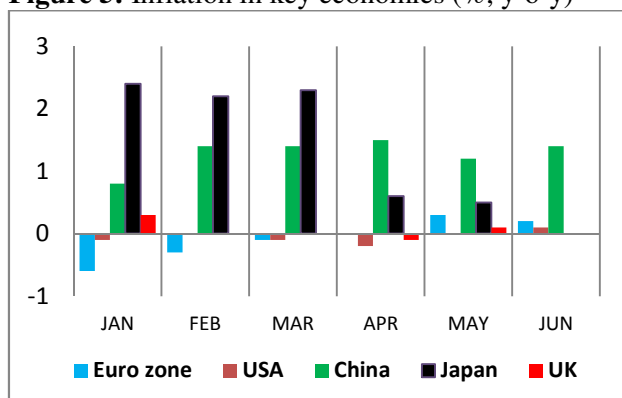
Source: EIU (July 15th 2015)

1.3. Global inflation developments and outlook

In 2015Q2, inflation remained well below target levels in most economies. It has started to rise from negative numbers in advanced economies while it declined in many emerging markets notably because of weak demand.

In the Euro area, inflation increased to 0.2% year-on-year in June from -0.1% in March 2015. For the first time since January 2015, CPI inflation in the U.S increased above 0.0% to 0.1% in June. The increase mainly came as a result of the uptick in the cost of shelter and food despite a drop in energy prices.

Figure 5: Inflation in key economies (% , y-o-y)



Source: <http://www.tradingeconomics.com>, 2015

Inflation rates continue to increase in EAC countries, with headline inflation standing at 7.0% in Kenya, 6.1% in Tanzania, and 7.7% in Burundi but remaining flat in Uganda at 4.9% in June 2015.

Table 2: Inflation in EAC countries (% , YoY)

	RWANDA	UGANDA	KENYA	TANZANIA	BURUNDI
Jul-14	1.9	4.3	7.7	6.5	3.1
Aug-14	0.9	2.8	8.4	6.7	5.9
Sep-14	0.2	1.4	6.6	6.6	5.5
Oct-14	0.5	1.8	6.4	5.9	3.5
Nov-14	0.7	2.1	6.1	5.8	4.2
Dec-14	2.1	1.8	6.0	4.8	3.7
Jan-15	1.4	1.3	5.5	4.0	3.5
Feb-15	0.7	1.4	5.6	4.2	1.2
Mar-15	0.8	1.9	6.3	4.3	4.7
Apr-15	0.9	3.6	7.1	4.5	7.5
May-15	2.2	4.9	6.9	5.3	7.2
June-15	2.8	4.9	7.0	6.1	7.7

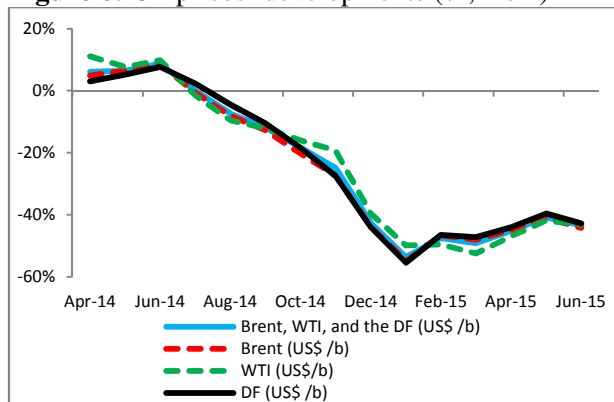
Source: Country Bureaus of Statistics

1.4. International commodity prices

Commodity prices fell by 1.6% in June, the first decline in three months, driven by the fall in prices of metals and energy following macroeconomic risks in Greece and China. Agricultural prices registered a slight increase. In the Dec 2014–June 2015 period, commodity prices fell by 5.8%, with declines recorded in all main indices, led by 10% drops in both metals and food.

Crude oil prices fell by 1.9% in June, averaging \$61.3/bbl and reversing gains from the previous months, due to strong OPEC production and possible suspension of sanctions against Iran. Global growth in oil consumption had somewhat increased in response to the cold winter; however, relatively low prices have so far stimulated consumption very modestly. Following these developments, the spot crude oil price is projected to decrease to around 56\$/bbl in 2015Q3.

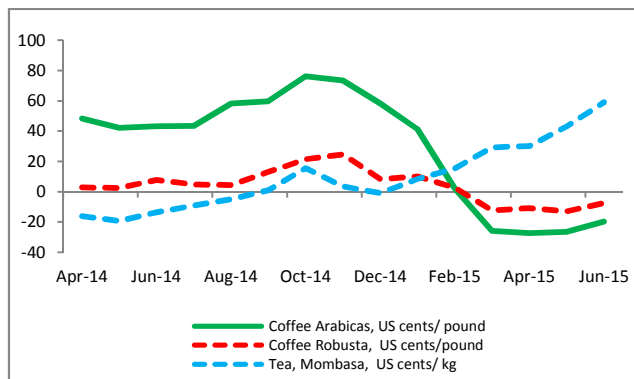
Figure 6: Oil prices' developments (% YoY)



Source: IMF, WEO (Database, July 2015)

Agriculture prices increased by 0.1% in June, the first gain in seven months, mainly reflecting supply constraints. The largest increase was for tea prices, which rose by 13% and to the highest level in over 2 years, due to lower production in Kenya as a result of a dry weather. Tea prices are expected to go up in 2015Q3 by 3.4% while coffee prices are projected to decline by 13.65% and 16% for other Milds Arabica and Robusta respectively during the same period.

Figure 7: Non-oil prices developments (% YoY)



Source: IMF, WEO (Database, July 2015)

2. THE DOMESTIC ECONOMY

2.1. Domestic demand and output

The Rwandan economy has gained momentum in 2015, with real GDP growing by 7.6% y-o-y in 2015Q1 after 6.5% of 2014Q4 and 7.5% of 2014Q1. This high growth implies that the

Government of Rwanda's projected real GDP growth rate of 6.5% in 2015 will be attained or even surpassed as already projected by the World Bank², which forecasted real GDP growth rate for 2015 to stand at 7.5%.

Growth in 2015Q1 was mainly driven by the services and industry sectors as well as the notable contribution from taxes less subsidies resulting from a combination of measures taken by the government of Rwanda to increase domestic tax revenue collections while at the same time prioritizing public expenditure by for example minimizing subsidies to some institutions of public interest. As a result, taxes less subsidies increased by 22%, the highest since 2008Q4.

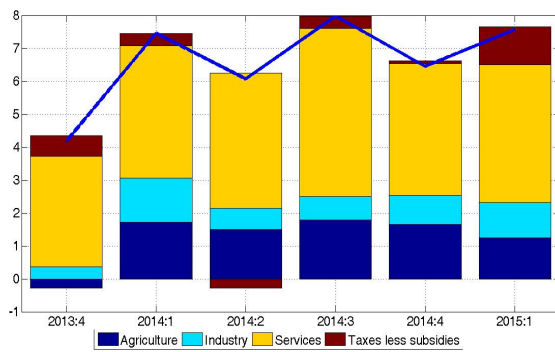
The services sector stagnated at 8% in both 2014Q4 and 2015Q1 compared to 9% in 2014Q1, though it remains the main driver of growth given its big share in real GDP. The stagnant performance of the services sector in 2015Q1 was mainly due to the slowdown in trade services, counterbalanced by the big increase in other services.

Trade services slowed to 6% in 2015Q1 compared to 9% of the previous quarter and 11% of 2014Q1. The weak performance of retail and wholesale trade as well as of transport services was responsible for this slowdown. Other services grew by 10% in 2015Q1 from 8% and 7% in 2014Q4 and 2014Q1 respectively. The good performance in other services was bolstered

² See the World Bank's Rwanda Economic Update-edition n°. 7 of February 2015

by the improvements in the subsectors of information and communication, financial services, public administration, administrative and support service activities and to a less extent by real estate activities.

Figure 8: Real GDP by Sector (% y-o-y)



Source: BNR, Monetary Policy & Research Department (2015)

Despite the contractionary effects from the mining sector, the industry sector expanded in 2015Q1, thanks to the good performance of the construction and manufacturing sub-sectors. Given the ongoing drop in international commodity prices, the mining sector contracted by -12% in 2015Q1 after growing by 1% during the previous quarter and by 20% in 2014Q1.

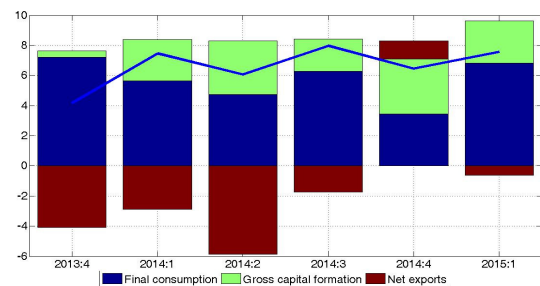
The manufacturing sector registered robust growth, reaching 8% in 2015Q1 after a contraction of -2% in 2014Q4 and growth of 7% in 2014Q1. Despite slowing to 11% in 2015Q1 relative to 12% in 2014Q4, growth in the construction subsector remained well above 8% registered in 2014Q1.

From the expenditure side, Real GDP growth in 2015Q1 was mainly supported by the rise in domestic demand despite contractionary effects from external demand. Though gross capital formation slowed to 8% in 2015Q1 from 11% of the previous quarter, total domestic demand

increased on the back of the expansion in total final consumption from 3% to 6% during the same period. The increase in total final consumption expenditure, dominated by household consumption expenditure, was supported by the ongoing accommodative monetary policy pursued by BNR.

Unlike in 2014Q4, external demand exerted downwards pressures on real GDP growth in 2015Q1 due to the widening of the trade deficit following higher growth in the import bill that outpaced the growth in export receipts.

Figure 9: Real GDP by expenditure (% y-o-y)



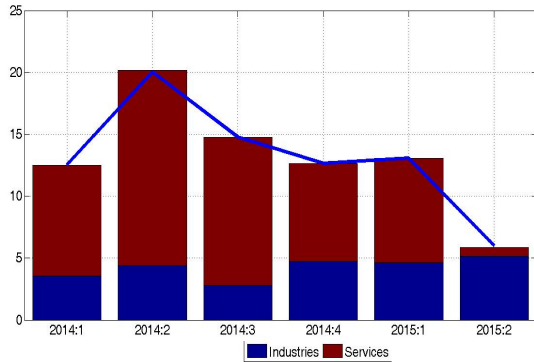
Source: BNR, Monetary Policy & Research Department (2015)

The Rwandan economy continued to perform well in 2015Q2 as indicated by high frequency indicators of economic activities. However, due to the base effect that negatively affected the sales for posts and telecommunication as well as the price effect that dragged down the sales for the petroleum companies, total turnovers for 2015Q2 misleadingly suggest that the economy slowed down, pushed to the downside by the decline in the services' sector turnovers.

The services' sector turnovers grew by a paltry 1.1% in 2015Q2 from 11.6% of the previous quarter, dragged downwards by falling sales for

petroleum companies as well as for posts and telecommunications.

Figure 10: Contribution to total turnovers

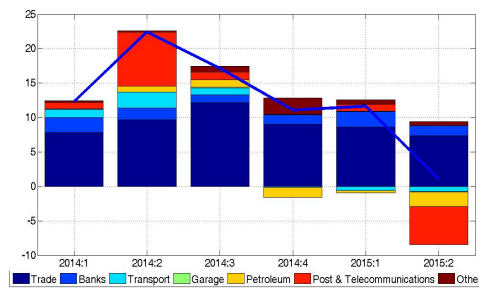


Source: BNR, Monetary Policy & Research Department (2015)

The turnovers for petroleum companies, which contracted for the last three quarters, significantly plummeted by -10.9% in 2015Q2 from -1.6% in 2015Q1 and -6.7% in 2014Q4, respectively. This decline was fueled by the observed fall in international oil prices, especially towards the end of 2014, that led to a number of cuts in local pump prices.

Sales for posts and telecommunications in 2015Q2 shrank by -43.5% from growth of 13.3% in 2014Q4 and 101.1% in 2014Q2, due to the base effect given that these sales during the reference period (2014Q2) were hiked by the big jump in MTN RWANDACELL SARL sales, which grew by 158%, influenced by the sale of MTN towers to IHS Holdings.

Figure 11: Services' turnovers



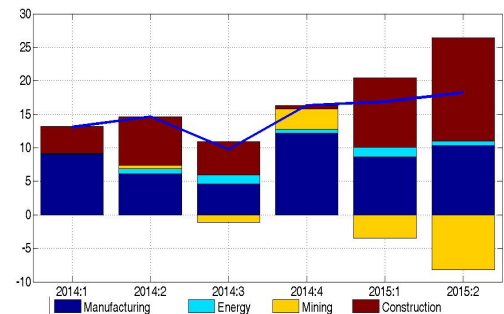
Source: BNR, Monetary Policy & Research Department (2015)

The big decline in the mining sub-sector and the small drop in the sales for the energy sector did not deter the industry sector from performing well in 2015Q2, following the sizable increase in sales for the construction sector and the uptick in manufacturing turnovers.

The slowdown in the sales for the mining sector accelerated in 2015Q2, with the contraction in sales reaching -48.5% from -24.2% of the previous quarter after a growth of 3.1% in 2014Q2. The mining sector's turnovers were also affected by the decline in international commodity prices. Sales for the energy sector marginally dropped, growing by 7.5% in 2015Q2 compared to 9.1% of the corresponding period in 2014.

On the upside, the construction sector turnovers significantly increased, growing by 52.3% in 2015Q2 after 39.8% in 2015Q1 and 27.2% in 2014Q2. The manufacturing sector also registered positive growth, standing at 23.1% in 2015Q2, compared to 16.9% of the previous quarter, and 13.1% of the corresponding period in 2014.

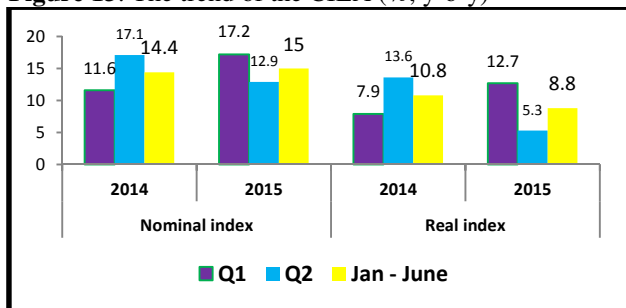
Figure 12: Industry turnovers



Source: BNR, Monetary Policy & Research Department (2015)

The composite index of economic activities (CIEA) also indicates continued growth in 2015Q2, though at a lower pace. The CIEA rose by 15% in nominal terms in the first half of 2015 compared to 14.4% of the corresponding period in 2014 whereas the real CIEA growth slow-paced to 8.8% from 10.8% during the same period in 2014.

Figure 13: The trend of the CIEA (% , y-o-y)



Source: BNR Monetary Policy & Research Department (2015)

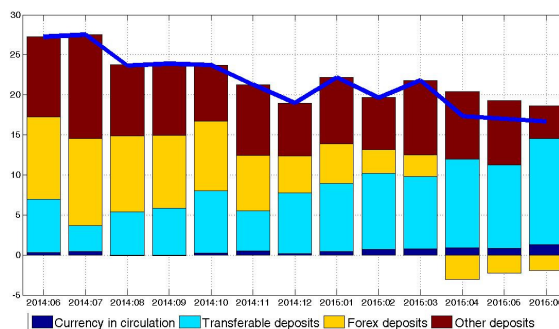
Economic growth in the first half of 2015 was propelled by the BNR accommodative monetary policy adopted since June 2013, resulting into sizable growth in economic financing. Compared to December 2014, outstanding credit to the private grew steadily from 9.8% in March to 11.4%, 13.6% and 15.1% in April, May and June 2015, respectively. By the same token, broad money (M3) progressively increased by 4.2%, 8.4%, 11.1% and 16.7% during the same months, respectively.

However, the y-o-y growth rates in monetary aggregates show some contraction, as a result of the base effect³ in favor of 2014 given the low levels of M3 and its relevant components in 2013. In year-on-year terms, broad money (M3) grew by 16.7% in June 2015 compared to 27.2%

in June 2014 while outstanding credit to the private sector rose by 27.5% from 14.1% during the same period, helping the economy to continue with its growth trajectory.

From the liability side, transferable deposits increased by 35.6% in June 2015 from 16.5% in June 2014 while foreign currency deposits, which contracted for the third consecutive month, declined by -9.2% in June 2015 after growing by 61.6% during the same period in 2014. Currency in circulation expanded by 13.0% in June 2015, from 2.7% in June 2014, explaining its increased contribution to M3. Generally, the decline in forex deposits and other deposits led to the y-o-y contraction in M3 in June 2015.

Figure 14: M3 from the liability side (% , y-o-y)

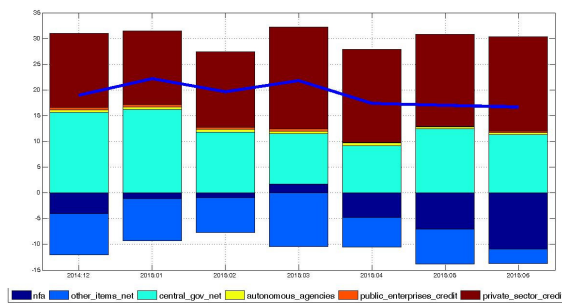


Source: BNR, Monetary Policy & Research Department (2015)

In June 2015, the sizable growth in outstanding credit to the private sector significantly contributed to M3 growth despite contractionary pressures from other items net.

³ Monetary aggregates in 2013 were affected by the aid delays that started in 2012H2 but expanded in 2014 after the resumption of aid disbursements

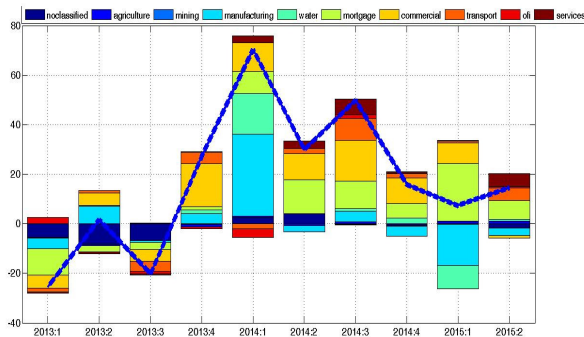
Figure 15: M3 from the asset side (% , y-o-y)



Source: BNR, Monetary Policy & Research Department (2015)

New authorized loans improved, with y-o-y growth standing at 14.5% in 2015Q2 from 7.3% of the previous quarter. Owing to the aforementioned base effect, new authorized loans contracted in 2015Q2 compared to the 29.9% realized in 2014Q2. During the first half of 2015, new authorized loans surged by 10.8%, rising from FRW 325.7 billion in the first half of 2014 to FRW 360.8 billion.

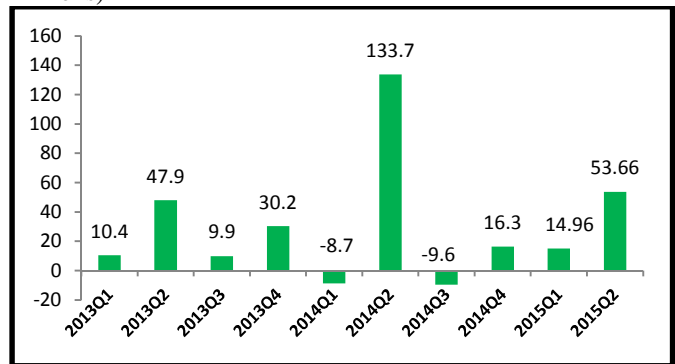
Figure 16: New authorized loans (% , y-o-y)



Source: BNR, Monetary Policy & Research Department (2015)

Though net government liquidity injections improved in 2015Q2, rising to FRW 53.66 billion compared to FRW 14.96 billion of the previous quarter it fell below the FRW 133.7 billion realized in 2014Q2 and unlikely to significantly have an impact on aggregate demand.

Figure 17: Government net liquidity injection (FRW Billions)



Source: BNR, Monetary Policy & Research Department (2015)

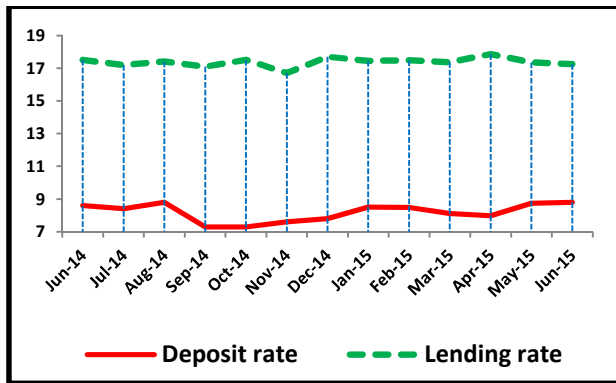
2.2. Financial Sector developments

2.2.1 Interest rate developments

Money market interest rates continued to decline in the first half of 2015 on the back of a loose monetary policy stance and increasing liquidity in the banking system. Consequently, the repo, T-bills and interbank interest rates fell respectively to 2.01%, 4.05% and 4.03% in June 2015 from 2.8%, 4.9% and 4.7% in December 2014.

As a corollary, there were positive developments in the trend of the spread between the lending and deposit rates. While deposit rate slightly increased to 8.8% in June 2015 from 8.6% in June 2014, the lending rate marginally decreased from 17.5% in June 2014 to 17.26% in June 2015, resulting into the narrowing of the spread to 8.46% in June 2015 from 8.9% of the same period in 2014.

Figure 18: Deposit and lending rates



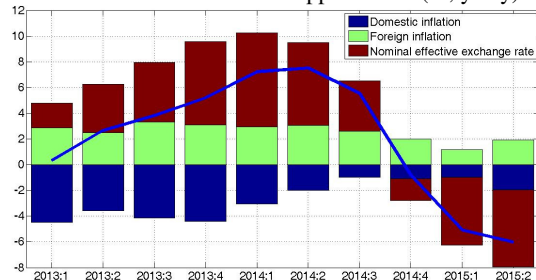
Source: BNR, Monetary Policy & Research Department (2015)

2.2.2 Exchange rate developments

Using seasonally adjusted data for foreign and domestic CPI, the REER appreciated by -6.01% y-o-y in 2015Q1 mainly due to the appreciation of the FRW against the currencies of major trading partners. This comes as good news at a time when the US dollar is strengthening against most of the currencies around the world, including the FRW.

The strength of the USD is mainly supported by the improvement in the US economy at a time when other economies are stumbling, coupled with rising long-term interest rates in the US a head of the expected tightening of monetary policy by the FED and the reduction in US imports, especially of oil.

Figure 19: Contribution to the REER appreciation (% , y-o-y)



Source: BNR, Monetary Policy & Research Department (2015)

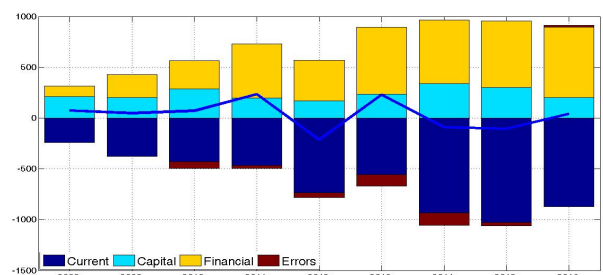
In view of the current global economic developments, the FRW depreciated against the USD (3.6%) and Burundian Franc (4.4%) between December 2014 and June 2015. However, the FRW appreciated versus the EURO (-4.2%), the Kenyan shilling (-4.7%), the Tanzanian shilling (-9.0%) and the Ugandan shilling (-12.9%) during the same period.

The pressures on the FRW emanating from the strengthening of the USD are further amplified by the already existing structural problems related with Rwanda's external accounts, notably the persistence of the trade deficit.

The 2015 BOP account projections remain unchanged. The balance of payments is expected to drop by 17.7% in 2015, with the BOP deficit likely to increase to USD 106.4 million from USD 90.4 million of the preceding year.

The main driver of the BOP deficit in 2015 is the widening current account deficit whereas the capital account balance and the financial account balance all have contractionary effects on the BOP deficit. The projected BOP surplus of USD 41.1 million in 2016 will be mainly due to the easing in the current account deficit.

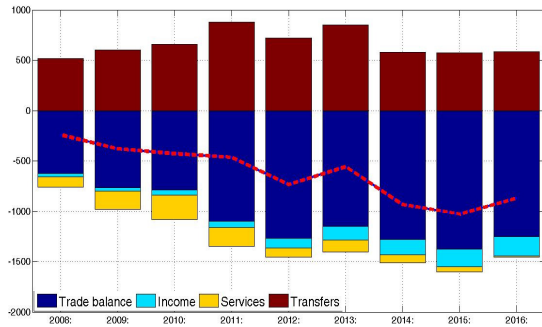
Figure 20: The BOP decomposition (Millions USD)



Source: BNR, statistics department (2015)

The current account deficit widened to reach USD 1028 million in 2015 compared to USD 932.9 million in 2014 due to the expanding trade deficit.

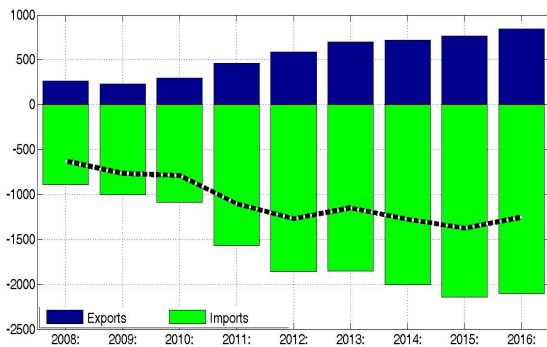
Figure 21: The current account (Million USD)



Source: BNR, statistics department (2015)

The imports bill are projected to increase from USD 2000.1 million in 2014 to USD 2139.56 in 2015 million whereas export revenues are expected to rise from USD 723.09 million in 2014 to USD 764.39 million in 2015, implying further widening of the trade balance, which may exert pressures on exchange rate developments.

Figure 22: Evolution of the trade balance (USD, millions)



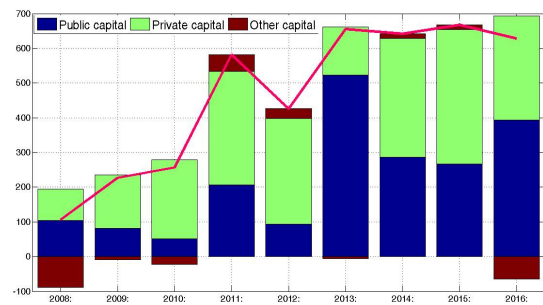
Source: BNR, statistics department (2015)

The coverage of imports by exports has been shrinking over the last three years, owing to the declining level of international reserves. In 2014, the reserves dropped to 4.4 months of imports

from 4.5 months of imports recorded during the previous year.

However, the financial transactions account balance is expected to rise by 4% in 2015, picking from USD 628.9 million in 2014 to USD 654.2 million mainly due to the increase in private capital. The latter is projected to grow by 13% (from USD 341.8 million to USD 387.3 million) and to more than offset the anticipated 7% contraction in public capital (from USD 287.1 million to USD 266.9 million), resulting into a marginal increase in the financial transactions account balance.

Figure 23: The financial account (Million USD)



Source: BNR, statistics department (2015)

2.3. Fiscal spending

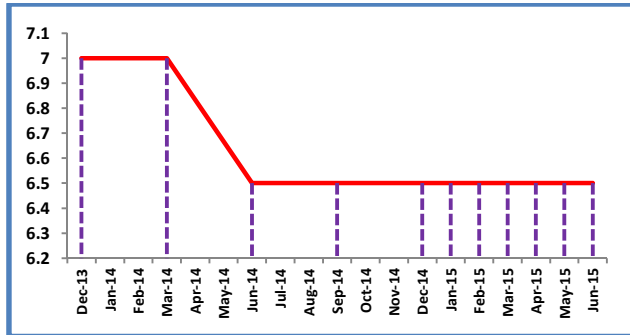
Fiscal spending is projected to increase by only 1.8% compared to 13.6% of the previous calendar year. In fiscal year terms, fiscal expenditure for 2015/16 is expected to increase by only 2.4% from 10.2% of the previous fiscal year. These developments may constrain aggregate demand but also exert downward pressures on inflation.

2.4. Previous monetary policy stance

The National Bank of Rwanda maintained its policy rate, the Key Repo Rate, unchanged at 6.5% in the June 2015 MPC meeting. This KRR level has been maintained since June 2014 owing

to lower inflation that gave room to continue stimulating economic growth to counteract the negative effects of the shortfall in aid disbursements faced in the second half of 2012.

Figure 24: The Key Repo Rate in Rwanda



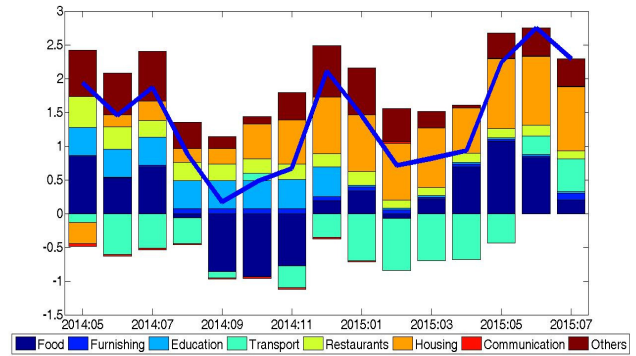
Source: Monetary Policy & Research Department (2015)

The current accommodative monetary policy has helped to encourage the financing of the economy. As result, new authorized loans to the private sector increased by 10.8% in the first half of 2015 while outstanding credit to the private sector increased by 15.1% between December 2014 and June 2015 against 7.9% recorded in the corresponding period of 2014.

2.5. Inflation developments

Generally, inflation in Rwanda continues to record moderate and low levels though it has been increasing since March from 0.8% to 2.8% in June 2015. On average, headline inflation increased from 1% in 2015Q1 to 2% in 2015Q2 mainly driven by an uptick in food, housing and transport inflation.

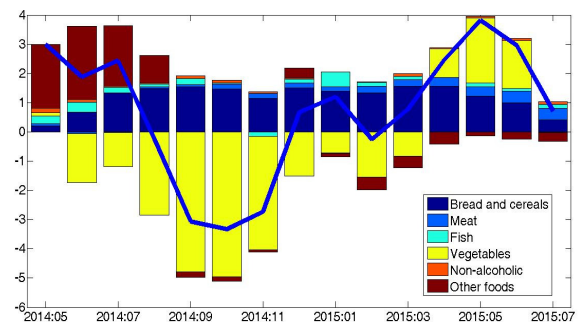
Figure 25: Contribution to headline inflation (% , y-o-y)



Source: BNR, Monetary Policy & Research Department (2015)

Food inflation increased from 0.8% in March to 2.9% in June 2015 as a result of the decline in food crop production in 2015Q1 (4% in 2015Q1 from 6% 2014Q1) and the expected reduced performance of agricultural season B 2015 as well as the exports of some vegetables to Uganda which all together reduced the supply on domestic markets in 2015Q2.

Figure 26: Contribution to food inflation (% , y-o-y)

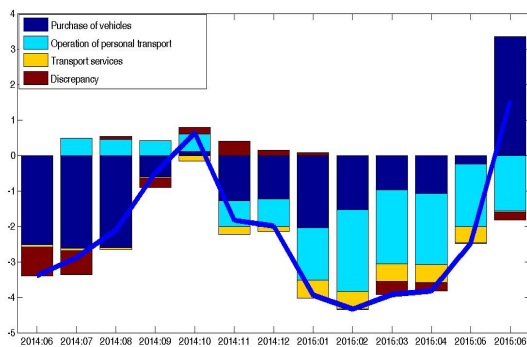


Source: BNR, Monetary Policy & Research Department (2015)

Housing inflation slipped from 3.8% in March to 2.9% in April on the back of falling inflation of electricity but bounced back to 4.5% in June following the seasonal increase in the prices of firewood and charcoal.

Transport deflation eased significantly from -3.9% in March to an inflation of 1.5% in June 2015 due to the increase in prices of cars, the upward revision of local pump prices from 810FRW/liter to 935 FRW/liter following the increase in international oil prices and in levy tax for road maintenance.

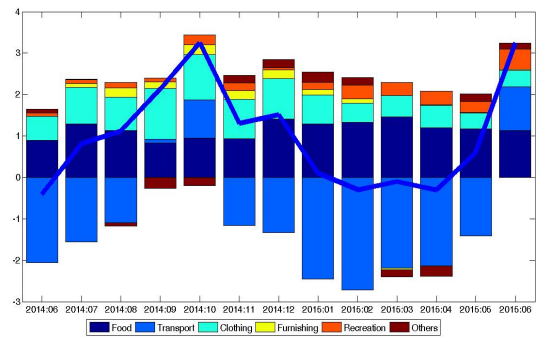
Figure 27: Contribution to transport inflation (% , y-o-y)



Source: BNR, Monetary Policy and Research Department (2015)

Imported inflation increased from -0.1% in the 2015Q1 to 1.2% in 2015Q2 on average. It increased from -0.1% in March to 3.3% in June following the slight increase in international oil prices and gradually growing inflationary pressures in the EAC countries.

Figure 28: Contribution to imported inflation (% , y-o-y)

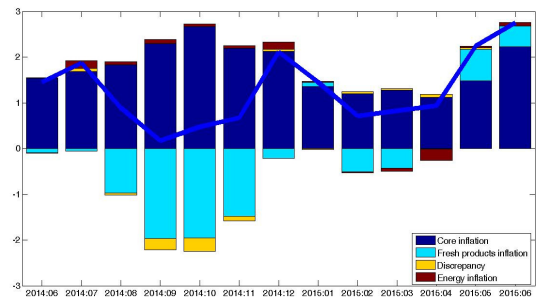


Source: BNR, Monetary Policy and Research Department (2015)

Domestic inflation increased from 1.4% in 2015Q1 to 2.3% in 2015Q2 on average, reflecting a slight increase in domestic food prices compared to the same period in 2014.

Though it eased from 2.5% in the first six months of 2014 to 2% in the same period of 2015, core inflation remained above headline inflation, with the former rising from 1.8% in March to 3.0% in June 2015. The trend in core inflation reflects improving aggregate demand as a result of the continued BNR accommodative monetary policy adopted since June 2013.

Figure 29: Contribution to headline inflation by source (% , y-o-y)



Source: BNR, Monetary Policy and Research Department (2015)

3. INFLATION OUTLOOK

3.1 Domestic aggregate demand

Though aggregate demand improved in 2015Q1 compared to the previous quarter, aggregate demand is expected to remain weak in the second and third quarter of 2015, especially due to the expected developments in fiscal spending. Therefore, no significant demand-push inflationary pressures are expected going forward.

3.1.1 The Composite Index of Economic Activities

The deceleration in the growth of the real CIEA to 8.8% in 2015Q2 from 10.8% during the same period in 2014 implies slowing economic activities during 2015Q2.

3.1.2 Turnovers of industry and services

The distortions from the service sector due to both price and base effect masks the true performance of total turnovers in 2015Q2. The good performance of the industry turnovers, coupled with the expected improvement in the agriculture sector, supports positive growth prospects.

3.1.3 Credit to Private Sector

The continued growth in outstanding credit to the private sector from 9.8% in March to 11.4%, 13.6% and 15.1% in April, May and June 2015, respectively, as well as in new authorized loans, which grew y-o-y by 14.5% in 2015Q2 from 7.3% of the previous quarter, imply improving aggregate demand in 2015Q2 but still below the level of the same quarter last year.

3.2 Supply shock

Despite edging up in May and June 2015, food inflation eased in July on the back of the availability of season B harvests, especially of fresh foods. Looking forward, the outturn of season C harvests will determine food inflation developments.

3.3 Exchange rate developments

Just like many other currencies around the world, the FRW has depreciated against the USD, though to a less extent. Going forward, the pass through to inflation will remain mitigated by the appreciation of the FRW against a basket of currencies of major trading partners.

3.4 Global and regional inflationary pressures

Inflation remains subdued around the globe though some inflationary pressures in the EAC region, especially in Uganda and Tanzania, are cropping up. Generally, inflation around the world remains suppressed owing to the current decline in commodity prices as well as still weak aggregate spending in many economies. These two factors are unlikely to reverse in the near term and thus may not pose serious challenges to the inflation outlook.

3.5 International commodity prices

Tea prices are expected to go up while coffee prices are projected to decrease in 2015Q3. Though crude oil prices increased in 2015Q2, they are likely to decline again in 2015Q3 following the modest rise in consumption and the strong OPEC production and possible suspension of sanctions against Iran. However, the local pump prices are not expected to reduce in

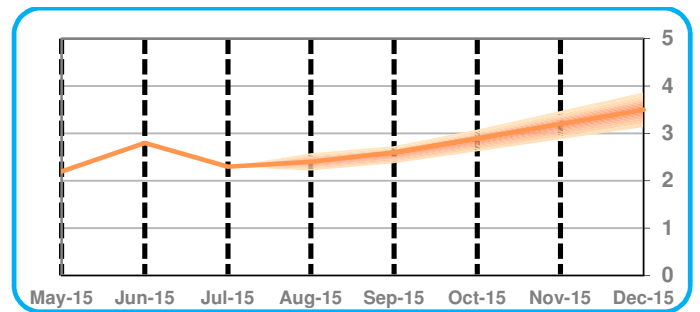
2015Q3 because the last upward revision in May was mostly triggered by the levy on road maintenance.

3.6. Inflation forecasts

The current macroeconomic environment is characterized by: (i) the low level of inflation mainly due to the decline in international commodity prices; (ii) good agricultural harvests; (iii) weak aggregate demand as well as; (iv) the emerging exchange rate pressures, resulting from the strengthening of the US dollar and amplified by the already existing structural problem of a persistent trade deficit.

In view of these key risks, inflation is projected to stand at around 2.6% in 2015Q3 while the forecast for 2015Q4 remain unchanged at around 3.5%. The main risks to watch in the coming months are exchange rate developments and the performance of the agriculture sector. However, the good coordination between fiscal and monetary policies will help to moderate any emerging inflationary pressures.

Figure 30: Inflation fan chart



Source: BNR, Monetary Policy & Research Department (2015)

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