**National Bank of Rwanda**

# QUARTERLY INFLATION REPORT


**WP02/2016Q1**

**Kigali, June 2016**

## 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 |

# CONTENTS

# 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.

While Africa is facing slowing growth and global headwinds, Rwanda's economy is looking resilient by comparison. In the first quarter of 2016, real GDP grew by 7.3 percent y-o-y from 7.0% recorded in 2015Q4 and 7.6% in 2015Q1. Growth in 2016Q1 was mainly fueled by the good performance of the industry and agriculture sectors, though the service sector hitherto retains the biggest share in total GDP. Going forward, the economy is expected to slightly slowdown given that, growth in total turnovers slowed to 7.0% in the first two months of 2016Q2 compared to 11.1% in the same period of 2015. During the same period, the real composite index of economic activities grew by 12.2% from 14.5%.

Monetary policy continues to be supportive as outstanding credit to the private sector grew by 25.3% in 2016Q1, up from 19.2% in the last quarter of 2015. However, fiscal policy is somewhat restrictive as net government liquidity injections declined in 2016Q1 to reach FRW 2.7 billion from FRW 60.2 billion recorded in the previous quarter. The real GDP growth projection of 6.0% for 2016 is still maintained.

In line with the decline in both net foreign assets and foreign exchange deposits, the widening of the trade deficit, as well as the broad-based strengthening of the USD, the FRW has been weakening against currencies of some trading partners, leading to the depreciation of both the nominal and real effective exchange rate in 2016Q1. In 2016Q1 headline inflation slightly increased to 4.5% from 4.1% recorded in the last quarter despite the drop in food inflation to 8.2% from 8.6% during the same period. The latter was due to the slight decline in fresh products inflation from 13.9% in 2015Q4 to 12.4% in 2016Q1. However, upward pressures came from energy inflation which edged up to reach 4.2% in 2016Q1 from 2.9% of the previous quarter and from core inflation which rose from 1.9% to 2.8% during the same period. Domestic inflation slightly dropped from 10.1% to 9.9% mainly in tandem with declining food prices whereas imported inflation eased from 2.5% to 1.1% as international commodity prices have remained low.

Looking ahead, risks such as the exchange rate depreciation, the El Nino effects and the increased uncertainty of the trend in international oil and other commodity prices remain. Other pressures are expected to continue coming from the effect of a level shift caused by the upward revision in local bus fares, education fees, taxes on second hand clothes and shoes and in domestic fuel prices. In addition, some significant downside pressures may come from the downscaling of the external tariffs on sugar and rice. In view of the above upside and downside risks, inflation is projected to hover between 4.0%-4.7% in 2016Q2 and 3.6%-4.6% in 2016Q3.

## *ACKNOWLEDGEMENTS*

A team from the Monetary Policy & Research Department, spearheaded by the Modeling and forecasting division, prepared the 2016Q1 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) edited and reviewed the report. Other contributors include Mr. NUWAGIRA Wilberforce (Manager, Balance of payments division).

## 1. EXTERNAL ENVIRONMENT

### 1.1. Global economic activities

The global economy grew by 3.1% in 2015 and is projected to grow by 3.2% in 2016 revised down by 0.2% compared to January 2016 projections. The downward revision is due realignments taking place in different economies related to slowdown and rebalancing in China, reducing capital flows and investment in emerging markets and developing economies.

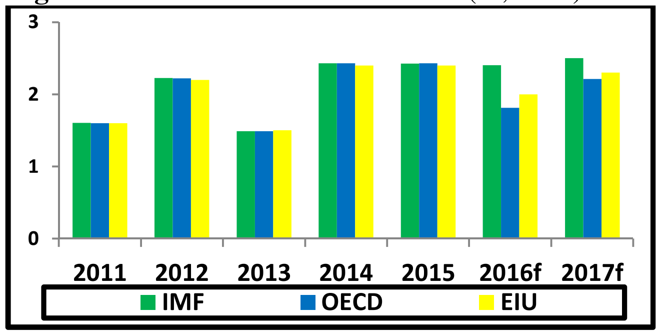
**Table 1:** Economic growth developments (in %)

| | 2015 | | 2016 | | | 2015 | 2016 Proj. |
|---|---|---|---|---|---|---|---|
| | Q3 | Q4 | Q1 | Q2* | Q3* | | |
| **World (YOY)** | - | - | - | - | - | 3.1 | 3.2 |
| **USA (QoQ)** | 2 | 1.4 | 0.8 | 2.2 | 2.3 | 2.4 | 2.4 |
| **Euro area (YoY)** | 1.6 | 1.6 | 1.5 | 1.5 | 1.6 | 1.6 | 1.5 |
| **Japan (QoQ)** | 1.6 | -1.7 | 1.7 | 0.8 | 1.5 | 0.5 | 0.5 |
| **China (YoY)** | 6.9 | 6.8 | 6.7 | 6.6 | 6.5 | 6.9 | 6.5 |
| **India (YoY)** | 7.7 | 7.2 | 7.9 | 7.5 | 7.6 | 7.3 | 7.5 |

**Source:** BLOOMBERG & IMF WEO, April 2016 (** indicates projections*).

The U.S economy increased at an annual rate of 0.8% quarterly basis (SAAR) in 2016Q1, according to the second estimates released by the Bureau of Economic Analysis in May 2016. This increase is accounted for by an increase in consumer spending on services and in the state and local government spending but was offset by a decrease in exports and in the federal government spending. In seasonally unadjusted terms, the IMF projects that the US real GDP will grow by 2.4% in 2016 down by 0.2% projected in January 2016.

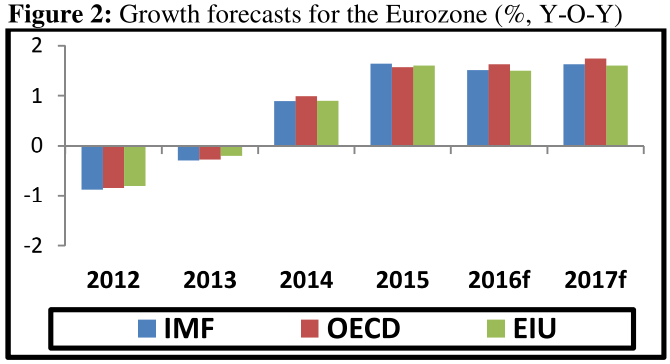
**Figure 1**: Growth forecasts for the US (%, YoY)




**Source:** IMF, OECD & EIU (May. 2016)

Indicators point to a mild economic growth in the Euro area in 2016Q1 before the release of new data based on the worsening of the business and consumer confidence and may prolong in the short term. The IMF also revised down the economic growth in Eurozone by 0.2% in 2016.

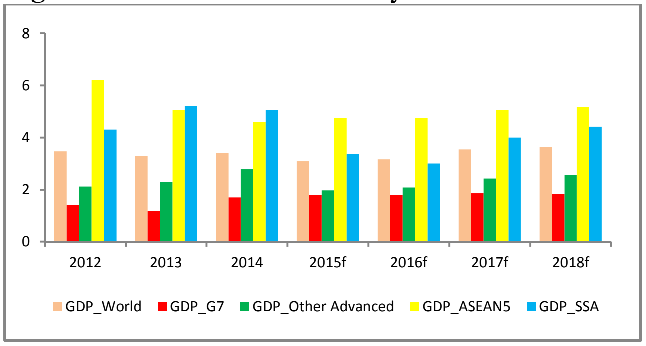
**Figure 2:** Growth forecasts for the Eurozone (%, Y-O-Y)




**Source:** IMF, OECD & EIU, (May. 2016)

Growth in emerging markets and developing economies has been revised down in April 2016 to 4.1%. Apart from the Chinese economy whose projections went up by 0.2% to 6.5% reflecting resilience in domestic consumption and other emerging Asian economies whose economic recovery remained strong, other emerging and developing economies fell short of expectations and their projections were generally revised down.

**Figure 3:** Growth outlook for key economies



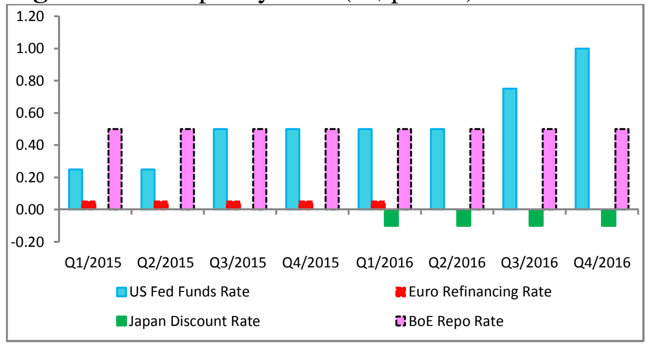

**Source:** IMF & World Bank (Feb. 2016)

Global economic growth is projected to slide down to 3.2% in 2016. This drop is likely to be reflected in all economies except some Asian economies whose growth is so far in line with initial projections. Most of the growth will be accounted for from emerging markets and developing economies but their growth will also remain modest.

### 1.2. Fiscal and Monetary policies and international financial markets

Monetary policies are expected to remain generally accommodative especially where inflation is still below targets while fiscal is expected to be neutral especially in advanced economies. The quantitative easing program is still going on in the Euro area and the refinancing rate was revised down to 0.0% in June 2016. The US Fed kept the 0.25-0.5 range as the economic indicators do not support another increase. Generally, financial conditions may turn tightened following increasing yields and some concerns of persistent low inflation that may push up real interest rate.

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

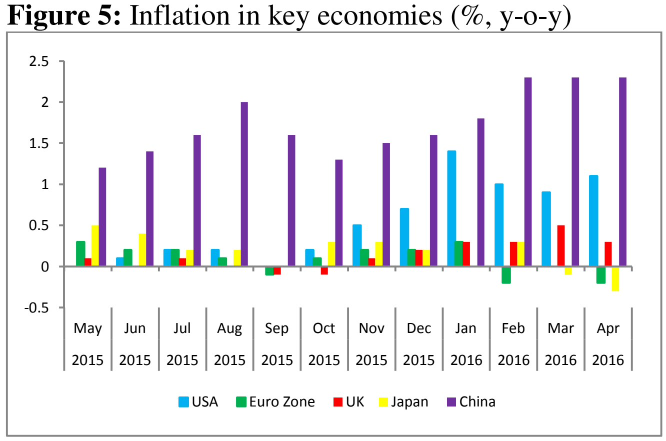



**Source:** http://www.tradingeconomics.com, June-2016

### 1.3. Global inflation developments and outlook

Except in a small number of countries where inflation rose due to exchange rate depreciation, generally inflation remained subdued around the globe and below target always on the back of low commodity prices. In EAC member countries, inflation rates were generally falling in the first quarter of 2016 but remained above 5% except in Rwanda and Burundi.

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




**Source:** http://www.tradingeconomics.com, June-2016

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

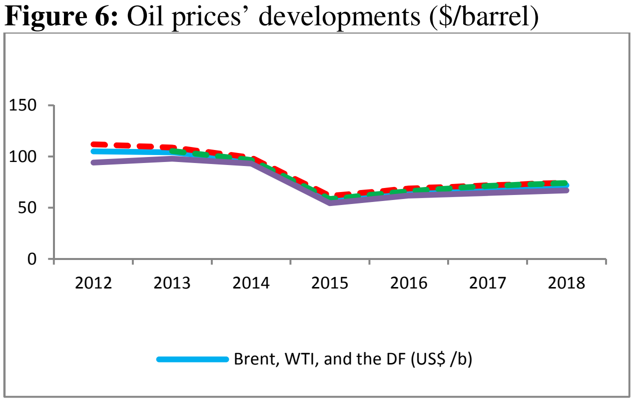
| | RWANDA | UGANDA | KENYA | TANZANIA | BURUNDI |
|---|---|---|---|---|---|
| May-15 | 2.2 | 4.9 | 6.9 | 5.3 | 7.2 |
| June-15 | 2.8 | 4.9 | 7.0 | 6.1 | 7.7 |
| July-15 | 2.3 | 5.4 | 6.6 | 6.4 | 8.0 |
| Aug-2015 | 3.0 | 4.8 | 5.8 | 6.4 | 4.2 |
| Sept-15 | 3.7 | 7.2 | 6.0 | 6.1 | 4.1 |
| Oct-15 | 2.9 | 8.8 | 6.7 | 6.3 | 5.6 |
| Nov-15 | 4.8 | 9.1 | 7.3 | 6.6 | 5.8 |
| Dec-15 | 4.5 | 9.3 | 8.0 | 6.8 | 7.1 |
| Jan-16 | 4.5 | 7.6 | 7.8 | 6.5 | 6.3 |
| Feb-16 | 4.4 | 7.7 | 6.8 | 5.6 | 6.7 |
| Mar-16 | 4.6 | 6.2 | 6.5 | 5.4 | 4.3 |
| Apr-16 | 4.7 | 5.1 | 5.3 | 5.1 | 2.6 |
| May-16 | 4.6 | 5.4 | 5.0 | - | - |

**Source:** Country Bureaus of Statistics (2016)

### 1.4. International commodity prices

Generally, in 2016Q1 commodity prices reached the lowest level in the last ten years with the price of the barrel selling at 29.9 USD in January 2016. Despite high uncertainty around oil prices, IMF still project that oil prices are likely to gradually and slightly increase since 2016Q2.

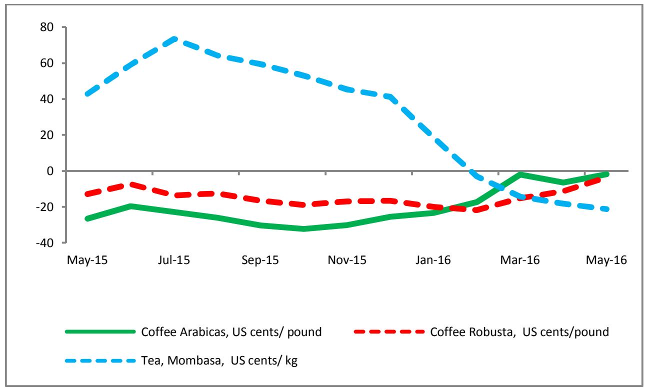
**Figure 6:** Oil prices' developments ($/barrel)




**Source:** IMF, WEO Database (June 2016)

Food prices fell between 2015Q4 and 2016Q1 and are expected to remain below but gradually increasing. For beverages price; coffee prices also dropped in 2016Q1 and are projected to remain around the same level during 2016.

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




**Source:** IMF, WEO Database (June 2016)

## 2. THE DOMESTIC ECONOMY

### 2.1. Domestic demand and output

While Africa is facing slowing growth and global headwinds, Rwanda's economy is looking resilient by comparison. In the first quarter of 2016, GDP at current market prices was estimated to be RWF 1,536 billion, up from RWF 1,384 billion in the same quarter of 2015. Estimates calculated in 2011 prices shows that GDP was 7.3 percent higher in real terms compared to the same quarter of 2015 (NISR, 2016Q1[1]).

Growth in 2016Q1 was mainly fueled by the good performance of the industry and agriculture sectors, though the service sector hitherto retains the biggest share in total GDP. The service sector grew in real terms by 7% y-o-y in 2016Q1, down from 8% recorded in the previous quarter and contracted by 1.2% in q-o-q terms after growing by 2% in the previous quarter. Conversely, the industry sector performed pretty well in y-o-y

[1] NATIONAL INSTITUTE OF STATISTICS OF RWANDA, Gross Domestic Product – 2016Q1

terms, growing by 10% in 2016Q1 from 6% recorded in 2015Q4 but slowed in q-o-q terms to 4.6% from 7.7% during the same period.

In 2016Q1, y-o-y growth of the agriculture sector surpassed its historical average of 5.0% to reach 7% from 5% recorded in 2015Q4. However, the slowdown in the sector's performance doubled, in q-o-q terms, from -1% in 2015Q4 to -2% in 2016Q1.

Looking at q-o-q growth rates, it is clear that growth in 2016Q1 was mainly buoyed by the industry sector, despite growing at a lower pace, while other sectors contracted.

Whilst trade services grew in y-o-y terms by 10% in 2016Q1 from 8% in the previous quarter, growth in other services slowed to 5% from 8% during the same period and thus impacting the overall performance of the service sector. Growth in trade services was mainly supported by the good performance in wholesale and retail trade, which grew by 11% from 9%, and in transport, growing by 7% from 4% during the same period.

The slowdown in other services was due to the reduced performance in almost all its sub-components save for financial services, human health & social work activities as well as in cultural, domestic & other services.

In q-o-q terms, other services recorded zero growth whereas trade services contracted by 4% in 2016Q1 as the performance for all of its components contracted.

The contraction in the mining sub-sector has remained somewhat lower, standing at 5% y-o-y in 2016Q1 and 4% in 2015Q4 after 15% recorded in 2015Q3. This trend is in line with the observed trend in international commodity prices, especially due to the fact that the contraction in prices for metals and minerals reached 18.6% during the first four months of 2016 after a 15.3% in the corresponding period of 2015. The construction sub-sector performed significantly well, growing by 13% y-o-y in 2016Q1 from 9% in the previous quarter and thus pushing up its share in the industry sector to 54% from 53% during the same period. The robust performance of the construction sub-sector is partly due to the lag effect of the increase in new authorized mortgage loans by 77.7% in 2015Q4 from 58.3% of the previous quarter.

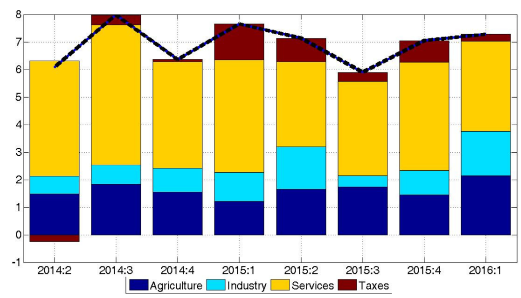
The y-o-y expansion of the manufacturing sub-sector almost doubled after reaching 10% in 2016Q1 from 6% of the previous quarter and thus significantly contributing to good performance of the industry sector. Electricity recorded the most robust performance after growing by 25% on both annual and quarterly basis in 2016Q1 from 0% recorded in the previous quarter as a result of the increase in electricity production following the construction/rehabilitation of hydro-power plants, notably Mukungwa 1 and Kivuwatt.

In q-o-q terms, the construction sub-sector slowed from 15.7% in 2015Q4 to 6.8% in 2016Q1 following the fact that some big public construction projects are nearing their completion and new authorized loans to the sub-sector contracted by 7% q-o-q in 2016Q1 from a growth of 28.8% recorded in the final quarter of 2015.

The manufacturing sub-sector recorded 6.5% growth on quarterly basis in 2016Q1 after zero growth in the preceding quarter on the back of operationalization of new manufacturing companies such as AFRIPRECAST. This, in addition to the robust performance of the electricity sub-sector and somewhat good performance in construction helped to support the performance of the industry sector in particular and of the whole economy in general.

The value of export crops grew on annual basis by 86% in 2016Q1 from 8% in 2015Q4 mainly due to a remarkable performance in pyrethrum, whose value grew by 130% in the first four months of 2016 from 69.3% of the same period last year. During the same period, coffee exports increased in value by 10.1%, despite a decline in unit price by 27.2%, due to the increase in production, from 917 tons in 2015Q1 to 3,549 tons in 2016Q1 owing to favorable rainfall in Northern Province, and the rise in the number of operational coffee washing stations from 216 in 2015Q1 to 234 in 2016Q1. However, tea exports decreased in volume by 3.4% but increased in value by 0.6% due to the rise in unit price by 4.2% to USD 2.63/Kg from USD 2.52/Kg in the first four months of 2015. The share of coffee, tea and pyrethrum exports in total exports stands at 58% on average in the 2008Q1-2016Q1 period. Thus, any contraction in these export crops exerts downward pressures on export receipts (i.e. worsens the external imbalance) and has detrimental effects on exchange rate developments.

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




**Source:** BNR, Monetary Policy & Research Department (2016)

From the expenditure account, real GDP growth in 2016Q1 was mainly boosted by the improving performance in gross capital formation, which grew by 22.3% from 9.6% in the previous quarter.

The good performance in gross capital formation resulted from robust growth in gross fixed capital formation, which rose from 10.8% in 2015Q4 to 22.2% in 2016Q1 as growth in construction slightly edged up from 9% to 13.3% and other capital grew by a remarkable 43.1% from 14.7% during the same period.

Generally, domestic demand grew by 7.6% y-o-y in 2016Q1, down from 10.3% in 2015Q4. On quarterly basis, domestic demand grew by 0.6% from 4% during the same period. The shrinking performance in domestic demand is mainly attributable to the contraction in total final consumption by 2.6% q-o-q in 2016Q1 after a growth of 0.5% the previous quarter.

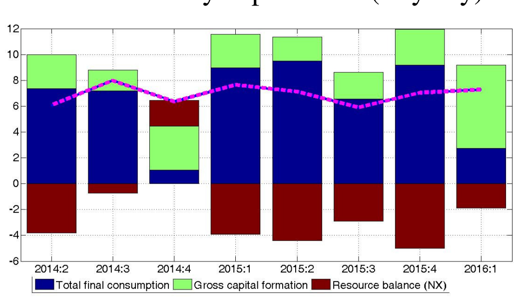
Though it slowed to 10.4% in 2016Q1 from 16.2% in 2015Q4, the q-o-q growth in gross capital formation had significant positive contribution to real GDP growth. It was however complemented by the ease in the trade deficit, whose q-o-q growth dropped to 6.5% from 12.3% during the same period.

The q-o-q contraction in total final consumption expenditure was mainly due to the shrinking in private consumption by -2.9% in 2016Q1 from 0.3% in the previous quarter while government consumption remained unchanged.

The reduction in the trade deficit resulted from a very significant drop in the growth of the imports bill, from 7.5% in 2015Q4 to 1.8% in 2016Q1 despite the fall in the growth of export receipts from 2.2% to -3.5% during the same period.

However, the trade balance remains in deficit and continues to have contractionary effects on economic growth mainly due to the price effect that adversely affected export receipts from minerals, notably Coltan, Cassiterite (tin) and wolfram at a time when the import bill has been steadily growing.

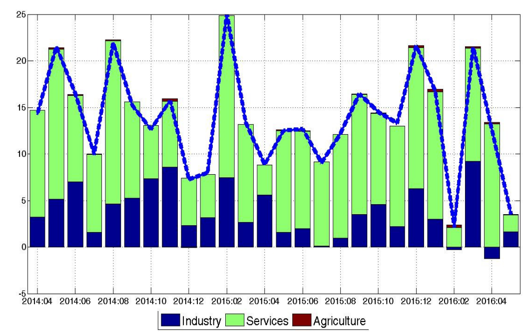
**Figure 9:** Real GDP by expenditure (% y-o-y)




**Source:** BNR, Monetary Policy & Research Department (2016)

High frequency indicators point to a slight economic slowdown in 2016Q2. In annual terms, growth in total turnovers declined from 21.5% in March to 12.6% and 3.5% in April and May 2016, respectively mainly due to the slowdown in the service sector turnovers, which grew by 2.4% in May from 19.2% in April 2016. The industry's sector turnovers grew by 6.6% in May after -4% in April 2016.

**Figure 10:** Total turnovers (%, YoY)

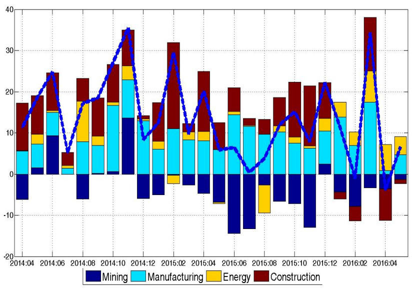



**Source:** BNR, Monetary Policy & Research Department (2016)

Despite showing some signs of recovery, commodity prices are still in freefall and quite uncertain. Consequently, the contraction in the mining sub-sector's turnovers widened from 28.3% in March to 40.1% in April before narrowing to 17.5% in May 2016. Growth in the construction subsector weakened to -2.6% in May from -20.9% in April while growth in manufacturing edged up to reach 11.1% from 1.8% during the same period.

In addition to the improving performance in the mining, construction and manufacturing sub-sectors, the performance of the industry sector was further supported by growth in the energy subsector's turnovers, despite slowing down to 59% in May from 76% in April and 85% in March 2016. The good performance of the energy sector is due to the 35.2% increase in electricity tariffs since September 2015 and the increase in electricity production as a result of the construction/ rehabilitation of hydro-power plants, notably Mukungwa 1 and Kivuwatt.

**Figure 11:** Industry turnovers

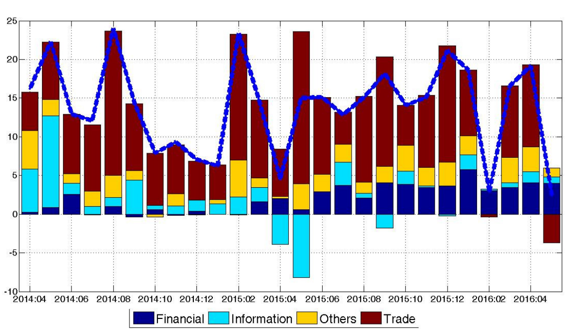



**Source:** BNR, Monetary Policy & Research Department (2016)

Retail and wholesale trade turnovers, whose share in total services' turnovers stands at 61%, contracted by 5.4% may after growing by 17.2% in April and 15.6% in March 2016.

The turnovers for information and communication grew by 13.7% in May from 18.8% of the previous month while financial and insurance activities turnovers expanded by 46.2% from 27.9% during the same period. Other services grew by 19.9% in April before slowing to 6.9% in May. Nonetheless, these three sub-sectors were the main contributors to the good performance in services as retail and wholesale contracted.

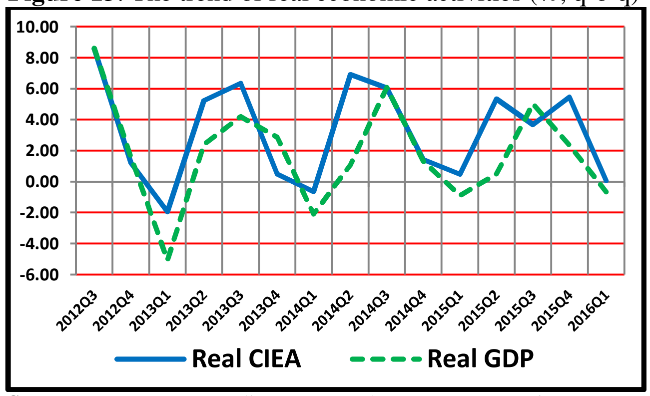
**Figure 11:** Services' turnovers




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

On q-o-q basis, the real composite index of economic activities (CIEA) is more correlated with GDP. The real CIEA confirms that the economy may slowdown going forward. In 2016Q1, growth in the real CIEA dropped to 0.06%, on average, from 5.5% recoded in the previous quarter while it grew by 11.1% in April, down from 15.2% in March 2016.

**Figure 13**: The trend of real economic activities (%, q-o-q)



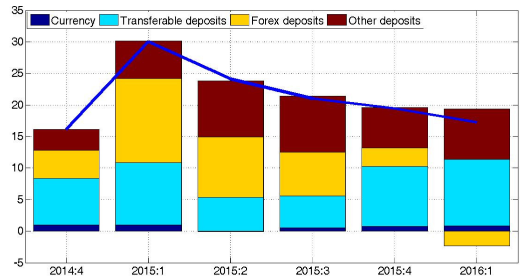

**Source:** BNR Monetary Policy & Research Department (2016)

Until now, BNR has maintained its accommodative monetary policy stance and this has helped to maintain higher levels of broad money and credit to the private sector to continue supporting the economy.

From the liability side, M3 y-o-y growth slowed to 17.2% in 2016Q1 from 19.5% recorded in the previous quarter as foreign exchange deposits contracted by 10% from growth of 15% during the same period. Total deposits grew by 17% in 2016Q1, down from 20% of the previous quarter despite the acceleration in the growth of transferable deposits to 29.4% from 25.5% during the same period.

The contraction in foreign exchange deposits has negative implications on exchange rate developments.

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

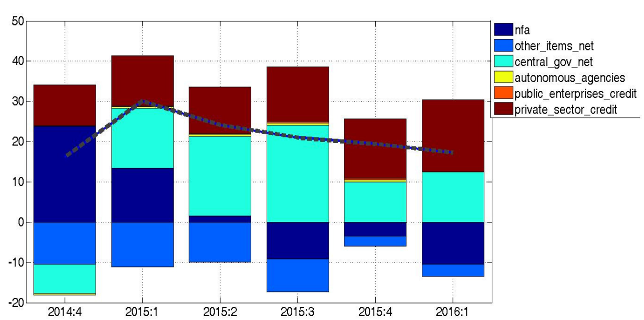



**Source:** BNR, Monetary Policy & Research Department (2016)

As expected, the contraction in foreign exchange deposits should be a mirror image of what could be happening to net foreign assets. In annual terms, net foreign assets contracted for the third consecutive quarter with growth reaching -16.2% in 2016Q1 from -5.1% realized in the previous quarter. Other contractionary effects on broad money came from other items net. However, M3 growth continued to be propped up by credit to the private sector as well as by net credit to the central government.

In y-o-y terms, outstanding credit to the private sector expanded by 25.3% in 2016Q1, up from 19.2% in the last quarter of 2015, thanks to the continued BNR accommodative monetary policy stance.

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



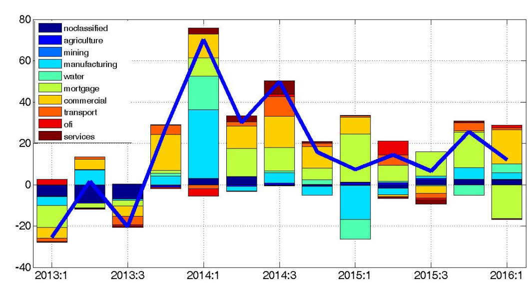

**Source:** BNR, Monetary Policy & Research Department (2016)

In 2016Q1, total new authorized loans increased by 12.1%, down from 25.7% in the previous quarter as mortgage loans contracted by 44.6% from growth of 77.7% during the same period. The contraction in mortgage loans was mainly due to the base effect following issuance of loans to some construction companies (such as catchup investment and Intare investment) in the first two months of 2015.

Growth in loans to commerce, hotels and restaurants rose from 1.5% in 2015Q4 to a remarkable 39.1% in 2016Q1, with the share in total loans also edging up to reach 52.1% in 2016Q1 from 35.8% in the previous quarter.

Despite a big loan issued to AFRIPRECAST limited, growth in total loans to manufacturing eased to 69.5% in 2016Q1 from 80% in the last quarter of 2015. Remarkable progress was registered in loans authorized for water & energy activities, with its share rising from 0.02% to 3.9% during the same period, mainly on the account of loans issued to Amahoro energy limited in January-February 2016. The declining trend in new authorized loans poses a downside risk to outstanding credit to the private sector.

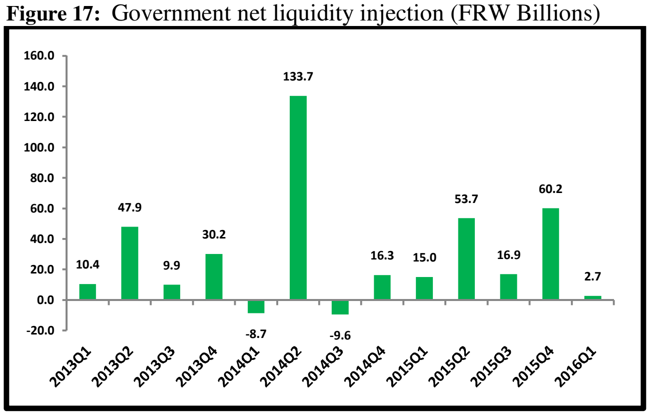
**Figure 16:** New authorized loans (% y-o-y)




**Source:** BNR, Monetary Policy & Research Department (2016)

As predicted in the 2015Q4 inflation report, net government liquidity injections declined in 2016Q1 to reach FRW 2.7 billion from FRW 60.2 billion recorded in the final quarter of 2015. This decline in net government injections coincided with slowing growth and subdued inflation.

**Figure 17:** Government net liquidity injection (FRW Billions)



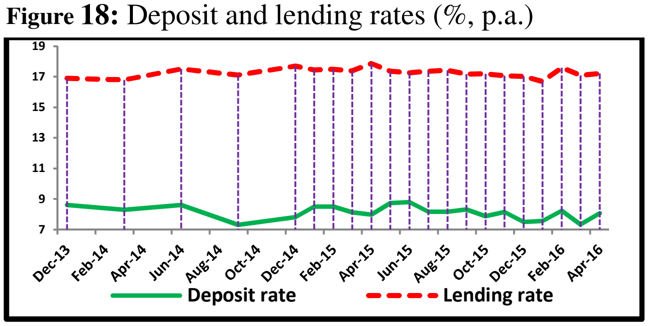

**Source:** NBR, Monetary Policy & Research Department (2016)

## 2.2. Financial Sector developments

### 2.2.1 Interest rate developments

Following the central bank's decision to keep the level of excess reserves within the range between 20% and 30% above the required reserves, money market interest rates have continued to trend upwards, getting closer to the key repo rate, ahead of the implementation of a price based monetary policy using the interest rate as the operating target by end of 2018. The spread between the lending and deposit rates however widened from 9.5% in 2015Q4 to 9.8% in 2016Q4.

**Figure 18:** Deposit and lending rates (%, p.a.)



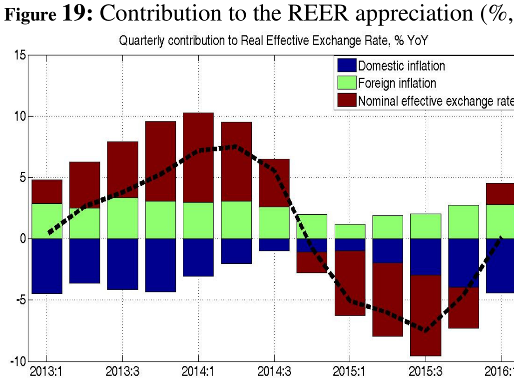

**Source:** BNR, Monetary Policy & Research Department (2016)

### 2.2.2 Exchange rate developments

The real effective exchange rate (REER) depreciated by 0.14% on annual basis in 2016Q1 after appreciating by 4.5% in 2015Q4. The REER depreciation however eased from 2.5% in March to 2.0% in April 2016.

The main driver of the REER depreciation in 2016Q1 was the depreciation in the nominal effective exchange rate (NEER) as domestic and foreign inflation remained broadly unchanged. From an appreciation of 3.3%, the NEER depreciated by 1.8% in 2016Q1, the highest since 2014Q4. This depreciation in both the REER and NEER was a result of the rallying of the USD and the weakening of the FRW against some other trading partners' currencies, notably for the big Eurozone economies like UK, Sweden and Switzerland.

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




**Source:** BNR, Monetary Policy & Research Department (2016)

In 2016Q1, the FRW appreciated y-o-y against: the Ugandan shilling by 7.6%, the Kenyan shilling by 2.4%, the Tanzanian shilling by 9.9% and the South African Rand by 19.2%. However, it depreciated y-o-y against: the Burundi Franc by 9.2%, the USD by 8.2%, the Euro by 7.6%, the pound by 1.8%, the Swedish krona by 8.6% and the Swiss franc by 3%.

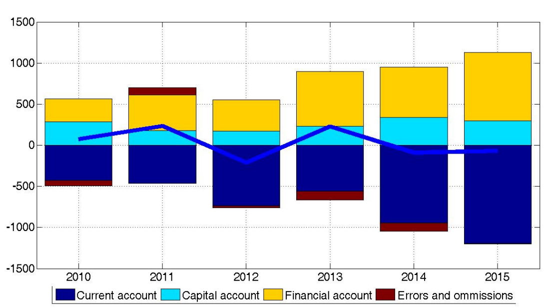
On the basis of the 2008 bilateral trade shares, the US, Euro, UK, Sweden and Switzerland account for 63% of total trade between Rwanda and the ten main trading partners, thus having a greater influence on exchange rate dynamics.

Exchange rate dynamics are highly dependent on the balance of payments position as these summarize the status of trade, financial and capital flows. Recently, the depreciation effects from a persistent trade deficit has been re-enforced by the strengthening of the USD and the appreciation of regional currencies against the FRW.

Exchange rate pressures are largely linked to the structural problem of the persistence of the trade deficit given that Rwanda is up to now a net importer.

In 2015, the current account deteriorated further and dragged down the overall balance of payments. However the increase in the financial account helped to prop up the overall balance. The overall BOP deficit eased from USD 90.5 million to USD 28.6 million, thus falling by 68.5%.

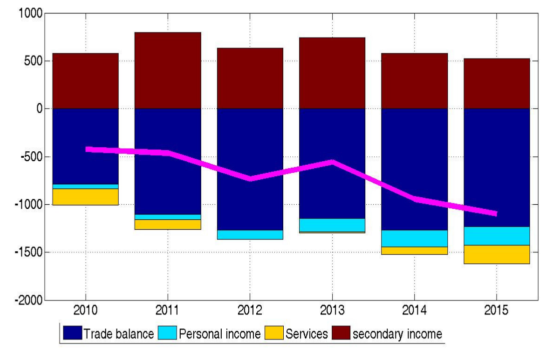
**Figure 20:** The BOP decomposition (Millions USD)




**Source:** BNR, statistics department (2015)

The current account deficit widened by 16.2% after rising from USD 945.4 million in 2014 to USD 1098.3 million in 2015. The widening of the current account deficit is mainly due to the increase in net services, in addition to the long standing shortfall in the trade balance.

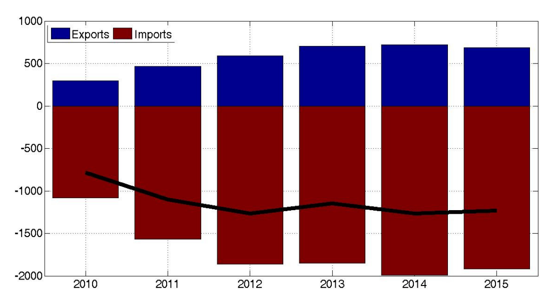
**Figure 21:** The current account (Million USD)




**Source:** BNR, statistics department (2016)

The trade deficit remained broadly stable as the decline in exports was compensated by the fall in imports. During the entire 2015, commodity prices plunged as global demand faltered and supply for some commodities was more than enough. The balance of goods and services increased by 6.2% in 2015 from 15.6% recorded last year. While the value of export receipts declined by 5.5% in 2015, the value of imports followed suit, falling by 3.7% and thus having an almost neutral effect on the trade balance.

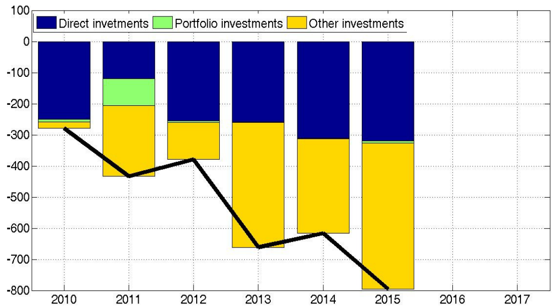
**Figure 22:** Evolution of the trade balance (USD, millions)




**Source:** BNR, statistics department (2016)

The higher CA deficit has been financed by increasing debt as aid flows have been declining. Thus, other debt instruments grew by 62.2% in 2015, from USD 1.56 million to USD 72.98 million.

**Figure 23:** The financial account (Million USD)




**Source:** BNR, statistics department (2016)

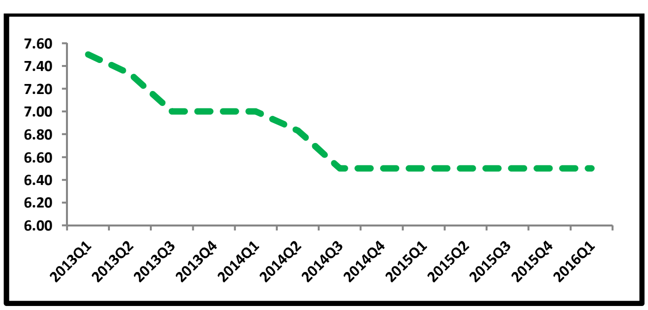
## 2.3. Fiscal spending

From the expenditure account, government expenditure plunged by 8% in 2015Q4, thus negatively impacting domestic aggregate demand. The declining trend in government expenditure, continued in 2016Q1 as net government liquidity injections declined to FRW 2.7 billion from FRW 60.2 billion recorded in the previous quarter.

## 2.4. Previous monetary policy stance

BNR has maintained its accommodative monetary policy stance in 2015 by keeping the KRR unchanged at 6.5%. This policy stance is justified by the current ease in inflation that gives room for increasing the financing of economic activities and to encourage domestic savings and financial sector deepening.

**Figure 24:** The Key Repo Rate in Rwanda



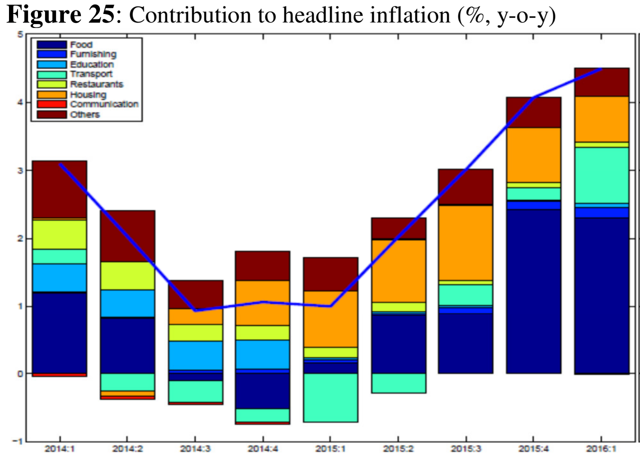

**Source:** Monetary Policy & Research Department (2016)

In response to an accommodative monetary policy stance, y-o-y growth in the stock of credit to the private sector picked up to reach 25.3% in 2016Q1 from 19.2% in the last quarter of 2015.

## 2.5. Inflation developments

In 2016Q1 headline inflation went up to 4.5% on average from 4.1% recorded in 2015Q4. This increase was mostly reflected in transport inflation reaching 4.6% from 1.0% during the same period. But, though food inflation slightly reduced, it remained high as the effect from the jump in vegetables that took place in 2015Q4 has not yet died out. Housing inflation declined to 3.0% from 3.5% but was not big enough to offset the pressures from food and transport.

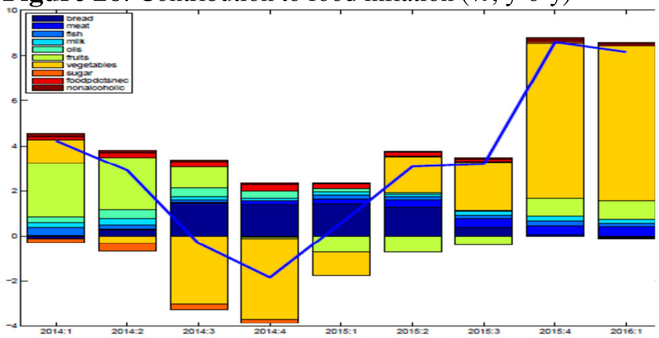
**Figure 25**: Contribution to headline inflation (%, y-o-y)




**Source:** BNR, Monetary Policy & Research Department (2016)

Food inflation slightly declined from 8.6% on average in 2015Q4 to 8.2% in 2016Q1 as inflation for bread and cereals slid from 0.3% to a deflation of 0.25% while inflation for vegetables remained almost constant at around 19.2% when comparing the two quarters.

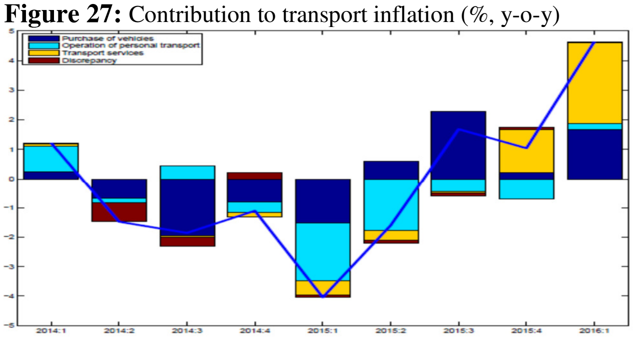
**Figure 26**: Contribution to food inflation (%, y-o-y)




**Source:** BNR, Monetary Policy & Research Department (2016)

The transport inflation jumped in part reflecting the effect of the exchange rate depreciation on purchase of vehicles (inflation in purchase of vehicles went up from 0.6% to 4.2%) but also reflecting the increase in bus fares for local transport. Indeed, the increase in bus fares covers the 3 months while it covered only 2 months in the previous quarter as it started in November 2015.

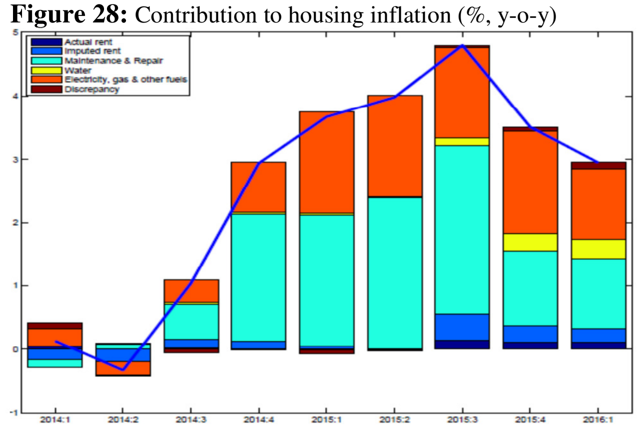
**Figure 27:** Contribution to transport inflation (%, y-o-y)




**Source:** BNR, Monetary Policy and Research Department (2016)

Most of the downward pressures on inflation in 2016Q1 came from housing despite the effect of increased tariffs for water and electricity. Housing inflation slowed down following the falling in inflation for solid fuels (firewood and charcoal) from 7.0% to 4.4% because of the base effect. Indeed, in 2014Q4 solid fuels inflation was 5.4% and jumped to 10% in 2015Q1.

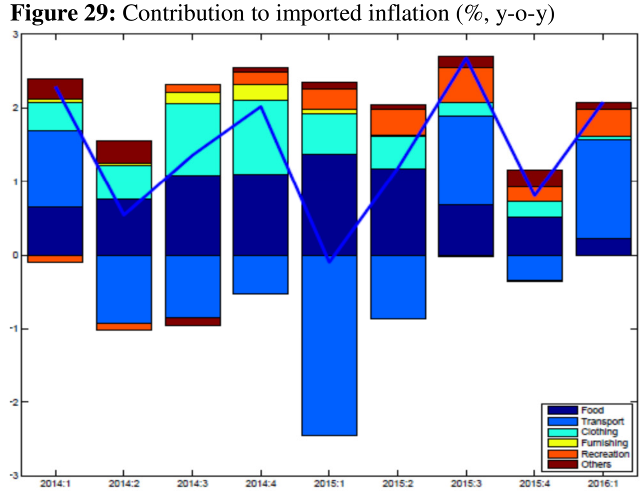
**Figure 28:** Contribution to housing inflation (%, y-o-y)




**Source:** BNR, Monetary Policy and Research Department (2016)

Except in 2015Q3, imported inflation was very moderate in 2015 hovering around 1.1% on average. In 2016Q1, imported inflation bounced up to 2.1% on average and continued to be driven by transport costs which were affected by purchase of vehicles while imported food inflation reduced from 2.5% to 1.1%.

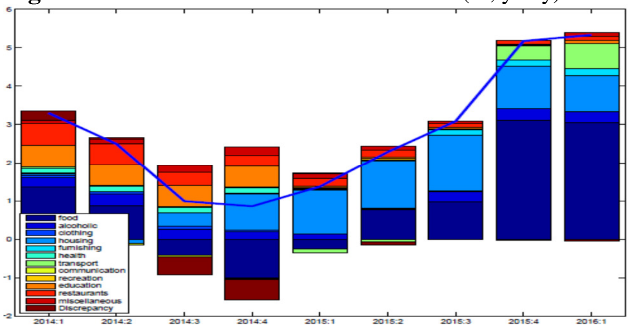
**Figure 29:** Contribution to imported inflation (%, y-o-y)




**Source:** BNR, Monetary Policy and Research Department (2016)

Domestic inflation continued to show the same trend as in headline inflation. It recorded low levels in 2015Q1 to 2015Q3 on average and picked up to 5.2% in 2015Q4 and remained high in 2016Q1 at 5.3%. This was a result of the variations in the domestic food prices.

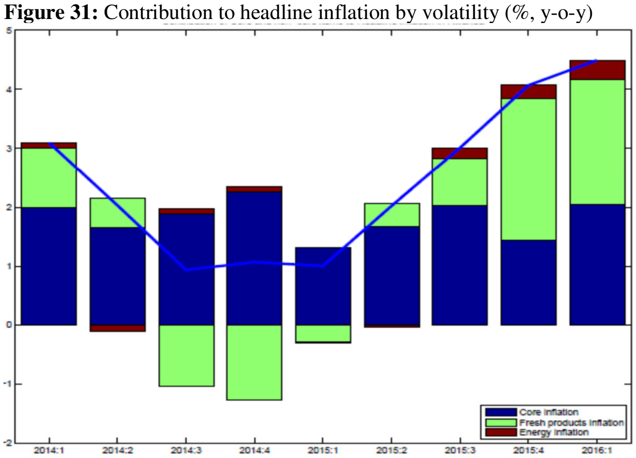
**Figure 30:** Contribution to domestic inflation (%, y-o-y)




**Source:** BNR, Monetary Policy and Research Department (2016)

Core inflation stood at 2.8% in 2016Q1 on average slightly above the levels recorded in 2015. This is linked to the still weak but improving aggregate demand and justifies the decision of the BNR to continue implementing an accommodative monetary policy.

**Figure 31:** Contribution to headline inflation by volatility (%, y-o-y)




**Source:** BNR, Monetary Policy and Research Department (2016)

## 3. INFLATION OUTLOOK

### 3.1 Domestic aggregate demand

Though the global economy is faced with several challenges, the Rwandan economy has continued to perform relatively well. Thus, domestic aggregate has remained low but is progressively improving, thanks to the BNR accommodative monetary policy.

#### 3.1.1 The Composite Index of Economic Activities and turnovers

Despite the ongoing sluggish global economic recovery, real GDP grew by 7.3 percent y-o-y in 2016Q1, up from 7.0% realized in 2015Q4. Going forward, the economy is expected to slightly slowdown given that real GDP growth for all sectors is contracting in q-o-q terms but also judging from the trend of high frequency indicators. In the first two months of the second quarter, growth in total turnovers slowed to 7.0% in 2016 compared to 11.1% in the same period of 2015 whereas growth in the real composite index of economic activities also dropped to 12.2% from 14.5% during the same period.

#### 3.1.2 Credit to Private Sector

The financing of the economy has remained quite robust as y-o-y growth in credit to the private sector expanded from 19.2% in 2015Q4 to 25.3% in 2016Q1. Going forward, aggregate demand is expected to remain non-inflationary. However, the stock of credit may decline in near future following the decrease in annual growth of new authorized loans from 25.7% in 2015Q4 to 12.1% in the following quarter.

### 3.2 Supply shock

Food harvest in 2016 season-A increased compared to 2015 season-A though food inflation was higher in 2016Q1. Food inflation may ease in 2016Q2 looking at the April and May trend. Yet, the Rwanda Meteorology Agency, maintains that the El Niño effect persisted till May 2016 and that the agricultural season B may have been affected but Since June the climate may evolve in neutral conditions. We then expect food inflation to continue easing but may peak up in the middle of the dry season ahead.

### 3.3 Exchange rate developments

The FRW depreciated against the USD by 4.1% in May 2016 and this trend is expected to continue and the depreciation is expected to reach 8% by the end of December 2016. This coupled with the depreciation of the FRW against the currencies of the Eurozone, UK, Sweden and Switzerland has led to the depreciation of both the nominal and real effective exchange rate, with negative implications on imported inflation and competitiveness.

### 3.4 Global and regional inflationary pressures

Inflation around the world is still evolving below targets standing at 1.1% in US for April and in deflation of -0.1% for May in euro zone. In the EAC region, since January 2016 inflation has generally eased and likely lessened imported inflation. However, this trend is likely to reverse since the entire region was hit by the El Niño which affected the agriculture produce and may be insufficient during the dry season.

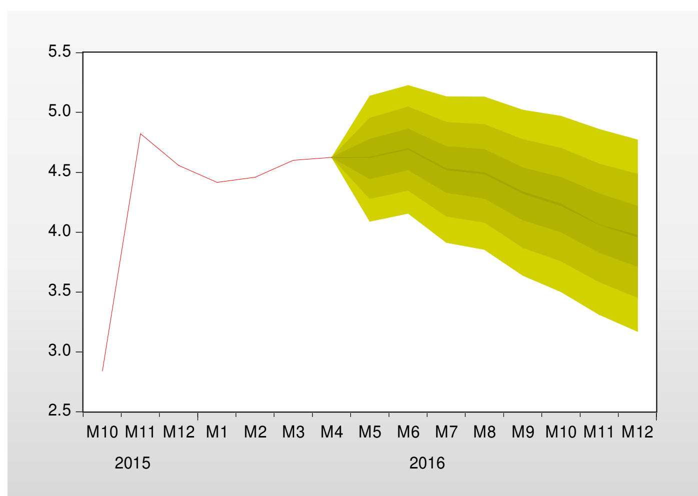
### 3.5 International commodity prices

The IMF projects a small but gradual increase in international oil prices till the remaining quarters of 2016. These developments will pose upward pressures on fuel and lubricants inflation. Beverage export products will slightly fall or remain unchanged and exert further pressures on exchange rate.

### 3.6. Inflation forecasts

Since November 2015, headline inflation has remained slightly above 4% mainly due to the vegetables inflation shock. However, risks such as the depreciation of the nominal and real effective exchange rate, bad weather and the volatility in international oil and other commodity prices remain. Other upside inflationary pressures may come from the level shift in domestic bus fares, education fees, taxes on second hand clothes and shoes and in domestic fuel prices. On the downside, some deflationary pressures may come from the reduction in the tariffs on commodities like sugar and rice. In view of the above risks, inflation is expected to lie between 4.0%-4.7% in 2016Q2 and 3.6%-4.6% in 2016Q3.

**Figure 32**: Inflation fan chart




**Source**: BNR, Monetary Policy & Research Department (201

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