National Bank of Rwanda

QUARTERLY INFLATION REPORT

WP02/2015Q1

Kigali, May 2015

LIST OF ACCRONYMS

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

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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.

As previously stated in the 2014Q4 inflation report, the Rwandan economy has continued to strengthen, growing by 7.0% in 2014 compared to 4.7% in 2013. However, the economy slowed from 8% in 2014Q3 to 6.2% in 2014Q4 following the contraction in manufacturing as well as in mining and quarrying. Growth in 2014Q4 was also constrained by weak aggregate demand as total final consumption increased by only 2% in 2014Q4 from 8% in 2013Q3.

The economy regained momentum in 2015Q1, though at a slow pace, as indicated by high frequency indicators. The service sector turnovers slightly dropped to 11.6% in 2015Q1 from 12.5% in 2014Q1 whereas the industry sector turnovers grew by 16.9% from 13.0% during the same period, making total turnovers to modestly grow by 13% in 2015Q1 from 12.6% in 2014Q1.

Good economic performance is boosted by the BNR accommodative monetary policy given that outstanding credit to the private sector surged by 21.2% in March 2015 from 11.8% in March 2014 whereas new authorized loans increased by 30.4% in March 2015 compared to 23.7% in March 2014 if the December-March period is considered.

In December 2014-March 2015 period, the Rwandan Franc has remained relatively stable, mildly depreciating against the USD by 2%, the Kenyan Shillings by 0.3% and the Burundian Franc by 2.4%. During the same period, the RWF appreciated against: the British pound by 2.7%, the Euro by 9.1%, the Tanzanian shillings by 4.6% and the Ugandan shillings by 4.7%. The continued relative stability of the Rwandan Franc will continue to cushion the economy from imported inflation.

Despite slightly rising to 0.9% in April 2015 from 0.8% of the preceding month, headline inflation remained low and stable in 2015Q1, slightly declining to 1% on average from 1.1% of the previous quarter. Low inflation levels were mainly shaped by price movements in food, housing, transport and education costs. Looking ahead, headline inflation is projected to remain contained, standing at around 2.8% in June and 3.5% in December 2015, owing to the fact that inflation in the region is still low but rising, aggregate demand is still weak but improving whereas local pump prices have been revised upwards with minimal short-run inflationary effects.

ACKNOWLEDGEMENTS

A team from the Monetary Policy & Research Department, spearheaded by the Modeling and forecasting division, prepared the 2015Q1 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

In 2014, the global economy stagnated at 3.4%, due to lower than expected growth in emerging markets (especially in the second half of 2014) despite a slight pickup in growth of advanced economies principally the US economy. Generally, the world economy was influenced by global low inflation, expected rise in interest rates in the US, the decline in oil prices and large exchange rates movements.

Table 1: Economic growth developments (in %)

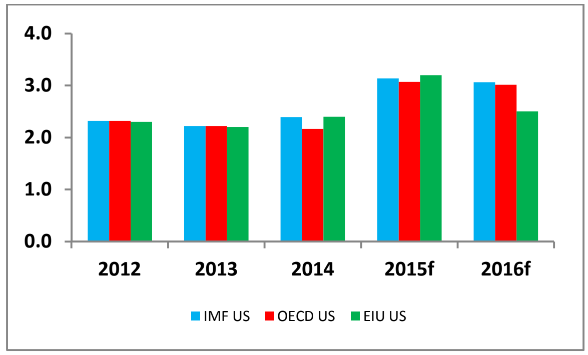
	2014				2015	2013	2014	2015[1]
	Q1	Q2	Q3	Q4	Q1			
World	1.9	2.4	2.8	2.4	2.0	3.4	3.4	3.5
USA (QoQ)	-2.1	4.6	5.0	2.2	0.2	2.2	2.4	3.1
Euro area	1.1	0.8	0.8	0.9	1.0	-0.5	0.9	1.5
Japan	5.1	-6.4	-2.6	1.5	2.3	1.6	-0.1	1.0
UK (YoY)	2.7	2.9	2.8	3.0	2.4	1.7	2.6	2.7
China	7.4	7.5	7.3	7.3	7.0	7.8	7.4	6.8
India (YoY)	4.6	5.7	5.3	7.5	7.4	6.9	7.2	7.5

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

The U.S economy grew by 2.4% in 2014 from 2.2% in 2013 and by 2.6% in 2014Q4 from 5% in 2014Q3 on quarterly basis. This growth was supported by buoyant industrial activities and increased consumption following the drop in unemployment rate, consumer confidence and lower oil prices. The US economy is expected to increase by 3.1% in 2015Q1 and it will continue to be driven by declining unemployment rate that reached 5.5% in February 2015. However, the 2015Q1 growth may be affected by the bad weather while net exports will be affected by the strong value of the US dollar.

[1] 2015 figures are WEO projections

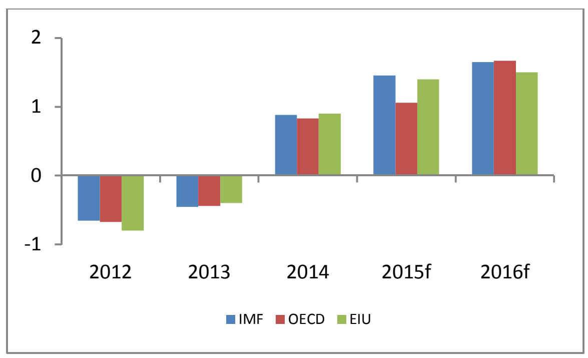
Figure 1: Growth forecasts for the US (%, YoY)



Source: IMF, OECD & EIU (May. 2015)

The Euro zone recorded growth of 0.9% in 2014 compared to -0.5% of 2013 but it is still far below potential. The Euro zone economy is expected to rebound, with growth reaching 1.2% in 2015 on the back of improving financial conditions, less restrictive fiscal policy, lower oil prices and increased net exports due to the depreciating Euro.

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

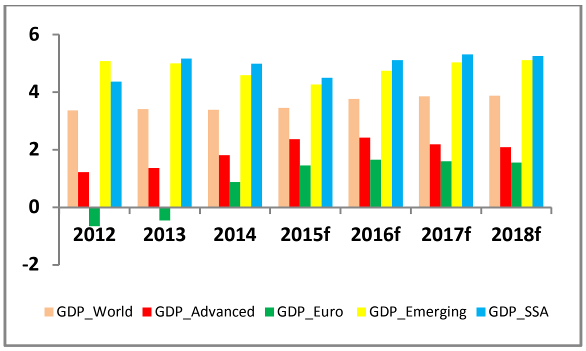


Source: IMF, OECD & EIU (May 2015)

The Japanese economy went almost in recession with a growth of -0.1% in 2014 reflecting weak consumption following increased consumption tax. The 2015 projections are slightly optimistic as the economic growth is expected to stand at 1% supported by falling oil prices and expected rise in wages.

Emerging economies generally slowed down but with mixed performance; with growth in China and Latin America declining while India and Russia recorded stronger than expected growth in the second half of 2014. In the outlook, the Chinese economy expects a growth of around 7% on the back of fiscal stimuli. Latin America will face challenges as the world expects commodity prices to continue falling while geopolitical tensions and oil prices still weaken the outlook for the Russian economy.

Figure 3: Growth outlook for key economies



Source: IMF, WEO (May 2015)

Global economic growth outlook is still maintained at the same level as in the January 2015 WEO, with growth projections of 3.5% and 3.8% in 2015 and 2016 respectively. To achieve this growth, fiscal consolidation is anticipated to be moderate in a majority of countries and monetary policies are also likely to remain accommodative with gradual tightening expected in the US. The global growth is projected to be driven by the US in 2015 as the emerging markets decelerate further but the latter are expected to rebound in 2016. The global economic growth will be subject to oil prices movements, the prevailing low global inflation, the strengthening of the US dollar and lower potential growth in advanced economies and in emerging markets.

1.2. Monetary policy and international financial markets

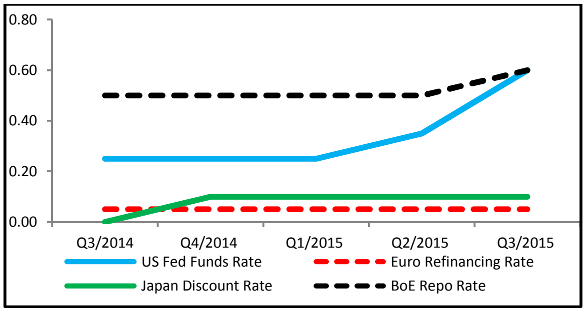
Monetary policies remained accommodative around the globe to continue supporting the economic recovery. Long term nominal interest rates and government bond yields declined consistent with low inflation, low oil prices, weak demand and falling real interest rates due to reduced term premiums.

In March 2015 the U.S Federal Reserve kept the interest rate at 0.25%. The Fed is expected not to raise interest rate even in June or longer given the decelerated economic performance in 2015Q1 and the reduced pace in job creation. This view is echoed by the IMF, which advised the FED in the May 2015 article IV to defer monetary policy tightening until 2016 so that the economy and employment can continue to grow.

In April, The European Central Bank kept the refinancing interest rate unchanged at 0.05%. In March, the ECB started the quantitative easing and confirms signs of its effectiveness in supporting economic recovery in the Euro area.

In emerging markets, Brazil and Russia tightened their policies in 2015Q1 as expected. Brazil tightened again in April reacting to higher inflation while Russia surprisingly loosened due to reducing inflation expectations. The People's Bank of China cut further the interest rate to 5.1% in May 2015 because of low growth. However, monetary policy is less effective as it used to be in China, explaining the increased reliance on the fiscal stimulus.

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



Source: http://www.tradingeconomics.com (Jan. 2015)

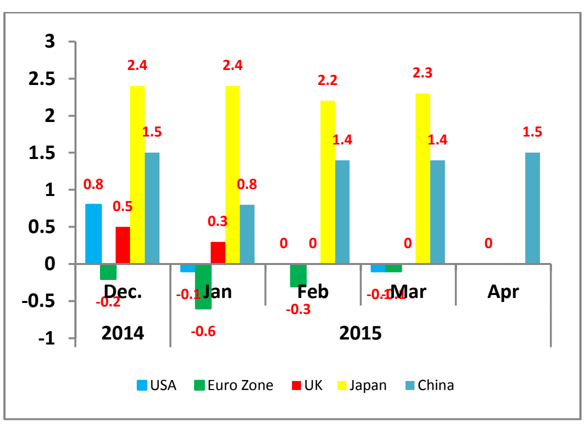
1.3. Global inflation developments and outlook

In 2015Q1, inflation remained benign in advanced countries, in emerging markets and in developing economies as well. Low inflation levels reflected low oil prices and softer prices for other commodities.

In the Euro area and in the US, inflation evolved in negative in 2015Q1 and stood at -0.1% in March 2015. The inflation continues to be below the 2% target due to lower energy costs.

In Japan, headline inflation evolved around 2.3% in 2015Q1 above market expectations while in China it stood at 1.5% in April and remained below market desired level.

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



Source: http://www.tradingeconomics.com

In EAC, same as 2014Q4 headline inflation was benign and non-inflationary in 2015Q1. In April 2015, headline inflation bounced slightly up in all EAC countries due to increased food prices despite downward pressures from transport following the low oil prices.

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

	RWANDA	UGANDA	KENYA	TANZANIA	BURUNDI
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	-

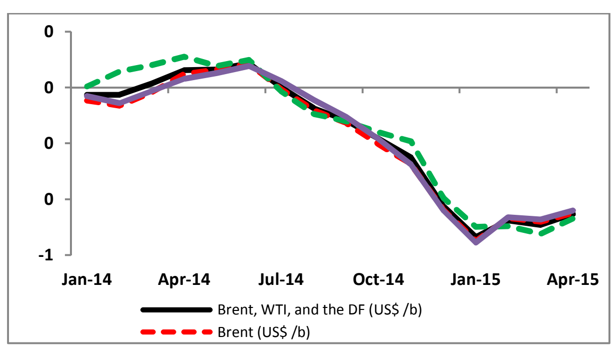
Source: Country Bureaus of Statistics

1.4. International commodity prices

Following the continued appreciation of the US dollar against other major currencies, main indices declined and commodity prices fell by 2.8% in March 2015.

Crude oil prices fell 3.8% in March, averaging USD 52.8/bbl from USD 55/bbl in early February due to easing demand and surplus supply. Prices were also affected by geopolitical events in Yemen and negotiations with Iran, with prices topping $56/bbl in early April.

Figure 6: Oil prices' developments (%, YoY)

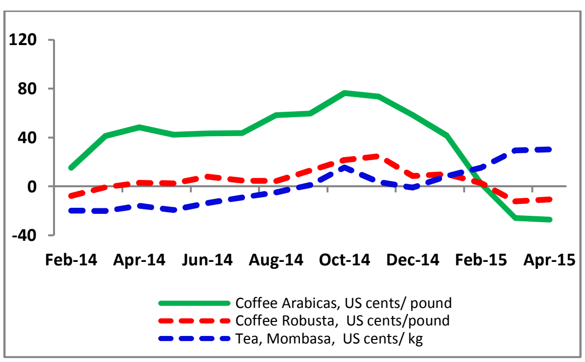


Source: IMF, WEO (Database, May 2015)

Prices for non-oil commodities also generally fell in March 2015. Metals prices fell by 1.9% in March, down an 8th straight month, due to weak demand, particularly in China, and continued increases in supply. Prices for many metals dropped with the largest decline coming for iron ore, down 9%. These declines were partly offset by Copper prices which rose by 4% because of supply disruptions and Uranium prices which also rose 4% due to relatively strong demand.

Agriculture prices fell by 2.4 % in March, and were down 10 of the last 11 months, reflecting plentiful supply and favorable production outlooks. Coffee Arabica and Robusta prices dropped by 11% and 5% respectively, owing to higher exports from Brazil, following a depreciating currency. Tea prices increased 4% due to production in Kenya because of dry weather.

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



Source: IMF, WEO (Database, May 2015)

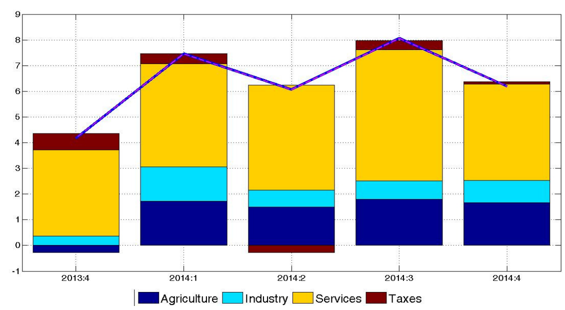
2. THE DOMESTIC ECONOMY

2.1. Domestic demand and output

After slowing to 4.7% in 2013, real GDP grew by 7.0% in 2014, surpassing the initial projection of 6.0%. In annual terms, real economic growth slowed from 8.0% in 2014Q3 to 6.2% in 2014Q4 though the latter is still higher than the 4.2% growth recorded in 2013Q4.

Economic growth in 2014Q4 was buoyed by the service sector, which grew by 8% compared to 7% in 2013Q4. The industry sector also propelled growth, rising by 5% in 2014Q4 compared to 3% in 2013Q4. Growth in agriculture was however more robust, standing at 5% in 2014Q4 from -1% in 2013Q4.

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



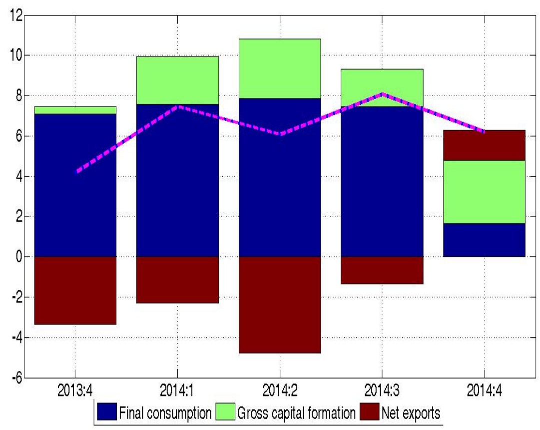
Source: BNR, Monetary Policy & Research Department (2015)

Industry sector growth was largely bolstered by the good performance of the construction subsector, which rose by 12% in 2014Q4 from the zero-growth pattern observed in the same quarter of 2013. Electricity also registered higher growth of 9% in 2014Q4, just like in 2013Q4. However, total manufacturing contracted by -2% in 2014Q4 compared to a positive growth of 3% in 2013Q4. Growth in mining and quarrying drastically fell to 1% from 16% during the same period whereas food manufacturing plunged by -11% from 6%.

The contraction in manufacturing as well as in mining and quarrying provoked the decline in real GDP growth in the last quarter of 2014 to 6.2% compared to 8% in the previous quarter and 4.2% in the same period in 2013.

Growth in 2014Q4 was also constrained by weak aggregate demand as total final consumption increased by only 2% from 8% in both 2014Q3 and 2013Q4 respectively. The main driver of growth was gross capital formation, which grew by 11% in 2014Q4 compared to 7% in 2014Q3 and 1% in 2013Q4.

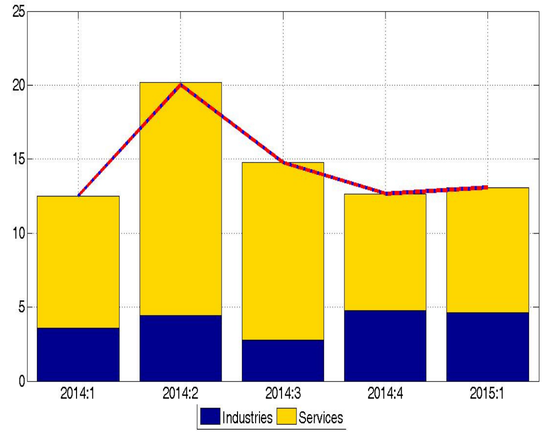
Figure 9: Real GDP by expenditure (% y-o-y)



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

Data on high frequency indicators show that the economy improved in 2015Q1. Total turnovers, which cover non-agricultural economic activities, increased by 13% in 2015Q1 from 12.6% of the same quarter in 2014 whereas industry sector turnovers increased by 16.9% from 13.0% but growth in service sector turnovers slightly dropped to 11.6% from 12.5% during the same period.

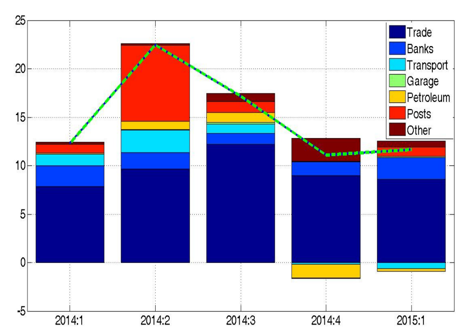
Figure 10: Contribution to total turnovers



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

The slight decrease in service sector turnovers in 2015Q1 was mainly due to the decline in turnovers for trade services, transport and petroleum companies. Nonetheless, turnovers for banks as well as for posts and telecommunications registered increasing positive contribution to the services sector turnovers. The turnovers for banks grew by 14.8% in 2015Q1 compared to 14.2% in 2014Q1 whereas turnovers for posts and telecommunications augmented by 13.3% from 12.5% during the same period. Turnovers for trade services had the biggest positive contribution, despite registering modest growth of 18.4% in 2015Q1 from 17.5% of the same period in 2014.

Figure 11: Services' turnovers

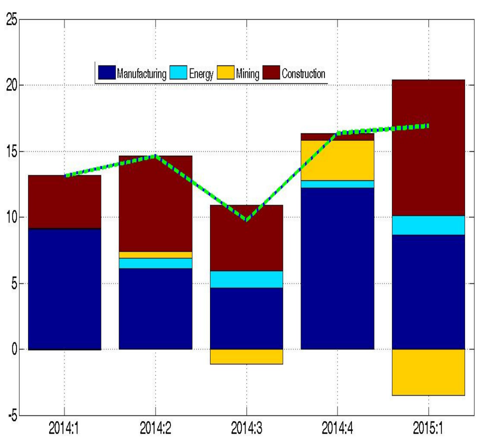


Source: BNR, Monetary Policy & Research Department (2014)

The expansion in the industry sector turnovers was mainly due to the high increase in turnovers for manufacturing, construction and energy while mining turnovers had a negative contribution. The latter contracted by -24.2% in 2015Q1 from 0.4% growth in 2014Q1. The construction subsector turnovers grew by 39.8% in 2015Q1, from 15.8% of the same period in 2014.

Despite marginally decelerating to 17.0% in 2015Q1 from 18.8% in 2014Q1, the manufacturing sub-sector remained one of the biggest contributors to industry turnovers. The energy sub-sector recorded significant increase in turnovers, growing by 17.0% in 2015Q1 from the contraction of -0.6% in 2014Q1.

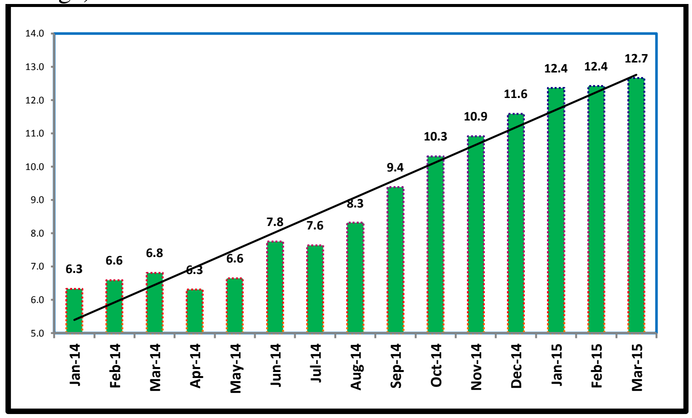
Figure 12: Industry turnovers



Source: BNR, Monetary Policy & Research Department (2014)

Improvement in real economic activities for 2015Q1 is further affirmed by the upward trend in the real Composite Index of Economic Activities (CIEA). On annual basis, the real CIEA increased by 12.7% in March 2015 compared to 12.4% in the previous two months.

Figure 13: The trend of the Real CIEA (annual average % change)

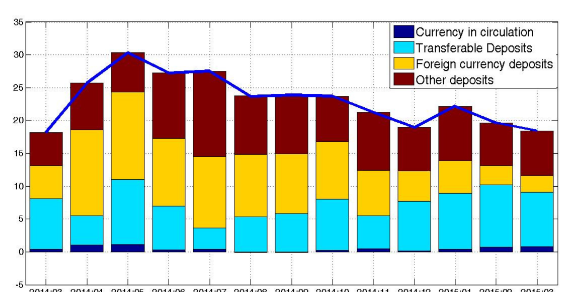


Source: BNR Monetary Policy & Research Department

The observed improvement in real sector activities has partly been a result of increased economic financing supported by the BNR accommodative monetary policy stance adopted since June 2013. Owing to monetary policy loosening, money supply (M3) increased by 18.4% y-o-y in March 2015 compared to 18.2% recorded in the same period of 2014.

From the liability side, transferable deposits increased by 22.6% in March 2015 from 21.3% in March 2014 while foreign currency deposits declined to 12.9% from 28.6% during the same period. Though currency in circulation grew by 7.3% in March 2015 from 3.6% in March 2014, its contribution to M3 growth declined given the fall in its share in M3 from 10.5% in March 2014 to 9.5% in March 2015.

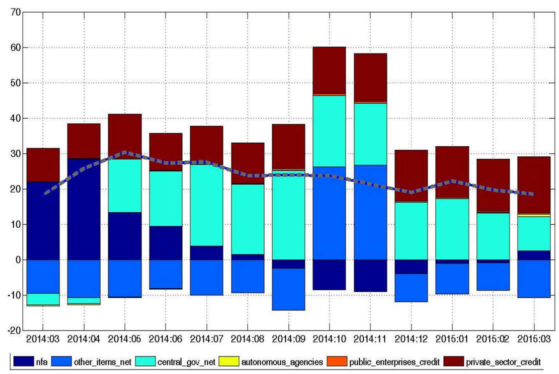
Figure 14: M3 from the liability side (%, y-o-y)



Source: BNR, Monetary Policy & Research Department (2014)

From the asset side, outstanding credit to the private sector surged by 21.2% in March 2015 from 11.8% in March 2014. Taking December 2014 as a reference period, outstanding credit to the private sector grew by 1.5%, 3.4% and 5.4% in January, February and March 2015 respectively.

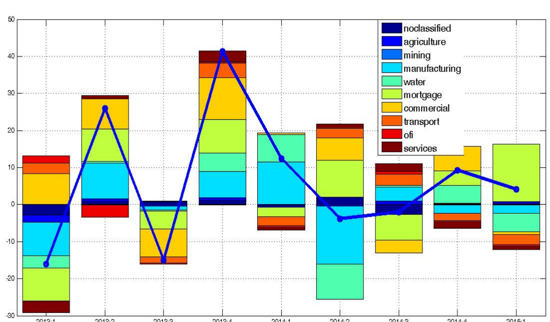
Figure 15: M3 from the asset side (%, y-o-y)



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

However, growth in new authorized loans weakened, standing at 7.3% in 2015Q1 from 15.8% of the previous quarter and 70.2% in 2014Q1 and most of these loans (36.2%) went to mortgages. In year-on-year terms, new authorized loans increased by 13.2% in March 2015. Between December and March, new authorized loans increased by 30.4% in March 2015 compared to 23.7% in March 2014.

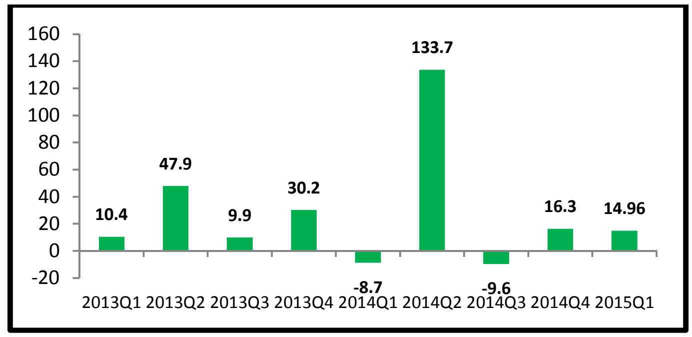
Figure 16: New authorized loans (%, QoQ)



Source: BNR, Monetary Policy & Research Department (2014)

In 2015Q1, government net liquidity injections declined to RWF 14.9 billion from RWF 16.3 billion of the previous quarter but quite higher compared to RWF -8.7 billion recorded in 2014Q1. However, these liquidity injections are still low to stimulate the increase in aggregate demand.

Figure 17: Government net liquidity injection (FRW Billions)



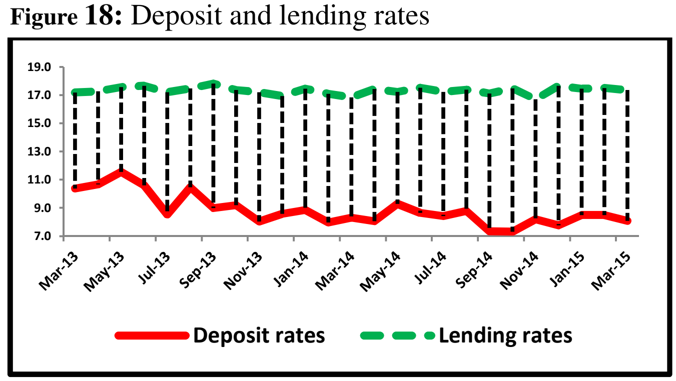
Source: NBR, Monetary Policy & Research Department (2014)

2.2. Financial Sector developments

2.2.1 Interest rate developments

The deposit rate fell to 8.09% in March 2015 from 8.31% in March 2014 whereas the lending rate increased from 16.83% in March 2014 to 17.37% in March 2015, leading to the uptick in the interest rate spread from 8.52% to 9.28% during the same period. Lending rates have remained higher on the back of higher commercial banks' operating costs and higher provisions for bad debts.

Figure 18: Deposit and lending rates

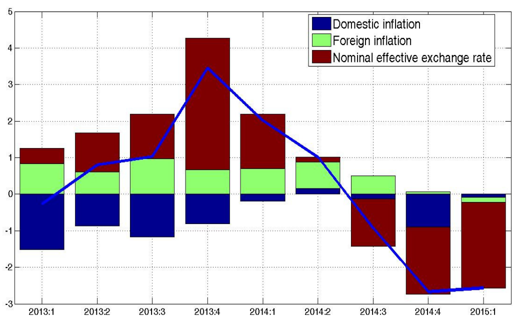


Source: BNR, Monetary Policy & Research Department (2014)

2.2.2 Exchange rate developments

The REER appreciated by -2.6% in 2015Q1 mainly due to the appreciation of the RWF against the currencies of major trading partners as well as the decline in Rwandan headline inflation relative to the level of inflation in main trading partners.

Figure 19: Contribution to the RER appreciation (%, q-o-q)



Source: BNR, Monetary Policy & Research Department (2014)

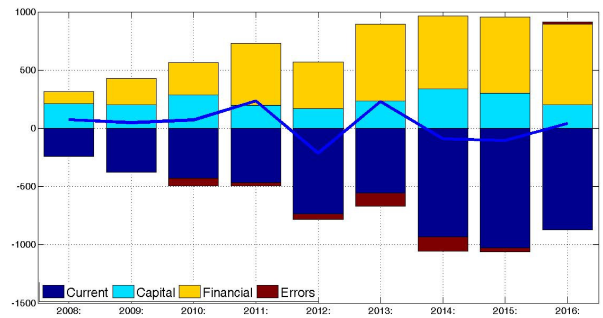
Between December and March, the RWF depreciated against: the USD by 2%, the Kenyan Shillings by 0.3% and the Burundian Franc by 2.4%. During the same period, the RWF appreciated against: the British pound by 2.7%, the Euro by 9.1%, the Tanzanian shillings by 4.6% and the Ugandan shillings by 4.7%.

In Rwanda, exchange rate movements are in part influenced by two components of the BOP account: the financial and capital inflows especially foreign aid but also by the trade balance.

Basing on projections, the balance of payments are expected to drop by 17.7% in 2015, with the BOP deficit increasing to USD 106.4 million from USD 90.4 million of the preceding year. A BOP surplus of USD 41.1 million is however projected in 2016.

The main driver of the BOP deficit in 2015 is the current account, exerting positive influence on the BOP deficit whereas the capital account balance and the financial account balance all have negative 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.

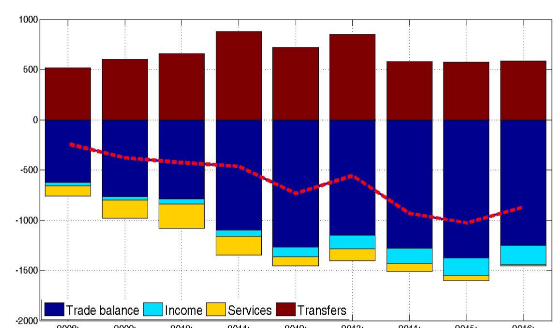
Figure 20: The BOP decomposition (Millions USD)



Source: BNR, statistics department (2014)

The current account deficit widened in 2015 to reach USD 1028 million in 2015 compared to USD 932.9 million in 2014. The widening current account deficit in 2015 is mainly attributed to the expansion of the trade deficit.

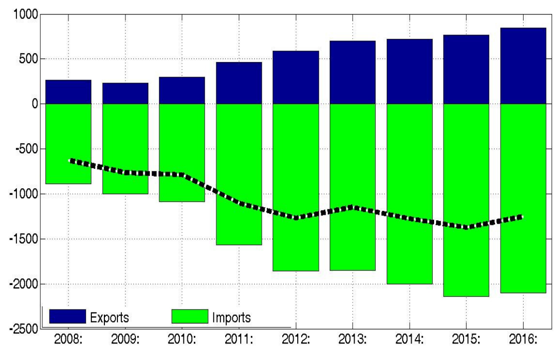
Figure 21: The current account (Million USD)



Source: BNR, statistics department (2014)

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 dynamics.

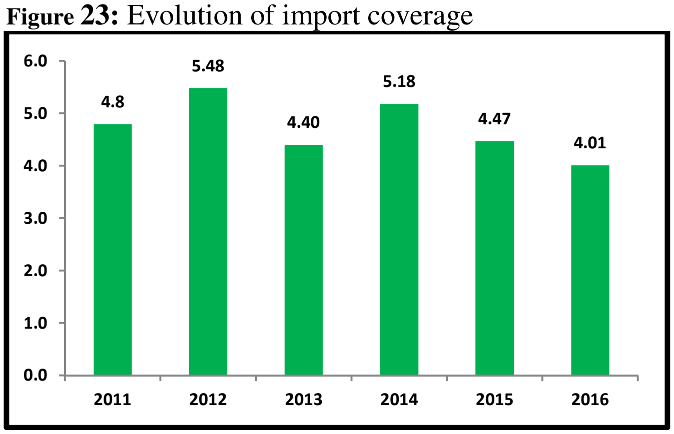
Figure 22: Evolution of the trade balance (USD, millions)



Source: BNR, statistics department (2014)

In terms of months of imports, the cover rate of imports by exports dropped to 4.47 from 5.18 months of imports between 2014 and 2015, further affirming that there are likely to be exchange rate pressures throughout the current year.

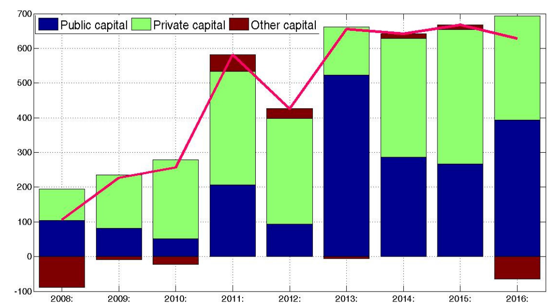
Figure 23: Evolution of import coverage



Source: Monetary Policy & Research Department (2014)

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 24: The financial account (Million USD)



Source: BNR, statistics department (2014)

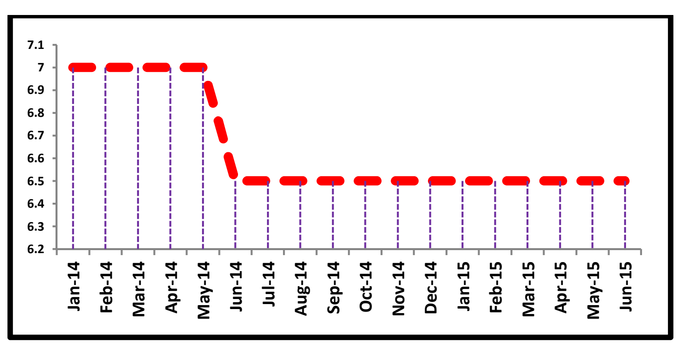
2.3. Fiscal spending

Aggregate demand has continued to improve on the back of expansionary fiscal and monetary policies. Fiscal spending increased by 8.5% Y-o-Y in March 2015 on cash basis, compared to 2.8% of the same period in 2014 while it increased by 24.1% between March and February 2015. This trend in fiscal spending provides positive prospects for recovery in aggregate demand but may also result into inflationary pressures in future.

2.4. Previous monetary policy stance

Hitherto, the National Bank of Rwanda has continued with an accommodative monetary policy stance, maintaining the key repo rate at 6.5% p.a. since June 2014.

Figure 25: The Key Repo Rate in Rwanda



Source: Monetary Policy & Research Department (2015)

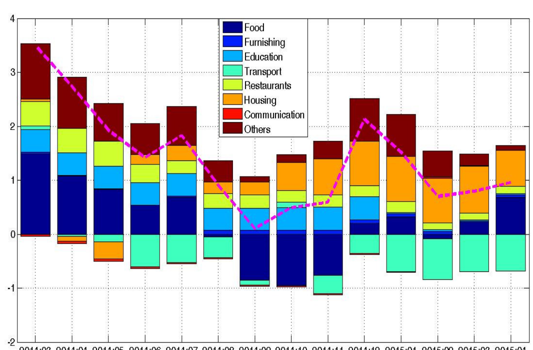
Monetary policy easing has paid off given that outstanding credit to the private sector during the first three months increased by 20% in 2015 compared to 12% in the same period of 2014. Monetary policy can be expected to remain easy as long as aggregate demand remains weak and inflation is subdued.

2.5. Inflation developments

In 2015Q1, headline inflation remained low and stable slightly declining to 1% on average from 1.1% of the previous quarter and stood at 0.9% in April. Low inflation levels resulted from price movements in food, housing, transport and education costs.

From 2014Q4 to 2015Q1 food prices increased from -1.8% to 0.6% and housing inflation moved from 2.9% to 3.7%. The main deflationary pressures came from transport prices that reduced from -1.1% to -4.1% and education costs that fell from 7.4% to 0.4% during the same period.

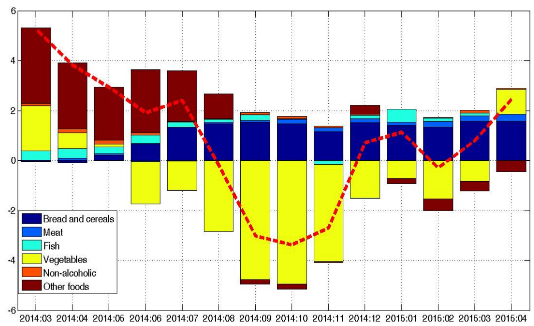
Figure 26: Contribution to headline inflation, (% YoY)



Source: Monetary Policy & Research Department (2015)

The quarterly average increase in food inflation was driven by the ease in vegetables deflation from -9.6% in 2014Q1 to -2.9% in 2015Q1 consistent with the expected food variability during the transition period between seasons A and B. vegetables were deflationary in March 2015 but inflationary during the same period of 2014.

Figure 27: Contribution to food inflation, (% YoY)

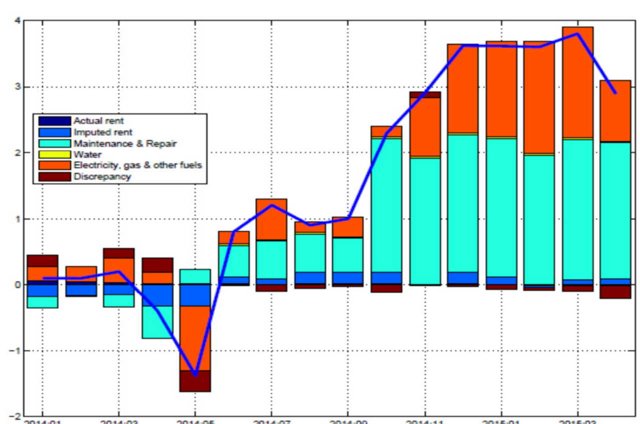


Source: Monetary Policy & Research Department (2015)

Education inflation fell basically because the school fees remained relatively stable compared to 2014. School fees did not change in the beginning of the new academic year in January 2015 in comparison to 2014 and this was mainly reflected in school fees inflation for secondary education that fell from 12.5% to 0.05%.

Housing inflation stayed constant since December 2014 but picked up in March 2015 from 3.6% to 3.8% mainly due to the increase in imputed rentals for own-occupiers from -0.1% in February to 0.2% in March 2015.

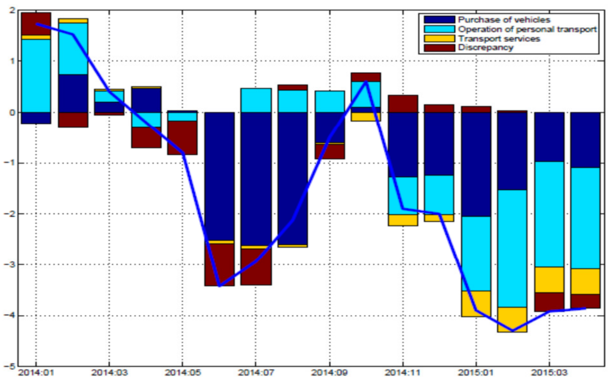
Figure 28: Contribution to housing inflation, (% YoY)



Source: Monetary Policy & Research Department (2015)

Transport inflation decreased partly due to the reduction in local pump prices from 895 RWF/liter in mid-December 2014 to 845 RWF/liter in January and to 810 RWF/liter in early February 2015 as a result of the continued fall in international oil prices that reached USD 47.11 per barrel in January. This reduction was reflected in the transport inflation principally in fuels and lubricants.

Figure 29: Contribution to transport inflation, (% YoY)

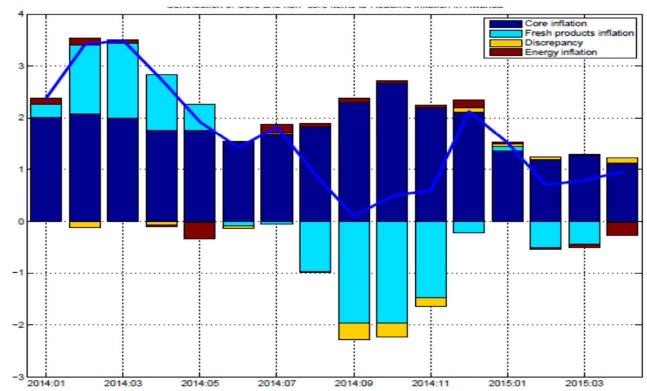


Source: Monetary Policy & Research Department (2015)

Imported inflation slid into negative numbers from 2% in 2014Q1 to -0.1% in 2015Q1 on average reflecting mainly the fall in international transport inflation following the decline in oil prices. Generally, inflation for other imported CPI components like food and clothing also slid in 2015Q1 principally reflecting the easing inflation in major trading partners.

Domestic inflation was subdued standing at 1.4% on average but higher than 0.9% of the previous quarter. Domestic inflation was mainly driven by falling inflation for education and transport that was offset by a slight increase in housing inflation.

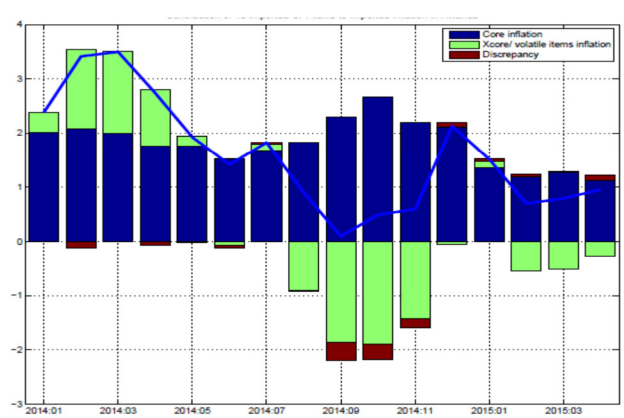
Figure 30: Headline inflation by source, (% YoY)



Source: Monetary Policy & Research Department (2015)

Core inflation was moderate in 2015Q1 but has been declining since October 2014 despite the prevailing BNR accommodative monetary policy stance. Core inflation was 3.1% on average in 2014Q4 and it slid to 1.7% in 2015Q1. Although this may be linked to the normal slowdown in the aggregate demand in the first months of every first quarter, core inflation remained subdued at 1.6% in April 2015 indicating that aggregate demand may take more time to recover from this slowdown.

Figure 31: Inflation by volatility, (% YoY)



Source: Monetary Policy & Research Department (2015)

3. THE INFLATION OUTLOOK

3.1 Domestic aggregate demand

Despite the ongoing expansionary fiscal and monetary policies, aggregate demand is still weak and is expected to remain so in the near term and thus unlikely to pose much inflationary pressures.

3.1.1 The Composite Index of Economic Activities

The Rwandan economy continued to perform well in 2015Q1 as indicated by high frequency indicators. On annual basis, the real CIEA increased by 12.7% in March 2015 compared to 12.4% in the previous two months. However, the trend of the real CIEA for the last three months shows some slight deceleration in economic activities.

3.1.2 Turnovers of industry and services

Total turnovers, which cover non-agricultural economic activities, increased by 13% in 2015Q1 from 12.6% of the same quarter in 2014. The trend of total turnovers in the last two quarters shows stagnation in economic activities, which confirms some slowdown as indicated by the real CIEA.

3.1.3 Credit to Private Sector

Growth in new authorized loans weakened to 7.3% in 2015Q1 from 15.8% of the previous quarter indicating that economic activities may not accelerate much.

3.2 Supply shock

From January to April 2015 food supply (especially vegetables) exerted inflationary pressures and this is likely to continue as the sunny season approaches in June.

3.3 Exchange rate developments

Generally, the Rwandan franc continues to appreciate against the currencies of major trading partners and this will contribute to lessen the imported inflation.

3.4 Global and regional inflationary pressures

Global inflation has remained subdued. In the Euro area and in the US, inflation evolved in negative in 2015Q1 and stood at -0.1% in March 2015. Inflation continues to be below the 2% target due to lower energy costs. However, inflation has started to pick up in the EAC region and this may exert inflationary pressures especially in terms of rising imported food prices.

3.5 International commodity prices

Though crude oil prices declined in March to USD 52.8/bbl from USD 55/bbl in early February, it increased to $56/bbl in early April. This recent increase has prompted the revision of local pump prices from 810 RWF/liter to 840 RWF/liter though this will have less inflationary pressures in the short run.

3.6. Inflation forecasts

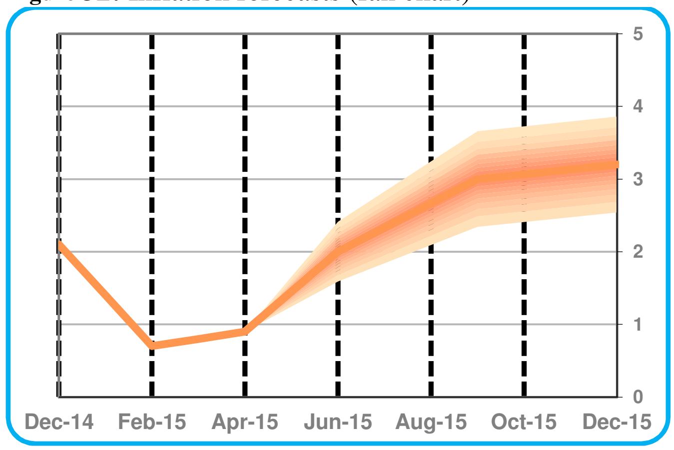
Headline inflation has remained benign in Rwanda, standing at 0.9% in April from 0.8% in March 2015. In March and April 2015, inflation started to rise mainly due to the gradually increasing food inflation and the slowdown in transport deflation.

Global economic performance is improving but still at a slow pace, led by the US, implying weak global demand. Commodity prices are generally still low though international oil prices has started to trend upwards, leading to upward revision of local pump prices. These pressures are however mild and will not significantly impact inflation developments in the few coming months.

Recently, food prices, especially of fresh foods, have started to pick up due to the dwindling supply as we move towards the sunny season that normally starts in June.

The RWF is expected to remain relatively stable, mildly depreciating against the USD and the Kenyan Shilling but appreciating against the Ugandan and Tanzanian shillings. This will help to continue mitigating imported inflation. The outlook shows that inflation will remain benign and generally in line with the medium term target of 5% until the end of 2015.

Figure 32: Inflation forecasts (fan chart)



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

Thus, inflation is projected to be around 2.8% in June and 3.5% in December 2015 while the main risks to the inflation outlook remain food supply shocks and developments in international oil prices.

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KN 6 AVENUE 4, P.O. Box 531 Kigali
Tel. :(250)252 574282, Fax: (250) 252 577391
Email: info@bnr.rw
Web: www.bnr.rw
Swift code: BNRWRWRW