National Bank of Rwanda

# QUARTERLY INFLATION REPORT


$$I_{a,i}^{t} = I_{a,i}^{t-1} \times \prod_{k=1}^{K_{a,i}}$$

**WP02/2016Q2**

**Kigali, September 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 |
| **CIEA** | Composite Index of Economic Activities |
| **SAAR** | Seasonally Adjusted Annual Rate |

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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 (MPC) decision making process.

In 2016Q2, the global economy continued to face headwinds, including weaker growth among advanced economies and persistently low commodity prices as well as lackluster global trade and capital flows. However, conditions remained markedly challenging for commodity exporters which continued to struggle to adjust to the new era of depressed prices whereas commodity importers remained broadly resilient. In this context, the Rwandan economy remained generally robust, growing by 6.5% in real terms during the first half of 2016 from 7.4% of the same period in 2015 as real GDP growth in 2016Q2 dropped to 5.4% compared to 7.2% of the same period in 2015, mainly constrained by the reduced performance of the agriculture sector and the contraction in the industry sector. Going forward, the trend of the real Composite Index of Economic Activities (CIEA) and total turnovers indicate that the Rwandan economy may slightly improve in 2016Q3. During the first two months of 2016Q3, total turnovers increased by 14.4%, up from 11.0% registered in the corresponding period of 2015Q3 whereas the real CIEA grew by 11.2% from 10.3% during the same period.

Despite the observed decline in year-on-year growth for outstanding credit to the private sector to 19.6% and 21.5% in August and July 2016 respectively from 26.9% and 27.3% realized in the same months of 2015, monetary policy broadly remains supportive. The decline in outstanding credit was largely due to the increase in short-term lending and thus the stock of credit is expected to rise following the increase in new authorized loans by 11.5% in the first eight months of 2016, up from 9.8% recorded in the same period of last year.

In line with the structural problem of a persistent trade deficit and the recent increase in the demand for foreign exchange by some big strategic investment projects under the Private-Public Partnership (PPP) framework, pressures on the FRW has been increasing, thus raising the pass through to domestic prices.

In 2016Q2 headline inflation went up to 4.9% on average from 4.5% recorded in 2016Q1. This increase was mostly reflected in transport inflation, reaching 7.3% from 4.6% during the same period. Though food inflation continued to reduce in 2016Q2, the effect from the jump in prices for vegetables that took place in 2015Q4 did not die out completely and was even exacerbated by an even bigger jump in June and July that has persisted up to August. The surge in core inflation from 2.8% in 2016Q1 to 3.8% in 2016Q2 came in anticipation of the announced increase in external common tariff of some food products classified as core namely imported oils and sugar as well as from the exchange rate effect. In addition, inflation of other local core products such as milk products edged up in 2016Q2 due to the dry season. Imported inflation continued to hike in 2016Q2 to reach 4.0% on average from 2.1% in 2016Q1 and this trend continued in July and August. Imported inflation was mostly driven by transport costs which were affected by purchase of vehicles and imported food inflation which bounced up to 2.3% from 1.1% during the same period following the levy applied on processed food imported from the EAC region that do not meet the originality conditions. Domestic inflation slightly reduced but remained high in 2016Q2 at 5.2% from 5.3% as a result of the slowdown in food inflation in April and May.

Looking ahead, the main risks to the inflation outlook remain the volatile and weather-dependent food prices and the growing exchange rate pressures. Although some mild downward pressures may come from the reduction in local pump prices, upward pressures will continue to come from the effect of the increase in tariffs for products such as sugar, imported cooking oils, cement, clothing and footwear. Additional upward pressures will also continue to come from the level shifts in local bus fares and in education fees, as well as from the increase in prices of soft drinks produced by Bralirwa. In view of the above upside and downside risks, inflation is expected to lie between 5.6% and 6.6% in September 2016 and between 5.2% and 6.2% in December 2016.

***ACKNOWLEDGEMENTS***

A team from the Monetary Policy & Research Department, spearheaded by the Modeling and forecasting division, prepared the 2016Q2 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.

## 1. EXTERNAL ENVIRONMENT

### 1.1. Global economic activities

The world economy lost momentum in the first half of 2016. It is estimated to have grown by 2.9% in 2016H1 lower than the April and July 2016 IMF projections. This sluggishness is mainly observed in advanced economies and Sub-Saharan Africa while emerging markets economies in Asia and Europe showed relatively positive economic growth.

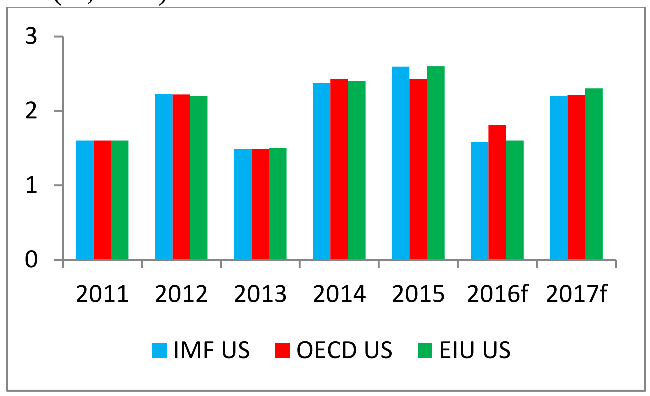
**Table 1:** Economic growth developments (in %)

| | 2015 | 2016* | | | | 2015+ | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | Q3 | Q4 | | | |
| World (YoY) | - | - | - | - | - | 3.2 | 3.1 | 3.4 |
| USA (YoY) | 1.9 | 1.6 | 1.2 | 1.5 | 1.8 | 2.6 | 1.6 | 2.2 |
| Euro area (YoY) | 2.0 | 1.7 | 1.6 | 1.5 | 1.4 | 2.0 | 1.7 | 1.5 |
| Japan (QoQ) | -1.7 | 2.1 | 0.7 | 0.9 | 1.0 | 0.5 | 0.5 | 0.6 |
| China (YoY) | 6.8 | 6.7 | 6.7 | 6.5 | 6.5 | 6.9 | 6.6 | 6.2 |
| India (YoY) | 7.2 | 7.9 | 7.1 | 7.7 | 7.6 | 7.6 | 7.6 | 7.6 |

**Source:** *BLOOMBERG & +IMF WEO, Aug. 2016

In 2016Q2 the US economy grew by 1.4% (SAAR) from 0.8% recorded in 2016Q1, according to the third estimates released by the Bureau of Economic Analysis in September 2016. Despite the increase in imports and reduction in state and local government spending and in residential fixed investment, real GDP in US increased on account of the upturn in personal consumption expenditure, nonresidential fixed investment and exports.

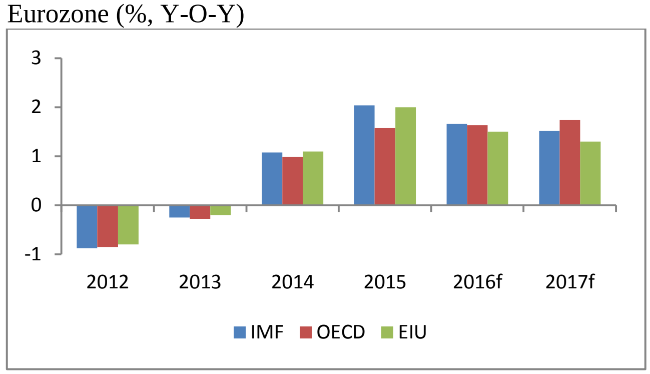
**Figure 1**: Growth developments & forecasts for the US (%, YoY)




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

The euro area slowed down in 2016Q2 at 1.6% from 1.7% of 2016Q1 on annual basis (unadjusted) but generally remained on the recovery path. In 2016Q2 the growth was mainly supported by the upturn in private consumption (due to increase in employment) and in net exports.

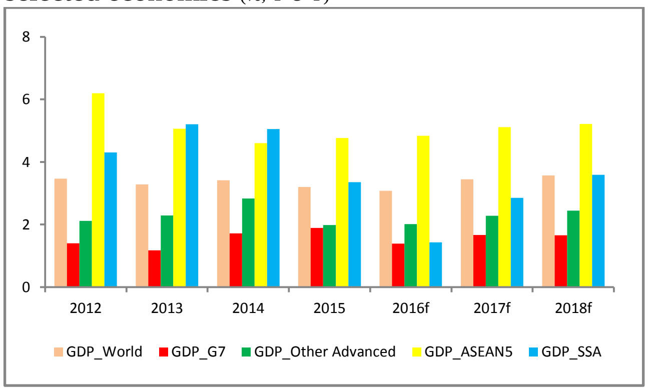
**Figure 2:** Growth developments & forecasts for the Eurozone (%, Y-O-Y)




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

In emerging markets and developing economies growth recorded mixed performance in the first half of 2016. Growth in emerging Asia and Europe was positive and generally in line with forecasts. Latin America especially Brazil's economy remained in recession while the economic activity in Sub-Saharan Africa weakened as Nigeria entered into a recession and the South African economy remained flat.

**Figure 3:** Growth developments & outlook for selected economies (%, Y-O-Y)



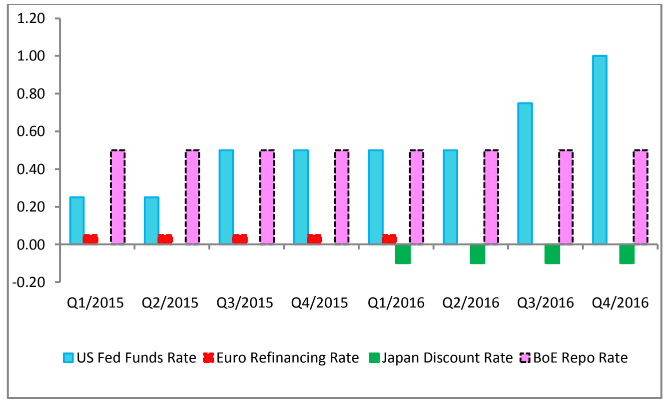

**Source:** IMF & World Bank (Aug. 2016)

So far, the developments in global economic activity has led to the revision of the projected growth for 2016 down to 3.1%, lower than the growth recorded in 2015. Economic activities are expected to stabilize or pick up in emerging and developing economies but are projected to decline in major advanced economies.

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

Fiscal policy around the world is still expected to remain expansionary more than it was anticipated in 2016Q1. Monetary policy authorities for major economies are also expected not to raise the interest rates for a longer time given the gloomy sentiment emanating from BREXIT, subdued inflation and still weak economic activities especially in advanced economies.

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

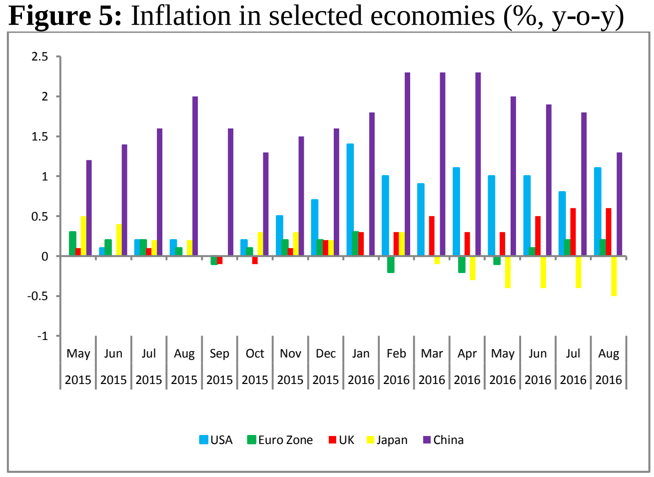



**Source:** http://www.tradingeconomics.com, Aug. 2016

### 1.3. Global inflation developments and outlook

Generally inflation remained subdued around the globe and below target mostly on the back of weak economic activity and low commodity prices.

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




**Source:** http://www.tradingeconomics.com, Aug. 2016

In EAC member countries, inflation rates were generally lower in 2016Q2 compared to 2016Q1 but in Rwanda it started to go above the objective of 5% since June 2016.

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

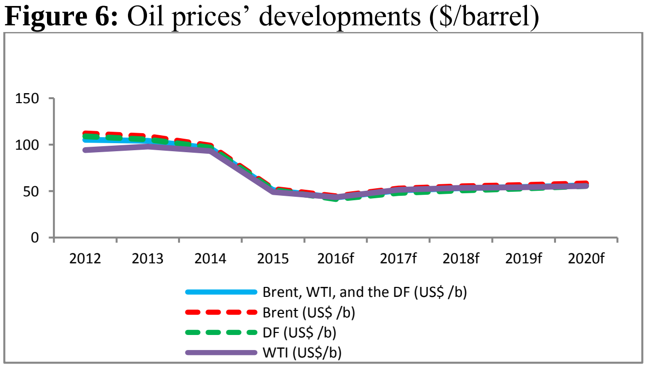
| | RWANDA | UGANDA | KENYA | TANZANIA | BURUNDI |
|---|---|---|---|---|---|
| Aug-2015 | 3.0 | 4.8 | 5.8 | 6.4 | 4.2 |
| Sept-15 | 3.7 | 7.2 | 6.0 | 6.1 | 4.1 |
| Oct-15 | 2.9 | 8.8 | 6.7 | 6.3 | 5.6 |
| Nov-15 | 4.8 | 9.1 | 7.3 | 6.6 | 5.8 |
| Dec-15 | 4.5 | 9.3 | 8.0 | 6.8 | 7.1 |
| Jan-16 | 4.5 | 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 | 5.2 | 2.7 |
| Jun-16 | 5.5 | 5.9 | 5.8 | 5.5 | 3.9 |
| Jul-16 | 6.9 | 5.1 | 6.4 | 5.1 | 3.9 |

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

### 1.4. International commodity prices

Generally, in 2016Q2 commodity prices showed a small recovery reflected in fuel products and non-fuels commodities as well. Despite high uncertainty around oil prices, the IMF still projects that oil prices are likely to gradually and slightly increase in the second half of 2016.

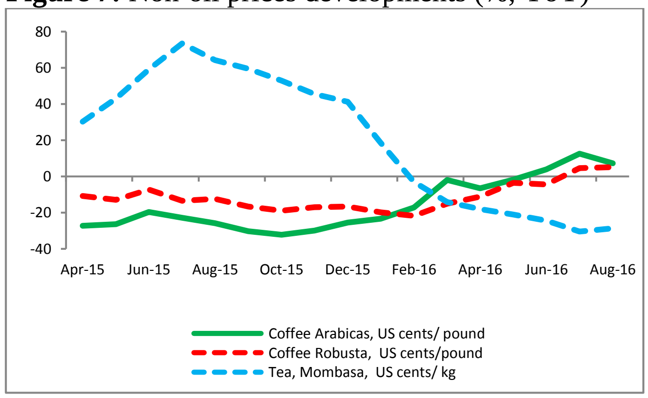
**Figure 6:** Oil prices' developments ($/barrel)




**Source:** IMF, WEO Database (Aug. 2016)

Food prices went up between 2016Q1 and 2016Q2 and are expected to remain above their 2016Q1 level in 2016Q3. Coffee prices also increased in 2016Q2 and are projected to remain around the same level towards the end of 2016 but tea prices dropped and are likely to remain below their 2016Q1 level in the 2016H2.

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




**Source:** IMF, WEO Database (Aug. 2016)

## 2. THE DOMESTIC ECONOMY

### 2.1. Domestic demand and output

In 2016Q2, global economic performance remained sluggish as Emerging market and developing economies (EMDEs) continued to face headwinds, including weaker growth among advanced economies and persistently low commodity prices, as well as lackluster global trade and capital flows.

However, divergences between commodity exporters and importers persisted. Conditions remained markedly challenging for commodity exporters, which continued to struggle to adjust to the new era of depressed prices. In contrast, commodity importers remained broadly resilient to headwinds, although the expected growth windfall from low energy prices has been surprisingly modest.

Despite the above global headwinds, the Rwandan economy remained generally robust, with nominal GDP at current market prices estimated at RWF 1,549 billion in the second quarter of 2016, up from RWF 1,428 billion in the same quarter of 2015. In real terms, growth of the Rwandan economy slightly slowed to 6.5% during the first half of 2016 from 7.4% of the same period in 2015.

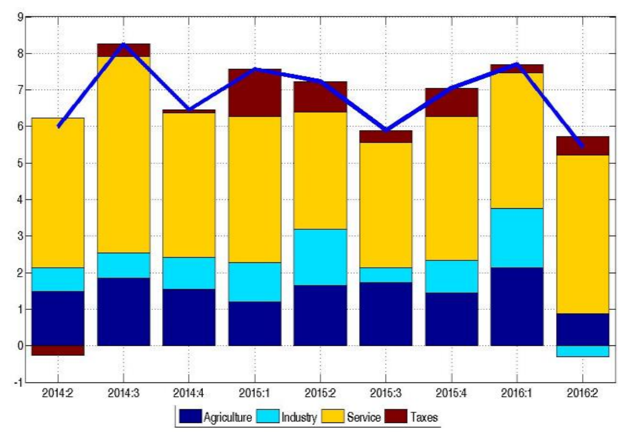
Growth in real GDP dropped to 5.4% in 2016Q2 compared to 7.2% of the same period in 2015 and 7.6% in 2016Q1, mainly constrained by the reduced performance of the agriculture sector and the contraction in the industry sector.

The service sector grew by 9% in 2016Q2 from 6% in 2015Q2 and 8% in 2016Q1. The main driver of the good performance in services was trade and transport services, which grew on annual basis by 12% in 2016Q2 from 5% in the same period of 2015 while growth in other services stagnated at 7% during the same period.

Growth in trade and transport services was buoyed by the robust performance in both wholesale and retail trade and in transport services. Wholesale and retail trade grew by 13% in 2016Q2 from 5% in 2015Q2 whereas growth in transport services reached 6%, up from 4% during the same period.

This robust performance was however dampened by the drop in agriculture GDP growth to 3% in 2016Q2 from 6% and 7% in 2015Q2 and 2016Q1 respectively, due to the effect of the long spell of the dry season, and the contraction in industry GDP growth to -2% in 2016Q2 from 10% in both 2016Q1 and 2015Q2.

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




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

The poor performance of the industry sector in 2016Q2 was mainly attributed to the contraction in both the construction sub-sector (-6.0%) and the mining sub-sector (-13.0%). The latter has been contracting since 2015Q1, following the ongoing plunge in international prices for metals.

The poor performance of the construction sector was a result of the completion of big projects that were under construction like Kigali Convention

Center (KCT), Marriott hotel and roads which required huge importation of construction materials mostly in 2015. This led to low imports of construction materials in the first half of 2016 (-30.6%), in line with the observed contraction in construction activities in 2016Q2.

From the expenditure account, the observed slowdown in real GDP growth in 2016Q2 was mainly due to gross capital formation whose growth slowed to 8.9% in 2016Q2 from 22.3% in 2016Q1 as gross fixed capital formation slowed to 9.5% from 22.2% and inventories contracted by 15.4% after growing by 12.5% during the same period.

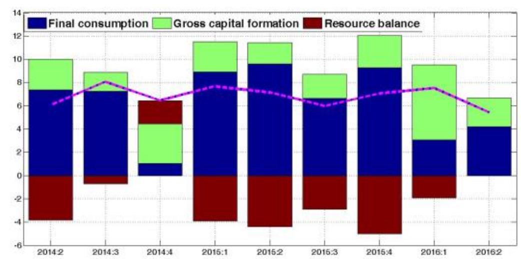
The slowdown in gross fixed capital formation resulted from construction, which after growing by 13.3% in the previous quarter, contracted by 6.5% in 2016Q2 following the phasing out of the aforementioned construction projects.

Growth in total final consumption rose from 3.3% in 2016Q1 to 4.5% in 2016Q2 following the recovery in private consumption from -3.0% to 2.2% that helped to offset the slowdown in government consumption from 23.2% to 18.7% during the same period.

Generally, despite the improvement in private consumption from 3.3% in 2016Q1 to 4.5% in 2016Q2, growth in domestic demand slowed to 5.5% in 2016Q2 from 7.8% in the previous quarter following the slowdown in gross capital formation recorded in 2016Q1.

Exports of goods and services grew by 16.7% in 2016Q2 from 7.8% in the previous quarter while imports of goods and services rose by 10.6% from 8.4% during the same period. As a result, the trade deficit expanded by 5.8% in 2016Q2, down from 8.5% recorded in the previous quarter.

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

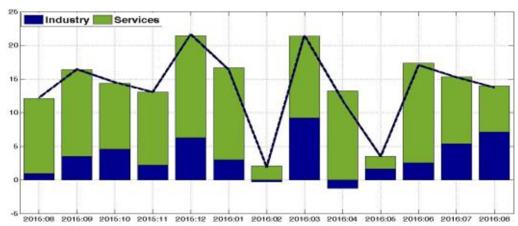



**Source:** BNR, Monetary Policy & Research Department (2016)

In line with the leading economic indicators, Rwanda's economic performance in 2016Q3 is expected to be higher than in 2016Q2. In annual terms, total turnovers in the first two months of 2016Q3 increased by 14.4% up from 11.0% registered in the corresponding period of 2015Q3, with declining contribution from services and growing contribution from the industry sector turnovers.

The big increase in service sector turnovers observed in June is partly linked with the five meetings hosted by Rwanda, in which at least 2800 delegates attended. The number of meetings and delegates went on gradually reducing in subsequent months (http://www.rcb.rw/mice-calendar-events/).

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



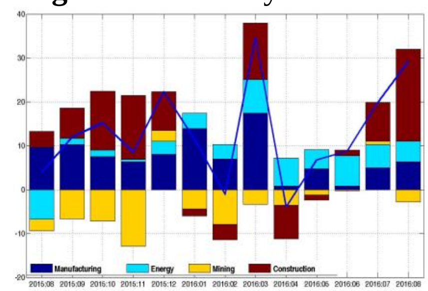

**Source:** BNR, Monetary Policy & Research Department (2016)

Though the construction sub-sector was not doing well in 2016Q2, growth in its turnovers hiked from 4.1% in June to a remarkable 33.6% and 69.0% in July and August 2016 respectively compared to 19.6%, 7.0% and 12.7% recorded during the same months in 2015.

The turnovers for the construction sector significantly increased during the first two months of 2016Q3 as a result of the ongoing construction of roads and the turnovers declaration of works done in the previous quarters. This is evidenced, for instance, by a high increase in turnovers of two construction companies that grew by 532.8% and 76.4%, having a combined share of 31.6% in July – August 2016 of the total turnovers of the construction sub-sector.

The performance of the mining sector remains constrained by the ongoing slump in international commodity prices. Following the reconstruction of Mukungwa 1 and Kivuwatt hydro-power plants, the turnovers for the energy sector is expected to remain high going forward.

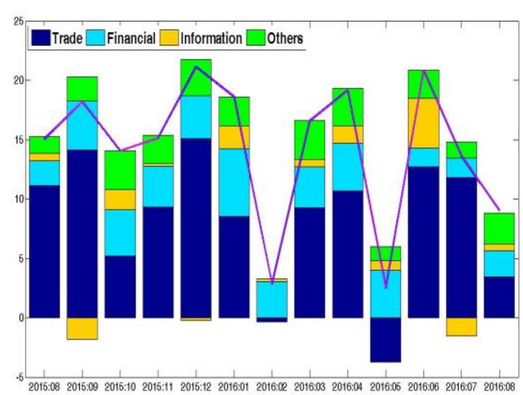
**Figure 11:** Industry turnovers




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

Growth in the service sector turnovers slid from 21% in June 2016 to 13.6% and 9.0% in July and August respectively. This decline was mainly due to the reduced performance in trade services, especially retail and wholesale trade. Growth in trade services eased from 20.7% in June to 20.2% and 5.2% in July and August 2016 respectively.

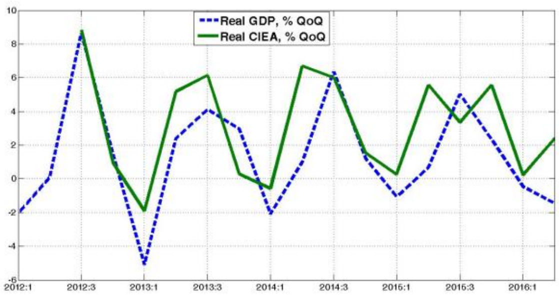
**Figure 11:** Services' turnovers




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

The real CIEA, which is highly correlated with real GDP (figure 13), grew by 11.2% in the first two months of 2016Q3, up from 10.3% recorded in the corresponding period of 2015Q3, confirming that the economy is likely to improve in the third quarter of 2016.

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

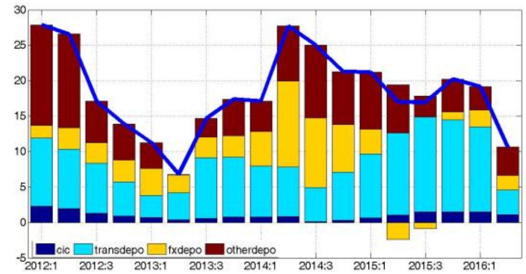



**Source:** BNR Monetary Policy & Research Department (2016)

Owing to a prudent monetary policy implemented by BNR, money supply (M3) grew by 10.6% y-o-y in 2016Q2, lower than 19.2% recorded in the previous quarter and 17.0% in 2015Q2.

From the liability side, the deceleration in broad money (M3) growth was mainly due to the decline in transferable deposits, whose growth eased to 8.6% y-o-y in 2016Q2 from 32.5% of the same period in 2015 and 31.5% in 2016Q1. Growth in foreign currency deposits improved to 12.2% in 2016Q2, after contracting by 10.7% during the same period in 2015. Other deposits recorded growth of 12.1% in 2016Q2 compared to 9.9% in the previous quarter but remained below 21.4% recorded in 2015Q2. Due to the low level of economic activities, currency in circulation grew by 11.6% in 2016Q2 from 16.2% of the previous quarter.

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



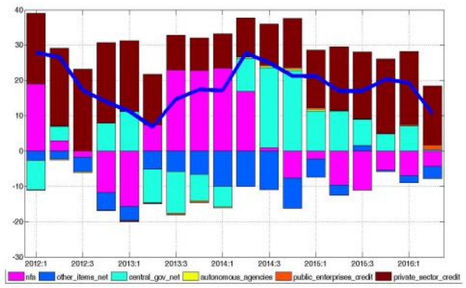

**Source:** BNR, Monetary Policy & Research Department (2016)

From the asset side, the deceleration in M3 growth was mainly caused by the significant drop in growth of net domestic assets (NDA) to 27.4% in 2016Q2 from 55.4% of the previous quarter and 71.3% in 2015Q2. This drop more than offset the ease in the contraction of net foreign assets (NFA) to 9.6% from 13.1% and 15.5% during the same period.

The deceleration in the growth of NDA was mainly due to the fall in in credit to the private sector and net credit to the government. In 2016Q2, growth in credit to the private sector declined to 22.4% from 27.3% of the previous quarter and 26.0% in 2015Q2. While the growth in central government credit eased to 15.0% in 2016Q2 from 33.7% in 2016Q1, central government deposits grew by 18.0% from -5.0%

during the same period, leading to an improvement in central government net credit.

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




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

New authorized loans expanded by 17.3% in the first half of 2016 from 10.8% in the same period of 2015. In terms of shares, Commerce, restaurants and hotels kept dominating other sectors with a share of 41.8% in the first half of 2016, higher than 40.0% recorded in the corresponding period of 2015. These were followed by Public works and building with a share of 29.6%, lower than 31.1% recorded the same period of last year.

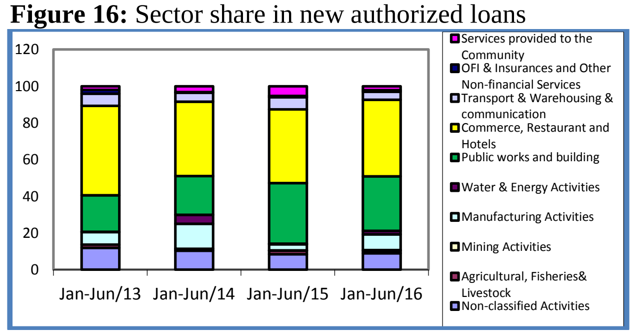
Activities not classified elsewhere, mainly composed of personal loans owned a share of 8.9% against 8.5% in the same period of 2015 while Manufacturing activities accounted for 8.5% higher than 3.4% recorded in 2015H1.

This high growth in the share of loans in manufacturing activities was mainly explained by the financing of the three big companies representing 4.5% of total loans authorized in the first six months of 2016. The reduction in share of loans to transport & warehousing & communication sector in the first half of 2016 was due to the base effect.

It is important to note that the share of Water and energy activities sector picked up to 1.9% of total loans in the first six months of 2016 compared to 0.3% in the similar period of 2015 on the back of a big loan equivalent to 1.7% of total loans in 2016H1 oriented in electricity production.

The share of Agricultural sector financing remained low standing at 1.5% of total loans in the first six months of 2016 against 1.9% in the same period of 2015.

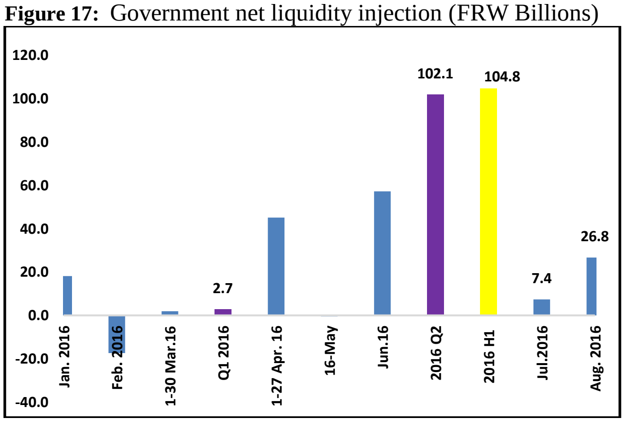
**Figure 16:** Sector share in new authorized loans




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

Net government liquidity injections improved from FRW 2.7 billion in 2016Q1 to FRW 102.1 billion in 2016Q2, pointing to an expansionary fiscal policy stance in line with the increased fiscal spending towards the end of the fiscal year. Looking ahead, net government injections are expected to remain low, constraining aggregate demand and suppressing demand-side inflationary pressures.

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



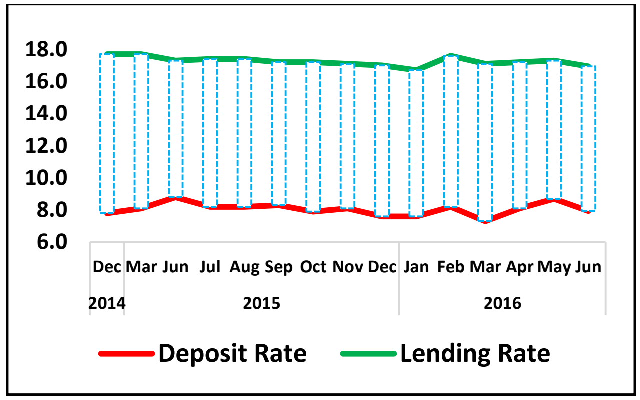

**Source:** NBR, Monetary Policy & Research Department (2016)

## 2.2. Financial Sector developments

### 2.2.1 Interest rate developments

As result of tight liquidity conditions, the monetary policy orientation of keeping money market interest rates around the policy rate and having an active interbank market, the gap between the policy rate and money market rates has continued to narrow. In June 2016, the spread between the lending and deposit rate reached 9.01% from 8.5% in the same period of 2015 and this was mainly due to the drop in the deposit rate to 7.94% from 8.8% while the lending rate marginally dropped to 16.95% from 17.30%.

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



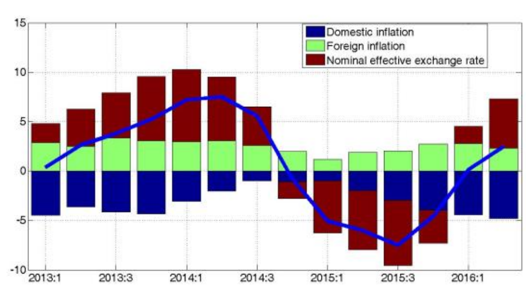

**Source:** BNR, Monetary Policy & Research Department (2016)

### 2.2.2 Exchange rate developments

Since the beginning of 2016, the Nominal Effective Exchange Rate (NEER) has been exerting depreciating pressures on the Real Effective Exchange Rate (REER). The NEER year-on-year depreciation increased from 1.8% in 2016Q1 to 5.0% the following quarter.

The REER depreciation has been however lessened by the stability of foreign inflation at around 2% (for the last five quarters) and rising domestic inflation as the latter has appreciating effects. Following the shock in prices for vegetables, headline inflation came close to the medium-term objective of 5%, to reach 4.9% in 2016Q2 from 4.5% in the previous quarter. It stood at 5.5% in June 2016.

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




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

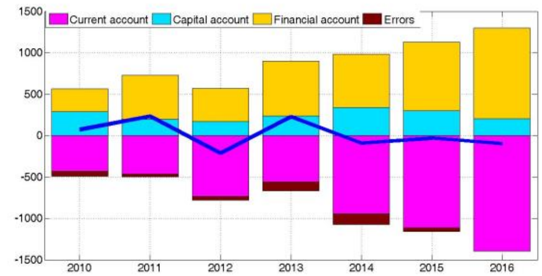
During the first half of 2016, the Rwandan Franc (FRW) has been under relative pressure resulting mainly from the widening mismatch between imports and exports as well as the decline in commodity prices. As a result, relative to December 2015, the FRW depreciation against the USD reached 4.8% end June 2016 compared to 3.6% in June 2015.

In the same period, the FRW appreciated by 5.0% versus the GBP and depreciated by 6.6% against the EURO. It also depreciated by 6.1%, 3.7% and 3.3% against the Kenyan shilling, the Ugandan shilling and the Tanzanian shilling respectively, while it appreciated by 3.7% versus the Burundian franc.

Exchange rate pressures are largely linked to the structural problem a persistent trade deficit given that Rwanda is up to now a net importer, largely exporting low-priced primary commodities and importing high-value imports.

In 2016, the current account is projected to deteriorate further and offset the expected increase in the financial account. Thus, the overall BOP deficit is projected to widen from USD 28.6 million in 2015 to USD 96.6 million.

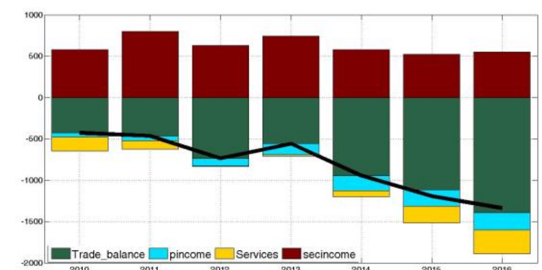
**Figure 20:** The BOP decomposition (Millions USD)




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

The current account deficit is expected to widen from USD 1194.02 million in 2015 to USD 1338.04 million in 2016, growing by 12.1%. The widening of the current account deficit is mainly due to the increase in the trade deficit, net services and personal income.

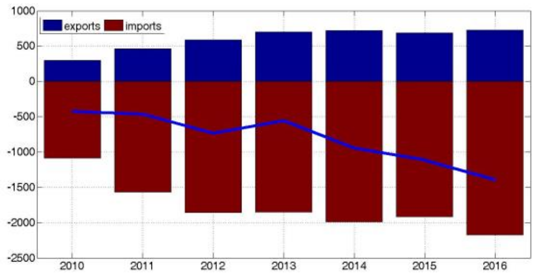
**Figure 21:** The current account (Million USD)




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

The trade deficit is projected to widen by 25.2% in 2016, rising from USD 1113.861 million in 2015 to USD 1393.505 million in 2016. Imports are expected to edge up by 13.3%, from USD 1917.43 million in 2015 to USD 2173.098 million in 2016. During the same period, exports are projected to grow by 6.3%, rising from USD 683.672 million to USD 726.751 million. Until now, commodity prices have remained low as global demand continues to falter and supply for some commodities has been quite high.

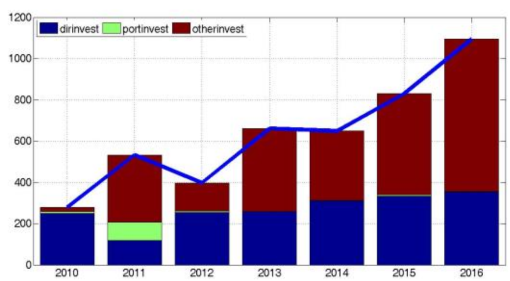
**Figure 22:** Evolution of the trade balance (USD, millions)




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

The major source of current account deficit financing is the expected increase in other investments, from USD 490.6 million in 2015 to USD 738.5 million in 2016. Direct investments are projected to grow by 6.3% in 2016, rising from USD 333.0 million in 2015 to USD 353.9 million in 2016.

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




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

## 2.3. Fiscal spending

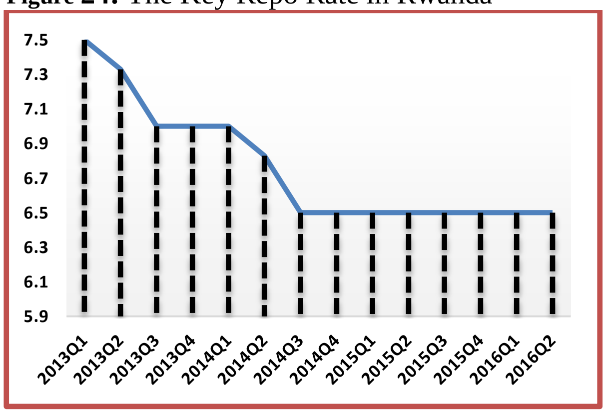
From the expenditure account, growth in government expenditure slowed from 23.2% in 2016Q1 to 18.7% in 2016Q2. This, coupled with the expected decline in net government liquidity injections may have negative consequences on economic growth in 2016Q3.

## 2.4. Previous monetary policy stance

In view of the current liquidity shortage, growing exchange rate pressures and rising but still subdued inflationary pressures, BNR decided to keep the KRR at 6.5%. Downside factors are mainly slowing economic growth and the somewhat declining financing of the economy by the banking sector.

On the upside, rising inflation and growing exchange rate pressures are some of the key considerations. To counter-balance these opposing forces, the MPC judged that it is appropriate to maintain its monetary policy stance in 2016Q3.

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



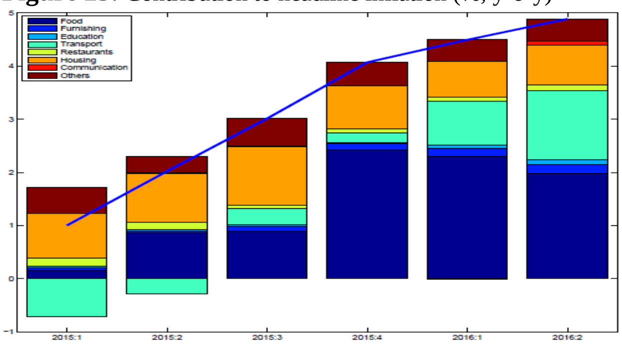

**Source:** Monetary Policy & Research Department (2016)

## 2.5. Inflation developments

In 2016Q2 headline inflation went up to 4.9% on average from 4.5% recorded in 2016Q1. This increase was mostly reflected in transport inflation reaching 7.3% from 4.6% during the same period.

Though food inflation continued to reduce in 2016Q2, the effect from the jump in vegetables that took place in 2015Q4 did not die out completely and was even exacerbated by another jump in June and July and persisted up to August. Housing inflation slightly increased to 3.2% from 3.0% but was not big enough to offset the pressures from food and transport.

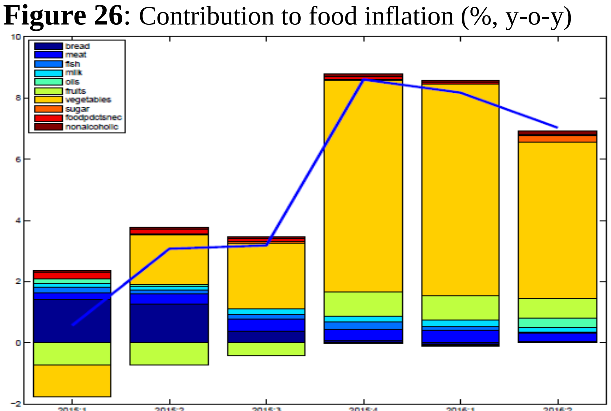
**Figure 25**: Contribution to headline inflation (%, y-o-y)




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

Food inflation slightly declined from 8.2% on average in 2016Q1 to 7.0% in 2016Q2 as inflation for vegetables slid from 19.2% to 14.3% outweighing the increase in inflation for bread and cereals from -0.2% to 0.2%.

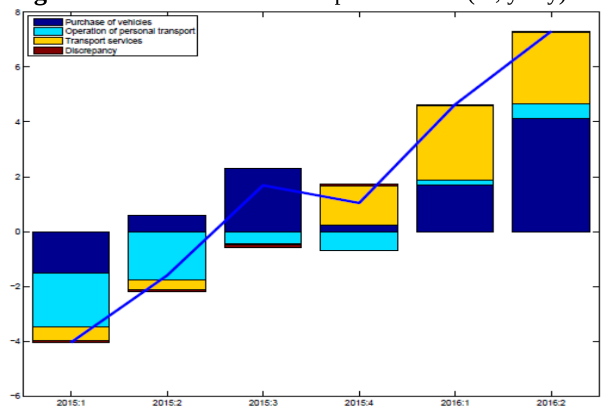
**Figure 26**: Contribution to food inflation (%, y-o-y)




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

The transport inflation went up in 2016Q2 from 4.7% to 7.3%. As in the last quarter, this jump came from the effect of the exchange rate depreciation on purchase of vehicles whose inflation in purchase hiked from 4.2% to 10.3%.

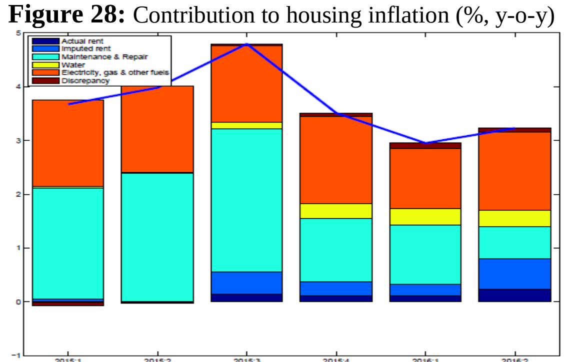
**Figure 27:** Contribution to transport inflation (%, y-o-y)




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

Contrary to the last quarter, housing inflation increased in 2016Q2 due to the pickup in solid fuels inflation from 4.4% to 5.7% and the increase in housing imputed rentals from 0.5% to 1.4%.

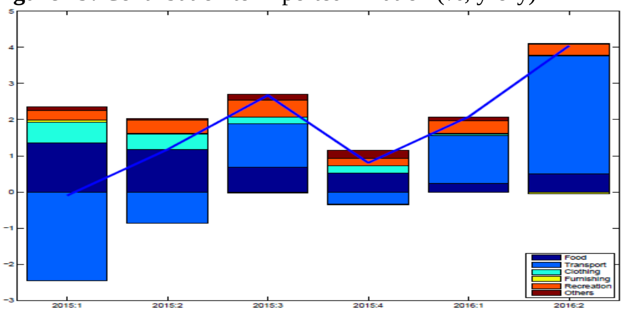
**Figure 28:** Contribution to housing inflation (%, y-o-y)




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

Imported inflation continued to hike in 2016Q2 to reach 4.0% on average from 2.1% in 2016Q1 and this trend continued in July and August. Imported inflation was mostly driven by transport costs which were affected by purchase of vehicles and imported food inflation which bounced up to 2.3% from 1.1% during the same period following the levy applied on processed food imported from the EAC region that do not meet the originality conditions.

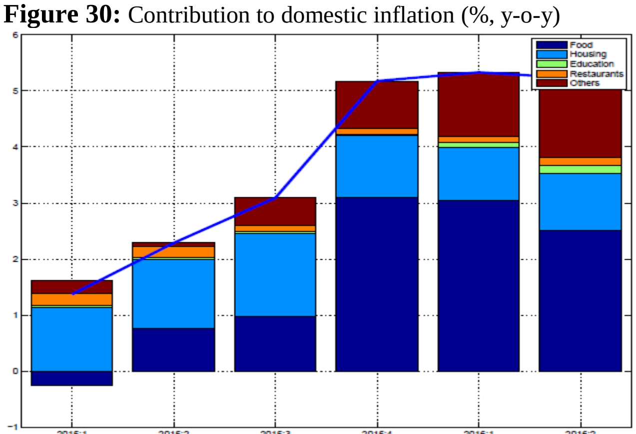
**Figure 29:** Contribution to imported inflation (%, y-o-y)




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

Domestic inflation slightly reduced but remained high in 2016Q2 at 5.2% from 5.3% as a result of the slowdown in food inflation in April and May.

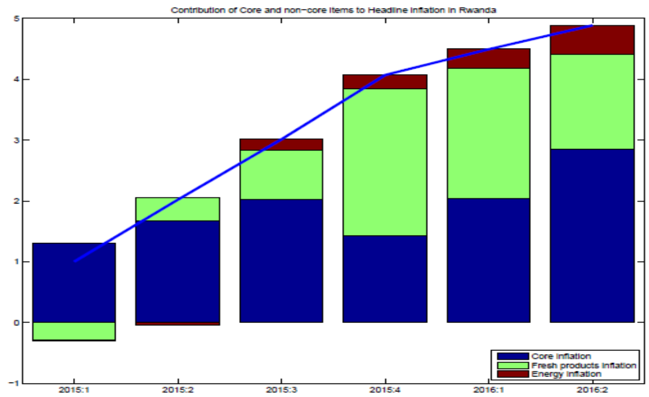
**Figure 30:** Contribution to domestic inflation (%, y-o-y)




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

Core inflation edged up for the second quarter in row from 2.8% in 2016Q1 to 3.8% in 2016Q2 and it increased again in July and August. The surge in core inflation came in anticipation of the announced increase in external common tariff of some food products classified as core namely imported oils and sugar. In addition, inflation of other local core products such as milk products edged up in 2016Q2 due to the dry season.

**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

Domestic demand[1] slowed to 5.5% in 2016Q2 from 7.8% in the previous quarter as growth in gross capital formation slowed to 8.9% from 22.3% in 2016Q1. Going forward, the prudent monetary policy stance adopted by BNR is expected to induce further increase in new authorized loans in 2016Q3 though this may not be enough to ease liquidity conditions especially if government spending does not improve.

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

The trend of the real CIEA and total turnovers indicate that the Rwandan economy is likely to slightly improve in 2016Q3 compared to the same period in 2015. Total turnovers in the first two months of 2016Q3 increased by 14.4% up

[1] Domestic Demand is defined as the sum of Consumption (C), Investment (I) and Government Expenditure (G)

from 11.0% registered in the corresponding period of 2015Q3 whereas the real CIEA grew by 11.2% from 10.3% during the same period.

### 3.1.2 Credit to Private Sector

The observed decline in year-on-year growth for outstanding credit to the private sector to 19.6% and 21.5% in August and July 2016 respectively from 26.9% and 27.3% realized in the same months of 2015 was largely due to the increase in short-term lending. During the first eight months of 2016, the share of short term loans in total new authorized loans reached 43.5%, up from 38.7% recorded in the same period of 2015.

The stock of credit is however expected to rise following the increase in new authorized loans by 11.5% in the first eight months of 2016, up from 9.8% recorded in the same period of last year.

## 3.2 Supply shock

Following the effect of the prolonged dry season, food prices have remained quite elevated in 2016. Though food inflation continued to reduce in 2016Q2, the effect from the jump in prices for vegetables that took place in November 2015 did not die out completely and was even exacerbated by another jump in June and July that has persisted up to August. Looking ahead, food prices are expected to ease in the coming months following the resumption of the rainy season.

## 3.3 Exchange rate developments

In addition to the longstanding structural problem of a persistent trade deficit, the recent exchange rate pressures have been amplified by the high demand for foreign exchange by big projects under the Public-Private Partnership (PPP) framework. As a result, relative to December 2015, the FRW depreciation against the USD reached 4.8% end June 2016 compared to 3.6% in June 2015.

In the same period, the FRW appreciated by 5.0% versus the GBP and depreciated by 6.6% against the EURO. It also depreciated by 6.1%, 3.7% and 3.3% against the Kenyan shilling, the Ugandan shilling and the Tanzanian shilling respectively, while it appreciated by 3.7% versus the Burundian franc.

The increasing depreciation of the FRW against currencies of major trading partners, especially in the region, has led the NEER year-on-year depreciation to increase from 1.8% in 2016Q1 to 5.0% the following quarter, significantly contributing to the rise in the REER depreciation from 0.14% to 2.5% during the same period. These developments have important implications on inflation and on competitiveness.

## 3.4 Global and regional inflationary pressures

Generally, inflation remained subdued around the globe and below target, mostly on the back of weak economic activity and low commodity prices.

In EAC member countries, inflation rates were generally lower in 2016Q2 compared to 2016Q1 but in Rwanda it started to go above the objective of 5% since June 2016, following an adverse supply shock.

## 3.5 International commodity prices

In 2016Q2, prices for both fuel and non-fuels commodities showed a small recovery. The IMF expects oil prices to gradually and slightly increase in the second half of 2016. Food prices also went up between 2016Q1 and 2016Q2 and are expected to remain above their 2016Q1 level in 2016Q3. While coffee prices also increased in 2016Q2 and are projected to remain around the same level towards the end of 2016, tea prices dropped and are likely to remain below their 2016Q1 level in the 2016H2. Therefore, this may continue to have adverse implications on exchange rate developments whereas the effect on inflation is expected to remain muted.

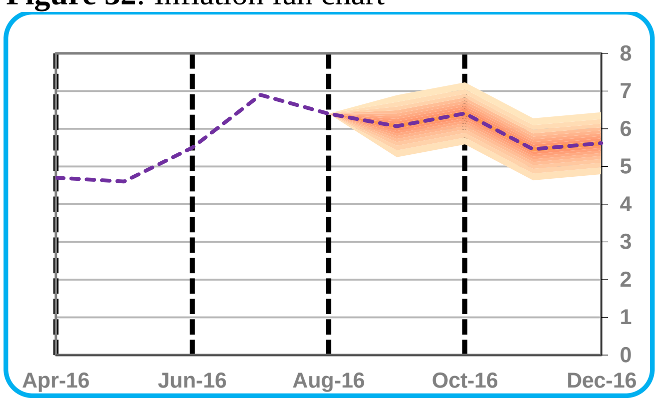
## 3.6. Inflation forecasts

Looking ahead, the main risks to the inflation outlook remain the volatile and weather-dependent food prices and the growing exchange rate pressures. Although some mild downward pressures may come from the reduction in local pump prices, upward pressures will continue to come from the effect of the increase in tariffs for products such as sugar, imported cooking oils, cement, clothing and footwear.

Additional upward pressures will also continue to come from the level shifts in local bus fares and in education fees, as well as from the increase in prices of soft drinks produced by Bralirwa.

In view of the above upside and downside risks, inflation is expected to lie between 5.6% and 6.6% in September 2016 and between 5.2% and 6.2% in December 2016.

**Figure 32**: Inflation fan chart




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

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