National Bank of Rwanda

QUARTERLY INFLATION REPORT

WP02/2014Q4

Kigali, January 2015

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.

The Rwandan economy has continued to perform well in the aftermath of the 2013 economic slowdown, with real GDP growth averaging 7.1% in the first three quarters of 2014 compared to 4.9% in the same period of 2013. Real GDP grew by 7.5%, 6.1% and 7.8% in 2014Q1, 2014Q2 and 2014Q3 respectively.

The economy continued to grow in 2014Q4 as indicated by high frequency indicators. Total turnovers increased by 12.7% in 2014Q4 from 9% in the same quarter of 2013 and 14.8% in 2014Q3. Likewise, the real Composite Index of Economic Activities (CIEA) grew on annual basis by 12.5% in 2014Q4 compared to 2.9% in 2013Q4.

Economic financing has continued to increase as evidenced by money supply growth which increased consecutively throught 2014Q4, rising by 17.6%, 18% and 18.5% in October, November and December respectively. The uptick in economic financing is also indicated by the growth in new authorized loans which increased on quarterly basis by 9.3% in 2014Q4 from -2% of the previous quarter.

The Rwandan Franc has continued to remain stable, depreciating against the USD by 3.6% in 2014Q4 from 6.1% in 2013Q4 but appreciating against currencies of major trading partners in the region and thereby cushioning the domestic economy from imported inflation.

Though it rose by 2.1% in December 2014 from 0.7%, 0.5% in November and October respectively, headline inflation dropped to 1.4% in January 2015 and is likely to remain benign following the current trend in international commodity prices, good agricultural harvests, exchange rate stability and lower inflation in regional trading partners. However, food supply shocks and developments in international oil prices are likely to weigh on inflation developments. Given the above, inflation projections are set at 2% and 3.5% in 2015Q1 and 2015Q4 respectively.

ACKNOWLEDGEMENTS

A team from the Monetary Policy & Research Department, spearheaded by the Modeling and forecasting division, prepared the 2014Q3 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 Dr. 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 Activity

The world economic recovery remained sluggish in 2014 with real GDP growth stabilizing at 3.3% as in 2013. Advanced economies continued to be influenced by the persistent effects of the global financial crisis in form of weak demand, high debt and unemployment rate. In emerging market and developing economies, economic growth slowed down due to rising geopolitical tensions, weak global demand and tightening financial market conditions.

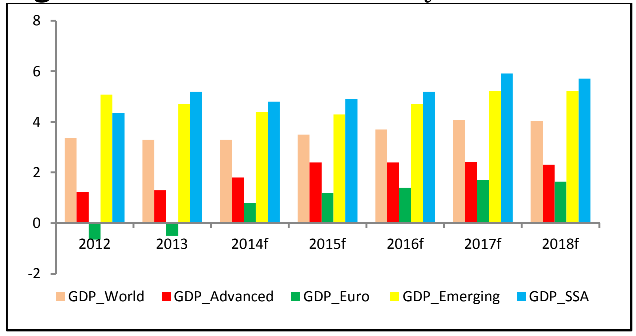
Table 1: Economic growth (%)

	2014				Annual		
	Q.1	Q.II	Q.III	Q.IV	2013	2014	2015
World (Y0Y)	1.9	2.4	2.8	2.6	3.3	3.3	3.5
USA (QoQ)	-2.1	4.6	5.0	2.6	2.2	2.4	3.6
Euro area (YoY)	1.1	0.8	0.8	0.7	-0.5	0.8	1.2
Japan (QoQ)	5.8	-6.7	-1.9	2.9	1.6	0.1	0.6
UK (YoY)	2.4	2.6	2.6	2.7	1.7	2.6	2.7
China (Y0Y)	7.4	7.5	7.3	7.3	7.8	7.4	6.8
India (YoY)	4.6	5.7	5.3	5.2	5.0	5.8	6.3

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

The IMF revised downwards the 2015 forecast for world economic growth by 0.3%, from the 3.2% October 2014 projection to 3.5% January 2015 projection. The revisions reflect a reassessment of prospects in China, Russia, the euro area, and Japan as well as weaker activity in some major oil exporters because of the sharp drop in oil prices. The United States is the only major economy for which growth projections have been raised from 3.1% to 3.6% in 2015.

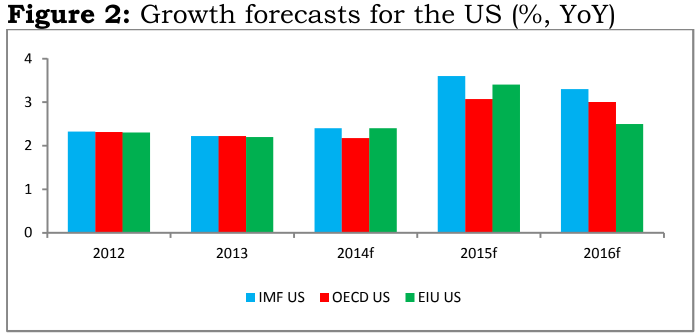
Figure 1: Growth outlook for key economies



Source: IMF, WEO (October 2014 & January 2015)

The U.S economy grew by 2.4% in 2014 from 2.2% in 2013. On quarterly basis, it grew by 2.6% in 2014Q4 from 5% in 2014Q3.The US economy is expected to increase by 3.6% in 2015. Business investment and private consumption will remain the key drivers of growth while net exports are likely to be affected by the strong value of the US dollar.

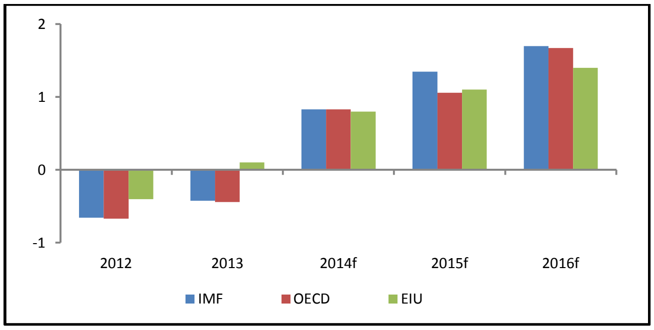
Figure 2: Growth forecasts for the US (%, YoY)



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

In the Euro Area, real GDP growth stood at 0.7% in 2014Q4 from 0.8% of 2014Q3. In annual terms, economic growth increased by 0.8% in 2014 and is expected to rise by 1.2% in 2015 on the back of improving financial conditions, the progress in fiscal consolidation, structural reforms and lower energy prices.

Figure 3: Growth forecasts for the Eurozone (%, Y-O-Y)



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

The Japanese economy is estimated to have grown by 0.1% in 2014 despite important fiscal and monetary stimulus. On quarterly basis, it increased by 2.9% in 2014Q4 from -1.9% in 2014Q3. The poor performance of the Japanese economy resulted from the increase in the sales tax, the decline in public works, residential investments and low productivity.

The Chinese economy increased by 7.4% in 2014 due to increased wage-cost, appreciation of the Renminbi and slowdown of investment in real estate and industrial production. On quarterly basis, the Chinese economy expanded by 7.3% in both 2014Q3 and 2014Q4. In 2015, the Chinese economy is expected to slow down to 6.8% despite the ongoing fiscal and monetary stimulus.

1.2. Monetary policy and international financial markets

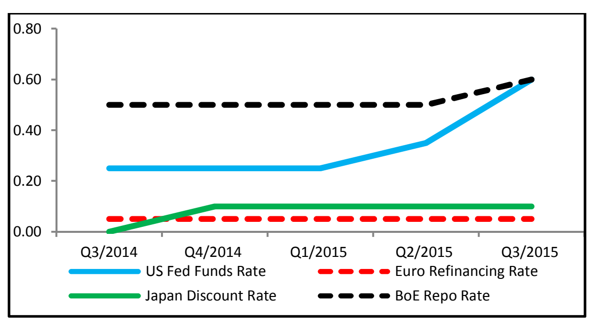
Monetary policy is still accommodative in advanced economies and policymakers remain vigilant of the effects of their decisions especially in emerging markets. Policy rates were kept unchanged or cut in some economies to continue supporting the sluggish economic recovery in lieu of benign inflation.

The FED has continued to pursue an accommodative monetary stance, keeping the interest rate at 0.25%. Interest rates are expected not to rise before April 2015 and Fed policymakers pledge to be patient in deciding when to raise interest rates.

In the Euro area, The European Central Bank announced in January 2015 the quantitative easing program to start in March (an asset purchase plan of 60 Billion euros a month) aiming to boost growth and fight low inflation. The refinancing interest rate remained unchanged at 0.05%.

In emerging markets, China cut the interest rate to 5.6% in November. It kept it unchanged in February 2015 but lowered the reserve requirement ratio to 19.5% aiming to boost private sector credit to support economic growth. Russia cut its interest rate as it expects inflation to fall in 2015 while India kept it unchanged as they wait to see the impact of the last reduction in interest rates. Brazil further tightened the policy rate in January in reaction to the inflation hike.

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



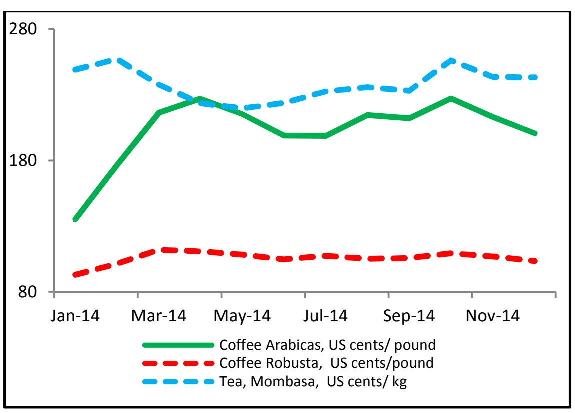
Source: http://www.tradingeconomics.com (Jan. 2015)

1.3. International commodity prices

During 2014 commodity prices fell by 29.2% on annual basis, with energy dropping by 39% and non-fuel prices falling by 9.9%. This slowdown in commodity prices reflects mostly, the continuous increase in commodities' supply while global demand remains weak, as well as the appreciation of the US dollar. Globally, commodity prices are expected to weaken further in 2015 on the back of expected decline in global aggregate demand.

For the seventh consecutive month, agriculture prices fell by 1% in December on the back of ample supplies for most commodities. On monthly basis, coffee (both Arabica & Robusta) prices fell by 6% and by 3% in November and December respectively, as wet weather in Brazil improved production prospects.

Figure 5: Non-oil prices' developments

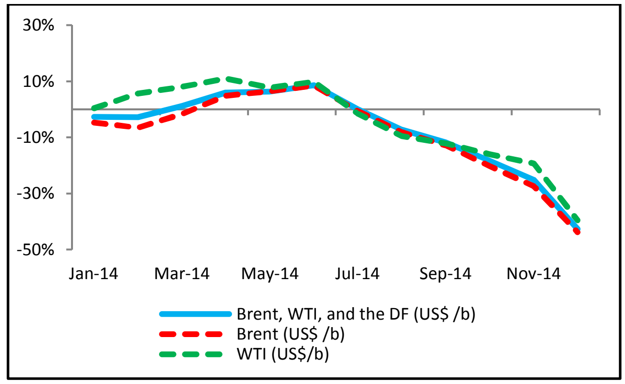


Source: IMF, WEO (Database, January 2015)

Prices for metals fell by 4.9% in December and the metals' price index dropped by 17% in 2014 generally due to ample supplies and the slowing demand especially in China.

Crude oil prices plunged by 21.3% in December, from an average of $60.6 per barrel to below $46 per barrel in early January. The on-going decline reflects expectations of a continued market surplus due to weak demand, large gains in non-OPEC supply, and OPEC's intention to maintain its market share.

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



Source: IMF, WEO (Database, January 2015)

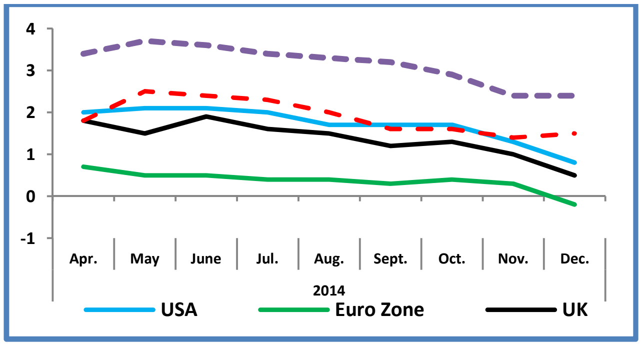
1.4. Global inflation developments and outlook

In advanced countries, inflation remained below target in 2014, mainly as a result of falling oil prices, while it remained contained in emerging and developing economies.

In the Euro area, inflation decelerated to 0.2% in December from 0.3% in September and 0.5% in June 2014. Deflationary pressures remained a concern due to large output gaps, weak economic recovery and the strong value of the Euro.

In USA, inflation decelerated to 0.8% in December 2014 from 1.7% and 2.1% in September and June respectively. In Japan, headline inflation declined to 2.4% in December 2014 from 3.6% in June and 3.2% in September 2014.

Figure 7: Inflation in key economies (%, y-o-y)



Source: http://www.tradingeconomics.com

Headline inflation has remained moderate in EAC owing to positive agriculture performances, despite some seasonal shocks, and partly due to softening prices of energy.

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

	2012	2013	2014		
	Dec.	Dec.	Jun	Sep.	Dec.
Uganda	5.5	6.7	4.9	1.4	1.8
Kenya	3.2	7.2	7.4	6.6	6.0
Tanzania	12.1	5.6	6.4	6.6	4.8
Burundi	11.8	9.0	3.3	5.5	3.8
Rwanda	3.9	3.7	1.4	0.2	2.1

Source: Country Bureaus of Statistics

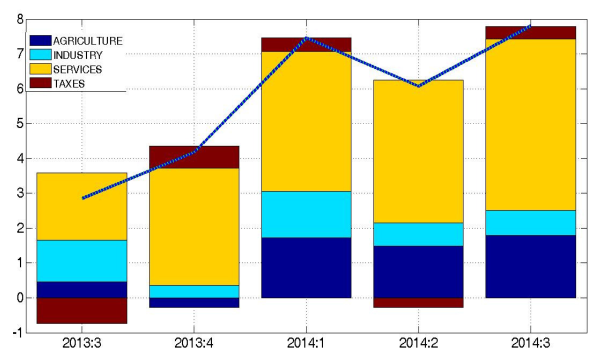
Inflation is expected to remain subdued in different major economies given the continued weak global aggregate demand and accommodative monetary policies being pursued in these economies. The Economist Intelligence Unit predicts a decline in average global inflation from 3% in 2014 to 2.8% in 2015.

2. THE DOMESTIC ECONOMY

2.1. Domestic demand and output

The Rwandan economy has continued to perform well in the aftermath of the 2013 economic slowdown, with real GDP growth averaging 7.1% in the first three quarters of 2014 compared to 4.9% in the same period of 2013. Real GDP grew by 7.5%, 6.1% and 7.8% in 2014Q1, 2014Q2 and 2014Q3. After growing by 5% in 2013Q2 and 1% in 2014Q1, the performance of the agriculture sector improved, registering growth of 6% in 2014Q3.

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

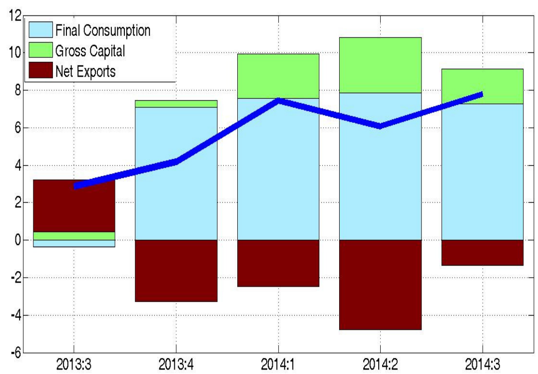


Source: BNR, Monetary Policy & Research Department (2014)

Growth of the industry sector slightly slowed down to 4% in 2014Q3 from 5% of the previous quarter and 9% of 2013Q3. However, mining and construction bounced back to the growth of 22% and 8% in 2014Q3 from 4% and 5% recorded in 2014Q2 respectively. Growth in total manufacturing slid to -5% after positive growth of 5% in both 2014Q2 and 2013Q3, thereby dragging down growth in the industry sector.

Despite slowing down to 8% in 2014Q3 from 9% in 2014Q2 and 0% in 2013Q3, growth in total final consumption expenditure remained the main driver of real GDP growth. Nonetheless, both government and household expenditure improved in 2014Q3 compared to the 2013Q3 levels. After growing by 5% in 2013Q3, government expenditure rose by 26% in the same period of 2014 whereas growth in household expenditure picked to 5% in 2014Q3 from -1% in the same period of 2013.

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

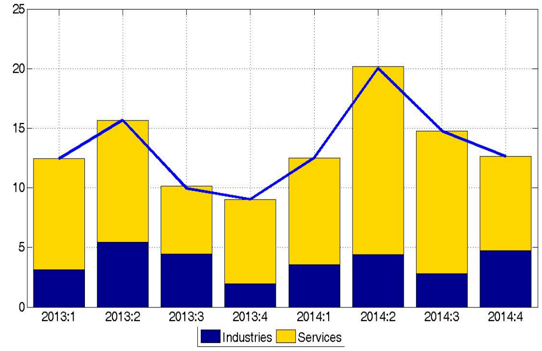


Source: BNR, Monetary Policy & Research Department (2014)

The economy continued to grow in 2014Q4 as indicated by the trend in turnovers and the composite index of economic activities. Total turnovers increased by 12.7% in 2014Q4 from 9% in the same quarter of 2013 and 14.8% in 2014Q3. The good performance of the service sector continues to be the main driver of growth, having grown by 11% in 2014Q4 compared to 10% of the same period in 2013.

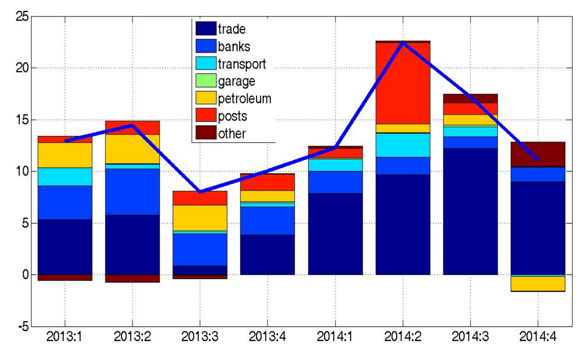
The industry sector turnovers also improved, growing by 16.5% in 2014Q4 from 9.3% of the previous quarter and 6.7% in 2013Q4.

Figure 10: Contribution to total turnovers



Growth in services turnovers was mainly driven by trade services, banks and insurance companies as well as other services. Turnovers for trade services grew by 19.5% in 2014Q4 from 8.2% of the same quarter in 2013 whereas turnovers for banks and insurance companies increased by 9.6% in 2014Q4, above 7.3% of the previous quarter but lower than 20.2% registered in 2013Q4.

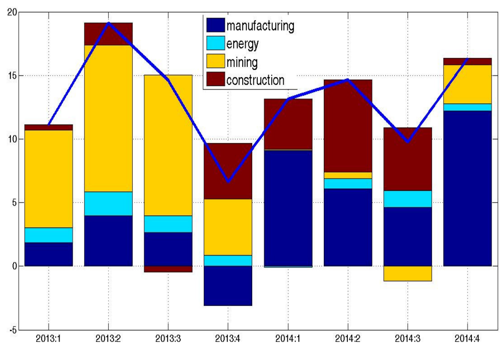
Figure 11: Services' turnovers



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

Growth in the industry sector turnovers was propelled by manufacturing and mining turnovers, which grew by 26.5% and 22.2% in 2014Q4 respectively, compared to -5.9% and 42.3% respectively in 2013Q4. For the first time in the last three years, turnovers for petroleum companies negatively contributed to total turnovers growth after plunging by -6.9% in 2014Q4 from 5.2% of the same period in 2013 on the back of the declining local pump prices, which were lowered twice in 2014Q4.

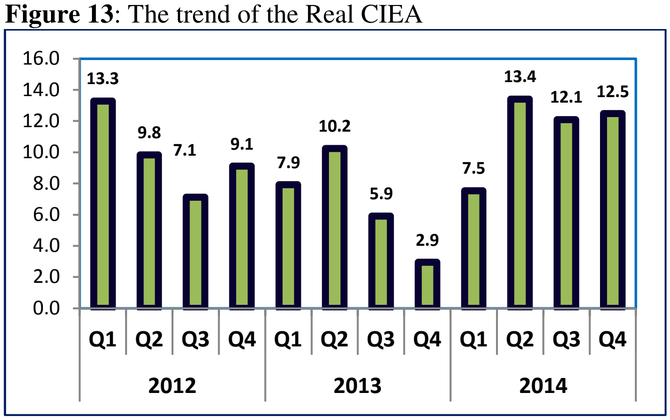
Figure 12: Industry turnovers



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

Positive growth is further indicated by the upward trend in the real Composite Index of Economic Activities (CIEA). On annual basis, the real CIEA increased by 12.5% in 2014Q4 compared to 2.9% in 2013Q4.

Figure 13: The trend of the Real CIEA

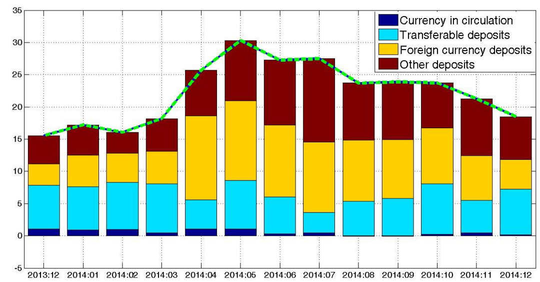


Source: Monetary Policy and Research Department

Though money supply (m3) decreased in annual percentage change terms to 18.5% in December 2014 from 21.3% of the previous month, it remained well above the 15.6% increase attained in December 2013. In comparison to December 2013, money supply increased consecutively throught 2014Q4, growing by 17.6%, 18% and 18.5% in October, November and December respectively.

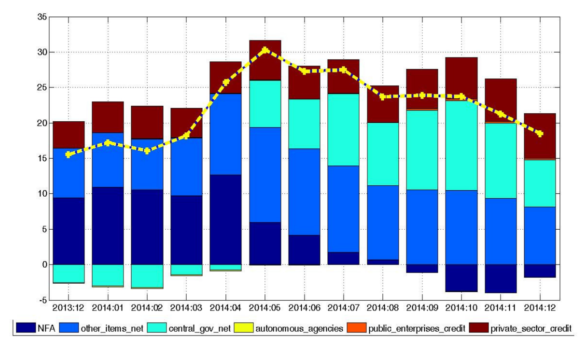
From the liability side, total deposits increased by 20.6% between December 2014 and December 2013, mainly driven by transferable deposits which increased by 19.1%.

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



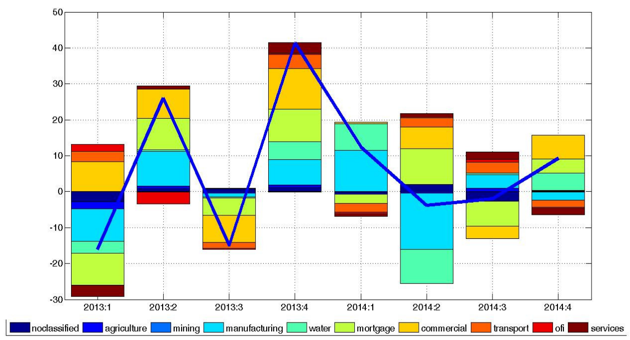
From the asset side, outstanding credit to the private sector increased by 19.6% in December 2014/13, the -5.6% contraction in net foreign assets was offset by the 81.3% increase in net domestic assets, helping to raise M3.

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



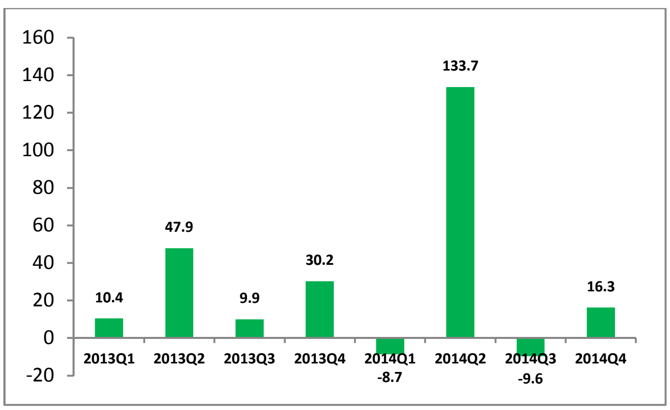
Increased economic financing is also evidenced by the upward trend in new authorized loans which grew on quarterly basis by 9.3% in 2014Q4, led by loans to commerce, restaurants and hotels which increased by 15.8%.

Figure 16: New authorized loans



Net government liquidity injections increased by 33.8% on annual basis in 2014 from 29.6% in 2013. In 2014Q4, government net liquidity injections rose to RWF 16.3 billion from the previous quarter's contraction of RWF -9.6 billion.

Figure 17: Government net liquidity injection (FRW Billions)



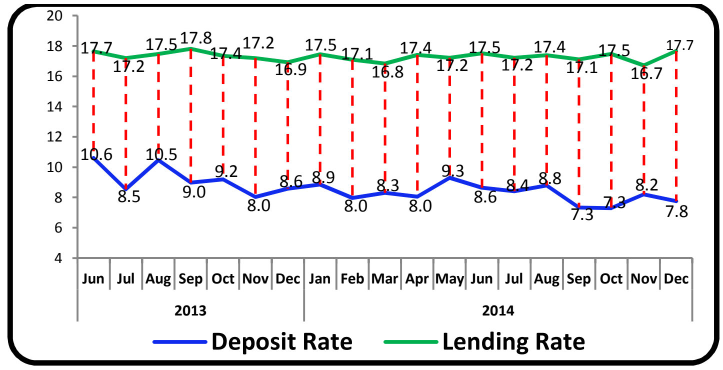
Source: NBR, Monetary Policy & Research Department (2014)

2.2.Financial Sector developments

2.2.1 Interest rate developments

On average, the deposit fell to 8.2% in 2014 from 9.9% in 2013 while the lending rate slightly dropped to 17.2% in 2014 from 17.3% in 2013, keeping the interest rate spread wide. The latter is generally attributable to the asymmetric response of lending and deposit response, with the former exhibiting rigidities emanating from the commercial banks' higher operating costs and higher provisions for bad debts.

Figure 18: Deposit and lending rates

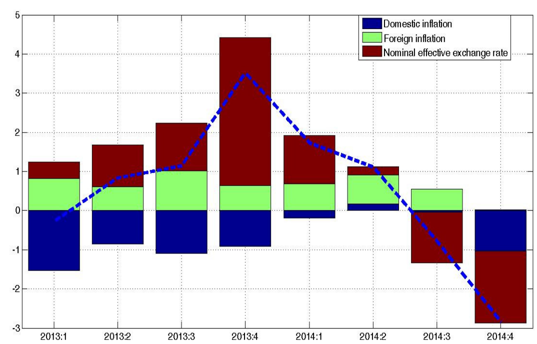


Source: BNR, Monetary Policy & Research Department (2014)

2.2.2 Exchange rate developments

The REER appreciated by 2.9% in 2014Q4, mainly due to the 1.8% appreciation of the nominal value of RWF against a basket of currencies of major trading partners as well as the decline in domestic inflation relative to inflation in major trading partners.

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



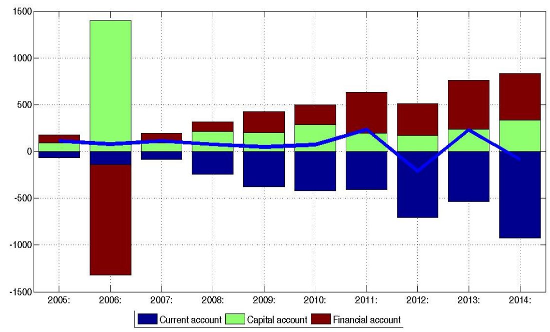
Source: BNR, Monetary Policy & Research Department (2014)

Concerning the bilateral nominal exchange rate, the Rwandan franc depreciated against the USD by 3.6% in 2014 compared to 6.1% in 2013 and against the Burundian Franc by 1% in 2014 from 4.9% of the previous year.

However, the RWF appreciated in 2014 against the British pound (-2.4%), Euro (-8.5%), Kenyan shillings (-2.8%), Tanzanian shillings (-7%) and Ugandan shillings (-6.7%).

Exchange rate market developments are closely linked to the developments in the balance of payments. The latter improved more than what was projected, registering a deficit of only USD 86.1 million instead of the initially projected USD 185.7 million in 2014.

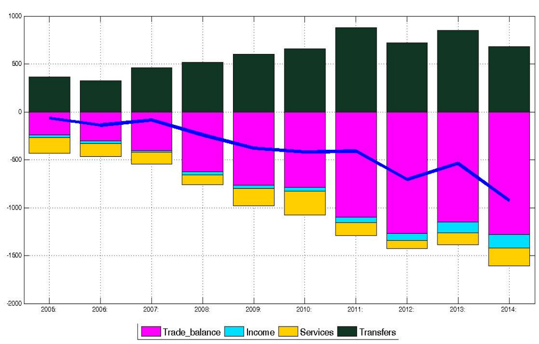
Figure 20: The BOP decomposition (Millions USD)



Source: BNR, statistics department (2014)

However, the current account deficit continued to widen, rising from USD 557.5 million in 2013 to USD 912.1 million and this was largely due to the increase in the trade deficit from 1148.4 million to 1280.5 million during the same period.

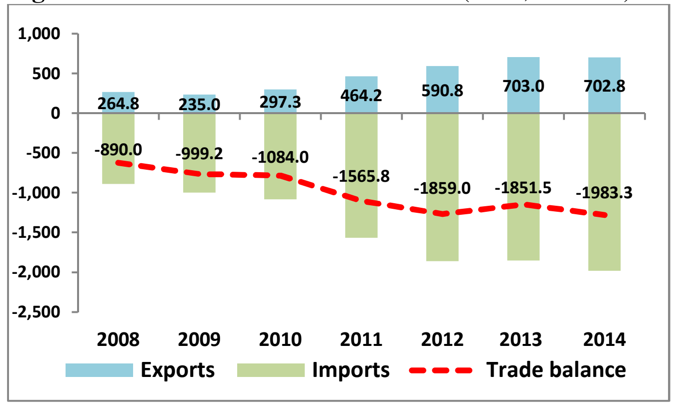
Figure 21: The current account (Million USD)



Source: BNR, statistics department (2014)

The imports bill increased from USD 1851.5 million in 2013 to USD 1983.3 million whereas export revenues shrank from USD 703 million to 702.8 million, thereby leading to the widening of the trade deficit.

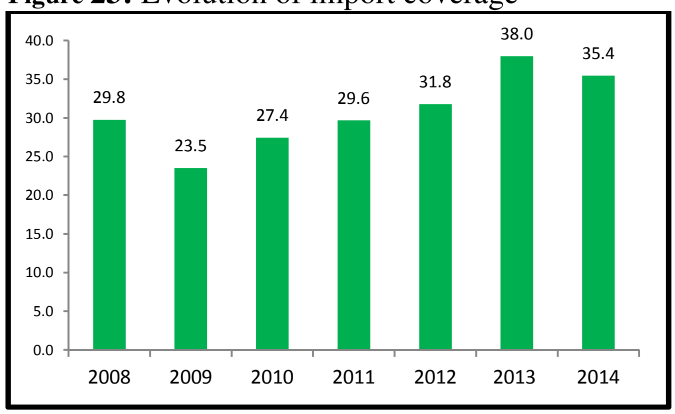
Figure 22: Evolution of the trade balance (USD, millions)



Source: BNR, statistics department (2014)

In annual terms, the cover rate of imports by exports dropped to 35.4% in 2014 from 38% in 2013 and this poses challenges on exchange rate market developments.

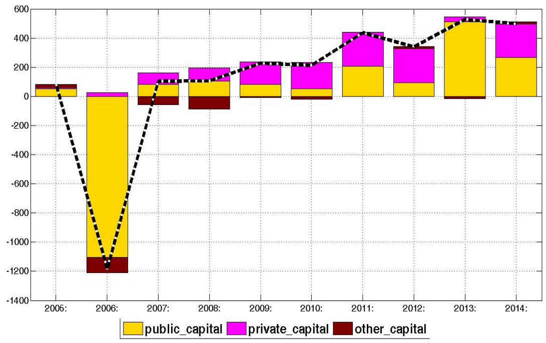
Figure 23: Evolution of import coverage



Source: Monetary Policy & Research Department (2014)

The financial transactions account balance declined from USD 661.3 million in 2013 to USD 497.2 million in 2014. Interestingly, private capital increased from USD 137.9 million in 2013 to USD 232 million in 2014 whereas public capital decreased from USD 523.4 million in 2013 to USD 265.1 million in 2014 and other capital rose from a deficit of USD 5.99 million to a surplus of USD 12.9 million.

Figure 24: The financial account (Million USD)



Source: BNR, statistics department (2014)

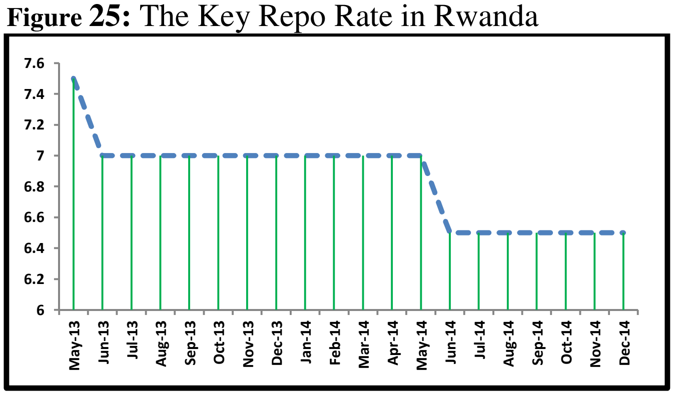
2.3. Fiscal spending

Aggregate demand has continued to improve on the back of expansionary fiscal and monetary policies. As of January 2015, total expenditure on cash basis increased by 24.6% against the corresponding month in 2014/2013 and by 30.9% compared to December 2014.

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



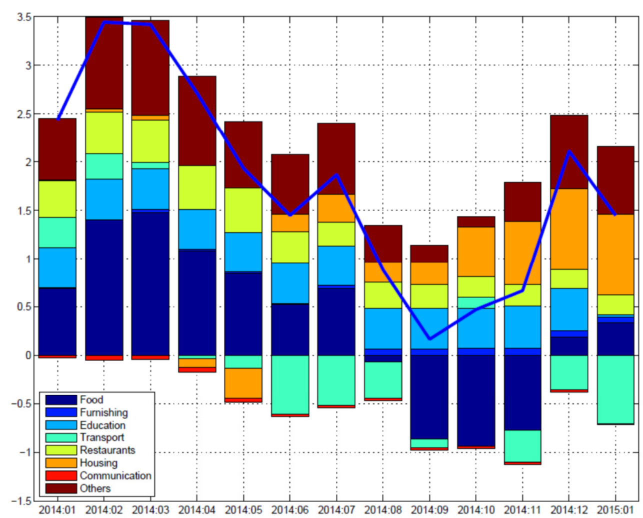
Source: Monetary Policy & Research Department (2014)

Consequently, credit to the private sector increased by 19.6% in 2014 from 17.9% in 2013. The expansionary monetary policy is premised on the fact that domestic inflation is still low whereas aggregate demand is faltering.

2.5. Inflation developments

Headline inflation increased from 0.2% in September to 0.5% in October and to 0.7% and 2.1% in November and December 2014 respectively. CPI inflation remained below the 5% target and mainly reflects the uptick in food and housing inflation. From September to December 2014, food prices increased from -3.1% to 0.7% while housing inflation moved from 2.3% to 3.6%. In January 2015, food and housing inflation increased to 1.2% and 3.7% respectively.

Figure 26: Contribution to headline inflation, % YoY

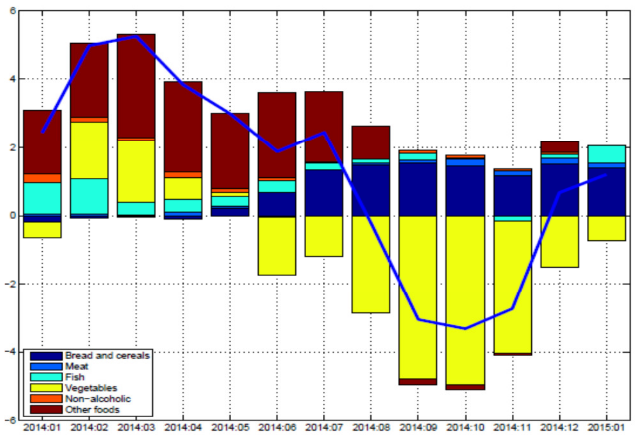


Source: Monetary Policy & Research Department (2014)

Food inflation declined since April to October 2014, mainly due to good agricultural production especially for vegetables, but rose again in the remaining months of 2014Q4. Vegetables' inflation increased from -13.8% in October to -4.1% in December 2014 whereas Bread and cereals' inflation did not change much, standing at

7.3% on average in 2014Q4 compared to 7.7% of the previous quarter.

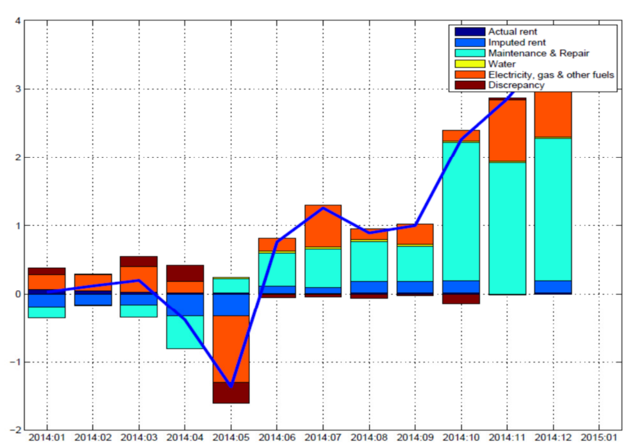
Figure 27: Contribution to food inflation, % YoY



Source: Monetary Policy & Research Department (2014)

Housing inflation increased from 1% in September to 3.6% in December 2014 and has been higher in the last quarter compared to the three previous quarters this year. Its contribution into headline inflation reached 48.5% in 2014Q4 from 18.8% of the previous quarter. The increase in housing inflation was mainly driven by the uptick in prices of firewood and charcoal from 1% in September to 9% in December 2014. Other main contributors into housing inflation were actual and imputed rent.

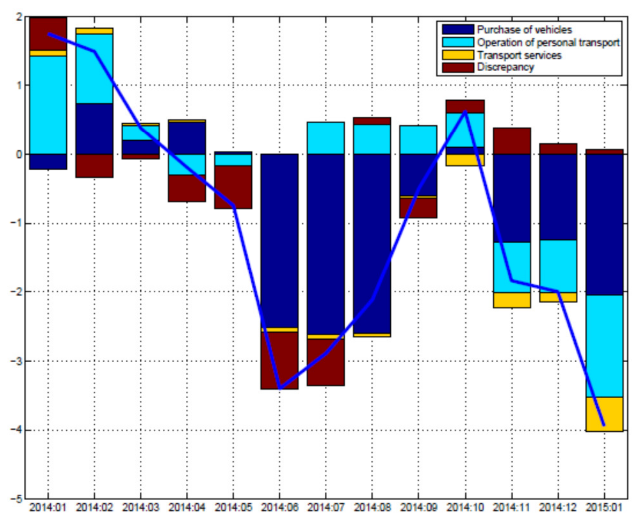
Figure 28: Contribution to housing inflation, % YoY



Source: Monetary Policy & Research Department (2014)

Following the continued fall in international oil prices, the local pump prices were revised downwards twice in 2014Q4 (November and December) to 895FRW/liter by end December 2014. As a corollary, transport deflation increased from -0.5% in September to -2.0% in December. Furthermore, inflation for purchase of vehicles declined from -1.5% to -3.10% as a result of a discount of Suzuki cars from 18 million to 15 million FRW in November and December 2014. The reduction in local pump prices was the main reason for the declining contribution of fuels and lubricants into personal transport inflation during the fourth quarter of 2014.

Figure 29: Contribution to transport inflation, % YoY

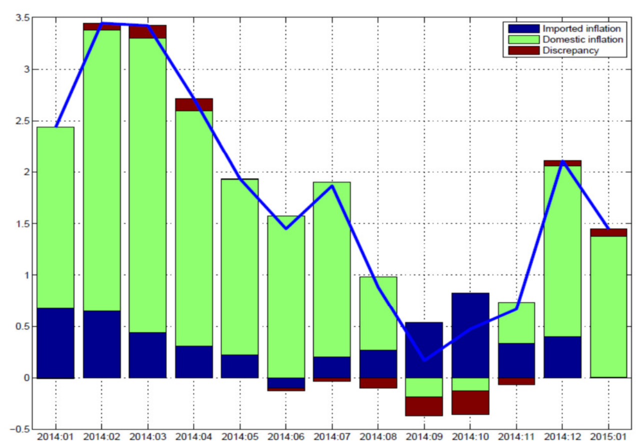


Source: Monetary Policy & Research Department (2014)

Despite the deflationary pressures from some CPI items like food, transport and communication especially during the first two months of 2014Q4, domestic goods inflation increased from -0.2% in September to 2.2% in December mainly due to the decrease in local food deflation from -4.3% in September to -0.8% in December and in housing inflation from 1% to 3.76% during the same period.

Imported inflation moved from 2.1% in September to 1.6% end December. This movement reflects principally the fall in imported transport inflation from 0.15% to -3.1% during the same period. Falling imported clothing and footwear inflation (from 8.9% to 6.9%) also pushed down imported inflation while imported food and alcoholic beverages exerted upward pressures rising from 4% to 6.8% during the same period.

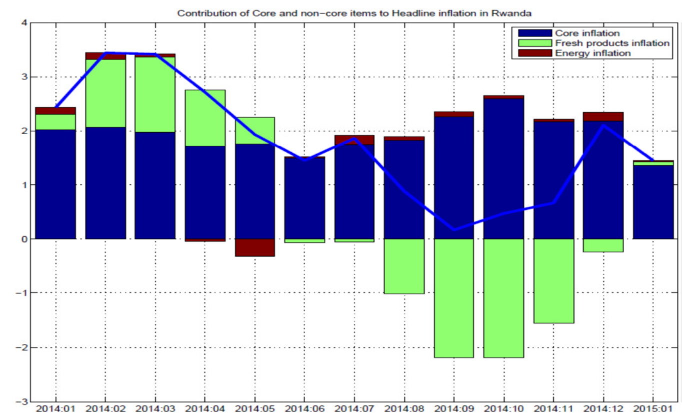
Figure 30: Headline inflation by source, % YoY



Source: Monetary Policy & Research Department (2014)

In 2014Q4, core inflation stood at 3.1% on average and remained higher than the average of the previous quarters this year. In annual terms, core inflation rose from 2.0% in June to 2.9% in December 2014 as a result of the progressive improvement in aggregate demand following BNR's accommodative monetary policy.

Figure 31: Inflation by volatility, % YoY



Source: Monetary Policy & Research Department (2014)

3. THE INFLATION OUTLOOK

3.1 Domestic aggregate demand

The Rwandan economy continued to perform well in 2014Q4 as indicated by high frequency indicators, notably the composite indicator of economic activities, credit to the private sector and total turnovers. However, aggregate demand is still non-inflationary.

3.1.1 The Composite Index of Economic Activities

The Rwandan economy has continued its growth trajectory as indicated by the upward trend in the real Composite Index of Economic Activities (CIEA). In annual average terms, the y-o-y % change in the real CIEA increased to 11.4% in December 2014 from 6.7% in December 2013 and 10.7% in November 2014. Continued economic recovery is an indicator of the sustained progressive increase in aggregate demand though the latter still remains negative and generally non-inflationary.

3.1.2 Turnovers of industry and services

In annual terms total turnovers increased by 11.8% in January 2015, mainly driven by industry turnovers which increased by 13.9% whereas services turnovers rose by 11% during the same period.

3.1.3 Credit to Private Sector

The new authorized loans grew on quarterly basis by 9.3% in 2014Q4 and are likely to continue growing following the BNR accommodative monetary policy. This will evidently positively affect economic activities in the forthcoming quarter.

3.2 Supply shock

Since June to December 2014, prices for fresh products exerted deflationary pressures. This changed in January 2015 when prices for fresh foods positively contributed to headline inflation. Looking ahead, food prices are likely to continue increasing until March 2015 given that rainfalls decreased in September-January period from 122mm in 2014 to 117mm in 2015.

3.3 Exchange rate developments

The Rwandan Franc has continued to remain stable, depreciating against the USD by only 3.6% in 2014 compared to 6.1% in 2013 and against the Burundian Franc by 1% in 2014 from 4.9% of the previous year. The FRW appreciated against currencies of major trading partners in the region and this has cushioned the domestic economy from imported inflation.

3.4 Global and regional inflationary pressures

Globally, inflation remained subdued, driven mainly by the continued fall in oil prices, and is expected to remain contained given that the projections of the global economic growth were revised down to 3.5% from 3.8%.

According to Eurostat's flash estimate, the euro area annual inflation was 0.2% in December 2014 from 0.3% in November, driven by a fall in energy prices and non-energy industry goods' prices. The US inflation rate continues to ease standing at 0.8% in December from 1.3% in November 2014 due to the continued fall in energy cost whereas the index for food increased.

Inflation remained relatively stable in the EAC region decreasing in Kenya, Tanzania and in Uganda following an uptick in food inflation.

The developments in international commodity prices, regional inflation developments and in global economic growth hitherto pose no inflationary pressures to domestic inflation.

3.5 International commodity prices

Commodity prices fell by 12% in December, mainly reflecting a sharp decline in oil prices. Non-fuel prices fell 2.2% in part reflecting appreciation of the U.S. dollar up by 2.3% against a broad group of currencies. During 2014 commodity prices fell 29.2% on annual basis, with energy dropping 39% and non-fuel prices falling by 9.9%.

For the seventh consecutive month, agriculture prices fell by 1% in December on the back of ample supplies for most commodities. Coffee (Arabica & Robusta) prices fell by 6% and 3% in November and December respectively, as wet weather in Brazil improved production prospects.

Prices for metals fell by 4.9% in December, down for the fifth consecutive month. During 2014 the metals index fell by 17% following ample supplies and the slowing demand growth particularly in China.

Crude oil prices plunged by 21.3% in December, averaging $60.6 per barrel and falling below $46 per barrel in early January. The on-going decline reflects expectations of a continued market surplus due to weak demand, large gains in non-OPEC supply, and OPEC's intention to maintain its market share. Given that local pump prices were reduced in December and that these prices are controlled, there are likely to be no pressures to weigh on inflation in January 2015.

3.6. Inflation forecasts

Headline inflation has continued to ease in Rwanda, reaching 2.1% in December 2014 and 1.4% in January 2015. In the fourth quarter of 2014, food inflation started to contribute positively to headline inflation and this is likely to continue even during the next quarter.

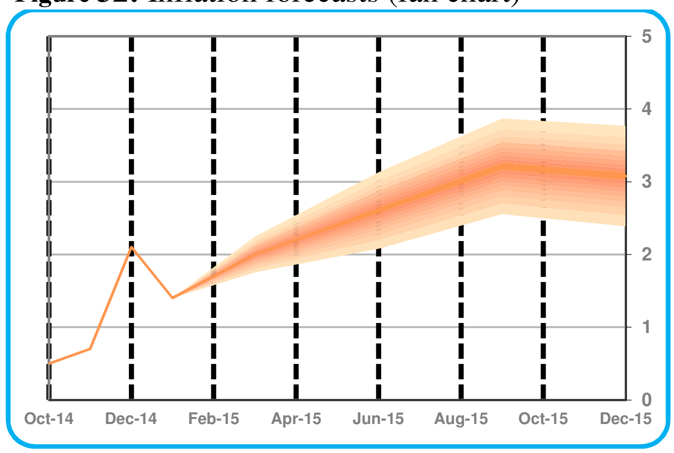
Globally, the world economy has continued to improve but at a slowing pace. Aggregate demand is still low whereas international commodity prices have continued to decline. Consequently, local pump prices were revised downwards to 845 RWF/liter in early February 2015. The local pump prices are likely to remain stable until March 2015 and this will negatively affect inflation developments.

Since December 2014, prices for fresh products started to exert inflationary pressures and this is likely to continue until March 2015 given the current low level of rainfalls relative to the previous season A.

The RWF is expected to remain stable, mildly depreciating against the USD but appreciating against major trading partners in the EAC region. This, coupled with subdued inflation in the region, will help to continue mitigating imported inflation.

Looking ahead, inflation is projected to be around 2% in March and 3.5% in December 2015 while the main risks to the inflation outlook remain food supply shocks and developments in international oil prices.

Figure 32: Inflation forecasts (fan chart)



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

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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