National Bank of Rwanda

QUARTERLY INFLATION REPORT

WP03/2014Q3

Kigali, December 2014

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.

After the 2013 economic slowdown, the Rwandan economy has continued to recover, evolving towards the attainment of the projected real GDP growth rate of 6% by the end of 2014. In 2014Q3, real GDP growth increased to 7.8% from 6.1% in 2014Q2 compared to 7.2% in 2013Q2 and 2.9% in 2013Q3.

Average real GDP growth stood at 7.1% during the three quarters of 2014 compared to 4.9% in the same period of 2013. There are positive growth prospects for 2014Q4 given that total turnovers increased by 15% in October and 10% and November in against 6% and 5% in 2013the same period. The real CIEA grew by 13% in November from 11.7% in October and confirms positive growth prospects for 2014Q4. The near-term economic growth will continue to be driven by the service sector.

Economic financing has continued to increase as indicated by growth in money supply, increasing by 21.9% in September 2014 compared to 16.7% recorded in the same period of 2013. The new loans to private sector continued to increase in 2014Q3, rising by 50% compared to the same period in 2013 and between December and November, the new loans rose by 42% on annual basis in 2014 compared to a decrease of 8% recorded in 2013.

Though the RWF depreciated by 3.2% in November and by 3.6% in December against the USD, imported inflationary pressures will remain dampened by the appreciation of the RWF against most of the regional currencies. However, some exchange rate pressures exist as a result of the widening trade deficit.

Inflation decelerated to 0.7% in November from 2.4% in January 2014. Inflationary pressures remained low as a result of sustained and well-coordinated monetary and fiscal policies, limited inflationary pressures from trading partners, falling international oil prices and positive supply shock. However, some risks remain and are mainly linked to the end-of-year festivities and food supply shocks. Given the current low level of aggregate demand and the global price levels, inflation is projected to be around 2% and 2.5% in December and March 2015.

ACKNOWLEDGEMENTS

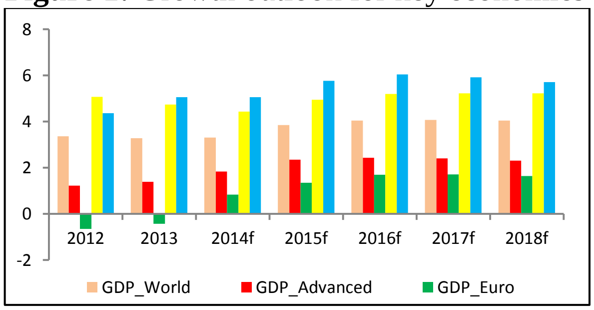
A team from the Monetary Policy & Research Department, spearheaded by the Modeling and forecasting division, prepared the 2014Q3 inflation report with notable contribution from Mr. Mathias KARANGWA (Manager, Modeling & forecasting division) & Mr. MWENESE Bruno (Senior Economist, Modeling & forecasting division) whereas Mr. Ananias GICHONDO (Director, Monetary policy & 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 (Principal economist, Economic Research and Financial Stability Analysis division).

1. EXTERNAL ENVIRONMENT

1.1. Global Economic Activity

The global economy is expected to strengthen in 2014Q3, with World real GDP projected to grow by 2.9% after 2.4% in 2014Q2 and 1.9% in 2014Q1. The weak growth in 2014Q1 and 2014Q2 continues to weigh on the expected annual growth in 2014, tempting the IMF to revise downwards world GDP growth by 0.4% from 3.7% as per April estimates to 3.3% in the October estimates.

Figure 1: Growth outlook for key economies



Source: IMF, WEO (October 2014)

Growth is expected to strengthen in 2014–15 across most advanced economies, but at a different pace across regions. The strongest rebound in growth is expected in the U.S, whereas the crisis legacy brakes will ease only slowly in the euro area, and growth in Japan will remain modest. Growth elsewhere, including in other Asian advanced economies, Canada, and the United Kingdom, is projected to be solid.

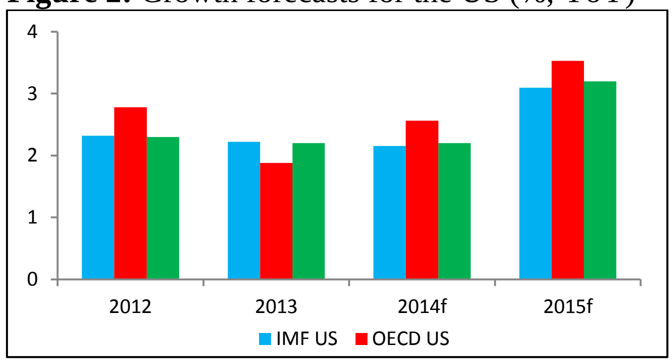
Table 1: Real GDP growth (% change)

	Quarterly (BLOOMBERG)					
	2014Q.I	2014Q.II	2014Q.III	2014Q.IV	2014	2015
World (YoY)	1.9	2.4	2.9	2.7	3.3	3.8
USA (QoQ)	-2.1	4.6	3.5	3.0	2.2	3.1
Euro area (YoY)	1.0	0.7	0.7	0.7	0.8	1.3
Japan (QoQ)	6.0	-7.1	2.8	1.9	0.9	0.8
UK (YoY)	2.9	3.2	3.0	3.0	3.2	2.7
China (YoY)	7.4	7.5	7.3	7.3	7.4	7.1

Source: BLOOMBERG & IMF (October 2014)

In the U.S, the legacy of the weak first quarter of 2014 is present but conditions remain in place for a stronger pickup in the recovery. Following the improving financial conditions, the reduced fiscal drag as well as the continuous improvement in labor market conditions and housing wealth, the U.S economy increased by 3.5% in 2014Q3 against 4.6% and -2.1% in 2014Q2 and 2014Q1 respectively. By the end of 2014, The U.S. economy is expected to grow by 2.2%, lower than the 2.8% projection in the April 2014 IMF WEO report.

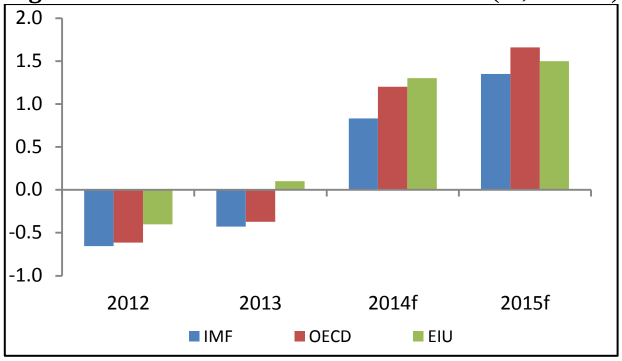
Figure 2: Growth forecasts for the US (%, YoY)



Source: IMF, OECD & EIU (October 2014)

Growth in the Euro area is estimated, for the second straight quarter, to stand at 0.7% in 2014Q3 from 1.0% in 2014Q1. Growth is projected to average 0.8 percent in 2014 and 1.3 percent in 2015 and to remain uneven across countries; improving only in Spain while contracting in Germany, France and Italy. This modest recovery will be supported by a reduction in the fiscal drag, accommodative monetary policy and improving credit conditions.

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



Source: IMF, OECD & EIU (October 2014)

Growth in emerging markets and developing economies is projected to increase modestly in the second half of 2014 and into 2015, supported by stronger domestic demand as well as a recovery in external demand associated with faster growth in advanced economies. However, the growth forecast is lower by 0.3% reflecting the weaker first half and structural factors.

In Asia, growth remained robust, driven by China and India despite some moderation in the Chinese economy. In the 2014Q3, the Chinese economy grew by 7.3%, the slowest growth since 2009 after 7.5% in the 2014Q2 and 7.4% in 2014Q1 due to the slowdown in investment in real estate and in industrial production. By the end of 2014, the Chinese economic growth rate is estimated to decrease to 7.4% and to further decelerate to 7.3% in 2015 though the Chinese authorities resolved to grant tax relief for small and medium enterprises, increase fiscal and infrastructure expenditures and to reduce the reserve ratio to support the economy.

In Japan, growth in the first half of the year was affected by the April consumption tax hike, which boosted activity in the first quarter at the expense of the second quarter. Despite the larger-than-expected contraction in the second quarter (-7.1%), real GDP is now projected to increase by 2.8% in 2014Q3 and by 0.9% for the whole of 2014.

During 2014Q3, the global economic growth strengthened on account of improving financial conditions and supportive monetary policy and fiscal policy. However, the 2014 forecasts were revised down following weak performance in the first half of 2014. Moreover, the downside risks to growth have increased owing to the increase in geopolitical risks, including the turmoil in the Middle East and international tensions surrounding the situation in Russia and Ukraine. In addition, risks related to expected monetary policy normalization in the U.S. and to below target inflation in the Euro zone remain.

1.2. Monetary policy and international financial markets

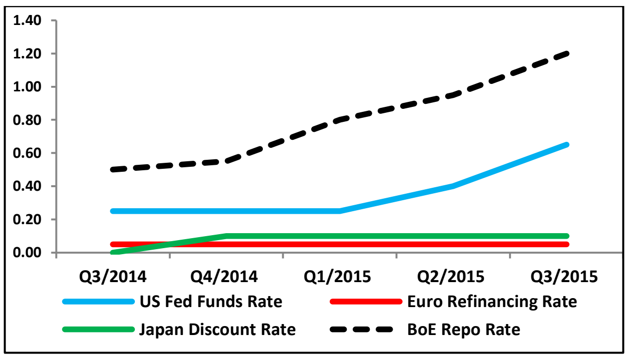
Monetary policy conditions have remained very accommodative in advanced economies and broadly unchanged in emerging markets since the spring. By the end of September 2014, the Fed funds rate stood at 0.25%, the refinancing rate in the Euro area was reduced to 0.05% and the repo rate remained at 0.5% in the UK.

In the U.S. markets still expect the Federal Reserve Bank to start increasing the federal funds rate by mid-2015. In 2014Q3, the reduction in the monthly volume of asset purchases by the Federal Reserve Bank has continued, and purchases are expected to be wound down by the fall of this year.

In the euro area, the European Central Bank (ECB) has announced a range of actions to tackle low inflation and address fragmentation, including a reduction in policy rates, targeted credit easing, and other measures to boost liquidity.

In emerging markets, capital flows have remained robust despite generally weaker activity, and exchange rates have either stabilized or strengthened in some of these economies.

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



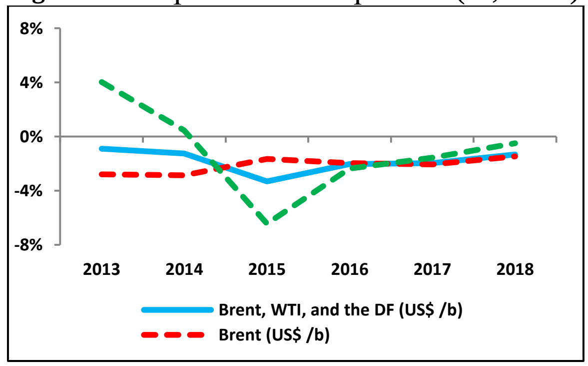
Source: http://www.tradingeconomics.com(Oct 2014)

1.3. International commodity prices

Commodity prices declined in 2014Q3 reflecting falling energy prices by -6.2% and non-energy prices by -2.6% mainly due to weak demand together with improving global supply.

Despite the ongoing geopolitical tensions in major oil producers (Iraq, Syria and Russia), crude oil prices have dropped by -5.6% in 2014Q3 due to global oversupply and the strengthening US dollar. Compared to the previous quarter, Brent price fell by -7.0% in 2014Q3 averaging USD 102.08/barrel after it rose by 1.8% in 2014Q2. Oil prices are expected to remain soft in both 2014 and 2015, before slightly increasing thereafter, owing to plentiful new supply from the US and several OPEC members.

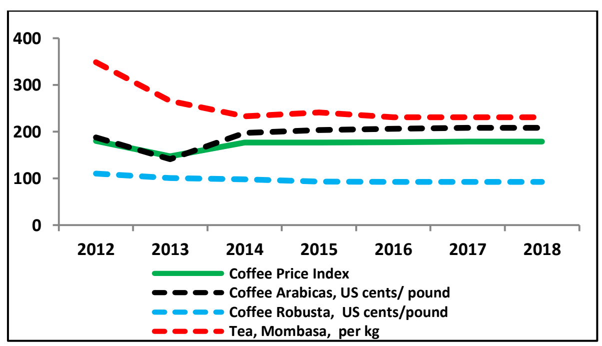
Figure 5: Oil prices' developments (%, YoY)



Source: IMF, WEO (Database, October 2014)

While almost stable in 2014Q2 as result of good performances in agriculture sector and low demand for industrial raw materials, non-energy prices fell by -2.6% in 2014Q3 mainly as a result of decreasing agriculture prices (-5.0%) whereas fertilizer prices rose by 5.9% while metals and minerals prices increased by 2.6% each. The prices for non-energy commodities are expected to either slightly drop or remain flat until 2018.

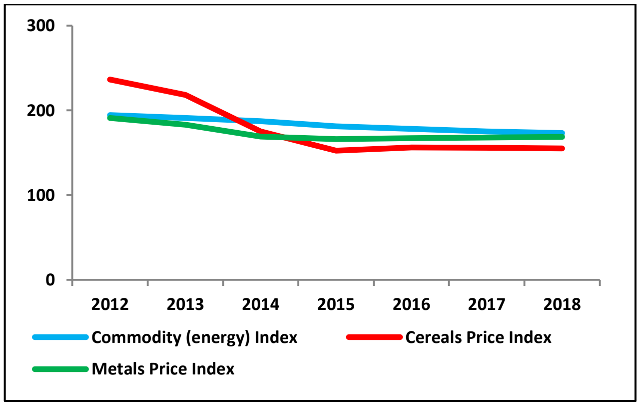
Figure 6: Non-oil prices developments



Source: IMF, WEO (Database, October 2014)

Globally, for 2014 metals prices are projected to further drop by -7.5% against a decline of -4.3% in 2013. Non-fuel commodity prices are expected to continue to fall in 2014, declining by -3.0% after a drop of -1.2% in 2013. The general outlook for international commodity prices is by and large benign until at least 2018.

Figure 7: Outlook for key commodity prices

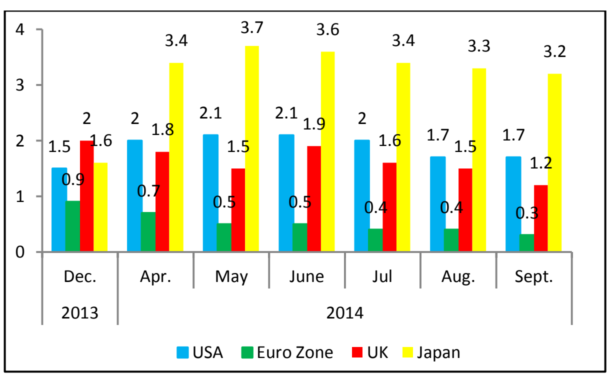


Source: IMF, WEO (Database, October 2014)

1.4. Global inflation developments and outlook

Inflation remains subdued in advanced economies and deflation continues to be a concern especially in the Euro zone. In the U.S, inflation remained almost stable at 1.7% in September 2014 from 2.0% in July 2014 reflecting falling energy prices. Inflation measured with the personal consumption expenditure deflator is projected to be 1.6% at the end of 2014 and to gradually rise thereafter towards the Federal Reserve's longer-term objective of 2%.

Figure 8: Inflation in key economies (%, y-o-y)



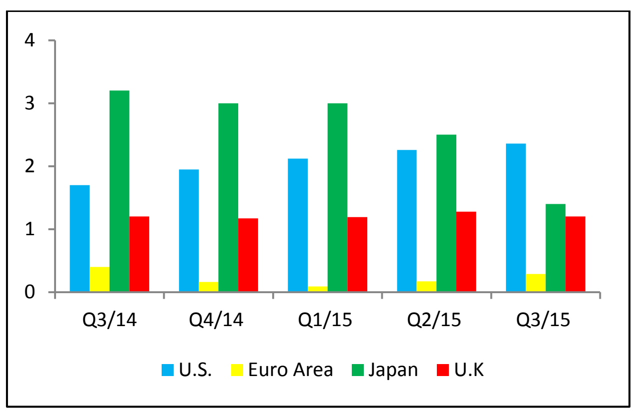
Source: http://www.tradingeconomics.com

In the euro area, inflation slid to 0.3% in September from 0.4% in both August and July 2014 owing to a decline in energy prices. Inflation is projected to increase gradually to 0.9% (YoY) in 2015 and 1.2% in 2016 as the recovery strengthens and output gaps slowly improve. But price pressures are expected to remain very subdued because of the combined effects of persistently low output gaps and weak credit conditions.

Inflation in Japan stood at 3.2% in September from 3.3% in August 2014 and is projected to rise to an annual average rate of 2.7% in 2014. This rise reflects the consumption tax increase, but underlying inflation is rising as well and is projected to stand at 1.1% in 2014.

In emerging markets and developing economies, inflation is projected to decline in 2014 and to remain broadly unchanged in 2015. The recent decline reflects to an important extent the softening of international commodity prices particularly those for food commodities, which have a high weight in the consumer price index baskets for these countries.

Figure 9: Global inflation outlook (% y-o-y)



Source: http://www.tradingeconomics.com/forecasts

In the EAC, since 2013, headline inflation has remained moderate on the back of positive performances in the agriculture sector despite some seasonal shocks. For 2014, Uganda's headline inflation dropped to 1.4% in September from 4.9% in June 2014 due to a sharp drop in food prices.

Kenya's inflation fell to 6.6% in September from 8.4% in August 2014 due to lower energy and transport costs.

Table 2: Annual headline inflation in EAC countries, in %

	2014								
	Jan	Feb	Mar	Apr	Ma	Jun	Jul	Aug	Sept
Uganda	6.9	6.8	7.1	6.7	5.4	4.9	4.3	2.8	1.4
Kenya	7.2	6.9	6.3	6.4	7.3	7.4	7.7	8.4	6.6
Tanzani	6.0	6.0	6.1	6.3	6.5	6.4	6.5	6.7	6.6
Burundi	6.0	5.9	3.8	4.8	3.4	3.3	3.1	5.9	5.5
Rwanda	2.4	3.5	3.4	2.7	1.9	1.4	1.9	0.9	0.2

Source: Central Banks Websites

2. THE DOMESTIC ECONOMY

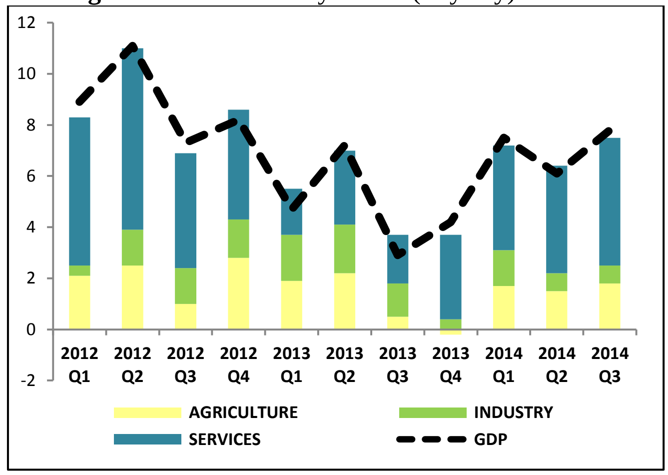
2.1. Domestic demand and output

The Rwandan economy has continued to recover from the 2013 economic slowdown, with real GDP growing by 7.1% on January-September period of 2014 compared to 4.9% of the same period in 2013.

Consistent with the ongoing recovery, real GDP growth increased to 7.8% in 2014Q3 from 6.1% of the previous quarter and 2.9% in 2013Q3, mainly due to the good performance of the service sector, whose growth rose to 10% in 2014Q3 from 9% of 2014Q2 and 4% in 2013Q3. Growth in the agriculture sector slightly went up at 6% in 2014Q3 from 5% of 2014Q2 but this level is remarkably higher than 1% registered in 2013Q1, thereby contributing by 1.8 percentage points in real GDP growth in 2014Q3.

The industry sector slowed down, growing by 4% in 2014Q3 compared to 5% and 9% in 2014Q2 and 2013Q3 respectively.

Figure 10: Real GDP by Sector (% y-o-y)

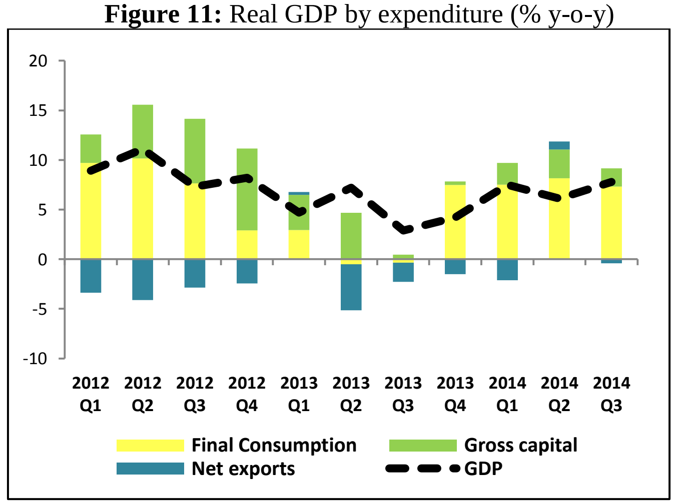


Source: BNR, Monetary Policy & Research Department (2014)

Though mining and construction bounced back to the growth of 22% and 8% in 2014Q3 from 4% and 5% recorded in 2014Q2 respectively, industry sector slowed down, the biggest effect came from manufacturing especially food and beverages & tobacco.

From a contraction of -0.6% and -0.4% in 2013Q2 and 2013Q3 respectively, total final consumption, which was the main driver of real GDP growth on the expenditure side, grew by 9.1% and 8.1% in 2014Q2 and 2014Q3 respectively. Exports expanded by 3% in 2014Q3 from -5% in 2014Q2, and from 14% in 2013Q3 and 35% in 2013Q2.

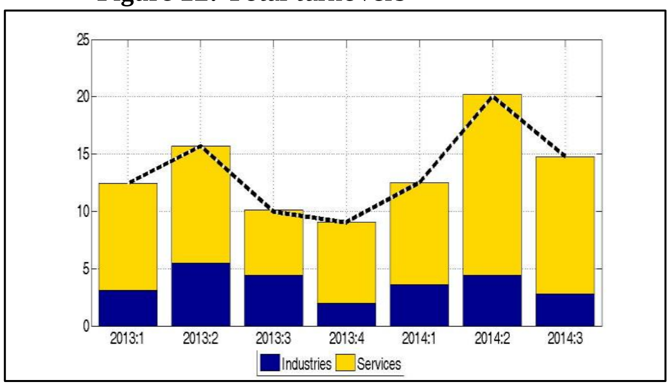
Figure 11: Real GDP by expenditure (% y-o-y)



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

The GDP growth for 2014Q3 is in line with the expectations based on total turnovers increase of 14.8% against 10.0% in 2013Q3. Growth in turnovers was mainly driven by the good performance of the service sector, whose sales increased by 17.2% in 2014Q3 against 7.9% in 2013Q3, though it fell below the 22.4% growth registered in 2014Q2. The industry sector slowed down to 9.3% in 2014Q3 from 14.9% of the previous quarter and 15.5% of 2013Q3.

Figure 12: Total turnovers

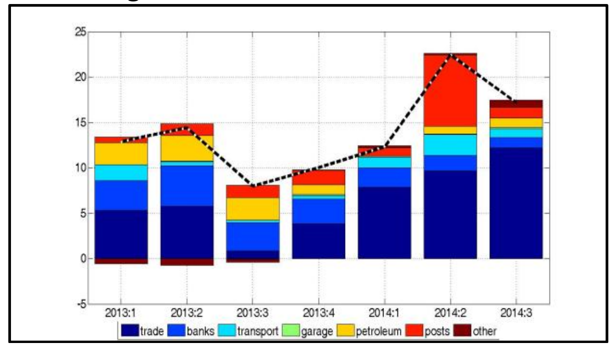


Source: BNR, Monetary Policy & Research Department (2014)

Considering the first nine months, total turnovers grew by 15.9% in 2014 against 12.5% of the same period in 2013. The services sector's turnovers rose by 17.5% in the first nine months of 2014 from 11.4% in the same period of 2013. During the same period, growth in the industry turnovers slid to 12.2% in 2014 from 15.3% in 2013.

The main contributor to the good performance of the service turnovers was trade services, whose sales increased by 27.5% in 2014Q3 from 20.8% of the previous quarter and 1.8% of 2013Q3.

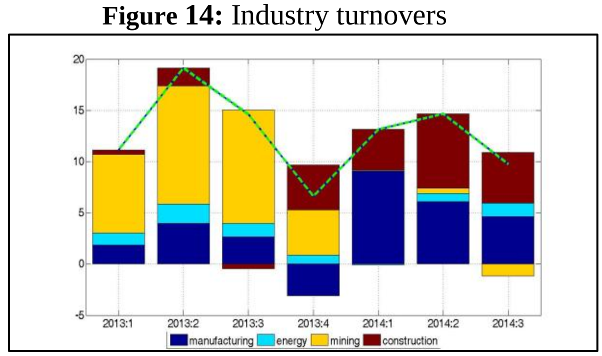
Figure 13: Services' turnovers



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

The deceleration in the industry sector turnovers in 2014Q3 was due to the fall in mining turnovers to -5.9% from 98.0% in the same period of 2013. The sector was buoyed by manufacturing whose turnovers increased from 4.9% in 2013Q3 to 9.2% in 2014Q3 and construction from -1.7% to 22.8% during the same period.

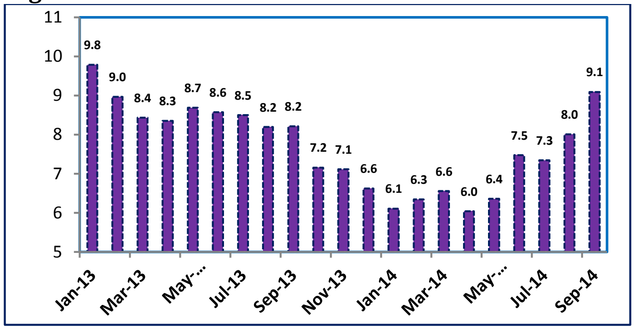
Figure 14: Industry turnovers



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

The trend of the real Composite Index of Economic Activities (CIEA) also confirmed positive growth for 2014Q3.The real CIEA grew by 12.1% in 2014Q3 compared to 5.9% in 2013Q3 as a result of improving domestic demand and better performance of non-agricultural activities.

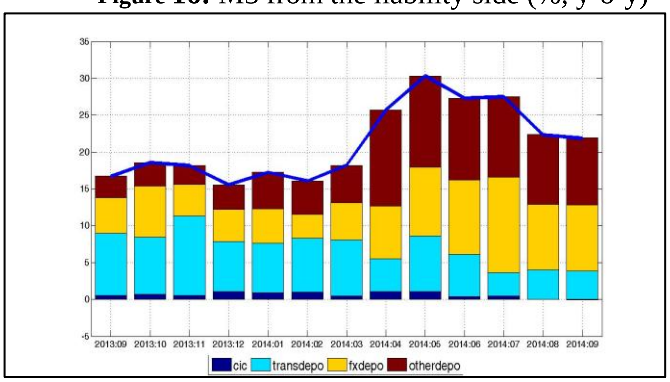
Figure 15: The trend of the Real CIEA



Source: Monetary Policy and Research Department

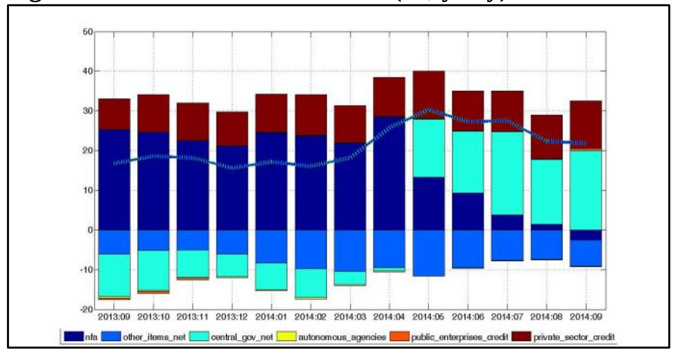
Economic financing has continued to increase as indicated by growth in both money supply and credit to the private sector. In annual terms, money supply (M3) rose by 21.9% in September 2014 from 22.4% in August 2014 and 16.7% recorded in the same period of 2013. For the last two months, the growth in M3 is mainly driven by the uptick in transferable deposits.

Figure 16: M3 from the liability side (%, y-o-y)



The M3 growth from the asset side was mainly driven by net domestic assets, which grew in y-o-y terms by 81.4% in September 2014 from 65.2% of the previous month and -20.4% in September 2013. Growth in net domestic assets was mainly due to high government borrowing and the increase in the outstanding credit to the private sector.

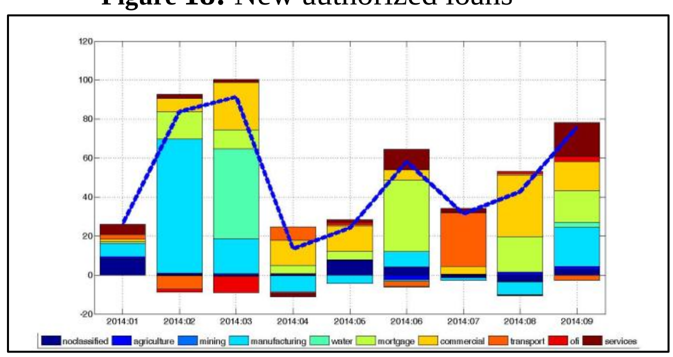
Figure 17: M3 from the asset side (%, y-o-y)



The above mentioned sectoral economic performance is evident in the trend of sectoral loan allocations. The sub-sectors of the service and industry sectors, notably, manufacturing, mortgage as well as commerce and restaurants, received the largest portion of new authorized loans in September 2014. Services offered to the community also attracted a big chunk of new loans in September 2014.

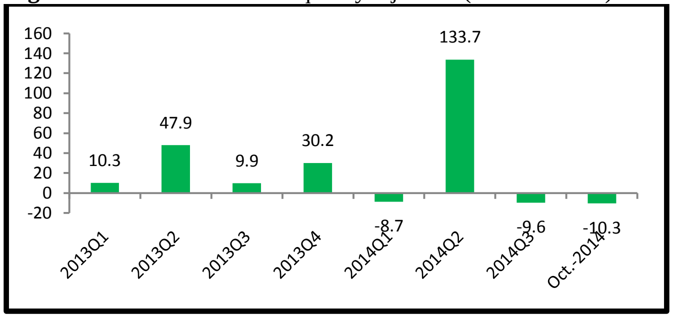
New authorized loans for manufacturing activities grew by 132.4% in September 2014 new loans to mortgages rose by 58.0% during the same period.

Figure 18: New authorized loans



Net government liquidity injections have been declining, reaching -9.6 Billion RWF in 2014Q3 and -10.3 Billion RWF in October 2014 from 133.7 Billion RWF in 2014 Q2. This declining trend in net government injections will continue to depress aggregate demand.

Figure 19: Government net liquidity injection (FRW Billions)



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

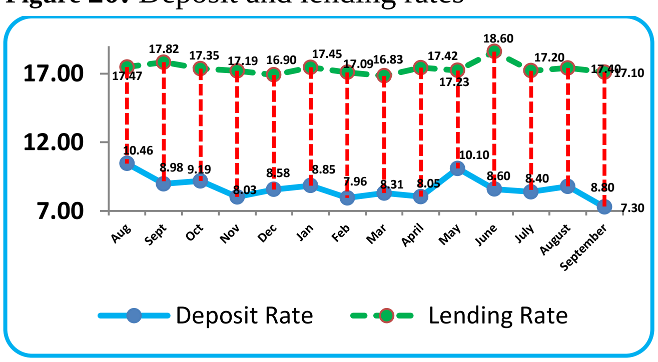
2.2.Financial Sector developments

2.2.1 Interest rate developments

The continued monetary policy easing has resulted into the decline in short term interest rates whereby the T-bills and interbank rates declined respectively from 5.6 % and 5.7% end June 2014 to 5.5% and 5.6% end September 2014. The T-bills rate declined further to 5.4% in October while the interbank rate slightly went up to 5.7% during the same period.

After stabilizing at around 8.5% in the first eight months of 2014, commercial banks deposit rates declined to 7.3% in September. Conversely, lending rates have remained high, though they slightly fell to 17.1% in September 2014 from 17.4% of the previous month. Given this, the spread between the lending and deposit rates has risen to 9.8% in September from 8.6% of the previous month.

Figure 20: Deposit and lending rates

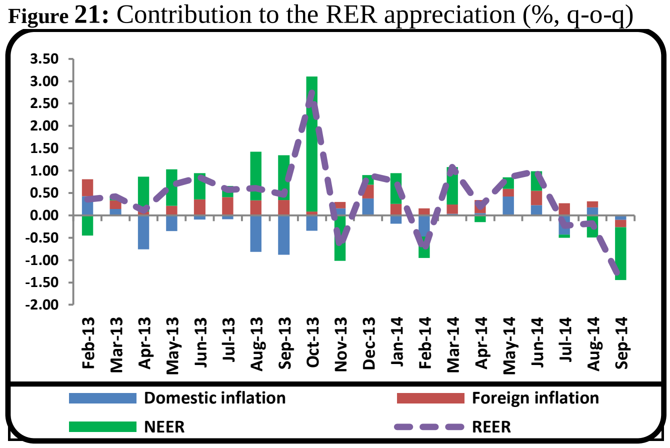


Source: BNR, Monetary Policy & Research Department (2014)

2.2.2 Exchange rate developments

The REER slightly appreciated by 1.5% in September 2014, mainly due to the appreciation of the nominal value of RWF against a basket of currencies of major trading partners. This appreciation was further re-enforced by the increase in relative prices following the lower level of domestic inflation relative to inflation in major trading partners.

Figure 21: Contribution to the RER appreciation (%, q-o-q)



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

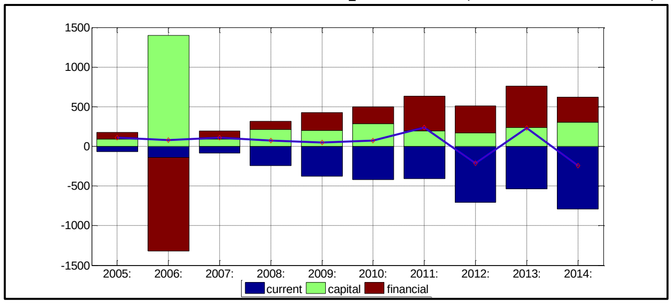
Concerning the bilateral nominal exchange rate, the Rwandan franc depreciated against the USD by 2.5% during the first nine months of 2014 compared to 4.1% of the same period in 2013.

During the same period, the RWF depreciated by 1.2% against the GBP, while it appreciated by 5.5% versus the EURO. Concerning the East African region, the RWF appreciated by 2.3% against the Kenya shilling, 4.6% versus the Ugandan shilling, and 3.1% against the Tanzanian shilling but depreciated by 2.3% versus the Burundi franc.

Estimates show that the balance of payments will deteriorate by the end of 2014, falling from USD 228.5 million in 2013 to USD -241.5 million in

2014. This deterioration will result from the widening of the current account deficit and will continue to exert pressures on the exchange rate developments.

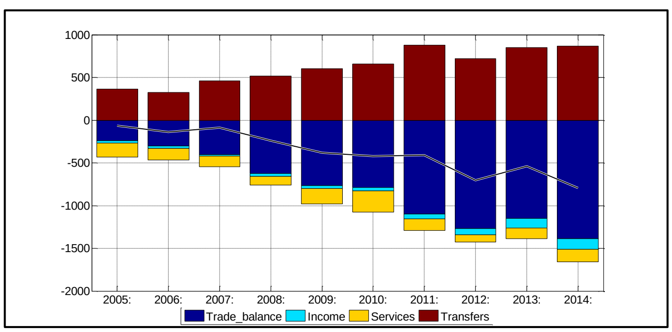
Figure 22: The BOP decomposition (Millions USD)



Source: BNR, statistics department (2014)

The current account deficit will be dragged downwards by the increase in the trade deficit from USD -1148.4 million in 2013 to USD -1384.4 million in 2014. Other negative contributors are services and income while transfers are expected to have a positive but stable contribution.

Figure 23: The current account (Million USD)

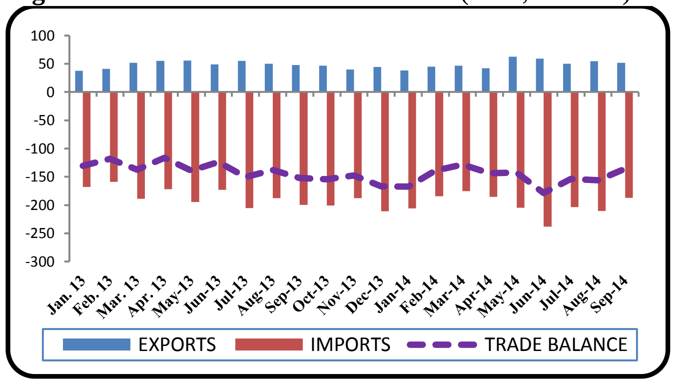


Source: BNR, statistics department (2014)

In line with the projected trade deficit for 2014, imports are expected to reach USD 2135.4 in 2014 million from USD 1851.5 million in 2013 whereas exports are expected to rise to USD 1384.4 million from USD 1148.4 million during the same period.

Recent data confirms the general trend of the above projections following the slight increase in exports value (1.6%) compared to increase in imports value CIF (8.9%) during the first nine months of 2014 thereby leading to the widening of the trade deficit by 11.6%.

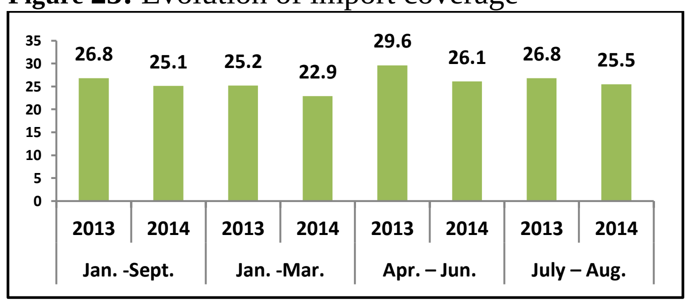
Figure 24: Evolution of the trade balance (USD, millions)



Source: **Source:** BNR, statistics department (2014)

The cover rate of imports by exports slid to 25.1% in January-September 2014 from 26.8% of the same period in 2013.

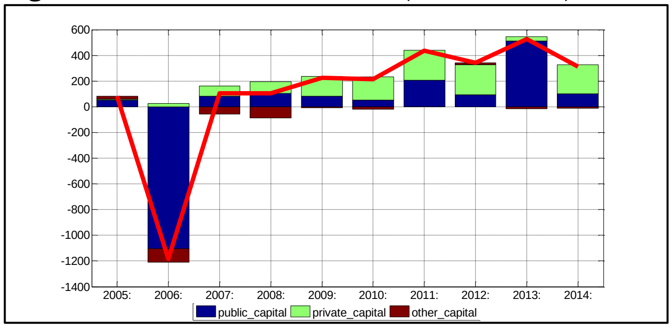
Figure 25: Evolution of import coverage



Source: Monetary Policy & Research Department (2014)

The financial account balance is projected to decline by 41% in 2014, from USD 528.01 million in 2013 to USD 313.24 million in 2014, mainly due to the expected huge decrease in public capital from USD 512.7 million in 2013 to USD 101.5 million in 2014 whereas private capital is projected to rise from USD 32.5 million to USD 224.3 million over the same period.

Figure 26: The financial account (Million USD)



Source: BNR, statistics department (2014)

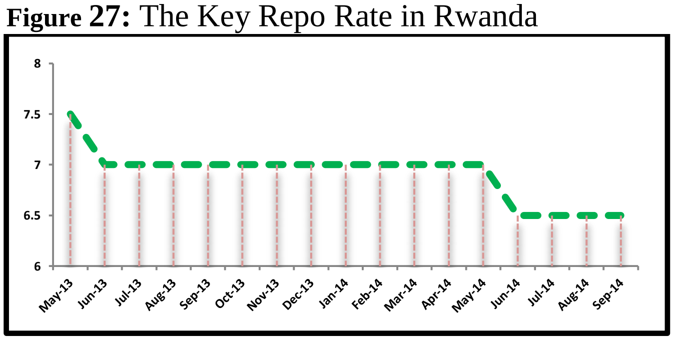
2.3.Fiscal spending

As of September 2014, total expenditure increased by 2.9% against the corresponding month in 2013/2014 and by 2.4% compared to the previous month of 2014, mainly due to the increase in capital expenditure. The current level of government expenditure and net government liquidity injections however are expected not to speed up the recovery in aggregate demand.

2.4.Previous monetary policy stance

Since June 2013, the National Bank of Rwanda has been pursuing a supportive monetary policy stance. Monetary policy was loosened further in June 2014 when the KRR was lowered from 7.0% to 6.5% and this rate was maintained in 2014Q3.

Figure 27: The Key Repo Rate in Rwanda



Source: Monetary Policy & Research Department (2014)

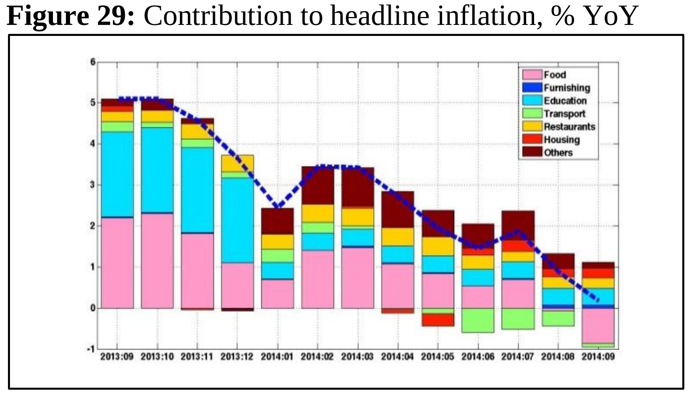
The continued adoption of the accommodative monetary policy is aimed at stimulating credit to the private sector so as to sustain the ongoing economic recovery. This is also motivated by the low inflationary pressures and the still weak aggregate demand.

2.5.Domestic inflation developments

Headline inflation decelerated from 1.9% to 0.2% from July to September 2014, with deflationary pressures mainly coming from food and transport as well as from the base effect. Food inflation decreased from 2.4% in July to -0.2% in August 2014 and to -3.1% in September 2014. During 2014Q3, transport recorded a deflation though at a decelerating rate, moving from -2.9% in July to -0.5% in September.

Following the early onset of the dry season in 2013 that caused food products shortage, the CPI became relatively high increasing by 1.2% both in August and September, while it increased a lower rate of 0.2% and 0.5% during the same period in 2014. This was reflected in a food deflation of -0.2% in August and -3.1% in September 2014 compared to food inflation of 4.9% and 7.8% in the same period of 2013. Generally, headline inflation has been following the downward trend of food inflation since September 2013.

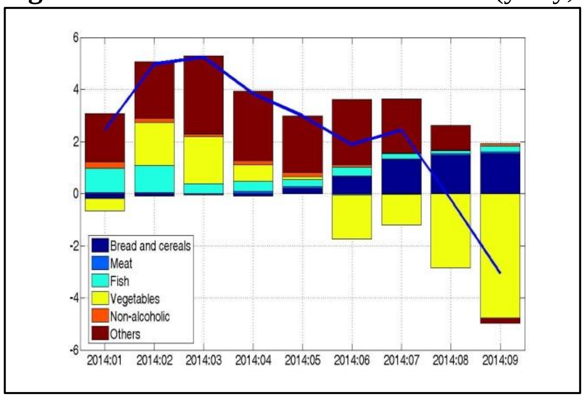
Figure 29: Contribution to headline inflation, % YoY



Source: Monetary Policy & Research Department (2014)

The downward trend in food inflation is explained by the deflation for fresh products, which increased from -0.4% in July to -5.6% in August 2014 and to -11.3% in September thereby leading to the increase in overall deflation in food from 2.4% to -0.2% and -3.1% during the same months respectively. The inflation in bread and cereals increased from 7.1% in July to 8.2% in September 2014 but this continued to be outweighed by the deflation in vegetables, which increased from -3.3% to -13.3% for the same period in 2014.

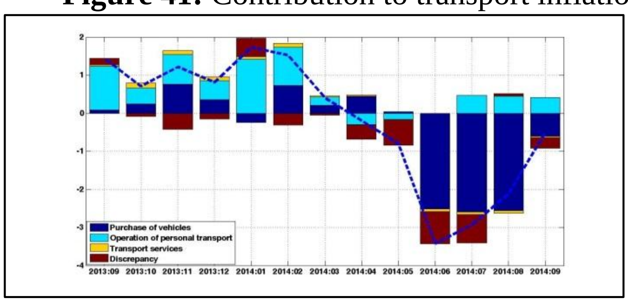
Figure 40: Contribution to food inflation (y-o-y, %)



Source: BNR, Monetary Policy & Research Department

The decrease in the prices of fresh food came as a result of the increased production of fresh foods in marshlands recorded in August and September 2014 compared to the same period in 2013.

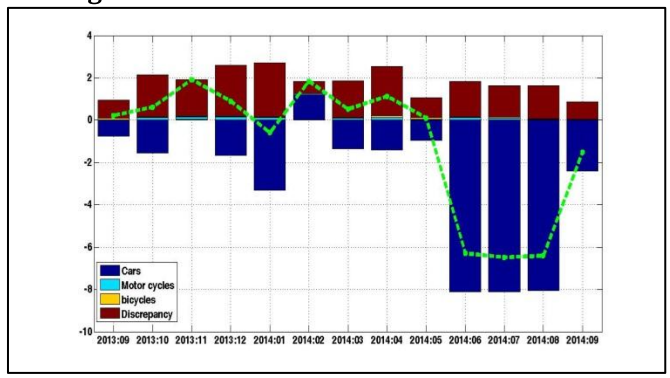
Figure 41: Contribution to transport inflation



Source: BNR, Monetary Policy and Research Department

For the last four months, the trend of transport inflation has been shaped by the contribution of prices for vehicles, notably the price of cars. In June 2014, two out of the three categories of cars included in the CPI basket, registered price reductions, thus exerting deflationary pressures to transport inflation. The price of Jeep Suzuki- Jimmy brand, imported from Japan, contracted by -19.2% in June but later rose by 17.7% in September 2014. The price of Toyota corolla, also imported from Japan, was decreased by -4% in June but raised again in August 2014 by 6.1%. As a result, the contribution of car prices to vehicles deflation eased in September 2014.

Figure 42: Contribution to vehicles inflation

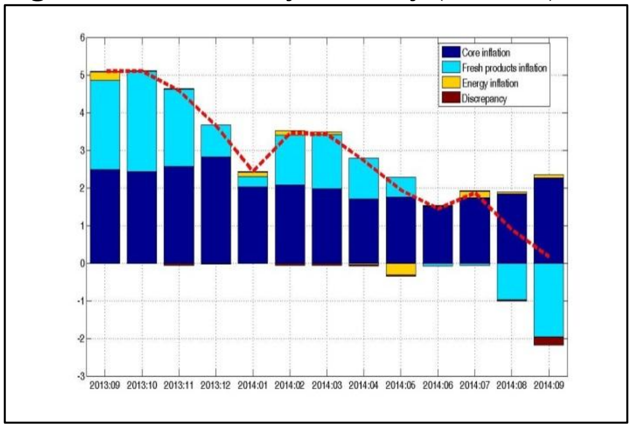


Source: BNR, Monetary Policy and Research Department

The main inflationary pressures came from: alcoholic beverages whose inflation rose by 7.4% in 2014Q3 on average and clothing and footwear, whose inflation increased by 7.3% in 2014Q3 on average.

Core inflation continued its upward trend in September 2014 standing at 3.0% from 2.5% and 2.3% in August and July 2014 respectively. Energy inflation increased to 2.2% in September from 0.8% and 1.2% of August and July 2014 respectively and its contribution into headline inflation also increased to 23.3% from 6.7% and 9.3% during the same period. Nonetheless, fresh products inflation continued to pull down inflation further and since July 2014 core inflation is moving above headline inflation.

Figure 43: Inflation by volatility (%, YoY)

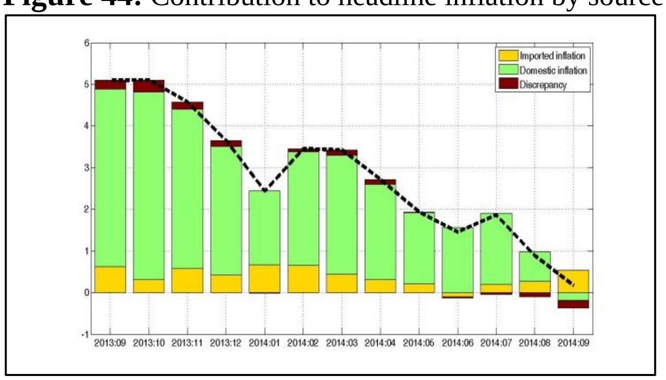


Source: BNR, Monetary Policy and Research Department

As domestic goods inflation reduced for the second consecutive month to -0.2% in September from 1% and 2.3% of August and July respectively, imported inflation continued to rise, reaching 2.1% in September from 1.1% of August and 0.8% of July 2014.

The contribution of imported inflation reached 151% from 11% whereas the contribution of domestic goods inflation fell to -51% from 89% over the same period.

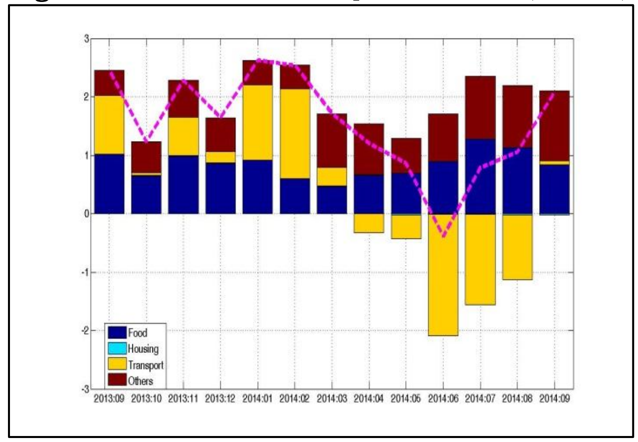
Figure 44: Contribution to headline inflation by source



Source: BNR, Monetary Policy and Research Department

The contribution of imported inflation was elevated mainly by the fact that for the first time in the last six months of 2014, imported transport registered modest inflation of 0.15% in September from a deflation of -3.6% of July 2014.

Figure 45: Contribution to imported inflation (%, YoY)

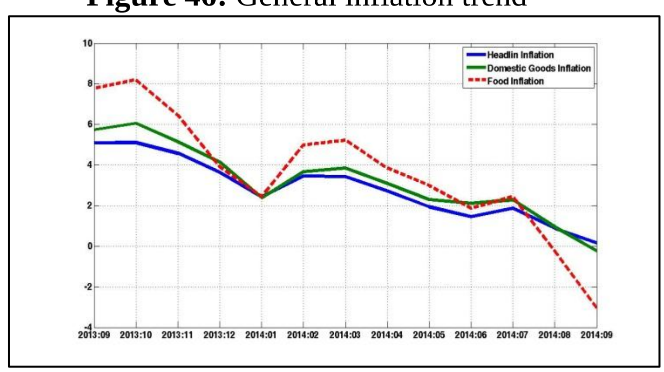


Source: BNR, Monetary Policy and Research Department

Consequently, transport deflation eased from -2.9% in July to -0.5% in September 2014, thus reducing its contribution to headline inflation.

The main contributors to domestic goods inflation were Housing, water & electricity, clothing and footwear, alcoholic beverages and restaurants and hotels, altogether accounting for 92% on average in total domestic goods inflation for 2014Q3. In line with the above analysis, it is clear that both domestic goods inflation and headline inflation have been trending together with food inflation.

Figure 46: General inflation trend



Source: BNR, Monetary Policy and Research Department

3. THE INFLATION OUTLOOK

3.1 Domestic aggregate demand

Despite the continued improvement in economic activities as indicated by high frequency indicators, notably the composite indicator of economic activities, credit to the private sector and total turnovers, demand pressures are still minimal as indicated by the negative but improving output gap thus posing no significant pressures on inflation developments.

3.1.1 The Composite Index of Economic Activities

The economy continues to recover as affirmed by the trend in the real CIEA. In annual average terms, the real CIEA rose by 13% in November 2014 from 11.7% of the previous month. In 2014Q3, the real CIEA increased by 12.1% from 5.9% of the same period in 2013.

3.1.2 Turnovers of industry and services

Growth prospects continue to be positive as total turnovers increased by 15% in October and by 10% in November 2014 compared to 6% and 5% the same months of 2013 respectively. For the January-November period of 2014, total turnovers increased by 15.2% compared to 11.1% in the same period of 2013.

3.1.3 Credit to Private Sector

The financing of the economy strengthened in November 2014 with new loans increasing by 12.5% on annual basis. Between December and November, the new loans are estimated to have risen by 42% on annual basis in 2014 compared to a decrease of 8% recorded in 2013.

3.2 Supply shock

Food crops production tends to follow the variations in rainfalls. The food inflation in 2014Q3 recorded low levels following the good agriculture performance in the same quarter which was in line with the increase in rainfalls. The average rainfalls from August to November 2014 increased to 121mm from 104mm of the same period in 2013. Therefore, no inflationary pressures are likely to come from food.

3.3 Exchange rate developments

The REER has slightly appreciated by 0.3% in November 2014 mainly driven by an appreciation of the nominal value of FRW against some currencies of the major trading partners. In November 2014, the banking system recorded an increase of 12.7% and 9.7% in forex resources and expenditures, respectively compared to 2013, leading to excess liquidity of USD 24.8 million in commercial banks. These developments in domestic forex market contributed to the stability of FRW and will help to limit the pass through to imported inflation.

3.4 Global and regional inflationary pressures

Global inflationary pressures are expected to remain subdued as real economic activity remains substantially below potential especially in advanced economies, whereas it is often close to or somewhat below potential in emerging markets and developing economies. Declines in the prices of commodities, especially fuels and food, have been a common force behind recent decreases in headline inflation across the world including in the EAC.

3.5 International commodity prices

Commodity prices fell by 5.9% in November, mainly reflecting the sharp drop in oil prices though non-fuel prices overall were marginally higher despite the appreciation of the U.S. dollar up to 2.4% against a group of major currencies. Agriculture prices increased by 0.4% in November, up for the first time in seven months, but Arabica coffee prices dropped 6% as a result of increase rains in Brazil.

Metals prices fell by 0.3% in November, down a fourth consecutive month, on continuing concerns about global demand; in particular the slowdown in China and other emerging economies.

Crude oil prices plunged by 10.7% in November, averaging $77.0 per barrel, and fell below $60 per barrel in early December reflecting the expectations of a continued market surplus following OPEC's decision on November 27th to leave its production target unchanged.

The local pump prices have been lowered from 960 RWF/liter to 895 RWF/liter in December 2014. These developments indicate that there are no pressures likely to weigh on inflation in December and the first quarter of 2015.

3.6 End-of-year festivities

Inflationary pressures always tend to build up towards the end of the year due to increased spending during the festive season. As a result inflation tends to go especially in December.

3.7. Inflation forecasts

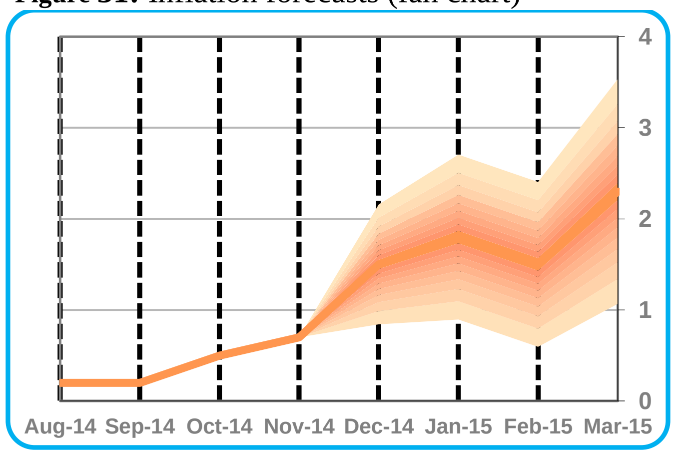
Headline inflation has continued to ease in Rwanda, reaching 0.2% in September and at 0.7 in November 2014. The consistent drop in inflation in 2014Q3 was especially driven by the decrease in prices for fresh foods as well as in transport costs.

Globally, the world economy has continued to recover but demand pressures are still subdued. International commodity prices have also continued to ease while local pump prices have also been revised downwards to 895 RWF/liter. Consequently, global demand and supply conditions are pushing for continued deceleration in prices.

Domestically, the food supply increased and is expected to continue improving while demand for both local and imported goods may go up towards the end of the year and thus exerting some inflationary pressures. The RWF is expected to mildly depreciate against the USD but is expected to appreciate 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 slightly rose to 0.5% in October and to 0.7 in November 2014 and is projected not to exceed 2% in December 2014 and to be around 2.5% in March 2015 while the main risks to the inflation outlook remain food supply shocks.

Figure 31: Inflation forecasts (fan chart)



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

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