National Bank of Rwanda

QUARTERLY INFLATION REPORT

WP02/2015Q3

Kigali, November 2015

LIST OF ACCRONYMS

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

CONTENTS

EXECUTIVE SUMMARY

The quarterly Inflation report presents the National Bank of Rwanda's assessment of the current and future macroeconomic developments influencing inflation. The inflation forecasts are one of the inputs to the Monetary Policy Committee decision making process.

Despite the ongoing weak economic performance around the world, the broad-based strengthening of the USD and the underperformance of exports resulting from the freefall in international commodity prices, the Rwandan economy has remained resilient, with real GDP growing by 7.6% in 2015Q1 and 7.0% in 2015Q2, prompting the Government of Rwanda to revise the 2015 real GDP growth projection to 7.0% from the initial projection of 6.5%.

Growth in the services sector slightly slowed to 6.2% in 2015Q2 after 8.4% recorded in the previous quarter as the performance in trade & transport services as well as in other services somewhat weakened. Nonetheless, economic growth was bolstered by the good performance in the construction and manufacturing-led industry sector and in the agriculture sector. Despite the contractionary effects from external demand and government expenditure, growth in private consumption and gross capital formation was high enough to sustain aggregate spending, thanks to the BNR accommodative monetary policy stance. As evidenced by the trend in high frequency indicators, the Rwandan economy continued to perform well in 2015Q3.

Despite registering higher growth and lower inflation levels, some challenges remain including: the negative effects from weakening international commodity prices that have especially hit the mining sector, the decline in government spending with adverse effects on aggregate demand, the continued depreciation of the FRW against the USD emanating from the ongoing broad-based strengthening of the USD in addition to the already existing structural problem of a persistent trade deficit, and the dependency of agriculture on weather.

The rise in average headline inflation from 2.0% in 2015Q2 to 3.0% in 2015Q3 was mainly due to the upward pressures from rising food, housing, transport and imported inflation. Going forward however, a prudent monetary policy and efficient coordination between monetary and fiscal policies coupled with the appreciation of the FRW against many currencies of key trading partners will continue to help to keep inflation under check. In view of the above, inflation is projected to lie between 2.5% and 4.0% in December 2015.

ACKNOWLEDGEMENTS

A team from the Monetary Policy & Research Department, spearheaded by the Modeling and forecasting division, prepared the 2015Q3 inflation report with notable contribution from Mr. Mathias KARANGWA (Manager, Modeling & forecasting division) & Mr. MWENESE Bruno (Senior Economist, Modeling & forecasting division) whereas Prof. Kasai NDAHIRIWE (Director, Monetary policy and Research Department) and Prof. Thomas Kigabo RUSUHUZWA (Chief Economist and DG-Monetary Policy Directorate) edited and reviewed the report. Other contributors include Mr. NUWAGIRA Wilberforce (Manager, Balance of payments division).

1. EXTERNAL ENVIRONMENT

1.1. Global economic activities

The IMF revised down the world output growth outlook by 0.2% twice in a row from 3.5% to 3.3% and 3.1% in April, July and October 2015 respectively. This slowdown is mainly from emerging markets and developing economies while most of growth is driven by the advanced countries, despite recording a rather weak economic recovery. The recent economic developments were mainly shaped by depreciating currencies and the lower exports following declining international commodity prices which affected mostly emerging markets and developing economies.

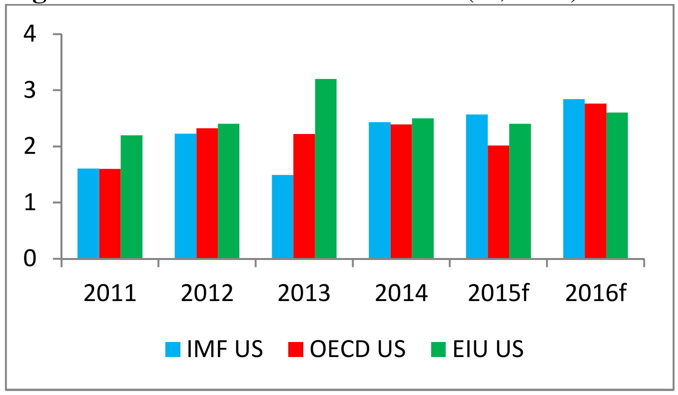
Table 1: Economic growth developments (in %)

	2015 Quarterly				2015 IMF Forecasts	
	Q1	Q2	Q3	Q4 Proj.	October	July
USA (QoQ)	0.6	3.9	2.0	2.3	2.6	2.5
Euro area (YoY)	1.2	1.5	1.7	1.6	1.5	1.5
Japan (QoQ)	4.5	-1.2	0.6	1.3	0.6	0.8
UK (YoY)	2.7	2.4	2.3	2.2	2.5	2.4
China (YoY)	7.0	7.0	6.9	6.9	6.8	6.8
India (YoY)	7.5	7.0	7.4	7.5	7.3	7.5

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

The U.S economy is estimated to have grown at around 1.5% in 2015Q3 by the US Bureau of Economic Analysis from 3.9% realized the previous quarter in seasonally adjusted terms. The deceleration in real GDP in the third quarter primarily reflected a downturn in private inventory investment and decelerations in exports and in nonresidential fixed investment. Consequently, the IMF revised down the US economic growth projection to 2.0% for 2015 from 2.1% projected in July.

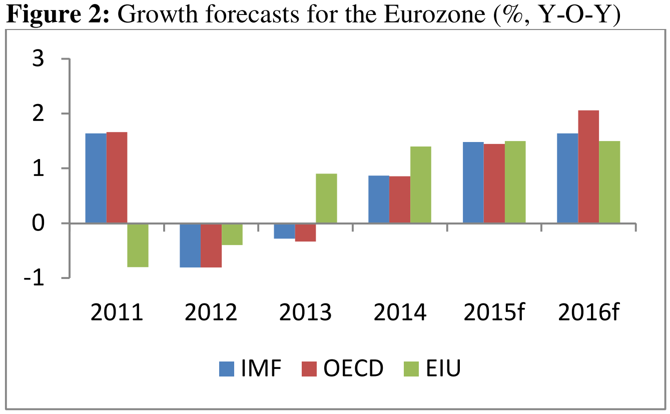
Figure 1: Growth forecasts for the US (%, YoY)



Source: IMF, OECD & EIU, WB (Nov. 2015)

The 2015Q3 Eurozone economy grew by 1.6% year-on-year but generally the outlook remained unchanged for the 2015Q4 and the whole year of 2015 in line with the July forecasts. This performance was sustained by the recovery in the aggregate demand and the fall in the unemployment rate in some member countries.

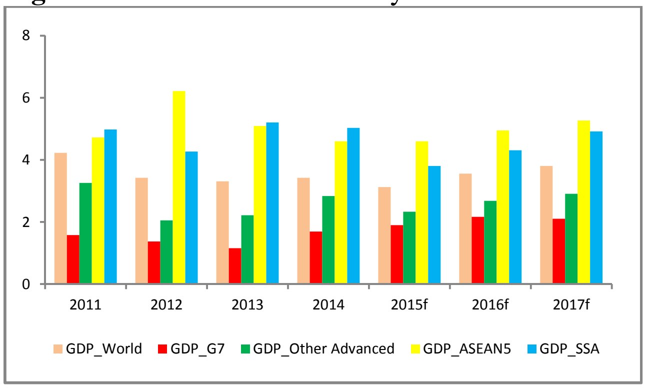
Figure 2: Growth forecasts for the Eurozone (%, Y-O-Y)



Source: IMF, OECD & EIU, WB (Nov. 2015)

The Chinese economy grew by 6.9% in the third quarter of 2015, narrowly above market expectations. It is the slowest growth since the first quarter of 2009, mainly due to a slowdown in industrial output, sluggish property investment and a contraction in exports. Generally, the economic activity remained weak in emerging markets economies due to lower exports but also a slowdown in domestic demand. In Sub-Saharan Africa, output growth is expected to slow down following unfavorable international commodity prices.

Figure 3: Growth outlook for key economies



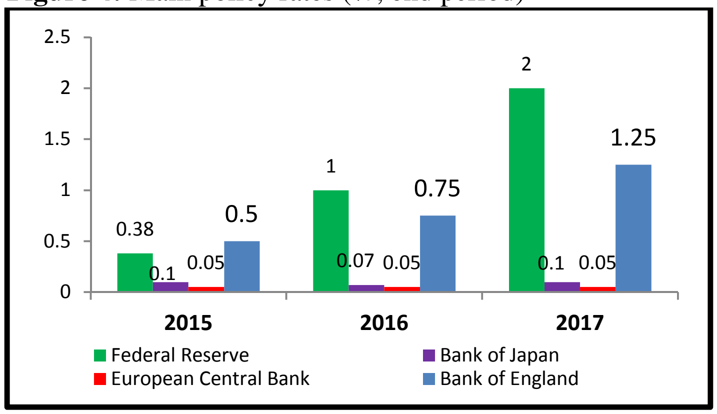
Source: IMF & World Bank (Nov. 2015)

Globally, the world output growth is projected to stand at 3.1% in 2015 from 3.4% in 2014, but it is expected to pick up to 3.6% in 2016. The trend of economic growth will depend on its reaction on fiscal and monetary policies which are likely to remain accommodative in most of countries. It will also be influenced by the movements in oil prices estimated to slightly pick up in 2016 and non-oil commodity prices which are expected to stabilize in 2016 but at low levels.

1.2. Fiscal and Monetary policies and international financial markets

Fiscal consolidation is projected to moderate in advanced economies. In emerging markets, the fiscal policy stance is projected to turn more expansionary to offset the slowdown. On the monetary policy front, advanced economies are likely to keep an accommodative policy. In a number of emerging market economies, policy rates are generally expected to be on hold until the Fed's rate starts increasing. In September and October, the FED maintained it policy rate at the zero lower bound on the back of low inflation and concerns about "heightened uncertainties abroad" despite improvements in the labor markets and economic growth. If the FED decides to tighten in December, the policy rate will only be increased slightly, as expected by the Economist Intelligence Unit.

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



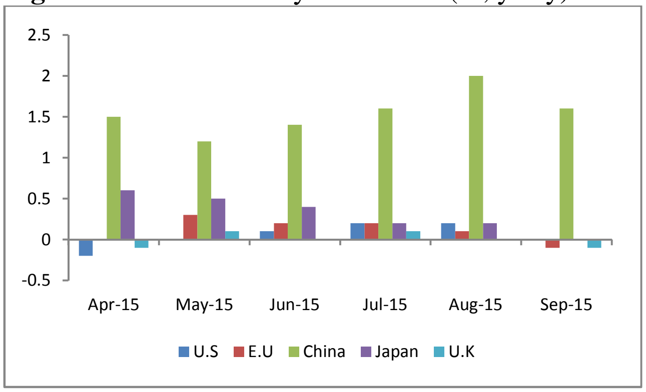
Source: EIU (November 18th 2015)

1.3. Global inflation developments and outlook

In 2015Q3, following low oil prices inflation dropped in advanced countries and continues to evolve below target levels but was above zero. In emerging market economies, lower commodity prices have also contributed to lowering headline inflation, but sizable currency depreciation has led to offsets on the upside in some economies.

In the Euro area, inflation decreased from 0.2% year-on-year in June to -0.1% in September 2015 and was on average below the 2015Q2 level. For the U.S, the 2015Q3 average inflation was higher than the previous quarter from 0.0% to 0.1%.

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



Source: http://www.tradingeconomics.com, 2015

In 2015Q3, headline inflation in EAC countries increased on average compared to the previous quarter. Generally, it was related to the availability of food during this period.

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

	RWANDA	UGANDA	KENYA	TANZANIA	BURUNDI
Oct-14	0.5	1.8	6.4	5.9	3.5
Nov-14	0.7	2.1	6.1	5.8	4.2
Dec-14	2.1	1.8	6.0	4.8	3.7
Jan-15	1.4	1.3	5.5	4.0	3.5
Feb-15	0.7	1.4	5.6	4.2	1.2
Mar-15	0.8	1.9	6.3	4.3	4.7
Apr-15	0.9	3.6	7.1	4.5	7.5
May-15	2.2	4.9	6.9	5.3	7.2
June-15	2.8	4.9	7.0	6.1	7.7
July-15	2.3	5.4	6.6	6.4	8.0
Aug-15	3.0	4.8	5.8	6.4	4.2
Sept-15	3.7	7.2	6.0	6.1	4.1

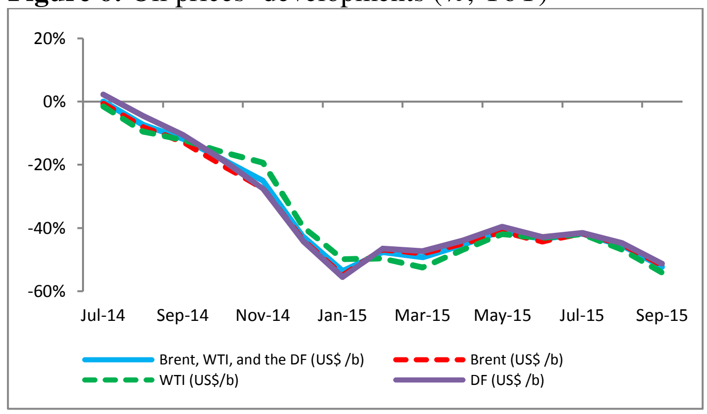
Source: Country Bureaus of Statistics

1.4. International commodity prices

After a drop of 9.2% in August, the decline in commodity prices eased and decreased by 1% in September 2015, but it dropped by 16% from June 2015. This deceleration was reflected in prices of some industrial inputs, agricultural raw materials, metals and crude oil.

Crude oil prices increased by 1.2% in September up to 46.3 USD per barrel on average from 45.7USD recorded in August. This is the first monthly increase in 4 months, due in part to a sharp drop in investment in the oil sector.

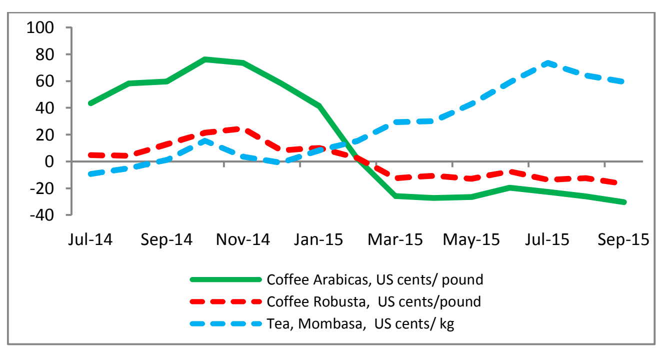
Figure 6: Oil prices' developments (%, YoY)



Source: IMF, WEO (Database, Nov. 2015)

Agriculture prices decreased 2.9% in September; down for the third consecutive month with Coffee prices as a whole decreasing 6%, reversing gains from the previous month, as favorable weather in Brazil improved production prospects.

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



Source: IMF, WEO (Database, Nov. 2015)

2. THE DOMESTIC ECONOMY

2.1. Domestic demand and output

The Rwandan economy registered robust growth in the first half of 2015, with real GDP growing by 7.3% year-on-year compared to 6.8% in the same period of 2014. Real GDP expanded by 7.6% and 7.0% in 2015Q1 and 2015Q2 respectively, against 7.5% and 6.1% of the same quarters in 2014. Out of the 7.0% growth for 2015Q2, 44% was accounted for by the service sector, 24% by the agriculture sector, 21% by the industry sector and the remaining 11% by taxes less subsidies.

Despite the negative effects from weak export commodity prices that have particularly hit the mining sector, the Government of Rwanda has revised upwards the 2015 real GDP growth projection from 6.5% to 7.0%.

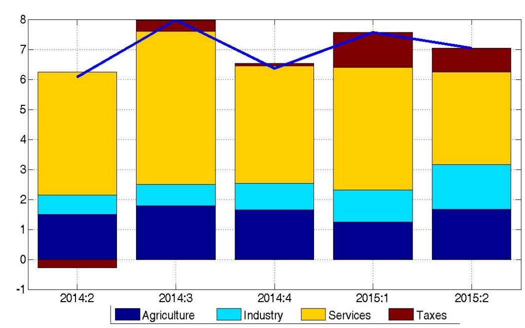
In 2015Q2, growth in the services sector slowed to 6.2% after 8.4% and 8.5% recorded in 2015Q1 and 2014Q2. During the same periods, growth in the industry sector improved to 10.5% after 6.9% and 4.5% whereas growth in the agriculture sector also rose to 5.5% after 4.1% and 4.8%. However, despite the improved performance of the industry and agriculture sectors, the services sector remains the main contributor to growth.

The slowdown in services sector growth was due to the relatively weak performance in trade & transport services as well as in other services. Growth in trade & transport services slowed to 5.2% in 2015Q2 after 5.9% and 10.4% recorded in 2015Q1 and 2014Q2 respectively. Likewise, growth in other services dropped to 6.7% from 9.7% and 7.5% in 2015Q1 and 2014Q2 respectively.

The performance of trade and transport services weakened further in 2015Q2 mainly due to the drop in growth for wholesale and retail services to 5.3% in 2015Q2 from 6.2% of the previous quarter and 1.03% in 2014Q2. Growth of maintenance & repair of motor vehicles has stabilized at 20% since 2014Q3 whereas that of transport services slightly dropped to 2.8% in 2015Q2 from 2.9% of the previous quarter.

Despite the improved performance in real estate in 2015Q2, growth in other services declined on the back of the decrease in growth for information and communication services.

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



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

The performance of the industry sector has been improving since 2014Q2 following robust growth in construction and lately in manufacturing. Following the ongoing plunge in international commodity prices, Rwanda's mining subsector exerted contraction pressures on growth in the first half of 2015, though some improvement was registered in 2015Q2.

Strong industry sector performance was mainly buoyed by the robust growth in construction, which reached 15.6% in 2015Q2 after 11.4% in 2015Q1 and 4.1% in 2014Q2. This subsector grew by 13.5% in the first semester of 2015 compared to 5.7% of the same period in 2014.

In line with the reorientation of BRALIRWA's sales strategy to respond to the regional trade restrictions faced since 2014, there has been a rebound in the manufacturing sector in 2015. After contracting by -4.9% and -1.7% in 2014Q3 and 2014Q4 respectively, the sector recovered to record a growth rate of 7.1% in 2015Q1 and 8.9% in the following quarter. Indeed, the sector's recent growth levels surpassed the 5.7% growth recorded in 2014Q2. The good performance in manufacturing was bolstered by high growth in beverages and tobacco as well as in wood and paper.

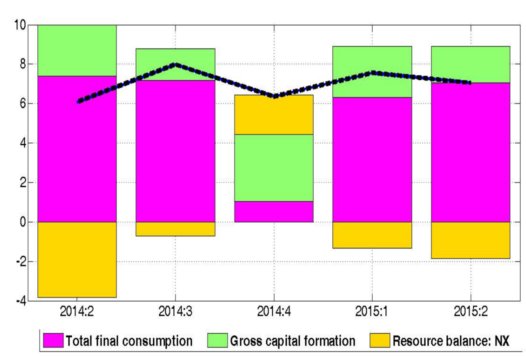
The improved performance of the agriculture sector was due to high growth in food crops and export crops. Following the uptick in international tea and coffee prices, growth in export crops hiked to 33.3% in 2015Q2 after contracting by -6.3% in the same period of 2014 and recording zero growth in 2015Q1. Growth in food crops stagnated at 4.1% in the first and second quarter of 2015 though it remains the biggest contributor to the agriculture sector growth.

Growth in total final consumption continues to be the main contributor to real GDP growth from the expenditure side, followed by gross capital formation. Total final consumption grew by 8% year-on-year in 2015Q2, improving by one percentage point compared to the previous quarter but stagnating in relation to 2014Q2.

Government expenditure, which has contracted for the last three quarters, plunged by -28% in 2015Q2 due to the back loading of current expenditure to the closing months of the fiscal year 15/16 i.e. in the January-June 2016 period, compared to a growth of 26% recorded in 2014Q2. This contraction was however offset by the rise in private expenditure to 17% in 2015Q2, the highest since 2009 and above the 5% and 8% levels recorded in 2014Q2 and 2015Q1 respectively.

After stabilizing at 9% in 2014Q2 and 2015Q1, growth in gross capital formation slightly fell to reach 7% in 2015Q2, fueled by the notable increase in construction investments by 16% after 12% in the preceding quarter and 5% in the 2014Q2. For the second time in 2015, net exports had contractionary effects on growth mainly due to the price effect that adversely affected export receipts from minerals, notably Coltan, Cassiterite (tin) and wolfram at a time when the import bill was steadily growing.

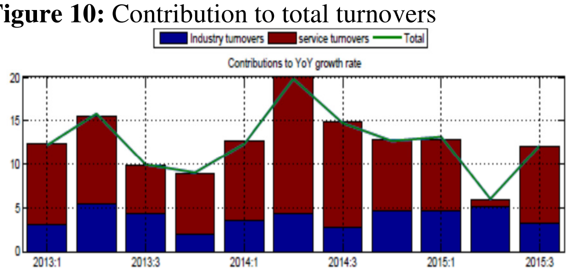
Figure 9: Real GDP by expenditure (% y-o-y)



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

Growth remained robust in 2015Q3 as evidenced by the trend of high frequency indicators of economic activities. Total turnovers grew by 12.2% in 2015Q3 compared to 6.0% recorded in the previous quarter. After the slowdown in services turnovers in 2015Q2 due to the price effect for petroleum companies and the base effect arising from higher MTN sales in April-May 2014, turnovers for the services sector generally improved in 2015Q3. In addition, the steady increase in industry sector turnovers in 2015Q3 helped to propel growth.

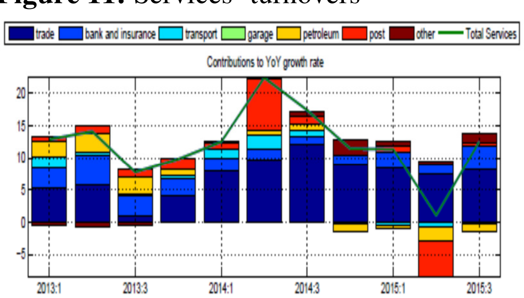
Figure 10: Contribution to total turnovers



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

Supported by the good performance in trade services and in banks and insurance, services sector turnovers grew by 12.5% in 2015Q3 from 1.0% of the previous quarter. During the same period, turnovers for trade services expanded by 16.8% from 16.3% whereas those for banks and insurance significantly rose by 26.2% from 11.3%.

Figure 11: Services' turnovers

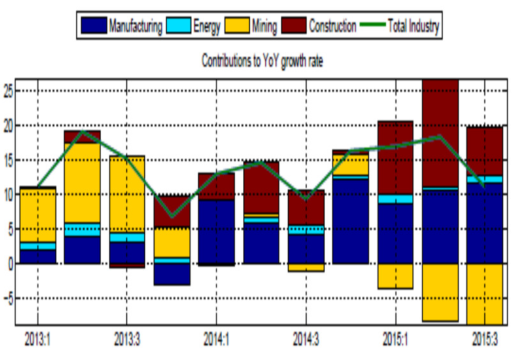


Source: BNR, Monetary Policy & Research Department (2015)

Growth in the industry sector turnovers slowed to 11.1% in 2015Q3 from 18.3% in the preceding quarter following the reduced performance for construction and mining.

Mining turnovers contracted further by -51.5% in 2015Q3 compared to -48.5% recorded in the previous quarter. Though it remained positive, growth in construction turnovers declined to 28.4% from 52.3% of the quarter before. Manufacturing turnovers buoyed the performance of the industry sector after registering stable growth of around 23% in 2015Q2-Q3.

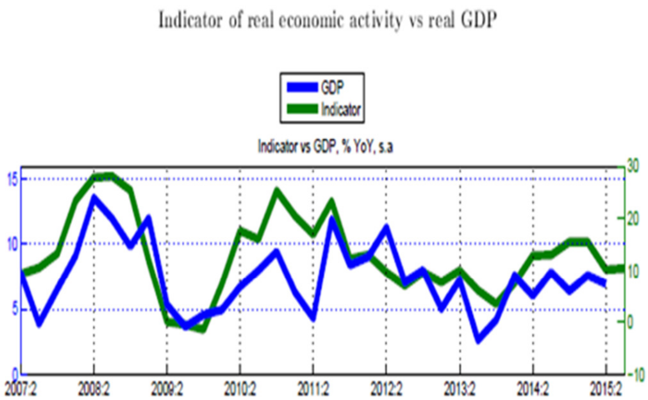
Figure 12: Industry turnovers



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

The real composite index of economic activities increased by 10.2% in 2015Q3 on average from the same period in 2014 but this increase is lower than 12.8% recorded in 2014. These developments point to a surge in the non-agricultural output but at a slower rate and may not lead to increased inflation compared to 2014Q3.

Figure 13: The trend of the CIEA (%, y-o-y)



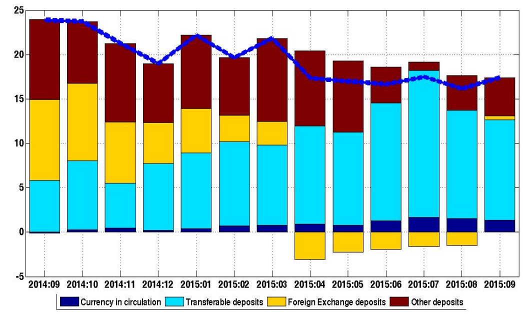
Source: BNR Monetary Policy & Research Department (2015)

In 2015Q3, BNR maintained an accommodative monetary policy stance set in June 2014 when the KRR was cut from 7% to 6.5%. As a result, broad money year-on-year growth remained relatively high at 17.4% in September 2015 from 23.9% of the same period last year. Remarkable growth was recorded in private sector credit from 16.6% in September 2014 to 27.6% in the same month of 2015.

Foreign exchange deposits reversed their trend, turning from being contractionary for the last five months since April 2015 to positive growth in September 2015 and thus fueling the uptick in M3 despite the recorded small decrease in transferable deposits as well as in currency in circulation.

Growth in transferable deposits, which has been declining since August 2015, slowed from 33.5% year-on-year in August 2015 to 30.8% the next month. Currency in circulation annual growth marginally dropped from 17.1% to 15.5% during the same period. This was however offset by the recovery in foreign exchange deposits, which grew by 2.4% in September 2015 after contracting by -7.1% in the previous month.

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



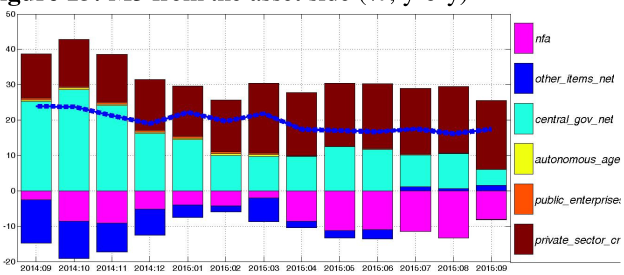
Source: BNR, Monetary Policy & Research Department (2015)

From the asset side, the main contractionary effects on M3 came from net foreign assets and recently in net government credit. The contribution of private sector credit has however continued to back M3 growth. Net foreign assets, which started to contract in September 2014, recorded negative growth of -14.8% in September 2015, improving from -23.8% in the previous month.

Central government net credit has also generally been declining since September last year following the mismatch between growth in central government credit and central government deposits. Though it improved after rising from 1.6% in August 2015 to 36.9% the following month, growth in government deposits fell short of the growth in government credit, despite dropping of the latter from 58.4% to 52.7% during the same period.

Growth in credit to the private sector remained robust, averaging around 27% since June 2015 and helping to bolster growth in M3. In relation to December 2014, credit expanded by 20.9% in September 2015, to exceed the program target of 19.7 percent by end December 2015. Generally, M3 growth has been driven by net government credit and private sector credit and recently by the rise in net foreign assets.

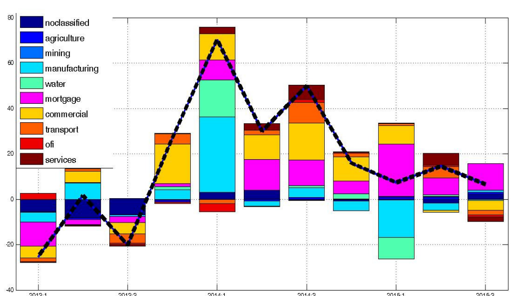
Figure 15: M3 from the asset side (%, y-o-y)



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

However, new authorized loans have been declining since 2014Q3 and this may reduce the stock of credit in the economy in the coming months. Annual growth in new authorized loans slowed to 6.5% in 2015Q3 from 14.5% of the previous quarter and 49.8% in 2014Q3. Traditionally, most of the credit flows to commerce and hotels as well as to mortgages. Currently, new authorized loans are dominated by mortgage lending, which increased by 58.1% in 2015Q3 after 28.6% recorded in the preceding quarter.

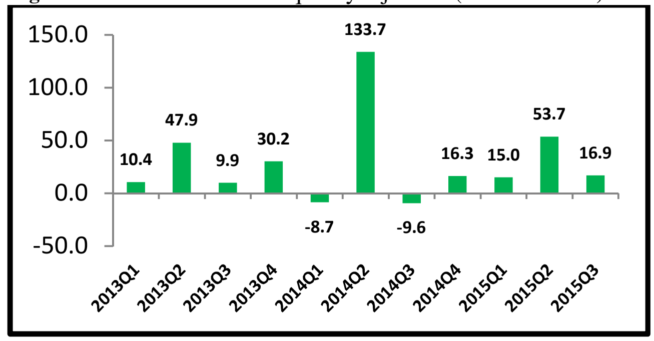
Figure 16: New authorized loans (%, y-o-y)



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

Net government liquidity injections contracted by -69%, falling from 53.7 FRW billion in 2015Q2 to 16.9 FRW billion in 2015Q3. This has negative implications on aggregate demand as already reflected in declining core inflation.

Figure 17: Government net liquidity injection (FRW Billions)



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

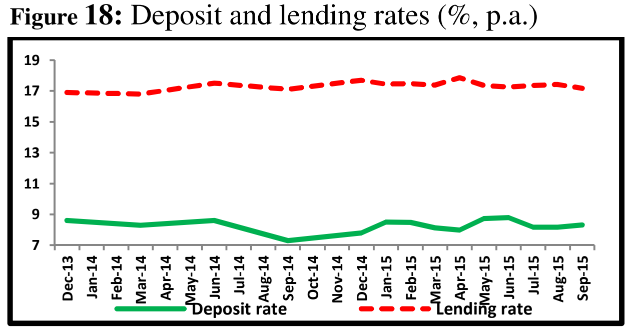
2.2. Financial Sector developments

2.2.1 Interest rate developments

In line with the current BNR accommodative monetary policy stance and structural excess liquidity in Rwanda's commercial banking industry, money market rates (Repo, T-bills and inter-bank rates) have continued to decline. However, structural liquidity, among other factors, has continued to impede the pass through from the policy rate to deposit and lending rates.

In 2015, lending rates dropped from 17.26% in June to 17.17% in September whereas deposit rates dropped from 8.80% to 8.32% thus widening the spread from 8.46% to 8.85% during the same period. Despite this slight increase, the spread has generally fluctuated between 8-9 percent p.a. at least since December 2013.

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



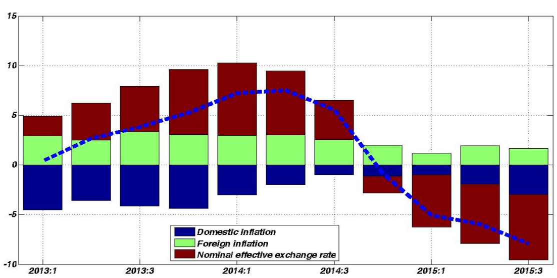
Source: BNR, Monetary Policy & Research Department (2015)

2.2.2 Exchange rate developments

The appreciation of the real effective exchange accelerated in 2015Q3 due to the increased appreciation of the nominal effective exchange rate, increase in domestic inflation and the drop in foreign inflation. The nominal effective exchange rate appreciated y-o-y by 6.6% in 2015Q3 compared to 6.0% recorded in the previous quarter on the back of the reduced FRW depreciation against the USD as well as the continued appreciation of the FRW against most of the trading partners' currencies.

Domestic inflation increased on average from 2.0% in 2015Q2 to 3.0% in 2015Q3, mainly due to rising food prices, whereas foreign inflation dropped on average from 1.9% to 1.6% during the same period as a result of the continued drop in international commodity prices.

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



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

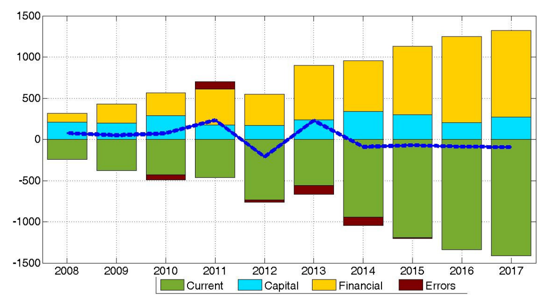
Consistent with the above NEER appreciation levels, the FRW depreciated against the USD (5.2%) and Burundian Franc (6.3%) between December 2014 and September 2015. However, the FRW appreciated versus the EURO (-2.6%), the Kenyan shilling (-9.4%), the Tanzanian shilling (-15.5%) as well as the Ugandan shilling (-20.9%) during the same period.

Amplified by the ongoing broad-based strengthening of the USD, a persistent current account deficit is the main driver of the FRW depreciation against the USD.

Historically, Rwanda has experienced a BOP deficit mainly emanating from the ever increasing current account deficit.

In the 2015/16 fiscal year[1], the balance of payments deficit is projected to increase by 26% in 2016, rising from USD 71.2 Million in 2015 to USD 89.64 Million in 2016. The increase in capital and financial account will help to offset the uptick in the current account deficit and therefore maintain the BOP deficit stable at close to USD 90 million in the entire 2015-17 period.

Figure 20: The BOP decomposition (Millions USD)

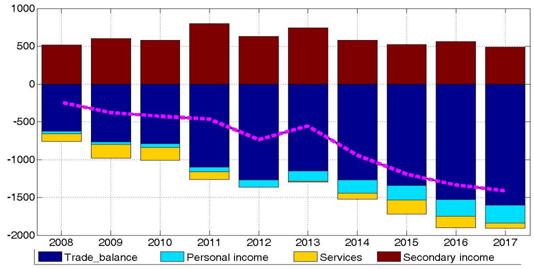


Source: BNR, statistics department (2015)

The current account deficit is expected to expand by 26.3%, 12.1% and 5.7% in 2015, 2016 and 2017 respectively, starting at a level of USD 69.6 million in 2014. BPM6 renames "***remittances***" as "***secondary income***" while "***income***" is renamed as "***personal income***". The main driver of the current account deficit is the widening trade deficit.

[1] In the 2015/16 fiscal year, the government of Rwanda switched from the 5th to the 6th Balance of Payments Manual (BPM).

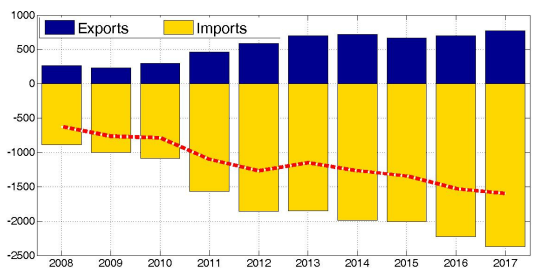
Figure 21: The current account (Million USD)



Source: BNR, statistics department (2015)

The trade deficit is expected to grow by 6.1%, 13.7% and 4.6% in 2015, 2016 and 2017 respectively, having started at a level of USD 1267.1 million in 2014. The persistence of the trade deficit is a longstanding structural problem faced by the Rwandan economy, resulting from the low import coverage by exports.

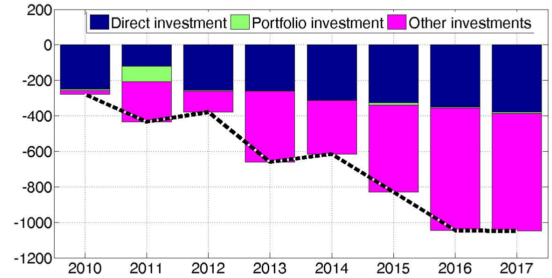
Figure 22: Evolution of the trade balance (USD, millions)



Source: BNR, statistics department (2015)

The financial account balance is projected to stand at USD -830.6, -1045.9 and 1049 million in 2015, 2016 and 2017 respectively. In the BMP6, the financial transactions account items were revised from "private capital, public capital and other capital" to "direct, portfolio and other investments". As it appears, the main driver of the financial transactions account is the other investments.

Figure 23: The financial account (Million USD)



Source: BNR, statistics department (2015)

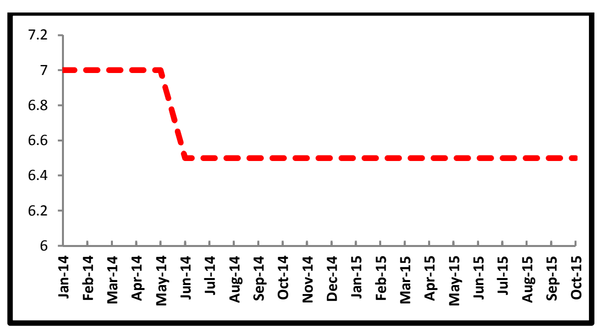
2.3. Fiscal spending

Government consumption expenditure plunged by -28% in 2015Q2 and this is likely to continue given that net government liquidity injections contracted by -69% in 2015Q3. The deflationary effects from these developments have already been reflected by the trend of core inflation.

2.4. Previous monetary policy stance

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

Figure 24: The Key Repo Rate in Rwanda



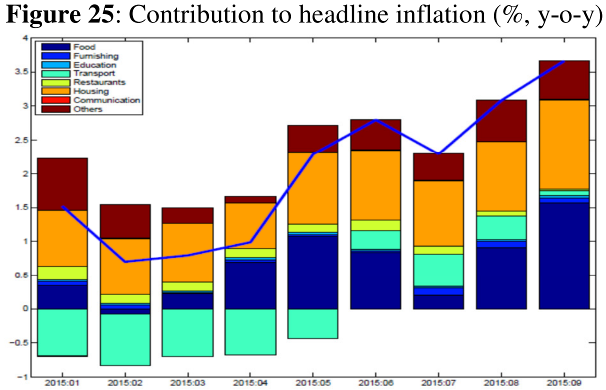
Source: Monetary Policy & Research Department (2015)

In response to an accommodative monetary policy and high liquidity in the banking system, the money market rates (repo, inter-bank and T-bills rates) have been declining. Credit to the private sector picked up by 20.9 percent in September 2015, just in excess of the 19.7 percent by end December 2015.

2.5. Inflation developments

In 2015Q3 headline inflation recorded acute variations reflected in the most volatile and most weighted components of the CPI basket namely in food and oil prices. However, headline inflation is still at low levels standing at 3% in 2015Q3 higher than 2% of 2015Q2 and 1% of 2014Q3 on average.

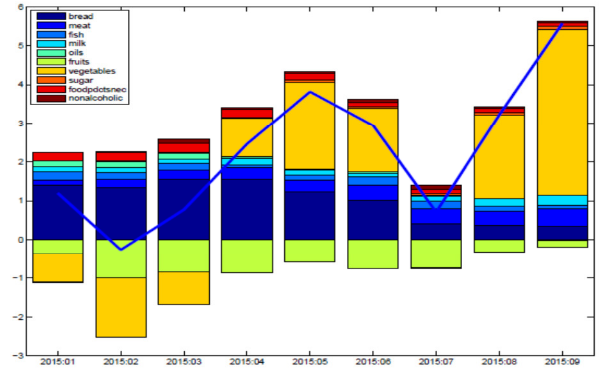
Figure 25: Contribution to headline inflation (%, y-o-y)



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

Food inflation moved from 2.9% in June to 0.7% in July and Jumped to 5.6% in September 2015. These big changes were reflected in vegetables prices which dropped from 4.5% in June to -0.07% in July and sprung up to 11.9% in September following their availability on the markets usually scarce in season transition. The swings in vegetables prices were much enough to offset the reduction in bread and cereals inflation from 5.3% in June to 1.8% in September.

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

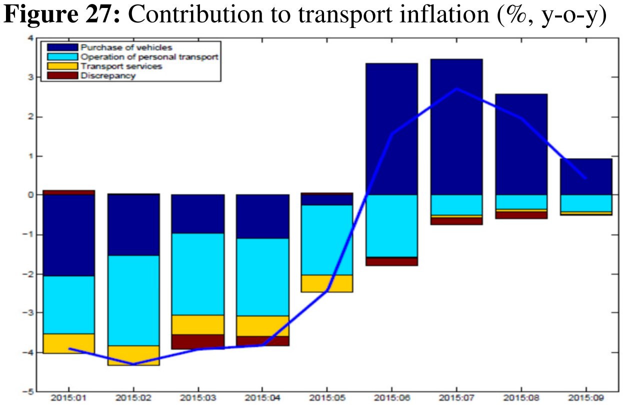


Source: BNR, Monetary Policy & Research Department (2015)

Transport inflation picked up to 1.7% in 2015Q3 from -1.6% of the previous quarter on average. This increase was reflected in the prices of motor cars and the increase in local pump prices from 840FRW/liter in June to 935FRW/liter and 920 FRW/liter in July and August-September respectively. The latter followed the developments in international oil prices and the taxes and levies for road maintenance.

Housing inflation was 4.8% on average in 2015Q3 higher than 4.0% of the previous quarter and 1.0% of 2014Q3. This increase resulted from the uptick in the costs of maintenance and repair of dwellings and the rise in the electricity and water tariffs as well as the increase in prices of charcoal and firewood.

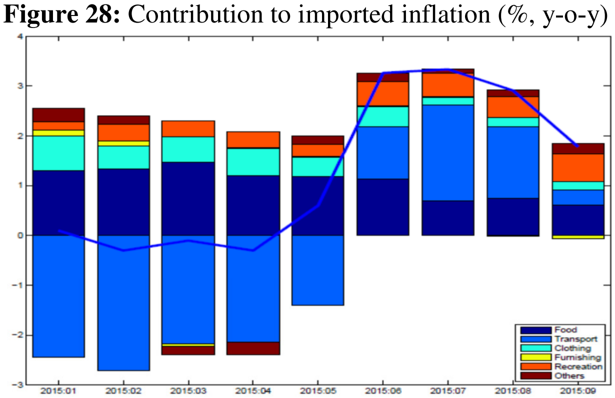
Figure 27: Contribution to transport inflation (%, y-o-y)



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

In 2015Q3 imported inflation recorded 2.7% higher average increase since 2013Q2 from 1.2% and 1.3% of 2015Q2 and 2014Q3 respectively. Imported inflation continued to be influenced by the international transport costs heavily dependent on international oil prices which fell from 61.30$ to 54.43$ and to 45.72$ per barrel in June, July and August respectively. Furthermore, imported inflation in 2015Q3 was also subjective to the prevailing appreciation of the FRW against major currencies of the regional trading partners and the relatively low inflation in those countries.

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

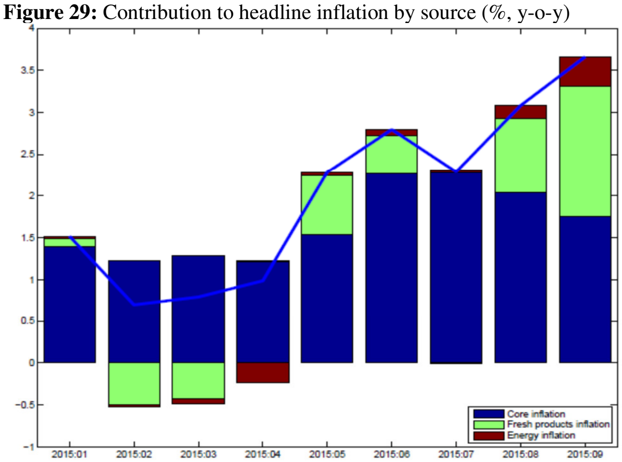


Source: BNR, Monetary Policy and Research Department (2015)

Domestic inflation picked higher in 2015Q3 at 3.1% from 1% of the same period last year and 2.3% of the previous quarter. This was a result of the variations in the domestic food prices with some influence from maintenance and repair of dwellings.

Core inflation picked up in 2015Q3 standing at 3.0% and 2.7% in July and August respectively. However, core inflation remained low in the outlook based on the still weak but recovering aggregate demand foreseen in the medium term.

Figure 29: Contribution to headline inflation by source (%, y-o-y)



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

3. INFLATION OUTLOOK

3.1 Domestic aggregate demand

Economic activities continued to increase in 2015Q2 and 2015Q3 as evidenced by the growth in the Composite Index of Economic Activities and the growth in the Credit to the Private Sector. However, the contraction government expenditure has led to the decline in underlying/core inflation. Looking ahead, aggregate demand is expected to remain non-inflationary as government expenditure is likely to remain weak in 2015.

While December-January is generally a period of high spending, aggregate demand is still assessed as low following the back loading of current government spending to January-June 2015/16 period.

3.2 Supply shock

Since June 2015, food inflation recorded very acute variations between months. These changes were mostly related to availability of vegetables in urban markets. Ordinarily, the end December-January is a period when fresh products are available on the markets and would expect falling food inflation. However, weather-forecasts predict abnormal rains that might destroy crops and bring about increasing food prices.

3.3 Exchange rate developments

The FRW annual depreciation for December 2015 was revised up to 7.5% from the initial projection of 6.5%. However, the exchange rate pass-through to inflation will remain mitigated by the appreciation of the FRW against a basket of currencies of major trading partners, the falling international commodity prices and the low degree of the pass-through as witnessed in Rwanda over the past years.

3.4 Global and regional inflationary pressures

The low risks related to global and regional inflationary pressures did not significantly change since 2015Q2. Generally, inflation around the world remains below target on the back of the current decline in commodity prices and the weak aggregate demand. Thus, this poses no serious challenges to the inflation outlook.

3.5 International commodity prices

In 2015Q4 and 2016Q1, Coffee prices are projected to decline while Tea prices may go up in 2015Q4 but drop again in 2016Q1. International oil prices are projected to be slightly increasing going forward. Therefore, local pump may increase and affect transport inflation. Indeed, these projections are still subject to revisions given the continuing ample supply.

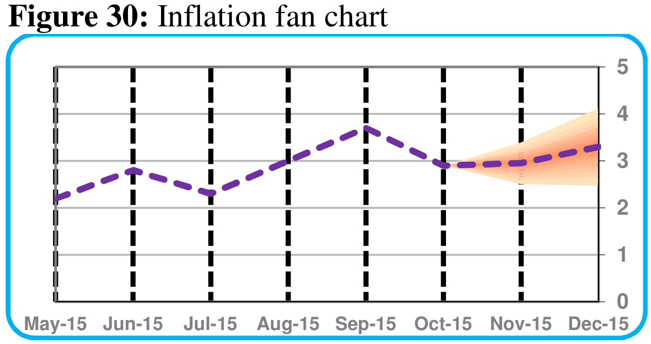
3.6. Inflation forecasts

Since December 2013, Rwanda has recorded low inflation with the highest number being 3.7% in September 2015. This was linked to some international and domestic macroeconomic factors which are still into play. These factors are global low inflation, falling international commodity prices especially oil, weather-dependent agricultural harvests as well as weak aggregate demand.

Inflation will continue to be subject to these factors in addition to prevailing exchange rate pressures, resulting from the broad-based strengthening of the US dollar.

In view of the above uncertainties and the existing good coordination between fiscal and monetary policies, headline inflation is likely to lie between 2.5% and 4.0% in December 2015.

Figure 30: Inflation fan chart



Source: BNR, Monetary Policy & Research Department (2015

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