National Bank of Rwanda

MONETARY POLICY COMMITTEE

MONETARY AND EXCHANGE RATE DEVELOPMENTS: CURRENT TRENDS AND WAY FORWARD

18TH NOVEMBER, 2011

I. INTRODUCTION

The Monetary Policy Committee (MPC) of the National Bank of Rwanda (BNR) held an extraordinary meeting at its Headquarters on 18th November 2011 to review the monetary policy stance since its last ordinary meeting of 7th October 2011 and to decide on the way forward.

This meeting was in line with the MPC commitment to monitor closely the current challenges in the international economy related to the debt crisis in Europe and USA and regional inflationary pressures in order to timely prevent their negative impact on the Rwandan economy.

The monetary policy so far implemented in 2011 continues to sustain Rwanda's macroeconomic stability. The financial sector is sound and resilient to external shocks, the inflation remains moderate, the currency is stable and this has contributed to high economic growth expected to reach 8.8% by the end of the year.

However, there still exist risks in the global economy that may affect Rwanda. This includes: the persistent debt crisis in the euro zone, the global high food and fuel prices and increasing regional inflationary pressures. This calls for preventive action to mitigate any negative impact on the Rwandan economy.

In view of the above, the MPC has decided to further tighten the monetary policy stance by raising the Central Bank rate (KRR) from 6.5% to 7.0%.

This document provides in detail the underlying factors behind this MPC's decision.

II. CURRENT ECONOMIC SITUATION

II.1 GLOBAL ECONOMIC ENVIRONMENT

a. Economic growth

The world economic recovery observed after the 2008-2009 global financial crisis is slowing down in advanced economies due to renewed stress in the euro area and US caused by European sovereign debts and US fiscal situation. The current European and USA Debt Crisis are expected to significantly impact the rest of the world given their role in the global economy. The growth perspectives across the world are also negatively impacted by the high oil and food international prices. Current economic turmoil is exacerbated by political concerns in Arab countries and consequences of the earthquake in Japan. Considering these downside risks to the recovery in advanced economies and their negative impact on the world economy, IMF has reviewed down the global economic growth projection in 2011, from 4.4% to 4.3%.

In advanced economies, different indices remain stable show a decline in markets' confidence by economic agents. Global manufacturing Purchasing Managers' Index for output which stood at 52.0 in September reduced to 49.9 in October 2011. The manufacturing sector indicates some signs of contraction.

In the emerging and developing economies, the economic activity has been moderating modestly, which should assist in alleviating overheating pressures in certain economies. These economies grew by 7.3% in 2010 and are expected to grow on average by 6.4% end 2011. In Sub-Saharan Africa, economic growth is expected to reach 5.1% end 2011 from 5.0% in 2010.

b. Inflation and Commodity prices

Inflationary pressures have been upward on increasing energy and non-energy commodity prices. In September, annual inflation rose to 3.9% in USA, 0.0% in Japan, 5.2% in the United Kingdom and 3.3% in Euro area in September 2011.

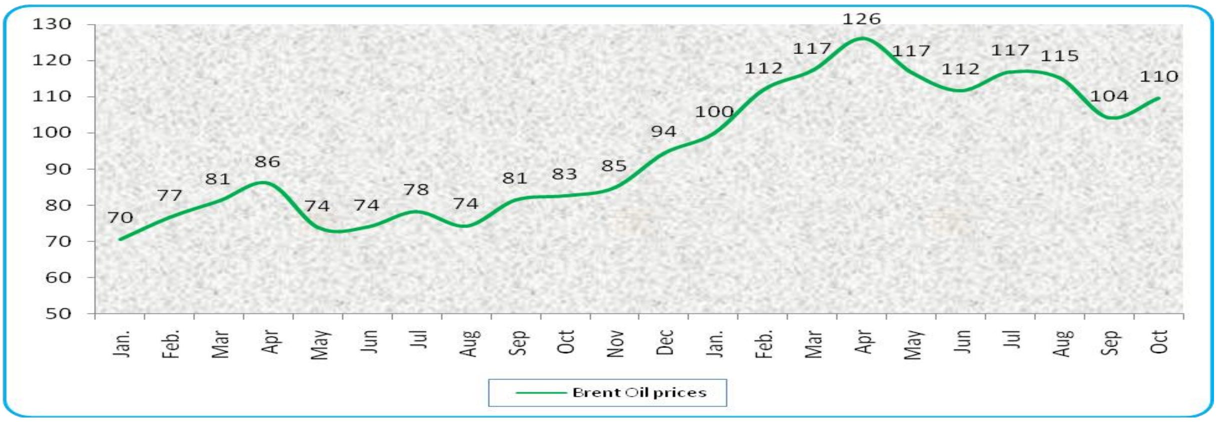
In the EAC region, drawn by increase in oil and food prices, inflation continued to rise in 2011. In October 2011, on annual basis, it hit 30.5% in Uganda, 18.9% in Kenya, 13.3% in Burundi and 7.8% in Rwanda from globally low levels in December 2010 of 3.1%, 4.5%, 5.6%; 4.9% and 0.2% respectively.

Table 1: Annual inflation in EAC countries in %

	2010				2011						
	Mar	Jun	Sept	Dec	Jan	Mar	June	July	Aug	Sept	Oct
Uganda	7.5	4.2	0.3	3.1	5.0	11.1	15.8	18.8	21.4	28.3	30.5
Kenya	4.0	3.5	3.2	4.5	5.4	9.2	14.5	15.5	16.7	17.3	18.9
Tanzania	9.0	7.2	2.7	5.6	6.4	8.0	10.9	13.0	14.1	16.8	17.9
Burundi	6.6	9.7	3.5	4.9	4.8	5.7	8.6	9.1	11.1	11.7	13.3
Rwanda	2.1	5.0	1.5	0.2	1.1	4.1	5.8	7.1	7.5	6.6	7.8

Concerning commodity markets, the World economy is also facing high oil and food prices due to an increased demand from emerging markets and an important decline in supply.

Fig.1: Brent oil prices trend



Source: NBR, Monetary Policy and Economic Analysis Department

Non-energy commodity prices also recorded an increasing trend. Food prices recently rose to the same highest levels as during the food crisis of 2007-08. Indeed, even if there has been a slight decline since the peak in February 2011, international food prices remain very high compared to last year. On average, the World Bank food prices index increased by 30% in October 2011 on annual basis, mainly attributed to Maize (+83%), Sugar (+60%), Wheat (+52%) and Soybean (+47%). Food price increase is explained mainly by adverse weather conditions in the major producing countries, while the demand is rapidly increasing, especially in emerging economies.

c. Financial markets

Central banks in developed countries maintained their policy rates unchanged and low enough to boost economic recovery except the European Central Bank which increased its key rate by 1.25% on 3rd, November 2011; it was 1.5% since July 2011, after maintaining it unchanged at historically low levels for almost two years. In USA and Japan, monetary policy rates were stable at 0.25% and 0.1% respectively. In October, three month rates were slightly up in USA (0.38% after 0.33% in September), at 0.16% in Japan and 1.53% in the Euro area. Ten year Government bonds' rates rose in all leading economies (USA, Euro Area Japan and UK) between October and September. They increased to 2.123% from 1.961% in USA, to 2.042% after 1.867% in Euro Area, to 1.012% from 1.005% in Japan and 0.963% after 0.898% in UK respectively in October and September 2011.

With regard to exchange market, the dollar appreciated by 4.0% against the Euro and 3.4% versus GBP end October 2011, while it depreciated against the Japanese Yen (1.2%) end October 2011, after it had depreciated end September versus the Euro and GDP. Foreign exchange markets experienced high volatility following the Japanese earthquake but also due to renew concerns about debt crisis in Europe.

II.2 NATIONAL ECONOMIC PERFORMANCE

a. Production

For the year 2011, economic growth was initially expected to decline marginally to 7% from 7.5% achieved in 2010, reflecting expected adverse impact of rising fuel and food prices. However, according to current developments in key economic indicators of economic activities, economic performance for the current year would be at 8.8%, beyond 7.0% initial projected and against 7.5% achieved in 2010. This performance is driven by the agriculture sector (+8.2%) reflecting the positive impact of ongoing reforms and weather conditions, the industry sector (+15.1%) and the services sector (+8.5%) both boosted by a significant improvement in credit markets' conditions.

In agricultural activities, according to the Ministry of Agriculture and Animal Resources (MINAGRI), harvests for 2011 seasons A and B performed better (10.4%) than the harvest recorded in the same seasons of last year (9.5%) as the Government Crop Intensification Program continues to focus on increased supply and use of fertilizers and selected seeds and land consolidation program.

The non-agriculture activities also performed well as evidenced by the NBR Composite Indicator of Economic Activities (CIEA) which increase in nominal terms by 14.7% in September 2011 compared to 7.1% recorded in the same period of 2010, reflecting a continuity of better performance of the economy in 2011. On average, the CIEA rose by 9.8% in the first nine months of 2011 compared to 6.9% in the first nine months of 2010.

Table 2: Composite Indicator of Economic Activities (Base 2006: 100)

		Composite Index (CIEA)	**% Change**	
			Monthly	**Annual**
2010	January	168.5	-6.2	1.7
	February	171.7	1.9	4.0
	March	175.6	2.3	3.4
	April	177.0	0.8	8.8
	May	178.0	0.6	8.0
	June	184.6	3.7	8.8
	July	182.3	-1.2	9.1
	August	186.4	2.3	10.7
	September	181.6	-2.6	7.1
	October	183.9	1.3	12.1
	November	182.4	-0.8	6.9
	December	195.6	7.2	8.9
2011	January	185.2	-5.3	9.9
	February	182.0	-1.8	6.0
	March	192.7	5.9	9.8
	April	188.7	-2.1	6.6
	May	196.1	3.9	10.1
	June	202.0	3.0	9.4
	July	199.8	-1.1	9.6
	August	208.4	4.3	11.8
	September	208.3	-0.1	14.7

Source: *BNR, Monetary Policy and Economic Analysis Department*

The performance in non agricultural economic activities is also evidenced by the Index of Industrial production which increased by 20.1% in September compared to the corresponding period of the previous year. This performance is attributed to Mining and Quarrying (+105.2%) as a result of increase in volume of Coltan and Wolfram. Manufacturing index rose by 5.9% and electricity, gas and water supply" increased by 1.6%. The rise in manufacturing resulted from good performance from manufacture of food products (+16.2%), and beverages and tobacco (+1.1%), which are among the main components of the manufacturing industries.

Table 3: Quarterly Index of Industrial Production (base: 2008 = 100, in % Changes)

Activity Group	Weights	Quarterly % Change					Annual Change		
		2010			2011		2011		
		Junea	Sept	Dec	MarQ	June	Mar	June	Sept
TOTAL RWANDA	**10000**	**8.3**	**6.0**	**-1.8**	**-2.2**	**15.4**	**10.1**	**17.4**	**20.1**
Mining and quarrying	**1824**	**15.2**	**28.5**	**-3.3**	**64.7**	**-17.5**	**135.4**	**68.7**	**105.2**
Manufacturing	**6781**	**5.1**	**8.3**	**-4.1**	**-14.8**	**22.1**	**-7.1**	**8.1**	**5.9**
Manufacture of food products	*3178*	*10.5*	*2.3*	*-1.6*	*-16.6*	*48.0*	-7.4	24.3	16.2
Manufacture of Beverages and tobacco products	*1937*	*-1.4*	*27.0*	*-4.5*	*-10.8*	*3.6*	6.6	12.0	1.1
Manufacture of textiles, tanning and dressing of	*203*	*-16.0*	*-27.0*	*-1.3*	*-0.9*	*9.4*	-40.0	-21.7	-13.8
Manufacture of wood, paper and paper products,	*50*	*-0.7*	*25.5*	*26.9*	*-16.3*	*-9.2*	33.7	21.0	-9.0
Manufacture of chemicals and chemical products	*290*	*-5.9*	*-2.2*	*4.6*	*-19.9*	*-20.6*	-22.8	-34.9	-8.3
Manufacture of rubber and plastics products	*91*	*0.3*	*7.9*	*-1.8*	*-1.1*	*-16.1*	4.9	-12.2	-21.2
Manufacture of other non-metallic mineral	*647*	*17.0*	*-19.1*	*-13.9*	*-8.1*	*23.4*	-25.2	-21.0	18.9
Manufacture of fabricated metal products,	*366*	*2.3*	*17.5*	*-13.6*	*-32.9*	*24.3*	-30.3	-15.3	-20.2
Manufacture of furniture; manufacturing n.e.c.	*18*	*-21.0*	*16.8*	*-49.1*	*4.4*	*34.6*	-51.0	-16.6	-23.7
Electricity, gas and water supply	**1395**	**26.6**	**-11.9**	**9.7**	**-12.4**	**18.8**	**7.1**	**0.6**	**1.6**
Electricity, gas, steam and hot water supply	*1210*	*30.9*	*-17.2*	*9.8*	*-8.1*	*20.5*	9.4	0.7	3.8
Collection, purification and distribution of water	*185*	*9.5*	*17.7*	*8.7*	*-34.2*	*10.5*	-7.8	-6.9	-14.0

Source: NBR, Statistics Department

Regarding the business climate, the total turnovers registered by large companies in the industry and service sectors have been performing better, increasing by 25.2% during the first nine months of 2011 compared to the corresponding period of the previous year.

Turnovers for the industry (+27.1%) and Services (+24.4%) represented about 32% and 68% of the total turnovers respectively.

Table 4: Developments in Industry and Services sector's total turnovers

	Monthly % change 2011									Annual change		
	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sept.	Jan.-Sept. 2009	Jan.-Sept. 2010	Jan.-Sept. 2011
INDUSTRIES	-26.2	**-6.8**	**8.9**	**8.6**	**7.3**	**16.2**	**8.2**	**10.3**	**-3.5**	**-0.9**	**22.3**	**23.0**
Manufacturing	-10.8	-7.3	10.4	23.9	0.9	2.0	4.5	6.4	6.3	31.3	14.6	19.0
Energy	-50.9	24.6	134.3	-	-	164.8	-	11.5	8.4	-19.3	103.4	44.0
Mining	-70.5	10.8	29.7	-2.1	11.5	-7.9	28.9	-	28.8	-0.8	66.5	29.5
Construction	**-21.6**	**-4.0**	**20.1**	**-7.9**	**7.9**	**8.2**	**-4.5**	**14.8**	**5.4**	**5.1**	**24.0**	**24.4**
SERVICES	-27.5	**-4.6**	**28.6**	**-8.9**	**7.7**	**5.6**	**-2.9**	**11.3**	**-2.2**	**5.5**	**16.5**	**20.7**
Trade Services	-22.8	-	24.9	-	-0.8	7.8	2.6	1.0	52.9	12.7	36.6	25.7
Banks & Insurance Companies	-7.1	10.8	-13.6	28.5	2.4	-5.5	28.3	10.9	8.5	21.0	42.5	13.6
Transport and Storage	-4.5	-	18.5	6.3	15.8	5.9	-	-2.4	-0.1	-5.6	-46.7	32.3
Garage Services	-4.4	-2.0	18.4	-3.7	9.0	8.8	-8.2	30.3	-3.0	-19.2	38.7	53.6
Petroleum Companies	-26.4	11.8	1.4	-	7.8	28.9	-	28.9	4.5	26.6	21.2	-2.2
Posts & Telcom.	-22.2	**-9.6**	**13.5**	**-**	**28.8**	**10.1**	**-**	**4.3**	**-2.5**	**26.5**	**18.0**	**20.3**
Other Services	**-31.6**	**-2.7**	**22.9**	**-6.3**	**6.1**	**11.6**	**-0.8**	**6.7**	**5.3**	**3.8**	**27.9**	**25.2**
TOTAL SALES	-26.2	**-6.8**	**8.9**	**8.6**	**7.3**	**16.2**	**8.2**	**10.3**	**-3.5**	**-0.9**	**22.3**	**23.0**

Source: *RRA, Department of Large Tax Payers*

The improvement of business climate in industry sector was attributed to all sub sectors, of which turnovers increased remarkably: mining industry (+44.0%), construction (+29.5%), manufacturing industries (+23.0%) and energy sector (+19.0%). The industry sector is dominated by manufacturing industries with a share of about 49.1% in the first nine months of 2011. The good performance in energy sector results from ongoing investment in power generation and distribution as well as water projects.

b. External trade

b.1 Exports

In 2011, Rwanda external trade has been performing compared to 2010, exports and imports increasing significantly in volume and in value. By end September 2011, exports rose by 42.1% and 51.4% respectively in volume and in value compared to the same period of 2010, while imports increased by 16.5% and by 21.0% respectively in volume and value. However, the structural trade deficit deteriorated by 14.3%, while the imports cover ratio improved to 23.1% from 18.4% in January-Sept 2010.

Table 5: Trade balance developments (In USD millions, except otherwise indicated)

	Jan-Sept.2010	Jan-Sept.2011	% change in value
Total Exports value	185.3	280.5	51.4
Total imports value	1,005.0	1,216.5	21.0
Trade deficit	-819.8	-936.0	-14.2
Imports cover, in %	18.4	23.1	

Rwanda exports are still characterized by a low level of diversification in terms of products and destinations. Exports remain dominated by traditional products namely coffee, tea and minerals which accounted for 75.2% of total exports during the first nine months of 2011. The value of mineral exports was USD 110.0 million representing 39.2% of total export earnings against 23.9% in 2010, while coffee and tea amounted to USD 100.8 millions that is 35.9% of total export earnings against 44.3% in 2010.

Table 6: Export developments (Value in million of USD, Volume in tons)

Product/Period	Jan-Sept 10		Jan - Sept 11		Variation in %	
	Volume	Value	Volume	Value	Volume	Value
TOTAL EXPORTS	**82.9**	**185.3**	**117.8**	**280.5**	**42.12**	**51.42**
Coffee	12.6	38.1	10.3	50.5	-18.50	32.63
Tea	17.2	44.1	18.4	50.3	6.91	14.25
Tin	2.8	26.2	4.9	74.6	79.63	184.71
Coltan	0.6	13.6	0.6	26.1	9.09	91.04
Wolfram	0.6	4.3	0.6	9.3	1.20	114.63
Hides and Skins	2.6	2.7	4.2	5.4	62.28	103.27
Pyrethrum	0.0	1.4	0.0	3.9	165.58	184.17
Re-exports	6.0	31.8	13.4	26.5	123.12	-16.79
Other export products	40.4	23.1	65.1	33.9	61.27	46.91

Source: *NBR, Statistics Department*

During the period under review, coffee exports increased by 32.6% in value driven by the increase in unit price which increased by 62.8% standing at USD 4.9 /Kg on average during the period Jan-September 2011 from USD 3.0/Kg during the same period of 2010 while the volume reduced by 18.5%. Coffee exports volume declined due to the sharp decline in coffee production during the first three months of 2011. This decline is attributed to the usual coffee production cycle, when a good harvest is followed by a bad one.

b.2 Imports

Regarding the imports, in the first nine months of 2011 compared to the same period of 2010, the total imports increased both in value and volume by 21.0% and 16.5% respectively. The volume and value increased for the all categories except for consumer goods of which the volume reduced by 3.0% on sharp decline in food imports (-9.0%) as domestic food crop production has increased significantly (15.64% in the season B 2011). Also, some EAC countries from where important volume of food stuffs is imported have experienced a drought.

Table 7: Imports Developments (Value CIF in million of USD, Volume in thousands of tons)

	Jan - Sept 10		Jan - Sept 11		In % Change		In % of Total
	Volume	Value	Volume	Value	Volume	Value	Value
TOTAL IMPORTS	**851.19**	**1,005.02**	**991.73**	**1,216.50**	**16.5**	**21.0**	**100.0**
CONSUMER GOODS	**348.1**	**309.2**	**337.5**	**350.3**	**-3.0**	**13.3**	28.8
Food products	283.0	114.9	257.9	131.3	-8.9	14.3	10.8
Health and care	20.3	67.8	21.9	82.1	8.0	21.2	6.8
CAPITAL GOODS	**30.5**	**261.4**	**37.9**	**292.3**	**24.0**	**11.8**	24.0
Transport Materials	4.9	45.7	7.7	59.2	57.8	29.7	4.9
Machines, devices and tools	14.3	161.5	14.7	150.5	3.4	-6.8	12.4
INTERMEDIARY GOODS	**328.5**	**281.0**	**454.4**	**347.7**	**38.3**	**23.7**	28.6
Construction materials	187.0	118.2	263.6	137.2	41.0	16.1	11.3
Industrial products	110.6	114.5	149.5	161.5	35.1	41.0	13.3
Fertilizers	19.6	14.0	27.6	19.6	41.0	39.8	1.6
ENERGY AND LUBRICANTS	**144.1**	**153.5**	**162.0**	**226.3**	**12.4**	**47.4**	18.6
Fuel	138.2	144.3	155.8	217.0	12.7	50.4	17.8

Source: *NBR, Statistics Department*

Consumer goods imports value increased from USD 309.2 million for the first nine months of 2010 to USD 350.3 million during the same period of 2011 that is 13.3% increase and represented 28.8% of total value imports, and this category of goods remained dominated by food products and health and care (pharmaceutical and perfumes).

With regard to Capital goods, their imports rose by 24.0% in volume and by 11.8% in value with a sharp increase in transport materials which recorded respective increase in volume and value of 57.8% and 29.7% while machines, devices and tools increased in volume (3.4%) and reduced in value (-6.8%).

Concerning intermediary goods, their imports came on the second position in terms of share of total imports (28.6%) after consumer goods. Their value increased by 23.7% while their volume rose by 38.3%. This performance is explained by construction materials which rose by 16.1% in value and by 41.0% in volume. In construction materials, the increase is attributed mainly to the cement and other similar products and metallic construction material which respectively increased by 42.9% and 25.0% in value. For the industrial products, their value rose by 41.0% while their volume increasing by 35.1%, and this increase in value was explained by food industries, chemicals industries, various industries and paper industries whose importation increasing respectively by 59.6%, 36.1%, 48.9% and 30.2% in value. However, fertilizers recorded an increase both in value and volume with respectively by 39.8% and 41.0% as the Government policy continues to promote the use of fertilizers in agriculture sector for sustaining the increase of domestic production.

Imports of energy and lubricants of which more than 90% is fuel rose by 47.4% in value due mainly to the high cost of petroleum products, as the volume increased by 12.4%. This no less significant increase in imported volume of fuel was driven by a higher domestic demand, boosted by dynamic economic activities.

III. INFLATION DEVELOPMENTS

III.1 CURRENT TREND

Inflation in Rwanda has been increasing during the first ten months of 2011 but maintained at relatively low level compared to other EAC countries. On annual basis, headline inflation reached 7.76% in October from 6.64% in September 2011, after 0.23% in December 2010. In terms of annual average, inflation has increased by 4.4% in October against 3.7% in September, 2.5% in June, 2.2% in March 2011 and 2.3% in December 2010.

Table 8: Annual and monthly Inflation trend (% change in CPI, base 2009:100)

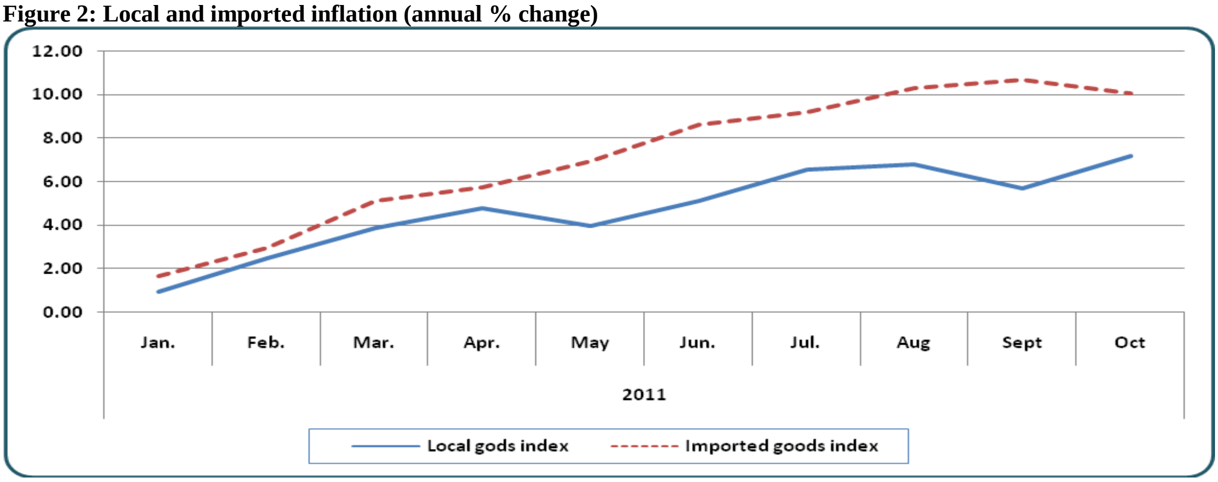
	Weights	Annual Headline Inflation					Monthly Inflation			
		2010	2011				2011			
		Dec.	Mar.	Jun.	Sept.	Oct.	Mar.	Jun.	Sept.	Oct.
Headline Inflation	**10 000**	0.23	4.11	5.82	6.64	7.76	1.91	1.54	0.39	0.58
1. Food and non-alcoholic beverages	3 538	-2.69	4.22	7.16	6.30	9.61	4.36	2.41	-0.44	1.46
- Bread and cereals	*733*	*-10.64*	*-3.66*	*16.55*	23.62	25.54	*5.15*	*6.12*	-0.17	-0.23
- Meat	*274*	*5.00*	*7.56*	*7.44*	10.67	9.55	*-0.03*	*0.34*	1.57	1.63
- Fish	*83*	*9.39*	*15.38*	*16.04*	17.16	19.24	*0.31*	*2.05*	3.39	1.13
- Vegetables	*1 200*	*-5.20*	*4.49*	*-2.81*	-10.99	-2.35	*9.85*	*1.79*	-0.21	3.76
- Non-alcoholic beverages	*160*	*-0.26*	*0.78*	*2.89*	6.74	6.62	*-0.18*	*1.86*	0.25	-0.88
2. Alcoholic beverages and tobacco	240	4.06	-0.64	1.48	3.75	2.88	-1.32	0.53	-1.31	-0.36
3. Clothing and footwear	377	1.59	4.30	6.70	9.23	8.72	-0.21	0.09	0.38	-0.08
4. Housing, water, electricity, gas and other fuels	2 204	1.63	3.55	2.09	4.81	5.08	0.32	0.95	2.70	0.66
5. Furnishing, household equipment and routine	457	-2.37	0.14	0.45	4.65	6.08	0.56	-0.06	0.38	0.61
6. Health	163	-1.14	-0.68	-0.23	2.77	1.93	0.56	0.89	0.12	-0.57
7. Transport	1 189	4.07	5.07	11.35	12.64	11.86	1.18	3.08	0.04	-0.38
8. Communication	288	-0.44	2.01	0.88	-6.77	-5.91	0.63	-0.44	-5.72	-0.40
9. Recreation and culture	256	1.38	4.68	4.61	6.96	5.04	2.24	-0.33	0.86	-0.31
10. Education	331	6.51	19.91	20.85	20.76	20.75	0.52	0.78	0.00	0.00
11. Restaurants and hotels	558	-0.44	-0.91	-0.22	2.46	2.09	0.18	-0.01	1.59	-0.41
12. Miscellaneous goods and services	400	2.38	6.98	7.46	7.16	8.30	1.92	1.89	0.80	0.68

Source*: NBR, Statistics Department*

The rise in the annual headline inflation was attributed primarily to education (+20.75%) due to the increase in private school fees that were recorded at the beginning of the year, transport (+11.86%), as well as food and non alcoholic beverages (+9.61%). Food prices which started rising in June 2011, was attributed mainly to prices of bread and cereals (25.54%) and fish (19.24%). During the first ten months of the year, energy prices have been rising due the increasing international oil prices, where since January, fuel prices have increased by 12.7%, from a pump price of Rwf 887 to Rwf 1 000 per litre in October 2011.

The major contributors of annual headline inflation were foods and non alcoholic beverages (+3.54), transport (+1.19%) and education (+0.69%) which account for about 80% of October 2011 annual headline inflation.

Figure 2: Local and imported inflation (annual % change)



By origin of products, the price index for locally produced goods increased only by 7.19% in October from 5.69% in September 2011, after a decline of 0.07% in December 2010, while prices for imported goods rose by 10.08% in October 2011 after 10.69% in September 2011 and to 1.45% in December 2010.

Table 9: Inflation by origin, in % annual change

	Weights	Annual % Change							
		2010			2011				
		Dec.	Mar.	May	Jun.	Jul.	Aug.	Sept	Oct.
Overall inflation	**10 000**	**0.23**	**4.11**	**4.54**	**5.82**	**7.14**	**7.52**	**6.64**	**7.76**
Local Goods	*7947*	*-0.07*	*3.86*	*3.95*	*5.12*	*6.62*	*6.82*	*5.65*	*7.19*
Imported Goods	*2053*	*1.45*	*5.10*	*6.92*	*8.65*	*9.20*	*10.36*	*10.66*	*10.08*
Fresh Food Products	*1403*	*-1.06*	*10.69*	*5.51*	*6.51*	*8.25*	*4.56*	*-4.26*	*2.71*
Energy	*767*	*3.61*	*4.95*	*4.85*	*4.99*	*5.96*	*7.25*	*7.27*	*7.26*
Underlying inflation	**7829**	**0.15**	**2.78**	**4.32**	**5.77**	**7.04**	**8.15**	**8.95**	**8.88**

The underlying inflation which excludes fresh foods and energy from the overall CPI, on annual average reached 4.4% in October from 1.4% in December 2010. The underlying inflation on annual change rose to 8.8% from 0.15% in December 2010.

III.2 INFLATION FORECASTS

Given the international and regional economic environment characterized by high oil prices, food shortages and increasing demand especially for food, Rwanda faced higher inflation during June, July August, September and October 2011. NBR's forecasts show that even though inflation will be maintained at single digit, it is not expected to slow down until December 2011 unless the existing food shortage and food inflation in the region and the current oil shock subside.

The possible impact of oil prices has been measured by the VAR model result that postulates 0.06 elasticity. This simply means that a 10% increase in international oil price would provoke a 0.6% increase in domestic prices. Oil prices don't pose only direct impacts to domestic prices but has a pass-through to other items, especially transport which is one of the major contributors of overall inflation. Currently, oil prices have increased modestly since May 2011 and likely to stabilize as the political turmoil in oil producing is likely to end. This coupled with government policy of subsidizing oil prices will continue to lessen domestic inflationary pressures.

If prices for regionally sourced imports continue to escalate, imported inflation will continue to exert inflationary pressures to Rwanda. However, the severity of imported inflation will be reduced by current performance in domestic production as well as the stability or appreciation of the RWF vis-a-vis regional currencies since the country remains a net importer. However, aggregate demand for goods and service is likely to continue increasing as revealed by the increase in economic activities. Based on the above positive and negative shocks, inflation is projected to be 8.7% instead of the initial (March) projection of 7.5%.

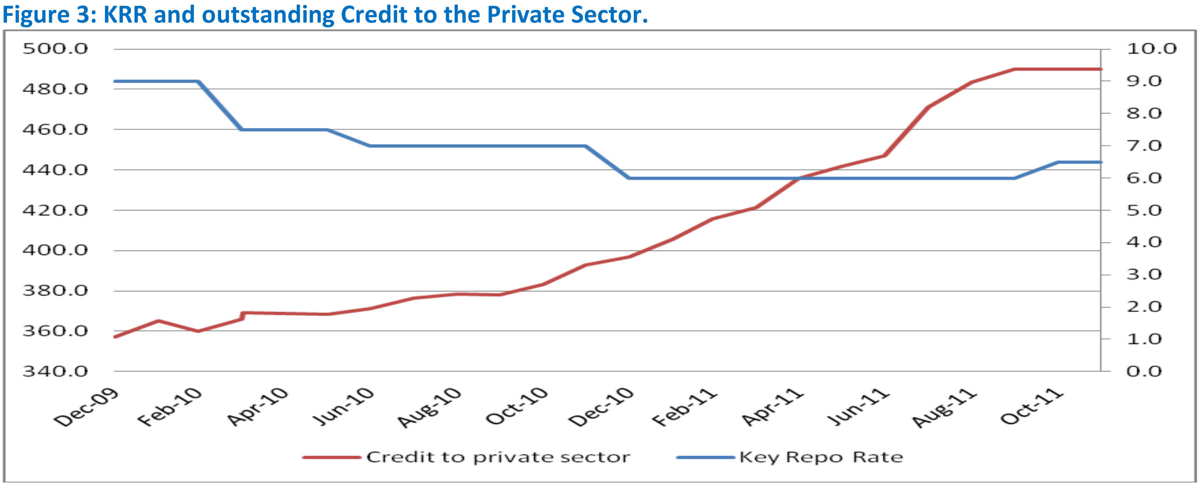
IV. MONETARY SECTOR DEVELOPMENTS

IV.1 CURRENT MONETARY POLICY STANCE

In response to developments in inflation, the short term NBR Monetary Policy has been prudent enough to avoid any exacerbation of exogenous shocks, while continuing stimulating required lending to the productive activities to sustain higher economic growth in 2011. Also, the monetary policy effectiveness continued to be improved significantly as a result of well established communication strategy which created an interactive and platform of exchanging information and coordinated implementation of policy measures to tackle the rising inflationary shocks.

To this effect, from 6% maintained stable during the first 3 quarters, on 7th October 2011, the Central Bank policy rate was reviewed upward to 6.5%. This decision of tightening the monetary policy was taken in response to accelerating money supply in the context on high inflationary pressures. I aimed at slowing down the over-speeding growth of the credit to the private sector and keeping it at a sustainable pace. However, it was expected that the slowing down of the credit growth would be moderate enough for not discouraging the financing of productive activities.

Figure 3: KRR and outstanding Credit to the Private Sector.



Source: Monetary Policy and Economic Analysis Department

IV.2 MONEY SUPPLY AND DEMAND

a. Money Supply

Between December 2010 and September 2011, broad money supply (M3) has increased by 16.0% against 8.4% in the same period of the previous year. The Net Foreign Asset (NFA) of the banking system declined and has been 0.4% in September 2011 compared to December 2010, contributing to the decrease in M3, while the Net Domestic Assets increasing significantly standing at RWF 193.2 billion at end September 2011 against 97.0 billion at the end of December of 2010. The downward trend in NFA, during the period under review, is mainly explained by sales to banks, Government spending, and the delay in budget support disbursements realized during the period under review. In fact, Government budget support stood at USD 325.12 million while sales to banks reached USD 224.57 million and Government spending USD 224.78 million.

Table 10: Monetary developments (RWF billion)

	2010	2011									Change (%)
	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Sep-11/Dec-10
Net foreign assets	518.9	498.0	493.2	464.4	528.3	499.8	485.3	459.1	504.2	521.0	0.4
Net domestic assets	97.0	112.2	126.3	162.0	119.5	170.3	227.3	245.2	224.6	193.2	99.3
of which net credit to government	-131.3	-122.5	-123.0	-98.6	-146.9	-90.5	-48.2	-65.3	-88.9	-114.6	12.7
Credit to private sector	397.1	405.9	415.7	421.4	435.9	442.0	447.0	471.2	483.8	490.1	23.4
Broad money M3	615.9	610.3	619.6	626.5	647.9	670.1	712.7	704.1	727.2	714.2	16.0
Broad money M2	516.7	501.8	500.7	510.7	537.1	558.6	600.4	595.4	610.6	591.1	14.4
Money M1	330.6	317.9	311.7	323.1	345.0	354.3	374.2	361.6	361.7	356.2	7.8
Currency in circulation	90.5	83.7	82.7	83.9	89.6	89.7	101.5	100.9	95.3	93.4	3.2
Deposits	525.5	526.6	536.9	542.5	558.3	580.4	611.1	603.3	631.9	620.8	18.1
of which: demand deposit	240.1	234.2	229.0	239.1	255.4	264.6	272.7	260.7	266.5	262.8	9.5
time deposit	186.1	183.9	189.0	187.6	192.1	204.3	226.2	233.8	248.9	234.8	26.2
In foreign currency	99.2	108.4	118.8	115.8	110.8	111.5	112.3	108.8	116.6	123.1	24.1

Source: Statistics Department

The growth in Net Domestic Assets was driven by both net credits to Government and Private sector with increased respectively 12.7% and 23.4% between end December 2010 and end September 2011. Following higher money demand for financing economic activities in 2011, the credit to private sector increased higher than the projected level of 19.2% in 2011 monetary program and against 5.8% in the corresponding period of 2010.

Table 11: Annual growth in monetary aggregates (%)

	2009	2010	2010(Sep)	2011 (sep)
Net foreign assets	9.7	17.2	9.5	0.4
Net domestic assets	30.2	18.9	5.5	99.3
of which net credit to government	0.3	7.1	6.3	12.7
Credit to private sector	***4.8***	***11.1***	***5.8***	***23.4***
Broad money M3	12.9	17.0	8.4	16.0
Broad money M2	11.8	20.3	8.7	14.4
Money M1	7.5	23.8	10.0	7.8
Currency in circulation	-4.8	17.5	6.2	3.2
Deposits	16.1	17.4	9.3	18.1
of which: demand deposit	13.4	26.3	11.5	9.5
time deposit	19.9	14.6	6.5	26.2
In foreign currency	17.9	2.3	7.4	24.1

Source: Statistics Department

New authorized loans by the banking system to the private sector have been significantly increasing, to respond to higher demand for credit in the context of improved economic dynamism. By 5th November 2011, banks authorized new loans amounting to RWF 274.2 billion versus RWF 226.6

billion during the first ten months of 2010. New authorized loans continued to be granted mainly to Commerce, Restaurants and Hotels, public works and building & industry, and activities not classified elsewhere with 35.7%, 25.5% and 15.0% respectively. Agriculture received only 3.9% of new authorized loans 2011 vis-à-vis 1.9% in 2011.

Table 12: New authorized loans (RWF billion)

ACTIVITY BRANCH	2009	2010					2011				
		Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Oct	Nov[1/]
AGRICULTURE, ANIMAL, HUSBANDARY&FISHING	3.7	0.9	1.6	1	1.6	5.1	3.8	1.9	4.2	0.6	0.1
MINING INDUSTRIES	0.1	0	0.1	0	0	0.1	0	0	0	0.0	0.0
MANUFACTURING INDUSTRIES	20.1	7	5.6	7.2	7	26.8	2.5	7.8	3.4	0.7	0.5
ENERGY AND WATER	3.2	0	0.4	0.5	0.5	1.4	0	0.1	0.01	0.0	0.0
PUBLIC WORKS AND BUILDING & INDUSTRY	36.7	7.5	8.6	14.7	14.3	45.1	14.3	20.7	26.7	6.4	1.1
COMMERCE, RESTAURANT & HOTELS	73	19.9	37.1	28.4	26.4	111.8	20.8	29.5	35.5	9.4	1.5
TRANSPORT, WAREHOUSING & COMMUNICATIONS	31.9	9	3.8	3.5	6.4	22.7	2.6	3.2	7.6	2.0	0.2
O.F.I, INSURANCES AND OTHE R NON FINANCIAL SERVICES	7.5	1.5	1.5	4.2	1.3	8.5	7	1.3	8.2	0.3	0.7
SERVICES PROVIDED TO THE COMMUNITY	4.7	1.3	3.4	2.3	2.8	9.8	1.6	2.2	1.3	0.8	0.1
ACTIVITIES NOT CLASSFIED ELSEWHERE	17.6	5.5	7.4	9	9.1	30.9	8.3	10.1	14.7	6.3	1.3
TOTAL	**198.4**	**53**	**69.3**	**71**	**69.3**	**262.0**	**60.9**	**76.9**	**101.6**	**26.6**	**5.4**

Source: Credit Reference Bureau

1/: Data by November 5, 2011

For the year 2011 the coffee season financing has been significantly increasing following much high prices compared to 2010, while the produced volume was lower. The situation from January to 5th November 2011 shows that the coffee campaign financing amounted for RWF 17.8 billion against RWF 8.3 billion last year.

Money demand

On the demand side, both components of broad money, namely currency in circulation and deposits increased respectively by 3.2% and 18.1% between December 2010 and September 2011. In the same period of 2010, currency in circulation increased by 6.2% and deposits by 9.3%. The current trend in currency in circulation continues to be mainly driven by economic activities boosted by a number of Government projects injecting money in rural area coupled with some structural factors such as insufficient development of non cash payment instruments, cash utilization in the cross border trade and seasonally effects, mainly from the financing of coffee season. The significant increase in banking system deposits is mainly attributed to the time deposits in RWF and deposits in foreign currency with a growth of 26.2% and 24.1% respectively.

IV.3 INTEREST RATES DEVELOPMENTS

With regard to short-term interest rates, through to September 2011, they have been kept low and stable to discourage banks to invest in money market instruments, with exception of repo rate which has been steady at its maximum level (6.0%) since early this year, following the signal given by BNR of a need of liquidity to achieve monetary targets as set in the PSI program. However, in October 2011, all short-term interest rates have been on upward path as response to the increase of the central bank policy interest rate to 6.5 percent from 6.0 percent in force during the third Quarter 2011.

Table 13: Short-term interest rates developments, in %

	2010				2011									
	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
Key Repo Rate	7.0	7.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.5
Discount Rate	11.0	11.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Repo rate	7.5	5.2	5.1	5.5	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.4
Treasury Bills Rate	7.6	7.5	7.3	7.3	7.2	7.0	7.2	7.1	7.1	6.8	6.8	6.7	6.7	7.2
Interbank rate	7.4	7.3	7.2	6.8	6.7	6.7	6.7	6.9	6.9	7.0	6.9	6.9	6.9	7.4

Source: Financial Department

Regarding to commercial banks, lending rate continued to stand at high levels for long time as it fluctuated between 16% and 17% along this year, while deposit rate has been decreasing and recording its lowest level (6.5%) in September 2011.

Table 14: Commercial banks' rates interest rates developments, in %

	2010				2011									
	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
Key Repo Rate	7.0	7.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.5
Discount Rate	11.0	11.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.5
Deposit Rate	6.2	6.5	7.1	7.1	7.5	7.5	7.5	8.7	7.9	8.0	6.8	6.6	6.5	na
Lending Rate	16.8	17.3	17.5	16.9	15.6	16.9	16.6	16.2	16.9	17.0	16.6	17.0	17.0	17.0

Source: Statistics Department

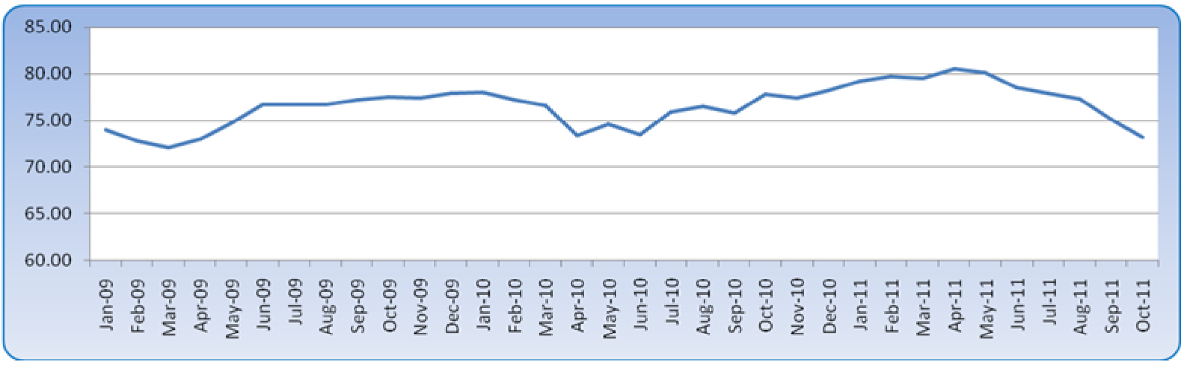
Deposit interest rate has been decreasing mainly during the third quarter, standing at 6.5% in September from 6.6% in August after 6.8% and 8.0% in July and June respectively. On the other side, the lending interest rate has been stable and stood at 17.0%. The high level of lending rate has been explained for long time by a risk incurred by banks, the level of nonperforming loans among other factors. Furthermore, FINABANK, BPR and BK have been in overall loaning expensively.

V. EXCHANGE RATE DEVELOPMENTS

The Rwandan franc has been stable versus USD, as it stood at RWF 601.88/1USD by end October, 2011 from 594.45/1USD by end December 2010, which is a depreciation of 1.2%. However, RWF significantly depreciated against both EUR and GBP by 8.9% and 5.9% respectively during the same period. EUR and GBP have been under pressures following the debt crisis.

Against regional currencies, While Kenya, Uganda and Tanzania Currencies have been falling a lot vis-à-vis USD along with this year, RWF appreciated considerably by 17.0%, 9.8% and 15.1% respectively between December 2010 and September, 2011. However, it depreciated by 2.5% vis-à-vis Burundi franc. In this regards, the Real Effective Exchange Rate appreciated by 7.1% in October 2011 compared to December 2010. This trend was consistent with the trend of Rwandan Franc against regional currencies.

Figure 4: Real effective exchange rate (as at end October 2011)



Source: Research and Policy Analysis Department

VI. MONETARY POLICY SHORT TERM ORIENTATION

The monetary policy implemented during the first 11 months of 2011 allowed the National Bank of Rwanda to achieve its core mission of maintaining inflation at moderate levels while continuing to stimulate the economic financing. However, considering the outlook of persistent higher global and regional inflationary pressures, there is a need of further tightening the monetary policy stance as a preventive measure, to avoid exacerbating inflationary pressures in near term.

In fact, the Central Bank has decided to further contain the upward movement in credit to the private sector during the coming months and keep it at a more sustainable pace and avoid risks of monetary inflation. In this regard, on 18th November 2011, the Key Repo Rate was reviewed upward from current 6.5% to 7.0%. Therefore, the interbank interest rates' corridor became] 5%-9% [and the discount rate 11%.

By increasing its KRR by 0.5 percentage points in one month period, the NBR intends to avoiding exacerbate the pass-through of global high inflationary pressures already affecting seriously regional trade partners. Meanwhile, it is expected that the reviewed KRR will not discourage savings mobilization since on average, the deposit interest rates are kept positive in real terms.

Also, to maintain the national currency exchange rate stability as another key factor limiting the pass-through of imported inflation on domestic markets, the NBR remains committed to maintain the RWF exchange rate market driven, while intervening time to time on foreign exchange market to smoothen the exchange rate volatility.

However, to achieving expected result, the NBR will continue to closely monitor developments in underlying factors of inflation so as to take timely appropriate measures, using the policy rate and other tools. Also, the existing good coordination of different Government stakeholders and Central Bank in dealing with external shocks will continue, especially with regard to fiscal and monetary policies.

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