NATIONAL BANK OF RWANDA
BANKI NKURU Y'U RWANDA

MONETARY POLICY REPORT

August 2023

NBR IDENTITY STATEMENT

The National Bank of Rwanda strives to be a World class Central Bank contributing to economic growth & development, by using robust monetary policy tools to maintain stable market prices. The Bank ensures financial stability in a free market economy as it embraces innovation, inclusiveness, and economic integration.

VISION

To become a World Class Central Bank

MISSION

To ensure Price Stability and a Sound Financial System

OUR CORE VALUES

INTEGRITY

We uphold high moral, ethical and professional standards for our people, systems and data

MUTUAL-RESPECT AND TEAM-WORK

We keep ourselves in high spirit, committed to each other for success

ACCOUNTABILITY

We are result-focused and transparent, and we reward according to performance

EXCELLENCE

We passionately strive to deliver quality services in a timely and cost effective manner. We continuously seek improvement by encouraging new ideas and welcoming feedback that adds value to customer services.

NBR
Key Strategic Focus
(2017/18-2023/24)

The National Bank of Rwanda strategic plan sets out six strategic focus areas in which the Bank must excel to achieve its mission and vision. The strategy was designed based on Rwanda's aspirations for economic transformation in line with the National Strategy for Transformation (NST1).

SUMMARY OF NBR's
MONETARY POLICY STRATEGY

OBJECTIVE

Monetary Policy shall maintain price stability by keeping headline consumer price inflation within the band of 2% and 8%, with a focus of having it close to 5% in the medium term. In line with best practices, price stability is the primary and overriding objective of the NBR's monetary policy.

NBR shall also ensure financial stability as well as support other general objectives for economic development. NBR will set the Central Bank Rate (CBR) to stabilize inflation in the medium term.

The monetary policy framework is forward looking, therefore relying on the projections of inflation, taking into account economic developments.

DECISION-MAKING PROCESS

The Monetary Policy Committee (MPC) usually holds four quarterly meetings per year, where it decides on the monetary policy stance by setting the CBR to stabilize medium term inflation. Before the MPC decision, there is extensive assessment and economic analysis to guide discussions.

COMMUNICATION

A press release with the monetary policy decision and its main rationales is always published the day after the MPC decision and the Governor holds a press conference. The monetary policy report, detailing recent economic developments, projections, and reasons behind the decision is also published at the same time as the press release.

CONTENTS

I. MONETARY POLICY COMMITTEE DECISION, OUTLOOK, AND RISKS

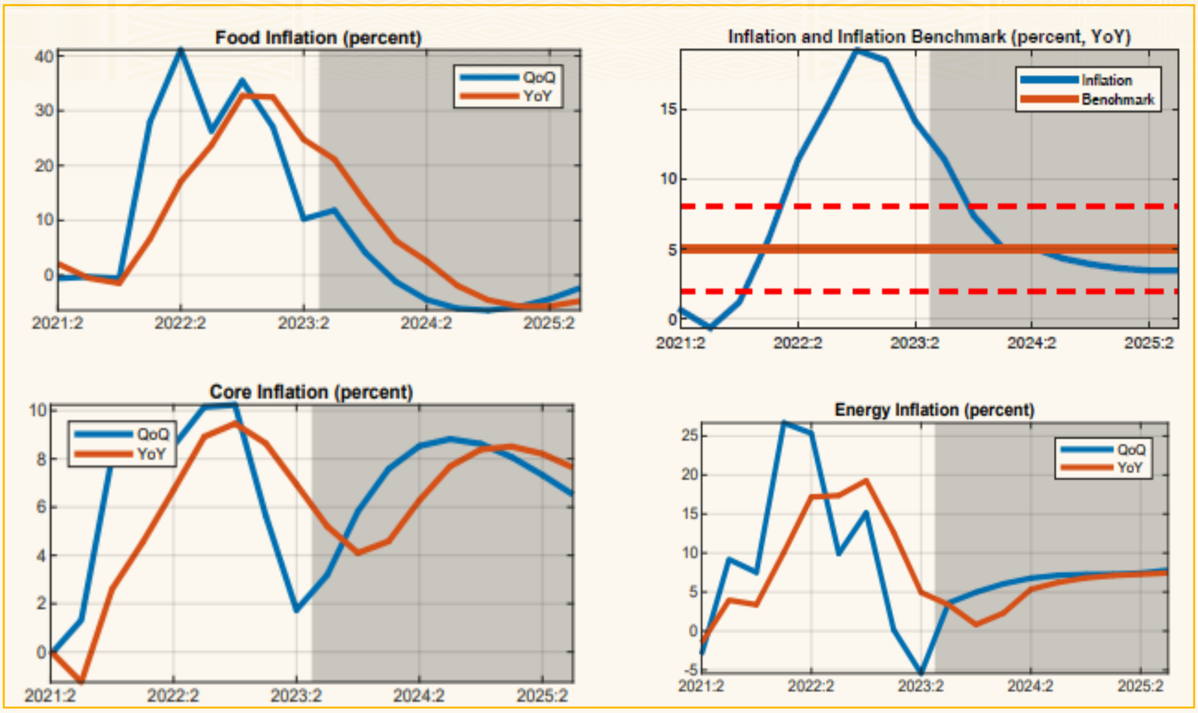
The Monetary Policy Committee (MPC) meeting convened on August 16, 2023, to review the impact of its previous decisions, assess recent global and domestic economic developments, and decide on the Central Bank Rate (CBR) for the next quarter.

The inflation projections for August 2023 MPC indicate that headline inflation (y-o-y) is on a declining trend, although still evolving above the medium-term inflation benchmark of 5%, following the continued global economic challenges and the effect of domestic agricultural production.

Though headline inflation (y-o-y) remains high, it is expected to slow down and evolve into single digits towards the end of 2023Q4, reflecting the effect of NBR's past monetary policy decisions, other policy measures, and the impact of the global economy, which is expected to be non-inflationary over the policy horizon. The projected decline in headline inflation (y-o-y) reflects the decelerations in all key components of headline inflation, namely core inflation, energy inflation, and food inflation in the near term. Over the medium, core inflation is projected to pick up on the back of the expected pressures mainly from imported costs as US Dollar versus FRW continues to appreciate. Energy inflation is projected to remain at the current levels, consistent with the projected supply and demand conditions of energy products. Food inflation is expected to ease due to the agricultural normalization over the policy horizon.

However, the projections are exposed to risks. Some of the risks to the forecasts are divided into two folds: (1) Risks associated with international economic developments such as geopolitical tensions-end of grain deal that will have an impact on imported food prices and the possible impact on international oil prices from the cuts in oil supply by OPEC and Saudi Arabia. (2) Risks associated with weather conditions that might affect agricultural production going forward.

Based on the prevailing economic conditions, the MPC decided to hike the Central Bank Rate (CBR) from 7.0 to 7.5 percent, to tame inflationary pressures affecting the purchasing power of consumers. NBR remains committed to achieve price stability by bringing inflation within the medium-term objective bound of 2 –8 percent and will continue to monitor macroeconomic developments and take appropriate action when necessary.


Food Inflation (percent)
QoQ
YoY
40
30
20
10
0
2021:2
2022:2
2023:2
2024:2
2025:2
Inflation and Inflation Benchmark (percent, YoY)
Inflation
Benchmark
15
10
5
0
2021:2
2022:2
2023:2
2024:2
2025:2
Core Inflation (percent)
QoQ
YoY
10
8
6
4
2
0
2021:2
2022:2
2023:2
2024:2
2025:2
Energy Inflation (percent)
QoQ
YoY
25
20
15
10
5
0
-5
2021:2
2022:2
2023:2
2024:2
2025:2

II. CURRENT ECONOMIC CONDITIONS

SUMMARY

Global inflation is easing with a remarkable reduction in advanced economies, reflecting declining international commodity prices as well as expected cooling effects of monetary tightening on economic activity, but remained above central bank targets. As result, central banks across the world continued tightening monetary conditions to help inflation return to their targets.

The world economic growth is projected to slow down in 2023, reflecting tighter financial conditions as well as geopolitical tensions and related disruptions. Consistently, global commodity prices continued to decrease in 2023Q2 amid slowing global demand. Both energy and non-energy commodity prices dropped as previously projected.

Rwanda continues to record strong economic performance. In 2023Q1, the economy grew by 9.2 percent; with tourism, trade services and industry sector leading the way, partly backed by financing from Economic Recovery Fund 2 (ERF 2) and Manufacture and Build to Recover Program (MBRP). However, unfavorable weather conditions led to poor food crop harvest in 2023 season A, weighing down the overall agriculture sector growth. High frequency economic indicators signal continuous expansion of economic activity in 2023Q2.

However, the current account deficit widened to 12.2 percent of GDP in 2023Q1, on account of deteriorating terms of trade and decreasing government grants. In 2023Q2, Rwanda's trade deficit widens driven by increasing imports bill by 9.9 percent, primarily due to high domestic demand of capital goods and food products, reflecting strengthening domestic economic activities and poor agricultural output. Similarly, Rwanda's exports remained resilient, rising by 5.3 percent, driven by good performance of manufacturing exports and ICBT.

Looking at the domestic credit conditions, credit to the private sector increased by 13.2 percent in 2023Q2 from 16.5 percent in 2022Q2. Regarding interest rates, money market rates increased following the monetary policy tightening, but the banks' lending rate remains relatively stable.

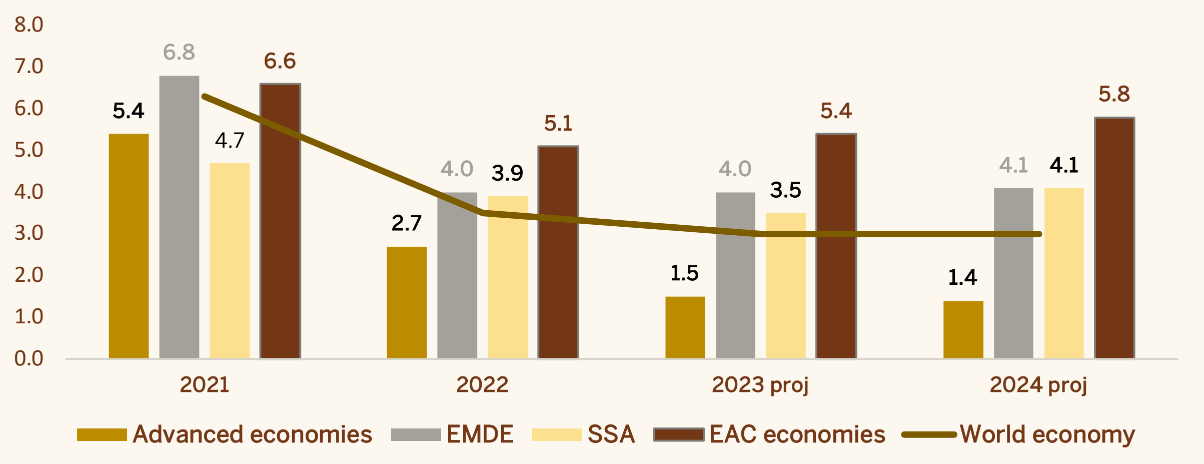
Headline inflation (y-o-y) decelerated significantly to 15.2 percent in 2023Q2 from 20.2 percent recorded in the previous quarter. This reflects the declines from core, fresh food, and energy inflation. The downward trend observed in core inflation reflects the eased pressures mainly recorded from domestic costs of production, while the slowdown observed in fresh foods inflation is attributed to the improved supply of agricultural output, originating from imported fresh vegetables to offset crops damaged by floods in May 2023. Over the same period, energy inflation reduced due to an increased supply of solid fuels, coupled with the downward revisions in local pump prices consistently with the reduction in the international oil prices throughout 2023Q2.

II.1. Global Economy and Financial Markets

The global economy is projected to slow in 2023

According to the International Monetary Fund (IMF)'s World Economic Outlook (WEO) update in July 2023, the world economic growth is projected to slow to 3.0 percent in 2023, 0.2 percentage higher than April 2023 projections, from 3.5 percent in 2022. This slowdown reflects tighter financial conditions, geopolitical tensions and related disruptions as well as weaker external demand. Economic growth in advanced economies is projected to decelerate from 2.7 percent in 2022 to 1.5 percent in 2023 and is projected to remain at 1.4 percent in 2024 with weaker manufacturing offsetting stronger services activity.

Chart 1: GDP growth and projections across regional blocks (% change)



Source: IMF WEO update, July 2023

In 2023Q1, the US economy expanded by 1.3 percent (y-o-y), after growing by 2.6 percent in 2022Q4, reflecting decline in both private inventory and non-residential fixed investments, partially offset by increased consumer expenditure and improved exports. Growth is projected at 1.8 percent in 2023, 0.2 percentage point higher than in April forecast, from 2.1 percent in 2022, on account of resilient consumption growth in the first quarter.

In the Euro area, GDP grew by 1.3 percent in 2023Q1, underpinned by lower energy prices, waning supply constraints, improved business confidence and a strong labour market, slower compared to 1.8 percent in 2022Q4. Annual growth is projected at 0.9 percent in 2023, 0.1 percentage point higher than in April forecast, after 3.5 percent in 2022, following strong services and tourism for Italy and Spain.

Real GDP growth in the United Kingdom decelerated to 1.0 percent in 2023Q1 from 1.9 percent in 2022Q4, primarily driven by reduced household consumption due to higher inflation. The economy is set to grow by 0.4 percent (y-o-y) in 2023, 0.7 percentage point higher than in April forecast, reflecting stronger than expected demand and resilient financial sector as the March global banking stress disappears.

In 2023Q1, the Japan's economy grew by 1.3 percent (y-o-y), after 0.4 percent in 2022Q4, higher than initially expected, driven by higher domestic demand despite lower export demand. Japan's economy is projected to grow by 1.4 percent in 2023, 0.1 percentage point higher than in April forecast, from 1.1 percent in 2022, supported by increasing demand and accommodative policies. However, growth is projected to slow to 1.0 percent in 2024, as the effects of past stimuli dissipate.

Emerging market and developing economies are projected to remain broadly stable at 4.0 percent in 2023 and projected to grow by 4.1 percent in 2024. Economic prospects are on average stronger than for advanced economies, but these prospects vary widely across regions.

In 2023Q1, the Chinese economy grew by 4.5 percent (y-o-y), higher than 2.9 percent in 2022Q4, better-than-expected growth mainly supported by consumption recovery, export resilience and improving property market. China's economy is projected to grow by 5.2 percent in 2023, forecast unchanged relative to April forecast.

India's economy performed strongly in 2023Q1 growing by 6.1 percent from 4.5 percent in 2022Q4, driven mainly by strong private consumption, increased service exports, and a thriving manufacturing sector. Annual growth is projected at 6.1 percent in 2023, 0.2 percentage point upward revision compared with April forecast, reflecting momentum from stronger-than-expected growth in the fourth quarter of 2022 as a result of a stronger domestic investment.

The Sub-Saharan African economy is projected to slow from 3.9 percent in 2022 to 3.5 percent in 2023, 0.1 percentage point lower than April 2023 projections, amid growth declines of the two major economies of Nigeria and South Africa. Growth in Nigeria is projected to decline gradually, reflecting security issues in the oil sector, while South Africa's growth decline reflects power shortages. The weaker output also reflects lower trading partner growth, tighter financial and monetary conditions, and a negative shift in the commodity terms of trade. The Sub-Saharan Africa's economy is expected to rebound to 4.1 percent in 2024.

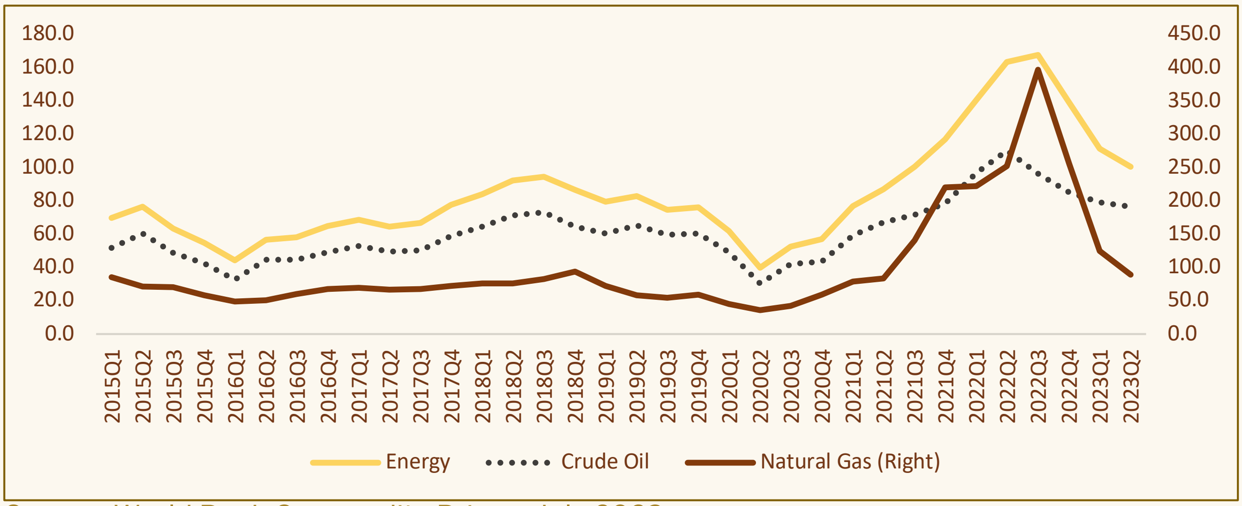
The economic performance in the East African Community (EAC-5[1]) countries is projected at 5.4 percent in 2023, from 5.1 percent in 2022. In line with these projections, EAC economies recorded strong performance in 2023Q1; 9.2 percent in Rwanda, 4.9 percent in Uganda, 5.7 percent in Tanzania and a moderate growth of 1.1 percent in Kenya.

Commodity prices continued to decline in 2023 due to the slowing global demand

Consistent with the projected slowdown in global economic growth, global commodity price index decreased for the second consecutive quarter, dropping by 32.2 percent and 17.2 percent in 2023Q2 and 2023Q1 respectively. It is projected to drop by 21.2 percent on average in 2023 amid slowing global demand.

Energy prices dropped by 38.5 percent in 2023Q2 after decreasing by 9.6 percent in 2023Q1, reflecting falling prices of crude oil and natural gas, and projected to drop by 25.8 percent in 2023 after rising by 60.0 percent in 2022.

Chart 2 – Energy commodity prices index in nominal US dollar (2010=100)



Source: World Bank Commodity Prices, July 2023

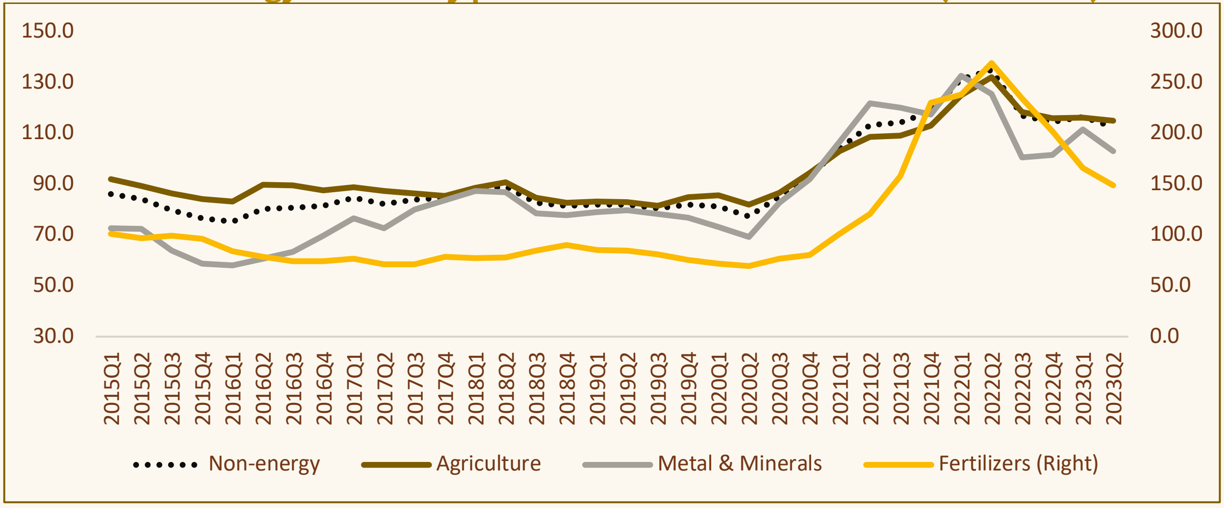
In July 2023, IMF projected crude oil prices to drop by 20.7 percent in 2023, amid slowing global growth. Natural gas index dropped following a mild winter in Europe which kept energy prices down. The World Bank projects natural gas average prices to drop by 39.2 percent in 2023, after surging by 110.7 percent in 2022.

Non-energy commodity prices dropped by 16.6 percent in 2023Q2, after 3.5 percent in 2023Q1, owing largely to declining prices of all non-energy commodity prices. World Bank

[1] EAC-5 members are Burundi, Kenya, Rwanda, Tanzania and Uganda

projects non- energy commodity prices to drop by 9.6 percent in 2023 and drop further by 2.7 percent in 2024.

Chart 3– Non-energy commodity prices index in nominal US dollar (2010=100)



Source: World Bank Commodity Prices, July 2023

Food prices dropped by 15.0 percent in 2023Q2 after 2.3 percent in 2023Q1, of which, oils & meals (-28.1 percent), and grains (-15.8 percent). Global food prices are projected to drop by 7.9 percent in 2023 after increasing by 18.0 percent in 2022. Coffee (Arabica) prices dropped by 17.8 percent in 2023Q2 after falling slightly by 0.3 percent in 2023Q1, and projected to drop by 14.7 percent in 2023. Tea prices (Mombasa) dropped by 4.9 percent in 2023Q2 after falling by 5.0 percent in 2023Q1, and tea average prices are projected to drop by 11.5 percent in 2023 after increasing by 13.4 percent in 2022.

Prices of metals and minerals declined reflecting slowing global demand. Tin prices dropped by 28.8 percent in 2023Q2 after a slight decrease of 0.6 percent in 2023Q1, undermined by a reduced demand from the electronics sector. Tin average prices are projected to drop by 23.4 percent in 2023 after decreasing by 3.2 percent in 2022, but projected to slightly increase by 2.1 percent in 2024.

Prices for fertilizers dropped following easing supply disruptions. The World Bank projected fertilizers to drop by 36.9 percent in 2023 after increasing by 54.8 percent in 2022, and drop further by 7.1 percent in 2024, as supply disruptions ease gradually.

Global inflation is expected to ease in 2023 but will remain above the central bank's target

Globally, inflation is easing with a remarkable reduction in advanced economies but remained above central bank targets. World annual average inflation is projected to ease to 6.8 percent in 2023, 0.2 percentage point lower than April 2023 forecasts and 5.2 percent in 2024 from

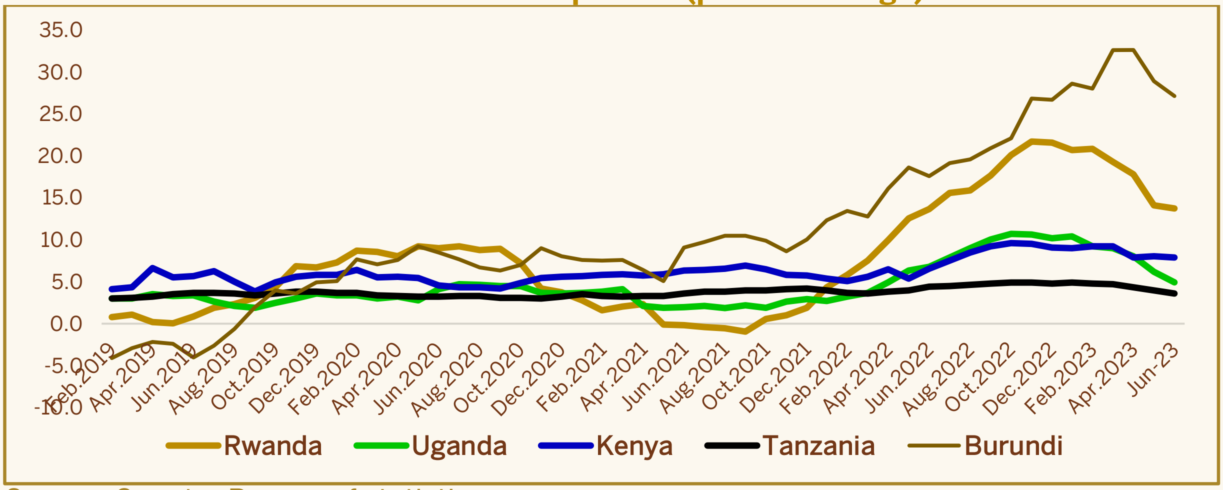
8.7 percent in 2022. The projected disinflation in 2023 reflects essentially declining international commodity prices as well as the expected cooling effects of monetary tigtening on economic activity.

In advanced economies, consumer price inflation is expected to ease to 4.7 percent in 2023 and ease further to 2.8 percent in 2024 from 7.3 percent in 2022. In line with this projected easing inflation, US headline inflation decelerated to 3.0 percent in June 2023 from 4.0 percent in May, Eurozone inflation eased to 5.5 percent in June 2023 from 6.1 percent in May, and annual headline inflation for UK eased to 7.9 percent in June 2023 from 8.7 percent, reflecting falling energy and easing food prices.

In emerging market and developing economies, inflation is expected to slightly ease to 8.3 percent in 2023 and further to 6.8 percent in 2024 from 9.8 percent in 2022, reflecting falling energy and easing food prices. China's consumer prices flattened to 0 percent in June 2023 from 0.2 percent in May mainly due to decline in non-food prices. In Sub-Saharan Africa, inflation is projected to ease from 14.5 percent in 2022 to 14.0 percent in 2023 and further to 10.5 percent in 2024.

In the EAC-5 countries, annual average inflation is projected to remain unchanged at 7.0 percent in 2023 and ease to 5.4 percent in 2024. Consistent with this projected path, inflation in EAC countries decreased during the last three months, mainly due to easing food prices.

Chart 4- EAC-5 Headline Inflation developments (percent change)

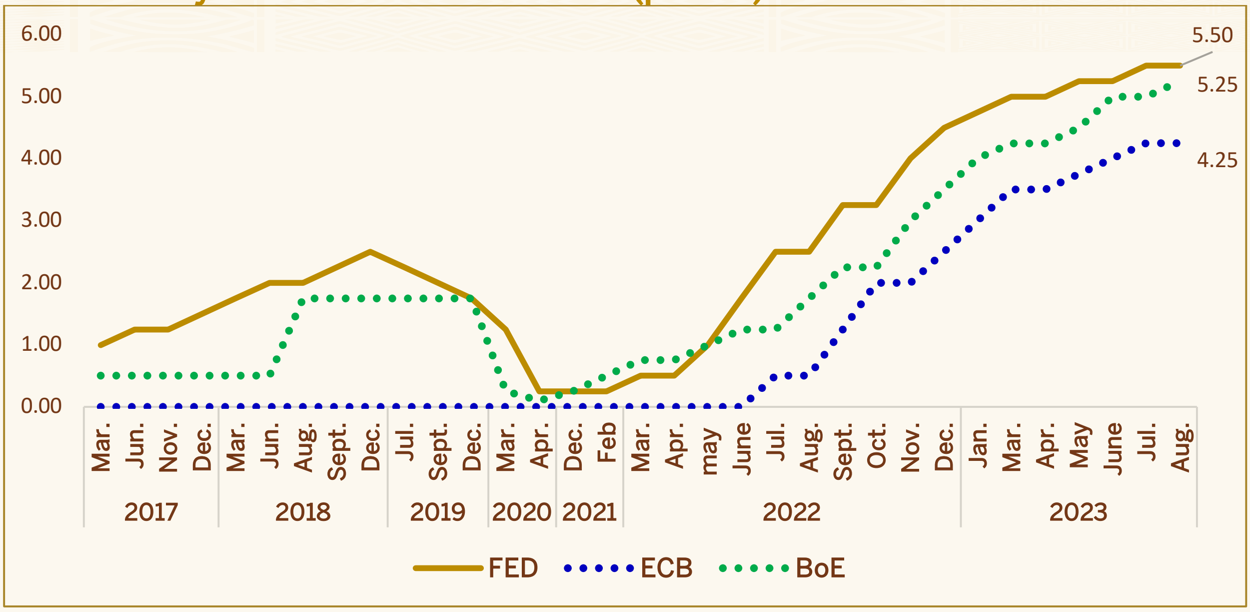


Source: Country Bureau of statistics

Monetary conditions tighten globally amid heightened inflation risks

In the face of persistently elevated inflationary pressures, central banks in advanced economies continued tightening monetary policy to bring inflation back to targets.

Chart 5- Policy rates for selected economies (percent)



Slowing US dollar on cooling monetary policy tightening

The dollar index decreased in June 2023, reflecting the cooling monetary policy tightening by the Federal Reserve. By end June 2023, the US dollar depreciated by 6.29 percent (y-o-y), against the British pound, and by 3.51 percent against the Euro. The dollar however appreciated by 8.17 percent against the Japanese Yen, and by 5.43 percent against the Chinese Yuan.

Expected impact of global economy on Rwandan economy is mixed

The projected declines in energy prices are expected to reduce Rwanda's energy import bill. This expected impact is based on the recent IMF July 2023 crude oil projections and World Bank April 2023 natural gas projections. On the other hand, the expected decline in non-energy commodity prices such as coffee, tea and minerals, is expected to impact negatively Rwanda's traditional exports earnings. These declines in commodity prices are foreseen to continue in 2024.

With regard to exchange rate, the current appreciation trend of the US dollar against the Rwandan franc is making our imports more expensive, but the cooling monetary policy tightening by the Federal Reserve is expected to ease the strength of the USD against other currencies.

Inflation in major economies is expected to slow down as result of easing energy and food prices. However, the recent formal withdrawal of Russia from a UN-brokered deal to export

Ukrainian grain across the Black Sea, risking tens of millions of tons of food exports around the world, is likely to result into high food prices.

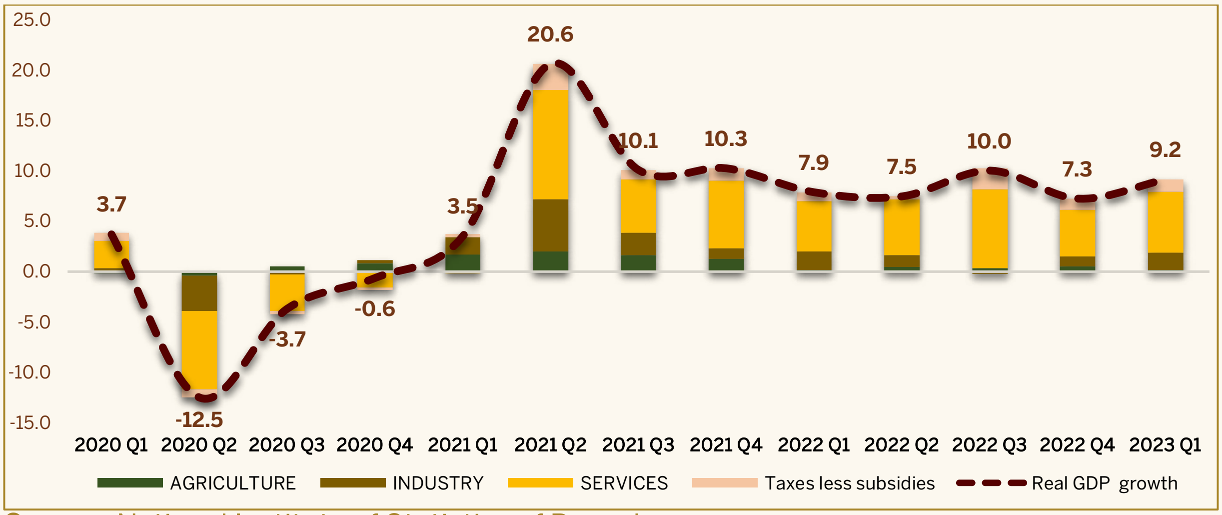
In a nutshell, the weakening global demand and declining commodity prices are likely to reduce imported inflationary pressures.

II.2. Domestic economic performance and labour market

Robust economic performance in 2023Q1, with services and industry sectors' performance limiting the impact of climate change.

Since 2021Q2, Rwanda has been recording remarkable economic growth backed by the economic recovery plan. In 2023Q1, growth stood at 9.2 percent mainly boosted by good performance of services sector (+ 12.8 percent) which represented 49 percent of real GDP.

Chart 6: Real Gross Domestic Product (y-o-y, percentage change)



Source: National Institute of Statistics of Rwanda

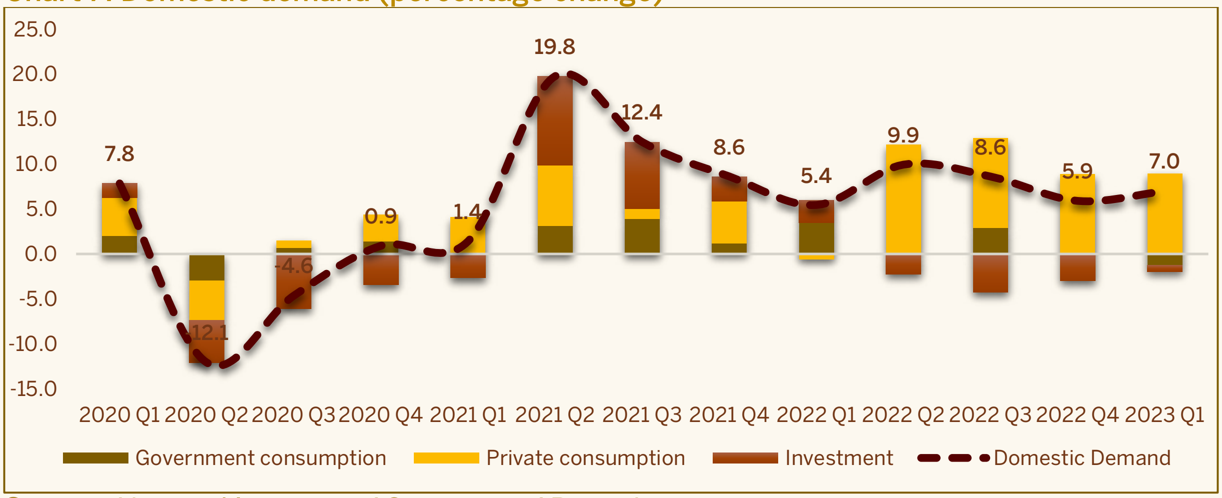
The tourism industry continued to strongly recover in tandem with strong momentum of global tourism recovery expected to fully recover to pre-pandemic level early 2024. Domestically, the tourism rebound is reflected by continuous strong growth of transport (+19.4 percent) and hotels and restaurants (+42.4 percent), which contributed by 27.0 percent to the growth of services sector. Furthermore, contact-intensive services such as Trade services (+42.4 percent), real estate (+42.4 percent) and education (+42.4 percent) continued to expand supported by strong private consumption, increased bank financing and the economic recovery fund (ERF). Similarly, financial services kept growing firmly with double-digit growth rates. In addition, the expansion of ICT services, evidenced by a strong growth in Information and communication (+42.4 percent), points to a growing Rwanda's digital transformation which contributes to productivity gains across sectors.

The industry sector substantial growth of 8.8 percent contributed significantly to the economic expansion of 2023Q1. This growth performance was mainly driven by expanding manufacturing activities (+15.7 percent) and mining and quarrying (+14.7 percent). The increase in manufacturing activities reflected remarkable progress in food processing (+21.6 percent), while the growth in mining and quarrying was supported by high metal and minerals prices on international market.
While non-agriculture sectors expanded, the agriculture sector faced weather challenges that led to weak performance. The sector grew by 0.8 percent in 2023Q1, primarily weighed down by the decline of food crop production (-3.2 percent) attributed to unfavorable weather conditions and crop diseases in season A 2023. Other subsectors within agriculture, such as exports crops, livestock, forest, and fishing, recorded a growth of 7.7 percent, but was not enough to offset the challenges faced by food crops.

Expansion of the domestic demand supported by private consumption.

Domestic demand grew by 7.0 percent in 2023Q1 led mainly by private consumption which increased by 14.2 percent. Private consumption expansion has been strong since 2022Q2, on account of increased consumer confidence after the lift of Covid-19 containment measures following a successful vaccination campaign. On another hand, government consumption and investment declined in 2023Q1. Investment declined for the fourth consecutive quarter, as most infrastructure projects undertaken as part of the post-COVID recovery plan were completed in the first half of 2022.

Chart 7: Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

Continuous improvement in employment fuelled by industry and services sector performance.

The labour market improved significantly throughout 2022 and the momentum continued in 2023Q1, supported by the aforementioned good performance in industry and services sectors. Following improvements in employment and labor participation, the unemployment rate fell to 17.2 percent in 2023Q1 against an average rate of 20.5 percent in 2022. Labour participation increased to 57.6 percent in 2023Q1 from 56.0 percent average of 2022. Employment remained robust, increasing by 6.1 percent in 2023Q1 from 8.2 percent in 2022. Manufacturing industries, trade and transportation services, as well as hotels and restaurants, contributed significantly to the increase in employment.

Table 1: Labour market indicators (percentage)

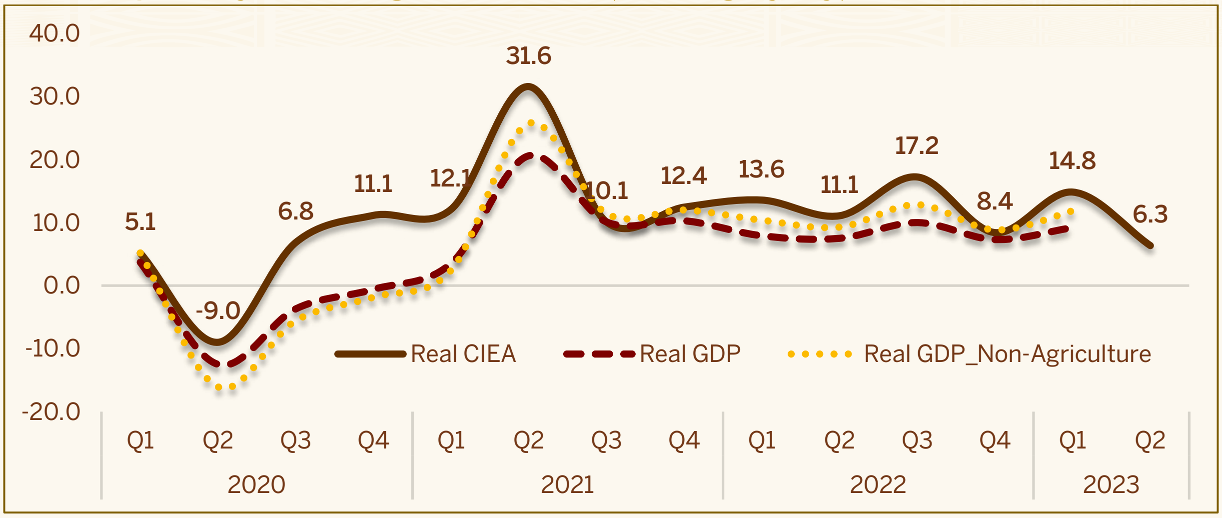
	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4	2023 Q1
Unemployment Rate	13.1	22.1	16.0	20.3	17.0	23.5	19.4	23.8	16.5	23.0	18.1	24.3	17.2
Labour Force Participation Rate	55.6	55.2	58.2	56.5	50.6	53.3	50.9	61.0	54.5	54.3	56.6	58.7	57.6
Employment %YoY													
Total	12.0	-1.8	16.3	0.1	-10.2	-2.2	-13.3	6.6	11.9	6.0	16.7	-1.7	6.1
Agriculture	23.9	10.5	6.7	15.7	6.6	7.0	19.0	16.0	12.2	-0.9	19.1	-5.2	-6.4
Industry	-2.5	9.3	41.8	13.7	-21.6	-15.2	-31.6	-7.1	13.1	6.7	16.4	-3.3	5.9
manufacturing	-3.3	-14.8	32.3	-29.4	-27.1	-9.6	-40.5	9.5	10.6	20.0	35.5	5.8	23.2
Construction	6.1	36.2	59.3	49.5	-9.4	-15.4	-25.1	-9.9	17.1	-5.4	7.8	-14.4	-6.5
Services sector	9.3	-12.8	17.6	-16.5	-23.2	-4.2	-26.7	4.1	12.1	16.0	12.2	4.9	27.8
Trade services	-7.8	-7.2	31.0	-26.1	-20.6	-31.0	-36.5	-3.8	7.2	29.1	-5.9	-0.7	36.8
Transport	0.6	-30.6	-0.4	-21.1	-16.0	35.6	-1.1	16.4	26.6	29.2	35.6	15.2	22.1
Hotels and Restaurants	55.5	-52.4	27.3	-28.7	-54.6	15.3	-71.3	-6.2	11.5	18.1	107.1	31.2	86.8

Source: National Institute of Statistics of Rwanda

A good economic performance continued in 2023Q2, despite a poor agricultural performance.

The Composite Index of Economic Activities (CIEA) increased by 6.3 percent in 2023Q2 year-on-year signaling continuous good economic performance. However, this growth was slower than the 14.8 percent growth recorded in the previous quarter. Quarter-on-quarter, the CIEA declined by 3.4 percent, reflecting a slow pace in the expansion of private consumption. The latter is evidenced by a quarter-on-quarter decline in VAT (-4.6 percent in 2023Q2).

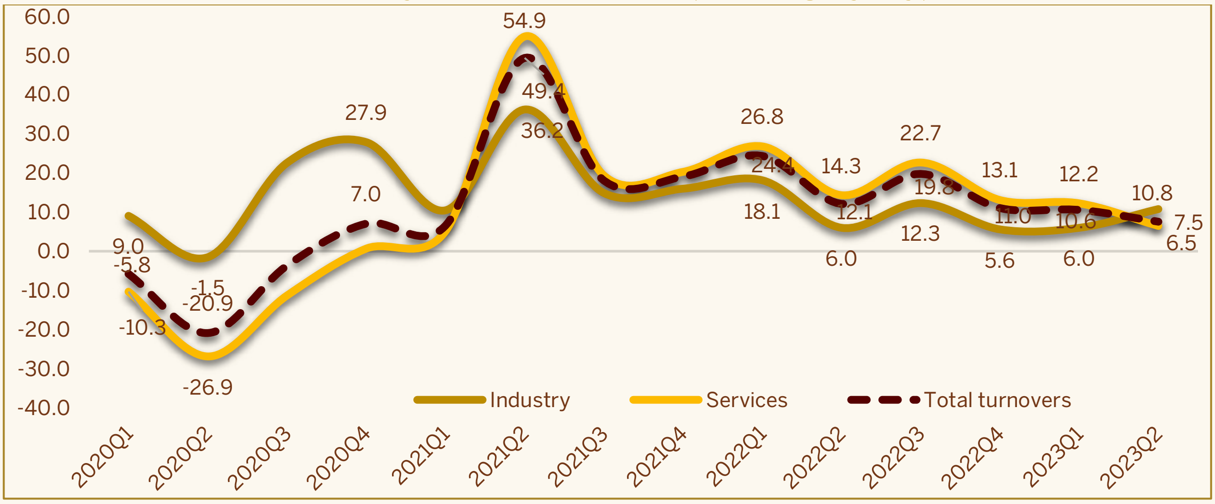
Chart 8: Quarterly real GDP growth vs CIEA (% change, y-o-y)



Source: NBR, Monetary Policy Department

The Good economic performance in 2023Q2 continued to be backed by services and industry activities. Trade services, supported by private consumption and banking financing, tourism robust recovery reflected in downstream services such as hotels and transport as well as telecommunication, continued to drive the growth of the services sector. The sector 's total turnovers grew by 6.5 percent year-on-year in 2023Q2.

Chart 9: Turnovers of industry & services sectors (% change, y-o-y)



Source: NBR, Monetary Policy Department

The industry sector's strong performance evidenced by the sector's total turnover growth of 10.8 percent, was driven by the recovery of construction activities in addition to continuous strong performance of manufacturing activities.

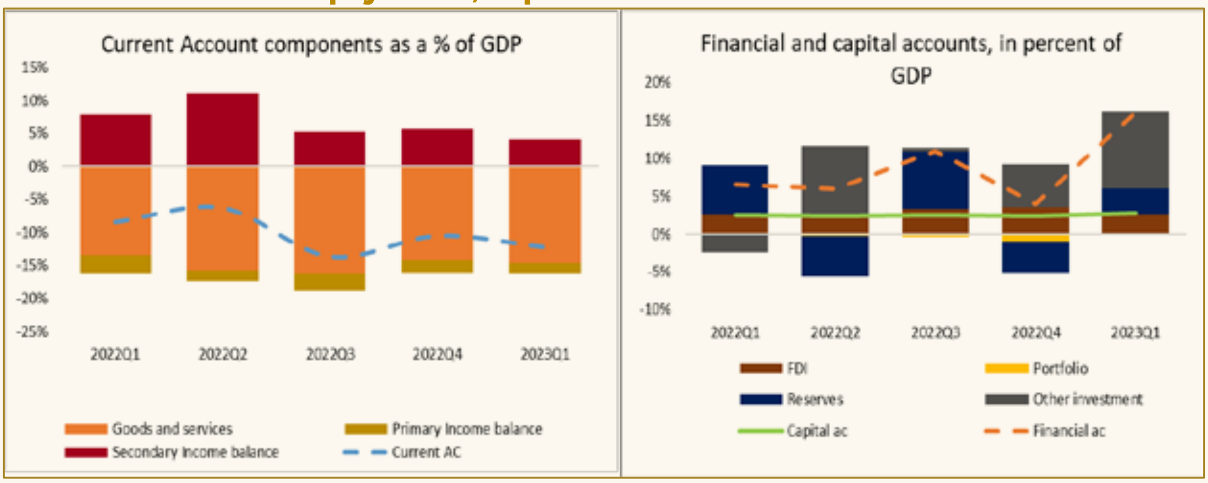
The agriculture sector performance remained weak in 2023Q2, following the bad harvest of food crop production in season A 2023. The climate shock did not spare season B, as it is expected that the food crop production of the season will be poor. The floods and the early end of the rainy season severely damaged crop production, mainly Irish potatoes and beans, the two important staple food products.

Overall, despite the poor performance of the agriculture sector, posing a high risk of inflationary pressures, the real GDP growth for 2023Q2 is expected to remain strong though decelerating.

II.3. External sector, and exchange rates developments

The current account deficit (CAD) widened to 12.2 percent of GDP, primarily due to increasing goods trade deficit and reduced budgetary grants, despite strong recovery in service exports and resilient remittances inflows. Specifically, in 2023Q1 goods exports rose by 28.7 percent largely attributable to the good performance of manufacturing exports and high export quantities of traditional commodities that partially offset the recorded decline in global commodity prices. Similarly, imports of goods soared by 36.7 percent supported by higher inflows of capital imports, reflecting strong domestic economic activities. Besides, the domestic demand for food imports surged, reflecting lower domestic agricultural output due to unfavorable weather patterns.

Chart 10: Balance of payments, in percent of GDP.



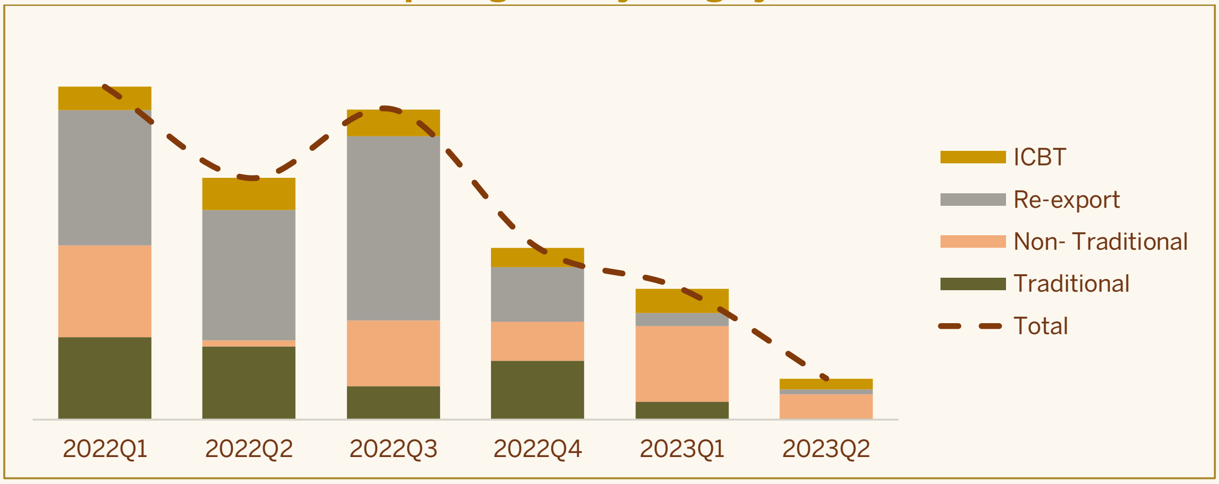
Source: Statistics department, BNR

In terms of financing, the CAD was partially financed by higher budget loan disbursements and private inflows mostly foreign direct investment (FDI). In the first quarter of 2023, net FDI inflows surged by 16.7 percent supported by government programs to support the economy such as Manufacture and Build to Recover Program (MBRP) as well as improving domestic economic conditions. The shortfall from the financial account surplus to finance the CAD was compensated by drawing down international gross reserves by USD 126 million in 2023Q1. However, the international gross reserves continue to be adequate, covering 4.0 months as of end March 2023.

Exports continued to grow in 2023Q2 driven by non-traditional exports.

In 2023Q2, merchandise exports experienced a growth of 5.3 percent. This increase can be attributed to two main factors: a relatively good performance of manufacturing exports and informal cross border trade. These positive developments outweighed the negative impact of declining commodity prices, which mostly affect Rwanda's traditional minerals exports.

Chart 11: Contribution to exports growth by category, %



Source: Statistics department, BNR

Earnings from traditional exports grew by 0.6 percent year-on-year. This sluggish growth was primarily driven by declining receipts from minerals and tea following the decline in international prices. In contrast, revenues from coffee exports, recorded a remarkable surge of 46.7 percent largely driven by exports quantities, which outweighed the decline in prices.

Non-traditional exports[2] continue to show strength, rising by 14.5 percent in 2023Q2. This growth can be primarily attributed to the increased exports of different manufactured goods, such as agro-processed goods and cement, which reflects the positive performance of domestic manufacturing activities and steady regional demand. Furthermore, receipts from re-exported products also saw a modest increase of 1.6 percent year-on-year. This rise was

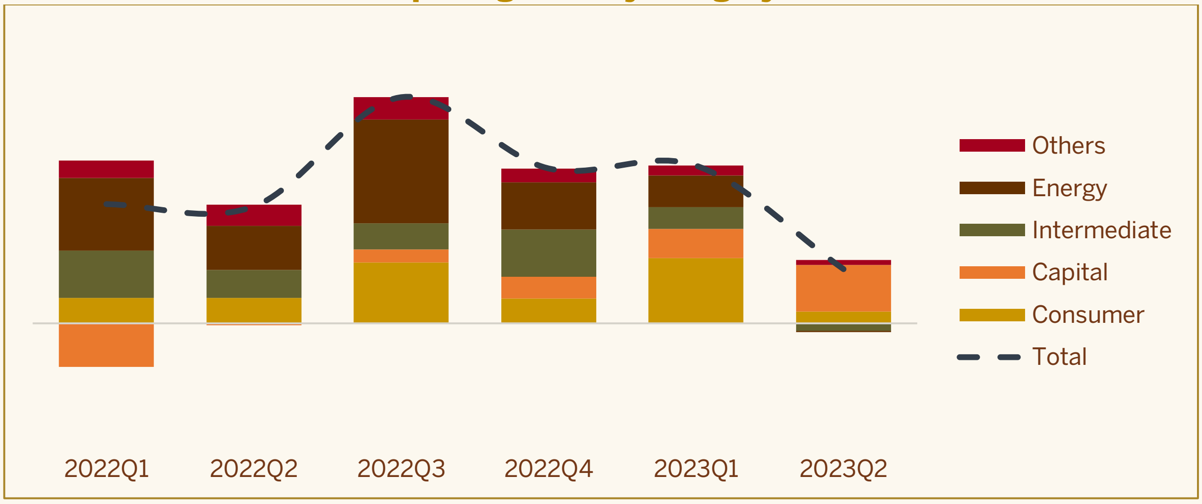
[2] Non-traditional exports refer to domestic exports other than those in traditional exports (coffee, tea, minerals, hides and skins and pyrethrum).

driven by higher revenues from non-fuel products, most especially food products. Lastly, export revenues from Informal Cross-Border Trade (ICBT) experienced significant growth, increasing by 16 percent in 2023Q2. This significant increase reflects the resumption of cross-border movements after the Covid-19 pandemic.

The growth in imports is attributable to the increasing trend in capital goods.
Similarly, there was a notable increase in merchandise imports by 9.9 percent during 2023Q2. This rise can be mainly attributed to a significant uptick of 44.5 percent in capital goods volume, indicating a surge in investment projects.

Besides, food imports remained high due to the underperformance of the agriculture sector, which was exacerbated by floods and compounded by robust domestic demand. Specifically, the food import bill increased by 23 percent, primarily driven by elevated imports of food products like cereals, vegetables, fruits, spices, and sugar. In contrast, intermediate goods imports experienced a decline of 4.8 percent, driven by lower imports of industrial products, which outweighed the increase in construction materials that recorded an increase of 29.7 percent, reflecting a boost in construction activities. As a result, Rwanda's merchandise trade deficit expanded by 12.7 percent in 2023Q2 compared to the same period of 2022.

Chart 12: Contribution to imports growth by category



Source: Statistics department, BNR

The external sector outlook is projected to worsen in 2023 before improving in 2024. The current account deficit is projected to widen to 11.3 percent of GDP, largely driven by expanding goods deficit as imports are projected to remain high to support the improving domestic economy and post-flood reconstruction activities. Besides, merchandise export growth is expected to slow down from the recent peaks, due to decreasing traditional commodity prices. The increase in the goods deficit will be lessened by a continued strong recovery of service exports, largely driven by travel and air transport. Furthermore, remittances will continue to flow in, thanks to improving economic conditions in countries hosting Rwanda's diaspora and the ease of remitting money.

On the financing side, the CAD will continue to be financed by government borrowings as well as private inflows, mostly Foreign Direct Investment (FDI). The steady inflows from FDI will be attributable to stable macroeconomic conditions and a continued good investment climate. The international gross official reserves will continue to be adequate to caution for external shocks, covering more than 4 months of prospectives imports of goods and services.

Higher nominal depreciation and declining domestic inflation led to slower appreciation of the franc in real effective terms.

In 2023Q2, the franc remained weak reflecting widening current account deficit and the dollar shortage on slowing external financing. The budgetary support which represents a big share of foreign inflows was subdued on average in the first six months of 2023 compared to the same period last year, respectively 29 percent after 40 percent. Similarly, higher international commodity prices continued to drive up the import bill, and the dollar remained strong against most currencies following the Federal Reserve's more tight policy moves. On an annual basis, the FRW depreciated by 13.67 percent in 2023Q2 faster than 8.35 percent recorded in the previous quarter.

Table 2: Appreciation/Depreciation rate of FRW against selected currencies (end period, y-o-y)

	FRW/USD	FRW/GBP	FRW/EUR	FRW/JPY	FRW/KES	FRW/TZS	FRW/UGX	FRW/BIF
Dec-18	4.04	-1.96	-0.07	6.20	5.46	1.24	1.77	1.93
Dec-19	4.94	8.48	2.81	6.25	4.53	3.73	5.13	-0.24
Dec-20	5.42	9.42	15.71	11.43	-1.34	5.66	7.17	2.53
Dec-21	3.82	2.94	-4.39	-6.96	0.24	4.78	6.85	1.00
Dec-22	6.05	-5.30	-0.04	-7.90	-2.80	4.47	1.17	2.03
Jun-23	13.67	18.24	18.12	7.24	-4.73	9.70	16.67	-17.20

Source: NBR, Monetary Policy Department

Relative to regional currencies, the FRW continued to gain against the KES and BIF. Insufficient dollar supply has dragged the value of the Kenya shilling, adding to pressures from significantly large current account deficit and rising dollar demand especially from energy sector. According to the International Monetary Fund, Kenya is expected to face foreign exchange pressures until the year 2026. The BIF depreciated quickly, affected by the latest decision by the Central Bank to adjust the official rate to the market rate. In contrast, the Rwandan franc remained weak versus the Tanzanian and the Ugandan shillings. The UGS was boosted by increased dollar inflows from remittances, offshore portfolio investments, inflows from non-government organizations, as well as foreign direct investments, especially in oil and gas.

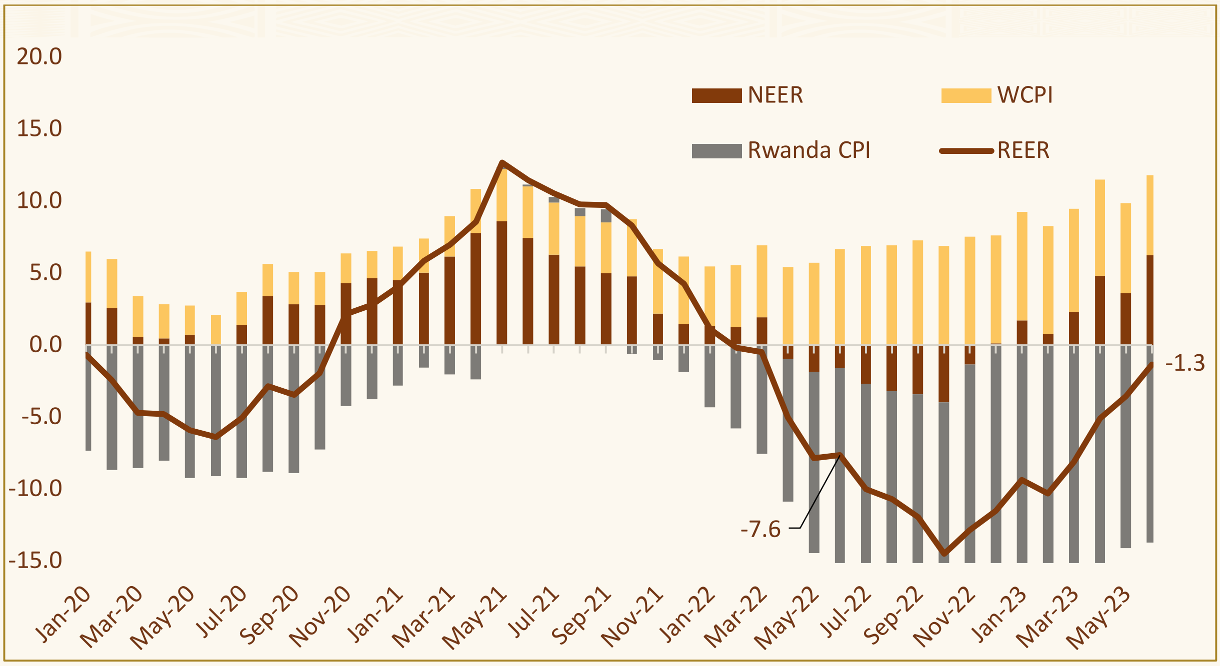
In 2023Q2, the Rwandan Franc appreciated by 4.73 percent vis-à-vis the KES from an appreciation of 5.90 percent in the 2023Q1. Similarly, the FRW gained by 17.20 percent vis-à-vis the BIF, against a depreciation of 6.79 percent the previous quarter. The Franc weakened by 9.70 and 16.67 percent versus the TZS and UGS, faster than 7.34 percent and 2.90 percent depreciation in 2023Q1 respectively.

The foreign exchange shortage in the FX market prompted the NBR to intervene in the foreign exchange markets to limit the high volatility and speculation. Foreign exchange sales to banks amounted at $149 million in the first six months of 2023 compared to $128 million in the corresponding period of the previous year.

In the medium term, the franc is foreseen to remain stable as the country has adequate reserve buffers. As of end June 2023, the level of international reserves was equivalent to 4.4 months of prospective imports of goods and services, well above the NBR benchmark.

In nominal effective terms, the FRW depreciated faster against the weighted currencies of trading partners. As of end June 2023, the franc lost 6.3 percent year-on-year against 2.3 percent depreciation end March 2023. In real terms, the franc appreciated by 1.3 percent as high domestic inflation continues to outpace the combined effect of the weighted foreign inflation and the nominal effective depreciation. This franc appreciation was however slower than 8.1 percent appreciation recorded end March 2023.

Chart 13: Drivers of REER movement



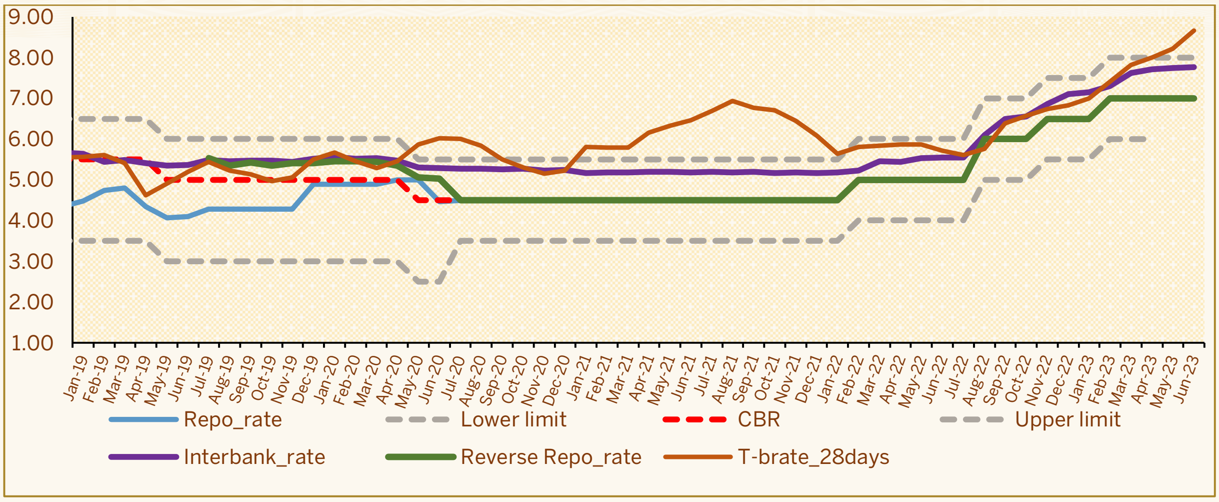
Source: NBR, Monetary Policy and Research Directorate

With an appreciation of the real effective exchange rate, domestic products remain less competitive compared to foreign goods.

II.4. Domestic Credit Conditions

The Monetary Policy Committee (MPC) meeting held on February 14th, 2023, raised the Central Bank Rate (CBR) by 50 basis points to 7 percent, in addition to the 150 basis points increase that occurred in the August and November 2022 MPC rounds. This aimed to fight against inflationary pressures affecting consumers' purchasing power. Consequently, money market rates were steered around the central bank rate, and the interbank rate increased by 223 basis points to 7.74 percent on average in 2023Q2 from 5.51 percent in 2022Q2.

Chart 14: Money market rates developments

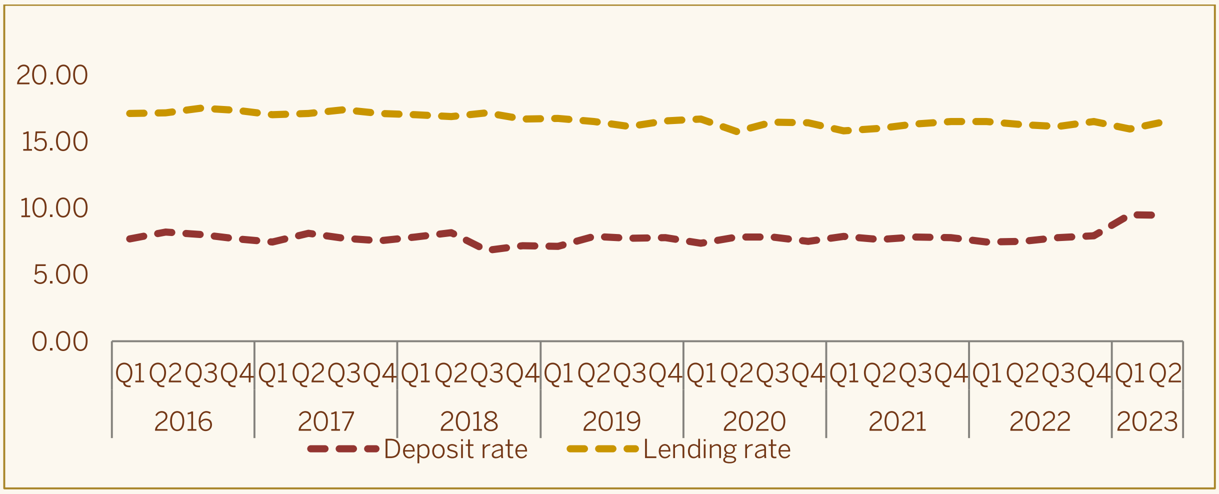


Source: NBR, Monetary Policy Department

The cost of bank lending has risen in 2023Q2. The lending rate on new debt rose by 23 basis points, to 16.54 percent in 2023Q2 compared to same period of 2022. This resulted from an increased share of large loans with short-term maturity, which are priced at higher rates.

During the same period, the deposit rate increased by 195 basis points to 9.46 percent in 2023Q2 compared to 2022Q2, which was a result of an increased share of long-term deposits and the effect of big depositors pricing.

Chart 15: Market interest rates (percent average)

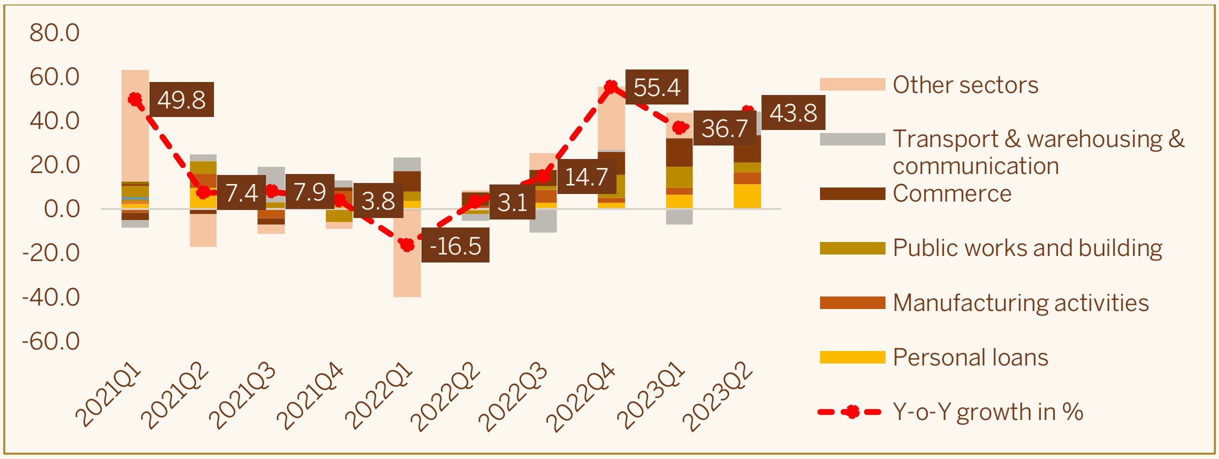


Source: NBR, Monetary Policy Department

The outstanding credit to the private sector's growth decelerated to 13.2 percent in 2023Q2 compared to the growth of 16.5 percent in 2022Q2, reflecting the current tight monetary policy stance.

In 2023Q2, credit to private sector increased by 13.2 percent, lower than the 16.5 percent growth observed during the same period in 2022. Newly Authorized loans (NALs) significantly increased to 43.8 percent in the second quarter of 2023, compared to a growth of 3.1 percent recorded in the same period of the year before. NALs increase for 2023Q2 is mostly seen in four industries: manufacturing, public works and buildings, personal loans, and trade. In a similar vein, on quarter on quarter, NALs rose by 17,6 percent in 2023Q2 compared to a drop of 14.7 percent in 2023Q1.

Chart 16: Contributions of sectors to the change in NALs (Y-o-Y % changes)



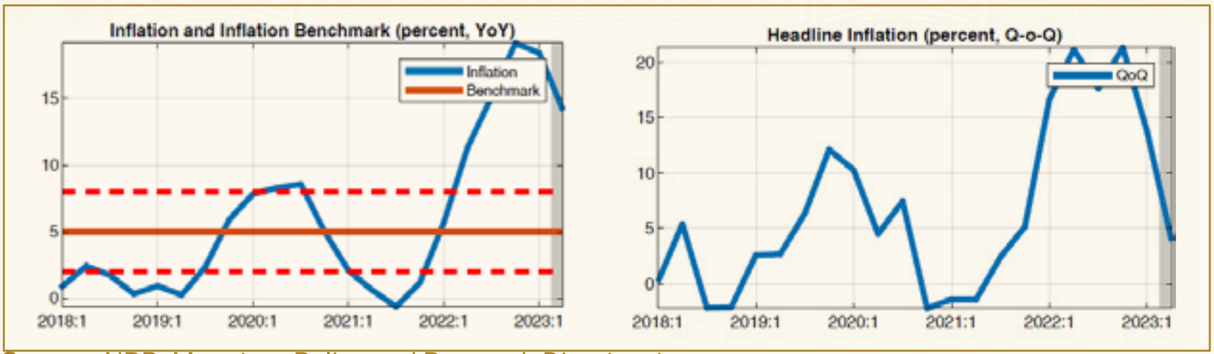
Source: NBR, Monetary Policy Department.

II.5: Prices developments

Headline inflation dropped in 2023Q2, reflecting a decline recorded in the core, fresh food, and energy inflation.

In 2023Q2, headline inflation (y-o-y) dropped to 15.2 percent from 20.2 percent recorded in the previous quarter. The deceleration in headline inflation reflects the decreases in its key components that happened over the same period. Core inflation (y-o-y) decelerated to 9.7 percent in 2023Q2 from 13.9 percent recorded in 2023Q1, reflecting a decline in core food, core housing and core transport inflation. Fresh food inflation decreased to 40.4 percent from 48.8 percent in 2023Q1 from improved food supply, mainly for fresh vegetables and fruits. Similarly, energy inflation decreased to 5.1 percent in 2023Q2 from 13.6 percent recorded in 2023Q1 due to a decline in pressures coming from liquid and solid fuels.

Chart 17: Developments in headline inflation (y-o-y & q-o-q)



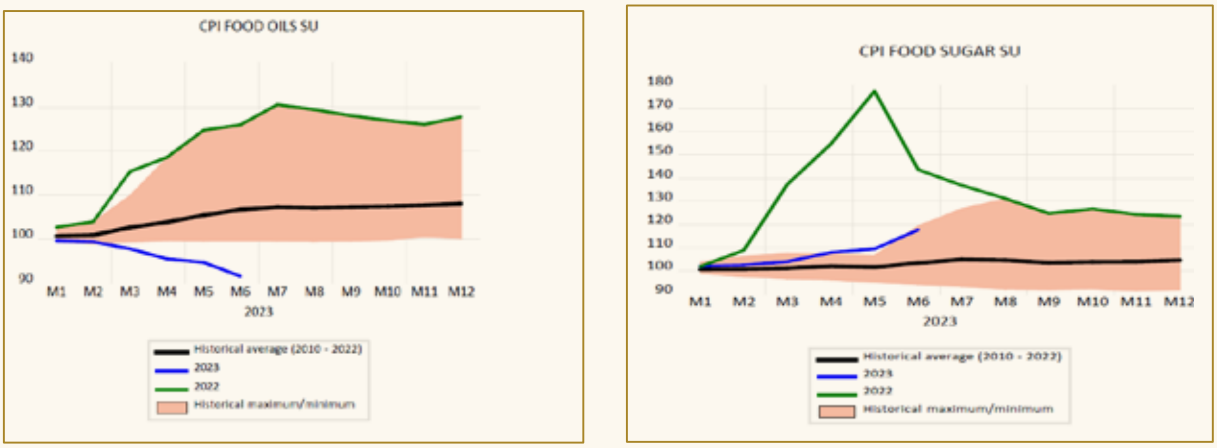
Source: NBR, Monetary Policy and Research Directorate

Core inflation is easing, following the deceleration observed in imported and domestic costs of production.

The decline observed in core inflation stems from a slowdown in core foods inflation (from 29.0 percent to 14.4 percent), core transport (from 9.8 percent to 6.7 percent), and core housing (from 5.0 percent to 3.1 percent) inflation. The deceleration in core food inflation reflects the ample global supplies, mainly cereals and cooking oils.

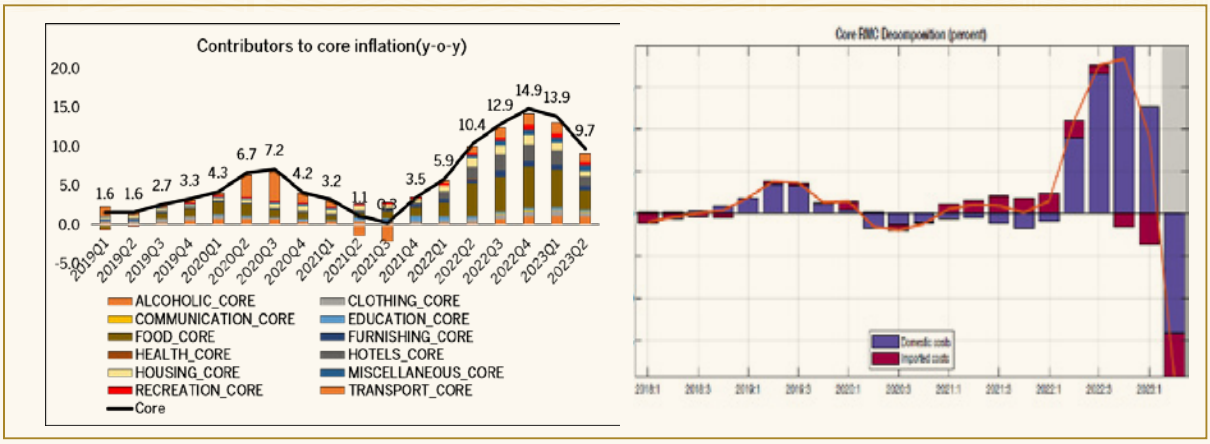
Over the same period, the deceleration in core housing inflation resulted from the decrease recorded in price pressures for housing maintenance (services and materials), while the decrease in core transport reflected the base effect of higher prices recorded last year the same quarter.

Chart 18: Evolution in consumer price indices of some core food items



Source: NBR, Monetary Policy and Research Directorate

Chart 19: Core inflation (percentage change)

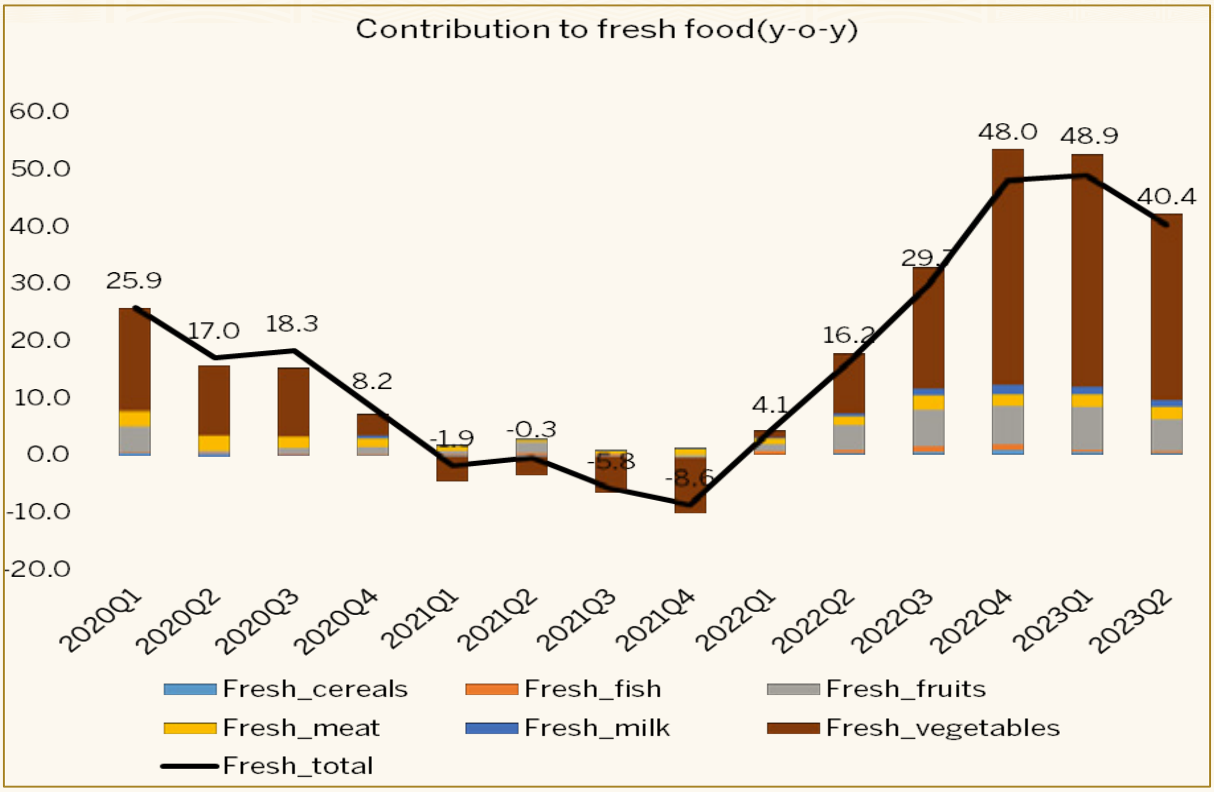


Source: NBR, Monetary Policy and Research Directorate

Fresh food inflation dropped on the back of improved supply in the domestic markets.

The decrease in fresh foods inflation for 2023Q2 resulted from a deceleration in fresh vegetables and fresh fruits inflation that reduced from 74.5 percent to 59.5 percent and from 35.4 percent to 25.4 percent, respectively. Fresh vegetable inflation decelerated on the back of a good supply of fresh foods, such as fresh beans, Irish potatoes, and sweet potatoes, consistent with the harvesting period of agriculture season B and the prices regulations applied specifically on Irish potatoes and maize grain. The slowdown in fresh fruit inflation observed in 2023Q2 reflects a deceleration in cooking banana and groundnuts (peanut &flour) prices, reflecting a good supply that resulted from improved domestic and imports of fresh fruits products, coupled with a base effect of higher prices recorded in fruits inflation last year the corresponding period.

Chart-20: Contributors to fresh foods inflation (y-o-y)

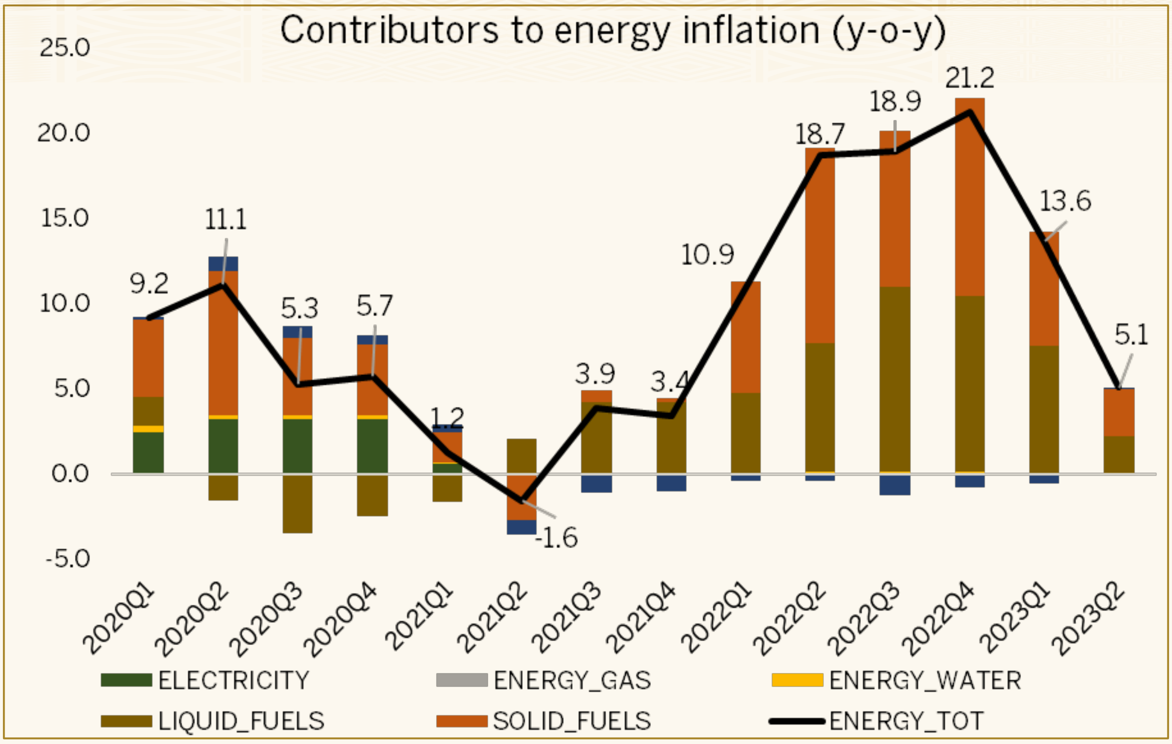


Source: NBR, Monetary Policy and Research Directorate

In 2023Q2, energy inflation slowed down, reflecting the deceleration recorded in both liquid and solid fuels inflation.

In 2023Q2, energy inflation (y-o-y) dropped to 5.1 percent from 13.6 percent recorded in the previous quarter. Liquid fuels inflation decelerated to 8.5 percent from 29.4 percent, reflecting the downward revision in local pump prices as international oil prices were at a declining trend. Similarly, solid fuels inflation decelerated to 5.4 percent from 13.0 percent, as a result of the declines in firewood prices, coupled with the base effect.

Chart-21: Contributors to energy inflation (y-o-y)

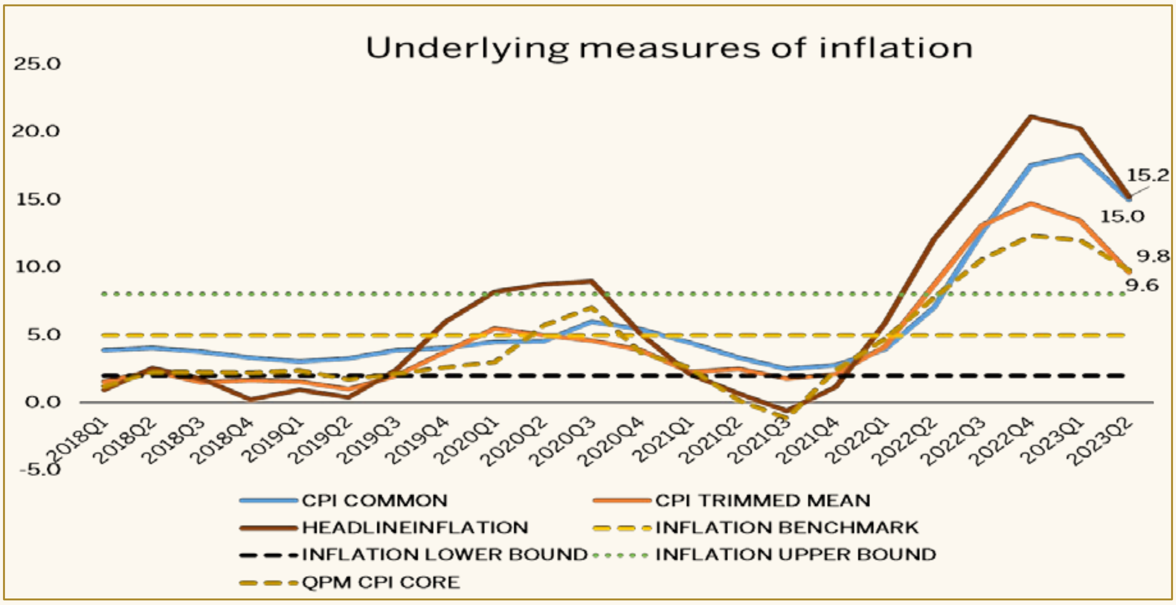


Source: NBR, Monetary Policy and Research Directorate

***Underlying inflation measures indicate a broad-based decrease in inflation*.**

In line with the near-term projections done in the May 2023 MPC forecasting round, underlying measures of inflation reduced in 2023Q2 on the back of the developments recorded in both domestic and international economies. Consumer Price Indice (CPI) Trimmed mean decreased to 9.6 percent in 2023Q2 from 13.4 percent recorded in 2023Q1, Consumer Price Indice (CPI) Common decreased to 15.0 percent in 2023Q2 from 18.3 percent in 2023Q1, while Consumer Price Indice (CPI) core (excluding food and energy) eased to 9.8 percent in 2023Q2 from 12.0 percent in 2023Q1 resulting from a decrease noted in core housing and core transport inflation.

Chart 22: Indicators of underlying inflation vs headline inflation (y-o-y)



Source: NBR, Monetary Policy and Research Directorate

III. INFLATION OUTLOOK

Forecast assumptions

The global growth projection indicates a decrease from an estimated 3.5 percent in 2022 to 3.0 percent in 2023 and 2024. Although the July 2023 forecast is slightly higher than the April 2023 WEO projections, the global economy over the medium term remains subdued compared to the historical trends due to tightening monetary policy cycles adopted by several central banks.

The updated projection in July 2023 is 0.2 percentage points higher than the growth projected in April 2023. However, there was no change in the forecast for 2024. Despite this upgrade, the projected growth for 2023-24 remains significantly below the historical average of 3.8 percent recorded from 2000 to 2019, reflecting weaker manufacturing and idiosyncratic factors that outweigh more robust services activity.
Although there have been some positive developments in the aftermath of the Covid-19 pandemic, it is worth noting that the global economy will remain below the potential levels. As a result, the global economic impact on Rwanda will remain non-inflationary over the policy horizon.

Global inflation and international food prices are expected to decline over the policy horizon, exerting reduced pressures on imported inflation.

Global headline inflation is expected to decrease from an average of 8.7 percent in 2022 to 6.8 percent in 2023 and further decline to 5.2 percent in 2024. These projections broadly align with the forecasts made in April. However, it is important to note that the expected inflation rates will remain higher than the pre-pandemic levels observed during 2017-2019, which were around 3.5 percent.

Since the start of 2023, inflation rates declined following the ease in both domestic and global cost of production, resulting from tightening monetary policy and a slowdown in global economic recovery. Global inflation is expected to slow down, with a projected rate of 6.8 percent in 2023, down from 8.7 percent in 2022. The trend is expected to continue in 2024, supported by lower international commodity prices and tighter monetary policy. Though core inflation is expected to remain high due to the impact of the war in Ukraine and the recent suspension of the Black Sea Grain Initiative, it is expected to gradually ease over the medium term. In advanced economies such as the USA and Eurozone, headline inflation is expected to be closer to the target levels towards the beginning of 2025.

Over the policy horizon, international food and energy prices are projected to decline gradually, unlike April 2023 projections, exerting mild pressures on imported inflation. Energy inflation is projected to remain relatively stable at its current levels, following the expected gradual decline in both international oil prices and domestic costs of production.

During the same period, food prices are projected to slow down and will likely evolve to a single digit in early 2024, resulting from eased pressures from agricultural production and domestic costs of production.

In accordance with the current projected path in global inflation and reduced demand for international commodities over the medium term, pressures on imported prices are projected to reduce slightly, thereby alleviating the pressure on domestic inflation. Despite the projected easing trend in global food and energy prices, prices will remain high though they are projected to evolve below the levels recorded in 2022.

Drivers of inflation projections

The path and magnitude of August 2023 inflation projections are driven by both domestic and imported costs of production. In the near term, domestic costs of production though it will be at its declining trend, will put mild pressures on core inflation but become neutral over the policy horizon. The expected easing trend in domestic costs of production in the medium term will reflect the tightening monetary conditions and a non-supportive global economy.

The current projections of core inflation indicate that imported costs of production will remain inflationary, exerting pressures on core inflation from 2024H2.

Over the medium term, energy inflation is expected to stabilize and remain at the current levels. High cost pressures on energy prices that pushed up energy inflation in 2022 have eased in the last three quarters and are projected to be neutral on the back of low pressures from domestic costs of production and international oil prices.

Food inflation (including processed food and beverages) is projected to slow down and will likely evolve to a single digit in early 2024, reflecting expected easing pressures from both domestic agricultural production as it normalizes, the expected downward from domestic costs of production coupled with the projected gradual decline in the international food prices.

Baseline projections of key macroeconomic indicators

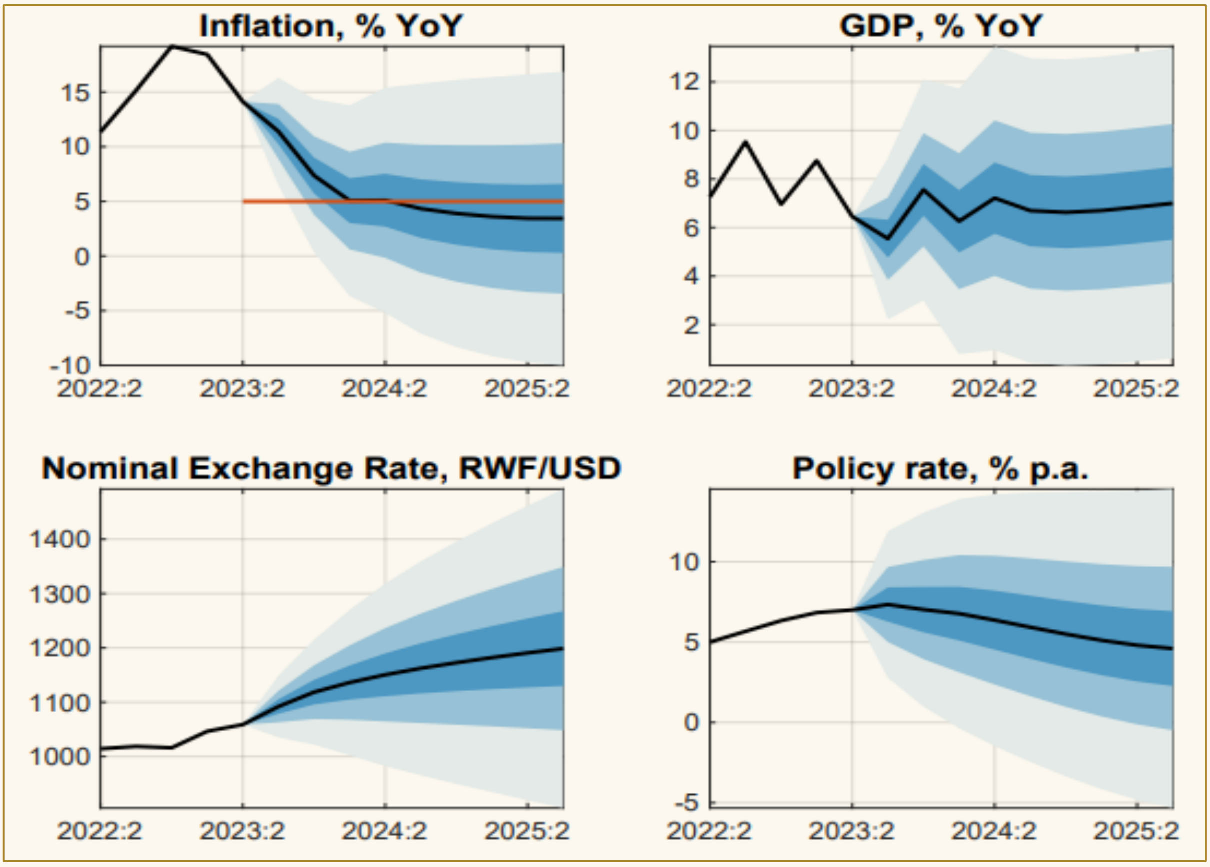
The August 2023 MPC headline inflation projection for 2023 remains unchanged from the May 2023 MPC round projection, but the current forecast noticed the upward pressures from import costs that are expected to affect core inflation. Thus, the inflation projections for 2024 were revised upward, unlike the previous forecasts.

In line with the recent domestic economic developments, assumptions on the global economy, and other macroeconomic variables, headline inflation is projected to average 13.9 percent in 2023 and 4.7 percent in 2024.

Core inflation will slightly decelerate in 2023 before picking up (but will remain within the benchmark band) over the policy horizon. These pressures on core inflation will result mainly from imported costs from the expected developments in the global and domestic economies.

Unlike core inflation, pressures on food inflation are projected to slow down following the expected gradual deceleration in international food prices as global demand reduces and domestic agricultural production normalizes. Similarly, energy inflation is anticipated to ease due to the expected drop in domestic costs of production,

The figure below presents the projections for key domestic macroeconomic variables over the policy horizon.



Source: NBR, Monetary Policy, and Research Directorate

Risks to the baseline projections

The projections above are entitled to risks that include international economic developments, such as the end of the grain deal that will impact imported food prices. Additionally, there is a possible impact on global oil prices from the cuts in oil supply by OPEC and Saudi Arabia. Consistent with the current pressures on domestic agricultural food production cycles, weather conditions on agricultural production are likely to continue posing risks to food inflation. Similarly, the prevailing appreciation of the US dollar versus FRWs is projected to exert pressures imported inflation.

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