National Bank of Rwanda

Banki Nkuru y'u Rwanda

MONETARY POLICY REPORT

November 2019

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I. GLOBAL ECONOMIC AND FINANCIAL DEVELOPMENTS

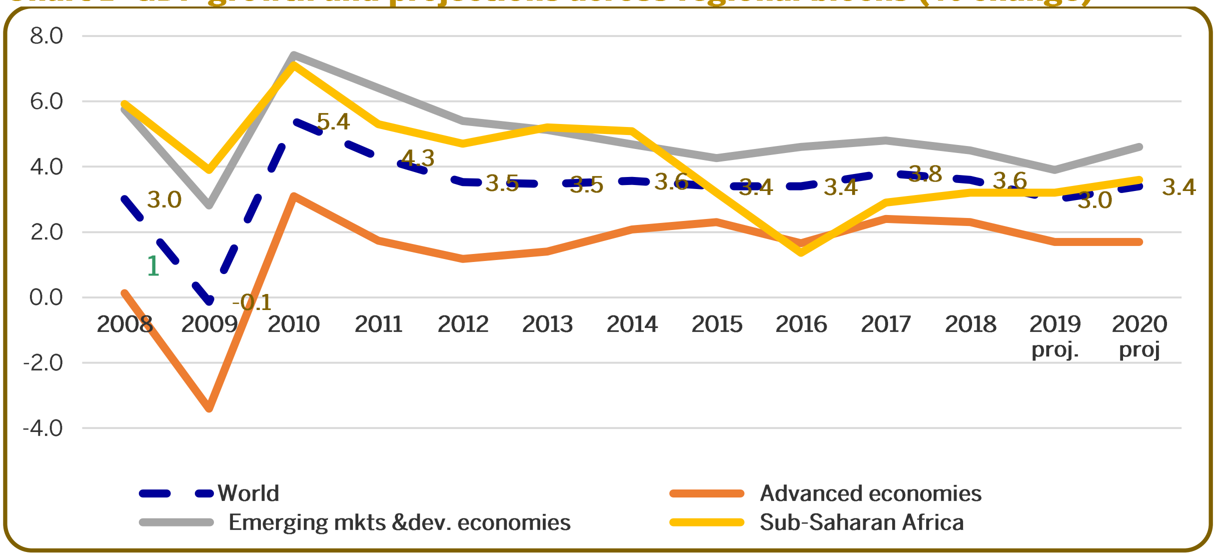
1.1 Economic Growth

According to the IMF's October 2019 estimates, global growth is projected to slow down from 3.6 percent in 2018 to 3.0 percent in 2019 (revised down by 0.2 percentage point relative to July WEO update). The projected global growth for 2019 is the weakest growth since 2009. Apart from Sub-Saharan Africa, more than half of countries are expected to register per capita growth lower than their median rate during the past 25 years. The marked deceleration reflects carryover from broad-based weakness in the second half of 2018, followed by a mild growth uptick in the first half of 2019.

Continued macroeconomic policy support in major economies and projected stabilization in some stressed emerging market economies are expected to lift global growth modestly over the remainder of this year and into next year, bringing projected global growth to 3.4 percent in 2020.

Growth in advanced economies stabilized in the first half of 2019, after a sharp decline in the second half of 2018. In 2019, growth is projected to soften to 1.7 percent (0.2 percentage point lower than in July 2019 WEO update), mostly reflecting downward revision for all major advanced economies (United States and Euro Area). Real GDP growth is projected to remain at 1.7 percent in 2020.

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



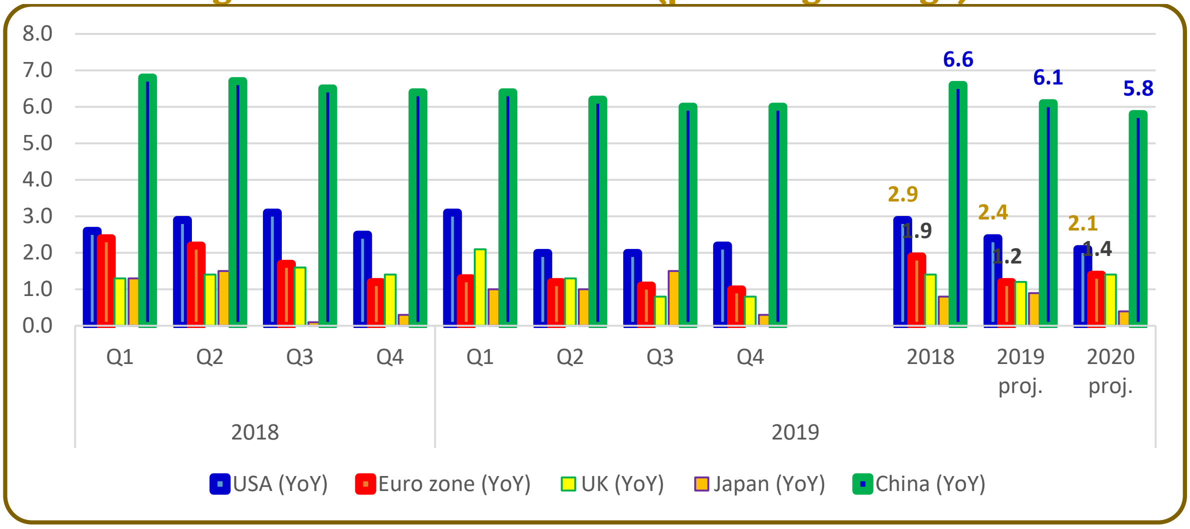
Source: IMF, WEO, October 2019

In 2019Q3, the US economy grew by 1.9 percent (y-o-y), after 2.0 percent in 2019Q2 and 3.1 percent in 2019Q1; reflecting positive contributions from personal consumption expenditures, government spending, residential fixed investment, and exports that were partly offset by negative contributions from nonresidential fixed investment and private inventory investment. The US economy maintained momentum in the first half of this year. Growth in 2019 is projected at 2.4 percent (0.2 percentage point lower than in July 2019 WEO update). The projected moderation reflects an assumed shift in the fiscal stance from expansionary in 2019 on broadly neutral in 2020 as stimulus from the recently adopted two-year budget deal offsets the fading effects of the 2017 tax cuts and jobs act.

GDP growth in the Euro Area decelerated to 1.1 percent in 2019Q2, after growing by 1.2 percent in 2019Q1, and projected to stabilize at 1.1 percent in 2019Q3. Weaker growth in foreign demand and a drawdown of inventories (reflecting weak industrial production) have kept a lid on growth since mid-2018. The Eurozone registered strong growth in the first half of 2019 than in the second half of 2018, but the Germany economy contracted in 2019Q2 as industrial activity slumped. Growth is projected at 1.2 percent in 2019 (0.1 percentage point lower than in July 2019 WEO update) and 1.4 percent in 2020. The 2019 forecast is revised down slightly for France and Germany (due to weaker-than-expected external demand in the first half of the year). The outlook is also slightly weaker for Spain, with growth projected to slow gradually from 2.6 percent in 2018 to 2.2 percent in 2019 and 1.8 percent in 2020.

Real GDP in the United Kingdom decelerated to 1.2 percent in 2019Q2 from 1.8 percent in 2019Q1, following a contraction in the second quarter compared to the previous quarter, dropping by 0.2 percent (q-o-q) after growing by 0.5 percent in the previous quarter. The economy slowed with investment held back by Brexit-related uncertainty. The UK's economy is set to grow by 1.2 percent in 2019 and 1.4 percent in 2020. The 0.1 percentage point lower projection for 2019 and unchanged projection for 2020 (relative to the July 2019 WEO update) reflects the combination of a negative impact from weaker global growth and ongoing Brexit uncertainty and a positive impact from higher public spending announced in the recent spending review. The economy contracted in the second quarter, and recent indicators point to weak growth in the third quarter. The forecast assumes an orderly exit from the European Union followed by a gradual transition to the new regime. However, as of early September, the final decision on Brexit remains highly uncertain.

Chart 2- GDP growth in selected countries (percentage change)



Source: BLOOMBERG and IMF, WEO, October 2019

Japan's economy posted strong growth in the first half of 2019, driven by robust private and public consumption. The economy is set to grow by 0.9 percent in 2019 (unchanged relative to the July 2019 WEO update). Strong private consumption and public spending in the first half of 2019 outweighed continued weakness in the external sector. Growth is projected at 0.5 percent in 2020 (0.1 percentage point higher than anticipated in the July 2019 WEO update), with temporary fiscal measures expected to cushion part of the anticipated decline in private consumption following October 2019 increase in the consumption tax rate.

In emerging market and developing economies, preliminary data suggest a modest pickup in the first half of 2019, but well below its early 2018. Growth is expected to slow down to 3.9 percent in 2019 (0.2 percentage point lower than in July 2019 update), before improving to 4.6 percent in 2020 (0.1 percentage point lower than in July update), reflecting slowdown revision in all major regions, except emerging and developing Europe.

In China, the effects of escalating tariffs and weakening external demand have exacerbated the slowdown associated with needed regulatory strengthening to rein in the accumulation of debt. The Chinese economy grew by 6.0 percent in 2019Q3; lower than 6.2 percent in 2019Q2, and 6.4 percent in 2019Q1, slowing more than expected and its weakest pace in almost three decades as the bruising US trade war hit factory production. With policy stimulus expected to continue supporting activity in the face of the adverse external shock, growth is set at 6.1 percent in 2019 and 5.8 percent in 2020 (0.1 percentage point and 0.2 percentage point lower than in July 2019 WEO update). China's trading partners and investors are closely watching the health of the World's second-largest economy as the trade war with the US fuels fears about a global recession.

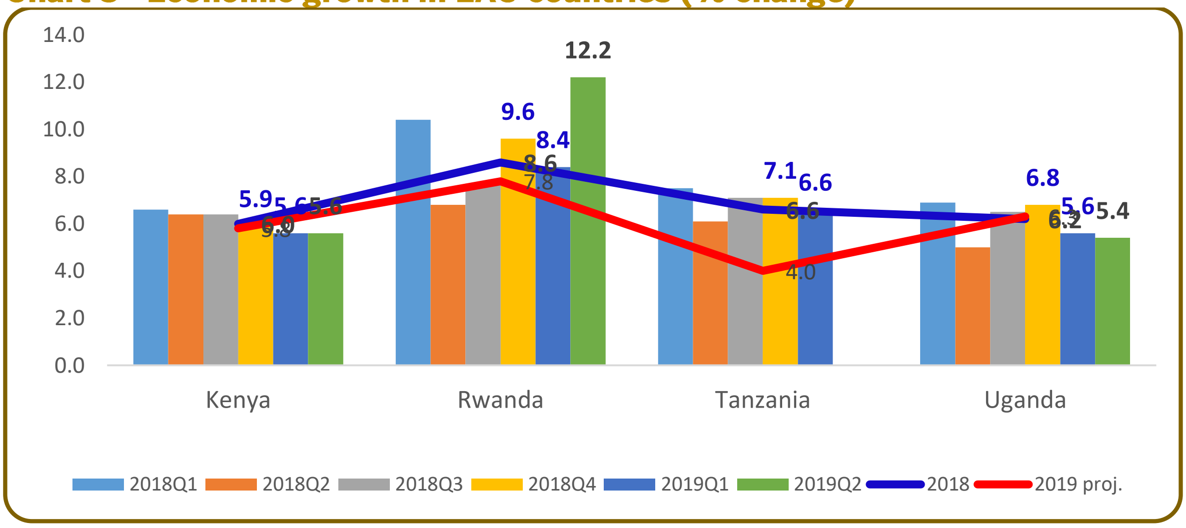
India's economy decelerated further in 2019Q2, held back by sector-specific weaknesses in the automobile sector and real estate, as well as persistent uncertainty about the health of nonbank financial companies. India's economy is set to grow by 6.1 percent in 2019, picking up to 7.0 percent in 2020. The downward revision relative to the July 2019 WEO update of 0.9 percentage points for 2019 and 0.2 percentage points for 2020 reflects a weaker-than-expected outlook for domestic demand. The lagged effects of monetary policy easing, a reduction in corporate income tax rates, recent measures to address corporate and environmental regulatory uncertainty, and government programs to support rural consumption, will support growth.

In Sub-Saharan Africa, growth is projected to remain at 3.2 percent in 2019 (0.2 percentage point lower than the July 2019 WEO update), and rise to 3.6 percent in 2020. Growth is forecast to be lower than previously envisage for about two-thirds of the countries in the region. The downward revision reflects more challenging external environment, continued output disruptions in oil-exporting countries, and weaker –than-anticipated growth in South Africa.

In South Africa, despite a moderate rebound in the second quarter, growth is expected to be weaker in 2019 than projected in April 2019 WEO following a very weak first quarter, reflecting a larger-than-anticipated impact of labor strikes and energy supply issues in mining, together with weak agricultural production.

The economic performance in the East Africa Community countries (EAC) in the second quarter of 2019, on average, was higher compared to the second quarter of the previous year. Real GDP growth is projected at 5.6 percent in 2019 after 6.5 percent in 2018, following projected slowdown for some EAC countries compared to the previous year, including Tanzania, Kenya, and Rwanda.

Chart 3 - Economic growth in EAC countries (% change)



Source: IMF, WEO October 2019 & Country Bureau of Statistics websites

Kenya's real GDP decelerated from 6.4 percent in 2019Q1 to 5.6 percent in 2019Q2, mostly due to a slowdown in activities of agriculture, manufacturing, and transportation. Agriculture's performance was mostly hampered by a delay in the start of the long rains, while the transportation industry was negatively impacted by a rise in prices of fuel. Economic growth is projected at 5.6 percent in 2019, from 6.3 percent recorded in 2018. Downside risks include; fiscal consolidation in 2019, while upside risks include; policies to achieve the fiscal deficit target of 6 percent of GDP in 2018/19 and 2019/2020, policies to support higher credit growth to the private sector, structural reforms aiming to ensure the sustainability of investment-driven, inclusive growth.

Rwanda's economy grew by 12.2 percent in 2019Q2 up from 8.4 percent in 2019Q1, and project to grow at 8.5 percent in 2019. The economic outlook is subjected to balanced risks, where potential downside risks include; variable weather/climatic change, and commodity price movements, while upside risks to growth include; acceleration of several large public and private ongoing projects (including peat power plant, tin smelting factory, new energy distribution substitutions and construction of new special economic zones) as well as their potential impact on productivity, and enhanced regional trade ties.

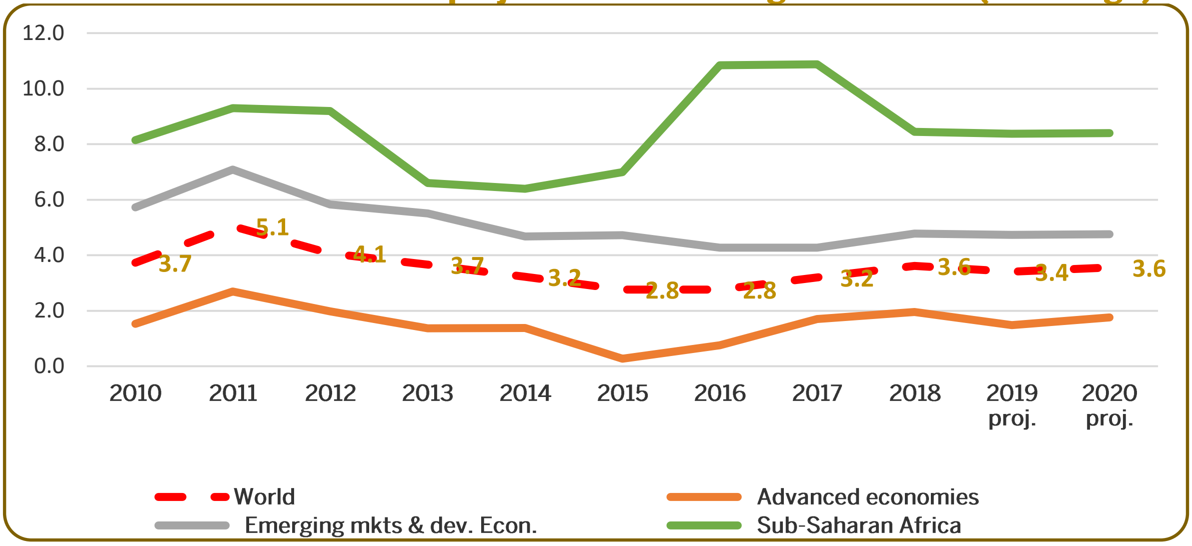
In Uganda, GDP growth stood at 5.4 percent in 2019Q2 from 5.6 percent in 2019Q1, attributed mainly to agriculture sector (+4.5 percent), mainly due to an increase in food and cash crops (+4.4 percent and 9.2 percent, respectively). The economy is expected to grow at 6.2 percent in 2019, with growth close to potential, supported by improved agricultural production, strong pick up in private investment and consumption, as well as public investment, particularly in preparation for future oil production. Risks to the outlook are tilted to the downside, including from weather-related shocks, shocks from the global economic environment, and the political and security situation in the run-up to the 2021 general elections.

Tanzania's economic growth stood at 6.6 percent in 2019Q1 from 6.3 percent in 2018Q4, and projected at 5.2 percent in 2019. In Burundi, growth is projected to remain subdued at 0.4 percent in 2019 from 0.1 percent in 2018.

1.2 Inflation Developments

World annual average inflation is projected at 3.4 percent in 2019 and 3.5 percent in 2020, from 3.6 percent in 2018, in line with falling commodity prices and softening global demand. As the global expansion has weakened, core inflation across advanced economies has fell further below the target and below historical averages in many emerging market and developing economies. Consistent with the softening of energy prices and the moderation in growth, consumer price inflation is expected to average 1.5 percent in 2019 in advanced economies, down from 2.0 percent in 2018.

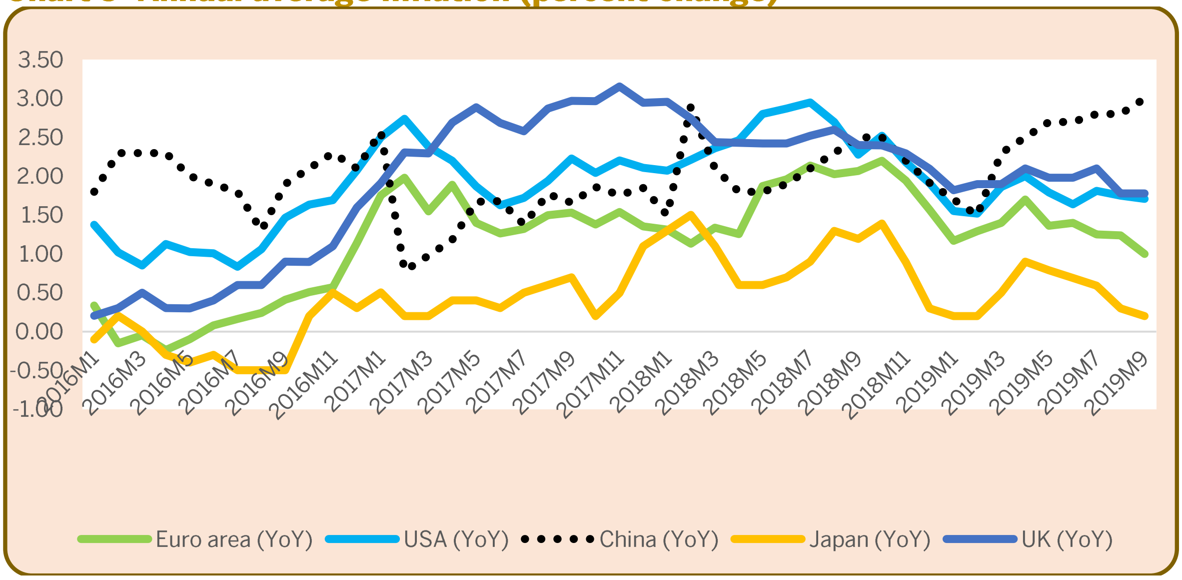
Chart 4- Global inflation and projections across regional blocks (% change)



Source: IMF, WEO, October 2019

Inflation in the emerging market and developing economies excluding Venezuela is expected to edge down to 4.7 percent in 2019 from 4.8 percent in 2018. Exceptions include China, in part, due to rising pork prices, and Argentina, where inflation has increased on the back of the peso depreciation. In Sub-Saharan Africa, annual average inflation is projected to ease to 8.4 percent in 2019 from 8.5 percent in 2018, reflecting a large decline in global energy prices.

Chart 5- Annual average Inflation (percent change)



Source: National statistics offices

The US annual average inflation was at 1.7 percent in September 2019, unchanged from the previous month, slightly below market expectations of 1.8 percent, as pick up in food inflation was offset by a further decline in energy prices. Core inflation rate was at 2.4 percent, in line with market expectations. The annual average inflation eased to 1.76 percent in 2019Q3, from 1.81 percent in 2019Q2, and projected at 1.8 percent in 2019 down from 2.4 percent in 2018. With the US economy operating above potential, core consumer price inflation is projected at about 2.6 percent in 2020-2021, above its medium-term of 2.2 percent (the level consistent with medium-term target of 2.0 percent for personal consumption expenditure inflation).

The annual inflation rate in the Eurozone dropped to 0.8 percent in September 2019 from 1.2 percent in the previous month, due to further falling of energy prices. The highest annual inflation rate was recorded in France (1.1 percent), followed by Germany (0.9 percent), Italy (0.2 percent), and Spain (0.2 percent). The annual core inflation, at which the ECB looks in its policy decisions, was at 1.0 percent, after a 0.9 percent in the previous month. The annual average inflation eased to 1.16 percent in 2019Q3, from 1.49 percent in 2019Q2, and projected at 1.2 percent in 2019 down from 1.8 percent in 2018. However, headline inflation is expected to rise gradually, from 1.2 percent in 2019 to 1.4 percent in 2020.

The annual inflation rate in the United Kingdom was at 1.7 percent in September 2019, unchanged from the previous month, amid slowdown in transport, as fuel prices dropped the most since August 2016. The annual core inflation rate went up to 1.7 percent in September 2019 from 1.5 percent in the previous month. The annual average inflation eased to 1.89 percent in 2019Q3, from 2.02 percent in 2019Q2, and projected at 1.8 percent in 2019 down from 2.5 percent in 2018.

Japan's annual inflation slightly rose to 0.2 percent in September 2019, from 0.3 percent in the previous month, amid further fall in transport and communication prices. This raises the chances of further stimulus after the Bank of Japan decided to leave policy unchanged during its September meeting but left the window wide open for easing, calling for a review of prices and the economy in October 2019. The annual core inflation stood at 0.3 percent, easing from a 0.5 percent increase in the previous month. The annual average inflation eased to 0.36 percent in 2019Q3, from 0.79 percent in 2019Q2, and projected to stabilize at 1.0 percent in 2019 as in 2018. The core inflation rate is projected to rise to about 1.0 percent in 2019 – 2020 due to the October consumption tax increase, inching up further in the medium term.

In China, annual inflation rose to 3.0 percent in September 2019, from 2.8 percent in the previous month, the highest inflation rate since October 2013, mainly due to persistently high pork prices following an outbreak of African swine fever. Food inflation rose to 11.2 percent in September 2019, the highest since October 2011, as pork prices climbed by 69.3 percent, the seventh consecutive month of increase, after a 46.7 percent in the previous month. The annual core inflation stabilized at 1.5 percent in September 2019, unchanged from the previous month. The annual average inflation rose to 2.9 percent in 2019Q3, from 2.6 percent in 2019Q2, and projected to rise to 2.3 percent in 2019 from 2.1 percent in 2018.

In EAC, annual average inflation is projected at 4.3 percent in 2019, from 3.6 percent in 2018. The stable and low inflation in the region results from good agriculture production due to favorable weather conditions.

Burundi's annual average inflation rose to 2.0 percent in September 2019, following a deflation of 0.6 percent in the previous month, and it was the first increase in consumer prices after nineteen months of deflation, mainly driven by high prices of food & non-alcoholic beverages, recreation & culture, and housing & utilities. The annual average inflation reached a deflation of 0.4 percent in 2019Q3, from a deflation of 2.9 percent in 2019Q2, and projected to rise to 7.3 percent in 2019 from 1.2 percent in 2018.

The annual average inflation in Kenya slightly declined to 3.8 percent in September 2019, from 5.0 percent in the previous month, as prices slowed mostly for transport. This was the lowest inflation since April 2018, thus moving below the mid-point of Central Bank's 2.5-7.5 percent target. The annual average inflation eased to 5.0 percent in 2019Q3, from 5.9 percent in 2019Q2, and projected to rise to 5.6 percent in 2019 from 4.7 percent in 2018.

Rwanda's headline inflation rose to 3.1 percent in September 2019 from 2.3 percent in the previous month. The rise in inflation was mainly reflected in fresh food, clothing & footwear as well as hotels & restaurants. The annual average inflation rose to 2.4 percent in 2019Q3, from 0.4 percent in 2019Q2 and 1.8 percent in 2018Q3, and projected at around 2.3 percent in 2019 up from 1.4 percent in 2018.

The annual average inflation in Tanzania eased to 3.4 percent in September 2019, from 3.6 percent in the previous month, amid falling prices of non-food products. Prices decreased for housing & utilities, clothing & footwear, communication, and hotels & restaurants. The annual average inflation rose to 3.6 percent in 2019Q3, from 3.5 percent in 2019Q2 and 0.2 percent in 2018Q3, and headline inflation projected to slightly rise to 3.6 percent in 2019 from 3.5 percent in 2018.

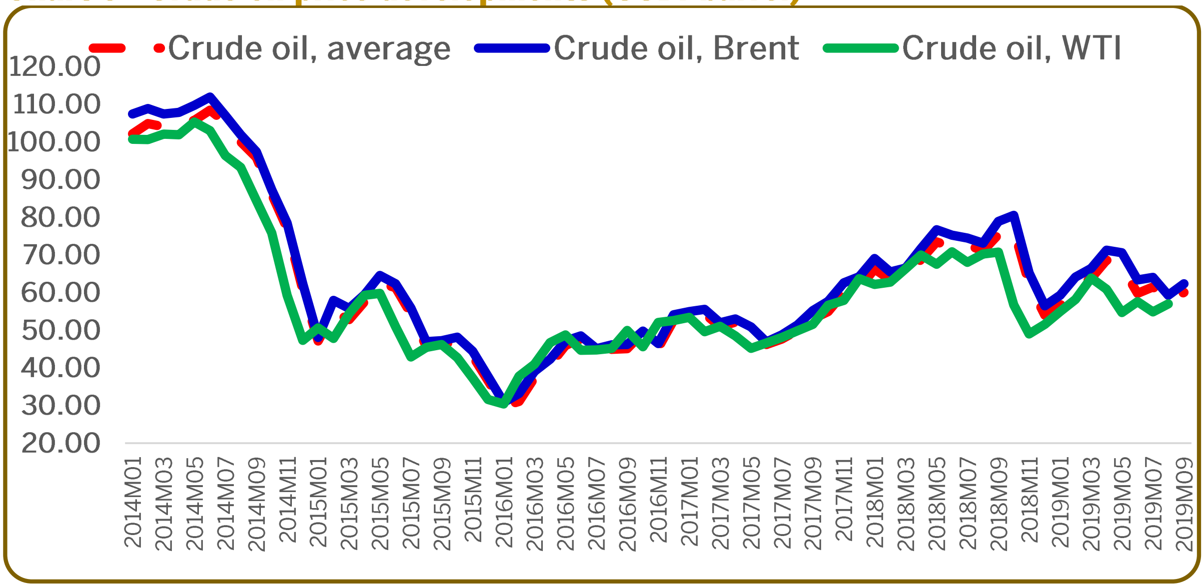
Uganda's headline inflation eased to 1.9 percent in September 2019, from 2.1 percent in the previous month, as prices fell for food & non-alcoholic beverages, mostly sugar and bananas, as well as communication. The annual core inflation slightly declined in September 2019 compared to the previous month. The annual average inflation eased to 2.2 percent in 2019Q3, from 3.4 percent in 2019Q2 and 4.1 percent in 2018Q3, and expected to rise to 3.2 percent in 2019 from 2.6 percent in 2018.

1.3 Global commodity prices

In the first nine months of 2019, global commodity prices decreased, reflecting supply influences and softening global demand. Energy prices fell by 13.1 percent in the first nine months of 2019, compared to an increase of 34.0 percent in the corresponding period of 2018, and non-energy commodity prices decreased by 5.6 percent, following a decline in prices of agricultural commodities and metals & minerals.

Crude oil prices decreased by 11.4 percent on average, in Jan- September 2019, compared to an increase of 37.0 percent in the corresponding period of 2018 on the back of softening global demand. On a quarterly basis, crude oil prices fell by 18.2 percent in 2019Q3 compared to a rise of 45.5 percent in the same period of 2018.

Chart 6 - Crude oil price developments (USD/barrel)



Source: World Bank commodity prices, September 2019

Going forward, crude oil prices are projected to decrease by 12.2 percent in 2019 and further by 3.3 percent in 2020.

In January – September 2019, average prices for agriculture commodities decreased (-5.9 percent) due to the falling prices of beverages (-6.1 percent); of which Coffee Arabica (-4.1 percent), Coffee Robusta (-13.4 percent), and average tea auction (-11.5 percent). During the same period, prices decreased by 5.8 percent for food; of which oils & meals (-12.0 percent), other foods (-3.2 percent), and grains (-0.2 percent).

In 2019, agricultural commodity prices are projected to decrease by 4.7 percent, attributed mainly to the projected falling prices of beverages by 5.3 percent; with Coffee Arabica, Coffee Robusta and Tea average auction prices expected to decrease by 4.4 percent, 13.4 percent and 10.5 percent, respectively. Metals & mineral prices decreased by 6.2 percent in the first nine months of 2019, compared to an increase of 10.1 percent in the same period of 2018, attributed to softening global demand, a strengthening US dollar as well as growing trade tensions between US and China. Metals & mineral prices are projected to decrease by 5.2 percent in 2019, a deeper decline than anticipated in the October 2018 forecast, and further decrease by 1.4 percent in 2020, on expectations of subdued global industrial demand.

Prices for fertilizers went up by 4.4 percent in the first nine months of 2019 compared to an increase of 9.6 percent in the corresponding period of 2018, as a result of high import demand from India. Fertilizers' prices are projected to slightly decrease by 0.6 percent in 2019, following modest global demand, but increase by 2.2 percent in 2020, on continued acreage expansion.

1.4 Monetary policy and financial markets

1.4.1 Monetary policy

Monetary policy remained accommodative in most advanced economies. The US Federal Reserve cut the Federal Funds rate in July, September and October 2019. The Bank of England (BoE) has maintained its policy rate at 0.75 percent, following the last increase by 25 basis points on 2nd August 2018. In September 2019, the European Central bank reduced its deposit rate and announced a resumption of quantitative easing.

In September 2019, the ten- year government bond rate decreased in USA, Eurozone, UK, and Japan to 1.665 percent, -0.571 percent, 0.488 percent and -0.213 percent, respectively, from 2.685 percent, 0.242 percent, 1.277 percent and 0.003 percent in December 2018.

The three-month deposit rates remained negative in the Eurozone and Japan, standing at -0.453 percent and -0.270 percent in September 2019, respectively, affecting banks' deposits in the Central Bank and encouraging economic financing. In the USA and UK, deposit rates decreased to 2.120 percent and 0.805 percent, respectively, from 2.770 percent and 0.900 percent in December 2018.

1.4.2 Foreign Exchange Markets

On the foreign exchange market, the US dollar is appreciating against major currencies, notably the Euro and British Pound, while weakening against the Japanese Yen. Compared to December 2018, the US dollar appreciated by 5.21 percent against the Euro, and by 3.78 percent against the British Pound in September 2019, from a respective appreciation of 3.44 percent and 3.70 percent in September 2018. However, the dollar depreciated by 1.47

percent against the Japanese Yen, compared to an appreciation of 0.90 percent in September 2018.

II. DOMESTIC ECONOMY AND FINANCIAL DEVELOPMENTS

2.1 Domestic Demand and Output

The Rwandan Real GDP grew by 12.2 percent in 2019Q2, the highest recorded in the last ten years, from an 8.4 percent and 6.8 percent increase in 2019Q1 and 2018Q2, respectively. The industry sector, which grew by 21.3 percent, was the main driver of economic growth, followed by the services (+11.6 percent) and agriculture (+5.4 percent) sectors. The composite index of economic activities evidences a continuous strong economic performance in 2019Q3.

2.1.1 Output and the Near-Term Outlook

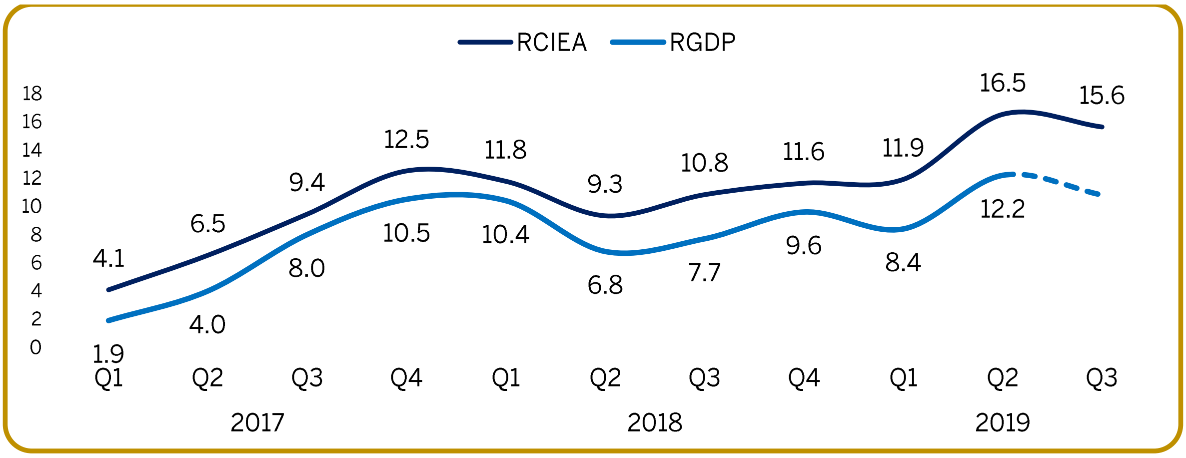
The remarkable growth in the industry sector was boosted mainly by booming construction activities. Construction industry, representing 44.9 percent of industry sector, increased by 31.6 percent, a progress from 10.5 percent in 2018Q2 backed by recent infrastructure projects. Moreover, manufacturing industries, which comprise 35.3 percent of the industry sector, grew by 15.9 percent from 12.4 percent; also reflecting the increase in production of construction materials.

Regarding the services sector, the growth of the trade and transport (+20.4 percent), hotel and restaurants (+ 13.4 percent), financial services (+13.3 percent), Professional, scientific & technical activities (+12.6 percent) and public administration (+11.7 percent) mainly drove the sector's performance. The high growth of Professional, scientific & technical activities was consistent with the expansion of construction activities while the tourism industry's good performance is linked to Rwanda's good positioning as a destination for international conferences and exhibitions. Thus, by the end of June 2019, international meetings hosted increased by 440.0 percent, and the delegates' number increased by 152.2 percent, compared to the same period of 2018.

The agricultural sector's performance was supported by favorable weather conditions. However, the recorded growth (+5.4 percent) was lower than the 6.5 percent in 2018Q2 as food crops production, representing 58.6 percent of agriculture sector, decelerated from 5.9 percent in 2018Q2 to 3.6 percent in 2019Q2. Nonetheless, this trend was limited by the good performance of export crops (+5.6 percent) and livestock (+14.1 percent). The slowdown in food production was largely due to the decline in cultivated land for maize (-1.4 percent) and Irish potatoes (-2.2 percent).

The Rwandan economic growth is expected to remain high in the third quarter of 2019, as evidenced by high frequency indicators. The composite index of economic activities (CIEA) increased in real terms by 15.6 percent in 2019Q3, from 10.8 percent recorded in 2018Q3.

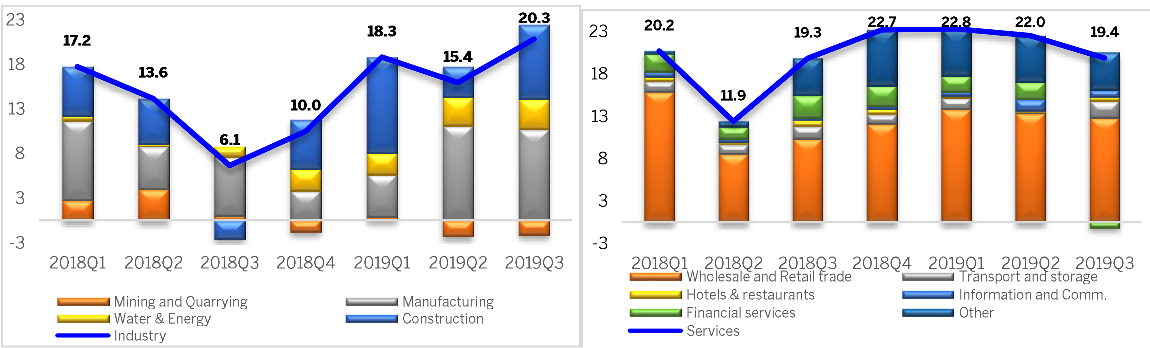
Chart 4- Quarterly Real GDP growth vs CIEA (% change, y-o-y)



Source: NBR, Monetary Policy Department

In addition, the total turnovers of industry and service sectors increased by 19.6 percent in 2019Q3 from 15.9 percent in 2018Q3. Construction, that grew by 35.1 percent from a decline of 7.6 percent, and manufacturing, which increased by 18.0 percent from 12.2 percent, were the roots of the 20.3 percent growth of the industry sector (from 6.1 percent).

Chart 5- Turnovers of industry & services sectors (% change, y-o-y)



Source: NBR, Monetary Policy Department

The performance of the services sector (+19.4 percent from +19.3 percent) was mainly led by trade services that increased by 19.1 percent in 2019Q3 from 14.7 percent in 2018Q3 and represented 64.1 percent of total services sector turnovers. Furthermore, the services sector was supported by the developments in transport services with sales growth of 33.5 percent from 26.4 percent as well as improvement in tourism industry. Hotels' turnovers increased by 19.3 percent from 34.1 percent, with the number of MICE delegates almost doubling to 10,497 in 2019Q3, compared to the corresponding period of 2018.

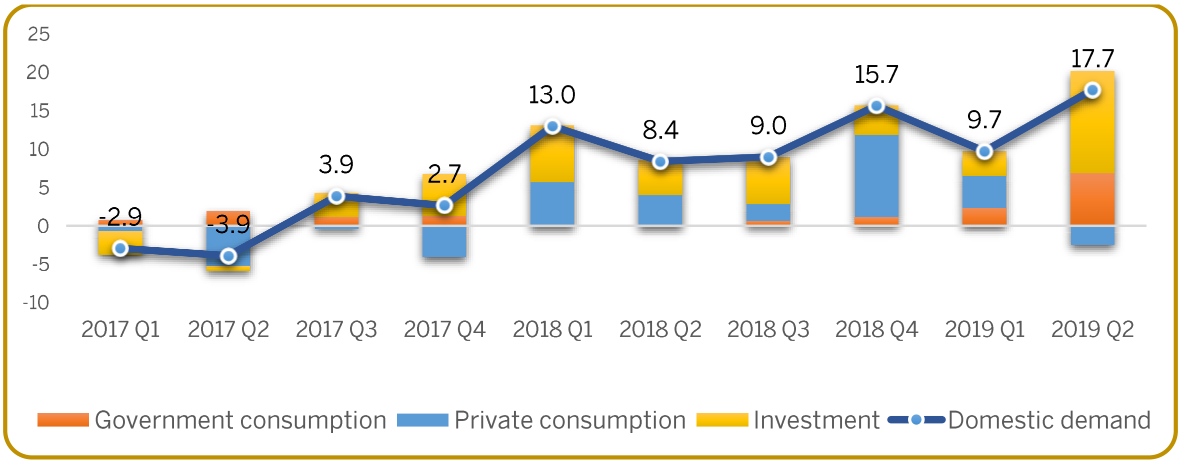
On the other hand, the index of industrial production fell by 13.4 percent in 2019Q3 from 15.0 percent in 2018Q3. This drop was mainly caused by mining, whose production index plunged by 47.4 percent from an increase of 7.0 percent due to declining international commodity prices. Metal and mineral international prices declined by 6.2 percent in the first nine months of 2019 from an increase of 10.1 percent in the corresponding period of 2018. The production index of the manufacturing subsector grew by 12.7 percent on top of 26.4 percent recorded last year, which also reflects its good performance as has been demonstrated by the turnovers' increases.

2.1.2 Domestic demand

Domestic demand grew at a high pace throughout 2018 and continued in 2019, mainly driven by strong investment and improvement in total final consumption.

In 2019Q2, gross capital formation grew by 51.8 percent from 19.4 percent in 2018Q2. It was mainly driven by construction investment, representing 48.1 percent of total investments, that increased by 31.7 percent from 10.3 percent. Other fixed investments also recorded high growth, to 81.0 percent from 32.9 percent.

Chart 6- Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

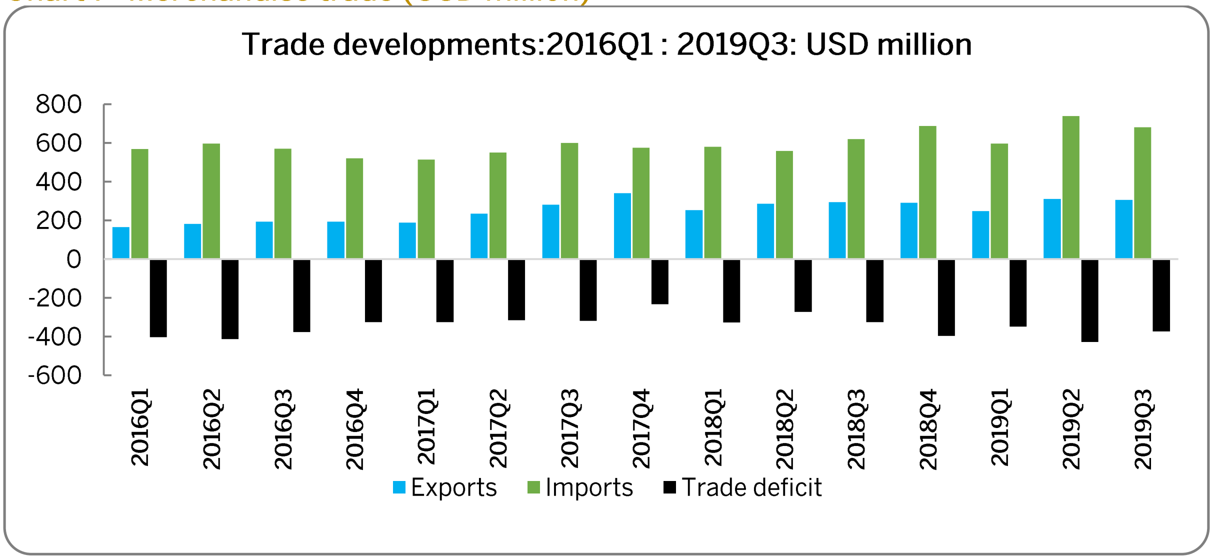
The total final consumption grew by 6.0 percent in 2019Q2, mainly led by government consumption, which rose by 57.5 percent from a decline of 0.8 percent in the same period of last year. This robust government consumption supported the domestic demand by outweighing the decline in private consumption (-3.9 percent from 6.4 percent).

2.2 External Sector Developments

Rwanda's exports continue to grow, rising by 4.2 percent in 2019Q3 year-on-year to USD 305.8 million (from 293.5 million in 2018Q3). The growth emanates from the continued good performance of non-traditional exports (+11.3 percent) and re-exports (+30.3 percent), albeit a fall in traditional exports (-19.3 percent). The persistent loss of momentum in global trade affected Rwanda's traditional exports through decreases in prices. However, non-traditional exports and re-exports showed resilience to the weakening global trade partly due to continued higher demand in the region. On the other hand, imports grew by 9.8 percent in 2019Q3 compared to the same period of the previous year. Imports growth is mainly explained by high domestic demand for capital and intermediary goods, to support the growing investments in the country.

As a result, Rwanda's trade deficit increased by 14.8 percent to USD 374.0 million in 2019Q3 (from USD 325.8 million in 2018Q3). In the first nine months of 2019, Rwanda's trade deficit totaled USD 1,151.8 million (from 927.2 million in 2018 of the same period), representing an increase of 24.2 percent, following the rise in imports (+14.6 percent) that outweighed the increase in exports (+3.9 percent).

Chart 7- Merchandise trade (USD million)



Source: NBR, Statistics Department

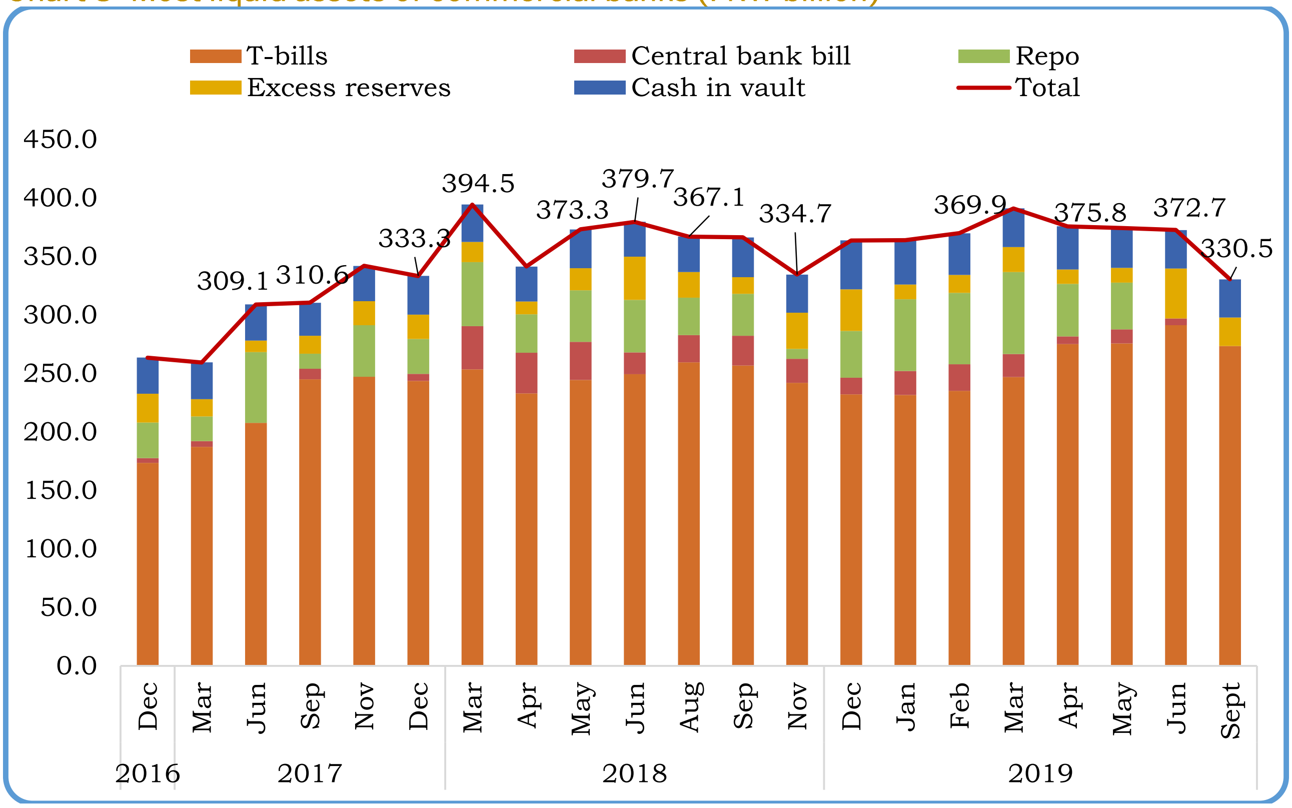
In 2019, the current account deficit is expected to be higher than the 7.9 percent of GDP recorded in 2018, partly due to higher imports –reflecting the rise of domestic demand– and a lower exports growth resulting from the slowdown in external demand. The Rwanda's current account deficit will continue to be financed by a steady rise of capital inflows, including Foreign Direct Investments (FDI) and external borrowings. As a result, Rwanda will continue to build-up its forex exchange reserves, with the reserves in months of imports of goods and services expected to remain above 4 months.

III. FINANCIAL AND MONETARY DEVELOPMENTS

3.1 Banking System Liquidity Conditions

In September 2019, the most liquid assets dropped down by 9.1 percent, to RWF 330.5 billion from RWF 363.7 billion in December 2018, compared to the growth of 9.9 percent recorded during the same period of the previous year. This decline is attributed to the increase of banks and non-banks' investments in Treasury bonds, which finally financed government external outlays. In this regard, government external spending rose up by 11.9 percent, standing at RWF 309.4 billion in 9M2019 from RWF 276.4 billion in 9M2018. Consequently, net fiscal injection declined by 29 percent while it had increased by 16.0 percent during the same period.

Chart 8- Most liquid assets of commercial banks (FRW billion)



Source: NBR, Monetary Policy and Research Directorate

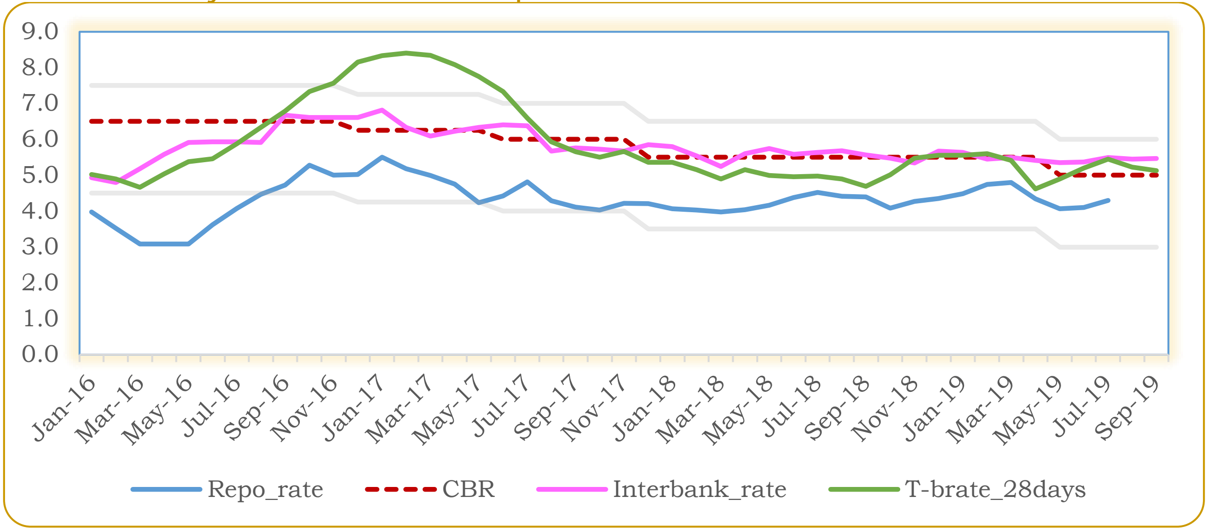
3.1 Monetary Policy and Interest Rates

The CBR declined but short-term interest rates increased in the first nine months of 2019, except interbank rate. However, they all remained within the band due to NBR's proper liquidity management.

3.1.1 Interest rates development

Money market interest rates continued to stabilize around the central bank rate. Interbank rate declined by 14 basis points to 5.46 percent on average in the first nine months of 2019, from 5.60 percent in the same period of 2018. During the same period, T- bill rates grew to 5.23 percent from 5.01 percent. Repo rates also increased to 4.40 percent in the first seven months of 2019 from 4.17 percent in the same period of 2018. No repo transaction was recorded in August and September, a period that was characterized by reverse repo operations. Average reverse repo rate stood at 5.44 percent in 2019Q3.

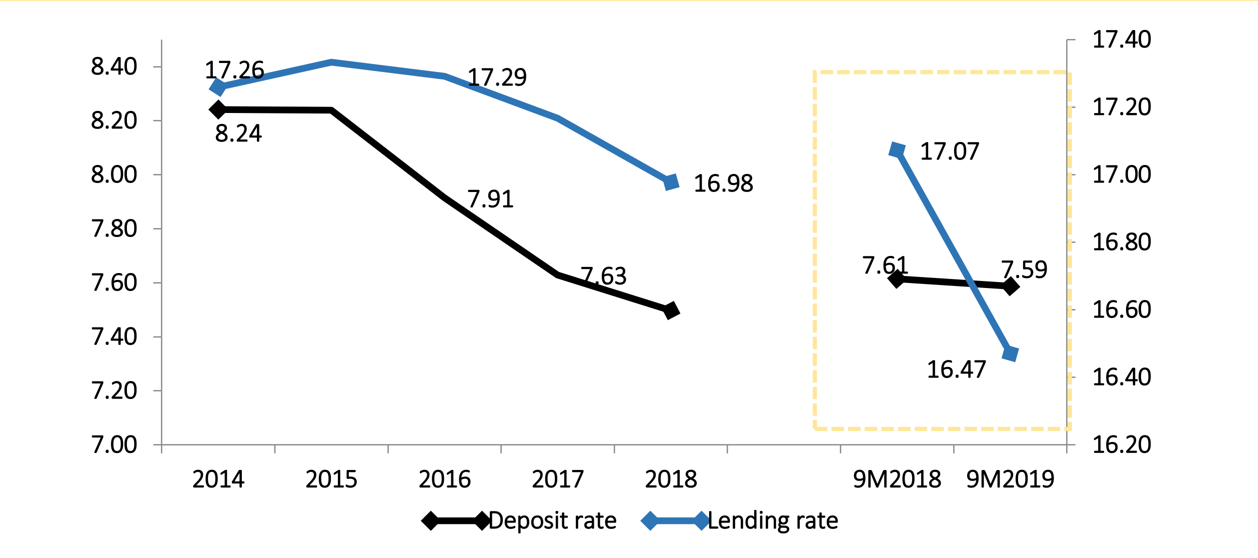
Chart 9- Money market rates developments



Source: NBR, Monetary Policy and Research Directorate

The market rates followed a downward trend, signaling the continued improvement of monetary transmission mechanism. In the first nine months of 2019, average lending rates declined to 16.47 percent from 17.07 and deposit rate dropped slightly to 7.59 percent from 7.61 percent. As a result, the spread between lending and deposit rates reduced significantly, to an average of 8.88 percent in the first three quarters of 2019, from 10.33 percent in the corresponding period of 2018.

Chart 10- Market interest rates (percent average)



Source: NBR, Monetary Policy and Research Directorate

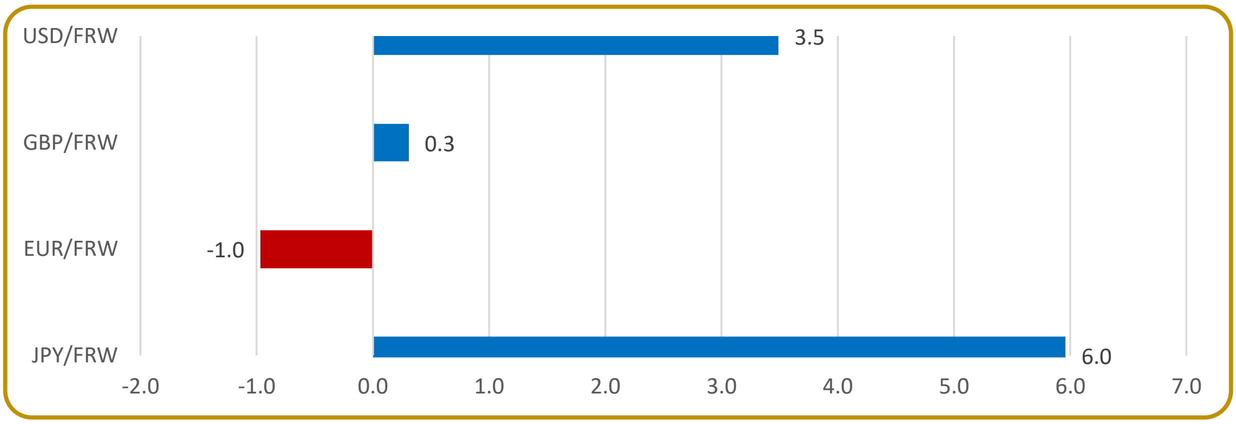
3.2 Exchange Rate Developments

3.2.1 The exchange rate: bilateral and effective

By end September 2019, Rwandan franc depreciated by 3.5 percent against the USD, higher than 2.9 percent observed in September last year. It is projected to depreciate by 4.8 percent by end December 2019, which is higher than 4.0 percent recorded end December 2018, in line with external sector developments.

Compared to the British pound, the FRW depreciated by 0.3 percent, while it appreciated by 1.0 percent against the Euro. With regards to regional currencies, the Rwandan franc remained relatively stable and by end September 2019 the Rwandan franc was trading at 8.75, 0.40, 0.25 and 0.49 against Kenyan shilling, Tanzanian shilling, Ugandan shilling and Burundian franc from an exchange rates of 8.61, 0.38, 0.23 and 0.49 respectively.

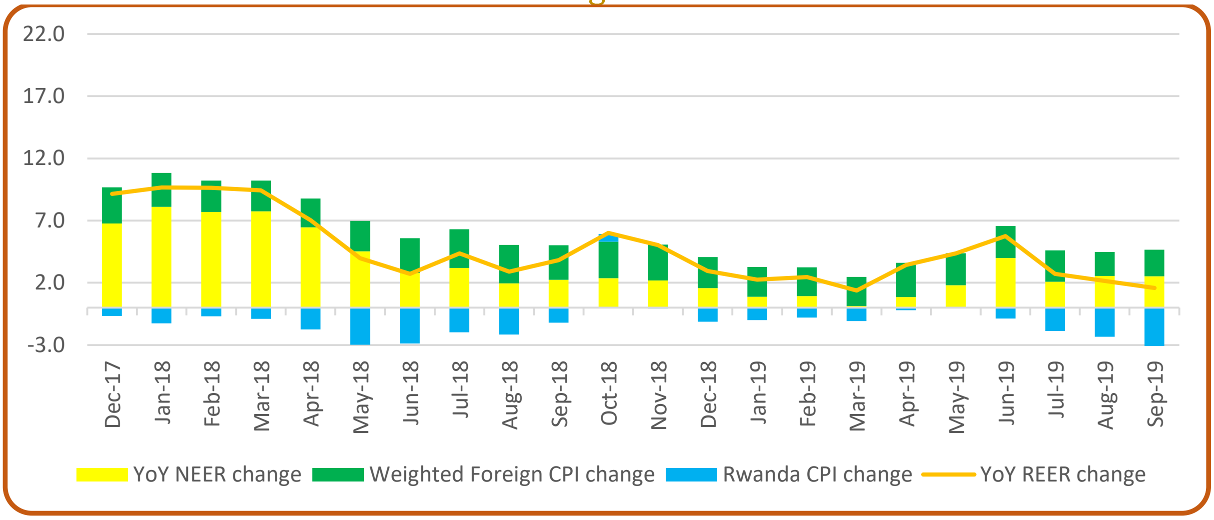
Chart 12- Depreciation rate of selected currencies against the FRW (in % compared to June 2018)



Source: NBR, Monetary Policy Department

Looking at the currency basket for Rwanda's main trading partners, the FRW real effective exchange rate depreciated by 1.6 percent (y-o-y) end September 2019 against 3.8 percent recorded during the corresponding period in 2018. This was mostly attributable to the depreciation of the nominal value of the FRW against currencies of some of the major trading partners. In nominal effective terms, it depreciated by 2.5 percent compared to a depreciation of 2.2 percent end September 2018.

Chart 13- Drivers of real effective exchange rate

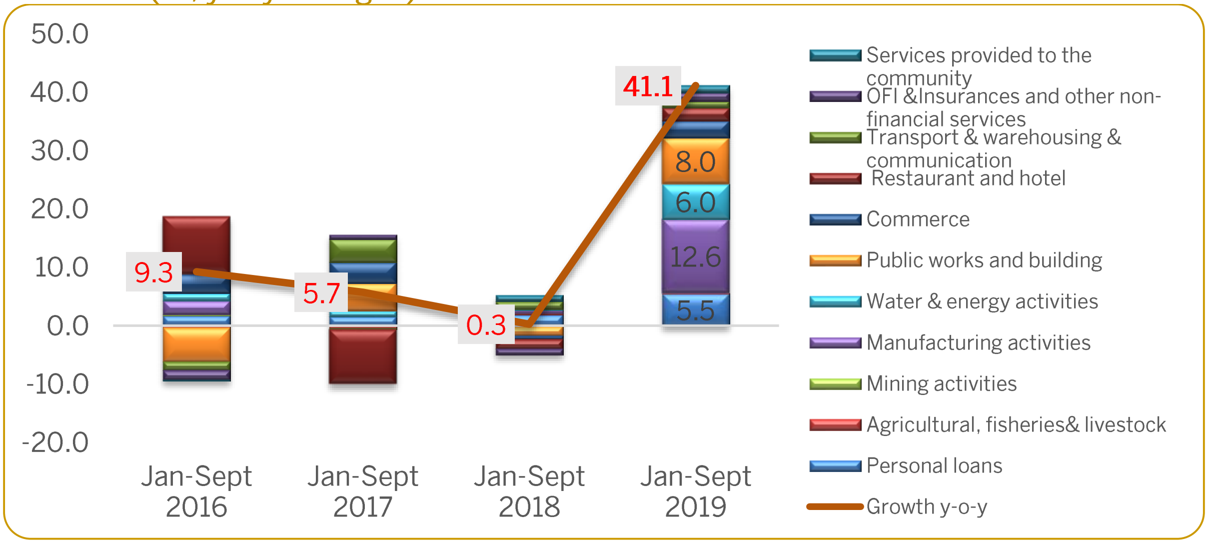


Source: NBR, Monetary Policy Department

3.3 Credit

New Authorized Loans (NALs) grew by 41.1 percent in the first nine months of 2019, from 0.3 percent in the same period of the previous year. That observed growth in NALs is mainly reflected in Manufacturing, Public works and building, Water & Energy and Personal loans. The increase was attributed to high demand for loans, which increased by 27.6 percent in value and 15.2 percent in volume, in the first nine months of 2019, from a growth of 17.8 percent in value and 7.9 percent in volume in the corresponding period of 2018. In addition, the rate of loan rejection in 9M2019 decelerated to 18.8 percent in value and 3.5 percent in volume, down from 26.6 percent and 10.5 percent in 9M2018, respectively.

Chart 14- Contributions of sectors of activity to the growth of new authorized loans (%, y-o-y changes)

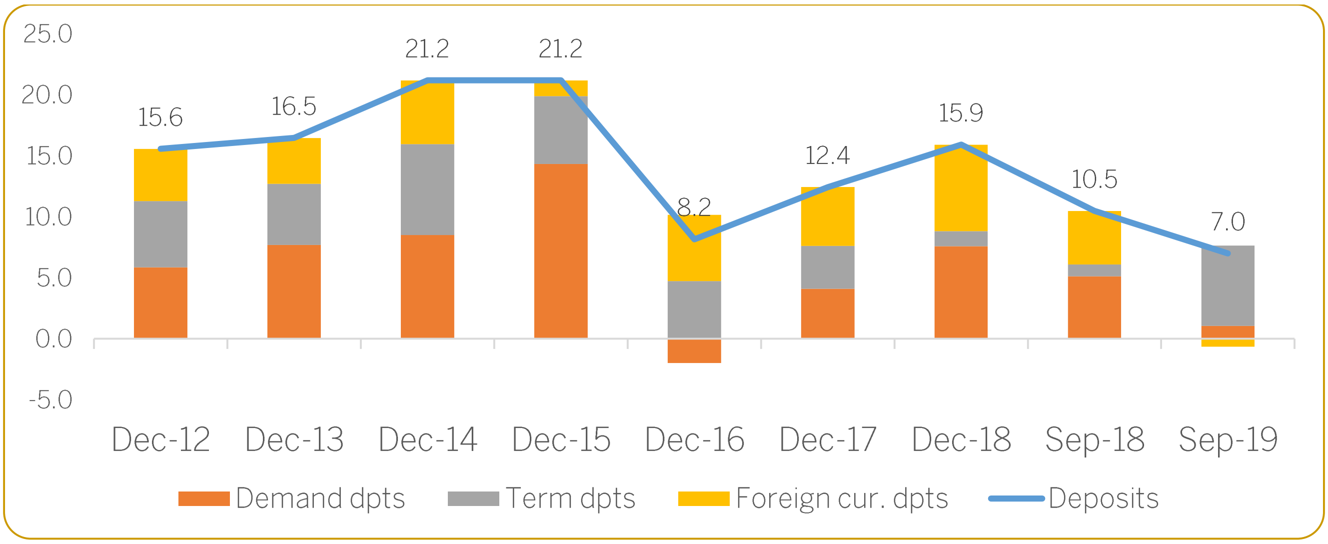


Source: Financial Stability Monitoring Department

3.4 Money

During the first nine months of 2019, M3 increased by 6.4 percent from 9.5 percent in the same period of last year. In 9M 2019, total deposits grew by 7.0 percent from a growth of 10.5 percent in the corresponding period of the year before. This low growth in total deposits was mainly caused by the decline in Social Security Fund deposits by 3.0 percent in 9M2019 from a growth of 17.2 percent in the corresponding period of 2018, while the currency in circulation slightly increased by 0.4 percent from a drop of 0.1 percent.

Chart 15: Contributions to total deposits growth (percent)

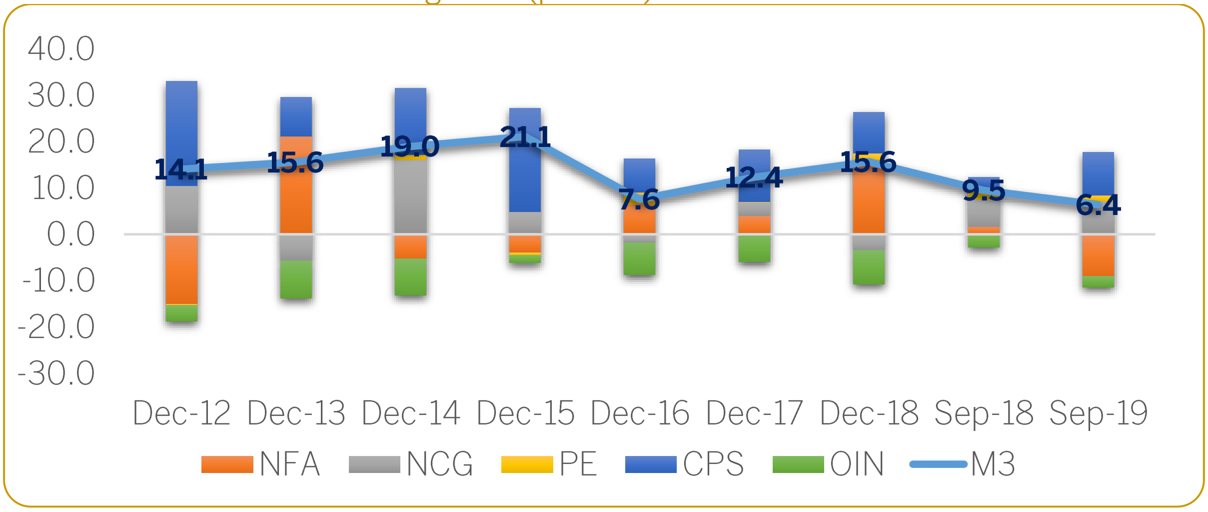


Source: NBR, Statistics Department

With regard to broad money M3 counterparts, Credit to private sector (CPS) was the main contributor to M3 growth with 9.3 percent in September 2019 followed by the Net Credit to

Government (NCG) with 7.1 percent and public enterprises with 1.4 percent. This was partly offset by a negative contribution of Net Foreign Assets (NFA) and Other Items Net (OIN) by - 9.1 percent and - 2.3 percent respectively. In this perspective, banks' NFA reduced by 41.8 percent in the first nine months of 2019 from a growth of 106.2 percent in the corresponding period of 2018, due to increased loans in foreign currency and the base effect of 2018. In addition, NBR's NFA declined by 13.1 percent from -3.8 percent due to less foreign inflows (-6.2 percent vs -2.0 percent) and high outflows (+10.2% vs -0.9 percent).

Chart 16 – Contributions to M3 growth (percent)



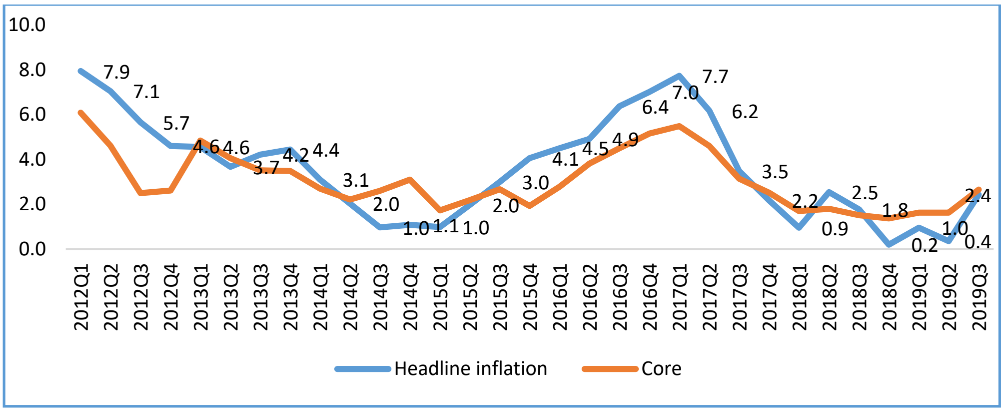
Source: NBR, Statistics Department

IV. INFLATION DEVELOPMENTS AND OUTLOOK

4.1 INFLATION DEVELOPMENTS

In 2019Q3, headline inflation picked to 2.4 percent from 0.4 percent recorded in 2019Q2. This uptick observed in headline inflation was attributed to a base effect and a rise in prices of locally produced foods. Over the same period, core inflation rose, following a steady increase in prices of imported foods and clothes.

Chart 17- Headline and core Inflation developments (%, Y-o-Y)



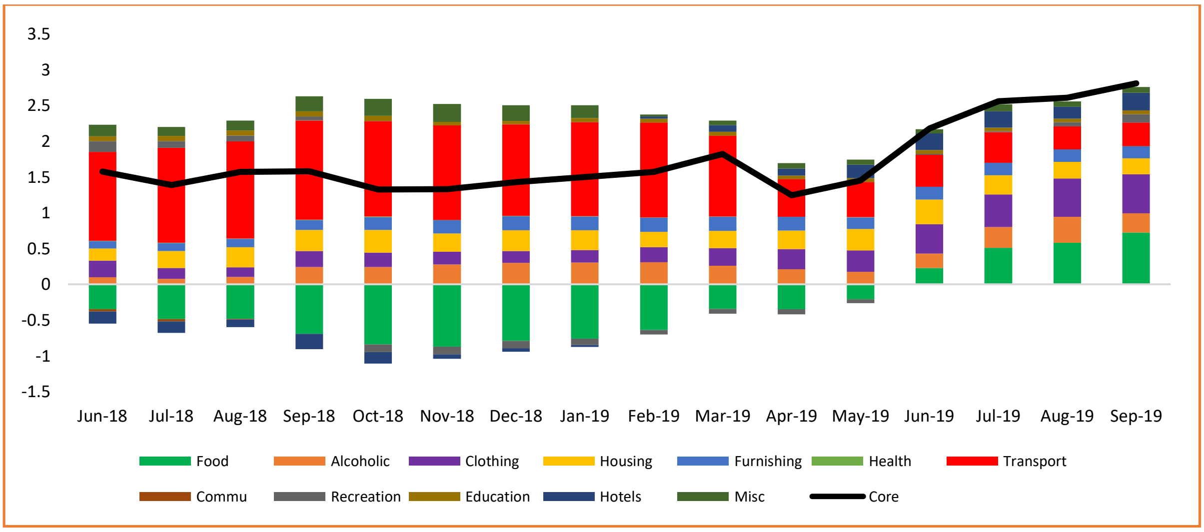
Source: NBR, Monetary Policy and Research Directorate

4.1.1 Contributors to headline inflation

4.1.1.1 Core inflation

Core inflation stabilized at 1.6 percent during the first two quarters of 2019, while it increased to 2.7 percent in 2019Q3. In addition to base effect, prices of imported goods were key drivers of core inflation. Following upward trends in international food prices, core food inflation (that represents around 21.5 percent in total core inflation) increased and the changes were reflected in key core food products such as rice and sugar. Similarly, international prices for imported clothes picked up, leading to an increase in clothing inflation that account for around 7.0 percent in core inflation.

Chart 19-Contributors to core inflation



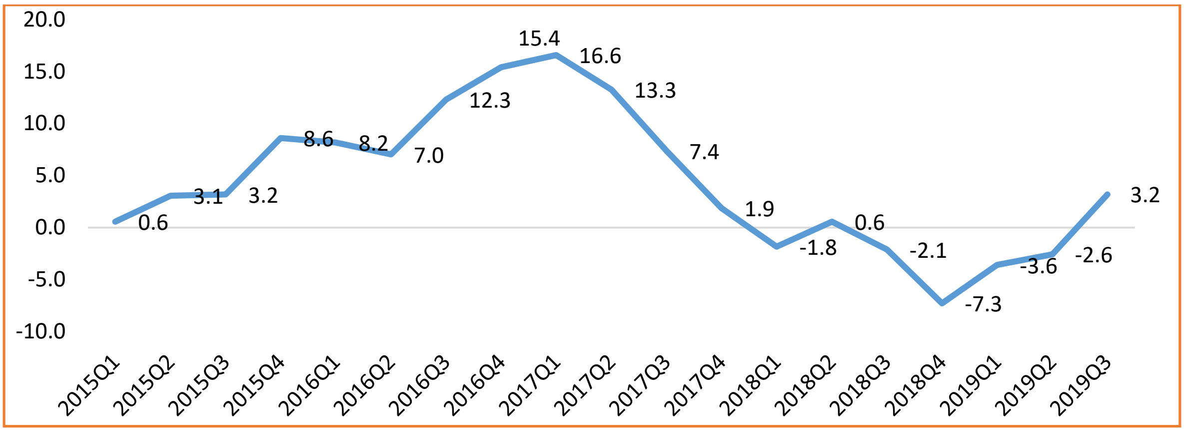
Source: NBR, Monetary Policy and Research Directorate

The uptick in core inflation was also driven by domestic cost pressures, as suggested by the upward trend in Producer Price Index. The domestic cost pressures were consistent with the positive non-agricultural output gap, which was mainly driven by easy monetary conditions. Real interest rate was easing following cuts in policy rate and higher inflation expected in the future, which led to increased domestic consumption. Undervalued real exchange rate, a result of higher nominal depreciation and low domestic inflation relative to trading partners, increased the real cost of importing goods (potentially leading to substitution in favor of domestic products).

4.1.1.2 Food inflation

In 2019Q3, food inflation increased to 3.2 percent (year-on-year) from a deflation of -2.6 percent recorded in the previous quarter. The rise in food inflation was reflected in the easing of vegetable deflation from -9.6 percent in 2019Q2 to -1.9 percent in 2019Q3. The upward pressures in vegetable inflation resulted from a steady increase in vegetable prices. Moreover, owing to observed differences in seasonal weather conditions, the pressures in vegetable inflation were compounded by the base effect of a sharp decrease in vegetable prices recorded last year during the same period. These developments were in line with market players' food price expectations captured from a survey conducted in June 2019. A similar survey carried out in September 2019 suggested that prices for most fresh food products are likely to decrease towards the end of 2019Q4.

Chart 18-Food prices inflation



Source: NBR, Monetary Policy and Research Directorate

4.1.1.3 Energy inflation

Energy deflation decelerated to -1.8 percent in 2019Q3 from -4.1 percent recorded in the previous quarter. This deceleration was mainly attributed to solid fuel deflation (charcoals and firewood), which reduced to -3.3 percent in 2019Q3 from -8.5 percent of the previous quarter. Although prices of solid fuels remained stable on a quarter-on-quarter basis, deflationary pressures were subdued by a base effect of sharp decrease in prices recorded last year during the same period. The deceleration in solid fuels deflation was moderated by the drop in fuels and lubricants inflation to -2.5 percent in 2019Q3 from 1.3 percent recorded in the previous quarter. The downward trend in fuel prices resulted from the downward revision of local pump prices from 1096FRW per liter in June to 1080 FRW in July and to 1067 FRW in September 2019.

Chart 20-Energy inflation

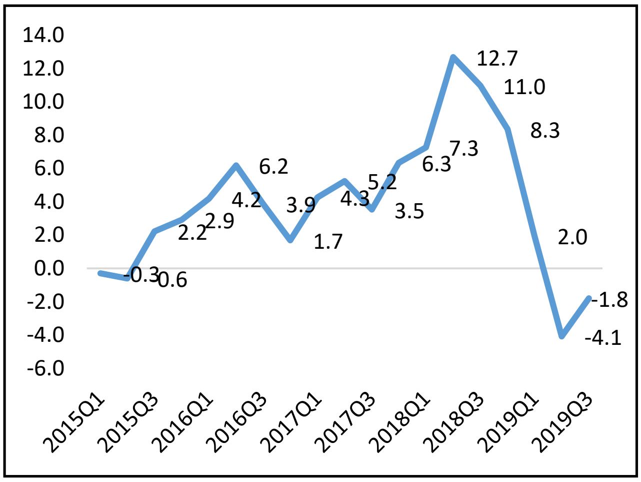
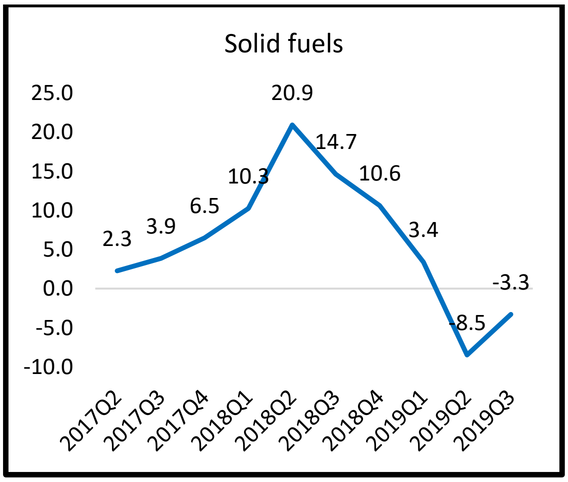


Chart 21: Solid fuels inflation



Source: NBR, Monetary Policy and Research Directorate

Table 1: Developments in headline inflation on quarterly basis (Y-o-Y, % change)

	2017				Annual (Y-o-Y)	2018				2019		
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4	Q1	Q2	Q3
Headline	7.7	6.2	3.5	2.2	4.9	0.9	2.5	1.8	0.2	1.0	0.4	2.4
Domestic	7.4	6.0	3.4	1.4	4.5	-0.1	1.8	0.9	-0.7	0.5	-0.4	1.9
Food:	16.6	13.3	7.4	1.9	9.8	-1.8	0.6	-2.1	-7.3	-3.6	-2.6	3.2
- Vegetables	21.0	13.3	4.6	-0.5	9.6	-5.4	2.3	-3.3	-13.5	-6.2	-9.6	-1.9
Housing	2.0	1.8	1.7	2.3	2.0	2.4	4.4	3.6	3.0	1.7	-0.5	0.4
Transport	8.5	5.4	1.2	3.0	4.5	3.0	8.2	10.3	9.7	7.7	3.2	1.9
Imported	8.8	6.9	3.9	4.7	6.0	4.4	5.0	4.9	3.3	2.5	2.8	4.2
Core	5.5	4.6	3.1	2.5	3.9	1.7	1.8	1.5	1.4	1.6	1.6	2.7
Energy	4.3	5.2	3.5	6.3	4.8	7.3	12.7	11.0	8.3	2.0	-4.1	-1.8

Source: NBR, Monetary Policy and Research Directorate

4.2 INFLATION OUTLOOK

4.2.1 Assumptions of baseline projections

Assumption 1: Base effect is exerting upward pressures on inflation

Since 2018Q3, lower prices were recorded, especially on domestic and imported food products, following good weather conditions and a decrease in international food prices. The base effect of the decrease in food prices created upward pressures on food and core inflation in 2019Q3, which is projected to continue in the next two quarters (2019Q4 and 2020Q1).

Assumption 2: The fiscal policy is expected to be expansionary

The budget deficit is expected to widen through 2019Q4 and 2020Q1. A considerable portion of the budget is expected to be injected in the domestic economy, and the expansionary fiscal stance is projected to boost domestic demand. In the next quarters, this may contribute to upward demand pressures that have started to pile up in 2019Q3 mildly.

Assumption 3: Global demand (US & Eurozone) to remain subdued and non-inflationary

In the Eurozone, projected inflation remains below target, and the economic growth expected to hover below capacity. In the US, the Fed has cut the rate anticipating weaker demand and inflation pressures, partly due to trade disputes with China. The IMF issued an outlook in October, suggesting that global economy will expand at an unusually slow pace of about 3.0 percent this year and 3.4 percent next year.

Assumption 4: Pressures from international prices (food and oil) slightly tilted upward

International food prices have been increasing in the recent past. Going ahead, the increase in international food prices is expected to continue but the pressures will be slightly moderated by an anticipated drop in global oil prices due to global slowdown. Imported food prices such as sugars and rice are likely to exert upward pressures, in line with the international prices, while projections on global oil prices point to a further reduction in 2020, but will not entirely offset the mentioned upward pressures in food prices. Therefore, mild external upward pressures are expected to impact domestic prices.

4.2.2 Inflation forecasts

In 2019Q3, headline inflation leaped over the lower bound, mainly driven by pressures from domestic and imported food prices. On average headline inflation is projected at 2.3 percent in 2019, which is consistent with the previous projections. Based on the assumption of continued global economic slowdown and pressures from imported inflation, couple with mild fiscal injection over the policy horizon, upward pressures are expected over the policy horizon. However, medium-term projections of inflation remain within the benchmark band (2.0 percent and 8.0 percent).

Risk assessment points to downward pressures on food prices in 2019Q4 and 2020Q1, given the considerable likelihood of bumper harvests in Season A.

Taking into account the base effects and the projected risk of downward pressures from drop in domestic food prices, the Monetary Policy Committee meeting held on November 14, 2019, decided to maintain the Central Bank Rate at 5 percent.

Chat 22-Baseline inflation forecasts