National Bank of Rwanda

Banki Nkuru y'u Rwanda

MONETARY POLICY REPORT

MAY 2021

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EXECUTIVE SUMMARY

The global economy is projected to record a noticeable but uneven recovery from the worst recession since World War II.

According to estimates published by IMF in April 2021, the global economy is projected to grow by 6 percent in 2021, from a contraction of 3.3 percent in 2020 that resulted from the negative impact of COVID-19. However, global economic prospects remain uncertain due to the delayed global vaccine rollout, impact of COVID-19 new variants and discrepancy in growth across countries. Market uncertainties are linked to multiple factors, such as effectiveness of policy support, exposure to cross-country spillovers, and preexisting economic conditions.

The domestic economy is expected to recover from the negative impact of COVID-19.

Rwanda's real GDP contracted by 3.4 percent in 2020, the first recession since 1994. Backed by supportive policy measures and eased containment measures, the economy recorded a gradual recovery since 2020Q3 after a deep contraction in 2020Q2. The recovery is expected to continue in 2021, evidenced by an increase in the Composite Index of Economic Activities (CIEA) which rose by 10.2 percent in 2021Q1, better than 5.5 percent in 2020Q1. Real GDP is projected to rebound to 5.1 percent in 2021, supported by sound economic policies and the vaccine rollout.

The trade balance improved, reflecting rising exports and reducing imports.

In 2021Q1, trade balance improved by 7.4 percent as export continues to recover while imports fall partly due to subdued demand. Merchandise exports rose by 6.5 percent, y-o-y, mainly driven by revenues from traditional exports on improving commodity prices and increased export volumes while imports fell by 11.3 percent mainly driven by lower imports of consumer goods on decreased imports of food products, and intermediate goods. The decline in imports of intermediate goods resulted from lower demand of construction materials following the completion of public schools as well as rising domestic production of cement following the launch of the new cement manufacturer in the second half 2020. However, imports of capital goods rose substantially, rising by 12 percent, driven by imports of electrical equipment to support the power sector growth as the government plans to supply electricity to 100% of the population by 2024.

Foreign exchange market remains stable.

In 2020, the FRW depreciated by 5.4 percent against the USD. As of end April 2021, the FRW had depreciated by 0.993 percent compared to 0.996 percent in the same period of

2020. In 2021, the foreign exchange market is expected to remain stable, with adequate foreign exchange reserves held by NBR covering more than four months of prospective imports.

Lending rates continue to decrease in line with recent trends in CBR.

The continuing accommodative monetary policy stance has contributed to a further reduction in money market and market interest rates. The interbank rate continues to be steered around the Central Bank Rate, dropping by 4 basis points to 5.2 percent in 2021Q1. During the same period, average lending rate reduced by 91 basis points to 16.35 percent, thereby easing the cost of borrowing during the ongoing economic recovery.

Monetary aggregates remained resilient to the impact of COVID-19.

The monetary sector remains resilient owing to supportive policy measures. As of March 2021, broad money grew by 22.5 percent compared to 12.3 percent growth in March 2020. In the same period, outstanding credit to private sector grew by 22.0 percent compared to 12.5 percent in March 2020. This growth was driven by new authorized credit disbursed during that period and other economic policy support measures.

Headline inflation is expected to evolve slightly below the benchmark of 5 percent over the next four quarters.

Headline inflation eased from 5.1 percent in 2020Q4 to 2.1 percent in 2021Q1 mainly reflecting a decline in core inflation that stood at 3.2 percent in 2021Q1 from 4.2 percent recorded in the previous quarter. In 2021Q2, headline inflation is expected to stand at around 2.7 percent. Overall, average headline inflation is projected at 2.2 percent in 2021.

I. RECENT DEVELOPMENTS AND OUTLOOK

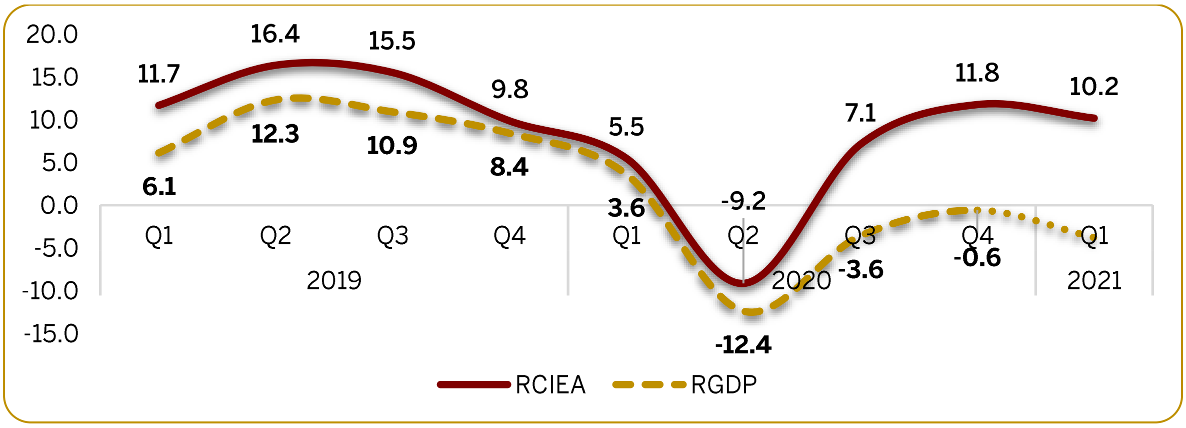
1.1 Recent developments

The second wave of COVID-19 infection observed in December 2020 led to movement restrictions between December 2020 and February 2021. This constrained the recovery of economic activities observed in the second half of 2020. The composite index of economic activities (CIEA) increased by 10.2 percent in 2021Q1 from 11.8 percent in 2020Q4, signaling a slowdown in economic activities.

High-frequency indicators point to the reverse of economic recovery in 2021Q1

Fiscal and monetary stimulus, as well as ease of containment measures, have helped the recovery of economic activities during the 2020Q3 and 2020Q4. In 2021Q1, this recovery was constrained by new movement restriction measures, in response to the second wave of COVID-19 infection observed in December 2020. As a result, the Composite Index of Economic Activities (CIEA) increased by 10.2 percent in 2021Q1 from 11.8 percent in 2020Q4, signaling a slowdown in economic activities.

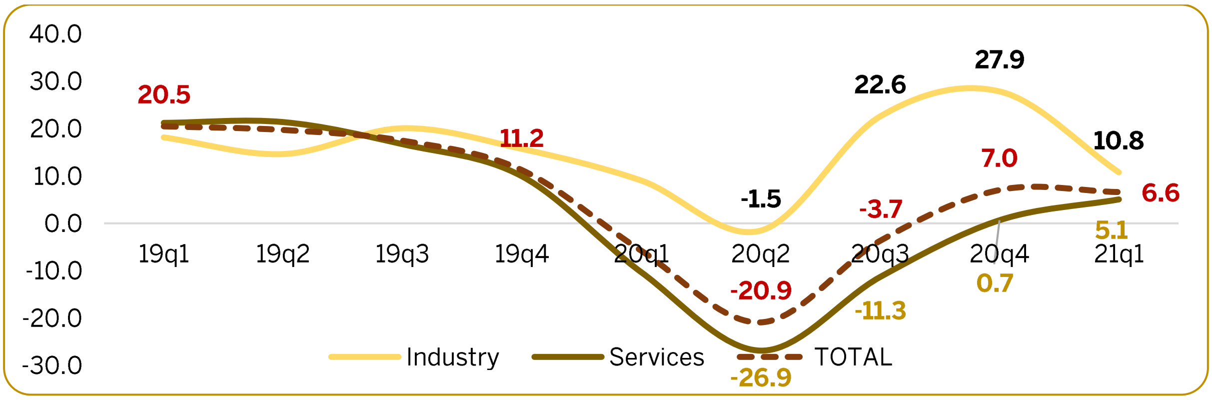
Chart 1: Quarterly Real GDP growth vs CIEA (% change, y-o-y)



Source: NBR, Monetary Policy Department

Similarly, total turnovers of the industry and services sectors grew by 6.6 percent in 2021Q1, slower than the 7.0 percent recorded in 2020Q4, but the overall performance of these sectors was better compared to 2020Q1, where total turnovers fell by 5.8 percent.

Chart 2: Turnovers of industry & services sectors (% change, y-o-y)



Source: NBR, Monetary Policy Department

The deceleration of the growth of total turnovers reflected mainly the slowdown in the performance of industry sector, which total sales grew by 10.8 percent in 2021Q1 against 27.9 percent recorded in 2020Q4. This slowdown in the industry sector is concurrent with the slowdown in the manufacturing subsector (14.8 percent from 39.6 percent) as well as the decline in the construction subsector (-1.3 percent from 14.1 percent). This trend was mainly caused by supply chain disruption and the decline in demand for industrial products amid the partial lockdown. However, mining and quarrying continued to recover (22.2 percent in 2021Q1 from 6.8 percent in 2020Q4) supported by the increase in metal and minerals prices on international market (45.6 percent in 2021Q1 from 19.7 percent in 2020Q4). The recovery continued in the energy and water subsector as well (22.6 percent in 2021Q1 from 19.0 percent in 2020Q4).

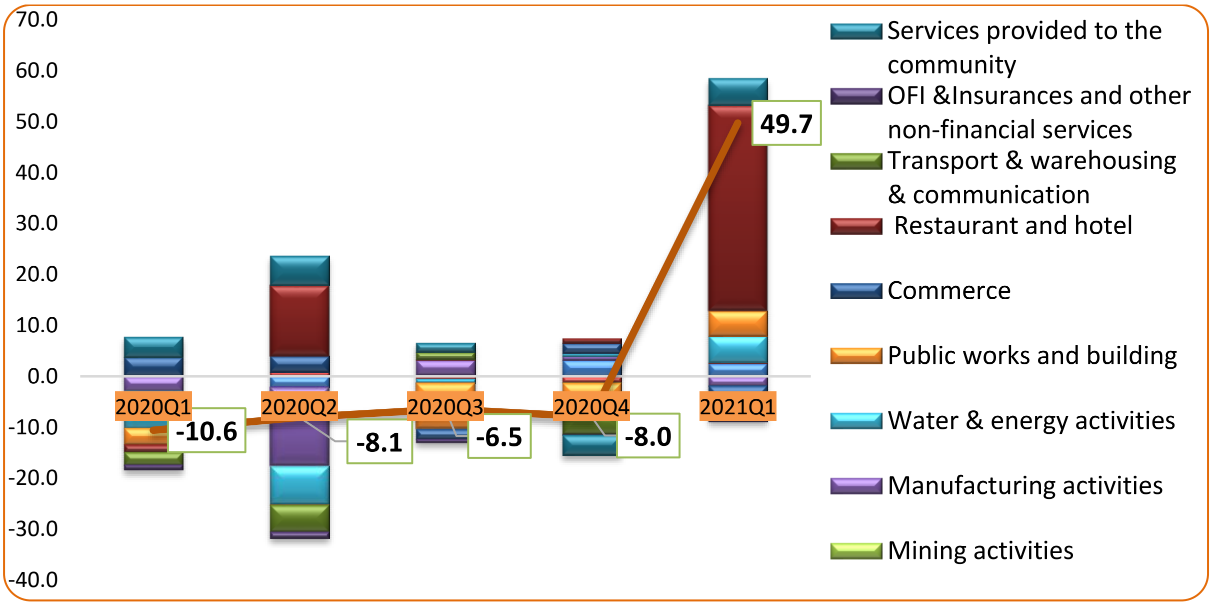
The services sector's total turnovers grew by 5.1 percent in 2021Q1 after 0.7 percent and -10.3 percent registered in 2020Q4 and 2020Q1 respectively. The overall improvement in the services sector resulted mainly from the upward trend in turnovers of trade services that represented 64.5 percent of total turnovers of the sector. Trade services grew by 9.7 percent in 2021Q1 following 0.5 percent in 2020Q4. Furthermore, financial services, as well as information and communication, continued to record good performance, with their turnovers growing by 8.8 percent and 11.5 percent in 2021Q1 respectively, after 16.9 percent and 24.8 percent in 2020Q4. However, tourism related services continued to perform poorly as the sector has been severely affected by the pandemic control measures. These services include hotels and restaurants (-47.9 percent in 2021Q1 from -37.7 percent in 2020Q4) as well as transport services (–6.0 percent in 2021Q1 from 5.6 percent in 2020Q4). The recovery of this industry is foreseen to be slow. According to World Tourism Organization (UNWTO), the return to pre-COVID-19 performance is not expected before 2023. This organization projected a decline of international tourist arrivals between 55 and 70 percent in 2021 after a drop of 72 percent in 2020.

Sound credit to the private sector owing to supportive policy measures.

The outstanding Credit to the Private Sector (CPS) rose by 22.0 percent in March 2021, y-o-y, higher than the 12.5 percent growth in March 2020. The increase in the stock of CPS in the first three months of 2021 was due to new disbursed loans in 2021.

New Authorized loans started on a high note in 2021Q1, recording a y-o-y growth of 49.7% from previously -10.6% in the same period of 2020. This growth was caused by a very high-value loan in the hotels and restaurants sector which has led to a jump in the value of the sector's loans from FRW 6.1 billion to FRW 95.3 billion (a 1460% increase). Other sectors that also experienced increases are the water & energy activities (2962.1%), services to the community (61.0%), public works & buildings (24.2%), Personal loans (16.3%), and Agricultural, fisheries & livestock (13.3%). Commerce, Manufacturing, Transport & warehousing, and OFI & Insurances experienced declines of -10.7%, -17.2%, -45.6% and -45.6% respectively.

Chart 3: Contributions of Sectors to the Change in New Authorized Loans (y-o-y % changes)



Source: NBR, Monetary Policy Department

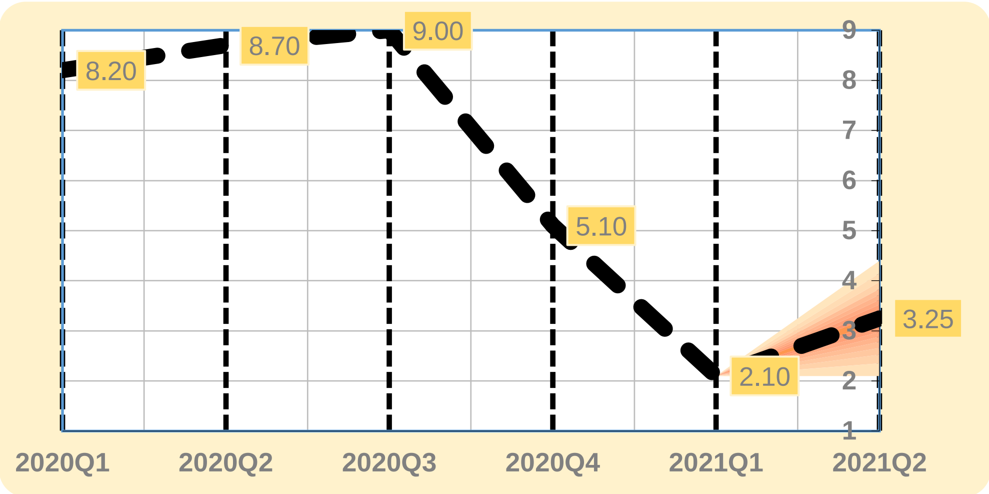
Headline inflation is projected to evolve below the benchmark of 5.0 percent in 2021Q2

In 2021Q2, headline inflation is projected to remain below the benchmark of 5.0 percent. The projected headline inflation mainly reflects the developments in both domestic and global environment. Core inflation slightly surged following an increase in school fees and other schooling-related charges and its effect is expected to continue throughout 2021Q2.

Though international food prices continue to record an upward trend on the back of disruptions in the supply chains and the slight recovery in global demand, the upward pressures in food inflation from external side will be offset by some expected downward trend in domestic food prices, despite some uncertainties that are linked to weather conditions in 2021Q2.

Energy inflation is projected to pick up slightly in 2021Q2 following the observed upticks in commodity prices as the global economy is recovering over the same period. The effect of increasing commodity prices is anticipated to be transmitted into local pump prices which will affect transport related energy components.

Chart 4: Quarterly Inflation (%, Y-o-Y), Fan chart



1.2 Global economic outlook

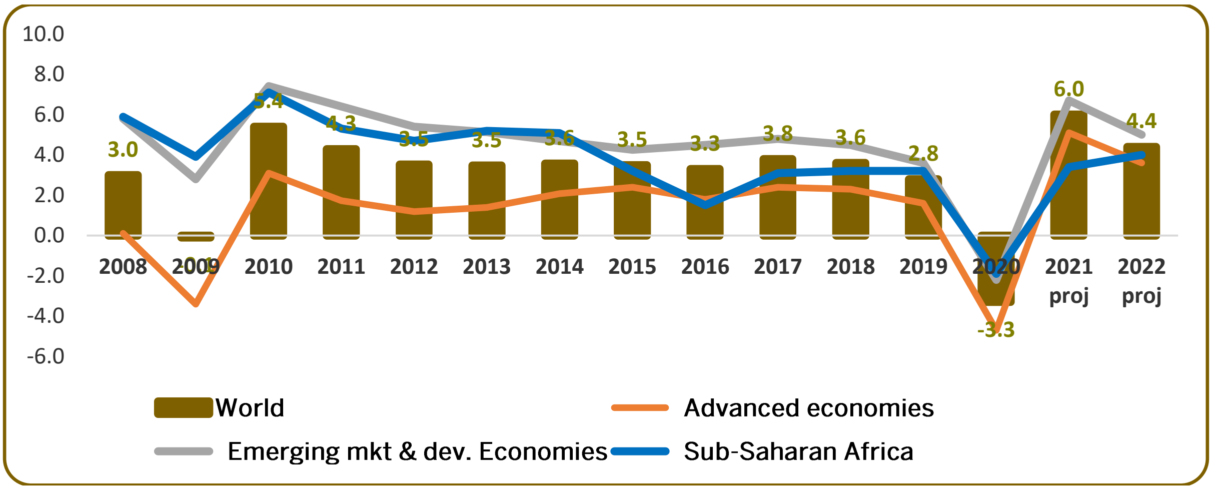
According to the International Monetary Fund's (IMF) World Economic Outlook (WEO) published in April 2021, the world economic growth is projected to recover from a contraction of 3.3 percent recorded in 2020, growing by 6.0 percent in 2021 and 4.4 percent in 2022. The growth projections for 2021 and 2022 are 0.5 and 0.2 percentage points stronger than in January forecast, reflecting additional fiscal support in a few large economies and the anticipated vaccine-powered recovery in the second half of the year.

Global growth projected to recover in 2021 after being hit hard in 2020

The world economy is projected to recover from a contraction of 3.3 percent in 2020, growing by 6.0 percent in 2021and 4.4 percent in 2022. The growth projections for 2021 and 2022 are 0.5 and 0.2 percentage points higher than in the January forecast, reflecting additional fiscal support in a few large economies and the anticipated vaccine-powered recovery in the second half of the year. This pace reflects a continued adaptation of all sectors of the economy to the challenging health situation. However, the strength of the projected recovery varies across countries, depending on the effectiveness of policy support to limit persistent damage, the severity of the health crisis, structural characteristics of the economy, and the exposure to foreign spillovers.

Beyond 2022, global growth is projected to moderate to 3.3 percent into the medium term. Persistent damage to supply potential across both advanced and emerging market economies and slower labor force growth because of population aging (largely in advanced economies, but also in a few emerging market economies), and necessary rebalancing to a sustainable growth path in China, are all expected to weigh on the growth outlook for the global economy in the medium term. GDP levels are projected to remain well below the pre-pandemic trend path through 2024 for most countries.

Chart 5: GDP growth and projections across regional blocks (% change)



Source: IMF WEO, April 2021

In advanced economies, growth is projected to recover by 5.1 percent in 2021 and to moderate to 3.6 percent in 2022, after a contraction of 4.7 percent in 2020, reflecting recovery in all major economies. These economies include the United States (6.4 percent after -3.5 percent), Eurozone (4.4 percent after -6.6 percent), United Kingdom (5.3 percent from -9.9 percent), Japan (3.3 percent from -4.8 percent), Germany (3.6 percent after -4.9 percent), France (5.8 percent compared to -8.2 percent), Italy (4.2 percent after -8.9 percent), and Spain (6.1 percent from -9.1 percent). GDP growth for 2021 has been revised up by 0.8 percentage points and by 0.5 percentage points for 2022. As the vulnerable population gets vaccinated, contact-intensive activities are expected to resume and drive a significant pickup in growth.

Relative to the January WEO update, the US growth projection for 2021 is revised up by 1.3 percentage points, reflecting carryover from the strong momentum in the second half of 2020 and the fiscal package of December 2020. Similarly, the 0.2 percentage points upward revision to Japan's 2021 projections mostly reflects the additional fiscal measures introduced at the end of 2020.

Emerging market and developing economies are projected to rebound by 6.7 percent in 2021, after contracting by 2.2 percent in 2020, and projected to grow by 5.0 percent in 2022. Tourism-based economies within this group such as Fiji, Seychelles, and Thailand face particularly difficult prospects considering the expected slow normalization of cross-border travel. Vaccine procurement data suggest that effective protection will remain unavailable for most of the population in 2021. Lockdowns and containment measures may be needed more frequently in 2021 and 2022 than in advanced economies, increasing the likelihood of medium-term scarring effects on the potential output of these countries. However, the strength of the recovery varies across countries depending on regional differences in the severity of the pandemic, economic structure, exposure to specific shocks, and the effectiveness of the policy responses to combat the fallout.

In China, GDP growth is projected at 8.4 percent in 2021, from 2.3 percent recorded in 2020. Compared to the projected growth of 8.1 percent in January 2021 (WEO update), the projected growth for 2021 reflects the effective containment measures, a significant public investment response, and central bank liquidity support. In 2022, the Chinese economic growth is projected at 5.6 percent.

According to the IMF April projections, India's economy is projected to recover highly by 12.5 percent in 2021, from a contraction of 8.0 percent recorded in 2020, and projected to grow by 6.9 percent in 2022. The projections for 2021 have been revised up by one percentage point, reflecting carryover from a stronger than expected recovery after the ease of lockdowns.

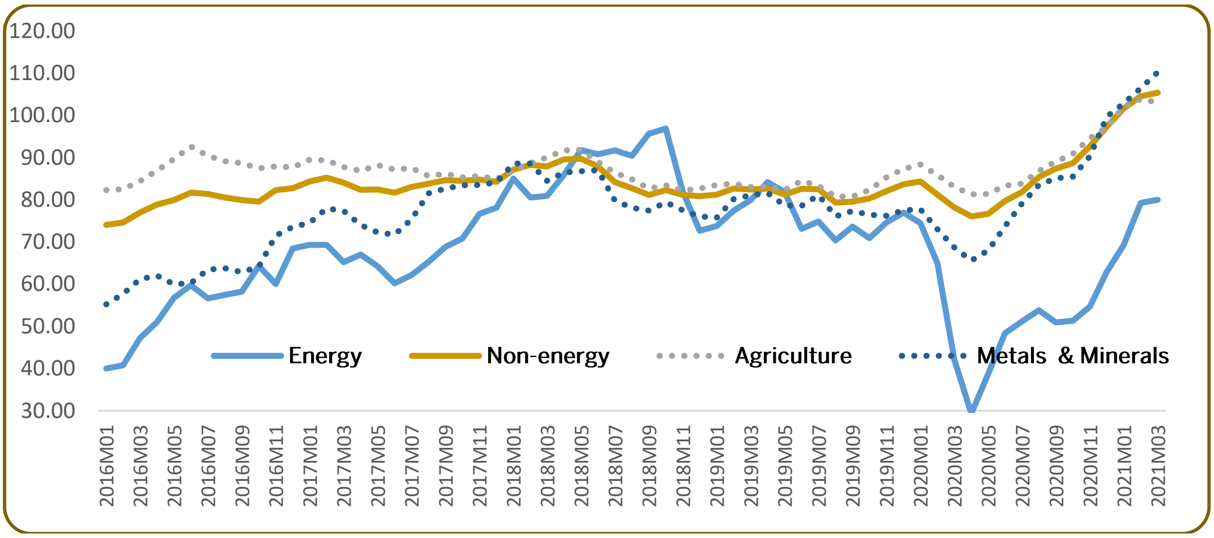
The Sub-Saharan African economy is projected to rebound to 3.4 percent in 2021, significantly lower than the trend anticipated before the pandemic, compared to a contraction of 1.9 percent in 2020, reflecting economic recovery mainly in Nigeria (2.5 percent) and South Africa (3.1 percent). However, the pandemic continues to exert a large toll on the region, especially, for Ghana, Kenya, Nigeria, and South Africa. Tourism-reliant economies will likely be the most affected.

The economic performance in the East African Community (EAC) countries is projected to recover by 5.7 percent in 2021 and to moderate to 5.3 percent in 2022 after a contraction of 0.2 percent recorded in 2020, following a projected recovery in all member countries compared to the previous year.

Higher global commodity prices induced by a rebound in global demand

In 2021Q1 (y-o-y), global commodity prices increased, reflecting a rebound in global demand. Energy prices rose by 25.9 percent from a drop of 21.5 percent in 2020Q1, attributed mainly to the crude oil prices (20.9 percent). Non-energy commodity prices increased highly by 27.8 percent in 2021Q1, after a decline of 1.0 percent in 2020Q1, owing to higher prices for agricultural commodities (20.1 percent); metals & minerals (45.6 percent), and fertilizers (33.5 percent). In March 2021 (y-o-y), energy commodity prices highly increased by 90.1 percent compared to a drop of 47.4 percent, while non-energy commodity prices increased by 34.8 percent after a decline of 5.2 percent in March 2020 (y-o-y).

Chart 6 - Commodity Prices Index in Nominal US Dollar (2010=100)



Source: World Bank, April 2021

In 2021Q1, crude oil prices increased by 20.9 percent on average compared to a decline of 18.9 percent in 2020Q1, following the rebound in global demand. In March 2021 (y-o-y), crude oil prices sensitively rose by 98.2 percent compared to a drop of 49.5 percent in the same period of the previous year. In April 2021, World Bank projects oil prices to increase by 35.7 percent, from USD 41.26/barrel in 2020 to USD 56.00/barrel in 2021, reflecting an expected rise in oil consumption.

In 2021Q1, average prices for agricultural commodities increased by 20.1 percent from 2.8 percent in 2020Q1, driven by supply shortfalls and stronger-than-expected demand in some oils and meals. In March 2021 (y-o-y), agriculture commodities rose by 24.1 percent after 0.1 percent in March 2020 (y-o-y) due to the rising prices of food (29.5 percent); of which oils & meals, grains, and other foods prices rose by 50.0 percent, 26.0 percent and 9.3 percent, respectively. Agricultural commodity prices are projected to further increase by 13.5 percent in 2021, attributed mainly to the projected rising food prices (17.1 percent) and beverages (1.4 percent).

Metals & mineral prices went up highly by 45.6 percent in 2021Q1, compared to a decline of 7.4 percent in 2020Q1, reflecting the impact of rising demand that favored industrial production activities. Prices increased for precious metals as uncertainties overshadowed prospects for the global economy and increased the demand for safe-haven assets. Precious metals rose by 19.4 percent after an increase of 19.3 percent in 2020Q1. Metals & mineral prices are projected to increase by 27.3 percent in 2021, but will later drop by 9.9 percent in 2022.

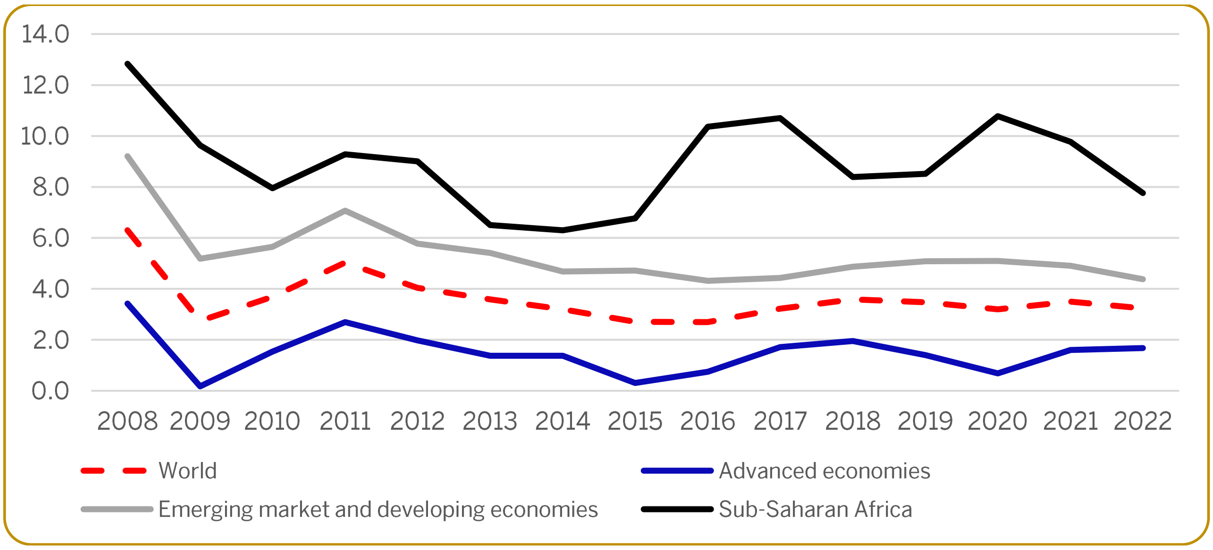
Prices for fertilizers rose by 33.5 percent in 2021Q1 from a drop of 15.9 percent in 2020Q1. In March 2021 (y-o-y), prices increased by 42.1 percent, after a decline of 13.0 percent in the corresponding month of 2020. The World Bank projects an increase of 27.1 percent in 2021 and a decrease of 0.5 percent in 2022.

Global inflation expected to remain subdued untill 2022

World annual average inflation is projected at 3.5 percent in 2021 from 3.2 percent in 2020, following a rebound in global demand and rising commodity prices, but projected to ease to 3.2 percent in 2022. Consistent with persistent negative output gaps, inflation is expected to remain subdued until 2022.

In advanced economies, consumer price inflation is projected to slightly increase to 1.6 percent in 2021 from 0.7 percent in 2020, reflecting stronger economic activities and higher commodity prices. The annual average inflation is projected to rise to 2.3 percent in 2021 from 1.2 percent in 2020 in the United States, at 1.5 percent from 0.9 percent in the United Kingdom, and at 2.2 percent after 0.4 percent in Germany, over the same period. However, due to subdued wage growth, higher unemployment and underemployment rates, core inflation remained low, giving room to Central Banks for further monetary easing.

Chart 7- Global inflation and projections across regional blocks (% change)



Source: IMF, April 2021

In the emerging market and developing economies, inflation is projected to ease to 4.9 percent in 2021, from 5.1 percent in 2020, and is projected to decelerate further to 4.4 percent in 2022. The Chinese annual average inflation is projected to ease at 1.2 percent in 2021, from 2.4 percent in 2020, and projected at 1.9 percent in 2022.

In Sub-Saharan Africa (SSA), annual headline inflation is projected to ease to 9.8 percent in 2021, from 10.8 percent in 2020, following projected falling inflation rates in Ethiopia (13.1 percent from 20.4 percent), DRC (10.9 percent after 11.3 percent), and Zimbabwe (99.3 percent from 557.2 percent). Sub-Saharan inflation is projected to ease further to 7.8 percent in 2022.

In the five countries of the East African Community (EAC), annual headline inflation is estimated to ease at 4.4 percent in 2021, from 4.5 percent in 2020, reflecting the projected lower inflation rate in Burundi (4.1 percent from 7.3 percent in 2020), Rwanda (2.5 percent from 7.7 percent), and Kenya (5.0 percent compared to 5.3 percent). The EAC stable and low inflation is attributed to good agriculture production owing to favorable weather conditions, and effective monetary policies implemented by Central Banks.

1.3 Key macroeconomic projections

In 2021Q1, headline inflation decelerated to 2.1 percent. In the near term, headline inflation is expected to remain below the 5.0 percent inflation benchmark. Over the medium term, core inflation is projected to slightly pick up in 2022 following the gradual economic recovery. Food inflation is projected to increase on the back of imported prices. In line with international oil prices, imported energy will continue to exert upward pressures on energy inflation over the same period. As a result, headline inflation is projected to evolve at 2.2 percent in 2021 and will then increase to 6.5 percent in 2022.

1.3.1 Assumptions

Though the global economy continues to recover, it will remain subdued to support the domestic economy.

Current projections continue to indicate a rise in the global economy in the next 2 years. The rising trend of the global economy in 2021, reflects the additional fiscal support to curb the effects of the Covid-19 pandemic in many economies, the projected vaccine-powered recovery expected in the second half of the year as well as the continued adaptation of economic activity to subdued mobility. Over the medium term, global economic growth is expected to moderate as a result of the anticipated effects of Covid-19 in both advanced and some emerging market economies.

Despite the expected positive trend in global demand or economic recovery going forward, some uncertainties remain. The worries are linked to the path of the pandemic, the effectiveness of policy support to provide a bridge to vaccine-powered normalization, adding to the trend of financial conditions. In line with the aforementioned path in the global economy especially for 2021 and 2022, the trend is projected to evolve below potential levels and that will continue to weigh on the domestic economy.

The rising trend of the global commodity prices is expected exert mild pressures on imported inflation.

The trend of international commodity prices over the forecasting horizon will be supported by global economic recovery and the decision about the quantity of oil to produce. However, the duration of the recovery is still uncertain, implying that the projected path in prices is highly dependent on the progress of the Covid-19 containment measures. With the expected trends in both international oils and food prices, pressures on imported inflation are expected to be moderate over the same period.

Expansionary fiscal policy is expected to continue but it will remain non-inflationary.

In 2020, the fiscal sector increased spending to limit COVID-19 effects, and the path is expected to continue throughout 2021 reflecting spending needs for the Economic Recovery Fund (ERF), and the vaccine for Covid-19. Despite the projected rising trend in fiscal spending, the stimulus on the economic growth will remain subdued, hence exerting low pressures on inflation throughout the forecasting horizon.

1.3.2 Baseline projections of key macroeconomic variables

The economy is projected to recover from the recession recorded in 2020.

Though the economy declined in 2020, projections indicated a progressive recovery over the policy horizon. The recovery will be partly driven by global demand, domestic efforts to contain COVID-19 effects, and the vaccine rollout. However, pressures from economic activity on inflation will remain subdued during the same period.

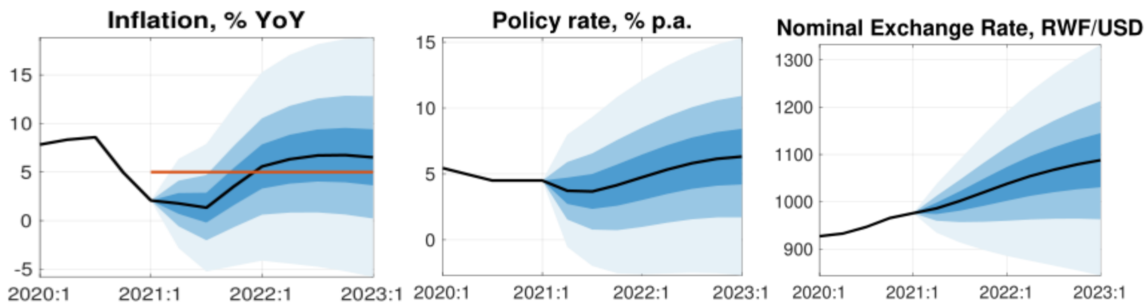
Domestic agricultural production is expected to be non-inflationary

The onset period of rainfall started in February and March 2021 while the cessation period of rainfall is expected towards the Mid-May and the beginning of June 2021. The anticipated rainfall is expected to be favorable for agricultural production, hence subdued pressures from food inflation going forward.

1.3.3 Projection of key macroeconomic indicators

Consistent with the projected trend in the global economy and commodity prices, domestic fiscal policy and other key macroeconomic variables, headline inflation is projected at 2.2 percent in 2021. Headline inflation will then pick up to 6.5 percent in 2022.

Chart 8: Projections



Source: NBR, Monetary Policy and Research Directorate

Going forward, both imported and domestic costs of production are expected to exert mild upward pressures on core inflation (core excluding food items) towards the beginning of 2022. The increasing trend of food inflation that started in 2021Q1 following the hike in international food prices will be easing over the medium term. Besides, the expected path in food inflation will be reflecting domestic agricultural production. In line with the increasing trend in international oil prices, imported energy items are expected to continue exerting pressures on energy inflation in 2021.

II. DOMESTIC ECONOMIC DEVELOPMENTS

2.1 Economic growth

Rwanda's real GDP contracted by 3.4 percent in 2020 compared to a growth of 9.5 percent registered in 2019. The highest contraction was recorded in 2020Q2, and a gradual recovery started subsequently, on the back of supportive policy measures and easing COVID-19 containment measures. The contraction in real GDP slowed to -3.6 percent and -0.6 percent in 2020Q3 and 2020Q4 respectively, after -12.4 percent in 2020Q2.

Gradual recovery of domestic economy from the contraction caused by the COVID-19 pandemic.

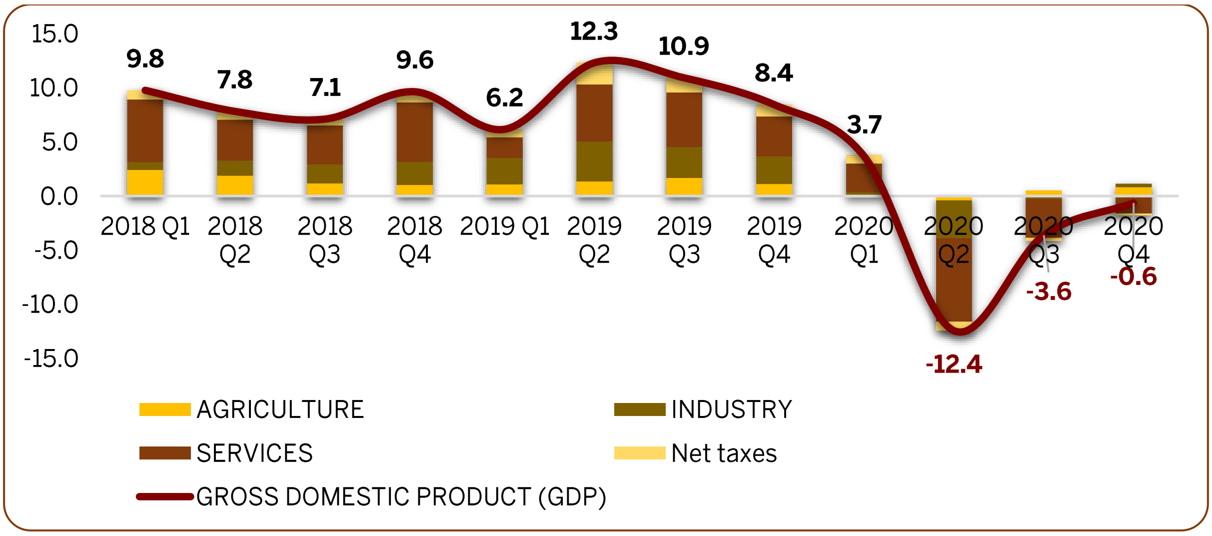
Rwanda's real GDP contracted by 3.4 percent in 2020 compared to a growth of 9.5 percent recorded in 2019. However, the second half of 2020 recorded a gradual recovery helped by supportive policy measures and easing COVID-19 containment measures. In 2020Q4, the real GDP decreased by 0.6 percent, better than -3.6 percent and -12.4 percent recorded in 2020Q3 and 2020Q2 respectively.

The services sector output decreased by 5.5 percent in 2020 from an increase of 8.3 percent in 2019, reflecting a heavy COVID-19 impact on tourism-related services. This slowdown translated mainly in the decline of air transport services (-64.7 percent from 17.7 percent), Hotels & restaurants (-40.2 percent from 9.7 percent), as well as Travel agents & tour operators (-40.2 percent from 7.7 percent). Furthermore, the negative impact of the pandemic was also observed in other subsectors, of which wholesale and retail trade (-3.3 percent from 15.7 percent), financial services (-2.4 percent from 8.4 percent), and education (-37.5 percent from 2.2 percent). Information and communication was the only subsector that performed well (29.2 percent from 9.1 percent), supported by strong demand for telecommunication services to support teleworking.

In the industry sector, the adverse impact of the COVID-19 pandemic was broad-based. Construction declined by 5.7 percent in 2020 from a growth of 32.8 percent in 2019, mining and quarrying contracted further to -31.2 percent from -0.3 percent while manufacturing slowed down to a growth of 2.0 percent from 11.3 percent previously. Electricity and water rose by 1.9 percent and 2.4 percent respectively from 7.2 percent and 2.1 percent.

In 2020, growth in agriculture slid to 0.9 percent from 5.0 percent in the previous year, mainly led by a slowdown in food production, which represented 62.9 percent of agriculture gross value added in 2020. Food crop production grew by 0.3 percent, significantly lower than 4.0 percent reached in 2019, reflecting bad weather conditions that prevailed during 2020 agricultural season A. In addition, export crops (-9.4 percent from 4.5 percent) and fishing (-15.5 percent from 3.7 percent) subsectors poorly performed as a result of sluggish foreign and domestic demand following the COVID-19 pandemic.

Chart 9: Real Gross Domestic Product (percentage change)



Source: National Institute of Statistics of Rwanda

The domestic demand remains subdued though recovering

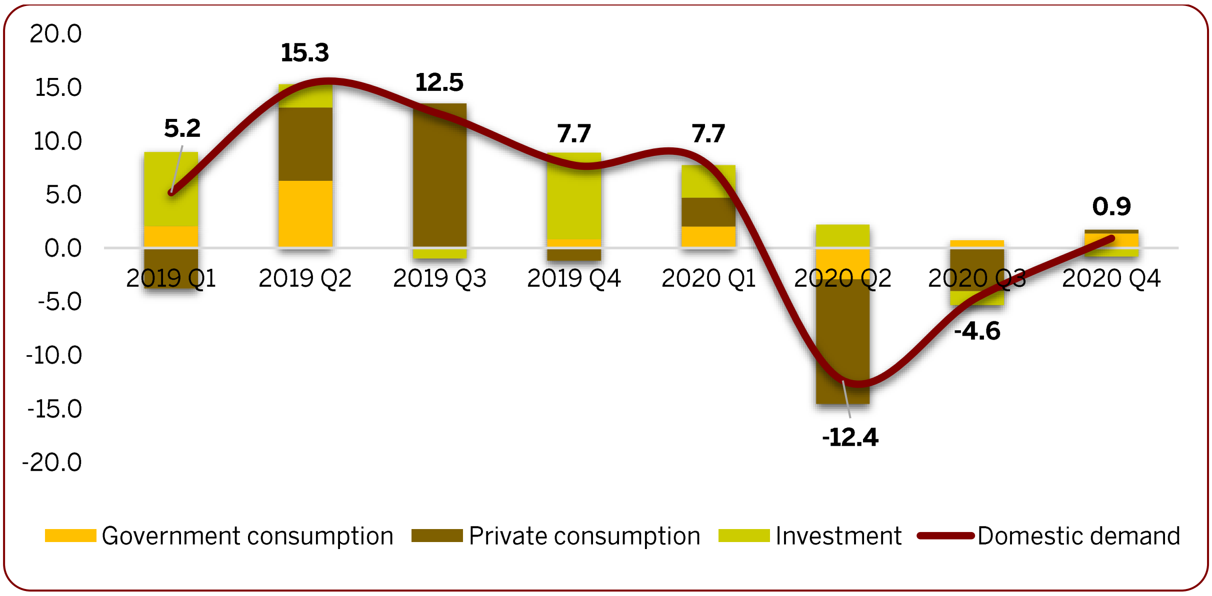
The sanitary crisis, induced demand shocks as a consequence of virus containment measures. In this regard, the domestic demand in Rwanda fell by 2.2 percent in 2020 and private consumption was the most hit. The latter contracted by 5.0 percent against a growth of 5.5 percent in 2019 while government consumption and investment decelerated, growing by 1.9 percent and 3.5 percent respectively in 2020 from 17.6 percent and 20.8 percent during the preceding year.

Although the demand shrunk on an annual basis, it took a recovery path during the second half of 2020. In 2020Q4, it grew by 0.9 percent, improving from a decrease of 4.7 percent and 12.1 percent in 2020Q3 and 2020Q2 respectively.

The improvement in domestic demand was mainly led by Government consumption, which grew by 10.6 percent in 2020Q4 after 5.9 percent in 2020Q3 and a decline of 17.6 percent in 2020Q2. . Helped by the ease of restriction measures as well as improvement in employment, private consumption recorded a growth of 0.6 percent in 2020Q4 after two consecutive quarters of decline (-5.8 percent in 2020Q3 and -18.4 percent in 2020Q2). Employment increased by 7.9 percent during the second half of 2020 after dropping by 1.8 percent in 2020Q2, following the resumption of economic activities.

In respect of investment expenditure, it decreased by 2.9 percent in 2020Q4, improving from a decline of 7.4 percent recorded in 2020Q3, amid a slowdown in machine and equipment, which investment grew by 5.5 percent from 10.6 percent, while construction investment fell less than previously (-2.5 percent from -5.5 percent).

Chart 10: Domestic demand (percentage change)



Source: National Institute of Statistics of Rwanda

Rwanda's trade balance improved as exports went up while imports fell.

In 2021Q1, merchandise exports[1] rose by 6.5 percent, y-o-y, mainly driven by revenues from traditional exports on improving commodity prices and increased export volumes. The increase in export volumes may also be explained by sales of existing stocks and improving global trade as disruptions caused by the Covid-19 reduce.

Traditional exports rose by 14.1 percent to USD 64.0 million in 2021Q1 from USD 56.09 million in the corresponding period of last year, due to the increased receipts from coffee exports (+64.0 percent) and minerals (+21.8 percent), partly reflecting improving global commodity prices.

Moreover, non-traditional exports slightly rebounded in 2021Q1, rising by 0.1 percent in value, mainly attributed to increased exports of horticulture to European market as well as manufacturing exports mainly construction materials to neighboring countries. Lastly, receipts from re-exported products soared by 14.5 percent, largely driven by exports of food products while revenues from Informal Cross-Border Trade (ICBT) decreased by 21.0 percent. ICBT exports, which represent 9.2 percent of total merchandise exports receipts,

[1] Merchandise exports/ imports refers to exports/imports excluding gold. It includes formal exports and informal cross-border trade (ICBT).

continue to be severely affected by lower cross-border movements due to the COVID-19 pandemic.

Merchandise imports fell by 11.3 percent mainly driven by lower imports of consumer goods on decreased imports of food products, and intermediate goods, partly due to the partial lockdown imposed early 2021 to reduce the spread of COVID-19. The decline in imports of intermediate goods is also on lower demand of construction materials following the completion of public schools as well as rising domestic production of cement following the launch of the new cement manufacturer in the second half 2020. However, imports of capital goods soared substantially, rising by 12 percent, driven by imports of electrical equipment to support the power sector growth as the government plans to supply electricity to 100% of the population by 2024.

As a result, Rwanda's trade balance improved by USD 71.3 million (7.4 percent growth), amounting to USD 888.2 million in the first quarter of 2021, down from USD 959.5 million recorded a year earlier.

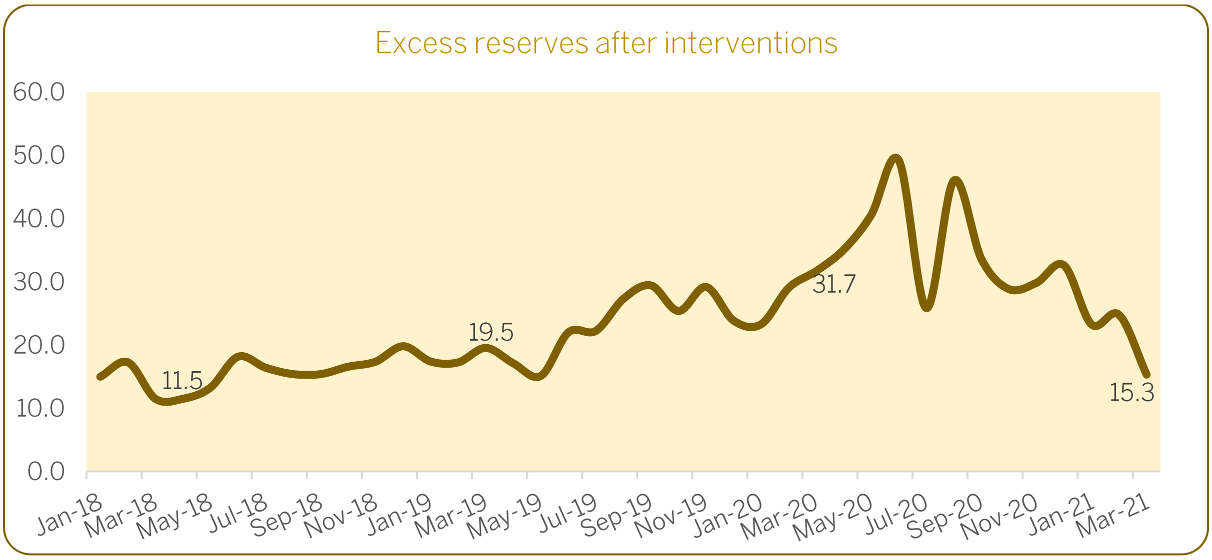
2.2 Financial and monetary developments

In February 2021, the Monetary Policy Committee (MPC) decided to hold the Central Bank Rate (CBR) at 4.5 percent to maintain an accommodative monetary policy stance. In addition, NBR increased its reverse repo operations to ensure the banking system liquidity conditions are stable. As a result, excess reserves by banks - which is the surplus on the regulatory reserve requirement - remained sound. In 2021Q1, broad money and outstanding credit to private sector grew by 22.5 percent and 22.0 percent (y-o-y), respectively. In line with the ongoing NBR accommodative monetary policy stance, market interest rates in the economy reduced further. In 2021Q1, y-o-y, the average lending rate reduced by 91 basis points to 15.82 percent, which is favorable to continue supporting the economic recovery.

The NBR increased its reverse repo operations to ensure the banking system liquidity conditions are stable.

Despite the slowdown of economic activities in 2021Q1, excess reserves by banks - which is the surplus on the regulatory reserve requirement - remained sound, owing to supporting monetary policy instruments, mainly the reverse repo. To that end, the reverse repo stock increased to FRW 87.5 billion as of end March 2021 from FRW 20 billion in the same period of the previous year.

Chart 11: Excess reserves in the Banking System (FRW billion)

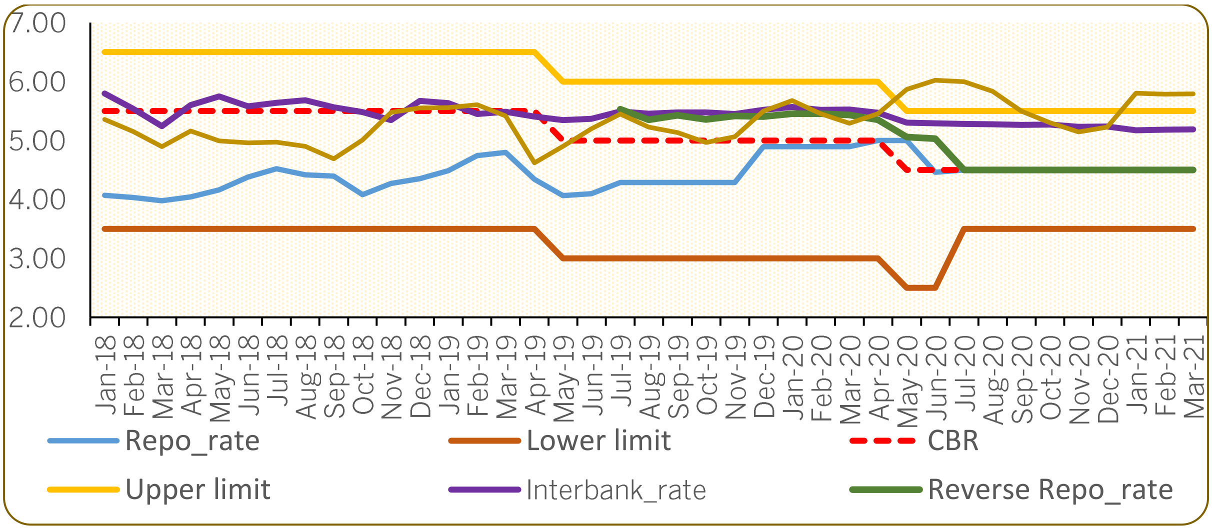


Source: NBR, Monetary Policy and Research Directorate

Money Market rates were largely steered around the central bank rate.

The Monetary Policy Committee (MPC) decided in February 2021 to hold the central bank rate (CBR) at 4.5 percent to maintain an accommodative monetary policy stance. Money market rates except T-bills rates have been steered around the central bank rate, in the symmetric corridor of ±1 percent, as a result of the policy rate cut and other measures to support the liquidity of banks. The interbank rate dropped by 36 basis points to 5.18 percent in 2021Q1, from 5.54 percent in 2020Q1. However, T-bills rate rose by 31 basis points to 5.79 percent in 2021Q1, from 5.48 percent in 2020Q1. The repo and reverse repo rates were at 4.5 percent, following the revised monetary policy framework which set these rates at the policy rate since July 2020.

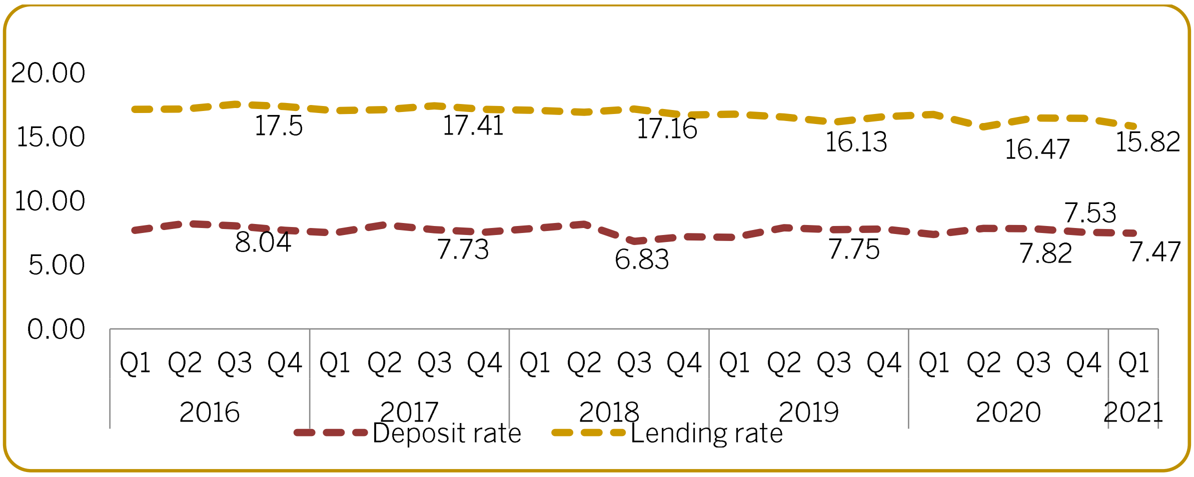
Chart 12: Money market rates developments



Source: NBR, Monetary Policy and Research Directorate

Regarding market rates, the lending rate decreased by 91 basis points to 15.82 percent in 2021Q1 from 16.73 percent in 2020Q1, reflecting a declining trend in lending rates for both corporate and individual borrowers. The deposit rate increased by 9 basis points to 7.47 percent on average in 2021Q1 from 7.38 in 2020Q1. As a result, the spread between the lending rate and the deposit rate fell by 100 basis points to 8.35 percent on average in 2021Q1, down from 9.35 percent in 2020Q1.

Chart 13: Market interest rates (percent average)



Source: NBR, Monetary Policy and Research Directorate

The foreign exchange market remains stable.

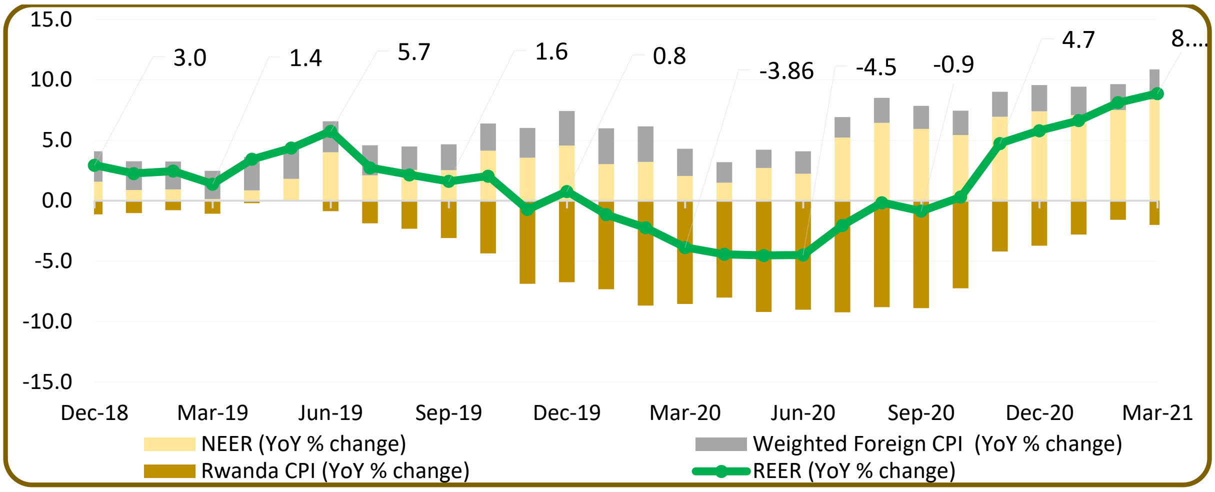
In the first quarter of the year 2021, the depreciation of the Rwandan franc was relatively higher, compared to the same period of 2020. This was mainly due to subdue forex inflows as the supply chain disruptions continued to constrain foreign transactions, amid rising demand for forex linked with continuous imports of essential goods and healthcare products.

End March 2021, the FRW depreciated by 5.22 percent year-on-year vis-à-vis the USD after 4.71 percent depreciation recorded at the end of March 2020. It also weakened against the Euro, Yen and the British Pound by 11.81 percent, 2.76 percent and 17.06 percent respectively against 2.70 percent, 7.09 percent depreciations and 1.17 percent appreciation registered in the same period last year.

With regard to the regional currencies, the FRW weakened by 0.57 percent and 4.90 percent against the Kenyan and Tanzanian shilling respectively, slower than 0.81 percent and 5.27 percent reached last year. The local currency also weakened versus the Ugandan and Burundian franc, losing 9.01 percent and 2.08 percent compared to 2.76 percent and 0.04 percent, respectively recorded in March 2020.

In real effective terms, the FRW depreciated by 8.88 percent (y-o-y) end March 2021, against an appreciation of 3.86 percent recorded during the corresponding period of 2020. This depreciation of the FRW was mostly attributable to higher nominal depreciation of the franc compared to a basket of currencies of the main trading partners, together with relatively higher weighted foreign inflation than the domestic inflation. In nominal effective terms, the franc depreciated by 8.39 percent in March 2021 compared to a depreciation of 2.06 percent end March 2020.

Chart 14: Drivers of REER movement



Source: BNR, Monetary Policy and Research Department

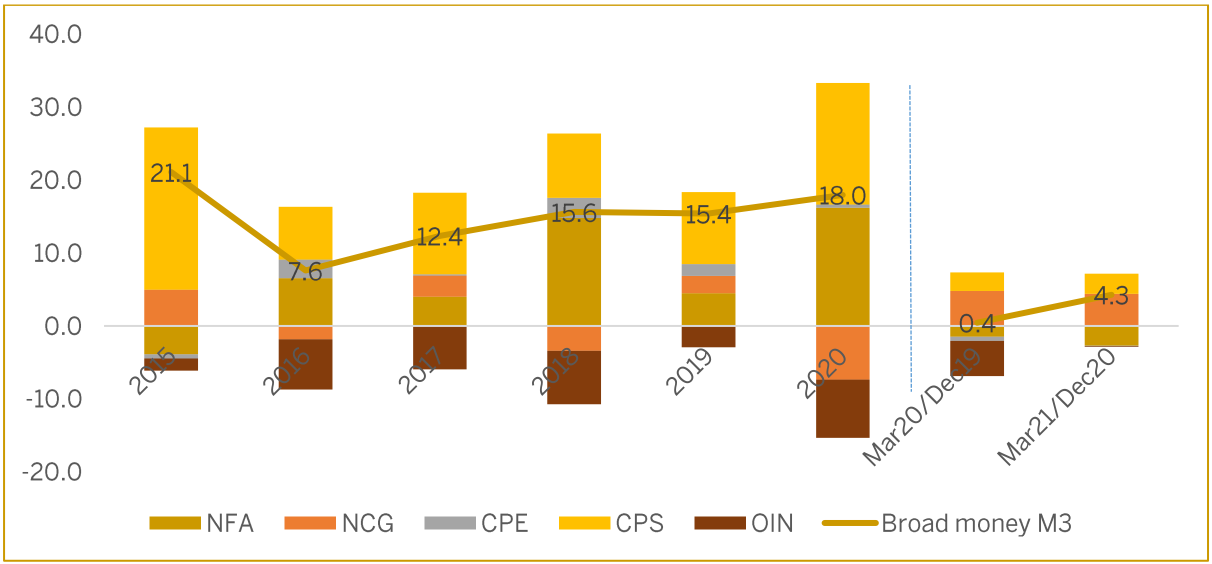
Broad money M3 picked up in the first three months of 2021, in line with the implementation of the accommodative monetary policy stance.

The broad money M3 expanded by 22.5 percent y-o-y in March 2021 higher than an increase of 12.3 percent in March 2020. In the same period, outstanding credit to private sector grew by 22.0 percent compared to 12.5 percent in March 2020. This growth was driven by new authorized credit disbursed during that period and other economic policy support measures.

In the first three months of 2021, the broad money M3 picked up by 4.3 percent from a minor growth of 0.4 percent recorded in the same period of the previous year. The net credit to government (NCG) and the credit to the private sector (CPS) contributed 4.4 percent, 2.7 percent respectively to the growth of M3 in the first three months of 2021 from 4.8 percent and 2.5 percent in the same period of the year before. However, the net foreign assets (NFA), the credit to the public enterprises (CPE) and the other items net (OIN) slightly pulled down that growth of M3 by 2.7 percent for NFA and 0.1 percent for CPE and OIN from - 1.5 percent, - 0.6 percent and – 4.8 percent respectively in the same period of the previous year.

The higher contribution of NCG to the growth of M3 was explained by the increase in government spending from which resulted an improved fiscal injection in 2021Q1. This reduced the government deposits by 10.3 percent from - 5.7 percent in the same period of the year before. The contribution of outstanding CPS remained explained by the restructured loans in addition to the rise of new authorized loans in the first quarter of 2021 especially in the hotel sector as shown in the following parts. The negative contribution of NFA mainly resulted from the contraction in NBR's NFA caused by the slowdown in the growth of foreign revenues to 17.2 percent in 2021Q1 from an increase of 133.7 percent in 2020Q1 amid low outflows. This has been offset by an improvement in NFA of commercial banks, which rose by 15.6 percent from + 3.2 percent, in line with recovering external sector.

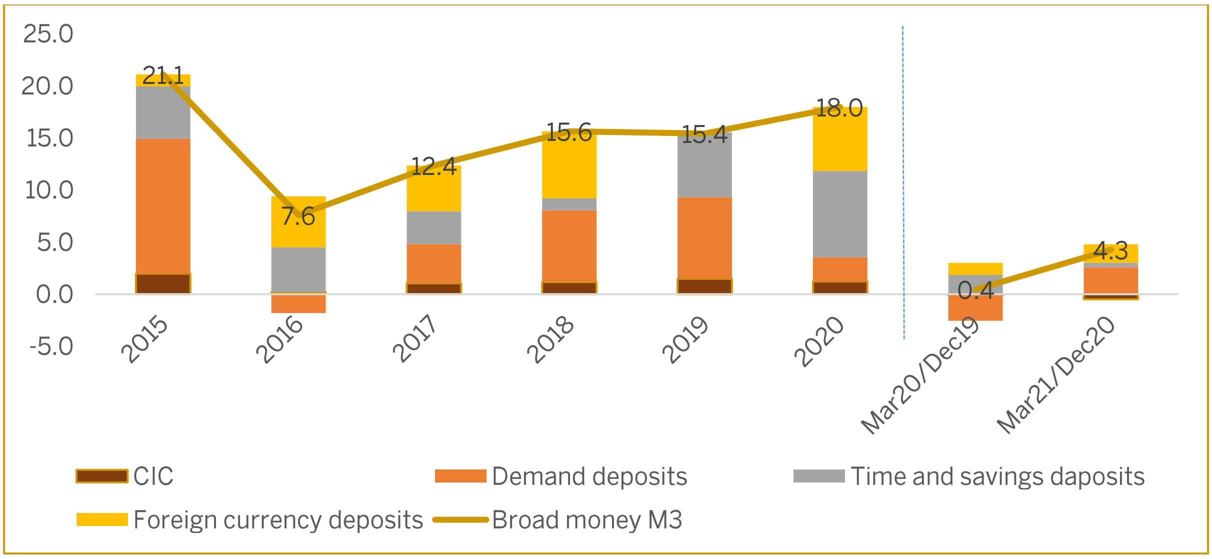
Chart 15: Contributors to M3 growth from assets side



Source: NBR, Monetary Policy and Research Department

With regard to the broad money M3 components, its growth of 4.3 percent between December 2020 and March 2021, was mainly attributed to the growth of demand deposits with a contribution of 2.6 percent from - 2.4 percent, foreign currency deposits that contributed 1.8 percent from 1.2 percent, and time and savings deposits with 0.4 percent from 1.8 percent. However, the currency in circulation reduced the growth of M3 with a contribution of – 0.5 percent from - 0.1 percent.

Chart 16: Contributors to M3 growth from liabilities side



Source: NBR, Monetary Policy and Research Directorate

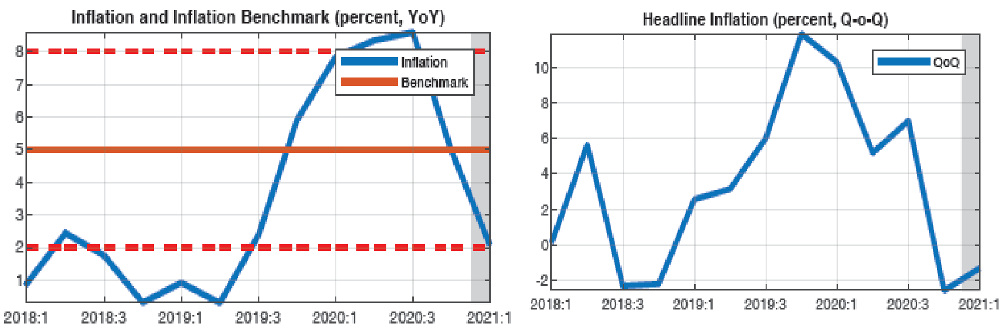
III. INFLATION DEVELOPMENTS

As projected during the forecasting round of February 2021, headline inflation decelerated to 2.1 percent in 2021Q1. The ease in headline inflation was mainly reflected in core, food and energy components. The aforementioned disinflation was attributed mostly on base effects as well as good agricultural production that was recorded in Season A 2021.

Headline inflation decelerated, reflecting a decline in all its components.

In 2021Q1, headline inflation decelerated to 2.1 percent from 5.1 percent recorded in the previous quarter. The decline in headline inflation was reflected in all main components. From 2020Q4 to 2021Q1, core inflation eased from 4.2 percent to 3.2 percent, food inflation declined from 6.2 percent to -0.4 percent, and energy inflation dropped from 5.2 percent to 1.3 percent.

Chart 17: Developments in headline inflation (Y-o-Y, % change)

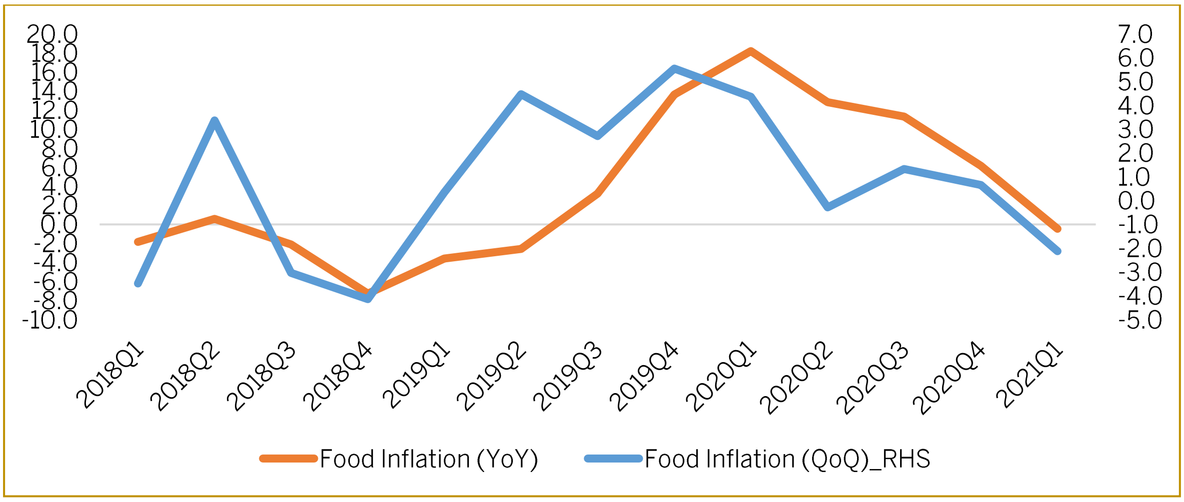


Source: NBR, Monetary Policy and Research Directorate

Food inflation declined following good domestic agricultural production, coupled with base effect.

In 2021Q1, food and alcoholic beverages inflation slowed down in both y-o-y and q-o-q terms. The downward trend in food inflation mainly followed good agricultural production in Season A 2021 especially for fresh food items. In the corresponding period of 2020, higher prices resulted from bad harvest. However, in the season under review good agricultural production started towards the end of 2020 and continued through 2021Q1 on the back of favorable weather conditions, indicating that the decline in food inflation also reflected the base effect.

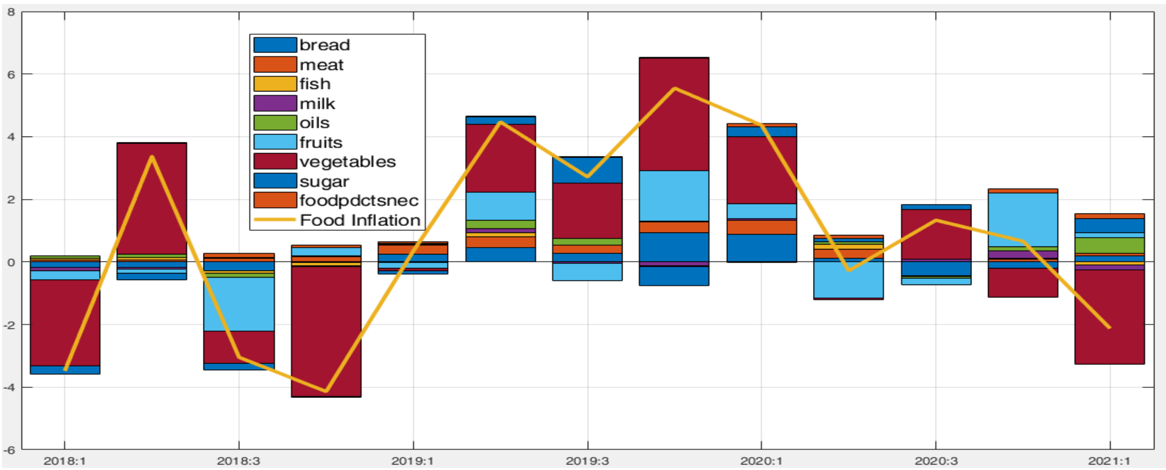
Chart 18: Development of food inflation (percentage change)



Source: NBR, Monetary Policy and Research Directorate

In q-o-q terms, food inflation dropped on the back of the decline in fresh products that outweighed uptick in prices of some processed and imported food items in line with the international prices.

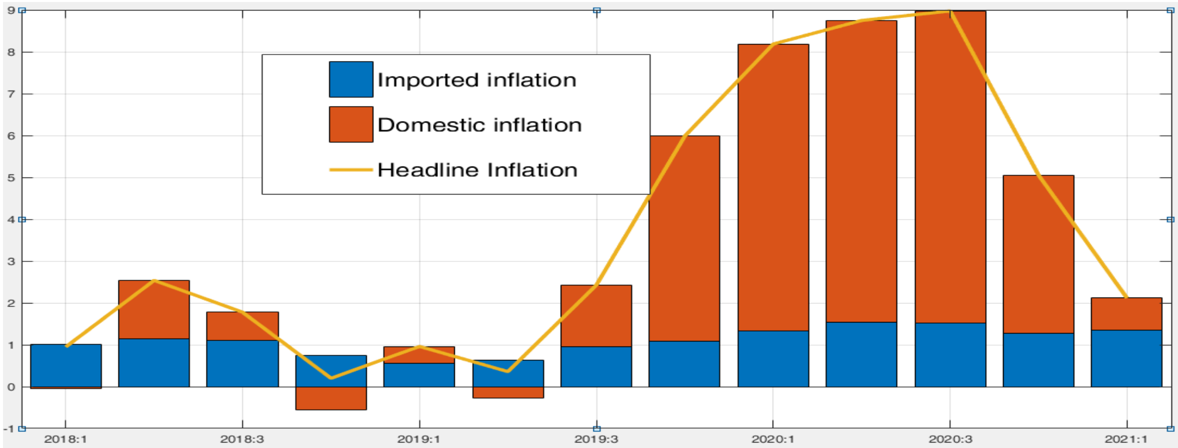
Chart 19: Development of food inflation (%, q-o-q)



Source: NBR, Monetary Policy and Research Directorate

Subsequently, unlike domestic inflation, imported inflation pushed up headline inflation. While imported inflation surged from 5.6 percent in 2020Q4 to 5.9 percent in 2021Q1, domestic inflation mainly declined from 4.9 percent to 1.0 percent, during the same period, reflecting the huge supply of vegetables from season A 2021. As depicted in figure 5, upward pressures in 2021Q1 resulted mostly from outside and they are largely reflected in food components.

Chart 20: Contribution to headline inflation (%, y-o-y)



Source: NBR, Monetary Policy and Research Directorate

It is worth to note that food prices remain the key driver of both domestic and imported inflations. On one hand, the current trend in domestic inflation is partly explained by base effect, coupled with effects of season A 2021 agricultural production. On the other hand, imported inflation is partly explained by the difficulties in the supply chains of food products, increase in the international prices, and difficulties in the supply chain of transport related products as a result of Covid-19, coupled with the effects of exchange rate.

Chart 21: Domestic inflation (%, y-o-y)

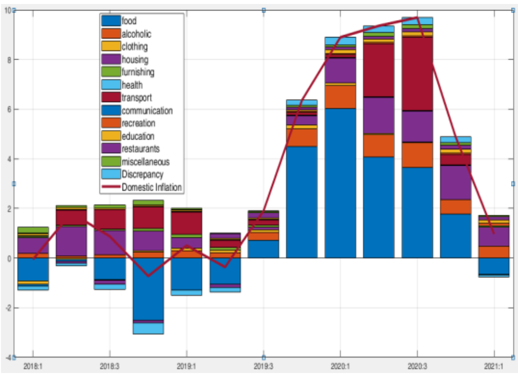
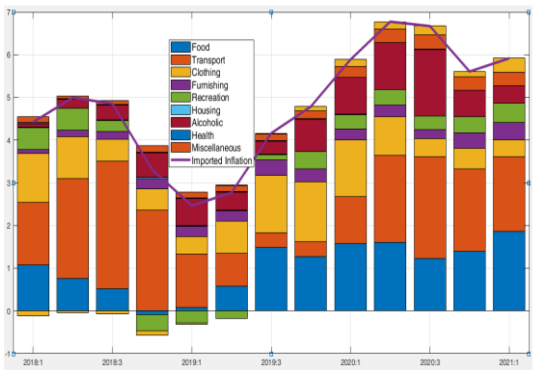


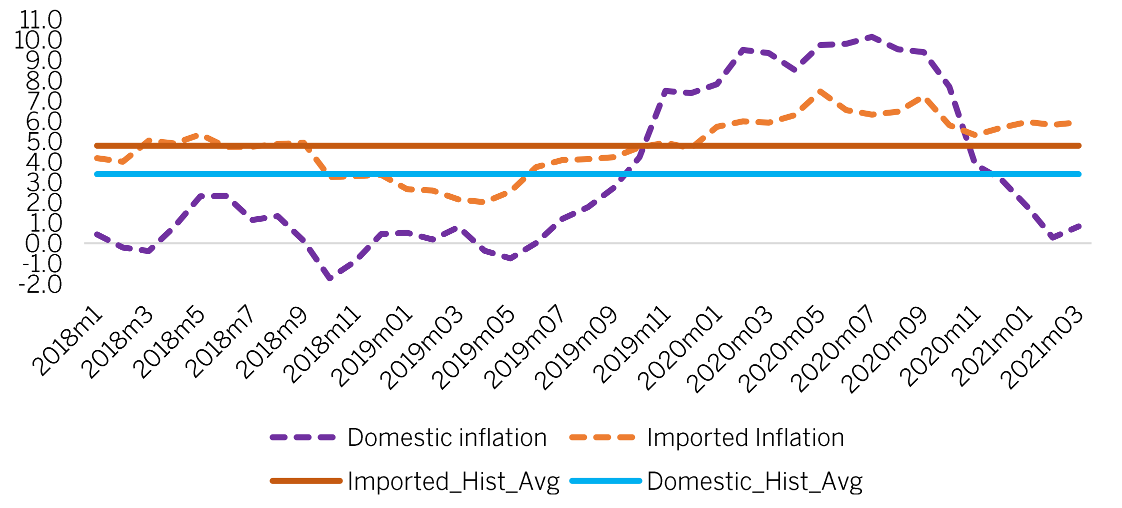
Chart 22: Imported inflation (%, y-o-y)



Source: NBR, Monetary Policy and Research Directorate

Over the past three years (2018M01-2021M03), imported inflation (y-o-y) evolved at 4.8 percent while domestic inflation (y-o-y) stood at 3.4 percent, meaning that imports brought more pressures than domestic production. Considering the period of 2021Q1, domestic inflation is lower than the average while imported inflation is higher than average. This reflects the continuous uptick in international food prices, putting pressures on prices of imported food items on domestic markets.

Chart 23: Developments of domestic vs imported inflations (%,y-o-y)

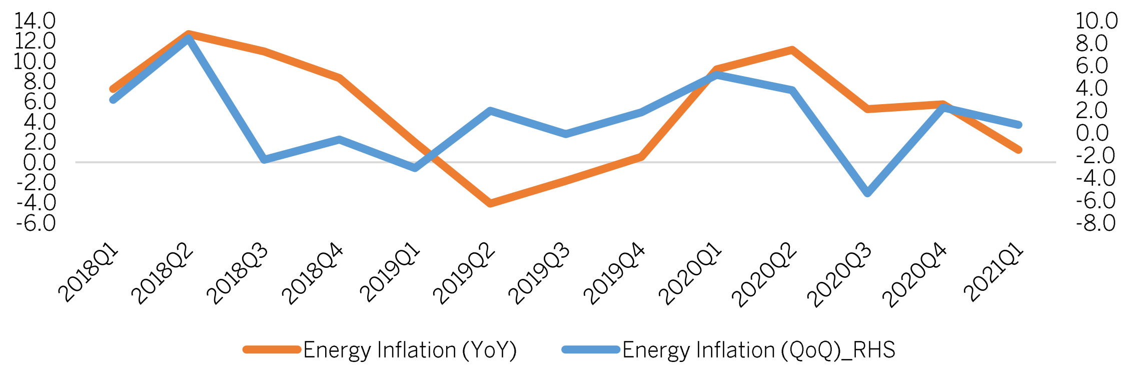


Source: NBR, Monetary Policy and Research Directorate

Energy inflation eased on the back of base effect

Energy inflation reduced in both y-o-y and q-o-q terms. The decelerations in energy inflation observed in 2021Q1 mainly resulted from the base effect. Last year in the corresponding period, higher prices were recorded and this was attributed to the upward revision in electricity tariffs. In addition, on the onset of the Covid-19 outbreak, higher prices for solid fuels were noted as consumers rushed to build stocks. Though base effects pushed down energy inflation, this declining trend was partly offset by the surge in international oil prices which were transmitted into local pump prices, starting from January and March 2021.

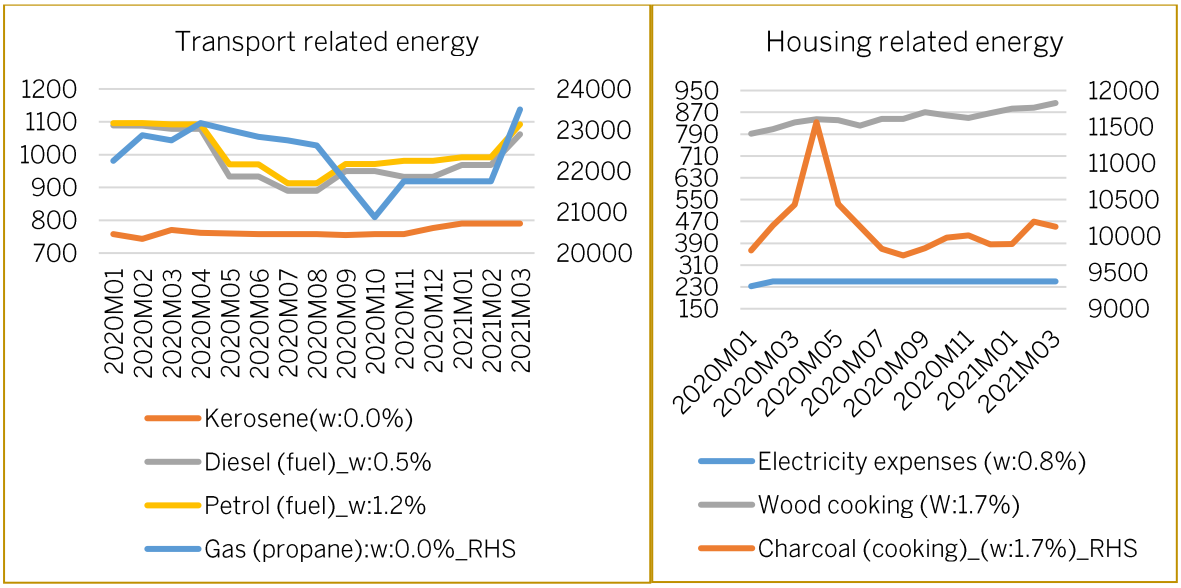
Chart 24: Energy inflation (percentage change)



Source: NBR, Monetary Policy and Research Directorate

Housing related energy prices are offsetting upward pressures from transport related energy.

Chart 25: Developments in energy (price levels)



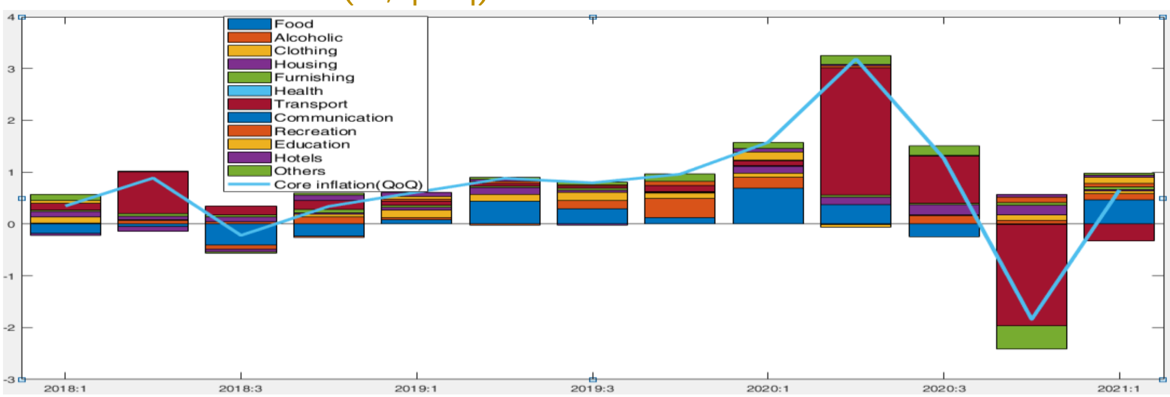
Source: NBR, Monetary Policy and Research Directorate

Though core inflation eased in 2021Q1, y-o-y, some upward pressures were recorded from education.

The easing trend observed in core inflation was mostly reflected in alcoholic beverages. Such movement reflects the higher prices recorded in alcoholic beverages component following the effect of measures to fight against tax evasion, last year during the same period.

Despite the slowdown in core inflation (y-o-y), upward pressures emerged in quarter on quarter terms. In 2021Q1, core education inflation surged and the rise was attributed to the increase in school fees in March 2021. Additionally, some core food and transport items showed an uptick in prices as a result of disruptions in the supply chains during the Covid-19 crisis. The hike in core food price pressures is on the back of the continued increase in the international food prices that started in May 2020 until now.

Chart 26: Core inflation (%, q-o-q)

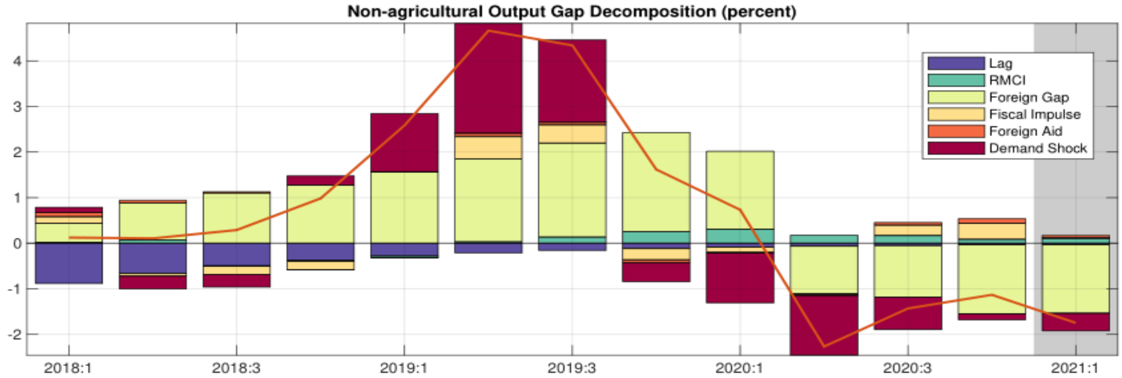


Source: NBR, Monetary Policy and Research Directorate

Moderate pressures on core inflation, in line with subdued economic growth

Economic growth in non-agricultural sectors remained slow following Covid-19 measures, such as lockdowns and limited inter-districts movements. Still, though fiscal and monetary sectors became more supportive, the projected GDP growth is not expected to be inflationary. Additionally, the trend in global environment continues to weigh on the domestic economic recovery, reflecting minimum pressures on core inflation.

Chart 27: Developments in non-agricultural output gap



Source: NBR, Monetary Policy and Research Directorate

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