NATIONAL BANK OF RWANDA
BANKI NKURU Y'U RWANDA

Policy Dialogue on Inflation

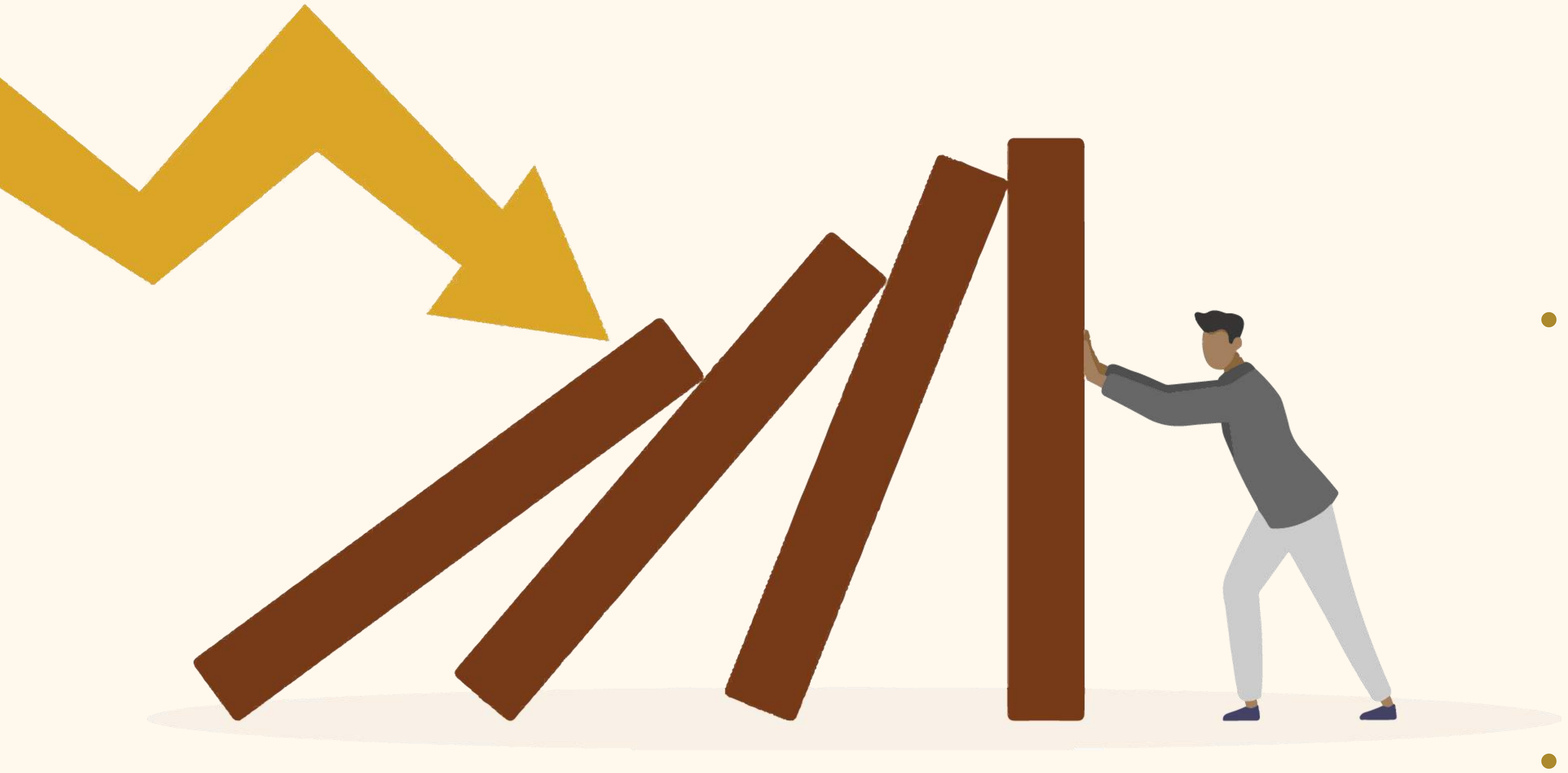
February 2023

Public-Private Policy Dialogue organised by EPRN Rwanda (www.eprnrwanda.org)

Outlines

1. Global economy
2. Real sector
3. External sector
4. Monetary sector
5. Inflation

Forces Affecting Global Developments



- **Russia-Ukraine War**
  - ➢ Still higher energy and food prices though decelerating despite Black sea grain deal
- **Tight financial conditions**
  - ➢ High cost of living caused by persistently high and broadening inflation pressures,
  - ➢ Rapid and synchronized tightening of monetary conditions
- **Resurgence of COVID-19 in China**
- **Climate change.**

Global **Inflation Developments**

Inflation is expected to fall but remains elevated

World Inflation is projected to decrease from

8.8%		6.6%
2022	TO	2023

Global Commodity Price Developments and outlook (y-o-y)

Global Energy Index

2022 Q3		2022 Q4	Projected to 2023
+66.6%	TO	**+18.7%**	-11.2%

Crude Oil

2022Q3		2022Q4
+34.6%	TO	+8.9%

Non-Energy Index

2022Q3		2022Q4	Projected to 2023
+2.6%	TO	-2.4 %	-8.1%

Agriculture Commodities

2022 Q3		2022 Q4
+8.5%	TO	2.6%

Global Economy to continue recovering, but at a slower pace

Global Economy projected to grow at a slower pace

2.9%		3.1%
2023	&	2024

After a growth of

3.4%

2022

Regional Economy Continues to Recover

Sub Saharan Economy projected to grow by

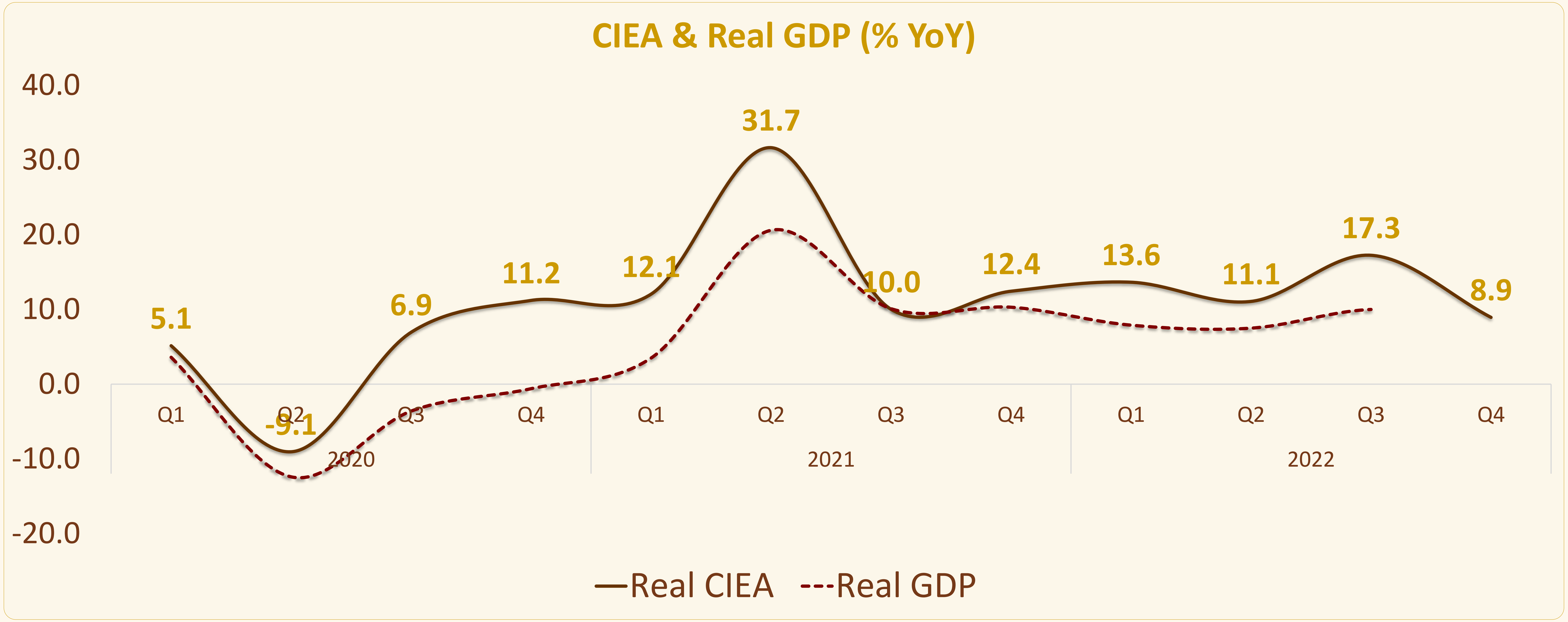
3.8% 2023 & 4.1% 2024

Following a growth of

3.8% 2022

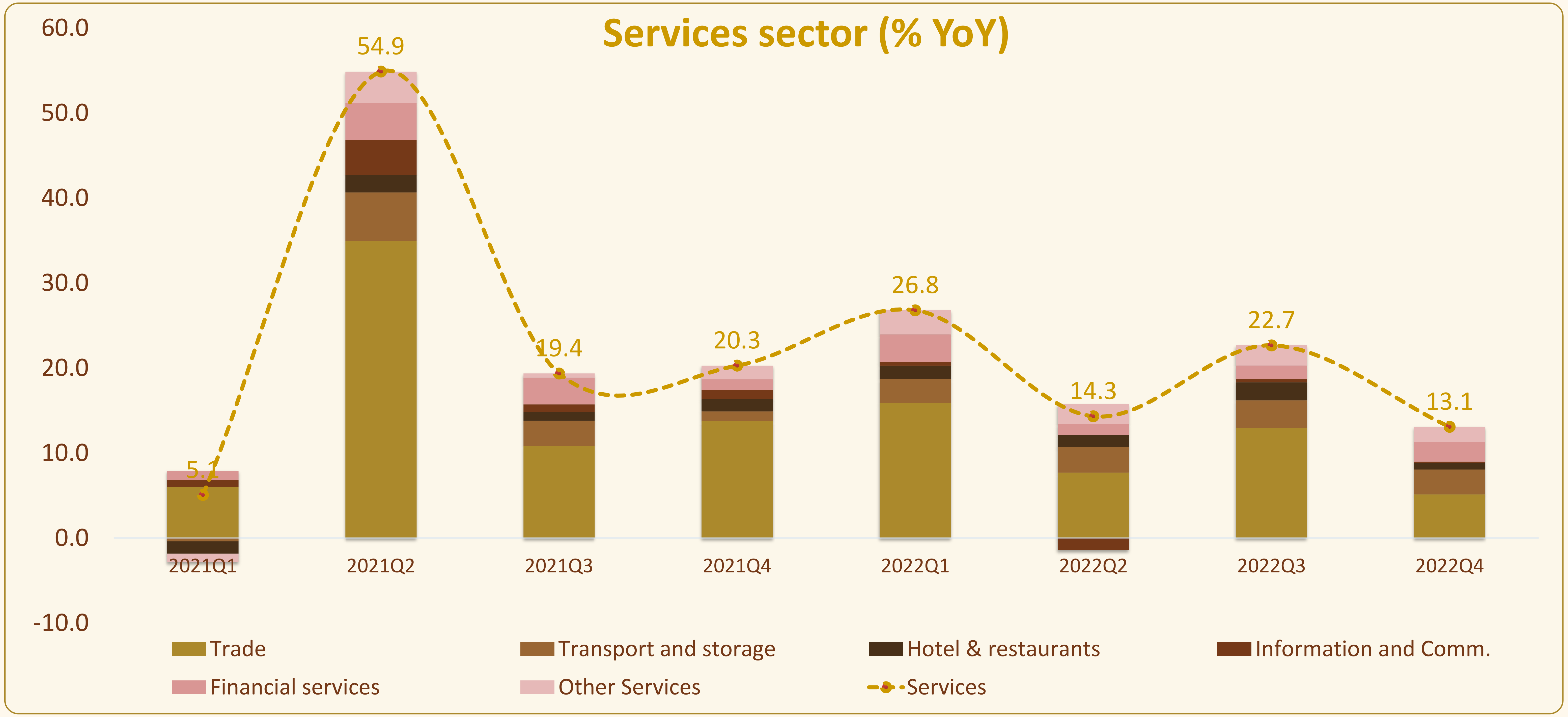
Rwandan Economy to remain resilient, after growing by 8.5% on average in the first 3 quarters of 2022

Composite Index of Economic Activities point a persistent momentum of growth, despite a weak performance of the agriculture sector



Rwandan Economy to remain resilient

On back of buoyant services sector



Strong performance of service sector, mainly driven by trade services & strong rebound of tourism-related services

External Sector Performance

Merchandise export performed well

+31.4%

2022

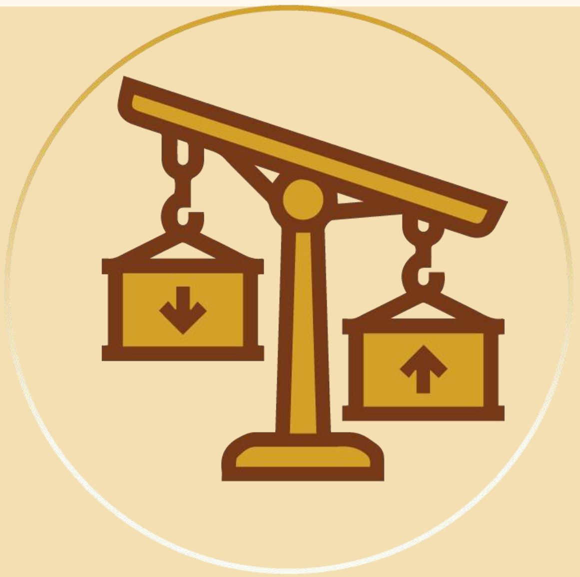
Attributed to rising global commodity prices and good performance of manufacturing activities.

Merchandise imports rose by

+23.6%

2022

Attributed to higher international commodity and fuel prices combined with the recovery of domestic economic activities.



Merchandise Trade Deficit increased by

+19.1%

2022

Mainly due to higher imports despite growing exports

FRW depreciation vs USD

6.05%

2022

Monetary Policy Developments

Interbank rate increased from

5.18% — 2021 TO 2022 — 5.92%

Lending rate increased by

+20 bps

16.18% — 2021 TO 2022 — 16.38%

Deposit rate dropped by

12bps

7.78% — 2021 TO 2022 — 7.66%

Inflation Developments

Av. headline inflation rose from

0.8% (2021) TO 13.9% (2022)

- Reflecting the war in Ukraine that exacerbated an already existing increasing trend of commodity prices;
- Increased prices of agriculture inputs;
- Lower domestic food supply linked to unfavorable weather.

Inflation Developments

Core Inflation increased from

2.1% 2021 TO 11.0% 2022

Energy Inflation increased from

1.8% 2021 TO 17.4% 2022

Fresh food Inflation rose from

-4.2% 2021 TO 24.6% 2022

Inflation Outlook

Recent inflation at

20.7%

Jan 2023

From

21.7%

Nov 2022

&

21.6%

Dec 2022

- International commodity prices including energy and food are projected to continue declining over the medium term, easing pressures on domestic inflation.

- Inflationary pressures are expected to remain, before converging below 8% before the end of the year 2023.

Monetary Policy

What is the Central Bank Rate (CBR)?

- The central bank rate is the rate at which the National Bank of Rwanda lends short term money to commercial banks.
  - It is the primary tool used to control Inflation, by influencing consumption vs savings.
- **The CBR is the most significant rate for Rwandans because all the interest rates on loans they acquire, as well as the returns on their deposits, are influenced by the CBR.**
- Central banks do manipulate short-term interest rates to affect the rate of inflation (increase in prices) in the economy.
- **The ultimate objective of all central banks is price stability: maintain a low and stable inflation, which is estimated for Rwanda at 5 percent on annual average, with a tolerance band of ±3 percent.**

How does the Central Bank Rate affect inflation?

Thus, central banks often reduce the CBR, the same trend is followed by all other interest rates including the interest rate at which banks lend to the public.

- So, more people are able to borrow more money.
- The result is that consumers have more money to spend.
- This causes the economy to grow.
- However, **inflation might increase.**

The opposite is also true: when central banks increase interest rates, **consumers tend to save more because returns from savings are higher:**

- The tradeoff is now between holding cash and spending on one hand, or saving and receiving relatively higher returns from banks on the other hand**.**
- **With less disposable income being spent, demand pressures slow down and inflation decreases.**

How does the Central Bank Rate affect inflation?

- In other words, when interest rates are low, individuals and businesses tend to demand more loans.

- Each bank loan increases the money supply.
- A growing money supply tends to increase inflation.

- **Thus, low interest rates tend to result in more inflation.**
- **High interest rates tend to lower inflation.**

How does the Central Bank Rate affect inflation?

- **To summarize:** after analyzing economic indicators' performance and forecast, the Monetary Policy Committee of the BNR will decide on the Central Bank rate intended to keep the economy in balance.
- By moving it up or down, BNR attempts to achieve stable prices, and stable economic growth.
- **The BNR will raise CBR to reduce inflation and decrease it to avoid deflationary pressures while spurring economic growth.**
- **Caveat: Although it still plays a role, Monetary Policy effect is less efficient if inflation comes from supply shocks:**
  - Weather conditions affecting Agriculture production
  - Purely external shocks
  - Regulatory decisions

Monetary Decisions in 2022

- **In February 2022 (before the war)**, Global inflation was high but Inflation projections were showing that it would still be within the band (below 8%). MPC decided to raise the CBR by 50 basis points from 4.5% to 5.0%

- **In May 2022**, the inflation pressures were mainly driven by imported costs from international commodity prices and global inflation. As the shock's impact was still being analyzed and there was too much uncertainty, MPC decided to maintain the CBR at 5%.

- **In August 2022**, global inflation was more pessimistic, international commodity prices still high and tighter financial conditions, the MPC decided to raise the CBR by 100 basis points from 5.0% to 6.0%.

- **In November 2022**, the outlook indicated a strong and broad based increase in inflation, and poor domestic food production and global shocks were expected to keep exerting pressure on inflation. Therefore, the CBR was raised by 50 basis points from 6.0% to 6.5%. Additionally, the reserve requirement ratio was reinstated to pre-covid levels to 5% from 4% as an additional measure.

Latest Monetary Policy Decision

Central Bank Rate (CBR) increased to

7.0%

thank you