National Bank of Rwanda

MONETARY POLICY AND FINANCIAL STABILITY STATEMENT

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Governor

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EXECUTIVE SUMMARY

During the Year 2009, the National Bank of Rwanda implemented its Monetary Policy in unprecedented turmoil of the international and national economic and financial environment. In 2009, the world real GDP declined by 1.1% mainly due to weak performance in leading developed economies, the most affected by the global financial crisis.

Like many other developing countries, Rwanda was also affected by this global economic recession and negative effects were particularly observed in its export sector through low international commodity prices. Although the liquidity crunch in the domestic banking system prevailing at the beginning of the year 2009 originated mainly from a duration mismatch (short- term liquidity and long- term investment mismatch) in domestic credit markets, spillover effects of the global economic recession in the domestic banking system exacerbated the situation.

The economic growth declined significantly from 11.2% recorded in 2008 to 5.5% in 2009. While the agriculture sector performed well (10.4%) boosted by favorable weather conditions and Government Green Revolution Program, the Industry and services sectors performed badly due to the fall in global demand and tightened credit conditions in the banking system. Their growth rates were 1.1% and 4.3% respectively. Despite the low growth rate achieved in 2009, inflation has significantly declined, backed by good performance in food production, decline in worldwide consumer goods' prices, the stable exchange rate of RWF and the limited money supply growth. On annual basis, the overall inflation fell from 22.3% in December 2008 to 5.74% in December 2009.

Despite the negative effect of the global economic recession on the external sector, Rwanda managed to record a positive balance of payments of USD 57.05 millions by the end of 2009, thanks to relatively important foreign capital inflows. These inflows offset the current account deficit, and allowed BNR to keep a comfortable external position with gross official reserves representing 6.2 months of imports of goods and services. This development contributed to maintaining a stable exchange rate in 2009.

To avoid deeper decline of the growth rate, policy measures were undertaken by Government and BNR. While Government kept momentum to stimulate agriculture production, appropriate policy measures have been taken by the Central Bank addressing the liquidity crunch and credit to private sector conditions, with

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the objective of restoring confidence in the banking system. Indeed, banks benefited from important liquidity injection through the reduction of the Reserve Requirement Ratio from 8% to 5% in February 2009, followed by the decision to suspend rolling over Government T-bills that matured in 2009. Furthermore, the establishment of the Central Bank refinancing and Government deposit facilities were put in place to help banks to maintain lending operations to the economy. These measures resulted in significant improvement in banking liquidity and lending operations recovered their normal trend in the second half of 2009.

Following the publication of the new banking law, the regulations on liquidity ratio, capital adequacy requirements and regulation on accreditation and other requirements for external auditors of banks and Insurance and Insurance Brokers have been issued to all banks. In line with microfinance best practices compliance and the professionalization of microfinance sector, the new microfinance Law establishing the organization of microfinance activities was published in the Official Gazette as well as its implementing regulation. With regard to the supervision of banks, the risk- based supervision approach continued to focus on identifying risky management practices in the financial sector.

The soundness indicators of the banking system and Micro finance sector remained strong in 2009. All banks are compliant with the minimum capital required of 5 billion RWF, the capital adequacy ratio increased to 19.4% against 15.9% in December 2008 and the NPLs stood at 12.8% from 12.6% in 2008. With regard to microfinance sector, total assets increased by 20% and equity by 28.8%. The gross loans and deposits increased also by 16.4% and 18.8 % respectively.

In 2009, BNR and stakeholders continued to work on the payment system modernization program to ensure that payment systems are efficient and reliable. This program involves introduction of new payment instruments, mechanisms (systems) and improving the legal environment. To ensure that time critical payments are settled in real time, BNR is working on the implementation of a real time settlement system-the Rwanda Integrated Payments Processing System, encompassing the Automated Clearing House (ACH), the Real Time Gross Settlement (RTGS) and the Central Securities Depository (CSD), all three running on the same platform. The Rwandan banks continued to issue payment cards and SIMTEL as a common platform ensures that the infrastructure on which they are used is interoperable.

In 2010, BNR will continue to implement a proactive monetary policy to ensure that the level of the banking system liquidity, as well as the Central Bank policy

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rate will contribute to stimulate domestic savings and support the higher economic growth perspectives for 2010 while maintaining the headline inflation in single digit number. The BNR policies will support Government and financial institutions initiatives aimed at increasing financing to the agriculture sector and related activities by reforming the management of the Agriculture Guarantee Facility and other Government Financial Facilities to make them more suitable and accessible by farmers and other SMEs operating in rural areas.

The financial sector deepening reforms will be strengthened in 2010, focusing more on increasing access to financial services through the expansion of the banks branches network and a full implementation of Umurege SACCO program. A partnership between banks and MFIs will be stimulated in order to increase availability of viable financial services in the rural areas. BNR will continue to strengthen the prudential surveillance of our financial system. The publication of all regulations implementing the new banking and insurance laws will be completed in 2010, while intensifying on-site inspections and strengthening the surveillance system and the resolution framework. The legal framework to supervise the pension sector will be established as well.

BNR will work closely with CMAC to push forward the development of the domestic capital market. The enactment of the collective investment schemes law as well as the reform of the pension sector will create a new institutional framework to stimulate long term domestic saving, creating an enabling environment for the diversification of securities to be traded on the Rwanda OTC market.

Concerning payment system modernization, BNR shall endeavour to have the following laws passed: the Electronic Transactions law and the Book entry securities holding (CSD) law. About retail payment systems, concerted effort will be put in the following areas: International connectivity, International acquiring, International issuing, Cards acquisition, ATM and POS deployment based on the principle of interoperability. Implementation of the Rwanda Integrated Payments Processing System (RIPPS) will kick off.

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I. OVERVIEW OF ECONOMIC ENVIRONMENT IN 2009

I.1 INTERNATIONAL ECONOMIC ENVIRONMENT

I.1.1 Economic growth

The world economy in 2009 has been in deep recession, following the global financial crisis which occurred in the second half of 2007 and became acute in 2008. According to the IMF estimates, world real GDP declined by 1.1% on average in 2009 after an increase of 3% and 5.2% in 2008 and 2007 respectively. This underperformance initially concerned developed economies, but later extended to emerging and developing countries. In the United States, after a growth of 2.1% and 0.4% recorded respectively in 2007 and 2008, IMF estimates real GDP to decline by 2.7% in 2009. In the Euro Zone, real GDP contraction was estimated at 4.2% against a growth of 0.7% in 2008 and 2.7% in 2007. In Japan, real GDP declined by 5.4% in 2009 after a slight contraction of 0.7% in 2008 against a growth of 2.3% in 2007.

However, following concerted financial stimulus and encouraging policy measures aimed at improving the financial conditions, the world economy started to show signs of a slow recovery in the third quarter of 2009 and is expected to recover by 3.1% in 2010. In the USA, economic growth was 2.8% in the third quarter of 2009 and it is expected to increase by 1.5% in 2010. In Euro Zone, the economy is also expected to slightly recover by 0.3% in 2010 and by 1.7% in Japan. The economic activity in emerging and developing economies is also expected to increase by only 1.7% in 2009 and by 5.1% in 2010 against 6% and 8.3% in 2008 and 2007. In China, the economy is expected to grow by 8.5% and 9% respectively in 2009 and 2010 against 9% and 13% respectively in 2008 and 2007. In Africa, the economic growth would decelerate to 1.7% in 2009 and to 4.0% in 2010 against 5.2% and 6.3% recorded respectively in 2008 and 2007.

I.1.2 Inflation and commodity prices

Concerning price developments, World inflation pressures eased in 2009 thanks to the diminishing commodity prices after important inflationary shock in 2008 caused by high oil and food prices. In the USA, prices are expected to decline by

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0.4% in 2009 after an increase of 3.8% in 2008. In the euro zone, harmonized inflation would stand at 0.3% in 2009, after 3.3% recorded in 2008. In Japan, inflation would fall to -1.1% in 2009 against 1.4% recorded in 2008.

With regard to commodity markets, after the historical level of 147.5 dollars per barrel in July 2008 on London market, oil prices have been declining since then following the effect of global economic crisis. During the first quarter of 2009, oil prices declined by 19.5% but started to recover since the second quarter, reflecting the increasing optimism in economic perspectives and thus in oil demand. On average in 2009, oil prices declined by 36.6% after respective increase of 36.4% and 10.7% in 2008 and 2007. For non energy commodities, prices fell by 21.6% in 2009 after an increase of 21% in 2008 in low and middle income countries. In aggregate terms, world prices of non energy commodities denominated in dollars were expected to decrease by 20.3% in 2009 in comparison with 2008.

I.1.3 Financial markets

In the financial markets, central banks in developed economies cut policy rates with the objective of improving credit provision. The USA Federal Reserve policy rate has been kept in the range of 0 and 0.25% since December 17th 2008. Three Months interest rates fell to 0.25% in December from 0.3% in September 2009 and ten year government bond yield increased to 4.17% in December from 3.61% in September 2009.

The European Central Bank maintained its discount rate unchanged at 1.0% in its meeting on 3rd December 2009, and the three months (EURIBOR) rate declined to 0.71% in December from 0.77% in September 2009. The same trend has been observed in Japan where the policy rate is still at 0.1%, three months interest rates stood at 0.28% in December from 0.36% in September the same year and the ten year government bond yield slipped to 1.42% in December against 1.45% in September 2009.

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With regard to exchange market, on annual average, the US dollar has been depreciating vis-à-vis the euro. However, according to Eurostat estimates, after an appreciation of 7.3% in 2008, the euro depreciated by 5.2% in 2009 against USD. Compared with the euro, the Japanese yen continued to appreciate in 2009 as in 2008, by 14.5% and 5.5% respectively.

I.2 NATIONAL ECONOMIC PERFORMANCE

I.2.1 Economic Growth

During the year 2009, Rwandan economy has been affected by unfavorable international economic environment, exacerbated by the liquidity crunch experienced by the banking sector at the beginning of the Year 2009. According to MINECOFIN estimates, the 2009 real GDP growth declined to 5.5% after a high growth of 11.2% recorded in 2008. While the agriculture sector performed well (+10.4%) boosted by favorable weather conditions and ongoing Government Green Revolution programme, industry (1.1%) and services (4.3%) underperformed, due mainly to the fall in global demand and tightened banking system credit conditions.

Table 1: Real GDP Growth, in %

	2005	2006	2007	2008	2009 estim.
Real GDP	**9.4**	**9.2**	**5.5**	**11.2**	**5.5**
Agriculture	6.0	3.0	2.7	8.7	10.4
0f Which Food crop	8.0	1.0	4.0	9.0	12.6
Export crop	-22.0	33.0	-29.2	29.3	-11.9
Industry	**9.0**	**12.0**	**9.1**	**16.3**	**1.1**
Of which Manufacturing	8.0	13.0	0.8	8.3	3.0
Mining and quarrying	30.0	-14.0	42.8	-15.7	-14.6
Construction	9.0	13.0	15.0	28.2	1.2
Services	**12.0**	**13.0**	**7.3**	**11.5**	**4.3**
Of which Wholesale & retail trade	13.0	18.0	1.2	12.0	2.1
Transp. storage, Communication	17.0	23.0	9.1	21.1	10.0
Real estate & business services	8.0	4.0	11.3	16.0	3.9

Source: MINECOFIN, Macroeconomic Unit

In 2009, the business environment was affected as evidenced by low level of turnovers compared to previous years. Total turnover of large companies of industry and service sectors slightly rose by 1.41% and 4.95% against 30.73% and 37.33% in 2008. The total sales slightly increased by 3.91% after significant increase of 35.31% and 30.70% in 2008 and 2007 respectively.

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Table 2: **Annual % changes for the Industry and Services sector's total turnovers of large companies**

	2005	2006	2007	2008	2009
INDUSTRIES	**13.81**	**34.77**	**31.53**	**30.73**	**1.41**
Manufacturing	10.07	23.01	18.84	30.82	-3.12
Energy	46.72	87.90	8.21	36.41	26.14
Mining	4.79	187.01	68.02	35.03	-13.86
Construction	2.64	25.73	77.23	26.34	8.32
SERVICES	**19.46**	**25.50**	**30.41**	**37.33**	**4.95**
Trade Services	10.86	26.95	43.20	34.02	3.30
Banks & Insurance comp.	36.81	26.10	32.71	36.61	13.75
Transport and Storage	10.51	16.93	27.04	25.31	35.73
Garage Services	-4.30	-37.08	35.82	206.42	-36.53
Petroleum companies	27.80	36.65	1.03	50.01	-14.31
Posts & Telecommunication	17.56	21.37	47.13	28.83	22.93
Other Services	38.59	2.18	21.34	41.3	20.12
TOTAL SALES	**17.80**	**28.14**	**30.70**	**35.31**	**3.91**

Source: RRA, Department of Large Tax Payers

II.2.2 External Sector

The external trade was seriously affected by the global economic and financial crisis in the Rwandan economy. Export activities have been affected mainly by low international prices of minerals, while imports volumes continue to increase.

a. Exports

The total export declined by 29.3% in value and by 15.09% in volume against an increase of 41.06% and 37.23% in 2008 respectively. Rwandan exports remained dominated by traditional export products such as coffee, tea and minerals, constituting more than 72.7% of total export earnings in 2009. The value of major mineral exports was USD 54.58 million representing 28.31% of total export earnings, while coffee and tea totalized USD 85.53 millions, which represent 44.36% of total export earnings.

Coffee exports performed poorly, falling by 20.75% from a value amounting USD 47.05 millions in 2008 to USD 37.29 million in 2009. The underperformance of coffee is mainly in volume, even if prices slightly declined as well. However, tea exports performed better with international prices increasing from an average of 2.27USD/kg to 2.58 USD/Kg. The value of tea exports increased by 7.31% reaching USD 48.24 millions.

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Table 3: Export developments, Value in USD millions, Volume in tons)

	2008		2009		Annual % Change	
	Volume	Value	Volume	Value	Volume	Value
Coffee	18.19	47.05	14.99	37.29	-17.58	-20.75
Tea	19.10	40.05	18.69	48.24	-5.74	7.31
Tin	4.12	41.15	4.27	28.58	1.81	-30.71
Coltan	1.22	37.21	0.95	20.24	-20.20	-43.83
Wolfram	1.67	12.90	0.87	5.76	-48.80	-57.03
Hides and skins	1.93	2.85	1.79	1.96	-7.34	-31.16
Pyretrhrum	3.30	0.38	3.18	0.64	-3.64	68.08
Others	61.60	36.34	57.48	27.74	-5.7	-18.44
Re-exports	12.72	43.83	4.18	22.38	-69.15	-57.62
Total	**123.85**	**261.76**	**106.40**	**192.82**	**-15.09**	**-29.30**

Source: BNR, Statistics Department

The mining sector was the most affected by the declining international prices. The value of exported tin, coltan and wolfram declined respectively by 30.71%; 43.83% and 57.03% compared to 2008. The average price of tin and coltan dramatically decreased, respectively by 31.9% and 29.6%. Except for pyrethrum export value that increased by 68.08%, the downward trend of exports was also observed in non-traditional Rwandan exports like hides and skins (-31.2%) as well as re-exports (-57.62%).

b. Imports

Imports in 2009 increased by 8.19% in value and 17.02% in volume compared to 2008. This upward trend is mainly due to the import of consumer goods as well as energy and lubricants which value increased by 20.52% and 31.43% respectively.

Table 4: Imports developments (Value CIF in millions of USD, Volume in thousands of tons)

	2008		2009		Annual Change (%)	
	Volume	Value	Volume	Value	Volume	Value
CONSUMER GOODS	**253.66**	**284.08**	**354.81**	**342.38**	**39.87**	**20.52**
Of Which: Food product	172.07	87.07	261.57	115.86	52.01	33.07
Health and care	21.43	66.50	26.12	100.93	21.88	51.78
CAPITAL GOODS	**39.86**	**367.29**	**39.75**	**362.69**	**-0.28**	**-1.25**
Of Which: Transport Material	11.77	63.30	8.94	58.34	-24.01	-7.83
Machines, devices and tools	19.55	249.80	18.07	235.89	-7.57	-5.57
Other capital goods	8.55	54.20	12.74	68.45	49.02	26.31
INTERMEDIARY GOODS	**367.94**	**323.87**	**408.80**	**313.14**	**11.11**	**-3.31**
Of Which: Construction materials	241.18	136.19	243.22	128.15	0.84	-5.91
Industrial products	100.85	139.23	108.67	124.59	7.75	-10.52
Fertilizers	14.63	19.07	45.65	30.80	212.04	61.52
ENERGY AND LUBRICANTS	**186.72.08**	**161.48**	**189.63**	**208.83**	**1.36**	**31.43**
Of which: Fuels	181.26	152.93	183.51	199.37	1.30	32.62
TOTAL	**848.54**	**1134.14**	**992.99**	**1227.0**	**17.02**	**8.19**

Source: BNR, Statistics Department

Compared to last year, the value of import of intermediary goods and capital goods fell by 3.31% and 1.25% respectively in 2009 reflecting poor performance of industry and services sectors of the economy. The sharp increase in both value and volume in fertilizers with respective growth rates of 61.52% and 212.04% is mainly due to the Government policy that aims at increasing agricultural production, so that fertilizers are abundantly imported and distributed to farmers on subsidized prices.

Consumer goods represents 27.90% of total imports value, and remained dominated by food products with a share of 34%. Compared to 2008, Food Products increased by 33% in value due especially to high increase in imports of cereals, flour and seeds. The value of health and care products increased highly (+51.78%), and 21.88% in value and volume respectively.

In addition to formal exports and imports, there are other significant imports and exports, as evidenced by the results from the current survey on cross border trade with neighbouring countries conducted since May 2009. Until end September 2009, this survey showed the country's net export RFW 5,178.03 millions. Nevertheless, except with DRC, where a positive trade balance of USD 11.3 millions is recorded, Rwanda has recorded a trade deficit with all other neighbouring countries during that period of May-Sept. 2009. The most important deficit was registered in trade with Uganda.

The results of this survey indicate that Rwanda exports mainly food products in neighboring countries increased as the crop intensification program generated significant production volume for some crops like cassava and maize. These dynamics call for strengthening the crop intensification program to take advantage of market opportunities in the region.

Table 5: Imports and exports from cross board survey (in thousands of USD)

	BURUNDI	DRC	TANZANIA	UGANDA
May	310.58	3 274.87	1.63	148.45
June	361.14	2 709.82	1.67	215.79
July	450.57	3 301.13	1.54	246.54
August	435.77	2 886.61	1.03	270.98
September	654.55	2 477.66	1.99	331.39
Exports	**2 212.61**	**14 650.06**	**7.86**	**1 213.15**
May	389.65	685.09	19.34	535.78
June	422.69	409.41	11.80	539.36
July	555.33	972.01	13.62	524.12
August	547.77	614.50	11.04	611.37
September	715.74	703.30	12.11	675.49
Imports	2 630.14	3 384.30	68.11	2 886.49
Trade balance	**-417.53**	**11 265.76**	**-60.25**	**-1673.34**

Source: BNR, Statistics Department

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c. Overall Balance of Payment

Beside the deterioration of current account deficit from USD 241.26 to 362.52 million between 2008 and 2009, an estimated positive overall balance of USD 57.05 million was recorded by the end 2009, thanks to important capital transfers. Net current transfers reached USD 593.45 million from 518.57 million in 2008, driven by official transfers and remittances, which increased respectively by 15.78% and 39.21%.

Table 6: Net Current Transfers (in USD millions)

	2006	2007	2008	2009 estim.	% Change
Current transfers (net)	**325.54**	**461.32**	**518.57**	**698.60**	***34.71***
Current private transfers (net)	**77.15**	**98.82**	**72.61**	**79.71**	***3.37***
Remittances from Diaspora	25.01	98.50	63.31	88.13	*39.20*
Private transfers for churches and associations	72.87	32.67	45.20	34.80	*23.02*
Current officials transfers (net)	**248.39**	**362.50**	**445.96**	**513.74**	***15.20***
Current support net	128.35	259.27	339.76	410.63	*20.86*
Humanitarian aid	122.77	107.11	110.32	110.47	*0.14*

Source: NBR, Statistics Department

Capital and Financial Account balance increased by 34.75% in 2009 compared to 2008, Capital account balance fell by 4.74% while financial transactions account balance increased by 113.05% due especially to the level of long term private debt disbursement and foreign direct investments. Globally, a comfortable external position was maintained in 2009, with sufficient gross official reserves estimated at 6.2 months of imports of goods and services.

Table 7: Estimate BOP 2009 summary (in USD millions)

	2006	2007	2008	2009
Trade balance	-299,02	-404,39	-624,16	-769,54
Services and income (net)	-160,95	-140,38	-135,67	-186,43
Current account balance	-134,43	-83,45	-241,26	-362,52
Capital and Financial account balance	216,0	196,7	316,12	425,97
Errors et Omissions	-0,03	-2,66	-16,86	-6.40
Overall balance	**81,52**	**110,60**	**58,01**	**57,05**

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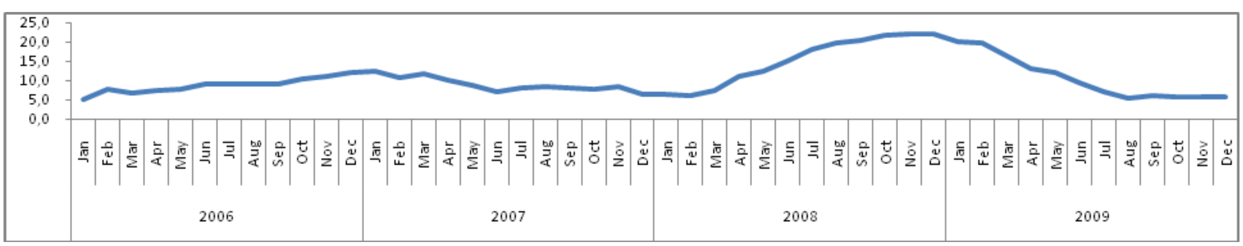
II. MONETARY SECTOR DEVELOPMENTS IN 2009

II.1 INFLATION

After high inflationary pressures, particularly in the first three quarters of 2008, Rwanda experienced low inflation in 2009, due to good performance in food production, a decline in import prices, stable RWF against USD and limited growth of money supply. From a high inflation rate of 22.3% in December 2008, the annual headline inflation fell to 5.74% in December 2009. The underlying inflation, which does excludes fresh foods and energy, dropped to 3.5% in December 2009 from 22.1% in December 2008. The objective of keeping inflation in one digit number in 2009 was largely achieved.

The annual average inflation dropped to 10.3% in December 2009 from 15.4% in December 2008 and the underlying average inflation has come down to 8.5% from 17.8% during the same period. The price index for locally produced goods significantly declined from 22.9% in December 2008 to 6.3% in December 2009 on annual change, and prices for imported goods fell from 21.6% in December to 1.4% in December 2009. Due to the improvement in agriculture production for the last two years, prices for food and non alcoholic beverages declined on annual basis from 30.9% in December 2008 to 9.0% in December 2009. Energy prices also fell significantly from 19% in December 2008 to 1.3% in December 2009.

Chart 1: Overall inflation (annual % change in CPI, base 2009:100)



<u>Source</u>: BNR, Statistics Department

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II.2 MONETARY AGGREGATES DEVELOPMENTS

II.2.1 Money Supply

While the 2009 Monetary Program projected an increase of 17% in Broad Money supply in consistency with an expected increase of 23% of credit to private sector, annual Broad Money supply increase reached only 6.7% in 2009 and the credit to private sector contracted by 1.8%. The slight increase in money supply was generated exclusively by the increase in net foreign assets of the banking system.

Table 8: Monetary aggregates developments in 2008-2009(end period, in RWF billion)

	2008	2009	Annual Change (%)
Net foreign assets	**403.8**	**441.7**	**9.4**
Net domestic assets	**61.6**	**54.1**	**--12.2**
Domestic credit	199.3	187.6	-6.4
Government (net)	-142.0	-147.1	-3.6
Autonomous Agencies	-0.4	-1.9	328.7
Public enterprises	1.8	3.0	69.6
Private sector	**340.0**	**333.7**	**-1.8**
Other items net	-137.7	--133.5	3.0
BROAD MONEY (M3)	**466.4**	**497.7**	**6.7**
Currency in circulation	**80.9**	**77.0**	**-4.8**
Deposits	**385.5**	**420.7**	**9.1**
of which: Transferable	167.7	180.3	7.5
Nontransferable	135.5	143.4	5.8
Foreign currency	82.3	97.0	17.9

Source: BNR, Statistics Department

a. Foreign assets

The increase of foreign assets in the banking system resulted from the important external budget support disbursements, as well as private capital inflows via the banking system. Budget support disbursed in 2009 reached USD 409.63 million against USD 370.5 million in 2008, which is an increase of 10.6%. In commercial banks, foreign assets increased by 9.8% in 2009, against 11.3% in 2008. As a result, the Net Foreign Assets strongly increased during the second and third quarters respectively by 11.7% and 8.9%, before a moderate increase of 4.1% during the last quarter.

b. Credit to the economy

Contrary to 23% planed at the beginning of the year, the outstanding credit to private sector fell by 1.8% as a consequence of the liquidity problem experienced by the banking system between the last quarter 2008 and the second quarter 2009. The outstanding credit to private sector was on a declining trend during the first 3 quarters of 2009, as it declined successively by 0.5%, 3.3% and 1.2% respectively.

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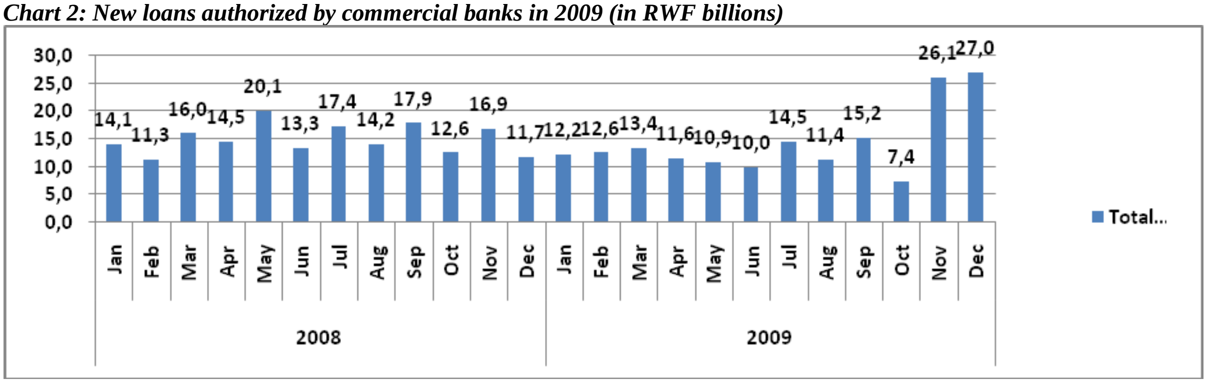
However, from the last quarter 2009, particularly in November and December, the credit to private sector has been increasing. For example, between September and December of 2009, the outstanding credit to private sector increased by 2.65% following the regained confidence in the banking system, stimulated by different measures taken by BNR and the Government, which include the reduction of reserve requirement, the introduction of BNR refinancing facility against collaterals as well as the Government long term deposit facilities.

Chart 2: New loans authorized by commercial banks in 2009 (in RWF billions)



Source: BNR, Financial Stability Directorate

This improvement in the credit market is reflected in the significant increase of new authorized loans to the economy by commercial banks since the third quarter of this year. The new authorized loans increased by 26.4% and 47.2% during the last quarters of 2009 respectively and reached at RWF 60.5 billion in last quarter, which is the double of its level in second quarter. The new authorized loans to public works and building industry increased by 48.5% and 51.7% in the last two quarters of 2009 respectively, while it increased by 14.5% and 6.4% respectively for the commerce, and restaurant and hotels sector.

Table 9: Authorized new loans to the economy by commercial banks (in RWF billion)

ACTIVITY BRANCH	2007	2008	2009 Total	% weight	% change 2008-09
AGRICULTURE,ANIMAL HUSBANDARY	3.59	1.91	2.17	1,3	13.6
MINING INDUSTRIES	0.01	0.00	0.00	0,0	-
MANUFACTURING INDUSTRIES	13.67	9.96	15.58	9,0	56.4
ENERGY AND WATER	0.17	0.23	1.81	1,1	687.0
PUBLIC WORKS AND BUILDING	26.47	53.86	35.98	20,9	-33.2
COMMERCE,RESTAURANT & HOTELS	60.85	73.04	61.45	35,7	-15.9
TRANSPORT,WAREHOUSING &	14.06	17.82	30.46	17,7	70.9
O.F.I,INSURANCES AND OTHER NON-	2.56	1.99	5.02	2,9	152.3
SERVICES PROVIDED TO THE	2.92	9.37	3.56	2,1	-62.0
ACTIVITIES NOT CLASSFIED	7.99	11.99	16.26	9,4	35.6
TOTAL	**132.3**	**180.18**	**172.3**	**100,0**	**-4.4**

Source: Statistics Department

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II.2.2 Money Demand

On demand side, Broad Money growth recorded in 2009 was driven by the growth in deposits which stood at 9.1%, while currency in circulation declined by 4.8%. Foreign exchange deposits recorded the highest growth rate of 17.9%, while transferable and non transferable deposits in RWF increased by 7.5% and 5.8% respectively.

In addition to slowing down economic activity in 2009, the important decline in currency in circulation would be explained by the financial deepening with fast-expanding banks' branches and microfinance institutions countrywide, as well as the administrative measures undertaken to use more banks accounts in payments rather than using cash. 22 New commercial banks branches were opened and Deposits in microfinance institutions increased by 18.8% in 2009.

II.3 LIQUIDITY MANAGEMENT AND INTEREST RATES

II.3.1 Liquidity management

BNR proactive monetary policy

Contrary to the previous years, the banking system has experienced tight liquidity conditions since the last quarter of 2008. Starting from the first quarter 2009, BNR and Government implemented different measures allowing banks to rebuild significantly their liquidity conditions and lending capacity. In view of the liquidity shortage, BNR reduced the Reserve Requirement rate from 8% and 5% and all T-bills maturing in 2009 were not rolled over. Two liquidity facilities have been put in place: the 3 to 12 months BNR refinancing facility and the 5-year-Government long term deposit facility. In addition, a Master swap agreement between BNR and International Finance Corporation (IFC) has been signed. IFC and BNR agreed to enter into Dollar /Rwanda Francs cross-currency swap transactions to facilitate long term lending to the Private sector.

Table 10: Disbursed amount in facilities (RWF billion, end January 2010)

Facility	Amount (RWF billion)	Using the facility
3 to 12 month BNR liquidity facility	8.73	4
5-year-Government long term deposit facility	6.99	5

Source: BNR, Financial Markets Department

These measures produced progressively significant positive impact on banking system liquidity conditions as well as the capacity of banks to finance the economy. The net total borrowing by BNR from commercial banks to absorb short term excess liquidity increased from 0 at end March 2009 to RWF 60.0 billion by end 2009. Today, it fluctuates between RWF 40 and 50 billion, a level which gives confidence to banks to extend their lending operations to the economy with minimum risk of liquidity shortage. At the same time, the interbank money market became very dynamic facilitating the distribution of available liquidity within the banking system. The volume of interbank transactions has reached the level never recorded in the previous years.

Table 11: Interbank market operations (RWF billion)

Year	2007	2008	2009					% change
			Q1	Q2	Q3	Q4	Total	2008-09
Amount	23.65	169.24	195.41	130.41	87.92	123.95	537.69	217.71%

Source: BNR, Financial Markets Department

In January 2009, BNR increased its Key Repo Rate (KRR) from 8% to 9% to stimulate domestic saving. Taking into consideration the improvement in banking liquidity condition and the current downward trend of inflation, BNR reduced its KRR on 18th December 2009 from 9% to 7.5% and decide to use effectively the KRR as the maximum rate at which the BNR mops up liquidity from the banking system and as the minimum rate for injecting liquidity. BNR has also decided to set the discount rate as the KRR+4%. As a result, the discount rate has been reduced from 12.5% to 11.5%. This reduction of the cost of funds for commercial banks is expected to be transmitted in credit markets by lowering bank’s lending rates.

Improvement of Communication strategies

Bearing in mind that monetary policy is most effective when it is effectively communicated, BNR has improved its communication strategy with the public by deciding to release quarterly monetary policy decisions taken by the Central Bank Monetary Policy Committee. This decision reinforces the existing communication channels including periodic monetary policy statements and other communication events. Communication is a vital tool in the implementation of monetary policy as it significantly contributes to shape expectations and influence the behavior of the public in ways that support the policy outcomes.

II.3.2 Interest rates developments

With the consolidation of comfortable short term liquidity in the banking system since the second half of 2009, money market interest rates have been recording a declining trend. The average Repo rate fell from 7.3% in January 2009 to 4.4% in December 2009.

Regarding the commercial banks' rates, banks become aggressive in deposits collection and increased deposit interest rates between January and December 2009, from a monthly weighted average of 5.5% to 8.54%, after reaching a high level of 9.94% in July. Lending rates have also been increasing since January 2009 to reach 17.4% on average, before declining to 15.77% in December 2009. This upward trend in lending rates in 2009 is due to the uncertainties in credit markets, on both demand and supply sides, as the nonperforming portfolio has increased. As inflation rate in Rwanda has been significantly declining during 2009, positive real interest rates were restored in the second half of the year.

Table 12: Interest rates developments in 2009 (%)

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
BNR Policy Rates												
Key Repo Rate	8.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00	9.00
Discount Rate	12.80	12.00	12.00	12.00	12.00	12.00	12.50	12.50	12.50	12.50	12.50	12.50
Money Market												
Repo rate	7.28	6.50	5.02	2.38	4.63	5.50	4.68	4.37	4.27	4.61	4.50	4.39
Refinancing Facility	-	-	-	-	-	-	-	10.76	10.50	10.50	10.5	10.5
Treasury Bills Rate	7.62	7.66	7.57	7.68	8.85	9.13	10.34	10.59	9.90	9.39	8.15	7.75
Commercial Banks												
Interbank Rate	8.67	9.15	7.49	4.95	5.47	6.40	5.95	5.10	5.88	5.22	5.41	4.89
Deposit Rate	5.51	5.61	6.57	7.58	9.15	9.44	9.94	8.77	8.86	8.84	8.91	8.54
Lending Rate	16.33	16.18	15.74	16.81	16.64	16.89	17.28	17.41	17.56	17.63	16.44	15.77

Source: BNR, Financial Markets Department

II.4 EXCHANGE RATE AND FOREX MARKET

II.4.1 Exchange rate

After some volatility during the first half of 2009, Rwandan Franc has recovered its stability against the USD since July. From December 2008 to December 2009, the RWF slightly depreciated by 2.82% against USD, while when compared with other strong foreign currencies, RWF depreciated against the Euro and GBP by 12.31% and 11.98% respectively. The relatively stable exchange rate of Rwandan Franc against USD reflects the sufficient level of foreign assets in the banking system compared to the prevailing demand for forex. Higher depreciation against EUR and GBP mainly reflects the depreciation of the USD against these currencies on international forex markets.

II.4.2 BNR intervention mechanism in Forex Market

Before 2007, BNR used to intervene on Foreign Exchange Market by selling to commercial banks a given amount using the auction system. This intervention

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mechanism was abandoned in June 2007 and replaced by a new arrangement whereby the BNR sells forex to commercial banks on demand basis.

However, during the year 2009, the volume of BNR forex sales to commercial banks was dramatically declining, from the total amount of USD 376.4 million in 2008 to USD 228.1 million in 2009. This new development in domestic foreign exchange market was explained by the existence of other sources of forex for commercial banks, as well as the improvement in interbank foreign exchange market operations. Compared to the total amount of USD 2.0 million recorded in 2008 and USD 2.85 million during the first half of 2009, the foreign exchange interbank market operations increased significantly to a total of USD 24.15 million during the second half of 2009. This was a positive signal that further development of the interbank market was possible.

With a view to encourage the development of the interbank market, BNR decided to reform its intervention mechanism in the foreign exchange market in such a way to avoid unnecessary competition with interbank transactions. Thus, starting from September 21st, 2009, BNR sells foreign exchange on demand to banks only on specific days when the level of liquidity in the market justifies BNR intervention. The new policy aims at stimulating further the already growing foreign currency interbank market.

In addition, to enhance further the foreign exchange interbank market, other important measures are being implemented, such as promulgating a Code of Conduct and creating an Association of the Foreign Exchange Dealers. Finally, the process of fully liberalization of the Rwandan foreign exchange market was completed by the end of 2009 with the waiving of some remaining restrictions on capital account.

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III. FINANCIAL SYSTEM STABILITY IN 2009

III.1 BANKING SYSTEM

The Rwandan banking system comprises of 12 financial institutions, including 8 commercial banks (KCB, BANCOR, COGEBANQUE, BCR, BK, BPR, FINA BANK, ECOBANK) and 4 other banks and financial intermediaries (BRD, BHR, Urwego Opportunity Bank and Continental Discount House Rwanda (CDHR).

III.1.1 Financial soundness

The Rwandan banking system regulation aims at achieving financial stability. There have been specific requirements looking for controlling risk in financial institutions for many years. Since 1999 internal controls, limits for clients' exposure, loss provisions, credit risk control, and solvency among others have been required and continuously checked by the Central Bank. Nowadays the regulation requires specific structures in each financial institution to manage credit and operational risk.

The effect of the global financial crisis on Rwandan banks was mild demonstrating the importance of risk management. In 2009, the banking system showed few signs of distress as banks were not directly affected by the crisis reflecting favorable starting positions. All banks are now compliant with the minimum capital required of 5 billion RWF. As at December 2009 paid up capital had reached 53.5 billion RWF and registered an annual growth of 14.4 percent.

Similarly, shareholders funds reached 78.6 billion RWF recording an annual growth of 17.4 percent. The capital adequacy ratio (CAR) on a consolidated basis increased to 19.4% against 15.9% in December 2008. The increase in capital ratios was due to capital injection. Generally, the banking system is well capitalized and all banks are in compliance with the required minimum capital adequacy ratio of 15%, this capital level is well above the Basel minimum requirement of 8%. During 2009 stress testing showed a resilience of banks' capital to shocks in terms of increase NPLs.

However a declining asset quality was observed through a slight increase in NPLs with a ratio of Non Performing loans (NPL) to total loan portfolio (gross) of 12.8% at end December 2009 compared to 12.6% in 2008. The net NPL ratio stood at 11% if the interest in suspense (Interest on NPL) is not taken into account while the 2009 objective was to reduce this indicator to 7%. To address this issue, the Central Bank reinforced its monitoring of bank's NPL recovery plans in order to reach the threshold of 7% for each bank by end 2010. At the same time, BNR increased its monitoring of sectoral concentration in loan portfolio risk correlation through off/on site supervision and prudential meetings (risk management monitoring).

During the same period profitability was eroded, and at end December 2009 consolidated net profit after tax was RWF 4.2 billion RWF compared to 12 billion in December 2008. This deterioration is due to the loss registered by some commercial banks following the deterioration of their assets quality.

Table 13: Consolidated financial soundness indicators of commercial banks (in %)

Indicators	2008	2009			
	December	March	June	September	December
Solvency ratio	15.9	19.1	19.3	20.5	19.4
NPLs / Gross Loans	12.6	13.9	13.4	13.6	12.8
NPLS net/Net loans	10.5	9.8	11.1	11.7	11.0
Provisions / NPLs	66.3	66.9	70.9	65.9	56.5
Earning Assets / Total Assets	81.3	78.4	77.3	77.1	79.2
Large Exposures / Gross Loans	17.4	18.4	17.5	16.9	15.5
Return on Average Assets	2.4	1.6	0.9	1.0	0.8
Return on Average Equity	18.5	11.4	6.4	7.0	5.4

Regarding the establishment of a Private Credit Reference Bureau in Rwanda, the draft law on the Rwandan credit bureau industry is ready for cabinet consideration. Market driven initiative to select one credit bureau service provider is being finalized by the Bankers' Association. The Central Bank will foster the licensing and oversee the operation of the selected service provider. The Central Bank will also sensitize the public on the importance of the credit bureau industry in Rwanda.

III.1.2 Access to financial services: development of the banks' branches network

In response to the 2008 Rwanda Finscope survey which called on improving the access to financial services, BNR has registered a marked expansion of the current banks branches network. During 2009, 22 additional branches were opened by commercial banks. The total number of banks' branches is now 105 across the country. Banque Populaire du Rwanda has 102 sub-branches and 80 counters. During the same period the number of deposit accounts operated by the commercial banks (including BPR) increased by 8% from 1,176,140 at the end of December 2008 to 1,270,654 at end 2009.

III.1.3 Legal and regulatory framework reforms

Following the publication of the new banking law, the process to update the prudential regulations has been ongoing during 2009. As of end august 2009, the regulations on liquidity ratio, capital adequacy requirements and regulation on accreditation and other requirements for external auditors of banks and Insurance and Insurance Brokers have been issued to all banks.

With regard to the supervision of banks, the risk based supervision approach adopted by BNR continued to focus on identifying risky management practices in the financial sector. As this approach emphasizes on understanding and assessing the quality of risk management systems, the recommendations of offsite and onsite supervision reports requested banks' management to address the highlighted specific weaknesses.

III.2 MICROFINANCE SECTOR

During the year 2009, the development of MFIs focused on overcoming financial exclusion due to various barriers as evidenced by Rwanda Finscope 2008 survey. Licensing new MFIs, off-site and on-site examinations have been performed on ongoing basis. In order to improve the efficiency of MFI's operations, during the year 2009, on-site examinations were conducted in 28 MFIs including the 5 biggest ones.

III.2.1. Legal and regulatory framework

In line with microfinance best practices compliance and the professionalization of microfinance sector, the new microfinance Law n°40/2008 of August 26th, 2008, establishing the organization of microfinance activities adopted by the Parliament in 2008 was published in the Official Gazette No 13 of March 3rd, 2009. The implementing regulation of this Law was published in the Official Gazette of the Republic of Rwanda no 28 of July 13th, 2009.

Considering the consolidated financial position of MFIs, total assets increased by 20% from December 31st, 2008 to September 30th, 2009 while equity has increased by 28.8%. This situation is coupled with an increase of gross loans and deposits by 16.4% and 18.8 %, respectively. Cash and equivalent increased by 64.3% between the two periods. The increase in cash and equivalent is mainly due to the increase in deposits of 18.8% while gross loans increased only by 16.4%. The loan portfolio has deteriorated with an increasing delinquency rate moving from 5% at the end of December 2008 to 8.4% at the end of September 2009.

The consolidated financial position of the microfinance sector CSS excluded, shows a positive trend with the exception of the NPL rate which deteriorated. It increased to 10.9% at the end of September 30th, 2009 against 7.5% at the end of December 31st, 2008.

Table 14: MFIs Consolidated financial situation (in millions RWF)

MFIs (CSS included)	Dec-08	Sep-09	% Change
Total Assets	**60,134.4**	**71,971.4**	**19.7**
Cash and cash equivalent	10,144.2	16,664.1	64.3
Gross Loans	42,321.0	49,261.0	16.4
Non Performing Loans (Gross)	**2,120.1**	**4,115.8**	**94.1**
Provisions	1,065.5	2,265.6	112.6
Net Loans (Net of Provisions)	41,255.5	46,995.4	13.9
Delinquency Rate, in %	**5.0**	**8.4**	**3.4 points**
Total Deposits	**38,317.0**	**45,503.8**	**18.8**
Equity	16,237.0	20,916.1	28.8
Capital adequacy, in %	**27.0**	**29.1**	**2.1 points**
Liquidity Ratio (Quick), in %	**37.2**	**48.9**	**11.7 points**

Source: Microfinance Institutions Supervision Department

In order to professionalize the microfinance sector and to improve the Management Information System (MIS) of MFIs, the Association of Microfinance Institutions in Rwanda (AMIR) has put in place a computerization strategy for the MFIs. This strategy has been sent to CGAP for comments and CGAP agreed to finance the services of an expert who will support MFIs to implement the strategy during the pilot phase.

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Table 15: Compliance with prudential norms

	Dec-08			Sep-09		
	Nbr of MFIs	**% of MFIs**	**Respect(R)/ non respect (NR)**	**Nbr of MFIs**	**% of MFIs**	**Respect(R)/ non respect (NR)**
MFIs with NPL <10%	51	68.00%	**R**	38	50.67%	**R**
MFIs with NPL >=10%	24	32.00%	**NR**	37	49.33%	**NR**
LIQUIDITY>=30.00%	56	76.09%	**R**	52	69.33%	**R**
LIQUIDITY<30.00%	19	23.91%	**NR**	23	30.67%	**NR**
SOLVENCY>=15.00%	60	80.0%	**R**	54	72.00%	**R**
SOLVENCY<15.00%	15	20.0%	**NR**	21	28.00%	**NR**

Source: Microfinance Institutions Supervision Department

It was planned to reduce the number of MFIs which do not comply with prudential standards by 50% at the end of 2009. However, the comparison between the two periods (December 2008 and September 2009) shows deterioration. In fact, the number of MFIs which comply with the capital adequacy ratio decreased from 80% to 72% of all MFIs. The deterioration has been also observed for the other indicators such as NPL rate and liquidity ratio as shown in the table above.

This situation would be due to the combination of many factors including the negative impact of the global financial crisis as well as the bad governance which characterised many MFIs according to the BNR on-site examination reports.

The liquidation process of the 9 closed MFIs in June 2006 is ongoing. At the end of December 2009, more than 1 billion RWF was used to compensate depositors for 50% of their deposits. End of July 2009 has been set as the final deadline for depositors to declare their deposits. The objective of the year 2010 is to close this operation and distribute the liquidation proceeds to the depositors.

In line with the Government's strategy of domestic savings mobilization and building an inclusive financial system in Rwanda, the "UMURENGE SACCO program" was adopted. The main objective of the program is to allow unbanked but bankable people access to financial services at low transaction costs. At the end of December 2009, the implementation of UMURENGE SACCO was at the stage of sensitizing members and collecting capital shares. In an effort to mobilize people to adhere to this program, BNR jointly with FSDP/MINECOFIN and

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Rwanda Cooperative Agency (RCA) visited all the provinces of the country in November / December 2009.In order to accelerate the licensing process of SACCOs created in line with UMURENGE SACCO program, a simplified licensing procedure has been set up by BNR.
According to the report from Rwanda Cooperative Agency (RCA), 230 SACCOs out of 416 sectors have obtained their legal status as of the end of January 2010. However, only 63 SACCOs so far submitted their application files requesting a license to BNR and 25 of them have completed the licensing requirements and others are in the process of doing so.

III.3 NON-BANK FINANCIAL SECTOR

The inclusion of NBFIs supervision within the mandate of BNR was in recognition of the valuable role that these institutions play in the stability of the financial system and in the economic growth of the country. The BNR aims at developing and regulating NBFIs as an important component of a broad, balanced and efficient financial system that provides a sound base for the country’s economic growth and prosperity.

During the year 2009, a number of activities were done to ensure the stability of non bank financial institutions. The activities range from legal framework to financial performance monitoring.

The existing private pension schemes lack legal and regulatory framework for both individual and occupational pension schemes hence less assurance of effective and efficient operation due to lack of clear rules of the game. To fill the current gaps, the Bank drafted a law regulating pension funds (public and private) which was presented to the Minister of Finance for cabinet approval in June 2009. The law will enhance transparency, accountability and professionalism which are core to the development of the financial sector as a whole.

In 2009, the National Bank of Rwanda (BNR) drafted a law governing Collective Investment Schemes that is, mutual funds, unit trusts and investment companies. The draft law was presented to minister of Finance in July 2009 and a decision was

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taken to handover the responsibility to regulate and supervise collective investment schemes to the Capital Market Advisory Commission.

BNR's endeavours since its new NBFI supervisory and regulatory role includes also drafting a new law governing organization and supervision of the activity of insurers and insurance intermediaries. This law was adopted by the Parliament and published in the Official Gazette on 31st March 2009. Additionally, BNR drafted all Insurance Core Regulations provided within this law, and a number of them have been published on the Bank's web.

A comprehensive financial and management audit has been conducted for all insurance companies operating in the country. Major findings of the audit range from non separation of short and long term insurance businesses, capital inadequacy, improper valuation of assets and liabilities to corporate governance issues. Key recommendations include separation of short from long term insurance businesses, increasing share capital for each insurance business, continuous capacity building at all levels, actuarial valuation of long term insurance contract liabilities and observance of good corporate governance standards and best practices.

III.4 CAPITAL MARKET

The Rwanda over the Counter (ROTC) Market has been in existence since early 2008. A number of achievements have been registered within the framework of Capital Market Development, including:

- Capital market legal framework: the law establishing the Capital Market Authority, the law to regulate the Capital Markets and the law to regulate the Collective Investment Schemes were drafted.
- National public Education and awareness campaigns have been organized for both Government and Private Institutions. A total of 3 493 people have received the basics on Capital Market.
- New Listings: There has been an increase in the number of listed securities on the ROTC following the privatization of government shares in some enterprises. To facilitate the privatization of BRALIRWA, the Minister of

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Finance and Economic Planning put in place a Capital Market Privatization Committee to provide the over-all guidance and coordinate the privatization process of BRALIRWA on behalf of the Government.

- Capital Market Incentives: A package of both none and fiscal incentives have been approved by the Cabinet. RRA and MINECOFIN are working together to amend the tax law.
- Regional Integration: Following Rwanda's joining of the EAC, the Capital Market Advisory Council (CMAC) has signed a Memorandum of Understanding with the East African Securities Regulatory Authorities (EASRA), the regional body of capital market regulators. CMAC has also joined East Africa Stock Exchange Association.

Today, the securities which are listed at the Capital Market include the 2 -year Government Bond (2.5 billion RFW) which was issued in January 2010, 3 -year Government Bond(5 billions) issued in 2008, BCR's Corporate Bond (5 billions RFW) and Kenya Commercial Bank shares which are Cross-listed in the EAC Region. The Rwanda Diaspora Mutual Fund was licensed and successfully launched during the last Diaspora Convention which took place on 13-15th December 2009.

III.5. PAYMENT SYSTEM MODERNIZATION

In 2009, BNR and stakeholders continued to work on the payment system modernization program to ensure that payment systems are efficient and reliable. This program involves introduction of new payment instruments, mechanisms (systems) and improving the legal environment.

To this end a robust legal framework is highly desirable because this raises public confidence in Payment Systems. In 2009, a lot of work was done in this regard; the Payment system Law was passed by Parliament and is now at the stage of being published in the Official Gazette; the regulation governing the Payment Service Providers was approved by the BNR board. To ensure that time critical payments are settled in real time, BNR is working on the implementation of a real time settlement system-the Rwanda Integrated Payments Processing System,

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encompassing the Automated Clearing House (ACH), the Real Time Gross Settlement (RTGS) and the Central Securities Depository (CSD), all three running on the same platform. In 2009, the tender process was finalized, selection of the vendor was done and the contract negotiated successfully.

The Rwandan banks continued to issue payment cards and SIMTEL as a common platform ensures that the infrastructure on which they are used is interoperable. In addition, the two banks (BK and ECOBANK) obtained the Visa international issuing and acquiring licences as principal members and the others have either taken up associate membership with parent companies (KCB) or will simply do domestic business. On the other hand to ensure that domestic transactions are performed electronically, SIMTEL has developed a domestic CHIP and PIN card. This has been tested and will be launched in the First quarter 2010. At the close of 2009, 10 Ecobank ATMs could accept international cards and all ATMs will be able to accept all kinds of cards when the Host-to-host-connectivity between SIMTEL and E-process and MSCC are completed.

The year 2009, also saw several initiatives in mobile payments and remittances being licensed. MTN was given the authorisation to operate the “MTN Mobile Money” as a mobile payment service and other stand alone Remittance Services Providers (RSP) were licensed. Notable among them are: Dahabshill money transfer and Express Union Money transfers. This will ensure that the Rwandan Diaspora can easily remit funds back home and will also enhance the compilation of our remittances statistics.

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IV. MONETARY POLICY AND FINANCIAL SECTOR REFORMS IN 2010

IV.1 MONETARY AND EXCHANGE RATE POLICY ORIENTATION

In 2010, the BNR monetary policy will be conducted in a good international and national environment compared to last year. According to the IMF estimates, the world economic activity would recover by 3.1% in 2010 against a decrease of 1.1% on average in 2009 and come back to the normal trend as the global real GDP has increased by 3% and 5.2% in 2008 and 2007 respectively. This recovery in the world economic activities will have a positive impact on Rwandan external sector as well as the private transfers to Rwanda.

As mentioned earlier, the banking liquidity conditions and the capacity of banks to give loans to private sector have recovered to normal levels since mid-2009 and lending activity has been increasing since the third quarter of 2009. In addition, Rwanda expects an important budget support estimated at USD 519.03 million in 2010 against USD 409.63 million in 2009, which is an increase of 26.7%. Based on these developments and expectations, the credit to private sector is expected to increase by at least 20%, coming back to the high growth rates observed before 2009. Indeed, annual growth of the credit to private sector between 2005 and 2008 was 29% on average and fluctuated between 26.1% and 36.3%. With this estimated level of credit to private sector, real GDP growth could be expected in the range of 7 – 8%, as observed in average during the period 2004-2008.

IV.1.1 Interest Rates and Liquidity Management

The BNR monetary policy in 2010 will focus more on supporting the gradual economic recovery consistent with higher economic growth perspectives for 2010 while maintaining the headline in one digit number. To this end, BNR will continue to implement a proactive monetary policy during the year 2010 to ensure that the level of the banking system liquidity, as well as the Central Bank policy rate will be kept at such levels which will give strong confidence to the banking system and stimulate domestic savings and lending to private sector. In terms of monetary program, Broad Money supply is expected to grow by 15% in 2010, accommodating gradually a strong recovery in private sector credit after a contraction in 2009.

For the first quarter 2010, the Key Repo Rate was reduced from 9% to 7.5% and the discount window rate has been also revised downward, from 12.5% to 11.5%. We do expect that this reduction of the cost of funds for commercial banks will stimulate the lowering of bank's lending rates. According to market conditions developments, the BNR will adjust its policy rate on a quarterly basis, with the main objective of maintaining interest rates positive in real terms to stimulate domestic savings while keeping the cost of funds at reasonable levels to encourage productive investments. Monetary Policy in 2010 will also pay attention to building a credible yield curve for Government securities to be used as benchmark for pricing private securities in capital market.

The Agriculture sector performance has been recently the main booster of the Rwandan economic growth and constitutes the important stabilizing factor of inflation in Rwanda. With its contribution to the achievement of the BNR monetary policy objective of maintaining low and stable inflation, the Central Bank policies will support Government and financial institutions initiatives aimed at increasing financing to the agriculture sector and related activities, such as Agro-processing and distribution. In view of these, BNR is working with other stakeholders to reform the management of the Agriculture Guarantee Facility to make it more suitable and accessible by farmers and other SMEs operating in the Agri-business industry. BNR is also in discussion with BRD, BPR and AMIR to identify the constraints to agriculture lending. The results of these consultations will help BNR to restructure its facilities to improve incentives for agricultural lending. They will also be used to advise Government on policy actions to be taken to address the supply side constraints especially agricultural supply chain.

IV.1.2 Exchange rate policy

Concerning the exchange rate policy for 2010, the priority of the National Bank of Rwanda remains to maintain a stable and predictable exchange rate of the RWF, and ensure that it remains fundamentally market driven. Thus, BNR will continue to intervene on the market by selling and buying foreign exchange to banks to

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smoothen the RWF exchange rate volatility depending on the market demand and the volume of official foreign exchange reserves available.

Thus, in case there is an unexpected balance of payments pressures, it will require policy flexibility to maintain macro-economic stability and adjust to shocks. More specifically, flexible exchange rate policy and proactive monetary policy will be reinforced, in order to avoid possible strong external shocks from higher imports or declining foreign exchange inflows which could lead to excessive reserve losses.

However, as previously, the BNR's interventions on foreign exchange market should be in line with its monetary policy objective of low inflation. Indeed, the Central Bank sales and purchases to or from commercial banks will be maintained among important tools to be used in 2010 to regulate the banking system liquidity. Regarding the Forex market infrastructure development, the BNR will continue the process of modernization of operations, by introducing a communication platform such as Reuters and other market technologies to enhance the market-determined Foreign exchange system.

IV.2. FINANCIAL SECTOR DEEPENING

The lessons from the financial crisis for Rwanda financial sector are that, even if the financial sector (banking, microfinance and NBFIs) in Rwanda is fully liberalized and at the same time closely regulated in order to protect depositors, we need to strengthen the macro prudential surveillance of our financial system. At the same time we need to improve risk management and corporate governance in the financial sector. Before the end 2010 BNR will put in place a crisis management framework which will include more stress testing, a strengthened surveillance system and a resolution framework. To monitor the financial sector trend regionally we will also develop via EAC MoU a cross border crisis framework. At the same time financial inclusion and long term finance mobilization will remain at the center of our policies.

IV.2.1 Banking sector reforms

During 2010, we will complete the update of prudential regulation in order to have in place a comprehensive legal and regulatory framework for the entire financial

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sector. In order to increase the banks outreach, BNR will encourage the banking sector to continue to expand their branch network in order to increase access to finance especially in the rural area.

A partnership between banks and MFIs will be stimulated in order to increase availability of viable financial services in the rural areas. BNR will also participate actively in the restructuring of the Rwanda Housing Bank (BHR). In order to improve the quality of bank's portfolio, the central bank will continue to monitor closely the recovery of non performing loans. In view of the global economic crisis that affected our banks, BNR has decided to maintain the benchmark of maximum level of 7% by end 2010. At the same time, the Central Bank will continue to play its role in the discussions to establish financial schemes or collective investments funds in order to boost lending to mortgage industry and agri- business.

In order to use the credit bureau, as a tool for managing risk and thereby increasing access to credit, the Central Bank will modernize the Public Credit Registry and reinforce the quality of information on credit by assisting the Rwanda Banker's Association to establish a Private Credit Bureau which will include information on banks credit and the microfinance segments. At a later stage this credit bureau will involve as well the insurance sector and other participants. The feasibility Study to establish a deposit guarantee scheme in the Rwandan banking system will be undertaken in 2010.

IV.2.2 Microfinance sector reforms

During the year 2010, in order to improve access to financial services, BNR will join efforts with its partners in order to closely monitor the MFI sector in particular the UMURENGE SACCO program via its licensing and the support to its capacity building program. In order to promote compliance with prudential norms, BNR will reinforce its onsite and offsite supervision of MFIs via risk based supervision and will conduct a study to establish a stabilization fund aimed at protecting deposits in case of MFIs failure.

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IV.2.3 Non-Banking Financial Sector reforms in 2010

During 2010, BNR will continue its onsite and offsite supervision activities and its monitoring of capital build up and separation of short and long term insurance business in order to maintain a safe and sound insurance sector. The Bank will also ensure that the insurance contract law and the mandatory insurance law are completed in 2010. The National Bank of Rwanda (BNR) will undertake an on-site inspection for the Social Security Fund of Rwanda (CSR) and the off-site examination of its 2008 and 2009 financial reports. At the same time we do expect that the law governing pension schemes and accounts will be enacted shortly. The bank will also ensure that all the core pension regulations are provided to support the implementation of the pension law.

IV.2.4 Capital market

A number of activities have been planned for 2010-2011. According to CMAC action plan, it is envisaged that the number of Active investors will increase significantly as a result of the Public Education. The Legal framework is expected to be completed and have all laws concerning the Capital Market published.

The number of listed securities will increase following the new Treasury Bond issuance program which has been approved by the Ministry of Finance and Economic Planning. It is also expected that the first Rwanda Unit Trust will be in place by December 2010. Besides, due to fiscal and non-fiscal incentives which will be introduced, new debt instruments such as the Corporate Bonds, Municipal Bonds, Government shares in companies to be privatized and foreign securities will be listed on the Rwandan Market. Capacity Building, aimed at availing sufficient professionals in the industry have been programmed.

IV.2.5 Payment system modernisation

Concerning the legal and regulatory framework, in 2010, the BNR shall endeavour to have the following laws passed: the Electronic Transactions law and the Book entry securities holding (CSD) law. Several regulations will be drafted and passed based on the above mentioned laws and more importantly the BNR will carry out an assessment of the present legal framework with a view to identifying all the

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gaps and be able to work towards filling them in order to have a robust legal framework that can support modern payment systems.

Concerning retail payment systems, concerted effort will be put in the following areas: International connectivity, International acquiring, International issuing, Cards acquisition, ATM and POS deployment based on the principle of interoperability. As a first step to ‘card’ issue to their clients, all the banks have plans to issue a debit card; either a ‘family’ card in the case of the regional banks or a proprietary card for domestic purposes and deploy ATMs at their branches and remote areas as well. The banks that use other switches outside the country for various reasons will implement a host-to-host strategy so as to be able to accept both international and domestic non VISA branded cards on their infrastructure.

Implementation of the Rwanda Integrated Payments Processing System (RIPPS) will kick off in March 2010 and it is envisaged to take 10 months to complete. This is an integrated system comprising the Automated Clearing House (ACH), the Real Time Gross Settlement System (RTGS) and the Central Securities Depository (CSD). BNR intends to link the RTGS part of RIPPS to the East African Payment System (EAPS) that links the other RTGS systems of Uganda, Kenya, Tanzania and Burundi (when Burundi implements one).

IV.2.6. EAC Monetary Union

The Central Bank will continue to participate and play a leading role in all activities related to the establishment of regional Monetary Union. These include among others the implementation of the recommendations of a report of study on EAC Monetary Union by the European Central Bank (ECB), which has been reviewed by Experts from EAC Central Banks. Among them include: Protocol for the establishing the EA Monetary Union (EAMU), the economic convergence criteria that are crucial for the full attainment of the EAMU, and the establishing of EA Monetary Institute (EAMI) to spearhead the Monetary Union process.

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