



NATIONAL BANK OF RWANDA

Quarterly Economic and Financial Report: Developments and Prospects



SECOND QUARTER 2014

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EXECUTIVE SUMMARY

The quarterly economic and financial developments and prospects report presents the National Bank of Rwanda's assessment of the recent developments and prospects on economic and financial developments influencing the real sector dynamics in particular and macroeconomic stability in general.

The global economy is recovering in 2014Q2 after some moderation in 2014Q1 owing to the economic slowdown in US and China. It grew by 2.3% in 2014Q2 from 1.9% in 2014Q1 and according to IMF forecasts; the global real GDP growth is projected to further strengthen over the forecast horizon, rising from 3.2% in 2013 to 4.1% in 2016. This performance is mainly driven by the improvement in the underlying economic fundamentals in advanced economies.

The Rwandan economy continues to recover from the economic slowdown in 2013 on the account of good performance recorded in the first and second quarters of 2014. In Q1 and Q2 of 2014, the economy grew by 7.5% and 6.1% respectively as a result of good performance in service and agriculture sectors that grew by 9% and 5% respectively.

The economy is expected to continue recovering in 2014Q3 owing to the fact that the indicators of economic activity show increased real sector activity. Total turnovers increased by 13.5% in the first two months of 2014Q3 from 9.6% in the same period of 2013.

Real GDP growth is expected to continue being driven by the service sector given the high increase in services turnovers to 16.2% in the first two months of 2014Q3 from 4.2% of the corresponding period of 2013. With regard to economic financing, new authorized loans increased on annual basis by 29.9% in 2014Q2 compared to 1.6% of the same period in 2013. Net government injection reached RWF 133.7 Billion in 2014Q2 from RWF -8.7 Billion realized in the previous quarter 2014, M3 increased from 8.6% in 2013Q2 to 17.1% in 2014Q2.

Inflation continues to be low and stable on the account of sustained and well-coordinated monetary and fiscal policies, limited inflationary pressures from trading partners and easing international oil prices. Inflation decelerated to 1.4% in June from 2.4% in January 2014. However, there are some risks linked to agricultural production given the poor performance in season B 2014 harvests and geopolitical tensions in Eastern Europe and the Middle East which may lead to increase in oil prices.

Regarding the external sector performance, trade deficit has worsened in 2014Q2 to USD 464.35 million from USD 379.83 million in 2013Q2 as a result of increase in imports by 16.4% in value while exports slightly increased by 2.4% mainly due to the fall in international commodity prices.

The central government operations have been expansionary and largely in line with the second Economic Development and Poverty Reduction Strategy (EDPRS II). Despite focusing on achieving fiscal consolidation in 2013/2014 fiscal framework, fiscal policy remains expansionary and is stimulant to demand.

Since June 2013, the monetary policy stance remains accommodative in order to support the financing of the economy. As a result credit to private sector is showing signs of recovery in line with current accommodative monetary policy stance. Banking system liquidity conditions remain healthier during 2014Q2 thanks to the resumption of fiscal injection and the on-going accommodative monetary policy. This is reflected by a downward trend in most of short term interest rates. Further still, the Rwandan currency has remained quite stable recording a nominal depreciation of 1.9% against USD in 2014Q2 compared to 1.2% recorded in 2014Q1.

The Rwandan financial system remains sound and well placed to support expansion in the economy. The banking system is well capitalised, funding and liquidity buffers are comfortably above required minimums, and non-performing loans continue to decline. Regulatory changes in recent past have helped to improve prudential standards for both banks and non-bank deposit-takers. Nonetheless, BNR will continue to monitor developments in the financial sector to mitigate any potential risks.

I. INTERNATIONAL ECONOMIC OUTLOOK

After a slowdown in 2014Q1, the global activity recovered in the second quarter of 2014 driven mainly by improving underlying fundamentals in developed countries and partly by a rebound in some emerging markets. Due to persistent spare capacity of production and softening commodity prices, world inflationary pressures remained low. Consistently, monetary policy in major economies remained accommodative to boost the economic activity and to shift inflation closer to policy targets. However, downside risks persist with respect to rising geopolitical woes that may affect energy prices and possible rising long-term interest rate.

1.1 Economic Growth

The world economic activity continued to recover moderately in 2014Q2 driven mainly by a strong growth in US and Chinese economies while the Japanese sharply contracted. Global real GDP increased year-on-year by 2.4% after 1.9% in 2014Q1 and it is expected to improve to 2.9% in the third quarter 2014. In advanced economies, despite the US weather-related contraction in 2014Q1, real GDP growth is gaining momentum and projected to reach 1.8% in 2014 and 2.3% in 2015 from 1.4% in 2013.

Table 1: Economic growth developments (in %)

	Quarterly (BLOOMBERG)					Annual (IMF)	
	2013			2014		2013	2014
	Q2	Q3	Q4	Q1	Q2		
World (YoY)	2.1	2.7	2.6	1.9	2.4	3.3	3.3
USA (QoQ)	1.8	4.5	3.5	-2.1	4.6	2.2	2.2
Euro area (YoY)	-0.6	-0.3	0.5	1.0	0.7	-0.4	0.8
Japan (QoQ)	3.4	1.8	-0.5	6.0	-7.1	1.5	0.9
UK (YoY)	1.8	1.7	2.7	2.9	3.2	1.7	3.2
China (YoY)	7.5	7.8	7.7	7.4	7.5	7.7	7.4
India (YoY)	4.7	5.2	4.6	4.6	5.7	5.0	5.6

Source: Bloomberg & IMF WEO, July 2014

In USA, the economic activity rebounded by 4.6% quarter-on-quarter annualized from a contraction of 2.1% in 2014Q1 owing to waning impact of hard winter and positive contribution from private consumption, private fixed investment and stronger exports. The US economy is expected to continue growing supported by improving financial conditions, waning fiscal drag and continuous improving labor market and housing wealth.

The Euro area economic growth increased by 1.0% and 0.7% year-on-year respectively in 2014Q1 and 2014Q2 on the account of structural reforms and fiscal consolidation, an accommodative monetary policy and improving financing conditions. The recovery is expected to further broaden as real GDP growth would reach 0.7% in 2014Q3 and 0.8% by end 2014. In Japan, the economy grew by 6.0% in 2014Q1, but deeply contracted by 7.1% in 2014 Q2 partly due to the increase in sales tax

from 5% to 8% in April 2014. The economy is expected to grow by 0.9% in 2014 but to slightly slowdown to 1.1% in 2015 as fiscal stimulus is planned to decrease.

In emerging and developing economies, growth is expected to decelerate to 4.6% by end 2014 due to rising vulnerabilities and weak global demand that affect commodity exporting countries but to regain to 5.2% by end 2015. In Asia, growth stayed robust driven by China and India despite some moderation in the Chinese economy with an expansion of 7.5% in the 2014Q2 and 7.4% in 2014Q1 against 7.7% in 2013Q4 due to the weak performance in real estate, heavy industry sector and external demand. Chinese growth rate is estimated to decrease to 7.4% by end 2014 and to further decrease to 7.3% in 2015 though the Chinese authorities resolved to grant tax relief for small and medium enterprises, increase fiscal and infrastructure expenditures and reduce the reserve ratio to support the economy.

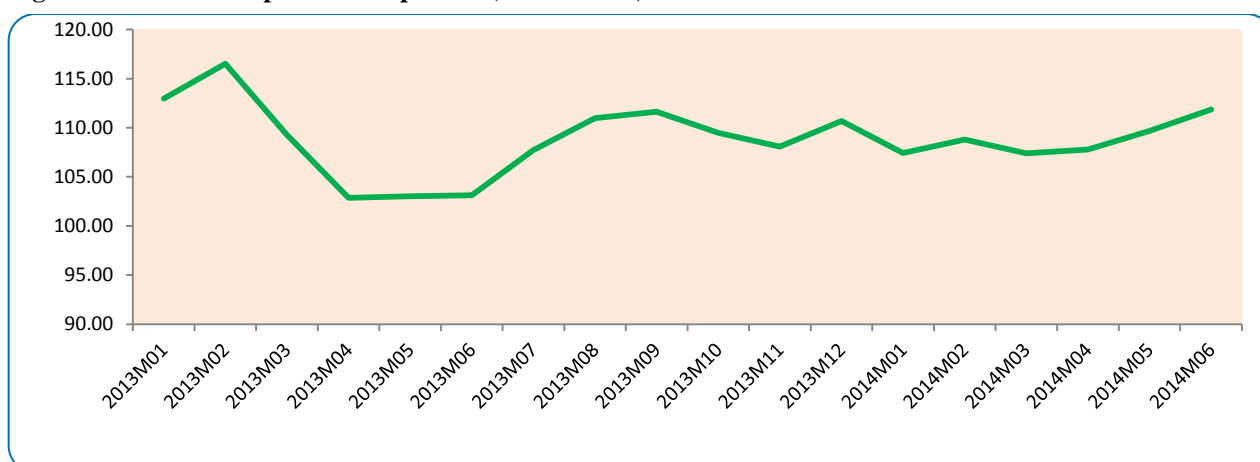
In Sub-Saharan Africa, supported mainly by commodity related projects, the economy is projected to grow by 5.4% and 5.5% respectively in 2014 and 2015 from 5.4% and 5.1% respectively in 2013 and 2012.

1.2 Inflation and Commodity Prices

1.2.1 Commodity prices

On commodity markets, energy prices slightly rose by 1% in 2014Q2 compared to 0.5% of 2014 Q1, driven by crude oil prices (+2.6%) which were particularly affected by rising tensions between Western countries and Russia over the Ukrainian conflict and by Iraq uprising as well as upward pressures on US natural gas prices due to particularly cold winter. Brent prices rose by 1.7% averaging USD 109.78/barrel in 2014Q2 from USD 107.88/barrel and USD 109.41/barrel in 2014Q1 and 2013Q4 respectively.

Figure 1: Brent crude price developments (USD/ barrel)



Source: World Bank, October 2014

Non-energy prices remained almost stable during the first and the second quarters of 2014, increasing by 0.6% and 0.1% respectively mainly due to good performances in agriculture sector and low demand for industrial raw materials particularly by China. Metals and minerals prices fell on average by 1.0% in 2014Q2 due to excess supply conditions and following closures of some Chinese high-cost capacity after a decline of 3.2% in 2014 Q1. Prices fell particularly for Iron ore (-14.8% in 2014Q2 after -10.7% in 2014Q1) on increased low-cost supply from Australia and Brazil. However, prices of base metals increased by 2.1% in the 2014Q2 while precious metals fell by 1.0%: Nickel price increased by 26.0%, Tin by 2.3%, Aluminium by 5.3% while gold lost 0.4%. Prices for fertilizers also fell by 6.5% in 2014Q2 after an increase of 4.7% in 2014Q1.

Food prices rose by 0.6% in 2014Q1 on the back of adverse weather and crop diseases in USA and Asia but fell again by 0.4% in 2014Q2 following improved weather conditions. The increase in beverages prices was sustained in 2014Q2 standing at 10.8% from 13.7% in 2014Q1 mainly led by higher prices of Arabica coffee (+22.1%) owing to drought in Brazil and disease in Central America. Meanwhile, tea prices fell by 13.4% in the Mombasa auction in 2014Q2 on higher supply and relatively weak demand.

Table 2: Commodity price developments (quarterly change, in %)

	2012		2013				2014	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Crude oil, Brent	1.0	0.5	2.2	-8.8	6.9	-0.6	-1.4	2.6
Coffee, Arabica	-0.1	-10.7	-6.1	-4.7	-6.8	-7.2	38.2	22.1
Coffee, Robusta	1.3	-6.2	3.8	-5.9	-5.0	-9.3	15.0	6.4
Tea, Mombasa auctions	7.6	-1.2	-4.4	-18.1	-5.4	-4.3	7.1	-13.4
Soybeans	17.6	-10.1	-6.3	-10.8	4.3	5.3	-0.5	-6.3
Maize	21.6	-3.5	-3.9	-4.5	-17.0	-17.6	5.3	2.0
Sorghum	Na	Na	2.3	-11.0	-15.7	-7.8	10.9	-2.2
Wheat, US SRW ⁽¹⁾	32.4	1.2	-11.8	-7.5	-6.4	7.3	-4.5	-0.2
Bananas EU	-16.1	12.3	-0.6	-2.1	-8.3	-4.7	12.5	8.2
Bananas Us	-2.0	-1.6	-1.6	-2.4	2.9	-0.8	2.4	-2.6
Sugar, world	-0.4	-7.5	-5.6	-5.6	-2.4	3.1	-5.2	7.8
Aluminium	-2.7	3.9	-0.2	-8.2	-2.9	-0.9	-3.3	5.3
Gold	2.7	3.7	-5.1	-13.2	-6.1	-4.3	1.7	-0.4
Tin	-6.1	11.6	11.2	-13.0	2.0	7.4	-1.1	2.3

Source: World Bank Website

SRW: Soft red winter

Globally, commodity prices are projected to decrease further in 2014 as aggregate demand in China is expected to decline. Moreover, there are signs of better agricultural production except for coffee whose production is expected to reduce particularly in Brazil, the biggest producer. Non-fuel commodity prices are expected to continue falling in 2014 (-1.7% from a decline of 1.2% in 2013) whereas metals prices are projected to further drop in 2014 by 6.8% from a decline of 3.5% and 14.3% in 2013 and 2012 respectively.

1.2.2 CPI Inflation

Inflationary pressures remained contained owing to softening commodity prices, lower than potential global output due to weak domestic and external demand in both developed and emerging economies. In developed countries, inflation slid to 1.4% in 2013 from 2.0% in 2012 while projected to reach 1.6% in 2014 and 1.7% in 2015.

Table 3: Annual inflation developments in %

	2013					2014					
	Jan.	Mar.	Jun.	Sept.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.
USA	1.6	1.5	1.8	1.2	1.5	1.6	1.1	1.5	2.0	2.1	2.1
Euro Zone	2.0	1.7	1.6	1.1	0.9	0.8	0.7	0.5	0.7	0.5	0.5
UK	2.7	2.8	2.9	2.7	2.0	1.9	1.7	1.6	1.8	1.5	1.9
Japan	-0.3	-0.9	0.2	1.0	1.6	1.4	1.5	1.6	3.4	3.7	3.6
China	2.7	2.0	2.6	3.1	2.5	2.5	1.9	2.4	1.8	2.5	2.4

Source : National Statistics Offices

In Euro area, deflationary pressures remained high. Inflation slid to 0.5% in June, the level it reached in March 2014 from 0.8% in January 2014 due to capacity under-utilization. In USA, inflation rose to 2.1% in June 2014 from 1.5% in March the same year due to strengthening demand and to rising gasoline prices. Similarly, in Japan, annual inflation hiked to 3.6% in June 2014 from 1.6% in March 2014 following a sales tax hike in April 2014. The tax increase was aimed to cover rising social welfare cost related to ageing Japanese population. It is expected to increase again to 10% in October 2015. By end 2014, inflation is projected at 1.4%, 0.9% and 2.8% respectively in USA, Euro area and Japan.

In emerging and developing economies, inflation stood at 5.9% in 2013 after 6.1% in 2012 whilst it is expected at 5.4% in 2014 and 5.3% in 2015. In Sub-Saharan Africa, inflation slowed down in most countries as result of more stable global commodity prices, favorable weather conditions and tight monetary policy. From 9.0% in 2012, inflation slid to 6.3% in 2013 and is projected to further decelerate to 6.1% and 5.9% respectively in 2014 and 2015.

In EAC, despite some seasonal shocks since 2013, headline inflation has remained moderate owing to positive agriculture performances. In June 2014, headline inflation declined in Uganda to 4.9% from 7.1% in March 2014 following the continued ease of food inflation. In Kenya, headline inflation rose to 7.4% in June 2014 from 6.3% in March mainly due to rising food prices. In Tanzania, inflation also increased to 6.4% in June from 6.1% in March 2014. Burundi inflation slid to 3.3% in June from 3.8% in March 2014 on declining prices of alcoholic beverages and tobacco while prices rose in food and non-alcoholic beverages.

Table 4: Annual headline inflation in EAC countries, in %

	2013					2014					
	Jan.	Mar.	Jun.	Sept.	Dec.	Jan.	Feb.	Mar.	Apr.	May	Jun.
Uganda	4.9	4.0	3.4	8.4	6.7	6.9	6.8	7.1	6.7	5.4	4.9
Kenya	3.7	4.1	4.9	8.3	7.2	7.2	6.9	6.3	6.4	7.3	7.4
Tanzania	10.9	9.8	7.6	6.1	5.6	6.0	6.0	6.1	6.3	6.5	6.4
Burundi	7.6	5.9	11.4	12.1	9.0	6.0	5.9	3.8	4.8	3.4	3.3
Rwanda	5.7	3.3	3.7	5.1	3.7	2.4	3.5	3.4	2.7	1.9	1.4

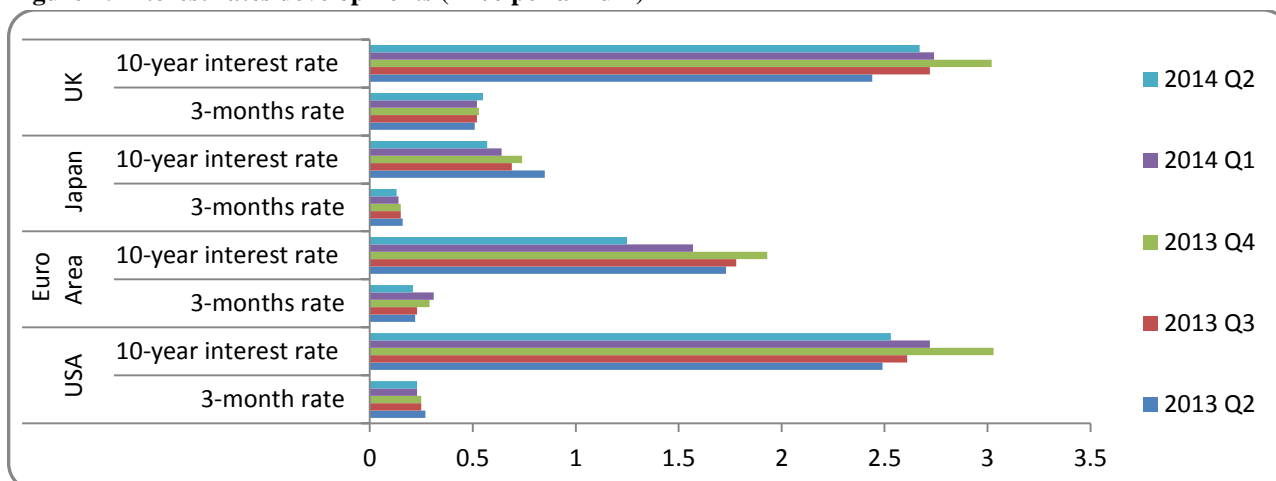
Source: Central Banks Websites

1.3 Monetary Policy and Financial Markets

Monetary policy in major countries remained accommodative to boost economic activities. In the Euro area, on June 5th 2014, the ECB further reduced its key policy rate from 0.25% to 0.15% and revised down to -0.1% its deposit facility to give a boost to the faltering European economic recovery and to shift inflation closer to the objective of 2 %. Holding excess reserves or any other deposits lodged within the Euro system is discouraged by this negative deposit rate. Additional policy stimulus includes also targeted longer-term refinancing operations and future outright purchases of assets-backed securities among others. Other central bank rates remained unchanged, at 0.25% in USA, 0.50% in UK and 0.10% in Japan.

The 10-year interest rates have been declining since the beginning of this year in all the major economies following geopolitical tensions and mixed economic data releases especially in USA and Euro area particularly for the 2014Q1.

Figure 2: Interest rates developments (in % per annum)



Source: Bloomberg Database

On the foreign exchange market, the dollar weakened versus the Pound (0.6%), the Yen (2.0%) and the Euro (0.2%) in 2014Q1. In 2014Q2, the dollar recovered by 0.6% versus the Euro supported by a relative economic growth and a continuous accommodative monetary policy in USA, but continued to depreciate versus the Yen (1.8%) and the GBP (2.7%). The Yen was supported by strong trade surplus and the policy stimulus in Japan and the GBP was supported mainly by strengthening economic outlook.

Table 5: Exchange rate developments

	2012	2013				2014	
	Q4	Q1	Q2	Q3	Q4	Q1	Q2
USD/1EUR	1.32	1.28	1.30	1.35	1.38	1.38	1.37
USD /1 GBP	1.63	1.52	1.52	1.62	1.66	1.67	1.71
YEN/1USD	86.62	94.22	99.33	98.21	105.26	103.23	101.33

Source: Bloomberg database

II. NATIONAL ECONOMIC PERFORMANCE

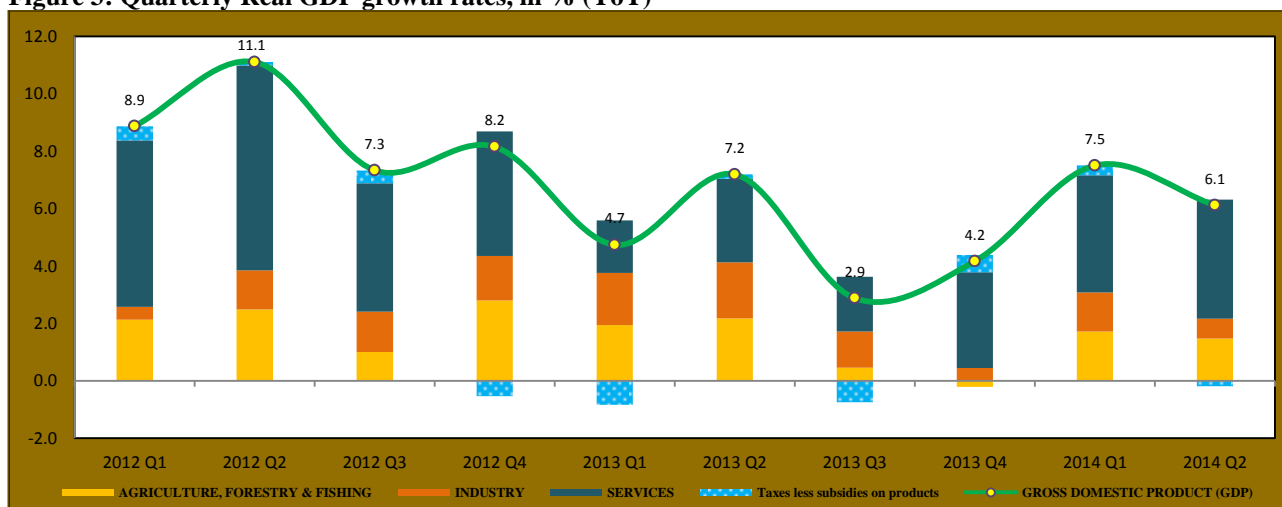
2.1 Real Sector Performance

Despite a slowdown in real GDP growth in 2013 due to poor agricultural performance and lagged effects of budget support disbursement suspension, Rwanda's economy started recovering in 2014Q1 and continued to grow in 2014Q2. The economy is projected to continue recovering owing to the positive trends observed in some economic indicators. In view of this, the assessment of domestic economic performance reflects mainly on developments of key economic indicators such as turnovers of industry and service sectors, VAT collections, composite index of economic activities, output gap as well as credit to the private sector.

2.1.1 Economic Growth

The Rwandan economy continued to recover in 2014Q2 after a slow down in 2013 due to the good performance in all sectors of the economy and evolves towards achieving the projected growth of 6.0% by the end of 2014. In 2014Q2, the real GDP grew by 6.1% slightly lower than 7.5% in 2014Q1 and 7.2% in 2013Q3. The real GDP growth was mainly attributed to service sector (+11%), followed by Agriculture sector (+5%) and Industry sector (5%).

Figure 3: Quarterly Real GDP growth rates, in % (YoY)



Source: BNR, Monetary Policy and Research Department

The GDP growth is expected to continue gaining pace driven by gradual recovery of domestic aggregate demand on the account of robust credit expansion and increased government spending to finance government's strategic investments.

2.1.2: Leading Indicators of Economic Activities

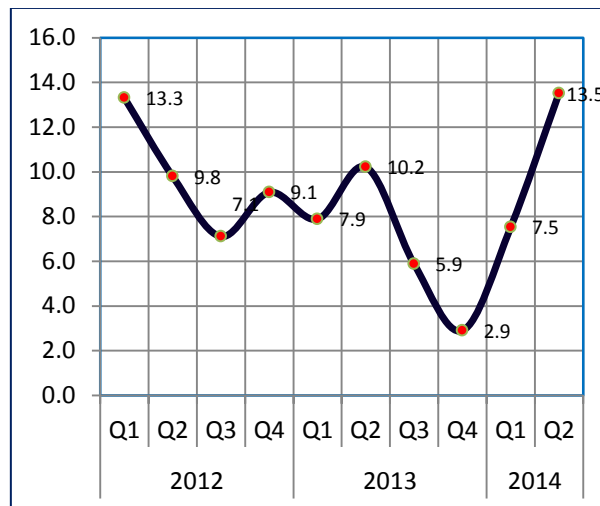
The analysis of selected key indicators of real sector activity shows that economic growth is continuing to recover and this is attributable to improving consumer spending and business environment as evidenced by VAT collections, the BNR composite index of economic activities (CIEA), and total turnovers registered by large companies in industry and services sectors.

Figure 4: Trend in VAT collections



Source: BNR, Monetary Policy and Research Department

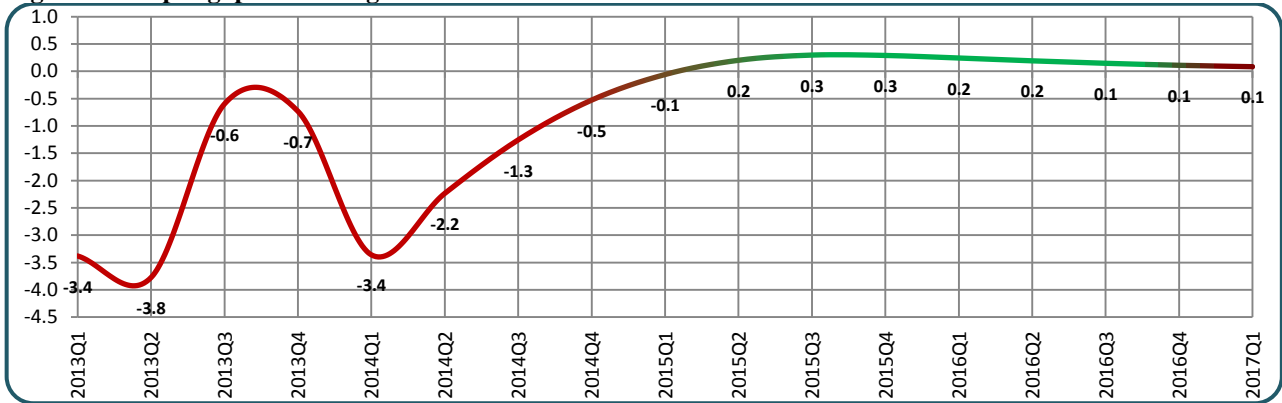
Figure 5: Growth in Real CIEA



Source: BNR, Monetary Policy and Research Department

During 2014Q2, consumer spending estimated by VAT collections grew from FRW 48.5 billion to FRW 77.9 billion (+60.7%), affirming a continuous growing optimism in economy bolstering the economic recovery. The consumer spending corroborates the trend shown by the composite index of economic activities, an indication of an upturn in economic activity. The upward trending Real CIEA is not only on the account of strong consumption demand but also business developments in industry and services sectors stemming from continuous business environment reforms that led Rwanda to be ranked 32nd in 2014 from 54th 2013 as by World Bank's ease of doing business report 2014. The CIEA rose by 13.5% in 2014Q2 after 10.2% in the same period of 2013, hence coinciding with the output gap prediction showing a progressive recovery from the downturn. The output gap though negative in both Q1 and Q2 of 2014, it depicts a recovery trend and is projected to close by 2015Q1.

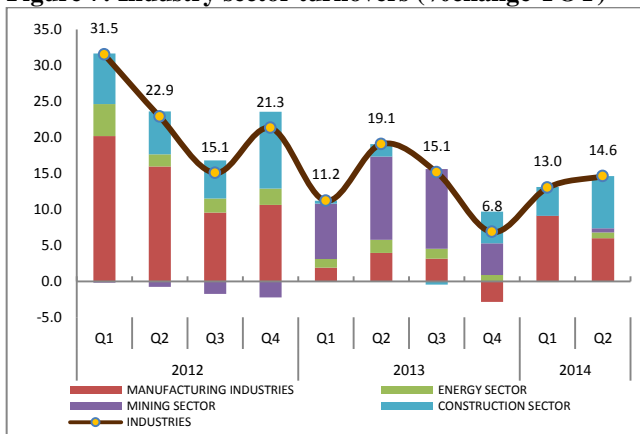
Figure 6: Output gap in %change



Source: BNR, Monetary Policy and Research Department

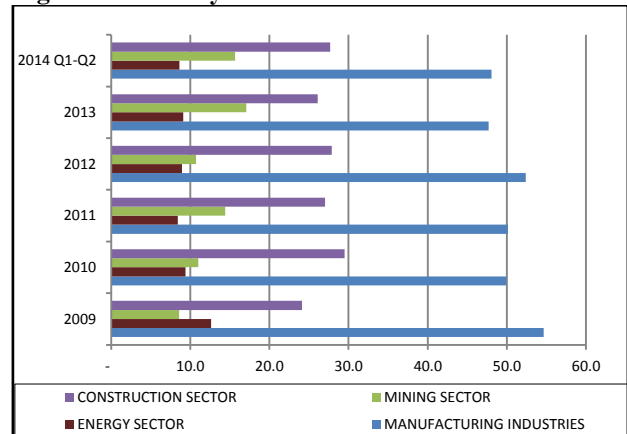
The economic growth is further observed in the trends of turnovers for services and industry sectors. The industry sector rose by 14.6% in 2014Q2 driven by manufacturing (+13.1%) and construction (+27.2%) sectors. Construction sector has been boosted by key public investments such as Kigali convention centre and transport and energy infrastructure. However, the mining sector remains vulnerable to fluctuations in international prices. Declining mineral prices in 2014 led the mining sector turnovers to decelerate by 3.1% in 2014Q2 compared to 106.8% of the corresponding period in 2013.

Figure 7: Industry sector turnovers (%change YOY)



Source: BNR, Monetary Policy and Research Department

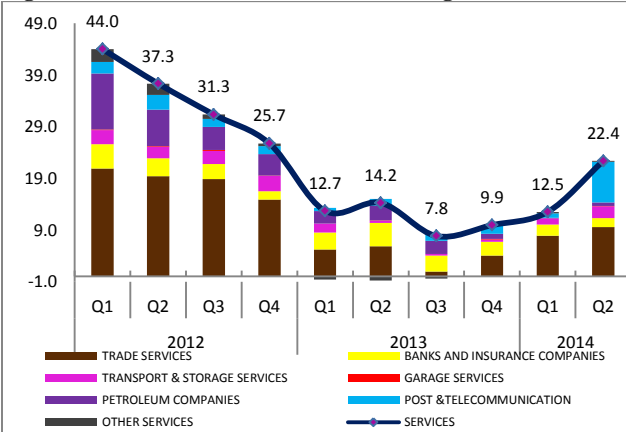
Figure 8: Industry subsector's shares



Source: BNR, Monetary Policy and Research Department

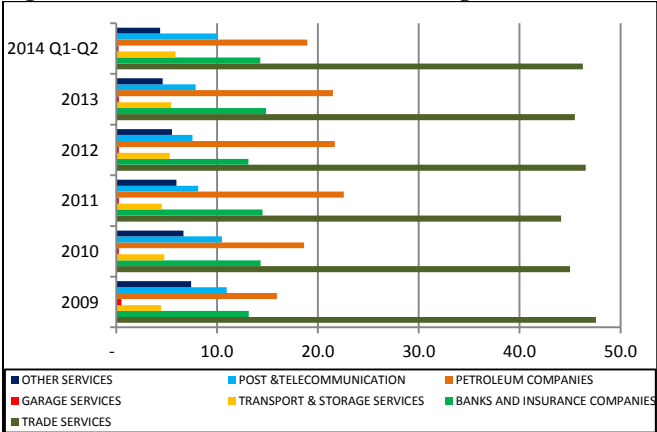
The services sector which contributes 71.6% of total turnover grew by 22.4% in 2014Q2 from 14.2% in the same period of 2013 and remains the key driver of the economic activities in the first two months of 2014Q3 and guarantees the continuation of growth in subsequent period. The upward trend of this sector has been largely supported by trade services which mostly contributed to the growth of the services sector in 2014Q2. This subsector rose by 20.6% in 2014Q2 from 12.5% in the same period of 2013. This trend of trade services evidences a private consumption demand. The later, representing 80% of Real GDP, indicates therefore a strong recovery and guarantees the achievement of the projected 6.0% growth rate at the end of 2014.

Figure 9: services sector turnovers (%change YOY)



Source: BNR, Monetary Policy and Research Department

Figure 10: Services sector turnovers (%change YOY)



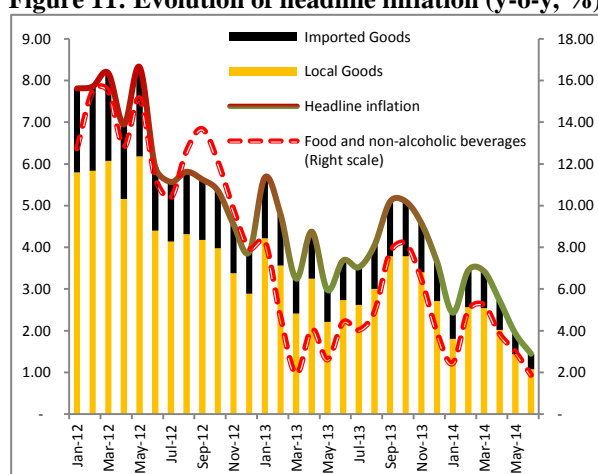
Source: BNR, Monetary Policy and Research Department

2.2 Price Developments

During 2014Q2, inflation has remained low and stable thanks to efficient and well-coordinated monetary and fiscal policies, low commodity prices on the international market, stable RWF exchange rate and easing inflationary pressures in EAC trade partner states.

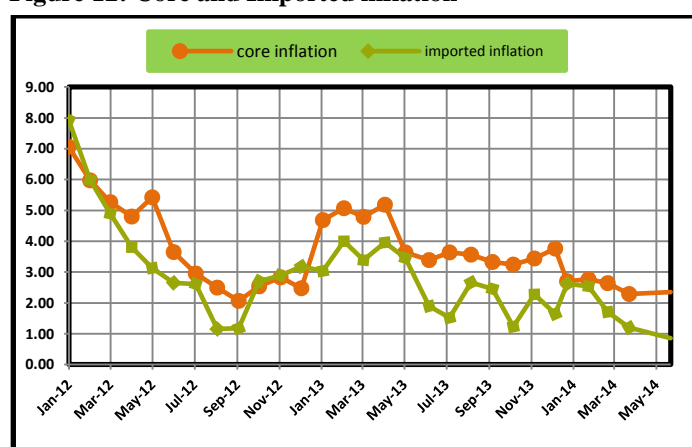
The headline inflation decelerated to 1.45% in June 2014 from 3.43% in March 2014 and 3.65% in December 2013. Food and non-alcoholic beverages prices led the decline as they slid to 1.9% in June 2014 after 5.3% in March 2014 and 3.6% in 2013Q4. Domestic inflation continued to be the major source of inflation pressures as it increased to 2.1% while imported inflation decelerated to -0.4% in June 2014.

Figure 11: Evolution of headline inflation (y-o-y, %)



Source: BNR, Monetary Policy and Research Department

Figure 12: Core and Imported inflation



Source: BNR, Monetary Policy and Research Department

The deflation of fresh products to 0.5% after +4.9% in December 2013 and +5.1% in June 2013 backed the decline of food and non-alcoholic beverages prices. Vegetables which account for 35.9% of the food basket had their prices contracted on annual basis by 4.7% in June 2014 due to the good harvest. Looking forward reforms to improve agricultural productive capacities such as crop intensification and land consolidation programs are expected to further contribute to the deceleration of food prices and ensure that inflation remains below its medium term central path of 5%.

Core inflation, which excludes fresh products and energy, remained stable at around 2.5% on average since January 2014 and down from 4.0%, the average of 2013. Imported inflation dropped from 1.9% in June 2013 to 1.7% in March 2014 and -0.4% in June 2014 as a result of decline in transport costs (-4.8%), single digit and stable regional countries inflation and regained overall stability of RWF.

III. PUBLIC FINANCE AND DOMESTIC DEBT

3.1 PUBLIC FINANCE DEVELOPMENTS

In line with implementation of fiscal consolidation strategy (FCS) through increased domestic revenue mobilization and expenditure prioritization, much effort is devolved on efficiency in tax collection and tax base widening as the economy continues to grow. The total revenues and grants contributing 27.9% of nominal GDP during the second quarter¹ grew by 37.3% from FRW 267.2 billion in its preceding quarter. The overall fiscal deficit including grants aggravated to FRW 158.6 billion from FRW 67.7 billion on account of higher government spending that increased by 31.6% with a share of 36.9% to nominal GDP.

Table 6: Summary of key Central Government Operations (billion FRW)

	FY2013/2014				% change Q4/Q3
	Q1	Q2	Q3	Q4	
Total Revenue and grants	327.9	374.4	267.2	366.8	37.3
Domestic revenue	181.9	227.1	214.2	238.9	11.5
Total tax revenue	174.5	185.1	188.6	212.8	12.9
Non-tax revenue	7.4	41.9	25.6	26.1	1.8
Grants	146	147.4	53	127.9	141.3
Total Expenditure and net lending	299.1	387.1	368.1	484.6	31.6
Current expenditure	172.8	190.7	193.6	219.5	31.5
Capital expenditure	131.9	185.9	149.4	244.9	63.9
Net Lending	-5.6	10.5	25.1	20.2	-19.5
Primary Balance/Deficit	-32.7	-15.6	-52.2	-93.8	79.9
Overall deficit, Including grants (cash basis)	53	-45.3	-67.7	-158.6	134.3
Overall deficit, Excluding grants (cash basis)	-93	-192.7	-120.7	-286.5	137.4
Financing	-53	45.3	67.7	158.6	134.3
Foreign financing (net)	13.3	13.8	14.2	63.5	348.1
Domestic financing	-66.3	31.5	53.5	95.1	77.7
Nominal GDP	1,233.0	1,308.0	1,282.0	1,314.0	2.5

Source: Ministry of Finance and Economic Planning (MINECOFIN)

3.1.1 Revenues and Grants

The domestic revenues contributed FRW 238.9 billion accounting to 18.2% of nominal GDP, was above the previous third quarter by 11.5% following an increase in tax revenues by 12.9%. This increase against the previous quarter was derived largely from increases in taxes on goods and services (+16.0%) and direct taxes (+11.7%). This is coordinated to continued commitment of the government to build-up the revenue-enhancing measures that is in line with FCS objective.

Non-tax revenue for the period rose by 1.8% to FRW 26.1 billion from FRW 25.6 billion of the previous quarter. Total grants amounting to FRW 127.9 billion with a share of 9.7% to nominal GDP increased by 141.3%, the highest across other quarters on the back of the delayed aid inflows disbursed towards the end of the fiscal year.

¹ Second quarter of the calendar year corresponds to the fourth quarter of the fiscal year

3.1.2 Expenditure and Net Lending

With a share of 16.7% to nominal GDP, the current expenditure for 2014Q4 amount to FRW 219.5 billion from FRW 193.6 billion of the third quarter, posing an upsurge of 13.4%. This mostly resulted from increase in interest payment (+191.0%) as well as in exceptional spending (+57.2%) despite a reduction in payment of transfers by 5.5%.

Capital expenditure totalled to FRW 244.9 billion against FRW 149.4 billion of the previous quarter and holds a share of 18.6% to nominal GDP. This was due to increase in both foreign and domestic financed spending that respectively upgraded by 63.6% and 64.2%. The increase in capital expenditure is mostly ordained to strategic investment projects.

3.1.3 Deficit Financing

The cash deficit of FRW 158.6 billion possessing 12.1% of nominal GDP increased by 134.3% compared to the previous quarter was financed with net foreign capital loan receipts of FRW 63.5 billion and net domestic resources of FWR 95.1 billion. The foreign financing accounted for 4.8% of nominal GDP while net domestic finance contributed 7.2% of nominal GDP in the same period.

3.2 DOMESTIC DEBT DEVELOPMENTS

The stock of Government domestic debt at end 2014Q3 was FRW 297.7 billion, representing an increase of 18.0% compared to the same preceding quarter largely driven by growth in holdings of the banking sector (+40.2%). Banking sector continues to dominate the Government T-bill market and remains the main holder of the outstanding debt instrument with FRW 151.3 billion increased from FRW 121.9 billion end 2013Q3. The overall debt outstanding of the Non-banking sector slowed down by 9.7% against the same end period of the previous year, but increased by 21.7% against the preceding quarter following 96.3% increase in issuance of new development bonds. The shortfall in non-banking sector against the corresponding 2013Q3 resulted mostly from reduction of 61.1% in purchase of T-bills for treasury issues. In terms of aggregate domestic debt stock outstanding, the Banking sector remains the main holder with a lion's share of 61.9% followed by non-banking sector (+24.9%) and BNR (+13.2%).

Table 7: Sectoral Composition of Public Domestic Debt (billion FRW)

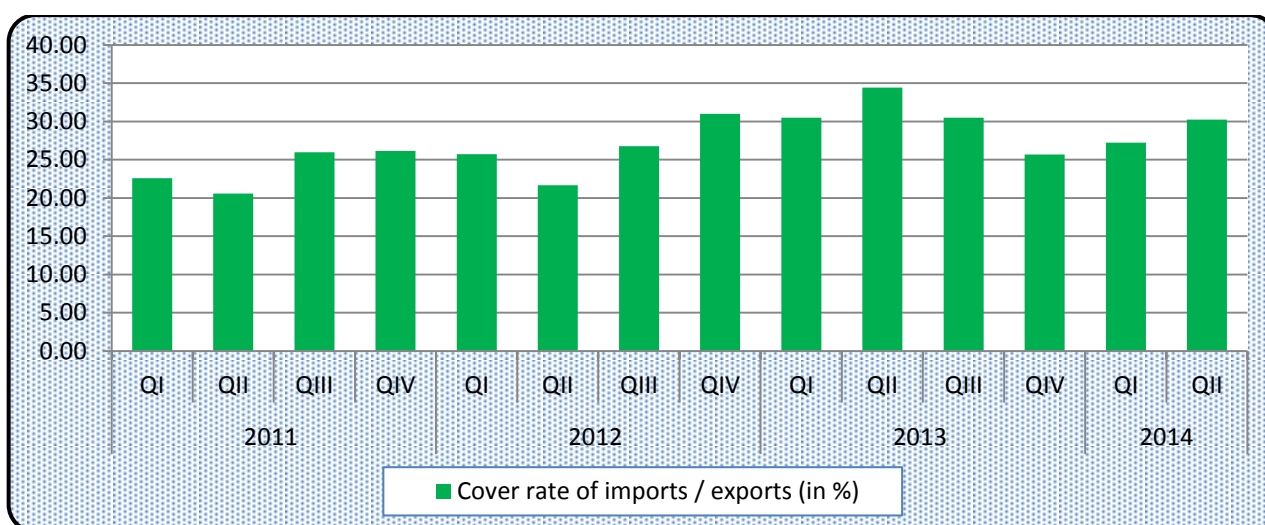
Sector	2013		2014			%change Q3 2014 /Q3 2013
	Q2	Q3	Q1	Q2	Q3	
BNR (excluding monetary instruments)	38.6	38.6	38.6	38.6	38.6	0
Consolidated debt	38.6	38.6	38.6	38.6	38.6	0
Overdraft	0	0	0	0	0.6	
Banking Sector	121.6	131.5	166.1	173.6	184.4	40.2
Development bonds	7.5	7.4	10.5	27.8	31.8	329.7
Bonds issued at MINECOFIN	2.5	2.1	1.5	1.4	1.3	-38.1
Treasury bills (issued at BNR for treasury issues)	111.5	121.9	154.0	144.4	151.3	24.1
Non-Banking Sector	96.9	82.1	63.6	60.9	74.1	-9.7
Development bonds	1.0	1.1	7.0	10.7	21.0	1809.1
Consolidated debt to RSSB	45.0	43.4	40.0	34.0	34.0	-21.7
Bonds issued at MINECOFIN	0.9	0.9	0.9	0.9	0.9	0
Treasury bills (issued at BNR for treasury issues)	43.6	30.3	9.3	8.9	11.8	-61.1
Other bonds for old arrears	6.4	6.4	6.4	6.4	6.4	0
TOTAL DOMESTIC DEBT STOCK	257.0	252.2	268.2	273.1	297.1	17.8

Source: BNR, Statistics Department

IV. EXTERNAL TRADE DEVELOPMENTS

In 2014Q2, Rwanda's trade balance recorded a deficit of USD 464.35 million from USD 379.83 million in 2013Q2. Exports covered 26.1% of imports from 29.6% in 2013Q2. Including informal cross border, exports covered 30.2% of imports from 34.4% recorded in 2013Q2. Trade deficit is expected to persist in the short to medium term as strong demand for both intermediate and capital goods as well as lubricants continue to outstrip the gradually expanding but still narrow export base.

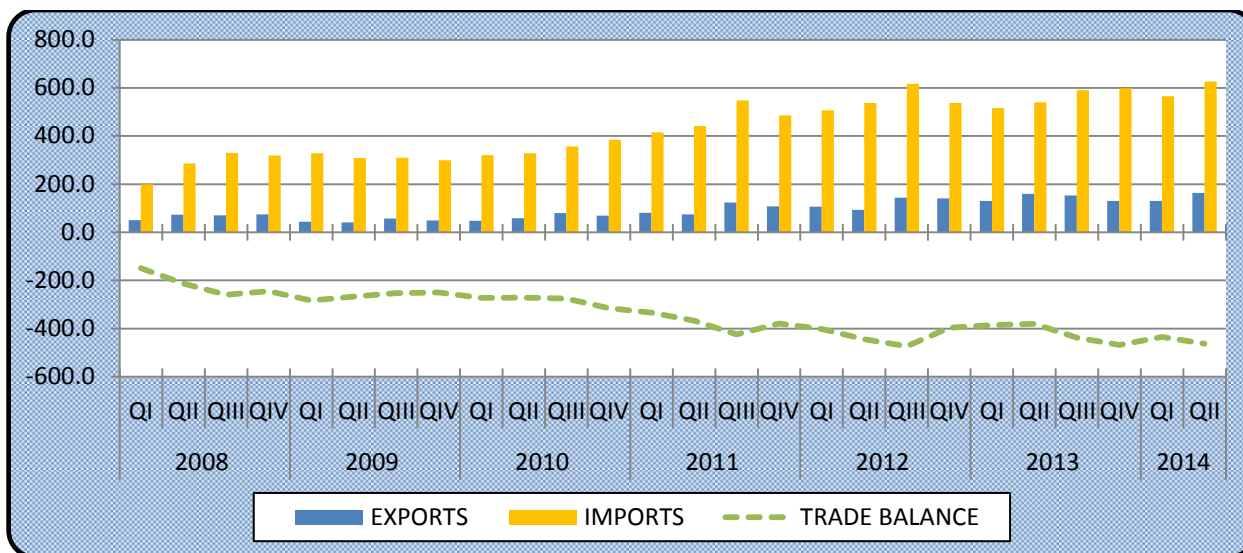
Figure 13: Cover rate of imports /exports in %



Source: BNR, Monetary policy and Research Department

Trade balance deteriorated due to the increase of imports by 16.4% while exports increased by 2.4% during the second quarter 2014.

Figure 14: Trade balance in millions of USD



Source: BNR, Monetary policy and Research Department

4.1 Formal exports

Although Rwandan exports are less diversified and characterized by lower volume compared to imports, their volume decreased by 3.4% but their value increased by 2.4% in 2014Q2 compared to the corresponding period in 2013, driven mainly by re-export products (+66.4%). Though exports value remain lower than target, concerted efforts are being put in place to increase exports value towards achieving 28% annual exports target set in the EDPRS II.

Traditional exports sensitively decreased in value by 21.4% attributed to decrease in export earnings of coffee (-10.3%), tea (-4.9%), coltan (-47.8%), wolfram (-37.2%), hides and skins (-15.9%) and pyrethrum (-26.8%) as a result of the fall in international commodity prices. They also decreased in volume by 2.3% mainly attributed to contraction in the volume of coffee (-20.6%), coltan (30.3%) and wolfram (-15.3%). However, cassiterite exports rose in both value and volume by 42.4% and 35.6% attributed to the international market price increase (+5.1%).

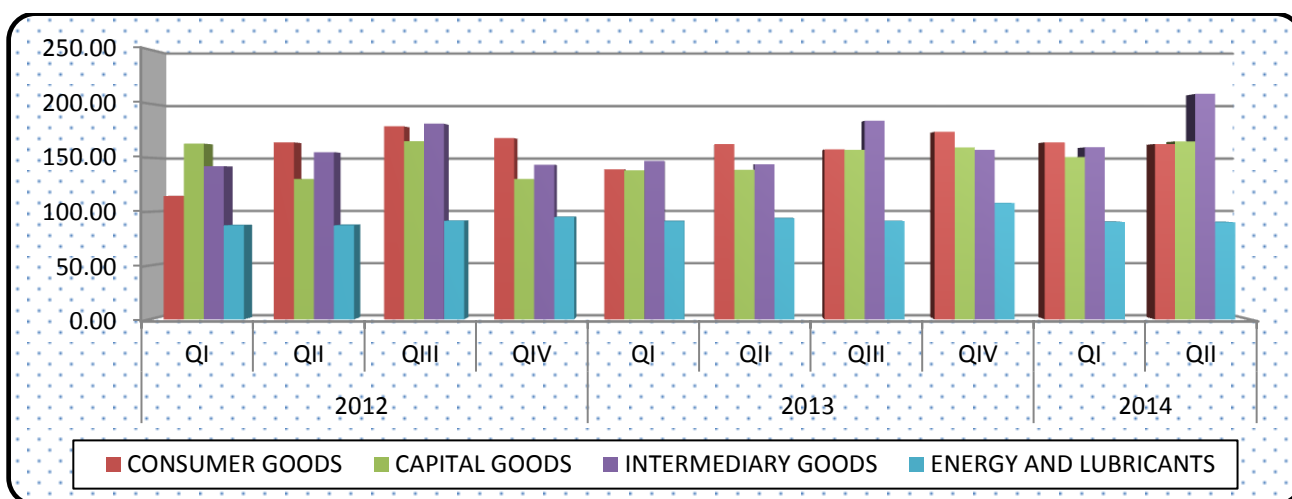
The volume of coffee exports (-20.5%) declined due to bad weather conditions especially lack of rainfall in 2013Q4 which caused the decline of production by 5.7% and 5.8% respectively in 2014Q1 and 2014Q2. Despite the increase of 8.2% in volume, the value of tea exports receipts decreased by 4.3% from USD 14.92 million to USD 14.28 million due to the decline of unit prices (11.4%). This decline resulted from high increase in tea supply at the Mombasa auction, where 71% of Rwanda's tea was traded, following high production of tea in most of the tea growing countries while the demand remained unchanged.

The mining sector which is dominated by coltan (+46.7%), cassiterite (+42.5%) and wolfram (+10.7%) accounting for almost 90% of the total mineral exports underperformed, mainly attributable to the decline in unit price of coltan exports (-25.5%) and wolfram exports (-24.7%).

4.2 Formal Imports

In 2014Q2, total imports CIF recorded an increase of 16.5% in value and 4.3% in volume. The rise in volume was mainly attributed to an increase in capital goods (+14.3%), intermediary goods (+5.3%) consumer goods (+2.2%) as well as energy and lubricants (+3.4%), which are four components of Rwanda's imports.

Figure 15: Imports developments in USD millions



Source: BNR, Monetary policy and Research Department

The increase in total imports CIF was mainly attributed to an increase in value for intermediary goods (+45.1%) and capital goods (+19.7%). The imports value for consumer goods slightly rose by +0.2% and this slight increase attributed to the increased demand for sugar and sweets which represent 35.1% and 13.8% of total imports of food products and consumer goods, respectively.

The demand for imports of sugar and sweets increased by 21.5% in volume, due to low domestic production which declined by 9.2% in 2014Q2, as KABUYE SUGAR WORKS closes during the second quarter for maintenance of machinery.

Capital goods, which represent 26.4% in 2014Q2, are dominated by machines, devices and tools, increased both in value (+19.7%) and volume (+14.3%), and this rise in volume was mainly attributed to high imports of machinery (+35.4%) and these were dominated by imports of telephones and other materials for network. There were also high imports of different companies including former EWASA, CIMERWA and RWANDAIR.

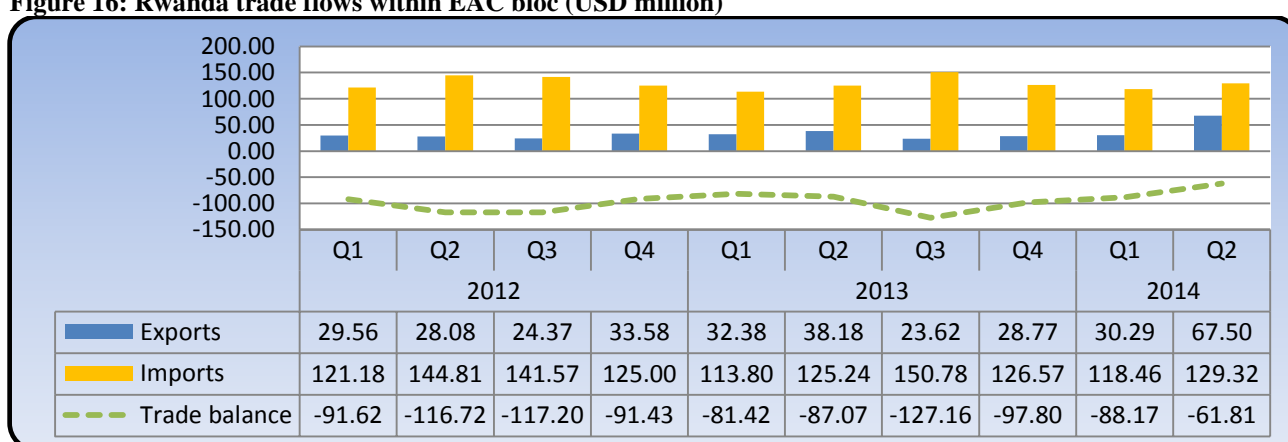
Intermediary goods which took the lion's share (+48.6%) of total volume of imports in 2014Q2, increased in both value (+45.1%) and volume (+5.3%). These imports are dominated by construction materials and industrial products, and high increase in imports value was mainly attributed to a rise in other construction materials (+51.4%) as well as industrial products (+21.2%). The rise in volume of intermediary good's imports on the other hand, was attributed mainly to the increase in demand

for industrials products (+23.8%). However, cement and other similar products decreased in volume (-3.0%) and this was a result good performance (+0.9%) recorded in local production of cement during 2014Q2 compared to the same period of 2013.

4.3 Trade with EAC countries

Rwandan exports to other EAC member countries sensitively increased by 76.8%, amounting to USD 67.5 million in 2014Q2 from USD 38.2 million in 2013Q2. Imports from EAC region slightly increased by 3.3%; amounting to USD 129.3 million from USD 125.2 million in 2013Q2. These developments have narrowed the trade deficit with EAC countries to USD 61.8 million from USD 87.1 million.

Figure 16: Rwanda trade flows within EAC bloc (USD million)



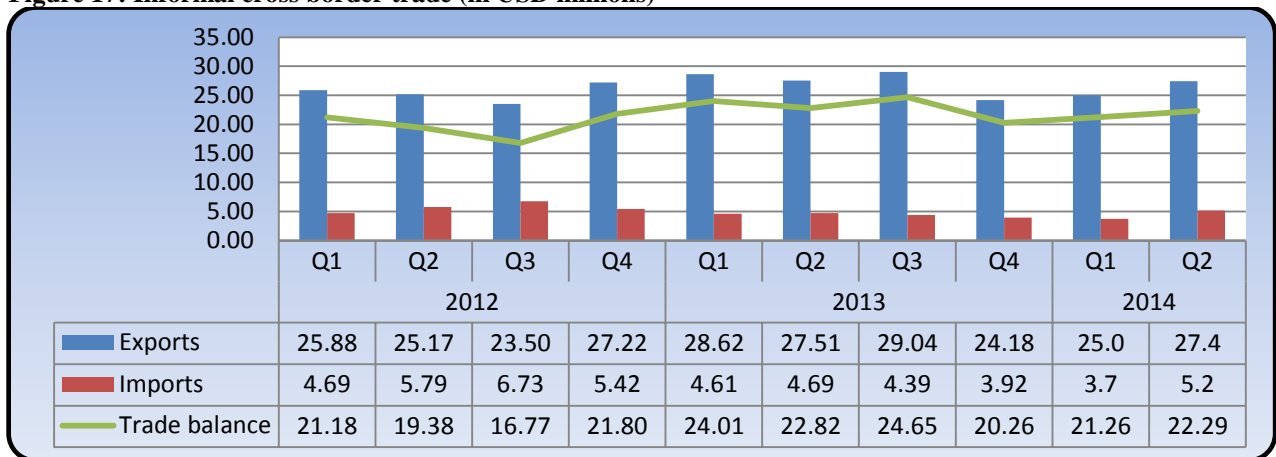
Source: BNR, Monetary policy and Research Department

Rwanda's main exports to EAC countries were tea (Mombasa auction), raw hides and skins of bovine, coffee, bars and rods of iron or non-alloy steel, leguminous vegetables, and beer made from Malt. On the other hand, major imports from EAC countries were cement, refined and non-refined palm oil, animals or vegetable fats and oils, mineral or chemical fertilizers, second hand clothes and other second hand articles, cane or beet sugar and chemically pure sucrose, among others.

4.4 Informal cross-border trade

With regard to the informal cross-border trade, total exports slightly decreased by 0.2% amounting to USD 27.45 million from USD 27.51 million, representing about 16.8% of formal exports. This decline is due mainly to trade barriers imposed by DRC on exports from Rwanda during the second quarter of 2014. In general, agriculture products and livestock were the major commodities traded in informal cross border exports. In terms of destination, exports to DRC, Burundi and Uganda increased by 8.9%, 1.7% and 7.7% respectively, while exports to Tanzania decreased by 65.0%.

Figure 17: Informal cross border trade (in USD millions)



Source: BNR, Monetary policy and Research Department

Informal imports increased by 10.0% from USD 4.7 million to USD 5.2 million in 2014Q2, leading to a decrease of about 2.3% in Rwanda’s positive informal trade balance from USD 21.3 million to USD 22.3 million with neighbouring countries. The main imported products from neighbouring countries are coffee, Irish potatoes, husked rice, sorghum, bananas for cooking, poultry live, and other manufactured and recycled products, where the main trading partners are Uganda, Burundi and Democratic Republic of Congo (DRC) which represent a share of 37.0%, 33.0% and 28.2% respectively.

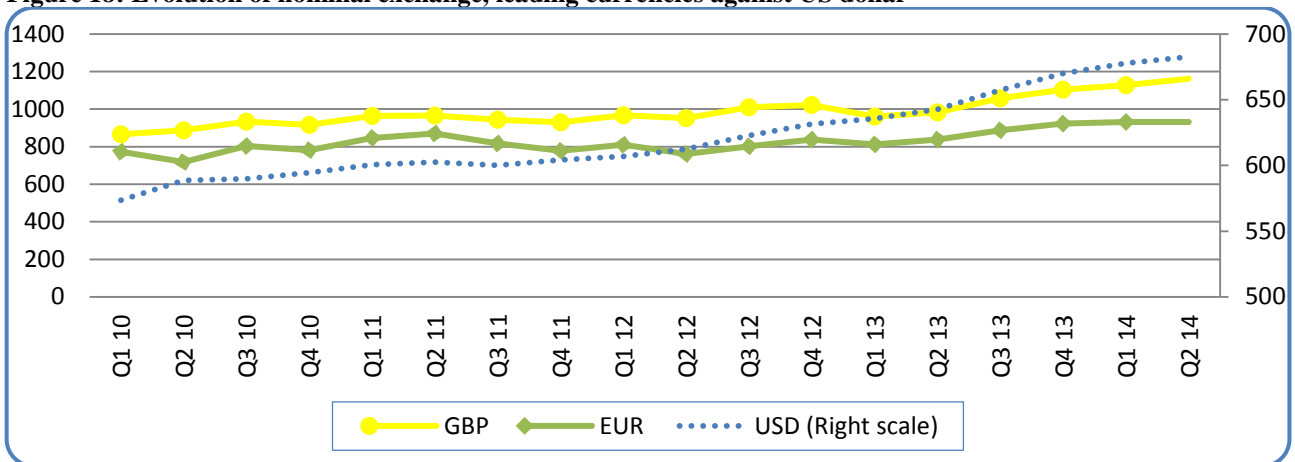
V. EXCHANGE RATE AND FOREIGN MARKET DEVELOPMENTS

The Rwandan Franc (RWF) was under relative pressure in the first half of 2014 resulting from high demand of forex to finance imports. The BNR kept the RWF exchange rate fundamentally market driven, while continuing to intervene on the domestic foreign exchange market by selling foreign exchange to banks to smoothen the RWF exchange rate volatility.

5.1 Exchange Rate Developments

During 2014Q2, RWF depreciated against the USD by 1.9% trading between RWF 682.54 per dollar against RWF 670.08 per dollar traded in 2013Q4. This depreciation recorded against USD in 2014Q2 is almost the same compared with total depreciation of 1.8% to 2013Q2.

Figure 18: Evolution of nominal exchange, leading currencies against US dollar

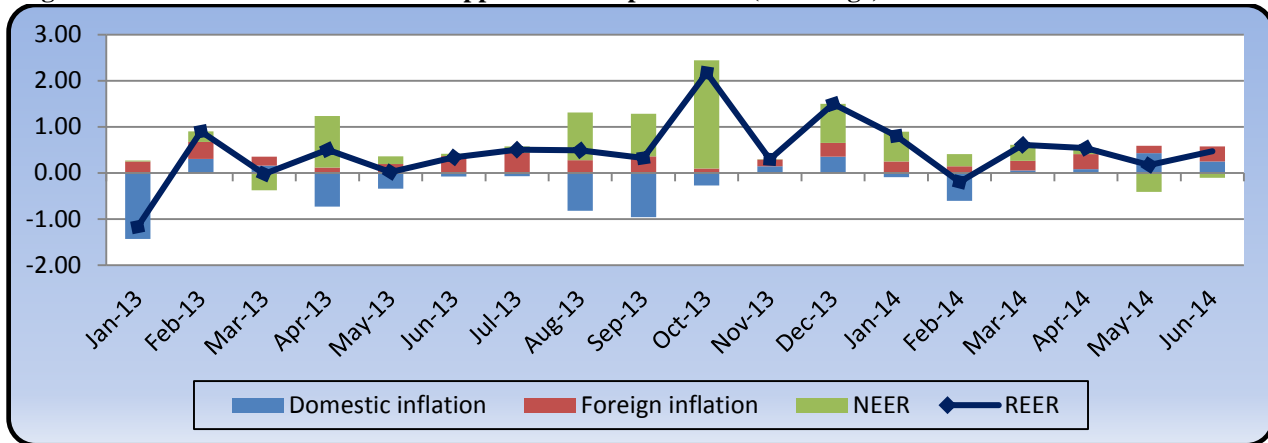


Source: BNR, Monetary policy and Research Department

In the same period, the RWF depreciated by 5.3% against the GBP and by 1.0% versus the EURO, as USD strengthened against those currencies. Concerning the East African region, RWF appreciated against all regional currencies, except the Burundian franc. It appreciated by 0.9% against the Kenya shilling, 2.5% versus the Ugandan shilling, and 5.3% against the Tanzanian shilling but depreciated by 0.6% versus the Burundian franc. The appreciation of FRW against shillings was the regional currencies that were strongly weakened against USD.

The Rwanda Real Effective Exchange Rate (REER) depicts a depreciating trend since 2013Q1 though the depreciation started easing in 2014Q1. The REER has slightly depreciated by 0.3% in June 2014 mainly driven by increase of relative prices due to their higher level relative to domestic inflation as well as a slight depreciation of the nominal value of RWF against some currencies of major trading partners. The easing pace of REER exchange rate depreciation has helped to insulate imported inflation.

Figure 19: Contribution to the REER appreciation/depreciation (% change)



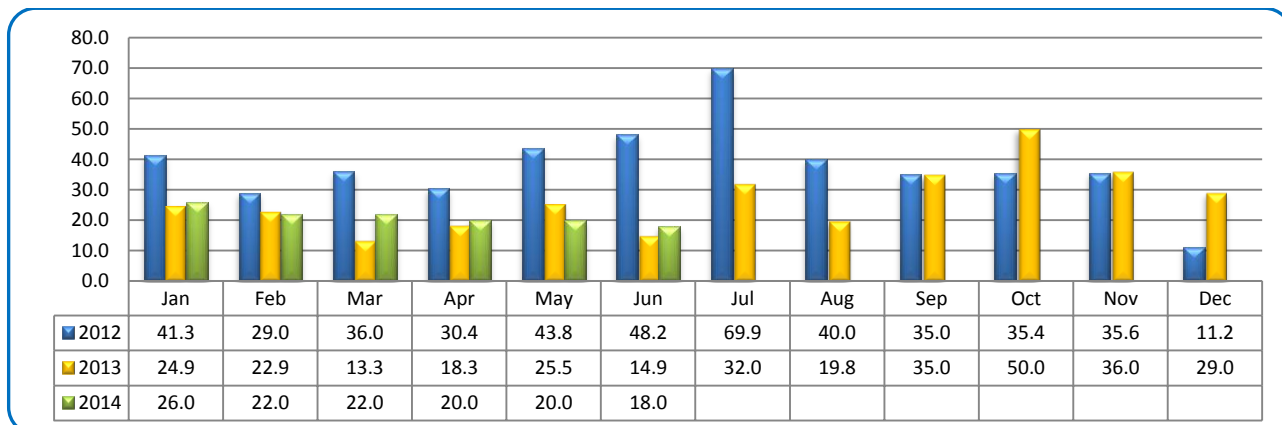
Source: BNR, Monetary policy and Research Department

5.2 Domestic Foreign Exchange Markets

In 2014Q2, the banking system recorded a decrease of 22.7% in forex resources and 14.4% expenditures compared to the same period of 2013, leading to a cash deficit of USD 5.68 million at the level of commercial banks.

Facing higher demand for forex, BNR managed to keep the stability of the local currency through interventions on forex exchange market. Sales to commercial banks of US dollar slightly decreased by 1.1%, that is, from USD 58.66 million sold to market in the second quarter of 2013 to USD 58.00 million sold in the second quarter of 2014.

Figure 20: BNR Sales to banks in millions of USD



Source: BNR, Financial Markets Department

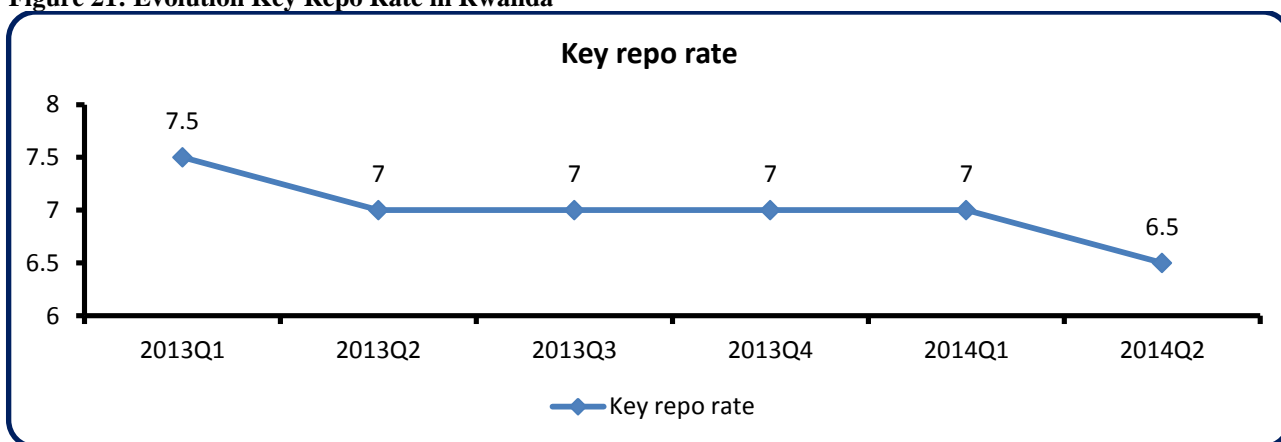
VI. MONETARY SECTOR DEVELOPMENTS

6.1 Monetary Policy Stance

Since June 2013, the central bank has pursued an accommodative monetary policy stance in line with the objectives of maintaining low inflation and supporting economic growth. The key repo rate (KRR) was revised down from 7% held since June 2013 to 6.5% in June 2014 in light of receding inflationary pressures globally, regionally and domestically along with the need to support growth in private sector credit and hence the on-going economic recovery.

The accommodative monetary policy stance has contributed to the year on year increase in total new loans to private sector from 1.56% in 2013Q2 to 29.9% in 2014Q2 and this will spur economic growth in the short to medium term. Nonetheless, the rate of increase in outstanding private sector credit in 2014 is so far not as strong as in 2012. The slowdown is due to various factors including notably cautious business approach by commercial banks due to slightly high non-performing loans ratio (from 5.9% in June 2012 and 6.9% in June 2013 to 6.6% in June 2014) and lagged effect from the economy slowdown in 2013.

Figure 21: Evolution Key Repo Rate in Rwanda

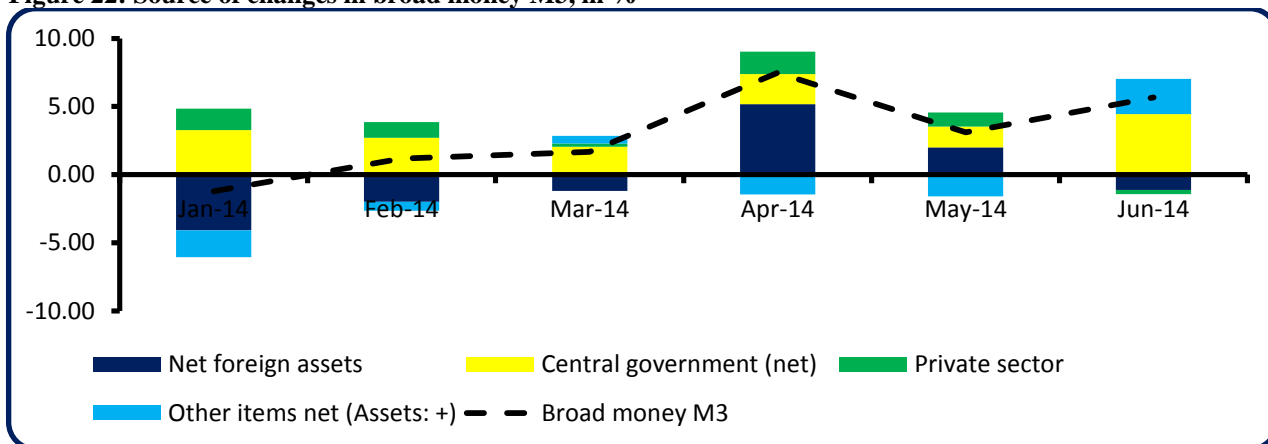


Source: BNR, Monetary Policy and Research Department

6.2 Monetary Aggregates Developments

Monetary sector developments in the first six months of 2014 depict signs of increased liquidity levels in the system. Money supply growth (M3) was on the rise during this quarter under review. M3 grew by 17.1% in 2014Q2 compared to 8.6% in same period of 2013. This growth in M3 has been mainly driven by high increase in net credit to government and net foreign assets (only in April and May) whereas the contribution of credit to private sector was moderate as depicted in the next chart. This upward trend in M3 is expected to continue amid a favourable policy stance.

Figure 22: Source of changes in broad money M3, in %



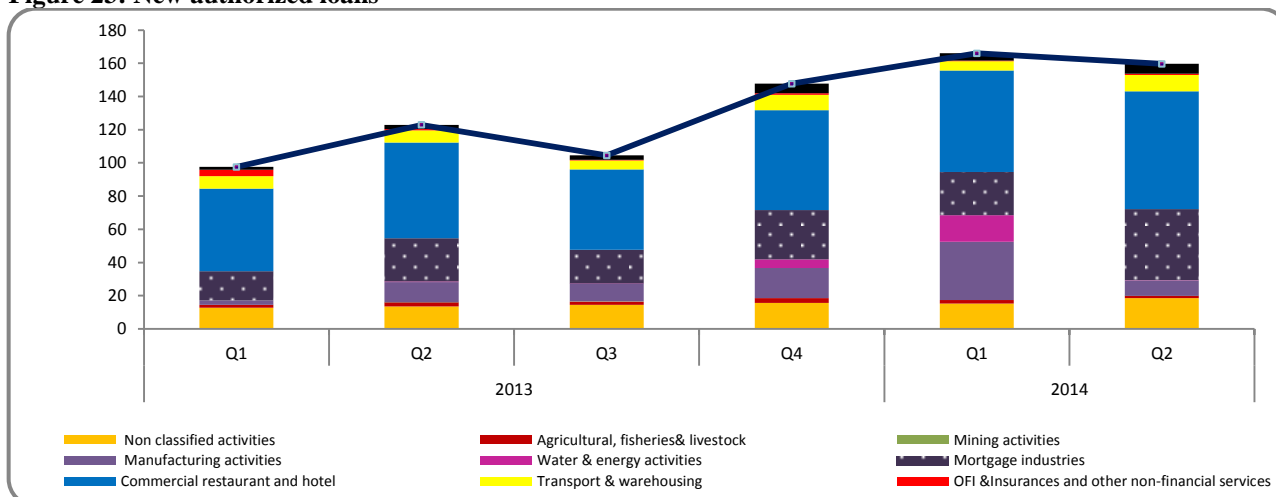
Source: BNR, Statistics Department

The main components of M3, particularly banks deposits and currency in circulation expanded by 18% and 9.1% respectively in 2014Q2 from their level by end 2014Q1, compared to 8.4% and 10.1% recorded in 2013Q2. This reflected the on-going preference for deposits at the expense of cash amid financial system modernization. Foreign currency deposits registered the highest increase in 2014Q2 (+32.2%) compared to time deposits (+12.3%) and demand deposits (+15.7%). This huge expansion in foreign currency deposits was mainly from sale of MTN’s mobile network towers.

6.3 Developments in Banks Credit

Outstanding credit to private sector continued to follow its recovery path in 2014Q2 with a quarter on quarter increase of 3.2% compared to 1.6% registered in the corresponding period of 2013. This was as a result of improvement in commercial banks’ lending as total new authorized loans in 2014Q2 amounted to RWF 159.7 billion from RWF 122.9 billion in 2013Q2 thereby recording a huge expansion of 29.9% compared to 1.5% registered in the same period in 2013. With regard to the distribution of new authorized loans, in industry sector, a sizable amount went to mortgage whereas in services sector a big chunk of the loans went to commerce, restaurant and hotels. This is consistent with the fact that trade and construction sectors have been respectively the first and third contributors to GDP growth in the last 5 quarters although hotels ‘contribution to GDP growth has been weak. Besides, the gradual increase in new loans to manufacturing sector in May and June 2014 contributed to an upturn of manufacturing turnovers in the same period.

Figure 23: New authorized loans



Source: BNR, Monetary Policy and Research Department

6.4 Interest Rate Trends

Developments in interest rates on the money market for the first half of 2014 showed a decline in rates on the account of the good banking system liquidity conditions along with the current accommodative monetary policy stance. Repo, Treasury bills and interbank interest rates remained low respectively at 3.7%, 5.7% and 5.7% in June 2014 compared to 3.3%, 6% and 5.8% in March but clearly lower than 6.7%, 10.8% and 9.6% in June 2013.

Commercial banks deposit interest rates stood at 8.65% by the end of 2014Q2 lower than 10.6% recorded in the corresponding period of 2013 while the lending rates remained almost stable at 17.52% by end 2014Q2 against 17.65% in the same period of 2013.

On deposits rate by maturity, their movement were generally influenced by demand from commercial banks especially for 6 and 12 months maturities as banks managed to collect more deposits by raising deposits rate with some few exceptions. The ‘yield curve’ for short term deposits has been generally normal with a positive relationship between the yield and maturity except in June 2014 due notably to one bank which collected one month deposits at exceptional high rate.

Regarding lending rate by maturity, they were volatile for short term, stable for medium term and increasing for long term during 2014Q2 as shown in the figure below. Nevertheless, the ‘yield curve’ for lending rate is inverted as long term lending rates are lower than short term. This is mainly due to the fact that, long term rates are mostly granted to big corporations with lower perceived risks which are also their regular customers compared to individuals who often receive short and medium term loans.

Figure 24a: Deposits rates by maturity

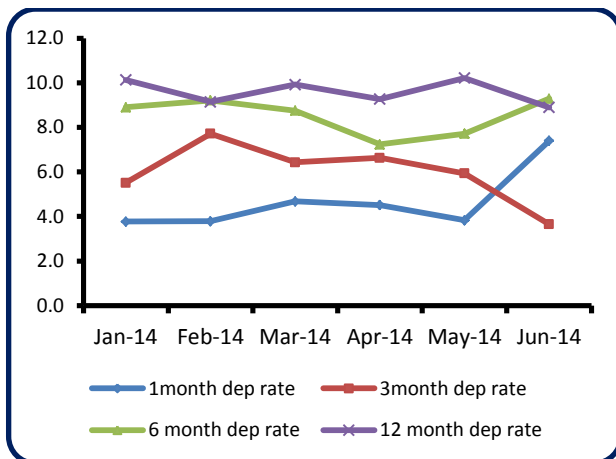
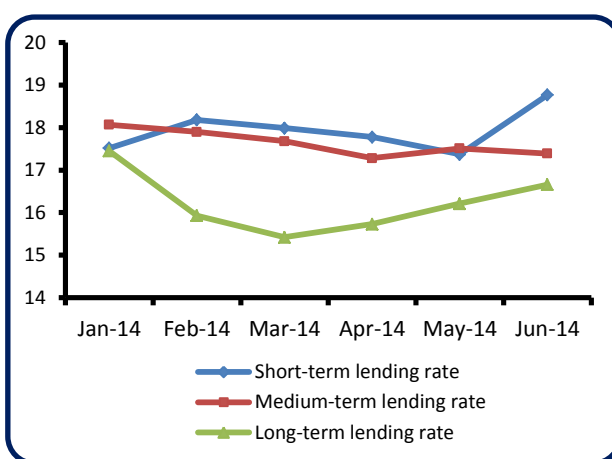


Figure 24b: Lending rates by maturity



Source: BNR, Monetary Policy and Research Department

Comparing average deposits rate in Rwanda with other EAC countries in 2014Q2, deposits rates in Uganda and Tanzania were declining in May and June while remaining stable in Kenya and Burundi. Rwanda has the second highest deposits rates in the region. Note that the sharp fall in Uganda rate followed the cut in policy rate from 11.5% to 11% in June 2014.

Similar to deposits rate, Uganda has also the highest lending rate among EAC countries. Contrary to Rwanda where lending rates slightly went up during 2014Q2, lending rates have been stable in other EAC countries even marginally declining in Uganda and Kenya in June 2014. In general, lending rates were less volatile than deposits rate in 2014Q2.

Figure 25a: Deposits rates in EAC countries

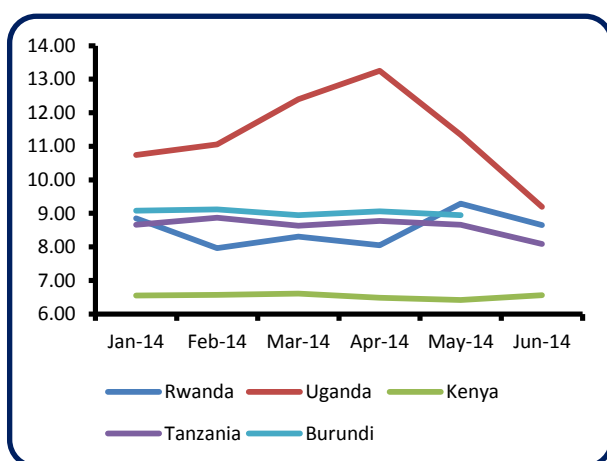
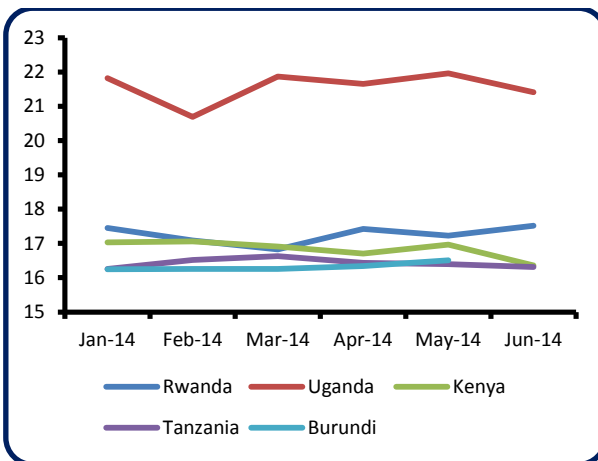


Figure 25b: Lending rates in EAC countries



Source: BNR, Monetary Policy and Research Department

Subsequently, interest rate spread between lending and deposit rates in Rwanda widened to reach 8.9% in June 2014 from 7.0% in June 2013. This was due to the fact that the lending rate has been stickier than the deposit rate as the sector has been facing high operating costs over time and relatively high non-performing loans ratio despite its consistent decline as it fell to 6.6% in June 2014 from 6.7% and 6.9% in March 2014 and December 2013 respectively, but still above the

benchmark of 5%. Compared to other EAC countries, the latest information from Uganda (3.9% in June 2013) and Kenya (5.6% in May 2014) shows that NPLs ratio is lower compared to Rwanda, while the situation is different for Tanzania (8.3% in March 2014).

Regarding operating costs in the banking sector, salaries and staff costs have the highest percentage in total expenses of the banking sector although this has been gradually declining (from average of 33% to 29% and 28% in 2012, 2013 and June 2014 respectively), while interest expenses on deposits and other interest expenses were gradually going up. The share of other items remained almost stable. If the proportion of staff costs continues to shrink, this would favour a smooth monetary policy transmission as banks would react more on changes in money market rates.

Figure 26a: Decomposition of expenses (% of Tot expenses)

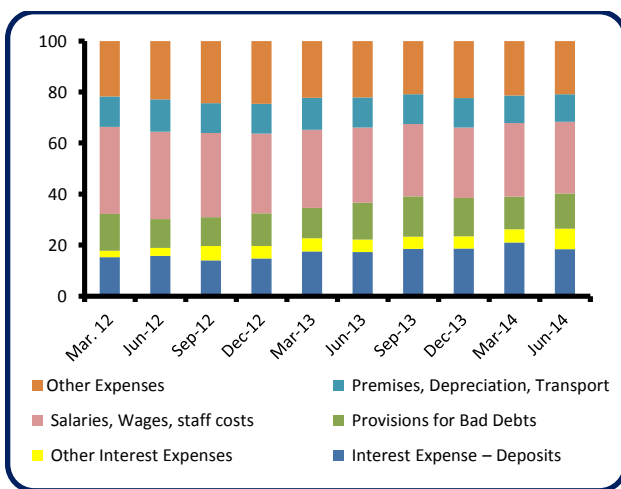
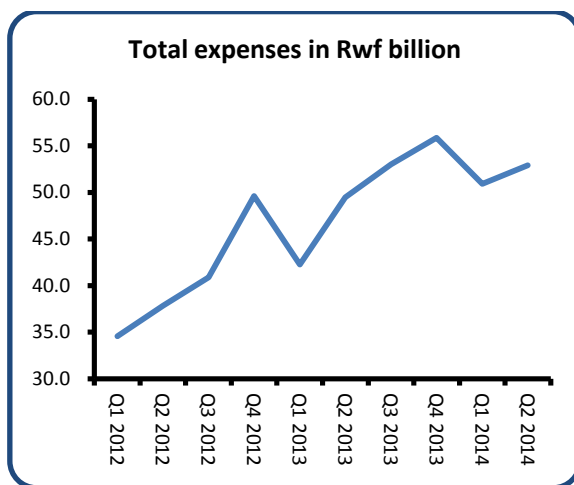
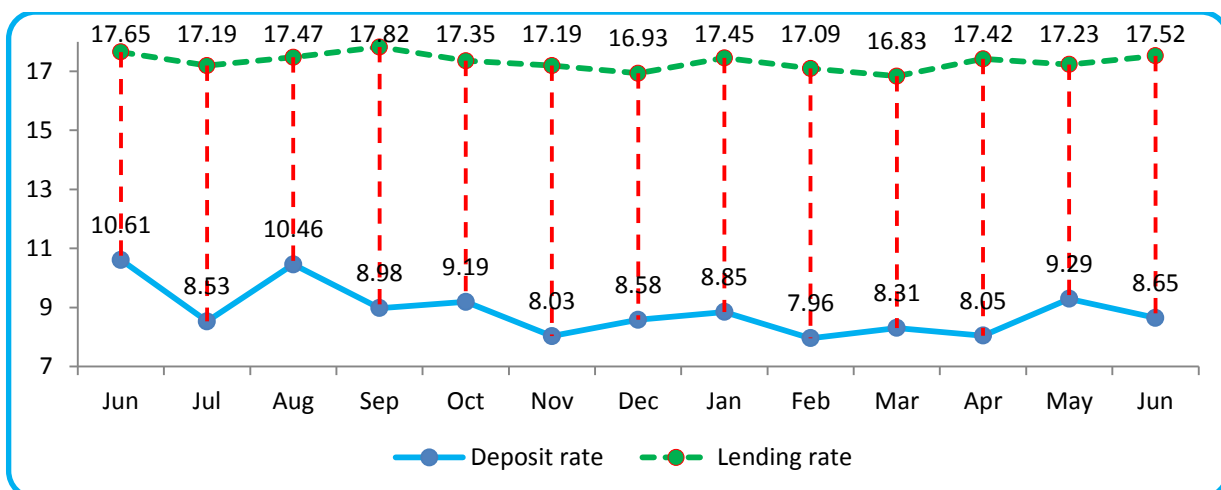


Figure 26b: Banking sector total expenses (in Billion)



Source: BNR, Monetary Policy and Research Department

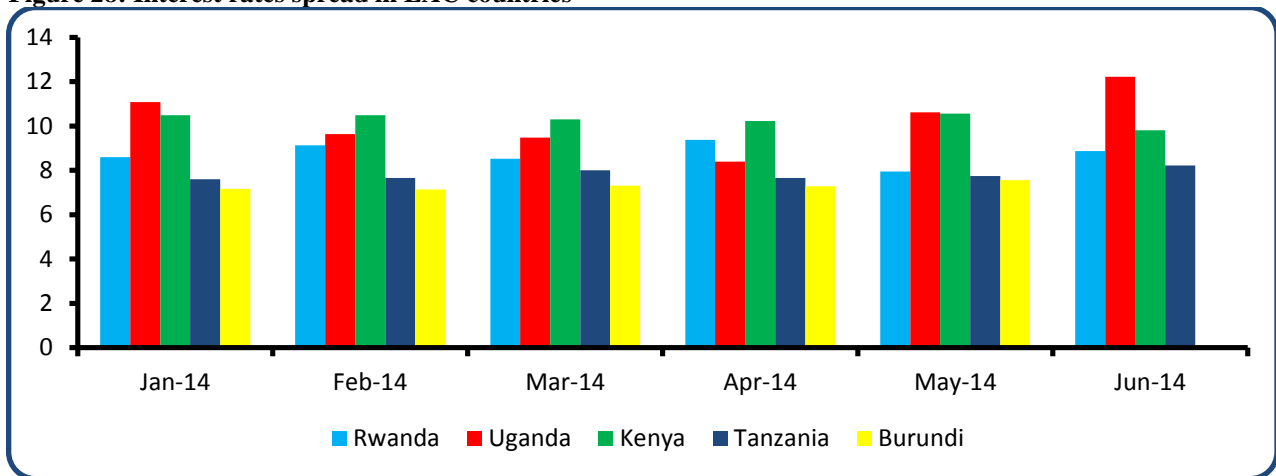
Figure 27: Deposit and Lending rates



Source: BNR, Monetary Policy and Research Department

Regarding the spread in the EAC countries, there were no big changes in 2014Q2 except in Uganda where the spread went up amid a sharp decline in deposits rate. Besides, Uganda and Kenya continued to have the highest spread in the region especially in May and June 2014.

Figure 28: Interest rates spread in EAC countries



Source: BNR, Monetary Policy and Research Department

VII. FINANCIAL STABILITY ANALYSIS

Looking at the stability of the financial system in 2014Q2, all indicators show that Rwanda financial system remained healthy and well performing amid a favourable global and domestic economic environment.

The world economy is gradually recovering from 2013 and 2012 slowdown and world inflationary pressures are expected to remain subdued in the near future. Consequently, monetary policy in major advanced economies remains accommodative to boost the economic activity and drive up inflation closer to policy targets. Lower interest rates in developed world imply easy financial conditions and lower risk of capital outflow for the moment.

Rwanda economic performance since the beginning of 2014 has been generally encouraging. Recovery in economic activities is on track as real GDP growth reached 7.4% in 2014Q1 and trends in other leading indicators suggest a sustained recovery in 2014Q2. BNR kept its accommodative monetary policy stance and banking system liquidity remained at comfortable level. On the external side, during fiscal year 2013/2014, current account deficit declined by 5.8% implying an improvement on national saving-investment balance. However, due to lower inflows from the capital and financial account, the overall balance deteriorated and external debt which is mostly from public sector went up. Consequently, the Rwandan francs exchange rate has been under relative pressure in 2014 against US dollar.

7.1 Financial Sector Performance Indicators

Rwanda's financial system is dominated by banking sector with 67.6% of the system's total assets. The microfinance has 5.6% and the non-banking financial institutions account for 26.7% (insurance 9.4% and pension 17.3%). The following section focuses on the banking sector due to its prominence and role in effectiveness of monetary policy transmission.

Currently, our banking system has 16 banks including the two recently established (AB bank and Crane Bank). The concentration and competition in the banking sector as measured by the Herfindahl Hirschman Index (HHI) has significantly improved from a moderately concentrated market in the last decade (HHI above 0.15) to an unconcentrated market (HHI below 0.15) although in recent years, HHI has remained fairly stable around 0.14 on loans and deposits markets.

The banking sector performance during 2014Q2 continued to improve as its total assets reached FRW 1,767.6 billion end June 2014, registering 17% increase since the beginning of 2014. This expansion is mainly driven by credit to private sector which is the main component of banking sector

total assets. The increase in outstanding credit to private sector from commercial banks and other specialized banks reflected a recovery in private sector financing and totalled FRW 904.5 billion by end 2014Q2, thereby recording an increase of 7.2% since the beginning of 2014. However, despite this recovery in private sector financing, it is obvious that other banking sector assets registered higher increase in percentage than credit to private sector implying that there is still room for private sector financing.

Besides, looking at the funding side, expansion in total deposits in the banking sector has been stronger in 2014 (+20.6%) compared to credit granted. This is also reflected by the ongoing downward trend in loans to deposits ratio of commercial banks which reached 0.73 by end 2014Q2 from 0.83 by end 2014Q1 and 0.82 by end of 2013. This level of loans to deposits ratio indicates that banking system has enough liquidity to cover for funding requirement and there is a low risk of asset-liability mismatches. Nevertheless, if this ratio continues to decrease, banks would not be earning the optimal return from their resources.

Evolution of financial soundness indicators in 2014Q2 is satisfactory as most of indicators remained at the adequate level or improved. The capital adequacy ratio stood at 23.6% by end 2014Q2 improving on 22.6% recorded in 2014Q1, well above 15% benchmark. This implies that the Rwandan banking institutions are able to withstand shocks to their balance sheets.

Table 8: Key soundness indicators, in %

Indicator	2013			2014	
	June	September	December	March	June
Solvency ratio (total capital)	23.1	22.9	23.1	22.6	23.6
NPLs / Gross Loans	6.9	7.2	6.9	6.7	6.6
NPLS net/Gross loans	3.2	6.5	6.0	5.7	5.5
Provisions / NPLs	54.8	50.3	53.3	56.4	50.0
Earning Assets / Total Assets	80.8	79.1	78.6	82.1	80.7
Large Exposures / Gross Loans	8.0	9.9	11.6	15.1	15.9
Return on Average Assets	2.1	1.7	1.5	2.3	2.1
Return on Average Equity	9.9	8.3	7.4	11.9	12.2
Cost of deposits	3.5	3.8	3.8	4.1	3.3
Liquid assets/total deposits	46.2	48.8	49.4	46.3	51.4
FOREX exposure/core capital	-3.1	-3.0	-2.2	-12.6	-1.7

Source: BNR, Bank Supervision Department

The Banking sector profitability also remained resilient as reflected by the evolution of return on assets (ROA) and return on equity (ROE) which stood at 2.1% and 12.2% by end 2014 Q2 from 2.3% and 11.9% by end 2014Q1 respectively. Moreover, the sector remains well capitalized as the ratio of liquid assets to total deposits went up to reach 51.4% by end of 2014Q2 from 46.3% in 2014Q1, well above 20% as regulatory benchmark.

With regard to the quality of assets especially on loan portfolio as reflected by the ratio of non-performing loans to gross loans ratio (NPL ratio), this remained almost unchanged in 2014Q2 (6.6%) compared to 2014Q1 (6.7%). Nonetheless, there has been a slight improvement compared to the situation by end 2013 (6.9%). The improvement is mainly due to the effort deployed by banks in loan recovery and cleaning up of the balance sheet through write offs of impaired loans.

Concerning the sectoral distributions of new loans to total new loans, there was no improvement in diversification as the two main sectors namely the commerce, restaurants and hotels and the mortgage industries attracted around 70% of total new loans in 2014Q2. However, this apparent lack of diversification in credit distribution is not matter of much concern as the trade sector and construction sector are respectively the first and third in contribution to the growth rate of real GDP in the last 5 quarters.

About the sensitivity of the banking sector to exchange rate volatility, the figure on forex exposure to capital ratio indicates an improvement in 2014Q2 (-1.7%) from a vulnerable position in 2014Q1 (-2.6%). This implies smaller exposure to exchange rate risk in 2014Q2.

Regarding the microfinance sector, it has also been stable and well performing with a significant increase in their assets and higher capital adequacy ratio of 31.9% well above 15% required. Nonetheless, there has been a slight deterioration of NPLs ratio to 6.2% in 2014Q2 from 5.9% in 2014Q1. This sector is dominated by UMURENGE SACCOs, representing 46.7% of the total sector's asset base.

Similarly, the non-bank financial institutions sector continued to perform well as shown by growth in assets and improved liquidity positions. However, the insurance sector's profitability was negatively affected by new comers on the market.

7.2 Financial Stability and Monetary Policy

A well-functioning financial system is crucial for effective transmission of monetary policy. Besides, monetary policy stance may have implications on financial system health. According to the above mentioned indicators, the Rwandan financial system in general and banking system in particular is healthy and sound and a priori should favour a smooth transmission of monetary policy. However, there have been some persistent issues in 2014Q2 as well as in 2014Q1 which may impede monetary policy transmission. Actually, the accommodative stance of monetary policy was transmitted to money market rates but not fully in banks' lending rates despite comfortable level of liquidity in the financial system and lower rates of return in alternative assets.

Consequently, the interest rate spread remained higher in 2014 Q2 (8.7% on average). Although this indicates high profitability in the banking sector, it can also reflect a weakened transmission of monetary policy and lack of competitiveness in the banking sector. In view of that, the Herfindahl index in 2014Q2 remained almost stable as in the previous year around 0.14 on deposits as well as loans markets. This figure shows that the market is competitive but not fully. Despite the fact that the degree of competitiveness in the banking sector has improved compared to the last decade, it is worthy to mention that there has been no clear sign of improvement in competitiveness for the last three years.

In addition, wages and staff costs continue to be the main component in financial system expenses and this situation also may hamper the transmission from policy rates to banks rates.

VIII: ECONOMIC OUTLOOK AND RISKS

8.1 Global Economic Outlook

The global economic recovery is projected to remain on track with global growth expected to rebound from 1.9% in 2014Q1 to 2.3% in 2014Q2 mainly bolstered by improving economic fundamentals in the advanced economies. However, the global economic recovery in advanced economies may exert some upward pressures on global demand but inflationary pressures are likely to remain weak on the account of existence of spare capacity.

Globally, commodity prices are projected to remain weak throughout 2014 as the world expects aggregate demand in China to decline coupled with ample agricultural supply. However, global financial markets are anticipated to remain vulnerable to volatility which may occasionally cause exchange rate volatility in Rwanda.

As the world economy continues to gradually recover in 2014, exports for developing and emerging economies may surge leading to higher export revenues and thus serving to ease currency depreciations. This however is still dependent on economic performance in China as well as the trend of export commodities' prices, which have remained stable over the past and are likely to ease in the near future.

8.2 Domestic Economic Outlook

After a slow down in 2013, the domestic economic activity gained momentum in Q1 and Q2 of 2014 growing by 7.5 % and 6.1% respectively compared to 4.1% in 2013Q4 on the account of robust growth in agriculture, service and industry sectors and it is expected to further pick up in 2014Q3 as evidenced by continued growth in total turnovers of industry and services along with positive trends in credit to the private sector and gradually surging domestic demand.

8.3 Risks to Domestic Economic Outlook

Rwanda's economic growth is projected to reach 6.0% by the end of 2014 and 6.7% in 2015 compared to 4.7% registered in 2013 but signs of recovery are evident in the strong performance recorded in Q1 and Q2 of 2014. Nonetheless, the economic growth outlook is likely to be affected by changing global environment, slow credit growth and delay in the implementation of capital expenditures and as such the domestic growth and inflation remain subject to some amount of uncertainty given that developments in both the external environment and the domestic economy are less certain leading to some degree of risk surrounding growth projections.

A stronger than expected rebound in the global economy may prompt an increase in commodity prices and thus global inflation, which could feed through to domestic inflation. However, a build-up in global inflation seems unlikely given weak global demand and ample agricultural supplies along with low inflationary pressures in most advanced economies.

Regional inflation remains subdued and agriculture produce in EAC region is expected to perform well. This coupled with falling oil prices with its effects on international transport costs will ease pressures on imported inflation.

Further still, the recovery in the global economy is expected to induce a surge in capital flows such as remittances, Aid flows and foreign direct investments to Rwanda and this is likely to lead to the real appreciation of Rwanda's exchange rate thereby adversely impacting exports. This may worsen Rwanda's trade balance in the short to medium term.

Rwanda's export sector didn't perform well in 2014Q2 compared to 2014Q1 mainly due to poor production and the fall in commodity prices on the international market thus aggregate demand remain weak amid economic recovery. As a result, Rwanda's trade balance continues to be in a deficit and is expected to persist in the short to medium term as strong demand for imports of intermediate, capital goods and lubricants continue to outstrip the expanding but still narrow export earnings. The share of export earnings to imports receded to 30% in 2014Q2 up from 32% in 2014Q1 and the weakness of the current account indicates the vulnerability of her external sector.

Lending rates remain relatively high, reflecting structural factors such as high operating costs and rising provisions for bad debt and this further led to the widening of the interest rate spread implying that cost of borrowing remains high constraining potential borrowers. However, the recovery in credit growth has picked up since the first quarter of 2014, most likely as a result of falling non-performing loans. Despite the fact that monetary policy stance remains accommodative, lending rates are not expected to change in the short to medium term given that structural factors like high operating costs persist.

8.4 Policy Outlook, Implications and Conclusion

Rwanda's economy continues to recover from 2.7% in 2013Q4 to 7.5% and 6.1% % in Q1 and Q2 of 2014 respectively after a slow down in 2013 which was attributable to adverse effects of aid cuts, deceleration of credit to private sector as well as unfavourable weather that caused poor performance of the agriculture sector. Inflation has been maintained to single digit over the period under review

The current BNR monetary policy stance remains supportive to the economy by aiding the economy to fully recover from the adverse effects of cuts and delays in budget support disbursements faced in 2012.

However, to timely mitigate any risks to economic outlook, BNR should continue to monitor developments in underlying economic fundamentals particularly economic growth, inflation and exchange rate developments so as to take appropriate measures. Also, coordination between macroeconomic policies will remain a top priority so as to avoid being hit by both supply and demand shocks.

Table 1: Export developments (Value in millions of USD, Volume in thousands of tons)

	2012				2013				2014		% change
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q2 14 /Q2 13
Coffee											
- Value	4.97	7.03	24.39	24.49	11.57	8.64	17.28	17.41	5.05	7.75	-10.3
- Volume	1.29	2.1	6.47	7.13	3.7	3.23	6.31	6.75	2.20	2.57	-20.5
- Price USD/KG	3.84	3.35	3.77	3.44	3.13	2.67	2.74	2.58	2.29	3.02	13.1
Tea											
- Value	18.22	15.31	16.43	15.76	16.77	14.93	12.38	11.4	14.20	14.28	-4.3
- Volume	6.68	5.23	5.43	5.11	5.56	5.96	5.03	4.46	5.66	6.45	8.2
- Price USD/KG	2.73	2.93	3.02	3.08	3.02	2.5	2.46	2.56	2.51	2.22	-11.4
Mining											
- Value	34.18	30.46	37.13	34.31	46.71	68.16	64.67	46.16	43.50	49.95	-26.7
- Volume	2.01	1.68	1.9	1.94	2.04	2.53	2.47	2.54	2.56	2.66	5.3
Cassiterite											
- Value	16.14	11.07	12.32	13.38	16.5	14.92	14.5	15.15	17.54	21.25	42.4
- Volume	1.36	0.96	1.12	1.19	1.12	1.23	1.29	1.25	1.44	1.67	36.1
- Price USD/KG	11.85	11.54	10.97	11.21	14.73	12.09	11.24	12.12	12.22	12.69	5.0
Coltan											
- Value	11.54	12.19	18.07	15.12	24.34	44.69	43.94	21.59	17.51	23.34	-47.8
- Volume	0.27	0.27	0.33	0.27	0.42	0.74	0.73	0.59	0.47	0.51	-30.7
- Price USD/KG	42.35	44.75	54.96	55.75	58.42	60.73	60.34	36.91	37.41	45.49	-25.1
Wolfram											
- Value	6.51	7.2	6.74	5.81	5.86	8.55	6.23	9.42	8.45	5.37	-37.2
- Volume	0.38	0.45	0.45	0.47	0.5	0.56	0.45	0.7	0.65	0.48	-14.8
- Price USD/KG	17.14	16.16	14.91	12.29	11.73	15.17	13.79	13.39	12.93	11.25	-25.9
Hides and Skin											
- Value	2.54	2.4	6.15	3.28	3.48	3.77	4.49	4.29	5.15	3.17	-16.0
- Volume	1.88	1.79	4.15	2.2	2.19	2.37	2.83	2.91	3.16	2.10	-11.6
- Price USD/KG	1.35	1.34	1.48	1.49	1.59	1.59	1.58	1.48	1.63	1.51	-4.9
Pyrethrum											
- Value	2.58	1.95	2.62	2.56	2.31	1.51	0.01	0.15	0.34	1.10	-26.9
- Volume	0.01	0.01	0.01	0.01	0.01	0.01	0	0	0.00	0.01	-42.1
- Price USD/KG	259.99	258.02	256.15	257.37	243	242.98	218.98	166.45	126.38	190.44	-21.6
I. MAIN EXPORTS											
- Value	62.49	57.16	86.72	80.39	80.84	97.01	98.83	79.4	68.24	76.26	-21.4
- Volume	11.88	10.8	17.97	16.39	13.49	14.1	16.65	16.65	13.58	13.78	-2.3
II. OTHER EXPORTS											
- Value	18.01	18.51	31.43	20.04	18.17	26.06	20.43	17.26	22.69	26.35	1.1
- Volume	37.19	36.95	52.03	48.41	41.24	39.47	34.7	34.48	32.19	38.29	-3.0
III. REEXPORTS											
- Value	25.12	16.88	25.49	40.5	31.13	36.71	33.16	34.03	38.91	61.08	66.4
- Volume	14.32	9.68	12.74	20.32	18.87	26.36	26.14	26.21	27.92	25.08	-4.9
TOTAL GENERAL											
- Value	105.63	92.55	143.64	140.93	130.14	159.79	152.41	130.69	129.85	163.69	2.44
- Volume	63.38	57.43	82.74	85.12	73.6	79.93	77.48	77.35	73.69	77.15	-3.47

Table 2: Imports Developments (Value CIF in millions of USD, Volume in thousands of tons)

	2013						2014				% change	
	Q2		Q3		Q4		Q1		Q2		Q1 2014/Q1 2013	
	Volume	Value	Volume	Value	Volume	Value	Volume	Value	Volume	Value	Volume	Value
TOTAL IMPORTS	414.9	539.6	483.8	590.6	467.0	599.0	405.4	565.1	433.2	627.0	4.4	16.2
Consumer goods	138.1	162.7	150.5	157.7	153.9	173.9	130.9	164.3	141.3	162.7	2.3	0.0
Food products	104.7	61.2	113.3	63.6	117.6	56.3	90.6	53.0	104.5	64.1	-0.2	4.7
Health & care	9.0	46.7	10.3	26.5	8.0	44.5	9.2	45.8	9.5	33.0	5.5	-29.2
Goods of domestic use	4.3	9.4	5.3	19.4	3.9	14.1	3.1	7.0	3.5	8.4	-17.8	-9.9
Capital goods	13.2	139.0	16.3	157.3	17.2	159.6	14.9	150.7	15.0	165.2	14.0	18.9
Transport materials	3.5	26.9	3.5	18.5	3.4	21.5	2.7	21.1	3.6	28.8	1.6	6.9
Machines, devices and tools	5.6	81.9	7.8	109.0	9.2	104.4	9.5	108.3	7.4	103.3	31.7	26.2
Intermediary goods	199.5	144.1	247.8	184.2	223.4	157.3	192.4	159.7	210.3	209.0	5.4	45.0
Construction mater.	120.0	50.7	134.0	61.3	136.7	60.5	113.9	63.3	115.2	54.8	-4.0	8.2
Industrial products	65.3	72.3	77.5	81.9	76.0	79.0	66.9	73.2	81.1	87.7	24.1	21.4
Fertilizers	7.3	6.6	29.4	26.6	4.1	3.4	4.6	3.8	5.9	3.9	-18.2	-40.1
Energy and lubricants	64.2	94.0	69.2	91.3	72.5	108.1	67.3	90.4	66.6	90.2	3.8	-4.0
Petroleum products	62.2	89.4	66.9	87.3	70.5	104.4	65.0	86.2	64.4	86.8	3.6	-2.9
TRADE BALANCE (exports less imports)		-379.8		-438.1		-468.3		-435.23		-		
Cover rate of imports/ exports, %		29.6		25.8		21.8		22.98		25.91		

Source: BNR, Statistics Department

Table 3: Trade flow of Rwanda within EAC bloc (USD million)

	2012				2013				2014		Variation in % (Q2 14/Q2 13)
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	
Exports to EAC	29.27	28.08	24.37	33.58	32.38	38.18	23.62	28.77	30.29	67.50	76.8
Imports from EAC	121.18	144.81	141.57	125	113.8	125.24	150.78	126.57	118.52	129.32	3.3
Trade balance	-91.91	-116.72	-117.2	-91.43	-81.42	-87.07	-127.16	-97.8	-88.23	-61.81	29.0
Total trade	150.44	172.89	165.94	158.58	146.17	163.42	174.4	155.34	148.80	196.82	20.4

Source: BNR, Statistics Department

Table 4: Rwanda informal cross border trade (in USD millions)

	2012					2013					2014		Variation in % (Q2 14/Q2 13)
	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total	Q1	Q2	
Exports	25.88	25.17	23.50	27.22	101.77	28.62	27.51	29.04	24.18	109.34	25.00	27.45	-0.2
Imports	4.69	5.79	6.73	5.42	22.63	4.61	4.69	4.39	3.92	17.61	3.74	5.16	10.0
Trade balance	21.19	19.38	16.77	21.80	79.14	24.01	22.82	24.65	20.26	91.73	21.26	22.29	-2.3

Source: BNR, Statistics Department