NATIONAL BANK OF RWANDA

Quarterly Economic and Financial Report: Developments and Prospects

THIRD 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.

For the third consecutive year, the world economic activity is sluggish, real GDP growth is expected to stabilize at 3.3% by the end of 2014, the same level as in 2013 and almost unchanged compared to 3.4% recorded in 2012 but to slightly increase by 3.8% by the end of 2015. In advanced economies, the recovery remained moderate following weak economic performances in US, Japan and Euro Area. The recovery in emerging market and developing economies has also slowed due to rising geopolitical tensions, weak global demand and tightening financial market conditions.

The Rwandan economy continued to recover in 2014Q3, growing by 7.8% bolstered by good performance in all economic sectors and strong consumption demand. This economic recovery is expected to continue in 2014Q4 driven mainly by the services sector as evidenced by total sales of services sector which rose by 12.2. % in the first two months of 2014Q4 from 5.4% recorded in the same period of 2013. These good performances are supported by significant increase in banking financing to the private sector as new loans rose by 20.1% in the first two months of 2014Q4 from RWF 94.1 billion in the first two months of 2013Q4 to RWF 113.5 billion in the same period of 2014Q4.

Regarding the external sector performance, in 2014Q3, Rwanda's trade deficit continued to widen as the commercial deficit remained large due to the high imports relative to exports. Consequently, the cover rate of imports by exports slightly decelerated to 25.7% from 25.9% achieved in the same period of the previous year.

During 2014Q3, inflation in Rwanda remained subdued and was maintained below this year's target of 5%. It decelerated to 0.2% in September from 2.4% in January 2014. Inflationary pressures remained low as a result of sustained and well-coordinated monetary and fiscal policies, limited inflationary pressures from trading partners and stability of international oil prices .However, some risks remain and are mainly linked to the end-of-year festivities and food supply shocks. Given the current low level of aggregate demand and the global price levels, inflation is projected to be around 2% in December 2014.

Since June 2013, the monetary policy stance remains accommodative in order to support the financing of the economy. This has resulted into strong growth in credit to the private sector and increased liquidity injection from the fiscal operations as such banking system liquidity conditions remain healthier and most of the short term interest rates are showing a downward trend. Further still, the RWF has remained quite stable recording a nominal depreciation of 2.5% between Dec.2013 and September 2014.

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

Regarding the stability of the financial system, the main indicators depict a favourable picture as in the previous quarter despite a slight decline observed in profitability indicators of the banking system. Overall, Rwanda's banking system remained stable and sound amid improving domestic and global economic environment. Furthermore, the outlook is positive amid easy financial conditions in developed world and on-going recovery of real sector in Rwanda along with accommodative monetary policy.

I. INTERNATIONAL ECONOMIC OUTLOOK

During the second half of the year 2014, the global activity continued to gradually recover driven mainly by accommodative monetary policies in advanced economies, favorable financial market conditions and improved global sentiment. However, downside risks persist with respect to rising geopolitical concerns that may affect these positive economic prospects. World Inflationary pressures remained contained reflecting declining commodity prices coupled with persistent spare capacity of production in developed economies. Consistently, monetary policy in major economies remained accommodative to boost the economic activity and to shift inflation closer to policy targets.

1.1 Economic Growth

After a weak first half of the year 2014, the world economic activity is gradually improving in the second half of the year helped by continuous accommodative monetary policy in developed countries and favourable financial market conditions. However, downside risks persist related to rising geopolitical tensions and financial market concerns in emerging economies. Global real GDP increased year-on-year by 2.6% in 2014Q3 after 2.5% in 2014Q2 and 2.0% in 2014Q1. For the whole year 2014, IMF, in its October 2014 estimates, revised down the world GDP growth to 3.3%, which is 0.4% lower than April 2014 forecasts following the first half of the year 2014 weaker than expected performances particularly in USA, Euro Area, Japan and in some big emerging economies.

Table 1: Economic growth developments (in %)

	Quarterly (BLOOMBERG)						Annual (IMF)		
	2013		2014						
	Q3	Q4	Q1	Q2	Q3	Q4	2013	2014	2015
World (Y0Y)	2.7	2.5	2.0	2.5	2.6	2.6	3.3	3.3	3.8
USA (QoQ)	4.5	3.5	-2.1	4.6	3.9	2.5	2.2	2.2	3.1
Euro area (YoY)	-0.3	0.4	1.1	0.8	0.8	0.7	-0.4	0.8	1.3
Japan (QoQ)	1.6	-1.5	5.8	-6.7	-1.9	2.8	1.5	0.9	0.8
UK (YoY)	1.7	2.7	2.9	3.2	3.0	3.0	1.7	3.2	2.7
China (YoY)	7.8	7.7	7.4	7.5	7.3	7.3	7.7	7.4	7.1
India (YoY)	5.2	4.6	4.6	5.7	5.3	5.3	5.0	5.6	6.4

Source: BLOOMBERG& IMF WEO, October 2014

In advanced economies, despite the US weather-related contraction in 2014Q1 and the Japanese contraction in 2014Q2, real GDP growth is gaining momentum and projected to reach 1.8% in 2014 and 2.3% in 2015 from 1.4% in 2013. Particularly in USA, the economy grew by 3.9% in 2014Q3 against expectations of 3.0% driven by improving financial conditions, waning fiscal drag and continuous improving labour market and housing wealth against 4.6% and -2.1% respectively in 2014Q2 and 2014Q1. The largest contribution to the GDP growth in 2014Q3 came from net exports while consumption expenditure and private investment slowed compared to the previous quarter. By end 2014, US economy is expected to grow at 2.2% lower than 2.8% expected by April 2014 forecast mostly because of the first quarter severe cold winter which provoked a contraction in US economic activity.

In Euro Area, the economic growth remained fragile due to weak investment and exports together with persistent worries about continuous economic growth. Real GDP growth has, for the second consecutive quarter, increased by 0.8% in 2014Q3 helped by structural reforms and fiscal consolidation, accommodative monetary policy and improving financing conditions against 1.1% in 2014Q1. The growth is expected at 0.8% in 2014 and 1.3% in 2015.

In Japan, after a weak first half of the year 2014 as a result of the sales tax hike in April 2014, the economy again contracted by 1.9% in 2014Q3 after a decline of 6.7% in 2014Q2. GDP growth is projected at 0.9% on average in 2014 helped by fiscal stimulus but to slightly slowdown to 0.8% in 2015 as stimulus is planned to decrease.

In emerging and developing economies, growth is expected to decelerate to 4.4% by end 2014 due to rising vulnerabilities and weak global demand that affected particularly commodity exporting countries but to regain to 5.0% by end 2015. In Asia, growth stayed robust driven by China and India despite some moderation in the Chinese economy. In 2014Q3, Chinese economy grew by 7.3%, the slowest growth since 2009 after 7.5% in 2014Q2 and 7.4% in 2014Q1 due to the slowdown in investment in real estate and in industrial production. By end 2014, Chinese growth rate is estimated to decelerate to 7.4% and to further decelerate to 7.1% in 2015 despite the Chinese authorities resolved to grant tax relief for small and medium enterprises, increase fiscal and infrastructure expenditures and to reduce the reserve ratio to support the economy.

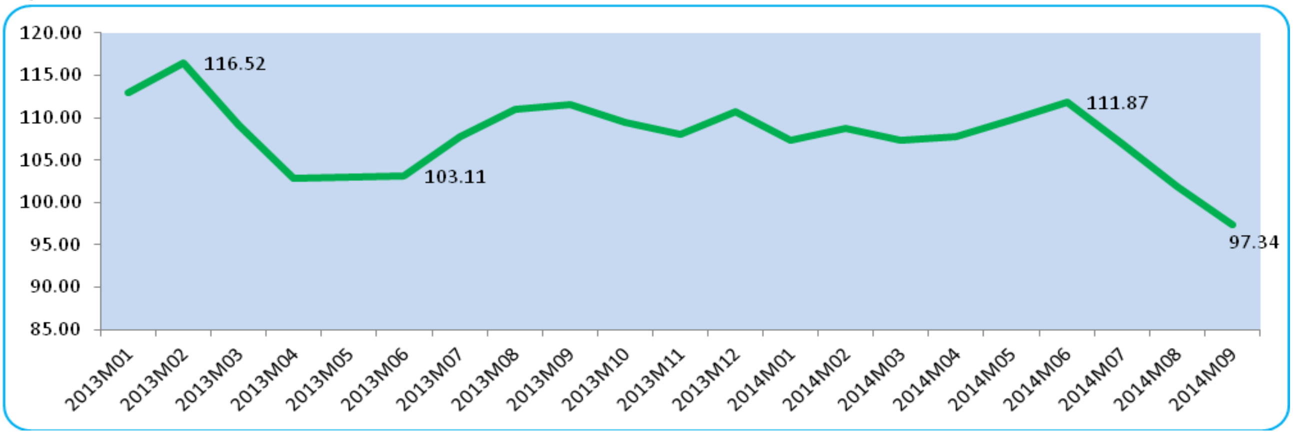
In Sub-Saharan Africa, supported mainly by commodity related projects, the economy is projected to grow by 5.4% and 5.5% respectively in 2014 and 2015 from 5.4% and 5.1% respectively in 2013 and 2012.

I. 2 Inflation and Commodity Prices

1.2.1 Commodity prices

On commodity markets, prices declined in 2014Q3 driven by both energy (-6.2%) and non-energy prices (-2.6%) mainly due to weak demand together with improving global supply and partly due to an appreciation of the US dollar. Prices dropped particularly in energy (-6.2%) reflecting declining crude oil prices which dropped by 5.6% as global supply outpaced demand and on strengthening US dollar. Rising geopolitical tensions in major oil producers (Iraq, Syria and Russia) did not provoke significant supply disruptions and the latter were overcompensated by unconventional oil production in North America. Compared to the previous quarter, Brent price fell by 7.0% in 2014Q3 averaging USD 102.08/barrel after increasing by 1.8% in 2014Q2.

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



Source: World Bank Website

While almost stable in 2014Q2 as result of good performances in agriculture sector and low demand for industrial raw materials particularly by China, non-energy prices fell by 2.6% in 2014Q3 mainly driven by agriculture prices (-5.0%) while prices rose for fertilizers (5.9%) and for metals and minerals (2.6%).

Agriculture prices fell by 5.0% in 2014Q3 owing to improved supply prospects after an increase of 1.1% in 2014Q2: food prices dropped by 6.3%, agricultural raw materials by 4.6% but prices for beverages almost stabilized (+0.5%). While average prices stabilized for tea, the slowdown in coffee prices (-2.4% for Arabica and -1.6% for Robusta) on improved production in Colombia and strong exports from Brazil was offset by the increase in cocoa prices (4.7%).

On contrary, prices rose by 5.9% in 2014Q3 for fertilizers on the back of supply constraints in many areas including Egypt, Ukraine and China. Similarly, after a decline of 1.0% in 2014Q2, metals and minerals prices rose by 2.6% in 2014Q3 led by base metals prices (+5.3%) and less decline in precious metals (-0.5% in 2014Q3 against -1.0% in 2014Q2) as the rebound in the world's biggest economy points to a global output recovery.

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

	2012	2013		2014		
	Q4	Q3	Q4	Q1	Q2	Q3
Crude oil, Brent	0.5	6.9	-0.6	-1.4	2.6	-7.0
Coffee, Arabica	-10.7	-6.8	-7.2	38.2	22.1	-2.4
Coffee, Robusta	-6.2	-5.0	-9.3	15.0	6.4	-1.6
Tea, Mombasa auctions	-1.2	-5.4	-4.3	7.1	-13.4	1.0
Soybeans	-10.1	4.3	5.3	-0.5	-6.3	-11.7
Maize	-3.5	-17.0	-17.6	5.3	2.0	-18.7
Sorghum	Na	-15.7	-7.8	10.9	-2.1	-16.0
Wheat, US SRW(1)	1.2	-6.4	7.3	-4.5	-0.1	-18.9
Bananas EU	12.3	-8.3	-4.7	12.5	8.2	-12.8
Bananas Us	-1.6	2.9	-0.8	2.4	-2.6	1.4
Sugar, world	-7.5	-2.4	3.1	-5.2	8.1	-4.9
Aluminium	3.9	-2.9	-0.9	-3.3	5.3	10.5
Gold	3.7	-6.1	-4.3	1.7	-0.4	-0.6
Tin	11.6	2.0	7.4	-1.1	2.3	-5.3

Source: World Bank Website

SRW: Soft red winter; (2) HRW: Hard Red Winter

For the whole year 2014, metals prices are projected to further drop by 7.5% against a decline of 4.3% in 2013. Non-fuel commodity prices are expected to continue to fall in 2014 declining by 3.0% after a drop of 1.2% in 2013.

1.2.2 Inflation

Inflationary pressures remained contained during the recent months, thanks to persistent ample capacity of production in developed countries and softening commodity prices especially energy prices. In developed countries, inflation slid to 1.4% in 2013 and it is projected to slightly rise to 1.6% in 2014. In emerging and developing economies, inflation stood at 5.9% in 2013 and it is foreseen to stand at 5.5% in 2014.

Table 3: Annual inflation developments in %

	2013					2014	
	Dec.	Apr.	May	Jun.	Jul.	Aug.	Sept.
USA	1.5	2.0	2.1	2.1	2.0	1.7	1.7
Euro Zone	0.9	0.7	0.5	0.5	0.4	0.4	0.3
UK	2.0	1.8	1.5	1.9	1.6	1.5	1.2
Japan	1.6	3.4	3.7	3.6	3.4	3.3	3.2
China	2.5	1.8	2.5	2.4	2.3	2.0	1.8

Source: National Statistics Offices

In the Euro area, inflation slid to 0.3% in September from 0.4% in both August and July 2014 owing to a decline in energy prices. In USA, inflation remained almost stable at 1.7% in September 2014 from 2.0% in July 2014 reflecting falling energy prices. Inflation in Japan decelerated to 3.2% in September 2014 from 3.3% in August 2014 owing to a decline in prices for culture and recreation, transportation, and fuel, light and water charges while prices rose in most of the remaining items.

In EAC, since 2013, headline inflation has remained moderate on the back of positive performances in agriculture sector despite some seasonal shocks. For 2014, Uganda's headline inflation dropped to 1.4% in September from 4.9% in June 2014 due to a sharp drop in food prices. Kenya's inflation fell to 6.6% in September from 8.4% in August 2014 due to lower energy and transport costs.

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

	2012	2013	2014								
	Dec.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.
Uganda	5.5	6.7	6.9	6.8	7.1	6.7	5.4	4.9	4.3	2.8	1.4
Kenya	3.2	7.2	7.2	6.9	6.3	6.4	7.3	7.4	7.7	8.4	6.6
Tanzania	12.1	5.6	6.0	6.0	6.1	6.3	6.5	6.4	6.5	6.7	6.6
Burundi	11.8	9.0	6.0	5.9	3.8	4.8	3.4	3.3	3.1	5.9	5.5
Rwanda	3.9	3.7	2.4	3.5	3.4	2.7	1.9	1.4	1.9	0.9	0.2

Source: Central Banks Websites

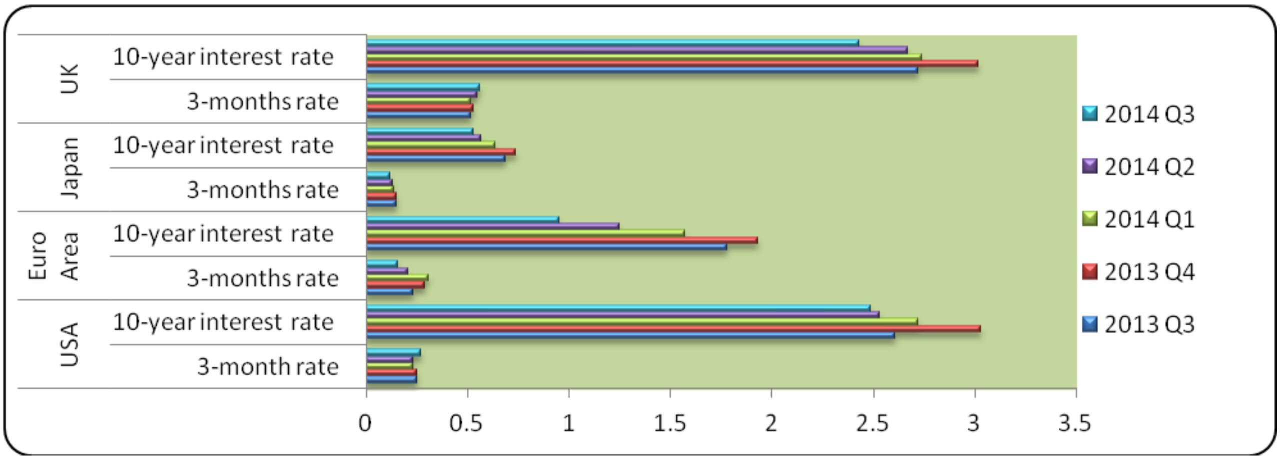
In Rwanda, inflation has decelerated to 0.2% in September 2014 from 1.4% end June 2014 due mainly to significant decline in food and non-alcoholic beverages. Burundi’s inflation slightly eased to 5.5% on decline in prices of alcoholic beverages and tobacco while prices rose in the remaining CPI components.

I. 3 Monetary Policy and Financial Markets

Monetary policy in major countries remained accommodative to boost economic activity. In the Euro area, on September 4, 2014 the ECB decided to reduce the policy rate to 0.05% from 0.25% and the deposit facility to -0.20% from -0.10% to reflate European economic activity and to shift inflation closer to the objective of 2%. Additional policy stimulus includes also targeted longer-term refinancing operations and future outright purchases of assets-backed securities among others. Central bank rates remained at 0.25% in USA, 0.50% in UK and 0.10% in Japan. In USA, while the monetary policy remained accommodative, the assets purchase is completed this October 2014.

The 10-year interest rates have been declining since the beginning of this year in all major economies following geopolitical tensions and due to 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, during 2014Q3, the dollar strengthened by 7.8% versus the Pound, by 5.2% versus the Euro and by 8.3% versus the Yen supported by positive economic data and a continuous improvement in labor market. The Euro is dampened by poor economic data, interest rate differentials and renewed disinflationary pressures.

Table 5: Exchange rate developments

	2012	2013		2014		
	Q4	Q3	Q4	Q1	Q2	Q3
USD/1EUR	1.32	1.35	1.38	1.38	1.37	1.26
USD /1 GBP	1.63	1.62	1.66	1.67	1.71	1.62
YEN/1USD	86.62	98.21	105.26	103.07	101.29	109.65

Source: Bloomberg Database

II. NATIONAL ECONOMIC PERFORMANCE

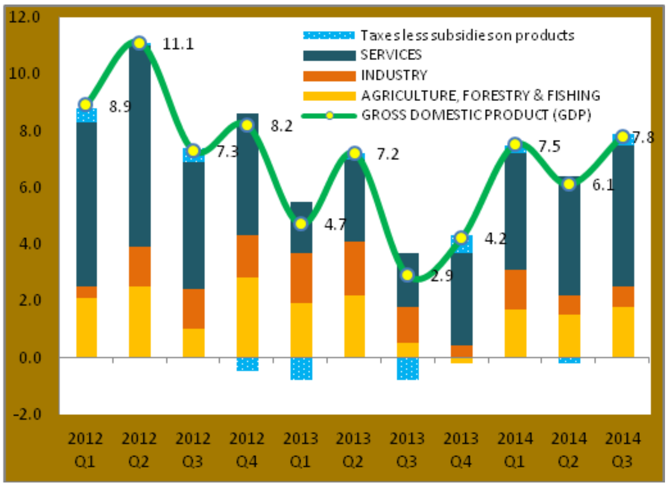
2.1 Real Sector Performance

The Rwandan economy started recovering in 2014Q1 and continued to grow through Q2 and Q3 of 2014, despite a slowdown in real GDP growth in 2013 due to poor agricultural performance and lagged effects of budget support disbursement suspension. 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

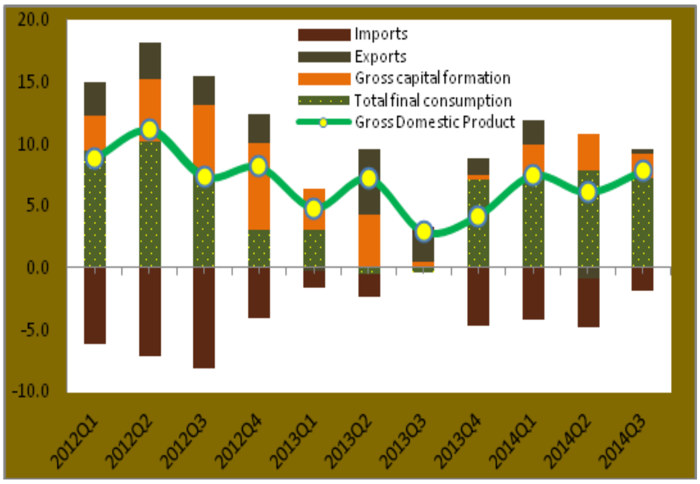
In 2014Q3, the real GDP grew by 7.8% higher than 6.1% and 7.5% in Q2 and Q1 of 2014 respectively as well as 2.9% registered in 2013Q3. The real GDP growth was mainly attributed to the service sector (+10%), followed by Agriculture sector (+6%) and Industry sector (+4%). The economic recovery that continued in 2014Q3 evolves towards achieving the projected growth rate of 6.0% by the end of 2014. 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.

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



Source: Monetary Policy and Research Department

Figure 4: Aggregate demand, Quarterly growth rates in % (YoY)

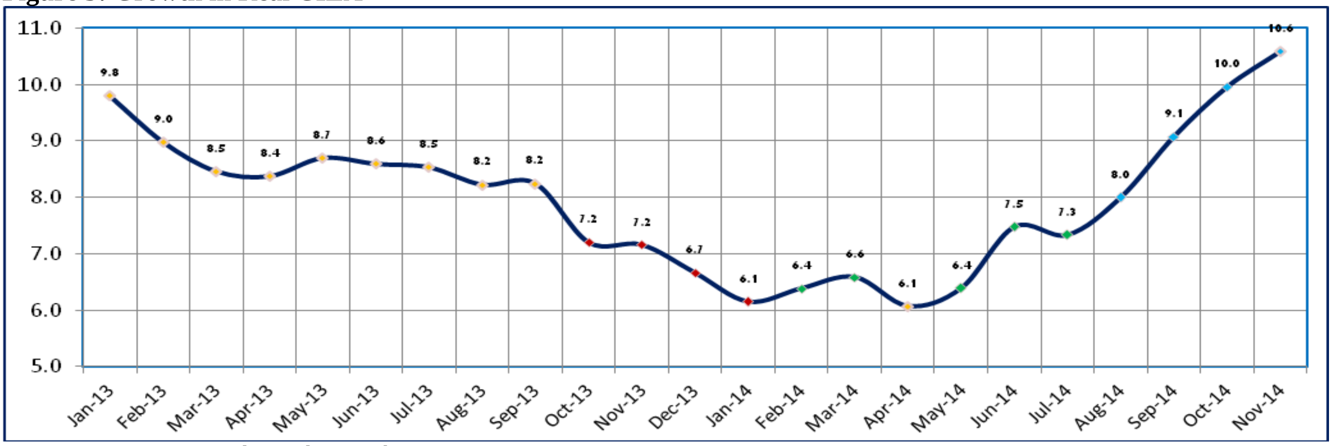


Source: Monetary Policy and Research Department

2.1.2 Leading Indicators of Economic Activities

The key indicators of the real sector during 2014Q3 indicate that economic growth is continuing and this is attributable to improving consumer spending and business environment as evidenced by BNR composite indicator of economic activities (CIEA) as well as total turnovers registered by large companies in industry and services sectors.

Figure 5: Growth in Real CIEA

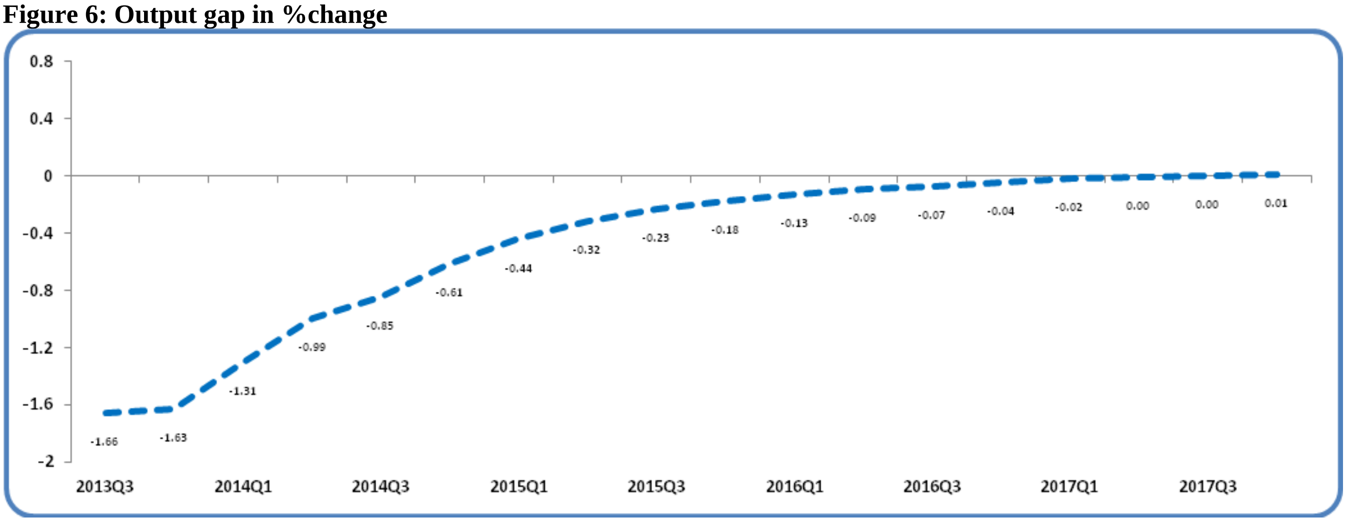


Source: BNR, Monetary Policy and Research Department

The CIEA indicates improvement in economic activities since 2014Q1 and signals that economic recovery continues in 2014Q4. The CIEA rose by 10.6% and 10.0% in November and October 2014 respectively against 6.7% and 7.2% in the same period of 2013, this good performance results from improving consumption demand and improved businesses in industry and services sectors.

The output gap, though negative for the whole of 2014, depicts a gradual recovery trend and is likely to close in 2017Q1.

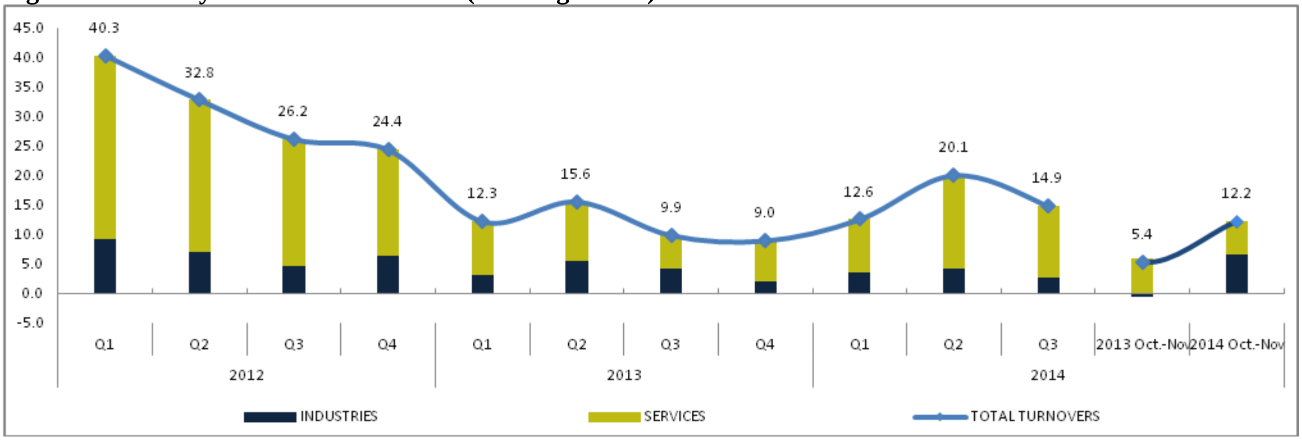
Figure 6: Output gap in %change



Source: BNR, Monetary Policy and Research Department

The economic growth prospects in 2014Q4 is further observed in the trends of turnovers for services and industry sectors that increased by 12.2% in the first two months of 2014Q4 well above 5.4% registered in the same period of 2013.

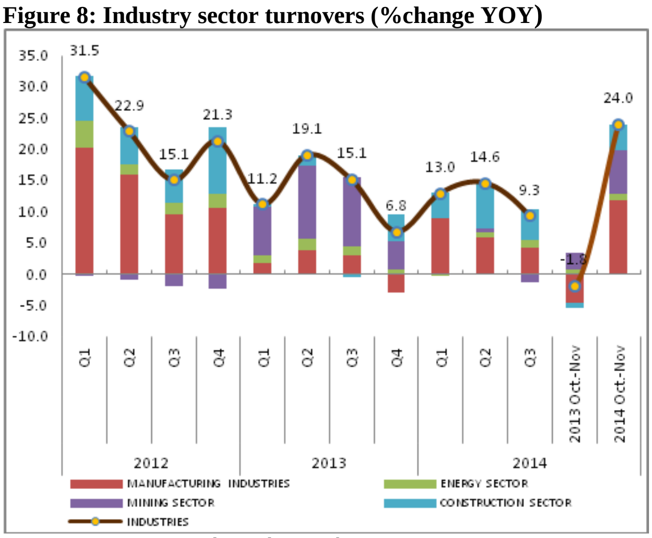
Figure 7: Industry & Services turnovers (%change YOY)



Source: BNR, Monetary Policy and Research Department

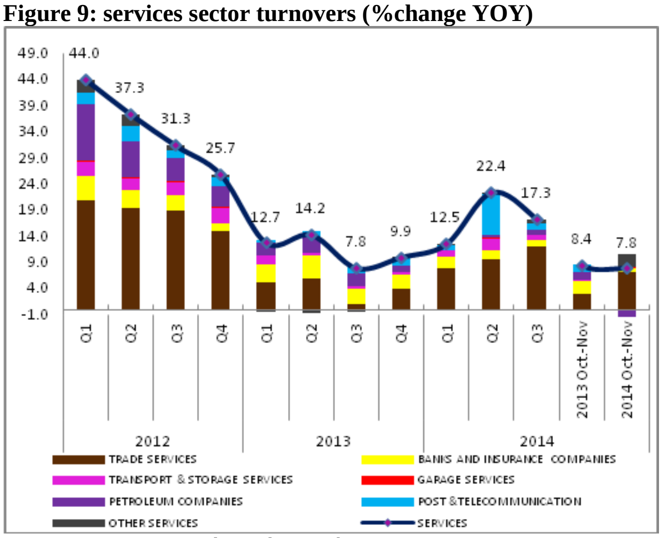
The progress in non-agricultural activities is mainly led by good performance in services sector that contributed 6.6 percentage points to the growth rate of the sector in the first two months of 2014Q4 and grew by 7.8% driven by the growth in trade services from 6.3% in the first two months of 2013 to 16.3% in the corresponding period of 2014 have been driven by improvement in consumption demand, hence led developments in services sector. Despite this contribution of trade services sub-sector, October-November 2014 growth rate of services sector is lower than the rate of the same period of 2013 following declines in petroleum sub-sector, the second major contributor to the services sector. Petroleum companies' sales fell by 2.2% end November 2014 after +11.1% registered end November 2013 as local pump prices declined from Rwf 1030 to Rwf 1010 in March 2014 then to Rwf 960 in November 2014 following decline of oil prices on international market.

Figure 8: Industry sector turnovers (%change YOY)



Source: BNR, Monetary Policy and Research Department

Figure 9: services sector turnovers (%change YOY)



Source: BNR, Monetary Policy and Research Department

The industry sector grew by 24.0% in the first two months of 2014Q4 attributed to manufacturing and construction sub-sectors which accounted for 74.2% of the total sales of the industry sector. Manufacturing sub-sector increased by 25.0% in the first two months 2014Q4 from a decline of 8.9% in the same period of 2013 while construction rose by 14.4% after a decline of 2.4% in the same period of 2013, driven by improving gross fixed capital formation which rose by 8.9% on average in the first three quarters of 2014. In addition, mining sector increased by 49.4% after 24.4%. Moreover, credit expansion continued to support developments in industry and services sectors.

Table 6: New loans to leading sub-sector in industry and services sectors

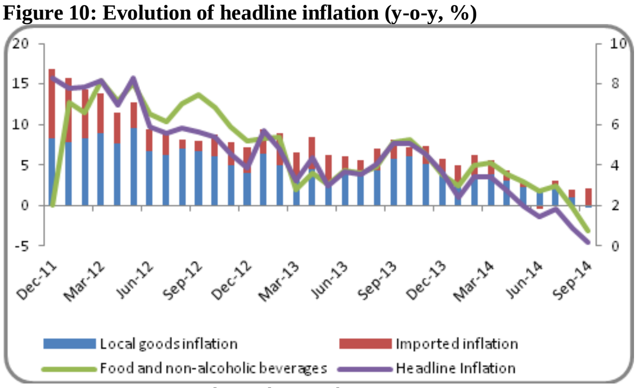
	2013					2014				% change
	Q1	Q2	Q3	Q4	Oct-Nov	Q1	Q2	Q3	Oct-Nov	
Manufacturing	2.7	12.2	10.9	10.9	9.3	35.2	9.4	15.4	8.0	-14.1
Mortgage industries	17.5	26.0	20.1	20.1	15.1	26.0	42.7	31.8	22.9	52.3
Commercial restaurant and hotel	49.7	57.7	48.5	48.5	41.1	61.0	71.0	65.5	46.8	13.9
Total credit to private sector	97.5	122.9	104.4	104.4	94.1	166.0	159.7	156.5	113.5	20.6
Share	71.8	78.1	76.1	76.1	69.5	73.7	77.1	72.0	68.4	

Source: BNR**,** Monetary Policy and Research Department

2.2 Price Developments

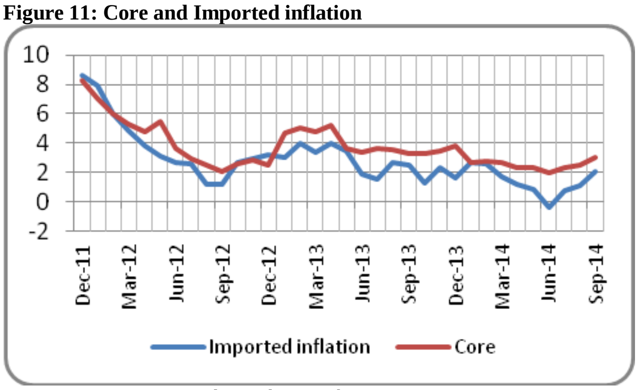
In 2014Q3, inflation remained on the downside following the continued decline in food prices, good performance of the economy, easing inflationary pressures from trading partners as well as base effect. Headline inflation declined from 1.4% in June to 0.2% in September 2014 compared to a rise from 3.7% in June to 5.1% in September 2013. The decline in headline inflation in 2014Q3 resulted from a decline in food prices from 1.9% in June to -3.1% in September 2014. Imported inflation rose from -0.4% in June to 2.1% in September whereas domestic inflation decelerated from 2.1% to -0.2% during the same period.

Figure 10: Evolution of headline inflation (y-o-y, %)



Source: BNR, Monetary Policy and Research Department

Figure 11: Core and Imported inflation



Source: BNR, Monetary Policy and Research Department

The decline of fresh products (-11.3%) in September 2014 after +4.9% in December 2013 and +5.1% in June 2013 backed the decline in prices of food and non-alcoholic beverages. Vegetables which account for 35.9% of the food basket had their prices contracted on annual basis by 13.3% in September 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%.

Though remained stable at around 2.5% on average since January 2014 and down from 4.1%, the average of year 2013, Core inflation which excludes fresh food and energy rose from 2.0% in June to 3.0% in September 2014. The base effect has continued to influence inflationary developments.

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 put 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 quarter[1] 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 7: 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

[1] Quarter two in calendar year corresponds to quarter four in fiscal year

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.

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 8: Sectoral Composition of Public Domestic Debt (billion FRW)

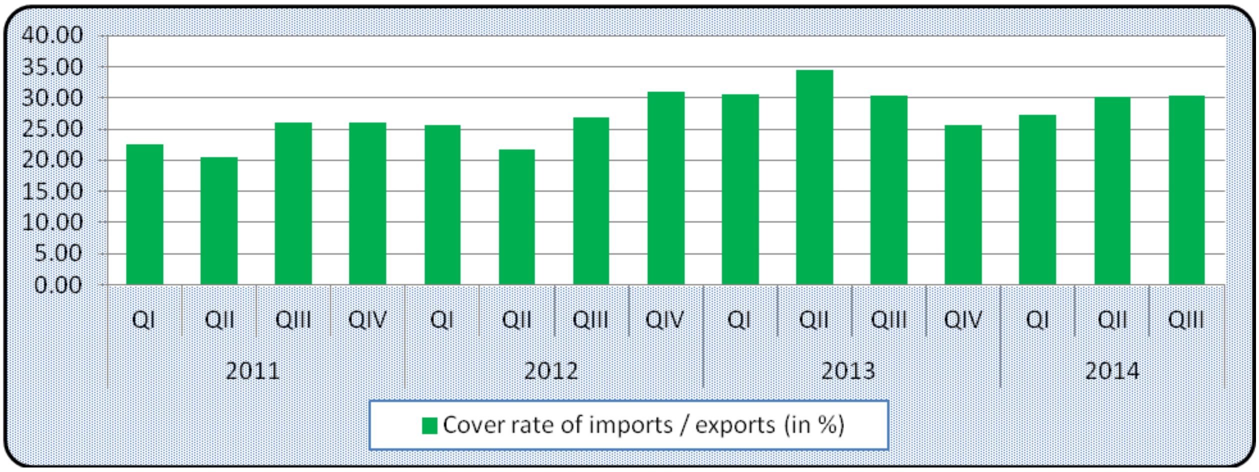
Sector	*2013*		*2014*			*%change 2014Q3/ 2013Q3*
	Q2	**Q3**	**Q1**	**Q2**	**Q3**	
BNR (excluding monetary instruments)	**38.6**	**38.6**	**38.6**	**38.6**	**38.6**	**0**
Consolidated debt	38.6	38.6	38.6	38.6	38.6	0
Overdraft	0	0	0	0	0.6	
Banking Sector	**121.6**	**131.5**	**166.1**	**173.6**	**184.4**	**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 2014Q3, Rwanda's trade balance recorded a deficit of USD 445.89 million from USD 440.46 million in the corresponding period of 2013. Exports covered 25.9% of imports from 25.7% in 2013Q3. Including informal cross border, exports covered 30.4% of imports, the same as covered in 2013Q3. Trade deficit is expected to persist in the short to medium term as strong demand for intermediary and capital goods as well as lubricants continue to outstrip the gradually expanding but still a narrow export base.

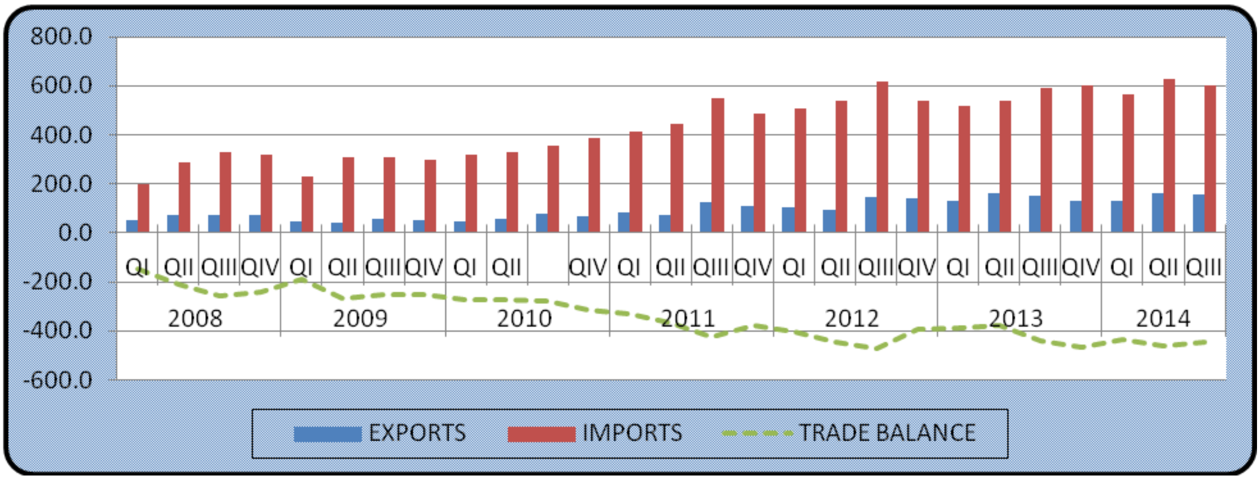
Figure 12: Cover rate of imports /exports in %



Source: BNR, Statistics Department

Trade balance deteriorated due to the fact that Rwandan external trade is characterized by lower volume of exports compared to imports. In 2014Q3, imports increased by 1.5% while exports increased by 2.3%.

Figure 13: Trade balance in millions of USD



Source: BNR, Statistics Department

4.1 Formal exports

In 2014Q3, the value of exports slightly increased by 2.3%, and highly increased by 40.6% in volume compared to the corresponding period in 2013, driven by coffee (+63.1%), cassiterite (+28.7%) and re-exports (+35.5%) which constitute 47.8% of the total exports earnings. Though, still lower than the annual export growth target, much effort is being put in place to bolster exports so as to achieve the 28% annual exports growth target set in the EDPRS II.

Table 9: Export developments (Value FOB in millions of USD, Volume in thousands of tons, Price in USD/Kg)

	2012		2013				2014			
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	% Change, 2014Q3/2013Q3
Principal Exports										
- Value in USD	**86.72**	**80.39**	**80.84**	**97.01**	**98.83**	**79.40**	**68.40**	**76.18**	**103.14**	**4.36**
- Volume in KG	**17.97**	**16.39**	**13.49**	**14.10**	**16.65**	**16.65**	**13.67**	**13.83**	**17.39**	**4.46**
Re-exports										
- Value in USD	25.49	40.50	18.17	26.06	20.43	17.26	38.91	61.08	27.68	35.53
- Volume in KG	12.74	20.32	41.24	39.47	34.70	34.48	27.92	25.08	40.55	16.88
Other Exports										
- Value in USD	31.43	20.04	31.13	36.71	33.16	34.03	22.69	26.35	25.12	-24.24
- Volume in KG	52.03	48.41	18.87	26.36	26.14	26.21	32.19	38.29	50.97	94.99
TOTAL GENERAL										
- Exports Value	**143.64**	**140.93**	**130.14**	**159.79**	**152.41**	**130.69**	**130.00**	**163.61**	**155.94**	**2.32**
- Exports Volume	**82.74**	**85.12**	**73.60**	**79.93**	**77.48**	**77.35**	**73.78**	**77.21**	**108.91**	**40.56**

Source: BNR, Statistics Department

Traditional exports increased in value by 4.4% due to increase in coffee exports (+63.1%), cassiterite (+28.7%), wolfram (+9.7%), and pyrethrum (+210%) exports earnings as a result of the rise in international commodity prices. They also increased in volume by 4.5%.

The volume of coffee exported increased by 40.6%, despite a contraction in the coffee production (-1.6%) in 2014Q3 compared to the same period of the last year due to bad weather conditions especially insufficient rainfall in 2013Q4. The same production declined by 5.7% and 5.9% respectively in 2014Q1 and 2014Q2. Despite the rise of 9.8% in volume, the value of tea exports earnings slightly decreased by 0.3% due to the decline of unit prices (9.2%). 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 constant.

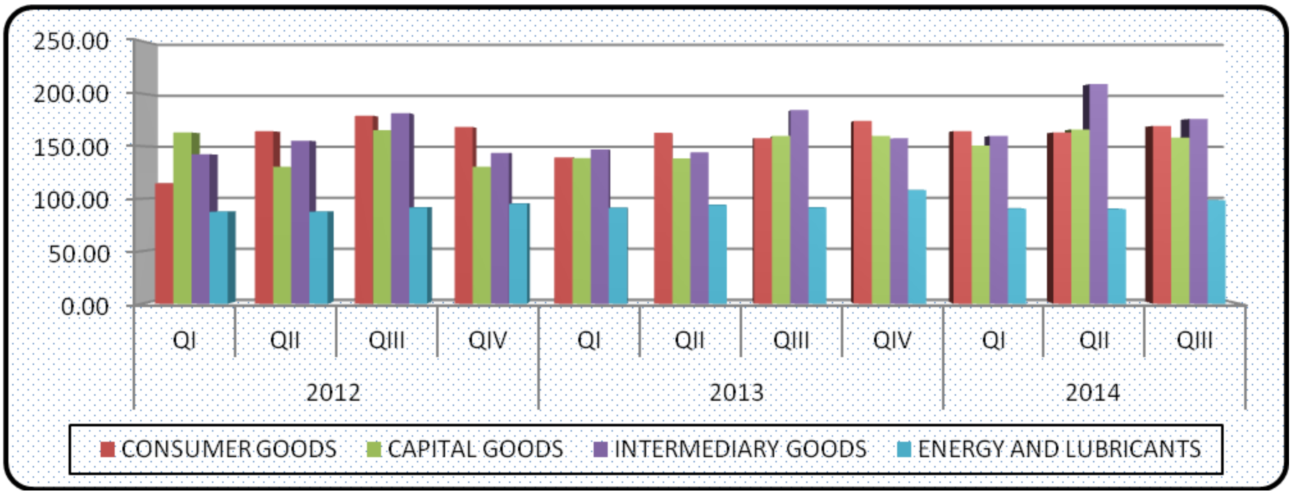
The mining sector which is dominated by coltan, cassiterite and wolfram with 31.3%, 57.2% and 11.5% of the total minerals exports respectively underperformed (-7.8%), mainly attributable to the decline in unit price of coltan exports (-18.2%), despite the increase in unit price of cassiterite exports (6.1%).

Regarding non-traditional exports (other exports) which are dominated by foods and beverages, live animals, fruits and vegetables, and cosmetic products, mainly exported to the neighbouring countries apart from hand crafts which are mainly exported to developed countries, despite their high increase in volume (95.0%), they decreased by 24.2% in value. Re-exports which include petroleum products, vehicles and machines & engines increased in both value (+35.5%) and volume (+16.9%), attributed mainly to the high quantity of machines re-exported in July 2014 for USD 26.92 million.

4.2 Formal Imports

In 2014Q3, total imports CIF recorded an increase of 8.2% in volume and 1.5% in value. The increase in volume was essentially driven by consumer goods (+14.2%), intermediary goods (+6.3%) as well as energy and lubricants (+5.4%), but capital goods decreased by 8.1%. The slight increase in total imports CIF was mainly attributed to the increase in value of imports of consumer goods (+7.4%) and energy and lubricants (+7.8%), since imports value for capital goods and intermediary goods, respectively decreased by 0.9% and 4.6%.

Figure 14: Imports developments in USD millions



Source: BNR, Statistics Department

The rise in imported volume of consumer goods was attributed to the increase in food products (17.7%), beverages and tobacco (+42.6%) as well as articles of clothing (+11.2%).The increase in imports value of consumer goods (+7.4%) was due to the increased demand for meat and fish (+82.2), vegetables, fruits and spices (+17.4%), salt (+66.4%) as well as various food preparations (+12.1%).

Capital goods decreased in both volume (-8.1%) and value (-0.9%) attributed mainly to machines, devices and tools which declined by 13.0% in volume and by 7.3% in value. The imports of machinery were dominated by imports of phones and other materials for network as well as imports of different companies including former EWASA, CIMERWA and RWANDAIR.

Intermediary goods made up of construction materials and industrial products accounting for 52.8% and 29.4% respectively, increased by 6.3% in volume mainly attributed to the increase of industrial products for food industries (+30.3%, chemicals industries (+61.9%) and woods industries (+41.0%). However, cement and other similar products decreased in volume (-5.2%) but increased in value (+3.3%). This increase in volume for cement was due to the good performance (+0.9%) recorded in local production of cement during 2014Q3 compared to the same period of 2013.

4.3 Trade with EAC countries

Rwandan exports to other EAC member countries increased by 13.8%, amounting to USD 26.88 million in the 2014Q3 from USD 23.62 million in 2013Q3. Imports increased by 4.5%, amounting to USD 157.51 million from USD 150.78 million in 2013Q3. These developments have favoured the trade deficit with EAC countries to USD 130.63 million from USD 127.16 million.

Figure 15: Trade flow of Rwanda within EAC bloc (USD million)

	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Exports	29.56	28.08	24.37	33.58	32.38	38.18	23.62	28.77	30.29	55.12	26.88
Imports	121.18	144.81	141.57	125.00	113.80	125.24	150.78	126.57	118.46	120.18	157.51
Trade balance	-91.62	-116.72	-117.20	-91.43	-81.42	-87.07	-127.16	-97.80	-88.17	-65.07	-130.63

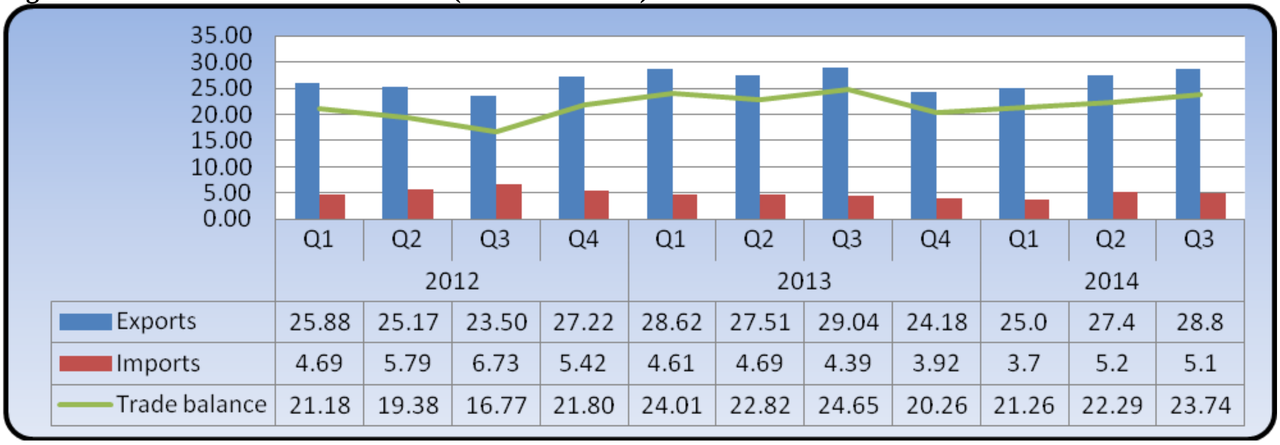
Source: BNR, Statistics Department

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, minerals or chemical fertilizers, second hand clothing and other second hand articles, cane or beet sugar and chemically pure sucrose, among others.

4.4 Informal cross-border trade

With regard to informal cross-border trade, total exports slightly decreased by 0.8% amounting to USD 28.80 million from USD 29.04 million, accounting for 18.5% of formal exports. This decline was due mainly to the impact of trade barriers imposed by DRC on exports from Rwanda during the previous quarter. In general, agriculture products and livestock were the major export commodities traded in informal cross border. In terms of destination, exports to DRC and Burundi increased by 5.9% and 10.8% respectively, while exports to Uganda and Tanzania decreased by 10.0% and 0.7% respectively.

Figure 16: Informal cross border trade (in USD millions)



	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3
Exports	25.88	25.17	23.50	27.22	28.62	27.51	29.04	24.18	25.0	27.4	28.8
Imports	4.69	5.79	6.73	5.42	4.61	4.69	4.39	3.92	3.7	5.2	5.1
Trade balance	21.18	19.38	16.77	21.80	24.01	22.82	24.65	20.26	21.26	22.29	23.74

Source: BNR, Statistics Department

Informal imports increased by 15.1% from USD 4.39 million to USD 5.06 million in 2014Q3, leading to a decrease of 3.7% in Rwanda's positive informal trade balance from USD 24.65 million to USD 23.74 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, and the main trading partners are Uganda, Burundi and Democratic Republic of Congo (DRC) which represent a share of 48.8%, 37.7% and 11.1% respectively.

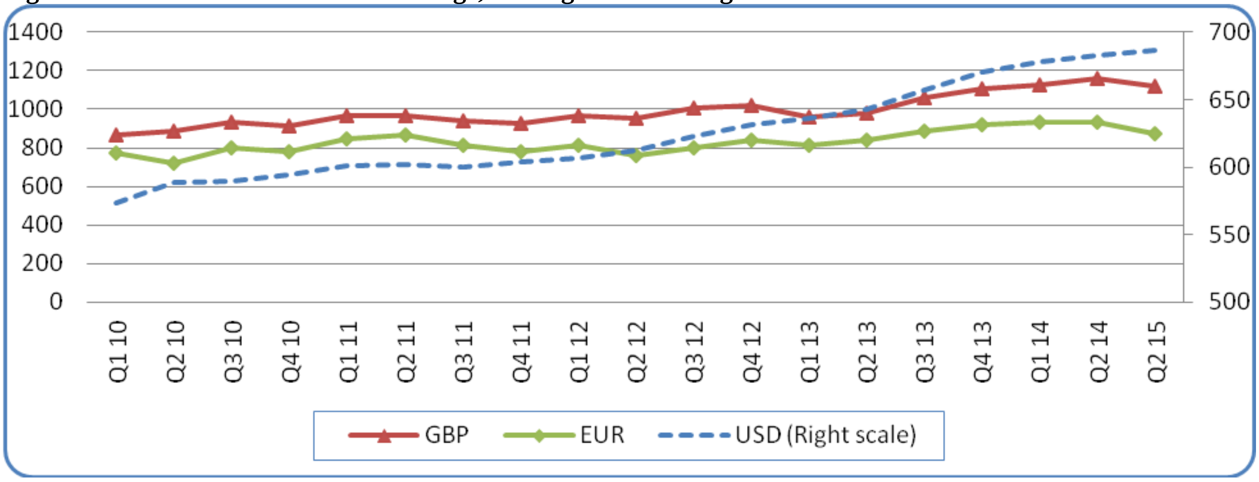
V. EXCHANGE RATE AND FOREIGN MARKET DEVELOPMENTS

The Rwandan Franc was under relative pressure in the 2014Q3 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 2014Q3, RWF depreciated against the USD by 2.5, trading between RWF 686.92 per dollar against RWF 670.08 per dollar traded in 2013Q4. This depreciation recorded against USD in 2014Q3 is lower than total depreciation of 4.1% recorded in 2013Q2.

Figure 17: Evolution of nominal exchange, leading currencies against US dollar

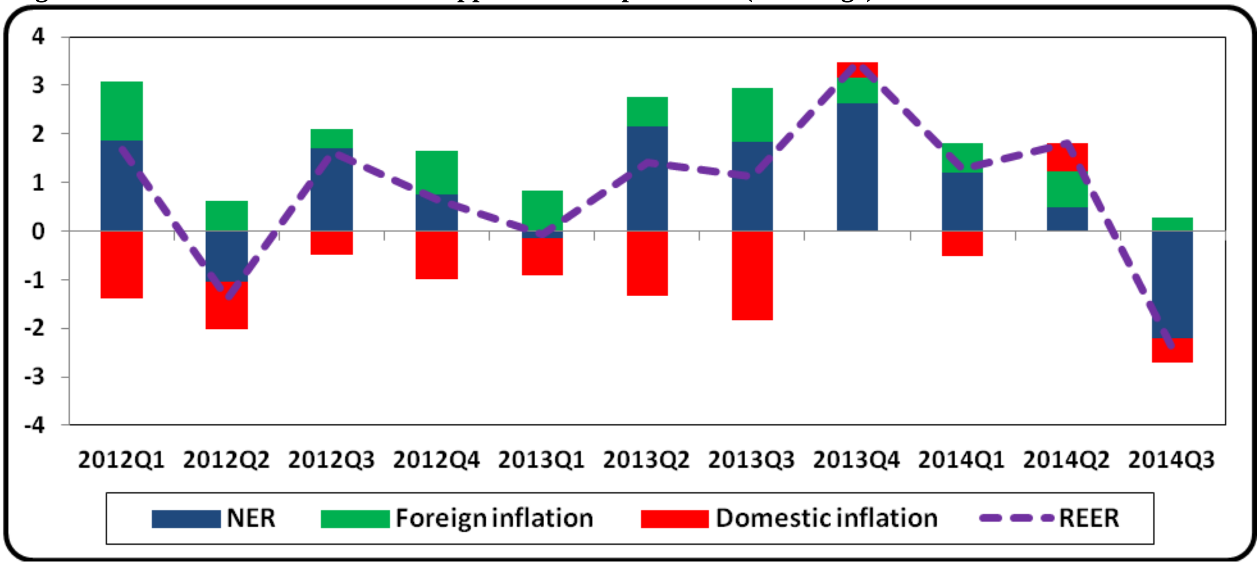


Source: BNR, Monetary Policy and Research Department

In the same period, the RWF depreciated by 1.2% against the GBP as USD strengthened against this currency, while appreciated by 5.5% versus the EURO. Concerning the East African region, RWF appreciated against all regional currencies, except the Burundian franc. It appreciated by 2.3% against the Kenya shilling, 4.6% versus the Ugandan shilling, and 3.1% against the Tanzanian shilling while depreciating by 2.3% versus the Burundi franc. The appreciation of FRW against shillings was due to the weakened regional currencies against USD.

The Real Effective Exchange Rate (REER) depicts a depreciating trend since 2013Q1 though the depreciation started easing in 2014Q1, the REER has depreciated by 1.5% in September 2014 mainly driven by an appreciation of the nominal value of RWF against some currencies of the major trading partners, despite an increase of relative prices due to their higher level relative to domestic inflation.

Figure 18: Contribution to the REER appreciation/depreciation (% change)



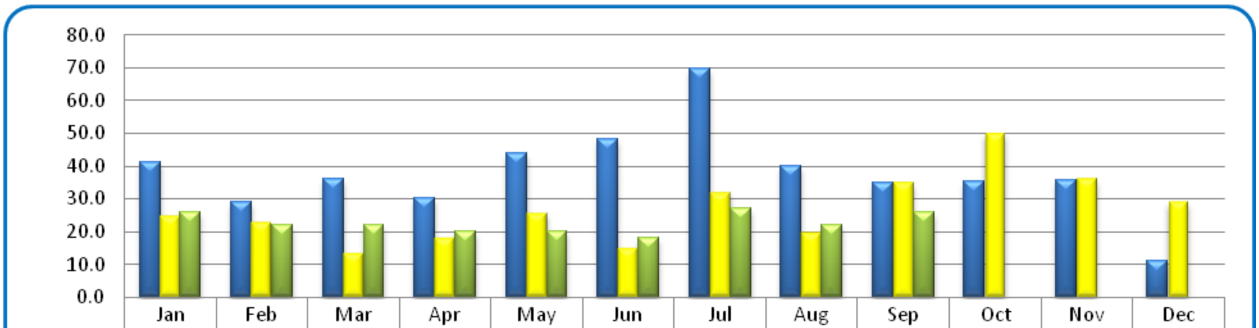
Source: BNR, Monetary Policy and Research Department

5.2 Domestic Foreign Exchange Markets

In 2014Q3, the banking system recorded a decrease of 11.8% and 15.8% respectively in forex resources and expenditures compared to the same period of 2013, leading to a cash deficit of USD 55.20 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 increased by 1.7%, that is, from USD 206.53 million sold to market end third quarter 2013 to USD 203.00 million sold end third quarter 2014.

Figure 19: BNR Sales to banks in millions of USD



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2012	41.3	29.0	36.0	30.4	43.8	48.2	69.9	40.0	35.0	35.4	35.6	11.2
2013	24.9	22.9	13.3	18.3	25.5	14.9	32.0	19.8	35.0	50.0	36.0	29.0
2014	26.0	22.0	22.0	20.0	20.0	18.0	27.0	22.0	26.0			

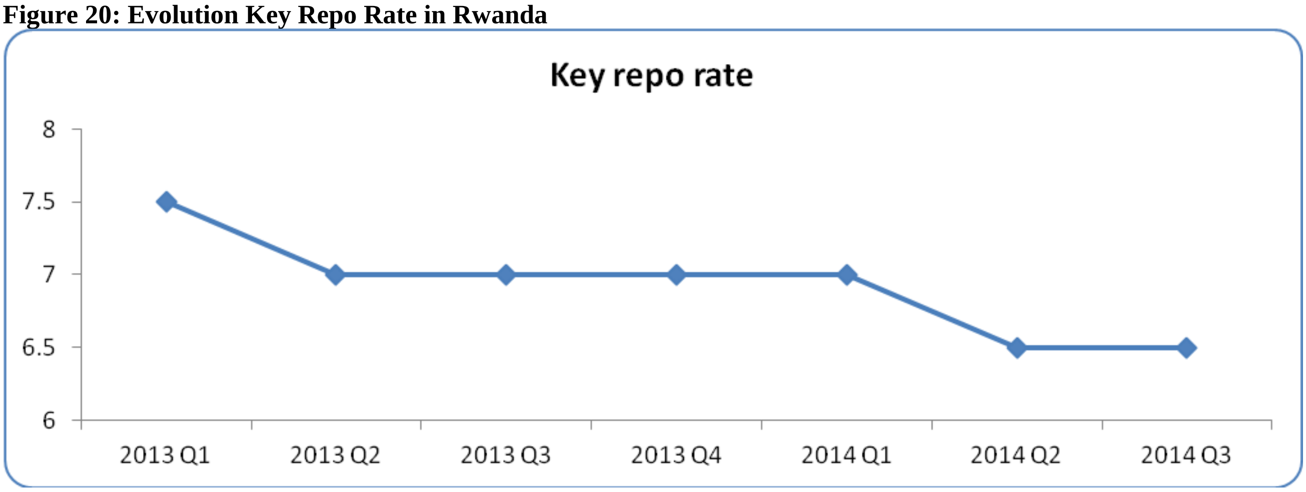
Source: BNR, Financial Markets Department

VI. MONETARY SECTOR DEVELOPMENTS

6.1 Monetary Policy Stance

In 2014Q3, BNR maintained accommodative monetary policy stance adopted since June 2013 to continue supporting the economy which grew by 7.8% from 6.1% and 7.5% in Q2 and Q1 of 2014 respectively by reducing KRR to 6.5% from 7%. This was supported by the prevailing macroeconomic conditions characterized by weak aggregate demand, lower inflation and low depreciation of exchange rate. Thanks to the expected expansion of credit to the private sector, the economy will recover from the adverse effects of cuts and delays in budget support disbursements faced in 2012.

Figure 20: Evolution Key Repo Rate in Rwanda



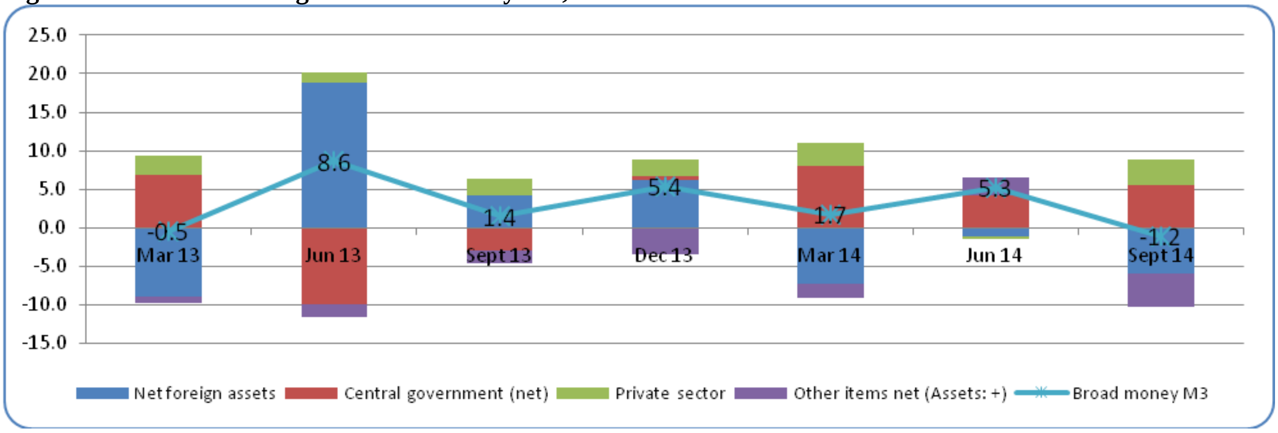
Source: BNR, Monetary Policy and Research Department

6.2 Monetary Aggregates Developments

The broad money (M3) contracted by 1.2% in 2014Q3 after its continuing expansion since the 2013Q2 due to a decline in net foreign assets (NFA) by 10.1% despite a huge increase in net credit to government (NCG) and credit to private sector (CPS) by 502.8% and 5.1% respectively.

Actually NFA declined in 2014Q3 due to a contraction in foreign inflows by 53.5% compared to the previous quarter. NCG expanded due to a high increase in government spending compared to the revenues while CPS went up because of the current accommodative monetary policy stance. The figure below depicts how different counterparts of M3 have been contributed to its variation.

Figure 21: Source of changes in broad money M3, in %



Source: BNR, Statistics Department

Considering the main components of M3, currency in circulation dropped by 11.6% in 2014Q3 compared to the previous quarter versus a decline of 8.5% recorded in the same period of the year before, demand deposits marginally went down by 0.3% compared to a decline of 1% in 2013Q3. This was on the profit of term deposits which expanded by 4.7% in 2014Q3 compared to 9.2% recorded in 2013Q3 due to improvement in the saving culture facilitated by the continuing improvement in financial inclusion, sensitization through media and BNR's publications.

Foreign currency deposits went down by 6.6% in 2014Q3 following a shrunk in foreign inflows by 53.5% after registering a higher increase in 2014Q2 (+32.2%) due to a huge expansion in foreign currency deposits from sale of MTN's mobile network towers.

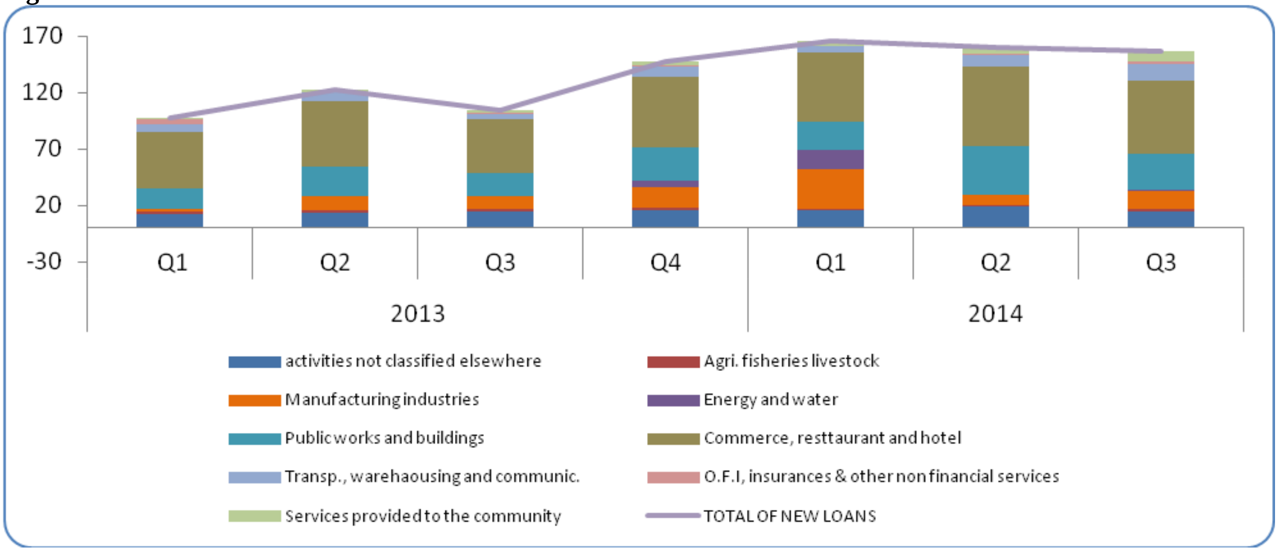
6.3 Developments in Banks Credit

Outstanding credit to private sector followed the upward trend since the 2013Q2 increasing by 5.1% in 2014Q3 compared to the previous quarter. This continuing recovery in the stock of credit to the private sector was a result of improvement in commercial banks' lending in 2014 though total new authorized loans slightly declined to FRW 156.5 billion in 2014Q3 from FRW 159.7 billion in 2014Q2 but a huge increase compared to FRW 104.4 billion recorded in 2013Q3.

Regarding the distribution of new authorized loans, by economic sector, Commerce, Restaurants and Hotels continued to take the lion's share of 41.8% followed by Public Works and Buildings, Manufacturing Industries and Activities not Classified Elsewhere with 20.3%, 9.8% and 9.1% respectively in 2014Q3, both totalizing 81% of total loans authorized in that period from 45.8%, 19.3% 11.0% and 13.9% respectively recorded in 2013Q3 both totalling 90% of total loans authorized in that quarter.

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 6 quarters although hotels 'contribution to GDP growth remained weak. Besides, the high increase of 132.2% in new loans to manufacturing sector in the first nine months of 2014 compared to the same period of 2013 contributed to the expansion of 13% in manufacturing turnovers in the same period.

Figure 22: New authorized loans



Source: BNR, Monetary Policy and Research Department

6.4 Interest Rate Trends

The level of short term interest rates remained relatively low in line with comfortable liquidity situation in the banking system and the current accommodative policy stance as the MPC decided to revise downwards the policy rate from 7.0% to 6.5% in June 2014 to be effective since then and for the quarter under review. Apart from repo rate which increased by 50 basis points to 4.2% in September 2014 from 3.7% in June 2014, T-bills rate and interbank rate declined respectively to 5.5% and 5.6% from 5.6% and 5.7% during the same period. That unexpected trend in repo rate was explained by the central bank behaviour on money market to avoid negative effects of heavy fiscal injections in May and June 2014 amid the closing of fiscal year of 2013/2014.

Table 10: Short-term interest rates

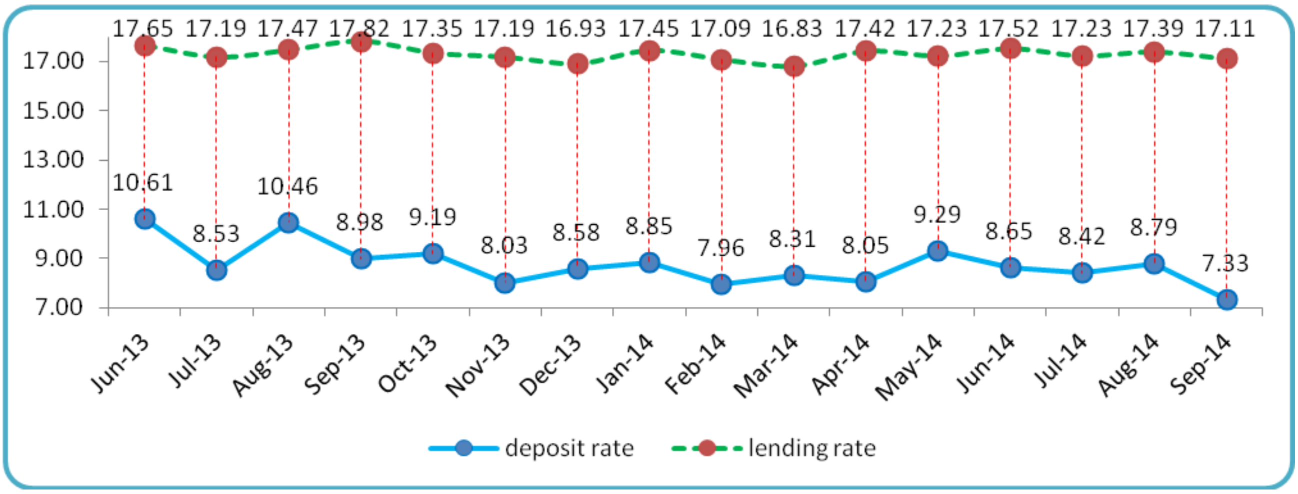
	2013				2014								
	Jun	**Aug**	**Sep**	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sept**
Key Repo Rate	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	6.5	6.5	6.5	6.5
Discount Rate	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	10.5	10.5	10.5	10.5
Repo rate	6.7	5.6	5.4	4.0	4.3	3.7	3.3	3.1	3.6	3.7	3.9	4.4	4.2
T-Bills Rate	10.8	8.6	7.1	5.6	6.4	6.1	6.0	6.0	5.9	5.6	5.5	5.2	5.5
Interbank Rate	9.6	7.6	7.0	5.6	5.6	5.8	5.8	5.6	5.7	5.7	5.5	5.5	5.6

Source: BNR, Statistics Department

Regarding market interest rates, both deposit and lending interests rates dropped respectively to 7.3% and 17.1% in September 2014 from 8.6% and 17.5% in June 2014, in line with short-term interest rates and thus in line with the current monetary stance in spite of the fact that interest rates pass-through in Rwanda has been very weak over time.

However, the interest rate spread continued to oscillate at high level due to the rigidity in the decline of lending interest rates. The aforementioned rigidity has been mainly explained by high operating costs, credit risk on one side and the low bargaining power of banks' customers. Regarding the risk premium, it also continued to stand at high levels reaching 11.6% in September 2014 from 11.9% in June 2014; this was imputed to the persistence of risk-aversion among commercial banks following low economic activities as evidenced by low inflation figures during the quarter under review. The inflation stood at 1.9%, 0.9% and 0.2% respectively in July, August and September 2014.

Figure 23: Deposit and Lending rates



Source: BNR, Monetary Policy and Research Department

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, and therefore the 'yield curve' for short term deposits has been generally normal.

Regarding lending rate by maturity, 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

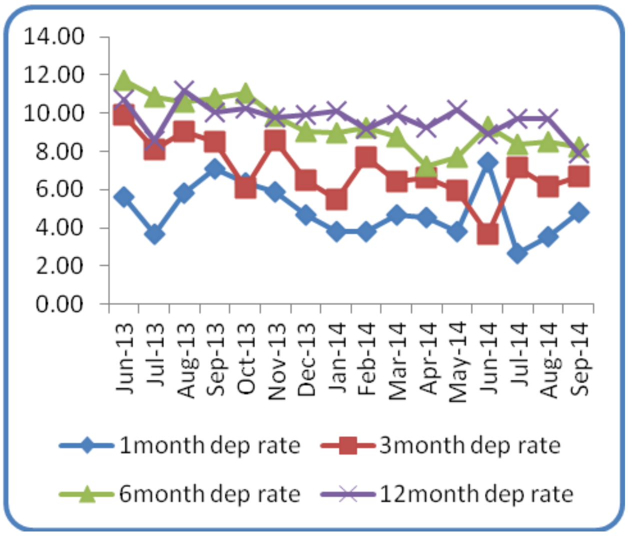
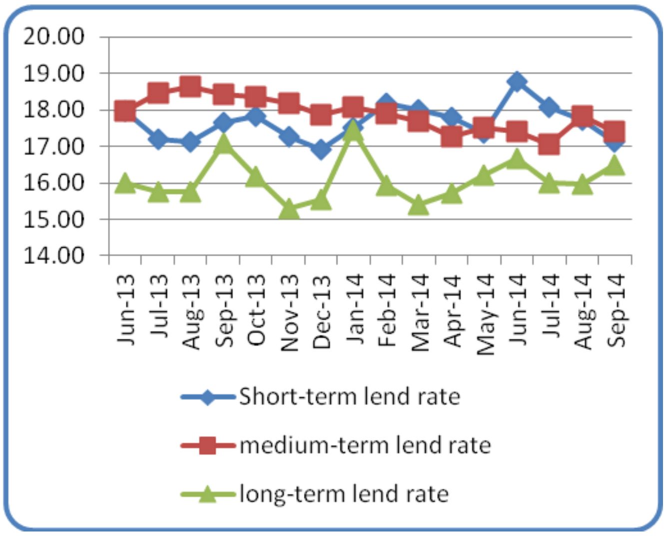


Figure 24b: Lending rates by maturity



Source: BNR, Monetary Policy and Research Department

Comparing average deposits rate in Rwanda with other EAC countries in 2014Q3, deposit rates in Uganda and Rwanda were declining, while remaining almost stable in Kenya, Burundi and Tanzania. Rwanda has had the third highest deposit rate since May 2014 and in September it seemed to become the fourth in the region behind Uganda, Tanzania and probably Burundi of which data for August and September 2014 were not yet published when this report was published. The Kenyan deposit rate has been the lowest over time. It is vital to mention that the sharp fall in Uganda’s deposit rate followed the cut in policy rate from 11.5% to 11% in June 2014.

Similar to deposit rate, Uganda has also the highest lending rate among EAC countries and Rwanda is ranked the second, while Kenya and Tanzania were having the lowest rates.

Figure 25a: Deposits rates in EAC countries

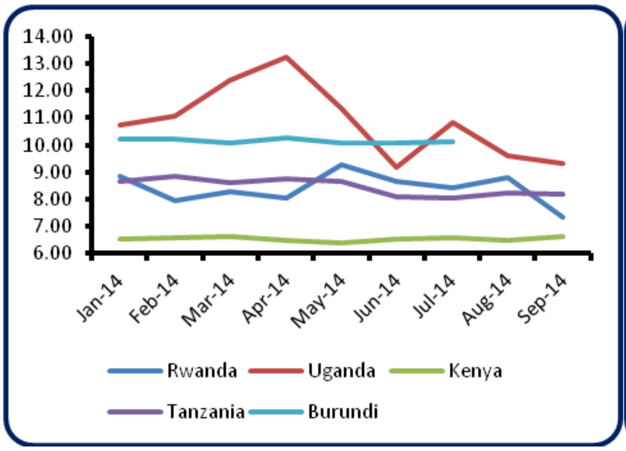
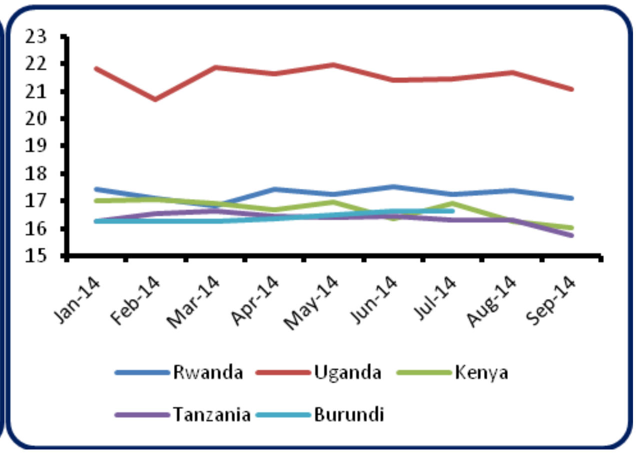


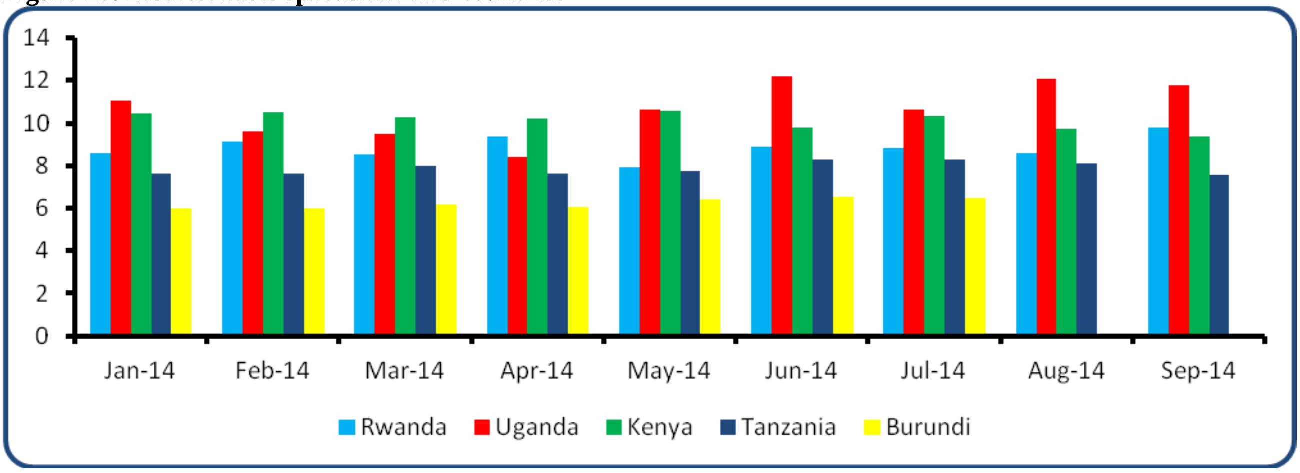
Figure 25b: Lending rates in EAC countries



Source: BNR, Monetary Policy and Research Department

Regarding the spread in the EAC countries, there were no big changes in 2014Q3 except in Rwanda where the spread went up amid a decline in deposits rate. Besides, Uganda and Kenya continued to have the highest spread in the region especially in July and August 2014.

Figure 26: Interest rates spread in EAC countries



Source: BNR, Monetary Policy and Research Department

VII. FINANCIAL STABILITY ANALYSIS

Regarding the stability of the financial system, the main indicators depict a favourable picture as in the previous quarter despites a slight decline observed in profitability indicators of banking system. Overall, Rwanda's banking system remained stable and sound amid improving domestic and global economic environment.

The world economy continued to recover from previous years' slowdown and world inflationary pressures are expected to remain low in the near future. Subsequently, monetary policy in major 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. However, there are some risks notably from the growth prospects of Euro zone countries and effects of Fed tapering on emerging countries.

Recovery in economic activities in Rwanda was sustained in 2014Q2 with a real GDP growth of 6.1% from 7.5% in 2014Q1. BNR's monetary policy committee maintained an accommodative monetary policy stance to support the financing of the economy, thereby keeping the banking system liquidity at comfortable level. On the external side, during fiscal year 2013/2014, current account deficit declined implying an improvement on national saving-investment balance. However, due to lower inflows from the capital and financial account, the overall balance deteriorated and the Rwandan franc exchange rate has been under relative pressure in 2014 against US dollar.

7.1 Financial sector performance indicators

The focus here is on performance indicators of the banking sector due to its prominence in the whole financial system and its role in effectiveness of monetary policy transmission.

During 2014Q3, the banking sector performances were mixed compared to the previous quarter where all performance indicators were moving in the right direction. Firstly, expansion of total assets of the banking sector decelerated to 1.2% on quarterly basis from 12.4% in 2014Q2, reaching RWF 1,788 billion from 1,767.6 billion. In fact, this marginal increase was again driven by increasing outstanding credit to private sector but partially cancelled by a reduction in claims to domestic and banks abroad.

Considering the funding side, the increase in total deposits were lower than in 2014Q2 while paid up capital was the main source of increase in liabilities. Therefore, loans to deposits ratio has moved upward from 0.76 in 2014Q2 to 0.80 in 2014Q3, implying an expansion of earning assets in the whole banking system. This can also be illustrated by an increase of earning assets to total assets ratio from 80.6% to 83% in 2014Q3.

Despite this positive change in banking system's portfolio allocation, the profitability indicators slightly deteriorated in 2014Q3 as return on average assets (ROA) and return on average equity (ROE) which stood at 1.9% and 10.9% by end 2014Q3 from 2.1% and 12.1% by end 2014Q2 respectively, amid a marginally higher increase in overhead cost than income.

Table 11: Key soundness indicators, (percent)

Indicator	2013		2014		
	September	December	March	June	September
Solvency ratio (total capital)	22.9	23.1	22.6	23.6	23.8
NPLs / Gross Loans	7.2	6.9	6.7	6.6	6.3
NPLS net/Gross loans	6.5	6	5.7	5.5	5.3
Provisions / NPLs	50.3	53.3	56.4	50	55.3
Earning Assets / Total Assets	79.1	78.6	82.1	80.6	83
Large Exposures / Gross Loans	9.9	11.6	15.1	15.8	14.9
Return on Average Assets	1.7	1.5	2.3	2.1	1.9
Return on Average Equity	8.3	7.4	11.9	12.2	10.9
Cost of deposits	3.8	3.8	4.1	3.4	3.2
Liquid assets/total deposits	48.8	49.4	46.3	54.2	51.1
FOREX exposure/core capital	-3	-2.2	-12.6	-1.5	-4.8

Source: BNR, Bank Supervision Department

The evolution of other financial soundness indicators in 2014Q3 was satisfactory as most of indicators remained at the adequate level or improved. The capital adequacy ratio reached at 23.8% in 2014Q3 from 23.6% in 2014Q2, well above 15% required, implying that Rwandan banking sector has strong ability to withstand shock to its balance sheet. In addition, banking system liquidity remained sound ratio of liquid assets to total deposits and reached 51.1% by end 2014Q3 from 54.2% in 2014Q2, well above 20% as regulatory benchmark.

Banking system's assets quality slightly improved in 2014Q3 as the ratio of non-performing loans to gross loans (NPLs ratio) decreased to reach 6.3% from 6.6%, though it is still above the benchmark of 5%.

Regarding the sectoral distributions of new loans to total new loans, two main sectors namely the commerce, restaurants and hotels and the mortgage industries continued to attract a bigger chunk of total new loans with around 62% in 2014Q3. However, this apparent concentration in credit distribution is not matter of much concern as the two sectors are respectively the first and third in contribution to the growth rate of real GDP in the last 5 since last year.

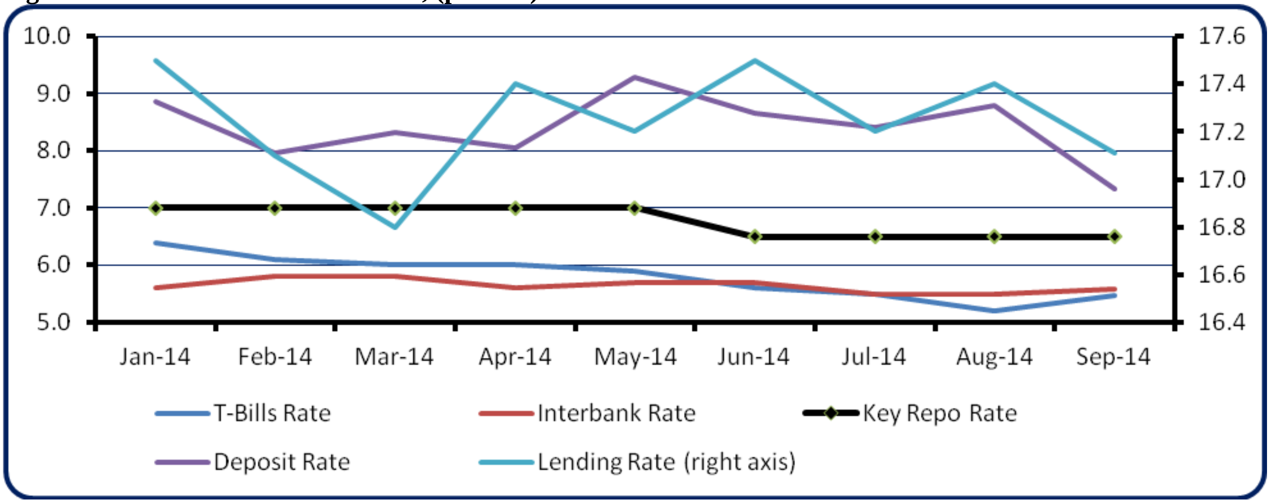
Meanwhile, the sensitivity of the banking sector to exchange rate volatility, deteriorated in 2014Q3 (-4.8%) while it had significantly improved in 2014Q2 (-1.5%). Even though this situation, combined with gradual depreciation of RWF increase the exposure to exchange rate risk, this does not pose a major risk as capital buffers are enough to mitigate such risks.

7.2 Financial stability and Monetary Policy

It is well recognized that a well-functioning financial system is crucial for effectiveness of monetary policy transmission and also monetary policy stance may have implications on financial system soundness. The soundness indicators in 2014Q3 are not much different from the ones in 2014Q2 and suggest a sound banking system which a priori should favour a smooth transmission of monetary policy.

Nevertheless, the same old impediments on smooth monetary policy transmission were present in 2014Q3 as the current accommodative stance of monetary policy was transmitted to money market rates (T bills rate and interbank rate) but not fully in banks' lending rates despite comfortable level of liquidity in the financial system and lower rates of return in alternative assets.

Figure 27: Evolution of interest rates, (percent)



Source: BNR, Financial Markets Department and Monetary Policy Directorate

The interest rate spread went up to 9.8% in 2014Q3 from 8.6% in the previous quarter. Even if this would imply more profitability in the banking sector, it can also reflect high perceived risks, weakened transmission of monetary policy and lack of competitiveness in the banking sector. On that point, the Herfindahl index (HHI) in 2014Q3 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 not concentrated but this level is close to 0.15 above which the market is considered as moderately concentrated. Nonetheless, there have been notable improvements as HHI has significantly declined compared to the period prior 2010.

Besides, wages and staff costs continued to be the main component in financial system expenses and this may impede the transmission from policy rates to banks rates. Actually, the overhead to income ratio rose to 49.3% in 2014Q3 from 48.8% in 2014Q2. However, this situation is improving as the overhead to income ratio is gradually trending downward since 2010.

7.3 Economic prospects and financial stability

Growth prospects for the remaining year are satisfactory and would likely support the soundness of households and corporate sector. Inflation is expected to remain moderate and monetary policy is expected to remain accommodative as long as inflationary pressures are low and output gap is still negative. In such a context, liquidity in the banking system will be adequate enough to keep short term interest rate low and less volatile and not disrupt financial markets.

Considering this positive outlook in both domestic and global economy, there is no major risks on financial sector stability. Banks are well capitalized to withstand shocks to their balance sheets, their assets quality improving and with current higher margin and positive growth prospects, banks profitability would also improve.

The downside risks would arise from the negative effect of higher lending rates on households' sector soundness especially if robust rate of real economic growth are not achieved in the near future, to curb households indebtedness and nonperforming loans which subsequently would negatively impact banking sector soundness. Secondly, the recent deterioration of banks' forex exposure due to a decline in banking sector foreign assets may worsen, as the current account deficit is projected to worsen by end 2014 and in 2015.

VIII: ECONOMIC OUTLOOK AND RISKS

8.1 Global Economic Outlook

The world economic recovery remained sluggish and is expected to stabilize at 3.3% by the end of 2014 and to slightly improve to 3.8% by the end of 2015.

Inflationary pressures remained below the Central Banks targets in advanced economies owing to persistent spare capacity of production and softening commodity prices especially energy prices. In developed countries, inflation slid to 1.4% in 2013 while projected to slightly rise to 1.6% in 2014 and by 1.8% in 2015. In emerging and developing economies, inflation stood at 5.9% in 2013 and foreseen to stand at 5.5% in 2014 and 5.6% in 2015.

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 continued to grow through Q1, Q2 and Q3 of 2014 growing by 7.5 % and 6.1% and 7.8% respectively compared to 4.2% registered in 2013Q4 on the account of robust growth in agriculture, service and industry sectors. This growth is expected to further pick up in 2014Q4 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 registered in the first three quarters of 2014. Nonetheless, the economic growth outlook is likely to be affected by changing global environment as well as delay in the implementation of capital expenditures 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.

Though sluggish, the 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 agricultural 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 rebound 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 did not perform well in 2014Q3 compared to 2014Q2 mainly due to poor production and the fall in commodity prices on the international market thus aggregate demand remain weak in spite of 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 intermediary, capital goods and lubricants continue to outstrip the expanding but still narrow export earnings albeit falling energy prices that would otherwise reduce the import bill and boost trade balance. The share of export earnings to imports receded to 26% in 2014Q3 from 30% in 2014Q2 and the weakness of the current account insinuate the vulnerability of the 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 the 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 and recovery in economic activities. Despite the fact that monetary policy stance remains accommodative, lending rates are expected to remain relatively stable 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 4.2% in 2013Q4 to 6.1% in 2014Q2 and 7.8% in 2014Q3 and evolves towards achieving a growth rate of 6% by the end of 2014 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 led to poor performance of the agriculture sector. Inflation has been maintained to a single digit over the period under review.

The current BNR monetary policy stance remains supportive to the economy by supporting 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 potential risks to economic outlook, BNR should continue to closely monitor developments in underlying economic fundamentals particularly economic growth, inflation and exchange rate developments so as to take appropriate measures.

APPENDICES

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

	2012				2013				2014			% Change
	QI	QII	QIII	QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIII 14 / QIII 13
Coffee												
- Value in USD	4.97	7.03	24.39	24.49	11.57	8.64	17.28	17.41	5.05	7.75	28.18	63.11
- Volume in KG	1.29	2.1	6.47	7.13	3.70	3.23	6.31	6.75	2.20	2.57	6.78	7.49
- Price USD/KG	3.84	3.35	3.77	3.44	3.13	2.67	2.74	2.58	2.29	3.02	4.15	51.75
Tea												
- Value in USD	18.22	15.31	16.43	15.76	16.77	14.93	12.38	11.40	14.36	14.21	12.34	-0.31
- Volume in KG	6.68	5.23	5.43	5.11	5.56	5.96	5.03	4.46	5.75	6.50	5.53	9.82
- Price USD/KG	2.73	2.93	3.02	3.08	3.02	2.50	2.46	2.56	2.50	2.19	2.23	-9.22
Mining												
- Value in USD	34.18	30.46	37.13	34.31	46.71	68.16	64.67	46.16	43.50	49.95	59.63	-7.80
- Volume in KG	2.01	1.68	1.9	1.94	2.04	2.53	2.47	2.54	2.56	2.66	2.82	14.32
Cassiterite												
- Value in USD	16.14	11.07	12.32	13.38	16.50	14.92	14.50	15.15	17.54	21.25	18.67	28.72
- Volume in KG	1.36	0.96	1.12	1.19	1.12	1.23	1.29	1.25	1.44	1.67	1.57	21.32
- Price USD/KG	11.85	11.54	10.97	11.21	14.73	12.09	11.24	12.12	12.22	12.69	11.92	6.10
Coltan												
- Value in USD	11.54	12.19	18.07	15.12	24.34	44.69	43.94	21.59	17.51	23.34	34.13	-22.33
- Volume in KG	0.27	0.27	0.33	0.27	0.42	0.74	0.73	0.59	0.47	0.51	0.69	-5.10
- Price USD/KG	42.35	44.75	54.96	55.75	58.42	60.73	60.34	36.91	37.41	45.49	49.38	-18.15
Wolfram												
- Value in USD	6.51	7.2	6.74	5.81	5.86	8.55	6.23	9.42	8.45	5.37	6.83	9.74
- Volume in KG	0.38	0.45	0.45	0.47	0.50	0.56	0.45	0.70	0.65	0.48	0.57	25.64
- Price USD/KG	17.14	16.16	14.91	12.29	11.73	15.17	13.79	13.39	12.93	11.25	12.05	-12.66
Hides and Skin												
- Value in USD	2.54	2.4	6.15	3.28	3.48	3.77	4.49	4.29	5.15	3.17	2.94	-34.45
- Volume in KG	1.88	1.79	4.15	2.2	2.19	2.37	2.83	2.91	3.16	2.10	2.26	-20.40
- Price USD/KG	1.35	1.34	1.48	1.49	1.59	1.59	1.58	1.48	1.63	1.51	1.30	-17.65
Pyrethrum												
- Value in USD	2.58	1.95	2.62	2.56	2.31	1.51	0.01	0.15	0.34	1.10	0.05	210.04
- Volume in KG	0.01	0.01	0.01	0.01	0.01	0.01	0.00	0.00	0.00	0.01	0.00	470.15
- Price USD/KG	259.99	258.02	256.15	257.37	243.00	242.98	218.98	166.45	126.38	190.44	119.08	-45.62
Principal Exports												
- Value in USD	**62.49**	**57.16**	**86.72**	**80.39**	**80.84**	**97.01**	**98.83**	**79.40**	**68.40**	**76.18**	**103.14**	**4.36**
- Volume in KG	**11.88**	**10.80**	**17.97**	**16.39**	**13.49**	**14.10**	**16.65**	**16.65**	**13.67**	**13.83**	**17.39**	**4.46**
Reexports												
- Value in USD	29.38	16.88	25.49	40.50	18.17	26.06	20.43	17.26	38.91	61.08	27.68	35.53
- Volume in KG	17.90	9.68	12.74	20.32	41.24	39.47	34.70	34.48	27.92	25.08	40.55	16.88
Other Exports												
- Value in USD	20.31	18.51	31.43	20.04	31.13	36.71	33.16	34.03	22.69	26.35	25.12	-24.24
- Volume in KG	42.22	36.95	52.03	48.41	18.87	26.36	26.14	26.21	32.19	38.29	50.97	94.99
TOTAL GENERAL												
- Exports Value	**105.63**	**92.55**	**143.64**	**140.93**	**130.14**	**159.79**	**152.41**	**130.69**	**130.00**	**163.61**	**155.94**	**2.32**
- Exports Volume	**63.38**	**57.43**	**82.74**	**85.12**	**73.60**	**79.93**	**77.48**	**77.35**	**73.78**	**77.21**	**108.91**	**40.56**

Source: Statistics Department

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

	2013				2014						% change	
	Q3		Q4		Q1		Q2		Q3		2014Q3/2013Q3	
	Volume	Value	Volume	Value	Volume	Value	Volume	Value	Volume	Value	Volume	Value
TOTAL IMPORTS	483.59	592.87	467.01	599.24	405.4	565.1	432.6	628.0	523.0	601.8	8.2	1.5
Consumer goods	150.52	157.56	153.90	174.00	130.9	164.3	141.1	163.0	171.9	169.2	14.2	7.4
Food products	113.32	63.52	117.62	56.35	90.6	53.0	104.26	64.05	133.40	67.73	17.7	6.6
Health & care	10.31	26.48	8.02	44.49	9.2	45.8	9.50	33.08	10.78	43.24	4.6	63.3
Goods of domestic use	5.27	19.40	3.87	14.09	3.1	7.0	3.49	8.51	4.45	10.59	-15.6	-45.4
Capital goods	16.24	159.63	17.20	159.68	14.9	150.7	15.04	165.84	14.92	158.24	-8.1	-0.9
Transport materials	3.53	18.56	3.37	21.68	2.7	21.1	3.58	29.03	3.54	21.54	0.2	16.0
Machines, devices and tools	7.82	111.09	9.14	104.29	9.5	108.3	7.45	103.71	6.80	102.98	-13.0	-7.3
Intermediary goods	247.59	184.38	223.40	157.42	192.4	159.7	210.13	209.07	263.27	175.95	6.3	-4.6
Construction mater.	134.04	61.26	136.71	60.54	113.9	63.3	115.22	55.03	139.62	51.78	4.2	-15.5
Industrial products	77.23	81.94	76.01	78.95	66.9	73.2	80.88	87.59	95.39	92.95	23.5	13.4
Fertilizers	29.38	26.58	4.09	3.39	4.6	3.8	5.92	3.93	19.64	14.69	-33.2	-44.7
Energy and lubricants	69.23	91.30	72.52	108.14	67.3	90.4	66.34	90.03	72.96	98.44	5.4	7.8
Petroleum products	66.85	87.32	70.49	104.35	65.0	86.2	64.01	86.36	71.02	94.93	6.2	8.7
TRADE BALANCE (exports less imports)		-440.46		-468.55		-435.06		-464.35		-445.89		-1.2
Cover rate of imports/ exports, %		25.7		21.8		23.0		26.1		25.9		0.8

Source: BNR, Statistics Department