



Banque Nationale du Rwanda
National Bank of Rwanda

MONETARY POLICY COMMITTEE

**REVIEW OF THE ECONOMIC AND MONETARY DEVELOPMENTS
AS OF END JUNE 2010 AND MONETARY POLICY DIRECTION FOR
THE 3RD QUARTER 2010**

JULY, 2010

I. SUMMARY

The second quarterly meeting of the Monetary Policy Committee (MPC) of the National Bank of Rwanda was held on the 16th July 2010 to (i) review the developments of the national economy in the first half of 2010, (ii) make an assessment of the impact of the decisions taken by the Committee in its last meeting and (iii) decide on the monetary policy direction for the 3rd quarter 2010.

The MPC noted a sustained economic recovery driven by continuous good performance of the agriculture sector, strong improvement in exports activities linked to the on-going recovery of the global economy and significant recovery in the services and the construction activities. This performance was associated with a high growth in the banking activity after the 2009 liquidity crunch which had affected negatively the credit markets.

The previous decision of the MPC to revise downward the Central Bank rate while maintaining it positive in real terms has significantly contributed to keep adequate level of the liquidity in the banking system and resulted in a general downward trend of interest rates in the money market. This money market environment has encouraged banks to increase the volume of new loans to the private sector, amounting to RWF 121.9 billion in the first half of 2010 against RWF 83.8 billion approved in the same period of 2009, that is an increase of 45.5%. However, despite the high increase in the volume of new loans authorized by banks, the increase in monetary aggregates remains moderate and below the 2010 Monetary Program targets.

It is on this background that the MPC held on 16th July 2010 decided to maintain the Central Bank policy rate at 7% to continue to give a stimulating signal to the credit market. The decision is also based on the current inflation trend projected to 6% at end September 2010, providing comfort that the Central Bank rate is maintained positive in real terms.

As regard to the exchange rate policy, the National Bank of Rwanda will closely monitor the behavior of the currencies of the main trade partners of Rwanda and package the intervention mechanism on the foreign exchange market in such a way to maintain stable the Real Effective Exchange Rate of the national currency.

II. CURRENT ECONOMIC AND FINANCIAL ENVIRONMENT

II.1 ECONOMIC PERFORMANCE:

Continuing good performance in agriculture sector and positive signs of recovery in non-agriculture activities.

In 2010, Rwandan economy is evolving in more favorable international and national economic and financial environment compared to 2009. The country is recording sustained agriculture sector performance, significant recovery in non-agriculture activities, low inflation and important improvement in banking system liquidity conditions.

1. Agriculture Sector

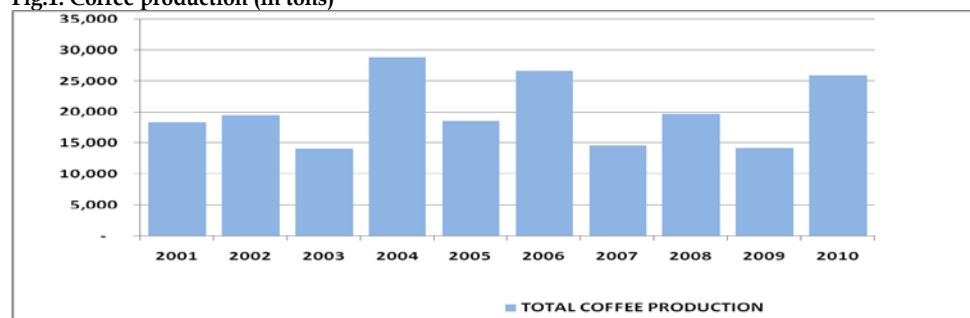
In agriculture sector, the performance recorded during the last 2 years maintained momentum during this year 2010. The 2010 season A and B harvests recorded an increase of 8.2% compared to 2009, driven by cereals and roots & tubers production which increased by 18.7% and 18.8% respectively.

This sustained good performance of agriculture is attributed to the Government Crop Intensification Program and conducive climatic conditions. Following a particular focus made on cereals production, Rwanda is currently recording a boom in maize production with an increase of 53.7% in 2010, compared to 2009. This performance is currently leading to a dynamic trade activity of this crop.

Considering that the cereals constitute the main marketable foodstuffs and the necessity to support farmers to find market opportunities, the Government of Rwanda, supported by WFP, decided to buy important volume of cereals and to encourage the private sector to do the same for supplying prisons, schools, soldiers and refugees in Darfur as well. To date, around 21.5 thousand tons of maize were purchased from farmers, injecting in rural zone significant liquidity rounding RWF 4.5 billion and thus, contributing to poverty alleviation.

Regarding the export crops, a noticeable increase in coffee production during the 2010 coffee season is being recorded, when compared to previous year. Indeed, the production of tradable coffee is estimated to reach 26 thousand tons, from 14.25 thousand tons in 2009 as a result of more use of fertilizers, recently renewed plantations and expansion of cultivated area under coffee and to seasonal factor (favorable coffee cycle and conducive climate conditions).

Fig.1: Coffee production (in tons)



Source: OCIR Cafe.

Concerning tea, its production increased from 9.2 thousand tons in the first five months of 2009 to 11.5 thousand tons in the corresponding period of 2010, which is an increase of 24.8%. The improvement in tea production is attributed

to the privatization of some tea factories which led to improvement of their production.

2. Non - Agricultural Economic Activities

In general, Non agricultural economic activities performed well during the first half of 2010, showing a significant improvement in business activities. In nominal terms, the Composite Indicator of Economic Activities (CIEA) increased by 9.2% in May 2010 on annual basis, showing a significant improvement compared to 3% recorded in March 2010 and -0.7% in December 2009.

Table 1: Composite Indicator of Economic Activities (Base 2006: 100)

		CIEA	% Change	
			Monthly	Annual
2008	March	139.4	3.7	23.2
	June	157.5	2.0	30.8
	September	174.6	3.1	34.9
	December	179.9	3.6	30.2
2009	March	168.0	3.8	20.5
	June	168.4	3.7	6.9
	September	168.3	1.2	-3.6
	December	178.6	5.5	-0.7
2010	January	166.6	-6.7	2.1
	February	169.9	2.0	4.9
	March	173.1	1.9	3.0
	April	175.2	1.3	9.8
	May	177.4	1.2	9.2

Source: Research and Policy Analysis Department

The overall improvement in non agriculture sector during the first half of 2010 is attributed to different sectors mainly construction companies, services, financial services, imports and exports activities as well.

During the first five months of 2010, the total turnovers registered by large companies in industry and service sectors rose respectively by 18.9% and 29.8%, compared to the same period of 2009, mainly driven by the mining sector (+50.7%), construction (+36.8%), banks & insurance services (+47.7%) and transport and storage services (+83.1%).

Concerning the external trade, during the first half of 2010, exports activities performed significantly better than the same period of 2009. They increased by 24.2% and 15.2% respectively in value and volume terms. However, despite the upward trend of imports during the last years, their value declined by 3.9% during the first half of 2010 due to price effect, while the volume increased by 18.7%.

II.2 INFLATION: *Maintained at low level despite an expected moderate increase by September 2010*

During the Second Quarter of 2010, Rwanda experienced a slight increase in inflation explained mainly by the seasonal shortage of fresh food products, while during the first quarter, the country recorded 3 successive months of quite stable consumer prices level. On annual basis, overall inflation rose to 5.0% in June 2010 from 2.1% in March. By origin, it stood at 5.0% in June for locally produced consumer goods, against 1.6% for imported goods. Due to seasonal factor, prices of fresh food products were relatively higher during the second quarter 2010 and reached 14.7% in June on annual basis. Recent increase in oil prices on international market has been transmitted on local market, as during the second quarter 2010 energy index rose significantly and on annual

basis, it reached 6.8% in June 2010 against 1.6% in March 2010.

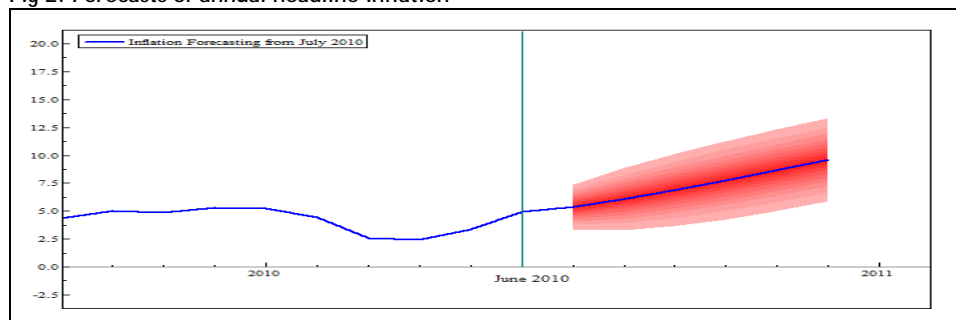
Table 2: Annual average inflation developments in % change

	Weight	Annual inflation					Monthly inflation				
		2009	2010				2009	2010			
		Dec.	Mar.	Apr.	May	June	Dec.	Mar.	Apr.	May	June
Overall inflation	10 000	5.7	2.1	2.7	4.2	5.0	-1.1	0.4	0.5	0.5	0.3
Local	7947	6.3	2.7	3.3	5.0	5.9	-1.6	0.5	0.6	0.6	0.4
Imported	2053	1.4	-0.4	0.5	1.0	1.6	0.9	0.2	0.6	0.1	-0.1
Fresh Food	1403	20.5	4.6	6.8	12.7	14.7	-7.3	3.0	2.6	2.2	0.0
Energy	767	1.3	1.6	4.1	6.0	6.8	-2.8	0.9	2.9	1.9	0.8
Underlying inflation	7829	3.5	1.6	1.8	2.5	3.1	0.4	-0.1	-0.1	0.1	0.3

Source: NBR, Statistics Department

For the coming 3rd Quarter, the forecasted annual headline inflation is expected to be maintained at a low level, rounding 6% in September. The expected low inflation would be explained by continuing good performance in food production, the main driver of inflation in Rwanda. It is also expected that imported inflation would be maintained low and stable, according to World Bank global outlook of June 2010 projecting inflation in leading economies (G-7) at 1.5% in 2010, while the manufacturing unit export value would remain unchanged. After a short period of depreciation against USD, RWF is also expected to be stable, while the current appreciation of the national currency against EUR and GBP, as well as regional currencies would contribute to declining imported inflation.

Fig 2: Forecasts of annual headline inflation



Source: Research and Policy analysis Department

II.3 EXCHANGE RATE AND FOREX MARKETS DEVELOPMENTS:
Adjusted exchange rates corridor system for more market efficiency.

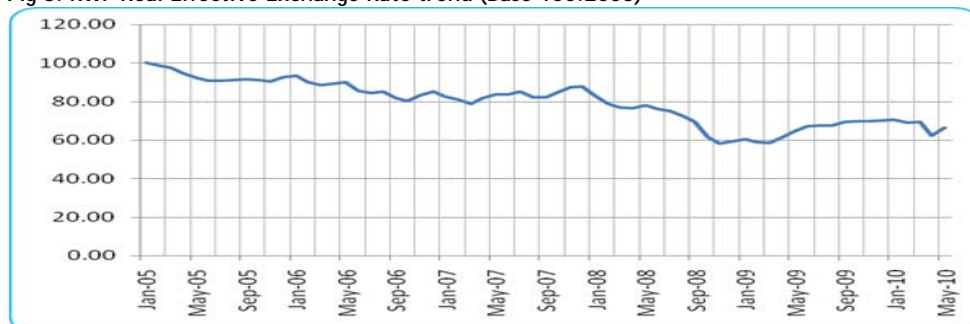
As part of an ongoing program to improve the operation of the foreign exchange market, the existing foreign exchange rates corridor used as the framework for BNR intervention has been adjusted from July 2nd, 2010 aiming at further enhancing the exchange rate flexibility. It is designed to ease the unpredictability characterizing the timing of current intervention and is expected to help stimulating interbank foreign exchange market and improving market efficiency.

During the first half of 2010, Rwandan Franc has recorded a significant depreciation of 3% against the USD, from RWF 571.24 per 1 USD by end 2009 to RWF 588.58 by end June 2010. Aiming at safeguarding the Rwandan export sector competitiveness, the BNR has deliberately accommodated this slightly higher RWF depreciation against USD to offset the effect of the appreciation of the USD on international market.

Against EURO and GBP, RWF considerably appreciated during the same

period, respectively by 12.3% and 2.2%, to the advantage of importers using those currencies. Moreover, against regional currencies, RWF appreciated during the first quarter 2010. Indeed, it appreciated by 8.7% against Ugandan Shilling, 1.7% against Kenyan Shilling, 0.1% versus Tanzanian Shilling and depreciated by 2.1% against Burundi Franc. This trend has reversed since April 2010 and the Real Effective Exchange Rate slightly depreciated.

Fig 3: RWF Real Effective Exchange Rate trend (Base 100:2005)



Source: Research and Policy Analysis Department

II.4 MONETARY DEVELOPMENTS AND LIQUIDITY CONDITIONS:

Rapid recovery in money supply during the second quarter 2010 and maintained comfortable level of banking system liquidity.

1. Money supply conditions

After a declining trend in Broad Money due mainly to the reduction in Net Foreign Assets and low credit distribution between December 2009 and March 2010, the second quarter of 2010 has recorded a rapid recovery of Money Supply. By end June 2010, Broad Money is estimated to increase by 8.5% compared to its end March level.

Table 3: Key monetary aggregates (in RWF billion)

	2009	2010				% Change	
		Mar	Apr	May	June Estim.	Dec 09- June 10 Dec 09	2010 Mar-June
Net foreign assets	441.8	407.8	405.9	401.6	482.4	9.2	18.3
Net domestic assets	57.1	72.8	88.9	100.2	46.4	-18.7	-36.3
Domestic credit	190.3	221.6	232.1	230.8	186.8	-1.8	-15.7
Government (net)	-142.6	-113.5	-107.5	-106.9	-158.1	-10.9	-39.3
Autonomous Agencies	-1.9	-1.9	-2.0	-1.9	-0.2	-89.8	-90.2
Public enterprises	3.0	2.8	2.9	2.8	2.8	-7.3	0.5
Private sector	331.7	334.2	338.6	336.8	342.3	3.2	2.4
Other items net	-133.2	-148.7	-143.1	-130.7	-140.4	-5.4	5.6
Broad money (M3)	499.0	480.6	494.8	501.8	521.4	4.5	8.5
Currency in circulation	77.0	68.6	72.8	75.3	81.1	5.3	18.3
Deposits	422.0	412.0	422.0	426.5	440.3	4.3	6.9
of which: Transferable	181.6	181.8	198.5	196.2	204.8	12.8	12.7
Nontransferable	143.4	135.5	131.5	139.0	140.3	-2.1	3.6
Foreign currency	97.0	94.8	92.0	91.3	95.1	-2.0	0.3

Source: Statistics Department

However, compared to projected increase in Money supply, current monetary developments are still moderate as Broad Money has increased by only 4.5% between end December 2009 and end June 2010, against 8.4% projected in the Monetary Program. The current moderate trend is mainly explained by a low increase in outstanding credit to private sector, estimated at only 3.2% between

end December 2009 and end June 2010 against 6.7% projected.

The growth in outstanding credit to private sector has been only 1.5% in May 2010, although a significant improvement in June was recorded, leading to an increase estimated at 3.2% compared to end December 2009 level.

However, the new authorized loans by banks during this year 2010 indicate a strong recovery process from the liquidity crunch experienced in 2009. During the second Quarter 2010, the new authorized loans stood at RWF 69.33 billion by end June 2010, against RWF 52.6 billion authorized during the previous Quarter, that is a total of RWF 121.93 billion authorized during the first half of the year. This represents an increase of 45.5% compared with the same period of 2009 where an amount of RWF 83.8 billion was authorized.

The moderate growth of the outstanding credit to private sector while the volume of new authorized loans significantly increased simply reflect simultaneous efforts by banks in recovering non-performing loans distributed before 2009. Preliminary statistics at end June 2010 indicate that the size of non-performing loans is coming down in 2010.

Fig 4: New authorized loans by banks to Private sector (in RWF billion)



Source: Financial Stability Directorate, Credit Reference Bureau.

2. Money demand

Currency in circulation recorded an overall increase of 5.3% between December 2009 and June 2010, following important decline (-10.9%) during the first quarter and a strong growth during the second (+18.3%). This increase of the currency in circulation is boosted by an important coffee campaign financing, good harvest in food production which is usually followed by improvement in trade activities requiring more use of cash and a recovery in construction activities as well.

With regards to banking system deposits, they increased by 4.3% during the first half of 2010 driven by demand deposits (transferable), while term deposits (Non-transferable) and Foreign Currency deposits both declined by around 2.0%.

3. Interest rates developments.

In line with the last KRR reviews and short term liquidity developments in the banking system, the interest rates on Money Market have been significantly fluctuating during the second quarter 2010. From 4.4% in March, average Repo rate fell to 3.4% in April before increasing to 3.9% and in 5.2% respectively in May and June following an increase in BNR mopping up operations to regulate the banking system liquidity. Average Treasury bills rate declined from 8.4% in March to 7.2% in June 2010. In addition, the interbank rate has been declining

since the beginning of this year from 7.1% in January to 6.1% in May 2010, before a slight increase to 6.6% in June 2010.

This trend in T-bills and interbank interest rates is consistent with BNR’s expectations as a response to the reduction of its policy rate from 9% to 7.5% on 18th December 2009 and to 7% on 24th March 2010.

However, regarding the commercial bank’s rates, the impact of the KRR reviews is not yet significant on lending rates, while the deposit rates considerably declined. Following the important increase in 2009 in view of attracting deposits to reach 9.4% in June, the average deposit rate has been declining and stood at 8.5% in December and 6.9% in June 2010. But, on the other side, the average lending interest rate remained high at 16-17% despite the two consecutive reductions of the KRR in December 2009 and March 2010. The delay to adjust lending rates is a normal precautionary behavior in the banking system, after a period of liquidity crisis.

Based on the current macroeconomic environment showing a recovery, the BNR expects a gradual decrease in lending rate. As inflation rate in Rwanda remains low from 5.7% to 5.0% between December 2009 and June 2010, banks real deposit and lending rates have been maintained positive.

Table 4: Interest rates (in percentage)

	2009					2010					
	Jan	Mar	June	Sept	Dec	Jan	Feb	Mar	Apr	May	June
BNR Policy Rates											
Key Repo rate	8.0	9.0	9.0	9.0	9.0	7.5	7.5	7.5	7.0	7.0	7.0
Discount rate	12.8	12.0	12.0	12.5	12.5	11.5	11.5	11.5	11.0	11.0	11.0
Money Market rates											
Repo rate	7.3	5.0	5.5	4.3	4.4	5.3	4.6	4.4	3.5	3.9	5.2
Refinancing Facility rate	-	-	-	10.5	10.5	-	-	9.0	9.2	-	9.2
Treasury Bills rate	7.6	7.6	9.1	9.9	7.7	9.1	8.8	8.4	7.9	7.6	7.2
Commercial Banks rates											
Interbank rate	8.7	7.5	6.4	5.9	4.9	7.1	7.3	6.8	6.3	6.1	6.6
Deposit rate	5.5	6.6	9.4	8.9	8.5	7.6	7.1	7.2	6.9	6.9	6.9
Lending rate	16.33	15.74	16.89	17.56	15.8	17.3	16.1	16.9	16.6	16.7	16.8

Source: Statistics Department

II.5 ROOM FOR INCREASING CREDIT TO PRIVATE SECTOR:

Moderate money supply during the first half of 2010 and continuing improvement in liquidity conditions give additional room to increase the credit to private sector.

1. Monetary Program space

Current Monetary developments remained below the 2010 Monetary Program projections, giving the monetary policy additional room to stimulate further credit expansion during the third quarter 2010.

Table 5: Projections of Key monetary aggregates for the 2nd half of 2010 (in percentage)

	Quarterly % change					
	March		June		Sept	Dec.
	Act	Proj	Act	Proj	Proj	Proj
Net Foreign Assets	-7.7	-6.6	18.3	9.8	-2.0	1.4
Net domestic assets	27.5	25.0	-36.3	11.1	31.9	-8.6
Domestic credit	16.4	17.6	-15.7	-7.7	25.4	-6.9
Government (net)	-20.4	-20.2	-39.3	-29.7	11.2	-18.8
Public nongovernment	0.0	0.0	-89.5	0.0	0.0	0.0
Public enterprises	-6.7	-0.7	0.0	0.0	0.0	0.0
Private sector	0.8	2.6	2.4	3.9	11.2	1.0
Other items (net; asset +)	11.6	12.5	-5.6	-21.2	18.9	-5.0
Broad money	-3.7	-1.5	8.5	10.1	5.0	-1.2
Currency in circulation	-10.9	-9.7	18.2	24.4	3.5	-9.3
Deposits	-2.4	-0.1	6.9	7.9	5.3	0.2

Source: Research and Policy Analysis Department

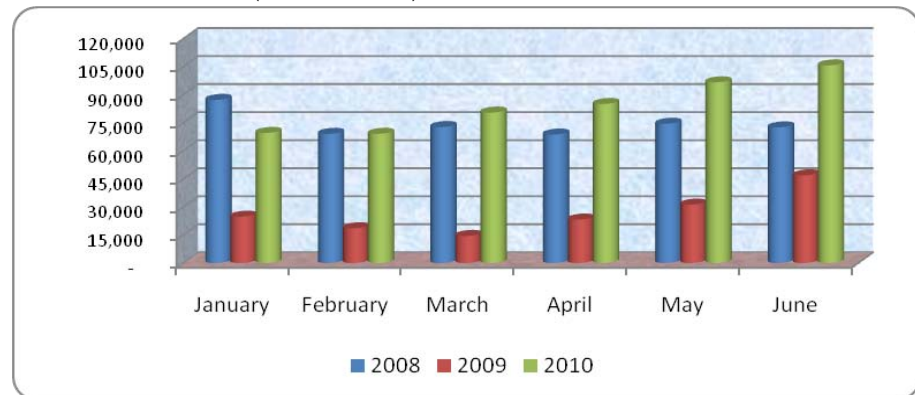
Strong acceleration in deposit growth is seemingly able to accommodate sustained growth of bank credit during the third quarter. Also, taking into account that the increase in outstanding credit to private sector in the first and second quarter was significantly less than projected, this gives additional room to credit expansion in the third quarter 2010. Thus, during the third quarter, the increase in outstanding credit could be higher than 11.2% projected, as long as the liquidity conditions remain comfortable and monetary targets achieved.

2. Liquidity conditions

Recent changes in banking system liquidity level show a continuing improvement as evidenced by the dynamism in Money and Interbank Market activity. Excess liquidity in the banking system considerably increased during the period after the global financial crisis. In 2010, the banking system liquidity situation considerably improved and significant excess reserves emerged, so that the BNR regularly intervenes to absorb excess liquidity in order to keep the Monetary aggregates consistent with quantitative targets defined by the 2010 Monetary Program.

The net BNR credit to commercial banks resulting from mopping up operations of excess liquidity has been increasing during the whole first half of 2010. It has been fluctuating between RWF 54 billion in December 2009 and RWF 58.8 billion as of June 30, 2010, a very high level which should give confidence to banks to more extend their lending operations to the economy.

Fig 5: Outstanding Net borrowing by BNR and Government interventions on Money Market (In RWF million)



Source: Financial Markets Department

III. MONETARY POLICY DIRECTION FOR THE 3RD QUARTER 2010

BNR POLICY

RATE:

*Maintained at 7%
for the third quarter
2010.*

Current monetary developments are still moderate and are not viewed as jeopardizing the achievement of price stability over the short term as inflation in June 2010 reached 5.0%. Current important short term liquidity would be maintained in third Quarter 2010, giving enough confidence to banks for increasing lending activity.

For the second Quarter 2010, BNR reduced its KRR from 7.5% to 7.0% and this has significantly contributed to the increase of new authorized loans by banks. The lending activity increased as expected while, at the same time, the liquidity remained at comfortable levels. Considering the sustained improvement in liquidity followed by a decline in Money Market interest rates, while the inflation is maintained at a low level and projected at around 6.0% by September 2010, the current economic environment gives room to the BNR to continue to give a stimulating signal to the credit market by consistently maintaining its policy rate.

Therefore, the MPC meeting held on 16th July, 2010 decided to maintain unchanged the BNR policy rate at 7.0% for the third Quarter 2010. In this context, interbank interest rates' corridor would remain]5.0% - 9.0%[and the discount rate at 11.0%.

Furthermore, BNR will closely monitor the behavior of the RWF exchange rate versus the currencies of trade partners to maintain stable the REER during the third quarter 2010.

*

*

*