



Banque Nationale du Rwanda National Bank of Rwanda

MONETARY POLICY COMMITTEE

Press release

CENTRAL BANK POLICY RATE REVIEW: ORIENTATION
FOR THE SECOND QUARTER 2010

March, 2010

OVERVIEW

To address the issue of liquidity crunch occurred earlier 2009, different measures put in place by BNR and Government improved significantly the banking system liquidity conditions and its lending capacity. The money markets operations are enhanced and credit to private sector distribution is progressively recovering. However, new credits distribution and allocation by economic activities have to be sufficiently boosted by an accommodating monetary policy.

In the current context of low inflation observed since the second half of 2009 with expectations to maintain this trend in short term perspectives; the BNR has sufficient room to enhance its proactive Monetary Policy with the objective to further stimulate banking system credit distribution to private sector, necessary for achieving projected economic growth in 2010.

The National Bank of Rwanda policy rate, the Key Repo Rate (KRR), constitutes today one of important tools for liquidity management. While it is the median of the interbank interest rates corridor, the KRR is used as the maximum rate to mop up excess of liquidity and minimum rate to inject additional liquidity. Therefore, the KRR and its movements depend on changes in short term banking system liquidity and the Central Bank target on reserve money.

Consequently, it is necessary for the Central Bank to review regularly the KRR in order to keep coherent the banking system liquidity conditions and the need for the economic financing. Following the Monetary Policy Committee decision made on 18th December 2009, this review has to be made on quarterly basis. The last review has been made on the 18th December 2009 and the KRR reduced from 9.0% to 7.5%, according to prevailing liquidity conditions, inflation trend and need for economic financing for the first Quarter 2010.

For the 2nd Quarter, following an assessment of the current developments in key economic fundamentals of Rwanda, the Monetary Policy Committee decided to proceed by a new reduction in the KRR from 7.5% to 7%. This adjustment is coherent with developments in banking liquidity conditions and dynamism in the economy expected for the 2nd Quarter 2010.

I. CURRENT ECONOMIC PERFORMANCE

I.1 Real Sector:

Sustained performance of agriculture and signs of recovery in non agriculture activities

From the last quarter of 2009, Rwandan economy is on recovering process boosted by better international economic environment, continuing agriculture sector performances and improvement in banking system liquidity conditions.

The good performance of Agriculture Sector observed during the last 2 years is continuing in 2010, boosted by the Government Crop Intensification Program and conducive weather conditions. The overall production in cereals increased by 25.15% mainly due to the high increase in the production of maize (+51.11%), and wheat (+10.59%). The total production of roots and tubers experienced better performance with 17.39% mainly attributed to Irish potatoes (+25.8%) and cassava (+20.0%) due to continuous expansion in the land area under cultivation and, for cassava, to the adoption of new cassava trees (cultivars) that are resistant to the Cassava Mosaic Disease (CMD). The production of bananas decreased by 8.8% compared to the same period of 2009A and this was a result of uprooting non-productive banana plantations that were heavily infected while maintaining those that are productive.

Concerning export crops, while coffee production decreased by 56.9% during the first quarter 2010 as the 2010 harvest season was not yet started, OCIR CAFE projects to reach 26000 tons in 2010 against 16000 tons in 2009, which is a strong increase of 62.5%. This performance would be attributed to some combined key factors such as more use of fertilizers, importance of new plantations and favorable coffee harvest cycle. Concerning Tea, during the first quarter compared to the same period of 2009, its production experienced a strong increase of 36.1%, from 5173.53 to 7040.36 tons. This performance can be attributed to the privatization of some tea factories which led to improvement of their productivity.

For non-agriculture activities, as evidenced by the Composite Indicator of Economic Activities (CIEA) in industry and services of the first quarter 2010, different activities are showing positive signs of recovering from weak performances experienced in 2009, mainly due to credit squeeze and unfavorable international economic environment. However, the improvement is still quite moderate as the nominal increase in CIEA is estimated at 1.34%; 4.11% and 2.10% in January, February and March 2010 respectively on annual basis. This slow recovery process indicates the need for further stimulus for economic activities.

II.MONEY SECTOR DEVELOPMENTS

II.1 Inflation:

*Low level
expected to be
maintained in
short term*

Rwanda is continuing to experience low inflation mainly driven by good food production, stable RWF exchange rate, and limited increase in monetary aggregates. During the first quarter of 2010, inflation increased by 0.4% in March 2010 against -0.71% in January and -0.45% in February.

The slight rise in inflationary pressures was attributed to seasonal factor and were driven by prices for alcoholic beverages and tobacco (+3.43%), food and non alcoholic beverages (+1.02%) and restaurants and hotels (+0.76%). On annual basis, inflation stayed moderate standing at 2.05% in March 2010, after 2.46% and 4.54% respectively in February and January 2010.

With regard to the origin, imported monthly inflation increased slightly by 0.16% in March following -0.12% in February and + 0.19% in January 2010. The same trend was kept by the annual imported inflation which became negative (-0.38%) coming from +0.13% and +1.2% in February and January respectively. Local goods index though remained positive has been declining on annual basis. On monthly basis, local inflation became positive in March reaching 0.45% against 2.7% on annual basis. Taking into consideration actual trend in inflation, the performance in food production, the main stabilizer of inflation in Rwanda, as well as the stable RWF against USD, the most used hard currency for imports, the inflation is forecasted to move in a range of 2.69% to 3.8% from April to June 2010.

II.2. Money supply:

*Recovery in credit
Distribution process
but need for more
improvement*

By end March 2010, Monetary aggregates developments show a net decline in Broad Money of 3.8% compared to end December 2009 level against 7.7% during the same period of last year. As for the Broad Money counterparts, net foreign assets dropped by 7.7% during the same period due to low budget support disbursements during the first quarter 2010. Consequently, Banking system Net Credit to Government grew by 12%, although it remained stable between February and March, when Government expenditures have been fully offset by its revenues.

During the first quarter, Credit to the economy shows some signs of recovery as credit to private sector recorded a slight increase of 0.7% by end March 2010 compared to end December 2009. However, the improvement was much significant in March as it increased by 1.6% compared to end February level.

It is worth to notice that the low increase in outstanding credit to private sector is due to the importance of loan recovery in the banking system. Indeed, although new distributed loans are significantly higher than last year, they are almost offset by reimbursements being recorded.

During the first quarter of 2010, new authorized loans by commercial banks to private sector stood at RWF 46.5 billion against 39.7 billion in the same period of 2009, which is an increase of 14.6%. This increase is showing a significant improvement in credit market, although banks enhanced the risk management, leading to tightened credit conditions.

Since June 2008 the banking liquidity in Rwanda has started to decrease in such way that in January 2009 National Bank of Rwanda was obliged to inject liquidity in the banking system. Starting from the second half of 2009, the volume of the BNR interventions on the money market to mop up liquidity has increasingly gone up reflecting the level of excess liquidity in the banking system.

II.3 Liquidity developments:

Building up of short term liquidity

The net total borrowing by BNR from commercial banks to absorb short term excess liquidity increased from 0 at end March 2009 to 53.0 billion by end March 2010, a level which should give confidence to banks to extend their lending operations to the economy with minimum risk of liquidity shortage.

Moreover, interbank money market continued to be very dynamic Facilitating the distribution of available liquidity within the banking system. The volume of interbank transactions by end March 2010 was RWF 168.5 billions against RWF 125. 5 billions recorded last quarter 2009, which is an increase of 34.3%.

III.3 Interest rates:

Declining short term rates

With the consolidation of comfortable short term liquidity in the banking system since the second half of 2009, money market interest rates have been on a downward trend. The average Repo rate fell from 7.3% in January 2009 to 4.4% in December 2009 and to 5.3% and 4.4% in January and March 2010 respectively.

On Interbank Market, it appeared that starting from end January 2010 interbank rate is below the floor of the interbank corridor set, moving around 5.2%.

Regarding the credit market, banks increased deposit rate in view of attracting deposits since 2nd Quarter 2009 where it was fluctuating between 7.67% and 9.6%. However, it has been declining and reduced to 7.12% in March 2010 from 8.07% in December 2009. On the other side, lending interest rate continued to rise and reached 16.7% in March 2010 from 16.1% the previous month after a level of 15.8% in December 2009 and 17.3% in January 2010.

III. SHORT TERM PERSPECTIVES AND POLICY ORIENTATION

III.1 Short term liquidity:

Current important short term liquidity would be maintained in second Quarter 2010

Current monetary aggregates increase is still moderate and is not viewed as jeopardizing the achievement of price stability over the short term as March 2010 inflation reached 2.0%. Current comfortable short term liquidity would be maintained in second Quarter 2010, giving enough confidence to banks for increasing the lending to the economy without fear to fall in treasury shortfall.

For the first Quarter 2010, BNR reduced its KRR from 9% to 7.5% and decided to use effectively the KRR as the maximum rate at which the BNR mops up liquidity from the banking system and as the minimum rate for injecting liquidity. The discount rate was set at the KRR+4%. This reduction of the cost of funds for commercial banks was expected to be transmitted in credit markets by lowering bank's lending rates.

III.3 BNR Policy Rate:

The Key Repo Rate is reduced from 7.5% to 7.0% for the second quarter 2010

However, the bank's lending rates didn't reduce as expected while the liquidity conditions continue to improve. Considering the continued increase in short term liquidity followed by a clear declining trend in Money Market interest rates, while the inflation is maintained at a low level and projected at 3.8% by June 2010, current environment gives room to the BNR to pursue the policy of stimulating the credit market by reviewing downward its Policy rate, while keeping interest rates positive in real terms.

Considering the above mentioned developments both in economic activities and liquidity conditions, the Monetary Policy Committee, in its quarterly ordinary meeting held on 24th March 2010 decided to review downward the KRR from 7.5% to 7.0%, to be in force during the second Quarter 2010.

Therefore, Interbank interest rates' corridor became] 5.0% - 9.0% [and the discount rate declines to 11.0%. This measure aims to further stimulate banks to increase lending to the private sector. Indeed, while the BNR monetary policy ultimate objective remains to maintain the price stability, this new reduction of the KRR will further stimulate banks to improve their lending conditions, necessary for speeding up the

current slow economic recovery, from weak performance recorded in 2009.

The current downward KRR review does not jeopardize the domestic savings mobilization strategy, as the interest rates are kept positive in real terms while continuing to lower the cost of funds for the banking system.

In view of this decision, the Central Bank expects an improvement in the credit conditions as the cost of funds declines while the banking liquidity remains sufficient. Indeed, this decision is of great benefit to both the banking system and private sector.
