BANKI NKURU Y' U RWANDA– NATIONAL BANK OF RWANDA- BANQUE NATIONALE DU RWANDA

Monetary Policy and Financial Stability Statement

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TABLE OF CONTENTS

MONETARY POLICY AND FINANCIAL STABILITY STATEMENT

I. INTRODUCTION

This statement by the Governor of National Bank of Rwanda is essentially a mid-term review of the implementation of the monetary and financial sector development program of the year 2008, presented on 21st February 2008.

After a brief overview of the international and national economic environments during the first half of 2008, an assessment is done on the implementation of monetary policy orientation and financial sector development plan during the first six months of this year.

Secondly, the booklet presents prospects for monetary and exchange rate policies as well as the expected achievements in the financial sector development for the second half of the year.

This statement should be of great interest for the Central Bank's partners in Rwanda's economic and financial management and the private sector who need to have a good understanding of the economic and financial environment in which they operate. It also interests university institutions, especially for their research activities.

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II. ECONOMIC OUTLOOK IN 2008

II.1. International economic environment

The global economic expansion has engaged in a slow trend following a major financial crisis especially in the advanced economies, particularly in the United States, where turbulences in the housing market continue to exacerbate financial stress. The emerging and developing economies have so far been less affected by financial market developments and have continued to grow at a rapid pace, led by China and India, although activity is beginning to slow down in some countries.

In Africa, the economic growth rate was registered at 5.8% at the end of December 2007, and it is projected to 6.2% at the end 2008. These performances are the result of a combination of factors such as the significant appreciation of the terms of trade for the non-energy commodities exporters and the rise of the foreign assistance in favor of certain countries. Moreover, the contribution to the growth of the oil-producer countries was very significant.

At the same time, the world is experiencing one of the worst inflationary shocks in the last 60 years. The inflation developments in many countries were largely affected by increases in prices of food and oil in the global markets leading to change in relative prices. Oil prices started rising sharply at the beginning of the decade, and has currently climbed to record-high levels. In New York market, the

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oil price rose by 43%, from USD 99.29/barell in December 2007 to USD142/barell in June 2008.

While consumer nations have suggested that a higher supply of oil by OPEC countries would help to calm oil markets, in accordance with a high demand, OPEC member countries have repeatedly blamed factors including speculation, a weak dollar and political instability. Some sources indicate that a recent 25 percent rise in the price of oil had nothing to do with underlying supply and demand but it's a pure speculation. It can be noted for example that the number of transactions involving oil futures on the New York Mercantile Exchange has almost tripled from 2004 to May 2008. These conflicting positions indicate that increase in oil price can continue for long.

More recently, we have seen an impressive increase in food prices with serious inflationary effects in many countries. Food prices have reached in some cases their highest levels in history. This is mainly due to increased demand from emerging markets (especially China, India and oil-exporting countries) and the use of grains in biofuels production.

In the financial market, the Federal Reserve has been cutting interest rates successively by 125 basis points in January and twice by 25 basis points in March

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and April 2008, bringing the Fed funds rate to 2% in June. The three months interest rates followed the same momentum and significantly dropped since end 2007. While they set at 4.7% in the last quarter 2007, they fell to 2.69% during the first quarter 2008 and slightly picked up to 2.78% in the second quarter of 2008.

In the context of strong inflationary pressures, interest rates in other markets followed the same trend as in US, except in Japan.

On the foreign exchange market, the American dollar continued to depreciate compared to the euro in the first quarter 2008. On quarterly average, euro was equivalent to 1.58USD. However, as the American economy strengthened in the second quarter, the trend was reversed and the dollar recorded a slight appreciation as the Euro was traded at 1.56$US. Vis-à-vis the Japanese yen, the dollar would appreciate by 3.4% standing at an average of 103 yens at the end of the second quarter and by 0.5% in comparison with the GDP.

II.2. National Economic Environment

The real sector of the economy recorded good performance in the first half of 2008. According to MINAGRI, the agriculture sector improved following government policies to increase the availability, accessibility and affordability of fertilizer to farmers, on the one hand, and to use certified seed, on the other hand.

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Table 1: Food crop production (I tonns)

	2005	2006	2007	2008	% Change
Total crops	**7293028**	**7137071**	**6905486**	**8234188**	**-**
Annual % Change	**19.6**	**-2.1**	**-3.2**	**19.2**	**-**
Cereals	**409358**	**361674**	**355550**	**461163**	**29.7**
Sorghum	227972	187380	166769	144418	-13.4
Maize	97251	91813	102447	166853	62.9
Wheat	21942	19549	24633	67868	175.5
Paddy	62194	62932	61701	82024	32.9
Pulses	**252304**	**333743**	**404827**	**392305**	**-3.1**
Beans	199648	283387	331107	308563	-6.8
Peas	18854	14198	16649	17150	3.0
Groundnuts	10099	9020	16118	24472	51.8
Soya	23703	27138	40953	42120	2.8
Roots & Tubers	**3118051**	**2930095**	**2543501**	**3815125**	**50.0**
Irish potatoes	1314052	1285149	769912	1161943	50.9
Sweet potatoes	885468	777034	845132	826440	-2.2
Taro	136895	125387	151513	144919	-4.4
Cassava	781637	742525	776944	1681823	116.5
Bananas	**2813075**	**2653548**	**2698176**	**2603949**	**-3.5**
Market gardening & fruits	**700240**	**858011**	**903432**	**961646**	**6.4**

Source: Minagri

Comparing with 2007, the production (MT) of roots and tubers, fruits, vegetables and cereals for 2008 has improved significantly, thanks to ongoing green revolution program. This program explains the good performances in some crops like roots and tubers (+50%), as well as cereals, particularly wheat (+175.5%) and maize (+62.9%).

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In non agriculture sectors, there was a noticeable improvement essentially in the industry and service sectors. The total turnovers achieved by large companies reached RWF 504.23 billion compared with RWF 359.25 billion realized in the same period of year 2007, which represents an increase of 40.36%. The industrial and services sectors activities grew their turnover by 38.93% and 40.95% respectively. The good performance in industrial sector is essentially due to increasing activity of construction and public works sector 45.17% and manufacturing sector 42.68%.

In the service sector, general trade, importers and distributors of petroleum products, as well as the banks and insurances companies recorded a turnover growth of 38.19%, 53.26% and 45.54% respectively, whereas large telecommunication companies have achieved a growth of 23.94% of their turnovers compared with the corresponding period in 2007.

During the first semester of 2008, imports rose by 56% in value and 4.3% in volume when we compared with the same period in 2007. The higher increase in value is mainly due to the increase in import prices, especially for equipment goods (68.2%), consumption goods (56%), fuel (31.3%) and intermediate goods (24.6%). The lower growth of imports' volume (4.3%) is essentially due to the decrease by 30.1% of foods import volume. Import of capital goods, intermediate goods and energy increased respectively by 16.4%, 27.4% and 8.1%.

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Table 2: Imports by end June 2008

Imports	2008		2007		Variation	
	By end June		By end June			
	Value	Volume	value	Volume	value	Volume
Capital Goods	160,8	16 980	82,1	14 593	95,8%	16,4%
Intermediate Goods	132,9	160 371	83,7	125 883	58,8%	27,4%
Energy Products	73,0	92 128	51,4	85 188	42,0%	8,1%
Consummer Goods	118,7	118 597	93,8	146 279,6	26,5%	-18,9%
Food Products	38,4	82 604	35,4	118 148	8,5%	-30,1%
Other Goods	80,3	35 993	58,5	28 132	37,3%	27,9%
Total	**485,38**	**388 077**	**311,1**	**371 943**	**56,0%**	**4,3%**

Source: Foreign exchange inspection and balance of payment

In the same period, exports value increased by 53.5%, compared with the same period in 2007, due to the good performance of mining, coffee and tea sectors which represented respectively 39.8%, 9.8% and 18.3% of the total exports value.

Table 3: Exports by end June 2008

Exports	2008 By end June		2007 By end June		Variation	
	Value	Volume	value	Volume	value	Volume
Coffee	12,0	4 916	8,1	3 654	48,2%	34,5%
Tea	22,4	10 867	17,1	10 164	31,1%	6,9%
Cassiterite (Tins)	22,3	2 277	13,9	2 162	59,9%	5,3%
Coltan	19,5	570	7,1	413,6	174,5%	37,8%
Wolfram	6,8	905	10,9	1 499	-37,4%	-39,6%
Hides And Skins	1,6	951	1,8	873	-8,7%	9,0%
Pyrethrium	0,4	3,3	1,8	30	-78,7%	-89,0%
Reexports	19,4	7 611	13,3	9 625	46,3%	-20,9%
Other Products	17,7	36 455	5,6	9 564	217,2%	284,4%
Total	122,12	64 554	79,57	16 394	53,5%	70,3%

Source: Foreign Exchange Inspection and balance of Payment Department

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MONETARY POLICY AND FINANCIAL STABILITY STATEMENT

According to provisional data, total Government expenditure amounted to Rwf 267.4 billion at the end of the first semester 2008, close to the target of Rwf 268.1 billion for the period. The performance of the same period in the previous year was Rwf 225.6 billion; this is an increase of 18.5%.

In particular, capital spending has taken up big momentum, arising at Rwf 99.2 billion slightly above the target of Rwf 95.6 billion; this category of public expenditure amounted to RWF80.8 billion at the end of the same period of 2007, thus the increase was 23% in 2008.

On the revenue side, tax collection performed well and external aid to support government program has been increasing both budgetary and projects support ($313.4 million in 2008 compared with $240.3 million in 2007). The tax revenue amounted to Rwf 161.1 billion, far beyond the target of Rwf 143.9 billion; the performance for the corresponding period of 2007 was Rwf 124.3 billion.

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III. MONETARY DEVELOPMENTS IN FIRST SEMESTER 2008

III.1. Inflation

Rwanda experienced high inflationary pressures during the first half of 2008. The change of the overall price index as of end June 2008 is 13.1% compared to December 2007, against 4.5% in the corresponding period of 2007. The change in the index of locally produced goods and services was 12.4%, while the increase for imported goods was 15.8%. The imported inflation is mainly attributed to oil prices and food prices particularly cereals, cooking oil, fish and sugar. Other items fuelling inflation are alcoholic beverages, transport and education. It's the first time for several years that imported inflation has been so much significant in Rwanda; indeed, as already mentioned; imported inflation had decreased by 1% during the first half 2007.

It is important to underscore that the cost imported raw materials for local industries recorded a significant increase at the same time, which affected almost all locally produced goods by main local manufactures. Compared to the same period of 2007, the unit value of raw materials for these industries increased by around 24.6% during the first half of 2008.

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Table 4: Inflation in 2008 by categories and origin (% change)

Categories	Weights	Annual change (June 07- June 08)			Semester 1, 2008 (Dec 07- June 08)		
		Global	Local	Imported	Global	Local	Imported
1. Food and non-alcoholic beverages	3 709	19.5	14.8	34.8	16.3	13.6	25.7
2. Alcoholic beverages and tobacco	221	13.5	13.1	14.1	13.4	12.2	13.2
3. Clothing and footwear	500	7.2	10.7	5.2	3.3	1.8	4.0
4. Housing, water, electricity, gas and other fuels	1,579	12.2	10.9	39.2	11.5	10.8	26.1
5. Furnishing, household equipment and routine household maintenance	764	19.4	24.8	5.6	17.2	21.4	5.8
6. Health	708	8.9	7.7	8.7	7.3	7.5	5.6
7. Transport	987	21.2	19.7	24.2	14.5	13.4	16.6
8. Communication	37	-10.4	-12.5	1.4	-13.6	-15.1	1.2
9. Recreation and culture	206	0.7	3.7	0.8	-0.2	0.5	0.5
10. Education	432	12.6	12.2	-	14.5	13.9	-
11. Restaurants and hotels	273	7.1	6.9	-	14.5	14.2	-
12. Miscellaneous goods and services	584	9.8	4.6	16.0	5.4	4.7	6.2
Total	**10 000**	**15.4**	**13.5**	**21.9**	**13.1**	**12.4**	**15.8**

Source: NBR, Research Department

It is worth to underscore the following facts which clarify the origin and nature of the inflationary pressures the country is facing:

1. The national economy is facing two crucial external shocks related to the rise in oil and food prices, particularly for cereals. This is a world phenomenon which related to the rise of the overall demand for the consumption and production of the bio-fuels in the emerging and developed countries.

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2. The increasing domestic and sub-regional aggregate demand, as well as the substitution effect, are also behind the inflationary pressures the country continues to face. Despite the improvement in agriculture production, a new phenomenon was recently noticed whereby a bulk of food products particularly beans, potatoes and vegetables were by some time exported to the neighbouring countries, creating a situation of shortage on local markets. The increasing prices on imported products has been creating pressure on local products by the substitution effect, exacerbating the inflation. In addition, some speculative behaviour in domestic trade system (intermediate cooperatives) has been contributing to increase inflation, before such distortions were removed in May 2008 by the Government.

3. While the aggregate demand is increasing, some reforms in the environment sector have a short term negative impact on supply of some products. It is the case with meat for which the price has been increasing significantly due to a progressive fall in livestock size, following the restrictive measures to ban cattle breeding outside farms. In addition, the current livestock policy is focussing on promoting dairy cattle than beef cattle, as this is economically much more profitable for small farmers.

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4. The increasing in housing rent constitutes also a big challenge for householders. This increase resulted from a significant increase in prices of construction materials imported or produced locally. It should be noted that the rent experienced a higher rise at the beginning of 2007 and 2008, after a long period of stability.

5. School fees again had increased at the beginning of this year, a situation which had been recorded for the past few years. The rise in the school fees significantly contributed in overall inflation in January 2008. The private schools at all levels are the most responsible for this increase which resulted from the competition to attract and retain the best teachers, whereby the majority of them reviewed the fees upward to be able to increase wages and accommodate other operating expenses.

III.2. Monetary Aggregates, Liquidity Management And Interest Rates

By end of the first half of 2008, extended broad money increased by 4.4% against an increase of 6.5% recorded during the same period of 2007. This development is a result of a moderate increase in net foreign assets (15 %) against a strong decrease in net domestic assets (-46.8%), following a strong decline in net credit to Government (-94.6) and an increase in credit to private sector (13.8 %).

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The strong decrease in net credit to Government observed in the first half of 2008 is explained by the high volume of external disbursements. Indeed, Government budget and projects supports amounted to USD 313.4 million against USD 240.34 recorded during the first semester of 2007.

However net foreign assets recorded a moderate increase following intensive sales of foreign exchange by the NBR to commercial banks; these sales totaled USD 234.8 million during the first half of the year, which represents an increase of 51.6% in comparison with the same period of 2007.

The moderate increase in broad money is also explained by BNR's open market operations and by significant transfers abroad by local investors. The credit to private sector rose by 13.8%; this rate was 9% at the same period of 2007. Commerce, restaurants and hotels sector leads with 29.1% of total credit allocated, closely followed by the construction sector with 28.2%.

As to the demand for money, one would mention that currency in circulation increased by 14.6%, while deposits increased by 2.6%. The growth of currency in circulation (14.6%) associated with a low growth of M2 (4.4%) indicates a

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preference for people to hold cash, as a consequence of increasing in inflation and seasonality factors (coffee campaign).

Table 3: Broad money (in Rwf billion)

	2007				2008					
	Mar	**June**	**Sept**	**Dec.**	**Jan.**	**Feb.**	**Mar**	**Apr**	**May**	**June**
Net foreign assets	**261.2**	**347.7**	**319.4**	**351.6**	**350.6**	**326.4**	**367.2**	**358.2**	**371,8**	**405,0**
Net domestic assets	**52.0**	**-5.9**	**54.8**	**74.1**	**66.9**	**94.5**	**61**	**83.8**	**77,3**	**39,4**
Domestic credit	164.1	106.2	176.1	183.7	183.6	201.3	171.3	198	190,1	148,4
Net credit to Government	-59.9	-125.6	-73.8	-75.4	-75.8	-60.1	-98.7	-81.2	-101,9	-146,7
Autonomous agencies	-0.5	-0.5	-1.8	-1.3	-0.9	-0.9	-0.2	-0.3	-0.3	-0,5
Public enterprises	2.0	1.7	1.9	1.8	1.5	1.4	1.4	1.4	5,6	1,3
Private Sector	222.5	230.5	249.8	258.6	258.7	260.9	268.8	278	286,7	294,3
Other items net	-112.1	-112	-121.3	-109.6	-116,70	-106.8	-110.4	-114.1	-112,8	-109.0
Broad Money	**313.2**	**341.8**	**374.2**	**425.7**	**417.5**	**420.9**	**428.2**	**442.1**	**449,1**	**444,4**
Currency in circulation	**47.2**	**51.7**	**52.8**	**63.2**	**61.1**	**59.7**	**61.3**	**65.4**	**67.5**	**72,4**
Deposits	**265.9**	**290.1**	**321.4**	**362.4**	**356.4**	**361.3**	**366.9**	**376.7**	**381,6**	**372.0**
On Which: Demand deposits	104.7	113.4	126.2	154.7	144.5	145.5	151.3	130.3	150,7	**147,1**
Time deposits	104.7	118.3	133.5	139.1	143	145.4	146	170.7	151,8	**145,1**
Foreign exchange deposits	56.6	58.5	61.7	68.6	68.9	70.3	69.6	75.7	79,1	**79,8**

Source: Research department

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MONETARY POLICY AND FINANCIAL STABILITY STATEMENT

The excess liquidity observed in the banking system during the year 2007 persisted during the first semester of 2008, but has been decreasing. To adjust this liquidity with monetary indicators such as defined in the annual program, the National Bank of Rwanda significantly mopped up excess liquidity through weekly auctions, the overnight facility, the issuance of Treasury bills coupled with sales of foreign exchange. During the first quarter 2008, Government bonds were issued for a total amount of RWF14.257 billion and helped to transform a significant portion of government debt into medium and long-term debt.

The NBR domestic debt reduced significantly from FRW 57.3 billions on 31/12/2007 to 33.2 billions on 31/07/08.The interest rates in the money market increased moderately compared to June 2007. The mopping-up rate has increased from 5.59 % in June 2007 to 6.79 % in June 2008. This is a result of NBR's operations in the money market to sterilize the excess liquidity in the banking system by selling foreign exchange and extending maturity for Government securities. The lending rates applied by the banks have been fluctuating around 16%, while the deposit rates and short terms T-bills rates have been pursuing their declining trend as shown in the following table.

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Table 6: Interest rate developments (in %)

	2007			2008	
	Jun	Sep	Dec	Mar	June
Mopping up rate	5.59	5.52	5.26	5.20	6.79
Interbank market rate	6.33	5.20	6.00	6.99	6.62
Discount rate	12.50	12.50	12.50	12.50	12.50
Weighted treasury bills rate	7.03	6.62	5.89	6.34	6.50
Deposit rate	7.65	7.35	6.77	5.69	6.05
Lending rate	16.03	15.84	16.10	15.59*	16.09*

Source: DMMF

III.3. Exchange rate developments

As in 2007, the Rwanda franc exchange rate was stable in the first half of 2008. A slight appreciation of 0.9% against the $US was observed between December 2007 and June 2008. The behaviour of the Rwanda franc was a bit different against the GBP and the EURO, as a depreciation of 0.4% against the GBP was recorded between December 2006 and June 2007, while a reverse trend with an appreciation of 3.3 % was observed between December 2007 and June 2008. In contrast, the Rwandan franc was weak against the EURO, as it depreciated by 0.7% between December 2006 and June 2007, and by 5.9% in the same period in 2008.

The stability of the Rwanda franc is a combined result of important inflows of foreign exchange stemming from external aid (budget and project supports),

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private transfers good performance of exports and the intervention policy of the Central Bank in the foreign exchange market.

By end of June 2008, the foreign exchange stock of the whole banking system amounted to Rwf 405 billion, while it was established at Rwf 347.7 billion in June 2007 that is an increase of 16.5 %.

On the inflow side, one should mention that the external aid recorded a significant increase in 2008 compared with 2007. The combined budget and project supports amounted to $US 240.2 million between December 2006 and June 2007 against $US 313.4 million in the same period in 2008. Its important to mention that there is a significant amount of projects support which doesn't transit on NBR accounts.

On the expenditure side, the huge increase in foreign exchange inflows was compensated by a strong upward trend in foreign exchange demand by Government and by private sector through commercial banks. The total sales of foreign exchange by the Central Bank to Government and commercial banks amounted to $US 234.8 million between December 2007 and June 2008 against $US 154.9 million in 2007 in the same period. This increase (51.6%) of sales of foreign exchange is a result of higher demand of foreign exchange and the

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economy's capacity to absorb growing inflows from scaling up of external assistance. The ratio expenditure-foreign aid inflow is estimated at 75 % by the end June 2008.

The big push in selling foreign exchange by the Central Bank in 2008 was a deliberate policy by NBR in the current circumstances where Rwanda benefited from a scaling up in external aid, because the only way to allow substantial increase in Government expenditure without jeopardizing macroeconomic stability is to allocate higher amount of foreign exchange to imports corresponding to more real resource transfer from the rest of the world to national economy. One consequence of such a policy would be an appreciation of the local currency that might lead to the so-called Dutch disease by hampering the flow of exports, but in the case of Rwanda, the appreciation of the local currency has been moderate and does not constitute a big issue so far.

However, it should be noted that, the bulk of the aid inflows has been disbursed in the first half of 2008 and much less additional budget support is expected in the second half of the year ($US 110 million).

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IV. FINANCIAL SYSTEM STABILITY

IV.1. Banking sector performance

In order to strengthen the banking financial stability, it was requested to all banks in December 2006 to increase the minimum share capital to RWF 5 billions at latest on 01/01/2008 and all banks respect this share capital requirement on 30/06/2008.

With consolidated assets of RWF 492 billions as of 30/06/2008 against RWF 467.5 billions of end December 2007, representing an increase of 5.2%, the Rwandan commercial banks activity, including “Banque Populaire du Rwanda, experienced a moderate increase. Although credit increased by 14.8% from RWF 279.9 to 321.2 billions, deposits increased by 3.9% only from RWF 363.2 billions to RWF 377.3 billions.

The NPL (non performing loan) size reduced substantially from 14.3 % end December 2007 to 8.8 % to end June 2008 and the solvency of the whole banking sector system has strengthened from 15.1 % to 16.6 %.

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With regard to the profitability, a net improvement is recorded in 2008 since the return on equity increased from 15.5% to 24.5% between December 2007 and June 2008.

Table 7: Banking stability indicators

				With BPR	Without BPR	With BPR	Without BPR
	31/06/07	**30/09/2007**	**31/12/2007**	**31/03/2008**	**30/03/2008**	**30/06/2008**	**30/06/2008**
Solvency ratio (in %)	13.30%	12.80%	16.60%	15.10%	18%	16.60%	15.70%
NPLs /total loan Gross (in %)	23.70%	23.70%	18.10%	12.20%	10.60%	12%	10.70%
NPls / total loans without agios (in%)	17.60%	19.60%	14.30%	7.40%	7.20%	7.60%	8.80%
Provisions /NPLs	81.30%	61%	58.80%	78.10%	76.1%	75.50%	71.3%
NPL Gross (in Billion)	46	47	40.9	35.9	30.9	38.5	34.1
Goss loans (in billion)	187.4	218.8	221.3	294.7	225.8	321.2	316.8
Net loans(in billion)	172.3	202.9	204.4	280.2		305.9	
Write off loans(in billion)				21.9	18.2	24.5	20.9
Goss loan with write off loans	187.4	218.8	221.3	316.6	313	345.7	342.2
ROA	3%	2.30%	1.50%	3.40%		3%	
ROE	7.90%	25.90%	15.50%	27.80%		24.50%	

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IV.2. Ongoing reforms in the banking sector

The Reform of the banking sector legal framework to comply with international standards has been accelerated with the publication of the new banking law. Several regulations have been updated to start implementation of this new law. We will mention those related to licensing, corporate governance, risk concentration, etc.

The restructuring of banks has accelerated as well with the acquisition of 75 % shares in BANCOR by ACCESS Bank from Nigeria, the acquisition of 40 % shares in COGEBANQUE by a group of three institutional investors (BIO, AFRICINVEST and SHORE CAPITAL).

The Banques Populaires Network has been transformed into a fully fledged commercial bank with the participation of a strategic investor RABOBANK, which currently holds 35% of BPR share capital. BRD has been recapitalized during the first quarter 2008, with the entry of a new shareholder, ADC (African Development Corporation) who acquired 25% of BRD share capital.

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With regard to the Bank of Kigali, the privatization process is still underway. Barclay bank has completed the due diligence. We are waiting for its technical and financial offer.

The BHR restructuring constitutes one of our priorities as well. Discussions are underway to transform this bank into a Mortgage Liquidity Facility to refinance primarily mortgage lenders (mainly commercial banks) operations. A MOU (memorandum of understanding) has been signed with IFC which expressed interest to support this reform.

IV.3. Opening new banks and branches

One of the main objectives of the financial sector development plan is to increase access to financial services by the population. This will be achieved by easing conditions to open bank accounts, expanding the banks branches network and licensing new banks. During the first half of 2008, three new bank branches were opened and a Kenyan bank got a license to operate in Rwanda. Furthermore, the transformation of Banque Populaire du Rwanda as a commercial bank has dramatically increased the number of bank branches offering a complete range of financial services to the population. The BPR network has currently 18 large branches, 111 sub-branches as well as an increasing number of points of sale over

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the country. The number of deposit accounts operated by commercial banking system (including BPR) increased by 2 % from 751.142 end December 2007 to 765.945 end June 2008, which represent roughly 17 % of adult population.

IV.4. Microfinance Sector

A law governing micro finance activities has been adopted by the Parliament and will be official published in the gazette together with its implementing regulations.

Two funds (capacity building fund and credit fund) were put in place for the training of directors and managers and refinancing activities that have a significant impact on poverty reduction. Decisions on such support are in the implementation phase and the New Association of microfinance institutions which will assist the Government in monitoring the programmes planned for the microfinance sector has set up its permanent office headed by an Executive Secretary.

Licensing new micro finance and off site and on site examinations has been an ongoing process. A number of big microfinance institutions operating in a network are conducting organisational and financial audits to improve the

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efficiency of their operations. These audits will provide strategic directions to be taken to develop these institutions.

The activity in the microfinance sector has been consolidating during the first half of 2008, with a 17 % increase in total assets, 23% increase in total deposits, 13 % increase in total outstanding volume of credit while the NPL (Non Performing Portfolio) has been declining by 3%.

Table 8: MFI consolidated financial position (in thousands of RWF)

Rubriques	31/12/2007	Variation en %	30/06/2008
Total assets	46 203	17	54 466
Deposits	28 556	23	35 272
Gross loans	28 617	13	32 266
NPLs	2 257	- 3	2 178
Provisions	1 541	-20	1 225
Net loans	27 075	14	31 040
Liquidity	9 780	27	12 455
Equity (Including subventions)	12 595	25	15 734

We would point out that CSS occupies respectively 63% of deposits and 57% of outstanding credits as at the end of June 2008 of microfinance sector. The beneficiaries of services rendered by MFIs amount with 639 thousand persons as at the end of June 2008 against 626 thousand as at December 2007, an increase of 2 % like for the banking sector.

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IV.3. Credit Reference Bureau

Compuscan which is a credit bureau from South Africa has accepted to operate in Rwanda. The project discussions with all stakeholders have been held and a partnership agreement is expected to be signed before the end of the year.

IV.4. Non banking financial sector regulation

Concerning the supervision of the financial system, the Bank's mandate was extended to include supervision of Non-bank Financial Institutions (Pension Funds, Insurance Companies, etc). To fulfil this new mission, the National Bank of Rwanda will develop the legal and regulatory framework for the sound functioning and supervision of Non-bank Financial Institutions.

To this effect, a law governing the organization and supervision of insurance industry was approved by the government and passed by the Parliament in July 2008.

IV.5. Capital market developments

The Capital Market Advisory Council was officially launched on January 31st, 2008 by H. E the President of the Republic. During the first semester of 2008, the government issued three Treasury bonds and another corporate bond was issued

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by the BCR bank to finance its mortgage portfolio. Secondary market operations have also taken place at the Rwanda OTC market (ROTC).
To date, the bond market transacted a total turnover of Rwf 281,800,000 and the two active debt securities so far are the two 2 years government Treasury bonds that will mature in 2010 and a three years treasury bond. There is also a 10 years BCR bond that will mature in 2017.

The results indicate a good opportunity to issue bonds with long duration in order to efficiently intermediate the use of increasing inflows the country is getting. The Bank pursues this program in collaboration with the Capital Market Advisory Council whose Executive Secretariat is already operational.

Table 9: Existing t-bonds issuances (Amount in billion)

Auction date	Amount of the Bond in RWF	Offered amount by Bidders	Retained amount by the Bank	Average price/RWF 100	Interest rate	Maturity
17/01/2008	5	7.550	5	99.951	8%	2 Years
31/01/2008	5	4.257	4.257	99.558	8%	2 Years
28/02/2008	5	7.227	5	99.444	8.25%	3 Years
31/01/2008	1 *	1.5	1	100.25	9%**	10 years

Source: DMMF
*: approved bond issuance program was RWF 5 billion to be issued in note series. The first note series was 1 Billion**.**
**: floating rate

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CMAC is also working on the development of an appropriate legal framework for the capital market in Rwanda. The process of appointing a consultant to draft the legal framework is supposed to be completed in the 3rd quarter of 2008.

A public education program is also underway. Its first pilot program targeted the media, C.E.O.s, managers and employees of leading institutions in the country, plus the Senate and Parliament, Cabinet ministers and Secretary Generals, opinion leaders in all 30 districts of the country plus members of the military, women associations and academic institutions. The mode of communication involved a series of seminars and workshops countrywide to sensitize the public on capital markets, especially in view of the upcoming IPOs. The next phase of public education is being recorded and will start being aired on TV and Radio to target the larger audience.

IV.6. Payment System Modernization

In line with the Payment Systems modernisation program, during the first half 2008, the National Payments Council (NPC) was put in place, the National Payment Systems law and the National Payment System Framework and Strategy were drafted and are ready to be presented to the Government. On the other hand all agreements and procedures were completed to enable ADC takeover of SIMTEL. SIMTEL has been restructured and has new majority ownership by ADC as well as new management. Within its new mandate SIMTEL is earnestly

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working on the Rwanda Payment Card project. This is a project to integrate and embed a Banking card aspect into the National ID cards.

To ensure that time critical payments are settled in real time, the NBR is working to implement a real time settlement system-the RIPPS. This system will encompass the Automated Clearing House, the Real Time Gross Settlement and the Central Securities Depository in one. The Bidding documents have been drafted and RFP (Request for Proposal) will be sent shortly to selected potential service providers to bid.

The API (Automated Payment Invoice) is a project to automate the payment of regular invoices by both individuals and companies to particular service providers notably, electricity and water company and telecommunications. It is in the pilot testing phase with one service provider-Electrogaz and two banks Banque Populaire du Rwanda and Banque de Kigali.

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V. MONETARY POLICY AND FINANCIAL SECTOR REFORMS IN THE SECOND HALF OF 2008

Current inflationary shocks pose a serious challenge to monetary policy, because the imported inflation is one that monetary policy has little power to tackle. The world is at a moment in which monetary policy is put under a serious stress test that will be crucial in identifying future refinements in the policy frameworks.

V.1. Monetary and Exchange policy guidelines in the second half of 2008

Taking into account the pass- through from fuel and imported items prices to domestic inflation and indication that prices are still going higher, National Bank of Rwanda will continue to closely monitor the monetary developments so as to minimize the adverse effects of money increase on prices. This requires continuously monitoring the expansion of liquidity within the banking system and if necessary intervening on the money market to maintain liquidity at the desired level.

Foreign exchange sales to banks and Government by the NBR will continue to be one of the important instruments to regulate the liquidity within the Rwandan economy.

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MONETARY POLICY AND FINANCIAL STABILITY STATEMENT

During the first semester 2008, Interest rates in money market fluctuated between 5% and 7%. As preliminary indications tend to show, the banks' cash flow has significantly reduced in July and would soon become tight, since a number of important projects requiring funding in foreign exchange are likely to be implemented in a short period ahead. One could predict that these developments will bring interest rates in an upward trend.

Following a massive sale of foreign exchange to the market, the NBR domestic debt reduced significantly from FRW 57.3 billions on 31/12/2007 to 33.2 billions on 31/07/08. Inter bank operations have resumed and are likely to intensify in the near future. In line with the interest rate policy set in August 2005 and taking into account the recent developments, the time has come for NBR to provide banks with a new reference for their exchange of liquidity. From the 8th August 2008, the REPOS (Repurchase Agreements) operations have replaced the overnight and 7 days auctions for an efficient management of liquidity in the current environment. This new mechanism had started with Repo operations varying from 1 to 14 days but the duration will be reviewed from time to time depending on the way this instrument will prove to be successful.

Based on the situation prevailing on the money market, the expected trend in the near future, the NBR set the Money market reference rate at 8% (Key Repo rate)

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per annum and the inter bank rate corridor has been set to 125 basis points (1.25%) below and above the key Repo rate. This choice has taken into account the fact that the current trend in inflation is mainly driven by exogenous shocks. Indeed, despite a lower money increase and a relative appreciation of the domestic currency, the overall inflation is increasing compared with last year.

In case of shortage of liquidity in the banking system, the NBR will lend money to banks on a competitive basis at a minimum rate equal to the upper limit of the inter bank corridor (9.25%). In a similar manner, if there is excess liquidity in the system, the NBR will absorb excess funds on a competitive basis at a maximum rate equal to the above limit of the interbank corridor (6.75%).

The NBR last resort facility remains available just in case a bank fails to get the desired liquidity from the Repo auction or the inter bank market. The interest rate to be applied on this facility is set at the daily clearing Repo auction rate plus a penalty of 2%.

Banks and other investors have also the opportunity to invest in medium and long term instruments, namely T- bills and T-bonds which are not concerned by the above policy rate. These instruments will continue to be issued at interest rates driven by the market forces.

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Prudent monetary policy is necessary but not a sufficient condition to achieve price stability in the current context. The fiscal policy and structural reforms in the real sector are also critical in this respect.

V.2. Reforms in the financial sector for the second half of 2008

The ongoing programs to implement the FSDP (Financial Sector Development Program) will be accelerated during the second half of the year. Theses programs cover the banking system and micro finance sector reforms, the capital market development, the non bank financial service regulation and the modernization of the payment systems.

A.Banking sector reforms

The main actions during the second half of 2008 will be consolidating the achievements in strengthening the financial position of banks and putting in place a legal and regulatory framework in conformity with international banking supervision standards. The new banking law and its implementing regulations will be subject to monitoring for compliance by banks from the second half of 2008.

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The efforts to reorganize the banks' credit portfolio will be pursued to reduce the level of non performing loan with the objective of a level less than 10% to be observed by each bank by the end of 2008. The establishment of a Credit Reference Bureau will consolidate the good performance observed so far in this area.

Other developments expected in the banking sector during the second half of 2008 are:

- The opening of international operations by BPR
- The opening of the newly licensed bank
- The expansion of the branches network by current banks
- Finalising the process of privatization of BK
- The restructuring of BHR which will be transformed into a Mortgage liquidity facility

B. Modernization of microfinance institutions

As mentioned, two funds (capacity building fund and credit fund) are in place to finance training of directors and managers of MFIs and supported the building of MIS (Management Information System) and refinancing activities that have a

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significant impact on poverty reduction. During the second semester 2008, these funds will start implementation.

C.Nonbanking financial sector regulation

To deliver on the new mandate to supervise the NBFI, the National Bank of Rwanda is developing the legal and regulatory framework for the sound functioning and supervision of Non-bank Financial Institutions.

To this effect, a law governing the organization and supervision of insurance industry was approved by the government and passed by the Parliament in July 2008. During the remainder of the 2008, various laws will be drafted and submitted to the Government for approval. These include the law governing insurance contracts and the law governing compulsory/mandatory insurance, the law regulating Pension Funds, and the law governing collective investment schemes. The last two laws (pensions and collective investment schemes) are intended to support the development of the contractual savings as well as long-term investment vehicles.

In addition, financial and management audit of insurance companies will be carried out in 2008; the procurement process to do the assignment is under way

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and is expected to have been finished not later than September 2008. This audit will enable the NBR to assess the management and financial health of insurance companies.

Furthermore, the Bank will follow up closely two new Government projects: the Universal Medical Insurance and Rural Insurance Strategy. During the first half of 2008, the project conceptual framework papers were put in place and stakeholders' workshops conducted in respect of each project and further recommendations leading to implementation were made. The two projects form part of the Economic Development and Poverty Reduction Strategy (EDPRS) and Vision 2020.

D.Capital market developments

As mentioned, three issues of government bonds have taken place as of June 2008. There are some other issuers working on raising debt capital through the bond market. The city of Kigali is presently working on a municipal bond which they are planning to launch next month. We expect also some big corporate coming to the market to raise funds by issuing bonds.

CMAC will continue to work on the development of an appropriate legal framework for the capital market in Rwanda.

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E. Payment system modernisation

During the second semester, the National Payment System (NPS) Framework and Strategy shall be passed by Government and published. It is also envisaged that the Payment Systems law will be approved by the Government too. More to that the Securities holding law will be drafted to give legal protection and backing securities operations.

Concerning SIMTEL Action Plan, the RPC will be developed and tested during the second semester 2008 and ready for launching early 2009. Furthermore, in order to promote the VISA debit cards usage, we plan to start personalizing the current VISA debit cards here in Rwanda at SIMTEL. This will ensure that all account holders in banks are given cards in less than 48 hours. Better still, our ATMs will be enhanced to accept international cards and the ATM network expanded to offer a wider coverage.

Within the second semester 2008 we expect to conclude negotiations with the winning company for the provision of the RIPPS software and sign a contract.

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