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

Monetary Policy Statement

Review of Monetary Policy and Financial Sector Developements in 2007 and Monetary Guideline for 2008

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I. INTRODUCTION

The year 2007 has just ended and it is time to assess the National Bank of Rwanda's monetary policy for the past year and consider new prospects for the ongoing one.

With technical and financial support from its development partners, the Government of Rwanda puts in place an economic program each year to ensure short term implementation of the medium-term program stated in the Economic Development and Poverty Reduction Strategy (EDPRS).

Monetary policy, which falls within the responsibilities of the National Bank of Rwanda is part of this program and has a particular role of creating an environment that is conducive for fostering production and investment through ensuring macroeconomic stability. The National Bank of Rwanda's action is geared towards controlling liquidity within the national economy and monitoring the financial system.

This monetary policy statement will give a broad outline of the Bank's 2007 monetary policy and the policy stance for 2008.

But before going further, allow me to make a short review of the national and international economic environment in which the Bank implemented its monetary policy.

II. OVERVIEW ON ECONOMIC ENVIRONMENT IN 2007 AND FORECASTS FOR 2008

II.1 INTERNATIONAL ECONOMIC ENVIRONMENT

According to the IMF's estimates, growth of the world economy remained strong during the year 2007. In real terms, the growth rate of the world economy is estimated at 5.2% mainly explained by good performances of the emerging economies. The Chinese economy experienced a growth rate of 10.9% while India and Russia also recorded a strong expansion. Economic growth also remained strong in other developing countries including low-income economies in Africa.

Inflation remained under control in most of the developed countries, but it accelerated significantly in many emerging and developing countries due to increase in energy and foodstuffs prices.

In the United States, underlying inflation stabilized at 2.3%. Throughout the year 2007, the overall inflation represented 2.7%, against 3.2% in 2006.

In Japan, in spite of four years of positive growth, the price level remained very low because of low wage level. In November 2007, inflation stood at 0.6%, against 0.3% in October, while it represented 0.4% when you exclude foodstuffs, against 0.1% in the same month.

Financial markets were characterized by volatility, which were aggravated by the crisis in the mortgage market in the United States, with repercussions on international financial markets.

In the face of such turbulences, the Federal Reserve significantly reduced the Fed Funds rate from 5.25% in December 2006 to 4.25% in December 2007. This easing of financing conditions, conducted to reduce the deterioration of financial markets, resulted in the weakening of the dollar against major foreign currencies. The spread between the reference rate and the three-month rate widened during this period. On annual average, the American three-month rates stood at 5.3% in 2007, against 5.19% the previous year.

In the Euro zone, the European central Bank, in its meeting of December 6, 2007 decided to maintain its main reference interest rate at 4% to stave off inflation pressures from strong growth in currency and credit,. The money market's three-month rates resumed their upward trend in December after two consecutive falls in November and October. While this rate had been 3.75% in January, it increased to 4.85% in December 2007. The same trend continued in terms of annual average as this rate increased from 3.08% to 4.28% between 2006 and 2007.

The Japanese Central Bank kept an accommodating monetary policy by maintaining its reference rate at 0.5% since February because of its fragile growth, strong sensitivity to financial crisis and lack of inflationary pressures. Thus, the average of the three-month deposit rate increased from 0.3% to 0.79% between 2006 and 2007.

In the commodity market, oil prices increased during most of the second half of 2007. By the end of the year, crude oil prices were already fluctuating around USD 95 per barrel in New York, which was almost 50% higher than that of the beginning of the year. The rise in oil prices was primarily due to the world demand pressure, on one hand, and to low production investments as well as continuous geopolitical tensions in oil-producing countries, on the other.

Although the world economic growth forecasts for 2007 were not perturbed, they are likely to be revised downwards for 2008 due to the crisis prevailing in financial markets, which are likely to cause a marked world economic downturn, the risk of inflationary pressures, volatility of oil markets as well the effect of the massive inflow of foreign currencies in emerging countries. According to the World Bank, the deepening crisis in the mortgage market in the United States and the fall of the dollar are likely to contribute to the slowdown of the world growth in 2008.

On average, growth of the world economy remained strong, with a rate estimated at more than 4%, supported by generally solid fundamentals and a strong expansion in emerging and developing countries.

II.2 NATIONAL ECONOMIC ENVIRONMENT

The real growth of the Rwandan economy was estimated at 6.0% in 2007, against 5.5% in 2006. This was due to performances of the industrial sector, construction and services sectors, in spite of the decline in agricultural production as a result of bad climatic conditions.

In 2007, the agricultural sector added value was estimated to reduce by 1.8%, compared to the year 2006, following the fact that the season (2007B) was marked by a delay in the rainfall, which resulted in low harvests in several areas of the country. However, a poor performance in agriculture was compensated by good results in other sectors which were undoubtedly related to the progressive improvement in electricity supply and the consolidation of macro economic stability, which increased investors and consumers confidence.

Table 1: Real GDP growth (in %)

	2004	2005	2006	2007
Real GDP	5.3	7.1	5.5	6.0
Agriculture	0.1	4.8	1.1	-1.8
Manufacturing industry	12,4	6,9	8,2	12,5
Construction and public works	19,1	7,7	5,2	15,2
Services	7.9	9.1	8.1	9,2

Source: MINECOFIN

The increase in manufacturing added value was estimated at 8% in 2007, against 13.5% in 2006. Performances achieved by food industry, particularly by tea and beverages sub-sector, strongly contributed to this increase.

In the area of services, business climate significantly improved in 2007, compared to the previous year, particularly in general and retail trade, telecommunications as well as banking and insurance sectors. These factors explain the increase in the service sector added value, which was estimated at 9.8%, against 8.1% in 2006.

The construction sector continues to develop in a favourable economic environment, increasingly contributing to the dynamism of the national economy. The added value of this sector showed a strong growth of 10.7 and 8.0%, respectively in 2006 and 2007. This performance is explained by major road infrastructure construction and rehabilitation projects as well as a significant dynamism that have been on going for ten years in the construction of commercial and residential buildings.

The mining sector, strongly stimulated by the firmness of the world ore prices, also recorded appreciable performances during the last two years. The rise in the added value in this sector was thus estimated to have increased in real terms from 26.6% in 2006 to about 40% in 2007.

The national economic situation in 2007 was marked by a significant increase in terms of trade, however, trade deficit worsened following more significant increase in imports (30.5%), in comparison with exports (19.2%). Compared to the previous year (14.2%), the increase in exports was primarily explained by the good performances of the mining sector, which brought in 40% of export earnings, thus exceeding coffee and tea.

The volume of coffee exports strongly fell by about 50% in 2007, compared to 2006. This poor performance can primarily be explained by poor rainfall at the end of the year 2006 and the beginning of 2007. This is normally a flowering period in which coffee-trees need much more rain. Tea exports were almost 20 000 tons in 2007, against 16.5 tons in 2006, which represents an increase of 17.5%. However, in terms of value , exports slightly fell by 1.24%, compared to the year 2006, following the fall of 11.34% in average price on the international market.

Concerning the balance of payments, the current balance deficit widened in terms of both goods and service, compared to 2006. This situation primarily resulted from the increase in the value of imports and related costs, particularly transport and insurance costs.

However, the more significant inflow recorded in financial capital and transactions contributed to completely offset the current balance deficit and realise a positive balance of payments of USD 110.45 million, against USD 81.52 million in 2006. This inflow mainly came from budget supports and foreign loan disbursements to finance development projects, from the privatization of RWANDATEL Company (USD 100 million of which 50% were disbursed in 2007), as well as the recapitalization of the Rwandan banks whose minimum capital was to be increased from RWF 1.5 billion to RWF 5 billion from January 1, 2008.

III. MONETARY DEVELOPPEMENTS IN 2007

III.1 INFLATION

In spite of a strong inflationary pressure observed in the first quarter as a result of the increase in excise duties on beverages and telecommunication as well as increase on , school fees and medical care tariffs, the year 2007 experienced a significant reduction in inflation rate, compared to the last two previous years.

Table 2: Main CPI developments (CPI; Base 2003= 100; changes in %)

Year		2006				2007
Period	Weighted	Dec	Mar	Jun	Sep	Dec
FRESH PRODUCTS INDEX	2 186	167.0	182.5	161.9	176.4	161.7
Monthly changes		*2.8*	*0.9*	*-2.7*	*2.2*	*-7.3*
Year-to-year basis		*34.2*	*22.1*	*3.9*	*7.3*	*-3.2*
ENERGY INDEX	761	225.1	225.3	228.	229.3	231.9
Monthly changes		*-0.5*	*1.5*	*-0.9*	*-0.1*	*-0.2*
Year-to-year basis		*15.1*	*3.3*	*-0.4*	*0.8*	*3.0*
INDEX EXCLUDING FRESH PRODUCTS AND ENERGY (underlying inflation)	7 053	120.5	129.4	129.8	131.4	133.3
Monthly changes		*0.6*	*3.2*	*0.2*	*0.4*	*0.9*
Year-to-year basis		*6.1*	*10.5*	*10.0*	*9.7*	*10.6*
GENERAL INDEX	10 000	137.0	146.4	143.2	147.1	146.0
Monthly changes		*0.9*	*2.5*	*-0.5*	*0.7*	*-1.0*
Year-to-year basis		*12.1*	*12.0*	*7.3*	*8.0*	*6.6*

Source: NBR, Research Department.

Headline inflation represented 6.6% in December 2007, against 12.1% in the same month of 2006 in term of year-to-year basis, while on annual average it passed to 9.1% in December 2007,

against 8.9% in December 2006. It should be recalled that the 2007 objective was to restrict inflation at 5%.
During the year 2007, inflation pressures were high only in the first quarter in which the cumulated average level was 6.7%, while for the rest of the year, prices fluctuated only slightly. During the second quarter, due to the seasonal effect of the season B harvest on prices of locally-produced foodstuffs, a 2.2% disinflation was recorded as a result of the significant fall in foodstuffs prices.

Underlying inflation was 10.6% in December 2007, against 6.1% in the same period of 2006. On annual average, it was reached 9.7%, compared to 4.0% in 2006. In the first quarter, this upward trend was exclusively explained by the increase in excise duties of beverages and telecommunication as well as increase in the water and healthcare tariff (KFH), and school fees. Indeed, except for the effects of these increases, underlying inflation was maintained at a low level during the rest of the year, with a cumulated rate of 3% between April and December 2007, a positive effect of the National Bank of Rwanda's monetary policy in 2007.

III. 2. EXCHANGE RATE AND FOREIGN RESERVES MANAGEMENT

For the fourth consecutive year, the RWF remained stable on the exchange market, one of the important factors behind the good performance of the Rwandan economy. The developments of the exchange rates of the RWF against major international currencies maintained the same trend that had started at the

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beginning of the year 2004, with a slight but continuous appreciation of the FRW against the USD, the currency mostly used in the country's trade with the rest of the world. Thus, the RWF appreciated in nominal terms by 0.92% against the USD between December 2006 and December 2007.

However, in relation to the Euro and the British Pound (BP), the exchange rate of the RWF was rather marked by frequent fluctuations and depreciation. Between December 2006 and December 2007, the RWF depreciated against the BP and the Euro respectively by 2.59% and 8.95%. These fluctuations were related to the performances of these two currencies on international foreign exchange markets.

It should be recalled that the stability of the RWF is backed by a relative abundance of foreign currency inflows to the country's banking system, primarily coming from donor budget support to GOR , development projects, and private transfers and from the continuous improvement in the performances of the goods and service export receipts.

On the local exchange market, the year 2007 was characterized by a significant fast increase in foreign currency demand, compared to the previous years. This situation was primarily explained by the fast increasing domestic imports demand. It should be noted that in 2007, the National Bank of Rwanda increased the sale of exchange currencies to the private sector through the banking system, in order to sterlise excess liquidity injected into the system through a significant budgetary expenditure program. The commercial banks' foreign currency demand significantly exceeded forecasts.

Table 3: NBR's foreign currency revenues and expenditure (in millions of USD)

Description	2006 Results	2007 Estimates	2007 Results	2007 Absolute changes Real/Provisional
Revenues	**448.04**	**485.16**	**655.89**	**170.73**
Of which: Budgetary supports	121.22	278.81	234.69	-44.12
Supports to projects	150.7	135.02	151.1	16.08
Expenditures	**415.3**	**483.73**	**549.34**	**65.61**
Of which: Sales to customers	**308.67**	**449.58**	**410.81**	**-38.77**
Government	109.94	167.73	137.01	-30.72
Commercial banks	137.05	196.45	235.72	39.27
Other customers	61.68	85.4	38.08	-47.32
NBR's gross reserves at the end of the period	**440.69**	**442.12**	**553.87**	**111.75**

Source: NBR, Department of International Operations

Lastly, in August 2007, in order to properly tailor our foreign exchange intervention to the changing market conditions, the Bank suspended the foreign currency auction sale system. In the current context where the domestic banking system has the capacity to satisfy all domestic exchange market's foreign currency demands, the BNR opted for a policy of selling foreign currencies to the banks on demand as opposed to scheduled auction days and at day's reference rate.

III.3. MONETARY AGGREGATES AND INTEREST RATES

There was a significant difference between the increase in money supply, M2, (+31.25%) and that of the nominal GDP (+13%). This difference is explained by the fast monetization of the economy that took place in 2007, while maintaining inflation at a moderate level. Money supply increased by 31.25%, from RWF 285.6 billion to RWF 374.9 billion between December 2006 and December 2007, as a result of the accumulation of net external reserves (+23.4%) and a fast increase in credit to the private sector (+20.9%). On the other hand, over the same period, the net credit to Government dropped by 16.8%, due to the accumulation of its deposits in the banking system.

As regards currency demand, average deposits and fiduciary currency respectively accounted for 82.4% and 17.6% of money supply over the period. In terms of contribution to monetary growth, deposits and fiduciary currency contributed by about 86.6% and 13.4%, respectively.

Table 4: Monetary aggregate developments at the end of the period (in billions of RWF, unless otherwise indicated)

	2006	2007		% Change	
		Progr	Results	Real/Progr	2007/2006
Net external assets	**284.7**	**266.4**	**351.5**	**85.1**	**23.4**
Net domestic assets	**0.9**	**46.0**	**23.4**	**-22.6**	**2485.5**
Domestic credit	93.4	136.4	115.8	-20.6	24.0
Net Credit to Government	-69.2	-54.0	-80.9	-26.9	16.8
Autonomous agencies	-2.0	-2.0	-1.3	0.7	-35.6
Public companies	2.4	2.5	1.8	-0.7	-26.8
Private sector	162.2	189.9	196.1	6.2	20.9
Other net items	-92.5	-90.4	-92.3	-1.9	-0.1
BROAD MONEY	**285.7**	**321.4**	**374.9**	**53.5**	**31.3**
Currency in circulation	**54.7**	**60.6**	**67.4**	**6.8**	**23.3**
Deposits	**231.0**	**251.8**	**307.5**	**55.7**	**33.1**
Of which: Sight deposits	103.1	126.0	160.6	34.6	55.7
Time deposits	69.0	80.8	78.3	-2.5	13.5
Currency deposits	58.8	45.0	68.6	23.6	16.6

Source: NBR, Research Department

The fact that the monetary expansion was coupled with a significant deposit growth and a moderate fiduciary currency growth represented a greater expansion of financial services, which made it possible to bring more households' financial assets into the banking system.

Nevertheless, one could observe a persistence of excess liquidity in the banking system throughout the year. Further to this situation, the interest rates on the money market experienced a significant fall during the year 2007, both the rate on Open Market Operations and the Treasury bills rates dropped by 2.1% between December 2006 and December 2007.

However, in spite of the fall in interest rates on the money market, banks's lending rates remained the same , fluctuating around 16%, while the discount rates dropped markedly, falling from 8.1% in December 2006 to 7.4% in December 2007.

Table 5: Interest rate developments (in %)

	2006	2007			
	Dec	Mar	Jun	Sep	Dec
Money market rate	7.4	8.7	5.6	5.5	5.3
Interbank market rate	7.4	7.9	6.6	5.2	6.0
Mopping up rate	12.5	12.5	12.5	12.5	12.5
Weighted treasury bills rate	8.1	9.6	7.0	6.6	6.0
Discount rate	8.1	7.9	7.7	7.4	7.4
Lending rate	16.4	16.0	16.0	15.8	16.1

Source : BNR, Monetary and Financial Markets Department.

III.4 BANKING SYSTEM LIQUIDITY MANAGEMENT

The Rwandan banking system has been experiencing a situation of continuous excess liquidity since 2004. To align the bank's liquidity with monetary indicators such as defined in the annual monetary program, the NBR had to regularly intervene to sterilize excess liquidities by borrowing from the money market and selling currencies to the banks.
Sterilization resulted in a significant increase of 16.2% in the Central Bank's domestic debt to commercial banks, which increased from RWF 49.3 billion to RWF 57.3 billion between the end of 2006 and the end of 2007.

In spite of significant increase in the amount of foreign exchange that the NBR was able to sell to the banks, demand remained insufficient to absorb the banking system's excess liquidities mainly generated by financial inflow of increasing budgetary supports. To keep the monetary program on track, it is important to reinforce the economy's capacity to absorb growing inflows from scaling up of external assistance.

Table 6: Some of the NBR's financial indicators

Indicators	2004	2005	2006	2007
1. Official reserves (in millions of USD)	314.5	405.7	439.7	558.7
(in month ly NFGS* imports)	7.3	7.5	6.8	6.9
2. NBR's objective (planned 6 month NFGS imports)	277.5	344.8	364.5	488.6
3. Excess reserves (in millions of USD)	37.0	63.2	75.2	65.2
4. Nominal rise in the exchange rate of the RWF against the USD (in %)	2.4	2.4	0.7	0.9
5. NBR's domestic debt (in billions of RWF)	11.4	41.3	49.3	57.3
6. Resultants on exchange rate fluctuations (in billions of RWF)	-1.2	-4.2	-2.0	-1.0

*NFGS: Non factor goods and services

Source: NBR, Research Department

IV. FINANCIAL SYSTEM STABILITY

IV.1 BANKING SYSTEM

The restructuring process of the banking system that has been going on for a few years now has given satisfactory results; the soundness of the banks was much consolidated and all those in difficulties have recovered and consolidated their activities.
Regarding business performance, the total balance sheet for commercial banks grew by 43% from RWF 275.5 billion in December 2006 to RWF 393.7 billion in December 2007. This improvement in the banks' activities was due to the increase in credit distributed (+26.6%). The amount of gross credit increased from RWF 171.3 billion in December 2006 to RWF 224.8 billion in December 2007.

Table 7: Commercial banks' performance indicator developments (in %)

Indicators	Dec 2006	Dec 2007
Solvency ratio	13.7	16.3
Banks' equity capitals, total	25.9	39.9
NPL*/ Total credits	26.0	18.6
Net charges on NPLs/net charges on credits	19.0	14.3
Efficiency ratio	79.8	70.0

* NPL: Non performing loans
Source: NBR, Bank Supervision Department

At a consolidated level, banks' solvency markedly improved to 16.3% at the end of December 2007, against 13.7% at the end of December 2006. From the first quarter 2008, all the banks' current solvency ratio has been higher than the required 10%. In addition, all banks have been able to mobilise resources necessary to comply with the new minimum capital of RWF 5 billion set by the Central Bank.

Concerning the quality of the credit portfolio, even though the gross amount of Non performing loans (NPL) decreased from RWF 42.8 billion to RWF 42.0 billion between the end of December 2006 and December 2007, their share in the gross credit portfolio significantly improved, decreasing from 26.0% to 18.6 % during the same period. This rate becomes 14.3% at the end of 2007 if the suspended interest and bank charges are not considered.

Concerning the supervision of banks, the year 2007 was primarily concerned with solving the problems of one of the banks in difficulty, reorganizing the UBPR network, the privatization process of the country's biggest bank, installation of an automated reporting system for financial institutions, and adoption the new risk-based supervision approach for bank supervision.

IV.2. LEGAL AND STATUTORY FRAMEWORK REFORMS

To make the Rwandan banking supervision framework comply with the financial sector's development plan, international standards and best practices, several reforms were initiated by the NBR. A new banking law was adopted by Parliament, the relevant regulations to implement this law were elaborated, and a micro finance law was approved by the Government of Rwanda and submitted for approval of Parliament. The regulation on writing off after six months or more, from the bank's balance sheets of loans declared unrecoverable was adopted.

Lastly, it is significant to stress that entry of regional and international banks in our financial system strengthened the national banking system's financial soundness and improved its competition and competitiveness for the benefit of our economy.

IV. 3. MICROFINANCE SECTOR

The reorganization of the micro finance sector intensified during the year 2007. Periodic meetings between the NBR Management and the MFI managers, in the presence of Provincial Governors, and the Mayor of Kigali City and other local government authorities, enabled us to solve most of the problems of licensing of institutions that had with difficulties to comply with necessary statutory conditions. Important decisions were taken during these meetings, including a concerted reorganization of viable institutions and liquidation of those which were insolvent.

The minimum authorized capital of the MFIs that have adopted legal statutes of limited companies was increased from RWF 100 million to RWF 300 million, and the majority of those concerned with the issue took the necessary steps to mobilize the resources required on 31/12/2007. Those unable to comply are negotiating plans to merge with other MFIs, or to be absorbed by them.

The liquidation of the MFIs that were closed in 2006 continued in 2007. The liquidators signed a contract that enabled them to start the debt collection process with support from district-based collection commissions. The process of paying off the depositors also accelerated. In December 2007, an amount of 1.036 billion had already been given out to declared depositors. This amount accounted for 96% of the installment of 50% that the Government was committed to compensate the depositors whose declaration were in conformity with the liquidators' records .

IV.4 PAYMENT SYSTEMS MODERNIZATION

SIMTEL (Société Interbancaire de Monétique et Télécompensation), whose operations were inaugurated in February 2005, has signed a partnership agreement with a strategic partner, a German investment company that intends to avail its know-how and make significant investments in the modernization of the Rwandan payment system.

V. MONETARY POLICY AND FINANCIAL SECTOR DEVELOPPMENT IN 2008

Consolidation of our achievements as regards macroeconomic and financial stability will remain the major concern for the monetary policy and related activities to be implemented by the National Bank of Rwanda in 2008. Financial stability means moderate inflation (an objective of reducing inflation to 7% was set for the year 2008), a stable and predictable exchange rate, and a sound banking sector, including the microfinance sector. To maintain financial stability is an important prerequisite to stimulate private investment necessary for achieving the objective of economic growth rate of between 5.5% and 6.5% in accordance with Government's 2008 economic and financial program.

The monetary management in 2008 is faced with significant challenges which will likely exacerbate inflationary pressures. Most significant ones being the shock due to rise in oil prices, and the potential impact of the recent socio-political crisis in Kenya. These two external factors are coupled with internal factors, including an accelerated strong growth potential for credit distribution due to the recapitalization of the banks and micro finance institutions, as well as a significant increase in the 2008 public expenditure program, in relation to the 2007 achievements. However, we have other favourable factors that will offset the above-mentioned risks and we therefore view the year 2008 with optimism as regards the monetary program. These include;

- good prospects for agricultural production, following the Government's efforts to revive the rural economy;
- No new tax measures to increase taxes in 2008, in addition to no upward revision of public service charges, except for transport;
- comfortable level of exchange reserves to make it possible to ensure foreign exchange stability , while meeting the increase foreign exchange demand, resulting from a strong increase in credit to the private sector;
- considerable increase in capital expenditure within the Government budget, which will result in the rise in foreign currency component expenditure without expansionist effect on bank liquidity;
- recent launching of the capital market; and
- Effectiveness of our financial system to deal with the growth of external financial inflows.

In addition, implementation of the FSDP recommendation and action plan will continue to make good progress. These actions are aimed to strengthen the competitiveness and improve the effectiveness of the banking and micro finance system so as to improve access to financial services, develop the capital market to contribute towards financing long-term investments and reducing transaction costs associated with the payment systems by developing a more modern payment system.

V.1. MONETARY AND EXCHANGE POLICY GUIDELINES

A. Liquidity management and inflation control

To achieve the objective of reducing headline inflation to less than 7% all over the year 2008, the National Bank of Rwanda will pursue a strict monetary policy through a daily monitoring of the monetary base as an instrument to control money supply. This requires of us to continue to supervise the expansion of liquidity within the banking system and, in case of need, to intervene on the money market to maintain liquidity at the desired level. Taking into account the comfortable level of Government exchange reserves currently available at the NBR, sale of foreign exchange will remain the main instrument needed to regulate the liquidity within the Rwandan economy during 2008. This will result in a new moderate appreciation of the exchange rate of the RWF against the dollar. In addition, this will contribute to the inflation control.

The NBR's liquidity management mechanism will soon be reviewed. The current instruments (overnight operations, open market operations, sale of Treasury Bills) will be replaced by a new unique liquidity purchase and repurchase instrument, "REPO" (Repurchase Agreement). The current interest rate structure adopted by the NBR on the money market will be adapted to the operating mechanism of this new instrument. In addition, with the recent launching of the bond market, the NBR considers to reorganize the current outstanding Treasury bills stock in 2008 so as to transform a significant portion of this debt into medium- and long-term securities that will be listed on the capital market. This operation will enable long- term starlisation of excess & liquidity from the banking system, which will facilitate efficient money market operations.

This rationalization effort to manage the bank liquidity in a situation of increasing budgetary assistance will require reinforcing the coordination of the Treasury operations with the NBR interventions on the money market.

However, it is important to note that monetary measures alone are not enough to control inflation, which is dependent on many other factors beyond control of NBR like climatic conditions and oil prices. A consultative operational framework for all Government institutions in charge of economic and financial management remains necessary for coherence and effectiveness of the policy measures in order to deal with exogenous shocks.

B. Exchange policy

As regards foreign exchanges, the priority of the National Bank of Rwanda will be to maintain a stable and predictable exchange rate, and ensure that a significant volume of foreign exchange sales necessary to ensure a monetary equilibrium that is compatible with the requirement to maintain the country's macroeconomic stability. It is a challenge to the NBR to achieve these two objectives at the same time.

V.2. FINANCIAL SECTOR DEVELOPMENTS

In 2008, the financial sector development prospects fall within the framework of the implementation of the Rwandan financial sector development plan whose scope covers the banking and micro finance sector reforms, the capital market development, the nonbanking financial service regulation and the modernization of the payment systems.

A. Banking sector reforms

During the last three years, the National Bank of Rwanda made significant progress in setting up a sound banking system. Today, almost all Rwandan banks are managed professionally, have attained a solid social capital base in conformity with internatonal standards.

The actions to be implemented in the banking sector during the year 2008 are primarily aimed at consolidating the achievements in this field, and putting in place a legal and statutory framework in compliance with international banking supervision standards. The current framework will therefore be updated to harmonize the current texts with the international banking supervision standards. After the promulgation of the new banking law, the relevant regulations for its implementation will be updated. Risk-based bank supervision will be strengthened with particular attention to good governance at bank level. The current efforts to reorganize the banks' credit portfolio will be pursued to reduce the level of nonperforming loan to between 5% and 10% by the end of 2008.

To improve credit information on banks' borrowers; a factor identified as one of the weaknesses of the business environment in Rwanda - the NBR intends to mobilize various partners within the banking environment, including all banks and large micro finance institutions, to put in place a Credit Reference Bureau in Rwanda as soon as possible

B. Modernization of micro finance institutions

The two last years' experience showed us that the micro finance sector was a very fragile sector and that it must be supported, supervised and modernized.

After significant efforts to reorganize the financial situation of this sector's institutions in 2007, the year 2008 will focus, inter alia, on enacting a law governing micro finance activities and its implementing regulations, intensifying off-site inspections of approved MFIs, improving the quality of information provided by them, capacity building by training their directors and managers, and putting in place refinancing facilities for the MFIs that have attained secure management standards within the framework of financing the activities that have a significant impact on poverty reduction.

Large micro finance institutions will be encouraged to adopt the statutes of "micro finance banks" that will enable them to fully participate in the National Payment System. Those showing satisfactory performances in the area of governance, consolidation of their equity capitals, positive operational profits , and able to produce reliable accounting and management information will be integrated into the national payment system through partnership agreements with commercial banks.

C. Nonbanking financial sector regulation

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

A law governing the organization of insurance industry was submitted for Government's approval. In 2008, two laws intended to respectively regulate the Private Pension Funds and the Unit Trusts will be adopted to support the development of the contractual savings industry as well as long-term investment instruments. In order to ensure financial soundness in this sector, financial and management audit for these institutions is planned in 2008.

D. Capital market developments

Within the framework of the capital market development, the first issue of two–year government bonds took place on January 17 and 31, 2008, for two respective amounts of RWF 5 billion and RWF 4 billion. The results indicated a good opportunity to issue bonds with long duration in order to deal with the current state of excess liquidities the banking system. The Bank will pursue this program in collaboration with the Capital Market Advisory Council whose Executive Secretariat is already operational. An annual schedule for subsequent issues with various maturity periods will very soon be published.

Due to the bond issue program with different maturity periods during the year 2008, a yield to maturity curve will be drawn by the private operators to inline with the capital market developments.

Since the capital market will bring together more actors, savers and investors, competitiveness in the financial system is expected to improve and reduce the current spread between the lending and deposit rates in the banking system.

E. Payment system modernisation

The National Payment Council will be in place this year. This body will be in charge of implementing the National Payment System Strategy. Our short-term objective is to equip Rwanda with an effective and secure payment system, and reduce transaction costs of services.

To this end, the 2008 action plan for the modernization of the payment system will focus on two important components aimed at putting in place a Real Time Gross Settlement and introducing an Automated Clearing House.

It is also envisaged to promote the use of bank cards on a large scale for both nationals and visitors through a SIMTEL Company network.