Letter of Intent

Ms Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Kigali, December 20, 2019

Dear Ms. Georgieva:

We are committed to preserve macroeconomic and financial stability, as pre-requisites for sustainable and more inclusive economic growth. Estimates indicate that, economic growth averaged 10.3 percent during the first half of 2019 mainly led by improved performance in construction activities and services. Strong import growth fueled by domestic demand and declining commodity prices of our main exports widen the trade deficit in 2019H1 despite an increase in volume and more diversification of exports products. The central bank continues to strengthen the monetary policy framework.

Lower-than-expected grants and loans disbursements combined with a higher-than-expected projects spending have resulted in a higher fiscal deficit through end June 2019 and a revision of the FY2019/20 fiscal stance is proposed in the program statement to accommodate repayment of a float caused by the shortfall in resources mentioned above.

Consistent with our program commitment to maintain our debt anchored at safe levels over the medium term, we are preparing a preliminary fiscal risks statement, with the assistance of IMF, to estimate plausible fiscal costs associated in anticipation of risks that could materialize in the medium term and we will prudently consider fiscal measures to build precautionary buffers. This is also necessary to preserve and create fiscal space for more financing of our government strategic plan, the NST1, in which SDG objectives are imbedded.

The Government remains fully committed to meeting the objectives of the program, as well as its specific targets. Attachment to this letter is the program statement, presenting performance under the program, and updating the specific policies to meet the program's objectives, including the associated quantitative targets and structural benchmarks. We will monitor progress continuously in consultation with the IMF, and we stand ready to take further measures if needed to reach our objectives. We will continue to consult with the IMF on the adoption of measures, and in advance of any revisions to policies included in this Program Statement in accordance with the IMF's policies on such consultations.

We will also provide the IMF with the information it requests for monitoring program implementation. We authorize the IMF to publish this Letter of Intent and its attachments, as well as the related Staff Report.

Sincerely,

/ s /	/s/
Ndagijimana, Uzziel	Rwangombwa, John
Minister of Finance and Economic Planning	Governor, National Bank of Rwanda

Attachments (2)

I. Program Statement (PS)

II. Technical Memorandum of Understanding (TMU)

Attachment I. Program Statement

I. RECENT DEVELOPMENTS AND PROGRAM PERFORMANCE

1. **Strong economic growth persists.** Economic growth reached an exceptional 12.2 percent in the second quarter of 2019, averaging 10.3 percent in the first half of 2019. This good performance was mainly driven by industry especially construction and manufacturing, as well as services, particularly trade and transport. The services sector's growth was the result of the good performance of trade and transport, where wholesale and retail trade grew by 23 percent and transport grew by 17 percent, boosted by air transport mainly from Rwandair. On the demand side, investment, was the main driver of this growth, growing at 40 percent in the first half of 2019.

2. **Fiscal performance for the fiscal year 2018/19 showed improved execution of projects financed by external loans, while budget grants and loans recorded a shortfall compared to projections.** On the revenue side, domestic revenue collections were better than anticipated and reflected the strong economic growth registered during the year. In the area of external resources, both grant and loan disbursements were lower than projected on account of delayed/cancelled funds. Consistent with the recently observed trend in higher execution of projects funded with external loans, foreign financed capital expenditure was also higher. This led to a deficit on commitment basis estimated at 6.4 percent of GDP. However, on cash basis, the deficit was lower than projected, explained by the delayed/cancelled disbursement of donor budget support funds. Some of the commitments of suppliers and contractors could not be paid before the close of the fiscal year. The Government attempted to solve the cash shortfall with an increase in the sale of government securities to the non- bank sector of the economy, but a gap remained and was carried forward to FY 2019/20.

3. **In May 2019, the twelve-month average CPI inflation went below 1 percent, the lower bound under the Monetary Policy Consultation Clause (MPCC).** Headline inflation had been on a decreasing trend since July 2018, mainly dragged down by deflationary pressures in domestic food and energy (charcoal and firewood) prices as well as imported food inflation. Fresh food inflation decelerated on the back of good weather conditions. Good/humid weather conditions further led to an increase in issuance of forest extraction and burning permits, resulting into increased supply and decreased prices of charcoal and firewood on the market. Imported food inflation followed consistent decreases in international food and oil prices. Cognizant of these developments, the monetary policy committee (MPC) decided in May to cut the central bank rate to an all-time low of 5 percent. Since June 2019, core inflation started to pick up; mainly driven by easy monetary conditions and subdued deflationary pressures in imported and domestic (fresh) food prices.

4. **As of June 2019, the growth of the most liquid assets in Rwandan francs reduced by 1.8 percent (y-o-y),** compared to the growth of 22.8 percent recorded during the same period of the previous year. This was due to preferences of banks to invest more in long-term government securities bearing in mind that the relatively growing interbank market and the Central Bank reverse repo operations can help to smoothen any temporal liquidity need. As results, excess reserves for

precautionary purposes reduced and money market interest rates continued to stabilize around the central bank rate.

5. **In January 2019, the NBR adopted a price-based monetary policy framework.** The move required strengthened analytical capacity to support forward-looking decision-making, a developed financial market, enhanced communication and modernized monetary policy processes, among other things. In the transition period, the NBR also continued to collaborate with IMF in building the capacity of its staff, especially in the areas of Forecasting and Policy Analysis Systems (FPAS). To support the FPAS, NBR introduced Price Expectations Surveys (PES) to continue supporting evidence-based analysis and forecasting of inflation.

6. **Moreover, the NBR has put in place a communication strategy, to support the new price-based monetary policy framework.** To anchor price expectations, the NBR regularly communicates to the public its policies and decisions, the rationale behind its policy decisions, the anticipated impacts of the decisions, and key macroeconomic trends through press conferences, press releases, targeted outreach, and different publications. The target groups include the public, financial sector players, think tanks, media, youths, academia, policy makers and international organizations.

7. **With the perspective of boosting interbank market activities and therefore improving the monetary policy transmission mechanism, the NBR established a Financial Markets Operations Committee (FMOC)** to improve daily liquidity management and guide NBR interventions on money market. In addition, the NBR introduced the bond reopening and the true repo mechanism to increase the trust of players on interbank market as all transactions are collateralized and ownership of security holders is fully transferred during the borrowing period.

8. **Broad money (M3) picked up by 14.0 percent in the year ending June 2019, from 9.6 percent recorded end June 2018, attributed to an increase in net domestic assets by 13 percent and an expansion of 15 percent in net foreign assets.** The rise in net domestic assets was explained by a year on year growth in the outstanding credit to the private sector by 18 percent end June 2019, compared to 7 percent recorded end June 2018. On money demand side, the currency in circulation increased by 11 percent, reflecting the booming economic activities and the continuing improvement in the monetization of economy. The currency in circulation to broad money ratio remains low and stable, standing at around 9 percent on average, for the last three consecutive years, ending June 2019. As result of continuing good economic conditions, the total deposits in the banking system picked up by 14 percent as of June 2019, from a growth of 9 percent recorded end June 2019, mainly driven by demand deposits which surged by 18 percent from 3 percent during the same period.

9. **Banking sector lending picked-up in the first nine months of 2019 on the back of increased demand for credit.** The outstanding loans of the banking sector increased by 18.4 percent (year-on-year) in September 2019, compared to a 9 percent growth registered in September 2018. Demand for loans particularly increased in the first half of 2019, compared to last

year, enabling banks to lend. All banks maintain capital and liquidity buffers above the minimum prudential requirements. The banking sector total Capital Adequacy Ratio (CAR) stood at 23.7 percent as at September 2019, above the 15 percent minimum prudential requirement. Banks also maintained high quality capital by holding a high proportion of Common Equity Tier 1 (CET1) in their capital stock. Banks also hold enough liquidity as the Liquidity Coverage Ratio (LCR) that indicates the proportion of Banks' liquid assets to their short-term obligations stood at 193 percent as at end September 2019, against 100 percent minimum prudential requirement. The capital and liquidity buffers indicate the level of resilience and ability to withstand adverse shocks.

10. Non-performing loans of banks declined and profits picked up. The Non-Performing Loans (NPLs) ratio of banks, reflecting the size of non-performing loans to gross loans, reduced from 7.2 percent in September 2018 to 5.3 percent in September 2019. The drop in NPLs ratio largely reflects the positive effects of the stronger economic performance in 2019, as well as write-offs of overdue NPLs. The banking sector profits also picked up in the first 9 months of 2019, which largely reflects the high growth of loans and recoveries.

11. Private insurers continue to recover from the underperformance registered in 2016. Private Insurers solvency level, a measure of the strength of Insurers' capital buffers held to cover all liabilities, improved from -53 percent in June 2016 to 188 percent in September 2019, compared to 100 percent prudential minimum. This was achieved through capital injections and revised premia for motor insurance. Despite this improvement, insurers still register underwriting losses, largely because of competition for few products (Motor) and related under-pricing of policies. Low insurance penetration, limited product differentiation, price undercutting, high operating costs are some of the key challenges facing the insurance sector. The NBR will continue working with the industryto address these challenges.

12. The microfinance sector holds adequate capital and liquidity. As of September 2019, the MFI sector Capital Adequacy Ratio (CAR), the measure of solvency, stood at 35.3 percent, well above the minimum regulatory requirement of 15 percent. The MFIs sector hold sufficient liquid assets and liquidity risks are very minimal. The liquidity ratio of the MFI sector stood at 87.8 percent at end September 2019, significantly above the prudential limit of 30 percent. The overly high liquidity position of MFIs relates to the still-limited investment opportunities of these institutions.

13. Rwanda's exports of goods and services continue to perform well; rising by 8 percent year-on-year in 2019 H1, driven by improved receipts from services (+15 percent) and merchandise trade (+3 percent). The developments in exports of goods and services reflect the government's policy plans to diversify its exports base to mitigate risks associated with high reliance on receipts from traditional exports. In addition, exports of services from air transport and tourism, following investment in these sectors, have been playing a pivotal role in diversifying the country's exports earnings. However, imports of goods and services also continued to rise, driven by high domestic demand of capital goods and intermediary goods to support the growing economic growth, widening the trade deficit.

14. The current account deficit was financed by rising Foreign Direct Investment (FDI) inflows and reduction in assets. Total net foreign liabilities (FDI, portfolio investment and other investments) decreased by 26 percent in 2019H1, largely attributed to delayed disbursement of public borrowings. As a result, Rwanda BOP recorded a deficit of USD 70 million, slightly decreasing the level of reserves in months of imports from 4.5 months recorded in 2018 to 4.3 months.

15. All but one of end-June program quantitative targets and structural reform targets were met. The fiscal deficit and net foreign assets quantitative targets for end June 2019 were met. On the end June 2019 reform targets, the government published a tax expenditure report following an updated methodology on the website of MINECOFIN; and procured an IT system that will capture all RSSB processes in an effort to strengthen management and sustainability of all schemes managed by RSSB.

II. OUTLOOK AND POLICIES

A. Fiscal Policies

16. In line with the trend observed in the first half of 2019, GDP growth forecast has been revised upward from 7.8 to 8.5 percent in 2019. The main drivers remain the same as for the first half, namely construction and manufacturing reflecting ongoing construction projects and Made in Rwanda policy; as well as trade and transport services following import growth. Growth is projected to remain strong in the medium term at 8 percent.

17. Revision of the fiscal projections for 2019/20 reflect some additional spending and repayment of debt, both domestic and external, as well as some additional external borrowing to clear the float of FY 2018/19. The payment by Government of a particular bank loan enters for the first time the fiscal accounts because a call was made on a Government guarantee. However, this loan was already part of our Debt Sustainability Analysis. In order to only consider debt creating flows for the deficit, this loan as well as the Peace keeping Operations (neutral over the years but sometimes pre-financed) have been excluded from the deficit definition to be considered under the program. In addition, Government is in the process of procuring additional resources including some external funding to close the financing gap arising from the delayed/cancelled external donor budget support funds in FY 18/19, to be used in clearing the 'float'. However, Government is committed to respect the agreed deficit in line with the resource envelope planned.

18. Government of Rwanda is strengthening disbursement monitoring by regularly engaging with implementing agencies and development partners and is committed to improve fiscal transparency. Projections of grants and loans for the fiscal year 2019/20 are based on prior actions that are certain to be achieved as to ensure that projections match achievements. During planning consultations, we will ensure that the specific disbursement linked indicators (DLIs), triggers and policy actions are reflected in the plans and subsequent budgets of the responsible line ministries and agencies. Further, to ensure strong monitoring within the fiscal year, the economic and social clusters, made of the relevant ministers and heads of agencies, will have ongoing discussions of any issues related to the progress of DLIs, triggers and policy actions. In addition, in line with its efforts to improve fiscal transparency, Government is committed to publish audit opinion of the consolidated financial statements of general government starting with FY 19/20.

19. We will continue to maintain prudent debt levels to guarantee fiscal sustainability. While the implementation of the NST1 and SDGs require more financing, we recognize that a deficit that translates into higher debt will increase vulnerability to shocks and lead to fiscal distress. Therefore, a fiscal anchor of a 5.5 percent of GDP as an overall deficit on a 5-year rolling average basis with a larger safety margin was set under the PCI program to preserve the country's fiscal position. But to be able to honor our commitments to invest more in both infrastructure and in human capital, and to deal with foreseeable fiscal risks, we would like to make a request to the Fund for a relaxation of the 5 years rolling average fiscal deficit target to 6 percent of GDP during the next review instead of 5.5 currently. We are strengthening our scenario analysis to estimate plausible fiscal risks in the medium term to be able to set a precautionary fiscal buffer that can absorb them when they materialize. The fiscal rule ceiling shall be revisited at the next review and considerations for increasing the ceiling on the fiscal rule should include:

- An updated DSA showing Rwanda remains at low risk of debt distress;
- A draft fiscal risk statement that has been considered by a fiscal risk committee;
- Commencing work on a fiscal risk registry;
- Longer-term commitments in the program for an annual fiscal risk statement submitted to parliament and producing a non-financial public sector balance sheet.

20. Our medium-term fiscal policies will continue to reflect fiscal consolidation and prudent borrowing to keep debt and external balances sustainable. Domestic revenue will remain a key source of funding for our future spending as ongoing tax policy and tax administration measures are expected to produce results. Tax-to-GDP ratio estimated at 16.4 percent of GDP in 2019/20, is expected to increase by 0.2 percent of GDP every year over the medium term. Regarding expenditures, current expenditure will remain contained at 15 percent of GDP and below in the medium-term as priority is given to capital expenditure maintained at 12 percent of GDP over the medium-term to implement our NST 1 priority projects. As a result, the non-debt creating fiscal deficit is currently projected at 5.5 percent of GDP in 2019/20 and 2020/21, declining to 5.3 percent of GDP in 2021/22, thus respecting the current fiscal rule under the program.

21. Rwanda's public and publicly guaranteed debt remains carefully managed. The latest Fund and Bank joint Debt Sustainability Analysis as of March 2019 assessed Rwanda's external debt position as having a low risk of debt distress with present value of 29 Per cent of GDP (against threshold of 55 Percent of GDP) at end 2018 higher than the 27.9 Per cent of GDP recorded in 2017. Rwanda's total public and publicly guaranteed debt stock in nominal terms amounted 55.3 percent of GDP as of end June 2019 compared to 53.1 percent of GDP at end December 2018. However, the debt portfolio is still dominated by external concessional loans with 63 percent of total debt. Going forward, the government's medium-term debt strategy aims to: maintain the low risk status while financing development projects through prioritizing concessional debt; support domestic market development with issuance of long-term debt securities in replacement of short-term debt securities; and mitigate risks associated with contingent liabilities. This debt strategy will help finance public investment that will translate into economic growth, increased domestic revenues, enhanced export performance, and build-up of international reserves, which in return will enhance the country's capacity to service and repay its debt. Government is regularly conducting DSAs to gauge its debt trends.

22. We will continue to strengthen our revenue administration to secure full compliance by all taxpayers and improve taxpayer services. Following several assessments of our tax system, including the TADAT (the Tax Administration Diagnostic Assessment) and technical assistances in different areas:

At the administration level:

- **RRA started using third party information** by interfacing and crosschecking with other sectors (Rwanda Development Board, Private Sector Federation, Rwanda Government Board, Rwanda Public Procurement Authority, etc.) and through internal IT systems, doing data matching to identified potential taxpayers to be registered for income tax and VAT. As a result of the above, the number of registered taxpayers during 2018/19 fiscal year increased by 12 percent.
- **Electronic Billing Machines**: RRA had a total of 24,022 VAT registered taxpayers as of end June 2019, of which 22,247 were expected to have EBM, out of which 20,987 taxpayers had acquired EBM, making an acquisition ratio of 94.3 percent. This means there are still some VAT registered taxpayers (1,260; equivalent to 5.7 percent) who are operating without having EBMs while they are supposed to have them.
- **IT systems helped improve capacity to detect tax evasion and increase compliance**
    - E-Tax and EBM VAT output validation controls to detect and prevent possible under reporting of VAT output are implemented since December 2018. The VAT output control is a mechanism by which RRA systems validate the amount of sales appearing in tax returns against the amount that was reported by the EBM machines of the taxpayers (Note: All sales through EBM are reported directly to RRA). In case the amount of sales appearing on a taxpayer's return is less than the amount reported by the EBM, the system will notify the taxpayer (through SMS) of this difference and ask them to rectify before finalizing the declaration. Else, it will capture the higher of the two amounts unless the taxpayer has tangible justifications.
    - The system controls to pre-fill the income tax quarterly prepayments of declaration form were implemented to prevent taxpayers from claiming wrong income tax advances. The Income tax Quarterly Prepayments (IQP) are advance quarterly payments of Corporate Income Tax (CIT) based on the CIT declared and paid the previous year. Therefore, instead of the taxpayer having to enter the prepayments

expected every quarter, the system will automatically pre-fill the amounts for which the taxpayer will only validate at the point of declaration.

- Interface between Domestic tax system (E-Tax) and Customs system (Electronic single window) was developed to provide both quick service delivery at the time of importing goods as well as safeguard revenue leakages. All checks (domestic and customs) are now done simultaneously which speeds up release of goods. To safeguard revenues, the system is able to detect regular importers who are not registered for domestic taxes including those whose annual import values (CIF) are above the VAT threshold but not registered for VAT. The system is constantly checked to ensure there is no compromise in system performances for both Domestic taxes and customs.

And at policy level, we are initiating development of a Medium-Term Revenue Strategy (MTRS) with the support of the IMF and other development partners. The objective is to identify key policies that will boost our tax collection. Our current work on tax expenditure and other analytical work will serve to inform this strategy. It is expected that the administrative measures mentioned above will yield more results as they are rolled over and gain amplitude in the medium term. We will further identify and/or adjust policies as needed to achieve the commitment of increasing tax revenues by 0.2 percentage points every year.

B. Monetary and Exchange Rate Policies

23. Inflation forecasts show that the 12-month average CPI inflation would evolve to around 2.2 by end of 2019. Forecast over the policy horizon indicates an increase in headline inflation, that will remain with the band. Based on this, MPC decided to maintain the policy rate at 5.0 percent in August 2019. Should any of the forecast assumptions deviate from its projections, the Committee will stand ready to take appropriate monetary policy measures (including adjusting the policy rate) to ensure that inflation remains within the benchmark band.

24. On the external side, the Current Account Deficit is projected to be 10.6 percent of GDP in 2019 (representing a 1.0 percentage point upward revision from the last projections), falling to 9.9 percent and 9.1 percent in 2020 and 2021, respectively. The projected positive external outlook in the medium term will benefit from a rebound of receipts from traditional exports as global demand weakness fade out coupled with the continued strong regional demand of non-traditional exports and re-exports as well as decreasing deficit from services. This CAD will be financed by continued steady capital inflows to Rwanda, thanks to pull factors including stable macro-economic environment, political stability and business enablement. As a result, Rwanda will continue to build up its buffers against external shocks, with the official reserves in months of imports of goods & services remaining stable, averaging 4.5 months over 2019–21.

25. BNR is committed to maintain a market driven exchange rate regime in line with the monetary policy framework. As the exchange rate is the first line of defense against external shocks, given the structural trade balance deficit for Rwanda, and considering that Rwanda is importing capital and intermediary goods in line with its NST, BNR will continue supplying foreign exchange to the market to satisfy foreign exchange demand, reflecting mostly execution of infrastructure capital projects. However, these sales are not affected to control the value of the exchange rate.

C. Financial Sector Policies

26. The NBR continued to make progress on a wide range of regulatory policies deemed important for a sound and stable financial system. In this respect, the Bank reviewed and enhanced the already existing legal instruments, but also established new ones. In establishing these legal instruments, the NBR was guided by international standards as well as market developments. Below are legal instruments gazetted since March 2019, as well as other initiatives:

i. Directive on Loan to Value Ratio;
ii. Regulation Governing the Shareholding, Acquisition and Amalgamation of Banks;
iii. Regulation on Major Investment and Placements of Banks;
iv. Insurance Sector Anti-fraud and Related Financial Crimes Forum;
v. Regulation on Minimum Internal Control and Audit for Banks;
vi. Law Governing Credit Reporting System;
vii. Law on Prevention and Punishment of Money Laundering and Terrorism Financing (AML/CFT Law);
viii. Regulation Governing Non-Deposit Taking Financial Institutions (NDFIS);
ix. Domestically Systemically Important Banks (DSIBs) Framework;
x. Regulation on Licensing Conditions for Banks and Insurers;
xi. Regulation Governing the Micro-Insurance Organization;
xii. The Directive on Risk Based Capital (RBC) Requirements.

27. NBR is committed to continue deepening financial markets, to further strengthen monetary policy transmission mechanism. In addition to regular quarterly issuance of Government bond, in June 2018 BNR started reopening mechanism with purpose of price discovery on secondary market and avail liquidity on that market. In line with capital market development and help people to save their money by investing in Government securities, BNR has successfully issued the 20 years bond in August 2019. All those initiatives have contributed to the development of bond market whereby volume and number of transactions on secondary market at stock exchange have increased significantly.

28. In addition, BNR is taking steps to implement true repo, which will contribute to the development of interbank market. This new framework consists of enhancing the existing interbank market whereby banks will be able to engage in safe and collateralized borrowing and lending activities with each other. Unlike the current forms of pledging securities, lending bank will be able to take full ownership of the collateral until the loan matures. This will reduce both the risk as well as the cost of engaging in short term transactions. This initiative will be supplemented by the rollout of Global Master Repurchase Agreement (GMRA).

D. Program Monitoring

29. **Progress in the implementation of the policies under this program will be monitored through quantitative targets (QTs), including an inflation consultation clause, continuous targets (CTs) and reform targets (RTs).** These are detailed in Tables 1 and 2, with definitions provided in the attached Technical Memorandum of Understanding.

III. MONETARY POLICY CONSULTATION WITH THE IMF EXECUTIVE BOARD

30. **In January 2019, BNR adopted a price-based monetary policy framework.** Based on positive developments in domestic financial systems and improved analytical capacity of staff to perform economic analysis and forecasting, the adoption of a forward-looking approach was meant to enhance the effectiveness and efficiency of monetary policy in Rwanda in order to maintain a stable inflation. With the improved operational framework, BNR committed to an explicit objective of maintaining inflation within a benchmark band of 5±3 percent.

31. **In March 2019, Rwanda requested for a three-year Policy Coordination Instrument (PCI). Under the PCI program, inflation benchmark for June 2019 was to be monitored under a Monetary Policy Consultation Clause (MPCC).** Consultation with IMF staff follows BNR inflation band of 5±3 percent, while consultation with IMF Executive Board is based on a wider band (5±4 percent).

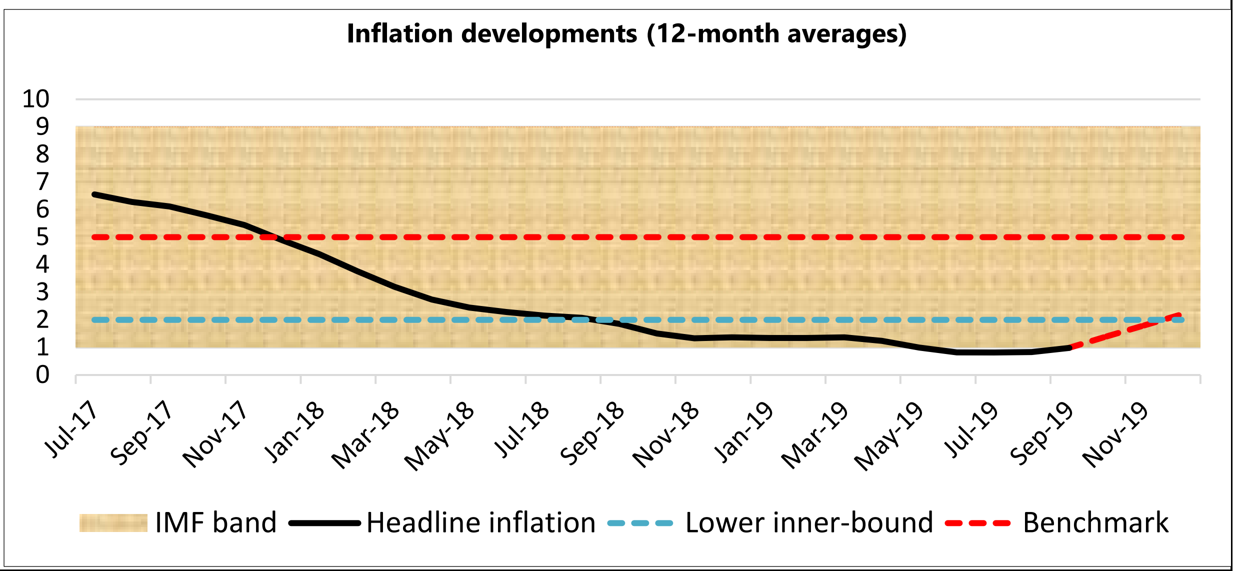
32. **In February 2019, BNR staff projections suggested continued low inflationary environment over the near term, with CPI inflation slowing down to 1.0 percent 2019Q1 and 0.8 percent in 2019Q2, which would bring the 12-month average CPI inflation to about 1.0 by 2019Q2.** The projections assumed, among other things, an uptick in domestic and international food prices over the 2019Q1–2019Q2 period.

Table 1. Rwanda: Inflation Projections

	Feb 2019 MPC	*May 2019 MPC*	*Aug 2019 MPC*
2019Q1	0.8		
2019Q2	0.7	0.4	
2019Q3	3.3	2.7	2.4
2019Q4	6.2	5.7	5
2020Q1	7.1	6.7	6
2020Q2	7.5	7.8	7.1
2020Q3	7.5	8.1	7.5
2020Q4	7.2	7.8	7.5
2021Q1		7.1	7.1
2021Q2			6.6

33. However, In June 2019, the twelve-month average CPI inflation went slightly below 1 percent, the outer bound under the MPCC, which requires consultation with IMF Board on the reasons for deviation and proposed monetary policy response. Since 2018Q3, headline inflation had been on a decreasing trend, from 2.9 percent in June 2018 to 0.0 percent in May 2019. During this period, the twelve-month average CPI inflation went from 2.3 percent to just 1.0 percent. From June to August 2019, the 12-month average CPI inflation remained at 0.8 percent (i.e. 0.2 percentage points below the lower bound), before up-ticking back to 1.0 percent in September 2018.

Figure 1. Rwanda: Inflation Developments, Near-Term Projections, and MPCC/IMF Band

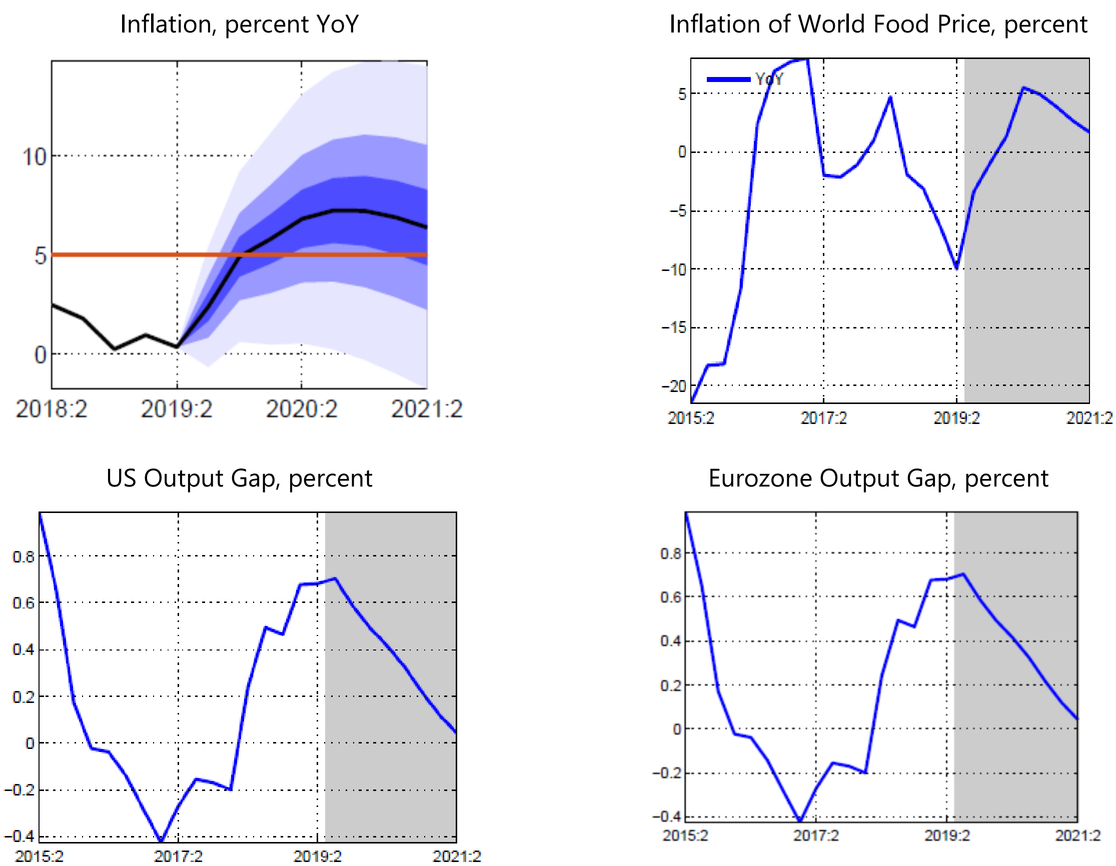


34. The fall of 12-month average CPI inflation below the lower bound (hence the breaching of MPCC target) was a result of unanticipated persistence of deflationary pressures in domestic and imported food prices. In 2018H2, domestic food inflation decelerated from -0.7 percent in July 2018 to -4.1 percent in December 2018. While domestic food prices were expected to pick up in 2019H1 (on account of decreased agricultural production in Season B), food CPI remained in deflationary zone, from -4.3 in January 2019 to -1.6 in June 2019. The persistence in food deflation mainly owed to good harvests of vegetables in Season B 2019. Based on FAO food price index, world food inflation was assumed to pick up to around 0.0 percent in 2019H1, from a deflation of around -5.0 percent in 2018Q4. However, by 2019Q1, world food deflation had actually slipped to below -5.0 percent. The deflation was mainly reflected in key food imports such as rice, sugar and cooking oils. The deceleration in imported food inflation, together with decrease in crude oil prices, indirectly contributed to a decrease in core inflation.

35. Cognizant of the new developments in domestic and imported food inflations, and in anticipation of subdued pressures from the external and weather outlook over the medium term, the monetary policy committee (MPC) meeting held in May 2019 decided to cut the central bank rate to an all-time low of 5 percent. With the policy rate cut, baseline inflation forecasts suggested 12-month average CPI inflation hovering around 2.45 by end of 2019 and 7.6 by end of 2020. Since June 2019, inflation started to pick up, mainly driven by easy monetary conditions and subdued deflationary pressures in domestic (fresh) and imported food prices.

36. Based on the new developments, inflation forecasts presented during August 2019 MPC meeting showed that, holding constant the prevailing monetary policy conditions, 12-month average CPI inflation would evolve to around 2.35 percent by end of 2019 and 7.7 by end of 2020. Staff projections assumed no major changes in assumptions from the previous forecasting round, including pick-ups in imported inflation, domestic food inflation and global economic slowdown (and concomitant decrease oil prices) over the policy horizon. Based on the forecasts and MPC members' assessments, MPC meeting decided to maintain the policy rate at 5.0 percent.

Figure 2. Inflation Forecasts and Assumptions (August 2019)



37. Recent developments are in line with past projections. As of September 2019, the 12-month average headline inflation had leaped over the 1 percent bound, mainly as a result of recent upward pressures in domestic and imported food prices, as well as domestic costs. The pickup in food inflation resulted from a base effect of last-year's drop-in food prices. Domestic cost pressures were consistent with the positive non-agricultural output gap, which was mainly driven by easy monetary conditions.

38. Despite the observed short-lived deviations from the consultation band, monetary authorities remain committed to the MPCC. MPC members continue to follow closely new developments in macroeconomic conditions and outlooks of external sector. Should any of the forecast assumptions deviate from its projections, the Committee will stand ready to take appropriate monetary policy measures (including adjusting the policy rate) to ensure that inflation remains within the benchmark band.

Table 1. Rwanda: Quantitative Targets (QTs), December 2019 – June 2020

	end-Dec 2019		end-Jun 2020	
	Prog.	Rev. Prog	Prog.	Rev. Prog
(Billions of Rwandan francs, unless otherwise indicated)				
Half-yearly Quantitative Targets[1]				
1. Ceiling on the debt-creating overall balance, including grants[2]	-276	-320	-589	-600
2. Floor on stock of Net Foreign Assets	980	972	858	910
3. Ceiling on flow of net accumulation of domestic arrears	0	0	0	0
Continuous Targets				
4. Ceiling on stock of external payment arrears (US$ millions)[3]	0	0	0	0
Monetary Policy Consultation Band[1,4]				
CPI Inflation target	5.0	5.0	5.0	5.0
Inflation, upper inner-bound, percent	8.0	8.0	8.0	8.0
Inflation, lower inner-bound, percent	2.0	2.0	2.0	2.0
Inflation, upper bound, percent	9.0	9.0	9.0	9.0
Inflation, lower bound, percent	1.0	1.0	1.0	1.0
Memorandum items:				
Total priority spending[2]	411	411	885	885
Flow of domestic revenue collection[2,5]	823	779	1726	1678
Stock of new external nonconcessional debt	700	700	700	700
Total budget support (US$ millions) [2]	439	477	617	742
Budget support grants (US$ millions)	196	222	293	339
Budget support loans (US$ millions)	243	255	324	403
RWF/US$ program exchange rate	879	923	879	923

Sources: Rwandan authorities and IMF staff estimates and projections.

[1] All items including adjusters are defined in the Technical Memorandum of Understanding (TMU).

[2] Numbers are cummulative from June 30, 2019.

[3] Continuous targets.

[4] When the end-of period year-on-year average inflation is above/below the outer band of the upper/lower bound, a formal consultation with the Executive Board would be triggered.

[5] Floor is adjusted to exclude UN peace keeping operations, in line with the TMU.

Table 2. Rwanda: Forward-Looking Reform Targets

Actions	Target Date
Fiscal	
Produce a report outlining detailed options for improving functioning of VAT, including measures that could be implemented in FY20/21.	end-Dec 2019
Automating the risk based verification process for refund claims.	end-Dec 2019
Begin producing quarterly budget execution reports in GFS 2014 format.	end-Dec 2019
Produce a comprehensive fiscal risk analysis statement.	end-Jun 2020
Contract a diagnostic study on optimal RSSB asset allocation.	end-Jun 2020
Expand coverage in fiscal reporting in GFS 2014 from budgetary central govt to central govt (i.e. including extrabudgetary entities) and local governments.	end-Dec 2020
Produce financial and management reports from the IT system for all schemes managed by RSSB.	end-Dec 2020
Monetary and Financial	
Improve communication for monetary policy by organizing quarterly outreach after each MPC meeting, including roundtable discussions with CEOs of commercial banks and other financial institutions, as well as other interested stakeholders.	end-Dec 2019
Publish macro projections for MPC decision making in quarterly inflation reports, according to best practices established by other central banks.	end-Jun 2020
Introduce a platform for issuing government securities using mobile phones.	end-Jun 2020
Produce a study on consumer payment behavor analyzing micro-level data on consumer payment choices.	end-Dec 2020
Expand industrial and market expectation surveys that feed into macro forecasting, begin collecting data to construct a purchasing manager's index, and accelerate publication of foreign private capital survey.	end-Dec 2020
Update the regulatory framework on true repo to rollout Global Master Repurchase Agreement (GMRA).	end-Jun 2021

Attachment II. Technical Memorandum of Understanding

1. **This memorandum defines the quantitative targets described in the Program Statement (PS) for the period: July 1, 2019 – June 30, 2020 supported by the IMF Policy Coordination Instrument (PCI),** and sets out the data reporting requirements.

2. **Program exchange rates**. For accounting purposes, the program exchange rates in Text Table 1 will apply.

Text Table 1. Program Exchange Rates from December 31, 2019
(US$ per currency unit, unless indicated otherwise)

Rwanda Franc (per US$)	923.1
Euro	1,024.6
British Pound	1,190.8
Japanese Yen (per US$)	107.0
SDR	1,273.9

A. Quantitative Program Targets

Ceiling on Debt-Creating Overall Fiscal Balance

3. **A ceiling applies to the debt-creating overall fiscal balance of the budgetary central government,** excluding Peace-Keeping Operations and including grants. The ceilings for December 31, 2019 and June 30, 2020 are cumulatively measured from June 30, 2019.

4. **Definition.** For the program, the debt-creating overall fiscal balanceis defined by the overall fiscal balance, valued on a commitment basis including grants and excluding the following items: (i) any transaction in expense and/or financial assets added to the budgetary central government arising from debt assumption of called loan guarantees for which the corresponding guaranteed loan had already been included in the Debt Sustainability Analysis of the IMF and World Bank (DSA); and (ii) all expenses in UN peacekeeping operations (PKO) and disbursed PKO financing. Overall fiscal balance is defined according to the GFSM 2014 as net lending/net borrowing after transactions in assets and liabilities are adjusted for transactions deemed to be for public policy purposes (policy lending). Budgetary central government expenditure (i.e. expenses plus net acquisition of non-financial assets) is defined on the basis of payment orders accepted by the Treasury, as well as those executed with external resources. This quantitative target is set as a ceiling on the debt-creating overall fiscal balance as of the beginning of the year.

Adjusters to the Debt-Creating Overall Fiscal Balance:

- The ceiling on the debt-creating overall balance will be adjusted upward by the amount of any shortfall between actual and programmed budgetary grants (as defined in Table 1a of the PS), up to a maximum of RWF 97 billion.

- The ceiling on the debt-creating overall balance will be adjusted upward, up to a maximum of RWF97 billion, representing the amount of *foreign financed net acquisition of non-financial assets* (*foreign financed capital expenditure*) financed with drawdown of accumulated government deposits.
- The ceiling on the debt-creating overall balance will be adjusted upward by the amount of unexpected public expenditures (expenses, and/or *net acquisition of non-financial assets*) on food imports in the case of a food emergency.

Floor on Net Foreign Assets of the National Bank of Rwanda

5. A floor applies to the net foreign assets (NFA) of the NBR for December 31, 2019 and June 30, 2020.

6. Definition. NFA of the NBR in Rwandan francs is defined, consistent with the definition of the Special Data Dissemination Standard (SDDS) template, as external assets readily available to, or controlled by, the NBR net of its external liabilities. Pledged or otherwise encumbered reserve assets (including swaps) are excluded; such assets include, but are not limited to, reserve assets used as collateral or guarantee for third party external liabilities. Reserves assets corresponding to undisbursed project accounts are also considered encumbered assets and are excluded from the measurement of NFA for program purposes. Foreign assets and foreign liabilities in U.S. dollars are converted to Rwandan francs by using the U.S. dollar/Rwanda franc program exchange rate. Foreign assets and liabilities in other currencies are converted to U.S. dollars by using the actual end-of-period U.S. dollar/currency exchange rate. Foreign liabilities include, inter alia, use of IMF resources.

Adjusters:

- The floor on NFA will be adjusted downward by the amount of any shortfall between actual and programmed budgetary loans and grants per Table 1 of the PS, capped at RWF 97 billion.
- The floor on NFA will be adjusted downward (upward) by the surplus (shortfall) of cash external debt service payments compared to originally-scheduled payments.
- The floor on NFA will be adjusted downward by the amount of unexpected public expenditures on food imports in the case of a food emergency.

Ceiling on the Stock of External Payment Arrears

7. A continuous ceiling applies to the non-accumulation of payment arrears on external debt contracted or guaranteed by the budgetary central government and entities that form part of the budgetary process.

8. Definition. External payment arrears are defined as the amount of overdue external debt service obligations (principal and interest) arising in respect of obligations incurred directly or guaranteed by the budgetary central government and entities that form part of the budgetary process. A payment is overdue when it has not been paid in accordance with the contractual date (taking into account any contractual grace periods). Arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is sought are excluded from this definition.

Ceiling on Net Accumulation of Domestic Expenditure Arrears of the Budgetary Central Government

9. A ceiling applies to net accumulation of domestic expenditure arrears of the budgetary central government.[1] The ceilings for June 30, 2019 is cumulatively measured from June 30, 2018. The ceilings for December 31, 2019 and June 30, 2020 are cumulatively measured from June 30, 2019.

10. **Definition.** Domestic expenditure arrears are defined as unpaid claims that are overdue by more than 90 days. Accumulation of domestic expenditure arrears of more than 90 days is calculated as a cumulative change in the stock of expenditure arrears of more than 90 days at each test date from the stock at the end of the previous fiscal year (June 30). Arrears related to claims preceding 1994 will not be counted in the calculation.

B. Monetary Policy Consultation Clause (MPCC)

11. **Definition**. MPCC headline inflation is defined as the year-on-year rate of change of monthly Consumer Price Index (CPI), averaged for the past 12-months, as measured by National Institute of Statistics Rwanda (NISR).

- If the observed headline inflation falls outside the ±3 percentage point range around the mid-point of target band value for end-June 2019, end-December 2019, and end-June 2020 test dates, the authorities will conduct discussions with the Fund staff.
- If the observed headline inflation falls outside the ±4 percentage point range around 5 percent for end-June and end-December 2019, and end-June 2020 test dates as specified in Table 1a in the PS, the authorities will complete a consultation with the Executive Board which would focus on: (i) the stance of monetary policy and whether the Fund-supported program remains on track; (ii) the reasons for program deviation, taking into account compensating factors; and (iii) proposed remedial actions if deemed necessary.

C. Memorandum Items and Data Reporting Requirements

12. For the purposes of program monitoring, the Government of Rwanda will provide the data listed below and in Table 1. Unless specified otherwise, weekly data will be provided within seven days of the end of each week; monthly data within five weeks of the end of each month; quarterly data within eight weeks.

[1] A negative target thus represents a floor on net repayment.

13. Data on **priority expenditure** will be transmitted on a quarterly basis. Priority expenditure is defined as the sum of those recurrent expenditures, domestically-financed capital expenditures, and policy lending that the government has identified as priority in line with the NTS. Priority expenditure is monitored through the Integrated Financial Management System (IFMS) which tracks priority spending of the annual budget at the program level of the end of each quarter.

14. Detailed data on **domestic revenues** will be transmitted on a monthly basis. The domestic revenue is defined according to GFSM 2014 taxes and other revenues s), per the budgetary central government statement of operations table, but including: (a) local government taxes (comprised of business licenses, property tax, and rental income tax); and (b) local government fees; and excluding and receipts from Peace Keeping Operations.

15. Data on **the contracting and guaranteeing of new non-concessional external borrowing with non-residents** will be transmitted on test dates. The data excludes external borrowing by two state-owned banks, the Bank of Kigali and Rwanda Development Bank (BRD), which are assumed not to seek or be granted a government guarantee. The data also applies to private debt for which official guarantees have been extended, including future swaps involving foreign currency loans guaranteed by the public sector, and which, therefore, constitute a contingent liability of the public sector. The data will exclude external borrowing which is for the sole purpose of refinancing existing public-sector debt and which helps to improve the profile of public sector debt. The data will also exclude on-lending agreement between Government of Rwanda and public-sector enterprises.

16. The authorities will inform the IMF staff in writing prior to making any changes in economic and financial policies that could affect the outcome of the financial program. Such policies include, but are not limited to, customs and tax laws, wage policy, and financial support to public and private enterprises. The authorities will inform the IMF staff of changes affecting respect of continuous QTs. The authorities will furnish a description of program performance according to QTs as well as reform targets within 8 weeks of a test date. The authorities engage to submit information to IMF staff with the frequency and submission time lag indicated in TMU Table 1. The information should be mailed electronically to the Fund. (email to the ResRep and the mission chief).

Table 1. Rwanda: Summary of Reporting Requirements			
	Frequency of Data[8]	Frequency of Reporting[8]	Frequency of Publication[8]
Exchange Rates[1]	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	W	W	M
Reserve/Base Money	W	W	M
Broad Money	M	M	M
Central Bank Balance Sheet	W	W	M
Consolidated Balance Sheet of the Banking System	M	M	M
Interest Rates[3]	M	M	M
Volume of transactions in the interbank money market, repo operations, and foreign exchange markets, sales of foreign currencies by NBR to commercial banks and other foreign currency interventions by NBR.	D	W	W
Composite Index of Economic Activity (CIEA) and sub-components compiled by the NBR	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] — General Government[5]	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[4]— Budgetary Central Government	Q	Q	Q
Financial balance sheet – Budgetary Central Government	A	A	A
Comprehensive list of tax and other revenues[6]	M	M	M
Budget tables	Submitted to Parliament		
Revised budget tables	Submitted to Parliament		
Disposal of non-financial assets and policy lending[6]	Q	Q	Q
Comprehensive list of domestic arrears of the government	SA	SA	SA
Stocks of public sector and public-Guaranteed Debt as compiled by MINECOFIN and NBR[7]	Q	Q	Q
External Current Account Balance	A	SA	A
Exports and Imports of Goods and subcomponents.	M	M	Q
Exports and Imports of Goods and Services and subcomponents	A	A	A

[1] Includes the official rate; Foreign Exchange Bureau Associations rate; weighted average of the interbank money market rates; and weighted average of the intervention rate by the NBR.
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[3] Both market-based and officially-determined, including discount rates, money market rates, key repo rate (KRR), rates for standing facilities, rates in repo transactions of the NBR with banks, interbank money market rate, rates on treasury bills, notes and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Includes proceeds from privatization, accompanied by information on entities privatized, date of privatization, numbers and prices of equities sold to the private sector.
[7] Includes debts of the Bank of Kigali. Also includes currency and maturity composition.
[8] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Semi-annually (SA); Irregular (I).