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Rwanda: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

December 21, 2017

The following item is a Letter of Intent of the government of Rwanda, which describes the policies that Rwanda intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Rwanda, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

Letter of Intent

Kigali, Rwanda
December 21, 2017

Ms. Christine Lagarde

Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C., 20431

Dear Ms. Lagarde,

1. In the attached update of the Memorandum of Economic and Financial Policies (MEFP), we outline progress and policies toward meeting the objectives of the economic program of the Rwandan government that is supported by the SCF arrangement and the PSI for Rwanda.

2. The external shocks experienced in 2015 have receded and the external account has registered an increase in coverage of reserves to above 4 months of imports, from 3.6 percent in 2015. This is partly explained by Rwanda's adjustment program involving significant exchange rate depreciation in 2016, public spending restraint, and prudent monetary policy. Other contributing factors include favorable movements in international commodity prices as well as increasing domestic production supported by Made in Rwanda strategies.

3. The fiscal situation has been in line with the program and the debt has also been kept at sustainable level. However, growth slowed in the first half of 2017 due to low contribution from the construction sector, adjustment policies and extended drought from 2016. Consequently, growth for 2017 has been revised down by 1 percentage points of GDP to a projection of 5.2 percent. In the medium term, the positive impact of the Made in Rwanda, the construction of a new airport and the investment in mining value addition should help stimulate growth.

4. We met all end-June 2017 and continuous quantitative assessment/performance criteria under the program and most structural benchmarks were met or are in progress. The indicative target on domestic arrears was not met by a small margin, owing to difficulties in separating out those less/greater than 90 days. This issue is being remedied going forward through improvements in treasury cash management forecasts in matching these against seasonal spending.

5. We will continue to safeguard the progress made to sustain long-term economic growth through keeping fiscal and external balances sustainable. Raising fiscal revenues is an important component of our consolidation strategy, we will continue to make progress in broadening the tax

base and strengthening the capacity in tax compliance. In addition, we are in the process of conducting a tax expenditure analysis to better target tax incentives. We will continue to press forward with public financial management reforms to enhance efficiency, transparency and accountability in the public sector to complement the envisaged fiscal consolidation efforts. On the external front, together with a gradual increase in financial flows, projected current account improvements should support a continued recovery in external buffers and external reserves are projected to reach 4.3 months of prospective imports by 2019.

6. Our monetary policy will continue to remain prudent to maintain the inflation close to our medium-term target level of 5 percent. To that end, we will continue to strengthen the monetary policy framework by maintaining our efforts to transition to interest rate-based operational framework, in the context of a flexible exchange rate regime.

7. In view of this performance of our program supported by the SCF arrangement and the PSI, our Government requests that the Executive Board of the IMF (i) complete the eighth review under the PSI and third review under the SCF program; (ii) approve the fourth disbursement under the SCF arrangement; and (iii) extend the PSI program until December 1, 2018, with proposed supporting program conditionality.

8. We are confident that the policies described in the attached MEFP will serve to achieve our program's objectives and, if necessary, our Government stands ready to take any additional measures that may be required. We will consult with the Fund on the adoption of such measures and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

9. We consent to the publication of this letter, and its attachments as well as the related staff report.

Sincerely yours,

/s/

Claver Gatete

Minister of Finance and Economic Planning

/s/

John Rwangombwa

Governor, National Bank of Rwanda

Attachments: I. Memorandum of Economic and Financial Policies
II. Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

Kigali, December 21, 2017

A. Introduction

1. This MEFP reviews performance under the SCF arrangement and PSI-supported program through end-June 2017 and discusses the macroeconomic outlook and policies of the Government for the remainder of 2017 and beyond. It also lays out proposed quantitative targets for end-December 2017, end-June 2018, and structural benchmarks through the 10th PSI review 2018.

B. Macroeconomic Developments and Program Performance through Q2 2017

Growth and Inflation

2. GDP growth during the first half of the year recorded a low rate of 2.9 percent on average, mainly due to low growth of the industry and services sectors. The lack of growth in industry (0.0percent) was the most disappointing, as activity in construction recorded a deceleration of -5.5 percent during the first half of 2017, following completion of large infrastructure projects of last year. At 5.5 percent, the services sector growth was well below its 5-year average growth, as its most important sector, wholesale & retail trade was affected by the slowdown in agriculture and reduced imports. Promisingly, though, the sub-sectors that have seen a lot of investment recently, hotels and restaurants, as well as real estate, grew strongly (13 percent and 7.5 percent respectively). In agriculture, whilst food crops are finally showing signs of recovering from the drought of last year, export crops shrunk relative to the first half of last year. However, overall agricultural growth was good at 4.5 percent.

3. During the remainder of 2017, agriculture output is expected to remain strong with a good season B for agriculture and construction is projected to pick up due to the preliminary phase of the Bugesera Airport. Reflecting the low outturn during the first half of the year, average GDP growth for 2017 has been revised down to 5.2 percent from 6.2 percent previously projected.

4. On average, headline inflation rose to 5.6percent during the first ten months of 2017, from 5.5 percent recorded during the same period of 2016. The main inflationary pressures in 2017 came from rising food prices in line with the effect of a prolonged dry season experienced in 2016 and early 2017. In 2017Q1 headline inflation remained high at 7.7 percent, but has since declined significantly, settling at 3.6 percent in October 2017. This decline in inflation was due to the easing of food inflation in line with an improvement in weather conditions, a reduction in exchange rate pressures, weak aggregate demand, and subdued pressures from the external sector as international commodity prices remain low and global inflation is generally anchored. Core inflation also remained moderate, averaging at 4.3percent in the first ten months of 2017 compared to 3.9 percent of the same period in 2016. Headline Inflation is expected to remain benign, standing at around 4.0 percent by end December 2017.

External Position

5. Since mid-2016, the adjustment policies implemented under the SCF have helped reverse growing external imbalances. During the first eight months of 2017, the trade balance in merchandise improved by 24.9 percent, driven by strong performance in formal exports, which grew by 44.9 percent, while formal imports declined by 7.9 percent. The strong export performance was broad based and supported by an increase in international commodity prices as well as increasing domestic production supported by Made in Rwanda strategies. The latter, combined with the previously-mentioned slowdown in construction activities, also helped reduce imports.

6. This has helped to rebuild reserves buffers to above 4 months of imports, from 3.6 months of imports in 2015 when the shock took place.

Fiscal Performance and Financing

7. Fiscal performance in FY2016/17 was largely satisfactory. Total domestic revenue collections were 0.6 percent of GDP higher than projected mainly reflecting faster disbursements related to UN Peace Keeping Operations. Tax revenue collections slightly exceeded the target by 0.1 percent of GDP. This performance was largely due to strong collection of corporate income taxes, especially from the financial and other services sectors (including transportation and storage sub sectors), as well from personal income taxes, reflecting increased employment in the services sector. This improved performance mitigated shortfalls from taxes on goods and services due to lower consumption taxes and lower taxes on international trade, both reflecting lower imports of used clothes, cement, and some types of vehicles and computer accessories, all stemming from policy incentives to reduce imports (under the umbrella of the “Made in Rwanda” campaign).

8. In the area of external disbursements, current grants registered a small excess, mainly on account of exchange rate differentials. Delays in the removal of bottlenecks for new project loan draw-downs led to lower disbursements and lower implementation of the foreign-financed projects than projected.

9. Regarding expenditures, total expenditure and net lending in fiscal year 2016/17 was about 0.5 percent of GDP higher than projected. Both recurrent and capital spending contributed to this performance. In the case of recurrent spending, the excess spending of 0.4 percent of GDP was mainly due to wage overruns on account of new recruitments of teachers and other civil servants in some economic ministries. With regards to capital spending, the excess came from draw-down of project deposits for the implementation of some on-going projects.

10. The overall deficit (on cash basis) was 4.9 percent of GDP. However, as a result of the lower draw-down of project loans, net domestic financing (0.4 percent of GDP) was slightly higher than the -0.1 projected. This did not count against the program indicative target for net domestic financing, however.

Debt Management

11. In the most recent debt sustainability analysis, Rwanda is assessed to be at low risk of debt distress, despite a temporary breach under the liquidity indicator, which is associated to the 10-year Eurobond maturing in 2023.

12. Rwanda's external debt portfolio remains mostly constituted of concessional loans (72 percent as end June 2017), and this will continue to be the main source of funding for public projects going forward.

13. At the end of FY 2016/2017, the share of domestic debt stock out of total debt stock increased to 23 percent, against 21 percent in December 2016. This increase was mainly attributed to debt securities issued for cash flow purposes, but to also a small portion of issued guarantees (RwF 80 billion), denominated in Rwandan franc, and which will be redeemed, if needed, within the next five years. Regarding domestic debt, the large share of shorter-term treasury bills is the main concern, as it could potentially constitute a rollover risk, however, government will continue to make efforts to extend the domestic debt maturity profile through issuance of longer-term bonds.

Monetary Policy and Exchange Rate Developments.

14. Given that both inflationary and exchange pressures were expected to decline, BNR conducted an accommodative monetary policy stance, reducing its policy rate (KRR) twice, from 6.5 percent to 6.25 percent in December 2016 and to 6.0 percent in June 2017. As result, as of end September 2017, broad money M3 and reserve money increased Y-o-Y by 16.4 percent and 9 percent respectively, against 13.0 percent and 10.9 percent projected for end December 2017 during the 7th PSI/2nd SCF review discussions in May 2017. Private sector credit growth also picked up, to 9.6 percent in September, compared to 9.1 percent recorded for the whole year 2016. However, despite the recovery observed in 2017 compared to 2016, the growth in monetary aggregates is still below historical trends on account of weak credit demand, reflecting the overall slowdown of economic activities.

15. In line with the monetary policy stance, money market interest rates have been declining and trends have evolved in tandem with the key repo rate. Interbank rates have remained close to the policy rate and the center of BNR's interest rate corridor (200 basis points), and recent movements in repo and T-bill rates are consistent with establishing a viable interest rate corridor. However, transmission to longer-term interest rates remains to fully materialize. In 2017Q3, both lending and deposit interest rates decreased, standing at 17.4 percent and 7.7 percent respectively, from 17.5 percent and 8.0 percent in 2016Q3.

16. Since the beginning of 2017, pressure on the Rwandan Franc (RwF) has eased. The RwF depreciated by 2.2 percent against the USD from end-December 2016 through end-September 2017. This more modest pace of depreciation, compared to 8.4 percent observed in the same period of 2016, reflects that the exchange rate is now more closely aligned with its equilibrium value and is supported by the observed improvement in Rwanda's external position. Going forward, the NBR will

ensure that the exchange rate remains market driven, only making timely interventions to smooth out excessive volatility in the exchange rate.

Financial Sector Developments

17. Rwandan financial soundness indicators suggest banking system remains highly liquid and well capitalized. As at end-September 2017, the capital adequacy ratio (CAR) stood at 22.2 percent—well above the regulatory minimum of 15 percent. However, asset quality and profitability indicators weakened somewhat y-on-y through September 2017, with NPLs at 8.3 percent and return on assets declining slightly to 1.6 percent, compared to 7.5 percent and 1.9 percent, respectively. The increase of NPLs ratio reflected the slowdown in economic activities and some impairment of a few large loans in banks due to weak credit underwriting and project monitoring. In line with BNR’s supervisory demands, the concerned banks have improved their loan recovery processes and are working with the debtors to improve their leverage ratios (including through opening up for further capital injections) and income-earning assets.

18. Performance among non-bank financial institutions has continued to strengthen. In microfinance institutions (MFIs), NPLs decreased from 8.2 percent in September 2016 to 8.0 percent in September 2017, while the capital adequacy ratio increased from 33.2 percent to 36.0 percent, significantly above the prudential minimum of 15 percent. There has also been notable improvement in the performance of private insurance companies in 2017. Their solvency ratio stood at 160 percent against -37 percent in September 2016 (and a prudential minimum of 100 percent), while liquidity ratio improved to 121 percent. This improvement partly reflects recent capital injections and improved revenue and cost management practices as part of the sub-sector’s reforms required by BNR.

Program Performance

19. All quantitative assessment criteria were met in the period under review although the IT on domestic arrears was not met, by a small margin, owing to difficulties in separating out those less/greater than 90 days. This issue is being remedied going forward through monthly tracking cash tax and non-tax flows to ensure better forecasting of inflows and spending needs, and prompt payment of all due bills. Most structural benchmarks were met. The only benchmark not met was the piloting of new Electronic Billing Machines (EBM) because RRA has decided to use alternative EBM solutions (software that can be installed on phones and computers) to lessen problems associated with the existing machines. This benchmark has been reformulated to focus on the new approach and is now proposed for the final PSI review in the second half of 2018.

C. Macroeconomic Outlook

Growth and Inflation

20. The economy is expected to grow by 6.5 percent in 2018 and above 7 percent from 2019 onward. All the main sectors are expected to contribute to this broad-based growth: agriculture led

by an increase in the production of food crops arising from the progress in irrigation and better application of fertilizer and improved seeds; industry boosted by construction associated with Bugesera Airport, roads and other big projects in real estate and industrial parks. Private sector credit growth is also projected to boost output as well as higher growth of agriculture impacting on trade in services. Inflation should remain contained at 5 percent by the end of 2018 as exchange rate pressures, global inflation, international commodity prices and aggregate demand are foreseen to remain subdued. However, adverse weather conditions could put pressure on food prices and threaten the inflation target.

External Position.

21. The external position is expected to continue to strengthen over the medium term. In 2017, the current account deficit is expected to narrow more than previously anticipated to 8.8 percent of GDP, reflecting, in part, observed strong export performance. The headline current account deficit is expected to widen temporarily in 2018, to 10 percent of GDP, due to imports associated with the construction of Bugesera Airport. But, excluding the impact of Bugesera, positive export trends and more modest import growth are expected to support the continued narrowing of the current account deficit to around 7.6 percent of GDP by 2019. Together, with a gradual increase in financial flows, these current account improvements should support a continued recovery in external buffers—gross official reserves are projected to reach 4.3 months of prospective imports by 2019.

D. Program Policies for 2017–18 and the Medium Term

Fiscal Policy Stance for FY17/18.

22. The original 2017/18 budget approved by Parliament reflected the continued fiscal consolidation and prudent borrowing policy to keep debt and external balances sustainable. Accordingly, the fiscal deficit projected for the fiscal year was 3.7 percent of GDP. Revenue and grants were estimated at 22.1 percent of GDP with tax revenue at 15.3 percent of GDP. Total expenditure and net lending was projected at 25.8 percent of GDP.

23. Fiscal performance in the first quarter of fiscal year 2017/18 falls close to the parameters of the original budget. Total tax revenue collections are marginally lower than the projected amount with consumption taxes accounting for the small shortfall. Total expenditure and net lending is marginally higher than the figure estimated for the period with higher net domestic finance plugging the resource gap.

24. The budget for fiscal year 2017/18 has been revised to provide resources for the creation of new Ministries and other public institutions by the new Government following the August elections and expand net lending (to the tourism sector). This cost is about 0.5 percent of GDP. Accordingly, the fiscal deficit is now revised upwards to 4.2 percent of GDP with the increase in the deficit financed by domestic credit at about 0.3 percent of GDP (the original budget had a government deposit drawdown of 0.2 percent of GDP).

Fiscal Policy Stance for FY 18/19.

25. Fiscal policy in 2018/19 and the medium term will continue the fiscal consolidation and prudent borrowing policies to make debt and external balances sustainable. Tax revenue collections (estimated at 15.7 percent of GDP in the revised budget for 2017/18) are projected to remain at the same level in 2018/19. Several on-going tax revenue policies and other administrative measures should drive improvement over the medium term. These measures include the revision of the property tax law and expansion of the use of the electronic billing machines beyond VAT to track total sales and boost all sources of tax collections. Moreover, the EBM expansion will improve data collection to help reduce fraud and other leakages.

26. Total expenditure and net lending (at 26.7 percent of GDP in the revised 2017/18 budget) is projected to decline to 26.4 percent of GDP in 2018/19. Expenditure prioritization measures are currently being implemented to contain recurrent spending. Consistent with these projections, the overall deficit projected at 4.2 percent of GDP in the revised 2017/18 budget, is expected to remain at broadly similar levels in 2018/19 and 2019/20.

Medium-Term Tax Policy and Administration Measures.

27. The main medium term tax strategy of the Rwanda Revenue Authority (RRA) is to improve overall tax compliance. The TADAT assessment report of August 2015 identified uneven compliance management interventions across the RRA. With IMF TA support, this led to the development of a *Compliance Risk Analysis Model and Tool* based on best practices to help improve the taxpayer's attitude and behavior toward fulfilling his obligations. Based on the technical support, RRA has developed the *Compliance improvement plan* for FY2016/2017 for the Construction and Hotels Sectors targeting better compliance across all taxpayer segments. i.e. Large, Medium and Small taxpayers. This has resulted in a very good performance of indirect tax revenues collected from the targeted sectors. The FY2017/18 compliance improvement plan will focus on Real Estate activities, bars and restaurants and professionals' activities as well as Importers and Customs brokers. It will also strengthen its oversight on the Construction and hotel Sectors.

28. The use of EBMs is the centerpiece of RRA's compliance strategy. Introduced in 2013, EBMs have helped boost VAT collection and RRA is planning to expand the use of the EBMs beyond VAT to improve the information basis for income tax collection. RRA is now developing a software alternative to the hardware EBM (EBM version 2) which is compatible with devices being used by businessmen. This will remove the necessity and cost of acquiring a new EBM device. By late 2018, the roll out of EBM version 2 software will be applied to 1,000 taxpayers, and raise registration beyond the usual annual increase of VAT registered taxpayers that use the hardware EBMs (Table 2).

29. To assess the effectiveness and economic impact of tax incentives in place to promote investment (Investment Code 2015) and stimulate local production (incentives associated with the "Made In Rwanda"), we have requested IMF TA support to help conduct a tax expenditure analysis. The TA will cover the documentation all of the current legislation that offers preferential tax treatment and provide cost estimates of the preferences against a suitable benchmark. This work is

ongoing and will help inform us to balance the positive economic impact of incentives against potential revenue loss over the medium term.

Public Finance Management Measures

30. In recent years, the financial sector has supported big projects that have expanded the economy. However, these investments may pose a risk to the stability of the financial sector and become explicit liabilities. To help mitigate fiscal risks and their potentials costs, we are planning to conduct a fiscal risk analysis of strategic sectors (hotels and insurance) to assess fiscal risks (Table 2). The objective of the analysis is to safeguard fiscal and financial sustainability.

31. The government is taking steps to improve the timeliness, frequency and coverage of fiscal reporting. The budget execution report is published every quarter and this year, steps are being taken to report in GFS-2014 framework starting FY2018/19. Starting FY2018/19, quarterly budget execution reports for the budgetary central government will be published in GFS-2014 format. Supporting work is underway to develop an accrual based chart of accounts and a roadmap and blueprint for migration to accrual accounting. The goal is to achieve comprehensive compilation and reporting of general government stock positions on financial assets and liabilities. An IMF Fiscal Transparency Evaluation has been requested for the second half of 2018, to assess the comprehensiveness, clarity, reliability, timeliness, and relevance of public reporting on public finances. This work will complement the transition to GFS-2014 framework and will provide, among other things, a systematic analysis of the scale and sources of fiscal vulnerability.

Monetary Policy Stance and Structural Reforms

32. Monetary policy remains prudent, supported by continued exchange rate flexibility. On 27th September, BNR's monetary policy committee (MPC) decided to keep the KRR at 6percent based on macroeconomic fundamentals, namely the ease in inflationary pressures, stable FRW exchange rate and still weak aggregate demand. The next ordinary MPC meeting is scheduled for December 2017 and the stance will depend on the prevailing macroeconomic fundamentals. However, it is worth mentioning that BNR projections show no sign of inflationary pressures, which indicates that the stance may remain accommodative.

33. Plans to transition to interest-rate based operational monetary policy framework are on track: BNR undertook steps to implement preconditions to move to a forward-looking monetary policy framework, especially those related to management of liquidity and policy making processes. Practically, BNR made progress by putting in place a "Financial Market Operations Committee" in charge of daily financial market analysis, liquidity management and forecasting. BNR also initiated regular discussions with commercial banks' treasurers about market developments, including money market operations. As result, the interbank market has started to grow in both depth and width and the BNR has succeeded in keeping the interbank market rate close to the Key Repo Rate for over a year.

34. Moreover, the NBR forecasting and policy analysis system (FPAS) for forward-looking policy formulation remains increasingly important and useful tool for MPC processes. Measures planned for 2017–18 to implement the framework that uses interbank money market rates as the operational target are:

- **Interbank market development.** A well-functioning interbank market not only facilitates liquidity management by banks, but it is also the cornerstone of financial market development. Similarly, the BNR can, through active and consistent management of system liquidity, influence the determination of interest rate in the interbank money market. In this context, BNR intends to introduce an electronic interbank trading platform to enhance information sharing among market participants and improve price discovery (Table 2). In addition, BNR is taking steps to deepen government securities market and enhance the yield curve. These include establishing a re-opening mechanism for long-term bonds (reissuing the same bond at different occasions) to gradually build their outstanding volumes to the desired levels to qualify them as benchmark bonds (Table 2).
- **Communication.** When central banks make the transition from quantitative to a market based monetary policy, effective communication becomes imperative. On this regard, BNR is developing a communication strategy to enhance its transparency and accountability by effectively communicating its policy decisions, economic developments and outlook, and through strengthening the communications content of the inflation report, in a bid to anchor price expectations. This will be important for markets and the public to understand the nature of shocks and BNR’s policy responses (Table 2).
- **Capacity development.** BNR will need to develop in-house capacity during the transition period and create a path where each block reinforces each other. There will be therefore need to build in parallel the different blocks of an IT scheme along different stages.
- **Forecasting and policy analysis system (FPAS).** The BNR has restructured its publications to become more compatible with forward looking communication, in particular, creating a more forward looking inflation report. The BNR will continue to operationalize the FPAS, by: (i) setting up a formal unified forecasting team with well-defined individual roles; and (ii) redesigning the forecast process to increase interactions with decision makers.
- **Determine the optimal level of inflation target range.** Having committed to move towards a price based monetary policy framework, BNR is conducting a study which will recommend an optimal band for headline or core inflation. (Table 2)
- **Reduce the level of excess reserves.** Rwanda’s banking system faces persistent and volatile bank excess reserves, which pose a challenge to monetary policy transmission mechanism and financial stability. Excess liquidity leads to disintermediation as it reduces banks’ profitability and discourages deposit taking. It also encourages excessive risk taking, lowers credit quality, compromises monetary policy transmission mechanism, and possibly destabilizes the foreign exchange market.

Financial Sector Stability and Development

35. BNR will continue to implement structural reforms in the financial sector to promote financial deepening and resilience:

- In the banking sector, a new Banking Law, gazetted in October 2017, paves the way for Rwanda to be fully compliant with the Basel Core Principles, harmonizes the financial sector legal framework with that across the EAC, introduces the risk management framework, and gives clarity on loan classification. New capital and liquidity regulations compliant to Basel II/III were also approved and gazetted in May 2017. Parallel reporting under the old and new framework has been on-going, while full implementation is expected to start early 2018;
- Other recent banking sector regulatory reforms include revisions on banks' business continuity management; a new cyber security regulation (establishing minimum prudent standards for protection against cybersecurity threats); and new regulation on the outsourcing of banks (to ensure that appropriate processes, procedures, and information systems are in place that can adequately identify, monitor, and mitigate operational risks arising from the outsourced activities). BNR also approved the revised regulations on corporate governance of banks and insurance companies. The revised regulations clarify and emphasize the role of the Board of Directors and enhance independence, suitability, transparency and accountability of Boards and subsidiary boards
- For non-banks, BNR is in the process of licensing new voluntary pension schemes and service providers following the enactment of the pension law in 2015 and its implementing regulation in 2016. BNR also approved new Microfinance and Insurance laws, both of which are undergoing reviews before parliamentary enactment, which will be followed by implementing regulations. We are also working with Access to Finance Rwanda (AFR) to establish micro-insurance regulatory frameworks to boost the penetration level in the insurance sector.
- To create a more calibrated, flexible and forward-looking regulatory framework in the Payment Systems space, the BNR reviewed the regulation on Payment System Providers (PSPs) to include an activity and risk based approach to supervision of PSPs as well as introduce Regulatory Sandboxes to enhance innovation. This regulation was further supplemented by two new regulations one for Remittance Services and another for Payment Initiation and Aggregation Services. This will allow these services to be expressly regulated.
- On consumer protection, in addition to the draft law on Financial Consumer Protection and the regulation on Key Facts Statements for Credit, Accounts and Insurance, the BNR put in place a single portal (price comparator) where consumers can compare bank charges prior to taking a bank related decision. The implementation of the disclosure regulations (Key Facts Statement) is on-going and monitored through on-site inspections.
- In the payment system development, BNR started enforcing e-money regulations for safeguarding the users. It is also assessing gaps in the Automated Clearing House (ACH) system and the RIPPS technology compared to standard principles for financial market infrastructure. BNR also approved the following regulations aim at strengthening the

payments system: regulation on Payment Service Providers; regulation on Payment Initiation Service (Payment Gateways, Payment Aggregators and Payment Providers); and the regulation on Remittance Service.

- On financial integrity, the BNR in collaboration with other Government institutions are conducting a national risk assessment of ML/FT. Findings from this exercise will inform strategies to bridge any gaps in the AML/CFT frameworks.

36. The Government of Rwanda requests the completion of the eighth review under the PSI and third review under the SCF arrangement. We also request extension of the current PSI program through December 1, 2018, and addition of two additional semi-annual reviews (9th and 10th Reviews) under the PSI. The 9th and 10th reviews under the PSI are expected to take place by end-June 2018 and December 1, 2018, respectively.

Table 1. Quantitative Assessment Criteria, Performance Criteria, and Indicative Targets¹

	December 2017	June 2018
	Proposed Program	Proposed Program
(Billions of Rwandan francs, unless otherwise indicated)		
Assessment/Performance criteria		
Ceiling on the overall fiscal deficit, including grants ^{2,3}	241	365
Net foreign assets of the NBR at program exchange rate (floor on stock) ³	657	575
Reserve money (ceiling on stock) (upper bound) ⁴	348	365
Reserve money (ceiling on stock) ⁴	341	357
Reserve money (ceiling on stock) (lower bound) ⁴	333	349
External payment arrears (US\$ millions) (ceiling on stock) ⁵	0	0
Indicative targets		
Net domestic financing (ceiling on flow) ^{2,3}	-35	27
Domestic revenue collection (floor on flow) ^{2,6}	556	1246
Net accumulation of domestic arrears (ceiling on flow) ²	0	0
Total priority spending (floor on flow) ²	346	730
New external debt contracted or guaranteed by nonfinancial public enterprises (US\$ millions) (ceiling on stock) ⁵	500	500
Memorandum items:		
Total budget support (US\$ millions) ^{2,6}	331	477
Budget support grants (US\$ millions)	101	217
Budget support loans (US\$ millions)	230	260
RWF/US\$ program exchange rate	830	830

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 for December 2017 and June 2018 are cumulative from 6/30/2017.

³ Subject to adjustors. See TMU for details.

⁴ Targets are calculated as an arithmetic average of the stock of reserve money for the 3 months in the quarter. AC and PC applies to upper bound only.

⁵ Ceilings on external arrears and external borrowing are continuous. The ceiling will exclude onlending agreement between Government of Rwanda and public sector enterprises.

⁶ Excluding demobilization and African Union peace keeping operations, HIPC and COMESA grants.

Table 2. Proposed Structural Benchmarks Under the PSI-Supported Program

Policy measure	Target date
<p>Monetary</p> <p>Establish an optimal level of headline or core inflation target range for monetary policy</p> <p>Develop and adopt a communication strategy on the objectives and operations of the monetary policy framework to enhance BNR transparency and accountability</p>	<p>10th PSI Review</p> <p>10th PSI Review</p>
<p>Financial Market</p> <p>Introduce Government bond reopening mechanisms with objective to develop benchmark bonds and promote depth and liquidity in the government bond market</p> <p>Establish an electronic interbank trading platform intended to improve banks' counterparty visibility and price formation in the market.</p>	<p>9th PSI Review</p> <p>10th PSI Review</p>
<p>Public Financial Management</p> <p>Provide quarterly revenues, expenditures, and financing estimates for the budgetary central government levels within 60 days of the end of each quarter.</p> <p>Begin publishing in GFS 2014 format for the quarter ending September 2018.</p> <p>Initiate a fiscal risk analysis of hotel and insurance sectors to assess potential contingent liabilities.</p>	<p>Each quarter</p> <p>10th PSI Review</p> <p>9th PSI Review</p>
<p>Fiscal Revenues</p> <p>Initiate the rollout of "EBM version 2" pilot, with the intent of reaching 1,000 new EBM users.</p>	<p>10th PSI Review</p>

Attachment II. Technical Memorandum of Understanding

Kigali, December 21, 2017

1. **This memorandum defines the quantitative targets described in the memorandum of economic and financial policies (MEFP) for the period July 1, 2017–December 31, 2018** supported by the IMF Policy Support Instrument (PSI), and sets out the data reporting requirements. This TMU updates the one of July 12, 2017.

I. QUANTITATIVE PROGRAM TARGETS

2. **The quantitative program will be assessed through assessment criteria (QAC), and indicative targets (IT) for the duration of the program.**

3. **QACs will apply for the following indicators for December 31, 2017 and June 30, 2018 (the test dates) throughout the program period:**

- Floor on stock of net foreign assets (NFA) of the National Bank of Rwanda (NBR);
- Ceiling on stock of reserve money;
- Ceiling on the overall fiscal deficit, including grants as measured on a commitment basis; and
- Ceiling on stock of external payment arrears of the public sector (assessed on a cont. basis).

4. **IT will apply to the following indicators for December 31, 2017 and June 30, 2018 (the test dates) throughout the program period:**

- Ceiling on flow of net domestic financing (NDF) of the budgetary central government;
- Floor on flow of domestic revenue collection of the budgetary central government;
- Ceiling on flow of net accumulation of domestic arrears of the budgetary central government;
- Ceiling on contracting or guaranteeing of new non-concessional external debt of nonfinancial public enterprises (assessed on a cont. basis); and
- Floor on flow of priority spending.

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

Text Table 1. Program Exchange Rates from June 30, 2017	
(US\$ per currency unit, unless indicated otherwise)	
Rwanda Franc (per US\$)	830.22
Euro	1.14
British Pound	1.30
Japanese Yen (per US\$)	111.94
SDR	1.35

II. INSTITUTIONAL COVERAGE OF THE FISCAL SECTOR

6. The budgetary central government fiscal operation table comprises the treasury and line ministries, hereafter referred to as “the government” unless specified otherwise.

III. TARGETS RELATED TO THE EXECUTION OF THE FISCAL PROGRAM

Ceiling on Net Domestic Financing of the Government (IT)

7. **A ceiling applies to NDF.** The ceilings for December 31, 2017, and June 30, 2018, are cumulatively measured from June 30, 2017.

8. **Definition.** NDF of the government is defined as the change in the sum of (i) net banking sector credit to the government and (ii) non-bank holdings of government domestically issued debt.

9. Net banking sector credit to the government is defined as:

- Consolidated credit to the government from the banking system (NBR and commercial banks, as recorded in the monetary survey). The outstanding consolidated government debt held by the banking system,¹ includes government debt to the NBR amounting to RWF 38.6 billion incurred as a result the overdraft to the pre-war government and the 1995 devaluation,² as well as the current overdraft with the NBR. Credit to the government will exclude treasury bills issued by the NBR for monetary policy purposes, the proceeds of which are sterilized in deposits held as other NBR liabilities.
- Less total government deposits with the banking system (as recorded in the monetary survey), including in the main treasury account, the accounts of line ministries, the fund for assistance to genocide survivors, the Rwanda Revenue Authority, the electoral commission, the demobilization commission, fonds routier, the privatization account, and the accounts of any other autonomous public enterprises and public agencies over which the government has direct control over their deposits. Thus, this definition excludes any government deposits over which the budgetary central government does not have any direct control (i.e., for project accounts, Global Fund money meant for the private sector, counterpart funds, and *fonds publics affectés*).

10. Non-bank holdings of government domestically issued debt consist of non-bank holdings of treasury bills, bonds (domestic and non-resident), old development bonds (pre-1994 debt), new

¹ Consisting of bank holdings of treasury bills, bonds (domestic), old development bonds (pre-1994 debt), new development bonds (including those used for recapitalization of banks), and other accounts receivable.

² The authorities will inform Fund staff of any substantive changes in government accounts with the banking system, which may affect the calculation of net bank claims.

development bonds (including those used for recapitalization of banks), and other accounts receivable.

Adjusters to NDF:

- The ceiling on NDF will be adjusted upward by the amount of any shortfall between actual and programmed budgetary grants and loans (as defined in Table 1 of the MEFP), up to a maximum of RWF 78billion. In the event that actual budgetary grants exceed programmed levels, the ceiling on NDF will not be adjusted. In the event that actual budgetary loans exceed programmed levels, the ceiling on NDF will be adjusted downward.
- The ceiling on NDF will be adjusted upward up to a maximum of RWF78 billion representing the amount of foreign financed capital expenditure financed with draw-down of accumulated government deposits as specified in the definition of NDF.
- The ceiling on NDF will be adjusted upward by the amount of unexpected public expenditures on food imports in the case of a food emergency.
- The ceiling on NDF will be adjusted upward (downward) up to a maximum of RWF78 billion, by any unplanned financing shortfall (surplus) from Peace Keeping Operations.

Overall Fiscal Deficit Including Grants (QAC)

11. **A ceiling applies to the overall fiscal deficit including grants.** The ceilings for December 31, 2017, and June 30, 2018, are cumulatively measured from June 30, 2017.

12. **Definition.** For the program, the overall fiscal deficit including grants is valued on a commitment basis. That is, the overall fiscal balance is the difference between the government's total revenue and grants and total expenditure and net lending (costs and acquisition net of nonfinancial assets). Government expenditure is defined on the basis of payment orders accepted by the Treasury, as well as those executed with external resources. This assessment criterion is set as a floor on the overall fiscal deficit as of the beginning of the year.

Adjusters to the Overall Fiscal Deficit Including Grants

- The ceiling on the overall deficit will be adjusted upward by the amount of any shortfall between actual and programmed budgetary grants (as defined in Table 1 of the MEFP), up to a maximum of RWF 78billion.
- The ceiling on the overall deficit will be adjusted upward, up to a maximum of RWF78 billion, representing the amount of foreign financed capital expenditure financed with draw-down of accumulated government deposits as specified in the definition of NDF.
- The ceiling on the overall deficit will be adjusted upward by the amount of unexpected public expenditures on food imports in the case of a food emergency.
- The ceiling on the overall deficit will be adjusted upward (downward), up to a maximum of RWF78 billion, by any unplanned financing shortfall (surplus) from Peace Keeping Operations.

Floor on Flow of Domestic Revenues (IT)

13. The floors for December 31, 2017, and June 30, 2018, are cumulatively measured from June 30, 2017.

14. **Definition.** The floor on domestic government revenue is defined as total government revenue (tax and non-tax revenues), 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.

Floor on priority expenditure

15. The floor applies to priority spending of the government. The floors for December 31, 2017, and June 30, 2018, are cumulatively measured from June 30, 2017.

16. **Definition.** Priority expenditure is defined as the sum of those recurrent expenditures, domestically-financed capital expenditures, and net lending that the government has identified as priority in line with the EDPRS2/NTS. Priority expenditure is monitored through the Integrated Financial Management System (IFMS) which tracks priority spending of the annual budget at the program level.

Net Accumulation of Domestic Expenditure Arrears of the Government (IT)

17. A ceiling applies to net accumulation of domestic expenditure arrears of the government.³ The ceilings for December 31, 2017, and June 30, 2018, are cumulatively measured from June 30, 2017.

18. **Definition.** Domestic expenditure arrears are defined as unpaid claims that are overdue by more than 90 days. These will include payments for tax refunds, employee expenses (wages and salaries, staff claims for travel, and other non-salary allowances), utilities, rents, recurrent goods and services, and construction works. 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.

IV. LIMITS ON DEBT

³ A negative target thus represents a floor on net repayment.

Limit on New External Debt of Nonfinancial Public Enterprises (IT)

19. **A ceiling applies to the contracting and guaranteeing by nonfinancial public enterprises of new external borrowing with non-residents (see below for the definition of debt guarantee and debt).** The ceiling excludes external borrowing by two state-owned bank, the Bank of Kigali and Rwanda Development Bank (BRD), which are assumed not to seek or be granted a government guarantee. The ceiling also applies to private debt for which official guarantees have been extended, including future swaps involving foreign currency loans guaranteed by the public sector (see below for swaps), and which, therefore, constitute a contingent liability of the public sector. The ceiling 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 ceiling will also exclude on-lending agreement between Government of Rwanda and public sector enterprises.

20. **Public sector includes the government, entities that are part of the budgetary process and nonfinancial public enterprises which are entities in which the government holds a controlling stake (owning more than 50 percent of shares),** but which are not consolidated in the budget. This definition of the public sector excludes and Rwanda Development Bank (BRD). For program purposes, the guarantee of a debt arises from any *explicit* legal obligation of the public sector to service a debt in the event of nonpayment by the debtor (involving payments in cash or in kind).

21. **The definition of debt** is set out in paragraph 8(a) of the Guidelines on Public Debt Conditionality in Fund Arrangements attached to Executive Board Decision No. 15688-(14/107), adopted December 5, 2014.

(a) The term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

- (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);
- (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and

- (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lesser retains the title to the property. The debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.
- (b) Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

Limit on the Stock of External Payment Arrears

22. A continuous performance/assessment criterion applies to the non-accumulation of payment arrears on external debt contracted or guaranteed by the government and entities that form part of the budgetary process. External payment arrears consist of external debt service obligations (principal and interest) that have not been paid at the time they are due, as specified in the contractual agreements, but shall exclude arrears on obligations that are subject to rescheduling. For the purpose of monitoring compliance with the PC on the non-accumulation of external arrears, external arrears are obligations that have not been paid on the due date (taking into account the contractual grace periods, if any). External payments arrears on external debt service obligations by nonfinancial public enterprises that the government holds a controlling stake (owning more than 50 percent of shares) but do not form part of the budgetary process and public private partnership projects (which are defined as (i) infrastructure projects which involve the (ii) granting of a government guarantee and the (iii) participation of a public enterprise) are not included in the coverage of this external arrears PC/AC, unless these external payment arrears are overdue (under the terms of the contracts including any grace periods) by more than 30 days.

II. V. TARGETS FOR MONETARY AGGREGATES

Net Foreign Assets of the National Bank of Rwanda (QAC)

23. A floor applies to the net foreign assets (NFA) of the NBR for December 31, 2017 and June 30, 2017.
24. **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 MEFP, capped at RWF 78 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.

Reserve money (QAC)

25. A ceiling applies to the stock of reserve money for June 30, 2017, and December 31, 2017 as indicated in Table 1. Quantitative Assessment Criteria and Indicative Targets of the MEFP. The ceiling is the upper bound of a reserve money band (set at +/- 2.2 percent) around a central reserve money target).

26. The stock of reserve money for a given quarter will be calculated as the arithmetic average of the stock of reserve money at the end of each calendar month in the quarter. Daily average of all the three months in the quarter will constitute the actual reserve money to be compared with the target.

27. **Reserve money** is defined as the sum of currency in circulation, commercial banks' reserves, and other nonbank deposits at the NBR.

Adjuster:

- The ceiling on the stock of reserve money will be adjusted symmetrically for a change in the required reserve ratio of commercial banks. The adjuster will be calculated as (new reserve ratio minus program baseline reserve ratio) multiplied by actual amount of liabilities (Rwanda Franc plus foreign-currency denominated) in commercial banks.

III. VI. DATA REPORTING REQUIREMENTS

28. 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 of the end of each quarter; annual data as available.

29. Data on **NDF** (showing separately treasury bills and government bonds outstanding, other government debt, and budgetary central government deposits), each type of debt to be shown by debt holder, will be transmitted on a monthly basis. Deposits of the government with the NBR and

with the commercial banks will be separated from the deposits of the public enterprises and autonomous public agencies and agencies that the government does not have any direct control over.

30. Detailed data on **domestic revenues** will be transmitted on a monthly basis. Data on **priority expenditure** will be transmitted on a quarterly basis. Data on accumulation and repayment of **domestic arrears** and the remaining previous year's stock of arrears will be transmitted on a quarterly basis.

31. Data on **foreign assets and foreign liabilities of the NBR** will be transmitted on a weekly basis, including breakdown of assets that are pledged or encumbered. This transmission will include daily and weekly data on the NBR's foreign exchange liabilities to commercial banks (including required reserves with the NBR) and the exchange rate used for their conversion into Rwanda francs will be shown separately.

32. Data on **reserve money** will be transmitted on a weekly basis. This transmission will include a daily and a weekly balance sheet of the NBR which will show all items listed above in the definitions of reserve money

33. 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 QACs and ITs. The authorities will furnish a description of program performance according to QACs and ITs as well as structural benchmarks 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: afrwa@imf.org).

TMU Table 1. Summary of Reporting Requirements

	Frequency of Data ⁹	Frequency of Reporting ⁹	Frequency of Publication ⁹
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 and foreign exchange markets and sales of foreign currencies by NBR to commercial banks	D	W	W
Consumer Price Index ⁴	M	M	M
Composite Index of Economic Activity (CIEA) and sub-components compiled by the NBR	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ⁵ —General Government ⁶	A	A	A
Revenue, Expenditure, Balance and Composition of Financing ⁵ — Budgetary Central Government	Q	Q	Q
Financial balance sheet – Budgetary Central Government	A	A	A
Comprehensive list of tax and other revenues ⁷	M	M	M
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 ⁸	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
GDP/GNP	A, Q	Q, SA	Q
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, interbank money market rate, rates on treasury bills, notes and bonds. ⁴ Includes General Index; Local Goods Index; Imported Goods Index; Fresh Products Index; Energy Index; General Index excluding Fresh Products and Energy; and their breakdowns as published by the NISR. ⁵ Foreign, domestic bank, and domestic nonbank financing. ⁶ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. ⁷ Includes proceeds from privatization, accompanied by information on entities privatized, date of privatization, numbers and prices of equities sold to the private sector. ⁸ Includes debts of the Bank of Kigali. Also includes currency and maturity composition. ⁹ Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Semi-annually (SA); Irregular (I).			