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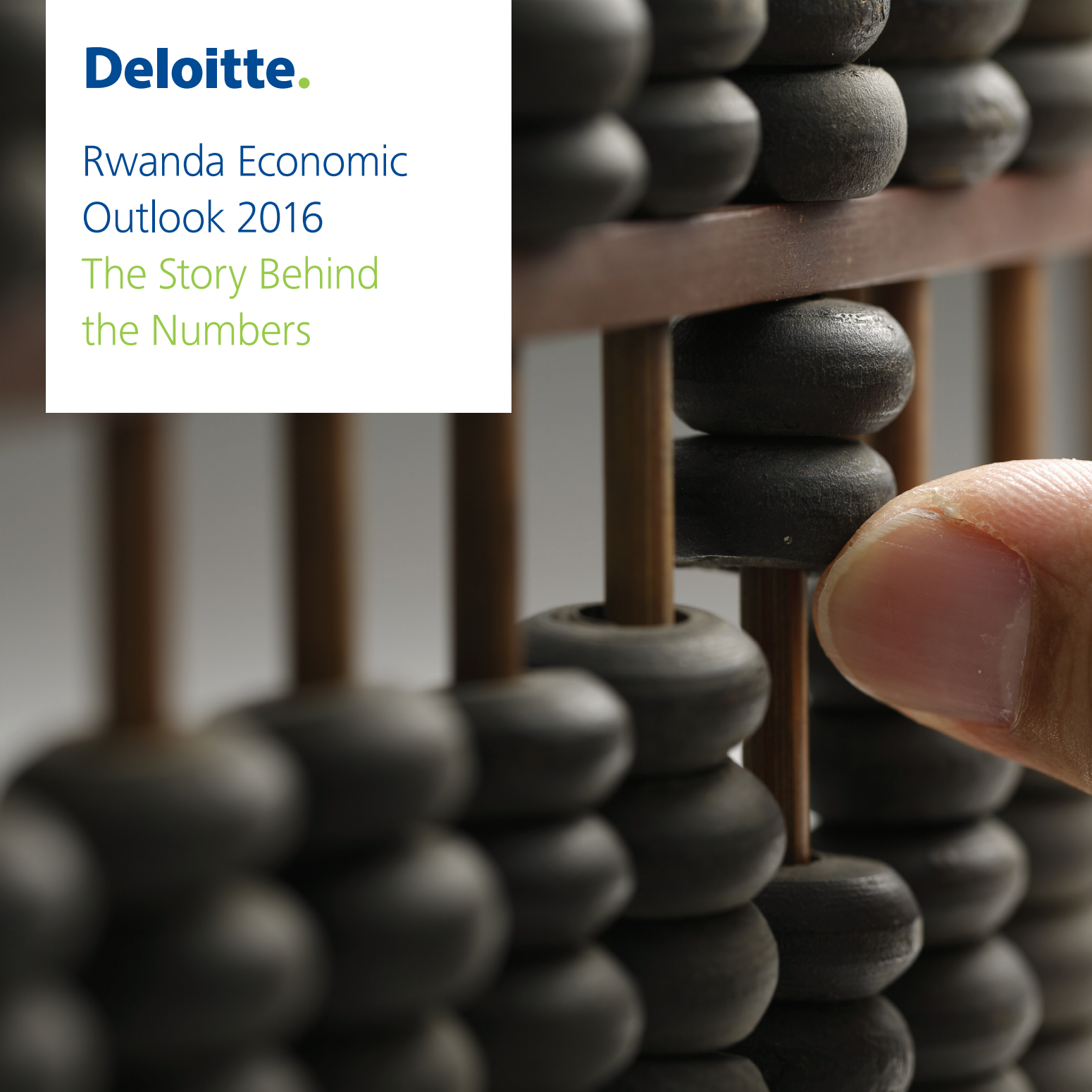
Rwanda Economic Outlook 2016

The Story Behind the Numbers



Preamble

The Rwanda Economic Outlook 2016 report provides an overview of Rwanda's economic environment and key sectors. The report also highlights significant allocations from the 2016/17 budget to various sectors in the country.

June 2016

Rwanda Economic Review

Political overview

The Economist Intelligence Unit (EIU) expects the internal political situation in Rwanda to remain stable. President Paul Kagame, has been given permission in a national referendum to stand for a third term in August 2017, and he is expected to win a large majority. This was after the events of 17 November 2015 when the upper house of Rwanda's parliament endorsed an amendment to the constitution - approved in the 18 December 2015 referendum, allowing President Paul Kagame, to run for a third term in office.

The President has been widely lauded for his record on reducing poverty, tackling corruption and maintaining high levels of economic growth. President Paul Kagame was expected to resign in 2017 in line with the constitution's two-term presidential limit however, the December 2015 referendum cleared him to run for an additional term. The ruling Rwandan Patriotic Front (RPF) will continue to dominate the political scene given its solid legislative majority.

According to the Rwandan Ministry of Disaster Management and Refugee Affairs, around 72,100 Burundians fleeing violence have entered Rwanda since mid-April 2015. There is an inherent risk that insecurity in border regions will worsen as the crisis in Burundi degenerates.

Economic overview

The agricultural sector's robust performance is expected to continue to be the driver behind Rwanda's economic growth, supported by continued investments aimed at boosting resilience to adverse weather-related shocks, increasing productivity and promoting commercial farming. Additionally, rising coffee and tea prices, will continue to incentivise farmers to produce greater volumes. Expansion in the industrial sector will be modest as falling grants and aid inflows affect donor- and government financed investment projects and subdued mineral prices weigh on mining sector activity.

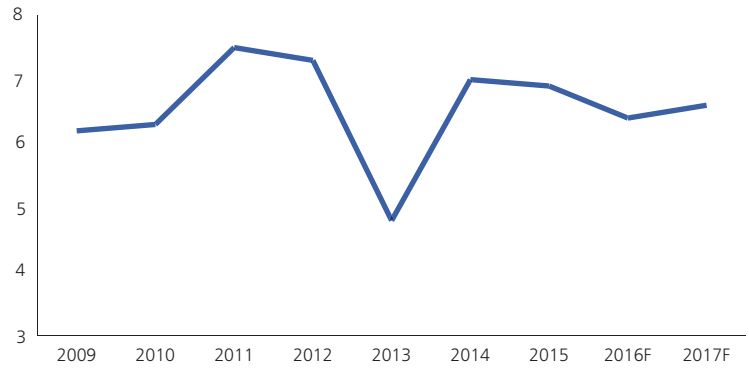
In 2016, consumption and investment will also drive economic growth. According to Business Monitor Intelligence, BMI, a combination of population growth, urbanisation and the migration of labour into higher value added sectors will make private consumption the key driver of economic growth over the duration 2016-2025. BMI forecast's that consumer spending will rise in real terms by 6.5% in 2016 and 6.6% in 2017. However, poor infrastructure will remain a significant barrier to quicker growth.

Inflation is forecast to rise from 2.5% in 2015 to 3.5% in 2016 and 5.5% in 2017, alongside strong economic growth and domestic demand, currency depreciation and rising global oil and food prices from late 2016.

The current-account deficit as a proportion of GDP will widen steadily from 4.4% in 2015 to 15.8% in 2017 as imports grow on the back of strong economic growth and as oil prices rise in 2017. The fiscal deficit as a proportion of GDP will narrow from 5.3% in 2014/15 to 4.9% in 2016/17 as the government cuts spending and revenue begins to rise on the back of improved tax collection.

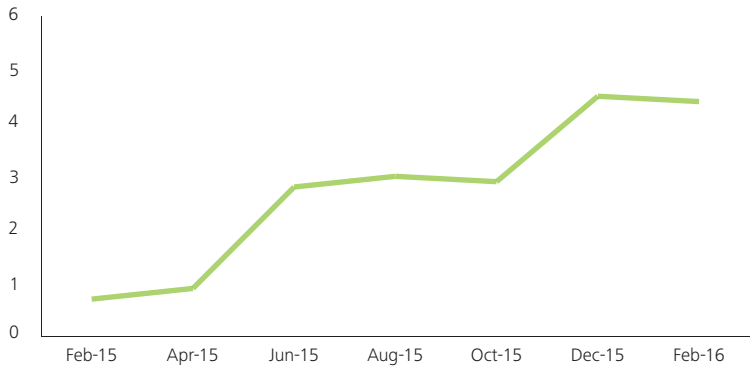
According to BMI, total external debt levels in the country have been rising steadily in recent years, from 16.1% of GDP in 2010 to an estimated 30.5% of GDP in 2015. Debt levels for 2016 and total external debt are forecast to amount to 35.2% of GDP and will be composed mostly of government debt.

Chart 1: Real GDP growth rates (%)



Source: Economist Intelligence Unit (EIU), Business Monitor International (BMI)

Chart 2: Annual consumer price inflation rates (%)



Source: National Institute of Statistics of Rwanda

GDP

In 2016/17, real GDP growth is forecast by the EIU to average about 6.6% driven by a combination of factors including foreign and public investment, services and exports.
Real GDP growth rate will slow down to 6.4% in 2016 from 6.9% in 2015. The primary headwind to the Rwandan economy in the 2016-2025 period will be the impact on debt as a result of falling foreign aid. Despite prudent fiscal policies to date, increases in debt levels will follow from the fall in foreign aid, since Rwanda is now deemed fit to transition from grant-based financing to loan-based financing by the IMF.

Rwanda has several structural strengths that will work in its favour over the coming decade, including sustainable drivers of real GDP growth, a strong commitment to reform and supportive business environment, rising productivity and services diversification. BMI has forecast a 7.1% average long-term real GDP growth over the next 10 years.

Inflation

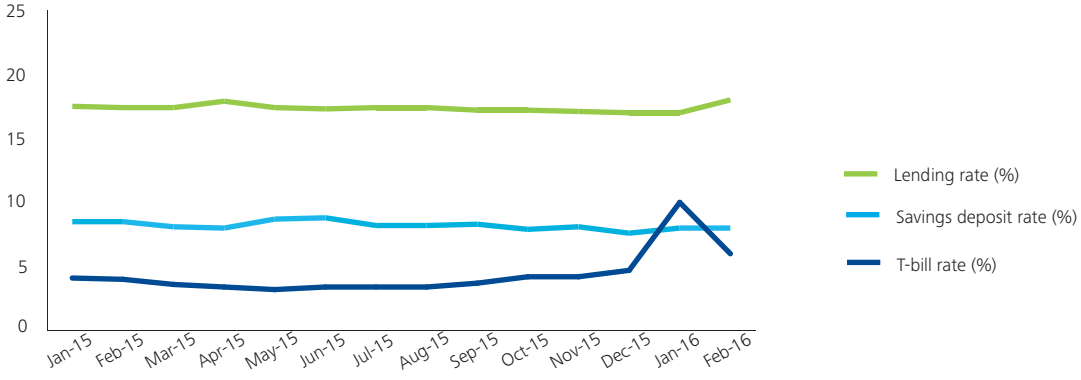
According to the National Bank of Rwanda, inflation in 2016 will remain below target owing to the continuous accommodative monetary policy to reflate the economy. Inflationary pressures will increase in 2016 as the Rwandan Franc (RWF) continues to depreciate against the United States dollar (USD) and strong economic growth increases demand pressures. The average inflation rate is forecast to move from 2.5% in 2015 to 3.5% in 2016. As oil prices rise in 2017 and the RWF depreciates further, inflation will be pushed up to an average of 5.5% that year.

Interest rates

Rwandan businesses face no difficulties obtaining foreign exchange or transferring capital associated with an investment into another currency and at a legal market-clearing rate. Since 1995, when the state abandoned the dollar peg, Rwanda has maintained a floating exchange rate regime, within which lending and deposit interests rates are all liberalised. In 2015, the annual average interest rates were 8.24% for deposit, 17.33% lending and 3.77% for 90 day T-Bills.

Non interest rate factors in the banking sector (including limited competition and high operating costs) in Rwanda limit the adjustment of lending rates to changes in policy rate. The deposit rates are forecast to stand at 8.6% in 2016 and 9.5% in 2017.

Chart 3: Interest rates in Rwanda (%)



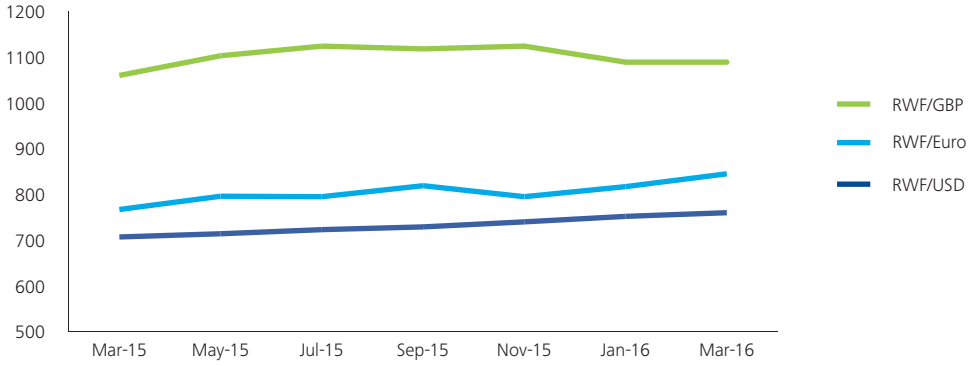
Source: National Bank of Rwanda

Exchange rates

Rwandan authorities have accepted an IMF recommendation to move the exchange-rate system away from a peg and towards a more market-based arrangement, allowing greater flexibility. As the peg to the USD has loosened, the Rwandese Franc has continued to depreciate. In 2015/16, the US dollar remained strong supported by the recovery in US economy and the widening interest rate differential between major developed economies and USA.

Fiscal and current-account deficits will put downward pressure on the Franc while monetary policy tightening in the US will lead to a strengthening of the dollar. The exchange rate is forecast to slip from an average of RWF722:USD1 in 2015 to RWF781:USD1 in 2016, before depreciating further, to RWF804:USD1, in 2017.

Chart 4: Exchange rates in Rwanda



Source: National Bank of Rwanda

Sectoral perspectives

Financial services

For the period 2015/16, Rwanda's financial sector continued to register strong growth, supported by various government initiatives to deepen financial intermediation and expand lending. The sector grew by 18% in quarter 3 of 2015.

The Government of Rwanda (GoR) through the National Bank of Rwanda (BNR) successfully issued a 15 year bond worth RWR 10 billion as part of its regular plan to finance infrastructure projects and develop its capital market. This was the longest tenure bond issued ever since the GoR started issuing Treasury Bonds in 2008, and the bond was over subscribed by 215.5%. The Bond, that was listed on the on the Rwanda Stock Exchange on Tuesday May 31 2016, was issued at par with the final coupon rate and yield at 13.5%.

In the first eleven months of 2015, the Net Foreign Assets (NFA) for the banking system fell by 23.1% following the decrease in both BNR NFA (-15.8%) and commercial banks' NFA (-64.0%). In November 2015 NFA stood at RWF 37.7 billion for commercial banks and 493 billion for BNR. In line with the sufficient level of liquidity in the banking system and current monetary policy stance, money market interest rates continued to be low in 2015. According to the BNR Monetary Policy Report of 2015, both repo and interbank interest rates stood respectively at 1.83% and 3.45% in November 2015 from 2.80% and 4.70% in December 2014. However, T-bills rate increased to 5.56% from 4.90% during the same period following that. The Government continued to significantly rely on domestic borrowing channels including T-bills, and in 2015 a total of RWF 43.8 billion of new T-bills were issued. Going forward, the GoR has set a targets of 80% adult population to have access to financial services by 2017 and 90% by 2020.

Under Rwanda's Economic Development and Poverty Reduction Strategy, (EDPRS) 2 targets, support function which focuses on the provision of economical, efficient and effective support services was allocated a total amount of RWF 214 billion representing 12% of the total budget for 2015/16

Public sector

Education

Rwanda's education system is still uncompetitive despite significant improvements following increased government education expenditure over the last two decades. The quality and the capacity of the education system has failed to keep pace with rising school enrolment rates, only a very small percentage of the labour force has been educated up to secondary school or tertiary education levels. This represents a stark lack of skill in the labour force. Due to these factors, Rwanda scored 29.8 out of 100 for Education, placing it eleventh in Sub-Saharan Africa.

The GoR continues to expand the capacity and quality of the education system, which will increase the education levels of the labour pool in the long term. In July 2015, GoR announced the 2015/2016 Budget. This 2015/2016 Budget revealed the improvements made to the education system over the course of 2014/2015. In relation to primary education, 1,608 classrooms and 2,604 latrines were built. For secondary education, 19 new schools were built and new classrooms were equipped with approximately 28,000 new desks.

In the 2015/2016 budget speech the GoR continued to demonstrate its commitment to enhance the education system and increasing the skills of the local labour market. The GoR wants to make Rwanda a middle-income country by 2020. In order to achieve this, they allocated USD 1.13 billion to increasing youth employment and increase productivity, a further USD 17.21 million towards skills development, and USD 6.67 billion to the National Employment Program.

Infrastructure and construction

Poor infrastructure remains a significant barrier to accelerated economic growth in Rwanda. The construction of a USD 40 million dry port will help to reduce significant non-tariff barriers to trade and improve access to coastal ports once completed in 2017. This is a joint venture between the GoR and a private cargo handling company. Likewise, other infrastructural improvements include the recently operational methane gas plant (Phase 2) in Lake Kivu, which will generate 75MW; a 28-MW hydropower plant on the Nyabarongo River; and an agreement to import 30MW from Kenya and 450MW from Ethiopia. These will add significantly to the national electricity supply in the long run and further support economic growth. The Government's ambitions are further supported by loans from International Finance Institutions (IFIs) and private foreign investment, as well as the five-year USD 20 million infrastructure bond launched in February 2016.

Under Rwanda's Economic Development and Poverty Reduction Strategy, EDPRS 2 targets, economic transformation is a cross-sectoral thematic area that was allocated RWF 409.4 billion in the 2015/16 fiscal year. This amount was channeled towards various infrastructure projects in Energy, Transport and Agriculture.

Over the fiscal year 2015/16, Rwanda announced plans to develop rail links to the Indian Ocean ports through Tanzania as they were cheaper and shorter than the Kenyan route. The Tanzanian option would cost Rwanda about USD 800 million to USD 900 million while the Kenyan one would cost USD 1 billion. The Dar es Salaam-Isaka-Kigali/Keza-Musongati (DIKKM) standard gauge railway (SGR) project is on-going and expected to be completed by March 2018 at an estimated to cost of USD 5.2 billion.

Healthcare

Rwanda's pharmaceuticals and healthcare sectors will be increasingly attractive to companies operating in the sector as the GoR progresses with the roll out of its health insurance scheme. Rwanda's community-based health insurance scheme (CBHI), the Mutuelle De Santé, has seen a noticeable improvement in subscription rates, with roughly 79% of the population now part of the scheme. This followed from the September 2015 63% subscription rate that prompted officials at the Rwanda Social Security Board (RSSB) to launch a three-month campaign (October to December 2015) to encourage more people to join the scheme. The 16% increase in subscriptions over the three months campaign period, represents a significant development considering there had been a decreasing trend in subscriptions since 2011. Healthcare expenditure is forecast to grow at a ten year local currency compound-annual growth rate (CAGR) of 11.2%, increasing from RWF 718.33 billion (USD 1.03 billion) in 2015 to RWF 2,071.47 billion (USD 2.49 billion) by 2025.

Foundational Sectors (that included health and education, public finance management (PFM) and justice, peace and stability) were allocated a total amount of RWF 674.5 billion equivalent to 38% of the 2015/16 total budget.

The RSSB is faced with the burden of paying a debt of RWF 13 billion (USD 17.67 million) owed to hospitals that was previously accumulated under the management of districts and the Ministry of Health. However, for a number of hospitals these heavy debts are lingering, which has created uncertainties regarding the future of the RSSB and healthcare delivery for Rwanda's population. Debts include:

- RWF 1.30 billion (USD 1.33 million) to University Teaching Hospital of Kigali (CHUK);
- RWF 450 million (USD 60,284) to Nyanza District Hospital;
- RWF 229 million (USD 30,678) to Kabutare Hospital; and
- RWF 200 million (USD 29,472) of arrears to Huye District Pharmacy.

Energy & Resources

GoR aims to raise the electrification rate to 70% by 2018 from the current 23% - particularly as funding flows from IFIs into the power sector. Improvements to the national power supply are critical in the development of the country's Information, Communication and Technology, ICT sector, a key driver of economic growth and at the centre of the government's plan to transform Rwanda into a knowledge-based economy.

In line with the EDPRS 2, the government aims to increase the power grid capacity to 563 megawatts (MW) by 2018 (capacity by mid 2015 was 160MW), and to cut the cost of electricity, which is much higher than in other EAC countries. However, the 563MW target remains distant and power constraints will remain a drag on Rwanda's economic performance. Electricity prices were raised in September 2015, to realign tariffs to better reflect production costs. This will help attract private investment in the national power grid and eventually lower energy tariffs in the long term.

In May 2016, the European Union (EU) awarded USD 200 million towards improvements in transmission and distribution (part of a larger USD 525 million deal with the Rwandan government). The African Development Bank (AfDB) has also been central in providing assistance to support the expansion of the power sector. It helped to finance the USD 200 million 26MW Kivu Watt gas plant - constructed by US firm Contour Global and inaugurated in May 2016 and has committed almost USD 500 million to developing joint initiatives between Rwanda and its neighbours. The 147MW Ruzizi III Hydropower Plant (HPP) will share power equally between Rwanda, Burundi and Democratic Republic of Congo; and the 80MW Rusumo HPP between Rwanda, Burundi and Tanzania. The Ruzizi HPP is also backed by a USD 16 million grant from Germany. GoR and Turkish firm Hakan Mining and Electricity Generation announced plans and agreements to invest USD 400 million to construct and operate a 80MW peat extraction and electricity generating power plant in Southern Rwanda.

Information, Communication and Technology (ICT)

Rwanda's robust economic growth will be underpinned by sustained investment in infrastructure, with the focus on expanding the power grid to support the ICT sector and improving regional transport links. Funding is expected to continue to flow into infrastructure as confidence grows in Rwanda's development trajectory.

Under the Accountable Governance theme of the EDPRS 2, a total of RWF 95.3 billion was allocated in the 2015/16 financial budget. Of this amount RWF 2 billion was allocated for National Cyber Security.

In Rwanda, mobile network coverage is at 99.79% of the country with a current subscriber base of 63.5% of total population. The long term outlook is to have subscribers grow to 7.4 million people by end of Q4 of 2016. In addition to existing ICT infrastructure and access network rollout program, continued investment in a 4G LTE network which is expected to increase internet penetration to 95% by end of 2016.

Current ICT projects in Rwanda include the USD 150 million ICT Park. This is a joint venture between the Government of Rwanda, Carnegie-Mellon University (CMU) and AfDB, and is structured around supporting growth in: energy, internet, multimedia and telecommunications, knowledge, e-government, financial and ICT services and export.

Agriculture

The agriculture sector, which grew by 5% in the first three quarters of 2015, was expected to improve by end 2015 (+5.5%) and slightly decelerate to 5.1% in 2016 owing to anticipated contraction in export due to declining commodity international prices.

Agriculture commodity prices dropped for the fourth year in 2015 declining by 13.1% on excess supply prospects despite El Niño fears. Coffee prices dropped by 20.3% (for Arabica) and by 12.4% (for Robusta) mainly reflecting improved supply conditions for Arabica coffee in Brazil and for Robusta coffee in Vietnam. Tea prices have increased substantially in recent months but started to slowdown as supply is likely to improve. Tea prices slightly fell by 0.4% in 2015 as prices increased sharply in Mombasa (Kenya) auction by 34.1% offsetting a decline of 16.4% in prices of tea in Colombo. Prices dropped by 5% for fertilizers driven by an abundant production capacity. Overall, commodity prices are expected to decline throughout 2016 as an oversupply persists with oil and metals leading the declines.

2016/17 Budget Outlook

The 2016/17 fiscal budget is estimated at RWF 1.9 trillion, a 7.7% increase from the previous year. Government 62.4% of the budget to be financed by domestic resources and 37.6% external resources. The domestic resources includes RWF 1.071 trillion tax revenue, RWF 110.8 billion non tax resources and RWF 34 billion domestic financing. External resources will include RWF 365.3 billion grants and 367.7 billion loans. In terms of expenditure, total recurrent expenditure is projected at RWF 958.7 billion, 49.2% of total 2016/17 budget. Net lending is projected at RWF 108.5 billion, 5.6% of the total budget. RWF 785.3 billion was budgeted for development expenditure, accounting for 40.3% of the total budget. Domestically financed projects are estimated at RWF 443.9 billion and this represents 22.8% of total budget, while externally financed projects are estimated at RWF 341.1 billion, 17.5% of the fiscal budget. Budget allocation on arrears were RWF 20 billion, 1% of total budget while allocation for deposits to boost GoR reserves were RWF 76.9 billion, 3.9% of the total budget.

Rwanda seeks to transform its economy through the implementation of EDPRS 2. To this effect 55% of total budget was allocated for thematic areas and 45% for the foundational sectors. This represents RWF 1.072 trillion and RWF 877.6 billion respectively. The thematic areas allocations were as follows:

- Economic transformation RWF 517 billion, 27% of total;
- Rural development RWF 256.6 billion, 13%;
- Productivity and Youth Empowerment RWF 106 billion, 5%; and
- Accountable Governance RWF 192 billion, 10%.
- The foundational sectors were allocated RWF 877.6 billion

This will be channelled towards: health, basic education, macro economic stability and public finance management, justice, peace and stability, food security and nutrition and decentralisation.

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