Rwanda

FY 2017/2018 Budget

June 2017

Welcome

PwC Rwanda's Budget Bulletin provides insight and analysis on the 2017/18 budget speech and other relevant materials.

We hope that you will find it insightful, and look forward to your comments.

In this bulletin

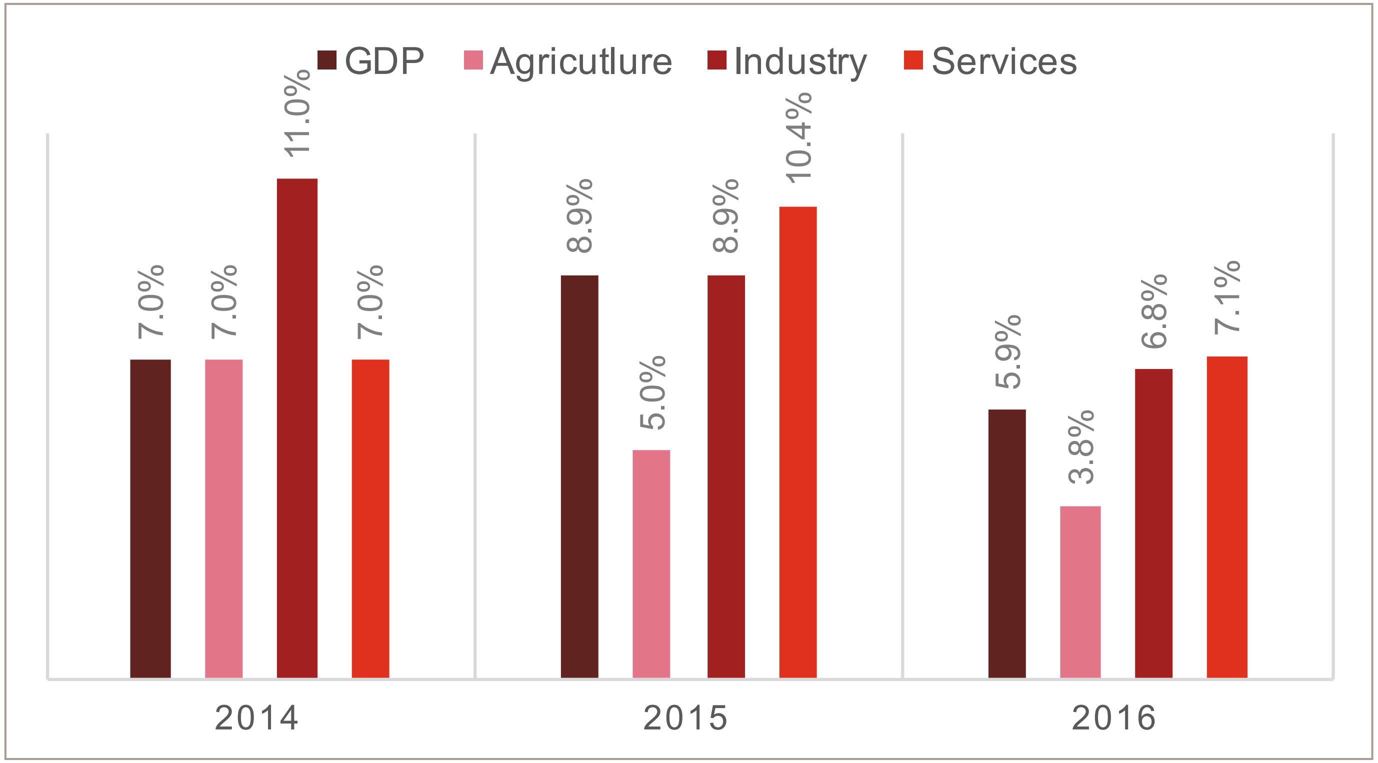
Rwanda economy

Sectoral performance in 2016

Rwanda GDP grew by 5.9%, slightly lower than the initially projected 6%. The growth was mainly driven by the service sector which grew by 7%.

The agricultural sector slowed down to 4% which was largely attributed to the drought in the Eastern and Southern provinces which slowed both export and food crops.

The Industry sector grew by 6.8% which is attributed to the rise in emerging industries in line with Made in Rwanda.



Projected growth rate

Sectoral performance in 2016

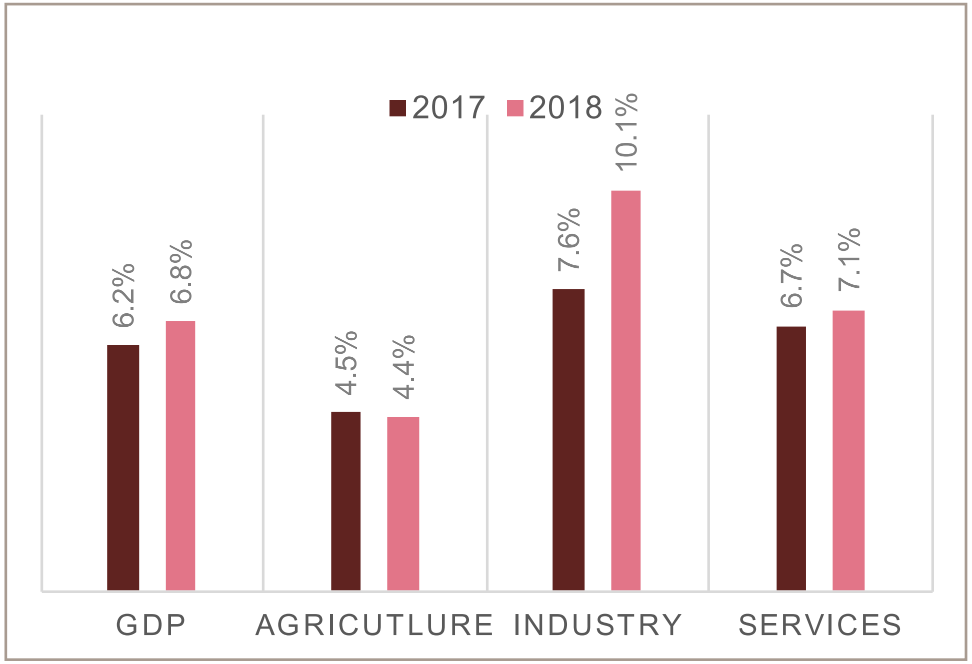
The growth forecast looks positive!

The Rwanda economy is projected to grow by 6.2% in 2017 and 6.8% in 2018 from 5.9% in 2016. This growth is supported by an improvement in the agriculture sector from food crops and export crops following on going investments in fertiliser, improved seeds and irrigation.

Industry is expected to grow with an expectation of an improvement in international mineral prices and domestic production to increase.

Construction sector is also expected to grow particularly due to the Bugesera airport project.

Services sector is projected to slow down in 2017 then grow moderately due to low performance in trade and transport due to the slow recovery in the growth of credit.



Budget for fiscal year 2017/2018

Resources and expenditures

The budget for FY 2017/2018 is projected at Rwf 2,094.9 billion which is an increase of Rwf 140.7 billion compared to the revised 2016/2017 budget.

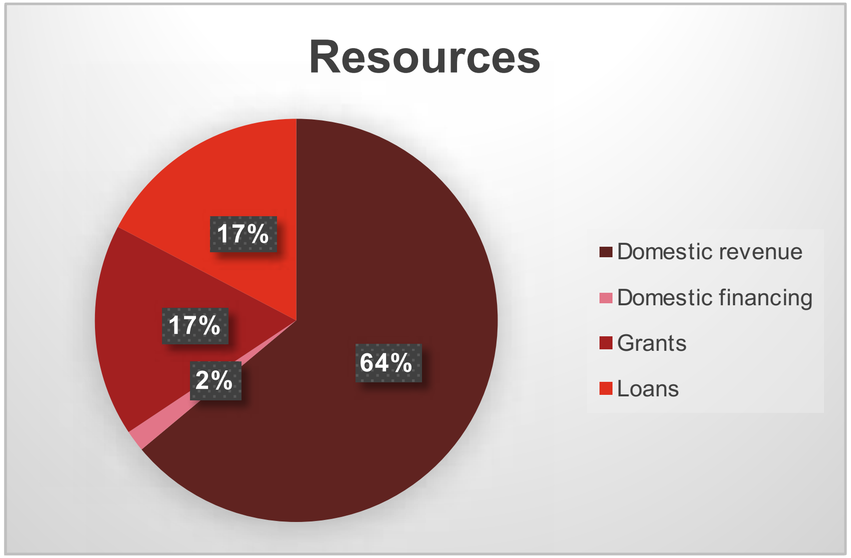
65.7%% of the resources to fund the budget are from domestic revenue including tax and non tax revenue and domestic financing. The increase in tax revenue is expected to rise from an increase in collection of VAT and direct taxes as a result of the "EBM for all" project. Grants and loans contribute 17% each to the resources.

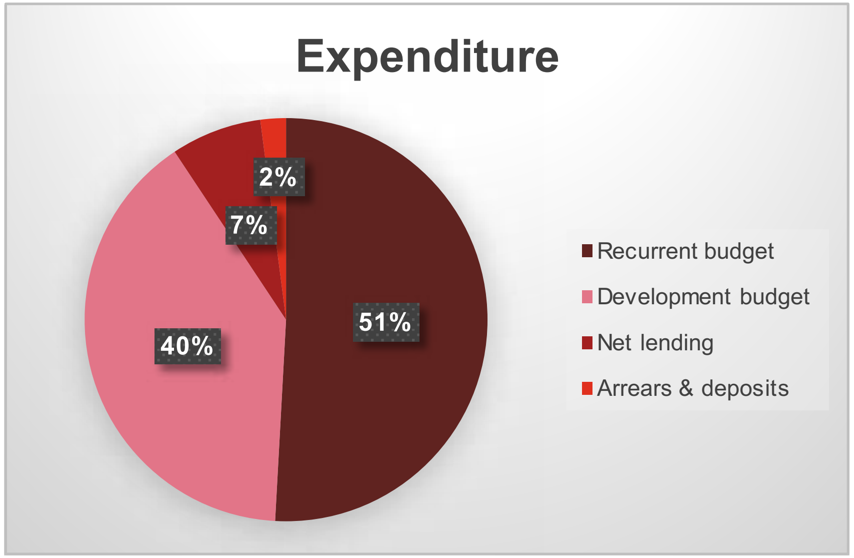
Under expenditure, 54% of the budget is allocated to recurrent expenditure while 37% is allocated to development expenditure. Recurrent expenditure has increased by Rwf 131.0 billon to Rwf 1125.0 billion in 2017/2018 from Rwf 994.0 billion in FY 2016/2017 driven by an increase in salaries and wages from implementation of the new teacher's statute, ongoing restructuring and creating new government agencies.

The increase is also attributed to purchase of goods and services, running costs and road maintenance costs.

Development expenditure reduced by Rwf 6.0 billion to Rwf 771.9 billion in 2017/2018. Domestic financed development projects increased by Rwf 25.4 billion from Rwf 434 billion in FY 2016/2017 to Rwf 459.4 in FY 2017/2018 to allow for the purchase of strategic food stocks, construction of dams and the Bugesera Airport.

However, foreign financed portion declined by Rwf 31.4 billion from Rwf 343.9 billion in FY 2016/2017 to Rwf 312.5 billion in FY 2017/2018.





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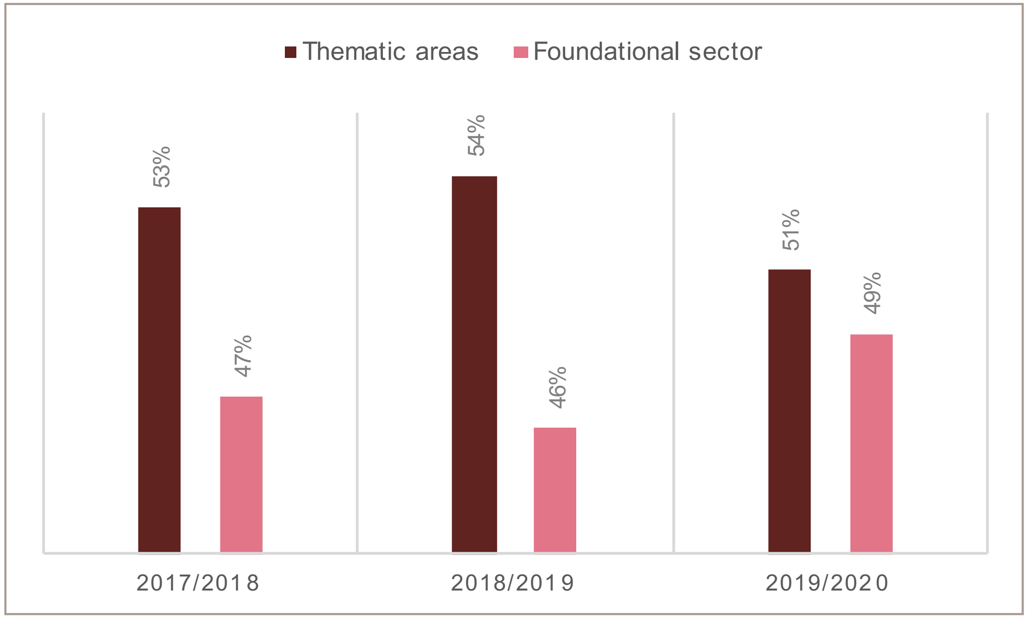
Resource allocation

Allocation to EDPRS II Priorities



In terms of resource allocation to the Economic Development and Poverty Reduction Strategy (EDPRS II), the thematic areas including economic transformation, rural development, productivity and youth employment and accountable governance are allocated 53% of the budget in 2017/2018, 54% in 2018/2019 and 51% in 2019/2020.

Economic transformation and rural development have been allocated 69% of this budget.

Foundational sectors such as education, justice, environment, public financial management, health and social protection are allocated 47% in 2017/2018, 46% in 2018/2019 and 49% in 2019/2020.

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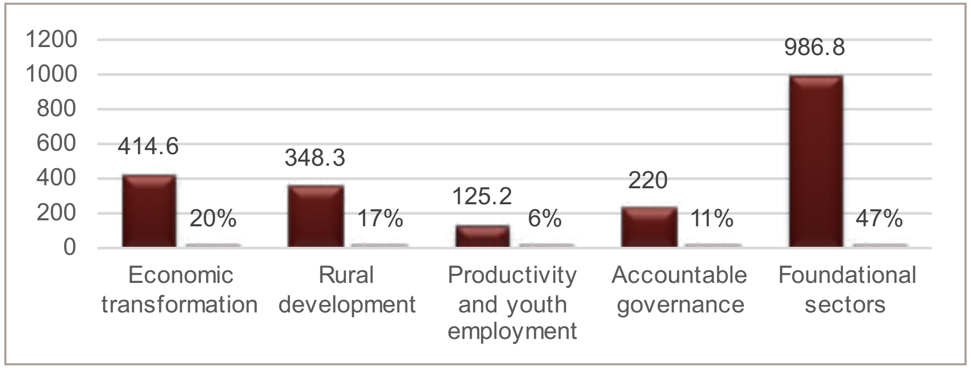

***53%* of the budget was allocated to thematic areas in 2017/2018 budget**

Economic transformation and rural development remain priority areas!

The largest allocation of resources is in economic transformation with initiatives targeted at exports, urbanization, financial and ICT sectors.

Rural development received the second largest allocation and is focused on agriculture and energy.

Key expenditure priorities

2017/2018 by sector

Education, transport and health received the largest allocation by sector.

- The focus is on air transport infrastructure through the Bugesera Airport and upgrading Kamembe airport. Other areas include improving public transport and road maintenance. This resulted in transport receiving an allocation at the same level as education.
- Key priorities in education include improving the quality of education, infrastructure development and operationalizing centers of excellence. This addresses a key issue facing the private sector on skills gaps.
- Health priorities are focused on improving human resources, constructing hospitals and fighting malnutrition.
- Other key priorities under energy are constructing transmission lines and improving energy efficiency. Under water, the key priorities are mainly in enhancing water supply in both rural and urban areas.
- Key priorities under exports include manufacturing promotion, MICE tourism, horticulture and tea.
- Key priorities in agriculture are mainly targeted in increasing crop productivity and building resilience to climate change.
- One would have expected a larger allocation to agriculture, being the backbone of the economy and exports due to the current initiative on "Made in Rwanda ".

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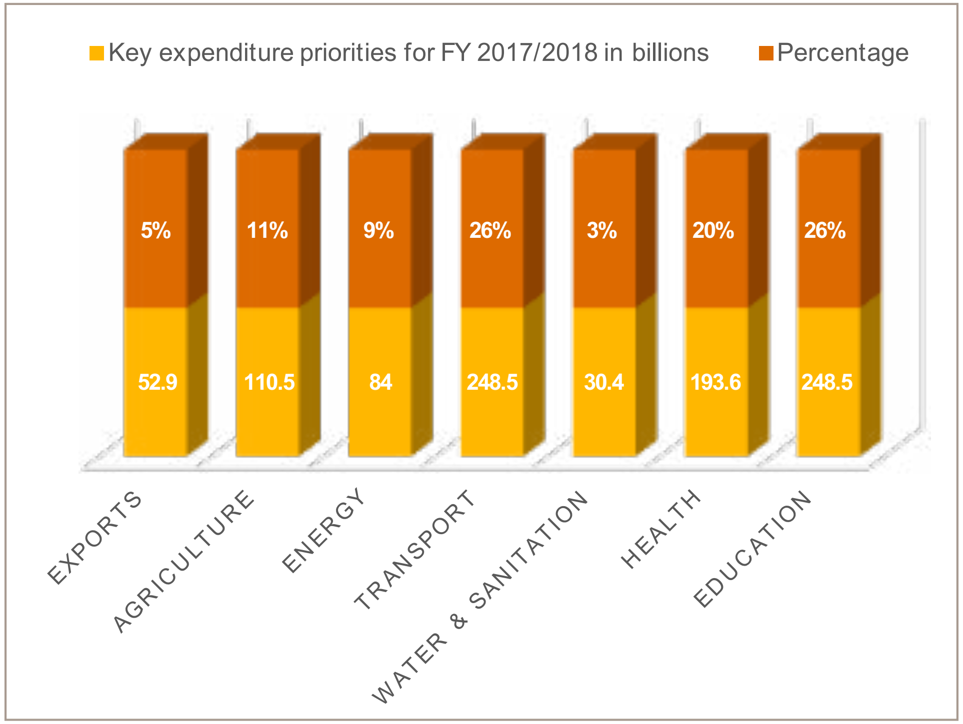

Inflation

Driven by rising food prices and transport cost

Rising global fuel and food prices poses significant threat

Inflation headline in 2016 stood at 7.3% in December from 4.55 in January. The annual average went up from 2.5% in 2015 to 5.7% in 2016, mainly driven by rising food prices and transport cost.

The increase in food prices was caused by reduction in food supply and poor performance of the agriculture production following poor harvests due to drought and floods in some parts of the country.

7%

The inflation rate projected for 2017

The rising global fuel and food prices as well as projected lower domestic harvest pose significant threat to inflation.

Other factors include imported inflation due to currency depreciation, increase in transport costs attributed to the increase in price of fuel. Therefore, inflation for 2017 is expected to increase to 7%.

Sectoral reforms – financial services sector

Focus on financial deepening

Operationalization of Basel framework and Deposit Guarantee Fund

The main aspect of this is the operationalization of the regulation on the Basel framework issued by National Bank of Rwanda (BNR) in 2016.

The regulations are expected to come into effect in the second half of 2017 after the end of BNR observation period where banks were submitting parallel reporting.

The framework which has been adopted by some of the neighboring East African Countries will help boost the capital base of banks with the introduction of addition 2.5% conservation buffer. The true benefit of adopting this framework will however be realized when banks fully embrace it in their day to day operating models.

Also in the list of resilient measures is the effecting of premium collections at rate of 0.1% of non-bank deposits through Deposit Guarantee Fund. The Fund is intended to protect small depositors to the tune of Rwf 500,000 per financial institution in the event of bank collapse.

Such a scheme did prove effective during the banking crisis in Kenya where deposit account with balances equal to or below guaranteed amount were promptly compensated and even enabled additional pay-outs above the guaranteed amounts.

Though a move in the right direction, the question remains on the sufficiency of the guaranteed amount of Rwf 500,000.

The Budget Framework Paper (BFP) has taken cognizant of the financial services industry on the areas of financial deepening and has introduced measures on resilience of the banking sector

Financial services sector

New banking bill

A new banking bill has been introduced

The new banking bill has been tabled in parliament for debate, the key changes in the provisions include:

- Harmonization of the country's banking legal framework with other East African Community (EAC) member states as the block gears up for monetary union;
- Define agency banking, which is growing trend in the industry;
- Redefine procedures for mergers and acquisitions within the industry;
- Updating classification procedures for loans and advances.

As part of the debates on the bill, there are press reports that legislators have sought explanations on why interest rate caps had not been included in the bill.

With recent experience from Kenya which adopted rate caps in 2016, we are of the view that it would be a wrong move for the Rwanda economy which is at phase where it is seeking to further deepen its financial sector.

An interest cap regime would limit access to the majority of retail borrowers which would fall in a "risky" category vis a vis deemed compensation from capped interest income.

With this said, the banking sector needs to be proactive and breakdown their expensive cost structure and pass on the benefit to borrowers in the form of lower rates before public pressure increases for reduced interest rates.

Saccos

Financial deepening taking root

There are exciting initiatives in the financial deepening front in particular the automation of the 416 Umurenge Saccos.

The automation would provide a platform for more effective mobilization of funds if connected to mobile phones and other channels as well as offer an opportunity to broaden the product range for Saccos when cooperative bank is formed.

This is a great opportunity optimize the wider reach of Saccos.

The other area of fund mobilization is around the continued development of the long-term savings scheme to cover citizens not formally covered by the Rwanda Social Security Board who are estimated to be on the majority.

Such measures are key to mobilizing funds and social benefits to the fragile informal sector. Implementation of the scheme is expected before end of the financial year.

The automation of 416 Umurenge Saccos will provide platform for mobilization fund

Insurance sector

Direct intervention

Though no specific measures were laid out in the BFP to respond to the challenges in the insurance sector, BNR has made pronouncements around suspending issuance of new insurance licenses and has also taken a more direct approach in intervening on some of the players facing difficulties.

We wait to see if BNR will adopt the risk framework akin to Solvency II that is being implemented across the globe to help in better risk identification and mitigation.

Other measures

1. The Rwanda Government is known for embracing technology and are now crafting a National Payment Strategy. The objective of this will be to build a world class payment system that is secure, reliable, efficient, scalable, cashless and that promotes financial inclusion;
2. In recognition of the lack of an active capital markets, Capital Markets Authority have been asked to develop strategies that will attract more players and integrate with stakeholders across the region.
3. Introduction of horizontal repos will provide BNR with a better mechanism to effect its monetary policy decisions.

Fiscal incentives

Tax exemptions and incentives to strategic sectors

The Minister for Finance and Economic Planning announced some fiscal incentives that target some strategic sectors. These are changes that are expected to become effective in financial year 2017/18.

The Government is committed to continue its current efforts towards promotion of " Made in Rwanda".

Overall, the Government key focus is to promote exports and implement import substitution strategies over the medium term in order to address external sector imbalances and grow the economy.

A combination of policy interventions focusing on textile, garments & leather industry, agricultural exports, construction & mining sector, services exports (tourism sector and ICT) and trade and investment facilitation such as industrial parks is expected to facilitate the attainment of this goal.

Promotion of made in Rwanda

One of strategies for reducing the import bill and minimize impact of currency depreciation is to focus on import substitution strategies.

The "Made in Rwanda" initiative is key strategy that is expected to support this policy objective. In an effort to encourage local industries, the following fiscal incentives are planned:

- Wheat grain will continuing paying duty at 0% instead of 35%;
- All capital machinery used in textile and leather industry will continue paying import duty of 0% instead of 25%;
- Importation of second hand clothes and shoes will be discouraged;
- Tax incentives and other exemptions for capital goods will remain in force.

Information Technology

Telecommunication equipment will continue to pay import duty at rate of 0% instead of 25%.

Financial sector

As a support towards a cashless economy, electronic transaction devices (smart cards, ATM cards, Point of sale cards and their operating machines) will pay import duty at 0% of 25%

Basic goods

- **Rice** will continue to pay import duty at rate of 45% or USD 345/MT instead of 75% or USD 345/MT;
- **Sugar** will continue to pay import duty at rate of 25% instead of 100% or 460 USD/MT whichever is higher
- Goods imported for use by Armed Forces Shop will continue paying duty at 0% instead of 10% and 25%.

Transportation sector

The reduction of import duty for Road tractors for Semi Trailers, Motor vehicles for transport of goods with gross weight exceeding 20 tons and buses for transportation of 50 persons and above to 0% from rates of 10% and 25% will continue to apply.

Import duty rate for Motor vehicles for transport of goods with gross weight exceeding 5 tons but not exceeding 20 tons will continue to be 10% instead of 25%.

Buses for transportation of more than 25 persons will continue paying import duty rate of 10% instead of 25%.

Tax administration reforms

Widening tax base and improved compliance management

There were no specific tax policy changes that were announced aimed at increasing tax revenue included in the 2017/18 budget.

However, building on from pronouncements in previous years, Rwanda Revenue Authority are implementing a number of administrative reforms which are expected to generate more tax revenue.

The key administrative reforms relate to strategies for widening the tax base and improving tax compliance management.

The tax revenue as a percentage of GDP is also declining in the medium terms and therefore new policy measures are required to offset foregone taxes through tax incentives.

Widening tax base

Taxpayer education is expected to enhance compliance. This will involve focusing on specific sectors.

RRA will also use third party information to identify unregistered taxpayers and validate accuracy of tax declarations.

There are also plans to implement Geographic Information System (GIS) tools to improve mapping and identify non-compliant taxpayers.

Roll out of the Electronic Billing Machines (EBMs) to non-VAT registered taxpayers is considered one of the key strategies for widening the taxpayers. The EBM implementation ensure that RRA are able to access taxpayer's business transaction in real time which makes compliance management effective.

RRA will also use third party information to identify unregistered taxpayers and validate accuracy of tax declarations

Tax administrative reforms

More initiatives to enhance compliance

Tax compliance management

A number of tax compliance management are planned. These include:

- Fully implementation of Electronic Cargo Tracking system to monitor imports and reduce transit time at borders;
- Implement the Supply Chain Management system to monitor stock movement at all levels of business;
- Intensify EBM back office monitoring and field operations;
- Systematically monitor and follow up non-filers, nil filers and non-payers;
- Systematically monitor VAT invoices to reject fictitious input VAT claims. This is to ensure that all VAT on inputs is accounted for in another taxpayer's declared sales;
- Effective use of risk management process by utilizing existing data to identify non-compliant taxpayers.

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