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Statement by Ms. Lundsager and Ms. Pollard on Rwanda
(Preliminary)
Executive Board Meeting 07/54
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Rwanda's progress under the PRGF weakened during the second review period, and risks to macrostability have increased. Monetary control is slipping, contributing to the rise in inflation last year. Debt sustainability remains a concern, as the fiscal deficit is expected to rise, and uncertainty has increased over a scaling-up of aid. We urge the authorities to bring the monetary program back on track, and to accelerate reform efforts to increase growth and support poverty reduction.

The authorities missed one quantitative performance criterion. Delays in reimbursement from the African Union (AU) for peacekeeping in Darfur resulted in a rise in net credit to the government above the program ceiling. We support the waiver for this missed criterion. We are concerned that the continued delays in payment are creating budgetary difficulties for the authorities and urge the AU to adhere to the agreed upon schedule of reimbursements.

We are most concerned about the reserve money criterion. Although this quantitative performance criterion was technically met, the authorities have not appropriately restrained the growth of reserve money. The Figure on page 6 of the staff report shows that reserve money was well-above target in all four quarters of 2006, except for the last day of the quarter, when adherence to the target criterion was measured. Further, we are uncertain whether the modification of the measurement of reserve money will be sufficient to prevent the National Bank of Rwanda (NBR) from continuing to work around the target. Rather than adjusting reserves at the end of each quarter to meet the target, under the new measurement the NBR could adjust reserves at the end of each month. *We would appreciate the staff's comments on whether it would be possible to measure reserves based on a monthly average.*

The program incorporated three structural benchmarks for the review period, and the authorities missed all three. Two of these benchmarks have since been met. The remaining benchmark, a review of the public sector wage structure, was scheduled to be met by the end of last year. The first review indicated that this benchmark was missed but that the review would be completed by the end of March. Now we are told that technical assistance is required, and the review will not be completed until the end of September. Completing this review should be a priority. As we noted in our January statement, civil service reform is necessary to support the authorities' expenditure priorities. *We would appreciate an update from the staff as to whether the June 15 benchmark for completion of a progress report on financial reporting by budgetary agencies was met, and if the micro finance law will be submitted to Parliament by the end of June.*

The strong growth in reserve money in both 2006 and the first quarter of 2007 does not make us optimistic that the 5 percent target for inflation this year can be met. The NBR appears to be unable or unwilling to restrain reserve money growth – its operational target for controlling inflation.

Based on our reading of the staff report, the staff's view on exchange rate policy appears to have changed since the first review. The January staff report (EBS/07/4) emphasized the need for exchange rate flexibility. For example, paragraph 18 stated, "More flexibility in the exchange rate is crucial if Rwanda is to absorb more aid and manage a likely real appreciation." Paragraph 35 argued that the main risk to the program "is that the monetary program could go off track if the NBR resists a nominal exchange rate appreciation." In contrast, the current report cautions that greater exchange rate flexibility will take time and notes concern by the NBR and banks that an appreciation could reduce the competitiveness of exports. The January *Selected Issues* paper on external competitiveness indicated that inflation has a more negative effect on exports than moves in the nominal exchange rate. *We would appreciate comments from the staff on this change in view.*

The staff notes that prospects for scaling up aid are uncertain. The authorities have indicated that if grants are not scaled up next year they will consider concessional borrowing for high-return projects. The recent debt sustainability analysis showed that the debt outlook remains highly vulnerable to an erosion of grant assistance. We urge donors to follow through on their commitments and urge the authorities to step up their reform efforts to prevent delays in funding. For example, a delay in completion of the PRSP has held up funding from the AfDB. Rwanda is eligible for a threshold program under the U.S. Millennium Challenge Account (MCA) but needs a concerted effort to address policy weaknesses to qualify for compact funds.

We support the completion of the second review but urge the authorities to strengthen their commitment to the program.