East Africa Quarterly Bulletin

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FIRST QUARTER 2013

- BURUNDI
- KENYA
- RWANDA
- SEYCHELLES
- TANZANIA
- UGANDA

Special Theme:

SME Financing through the Capital Markets – Prospects and Options for Rwanda

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The *East Africa Quarterly Bulletin* is produced by country economists of the African Development Bank Group's (AfDB) East Africa Regional Resource Center (EARC). The publication covers all five member states of the East African Community (EAC) as well as the Seychelles. It is part of the AfDB's monitoring of socio-economic developments across the continent and provides summary information on the previous quarter's major developments across the sub-region for which quarterly data are available on a timely basis. Each issue also includes a dedicated section on a topical subject (either about a single country or several of them).

This report is based on information gathered through consultations, review of country documents, and other relevant sources. Contributors to this issue include Bernis Byamukama, John Baffoe, Prosper Charle, Josef Loening, Susan Mpande, Vera Oling, Edward Sennoga, Joel Tokindang, Walter Odero, and Tilahun Temesgen, under the general guidance of Stefan Muller, Lead Economist EARC, Gabriel Negatu, Regional Director EARC; as well as the respective Resident Representatives of the AfDB in Burundi (Abou Ba), Rwanda (Negatu Makonnen), Tanzania (Tonia Kandiero), and Uganda (Jason Mochache, OIC).

The thematic section in this issue was authored by Edward Sennoga.

Please direct your feedback and comments to e.sennoga@afdb.org.

Angle de l'avenue du Ghana et des Rues
Pierre de Coubertin et Hédi Nouira
BP 323 -1002 TUNIS Belvédère
TUNISIA

Tel: +216 71 333 511 / 71 103 450
Fax: +216 71 351 933
E-mail: afdb@afdb.org
Web: www.afdb.org

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1 | REGIONAL OVERVIEW

Growth performance and other macroeconomic indicators for the EARC countries during the quarter under review show generally mixed results when compared with the previous quarter. For example, in Burundi, the only country for which real GDP data for Q1 2013 are available, real GDP growth improved slightly to 4.5% from 4.2% in Q4 2012. This improvement in growth performance for Burundi resulted primarily from expansion of the industry and services sectors. In Kenya, indicators of economic activity indicate that economic activity slowed down during the quarter under review in part due to the 4th March 2013 general elections.

For countries where relevant quarterly data are available, with the exception of Tanzania, the trade deficit widened as a result of reduced export earnings and higher or unchanged import costs.

Country specific challenges experienced during the quarter under review included reduced aid inflows and associated uncertainties (for Burundi, Rwanda and Uganda); lower than programmed revenues and accumulation domestic arrears (Burundi); and uncertainty associated with the general election and higher fiscal deficit due to increased spending (Kenya).

Central Banks in the region maintained a tight monetary policy stance focused on keeping inflation low while supporting judicious expansion in private sector credit. As a result, inflation during the quarter under review declined and was kept in single digits in all countries.

A number of policy and legislative changes were made during the quarter under review including the introduction of a VAT to replace the general services tax in Seychelles; adoption of a new income tax code in Burundi, and ratification of three pieces of media legislation in Rwanda. The IMF also completed the fifth review under the Policy Support Instruments for Tanzania and Uganda, confirming these countries' satisfactory macroeconomic performance.

The major downside risks to the region's economic outlook include the fragile global economic recovery; particularly in the euro area and risks of excessive fiscal consolidation in the United States, which among other things are expected to reduce the demand for the region's exports and investment inflows. The improving socio-political outlook in the Great Lakes region is also expected to positively influence the region's economic outlook.

II | COUNTRY UPDATES

BURUNDI

HIGHLIGHTS

- Real GDP growth increased, albeit marginally during the quarter under review due, to expansion in industry and services
- A weak global recovery and socio-political tensions in the Great Lakes region are the primary downside risks to real GDP growth in 2013

MACROECONOMIC DEVELOPMENTS

Table 1 – Selected Macroeconomic Indicators*

	Q4 2012	Q1 2013
Real GDP growth (%)	4.2	4.5
Inflation rate (CPI, %))	13.1	8.0
Fiscal balance	(41.3)	0.3
Total expenditure	152.1	164.9
Capital	50.4	43.1
Total revenue	110.8	115.0
Tax and non-tax revenue	110.8	90.0
Grants	-	25.0
External current account balance	(107.1)	(169.2)
Imports	139.7	190.0
Exports	32.6	20.8
Exchange rate (USD / FBu)	1,528.3	1,650.2
International reserves (in months of imports)	3.6	3.0
Total public debt (stock)	792.8	717.2 (p)
External	397.6	395.3 (p)
Domestic	395.2	321.9 (p)

*All figures in millions US Dollars unless indicated otherwise
Source: National Authorities and author computations

Economic Growth

Real GDP growth increased, albeit marginally, between 2012 Q4 and 2013 Q1 (see Table 1) mainly due to expansion in the industry and service sectors. The commencement of civil works for the Kabu 16 hydroelectric dam during the quarter under review and implementation of road projects financed by Japan and the African Development Bank contributed to growth in the industry sector. Moreover, the anticipated installation of the country's first national backbone network by the Burundi Backbone Systems Company (Burundi BBS) in Q2 2013 is expected to spur the performance of the services sector. Growth in the agriculture sector remained weak, in part due to poor performance of export crops, owing to the reductions in coffee production.

The outlook for the remainder of 2013 is mixed, given the continued fragile global economic environment and socio-political tensions in the Great Lakes region which could potentially affect tourism, trade, and foreign direct investment. To mitigate these risks, the government is participating in peace initiatives under the auspices of African Union and International Conference on the Great Lakes Region. Moreover, the government also plans to organize a series of sector conferences during the second half of 2013 to showcase economic opportunities in Burundi in a bid seek to attract potential investors.

- **Implementation of fiscal policy was constrained by reduced aid inflows and lower than programmed public revenue**
- **Two new tax legislations, one for the VAT and the other for income tax, were adopted to expand the tax base and ensure alignment with tax policy in other EAC partner states**

Fiscal Stance and Public Debt

Several negative shocks affected the implementation of government's fiscal policy during the quarter under review. First, budget support in 2013 will decline by about 20% compared to 2012 thus limiting government's ability to implement its public spending plan. The reduction in budget support disbursements in response to the delayed implementation of structural and sector reforms as previously agreed with development partners. Delayed reforms include liberalization of the coffee sector and public procurement reforms. However, the budget execution rate during the quarter under review was 20.8%, and in line with the benchmarks in the IMF program. Second, domestic revenue performance has been disappointing despite initiatives implemented by the authorities to boost revenue mobilization, particularly the introduction of a 10% tax on the remuneration of political representatives and the gradual expansion of the use of tax identification numbers (TIN), including in the informal sector. A new income tax law was also adopted in December 2012 to re-align inconsistencies between exemptions granted under the tax and investment codes. The major causes of the lower than programmed revenue yield included weak economic growth and destruction of Bujumbura's biggest market during a fire in January 2013.

Revenue collections amounted to FBu 140.2 billion (USD 90.0 million) during the quarter under review, representing a performance of 78%, compared to FBu 145.3 billion realized during the same period in 2012 and FBu 166.77 billion (USD 110.8 million) in Q4 of 2012. The Burundi Revenue Authority (OBR) is working closely with the Ministry of Finance to ensure effective implementation of the revenue enhancing measures.

In 2013, total revenue is projected to increase to FBu 615 billion (USD 392.8 million), compared to FBu 527.5 billion (USD 374.9 million) in 2012, an increase of 0.1% of GDP. Total expenditure is projected to increase by 4.5%, to FBu 1,290.9 billion (USD 813.7 million) in 2013 compared to the previous year. This increase is higher than the 3.8 % growth achieved in 2012 and reflects the government's objective of scaling up investments in economic and social infrastructure. The wage bill is projected at FBu 300.8 billion (USD 192.1 million) or 7.3% of GDP down from USD 199.0 million or 8.6% of GDP in 2012. The reduction in the wage bill is aimed at creating additional fiscal space for public investments in infrastructure development. The GDP share of capital expenditure is projected to increase from USD 400 million or 17% of GDP in 2012 to USD 462 million or 17.4% of GDP in 2013.

As part of a broader tax reform program, the Government adopted a new VAT in December 2012 designed of expand the VAT base, including tapping into the informal sector. In addition, the promulgation of the new income tax legislation in January 2013 led to a reduction in the income tax rate from 35% to 30%, in line with income tax rates in other EAC partner states. Moreover, the government plans to revise the investment code in 2013 to among other things, ensure consistency with the tax exemptions provided for in the income tax legislation.

The stock of domestic debt decreased from USD 395.2 million in December 2012 to USD 321.9 million in March 2013 due to the repayment of short-term debt from the banking sector following the disbursement of aid by the World Bank. However, the accumulation of domestic arrears experienced since 2012 remains unresolved and the government has undertaken an exercise to quantify all government arrears to inform its repayment plan.

Monetary and Financial Sector

The monetary policy stance in Q1 2013 has not changed significantly compared to the previous quarter and during 2012. To reduce inflationary pressures, maintain exchange flexibility, and to preserve the competitiveness of the economy, the government decided to maintain its policy rate at 16% during the quarter under review. However, credit to the economy, both public and private, increased by 16% to FBu 933.4 billion (USD 571 million) in February 2013 compared to the same period in 2012 on account of reduced government borrowing from the banking sector. Overall, the reduction in aid inflows contributed to a USD 18.6 million decrease in foreign assets in Q1 2013 compared to the same period in 2012.

However, heightened surveillance of the banking system is needed to ensure that challenges including: (i) payment delays to government suppliers which resulted in roll-over of commercial bank loans in 2012; (ii) reduced donor disbursements; and (iii) reduced export earnings from coffee do not compromise the liquidity and profitability of the banking system.

The Burundi Franc depreciated by 8% against the US Dollar during Q1 2013 vis-à-vis Q2 2012 due to reduced aid inflows and strong import demand for petroleum products and capital goods related to investments in the energy sector.

Headline inflation slowed to 5.9% for the year ended March 2013 from 9.4% in February and 7.6% in January 2013 in part due to reduced food prices following good harvests. Food price inflation increased by 7.3% in the twelve months to March 2013, down from 11.2% in February. Food and fuel account for 70% of the consumer price index. The government projects headline inflation of 14% in 2013 and higher than the 11.8 % recorded in 2012, primarily due to rising food and fuel prices.

External Sector

Burundi's import bill increased by 34% in Q1 2013 compared to the same period last year, driven by fuel imports which accounted for more than 25% of overall imports. Imports totaled FBu 310.2 billion (US$190.0 million) in Q1 2013, up from FBu 235.9 billion in Q1 2012. Export revenues also increased, albeit at a lower rate of 7.4% to BFu 34.1 billion (US$21.0 million) in Q1 2013 relative to the same period in 2012 due to a decrease in coffee production. Estimates at end-March 2013 indicate that the current account deficit (USD 169.2 million) was higher than the USD 107.1 million recorded during the previous quarter due to reduced coffee export receipts and the strong growth in imports particularly petroleum products and capital goods to support investments in the energy sector. The recent reductions in aid inflows have also contributed to the increase in the current account deficit. In spite of Burundi's efforts in recent years to improve the

- **Monetary policy stance was unchanged in both Q4 2012 and Q1 2013 with the central bank maintain its key policy rate at 16%**
- **Headline inflation continued to recede during the quarter under review on the back of lower food prices**
- **Strong import demand, reduced aid inflows, and minimal direct investments remain key drivers of the country's Balance of Payments deficit**

business climate, private capital flows remain minimal. Consequently, Burundi's overall balance of payments continued to post a deficit, estimated at 1.1% of GDP in March 2013 compared to 1.0% during the same period last year.

OTHER NOTABLE DEVELOPMENTS AND UPDATES

Political Developments

The government and opposition commenced talks March 2013 to identify ways of avoiding a repeat of the controversy over the 2010 elections that almost plunged the country into another civil war. The three-day discussions are the first since the 2000 Arusha Peace Agreement between the two sides. The discussions, organized by United Nations, were aimed at identifying a 'credible' roadmap to the upcoming 2015 general elections. Among other things, this roadmap is expected to contribute to an all-inclusive, transparent, free and fair general election.

Private Sector Activity

The central market in Bujumbura was completely destroyed by fire at the end of January 2013, causing losses to over 7,000 merchants, 80% of whom were women. The market was the epicenter of the nation's economy, providing goods to the entire country, as well as the neighboring Congo and Rwanda with daily trade amounting to about USD 4 million per day. The destruction of the central market immediately caused a food shortage, leading to an increase in food prices in the region of 10-20% and reduced tax revenues. The authorities have established several interventions to support the victims of the fire including opening of a relief support account at the central bank. The African Development Bank has prepared an emergency assistance program, which is being processed and reviewed internally.

The government has called upon investors to participate in the country's energy sector to support its electrification program. Burundi's hydropower potential is estimated at 300 MW while the country's current generation capacity stands at 45 MW up from 30 MW in 2005. The country is also participating in regional integration efforts to increase electricity generation and access. Burundi's energy sector is faced with several challenges including mobilization of funds and reduction of non-technical losses in the national network currently estimated at 30%. Still, the authorities are working towards increasing electricity access rate from the current 2% to 15% by 2015 in accordance with the Millennium Development Goals.

Donor Relations

The government signed in March 2013 a loan agreement with Kuwait Fund for Arab Economic Development Kuwaiti Dinars 2,900,000 (US$ 10 million) to finance the Bujumbura-Nyamitanga road project. The objective of the project is to improve transport infrastructure in the country's western corridor of Burundi, spur agriculture productivity and trade with the neighboring countries, and thus contribute to the overall economic and social development of the project area. In addition to the Kuwait Fund loan, it is expected that the Saudi Fund for Development and the Arab Bank for Economic Development will also contribute to the financing of the project.

- **The central market in Burundi was destroyed by fire causing losses to over 7,000 merchants, 80% of whom are women**
- **The government urged investors to participate in the country's energy sector to increase electricity access from the current 2% to 15% by 2015**

KENYA

HIGHLIGHTS

- **Main economic indicators for Q1 suggest that economic activity slowed down due to the March 2013 general elections**

MACROECONOMIC DEVELOPMENTS

Table 2 – Selected Macroeconomic Indicators*

	Q4 2012	Q1 2013
Real GDP growth (%)	4.7	-
Inflation rate (CPI, %)	3.2	4.1
Fiscal balance	(1,470)	(2,600)
Total expenditure	5,970	8,600
Capital	-	-
Total revenue	4,500	6,000
Tax revenue	-	-
Grants	-	-
External current account balance	(4,809)	(3,399)
Imports	-	-
Exports	-	-
Exchange rate (USD / KSh)	85.9	85.6
International reserves (in months of imports)	-	-
Total public debt (stock)	21,200	21,000
External	9,710	9,555
Domestic	11,490	11,445

*All figures in million US Dollars unless indicated otherwise
Source: National Authorities and author computations

Economic Growth

Although the Kenya National Bureau of Statistics is yet to release the economic growth figures for the first quarter of 2013, there are indications of reduced economic activity during the first quarter of 2013, compared to the 4.7% economic growth during the final quarter of 2012, as a result of the March 4th 2013 elections. Increased domestic demand in the run-up to the elections and improved access to credit were the key drivers of growth during the last quarter of 2012 and the first quarter of 2013. Kenya's economy is projected to grow at 5.6% in 2013. The agricultural sector, services sector, particularly, transport and communication and wholesale and retail, and the manufacturing/industrial sector, would remain the main sectors driving economic growth. Economic growth in 2013 would be propelled by the peaceful elections, favorable weather conditions, continued prudent macroeconomic and fiscal management, low lending rates resulting from low rate of inflation, and increased regional trade with countries within the East African Community. However, the slowdown of the global economy, particularly the recession in Eurozone is likely to affect horticultural export and the tourism sector.

Fiscal Stance and Public Debt

The central government cumulative revenue collection including appropriations in aid as at end of March 2013 amounted to USD 6 billion (equivalent to 13.6% of GDP) up from the December 2012 figure of USD 4.5 billion (equivalent to 10.1% of GDP). The central government cumulative expenditure and net lending for the period ending 18th Mach 2013 amounted to USD 8.6 billion (equivalent to 19.6% of GDP) compared to the 31st December 2012 figure of USD 5.97 billion (equivalent to 13.5% of GDP). The continued slow uptake was still largely attributed to low absorption in operations and maintenance, as well as slow utilization of domestically and foreign financed development expenditures.

As at end March 2013, public guaranteed debt stood at USD 21 billion or 46.6% of GDP. The domestic debt component was 54.5% and the foreign debt component 45.5%. The external debt decreased by USD 90 million in March 2013 due to exchange rate appreciation against world major currencies during the month. Gross public debt stood at USD 21.2 billion on 31st December 2012 comprising of 45.8 percent external and 54.2 percent domestic. According to the Debt Sustainability Analysis (DSA), Kenya's public debt is sustainable.

Monetary and Financial Sector

The tight monetary policy stance of the Central Bank of Kenya (CBK) during the first half of 2012 resulted in positive outcomes of low and stable inflation and exchange rates stability. Overall inflation declined from 18.9% in December 2011 to 10% in June 2012, and to 4.1% in March 2013. Consequently, CBK has adopted a gradual easing monetary policy stance since July 2012.The Central Bank Rate which was maintained at 18% from January to June, 2012, was reduced gradually overtime to 9.5% in March 2013. The overall aim of the monetary policy stance is to ensure low and stable inflation, enhance financial access, encourage economic growth, and ensure long-term sustainability of public debt.

Headline inflation stood at 4.1% at end of March 2013 from 4.5% in February 2013 but higher than the 3.2% at the end of the 4th Quarter in 2012. Declining inflation was mainly due to continued easing of fuel inflation, although the fall was marginal across all categories. Nonfood and non-fuel inflation declined from 4.5% in February 2013, to 4.2% in March 2013.

During the quarter, the Kenyan Shilling appreciated against major currencies; the US dollar, the Pound Sterling, the Euro, Japanese Yen, and the South African rand. As at end of March 2013, the average exchange rate was KSh 85.6 to the US dollar, KSh 129.6 to the Pound Sterling, KSh 109.5 to the Euro, KSh 90.9 to the Japanese Yen, and KSh 9.2 to the South African rand. The shilling closed the year 2012 exchanging at KSh 85.92 per US Dollar. The appreciation was as result of improved confidence leading to increased inflow from the diaspora, plans to issue the Eurobond to close the huge current account deficit, the discovery of hydrocarbons, and the post-election euphoria, among others.

- **Low absorption capacity in development spending continued to impede execution of the public spending plan**
- **The central bank gradually eased its monetary policy stance to support economic growth while maintaining price stability**
- **The Kenya shilling appreciated against major currencies during the quarter under review**

As at March 28, 2013, the usable official foreign exchange reserves held by Central Bank stood at USD 5,052 million, equivalent to 3.78 months of import cover, down from USD 5,396 million, equivalent to 4.24 months of import cover, at end-December 2012.

External Sector

The value of exports increased by 17.1% in January 2013 relative to December 2012, compared with 11.7% for the value of imports. The main contributors to exports continued to be coffee and tea while non-food industrial supplies dominated imports. Kenya's trade deficit in January 2013 was USD 955.2 million (KSh 83.6 billion) compared with USD 878.6 million (KSh 76.9 billion) in December 2012. The current account deficit increased by 41.5 percent to USD 4,809 million in the year to January 2013, from USD 3,399 million in the year to January 2012, following a 15.8% (USD 1,424 million) growth in the merchandise account deficit. Kenya continues to attract considerable net capital inflows in response to the attractive interest rate regime and relatively stable foreign exchange rate; and net financial inflows from bilateral and multilateral loans for projects. The net capital and financial inflows are helping to finance the huge current account deficit. Consequently, Kenya's overall Balance of Payments position improved from a deficit of USD 137 million in the year to January 2012 to a surplus of USD 941 million in the year to January 2013.

- **The Balance of Payments position improved to a surplus in the year to January 2013 compared to a deficit during the same period in 2012**
- **General elections held on 4th March 2013 were concluded peacefully**

OTHER NOTABLE DEVELOPMENTS AND UPDATES

Political Developments

Kenya had general elections on 4th March 2013. The historic general elections dominated political activity during the quarter. The presidential candidate for the Jubilee Coalition, Mr. Uhuru Kenyatta, was declared winner of the presidential elections. The presidential candidate for the Coalition for Reforms and Democracy (CORD), Mr. Raila Odinga, who came second, challenged the results on alleged irregularities in the voter registration process and the counting of votes cast. On March 30, 2013, the Supreme Court up-held the election results and confirmed Mr. Uhuru Kenyatta, as the winner and President-elect. Mr. Uhuru Kenyatta was sworn in as Kenya's 4th President on 9th April 2013. The elections also brought in 47 Governors (elected for the first time under the new constitution); 59 Senators; 349 Members of Parliament and 1,450 County Representatives.

Institutional reforms

Following the elections held in March 2013, new devolved structures begun failing into place with Governors taking their offices in the 47 new counties. The Transitional Authority which is responsible for managing transition to the new constitution following elections in March 2013 also posted interim staff including Accounting officers and temporary County Assembly staff.

On 12th June 2012, Kenya's parliament passed the Public Financial Management Act, and was signed into law by the President on 23rd July 2012. The Act provides for an effective management of public finances by the national and county governments, oversight responsibility of Parliament and County Assemblies, and the different responsibilities of government entities and other bodies. This will help improve public financial management in Kenya.

Donor Coordination and Aid Effectiveness

Kenya's Aid Effectiveness Group which monitors the implementation of international commitments on aid effectiveness met once during the quarter under review to discuss the expected Aid architecture after elections of March 2013. No major Development Partnership activities took place during the quarter. The peaceful outcome of the march general elections is likely to renew donor confidence in Kenya and increase donor activities in the country. However, this could be tampered by the fact that the the new President and his Deputy are currently under prosecution in the International Criminal Court (ICC). This might affect Kenya's foreign policy, overall donor relations and aid contributions.

RWANDA

HIGHLIGHTS

- Real GDP growth at 8.7% during Q4 2012 was higher than the 6.9% in the previous quarter on account of stronger performance in services and industry
- Tight monetary policy and the consequent reduction in private sector credit growth is expected to lead to a slowdown in real GDP growth in 2013. Other downside risks include the fragile global recovery and uncertain aid environment

MACROECONOMIC DEVELOPMENTS

Table 3 – Selected Macroeconomic Indicators*

	Q4 2012	Q1 2013
Real GDP growth (%)	8.7	-
Inflation rate (CPI, %)	4.6	4.6
Fiscal balance	-	-
Total expenditure	948.9 (July-Dec)	-
Capital	426.6 (July-Dec)	-
Total revenue	242.3	271.5
Tax revenue	239.1	268.6
Grants	316.3 (July-Dec)	385.6 (Jan-June)
External current account balance	(812) (2012)	(845) (2013)
Imports	515.9	515.6
Exports	140.9	130.1
Exchange rate (USD / RWF)	629.4	633.2
International reserves (in months of imports)	4.8 (2012)	3.8 (2013)
Total public debt (stock)	1,597 (2011)	1,652 (2012)
External	1,135 (2011)	1,171 (2012)
Domestic	462 (2011)	481 (2012)

*All figures in million US Dollars unless indicated otherwise
Source: National Authorities and author computations

Economic Growth

The most recent data available indicate that real GDP growth picked up in the 4th quarter of 2012 to 8.7% from 6.9% in the Q3 in spite of the delayed disbursements of general budget support during the second half of 2012. Growth in Q4 2012 was mainly led by the services sector which grew by 12% and contributed 43% of GDP. Table 3 illustrates trends in selected macroeconomic indicators between Q4 2012 and Q1 2013. The main service sector expansion areas during the quarter under review were telecommunications whole sale, and retail trade. The industry sector accounted for 17% of GDP during Q4 2012 and increased by 11% on account of strong growth in construction activities. Services and industry sector growth also benefited from expansion in credit to the private sector, which increased by 3.4% between December 2012 and March 2013, higher than the 2.7% growth rate registered in Q4 2012. Growth in the agriculture sector, which accounted for 34% of GDP during the quarter under review, although moderate at 3%, was higher than the 2% during the previous quarter. Increased food production due to favorable weather and increased productivity as a result of the Crop Intensification Program were the key drivers of growth in the agriculture sector. Real GDP growth averaged 8% during 2012 and exceeded the initial target of 7.7%.

Real GDP growth in 2013 is projected at 7.5% due to slower growth in services and construction sector in part due to the projected slowdown in private sector credit growth as a result of tight monetary policy. Other downside risks to the 2013 economic outlook include a fragile global economic recovery, in particular the renewed setbacks in the euro area and the risk of excessive fiscal consolidation in the United States, and the uncertain aid environment.

Fiscal Stance and Public Debt

The Fiscal policy stance in the quarter under review remained focused at ensuring increased revenue mobilization and expenditure prioritization consistent with the government's medium term fiscal consolidation strategy (FCS). In line with the FCS; domestic revenue collections for the Q1 2013 (USD 271.5 million) exceeded the target by 1% and were 12% higher than the USD 242.3 million outturn achieved during the previous quarter. Improved tax collections were realized for taxes on goods and services and income taxes which jointly account for 92% of the total tax revenues. The higher revenue yield is attributed to the efficiency gains from the implementation of various tax administration measures such as automation of tax filing and payment, increase in the tax rate for imported construction materials from 5% to 10%, the implementation of electronic billing machines VAT payers which helped to limit tax evasion and strong real GDP growth during the Q1 2013.

In February 2013, the FY 2012/13 budget was revised to reflect cut backs in aid and the proceeds from the USD 400 million sovereign bond issuance programmed for the first half of 2012. Total expenditure and net lending in the revised FY 2012/13 budget is now projected at USD 2.25 billion (30.5% of GDP) up from the initial USD 2.1 billion (28% of GDP). The share of capital expenditure in total spending amounted to 46% during the first half of FY 2012/13 (July-December 2012) and this share is projected to increase to 50% during the second half (January-June 2013) as some of the initially delayed capital projects are implemented. Revenue and grants are projected to remain stable at 25.4% and 25.3% of GDP in the initial and revised FY 12/13 budgets respectively. Consequently, the revised FY 2012/13 budget is now expected to close with an overall cash deficit of USD 569.5 million (7% of GDP) compared to USD 222.6 million (3% of GDP) in the initial budget and 2.2% in FY 2011/12.

The fiscal deficit will among others be financed by part of the sovereign bond proceeds. Moreover, proceeds from the sovereign bond will be used to retire short term commercial debt incurred at higher interest rates (USD 200 million), completion of Kigali Convention Center, one of the Government's strategic investment projects (USD 150 million) and construction of the Nyabarongo hydropower project (USD 50 million). As a result, net lending is projected to increase from 0.2% of GDP in the original FY 2012/13 budget to 4.6% of GDP in the revised FY 2012/13 budget.

Monetary and Financial Sector

- **Fiscal policy remained anchored on the government's fiscal consolidation strategy aimed at prioritizing public spending and increasing the mobilization of public revenues**
- **The FY 2012/13 budget was revised to reflect the cut-backs in aid and new revenues including the sovereign bond proceeds**

The National Bank of Rwanda (NBR) maintained a tight monetary policy stance by keeping its key policy rate unchanged at 7.5% during Q1 2013. This was aimed at achieving NBR's twin objectives of low and stable inflation low while supporting expansion in private sector credit. NBR also reduced the sale of Treasury Bills to reverse the decline in banking sector liquidity experienced during the second half of 2012. As a result, growth in private sector credit remained stable at 3% in both Q4 2012 and Q1 2013 with services and construction accounting for the bulk of the new authorized loans. Headline inflation mirrored similar trends remaining stable at 4.6% during the same period. Core inflation decreased from an average of 4.4% in Q4 2012 to 3.7% during the quarter under review in part due to lower inflation in the region and thus low imported inflation. Both headline and core inflation are in line with the NBR's medium term inflation target of 5%.

The reduced issuance of Treasury Bills during the quarter under review contributed to a slight reduction Treasury Bill rates from 12.4% in December 2012 to 12.2% in March 2013. As a result, interbank rates also decreased from 11.1% in December 2012 10.0% during Q1 2013, reflecting an improvement in the banking sector liquidity

Banks increased their deposit rates during the quarter under review to mobilize additional deposits required to meet the rising demand for domestic credit from both the public and private sector. As a result, deposit rates increased from an average of 8% in June 2012 to 10.5% in March 2013. Due to a shallow but expanding financial sector, lending rates have not responded commensurately to the increase in banking sector liquidity, averaging between 16.6% and 17% during the same period.

External sector

Exports earnings decreased by 8% to USD 130.1 million in between Q4 2012 and Q1 2013 on account of reduced 're-exports' particularly petroleum products. However, the share of principal exports in total export receipts increased from 57% to 62% during the same period on the back of increased receipts from tea and minerals which more than offset the reduction in coffee export earnings. Imports remained unchanged in value terms at USD 515 million during Q4 2012 and Q1 2013, with the increased capital and intermediate imports more than offsetting the decline in consumer goods imports. Consequently, the trade deficit increased by 3% to USD 385.8 million in Q1 2013 compared to the previous quarter. For 2013, export earnings are projected to increase to USD 678.8 million from USD 590.8 million in 2012, driven by higher earnings from minerals, tea and non-traditional exports particularly processed food products. Imports are projected to increase from USD 1,967 million to USD 2,142.2 million during the same period due to higher demand for capital and intermediate goods to support strategic investments. As a result, the trade deficit is projected to increase from USD 1.3 billion in 2012 to 1.4 billion in 2013. Reflecting the resumption in budget support disbursements; the current account deficit including official transfers is projected to decrease from 11.3% of GDP in 2012 to 10.2% in 2013.

The Balance of payments is projected to close with a surplus of USD 81.7 million in 2013 on account of higher net capital and financial inflows amounting to USD 941.9 million including the USD 400 million sovereign bond proceeds and foreign direct investments of USD 171.4 million. International reserves will thus increase

- **Monetary policy remained tight in line with the central bank's objective of low and stable inflation**
- **The central bank reduced its purchase of Treasury Bills to reverse the decline in banking sector liquidity experienced during the second half of 2012**
- **The trade deficit increased following a reduction in export earnings as imports remained unchanged between Q4 2012 and Q1 2013**
- **The Balance of Payments is projected to post a surplus in 2013 on account of higher capital and financial inflows**

from USD 843.45 million at end-December 2012 to USD 925.5 million or 3.8 months of imports at the end-2013.

The Rwandan franc depreciated by 0.6% against the US Dollar between Q4 2012 and Q1 2013, following a sharper depreciation of 4.5% between January and December 2012. The stability of the local unit against the USD and other major currencies during the quarter under review was in part due the resumption in budget support disbursements and the announcement of the upcoming launch of the sovereign bond.

OTHER NOTABLE DEVELOPMENTS AND UPDATES

Political Developments

The government and representatives of the private sector concluded the 10th annual National Leadership Retreat in March 2013 to discuss strategies for achieving the key objectives of the country's 2nd Economic Development and Poverty Reduction Strategy (EDPRS-2, 2013-2018).The key resolutions adopted include; fast tracking measures to strengthen coordination across the public sector to ensure improved service delivery; implementation of strategies to address key binding constraints to the country's socio-economic development, including energy, transport and skills deficits; and diversification of sources of development financing including private sector investment and finance. Sustained support to private sector development and investments in vocational training and entrepreneurship development were particularly singled out as critical to achieving the target of 200,000 off-farm jobs per year. These resolutions are aimed at achieving the target 11.5% average real GDP growth rate during the EDPRS-2 period.

Institutional reforms

President Kagame signed into law three new pieces of legislation relating to access to information, the functioning and organization of the Media High Council (MHC), and the regulation of the media. The three laws are expected to underpin the second phase of wide-ranging media reforms which will comprise the transformation of the state broadcasting agency into an autonomous broadcaster to increase its editorial independence, a change in the role of the MHC from regulation to media development and advocate for media freedom, and the establishment of a self-regulatory body for media practitioners to enhance professionalism. The reforms are expected to support fundamental changes in the media sector resulting in improved professionalism, editorial independence and freedom of expression.

Donor Relations

Donor coordination activities during the quarter under review focused on approaches to sustain donor dialogue given the uncertainty surrounding budget support. In particular, the government urged the Budget Support Harmonization Group Development Partners (DPs) to reexamine the framework for country dialogue. DPs discussed various approaches including revitalizing the Development Partner Coordination Group, the highest level coordination forum in Rwanda, to provide scope for more dialogue around national development processes and priorities.

- **Government and representatives of the private sector concluded the 10th Annual National Leadership retreat to discuss strategies for achieving the EDPRS-2 objectives**
- **Three pieces of legislation were signed into law to improve access to information and regulation of the media**

SEYCHELLES

HIGHLIGHTS

- **Real GDP growth in 2013 is projected exceed the achievement in 2012. However, the fragile global economy particularly in the euro area is expected to impact negatively on tourism**

MACROECONOMIC DEVELOPMENTS

Table 4 – Selected Macroeconomic Indicators*

	Q4 2012	Q1 2013
Real GDP growth (%)	2.8	-
Inflation rate (CPI, %)	6.5	6.2
Fiscal balance	(22.6)	(16.36)
Total expenditure	96.14	52.62
Capital	14.05	17.08
Total revenue	73.52	36.26
Tax revenue	63.62	-
Grants	60.6	6.5
External current account balance	(58)	(52)
Imports	298	258
Exports	146	164
Exchange rate (USD / SCR)	13.05	12.41
International reserves (in months of imports)	2.8	2.9
Total public debt (stock)	853	889
External	470	460
Domestic	383	429

*All figures in million US Dollars unless indicated otherwise
Source: National Authorities (draft monthly reviews January to March 2013) and author computations

Economic Growth

A slowdown in economic activity in Europe, Seychelles' main tourism market and slower completion of construction investments in the industry are the main downside risks that could affect economic prospects in the country in 2013. Despite these risks, GDP growth is expected to reach slightly above 3% in 2013, a higher pace than that of 2012. The marginal rise is in GDP is expected to be driven by a continued increase in tourist arrivals and an intensification in FDI inflows targeted towards the completion of tourism related infrastructure, essentially large occupancy hotels that had been on-going since 2010. As in 2012, Tourism and construction continued to be the main economic drivers in the first quarter of 2013. Tourism arrivals during the first quarter of the year at 59,050 were equivalent to 29% of total 2012 arrivals. FDI inflows in the construction industry were estimated to be USD 40 million in the first quarter of the year compared to USD 29 million in Q1 last year. The boom in construction was also seen by the increase of credit to the sector by 74% (i.e. over SCR 121 million or USD 9.7 million) in the early part of the first quarter of 2013. As a net food and fuel importer, global commodity prices will continue to be important economic fundamentals in determining the country's economic outlook in 2013.

- **Fiscal consolidation is aimed at achieving a 5.6% budget surplus in 2013**
- **The VAT was introduced to replace the general service tax and is expected to support the fiscal consolidation strategy**

Fiscal Stance and Public Debt

In 2013, Government continues to implement a fiscal policy consistent with achieving debt sustainability over the medium term, which is to reduce public debt to 50% of GDP by 2018. Fiscal consolidation in order to attain a primary budget surplus of 5.6% of GDP in 2013 will continue to be the target. During the first two months of 2013, the government attained an overall primary surplus of 0.7%, with 1% of GDP in January and a deficit of -0.3% in February.

In line with its on-going economic reform program (underpinned by the IMF supported External Fund Facility)and the Budget address of December 2012, the government introduced a number of Public Finance Management (PFM) reforms in January 2013 aimed at improving budget preparations, accounting and budget execution. Key among the changes were: the Introduction of a new Chart of Accounts to facilitate analysis of budget expenditure and preparation; development of a five year Public Sector Investment Program (PSIP)that will form the basis of capital investment planning and improve borrowing for investments whilst keeping debt sustainability levels sustainable; piloting of Program Performance Based Budgeting (PPBB) in the two largest ministries, Education and Health and instituting new reporting arrangements for all Accountants in Ministries to increase control of public finances and oversight by the Ministry of Finance. The overall aims of these reforms are to consolidate macroeconomic stability of the economy. The reforms are a result of the National Assembly's approval of the amendments to the Public Finance Management (PFM) Act in November 2012, aimed at strengthening the macroeconomic governance.

The government also introduced a Value Added Tax (VAT) of 15% to replace the General Service Tax (GST) on 1st January 2013. The VAT which should have been introduced from 1st July 2012 was delayed to enable further public consultations and preparations by the Seychelles Revenue Commission (SRC). Despite the delayed implementation which should have improved the uptake, tax revenues underperformed in the first two months of the quarter largely on account of below target collection in VAT. Total revenue from VAT was SCR 81 million (USD 6.4 million) which was 25% below expectations for the month of February 2013. On the other hand, GST over performed during this period with a collection of SCR 38 million (USD 3.04 million) when none was forecast, signaling the lag in full crossover of all businesses to VAT registration. According to the budget outlook for 2013, tax revenues are expected to grow by 7% over 2012 figures. Tax revenues are expected to amount to US$410m in 2013 or 32.7% of GDP compared to 32.3% of GDP in 2012.

Monetary and Financial Sector

The Central Bank of Seychelles (CBS) has prioritized the review of the reserve target framework to improve monetary policy management in light of the high exchange rate and interest rate fluctuations experienced in early 2012. The CBS, with support from the IMF, will analyze the possibility of using the interest rate as a monetary policy target. The reserve money target for the first quarter of 2013 is

SCR 1,950 million (USD 157,258) allowing for an extra SCR 30 million of total liquidity in the system compared to the previous quarter. This expansionary monetary policy stance is in line with the projected reduction in domestic inflationary pressures. As a result of the increase in liquidity, the lending rate decreased for the second consecutive month in March 2013.

The Seychelles Rupee appreciated against the US dollar, as supply continued to outstrip demand and traded at SCR 11.76/ USD in March 2013, compared to SCR 12.94/USD in January 2013. The appreciation of the SCR also led to a decrease in inflationary pressures. The Inflation rate decreased from 6.5% for the year ended December 2012 to 6.2% at end March 2013. The main determinants of inflation during the quarter under review were non-food items such as alcoholic beverages. The government forecasts an annual average inflation of 5.1% in 2013, compared to 7.2% in 2012.

- **The central bank announced intentions of replacing reserve money with interest rate as a monetary policy target**
- **Inflationary pressures continued to ease with headline inflation decreasing to 6.2% for the year ended March 2013 down from 6.5% in December 2012**
- **Reduction in imports contributed to a lower trade deficit**

External Sector

Seychelles import bill reduced by 30% in the first quarter of 2013 compared to the same period last year. This was closely correlated to a reduction in the import bill of mineral fuels by 19% over the same period. Mineral fuels accounted for 27% of overall imports in Q1 2013. The 11% appreciation of the SCR during the first quarter of 2013 also contributed to a reduction in import bill. Imports totaled SCR 3.09 million between January and March 2013, compared to SCR 3.86 million in Q4 2012, while exports totaled SCR 1.30 million and SCR 0.93 million during the same period respectively. The overall trade deficit in Q1 2013 was SCR 1.18 million (USD 90,000) down from a deficit of SCR 1.81 million (USD 140,000) in the previous quarter. The current account balance is projected post a deficit of USD 211 million in 2013, down from USD 231 million deficit in 2012.

OTHER NOTABLE DEVELOPMENTS AND UPDATES

Institutional Reforms

In line with the government's emphasis on enhancing service delivery, President Michel announced a number of changes and new appointments in the Government and in Public Sector Agencies, which formed part of the third phase of restructuring of government which started in March 2012. As part of the restructuring, the President streamlined and strengthened the functions of the Office of the President, office of the Vice-President, Departments of Public Administration and Public Service, and the Ministry of Finance, Trade & Investment. New senior level appointments were made in other Ministries and agencies such as Ministry of Tourism & Culture, Ministry of Land Use & Housing, the Agency for Social Protection, the Seychelles Investment Board, the Housing Finance Company and Property Management Company.

Donor Relations and Aid coordination

Following the flooding that Seychelles experienced at the end of January 2013 in 3 districts after severe weather hit the country causing floods, landslides and rock-falls, the Abu Dhabi government donated USD 2million towards the emergency works. The severe weather caused by the fringe effects of the Tropical Cyclone Felleng saw some parts of the country receive nearly half the expected rainfall for the month of January, over a 24hour period. The cost of the crisis which led to the temporary displacement of approximately 106 people, destroyed 50 homes, damaged schools, farmlands, road and water infrastructure, was estimated at USD$9million. The government set up a National Relief Fund to administer funds for the crisis. In the wake of this event, the Government of Seychelles requested for emergency assistance from the Bank, which is being processed and reviewed internally.

- **The Abu Dhabi government donated USD 2 million towards the emergency works program following the devastation caused by flooding**

The International Monetary Fund (IMF) conducted an Article IV mission to Seychelles in the first quarter of the year, 2013, and met with government to assess performance as at end-December 2012 for the 7th program review under the Extended Fund Facility (EFF) Arrangement. The mission concluded that the Seychellois economy had shown resilience despite the difficult global economic environment in 2012. Economic growth had held up buoyed by increasing tourist arrivals from non-traditional markets; fiscal policies had remained firmly on track toward the government's target of bringing public debt down to 50% of gross domestic product (GDP) by 2018; and debt restructuring was nearly complete. Furthermore, monetary tightening had been successful in reversing the inflationary pressures experienced in early 2012. The 7th review is expected to be considered by the IMF Executive Board in May 2013.

Following a request by the Government of Seychelles in late 2012 to the African Development Bank (AfDB) for the provision of budget support amounting to USD 20 million for the fiscal years 2013-2014, a team from the Bank travelled to Victoria in February 2013 to identify potential reform areas that could be supported to support under the program. The budget support operation which will be anchored on the government's Public Finance Management (PFM) action plan 2012-2014, is expected to be presented to the Board of Directors before the end of 2013. As the provision of a budget support operation was not envisaged at the time of preparation of the current Country Strategy Paper that was approved in 2011, the key reform areas to be supported under the program will be integrated into the proposed mid-term review (MTR) report of the Country Strategy Paper (CSP, 2011-2015), which will suggest a re-orientation of pillars for the remaining period. The preparation of the CSP MTR is expected to begin in Q2 2013 and be presented to the Board of Directors in Q3 2013.

TANZANIA

HIGHLIGHTS

- Steady growth performance is driven by a small set of rapidly expanding sectors
- GDP growth forecasts for 2013 and 2014 remain high at about 7% annually

MACROECONOMIC DEVELOPMENTS

Table 5 – Selected Macroeconomic Indicators*

	Q4 2012	Q1 2013
Real GDP growth (%)	7.0	-
Inflation rate (CPI, %)	19.0	9.8
Fiscal balance	-	-
Total expenditure	4,459	-
Capital	2,960	-
Total revenue	4,042	-
Tax revenue	2,980	-
Grants	872	-
External current account balance	(5,000)	(4,000)
Imports	13,000	13,000
Exports	8,000	9,000
Exchange rate (USD / TZS)	1,589	1,593
International reserves (in months of imports)	3.7	3.8
Total public debt (stock)	12,548	14,460
External	9,899	11,161
Domestic	2,649	3,299

*All figures in million US Dollars unless indicated otherwise
Source: National Authorities and author computations

Economic Growth

The Tanzanian economy continues to perform strongly. The country records an annual growth rate of 6.9% in 2012 and remains resilient to both internal and external shocks. The growth forecasts for 2013 and 2014 are around 7% and the business outlook is positive. The key growth drivers are the expansion in services, particularly telecommunication and financial intermediation, industry—including manufacturing and construction subsectors—and trade. Agriculture, which despite its low growth rate has a large share in GDP, is also important. The manufacturing subsector is projected to perform strongly, mainly driven by the increased production of chemicals, textiles, cement, and food processing. Growth of the agriculture sector for the first quarter of 2013 remained low at about 1.4%. Agricultural performance is uncertain because of the heavy dependence on rain fed production. Stable overall GDP growth over the past years is driven by the increase in domestic demand, given a population growth rate of 2.6% annually.

Stable economic performance is also due to the resilience to external shocks, thanks Tanzania's relative isolation from major world markets.

Fiscal Stance and Public Debt

- **Fiscal deficit has increased but is still sustainable. However, overall fiscal space is declining and debt management measures remain critical**
- **Shifts in the source of foreign capital due to non-concessional borrowing**

The current fiscal deficit is projected to be slightly higher than in the previous year. Based on the available information, cumulative government expenditures for the first half of the fiscal year 2013 2012/13 amounted to about TZS 6,023.2 billion (USD 3.8 billion) which was about 88% of the estimate budget estimate for the period. Recurrent expenditure amounted to TZS 4,018.5 billion (USD 2.5 billion), equivalent to about 87.2% of the budget estimate, while development expenditure reached TZS 2,004.7 billion (USD 1.3 billion), equivalent to 88.6% of the budget estimates for the period. Also, cumulative domestic revenue amounted to TZS 4,228.0 billion (USD 2.7 billion) for the first half of the fiscal year 2012/13 TZS 5,037.6 billion (USD 3.2 billion), equivalent to about 95.4% of the budget estimates. Grants amounted to TZS 1,138.6 billion (USD 715 million), compared to the projected amount of TZS 1,076.8 billion (USD 676 million). Tax revenues accounted for about 92% of domestic revenues, and tax revenue performance continues to be driven by trade taxes. Moreover, tax revenues were boosted, following the ongoing improvements in tax administration, including intensification of tax audits, and amendment of corporate tax assessments. Also, collections have been boosted by the continued increase in taxable transactions in some sectors, notably, telecommunication, oil and gas.

Tanzania's external balance remains under control, largely due to increased non-concessional borrowing. The external debt stock stood at USD 11.2 billion at the end of first quarter in 2013, compared to USD 9.9 billion recorded at the end of corresponding period in 2012. The increase was mainly on the account of new external debt disbursements. Tanzania's external debt is estimated at 37.3% of GDP end of 2012. The last debt sustainability analysis in 2012 indicates that the country's risk of debt distress remains low because of the high GDP growth forecast and an external debt stock that is predominantly concessional. However, the level of external non-concessional borrowing has grown significantly since 2010 to among other things, finance investments in natural gas and the energy sector. By the end of first quarter, the contracted non-concessional loans stood at around 7% of GDP and, by end of June 2013, could reach almost 8.9% of GDP.

Fiscal space is declining. While strong economic performance has created fiscal space for increased non-concessional financing of priority infrastructure spending, the fast accumulation of debt due to external non-concessional borrowing calls for attention to debt management measures. The government is in the process of addressing financial problems facing the Tanzania Electricity Supply Company (TANESCO), which has accumulated arrears in excess of an estimated USD 300 million by the end of first quarter 2013. There are also other accumulated arrears by the central government, largely due to unpaid construction works, and concerns over the potential unsustainability of the public pension system.

Monetary and Financial Sector

Monetary policy remained tight for the first quarter of 2013. The Central Bank of Tanzania has signaled its intentions of sustaining a tight monetary policy stance by maintaining the key policy rate at 12%. Growth of money supply slowed down to 13.5% compared to 15.7% in corresponding quarter in the previous year. Lending interest rates averaged 15.5%, while deposit rates averaged 3%. In line with these, money supply and interest rate developments, growth of private sector credit slowed to about 18%, compared to 24.3% recorded in the corresponding period in the previous year. Most of the private sector credit was channeled to manufacturing, building and construction, trade and personal activities.

Inflation is declining. Improved food supply, coupled with prudent monetary policy, have helped to ease inflationary pressures in the economy, with annual headline inflation falling consistently from a decade high of 19.8% recorded in December 2011 to 9.8% in March 2013. Core inflation, which excludes food and energy, has also declined from an annual average of 8.8% 2012 to 5.9% by end March 2013. Despite declining inflation rates, food prices remain relatively high in Tanzania, with implications for household welfare and the poorest segments of the population.

Tanzania enjoyed currency stability throughout 2012 and the first quarter of 2013, thanks to its overall prudent fiscal and monetary policy stance, and increased foreign capital inflows off-setting devaluation pressures. During the first quarter of 2013, the Tanzanian Shilling remained stable, averaging TZS 1,593.13 per USD, and oscillating between TZS 1,603.61 and 1,579.32 per USD. Despite higher domestic inflation rate than most neighboring countries, the Tanzanian Shilling is currently among the most stable currencies in the region.

- **The Bank of Tanzania maintained a tight monetary policy stance to ensure price stability**
- **The trade deficit decreased due to strong export performance**
- **External sector risks are associated with the capital account**

External Sector

Tanzania's trade deficit decreased, largely due to higher exports of minerals and agricultural cash-crops. Tanzania's export of goods and services reached USD 8.7 billion during the year ending March 2013, compared to USD 7.5 billion recorded during corresponding period in the previous year. The key drivers of this performance were gold exports, coffee, tobacco, and tourist travel receipts. Total imports reached USD 12.66 billion, representing a marginal increase over the USD 12.64 billion recorded during the same period in the previous year. Consequently, the current account narrowed significantly to a deficit of USD 3.7 billion, compared to a deficit of USD 4.6 billion in the corresponding period in 2012.

External risks are associated with Tanzania's capital account, which so far remains under control. At the end of first quarter, gross official reserves amounted to USD 3.8 billion, sufficient to cover about 3.8 months of projected import of goods and services. However, despite this conformable level of external reserves, during the first quarter of 2013, the country experienced pressures on the balance of payments, with an observed decline in net foreign assets. The external account remains vulnerable to shocks, notably international oil price developments. The situation is worsened by the continued financing problems in the energy sector, which relies heavily on the imported fuel, and whose debt may have exceeded 1.5% of GDP by end of the quarter under review.

OTHER NOTABLE DEVELOPMENTS AND UPDATES

Donor Relations

In January 2013, the IMF concluded the Fifth Review under the Policy Support Instrument (PSI), and First Review under the Standby Credit Facility (SCF) for Tanzania. The review highlighted Tanzania's continued strong economic performance and noted that fiscal consolidation measures have been successful in containing expenditure growth and maintaining the fiscal deficit within sustainable limits. The review singled out energy, and in particular, the financial difficulties facing the power utility, the Tanzania Electric Supply Company (TANESCO) as a key risk to the economic outlook. Shortly after the conclusion of the IMF review, Tanzania decided in February 2013 to draw the full amount of US$114.2 million under its SCF. The decision to withdraw funds was aimed to cushion the economy from emerging balance of payments pressures and prevent a further dwindling of foreign exchange reserves. Mitigating the escalating liquidity risks in the energy sector is also cited as another reason for utilizing the SCF.

- **The IMF continues to maintain a positive outlook for Tanzania despite energy sector risks**
- **The 'Big Results Now' initiative is underway to improve strategic planning**
- **Schooling exam mass failures and conflicts over the natural gas pipeline underscore development challenges**
- **President Xi Jinping's visit highlights growing commercial bond between China and Tanzania**

Strategic Planning

The Government formally launched the Big Results Now (BRN) initiative in February 2013. This is high-level strategic planning initiative is motivated by the desire for transformational change, with a particular focus on results. BRN is also an example of successful south-south cooperation, as the Performance Management and Delivery Unit from the Prime Minister's Department in Malaysia facilitated implementation of the BRN in Tanzania.

Political Risks

Protests erupted in February in the southern region of Mtwara over the decision to construct a 532 km long natural gas pipeline to Dar es Salaam. However, tensions were diffused temporarily, following high-level visits to the region. The pipeline, whose construction is projected to be completed by 2015, will produce an estimated 2,780MW and thus contribute to a reduction in the country's chronic energy problems. A USD 1.2 billion loan from China will finance the construction. These riots suggest that Tanzania may continue to experience tensions over natural resources which calls for better communication on benefits of natural resources across the country.

Education Sector

Tanzania's secondary education sector is in crisis. In the first quarter of 2013, the stunning 60% failure rate on the 2012 Form IV (lower secondary school) examinations shocked the nation. Preliminary investigations suggest that abrupt changes in the marking system may have led to candidates being awarded lower marks. Other proximate causes of this mass failure include lack of qualified teachers, poor and infrequently paid salaries, challenging work environment, and the shortage of schooling infrastructure, including teaching and training materials, as well as lack of laboratory facilities. Also, while over the past five years secondary schooling enrollment quadrupled, total public spending on secondary education grew only by 16%, which suggests that real expenditure per student declined. As a result, secondary schooling failure rates increased from about 10% in 2007 to 60% in 2012. A special commission has been established to investigate the massive failure rate and identify mitigating measures.

Chinese President Visit

Chinese President Xi Jinping visited Tanzania in March 2013 as part of his in his first foreign trip as head of state. Tanzania was the first country in Africa to be visited by the Chinese president, underlining a special historic relationship. It started in the 1960-70's during President Nyerere with the Chinese construction of the Tanzania-Zambia Railway Line. Economic relations have since then increased exponentially. China ranks among Tanzania's top foreign direct investors, with growing interests particularly in the extraction of natural resources.

Collaboration between Tanzania and China is expected to span a broad development agenda including energy and mining sectors, agriculture, industry, and infrastructure. It is estimated that currently more than 300 Chinese companies operate in Tanzania, with a total registered capital of over US$ 1 billion. The current trade volume is about US$ 1.5 billion. This Chinese presence is expected to grow further, especially following the conclusion of various bilateral agreements, including the USD 10 billion plan to develop the Bagamayo port and surrounding areas. More broadly, the symbolic visit signaled that Africa is firmly emerging as a strategic investment and trading partner for China.

UGANDA

MACROECONOMIC DEVELOPMENTS

Table 6 – Selected Macroeconomic Indicators*

	Q4 2012	Q1 2013
Real GDP growth (%)	0.8	-
Inflation rate (CPI, %))	4.9	4.1
Fiscal balance	(136)	(162.8)
Total expenditure	1,065	910.65
Capital	-	-
Total revenue	753.5	732.9
Tax revenue	695.2	674.6
Grants	204	61.5
External current account balance	(145)	(77)
Imports	458.5	437.6
Exports	266	291
Exchange rate (USD / UGX)	2,623.7	2,660.2
International reserves (in months of imports)	4.4	4.4
Total public debt (stock)	-	-
External	-	-
Domestic	-	-

*All figures in million US Dollars unless indicated otherwise
Source: National Authorities and author computations

Economic Growth

Uganda's economy is recovering from the slump suffered in 2012 when growth declined to 3.4% down from 6.7% in 2011. The most recent estimates indicate that real GDP expanded by 0.8% in Q4 of 2012 reflecting a much slower expansion in the economy compared to the growth rate of 3.3% attained in Q3 of 2012. Projections indicate that the economic recovery is expected to continue with real GDP growth projected at 5.25% in FY 2012/13 compared to the initial forecast of 4.3% and driven by strong growth in services, construction and manufacturing.
The service sector was the key driver of growth in Q4 2012, growing by 1.5% compared to 3.5% during the same period the previous year. Growth in services

HIGHLIGHTS

- **Real GDP increased at a reduced rate of 0.8% in Q4 2012 compared to the previous quarter due to sluggish growth in the industry and agriculture sectors** sector, which accounts for 45.1% of GDP, was driven by Transport and communication which increased at 5.7%, financial services (6.5%) and real estate activities (0.7%). Industrial Sector growth was moderate at 0.9%, but a marked rebound from the 12% contraction suffered during a similar period in 2011. The recovery in industry was driven by growth in construction (2.1%). However, declines were registered in mining & quarrying and manufacturing by 6.1% and 0.8% respectively. The agriculture sector, which accounts for 23.7% of GDP, recorded the weakest performance with a decline of 4.1% on account of a reduction in the value added for food crops which declined by 8.6%. Despite this, the value added in cash crops, fishing and forestry increased by 3.2%, 1.3% and 1.2% respectively.

Fiscal Stance and Public Debt

The government continued to pursue a tight fiscal stance in Q1, driven by lower than programmed revenue performance during the first three quarters of the fiscal year. A slowdown in economic activity and the continued suspension of aid disbursements by key development partners equivalent to 1.3% of GDP were main drivers of lower domestic revenues. Total expenditure for Q1 amounted to UGX 2,385.9 billion (USD 910.65 million), equivalent to 71% of the programmed expenditure levels. During Q1, Government organized a budget consultative workshop for FY 13/14 in March 2013 to discuss strategic priorities for 2013. The budget outlook discussed at these consultations is aligned with the National Development Plan (NDP). The budget envelope for FY 13/14 remains the same as in FY 12/13 and all Ministries, Departments, Agencies and Local Governments (MDALGs) were called upon to implement efficiency measures to improve the delivery of services. The focus on infrastructure and agriculture was appreciated by government and private sector representatives alike, especially the need for a well trained workforce, in particular through Business, Technical, and Vocational Education and Training.

The Government continued to focus on increasing domestic revenue mobilization and expenditure prioritization during the quarter. On a monthly basis, the net revenue collections for Q1 2013 reached UGX 1,767 billion (USD674.43 million) against a target of UGX 1,718.73 billion (USD 656 million). In spite of this strong domestic revenue performance during the quarter under review, cumulative revenue collections during the first three quarters of the fiscal year amounted to UGX 5,144 billion (USD 1,963 million) which represents a performance of 97.3% against the target.

Strong revenue performance was recorded in domestic taxes (117.11% performance against the target) while shortfalls were recorded in international trade taxes (90.22% of the target), and in fees and licenses (86.9% of the target). The shortfall in International Trade Taxes was mainly a result of the poor performance of the petroleum duty due to low fuel import volumes caused by repairs of the offloading Jetty in Mombasa. Moreover, the revenue shortfall was aggravated by a further 4.39% decline in the VAT on imports.

Going forward, URA has introduced additional revenue enhancing measures including quality audits for domestic taxes, rolling out the ASYCUDA tax management system to all customs business areas country wide, publications of non-compliant taxpayers, and leveraging the government's Integrated Finance Management System (IFMIS) and e-tax platform to enhance the audit yield.

- **Domestic revenue collections during the quarter under review exceeded the target but the cumulative revenue performance for the first three quarters of FY 2012/13 performed at 97% of the target**
- **FY 2013/14 budget outlook is aligned with the National Development Plan and seeks to consolidate gains in infrastructure, private sector and human development**

Other measures include strengthening collection of rental income tax in Kampala and eight (8) other municipalities, increasing the client base registration on the basis of the third party information (ASYCUDA, IFMIS, e-TAX) and tax clinics for the informal sector in Kampala.

Monetary and Financial Sector

The central bank continued to implement accommodative monetary policy in Q1 2013, maintaining the central bank rate (CBR) constant at 12% throughout Q1 2013, from a CBR average of 22% of Q1 in 2012. The accommodative monetary policy was aimed at sustaining the economic recovery by supporting judicious expansion in private sector credit on the back of easing inflationary pressures.

The annual headline inflation decreased from an average of 4.9% in Q4 2012 to 4.1% in Q1 2013. Annual headline inflation averaged 24.1% during Q1 2012. The decrease in inflation was driven by a decline in food crop prices following good harvests. However, core inflation slightly increased from an average of 4.1% in Q4 2012 to 5.9% in Q1 2013 suggesting a buildup of the core inflationary pressures driven by the high price levels for alcoholic beverages, clothing, and education charges. Private Sector Credit (PSC) growth, which fell significantly during FY 2011/12 and begun a steady recovery in Q4 of 2012, continued improving and attained 12.9% growth rate by end-February 2013 compared to the 4.4% recorded in October 2012. Further improvements in PSC growth are expected in 2013 on account of projections for a sustained economic recovery.

The exchange rate averaged UGX 2,659.4 against the US dollar during Q1 2013 compared to an average of UGX 2409.06 during Q1 of 2012. Whereas these developments represent a depreciation over the twelve-month period, the Uganda shilling appreciated slightly from January to March 2013 opening the year in January 2013 at UGX 2683.79 and closing March 2013 at UGX 2,636.89. the appreciation of the local unit during the quarter under review was mainly driven by reduced demand following the end of the festive season.

External Sector

The trade deficit reduced to UGX -381.67 billion (USD -145.4 million) during the quarter under review from UGX -509.05 billion (USD -194.3 million) in Q4 of 2012 due to the increase in export earnings. Export receipts amounted to UGX 764.81 billion (USD 291 million) at end-March 2013 compared to UGX 698.28 billion (USD 266.5 million) in Q4 in 2012. Export performance in Q1 2013 also exceeded the UGX 681.13 billion (USD 259.9m) recorded during the same period in 2012. The expansion in the export earnings during the quarter under review was driven by increased receipts from cotton, tobacco, hides and skin exports. COMESA countries accounted for 48.2% of Ugandan exports during the period under review. Imports decreased slightly from UGX 1,201.34 billion (USD 458.5 m) in Q4 to UGX 1,146.48 billion (USD 437.6m) between Q4 2012 and Q1 2013.

Provisional data depict improvements in the Balance of Payments (BOP) at end-February 2013 yielding a surplus of USD 162.1 million compared to USD 61.5 million during the same period in the previous year. Increase in direct investments is the principal driver of the higher BOP surplus. The stronger BOP surplus position contributed to the accumulation of international reserves to USD 3,046 million by end of March 2013, equivalent to 4.4 months of imports of goods and services.

- **The accommodative monetary policy pursued during the Q1 was aimed at maintaining inflation below the 5% medium term target and supporting the economic recovery**
- **The trade deficit reduced on the back of rising export receipts and declining imports**
- **Increased direct investments contributed to an increase in the Balance of Payments surplus, and an increase in international reserves**

OTHER NOTABLE DEVELOPMENTS AND UPDATES

Donor Relations

In January 2013 the IMF approved the 5th review under Uganda's Policy Support Instrument, reaffirming that the country's macroeconomic performance was "satisfactory". GDP real growth for FY 2012/13 is projected to reach only 4.25% up from the 3.4% in FY 2011/12 but lower than the initial projections of 5-6%, largely due to the aid suspension. The Government had met all end-June 2012 quantitative targets except on poverty spending and the stock of domestic arrears. Achievement of structural benchmarks was mixed, with progress on developing forecasting techniques and publishing related macroeconomic information and delays on other commitments, notably the issuance of national identification cards. The authorities requested the IMF to extend the PSI-supported program due to expire in May 2013 to August 2013, to provide time to complete the 6th review and discuss a successor PSI-supported program.

- **The IMF Board in January 2013 approved the 5th review under the Policy Support Instrument, confirming the country's satisfactory macroeconomic performance**

Political Developments

Investigations into corruption cases involving top government officials continued to dominate the political scene during Q1. The cases under investigations include that of officials in the Office of the Prime Minister (OPM) involved in the misappropriation of the USD 15 million meant for the northern Uganda recovery and reconstruction, the USD 24 million pension sector funds scam and the erroneous compensation of a leading businessman amounting to USD 54 million.

Private Sector Activity

The Private Sector Foundation in collaboration with the Ministry of Lands, Housing and urban development held a sensitization seminar to apprise the private sector stakeholders about the on-going installation and computerization of the Land Information System. The seminar was also used to sensitize the private sector on the new National Land Policy which was approved by Cabinet in February 2013. The Land policy will provide a framework for land administration in Uganda over the next 30 years.

AFRICAN DEVELOPMENT BANK GROUP

III | TOPICAL THEME

SMALL AND MEDIUM ENTERPRISE FINANCING THROUGH CAPITAL MARKETS – OPTIONS AND PROSPECTS FOR RWANDA[1]

1. Introduction

Rwanda's Vision 2020 identifies six priority pillars and three cross-cutting areas, the development of which is crucial for making the necessary long-term transformation. One of the pillars is the development of an efficient private sector spearheaded by competitiveness and entrepreneurship. The Rwanda 2011 Establishment Census reports that the country had over 123,000 business establishments in 2011 compared to an estimated 73,000 in 2008, representing a growth of nearly 70% over a three-year period. As Table 1 shows, of the 123,526 establishments, 96.5% were in the private sector, employing 91% of Rwanda's workforce, mostly in agriculture. Small and Medium Enterprises (SMEs) comprise 98% of all the establishments indicating that growth in the SME sector is of strategic importance in addressing unemployment in general and among the youth in particular.

Table 1: **Distribution of Establishments in Rwanda**

Total Establishments (number)	123,526
Establishments in the public sector (%)	3.5
Establishments in the private sector (%)	96.5
SMEs out of total establishments (%)	98
Micro-sized enterprises with 1- 3 workers (%)	92.6
Micro-sized enterprises with one worker (%)	72

Source: Ministry of Trade and Industry, 2011

Expansion in the SME sector also has the potential to reduce Rwanda's trade deficit, estimated at US$1,376 million in 2012, owing to the low export potential mainly driven by traditional crops (coffee and tea) and minerals. In addition, supporting SME development could be one approach to expanding the tax base to reduce fiscal deficits and donor dependence – external grants and loans contributed over 50% of the budget in FY 2011/12. Out of the 123,526 SMEs, only 25,000 (20%) were registered, of which 24% pay taxes regularly.

Several initiatives[2] have been implemented to promote SMEs and enhance their contribution to economic transformation. However, challenges to SME growth remain. In addition to the growth binding energy and transport constraints, most SMEs still depend on internally generated funds and borrowing from informal sources. About 22% of the SMEs employ working capital of less than RwF 500,000 (US$775). The Establishment Census 2011 reports that 89% of the enterprises are informal. This is compounded by the limited capacity of SMEs to develop bankable projects, particularly owing to limited human capital and skills[3]. In addition, financial institutions consider SMEs to be highly risky, with high transaction costs.

Studies[4] on SMEs rank lack of access to finance among the most critical constraints to the growth of SMEs and propose wide-ranging evidence in support of the use of capital markets to address this challenge. A primary one is raising funds for business growth and expansion. Some firms seek capital markets financing because it is cheaper than other forms of financing, particularly bank finance. Other benefits associated with capital markets

[1] This article draws on findings contained in a study conducted by the Rwanda Country Office on *'Leveraging Capital Markets for SME Financing in Rwanda'* which will be disseminated in Q3 2013.

[2] These include the adoption of the Financial Sector Development Program in 2008; launch of the SME Development Action Plan in 2011,; licensing of 416 Umurenge (village level) Savings and Credit Cooperatives (SACCOs) to extend credit including to SMEs; Rwanda Development Bank's lending programme for SMEs and Cooperatives; and establishment of a private venture fund – Business Partner's International – with an estimated US$8 million in loanable funds.

[3] A Capacity Needs Assessment of SMEs conducted by the Private Sector Federation in 2008 reports that many SMEs suffer from lack of technical and business skills, technical and industrial knowledge and finance accounting and management.

[4] For instance, Establishment Census—Analytical Report (2011) Ministry of Trade and Industry, National Institute of Statistics of Rwanda, Ministry of Public Service and Labor and Private Sector Federation; and the Global Competitiveness Report 2009/10.

financing include risk sharing and diversification to reduce exposure to risk for instance through a public offering and the increased publicity and public scrutiny which contribute to improved performance. It is also argued that capital markets facilitate mergers and acquisitions, thereby promoting efficiency, performance, and growth of firms.

This article presents a case for the need to explore options for using capital markets to finance SMEs. The article reviews and examines some of the evidence on what has worked in other countries in Africa and globally including in Asia, Brazil and Israel to provide lessons for Rwanda.

2. Main findings

Situation Analysis

Most micro and small enterprises employ up to four people and 93% of private sector establishments are SMEs with an average capital employed of Rwf 16.3 million (US$26,080). About 60% of the SMEs have a turnover of less than Rwf 50 million (US$ 80,000). A significant number of SMEs are engaged in wholesale and retail trade, accommodation and food processing services. The majority of the SMEs are not incorporated. According to the laws governing capital markets in Rwanda, incorporation is one of the basic requirements to list on the capital markets. About half the total establishments started operations in 2010 and are therefore relatively young. Most of the firms are family-owned or sole proprietorships (91%), which raises the issue of corporate governance, another key prerequisite for participating in capital markets. Table 2 summarizes some of the parameters used in defining SMEs in Rwanda.

Table 2: **Defining SMEs in Rwanda**

Size of enterprise	Net capital investments (millions of RwF)	Annual turnover (million RwF)	Number of Employees
Micro-enterprise	Less than 0.5	Less than 0.3	1 to 3
Small-enterprise	0.5 to 15	0.3 to 12	4 to 30
Medium-enterprise	15 to 75	12 to 50	31 to 100
Large enterprise	More than 75	More than 50	More than 100

Source: Ministry of Trade and Industry, 2010; US$ = RWF 645 as at 31st March 2013

Key requirements for accessing most formal sources of finance include preparing a business plan, monthly cash-flow projections, audited books of accounts, and a track record of the firm's banking transactions. Only 30% of the SMEs have a business plan and less than 30% prepare cash-flow projections. About 40% of SMEs use retained earnings to finance their operations; 30% use trade credit and 25% report using bank loans. Use of debt securities or equity financing among SMEs is limited.

Rwanda's Capital Markets Authority (CMA) was established in 2011 to spearhead the development of the capital market. The Rwanda Stock Exchange (RSE) Limited was incorporated in 2005 but launched in 2008 with the objective of carrying out stock market operations. Stock market operations are conducted in both the primary and secondary markets. The RSE listing rules and regulations provide a framework for facilitating trade in a fair and efficient securities market. The capital market is still nascent. Currently, the RSE has two domestic stocks - Bank of Kigali and Bralirwa Ltd; two cross-listings - Nation Media Group and Kenya Commercial Bank; five Treasury bonds and one corporate bond by the Commercial Bank of Rwanda. The listing requirements currently do not distinguish between SMEs and large firms. These comprise a minimum capital requirement of US$813,008; a well-formulated business plan; audited financial records; and a generally accepted corporate governance structure. Most SMEs do not meet these requirements.

Informality and the fact that most SMEs are not incorporated constrain access to finance particularly from the formal sources. The range of available financial products is also limited with most of the SMEs reporting heavy reliance on term loans. This is both an indication of limited diversification of financial products but also the fact that SMEs lack the necessary requirements to access other financial instruments. Given the low value of SME loans, the per-unit transaction costs of processing and tracking the performance of such loans are high. SMEs also tend to experience a more variable rate of return on their investments and higher rates of failure. These factors increase the risks associated with SME loans. Moreover, access to and affordability of business development services (BDS) remains low. This suggests that measures to increase access to finance should be coupled with interventions to expand access to business development services to ensure a holistic approach to SME growth and development.

The absence of a robust SME information collection and sharing system compounds the information asymmetry associated with the SME sub-sector and also contributes to the constrained access to financing. For equity and debt markets to be developed for SMEs, relevant and complete information about these enterprises has to be readily accessible.

Constraints Faced by SMEs in Accessing Financing and Banks in Lending to SMEs

Constraints faced by SMEs. To complement the 2011 Establishment Census, data was collected from a sample of 200 unlisted/unquoted private sector firms selected using stratified simple random sampling, using the register of enterprises used to conduct the 2011 Establishment Census. This complementary survey asked firms to rank the most pressing problems that hinder their business operations and growth and these are reported in Table 3.

Table 3: **Constraints Faced by SMEs**

	Constraints faced by SMEs	Proportion of respondents (%)
1	Difficulties in finding customers	56
2	Increasing cost of production (mainly due to rising wages)	43
3	High level of competition in the same line of business	42
4	Limited access to finance	38

Source: Author's computation from survey data

Constraints Faced by Financial Institutions. Banking financial institutions were also asked to document the key factors that constrain banks in their efforts to extend credit to SMEs. Seven of the 11 banking institutions contacted provided responses[5]. The Banks interviewed included those which have existed since 1967 and also the recently established ones. The key findings from this survey are summarized below.

i. All the banks interviewed indicated that they provide financing instruments tailored to SMEs, and indeed some have specialized SME departments. However, there are two major impediments to lending to SMEs. First, is the informality of SMEs, which means that the firms are not incorporated and therefore, cannot sue and cannot be sued. Thus, contractual obligations with such firms are difficult to enforce in case of default on loan repayments. Second, is the lack of bankable projects. All banks surveyed were of the view that the documentation required from SMEs to support loan applications did not comprise a major bottleneck to accessing bank financing;

ii. All seven banks surveyed indicated that term loans are the most widely used financing product by SMEs while only two banks indicated use of equity financing in spite of the availability of several financing options including overdraft facilities, asset financing and guarantees. For the SMEs to fully benefit from the available financing options, the banks would need to further simplify their requirements which include business plans, cash flow projections, incorporation/registration, and strict corporate governance requirements, among other things. Expanding access to quality and affordable business development services would provide an effective platform for addressing some of the SME-specific challenges that impede their access to financing;

[5] Rwanda has 10 commercial banks and 3 microfinance banking institutions.

iii. The average share of loans to SMEs in the total loan portfolio across the surveyed banks is 36%. The bulk of the financing requested by SMEs is working capital with a tenor of less than 2 years. Land, movable assets and buildings are the major forms of collateral. Microfinance institutions also accept group guarantee arrangements, certificates of deposit and household assets as collateral;

iv. The surveyed banks concurred that the government should play a leading role in making financing available to SMEs. The existing guarantee scheme under the Business Development Fund (BDF), formerly under the Rwanda Development Bank, while appropriate has only benefited a few SMEs. The limited ability of SMEs to raise the equity required by the banks is a major constraint and could be resolved via the creation of an equity fund for SMEs; and

v. In spite of the low default rates, SMEs are still considered risky borrowers with a short survival lifespan. The default rate on SME loan portfolios for most of the surveyed banks ranges between 2-7% with only one of the surveyed banks reporting a default rate of 35% on its SME loan portfolio. In addition, the low volume of SME loans increases the per unit transaction costs of processing and tracking the performance of such loans.

3. Lessons from the region and beyond: SME access to capital markets and related financial instruments

There are initiatives being undertaken within the region and beyond to enable SMEs to access financing from various sources including through the capital markets. These initiatives include private equity (PE) and venture capital (VC); fund of funds; and establishment of alternative investment market segments in the capital markets for SMEs.

Lessons from Private Equity/Venture Capital (PE/VC): The risks inherent in financing entrepreneurs without an established financial track record or collateral make them less preferred customers to the traditional commercial or investment banks. Venture capitalists provide equity-type financing designed to facilitate their participation in the investments with high growth potential with a view to supporting enterprise growth and also diversifying their own risk portfolios. Factors behind the success of equity and venture capital funds in Kenya, Tunisia and Brazil are summarized below.

Kenya	Tunisia	Brazil
Measures to support the establishment of equity funds should be coupled with broader measures to support enterprise development including the provision of business development services. This will ensure a steady supply of clientele for the equity fund managers.	While other financial institutions such as development banks could also contribute to the mobilization of risk capital, a framework to ensure complementarity of these banks with rather than substitution for venture capital funds is critical for the success of venture capital funds.	○ PE/VC initiative can be a private-public initiative. ○ PE/VC managers can act as catalysts for growth of companies before these companies list on the stock markets; ○ PE/VC provides more than finances. For instance, it may require a share in the company it is investing in, provide strategic advice and access to the PE/VC's valuable business network; ○ PE/VC exercises rigorous selection of firms to invest in, monitoring and governance that mitigate uncertainty and risks; ○ Through an agreement, PE/VC exits take place in the stock exchange, which promotes listing of SMEs on the stock markets; and ○ The success of PE/VC is also dependent on economic and institutional environment, including suitable legal and fiscal system and an efficient bureaucracy.

Lessons from Fund of Funds: A fund of funds (FoF), sometimes referred to as an 'umberalla' fund is an investment vehicle that invests in other investment funds as opposed to directly investing in stocks, bonds, or other securities. A FoF has several benefits including diversifying risk and reducing volatility while ensuring average returns to investors. FoFs have been implemented successfully in Israel, Korea and Ghana and the success factors are summarized below.

Israel Fund of Funds	Korea Fund of Funds	Ghana Venture Capital Fund
○ Government initiatives can act as triggers especially when coupled with a program design with in-built incentive structures in terms of options to buy out government shares over a given period of time; ○ Existence of an investor base and enterprises with growth potential is critical for successful PE/VC funding interventions; and ○ A dynamic capital market provides several complementary benefits to PE/VC financing mechanisms including an exit option via Initial Public Offerings (IPOs).	○ Government support ensures that a stable stream of PE/VC funding including during economic downturns and recessions; ○ An institutional framework that enshrines the fund manager's role in evaluating, selecting, and allocating capital to the most profitable uses assures professional independence and efficiency of the fund; and ○ The public (government funding)-private (management from a professional and independent fund manager) sector collaboration ensures sustainability and profitability of the fund which enhances its contribution to enterprise development.	○ Government initiative and partnership with the private sector is instrumental in particular by mitigating risks associated with financing SMEs; ○ Coupling PE/VC financing with technical assistance to develop the core business competencies ensures enterprise growth and thus secures the PE/VC investment; ○ Structured decision-making ensures that investment choices and decisions accommodate the interests of all stakeholders. For instance, fund managers are responsible for deal sourcing, selection, monitoring and exit of fund investments but final investment decisions are made by the Investment Committees comprising representatives of the fund's investors and independent professionals appointed by the fund's Board of Directors.

Lessons from Alternative Investment Market Segments: Simplified or less stringent listing requirements in Uganda, Tanzania and Kenya are yet to result in the listing of SMEs. For Kenya and Tanzania, it can be argued that it is still too early to infer the impact of simplified requirements for SME listings since implementation is yet to commence for Tanzania, and the initiative was only launched in January 2013 in Kenya. However, for Uganda, this suggests that simplifying the listing requirements is not a panacea. A holistic approach to addressing the constraints facing SMEs needs to be designed as is the case in South Africa, where relaxation of the listing requirements has been augmented by other business support services to the SMEs. For example, in addition to simplifying the listing requirements, programmes to support the development of core business competencies and awareness campaigns to demonstrate the benefits of capital markets to SMEs are also necessary. Complementing capital markets with alternative financing options such as venture capital and/or asset-backed securities should also be considered.

Lessons from Asset-Backed Securities: Asset securitization comprises the issuance of a debt instrument secured by a revenue-producing asset (mortgage loans, auto loans, credit card receivables and other assets) of the issuing company. The debt instrument is generally either rated by credit rating agencies or guaranteed by an independent guarantor. Lessons from the use of these securities are summarized below.

South Africa	South Korea	Spain	European Investment Fund
○ Presence of legal and accounting systems to support off-balance sheet transactions is necessary to mitigate the risk associated	○ Government initiative to establish a mortgage securitization body (Korea Mortgage Company) to issue mortgage-backed	Securitization legislation explicitly permitting the creation of special purpose investment companies and the establishment of a	○ Credit guarantees/ enhancements have a positive impact on securitization including for the SMEs, by facilitating asset-backed

with asset-backed securities; ○ Moreover, legal framework for securitization, in particular providing for the establishment of special-purpose vehicles as limited liability companies to manage securitization transactions, can catalyze the market.	securities collateralized by mortgage loans acquired from the country's National Housing Fund was key in fostering the securitization market; ○ Ratification of Asset Backed Securitization legislation has dual benefits. First, it provides a legal framework for guiding securitizations and, second, it recognizes the activities of special-purpose vehicles as limited liability companies to manage the securitized assets.	government-supported guarantee programme for SME securitizations was key in developing the securitization market in general and SME securitizations in particular.	security rating upgrades, mitigation of associated market risks, which consequently increases these asset's market value and uptake by investors. ○ The Business Development Fund in Rwanda which currently provides credit guarantees for commercial bank loans could consider, with the ratification of supporting legislation, providing credit enhancement for SME securitization.

4. Conclusion and Recommendations

SMEs play a significant role in economic development, including in Rwanda. However, in spite of several initiatives undertaken by the Government of Rwanda to address constraints facing SMEs, some bottlenecks persist. This article makes a case for the need to explore options for using capital markets to finance SMEs due to various benefits including the possibility of access to more affordable funds for business growth and expansion, risk sharing and diversification via a public offering; and increased publicity and scrutiny of SMEs' operations which comes with equity investments. Drawing on regional and international experiences, this article identifies several key recommendations with the potential to catalyze SME financing through capital markets and other sources. These recommendations include:

Enact Supporting Regulatory and Legal Reforms: While the regulatory and legal framework for the development of financial markets, including capital markets, is in place, the authorities should consider revising the listing requirements targeting the SME sector. The existing ones do not position SMEs to benefit from the equity and debt markets because these establishments are predominantly micro and small-scale enterprises, mainly sole proprietorships and family-owned. However, the authorities should not stop at relaxing the listing requirements. As the case of the AltX in South Africa has demonstrated, the Government of Rwanda will need to partner with the RSE, SME representatives and development partners to address the other SME-specific challenges such as financial management and reporting, issues of incorporation, and corporate governance.

Improve Information Collection and Sharing: The government, CMA, financial institutions and SMEs should consider developing an information gathering and sharing system on key indicators such as performance, profitability, market niche, among others. The proposed system could be modeled around the credit reference bureau although the scope of information collected, managed and shared will extend beyond credit. Supporting legislation will be necessary for the operationalization of such an information sharing system. The information required from a company should at least cover the key financial indicators captured when companies are trading on stock exchanges. A similar database has been developed by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN).

Encourage and Promote the Establishment of Private Equity and Venture Capital (PE/VC): Rwanda can benefit from existing venture capital funds within the East African region which particularly target SMEs. Rwanda's SMEs can initially benefit from these regional funds if information is availed to them regarding the requirements for accessing these funds. In addition, efforts should be made to market some of Rwanda's SMEs to the fund managers in the region. Developing a prospectus containing information on productivity, financial, and growth potential of these SMEs would be useful in this regard.

Establish a Rwanda Fund of Funds (RFF): The Government could consider initiating the establishment of a Fund of Funds by contributing seed capital and inviting potential partners to contribute to the fund. By setting up the Rwanda Fund of Funds, the Government will not only promote access to financing by SMEs but also ensure that the venture capital market has access to a steady supply of funding even during economic slowdowns.

Setting-up Asset-Backed Securities: Asset-backed securities should also be explored by the Capital Markets Authority for the benefit of SMEs. However, this would require various enablers including supporting legislation, credit enhancement, and a more vibrant securities exchange market, among other things. Moreover, appropriate mitigating measures would be necessary to alleviate the risks associated with asset-backed securities.

Review the Current Approach to Providing Business Development Services: While the privatization of the provision of Business Development Services (BDSs) is aimed at ensuring their sustainability, measures should be taken to ensure their wider access and affordability to the private sector including SMEs. For instance, measures to develop the capacity of the private providers of these BDSs and support to mobilize funding including from development partners should be fast-tracked. Cost-sharing between the Government and SMEs could also be considered in the short term.

IV | STATISTICAL ANNEX

A- SELECTED LONGER TERM STATISTICS

Table 1 - Basic Indicators, 2012

	Population (thousands)	Land area (thousands of km²)	Population Density (pop / km²)	GDP current prices (US $ Million)	GDP per Capita (current prices, $)	Annual real GDP growth (average over 2001-2012)
Burundi	8,775	28	313	2,530	288	3.8
Kenya	42,104	593	71	41,837	994	4.3
Rwanda	10, 537	26	416	6,950	667	7.9
Seychelles	92	0.455	202	971	10,571	2.6
Tanzania	49,929	945	53	27,978	650	6.9
Uganda	35,648	241	148	20,464	574	7.0
Africa	1,068,400	30,323	35	2,000,198	1,872	5.1

Note: * Fiscal year July (n-1)/June (n)

Sources: **ADB Statistics Department,** Various domestic authorities; IMF *World Economic Outlook 2012.*

Table 2 - Real GDP Growth Rates, 2001-2012

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011 (e)	2012 (p)
Burundi	2.1	4.5	-1.2	4.8	0.9	5.2	3.2	4.3	3.3	3.6	4	4.2
Kenya	4.5	0.5	2.9	5.1	5.9	6.3	7.1	1.7	2.5	3.6	4.2	5.1
Rwanda	6.7	9.4	0.3	5.3	7.1	5.5	8.8	11.2	4.5	5.1	5.3	7.7
Seychelles	-2.3	1.2	-5.9	-2.9	7.5	8.3	9.7	-0.9	-6.8	3.9	4.2	3.0
Tanzania	6	7.2	6.9	7.6	7.4	6.9	6.8	7.5	5.5	5.7	5.8	6.5
Uganda	8.8	7.1	6.2	5.8	10	7	8.1	9.2	7	7.4	7.9	4.2
East Africa	4.3	5	1.5	4.3	6.5	6.5	7.3	5.5	2.7	4.9	5.2	5.1
Africa	4.3	5.7	5.2	5.6	5.9	6.2	6.4	5.6	2.5	4.5	5.2	4.5

Note: * Fiscal year July (n-1)/June (n)

Sources: **ADB Statistics Department,** Various domestic authorities; IMF *World Economic Outlook 2012.*

Table 3 – Demand Composition and Growth Rates, 2010-2012

	2010				2011				2012 (e)			
	Total Final Consump-tion	Gross Capital Formation - Total	Exports	Imports	Total Final Consump-tion	Gross Capital Formation - Total	Exports	Imports	Total Final Consump-tion	Gross Capital Formation - Total	Exports	Imports
	Percentage changes, volume				Percentage changes, volume				Percentage changes, volume			
Burundi	3.8	9.6	-0.2	5.4	2.7	13.8	7.8	4.5	6.1	-2	3.2	4.3
Kenya	2	3.4	3.9	1	2.7	3.9	4.8	2	5.1	4.9	4.8	6.7
Rwanda	5.4	4.8	3.4	5.4	6.1	4	3.1	7.1	9.6	5.4	1.4	8.8
Seychelles	-0.9	4.3	2.8	-3.2	0.9	9.4	5.2	2.1	2	10.1	3.7	5.1
Tanzania	7.5	6.2	3.6	9.7	6.7	9.2	3.9	9.8	4.6	9.2	13.3	8.6
Uganda	10.1	17	0.7	16.9	9.7	18	1.6	15.8	6.5	13.6	-0.6	11.9

Note: * Fiscal year July (n-1)/June (n)

Sources: **ADB Statistics Department,** Various domestic authorities and IMF *World Economic Outlook 2012.*

Table 4 – Public Finances and Fiscal Indicators, 2008-2012 (percentage of GDP)

	2010			2011			2012 (e)		
	Total revenue and grants	Total expenditure and net lending	Overall balance	Total revenue and grants	Total expenditure and net lending	Overall balance	Total revenue and grants	Total expenditure and net lending	Overall balance
Burundi	27.6	32.8	-5.1	27.1	34.9	-7.7	26.3	34.2	-8
Kenya	23.6	29.7	-6.1	23.8	30.6	-6.8	26.1	34.1	-8
Rwanda	22.5	24.2	-1.7	23.1	24.3	-1.2	25.1	26.9	-1.9
Seychelles	33.3	30.2	3.1	33.4	31.6	1.8	41.9	39.3	2.6
Tanzania	21.5	25.3	-3.8	22	27.8	-5.8	48.8	57.8	-9.1
Uganda	14.5	15.8	-1.3	14.1	15.8	-1.7	15.6	18.6	-3
Eastern Africa	23.84	26.32	-2.48	23.92	27.47	-3.55	18.19	23.16	-5
Africa	29.6	33	-3.3	29.7	31.6	-1.9	27.61	30.51	-2.9

Notes: * Fiscal year July (n-1)/June (n)

Sources: ADB Statistics Department, Various domestic authorities, OECD/DAC, OECD Development Centre calculations and IMF *World Economic Outlook.*

Table 5 – Selected Monetary Indicators

	Inflation (percent)				Exchange Rate (LCU / $)			Reserves, excluding gold, ($ million) 2011	
	2009	2010	2011	2012 (e)	2010	2011	2012	Stock at year-end	Eq. Months of imports
Burundi	8.27	8.32	6.98	17.3	1,230.7	1,261.1	1,409.6	293.98	4.48
Kenya	9.29	7.35	6.36	8.6	79.2	88.9	84.5	4,264.38	3.08
Rwanda	10.31	6.35	5.67	6.1	583.3	600.1	614.0	1,050.04	5.74
Seychelles	31.73	2.99	3.14	7.5	12.1	12.4	13.7	252.31	2.26
Tanzania	12.1	8.53	6.2	15.6	1,441.9	1,586.2	1,586.9	3,726.16	3.57
Uganda	11.14	8.9	9.86	13.0	2,179.3	2,524.9	2,503.2	2,617.42	3.98
Africa*	9.9	7.73	7.04	8.4	...	...	...	173,177.77	5.31

Sources: ADB Statistics Department, Various domestic authorities; IMF *World Economic Outlook* & *International Financial Statistics* and authors' estimates and forecasts. *data on reserves is for sub-Saharan Africa

Table 6 - Balance of Payments Indicators, 2008-2012

	Trade balance ($ million)				Current account balance ($ million)				Current account balance (as % of GDP)			
	2009	2010	2011	2012 (e)	2009	2010	2011	2012 (e)	2009	2010	2011	2012 (e)
Burundi	-211.1	-262.9	-277.4	-414.9	-155.6	-179.6	-194.7	-289	-12.87	-13.44	-12.48	-16.2
Kenya	-5,979.2	-7,106.3	-7,715.7	-9,711.1	-2,551.7	-3,463.9	-2,591.7	-3,540	-6.68	-8.97	-6.62	-7.7
Rwanda	-456.1	-521.5	-578.1	-1127.2	-295.1	-293.6	-274.4	-681	-6.66	-6.18	-5.32	-10.5
Seychelles	-249.1	-249.6	-258.4	-464.8	-169.2	-236.9	-227.6	-193	-28.44	-37.03	-32.43	-25.8
Tanzania	-2,899.1	-3,739.9	-4,475.1	-2,328.7	-2,084.5	-3,100.7	-3,873.5	-4,314	-10.15	-13.57	-15.52	-9.1
Uganda	-1,311.8	-2,127.1	-2,940.3	-2,636	-1,011.8	-1,836.6	-2,696.1	-2,255	-5.93	-8.79	-10.92	-11.6
Africa	-1,332.5	18,407.7	23,335.7	81,730	-35,507.3	3,519.8	13,104.5	-7,136.7	-2.45	0.22	0.74	-0.36

Note: * Fiscal year July (n-1)/June (n)

Sources: ADB Statistics Department ; IMF WEO October 2012

Table 7 - External Debt Indicators

	Debt outstanding, at year end				Total debt outstanding (as % of GDP)				Debt Service (as % of Exports of goods and services)			
		of Which :										
	Total (USD m)	Multilateral (as % of total)	Bilateral	Private								
Country	2010	2010	2010	2010	2009	2010	2011	2012 (e)	2009	2010	2011	2012 (e)
Burundi	455	64.01	35.99	0	24.8	28.3	31.2	28.78	1.9	2.9	3.6	9.45
Kenya	8,756	48.93	49.78	1.29	24.2	24.7	23.3	31.58	5.5	6.3	6	4.55
Rwanda	776	80.45	19.55	0	16.7	19.1	20.6	15.14	3	2.8	3.5	7.09
Seychelles	478	4.89	90.26	4.85	118.8	92.1	59.1	44.41	12.8	9.6	28.1	2.44
Tanzania	8,149	50.58	29.46	19.96	31.6	30.3	29.3	38.46	2.2	1.5	1.9	2.01
Uganda	3,678	80.70	19.3	0	15.5	17	17.7	22.43	2.1	3.1	3.2	3.07
Africa	376,065	24.75	50.58	24.67	23.6	22.7	22.5	22.43	14.1	12.6	12.4	9.45

Sources: ADB Statistics Department; IMF, World Economic Outlook Database, October 2012; GDF Online Database, World Bank

B- SELECTED SEASONAL STATISTICS

Table 8 - Comparative Prices: Major Food Crops (January—March 2013) -(USD per metric Ton)

		Maize	Rice	Beans	Wheat	Sorghum	Millet
Burundi	January	607	839	840	641	517	-
	February	594	1,051	952	622	576	578
	March	505	1,047	1.020	619	616	-
Kenya	January	347	1,204	700	413	414	707
	February	351	1,215	721	427	432	706
	March	365	1,222	764	450	435	724
Rwanda	January	436	1,205	503	705	569	1,004
	February	466	1,084	531	709	453	991
	March	441	1,055	528	655	440	1,000
Tanzania	January	545	1,169	949	-	649	680
	February	557	1,151	947	-	651	779
	March	480	1,074	784	-	618	627
Uganda	January	279	1,161	608	-	350	527
	February	286	1,159	599	-	315	525
	March	320	1,194	628	286	314	527

Sources: Regional Agriculture Intelligence Network, except for Burundi whose data is from Burundi Institute of Statistics (ISTEEBU).

Table 9: Regional Annual Headline Inflation Developments (%, January—March 2013)

	January 2013	February 2013	March 2013
Burundi	7.6	9.4	5.9
Kenya	3.7	4.5	4.1
Rwanda	5.7	4.8	3.3
Seychelles	5.9	6.2	6.5
Tanzania	10.9	10.4	9.8
Uganda	4.9	3.5	4.0

Sources: National Statistics Bureaus (various countries)

About the African Development Bank Group

The African Development Bank Group – which comprises the African Development (ADB), the African Development Fund (ADF) and the Nigeria Trust Fund (NTF) – aims is to promote the economic development and social progress of its regional member countries. It contributes to improving the living conditions of the populations, as well as creating, expanding and rehabilitating productive and social investments. It finances development and structural adjustment projects and programs, provides advisory services and stimulates investments from other sources of finance. Although the ADF and NTF are legally and financially distinct from the ADB, they share the same staff, and their projects are subject to the same standards.