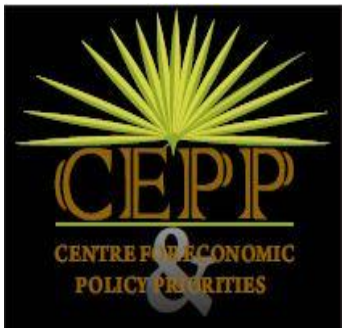


CENTRE FOR ECONOMIC & POLICY PRIORITIES (CEPP)

AN ASSESSMENT STUDY AND PROFILING OF DEBT BURDEN FOR RWANDA

Kigali, April 2021

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LIST OF ACRONYMS

COVID:	Coronavirus disease
DSA:	Debt Sustainability Analysis
EAC:	East African Community
GDP:	Gross Domestic Product
HIPC:	Highly Indebted Poor Countries
IDA:	International Development Agency
IFAD:	International Fund for Agricultural Development
IMF:	International Monetary Fund
MINECOFIN:	Ministry of Finance and Economic Planning
NPV:	Net Present Value
NST1:	National Strategy for Transformation
PFM:	Manual of Public Financial Management
PPP:	Public Private Partnership
SDR:	Special Drawing Rights
TFP:	Total Factor Productivity

Currencies

US$	United States dollar
EUR	Euro
CNY	Chinese Yuan Renminbi
RWF	Rwandan franc

EXECUTIVE SUMMARY

Rwanda's public and publicly guaranteed debt stock has been on the rise reaching 58.5 percent of GDP as of end December 2019, mainly as a result of high fiscal deficits, the real exchange rate depreciation and government guarantees. The majority of Rwanda's debt is external (79 percent), and essentially concessional (81.4 percent) and multilateral (73 percent of external debt) while domestic debt consists of 90 percent (as of June 2020) debt securities. Since 2017, the Government of Rwanda has been using quarterly treasury bond issuance as a way to develop the domestic capital market, and this has resulted in upward trend in domestic debt — an increase of 128 percent from December 2017 to June 2020. The bulk of Rwanda's debt has been spent on developing infrastructures where half of the total outstanding public debt is in energy, construction, transport, and communication sectors.

The government prioritizes concessional loans while limiting commercial borrowing and this trend is likely to continue. Based on the country's medium term debt strategy for 2021-2023, concessional borrowing is expected to reach 92 percent of total external borrowing in 2023. Moreover, Rwanda has turned to Asia, especially China and India for bilateral loans, however bilateral loans remain at 10 percent of total external loans as of June 2020. Prior to the COVID-19 pandemic, public debt had been growing but at sustainable levels—and continues to satisfy the EAC convergence criteria— and the risks of external and overall public debt distress had remained low. Until end 2019, the Rwandan economy had been growing steadily above seven percent and was expected to grow at 8 percent in 2020. Owing to COVID-19 pandemic, however, the Rwandan economy has contracted (-3.4 percent in 2020) due to measures put in place to contain the spread of this pandemic both within Rwanda and globally. Resultantly, the slowdown in revenue streams and need for additional financing to deal with the pandemic and its economic consequences, Rwanda's risk of debt distress has increased from low to moderate.

The economic recovery is projected to take place in 2021, but considering uncertainties surrounding this pandemic regionally and globally there are still considerable downsizing economic risks. This pandemic has undermined the capacity to absorb shocks to growth, exports, and external financing. Moreover, due to higher primary deficits and greater than expected exchange rate depreciation, debt service is expected to go up beyond sustainable level in 2023

when the Eurobond (US$400 million) issued in 2013 matures. Within the East African Community (EAC), Rwanda is moderately debt stressed; Burundi, Kenya and South Sudan have high risks of external and overall public debt distress while Uganda and Tanzania perform better, and these risks remain low.

Moving forward, Rwanda's debt portfolio still face considerable risks, mainly the negative effects of COVID-19 pandemic, higher real exchange rate depreciation and high interest rates on domestic markets. The main strength of the Rwanda's debt portfolio, however, is that 80 percent of external debt consists concessional loans. Rwandan authorities should continue to prioritize multilateral concessional long-term loans to ease pressure on its debt repayment profile, especially coming 2023 when the Eurobond matures. Moreover, given liquidity constraints on local currency market, they should adjust domestic borrowing not only because of high interest rates but also to avoid the risk of crowding out the private sector which has been hit by lockdowns and global disruption of supply chains and is trying to recover.

1. BACKGROUND

1.1. Context and Justification

Rwanda has achieved formidable economic performance in recent decades. Despite its landlocked position and post-conflicts status, Rwanda's per capita income has more than doubled from $350 in 1990 to $820 in 2019[1]. Since the early 2000s, Rwanda's growth rate in Gross Domestic Product (GDP) per capita has averaged 5 percent per year, which is second highest in the region. GDP has increased by 7 percent on average every year since 2010, while the government's growth objectives are 9.1 percent on average over 2017-2020 to reach Vision 2020 goals, 12 percent on average over 2025-2035 to reach upper-middle-income status by 2035 and more than 9 percent on average over 2036-2050 to reach high-income status by 2050. Nevertheless, even maintaining recent growth rates would not be sufficient to meet the government's ambitious set development objectives, while COVID-19 pandemic has sharply interrupted economic progress of Rwanda. Real GDP is estimated to have fallen by approximately 0.2 percent in 2020, compared to a forecast of 8 percent growth before the pandemic hit the country.

The Rwandan economy is expected to contract as a result of COVID-19 and will likely recover to the pre-pandemic trajectory by 2023. Furthermore, the successful health response to the COVID-19 crisis has come with a cost —lockdowns, social distancing, and increased costs associated with the pandemic have severely depressed economic activity. The share of the population below the international poverty (USD 1.9 per day in 2011 PPP prices) line fell from 77 percent in 2001 to 55.5 percent in 2017[2]. Poverty declined from 77% in 2001 to 55% in 2017. In the period 2014-2017, poverty reduction has remained less responsive to strong growth, reflecting the weakening job-creating potential of growth driven by capital-intensive sectors and a resulting slowdown in rural to urban and farm to non-farm transition of the workforce. Rwanda also made excellent progress in improving the welfare of its population through community health insurance schemes, which have improved the life expectancy at birth and reduced

[1] World Bank national accounts data. Accessed at https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=RW

[2] World Bank and Government of Rwanda. 2020. Future Drivers of Growth in Rwanda: Innovation, Integration, Agglomeration, and Competition. Washington, DC: World Bank.

maternal mortality. Further, access to prenatal care is virtually universal, and skilled health staff attend to over 90 percent of the births. Rwanda's education system has made significant progress in expanding coverage and achieving a high level of primary and secondary school enrollment. In the infrastructure sector, access to electricity, water and sanitation have also improved over the last years.

The pandemic also has jeopardized the progress made in reducing poverty and inequality in recent years. The crisis is dramatically increasing poverty in both rural and urban areas. The share of the population living below the international poverty line is 2.2 percentage points higher in 2020 and 5.1 percentage points higher in 2021, compared to a scenario prior to the occurrence of COVID-19 pandemic[3]. The performance and improvement in various sectors are partly attached to the increase in local and foreign borrowing which have increased the debt burden. Given the increase in debt for Rwanda, which has placed the country in moderate risk, it remains pertinent to discuss the level of debt and to which sectors the increased debt has been oriented to, so as to improve the welfare of citizens. Therefore, a trigger to the assessment and budget profiling for Rwanda.

1.2. Rationale for Assessing the Debt Burden

Rwanda's public debt has been rising steadily since 2013 that has largely reflected a public sector led growth model. In 2019, public debt of Rwanda amounted to 4.72 billion US dollars (including public sector guarantees), translating to 58.5 percent of GDP and an estimated to reach 68 percent in 2020[4] with external Debt in Rwanda is expected to reach 3,239 million US dollars by the end of 2020. Primary deficits due to higher public investment have been fuelling debt, as have real exchange rate depreciation and government guarantees. Rwanda's pre-COVID-19 fiscal imbalance has been exacerbated by the pandemic, posing an increasing threat to medium- and long-term fiscal sustainability. With slow growth in Total Factor Productivity (TFP), Rwanda's growth model has relied heavily on large public investments (12.3 percent of

[3] World Bank and Government of Rwanda. 2020. Future Drivers of Growth in Rwanda: Innovation, Integration, Agglomeration, and Competition. Washington, DC: World Bank

[4] Ministry of Finance and Economic planning 2020-). Rwanda Medium Term Debt Strategy, Fiscal Year 2020/21- 2022/23.

GDP in 2019) [5], many of which were executed at the district-level rather than by the central government. Massive public investment has been financed by increased borrowing, including on commercial terms, as volumes of external assistance and public savings have declined relative to public investments.

The government has been running much larger deficits and guarantees issued to attract investments in priority sectors were as high as 5 percent of GDP in 2018. The country is now at "moderate" risk of external and overall debt distress, due to both pre-COVID fiscal policies and the reduction in Rwanda's growth and export prospects coupled with larger financing/borrowing needs due to the pandemic[6]. Rwanda has implemented a significant number of investment climate reforms and climbed to the 29th place out of 46 sub-Saharan countries in 2019[7] in the Doing Business rankings, but private sector investment has remained comparatively sluggish.
Rwanda's economic growth outlook has slowed down and significantly deteriorated as a result of a global COVID-19 pandemic. Rwanda's economic outlook is likely to deteriorate with long-lasting implications for growth and poverty reduction because of narrowed fiscal space that constrains Rwanda's state-led growth model, even when the pandemic is anticipated to be transitory and short -term. Thus, GDP is expected to contract in 2021 and 2022 which will likely be the lowest growth in the last two decades. The fiscal deficit is expected to widen in 2021, and gradually decline over the medium term, which will affect the balance of payments, affecting foreign exchange reserves. Such may ultimately increase internal and external borrowing, thence broaden the debt burden for the country over the medium-term.

1.3. Approach and Methodology

This section describes the methodology process for gathering all data and generating relevant information needed to assess the fiscal and debt burden for Rwanda from a historical perspective to present. Then how the debt situation (worsened by COVID-19) affects cost and risk to the country's domestic revenues (in view of debt repayment), Social Sectors (taking a gender perspective in two sample sectors of Health and Education) and debt sustainability outlook in

[5] The seven-year Government Plan requires more than 40 percent of the government budget to be devoted to capital spending and net lending- (National Strategy for Transformation 1).
[6] 2020 Debt Sustainability Analysis, World Bank
[7] 17th edition of the World Bank Doing Business Report

view of debt sustainability/ DSA indicators, economic growth, equitable development, and macro-economic outlook for Rwanda.

1.3.1 Approach

The assessment of debt burden has been carried out in a transparent, consultative, and participatory manner. A balanced and fair approach with the necessary flexibility to adjust to the Rwandan policy and documentation' context and usability capacities was adopted. The assessment consistently upheld high ethical standards in analyzing the data bias and establishing validity of inputs from the external financing unit of the Ministry of Finance and Economic planning and other relevant stakeholders in debt management. Hence, the assessment was carried out based on the following approaches:

- A use of relevant data collection tool: In assessing the debt burden, interview guides were developed to acquire additional information to support the desk review. The tool interview guide was well designed to ensure its objectivity and transparency.
- A consultative process: the assessment involved consulting as many participants and stakeholders as possible in order to obtain a clear view on the ideas and thus provide recommendations in line with the real needs on debt burden.
- For the analysis and review of documents: A Document Review Framework (DRF) was developed. The DRF helped to properly synthesize the documents, generate themes, and provide accurate reference for the excerpt of text on the Rwandan debt reviewed documents.

The approaches used in the assessment and profiling of Rwandan debt burden are based on the principles below in Table 1.

Table 1: Assignment guiding principles.

Principle 1:	Impartiality and independence (the credibility of the assessment, analysis of information and conclusions).
Principle 2:	Credibility (the best expertise and independent assessment, as well as the highest level of transparency of the whole assignment process).
Principle 3:	Utility (assignment of assessing is presented in a clear and concise manner and reflect the different interests and needs of the parties involved).
Principle 4:	Full participation by stakeholders and debt recipients (all sides are involved in the assessment process and reflect the attitude of all relevant interested parties).

1.3.2 Methodology

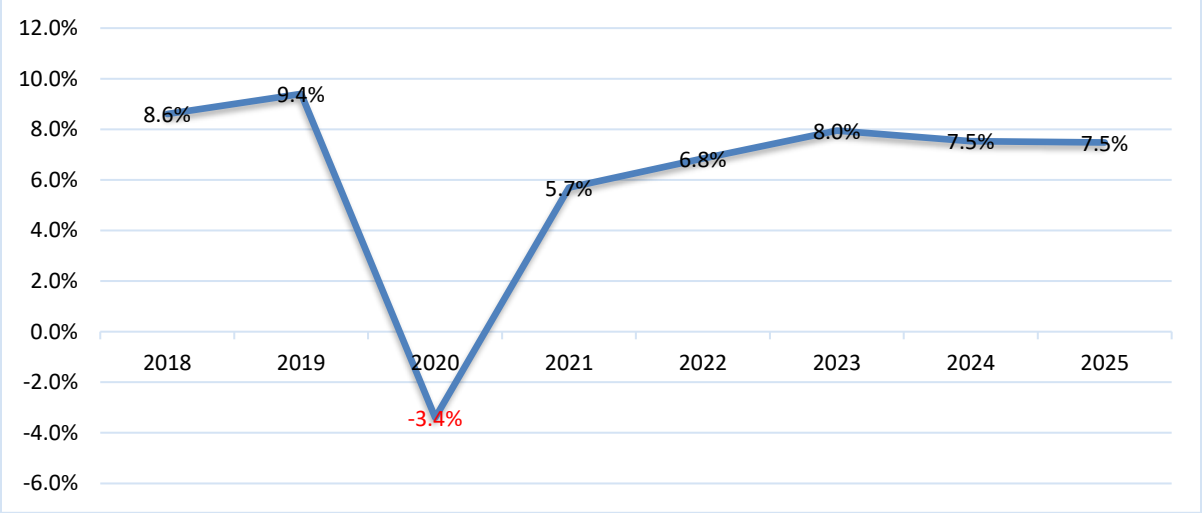
The methodology for this particular assessment consisted of consultative, and participatory approach. Qualitative approaches were used to collect primary and secondary information to undertake an estimation of the required new inputs into the analytical report. The methodological approaches employed desk review for secondary data, and Key Informants Interviews (KIIs) for primary data collection. In addition to Key Informants Interviews (KIIs), major stakeholders including development partners were consulted to provide narrative ideas regarding the debt burden for Rwanda and the envisaged approach that could be used to mitigate further debt accumulation. Beyond stakeholders, few civil society organizations and individuals in the academia were consulted to provide their view on debt burden for Rwanda.

The large part of the assessment was carried out under a desk review method. This method consisted of conducting an extensive literature review on the emerging documents about Rwandan debt and its impacts on growth and development. The desk review method facilitated to comprehend the context of the assessment and indicators to be assessed, and to develop data base on debt that would respond to the assessment objectives and specific tasks. The desk review provided the preliminary findings from the assessments of the Rwandan debt and its implications. This was based on the comparison of the other related debt reports in the region. The analysis based on data sets obtained from the Ministry of Finance and Economic planning, the National Bank of Rwanda, the National Institute of Statistics for Rwanda and for some indicators, data was obtained from the World Bank and International Monetary Fund. Data from the various sources was analysed together to ascertain that the final report responded to the assessment objectives.

1.4 Current Macroeconomic Context and Outlook

The macroeconomic framework shows that Rwanda was experiencing an economic boom before COVID-19 pandemic. As Figure 1 shows, Rwanda's GDP growth reached 9.4 percent in 2019, accelerating from 8.6 percent in 2018.

Figure 1: Real GDP growth and annual percentage change for Rwanda, 2018- 2025.



Source: Ministry of Finance and Economic Planning, 2021[8]

Growth acceleration was largely driven by large public investments for implementation of National Strategy for Transformation (NST1). The growth momentum for Rwanda has, however, been interrupted by the pandemic as the authorities put in place a nationwide lockdown to contain the spread of coronavirus while international flow of goods and services was disrupted with significant spill-overs to Rwanda' economy. Inflation increased rapidly from September 2019 as headline inflation of 1.2 percent was below the target band of 2.4 percent, for almost a year until mid-2019 as the recovery of the region from the droughts of 2016-17 helped suppress food price inflation. High rates of inflation (at 6.2 percent) resumed in the third quarter of 2019, fuelled by high food prices as the weather outlook in the region worsened because of excessive rains compared to the year 2020, where headline inflation stood at 8.9 percent. Overall, Further, as indicated in Table 1, headline inflation has been increasing for the recent three years. The government of Rwanda has maintained and remains committed to the flexible exchange rate regime since the policy change in 2015[9]. In December 2020, the Rwandan Franc depreciated by 5.4 percent against the United States Dollar, nominal year-on-year, from a depreciation of 4.9 percent in December 2019. In real effective (compared to a basket of

[8]Integrated Macro Framework, public dataset, updated in December 2020. http://www.minecofin.gov.rw/index.php?id=173&L=370

[9] National Bank of Rwanda, Monetary Policy and Financial Stability Statement, February 2021, page 41. https://www.bnr.rw/news-publications/publications/monetary-policy-financial-stability-statement/

currencies of Rwanda's main trading partners) terms, the Rwandan Franc depreciated by 5.8 percent (y-o-y) end December 2020, against a depreciation of 0.8 percent recorded end December 2019. The currency is expected to depreciate further given the negative effect of COVID-19 on exports and on, especially, tourism and hospitality revenues.

Similarly, the current account balance and the overall deficit have deteriorated during this period. In the same direction, official reserves in terms of months of imports have decreased by two months equivalent of imports from 2019 to 2020. A look at the interest rates indicates that the central cut the Central Bank Rate (policy rate) from 5.0 percent to 4.5 percent in April 2020 following the wake of COVID-19 pandemic and we observe a small reduction in the lending rate. Table 2 reports other key macroeconomic indicators in addition to GDP.

Table 2 Other key macroeconomic indicators

	2018	2019	2020
Exchange rate RWF/US$, period average	862.0	899.5	948.8
Headline inflation, CPI based, % change	1.4%	2.4%	6.9%
Current account balance, % of GDP	-8%	-9%	-16%
Gross official reserves, months of imports goods	5.7	6.7	4.7
Overall deficit (including grants), % of GDP	-4.6%	-6.4%	-12.3%
Lending rate	16.96	16.49	16.35
Deposit rate	7.51	7.64	7.64
Central Bank rate	5.5	5	4.5

Source: Ministry of Finance and Economic Planning, 2021

Rwanda's fiscal expansion embarked on in 2018 has been wider than expected, while fiscal pressure has further intensified due to COVID-19. On an accrual basis, the deficit reached 6.3 percent of GDP in fiscal year 2018-19, and 8 percent for 2019-2020. Rwanda has also been experiencing strong revenue mobilization momentum with 68 percent of the 2018/19[10] as domestic revenue contribution to budget before the crisis by reaping the benefits of several tax policy and administration reforms. However, levels of government debt for the fiscal year 2019-2020 saw an increase in budget deficit of 3 percent of GDP as compared to 2018/19. The frontloading of NST1 investment projects has led to larger than expected fiscal expansion in

[10]Joint World Bank -IMF Debt Sustainability Analysis, 2019

fiscal years 2018/19 and 2019/20. In 2020, both direct and indirect tax revenues reduced severely. While tax revenues were partly anticipated to recover in the second half of 2020, compared to 2019, the overall tax to GDP ratio declined by an estimated 2 percent of GDP.

1.5 Historical debt perspective of country debt

Priority spending almost doubled between 1998 and 2001, when Rwanda started to receive HIPC relief. Specifically, priority spending stood at 2.8 percent of GDP in 1998 and increased to 4.0 percent by 2000, with more than 80 percent of expenditure going to education during those years. Since the year 1999, the government maintained the policy of protecting social sector budget allocations from cuts during the course of the fiscal years that followed and reduced military spending, which has also enabled a reallocation of resources to priority areas. By 2001, priority spending had increased to 5.3 percent of GDP. The improved performance reflected the higher allocation to education and health, as well as a focus on new priorities such as infrastructure and decentralization, initiatives in 2004, such as electricity and export promotion. In addition, since the 2002 budget cycle, expenditures were classified in all ministries according to programs and subprograms, expected outputs, activities, and inputs; and as of 2003, budget preparation had been based on sectoral strategy notes prepared by line ministries, which improved the implementation process in key priority sectors.

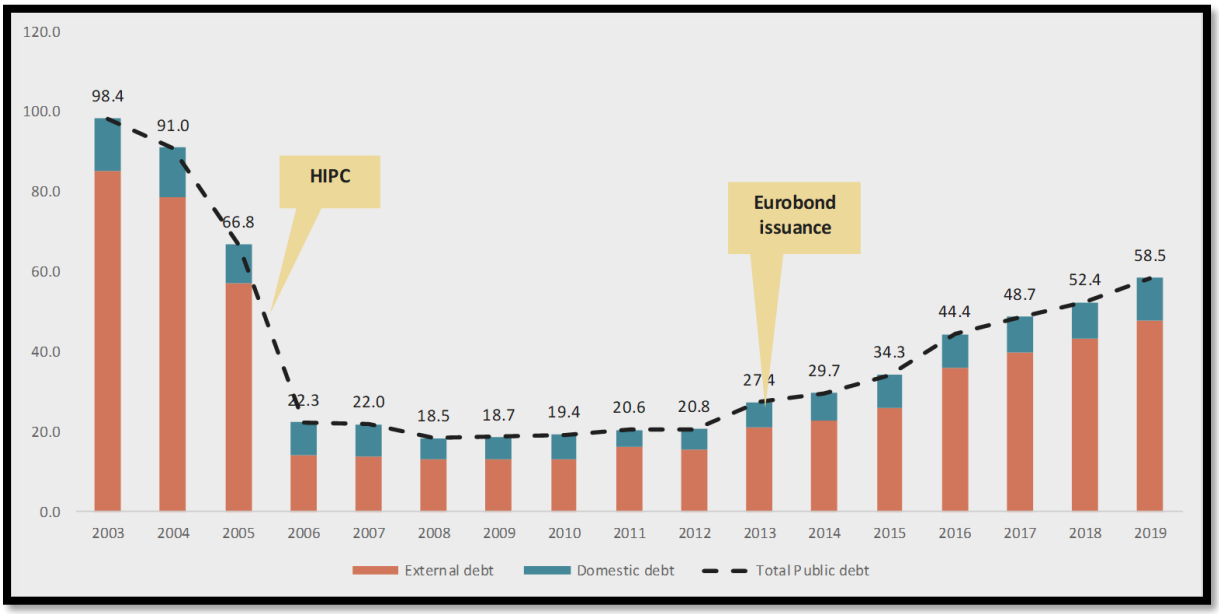
The NPV of debt-to-exports ratio at end of 2003 after full delivery of HIPC assistance stood at 326 percent. Moreover, despite ambitious assumptions regarding the degree of grant financing (83 percent of total financing with the remainder filled by loans), the revised debt to export ratio would peak at 343 percent in 2004 before declining to 171 percent by 2023. This was exacerbated by the lower export prices, changes in cross currency exchange rates, and a lower-than-expected concessionally of new borrowing, where all these variables were all unambiguously exogenous and outside the control of the authorities. In 2000, the International Monetary Fund (IMF) and the International Development Association (IDA) agreed that Rwanda had met the requirements to reach the decision point under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative[11]. The debt relief required to lower the NPV of debt-

[11] See http://www.imf.org/external/np/hipc/2000/rwa/rwadp.pdf and http://www.worldbank.org/hipc, "Rwanda—Enhanced Heavily Indebted Poor Countries (HIPC) Debt Initiative Decision Point Document".

to exports ratio to the 150 percent threshold under the Enhanced HIPC Initiative was estimated to be US$452.4 million in NPV terms. This relief represented a 71.3 percent reduction of Rwanda's debt, in NPV terms, after full use of traditional debt relief mechanisms. In the year 2004, the IMF had delivered interim assistance in the amount of US$20 million in nominal terms, and IDA had provided interim relief in the amount of US$56.5 million. Rwanda also benefited from interim debt relief from the African Development Bank Group (AfDB), the Arab Bank for Economic Development in Africa (BADEA), the OPEC Fund for International Development (OPEC Fund), the European Union, and Paris Club creditors.

Before Rwanda was granted debt relief under the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief (MDRI) initiatives respectively in 2005 and 2006, Rwanda's public debt was at unsustainable levels as depicted in Figure 2. After this debt relief, Rwanda's public debt became sustainable and steady, and varied between 20 and 22 as percent of GDP, until end 2012. The strong performance was viewed in most policy areas particularly in education and health where the completion point triggers surpassed the targets apart from the agriculture sector where privatization of the tea sub sector had not been fully implemented.

Figure 2: Evolution of Rwanda's Public Debt, 2003–2019 as a percentage of GDP



Source: Ministry of Finance and Economic Planning. 2020

Note: HIPC = Highly Indebted Poor Countries Initiative.

1.6 Rwanda's debt escalation

Rwanda's public-sector debt has increased in recent years, mainly due to large, planned investment projects. The increase reflects a long-planned comprehensive public investment strategy, including three large projects to support increased tourism and trade. The large projects include: the construction of the Kigali Convention Center (KCC), completed in 2016; the expansion of the national airlines Rwandair, which is still underway and construction of a new Bugesera airport to handle cargo and increased passenger loads, whose constriction has started. These projects, which are being completed through a series of PPPs and external guarantees, have contributed to an increase in external public debt to 37.5 percent of GDP in 2017 from 16.4 percent in 2012. In 2013 Rwanda issued the Eurobond of US$400 million, leading an increase in the proportion of commercial loan acquired mainly to finance Rwandair fleet expansion plan, the construction of Bugesera airport, the construction of Kigali Arena and high debt service and repayment since 2019 of the loans that were used to finance the Kigali Convention Center. The heightened debt service trend is expected to continue and will likely worsen in 2023 when the Eurobond falls due. This will put pressure on government coffers and significantly increase Rwanda's debt distress.

1.7 Rwanda's debt performance position before COVID-19.

Prior to the COVID-19 pandemic public debt, stood at 58.1 percent of GDP at the end 2019, and it is estimated to have reached nearly 66 percent of the GDP in 2020, or about 6 percentage points higher than the pre-crisis projection. Accordingly, the December 2020 Debt Sustainability Analysis (DSA), jointly conducted by the World Bank and the IMF, maintained a moderate risk of external and overall public debt distress. Due to COVID-19 pandemic and measures put in place to contain its spread globally and locally, Rwanda's primary deficit has widened, exports have sharply declined, and the country's coffers has become more susceptible to external shocks compared to the pre-pandemic period. As a result, the debt distress status has slipped from low to moderate. Debt and financial sector vulnerabilities were expected to remain elevated. The government of Rwanda still, was significantly mobilizing concessional financing from development partners, intended to close the fiscal financing gap in the financial year 2019-2020. It was also planned to have external concessional resources that would contribute to filling the fiscal financing gap.

1.8 Frameworks for debt management

Rwanda aims to reach upper middle-income status in 2035 and high-income status in 2050[12]. In order for Rwanda to be able to attain its anticipated targets, the needed GDP growth rates (annual average) are at least 12 percent during 2018-2035 and 10 percent from 2036 to 2050. Still, Rwanda will need to increase and attract and sustain high private investment, increase its domestic saving, promote higher investments to the potential growth led sectors and focus on improving its human through technical, vocational skills development and education. The Public Financial Management (PFM) Policies and Procedures manual, as updated in July 2019, provides a legal, regulatory, and institutional framework for, among others, public debt management. This manual gives the mandate to the Rwandan Ministry of Finance and Economic Planning (MINECOFIN) to (i) borrow and to permit borrowing for financing the central government budget deficit, (ii) raise loans for other public entities, and (iii) give and approve guarantees and security for the loans granted to public institutions by financial institutions (MINECOFIN, 2019a). In addition, the Public Debt Management Manual details the procedures the Ministry of Finance and Economic Planning follows to manage public debt. This document establishes the Debt Management Committee (DMC) which is chaired by the Government Chief Economist and meets quarterly and is responsible for, among other things, devising and updating public debt policy and strategy.

Rwanda's new external borrowing is planned to decline in coming years. With the development of local bond markets and improvement in the current account position, reliance on external borrowing is expected to decline. Compositionally, from 2018-2022, the framework assumes central government external borrowing needs are met mainly by disbursements of already contracted external multilateral and bilateral debt. It is anticipated that from 2022 onward, the framework assumes that such needs will be financed with a progressively increasing share of commercial debt, including bonds issued in the international capital markets. The framework assumes that, over the long-term, net domestic borrowing will increase gradually with a gradual lengthening of maturities, as government intensify efforts to develop the sovereign bond market. New domestic borrowing is expected to be contracted at an average nominal interest rate of 8 percent.

[12] Vision 2025, Republic of Rwanda

1.9 Historical and Current Fiscal Context

Rwanda's fiscal policy has been consistent with a macroeconomic framework focused on maintaining stability while promoting economic growth. The overall composition of public expenditure since the 2000's lays the foundations for achieving the national objectives of accelerating growth and reducing poverty as stipulated in the National Strategy for Transformation 1. The 2012 shortfall in aid put Rwanda's fiscal policy under pressure in the 2012-13 fiscal year, which led to spending adjustments. In the same fiscal years, less than 40 percent of budgetary grants (2 percent of GDP) were realized, forcing the government to resort to increased domestic borrowing, a build-up in arrears, and the postponement of some capital spending in order to sustain priority spending to alleviate the negative impact of the aid shortfall.

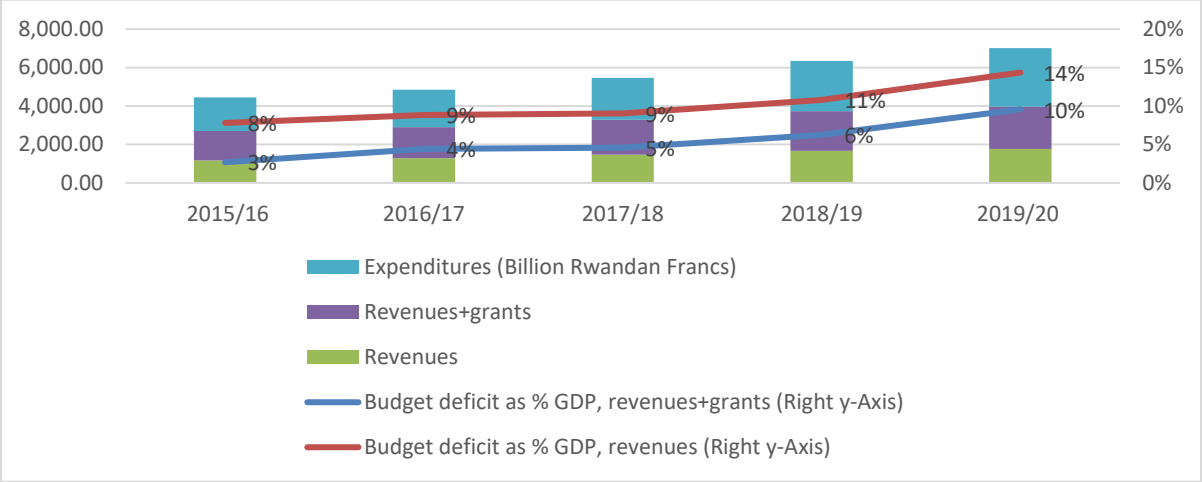
Rwanda's macroeconomic performance remains strong as growth continues to be realized beyond expectations, averaging 10.3 percent in the first half of 2019, on the back of a booming construction sector, a robust activity in services, and a healthy agricultural output. Thus, the 2019 growth projection was set to be 8.5 percent. This was partly compensated for by overperforming domestic revenues and lower net lending in 2019. Despite the increase in foreign-financed investment, unearmarked grants and concessional financing were still lower than expected due to technical reasons and some delays in meeting conditionality. The fiscal deficit in 2018/19 was higher-than-expected due to accelerated implementation of investment spending, accelerated by the stronger demand for the capital-goods imports needed for construction. In 2019, Rwanda's budget deficit amounted to around 5.19 percent of GDP.

The gap between government revenues and expenditures has widened since 2018 as shown in Figure 3. This indicates the deterioration of the budget deficit, even beyond the EAC convergence criteria[13]. The sharp increase in budget deficit excluding grants indicate that spending did not match domestic revenue mobilization and continued reliance on aid. Further, the widening of the deficit implies more public debt to finance this deficit. There is no doubt that due to COVID-19 pandemic, this deficit will deteriorate more in the fiscal year 2020/21 and probably for the other next two more fiscal years.

[13] The EAC convergence criterion requires overall budget deficit excluding grants of not more than 6 percent of GDP and including grants of not more than 3 percent of GDP.

The COVID-19 pandemic is likely to exert more pressure on deficit, especially in acquiring vaccines for the entire Rwandan population and other mitigation facilities. The government will likely introduce higher levels of spending in the coming quarters to offset the economic fallout from the coronavirus pandemic, which will contribute to the fiscal deficit rising to 12.6 percent of GDP in 2020. Revenue collections have also remained low due to the economic contraction in 2020 and the government's introduction of tax relief and deferrals aimed at supporting business entities recover from the shocks of COVID 19. The fiscal and monetary measures have remained intact with government committing to exchange rate flexibility and undertake measures to bolster revenue mobilization as well as reprioritizing spending with a view to bringing public debt to prudent levels in awake of COVID-19 pandemic.

Figure 3: Showing Government revenues and expenditures (In billion Rwandan Francs)



***Source**: Ministry of Finance and Economic Planning, 2021*[14]

2. PROFILING CATEGORIES OF DEBT

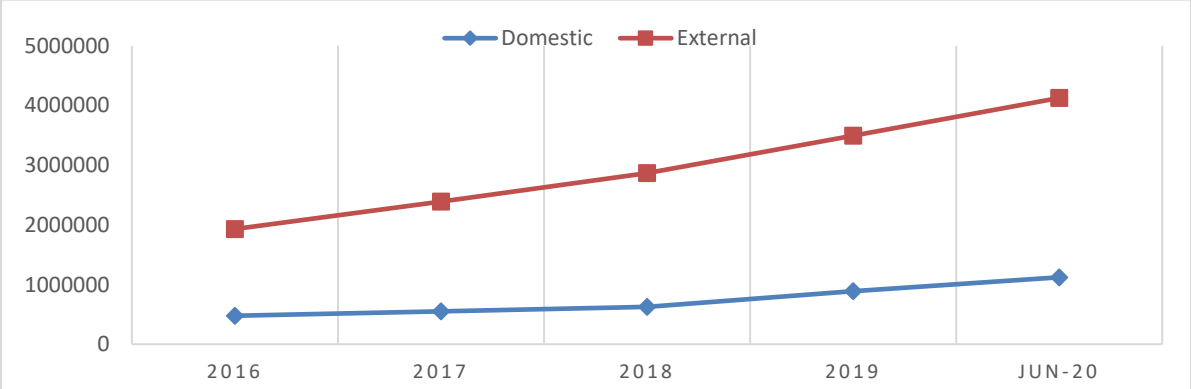
Rwanda's debt statistics, external or domestic debt is defined by currency criteria. It is defined as domestic if it is denominated in Rwandan Francs, while debt denominated in foreign currencies is external (MINECOFIN, 220b). The majority of Rwanda's debt is external (79 percent), and essentially concessional (81.4 percent) and multilateral (73 percent of external debt) while domestic debt consists of 90 percent (as of June 2020) debt securities. In terms of

[14] Integrated Macro Framework, public dataset, updated in December 2020. http://www.minecofin.gov.rw/index.php?id=173.

GDP, Rwanda's public and publicly guaranteed debt stock has been on the rise and reached 58.5 percent of GDP end December 2019 compared to 50.1 percent in June 2018, in nominal terms[15]. Figure 4 below depicts both components of debts and indicates that external debt stock has been increasing since 2016 while domestic debt started to rise around 2018. The remarkable increase in public and publicly guaranteed debt has been a result of high primary deficits and real exchange rate depreciation. For comparisons with domestic debt, external debt has been converted in Rwandan Francs, this sharp increase captures therefore the depreciation of the

Rwandan Franc vis-à-vis lenders' currencies and government guarantees. The primary deficit is driven by public investments that have been set forth in the National Strategy for Transformation (NST 1). The government of Rwanda has increased public investments, with limited effort towards Public Private Partnerships in investments projects. Even though the country has experienced limited public private partnership projects[16]in investments projects, it has at least implemented approximately 39 projects that can be broadly defined as public-private partnerships (PPPs). These projects have mainly been in energy sector(29), in ICT investment projects (3), in manufacturing (1) and in mining (6).

Figure 4: Domestic and external debt stock, Rwanda 2016-2020, in millions Rwandan Francs



***Source**: Ministry of Finance and Economic Planning, 2020b*[17]

[15] Rwanda Medium Term Debt Strategy, Fiscal Year Fiscal Year 2019/20 2021/22 and Fiscal Year 2020/21 2022/23.http://www.minecofin.gov.rw/fileadmin/templates/documents/Public_Debt_Policy/Rwanda__MTDS_FY__2020-21_2022-23.pdf

[16]PPPs are defined as long-term contracts between a public party and a private party for the development or management of a public asset or service.

[17] Statistical Bulletin, Central Government Public Debt, Bulletin no.1, September 2020, Kigali, Rwanda

The partnerships with private sector are limited to the service provision projects, rather than long-term investments like infrastructure. Limited PPPs limit the resource envelop for the government, thus forcing the government to seek out for debts from the external sources, thus increasing the debt burden as it is a case for Rwanda since 2016.

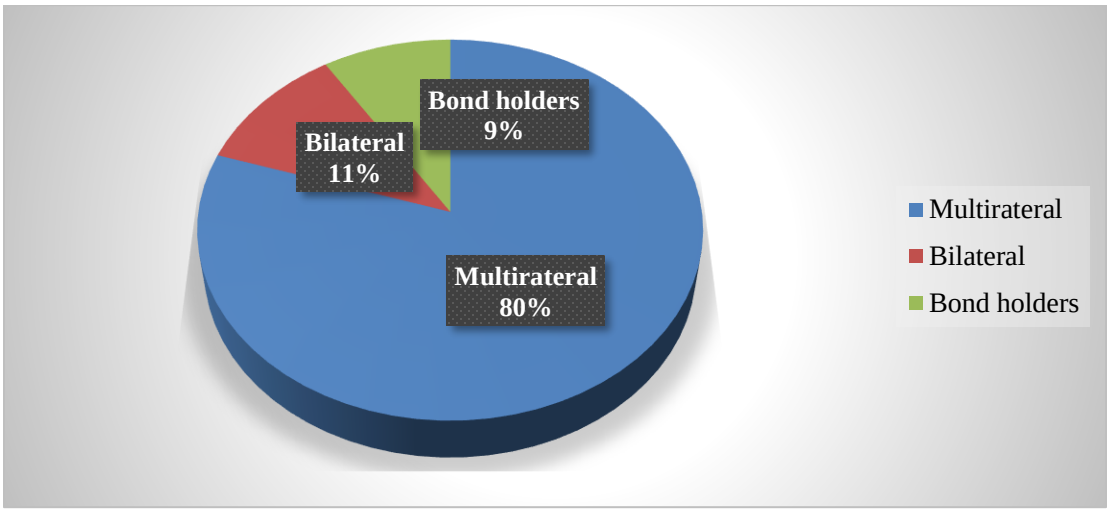
2.1 Status of External Debt

The bulk of Rwanda's external debt, as Figure 5 shows, comes from multilateral institutions (such as IMF, IDA, and IFAD) with a high proportion denominated in Special Drawing Rights (SDR)[18]. By the year 2019, external debt in SDR was 54 percent of total external debt followed by the US$ (31 percent), while the EUR and CNY counted 5 percent each (MINECOFIN, 2019a). In 2020, multilateral accounted for 80 percent, while bilateral accounted for 11 percent and bondholders had a share of 9 percent of total external debt. Since the SDR is a basket of currencies and not a real currency, this exposes more the public debt portfolio to exchange rate risk (volatility) because debt repayment is done in US$ and then converted to this basket of currencies.

Of recent, Rwanda has turned to Asia for bilateral debt where China has the lion share followed by India, South Korea, United Arab Emirates and Kuwait in the top five. Such extension on debt through bilateral debt and turn to Asia specifically increases the burden and this burden is spilled over to the citizens. The soar in external debt increases the burden to the taxpayers which affects their livelihoods and welfare.

[18]

Figure 5. External debt composition for Rwanda



Source: Ministry of Finance and Economic Planning, 2020b[19]

2.2 Extent of Disbursed external Debt and Undisbursed debt.

The grant component of new external financing is assumed to decline as Rwanda develops beyond 2020. As a result, grant equivalent external financing is projected to decline from 71 percent of total external financing in 2019 to 58 percent in 2028 to 39 percent by 2039, while average effective real interest rates on domestic debt rise from 1.6 percent in 2009-18 to 3.4 percent in 2030–39[20]. A scaling up of public debt for Rwanda, among other things to finance large projects, is pertinent with Rwanda's debt sustainability assessed against different borrowing scenarios to determine the fiscal space available. The faster exchange rate depreciation to correct external imbalances, and higher primary deficits, due to lower-than-assumed donor grants, were the main factors in the larger-than-expected accrual of debt (for Rwanda. Debt disbursement in Rwanda has increase since 2011 from 172.8 million dollars to 714.5 million dollars in 2019. Interestingly, the large proportion of the debt disbursement has been entirely to the public sector with small proportions of the private sector not guaranteed.

[19] Statistical Bulletin, Central Government Public Debt, Bulletin no.1, September 2020, Kigali, Rwanda
[20] Rwanda: First Review Under the Policy Coordination Instrument and Monetary Policy Consultation-Press Release; and Staff Report; IMF Country Report No. 20/9; December 20, 2019

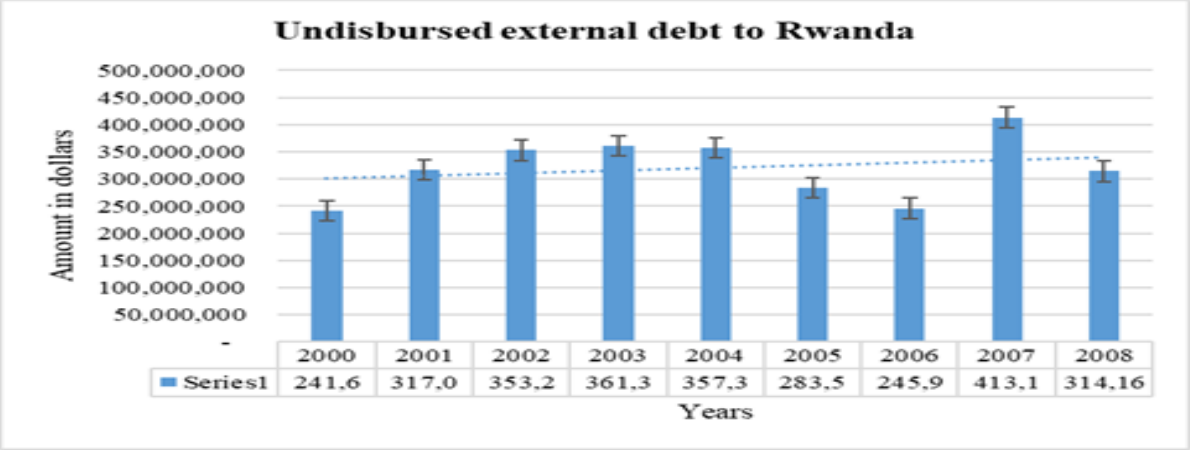
Table 3: Rwanda's debt disbursements(million dollars)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Disbursements (long-term)	172.8	455.7	657.6	776.8	659.4	774.9	713.5	847.1	714.5
Public Sector	229.8	93.7	526.6	286.8	375.7	368.1	407.2	492.0	714.5

Source: International debt statistics-World bank, 2021

The Rwandan government has re-focused on the development of local bond markets and improvement in the current account position. It is expected that external borrowing will decline from close to 5 percent of GDP on average over the last 5 years to under 2 percent of GDP in 2021. Through 2016-2021, the framework by central government assumed external borrowing needs were met mainly by disbursements of already contracted external multilateral and bilateral debt. In the same period, committed-but-undisbursed debt has always been equivalent to around 90 percent of estimated external financing needs and has increased since 2000. It is planned that effective 2022 onward, the external borrowing framework assumes that such needs will be financed with a progressively increasing share of commercial debt, including bonds issued in the international capital markets.

Figure 6. Undisbursed external debt to Rwanda (In Millions?)



Source: World Bank Global Development Finance.

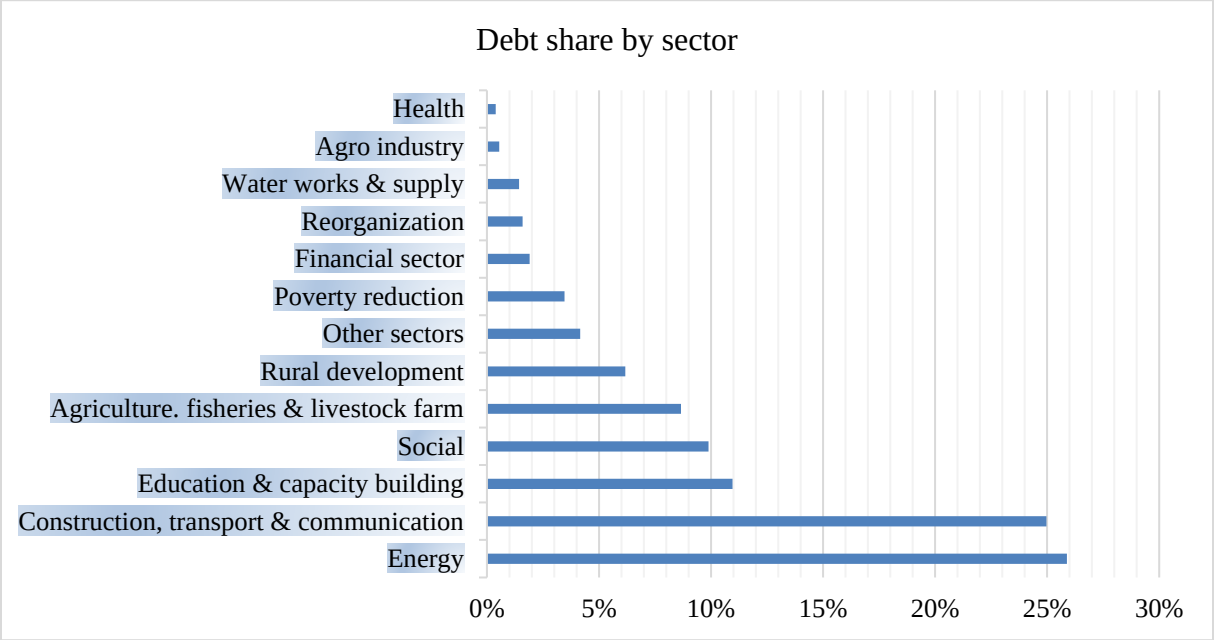
2.3 Sectors that have had the biggest external debt.

The assessment of the sector spending indicates that a quarter of the outstanding Rwanda's public debt is in the energy sector as depicted in Figure 7. This is in line with the National Strategy for Transformation 1 (NST1) for 2017–2024, which includes the target to reach universal access to electricity by 2024. The increase in energy accessibility is a priority for Rwanda under the economic transformation pillar where the government intends to generate energy at least cost sources of energy. The objective is to ensure a cost-reflective and competitive tariff that attracts more investments through medium- and long-term settings. Heavy investments in energy are aimed at accelerating growth through establishment of industries that require reliable and affordable electricity.

The emphasis on providing energy is increase the performance of key sectors such as mining, manufacturing, ICT, and commercial premises. Most of the debt acquired and invested in energy has been mainly oriented in network upgrading and strengthening as well as investing in loss reduction projects. The increase in the quality of electricity to boost industries has been given priority and upgraded in productive areas such as industrial zones, market centres and other socio-economic facilities such schools and health centres. Further, the government's effort to develop secondary cities has ensured energy extension services are prioritized in these cities.

The Rwandan debt is by far oriented to the construction, transport, and communication as the second sector that the government observes as important for sustainable growth and development. The government has focused on developing infrastructure that would support priority sub-sectors, such as agro-processing, construction, light manufacturing, horticulture, and tourism with high potential for growth that can generate employment for the majority of Rwandan youth. Investing in construction and transport like the construction of the new Bugesera airport, provides impetus for trade growth. The social sector is also one of the key sectors that benefit from debt; around 10 percent of outstanding public debt is in this sector while 3 percent has been spent on poverty reduction programs. It is worrying for the government however to use external debt to support social programs, which do not directly generate taxes to finance the loans. This increases the debt burden on the taxpayer since most social programs are oriented towards the poor (in the lower ubudehe category) for Rwanda' case.

Figure 7. Outstanding debt share by sector for Rwanda 9 what period?)



Source: Ministry of Finance and Economic Planning, 2020b[21]

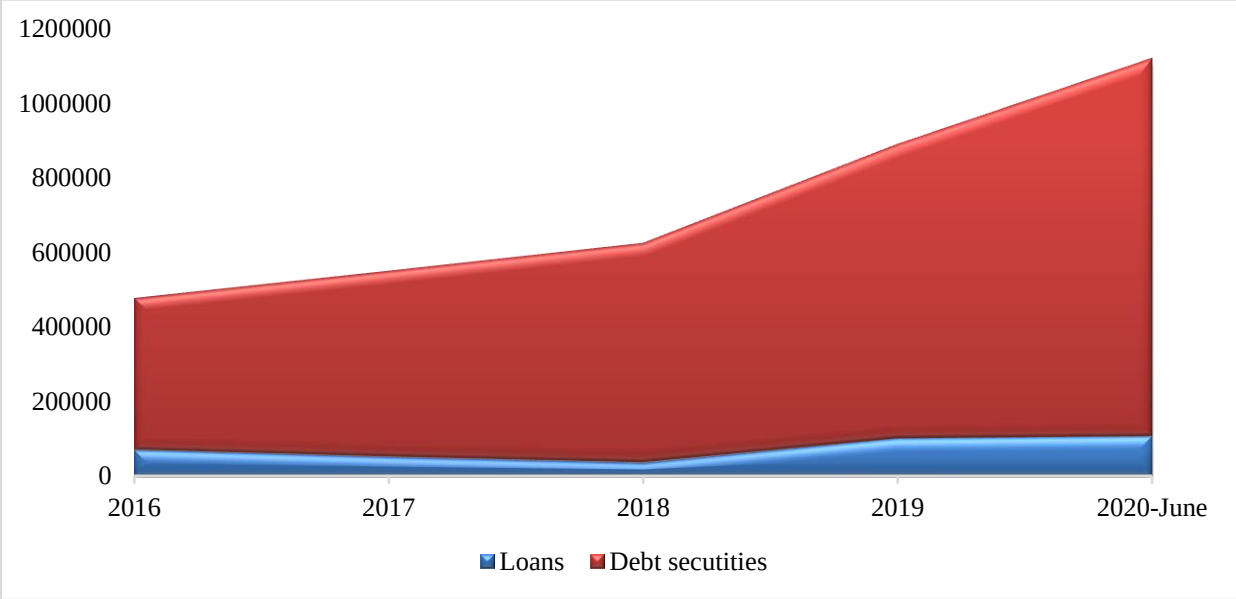
2.4 Status of Domestic Debt

Rwanda's domestic debt stood at 21 percent of the total debt as of end December 2019 and the bulk of it consists of debt securities (90 percent as of June 2020). While domestic debt was previously mainly composed by treasury bills, this shift was partly aimed at developing the local capital market by issuing treasury bonds. Since 2017, the Government of Rwanda has been using quarterly treasury bond issuance as a way to develop the domestic capital market, and this has resulted in upward trend in domestic debt — an increase of 128 percent from December 2017 to June 2020. Moreover, since 2018 there has been an increase in domestic loans contracted by state owned enterprises. Although domestic debt is immune to exchange rate risk because debt is contracted in the Rwandan Francs, the increase in public domestic debt may crowd out credit to private sector, especially if it is concentrated with commercial banks. This affects the lending capacity commercial banks to the private sector as well as investors in key sector of the economy. Further, the interest rates on domestic markets are very high[22] and there is relatively high refinancing risk due to the large share of outstanding short-term treasury bills. The massive rise in heavy project investments required to achieve Rwanda's growth inclination has to

[21] Statistical Bulletin, Central Government Public Debt, Bulletin no.1, September 2020, Kigali, Rwanda.
[22] In 2020 while the average interest rate on external debt was 2.7 percent, it was 12.8 for domestic debt.

originate predominantly from the private sector, since public investment is constrained by rising debt and limits on further external assistance.

Figure 8: Domestic debt by instrument type, in millions Rwandan Francs



Source: Ministry of Finance and Economic Planning, 2020b[23]

Loans have remained low since 2016 and only shown slight increase in 2019. The increase in internal loans exerts pressure on the private investments and business development given the liquidity limitation and the high interest rate of the financial institutions. Further, the increase in loans may increase speculation on the financial sector, and reduces the velocity of money, hence affecting the multiplier effect.

3. DEBT IMPLICATION ON RWANDAN ECONOMY

3.1 Cost and risk to the country's domestic revenues vis-à-vis debt repayment

Even though Rwanda is a moderate risk country on debt sustainability, the COVID-19 pandemic has driven rise in the fiscal deficit is increasing public debt, thus exacerbating existing challenges to sustainability, and increasing the urgency of shifting from large public investments to human capital development as the main driver of growth. The cost of debts are high as repayment and interest accrue towards the long-run. Rwanda's public debt has risen steadily

[23] Statistical Bulletin, Central Government Public Debt, Bulletin no.1, September 2020, Kigali, Rwanda

since 2013 and amounted to 58.1 percent of GDP at end 2019 (i.e., before the pandemic). The deterioration in output and export growth, during the pandemic coupled with increased borrowing needs, has resulted in a further deterioration in Rwanda's debt position. With reduced output, exports and changes in consumption trends reduces the country's domestic revenues, thus creating difficulties in debt sustainability and repayment.

The government initiated the Economic recovery plan, and the cost to mitigate the effects of COVID-19 is estimated to be US$900 million over the two fiscal years 2019/20 and 2020/21, which is equivalent to about 4.4 percent of GDP on average per year. Still, with the recovery plan in place, it would be difficult to revie the economy to its previous status of growth. With public debt now estimated to have reached nearly 66 percent of GDP in 2020, or about 6 percentage points higher than anticipated in 2019. The overall fiscal deficit is likely to increase in absolute terms and in percentage of GDP, and debt to remain high, through 2025 as a result of the pandemic. According to the World Bank[24], Rwanda has continued to rely on foreign financing from development partners with approximately borrowings of 10.2 percent of GDP in the year 2019-20, which is much higher than the level of fiscal deficit for the same year. Thus, forcing the net domestic financing to be negative approximately 0.8 percent of GDP. The continued changes in deficit financing are expected to have led to at least a 6 percent of GDP increase in public debt.

3.2 Implication of debt on gender in social sectors

With the slow growth in 2020, due to the global pandemic and which is anticipated to continue over a few years ahead, there has been an increase in poverty, where majority have been affected. The government needs to pay attention to social protection programs more than before. Besides supporting the more vulnerable people, the government needs to provide support to the female who are the majority in the country and who head some of the households from falling into deeper poverty. Additionally, high debts may affect the welfare of the most vulnerable people including women, boys and girls and the disabled as more internal resources may be projected to pay back the debts and thus reducing expenditure on social protection programs thus, affecting human capital investments. The public debt further needs to be re-oriented to

[24] source

investments in agriculture, which employees more than 80 percent of Rwandan population and mostly the poor. This would support an expenditure on social protection programs towards women, children and their nutrition in the sort and medium term. As more significant investments have been made to build an integrated social protection system in Rwanda over the last decade, more social protection programs need to be created and increase expenditure on the existing ones such as the direct cash transfers to the most vulnerable and poor families. Female-headed households have higher poverty rates than male headed households in Rwanda, thus more debt acquisition would have negative impact more on women and children than males. Further, debt by government invested in other sectors other than agriculture may widen the gender differences in the labor market. Women are more employed in agriculture and retail services, while men are more employed in sectors such as construction that have even continued to growth through the lockdown of the pandemic.

3.3 Implication of debt situation in respect to debt sustainability outlook

Assessing public and publicly guaranteed debt sustainability is crucial. Sustainability requires that a country be able to service its debt in the medium and long run without disrupting its budget implementation or having to restructure its total debt or default. Debt sustainability requires the repayment capacity. This capacity is assessed using ratios of the present value (PV) of external debt to GDP, exports and revenues, and the ratio of debt service to exports and revenues. The debt-to-GDP ratio indicates the potential of a country to service its debt via the allocation of resources to export-oriented production. Other factors also need to be considered in interpreting this ratio, *inter alia*, the proportion of concessional debt.

The ratio of debt to exports is by far good indicator of debt sustainability. Exports constitute the source of external income, thus when this ratio increases over time, this implies that debt is growing faster than exports and thus signals that the country may eventually not meet debt obligations. The ratio of debt service to exports indicates the proportion of export revenues that will be used to service the debt and the extent to which a negative shock to exports will affect debt sustainability. These indicators are presented in Table 4 and they indicate that Rwanda's public debt is sustainable and will be in the medium term. Moreover, the present value of

external debt to GDP of Rwanda is still below the EAC debt convergence criteria[25]. However, looking ahead in 2023 when the Eurobond (US$400 million) issued in 2013 matures, debt service will spike above sustainable levels.

Table 4. Debt sustainability ratios

	2019	2020	2021	2022	2023	2024	*DSA Threshold*
PV Debt to GDP	30.5	31.1	29.4	29.6	29.9	30.7	***55***
PV Debt to exports	138.4	138	132.9	133.6	132.1	133.4	***240***
PV Debt service to exports	4	10.5	13	8.4	21.5	7.2	***21***
PV Debt service to revenues	10.5	12.3	15.8	10.1	23.6	8.9	***23***

Source: Ministry of Finance and Economic Planning, 2020c[26]

For the past five years, the increase in Rwanda' public debt has been mainly driven by higher primary deficits and faster exchange rate depreciation. Owing to negative effects of COVID-19 pandemic there is little room to accommodate external shocks to growth, exports or external financing and the primary deficit will continue to increase and so will public debt. As a result, Rwanda has slipped from low to moderate risk of debt distress (World Bank, 2021). Within the EAC region, Rwanda still performs relatively well. Burundi, Kenya, and South Sudan are in high debt distress while for Tanzania and Uganda the risk of high debt distress is low as indicated in Table 5 below.

Table 5. Risk of debt distress in the East African Community

Country	Risk of external debt distress	Risk of overall debt distress
Tanzania	Low	Low
Uganda	Low	Low
Rwanda	Moderate	Moderate
Burundi	High	High
Kenya	High	High
South Sudan	High	High

Source: World Bank 2021

[25] One of the EAC convergence criteria requires public debt-to-GDP ratio of no more than 50 percent in net-present-value terms.

[26] Rwanda Medium Term Debt Strategy, Fiscal Year 2020/21- 2022/23, Kigali, Rwanda.

4. CONCLUSION

In the last five years, the increase in Rwanda' public debt has been mainly driven by higher primary deficits, due mainly to public investment. The public investments have mainly been in energy, transport, and construction, with a share of social protection programs. The country's strategy has been to maximize concessional financing from multilateral institutions while limiting commercial borrowing. Moreover, Rwanda has turned to Asia, especially China and India for bilateral loans which account for approximately 11 percent of the total Rwandan debt. However, Rwanda's public and publicly guaranteed debt is sustainable and satisfies the convergence criteria by the East African Community.

Though Rwanda's debt is at sustainable levels, due to COVID-19 the economy contracted, and extra financing was requested to finance the health sector, with focus on mitigation measures to contain the spread of the pandemic and deal with economic consequences of lockdowns. As a result, the country's debt portfolio became susceptible to external shocks and the risk of debt distress slipped from low to moderate. Within the East African Community (EAC), Rwanda performs relatively well in the middle; better than Burundi, Kenya, and South Sudan whose risk of external and overall public debt distress is high and worse than Uganda and Tanzania whose risk of debt distress remains low.

Moving forward, Rwanda's debt portfolio still face considerable risks, mainly the negative effects of COVID-19 pandemic, higher real exchange rate depreciation and high interest rates on domestic markets which risk to crowd-out credit to the private sector. Owing to negative effects of COVID-19 pandemic there is little room to accommodate external shocks to growth, exports, or external financing. The main strength of the Rwanda's debt portfolio, however, is that 80 percent of external debt consists concessional loans, which are on fixed terms, low interest rates and long grace periods and maturities. Authorities should continue to prioritize multilateral concessional long-term loans and reduce domestic borrowing especially from financial banks, not only because of high interest rates but also to avoid the risk of crowding out the private sector.

In order to enhance debt transparency, the Republic of Rwanda has approved and adopted a procedure manual on the process to be followed for the semi-annual publication of a debt statistical bulletin with comprehensive coverage of public debt and government guarantees. It can be noted that Rwanda's first statistical bulletin with comprehensive coverage of public debt, including government guarantees, was published in October 2020. The government effort to publish the Debt Statistical Bulletin on a semi-annual basis with a time lag of three months, will provide an overview of the levels of debt burden and mechanisms to reduce the debt burden could be broadly discussed between partners and offer citizens a basis for their engagement. With the current bet burden and ceiling, it would be advisable for Rwanda to avoid financing new projects(such as railways) through direct borrowing, which otherwise would displace public investments with higher short run returns in favour of investments that take decades to produce positive net social benefits.

Probably, Rwanda should use other financial instruments, such as a new "big bond" suggested where donors would offer long-term bonds at subsidized rates (borrowing in the market against future aid flows). Such a long-term, low-interest bond could offer a good source of finance for large investments projects because their level of synchronicity with the payoff horizon of same projects. In addition, Rwanda's economy requires to engage the private sector for it to play a leading role in achieving the rapid growth required to reach Rwanda's ambitious middle-income aspirations by the year 2035.

Against the continued challenging economic environment, still, Rwanda remains firmly committed to the main principle of macroeconomic stability. Even with the high debt and categorised as in the moderate risk zone, inflation remains moderate, as monetary policy remains prudent with no monetization of the additional financing requirement by the National Bank of Rwanda. The Rwandan government continues to rely heavily on concessional borrowing, which represents the overwhelming share of financing for the COVID-19 response. Concessional borrowing accounted for about 82.3 percent of total public external debt by the end of 2019, and this share is further estimated to have increased to more than 85 percent by the end of 2020. However, the Rwandan government remains committed to fiscal consolidation once the COVID-19 crisis abates.

4.1 Recommendations

- The implementation of the available sound debt management policy, in Rwanda, is important to proactively identify and mitigate high level debt risks.
- The effects of the fiscal and industrial policies are important especially in tax breaks and other policy incentives for investments in strategic sectors. This requires to be balanced better against the objectives of financial stability and fiscal sustainability.
- The government of Rwanda needs to broaden the base of potential institutional investors in key sectors that would boost the economy. Such investors could form a long-term source of financing, yet the base of institutional investors is quite narrow in Rwanda compared to other East African countries.
- The government should also source financing from regional sources of funding to complement to domestic resources, given the limited size of the domestic financial market. This could be through the listing of regional financial institutions and companies to the Rwandan stock exchange market. Global experience has shown that smaller countries tend to benefit more from regional integration by leveraging the position of the largest market in the region to create advantages of greater scale, efficiency, and visibility with institutional investors.
- The government should put in place strategies to prepare for repayment and servicing of the Eurobond of US$400 million that will mature in 2023. There are different strategies, and one of them, as Kenya has been doing for example, would be to issue another Eurobond to retire the one that matures. Whether this would be a good strategy for Rwanda, however, needs a thorough assessment.

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