



BANQUE DE LA REPUBLIQUE  
DU BURUNDI



2016

# FINANCIAL STABILITY REPORT

YEAR 2016 - NUMBER 2

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## ACRONYMS

ABEF	: Association des Banques et Etablissements Financiers
ACH	: Automated Clearing House
AFI	: Alliance for Financial Inclusion
ARCA	: Agence de Régulation et de Contrôle des Assurances
ARFIC	: Autorité de Régulation de la filière Café du Burundi
ASSUR	: Association des Assureurs du Burundi
ATS	: Automated Transfer System
BCBS	: Basel Committee on Banking Supervision
BIF	: Burundi Francs
Bn	: Billions
BRB	: Banque de la République du Burundi
CISF	: Comité Interne de Stabilité Financière
CNSF	: Comité National de Stabilité Financière
CSD	: Central Securities Depository
CTST	: Comité Technique de Stabilité Financière
DTI	: Debt-to-Income
E	: Equity
EAC	: East African Community
ECB	: European Central Bank
Etc.	: Et cetera
EU	: European Union
FI	: Financial Institutions
FSI	: Financial Soundness Indicators
GDP	: Gross Domestic Product
i.e	: id est
IMF	: International Monetary Fund
ISTEEBU	: Institut de Statistiques et d'Etudes Economiques du Burundi
Kg	: kilogramme
MBIF	: Millions of Burundi Francs
MFI	: Microfinance Institutions
MIS	: Management Information System
N°	: Number
NBI	: Net Banking Income
NPL	: Non-performing Loans
OBR	: Office Burundais des Recettes
P	: Provisional
Q	: Quarter
RIM	: Réseau des Institutions de Microfinance

ROA	: Return on Assets
ROE	: Return on Equity
RTGS	: Real Time Gross Settlement
SCEP	: Service Chargé des Entreprises Publiques
USD	: United States Dollar
Vs	: Versus

## MISSIONS OF BANQUE DE LA REPUBLIQUE DU BURUNDI

1. Define and implement monetary policy;
2. Define and implement exchange rate regime;
3. Hold and manage official exchange reserves;
4. Regulate and supervise banks, financial institutions and micro-finance institutions;
5. Issue banks notes and coins;
6. Promote a stable and sound financial system;
7. Promote a reliable, efficient and sound national payment system;
8. Act as a Government cashier;
9. Realize any task as provided in the statutes;
10. Realize any task that other laws could assign to the Bank, under reserve of its compatibility and its autonomy;

## VISION

The BRB, a modern Central Bank with technical competence able to impulse innovation and ensure the stability of the financial system for a durable development of the Burundian economy.





Following the 2007 international financial crisis, public authorities agreed on an appropriate regulatory and supervisory framework to safeguard financial stability. Financial stability is defined as «**the ability of financial intermediaries, markets and market infrastructures that compose it to withstand shocks without major disruption of financial intermediation and thus ensure the allocation of savings to profitable investments without serious failures**» (ECB, 2007)<sup>1</sup>.

It is within this framework of preserving financial stability that macro prudential policies have been developed with the aim of apprehending and preventing the emergence of systemic risks likely to appear in the financial system. Systemic risk is defined as the risk that the provision of financial products and services may be impaired to a point where economic growth and welfare could be significantly affected (ECB, 2017)<sup>2</sup>.

As for any period of crisis, the appearance of systemic risks in the financial system would affect economic agents such as households and entities, hampering access to credit and consumption, leading to a decrease in investment and growth. Such developments unavoidably lead to a rise in unemployment and a decline in purchasing power.

While the 2007 financial crisis did not directly affect most African countries due to their weak integration into global financial markets, this situation has been reversed in recent years as a result of developments in the financial sector. This evolution is marked by three specific aspects namely, the growing importance of financial markets, financial innovation and the process of strengthening the integration of different national financial systems.

Like the current development in Africa, the Burundian financial system is expanding more and more with the entry of new players including the arrival of regional banks and insurance companies and the introduction of new products based on new information technologies. All these developments expose Burundi to risks that could affect the financial system that must be identified by an appropriate regulatory and supervisory framework. Thus, an assessment and permanent monitoring of the resilience of the entire Burundian financial system is more than necessary, with a key role attributed to the Central Bank, as monetary authority and regulator of the banking and microfinance sector.

The first edition of the Financial Stability Report, published in 2016, enabled the monetary authority and other economic policy actors and the private sector to share the diagnosis of possible weaknesses and means of crisis prevention, in order to preserve the financial stability essential for the pursuit of economic development. The second edition capitalizes on these achievements to continue the implementation of an appropriate macroprudential policy, able to support the development of the financial sector as an integral part of the national poverty reduction strategy.

Jean CIZA

A handwritten signature in blue ink, appearing to read 'Jean CIZA', written over a white background.

Governor

<sup>1</sup> EUROPEAN CENTRAL BANK (2007), Financial Stability Review, Frankfurt, December

<sup>2</sup> EUROPEAN CENTRAL BANK (2017), Financial Stability Review, Frankfurt, May.

Burundi's financial sector remained resilient in 2016, despite the persistence of macroeconomic risks inherited from the situation of 2015. These risks include the worsening of the budget deficit, national currency depreciation, decrease of coffee and tea production, weak global and national economic growth and other risks leading to the deterioration of the credit portfolio of the banking sector.

The results of the stress tests conducted on the banking sector displayed that globally, the Burundian banking sector has sound financial health with respect to the liquidity, profitability and capital adequacy ratios. Nevertheless, the stress test carried out individually revealed vulnerabilities, following the deterioration of portfolio quality, liquidity ratio and capital adequacy ratio that would fall below the regulatory threshold in the event of shock. For banks that have not succeeded the stress tests, measures aiming at strengthening risk coverage, including the increase of capital and the constitution of sufficient provisions, are necessary to improve their solvency and liquidity levels.










The Central Bank introduced into the regulation on the capital buffer, the counter-cyclical buffer and the leverage ratio. Regarding the institutional framework, the Central Bank pursued the process of revision of the banking law which was promulgated in August 2017. The Bank also set up a Technical Financial Stability Committee (Comité Technique de Stabilité Financière: CTSF) and an Internal Financial Stability Committee (Comité Interne de Stabilité Financière: CISF). The Central Bank pursued the sensitization of stakeholders in order to set up the National Financial Stability Committee (Comité National de Stabilité Financière: CNSF) and sign a memorandum of understanding between the various financial system regulators.

For the year 2017, the outlook shows that the stability of the financial sector will improve in connection with the already started economic recovery although still nuanced.

At the macroeconomic level, the 2017 economic growth projections display a slight improvement of the economic activity, although it remains below the level recorded before the 2015 crisis, which could have positive effects on the health of the financial system. However, risks to the financial sector remain, among others, the fiscal deficit, the drought-

related drop in agricultural production, the downward trend in world prices and coffee and tea production, and the national currency depreciation, etc.

**Table 1: Risks to financial stability**

	Risk that the budget deficit increases
	Risk of national currency depreciation/risk of significant decrease of official reserves
	Risk of decrease of production following climate changes such as weak pluviometry (drought)
	Risk of decrease of coffee prices and production
	Risk related to a weak world economic growth and in main foreign trade partners of Burundi
<b>Legend</b>	
	Very high systemic risk
	High systemic risk
	Moderate systemic risk
	Reduced systemic risk

Note : The color indicates the intensity of the risk. The arrow indicates the direction of risk.

# 1

## CHAPTER 1: GLOBAL, REGIONAL AND NATIONAL MACROECONOMIC DEVELOPMENTS



## 1.1. International and regional developments.

### 1.1.1. International environment.

The stability of the international financial system improved in 2016 in connection with the acceleration of global economic activity, the recovery of commodity prices, the retrieval of capital flows in emerging countries, the decrease of the concern about growth in China.

In advanced economies, the pursuit of accommodative monetary policy has strengthened asset prices and led to a renewed appetite for risk. Thus, the slump in growth expected from the United Kingdom's Brexit vote and weaker than expected growth in the United States in the first half of the year was mitigated.

However, in advanced economies, a protectionist stance could reduce global growth and trade; slow down capital movements and markets volatility. In the euro zone, political tensions added to the structural difficulties of the banking system and high debt levels could lead to financial instability. The vote in favor of Brexit has led to uncertain spillover effects on the United Kingdom and the EU relationship and the magnitude of the reduction of their mutual trade and financial flows. It has increased uncertainty about political trends in other EU member states as well as populist and anti-economic integration policies worldwide.

For many emerging and developing countries, some factors continue to negatively affect economic activity: (i) the pursuit of adjustment of commodity exporting countries fa-

cing the declining revenues and terms of trade deterioration; (ii) weak demand in advanced countries; (iii) world trade shrinkage as well as (iv) internal conflicts and geopolitical tensions in several countries.

This context weakens the enterprises of many of these countries that are over-indebted and have been forced to significantly reduce their investments. For most of emerging countries, the challenge is to smoothly reverse the financial leverage of companies whose balance sheet is weakened and reimbursement capacity is weakened.

More specifically, in China, increasing risks threaten financial stability as loans continue to grow rapidly. Chinese banks assets now account for more than three times the GDP, and other non-bank financial institutions are more exposed to credit risk. Many financial institutions face a strong asset-liability asymmetry and high liquidity and credit risks.

### 1.1.2. Regional environment

Financial stability in sub-Saharan Africa<sup>3</sup> has improved despite weak economic growth due to the world commodity prices fall, the tight and volatile financial markets. However, the tightening of international financial conditions and the increase in public debt have been threats to Financial Stability in Sub-Saharan Africa for the year 2016. Indeed, the decline in export revenues combined with the tightening of international financial conditions encouraged commercial banks to borrow from central banks to invest in public debt. In some countries heavily relying on oil revenues, the stock of previous arrears is very large and constitutes a threat to Financial Stability.

<sup>3</sup> IMF, Regional Economic Outlook, April 2017

In the East African Community (EAC) countries, the financial system remained resilient and growth was 5.8 vs. 6.0% in 2015. Growth in Burundi has improved in 2016 (1.7 after -0.3% in 2015), while the other EAC countries generally have a growth rate of over 5.0%.

This performance is linked to the favorable oil prices on the international market and public investments. However, the EAC countries' currencies depreciation against the US dollar, the rise in the oil price on the international market,

the drought that is rife in most countries is a major risk to the stability of the financial system.

In 2016, the Ugandan Shilling, Burundi Franc and Rwandan Franc depreciated sharply while the Tanzanian and Kenyan Shillings stabilized. To reduce the negative effects on the financial sector, most central banks maintained accommodative monetary policies and made strong interventions in the foreign exchange market.

#### **Box I: Natural disasters in sub-Saharan Africa in general and in Burundi in particular**

According to the IMF's October 2016 Regional Economic Outlook Report, Sub-Saharan Africa suffered 1,603 reported natural disasters, which accounted for 18% of the worldwide total, and droughts accounted for 8%, twice the percentage observed in the world. These droughts were strongly correlated with El Nino. In consequence to the high frequency of these droughts, the regions of the Sahel and eastern and southern Africa recorded the highest rates of affected populations.

The economic and social effects of these natural disasters can be manifested in production and short- and long-term growth, on external balances through the decline in agricultural exports, on fiscal indicators through lower tax revenues and the increase in public expenses, on the deterioration of financial sector indicators through the losses suffered by enterprises and households. Most sub-Saharan countries faced an increased outage problem that negatively affected production due to drought.

In Burundi, despite the good performance recorded for cereals, production of main food crops fell in 2016 mainly due to poor weather conditions.

Production main food crops (in Tons)						
Year/Crop	2011	2012	2013	2014	2015	2016 (p)
Bananas	1,848,727	1,184,075	2,235,697	1,362,837	948,875	757,751
Tubers	1,560,229	2,051,323	3,333,042	3,203,169	3,413,523	2,721,143
Cereals	327,316	246,348	243,553	226,272	164,172	316,416
Leguminous (+Oilseed)	232,081	236,657	277,813	289,875	316,151	312,762
<b>Total</b>	<b>3,968,353</b>	<b>3,718,403</b>	<b>6,090,105</b>	<b>5,082,153</b>	<b>4,842,721</b>	<b>4,108,072</b>
Annual Change in Percentage						
Bananas		-36.0%	88.8%	-39.0%	-30.4%	-20.1%
Tubers		31.5%	62.5%	-3.9%	6.6%	-20.3%
Cereals		-24.7%	-1.1%	-7.1%	-27.4%	92.7%
Leguminous (+Oilseed)		2.0%	17.4%	4.3%	9.1%	-1.1%
<b>Total</b>		<b>-6.3%</b>	<b>63.8%</b>	<b>-16.6%</b>	<b>-4.7%</b>	<b>-15.2%</b>
<b>Source: Estimation based on Agricultural National Surveys</b>						
<b>(p)Provisional</b>						

For export crops, market coffee production has declined. Cumulative merchantable coffee production at the end of December for the 2016/17 campaign was 11,760 compared to 17,454 tons for 2015/2016, a decrease of 32.6%. But export revenues rose, due to the prices evolution on the international markets while those of tea declined in value as well as in volume from one year to another.

### 1.1.3. Challenges for Burundi's Financial Stability resulting from global developments

There are three main challenges for Burundi's Financial Stability resulting from global developments: (A) coffee and tea prices and production have declined, (B) national currency depreciation, (C) reduced economic growth in the world and, in particular, in Burundi's main trading partners.

### A. Decline of coffee and tea production

Coffee and tea are the main export products for Burundi with 41.1% for coffee and 21.1% for tea at the end of December 2016<sup>4</sup>.

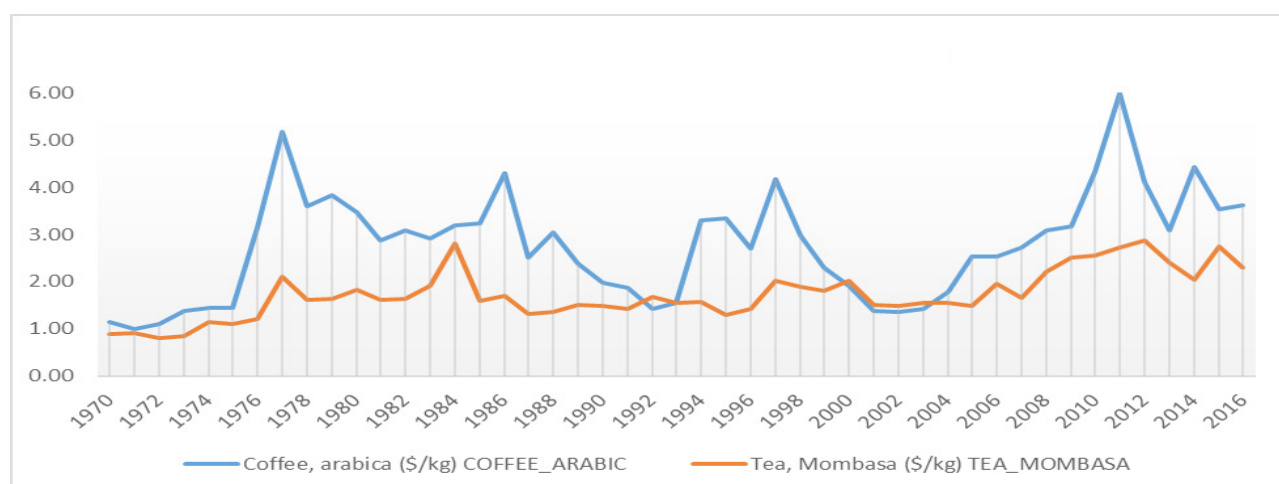
Although world coffee prices increased in 2016 (chart 1), export revenues were adversely affected by the decline in production.

Coffee production fell by 5,694 tons between the 2015/2016 and the 2016/2017 campaigns.

That of tea also fell by 1,601.90 tons, from 50,578.8 tons in 2015 to 48,976.9 tons in 2016. The critical threshold below which the coffee grower would work at a loss is 29 cents / kg (equivalent to 500 BIF). In December 2016, the price of coffee was USD 3.61 / kg.

<sup>4</sup> BANQUE DE LA REPUBLIQUE DU BURUNDI, Bulletin Mensuel, December 2016.



**Chart 1: Evolution of coffee and tea prices on the international market**

Source: World Bank Commodity price data, Avril, 2017.

The Burundian banking sector has a low exposure to the coffee sector (1.2% of the total volume of credit in December 2016). Exposures in the sector are listed in six banks that provide loans to this sector. Coffee loans represent 5.4% of the total equity of these six banks that finance this sector during the coffee campaign. However, the overdue loans rate in the coffee sector is very high, reaching 36.0% in December 2016.

## B. National currency depreciation

The risk that the national currency continues to depreciate has increased. Indeed, this is the

evolution recorded among the EAC region currencies, following the appreciation of the US dollar. In Burundi, the national currency depreciated by 5.3% in 2016 against 1.6% in 2015. This depreciation was caused by the deterioration of the level of foreign exchange reserves, and covered only 1.5 months of imports against 2.0 months for the previous year, which is lower than the EAC countries convergence criteria (4.5 months). This decrease in foreign exchange reserves is mainly related to the decline in external support, with total donations (current and capital) fallen by 16.5%.

**Table 2: Reserves<sup>5</sup> (months of imports of goods and services)**

	2004-08	2009	2010	2011	2012	2013	2014	2015	2016	2017p
Burundi	2.6	3.6	4	4.0	4.0	4.2	4.1	2	1.5	1.2
Kenya	2.9	3.4	2.9	2.8	3.7	3.9	5.3	5.1	4.8	4.8
Uganda	5.6	4.9	3.9	3.7	4.5	4.8	5.1	4.8	4.5	4.2
Rwanda	3.5	6.5	5.2	6.5	5.6	4.8	3.9	3.5	4	3.6
Tanzanie	4.8	4.6	4.1	3.5	3.6	4	4.3	4	3.7	3.9
EAC-5	4	4.3	3.7	3.5	4	4.1	4.8	4.6	4.3	4.3

Source : IMF, Regional economic outlook, April 2017.

<sup>5</sup> For Burundi, the data are from BRB till 2016 and; for 2017 forecasts as well as data for other countries are taken from IMF Report on Regional Economic Outlook.

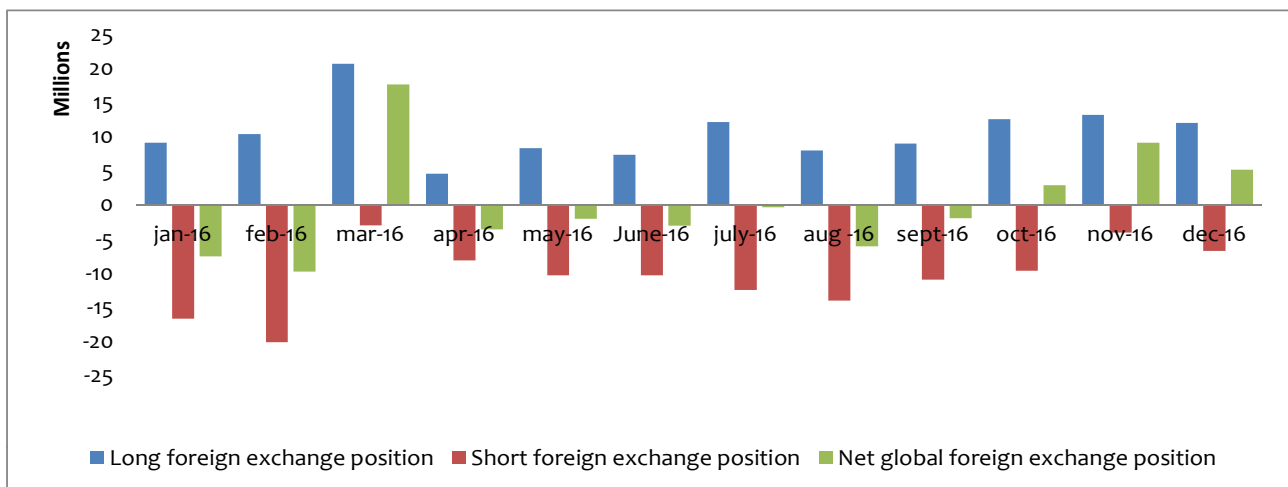
The banking sector has a low exposure to foreign currency loans (3.3% of total loans, December 2016). Nevertheless, the difficulties for banks in the event of a strong depreciation could be considerable and would come from two channels: (i) loans granted to importing enterprises and (ii) the foreign exchange position. In a severe stress test scenario concerning the depreciation of the BIF, the average capital adequacy ratio (22.3%) for the banking sector remains above the minimum threshold (14.5%), but the deterioration would be significant.

Concerning the banking system foreign exchange position, it varies a lot among banks. There are some banks with short positions and others with long positions.

When a bank has a short position, it is essential to take additional measures to hedge against the adverse consequences of depreciation by increasing its own equity to cope with potential losses.

At the end of December 2016, the sector's position was long (2.0% of equity); but the banking sector experienced short positions throughout 2016.

**Chart 2: Evolution of the banks' net foreign exchange position**



Source : BRB

### C. Weak worldwide economic growth and, in particular, in Burundi's main trading partners

The weak worldwide economic growth has systemic implications for the Burundian banking sector. First, the economic growth of

Burundi's main trading partners remains moderate, although emerging and developing countries as a whole have seen a slight acceleration of their growth in 2016, especially in the emerging countries of Asia.

**Table 3: Economic growth of the main partners**

	Percentage of exports per country in total export of Burundi (2016)	GDP 2014	GDP 2015*	GDP 2016*	GDP *2017
European Union	19.5	1.5	1.9	1.5	1.6
United States	2.2	2.4	2.6	2.4	2.5
EAC-5	11.5	5.9	6.1	6.1	6.3
Asia	17	6.9	6.6	6.6	6.2
* IMF Forecasts, World Economic Outlook (October 2016)					

Source: BRB ; IMF

Second, banks' exposures to companies exporting coffee, tea, beer and soap (accounting for more than 72% of the country's total exports in December 2016) are low (0.08% of to-

tal loan granted by banks, in December 2016). Banks are generally able to cope with negative developments in case exporting companies face difficulties to reimburse their loans.

**Table 4: Imports of goods and services as a percentage of GDP**

	2014	2015	2016	2017
Burundi	37.3	37.5	29	24.9
Kenya	32.9	27.9	25.5	26.2
Rwanda	33.2	35.6	37.1	33.6
Uganda	27.4	30.4	27.7	29.1
Tanzanie	28.3	27	25.8	26.7

Source: IMF, Regional Economic Outlook, April 2017

## 1.2. Domestic economic context

### 1.2.1. Domestic macroeconomic developments

#### 1.2.1.1. Economic growth

The stability of the financial system has been affected by weak economic growth, because of its impact on the reimbursement capacity of some economic sectors to which banks are exposed. Indeed, the growth rate was at 1.7% in 2016 against -0.3% in 2015.

This recovery is mainly driven by the sectors of Industry (2.6% versus -4% in 2015), Trade (2% versus -6.9% the previous year) and Transport (4% versus 18.6% the previous year)<sup>6</sup>.

Despite this recovery, the economic activity remains relatively moderate in the various sectors of the economy such as agriculture (-6%), construction (-2.1%) and hotels and tourism (-2%). In 2016, the agriculture sector, which accounts for a significant share of the economy (30% of nominal GDP), is dependent on climate change. It was impacted by the strong El Nino phenomenon which greatly reduced agricultural production.

<sup>6</sup> Ministère de la Bonne Gouvernance et de la planification, Cadrage macroéconomique du Burundi, juin 2017

According to the IMF's April 2017 report, the EAC recorded economic growth of 5.8 percent in 2016, above the average for sub-Saharan

Africa of 1.4 percent, due to macroeconomic stability, public investments and favorable energy prices.

**Table 5: Growth in EAC countries**

	2004-08	2009	2010	2011	2012	2013	2014	2015	2016	2017p
Burundi <sup>7</sup>	4.4	3.8	5.1	4	4.4	4.9	4.2	-0.3	1.7	0
Kenya	4.6	3.3	8.4	6.1	4.6	5.7	5.3	5.6	6	5.3
Uganda	8.3	8.1	7.7	6.8	2.6	4	5.2	5	4.7	5
Rwanda	9	6.3	7.3	7.8	8.8	4.7	7.6	8.9	5.9	6.1
Tanzania	6.5	5.4	6.4	7.9	5.1	7.3	7	7	6.6	6.8
EAC-5	6.2	5.2	7.4	6.9	4.6	5.8	6	6	5.8	5.7

Source: IMF, *Regional Economic Outlook*, April 2017

For Burundi, the magnitude of the economic downturn decreased in 2016. However, the growth remains below the EAC average. The slow growth constitutes a risk for financial stability because some sectors of the economy record high nonperforming loan ratios at the end of December 2016: Tourism and Hotels (29.9%), Agriculture (8.9%), Trade (15.3%), Construction (26.3%), Manufacturing (14.1%).

The stress test scenarios show that non-reimbursement in these sectors would lead to a sharp decrease in the equity of the banking sector. In such a situation, banks' equity would fall by the amount of the provisions made to cover these outstanding payments. Similarly, the capital adequacy ratio would drop considerably, but it would remain above the minimum threshold.

#### Box II: IMPACTS OF EXOGENOUS SHOCKS ON FINANCIAL STABILITY.

An exogenous shock is the manifestation of an exogenous impulse whose persistence of effects generates fluctuations at the origin of the cyclicity of the real economy. Like developing countries as well as the global economy, African economies have been facing recurring crisis since 2008, including the 2007 financial crisis, the sovereign debt crisis and the commodities crisis. As demonstrated during a high-level conference organized by the Banque des Etats d'Afrique Centrale on the topic "Central Banks Facing Exogenous Shocks: Strategies for Ending the Crisis" on January 25, 2017 in Yaoundé, the commodities crisis is an important source of exogenous shocks for African economies.

It is possible to develop a typology of shocks in economics based on four main criteria: (i) the market structure (supply shock, demand shock); (ii) time (temporary shock, permanent shock); (iii) assets (real shock, financial shock, monetary shock); (iv) monetary union (symmetrical shock, asymmetric shock).

<sup>7</sup> For Burundi, the data are taken from «Cadrage macroéconomique du Burundi», June 2017; the 2017 forecasts as well as data for other countries are taken from IMF Report on Regional Economic Outlook.

Also, shocks can be distinguished according to whether one is in a close economy or in a monetary union. In the case of close economy shocks can be distinguished according to four elements: (1) financial sphere and real sphere: supply shocks, demand shocks; (2) imperfect competition and risk: stochastic shocks; temporary shocks; (3) when assets are privileged: real shocks; financial shocks and monetary shocks; (4) when the impulse at the origin of the shock is preferred: exogenous shocks, endogenous shocks.

In the case of a monetary union, two generations of shocks can be considered. In the first generation of shocks, one distinguishes: (a) symmetric shocks, corresponding to an event having the same macroeconomic effect on all member countries of a monetary union; (b) asymmetric shocks, characterizing an event having a specific effect in each member country or group of member countries of a monetary union. The specificity of an asymmetric shock effects comes from the fact that the proportion in the intensity of the shock is different.

In the second generation of shocks (combination of two criteria: monetary union and time), one distinguishes (c) cyclical shocks (symmetric or asymmetric) and, (d) structural shocks (symmetric or asymmetric). The crisis produced two effects: (i) the decline in states revenues, (ii) the decline in central bank reserves. These effects have in turn produced various impacts.

The decline in states revenues has had the following impacts: (1) the decline in public investment; (2) the increase in public debt; (3) the default risk; (iv) the slowdown in growth.

The decline in central bank reserves has had the following impacts: (a) uncertainty about monetary stability; (b) uncertainty about the exchange rate.

These effects and impacts carry out two important challenges. On one hand, the slowdown of growth leads to the decline of reserves implying serious risks to economies: (i) monetary instability risk; (ii) currency crisis risk; (iii) debt crisis risk; (iv) balance of payments crisis

risk; (v) depreciation risk; (vi) systemic risk. On the other hand, a contagion problem likely to hinder the policies implemented. The origins of this problem lie in the real and financial interdependencies between countries.

### 1.2.1.2. Inflation and interest rates

Inflation fell by 0.1 percentage point in 2016 while lending rates increased by 0.37 basis points in 2016 (Table 5). Existing analyzes have shown that lending rates are much more dependent on the level of risk than the level of inflation<sup>8</sup>. The overnight facility rate decrease sharply (8.6% in 2016 compared to 12.4% in 2015) mainly as a result of the central bank's policy of relaxing refinancing conditions. This decline is related to the lowering of the 13-week Treasury bond rate to which the overnight facility rate is indexed. Even though in 2016 the budget deficit improved, it remains high (6.5% against 7.8% of GDP in 2015). To finance this deficit the State continued to rely on domestic indebtedness through the issuance of Treasury securities.

The divergent developments between the overnight facility rate and the lending rates highlight a poor transmission of monetary policy. However, deposit interest rates fell (7.7 versus 8.7% the previous year). This decline is somehow explained by the Central Bank interventions which supplied liquidity to the banking sector leading banks to have access to less expensive resources, which resulted in lower liquidity rates (3.1% versus 3.4% in 2015). As in 2015, banks faced liquidity problems<sup>9</sup> although the banking sector has sufficient prudential liquidity ratios.

Recent interest rate developments are therefore more related to banks liquidity needs and the financing of the Government's budget deficit. The increase in lending rates has had an effect on the level of overdue loans rate in the banking sector<sup>10</sup>.

**Table 6: Inflation Rates and Interest Rates**

	2010	2011	2012	2013	2014	2015	2016
Inflation	6.5	9.6	18.2	7.9	4.4	5.6	5.5
Overnight Facility rate	11.3	14.3	13.8	12.5	8.0	12.4	8.6
Interbank rates			12.29	9.48	7.5	7.5	3.3
Liquidity supply rate	-	13.3	-	-	-	3.4	3.1
Deposit rate	7.3	7.6	8.8	9.0	8.8	8.7	7.7
Lending rate	15.9	15.3	15.7	16.2	16.7	16.1	16.5

Source : BRB

### 1.2.1.3 Public Finances

The risk of budget deficit deepening has been identified as the greatest risk for financial stability. The difficulties for banks following the worsening of the budget deficit could come from two channels: (i) increase of the exposure (direct and indirect) of the banks towards

the Government and, (ii) crowding out effect of the private sector.

In the absence of an improvement in the public expenditure situation (22.4% of GDP in 2016 and in 2015) and in the presence of public revenue shortage (15.9% in 2016 against 16.5% of GDP in 2015) the budget deficit increased to 6.5% in 2016 against 7.8% of GDP in 2015. This

<sup>8</sup> Alexis NKUNZIMANA(2013), Les déterminants des taux d'intérêts débiteurs au Burundi, BRB

<sup>9</sup> From monetary policy point of view, banking liquidity corresponds to commercial banks reserves at the Central Bank net of its interventions on the money market.

<sup>10</sup>NTWENGUYE Roger Guy (2013), Etude des facteurs explicatifs des prêts non performants dans le secteur bancaire du Burundi, BRB.

decrease in government revenue was due, among other things, to the continued decline in donations (2.5% in 2016 compared to 3.0% of GDP in 2015).

Burundi has moved away from the EAC convergence criteria as well as Kenya and to a lesser extent Uganda and Tanzania.

**Table 7: Budget deficit in the EAC countries 2016.**

Country criteria	Budget deficit ( $\leq 3\%$ of GDP)			
	2014	2015	2016	2017(p)
Burundi*	4.3*	7.8*	6.5	8.3
Kenya	7.5	8.4	7.4	6.5
Ouganda	3.5	2.9	4.7	4.3
Rwanda	3.5	2.8	3.0	2.8
Tanzania	3.7	3.5	4.0	4.3

Source: \*BRB, Bulletin Mensuel, December 2016; IMF, Regional Economic Outlook, October 2016

The budget deficit increase has led to an increase rely on domestic debt. The ratio of

public debt to GDP increased to 44.1% in 2016 from 39.5% in 2015.

**Table 8: Public Debt in EAC Countries 2016.**

Country criteria	Total public debt				External public debt				Domestic public debt			
	Domestic public debt				2014	2015	2016	2017(p)	2014	2015	2016	2017(p)
	2014	2015	2016	2017(p)								
Burundi	33.9	39.5	44.1	57.1	19	15.5	15.2	26.9	14.9	24.0	28.9	30.2
Kenya	46.7	51.3	52.7	54.7	23.1	26.6	29.1	27.7	23.6	24.7	23.6	27.0
Ouganda	31.2	34.4	36.5	40.1	14.1	19.9	21.9	25.4	17.1	14.5	14.6	14.7
Rwanda	31.1	37.3	44.2	41.4	22.3	26.9	35.8	40.0	8.8	10.4	8.4	1.4
Tanzanie	33.8	36.5	38.3	40.3	23.6	27.1	29.4	30.3	10.2	9.4	8.9	10.0

Source: IMF, Regional Economic Outlook, April 2017.

The increase in domestic indebtedness has been demonstrated by the increase in the outstanding government securities in banks total assets. The outstanding Treasury bills and bonds increased from 253.7 billion in 2015

to 438.1 billion BIF in 2016, i.e. an increase of 72.7%, while loans to the private sector decreased by 1.3%. This reflects an increase in the exposure of banks vis-à-vis to the Government.

**Table 9: Treasury securities and loans the private sector in banks total assets**

	2010	2011	2012	2013	2014	2015	2016
Total Assets (Millions of BIF)	840 548.9	936 748.2	1 044 684.1	1 218 016.8	1 400 638.4	1 441 542.4	1 834 956.6
Treasury securities(MBIF)	109 938.3	85 318.2	49 858.1	109 019.9	147 702.7	253 788.1	438 167.9
Treasury securities in % total asset	13.1	9.1	4.8	9.0	10.5	17.6	23.9
Change in treasury securities share (%)		-30.4	-47.6	87.5	17.8	66.9	72.7
Loans to the private sector (MBIF)	394 556.4	535 251.2	607 741.7	645 360.9	702 640.6	673 746.6	792 831.8
Loans to the private sector in % the total asset	46.9	57.1	58.2	53.0	50.2	46.7	43.2
Change in loans to the private sector share (%)		21.7	1.8	-8.9	-5.3	-6.8	17.7
Other assets (MBIF)	91 657.7	93 665.1	104 332.0	137 109.1	142 777.2	139 767.3	346 870.9
Other Assets in % of total asset	10.9	10.0	10.0	11.3	10.2	9.7	18.9
Change in total asset in %		11.4	11.5	16.6	15.0	2.9	27.3

Source: BRB

The direct exposure of the banking sector to state-owned companies is limited considering the share of loans granted to them, which amounted to 0.9% of the loans portfolio at the end of 2016. However, a risk to Financial stability has emerged from the increase in indirect exposure to companies in transaction with

the public sector. Indeed, the increase in the budget deficit is likely to hinder the recovery of the Government debts to these companies. These companies operate mainly in sectors with high default rate such as coffee (32.0%), hotels and tourism (29.2%), other construction (26.0%) and small equipment (24.7%).

**Table 10: Evolution of Nonperforming loan rates by sector**

	dec-14	mar-15	jun-15	sept-15	dec-15	mar-16	jun-16	sept-16	dec-16
Housing		2.3	9.0	9	8.5	9.5	12.5	12.9	10.2
Other constructions		4.2	9.2	9.2	34.3	24.8	27.0	31.5	26.3
Manufacturing		2.5	4.1	4.1	15.5	13.2	15.4	14.4	14.1
Trade		16.1	16.2	16.2	19.4	22.6	20.0	23.6	15.3
Tourism		6.7	12.0	12	35.4	37.2	38.1	37.2	29.9
Agriculture		7.7	43.5	43.5	27.5	23.8	28.3	24.7	8.9
Craft		0	0.1	0.1	23.0	16.0	2.7	17.8	11.2
Small Equipment		10.1	11.9	11.9	27.5	38.2	36.3	34.7	24.7
Coffee		60.5	17.3	17.3	22.6	55.8	35.1	12.8	32.0
Other products		0.3	1.1	1.1	1.8	19.5	1.4	0.8	0.1
Others		30.6	31.9	31.9	7.3	10.4	9.7	10.5	6.5

Source: BRB



The share of these sectors in the banks' portfolio represents 50.7% at the end of 2016. The stress test showed that the banking sector is relatively resilient to basic shocks, but that more severe shocks, particularly for those related to the fragility of public finances, would have negative consequences on the loans portfolio of banks with exposure in the sectors listed above. Non-repayment in these sectors would lead to a significant decrease in the banks' equity, up to the amount of the provisions made to cover these overdue loans.

However, the banking sector would remain resilient since the capital adequacy ratio (22.3%) would remain above the regulatory threshold (14.5%).

Besides to the increase in the financing of the budget deficit by banks, the share of the banking sector's loans to the private sector fell to 43.2% in 2016 compared to 46.7% in 2015. The banks' preference for financing the Government has therefore caused a crowding out of the private sector.

### 1.2.2. Situation of households and enterprises

The indebtedness of households and enterprises and their ability to reimburse are important indicators for analyzing the stability of the financial system. During 2016, the debt of private enterprises over the GDP decreased to 6.4% against 7.6% in 2015. This reversion is consistent with the decline in loans to the private sector. The private enterprises debt is largely made by of commercial loans, which is 28.4% of the total amount of loans to enterprises. The other major components of private enterprise debt are loans to manufacturing (12.0%), hotels and tourism (7.0%), other constructions (3.7%) and coffee loans accounts for 1.1% of the overall amount of loans to enterprises. For state-owned companies, their indebtedness in relation to GDP remains very low; it remained at 0.1% as in 2015.

**Table 11: Debt of enterprises and households as a percentage of GDP**

	Household Debt	Private Companies Debt	State-owned Companies Debt
2010	8.7	6.4	0.3
2011	11.1	7.1	0.1
2012	10.3	7.0	0.2
2013	8.1	8.1	0.2
2014	7.2	8.0	0.2
2015	7.5	7.6	0.1
2016	7.9	6.4	0.1

Source : BRB, *Bulletins mensuels*, December 2016.

Household debt as a percentage of GDP slightly increased to 7.9 against 7.5% in 2015. Household debt is largely comprised of housing loans (24.7%), agricultural loans (6.7%), small equipment (6.1%) and others (53.3%).

The level of indebtedness of non-financial enterprises has an effect on the quality of the banking sector's portfolio. In 2016, overdue loans in sectors mainly financed by the banking

sector were 32.0% in the coffee sector, 29.9% in the hotel and tourism sector, 26.3% in other constructions and 15.3% in trade sector.

Overdue loans also declined in sectors where households ask for loans. They were 24.7% in small equipment, 8.9% in agriculture, 10.2% in housing and 6.5% in others. Regarding net debt, households' position is short of 51 209.4 MBIF in 2016.

**Table 12: Net Debt of Households and Enterprises in MBIF**

	Households Deposits	Households Loans	Households Net debt	Enterprises Deposits	Enterprises Loans	Enterprises Net debt	State-owned Enterprises Deposits	State-Owned Enterprises Loans	State-Owned Enterprises
2010	160 142.2	8 249.2	126 767.0	126.3	6.5	-72 848.3	35 000.4	8 249.2	26 751.2
2011	201 511.6	3 759.6	157 829.8	127.7	2.4	-109 691.1	44 638.1	3 759.6	40 878.5
2012	236 523.4	6 539.6	185 430.9	127.6	3.5	-130 851.3	40 162.4	6 539.6	33 622.8
2013	308 401.4	8 143.6	223 415.7	138.0	3.6	-193 460.2	46 879.4	8 143.6	38 735.8
2014	352 554.6	10 504.7	231 350.8	152.4	4.5	-202 228.7	31 773.3	10 504.7	21 268.6
2015	338 720.1	6 399.0	240 219.0	141.0	2.7	-155 460.6	44 116.7	6 399.0	37 717.7
2016	303 347.7	7 035.4	265 744.0	114.2	2.6	-50 544.6	40 457.4	7 035.4	33 422.0

Source : BRB, Bulletin mensuel, december 2016

For private companies, the net debt in 2016 remained negative and their position remained short of 50 544 MBIF. However, for state-

owned enterprises the net debt generates a savings surplus of 33 422.0 MBIF.

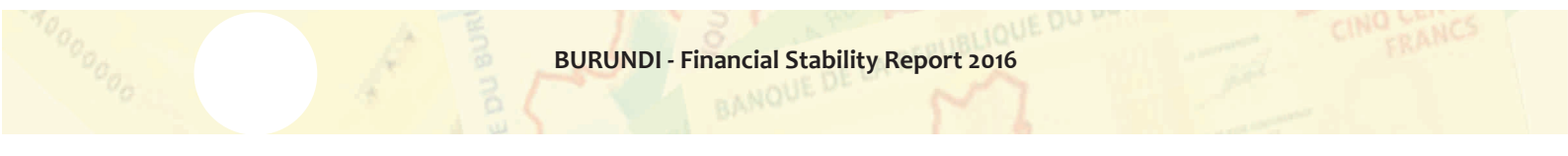
**Table 13: Enterprises Indebtedness over equity in MBIF**

Year	Enterprises Debt	State-owned Enterprises Debt	Equity ( E)	Enterprises Debt/ E	State-owned Enterprises Debt/ E
2010	160 142.2	8 249.2	126 767.0	126.3	6.5
2011	201 511.6	3 759.6	157 829.8	127.7	2.4
2012	236 523.4	6 539.6	185 430.9	127.6	3.5
2013	308 401.4	8 143.6	223 415.7	138.0	3.6
2014	352 554.6	10 504.7	231 350.8	152.4	4.5
2015	338 720.1	6 399.0	240 219.0	141.0	2.7
2016	303 347.7	7 035.4	265 744.0	114.2	2.6

Source : BRB, Bulletin mensuel, december 2016

Compared with total banking sector equity, the share of private enterprises debt decreased to 114.2 from 141.0% in 2015. This decrease is mainly due to the decline in loans

to the private sector. For state-owned enterprises, their indebtedness compared to equity slightly decreased at 2.6 from 2.7% in 2015.



# 2

## CHAPTER 2: FINANCIAL SYSTEM



The financial system stability and efficiency require the resilience and soundness of all its components. For 2016, the financial system remained resilient but faced significant challenges.

On one hand, it has faced exogenous challenges arising from global and regional developments, such as falling commodity prices, the US dollar appreciation, weak worldwide growth and drought. These adverse effects of the economic environment have spread to the financial sphere via the credit risk, liquidity risk and market risk channels to a lesser extent.

On the other hand, the financial system is exposed to a deterioration of the banks and microfinance institutions portfolio quality, as a result of a fragile domestic economic environment. Despite the decline in the size of the economic downturn in 2016, the financial sector has not yet fully recovered from previous year shocks and the level of overdue loans remains a concern. The vulnerabilities of banks and microfinance institutions could increase in the short term regarding the migration from performing loans to non-performing loans.

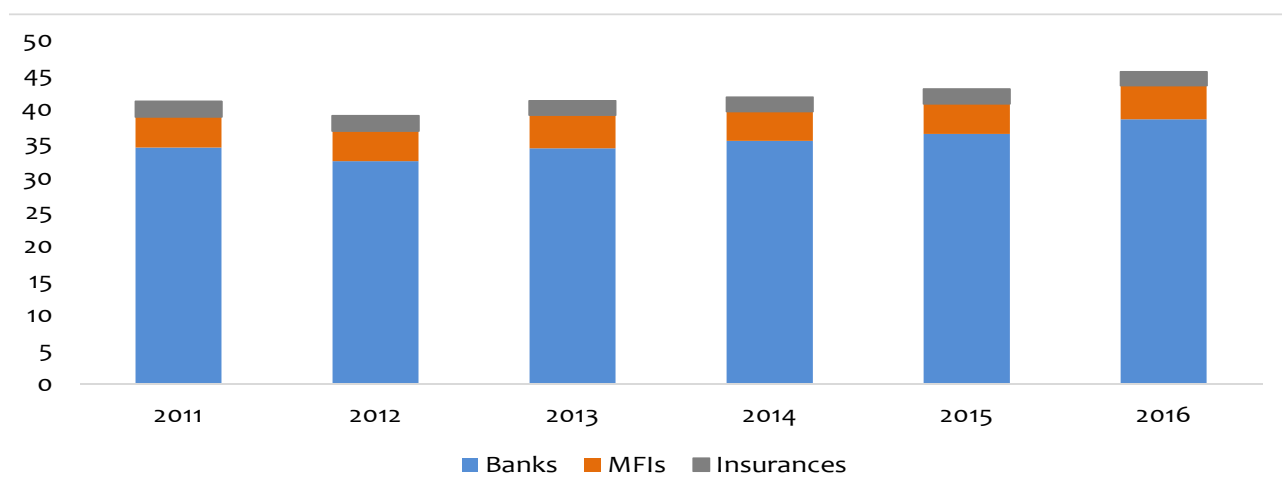
## 2.1. Structure of the financial system

Burundi's financial system is composed of four types of financial institutions, namely, microfinance institutions, insurance companies, social welfare institutions and banking sector. Financial intermediation has slowly increased in recent years with financial assets representing 38.6% of GDP in 2016 compared to 36.4% in 2015 (Chart 3).

The banking sector is the main component of the financial system with an average share over the last 5 years (measured as a percentage of assets) of 85% compared to microfinance (11%) and insurance companies (5%)<sup>11</sup>. It is important to note that data on social welfare institutions are not available.

In 2016, the banking sector comprises 12 institutions including 10 banks and 2 financial institutions. Microfinance has increased since 2011 from 21 to 33 in 2016. As for the insurance sector, it has 7 companies against 6 in 2015.

<sup>11</sup> Statistics for social safety net Institutions are not available.

**Chart 3: Financial System Structure (Assets / GDP)**

Source: BRB

## 2.2. Banking sector

Despite difficult economic environment, the banking sector has managed to show resilience and maintain its financial soundness following the prudential measures taken by the Central Bank. The increase of the regulatory capital adequacy ratio (from 12.5% to 14.5%), the introduction of the 2.5% capital buffer and the requirement for some banks to increase their

equity, has allowed strengthening the banking sector resilience to macroeconomic shocks.

The banking sector continues to display positive profitability and a good prudential liquidity level.

However, the non-performing loans level is relatively high (14.1%) compared to other EAC countries and the 5% benchmark in the region.

**Table 14: Non-performing loans in the region**

	2015	2016
Burundi	17.9	14.1
Kenya	6	11.7
Ouganda	5.1	10.4
Rwanda	6.3	7.6
Tanzania	8.6	8.2

Source : IMF/FSI

The banking sector loans to the economy represent only 16.7% of GDP in 2016 compared to 16.8% in 2015, a decrease of 0.1 percentage point. Loans are concentrated in the trade sector with more than 55% of total loans.

Loans granted by banks are generally short-term, i.e. 60% of total loans, while medium-term and long-term loans represent respectively 25% and 15% in 2016. Due to a low level of cross-border operations between domestic and foreign banks, the contagion risks for the sector are low.

### 2.2.1. Banking sector structure

The banks' total assets reached 1,834.9 billion BIF in 2016 compared to 1,521.8 billion BIF in 2015. Private domestic banks represent 41.9% (or 14.1% of GDP) of total assets versus 25.7% for foreign banks (8.7% of GDP) and 32.4% (10.9% of GDP) for public banks.

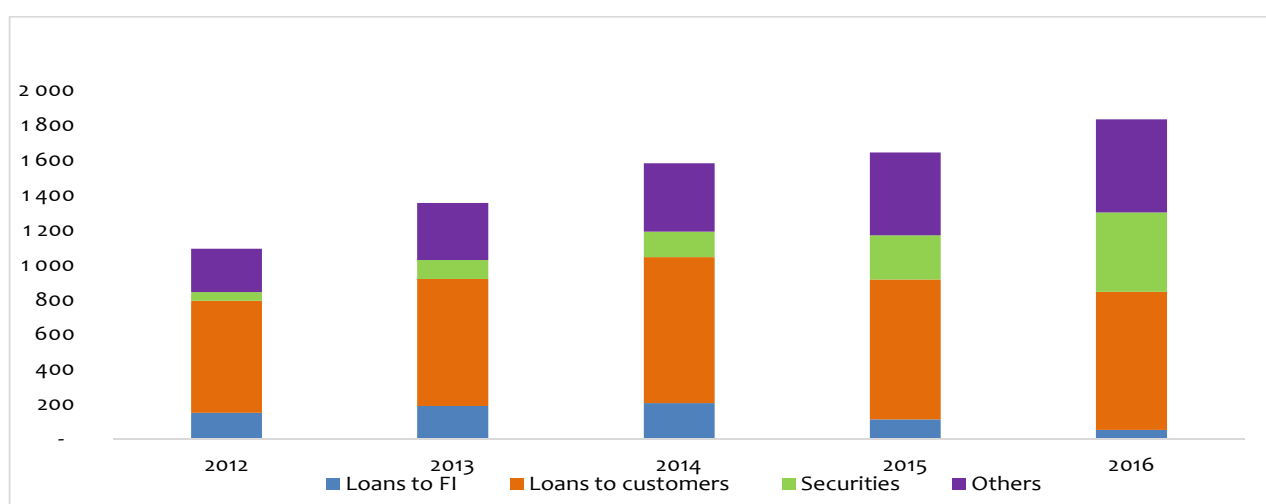
The banking sector is dominated by three systemically important banks that share more than 55% of assets, 50.7% of loans and 67% of deposits in the sector. These banks are exposed to the risk of an increase in the budget deficit in relation to the loans allocated

to companies supplying goods and services to the public administration as well as the risk of concentration on large debtors. The December 2016 stress test showed that systemically important banks remain resilient to shocks.

#### A. Banks' Assets

Over the last five years, the majority of assets are made of loans. The share of loans in total assets decreased to 43.2% from 55% in 2015. This decline is due to the increase in credit risk which led banks to favor investments in Treasury securities that are less risky.

**Chart 4: Bank Asset Structure (Billions of BIF)**



Source: BRB

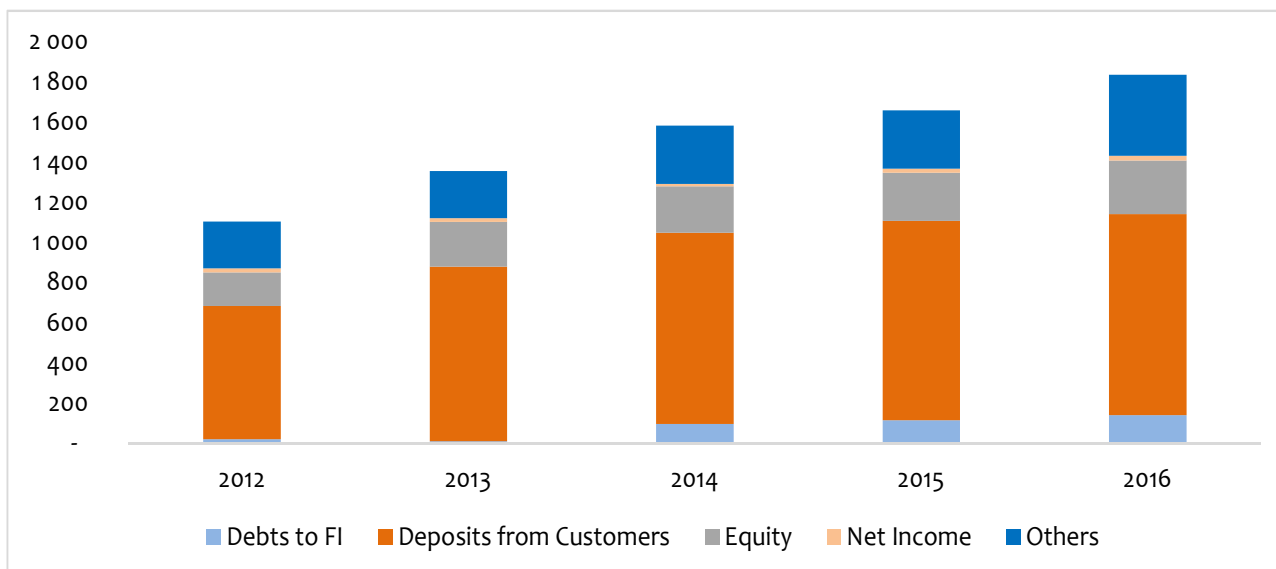
#### B. Banks Liabilities

Deposits are the main component of banks' resources accounting for 64.7% of total resources in 2016 compared to 60.4% in 2015.

Demand deposits represent 67.5% compared to 32.5% for term deposits.



**Chart 5: Evolution of the Banks' Resources Structure (Billions of BIF)**



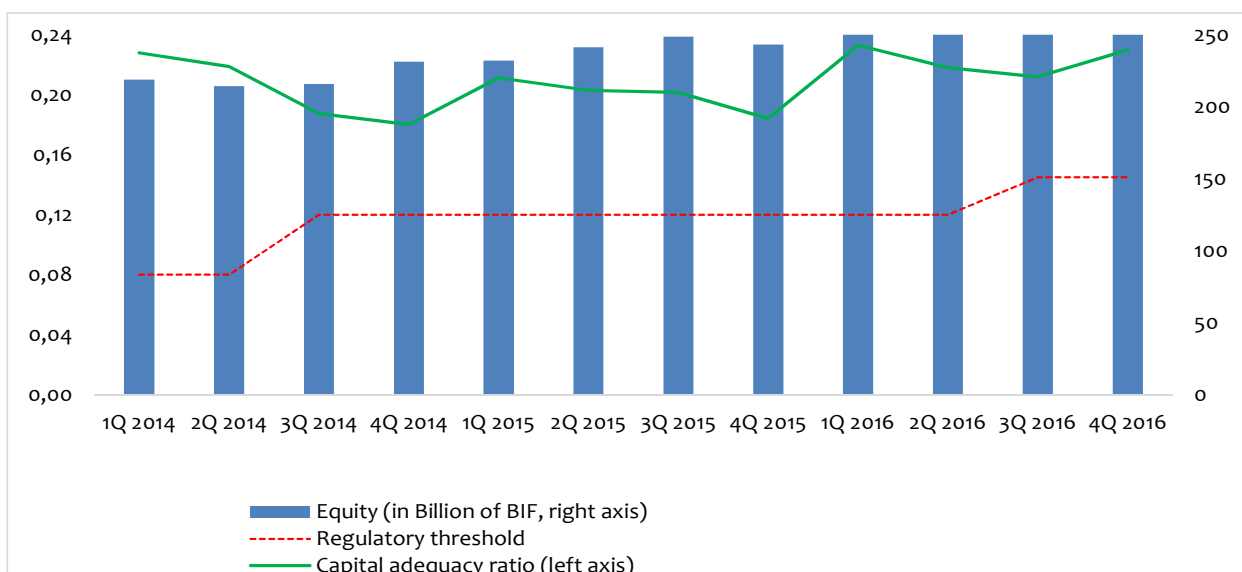
Source : BRB

### 2.2.2. Capital Adequacy

The banking sector is well capitalized and has sufficient capital in respect of the capital adequacy regulatory threshold. The total capital adequacy ratio was 23% at the end of December 2016 above the regulatory threshold of 14.5%. On a year to year basis, capital rose from 240 219 to 265 744 MBIF, an

increase of 10.0%, exceeding the inflation rate of 5.5% for the same period. In accordance with the Central Bank instructions some banks had to strengthen their equity by reinvesting a part of the result.

**Chart 6: Change in equity**

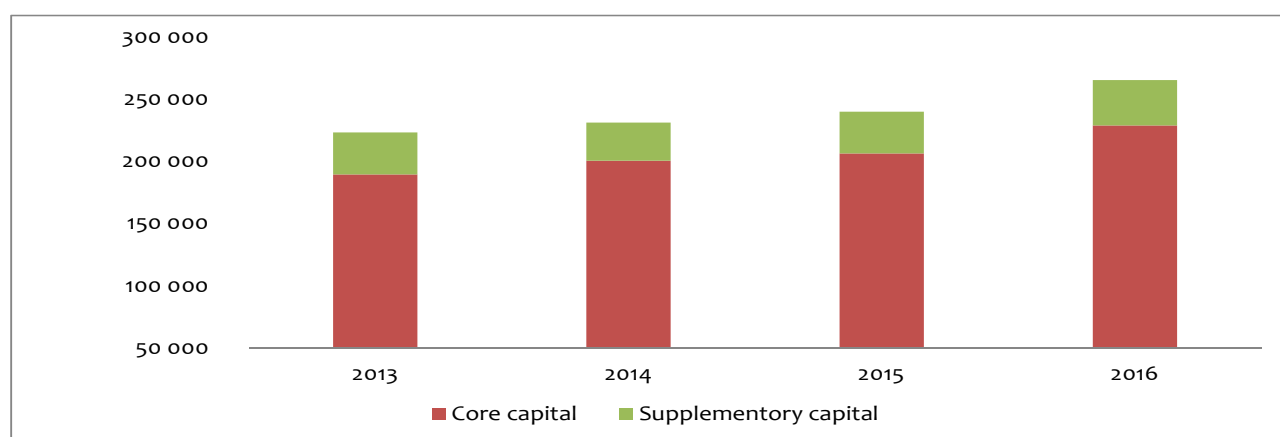


Source : BRB

Since 1st July 2016 and according to the Central Bank regulations, the total capital adequacy ratio threshold has increased from 12 to 14.5%. In addition, the banks were instructed to constitute from this period a capital buffer. The strengthening of equity enabled also the leverage ratio to remain at a good level (14.4%) compared to the minimum of 3% recommended by the Basel Committee on Banking Supervision (BCBS) and the threshold of 7% fixed by the BRB.

The composition of banks' equity is of high quality. Composed largely by paid-up capital and reserves and these elements have improved since 2014 to comply with Basel III requirements. Thus, the components of core capital (capital and reserves) and supplementary capital (quasi-capital) are those stated in Basel III.

**Chart 7: Composition of equity (MBIF)**



Source : BRB

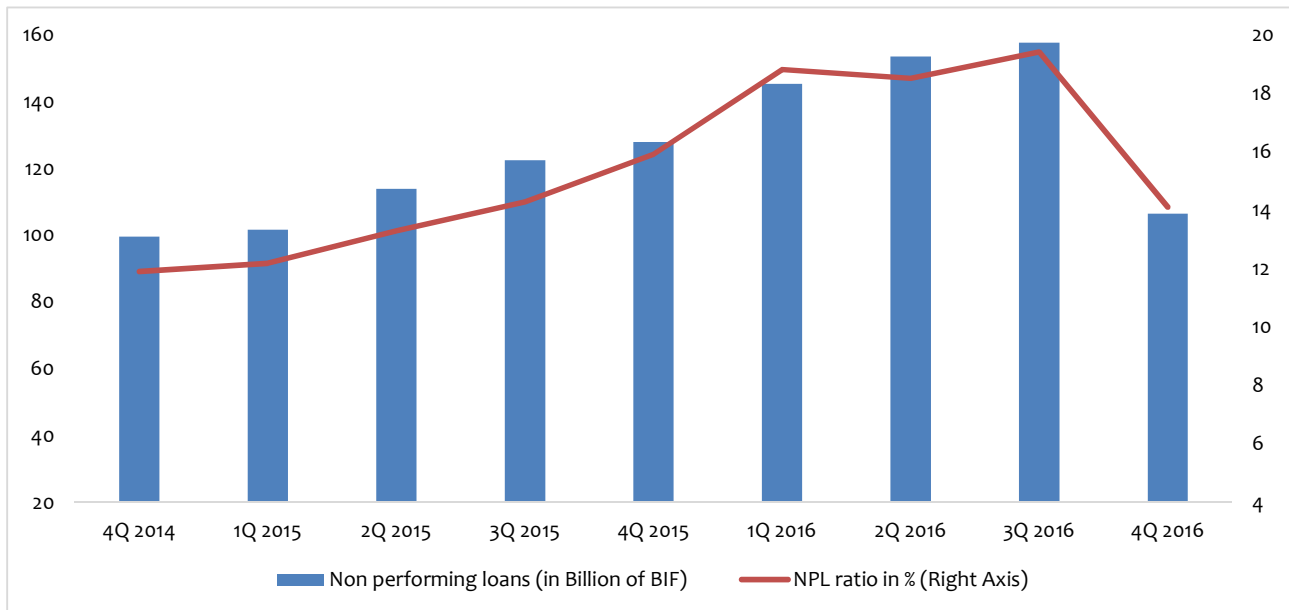
The increase of total equity should permit banks to resist any possible assets quality deterioration.

### 2.2.3. Quality of the loan portfolio

The quality of the loan portfolio deteriorated during in 2016 which poses a significant challenge to the stability of the financial system. It is for this reason that a write-off measure of loss loans was introduced in the 2017 budgetary law and the BRB issued an instruction to apply this measure.

The write-off was applied to the financial statements for the year ended December 31, 2016 which improved most of the portfolio quality indicators including the overdue loans rate, the non-performing loans rate and the provisioning rate. On a year to year basis, the non-performing loans ratio was 14.1% at the end of December 2016 compared to 17.9% at the end of December 2015. The default rate decreased from 18.3% at the end of 2015 to 17.5% at the end of 2016 while the provisioning rate was 79.7% compared to 67.3% at the end of December 2015.

**Chart 8: Non Performing Loans**

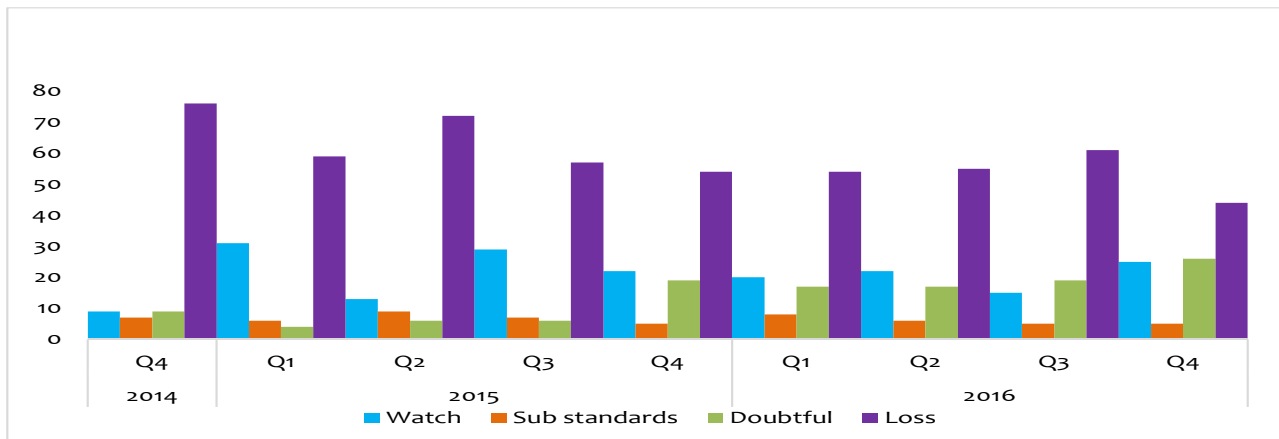


Source : BRB.

Compared to the end of December 2015 the amount overdue loans declined up to 11.8%. This decrease is due to the cleaning up of banks’ balance sheets following the write-off of loss loans that are unpaid for more than 24 months. As a result of this measure, at the end

of December 2016, the sectors with high non-performing loan rates are hotels and tourism (29.9%), construction (26.3%), small equipment (24.7%), trade (15.3%) and manufacturing (14.1%).

**Chart 9: Overdue Loans Structure**

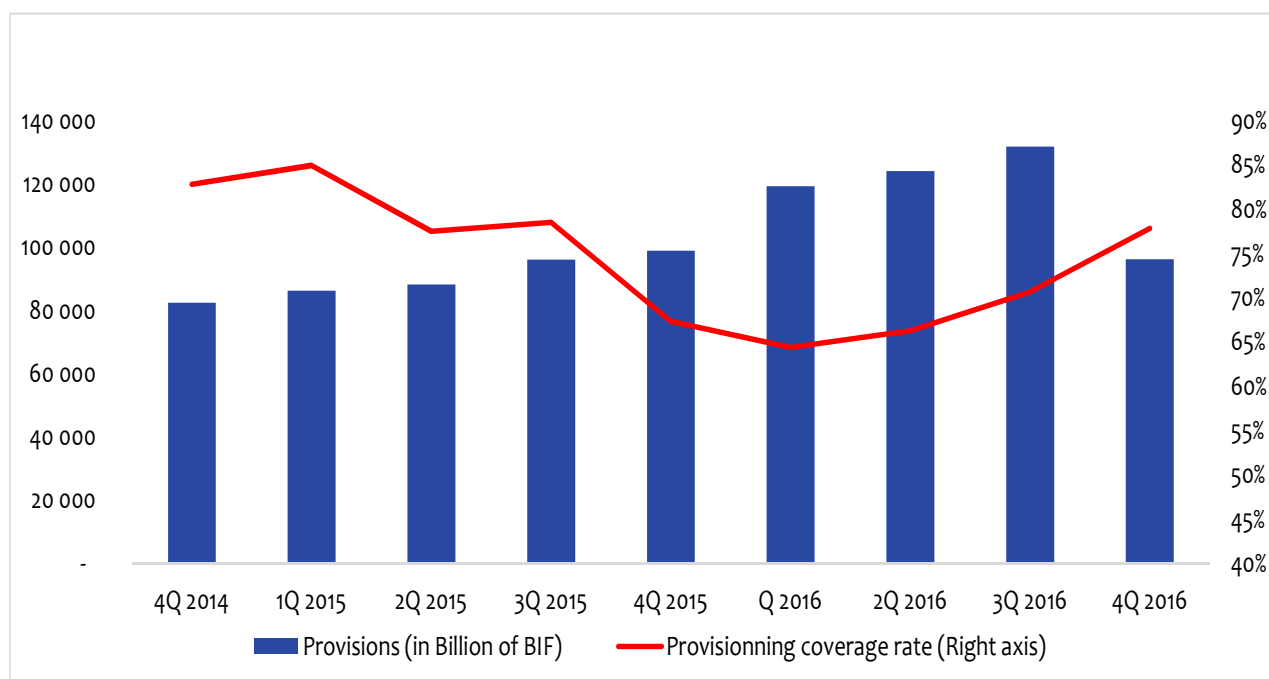


Source : BRB

The composition overdue loans analysis reveals that the level of watch loans (which is a key indicator of the future deterioration of the loan portfolio) remains high despite a slight decrease between 2016 and 2015. These

have been 32 132 MBIF in 2016 compared with 39 083 MBIF in 2015. The banking sector was cautious in setting up 79.7% of overdue loans at the end of December 2016 compared with 67.3% at the end of December 2015.

Graph 10: Evolution of the provisioning rate



Source : BRB

#### 2.2.4. Liquidity

Globally, the banking sector displayed throughout 2016 sufficient liquidity<sup>12</sup> ratios vis-à-vis to the regulatory standard of 20%.

The overall liquidity ratio reached 64% in 2016 against 53% in 2015, an increase of 11%.

This increase is due to the Treasury bills and bonds growth in the banks' portfolio.

Table 15: Evolution of Banks' Liquidity Ratio

	T1-2016	T2-2016	T3-2016	T4-2016
Liquidity Ratio in BIF	42 %	44 %	49 %	55 %
Liquidity Ratio in foreign currency	99 %	122 %	126 %	128 %
Global Liquidity Ratio	52 %	55 %	58 %	64 %

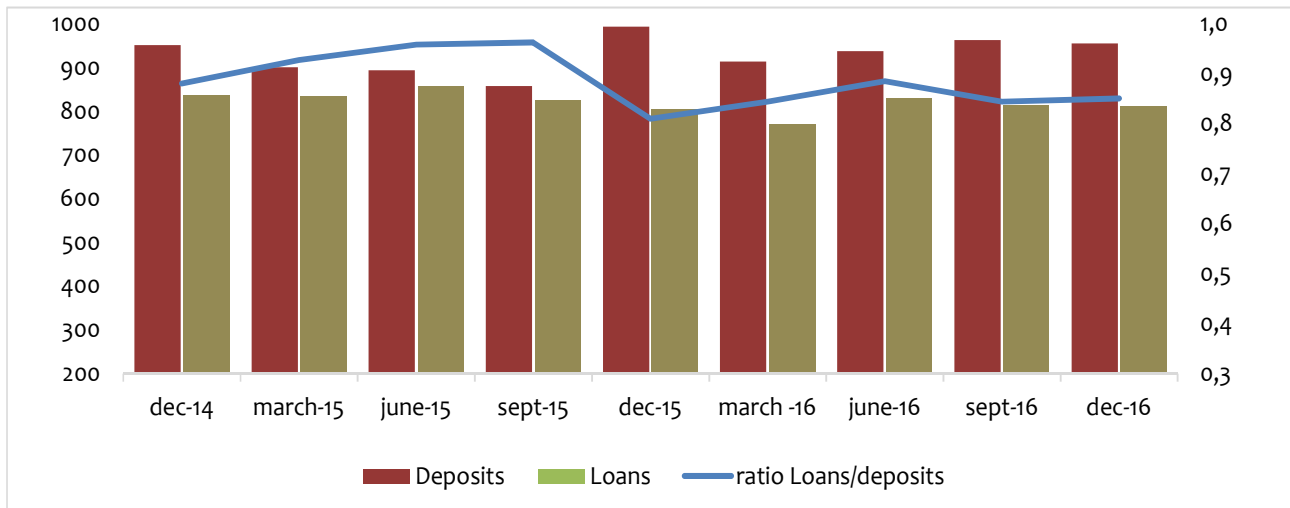
Source : BRB

For the lending activity, banks still maintain a comfortable margin compared to deposits,

with a loans-to-deposits ratio of 79% at the end of 2016.

<sup>12</sup> From prudential point of view, the liquidity ratio is given by liquid assets over total deposits while from the monetary point of view, the banking liquidity corresponds to commercial banks reserves at the Central Bank net of its interventions on the money market

Graph 11: Evolution of the loans / deposits ratio



Source : BRB

Despite this overall high liquidity ratio, some banks had to use to the interbank market and refinancing from the Central Bank. The latter, following the prevailing economic environment has relaxed the refinancing eligibility conditions to allow the banking sector to cope with liquidity shortage. The results of the stress test revealed that the liquidity of some banks would deplete during a 5-day distress period assuming a daily withdrawal rate of 15% for demand deposits and 3% for term deposits

Compared with December 2015, the results show that at the end of December 2016, banks were more sensitive to liquidity risk.

### 2.2.5. Market risk

The financial sector is weakly exposed to market risk because Burundi does not yet have a financial market on which financial products

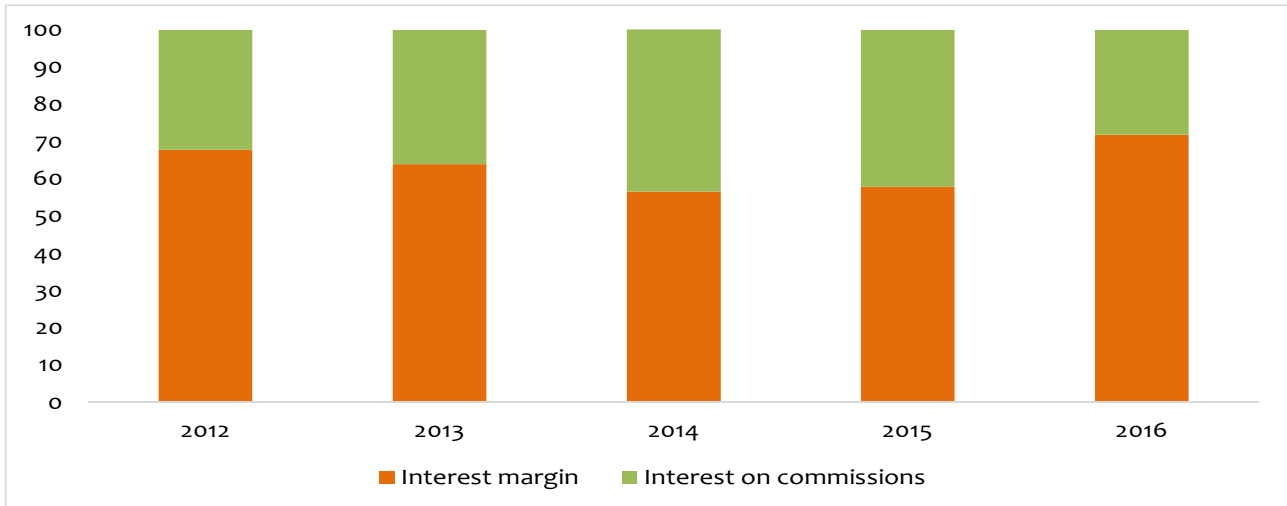
can be traded. Treasury securities in the banks' portfolio are held-to-maturity securities and are therefore not subject to price changes.

### 2.2.6. Profitability of the banking sector

Despite a difficult economic environment inherited from 2015 the banking sector has maintained its profitability. The net banking income (NBI) of the sector comes mainly from the interest margin with 72% against 28% of the margin on commissions.

In 2016, the relative share of the interest margin increased by 14 basis points while margin on commissions declined by the same amount. However, net banking income fell by 9.5%. This decline is explained by the risk aversion of banking sector to face the gradual deterioration of its loan portfolio.

Chart 12: Net Banking Income Structure in Percentage

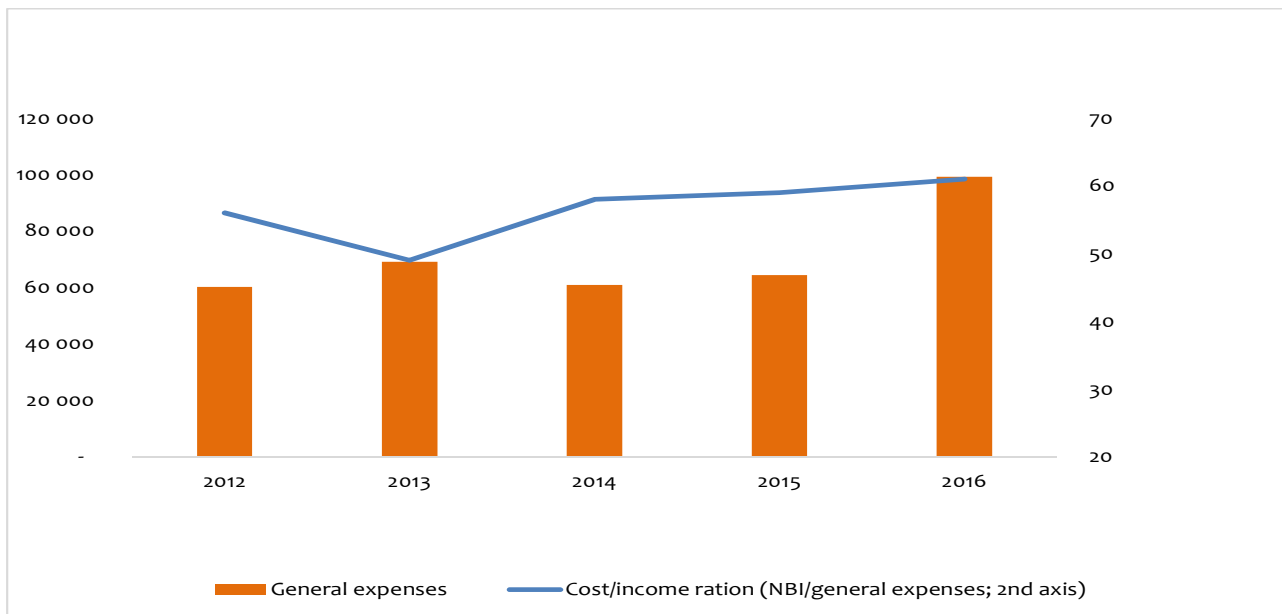


Source : BRB

In the banking sector, general expenses have an upward trend since 2014 following a relative increase in operating expenses which has led to a slight increase in the cost / income ratio

to almost 60% of net banking income ( see chart 13). This increase in general expenses negatively affected the sector’s income which decreased by 12.7% between 2015 and 2016.

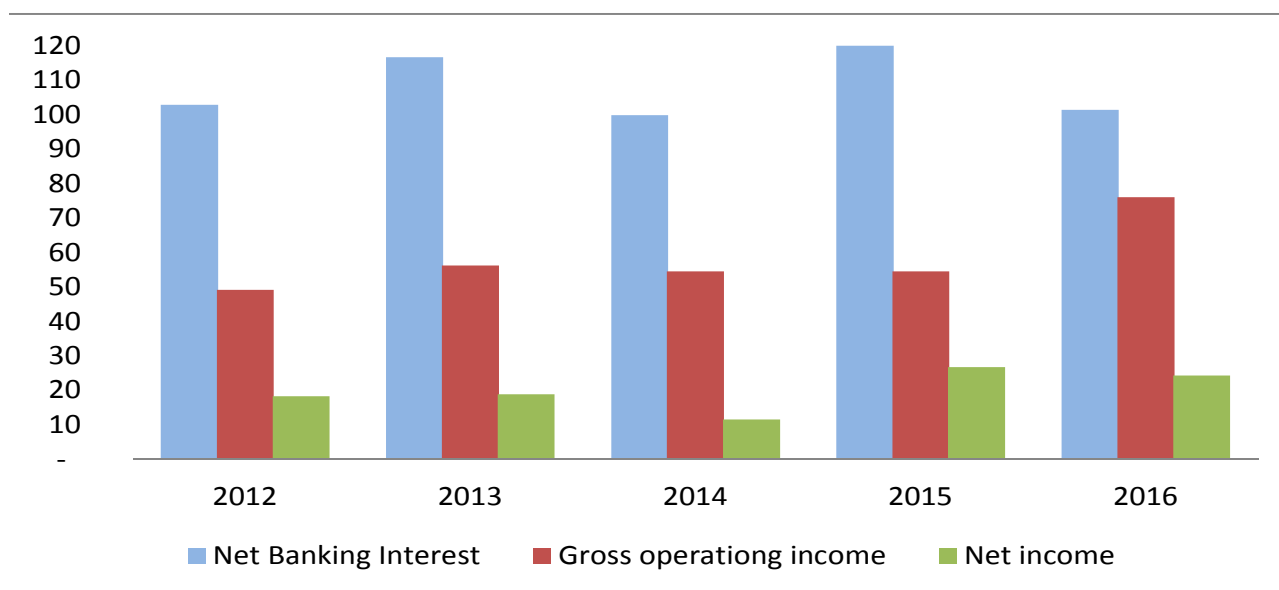
Chart 13: Change in general expenses and cost / income ratio



Source : BRB

Compared to the previous year, the banks net profit fell by 10.3%, from BIF 26.8 billion at the end of December 2015 to BIF 24.3 billion at the

end of December 2016. Return on assets (ROA) was 1.3% and the Return On Equity (ROE) was 8.8%.

**Graph 14: Evolution of Banks intermediate operating balances**

Source : BRB

### 2.2.7. Stress tests

The Banque de la République du Burundi has conducted stress tests to assess the resilience of the banking sector to the systemic risks facing the sector. Severe but plausible shocks are applied to the selected variables until the banks no longer meet the prudential standard of the capital adequacy ratio (14.5%, regulatory threshold). The data used are of 2016 year and the simulation assumptions are based on an analysis of the evolution of the Burundian economy over the last decade, 2006-2016.

Several macroeconomic assumptions were selected based on the analysis of the macro-financial environment and growth prospects. Considering the systemic risks related to the deterioration of macroeconomic indicators (increase of budget deficit, national currency depreciation, decline in coffee and tea production), the simulations assessed the impact of further deteriorations on banks equity.

The post-shock capital adequacy ratio is the main measure of bank resilience, while the change in non-performing loans is the major measure of credit risk. The stress test conducted in December 2016 focused on the two main potential sources of vulnerability for the banking sector, namely, credit and liquidity risks.

#### A. Stress test on credit risk

In December 2016, regarding credit risk, two scenarios were carried out:

(A) In the first scenario, a further deterioration of the loans portfolio was simulated in economic sectors exposed to the four risks mentioned above. These are the trade sector (+ 17%), small equipment (+ 8%), agriculture (+ 20%) and construction (+ 25%). The shocks used for the simulation correspond to the risks that have been identified.

Globally, the results showed that all sectors remain resilient to severe shocks.

(B) The second scenario focused on concentration risk in banks. The later assessed the commercial banks resilience to the default of their 5 largest debtors. This scenario assumed that 50% of loans of the 5 major debtors of each bank are reclassified as loss loans and assessed the impact on the banks' capital and capacities to hedge the risk. The results of this test showed that banks remain resilient to this shock. However, it is paramount to regularly monitor the evolution of major risks in accordance with Circular No. 6/2014 on the division of credit risks in banks.

### **B. Stress test on liquidity risk**

The indicators showed that banks liquidity risk remained stable. Banks have adequate liquid assets to finance short- and medium-term activities in a period of liquidity stress. The liquidity stress test consisted of determining the impact of a sudden and massive withdrawal of customer deposits.

Banks' resilience to liquidity risk is judged by their ability to withstand this shock without resorting to external liquidity in a 5-day period. This test does not take into account assumptions about the extension of maturity and possible use of external liquidity (for example the refinancing of the BRB).

The results revealed that the liquidity some banks would deplete during a 5-day distress period, assuming a daily withdrawal rate of 15% for demand deposits and 3% for term deposits.

Compared to December 2015, the results showed that at the end of December 2016, banks were more sensitive to liquidity risk than the previous year.

## **2.3 Microfinance sector**

The microfinance sector holds 11% of the total assets of the financial sector. This is a profitable sector despite the challenges encountered in 2016. It also has a positive impact on financial inclusion.

### **2.3.1 Structure of the sector**

The microfinance sector comprises 33 licensed MFIs, including 15 savings and credit cooperatives (first category), 17 microfinance companies (second category) and one micro credit program (third category) with 30 MFIs that are operational. Also, a cooperative dominates alone the market with 35% of deposits and 40% of loans and is established throughout the country. The number of branches of Microfinance Institutions increased from 205 in 2013 to 265 in 2016 which improves access to financial services.

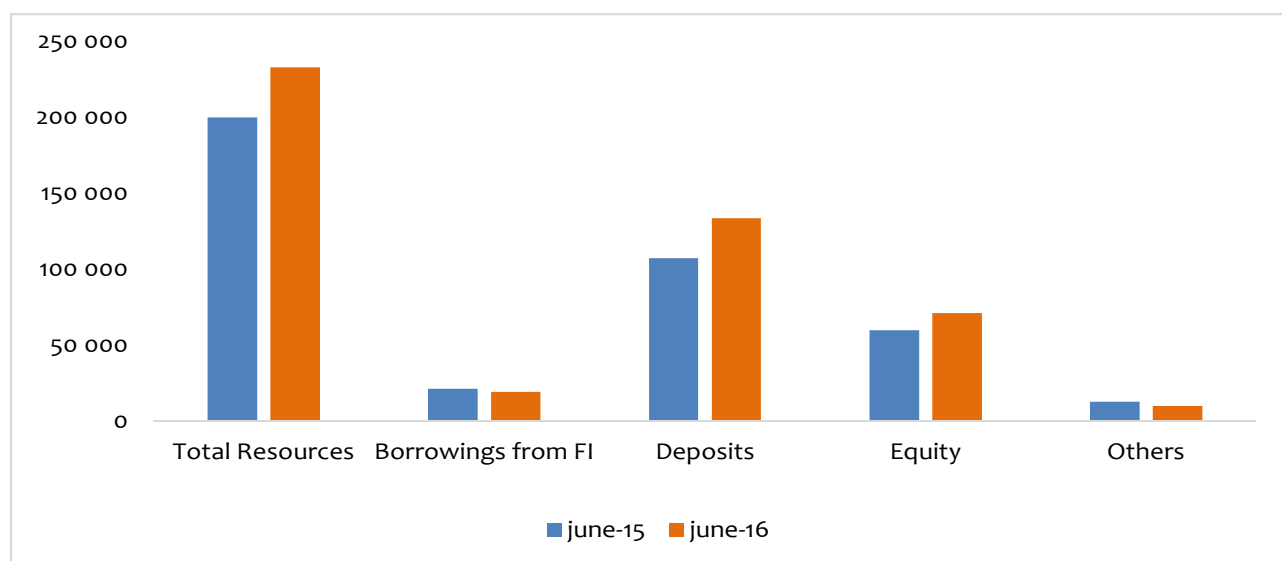
The microfinance sector total asset is 232 770.5 MBIF in 2016 of which 199 254.8 MBIF (86%) for MFIs in the first category and 33 515.6 MBIF (14%) for MFIs in the second category. There is a high concentration in this sector with 79% of the assets held by four MFIs.

### **2.3.2. Resources**

The resources of the MFIs have improved from 199 800 MBIF in 2015 to 232 770 MBIF in 2016. This change is mainly related to a growth of deposits which amounted to 133 159.60 MBIF in 2016 against 106 895.20 MBIF in 2015 (an increase of 24.5%) and a capital increase from 59 548.6 MBIF in June 2015 to 70 919.4 MBIF in June 2016.



Chart 15: Distribution of MFI resources in 2015 and 2016



Source : BRB

The resources of MFIs are limited and do not allow them to provide sufficient loans. To supplement these resources, MFIs use the banks that finance them at high rates compared to the interbank market. In recent years, the sector's capital has increased from 54 942.1 MBIF in 2013 to 70 919.4 MBIF in 2016.

According to the decree<sup>13</sup> regulating microfinance activities in Burundi, MFIs have the obligation to make reserves of 20% of net

profit to be allocated to equity without any limitation of duration or amount. In 2016, MFIs meet this regulatory requirement.

### 2.3.3. Assets

Assets increased by 17% from 2015 to 2016 in connection with the increase in loans by 29 617 MBIF. The share of loans in total assets of MFIs is 59% in 2016 against 55% in 2015.

<sup>13</sup> Décret n° 100/203 de la 22/07/2006 portant réglementation des activités de microfinance au BURUNDI.

Table 16: MFI assets.

	2016	2015	Gap 2016- 2015	variation in %
	232 770.5	199 800.3	32 970.2	16.5%
Assets	71 707.2	61 761.01	9 946.2	5.0%
Cash	138 515.4	108 898.5	29 616.9	14.8%
Outstanding Loans	11 760.7	10 431.2	1 329.5	0.7%
With Unpaid-Loans	22 547.9	29 140.8	-6 592.9	-3.3%
Others (with fixed assets )				

Source : BRB

The housing (62%) and trade (13%) sectors are the most funded while other sectors are poorly funded: agriculture and livestock (10%), social sector (9%), others (5%).

#### 2.3.4. Portfolio quality

The portfolio quality of the microfinance sector has improved slightly. The rate of the portfolio at risk was 8.5% in 2016 against 9.6% in 2015 with a worldwide benchmark of 5%. The provisioning rate was 36% at the end of June 2016.

Table 17: Portfolio Quality.

	2015	2016	Variation in %
Outstanding Loans	108 899	138 515	27.2
Unpaid Loans	10 431	11 761	12.7
Portfolio at Risk	9.6%	8.5%	-11.4
Provisions	4 579.3	4 245.5	-7.3
Provisioning Rate	44%	36%	-18.0

Source : BRB

The portfolio at risk is mainly made of trade (39%), agriculture (23%) and equipment (20%) sectors. The default rates for solidarity loans (17.8%) and groupings loans (18.5%) are low compared to the default rates for loans to individual customers (54%).

#### 2.3.5. Capital Adequacy

In 2016, the capital is 64 654.3 MBIF with a capital adequacy ratio of 27%. However, this ratio is asymmetrical since some MFIs are better capitalized than others.

#### 2.3.6. Liquidity of the sector

The microfinance sector has a liquidity ratio of 49% for a standard of 15%. However, 6% of MFIs remain below this standard. The loans / deposits ratio is 104% in 2016 while the standard is 100%.

#### 2.3.7. Profitability of the sector

The net profit of the sector is 5 326 MBIF in 2016 against 2 467.37 MBIF in 2015 i.e. an increase of 116%. Nevertheless, this result is largely

influenced by five MFIs which represent 85% the sector. In 2016, MFIs achieved a return on equity of 8% against 4% in 2015 and a return on assets of 2.2% against 1% in 2015.

### 2.3.8. Operational risk

The operational risk of the microfinance sector is mainly related to the Management Information Systems (MIS) and internal control insufficiencies. Indeed, some MFIs do not have good MIS while others still handle their operations manually. In addition to the MIS insufficiencies, their internal control is limited.

### 2.3.9. Exposure to the banking sector

The interconnections between the microfinance sector and the banking sector are not important and do not pose a significant risk. The impact of a bankruptcy of a microfinance institution on other institutions is limited. MFIs' operations with the banking sector focus on cash surplus investments and borrowings.

In fact, borrowings collected from the banking sector amounted to 18,886.8 MBIF in 2016 (i.e. 8% of total assets) compared to 21 008.2 MBIF in 2015 (i.e. 10% of total assets). Nevertheless, the investments made in the banking sector are significant with 71 707 MBIF at the end of December 2016, i.e. 31% of the total assets.

In addition to the adverse financial consequences for depositors, the main risk inherent to decentralized finance specific to the microfinance sector is that, in the event of the bankruptcy of an MFI, there is a loss of confidence in the financial system.

## 2.4. Insurance Sector

The insurance sector ensures a fundamental economic mission by securing individuals and entities against the potential risks they may face. In Burundi, this sector is one of the important sectors of the financial system accounting for 5% of the total assets of the financial sector. Indeed, it interacts with the banking sector through deposits, investments and loans. With 7 insurance companies and 15 brokers sharing the market, sector's capital remained stable in 2016 compared to 2015.

**Table 18: change in the penetration rate**

	2011	2012	2013	2014	2015	2016
GDP (in Billions of BIF)	2 989	3 609	4 131	4 138	4 520	4 759
Turnover (Billions BIF)	26	29	34	36	37	37
Penetration rate	0.86	0.80	0.81	0.87	0.82	0.78

Source : ARCA.

The penetration rate decreased in 2016 compared to 2015, from 0.82% to 0.78%, i.e. a decrease of 0.05%.

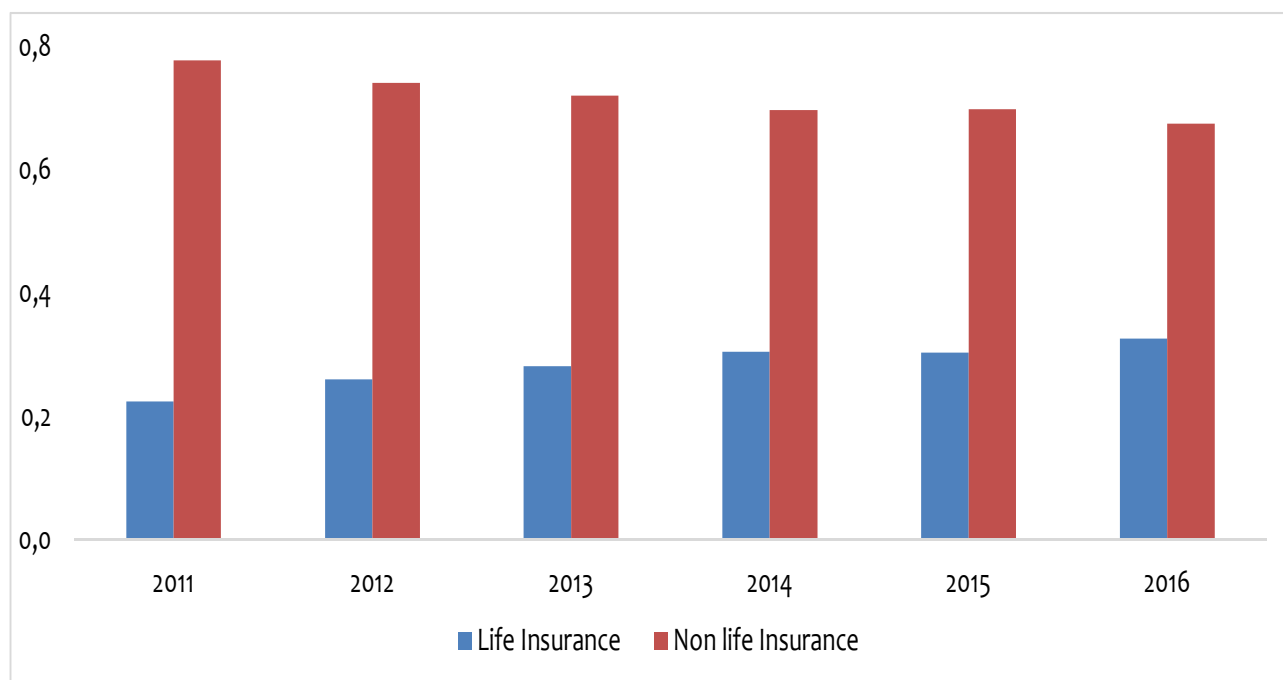
This rate is mainly influenced by non-life

insurance products, accounting for 67% of total turnover. However, this rate remains low compared to the African (2.8%) and global (6.1%) average .

It should be noted that, new insurance products, made compulsory by the Law “Loi N°1/02 du 7 Janvier 2014 portant code des

assurances au Burundi”, are not yet marketed. The introduction of those products should increase the penetration rate.

**Chart 16: Change in premiums per type of insurance**



Source : ARCA.

The chart above shows that in 2016, non-life insurance accounts for 67% of total premiums compared to 70% in 2015, while life insurance premiums rose from 30% to 33% from 2015

to 2016. However, the decline in non-life premiums is due to the fact that non-life products are declining, while life products are in a growth phase.

**Table 19: Change in claim ratio of the insurance sector**

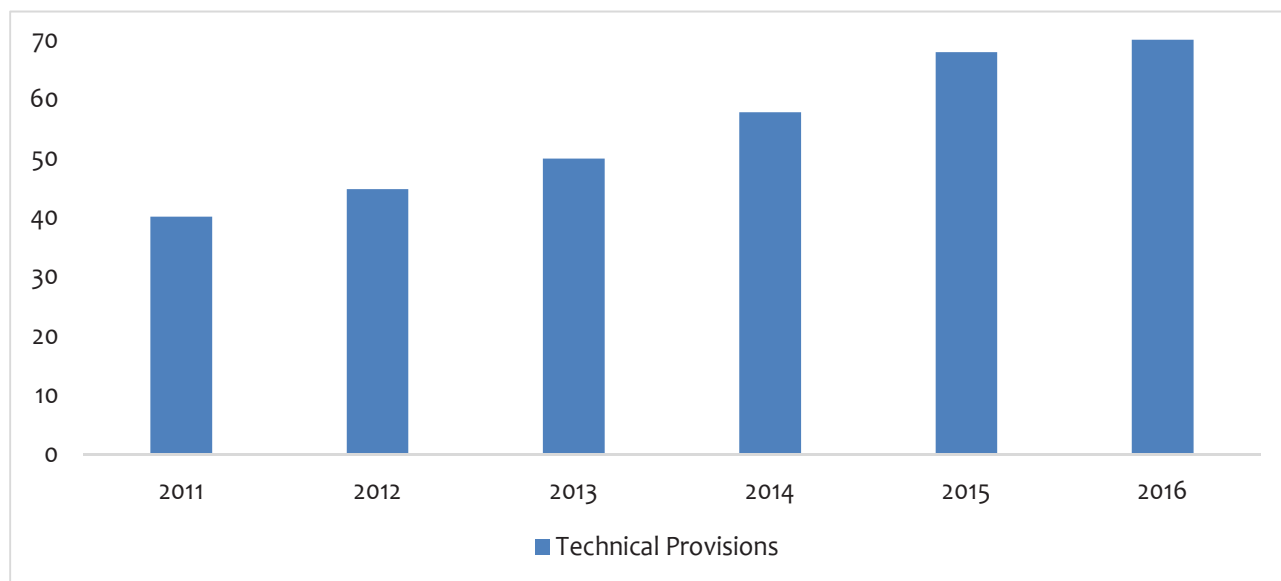
	2011	2012	2013	2014	2015	2016
<b>Total claims (in Billions BIF)</b>	7.6	12.5	13.1	14.7	15.3	14.9
<b>Total premiums (in Bn. BIF)</b>	26	29	34	36	37	37
<b>Claims Ratio</b>	29.5	43.4	38.8	38.0	41.3	40.3

Source : ARCA

This table indicates that in 2016 the claim ratio decreased by 1% compared to 2015. This situation is explained by the decline in claims

that the sector has repaid since the amount of premiums has slightly changed in 2016 compared to 2015.

Graph 17: Change in technical provisions



Source : ARCA

The technical provisions of the sector have been rising for the past five years. Between 2015 and 2016, technical provisions increased

by 7%, from 68 billion BIF to 72 billion BIF. It implies that the insurance industry has enough reserves to cover claims reimbursements.

# 3

## CHAPTER 3: MONEY MARKET AND MARKET INFRASTRUCTURES



The year 2016 was characterized by the decline in bank cash due to the slowdown of economic activity and the shrinkage of foreign exchange reserves held by banks. In this context, the Central Bank increased the outstanding amount of its interventions amounting to 83.6 billion BIF against 14.5 billion BIF at the end of December 2015.

As for market infrastructures, their operation in 2016 did not cause any disruption to Financial Stability. Thus, the clearing system worked smoothly as evidenced by the weak rejection of payment orders at the end of the day and the lack of default on advances and marginal lending facilities granted to participants.

Despite these developments, the main risks deriving from the money market and market infrastructures continue to come from the lack of a deep market and the high concentration of liquidity in some banks. Debt securities issued by the Treasury dominate the market, and banks and pension funds are the main investors in the public securities market.

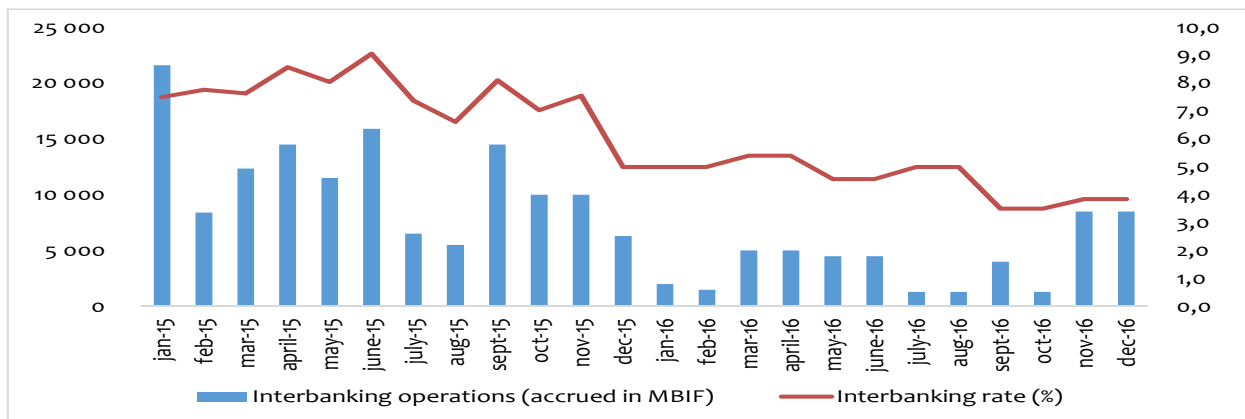
### 3.1. Money Market

In 2016, banks' refinancing needs increased to BIF 83.6 billion compared to BIF 14.5 billion in 2015. The volumes traded on the interbank market declined as a result of the Intensification of Central Bank interventions in the form of a normal liquidity supply, from BIF 3.5 billion in 2015 to BIF 11.4 billion in 2016, on monthly average. The intensification of liquidity supply operations has led banks to increase their subscriptions to the treasury securities market, whereby the outstanding amount rose from 258.9 to 433.1 billion of BIF between December 2015 and December 2016, i.e. an increase of 67.3%.

The average interbank rate between 2016 and 2015 was in the range of 4.5 and 7.5%.

The banking system faced cash difficulties in 2016 which did not affect interbank market rates following the quantitative easing policy adopted by the Central Bank.

**Chart 18: Interbank money market operations in Millions of BIF**



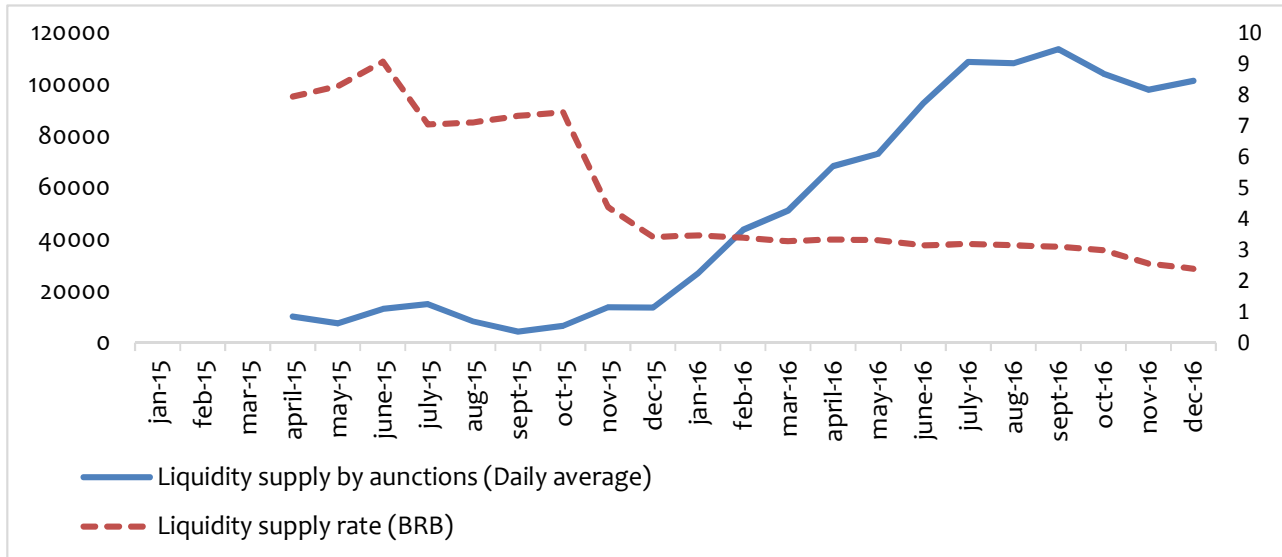


Source : BRB

Bank liquidity remains unequally distributed among banks. More than 70% of the total reserves are held by three banks. The liquidity

supply market has been more concentrated compared to other money market compartments and remains dominated by only a few commercial banks.

Graph 19: BRB refinancing

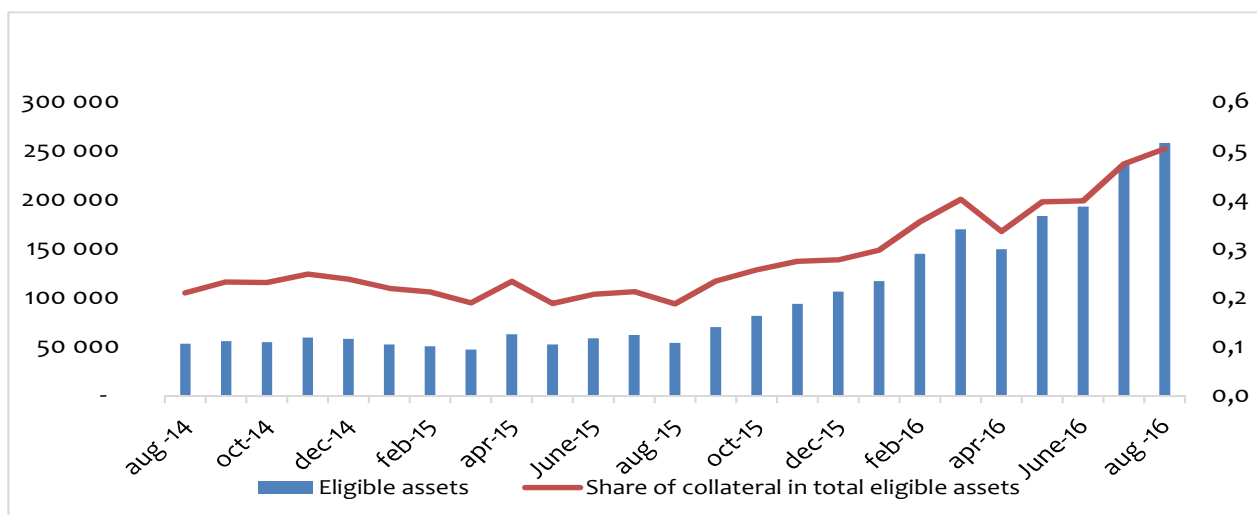


Source : BRB

Collaterals for refinancing increased in 2016. Indeed, the share of collateral raised by banks in relation to their eligible assets increased

with an average of 39.4% per month in 2016 against 22.4% in 2015.

Chart 20: Collateral of refinancing



Source: BRB

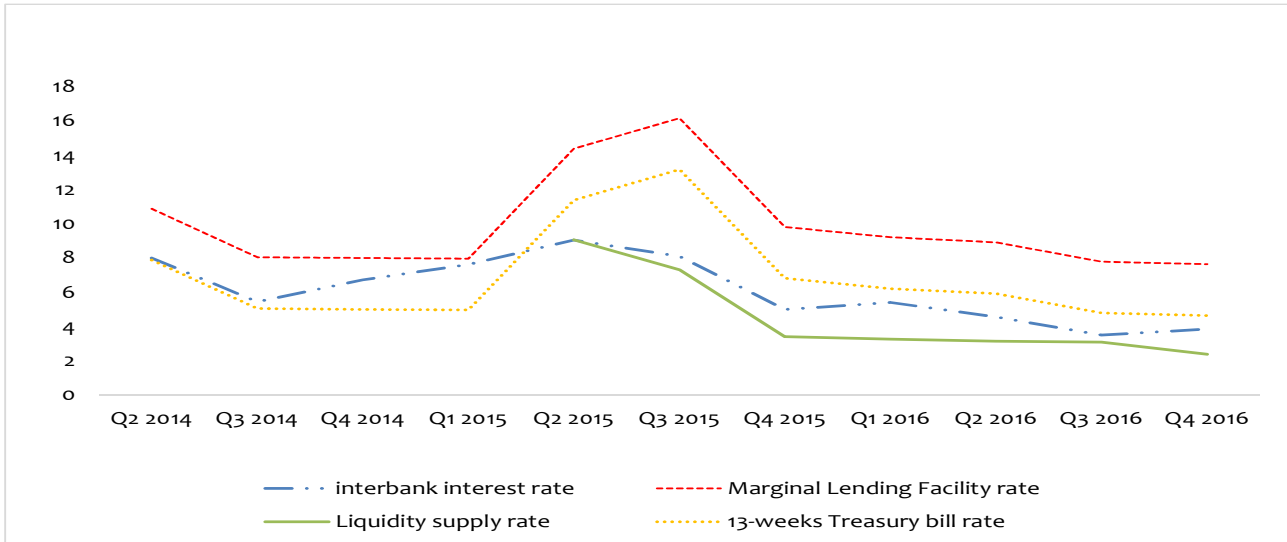
The year 2016 was characterized by the continuous decline of bank liquidity (daily average) linked to the decline in foreign exchange reserves. In this context, the

Central Bank has increased the amount of its interventions and money market rates have fallen. In fact, the average interest rate on liquidity supply auctions was 2.4 compared to

3.4% the previous year. Similarly, the average interbank interest rate fell from 4.25% to 3.68%, and the marginal lending facility rate

from 8.20% to 7.33%, as a result of the drop of 13-week treasury bill rate to which it is pegged, from 5.20 to 4.33%.

**Chart 21: Money Market Rates**



Source : BRB

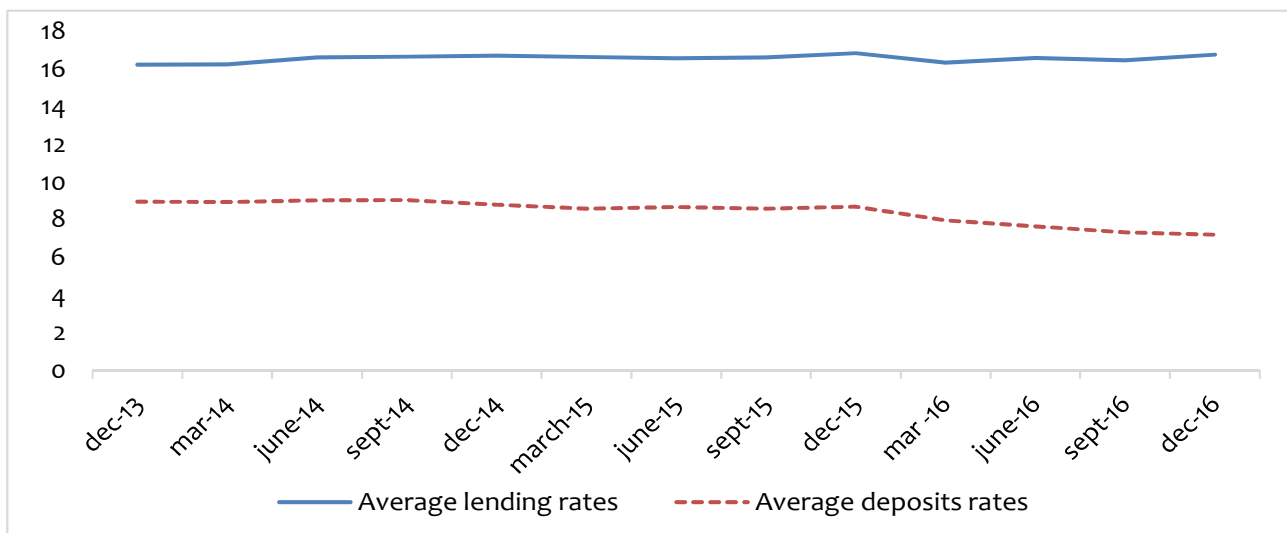
In 2016, the average interest rate on outstanding loans decreased from 16.65% in 2015 to 16.52%, i.e. a decrease of 0.13 percentage point.

Similarly, the average deposit rate fell from 8.60% to 7.71%. The decline was in cash

certificates (9.53% versus 8.57 %) and term deposits (9.58% versus 8.12%).

Conversely, interest rates on savings accounts (7.30 versus 6.95%) and on demand deposits (4.78 versus 4.38%) increased slightly.

**Chart 22: Average Deposit and Lending Rate**



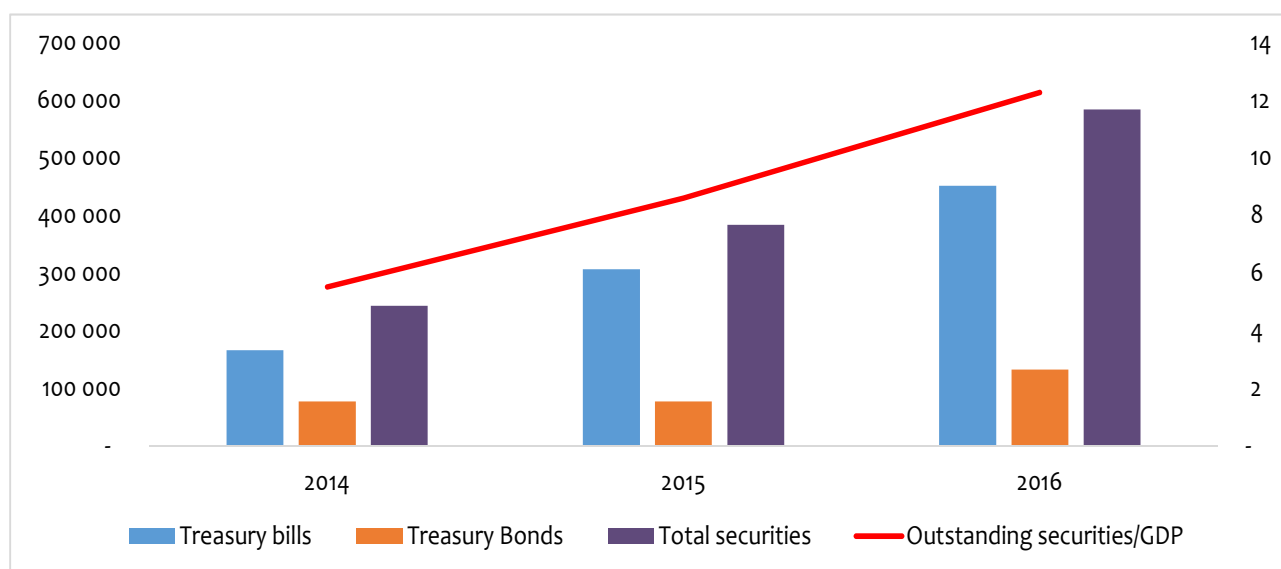
Source : BRB

● **Treasury Securities market**

Outstanding Government securities (treasury bonds and bills) reached BIF 433.1 billion at the end of 2016 compared to BIF 258.9 billion at the end of 2015, representing a growth rate

of 67.3%. The burden of the public debt to the banking sector over the GDP is 12.2% in 2016 against 8.6% in 2015. The increase in these debt ratios is due to the predominance of commercial banks on the public debt market.

**Chart 23: Change in Outstanding debt securities**



Source : BRB

At the end of 2016 the public securities market has a widely linked with the financial sector. Thus, the share of public securities held by banks and financial institutions account for 77.9%, i.e. 433 billion BIF. Pension funds and social welfare institutions represent 15% (BIF 82.8 billion) while insurance companies represent 7% (BIF 40.6 billion).

The public debt remains the first alternative investment for commercial banks due to the risk aversion. Like previous years, the Treasury has strongly participated in the debt market, raising significant amounts to finance the budget deficit.

**3.2. Market Infrastructure: Payment and Settlement System**

Market infrastructures constitute the platform for financial operations. They include the payment system with its three main components including the Automated Clearing House (ACH), the Real Time Gross Settlement (RTGS) and the Central Securities Depository (CSD). An electronic payment component is also ongoing implementation for the interoperability and clearing of blue card transactions. These are drivers of the financial system and through which financial transactions of payment, settlement and delivery are processed.

The effective operation of payment and settlement infrastructures is therefore essential to preserve Financial Stability due to the systemic risks they may cause in case of their failure. In fact, these infrastructures combine significant financial and / or operational risks and the interdependencies between the stakeholders must be scrutinized in order to avoid any disruptions that may create suspense and/or delays in the execution of operations within the system.

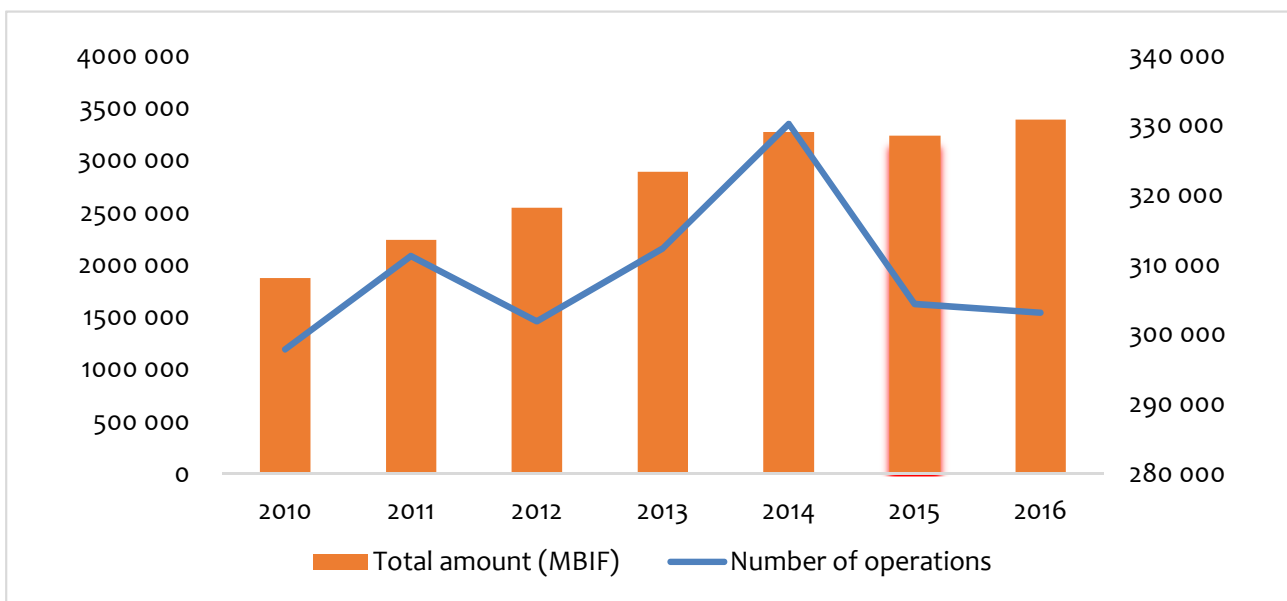
The importance of payment and settlement infrastructures is essential for the stability

of the financial system implying that the standards governing them are regularly reinforced.

• **Clearing house activities**

At the end of 2016, the clearing house processed 303,106 orders (checks and transfer orders) slightly decreased by 0.3% compared to the previous year. The orders total amount increased by 4.6%, from 3,229.8 billion BIF in 2015 to 3,387.02 billion BIF in 2016.

**Chart 24: Clearing House Transactions**



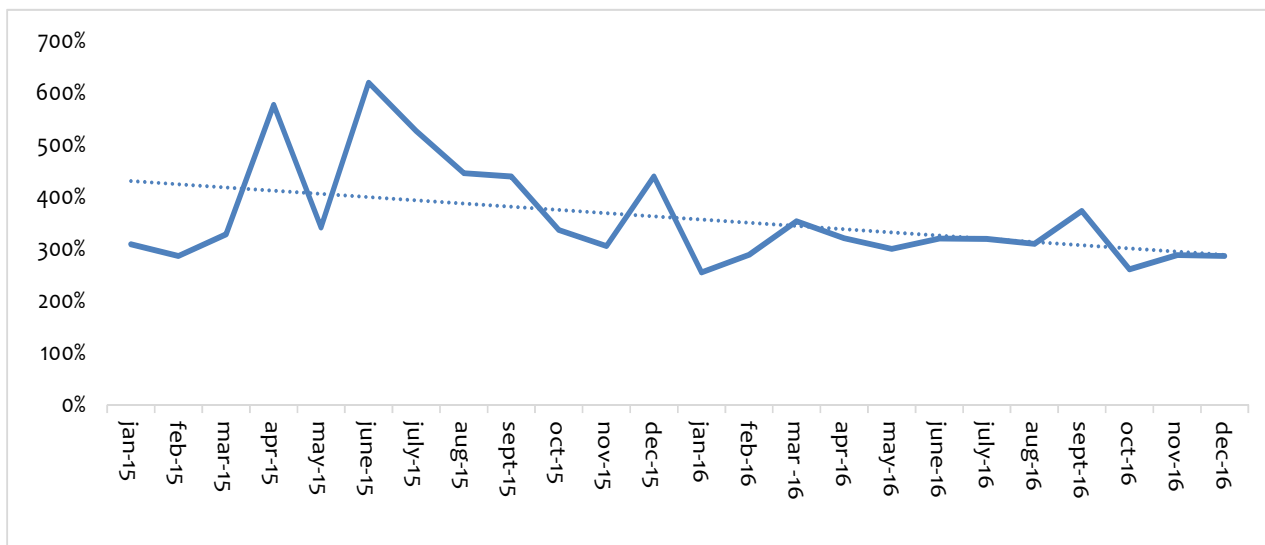
Source : BRB

The measure of the efficiency of the liquidity mechanisms of this system is ensured through the overnight facilities granted by the Central Bank to the participants as well as the liquidity outflow coefficient. In 2016, the provision of overnight loans as well as marginal lending facilities by the Central Bank to the participants helped to ensure the smooth running of the

settlement process and to prevent the system from experiencing blocking situations.

The Central Bank’s marginal lending facilities for the year 2016 were set at daily average of 484.4 MBIF against 1,175 MBIF in 2015 following the intensification of liquidity supply operations by the Central Bank.

**Chart 25: Outflow liquidity coefficient**



Source : BRB

The outflow liquidity coefficient reflects the efficiency of the payment system structure. It is calculated by the total payments made through the clearing house over the total banks’ reserves. A system with a low outflow liquidity ratio may be inefficient, but it may also be safer if banks hold relatively high reserves to cope with liquidity shocks.

The outflow liquidity coefficient was at 306% as daily average in 2016 compared to 412% in 2015. The decrease in this coefficient is mainly due to the increase in banks’ reserves of 63.8% in 2016 and a smaller increase in clearing house operations of 6.8%.

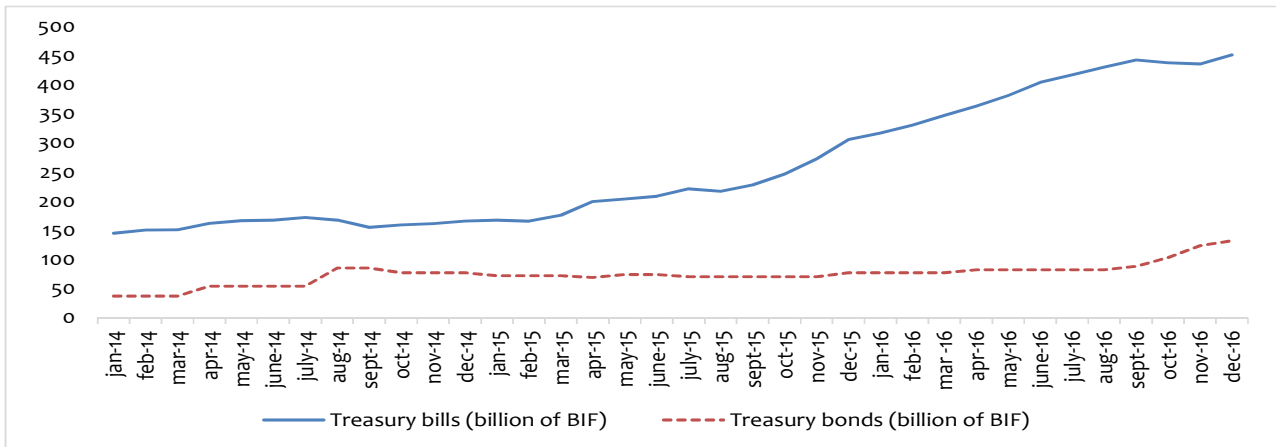
• **Securities Settlement System**

As the sole central depository of securities through the CSD that it manages, the BRB is the key player of the public securities market (treasury bonds and bills) by providing key features such as securities custody and management of the settlement versus delivery system which permits the settlement of all transactions carried out on the securities admitted to the central depository operations. The financial assets held as well as the flows processed via the CSD are an important element in the systemic risk assessment.

Before the migration to the CSD, the BRB had a semi-manual management and settlement system. Securities amounted to 582.8 billion

BIF at the end of 2016 compared with 383.0 billion BIF in 2015, representing a growth of 52.2%.

**Chart 26: Change in securities holdings**

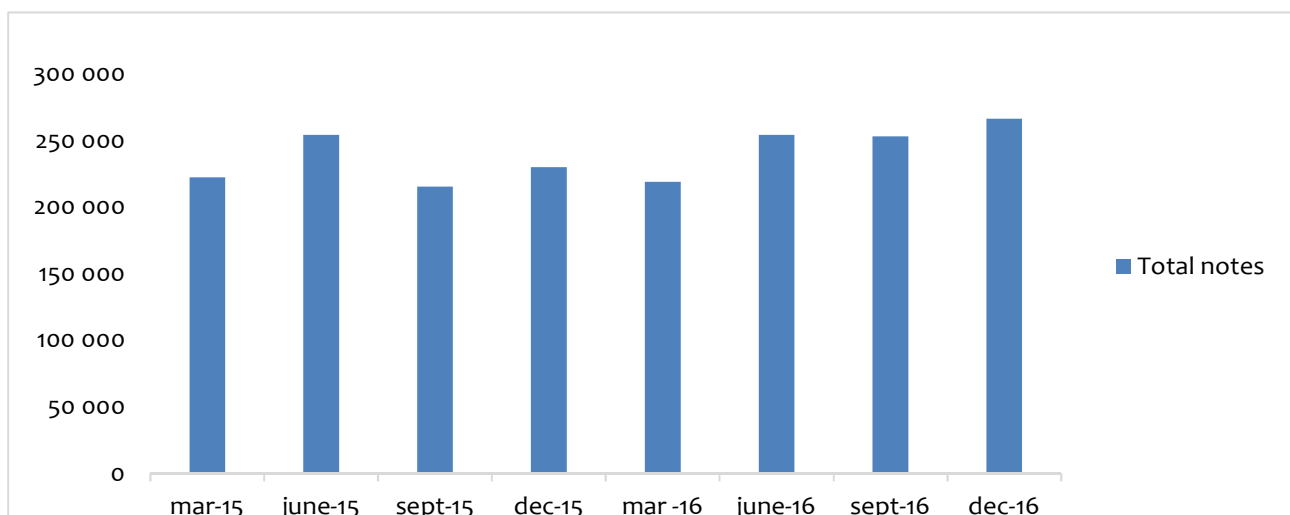


### 3.3. Means of payment

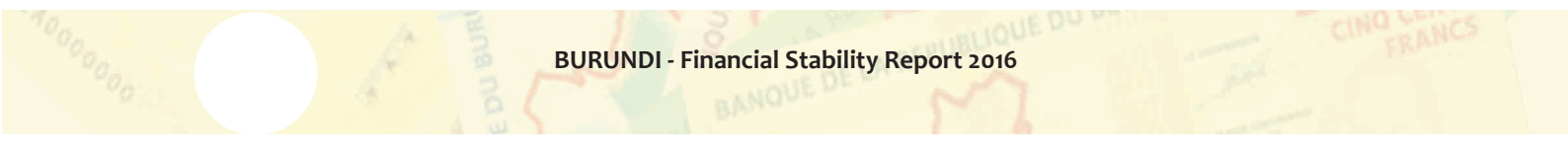
The currency in circulation outside the banking system increased by 15.9% in 2016 from 230 723.7 MBIF to 267 512.5 MBIF. The currency

in circulation is made of 99.47% of bank notes and 0.53% of coins.

**Chart 27: change in the notes in circulation**



Source : BRB



# 4

## CHAPTER 4 : MACROPRUDENTIAL POLICY FRAMEWORK





**M**acroprudential policy takes into account the interactions between the financial sector and the real sector to prevent and mitigate risks that could disrupt the functioning of the financial system or cause real economy unbalances.

The macroprudential policy mission is also to reduce financial imbalances, pro-cyclical phenomena and systemic risks, by anticipating measures to limit the excessive loans growth, the excessive economic agents' indebtedness, avoiding the loans concentration by debtors and / or sectors while enhancing the resilience of the financial system to adverse developments.

Given the macroeconomic and financial imbalances, Central Banks have opted for strategies to strengthen the microprudential surveillance (supervision) and the macro prudential policy. The adoption of macroprudential policies involves the content of these policies and the way of coordinating with macroeconomic policies.

It is in this perspective that the BRB undertook a tremendous reform project aiming at supporting the actual microprudential regulation focused on individual risks with a macroprudential analysis taking into account the risks as a whole that is focused on systemic

#### 4.1. Macroprudential Policy versus other policies

Given that Central Banks are institutions that better understand market behaviors and have always built strong relationships between the financial system and the real economy, they play a central role as supervisors to ensure

financial stability. The BRB, in addition to its price stability core mission, contributes also to the stability of the financial system. The macroprudential policy coordination with monetary policy is paramount due to their mutual implications.

As an illustration, macroprudential policy affects the monetary policy mechanisms by taking into account the effect on prices and returns on assets. It increases the effectiveness of monetary policy by preventing financial pressures that can affect interest rates. Macroprudential and monetary policies move in the same direction in case of expansion but can go in opposite directions when the pressures on the financial system are followed by an inflation risk. Similarly, monetary policy should remain focused on price stability, but also promote financial stability, which may require shifting the horizon of monetary policy objectives.

Regarding the coordination with macroeconomic policies, the macroprudential policy is so important and necessary that some Central Banks, beyond their price stability actual mission, must also support economic policies growth, in order to achieve a strong and sustainable growth. This is particularly relevant with fiscal policy and structural policies.

Fiscal policy interacts with financial stability due to the relationship between sovereign debt and bank balance sheets on one hand, and the link between the budget deficit and seigniorage, on the other hand. Regarding structural policies, it is the case of taxation and access to properties.

## 4.2. Financial Stability Institutional Framework

The financial system surveillance is the Banque de la République du Burundi statutory mission according to Article 6 of BRB statutes that deals with its missions and objectives.

Since a few years, the BRB has undertaken the process of setting up a financial stability monitoring framework and is working to establish a macroprudential surveillance arrangement. In 2016, remarkable progress was made in order to provide the BRB with an adequate institutional framework for monitoring financial stability, especially when the financial sector is exposed to systemic risks linked to macroeconomic disruptions.

In this perspective, the BRB has put in place a Financial Stability Technical Committee and a Financial Stability Internal Committee. The latter is chaired by the Governor and is the decision-making body for macro-prudential policy.

Based on economic, monetary and financial analysis, the Financial Stability Internal Committee decides on macroprudential instruments to be activated in case of financial distress to avoid the materialization of identified systemic risks. The establishment of this Committee allowed the BRB, like other EAC Central Banks, to have an appropriate decision-making framework for financial stability.

The Financial Stability Internal Committee continues the process of establishing a National Financial Stability Committee; meetings with other regulators of the financial system are scheduled in 2017. The BRB

continues its communication and sensitization campaign. Workshops were organized for other regulators and other partners, including the Institute of Statistics and Economic Studies of Burundi (Institut des Statistiques et Etudes Economiques du Burundi: ISTEEDU), the Department of State-owned Enterprises (Service Chargé des Entreprises Publiques: SCEP), the Association of Banks and Financial Institutions (Association des Banques et Etablissements Financiers: ABEF), the Network of Microfinance Institutions (Réseau des Institutions de Microfinance: RIM), the Burundian Revenue Authority (Office Burundais des Recettes: OBR), the Burundi Insurance Association (Association des Assureurs du Burundi: ASSUR) and the Insurance Regulation and Control Authority (Agence de Régulation et de Contrôle des Assurances: ARCA).

## 4.3. Prudential measures adopted

To prevent from contagion, the Banque de la République du Burundi undertook following actions:

- a. Strengthen the institutional framework for macroprudential policy coordination with other macroeconomic policies, such as through a draft memorandum of understanding for the establishment of a National Financial Stability Committee including the Ministry of Finance but also other stakeholders such as banks, insurance companies, microfinance institutions and pension funds professional associations and other regulatory bodies;
- b. Act as Government advisor for the implementation of counter-cyclical fiscal policies in order to better stand against cyclical shocks;

- c. Implement accommodative monetary policy against cyclical shocks;
- d. Ensure better coordination of monetary policy with fiscal policy;
- e. Strengthen strategic watch and economic intelligence by strengthening analysis and forecasting capabilities;
- f. Activate counter-cyclical instruments, such as regulations on provisioning; the obligation for some banks to strengthen their own equity through recapitalization or the reinvestment of profit into equity; the obligation to write off unpaid loans;
- g. Activate structural instruments such as the generalization of stress tests with a capital strengthening requirement; the use of financial soundness indicators.

## 4.4. Bank regulatory and supervisory framework

### 4.4.1. Regulation on sanctions matrix

With the aim of strengthening the resilience of the banking sector, taking into account the evolution of the activities and the related risks, the Central Bank has made changes to the old regulation about the sanctions matrix issued in 2008. The regulation aims to integrate the provisions of sanctions related to non-compliance with the regulations issued after 2008. The amendments also aim to address the non-respect of the Central Bank instructions, and clarify the shortcomings related to licensing conditions, the reporting, the credit risk management, internal control and other misconduct.

### 4.4.2. Specific measures taken by the BRB

Measures have been taken to facilitate the 2015/2016 coffee campaign financing. These measures consisted of financing this sector at a fixed rate of 3% and extending maturities up to 28 days.

In addition to this measure, the BRB has granted derogation on criteria of mobilization of the hotel sector backed loan effect, which have been accepted for mobilization at the Central Bank with a maximum number of payment incidents of 12 months for loans with outstanding amounts of at least 100 MBIF.

Concerning the loan portfolio, the BRB took measures that have strengthened the banking system soundness, such as those consisting in granting waiver to banks that have not yet implemented regulation 12/2013 on provisioning.

BRB has also adopted a decision to ease the rules related to the restructuring of loans by increasing the number of restructurings from 3 to 5.

## 4.5. Regulation of microfinance, foreign exchange bureaus and payment and transfer institutions

In 2016, the BRB undertook actions to improve the regulation of the microfinance, foreign exchange bureaus, payment institutions and instant cash transfer systems sectors.

### 4.5.1. Microfinance institutions

A joint BRB / RIM commission was set up with the mission of identifying challenges and proposing relevant solutions. The main identified challenges are related to the legal and regulatory framework, the loan portfolio deterioration, the realization collaterals, fiscal issues, delays in submission of MFIs financial statements and financial data to the Central of Information Exchange, the delay in the implementation of the Financial Inclusion National Strategy as well as the Microfinance Sector Policy and Strategy.

Regarding the challenges related to the legal and regulatory framework, these require the review of Decree No. 100/203 of 22 July 2006 regulating microfinance activities to update the regulation in the microfinance sector.

Other challenges concern the sanction matrix strengthening in order to improve MFI's capital.

### 4.5.2. Payment and transfer institutions

In order to improve the regulations of payment system, a regulation was issued regarding payment services, payment institutions activities as well as a regulation on activities of commercial agents in banks operations and payment services. Two transfer institutions were licensed under the article 80 of the foreign exchange regulation.

### 4.5.3 Foreign exchange bureaus

The BRB initiated a project to update the foreign exchange regulation as well as a project to develop computer software for managing and supervising foreign exchange bureaus.

## 4.6. Insurance Regulation

The Insurance Sector is supervised by the Insurance Regulation and Control Agency (Agence de Régulation et de Contrôle des Assurances: ARCA). Since its creation in 2013, the agency continues to work for enhanced supervision of the sector through a regulatory framework for prudential supervision. It is in this perspective that a number of reforms were undertaken in this sector such as the regulation on the principles and rules applicable to governance and the regulation on the establishment of a co-insurance system in Burundi.

### 4.6.1 Regulation on the governance of insurance companies

With this regulation, insurance companies are required to set up a governance system to ensure transparency, independence, accountability, fairness and probity in management.

They must have specialized audit committees in charge of auditing and risk management under the responsibility of the Board. The audit committee must ensure the independence of the external auditor and any other issue related to sound financial management. Regarding risk management, the Board of Directors is required to implement all strategies so that it can monitor all the risks inherent to their activities.

In line with the objective of strengthening the insurance sector, the regulation N° 540/93/004 of 05 October 2016 about insurance companies external audit licensing has been implemented. This is a major development because before this regulatory framework each insurance company used to hire external auditors

without prior approval of the supervisory authority.

#### 4.6.2. Regulation on the establishment of co-insurance in Burundi

The micro risks of insurance companies can be reduced by the co-insurance system. It is for this reason that a regulation No. 001 of 6/01/2017 on co-insurance in Burundi was adopted. It allows sharing risks between

insurers, strengthening communication between companies and having an overall view on risks that a single company would not cover alone. This regulatory framework is a way to mitigate rivalry between competitors and also permit insurance companies to save foreign currency since the amounts to be given to re-insurers are low in the case of co-insurance, which comforts insurance company with long foreign currency position.

## WAY FORWARD

The prospects for financial stability are linked in the short and medium term by two main factors. The evolution of the macro financial environment and the risks to which the banking sector is exposed as well as its resilience to those risks. Globally, risks to financial stability increased in 2016 mainly due to macroeconomic challenges combined with the increase in credit risk as a result of the continuing deterioration of the banks' portfolios quality. The stress tests results have shown that the banking sector has sufficient capital to withstand shocks in the short and medium term.

The banking sector also faces the credit risk associated with the increase in non-performing loans. These are rising in almost all sectors of the economy. The above-mentioned macroeconomic challenges have affected the performance of the banking sector, particularly the systemically important banks. The latter displayed non-performing

loan ratios above the sector average (15.6%) at the end of December 2016, which led to a decrease in their profitability.

The loans loss write-off measure of more than 24 months helped clean up banks' balance sheets and the category of loans loss was reduced by 76.2 billion BIF. This led to a decline in the non-performing loan rate, which was 14.1% at the end of December 2016 compared to 24% before the write-off.

In 2017, the continuation of this write-off measure will allow further cleaning up of the banking sector balance sheet. The Central Bank will continue the implementation of macroprudential policies that have already started such as strengthening the legal, regulatory and institutional framework. Similarly, the macroeconomic outlook displays economic activity increase and this will have a positive effect on the financial sector health in the medium term.

# 5

# APPENDIXES





Table 1: Financial Soundness Indicators (EAC)

	Dec-12	mars-13	juin-13	sept-13	Dec-13	mars-14	juin-14	sept-14	Dec-14	mars-15	juin-15	sept-15	Dec-15	mars-16	juin-16	sept-16	déc-16
BURUNDI	20.2	21.1	21.8	19.9	22.3	21.9	21.3	18.1	17.3	20.5	19.5	19.2	18.1	22.3	20.8	20.2	22.7
KENYA	21.8	23.2	23.3	22.9	23.2	18.2	17.6	17.8	19.2	19.2	18.9	18.7	21.7	18.8	18.1	18.3	18.9
TANZANIA	17.9	19.4	18	18.2	18.1	19.3	17.5	17.6	17	18.6	17.3	18	18.9	19.5	18.6	18.6	19.1
UGANDA	21.9	24.5	24.3	23.1	22.1	23.6	22.8	22.5	22.2	23.2	21.2	20.1	21	21.8	21.7	22.5	19.8
RWANDA	23.8	24.6	23.2	23	23.1	22.6	23.6	24.8	24.2	25.9	24.3	24.2	22.2	24.9	23.3	22.2	23.1
BURUNDI	8.7	9.5	9.6	9.5	9.9	10.1	11.3	11.2	10.9	12.1	13.1	14.1	17.9	18.3	18.5	19	14.7
KENYA	4.5	5	5.3	5.3	5	5.7	5.8	5.5	5.5	5.8	5.7	5.4	6	7.8	10.5	8.2	11.7
TANZANIA	7.4	6	6.3	5.5	5.1	8	6.6	7	6.6	5.9	6.5	6.3	8.6	9.5	9	8.2	9.6
UGANDA	4.2	4.4	3.8	4.2	5.8	5.9	5.6	5.1	4	4.1	3.8	3.7	5.1	6.6	8.2	7.6	10.4
RWANDA	6	6	5.4	6	5.9	5.8	5.3	5.3	5.2	5.7	5.5	5.8	6.2	6	7	7.4	7.1
BURUNDI	24.8	11.4	15.8	14.7	14.1	14.5	9.8	10.4	7.8	14.4	16.2	16.1	11.5	15.4	10.7	7.3	8.5
KENYA	29.6	32.6	33.6	32	30.9	31.7	32.5	27.9	26.9	42.6	28.8	28.2	26.4	27.7	28	28.1	25.9
TANZANIA	13.1	24.2	22.4	21.4	20.9	23.6	23.2	22.8	22.8	24.5	16	22.2	22.2	24.3	22.3	12.2	22.3
UGANDA	24.2	26.1	26.6	26	18.5	20.2	17.8	19.9	22.2	20.1	22.3	23	22.6	25.2	19.4	22.5	14.7
RWANDA	10.4	16.8	14.3	12	11.2	16.5	16.1	15.3	15.4	17.6	17.7	16.2	15.7	14.7	14	14.4	13.6
BURUNDI	3.6	1.8	2.6	2.3	2.2	2.3	1.6	1.6	1.2	2.3	2.6	2.6	1.9	2.5	1.7	1.1	1.3
KENYA	3.7	4.8	5	4.8	4.7	4.9	5	4.3	4.2	6.6	4.4	4.3	4	1.4	1.4	1.4	1.4
TANZANIE	2.5	3.1	2.9	2.7	2.7	3.1	3	3	3	3.2	2.1	2.9	2.9	3.4	2.2	1.7	3.1
UGANDA	3.9	4.5	4.6	4.4	3.1	3.3	2.9	3.2	3.6	3.3	3.6	3.7	3.6	4.2	3.2	3.8	2.4
	2.2	3.8	3.3	2.9	2.6	3.2	2.9	2.8	2.8	3.3	3.1	2.8	2.7	2.8	2.6	2.8	2.5

Source : FMI / FSI

Table 2: Banking sector's financial soundness Indicators

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
<b>CAPITAL ADEQUACY</b>											
Core capital	26 462.9	40 300.7	55 722.8	78 181.9	106 404.4	136 188.5	162 524.4	189 541.4	200 630.6	210 323.5	229 217.6
Total capital	44 676.7	51 304.3	67 882.4	97 880.4	126 767.0	157 829.8	185 430.9	223 415.7	231 350.9	243 523.4	265 744.0
<b>ASSET QUALITY</b>											
Non Performing loans ratio	17.41	16.95	22.56	11.34	8.96	6.91	7.71	9.4	11.11	16.91	12.1
<b>Performing loans</b>											
Normal	177 151	190 092	220 436	233 058	380 854	533 927	506 820	592 607	528 871	300 915	611 508
Watch	1 426	1 755	1 837	5 550	3 072	4 350	6 278	7 189	8 768	37 364	32 131
<b>Non performants loans</b>											
Doubtful	2 036	2 093	2 308	2 165	2 429	4 730	4 056	7 591	6 583	8 472	6 925
Sub standards	1 680	1 230	1 589	698	2 361	3 703	7 137	4 821	8 625	32 811	33 734
Loss	33 929	35 837	60 871	34 931	34 029	31 329	39 044	53 400	75 763	94 149	50 918
<b>Total NPL</b>	<b>37 645</b>	<b>39 160</b>	<b>64 768</b>	<b>37 795</b>	<b>38 819</b>	<b>39 762</b>	<b>50 238</b>	<b>65 812</b>	<b>90 971</b>	<b>135 433</b>	<b>106 403</b>
<b>PROFITABILITY</b>											
<b>Net Income</b>	<b>6 616.70</b>	<b>11 328.20</b>	<b>17 538.70</b>	<b>20 964.80</b>	<b>22 550.70</b>	<b>33 984.30</b>	<b>20 705.9</b>	<b>18 855.10</b>	<b>14 066.10</b>	<b>22 579.70</b>	<b>21 863.20</b>
ROA	1.979	2.33	2.83	6.38	4.08	6.91	4.18	4.49	1.85	2.23	1.80%
ROE	14.81	22.08	25.84	33.99	25.16	34.94	18.61	18.72	9.43	15.38	11.30%
	32 883.70	40 999.40	52 649.30	35 170.00	51 769.00	61 814.6	71 955.9	80 686.8	81 335.00	112 289.50	90 834.40
Margin interest	N/A	N/A	N/A	23 190.60	26 424.20	33 378.2	18 070.1	35 969.6	44 373.9	32 766.90	103 534.50
Margin on commission	18	17.5	16.7	16.5	15.85	15.29	15.67	16.24	16.71	16.85	16.77
Average lending rates	8.9	8.3	8.1	7.6	7.31	7.59	8.75	8.97	8.8	8.7	7.21
<b>LIQUIDITY</b>											
Liquid Assets	129 064.9	173 487.3	243 276.5	310 295.9	354 622.8	312 317.5	317 691.7	420 546.1	514 743.3	493 719.2	758 972.1
Liquid assets / Deposits	0.51	0.55	0.6	0.6	0.6	0.47	0.47	0.48	0.54	0.5	79.50%
Loans/deposits ratio	0.81	0.74	0.75	0.65	0.76	0.87	0.95	0.84	0.88	0.81	0.68
<b>MARKET</b>											
Foreign currency loans	2 424.8	458.9	2 483.0	474.2	3 025.2	3 141.0	127 363.2	2 714.5	2 227.6	4 179.4	23 163.7
Foreign currency deposits	49 545.1	72 865.2	106 564.3	136 350.7	145 126.5	155 089.7	185 108.5	199 349.5	225 790.8	154 231.8	180 504.9
Foreign currency assets	78 191.5	103 879.5	134 577.5	160 028.1	169 608.0	157 129.0	210 111.3	218 810.2	219 025.9	260 502.6	167 374.0
Foreign currency liabilities	46 538.1	72 865.2	78 770.1	140 381.3	150 062.2	157 869.0	203 792.6	222 629.7	252 723.5	248 580.5	180 504.9
Foreign currency loans/ Tier I	0.09	0.01	0.04	0.01	0.03	0.02	0.78	0.01	0.01	0.02	0.10
Foreign currency loans / Foreign currency deposits	0.05	0.01	0.02	0.003	0.02	0.02	0.69	0.01	0.01	0.03	0.13
Foreign currency assets/ Foreign currency liabilities	1.68	1.43	1.71	1.14	1.13	1	1.03	0.98	0.87	1.05	0.93

Source : BRB

Table3: Growth in GDP

	2012	2013	2014	2015	2016	2017
<b>Primary Sector</b>	<b>2.1</b>	<b>8.4</b>	<b>-3.6</b>	<b>0.3</b>	<b>-2.0</b>	<b>-0.3</b>
- Food Crops	1.3	15.2	-5.0	-1.9	-3.7	-3.0
- Agricultural exports	35.1	-13.8	10.6	20.1	-7.3	20.4
- Coffee	71.6	-73.3	22.5	53.1	-14.0	35.0
- Tea	3.0	68.8	9.3	14.1	-5.0	17.0
- Other agricultural exports	63.6	-42.7	-3.0	0.0	-12.0	10.0
- Forest	-9.5	10.0	6.0	12.6	13.0	10.5
- Livestock	0.9	-48.2	10.9	19.2	20.0	15.0
- Fishing	11.3	-27.5	14.9	13.3	15.0	10.0
<b>Secondary Sector</b>	<b>5.3</b>	<b>2.4</b>	<b>6.2</b>	<b>-2.7</b>	<b>1.4</b>	<b>-1.9</b>
- Extraction	7.9	5.7	-11.7	-4.8	-2.0	10.0
- Industries	3.1	2.2	13.0	0.8	2.6	-2.3
- agro-food industry	1.8	2.2	15.7	0.8	2.3	-2.0
- manufacturing industry	6.6	2.2	6.0	0.5	3.5	-3.2
- textiles industry	1.3	22.7	-25.4	-7.0	-3.0	-6.5
- Other manufacturing industry	7.2	0.1	9.8	1.2	4.0	-3.0
- Electricity, gas and water	15.4	5.5	2.5	-10.1	1.5	1.0
- Construction	8.9	2.3	-5.4	-10.1	-1.5	-2.0
<b>Tertiary sector</b>	<b>7.0</b>	<b>2.8</b>	<b>8.8</b>	<b>2.4</b>	<b>4.6</b>	<b>3.6</b>
- Trade	3.9	-17.1	11.5	-6.9	2.0	-1.0
- Transport and communication	9.1	-5.6	31.6	0.1	5.4	5.3
- Transports	1.2	-18.5	8.1	-18.6	4.0	-2.0
- Postal services, Telecommunication, Internet	13.4	0.6	40.8	5.8	5.8	7.0
- Banks and Insurances	8.1	1.0	14.3	19.5	10.0	10.0
- Hotels, Restaurant and other services	1.7	1.3	-9.5	0.2	0.5	0.7
- Public administration	11.3	13.6	19.6	5.6	6.0	6.5
- Education	15.0	0.5	4.0	4.7	4.5	5.0
- Health and social actions	13.7	4.4	4.3	4.5	11.5	11.5
- Group or individual activities	-44.4	23.9	42.6	7.9	7.9	7.9
- domestic services	-6.1	-5.7	-2.2	8.5	8.5	8.5
- SIFIM	-4.7	-0.1	29.2	20.5	9.0	15.0
GDP at factor cost	5.0	4.6	4.1	0.7	1.9	1.4
<b>Taxes</b>	<b>-0.2</b>	<b>8.0</b>	<b>5.2</b>	<b>-9.1</b>	<b>-0.4</b>	<b>12.6</b>
<b>GDP at market price</b>	<b>4.4</b>	<b>4.9</b>	<b>4.2</b>	<b>-0.3</b>	<b>1.7</b>	<b>2.5</b>

Source : Ministère de la Bonne Gouvernance et de la Planification, Cadrage Macroéconomique du Burundi, June 2017

Table 4: Evolution of key macroeconomic indicators

	2012	2013	2014	2015	2016
<b>GROSS DOMESTIC PRODUCTS AND PRICES</b>					
Real GDP growth (in %)	4.4	4.9	4.2	-0.3	1.7
Inflation rate (Annual average)	18.2	7.9	4.4	5.5	5.6
<b>EXTERNAL SECTOR</b>					
Exports, f.o.b. ( in millions of dollars)	134.7	94.0	131.8	120.1	109.4
Imports, C.I.F ( in millions of dollars)	751.5	811.0	768.7	716.4	734.8
Exports volume (in tons)	52 300	57 207	79 580	85 499	84 613
Imports volumes (in tons)	705 348	809 077	798 246	629 916	880458
Current account balance ( in millions of dollars)	-255.1	-250.2	-384.5	-373.3	-354.8
Exchange rate BIF/USD (period average)	1 442.5	1 555.1	1 546.7	1 571.9	1654.6
Exchange rate BIF/USD (end of period)	1 546.1	1 542.0	1 553.1	1 617.1	1688.6
Gross foreign reserves (in millions of USD, end of period)	312.9	321.2	317.3	136.4	95.4
Gross foreign reserves ( months of imports of the following year)	4.0	4.2	4.2	2.3	1.4
<b>MONEY</b>					
Net foreign assets (MBIF)	196 637.7	229 756.1	180 525.3	-76 150.1	-176 523.1
Domestic loans (in MBIF)	920 086.1	972 302.3	1 135 873.8	1 407 295.1	1 643 372.6
Net claims on the Government	277 057.5	274 749.0	384 697.0	687 259.5	910 311.1
Loans to private sector	643 028.6	697 553.3	751 176.8	723 344.8	724 923.0
Money Supply (M <sub>3</sub> )	856 091.2	939 527.9	1 045 336.7	1 060 791.0	112 9690.2
Money Supply (M <sub>2</sub> )	708 053.0	801 728.3	880 206.6	923 271.7	1 034 732.2
Money velocity (GDP/M <sub>2</sub> ; end of period)	4.8	4.9	5.1	4.8	4.6
Monetary Base (Growth rate)	16.1	23.6	15.8	-8.6	29.2
Liquidity supply interest rate ( in % )	-	-	-	3,4	3,1
Overnight facility rate ( in % )	13.8	12.5	8.0	9.8	8.6
Average commercial banks deposit rates (end of period, in %)	8.8	9.0	8.8	8.7	7.7
Average commercial banks' lending rates (end of period, in %)	15.7	16.2	16.7	16.9	16.5
<b>PUBLIC FINANCE</b>					
Revenues and grants (in % of GDP)	21.0	22,1	21.0	16.6	15.9
Expenses (in % of GDP)	24.6	25.0	25.3	24.7	22.0
Primary balance (in % of GDP, basis accruals)	-0.3	-2.4	-0.5	-6	-2.3
Overall balance (in % of GDP, basis accruals)					
- grants excluded	-8.2	-10.1	-9.5	-11.2	-8.5
- grants included	-3.6	-2.9	-4.4	-8.0	-6.0
Domestic debt (in MBIF)	539 600	597 962	727 264.4	1 069 551.8	1 376 307.8
External debt (in MUSD, end of period)	393	413	429.6	420	429.6
External debt service ratio (in % of exports)	3.4	3.5	4.1	5.8	6.6
External Debt (in % of the GDP)	18.1	16.1	15.7	15.6	15.2
GDP at market price (in billion of BIF)	3 365.8	3 812.5	4 185.1	4 423.2	4 754.9

Source : BRB

**Table 5: Evolution of convergence criteria in Burundi**

	2012	2013	2014	2015	2016
1. Annual inflation rate (ceiling = 8%)	18.2	8	4.4	5.5	5.6
2. Budgetary deficit grants included in % of GDP (ceiling = 3%)	3.6	2.9	4.1	8	6
3. Public debt in % of GDP (ceiling = 8%)	34.1	31.8	31.4	39.8	44.2
4. Foreign exchange reserves in months of import (minimum = 4.5 months)	4	4.2	4.1	2	1.5