INTERNATIONAL MONETARY FUND

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UNITED REPUBLIC OF TANZANIA

July 2015

SECOND REVIEW UNDER THE POLICY SUPPORT INSTRUMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR UNITED REPUBLIC OF TANZANIA

In the context of the second review under the Policy Support Instrument, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 6, 2015, following discussions that ended on March 19, 2015, with the officials of Tanzania on economic developments and policies underpinning the IMF arrangement under the Policy Support Instrument. Based on information available at the time of these discussions, the staff report was completed on June 19, 2015.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for the United Republic of Tanzania.

The documents listed below have been separately released:

Letter of Intent sent to the IMF by the authorities of Tanzania*
Memorandum of Economic and Financial Policies by the authorities of Tanzania*
Technical Memorandum of Understanding on Selected Concepts and Definitions Used in Monitoring of the Program Supported by the PSI*
*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

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FOR IMMEDIATE RELEASE
July 6, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second PSI Review for Tanzania

The Executive Board of the International Monetary Fund completed today the second review of Tanzania's economic performance under the program supported by the Policy Support Instrument (PSI)[1].

The PSI for Tanzania was approved by the Executive Board on July 16, 2014 (see Press Release No. 14/350). Tanzania's program under the PSI supports the authorities' medium-term objectives. These include: the maintenance of macroeconomic stability, the preservation of debt sustainability, and the promotion of more inclusive growth and job creation.

Following the Board discussion, Mr. Min Zhu, Deputy Managing Director and Acting Chair, made the following statement:

"Macroeconomic performance in Tanzania remains strong and medium-term prospects are favorable. Performance under the Policy Support Instrument was satisfactory through December 2014, but weakened in early 2015 due to a range of factors, including delays in mobilizing external financing and donor support. Against this backdrop, the authorities' corrective measures aimed at achieving the 2014/15 budget deficit target are commendable, though earlier expenditure ceiling adjustments could have helped preserve development spending.

"The draft 2015/16 budget, which targets an underlying deficit of 3.5 percent of GDP (excluding arrears clearance), is built on more prudent revenue and foreign financing assumptions. The fiscal target also puts Tanzania on a path to a 3-percent deficit over the medium term, which is consistent with maintaining a low risk of debt distress.

[1] The PSI is an instrument of the IMF designed for countries that do not need balance of payments financial support. The PSI helps countries design effective economic programs that, once approved by the IMF's Executive Board, signal to donors, multilateral development banks, and markets the Fund's endorsement of a member's policies (see http://www.imf.org/external/np/exr/facts/psi.htm). Details on Tanzania's PSI program are available at www.imf.org/tanzania.

"The authorities' plans to address verified domestic supplier arrears transparently through the budget are welcome. Commitment controls on expenditures and related sanctions for breaching rules need to be strengthened to ensure new arrears do not accumulate. The strategy to address arrears to pension funds needs to be finalized quickly to allow for clearance of these arrears in 2015/16.

"The current monetary policy stance is appropriate, delivering high growth and low and stable inflation. The use of foreign exchange intervention should be restricted to smoothing volatility in the foreign exchange market, with higher reliance on domestic-currency instruments to address excess liquidity situations."

INTERNATIONAL MONETARY FUND

UNITED REPUBLIC OF TANZANIA

SECOND REVIEW UNDER THE POLICY SUPPORT INSTRUMENT

June 19, 2015

KEY ISSUES

Tanzania's macroeconomic performance remains strong. Real GDP grew by about 7 percent in 2014 and inflation is now slightly below the authorities' 5 percent target. Growth is projected to remain strong and inflation moderate.

Program performance since the last review has been uneven. All end-2014 assessment criteria were met, though the indicative target on tax revenue collection was missed. Good progress was made on structural benchmarks. Shortfalls in domestic revenue continued in early 2015 and delays were incurred in mobilizing external financing and adjusting expenditure in the context of the mid-year budget review. Monetary policy was loosened unexpectedly in late 2014 and interventions in the foreign exchange market increased. These developments, together with shortfalls in external program financing, led to the end-March 2015 targets on net domestic financing and international reserves being missed.

The authorities intend to maintain a prudent fiscal policy in 2015/16. Expenditure measures were taken to adhere to the 2014/15 target for the overall deficit and the authorities are committed to a deficit (excluding arrears clearance) of 3.5 percent of GDP next year, consistent with a medium-term fiscal anchor of a deficit slightly below 3 percent of GDP. Discussions focused on measures that would allow a realistic but ambitious increase in revenue, to make more space for priority expenditure and reduce the risk of further arrears accumulation. The program allows for the settlement of existing arrears to suppliers and pension funds.

Monetary policy has been tightened recently. This will help address the excess liquidity situation, which likely contributed to disorderly conditions on the foreign exchange market and pressures on international reserves. The recent depreciation of the shilling against the U.S. dollar reflects to a large extent the strength of the dollar and should not be resisted.

Staff recommends completion of the second PSI review and modification of assessment criteria on net international reserves (NIR) and net domestic financing (NDF) for end-June 2015.

Approved By

Roger Nord (AFR) and Dhaneshwar Ghura (SPR)

A staff team consisting of Messrs. Joly (head), Gigineishvili, Raman (all AFR), Kpodar (FAD), and Ms. Farid (SPR) visited Dar es Salaam during March 5–19, 2015. Messrs. Baunsgaard (Resident Representative) and Rutachururwa and Ms. Shayo (local economists) assisted the mission. The mission met with Minister of Finance Saada Mkuya Salum; Bank of Tanzania Governor Ndulu; Permanent Secretary of the Treasury Dr. Likwelile; Deputy Permanent Secretary Prof. Mkenda; other senior officials; members of the Parliamentary Budget Committee; private sector representatives; and development partners. Mr. Tucker (OED) participated in discussions with the authorities.

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APPENDIX

BACKGROUND AND RECENT DEVELOPMENTS

1. **Parliamentary and presidential elections are scheduled for October 2015.** The presidential contest will see the election of a successor to outgoing President Kikwete. The referendum on a proposed new constitution, which largely preserves the current 2-government structure, was postponed to a yet-to-be announced date due to delays in registering voters.

2. **Donors have begun to re-engage following positive developments in the IPTL case.**[1] Following the submission of a report by the Controller and Auditor General to the parliamentary Public Accounts Committee in November 2014, a number of senior officials, including cabinet officials, have since resigned, or been removed. Investigations by the Prevention and Combating Corruption Bureau continue. The Financial Intelligence Unit has conducted an investigation into the possible breach of anti-money laundering rules by two banks. As a result, donors agreed to resume disbursing a large part of the committed budget support by the end of the fiscal year. However, the prospects for future engagement are less clear, pending further progress on the IPTL case.

3. **Recent macroeconomic performance remains strong** (Figure 1). New national accounts data (Box 1) are now used in the program. Quarterly accounts suggest that real GDP grew by about 7 percent in 2014, driven by construction, services, manufacturing, and agriculture. Lower global oil prices constitute a large positive income shock for Tanzania; as it is being passed through, it should provide a boost to private demand and activity. The oil price decline has also led to lower headline CPI inflation. The latter stood at 4.5 percent in April 2015, slightly below the authorities' 5 percent target. The external current account deficit in 2014/15 is now expected to fall to 9.5 percent of GDP owing to lower oil prices.

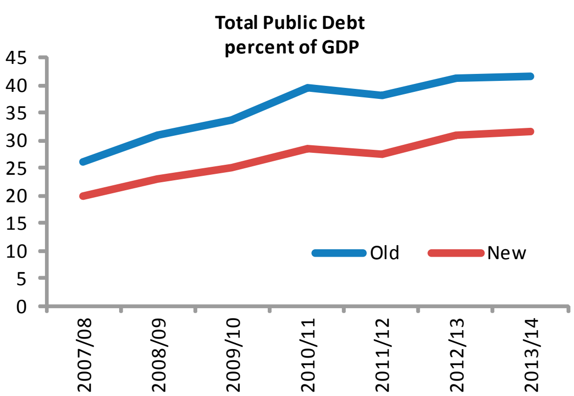
[1] This refers to the contentious transfer of ownership in IPTL, an independent power producer, and the related release of escrowed money at the central bank in favor of the new owner (see Box 1 in Country Report No. 15/14).

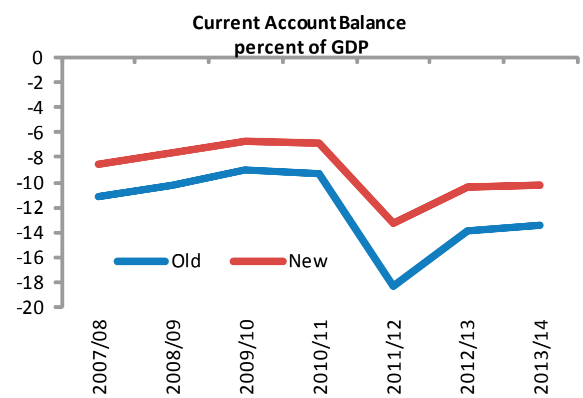
Box 1. Implications of National Accounts Revisions

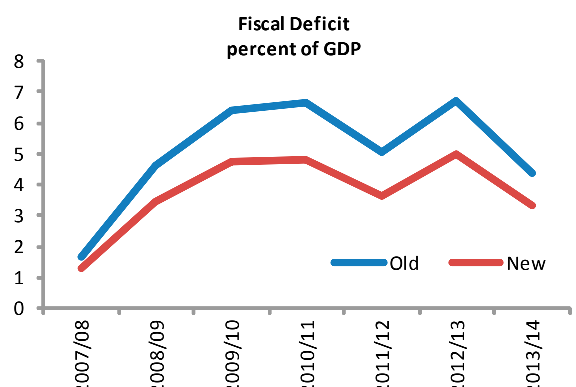
The National Bureau of Statistics released revised national accounts in late 2014. The changes reflect the rebasing of GDP from 2001 to 2007, a thorough utilization of several benchmark surveys conducted in recent years, and improved statistical techniques, including better use of the value-added tax collection data. As a result, nominal GDP for 2007 was revised up by 27.8 percent. The structure of the economy, however, remained broadly unchanged with agriculture remaining the largest sector (23.8 percent) followed by trade (10.1 percent), construction (9.6 percent) and manufacturing (7.6 percent). The new series exhibit lower average growth (6.4 percent vs. 7 percent before) but greater volatility over the past decade.

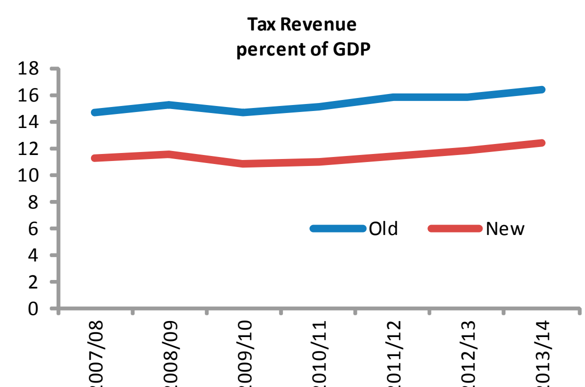
With the revision, the 2013 income per capita (GNI, WB Atlas method) increased from US$630 to US$860. This is still well below the IDA operational cutoff of US$1,195 in 2013. Therefore, Tanzania remains a low-income country for IDA and the IMF.

Some of the key ratios for macroeconomic analysis have improved noticeably: for 2013/14 total public debt declined from 41.5 percent of GDP to 31.6 percent, the current account deficit from 14.4 percent of GDP to 10.3 percent, and the overall fiscal deficit from 4.4 percent of GDP to 3.3 percent. At the same time, tax revenue collection also dropped from 16.3 percent of GDP to 12.4 percent, which is one of the lowest in the region.









Source: Tanzanian authorities, IMF staff calculations

4. **Program performance since the last review has been uneven.** All end-December assessment criteria were met, though the indicative target (IT) on tax revenue collection was missed and suppliers' arrears increased during the second half of 2014. Good progress was made on structural benchmarks (Text Table 1). However, shortfalls in domestic revenue continued. In addition, while spending was constrained by cash availability, the mid-year budget review expected to take place in January was delayed. As a result, expenditure ceiling adjustments required to meet the fiscal deficit objective underpinning the program were only made in early April. Monetary policy was loosened and interventions in the foreign exchange market increased (below). These developments, together with delays in contracting external nonconcessional borrowing (ENCB) and shortfalls in program assistance, led to missing the end-March 2015 ITs on net domestic financing (NDF) and net international reserves (NIR). However, average reserve money came in well below target.

5. **Monetary policy was loosened unexpectedly in late 2014.** Citing the need to support private sector credit growth and ensure adequate funds at the end of the calendar year when seasonal demand for liquidity rises, the Bank of Tanzania (BoT) lowered the statutory minimum reserves (SMR) ratio on non-government deposits from 10 to 8 percent. This led to a large and relatively lasting increase in excess reserves of banks and a concomitant fall in interest rates on the interbank and T-bill markets.

MEFP ¶5

6. **The pace of the shilling's depreciation against the U.S. dollar picked up in recent months.** Between mid-2014 and May 2015, the shilling depreciated by about 20 percent against the U.S. dollar, but appreciated against a number of other currencies (e.g., the euro), suggesting that movements against the U.S. dollar mostly reflected the latter's strengthening (Figure 3). Spurred by concerns over exchange rate volatility and possible overshooting, the BoT ramped up foreign exchange sales from US$41 million in December to a monthly average of US$85 million for January–April. Coupled with shortfalls in ENCB and program assistance and higher outflows (owing to higher-than-budgeted spending on imported biometric voter registration kits for the referendum and general elections, and external debt service payments), the larger-than-programmed sales of foreign exchange caused gross international reserves to decline from US$4.4 billion at end-December 2014 to US$4.1 billion in March 2015.[2]

7. **Existing budgetary suppliers' arrears have been verified and a plan to settle them is being finalized.** The verification exercise to finalize the stock as of end-June 2014 identified about TSh 860 billion of legitimate claims to be repaid (about 1 percent of GDP). The authorities expect to clear TSh 170 billion in 2014/15, with the rest to be settled in 2015/16.

MEFP ¶24

[2] The NIR decline also reflects a valuation effect related to the U.S. dollar appreciation against other reserve currencies.

8. A strategy to address arrears to pension funds was discussed by Cabinet but requires some more work to reconcile numbers and finalize. The government has agreed to cover its liabilities to the largest pension fund, the Public Sector Pension Fund (PSPF), estimated to amount to at least 1.5 percent of GDP. These arrears would be cleared by issuing securities to the PSPF. Cash payments started to be made to the PSPF in 2014/15 on account of current liabilities, and will be explicitly budgeted starting 2015/16, which should prevent new arrears from arising. The government is also committed to addressing arrears on loans extended by the pension funds to various public entities. The World Bank is working on an operation to support pension reforms, which is expected to be approved in the second half of 2015.

MEFP ¶23

9. Payments to two external creditors have been suspended while the authorities seek to establish the legitimacy of the claims. After agreeing to a revised payment schedule with Wallis Trading Company, with whom arrears had accumulated in recent years, the authorities informed staff that they were reconsidering the legitimacy of the claim and suspended payments. The authorities are also in discussion with Belgium on the validity of a loan contracted in the early 2000s. Having received more detailed information from the creditor in March 2015, the authorities are reviewing their records to confirm delivery of the equipment reportedly purchased with the loan.[3]

10. The authorities produced a policy paper that lays out good principles for a fiscal framework for managing revenues from natural gas. The paper, which benefitted from Fund TA, is comprehensive and draws extensively on international experience. It suggests the use of a range of indicators, such as the non-resource balance, to address the issue of the volatility of natural resource prices. The strategy also lays out the principles that will be used to establish a budget management framework for resource revenues, and in particular a Natural Gas Revenue Fund that will be fully integrated into the budget, with no parallel spending authority. The draft policy has been endorsed by the cabinet.

MEFP ¶22

[3] Considering that the authorities are disputing (i) the validity/legality of Wallis's debt claims and (ii) the existence of the arrears to Belgium pending the completion of the ongoing reconciliation of accounts, such disputed claims are not considered to give rise to external arrears for program purposes at this time.

Status of structural benchmarks scheduled for completion between December 2014 and April 2015

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Paymaster General (PMG) to issue a new circular requiring quarterly reporting of payment arrears to include a clear definition of arrears, an extension of the reporting coverage, an additional aging category to identify arrears of more than one year, documentation requirements, and a requirement that internal auditors in MDAs prescreen the arrears data before submission.	To enhance monitoring of arrears	December 31, 2014	Met.
Prepare a report on verification of arrears as of end-June 2014 that covers all ministries, departments and agencies.	To accelerate settlement of arrears	February 28, 2015	Met with a delay in April 2015.
Conduct a review of the relationship between the interbank cash market rates and excess reserves of commercial banks.	To prepare BoT's gradual shift to a price-based monetary framework.	December 31, 2014	Met.
Unify the Statutory Minimum Reserve and the clearing accounts that banks maintain at the BoT and implement partial reserve averaging for reserve requirements	To reduce excessive volatilities in short term money market interest rates.	April 30, 2015	Not met. Unification of the relevant accounts proved technically more challenging than expected and reserve averaging could have complicated the decision to tighten liquidity. Proposed to be rescheduled for end-2015.
Prepare and adopt a strategy to address government arrears to pension funds	To improve the sustainability of the funds	February 28, 2015	Not met. A broad strategy was discussed by the Cabinet and approved in March 2015, but required more work before finalization.
Prepare a draft policy paper on natural gas revenue management framework that fully integrates with the budget.	To strengthen fiscal sustainability and improve transparency in the use of natural gas resources	March 31, 2015	Met.

MEFP ¶6, 7

11. Financial stability indicators have improved (Table 5). Gross non-performing loans declined from 8.4 percent of total loans in September 2014 to 6.7 percent in March 2015. The banking system remains well capitalized and liquid, and most banks have complied with the BoT's directive to increase their minimum capital levels by end-March 2015. A key aspect of improving the financial supervisory framework is to strengthen capacity in view of the ongoing capital account liberalization. In particular, the BoT is planning to undertake a pilot examination under the new rules governing consolidated supervision in late 2015. A final resolution of FBME Bank, which has been placed under the BoT's close supervision following a finding by the U.S. authorities in July 2014 that it is an institution of primary money laundering concern, remains pending. It will depend on the final ruling by the U.S. authorities, which has not yet been made. In the meantime, the authorities are strengthening their AML/CFT supervisory framework.

POLICY DISCUSSIONS

A. Economic Outlook and Risks

12. The broad macroeconomic outlook is favorable. Growth is expected to remain robust, benefitting from the positive terms-of-trade shock from lower oil prices in the short term. Inflationary pressures also appear well contained. The outlook for the current account deficit has also improved on the back of lower oil imports. However, the outlook for capital and financial inflows is less favorable, particularly for external budget support (see ¶2) and FDI. While there is so far no indication that lower oil prices could affect long-term prospects for natural gas exploitation, the exploration phase is now largely over and related FDI flows are expected to drop.

13. Risks to the program. The main risks stem from fiscal policy, especially in view of the electoral context. Expenditure pressures may increase, which could lead to fiscal slippages and further arrears accumulation. Revenue mobilization efforts could also be affected, and more generally reforms could stall. Should these risks materialize, market financing could also prove more challenging to raise, with the risk of having to resort again to unorthodox financing facilitated by the central bank, as in early 2014/15. On the upside, higher donor budget support is possible, as the authorities have used fairly conservative assumptions in the 2015/16 budget

B. Fiscal Policy

MEFP ¶18

14. The authorities are on track to meet their overall deficit target in 2014/15. This reflects the cautious release of cash for budget expenditure in line with available revenue and financing resources. Revenue has continued to underperform, mainly reflecting weaker-than-expected demand for excisable products, challenges in the rollout of electronic fiscal devices, increasing imports from regional trade partners, and a shortfall in income tax revenue following a change in the withholding system. The outcome of the mid-year budget review was to reduce expenditure ceilings by 1.9 percent of GDP, of which 1.6 percent of GDP accounted for the postponement or cancellation of investment projects. This should allow the authorities to meet their deficit target of 3.8 percent of GDP (or 4 percent including suppliers' arrears clearance). On the financing side, delays in securing ENCB have also complicated budget management. Out of the US$800 million envisaged in the 2014/15 budget, only US$300 million had been disbursed by end-May 2015. Staff praised the authorities for taking difficult expenditure measures and their commitment to the overall deficit target, but also flagged that earlier completion of the mid-year budget review would have ensured a more orderly and efficient adjustment, with expenditures measures relying less on development spending. Earlier adjustment of expenditure and disbursement of ENCB would also have reduced the risk of arrears accumulation in the second half of the fiscal year.[4] With overall external financing lower than programmed, higher recourse to domestic financing will be required.

15. The authorities are targeting an overall budget deficit of 4.2 percent of GDP in 2015/16. Excluding the exceptional allocation for supplier arrears clearance (0.7 percent of GDP),[5] the draft budget presented to parliament envisages an overall deficit of 3.5 percent. This path for the underlying deficit is consistent with a deficit slightly below 3 percent of GDP in the medium term (see below). This underlying deficit also represents a significant effort, in light of the significant budget allocation for the organization of the general elections (about 0.5 percent of GDP) and the expected decline in budget support grants. The draft budget also includes an allocation to address current liabilities to the PSPF.[6]

MEFP ¶19

16. To make space for a significant increase in priority expenditure, revenue mobilization will be enhanced by a range of tax measures. They include new levies to finance rural electrification and railway development, but also a range of smaller measures affecting excises, VAT, and import duties. These measures, together with the implementation of the new VAT law that reduces exemptions, are expected to generate more than 1 percent of GDP in additional revenue. A range of measures will also be implemented to fight tax evasion and collect more revenue from public entities, but the yields are not included in the 2015/16 revenue projections due to uncertainties on their magnitude. Higher revenue will allow combining a reduction in the overall deficit (excluding arrears clearance) while raising the public investment effort and hiring new education and health workers.

MEFP ¶19

17. Preserving medium-term fiscal sustainability while meeting development needs will require strong policy actions. The debt sustainability analysis (DSA) update confirms that Tanzania remains at low risk of debt distress, provided fiscal and borrowing policies remain prudent. The DSA suggests that an overall fiscal deficit of about 3 percent of GDP in the medium term is an appropriate medium-term fiscal anchor (for the preservation of the low risk rating). To be consistent with regional commitments in the convergence towards the East African Monetary Union, a deficit slightly below 3 percent should actually be targeted in the medium term, to ensure that the debt convergence criterion can be met in downturns. The fiscal deficit could get

[4] Due to the late adjustment in allocations, arrears further accumulated between July-December 2014. Information on the first quarter of 2015 was not yet available at the time this report was finalized.

[5] The arrears in question only refer to the verified domestic suppliers' arrears as of end-June 2014 and do not cover arrears that may have accumulated in 2014/15 and arrears to pension funds.

[6] Staff noted that the budgeted amount was lower than payments expected to be made in 2014/15 and stressed the importance of an adequately large allocation to avoid the accumulation of new arrears to the PSPF.

close to 3 percent of GDP as soon as 2016/17, as exceptional expenditures (e.g., for arrears clearance and elections) would phase out. Staff stressed the importance of containing current spending to make room for investment. Further revenue mobilization efforts will also be required to finance the authorities' priority expenditures (infrastructure, education, health, and essential social services) and sustain high and inclusive growth.

18. The program is designed to facilitate the transparent clearance of domestic arrears. Beyond the clearance of suppliers arrears as of end-June 2014 built into the fiscal program's baseline, the program includes an adjustor to NDF in 2015/16 to allow for the clearance of arrears to pension funds, which will be mostly financed through the issuance of government securities to pension funds (see ¶8).

MEFP ¶25

19. Arrears prevention will hinge on a range of measures. A critical pre-requisite is to base the budget on realistic revenue estimates. Staff views the 2015/16 estimates as adequately ambitious while achievable. Another critical step will be to reintroduce by September 1, 2015 commitment controls in the Integrated Financial Management System (IFMS), which were removed last July to encourage ministries and agencies to normalize commitments made outside IFMS (new structural benchmark). Full budgeting for future liabilities to the PSPF would prevent further arrears. Finally, sanctions will be strengthened in the Budget Act regulations and will need to be applied forcefully.

MEFP ¶26, 28

20. Public financial and debt management will be strengthened in a number of areas. A new Budget Act was passed in early 2015, which strengthens the budget process and clarifies the legal roles and responsibilities of the various stakeholders. The Public Finance Act is also being reviewed. The Debt Management Department is expected to be fully operational in early 2015/16; it will be responsible for all debt management functions. The medium-term debt management strategy will be updated, presented the National Debt Management Committee, and approved by the Minister of Finance by end-December 2015 (new structural benchmark). A debt rating agency is currently being selected, paving the way to obtaining a sovereign rating and a possible Eurobond issuance in 2015/16.

C. Monetary and Exchange Rate Policies

MEFP ¶14

21. Staff expressed concern about the reduction of the reserve requirement in late 2014. Staff noted that it occurred in a context of robust private sector credit growth (about 20 percent) and inflation close (and expected to remain close) to the authorities' medium-term target of 5 percent. Rather, the tighter liquidity conditions anticipated by the BoT in December 2014 are a seasonal feature, driven by the need to pay taxes. Indeed, due to improved liquidity management by the BoT and commercial banks, excess reserves before the reduction took effect were not significantly different from typically comfortable levels. The lowering of the reserve requirement, together with the government's large recourse to the overdraft facility, led to a large increase in banks' excess reserves that likely increased exchange rate pressures and required mopping up by the BoT, including through higher-than-programmed foreign exchange sales.

22. Monetary policy was tightened in May. The BoT, citing concerns that an overshooting exchange rate could stoke inflation through higher import prices, reversed the earlier reduction in the reserve requirement. Staff welcomed the BoT's willingness to address the excess liquidity conditions. Earlier and more aggressive recourse to domestic currency instruments (repos, issuance of liquidity papers) would have helped. The government could also have supported the BoT by issuing more papers that could have been used to pre-fund suppliers' arrears clearance. In light of the excess foreign exchange sales in early 2015 and the expected external financing shortfall for the whole fiscal year, and despite the recent corrective action, the nominal NIR target for June 2015 is now out of reach and needs to be revised. The proposed new target for NIR would still ensure a reserve cover of 3.9 months of prospective imports, as before, because 2015/16 import projections have been revised downward. Significant reserve accumulation is programmed in 2015/16, which would allow for a further increase in the import cover ratio to 4 months of imports, in line with the Bank of Tanzania Act. Further gradual reserve accumulation is projected beyond 2015/16, to bring the reserve cover ratio to 4.5 months of imports (a convergence criterion for the East African Monetary Union).

23. Capital account liberalization is proceeding as scheduled and broadly consistent with the Fund's integrated approach. Following the liberalization of the capital account to intra-EAC flows in 2014, regional investors have expressed interest in participating in Tanzania's financial markets. Actual flows, however, remain small as interested investors are working through the registration and compliance requirements set out by the BoT. The next step will be to extend the current liberalization with the rest of the world later in 2015, in line with Tanzania's commitments under the EAC Common Market Protocol. The BoT's approach prioritizes long-term flows as they work to build regulatory and oversight capacity. The central bank continues to maintain a number of prudential measures, including capital flow measures in the form of restrictions on nonresidents' holdings of short-term debt securities and minimum holding periods. The entry of foreign banks into Tanzania and the emergence of a small but growing presence of Tanzanian banks abroad also underline the importance of implementing the recently-issued regulations on consolidated supervision.

D. Other Reforms

24. The financial situation of TANESCO, the power utility, has improved but arrears remain. The recovery of hydro capacity has allowed TANESCO to phase out all but one high-cost emergency power plant. The costs of thermal power generation have been further reduced thanks to lower oil prices and reduced technical losses, while improved metering and payment enforcement strengthened TANESCO's revenues. As a result, the electricity tariffs now reportedly fully cover operating costs. Further financial gains are expected after commissioning of the gas pipeline and a new gas-fired power

MEFP ¶21

plant in Kinyerezi, which are on track for completion in the coming months. Nevertheless, the situation seems to have deteriorated in early 2015, as suggested by the increase in arrears to suppliers from TSh 345 billion at end-2014 to TSh 587 billion (about US$293 million) at end-May 2015 . This undermines the credibility of TANESCO as a gas and electricity off-taker in turn making private sector investment in the energy sector more risky.

25. A strategy to address TANESCO's arrears will be prepared. It will be developed by the main stakeholders and finalized by end-September 2015 (new structural benchmark). Meanwhile, the tariffs will continue to be adjusted quarterly according to the mechanism in place, which takes into account the changes in oil prices, the exchange rate, and inflation. Staff noted that in light of the recent increase in arrears, the slight decrease in tariffs in March 2015 could have been suspended. The authorities argued that the credibility and acceptance of the adjustment mechanism requires that it be left to operate both upwards and downwards. Unless tariffs are determined to enable TANESCO to clear the stock of arrears, additional budget transfers are needed.

PROGRAM MONITORING

26. Both the NDF and the NIR targets for end-June 2015 are now out of reach and need to be modified. Quantitative assessment criteria and indicative targets are proposed for end-December 2015 and end-June 2016, as well as new structural benchmarks. In addition, to strengthen arrears monitoring and provide stronger incentives for realistic revenue projections, it is proposed to introduce an IT on arrears accumulation and to convert the existing IT on tax revenues to an assessment criterion.

STAFF APPRAISAL

27. Tanzania's macroeconomic performance remains favorable, but risks to program implementation have increased. Growth is projected to remain strong and inflation close to the authorities' target of 5 percent. Program targets for end-2014 were met but performance deteriorated in early 2015. The main risks in the next few months stem from fiscal policy implementation in an electoral context. Expenditure pressures may increase, which could lead to fiscal slippages and further arrears accumulation. Revenue mobilization efforts could also be affected, and more generally reforms could stall. Should these risks materialize, market financing could prove more challenging to raise. On the upside, higher budget support than budgeted is possible.

28. Staff welcomes the authorities' actions to stay the fiscal course in 2014/15, including their willingness to adjust expenditure ceilings to meet their overall deficit target. Staff notes, however, that earlier completion of the mid-year budget review would have ensured a more orderly and efficient adjustment, relying less on investment. Earlier adjustment of the budgetary expenditure envelope and mobilization of ENCB would also have reduced the risk of arrears accumulation in the second half of the fiscal year.

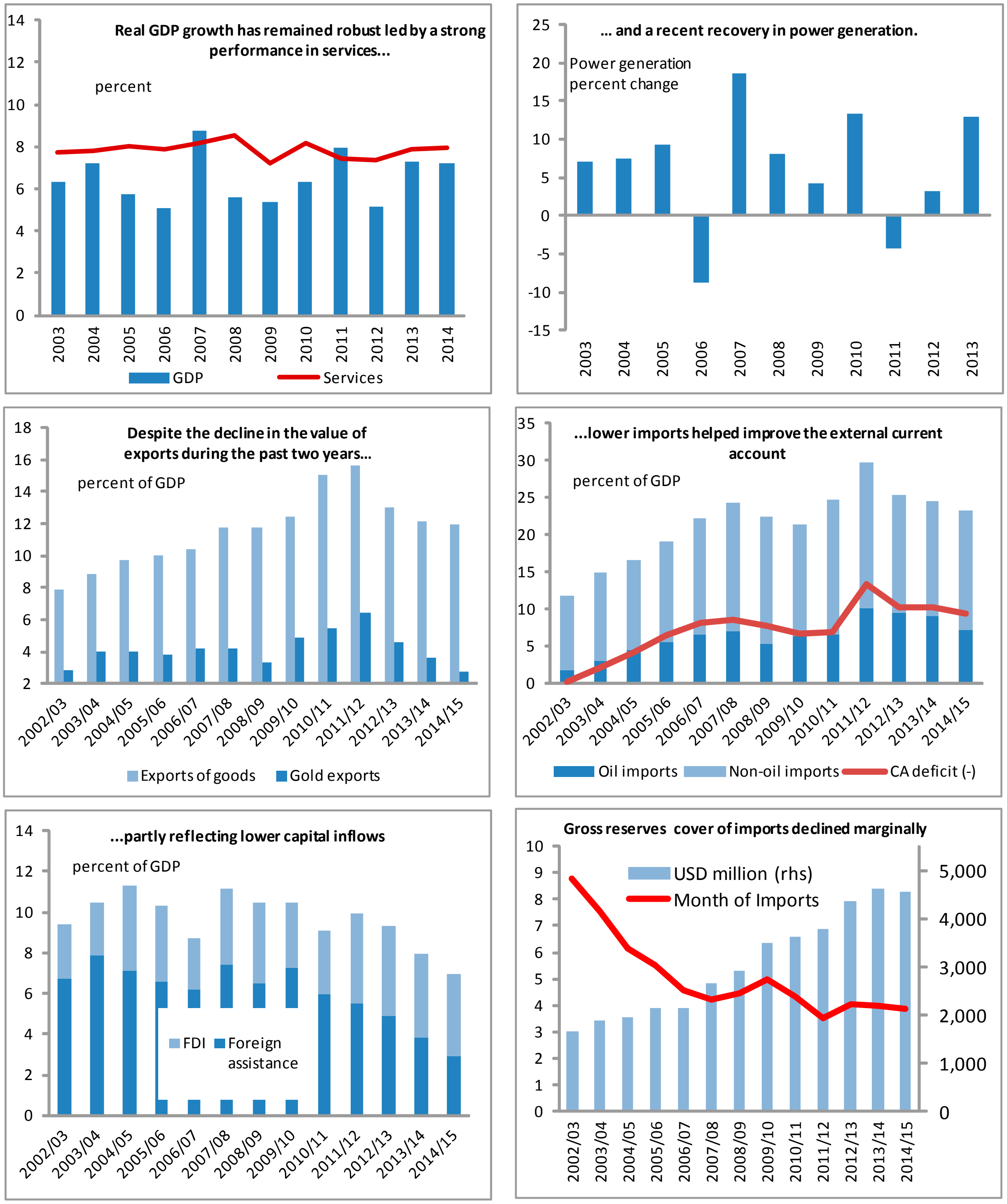
29. The draft budget for 2015/16 is ambitious and backed by more realistic revenue estimates than in past years. The targeted deficit of 3.5 percent of GDP (excluding arrears clearance) sends a strong signal about the authorities' intention to preserve fiscal sustainability and is consistent with the fiscal anchor of a deficit slightly below 3 percent of GDP in the medium term. To make space for a significant increase in priority expenditure, revenue mobilization will be enhanced by a range of credible and carefully quantified tax measures. This approach should reduce the risk of having to adjust expenditure downward in the course of the year, as was required in the past two years.

30. Preventing new arrears will require sustained efforts. Staff welcomes the progress made in identifying government arrears and settling suppliers' arrears explicitly through the 2015/16 budget. It urges the authorities to complete the work on arrears to pension funds and to use the flexibility allowed in the program to settle them. Preventing future arrears will require a range of steps, such as realistic revenue estimates, reintroducing commitment controls in IFMS, and a strengthening and forceful application of sanctions for breaching the rules.

31. Staff welcomes the recent tightening of monetary policy. The unexpected lowering of the reserve requirement in late 2014, together with the government's large recourse to the overdraft facility, led to a large increase in banks' excess reserves that likely exacerbated exchange rate pressures and led to unsustainable foreign exchange sales. Staff is of the view that earlier and more aggressive recourse to domestic currency instruments would have helped address the excess liquidity situation. It also reiterates the need to restrict the use of foreign exchange interventions to monetary policy objectives and smoothing volatility on the foreign exchange market. While it understands the needs to avoid an excessively rapid depreciation of the shilling against the U.S. dollar, staff notes that the depreciation reflected to a large extent the strength of the dollar.

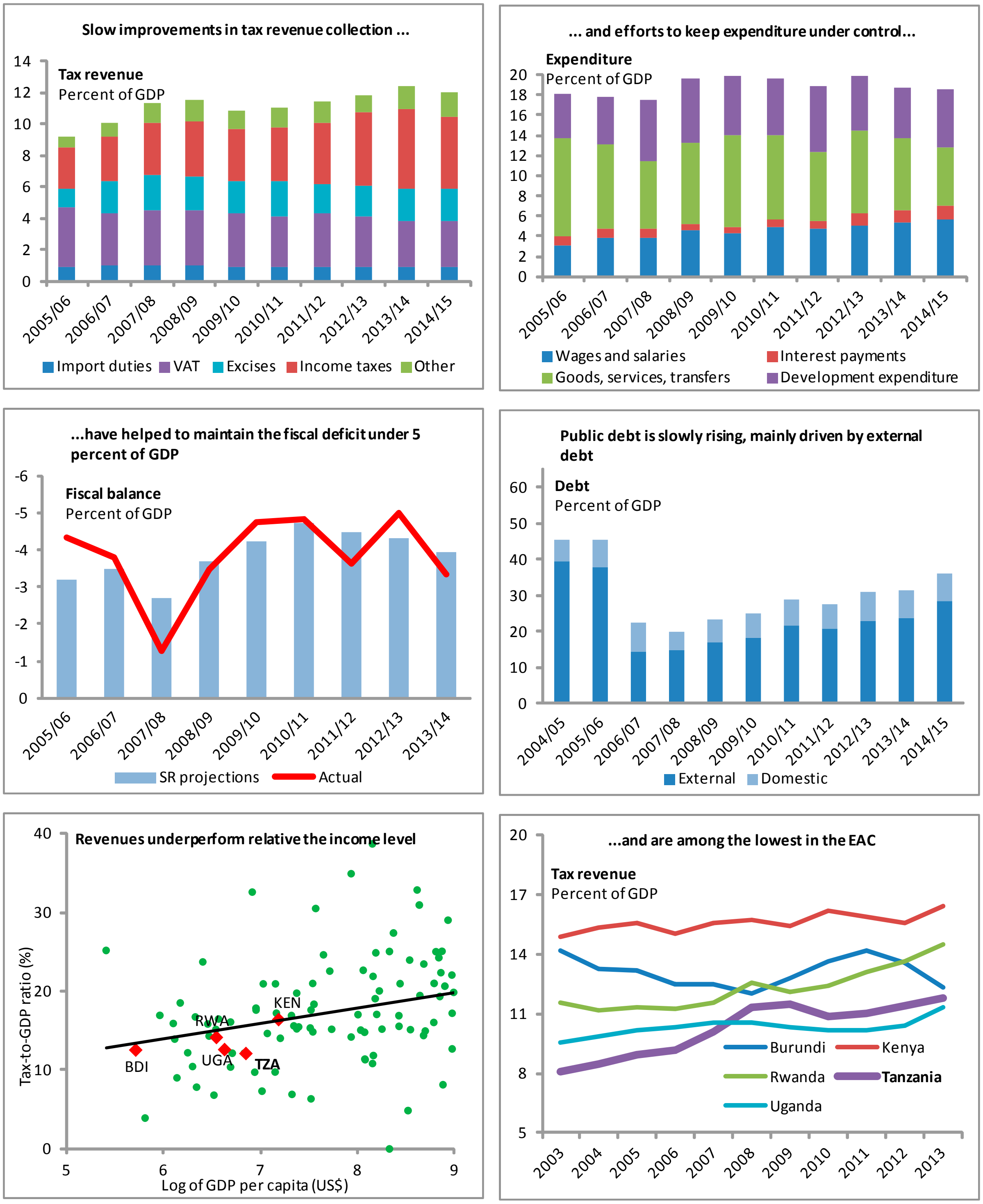
32. Staff recommends completion of the second PSI review, modification of assessment criteria on NIR and NDF for end-June 2015, introduction of a new assessment criterion on tax revenue, and setting of end-December 2015 assessment criteria.

Figure 1. Tanzania: Real Sector and External Developments



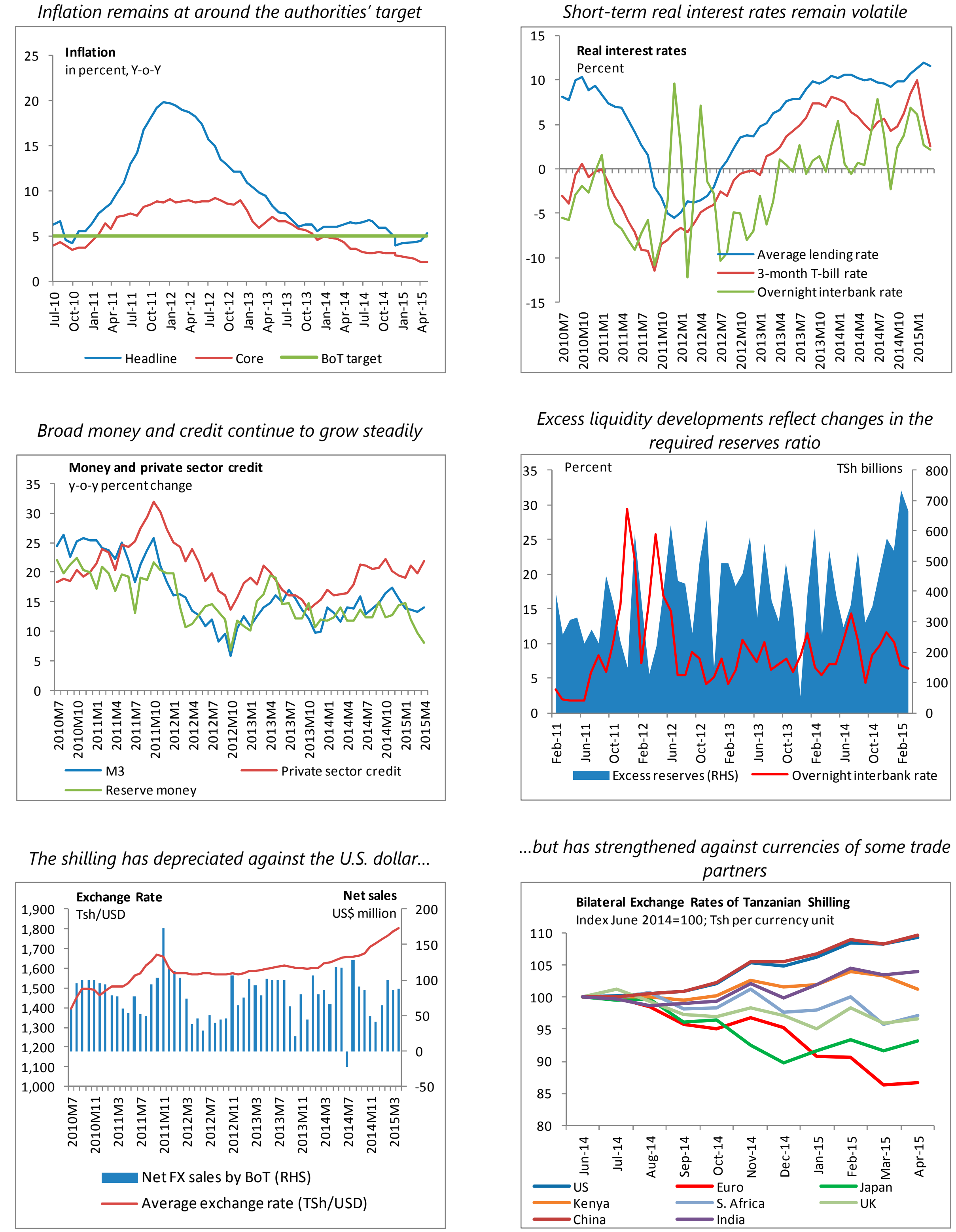
Source: Tanzanian authorities and IMF staff calculations.

Figure 2. Tanzania: Fiscal Developments



Source: Tanzanian authorities and IMF staff calculations.

Figure 3. Tanzania: Monetary and Inflation Developments



Sources: Bank of Tanzania and IMF staff calculations.

Table 1. Tanzania: Selected Economic and Financial Indicators, 2012/13–2017/18

	2012/13	2013/14	2014/15		2015/16		2016/17	2017/18
			Prog.[1]	Proj.	Prog.[1]	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)							
Output, prices and exchange rates								
Real GDP	6.2	7.3	7.1	7.2	7.0	7.2	7.1	7.0
GDP deflator	8.8	6.3	5.5	5.2	4.9	4.3	4.5	4.5
CPI (period average)	11.3	6.3	5.3	5.2	5.2	5.0	5.0	5.0
CPI (end of period)	7.6	6.4	4.8	4.8	5.2	5.0	5.0	5.0
Core inflation (end of period)[1]	4.5	3.1	…	…	…	…	…	…
Terms of trade (deterioration, -)	-1.2	-3.1	-0.4	3.5	-1.8	6.8	-3.7	-1.0
Exchange rate (period average, TSh/USD)	1,580	1,615	…	…	…	…	…	…
Real effective exchange rate (end of period; depreciation= -)	6.3	1.7	…	…	…	…	…	…
Money and credit								
Broad money (M3)	14.9	15.8	15.8	12.2	…	16.0	…	…
Average reserve money	14.5	13.7	15.0	9.0	…	13.4	…	…
Credit to nongovernment sector	17.1	21.4	19.5	17.5	…	14.1	…	…
Treasury bill interest rate (in percent; end of period)	13.9	12.7	…	…	…	…	…	…
Broad money (M3, as a percent of GDP)	23.2	23.6	24.3	23.5	…	24.4	…	…
Non-performing loans (end of calendar year, percent of total loans)[2]	7.1	6.8	…	…	…	…	…	…
	(Percent of GDP, unless otherwise indicated)							
Central government budget								
Revenues and grants	15.5	15.7	15.8	14.6	16.4	16.4	16.3	16.3
Of which: grants	2.6	2.1	1.8	1.3	2.0	1.5	1.3	1.1
Expenditures	20.6	18.7	20.5	18.6	22.8	20.6	19.3	19.3
Current	14.4	13.8	13.0	12.8	13.0	14.5	14.3	14.5
Development	6.2	4.9	7.5	5.7	7.5	6.1	5.0	4.8
Unidentified expenditure measures[3]	…	…	-1.0	0.0	-1.0	0.0	0.0	0.0
Overall balance[4]	-5.0	-3.3	-3.7	-4.0	-3.0	-4.2	-3.0	-3.0
Excluding grants[4]	-7.6	-5.5	-5.5	-5.3	-5.0	-5.7	-4.3	-4.1
Public debt								
Public gross nominal debt[5,6]	30.8	31.6	33.5	37.8	33.7	39.2	39.1	39.0
of which: external public debt[6]	23.1	23.8	26.6	30.2	27.4	30.9	30.8	30.8
Investment and savings								
Investment	29.1	29.3	25.1	29.1	25.4	29.3	29.6	29.4
Government	6.0	5.4	7.0	5.7	7.6	5.7	5.2	4.8
Nongovernment[7]	23.2	23.9	18.1	23.4	17.8	23.6	24.4	24.6
Gross domestic savings	16.2	16.4	14.7	19.3	15.8	20.9	22.2	22.5
External sector								
Exports (goods and services)	20.1	19.2	19.1	19.2	19.4	21.4	21.9	21.8
Imports (goods and services)	31.0	30.2	29.7	29.2	28.9	29.5	28.9	28.9
Current account balance	-10.3	-10.3	-10.2	-9.5	-10.4	-8.2	-7.0	-7.2
Excluding current transfers	-11.2	-11.2	-11.9	-10.1	-12.1	-8.5	-7.5	-7.6
Gross international reserves								
In billions of US$	4.4	4.6	5.1	4.5	5.7	4.9	5.6	6.1
In months of next year's imports	3.7	4.0	3.9	3.9	3.8	4.0	4.1	4.2
Memorandum items								
GDP at current market prices								
Billions of Tanzanian shillings	65,585	74,779	84,319	84,319	94,275	94,275	105,506	117,998
Millions of US$	41,498	46,290	48,161	48,161	47,256	47,256	51,430	56,167
GDP per capita (US$)	914	1,000	1020	1,020	981	981	1,047	1,121
Population (million)	45	46	47	47	48	48	49	50

Sources: Tanzanian authorities and IMF staff estimates and projections.

[1] From the first review under the Policy Support Instrument (IMF Country Report No. 15/14).

[2] E.g. Calendar year corresponding to 2012/13 is 2013.

[3] For 2014/15, these are the spending adjustments needed to achieve the budget deficit target. The authorities are expected to identify these adjustments during the mid-year budget review in January 2015. For 2015/16 and beyond, the adjustment factor is carried forward as a balancing item, as the final projections of the expenditure components will depend on the composition of adjustments in 2014/15.

[4] Actual and preliminary data include adjustment to cash basis.

[5] Net of Treasury bills issued for liquidity management.

[6] Excludes external debt under negotiation for relief, and domestic unpaid claims (reported in Table 2b).

[7] Including change in stocks.

Table 2a. Tanzania: Central Government Operations, 2012/2013–2017/18[1]
(Billions of Tanzanian Shillings)

	2012/13	2013/14	2014/15		2015/16		2016/17	2017/18
			Prog.	Proj.	Prog.	Proj.	Proj.	Proj.
Total revenue	8,443	10,182	11,807	11,231	13,540	14,042	15,794	17900
Tax revenue	7,730	9,294	10,661	10,130	12,253	12,408	14,097	16003
Import duties	584	694	814	732	913	865	968	1082
Value-added tax	2,146	2,189	2,689	2,521	3,306	3,408	3,919	4383
Excises	1,258	1,509	1,914	1,687	2,148	1,926	2,155	2411
Income taxes	3,034	3,779	3,964	3,887	4,448	4,390	5,019	5731
Other taxes	707	1,124	1,281	1,303	1,438	1,819	2,036	2395
Nontax revenue[2]	713	888	1,147	1,101	1,287	1,634	1,697	1898
LGA	221	315	458	388	515	522	584	653
Other	492	573	688	713	772	1,112	1,113	1244
Total expenditure	13,543	13,958	17,292	15,663	19,261	19,457	20,350	22749
Recurrent expenditure	9,445	10,299	10,950	10,834	12,216	13,714	15,110	17091
Wages and salaries [7]	3,350	3,969	4,733	4,733	5,311	5,572	6,236	6974
Interest payments	767	977	1,078	1,189	1,167	1,543	1,948	2384
Domestic	590	743	736	847	739	965	1,207	1428
Foreign[3]	177	234	342	342	428	579	741	956
Goods and services and transfers[2, 7]	5,328	5,352	5,140	4,912	5,737	6,598	6,926	7733
Of which: Transfers to PSPF	…	…	…	177	…	150	342	370
Of which: Transfers to TANESCO	419	399	146	0	…	…	…	…
Development expenditure [7]	4,098	3,660	6,343	4,829	7,045	5,743	5,241	5,658
Domestically financed	1,913	1,855	4,308	3,156	4,763	4,081	3,343	3,621
Of which: Clearance of suppliers' arrears	…	…	…	170	…	660	…	…
Foreign (concessionally) financed	2,185	1,805	2,035	1,673	2,282	1,662	1,898	2,037
Unidentified expenditure measures[6]	…	…	-858	0	-963	0	0	0
Overall balance before grants	-5,100	-3,776	-4,627	-4,432	-4,759	-5,415	-4,556	-4,849
Grants	1,728	1,588	1,497	1,075	1,897	1,431	1,378	1,326
Program (including basket grants)[4]	818	703	752	553	1,060	313	516	541
Of which: basket grants	281	189	195	203	219	81	208	218
Project	910	885	745	522	836	1,118	862	785
Net expenditure float[5]	259	-211	0	0	0	0	0	0
Statistical discrepancy	-170	-99	0	0	0	0	0	0
Overall balance after grants (cash basis)	-3,284	-2,498	-3,130	-3,357	-2,862	-3,984	-3,178	-3,523
Financing	3,284	2,498	3,130	3,357	2,862	3,984	3,178	3523
Foreign (net)	2,579	2,271	3,712	3,631	2,755	2,552	2,212	2583
Foreign loans	2,706	2,452	4,062	3,996	3,260	3,035	3,012	3572
Program (including basket loans)[4]	544	734	519	520	577	547	438	458
Of which: basket loans	186	208	94	98	105	118	124	131
Project	734	524	1,000	850	1,122	345	702	904
Nonconcessional borrowing	1,428	1,195	2,543	2,626	1,561	2,143	1,871	2210
Of which: gas pipeline	365	750	612	858	…	…	…	…
Amortization	-127	-181	-350	-365	-505	-483	-800	-990
Domestic (net)	705	227	-582	-274	107	1,432	966	940
Excluding gas pipeline	1069	977	29	583	107	1432	966	940
Bank financing	668	955	-20	577	-72	859	325	223
Nonbank financing	401	21	49	6	179	573	641	717
Credit to TPDC (gas pipeline)	-365	-750	-612	-858	…	…	…	…
Memorandum items:								
Total public debt (in percent of GDP)[8]	30.8	31.6	32.9	37.8	33.6	39.2	39.1	39.01
Domestic unpaid claims (end-period)	692	1,323	…	…	…	…	…	…
Of which: older than 90 days	461	1,077						
Recurrent expenditures (percent of recurrent resources)	105	96	89	94	85	96	96	95
Nominal GDP	65,585	74,779	84,319	84,319	94,275	94,275	105,506	117,998

Sources: Ministry of Finance; Bank of Tanzania; and IMF staff projections.

[1] Fiscal year: July–June.

[2] Includes sale of shares in two manufacturing companies amounting to 0.2 percent of GDP in 2015/16. Local Government Authorities' own revenues and the equal amount of transfers, are included starting from FY2009/10.

[3] Excludes interest payments on external debt obligations that are under negotiation for relief with a number of creditors.

[4] Basket funds are sector-specific accounts established by the government to channel donor support to fund-specific activities.

[5] The gross expenditure float for a fiscal year Y relates to expenditures that are recorded in Y, but for which the payment is made—and thus the financing is recorded—in the following fiscal year, Y+1. The net expenditure float for fiscal year Y is the difference between the gross expenditure float for Y and the gross expenditure float for the previous fiscal year, Y-1; in other words, the net expenditure float for Y relates to expenditures recorded in Y whose financing was recorded in Y+1, minus the additional financing that occurred in Y for expenditures that were recorded in Y-1.

[6] For 2014/15, these are the spending adjustments needed to achieve the budget deficit target. The authorities are expected to identify these adjustments during the mid-year budget review in January 2015. For 2015/16 and beyond, the adjustment factor is carried forward as a balancing item, as the final projections of the expenditure components will depend on the composition of adjustments to be undertaken in

[7] The change in 2014/15 projections compared to the program reflects reclassification of 1.5 percent of GDP from goods and services to development spending, and 0.1 percent of GDP from goods and services to wages and salaries.

[8] Excludes external debt under negotiation for relief and Treasury bills issued for monetary policy purposes.

Table 2b. Tanzania: Central Government Operations, 2012/13–2017/18[1]
(Percent of GDP)

	2012/13	2013/14	2014/15		2015/16		2016/17	2017/18
			Prog.	Proj.	Prog.	Proj.	Proj.	Proj.
Total revenue	12.9	13.6	14.0	13.3	14.4	14.9	15.0	15.2
Tax revenue	11.8	12.4	12.6	12.0	13.0	13.2	13.4	13.6
Import duties	0.9	0.9	1.0	0.9	1.0	0.9	0.9	0.9
Value-added tax	3.3	2.9	3.2	3.0	3.5	3.6	3.7	3.7
Excises	1.9	2.0	2.3	2.0	2.3	2.0	2.0	2.0
Income taxes	4.6	5.1	4.7	4.6	4.7	4.7	4.8	4.9
Other taxes	1.1	1.5	1.5	1.5	1.5	1.9	1.9	2.0
Nontax revenue[2]	1.1	1.2	1.4	1.3	1.4	1.7	1.6	1.6
LGA	0.3	0.4	0.5	0.5	0.5	0.6	0.6	0.6
Other	0.7	0.8	0.8	0.8	0.8	1.2	1.1	1.1
Total expenditure	20.6	18.7	20.5	18.6	22.8	20.6	19.3	19.3
Recurrent expenditure	14.4	13.8	13.0	12.8	13.0	14.5	14.3	14.5
Wages and salaries [6]	5.1	5.3	5.6	5.6	5.6	5.9	5.9	5.9
Interest payments	1.2	1.3	1.3	1.4	1.4	1.6	1.8	2.0
Domestic	0.9	1.0	0.9	1.0	1.0	1.0	1.1	1.2
Foreign[3]	0.3	0.3	0.4	0.4	0.4	0.6	0.7	0.8
Goods and services and transfers[2, 7]	8.1	7.2	6.1	5.8	6.8	7.0	6.6	6.6
Of which: Transfers to PSPF	…	…	…	0.2	…	0.2	0.3	0.3
Of which: Transfers to TANESCO	0.6	0.5	0.2	0.0	…	…	…	…
Development expenditure [6]	6.2	4.9	7.5	5.7	7.5	6.1	5.0	4.8
Domestically financed	2.9	2.5	5.1	3.7	5.1	4.3	3.2	3.1
Of which: Clearance of suppliers' arrears	…	…	…	0.2	…	0.7	…	…
Foreign (concessionally) financed	3.3	2.4	2.4	2.0	2.4	1.8	1.8	1.7
Unidentified expenditure measures[6]	…	…	-1.0	0.0	-1.0	0.0	0.0	0.0
Overall balance before grants	-7.8	-5.0	-5.5	-5.3	-5.0	-5.7	-4.3	-4.1
Grants	2.6	2.1	1.8	1.3	2.0	1.5	1.3	1.1
Program (including basket grants)[4]	1.2	0.9	0.9	0.7	1.1	0.3	0.5	0.5
Of which: basket grants	0.4	0.3	0.2	0.2	0.2	0.1	0.2	0.2
Project	1.4	1.2	0.9	0.6	0.9	1.2	0.8	0.7
Net expenditure float[5]	0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	-0.3	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance after grants (cash basis)	-5.0	-3.3	-3.7	-4.0	-3.0	-4.2	-3.0	-3.0
Financing	5.0	3.3	3.7	4.0	3.0	4.2	3.0	3.0
Foreign (net)	3.9	3.0	4.4	4.3	2.9	2.7	2.1	2.2
Foreign loans	4.1	3.3	4.8	4.7	3.5	3.2	2.9	3.1
Program (including basket loans)[4]	0.8	1.0	0.6	0.6	0.6	0.6	0.4	0.4
Of which: basket loans	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1
Project	1.1	0.7	1.2	1.0	1.2	0.4	0.7	0.8
Nonconcessional borrowing	2.2	1.6	3.0	3.1	1.7	2.3	1.8	1.9
Of which: gas pipeline	0.6	1.0	0.7	1.0	…	…	…	…
Amortization	-0.2	-0.2	-0.4	-0.4	-0.5	-0.5	-0.8	-0.8
Domestic (net)	1.1	0.3	-0.7	-0.3	0.1	1.5	0.9	0.8
Excluding gas pipeline	1.6	1.3	0.0	0.7	0.1	1.5	0.9	0.8
Bank financing	1.0	1.3	0.0	0.7	-0.1	0.9	0.3	0.2
Nonbank financing	0.6	0.0	0.1	0.0	0.2	0.6	0.6	0.6
Credit to TPDC (gas pipeline)	-0.6	-1.0	-0.7	-1.0	…	…	…	…
Memorandum items:								
Domestic unpaid claims (end-period, in percent of GDP)	1.1	1.8	…	…	…	…	…	…
Of which: older than 90 days	0.7	1.4	…	…	…	…	…	…
Recurrent expenditures (percent of recurrent resources)	105	96	89	94	85	96	94	94

Sources: Ministry of Finance; Bank of Tanzania; and IMF staff projections.

[1] Fiscal year: July–June.

[2] Includes sale of shares in two manufacturing companies amounting to 0.2 percent of GDP in 2015/16. Local Government Authorities' own revenues and the equal amount of transfers, are included starting from FY2009/10.

[3] Excludes interest payments on external debt obligations that are under negotiation for relief with a number of creditors.

[4] Basket funds are sector-specific accounts established by the government to channel donor support to fund-specific activities.

[5] The gross expenditure float for a fiscal year Y relates to expenditures that are recorded in Y, but for which the payment is made—and thus the financing is recorded—in the following fiscal year, Y+1. The net expenditure float for fiscal year Y is the difference between the gross expenditure float for Y and the gross expenditure float for the previous fiscal year, Y-1; in other words, the net expenditure float for Y relates to expenditures recorded in Y whose financing was recorded in Y+1, minus the additional financing that occurred in Y for expenditures that were recorded in Y-1.

[6] For 2014/15, these are the spending adjustments needed to achieve the budget deficit target. The authorities are expected to identify these adjustments during the mid-year budget review in January 2015. For 2015/16 and beyond, the adjustment factor is carried forward as a balancing item, as the final projections of the expenditure components will depend on the composition of adjustments to be undertaken in 2014/15.

[7] The change in 2014/15 projections compared to the program reflects reclassification of 1.5 percent of GDP from goods and services to development spending, and 0.1 percent of GDP from goods and services to wages and salaries.

Table 3. Tanzania: Monetary Accounts, 2013–2016
(Billions of Tanzania Shillings, unless otherwise indicated; end of period)

	2013	2014					2015						2016	
		March	June	Sept	Dec		March		June		Sept	Dec.	March	June
					Prog.[1]	Prel.	Prog.[1]	Prel.	Prog.[1]	Proj.	Proj.	Proj.	Proj.	Proj.
Bank of Tanzania														
Net foreign assets	6,187	6,294	6,399	5,956	6,063	6,380	7,023	6,132	7,580	7,623	7,920	8,138	8,333	8,759
Net international reserves	6,656	6,779	6,891	6,433	6,563	6,854	7,530	6,570	8,089	8,208	8,486	8,685	8,825	9,364
(Millions of U.S. dollars)	4,216	4,160	4,174	3,861	3,895	3,977	4,420	3,678	4,738	4,181	4,288	4,354	4,388	4,619
Net non-reserve foreign assets	-468	-485	-492	-477	-500	-473	-507	-437	-509	-585	-566	-548	-492	-604
Net domestic assets	-1,160	-1,180	-751	-157	46	-471	-936	-545	-1,017	-1,460	-1,436	-1,256	-1,719	-1,834
Credit to government	-500	-494	-7	627	658	355	384	649	-319	342	349	467	-10	193
Of which: Excluding counterpart of liquidity paper	1,000	818	1,358	1,399	1,444	934	1,027	1,720	609	1,355	1,543	776	1,900	1,355
Other items (net)	-660	-687	-744	-783	-613	-826	-1,320	-1,195	-697	-1,801	-1,784	-1,723	-1,709	-2,026
REPOs	-20	-33	-20	-12	-12	0	-12	0	-20	0	0	0	0	0
Other items, excluding REPOs (net)	-640	-653	-724	-772	-601	-826	-1,308	-1,195	-677	-1,801	-1,784	-1,723	-1,709	-2,026
Of which: Credit to nongovernment sector	57	58	59	63	63	65	63	81	63	81	58	81	58	81
Reserve money	5,028	5,114	5,648	5,799	6,109	5,909	6,087	5,587	6,564	6,163	6,484	6,881	6,613	6,926
Currency outside banks	2,764	2,732	3,072	3,143	3,234	3,245	3,199	3,147	3,556	3,331	3,518	3,791	3,603	3,870
Bank reserves	2,264	2,382	2,576	2,656	2,875	2,665	2,888	2,440	3,008	2,833	2,965	3,090	3,010	3,056
Currency in banks	561	444	525	510	520	584	543	543	574	569	593	606	482	573
Deposits	1,703	1,938	2,051	2,146	2,354	2,081	2,345	1,897	2,434	2,263	2,372	2,484	2,528	2,483
Required reserves	1,649	1,687	1,769	1,848	2,028	1,505	2,020	1,517	2,096	1,948	1,997	2,049	2,189	2,176
Excess reserves	54	251	282	297	326	576	325	379	337	315	375	435	338	307
Memorandum items:														
Stock of liquidity paper	1,500	1,312	1,365	772	785	579	643	1,071	929	1,013	1,194	309	1,910	1,162
Average reserve money	5,250	5,324	5,572	5,905	5,979	6,011	6,158	5,844	6,409	6,071	6,430	6,845	6,791	6,887
Monetary Survey														
Net foreign assets	6,576	6,602	6,773	6,371	6,483	6,552	7,448	6,388	8,006	8,034	8,334	8,556	8,755	9,185
Bank of Tanzania	6,187	6,294	6,399	5,956	6,063	6,380	7,023	6,132	7,580	7,623	7,920	8,138	8,333	8,759
Commercial banks	389	308	374	415	420	171	425	256	425	411	414	418	422	426
Net domestic assets	9,530	9,948	10,884	11,903	12,264	12,063	11,971	12,352	12,433	11,784	12,598	13,188	13,290	13,809
Domestic credit	12,947	13,636	14,778	15,986	16,484	16,064	16,568	17,312	17,011	17,376	18,188	18,982	19,557	20,145
Credit to government (net)	2,555	2,773	3,219	4,043	4,034	3,652	3,617	4,298	3,200	3,796	4,011	4,226	4,441	4,655
Credit to nongovernment sector	10,393	10,863	11,559	11,943	12,450	12,412	12,951	13,014	13,811	13,580	14,177	14,757	15,116	15,490
Other items (net)	-3,417	-3,689	-3,894	-4,083	-4,220	-4,001	-4,597	-4,960	-4,578	-5,592	-5,589	-5,795	-6,266	-6,336
M3	16,107	16,550	17,657	18,274	18,747	18,614	19,419	18,741	20,439	19,818	20,933	21,743	22,045	22,994
Foreign currency deposits	4,216	4,240	4,415	4,553	4,662	4,697	4,819	5,057	5,062	5,338	5,628	5,835	5,905	6,148
M2	11,891	12,310	13,241	13,721	14,086	13,917	14,600	13,683	15,377	14,480	15,304	15,908	16,140	16,846
Currency in circulation	2,764	2,732	3,072	3,143	3,234	3,245	3,199	3,147	3,556	3,331	3,518	3,791	3,603	3,870
Deposits (TSh)	9,127	9,578	10,170	10,578	10,851	10,672	11,401	10,536	11,821	11,149	11,786	12,117	12,536	12,976
Memorandum items:	(12-month percent change, unless otherwise indicated)													
M3 growth	10.0	11.6	15.8	14.7	16.4	15.6	17.3	13.2	15.8	12.2	14.5	16.8	17.6	16.0
M3 (as percent of GDP)[2]	21.5	22.1	23.6	21.7	22.3	22.1	23.1	22.2	24.3	23.5	22.2	23.1	23.4	24.4
Private sector credit growth	15.3	16.4	21.4	20.7	19.8	19.4	19.2	19.8	19.5	17.5	18.7	18.9	16.2	14.1
Average reserve money growth	12.1	14.0	13.7	14.9	13.9	14.5	15.7	9.8	15.0	9.0	8.9	13.9	16.2	13.4
Reserve money multiplier (M3/average reserve money)	3.07	3.11	3.17	3.09	3.14	3.10	3.15	3.21	3.19	3.26	3.26	3.18	3.25	3.34
Nonbank financing of the government (net)[3]	115	2	21	49	49	73	49	231	49	6	143	286	430	573
Bank financing of the government (net)[3]	291	510	955	824	815	432	398	1079	-20	577	215	430	645	859
Bank and nonbank financing of the government (net)[3]	406	511	977	873	864	505	446	1310	29	583	358	716	1074	1432
Foreign currency deposits (percent of M3)	26	26	25	25	25	25	25	27	25	27	27	27	27	27

Sources: Bank of Tanzania and IMF staff estimates and projections.

[1] From the first review under the Policy Support Instrument (IMF Country Report No. 15/14).

[2] "Program" reflects new GDP data.

[3] Cumulative from the beginning of the fiscal year (July 1).

Table 4. Tanzania: Balance of Payments, 2012/13–2017/18
(Millions of U.S. dollars, unless otherwise indicated)

	2012/13	2013/14	2014/15		2015/16		2016/17	2017/18
		Prel.	Prog.	Proj.[3]	Prog.	Proj.[3]	Proj.	Proj.
Current account	-4,284	-4,746	-4,905	-4,568	-4,893	-3,863	-3,607	-4,023
Trade balance	-5,084	-5,728	-5,903	-5,465	-6,020	-4,779	-4,881	-5,430
Exports, f.o.b.	5,398	5,619	6,111	5,825	6,663	6,416	7,063	7,586
Traditional agricultural products	820	836	927	973	1,013	1,038	1,112	1,186
Gold	1,899	1,659	1,582	1,349	1,617	1,457	1,461	1,519
Other	2,679	3,124	3,602	3,503	4,034	3,921	4,491	4,881
Imports, f.o.b	-10,482	-11,347	-12,014	-11,290	-12,683	-11,195	-11,944	-13,016
Of which: Oil	-3,923	-4,209	-3,918	-3,477	-3,723	-2,989	-3,269	-3,554
Services (net)	548	648	611	631	881	938	1,253	1,462
Of which: Travel receipts	1,757	1,973	1,980	1,980	2,239	2,102	2,289	2,508
Income (net)	-535	-409	-428	-415	-561	-588	-694	-826
Of which: Interest on public debt	-113	-128	-117	-162	-247	-290	-361	-455
Current transfers (net)	787	743	815	681	806	567	715	771
Of which: Official transfers	523	438	447	316	438	157	252	257
Capital account	739	748	509	363	553	627	491	450
Of which: Project grants[1]	676	548	443	298	482	561	420	374
Financial account	4,251	3,873	4,960	4,503	4,955	3,675	3,820	4,180
Foreign Direct Investment	1,836	1,924	2,206	1,959	2,788	1,890	2,057	2,247
Public Sector, net	1,701	1,404	2,205	2,074	1,589	1,219	1,078	1,229
Program loans	365	451	308	297	333	214	214	218
Non-concessional borrowing	920	738	1,511	1,500	900	1,074	912	1,052
Project loans	465	324	594	485	647	173	342	430
Scheduled amortization[2]	-49	-109	-208	-208	-291	-242	-390	-471
Commercial Banks, net	377	92	73	98	129	97	112	120
Other private inflows	338	453	475	372	449	469	573	584
Errors and omissions [3]	-250	358	0	-290	0	0	0	0
Overall balance	457	232	564	8	615	438	703	607
Financing	-457	-232	-564	-8	-615	-438	-703	-607
Change in BoT reserve assets (increase= -)	-569	-232	-509	44	-549	-374	-626	-518
Use of Fund credit	112	0	-56	-52	-65	-64	-78	-89
Financing gap	0	0	0	0	0	0	0	0
Memorandum items:								
Gross official reserves (BoT)	4,357	4,634	5,143	4,540	5,692	4,914	5,540	6,058
Months of imports of goods and services	3.7	4.0	3.9	3.9	3.8	4.0	4.1	4.2
Exports (percent of GDP)	13.0	12.1	12.5	12.1	12.8	13.6	13.7	13.5
Exports excl. gold (percent of GDP)	8.4	8.6	9.3	9.3	9.7	10.5	10.9	10.8
Imports (percent of GDP)	-25.3	-24.5	-24.6	-23.4	-24.4	-23.7	-23.2	-23.2
Imports excl. oil (percent of GDP)	-15.8	-15.4	-16.6	-16.2	-17.2	-17.4	-16.9	-16.8
Current account deficit (percent of GDP)	-10.3	-10.3	-10.2	-9.5	-10.4	-8.2	-7.0	-7.2
Foreign program and project assistance (percent of GDP)	4.9	3.8	3.7	2.9	3.7	2.3	2.4	2.3
Nominal GDP	41,498	46,290	48,161	48,161	47,256	47,256	51,430	56,167

Sources: Tanzanian authorities and IMF staff estimates and projections

[1] An adjustment to the estimated outturn is made by BoT to reflect unreported project grants.
[2] Relief on some projected external debt obligations is being negotiated with a number of creditors.
[3] Includes valuation changes in gross reserves resulting from the exchange rate movements of the US$ against other currencies.

Table 5. Tanzania: Financial Soundness Indicators, 2010–2015
(percent, end of period)

				2013				2014				2015
	2010	2011	2012	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec	Mar[p]
Access to bank lending												
Claims on the non-government sector to GDP [1]	13.4	14.3	14.3	13.1	13.6	14.0	14.9	15.3	16.4	17.0	17.7	18.7
Claims on the private sector to GDP [1]	12.8	13.5	13.3	12.4	12.9	13.4	14.1	14.3	15.5	16.1	16.4	17.3
Capital adequacy												
Capital to risk-weighted assets	18.5	17.6	17.5	19.5	18.1	18.3	17.9	19.2	17.8	18.1	17.7	19.1
Capital to assets	10.7	10.5	10.5	11.4	10.8	10.8	11.0	11.8	11.1	11.2	11.2	12.1
Asset composition and quality												
Net loans and advances to total assets	44.2	49.2	49.7	48.6	49.0	49.2	50.8	50.8	51.8	51.4	53.0	53.3
Sectoral distribution of loans												
Trade	17.3	20.0	20.9	21.4	21.2	20.3	20.9	19.9	20.2	21.4	21.8	22.5
Mining and manufacturing	13.9	12.6	11.9	12.3	12.3	12.3	11.9	11.8	12.5	12.6	12.3	12.2
Agricultural production	12.8	13.5	11.2	11.5	11.1	11.1	9.8	10.6	10.0	9.1	9.0	8.8
Building and construction	6.0	8.2	9.0	9.1	9.2	9.3	9.6	9.5	9.3	9.1	9.0	8.9
Transport and communication	9.1	7.3	6.9	7.3	7.0	7.4	7.0	7.0	7.2	7.0	7.1	7.2
Foreign exchange loans to total loans	31.6	33.0	33.5	34.0	34.8	35.6	35.4	36.0	35.9	35.7	36.3	37.5
Gross nonperforming loans (NPLs) to gross loans	9.7	6.7	8.1	7.7	8.1	7.1	7.1	7.9	8.1	8.4	6.8	6.7
NPLs net of provisions to capital	25.9	18.8	22.5	18.0	19.1	16.8	15.6	16.5	17.2	21.0	16.2	14.8
Large exposures to total capital	108.5	141.0	143.7	125.9	139.3	135.9	91.2	129.1	133.6	102.0	115.0	137.0
Earnings and profitability												
Return on assets	2.2	2.5	2.6	2.9	2.7	2.6	2.5	3.0	3.0	2.9	2.6	3.1
Return on equity	12.1	14.5	13.9	16.0	15.1	13.9	12.8	15.5	15.5	15.0	13.1	16.2
Net interest margin	8.5	8.4	…	…	…	…	…	…	…	…	…	…
Noninterest expenses to gross income	65.1	66.7	67.8	63.5	65.4	66.2	66.9	64.8	65.7	66.0	66.9	63.8
Personnel expenses to noninterest expenses	40.5	41.6	42.4	45.9	45.5	45.1	43.4	46.7	46.5	45.5	44.3	46.8
Liquidity												
Liquid assets to total assets	39.5	36.3	34.0	35.0	34.3	33.3	32.3	32.5	31.7	32.2	31.0	30.3
Liquid assets to total short term liabilities	45.3	40.1	38.4	40.2	38.4	37.0	36.2	36.4	35.6	37.7	36.1	37.6
Total loans to customer deposits	59.6	65.2	68.6	68.8	67.9	67.7	71.8	71.8	73.3	72.7	74.4	76.9
Foreign exchange liabilities to total liabilities	31.9	37.0	34.4	35.2	35.2	35.3	35.0	34.3	34.4	34.5	36.0	37.6

Source: Bank of Tanzania

[1] Calendar year; end of period claims relative to annual GDP. Based on new GDP series.

[p] Preliminary

Letter of Intent

June 18, 2015

Mrs. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Madam Lagarde:

The attached Memorandum of Economic and Financial Policies (MEFP) updates the ones from June 27, 2014 and December 18, 2014 under the Policy Support Instrument (PSI). It reports on recent economic developments and sets out macroeconomic policies and structural reforms that the Government will pursue in the following three years.

The Government is confident that the policies and measures set forth in the attached Memorandum will deliver the objectives of its program. We stand ready to take further measures that may become appropriate for this purpose and that are in line with the Government's policy objectives.
The Government will consult with the IMF at its own initiative or whenever the Managing Director of the IMF requests such a consultation before the adoption of any such measures or changes to the policies described in the attached Memorandum. The Government will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

The Government intends to disseminate this letter, the attached MEFP and the Technical Memorandum of Understanding (TMU), as well as related Fund staff reports, and hereby authorizes the IMF to publish the same after consideration by the Executive Board.

Yours Sincerely,

/s/	/s/
Saada Mkuya Salum (MP) MINISTER FOR FINANCE UNITED REPUBLIC OF TANZANIA	Prof. Benno Ndulu GOVERNOR, BANK OF TANZANIA UNITED REPUBLIC OF TANZANIA

Attachments
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding on Selected Concepts and Definitions Used in the Monitoring of the Program Supported by the PSI.

Attachment I. Memorandum of Economic and Financial Policies June 18, 2015

I. MACROECONOMIC DEVELOPMENTS AND PROGRAM PERFORMANCE

A. Recent Macroeconomic Developments and Outlook

Output and Prices

1. Real GDP. According to quarterly accounts, GDP grew by 7.2 percent in the first three quarters of 2014. Major contributors to growth were construction (18.3 percent); wholesale and retail trade (15.8 percent); transport and storage (13.7 percent); manufacturing (8.2 percent); and agriculture, forestry and fishing (9.7 percent). Based on leading indicators of economic activities in the fourth quarter of 2014, the program growth target of 7.2 percent for 2014 is likely to be met. Growth is expected to remain strong in 2015, spurred by continued investment in infrastructure, growing electricity generation, which will boost further manufacturing activities, a recovery in exports, and the positive income shock related to the recent sharp decline in oil prices. The recently revised national accounts confirmed that the economy has diversified over time; GDP was revised upward by more than 30 percent.

2. Inflation. Inflation fell well below the medium term target of 5 percent supported by decline in global oil prices and good regional food crop harvests. In addition, a prudent monetary policy stance since the end of 2011 has helped contain core inflation to a moderate level. Headline inflation was 4.5 percent in April 2015, while core inflation declined to about 2 percent. Inflation is expected to remain low in 2015, supported by low global oil prices and the waning away of the impact of the increase in domestic power tariff implemented in January 2014.

External Sector Developments

3. Balance of Payments. The current account deficit narrowed to USD 2,002 million during July - December 2014 compared with a deficit of USD 2,281 million registered in the corresponding period of the preceding year. This largely reflected lower oil imports (-25 percent) on account of the fall in oil prices in the world market. There was a rebound in non-traditional exports, largely attributed to improved export performance of manufactured goods, re-exports, fish and fish products exports, and exports of edible vegetables and oil seeds. For the full year (2014/15) the current account balance would record an improvement (9.4 percent of GDP, down from 10.3 percent in 2013/14), thanks to the full year impact of lower oil prices.

Fiscal Performance and Financing in the First Half of 2014/15

4. Fiscal Deficit. Total revenue collection for the first half of 2014/15 was 97 percent of the revised program target and 88 percent of the budget estimate. Decrease in output experienced by some manufacturing industries producing excisable goods due to the decline in demand contributed to underperformance of excise taxes. This has undermined VAT collection as well, which also affected by challenges in the rollout of electronic fiscal devices. Import duties collection was largely affected by a shift in importation of taxable imports from the rest of the world to regional economic blocks such as EAC and SADC of which majority are either not taxed or less taxed. Income tax collection was also below expectations despite efforts to boost tax compliance. Total cash expenditure for the first half of 2014/15 remained below the program envelope, as cash budgeting helped contain monthly expenditure. The overall fiscal deficit of the central government for the first half of the fiscal year was 1.8 percent of GDP (measured from the financing side, excluding arrears accumulation). Domestic financing was front-loaded in the first quarter, but went down in late December 2014 with the disbursement of a nonconcessional loan of US$ 300 million from China Development Bank to finance various infrastructure investment projects.

Monetary Policy

5. Monetary policy stance and exchange rate developments. Growth of monetary aggregates remained in line with the program targets. M3 grew by 15.6 percent in the year ending December 2014, while private sector credit grew by about 19 percent. Money market interest rates decreased from January 2015, as liquidity conditions among banks improved following the BoT decision to reduce the Statutory Minimum Reserve (SMR) ratio on private deposit liabilities by two percentage points. Both the overnight interbank cash market rates and weighted average yields on T-bills recorded their lowest rates since December 2012 at 3.14 percent and 11.61 percent respectively at end-February 2015. The Shilling exchange rate depreciated against the U.S. dollar in recent months, as the U.S. dollar appreciated against all major currencies.

Financial Sector and Capital Account

6. Financial sector stability. The banking sector remained vibrant with adequate liquidity and capital above regulatory requirements. Asset quality improved, as indicated by the ratio of non-performing loans (NPLs) to total loans. The latter declined from 8.5 percent in September 2014 to 6.5 percent in March 2015, reflecting write off as well as efforts made by banking institutions to recover NPLs. The moratorium period of three years for increasing the absolute core capital for commercial banks from TSh 5 billion to TSh 15 billion ended in March 2015. As at 31st March 2015, 30 out of 34 commercial banks had complied with the new requirement. To cope with increasing innovations, risks and new developments in the banking sector, the BoT carried out a review of the existing prudential regulations that were issued in 2008 and came up with revised as well as new prudential regulations in 2014. New regulations were issued on consolidated supervision, while revised regulations covered matters such as capital adequacy, credit concentration, external auditors, internal controls and internal audit, liquidity management, disclosures, and prompt corrective action.

In addition, the National Payment System Bill, which will allow for the issuance of regulations on mobile payments, went through first reading in the Parliament in February 2015.

7. FBME Bank. It is still under statutory management effectively from 24th July 2014 following the Notice issued on 15th July 2014 by the US Financial Crimes Enforcement Network (FinCEN) naming FBME as a bank of primary money laundering concern.. The BoT continues to closely monitor the operations of the bank in Tanzania while awaiting final FinCEN determination of the money laundering concern. The Bank is also engaging with other stakeholders so as to come up with a resolution strategy for the bank, in case the concern over the bank materializes. While the financial position and operations of the bank have been greatly affected by the notice, domestic depositors' money remain well secured.

8. Financial sector development. Mobile network operators (MNOs) in collaboration with banks have reached new milestones in the provision of financial services, with new innovative products and services which will further stimulate savings and trade across the EAC countries. In recent months MNOs have come together and signed bilateral agreements for interoperability of their mobile money services which is expected to significantly reduce costs across platforms. Furthermore, two MNOs have now been permitted to provide cross border mobile money transfers between Tanzania and Rwanda and between Tanzania and Kenya which will play a key part in increasing usage of the services for facilitating trade in the EAC region.

9. Consumer protection. The BoT has established a Complaints Resolution Desk to resolve complaints submitted by consumers of banking services. This decision is in line with the Financial Consumer Protection Strategy adopted by the National Council for Financial Inclusion. The Desk is a stop-gap arrangement pending the establishment of an Office of the Banking Ombudsman, scheduled for 2016/2017. The Desk commenced operations on 1st April, 2015 and handles disputes that have not been addressed by commercial banks to the customer's satisfaction. All banking institutions are now required to dedicate a senior officer who will handle all complaints submitted by their customers and only unresolved disputes will be submitted for resolution by the Desk.

10. Capital account liberalization. Since freer capital flows between EAC members were allowed in 2014, EAC investors have indicated interest in participating in Tanzania's capital markets, entering the market gradually, with increasing participation in the equity market. In this initial stage of liberalization, the BoT has maintained a number of prudential measures in the debt market, such as overall limits on foreign participation and minimum holding periods for investors. These measures are not aimed at deterring inflows but are designed to act as "speed bumps" to attract longer-term investors and ensure that risks are maintained at manageable levels. The BoT is constantly reviewing the experience with the controls and stands ready to modify them as regulators and the financial markets become more familiar in dealing with capital flows. The government remains committed to extending this liberalization to investors from the rest of the world by end of 2015.

IPTL case

11. Donors providing general budget support recognized in March 2015 that Tanzania's accountability institutions handled the IPTL issue in line with good governance principles. These donors pledged willingness to collaborate with the Government in pursuing further governance reforms and in strengthening the capacities of anti corruption institutions. They also indicated their intention to proceed with further gradual disbursement of budget support.

B. Program Performance

12. All assessment criteria for end-December 2014 under the PSI Program were met with comfortable margins, except for the indicative target on tax revenue. Good progress was achieved in the structural area: (i) the BoT has prepared a study on the relationship between interbank interest rates and excess reserves; (ii) the Paymaster General issued a new circular on arrears reporting. The definition of arrears has been included in a separate circular, issued on 8th December 2014; (iii) The unification of the Statutory Minimum Reserve and the clearing accounts and implementation of partial reserve averaging for reserve requirements were delayed in light of the decision to tighten liquidity following excessive volatility of the Shilling. This is now expected in December 2015; (iv) in May 2015 the Government approved the policy paper on a natural gas revenue management framework, which fully integrates with the budget; (v) The report on the verification of end-June 2014 arrears was finalized with a short delay in April 2015; and (v) a strategy to address government arrears to pension funds was prepared and discussed by cabinet in early March 2015.

II. THE ECONOMIC PROGRAM FOR THE REMAINDER OF 2014/15 AND FOR 2015/16

13. **Poverty reduction strategy**. The implementation MKUKUTA II has been extended for one year to ensure a harmonized review and preparation of both MKUKUTA III and the next 5-year development plan (FYDP II), for efficient use of national capacities and resources. MKUKUTA II Priority Areas for 2015/16 were identified from assessment of MKUKUTA II and from MDGs reports. The priorities cover areas related to MDG 1 (eradicating extreme poverty and hunger), MDG 4 (reducing child mortality), MDG 5 (improving maternal health), MDG 7 (ensuring environmental sustainability, and MDG 8 (promoting global partnerships for development), as well as issues on employment creation and raising productivity in agriculture. Other priority areas are Vulnerability and Social protection, Governance with focus on the Public Financial Management Reform Programme; as well as environment and gender. These priorities aim at providing guidance to stakeholders on budgeting, resource allocation and implementation. During this period, agencies' strategic plans will continue to be aligned to the identified priority areas and FYDP I.

A. Monetary, Exchange Rate, and Financial Sector Policies

14. Monetary policy stance. With inflation falling below the Government's medium-term target, the statutory minimum reserve requirement was reduced in late 2014. This decision was reversed in May 2015, in light of exchange rate pressures and volatility, and was accompanied by a tightening of limits on banks' net open positions. Future changes to the monetary policy stance will depend on the inflation outlook and the liquidity conditions of banks. Based on the latest projections, private sector credit is expected to maintain a healthy pace while bank liquidity is projected to stabilize at comfortable levels. Monetary operations will be geared towards managing liquidity effectively to reduce short term interest rate volatility in the money market. The agreed monetary program also provides the flexibility to respond to seasonal factors affecting liquidity demand. The Bank will remain vigilant and monitor inflation expectations and possible price shocks so as to ensure that the positive achievements are maintained.

15. Modernizing the monetary policy framework. The BoT continues to take measures to modernize its monetary policy framework. Modification of the functionality of the Tanzania Interbank Settlement Systems to facilitate implementation of reserve averaging is ongoing and we now expect to have it in place by end-2015. The partial reserve averaging will allow banks to directly access a portion in their respective SMR balances maintained at the BoT, thereby giving them greater flexibility in liquidity management. Further, the Bank has finalized an analytical study which suggests a range of excess reserves that would help to reduce short term volatility in the IBCM overnight rate. A roadmap to price-based monetary policy framework has also been developed to facilitate the shift. To start with, it will include the following steps:

- Unification of the Statutory Minimum Reserve (SMR) and clearing accounts of banks maintained at the BoT by December 31, 2015.
- Partial reserve averaging to allow banks to directly access a portion in their respective SMR balances maintained at the BoT by December 31, 2015.
- Broaden eligible government securities that can be pledged by banks to access standby facilities at the BoT, from securities which mature within 91 days to 180 days from the date of acquisition by September 30, 2015.
- Drawing on earlier analytical work, establish by September 30, 2015 an operational target for the range of excess reserves that is consistent with the average reserve money target. This will help to reduce short term volatility in the IBCM overnight rate.
- To enhance the modeling and forecasting capabilities in the BoT, establish modeling and forecasting unit by September 30, 2015.
- Develop a composite index of economic activity using high frequency data to help assess short term dynamics of economic activity.
- Broaden the coverage of the market expectation Survey.

16. Exchange rate policy. The Bank will continue to participate in the IFEM to manage liquidity and smooth short-term exchange rate volatility while building foreign exchange reserves to stay on course with the net international reserves target.

17. Banking supervision framework. The members of Tanzania Financial Stability Forum in their December 2014 meeting agreed the following policy actions to foster financial stability in the country:

- Each financial regulatory authority to review the existing prudential regulations to accommodate new developments associated with the liberalization of the capital account for EAC residents that became effective in May 2014;
- Forum members to formulate an Integrated Road Map to steer financial system development and reforms; and
- Pension funds to harmonize their reporting period to calendar year consistent with other financial sectors.

The BoT has requested technical assistance from the IMF through East AFRITAC to carry out a diagnostic study on the challenges facing community banks and come out with recommendations on the way forward.

B. Fiscal Policies

Budget Implementation in 2014/15 and Budget Plans for 2015/16

18. Budget Implementation in 2014/15. The mid-year budget review confirmed a large revenue shortfall, compared to initial budget projections. This shortfall has required significant expenditure adjustment to allow meeting the fiscal deficit target of 3.8 percent of GDP (excluding clearance of arrears). The review was an opportunity to reaffirm key spending priorities, and in particular those related to poverty, the organization of elections, and projects covered by the Big Results Now initiative. A number of current and capital expenditures of lesser priority were also identified and will not be implemented this fiscal year. Expenditure ceilings for MDAs were revised accordingly in the Information and Financial Management System (IFMS) to cap commitments and communicated to MDAs through a circular. We are confident that these steps will prevent the accumulation of new arrears to suppliers. The mobilization of external financing will be accelerated, but is still likely to come late, which will raise challenges for expenditure execution. We intend to front load domestic financing, using favorable market conditions to step up the issuance of short-term government securities.

19. Budget Plans for 2015/16. Debt sustainability analysis done by the IMF suggests that a deficit slightly below 3 percent of GDP in the medium term is consistent with the maintenance of a low risk of debt distress. It is also consistent with our regional commitments to introduce a common currency in the East African Community in 2024. In light of this useful fiscal anchor for our public finances, we intend to further reduce the fiscal deficit to 3.5 percent of GDP (excluding arrears clearance) in 2015/16. Such fiscal prudence is also meant to send a strong signal to financial markets, at a time when we are increasingly going to rely on market financing, whether domestic or external, in the coming years. The revenue to GDP ratio is expected to increase next year on account of the new VAT law, which to some extent has reduced tax exemptions, and other tax policy measures. We also intend to implement a number of measures to fight tax evasion forcefully. To avoid having to revise expenditures downward in the course of the year, we have quantified all these measures conservatively. Tax revenue will be monitored in the program through an assessment criterion.

20. Risks and contingency measures. In light of the remaining uncertainty on the extent of donor support next year, we have used conservative assumptions for budget support grants. Should grants or revenue turn out higher than expected, expenditure could be raised accordingly, keeping the overall fiscal deficit unchanged. Conversely, should revenue turn out to underperform in the course of the year, revenue measures and/or expenditure savings would be considered so as to keep to our deficit target. In both cases, adjustments would be made through a supplementary budget.

Fiscal Aspects of Energy

21. Power sector. The financial situation of TANESCO has improved noticeably following the 40.3 percent tariff increase in January 2012 and 40 percent in January 2014 coupled with a significant reduction in the cost of power generation due to the completion and commissioning of the Mwanza 60 MW power plant by end of 2013 and utilization of hydro capacity, which allowed TANESCO to retire all but one emergency power plant by end-2014. TANESCO has also managed to reduce technical losses and to improve revenue collection by introducing prepaid meters (LUKU), Automatic Meter Readers (AMRs), disconnecting non-paying customers and installing LUKU and AMR meters in government institutions. The EWURA automatic tariff adjustment formula, which adjusts electricity tariffs quarterly to reflect changes in the exchange rate, inflation and oil prices, will maintain tariffs at or above cost-recovery. Tariffs were decreased by 2.3 percent in March 2015 to reflect the recent significant decline in global oil prices, which was partly offset by inflation and the depreciation of the shilling against the U.S. dollar. Going forward, TANESCO's financial position is expected to further improve, as the cost of power generation is projected to fall with the completion of a new gas pipeline and a gas-fueled power plant. Nevertheless, TANESCO remains in arrears to its suppliers (Tsh 344.6 billion at end-2014 and Tsh 586.5 billion at end-May 2015). Unless these arrears are cleared, TANESCO's credibility as a gas-offtaker will be further weakened with negative implications on investment decisions by the private sector to expand near-shore gas production. A strategy to address these arrears will be prepared jointly by the government, EWURA, and TANESCO by end-September 2015 (new structural benchmark).

22. Fiscal framework for managing revenues from natural gas. The prospect of a substantial increase in natural gas revenues will create significant challenges for macro-fiscal policy and PFM. To address these issues, a policy on a gas revenue management framework, which draws on international experience, was developed and approved by the Cabinet in May 2015. Our fiscal framework will be designed with a view to: (i) ensuring fiscal sustainability; (ii) promoting economic and social development; (iii) and addressing the volatility of resource revenues. Indicators such as the non-resource balance, which delinks the fiscal position from the volatility of resource revenues, will be used to deliver these principles. The strategy also lays out the principles that will be used to establish a budget management framework for resource revenues, and in particular a Natural Gas Revenue Fund. The Fund will be fully integrated into the budget process. It will operate as a government account and will not have independent spending authority. Its operations will be fully transparent, have a strong governance structure, and invest prudently.

Fiscal Aspects of Pensions

23. Government liabilities to pension funds and pension reform. Cabinet discussed in March 2015 a comprehensive strategy to deal with government liabilities to pension funds. While some more work is required to finalize the strategy and implement it, its main principles have been approved. The government has agreed to settle the arrears related to pre-1999 reform PSPF beneficiaries by issuing non-cash special bonds to the PSPF. This settlement is expected to take place in the course of 2015/16. Future liabilities to the PSPF on account of pre-1999 reform beneficiaries will be explicitly budgeted on a yearly basis. Payments totaling to Tsh 177 billion will be made by end-June 2015, and Tsh 150 billion has been budgeted for 2015/16. The government also intends to clear in 2015/16 the arrears on loans made in the past by pension funds to various government entities through bond issuance. The bonds will have a range of maturities, taking into account the pension funds' future financial cash flows and the government debt's redemption profile. Finally, the government has decided to merge pension funds, so as to reduce excessively high overhead costs. A study is being prepared with ILO on a specific proposal.

C. Public Finance and Debt Management

Management of domestic arrears

24. Clearance and settlement of supplier arrears. The verification of supplier arrears outstanding as of end-June 2014 was completed in April 2015, with a few weeks' delay. The total amount of verified arrears amounts to Tsh 863 billion. We have started to repay these arrears in 2014/15, with the bulk of settlement done in 2015/16. An allocation of about 0.7 percent of GDP has been made to that effect in the budget framework for next fiscal year. Payments are expected to be made mostly in cash.

25. Arrears monitoring. We have taken a number of measures (included in two circulars issued in December 2014 and January 2015) that we trust will improve our quarterly monitoring of arrears. In light of the importance of preventing arrears accumulation and of the availability of a better gauge, we will monitor domestic arrears through an indicative program target. The objective will be to avoid any net accumulation of arrears, once the series is adjusted for the impact of arrears clearance. The amount of arrears cleared in the last quarter of 2014/15 will be provided in a report produced by the CAG by end-September 2015 verifying the settlement of arrears. There will be quarterly reporting on payments made to settle the arrears in 2015/16, which will be used for the purpose of adjusting the indicative target on net arrears accumulation, after verification by the Internal Auditor General. Finally, we will reintroduce strict commitment controls in IFMS, effective September 1, 2015 (new structural benchmark). These controls will ensure that commitments can only be made in IFMS if consistent with budget appropriations and cash released. Sanctions will be strengthened in the Budget Act regulations.

Public debt management

26. During 2014/15 the government expects to borrow an additional US$500 million in non concessional terms to finance the budget and to contract US$292 million for the financing of the Kinyerezi II 240MW power plant. In order to assess the impact of new borrowing, particularly non concessional, on the sustainability of the national debt and to provide guidance on the composition of budget financing in 2015/16, a DSA exercise will be carried out followed by updating of the Medium Term Debt Strategy (MTDS). The updated MTDS will discuss the pros and cons of the various forms of external non-concessional borrowing, including issuing a Eurobond; it will be presented to the National Debt Management Committee and approved by the Minister for Finance by end-December 2015 (new structural benchmark). The new Debt Management Department within the Ministry of Finance is expected to be in full operation in July 2015. The National Debt Management Policy and amendments of the Government Loans, Guarantees and Grants Act Cap. 134 will strengthen management of public debt and provide the legal underpinning for the new debt management department to effectively discharge its responsibilities. They are expected to be submitted to cabinet by July 2015.

Monitoring and Management of Fiscal Accounts in the Public Sector

27. **Monitoring of parastatals**. The Office of the Treasury Registrar (OTR) is setting up its own website, which will be used to disseminate the information it is collecting on the public enterprises. The website will include a list of all parastatals, with links to their most recent audited financial statements. In parallel, OTR is working on the aggregation of these financial statements, which will be used to produce more comprehensive government finance statistics. Good progress has indeed been made towards producing accounts for the general government.

28. **Budget and PFM bills**. The new Budget Act will provide detailed guidance in matters relating to Budget and instill budget discipline and credibility and put in place a legal framework that considers different aspects of the budget and the process as well as recognizing the legal roles and responsibility of different key stakeholders. The Public Finance Act, 2001 (as revised in 2004) is under review in order to incorporate sections which were not in the current Act and also to increase Transparency and Accountability of Public Funds which include: The preparation of financial statements using International Public Sector Accounting Standards (IPSAS), management of government assets, Internal Auditor General's Issues, electronic payments etc.

III. PROGRAM MONITORING

III. Assessment criteria for end-December 2015 and end-June 2016, and indicative targets for end-September 2015 and end-March 2016 are set as per Table 1. It is proposed to modify the NIR target for end-June 2015 to take into account the efforts made to smooth volatility on the foreign exchange market in early 2015, which led to large net foreign exchange sales. The NDF target for end-June 2015 would also be modified. New structural benchmarks are proposed in Table 2. The third and fourth reviews under the PSI are expected to take place by December 31, 2015 and June 30, 2016, respectively, on the basis of the assessment criteria and structural benchmarks indicated in Tables 1 and 2.

Table 1. Tanzania: Quantitative Assessment Criteria (AC) and Indicative Targets(IT) Under the Policy Support Instrument, December 2014–June 2016

	December 2014				March 2015				June 2015		Sept. 2015	Dec. 2015	Mar. 2016	June 2016
	Assessment Criteria				Indicative Target				AC		IT	AC	IT	IT
	Program	Adjusted Criteria	Preliminary	Met?	Program	Adjusted Criteria	Preliminary	Met?	Program	Modified	Proposed	Proposed	Proposed	Proposed
	(Billions of Tanzania Shillings; end of period, unless otherwise indicated)													
Net domestic financing of the government of Tanzania (cumulative, ceiling) [1, 2]	864	864	505	✓	446	946	1,310	✗	29	583	358	716	1,074	1,432
Average reserve money (upper bound) [3]	6,033	6,033	6,011	✓	6,219	6,219	5,844	✓	6,473	6,473	6,494	6,913	6,859	6,955
Average reserve money target [3]	5,973	6,011			6,158	6,158			6,409	6,409	6,430	6,845	6,791	6,887
Average reserve money (lower bound) [3]	5,913	5,913			6,096	6,096			6,345	6,345	6,365	6,776	6,723	6,818
Tax revenues (floor; IT through March 2015, AC thereafter)[1]	5,105	5,105	4,965	✗	7,854	7,854	7,426	✗	10,661	10,130	2,912	6,120	9,250	12,408
Priority social spending (floor; indicative target)[1]	1,200	1,200	1,387	✓	1,800	1,800	2,099	✓	2,400	2,400	700	1,400	2,100	2,800
Accumulation of domestic arrears (ceiling; indicative target)[1]										0	0	0	0	0
	(Millions of U.S. dollars; end of period)													
Change in net international reserves of the Bank of Tanzania (floor) [1, 4]	-235	-235	-77	✓	290	-13	-328	✗	608	176	137	231	305	438
Accumulation of external payment arrears (continuous AC ceiling)[1]	0	0	0	✓	0	0	0	✓	0	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (continuous AC ceiling) [5]	2,420	2,420	654	✓	2,420	2,420	934	✓	2,420	2,420	2,420	2,420	2,420	2,420
Memorandum item:														
Foreign program assistance (cumulative grants and loans) [1]	202	202	200		374	374	306		755	613	93	186	278	371
External nonconcessional borrowing (ENCB) disbursements to the budget [1]	149	149	338		846	846	364		1,147	1,010	269	537	806	1,074

Note: For precise definitions of the aggregates shown and details of the adjustment clauses, see the Technical Memorandum of Understanding (TMU).

[1] Cumulative from the beginning of the fiscal year (July 1).

[2] To be adjusted upward by up to TSh 500 billion for the U.S. dollar equivalent of a shortfall in the combined total of foreign program assistance and ENCB from the amounts shown in the memorandum item. To be adjusted downward by any ENCB disbursed for budget financing above programmed amount for the year as a whole. The 2014/15 ceiling be adjusted upward for any amount of expenditure arrears cleared during the fiscal year in excess of the budgeted amount of TSh 170 billion, and to be adjusted downward for any shortfalls compared to the same amount. The end-of-quarter limits in 2015/16 will be adjusted upward by the amount of arrears to pension funds cleared from the beginning of the fiscal year. This adjustor will be capped by the total amount of arrears identified in the strategy to clear arrears to pension funds.

[3] Assessment/performance criteria and indicative targets apply to upper bound only.

[4] Floor will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance and ENCB financing of the government up to the equivalent of TSh 500 billion.

[5] The cumulative ENCB ceiling of US$2,420 million applies from January 1, 2014 through June 30, 2016.

Table 2. Structural Benchmarks Under the Policy Support Instrument. December 2014-December 2015

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Public Finance Management/Fiscal Risks			
Prepare and publish a fiscal risk statement or subcomponents of it (e.g., a listing of all PPP projects with their key features and information on government guarantees)	To enhance fiscal risk management	June 30, 2015	In progress
Paymaster General (PMG) to issue a new Circular requiring quarterly reporting of payment arrears to include a clear definition of arrears, an extension of the reporting coverage (e.g. arrears on tax refunds and debt service), an additional aging category to identify arrears of more than one year, documentation requirements, including a proof that a claim was registered in the IFMS, and a requirement that internal auditors in MDAs prescreen the arrears data before submission to the Ministry of Finance.	To enhance monitoring of arrears	December 31, 2014	Met
Prepare a report on verification of arrears as of end-June 2014 that covers all ministries, departments and agencies.	To accelerate settlement of arrears	February 28, 2015	Met with a delay in April 2015
Reintroduce commitment controls in IFMS, which will prevent commitments to be made in the system that are inconsistent with budget appropriations and cash releases	To reduce the risk of arrears accumulation	September 1, 2015	New benchmark
Prepare a strategy to address TANESCO arrears	To enhance fiscal risk management	End-September 2015	New benchmark

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Monetary, Financial and Exchange Rate Policies			
Conduct a review of the relationship between the interbank cash market rates and excess reserves of commercial banks as a step to transitioning to a more interest rate-based monetary management framework.	To prepare BoT's gradual shift to a price-based monetary framework.	December 31, 2014	Met
Unify the Statutory Minimum Reserve and the clearing accounts that banks maintain at the BoT and implement partial reserve averaging for reserve requirements	To reduce excessive volatilities in short term money market interest rates.	April 30, 2015	Not met, in light of the decision to tighten liquidity following excessive volatility of the Shilling. Proposed to be rescheduled for end-2015.
Establish a modeling and forecasting unit at BoT	To improve liquidity and inflation forecast and facilitate the shift to a price-based monetary framework	End-September 2015	New benchmark
Pension System			
Prepare and adopt a strategy to address government arrears to pension funds	To improve the sustainability of the funds	February 28, 2015	Not met. A broad strategy was discussed by the Cabinet and approved in March 2015, but required more work before finalization.

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Public Debt Management			
Update the medium-term debt management strategy, and obtain approval by the Minister for Finance	To enhance public debt management	December 31, 2015	New benchmark
Public Enterprise Management			
Treasury Registrar to publish the audited accounts of public enterprises	To improve transparency and accountability of public enterprises	September 30, 2015	In progress
Managing Natural Resource Wealth			
Prepare a draft policy paper on natural gas revenue management framework that fully integrates with the budget.	To strengthen fiscal sustainability and improve transparency in the use of natural gas resources	March 31, 2015	Met

Attachment II. Technical Memorandum of Understanding on Selected Concepts and Definitions Used in the Monitoring of the Program Supported by the PSI

June 18, 2015

I. INTRODUCTION

1. The purpose of this Technical Memorandum of Understanding (TMU) is to describe concepts and definitions that are being used in the monitoring of Tanzania's program supported by the PSI, comprising the quantitative assessment criteria, the indicative targets and structural benchmarks monitored under the PSI.

2. The principal data sources are the standardized reporting forms, 1SRF and 2SRF, as provided by the Bank of Tanzania (BoT) to the IMF, and the government debt tables provided by the Accountant General's office.

3. The program exchange rate is TSh/USD1,649.

II. DEFINITIONS

Net international reserves

4. Net international reserves (NIR) of the BoT are defined as reserve assets minus reserve liabilities. The change in NIR is calculated as the cumulative change since the beginning of the fiscal year. The BoT's reserve assets, as defined in the IMF BOP manual (5th edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS), include: (i) monetary gold; (ii) holdings of SDRs; (iii) the reserve position at the IMF; (iv) all holdings of foreign exchange; and (v) other liquid and marketable assets readily available to the monetary authorities. Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guaranteed for a third party external liability (assets not readily available). The BoT's reserve liabilities include: (i) all short-term foreign exchange liabilities to nonresidents, of original maturities less than one year; and (ii) outstanding purchases and loans from the IMF.

5. NIR are monitored in U.S. dollars, and for program monitoring purposes assets and liabilities in currencies other than U.S. dollars shall be converted into dollar equivalent values using the exchange rates as of December 31, 2014 (as recorded in the balance sheet of the BoT).

	US$ per currency unit
British pound	1.5587
Euro	1.2147
Japanese yen	0.0097
Australian dollar	0.9236
Canadian dollar	0.9082
Chinese yuan	0.1608
SDR	1.4488

Reserve money and reserve money band

6. Reserve money is defined as the sum of currency issued by the BoT and the deposits of Other Depository Corporations (ODCs) with the BoT. The reserve money targets are the projected daily averages of March, June, September, and December within a symmetrical one percent band. The upper bound of the band for June and December serves as the assessment criterion and that for March and September, the indicative target.

Net domestic financing of the Government of Tanzania

7. Net domestic financing of the Government of Tanzania (NDF) includes financing of the budget of the central (union) government of Tanzania ("government") by the banking system (BoT and ODCs) and the nonbank public.

8. NDF is calculated as the cumulative change since the beginning of the fiscal year in the sum of:

(i) loans and advances to the government by the BoT and holdings of government securities and promissory notes (including liquidity paper issued for the monetary policy purposes) , minus all government deposits with the BoT.

(ii) all BoT accounts receivable due from the Government of Tanzania that are not included under (i) above;

(iii) loans and advances to the government by other depository corporations and holdings of government securities and promissory notes, minus all government deposits held with other depository corporations;

(iv) loans and advances to the government, and holdings of government securities and promissory notes by other public entities (e.g. pension funds) not covered by the central government accounts; and

(v) the outstanding stock of domestic debt held outside depository corporations, excluding: government debt issued for the recapitalization of the NMB and TIB; debt swaps with

COBELMO (Russia) and the government of Bulgaria; mortgage on acquired sisal estates; compensation claims; and debt of parastatal companies assumed by the government.

(vi) NDF will be measured net of any accumulation of central government claims on the Tanzania Petroleum Development Corporation (TPDC) as a result of the on-lending of an external credit to finance a gas pipeline.

Government deposits at the BoT

9. Government deposits at the BoT include government deposits as reported in the BoT balance sheet, 1SR–including counterpart deposits in the BoT of liquidity paper issued for monetary policy purposes, and foreign currency-denominated government deposits at the BoT, including the PRBS accounts and the foreign currency deposit account.

External payment arrears

10. External payment arrears consist of the total amount of external debt service obligations (interest and principal) of the government and the BoT that have not been paid at the time they are due, excluding arrears on external debt service obligations pending the conclusion of debt-rescheduling arrangements and arrears previously accumulated and reported to the Executive Board. The ceiling on external payment arrears is continuous and applies throughout the year.

Priority social spending

11. Priority social spending comprises spending on agricultural inputs, and central government transfers to local governments for health and education.

Tax revenues

12. Tax revenues include import duties, value-added tax, excises, income tax, and other taxes.

Domestic arrears

13. **Expenditure arrears** are defined as unpaid claims that are overdue by more than 30 days for goods and services and more than 90 days for contract works as set out in the government's Circular No 9 of 8th December 2014. These will include payments for tax refunds, employee expenses (wages and salaries, staff claims for travel, transfer and other non-salary allowances), utilities, rents, recurrent goods and services, and construction works. The indicative target on expenditure arrears is calculated as a change in the stock of expenditure arrears at the end of each quarter from the stock as of March 31, 2015. This change should be adjusted for the impact of any centralized clearance of arrears following the verification completed in April 2015.

14. **Arrears to pension funds** include government obligations to the Public Service Pension Fund (PSPF) on pre-1999 reform pension benefits paid on government's behalf and overdue payments on loans made by pension funds to public entities.

Contracting or guaranteeing of external debt on nonconcessional terms

15. The term "external debt" will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 6230-(79/140), as amended by Decision No. 14416-(09/91), effective December 1, 2009). External debt will be determined on the basis of currency of denomination of the debt. Government external debt is outstanding debt owed or guaranteed by the Government of Tanzania, the Bank of Tanzania, subnational governments, and companies in which the government has at least 50percent ownership, unless otherwise stipulated.[1] The ceiling on contracting and guaranteeing external nonconcessional debt is continuous and applies throughout the year.

16. Government debt is considered nonconcessional if the grant element is lower than 35 percent, computed using a discount rate of 5 percent. This PSI assessment criterion applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 6230-(79/140), as amended by Decision No. 14416-(09/91), effective December 1, 2009), but also to commitments contracted or guaranteed for which value has not been received.

Foreign program assistance

17. Foreign program assistance is defined as budget support and basket grants and loans received by the Ministry of Finance (MoF) through BoT accounts and accounts at other depository corporations and is calculated as the cumulative sum, since the beginning of the fiscal year, of the receipts from (i) program loans and (ii) program grants. Program assistance does not include nonconcessional external debt as defined in paragraphs 13 and 14.

III. ADJUSTERS

Net international reserves

18. The end-of-quarter quantitative targets for the change in the BoT's net international reserves will be adjusted downward by the amount in U.S. dollars of any shortfalls in (a) foreign program assistance and (b) external nonconcessional borrowing (ENCB) financing of the government budget in U.S. dollars (up to a limit equivalent to TSh 500 billion at the program exchange rate).

19. The shortfalls will be calculated relative to projections for foreign program assistance shown in table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Polices of the Government of Tanzania titled "Quantitative Assessment Criteria, and

[1] Excluded for these purposes, except if the government offers an explicit guarantee on the debt, are: Tanzania Investment Bank; Tanzania Port Authority; Tanzania Petroleum Development Corporation, National Development Corporation; National Housing Corporation; and Tanzania Airport Authority.

Indicative Targets under the Policy Support Instrument". For purposes of the adjuster, ENCB is measured excluding any non-concessional financing contracted for the gas pipeline.

20. Each quarterly shortfall will be converted from U.S. dollars to Tanzanian shillings using the program exchange rate (paragraph 3). The cumulative shortfall will be the sum of all quarterly shortfalls in Tanzanian shillings from the beginning of the fiscal year up to the date of assessment.

Net domestic financing

21. The end-of-quarter quantitative limits on the net domestic financing of the Government of Tanzania will be adjusted upward for any shortfalls in the combined total of foreign program assistance and ENCB financing of the government budget in U.S. dollars (up to a limit of TSh 500 billion). The shortfalls will be calculated relative to projections for foreign program assistance and ENCB financing shown in the Table on "Quantitative Assessment Criteria and Indicative Targets under the PSI" attached to the MEFP. For purposes of the adjuster, ENCB is measured excluding any non-concessional financing contracted in for the gas pipeline. Each quarterly shortfall will be converted from U.S. dollars to Tanzanian shillings using the program exchange rate (paragraph 17). The cumulative shortfall will be the sum of all quarterly shortfalls in Tanzanian shillings from the beginning of the fiscal year up to the date of assessment.

22. The limits referred to in the previous paragraph will be adjusted downward for any ENCB financing of the government budget in excess of the amount programmed for the year as a whole, indicated in the table referred to in the previous paragraph.

23. The end-2014/15 limit will be adjusted upward for any amount of expenditure arrears cleared during the fiscal year in excess of the amount included in the baseline projection (TSh 170 billion). The limit will be adjusted downward for any shortfalls compared to the same amount. The amount of expenditure arrears cleared during the fiscal year will be confirmed by the report from the CAG, to be prepared no later than September 30, 2015.

24. The end-of-quarter limits in 2015/16 will be adjusted upward by the amount of arrears to pension funds cleared from the beginning of the fiscal year. This adjuster will be capped by the total amount of arrears identified in the strategy to clear arrears to pension funds.

IV. DATA REPORTING REQUIREMENTS

For purposes of monitoring the program, the Government of Tanzania will provide the data listed in Table 1 below.

Table 1. Summary of Reporting Requirements

Information	Reporting Institution	Frequency	Submission Lag
Issuance of government securities.	BoT	Bi-weekly	1 week
Yields on government securities.	BoT	Bi-weekly	1 week
Daily excess reserves of commercial banks	BoT	Weekly	1 week
Daily data on transactions trough IFEM by exchange rate and volume, separating BoT and commercial bank transactions	BoT	Weekly	1 week
Daily data on reserve money and its components	BoT	Daily	1-day
Consumer price index.	NBS	Monthly	2 weeks
The annual national account statistics in current and constant prices.	NBS	Annually	6 months
The quarterly national account statistics in constant prices.	NBS	Quarterly	3 months
Balance sheet of the BoT (1SRF) and the currency composition of official foreign assets and official foreign liabilities.	BoT	Monthly	1 week
Consolidated accounts of other depository corporations and the depository corporations survey (2SRF and the DCS).	BoT	Monthly	4 weeks
Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor.	MoF	Monthly	2 weeks
External trade developments.	BoT	Monthly	4 weeks
Balance of payments	BoT	Quarterly	4 weeks
Standard off-site bank supervision indicators for other depository corporations.	BoT	Quarterly	6 weeks
Financial Soundness Indicators for other depository corporations.	BoT	Quarterly	6 weeks
Other depository corporation lending by activity.	BoT	Monthly	4 weeks
Commercial banks interest rate structure.	BoT	Monthly	4 weeks
Summary table of: (i) average reserve money; (ii) net domestic financing of the government; (iii) stock of external arrears; (iv) new contracting or guaranteeing of external debt on nonconcessional terms; and (v) net international	BoT and MoF	Monthly	4 weeks

Information	Reporting Institution	Frequency	Submission Lag
reserves.[1]			
Amount of arrears outstanding that are overdue by more than 30 days for goods and services and more than 90 days for contract works as set out in the government's Circular No 9 of 8th December 2014 for all government ministries.	MoF/AGD	Quarterly	4 weeks
The flash report on revenues and expenditures.	MoF/AGD	Monthly	4 weeks
The TRA revenue report	TRA	Monthly	4 weeks
The monthly domestic debt report.[1]	MoF	Monthly	4 weeks
Monthly report on central government operations.	MoF	Monthly	4 weeks
Detailed central government account of disbursed budget support grants and loans, and ENCB, and external debt service due and paid.	MoF	Monthly	4 weeks
Detailed central government account of disbursed donor project support grants and loans.	MoF	Monthly	4 weeks
Statement on new external loans contracted and guarantees provided by the entities listed in paragraph 14 of the TMU during the period including terms and conditions according to loan agreements.	MoF	Quarterly	4 weeks
Quarterly report on loans and advances to government by pension funds and other public entities not covered by the central government accounts	MoF	Quarterly	4 weeks
Report on priority social spending	MoF	Quarterly	6 weeks

[1]The MoF and BoT will reconcile data on BoT claims on the government, to ensure that such claims recorded in the BoT balance sheet are the same as those reported by the Accountant General of the MoF.

INTERNATIONAL MONETARY FUND

UNITED REPUBLIC OF TANZANIA

June 19, 2015

SECOND REVIEW UNDER THE POLICY SUPPORT INSTRUMENT—DEBT SUSTAINABILITY ANALYSIS

Approved By

Roger Nord and Dhaneshwar Ghura (IMF) and John Panzer (World Bank)

Prepared by the staffs of the International Monetary Fund and the International Development Association

Risk of external debt distress:	Low
Augmented by significant risks stemming from domestic public and/or private external debt?	No

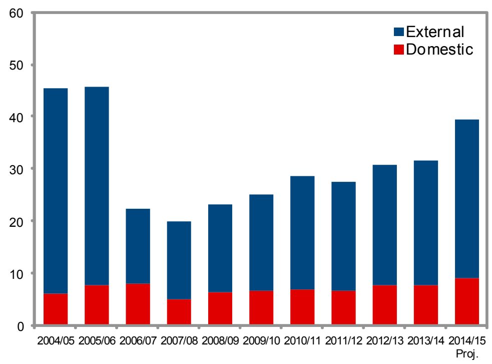
This debt sustainability analysis (DSA) updates the previous joint IMF/IDA DSA prepared in April 2014. The main changes from last year are revised national accounts, which show that nominal GDP is about 30 percent higher than earlier thought, and lower debt sustainability thresholds.[1] *Tanzania continues to face a low risk of debt distress based on the external DSA. The public debt outlook also remains favorable. However, stress tests highlight vulnerabilities to exchange rate depreciation under the external DSA and lack of fiscal consolidation under public DSA. These results highlight the need for Tanzania to continue implementing a prudent fiscal policy, with an overall deficit of 3 percent of GDP providing a good medium-term fiscal anchor. Recourse to nonconcessional borrowing is likely to further increase in the medium term, but this transition to market financing needs to be progressive and accompanied by a strengthening of debt management capacity and public investment management.*

[1] The three-year average score of the Country Policy and Institutional Assessment (CPIA) for 2011–13 has been for the second year in a row (slightly) below 3.75, the cutoff for strong performance, with corresponding annual CPIA scores are 3.7, 3.75 and 3.76 respectively. As a result, Tanzania is now rated as a "medium policy performer", which leads to lower applicable debt thresholds in the DSA.

BACKGROUND

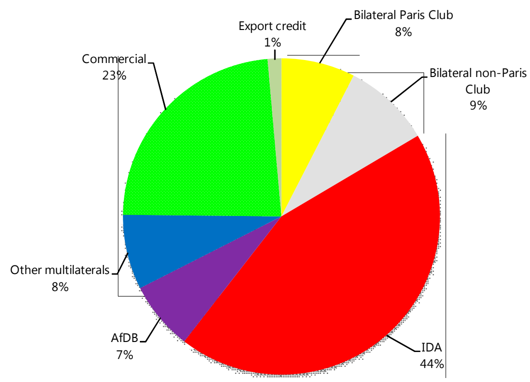
1. **Tanzania's public and publicly guaranteed (PPG) external debt as a share of GDP has steadily increased in recent years**[1] (Text Figure left panel). Since the Multilateral Debt Relief Initiative (MDRI) in 2006/07, which reduced total public debt-to-GDP ratio from 47 percent to 19 percent, PPG external debt (excluding arrears under negotiation for relief) has increased to about 29 percent of GDP at end-June 2014, or 17 percent of GDP in present value terms using a 5 percent discount rate. Total public sector debt (external plus domestic public debt) stood at about US$17.2 billion or 36 percent of GDP at end 2013/14, rising from 27.5 percent at end 2007/08.

Tanzania Public Debt, 2004-2015
(in percent of GDP)



Sources: Ministry of Finance, Bank of Tanzania, and IMF staff calculations.
Note: 2014/15 projection of domestic debt includes a one-off adjustment for recognizing outstanding domestic government liabilities, including outstanding pre-1999 pension benefits, suppliers' arrears, contingent liabilities, outstanding VAT refunds, defaulted public corporations and TANESCO arrears.

Compostition of PPG External Debt, June 2014



Sources: Ministry of Finance, Bank of Tanzania, and IMF staff claculations.
Note: Excludes arrears to non-Paris Club creditors inder negotiations for relief.

2. **The majority of Tanzania's PPG external debt is still concessional, but borrowing on non-concessional terms has increased in recent years** (Text Figure right panel). At end-2013/14, more than two-thirds of total public external debt was owed to multilateral institutions, of which the International Development Association (IDA) and the African Development Bank (AfDB) constitute the largest creditors. Government borrowing from commercial sources amounted to about 23 percent of the total stock at end-2013/14, having risen rapidly from about 2 percent at end-2009/10. New nonconcessional loans have mainly financed infrastructural projects. Since the last DSA, Tanzania contracted three new loans to finance the third terminal of the Dar es Salaam airport (€ 113 million), road construction projects (US$300 million) and the

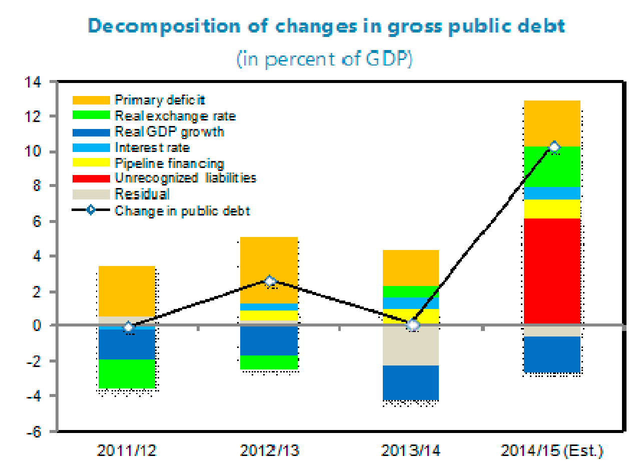
[1] Tables and Figures are in fiscal years (July–June). For example, 2014 refers to fiscal year 2014/15.

expansion of its gas-fuelled power generation capacity (US$292 million). This new nonconcessional borrowing was fully consistent with the program. The authorities are in the process of obtaining a sovereign risk rating, which would facilitate future Eurobond issuance.

3. **Domestic public debt stood at 7 percent of GDP at end-2013/14**, and mostly consisted of Treasury bills and bonds. Domestic public debt is held primarily by commercial banks (39 percent), the Bank of Tanzania (35 percent), and pension funds and insurance companies (23 percent).

4. **The current DSA mostly covers central government debt**. Owing to data limitations, non-guaranteed borrowing by local governments and most public enterprises is excluded, thus potentially understating the total public debt level. In this DSA, the domestic public debt stock incorporates from July 2014 several outstanding government liabilities that have yet to be formally recognized as debt and reflected as "unrecognized liabilities" in Text Figure 3, estimated at 6.3 percent of GDP. These include outstanding liabilities to the Public Service Pension Fund, loans by pension funds to MDAs including overdue payments, outstanding unpaid domestic claims,[2] government guarantees to public enterprises, arrears on VAT refunds, arrears accumulated by TANESCO, and other liabilities arising from court orders, and explicit government guarantees.[3] The government is in the process of implementing a plan to clear the pension fund arrears which include overdue payments on loans and outstanding pre-1999 pension benefits. The government is also committed to include explicit allocations in future budgets to address future liabilities to the PSPF. The fiscal projections underpinning this DSA include estimates for such allocations.

5. **The primary fiscal deficit has been a major contributor to public debt accumulation.** A decomposition of annual changes in the ratio of gross public debt to GDP shows that the primary fiscal deficit has made a sizable contribution to the debt ratio increase (Text Figure 3), while Tanzania's robust GDP growth has helped keep the debt ratio down.



Source: IMF Staff claculitions.

[2] Unpaid claims of duration above 90 days for construction work and above 30 days for others, estimated as of end-December 2014. Ministries with large claims include Works, Health, Education, Agriculture, Home Affairs, and Defense.

[3] In addition, the government has significant multi-year commitments arising from existing contracts, especially in the road sector, which are not included in the DSA.

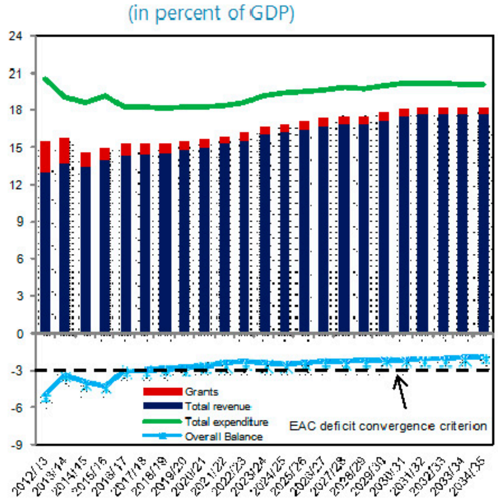
6. The National Bureau of Statistics revised the national accounts. The revisions reflect better coverage, improved statistical techniques, and the use of 2007 instead of 2001 as the new base year. The revised GDP series is used in the DSA. With nominal GDP about a third higher, many key ratios are now lower compared to the previous DSA.[4]

UNDERLYING ASSUMPTIONS

7. The current DSA assumes gradual and modest fiscal consolidation in the medium-term, supported by revenue efforts (Text Table and Text Figure 4). The deficit is projected to temporarily increase to 4.2 percent of GDP, partly on account of arrears clearance (0.7 percent of GDP) before declining to 3 percent of GDP in 2016/17 and stay slightly below that level in the outer years, consistent with the convergence criterion agreed under the East African Monetary Union (EAMU) protocol. Domestic revenues (excluding grants) are projected to increase significantly in 2015/16 backed by tax measures (including the new VAT law and new levies on imports and oil products to finance railway development and rural electrification). The revenue ratio is projected to grow gradually as a share of GDP in the medium-term, reflecting further revenue mobilization efforts required to address Tanzania's development needs in a context of a likely further decline in the aid to GDP ratio.

Fiscal reduction path, 2014/15-2034/35

(in percent of GDP)

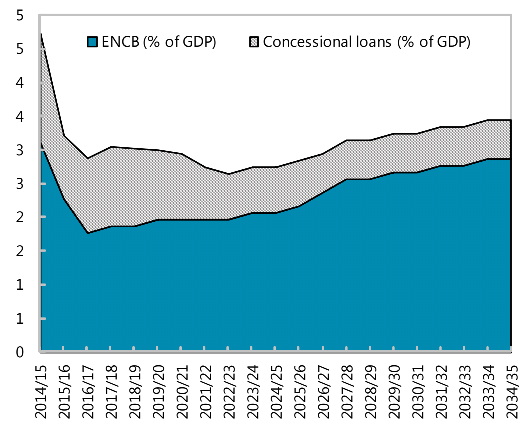


Sources: Ministry of Finance and IMF staff calculations.

Note: Fiscal year 2015/16-2034/35 represent the projection period under the DSA.

Foreign Financing Assumption

(in percent of GDP)



Sources: Ministry of Finance, Bank of Tanzania, and IMF staff calculations

[4] The baseline macroeconomic framework underlying the current DSA does not yet factor in the potential impact of possible future natural gas production from emerging offshore projects. Recent deep water exploration by major petroleum companies has confirmed large natural gas deposits. Final investment decision to develop these offshore gas discoveries is expected to take a while. Once this decision is made, the development phase would start, and it would take several years before commercial production and exports of LNG could begin. Similarly, significant fiscal revenues would not materialize for at least a decade from today.

8. The composition of external borrowing is assumed to gradually shift toward nonconcessional debt, consistent with a reduction in aid dependency as the economy matures (Text Figure 5). As mentioned earlier, external nonconcessional borrowing (ENCB) has picked up in recent years (including 2014/15). ENCB would gradually become the more prominent financing source, as illustrated by the decline in grant-equivalent financing in Figure 1.

9. Other macroeconomic assumptions have been revised from the previous DSA to reflect recent developments (see Box 1 for detail). Long-term average GDP growth is slightly lower at 6.6 percent which reflects the lower historical average in the revised national accounts. The financing terms assumption are less favorable than in the previous DSA, to reflect a slightly faster transition towards market financing. With offshore natural gas exploration almost completed, net FDI inflows are expected to decrease as a share of GDP in 2014/15 (a downward revision from the last DSA) and to stabilize at about 4 percent of GDP in the medium term.

EXTERNAL DSA

10. All PPG external debt burden indicators remain below indicative thresholds in the baseline scenario (Figure 1 and Table 1). The present value (PV) of public external debt as a share of GDP remains way below 20 percent of GDP throughout the projection period (against a threshold of 40 percent). Debt service indicators are projected to rise gradually over time, reflecting the increasing recourse to commercial borrowing.

11. All external debt ratios remain below the relevant thresholds under standard stress tests and alternative scenarios (Figure 1 and Table 3. However, stress tests show that external debt service as a ratio to revenue would nearly breach the threshold in 2018/19 in the event of a one-time 30 percent depreciation in the nominal exchange rate. In such a borderline case the probability approach is applied to assess the risk of debt distress.[5] The results show (Figure 3) that under this approach all PPG external debt indicators remain comfortably below indicative thresholds. However, this illustrates well the increased vulnerabilities associated with increasing reliance on ENCB.

12. The outlook for external debt service ratios is less favorable than in the previous DSA. This reflects that these ratios' denominators have not been affected by the recent GDP revisions, while the relevant debt thresholds have been lowered due to recent CPIA scores.[6] In addition, debt service has increased (reflecting the assumed higher reliance on ENCB in the medium and long term) while revenue has been affected by lower grant projections.

[5] The probability approach is applied to a borderline case, which is defined as one where the largest breach or near breach falls within a 10-percent band around the threshold. It incorporates a country's individual CPIA score and average GDP growth rate, whereas the traditional approaches uses one of the three discrete CPIA values (3.25 for weak performers, 3.50 for medium performers, and 3.75 for strong performers), and an average growth rate across LICs (for details see the *Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries)*.

[6] See footnote 1.

Box 1. Key DSA Assumptions

- **Growth and inflation.** Real GDP growth is projected to remain at about 7 percent over the short and medium term before gradually converging to the long term average of 6.5 percent. Inflation is projected at about 5 percent consistent with the authorities' inflation target.
- **Current account deficit.** The current account deficit is expected to improve in the short-term on account of a drop in oil prices in the world market and stabilize over the medium-term at about 7 percent of GDP. Exports and imports are assumed to grow at about 12 percent annually in the long-term. Export growth would be supported by traditional and non-traditional exports, while import growth would reflect to the dynamism of capital and consumer goods imports.

Selected Macroeconomic Indicators, Current vs. Previous DSA

		2013/14	2014/15	2015/16	2016/17	2017/18	Long term (average 2018-35)
Real GDP growth (percent)	Current DSA	7.3	7.2	7.2	7.1	7.0	6.6
	Previous DSA	7.1	7.1	7.1	7.0	6.9	6.9
Inflation (average)	Current DSA	6.3	5.2	5.0	5.0	5.0	5.0
	Previous DSA	5.8	5.1	5.0	5.0	5.0	5.0
Fiscal balance (% of GDP)	Current DSA	-3.3	-4.0	-4.2	-3.0	-3.0	-2.4
	Previous DSA	-5.2	-4.9	-4.0	-4.0	-4.0	-3.1
Current account (% of GDP)	Current DSA	-10.3	-9.5	-8.2	-7.0	-7.2	-8.2
	Previous DSA	-14.5	-13.4	-12.3	-11.8	-11.4	-10.1
FDI (% of GDP)	Current DSA	4.2	4.1	4.0	4.0	4.0	4.0
	Previous DSA	6.0	6.7	6.7	7.0	6.8	6.1

- **Fiscal deficit.** Reflecting the new GDP series, the overall fiscal deficit was revised from 4.9 percent of GDP to 4 percent of GDP in 2014/15, including 0.2 percent of GDP of arrears clearance. The deficit is projected to increase slightly to 4.2 percent in 2015/16 because of one-off expenditures related to suppliers arrears clearance (0.7 percent of GDP) and the cost of organizing the general elections (0.5 percent of GDP). New tax measures will also help contain the deficit in 2015/16. Over the medium and long-term, the deficit is projected to stay slightly below 3 percent of GDP, in line with the convergence criterion for the East African Monetary Union.
- **Aid and FDI flows.** External grants and concessional loans are assumed to gradually decline. With offshore natural gas exploration almost completed, net FDI inflows are expected to decrease as a share of GDP in 2014/15 and to stabilize at about 4 percent of GDP in the long term. This profile reflects the end of the exploration phase in the natural gas sector.
- **External nonconcessional borrowing.** ENCB is assumed to cover about half of gross foreign financing in the medium-term. Over the long-term, this share would further increase as ENCB substitutes for aid. The average grant element of new borrowing is projected to decline considerably over the long-term.
- **Domestic borrowing.** Net domestic borrowing would be maintained at moderate levels throughout the projection period as financing shifts toward more ENCB. New domestic debt is assumed to carry a real interest rate of 10 percent with average maturity of seven years.

PUBLIC DSA

13. Indicators of overall public debt and debt service do not point to significant vulnerabilities related to the level of domestic debt (Figure 2 and Table 2). In the baseline scenario, the PV of total public debt expressed as a share of GDP and revenues is expected to decline gradually over time, from about 30 percent. It would therefore remain well below the DSF benchmark level of 56 percent of GDP associated with heightened public debt vulnerabilities for medium performers, and the EAMU convergence criterion of 50 percent.

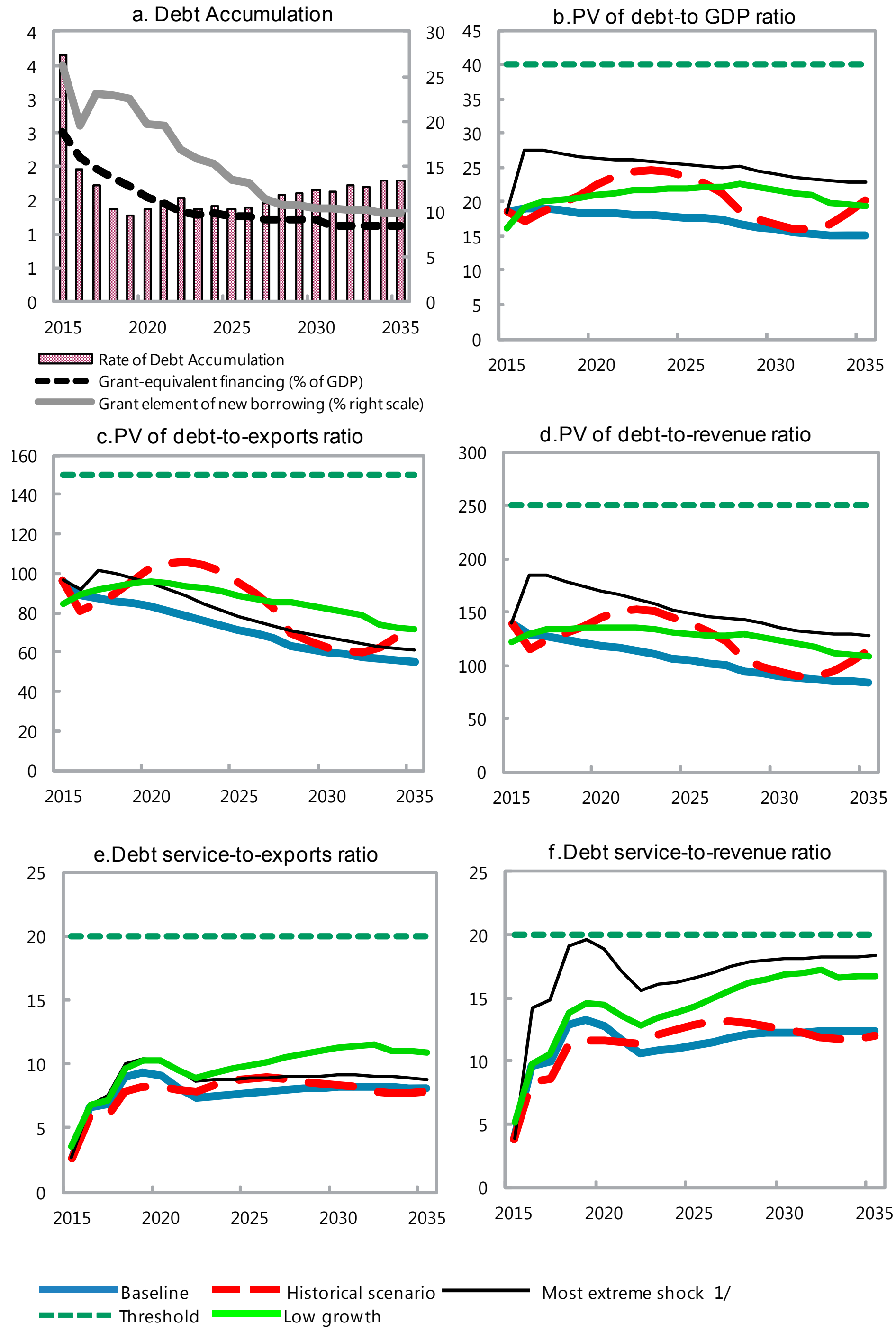
14. Stress tests confirm the importance of continued prudent fiscal policy. In a scenario assuming that the primary deficit (as a percent of GDP) remains at the projected 2015 level over the entire projection period, the PV of public debt would keep gradually growing. The debt service to revenue ratio would also reach much higher levels. The most extreme shock corresponds to a 10 percent of GDP increase in debt-creating flows in 2016, which would capture some of the government implicit contingent liabilities and/or non-central government borrowing that is not included in the DSA.

CONCLUSION

15. Tanzania continues to face a low risk of external debt distress and low risks from domestic public debt, but continued prudent policies and enhancing debt management capacity and public investment management are needed to preserve debt sustainability.

16. Authorities' views. The authorities concurred with the main results of the DSA, while stressing the need to find the right balance between continued fiscal prudence and addressing Tanzania's large development needs.

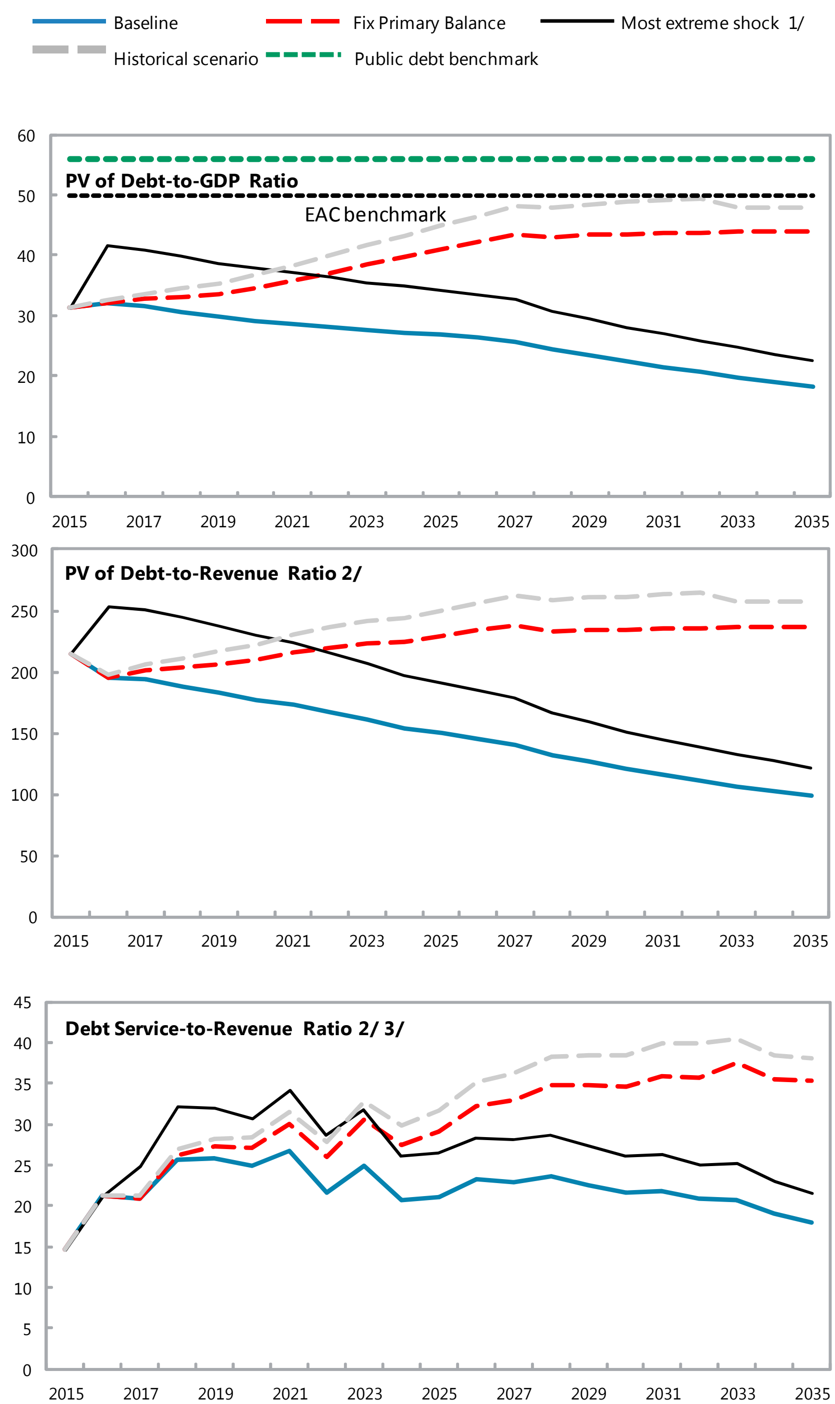
Figure 1. Tanzania: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2015–2035[1/]



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Tanzania: Indicators of Public Debt Under Alternative Scenarios, 2015–2035[1/]



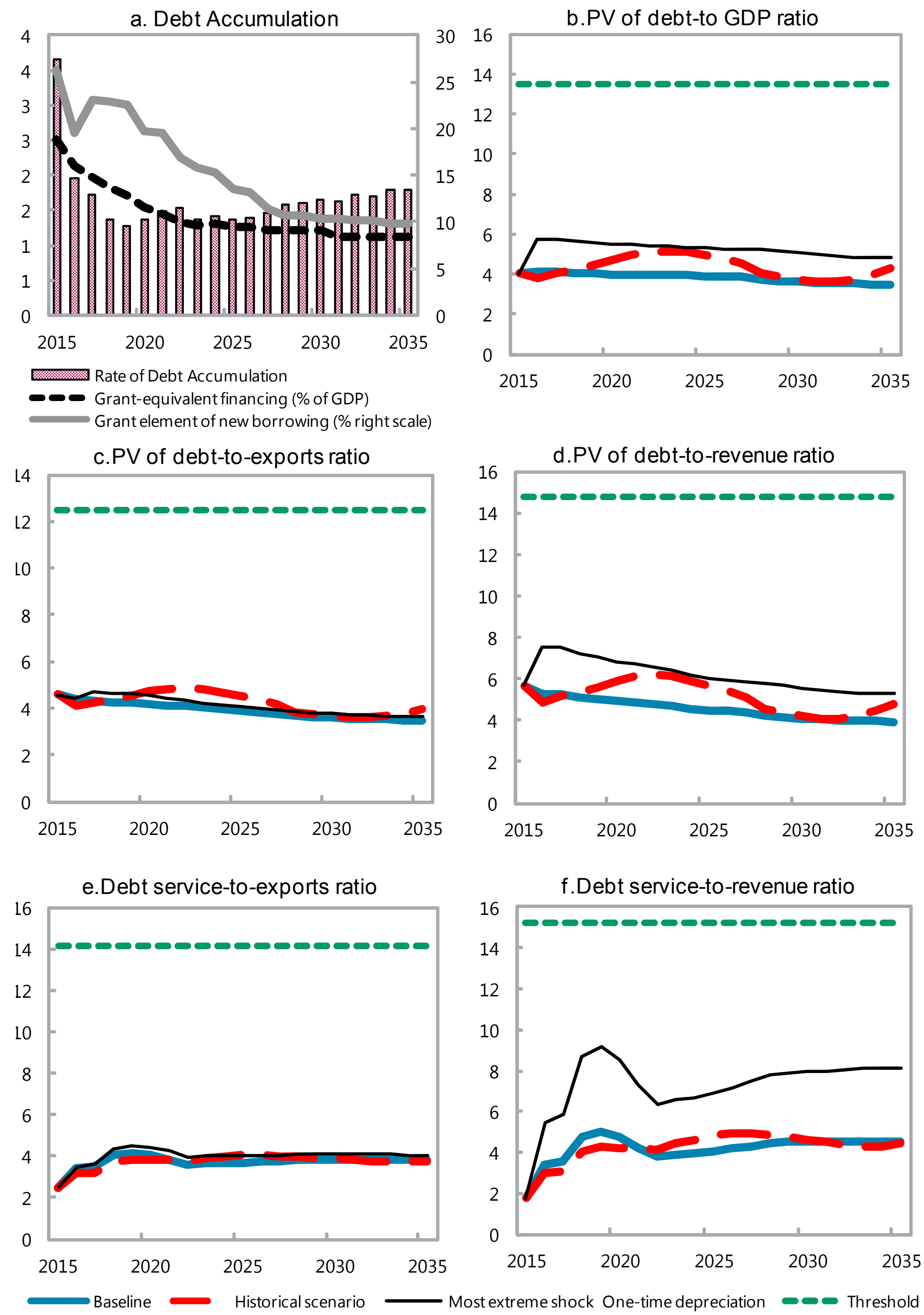
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025.

2/ Revenues are defined inclusive of grants.

3/ The volatile profile of debt service is due to the projected armotization for public domestic debt.

Figure 3. Tanzania: Probability of Debt Distress of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2015–2035[1/]



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2025. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Table 1. Tanzania: External Debt Sustainability Framework, Baseline Scenario, 2012–2035[1/]

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2012	2013	2014			2015	2016	2017	2018	2019	2020	2015-2020 Average	2025	2035	2021-2035 Average
External debt (nominal) 1/	**24.6**	**26.8**	**25.6**			**30.8**	**31.2**	**30.8**	**30.2**	**29.6**	**29.3**		**27.4**	**22.1**	
of which: public and publicly guaranteed (PPG)	20.8	23.1	22.4			27.7	27.9	27.5	26.9	26.3	26.0		23.9	19.0	
Change in external debt	-0.9	2.1	-1.2			5.2	0.3	-0.4	-0.6	-0.6	-0.3		-0.4	-0.2	
Identified net debt-creating flows	6.6	2.4	3.3			3.7	2.0	1.0	1.2	1.0	0.7		2.4	1.0	
Non-interest current account deficit	**13.1**	**10.0**	**9.9**	**8.0**	**2.6**	**9.1**	**7.5**	**6.4**	**6.5**	**6.2**	**5.9**		**7.5**	**5.5**	7.3
Deficit in balance of goods and services	13.9	10.9	11.0			10.0	8.1	7.1	7.1	6.6	6.1		7.5	5.1	
Exports	22.4	20.1	19.2			19.2	21.4	21.9	21.8	21.7	21.9		24.8	27.3	
Imports	36.3	31.0	30.2			29.2	29.5	28.9	28.9	28.3	28.0		32.3	32.4	
Net current transfers (negative = inflow)	-2.6	-1.9	-1.6	-2.8	0.7	-1.4	-1.2	-1.4	-1.4	-1.3	-1.2		-0.9	-0.4	-0.8
of which: official	-1.8	-1.3	-0.9			-0.7	-0.3	-0.5	-0.5	-0.4	-0.4		-0.3	-0.1	
Other current account flows (negative = net inflow)	1.8	1.0	0.6			0.4	0.6	0.7	0.9	0.9	0.9		0.9	0.8	
Net FDI (negative = inflow)	**-4.4**	**-4.4**	**-4.2**	**-3.7**	**0.6**	**-4.1**	**-4.0**	**-4.0**	**-4.0**	**-4.0**	**-4.0**		**-4.0**	**-4.0**	-4.0
Endogenous debt dynamics 2/	**-2.1**	**-3.2**	**-2.5**			**-1.3**	**-1.5**	**-1.4**	**-1.3**	**-1.2**	**-1.2**		**-1.0**	**-0.5**	
Contribution from nominal interest rate	0.2	0.3	0.3			0.5	0.8	0.6	0.6	0.7	0.7		0.7	0.8	
Contribution from real GDP growth	-1.5	-1.3	-1.7			-1.8	-2.3	-2.0	-2.0	-1.9	-1.9		-1.8	-1.3	
Contribution from price and exchange rate changes	-0.7	-2.1	-1.0			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**-7.5**	**-0.3**	**-4.5**			**1.5**	**-1.7**	**-1.3**	**-1.8**	**-1.5**	**-1.0**		**-2.9**	**-1.3**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	17.4			21.7	22.3	22.3	22.0	21.7	21.6		21.2	18.2	
In percent of exports	...	...	90.7			113.0	104.3	102.0	101.0	99.8	98.5		85.6	66.6	
PV of PPG external debt	**...**	**...**	**14.2**			**18.5**	**19.1**	**19.1**	**18.7**	**18.4**	**18.2**		**17.7**	**15.0**	
In percent of exports	**...**	**...**	**73.9**			**96.5**	**89.2**	**87.1**	**85.9**	**84.5**	**83.2**		**71.3**	**55.1**	
In percent of government revenues	**...**	**...**	**104.1**			**138.9**	**128.0**	**127.3**	**123.5**	**120.3**	**117.4**		**103.8**	**84.2**	
Debt service-to-exports ratio (in percent)	**3.6**	**3.0**	**3.2**			**4.0**	**8.0**	**8.1**	**10.2**	**10.6**	**10.4**		**8.9**	**9.1**	
PPG debt service-to-exports ratio (in percent)	**1.1**	**1.9**	**2.2**			**2.6**	**6.6**	**6.8**	**8.9**	**9.3**	**9.0**		**7.7**	**8.1**	
PPG debt service-to-revenue ratio (in percent)	**1.9**	**3.0**	**3.1**			**3.8**	**9.5**	**10.0**	**12.8**	**13.2**	**12.7**		**11.2**	**12.3**	
Total gross financing need (Billions of U.S. dollars)	3.4	2.6	3.0			2.8	2.5	2.2	2.7	2.8	2.8		5.8	11.9	
Non-interest current account deficit that stabilizes debt ratio	13.9	7.9	11.1			3.8	7.2	6.8	7.1	6.8	6.2		7.9	5.8	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.5	6.2	7.3	6.4	0.7	7.2	7.2	7.1	7.0	6.9	6.9	7.0	6.9	6.4	6.5
GDP deflator in US dollar terms (change in percent)	3.0	9.5	4.0	5.5	5.2	-3.0	-8.5	1.6	2.1	2.1	1.8	-0.6	1.9	5.5	3.7
Effective interest rate (percent) 5/	0.9	1.4	1.3	1.0	0.3	1.9	2.4	2.2	2.2	2.4	2.6	2.3	2.8	3.8	3.2
Growth of exports of G&S (US dollar terms, in percent)	13.3	4.4	6.6	14.7	8.3	3.9	9.5	11.4	8.9	8.7	9.7	8.7	11.5	13.0	12.1
Growth of imports of G&S (US dollar terms, in percent)	29.5	-0.6	8.5	17.2	11.8	0.7	-0.8	6.7	9.0	6.9	7.9	5.1	12.0	11.0	11.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	26.3	19.5	23.0	22.8	22.5	19.8	22.3	13.6	9.9	12.5
Government revenues (excluding grants, in percent of GDP)	12.7	12.9	13.6			13.3	14.9	15.0	15.2	15.3	15.5		17.0	17.8	17.2
Aid flows (in Billions of US dollars) 7/	1.2	1.1	1.0			1.2	1.1	1.1	1.1	1.2	1.1		1.4	3.6	
of which: Grants	1.2	1.1	1.0			0.6	0.7	0.7	0.6	0.6	0.6		0.9	2.3	
of which: Concessional loans	0.0	0.0	0.0			0.6	0.4	0.4	0.5	0.5	0.5		0.5	1.3	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.5	2.1	2.0	1.8	1.7	1.5		1.3	1.1	1.2
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			42.0	45.3	47.0	43.6	42.3	39.1		34.5	26.4	31.4
Memorandum items:															
Nominal GDP (Billions of US dollars)	35.7	41.5	46.3			48.2	47.3	51.4	56.2	61.3	66.7		102.2	296.6	
Nominal dollar GDP growth	9.7	16.3	11.5			4.0	-1.9	8.8	9.2	9.1	8.8	6.4	8.9	12.3	10.5
PV of PPG external debt (in Billions of US dollars)			6.1			7.8	8.8	9.6	10.3	11.0	11.8		17.5	45.5	
(PVt-PVt-1)/GDPt-1 (in percent)						5.3	2.0	1.7	1.4	1.3	1.4	2.2	1.4	1.8	1.6
Gross workers' remittances (Billions of US dollars)	0.0	0.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.1	0.1	
PV of PPG external debt (in percent of GDP + remittances)	...	...	14.2			18.5	19.1	19.0	18.7	18.4	18.2		17.7	15.0	
PV of PPG external debt (in percent of exports + remittances)	...	...	73.6			96.1	88.8	86.8	85.6	84.3	82.9		71.2	55.0	
Debt service of PPG external debt (in percent of exports + remittanc	...	...	2.2			2.6	6.6	6.8	8.9	9.3	9.0		7.7	8.1	

Sources: Tanzanian authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate cha

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Tanzania: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012–2035

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2012	2013	2014	Average 5/	Standard Deviation 5/	2015	2016	2017	2018	2019	2020	2015-20 Average	2025	2035	2021-35 Average
Public sector debt 1/	27.3	30.0	30.2			40.5	40.9	40.0	38.8	37.7	36.9		33.0	22.3	
of which: foreign-currency denominated	20.8	23.1	22.4			27.7	27.9	27.5	26.9	26.3	26.0		23.9	19.0	
Change in public sector debt	-0.1	2.7	0.2			10.3	0.4	-0.9	-1.2	-1.1	-0.8		-0.7	-0.8	
Identified debt-creating flows	-0.7	2.3	2.3			10.9	0.7	-0.7	-0.7	-0.6	-0.4		-0.5	-0.6	
Primary deficit	2.9	3.8	2.0	2.9	1.1	2.6	2.6	1.3	1.2	1.0	0.8	1.6	0.5	0.6	0.4
Revenue and grants	16.0	15.5	15.7			14.6	16.4	16.3	16.3	16.3	16.5		17.9	18.6	
of which: grants	3.3	2.6	2.1			1.3	1.5	1.3	1.1	1.0	1.0		0.9	0.8	
Primary (noninterest) expenditure	18.8	19.3	17.8			17.2	19.0	17.6	17.5	17.3	17.3		18.4	19.2	
Automatic debt dynamics	-3.6	-2.1	-0.7			1.1	-1.9	-2.1	-1.9	-1.6	-1.2		-1.0	-1.1	
Contribution from interest rate/growth differential	-1.9	-1.3	-1.4			-1.3	-2.0	-2.1	-1.9	-1.6	-1.4		-1.0	-0.5	
of which: contribution from average real interest rate	-0.2	0.4	0.6			0.7	0.7	0.7	0.7	0.9	1.1		1.2	0.9	
of which: contribution from real GDP growth	-1.7	-1.6	-2.0			-2.0	-2.7	-2.7	-2.6	-2.5	-2.4		-2.2	-1.4	
Contribution from real exchange rate depreciation	-1.7	-0.8	0.7			2.4	0.1	0.0	0.0	0.0	0.1		...	...	
Other identified debt-creating flows	0.0	0.6	1.0			7.3	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			6.3	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.6	1.0			1.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	0.6	0.4	-2.2			-0.6	-0.2	-0.2	-0.5	-0.5	-0.4		-0.2	-0.2	
Other Sustainability Indicators															
PV of public sector debt	...	...	22.0			31.3	32.1	31.6	30.7	29.8	29.2		26.8	18.3	
of which: foreign-currency denominated	...	...	14.2			18.5	19.1	19.1	18.7	18.4	18.2		17.7	15.0	
of which: external	...	...	14.2			18.5	19.1	19.1	18.7	18.4	18.2		17.7	15.0	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	3.9	5.9	3.8			4.7	6.1	4.7	5.4	5.2	4.9		4.3	3.9	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	139.5			214.6	195.3	193.9	188.3	182.7	177.0		149.7	98.4	
PV of public sector debt-to-revenue ratio (in percent)	...	...	161.3			235.2	215.3	210.8	202.2	195.1	187.9		157.5	102.7	
of which: external 3/	...	...	104.1			138.9	128.0	127.3	123.5	120.3	117.4		103.8	84.2	
Debt service-to-revenue and grants ratio (in percent) 4/	6.7	13.3	11.2			14.6	21.2	20.9	25.7	25.9	25.0		21.1	18.0	
Debt service-to-revenue ratio (in percent) 4/	8.4	16.0	13.0			16.0	23.3	22.7	27.6	27.7	26.5		22.2	18.8	
Primary deficit that stabilizes the debt-to-GDP ratio	3.0	1.2	1.9			-7.8	2.2	2.2	2.4	2.1	1.6		1.2	1.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.5	6.2	7.3	6.4	0.7	7.2	7.2	7.1	7.0	6.9	6.9	7.0	6.9	6.4	6.5
Average nominal interest rate on forex debt (in percent)	0.9	1.5	1.5	0.9	0.4	2.0	2.5	2.2	2.3	2.4	2.7	2.3	2.9	4.1	3.3
Average real interest rate on domestic debt (in percent)	1.1	6.7	9.4	3.6	3.6	8.9	4.4	5.1	6.0	7.1	8.4	6.7	10.9	13.0	11.7
Real exchange rate depreciation (in percent, + indicates depreciation	-8.4	-4.2	3.1	-2.4	5.7	11.2	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	11.3	8.6	6.3	9.7	2.0	5.2	4.3	4.5	4.5	4.5	4.2	4.5	5.0	5.5	5.3
Growth of real primary spending (deflated by GDP deflator, in percer	0.0	0.1	0.0	0.1	0.1	0.0	0.2	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	...	...	26.3	19.5	23.0	22.8	22.5	19.8	22.3	13.6	9.9	...

Sources: Country authorities; and staff estimates and projections.

1/ Gross public sector debt covers general government or non-financial public sector.

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3. Tanzania: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–2035

(In percent)

	Projections							
	2015	2016	2017	2018	2019	2020	**2025**	2035
PV of debt-to GDP ratio								
Baseline	18	19	19	19	18	18	**18**	15
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	18	17	19	20	21	22	**24**	20
A2. New public sector loans on less favorable terms in 2015-2035 2/	18	19	20	20	21	21	**23**	24
A3. Alternative Scenario : Low growth	16	19	20	20	21	21	**22**	19
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	18	19	19	19	18	18	**17**	16
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	18	19	21	20	20	19	**18**	15
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	18	17	17	17	17	16	**16**	14
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	18	18	19	18	18	18	**17**	15
B5. Combination of B1-B4 using one-half standard deviation shocks	18	15	14	14	14	14	**14**	14
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	18	27	28	27	27	26	**25**	23
PV of debt-to-exports ratio								
Baseline	97	89	87	86	85	83	**71**	55
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	97	80	85	90	96	102	**96**	74
A2. New public sector loans on less favorable terms in 2015-2035 2/	97	90	92	94	96	97	**93**	88
A3. Alternative Scenario : Low growth	85	90	91	93	95	96	**89**	71
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	97	86	85	83	82	80	**69**	56
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	97	92	101	99	98	95	**78**	61
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	97	86	85	83	82	80	**69**	56
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	97	86	85	84	82	81	**69**	56
B5. Combination of B1-B4 using one-half standard deviation shocks	97	79	73	72	71	70	**64**	56
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	97	86	85	83	82	80	**69**	56
PV of debt-to-revenue ratio								
Baseline	139	128	127	124	120	117	**104**	84
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	139	115	125	129	136	145	**139**	113
A2. New public sector loans on less favorable terms in 2015-2035 2/	139	129	134	135	136	137	**135**	135
A3. Alternative Scenario : Low growth	122	129	134	134	135	135	**129**	109
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	139	126	127	123	120	117	**103**	88
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	139	128	137	133	129	125	**106**	87
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	139	113	115	111	108	105	**93**	80
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	139	124	124	121	117	114	**100**	86
B5. Combination of B1-B4 using one-half standard deviation shocks	139	103	96	93	91	89	**83**	77
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	139	184	184	179	174	169	**149**	128

Table 3.Tanzania: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2015–2035 (concluded)

(In percent)

Debt service-to-exports ratio

Baseline	3	7	7	9	9	9	**8**	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	3	6	6	8	8	8	**9**	8
A2. New public sector loans on less favorable terms in 2015-2035 2/	3	7	6	8	7	8	**7**	10
A3. Alternative Scenario : Low growth	4	7	7	10	10	10	**10**	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	3	7	7	9	9	9	**8**	8
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	3	7	7	10	10	10	**9**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	3	7	7	9	9	9	**8**	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	3	7	7	9	9	9	**8**	8
B5. Combination of B1-B4 using one-half standard deviation shocks	3	7	7	8	9	8	**7**	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	3	7	7	9	9	9	**8**	8

Debt service-to-revenue ratio

Baseline	4	10	10	13	13	13	**11**	12
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015-2035 1/	4	8	9	11	12	12	**13**	12
A2. New public sector loans on less favorable terms in 2015-2035 2/	4	10	9	11	11	11	**10**	16
A3. Alternative Scenario : Low growth	5	10	10	14	15	14	**14**	17
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016-2017	4	10	10	13	14	13	**11**	13
B2. Export value growth at historical average minus one standard deviation in 2016-2017 3/	4	10	10	13	14	13	**12**	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016-2017	4	9	9	12	12	12	**10**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016-2017 4/	4	10	10	13	13	13	**11**	12
B5. Combination of B1-B4 using one-half standard deviation shocks	4	9	9	11	11	10	**9**	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	4	14	15	19	20	19	**17**	18
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	6	6	6	6	6	6	**6**	6

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 4. Tanzania: Sensitivity Analysis for Key Indicators of Public Debt 2015–2035

	Projections							
	2015	2016	2017	2018	2019	2020	2025	2035
PV of Debt-to-GDP Ratio								
Baseline	31	32	32	31	30	29	27	18
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	31	33	34	34	35	37	45	48
A2. Primary balance is unchanged from 2015	31	32	33	33	34	35	41	44
A3. Permanently lower GDP growth 1/	31	32	32	31	30	30	28	23
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	31	33	33	32	32	32	31	25
B2. Primary balance is at historical average minus one standard deviations in 2016-201	31	33	35	34	33	33	30	20
B3. Combination of B1-B2 using one half standard deviation shocks	31	33	35	34	34	33	32	24
B4. One-time 30 percent real depreciation in 2016	31	40	39	38	36	35	34	25
B5. 10 percent of GDP increase in other debt-creating flows in 2016	31	42	41	40	39	38	34	23
PV of Debt-to-Revenue Ratio 2/								
Baseline	215	195	194	188	183	177	150	98
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	215	198	207	211	216	222	250	257
A2. Primary balance is unchanged from 2015	215	195	201	203	206	210	229	236
A3. Permanently lower GDP growth 1/	215	196	195	190	185	180	158	122
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	215	199	202	199	195	192	173	132
B2. Primary balance is at historical average minus one standard deviations in 2016-201	215	204	218	212	205	199	167	108
B3. Combination of B1-B2 using one half standard deviation shocks	215	202	214	210	206	201	177	129
B4. One-time 30 percent real depreciation in 2016	215	243	239	230	223	216	187	134
B5. 10 percent of GDP increase in other debt-creating flows in 2016	215	253	251	244	237	230	191	122
Debt Service-to-Revenue Ratio 2/								
Baseline	15	21	21	26	26	25	21	18
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	15	21	21	27	28	28	32	38
A2. Primary balance is unchanged from 2015	15	21	21	26	27	27	29	35
A3. Permanently lower GDP growth 1/	15	21	21	26	26	25	22	21
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2016-20	15	21	21	27	27	26	24	22
B2. Primary balance is at historical average minus one standard deviations in 2016-201	15	21	21	28	28	27	23	20
B3. Combination of B1-B2 using one half standard deviation shocks	15	21	22	28	28	27	24	22
B4. One-time 30 percent real depreciation in 2016	15	23	25	32	33	32	30	30
B5. 10 percent of GDP increase in other debt-creating flows in 2016	15	21	25	32	32	31	26	21

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

Statement by Ms. Kapwepwe Executive Director for United Republic of Tanzania
and
Joseph Ansu Tucker, Senior Advisor to the Executive Director

July 6, 2015

1. Tanzania's strong macroeconomic fundamentals and performance, partly supported by successive Policy Support Instrument (PSI) arrangements with the Fund, have helped sustain the growth momentum, in spite of the challenges from the global economic environment. The steadfast implementation of the authorities' Five Year Development Plan and the current national growth strategy, MKUKUTA II, have accelerated the attainment of broad-based and inclusive growth and considerably reduced the incidence of poverty.

2. The authorities are appreciative of the constructive engagement with the Fund, including within the context of the ongoing PSI program and the provision of essential technical assistance. They thank staff for the candid policy dialogue which has guided implementation of their macroeconomic policy and development agenda. They remain committed to pursuing prudent macroeconomic policies, while further deepening their structural reform agenda, including laying a solid foundation for the management of the new gas economy. In line with this, the authorities request Executive Directors' support for the completion of the second review of the PSI and modification of assessment criteria.

Program performance

3. Tanzania continues to demonstrate a track record of judicious implementation of sound macroeconomic and structural policies, consistent with the PSI arrangement. Against the end-December 2014 test date, all quantitative assessment criteria, including net domestic financing (NDF) of the government, average reserve money, and net international reserves, were met with relatively comfortable margins. On the structural front, significant progress was recorded, notably in the preparation of a natural gas revenue management framework and in instituting measures to regularize domestic arrears. While acknowledging the fact that the end-March 2015 indicative targets on tax revenue collection and on NDF were missed, the authorities are confident of improved performance going forward on account of the decisive policy measures instituted to shore up domestic revenues and the reengagement of general budget support (GBS) partners.

Recent economic developments

4. Real GDP growth has over recent years followed an upward trajectory and is projected to have expanded by 7.3 percent in FY2014/15. Reflecting broad-based growth and increased diversification of the economy over time, the national account has been revised upward by more than 30 percent. Inflation remained well below the medium term target of 5 percent, while the current account deficit is estimated to have improved from 10.3 percent of GDP in FY2013/14 to 9.4 percent in FY2014/15. The stock of gross official reserves covered 3.9 months of projected imports of goods and services, excluding those financed by foreign direct investment.

5. Fiscal performance over the period was challenged by weak domestic revenue collection, partly on account of a decline in domestic demand and challenges encountered in the rollout of electronic fiscal devices to support VAT collection. Also, efforts at boosting tax compliance did not translate into increased income tax collection. On expenditures, policies focused on aligning expenditure with expected revenue outturns, and strengthening public expenditure management. Difficult expenditure adjustments by the authorities, including the revision of expenditure ceilings for MDAs capping their commitments in the Information and Financial Management System (IFMS) allowed attainment of the fiscal target of 3.8 percent of GDP in FY2014/15.

6. The conduct of monetary policy by the BoT was not ad hoc, but anchored on maintaining price stability consistent with the broader macroeconomic objectives of Government. To this end, growth of key monetary aggregates—M3, average reserve money, and private sector credit—remained broadly within their respective targets. In an effort to normalise liquidity conditions among banks, the BoT reduced the Statutory Minimum Reserve (SMR) ratio on private deposit liabilities by two percentage points in late December 2014. However, to address the excessive volatility of the Shilling against the US dollar occasioned by strengthening of the dollar following a rebound in the US economy, the cut in the SMR ratio was reversed in May 2015. The authorities also continued to steadfastly implement their Financial Sector Reform Program with the view to improve access and usage of formal financial services aimed at fostering economic growth and reducing poverty.

Near to medium-term outlook and policies

7. Growth is projected to remain robust at 7.3 percent in FY2015/16, supported mainly by infrastructure investment and productivity enhancement, and inflation is forecasted to remain in single digits in FY2015/16 and over the medium term. The current account balance is expected to improve further over the period, largely due to projected impressive export performance as the global economy continues to recover.

Fiscal policy and related reforms

8. An overall fiscal deficit of 3.5 percent of GDP is envisaged in FY 2015/16, reducing to below 3 percent over the medium term consistent with the authorities' plan to maintain a low risk of debt distress, and in line with the related East African Community (EAC) macroeconomic convergence criterion. The authorities will focus on implementing the 2015 Budget Act, strengthening revenue measures and tax administration, containing expenditure within the approved budget limits and enhancing the borrowing strategy.

9. On the revenue front, the authorities will seek to eliminate discretionary tax exemptions, while ensuring transparency in issuing statutory exemptions. The use of electronic fiscal devices (EFDs) in all business transactions will be strictly enforced to minimize tax evasion. Moreover, the recently introduced Tanzania Customs and Integrated System (TANCIS) and the Centralized Price Based Valuation System will be rolled out throughout the country, with a view to also address the persistent complaints of double taxation by importers of goods from Zanzibar to Tanzania mainland. The new VAT Act also becomes operational on July 1, 2015.

10. Cognizant of the country's continued low risk of debt distress, as reaffirmed by the updated debt sustainability analysis, the authorities will continue to utilize on external non-concessional borrowing (ENCB) to finance strategic infrastructure projects. They will seek to ensure that ENCBs are secured timely to prevent a recurrence of the fiscal challenges encountered in executing the 2014/15 budget. In addition, the authorities plan to issue Eurobonds and will soon be signing agreements with Moody's and Fitch Ratings agencies for the provision of credit rating.

11. The authorities remain committed to aligning expenditure with revenues outcomes, by effecting the necessary expenditure adjustments, where necessary. While noting staff's concerns that the upcoming presidential and parliamentary elections constitute a fiscal risk to the program, the authorities underscore the fact that experience with the conduct of elections in Tanzania does not support staff's assessment. They highlight that expenditures related to the elections have been fully incorporated in the 2015/16 budget.

12. The progress made thus far in addressing the perennial problem of accumulation of domestic arrears will be sustained. The authorities are determined to complete the repayment of outstanding arrears to suppliers arrears. They appreciate the inclusion in the program of an adjustor to NDF in FY2015/16 to allow for the clearance of arrears to pension funds, and have completed preparation of a strategy to address them. Going forward, they undertake to strengthen commitment controls in the IFMS, and ensure that liabilities to the Public Service Pension Fund will be fully budgeted.

13. My authorities value the support of GBS partners which they underscore should continue to be predicated on the principle outlined in the partnership framework memorandum, devoid of considerations that are outside their direct control. To this end, while appropriate action has been taken by the government in respect of the Independent Power Tanzania Ltd. (IPTL) case in line with the country's accountability and governance principles and mechanisms, the authorities wish to emphasize that the matter is currently subject to due process, including in international jurisdictions.

Monetary and exchange rate policies

14. The BoT will continue to implement tight monetary policy, supported by benign supply side factors, to tame inflation expectations, with the objective of maintaining inflation below the policy target of 5 percent over the medium term. In this context, the BoT will continue to deploy a mix of monetary policy instruments to ensure that liquidity is maintained at appropriate levels. In addition, the BoT will continue instituting measures to modernize its monetary policy framework by implementing its roadmap to price-based monetary policy framework. Furthermore, the BoT will continue to enhance monetary operations by strengthening liquidity management and forecasting.

15. On the exchange rate, the BoT reaffirms its commitment to a market determined exchange rate, and continues to see this as the first line of defense against external shocks. In this regard, the BoT will continue to participate in the foreign exchange market for liquidity management purposes and to smooth out short-term exchange rate volatility while strengthening the gross foreign reserves position to ensure at least 4 months of imports cover.

That said, the BoT is determined to utilize the policy instruments at its disposal to prevent episodes of extreme exchange rate volatility from undermining the progress accomplished in attaining low and stable inflation and efforts at building confidence in the market.

Financial sector stability

16. Financial soundness indicators up to end-March 2015 affirm that the banking system remains liquid, adequately capitalized and profitable. The BoT will continue to strengthen its financial stability monitoring tools and arrangements to preserve its stability and soundness. To this end, close supervision of the FBME Bank, alleged by US authorities to be an institution of primary money laundering concern, will continue. In the meantime, the BoT is considering an appropriate resolution strategy in the event this concern materializes, while, at the same time, taking action to strengthen the AML/CFT supervisory framework. As the authorities prepare to extend liberalization of the capital account outside the EAC, the BoT will seek to further strengthen its regulatory and oversight capacity.

Other reform measures

17. My authorities are pleased to disclose that following exploration in recent years, a series of significant discoveries of natural gas amounting to about 55.08 trillion cubic feet has been recorded. This is expected to attract significant investment flows over the medium term with correspondingly large export and budget revenue flows. To maximize the benefits of this potential natural resource wealth and preserve intergenerational equity, the authorities have prepared an Oil and Gas Revenue Management Policy. Cognizant of the potential macroeconomic and budget management challenges, an appropriate fiscal framework and rules for managing resource revenues, including a Natural Gas Revenue Fund fully integrated in the budget, will be established.

18. Deliberate policy measures by the national power utility, TANESCO, including two successive tariff increases over a two-year period, increase in power generation capacity, and a reduction in technical losses, have helped significantly improve the company's financial position. The upcoming completion of a new gas pipeline and a gas-fueled power plant is expected to reduce the cost of power generation, further strengthening its financial position. In line with program commitments, the authorities will prepare a strategy to clear all outstanding arrears to suppliers and ensure its strict implementation.

Conclusion

19. The Tanzanian economy's strong fundamentals and the authorities' commitment to sound policies have helped the economy sustain the growth momentum in spite of headwinds from a difficult external environment. The authorities are determined to persevere with efforts at sustaining macroeconomic stability, enhancing domestic resource mobilization, creating fiscal space for increased investment in infrastructure, and promoting broad-based and pro-poor growth. Finally, the authorities consider the Fund's policy advice and technical assistance critical to the successful implementation of their development agenda.