INTERNATIONAL MONETARY FUND

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UNITED REPUBLIC OF TANZANIA

January 2015

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

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

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on January 7, 2015, following discussions that ended on October 19, 2014, 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 December 19, 2014
- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Statement by the Executive Director** for United Republic of Tanzania.

The following documents 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*

*Also included in Staff Report

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INTERNATIONAL MONETARY FUND

December 19, 2014

UNITED REPUBLIC OF TANZANIA

FIRST REVIEW UNDER THE POLICY SUPPORT INSTRUMENT

KEY ISSUES

Macroeconomic developments remain favorable. Economic growth was strong during the first half of 2014 and is expected to remain close to 7 percent. Inflation remains in mid-single digits, consistent with the authorities' target of 5 percent by June 2015. New national accounts statistics show an upward revision of the 2007 GDP by 28 percent. The full series will be reflected in the program at the next review.

Program performance through June was broadly satisfactory but has deteriorated since and risks have risen. While all end-June assessment criteria were met, most end-September indicative targets were missed. The continuous assessment criterion on non-accumulation of external arrears was also missed and structural reform implementation was slower than expected. These developments reflect a range of factors, including delays in donor financing related to governance concerns, delays in mobilizing external non-concessional borrowing (ENCB), revenue shortfalls, the authorities' decision to front-load domestically-financed capital expenditure, and coordination issues.

Discussions focused on how to mitigate risks to budget implementation related to financing uncertainty and revenue shortfalls. Meeting the fiscal deficit target for 2014/15 will require revising downward revenue and expenditure during the mid-year budget review. Addressing forcefully and expeditiously the governance concerns arising from the IPTL case will be critical both for the resumption of donor financing and the business environment. In the meantime, the financing mix will tilt towards larger and more front-loaded ENCB. Better coordination of monetary and fiscal policies is required to reduce, and eventually eliminate, recourse to conversion of liquidity paper into financing paper.

Government arrears will be addressed comprehensively. A plan to verify and clear existing suppliers' arrears (which continued to accumulate in 2013/14), better monitor, and prevent the emergence of new ones will be implemented in the coming year. Broad principles of a strategy to deal with arrears to pension funds have been agreed.

Staff supports the authorities' request for the completion of the first PSI review, and proposes a waiver for non-observance of an assessment criterion and the modification of assessment criteria.

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 October 16–19, 2014. Messrs. Baunsgaard (Resident Representative) and Rutachururwa and Ms. Shayo (local economists) assisted the mission. The mission met with Vice President Bilal; 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; and development partners. Mr. Uwatt (OED) participated in the discussions.

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APPENDIX

RECENT DEVELOPMENTS

1. **A referendum was set for April 2015 on a new constitution.** The proposed draft will largely preserve the current 2-government structure (a union government that also governs the mainland, and a government for Zanzibar). Presidential and parliamentary elections are scheduled for October 2015.

2. **Recent macroeconomic performance has been positive** (Figure 1). Real GDP grew by 7 percent in 2013, driven by services, construction and manufacturing. Growth remained strong in the first half of 2014. Headline CPI inflation stood at 5.9 percent (y-o-y) in October, while core inflation (excluding food and energy) declined to about 3 percent. The external current account deficit in 2013/14 was lower than expected by almost 1 percent of GDP owing to higher non-gold exports and lower oil imports. Gross international reserves stood at US$4.6 billion in June, or 3.7 months of prospective imports. While the shilling has continued to depreciate gradually against the U.S. dollar, the real effective exchange rate appreciated by about 5 percent (y-o-y) in September, reflecting an appreciation against the euro and a positive inflation differential relative to trade partners.

3. **The National Bureau of Statistics released revised national accounts.** The revisions reflect better coverage, improved statistical techniques, and the use of 2007 instead of 2001 as the new base year. So far only 2007 data have been released, showing an upward revision of nominal GDP by 27.8 percent. The full new national accounts series are expected to be published soon and will be reflected in the program at the next review. The revisions are not expected to affect Tanzania's status as an IDA-eligible and PRGT-only country.

4. **Program performance through end-June 2014 was broadly satisfactory**. The overall fiscal deficit in 2013/14 was 4.4 percent of GDP, lower than programmed (5.2 percent). Tax collection was below the indicative target, reflecting shortfalls in most areas, particularly VAT (0.4 percent of GDP due to larger than expected refunds to the mining sector). Income tax collection overperformed thanks to a one-off tax payment on capital gains on the sale of natural gas exploration rights. Lower wage bill—reflecting delayed hiring and promotions—and capital expenditures more than offset revenue shortfalls. However, the stock of unpaid budgetary expenditures increased significantly, reaching an estimated 2.3 percent of GDP in September 2014. The monetary policy stance was in line with program objectives. Average reserve money growth remained stable and below its target. Broad money growth tracked it closely, while private sector credit grew much faster (21.4 percent at end-June 2014). With lower inflation since 2012, market rates have risen in real terms and become positive. Isolated instances of tight liquidity conditions in December 2013 and July 2014 resulted in volatility of short-term rates.

Box 1. The IPTL Case

This is based on the published report of the parliamentary Public Accounts Committee (PAC), itself based on a report by the Controller and Auditor General (CAG).

Independent Power Tanzania, Ltd. (IPTL), an independent power producer initially owned by a Malaysian firm (Mechmar, 70 percent) and VIP Engineering of Tanzania (30 percent), signed a long-term power purchase agreement (PPA) with Tanesco (Tanzania's power utility) in 1995. Early on, disputes arose between Tanesco and IPTL regarding capacity charges. These and other disputes were pursued through the courts in Tanzania and abroad, as well as through arbitration at the International Centre for Settlement of Investment Disputes (ICSID).

Mechmar defaulted on the original loans underpinning the project, which were then acquired by Standard Chartered Bank Hong Kong (SCBHK) in 2005. As IPTL stopped servicing the loans in2006, SCBHK declared it in default and sought to place IPTL under a liquidator. SCBHK also continued to pursue IPTL's financial claims against Tanesco.

In 2010-11, a new company established in Tanzania, Pan African Power (PAP), claimed to have acquired Mechmar's shares in IPTL from Piper Link, a company incorporated in the British Virgin Islands. PAP's claim was accepted by the Tanzanian High Court in September 2013 (but not by the High Court in the British Virgin Islands). In parallel, VIP Engineering sold its shares in IPTL to PAP.

Meanwhile Tanesco, with the support of budget transfers, continued to pay the disputed capacity charges into an escrow account set up in 2006 at the BoT. In late 2013, PAP was allowed access to the escrow account, which was closed down and the funds in it remitted out of Tanzania (about $122 million). According to the PAC report, the change in IPTL ownership and the transfer of the escrow account money to PAP were fraudulent and in addition involved funds which should have been used to pay VAT.

After discussion of the PAC report's findings, parliament made the following recommendations on November 29, 2014, including:

- The Government should take disciplinary action against the officials involved in the scheme, including several ministers. Parliament should do the same for MPs that received payments in the course of the operation.
- Legal action should be taken against those identified as the main culprits in the PAC report and the escrow account funds should be recovered.
- Commercial banks that facilitated the transfer of the escrow account funds should be investigated for the possible breach of anti-money laundering rules.

Status of end-June and end-September 2014 benchmarks

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Provide an allocation in the 2014/15 budget for centralized clearance of domestic arrears. Any payment from this centralized budget should be backed by a list of verified eligible creditors, in line with the priorities of a repayment strategy.	To accelerate clearance of domestic expenditure arrears.	June 30, 2014	Met.
Submit the draft regulations on consolidated supervision to Attorney General's Office.	To modernize the BoT's supervisory framework to better supervise consolidated financial firms.	June 30, 2014	Met.
Approve pension harmonization guidelines.	To limit contingent liabilities	September 30, 2014	Met.
Prepare a plan to address the outstanding and future obligations to pre-1999 pensioners of the PSPF.	To limit contingent liabilities	June 30, 2014	Not met. The MoF has expanded the scope of the work to address outstanding government obligations to all the pension funds. A strategy is expected to be prepared by end-February 2015.
Prepare the first quarterly report on (i) all external debt contracts signed and guaranteed by government, (ii) borrowing by public enterprises, and (iii) projected debt service on public debt.	To enhance public debt management	September 30, 2014	Not met. The report was produced in November, but did not include information on borrowing by public enterprises and debt service projections. The authorities plan to address these shortcomings before publication by end-December.
Include tabular information on each parastatal's revenues, expenditures, and profits and losses in Treasury Registrar Statements to Parliament (beginning with the September 2014 statements for the year ended June 30th, 2014)	To improve transparency and accountability of public enterprises	September 30, 2014	Not met. Implemented with delay. The report was published in November.

5. Pressures have emerged in early 2014/15. A combination of factors have affected monetary and fiscal policy implementation: (i) delays in donor disbursements because of governance concerns related to the transfer of ownership in an independent power producer (IPTL) (Box 1); (ii) delays in contracting ENCB; (iii) revenue shortfalls; and (iv) the authorities' decision to frontload domestically-financed development spending. Because of the tight financing situation, the final payments on external obligations to a private creditor were missed and arrears were accumulated.[1] The authorities represented that they have since engaged with the creditor in good faith discussions to reach an agreement on a new payment schedule. The revenue and external financing shortfalls also required relying more on net domestic financing (NDF), including from the BoT. Specifically, in addition to large overdrafts,[2] liquidity paper was converted into financing paper[3] and the corresponding deposits released to the budget. The ensuing excess liquidity was then sterilized with foreign exchange interventions. As a result of all these developments, most indicative targets for end-September were missed (MEFP Table 1). In addition, despite notable progress in certain areas, delays were incurred in the implementation of structural reforms.

POLICY DISCUSSIONS

A. Economic Outlook and Risks

6. The macroeconomic outlook remains favorable. Economic growth is projected to remain at about 7 percent this year and in the medium term, reflecting sustained dynamism in the manufacturing and services sectors. Construction of a natural gas pipeline and gas-fueled power plants would also lower the cost of power generation and reduce demand for expensive heavy fuel imports, with a positive impact on growth and the balance of payments. Inflation would stabilize around the authorities' 5 percent target.

7. The baseline scenario assumes resumption and full delivery of donor budget support by the end of the fiscal year. For that purpose, staff stressed the need to expeditiously and forcefully address the governance concerns raised by the IPTL case, which could also negatively affect the investment climate. The authorities underscored the Tanzanian government's record of acting forcefully in similar circumstances in the past.

8. Risks to the program are significant and mainly relate to fiscal policy implementation. These include (i) protracted delays in donor disbursements; (ii) lasting revenue

[1] These arrears arose from government guarantees issued to Air Tanzania for old aircraft lease contracts. The authorities have stopped issuing new guarantees. See Country Report No. 14/228.

[2] The Bank of Tanzania Act (2006) allows short-term advance to government up to one-eighth of the average revenues of the last three fiscal years and up to 180 days.

[3] Liquidity papers are short-term Treasury bills issued in the market for monetary policy purposes. The proceeds are deposited in a blocked account at the BoT to sterilize excess liquidity, with the BoT and the MoF sharing interest costs. These papers are netted out against the blocked deposits in the calculation of NDF.

shortfalls in 2014/15; and (iii) additional domestic arrears, particularly if expenditure adjustment is delayed. Discussions centered on mitigating the risks and adjusting policies to preserve macroeconomic stability and debt sustainability.

B. Fiscal Policy

MEFP ¶22-24

9. Keeping to the 2014/15 deficit target will require significant expenditure measures. Parliament approved the 2014/15 budget with a deficit of 4.9 percent of GDP, in line with the PSI. Despite new revenue measures amounting to 0.3 percent of GDP, mainly from higher excises, revenue projections look excessively ambitious. This was illustrated by the large revenue shortfall recorded in the first quarter of the fiscal year. At this juncture, the annual revenue shortfall is estimated at about 1 percent of GDP, even after assuming swift implementation of the new VAT law from January 2015. The authorities recognized this risk and committed to reconsider both revenue and expenditure plans in the context of the mid-year budget review by the cabinet in January 2015, with a view to reaching the same deficit target. While the authorities were not yet in a position to fully specify expenditure measures at the time of the discussion, they underscored that critical social and infrastructure spending would be preserved, in particular projects identified under the *Big Results Now* initiative. They also stressed their record of delivering on commitments to adjust in the course of the fiscal year, such as in 2013/14. Expenditure execution has already slowed down, as the budget operates essentially on a cash basis. Staff stressed the importance of completing the mid-year review as soon as possible to keep the program on track and reduce the risk of further arrears accumulation. In the medium-term, the authorities intend to pursue further gradual fiscal consolidation, notwithstanding the possibility of temporarily larger deficits in 2014/15 and 2015/16 to allow for the clearance of arrears to domestic suppliers and pension funds (¶17-18).

10. Higher recourse to ENCB is expected this fiscal year to address financing pressures. With already substantial recourse to net domestic financing in the first quarter and the time needed for the resumption of donor budget support, the authorities have decided to contract more ENCB this year and to frontload disbursements. They envisage contracting two loans at floating interest rates for a total of US$800 million, of which US$600 million would be disbursed in early 2015. This, together with existing financing for power plants, a water treatment plant and a water pipeline, and a new airport terminal, would bring total ENCB disbursements this year (excluding the gas pipeline loan) to $1,147 million, or US$247 million above the program projections. Staff flagged that this frontloading would reduce the amount subsequently available under the program's ENCB ceiling of $2.4 billion.

MEFP ¶31

11. Debt management capacity continues to be strengthened. In May 2014 the authorities decided to consolidate public debt management functions in the Debt Management Department at the ministry of finance. The new department still needs to be staffed and become operational. A

Cabinet paper on a National Debt Management Policy and amendments to the Government Loans, Guarantees and Grants Act are being prepared to support its operations.[4] Strengthening of capacity and the legal framework will contribute to better and more integrated debt management and will also help prevent the recurrence of external arrears. The authorities are still considering issuing a Eurobond, which would reduce interest rate risks compared to floating rate financing. They plan to obtain a sovereign rating in early 2015, which would pave the way for a Eurobond issuance in 2015/16.

C. Monetary and Exchange Rate Policies

MEFP ¶15–19

12. The current monetary policy stance remains consistent with the medium-term inflation objective of 5 percent. For the rest of the fiscal year, average reserve money is projected to grow broadly in line with nominal GDP, providing sufficient room for private sector credit while containing inflation. The occurrence of episodes of tight liquidity and interest rate volatility could be reduced by better incorporating seasonal factors (e.g., timing of crop financing, tax payments) and intra-month fluctuations in demand for cash (e.g., salary payments) in short-term projections. To give banks more flexibility in liquidity management, the BoT will move to partial required reserve averaging starting from end-April 2015 (new structural benchmark (SB)). Staff welcomed this move, which is in line with the Fund TA advice. In addition, the ongoing study on the relationship between banks' excess reserves and overnight rates is expected to provide analytical grounds for targeting a smoother path of excess reserves to reduce interest rate volatility. Better cash management by the Treasury would also help.

13. Better coordination of monetary and fiscal policies is required to reduce, and eventually eliminate, recourse to conversion of liquidity paper into financing paper. The frontloading of capital expenditure execution in the first quarter of the fiscal year was not programmed. The authorities stressed that this frontloading could only be implemented with the assistance of the central bank through the conversion of outstanding liquidity paper into financing paper, as large issuance of new government securities would have destabilized Tanzania's shallow financial markets. All proceeds from future sales of Treasury bonds during the fiscal year up to TSh 500 billion will now be placed in a sinking fund, exclusively to redeem the converted liquidity papers coming due. Any remaining converted papers will be retired using the government's own resources. The mission expressed strong concerns about the use of conversions, noting that they complicated substantially monetary policy implementation. The authorities stated that they did not plan to use conversions again during this fiscal year, and that they would minimize them in the future through better alignment of planned expenditure and financing.

[4] Staff provided extensive comments on the authorities' initial draft.

14. The authorities reiterated their commitment to a market-determined exchange rate and to further capital account liberalization. Interventions will be limited to mopping up liquidity coming from foreign assistance and external borrowing by the government, and smoothing short-term exchange rate volatility. The authorities intend to continue building up international reserves during the fiscal year to reach 3.9 months of prospective imports. Residents of the East African Community (EAC) are now allowed to participate in the long-term government securities market, and Tanzanian residents are also allowed to invest in other EAC countries. The remaining capital account restrictions limit investment in short-term papers, and also set out minimum holding periods for foreign investors. The authorities intend to extend this liberalization to the rest of the world by end-2015.

D. The Financial Sector

15. The financial system in Tanzania appears unaffected by developments around FBME bank. In July, the U.S. authorities made a finding that Tanzania-headquartered FBME Bank—the largest bank by asset size on a consolidated basis but with over 90 percent of its assets and operations in Cyprus—is of "primary money laundering concern" (Box 2). The Central Bank of Cyprus and the BoT took over the bank's operations in their respective jurisdictions while correspondent banks have severed ties with it. The impact on the rest of the domestic banking system seems to have been very limited. The banking system remains well capitalized and profitable, though non-performing loans increased from 7.1 percent of total loans at end-2013 to 8.4 percent at end-September 2014.

16. The authorities are strengthening financial sector supervision. At the request of the BoT, the Fund will provide additional technical assistance to review the adequacy of its supervisory mandate in light of the recent developments. New regulations provide a legal and organizational framework for consolidated supervision of complex financial institutions with substantial cross-border holdings. Institutional capacity in this area is being built with Fund technical assistance. A joint investigation by the BoT and the Financial Intelligence Unit (FIU) revealed weaknesses in FBME Bank's internal controls related to Know-Your-Customer requirements and remedial measures have been agreed with the bank . More generally, the FIU flagged capacity development needs and recommended increasing the number of inspectors and strengthening AML/CFT oversight by sector regulators. The authorities are encouraged to ensure effective implementation of the AML/CFT framework, including by adopting a risk-based approach to AML/CFT supervision.

MEFP ¶20–21

Box 2. FBME Bank

On July 17, 2014 the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) made a finding that a bank headquartered in Tanzania, FBME Bank, is of "primary money laundering concern."

On a consolidated basis, FBME Bank is the largest bank in Tanzania by asset size (about US$2.8 billion in 2013, or 8.4 percent of Tanzania's GDP in that year), but this overstates its systemic importance because over 90 percent of its operations and assets are in Cyprus. It was originally incorporated in Cyprus in 1982 as a subsidiary of a private Lebanese bank, the Federal Bank of Lebanon, before relocating to the Cayman Islands in 1986, with the Cyprus operations designated as a branch of the Cayman Islands' entity. It subsequently changed its domicile to Tanzania in 2003 for failing to meet capital adequacy standards and other bank regulations in the Cayman Islands. Its sole owners are two Lebanese nationals and the operations consist of a few branches in Tanzania and Cyprus and a representative office in Moscow.

In response to FinCEN's notice, the Central Bank of Cyprus (CBC) took over the operations of the Cyprus-based branch on July 18. The Cyprus branch is now under resolution, and is being administered by the CBC as the resolution authority. On July 24, the BoT placed supervisors in FBME Bank and appointed a former CEO of a large Tanzanian bank as a "statutory manager" at the bank, who will report to the BoT and be responsible for all key decisions at the bank. An investigation on the allegations is underway in Tanzania.

Based on the BoT's initial assessment, depositors in Tanzania are primarily corporations. The CBC has announced that Cyprus-based depositors would be covered by deposit insurance there, while local depositors are to be covered by Tanzanian deposit insurance. The BoT suggests that the bank's assets in Tanzania would be largely sufficient to cover liabilities to depositors in Tanzania. To date, there have been no spillovers from these developments owing to the low integration of FBME Bank into the Tanzanian financial system. Further, international correspondent banks have severed ties with the bank, which has prevented outflows.

The authorities expressed concern about the limited effective coordination of intervention measures between the two central banks early in this episode though this has improved. The final resolution of the bank will be contingent on FinCEN's decision on whether to impose a final rule against FBME Bank, which would prohibit financial institutions that are required to abide by its decisions from opening or maintaining correspondent accounts with FBME Bank.

E. Structural Reforms

MEFP ¶28-30

17. The authorities have developed a comprehensive strategy to address domestic payment arrears, consistent with IMF TA recommendations. To improve arrears' monitoring, a new circular will be issued by end-December 2014 (new SB) to provide a clear definition of arrears and broaden the coverage. Ministries, departments and agencies (MDA) will be required to prescreen arrears claims before submitting to the MoF. While the stock of unpaid claims is estimated at about 2.3 percent of GDP as of September 2014, the true size of arrears will only be known after verification. Centralized verification of end-June 2014 arrears will be completed by end-February 2015 (new SB) and all genuine claims will be settled in 2014/15 and 2015/16. The settlement plan will be guided by the fiscal and financing space with priority given to arrears on construction work, which typically carry high interest and penalty charges. An adjuster to net domestic financing would allow the fiscal deficit to increase in 2014/15 for this specific purpose. Reforms are also underway to tighten commitment controls and enhance cash management, which together with improved revenue forecasts would help prevent new arrears. It is also particularly important to ensure that expenditure commitments are only made against budget cash releases instead of budget appropriations.

MEFP ¶27

18. The authorities are committed to enhancing the sustainability of the pension system, including by addressing existing government arrears to the pension funds. According to World Bank staff analysis, government obligations to pension funds include arrears to the Public Service Pension Fund (PSPF) on pre-1999 pension benefits paid on the government's behalf (2.1 percent of GDP), overdue loans from pension funds to public entities (0.7 percent of GDP), and future liabilities to the PSPF on pre-1999 pension benefits. The authorities are finalizing a cabinet paper, to be adopted by end-February 2015 (new SB), which will address the situation. All arrears, including on loans, will be cleared through the budget in FY2015/16, and any future pre-1999 liabilities that may remain after the reform will be transparently budgeted each year. Any future loan to the government will be transparently recorded in the budget. Staff welcomed the recent parametric reform, which has harmonized pension benefits across funds for new members, and urged its extension to existing members of the PSPF and Local Authorities Pension Fund (LAPF) to further improve the pension system's financial sustainability. Additional savings could be achieved through consolidation of the pension sector.

MEFP ¶32

19. Monitoring and management of public enterprises is gaining momentum. The authorities recognize the importance of timely compilation and disclosure of financial information of parastatals. For that purpose, they published in November tabular information on the audited financial position of each parastatal for 2012/13 and 2013/14 on the MOF website. The authorities plan to regularly update the published information.

MEFP ¶26

20. The authorities are preparing a policy framework for managing natural gas revenues. The objective is to put in place a sound policy, legal and regulatory system well before the exploration reaches advanced stage. A draft policy paper, to be submitted to Cabinet by end-March 2015 (SB), will lay out key principles, such as the integration of resource revenues in the budget, transparency and accountability of spending.

PROGRAM MONITORING

21. Understandings have been reached with the authorities on modifications to quantitative targets under the program. These include changes to NDF, NIR and tax revenue targets for December 2014, March and June 2015 (MEFP Table 1). These modifications are prompted by the changes in the budget financing mix, the re-phasing of program assistance and ENCB disbursements, and revisions to revenue projections. Understandings have also been reached on a new NDF adjustor for 2014/15 to allow for the clearance of arrears to domestic suppliers, and that the cap on NDF and NIR adjustors, that has remained unchanged for almost three years at TSh 300 billion, be raised to TSh 500 billion to bring it back to about ¾ percent of GDP as in 2012. In addition, it is proposed that the definition of NDF in the Technical Memorandum of Understanding (TMU) be broadened to explicitly include government borrowing from pension funds. New structural benchmarks are aimed at addressing arrears and improving monetary policy implementation (MEFP Table 2).

STAFF APPRAISAL

22. Tanzania's macroeconomic performance has been favorable, but risks have increased. Growth is projected to remain strong and inflation appears contained. However, fiscal pressures are mounting in light of delays in external financing, shortfalls in revenue collection, and large arrears to pension funds and suppliers. Forceful policy responses are needed to counter these risks to macroeconomic stability and keep the program on track. Expeditiously and forcefully addressing the governance concerns raised by the IPTL case is critical for program financing and preserving the investment climate.

23. Staff welcomes the authorities' intention to keep the fiscal deficit target of 4.9 percent of GDP for 2014/15, and to revise downward both revenue and expenditure in the context of the mid-year budget review. The latter needs to be completed as soon as possible. Meanwhile, the authorities are encouraged to continue with their prudent execution of the budget and to start identifying lower priority expenditure. Operating with a realistic budget is critical to avoid the accumulation of new arrears.

24. The authorities' plan to address suppliers' arrears is ambitious and needs to be implemented forcefully and comprehensively. Recurrence of large domestic arrears undermines the whole budget process, weakens data reporting and policy analysis, and negatively affects the private sector. The plan includes measures to strengthen monitoring and verification of existing arrears, and to prevent new ones. The settlement of the verified stock of arrears needs to be budgeted and transparently reported. The fiscal program is proposed to accommodate this one-off operation.

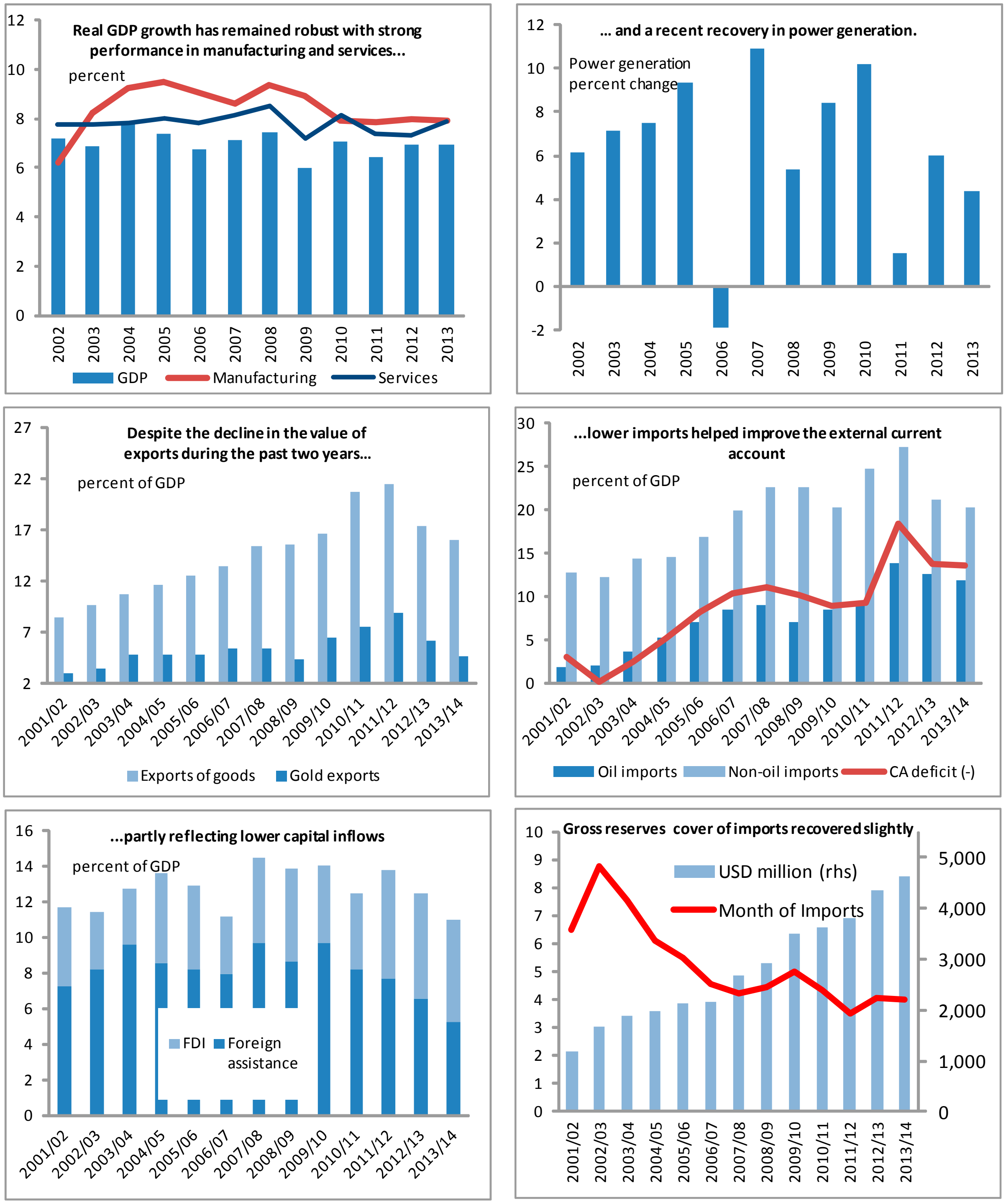
25. Enhancing the sustainability of the pension system, including by addressing existing government arrears to the pension funds, is critical. Staff welcomes the development of a strategy to settle the government's long-standing arrears to the pension funds. The budget should reflect the payment of these arrears, any future annual liabilities of the government that will remain after pension reforms, as well as any future financing received from the pension funds. Staff also welcomes the recent parametric reform and urges its extension to existing members to further improve the pension system's financial sustainability.

26. Debt management capacity needs to be strengthened. The decision to establish a debt management department is a good start, but more concerted efforts are needed to consolidate management of all obligations of the government, domestic and foreign, in one place. Once operational, the new department should assume the sole responsibility for recording, monitoring, servicing and reporting public debt.

27. The current monetary policy stance is appropriate, but recourse to conversion of liquidity paper into financing paper should be reduced and eventually eliminated. This practice indeed complicates substantially monetary policy implementation. The BoT is undertaking measures to strengthen short-term liquidity management and address occasional liquidity shortages. The measures envisaged to modernize the monetary policy framework, such as the introduction of partial reserve averaging, are welcome.

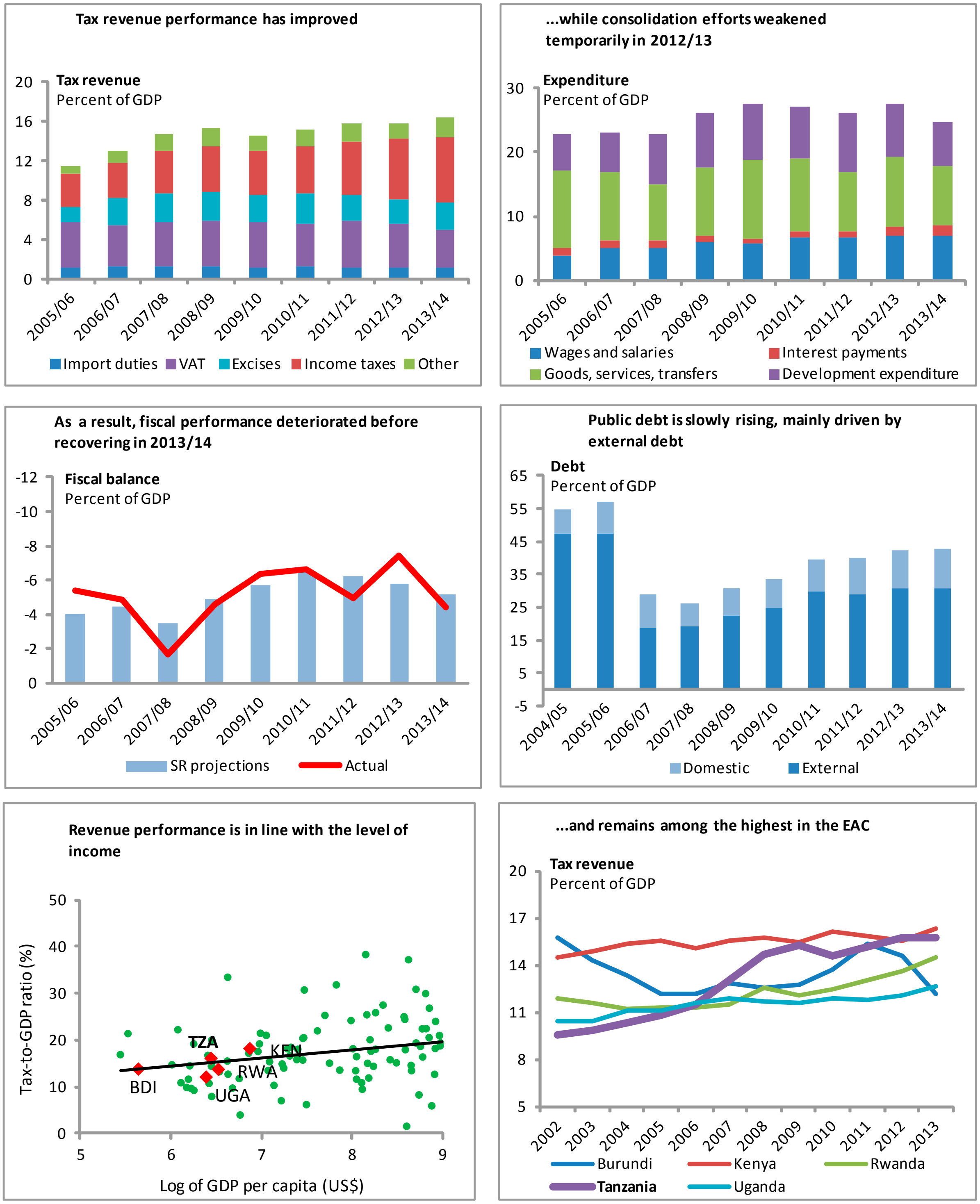
28. Based on the strength of the authorities' commitment, staff recommends completion of the first PSI review, modification of assessment criteria on NIR and NDF for end-December 2014 and end-June 2015, and a waiver for non-observance of a continuous assessment criterion on non-accumulation of external arrears. The waiver is sought based on the authorities' good faith efforts to engage with the creditor to reach an agreement on a new payment schedule and efforts to strengthen debt management to prevent the recurrence of external arrears.

Figure 1. Tanzania: Real Sector and External Developments



Sources: Tanzanian authorities and IMF staff calculations.

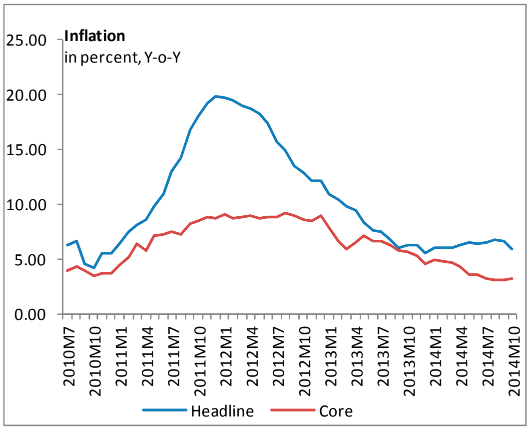
Figure 2. Tanzania: Fiscal Developments



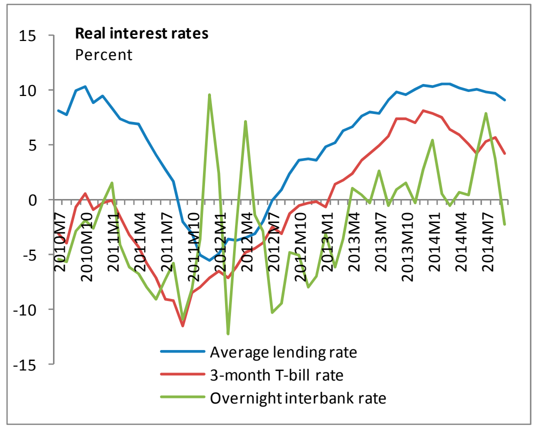
Sources: Tanzanian authorities and IMF staff calculations.

Figure 3. Tanzania: Monetary and Inflation Developments

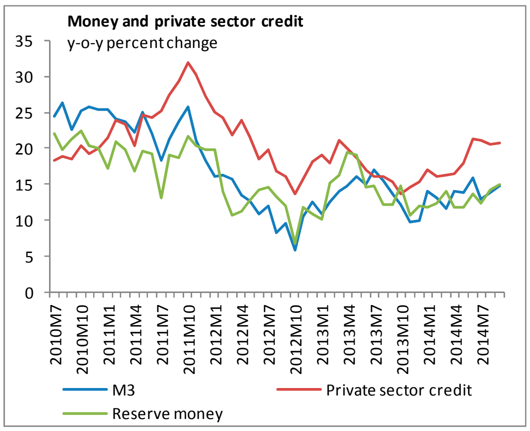
After falling in 2013, inflation remains subdued in 2014



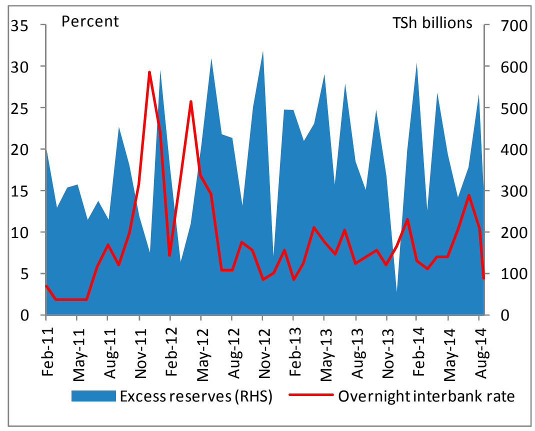
Real interest rates have risen and turned positive



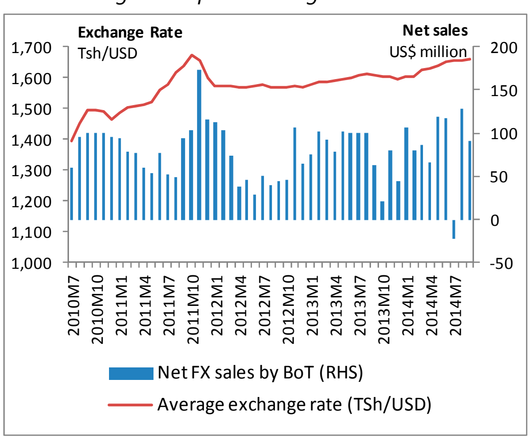
Broad money and credit growth have increased steadily



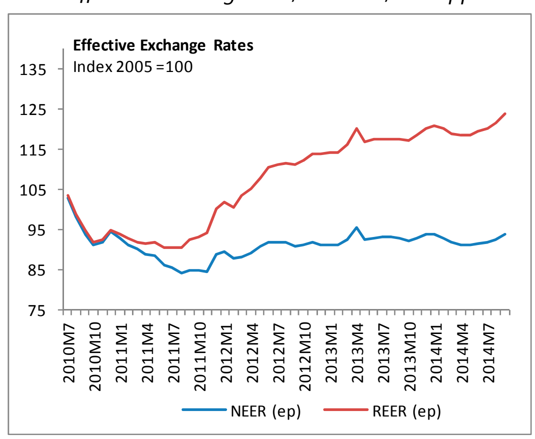
Short-lived episodes of tight liquidity have occurred



The shilling has depreciated against the U.S. dollar



The real effective exchange rate, however, has appreciated



Sources: Bank of Tanzania and IMF staff calculations.

Table 1. Tanzania: Selected Economic and Financial Indicators, 2011/12–2017/18

	2011/12	2012/13	2013/14		2014/15		2015/16	2016/17	2017/18
			Prog.[1]	Prel.	Prog.[1]	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)								
Output, prices and exchange rates									
Real GDP	6.7	6.9	7.1	7.1	7.1	7.1	7.0	7.0	6.9
GDP deflator	10.3	11.3	7.4	8.7	6.3	5.5	4.9	5.0	5.1
CPI (period average)	17.8	11.3	6.1	6.3	5.1	5.3	5.2	5.2	5.2
CPI (end of period)	17.4	7.6	5.7	6.4	5.0	4.8	5.2	5.2	5.2
Core inflation (end of period)[1]	8.9	4.5	…	…	…	…	…	…	…
Terms of trade (deterioration, -)	1.3	-1.8	-6.9	-5.4	-1.3	-0.4	-1.8	-2.3	-0.9
Exchange rate (period average, TSh/USD)	1,594	1,580	…	1,615	…	…	…	…	…
Real effective exchange rate (end of period; depreciation= -)[2]	22.3	6.3	…	1.7	…	3.6	…	…	…
Money and credit									
Broad money (M3)	10.9	14.9	14.5	15.8	15.5	15.8	…	…	…
Average reserve money	14.2	14.5	14.9	13.7	13.9	15.0	…	…	…
Credit to nongovernment sector	18.6	17.1	16.5	21.4	16.0	19.5	…	…	…
Treasury bill interest rate (in percent; end of period)	13.8	13.9	…	12.7	…	…	…	…	…
Broad money (M3, as a percent of GDP)	32.3	31.1	31.4	31.0	31.9	31.8	…	…	…
Non-performing loans (end of calendar year, percent of total loans)[3]	8.1	6.5	…	…	…	…	…	…	…
	(Percent of GDP, unless otherwise indicated)								
Central government budget									
Revenues and grants	22.1	20.8	21.7	20.7	21.7	20.7	21.4	21.7	21.9
Of which: grants	4.5	3.5	3.3	2.8	2.3	2.3	2.6	2.6	2.6
Expenditures	26.2	27.7	26.9	24.5	26.7	26.9	26.7	27.0	27.3
Current	17.0	19.3	18.5	18.1	18.4	17.0	16.9	16.9	16.8
Development	9.2	8.4	8.4	6.4	8.3	9.9	9.8	10.2	10.5
Unidentified expenditure measures[4]	…	…	…	…	…	-1.3	-1.3	-1.3	-1.3
Overall balance[5]	-5.0	-6.7	-5.2	-4.4	-4.9	-4.9	-4.0	-4.0	-4.0
Excluding grants[5]	-9.5	-10.2	-8.5	-7.2	-7.2	-7.2	-6.6	-6.6	-6.7
Public debt									
Public gross nominal debt[6,7]	38.0	41.3	41.5	41.5	42.7	43.8	44.0	44.0	44.2
of which: external public debt[7]	28.8	30.9	31.0	31.4	32.6	34.7	35.7	36.3	36.9
Investment and savings									
Investment	35.5	33.5	33.4	32.7	32.1	32.8	33.2	33.5	33.7
Government	8.8	8.0	8.4	7.8	8.6	9.1	9.9	10.2	10.4
Nongovernment[8]	26.7	25.5	25.0	24.9	23.6	23.7	23.3	23.3	23.2
Gross domestic savings	17.4	15.9	18.6	16.7	18.2	19.2	20.6	21.7	22.5
External sector									
Exports (goods and services)	31.0	26.9	25.3	25.2	25.6	25.0	25.3	25.8	26.1
Imports (goods and services)	50.2	41.6	39.8	39.7	39.8	38.9	37.7	37.5	37.3
Current account balance	-18.4	-13.8	-14.4	-13.5	-13.4	-12.9	-11.8	-11.4	-11.0
Excluding current transfers	-20.8	-14.7	-15.7	-14.7	-14.5	-14.0	-12.8	-12.3	-12.0
Gross international reserves									
In billions of US$	3.8	4.4	4.6	4.6	5.2	5.1	5.7	6.4	7.1
In months of next year's imports	3.5	3.7	3.6	3.7	3.8	3.9	4.0	4.1	4.3
Memorandum items									
GDP at current market prices									
Billions of Tanzanian shillings	41,125	48,946	55,559	56,867	63,263	64,226	72,081	80,990	90,967
Millions of US$	25,805	30,970	34,656	35,202	38,666	38,155	41,568	45,303	49,376
GDP per capita (US$)	581	679	…	749	…	789	834	883	934
Population (million)	44	47	…	48	…	50	51	53	54

Sources: Tanzanian authorities and IMF staff estimates and projections.

[1] Policy Support Instrument.

[2] The figure for 2014/15 reflects the change from July through September 2014.

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

[4] 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.

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

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

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

[8] Including change in stocks.

Table 2a. Tanzania: Central Government Operations, 2011/2012–2017/18[1]
(Billions of Tanzanian Shillings)

	2011/12	2012/13	2013/14		2014/15		2015/16	2016/17	2017/18
			Prog.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.
Total revenue	7,221	8,443	10,197	10,182	12,304	11,807	13,540	15,456	17542
Tax revenue	6,480	7,730	9,410	9,294	11,099	10,661	12,253	13,929	15827
Import duties	498	584	782	694	850	814	913	1,026	1153
Value-added tax	1,975	2,146	2,366	2,189	3,119	2,689	3,306	3,795	4263
Excises	1,029	1,258	1,609	1,509	1,832	1,914	2,148	2,413	2710
Income taxes	2,247	3,034	3,399	3,779	3,870	3,964	4,448	5,079	5796
Other taxes	732	707	1,254	1,124	1,428	1,281	1,438	1,615	1905
Nontax revenue[2]	741	713	787	888	1,205	1,147	1,287	1,527	1715
LGA	196	221	268	315	462	458	515	578	649
Other	545	492	519	573	743	688	772	949	1066
Total expenditure	10,765	13,543	14,926	13,958	16,881	17,292	19,261	21,894	24824
Recurrent expenditure	6,990	9,445	10,267	10,299	11,624	10,950	12,216	13,662	15304
Wages and salaries [6]	2,722	3,350	4,336	3,969	4,871	4,733	5,311	5,968	6703
Interest payments	436	767	1,052	977	1,068	1,078	1,167	1,247	1360
Domestic	345	590	788	743	726	736	739	753	796
Foreign[3]	91	177	264	234	342	342	428	494	564
Goods and services and transfers[2, 7]	3,831	5,328	4,879	5,352	5,685	5,140	5,737	6,447	7241
Of which: Transfers to TANESCO	…	419	353	399	…	146	…	…	…
Development expenditure [6]	3,775	4,098	4,659	3,660	5,257	6,343	7,045	8,233	9,520
Domestically financed	1,872	1,913	2,600	1,855	3,268	4,308	4,763	5,675	6,556
Foreign (concessionally) financed	1,902	2,185	2,059	1,805	1,989	2,035	2,282	2,557	2,963
Unidentified expenditure measures[6]	…	…	…	…	…	-858	-963	-1,082	-1,215
Overall balance before grants	-3,543	-5,100	-4,729	-3,776	-4,577	-4,627	-4,759	-5,356	-6,066
Grants	1,855	1,728	1,832	1,588	1,447	1,497	1,897	2,131	2,394
Program (including basket grants)[4]	1,021	818	830	703	702	752	1,060	1,191	1,338
Of which: basket grants	301	281	266	189	160	195	219	246	276
Project	834	910	1,002	885	745	745	836	940	1,056
Net expenditure float[5]	168	259	…	-211	…	0	0	0	0
Statistical discrepancy	-550	-170	…	-99	…	0	0	0	0
Overall balance after grants (cash basis)	-2,070	-3,284	-2,896	-2,498	-3,130	-3,130	-2,862	-3,225	-3,673
Financing	2,070	3,284	2,896	2,498	3,130	3,130	2,862	3,225	3673
Foreign (net)	1,735	2,579	3,247	2,271	2,946	3,712	2,755	2,883	3320
Foreign loans	1,816	2,706	3,441	2,452	3,326	4,062	3,260	3,569	4191
Program (including basket loans)[4]	419	544	624	734	465	519	577	607	682
Of which: basket loans	172	186	199	208	84	94	105	110	124
Project	595	734	591	524	1,000	1,000	1,122	1,261	1507
Nonconcessional borrowing	801	1,428	2,226	1,195	1,861	2,543	1,561	1,701	2001
Of which: gas pipeline	…	365	1,144	750	389	612	…	…	…
Amortization	-80	-127	-194	-181	-380	-350	-505	-686	-871
Domestic (net)	335	705	-351	227	184	-582	107	341	353
Of which: excluding gas pipeline	335	1069	793	977	572	29	107	341	353
Bank financing	10	668	640	955	376	-20	-72	-229	-237
Nonbank financing	324	401	153	21	196	49	179	571	590
Of which: credit to TPDC (gas pipeline)	…	-365	-1,144	-750	-389	-612	…	…	…
Memorandum items:									
Total public debt (in percent of GDP)[8]	38.0	41.3	41.5	41.5	42.7	43.8	44.0	44.0	44.19
Domestic unpaid claims (end-period)		692	…	1,323	…	…	…	…	…
Of which: older than 90 days		461		1,077					
Recurrent expenditures (percent of recurrent resources)	88	105	95	96	90	89	85	88	87.24
Nominal GDP	41,125	48,946	55,559	56,867	63,263	64,226	72,081	80,990	90,967

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

[1] Fiscal year: July–June.

[2] 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.

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

Table 2b. Tanzania: Central Government Operations, 2011/12–2017/18[1]
(Percent of GDP)

	2011/12	2012/13	2013/14		2014/15		2015/16	2016/17	2017/18
			Prog.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.
Total revenue	17.6	17.2	18.4	17.9	19.4	18.4	18.8	19.1	19.3
Tax revenue	15.8	15.8	16.9	16.3	17.5	16.6	17.0	17.2	17.4
Import duties	1.2	1.2	1.4	1.2	1.3	1.3	1.3	1.3	1.3
Value-added tax	4.8	4.4	4.3	3.9	4.9	4.2	4.6	4.7	4.7
Excises	2.5	2.6	2.9	2.7	2.9	3.0	3.0	3.0	3.0
Income taxes	5.5	6.2	6.1	6.6	6.1	6.2	6.2	6.3	6.4
Other taxes	1.8	1.4	2.3	2.0	2.3	2.0	2.0	2.0	2.1
Nontax revenue[2]	1.8	1.5	1.4	1.6	1.9	1.8	1.8	1.9	1.9
LGA	0.5	0.5	0.5	0.6	0.7	0.7	0.7	0.7	0.7
Other	1.3	1.0	0.9	1.0	1.2	1.1	1.1	1.2	1.2
Total expenditure	26.2	27.7	26.9	24.5	26.7	26.9	26.7	27.0	27.3
Recurrent expenditure	17.0	19.3	18.5	18.1	18.4	17.0	16.9	16.9	16.8
Wages and salaries [6]	6.6	6.8	7.8	7.0	7.7	7.4	7.4	7.4	7.4
Interest payments	1.1	1.6	1.9	1.7	1.7	1.7	1.6	1.5	1.5
Domestic	0.8	1.2	1.4	1.3	1.1	1.1	1.0	0.9	0.9
Foreign[3]	0.2	0.4	0.5	0.4	0.5	0.5	0.6	0.6	0.6
Goods and services and transfers[2, 7]	9.3	10.9	8.8	9.4	9.0	8.0	8.0	8.0	8.0
Of which: Transfers to TANESCO	…	0.9	0.6	0.7	…	0.2	…	…	…
Development expenditure [6]	9.2	8.4	8.4	6.4	8.3	9.9	9.8	10.2	10.5
Domestically financed	4.6	3.9	4.7	3.3	5.2	6.7	6.6	7.0	7.2
Foreign (concessionally) financed	4.6	4.5	3.7	3.2	3.1	3.2	3.2	3.2	3.3
Unidentified expenditure measures[6]	…	…	…	…	…	-1.3	-1.3	-1.3	-1.3
Overall balance before grants	-8.6	-10.4	-8.5	-6.6	-7.2	-7.2	-6.6	-6.6	-6.7
Grants	5.0	3.5	3.3	2.8	2.3	2.3	2.6	2.6	2.6
Program (including basket grants)[4]	2.5	1.7	1.5	1.2	1.1	1.2	1.5	1.5	1.5
Of which: basket grants	0.7	0.6	0.5	0.3	0.3	0.3	0.3	0.3	0.3
Project	2.0	1.9	1.8	1.6	1.2	1.2	1.2	1.2	1.2
Net expenditure float[5]	0.4	0.5	0.0	-0.4	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	-1.3	-0.3	0.0	-0.2	0.0	0.0	0.0	0.0	0.0
Overall balance after grants (cash basis)	-5.0	-6.7	-5.2	-4.4	-4.9	-4.9	-4.0	-4.0	-4.0
Financing	5.0	6.7	5.2	4.4	4.9	4.9	4.0	4.0	4.0
Foreign (net)	4.2	5.3	5.8	4.0	4.7	5.8	3.8	3.6	3.6
Foreign loans	4.4	5.5	6.2	4.3	5.3	6.3	4.5	4.4	4.6
Program (including basket loans)[4]	1.0	1.1	1.1	1.3	0.7	0.8	0.8	0.8	0.8
Of which: basket loans	0.4	0.4	0.4	0.4	0.1	0.1	0.1	0.1	0.1
Project	1.4	1.5	1.1	0.9	1.6	1.6	1.6	1.6	1.7
Nonconcessional borrowing	1.9	2.9	4.0	2.1	2.9	4.0	2.2	2.1	2.2
Of which: gas pipeline	…	0.7	2.1	1.3	0.6	1.0	…	…	…
Amortization	-0.2	-0.3	-0.3	-0.3	-0.6	-0.5	-0.7	-0.8	-1.0
Domestic (net)	0.8	1.4	-0.6	0.4	0.3	-0.9	0.1	0.4	0.4
Of which: excluding gas pipeline	…	2.2	1.4	1.7	0.9	0.0	0.1	0.4	0.4
Bank financing	0.0	1.4	1.2	1.7	0.6	0.0	-0.1	-0.3	-0.3
Nonbank financing	0.8	0.8	0.3	0.0	0.3	0.1	0.2	0.7	0.6
Of which: credit to TPDC (gas pipeline)	…	-0.7	-2.1	-1.3	-0.6	-1.0	…	…	…
Memorandum items:									
Domestic unpaid claims (end-period, in percent of GDP)	0.5	1.4	1.6	2.3	…	…	…	…	…
Of which: older than 90 days	…	0.9	…	1.9	…	…	…	…	…
Recurrent expenditures (percent of recurrent resources)	88	105	95	96	90	89	85	83	82

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

[1] Fiscal year: July–June.

[2] 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, 2012–2015
(Billions of Tanzania Shillings, unless otherwise indicated; end of period)

	2012	2013	2014							2015			
			March	June		Sept		Dec		March		June	
			Prel.	Prog.	Prel.	Prog.	Prel.	Prog.	Proj.	Prog.	Proj.	Prog.	Proj.
Bank of Tanzania													
Net foreign assets	5,385	6,187	6,294	6,306	6,399	6,455	5,956	6,860	6,063	7,183	7,023	7,361	7,580
Net international reserves	5,847	6,656	6,779	6,774	6,891	6,935	6,433	7,342	6,563	7,670	7,530	7,836	8,089
(Millions of U.S. dollars)	3,720	4,216	4,160	4,174	4,174	4,256	3,861	4,488	3,895	4,670	4,420	4,752	4,738
Net non-reserve foreign assets	-461	-468	-485	-468	-492	-480	-477	-482	-500	-487	-507	-476	-509
Net domestic assets	-860	-1,160	-1,180	-622	-751	-592	-157	-862	46	-989	-936	-904	-1,017
Credit to government	-196	-500	-494	-13	-7	25	627	-142	658	-207	384	-271	-319
Of which: Excluding counterpart of liquidity paper	723	1,000	818	1,299	1,358	1,336	1,399	1,170	1,444	1,105	1,027	1,040	609
Other items (net)	-664	-660	-687	-609	-744	-617	-783	-720	-613	-782	-1,320	-632	-697
REPOs	0	-20	-33	-33	-20	-33	-12	-33	-12	-33	-12	-33	-20
Other items, excluding REPOs (net)	-664	-640	-653	-576	-724	-584	-772	-687	-601	-749	-1,308	-599	-677
Of which: Credit to nongovernment sector	56	57	58	58	59	58	63	58	63	58	63	58	63
Reserve money	4,526	5,028	5,114	5,683	5,648	5,862	5,799	5,998	6,109	6,194	6,087	6,457	6,564
Currency outside banks	2,415	2,764	2,732	2,786	3,072	2,877	3,143	2,925	3,234	3,003	3,199	3,107	3,556
Bank reserves	2,111	2,264	2,382	2,897	2,576	2,985	2,656	3,073	2,875	3,192	2,888	3,349	3,008
Currency in banks	495	561	444	520	525	537	510	546	520	560	543	580	574
Deposits	1,616	1,703	1,938	2,377	2,051	2,448	2,146	2,528	2,354	2,631	2,345	2,770	2,434
Required reserves	1,475	1,649	1,687	2,069	1,769	2,131	1,848	2,200	2,028	2,290	2,020	2,411	2,096
Excess reserves	140	54	251	308	282	317	297	328	326	341	325	359	337
Memorandum items:													
Stock of liquidity paper	919	1,500	1,312	1,312	1,365	1,312	772	1,312	785	1,312	643	1,312	929
Average reserve money	4,685	5,250	5,324	5,629	5,572	5,845	5,905	5,973	5,979	6,158	6,158	6,409	6,409
Monetary Survey													
Net foreign assets	6,396	6,576	6,602	6,706	6,773	6,856	6,371	7,263	6,483	7,588	7,448	7,767	8,006
Bank of Tanzania	5,385	6,187	6,294	6,306	6,399	6,455	5,956	6,860	6,063	7,183	7,023	7,361	7,580
Commercial banks	1,011	389	308	400	374	401	415	403	420	405	425	406	425
Net domestic assets	8,251	9,530	9,948	10,752	10,884	11,330	11,903	11,381	12,264	11,726	11,971	12,400	12,433
Domestic credit	11,030	12,947	13,636	14,001	14,778	14,505	15,986	15,082	16,484	15,644	16,568	16,151	17,011
Credit to government (net)	2,019	2,555	2,773	2,904	3,219	2,998	4,043	3,092	4,034	3,186	3,617	3,280	3,200
Credit to nongovernment sector	9,010	10,393	10,863	11,097	11,559	11,507	11,943	11,990	12,450	12,458	12,951	12,871	13,811
Other items (net)	-2,779	-3,417	-3,689	-3,249	-3,894	-3,175	-4,083	-3,702	-4,220	-3,919	-4,597	-3,751	-4,578
M3	14,647	16,107	16,550	17,458	17,657	18,186	18,274	18,644	18,747	19,314	19,419	20,167	20,439
Foreign currency deposits	3,923	4,216	4,240	4,464	4,415	4,641	4,553	4,749	4,662	4,909	4,819	5,116	5,062
M2	10,725	11,891	12,310	12,994	13,241	13,545	13,721	13,895	14,086	14,404	14,600	15,051	15,377
Currency in circulation	2,415	2,764	2,732	2,786	3,072	2,877	3,143	2,925	3,234	3,003	3,199	3,107	3,556
Deposits (TSh)	8,310	9,127	9,578	10,208	10,170	10,668	10,578	10,971	10,851	11,401	11,401	11,943	11,821
Memorandum items:			(12-month percent change, unless otherwise indicated)										
M3 growth	12.5	10.0	11.6	14.5	15.8	14.1	14.7	15.8	16.4	16.7	17.3	15.5	15.8
M3 (as percent of GDP)	35.6	28.3	29.1	31.4	31.0	28.7	28.5	29.5	29.2	30.5	30.2	31.9	31.8
Private sector credit growth	18.2	15.3	16.4	16.5	21.4	16.3	20.7	15.4	19.8	14.7	19.2	16.0	19.5
Average reserve money growth	11.0	12.1	14.0	14.9	13.7	13.8	14.9	13.8	13.9	15.7	15.7	13.9	15.0
Reserve money multiplier (M3/average reserve money)	3.13	3.07	3.11	3.10	3.17	3.11	3.09	3.12	3.14	3.14	3.15	3.1	3.19
Nonbank financing of the government (net) [1]	27	115	2	153	21	49	49	98	49	147	49	196	49
Bank financing of the government (net) [1]	424	291	510	640	955	94	824	188	815	282	398	376	-20
Bank and nonbank financing of the government (net) [1]	450	406	511	793	977	143	873	286	864	429	446	572	29
Foreign currency deposits (percent of M3)	26.8	26.2	25.6	25.6	25.0	25.5	24.9	25.5	24.9	25.4	24.8	25.4	24.8

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

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

Table 4. Tanzania: Balance of Payments, 2011/12–2017/18
(Millions of U.S. dollars, unless otherwise indicated)

	2011/12	2012/13	2013/14		2014/15		2015/16	2016/17	2017/18
			Prog.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.
Current account	-4,736	-4,284	-4,992	-4,746	-5,163	-4,905	-4,893	-5,147	-5,449
Trade balance	-5,047	-5,084	-6,025	-5,728	-6,373	-5,903	-6,020	-6,432	-6,879
Exports, f.o.b.	5,562	5,398	5,516	5,619	6,067	6,111	6,663	7,317	8,041
Traditional agricultural products	785	820	933	836	1,037	927	1,013	1,079	1,150
Gold	2,288	1,899	1,688	1,659	1,679	1,582	1,617	1,687	1,800
Other	2,489	2,679	2,895	3,124	3,351	3,602	4,034	4,550	5,091
Imports, f.o.b	-10,609	-10,482	-11,541	-11,347	-12,440	-12,014	-12,683	-13,749	-14,920
Of which: Oil	-3,586	-3,923	-4,493	-4,209	-4,404	-3,918	-3,723	-3,838	-3,958
Services (net)	88	548	781	648	959	611	881	1,126	1,322
Of which: Travel receipts	1,431	1,757	1,945	1,973	2,191	1,980	2,239	2,470	2,726
Income (net)	-703	-535	-512	-409	-561	-428	-561	-640	-714
Of which: Interest on public debt	-64	-113	-132	-128	-148	-117	-247	-276	-306
Current transfers (net)	926	787	764	743	811	815	806	800	823
Of which: Official transfers	625	523	443	438	429	447	438	446	455
Capital account	778	739	690	748	522	509	553	602	654
Of which: Project grants[1]	715	676	625	548	456	443	482	526	573
Financial account	3,414	4,146	4,570	3,873	5,220	4,960	4,955	5,281	5,619
Foreign Direct Investment	1,574	1,836	2,074	1,924	2,575	2,206	2,788	3,171	3,308
Public Sector, net	1,092	1,701	2,084	1,404	1,801	2,205	1,589	1,613	1,802
Program loans	264	365	432	451	284	308	333	340	370
Non-concessional borrowing	505	920	1,374	738	1,138	1,511	900	951	1,086
Project loans	374	465	369	324	611	594	647	705	818
Scheduled amortization[2]	-51	-49	-89	-109	-232	-208	-291	-384	-473
Commercial Banks, net	0	377	119	92	129	73	129	59	59
Other private inflows	749	232	293	453	715	475	449	438	450
Errors and omissions	842	-144	0	358	0	0	0	0	0
Overall balance	298	457	268	232	578	564	615	736	824
Financing	-298	-457	-268	-232	-578	-564	-615	-736	-824
Change in BoT reserve assets (increase= -)	-275	-569	-268	-232	-519	-509	-549	-658	-735
Use of Fund credit	-23	112	0	0	-59	-56	-65	-78	-89
Financing gap	0	0	0	0	0	0	0	0	0
Memorandum items:									
Gross official reserves (BoT)	3,797	4,357	4,633	4,634	5,153	5,143	5,692	6,350	7,085
Months of imports of goods and services (current year)	3.5	4.1	3.9	4.0	4.0	4.2	4.4	4.5	4.6
Exports (percent of GDP)	21.6	17.4	15.9	16.0	15.7	16.0	16.0	16.2	16.3
Exports excl. gold (percent of GDP)	12.7	11.3	11.0	11.3	11.3	11.9	12.1	12.4	12.6
Imports (percent of GDP)	-41.1	-33.8	-33.3	-32.2	-32.2	-31.5	-30.5	-30.3	-30.2
Imports excl. oil (percent of GDP)	-27.2	-21.2	-20.3	-20.3	-20.8	-21.2	-21.6	-21.9	-22.2
Current account deficit (percent of GDP)	-18.4	-13.8	-14.4	-13.5	-13.4	-12.9	-11.8	-11.4	-11.0
Foreign program and project assistance (percent of GDP)	7.7	6.6	5.4	5.0	4.6	4.7	4.6	4.5	4.5
Nominal GDP	25,805	30,970	34,656	35,202	38,666	38,155	41,568	45,303	49,376

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.

Table 5. Tanzania: Financial Soundness Indicators, 2010–2014
(percent, end of period)

				2013				2014		
	2010	2011	2012	Mar	Jun	Sep	Dec	Mar	Jun[p]	Sep[p]
Access to bank lending										
Claims on the non-government sector to GDP [1]	18.0	19.9	18.5	20.5	21.2	21.9	19.5	20.2	21.5	22.2
Claims on the private sector to GDP [1]	17.2	18.9	17.3	19.3	20.1	21.0	18.5	18.8	20.4	21.0
Capital adequacy										
Capital to risk-weighted assets	18.5	17.6	17.5	19.5	18.2	18.4	18.2	19.2	17.8	18.1
Capital to assets	10.7	10.5	10.5	11.4	10.9	10.8	11.1	11.8	11.1	11.2
Asset composition and quality										
Net loans and advances to total assets	44.2	49.2	49.7	48.6	48.7	49.1	50.8	50.8	51.8	51.4
Sectoral distribution of loans										
Trade	17.5	20.0	20.9	21.4	21.2	20.3	20.9	19.9	20.2	21.1
Mining and manufacturing	14.1	12.6	11.9	12.3	12.3	12.3	11.9	11.8	12.5	12.6
Agricultural production	13.0	13.5	11.2	11.5	11.1	11.1	9.8	10.6	10.0	9.1
Building and construction	6.1	8.2	9.0	9.1	9.2	9.3	9.6	9.5	9.3	9.1
Transport and communication	9.2	7.3	6.9	7.3	7.0	7.4	7.0	7.0	7.2	7.0
Foreign exchange loans to total loans	32.0	33.0	33.5	34.0	34.8	35.6	35.4	36.0	35.9	35.7
Gross nonperforming loans (NPLs) to gross loans	9.8	6.7	8.1	7.7	7.5	7.1	6.5	7.9	8.1	8.5
NPLs net of provisions to capital	25.9	18.8	22.5	18.0	17.1	16.7	14.3	16.5	17.2	20.9
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
Earnings and profitability										
Return on assets	2.2	2.5	2.6	2.9	2.8	2.6	2.6	3.0	3.0	2.9
Return on equity	12.1	14.5	13.9	16.0	15.5	14.1	13.1	15.5	15.5	15.0
Net interest margin	8.5	8.4	…	…	…	…	…	…	…	…
Noninterest expenses to gross income	54.5	66.7	67.8	63.5	65.4	66.2	66.9	64.8	65.7	66.0
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
Liquidity										
Liquid assets to total assets	39.5	36.3	34.0	35.0	34.2	33.4	31.7	32.5	31.7	32.2
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
Total loans to customer deposits	58.9	65.2	68.6	68.8	67.5	67.7	71.4	71.8	73.3	72.7
Foreign exchange liabilities to total liabilities	31.9	37.0	34.4	35.2	35.2	35.3	35.1	34.3	34.4	34.5

Source: Bank of Tanzania

[1] Calendar year; end of period claims relative to annual GDP.

[p] Preliminary

Letter of Intent

December 18, 2014

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 one from June 27, 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/

Saada Mkuya Salum (MP)
MINISTER FOR FINANCE
UNITED REPUBLIC OF TANZANIA

/s/

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 December 18, 2014

I. MACROECONOMIC DEVELOPMENTS AND PROGRAM PERFORMANCE

A. Recent Macroeconomic Developments and Outlook

Output and Inflation

1. **Growth.** Economic growth remained robust in the first half of 2014, backed by strong growth in transport and communication, financial intermediation and electricity. The economy is projected to sustain strong growth momentum (about 7 percent in 2014 and 2015), supported by ongoing investments in roads, electricity and gas, and good weather conditions. The slow recovery of the global economy, in particular the euro area, and a further decline in gold prices remain the main risk affecting the economy's external environment.

2. **Inflation.** Headline inflation stood at 5.9 percent y-o-y in October 2014, marking a turnaround from the general upward trend since January 2014. Food inflation was 7.1 percent in October 2014 and energy inflation 11.6 percent. Core inflation remained subdued at 3.2 percent, thanks to prudent fiscal and monetary policies. Inflation is expected to remain in the single digits, helped by abundant food supply coupled with stable global oil prices. However ongoing geopolitical tensions in the Middle East are a risk to oil prices.

External Sector Developments in Fiscal Year 2013/14

3. **Current Account.** The current account deficit stabilized at 13.5 percent of GDP. Gold exports were affected by lower gold prices, but non-traditional exports continued to exhibit good performance, increasing by almost 17 percent. Lingering problems in the Euro zone continue to pose risks to global growth, which could in turn subdue demand for our exports, including tourism. Imports are likely to soften in line with projected decline in oil prices and lower oil imports, once the new gas pipeline is completed.

Fiscal Performance and Financing in Fiscal Year 2013/14

4. **Fiscal Deficit**. The overall fiscal deficit of the central government declined from 6.7 percent of GDP in FY2012/13 to 4.4 percent of GDP. Revenues turned out below program targets, with shortfalls observed in all revenue categories except in income taxes. VAT underperformance reflected larger than anticipated refunds, in particular to the mining sector, and weaker tax compliance, reflecting in part resistance by some traders in using electronic fiscal devices. Income tax, however, over-performed thanks to a windfall from the taxation of capital gains in a large transaction in the gas sector. Total expenditure was lower than programmed on account of a lower wage bill (reflecting delayed recruitment and promotions), transfers to

TANESCO, and under-execution of capital expenditure. Meanwhile, the stock of domestic unpaid claims (older than 90 days) by the government rose to about 2 percent of GDP at end-September 2014 from 0.9 percent of GDP the previous year.

5. Financing. External non-concessional loans contracted during 2013/14 to finance the budget amounted to US$348 million including, US$200 million from Credit Suisse and €113.7 million from HSBC for the ongoing Dar es Salaam International Airport-Terminal III project. An additional US$83 million was contracted from a bank syndicate led by Citi Bank (guarantee to TANESCO). Actual disbursement through end-June 2014 was US$738 million, out of which US$464 million was for the gas pipeline project and US$274 million for other development projects. Net domestic financing of the government budget was TSh 977 billion. The amount was used partly to finance development projects following the observed shortfall in ENCB and foreign program assistance.

Monetary Policy

6. Monetary policy stance. Growth in monetary aggregates was broadly within targets for end-June 2014, with M3 growing at an annual rate of about 16 percent and credit to the private sector by about 21 percent. The Shilling remained fairly stable although some mild pressure was observed in April-May 2014. Overall, the Shilling depreciated against the U.S. dollar by about 4 percent in the year to September 2014.

Financial Sector and Capital Account

7. Financial sector stability. The banking system remained well capitalized, profitable and liquid. However, the ratio of non-performing loans (NPLs) to gross loans deteriorated from 7.1 percent in September 2013 to 8.5 percent in September 2014, mainly on account of poor performance of large corporates in manufacturing, trade and agricultural sub sectors. Deterioration has also been noted in some banks' portfolio of SME and personal loans.

8. FBME Bank. On 15th July 2014 FBME Bank Limited, a Tanzania licensed bank with two branches in Cyprus, was named as a bank of primary money laundering concern by the US Financial Crimes Enforcement Network (FinCEN) with a proposed action to stop the bank's access to the US financial system. Following the FinCEN notice, the Central Bank of Cyprus (CBC) took over management of the two FBME branches in Cyprus on 18th July 2014. On 21st July 2014, the Bank of Tanzania placed FBME's Tanzania operations under close targeted supervision and on 24th July 2014 the bank was put under BOT's Statutory Management. Thanks to this prompt reaction, the rest of the banking system in Tanzania has remained stable and unaffected. The BOT has taken all necessary steps to protect domestic depositors' money in the FBME. BOT continues to strengthen its AML/CFT supervisory framework which includes, among other objectives, ensuring a detailed assessment of AML/CFT compliance.

9. Financial sector development.

- Mobile payment services have continued to grow, reaching an increasing share of the population. Recent innovations include linkages between telecommunication companies and banks offering micro-savings and micro-credit products, thereby enabling the unbanked population to have access to savings and credit services. While interoperability and public awareness of the mobile payment services has continuously attracted more customers to use the product, observing "know your customer" requirements will continue to be given emphasis in line with the National Payment System Bill that has been approved by the Cabinet.

- In an effort to expedite payments and minimize fraud incidences related to cheques, the Government has successfully connected all its sub-treasuries to its main system. The next step involves connecting stand-alone government ministries and government agencies to the system. This process commenced in August 2014.

- The BoT has developed a Bureau de Change Management System, which enables the BoT to receive real time data from bureau de change through Electronic Fiscal Devices (EFDs). Pilot testing of the system is underway and it is expected that the system will go live by December 2014. The system is expected to enhance efficiency in monitoring the operations of Bureaux de change and their compliance with applicable laws and regulations, including AML/CFT.

10. Capital account liberalization. Following the liberalization of capital account transactions implemented in May 2014, the BoT has finalized operational guidelines to ensure smooth implementation of the amended regulations. This has paved the way for residents of EAC countries to participate in primary auctions and subsequently secondary trading of securities issued by the Government with maturity of one year and above. Meanwhile, BoT has enhanced the Government Securities System (GSS) to allow participation of non-residents through licensed Central Depository Participant (CDP). The monitoring and reporting framework has also been strengthened to allow capturing of the capital flows data through Banking Supervision Information System (BSIS). Tanzanians are now allowed to invest in other EAC countries.

Pension Reform

11. The Social Security Regulatory Authority has already issued 9 guidelines to enforce good governance and improve performance of the pension sector. In July, 2014 SSRA issued new rules for the harmonization of pension benefits across the five defined benefits pension funds (NSSF, PSPF, PPF, LAPF and GEPF), thereby meeting the program's structural benchmark for end-September 2014. The issued rules do not apply to the existing members of the PSPF and LAPF prior 1st July 2014. This reform reduced the annual accrual rate from 2.22 to 2.07 percent, commutation factors reduced from 50 percent to 25 percent, and the income measure used to calculate pensions (the average of the three highest salaries in the 10 years preceding retirement instead of last salary). These measures will ensure fairness for beneficiaries across pension funds and improve the actuarial situation of the pension system.

B. Program Performance

12. Quantitative targets for end-June and end-September. All quantitative assessment criteria (AC) under the PSI arrangement for end-June 2014 were met. The continuous AC on external arrears was not met, as the tight financial situation early in the fiscal year did not allow making full payments to a private creditor. Discussions with this creditor are going on well for a revised payment schedule. The indicative target for tax revenue at end-June was missed. Most indicative targets for September 2014 were missed, due to exceptional circumstances. First, large shortfalls in program assistance and non-concessional borrowing were experienced, which the adjusters on net international reserves (NIR) and net domestic financing (NDF) could not fully address. Second, revenue collection was below the target. Third, the government decided in July to frontload domestically-financed capital expenditure more than envisaged under the program. This was facilitated through the conversion of liquidity papers into financing papers, with the corresponding release of blocked deposits at the BoT. The liquidity thus injected in the economy was partly mopped up through net sales of foreign exchange. As a result, NIR ended up below, and NDF above, their respective adjusted targets for end-September. The target for average reserve money, however, was almost met (missed by only TSh 1.2 billion).

13. Structural benchmarks. The BoT submitted the draft regulations on consolidated supervision to the Attorney General's Office in June 2014 and the regulations have subsequently been gazetted on 22nd August 2014 under GN No. 286 to 298. The 2014/15 budget includes an allocation of TSh 195 billion to start the clearance of domestic arrears. A plan to address outstanding and future liabilities to pre-1999 PSPF beneficiaries was delayed to allow for a more comprehensive plan to address all government arrears to pensions (para 27). The first quarterly report on debt was completed in November 2014 and tabular information on parastatals was published by the Treasury Registrar in November 2014.

II. THE ECONOMIC PROGRAM FOR 2014/15 AND THE MEDIUM TERM

14. Poverty reduction strategy. Tanzania's development agenda is guided by the Development Vision 2025 and implemented through the poverty-reduction strategy (MKUKUTA II) and the five-year development plan (FYDP). The next annual implementation report on MKUKUTA II will be completed by end-November 2014. MKUKUTA II comes to an end in June 2015 while the FYDP ends in June 2016. The government intends to extend the life of MKUKUTA II by one year so that the life of MKUKUTA II will end June 2016 in line with the FYDP. This will facilitate the harmonization of the MKUKUTA and FYDP documents from mid-2016 and also ensure alignment with the electoral cycle.

A. Monetary, Exchange Rate, and Financial Sector Policies

15. Monetary policy stance for 2014/15. The current monetary policy stance remains appropriate to reach the objective of 5 percent inflation rate by mid-2015. The targets for end-June 2015 for the growth in average reserve money (about 15 percent) and M3 (about 16 percent), will give room for growth of credit to the private sector of about 20 percent. To address seasonal liquidity needs while meeting quarterly average reserve money targets, the BoT will build sufficient buffers over the course of each quarter.

16. Modernizing the monetary policy framework. A retreat for the BoT's Board of Directors was organized to discuss the reforms towards a price-based monetary policy framework. Improvements in the BoT's macro-economic modeling and forecasting capacity is being implemented, with the help of the IMF. A study is also being undertaken to understand better the relationship between interbank market rates and banks' excess reserves. The BoT will unify the statutory minimum reserve (SMR) and the clearing accounts that banks maintain at the BoT and implement partial reserve averaging for reserve requirements by end-April 2015 (new structural benchmark). These reforms are expected to help reduce the volatility of interbank market rates.

17. Coordination of monetary policy and fiscal policy. In an environment of uncertain external financing and relatively shallow domestic financial market, the conversion of liquidity papers into financing papers has proved a convenient instrument to address temporary budget financing needs. However, further conversions are not expected this fiscal year. Going forward, recourse to conversion will be reduced to a minimum by aligning more closely the phasing of budget financing with the desired pattern for expenditure execution.

18. Exchange rate. The exchange rate will continue to be driven by market forces, with the BoT participating in the foreign exchange market for liquidity management purposes and to smooth out excessive short-term fluctuations in nominal exchange rate. The BoT's net sales in the foreign exchange market will be consistent with the targets of net international reserves (NIR). Recent deviations from the program path for NIR reflected to a significant extent delays in donor financing and nonconcessional borrowing; they are expected to be corrected in the coming months as the financing situation normalizes. Given recent developments towards realization of ENCB and program assistance, we request a downward revision to the end-December 2014 NIR target, and a slight upward revision to the end-June 2015 NIR target (reflecting higher ENCB over the entire year, see paragraph 31) as shown in Table 1.

19. Capital account liberalization. Having liberalized the capital account with the EAC, the government intends to extend the liberalization to the rest of the world by end-2015 drawing lessons from the EAC experience.

20. Banking supervision and resolution framework. The recent difficulties with FBME Bank underscore the urgency of conducting supervision on a consolidated basis and deepening the collaboration with foreign supervisors. Currently, BoT is developing the consolidated supervision framework, and has already issued consolidated supervision regulations and entered into memorandum of understanding (MoUs) with other regulators and foreign central banks. Draft off-site and on-site procedures have been prepared and the plan is to conduct pilot consolidated examination beginning year 2015 with full implementation by 2017. The next step is to build capacity of examiners in consolidated supervision; in this regard, the IMF is providing technical assistance to train BoT staff. Financial supervisors, both at the BoT and the Financial Intelligence Unit (FIU), the AML/CFT authority, are also strengthening the AML/CFT compliance framework in FBME Bank following a joint inspection. Over the medium term, the FIU is aiming to increase the number of compliance officers and strengthen the capacity in other regulatory agencies to carry out AML/CFT oversight, including the BoT and the Gaming Board.

21. **FBME** continues to be under BoT's statutory management, while awaiting FinCEN's final position on the activities of the bank. Upon this final position, the BoT will take appropriate actions on the future of the bank.

B. Fiscal Policies

Budget for 2014/15 and Medium-Term Fiscal Policies

22. **Budget for 2014/15**.The public investment effort is expected to remain substantial in FY2014/15, in particular to develop key transportation and energy infrastructure. About TSh 2.1 trillion has been allocated to finance projects included in the Big Results Now (BRN) Initiative, with a major focus on road infrastructure, energy and minerals, water including irrigation projects, education, transport and agriculture. The wage bill is expected to increase as a share of GDP, reflecting the full-year impact of recruitments in the previous fiscal year, planned additional recruitment in priority sectors and a general pay increase. For this purpose, the minimum monthly wage was raised from TSh 240,000 to TSh 265,000 in July 2014. The approval and implementation of the new VAT law, including a more effective and better funded VAT refund system, and the continuation of revenue administration reforms will contribute to strengthen revenue. The 2014/15 budget targets a deficit of 4.9 percent of GDP, in line with the program.

23. **Downside risks and corrective measures**. Revenue projections underpinning the 2014/15 budget have been reconsidered recently in light of final revenue outturns last fiscal year and recent developments in revenue collection. Both point to the need to revise revenue projection downwards, particularly for the income tax, by about 1 percent of GDP. Budget implementation is also affected by delays in contracting non-concessional borrowing and the disbursement of donor financing. The Parliament has pronounced itself on the special audit of the Controller and Auditor General on the IPTL case, and resolutions have been made and submitted to Government. The Government will study each one of them and ensure it addresses them. This is expected to pave the way for full disbursement of donor financing by end-June 2015. Given these developments, if revenue trends continue, both revenue and expenditure will be revised downwards during the mid-year budget review to reach the deficit target. The Cabinet will deliberate upon the mid-year report and direct that line ministries take measures to align expenditures with expected revenue flows. The review will be completed as soon as possible, to facilitate adjustment, and its outcome will be shared with Fund staff, including the revised expenditure allocations for MDAs. Expenditure measures will preserve BRN priority areas. In light of these risks, prudent execution of the budget is in order until the mid-year review. Expenditure execution has already been slowed significantly, since the budget operates on a cash availability basis. To address the uncertainty related to the timing of GBS resumption, an increase in the cap to the NDF adjuster (and NIR adjuster) is requested (from TSh 300 to TSh 500 billion).

24. Medium-term fiscal policies. In the medium term, the Government will focus on allocating resources into strategic areas and projects to ensure public resources are invested in a manner consistent with the priorities outlined in the MKUKUTA II and FYDP, including by giving priority to the projects identified under the BRN. With increasing reliance on market financing, the government will contain fiscal deficits to reasonable levels and ensure that public debt continue to be sustainable. In addition, the EAMU Protocol requires that fiscal deficits (including grants) be eventually reduced to well below to 3 percent, to maintain space for fiscal maneuver in case of need. We therefore intend to continue reducing the fiscal deficit gradually beyond FY2014/15.

Fiscal Aspects of Energy

25. Power sector. The financial situation of TANESCO has improved significantly in 2014 in the wake of the January 2014 tariff increase. Thanks also to support from development partners, the level of arrears has decreased. Arrears, however, remain sizeable and affect the status of TANESCO as credible off-taker for gas supplies from TPDC. These arrears will be addressed by the current initiative of TANESCO paying creditors on weekly basis as well as ongoing implementation of the Electricity Supply Industry (ESI) Reform Strategy and road map approved by the Government on 30th June 2014. TANESCO is also in the process of phasing out emergency power plants. In July 2014, Symbion Plants with 150MW was phased out without lowering the reliability of power supply delivery. Restructuring of TANESCO will be implemented gradually such that unbundling of generation segment will be done by December 2017, while unbundling of distribution from transmission segment by June 2021. The outcome of unbundling is expected to be an improvement in the efficiency of TANESCO and thus eliminating the need for Government subsidies to TANESCO.

26. Fiscal framework for managing revenues from natural gas. Work is ongoing on designing a macroeconomic and fiscal policy framework that will govern the overall use of natural resource revenues, should Tanzania become a major gas producer; procedures to ensure the revenues and associated expenditures are fully integrated and managed within the budget process; and reporting requirements to ensure transparency in the use of the natural resources. A draft policy paper on these issues will be prepared and submitted to Cabinet by end-March 2015.

Fiscal Aspects of Pensions

27. Pension reform. A strategy is expected to be adopted by Cabinet by end-February 2015 to address government arrears to pension funds and further improve the sustainability of the funds (new benchmark). These arrears have arisen first from liabilities related to pre-1999 reform PSPF beneficiaries. Second, arrears have been incurred on loans provided by pension funds to various public entities with a government guarantee, or directly to the government. The practice of extending such loans, which were not properly documented or recorded in the budget, was stopped more than two years ago following the issuance of Investments Guidelines in May 2012 by SSRA and BoT. Accordingly, such financing will not resume until the pension funds' loan exposure to the government drops below 10 percent of their assets. Any future lending will be properly recorded as government financing, and the corresponding expenditures will also be recorded in the fiscal accounts. The strategy will propose modalities for the settlement of arrears (e.g., rescheduling, securitization) and future budget will explicitly take into account the servicing of these debts (including the part of the loans recognized as government debt and not yet in arrears). The strategy will also propose options for addressing the future liabilities related to pre-1999 reform PSPF beneficiaries, taking into account the interests of beneficiaries and taxpayers. Any remaining annual fiscal obligations that have to be taken over by the government will be explicitly budgeted, starting next fiscal year.

C. Public Finance and Debt Management

Management of domestic arrears

28. Arrears monitoring. There is still uncertainty regarding the exact amount of existing arrears, reflecting the need to improve the monitoring system. In this regard, the Paymaster General (PMG) will issue a new Circular on the reporting of payment arrears and the provision of training to concerned government staff. The Circular will include, among others, 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. The issuance of new circular is a proposed new structural benchmark for end-December 2014.

29. Arrears verification and settlement. To accelerate the settlement of arrears, verification is being carried out centrally for all outstanding arrears as of end 30th June, 2014. A report with the conclusions of the verification process will be produced by end-February 2015 and will be shared with IMF staff (proposed new benchmark). Settlement of these verified arrears will be effected in 2014/15 and 2015/16 budget. Arrears for construction work are expected to be addressed first during the current fiscal year. To allow for arrears clearance, we request that the NDF target for 2014/15 be adjusted upward by the amount of arrears cleared. The size of the adjustor will be based on a report produced by the CAG by end-September 2015 verifying the settlement of arrears. For FY 2015/16, arrears clearance will be transparently included in the budget and fiscal space will be opened up to accommodate clearance of the remaining arrears and report similarly produced by CAG after the clearance.

30. Arrears prevention. Our PFM framework will be strengthened through the adoption by June 2015 of an amended Public Finance Act and a new Budget Act. These bills will expand the coverage of the PFM legal framework, remove conflicting and ambiguous requirements, codify PFM practices, and strengthen enforcement. The Government will strengthen its capacity for revenue forecasts to enhance the realism of the budget. To this end, technical support from the IMF and others will be sought whenever necessary. Furthermore, robust administrative measures will be put in place to improve compliance and revenue collection. All local purchase orders (LPOs) will be made through the Integrated Financial Management System (IFMS), and outreach to suppliers will be conducted to ensure that they accept only IFMS-generated LPOs. Cash management and forecasting and the fund release process will be strengthened. The Ministry of Finance will only release funds to MDAs, RSs and LGAs upon submission of monthly budget execution reports.

Public debt management

31. The decision to establish a Debt Management Department within the Ministry of Finance was made in May 2014. A Cabinet Paper on the National Debt Management Policy and amendments of the Government Loans, Guarantees and Grants Act Cap. 134 are being prepared with a view to strengthening management of public debt, including providing the legal underpinning for a new debt management department to effectively discharge its responsibilities. In addition to a project loan of $292 million to finance the Kinyerezi II power plant, the Government envisages to contract two non-concessional loans at floating rates to finance the budget. These loans are expected to amount to $800 million, with $600 million likely to be disbursed by the third quarter. The first quarterly report on debt will be published by end-2014. Subsequent reports will be published within a month following the end of each quarter.

Monitoring and Management of Fiscal Accounts in the Public Sector

32. Public sector monitoring. The Government has started to scrutinize the budget for public sector to ensure prudent financial management. All public institutions that collect revenue will have their budgets reviewed and approved by the Paymaster General and all excess funds will be deposited into the Government Consolidated Fund. To improve transparency, the Treasury Registrar will publish at least once a year in tabular format updated information on parastatals' revenues, expenditures, and profits and losses.

33. Budget Act and Public Finance Act. A Budget Act is being prepared for expected adoption by the end of FY2014/15. The Budget Act will provide specific detailed guidance in matters relating to Budget. Some of the issues intended to be covered include planning component, revenues and expenditures. The new law is expected to address gaps in existing laws, 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.

D. Other Reforms

Statistical Issues

34. Revised national accounts. The National Bureau of Statistics released revised national accounts statistics in October2014. The revised estimates, base year 2007, are based on a number of benchmark surveys conducted in recent years, including the 2007/08 Agriculture Survey; 2007 Household Budget Survey; 2006 Integrated Labor Force Survey; 2007 and 2008 Annual Surveys of Industrial Production; and 2007 Survey of Non-Government Organizations. In addition, extensive use has been made of administrative data, especially from the value-added tax system. The level for the revised GDP is 27.8 percent higher than the old GDP, 2001 base year. The structure of the economy is broadly unchanged with agriculture being the largest sector (23.8 percent) followed by trade (10.1 percent), construction (9.6 percent) and manufacturing (7.6 percent). The new data are being carefully analyzed and will be used in the PSI's macroeconomic framework from the next review.

35. Other statistical improvements. During 2013/14 international visitors exit surveys were undertaken. Data derived from the surveys were incorporated in the BOP statement. The BoT also continued to conduct annual Surveys of Companies with Foreign Liabilities (SCFL) to collect and analyze data on foreign private investment. Currently, fieldwork is ongoing to collect FDI data for 2013 and preliminary results of the SCFL are expected before end of 2014.

Program monitoring

36. Assessment criteria for end-December 2014 and end-June 2015, and indicative targets for end-March 2015 are set as per Table 1. The changes reflect adjustments to program targets prompted by the revisions to external financing and the shortfall of tax revenues relative to the projections in 2013/14 and the first quarter of the fiscal year. The second and third reviews under the PSI are expected to take place by June 30, 2015 and December 31, 2015, respectively, on the basis of the assessment criteria and structural benchmarks indicated in Tables 1 and 2, attached.

MEFP Table 1. Tanzania: Quantitative Assessment Criteria (AC) and Indicative Targets(IT) Under the Policy Support Instrument, June 2014–June 2015

	June 2014				Sept. 2014				Dec 2014		March 2015		June 2015	
	Assessment Criteria				Indicative Target				Assessment Criteria		Indicative Target		Assessment Criteria	
	Program	Adjusted Criteria	Preliminary	Met?	Program	Adjusted Criteria	Preliminary	Met?	Program	Revised	Program	Revised	Program	Revised
	(Billions of Tanzania Shillings; end of period, unless otherwise indicated)													
Net domestic financing of the government of Tanzania (cumulative, ceiling) [1, 2]	793	1093	977	✓	143	443	873	✗	286	864	429	446	572	29
Average reserve money (upper bound) [3, 6]	5,685	5,685	5,572	✓	5,903	5,903	5,905	✗	6,033	6,033	6,219	6,219	6,473	6,473
Average reserve money target [3]	5,629				5,845				5,973	5,973	6,158	6,158	6,409	6,409
Average reserve money (lower bound) [3]	5,573				5,787				5,913	5,913	6,096	6,096	6,345	6,345
Tax revenues (floor; indicative target)[1]	9,410	9,410	9,294	✗	2,775	2,775	2,401	✗	5,550	5,105	8,324	7,854	11,099	10,661
Priority social spending (floor; indicative target)[1]	2,200	2,200	2,783	✓	600	600	718	✓	1,200	1,200	1,800	1,800	2,400	2,400
	(Millions of U.S. dollars; end of period)													
Change in net international reserves of the Bank of Tanzania (floor) [1, 4, 6]	268	86	198	✓	82	-100	-270	✗	314	-235	496	290	578	608
Accumulation of external payment arrears (continuous AC ceiling)[1]	0	0	0	✓	0	0	15	✗	0	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (continuous AC ceiling) [5]	2,420	2,420	354	✓	2,420	2,420	354	✓	2,420	2,420	2,420	2,420	2,420	2,420
Memorandum item:														
Foreign program assistance (cumulative grants and loans) [1]	907	907	853		384	384	112		572	202	675	374	713	755
External nonconcessional borrowing (ENCB) disbursements to the budget [1]	675	675	274		225	225	15		450	149	675	846	900	1,147

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. To be adjusted upward by the full amount of domestic arrears cleared during the fiscal year.

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.

6 The program figure for end-June 2014 is the authorities' projection and is not an AC for the purposes of the first review.

MEFP Table 2: Structural Benchmarks under the Policy Support Instrument

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Public Finance Management/Fiscal Risks			
Provide an allocation in the 2014/15 budget for centralized clearance of domestic arrears. Any payment from this centralized budget should be backed by a list of verified eligible creditors, in line with the priorities of a repayment strategy	To accelerate clearance of domestic expenditure arrears	June 30, 2014	Met
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	
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	New benchmark
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	New benchmark

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Monetary, Financial and Exchange Rate Policies			
Submit the draft regulations on consolidated supervision to Attorney General's Office.	To modernize the BoT's supervisory framework to better supervise consolidated financial firms.	June 30, 2014	Met
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	
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	New benchmark

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Pension System			
Approve pension harmonization guidelines.	To limit contingent liabilities	September 2014	Met
Prepare a plan to address the outstanding and future obligations to pre-1999 pensioners of the PSPF.	To limit contingent liabilities	June 30, 2014	Not met. The MoF has expanded the scope of the work to address outstanding government obligations to all the pension funds. A strategy is expected to be prepared by end-February 2015.
Prepare and adopt a strategy to address government arrears to pension funds	To improve the sustainability of the funds	February 28, 2015	New benchmark
Public Debt Management			
Prepare the first quarterly report on (i) all external debt contracts signed and guaranteed by government, (ii) borrowing by public enterprises, and (iii) projected debt service on public debt.	To enhance public debt management	September 30, 2014	Not met. The report was produced in November, but did not include information on borrowing by public enterprises and debt service projections. The authorities plan to address these shortcomings before publication by end-December.

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Public Enterprise Management			
Treasury Registrar to publish the audited accounts of public enterprises	To improve transparency and accountability of public enterprises	September 30, 2015	
Include tabular information on each parastatal's revenues, expenditures, and profits and losses in Treasury Registrar Statements to Parliament (beginning with the September 2014 statements for the year ended June 30th, 2014)	To improve transparency and accountability of public enterprises	September 30, 2014	Not met. Implemented with delay. The report was published in November.
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	

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

December 18, 2014

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.

II. DEFINITIONS

Net international reserves

3. 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.

4. 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 March 31, 2014 (as recorded in the balance sheet of the BoT).

	US$ per currency unit
British pound	1.6649
Euro	1.3787
Japanese yen	0.0097
Australian dollar	0.9236
Canadian dollar	0.9082
Chinese yuan	0.1608
SDR	1.5456

Reserve money and reserve money band

5. 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

6. 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.

7. 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.

8. 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. 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.

Contracting or guaranteeing of external debt on nonconcessional terms

13. 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

14. 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 50 percent ownership, unless otherwise stipulated.[1] The ceiling on contracting and guaranteeing external nonconcessional debt is continuous and applies throughout the year.

15. 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 and program exchange rates

16. 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.

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

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 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 17). The cumulative shortfall will be the sum of all

[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.

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).

22. 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.

23. 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.

24. The end-2014/15 limit will be adjusted upward by the full amount of domestic arrears cleared during the fiscal year as confirmed by the report from the CAG, to be prepared no later than September 30, 2015.

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

Information	Reporting Institution	Frequency	Submission Lag
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 reserves.1	BoT and MoF	Monthly	4 weeks
Amount of payment claims outstanding of more than 30 days, 60 days, and 90 days for all government ministries. For each ministry, total claims outstanding to be divided into: (i) unverified claims; and (ii) claims verified but not yet paid.	MoF/AGD	Quarterly	4 weeks

Information	Reporting Institution	Frequency	Submission Lag
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
Monthly report on loans and advances to government by pension funds and other public entities not covered by the central government accounts	MoF	Monthly	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
COMMUNICATIONS DEPARTMENT

Press Release No. 15/02
FOR IMMEDIATE RELEASE
January 7, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First PSI Review for Tanzania

The Executive Board of the International Monetary Fund completed today the first review of Tanzania's economic performance under the program supported by the Policy Support Instrument (PSI)[1] and granted a waiver for the non-observance of the continuous assessment criterion on the non-accumulation of external arrears.

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 equitable growth and job creation.

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

"Macroeconomic developments in Tanzania remain favorable. Economic growth was strong during the first half of 2014 and is expected to remain close to 7 percent. Inflation remains in mid-single digits, consistent with the authorities' target of 5 percent by June 2015.

"Performance under the Policy Support Instrument was satisfactory through June, but has deteriorated since and risks have risen, stemming from delays in disbursements of donor assistance and external nonconcessional borrowing, and shortfalls in domestic revenues. Against this backdrop, the authorities' commitment to keep the program on track is welcome, and they have reaffirmed their intention to meet the budget deficit target and will review revenues and adjust expenditures accordingly in the context of the mid-year budget review. It will be critical to

[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 business environment to address the governance issues raised by the IPTL case, which would also unlock donor assistance.

“It will be important to strengthen the coordination between fiscal and monetary policies. The conversion of monetary policy instruments to financing papers facilitated the front-loading of capital expenditures but complicated monetary policy implementation. It will be more effective and less disruptive to accommodate the planned expenditure through better planning to align spending and financing.

“The issue of domestic arrears, which continued to accumulate, needs to be addressed comprehensively and forcefully. Work to verify and eventually clear arrears to suppliers already incurred is ongoing. The authorities’ plan to prevent future arrears accumulation is appropriately ambitious and will require sustained implementation. Addressing arrears to pension funds and making government relations with them more transparent is also critical to their sustainability.”

Statement by Ms. Kapwepwe, Executive Director for
United Republic of Tanzania
January 7, 2015

My Tanzanian authorities appreciate the productive engagement with the Fund, especially under the current Policy Support Instrument (PSI) arrangement. Since the inception of the new PSI, the economy has performed well. Program performance has been broadly good. The major challenge remains revenue shortfall that has already affected the pace of policy and program implementation. In spite of this, the authorities are determined to keep the program on track through continuous execution of appropriate policies. Some of these policies are enumerated in the Memorandum of Economic and Financial Policies (MEFP) attached to the staff report.

Recent Developments, Risk and Outlook

Economic performance in Tanzania has generally been strong, with real GDP growth averaging 7.0 percent over the last decade, including 2014. Headline inflation moderated to 5.8 percent y-o-y in November 2014 from the general upward trend recorded since January 2014 on account of discreet monetary policy stance and reduced supply bottlenecks.

Fiscal management has been challenging due to revenue underperformance coupled with dwindling external budgetary support and weaknesses in the public financial management (PFM) system. This notwithstanding, fiscal deficit is projected to decline in the medium-term. In addition, the pressure on the external sector is easing, with the current account deficit projected to decline on account of good performance of non-traditional exports and lower oil imports. The exchange rate has remained broadly stable, although there has been a slight depreciation of the Tanzanian shilling against the US dollar, and international reserves have been adequate to cover at least four months of imports.

The main risks to the economy are uncertainty about budget support and revenue shortfalls. Protracted delays in donor disbursements due to a governance issue with Independent Power Tanzania Ltd (IPTL) and continued revenue underperformance could derail budget implementation and further compound domestic arrears problem, especially if expenditure is not controlled. The positive side is that the authorities have taken steps to address the governance concerns of IPTL. As indicated in the staff report, Government investigation into the case has been concluded and Parliament’s recommendations are awaiting implementation.

Overall, the macroeconomic outlook remains favorable. Economic growth is projected to remain at about 7 percent in the medium term, on account of sustained good performance of the manufacturing and services sectors. A positive impact on growth and balance of payments is also expected from lower cost of power generation and reduced demand for expensive heavy fuel imports following the completion of a natural gas pipeline and gas- fueled power plants now under construction. Inflation is expected to stabilize at around the authorities’ 5 percent target.

Program Performance

Against the backdrop of impressive performance in previous Fund-supported program, the overall performance under the current PSI arrangement is broadly satisfactory. The performance would have been better but for the unexpected fiscal pressures experienced in the early days of the program. All the assessment criteria (AC) and most structural benchmarks (SBs) for end-June 2014 were met. The continuous AC on external arrears was not met due to tight financial situation experienced early in the year which prevented arrears payments. For end-September 2014, most indicative targets and SBs were either not met or met with delay owing mainly to circumstances beyond the authorities' control. However, the authorities are resolute to keep the program on track and are working assiduously to ensure that all targets and benchmarks in future reviews are met.

Policies Going Forward

Fiscal Policy
The authorities' focus is on addressing the emerging fiscal risk, particularly budget support uncertainty and revenue shortfall with the overall objective of achieving fiscal and debt sustainabilities in the medium-term. Accordingly, serious attention would be given to improving domestic revenue mobilization, including broadening of the tax revenue base and keeping expenditures within the revenue envelope, while preserving the requisite development and social expenditures. In this regard, significant actions to boost revenue have already been outlined in the 2014/15 budget and further measures are expected during the mid-year budget review. Efforts are also underway to enhance transparency of fiscal operations of all public institutions that collect revenues, including ensuring that excess funds are deposited into the Government Consolidated Fund.

Public spending would continue to be oriented towards social and productive sectors, including transportation and energy infrastructure. In doing this, steps would be taken to consistently align expenditures to expected revenues and ensure that the near-term fiscal deficit target is met while also gradually reducing it to below 3 percent of GDP in the medium-term in line with the East African Monetary Union Protocol.

Within the program period, the Tanzanian authorities would continue to rely on grants and concessional and non-concessional loans to finance key development projects. In doing this, the authorities are mindful of the need to strengthen the institutional framework for managing public debt and preserving debt sustainability. A decision to establish a Debt Management Department within the Ministry of Finance has already been taken. Further, a National Debt Management Policy is being developed and the Government Loans, Guarantees and Grants Act is to be amended to strengthen management of public debt and provide the legal backing for the new Debt Management Department.

Domestic arrears to the Public Service Pension Fund (PSPF) and suppliers are also receiving attention. As indicated in paragraphs **27 through 30 of MEFP,** appropriate strategies have been developed to prevent further accumulation, ensure orderly payment and eventual clearance of the arrears, including making adequate budgetary provision. An important component of this strategy is to strengthen the PFM framework by amending the Public Finance Act and enacting a new Budget Act. The Laws would expand the coverage of the PFM legal framework, streamline PFM practices, and strengthen enforcement.

Monetary and Exchange Rate Policies

Monetary policy would continue to support the broader macroeconomic policy objectives of government, including maintaining low and stable inflation and enhancing access to banking services for the under-banked. In the past years, a cautious monetary policy stance helped keep inflation within single digit. This monetary policy stance is expected to continue in the near-term while sustained efforts would be made towards modernizing the monetary policy framework. The ultimate goal is to transit to a price-based monetary policy framework. In this respect, a retreat on the new framework has been held for the BOT Board of Directors while the BOT's macro-modeling and forecasting capacity is being enhanced. The BOT is also working towards better understanding of the relationship between interbank market rates and bank's excess reserves in order to reduce interest rate volatility in the process of liquidity management. In addition, the BOT intends to move to partial required reserve averaging so as to provide banks with more flexibility in liquidity management. Furthermore, coordination of fiscal and monetary policies would be enhanced.

On exchange rate, government's intention is to allow market forces to drive its movement. Intervention in the foreign exchange market by the BOT would be limited to smoothening excessive volatility of the exchange rate and liquidity management. The authorities also plan to fully liberalize the capital account with the rest of the world, by December 2015, in the context of the East African Community Common Market Protocol.

Financial Sector Stability

Apart from the troubled FBME bank which is under BOT's statutory management, the banking system remains well capitalized, profitable and liquid even with a slight uptick in non-performing loans. However, the Bank of Tanzania intends to further sharpen and reinforce supervisory and regulatory frameworks (with the assistance of the Fund) in order to ensure greater resilience of the financial system. To date, new regulations that provide a legal and organizational framework for consolidated supervision of complex financial institutions with substantial cross-border holdings have been made while relevant institutional capacity is being built. The BOT also plans to ensure effective implementation of the AML/CFT framework. Complementary efforts to further deepen the financial system and boost financial inclusion are being undertaken, including the establishment of the Enterprise Growth Market, which allows small businesses to access capital, and mobile payment services.

Other Reforms

Other reforms are also underway to improve the resilience of the Tanzanian economy. The objective of these reforms is to enhance the public sector's support for growth while enhancing private participation in the economy. Among them are measures that seek to restore the financial sustainability of the national utilities company, TANESCO, and improve electricity generation. These include electricity tariff adjustments, injection of additional financial resources into the company and completion of the new gas pipeline and gas fueled power plants. The authorities are also developing an enduring institutional arrangement to transparently manage anticipated revenues from natural gas exploitation. This is in addition to ongoing efforts to improve the business climate and enhance competitiveness of the economy.

Conclusion

My Tanzanian authorities' track record of fruitful engagement with the Fund and the impressive performances under the past Fund-supported programs provides sufficient grounds to ensure that the current PSI arrangement would be successfully completed. The slight underperformance noticed in the first review was due to exceptional circumstances as outlined and the authorities have since taken appropriate measures to address it. In this regard, we urge Executive Directors to support my authorities' request for the completion of the first review, modification of assessment criteria on NIR and NDF for end-December 2014 and end-June 2015, and a waiver for non-observance of a continuous assessment criterion on non-accumulation of external arrears.