



UNITED REPUBLIC OF TANZANIA

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SECOND REVIEW UNDER THE POLICY SUPPORT INSTRUMENT—DEBT SUSTAINABILITY ANALYSIS

Approved By

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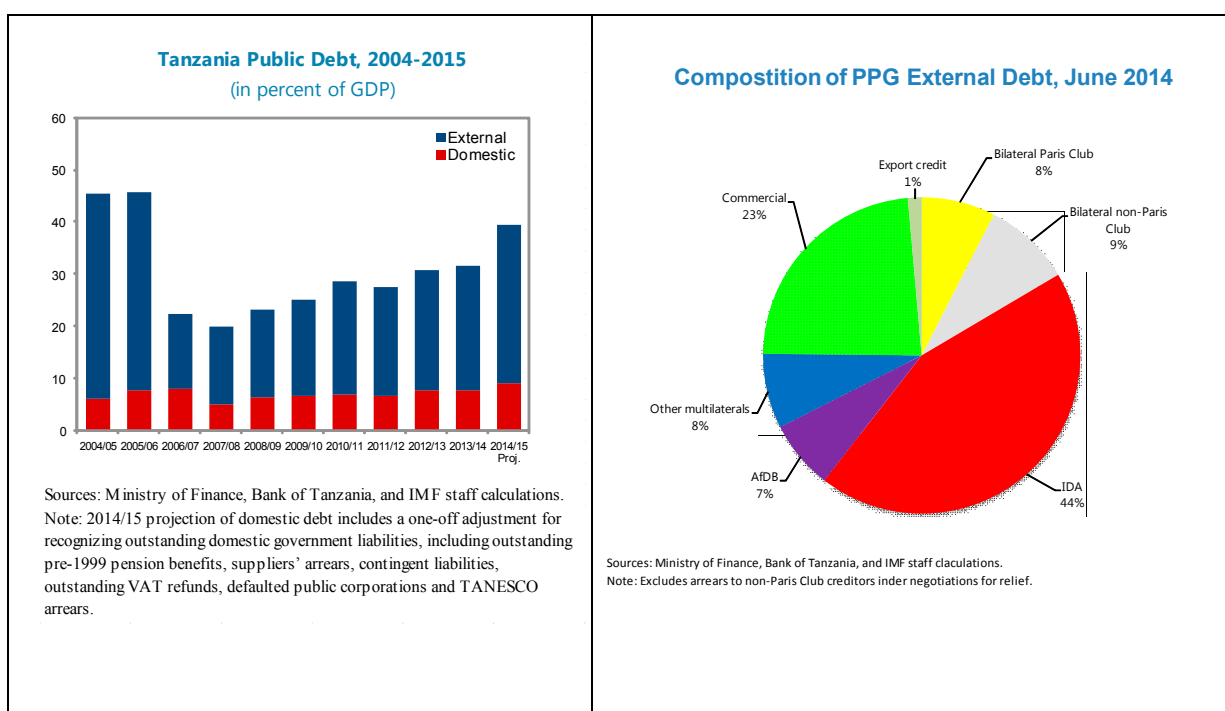
Risk of external debt distress:	Low
Augmented by significant risks stemming from domestic public and/or private external debt?	No

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

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

BACKGROUND

1. Tanzania's public and publicly guaranteed (PPG) external debt as a share of GDP has steadily increased in recent years¹ (Text Figure left panel). Since the Multilateral Debt Relief Initiative (MDRI) in 2006/07, which reduced total public debt-to-GDP ratio from 47 percent to 19 percent, PPG external debt (excluding arrears under negotiation for relief) has increased to about 29 percent of GDP at end-June 2014, or 17 percent of GDP in present value terms using a 5 percent discount rate. Total public sector debt (external plus domestic public debt) stood at about US\$17.2 billion or 36 percent of GDP at end 2013/14, rising from 27.5 percent at end 2007/08.



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

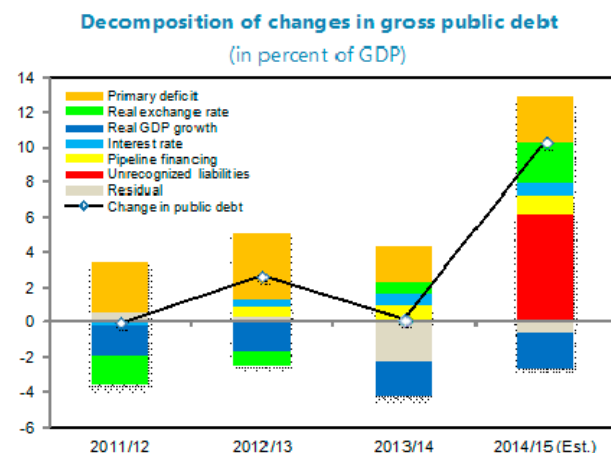
¹ Tables and Figures are in fiscal years (July–June). For example, 2014 refers to fiscal year 2014/15.

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

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

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

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



Source: IMF Staff calculations.

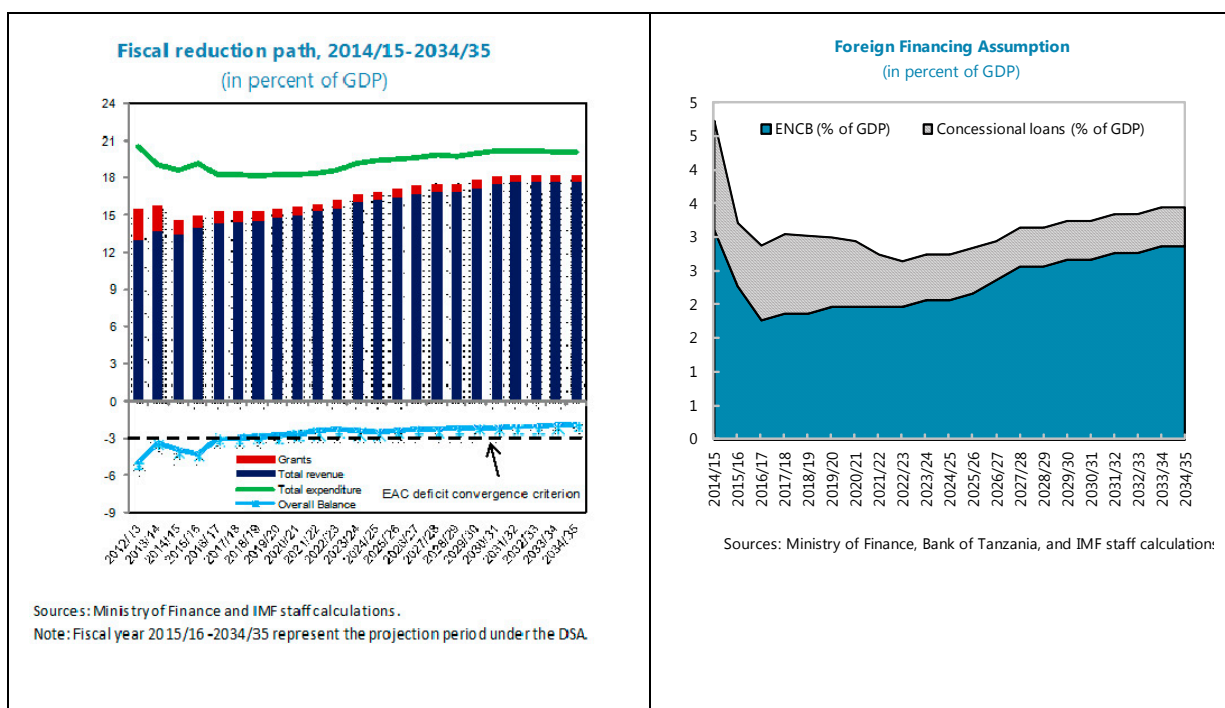
² Unpaid claims of duration above 90 days for construction work and above 30 days for others, estimated as of end-December 2014. Ministries with large claims include Works, Health, Education, Agriculture, Home Affairs, and Defense.

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

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

UNDERLYING ASSUMPTIONS

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



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

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

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

EXTERNAL DSA

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

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

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

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

⁶ See footnote 1.

Box 1. Key DSA Assumptions

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

Selected Macroeconomic Indicators, Current vs. Previous DSA

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

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

PUBLIC DSA

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

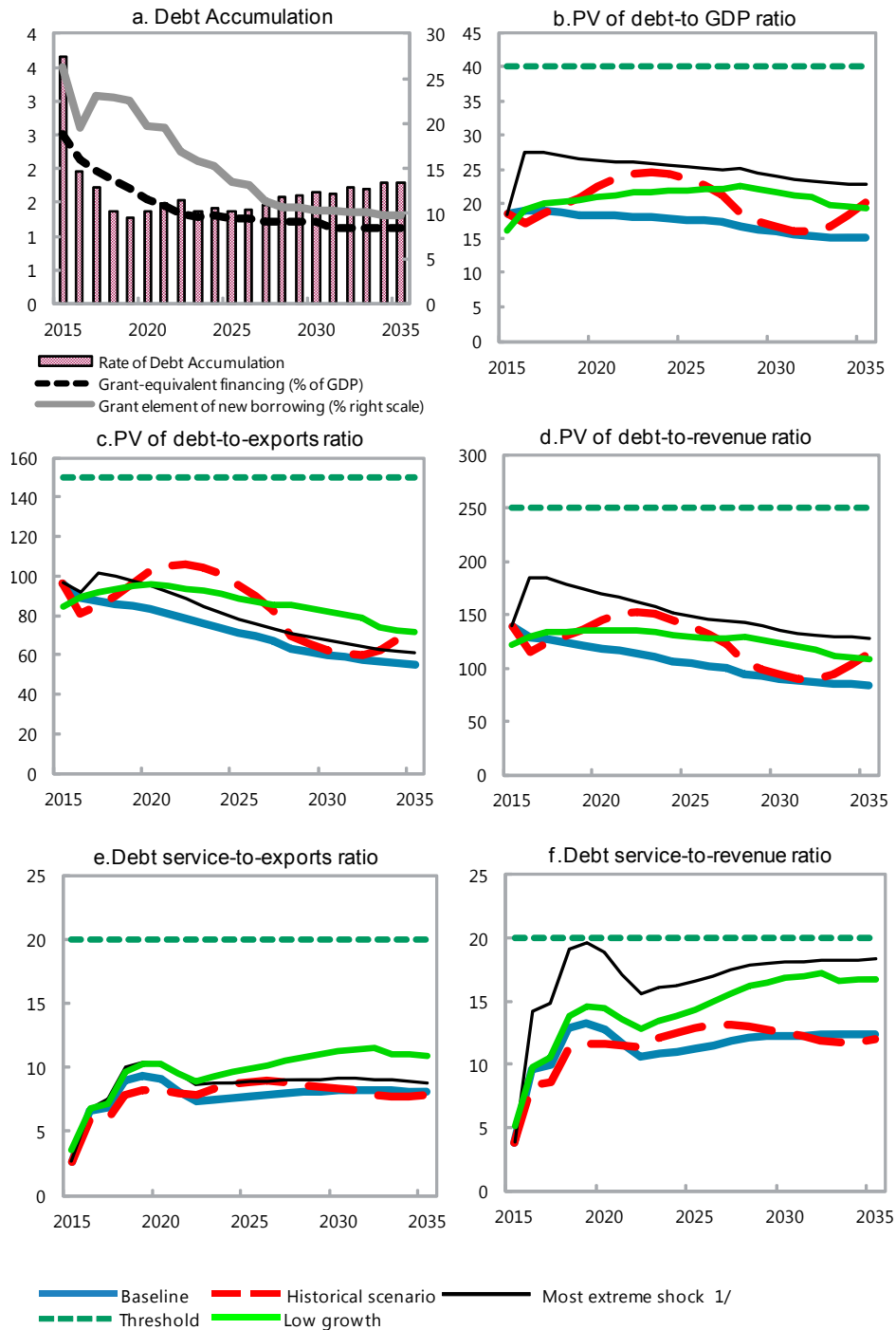
14. Stress tests confirm the importance of continued prudent fiscal policy. In a scenario assuming that the primary deficit (as a percent of GDP) remains at the projected 2015 level over the entire projection period, the PV of public debt would keep gradually growing. The debt service to revenue ratio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

CONCLUSION

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

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

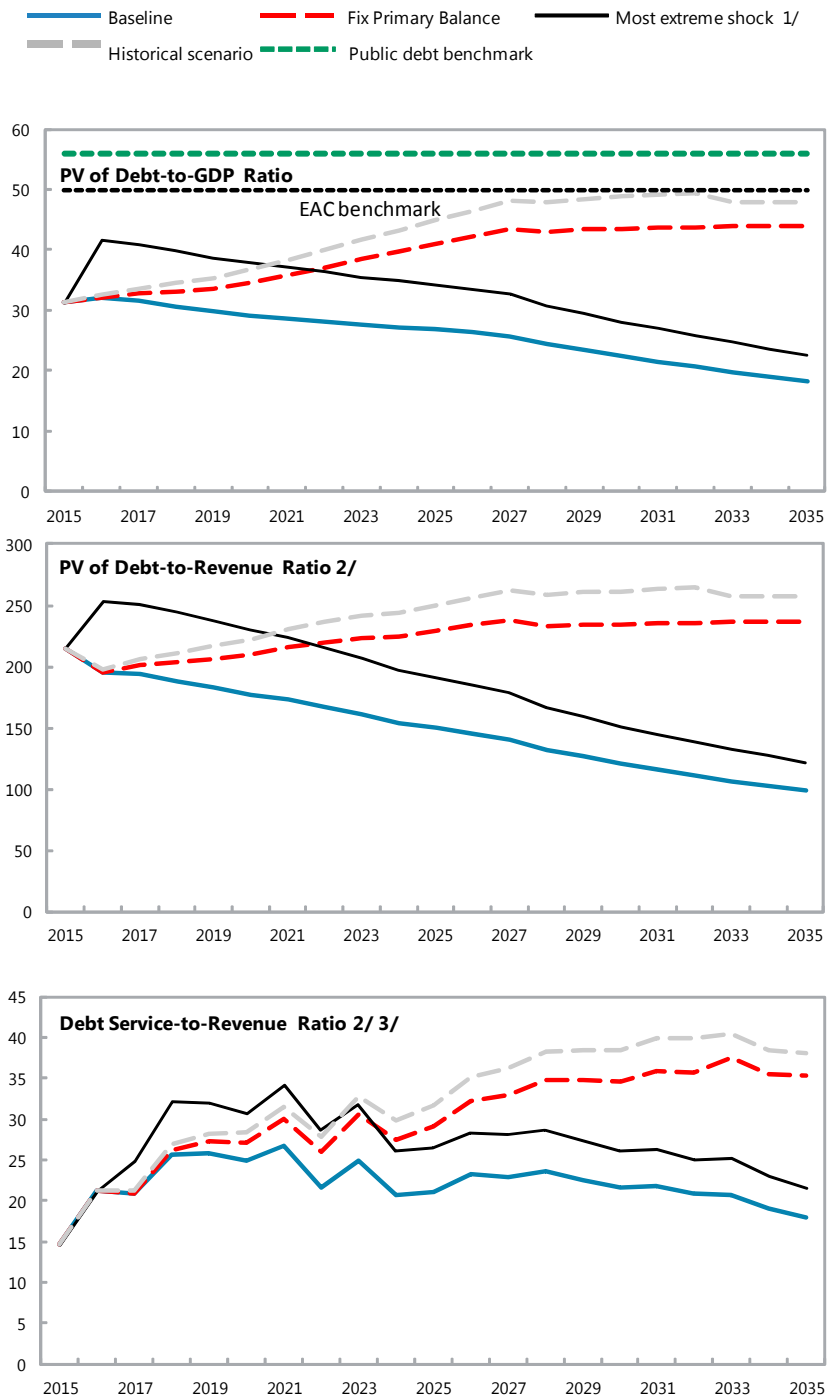
Figure 1. Tanzania: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2015–2035^{1/}



Sources: Country authorities; and staff estimates and projections.

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

Figure 2. Tanzania: Indicators of Public Debt Under Alternative Scenarios, 2015–2035^{1/}



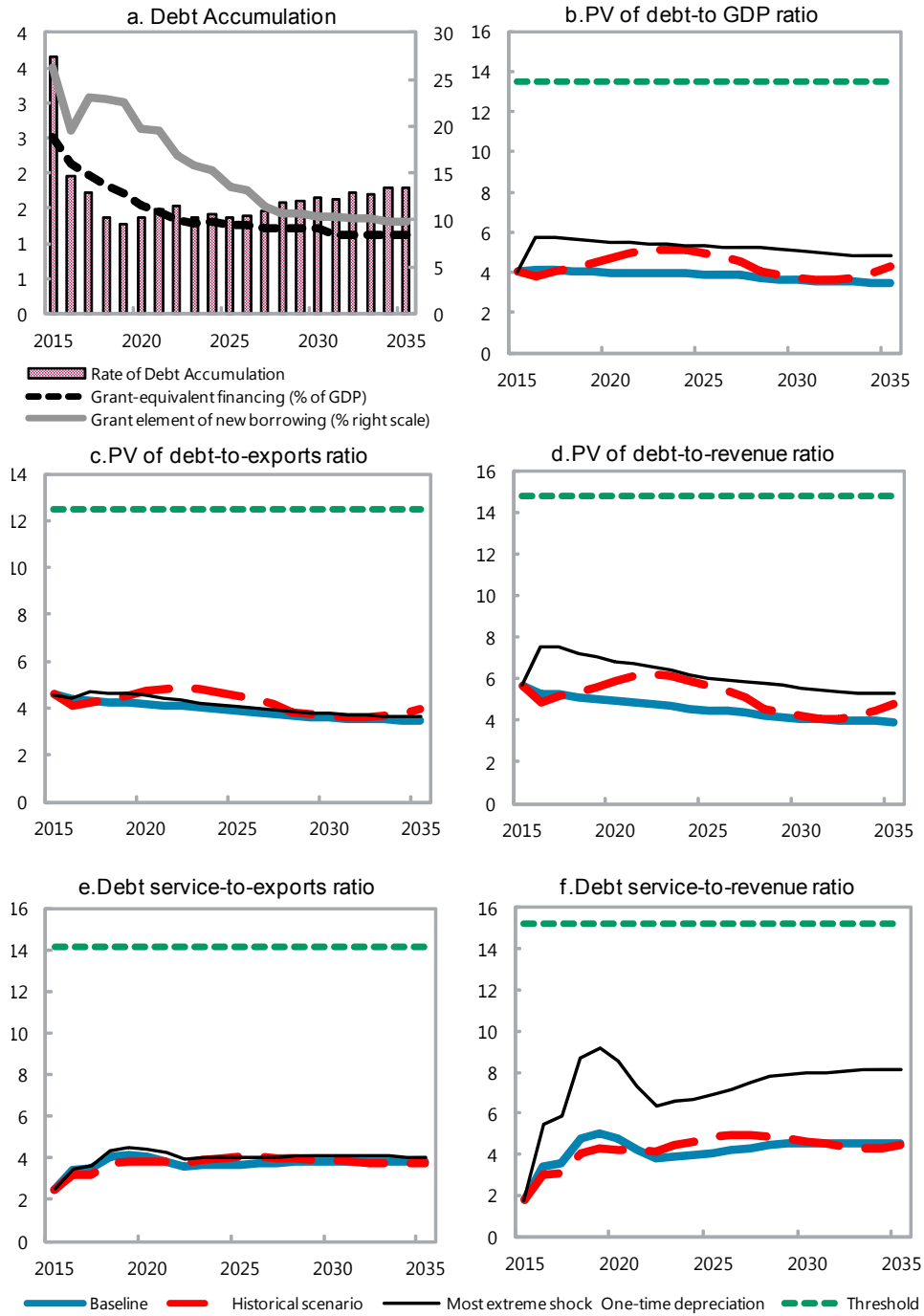
Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

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

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



Sources: Country authorities; and staff estimates and projections.

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

Table 2. Tanzania: Public Sector Debt Sustainability Framework, Baseline Scenario, 2012–2035
(In percent of GDP, unless otherwise indicated)

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

Sources: Country authorities; and staff estimates and projections.

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

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

3/ Revenues excluding grants.

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

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

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

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

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

(In percent)

Debt service-to-exports ratio								
Baseline	3	7	7	9	9	9	8	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015–2035 1/	3	6	6	8	8	8	9	8
A2. New public sector loans on less favorable terms in 2015–2035 2/	3	7	6	8	7	8	7	10
A3. Alternative Scenario : Low growth	4	7	7	10	10	10	10	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016–2017	3	7	7	9	9	9	8	8
B2. Export value growth at historical average minus one standard deviation in 2016–2017 3/	3	7	7	10	10	10	9	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016–2017	3	7	7	9	9	9	8	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016–2017 4/	3	7	7	9	9	9	8	8
B5. Combination of B1–B4 using one-half standard deviation shocks	3	7	7	8	9	8	7	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	3	7	7	9	9	9	8	8
Debt service-to-revenue ratio								
Baseline	4	10	10	13	13	13	11	12
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2015–2035 1/	4	8	9	11	12	12	13	12
A2. New public sector loans on less favorable terms in 2015–2035 2/	4	10	9	11	11	11	10	16
A3. Alternative Scenario : Low growth	5	10	10	14	15	14	14	17
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2016–2017	4	10	10	13	14	13	11	13
B2. Export value growth at historical average minus one standard deviation in 2016–2017 3/	4	10	10	13	14	13	12	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2016–2017	4	9	9	12	12	12	10	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2016–2017 4/	4	10	10	13	13	13	11	12
B5. Combination of B1–B4 using one-half standard deviation shocks	4	9	9	11	11	10	9	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2016 5/	4	14	15	19	20	19	17	18
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	6	6	6	6	6	6	6	6
Sources: Country authorities; and staff estimates and projections.								
1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.								
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.								
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).								
4/ Includes official and private transfers and FDI.								
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.								
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.								

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

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

Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

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

July 6, 2015

1. Tanzania's strong macroeconomic fundamentals and performance, partly supported by successive Policy Support Instrument (PSI) arrangements with the Fund, have helped sustain the growth momentum, in spite of the challenges from the global economic environment. The steadfast implementation of the authorities' Five Year Development Plan and the current national growth strategy, MKUKUTA II, have accelerated the attainment of broad-based and inclusive growth and considerably reduced the incidence of poverty.
2. The authorities are appreciative of the constructive engagement with the Fund, including within the context of the ongoing PSI program and the provision of essential technical assistance. They thank staff for the candid policy dialogue which has guided implementation of their macroeconomic policy and development agenda. They remain committed to pursuing prudent macroeconomic policies, while further deepening their structural reform agenda, including laying a solid foundation for the management of the new gas economy. In line with this, the authorities request Executive Directors' support for the completion of the second review of the PSI and modification of assessment criteria.

Program performance

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

Recent economic developments

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

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

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

Near to medium-term outlook and policies

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

Fiscal policy and related reforms

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

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

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

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

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

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

Monetary and exchange rate policies

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

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

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

Financial sector stability

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

Other reform measures

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

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

Conclusion

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