



UNITED REPUBLIC OF TANZANIA

July 2017

SIXTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT AND REQUEST FOR A SIX-MONTH EXTENSION OF THE POLICY SUPPORT INSTRUMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE UNITED REPUBLIC OF TANZANIA

In the context of the sixth review under the Policy Support Instrument and request for a Six-Month Extension of the Policy Support Instrument, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 23, 2017, following discussions that ended on May 12, 2017, with the officials of the United Republic of Tanzania on economic developments and policies underpinning the IMF arrangement under the Policy Support Instrument. Based on information available at the time of these discussions, the staff report was completed on June 12, 2017.
- A **Statement by the Executive Director** for the United Republic of Tanzania.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of the United Republic of Tanzania*

Memorandum of Economic and Financial Policies by the authorities of United Republic of Tanzania*

Technical Memorandum of Understanding*

*Also included in Staff Report

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

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IMF Executive Board Completes Sixth PSI Review for Tanzania and Approves Six-Month Extension of the Program

- Program aims to maintain macroeconomic stability and promote more equitable growth.
- Performance under the program has been satisfactory, macroeconomic performance has been strong, and medium-term outlook remains favorable.
- Sustained implementation of reforms, including to create a better and more predictable business environment, is critical.

On June 23, 2017, the Executive Board of the International Monetary Fund completed the sixth review of Tanzania's economic performance under the program supported by the Policy Support Instrument (PSI).¹

In completing the review, the Board approved the authorities' request for a six-month extension of the current PSI arrangement and granted a waiver for the nonobservance of the end-December 2016 assessment criterion on tax revenues because the slippage was minor. The PSI program has been instrumental for Tanzania in sustaining macroeconomic stability. It is against this background that the extension was approved from July 2017 to January 2018 to cover the period of negotiations for a successor PSI.

The PSI for Tanzania was approved by the Board on July 16, 2014 (see [Press Release No. 14/350](#)). Tanzania's program under the PSI aims at maintaining macroeconomic stability and promoting a more equitable growth. The program supports the authorities' objectives on reforms to strengthen public finance management practices, improve efficiency and transparency of public spending, and enhance revenue mobilization. Through these efforts, the program aims to provide the fiscal space to allow for infrastructure and priority social spending.

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 current PSI are available at www.imf.org/tanzania.

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

“Tanzania’s performance under the Policy Support Instrument has been satisfactory, macroeconomic performance has been strong, and the medium-term outlook remains favorable. Going forward, continued sound macroeconomic policies and increased efforts to advance structural reforms will be essential to sustain macroeconomic stability and high economic growth, and deliver on the development agenda.

“Budget execution in 2016/17 faced challenges, mainly due to external financing shortfalls that led to low execution of capital spending and a tight liquidity situation. Recent efforts to step up external financing mobilization and ease the liquidity situation should help enhance budget implementation, avoid further accumulation of domestic payment arrears, and support credit to the private sector.

“The 2017/18 budget reaffirms the authorities’ objective of scaling up public investment while preserving fiscal sustainability. However, potentially overoptimistic revenue projections call for its prudent implementation, including by delaying some large projects until the availability of revenues is confirmed during the mid-year budget review. The authorities are committed to pursue further public financial management reforms, including strengthening commitment controls to limit the accumulation of new domestic payment arrears.

“Recent measures to loosen the monetary policy stance are appropriate given the benign inflation outlook and decelerating credit growth. Going forward, the duration and extent of monetary loosening should be coordinated with fiscal developments. Efforts to transition toward a forward-looking monetary policy framework should continue swiftly. Plans to foster credit standards and increase capital buffers are key initiatives to ensure the banking system’s soundness.

“To achieve the authorities’ development agenda and maintain high economic growth, sustained implementation of reforms, including to create a better and more predictable business environment, is critical.”



UNITED REPUBLIC OF TANZANIA

June 12, 2017

SIXTH REVIEW UNDER THE POLICY SUPPORT INSTRUMENT AND REQUEST FOR A SIX-MONTH EXTENSION OF THE POLICY SUPPORT INSTRUMENT

KEY ISSUES

Tanzania's macroeconomic performance has been strong, albeit with a recent deceleration in economic growth. GDP grew by 7 percent in 2016. High frequency data, however, suggest a weakening of economic activity in late 2016. Inflation remains moderate and is expected to fall towards the authorities' 5 percent target. Key risks to the outlook are linked to slow budget implementation from financing shortfalls.

Program performance under the PSI has been broadly satisfactory. Most quantitative targets for December 2016 and March 2017 were met. While progress in structural reforms identified under the program has been generally slow, the authorities have stepped up efforts to advance them.

The government is implementing an ambitious development and reform agenda. The second Five-Year Development Plan aims at accelerating the economy's structural transformation by addressing the infrastructure gap and nurturing human development through a large increase in development expenditures. The authorities continue to push their drive against corruption and tax evasion, which is leading to higher fiscal revenues and reduced low-priority government spending. A better, more predictable business environment and strengthening of the government's dialogue with all stakeholders, including the private sector, will be crucial to achieve the Plan's envisaged private sector-led growth.

Macroeconomic policies will need to be closely coordinated. After a slow budget implementation during the first nine months of FY16/17, the government has stepped up its efforts to raise external financing and implement the public investment budget. The BoT has taken measures to ease the tight liquidity situation and support credit to the private sector. The monetary stance will need to be closely coordinated with fiscal developments, particularly in the face of a planned recovery in fiscal spending.

Staff supports the authorities' request for a 6-month extension of the PSI arrangement and recommends completion of its sixth review.

Approved By
Roger Nord (AFR) and
Daria Zakharova
(SPR)

A staff team consisting of Mr. Villafuerte (head), Mr. Jang, Ms. Radzewicz-Bak (all AFR), Mr. Tapsoba (FAD) and Mr. Iizuka (SPR) visited Dodoma and Dar es Salaam during April 3–13 and May 10–12, 2017. Messrs. Mukhopadhyay (Resident Representative) and Rutachururwa, and Ms. Shayo (local economists) assisted the mission. M. Attey and B. Tenison provided administrative and research support. Mr. Odonye (OED) participated in the discussions. The mission met with Minister of Finance and Planning Mpango; Bank of Tanzania Governor Ndulu; Permanent Secretary of the Treasury James; other senior officials; development partners; and representatives of the private sector and civil society.

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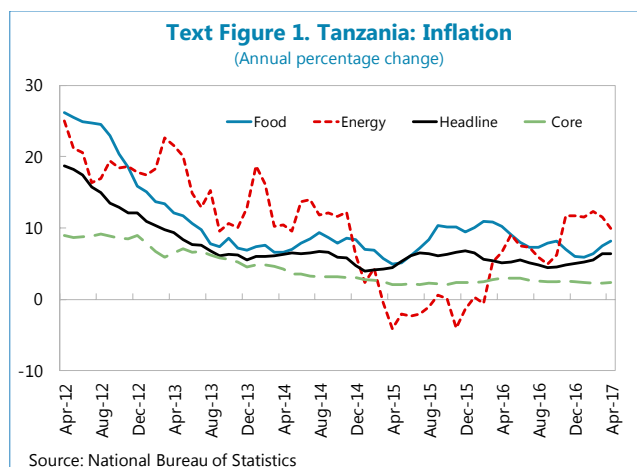
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RECENT DEVELOPMENTS

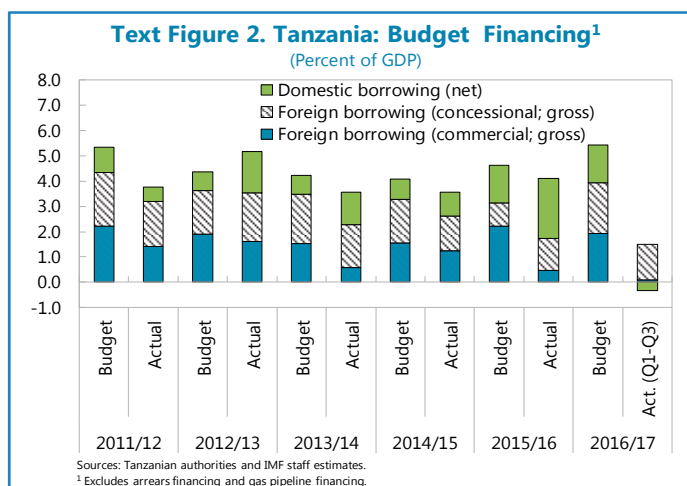
1. **Macroeconomic performance has been strong, albeit with growth slowing in late 2016.** Real GDP grew by 7 percent in 2016, in line with the authorities' targets, with activity particularly buoyant in the mining, construction, communication, and transportation sectors.

Quarterly GDP data and high frequency indicators, however, suggest a weakening of economic activity in late 2016 (with growth of 5.6 percent (yoy) in Q4 2016) and early 2017, reflecting slow budget execution, subdued private sector credit growth, and the impact of a drought. The drought led to an increase in 12-month inflation to 6.4 percent in April—somewhat above the authorities' target of 5 percent—with food prices rising by 12.0 percent (yoy).¹ However,



core inflation (excluding food and energy) remains subdued at 2.3 percent. The external current account deficit is estimated to have continued to narrow to 1.6 percent of GDP in the first half of 2016/17 due to lower imports of capital goods. Gross international reserves have increased to about 4 months of import cover in March 2017. After being stable in 2016 in the context of lower imports, the Tanzanian shilling has depreciated 3 percent since early 2017. The exchange rate appreciated slightly in real effective terms over that period (Figure 3).

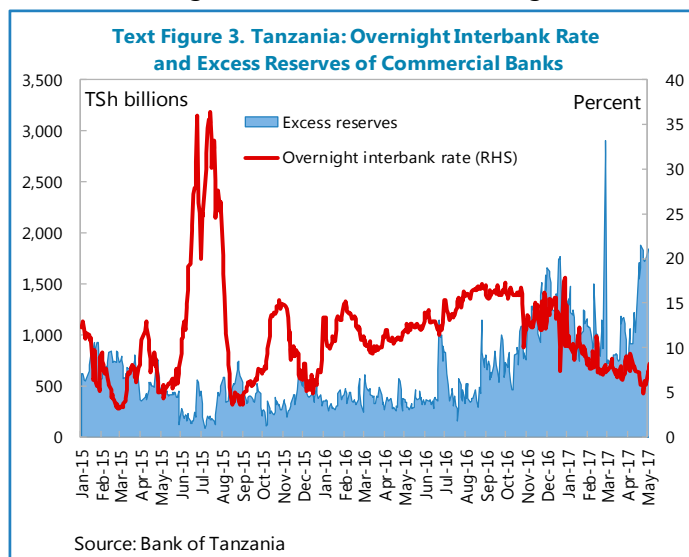
2. **Budget implementation in 2016/17 has faced challenges, largely on account of external financing shortfalls.** The 2016/17 budget and the program envisaged large increases in capital spending and revenue, and an overall fiscal deficit of 4.6 percent of GDP. Budget execution in July 2016–March 2017 was slower than expected, resulting in a deficit of 0.6 percent of GDP compared to a programmed deficit of 3.3 percent of GDP. Revenue was broadly in line with the program. Spending, particularly capital, was low due to external financing shortfalls, strengthened controls to rein in unproductive spending, and a more centralized and



¹ Some regions in Tanzania recently faced a drought, leading to food shortages there and higher food prices. Although maize prices increased by more than 80 percent (yoy) in April, the prices of other major food crops rose only modestly. According to the FAO, some 1.2 million people (out of total population of 49 million) are facing food shortages, and about 118,000 people are in dire need of help.

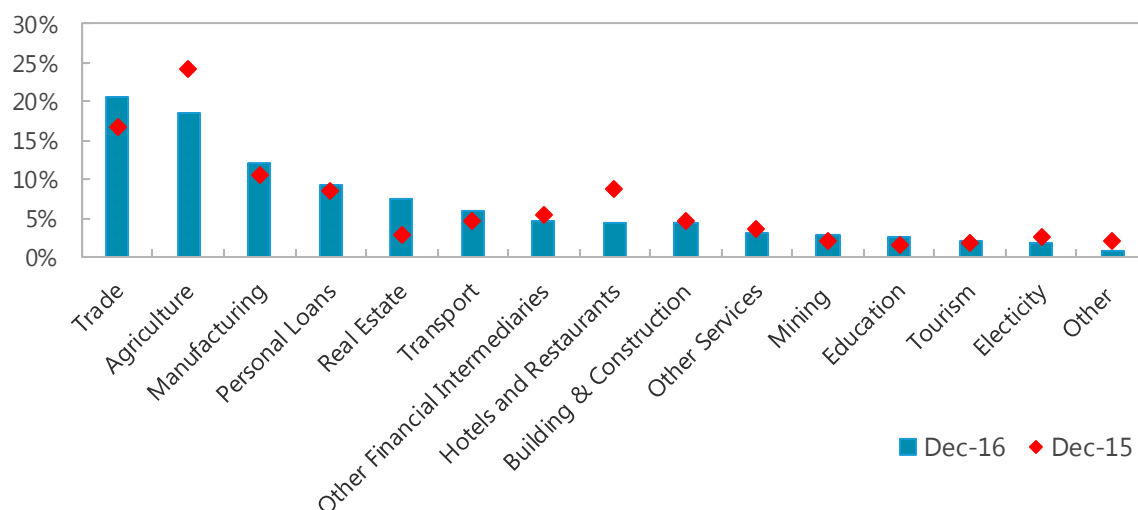
deliberate approach to decision-making. External financing shortfalls have been due to delays in contracting non-concessional loans (obtainment of a sovereign rating from a credit rating agency is still pending) and slower than expected mobilization of concessional financing due to delays in project preparation and implementation. The repayment of VAT refunds has slowed substantially because of ongoing audits.

3. **The monetary stance has continued to be tighter-than-programmed.** Average reserve money, the BoT's operational target, has consistently undershot targets, declining by 1.5 percent (yoy) in March. Under-execution of the budget due to external financing shortfalls and the transfer of public institutions' deposits from commercial banks to the BoT have tightened domestic liquidity. The BoT has partly alleviated it through reverse repos, unsterilized foreign exchange (FX) purchases, and FX swaps with banks. Those actions have helped stabilize and, recently, reduce the overnight interbank rate (text figure). In addition, the BoT recently lowered its discount rate (from 16 to 12 percent in March) and the statutory minimum reserve requirement (from 10 to 8 percent in April). Nonetheless, deposit and lending rates have not followed suit, reflecting weaknesses in the monetary transmission mechanism and structural issues in the banking sector. Annual broad money and private sector credit growth slowed to 4.1 percent and 3.7 percent, respectively, as of end-March.



4. **Nonperforming loans (NPLs) have continued to rise.** The NPL ratio rose to 9.6 percent in December 2016 from 7.9 percent a year ago, reflecting in particular significant increases in NPLs of the trade and real estate sectors in the context of a sharp fall in imports and falls in prices/increases in vacancy rates in residential and commercial properties. Although system-wide indicators show that the banking sector is well-capitalized, liquid, and profitable, there is considerable variation across banks. The BoT put a small state-owned bank, Twiga Bancorp, under administration in October 2016 for not meeting capital standards, and is currently reviewing applications from investors who are interested in injecting new capital in the bank. In early May, the BoT closed FBME Bank, which was named as being of primary money laundering concern by U.S. authorities in 2014, and placed it under liquidation. (MEFP ¶10-11)

Text Figure 4. Tanzania: Percentage contribution to NPLs by sector in 2015 and 2016



Source: Bank of Tanzania and IMF staff calculations

PROGRAM PERFORMANCE

Program implementation for the sixth PSI review

5. **Macroeconomic management has been broadly satisfactory.** Most quantitative targets for December 2016 and March 2017 were met, except for the assessment criterion on tax revenue that was missed by a small margin (0.01 percent of GDP).² Preliminary data indicate that the stock of domestic payment arrears (an indicative target for December 2016) increased during October–December 2016 by 0.5 percent of GDP to 1.9 percent of GDP, but this is reportedly mostly due to the addition of unverified claims from previous fiscal years.³ Staff supports a waiver for the non-observance of the end-December 2016 assessment criterion on tax revenues on the grounds that the slippage was minor.

6. **Progress with structural benchmarks, however, has been slow.** 2 out of 5 structural benchmarks were met as scheduled. The BoT Board approved the plan to move to an interest

² With regard to a claim made by Wallis Trading arising from government guarantees provided to Air Tanzania Company Limited (ATCL), its status remains unchanged since the 3rd PSI review. The audit of ATCL, which will help determine the validity of the claim on ATCL, was not completed at the time of discussions with staff. In addition, the authorities have not yet made a final determination on the validity of a loan contracted from Belgium in the early 2000s. These disputed claims are not considered to give rise to external arrears for program purposes at this time. Tanzania owes pre-HIPC Initiative arrears to non-Paris Club creditors which continue to be deemed away under the revised policy on arrears to official bilateral creditors, as the underlying Paris Club agreement is adequately representative and the authorities have made best efforts to resolve the arrears.

³ The stock of arrears is subject to a full verification exercise at the end of each FY. During a FY, claims that were rejected earlier but that are able to gather additional supporting documents are added to the stock of arrears, but they will be only formally verified for payment at the end of the FY. This is one of the reasons why the target for non-accumulation of domestic arrears is only an indicative target (IT) for end-December under the program.

rate-based monetary policy framework early this year and proceeded to review its collateral framework. However, the settlement of government arrears to pension funds was not met despite a successful completion of the verification exercise given a delay in Cabinet approval of the settlement strategy, but is expected to be completed by September.

Overall performance under the 2014-17 PSI arrangement

7. **The Tanzanian authorities' economic program supported by the 2014-17 PSI arrangement has been marked by strong macroeconomic management and outcomes, but uneven implementation of structural reforms.** The PSI arrangement is originally scheduled to expire in July 2017, but the authorities have requested a six-month extension (see ¶25).

- **Fiscal policy.** Revenue and deficit outturns have been broadly in line with program targets. The tax-to-GDP ratio has increased by about 1½ percent of GDP since FY2014/15, supported by President Magufuli's drive against corruption and tax evasion, but there is room for further improvement through tax policy and administration reforms. The government has faced difficulties raising budgeted external financing.
- **Debt sustainability.** The most recent debt sustainability analysis (DSA) conducted in mid-2016 suggests that Tanzania could afford a higher fiscal deficit of up to 4½ percent of GDP for a few years and still maintain a low risk of debt distress.
- **Public financial management.** Progress has been made in improving the accuracy and timeliness of the fiscal data, but domestic payment arrears have been a recurring issue. Some progress has been made in enhancing financial reporting of parastatals and in the production of a fiscal risk statement.
- **Monetary policy.** The BoT has successfully implemented a reserve money targeting framework, holding inflation at single digit levels. However, slow progress has been made in moving to an interest rate-based monetary policy framework and other related reforms. International reserves have remained at about 4 months of imports.
- **Financial sector policies.** The level of financial development has improved in recent years, though at a gradual pace. Key financial markets need to be further developed and their functioning needs to improve. Nearly two-thirds of adults have access to financial services, mainly due to the expansion of mobile money. The banking supervision framework has been strengthened.
- **Business climate.** The business climate has not significantly improved in recent years. An important concern of the private sector is that the government has not consulted with them before introducing policy and regulatory changes and that a lack of timely communication of government strategies is negatively affecting their decision-making. To facilitate private sector-led growth, the second five-year development plan for 2016/17-2020/21 aims to address the infrastructure gap and create a business climate that is conducive to job creation.
- **Natural resource management.** Tanzania could become a major producer and exporter of natural gas in the next decade. Progress was made with the adoption of the Petroleum Act

and the Oil and Gas Revenue Management Act. Onshore gas fields have been developed in recent years, with increasing production volumes being directed to gas-fueled electricity plants. However, a number of issues related to the legal, tax, and regulatory environment still need to be resolved to allow investors to make investment decisions on a large-scale offshore natural gas development including the establishment of an LNG export plant.

POLICY DISCUSSIONS

A. Economic Outlook and Risks

8. **Tanzania's second Five-Year Development Plan, 2016/17–2020/21 (FYDP II) aims at economic transformation through industrialization and human development.** The industrialization strategy seeks to capitalize on Tanzania's comparative advantages, particularly its agricultural and mining potential, and geographic location making it a natural trading and logistics hub for East Africa. To facilitate private sector-led growth, the government aims to address the infrastructure gap, which remains large in Tanzania, and create a business environment that is conducive to job creation. Considering large investment needs, the government plans to rely on enhanced mobilization of domestic revenue and the use of public-private partnerships (PPPs) for large infrastructure projects to limit government borrowing. The associated medium- and long-term macroeconomic frameworks are being updated together with ongoing costing and feasibility studies of key projects.

9. **The macroeconomic outlook remains favorable.** Assuming that the government raises external financing and ramps up budget execution, GDP growth is projected at 6¼ percent in 2016/17 and about 7 percent in 2017/18. Good rains in Tanzania's southern region in recent months and easing of drought conditions in its neighbors are expected to relieve pressures on food prices so that headline inflation is expected to remain contained at 5–7 percent in 2017 in line with the authorities' medium-term target of 5 percent, and supported by prudent monetary policy. The external current account deficit is projected at about 5 percent of GDP in 2016/17 before increasing to about 7 percent of GDP in 2017/18 as the implementation of FYDP II leads to higher capital spending and imports. Nevertheless, with- larger projected inflows of project loans and external nonconcessional borrowing (ENCB), international reserves are expected to rise to US\$5.0 billion (4 months of prospective imports) in 2017/18.

Text Table 1. Tanzania: Selected Economic Indicators

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Real GDP growth (%)	7.0	7.0	6.2	6.8	6.8	6.8	6.7
Inflation (yoy, %, end-period)	6.1	5.5	5.8	5.0	5.0	5.0	5.0
Overall fiscal balance (cash basis, % of GDP)	-3.3	-3.5	-2.9	-3.9	-4.6	-4.6	-3.8
Government capital spending (% of GDP)	4.4	4.5	7.9	8.9	9.6	9.7	9.0
External current account balance (% of GDP)	-9.8	-6.6	-4.9	-6.8	-7.1	-7.0	-6.6
Gross international reserves (in months of next year's imports)	4.4	4.0	4.0	4.0	4.1	4.3	4.5

Sources: Tanzanian authorities and IMF staff estimates and projections.

10. **Key risks to the economic outlook stem from potential budget financing shortfalls.**

External financing shortfalls, including delays in donor disbursements, could lead to both lower government spending and economic activity, or a further accumulation of domestic arrears if commitment controls are not enforced. In this regard, a tightening of global financial conditions could also complicate budget financing through an increase in financing costs. Domestically, a prolonged slowdown in private sector credit growth and sustained private sector uncertainty about the government's economic strategies could also have a negative impact on economic activity and the strong private sector-led growth envisaged in FYDP II. Discussions centered on mitigating those risks and adjusting policies to sustain strong economic growth.

B. Fiscal Policy

11. **The 2016/17 budget is now targeting an overall deficit of less than 3 percent of GDP (rather than 4.6 percent under the original budget and the program).** The mid-year budget review determined that projected revenue and financing will be lower than budgeted, requiring expenditure adjustments mostly on development spending.⁴ Non-concessional borrowing of \$500 million (1 percent of GDP), together with a drawdown of government deposits available at the BoT, is expected to enhance budget execution in the last quarter of the fiscal year, including of capital spending on the standard gauge railway (SGR).⁵ Staff urged the authorities to secure the planned commercial borrowing soon and revise the expenditure envelope in line with available resources so as not to incur domestic payment arrears.

⁴ In particular, non-tax revenue is projected to underperform on account of lower transfers of parastatals' past dividends to the government. In the case of the Tanzania Port Authority, most of its projected transfers are being used to finance the port's expansion and the acquisition of scanners.

⁵ A contract worth about \$1.2 billion (2.4 percent of GDP) for construction of the first 200 km stretch of the SGR was signed in February with a consortium of Turkish and Portuguese companies, but its financing beyond budgetary contributions is not clear yet. The 2016/17 budget includes 0.9 percent of GDP for the SGR. The tenders for construction of the remaining 1,000 km of the SGR are underway. Last year, the EXIM Bank of China signed an MoU for the SGR project with the Tanzanian government to conduct a feasibility study and provide financing of up to \$7.6 billion. The results of the feasibility study remain to be verified.

**Text Table 2. Tanzania: Summary Fiscal Operations
(Percent of GDP)**

	2015/16	2016/17				2017/18	
	Act.	Q1-Q3		Annual		Annual	
		Prog.	Act.	Prog.	Revised prog.	Budget	Prog.
Total revenue	14.4	11.5	11.5	15.8	15.3	16.4	15.4
Tax revenue	12.8	9.8	9.7	13.2	13.0	14.0	13.2
Nontax revenue	1.5	1.7	1.7	2.6	2.3	2.4	2.2
Total expenditure	18.3	15.8	12.7	21.8	19.1	21.0	20.1
Recurrent expenditure	13.9	8.3	7.7	12.1	11.2	11.1	11.2
Development expenditure	4.5	7.5	4.9	9.6	7.9	9.8	8.9
Grants	0.5	1.0	0.7	1.3	0.9	0.8	0.8
Overall balance	-3.5	-3.3	-0.6	-4.6	-2.9	-3.8	-3.9
Financing	3.5	3.3	0.6	4.6	2.9	3.8	3.9
Foreign (net)	1.4	2.1	0.9	3.7	1.9	2.5	2.5
Domestic (net)	2.1	1.2	-0.3	0.9	1.0	1.3	1.5

Sources: Tanzanian authorities and IMF staff projections

12. **The draft 2017/18 budget targets a deficit of about 4 percent of GDP with increased development expenditure.** The draft budget envisages the revenue to GDP ratio to increase by about 1¼ percentage points, through tax policy reforms and a strengthening of tax administration (Text Table 3). On expenditures, it proposes an increase in development spending to about 10 percent of GDP. Current expenditure would continue to be contained through efforts to reduce non-priority spending. The budget provides for about 1.5 percent of GDP to clear expenditure arrears. The deficit would be financed both from domestic (1.3 percent of GDP) and external sources (2.5 percent of GDP in donor aid and ENCB). (MEFP ¶21–22)

Text Table 3. Tanzania: Revenue Measures for 2017/18

	Impact	
	Tsh bln	% of GDP
Tax Policy Measures	132.2	0.11
1. Abolish VAT exemption on Supply of air charter services	0.8	0.001
2. Indexation of Excise Duty rates on non-petroleum products	33.6	0.03
3. Merge the Annual Motor Vehicles Licence with excise duty on fuels	11.1	0.01
4. EAC-compliant removal of tax exemptions on compact fluorescence bulbs (CFL) and light emitting bulbs (LED)	16.1	0.01
5. Increase of petroleum product fees	70.6	0.06
Tax Administration Measures	268.7	0.22
Domestic Taxes	195.6	0.16
1. Strengthen Block Management System and clean up taxpayers registry	57.1	0.05
2.a. Enhance business formalization, usage of EFD operations and electronic filling for all traders;		
2b. Strengthen usage of forensic technology and general surveillance to minimise tax evasion	102.8	0.08
2c. General strengthening VAT collection efficiency		
3. Implement electronic tax stamps	35.7	0.03
International Trade Taxes	73.0	0.06
4. Strengthen automatic TANCIS valuation capability and classification	37.3	0.03
5.a. Strengthen supervision on cargo verification and controls to all Internal Container Depots (ICDs) and Bonded Warehouses	35.7	0.03
5.b. Collaborate with other Government instruments for conducting anti-smuggling operations.		
TOTAL	400.9	0.33

Sources: Tanzanian authorities and IMF staff calculations

13. **Staff called for more realistic revenue projections in the 2017/18 budget to reduce the risk of domestic arrears' accumulation.** In staff's views, the authorities' revenue targets are overambitious by close to 1 percent of GDP on account of a more prudent estimated impact of tax policy and administration measures, overly low provisions for the repayment of VAT refunds, as well as optimistic assumptions on key underlying variables. Staff stressed that overoptimistic revenue and financing projections were one of the reasons behind the accumulation of expenditure arrears in recent years, and suggested to lower revenue projections and to target a deficit of about 4 percent of GDP in 2017/18 based on a realistic projection of available financing. Staff supported the budget's orientation toward development spending to address infrastructure gaps, but noted that the continued compression of recurrent spending should not come at the expense of lower delivery of essential public services. Staff also urged the authorities to start the process of mobilizing external financing early, including through finalization of a contract with rating agencies to obtain a sovereign credit rating, and by stepping up reforms and contacts with donors to ensure timely disbursements of project and budget support financing. (MEFP, ¶19)

14. **The authorities agreed to delay some development projects until the mid-year budget review in early 2018.** While the authorities were confident that the projected revenue target in the budget would materialize, they agreed that implementation of some large projects (including renovation of the Dar es Salaam port) amounting to 1.2 percent of GDP would be delayed until available revenues are confirmed in the mid-year budget review. Projects for which external financing has not been mobilized in the course of 2017/18 will be postponed. (MEFP ¶20)

15. **Sustained reforms in public financial management beyond realistic budgeting are required to prevent further incurrence of arrears.** The increase in the stock of domestic arrears during the last quarter of 2016 suggests difficulties in expenditure control and cash management and calls for more realistic budgets, tighter commitment controls (by extending the commitment ceilings' horizon to at least three months), and strengthened cash management (through development of monthly cash and borrowing plans). In addition, given Tanzania's development needs and constrained resources, improving investment spending efficiency and project appraisal and selection would help reduce spending pressure. In this regard, staff welcomed the authorities' plans to ensure rigorous feasibility and costing studies and to improve the transparency and availability of PPP-related information. Considering the envisaged scale-up of PPP projects and currently unclear institutional responsibilities, staff stressed their potential fiscal risks and encouraged the authorities to speedily finalize the ongoing amendments to the PPP Act.⁶

16. **The stock of arrears to pension funds will be cleared early in the next fiscal year.** The verification exercise completed in early 2017 resulted in a substantial decline in the stock of arrears by 1.8 percent of GDP to 2.9 percent of GDP. The MoF is waiting for Cabinet approval to settle those arrears through the issuance of non-cash bonds. Staff also urged the authorities to speed up their plans to introduce parametric reforms—including the harmonization of pension formula

⁶ Five projects considered to be implemented under PPPs are currently at the feasibility study stages with no information yet on their size: Dar–Chalinze toll road, 250 MW electricity generation plant, Phase II of the extension of the Dar es Salaam Rapid Transit, Kinyerezi III gas-fired electricity generation plant, and manufacturing of pharmaceuticals and medical supplies.

across the funds and the merging of some of the funds—aimed at ensuring the pension funds’ long term sustainability. (MEFP ¶13)

17. **Work toward enhanced transparency and monitoring of the public sector is underway.** The authorities are piloting 27 parastatals for the use of the financial analysis and reporting system (FARS) recently established by the Treasury Registrar to foster regular reporting of their financial information. Staff welcomed this action and encouraged the authorities to gradually extend the coverage to the remaining 127 parastatals to allow for a more comprehensive assessment of the public sector’s performance. (MEFP ¶23)

C. Monetary and Financial Sector Policies

18. **Staff supported the BoT’s efforts to address the tight liquidity situation.** Given the relatively benign inflation outlook (as suggested by the subdued core inflation) and decelerating monetary aggregates and credit growth, the BoT recently reduced its discount rate and reserve requirement. Staff noted, however, that the monetary policy stance will need to be coordinated with fiscal developments, particularly if the planned increase in government spending materializes. In this regard, the BoT needs to further strengthen liquidity forecasting—which will require better information sharing from the MoF—to facilitate stabilizing short-term interest rates.

19. **Steps to enhance the BoT’s monetary policy toolkit are underway.** To strengthen open market operations to effectively react to changes in liquidity and credit conditions, the BoT is exploring options to bolster its toolkit. Staff welcomed the BoT’s continued efforts to enhance the monetary policy framework, including the introduction of reserve averaging in January, the review of the BoT’s collateral framework, and the intention to collect and publish daily information on interbank cash market transactions to enhance transparency and liquidity of the market. The BoT plans to expand eligible collaterals for its operations and to review the design of the reverse repos, moves which staff supported.

20. **The BoT intends to introduce an interest rate-based monetary policy framework by end-2017.** The BoT’s Board approved the blueprint for such a move last January. The BoT continues to advance towards adoption of the overnight interbank cash rate as an operational target for monetary policy and the introduction of a policy rate and an interest rate corridor that could be formed by standing lending and deposit facilities. The reform agenda includes development of an electronic platform for the interbank money market to facilitate price discovery, integration of the forecasting and policy analysis system (FPAS) into the policy formulation process, and improvements in the functioning of domestic financial markets. Staff noted that such a framework will require increasingly greater exchange rate flexibility. Staff also made a presentation on the implications of adoption of a new monetary policy framework for IMF program conditionality at the authorities’ request. (MEFP ¶16)

21. **The BoT is taking measures to address high NPLs and strengthen financial sector supervision.** At end-2016, over 30 banks out of the 49 (for which data are available) had NPL ratios above the BoT’s 5-percent medium-term goal. At the same time, capital levels generally exceed regulatory minimums, including in many banks with high NPLs, thus providing buffers. The BoT has

requested banks with high NPLs to formulate and implement strategies to bring down the NPL ratio to 5 percent. It has also issued operational guidance on the recovery of problem loans and is closely monitoring the adequacy of provisions. Staff welcomed the BoT's ongoing efforts in this area and stressed the need to closely monitor the evolution of banks' asset quality and to strengthen credit standards and provision buffers. Following the issuance of Consolidated Supervision Regulations in 2014, the BoT has developed a supervisory framework for consolidated supervision and recently conducted a first pilot examination of one bank. The BoT is also strengthening bank capital definition and requirements in line with Basel III and the East African Community (EAC) convergence criteria. (MEFP ¶17–8)

D. Other Reforms

22. **Improving the business environment is crucial to meet FYDP's objectives of private sector-led growth.** An enabling investment climate is required to drive industrialization, including reliable supply of power, access to credit, and availability of skilled labor, which are among top constraints raised by the domestic manufacturing sector. FYDP II aims to address those constraints. Staff also stressed the importance of a more predictable business environment and strengthening the government's dialogue with all stakeholders, including the private sector. In this regard, staff welcomed the recent investor roundtable, including with the Tanzania National Business Council, convened by President Magufuli. Staff noted that a current export ban on mining concentrates might slow mining activities going forward and dampen FDI in the sector.

23. **Efforts are being made to clear arrears in the energy sector and put the public electricity utility (TANESCO) on a sustainable footing.** The stock of TANESCO's arrears to gas suppliers stood at 0.8 percent of GDP as of February 2017. An agreement was signed between Tanzania Petroleum Development Corporation (TPDC) and TANESCO requiring the latter to pay weekly Tsh 4.5 billion on account of 70 percent of TPDC's bill for gas delivery to TANESCO. Following a Presidential instruction to stop electricity provision to defaulting customers, TANESCO's collection rate has started to improve. The ongoing shift in the power generation mix towards gas is also lowering TANESCO's operating costs. Staff encouraged the authorities to swiftly operationalize the mechanism for centrally paying line ministries' electricity bills to TANESCO through the MoFP. Ernst & Young and the Controller and Audit General have started a financial assessment of TANESCO. The assessment needs to be accelerated as it will constitute the basis for future financial support from donors to the energy sector.

24. **Staff supported the government's strong drive against corruption.** The anti-corruption drive has resulted in higher fiscal revenues and uncovered fraudulent expenditures. The authorities are preparing a high-level conference on anti-corruption, with support from the World Bank, to draw on successful international experiences on anti-corruption efforts. On ongoing audits of VAT refund claims, staff urged the authorities to address expeditiously the private sector's concerns about them and called for setting up a transparent and predictable mechanism for auditing submitted claims. The authorities indicated lack of supporting documents as the main cause for the slowdown in repaying VAT refunds. Staff noted that AML/CFT tools could also be used as part of a comprehensive approach to take the authorities' anti-corruption drive forward.

PROGRAM MODALITIES

25. **The authorities requested to extend the current PSI arrangement by 6 months to January 2018.** The authorities believe that the current arrangement has served Tanzania well in anchoring their economic and reform agenda, and signaling policy intentions and performance to development partners and investors. They requested to extend the current three-year PSI (that expires in July 2017) to January 2018 to cover the period of negotiations for a successor PSI. (MEFP ¶124)

26. **Quantitative targets and structural benchmarks.** In line with the authorities' request for a PSI extension, the current indicative targets for June 2017 become assessment criteria, with proposed revisions to reflect the latest information, including on available financing for the 2016/17 budget. Indicative targets for September and December 2017 are also proposed. While staff prefers that the 2017/18 budget be based on lower realistic revenue projections, it can support the two-step approach to its implementation, with some large projects not to start before confirmation of availability of revenue at the time of the mid-year budget review. This approach will facilitate reaching the targeted fiscal deficit of about 4 percent of GDP while reducing the risk of arrears accumulation. Three new structural benchmarks linked to the modernization of the monetary policy framework are proposed in the authorities' memorandum of economic and financial policies. Staff supports a waiver for the missed end-December 2016 assessment criterion on tax revenues on the grounds that the breach (0.01 percent of GDP) was minor. (MEFP ¶113)

STAFF APPRAISAL

27. **The macroeconomic outlook remains favorable, but risks are tilted to the downside.** GDP growth is projected to remain strong and inflation to fall close to the authorities' target of 5 percent. There are, however, downside risks to economic growth in the short-term stemming from the recent tight stance of macroeconomic policies and the slow implementation of public investment.

28. **Program implementation has been broadly satisfactory in terms of macroeconomic policy management.** Most quantitative targets for December 2016 and March 2017 were met; the December 2016 assessment criterion on tax revenues was missed only by a small margin. Staff welcomes the envisaged tax policy and administration reforms and urges the authorities to further streamline tax exemptions.

29. **The pace of structural reforms has improved.** Two out of five structural benchmarks under the PSI were met within their established timelines. The remaining three benchmarks related to settlement of pension arrears are expected to be implemented soon once the Cabinet formally approves the settlement strategy already discussed. The whole process has been delayed due to reverification of arrears, which reduced the stock of arrears substantially.

30. **Staff welcomes the authorities' ambitious reform and development agenda.** They continue to push their drive against corruption and tax evasion, leading to higher fiscal

revenues. The government has started implementing the second Five-Year Development Plan, which aims at structural transformation of the economy by addressing the infrastructure gap and nurturing human development. A better, more predictable business environment and strengthening of the government's dialogue with all stakeholders, including the private sector, will be crucial. In this regard, staff welcomes the recent investor roundtable convened by President Magufuli.

31. **Budget implementation needs to be strengthened.** Budget execution in 2016/17 has been slow, largely on account of external financing shortfalls. The authorities have stepped up external financing mobilization, which will help budget implementation. In the meantime, staff urges the authorities to implement the budget prudently and to align expenditure commitments with available resources to prevent new arrears' accumulation. Ongoing efforts to rein in unnecessary spending are welcome, and various budget financing options and associated risks need to be carefully evaluated.

32. **The draft budget for 2017/18 is ambitious and will need to be implemented prudently.** The targeted deficit of about 4 percent of GDP sends a strong signal about the authorities' intention to preserve fiscal and debt sustainability. In staff's view, however, budgeted revenue projections are overambitious so careful prioritization and implementation of expenditures will be required to avoid arrears accumulation. In this regard, staff welcomes the authorities' intention to delay some large projects until the mid-year budget review in early 2018 confirms the availability of revenue. Staff encourages the authorities to secure the envisaged financing early to facilitate budget implementation.

33. **Ongoing efforts to address domestic arrears and strengthen public financial management are welcome.** Overoptimistic revenue and financing projections were one of the main reasons behind the accumulation of expenditure arrears in recent years. Recurrence of domestic arrears undermines the budget process and negatively affects the private sector. Continued reforms in cash management and commitment controls, including of multi-year projects are needed. While utilizing PPPs for infrastructure projects would reduce government borrowing, the related fiscal risks need to be closely monitored and reported. Continued efforts to better monitor and manage parastatals are welcome. The reverification of pension arrears claims has reduced the arrears stock substantially. Staff encourages the authorities to complete the settlement of the arrears to pension funds soon.

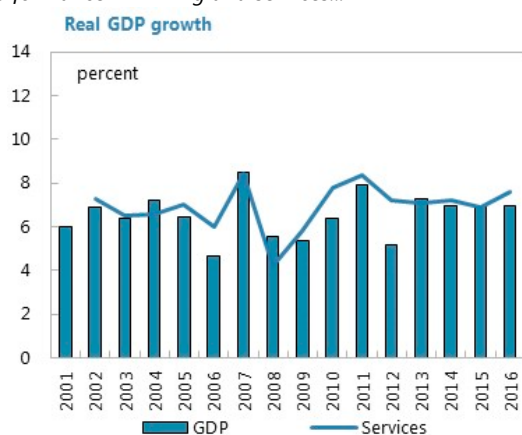
34. **The BoT has taken appropriate measures to ease the tight liquidity situation.** Given the relatively benign inflation outlook and decelerating credit growth, the BoT's recent policy measures to address the tight liquidity situation are appropriate. However, the extent and duration of the loosening in the monetary stance will need to be closely coordinated with fiscal developments, particularly in the context of the planned increase in fiscal spending. Staff supports the BoT's planned move to an interest rate-based monetary policy framework in late 2017. It encourages the BoT to press on with the reform agenda for introducing a forward-looking monetary policy, including expansion of eligible collateral for the BoT's operations, establishment of a policy rate and an interest rate corridor, and further modernization of monetary policy

instruments and operations. It will be important to address high nonperforming loans in the banking sector soon.

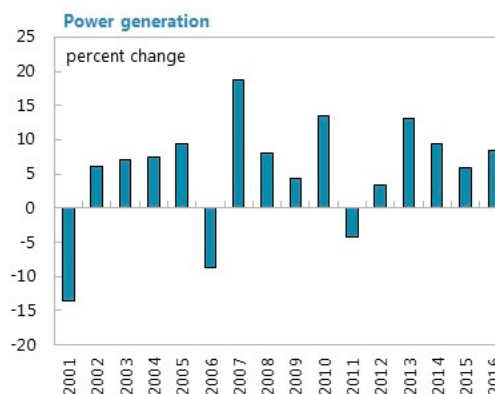
35. **Staff recommends completion of the sixth review under the PSI and approval of the authorities' request for an extension of the PSI.** Staff also supports a waiver for the non-observance of the end-December 2016 assessment criterion on tax revenues on the grounds that the slippage was minor.

Figure 1. Tanzania: Real Sector and External Developments

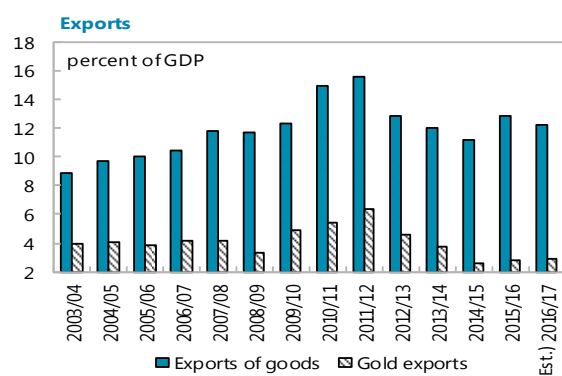
Real GDP growth has remained robust led by a strong performance in mining and services...



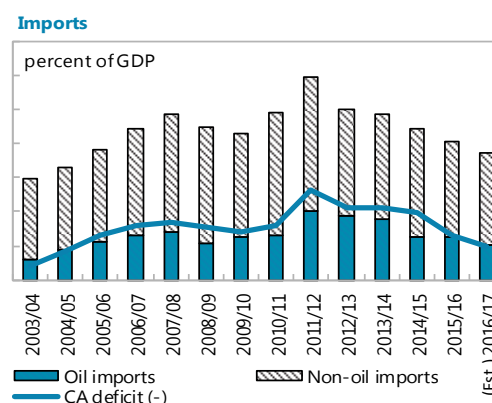
... and steady increases in power generation.



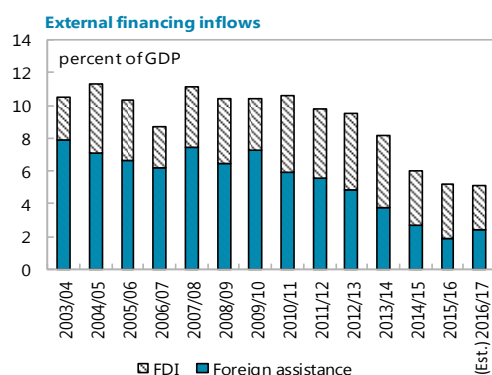
A recovery in exports...



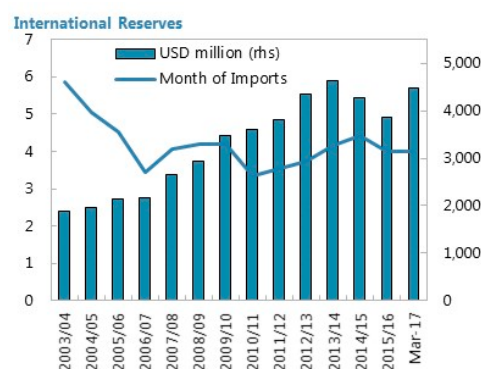
...and declining imports have improved the external current account balance.



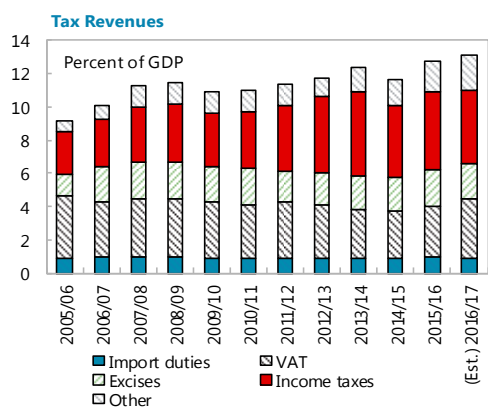
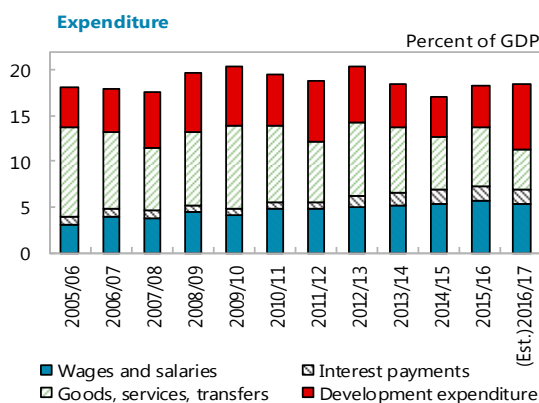
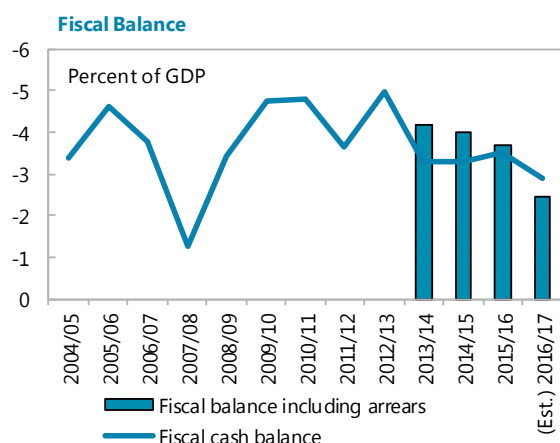
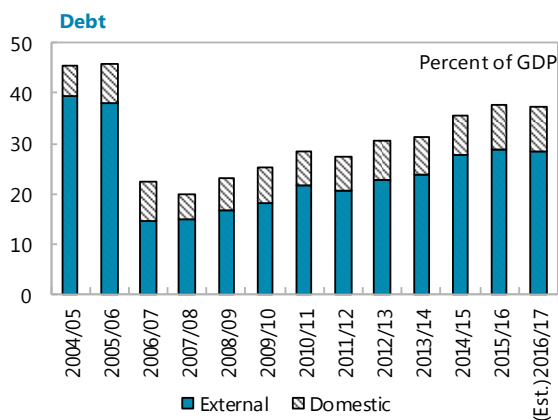
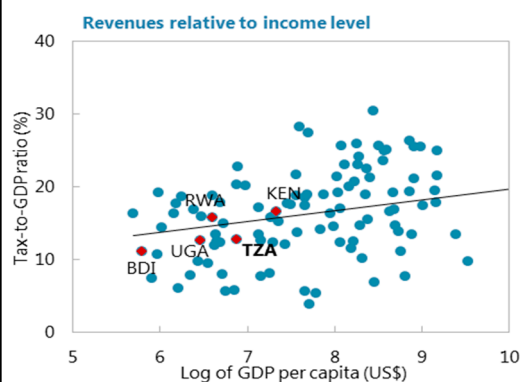
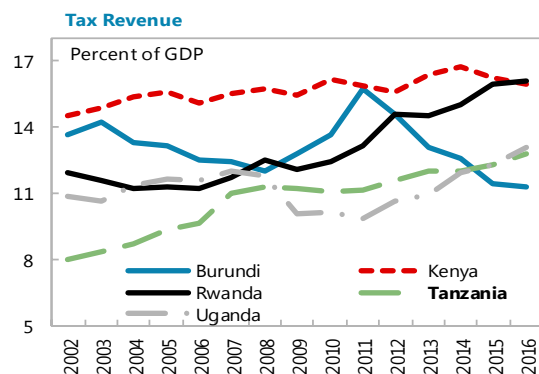
Despite lower external financing inflows ...



...international reserves have increased.



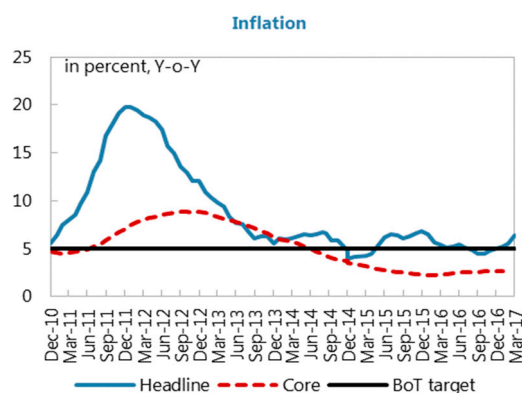
Source: Tanzanian authorities and IMF staff calculations.

Figure 2. Tanzania: Fiscal Developments*Gradual improvements in tax revenue collection ...**... and efforts to keep expenditure under control...**...have helped to maintain the fiscal deficit under control.**Public debt remains modest, albeit rising, mainly driven by external debt**Revenues underperform relative to the income level**...and are among the lowest in the EAC*

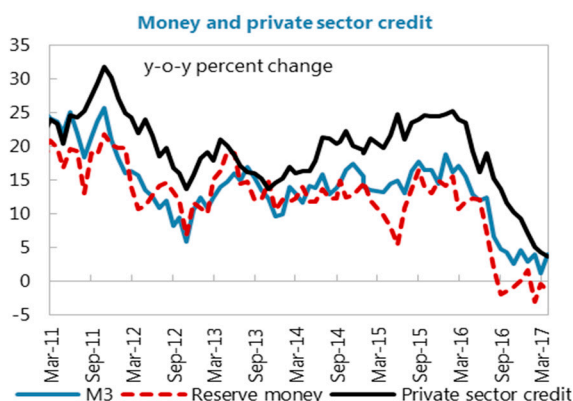
Sources: Tanzanian authorities and IMF staff calculations.

Figure 3. Tanzania: Monetary and Inflation Developments

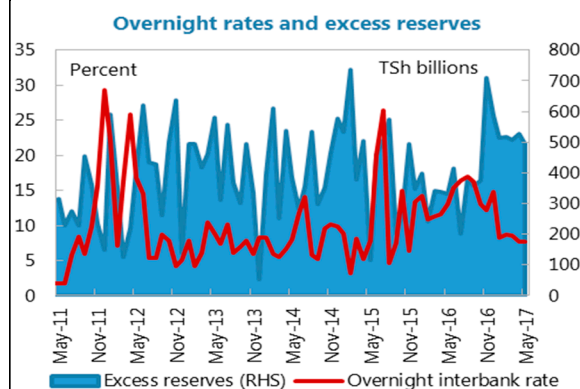
The recent drought led to an increase in inflation, due to rising food prices.



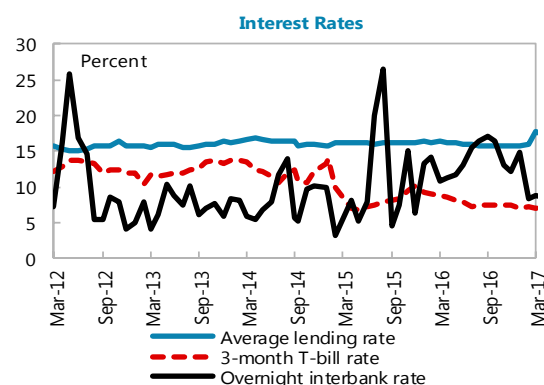
Monetary aggregates and credit have slowed sharply since Q2 2016



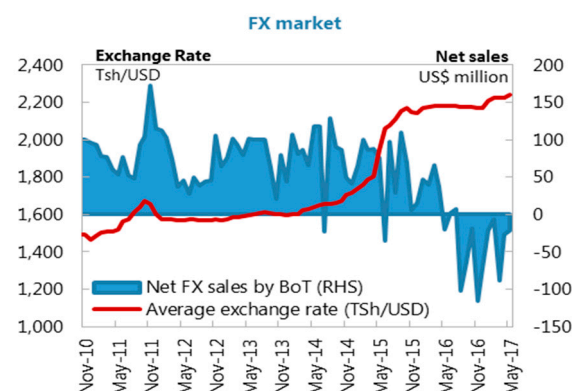
Overnight rates declined significantly



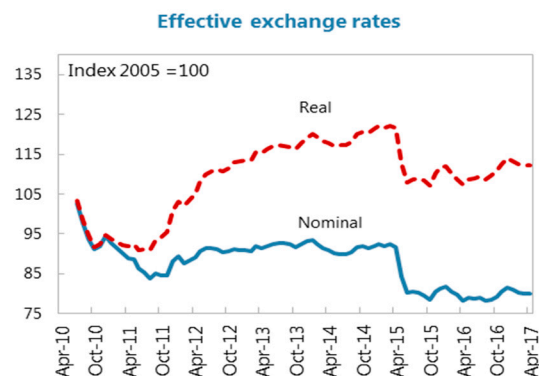
But other key rates remain stable.



The shilling remained stable while the BoT intervened on both sides of the FX market



The real exchange rate broadly mirrored developments in the nominal rate



Sources: Tanzanian authorities and IMF staff calculations.

Table 1. Tanzania: Selected Economic and Financial Indicators, 2014/15–2019/20

	2014/15	2015/16		2016/17		2017/18	2018/19	2019/20
		Prog. ¹	Prel.	Prog. ¹	Proj.	Proj.	Proj.	Proj.
(Annual percent change, unless otherwise indicated)								
Output, prices and exchange rates								
Real GDP	7.0	7.1	7.0	7.2	6.2	6.8	6.8	6.8
GDP deflator	5.8	6.0	6.7	5.3	5.2	5.1	5.0	5.0
CPI (period average)	5.4	5.9	6.0	5.0	5.4	5.1	5.0	5.0
CPI (end of period)	6.1	5.0	5.5	5.0	5.8	5.0	5.0	5.0
Core inflation (end of period)	2.2	...	3.0	...	...	...	...	...
Terms of trade (deterioration, -)	0.9	10.5	3.3	-0.2	-3.4	-3.0	0.8	1.1
Exchange rate (period average, TSh/USD)	1,764	...	2,156	...	...	...	...	...
Real effective exchange rate (end of period; depreciation= -)	-8.2	...	0.1	...	...	...	...	...
Money and credit								
Broad money (M3)	13.1	16.0	12.5	14.5	10.5	14.5	14.5	14.6
Average reserve money	10.8	13.4	7.2	12.5	8.2	12.6	11.8	11.8
Credit to nongovernment sector	21.0	19.0	19.1	15.0	6.5	11.4	12.5	12.5
Treasury bill interest rate (in percent; end of period)	10.0	...	15.1	...	...	...	...	...
Broad money (M3, as a percent of GDP)	23.4	23.9	23.1	...	...	...	...	...
Non-performing loans (end of calendar year, percent of total loans) ²	7.9	...	9.6	...	...	...	...	...
(Percent of GDP, unless otherwise indicated)								
Central government budget								
Revenues and grants	14.0	15.4	14.8	17.2	16.2	16.2	16.6	16.9
Of which: grants	1.2	1.0	0.5	1.3	0.9	0.8	1.0	1.0
Expenditures	17.1	18.7	18.3	21.8	19.1	20.1	21.3	21.5
Current	12.8	13.6	13.8	12.1	11.2	11.2	11.7	11.8
Development	4.4	5.1	4.5	9.6	7.9	8.9	9.6	9.7
Unidentified measures ³	...	0.0	...	0.0	0.0	0.0	0.0	0.0
Overall balance ⁴	-3.3	-3.3	-3.5	-4.6	-2.9	-3.9	-4.6	-4.6
Excluding grants ⁴	-4.3	-4.2	-4.0	-5.9	-3.8	-4.8	-5.7	-5.6
Including net accumulation of arrears	-4.0	-2.3	-3.6	-3.1	...	...	...	...
Public debt								
Public gross nominal debt ^{5,6}	35.4	37.5	37.5	39.2	37.3	37.8	39.2	40.4
of which: external public debt ⁶	27.6	29.0	28.7	30.7	28.4	28.4	29.9	31.1
Investment and savings								
Investment	28.9	29.4	28.2	32.3	30.1	32.0	33.6	33.9
Government	4.5	4.2	3.5	8.1	6.4	8.1	9.6	9.7
Nongovernment ⁷	24.4	25.2	24.7	24.2	23.7	23.9	24.0	24.1
Gross domestic savings	23.7	21.8	23.2	24.1	26.2	26.3	27.5	27.8
External sector								
Exports (goods and services)	18.4	21.2	20.7	20.9	19.6	19.6	19.5	19.3
Imports (goods and services)	27.6	28.8	25.7	29.2	23.5	25.3	25.6	25.4
Current account balance	-9.8	-8.6	-6.6	-9.1	-4.9	-6.8	-7.1	-7.0
Excluding current transfers	-10.4	-8.7	-6.7	-9.4	-5.3	-7.1	-7.4	-7.3
Gross international reserves								
In billions of US\$	4.3	4.2	3.9	4.7	4.5	5.0	5.6	6.2
In months of next year's imports	4.4	3.6	4.0	3.6	4.0	4.0	4.1	4.3
Memorandum items								
GDP at current market prices								
Billions of Tanzanian shillings	85,282	96,806	97,295	109,278	108,700	122,012	136,829	153,414
Millions of US\$	48,347	44,895	45,124	48,347	49,304	53,570	58,625	63,827
GDP per capita (US\$)	1,024	932	937	984	1,004	1,069	1,147	1,224
Population (million)	47	48	48	49	49	50	51	52

Sources: Tanzanian authorities and IMF staff estimates and projections.

¹ From the fourth review under the Policy Support Instrument.² E.g. Calendar year corresponding to 2014/15 is 2015.³ These are the revenue/spending adjustments needed to achieve the budget deficit targets.⁴ Actual and preliminary data include adjustment to cash basis.⁵ Net of Treasury bills issued for liquidity management.⁶ Excludes external debt under negotiation for relief, and domestic unpaid claims.⁷ Including change in stocks.

Table 2a. Tanzania: Central Government Operations, 2014/15–2019/20¹
(Billions of Tanzanian shillings)

	2014/15	2015/16		2016/17		2017/18		2018/19	2019/20
		Prog. ²	Prel.	Prog. ²	Proj.	Draft Budget	Proj.	Proj.	Proj.
Total revenue	10,958	14,014	13,907	17,321	16,656	19,977	18,781	21,335	24,458
Tax revenue	9,892	12,380	12,411	14,448	14,185	17,106	16,075	18,301	20,903
Import duties	784	842	923	994	982	1,193	1,175	1,318	1,478
Value-added tax	2,439	2,902	2,960	3,521	3,904	4,628	4,290	4,948	5,777
Excises	1,671	2,157	2,123	2,493	2,225	2,684	2,542	2,850	3,349
Income taxes	3,720	4,676	4,600	5,316	4,781	5,684	5,423	6,219	6,972
Other taxes	1,279	1,802	1,805	2,123	2,294	2,916	2,646	2,967	3,326
Nontax revenue ³	1,066	1,635	1,496	2,872	2,471	2,871	2,706	3,034	3,555
LGA	360	522	426	665	532	2,183	687	771	864
Other	706	1,113	1,070	2,207	1,939	687	2,018	2,263	2,691
Total expenditure	14,604	18,103	17,760	23,770	20,803	25,569	24,582	29,115	33,051
Recurrent expenditure	10,893	13,130	13,420	13,259	12,215	13,569	13,673	16,046	18,166
Wages and salaries ⁴	4,618	5,854	5,627	5,706	5,843	6,276	6,276	7,175	8,045
Of which: clearance of soc. contribution arrears	...	150	150	...	...	...	...	...	...
Interest payments	1,261	1,552	1,486	1,993	1,678	1,699	1,803	2,617	2,979
Domestic	917	1,060	1,010	1,372	1,216	1,026	1,130	1,784	1,958
Foreign ⁵	344	492	477	621	462	673	673	832	1,021
Goods and services and transfers ⁴	5,015	5,724	6,306	5,561	4,694	5,594	5,594	6,254	7,142
Of which: Transfers to PSPF	75	252	0	342	342	...	370	396	420
Of which: Transfers to TANESCO	0	194	0	...	...	...	...	...	...
Of which: new expenditure on education	...	175	131	...	...	...	...	...	...
Development expenditure ⁴	3,710	4,973	4,340	10,511	8,588	12,000	10,909	13,069	14,885
Domestically financed	2,265	3,453	2,905	7,393	6,249	9,388	8,298	8,605	9,955
Of which: Clearance of arrears ⁵	58	932	958	1,677	1,677	1,800	1,000	...	...
Foreign (concessionally) financed	1,446	1,520	1,435	3,118	2,338	2,611	2,611	4,463	4,930
Overall balance before grants	-3,646	-4,088	-3,853	-6,450	-4,147	-5,592	-5,801	-7,780	-8,593
Grants	1,024	927	495	1,423	1,007	998	998	1,431	1,536
Program (including basket grants) ⁶	510	156	86	358	368	344	344	375	448
Of which: basket grants	128	81	86	179	186	201	201	200	263
Project	514	771	409	1,065	639	653	653	1,056	1,088
Net expenditure float ⁷	-184	0	102	0	0	0	0	0	0
Statistical discrepancy	-1	0	-172	0	0	0	0	0	0
Unidentified measures	...	...	...	...	0	0	0	0	0
Overall balance (cash basis)	-2,807	-3,162	-3,428	-5,027	-3,140	-4,595	-4,804	-6,349	-7,057
Financing	2,807	3,162	3,428	5,027	3,140	4,595	4,804	6,349	7,057
Foreign (net)	2,634	1,860	1,390	4,057	2,034	2,990	2,990	5,086	5,642
Foreign loans	2,860	2,382	1,946	5,023	2,923	4,173	4,173	6,304	7,076
Program (including basket loans) ⁸	538	397	453	497	384	1,153	1,153	812	765
Of which: basket loans	163	118	162	193	118	355	355	271	286
Project	641	550	778	1,681	1,395	1,402	1,402	2,937	3,292
Nonconcessional borrowing	1,682	1,434	715	2,845	1,144	1,618	1,618	2,555	3,019
Of which: gas pipeline	627	289	261	...	29	0	...	...	...
Amortization	-227	-522	-556	-966	-889	-1,183	-1,183	-1,217	-1,434
Domestic (net)	173	1,301	2,038	970	1,106	1,605	1,813	1,263	1,415
Excluding gas pipeline	800	1,591	2,299	970	1,135	1,605	1,813	1,263	1,415
Bank financing	488	1,018	1,522	811	-22	1,484	1,088	449	502
Nonbank financing	312	573	777	159	1,156	121	726	814	913
Credit to TPDC (gas pipeline)	-627	-289	-261	...	-29	...	...	...	...
Memorandum items:									
Overall fiscal balance incl. net arrears accumulation	-3,391	-2,229	-3,538	-3,350	...	...	...	...	...
Total public debt (in percent of GDP) ⁹	35.4	37.5	37.5	39.2	37.3	...	37.8	39.2	40.4
Arrears (unpaid claims) ⁵	1,732	1,202	1,842	...	...	...	...	...	...
Recurrent expenditures (percent of recurrent resources)	96	93	96	76	73	67	72	75	74
Priority social spending	2,717	2,800	3,396	3,161	3,161	...	3,718	4,169	4,675
Nominal GDP	85,282	96,806	97,295	109,278	108,700	121,014	122,012	136,829	153,414

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

¹ Fiscal year: July–June.

² From the fourth review under the Policy Support Instrument.

³ Includes sale of shares in two manufacturing companies amounting to 0.2 percent of GDP in 2015/16. Local Government Authorities' own revenues and the equal amount of transfers, are included starting from FY2009/10.

⁴ The change in 2014/15 compared to the previous year 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.

⁵ Includes domestic expenditure arrears defined as unpaid claims that are overdue by more than 30 days for goods and services, and more than 90 days for contract works as set out in the government circular No 9 of 8th December 2014.

⁶ Excludes interest payments on external debt obligations that are under negotiation for relief with a number of creditors.

⁷ The net expenditure float for year Y relates to expenditures recorded in year Y whose financing was recorded in year Y+1, minus the additional financing that occurred in year Y for expenditures that were recorded in year Y-1.

⁸ Basket funds are sector-specific accounts established by the government to channel donor support to fund-specific activities.

⁹ Excludes external debt under negotiation for relief and Treasury bills issued for monetary policy purposes.

Table 2b. Tanzania: Central Government Operations, 2014/15–2019/20¹
(Percent of GDP)

	2014/15	2015/16		2016/17		2017/18		2018/19	2019/20
		Prog. ²	Prel.	Prog. ²	Proj.	Draft Budget	Proj.	Proj.	Proj.
Total revenue	12.8	14.5	14.3	15.8	15.3	16.4	15.4	15.6	15.9
Tax revenue	11.6	12.8	12.8	13.2	13.0	14.0	13.2	13.4	13.6
Import duties	0.9	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0
Value-added tax	2.9	3.0	3.0	3.2	3.6	3.8	3.5	3.6	3.8
Excises	2.0	2.2	2.2	2.3	2.0	2.2	2.1	2.1	2.2
Income taxes	4.4	4.8	4.7	4.9	4.4	4.7	4.4	4.5	4.5
Other taxes	1.5	1.9	1.9	1.9	2.1	2.4	2.2	2.2	2.2
Nontax revenue ³	1.3	1.7	1.5	2.6	2.3	2.4	2.2	2.2	2.3
LGA	0.4	0.5	0.4	0.6	0.5	1.8	0.6	0.6	0.6
Other	0.8	1.1	1.1	2.0	1.8	0.6	1.7	1.7	1.8
Total expenditure	17.1	18.7	18.3	21.8	19.1	21.0	20.1	21.3	21.5
Recurrent expenditure	12.8	13.6	13.8	12.1	11.2	11.1	11.2	11.7	11.8
Wages and salaries ⁴	5.4	6.0	5.8	5.2	5.4	5.1	5.1	5.2	5.2
Of which: clearance of soc. contribution arrears	...	0.2	0.2	...	...	...	...	...	...
Interest payments	1.5	1.6	1.5	1.8	1.5	1.4	1.5	1.9	1.9
Domestic	1.1	1.1	1.0	1.3	1.1	0.8	0.9	1.3	1.3
Foreign ⁵	0.4	0.5	0.5	0.6	0.4	0.6	0.6	0.6	0.7
Goods and services and transfers ⁴	5.9	5.9	6.5	5.1	4.3	4.6	4.6	4.6	4.7
Of which: Transfers to PSPF	0.1	0.3	0.0	0.3	0.3	...	0.3	0.3	0.3
Of which: Transfers to TANESCO	0.0	0.2	0.0	...	...	...	...	...	...
Of which: new expenditure on education	...	0.2	0.1	...	...	...	...	...	...
Development expenditure ⁴	4.4	5.1	4.5	9.6	7.9	9.8	8.9	9.6	9.7
Domestically financed	2.7	3.6	3.0	6.8	5.7	7.7	6.8	6.3	6.5
Of which: Clearance of arrears ⁵	0.1	1.0	1.0	1.5	1.5	1.5	0.8	...	...
Foreign (concessionally) financed	1.7	1.6	1.5	2.9	2.2	2.1	2.1	3.3	3.2
Overall balance before grants	-4.3	-4.2	-4.0	-5.9	-3.8	-4.6	-4.8	-5.7	-5.6
Grants	1.2	1.0	0.5	1.3	0.9	0.8	0.8	1.0	1.0
Program (including basket grants) ⁶	0.6	0.2	0.1	0.3	0.3	0.3	0.3	0.3	0.3
Of which: basket grants	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.1	0.2
Project	0.6	0.8	0.4	1.0	0.6	0.5	0.5	0.8	0.7
Net expenditure float ⁷	-0.2	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified measures	...	...	...	...	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-3.3	-3.3	-3.5	-4.6	-2.9	-3.8	-3.9	-4.6	-4.6
Financing	3.3	3.3	3.5	4.6	2.9	3.8	3.9	4.6	4.6
Foreign (net)	3.1	1.9	1.4	3.7	1.9	2.5	2.5	3.7	3.7
Foreign loans	3.4	2.5	2.0	4.6	2.7	3.4	3.4	4.6	4.6
Program (including basket loans) ⁸	0.6	0.4	0.5	0.5	0.4	0.9	0.9	0.6	0.5
Of which: basket loans	0.2	0.1	0.2	0.2	0.1	0.3	0.3	0.2	0.2
Project	0.8	0.6	0.8	1.5	1.3	1.1	1.1	2.1	2.1
Nonconcessional borrowing	2.0	1.5	0.7	2.6	1.1	1.3	1.3	1.9	2.0
Of which: gas pipeline	0.7	0.3	0.3	...	0.0	0.0	...	...	...
Amortization	-0.3	-0.5	-0.6	-0.9	-0.8	-1.0	-1.0	-0.9	-0.9
Domestic (net)	0.2	1.3	2.1	0.9	1.0	1.3	1.5	0.9	0.9
Excluding gas pipeline	0.9	1.6	2.4	0.9	1.0	1.3	1.5	0.9	0.9
Bank financing	0.6	1.1	1.6	0.7	0.0	1.2	0.9	0.3	0.3
Nonbank financing	0.4	0.6	0.8	0.1	1.1	0.1	0.6	0.6	0.6
Credit to TPDC (gas pipeline)	-0.7	-0.3	-0.3	...	0.0	0.0	...	...	...
Memorandum items:									
Overall fiscal balance incl. net arrears accumulation	-4.0	-2.3	-3.6	-3.1	...	...	...	...	...
Domestic unpaid claims (end-period) ⁹	2.0	1.2	1.9	...	...	...	...	...	...
Recurrent expenditures (percent of recurrent resource)	96	93	96	76	73	67.4	72	75	74
Priority social spending	3.2	2.9	3.5	2.9	2.9	...	3.0	3.0	3.0

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

¹ Fiscal year: July–June.

² From the fourth review under the Policy Support Instrument.

³ Includes sale of shares in two manufacturing companies amounting to 0.2 percent of GDP in 2015/16. Local Government Authorities' own revenues and the equal amount of transfers, are included starting from FY2009/10.

⁴ The change in 2014/15 compared to the previous year 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.

⁵ Includes domestic expenditure arrears defined as unpaid claims that are overdue by more than 30 days for goods and services, and more than 90 days for contract works as set out in the government circular No 9 of 8th December 2014.

⁶ Excludes interest payments on external debt obligations that are under negotiation for relief with a number of creditors.

⁷ The net expenditure float for year Y relates to expenditures recorded in year Y whose financing was recorded in year Y+1, minus the additional financing that occurred in year Y for expenditures that were recorded in year Y-1.

⁸ Basket funds are sector-specific accounts established by the government to channel donor support to fund-specific activities.

⁹ Excludes external debt under negotiation for relief and Treasury bills issued for monetary policy purposes.

(Billions of Tanzania shillings, unless otherwise indicated; end of period)

	2014	2015	2016					2017					2018	
	Dec.	Dec.	March	June	Sept.	Dec.		March	June	Sept.	Dec.		March	June
			Act.	Act.	Act.	Prog. ¹	Act	Act.	Prog. ¹	Proj.	Proj.	Proj.	Proj.	Proj.
Bank of Tanzania														
Net foreign assets	6,380	7,528	7,316	7,146	7,694	8,871	8,304	8,850	9,215	9,013	8,834	9,342	9,721	10,681
Net international reserves ²	6,854	8,075	7,881	7,758	8,260	9,452	8,838	9,413	9,796	9,585	9,409	9,920	10,302	11,264
(Millions of U.S. dollars) ²	3,971	3,758	3,616	3,560	3,797	4,195	4,068	4,233	4,329	4,249	4,151	4,355	4,501	4,898
Net non-reserve foreign assets	-473	-546	-565	-612	-566	-581	-533	-564	-582	-572	-575	-578	-581	-583
Net domestic assets	-471	-695	-794	-373	-1,075	-1,183	-1,450	-2,493	-1,664	-1,877	-1,519	-1,879	-2,495	-2,715
Credit to government	355	1,728	1,447	1,545	1,352	1,159	669	-31	2,816	423	845	837	1,150	915
Of which: Excluding counterpart of liquidity paper	934	1,786	1,473	1,642	1,432	1,299	751	544	2,867	892	1,122	1,175	1,311	1,327
Other items (net)	-826	-2,423	-2,241	-1,919	-2,426	-2,342	-2,119	-2,462	-4,480	-2,300	-2,363	-2,716	-3,645	-3,630
REPOs	0	0	0	0	0	-586	0	0	-1,514	100	200	300	500	357
Other items, excluding REPOs (net)	-826	-2,423	-2,241	-1,919	-2,426	-1,756	-2,119	-2,462	-2,965	-2,400	-2,563	-3,016	-4,145	-3,987
Of which: Credit to nongovernment sector	65	134	141	135	121	140	122	116	121	116	116	116	116	116
Reserve money	5,909	6,833	6,523	6,773	6,619	7,687	6,854	6,357	7,551	7,136	7,315	7,463	7,226	7,966
Currency outside banks	3,245	3,679	3,466	3,740	3,672	3,893	3,609	3,395	3,984	3,632	3,717	3,771	3,504	3,845
Bank reserves	2,665	3,155	3,056	3,033	2,947	3,794	3,246	2,962	3,567	3,505	3,599	3,692	3,722	4,121
Currency in banks	584	753	656	633	623	886	697	698	733	712	707	771	822	826
Deposits	2,081	2,401	2,401	2,400	2,324	2,908	2,549	2,264	2,833	2,793	2,892	2,921	2,901	3,294
Required reserves	1,505	2,053	2,059	1,985	1,966	2,444	1,963	1,936	2,414	1,893	1,882	1,898	2,012	2,120
Excess reserves	576	348	342	415	359	465	586	328	419	900	1,010	1,023	889	1,174
Memorandum items:														
Stock of liquidity paper	579	59	26	97	80	140	82	575	51	470	278	338	161	413
Average reserve money	6,011	6,862	6,533	6,624	6,636	7,652	6,980	6,434	7,418	7,164	7,279	7,459	7,300	8,067
Monetary Survey														
Net foreign assets	6,552	8,244	7,530	7,472	7,737	9,401	8,209	8,514	9,393	9,075	8,825	9,262	9,570	10,456
Bank of Tanzania ²	6,380	7,528	7,316	7,146	7,694	8,871	8,304	8,850	9,215	9,013	8,834	9,342	9,721	10,681
Commercial banks	171	716	214	326	44	531	-95	-336	178	62	-9	-80	-152	-225

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

¹ From the fourth review under the Policy Support Instrument.

² Includes short-term (less than 1 year) foreign exchange liabilities to residents.

³ "Program" reflects new GDP data.

⁴ Cumulative from the beginning of the fiscal year (July 1).

Table 4. Tanzania: Balance of Payments, 2014/15–2019/20
(Millions of U.S. dollars, unless otherwise indicated)

	2014/15	2015/16		2016/17		2017/18	2018/19	2019/20
		Prog. ¹	Prel.	Prog. ¹	Proj.			
Current account	-4,754	-3,844	-2,997	-4,417	-2,425	-3,655	-4,159	-4,467
Trade balance	-5,278	-4,449	-3,305	-4,980	-3,210	-4,352	-4,997	-5,352
Exports, f.o.b.	5,384	5,750	5,783	6,169	6,006	6,485	7,026	7,633
Traditional agricultural products	908	927	764	915	771	864	913	961
Gold	1,237	1,204	1,243	1,240	1,433	1,451	1,484	1,514
Other	3,239	3,619	3,775	4,014	3,802	4,170	4,629	5,158
Imports, f.o.b.	-10,662	-10,199	-9,088	-11,149	-9,217	-10,837	-12,023	-12,985
Of which: Oil	-3,063	-2,492	-2,803	-2,616	-2,523	-3,227	-3,449	-3,415
Services (net)	807	1,051	1,049	1,009	1,295	1,322	1,442	1,493
Of which: Travel receipts	2,010	2,256	2,094	2,348	2,208	2,327	2,455	2,598
Income (net)	-859	-840	-1,073	-901	-985	-1,086	-1,093	-1,126
Of which: Interest on public debt	-170	-289	-290	-313	-231	-355	-350	-421
Current transfers (net)	575	394	333	455	476	461	489	518
Of which: Official transfers	277	59	31	145	166	138	156	174
Capital account	427	471	320	589	397	398	569	574
Of which: Project grants ²	363	404	257	518	333	330	495	496
Financial account	3,373	3,382	2,479	4,344	2,765	3,952	4,225	4,583
Foreign Direct Investment	1,639	2,042	1,485	2,041	1,338	1,818	2,228	2,585
Public Sector, net	1,403	869	642	1,793	865	1,260	2,173	2,272
Program loans	281	184	207	220	156	506	343	314
Non-concessional borrowing	934	659	331	1,259	576	710	1,084	1,180
Project loans	363	255	361	744	534	615	1,258	1,370
Scheduled amortization ³	-175	-229	-256	-429	-402	-572	-512	-591
Commercial Banks, net	-26	21	142	53	163	305	-134	-409
Other private inflows	358	450	211	457	399	569	-42	134
Errors and omissions ⁴	653	0	-160	0	0	0	0	0
Overall balance	-301	9	-358	515	738	695	634	690
Financing	301	-9	358	-515	-669	-649	-634	-690
Change in BoT reserve assets (increase= -)	353	54	415	-438	-599	-568	-552	-656
Use of Fund credit	-52	-63	-57	-78	-70	-81	-82	-34
Financing gap	0	0	0	0	0	0	0	0
Memorandum items:								
Gross official reserves (BoT)	4,285	4,238	3,870	4,676	4,470	5,037	5,589	6,245
Months of imports of goods and services	4.4	3.6	4.0	3.6	4.0	4.0	4.1	4.3
Exports (percent of GDP)	11.1	12.8	12.8	12.8	12.2	12.1	12.0	12.0
Exports excl. gold (percent of GDP)	8.6	10.1	10.1	10.2	9.3	9.4	9.5	9.6
Imports (percent of GDP)	-22.1	-22.7	-20.1	-23.1	-18.7	-20.2	-20.5	-20.3
Imports excl. oil (percent of GDP)	-15.7	-17.2	-13.9	-17.6	-13.6	-14.2	-14.6	-15.0
Current account deficit (percent of GDP)	-9.8	-8.6	-6.6	-9.1	-4.9	-6.8	-7.1	-7.0
Foreign program and project assistance (percent of GDP)	2.7	2.0	1.9	3.4	2.4	3.0	3.8	3.7
Nominal GDP	48,347	44,895	45,124	48,347	49,304	53,570	58,625	63,827

Sources: Tanzanian authorities and IMF staff estimates and

¹ From the fourth review under the Policy Support Instrument.

² An adjustment to the estimated outturn is made by BoT to reflect unreported project grants.

³ Relief on some projected external debt obligations is being negotiated with a number of creditors.

⁴ Includes valuation changes in gross reserves resulting from the exchange rate movements of the US\$

Table 5. Tanzania: Financial Soundness Indicators, 2012–16
(Percent, end of period)

	2012	2013	2014	2015				2016			
				Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
Access to bank lending											
Claims on the non-government sector to GDP ¹	14.2	14.6	15.5	14.3	15.2	16.2	16.8	17.4	18.0	18.0	17.9
Claims on the private sector to GDP ¹	13.2	13.9	14.4	13.3	14.2	15.0	15.7	16.2	16.9	17.0	16.9
Capital adequacy											
Capital to risk-weighted assets	17.5	17.9	17.4	19.0	17.6	18.6	18.9	20.0	19.2	19.3	19.9
Capital to assets	10.5	11.0	11.2	12.1	11.2	12.1	12.0	13.0	12.7	13.2	13.5
Asset composition and quality											
Net loans and advances to total assets	49.7	50.8	52.9	53.3	52.8	53.5	54.6	55.1	56.1	56.5	55.6
Sectoral distribution of loans											
Trade	20.9	20.9	21.9	22.5	21.1	21.2	19.4	19.0	19.4	20.3	20.4
Mining and manufacturing	11.9	11.9	12.3	12.2	13.3	12.6	12.5	12.8	12.7	11.1	11.8
Agricultural production	10.7	9.3	8.6	8.3	8.5	8.1	7.6	7.6	7.4	6.7	6.8
Building and construction	4.7	4.9	5.3	5.1	4.7	4.7	4.7	4.6	4.6	4.3	4.5
Transport and communication	6.9	7.0	7.1	7.2	7.6	7.5	7.2	7.6	7.4	7.3	7.1
Foreign exchange loans to total loans	33.5	35.4	36.3	37.5	38.2	38.7	37.7	37.6	36.7	36.1	36.0
Gross nonperforming loans (NPLs) to gross loans	8.1	7.1	6.8	6.7	6.7	6.6	7.9	8.4	8.7	9.1	9.6
NPLs net of provisions to capital	22.5	15.6	16.0	14.8	16.2	14.8	18.6	18.8	21.1	21.7	22.1
Large exposures to total capital	143.7	91.2	123.2	129.6	125.8	117.4	123.3	129.2	128.5	125.9	109.6
Net open positions in foreign exchange to total capital	-1.7	1.5	-2.5	-2.1	-2.2	-2.3	1.4	-1.1	1.4	-2.4	-1.9
Earnings and profitability											
Return on assets	2.6	2.5	2.5	3.3	3.0	2.8	2.6	3.5	3.0	2.5	2.3
Return on equity	13.9	12.8	12.6	17.3	15.8	14.2	12.4	18.2	15.3	12.1	10.7
Interest margin to total income	65.6	67.4	67.8	67.8	65.9	66.4	66.6	65.7	68.1	69.4	69.7
Noninterest expenses to gross income	67.8	66.9	67.2	63.9	65.1	67.4	68.4	63.2	64.7	66.9	67.6
Personnel expenses to noninterest expenses	42.4	43.4	44.2	46.8	46.0	44.9	43.8	45.5	45.4	44.9	44.7
Liquidity											
Liquid assets to total assets	34.0	32.3	31.0	30.6	30.4	31.0	30.6	29.1	30.4	28.1	28.7
Liquid assets to total short term liabilities	38.4	36.2	35.8	38.9	37.7	37.3	37.3	36.6	37.1	34.2	35.1
Total loans to customer deposits	68.6	71.8	74.3	76.9	76.0	77.0	78.5	82.4	85.7	87.1	86.3
Foreign exchange liabilities to total liabilities	34.4	35.0	35.7	37.6	39.8	41.6	39.6	38.8	37.8	38.9	37.4

Source: Bank of Tanzania

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

Appendix I. Letter of Intent

Dodoma, June 12, 2017

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

Dear Madam Lagarde:

The attached Memorandum of Economic and Financial Policies (MEFP) updates the ones from June 27, 2014, December 18, 2014, June 18, 2015, December 24, 2015, June 28, 2016, and December 20, 2016 under the Policy Support Instrument (PSI). It includes a request for a six-month extension of the arrangement, reports on recent economic developments and sets out macroeconomic policies and structural reforms that the Government will pursue in coming 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/

Dr. Philip I Mpango (MP),
Minister of Finance and Planning
United Republic of Tanzania

/s/

Prof. Benno Ndulu,
Governor, Bank of Tanzania
United Republic of Tanzania

Attachments

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

Attachment I. Memorandum of Economic and Financial Policies

June 12, 2017

Macroeconomic Developments and Program Performance

A. Recent Macroeconomic Developments and Outlook

Output and Prices

1. **Growth.** Real GDP grew by 7.0 percent in 2016, with fastest growth rates recorded in information and communication (13.0 percent), construction (13.0 percent), transport and storage (11.8 percent), mining and quarrying (11.5 percent), financial services (10.7 percent), electricity supply (8.5 percent), and manufacturing (7.8 percent). Agriculture sector continued to record sluggish growth (2.1 percent), mainly due to adverse weather conditions. The sustained strong GDP growth was supported by improvements in infrastructure, stability of power supply, investments in provision of mobile and internet services, and subdued global oil prices. Growth is expected to remain strong at around 7 percent in 2017 on the back of expected rebound of the global economy, continued improvement in power supply, and implementation of infrastructural projects under the 2nd Five Year Development Plan.
2. **Inflation.** Headline inflation remained at single digits throughout 2016, consistent with sustained tight monetary and fiscal policy, subdued global oil prices, improvement in domestic power, and stability in the value of Tanzanian shilling against the US dollar. Average headline inflation rate in 2016 was 5.2 percent, down from 5.6 percent in 2015, while core inflation was 2.7 percent compared with 2.3 percent. In the year ending April 2017, headline inflation increased to 6.4 percent driven by rising food prices, while core inflation remained subdued at 2.3 percent. Headline inflation is projected to remain around the medium-term target of 5 percent in the near term, supported by an improvement in food supply attributed to favorable weather conditions in the region, sustained prudent fiscal and monetary policy, stability of value of the Tanzanian shilling against U.S. dollar, and continued stability of global oil prices.

External Sector Developments

3. **Balance of Payments.** During the first half of 2016/17, the current account deficit narrowed by almost half to US\$758.4 million, compared with US\$1,437.4 million recorded in the corresponding period in 2015/16. This development was mainly attributed to decline in import of goods and services particularly capital goods, oil, consumer goods and service payments—which outweighed the impact of decline in the value of exports of goods and services. The stock of gross official reserves increased from US\$3,870.3 million at the end of June 2016 to US\$4,325.6 million at the end of December 2016, and US\$4,482.6 million at the end of March 2017, sufficient to cover over 4 months of projected imports. The current account deficit is projected at around 5 percent of GDP in 2016/17 as the oil import bill (which accounts for about 30 percent of total imports) remains low on the back of subdued global oil prices and the

ongoing substitution of oil with natural gas for power generation; continued recovery of gold exports; and increase in receipts from tourism. Moreover, the value of traditional exports is projected to increase with some commodity prices in the world market. Going forward, the ratio of the external current account deficit to GDP is projected to increase in light of the projected increase in capital goods associated with anticipated investments in infrastructure.

Fiscal Performance and Financing for the Period of July 2016–March 2017

4. **Fiscal Deficit and Financing.** Fiscal performance for the first nine months was broadly on track, with tax revenue performing slightly below the program target. During the period, there was a significant shortfall in foreign inflows both from concessional and non-concessional sources. In addition, there was an underperformance in the government securities auctions, which explains the lower-than-expected spending outturns, notably on developing spending. A small overall fiscal deficit of 0.4 percent of GDP was thus recorded, compared to a programmed deficit of 3.3 percent of GDP. Domestic suppliers and contractors' arrears have continued to accumulate primarily due to the need to establish legitimacy through verifications. The Government has been allocating funds to settle the verified arrears based on resources availability. Claims on VAT refunds have increased in light of the Government's initiatives to verify the claims. Recent verification results indicated that only 10 percent of some submitted VAT claims were genuine. The Government is committed to settle verified VAT refunds on time, and going forward will put in place a transparent and tight mechanism for controlling misrepresentation of the VAT claims.

Monetary Policy

5. **Monetary policy stance and exchange rate developments.** Monetary aggregates sustained lower growth rates compared to the program targets for 2016/17, with average reserve money decelerating sharply despite the monetary policy measures pursued by the BoT in addressing the tight liquidity condition experienced by banks. The liquidity tightness is attributed to substantial decline in foreign budgetary inflows coupled with transfer of public institutions' deposits to the BoT, enhanced government revenue mobilization, and heightened expenditure management. The impact of the slow growth was partly dampened by gradual rise in the money multiplier and the velocity of circulation on the back of financial innovations especially the enhanced use of mobile phone financial services which has been boosted by interoperability across network operators. In the first half of 2016/17, 20.1 million transactions valued at TZS 988.9 billion took place, which is much higher than the 4.4 million transactions valued at TZS 178.1 billion that took place during similar period of the preceding financial year. The number of registered active users of mobile phone financial services was above 17.02 million by end-December 2016.

6. Annual growth of average reserve money was 1.7 percent in December 2016, and went down further to 0.8 percent in April 2017, from 14.2 percent growth recorded in December 2015. Broad money supply (M3) and credit to private sector registered annual growth rates of 2.9 percent and 7.2 percent, respectively, in December 2016, and 4.1 percent and 3.7 percent in

March 2017. Cognizant of the need to prop up aggregate demand the BoT took several measures including a reduction of the discount rate from 16 percent to 12 percent in March 2017 and a cut of statutory minimum reserve requirement on private deposits from 10 percent to 8 percent that became effective from 20th April 2017. The IBCM rate has declined from 12 percent rate to around 5–8 percent lately, reflecting the liquidity easing policy stance. Meanwhile, the Bank adopted a Statutory Minimum Reserve (SMR) averaging framework in January 2017, in a bid to reduce volatility in the IBCM rate. The shilling exchange rate against the US dollar remained stable throughout the first half of 2016/17, consistent with liquidity conditions and the improvement in the current account balance. In the middle of January 2017 though, the shilling experienced a short-lived depreciation against the USD, a phenomenon that was primarily associated with developments in the external environment.

Financial Sector and Capital Account

7. **Financial sector stability.** The banking sector remained sound and stable with growing number of supervised institutions and branch network in various parts of the country. On average, the sector is well capitalized with prudential liquidity remaining above the regulatory requirements. At the end of December 2016, the ratio of core capital to total risk weighted assets and off-balance sheet exposures was 17.8 percent compared with the minimum legal requirement of 10 percent, and the ratio of 16.8 percent recorded at the end of December 2015. The ratio of liquid assets to demand liabilities stood at 35.1 percent, well above the minimum regulatory requirement of 20 percent. The quality of the banking sector's assets deteriorated, as reflected by the increase in the ratio of non-performing loans (NPLs) to 9.5 percent of gross loans in December 2016 from 7.9 percent recorded at the end of December 2015—remaining above the BoT's medium term goal of not more than 5 percent. Sectors that had highest contribution to NPLs were trade (which accounted for about 2 percentage points), followed by agriculture (1.8), and manufacturing (1.1). The BoT has directed banks with high NPLs ratio to formulate and implement strategies to bring the ratio to at most 5 percent, and encouraged them to increase use of the existing credit reference system to reduce risks. As for profitability, the banking sector continued to be profitable with a return on assets of 2.25 percent and return on equity of 10.12 percent in the year ending December 2016. The level of profitability declined slightly compared to the year ending December 2015 when the sector recorded a return on assets of 2.59 percent and return on equity of 12.48 percent. The decline in profitability was mainly attributed to increasing level of provisions for loan losses.

8. **Financial sector regulation.** The BoT has developed a supervisory framework for consolidated supervision, following issuance of Consolidated Supervision Regulations, 2014; and conducted pilot examination on one of the commercial banks in 2016. In its efforts to implement Basel II, the BoT is developing rules for its implementation, covering: (i) the revision of the capital definition to bring it in line with the Basel III definition, taking into account the Tanzanian context; and the EAC convergence agenda of the minimum capital adequacy requirements to 10 (Tier 1) and 12 (total capital) percent; (ii) the addition of a capital conservation buffer of 2.5 percent, to be maintained as additional Common Equity Tier 1 (CET 1) above the minimum

requirements; (iii) requirements for domestic systemically important banks, at first defined as higher Pillar 2 requirements, with the need for explicit additional capital buffers to be considered in future; (iv) the addition of the Pillar 2 of the Basel framework, consisting of the Internal Capital Adequacy Assessment Process (ICAAP) by commercial bank and the Supervisory Evaluation and Review Process (SREP); and (v) the addition of leverage ratio. The timeframe for implementing these changes is by 2018. Further, effective August 2017, the Minimum Core and Total Capital Ratios shall remain 10 percent and 12 percent, respectively as prescribed in *Section 17 of the Banking and Financial Institutions Act, 2006*. However, banks and financial institutions shall be required to maintain a capital conservation buffer of 2.5 percent of risk-weighted assets and off-balance sheet exposures. The capital conservation buffer will be made up by items that qualify as Tier 1 capital.

9. **The BoT has prepared a draft concept note on development of Real Estate Price Index (REPI)**, comprising of the Terms of Reference, Memorandum of Understanding between BoT and National Bureau of Statistics and the proposed cost of constructing and compiling REPI. The concept note outlines in detail the rationale, methodology and categories of Residential Property Price Index, Commercial Rental Space Index, Land Price Index and Mortgage Price Index. The BoT is aware of challenges pertaining to developing REPI after learning experience from Uganda. To give a broad picture of real estate sector in Tanzania in relation to financial stability, the BoT collected and analyzed secondary data on residential and commercial properties from selected major public and private real estate developers such as DAR Property, National House Corporations, AVIC and Pension Funds. The survey findings were published in the March 2016 and September 2016 Financial Stability Reports, respectively. Going forward, during the financial year 2017/18, the BoT will conduct a Stakeholders' sensitization workshop with the first objective to inform key stakeholders about their role and the objective of the BoT of developing REPI. The workshop will also help to get a common understanding and participatory approach in developing the index, and will deliberate on the action plan and mode of cooperation among stakeholders.

10. **FBME Bank (T) Limited.** On 8th May 2017, the BoT closed operations of FBME Bank Limited, revoked the banking license, and placed it under liquidation; and appointed the Deposit Insurance Board (DIB) as a Liquidator. The decision was reached following the bank's long standing liquidity challenges as it failed to meet depositors' demands, and unviable future operations after the US Court upheld FinCEN Final Rule to bar FBME from accessing the US Financial Market on money laundering concerns. The Liquidator will in due course put in place necessary arrangement/plan to handle the affairs of depositors, creditors and debtors in accordance with the law.

11. **TWIGA Bancorp Limited.** In the exercise of its powers under sections 56(1)(g)(i) and 56(2) (a)-(d) of the Banking and Financial Institutions Act, 2006, the BoT with effect from October 2016 took over the administration of Twiga Bancorp Limited (Twiga). This measure was taken upon determination by the BoT that Twiga was significantly undercapitalized institution as provided under the Banking and Financial Institutions Act, 2006 and its regulations. This posed a systemic risk to the stability of the financial system and that the continuation of Twiga operations

would have been detrimental to its depositors and other creditors. As authorized under section 58(2)(i) of the Banking and Financial Institutions Act, 2006, the BoT resolved to reorganize ownership of Twiga to address the problem of undercapitalization by inviting interested entities and individuals to acquire shares and inject capital in Twiga Bancorp Limited. The BoT is currently reviewing applications from investors who are interested to buy shares and inject new capital in Twiga. Upon completion of the review process, the BoT will inform all stakeholders including the public regarding the new shareholding structure of the Twiga Bancorp Limited.

12. **Capital account liberalization.** The BoT has completed a draft Foreign Exchange Regulations, 2017 that has incorporated comments from the Capital Market and Security Authority. The plan is to fully open up the capital account by end September 2017.

B. Program Performance

13. **Quantitative targets and structural benchmarks.** Most assessment criteria and indicative targets for end-December 2016 and end-March 2017 were met, except the revenue targets which were missed by small margins. Preliminary data indicate that the December 2016 indicative target on accumulation of domestic arrears was missed by a small margin. Slow progress has been made on the implementation of structural benchmarks. However, the BoT prepared a framework for adoption of price based monetary policy that was approved by the Board in January 2017. The framework sets the overnight IBCM interest rate as an operational target of monetary policy to be monitored within a specified corridor. Currently, the BoT is developing a platform for transparent IBCM trading in order to make the IBCM rate more reflective of liquidity conditions among banks. In addition, the BoT has reviewed the collateral framework and is also working on modalities for extension of the range of securities eligible as collateral for access to BoT facilities. Progress has been made towards issuance of non-cash bonds to settle arrears to PSPF on account of 1999 reforms as well as loans on projects implemented on behalf of the Government. The verification exercise has been completed and established genuine arrears to be settled. It is envisaged that Cabinet approval for issuing the non-cash bonds will take place by end-July 2017.

The Economic Program for the remainder of 2016/17 and for 2017/18

14. **Economic Development Priorities.** The Government is confident in realizing its industrialization agenda consistent with FYDP II. This is based on the country's comparative advantages and on upgrading innovativeness, with a focus to integrating into the regional and global value chains to consolidate the country's trade share. Efforts are thus directed to build and reorganize domestic productive capacities, while also ensuring sustainability of a conducive environment for doing business and investing. With the current levels of income in the region, Tanzania is now better positioned to steer for export-led industrialization than before. The current industrial policy is on deepening the private sector-led industrial growth as a way of transforming the economy from its heavy reliance on agriculture. This is also enshrined in the

two major policy documents, namely: Tanzania Development Vision 2025 and Sustainable Industrial Development Policy for Tanzania 2020.

A. Monetary, Exchange Rate, and Financial Sector Policies

15. **Monetary policy stance.** In the remainder of 2016/17, liquidity situation in the banking system is expected to improve following measures taken by the BoT. The BoT will however, continue to monitor liquidity situation in the banking system, and participate actively in the money markets with a view to maintaining stability of short-term interest rates, while keeping inflation in check at around the medium-term target of 5.0 percent. Average reserve money is expected to grow by 8.2 percent in 2016/17, while M3 and credit to private sector are projected to grow by 10.5 percent and 6.5 percent, respectively. In 2017/18, velocity of money is expected to continue with an increasing trend given the enhanced use of digital financial services and other financial innovations. Likewise, the money multiplier is expected to rise following measures pursued by the BoT to reduce the SMR ratio. Thus, average reserve money is expected to grow by 12.6 percent in 2017/18, whereas M3 and private sector credit are expected to grow by 14.5 percent and 11.4 percent, respectively.

16. **Modernizing the monetary policy framework.** The BoT will continue with reforms towards adoption of a forward looking monetary policy framework with IBCM rate as an operational target. The reforms include among others the development of an electronic platform for interbank cash market operations, integration of the forecasting and policy analysis (FPAS) into the monetary policy formulation process, improvement in the functioning of domestic financial markets, expansion of the range of eligible collaterals for monetary operations and enhancement of coordination with the fiscal policy. This process will also involve issuing operational guidelines for commercial banks outlining new principles for conducting monetary operations, setting rules for disseminating information on IBCM results and overnight interest rates, and establishing eligibility criteria for access to standing facilities. Concurrently, the BoT will continue to monitor closely banks' free reserves in order to maintain stability in the IBCM rate.

17. **Exchange rate policy.** Exchange rates will continue to be market-determined, and the BoT will remain in the Interbank Foreign Exchange Market solely for liquidity management purposes and intervene occasionally to smooth out excessive short-term volatility in the exchange rate. These operations will however continue to be undertaken consciously without compromising the objective of maintaining adequate level of foreign exchange reserves necessary to insure against external shocks.

B. Fiscal Policies

Budget Implementation in 2016/17 and Budget Plans for 2017/18

18. **Budget Implementation in 2016/17.** Considering the budget execution for the first nine months and prospects for the remainder of the year, including securing the disbursement of a commercial loan amounting to \$500 million, total expenditure and hence overall fiscal deficit has

been revised downward by about 2 percent of GDP. Tax revenue projections have been revised downward by about 0.2 percent of GDP compared to the program. Non-tax revenue is expected to be 0.3 percent of GDP lower than programmed, mostly on account of shortfalls in the transfer of parastatals' past earned revenue to the Treasury. Expenditure savings come from delaying projects and cutting non-priority goods and services spending.

19. **Budget Plans for 2017/18.** The 2017/18 budget continues to implement FYDP II while striking a balance between raising public investment to address various development needs and ensuring debt sustainability. The budget assumes a deficit of around 3.8 percent of GDP and will be maintained at about 4½ percent of GDP in the medium term to cater for multi-year infrastructure projects and subsequently declining to about 3 percent of GDP. The Government recognizes that successful implementation of investment project hinges around realistic resources from domestic and foreign sources. Consistent with recent medium-term debt strategy (MTDS), budget financing will increasingly rely on project financing from multilateral development banks and export credit agencies, which is more affordable than market terms. To reduce rollover risks, the government will aim at lengthening the average maturity of domestic debt. The ongoing Government and Development partner initiative to revive and strengthen their relationships is expected to yield good results, notably a better predictability of foreign assistance.

20. **Risks and contingency measures.** The 2017/18 budget assumes continued strengthening of tax policy and administration. The Government is confident that the tax policy and administration measures outlined in the budget speech will yield the desired results. However, the Government recognizes the importance of sequencing of project implementation, particularly mega projects, to avoid bunching payment obligation and hence fiscal pressure. These projects include Government contribution on standard gauge railway construction and renovation of ports, including the Dar es Salaam port. The cost of these projects for 2017/18 budget is about 1.2 percent of GDP. Similarly, projects for which external financing has not been mobilized in the course of 2017/18 will be postponed. Conditioning the implementation of these projects to resources availability, coupled with strong commitment controls through IFMIS, would allow containing the budget deficit within the target and preventing further accumulation of expenditure arrears.

Revenue Mobilization

21. **Tax policy reforms.** The 2017/18 budget targets increasing tax and non-tax revenue yield from 15.3 percent of GDP in 2016/17 to 16.4 percent of GDP in 2017/18. The Government will continue with the review of tax exemption regime and improving presumptive taxation scheme. In its bid to build an industrial-growth economy the Government will implement pro-industrial growth policies through policy reforms in the VAT regime so as to release capital currently being tied in input VAT through the pay-and-refund exemption regime, putting in place incentives for development of industrial growth and rationalizing imposts.

22. **Tax administration reform** to be implemented in 2017/18 will include among others, providing a single platform for processing clearance of documents through implementation of Electronic Single Window system for port community and cross border trade; implementing an Integrated Domestic Revenue Administration System (IDRAS); strengthening the compliance management function; establishing data base for exchange of information; strengthening management and controls at Dar es Salaam port and other ports of entry; and building capacity in administration of specialized areas. The tax administration will continue rolling out to other regions the programmes of improving its taxpayer register by issuing enhancing taxpayer identification number in line with the roadmap for implementation of Tax Administration Diagnostic Assessment Tool (TADAT) study findings.

23. **The Government efforts will also be directed towards improving the performance and contribution of non-tax revenue collection.** In this regards, the Government will continue undertaking policy measures in strengthening non-tax revenue collection by MDAs, LGAs and Public Entities. Moreover, the Government will continue with implementation of roadmap for gradual transfer of non-tax revenue administration function to Tanzania Revenue Authority and enhance Revenue Gateway system to accommodate the accounting of non-tax revenue. The piloting of the financial analysis and reporting system (FARS) to 27 parastatals will be extended to 50 more parastatals in 2017/18.

Program Monitoring

24. **PSI Extension Request.** Tanzania has maintained good relationship with the International Monetary Fund (IMF) through Government successful implementation of various policy based programs. Currently, the government is implementing the Policy Support Instrument (PSI) Program, which was approved in July 2014 and is coming to an end in July 2017. The PSI program has been instrumental for Tanzania in sustaining macroeconomic stability. It is against this background that the Government requests extension of the program to January 2018 while designing a successor program.

25. Assessment criteria for end-June 2017 and indicative targets for end-September and end-December 2017 are set as per Table 1. The seventh review under the PSI is expected to take place by December 2017 on the basis of the assessment criteria and structural benchmarks indicated in Tables 1 and 2, attached.

Table 1. Tanzania: Quantitative Assessment Criteria (AC) and Indicative Targets (IT) Under the Policy Support Instrument, September 2016–December 2017

	Sep. 2016				Dec. 2016				Mar. 2017				June 2017		Sep 2017	Dec 2017
	IT				AC				IT				IT	AC	IT	IT
	Program ²	Adjusted Criteria	Actual	Met?	Program ²	Adjusted Criteria	Actual	Met?	Program ²	Adjusted Criteria	Actual	Met?	Program ²	Proposal	Proposal	Proposal
(Billions of Tanzania Shillings; end of period, unless otherwise indicated)																
Average reserve money (upper bound) ⁴	7,418	7,418	6,636	✓	7,729	7,729	6,980	✓	7,925	7,925	6,434	✓	7,958	7,236	7,352	7,534
Average reserve money target ⁴	7,345				7,652				7,846				7,879	7,164	7,279	7,459
Average reserve money (lower bound) ⁴	7,272				7,576				7,768				7,801	7,093	7,206	7,384
Tax revenues (floor) ³	3,385	3,385	3,456	✓	7,086	7,086	7,064	✗	10,672	10,672	10,580	✗	14,448	14,185	3,822	7,997
Priority social spending (floor; indicative target) ³	790	790	881	✓	1,580	1,580	1,758	✓	2,370	2,370	2,585	✓	3,160	3,160	930	1859
Accumulation of domestic expenditure arrears (ceiling) ^{3, 5}	0	0	-293	✓	0	0	190	✗	0	0	...		0	0	0	0
Fiscal balance (cumulative, floor) ^{3, 8, 9}	-1,219	-1,219	326	✓	-2,403	-2,403	94	✓	-3,650	-3,650	-658	✓	-5,027	-3,140	-1,392	-2,228
(Millions of U.S. dollars; end of period)																
Change in net international reserves of the Bank of Tanzania (floor) ^{3, 6, 7}	181	-119	171	✓	310	10	494	✓	439	139	603	✓	567	600	-98	106
Accumulation of external payment arrears (continuous AC ceiling) ³	0	0	0	✓	0	0	0	✓	0	0	0	✓	0	0	0	0
Memorandum items:																
Foreign program assistance (cumulative grants and loans; millions of U.S. dollars) ³	55	55	43		160	160	84		202	202	182		378	342	51	214
o.w. Program grants (millions of U.S. dollars) ³	5	5	43		34	34	56		50	50	56		108	167	51	149
External nonconcessional borrowing (ENCB) disbursements to the budget (millions of U.S. dollars) ³	315	315	20		629	629	52		944	944	113		1,259	507	139	276
Arrears to PSPF on account of the 1999 reform cleared from the beginning of fiscal year 2016/17 and 2017/18 in each fiscal year (billions of Tanzania shillings) ³			0				0				0					
Amount of loans in arrears made by pension funds to government entities and cleared by the government from the beginning of fiscal year 2016/17 and 2017/18 in each fiscal year (billions of Tanzania shillings) ³			0				0				0					

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

¹ From the third review under the Policy Support Instrument.

² From the fourth review under the Policy Support Instrument.

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

⁴ Assessment criteria and indicative targets apply to upper bound only.

⁵ Starting from June 2016, AC for the end of the fiscal year, otherwise IT.

⁶ 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 US\$300 million.

⁷ Starting end-December 2015 the NIR target excludes short-term (less than 1 year) foreign exchange liabilities to residents.

⁸ The fiscal deficit is measured on a cash basis from the financing side at the current exchange rates and is defined as a sum of (i) net domestic financing (NDF) of the Government; (ii) net external financing and (iii) privatization receipts as defined in the TMU.

⁹ The deficit in 2016/17 and 2017/18 will be raised by the amount of arrears to PSPF on account of the 1999 reform and the amount of loans in arrears made by pension funds to government entities (recognized by the government) that were cleared during the fiscal year. This adjuster will be capped by the total amount of arrears identified in the strategy to clear arrears to pension funds. The deficit will be increased by any shortfalls in foreign program grants up to a cumulative ceiling of equivalent to US\$200 million calculated at the program exchange rate.

Table 2. Tanzania: Structural Benchmarks Under the Policy Support Instrument, December 2016–December 2017

<i>Measure</i>	<i>Macroeconomic rationale</i>	<i>Target date</i>	<i>Status</i>
Public Financial Management			
Settlement of arrears to PSPF on account of 1999 reform	To address fiscal risks	End-December 2016	Not met. Verification of arrears by the Internal Auditor General has been completed. The MoFP is working on a Cabinet paper recognizing the debt and setting out strategy for settlement.
Settlement of arrears to pension funds on loans made to government	To address fiscal risks	End-December 2016	
Issuance of non-cash bonds in settlement of arrears to PSPF on account of the 1999 reforms as well as to all pension funds on loans made to the government.	To address fiscal risks	February 15, 2017	Not met; rescheduled to end-September 2017
Monetary and Financial Policies			
Prepare for the approval by the Bank of Tanzania's management, an operational plan to implement an interest rate corridor, describing the width of the corridor, the market interest rate that is to be targeted, and how open market operations are to be conducted.	To modernize the monetary policy framework	End-February 2017	Met. BoT staff presented operational details about the planned move to an interest rate-based framework to BoT management and the BoT's Board. On January 27, the BoT's Board approved the planned move later in the year. Preparations are underway for that move.
Complete a review of the Bank of Tanzania's collateral framework, with the aim of accepting government securities of all maturities as eligible collateral for accessing the BoT's standing facilities and windows. The review will include proposals on calculating the discount on securities, and discuss a timeline for implementation.	To modernize the monetary policy framework, and promote development of the government debt securities market	End-March 2017	Met. The BoT decided to expand eligible collateral and has reviewed its Bank Law to see if any changes are needed. The BoT has also contacted the Attorney General's office about their interpretation of the BoT Act in that regard. The BoT is awaiting the response from the Attorney General.
Issue operational guidelines for commercial banks outlining new principles for conducting monetary operations under a new interest rate-based monetary policy framework, setting rules for disseminating information on government securities' auction results and overnight interest rates, and establishing eligibility criteria for banks' access to standing facilities.	Operational steps that are needed to move to an interest rate-based monetary policy framework	Seventh Review	Proposed new benchmark
Expansion of eligible collateral by accepting government securities with longer remaining maturities (i.e.: over 90 days) for the BoT's lending facilities	To improve the functioning of the BoT's lending facilities	Seventh Review	Proposed new benchmark
Introduce an electronic platform for the interbank market	To improve price discovery mechanism in the interbank market and enhance transparency of interbank transactions	Seventh Review	Proposed new benchmark

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

June 12, 2017

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, 1SR and 2SR, as provided by the Bank of Tanzania (BoT) to the IMF, and the government debt tables provided by the Accountant General's office.
3. The program exchange rate is TSh/US\$ 2,223.92.

A. Definitions

Net international reserves

4. Net international reserves (NIR) of the BoT are defined as reserve assets of the BoT minus reserve liabilities of the BoT. 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 acquired through short-term currency swaps maturing in less than one year and other assets used as collateral or as guarantee for a third party external liability (assets not readily available). The BoT's reserve liabilities include: (i) all foreign exchange liabilities except government's foreign currency deposits of residual maturities more than one year; and (ii) outstanding purchases and loans from the IMF, as recorded in the financial position of Tanzania with the IMF by the Finance Department of the Fund.
5. NIR are monitored in U.S. dollars, and for program monitoring purposes assets and liabilities in currencies other than U.S. dollars shall be converted into dollar equivalent values using the exchange rates as of March 31, 2017 (as recorded in the balance sheet of the BoT).

	US\$ per currency unit
British pound	1.2459
Euro	1.0736
Japanese yen	0.0090
Australian dollar	0.7676
Canadian dollar	0.7498
Chinese yuan	0.1451
SDR	1.3619
Swedish Krona	0.1123
Kenyan Shilling	0.0097
South African Rand	0.0777

Reserve money and reserve money band

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

Fiscal cash deficit of the Government of Tanzania

7. The fiscal cash deficit of the Government (central and local governments only) will be measured on a cash basis from the financing side at the current exchange rates. The deficit is defined as the sum of: (i) net domestic financing (NDF) of the Government; (ii) net external financing and (iii) privatization receipts. Any amounts in foreign currency will be converted into Tanzanian shillings at the exchange rates as of the dates of the transactions.

- i. NDF is calculated as the cumulative change since the beginning of the fiscal year in the sum of:
 - a. loans and advances to the government by the BoT and holdings of government securities and promissory notes (including liquidity paper issued for monetary policy purposes), minus all government deposits with the BoT, which comprise 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).
 - b. all BoT accounts receivable due from the Government of Tanzania that are not included under (i) above;
 - c. loans and advances to the government by other domestic depository corporations and holdings of government securities and promissory notes, minus all government deposits held with other domestic depository corporations;

- d. 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
 - e. the outstanding stock of domestic debt held outside domestic depository corporations and other public entities, 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.
 - f. 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.
- ii. Net external financing is measured on a cumulative basis from the beginning of the fiscal year and is defined as the sum of disbursements minus amortization of budget support loans, project loans, external non-concessional borrowing (ENCB) including project ENCB directly disbursed to project implementers; and any other forms of Government external debt. The term “debt” will have the meaning set forth in paragraph 8(a) of the Guidelines on Public Debt Conditionality in Fund Arrangements (Executive Board’s Decision No. 15688-(14/107), adopted December 5, 2014. Government external debt is understood to mean a direct, i.e. not contingent, liability to non-residents of the Government of Tanzania.
 - iii. Privatization receipts consist of net proceeds to the Government of Tanzania in connection with the sale/purchase of financial assets that are not included in NDF and the sale of intangible nonfinancial assets, such as leases and the sale of licenses with duration of 10 years or longer.

Domestic expenditure arrears

8. Domestic expenditure arrears are defined as unpaid claims that are overdue by more than 30 days for goods and services and more than 90 days for contract works as set out in the government’s Circular No. 9 of 8th December 2014. These will include payments for tax refunds, employee expenses (wages and salaries, staff claims for travel, transfer and other non-salary allowances), utilities, rents, recurrent goods and services, and construction works. Accumulation of domestic expenditure arrears is calculated as a cumulative change in the stock of expenditure arrears at the end of each quarter from the stock at the end of the previous fiscal year (June 30).

External payment arrears

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

Priority social spending

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

Tax revenues

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

Arrears to pension funds

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

Foreign program assistance

13. Foreign program assistance is defined as budget support and basket grants and loans received by the Ministry of Finance and Planning (MoFP) 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 non-concessional external debt.

B. Adjusters**Net international reserves**

14. 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 non-concessional borrowing (ENCB) financing of the government budget, up to a limit of US\$300 million.

15. The shortfalls will be calculated relative to projections for foreign program assistance shown in the table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Policies 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.

Fiscal cash deficit

16. The end-of-quarter limits in 2016/17 and 2017/18 will be adjusted upward by the amount of arrears to PSPF on account of the 1999 reform cleared from the beginning of the fiscal year, and the amount of loans in arrears made by pension funds to government entities and cleared by the government from the beginning of the fiscal year. The cumulative upward adjustment to the limits on the deficits in 2016/17 and 2017/18 will be capped by the total amount of arrears and loans that are recognized and taken over by the authorities at the end of the verification and reconciliation process.

17. The end-of-quarter limits will be increased by any shortfalls in foreign program grants up to a cumulative ceiling of equivalent to US\$200 million calculated at the program exchange rate (para 3).

18. The foreign program grant shortfalls will be calculated relative to projections for foreign grants shown in the table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Policies of the Government of Tanzania titled "Quantitative Assessment Criteria, and Indicative Targets under the Policy Support Instrument".

C. Data Reporting Requirements

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

Table 1. Tanzania: 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 clearing balances of other depository corporations	BoT	Weekly	1 week
Daily data on transactions through IFEM by exchange rate and volume, separating BoT and transactions of other depository corporations	BoT	Weekly	1 week
Daily data on reserve money and its components	BoT	Daily	1-day
Consumer price index.	NBS	Monthly	2 weeks
The annual national account statistics in current and constant prices.	NBS	Annually	6 months
The quarterly national account statistics in constant prices.	NBS	Quarterly	3 months
Balance sheet of the BoT (1SRF) and the currency composition of official foreign assets and official foreign liabilities.	BoT	Monthly	1 week
Consolidated accounts of other depository corporations and the depository corporations survey (2SRF and the DCS).	BoT	Monthly	4 weeks
Information on foreign currency swaps entered into with residents and non-residents, including amounts, dates on which agreements come into effect and expire, and terms of swaps.	BoT	Monthly	4 weeks
Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor.	MoFP	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 corporations' lending by activity.	BoT	Monthly	4 weeks
Other depository corporations' interest rate structure.	BoT	Monthly	4 weeks

Table 1. Tanzania: Summary of Reporting Requirements (concluded)

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 non-concessional terms; and (v) net international reserves. ¹	BoT and MoFP	Monthly	4 weeks
Amount of arrears outstanding that are overdue by more than 30 days for goods and services and more than 90 days for contract works as set out in the government's Circular No. 9 of 8 th December 2014 for all government ministries.	MoFP/AGD	Quarterly	2 months
The flash report on revenues and expenditures.	MoFP/AGD	Monthly	4 weeks
The TRA revenue report	TRA	Monthly	4 weeks
The monthly domestic debt report. ¹	MoFP	Monthly	4 weeks
Monthly report on central government operations.	MoFP	Monthly	6 weeks
Detailed central government account of disbursed budget support grants and loans, and ENCB, and external debt service due and paid.	MoFP	Monthly	4 weeks
Detailed central government account of disbursed donor project support grants and loans.	MoFP	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.	MoFP	Quarterly	4 weeks
Quarterly report on loans and advances to government by pension funds and other public entities not covered by the central government accounts	MoFP	Quarterly	4 weeks
Report on priority social spending	MoFP	Quarterly	6 weeks

¹The MoFP 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 MoFP.

Statement by Mr. Maxwell Mkwezalamba, Executive Director for the United Republic of Tanzania, and Mr. Jackson Odonye, Senior Advisor to Executive Director

June 23, 2017

Our Tanzanian authorities welcome the Fund's engagement, and express their appreciation for the policy advice and technical assistance (TA) received over the years. They acknowledge that the Policy Support Instrument (PSI) has been instrumental in shaping Tanzania's macroeconomic policies. Noting that the current three-year PSI ends in July 2017, they consider an interim arrangement covering the period of negotiations for a successor PSI expected beginning in January 2018 to be essential to anchor policy and sustain the high level of growth achieved so far. In this regard, the authorities request for the completion of the sixth review under the PSI and a 6-month extension of the current PSI. They also request a waiver for the non-observance of the end-December 2016 assessment criterion on tax revenues that slightly missed the target.

The authorities welcome the staff report and broadly agree with the analysis on various reform efforts, including tackling corruption and tax evasion to improve revenue collection, and the drive for industrialization and human development under the government's second Five-Year Development Plan, 2016/17–2020/21 (FYDP II). They reiterate that the rebalancing of recurrent expenses in favor of capital spending will strengthen the delivery of key services and investment as well as create more job opportunities.

Performance Under the Policy Support Instrument

The performance of the program under the PSI arrangement was broadly satisfactory as most quantitative targets for December 2016 and March 2017 were met. Similarly, targets on average reserve money, net international reserves, priority social spending, overall fiscal balance, and non-accumulation of external reserves were met. The December 2016 assessment criterion on tax revenues was, however, missed by a small margin, partly due to the shortfall on income tax and excises.

The authorities are making concerted efforts to meet and sustain performance of all structural benchmarks. The authorities are also committed to ensure conclusion of the ongoing audit for payment of VAT refunds. The planned migration to an interest rate-based monetary policy framework also recorded notable progress. The recent consultation between the Bank of Tanzania (BoT) and Fund staff held in Washington, D.C., at the end of the 2017 IMF/WB Spring Meetings helped the authorities to finalize arrangements for migration by early 2018. On settlement of government arrears to pension funds, the verification exercise was completed and a Cabinet approval is expected by September to close this issue.

Economic Developments and Outlook

Tanzania has been among the best performers in the sub-Saharan Africa (SSA) region in recent years. The economy remained strong in 2016 conforming with the authorities' medium term targets, with growth averaging around 7 percent on the back of robust performance in mining, construction, and communication and transportation sectors. The real growth at 7 percent in 2016 confirms that the weakening economic activity in late 2016 was somewhat compensated. As a result, the authorities project growth at around 7 percent for 2016/17, instead of the projected GDP growth of 6.2 percent on Pages 8 and 9 and in Table 1 of the staff report. The two decades of strong growth has resulted in a six-fold increase in per capita GDP and is expected to continue in the medium term conditioned on recovery of the global economy, improved power supply, and implementation of infrastructural projects under the second FYDP II.

Over the course of 2016, inflation remained in single digit levels largely benefiting from tight monetary policy and fiscal restraint, subdued global oil prices, improved power supply, and exchange rate stability. Favorable rains in Tanzania's southern region and the easing of drought conditions in the neighboring countries should further dampen food prices. Therefore, inflation, which was 5 percent in 2016, is expected to remain low and stable in line with the authorities' medium term target.

Tanzania's external current account deficit has continued to narrow, and the stock of external reserves has remained adequate. By end-March 2017, reserves were equivalent to 4 months of import as imports shrunk. Consequently, the shilling has appreciated by 3 percent in real terms since early 2017.

Fiscal Policy and Public Finance Management

Considerable efforts have been made to ensure fiscal prudence and adequate resources needed to implement the government's development plan. The strong drive against corruption and tax evasion spearheaded by President John Magufuli is an important anchor, and government counts that the momentum can be sustained into the medium- to long-term. The authorities are adjusting spending in favor of investment to strengthen economic activity and create jobs, which is crucial for ensuring a sustainable development and inclusive growth.

Since FY2014/15, the revenue and deficit outturns have been broadly in line with program targets. The tax-to-GDP ratio has increased by about 1½ percent of GDP, influenced by the government's fight against corruption and tax evasion. In 2016/17, the fiscal performance for the first nine months was broadly on track and tax revenue remained largely on target. The 2017/18 budget will strike a balance between raising public investment to address various development needs to ensure debt sustainability as provisioned by the FYDP II. The fiscal deficit is projected to be maintained at about 4½ percent of GDP in the medium term, which will cater for multi-year infrastructure projects before declining to about 3 percent of GDP.

Regarding expenditure management, significant savings are expected from delaying projects and cutting non-priority spending in the medium term. The authorities are mindful that successful implementation of investment projects is conditioned on mobilization of adequate resources, both from domestic and foreign sources. The authorities are also lengthening the average maturity of domestic debts to reduce the rollover risks. Initiative to revive and strengthen relationships between the government and development partners is expected to enhance the predictability of foreign assistance.

Going forward, tax policy reforms will focus on increasing tax and non-tax revenue yield from 15.3 percent of GDP in 2016/17 to 16.4 percent of GDP in 2017/18. The review of the tax exemption regime will continue and improvements will be made to the presumptive tax scheme. Key tax administration reforms will focus on the Electronic Single Window System for processing documents; use of the Integrated Domestic Revenue Administration System (IDRAS); strengthening the compliance management function; establishing tax-payers' data base; strengthening ports' management and controls; and building capacity, including for managing the PPPs and associated risks. The performance of non-tax revenue will be strengthened through enhanced collection methods within the national departments and agencies, local government authorities, and public entities.

Debt Management Policy

Tanzania remains comfortable on debt sustainability and efforts will be made to maintain the trajectory. The recent debt sustainability analysis (DSA) conducted in mid-2016 reflects that Tanzania can afford a higher fiscal deficit of up to 4½ percent of GDP in the medium term and still retain its low risk profile. Additionally, the authorities are aiming to contract project financing from multilateral development banks and export credit agencies consistent with the objectives of their recent medium-term debt strategy (MTDS) to reduce the risk of debt distress.

Monetary, Exchange Rate, and Financial Sector Policy Issues

Pending developments in the financial market, the BoT will continue with the current discount rate and the statutory minimum reserves (SMR) ratio, and increase the use of reverse repos and foreign exchange (FX) sales to boost liquidity. Expectedly, these actions will complement fiscal developments and enhance collaboration of the relevant authorities, especially in anticipation of the planned fiscal spending. The BoT will also continue to build international reserves to absorb external shocks. Exchange rates will continue to be market-determined with the BoT managing and, occasionally, smoothing liquidity in the Interbank Foreign Exchange Market to remove excess volatility.

Modernizing the monetary policy framework to be more forward looking remains an important goal. Early in the year, the reform, which has interbank call market (IBCM) rate as an operational target, commenced with the introduction of reserve averaging. Improvements will continue on the development of an electronic platform for interbank cash market operations, integration of the forecasting and policy analysis system (FPAS) into the monetary

policy formulation process, improvement in the functioning of domestic financial markets, expansion of the range of eligible collateral for monetary operations, and enhancement of coordination with fiscal policy. The process will also involve issuing operational guidelines to commercial banks, outlining new principles for conducting monetary operations, setting rules for disseminating information on IBCM results and overnight interest rates, and establishing eligibility criteria for access to standing facilities. The BoT will also continue to monitor banks' free reserves to maintain stability in the IBCM rate.

The banking system's resilience has strengthened in recent years, reflecting the introduction of higher regulatory requirements. The sector remains sound and stable with banks maintaining adequate capital and mandatory prudential liquidity levels. The BoT has directed banks with high NPLs to formulate and implement strategies to bring their ratios to a maximum of 5 percent. It also encourages banks to increase the use of existing credit reference system and to tighten credit standards and reduce risks. Higher capital requirements will provide banks with additional buffers to withstand the recent increase in credit risk. The BoT has also put under administration one small bank for failing capital standards and closed another bank which had prolonged liquidity problems and a money laundering concern.

Structural Reforms

Tanzania's development priorities as outlined in the FYDPII are geared to facilitate industrial transformation and human development. The strategy seeks to harness its comparative advantage, particularly in agriculture and mining, and the potential of becoming a trading hub in East Africa. To this extent, the government is addressing infrastructure gaps to facilitate private sector-led growth, and creating a conducive business environment for job creation. It plans to tap Tanzania's enhanced domestic revenue potential to address large investment needs with public-private partnerships (PPPs) playing an important role in major infrastructure projects. Attention will be paid to raising skills to manage unintended risks of PPP projects. A full costing for the projects, which can be high, will be determined when current updates of the medium- to long-term macroeconomic frameworks are completed.

On improving the business environment to align with the FYDP's objectives of private sector-led growth, the authorities underscore the recent revival of dialogue with the private sector, spearheaded by the Minister of Finance in collaboration with the Minister for Industries, Trade and Investment. A quarterly forum was agreed for that purpose in addition to the forum for Tanzania's National Business Council, which is chaired by the President. These outlets have become veritable vehicles for disseminating government policies and collecting feedback.

Further, the government is making efforts to clear arrears in the energy sector to make the public electricity utility firm (TANESCO) sustainable. Given its stock of arrears to gas suppliers, an agreement has been reached between Tanzania Petroleum Development Corporation (TPDC) and TANESCO to gradually clear them. On natural resource management, the government team is almost through with the draft term sheet to facilitate the preparation of a host government agreement for the Liquefied Natural Gas project. Another effort is the government strong drive against corruption, which has resulted in higher fiscal

revenues and uncovered fraudulent expenditures. The draft Foreign Exchange Regulations 2017 prepared by the BoT has reflected the views of the Capital Market and Securities Authority preparatory to a full open capital account by end-December 2017.

Conclusion

Our authorities are steadfastly committed to the implementation of sound macroeconomic policies and look forward to continued engagement with the Fund. They also commit to continue their structural reforms aimed at unlocking the growth potential. In this regard, they look forward to the completion of the sixth review under the PSI and approval of the extension of the PSI for six months, including a waiver for the non-observance of the end-December 2016 assessment criterion on tax revenues.