

United Republic of Tanzania: Fourth Review Under the Policy Support Instrument and Request for an Arrangement Under the Standby Credit Facility—Staff Report; Debt Sustainability Analysis; Press Release on the Executive Board Discussion; and Statement by the Alternate Executive Director for The United Republic of Tanzania.

In the context of the fourth review under the policy support instrument and request for an arrangement under the standby credit facility, the following documents have been released and are included in this package:

- The staff report for the fourth review Under the Policy Support Instrument and Request for an Arrangement Under the Standby Credit Facility, prepared by a staff team of the IMF, following discussions that ended on April 20, 2012, with the officials of Tanzania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 22, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- Debt Sustainability Analysis.
- A Press Release summarizing the views of the Executive Board as expressed during its July 6, 2012 discussion of the staff report that completed the request and/or review.
- A statement by the Alternate Executive Director for the United Republic of Tanzania.

The documents listed below have been separately released.

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

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

Technical Memorandum of Understanding*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

UNITED REPUBLIC OF TANZANIA

Fourth Review Under the Policy Support Instrument and Request for an Arrangement Under the Standby Credit Facility

Prepared by the African Department
(In consultation with other departments)

Approved by Roger Nord and Elliott Harris

June 22, 2012

- **Fund relations:** A 3-year PSI-supported program was approved by the Executive Board on June 4, 2010. The first review was completed on December 3, 2010, the second on May 6, 2011, and the third on January 20, 2012.
- **Staff team:** Messrs. Allum (head), Davoodi, Gigineishvili (all AFR), Ms. Rahman-Garrett (SPR), Ms. Mineshima (FAD), Mr. Wakeman-Linn (senior resident representative through April 2012), and Mr. Baunsgaard (resident representative from May 2012).
- **Discussions:** Held in Dar es Salaam during March 1–14; in Washington during April 16–20; and subsequently through the resident representative in the run up to the 2012/13 budget. The team met with former Minister for Finance Mkulo; Governor Ndulu of the Bank of Tanzania; The Permanent Secretary of the Treasury, Mr. Khijjah; acting Permanent Secretary of the Treasury, Mr. Likwelile; other senior officials; and representatives of the private sector, civil society, development partners, and the press. Mr. Ndyeshobola (OED) participated in the discussions.
- **Review:** Staff supports the authorities' request for completion of the review and approval of a precautionary 18-month arrangement under the Standby Credit Facility for SDR 149.175 million (75 percent of quota) with access of SDR 37.3 million available on approval.

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EXECUTIVE SUMMARY

Tanzania's economy experienced adverse supply shocks in 2011. Regional drought conditions led to higher food prices as well as a slump in hydroelectric power generation. With a parallel rise in global fuel prices, inflation rose to almost 20 percent at end-2011, while an increase in petroleum imports to fuel emergency power generators boosted the external current account to an estimated 15 percent of GDP. Strong construction and services expansion helped sustain real GDP growth of 6.4 percent in 2011, despite the impact of significant power outages.

Tighter fiscal and monetary policies are addressing the inflationary impact of the drought/energy shock, while new investments will ease longer-term power constraints. Fiscal tightening in 2011/12 through strong revenue performance and tight expenditure management eased demand pressures, supported by tightened monetary conditions. Balance of payments pressures have abated, and inflation has begun to slowly recede. To address energy shortages, power tariffs were increased by 40 percent in January 2012 and a new externally-financed gas pipeline will allow expanded power generation using lower-cost natural gas.

Performance under the PSI-supported program has been generally satisfactory. All December 2011 and March 2012 quantitative assessment criteria and indicative targets were met, other than the March 2012 floor on net international reserves, which was missed on account of delays in contracting programmed external borrowing. All five structural benchmarks for the period through end-June 2012 were implemented.

The fiscal consolidation in 2011/12 involved some difficult adjustments relative to an initially expansionary budget. With fiscal tightening compounded by delays in accessing external concessional and commercial financing, cash limits were much tighter than budgeted. Partly as a consequence, domestic expenditure arrears rose slightly through March 2012, rather than being cleared as programmed.

Continued tight economic policies are targeted for 2012/13. The reduction in the overall fiscal deficit to 5½ percent of GDP will support disinflation and bring the deficit closer to a debt stabilizing level. With inflation declining only gradually, monetary policy will need to remain tight.

Even as it strengthens its macroeconomic buffers, Tanzania remains vulnerable to new external shocks. A renewed downturn in the global economy could adversely affect exports, foreign direct investment, and market financing. Accordingly, the authorities have requested an 18-month precautionary Standby Credit Facility (SCF) to run in parallel with the PSI.

Based on performance under the program and policy commitments for 2012/13, staff supports:

- completion of the fourth review under the PSI; and
- the request for an 18-month precautionary SCF.

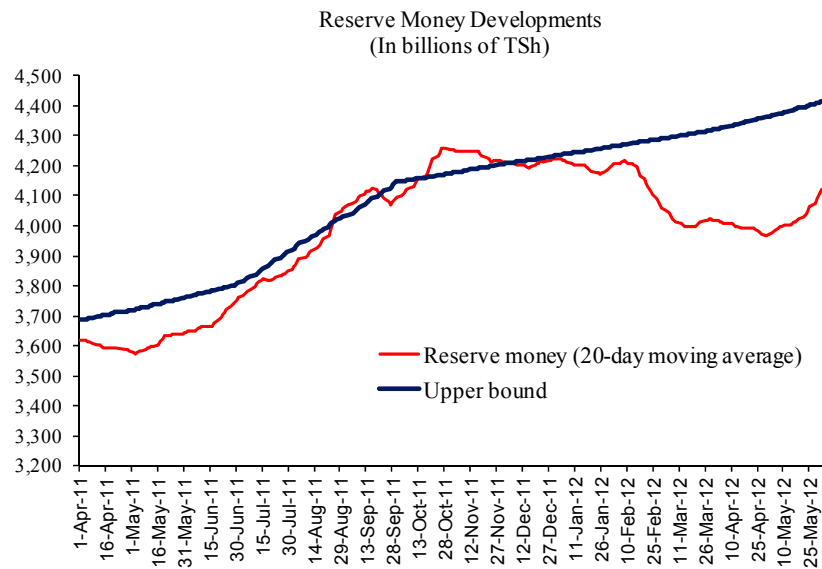
I. INTRODUCTION

1. **In 2011, Tanzania experienced important supply-side shocks from higher global fuel prices and regional drought.** After low rainfalls, hydro generation slumped, causing severe power outages early in the year. Petroleum imports surged on account of demand from private owners of standby generators and from large temporary thermal generators contracted to power the grid. Increased fuel imports contributed to currency pressures in 2011, which were exacerbated by market perceptions that monetary policy was responding too slowly to higher food and fuel prices.
2. **Fiscal and monetary tightening during 2011/12 addressed the most immediate external and pricing pressures,¹ but the power sector remains vulnerable.** The exchange rate has strengthened and inflation is edging lower. However, with reservoir water levels still low, further measures will be needed to address sector operating losses.
3. **In a May 2012 Cabinet reshuffle, Dr. William Mgimwa was appointed minister for finance** (one of six new ministers). On June 14, 2012, the government's 2012/13 budget was presented to parliament; this budget provides the basis for the fiscal framework and associated policy proposals described in this report and in the authorities' attached Memorandum of Economic and Financial Policies (MEFP).

II. RECENT DEVELOPMENTS AND ECONOMIC OUTLOOK

4. **Macroeconomic trends remain generally favorable.**
 - **GDP growth** in the first half of 2011/12 was 6.5 percent, unchanged from 2010/11 (Table 1 and Figure 1). Although electricity production declined 5 percent y-o-y in July–December 2011, growth benefitted from strong construction and services activity.
 - **Headline inflation** peaked at almost 20 percent in December 2011, led by food and energy prices (up 27 and 41 percent, respectively). With slowing food and energy price increases, inflation declined to 18.2 percent in May 2012. Core inflation (excluding food and energy) has been in the 8.7 to 9 percent range, up from about 4 percent a year earlier (Figure 2).
 - **Reserve money** has been held significantly below programmed levels since December 2011, resulting in higher interest rates, slowing liquidity and credit growth, and an appreciation rally in the currency in the fourth quarter of 2011 (Figure 2). Based on the headline CPI, the real exchange rate appreciated 16 percent in the year to April 2012.

¹ The fiscal year begins July 1.



- **Imports** were up 37 percent y-o-y in the first nine months of 2011/12, largely reflecting higher oil imports. Reflecting this trend, the current account deficit is projected at nearly 15 percent of GDP in 2011/12, up from the 9 percent of GDP range in recent years (Figure 1). The increased deficit is being financed through foreign direct investment and other private capital inflows (Table 4).
5. **Tanzania is on track to cut its overall cash basis fiscal deficit to 6.2 percent of GDP in 2011/12.** This would be below programmed levels (6.6 percent of GDP) (Figure 1).
- **Tax revenues are over-performing** (MEFP ¶4) Collections are projected to exceed programmed levels by 0.3 percent of GDP (Table 2b), reflecting strengthened tax administration, steps taken to tackle obstacles to mining taxation, and stronger than expected economic activity.
 - **Cash management has been tight** (MEFP ¶6). Full-year spending for the major budget components is projected to be at or below the tightened ceilings established at the time of the mid-year budget review.
6. **Financing flows strengthened in the second half, after delays in early-2011/12.** Reflecting initial financing challenges, a rolling balance of expenditure arrears to domestic suppliers equivalent to 1 percent of GDP remained outstanding as of end-March 2012, with the planned settlement delayed to late in the year. Public debt (excluding domestic arrears) at end-June 2012 is projected to approach 41 percent of GDP, up from 37½ percent of GDP a year earlier.

III. PROGRAM PERFORMANCE

7. **Most program goals for the 4th PSI review period were achieved.**
- **Quantitative targets.** All assessment criteria and indicative targets for December 2011 and March 2012 were met, except for the March 2012 indicative floor on net international reserves (NIR), which was missed by \$62 million (MEFP Table 1). This shortfall reflected continuing foreign currency sales at a time when external non-concessional borrowing fell significantly short of programmed levels. Subsequently, currency sales were scaled back, and if non-concessional borrowing is contracted as planned, the June 2012 NIR floor is projected to be narrowly met.
 - **Structural benchmarks.** All five structural benchmarks for the period through end-June 2012 were implemented (MEFP ¶14 and MEFP Table 3).

IV. POLICY DISCUSSIONS

A. Further steps to put public finances on a sustainable path

8. **The government aims to reduce Tanzania's fiscal deficit while safeguarding development and priority social spending.** A withdrawal of earlier countercyclical fiscal stimulus will, over time, bring public borrowing to a level consistent with debt stability while also narrowing the external current account deficit. In 2012/13, the central government fiscal deficit before grants is projected to decline by about 2.5 percentage points of GDP, in large part reflecting lower donor project financing as a number of one-off projects expire. The overall deficit after grants is projected to decline to 5½ percent of GDP, with further reductions targeted for subsequent years (MEFP ¶18 and Text Table 1). Despite the reduction in the deficit, the public sector borrowing requirement increases in 2012/13 owing to the construction of a foreign-financed gas pipeline, as discussed below.

Text Table 1. Fiscal and Debt Indicators, 2008/09–2013/14
(Percent of GDP)

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
	Est.	Est.	Est.	Proj.	Proj.	Proj.
Central government						
Overall deficit before grants	9.9	11.6	10.6	12.2	9.6	8.0
Overall deficit after grants ¹	4.6	6.4	6.9	6.2	5.5	4.5
Primary deficit	3.7	5.6	5.9	5.1	4.3	3.1
Public sector						
Public sector borrowing reqt. ²	4.6	6.4	6.9	6.2	8.6	5.4
Total public debt (nominal)	30.0	33.0	37.6	40.9	45.6	46.8

¹ Cash basis.

² Estimated as the overall cash deficit plus external borrowing to finance the new gas pipeline.

Source: Tanzanian authorities and Fund staff estimates.

9. **Strengthened revenue collections will contribute a projected 1½ percentage points of GDP to fiscal consolidation in 2012/13.** This combines an underlying increase in collections—through further improvements in tax administration and rising mineral sector tax receipts (MEFP ¶22)—and new revenue measures, including in the 2012/13 budget (MEFP ¶23 and Box 1).

Box 1. Revenue Measures in the 2012/13 Budget¹

	TSh billion	(% of GDP)
Tax measures	244	0.50
• New excise duties and increases in existing duties	144	0.30
• Abolition of tax exemptions	20	0.04
• Income tax reforms	12	0.02
• Other tax measures	68	0.14
Non-tax measures	113	0.23
• Increase in land rental fees	74	0.15
• Increase in a royalty rate for gold mining companies	39	0.08
Administrative and other gains	297	0.61
Total:	654	1.35

¹ See MEFP ¶22 and ¶23 for details.

10. **Recurrent spending is budgeted to decline in relation to GDP.** With continuing tight expenditure ceilings and public workforce expansion limited to priority sectors, major categories of non-interest recurrent spending are budgeted to see further modest declines in relation to GDP in 2012/13. The ratio of recurrent spending to recurrent incomes (revenues and budget support grants) is programmed to decline from 100 percent in 2011/12 to 95 percent in 2012/13 (Table 2a); this goes beyond the goal of 97 percent established in the third PSI review. Fiscal space is created for expanded pro-growth public investments even as the fiscal deficit is reduced.

11. **The 2012/13 budget assumes slightly higher reliance on external nonconcessional borrowing.** With a decline in concessional financing of the budget, external nonconcessional borrowing (ENCB) is projected at 2.6 percent of GDP, up slightly from the projected 2.3 percent of GDP in 2011/12.

12. **Total public sector expenditures remain buoyant, reflecting a large public enterprise investment in 2012/13.** The Tanzania Petroleum Development Corporation (TPDC) is constructing a gas pipeline over the coming two years equivalent to 4 percentage points of GDP, financed externally largely on concessional terms (Box 3). Although public sector fiscal accounts are not available, staff estimates suggest an increase in public sector borrowing measured including this pipeline of about 2½ percentage points of GDP in 2012/13, with a subsequent decline in 2013/14 (Text Table 1).

B. Fiscal risks and debt sustainability are being monitored closely

13. **Revenue collections will be key to program success in 2012/13.** Monitoring in this area will be enhanced by including in the program a new quarterly indicative floor for tax collections. In the event that revenue goals are not achieved, the government intends to keep the program on track through further savings in recurrent spending and/or by scaling back the planned increase in domestically-financed development projects (MEFP, ¶26). To safeguard priority sectors from such cuts, the government will preserve spending on agricultural inputs and educational and health transfers to local governments, with a new indicative floor for such spending established under the program (MEFP Table 2).

14. **Tanzania's debt sustainability assessment (DSA) has been updated to reflect new borrowing activities.** The DSA reflects the lower-than-projected debt outturn at end-2011/12, upward revisions to GDP, and updated public sector borrowing projections. The borrowing figures include two loans to parastatals in the context of the energy crisis—government borrowing of \$1.25 billion for the TPDC pipeline (Box 3),² and government guarantees for a \$135 million external commercial credit to the power utility, TANESCO (para 20). Based on the commercial component of these energy sector credits and infrastructure financing for the 2012/13 budget and to carry over a small amount of undisbursed credits for use in early-2013/14, the authorities have requested that the three-year PSI ceiling on contracting ENCB be increased to \$1,768 million (up from an initially programmed \$1.5 billion) (Box 2).

² The pipeline-related borrowing was included in the last DSA of April 2011.

Box 2. Raising the ENCB Ceiling

The higher ENCB ceiling through 2012/13 would accommodate the following credits:

<u>Projects:</u>	(\$ millions)	
	<u>Contracted under program</u>	<u>Disbursed by end-2012/13</u>
• Bank loans for power generation equipment purchases in 2011.	183	183
• Bank loan for road construction payments in 2011/12.	250	250
• Syndicated bank loan for various development projects. To be contracted by end-June 2012, and to disburse in 2011/12 and 2012/13.	350	350
• Syndicated bank loans for infrastructure spending, to be contracted in 2012/13 (with residual \$13 million disbursed in early-2013/14).	600	587
Total central government budget financing	1,383	1,370
• Commercial financing for TPDC gas pipeline, to be contracted in 2012/13 and to disburse in 2012/13 and 2013/14.	250	172
• Government guarantee for bank credit to TANESCO, to be issued around end-June 2012.	135	135
Total public sector commercial financing	1,768	1,677

15. **The updated DSA shows Tanzania's risk of debt distress remaining low.** The framework assumes a decline in the primary deficit to a debt-stabilizing level of 2½ percent of GDP by 2014/15 with further reduction to the 1½–2 percent of GDP range subsequently. With lower financing needs, commercial borrowing is assumed to average 1 percent of GDP annually beyond 2012/13. Under these conditions, external debt indicators remain well below risk thresholds and total public debt levels remain moderate. Scenario analysis indicates that the debt indicators are sensitive to further borrowing on expensive terms. To maintain future debt and fiscal sustainability, a sound debt management strategy and a stronger capacity for public investment planning and execution are needed. Debt sustainability is critically dependent on an assumed decline in the central government primary deficit, limited government guarantees of borrowing by public enterprises, and careful management of the risks posed by fiscal contingent liabilities. Debt sustainability could be supported over the medium to long term, if Tanzania were to successfully exploit what appear to be large deep water natural gas reserves. With investments to tap these resources, Tanzania would benefit from a surge in export and fiscal revenues starting in the early-2020s.

Box 3. Tanzania's Gas Pipeline Project

Project goals. Given the volatile and declining contribution of hydroelectric power (Figure 3) and the high cost of imported liquid petroleum fuels, Tanzania intends to draw increasingly on its natural gas reserves for power generation. Full utilization of gas reserves in Southern Tanzania (Songo Songo and Mnazi Bay) is currently hampered by pipeline capacity constraints. Accordingly, a new 36-inch diameter gas pipeline will allow for expanded delivery of gas to Dar es Salaam and nearby areas for power and industrial use. The project would be implemented over 18 months, starting in 2012/13.

Project costs and implementation. The cost is around \$1.25 billion (4.2 percent of 2012/13 GDP). Financing is being provided by Chinese banks through a combination of nonconcessional and concessional loans (roughly 1:4 ratio), with a small contribution from the Government of Tanzania. Chinese contractors will deliver the pipeline as a turnkey project to the parastatal Tanzania Petroleum Development Corporation (TPDC), which will run the pipeline on commercial terms.

Fiscal treatment. The external loans will be contracted by the government of Tanzania, which will extend a counterpart credit to TPDC. The central government fiscal presentation (Tables 2a–2b) records these transactions as a build-up of financial assets and liabilities “below-the-line” following standard GFSM 2001 practice. For debt service payments, a portion of the revenue from TPDC’s pipeline operations will be transferred to the central government as non-tax revenues (not included in the current fiscal framework), which will be used for interest payments to the foreign creditors (included in the framework). Principal repayments—TPDC’s repayments to the government and counterpart repayments by the government to the foreign creditors—will be recorded as a reversal of financial assets and liabilities “below-the-line”; these repayments are expected to begin around 2018/19. The project’s medium- to long-term fiscal implication will depend, in part, on the profitability of the pipeline.

Project evaluation. The authorities have shared with the IMF two feasibility studies for the project (structural benchmark); both indicate commercial viability (albeit with some differences in project cost assumptions). The broader economic benefits would exceed the commercial benefits, as a shift to low cost gas power generation will reduce power tariffs (relative to the alternative of liquid petroleum fuels). These savings would be passed on to industrial and other users, raising Tanzania’s competitiveness and growth prospects. The consultant studies indicate that existing gas reserves will be adequate to meet projected power generation needs for the coming decade. Access to additional new gas discoveries will be needed to make the pipeline viable over a 20-year period.

C. Structural Fiscal Reforms

Public finance management

16. **The authorities continue to strengthen public finance management.** Steps have been taken to enhance internal audits and accounting standards at both the central and local government levels (MEFP, ¶30–33). As a favorable development, the auditor general’s opinion on the consolidated public sector financial statements was upgraded from “adverse” in 2009/10 to “qualified” for 2010/11. To strengthen fiscal transparency, in 2011/12, the authorities started publishing on the MoF website the full budget documents and the summary “citizens’ budget” (a short user-guide to the budget process); they are committed to

continuing this practice (MEFP, ¶37). Further progress is needed to strengthen budget preparation and cash management, in particular to address too optimistic revenue estimates and a consequent dependence on cash budgeting; unpredictability in the release of budget funds; a tendency for government entities to lock-in cash resources well in advance of their spending needs; and significant idle balances of public funds maintained outside of the treasury single account arrangement. Transparent accounting is also needed for public enterprise borrowing and expenditures benefitting from government guarantees. Steps to strengthen PFM have benefitted recently from a broad IMF diagnostic mission and thematic support from the regional technical assistance center.

17. **Pension sector reforms are needed.** Tanzania's public sector pension fund schemes are not sustainable because of generous benefit formulas and low returns on invested assets. To address these issues, the Bank of Tanzania issued in March 2012 investment guidelines to the Tanzanian mainland schemes with a view to strengthening investment returns and governance (structural benchmark, MEFP ¶50). The government is also framing reforms to pension entitlement rules, supported by technical assistance from the World Bank. Multi-year Bank funding is being considered to underpin the financial needs of the sector pending the positive impact of reforms.

Tax policy reforms

18. **The government plans to draft a new VAT law to be effective in 2013/14.** The law would seek to follow international standards by reducing to a minimum exemptions and preferential treatments, which have steadily accumulated over time. A broadened tax base and simplified tax administration would help boost collections, potentially contributing substantially to the fiscal measures equivalent of 1.6 percent of GDP that remain to be identified to bring the overall fiscal deficit to 4½ percent of GDP in 2013/14 (Table 2b). The new VAT law is expected to benefit from technical assistance from the IMF (MEFP ¶23).

Public debt management

19. **The Government intends to take steps to raise Tanzania's debt management capacity from its current "low" rating** (MEFP ¶35). The launch by end-2012 of a new debt management office will consolidate Tanzania's fragmented debt management functions and strengthen capacity. The new office will compile data on government debt guarantees on a quarterly basis to further improve the monitoring of debt liabilities. Coordination between the relevant departments in the central bank and Ministry of Finance will also be strengthened to improve the consistency of external debt data. A second focus will be on strengthened institutional arrangements to appraise and select public investment projects. Existing procedures under which the Planning Commission provides a fragmentary assessment of investments does not provide strong assurances on value for money in public borrowing, an issue of particular concern given planned large investments in the gas pipeline and prospects for other sizeable infrastructure projects in coming years.

D. Energy sector Policies

20. **Further steps to strengthen power sector finances appear to be needed.**

TANESCO, the national power utility, is experiencing higher operating costs as a result of a drought-induced drop in hydro generation, which necessitated reliance on a costly emergency power generation program. It planned to bridge to a recovery in hydro production with a 40 percent tariff increase adopted January 2012 and government-guaranteed borrowing equivalent to 1 percent of GDP.³ But with only a limited recovery in dam water levels after the spring 2012 rains, hydro production is likely to remain depressed through 2012 (Figure 3) and the new gas pipeline will not allow expanded gas-fired power generation until 2014. An updated review of power generation costs for purposes of tariff setting has been commissioned by the Energy and Water Utility Regulatory Authority (EWURA), to be completed by July 2012. The authorities support early implementation of the findings of the review, potentially including a further tariff adjustment (MEFP, ¶39). The adequacy of the tariff structure would be assessed in the context of the next program review under the PSI/SCF.

E. Monetary, Exchange Rate, and Financial Sector Policies

21. **Monetary policy will remain tight to reduce core inflation.** The BoT expects that, with a return to more normal harvests, headline inflation will drop in the coming months, easing price expectations. Disinflation is being reinforced by holding base money below its programmed path, which has helped slow credit and liquidity growth. However, given Tanzania's shallow financial system,⁴ the transmission of monetary policy to inflation is projected to be relatively slow, with core inflation declining only to the 7–8 percent range by end-2012. With a view to strengthening policy transmission over the medium term, the BoT intends to move beyond strict reserve money targeting, with more active use of interest rate as a policy tool for monetary management and as a policy signal; these steps are being supported by Fund technical assistance. The Bank of Tanzania will maintain its floating exchange rate regime with intervention limited to short-term smoothing operations.

22. **The financial sector remains generally sound and profitable.** The banking sector is well capitalized at 18½ percent at end-March 2012 with ample liquidity (Table 5). Non-performing loans rose from 6.7 percent at end-December 2011 to 7½ percent in March 2012. Steps are being taken to ensure that BoT oversight keeps pace with the rapid growth of mobile phone-based financial services (MEFP ¶47). To further strengthen supervision, the BoT has been receiving TA from the IMF on conducting stress testing and putting in place a

³ The loan would be repaid out of future TANESCO revenues.

⁴ Private credit and total deposits are each about 18 percent of GDP.

crisis resolution framework. These efforts are being synchronized with other East African Community countries as part of a goal to harmonize supervision frameworks.

23. **Tanzania’s AML/CFT legal framework was recently amended to comply with the action plan agreed with the Financial Action Task Force.** These changes, including to the legal framework for Zanzibar, were enacted in February 2012 under a new AML/CFT law.

V. PROGRAM ISSUES

A. SCF Request

24. **As Tanzania strengthens its macroeconomic buffers, it remains vulnerable to a renewed global downturn.** Its fiscal deficit, public debt, and inflation levels are higher than at the time of the 2008–09 global recession, while gross reserve cover is lower. Although Tanzania does not face an immediate balance of payments need, the authorities’ request for a precautionary SCF would provide welcome support in the event of a deterioration in external demand and access to global market financing.

25. **Access.** Requested SCF access is 75 percent of quota (SDR 149.175 million, about \$225 million) with equal semi-annual disbursements over an 18-month period (Table 7). Staff considers that the requested access would provide a sufficient financial cushion to withstand adverse shocks to market financing (Table 8), with the proposed duration of the arrangement providing reasonable time to strengthen policy buffers.

26. **Conditionality and reviews.** Objectives under the SCF would match those under the PSI: enhancing fiscal and debt sustainability, reducing inflation, and resolving the power crisis to enhance growth prospects. In the event of an adverse shock, corrective measures to keep the program supported by the PSI and SCF on track would likely be needed. These measures, as well as options for financing from non-Fund sources would be reviewed in light of the nature and scale of the shock (MEFP ¶156). Semi-annual reviews under the SCF would be synchronized with the PSI (Table 7).

27. **Capacity to repay.** The authorities’ commitment to implement their program and the favorable prospects for gold, gas, and other commodity exports provide reasonable assurances of Tanzania’s capacity to repay the Fund (Table 6). If purchases were made as scheduled, the repurchases peak in 2018/19 and are completed by 2023/24. Outstanding Fund credit would amount to less than 5 percent of exports of goods and services or 1.7 percent of GDP. Its current obligations to the Fund are SDR 227 million at end-May 2012 and the risk of debt distress is low (paragraph 15).

28. **Safeguards assessment.** The proposed SCF arrangement requires an update of the last assessment of safeguards (2009) no later than the first SCF review. The update assessment is in progress. The BoT has published its audited financial statements for the year

ended June 30, 2011, which are prepared in accordance with international standards and received an unqualified audit opinion.

B. Program Modalities

29. **Program targets and benchmarks.** MEFP Tables 2 and 4 define the proposed program goals through the fifth and sixth reviews under the PSI and corresponding first and second reviews under the SCF. These comprise:

- Assessment and performance criteria (through end-December 2012 and end-June 2013, respectively);
- Indicative targets (with new targets for tax revenues and priority social spending); and
- Structural benchmarks (through December 2012).

VI. STAFF APPRAISAL

30. **Tanzania's continuing robust growth is welcome.** Staff encourages the authorities to take advantage of the generally favorable outlook for foreign direct investment and growth to strengthen economic buffers and step up the pace of economic reforms.

31. **The planned path of fiscal consolidation is, on balance, reasonable.** Stabilizing public debt, which has grown rapidly in recent years, remains important for long-term sustainable growth. Although 2012/13 would mark only a partial step toward debt stability, debt remains sustainable and provided that access to financing remains good, a gradual strategy for fiscal consolidation is likely to enjoy broader public support. That said, the government should seize any opportunity to over-perform against fiscal targets in 2012/13—as appears likely in 2011/12—to minimize risks to the medium-term adjustment effort.

32. **Structural fiscal reforms remain important.** The authorities should step up efforts to rein in Tanzania's overly generous tax exemptions, where only limited progress is planned for 2012/13. Modernization of the VAT regime is a priority, and the new reduced VAT rate should be maintained only on a temporary basis, pending the broader VAT reforms. Further steps should be taken to streamline recurrent spending commitments. Improvements in budget planning and execution and in transparency and accountability are also priorities.

33. **Procedures for utilizing non-concessional borrowing should be further strengthened.** In particular, strengthened institutional arrangements to evaluate and select public investment projects are needed to provide more solid assurances of value for money.

34. **Off-budget liabilities need careful management to limit risks to public finances.** The government should move expeditiously with reforms to strengthen the actuarial position of the public pension funds. The financial position of the power utility should also be

safeguarded. With reduced prospects for an early recovery in hydro production, further steps to strengthen power sector finances should be adopted expeditiously.

35. **Headline inflation may have peaked, but further efforts are needed to unwind core price pressures.** Sustained tight monetary policies, supported by a steady pace of fiscal consolidation, will need to be maintained until inflationary expectations are durably reduced. Staff supports the BOT's intention to move toward more active use of interest rates to control liquidity and to signal its policy stance. Exchange market intervention should be strictly limited to short-term smoothing, with macroeconomic policies tightened, if needed, in the event of more substantive balance of payments pressures.

36. **Supervision of the financial sector should be further enhanced.** The focus should be on identifying risks from rising cross-border banking activities, rapid expansion of mobile phone banking, and the growing pension and insurance sector. The authorities are encouraged to pursue implementation of their AML/CFT action plan.

37. **Staff supports the authorities' request for an 18-month arrangement under the SCF.** Tanzania has no immediate balance of payments need, and the arrangement is appropriately designed as a precautionary safeguard for the program against risks of a renewed global downturn and possible retrenchment in international financing.

38. **All but one indicative target for the fourth review under the PSI was met and staff recommends completion of the review.** Staff supports the authorities' request for setting of end-December 2012 assessment criteria under the PSI and end-December 2012 and end-June 2013 performance criteria under the SCF.

Table 1. Tanzania: Selected Economic and Financial Indicators, 2008/09–2013/14

	2008/09	2009/10	2010/11	2011/12		2012/13	2013/14
			Prel.	Prog. ⁵	Proj.	Proj.	Proj.
(Annual percentage change, unless otherwise indicated)							
National income and prices							
Real GDP growth	6.2	7.3	6.5	6.0	6.4	6.6	6.9
Consumer prices (period average)	11.8	10.5	7.0	13.7	17.7	10.4	7.7
Consumer prices (end of period)	10.7	7.2	10.9	9.0	16.6	8.9	6.4
External sector							
Export, f.o.b (in millions of U.S. dollars)	3,268	3,798	4,896	5,865	5,598	6,305	7,126
Imports, f.o.b. (in millions of U.S. dollars)	-6,220	-6,596	-8,012	-9,039	-10,202	-11,157	-11,720
Export volume	8.0	6.8	11.1	8.6	4.6	10.1	12.3
Import volume	10.4	5.3	6.9	8.5	20.1	9.3	6.5
Terms of trade	7.5	8.5	1.6	6.3	3.2	2.3	2.1
Nominal effective exchange rate (end of period; depreciation= -)	-3.7	-3.7	-17.7	...	...	...	...
Real effective exchange rate (end of period; depreciation= -)	6.3	0.3	-13.4	...	...	...	...
Money and credit							
Broad money (M3)	18.5	25.1	22.0	20.0	16.1	17.4	17.5
Net foreign assets	15.8	25.3	10.2	15.9	13.7	13.6	18.2
Net domestic assets	21.7	25.0	35.7	23.9	18.2	20.8	16.9
Credit to nongovernment sector	33.1	16.7	25.2	23.0	16.7	20.0	20.1
Velocity of money (GDP/M3; average)	3.6	3.4	3.2	3.0	3.2	3.2	3.1
Treasury bill interest rate (in percent; end of period) ¹	7.0	3.3	4.8	...	...	...	...
(Percent of GDP)							
Public Finance							
Revenue (excluding grants)	16.2	15.9	16.4	17.8	17.4	18.8	18.8
Total grants	5.1	4.6	4.7	6.6	6.0	4.2	3.5
Expenditure	26.1	27.5	27.0	31.1	29.6	28.4	26.8
Unidentified fiscal measures	0.0	0.0	0.0	0.0	0.0	0.0	-1.6
Overall balance (excluding grants) ²	-9.6	-11.1	-11.3	-13.2	-12.2	-9.6	-8.0
Overall balance (including grants) ²	-4.6	-6.4	-6.6	-6.6	-6.2	-5.5	-4.5
Domestic financing	0.8	1.9	3.6	1.0	1.0	-1.9	-0.2
Domestic debt stock (end of period) ³	8.4	9.1	10.6	10.3	10.0	9.5	9.3
Savings and investment							
Resource gap	-12.7	-11.3	-12.2	-11.7	-14.1	-13.5	-11.8
Investment	29.4	30.6	31.7	28.6	33.0	34.1	33.3
Government	8.4	8.4	8.9	10.3	9.7	9.6	9.2
Nongovernment ⁴	21.0	22.2	22.8	18.3	23.3	24.5	24.1
Gross domestic savings	16.6	19.3	19.5	16.9	18.8	20.5	21.5
External sector							
Current account balance (excluding current transfers)	-13.5	-11.9	-12.5	-12.9	-17.4	-16.7	-14.3
Current account balance (including current transfers)	-10.1	-9.1	-9.4	-10.0	-14.9	-14.7	-12.5
(Millions of U.S. dollars, unless otherwise indicated)							
Balance of payments							
Current account balance (excluding current transfers; deficit= -)	-2,827	-2,691	-2,933	-3,090	-4,427	-4,742	-4,446
Gross official reserves (end of period)	2,930	3,483	3,610	3,868	3,783	4,055	4,280
In months of imports of goods and services (current year)	4.5	5.0	4.3	4.1	3.6	3.6	3.6
External debt stock (end of period; percent of GDP)	26.2	28.8	33.0	38.1	36.2	39.9	41.0

Sources: Tanzanian authorities and IMF staff estimates and projections.

¹ End-year (June) monthly weighted-average yield of 35-, 91-, 182-, and 364-day treasury bills.² Including adjustment to cash basis.³ Net of Treasury bills issued for liquidity management.⁴ Including change in stocks.⁵ From the third review under the PSI.

Table 2a. Tanzania: Central Government Operations, 2008/09–2013/14¹
(Billions of Tanzania Shillings)

	2008/09	2009/10	2010/11	2011/12		2012/13		2013/14
				Prog. ⁷	Proj.	Budget	Proj.	Proj.
Total revenue	4,293	4,800	5,739	7,068	7,160	9,077	9,077	10,405
Tax revenue	4,044	4,428	5,296	6,209	6,371	8,070	8,070	9,254
Import duties	359	367	449	544	534	648	648	740
Value-added tax	1,231	1,390	1,531	1,946	1,932	2,457	2,457	2,836
Excises	762	838	1,052	1,080	1,042	1,384	1,384	1,582
Income taxes	1,229	1,334	1,660	1,950	2,143	2,732	2,732	3,123
Other taxes	463	499	604	689	721	849	849	971
Nontax revenue ²	249	372	443	858	789	1,007	1,007	1,151
LGA		138	158	350	200	362	362	414
Other	249	234	285	508	589	645	645	737
Total expenditure	6,907	8,312	9,439	12,325	12,172	13,740	13,740	14,816
Recurrent expenditure	4,681	5,700	6,690	7,717	7,815	9,212	9,212	10,531
Wages and salaries	1,609	1,723	2,346	2,892	2,768	3,147	3,147	3,598
Interest payments	243	249	353	456	454	555	677	774
Domestic	208	208	285	334	334	335	405	414
Foreign ³	35	41	68	123	120	220	272	359
Goods and services and transfers ²	2,830	3,728	3,991	4,368	4,593	5,510	5,388	6,160
Development expenditure	2,226	2,611	2,749	4,609	4,357	4,528	4,528	5,162
Domestically financed	906	1,005	985	1,714	1,466	2,214	2,214	2,531
Foreign (concessionally) financed	1,320	1,607	1,764	2,894	2,891	2,314	2,314	2,632
Unidentified fiscal measures ⁴	0	0	0	0	0	0	0	-878
Overall balance before grants	-2,614	-3,512	-3,701	-5,258	-5,012	-4,663	-4,663	-4,411
Grants	1,340	1,405	1,627	2,627	2,480	2,009	2,009	1,945
Program (including basket grants) ⁵	798	924	1,062	1,211	1,065	878	878	1,024
Of which: basket grants	194	258	335	444	444	256	256	359
Project	462	439	370	908	908	696	696	744
MDRI (IMF) grant relief	68	22	0	0	0	0	0	0
MCA funding	12	20	196	507	507	434	434	178
Overall balance after grants	-1,275	-2,107	-2,073	-2,631	-2,533	-2,655	-2,655	-2,466
Adjustment to cash ⁶	60	167	-248	0	0	0	0	0
Overall balance (cash basis)	-1,215	-1,940	-2,322	-2,631	-2,533	-2,655	-2,655	-2,466
Financing	1,215	1,940	2,322	2,631	2,533	2,655	2,655	2,466
Foreign (net)	956	1,380	1,077	2,234	2,136	3,558	3,558	2,577
Foreign loans	984	1,448	1,120	2,351	2,250	3,789	3,789	2,881
Program (including basket loans) ⁵	495	752	394	619	536	379	379	504
Of which: basket loans	163	194	221	258	250	159	159	191
Project	489	696	643	778	783	1,864	1,864	1,684
Of which: gas pipeline	...	...	...	...	...	1,095	1,095	524
Nonconcessional borrowing	0	0	82	954	931	1,546	1,546	693
Of which: gas pipeline	...	...	...	...	...	292	292	140
Amortization	-27	-68	-43	-117	-114	-232	-232	-304
Domestic (net)	214	560	1,244	397	397	-903	-903	-111
Of which: excluding gas pipeline	214	560	1,244	397	397	484	484	553
Bank financing	214	585	907	357	357	484	434	553
Nonbank financing	0	-25	337	40	40	-1,387	-1,337	-664
Of which: credit to TPDC (gas pipeline)	...	...	...	...	...	-1,387	-1,387	-664
One-off transfers from agencies	0	0	0	0	0	0	0	0
Privatization proceeds	45	10	0	0	0	0	0	0
Amortization of parastatal debt	0	-9	0	0	0	0	0	0
Memorandum items:								
Total public debt (in percent of GDP) ⁸	30.0	33.0	37.2	42.6	40.6	44.8	44.8	46.3
Recurrent expenditures (percent of recurrent resources)	96	104	103	98	100	95	95	95
Nominal GDP	26,497	30,253	34,913	39,684	41,120	48,385	48,385	55,316

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

¹ Fiscal year: July–June.

² Local Government Authorities' own revenues (about 0.5 percent of GDP), and the equal amount of transfers, are included starting from FY2009/10.

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

⁴ Fiscal measures are treated as expenditure savings in the fiscal accounts. In practice, part of the adjustment could be through additional revenue.

⁵ Basket funds are sector-specific accounts established by the government to channel donor support to fund-specific activities.

⁶ Unidentified financing (+)/expenditure (-). Includes expenditure carryover from the previous year.

⁷ From the third review under the PSI.

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

Table 2b. Tanzania: Central Government Operations, 2008/09–2013/14¹
(Percent of GDP)

	2008/09	2009/10	2010/11	2011/12		2012/13		2013/14
				Prog. ⁷	Proj.	Budget	Proj.	
Total revenue	16.2	15.9	16.4	17.8	17.4	18.8	18.8	18.8
Tax revenue	15.3	14.6	15.2	15.6	15.5	16.7	16.7	16.7
Import duties	1.4	1.2	1.3	1.4	1.3	1.3	1.3	1.3
Value-added tax	4.6	4.6	4.4	4.9	4.7	5.1	5.1	5.1
Excises	2.9	2.8	3.0	2.7	2.5	2.9	2.9	2.9
Income taxes	4.6	4.4	4.8	4.9	5.2	5.6	5.6	5.6
Other taxes	1.7	1.7	1.7	1.7	1.8	1.8	1.8	1.8
Nontax revenue ²	0.9	1.2	1.3	2.2	1.9	2.1	2.1	2.1
LGA		0.5	0.5	0.9	0.5	0.7	0.7	0.7
Other		0.8	0.8	1.3	1.4	1.3	1.3	1.3
Total expenditure	26.1	27.5	27.0	31.1	29.6	28.4	28.4	26.8
Recurrent expenditure	17.7	18.8	19.2	19.4	19.0	19.0	19.0	19.0
Wages and salaries	6.1	5.7	6.7	7.3	6.7	6.5	6.5	6.5
Interest payments	0.9	0.8	1.0	1.2	1.1	1.1	1.4	1.4
Domestic	0.8	0.7	0.8	0.8	0.8	0.7	0.8	0.7
Foreign ³	0.1	0.1	0.2	0.3	0.3	0.5	0.6	0.6
Goods and services and transfers ²	10.7	12.3	11.4	11.0	11.2	11.4	11.1	11.1
Development expenditure	8.4	8.6	7.9	11.6	10.6	9.4	9.4	9.3
Domestically financed	3.4	3.3	2.8	4.3	3.6	4.6	4.6	4.6
Foreign (concessionally) financed	5.0	5.3	5.1	7.3	7.0	4.8	4.8	4.8
Unidentified fiscal measures ⁴	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-1.6
Overall balance before grants	-9.9	-11.6	-10.6	-13.2	-12.2	-9.6	-9.6	-8.0
Grants	5.1	4.6	4.7	6.6	6.0	4.2	4.2	3.5
Program (including basket grants) ⁵	3.0	3.1	3.0	3.1	2.6	1.8	1.8	1.9
of which: basket grants	0.7	0.9	1.0	1.1	1.1	0.5	0.5	0.6
Project	1.7	1.5	1.1	2.3	2.2	1.4	1.4	1.3
MDRI (IMF) grant relief	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
MCA funding	0.0	0.1	0.6	1.3	1.2	0.9	0.9	0.3
Overall balance after grants	-4.8	-7.0	-5.9	-6.6	-6.2	-5.5	-5.5	-4.5
Adjustment to cash ⁶	0.2	0.6	-0.7	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-4.6	-6.4	-6.6	-6.6	-6.2	-5.5	-5.5	-4.5
Financing	4.6	6.4	6.6	6.6	6.2	5.5	5.5	4.5
Foreign (net)	3.6	4.6	3.1	5.6	5.2	7.4	7.4	4.7
Foreign loans	3.7	4.8	3.2	5.9	5.5	7.8	7.8	5.2
Program (including basket loans) ⁵	1.9	2.5	1.1	1.6	1.3	0.8	0.8	0.9
Of which: basket loans	0.6	0.6	0.6	0.6	0.6	0.3	0.3	0.3
Project	1.8	2.3	1.8	2.0	1.9	3.9	3.9	3.0
Of which: gas pipeline	...	...	...	...	...	2.3	2.3	0.9
Nonconcessional borrowing	0.0	0.0	0.2	2.4	2.3	3.2	3.2	1.3
Of which: gas pipeline	...	...	...	...	...	0.6	0.6	0.3
Amortization	-0.1	-0.2	-0.1	-0.3	-0.3	-0.5	-0.5	-0.6
Domestic (net)	0.8	1.9	3.6	1.0	1.0	-1.9	-1.9	-0.2
Of which: excluding gas pipeline	...	...	...	...	...	1.0	1.0	1.0
Bank financing	0.8	1.9	2.6	0.9	0.9	1.0	0.9	1.0
Nonbank financing	0.0	-0.1	1.0	0.1	0.1	-2.9	-2.8	-1.2
Of which: credit to TPDC (gas pipeline)	...	...	...	...	...	-2.9	-2.9	-1.2
One-off transfers from agencies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization proceeds	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization of parastatal debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

¹ Fiscal year: July–June.

² Local Government Authorities' own revenues (about 0.5 percent of GDP), and the equal amount of transfers, are included starting from

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

⁴ Fiscal measures are treated as expenditure savings in the fiscal accounts. In practice, part of the adjustment could be through additional revenue effort.

⁵ Basket funds are sector-specific accounts established by the government to channel donor support to fund-specific activities.

⁶ Unidentified financing (+)/expenditure (-). Includes expenditure carryover from the previous year.

⁷ From the third review under the PSI.

Table 3. Tanzania: Monetary Accounts, 2009–2013
(Billions of Tanzania shillings, unless otherwise indicated; end of period)

	2009 June	2010 June	2011				2012				2013		
			June	Dec	Actual	March	June	Sept	Dec	March	June		
												Prog. ²	Prog. ²
Bank of Tanzania													
Net foreign assets	3,401	3,949	4,618	5,075	4,863	5,246	4,531	5,380	5,151	5,492	5,841	6,142	5,956
Net international reserves	3,464	4,336	5,098	5,575	5,319	5,746	4,993	5,880	5,634	5,983	6,340	6,649	6,470
(Millions of U.S. dollars)	2,666	3,143	3,243	3,322	3,395	3,423	3,170	3,500	3,415	3,570	3,724	3,847	3,688
Net non-reserve foreign assets	-63	-387	-479	-500	-456	-500	-462	-500	-484	-491	-499	-507	-514
Net domestic assets	-723	-580	-829	-868	-751	-945	-650	-920	-702	-787	-1,049	-1,285	-774
Credit to government	-712	-628	-186	-181	7	-231	-39	-161	-189	-293	-187	-215	-187
Of which: Excluding counterpart of liquidity paper	278	581	791	469	377	569	681	639	630	597	703	675	703
Other items (net)	-11	48	-642	-687	-758	-713	-611	-759	-513	-494	-862	-1,070	-587
REPOs	-131	-117	-54	42	-30	19	0	-24	0	0	0	0	0
Other items, excluding REPOs (net)	120	165	-588	-729	-728	-732	-611	-735	-513	-494	-862	-1,070	-587
Of which: Credit to nongovernment sector	40	89	86	86	79	86	78	86	78	78	78	78	78
Reserve money ¹	2,678	3,369	3,790	4,207	4,112	4,302	3,881	4,459	4,448	4,705	4,793	4,858	5,182
Currency outside banks	1,424	1,680	2,081	2,295	2,236	2,247	2,145	2,463	2,341	2,616	2,651	2,625	2,838
Bank reserves	1,255	1,689	1,709	1,912	1,876	2,055	1,736	1,996	2,107	2,089	2,142	2,232	2,345
Currency in banks	259	351	423	505	458	494	348	542	515	576	583	578	624
Deposits	996	1,338	1,286	1,407	1,418	1,560	1,388	1,455	1,592	1,513	1,558	1,655	1,720
Required reserves (calculated) ¹	787	994	1,172	1,296	1,306	1,434	1,316	1,328	1,402	1,333	1,373	1,458	1,594
Excess reserves (calculated)	209	344	114	112	112	126	72	127	189	180	185	197	126
Memorandum items:													
Stock of liquidity paper	990	1,209	977	650	370	800	720	800	819	890	890	890	890
Average reserve money	2,602	3,138	3,746	4,193	4,222	4,278	4,015	4,420	4,342	4,688	4,788	4,817	5,058
Monetary Survey													
Net foreign assets	4,203	5,266	5,804	6,514	6,274	6,602	5,864	6,728	6,602	6,966	7,338	7,662	7,499
Bank of Tanzania	3,401	3,949	4,618	5,075	4,863	5,246	4,531	5,380	5,151	5,492	5,841	6,142	5,956
Commercial banks	802	1,316	1,186	1,439	1,410	1,356	1,332	1,348	1,451	1,474	1,497	1,520	1,543
Net domestic assets	3,629	4,536	6,154	6,842	6,748	7,039	7,138	7,626	7,276	7,745	8,003	8,191	8,786
Domestic credit	4,580	5,908	8,126	9,089	8,720	9,390	9,166	9,980	9,572	10,145	10,513	10,813	11,525
Credit to government (net)	128	713	1,620	1,899	1,471	1,885	1,918	1,977	1,977	2,137	2,235	2,335	2,410
Credit to nongovernment sector	4,452	5,195	6,506	7,190	7,249	7,504	7,248	8,003	7,595	8,009	8,278	8,478	9,114
Other items (net)	-951	-1,372	-1,972	-2,247	-1,972	-2,351	-2,028	-2,354	-2,296	-2,401	-2,509	-2,622	-2,738
M3	7,832	9,801	11,958	13,357	13,021	13,641	13,002	14,353	13,877	14,711	15,342	15,853	16,285
Foreign currency deposits	2,064	2,522	3,291	3,873	3,792	3,956	3,675	4,091	3,955	4,119	4,296	4,439	4,560
M2	5,768	7,279	8,667	9,483	9,230	9,685	9,327	10,263	9,922	10,592	11,046	11,414	11,725
Currency in circulation	1,424	1,680	2,081	2,295	2,236	2,247	2,145	2,463	2,341	2,616	2,651	2,625	2,838
Deposits (TSh)	4,344	5,599	6,586	7,188	6,994	7,438	7,182	7,800	7,581	7,975	8,395	8,789	8,888
Memorandum items:													
	(12-month percent change, unless otherwise indicated)												
M3 growth	18.5	25.1	22.0	21.3	18.2	21.4	15.7	20.0	16.1	14.9	17.8	21.9	17.4
M3 (as percent of GDP)	29.6	32.4	34.3	32.5	31.7	34.4	31.6	36.2	33.7	30.4	31.7	32.8	33.7
Private sector credit growth	33.1	16.7	25.2	25.7	26.8	24.7	20.4	23.0	16.7	13.9	14.2	17.0	20.0
Average reserve money growth	26.7	20.6	19.3	19.0	19.8	18.0	10.7	18.0	15.9	14.5	13.4	20.0	16.5
Reserve money multiplier (M3/average reserve money)	3.0	3.1	3.2	3.2	3.1	3.2	3.2	3.2	3.2	3.1	3.2	3.3	3.2
Nonbank financing of the government (net) ³	1	0	337	20	22	30	151	40	40	40	42	42	50
Bank financing of the government (net) ³	279	-111	907	280	-148	266	298	357	357	160	258	358	434
Bank and nonbank financing of the government (net) ³	281	-111	1,244	300	-127	296	449	397	397	200	300	400	484

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

¹ In January 2009 the reserve requirement on government deposits was increased to 20 percent (from 10 percent) and cash in banks was no longer counted towards required reserves. In November 2011 it was further increased to 30 percent.

² From the third review under the PSI.

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

Table 4. Tanzania: Balance of Payments, 2008/09–2013/14
(Millions of U.S. dollars, unless otherwise indicated)

	2008/09	2009/10	2010/11	2011/12		2012/13	2013/14
				Prel.	Prog. ⁴			Proj.	Proj.
Current account	-2,124	-2,054	-2,196	-2,399	-3,778	-4,178	-3,872
Trade balance	-2,952	-2,797	-3,115	-3,174	-4,603	-4,853	-4,594
Exports, f.o.b.	3,268	3,798	4,896	5,865	5,598	6,305	7,126
<i>Of which:</i>							
Traditional agricultural products	510	466	697	832	743	861	1,002
Gold	925	1,493	1,787	2,216	2,487	2,871	3,202
Other	1,834	1,839	2,412	2,816	2,368	2,572	2,922
Imports, f.o.b.	-6,220	-6,596	-8,012	-9,039	-10,202	-11,157	-11,720
<i>Of which: Oil</i>	-1,485	-1,937	-2,155	-2,466	-3,522	-3,408	-3,291
Services (net)	163	168	243	336	263	412	593
<i>Of which: Travel receipts</i>	1,163	1,197	1,357	1,524	1,564	1,724	1,870
Income (net)	-275	-307	-318	-290	-358	-595	-747
<i>Of which: interest on public debt</i>	-28	-25	-40	-74	-42	-155	-202
Current transfers (net)	940	883	995	729	921	857	877
<i>Of which: official transfers</i>	703	637	737	691	649	563	574
Capital account	379	514	560	616	706	500	489
<i>Of which: project grants¹</i>	317	451	496	547	640	433	417
Financial account	1,929	2,220	2,183	2,043	3,044	3,952	3,611
Foreign Direct Investment	1,100	988	1,058	542	1,444	1,579	1,897
Public Sector, net	721	1,068	725	1,343	1,355	2,089	1,402
<i>Of which:</i>							
Program loans	400	612	267	370	330	222	239
Non-concessional borrowing	0	0	55	575	578	908	389
Project loans	387	520	432	469	484	1,095	945
Scheduled amortization ²	-19	-15	-29	-70	-37	-136	-171
Commercial Banks, net	-119	-342	207	-61	-137	0	0
SDR allocation ³	0	249	0	0	0	0	0
Other private inflows	227	257	193	219	383	284	312
Errors and omissions	-166	-203	-448	0	200	0	0
Overall balance	18	478	100	260	172	274	229
Financing	-18	-478	-100	-260	-172	-274	-229
Change in BoT reserve assets (increase= -)	-264	-570	-128	-258	-172	-273	-225
Use of Fund credit	246	93	29	-3	0	-1	-3
Financing gap	0	0	0	0	0	0	0
Memorandum items:							
Gross official reserves (BoT)	2,930	3,483	3,610	3,868	3,783	4,055	4,280
Months of imports of goods and services (current year)	4.5	5.0	4.3	4.1	3.6	3.6	3.6
Exports (percent of GDP)	15.6	16.8	20.9	24.5	22.0	22.2	23.0
Imports (percent of GDP)	-29.7	-29.2	-34.2	-37.8	-40.1	-39.3	-37.8
Current account deficit (percent of GDP)	-10.1	-9.1	-9.4	-10.0	-14.9	-14.7	-12.5
Foreign program and project assistance (percent of GDP)	8.6	9.8	8.2	8.7	8.3	8.1	7.0
Nominal GDP	20,956	22,620	23,422	23,909	25,415	28,423	31,044

Sources: Tanzanian authorities and IMF staff estimates and projections.

¹ An adjustment to the estimated outturn is made by BoT to reflect unreported project grants.

² Relief on some projected external debt obligations is being negotiated with a number of creditors.

³ In 2009, Tanzania received SDR 147.4 million on August 28 and SDR 11.7 million on September 9 (US\$249 million in total).

⁴ From the third review under the PSI.

Table 5. Tanzania: Financial Soundness Indicators, 2008–2012
(Percent, end of period)

	2008	2009	2010	2011	2011				2012
					Mar	Jun	Sep	Dec	Mar
Access to bank lending									
Claims on the non-government sector to GDP ¹	17.9	19.4	18.0	22.8	18.8	20.4	22.4	22.8	23.7
Claims on the private sector to GDP ¹	17.1	18.6	17.2	21.6	18.1	19.7	21.5	21.6	22.5
Capital adequacy									
Capital to risk-weighted assets	17.0	18.3	18.5	17.8	19.2	18.2	17.4	17.8	18.5
Capital to assets	10.1	10.9	10.7	10.7	11.2	10.6	10.4	10.7	11.4
Asset composition and quality									
Net loans and advances to total assets	50.6	46.3	44.2	49.4	44.8	45.9	47.3	49.4	50.0
Sectoral distribution of loans									
Trade	18.5	18.8	17.5	20.2	18.6	19.4	20.0	20.2	19.9
Mining and manufacturing	14.7	12.0	14.1	12.8	14.0	13.3	13.4	12.8	12.5
Agricultural production	10.4	10.2	13.0	13.5	13.1	13.2	14.3	13.5	12.9
Building and construction	4.9	5.0	6.1	7.8	7.7	7.4	7.8	7.8	8.7
Transport and communication	7.3	9.2	9.2	7.2	9.5	8.5	7.8	7.2	7.9
Foreign exchange loans to total loans	31.8	28.5	32.0	33.5	32.6	34.6	35.3	33.5	33.9
Gross nonperforming loans (NPLs) to gross loans	6.2	6.6	9.8	6.7	9.6	9.1	8.1	6.7	7.5
NPLs net of provisions to capital	22.0	17.6	25.9	17.1	24.6	25.4	21.7	17.1	18.9
Large exposures to total capital	199.4	54.4	108.5	96.4	95.0	110.9	122.3	96.4	111.6
Earnings and profitability									
Return on assets	3.8	3.2	2.2	2.7	3.0	3.0	3.0	2.7	3.0
Return on equity	23.2	18.4	12.1	15.1	17.8	17.9	17.2	15.1	17.4
Net interest margin	76.7	73.3	75.8	77.7	77.6	78.5	78.5	77.7	73.1
Noninterest expenses to gross income	48.8	47.6	54.5	55.5	52.1	53.7	54.5	55.5	52.3
Personnel expenses to noninterest expenses	40.6	42.6	40.5	41.8	44.4	43.8	42.7	41.8	45.1
Liquidity									
Liquid assets to total assets	37.6	40.5	39.5	36.0	38.8	38.2	37.6	36.0	35.1
Liquid assets to total short term liabilities	41.7	46.5	45.3	40.5	44.3	43.2	41.8	40.5	39.2
Total loans to customer deposits	68.4	61.6	58.9	64.5	59.6	61.5	63.0	64.5	65.9
Foreign exchange liabilities to total liabilities	32.5	29.7	31.9	37.1	33.3	33.9	36.0	37.1	33.9

Source: Bank of Tanzania

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

Table 6. Tanzania: Indicators of Capacity to Repay the Fund^{1,2}

	Projection											
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Fund obligations based on existing credit												
<i>(in millions of SDRs)</i>												
Principal	1.1	2.2	18.2	43.7	44.6	44.0	43.8	27.9	2.0	0.0	0.0	0.0
Charges and interest	0.0	0.6	0.6	0.5	0.4	0.3	0.2	0.1	0.1	0.1	0.1	0.0
Fund obligations based on existing and prospective credit												
<i>(in millions of SDRs)</i>												
Principal	1.1	2.2	18.2	43.7	52.9	68.9	72.8	61.0	35.1	12.4	8.3	0.0
Charges and interest	0.0	0.9	1.2	1.1	1.0	0.8	0.5	0.3	0.1	0.1	0.1	0.0
Total obligations based on existing and prospective credit												
<i>In millions of SDRs</i>												
In millions of US\$	1.1	3.1	19.3	44.8	53.9	69.7	73.3	61.3	35.3	12.5	8.3	0.0
<i>In millions of US\$</i>												
In percent of exports of goods and services	0.0	0.0	0.3	0.5	0.6	0.7	0.6	0.5	0.3	0.1	0.0	0.0
In percent of debt service ³	0.6	1.3	6.0	12.5	12.3	12.7	11.9	8.9	4.6	1.5	0.9	0.0
In percent of GDP	0.0	0.0	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.0	0.0	0.0
In percent of Gross International Reserves	0.0	0.1	0.7	1.4	1.6	1.9	1.9	1.4	0.7	0.2	0.1	0.0
In percent of quota	0.6	1.6	9.7	22.5	27.1	35.0	36.8	30.8	17.7	6.3	4.2	0.0
Outstanding Fund credit												
<i>In millions of SDRs</i>												
In millions of US\$	301.0	336.0	355.1	311.4	258.5	189.6	116.9	55.9	20.7	8.3	0.0	0.0
<i>In millions of US\$</i>												
In percent of exports of goods and services	460.7	514.3	543.3	476.0	394.8	289.5	178.4	85.3	31.6	12.6	0.0	0.0
In percent of debt service ²	5.0	5.0	4.7	3.8	2.8	1.9	1.0	0.4	0.1	0.1	0.0	0.0
In percent of GDP	155.7	138.1	111.1	86.6	59.0	34.6	19.0	8.1	2.7	1.0	0.0	0.0
In percent of Gross International Reserves	1.6	1.7	1.6	1.3	1.0	0.7	0.4	0.2	0.1	0.0	0.0	0.0
In percent of quota	11.4	12.0	12.0	9.9	7.8	5.2	3.0	1.3	0.4	0.2	0.0	0.0
Net use of Fund credit (in millions of SDRs)												
Disbursements	110.8	35.0	-18.2	-43.7	-52.9	-68.9	-72.8	-61.0	-35.1	-12.4	-8.3	0.0
Repayments	111.9	37.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	1.1	2.2	18.2	43.7	52.9	68.9	72.8	61.0	35.1	12.4	8.3	0.0
Memorandum items:												
Exports of goods and services (in millions of US\$)	9,168	10,293	11,453	12,661	14,064	15,611	17,328	19,235	21,350	23,699	26,306	29,199
Debt service (in millions of US\$) ²	296	372	489	550	669	836	937	1,049	1,176	1,307	1,406	1,491
Nominal GDP (in millions of US\$)	28,423	31,044	33,886	36,991	40,360	43,813	47,350	51,165	55,288	59,766	64,608	69,841
Gross International Reserves (in millions of US\$)	4,055	4,280	4,518	4,800	5,085	5,542	6,041	6,585	7,243	7,968	8,765	9,641
Quota (millions of SDRs)	198.9	198.9	198.9	198.9	198.9	198.9	198.9	198.9	198.9	198.9	198.9	198.9

Sources: IMF staff estimates and projections.

^{1/} 1/ Assumes full drawings under the SCF, with disbursements of SDR 37.3 million (18.75 percent of quota) available upon approval of the request (July 2012) and following completion of SCF reviews in December 2012, June 2013, and December 2013 for a total of SDR 149.175 million (75 percent of quota).

^{2/} The table is presented using Tanzania's fiscal year, which begins on July 1.

^{3/} Total debt service includes IMF repayments.

Table 7. Disbursements and Timing of Reviews under the SCF Arrangement ¹

Date of availability ²	Conditions	Amount (SDR millions)	Percent of quota	Amount (\$m)³
Upon Board approval	Board approval of the arrangement	37.300	18.75	56.5
September 30, 2012	Observance of end-June 2012 performance criteria and structural benchmarks and completion of first SCF review (fifth PSI review). ⁴	37.300	18.75	56.5
March 31, 2013	Observance of end-December 2012 performance criteria and structural benchmarks and completion of second SCF review (sixth PSI review).	37.300	18.75	56.5
September 30, 2013	Observance of end-June 2013 performance criteria and structural benchmarks and completion of third SCF review.	37.275	18.75	56.5
Total		149.175	75.00	226.0

¹ Tanzania's quota is SDR 198.9 million.

² The disbursement schedule may be adjusted as circumstances warrant, while remaining within the overall available envelope. Financing would become available based on completion of the associated SCF reviews, which would be conducted at the same time as the PSI review.

³ At an assumed exchange rate of \$1 = SDR 0.66.

⁴ Tanzania's PSI arrangement expires June 3, 2013.

Table 8. Tanzania Balance of Payments: Baseline and Stress Scenario 2009/10–2012/13
(Millions of U.S. dollars, unless otherwise indicated)

	2009/10	2010/11	2011/12	2012/13 Baseline	2012/13 Stress ³
Current account	-2,054	-2,196	-3,778	-4,178	-4,231
Trade balance	-2,797	-3,115	-4,603	-4,853	-4,915
Exports, f.o.b.	3,798	4,896	5,598	6,305	6,177
Imports, f.o.b.	-6,596	-8,012	-10,202	-11,157	-11,092
Services (net)	168	243	263	412	391
Income (net)	-307	-318	-358	-595	-564
Financial account	2,220	2,183	3,044	3,952	3,780
Foreign Direct Investment	988	1,058	1,444	1,579	1,439
Public Sector, net	1,068	725	1,355	2,089	2,089
Other private inflows	257	193	383	284	251
Overall balance	478	100	172	274	49
Financing	-478	-100	-172	-274	-274
Change in BoT reserve assets (increase, -)	-570	-128	-172	-273	-273
Use of Fund credit	93	29	0	-1	-1
Financing gap	0	0	0	0	-225
Potential IMF financing from SCF ^{1/}					150
Other financing/adjustment need ^{2/}					75
Remaining financing gap					0
Memorandum items:					
Gross official reserves (BoT)	3,483	3,610	3,783	4,055	4,055
Months of imports of goods and services (current year)	5.0	4.3	3.6	3.6	3.6
Exports (percent of GDP)	16.8	20.9	22.0	22.2	22.0
Imports (percent of GDP)	-29.2	-34.2	-40.1	-39.3	-39.4
Current account deficit (percent of GDP)	-9.1	-9.4	-14.9	-14.7	-15.0
Foreign program and project assistance (percent of GDP)	9.8	8.2	8.3	8.1	8.2
Nominal GDP	22,620	23,422	25,415	28,423	28,139

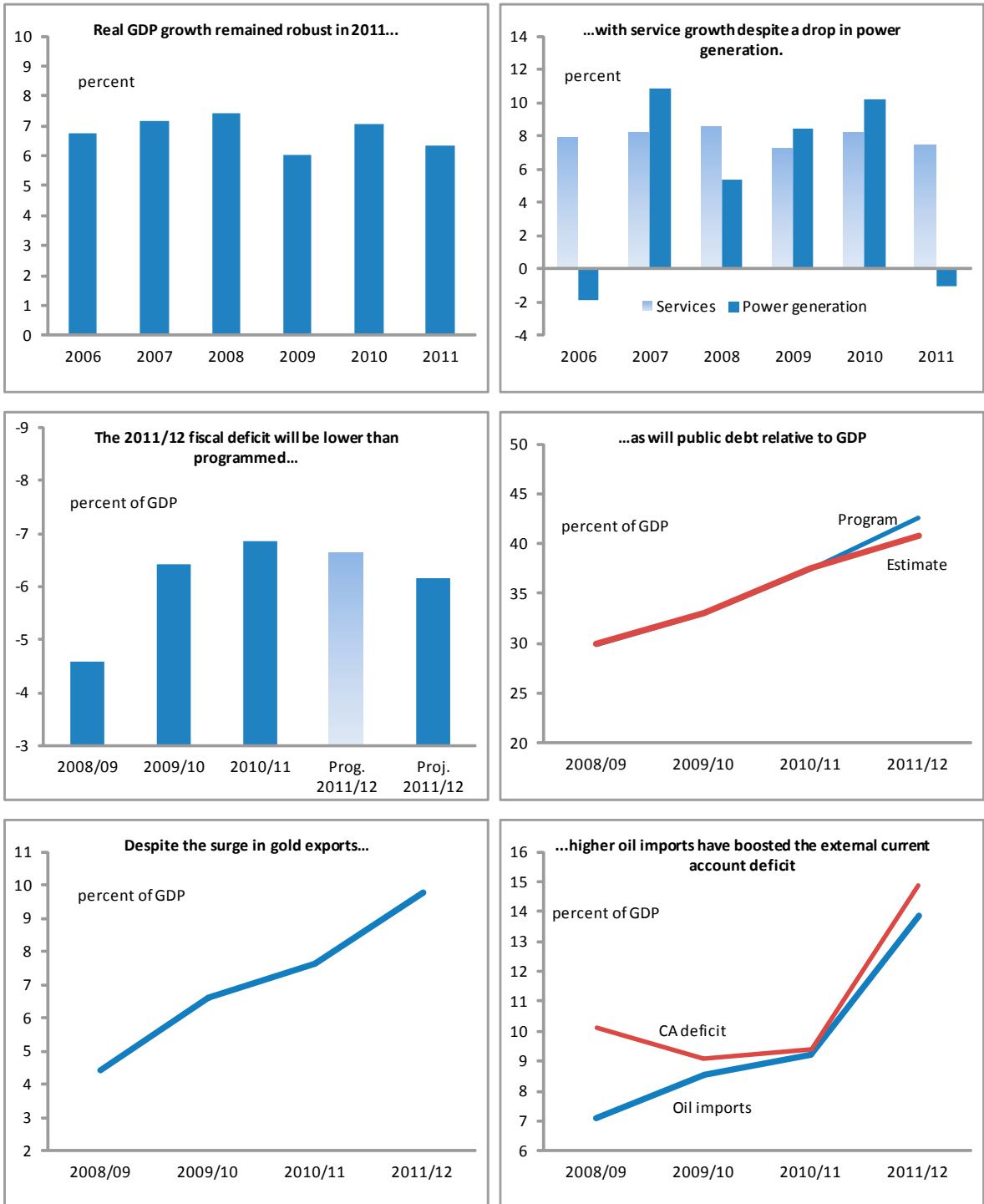
Sources: Tanzanian authorities and Fund staff estimates and projections.

¹ Assumes that IMF financing will be slightly below available amounts of US\$169.5 mn through June 2013 under the SCF.

² The balance between policy tightening and new financing from non-Fund sources would reflect the nature of the stress outcome and terms of available financing.

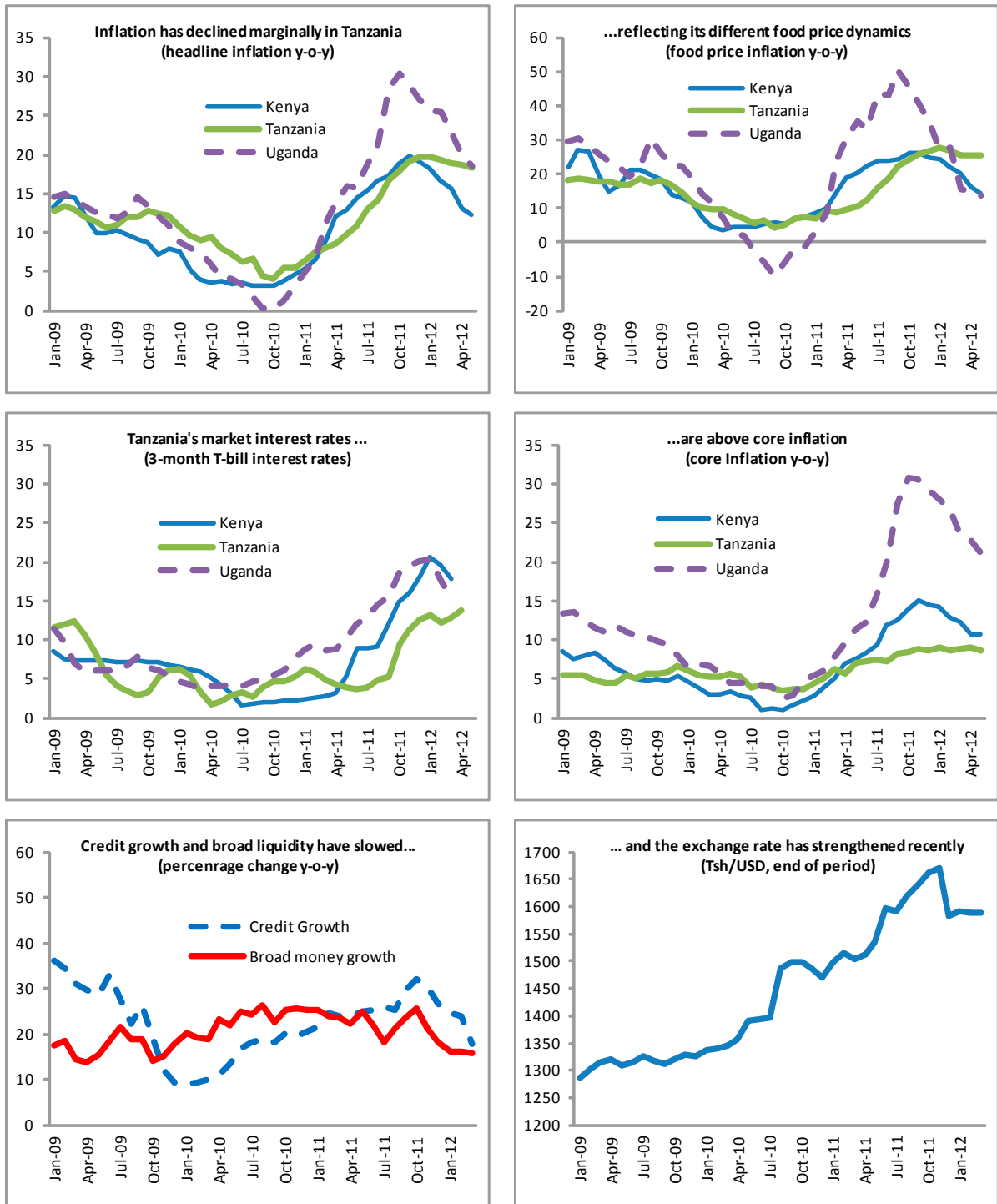
³ The stress scenario assumes a decline in FDI (non-gas related) and private capital flows, a corresponding decrease in imports related to the lower FDI, and lower exports in response to falling global demand.

Figure 1. Tanzania: Real Sector, Fiscal and External Developments



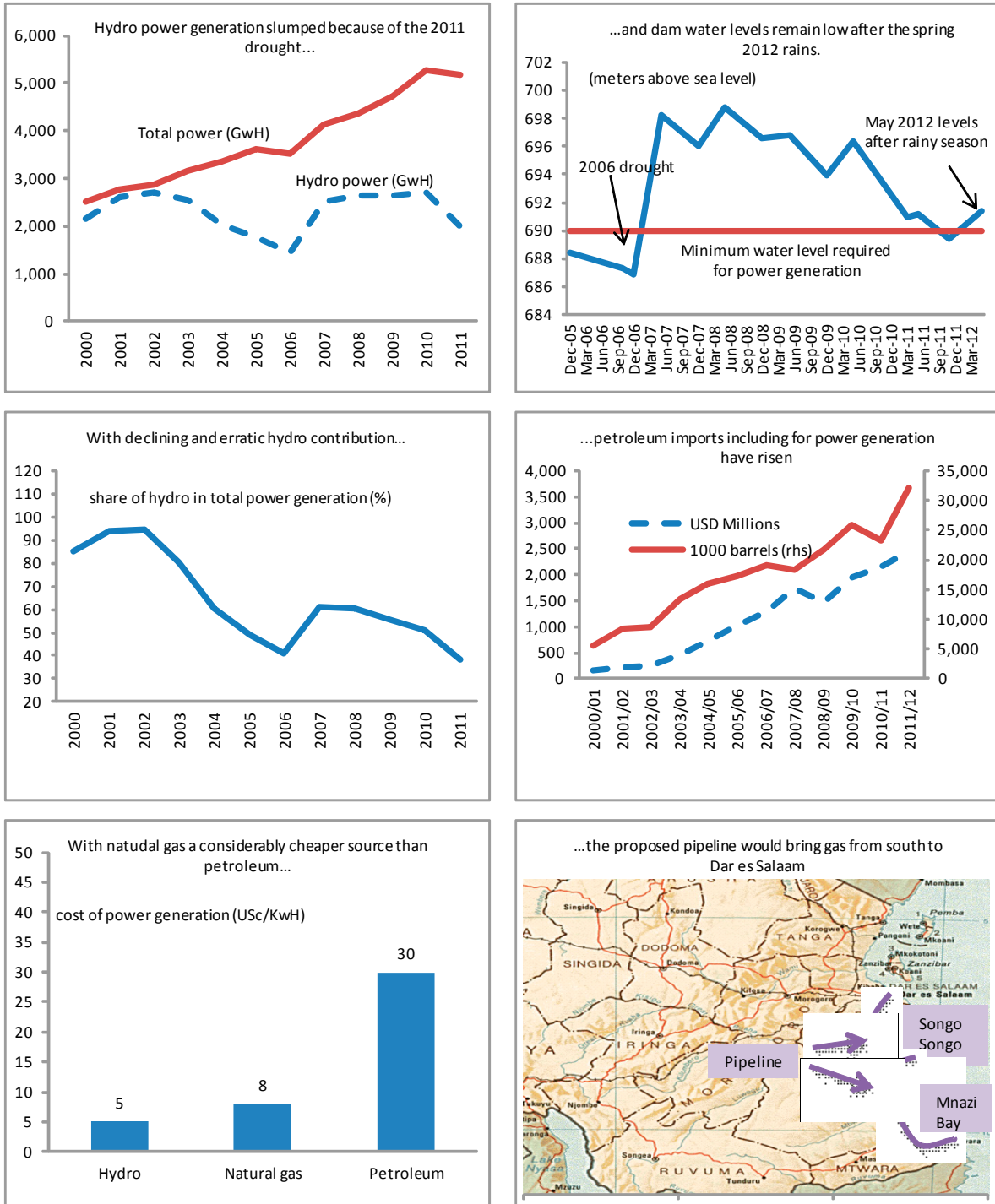
Source: Tanzania authorities and IMF staff calculations

Figure 2. Tanzania: Responding to Price Shocks with Monetary Tightening



Source: Tanzania authorities and IMF staff calculations

Figure 3. Tanzania: Energy Sector



Source: Tanzania authorities and IMF staff calculations

LETTER OF INTENT

Dar es Salaam
June 21, 2012

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

Dear Madam Lagarde:

1. The Government of Tanzania remains committed to policies that will sustain macroeconomic stability while promoting accelerated economic growth and poverty reduction. These goals are being successfully pursued under the economic and financial program supported by the Policy Support Instrument (PSI).
2. All quantitative assessment criteria under the program were met at end-December 2011, and all quantitative indicative targets but one were met for March 2012. All five structural benchmarks for the period through end-June 2012 have been implemented.
3. Tanzania's economy continues to grow strongly. Despite power shortages, real GDP grew by 6.4 percent in 2011. With rapid growth in foreign direct investments in the offshore gas sector, even stronger growth is projected for 2012 and beyond.
4. Inflation rose in 2011 due to higher global oil prices and a surge in regional and global food prices. With tighter fiscal and monetary policies and a slowing of food price inflation, headline inflation has gradually begun to fall. In the absence of further shocks, headline inflation is projected to return to single digits by end-2012.
5. The Government is pursuing continued fiscal consolidation in 2012/13 to progressively rebuild fiscal buffers after responding to the last global recession with counter-cyclical fiscal policies in 2009/10 and 2010/11. The budget aims to reduce the overall fiscal deficit to 5½ percent of GDP in 2012/13, down from the 6–6½ percent of GDP range in the preceding year. Over the medium-term, a further reduction in the deficit to debt-stabilizing levels is targeted.
6. With a temporary reduction in Tanzania's hydroelectric generation requiring increased reliance on liquid petroleum-based thermal generation, and high global oil prices, Tanzania's current account deficit is projected to increase to around 15 percent of GDP in 2011/12. Over the year ahead, the deficit is projected to narrow as domestic savings are

boosted through fiscal consolidation, the recent power tariff adjustment, and tighter monetary policies.

7. While Tanzania's macroeconomic prospects are generally favorable and it has no immediate exceptional financing needs, the country is vulnerable to a worsening of the global economic outlook. With the fiscal deficit, public debt stock, and inflation higher than at the start of the last global recession and lower reserve cover, Tanzania's room for macroeconomic maneuver is more limited than in the past. To safeguard adjustment plans against the downside risks of a global slowdown, the Government is requesting approval of an 18-month precautionary Standby Credit Facility (SCF) in an amount of 75 percent of quota.

8. Following discussions and consultations with the Fund staff, I hereby transmit this Letter of Intent and the attached Memorandum of Economic and Financial Policies (MEFP), which reviews the implementation of the program through the first nine months of 2011/12 and the policies that the Government intends to pursue in 2012/13 under the program supported by the PSI and requested precautionary SCF.

9. The Government of Tanzania requests completion of the fourth review under the PSI based on overall performance under the program and the Government's policy intentions going forward. The Government is confident that the policies and measures set forth in the attached Memorandum will deliver the objectives of the program. We stand ready to take any further measures that may become appropriate for this purpose. 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. It is expected that the fifth review will take place before end-December 2012, and the sixth and final review before June 3, 2013.

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

Yours Sincerely,

/s/

Dr. William A. Mgimwa (MP)
MINISTER FOR FINANCE
UNITED REPUBLIC OF TANZANIA

/s/

Prof. Benno Ndulu
GOVERNOR, BANK OF TANZANIA
UNITED REPUBLIC OF TANZANIA

Attachments:

Memorandum of Economic and Financial Policies

Technical Memorandum of Understanding on Selected Concepts and Definitions Used in the
Monitoring of the Program supported by the PSI and SCF

Attachment I. Memorandum of Economic and Financial Policies

June 21, 2012

I. Macroeconomic Developments and Program Performance

A. Macroeconomic Prospects for 2011/12

Output and inflation

1. Tanzania's economic growth performance remains strong, despite power shortages in the first three quarters of 2011. GDP growth was 6.4 percent in 2011, up from a programmed 6.0 percent, supported by strengthened activity in transport, communications, financial intermediation, and construction. Economic growth in financial year 2011/12 is projected to be at least 6½ percent.
2. Earlier inflationary pressures are now gradually unwinding. Headline inflation peaked at 19.8 percent in December 2011, driven mostly by the food price impact of the drought in the Horn of Africa and higher global oil prices. With some spillovers to other prices, and currency depreciation in late-2011, core inflation (excluding food and fuel) rose from 3.7 percent in December 2010 to 8.7 percent in December 2011. The 40 percent rise in domestic power tariffs in January 2012 had only a limited impact on prices, due to the low weight of power costs in the consumer price index and because the impact on business costs was offset by savings from reduced usage of standby generators. Following steps to tighten fiscal and monetary policies in 2011, headline inflation eased to 18.2 percent in May 2012. With projected declines in food prices after seasonal rainfalls in March-May, headline inflation is projected to decline to single digits by around end-2012.

Fiscal performance

3. **Overall fiscal position.** The January 2012 mid-year budget review adopted plans to reduce the overall fiscal deficit (including grants) to 6.6 percent of GDP in 2011/12. This required savings of 1.1 percentage points of GDP relative to the approved 2011/12 budget—to be achieved by slowing nonpriority expenditure growth while protecting key infrastructure projects and social spending. Despite shortfalls in revenues and grants, this deficit target is expected to be surpassed, with the overall deficit declining to the 6.1 percent of GDP range, down from 6.9 percent of GDP in 2010/11.
4. **Revenues:** Tax revenues were buoyant in the first nine months of 2011/12, supported by strong economic growth and administrative measures taken by the Tanzania Revenue Authority (TRA). The latter included the establishment of tax service centers to support tax compliance; introduction of intensified risk-based and quality tax audits; and roll-out and enforced usage of electronic fiscal devices (EFDs) to track tax collections at point-of-sale. In addition, the resolution of tax disputes with a mining company contributed to favorable

corporate income tax collection. With continuing strong economic growth, tax revenues are projected to rise by 0.3 percentage points of GDP in 2011/12. Despite this, overall revenue collections are projected to fall 0.4 percent of GDP below programmed levels on account of a shortfall in nontax revenues, which were adversely affected by delays in introducing business licence fees by local governments (LGAs).

5. **Foreign grants:** Delays in grant disbursements early in the year were largely but not entirely eliminated by end-December 2011. As a result, and with an upward revision to GDP, grant receipts in 2011/12 are projected to be 0.6 percent of GDP lower than programmed.

6. **Expenditures:** Cash management was tight through 2011/12. Recurrent and domestically-financed development spending in the first nine months were 61 and 65 percent of programmed full-year totals, respectively. With continuing tight management, the government projects that spending will be kept below ceilings adopted in the mid-year budget review. On current projections, overall expenditures are projected to be about 1.5 percent of GDP lower than programmed, largely reflecting savings in the wage bill and capital spending as a percentage of GDP.

7. **Financing:** Good progress is being made in contracting planned non-concessional financing, with disbursements in the first nine months equivalent to about 53 percent of the full-year plan. Domestic financing of the deficit was below programmed levels through March 2012, and is projected to remain below the 1 percent of GDP program ceiling for the full year.

Monetary policies

8. After meeting reserve money targets at end-December 2011, monetary policies were further reinforced in early-2012 to tackle inflationary pressures. Reserve money was held 7 percent below the end-March 2012 program ceiling, and tighter liquidity conditions have been associated with increased market interest rates and a stronger currency after weakness in the second half of 2011. Liquidity and credit growth have slowed. At end-March 2012, annual growth rates of M3 and private sector credit were 15.7 and 21.9 percent, compared to programmed growth rates of 21 and 25 percent, respectively.

External developments

9. During the first nine months of 2011/12, the current account deficit (excluding official transfers) rose to \$3,952 million compared to \$1,773 million recorded in the first nine months of 2010/11, reflecting a surge in imports of oil and capital goods. The increase in oil imports reflects higher global prices as well as greater volumes of oil imports to fuel new petroleum-based thermal and back-up power generators. The rise in imports of capital goods reflects higher foreign direct investment for oil and gas exploration. Exports of goods and services were 8.8 percent higher than the amount recorded in the corresponding period in 2010/11, largely on account of the increase in travel receipts and the price and volume of gold.

10. In 2011/12, the current account balance (excluding official transfers) is estimated to show a deficit of 15 percent of GDP compared to about 9½ percent of GDP in 2010/11. The deficit is projected at 14½ percent of GDP in 2012/13, before declining in subsequent years as a rise in hydro-electric power generation eases demand for imported petroleum fuels and as fiscal consolidation reduces other import needs.

11. The shilling depreciated by an average of 10.3 percent against the dollar in 2011 compared with 6.7 percent in 2010. This was associated with increased foreign currency demand to finance rising oil imports; general strength in the dollar globally; and high domestic inflation relative to that of trading partners. In line with measures taken by the Bank of Tanzania to tame inflationary pressures and exchange rate volatility, the shilling strengthened from end-November 2011 and stabilized starting January 2012. Gross international reserves stood at \$3,533.4 million at end-March 2012, equivalent to 3.7 months of projected 2011/12 imports of goods and services.

B. Program performance through March 2012

Quantitative targets

12. All PSI assessment criteria for end December 2011 were met (Table 1 attached). Reflecting strong revenue collection and tight limits on recurrent spending, net domestic financing through December was 1.4 percent of GDP lower than programmed. The change in net international reserves (NIR) through end-December was 0.7 percent of GDP above the adjusted program floor, and average reserve money was 0.3 percent below the program ceiling. The continuous criterion on the non-accumulation of external payments arrears was met, while contracts for external non-concessional borrowing (ENCB) were less than half of the program ceiling of \$1,050 million.

13. Indicative targets for end-March 2012 were also met, except for the floor on the accumulation of NIR, which was missed by 0.3 percent of GDP (MEFP Table 1). This shortfall reflected increased demand for foreign exchange to finance the rising oil import bill and infrastructure investments at a time when external non-concessional borrowing fell significantly short of programmed levels. The June 2012 NIR floor is projected to be narrowly met given the progress made in contracting external non-concessional borrowing.

Structural benchmarks

14. All five structural benchmarks for the period through end-June 2012 were implemented (MEFP Table 3):

- The Ministry of Finance posted to its internet website copies of the full four volumes of revenue and public expenditure estimates for the 2011/12 budget as approved by the National Assembly; this was completed in December 2011, well ahead of the March 2012 benchmark date.
- The increase in domestic power tariffs of not less than 40 percent was met with a two-week delay in mid-January 2012.

- In January 2012, the government submitted legislation to Parliament (February benchmark) to tighten the existing anti-money laundering framework in line with Financial Action Task Force (FATF) recommendations; this legislation has been approved and was signed into law by the President on February 20, 2012.
- In March 2012, the Bank of Tanzania issued Social Security Scheme Investment Guidelines as mandated in the Social Security Regulatory Authority Act 2008 (end-March 2012 benchmark, carried forward after being missed in 2011).
- And in May 2012, the authorities provided IMF staff with two technical and economic evaluations by independent consultants of the proposed gas pipeline project (end-June 2012 benchmark).

II. ECONOMIC PROGRAM FOR 2012/13 AND THE MEDIUM TERM

A. Economic prospects for 2012/13 and the medium term

15. Medium-term growth prospects are generally favorable. Private investor confidence has been buoyed by robust growth in the East African regional market and by initial investments in Tanzania associated with oil and gas exploration. Growth is also benefitting from implementation of MKUKUTA II, the Five Year Development Plan, and initiatives under the Southern Agricultural Growth Corridor of Tanzania (SAGCOT). The program assumes growth of 6½–7 percent in 2012/13 rising to the 7–7½ percent range over the medium term. The near-term growth outlook is potentially vulnerable to a deterioration in global growth and also depends on ensuring adequate power supplies. For the medium term, investments in the gas sector are expected to rise sharply and there will be scope to reduce energy prices using existing domestic gas supplies; there may be, therefore, some upside potential to growth over this period.

16. Based on appropriately tight fiscal and monetary policies, the goal is to reduce core inflation over the year ahead. In the absence of new external price shocks, headline inflation is projected to decline to single digits by end-2012 and to the 5 percent range over the medium term.

17. In the external sector, the large trade deficit for 2011/12 is projected to slowly unwind as domestic gas and hydro power generation substitute for petroleum-based thermal capacity under the emergency power plan. Over the medium term, improved trade performance will also be needed to offset any decline in donor grant and loan funding relative to Tanzania's fast-growing economy. Given the need for smaller trade and current account deficits in future years, economic policies will be focused on strengthening the business environment and maintaining a competitive currency. While non-concessional financing will partly serve to underpin infrastructure spending in the context of a projected decline in donor project funding relative to GDP, borrowing will be strictly limited to levels consistent with maintaining favorable debt sustainability characteristics.

18. Following countercyclical fiscal policies in 2009/10 and 2010/11, which helped Tanzania weather the global recession, a first step toward rebuilding fiscal buffers was taken in 2011/12. This process will continue over the coming years with a view to reducing annual borrowing and stabilizing the public debt-GDP ratio at less than 50 percent of GDP. Consistent with this strategy, the fiscal deficit will be reduced to 5½ percent of GDP (after grants) in 2012/13 with further reductions in subsequent years to achieve a medium-term debt-stabilizing deficit. This fiscal consolidation will help support the adjustment toward smaller current account deficits. The pace of consolidation in 2013/14 and beyond will be reviewed ahead of the 2013/14 budget, taking into account economic conditions at that time.

B. Fiscal policies for the 2012/13 budget

19. The 2012/13 budget is guided by Tanzania's five-year development plan and its development strategy, MKUKUTA II. The deficit target represents a projected consolidation of about 3 percentage points of GDP in the overall balance before grants and approaching 1 percent of GDP after grants. The budget balances an increase in tax revenue collections with savings in expenditures.

20. The budget will slow but not fully halt the upward trend in the public debt-GDP ratio. The rise in the debt ratio from about 41 percent of GDP at end-June 2012 to 45½ percent of GDP at end-June 2013 largely reflects borrowing equivalent to 3.1 percent of GDP contracted to finance construction of a new gas pipeline to be managed commercially by the Tanzania Petroleum Development Corporation (TPDC) (see below).

Revenues

21. Revenue collections are budgeted to increase by 1 percentage point of GDP in 2012/13, driven by higher tax collections. The increased yields reflect favourable economic growth, continuing steps to strengthen tax administration, and tax policy measures included in the 2012/13 budget.

22. A number of steps are being taken to strengthen **tax administration**:

- The TRA will further strengthen its audit, enforcement, and valuation capacities. It will extend the use of EFDs to non-VAT traders, and will enhance IT systems (including by implementing a single window system for customs administration and an e-tax revenue system for domestic revenue administration). It will also improve the management of tax exemptions by scrutinizing applications and conducting risk-based audits of beneficiaries. National Identification Cards (IDs) will be introduced in August 2012 to help expand tax coverage of the informal sector. These combined measures are projected to have a revenue yield of 0.3 percent of GDP.
- The TRA expects to resolve outstanding tax disputes with a mining company. The associated reduction in the government's refunding liabilities to this company, combined with strengthened mining tax administration, is projected to have a revenue yield of 0.1 percent of GDP.

- For nontax revenues, user fees and charges will be increased to reflect the value of services provided and to compensate for recent inflation;
- A study on integration and harmonization of revenue collection systems will be completed with findings implemented to improve systems of collection and administration of non-tax revenue focusing on issuing receipt, licensing and improve retention schemes' rates;
- A review will be conducted of the laws/acts governing the various institutions and agencies that collect fees, levies, and duties with a view to enhancing their contributions to the consolidated fund; and
- Steps will be taken to enhance the capacity of the MDAs, RSs and LGAs to strengthen monitoring of revenue collections.

23. A number of **revenue measures** were introduced in the 2012/13 budget with a projected overall yield of 0.5 percent of GDP:

- A large part of the tax effort will come through new and uprated excise taxes. A new excise duty will be imposed on natural gas of TSh0.35/SCF; a new excise duty will be applied on CDs and DVDs; excises for non-petroleum products will rise by 20 percent (25 percent for beer); the mobile phone airtime duty will be increased from 10 to 12 percent; exemptions from motor vehicles excises will be abolished; and a new excise duty will apply to fruit juices. The overall yield is estimated at 0.30 percent of GDP.
- Initial steps will be taken to reduce other tax exemptions. The import duty exemption for motor vehicles with engine capacity over 3,000 c.c. will be abolished and the exemption for "deemed" capital goods will be reduced by an initial step from 100 to 90 percent of the due tax. The combined yield is estimated at 0.04 percent of GDP.
- On income taxes, a new 10 percent withholding tax will be applied to nonresident interest income, and a 10 percent withholding tax will apply to inter-company dividend distributions, with an estimated yield of 0.02 percent of GDP.
- Other tax policy reforms will yield an estimated 0.14 percent of GDP in 2012/13. These include an increase in the airport service charge from \$30 to \$40 per person; an increase in the export tax on hides and skins from 40 to 90 percent; and the launch of a scheme to make available vanity auto license plates at a charge of about \$3,000 for a five-year period. In addition, current beneficiaries of VAT relief under Schedule III will be subject to a reduced-rate VAT rate of 10 percent. Although the government strongly favors a VAT regime with a single rate, this will extend the VAT to exempt activities pending a more comprehensive review of the regime. The government will finalize in the coming months, with technical assistance from the IMF, a draft new VAT law, in line with international standards and with minimal exemptions. The

intention is to adopt the law by December 2012 and to begin implementation from July 1, 2013.

- On non-tax revenues, land rents, which have remained unchanged for some years, will be increased, yielding a projected TSh 74 billion (0.15 percent of GDP). This increase will be administered by the Ministry of Lands, and the projected additional collections will finance an urban development project. The latter will be financed entirely from the Ministry's retained incomes, and the Ministry will not proceed with the project before ensuring that the rent increase is in place and that revenue collections are coming in on track. Under this approach, there is no risk that the project will require financing from the consolidated fund or result in expenditure arrears. Royalty rate for gold mining companies, which is administered by the Ministry of Energy and Minerals, will also be raised from 3 percent to 4 percent, yielding a projected TSh 39 billion (0.08 percent of GDP).

Expenditure policies

24. Overall expenditures are projected to decline by about 1.3 percentage points of GDP in 2012/13. The decline is driven by lower foreign-financed capital spending, with both loan and grant financing budgeted to decline in comparison with 2011/12 levels. For outlays financed from domestic resources, the budget shifts from recurrent to development spending.

- The wages and salary bill (excluding parastatals) will decline from a projected 6.7 percent of GDP in 2011/12 to a budgeted 6.5 percent of GDP in 2012/13. With tight recruitment limits, public sector employment will expand no faster than in 2011/12, while wage and salary increases would be somewhat lower than the average for recent years, consistent with plans to reduce underlying inflation.
- Non wage, non-interest recurrent spending will be broadly unchanged at 11.2 percent of GDP in 2012/13. This will be achieved through continuing tight limits on low-priority spending.
- Domestically-financed development spending is budgeted to increase from a projected outturn of 3.6 percent of GDP in 2011/12 to 4.6 percent of GDP in 2012/13. The 2012/13 budget includes a provision of 0.4 percent of GDP to cover any carry forward of unpaid bills from 2012/13.

25. With the budgeted rebalancing from recurrent to development spending, the ratio of recurrent spending to recurrent incomes (revenues plus program grants) is projected to decline from 100 percent in 2011/12 to 95 percent in 2012/13. This compresses into one year the earlier plans for a phased reduction of this ratio to 97 percent in 2012/13 and 95 percent in 2013/14 and beyond.

Fiscal contingencies

26. After two years of increased tax revenues in relation to GDP, the government is confident that further gains in tax administration, growing collections from the natural resources sector, and the tax policy measures in the budget will allow it to meet its 2012/13 revenue goals. To safeguard the fiscal adjustment program, tax revenue collections will be monitored closely against a new indicative quarterly target for tax revenue collections (MEFP Table 2). In the event of a shortfall relative to this target, the government will take prompt corrective steps, as needed, to keep the fiscal program on track. Fiscal contingencies would include (a) a further effort to streamline non-wage, non-interest recurrent spending with savings in lower priority areas; and (b) a less ambitious increase in domestically-financed capital spending, possibly by delaying outlays on new projects into the subsequent year. Priority spending on agricultural inputs and health and education transfers to local government authorities will be preserved in the context of any further such tightening of the spending budget, and a new indicative quarterly floor on such spending has been adopted (MEFP Table 2).

Financing

27. Although the smaller fiscal deficit will reduce net public borrowing needs in 2012/13, the latest survey of donor financing plans suggests a decline in combined program and project loans of about 0.8 percent of GDP in 2012/13. With net domestic financing of the budget of 1.3 percent of GDP in 2012/13, a slightly higher utilization of external non-concessional borrowing to finance the budget is programmed (2.6 percent of GDP, compared to 2.3 percent in 2011/12). Preparations for this borrowing are well-advanced and the government does not see risks of a financing shortfall.

28. As part of the government's energy strategy (see Section D below), TPDC will oversee the construction of a new gas pipeline over an 18-month period starting in 2012/13 with implications for the public sector borrowing requirement. The pipeline will be constructed at a provisionally-estimated cost of \$1.2 billion (4.2 percent of 2012/13 GDP), financed by a combination of external concessional and nonconcessional loans with a small Tanzanian budget contribution. The government will contract this financing, extending a counterpart credit to the TPDC, which will operate the pipeline on a commercial footing. Operating income from the pipeline will be dedicated to servicing TPDC's obligations to the government, which will, in turn, service the external credits. Borrowing for this project is projected at 3.1 percent of GDP in 2012/13 and 0.9 percent of GDP in 2013/14.

C. Public Financial Management

29. The government is committed to further strengthening public financial management (PFM) systems in the context of the PFMRP IV, which will be implemented over five years starting from January 2012 with assistance from international donors, including the IMF. Under the PFMRP IV, government efforts to strengthen PFM systems will focus on revenue management, planning and budget management, budget execution, transparency and accountability, budget control and oversight, change management, programme monitoring and evaluation.

Audit and payments systems

30. Steps have been taken to strengthen the internal control systems and develop risk management strategies for central government ministries, departments and agencies (MDAs) and local government authorities (LGAs). The Internal Audit Division, in collaboration with Japanese International Agency (JICA), has developed and disseminated an Internal Audit Handbook to internal auditors of MDAs and LGAs. The Handbook provides internal auditors in the public sector with modern audit tools and techniques. The division is also in the process of acquiring software for payroll audit and will develop an Audit Policies and Procedure Manual by December 2012. The Manual will include (i) an internal audit manual in line with the International Professional Practice Framework, (ii) a procurement audit manual (iii) a quality assurance improvement program procedure manual, and (iv) guidelines on implementation of institutional risk management framework.

31. The government is committed to improve the quality of public sector financial statements. In particular, the government will take measures to address the issues raised in the latest Auditor General's audit report on the 2009/10 and 2010/11 public financial statements, including, but not limited to: (i) the lack of the balance sheet (financial position); (ii) the loss of banking evidence of certain transactions; and (iii) the nondisclosure of some investments, liabilities, and value of assets.

32. The Assistant Accountant General responsible for LGAs (AAG-LGA) has been charged with enhancing the accountability of LGAs' financial management. A Treasury Circular No. 7 of 2011/2012 was issued on February 15, 2012 and circulated to LGAs, requiring them to comply with the activities under the AAG-LGA. Currently, AAG-LGA is establishing a database for all accountants under LGAs and reviewing the LGAs financial memorandum, Local Government Finance Act, and Local Government Accounting Manuals, Circulars, and Regulations.

33. The number of dormant government bank accounts has been further reduced, shifting toward consolidating LGAs' accounts to six per council. A full transition to operating with the designated six accounts per council is expected to start from 2012/13, as soon as the remaining 3,524 dormant accounts have been closed. The government has also improved its financial management system for better service delivery. The improvements include (i) the introduction of a computerized pensions system, which improves the efficiency of pension payments, including by avoiding double payments to pensioners and (ii) the upgrade of IFMIS. The process to roll out Electronic Payments System to RAS officers and sub treasuries is ongoing, which will help to make payments on real time to customers, reduce expenditure float, and reduce number of government accounts at commercial banks.

Domestic arrears

34. To better track domestic arrears issues, the government will continue compiling domestic arrears on a quarterly basis and is sharing these data with the IMF and other development partners. An expenditure allocation was made in the 2011/12 budget for clearing domestic arrears carried over from 2010/11. In practice, with tight cash limits early in the year, domestic arrears rose from TSh 367 billion at end-June 2011 to TSh 455 billion

(1.1 percent of GDP) at end-March 2012. Arrears on construction work were reduced over this period, but arrears on goods and services rose from negligible levels in June 2011 to 0.4 percent of GDP at end-March 2012. The government intends to clear all remaining arrears by end-2011/12, and has allocated resources equivalent to 0.4 percent of GDP in the 2012/13 development budget to cover any unexpected payment float from 2011/12. To avoid future domestic arrears, the government will strengthen financing plans for multi-year projects and contracting practices.

Public debt management

35. Tanzania's debt management capacity is currently rated as low according to the DEMPA, CPIA and PEFA metrics. The government aims to strengthen its debt capacity rating drawing on the advice and support of the World Bank, IMF, and other development partners. In particular, efforts will be made to:

- *Ensure that Tanzania's debt management strategy minimizes budgetary risks and ensures long-term debt sustainability.* A medium-term debt management strategy has been put in place. Going forward, nonconcessional borrowing decisions will be made under this strategy, and public investment decisions will be made with a view to maximizing returns on investments;
- *Make available adequate and current statistics on both domestic and external debt stock and flows.* As one of its recent steps to strengthen debt management, the government established a unified public debt statistics database under a single monitoring unit.
- *Facilitate effective inter-agency coordination on debt management and debt sustainability issues.* To further streamline debt management, the government intends to consolidate debt management functions by establishing Debt Management Office (DMO) in the Ministry of Finance; and
- *Task the newly established Debt Management Office (DMO) with monitoring new borrowing to ensure debt sustainability.* To improve debt monitoring, a record of all government debt guarantees will be compiled by the DMO and shared with the IMF on a quarterly basis, within 6 weeks of the end of each quarter.

36. Through April 2012, the government contracted external non-concessional borrowing (ENCB) of \$433 million to finance government infrastructure projects in the energy, roads, and other sectors. By end-June 2012, the government plans to contract a further \$350 million of ENCB for diverse infrastructure projects to be financed in the 2011/12 and 2012/13 budgets. In 2012/13, ENCB will include an additional \$250 million to finance a multi-year gas pipeline project (see below), further external non-concessional credit of \$600 million to finance infrastructure projects in 2012/13 and beyond, and a planned government guarantee of \$135 million to the state power utility TANESCO. As a result, cumulative contracting/guaranteeing of ENCB under the three-year PSI is projected at \$1,768 million, up slightly from the initially envisaged \$1,500 million. The government requests approval for

this higher ceiling, which has no significant impact on debt sustainability. To ensure compliance with this ceiling, the government is ensuring close monitoring of any external non-concessional borrowing by the public enterprise sector.

Fiscal transparency

37. Going beyond the structural benchmark on fiscal transparency (Table 3), the Ministry of Finance published on its internet website the summary 2011/12 “citizens’ budget”, which provides an overview to facilitate public understanding of the budget. In the year ahead, the corresponding 2012/13 budget documents will be added to the Ministry’s website.

D. Energy sector policies

38. In 2011, Tanzania suffered severe power shortages when droughts in late 2010 undercut hydropower capacity. In response, the Government implemented an Emergency Power Plan (EPP), procuring temporary power generating capacity from the private sector. With expensive liquid-fuel generated thermal energy replacing cheap hydropower, the financial situation of TANESCO deteriorated. Accordingly, under emergency procedures, the Energy and Water Utility Regulatory Authority, EWURA, approved an increase in electricity tariffs of 40 percent in January 2012. In addition, TANESCO is borrowing TSh 408 billion (1.0 percent of GDP) to temporarily cushion its liquidity position.

39. To complete the tariff review process, EWURA is conducting a more comprehensive review of TANESCO’s new cost structure, to be completed within 6 months of the January 2012 emergency tariff adjustment. A consultant has been contracted to conduct the cost of service study (COSS). Given the importance of safeguarding TANESCO’s financial viability, the Government supports EWURA’s intention to quickly follow through on the COSS recommendations, including regarding the appropriate level of tariffs.

40. The Government’s medium-term objective is to ensure a steady supply of electricity to the economy at lower costs. To this end, the Government is finalizing a project to construct a new gas pipeline to address capacity constraints in bringing lower cost natural gas from shallow water offshore reserves in Songo Songo and the Mnazi Bay to Dar es Salaam and surrounding areas for electricity generation and other uses. The government has commissioned independent external evaluations that show that the project is commercially viable for TPDC. The broader economic benefit will be exceed the commercial return, as industrial and other power users will benefit from lower power tariffs than would otherwise be possible, boosting Tanzania’s competitiveness and growth prospects. The government has also confirmed that debt contracted under the project will not pose risks for debt sustainability.

41. The Government is keen to explore additional renewable energy resources in Tanzania, in particular hydro and wind power. Assistance in this area is being provided by the World Bank, which is assessing Tanzania’s energy capacity under its ongoing Energy Sector Management Program (ESMAP).

E. Monetary, financial sector, and exchange rate policies

Monetary and exchange rate policies

42. The Bank of Tanzania (BoT) will continue to implement its reserve money targeting program using a combination of monetary policy instruments to slow core inflation. Demand for currency is projected to rise through June 2012 as crop procurement commences, and BoT will ensure that any associated expansion of reserve money is consistent with its anti-inflationary policies. For 2012/13, the annual growth rates of average reserve money and M3 are targeted at 16.5 percent and 17.4 percent, respectively. This is consistent with the programmed slowing of inflation, while providing room for private sector credit to grow by 20 percent in the year ending June 2013. The BoT stands ready to tighten liquidity conditions should the need arise.

43. The exchange rate will remain market determined and the BoT will continue to participate in the foreign exchange market for liquidity management purposes and to smooth out short-term fluctuations in the exchange rate, while maintaining an adequate level of international reserves.

44. The BoT intends to move toward a more active use of interest rate in managing monetary policy and will be seeking assistance from the IMF and others. In this regard, BoT has been working closely with other EAC partner states in coordinating its monetary policy as all partners have begun taking steps toward achieving an EAC monetary union.

Financial sector stability

45. BoT in collaboration with other financial sector regulators have taken a number of initiatives aimed at enhancing stability in the financial sector. These include enhancing financial stability monitoring and tools, banking regulations, insurance and Social Security Sectors, and mobile financial services. The BoT continues to publish semi-annual financial stability reports on its web site, with the latest report for September 2011 and the next scheduled for June 2012.

46. The review of regulations relating to the Microfinance Companies and Financial Cooperatives commenced in January 2012, with a view to accommodating changes in the sector. BoT is drafting Agency Banking Regulations to allow banks to extend their outreach through non-banking retail outlets such as supermarkets, petrol stations and other agencies. Further, the Tanzania Insurance Regulatory Agency (TIRA) is drafting micro-insurance regulations to provide a framework for introduction of insurance products catering for low-income households and micro-enterprise operators.

47. The growth of mobile financial services is rapidly expanding financial inclusion, with the number of users of mobile financial services up from 14 thousand at end-June 2008 to 21 million at end-December 2011. The BoT is in the final stages of drafting mobile financial services regulations to license and regulate the sector and address consumer protection issues. The regulatory and supervisory function will be carried out by BoT in collaboration

with the Tanzania Communication Regulatory Authority; to that effect, a bilateral MoU has been signed.

48. Financial soundness indicators at end-March 2012 indicated that the banking system remained sound, profitable and liquid, in the whole. The banking sector was adequately capitalized with ratios of core capital and total capital to risk-weighted assets of 17.9 and 18½ percent, respectively, compared with legal minimum requirements of 10 and 12 percent. The ratio of non-performing loans to total loans was 7½ percent at end-March 2012, down from 9.3 percent a year earlier (albeit up slightly from 6.7 percent at end-December 2011). Personal loans and those for wholesale and retail trade continued to account for some 40 percent of total loans, outpacing lending to other sectors. Overall liquidity remains satisfactory with a ratio of liquid assets to demand liabilities of 39.2 percent, compared to a statutory requirement of 20 percent.

49. BoT continues to further enhance its regulatory and supervisory effectiveness. Credit Reference Bureau and Databank Regulations have been finalized and gazetted. Steps to launch a credit reference system (CRS) are advanced, with a credit databank to become operational by end-September 2012. Prospective private credit reference bureaux have shown interest in applying for licenses and a review is being conducted of their eligibility. An effective and efficient CRS will facilitate information sharing between lenders and thereby address impediments that have boosted borrowing costs. Regulations for supervision of development finance institutions were published in March 2012. A joint team comprised of members from BoT and the Tanzanian Bankers' Association has been formed to carry out a review and study of Basel II and III and propose a roadmap for implementation of the capital accords.

Social security system reforms

50. The government is determined that public finances not be undermined by off-budget liabilities. In this context, a review of the public pension system conducted in collaboration with the World Bank suggests that the associated pension schemes face actuarial deficits. The Social Security Regulatory Authority (SSRA) is working closely with the Ministry of Finance to address these actuarial shortfalls. To strengthen pension fund returns, in March 2012, the Bank of Tanzania issued Social Security Scheme investment guidelines as mandated in the Social Security Regulatory Authority Act 2008. These guidelines cover actuarial valuation, investment management, mortgage lending, financial reporting, and governance issues. The government also intends to reform pension entitlement rules to help restore actuarial balance in the funds. Technical assistance is being provided by the World Bank, and the government is considering a multi-year World Bank loan package which could provide resources to support near-term benefit payments pending the beneficial impact of the policy reforms.

Anti-money laundering policies

51. In October 2011, the international Financial Action Task Force (FATF) identified Tanzania as one of five jurisdictions not making sufficient progress in improving policies on anti-money laundering and countering the financing of terrorism (AML/CFT). Specifically,

FATF sought progress on (i) adequately criminalizing money laundering and terrorist financing; (ii) establishing and implementing adequate procedures to identify and freeze terrorist assets; (iii) establishing adequate record-keeping requirements; (iv) establishing a fully operational and effectively functioning Financial Intelligence Unit; (v) establishing effective know your customer (KYC) measures; and (vi) designating competent authorities to ensure compliance with AML/CFT requirements. The FATF required that Tanzania take actions to implement significant components of its AML/CFT action plan by February 2012.

52. Responding to the FATF decision, legislation was submitted to the Parliament to address important deficiencies in the pre-existing AML Law. This legislation addressed the issues identified by the FATF. Parliament approved the amended AML/CFT legislation on February 3, 2012 and it was signed into law by the President on February 20, 2012.

53. Under earlier regulations, bank accounts of businesses and individuals who have not provided adequate documentation to comply with KYC procedures were to have been closed by mid-March 2012. With insufficient institutional capacity to meet this deadline, the government extended the moratorium for compliance with Anti-Money Laundering Regulations 2007 by banks and financial institutions for one year until March 14, 2013. During this period, the banks and financial institutions will be required to submit quarterly reports to the BoT showing steps that have been taken to comply, and challenges, if any.

III. PROGRAM RISKS AND STANDBY CREDIT FACILITY (SCF) REQUEST

54. Although Tanzania's growth prospects are good, the government's adjustment and reform policies face risks from factors outside of the country's control. Continuing drought conditions would pose risks to food prices and hydroelectric generation capacity. A further spike in food prices would require an appropriate response to ensure food security while countering inflationary pressures. An extended slump in hydro capacity would require continuing high levels of petroleum imports for thermal generation. To avoid any adverse impact on the budget, these costs would need to be passed on through appropriate adjustments to power tariffs.

55. A more fundamental risk is to global growth prospects and capital markets. In the event that the projected global slowdown for 2012 were to intensify, Tanzania would be affected through more difficult market conditions for its goods and services exports (including importantly tourism) as well as more constrained access to non-concessional financing. Moreover, while donor funding commitments have been largely agreed for 2012/13, a more difficult budget situation in advanced economies could weaken donor flows. Accordingly, while Tanzania's current financing needs are projected to be comfortably met through a combination of concessional and non-concessional funding; a financing gap could emerge in the event of a sharp global downturn.

56. With the fiscal deficit and public debt now higher than at the start of the last global recession, Tanzania would not have the flexibility to pursue aggressive countercyclical fiscal policies. Accordingly, the government would aim to preserve the broad thrust of its fiscal consolidation efforts, while seeking new financing, as needed, to close any financing gap.

The precise nature of Tanzania's policy response in the event of a shock would be developed in consultation with the IMF.

57. To position Tanzania to weather any such shock, the Government is requesting approval of support from the IMF under an 18-month precautionary SCF. The intention would be to accumulate undrawn balances under the SCF that could be available quickly in the event that Tanzania's balance of payments comes under pressure as a result of less favorable global market conditions. The government emphasizes that the arrangement will be precautionary in nature, and would only be utilized in the event of shocks. In conjunction with the request for a SCF, an update of the 2009 safeguard assessment of the BoT was initiated in April 2012 and is expected to be completed no later than the first review. The central bank is committed to implementing the recommendations resulting from the assessment.

IV. OTHER PROGRAM ISSUES

Statistical issues

58. The BoT currently uses the CPI excluding food and energy prices as a proxy for core inflation. A new core inflation index, which is consistent with recommendations made by the EAC countries, is expected to be released by September 2012. The BoT also intends to strengthen the balance of payments data through (i) developing alternative, more reliable data sources on remittances; and (ii) improving the tracking of FDI data, including those related to gas and oil exploration.

59. Progress has been made in moving fiscal accounts to the GFSM 2001 format, in line with international best practice. The ministry of finance will address the few remaining issues for the economic classification on the GFSM2001 format supported by the IMF, if needed. Reporting of fiscal data in the GFSM 2001 format for 2008/09 onwards to the IMF Statistical Yearbook will be initiated by end-2012 in close collaboration with the National Bureau of Statistics. More broadly, efforts will be made to compile improved data on public sector financial and nonfinancial assets, as well as to prepare expenditure data according to a functional classification.

60. With the technical assistance from the IMF, the BoT is continuing to strengthen Tanzania's balance of payments (BoP) statistics. At present, external trade statistics are compiled quarterly, while the full BoP is produced on an annual basis only. To improve monitoring of the external sector and strengthen related policy analysis, the BoT will begin compilation of comprehensive BoP estimates on a quarterly basis starting in December 2012 (structural benchmark). To improve the quality and timeliness of travel data, the Visitors' Survey will be conducted at least twice a year, in the high and low tourist season, together with a survey on resident travelers on the debit side. Working toward quarterly compilation for the Survey of Companies with Foreign Liabilities (SCLF) will enhance the quality and timeliness of financial accounts, including FDI data.

61. To further improve external debt data, the authorities will compile the Gross External Debt Position (GEDP) data on a quarterly basis by September 2012 for publication in the

Quarterly External Debt Statistics (QEDS) database. In addition, the Ministry of Finance and Bank of Tanzania will enhance coordination between their institutions to reduce discrepancies and address inconsistencies in external debt data.

Program monitoring

62. Progress in the implementation of the policies under this program will be monitored through assessment criteria (ACs), performance criteria (PCs), indicative targets (IT), and structural benchmarks (SBs) as documented in the attached tables. The government requests that two new indicative targets be included under the arrangement: a quarterly indicative target on tax revenue collections, and a quarterly indicative floor for priority spending on agricultural inputs and health and education transfers to local government authorities (paragraph 26).

63. The fifth and sixth reviews under the PSI arrangement are expected to be completed by end-December 2012 and end-May 2013, respectively; the parallel first and second reviews under the SCF arrangement are expected to be completed on the same schedule.

MEFP Table 1. Tanzania: Quantitative Assessment Criteria Under the Policy Support Instrument, 2011-2012

	December 2011			March 2012				
	Assessment Criteria	Adjusted Criteria	Preliminary Met?	Indicative Target	Adjusted Targets	Preliminary Met?	Met?	
(Billions of Tanzania Shillings; end of period, unless otherwise indicated)								
Net domestic financing of the government of Tanzania (cumulative, ceiling) ^{1,2}	300	449	-127	✓	296	596	449	✓
Average reserve money (upper bound) ³	4,235	4,235	4,222	✓	4,321	4,321	4,015	✓
Average reserve money target ³	4,193	...			4,278			
Average reserve money (lower bound) ³	4,151	...			4,235			
Tax revenues (floor; indicative target) ¹								
Priority social spending (floor; indicative target) ¹								
(Millions of U.S. dollars; end of period)								
Change in net international reserves of the Bank of Tanzania (floor) ^{1,4}	80	-10	167	✓	180	1	-62	X
Accumulation of external payment arrears (ceiling)	0	0	0	✓	0	0	0	✓
Contracting or guaranteeing of external debt on nonconcessional terms (continuous ceiling) ⁵	1,050	1,050	433	✓	1,050	1,050	433	✓
Memorandum item:								
Foreign program assistance (cumulative grants and loans)	628	628	608		831	831	652	
External nonconcessional borrowing (ENCB) disbursements to the budget ¹	291	291	222		441	441	234	

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

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

² To be adjusted upward by up to TSh 300 billion for the U.S. dollar equivalent of a shortfall in the combined total of foreign program assistance and ENCB from the amounts shown in the memorandum item. To be adjusted downward by any ENCB disbursed for budget financing above programmed amount for the year as a whole (US\$575 million for 2011/12)

³ Assessment criteria and benchmarks apply to upper bound only.

⁴ Floor will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance and ENCB financing of the government upto the equivalent of TSh 300 billion.

⁵ To be used exclusively for infrastructure investment projects. Continuous assessment criteria; cumulative from July 1, 2010.

**MEFP Table 2. Tanzania: Quantitative Assessment Criteria (AC), Performance Criteria (PC) and Indicative Targets Under the Policy Support Instrument and Stand-by Credit Facility
June 2012-June 2013**

	June 2012	September 2012	December 2012	March 2013	June 2013
	AC/PC	Indicative Target	AC/PC	Indicative Target	Performance Criteria
(Billions of Tanzania Shillings; end of period, unless otherwise indicated)					
Net domestic financing of the government of Tanzania (cumulative, ceiling) ^{1,2}	397	200	300	400	484
Average reserve money (upper bound) ³	4,464	4,735	4,835	4,866	5,108
Average reserve money target ³	4,420	4,688	4,788	4,817	5,058
Average reserve money (lower bound) ³	4,376	4,641	4,740	4,769	5,007
Tax revenues (floor; indicative target) ¹	...	1,880	3,961	5,986	8,011
Priority social spending (floor; indicative target) ¹	...	517	1,033	1,550	2,066
(Millions of U.S. dollars; end of period)					
Change in net international reserves of the Bank of Tanzania (floor) ^{1,4}	258	155	310	432	273
Accumulation of external payment arrears (continuous ceiling)	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (continuous ceiling) ⁵	1,050	1,668	1,668	1,668	1,668
Memorandum item:					
Foreign program assistance (cumulative grants and loans) ¹	1,062	397	567	746	785
External nonconcessional borrowing (ENCB) disbursements to the budget ¹	575	240	429	619	737

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

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

² To be adjusted upward by up to TSh 300 billion for the U.S. dollar equivalent of a shortfall in the combined total of foreign program assistance and ENCB from the amounts shown in the memorandum item. To be adjusted downward by any ENCB disbursed for budget financing above programmed amount for the year as a whole (US\$575 million for 2011/12)

³ Assessment criteria and benchmarks apply to upper bound only.

⁴ Floor will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance and ENCB financing of the government upto the equivalent of TSh 300 billion.

⁵ To be used exclusively for infrastructure investment projects. Continuous assessment criteria; cumulative from July 1, 2010.

MEFP Table 3. Structural Benchmarks under the 4th PSI review

	Measure	Target date	Status
1)	Issuance of investment guidelines for pension funds.	End-Sep 2011 (postponed to end-Mar 2012)	<i>Met with delay.</i> Social Security Investment guidelines were in March 2012.
2)	Regulatory authority approval of an increase in TANESCO's weighted average power tariff of not less than 40 percent to reduce its subsidies and better position it to repay the new loan that it is contracting to cover operating costs.	End-Dec 2011	<i>Met with short delay.</i> The tariff increase of 40.3 percent was implemented on January 15, 2012.
3)	The Government will submit to parliament draft legislation to tighten the existing AML framework in line with FATF recommendations and address national jurisdictional issues in support of Tanzania's AML/CFT action plan agreed with the FATF.	End-Feb 2012	<i>Met in advance.</i> The legislation was submitted to parliament in January, approved on February 3, 2012, and signed into law by the President on February 20, 2012.
4)	The Ministry of Finance will make available on a permanent basis on its internet website copies of the full four volumes of revenue and public expenditure estimates as submitted to and approved by the National Assembly, starting with the 2011/12 budget.	End-Mar 2012	<i>Met in advance.</i> The four volumes were made available on the internet before end-2011.
5)	The Ministry of Finance will provide to the IMF the technical and economic evaluation of the proposed gas pipeline project.	End-Jun 2012	<i>Met in advance.</i> A feasibility study of the gas pipeline conducted by independent consultants and engineers in 2010-11 was provided to Fund staff in late-May 2012. A further feasibility study conducted by a second consultant in 2011-12 was also provided to Fund staff in May.

**MEFP Table 4. Structural Benchmarks for Fifth and Sixth Reviews under the PSI
and First and Second Reviews under the SCF**

	Benchmark	Macroeconomic rationale	Date	¶
1)	Regulatory authority completion of cost of service study for the power utility, TANESCO, and implementation of any findings in regard to the power tariff regime.	Addresses contingent fiscal liabilities by ensuring financial viability of TANESCO.	End-August 2012	38
2)	The Ministry of Finance, Planning Commission, and TRA will prepare a report identifying steps to be taken to prepare Tanzania's macroeconomic management for the new gas economy, and identifying the nature of any corresponding technical assistance needs.	Supports early preparation for major macroeconomic challenges in the years ahead.	End-Dec 2012	MEFP for 3 rd PSI review
3)	Establish a new Debt Management Office (DMO) in the Ministry of Finance to consolidate public debt management functions.	Seeks to ensure strong, consolidated monitoring of debt liabilities to underpin sound public debt management.	End –Dec. 2012	34
4)	Compile and share with IMF a quarterly report of all government debt guarantees within 6 weeks of the end of each quarter. This will start with the first quarter of 2012/13.	The more frequent monitoring of debt guarantees will strengthen public debt management.	End-Nov. 2012	34
5)	Compile and publish full preliminary balance of payments data on a quarterly basis within 3 months of the end of the relevant quarter.	Seeks to strengthen macroeconomic and policy analysis	End-Dec. 2012 (for data through end-September 2012)	61

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

June 21, 2012

I. INTRODUCTION

1. The purpose of this Technical Memorandum of Understanding (TMU) is to describe concepts and definitions that are being used in the monitoring of Tanzania's program supported by the SCF and PSI, comprising the quantitative assessment criteria under the PSI arrangement; the performance criteria under the SCF arrangement; and the indicative targets and structural benchmarks jointly monitored under the SCF and PSI.
2. The principal data sources are the standardized reporting forms, 1SR and 2SR, as provided by the Bank of Tanzania to the IMF, and the government debt tables provided by the Accountant General's office.

II. DEFINITIONS

Net international reserves

3. Net international reserves (NIR) of the Bank of Tanzania (BoT) are defined as reserve assets minus reserve liabilities. The change in NIR is calculated as the cumulative change since the beginning of the fiscal year. The BoT's reserve assets, as defined in the IMF BOP manual (5th edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS), include: (i) monetary gold; (ii) holdings of SDRs; (iii) the reserve position at the IMF; (iv) all holdings of foreign exchange; and (v) other liquid and marketable assets readily available to the monetary authorities. Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guaranteed for a third party external liability (assets not readily available). The BoT's reserve liabilities include: (i) all short-term foreign exchange liabilities to nonresidents, of original maturities less than one year; and (ii) outstanding purchases and loans from the IMF.
4. NIR are monitored in U.S. dollars, and for program monitoring purposes assets and liabilities in currencies other than U.S. dollars shall be converted into dollar equivalent values using the exchange rates as of May 31, 2012 (as specified below, taken from International Financial Statistics.)

	US\$ per currency unit
British pound	1.5405
Euro	1.2365
Japanese yen	0.01284

Reserve money and reserve money band

5. Reserve money is defined as the sum of currency issued by the BoT and the deposits of commercial banks 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 serves as the assessment criterion (PSI), performance criterion (SCF), or indicative target.

Net domestic financing of the Government of Tanzania

6. Net domestic financing of the Government of Tanzania (NDF) includes financing of the budget of the central (union) government of Tanzania (“government”) by the banking system (BoT and commercial banks) and the nonbank public.

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

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

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

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

(iv) the outstanding stock of domestic debt held outside depository corporations, excluding: government debt issued for the recapitalization of the NMB and TIB; debt swaps with COBELMO (Russia) and the government of Bulgaria; mortgage on acquired sisal estates; compensation claims; and debt of parastatal companies assumed by the government.

8. For 2012/13 and 2013/14, NDF will be measured net of any accumulation of central government claims on the Tanzania Petroleum Development Corporation (TPDC) as a result of the on-lending of an external credit to finance a gas pipeline.

Government deposits at the BoT

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

External payment arrears

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

Priority social spending

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

Tax revenues

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

Contracting or guaranteeing of external debt on nonconcessional terms

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

14. Government debt is considered nonconcessional if the grant element is lower than 35 percent, calculated using discount rates based on Organization for Economic Cooperation and Development (OECD) commercial interest reference rates (CIRR), adjusted as appropriate for different maturities. For maturities of less than 15 years, the grant element will be calculated based on 6-month averages of commercial interest rates. For maturities longer than 15 years, the grant element will be calculated based on 10-year averages. This PSI assessment criterion applies not only to debt as defined in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board’s Decision No. 6230-(79/140), as amended by Decision No. 14416-(09/91), effective December 1, 2009), but also to commitments contracted or guaranteed for which value has not been received.

¹ Excluded for these purposes, except if the government offers an explicit guarantee on the debt, are: Tanzania Investment Bank; Tanzania Port Authority; Tanzania Petroleum Development Corporation; Dar es Salaam Rapid Transport Authority; Economic Processing Zones Authority; National Development Corporation; Small Industries Development Organization; National Housing Corporation; National Identity Authority; Dar es Salaam Water and Sewage Authority; and Tanzania Airport Authority.

Foreign program assistance and program exchange rates

15. Foreign program assistance is defined as budget support and basket grants and loans received by the Ministry of Finance (MoF) through BoT accounts and accounts at other depository corporations and is calculated as the cumulative sum, since the beginning of the fiscal year, of the receipts from (i) program loans and (ii) program grants. Program assistance does not include nonconcessional external debt as defined in paragraphs 7 and 8. Foreign program assistance is measured excluding bilateral loans in 2012/13 and 2013/14 for purposes of construction of the gas pipeline.

16. The program exchange rate for the period July 1, 2012 through June 30, 2013 is TSh/USD 1590.

III. ADJUSTERS

Net international reserves

17. The end-September 2012, end-December 2012, end-March 2013, and end-June 2013 quantitative targets for the change in the BoT's net international reserves will be adjusted downward by the amount in U.S. dollars of any shortfalls in (a) foreign program assistance and (b) external nonconcessional borrowing (ENCB) financing of the government budget in U.S. dollars (up to a limit equivalent to TSh 300 billion at the program exchange rate).

18. The shortfalls will be calculated relative to projections for foreign program assistance shown in table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Policies of the Government of Tanzania titled "*Quantitative Assessment Criteria, Performance Criteria, and Indicative Targets under the PSI and SCF*". For purposes of the adjuster, ENCB is measured excluding any non-concessional financing contracted in 2012/13 and 2013/14 for purposes of the gas pipeline.

19. Each quarterly shortfall will be converted from U.S. dollars to Tanzanian shillings using the program exchange rate (paragraph 16). The cumulative shortfall will be the sum of all quarterly shortfalls in Tanzanian shillings from the beginning of the fiscal year up to the date of assessment.

Net domestic financing

20. The end-September 2012, end-December 2012, end-March 2013, and end-June 2013 quantitative limits on the net domestic financing of the Government of Tanzania will be adjusted upward for any shortfalls in foreign program assistance and ENCB financing of the government budget in U.S. dollars (up to a limit of TSh 300 billion).

21. The shortfalls will be calculated relative to projections for foreign program assistance and ENCB financing shown in the Table on "*Quantitative Assessment Criteria, Performance Criteria, and Indicative Targets under the PSI and SCF*" attached to the MEFP. For purposes of the adjuster, ENCB is measured excluding any non-concessional financing contracted in 2012/13 and 2013/14 for purposes of the gas pipeline. Each quarterly shortfall will be converted from U.S. dollars to Tanzanian shillings using the program exchange rate

(paragraph 16). The cumulative shortfall will be the sum of all quarterly shortfalls in Tanzanian shillings from the beginning of the fiscal year up to the date of assessment.

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

IV. DATA REPORTING REQUIREMENTS

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

Table 1. Summary of Reporting Requirements

Information	Reporting Institution	Frequency	Submission Lag
Issuance of government securities.	BoT	Bi-weekly	1 week
Yields on government securities.	BoT	Bi-weekly	1 week
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 (1SR) and the currency composition of foreign assets and liabilities.	BoT	Monthly	1 week
Consolidated accounts of other depository corporations and the depository corporations survey (2SR and the DCS).	BoT	Monthly	4 weeks
Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor.	BoT	Monthly	2 weeks
External trade developments.	BoT	Monthly	4 weeks
Balance of payments	BoT	Quarterly	4 weeks
Standard off-site bank supervision indicators for other depository corporations.	BoT	Quarterly	6 weeks
Financial Soundness Indicators for other depository corporations.	BoT	Quarterly	6 weeks
Other depository corporation lending by activity.	BoT	Monthly	4 weeks
Commercial banks interest rate structure.	BoT	Monthly	4 weeks
Summary table of: (i) average reserve money; (ii) net domestic financing of the government; (iii) stock of external arrears; (iv) new contracting or guaranteeing of external debt on nonconcessional terms;	BoT and MoF	Quarterly	4 weeks

Information	Reporting Institution	Frequency	Submission Lag
and (v) net international reserves. ¹			
Amount of payment claims outstanding of more than 30 days, 60 days, and 90 days for all government ministries. For each ministry, total claims outstanding to be divided into: (i) unverified claims; and (ii) claims verified but not yet paid.	MoF	Quarterly	4 weeks
The flash report on revenues and expenditures.	MoF	Monthly	4 weeks
The TRA revenue report	TRA	Monthly	4 weeks
The monthly domestic debt report. ¹	MoF	Monthly	4 weeks
Monthly report on central government operations.	MoF	Monthly	4 weeks
Detailed central government account of disbursed budget support grants and loans, and external debt service due and paid.	MoF	Monthly	4 weeks
Detailed central government account of disbursed donor project support grants and loans.	MoF	Monthly	4 weeks
Statement on new external loans contracted and guarantees provided by the entities listed in paragraph 7 of the TMU during the period including terms and conditions according to loan agreements.	MoF	Quarterly	4 weeks
Report on priority social spending	MoF	Quarterly	6 weeks

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

INTERNATIONAL DEVELOPMENT ASSOCIATION AND
INTERNATIONAL MONETARY FUND¹

UNITED REPUBLIC OF TANZANIA

Joint World Bank/IMF Debt Sustainability Analysis

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

Approved by Jeffrey Lewis and Marcelo Guigale (World Bank)
and Roger Nord and Elliot Harris (IMF)

June 22, 2012

Tanzania's risk of debt distress remains low even when taking into account government borrowing from both domestic and external sources, including on non-concessional terms. While the planned contracted external non-concessional borrowing (US\$1.77 billion over the three-year PSI period through 2013 and 1 percent of GDP per year thereafter) increases the present value (PV) of debt-to-GDP and other indicators, it is not projected to jeopardize long-term debt sustainability. Alternative scenarios continue to suggest that debt indicators are sensitive to further borrowing on expensive terms. In addition, public debt sustainability analysis (DSA) raises some concern under an alternative scenario of persistently large primary deficits. This highlights that a sound debt management strategy, a conservative approach to non-concessional borrowing, and commitment to fiscal discipline are important factors for maintaining debt and fiscal sustainability. On the positive side, debt- and debt service indicators could be substantially more favorable than in the current DSA if recent favorable deep-water gas exploration results were to result in successful commercialization of new large-scale reserves over the coming decade with a rise in natural gas exports and associated government revenues.

I. BACKGROUND

1. **Tanzania's macroeconomic performance over the last decade has been strong.** Growth averaged 7 percent per year during 2002–2011 which, together with increased revenue collection, donor funding, and HIPC debt relief, provided room for an expansion in public spending. Higher global food and fuel prices and a regional drought in 2011 caused a drop in hydroelectric generation and increased fuel prices, leading to a peak in headline

¹ Prepared by the IMF and World Bank staff in consultation with the authorities. This DSA replaces the previous one prepared in April 2011. Tables and figures are in fiscal years (July–June). For example, 2012 refers to fiscal year 2011/12.

inflation of almost 20 percent and a widening current account deficit of about 15 percent of GDP in 2012. Core inflation (excluding food and energy) has stabilized at 9 percent, up from about 4 percent a year earlier. Despite these supply shocks, real GDP growth in 2011 was 6.4 percent, supported by strong construction and services expansion.

2. **Tanzania has benefited from extensive debt relief.** HIPC and MDRI debt relief reduced Tanzania's debt burden sharply to 20.6 percent of GDP at end-June 2007. External debt has steadily crept upwards since then, amounting to 34.7 percent of GDP by end-June 2011.^{2,3} In present value (PV) terms, the public and publicly guaranteed sector (PPG) external debt stood at about 26.7 percent of GDP at end-June 2011, or 88.1 percent of exports, while public external debt service was around 1 percent of exports. The current DSA only refers to central government debt, except for a US\$135 million guarantee extended to the power utility, TANESCO, but contingent risk from debt by other state-owned enterprises and pension funds could be sizable.⁴ The authorities intend to broaden their coverage to include contingent liabilities, including stepping up their compilation of data on debt guarantees. Public domestic debt stood at 10.6 percent of GDP at end-June 2011, up by 1.5 percent of GDP from the previous year.

3. **The authorities' medium-term policy is focused on stepping up public investment.** The poverty reduction strategy for 2011–2015 (MKUKUTA II) and the five-year development plan for 2012–2016 support growth, including through increased infrastructure spending, especially in transportation, power generation, and irrigation. Inadequate infrastructure is considered a key constraint to capacity building, the business environment, productivity and subsequently higher growth in the country and in the region. The authorities have been using the space provided under the PSI program for non-concessional external borrowing for development and infrastructure spending.

II. BASELINE ASSUMPTIONS

4. **Changes in baseline assumptions are minimal from the previous DSA (Box 1).** The medium-term growth path (of about 7.5 percent annually) is virtually unchanged. Similarly, inflation (GDP deflator) is projected at the Bank of Tanzania's medium-term

² The debt stock excludes about US\$907 million in HIPC-eligible arrears as of April 2012, which are expected to be canceled upon the conclusion of formal agreements on HIPC debt relief.

³ Tanzania's average CPIA score from 2009-2011 was 3.77, which places it in the "strong" performance category.

⁴ A recent World Bank study indicates that the first scheme PSPF, among existing pension funds, would be bankrupt by 2015 and would have to call on the implicit government guarantee. The system remains underfunded and creates new fiscal obligations for the government every year until pension system reforms take place. The Bank estimates that, in the absence of reforms, contingent liabilities related to pension funds could amount to US\$15 billion in present value terms as of 2011 (59 percent of 2012 GDP).

objective of 5 percent. The noninterest current account deficit is expected to increase in 2012 and 2013 before improving steadily to about 7.9 percent of GDP in the long term, due to the supply response to the buildup in infrastructure.

Box 1. Comparison with the Previous DSA

Changes in assumptions with respect to the previous DSA are mostly limited to updating prices and interest rates to reflect prevailing market conditions and incorporating the terms of external nonconcessional borrowing and revisions in the debt stock as provided by the authorities as they proceed with upgrading their data base and debt monitoring capacity.

- **Growth:** Growth is projected to remain at 7.5 percent over the medium and long term.
- **Exports and imports:** Export growth is kept somewhat higher than import growth to reflect higher infrastructure spending and export-led growth.
- **Development spending:** Development spending increases from 7.9 percent of GDP in 2011 to an average of 9.8 percent during 2012-2014, which then declines to around 8 percent due to an assumed decline in external non-concessional borrowing, before going back to 9.5 percent in the long run.
- **External nonconcessional borrowing:** Contracting and guaranteeing of external non-concessional debt during the PSI program period through 2013 is projected at US\$1.77 billion, up from an earlier assumption of US\$1.5 billion; this figure includes US\$135 million of government guarantee for the power utility TANESCO. The estimated terms of this borrowing are incorporated. As in the previous DSA, non-concessional borrowing is assumed to average 1 percent of GDP a year after the PSI program period. The assumed average interest rate remains at 8 percent, in line with prevailing market conditions.
- **Foreign concessional loans and grants:** External grants decline to about 3 percent of GDP by 2015 and thereafter, lower than in the previous DSA. Foreign concessional loans also decline in percent of GDP to reflect a gradual reduction in aid dependency.
- **Fiscal deficit:** The projected fiscal deficit for 2012 is slightly higher compared to the previous DSA. However, the overall fiscal deficit declines to 3 percent of GDP by 2017 and then further toward 2.5 percent of GDP. This is consistent with a decline in the primary deficit to below its debt-stabilizing level of 2-2½ percent of GDP (Table 3). The fiscal consolidation is expected to be achieved through efficiency gains from strengthened tax administration, tax reforms, including the introduction of a new VAT law, and prioritization of expenditure. The alternative scenario whereby the primary deficit is fixed throughout the entire projection period shows substantial deterioration in all debt indicators.

5. **Borrowing assumptions are slightly revised.** Domestic and external non-concessional borrowing is expected to be used to finance infrastructure investment. This includes contracted non-concessional external financing of US\$1.77 billion over the PSI

program period (with disbursements of US\$55.3 million in 2011, US\$642.7 million in 2012, and US\$978.1 million expected in 2013) and 1 percent of GDP for the remainder of the projection period. Domestic financing is projected at about 1 percent of GDP for 2012–2015 and not exceeding 1 percent of GDP thereafter. The real interest rates on new domestic borrowing are assumed to increase gradually toward 3.5 percent (with automatic rollover), while external nonconcessional borrowing is assumed to have an average nominal interest rate of 8 percent, with a 1-year grace period and 10-years' maturity.

6. Government revenues are assumed to increase as a percent of GDP while external grants and concessional loans will decline. Domestic revenues (excluding grants) grow from 17.4 percent of GDP in 2012 to about 22.1 percent of GDP by 2032, consistent with IMF staff estimates of Tanzania's tax potential. On the other hand, external grants decline from 6.0 percent of GDP in 2012 to 3 percent of GDP by 2015 and thereafter. External concessional loans (both program and project loans) would increase from 3.2 percent of GDP in 2012 to 4.6 percent of GDP in 2013 due to expected concessional project loans from China to build a new gas pipeline to bring lower cost natural gas from shallow water offshore reserves to the Dar es Salaam area. External concessional loans are then expected to start declining, reaching 2 percent of GDP by 2017, consistent with a gradual reduction in Tanzania's aid dependency. Annual development spending is assumed to stabilize at 9.5 percent of GDP for the long term. Annual maintenance costs equal to 5 percent of the total value of the accumulated additional infrastructure spending are added to government recurrent spending throughout the period.

7. Further strengthening of Tanzania's debt management capacity and operations is needed, and the authorities are taking steps in this direction. The authorities have developed a medium-term debt management strategy based on quantitative analysis of costs and risks of alternative strategies. To further consolidate debt management, the authorities intend to establish a new Debt Management Office in the Ministry of Finance, which is expected to consolidate Tanzania's fragmented debt management functions, improve capacity, debt monitoring, and compile data on government debt guarantees on a quarterly basis. Given Tanzania's rising debt, it is important to be able to monitor debt accurately, promote effective inter-agency coordination on debt management and debt sustainability issues, and improve consistency and accuracy in compiling and reporting debt data. In addition, investment projects need to be subject to a sound evaluation and prioritization process, including assessing economic returns from infrastructure investments from external non-concessional borrowing, to ensure high returns and growth benefits from additional borrowing.

III. EXTERNAL AND FISCAL DEBT SUSTAINABILITY ANALYSIS

8. The risk of external debt distress remains low under the baseline scenario. Debt indicators are slightly higher than in the last DSA exercise, but do not jeopardize long-run

sustainability (Figure 1). Debt service indicators increase gradually throughout the projection period, but stay below risk thresholds. The PV of public external debt-to-GDP ratio would increase from 28.2 percent of GDP in 2012 to 31.8 percent by 2013, before falling to 15.6 percent by the end of the projection period. The PV of debt-to-exports is expected to peak at 98.7 percent of GDP in 2013, before declining to 38.4 percent in 2032. The debt service-to-export and debt service-to-revenues ratios would reach 5.5 and 10.3 percent by 2022, respectively, before falling to 4.6 and 8.4 percent, respectively, by 2032. The rising debt service-to-revenue ratio for both external and total public debt despite a rising revenue-to-GDP ratio and a declining debt-GDP path reflects the shorter maturity and grace period of external nonconcessional borrowing, which has risen significantly in recent years with a bunching of disbursements in 2013.

9. **Alternative scenario and shock analysis indicate that Tanzania's debt dynamics remains sensitive to the terms of external borrowing.** Tanzania's public external debt would remain below the relevant risk thresholds under the standard bound tests and extreme shocks.⁵ The alternative scenario based on less favorable financing terms shows the largest deterioration for most indicators (e.g. the PV of debt-to-GDP ratio increases from 28 percent in 2012 to 39 percent in 2016, before declining to 32 percent in 2032). The high investment, low growth alternative scenario shows a rapid increase in PV of debt-to-GDP, exports, and revenue, in the medium term—close to the levels of the most extreme shock scenarios—before falling close to the baseline scenarios in the long run.

10. **The path of total public debt, which includes external debt and domestic debt, is also projected to be sustainable.** The PV of public debt-to-GDP ratio increases from 38.2 percent in 2012 to 41.3 percent by 2013, before declining to 25.0 percent by the end of the projection period. Similarly the PV of public debt-to revenue ratio peaks at 186.8 percent in 2015 before declining to 99.4 in 2032. Debt service-to-revenue increases from 5.9 percent in 2012 to 12.0 in 2022, before falling to 10.2 by end of the projection period (Figure 2).

11. **Public debt sustainability is particularly sensitive to the fiscal position (Figure 2).** Under an alternative scenario, for which the primary deficit is fixed at recent levels throughout the projection period, all debt indicators deteriorate substantially. Under this scenario, the PV of debt-to-GDP ratio would keep rising throughout the projection period, from 38 percent to 65 percent (A2 in Table 4). Although some reduction in the primary deficit is projected to have been achieved in 2012 (after increases in earlier years on account of expansionary fiscal policies during the global recession), further strengthening of the primary balance will be critical to prevent an unsustainable debt buildup. Revenue

⁵ Debt burden thresholds for Tanzania are PV of debt to GDP ratio of 50 percent, PV of debt-to-exports ratio of 200 percent, PV of debt-to-revenue ratio of 300 percent, debt-service-to-exports ratio of 25 percent, and debt-service-to-revenue ratio of 22 percent.

reform will be imperative to generate sufficient revenues in a non-distortionary manner. Balancing higher demands on the budget against financing constraints will also call for significant increases in spending efficiency. Reducing the deficit, while funding additional expenditures in areas where they are critically needed, such as health and education, will likely require ambitious tax policy and PFM measures, areas where IMF and World Bank technical assistance has recently been provided.

IV. POSSIBLE IMPACT OF EXPLOITING NATURAL GAS RESOURCES

12. **The DSA does not take into account the possible long-term impact of exploiting Tanzania's deep water natural gas resources.** Shallow water natural gas reserves of around 2 trillion cubic feet (TCF) have already been commercialized for the domestic market, and recent deep water exploration by major petroleum companies has confirmed further large deposits. By June 2012, estimated total recoverable natural gas volumes have been increased by 12 TCF, and press reports speculate that the upside potential is as much as 60 TCF, reflecting newly discovered deep water reserves (thereby approaching the size of Mozambique's offshore reserves, currently confirmed at 70–100 TCF). If current discoveries are developed, commercial production of liquid natural gas (LNG) could be upwards of 0.4 TCF per annum.

13. **Commercialization of the offshore reserves would take about a decade.** The next five to ten years would see continuing exploration. After commerciality has been declared this would be followed by design and negotiation of investment proposals. If an LNG export project were to advance, cumulative foreign direct investments could be in the \$20–30 billion range; one scenario would be for the peak level of direct investment to be concentrated in 2017–2020, with LNG production starting between 2020 and 2025 and extending over perhaps two decades. The balance of payments and fiscal impact is highly uncertain, not least given the recent variation in natural gas prices.⁶ Prices have declined over the past decade from \$10 per 1,000 cubic foot to the \$2–3 range, following the expansion of US natural gas production. At a prospective price of \$10 per 1,000 cubic foot in the Far East export market, export earnings could significantly exceed \$3 billion annually (10 percent of current GDP). The fiscal impact would build up gradually, with tax yields initially depressed by deductions on investments. But from the mid-2020s, fiscal receipts might be in the range of two-thirds of net gas export revenues.

14. **Debt dynamics would be substantially enhanced by expanded gas production.** The potential start of large-scale gas exports around 2020 would reduce debt- and debt service to export ratios in the second half of the DSA period. Public debt accumulation would also be favorably impacted over this period, with rising gas sector revenues reducing

⁶ Prices have declined over the past decade from \$10 per 1,000 cubic foot to the \$2–3 range, following the expansion of US natural gas production.

public borrowing needs and surplus fiscal resources potentially saved in a “future generations” fund, thereby also reducing net public debt. A more specific DSA scenario incorporating new gas sector production could be developed in the coming years when the size of Tanzania’s gas reserves is known with more confidence.

V. CONCLUSION

15. **Based on the updated DSA, Tanzania’s debt indicators are expected to remain below indicative, country-specific thresholds.** The projected borrowing to finance infrastructure investments over the medium term will increase the present value (PV) of debt-to-GDP and other indicators in the near term, but should not jeopardize long-term debt sustainability. While in general the downside scenarios and sensitivity analysis support the assessment of a low risk of debt distress, increased non-concessional borrowing on expensive terms, and large and persistent primary deficits can reverse this outlook. Therefore a sound debt management strategy, a conservative approach to non-concessional borrowing, and commitment to fiscal discipline are key factors for maintaining debt and fiscal sustainability. There is also potential for significantly more favorable debt- and debt service indicators than in the current DSA if the ongoing deep-water gas exploration leads to successful commercialization of large-scale reserves in the coming decade and if the fiscal revenues from these resources are managed wisely.

Table 1: External Debt Sustainability Framework, Baseline Scenario, 2009–2032 ^{1/}

	(In percent of GDP, unless otherwise indicated)												
	Actual			Historical Average	Standard Deviation	Projections							2018-2032 Average
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012-2017 Average		2022	2032
External debt (nominal) 1/	27.1	29.9	34.7			35.4	39.4	40.0	41.0	41.8	42.6	40.4	34.0
o/w public and publicly guaranteed (PPG)	22.4	24.9	28.5			30.3	35.3	36.3	36.2	35.7	34.8	29.0	22.2
Change in external debt	3.7	2.8	4.8			0.7	4.0	0.6	1.0	0.8	0.8	-0.8	-0.4
Identified net debt-creating flows	2.7	2.7	3.8			7.1	7.1	3.9	3.6	3.4	3.1	1.4	1.2
Non-interest current account deficit	9.9	8.9	9.1	6.8	3.8	14.5	14.1	11.8	11.4	11.1	10.5	8.9	7.9
Deficit in balance of goods and services	13.3	11.6	12.3			17.1	15.6	12.9	12.4	12.1	11.6	9.7	7.9
Exports	24.3	25.4	30.3			32.0	32.3	33.2	33.8	34.2	34.8	37.1	40.7
Imports	37.6	37.0	42.5			49.0	47.9	46.0	46.2	46.3	46.4	46.8	48.6
Net current transfers (negative = inflow)	-4.5	-3.9	-4.2	-3.7	0.9	-3.6	-3.0	-2.8	-2.6	-2.5	-2.3	-1.8	-1.1
o/w official	-3.4	-2.8	-3.1			-2.6	-2.0	-1.9	-1.7	-1.6	-1.5	-1.2	-0.7
Other current account flows (negative = net inflow)	1.1	1.2	1.1			1.0	1.5	1.7	1.6	1.5	1.3	1.0	1.1
Net FDI (negative = inflow)	-5.2	-4.4	-4.5	-4.3	0.8	-5.7	-5.6	-6.1	-6.0	-5.9	-5.7	-5.9	-5.5
Endogenous debt dynamics 2/	-1.9	-1.8	-0.8			-1.7	-1.5	-1.8	-1.8	-1.8	-1.7	-1.6	-1.2
Contribution from nominal interest rate	0.2	0.2	0.2			0.4	0.6	0.7	0.8	0.9	1.0	1.3	1.2
Contribution from real GDP growth	-1.4	-1.6	-1.9			-2.1	-2.1	-2.5	-2.6	-2.7	-2.7	-2.8	-2.4
Contribution from price and exchange rate changes	-0.7	-0.3	0.9			...	...	...	...	...	...	...	...
Residual (3-4) 3/ 4/	1.0	0.0	1.0			-6.5	-3.1	-3.3	-2.6	-2.7	-2.2	-2.2	-1.6
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
PV of external debt 5/	...	...	32.9			33.3	36.0	35.3	36.0	36.7	37.6	35.2	27.4
In percent of exports	...	...	108.5			104.2	111.6	106.5	106.5	107.4	108.0	94.9	67.4
PV of PPG external debt	...	...	26.7			28.2	31.8	31.6	31.2	30.6	29.8	23.9	15.6
In percent of exports	...	...	88.1			88.2	98.7	95.3	92.4	89.5	85.5	64.3	38.4
In percent of government revenues	...	...	162.3			161.9	169.8	167.9	167.2	160.5	152.8	119.6	70.7
Debt service-to-exports ratio (in percent)	4.6	3.0	4.0			3.1	4.5	4.8	5.2	5.7	6.6	8.9	7.9
PPG debt service-to-exports ratio (in percent)	0.9	0.9	1.0			1.8	3.2	3.6	4.3	4.3	4.8	5.5	4.6
PPG debt service-to-revenue ratio (in percent)	1.4	1.5	1.9			3.3	5.5	6.4	7.7	7.8	8.5	10.3	8.4
Total gross financing need (Billions of U.S. dollars)	1.2	1.2	1.4			2.5	2.8	2.3	2.4	2.6	2.9	4.0	8.8
Non-interest current account deficit that stabilizes debt ratio	6.2	6.1	4.3			13.8	10.1	11.1	10.4	10.3	9.7	9.6	8.3
Key macroeconomic assumptions													
Real GDP growth (in percent)	6.7	6.5	6.7	7.0	0.3	6.4	6.6	6.9	7.1	7.1	7.0	6.9	7.5
GDP deflator in US dollar terms (change in percent)	3.2	1.3	-2.9	2.3	6.0	2.0	4.9	2.1	1.9	2.0	2.0	2.5	1.9
Effective interest rate (percent) 6/	1.1	0.8	0.8	0.6	0.5	1.2	2.0	2.0	2.2	2.3	2.5	2.0	3.3
Growth of exports of G&S (US dollar terms, in percent)	5.2	12.8	23.7	16.7	7.3	14.5	12.9	12.3	11.3	10.5	11.1	12.1	10.5
Growth of imports of G&S (US dollar terms, in percent)	4.4	6.2	19.1	18.9	11.4	25.0	9.2	5.0	9.6	9.4	9.3	11.3	10.0
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	20.3	18.7	30.8	29.0	26.2	25.0	25.0	23.8
Government revenues (excluding grants, in percent of GDP)	16.2	15.9	16.4			17.4	18.8	18.8	18.7	19.1	19.5	20.0	22.1
Aid flows (in Billions of US dollars) 8/	1.1	1.1	1.1			2.1	2.1	1.9	1.7	1.7	1.8	2.7	6.7
o/w Grants	1.1	1.1	1.1			1.5	1.2	1.1	1.0	1.1	1.2	1.9	4.8
o/w Concessional loans	0.0	0.0	0.0			0.6	0.9	0.8	0.6	0.6	0.6	0.8	1.9
Grant-equivalent financing (in percent of GDP) 9/	...	...	...			7.1	5.7	5.1	4.1	3.8	3.7	3.7	3.6
Grant-equivalent financing (in percent of external financing) 9/	...	...	...			62.0	46.3	58.6	61.0	61.9	62.5	62.9	63.1
Memorandum items:													
Nominal GDP (Billions of US dollars)	21.0	22.6	23.4			25.4	28.4	31.0	33.9	37.0	40.4	63.8	159.4
Nominal dollar GDP growth	10.1	7.9	3.5			8.5	11.8	9.2	9.2	9.2	9.1	9.5	9.6
PV of PPG external debt (in Billions of US dollars)	...	...	5.8			7.0	8.8	9.7	10.4	11.2	11.9	15.1	24.8
(PVt-PVt-1)/GDPt-1 (in percent)	...	...	...			5.1	6.9	3.1	2.5	2.2	1.9	3.6	1.1
Gross workers' remittances (Billions of US dollars)	...	...	...			...	...	...	...	...	...	...	...
PV of PPG external debt (in percent of GDP + remittances)	...	...	26.7			28.2	31.8	31.6	31.2	30.6	29.8	23.9	15.6
PV of PPG external debt (in percent of exports + remittances)	...	...	88.1			88.2	98.7	95.3	92.4	89.5	85.5	64.3	38.4
Debt service of PPG external debt (in percent of exports + remittances)	...	...	1.0			1.8	3.2	3.6	4.3	4.3	4.8	5.5	4.6

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

4/ About 3 percent of the residual in 2012 and a large part in later years is explained by capital transfers.

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

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

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

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

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

Table 2a: Tanzania: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012–2032

(In percent)

	Projections																
	2012	2013	2014	2015	2016	2017	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
PV of debt-to GDP ratio																	
Baseline	28	32	32	31	31	30	24	23	22	21	20	19	18	18	17	16	16
A. Alternative Scenarios																	
A1. Key variables at their historical averages in 2012-2032 1/	28	26	23	21	18	16	10	10	10	10	10	11	11	11	11	12	12
A2. New public sector loans on less favorable terms in 2012-2032 2	28	34	38	38	39	38	36	35	35	34	34	33	33	33	32	32	32
A3. High investment, low growth	28	33	35	36	36	36	31	30	29	27	26	25	23	22	21	20	18
B. Bound Tests																	
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	28	31	31	31	30	29	24	23	22	21	20	19	18	17	17	16	16
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	28	32	34	33	33	32	25	24	23	22	21	20	19	18	17	17	16
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	28	34	36	36	35	34	27	26	25	24	23	22	21	20	19	19	18
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	28	33	36	35	34	33	26	25	24	22	21	20	19	19	18	17	16
B5. Combination of B1-B4 using one-half standard deviation shocks	28	34	38	37	36	35	28	26	25	24	23	22	21	20	19	18	17
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	28	43	44	43	42	41	33	31	30	29	28	26	25	24	23	22	22
PV of debt-to-exports ratio																	
Baseline	88	99	95	92	90	86	64	61	57	54	52	49	47	44	42	40	38
A. Alternative Scenarios																	
A1. Key variables at their historical averages in 2012-2032 1/	88	80	70	61	53	45	27	26	26	26	27	28	28	28	29	29	29
A2. New public sector loans on less favorable terms in 2012-2032 2	88	106	114	113	112	110	96	93	91	89	87	85	84	82	81	79	78
A3. High investment, low growth	87	101	105	106	105	103	84	80	76	71	67	63	60	56	52	49	45
B. Bound Tests																	
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	88	96	94	91	88	84	63	60	57	54	51	48	46	44	42	40	38
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	88	102	108	104	101	96	72	67	63	60	57	54	51	48	46	43	41
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	88	96	94	91	88	84	63	60	57	54	51	48	46	44	42	40	38
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	88	102	107	103	100	95	70	66	62	59	55	52	49	47	44	42	40
B5. Combination of B1-B4 using one-half standard deviation shocks	88	101	103	100	97	92	68	64	60	57	54	51	48	46	43	41	39
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	88	96	94	91	88	84	63	60	57	54	51	48	46	44	42	40	38
PV of debt-to-revenue ratio																	
Baseline	162	170	168	167	161	153	120	113	107	102	96	91	86	82	78	74	71
A. Alternative Scenarios																	
A1. Key variables at their historical averages in 2012-2032 1/	162	138	124	110	94	80	49	48	49	49	50	51	52	52	53	53	54
A2. New public sector loans on less favorable terms in 2012-2032 2	162	183	200	205	202	197	178	174	170	166	162	158	155	152	149	146	144
A3. High investment, low growth	159	174	184	191	188	184	157	149	142	133	125	118	110	103	96	90	84
B. Bound Tests																	
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	162	165	166	165	158	151	118	112	106	100	95	90	85	81	77	73	70
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	162	170	179	178	170	162	125	118	112	105	100	94	89	84	80	76	72
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	162	179	191	190	183	174	136	129	122	116	110	104	98	93	89	85	81
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	162	176	189	187	179	170	131	123	116	109	103	97	91	86	82	77	73
B5. Combination of B1-B4 using one-half standard deviation shocks	162	183	199	198	189	180	139	131	123	116	110	103	98	92	87	83	79
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	162	231	231	231	221	211	165	156	148	140	133	126	119	113	108	102	98

Table 2b: Tanzania: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012–2032 (continued)

	(In percent)																
	Debt service-to-exports ratio																
Baseline	2	3	4	4	4	5	6	5	5	5	5	5	5	5	5	5	5
A. Alternative Scenarios																	
A1. Key variables at their historical averages in 2012-2032 1/	2	3	3	4	3	4	3	3	3	3	3	3	3	3	3	3	3
A2. New public sector loans on less favorable terms in 2012-2032 2	2	3	5	3	3	4	6	6	6	6	6	6	6	6	6	6	6
A3. High investment, low growth	2	3	4	5	5	6	8	7	7	7	7	7	7	7	6	6	6
B. Bound Tests																	
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	2	3	4	4	4	5	6	5	5	5	5	5	5	5	5	5	5
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	2	3	4	5	5	5	6	6	6	6	6	6	6	5	5	5	5
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	2	3	4	4	4	5	6	5	5	5	5	5	5	5	5	5	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	2	3	4	5	5	5	6	6	6	6	6	5	5	5	5	5	5
B5. Combination of B1-B4 using one-half standard deviation shocks	2	3	4	5	5	5	6	6	5	5	5	5	5	5	5	5	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	2	3	4	4	4	5	6	5	5	5	5	5	5	5	5	5	5
	Debt service-to-revenue ratio																
Baseline	3	6	6	8	8	8	10	10	10	10	10	9	9	9	9	9	8
A. Alternative Scenarios																	
A1. Key variables at their historical averages in 2012-2032 1/	3	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6	6
A2. New public sector loans on less favorable terms in 2012-2032 2	3	6	9	6	6	7	11	11	11	12	12	12	12	12	12	12	12
A3. High investment, low growth	3	6	7	9	9	10	14	14	13	13	13	13	12	12	12	11	11
B. Bound Tests																	
B1. Real GDP growth at historical average minus one standard deviation in 2013-2014	3	6	6	8	8	9	10	10	10	10	10	9	9	9	9	9	8
B2. Export value growth at historical average minus one standard deviation in 2013-2014 3/	3	6	7	8	8	9	11	11	10	10	10	10	10	9	9	9	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2013-2014	3	6	7	9	9	10	12	11	11	11	11	11	11	10	10	10	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2013-2014 4/	3	6	7	8	9	9	11	11	10	10	10	10	10	9	9	9	9
B5. Combination of B1-B4 using one-half standard deviation shocks	3	6	7	9	9	10	12	12	11	11	11	11	11	10	10	10	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	3	8	9	11	11	12	14	14	13	13	13	13	13	13	12	12	12
<i>Memorandum item:</i>																	
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8

Sources: Country authorities; and staff estimates and projections.

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

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

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

4/ Includes official and private transfers and FDI.

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

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

Table 3: Tanzania: Public Sector Debt Sustainability Framework, Baseline Scenario, 2009–2032

(In percent of GDP, unless otherwise indicated)

	Actual			Average	5/	Standard Deviation	5/	Estimate					Projections				
	2009	2010	2011					2012	2013	2014	2015	2016	2017	2012-17 Average	2022	2032	2018-32 Average
Public sector debt 1/	30.8	34.0	39.2					40.3	44.7	45.6	45.5	44.9	44.0		38.3	31.5	
o/w foreign-currency denominated	22.4	24.9	28.5					30.3	35.3	36.3	36.2	35.7	34.8		29.0	22.2	
Change in public sector debt	-2.8	3.2	5.1					1.1	4.4	0.9	-0.1	-0.6	-0.9		-1.1	-0.4	
Identified debt-creating flows	1.9	4.3	4.6					1.0	4.2	1.0	-0.1	-0.6	-0.9		-1.2	-0.5	
Primary deficit	3.9	6.2	4.9	2.8		2.2		5.1	4.1	3.1	2.5	2.0	1.6	3.1	1.1	1.2	1.2
Revenue and grants	21.3	20.5	21.1					23.4	22.9	22.3	21.7	22.1	22.5		23.0	25.1	
of which: grants	5.1	4.6	4.7					6.0	4.2	3.5	3.0	3.0	3.0		3.0	3.0	
Primary (noninterest) expenditure	25.2	26.7	26.0					28.5	27.0	25.4	24.2	24.1	24.1		24.1	26.3	
Automatic debt dynamics	-1.8	-1.8	-0.3					-4.0	-3.0	-3.2	-2.7	-2.6	-2.6		-2.2	-1.7	
Contribution from interest rate/growth differential	-2.4	-1.9	-2.2					-2.4	-2.4	-2.7	-2.7	-2.6	-2.6		-2.2	-1.7	
of which: contribution from average real interest rate	-0.3	0.0	-0.1					-0.1	0.2	0.2	0.3	0.4	0.4		0.5	0.5	
of which: contribution from real GDP growth	-2.1	-1.9	-2.1					-2.4	-2.5	-2.9	-3.0	-3.0	-2.9		-2.7	-2.2	
Contribution from real exchange rate depreciation	0.6	0.0	1.9					-1.6	-0.7	-0.5	0.0	0.0	0.0		...	...
Other identified debt-creating flows	-0.2	0.0	0.0					0.0	3.1	1.2	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.2	0.0	0.0					0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0					0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0					0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0					0.0	3.1	1.2	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	-4.7	-1.1	0.6					0.1	0.2	-0.1	0.0	0.0	0.0		0.1	0.1	
Other Sustainability Indicators																	
PV of public sector debt	...	...	37.3					38.2	41.3	40.9	40.5	39.9	39.1		33.1	25.0	
o/w foreign-currency denominated	...	...	26.7					28.2	31.8	31.6	31.2	30.6	29.8		23.9	15.6	
o/w external	...	...	26.7					28.2	31.8	31.6	31.2	30.6	29.8		23.9	15.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...					...	...	...	...	...	...		...	...
Gross financing need 2/	11.0	11.2	10.4					11.4	10.6	9.6	9.2	8.7	8.5		8.3	8.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	176.8					162.9	180.4	183.1	186.8	180.7	173.6		144.0	99.4	
PV of public sector debt-to-revenue ratio (in percent)	...	...	226.9					219.3	220.3	217.3	216.8	209.1	200.4		165.6	112.8	
o/w external 3/	...	...	162.3					161.9	169.8	167.9	167.2	160.5	152.8		119.6	70.7	
Debt service-to-revenue and grants ratio (in percent) 4/	4.8	4.5	5.4					5.9	8.2	8.7	9.7	9.9	10.5		12.0	10.2	
Debt service-to-revenue ratio (in percent) 4/	6.3	5.8	6.9					7.9	10.0	10.4	11.3	11.5	12.1		13.8	11.6	
Primary deficit that stabilizes the debt-to-GDP ratio	6.7	2.9	-0.2					3.9	-0.3	2.2	2.7	2.6	2.5		2.2	1.6	
Key macroeconomic and fiscal assumptions																	
Real GDP growth (in percent)	6.7	6.5	6.7	7.0		0.3		6.4	6.6	6.9	7.1	7.1	7.0	6.9	7.5	7.5	7.5
Average nominal interest rate on forex debt (in percent)	0.7	0.5	0.8	0.5		0.4		1.2	2.1	2.1	2.2	2.2	2.2	2.0	2.7	3.1	2.9
Average real interest rate on domestic debt (in percent)	-2.1	2.0	2.0	-0.1		2.4		-1.5	-0.4	2.0	2.8	3.3	3.3	1.6	3.5	3.5	3.5
Real exchange rate depreciation (in percent, + indicates depreciation)	3.6	0.1	8.3	1.0		6.6		-5.9	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	8.6	7.2	8.2	7.6		1.1		10.7	10.3	6.9	5.0	5.0	5.0	7.2	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.2	0.1	0.0	0.1		0.1		0.2	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	...		...		20.3	18.7	30.8	29.0	26.2	25.0	25.0	23.8	22.8	...

Sources: Country authorities; and staff estimates and projections.

1/ Covers central government debt, except for a US\$135 million guarantee extended to the power utility TANESCO.

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

3/ Revenues excluding grants.

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

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

Table 4: Tanzania: Sensitivity Analysis for Key Indicators of Public Debt, 2012–2032

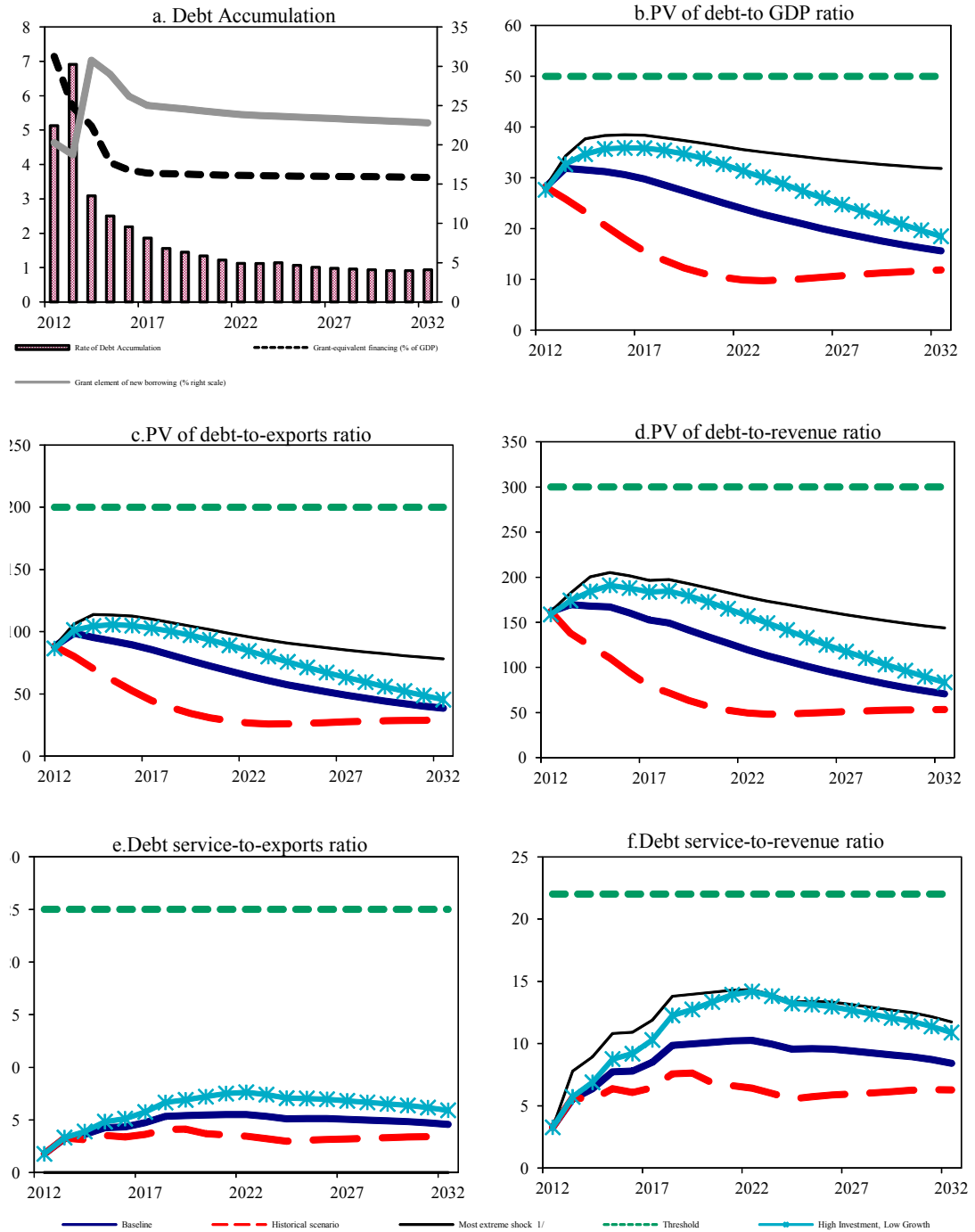
	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	38	41	41	41	40	39	33	25
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	38	40	39	39	39	40	41	42
A2. Primary balance is unchanged from 2012	38	42	43	45	47	49	56	65
A3. Permanently lower GDP growth 1/	38	41	41	41	40	39	34	27
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	38	41	41	41	40	39	33	26
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	38	42	43	43	42	41	35	26
B3. Combination of B1-B2 using one half standard deviation shocks	38	41	41	41	40	39	33	25
B4. One-time 30 percent real depreciation in 2013	38	53	51	50	49	48	40	31
B5. 10 percent of GDP increase in other debt-creating flows in 2013	38	50	49	49	48	47	39	29
PV of Debt-to-Revenue Ratio 2/								
Baseline	163	180	183	187	181	174	144	99
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	163	175	177	181	179	176	176	166
A2. Primary balance is unchanged from 2012	163	184	195	209	213	218	244	260
A3. Permanently lower GDP growth 1/	163	181	183	187	182	175	147	109
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	163	180	184	187	181	175	145	101
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	163	184	194	197	191	183	151	103
B3. Combination of B1-B2 using one half standard deviation shocks	163	179	185	189	183	175	145	99
B4. One-time 30 percent real depreciation in 2013	163	231	228	230	221	211	175	123
B5. 10 percent of GDP increase in other debt-creating flows in 2013	163	218	220	224	216	208	171	114
Debt Service-to-Revenue Ratio 2/								
Baseline	6	8	9	10	10	10	12	10
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	6	8	9	9	10	10	13	14
A2. Primary balance is unchanged from 2012	6	8	9	10	11	12	16	20
A3. Permanently lower GDP growth 1/	6	8	9	10	10	11	12	11
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2013-2014	6	8	9	10	10	11	12	10
B2. Primary balance is at historical average minus one standard deviations in 2013-2014	6	8	9	10	10	11	13	11
B3. Combination of B1-B2 using one half standard deviation shocks	6	8	9	10	10	11	12	10
B4. One-time 30 percent real depreciation in 2013	6	9	11	13	13	14	17	16
B5. 10 percent of GDP increase in other debt-creating flows in 2013	6	8	10	12	12	12	15	12

Sources: Country authorities; and staff estimates and projections.

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

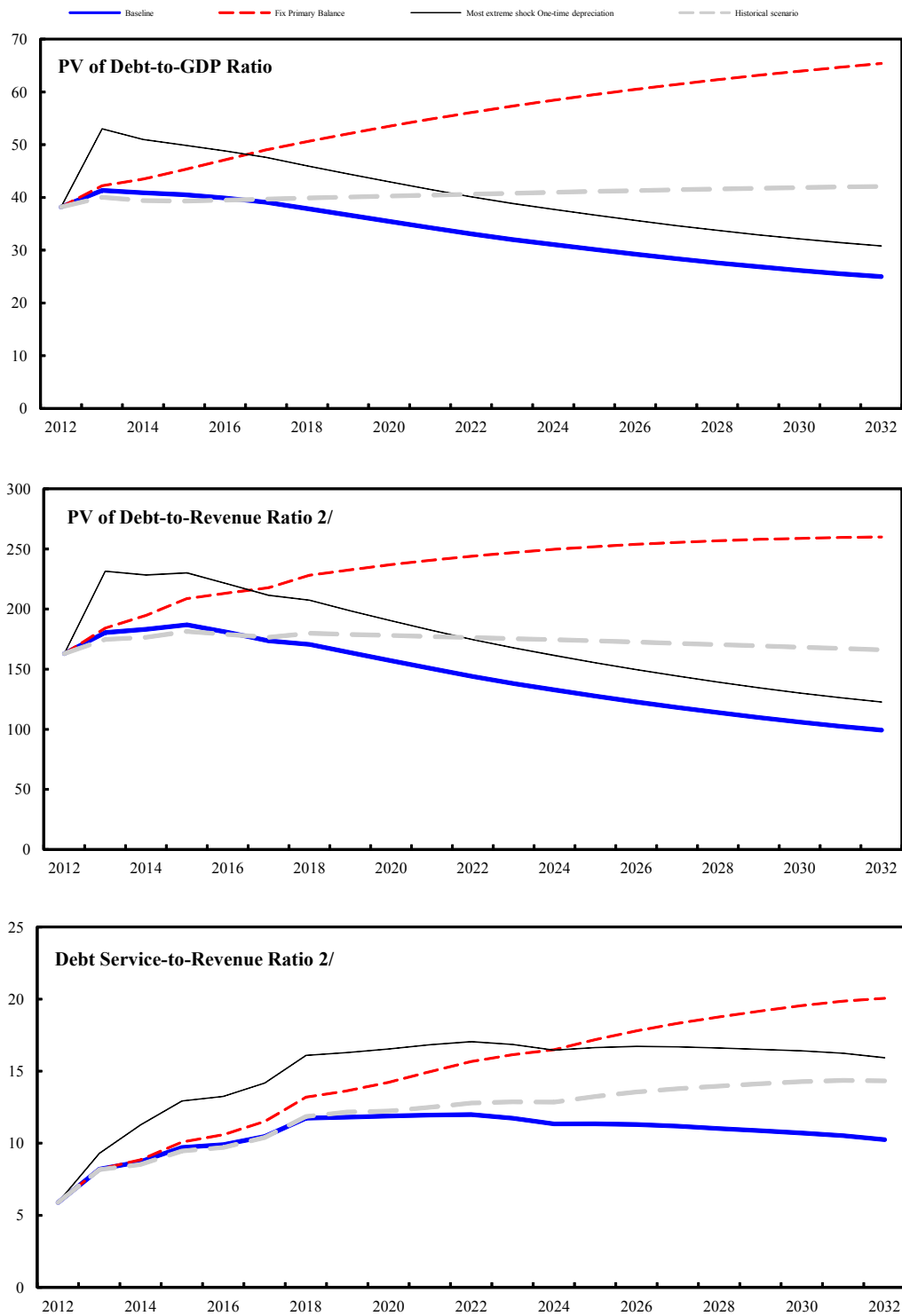
2/ Revenues are defined inclusive of grants.

Figure 1: Tanzania: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2012–2032 ¹



Sources: Country authorities; and staff estimates and projections.

^{1/} The most extreme stress test is the test that yields the highest ratio in 2022. In figure b. it corresponds to a Terms shock; in c. to a Terms shock; in d. to a Terms shock; in e. to a shock and in figure f. to a One-time depreciation shock

Figure 2: Tanzania: Indicators of Public Debt under Alternative Scenarios, 2012–2032¹

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2022.

2/ Revenues are defined inclusive of grants.

**INTERNATIONAL MONETARY FUND**EXTERNAL
RELATIONS
DEPARTMENT

Press Release No. 12/252
FOR IMMEDIATE RELEASE
July 6, 2012

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Review under the Policy Support Instrument for Tanzania and Approves a US\$224.9 Million Precautionary Arrangement under the Standby Credit Facility

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Tanzania's performance under the Policy Support Instrument (PSI) and approved a precautionary 18-month arrangement under the Standby Credit Facility (SCF) for SDR 149.175 million (about US\$224.9 million).

The precautionary SCF Arrangement is designed to provide Tanzania a financial cushion to withstand deterioration in external demand and access to global market financing. As the country is not facing any immediate balance of payment needs, the program will form part of an overall strategy to stave off any adverse effects that Tanzania could be facing as a result of the uncertainties in the global economy.

The PSI for Tanzania was approved by the Executive Board on June 4, 2010 (see Press Release [No. 10/ 227](#)). All December 2011 and March 2012 quantitative assessment criteria and indicative targets were met, other than the March 2012 indicative target on the floor on net international reserves. All five structural benchmarks for the period through end-June 2012 were implemented.

Following the Executive Board's decision on Tanzania, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair, issued the following statement:

“The Tanzanian economy grew steadily in 2011 despite severe power shortages that were induced by regional droughts. At the same time, higher food and energy prices pushed inflation up to 20 percent. The authorities are to be commended for taking prudent policy measures to contain domestic demand and inflationary pressures. To this end, the monetary stance was tightened to moderate credit and broad money growth, and the fiscal position was strengthened by improved revenue performance and tight expenditure controls. The construction of a new

externally-financed gas pipeline is intended to address the vulnerabilities of the hydro dependant power sector and secure a durable supply of low-cost electricity in the medium term.

“The budget for 2012/13 is appropriately targeted at further reducing the deficit, which is essential for rebuilding fiscal buffers and strengthening debt sustainability. Although the growth outlook remains positive, the volatile global economy poses risks to revenue collection. To preserve the fiscal adjustment path and avoid a build-up of arrears, any revenue shortfalls would need to be offset by cutbacks in recurrent and non-priority capital expenditures, while safeguarding critical social and development spending.

“The sustained tightening of monetary policy in 2012/13 is aimed at supporting disinflation toward the authorities’ single-digit objective. In order to better manage liquidity and strengthen its anti-inflationary capacity, the Bank of Tanzania intends to move to more active use of interest rates as a policy instrument. The flexible exchange rate regime will ease the burden on monetary policy and help maintain adequate international reserves.

“While Tanzania does not face an immediate balance of payments need, the newly approved Standby Credit Facility (SCF) provides a comfortable buffer against external shocks. The authorities intend to treat the SCF as precautionary and will only draw the Fund resources should external demand deteriorate or access to international financial markets become more limited,” Mr. Shinohara added.

Recent economic developments

GDP growth in the first half of 2011/12 was 6.5 percent, unchanged from 2010/11. Although electricity production declined, growth benefitted from strong construction and services activity.

Headline inflation peaked at almost 20 percent in December 2011, led by food and energy prices (up 27 and 41 percent, respectively). With slowing food and energy price increases, inflation declined to 18.2 percent in May 2012. Core inflation has been in the 8.7 to 9 percent range, up from about 4 percent a year earlier.

Imports were up 37 percent in the first nine months of 2011/12, largely reflecting higher oil imports. Reflecting this trend, the current account deficit is projected at nearly 15 percent of GDP in 2011/12, up from the 9 percent of GDP range in recent years. The increased deficit is being financed through foreign direct investment and other private capital inflows.

Tanzania is on track to cut its overall cash basis fiscal deficit to 6.2 percent of GDP in 2011/12. Tax revenues are over-performing. Collections are projected to exceed programmed levels, reflecting strengthened tax administration, steps taken to tackle obstacles to mining taxation, and stronger than expected economic activity.

Summary of the SCF Arrangement

The precautionary SCF Arrangement would provide support in the event of a deterioration in external demand and access to global market financing. As Tanzania strengthens its macroeconomic buffers, it remains vulnerable to a renewed global downturn. Its fiscal deficit, public debt, and inflation levels are higher than at the time of the 2008–09 global recession, while gross reserve cover is lower.

The objectives under the SCF Arrangement for Tanzania would match those under the PSI: enhancing fiscal and debt sustainability, reducing inflation, and resolving the power crisis to enhance growth prospects. In the event of an adverse shock, corrective measures to keep the program supported by the PSI and SCF Arrangement on track would likely be needed. These measures, as well as options for financing from non-Fund sources would be reviewed in light of the nature and scale of the shock.

**Statement by Mr. Momodou Saho, Alternate Executive Director for
The United Republic of Tanzania Executive
July 6, 2012**

1. My Tanzanian authorities remain fully determined to persevere with prudent and sound macroeconomic policies and to strengthen domestic sources of inclusive growth. To that end, they intend to deepen further their structural reform agenda and strengthen the country's macroeconomic fundamentals and policy framework, including laying a good foundation for the management of the new gas economy, to shore up the economy's broad-based and inclusive growth. They are, in particular, aware of the daunting challenges emanating from the protracted global economic distress. With their policy stance and unrelenting support from the international community and policy guidance from the Fund, my authorities are confident that they stand a good chance of mitigating the strong headwinds emanating from the current round of exogenous shocks.

2. My authorities are appreciative of the Fund's constructive engagement and support under the PSI. They especially thank staff for the fruitful policy dialogue and advice under the program and for the related technical assistance packages. Going forward, the authorities are determined to further strengthen their engagement with the Fund and their development partners, and persevere with their key national and regional objectives set out in their respective MKUKUTA and the EAC protocols.

3. To this end, and in view of the strong performance under the program—with all end-December 2011 quantitative performance criteria met with good margins, and all but one March 2012 indicative targets met, and strong implementation of all end-June 2012 structural benchmarks—they request Directors' support for the completion of the fourth review of the PSI. In view of the protracted global economic distress, the authorities request Directors' support for an 18-month precautionary arrangement under the SCF. They also request Directors' support for setting of end-December 2012 assessment criteria under the PSI and end-December 2012 and end-June 2013 performance criteria under the SCF.

Recent economic developments and respective policy environment

4. Tanzania's strengthened economic fundamentals have helped the economy weather the current global economic distress and region-specific supply shocks. As a result, and despite the effects of the weather-induced power shortages and supply-related inflationary pressures, real GDP grew at a faster pace of 6.4 percent in 2011 than the programmed 6.0 percent, on account of strong construction and services activity. Notwithstanding the heightened global economic uncertainties, the prospects for near-to-medium term growth remain positive. The coming on stream of the new gas pipeline coupled with rapid growth in FDI in the gas sector and stronger investment in key economic and social sectors will augur well for economic growth in the medium term.

5. The easing of global food and fuel prices, normalization of the weather conditions in the region and the recent appreciation of the exchange rate have resulted in a gradual decline in the pressure on domestic inflation. Coupled with the Bank of Tanzania's (BoT) tightened monetary policy stance, inflation is on a downward trajectory. Additionally, the BoT is strengthening the operation of its policy instruments for sterilization of liquidity and broadening of its monetary policy transparency. Given that the flexible exchange rate regime has served the country well, the authorities reaffirm their commitment to maintaining this regime.
6. External balances weakened in 2011/2012 mainly due to a sharp rise in import costs (mainly fuel) and imports of capital goods, while exports of goods and services recorded almost a double digit growth reflecting strong performance in travel receipts and price and volume of gold. The shilling that had depreciated during the first half of the fiscal year, strengthened subsequently in line with measures taken by BoT to rein in inflationary pressures. Gross official reserves by end-March 2012 stood at 3.7 months of import cover, the same level as of end-September 2011 (still down from 4.4 months of import cover at end-June 2011). This was also due to negative valuation effects on reserves held in euros and sterling when these currencies depreciated against the dollar.
7. My authorities' fiscal policy outturn in FY 2011/2012 broadly remained within the PSI targets, mainly due to a proactive management of spending and significant improvement in revenue performance. Reflecting the growing development financing needs especially with respect to education, health and infrastructure, the 2011/12 budget was approved to support the authorities' efforts to meet these and other development needs. However, with downside risks emanating from uncertainties in external financing and rising inflationary pressures, my authorities, through broad-based expenditure savings and strict application of cash management coupled with enhanced revenue collection efforts, had at mid-year review revised downwards the projected fiscal deficit to 6.6 percent of GDP. The outturn on the recurrent budget is projected to be well within the budget estimates. The outturn on the development expenditure, however, will be 11 percent below the budget estimates mainly due to the shortfall in external financing and non-concessional borrowing.
8. On the revenue front, the 2011/2012 performance is well above the previous year's outturn by 1.0 percent of GDP reflecting the authorities' perseverance with their enhanced revenue collection efforts and strong economic activity. Strong performance was registered particularly on tax and non-tax revenues, the outturn of which will be 104 percent and 108 percent of the budget estimates respectively. As a result, the overall deficit for FY2011/2012 will be 6.2 percent of GDP, well below the mid-year and program target of 6.5 percent of GDP. Consistent with the authorities' commitment to create fiscal space for infrastructure and other development spending, the recurrent budget for the FY2011/2012 will generate a small surplus.

9. The authorities have made progress in raising funds from external non-concessional borrowing while strictly observing the agreed borrowing targets under the PSI. In light of that progress and the additional non-concessional component of the gas pipeline financing, the authorities are requesting a modest augmentation of the three year ceiling to enable them meet their financing needs. They are mindful of their commitment to ensure these funds are committed to highly financially viable projects. They are also mindful of the debt sustainability implications and, in this regard, they commit to limit their ambitions for non-concessional borrowing to the new program ceiling. They are also mindful of the recent DSA update that indicates that the country's risk of debt distress remains low even when taking into account government borrowing from domestic and external sources, including on non-concessional terms.

10. The financial sector remains sound and the banks have a strong capital base. In this regard, the sector continues to weather the impact of the protracted global economic headwinds. The upturn in the level of non-performing loans (NPLs) that had reversed during the first half of 2011/2012, do warrant additional effort by the authorities to monitor these aggregates and the banks' loan portfolio. To enhance its supervisory function, the BoT with the support of the Fund TA is conducting stress tests and putting in place a crisis resolution framework. Building on the now completed regulatory framework for the pension sector, the authorities, with the support of the World Bank, are evaluating the sustainability of the pension schemes with the view of designing reforms to pension entitlement rules.

Medium-term policy framework and accompanying reforms

Fiscal policy and related reforms

11. My authorities' fiscal policy, going forward, will strive to strike and maintain an appropriate balance between the objective of supporting inclusive growth and maintaining macroeconomic stability. To achieve these objectives, the authorities intend to further reduce the overall fiscal deficit through expenditure restraint and revenue enhancing measures. On the former, the authorities intend to contain recurrent spending especially on the wage bill and create the fiscal space necessary for sustained budgetary spending levels for priority services, and sustained scaling-up of investment in infrastructure and primary sectors to shore-up the economy's growth momentum. Deepening of structural reforms to improve budget execution and efficiency will continue to be prioritized. Internal control systems will be strengthened further and risk management strategies developed for all spending agencies.

12. On the revenue front, the authorities have embarked on further revenue enhancing reforms with the view of broadening the tax base and raising the revenue yield. Key revenue reform measures include, *inter alia*, streamlining the scope of tax expenditures and eliminating tax holidays, enacting a new VAT law (with the support of Fund TA) to broaden the base and attain international standards, and broaden the tax regime for the mining sector.

In this regard, the FY 2012/2013 budget will entail a further reduction of the overall deficit to 5.5 percent of GDP, and lower deficit in the outer years. The recurrent budget is programmed to generate a modest surplus, while maintaining the spending thrust with respect to priority social services. Development spending continues to prioritize infrastructure and key primary sectors. Cognizant of the overall resource limitations—especially the declining concessional inflows—, the authorities intend to facilitate greater inflows of FDI and private sector participation through PPPs, and target to fully utilize the augmented non-concessional financing window. Domestic financing of the budget will also increase from the current 71 percent of total expenditure (net of rollover financing) to 77 percent in FY2012/13 and higher in the outer years. The authorities will especially remain vigilant of the contingent liabilities arising from greater use of FDI and PPPs, and debt sustainability implications of non-concessional funding.

Monetary and exchange rate policies

13. My authorities will persevere with the tight monetary policy stance with the objective to bring down inflation to the BoT's policy target of 5 percent in the medium term. The authorities will remain vigilant and closely monitor risks to inflation, especially those arising from the protracted high global commodity prices and regional supply shocks. To achieve the objective of anchoring its monetary policy on low and stable inflation, while supporting growth through maintaining sufficient liquidity in the financial system, the BoT will set its policy rate consistent with its disinflationary path. The BoT will further bolster its monetary policy instruments including an active use of interest rate as a policy tool for monetary management and as a policy signal, and continue to improve liquidity forecasting. The BoT is committed to further improve its regulatory and supervisory effectiveness and the transparency of its policy stance and promote orderly financial markets.

14. On the exchange rate, the BoT reaffirms its commitment to a market determined exchange rate, and continue to see this as the first line of defense against external shocks. In this regard, the BoT will continue to participate in the foreign exchange market for liquidity management purposes and to smooth out short-term fluctuations in the exchange rate. The authorities will also seek to make progress in the preparations for and negotiations of the East African Monetary Union. To that end, they and other EAC partners continue to appreciate the Fund's support in key areas of the preparations and, going forward, welcome further support.

Financial sector stability

15. Financial soundness indicators at end-March 2012 indicate that the banking system remains sound, profitable and liquid, and adequately capitalized, except that the recent decline in NPLs has been reversed. The BoT will continue to strengthen its financial stability monitoring tools to ensure stability and soundness of the financial system, also benefiting from the Fund's TA for this purpose. These efforts are also being synchronized with other

East African Community partner states with the view to harmonize supervision frameworks. In March 2012, BoT issued the investment guidelines for the pension sector paving the way for strengthening the investment returns of the social security funds. The authorities have amended their AML/CFT framework, under a new AML/CFT law of February 2012, to comply with the action plan agreed with the FATF also including a legal framework for Zanzibar.

Energy policies and the new gas economy

16. Though the new power generating capacity under the authorities' Emergency Power Plan (EPP) has considerably mitigated the power crisis, it is based on expensive hydrocarbons the supply of which has significant implications on the import bill and the government budget. To strengthen the power sector finances, the authorities have also embarked on a process of tariff adjustment and measures to enhance productivity improvements in power generation. On tariff adjustment, and in addition to the recent tariff adjustment, the authorities have commissioned a study to review power generation costs the results of which will inform an early decision on subsequent energy tariff structure.

17. On productivity improvements in power generation, the authorities intend to commission shortly the construction of a commercially viable gas pipeline, the financing of which is well within the PSI targets, to supply natural gas for power generation and other uses. It is envisaged that the new sources of energy will substantially improve the supply of electricity and other sources of energy for industrial, services and household use at a much lower cost than current. The authorities are also aware that in a macroeconomic and budget management context, considerable work will be needed to manage the new natural gas economy as well as mitigate the related Dutch disease effects. They have, in this regard, requested the Fund's comprehensive TA support under the Topical Trust Fund for Managing Natural Resources Wealth (MNRW-TTF).

The SCF program

18. The 2008/09 global financial and economic crises had serious adverse impacts on the Tanzanian economy, necessitating a sizable fiscal stimulus and a funding program from the Fund. On the basis of that experience and notwithstanding the strengthened macroeconomic buffers, the authorities are mindful of the vulnerabilities of the economy to the renewed global economic distress. In that regard, and for precautionary purposes, they request an 18-month arrangement under the SCF.

Conclusion

19. Tanzania's macroeconomic fundamentals and the authorities' continued commitment to strong and sound policies helped the economy to sustain a growth momentum despite the

renewed global economic distress. They are aware of the build-up of new risks and are, therefore, prepared to take appropriate measures to mitigate them and shield the country's macroeconomic stability. In the near term, and notwithstanding the need for strengthening fiscal buffers, the authorities are determined that their economic program sustains macroeconomic stability, enhances domestic resource mobilization, promotes broad-based and pro-poor growth, and creates fiscal space for increased investment in infrastructure, primary sectors and core MDG clusters. They are also focusing on the future opportunities and challenges arising from the new natural gas economy. Going forward, they request continued support from the Fund, other international financial institutions and development partners in their efforts to strengthen macroeconomic stability, exploit new growth drivers, and achieve their development goals.