Tanzania and the IMF

Press Release:
IMF Executive Board Completes Seventh Review under Tanzania's PSI; Approves a Three-Year PSI, Completes Second Review Under the ESF and Approves US$29.1 Million Disbursement
June 4, 2010

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Tanzania: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

May 10, 2010

LETTER OF INTENT

May 10, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

1. Tanzania has continued to benefit from policy advice and financial support from the Fund— under the Policy Support Instrument (PSI), as well as balance of payment support—through the Exogenous Shock Facility (ESF). The implementation of programme under both the PSI and ESF has progressed well with sound macroeconomic policies that have helped to mitigate negative impacts of the global financial and economic crisis. The government intends to preserve macroeconomic stability, consolidate attained achievements and implement strategies for stimulating growth and poverty reduction.

2. During July–December 2009 period, performance under the programme was good. All PSI/ESF programme assessment/performance criteria for December 2009 were attained with good margins. Average reserve money was below the target by Tshs 73.0 billion, while Net International Reserves (NIR) was above the target by USD 575 million. In addition, the narrowing of the current account deficit on account of a decline in import bill coupled with an increase in exports contributed positively to the improvement of NIR. Net domestic financing of the Government budget was below the ceiling by Tshs 83.1 billion.

3. The impact of the global financial crisis on economic growth became more noticeable in 2009 compared to 2008. However, economic indicators suggest that growth was affected by the crisis by a lesser extent than expected. The economy continued to experience inflationary pressures mainly due to high food prices whereas nominal exchange rate remained fairly stable during the period. The Lombard and discount rates were revised downwards to make the instruments more attractive and enhance flexibility in provision of liquidity.

4. Provisional growth indicators depict a slowdown in real GDP growth to 5.4 percent in the first half of 2009, compared to 7.0 percent in the corresponding period in 2008. The economy is expected to strengthen in the second half and push the real GDP growth to 5.5 percent or higher for 2009 compared to 5.0 percent which was projected earlier. As the world economy recovers from the crisis and the demand for exports improves, the growth is expected to pick up in the medium term.

5. Government policy for the remainder of 2009/10 will continue to focus on appropriate fiscal and monetary policies to stimulate economic activities against the backdrop of the impact of the global economic crisis. In the medium term, the government will put emphasis on the priority areas that will accelerate pro-poor economic growth in line with MKUKUTA II.

6. Following discussions and consultations with the Fund staff, I hereby transmit the letter of intent and memorandum of economic and financial policies which reviews the implementation of the programme during the first half of 2009/10 and describes the objectives and policies that the government intends to pursue during the remainder of the fiscal year and 2010/11 and over the medium term.

7. In view of this performance and in support of our policies going forward, the Government of Tanzania requests the completion of the seventh review under the PSI and the second review under the ESF arrangement, the disbursement of the third tranche under the ESF arrangement, equivalent to SDR 19.89 million, and a new three-year programme under the PSI framework.

8. The Government of Tanzania is confident that the policies set forth in the attached MEFP are adequate to achieve the objectives of its programme but it will, in further consultation with the Fund, take any appropriate measures for this purpose. We will regularly update the Fund on developments in our economic and financial policies, and provide the data needed for the monitoring of the programme—including in the context of twice-yearly reviews. The first and second reviews under the new PSI are expected to take place by end-November 2010 and end-May 2011, respectively, on the basis of the assessment criteria and structural benchmarks indicated in Tables 1, 2, and 3 attached to this letter. In addition, the Government will consult regularly with the Fund on any relevant developments at the initiative of the Government or the Fund.

9. The Government of Tanzania intends to disseminate this letter and the attached MEFP 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/
Mustafa H Mkulo (MP)
MINISTER FOR FINANCE AND ECONOMIC AFFAIRS
UNITED REPUBLIC OF TANZANIA

Attachment: Memorandum of Economic and Financial Policies.

Attachment I. Tanzania: Memorandum of Economic and Financial Policies

I. Recent Macroeconomic Developments and policies for the remainder of 2009/10

Recent economic developments

1. Impact of the global financial crisis (GFC) on economic growth became more noticeable in 2009 compared to 2008, albeit to a lesser extent than expected. This is reflected in the relatively good performance in traditional exports, cement production and the index of manufacturing industry. Provisional figures indicate a slowdown in real GDP growth to 5.4 percent during the first half of 2009, compared with a growth of 7.0 percent in the corresponding period in 2008. The economy is expected to strengthen in the second half and push the real GDP growth to 5.5 percent or higher for 2009 compared to 5.0 percent which was projected earlier. This is based on the preliminary results from the third quarter of 2009 which indicated strong performance in manufacturing, construction, trade and transport and communication.

2. The economy continued to experience inflationary pressures attributed to food supply shortages in the neighbouring countries and some parts of Tanzania, as well as high domestic transportation costs. Food inflation remained above 17.0 percent up to November 2009, before declining to 14.5 percent in December 2009 and further to 10.1 percent in February 2010 giving an indication of improving food supply in the region. Non-food inflation rate stayed below 5.0 percent up to October 2009, before bouncing back to 8.4 percent and 10.0 percent in December 2009 and January 2010, respectively, due to rebound in the world oil prices. Recent improvement in food supply in the region led to further decline in headline inflation to 9.6 percent in February 2010.

3. The trade account in 2009 depicted positive developments as low global demand for exports was offset primarily by a reduction in the import bill due to lower import prices. Notwithstanding the low demand for exports, as reflected in the decline in average prices of traditional exports, the value of exports in 2009 increased due to an increase in the volume of all traditional exports, except for tea and tobacco. Gold exports registered large volumes and price increases. Import of goods and services declined during the same period on account of decrease in value of oil import associated with the fall in world market prices. Improved performance of the trade account led to a reduction in current account deficit to USD 978.7 million in the first half of 2009/10, from a deficit of USD 1,214.2 million recorded in the corresponding period a year earlier. During 2009/10, the current account is projected to record a deficit (excluding current transfers) equivalent to 11.5 percent of GDP compared to 13.1 percent of GDP in 2008/09. The overall balance of payments is projected to record a surplus of USD 347.4 million, largely due to improvement in the current account, together with disbursements from development partners and SDR allocation. Consequently, official gross reserves by end-June 2010 are estimated at USD 3,461.0 million, which is equivalent to 5.2 months of imports of goods and services.

Performance under the programme

4. All PSI/ESF programme assessment/performance criteria for December 2009 were attained with good margins. Average reserve money was below the target by Tshs 73.0 billion, while Net International Reserves (NIR) was above the target by USD 575 million. The over performance in NIR is largely explained by the narrowing of the current account deficit and the allocation of Special Drawing Rights (SDR). Net domestic financing of the Government budget was below the ceiling by Tshs 83.1 billion.

Fiscal policy

5. Total revenue collection for the first three quarters of 2009/10 was below budget estimates, with all categories falling short of targets. Total domestic revenue collection (excluding LGAs own sources) was 91 percent of budget estimates during the period. The underperformance was particularly high in excise (87 percent) and non-tax revenue categories (80 percent). The under-performance in excise duties is attributed to the non-implementation of the removal of special fuel levy exemptions granted to existing mining companies. This was prompted by the need to honour existing contracts. In addition, production of the main excisable items, more specifically beer and cigarettes, was below projected levels. The VAT registered a relatively better performance (96 percent) despite delayed implementation of an electronic tax registers scheme. Undercollection in non-tax revenues is attributed to a delay in the implementation of new rates, approved in the 2009/10 budget, associated with residence permits, VISAs, and immigration fees. In addition, the global economic slowdown coupled with power outages during August and September 2009 impacted adversely on the revenue collection. The shortfall in revenues has been addressed through frontloading of foreign assistance and modest adjustment of non-priority expenditure.

6. During the first three quarters of 2009/10, expenditure policy focused on mitigating the impact of the global economic crisis, and incorporated unanticipated spending needs due to natural disasters. Government expenditure during the period was Tshs 6,143.9 billion, equivalent to 91.4 percent of the estimated amount. Foreign-financed development expenditure was executed as budgeted while domestically-financed development expenditure was below the budget level by 25 percent. However, enhanced revenue efforts during the fourth quarter should ensure a smooth implementation of planned development projects. Overall recurrent expenditure was below the budget level, despite unanticipated spending related to food distribution to drought affected regions, electricity generation for emergency power supply due to reduced production of hydro-power supply following prolonged droughts in some regions, and teachers' verified claims. In addition, there were continued efforts to repair infrastructure networks and houses damaged by severe flooding in some parts of the country.

7. Budget support for the July 2009–March 2010 period was Tshs 989.6 billion, equivalent to 82.9 percent of the annual budget projection. Net domestic financing recorded a borrowing of Tshs 155.3 billion, well within the ceiling for the period. During the same

period, grant and loan disbursements for development projects, including basket funds, were 104 percent of the projected level.

8. Revenue collection for 2009/10 is estimated at 94.2 percent of the budget, aided by the expected stronger economic performance in the fourth quarter, as well as additional administrative efforts. The remaining shortfall in domestic revenues and foreign financing will call for some corrective measures during the last three months of the year, including scaling down non-core expenditures without jeopardising service delivery.

Fiscal stimulus

9. The main thrust of government policy during 2009/10 focused on the combined impact of fiscal and monetary policies in mitigating the severity of the global economic downturn on domestic economic activities, and setting the economy on a firm footing for returning to its medium-term growth path, as the global economic and financial conditions normalize. In this regard, the government put in place an economic rescue plan, totalling about Tshs 1.7 trillion aimed at protecting employment and income, ensuring food security and protection of investment in infrastructure and key social services. The plan includes measures targeted for the most affected sectors, as well as additional financing sources to maintain uninterrupted general expenditures. During the first nine months, 69.6 percent of the plan was implemented: this consisted of Tshs 660.8 billion in domestic financing to fill revenue shortfalls in 2008/09 and 2009/10; Tshs 93.2 billion for food security, and protection of employment and income in adversely affected sectors; Tshs 8 billion for enhancement of existing SMEs and Export Credit Guarantee Schemes; and Tshs 10.0 billion for power generation. Tshs 411.2 billion was received from the IMF through ESF to bolster the level of international reserves. A transparent guideline and monitoring framework for the new guarantee schemes has been put in place in addition to the existing framework for monitoring the SME and export credit guarantee facilities.

Public Financial Management

10. The Government continues to strengthen public financial management in order to ensure that public resources are utilized in the most efficient and effective manner. This requires effective budget planning, implementation and monitoring in a streamlined system of resource management. After introduction of a new economic classification (GFS 2001) annual accounts are now being prepared using the IPSAS format, which facilitates improved expenditure tracking and monitoring. A functional classification of budget items is being developed, which will also serve as a basis for developing an index for monitoring priority social spending. The internal audit process will be strengthened through the introduction of a centralized independent internal audit department; the necessary amendments to the Public Finance Act, 2004 (Cap 348) were submitted to Parliament in April 2010. The annual report of the Controller and Auditor General for FY2008/09 reveal a sharp upward trend (to 91 percent from 71 the previous year) in unqualified opinions (passing audits) for the central government, while financing reporting of local governments was reported to be considerably improved, partly due to extensive training.

11. The Cash Management Unit (CMU) continues to prepare a three month rolling cash flow forecast during the year, based on Ministries, Departments and Agencies' (MDA) forecasts. The cash flow forecasts are updated monthly to capture recent developments and are provided to the Budget Ceiling Committee, which allocates resources to MDAs on monthly basis. Efforts have been made to enhance the capacity of the CMU, line Ministries and other spending agencies in order to improve in-year cash flow projection. This will facilitate smooth liquidity forecasting and monetary operations by the Bank.

Monetary and Exchange Rate Policies

12. During the first eight months of 2009/10, the Bank continued to implement a modestly relaxed monetary policy stance which was adopted in the last quarter of 2008/09. Beginning July 2009, the Bank reviewed the Lombard and discount rates with a view to making them more active instruments of monetary policy and to enhancing flexibility in provision of liquidity to the economy. In spite of this, the window remained inactive as banks continued to maintain a cautious stance in lending to the private sector following the GFC, which resulted to higher liquidity in the banking system. In the first eight months of 2009/10, stock of credit to the private sector grew by 5.0 percent compared with 29.7 percent recorded in the corresponding period a year earlier. Banks increased their preference for Treasury Bills and holdings of net foreign assets: the market for Treasury Bills was oversubscribed by 77.8 percent during July 2009 to February 2010 compared with 2.6 percent recorded in a similar period a year earlier. Change in NFA more than doubled over the same period by Tshs 263.8 billion compared with Tshs 91.1 billion registered in a similar period a year earlier.

13. In the Interbank Foreign Exchange Market (IFEM), the exchange rate continued to be market determined, while the Bank continued to participate primarily to meet liquidity management objectives, while fostering orderly market developments. During the first eight months of 2009/10, the Bank maintained a steady sale of foreign exchange in the IFEM, selling a total of USD 721.0 million, which is more than the USD 640.9 million sold in the corresponding period of 2008/09. Over the period the shilling remained fairly stable, depreciating by only 1.9 percent compared with the depreciation rate of 11.3 percent recorded in a similar period a year earlier.

14. The Bank continued with daily surveillance of the banking system to ensure financial stability and adherence to laws and regulations which is crucial in attaining the broader macroeconomic objectives of the government. As a result of the low level of integration to the global financial system, Bank's effective supervision and surveillance and the impact of the government stimulus package, the financial system in Tanzania remained stable and sound despite the uncertainties associated with the global financial crisis.

15. The Bank will continue to work toward its objective of maintaining macroeconomic stability with low and stable inflation. Given the growth performance in the first three quarters of 2009/10 and gradual recovery in the global economy, monetary policy will remain modestly accommodative to help in stimulating private sector recovery during 2009/10. In this context, the Bank will remain vigilant towards maintaining appropriate

levels of liquidity that will provide sufficient room for the growth of domestic credit to support macroeconomic recovery. With prudent fiscal policy, favourable weather conditions, and improved food supply in neighbouring countries, it is expected that the targeted inflation rate for end June 2010 of 8 percent will be achieved.

II. PROGRAMME FOR 2010/11 AND IN THE MEDIUM TERM

16. In the medium term, the government will continue to pursue prudent macroeconomic policies with the aim of stimulating economic activity. The inflation rate is expected to slow down further in the medium term as food supply improves, the exchange rate remains stable, and fiscal and monetary policies remain prudent. In addition, with the expected recovery in global economic outlook, real GDP growth is projected at 6.2 percent in 2010, and back to pre-crisis levels of around 7.5 percent by 2013. On the other hand, the projected growth in domestic revenue will not be commensurate with needs to finance large-scale infrastructure development projects. To this end, the fiscal deficit after grants is expected to be around 4.8 percent of GDP in the medium term, and will be financed through domestic borrowing, concessional and non-concessional external borrowing.

MKUKUTA

17. The Government emphasis for the next five years will continue to be in line with the National Development Vision 2025 through a successor poverty reduction strategy (MKUKUTA II). The vision for Tanzania is to become a middle income country, attaining high-quality of life, peace, security and unity, good governance and rule of law, an educated society, and a strong and competitive economy. The current MKUKUTA has registered impressive achievements in most of its social well-being targets. Main achievements include an increase in the enrolment rate at all levels of education, an increase in the number of healthcare facilities, and more women in political and decision making positions. MKUKUTA II has a sharper prioritization on measures to accelerate growth as a sustainable means of reducing poverty. A draft of the successor strategy has been shared with wide range of stakeholders so as to identify gaps, ascertain priorities and generally enhance national ownership of development initiatives. The draft strategy will go through the government approval process by end-June 2010.

18. MKUKUTA II will place greater emphasis on building up infrastructure, a necessary condition for achieving sustained higher growth. Infrastructure spending will be focused on transportation, power, and communication. It will also place emphasis on growth-enhancing sectoral interventions, for example, agriculture, manufacturing, and tourism, which should have a strong impact on productivity and job creation. Combining infrastructure building and sectoral strategies is expected to create growth synergies, especially for transforming agriculture.

19. The Government's strategy for agricultural development is titled "Kilimo Kwanza" or "agriculture first." The emphasis on the Kilimo Kwanza strategy is intended to boost agricultural productivity and improve food distribution through investment in rural roads and markets. The strategy also aims at improving irrigation infrastructure and access to financing,

including through the establishment of a commercially-run Agricultural Bank, community banks and enhancement of the window for agricultural credit at Tanzania Investment Bank.

20. The government is committed to support private sector growth. In addition to investment to address infrastructure gaps, a comprehensive programme is being formulated with the overall objective of reducing the cost of doing business in Tanzania. The President appointed a Regulatory Reform Task Team under the leadership of the Prime Minister's Office. The team has come up with a set of recommendations aimed at improving the business environment. These include recommendations on starting business, on dealing with construction permits, on registering property, on employing workers, on trading across borders, on paying taxes, and on getting credit. It is expected that critical short-term measures that involve legislative and statutory reviews and reforms will be submitted to the Parliament in July 2010.

21. The National Social Protection Framework (NSPF) is being developed, which identifies measures to protect vulnerable groups such as: orphans and children; people with disabilities; the elderly; people living with HIV & AIDS and long term illnesses; vulnerable women; former inmates and people disabled by accidents, wars and conflicts. The NSPF is expected to be approved by the Cabinet by end-June 2010 and the specific interventions are being discussed in the context of the MKUKUTA II.

Fiscal and Monetary Policies

22. The Government will continue to strengthen domestic resource mobilization in the medium term. Areas under consideration include a widening of the tax base, including the informal sector which will be facilitated by the introduction of national IDs and administrative improvement of the fiscal regime, including management of tax exemptions. The revenue to GDP ratio is projected to increase to 16.3 percent in 2010/11 and further to 16.9 percent by 2012/13.

23. Starting in FY10/11, expenditure policy will place more emphasis on infrastructure investment, while maintaining priority social spending, through gradual withdrawal of fiscal stimulus measures and rationalizing non-priority goods and services spending. Total expenditure is projected be 27.1 percent of GDP in 2010/11, and decline to 25.8 percent of GDP in 2012/13. The spending level in the medium term reflects conservative assumptions on donor financing, as well as increased revenue collection and non-concessional borrowing.

24. The Government will continue to finance development projects mainly through concessional borrowing and will retain its own 35 percent grant element floor for external borrowing. However, in light of the pressing infrastructure needs, the government intends to make use of additional domestic financing of 1 percent of GDP each year and non-concessional external financing of up to USD 1.5 billion over the 3 year PSI period, roughly evenly phased. Priority projects have already been identified in line with the Medium-term Public Investment Plan (MPIP, see paragraph 29), including roads and railways that are critical for improving the integration of transportation networks within the region and increased capacity of energy generation. While the government will seek to maximize the concessionality of new borrowing, necessary exemptions to the grant element floor specified

in the Government Loans, Guarantees and Grants Act 1974 (As amended in 2004) will be approved for specific projects with a clear high rate of return and with due consideration for absorptive capacity constraints. The government has resumed the process of identifying firms which will provide consultancy services on sovereign credit rating and subsequent issuance of a Eurobond. The anticipated level of borrowing would not affect the sustainability of debt as indicated by the 2009 World Bank/IMF Debt Sustainability Analysis. The Government will continue to monitor closely public debt developments, and is formulating a comprehensive Medium Term Debt Strategy which will be completed in October 2010. The medium term debt strategy will be revisited every two years and will include a detailed analysis of contingent liabilities, including those arising from government guarantees.

25. The Government will continue reforms in public financial management to ensure effective planning, implementation of public spending and integrity of the budget. The strengthening of the alignment of annual budget with the medium term plan will be given continued priority. To this end, MoFEA will improve outer year revenue projections to provide execution bodies with more concrete ceilings, which would provide a realistic signal about the actual resource envelope. Outer year spending plans will also be strengthened to make them built on medium term affordability consideration with specific projects clearly prioritised. To ensure timely execution of budget expenditures, the procurement law will also be reviewed with the objective of streamlining the procurement process.

26. Commitment control and expenditure tracking and monitoring will continue to be strengthened. MoFEA has already issued a guideline to prohibit expenditure commitment beyond the budget, and will continue to monitor expenditure development at spending agencies in a timely manner. As a means for improving monitoring of the process for clearing payment claims, MoFEA will begin collecting data on a quarterly basis beginning with end-June 2009 (to be reported by end-September 2009), in three of the largest spending ministries (Infrastructure, Health, Home Affairs), on the amount of payment claims outstanding more than 30 days, 60 days and 90 days. Monitoring the stock of claims outstanding over time will enable a more accurate monitoring of the fiscal situation, and facilitate better projections of cash flow needs and smoother implementation of monetary policy.

27. A bridge table for GFS functional classification has been developed to facilitate an effective monitoring of the alignment between policy objectives and actual expenditure, and the 2010/11 budget will include a presentation consistent with GFS2001 functional classification.

28. The Government will continue to implement the Medium-Term Pay Policy (MTPP) focussing mainly on recruiting new staff in education, agriculture, livestock, irrigation and health sectors, as well as maintaining competitive salary levels, transparency and equity in payscales for the public service. The medium-term projection indicates that wages will be around 6.1 percent of GDP in 2010/11 to 2012/13.

29. The government has prepared the Medium-term Public Investment Plan (MPIP) with the aim of improving the alignment between policy objectives and the budget by providing

enhanced policy coordination and clearer prioritization of public investment projects. The MPIP has identified priority infrastructure projects that will accelerate economic growth and poverty reduction, such as energy, agriculture and transportation. Given budgetary resource constraints and potential efficiency gains, greater participation of the private sector in financing and/or implementing infrastructure projects through Public Private Partnership (PPP) arrangements will be encouraged. In this regard, the Government is working on legal and institutional frameworks for PPPs, and plans are underway to establish a PPP Unit in the MoFEA to manage associated fiscal risks and provide advisory services for promotion and contracting of PPPs.

30. Monetary policy will focus on maintaining sufficient liquidity among banks to support credit growth, while preserving the primary objective of attaining and maintaining low and stable inflation. During financial year 2010/11, the Bank is targeting annual growth rate of average reserve money of 18.5 percent and broader monetary aggregates, M2 and M3 at 20.7 percent and 21.0 percent, respectively, which should be consistent with an adequate supply of credit to the economy. The rebound of world oil prices could pose a risk to sustaining lower inflation. Another challenge may come from potential disruptions to the transportation network caused by natural disasters, such as flooding.

31. The Bank will remain vigilant in safeguarding the current stability in the financial sector as the adverse effects of the global financial turmoil subside. The Bank will maintain strict surveillance over all banks operating in Tanzania on daily basis, and the early warning system which has already been put in place will be enhanced to ensure that all financial indicators remain sound.

32. The Bank's liquidity windows including the intra day loan facility (ILF) and its overnight refinancing facility, i.e. the Lombard window will remain open for banks in need of liquidity to square their positions. The Bank will maintain its foreign exchange policy, including its presence in the foreign exchange market and strengthen its oversight in the market. Measures will be taken to sustain orderly developments in the market and ensure safety in payment systems to protect the financial system from possible contagion effects.

Financial sector stability

33. The financial sector in Tanzania continues to strengthen following the ongoing Second Generation Financial Sector Reform programme. For the banking sector as a whole, financial indicators are broadly sound. Ongoing reforms are expected to enhance stability and access to financial services, including the establishment of a credit reference system. The procurement process for a consultant to assist in the establishment of this credit reference databank is at an advanced stage, and credit reference bureau regulations and licensing guidelines are in the approval process. Regarding improving access to long term development finance, the Government has approved a framework which will allow the Tanzania Investment Bank to operate as a Development Finance Institution with a window for lending to the agricultural sector. With regard to relocation of credit guarantee schemes that are currently operated by the Bank on behalf of Government, a draft report on the future structure and modus operandi of the schemes outside the Bank is under discussion.

34. Regarding financial supervision of pension funds, the new Social Security (Regulatory Authority) Act became effective 1st November 2008. The Ministry of Labour, Employment, and Youth Development has finalized regulations to implement the law. Amendments to the existing pension fund-specific legislation to bring them into conformity with the new regulatory regime are already in place after being approved by the Minister. The process of recruiting the CEO for the Regulatory Authority and subsequent issuance of investment guidelines for the pension funds, in consultation with the regulator, is expected to be completed by end-June 2010. In the meantime, the BoT will introduce a data collection and reporting system for pension funds.

35. The Bank continued to implement the recommendations of the IMF Safeguards Assessment Mission of August 2009. The Bank is currently evaluating some firms that expressed interest on advising the Directorate of Internal Audit on issues related to risk assessment. The process of engaging a consulting firm to conduct a comprehensive risk assessment at the Bank is at the contract negotiation stage. The 2008/09 statutory audit commenced in October 2009 and the audit report (unqualified opinion) was adopted by the Board on 22nd December 2009. The accounts were published in the Bank website in January 2010.

36. A tentative plan for timing and sequencing of capital account liberalization was included in the EAC Common market protocol which was signed on 20th November 2009 by Heads of States. The Bank management is working on the development of an action plan toward the gradual lifting of restrictions/residual controls as proposed in the timing and sequencing plan. The removal of restrictions shall be progressive in accordance with the schedule on the Free Movement of Capital specified as an annex to the Common Market Protocol. Among the restrictions that the Government intends to eliminate by 2012, include sale or issue of debt securities abroad and outward direct investments by residents.

37. The Bank is preparing an action plan to address key issues identified as part of the FSAP update. Main areas of focus on the action plan will be on safeguarding financial stability, improving financial intermediation, promoting long-term finance and deepening financial access. A new Financial Stability Report, reinforcing macro prudential surveillance, will be issued to the BoT Board by end-June 2010. Meanwhile, the Bank, in collaboration with the Tanzanian Investment Center and the National Bureau of Statistics, continues to perform annual surveys to monitor private capital flows, including foreign direct investment. The Bank will need to develop capacity for high frequency monitoring of portfolio capital flows as a precursor to capital account liberalization.

38. An outline that provides a broad framework for Crisis Management for the whole financial sector was produced in February 2010 in response to FSAP recommendations. A follow up mission to guide the development of crisis management in each component of the financial sector is scheduled for August 2010. The Bank of Tanzania has formulated an action plan to develop the crisis management framework for the banking industry and other regulatory agencies have been informed about the requirement to prepare crisis management

frameworks in their sectors. The Tanzania Financial Regulators Forum, which is scheduled to be launched in the third quarter of 2010, will coordinate the preparation of the whole financial sector crisis management framework.

39. In order to deepen coverage of the Deposit Insurance Fund, the Minister for Finance and Economic Affairs has approved the maximum insurance coverage from the current level of Tshs 500,000 to Tshs 1,500,000 per depositor per bank effective May, 2010. Legal process to implement the new level is in the final stages. The new level will meet the recommended limits by the International Association of Deposit Insurers (IADI). Meanwhile, the recommendations to increase minimum capital requirements from Tshs 5 billion to Tshs 15 billion for commercial banks and from Tshs 2.5 billion to Tshs 7.5 billion for financial institutions have been approved by the Board of the Bank of Tanzania. The Bank will also establish, by end-March 2011, a framework for providing emergency liquidity assistance, beyond day-to-day liquidity management tools.

Statistical issues

40. The National Bureau of Statistics (NBS) is finalizing revision of weights of items in the Consumer Basket on the basis of results from Household Budget Survey (HBS). The new weights will start to be employed in calculating inflation from April, 2010. The new inflation formula will reflect the latest consumption pattern based on the HBS analysis results. The NBS, with the support of the Bank, is also developing a core inflation indicator in order to provide a better assessment of underlying inflation excluding supply-side effects, based on a harmonized methodology to be agreed by all EAC countries.

III. PROGRAMME MONITORING

Table 1 indicates quantitative indicative targets for the current PSI-supported program, which ends in May 2010. Quantitative assessment criteria for end-June and end-December 2010 and quantitative indicative targets for end-September 2010 and end-March 2011 will monitor programme implementation under the new PSI (Table 2). The government and IMF staff also agreed on the structural benchmarks listed in Table 3. Further detail is contained in the attached Technical Memorandum of Understanding.

MINISTRY OF FINANCE AND ECONOMIC AFFAIRS
DAR ES SALAAM,
TANZANIA

May 10, 2010

Table 1. Tanzania: Quantitative Assessment/Performance Criteria and Indicative Targets Under the Policy Support Instrument and the Exogenous Shocks Facility, September 2009–March 2010

	2009				2010	
	September		December		March	
	Indicative Targets	Actual	Assessment/ Performance Criteria Program	Actual	Program Indicative Targets	Prelim.
	(Billions of Tanzania Shillings; end of period, unless otherwise indicated)					
Net domestic financing of the government of Tanzania (cumulative, ceiling) [1, 2]	279	-208	95	12	168	168
Accumulation of budgetary arrears (ceiling; indicative target only)	0	0	0	0	0	[0]
Average reserve money (upper bound) [3]	2,862	2,846	3,009	2,936	3,089	3,026
Average reserve money target [3]	2,833		2,979		3,058	
Average reserve money (lower bound) [3]	2,805		2,949		3,028	
	(Millions of U.S. dollars; end of period)					
Net international reserves of the Bank of Tanzania (floor) [4]	2,234	3,292	2,648	3,223	2,726	3,223
Accumulation of external payments arrears (ceiling) [5]	0	0	0	0	0	[0]
Contracting or guaranteeing of external debt on nonconcessional terms (ceiling) [5]	0	0	0	0	0	0
Memorandum item:						
Foreign program assistance (cumulative grants and loans) [1]	315	686	818	809	1,139	1,107

Note: For precise definitions of the aggregates shown and details of the adjustment clauses, see the Technical Memorandum of Understanding (TMU) attached to the Government's letter of November 13, 2009.

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

[2] To be adjusted upward by up to TSh 250 billion for the U.S. dollar equivalent of a shortfall in foreign program assistance from the amounts shown in the memorandum item.

[3] Assessment criteria and benchmarks apply to upper bound only.

[4] Floors are set US$200 million below projected levels. Floor will be adjusted downward for any shortfall in foreign program assistance from the amounts shown in the memorandum item up to the equivalent of TSh 250 billion.

[5] Continuous PC; excludes debt-service payment arrears pending debt-rescheduling arrears.

Table 2. Tanzania: Quantitative Assessment Criteria and Indicative Targets Under the Policy Support Instrument, June 2010–June 2011

	2010			2011	
	June	September	December	March	June
	Proposed Assessment Criteria	Proposed Indicative Targets	Proposed Assessment Criteria	Proposed Indicative Targets	Proposed Indicative Targets
	(Billions of Tanzania Shillings; end of period, unless otherwise indicated)				
Net domestic financing of the government of Tanzania (cumulative, ceiling) [1, 2]	506	250	211	231	350
Average reserve money (upper bound) [3]	3,193	3,406	3,514	3,622	3,783
Average reserve money target [3]	3,161	3,372	3,479	3,586	3,746
Average reserve money (lower bound) [3]	3,129	3,338	3,444	3,550	3,708
	(Millions of U.S. dollars; end of period)				
Net international reserves of the Bank of Tanzania (floor) [4]	3,079	3,061	3,207	3,317	3,374
Accumulation of external payments arrears (ceiling)	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (continuous ceiling) [5]	0	525	525	525	525
Memorandum item:					
Foreign program assistance (cumulative grants and loans) [1]	1,416	329	770	933	1,055

Note: For precise definitions of the aggregates shown and details of the adjustment clauses, see the Technical Memorandum of Understanding (TMU) attached to the Government's letter of May10, 2010.

[1] Cumulative from the beginning of the fiscal year (July 1).
[2] To be adjusted upward by up to TSh 250 billion for the U.S. dollar equivalent of a shortfall in foreign program assistance from the amounts shown in the memorandum item.
[3] Assessment criteria and benchmarks apply to upper bound only.
[4] Floor will be adjusted downward for any shortfall in foreign program assistance from the amounts shown in the memorandum item up to the equivalent of TSh 250 billion.
[5] Continuous assessment criteria; ceiling applies throughout the year.

Table 3. Proposed Structural Benchmarks During First Year of New PSI, 2010/11

Measure	Target Date of Implementation	Justification
Poverty Reduction Strategy		
Adoption of MKUKUTA II by Cabinet.	End-June, 2010	Provides the overall framework for policy interventions.
Approval by Cabinet of a new National Social Protection Framework.	End-June, 2010	To provide a reliable and comprehensive social safety net targeted to the most vulnerable and better automatic stabilizers in the event of future shocks.
Financial Sector		
Appoint Head of Social Security Regulatory Agency and issue investment guidelines for pension funds.	End-June, 2010	Absence of effective regulation/supervision of the social security funds—which hold assets of 10 percent of GDP or one quarter of the financial system—adds considerable risk to the financial system and public finances.
Introduce data collection and reporting system for pension funds.	End-June, 2010	Enables higher frequency and more accurate monitoring of risks in the financial sector.
Submit Financial Stability Report to the BoT Board.	End-June, 2010	Reinforces macro prudential surveillance.
Notification to banks to increase contributions to the Deposit Insurance Fund.	End-June, 2010	Deepens deposit insurance coverage.
Establish framework for emergency liquidity assistance beyond day-to-day liquidity management and tools.	End-March, 2011	Provides mechanism for expedited handling of liquidity problems with systemic implications.
Fiscal		
Debt management: Prepare a Medium-Term Debt Strategy consistent with resource needs under the new PRS and reflecting contingent liabilities.	End-December, 2010	Critical for ensuring sustainability of the government's borrowing strategy and for facilitating broader access to capital markets.
Establish a PPP unit within the MoFEA.	End-December, 2010	Essential for MoFEA to be able to implement its gate-keeping responsibilities specified in the PPP legislation.
Develop an index for monitoring priority social spending.	End-December, 2010	Facilitates monitoring the implementation of social spending.
Collect data, on a quarterly basis, on payment claims outstanding over 30, 60, and 90 days in Ministries of Infrastructure, Health, and Home Affairs. End-June data to be provided by end-September.	End-June, 2010	Enables a more accurate monitoring of the fiscal situation, and facilitates better projections of cash flow needs and smoother implementation of monetary policy.
Statistics		
Develop core inflation index.	End-December, 2010	Provides more meaningful indicator of the stance of monetary policy and a key EAC convergence indicator.

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

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 the quantitative PSI assessment criteria and indicative targets under Tanzania's program supported by the PSI arrangement. The principal data source is 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

2. Net international reserves (NIR) of the Bank of Tanzania (BoT) are defined as reserve assets minus reserve liabilities. The BoT's reserve assets, as defined in the IMF BOP manual (5^{th} 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.

Reserve money and reserve money band

3. 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 or indicative target.

Net domestic financing of the Government of Tanzania

4. 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. 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 COMELCO (Russia) and the government of Bulgaria; mortgage on acquired sisal estates; compensation claims; and debt of parastatal companies assumed by the government. Government deposits that reflect the unspent portion of nonconcessional borrowing designated for specific infrastructure projects, and which are held in ring-fenced accounts exclusively for that purpose, will be excluded from (i) and (iii) above in the calculation of net domestic financing.

Government deposits at the BoT

5. 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 payments arrears

6. External payments 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 payments arrears is continuous and applies throughout the year.

Contracting or guaranteeing of external debt on nonconcessional terms

7. 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 or the Bank of Tanzania. The scope of the criterion will be expanded at the time of the first review of the PSI-supported program to include public sector debt, including public enterprises that are not explicitly excluded. External debt contracted in the interim will be subject to the program ceiling according to the revised definition as of the first review; the ceiling on external debt is continuous and applies throughout the year.

8. 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.

Foreign program assistance

9. Foreign program assistance is defined as budget support and basket grants and loans received by the Ministry of Finance and Economic Affairs (MoFEA) 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.

Program exchange rate

10. For 2010/11, the end-of-period program exchange rates are set at T Sh 1360 per U.S. dollar, T Sh 1370 per U.S. dollar, T Sh 1380 per U.S. dollar, and T Sh 1390 per U.S. dollar for Quarters I–IV, respectively. For 2010/11, the period average program exchange rates are T Sh 1355 per U.S. dollar, T Sh 1365 per U.S. dollar, T Sh 1375 per U.S. dollar, and T Sh 1385 per U.S. dollar for Quarters I–IV, respectively. For 2010/11 as a whole, the program average exchange rate is set at T Sh 1370 per U.S. dollar.

III. ADJUSTERS

Net international reserves

11. The end-June, end-September, end-December 2010 and end-March 2011 quantitative targets for the BoT's net international reserves will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance in U.S. dollars (up to a limit of T Sh 250 billion, converted into U.S. dollars at the corresponding program average exchange rate), relative to projections shown in the Quantitative PSI Assessment Criteria and Indicative Targets Table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Polices of the Government of Tanzania.

Net domestic financing

12. The end-June, end-September, end-December 2010 and end-March 2011 quantitative limits on the net domestic financing of the Government of Tanzania will be adjusted upward for any shortfall in foreign program assistance in U.S. dollars (up to a limit of T Sh 250 billion, evaluated using the corresponding program annual average exchange rate), relative to projections shown in the Quantitative PSI Assessment Criteria and Indicative Targets Table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Polices of the Government of Tanzania.

IV. DATA REPORTING REQUIREMENTS

13. 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).	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 MoFEA	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 in the Infrastructure, Health and Home Affairs ministries. For each ministry, total claims outstanding to be divided into: (i) unverified claims; and (ii) claims verified but not yet paid.	MoFEA	Quarterly	3 months
The flash report on revenues and expenditures.	MoFEA	Monthly	4 weeks
The TRA revenue report	TRA	Monthly	4 weeks
The monthly domestic debt report.[1]	MoFEA	Monthly	4 weeks
Monthly report on central government operations.	MoFEA	Monthly	4 weeks
Detailed central government account of disbursed budget support grants and loans, and external debt service due and paid.	MoFEA	Monthly	4 weeks
Detailed central government account of disbursed donor project support grants and loans.	MoFEA	Monthly	4 weeks
Statement on new loans contracted during the period including terms and conditions according to loan agreements.	MoFEA	Quarterly	4 weeks

[1] The MoFEA 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 MoFEA.