International Monetary Fund

Tanzania and the IMF

Press Release:
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January 20, 2012

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

December 23, 2011

The following item is a Letter of Intent of the government of Tanzania, which describes the policies that Tanzania intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Tanzania, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

LETTER OF INTENT

Dar es Salaam
December 23, 2011

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 programme supported by the Policy Support Instrument (PSI).

2. In the period through end-June 2011, the Government met three PSI quantitative assessment criteria while two criteria were missed due to temporary costs incurred in clearing part of the expenditure float in the budget and delays in contracting external nonconcessional borrowing. At the same time, progress has been made in implementing the structural reform program, with three structural benchmarks met and two planned for implementation, with a short unavoidable delay, by March 2012.

3. Tanzania's economy continues to grow strongly. Despite power shortages, real GDP grew by 6.3 percent in the first half of 2011, and most leading indicators remain favorable. Accordingly, the Government is strongly of the view that the revised 6.0 percent GDP growth projection for 2011 will be achieved and most likely surpassed. Growth is projected to increase to 7.2 percent in 2012 and remain above this level in the medium term.

4. Inflation has risen on account of the pass through from higher global oil prices, a regional surge in food prices, and a power tariff increase in January 2011. Inflation is projected to peak around October levels of 17.9 percent and remain at double digit level, before declining to around 9 percent by June 2012. These projections assume good rainfall and favorable harvests in early 2012.

5. The Government's expenditure policies continue to be guided by the National Strategy for Growth and Reduction of Poverty (MKUKUTA II), which focuses on improving the livelihoods of Tanzanians. The efficiency of resource utilisation and service delivery is being promoted by core programmes covering public financial management

reform, public service reform, local government reform, legal sector reform, and a national anti-corruption strategy. The Government is also implementing a roadmap for improving the business climate.

6. Following discussions and consultations with the Fund staff, I hereby transmit this Letter of Intent and the attached Memorandum of Economic and Financial Policies, which reviews the implementation of the programme in 2010/11 and the first quarter of 2011/12 and policies that the Government intends to pursue this year and beyond.

7. The Government of Tanzania requests waivers for the two missed assessment criteria and completion of the third 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 set forth in the attached MEFP are adequate to achieve the objectives of its programme, and following further consultation with the Fund, will take any appropriate measures for this purpose. The Government will regularly update the Fund on developments in its economic and financial policies, and will provide the data needed for monitoring the programme. The Government will consult regularly with the Fund on any relevant developments at the initiative of the Government or the Fund.

8. 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
MINISTER FOR FINANCE
UNITED REPUBLIC OF TANZANIA

Attachments:
Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment I. **Memorandum of Economic and Financial Policies**

December 23, 2011

I. Recent Macroeconomic Developments

1. Tanzania's macroeconomic performance remained strong, despite shortages of power from hydroelectric generators. Growth was 6.3 percent in the first half of 2011, down only modestly from 7.4 percent in the corresponding period in 2010. Double-digit growth was achieved in construction (16.3 percent), transport and communication (11.7 percent), and financial intermediation (11.1 percent). Based on performance in the first half of 2011, the full year GDP growth projection of 6.0 percent is likely to be achieved, and possibly exceeded.

2. Inflation has risen from 4.2 percent in October 2010 to 17.9 percent in October 2011 reflecting drought-based regional food supply shortages, high global fuel prices, and an increase in domestic power tariffs in January 2011. Core inflation remained in single digits, at 8.5 percent in October 2011.

3. In 2010/11, total revenues performed well, rising 19.6 percent from 2009/10 levels and exceeding PSI projections by 0.4 percent of GDP; this reflected favorable implementation of the revenue measures outlined in the November 2010 MEFP. However, combined grant and foreign loan financing fell 3.8 percent of GDP below PSI projections. Responding to this funding shortfall, expenditures were kept 1.8 percent of GDP below PSI projections, and domestic arrears equivalent to about 1 percent of GDP were carried over into 2011/12, primarily in regard to road infrastructures. Recurrent spending exceeded PSI projections by 1.2 percent of GDP reflecting difficulties in making the sizeable spending cuts targeted under the PSI, in relation to GDP. Expenditure savings were partly offset by unbudgeted costs to reduce the expenditure float amounting to 0.9 percent of GDP. The overall deficit of 6.9 percent of GDP was only slightly above the PSI program goal of 6.5 percent of GDP.

4. For 2011/12, revenue collections in the first quarter were favorable, broadly in line with budget goals for the full year. At the same time, donor funding started the year unusually slowly, with no general budget support and overall receipts equivalent to just 7 percent of full-year donor commitments. Most donors are expected to disburse in the second and third quarters of the fiscal year. Expenditures in the first quarter were kept in careful check, with development expenditures focused on repaying arrears carried over from 2010/11.

5. Reserve money remained on track in 2010/11 and through the first quarter of 2011/12, while broader liquidity aggregates slightly exceeded program projections. At end-September 2011, broad money supply (M3) recorded a growth rate of 23.7 percent compared with the projected rate of 19.8 percent under the PSI. Similarly, credit to the private sector

grew somewhat faster than projected under the PSI program through September 2011, partly mirrored in a decline in the net foreign assets (NFA) and excess reserves of banks. Monetary policies have been tightened in recent months to address risks to inflation, and the weighted average Treasury bill yield increased from less than 5 percent in June 2011 to 15.16 percent in November.

6. In 2010/11, the external current account deficit (excluding official transfers) widened to 13 percent of GDP, compared with 12 percent of GDP in 2009/10. Imports of goods and services rose by 19.4 percent (compared to 5.8 percent in the preceding year), reflecting higher global oil prices and a surge in imports of capital goods. Export growth was also strong (23.8 percent, compared to 12.8 percent in 2009/10), reflecting strong performance of traditional and manufactured exports and favorable commodity export prices, particularly for gold. At end-June 2011, gross international reserves were $3,610 million, equivalent to 4.4 months of projected imports of goods and services. At end-September 2011, reserves fell to $3,473 million (3.7 months of projected import cover), reflecting in part delays in donor financing and non-concessional borrowing, as well as negative valuation effects on reserves held in Euros and sterling when these currencies depreciated against the dollar.

7. The exchange rate depreciated by 11.2 percent against the dollar through end-November 2011. This partly reflected demand for foreign currency to pay oil import bills inflated by high global prices and demand linked to back-up generators operated by businesses and households during load-shedding.

8. Tanzania's public and private external debt rose from $6.5 billion at end-June 2010 to $7.7 billion at end-June 2011 (33 percent of GDP). Over the same period, total public debt (domestic and external) increased from 33 to 38 percent of GDP.

II. Performance under the PSI program through September 2011

Quantitative targets

9. Three of the five June 2011 PSI assessment criteria were met, while two were missed:

- The reserve money ceiling was met with a margin of 1.5 percent (TSh 58.4 billion);
- Contracting of external non-concessional debt of $103 million was well below the relevant PSI ceiling ($525 million);
- The continuous criterion on the non-accumulation of external payments arrears was also met;
- Net international reserves (NIR) were $178 million below the adjusted program floor, reflecting the shortfall in external non-concessional borrowing relative to program plans noted above; and
- Net domestic financing of the budget was TSh 813 billion higher than the adjusted program ceiling. This reflected the shortfall in non-concessional borrowing noted

above, as well as improved procedures for government payments which resulted in a TSh 280 billion reduction in the expenditure float that had to be financed.

10. For September 2011, four out of five indicative targets were met. Average reserve money and net domestic financing were below their respective ceilings by TSh 52 billion and TSh 68 billion, respectively. The Government remained within the $525 million continuous ceiling on non-concessional debt through October, signing loan agreements for $350 million (with a potential to increase to $410 million depending on market response during syndication); no external arrears were incurred. The adjusted NIR target was missed by $340 million at end-September, with about half of the shortfall being a carry-over from the corresponding shortfall in June 2011, the remainder reflecting payments to clear domestic arrears to foreign contractors, unexpectedly high government imports of fuel for thermal power generation, and revaluation losses due to bilateral currency movements against the dollar. The government requests a modification of the assessment criterion on NIR from measuring NIR on a stock basis to a flow basis to eliminate base effects from performance measurement.

Structural benchmarks

11. Progress has been made in implementing the structural reform program, with three benchmarks met and two unavoidably delayed to March 2012. A medium-term debt strategy was prepared in January 2011 and published in June 2011 as scheduled; a unified debt database was established within the Ministry of Finance ahead of the end-December deadline; and the Government has developed a framework based on MKUKUTA II that permits monitoring various dimensions of social spending. Investment guidelines for pension funds have been developed, but reflecting the need to complete a preliminary actuarial assessment, will be issued with a delay by end-March 2012. Work on a National Social Protection Framework (NSPF) has been integrated into an ongoing, broader national social security reform program. This reform involves multiple institutions and the timing for approval is currently uncertain. Since Tanzania maintains an existing social protection system, and development of a more comprehensive social protection framework would not entail immediate changes on the ground, the Government requests that this benchmark be dropped.

III. Economic Program for 2011/12 and the Medium Term

Economic prospects

12. Economic performance is expected to strengthen further in 2012 and over the medium term, benefitting from implementation of MKUKUTA II, the Five Year Development Plan, and initiatives under the Southern Agricultural Corridor of Tanzania (SAGCOT). Reflecting favorable weather, GDP growth is projected at 7.2 percent in 2012, with somewhat higher growth over the medium term.

13. With food scarcity in the Eastern Africa region, high oil prices, and recent exchange rate depreciation, inflation is projected at about 15 percent in December 2011. Assuming

good short-rains and favorable harvests in the first quarter of 2012, inflation is projected to ease to single digits by June 2012. Inflation would subsequently be kept in single digits by tight fiscal and monetary policies.

14. In 2011/12, the external current account deficit (excluding official transfers) is projected to remain at 13.0 percent of GDP. Over the medium term, the current account deficit is projected to return to an average of 11 percent of GDP as fiscal tightening slows import growth relative to exports.

15. The Government will continue to enhance efficiency in resource utilisation and service delivery by structural reforms in the following key areas: public financial management reform, public service reform, local government reform, legal sector reform, and a national anti-corruption strategy. In addition, the Government is supporting private sector led growth through a roadmap for improving the business climate: this roadmap has identified several "quick wins" and short-term actions that the Government intends to implement.

Fiscal policy for 2011/12

16. The 2011/12 budget envisaged total expenditure of 32.1 percent of GDP targeted on MKUKUTA II goals, up from an outturn of 27.2 percent of GDP a year earlier. This included a rise in the development spending to 12.5 percent of GDP (up from 7.9 percent of GDP a year earlier), together with recurrent spending equivalent to 19.6 percent of GDP (up from 19.3 percent of GDP a year earlier). Although the higher spending was partly offset by a projected rise in revenues and grants in relation to GDP, the budgeted fiscal deficit for 2011/12 was 7.6 percent of GDP, up from an outturn of 6.9 percent of GDP a year earlier.

17. Given the importance of safeguarding Tanzania's reputation for prudent fiscal management, and in light of the less favorable global financing situation, the Government has decided to adopt mid-year measures to reduce the 2011/12 deficit to 6.6 percent of GDP (compared to an earlier 2011/12 deficit goal under the PSI of 6.0 percent of GDP). A broad-based range of expenditure savings have been identified through a line by line review of the budget. These have been approved by the Government, and are being reflected in cash ceilings for the remainder of 2011/12. Specifically:

- Savings in goods and services and transfers will amount to TSh 203 billion (0.5 percent of GDP). Cuts are being made, without serious adverse economic impact, to extra duty allowances, training, travel, office running costs, vehicle operating costs, allocations to government agencies and boards, and some activities of local government authorities (LGAs) and new administrative areas;

- Savings in domestically-financed development expenditures will amount to TSh 157 billion (0.4 percent of GDP). A number of construction and rehabilitation projects have been identified that can be slowed without incurring penalties; and

- Additional revenues will amount to TSh 86 billion (0.2 percent of GDP). This represents additional income taxes under an agreement with a mining company.

18. The Government is confident that the careful review that was conducted to identify the above savings will result in successful application of the cash management system and full realization of the savings. The Government will finance the 2011/12 budget deficit without exceeding the PSI ceiling on net domestic financing (NDF) equivalent to 1 percent of GDP. Some further external non-concessional borrowing (ENCB) will be contracted in the coming months, within the PSI limits, to fund infrastructure projects in the 2011/12 budget. Foreign currency financing proposals have been obtained from a number of banks, and a committee has been formed to choose the best options. While the approved 2011/12 budget assumed ENCB of $822 million, the corrective measures described above would reduce the ENCB funding need to a projected $575 million.

Fiscal policy in 2012/13 and the medium term

19. The Government is determined to maintain prudent fiscal policy in 2012/13 and beyond. A particular focus will be given to ensuring that recurrent spending is kept to an affordable level. Given Tanzania's development needs, recurrent spending has risen in recent years to fund a growing provision of socially important secondary and tertiary education as well as a broadened range of social programs provided at the local government level (the latter under the "decentralization by devolution" ("D by D") framework). However, as a result, recurrent spending exceeded recurrent incomes (revenues plus grants) in the two most recent years. To ensure that recurrent spending is not debt-financed and to create fiscal space for growth-promoting development spending, the Government intends to ensure that recurrent spending does not exceed 97 percent of recurrent incomes in 2012/13 and 95 percent in 2013/14 and beyond.

20. To achieve this goal, the Government will develop policies in the context of the 2012/13 budget to raise revenue collections as a share of GDP and/or slow the pace of recurrent spending in relation to GDP. The mix of policies to rebalance recurrent incomes and spending will be discussed with the Fund in the context of the fourth PSI review.

21. On the expenditure side, the Government intends to pay particular attention to the scope for expenditure savings in:

- The central government wage bill and associated allowances regime (equivalent to 5.3 percent of GDP in 2011/12);

- The decentralization program for social programs. It will be important not to undermine the delivery of decentralized education, health, water and other programs. At the same time, reforms to strengthen service delivery quality are needed, and the costs of the decentralized expenditure program are high and rising (transfers to local authorities to fund these programs are projected to rise from 5 percent of GDP in 2009/10 to more than 5.6 percent of GDP in 2011/12);

- The student loan program, where annual costs are around 0.6 percent of GDP, and where reforms to strengthen the targeting of assistance are being adopted; and

- Transfers to public institutions, including colleges, universities, institutes, agencies, boards, and commissions. Excluding the Tanzanian Revenue Authority and the Tanzanian Road Fund, which benefit from important self-financing, current grants to these bodies are projected at 1.6 percent of GDP in 2011/12. Potential savings could be realized by commercializing, privatizing, or closing institutions.

22. In considering the scope for revenue gains, the Government will examine the case for reforms in the following areas:

- Rationalized tax exemptions, including avoidance of preferential treatment under the income and indirect taxes, elimination of tax holidays, and limitation of Special Economic Zone and Export Processing Zone preferences to indirect taxes;

- Inclusion of capital goods and petroleum products in the VAT base, drawing on a planned comprehensive review of Tanzania's VAT regime to be supported by IMF technical assistance in early-2012;

- Increase of user fees and charges to more closely reflect the value of services provided and to compensate for recent inflation; and

- Application of more stringent rules for the transfer of fees collected by MDAs to the consolidated fund.

Public Financial Management

23. The Government is committed to further strengthening public financial management (PFM) systems so as to achieve a high level of public service delivery. The PFMRP IV program will continue to strengthen Tanzania's PFM systems, focusing on revenue management, planning and budget management, budget execution, transparency and accountability, budget control and oversight, change management, programme monitoring and evaluation. The PFMRP Phase IV will be implemented in a span of five years beginning January 2012.

24. The Government is taking steps 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 amendment of the Public Finance Act in 2010 established a fully-fledged Internal Audit General Department (IAGD), and in April 2011, an Internal Auditor General was appointed. To ensure a high degree of operational independence, the Head of the IAGD reports directly to the Permanent Secretary (Ministry of Finance), who is also the Paymaster General.

25. In strengthening the management and control of public funds, the Public Finance Act, 2011 (amended 2004) has been reviewed to empower the Paymaster General and the Accountant General to oversee public financial management at the LGA level. Through these changes, the Government has created the post and appointed a new Assistant Accountant General responsible for management of LGA finances.

26. To better track domestic arrears issues, the Government has begun to compile outstanding liabilities by aging analysis on a quarterly basis since end June 2010 and is providing these data to IMF and other development partners. Currently, the Government has compiled reports for financial year 2010/11 and the first quarter of 2011/12. The Government is determined that the accumulation of domestic arrears in 2010/11 will not be a recurrent issue, and has allocated resources in the 2011/12 budget that are projected to be adequate to clear the arrears stock at end-June 2011. Importantly, the 2011/12 budget for the Ministry of Infrastructures, which accounted for 80 percent of recorded arrears at end-September 2011, is estimated to be adequate to clear these arrears during the course of the year without a carry-over into 2012/13.

27. In 2010/11, 13,236 dormant government bank accounts were closed, to promote more efficient supervision and to reduce costs. For the current financial year, 983 dormant accounts have been identified and the closure process is ongoing. Under the new arrangement, each LGA will be limited to six bank accounts.

28. As part of a continuing program to strengthen fiscal transparency, the Ministry of Finance will make available from end-March 2012 on its internet website the full four volumes of public expenditure estimates for the 2011/12 budget as submitted to the National Assembly. In the year ahead, the corresponding 2012/13 budget documents will be added to the Ministry's website.

Debt management

29. To help ensure the sustainability of Tanzania's national debt, the Government conducted a Debt Sustainability Analysis (DSA) in September 2010 and the report was published in December 2010. The DSA, which incorporated non concessional borrowing, shows that Tanzania's public debt is expected to remain sustainable in the medium and long term. However, the Government recognizes that external debt sustainability is sensitive to the terms of borrowing and effective utilization of funds to finance high priority investment projects. In addition, fiscal debt sustainability is sensitive to large and persistent primary deficits. The Government will continue to control the issuance of guarantees on loans to various public institutions in order to maintain public debt sustainability.

30. The Government is committed to improving its debt monitoring capacity (including through structural benchmarks in the context of the PSI-supported program). The Government has, with the help of IMF-World Bank technical assistance, adopted the Medium Term Debt Strategy (MTDS) tool and published its results in June 2011. The Government has also established a unified single debt database under the Accountant General's Department with the aim of maintaining quality debt data under one roof.

Energy sector policies

31. Reflecting poor rains in late 2010 and a consequent reduction in hydropower generation capacity, Tanzania has suffered severe power shortages equivalent to as much as 300MW over the past year. In response, the Government has embarked on implementation of

an Emergency Power Plan (EPP) that has already resulted in a much improved power supply situation. Between July and October 2011, an additional 217.5 MW of capacity was added to the power grid, equivalent to about a third of average demand. This new emergency power generation capacity has, to a large extent, mitigated the power crisis and is expected to be adequate to tide the country through 2012, after which new generating capacities will come on line.

32. Most of the new generation capacities are based on expensive liquid fuels, rather than low-cost natural gas, whose supplies are currently constrained. The cost to the state power utility, TANESCO, of the additional power purchases considerably exceeds the current average tariff, creating subsidy needs that will diminish when low-cost gas supplies are expanded through a planned new pipeline (see below). The near term additional costs will be met by a combination of tariff adjustment and borrowing by TANESCO, which would allow it to recoup the temporary subsidies over a longer period. Accordingly, TANESCO is in the process of arranging a seven-year domestic currency bank loan amounting to TSh 408 billion (1.0 percent of GDP) which will be repaid out of future tariff revenues. To limit the near-term subsidy and provide resources for loan repayment, TANESCO has submitted an application for a tariff increase and the Government will work with TANESCO and the energy and water utility regulatory authority, EWURA, to ensure that the regulatory review is completed and that a weighted average tariff adjustment of no less than 40 percent will be implemented by end-December 2011.

33. Going forward, the Government is alert to the fiscal risks that can arise from under-funded state power sector operators, and is determined to ensure that productivity improvements by TANESCO are accompanied by tariff adjustments over the period ahead that ensure its financial viability. The Government will re-examine the adequacy of the tariff structure in the context of the fourth PSI review in light of changes in generation capacity and developments in TANESCO's costs and revenues.

34. The Government is negotiating a $1.2 billion financing package (5 percent of GDP) to finance a gas pipeline from Mtwara to Dar Es Salaam for fuel electricity generation and other uses. The planned financing package involves a combination of a concessional loan (75 percent of the total), a commercial loan (20 percent), and a contribution by the Government of Tanzania (5 percent). The commercial loan will be guaranteed by the government, and will be subject to the ENCB ceiling under the PSI. Given the scale of the project, the Government will ensure that it has a high rate of economic return, and will share with the IMF the technical and economic evaluation of the project.

35. Looking further ahead, Tanzania has recently seen favourable offshore natural gas exploration results. There appear to be good prospects that commercial quantities of natural gas will be confirmed, resulting in multi-billion dollar foreign direct investments in Tanzania's natural gas sector over the next 5 years, and the start of correspondingly large export and budget revenue flows around the end of the current decade. Discussions in Tanzania on how to position the country to best take advantage of this potential resource wealth have been initiated and a Natural Gas Master Plan will be finished by June 2012. In a macroeconomic and budget management context, considerable work will be needed, including design and adoption of a gas/petroleum revenue management bill covering the

budget treatment of gas revenues; possible launch of a future generations fund to save a portion of the resource wealth; review of Tanzania's tax regime to ensure its adequate cover of the gas sector; and development of staff expertise in the Tanzania Revenue Authority (TRA) on tax issues associated with the development and exploitation of gas. To start the preparation process, the Ministry of Finance, Planning Commission, and TRA will prepare a report by December 2012 identifying what steps will need to be taken to prepare Tanzania's macroeconomic management for the new gas economy, and identifying the nature of any corresponding technical assistance needs. The Government would welcome Fund staff contributions to this advance planning exercise, drawing on best international practice.

Monetary and exchange rate policies

36. The Bank of Tanzania (BoT) will continue to implement its reserve money targeting framework with a view to keeping core inflation in single digit levels and on track for the medium term goal of 5 percent inflation. The BoT views most of the recent hike in inflation as temporary, and likely to unwind soon on the assumption that good short-rains and harvests will reduce food inflation, and as the improved domestic power supply eases import demand for petroleum to fuel back-up generators, thereby easing pressures on the currency. At the same time, annual growth of average reserve money has been targeted to slowdown to 18 percent in the year ending June 2012, compared to 19 percent recorded in the year ending June 2011. Consistent with this, M3 growth is projected to slow from 23.7 percent in September 2011 to 20.0 percent by June 2012, giving room for credit to private sector to grow by 23 percent. The BoT will monitor risks to inflation closely, and stands ready to further tighten liquidity conditions as needed.

37. In the near term, implementation of the reserve money program will focus on unwinding a surge in reserve money in late-September that led to higher levels of liquidity through October. The BoT is sterilizing this liquidity through a combination of monetary policy instruments. The sterilization effort is also being supported by an increase in the minimum reserve requirements on government deposits from 20 percent to 30 percent effective November 2011 and the decision to raise the BoT's Bank Rate by 200 basis points to 9.58 percent from October 2011 and further to 12.00 percent in November.

38. 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. The BoT believes that recent currency pressures have been exacerbated by positions taken by banks against the shilling, and accordingly the BoT has reduced the prudential limit on the net open foreign currency position of commercial banks from 20 percent to 10 percent of core capital effective October 26, 2011. In addition, BoT has tightened the enforcement of existing restrictions on non-residents' access to credit facilities and other sources of Tanzania shilling funding, where these are not backed by underlying economic activities.

Financial sector stability

39. The BoT continues to enhance financial stability monitoring tools and arrangements in order to ensure stability and soundness of the financial system. A financial regulators forum will be launched shortly to assume joint responsibility for safeguarding the stability of the financial system and to coordinate crisis management and resolution. A draft MOU to establish the Forum has been circulated for comments. With assistance from IMF, the BoT has developed a framework for financial stability monitoring and reporting. The BoT published its first Financial Stability Report in December 2010, followed by a half year review in June 2011. A second Financial Stability Report is scheduled to be published before end-2011. To strengthen the monitoring framework, property price indices and corporate and household balance sheets will need to be developed, and the BoT has requested additional TA from the Fund to address this gap. At the regional level, arrangements for sharing regional financial soundness indicators have been put in place.

40. To promote the soundness and stability of the pension sector, the regulatory structure for the sector was set up in mainland Tanzania in 2010 by the establishment of the Social Security Regulatory Authority (SSRA) under the Social Security (Regulatory Authority) Act, 2008. The SSRA is responsible for the regulation and supervision of the pension sector in mainland Tanzania. Since its inception, the SSRA has taken steps to enhance the stability of the pension sector by: (i) reviewing the Social Security (Regulatory Authority) Act, 2008 in order to create conducive environment for effective regulation and supervision of the sector; (ii) registering the existing social security funds (SSFs) as per section 8 of the Social Security (Regulatory) Authority Act, 2008 in order to introduce regulatory oversight over the sector; and (iii) commissioning an actuarial valuation and portfolio review of all existing SSFs in order to obtain data which will form a basis for various policy decisions regarding the pension sector reform and oversight. Investment guidelines have been developed, and it is expected that the guidelines will be issued before end-March 2012.

41. The insurance sector continues to attract new players, but remains very concentrated, with the largest five insurance companies holding 66 percent of total assets as of March 2011, led by the state-owned NIC Limited with nearly 40 percent of total assets. The company is undergoing a restructuring process prior to considering its privatisation. NIC assets not directly identified with life and non-life business have been sold, with the proceeds used to settle accumulated verified claims and to modernize the business. As a result, injection of government equity into NIC has not been necessary. The level of competition in the insurance sector is expected to grow with the envisaged regulatory changes to allow banks to engage in insurance services.

42. Financial soundness indicators at end-September 2011 indicate that the banking system remains sound, profitable and liquid, in the whole. It was adequately capitalised with the ratios of core capital to total risk weighted assets and other off-balance sheet exposures of 16.8 percent and 17.3 percent, compared with the legal minimum requirements of 10.0 percent and 12.0 percent, respectively. The ratio of non-performing loans (NPLs) declined to 8.1 percent end-September 2011, from 9.3 percent end December 2010. This is partly attributed to efforts taken to improve the quality of loan portfolios by strengthening

credit underwriting and administration practices, strict follow-up and recovery of NPLs, and a focus of supervisory attention on banking institutions with high NPLs. Overall liquidity remains satisfactory with a ratio of liquid assets to demand liabilities of 41.8 percent, compared to a statutory requirement of 20 percent. The sector also continued to be profitable with return on average assets of 3.0 percent. According to self-assessment on the 25 Basle Core Principles for Effective Banking Supervision conducted in November 2010, the Bank has fully complied with 5 core principles, largely complied with 19 principles but was materially non-compliant with one core principle (i.e. BCP No. 12—Country and Transfer Risks).

43. There have been important developments in the regulation and supervision of banks aimed at enhancing soundness. In the period under review, the risk-based supervision framework was revised to reflect new developments in supervisory principles and standards and incorporate best practices in risk management. Business continuity guidelines have also been issued to banks and financial institutions, and the BoT has initiated the process of developing prudential guidelines for effective supervision of Islamic banking business, the use of which has been growing rapidly. A consultant has been commissioned to spearhead the process of putting in place a comprehensive regulatory and supervisory framework for development finance institutions.

44. Progress has been made in the establishment of a credit reference system. Credit Reference Bureau and Databank Regulations have been finalized and gazetted. A contract for the supply, installation and commissioning of a Credit Reference Databank System at BoT has been signed and the vendor has commenced work. A public notice intended to entice interested and eligible private credit reference bureau operators to apply for a license has also been issued. Potential international credit reference bureau operators have shown interest and some are seeking local partners.

45. The BoT continues to help banks and mobile network operators develop mobile banking through a mobile payment policy partnership. Mobile payment regulations have been drafted by the BoT to promote financial inclusion of the under-banked and unbanked. These will be reviewed by stakeholders by end-December 2011.

46. 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). FATF requires that Tanzania take actions to implement significant components of its AML/CFT action plan by February 2012. The Government recognizes the importance for Tanzania's financial sector of a positive FATF assessment and will take determined steps to implement its agreed action plan ahead of the above deadline. In particular, draft legislation to tighten the existing AML framework in line with FATF recommendations and address national jurisdictional issues will be submitted to parliament with a view to approval by end-February.

Statistical issues

47. The BoT currently uses the CPI excluding food and energy prices as a proxy for core inflation following revision of the CPI in November 2010. A new core inflation index is being developed, excluding some goods whose prices are subject to volatility due to weather influences and shocks to international prices.

Programme monitoring

48. Progress in the implementation of the policies under this program will be monitored through assessment criteria (ACs), indicative targets (IT), and structural benchmarks (SBs) as documented in the attached tables. The government requests a modification of the assessment criterion on NIR from measuring NIR on a stock basis to a flow basis to eliminate base effects from performance measurement. The assessment criterion on external debt is requested to be changed to make it cumulative from the beginning of the program instead of the fiscal year to allow for more flexibility in the timing of contracts within the agreed 3-year program ceiling of US$1.5 billion. The fourth review is expected to be completed by end-June 2012 and the fifth review by end-December 2012.

MEFP Table 1. Tanzania: Quantitative Assessment Criteria Under the Policy Support Instrument, June and September 2011

	June				September			
	Assessment Criteria	Adjusted Criteria	Actual	Met?	Indicative Target	Adjusted Targets	Actual	Met?
	(Billions of Tanzania Shillings; end of period, unless otherwise indicated)							
Net domestic financing of the government of Tanzania (cumulative, ceiling) [1, 2]	347	431	1244	X	122	372	304	✓
Average reserve money (upper bound) [3]	3,804	3,804	3,746	✓	4,147	4,147	4,095	✓
Average reserve money target [3]	3,766				4,106			
Average reserve money (lower bound) [3]	3,729				4,065			
	(Millions of U.S. dollars; end of period)							
Net international reserves of the Bank of Tanzania (floor) [4]	3,477	3,421	3,243	X	3,622	3,458	3,119	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]	525	525	103	✓	525	525	250	✓
Memorandum item:								
Foreign program assistance (cumulative grants and loans) [1]	1,058	1,058	1,002		299	299	24	

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 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] To be used exclusively for infrastructure investment projects. Continuous assessment criteria; ceiling applies throughout the fiscal year.

MEFP Table 2. Quantitative Assessment Criteria and Indicative Targets Under the Policy Support Instrument, December 2011-June 2012

	2011		2012	
	September	December	March	June
	Actual	Assessment Criteria	Indicative Targets	Assessment Criteria
	(Billions of Tanzania Shillings; end of period, unless otherwise indicated)			
Net domestic financing of the government of Tanzania (cumulative, ceiling) [1, 2]	304	300	296	397
Average reserve money (upper bound) [3]	4,095	4,235	4,321	4,464
Average reserve money target [3]		4,193	4,278	4,420
Average reserve money (lower bound) [3]		4,151	4,235	4,376
	(Millions of U.S. dollars; end of period)			
Change in net international reserves of the Bank of Tanzania (floor) [4]	-124	80	180	258
Accumulation of external payment arrears (continuous ceiling)	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (continuous ceiling) [5]	350	1,050	1,050	1,050
Memorandum items:				
Foreign program assistance (cumulative grants and loans) [1]	24	628	831	1,062
External nonconcessional borrowing (ENCB) disbursements to the budget [1]	191	291	441	575

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

[1] Cumulative from July 1, 2011.

[2] To be adjusted upward by up to TSh 300 billion for the U.S. dollar equivalent of any shortfall in the combined total of foreign program assistance and ENCB from the amounts shown in the memorandum items. To be adjusted downward by any ENCB disbursed for budget financing above the 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] Cumulative from July 1, 2011. Floor will be adjusted downward for any shortfall in the combined total of foreign program assistance and ENCB from the amounts shown in the memorandum items up to the equivalent of TSh 300 billion.

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

MEFP Table 3. Tanzania: Structural Benchmarks for 2011/12

Measure	Target Date	Status
Poverty Reduction Strategy		
Approval by Government of a new National Social Protection Framework (NSPF).	End-June, 2011	Proposed to be dropped. Work on a NSPF has been integrated into an ongoing, broader, national social security reform program.
Financial Sector		
Issuance of investment guidelines for pension funds.	End-September, 2011	Proposed delayed to end-March 2012 to complete an actuarial assessment.
Fiscal		
Debt management: Prepare a Medium-Term Debt Strategy consistent with resource needs under the new PRS and reflecting contingent liabilities.	End-June, 2011	Met.
Establish a unified public debt statistics database under a single monitoring unit.	End-December, 2011	Met.
Develop an index for monitoring priority social spending.	End-December, 2011	Met.

MEFP Table 4. New structural benchmarks established in the 3rd PSI review

Benchmark	Macroeconomic Rationale	Date	¶
• 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.	Reduces potential fiscal costs by strengthening TANESCO's finances	End-December 2011	32
• 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.	Improves transparency of government's finances and supports budget monitoring and control by the public	End-March 2012	28
• The Ministry of Finance will provide to the IMF the technical and economic evaluation of the proposed gas pipeline project.	Promotes evaluation of large investment projects by the government to help ensures value for money	End-June 2012	33
• 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 changes in the years ahead	End-December 2012	34
• 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.	Supports compliance with international financial norms and integrity of financial system	End-February 2012	45

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

December 23, 2011

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, indicative targets, and structural benchmarks under Tanzania's program supported by the PSI arrangement. 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

2. 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 (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.

3. 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 June 30, 2011 (as specified below, taken from International Financial Statistics.)

	US$ per currency unit
British pound	1.6008
Euro	1.4453
Japanese yen	0.0124

Reserve money and reserve money band

4. 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

5. 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 COBELMO (Russia) and the government of Bulgaria; mortgage on acquired sisal estates; compensation claims; and debt of parastatal companies assumed by the government.

Government deposits at the BoT

6. 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

7. 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.

Contracting or guaranteeing of external debt on nonconcessional terms

8. 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.

9. 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 and program exchange rates

10. 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.

11. Program exchange rates for the period October 1, 2011 through June 30, 2012 are:

	October-December 2011	January-March 2012	April-June 2012
TSh/US$ average	1,671	1,678	1,679
TSh/US$ end-period	1,678	1,679	1,680

III. ADJUSTERS

Net international reserves

12. The end-December 2011, end-March 2012, and end-June 2012 quantitative targets for the change in the BoT's net international reserves will be adjusted downward by the amount

[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.

in U.S. dollars of any shortfalls in foreign program assistance and external nonconcessional borrowing (ENCB) financing of the government budget in U.S. dollars (up to a limit of TSh 300 billion). The shortfalls will be calculated 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. Each quarterly shortfall will be converted from U.S. dollars to Tanzanian shillings using that quarter's program average exchange rate. 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

13. The end-December 2011, end-March 2012, and end-June 2012 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). The shortfalls will be calculated 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. Each quarterly shortfall will be converted from U.S. dollars to Tanzanian shillings using that quarter's program average exchange rate. 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.

14. 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

15. 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

Table 1. Summary of Reporting Requirements (continued)

Information	Reporting Institution	Frequency	Submission Lag
Summary table of: (i) average reserve money; (ii) net domestic financing of the government; (iii) stock of external arrears; (iv) new contracting or guaranteeing of external debt on nonconcessional terms; and (v) net international reserves.[1]	BoT and MoF	Quarterly	4 weeks
Amount of payment claims outstanding of more than 30 days, 60 days, and 90 days for all government ministries. For each ministry, total claims outstanding to be divided into: (i) unverified claims; and (ii) claims verified but not yet paid.	MoF	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

[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.