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Tanzania and the IMF

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July 6, 2015

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

June 18, 2015

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 a policy support instrument 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

June 18, 2015

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

Dear Madam Lagarde:

The attached Memorandum of Economic and Financial Policies (MEFP) updates the ones from June 27, 2014 and December 18, 2014 under the Policy Support Instrument (PSI). It reports on recent economic developments and sets out macroeconomic policies and structural reforms that the Government will pursue in the following three years.

The Government is confident that the policies and measures set forth in the attached Memorandum will deliver the objectives of its program. We stand ready to take further measures that may become appropriate for this purpose and that are in line with the Government's policy objectives.

The Government will consult with the IMF at its own initiative or whenever the Managing Director of the IMF requests such a consultation before the adoption of any such measures or changes to the policies described in the attached Memorandum. The Government will provide the Fund with such information as the Fund may request in connection with the progress made in implementing the economic and financial policies and achieving the objectives of the program.

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

Yours Sincerely,

/s/	/s/
Saada Mkuya Salum (MP) MINISTER FOR FINANCE UNITED REPUBLIC OF TANZANIA	Prof. Benno Ndulu GOVERNOR, BANK OF TANZANIA UNITED REPUBLIC OF TANZANIA

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

Attachment I. Memorandum of Economic and Financial Policies
June 18, 2015

I. MACROECONOMIC DEVELOPMENTS AND PROGRAM PERFORMANCE

A. Recent Macroeconomic Developments and Outlook

Output and Prices

1. Real GDP. According to quarterly accounts, GDP grew by 7.2 percent in the first three quarters of 2014. Major contributors to growth were construction (18.3 percent); wholesale and retail trade (15.8 percent); transport and storage (13.7 percent); manufacturing (8.2 percent); and agriculture, forestry and fishing (9.7 percent). Based on leading indicators of economic activities in the fourth quarter of 2014, the program growth target of 7.2 percent for 2014 is likely to be met. Growth is expected to remain strong in 2015, spurred by continued investment in infrastructure, growing electricity generation, which will boost further manufacturing activities, a recovery in exports, and the positive income shock related to the recent sharp decline in oil prices. The recently revised national accounts confirmed that the economy has diversified over time; GDP was revised upward by more than 30 percent.

2. Inflation. Inflation fell well below the medium term target of 5 percent supported by decline in global oil prices and good regional food crop harvests. In addition, a prudent monetary policy stance since the end of 2011 has helped contain core inflation to a moderate level. Headline inflation was 4.5 percent in April 2015, while core inflation declined to about 2 percent. Inflation is expected to remain low in 2015, supported by low global oil prices and the waning away of the impact of the increase in domestic power tariff implemented in January 2014.

External Sector Developments

3. Balance of Payments. The current account deficit narrowed to USD 2,002 million during July - December 2014 compared with a deficit of USD 2,281 million registered in the corresponding period of the preceding year. This largely reflected lower oil imports (-25 percent) on account of the fall in oil prices in the world market. There was a rebound in non-traditional exports, largely attributed to improved export performance of manufactured goods, re-exports, fish and fish products exports, and exports of edible vegetables and oil seeds. For the full year (2014/15) the current account balance would record an improvement (9.4 percent of GDP, down from 10.3 percent in 2013/14), thanks to the full year impact of lower oil prices.

Fiscal Performance and Financing in the First Half of 2014/15

4. Fiscal Deficit. Total revenue collection for the first half of 2014/15 was 97 percent of the revised program target and 88 percent of the budget estimate. Decrease in output experienced by some manufacturing industries producing excisable goods due to the decline in demand contributed to underperformance of excise taxes. This has undermined VAT collection as well, which also affected by challenges in the rollout of electronic fiscal devices. Import duties collection was largely affected by a shift in importation of taxable imports from the rest of the world to regional economic blocks such as EAC and SADC of which majority are either not taxed or less taxed. Income tax collection was also below expectations despite efforts to boost tax compliance. Total cash expenditure for the first half of 2014/15 remained below the program envelope, as cash budgeting helped contain monthly expenditure. The overall fiscal deficit of the central government for the first half of the fiscal year was 1.8 percent of GDP (measured from the financing side, excluding arrears accumulation). Domestic financing was front-loaded in the first quarter, but went down in late December 2014 with the disbursement of a nonconcessional loan of US$ 300 million from China Development Bank to finance various infrastructure investment projects.

Monetary Policy

5. Monetary policy stance and exchange rate developments. Growth of monetary aggregates remained in line with the program targets. M3 grew by 15.6 percent in the year ending December 2014, while private sector credit grew by about 19 percent. Money market interest rates decreased from January 2015, as liquidity conditions among banks improved following the BoT decision to reduce the Statutory Minimum Reserve (SMR) ratio on private deposit liabilities by two percentage points. Both the overnight interbank cash market rates and weighted average yields on T-bills recorded their lowest rates since December 2012 at 3.14 percent and 11.61 percent respectively at end-February 2015. The Shilling exchange rate depreciated against the U.S. dollar in recent months, as the U.S. dollar appreciated against all major currencies.

Financial Sector and Capital Account

6. Financial sector stability. The banking sector remained vibrant with adequate liquidity and capital above regulatory requirements. Asset quality improved, as indicated by the ratio of non-performing loans (NPLs) to total loans. The latter declined from 8.5 percent in September 2014 to 6.5 percent in March 2015, reflecting write off as well as efforts made by banking institutions to recover NPLs. The moratorium period of three years for increasing the absolute core capital for commercial banks from TSh 5 billion to TSh 15 billion ended in March 2015. As at 31st March 2015, 30 out of 34 commercial banks had complied with the new requirement. To cope with increasing innovations, risks and new developments in the banking sector, the BoT carried out a review of the existing prudential regulations that were issued in 2008 and came up with revised as well as new prudential regulations in 2014. New regulations were issued on consolidated supervision, while revised regulations covered matters such as capital adequacy, credit concentration, external auditors, internal controls and internal audit, liquidity management, disclosures, and prompt corrective action. In addition, the National Payment System Bill, which will allow for the issuance of regulations on mobile payments, went through first reading in the Parliament in February 2015.

7. FBME Bank. It is still under statutory management effectively from 24th July 2014 following the Notice issued on 15th July 2014 by the US Financial Crimes Enforcement Network (FinCEN) naming FBME as a bank of primary money laundering concern.. The BoT continues to closely monitor the operations of the bank in Tanzania while awaiting final FinCEN determination of the money laundering concern. The Bank is also engaging with other stakeholders so as to come up with a resolution strategy for the bank, in case the concern over the bank materializes. While the financial position and operations of the bank have been greatly affected by the notice, domestic depositors' money remain well secured.

8. Financial sector development. Mobile network operators (MNOs) in collaboration with banks have reached new milestones in the provision of financial services, with new innovative products and services which will further stimulate savings and trade across the EAC countries. In recent months MNOs have come together and signed bilateral agreements for interoperability of their mobile money services which is expected to significantly reduce costs across platforms. Furthermore, two MNOs have now been permitted to provide cross border mobile money transfers between Tanzania and Rwanda and between Tanzania and Kenya which will play a key part in increasing usage of the services for facilitating trade in the EAC region.

9. Consumer protection. The BoT has established a Complaints Resolution Desk to resolve complaints submitted by consumers of banking services. This decision is in line with the Financial Consumer Protection Strategy adopted by the National Council for Financial Inclusion. The Desk is a stop-gap arrangement pending the establishment of an Office of the Banking Ombudsman, scheduled for 2016/2017. The Desk commenced operations on 1st April, 2015 and handles disputes that have not been addressed by commercial banks to the customer's satisfaction. All banking institutions are now required to dedicate a senior officer who will handle all complaints submitted by their customers and only unresolved disputes will be submitted for resolution by the Desk.

10. Capital account liberalization. Since freer capital flows between EAC members were allowed in 2014, EAC investors have indicated interest in participating in Tanzania's capital markets, entering the market gradually, with increasing participation in the equity market. In this initial stage of liberalization, the BoT has maintained a number of prudential measures in the debt market, such as overall limits on foreign participation and minimum holding periods for investors. These measures are not aimed at deterring inflows but are designed to act as "speed bumps" to attract longer-term investors and ensure that risks are maintained at manageable levels. The BoT is constantly reviewing the experience with the controls and stands ready to modify them as regulators and the financial markets become more familiar in dealing with capital flows. The government remains committed to extending this liberalization to investors from the rest of the world by end of 2015.

IPTL case

11. Donors providing general budget support recognized in March 2015 that Tanzania's accountability institutions handled the IPTL issue in line with good governance principles. These donors pledged willingness to collaborate with the Government in pursuing further governance reforms and in strengthening the capacities of anti corruption institutions. They also indicated their intention to proceed with further gradual disbursement of budget support.

B. Program Performance

12. All assessment criteria for end-December 2014 under the PSI Program were met with comfortable margins, except for the indicative target on tax revenue. Good progress was achieved in the structural area: (i) the BoT has prepared a study on the relationship between interbank interest rates and excess reserves; (ii) the Paymaster General issued a new circular on arrears reporting. The definition of arrears has been included in a separate circular, issued on 8^{th} December 2014; (iii) The unification of the Statutory Minimum Reserve and the clearing accounts and implementation of partial reserve averaging for reserve requirements were delayed in light of the decision to tighten liquidity following excessive volatility of the Shilling. This is now expected in December 2015; (iv) in May 2015 the Government approved the policy paper on a natural gas revenue management framework, which fully integrates with the budget; (v) The report on the verification of end-June 2014 arrears was finalized with a short delay in April 2015; and (v) a strategy to address government arrears to pension funds was prepared and discussed by cabinet in early March 2015.

II. THE ECONOMIC PROGRAM FOR THE REMAINDER OF 2014/15 AND FOR 2015/16

13. **Poverty reduction strategy**. The implementation MKUKUTA II has been extended for one year to ensure a harmonized review and preparation of both MKUKUTA III and the next 5-year development plan (FYDP II), for efficient use of national capacities and resources. MKUKUTA II Priority Areas for 2015/16 were identified from assessment of MKUKUTA II and from MDGs reports. The priorities cover areas related to MDG 1 (eradicating extreme poverty and hunger), MDG 4 (reducing child mortality), MDG 5 (improving maternal health), MDG 7 (ensuring environmental sustainability, and MDG 8 (promoting global partnerships for development), as well as issues on employment creation and raising productivity in agriculture. Other priority areas are Vulnerability and Social protection, Governance with focus on the Public Financial Management Reform Programme; as well as environment and gender. These priorities aim at providing guidance to stakeholders on budgeting, resource allocation and implementation. During this period, agencies' strategic plans will continue to be aligned to the identified priority areas and FYDP I.

A. Monetary, Exchange Rate, and Financial Sector Policies

14. **Monetary policy stance**. With inflation falling below the Government's medium-term target, the statutory minimum reserve requirement was reduced in late 2014. This decision was reversed in May 2015, in light of exchange rate pressures and volatility, and was accompanied by a tightening of limits on banks' net open positions. Future changes to the monetary policy stance will depend on the inflation outlook and the liquidity conditions of banks. Based on the latest projections, private sector credit is expected to maintain a healthy pace while bank liquidity is projected to stabilize at comfortable levels. Monetary operations will be geared towards managing liquidity effectively to reduce short term interest rate volatility in the money market. The agreed monetary program also provides the flexibility to respond to seasonal factors affecting liquidity demand. The Bank will remain vigilant and monitor inflation expectations and possible price shocks so as to ensure that the positive achievements are maintained.

15. Modernizing the monetary policy framework. The BoT continues to take measures to modernize its monetary policy framework. Modification of the functionality of the Tanzania Interbank Settlement Systems to facilitate implementation of reserve averaging is ongoing and we now expect to have it in place by end-2015. The partial reserve averaging will allow banks to directly access a portion in their respective SMR balances maintained at the BoT, thereby giving them greater flexibility in liquidity management. Further, the Bank has finalized an analytical study which suggests a range of excess reserves that would help to reduce short term volatility in the IBCM overnight rate. A roadmap to price-based monetary policy framework has also been developed to facilitate the shift. To start with, it will include the following steps:

- Unification of the Statutory Minimum Reserve (SMR) and clearing accounts of banks maintained at the BoT by December 31, 2015.

- Partial reserve averaging to allow banks to directly access a portion in their respective SMR balances maintained at the BoT by December 31, 2015.

- Broaden eligible government securities that can be pledged by banks to access standby facilities at the BoT, from securities which mature within 91 days to 180 days from the date of acquisition by September 30, 2015.

- Drawing on earlier analytical work, establish by September 30, 2015 an operational target for the range of excess reserves that is consistent with the average reserve money target. This will help to reduce short term volatility in the IBCM overnight rate.

- To enhance the modeling and forecasting capabilities in the BoT, establish modeling and forecasting unit by September 30, 2015.

- Develop a composite index of economic activity using high frequency data to help assess short term dynamics of economic activity.

- Broaden the coverage of the market expectation Survey.

16. Exchange rate policy. The Bank will continue to participate in the IFEM to manage liquidity and smooth short-term exchange rate volatility while building foreign exchange reserves to stay on course with the net international reserves target.

17. Banking supervision framework. The members of Tanzania Financial Stability Forum in their December 2014 meeting agreed the following policy actions to foster financial stability in the country:

- Each financial regulatory authority to review the existing prudential regulations to accommodate new developments associated with the liberalization of the capital account for EAC residents that became effective in May 2014;
- Forum members to formulate an Integrated Road Map to steer financial system development and reforms; and

- Pension funds to harmonize their reporting period to calendar year consistent with other financial sectors.

The BoT has requested technical assistance from the IMF through East AFRITAC to carry out a diagnostic study on the challenges facing community banks and come out with recommendations on the way forward.

B. Fiscal Policies

Budget Implementation in 2014/15 and Budget Plans for 2015/16

18. Budget Implementation in 2014/15. The mid-year budget review confirmed a large revenue shortfall, compared to initial budget projections. This shortfall has required significant expenditure adjustment to allow meeting the fiscal deficit target of 3.8 percent of GDP (excluding clearance of arrears). The review was an opportunity to reaffirm key spending priorities, and in particular those related to poverty, the organization of elections, and projects covered by the Big Results Now initiative. A number of current and capital expenditures of lesser priority were also identified and will not be implemented this fiscal year. Expenditure ceilings for MDAs were revised accordingly in the Information and Financial Management System (IFMS) to cap commitments and communicated to MDAs through a circular. We are confident that these steps will prevent the accumulation of new arrears to suppliers. The mobilization of external financing will be accelerated, but is still likely to come late, which will raise challenges for expenditure execution. We intend to front load domestic financing, using favorable market conditions to step up the issuance of short-term government securities.

19. Budget Plans for 2015/16. Debt sustainability analysis done by the IMF suggests that a deficit slightly below 3 percent of GDP in the medium term is consistent with the maintenance of a low risk of debt distress. It is also consistent with our regional commitments to introduce a common currency in the East African Community in 2024. In light of this useful fiscal anchor for our public finances, we intend to further reduce the fiscal deficit to 3.5 percent of GDP (excluding arrears clearance) in 2015/16. Such fiscal prudence is also meant to send a strong signal to financial markets, at a time when we are increasingly going to rely on market financing, whether domestic or external, in the coming years. The revenue to GDP ratio is expected to increase next year on account of the new VAT law, which to some extent has reduced tax exemptions, and other tax policy measures. We also intend to implement a number of measures to fight tax evasion forcefully. To avoid having to revise expenditures downward in the course of the year, we have quantified all these measures conservatively. Tax revenue will be monitored in the program through an assessment criterion.

20. Risks and contingency measures. In light of the remaining uncertainty on the extent of donor support next year, we have used conservative assumptions for budget support grants. Should grants or revenue turn out higher than expected, expenditure could be raised accordingly, keeping the overall fiscal deficit unchanged. Conversely, should revenue turn out to underperform in the course of the year, revenue measures and/or expenditure savings would be considered so as to keep to our deficit target. In both cases, adjustments would be made through a supplementary budget.

Fiscal Aspects of Energy

21. Power sector. The financial situation of TANESCO has improved noticeably following the 40.3 percent tariff increase in January 2012 and 40 percent in January 2014 coupled with a significant reduction in the cost of power generation due to the completion and commissioning of the Mwanza 60 MW power plant by end of 2013 and utilization of hydro capacity, which allowed TANESCO to retire all but one emergency power plant by end-2014. TANESCO has also managed to reduce technical losses and to improve revenue collection by introducing prepaid meters (LUKU), Automatic Meter Readers (AMRs), disconnecting non-paying customers and installing LUKU and AMR meters in government institutions. The EWURA automatic tariff adjustment formula, which adjusts electricity tariffs quarterly to reflect changes in the exchange rate, inflation and oil prices, will maintain tariffs at or above cost-recovery. Tariffs were decreased by 2.3 percent in March 2015 to reflect the recent significant decline in global oil prices, which was partly offset by inflation and the depreciation of the shilling against the U.S. dollar. Going forward, TANESCO's financial position is expected to further improve, as the cost of power generation is projected to fall with the completion of a new gas pipeline and a gas-fueled power plant. Nevertheless, TANESCO remains in arrears to its suppliers (Tsh 344.6 billion at end-2014 and Tsh 586.5 billion at end-May 2015). Unless these arrears are cleared, TANESCO's credibility as a gas-offtaker will be further weakened with negative implications on investment decisions by the private sector to expand near-shore gas production. A strategy to address these arrears will be prepared jointly by the government, EWURA, and TANESCO by end-September 2015 (new structural benchmark).

22. Fiscal framework for managing revenues from natural gas. The prospect of a substantial increase in natural gas revenues will create significant challenges for macro-fiscal policy and PFM. To address these issues, a policy on a gas revenue management framework, which draws on international experience, was developed and approved by the Cabinet in May 2015. Our fiscal framework will be designed with a view to: (i) ensuring fiscal sustainability; (ii) promoting economic and social development; (iii) and addressing the volatility of resource revenues. Indicators such as the non-resource balance, which delinks the fiscal position from the volatility of resource revenues, will be used to deliver these principles. The strategy also lays out the principles that will be used to establish a budget management framework for resource revenues, and in particular a Natural Gas Revenue Fund. The Fund will be fully integrated into the budget process. It will operate as a government account and will not have independent spending authority. Its operations will be fully transparent, have a strong governance structure, and invest prudently.

Fiscal Aspects of Pensions

23. Government liabilities to pension funds and pension reform. Cabinet discussed in March 2015 a comprehensive strategy to deal with government liabilities to pension funds. While some more work is required to finalize the strategy and implement it, its main principles have been approved. The government has agreed to settle the arrears related to pre-1999 reform PSPF beneficiaries by issuing non-cash special bonds to the PSPF. This settlement is expected to take place in the course of 2015/16. Future liabilities to the PSPF on account of pre-1999 reform beneficiaries will be explicitly budgeted on a yearly basis. Payments totaling to Tsh 177 billion will be made by end-June 2015, and Tsh 150 billion has been budgeted for 2015/16. The government also intends to clear in 2015/16 the arrears on loans made in the past by pension funds to various government entities through bond issuance. The bonds will have a range of maturities, taking into account the pension funds' future financial cash flows and the government debt's redemption profile. Finally, the government has decided to merge pension funds, so as to reduce excessively high overhead costs. A study is being prepared with ILO on a specific proposal.

C. Public Finance and Debt Management

Management of domestic arrears

24. Clearance and settlement of supplier arrears. The verification of supplier arrears outstanding as of end-June 2014 was completed in April 2015, with a few weeks' delay. The total amount of verified arrears amounts to Tsh 863 billion. We have started to repay these arrears in 2014/15, with the bulk of settlement done in 2015/16. An allocation of about 0.7 percent of GDP has been made to that effect in the budget framework for next fiscal year. Payments are expected to be made mostly in cash.

25. Arrears monitoring. We have taken a number of measures (included in two circulars issued in December 2014 and January 2015) that we trust will improve our quarterly monitoring of arrears. In light of the importance of preventing arrears accumulation and of the availability of a better gauge, we will monitor domestic arrears through an indicative program target. The objective will be to avoid any net accumulation of arrears, once the series is adjusted for the impact of arrears clearance. The amount of arrears cleared in the last quarter of 2014/15 will be provided in a report produced by the CAG by end-September 2015 verifying the settlement of arrears. There will be quarterly reporting on payments made to settle the arrears in 2015/16, which will be used for the purpose of adjusting the indicative target on net arrears accumulation, after verification by the Internal Auditor General. Finally, we will reintroduce strict commitment controls in IFMS, effective September 1, 2015 (new structural benchmark). These controls will ensure that commitments can only be made in IFMS if consistent with budget appropriations and cash released. Sanctions will be strengthened in the Budget Act regulations.

Public debt management

26. During 2014/15 the government expects to borrow an additional US$500 million in non concessional terms to finance the budget and to contract US$292 million for the financing of the Kinyerezi II 240MW power plant. In order to assess the impact of new borrowing, particularly non concessional, on the sustainability of the national debt and to provide guidance on the composition of budget financing in 2015/16, a DSA exercise will be carried out followed by updating of the Medium Term Debt Strategy (MTDS). The updated MTDS will discuss the pros and cons of the various forms of external non-concessional borrowing, including issuing a Eurobond; it will be presented to the National Debt Management Committee and approved by the Minister for Finance by end-December 2015 (new structural benchmark). The new Debt Management Department within the Ministry of Finance is expected to be in full operation in July 2015. The National Debt

Management Policy and amendments of the Government Loans, Guarantees and Grants Act Cap. 134 will strengthen management of public debt and provide the legal underpinning for the new debt management department to effectively discharge its responsibilities. They are expected to be submitted to cabinet by July 2015.

Monitoring and Management of Fiscal Accounts in the Public Sector

27. Monitoring of parastatals. The Office of the Treasury Registrar (OTR) is setting up its own website, which will be used to disseminate the information it is collecting on the public enterprises. The website will include a list of all parastatals, with links to their most recent audited financial statements. In parallel, OTR is working on the aggregation of these financial statements, which will be used to produce more comprehensive government finance statistics. Good progress has indeed been made towards producing accounts for the general government.

28. Budget and PFM bills. The new Budget Act will provide detailed guidance in matters relating to Budget and instill budget discipline and credibility and put in place a legal framework that considers different aspects of the budget and the process as well as recognizing the legal roles and responsibility of different key stakeholders. The Public Finance Act, 2001 (as revised in 2004) is under review in order to incorporate sections which were not in the current Act and also to increase Transparency and Accountability of Public Funds which include: The preparation of financial statements using International Public Sector Accounting Standards (IPSAS), management of government assets, Internal Auditor General's Issues, electronic payments etc.

III. PROGRAM MONITORING

29. Assessment criteria for end-December 2015 and end-June 2016, and indicative targets for end-September 2015 and end-March 2016 are set as per Table 1. It is proposed to modify the NIR target for end-June 2015 to take into account the efforts made to smooth volatility on the foreign exchange market in early 2015, which led to large net foreign exchange sales. The NDF target for end-June 2015 would also be modified. New structural benchmarks are proposed in Table 2. The third and fourth reviews under the PSI are expected to take place by December 31, 2015 and June 30, 2016, respectively, on the basis of the assessment criteria and structural benchmarks indicated in Tables 1 and 2.

Table 1. Tanzania: Quantitative Assessment Criteria (AC) and Indicative Targets(IT) Under the Policy Support Instrument, December 2014–June 2016

	December 2014				March 2015				June 2015		Sept. 2015	Dec. 2015	Mar. 2016	June 2016
	Assessment Criteria				Indicative Target				AC		IT	AC	IT	IT
	Program	Adjusted Criteria	Preliminary	Met?	Program	Adjusted Criteria	Preliminary	Met?	Program	Modified	Proposed	Proposed	Proposed	Proposed
	(Billions of Tanzania Shillings; end of period, unless otherwise indicated)													
Net domestic financing of the government of Tanzania (cumulative, ceiling) [1, 2]	864	864	505	✓	446	946	1,310	✗	29	583	358	716	1,074	1,432
Average reserve money (upper bound) [3]	6,033	6,033	6,011	✓	6,219	6,219	5,844	✓	6,473	6,473	6,494	6,913	6,859	6,955
Average reserve money target [3]	5,973	6,011			6,158	6,158			6,409	6,409	6,430	6,845	6,791	6,887
Average reserve money (lower bound) [3]	5,913	5,913			6,096	6,096			6,345	6,345	6,365	6,776	6,723	6,818
Tax revenues (floor; IT through March 2015, AC thereafter)[1]	5,105	5,105	4,965	✗	7,854	7,854	7,426	✗	10,661	10,130	2,912	6,120	9,250	12,408
Priority social spending (floor; indicative target)[1]	1,200	1,200	1,387	✓	1,800	1,800	2,099	✓	2,400	2,400	700	1,400	2,100	2,800
Accumulation of domestic arrears (ceiling; indicative target)[1]										0	0	0	0	0
	(Millions of U.S. dollars; end of period)													
Change in net international reserves of the Bank of Tanzania (floor) [1, 4]	-235	-235	-77	✓	290	-13	-328	✗	608	176	137	231	305	438
Accumulation of external payment arrears (continuous AC ceiling)[1]	0	0	0	✓	0	0	0	✓	0	0	0	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (continuous AC ceiling) [5]	2,420	2,420	654	✓	2,420	2,420	934	✓	2,420	2,420	2,420	2,420	2,420	2,420
Memorandum item:														
Foreign program assistance (cumulative grants and loans) [1]	202	202	200		374	374	306		755	613	93	186	278	371
External nonconcessional borrowing (ENCB) disbursements to the budget [1]	149	149	338		846	846	364		1,147	1,010	269	537	806	1,074

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 500 billion for the U.S. dollar equivalent of a shortfall in the combined total of foreign program assistance and ENCB from the amounts shown in the memorandum item. To be adjusted downward by any ENCB disbursed for budget financing above programmed amount for the year as a whole. The 2014/15 ceiling be adjusted upward for any amount of expenditure arrears cleared during the fiscal year in excess of the budgeted amount of TSh 170 billion, and to be adjusted downward for any shortfalls compared to the same amount. The end-of-quarter limits in 2015/16 will be adjusted upward by the amount of arrears to pension funds cleared from the beginning of the fiscal year. This adjustor will be capped by the total amount of arrears identified in the strategy to clear arrears to pension funds.

[3] Assessment/performance criteria and indicative targets apply to upper bound only.

[4] Floor will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance and ENCB financing of the government up to the equivalent of TSh 500 billion.

[5] The cumulative ENCB ceiling of US$2,420 million applies from January 1, 2014 through June 30, 2016.

Table 2: Structural Benchmarks under the Policy Support Instrument. December 2014-December 2015

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Public Finance Management/Fiscal Risks			
Prepare and publish a fiscal risk statement or subcomponents of it (e.g., a listing of all PPP projects with their key features and information on government guarantees)	To enhance fiscal risk management	June 30, 2015	In progress
Paymaster General (PMG) to issue a new Circular requiring quarterly reporting of payment arrears to include a clear definition of arrears, an extension of the reporting coverage (e.g. arrears on tax refunds and debt service), an additional aging category to identify arrears of more than one year, documentation requirements, including a proof that a claim was registered in the IFMS, and a requirement that internal auditors in MDAs prescreen the arrears data before submission to the Ministry of Finance.	To enhance monitoring of arrears	December 31, 2014	Met
Prepare a report on verification of arrears as of end-June 2014 that covers all ministries, departments and agencies.	To accelerate settlement of arrears	February 28, 2015	Met with a delay in April 2015
Reintroduce commitment controls in IFMS, which will prevent commitments to be made in the system that are inconsistent with budget appropriations and cash releases	To reduce the risk of arrears accumulation	September 1, 2015	New benchmark
Prepare a strategy to address TANESCO arrears	To enhance fiscal risk management	End-September 2015	New benchmark

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Monetary, Financial and Exchange Rate Policies			
Conduct a review of the relationship between the interbank cash market rates and excess reserves of commercial banks as a step to transitioning to a more interest rate-based monetary management framework.	To prepare BoT's gradual shift to a price-based monetary framework.	December 31, 2014	Met
Unify the Statutory Minimum Reserve and the clearing accounts that banks maintain at the BoT and implement partial reserve averaging for reserve requirements	To reduce excessive volatilities in short term money market interest rates.	April 30, 2015	Not met, in light of the decision to tighten liquidity following excessive volatility of the Shilling. Proposed to be rescheduled for end-2015.
Establish a modeling and forecasting unit at BoT	To improve liquidity and inflation forecast and facilitate the shift to a price-based monetary framework	End-September 2015	New benchmark
Pension System			
Prepare and adopt a strategy to address government arrears to pension funds	To improve the sustainability of the funds	February 28, 2015	Not met. A broad strategy was discussed by the Cabinet and approved in March 2015, but required more work before finalization.

Measure	***Macroeconomic rationale***	***Target date***	***Status***
Public Debt Management			
Update the medium-term debt management strategy, and obtain approval by the Minister for Finance	To enhance public debt management	December 31, 2015	New benchmark
Public Enterprise Management			
Treasury Registrar to publish the audited accounts of public enterprises	To improve transparency and accountability of public enterprises	September 30, 2015	In progress
Managing Natural Resource Wealth			
Prepare a draft policy paper on natural gas revenue management framework that fully integrates with the budget.	To strengthen fiscal sustainability and improve transparency in the use of natural gas resources	March 31, 2015	Met

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

June 18, 2015

I. INTRODUCTION

1. The purpose of this Technical Memorandum of Understanding (TMU) is to describe concepts and definitions that are being used in the monitoring of Tanzania's program supported by the PSI, comprising the quantitative assessment criteria, the indicative targets and structural benchmarks monitored under the PSI.

2. The principal data sources are the standardized reporting forms, 1SRF and 2SRF, as provided by the Bank of Tanzania (BoT) to the IMF, and the government debt tables provided by the Accountant General's office.

3. The program exchange rate is TSh/USD1,649.

II. DEFINITIONS

Net international reserves

4. Net international reserves (NIR) of the BoT are defined as reserve assets minus reserve liabilities. The change in NIR is calculated as the cumulative change since the beginning of the fiscal year. The BoT's reserve assets, as defined in the IMF BOP manual (5th edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS), include: (i) monetary gold; (ii) holdings of SDRs; (iii) the reserve position at the IMF; (iv) all holdings of foreign exchange; and (v) other liquid and marketable assets readily available to the monetary authorities. Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guaranteed for a third party external liability (assets not readily available). The BoT's reserve liabilities include: (i) all short-term foreign exchange liabilities to nonresidents, of original maturities less than one year; and (ii) outstanding purchases and loans from the IMF.

5. NIR are monitored in U.S. dollars, and for program monitoring purposes assets and liabilities in currencies other than U.S. dollars shall be converted into dollar equivalent values using the exchange rates as of December 31, 2014 (as recorded in the balance sheet of the BoT).

	US$ per currency unit
British pound	1.5587
Euro	1.2147
Japanese yen	0.0097
Australian dollar	0.9236
Canadian dollar	0.9082
Chinese yuan	0.1608
SDR	1.4488

Reserve money and reserve money band

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

Net domestic financing of the Government of Tanzania

7. 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 ODCs) and the nonbank public.

8. 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 for the 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;

(iv) loans and advances to the government, and holdings of government securities and promissory notes by other public entities (e.g. pension funds) not covered by the central government accounts; and

(v) 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.

(vi) NDF will be measured net of any accumulation of central government claims on the Tanzania Petroleum Development Corporation (TPDC) as a result of the on-lending of an external credit to finance a gas pipeline.

Government deposits at the BoT

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

External payment arrears

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

Priority social spending

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

Tax revenues

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

Domestic arrears

13. **Expenditure arrears** are defined as unpaid claims that are overdue by more than 30 days for goods and services and more than 90 days for contract works as set out in the government's Circular No 9 of 8th December 2014. These will include payments for tax refunds, employee expenses (wages and salaries, staff claims for travel, transfer and other non-salary allowances), utilities, rents, recurrent goods and services, and construction works. The indicative target on expenditure arrears is calculated as a change in the stock of expenditure arrears at the end of each quarter from the stock as of March 31, 2015. This change should be adjusted for the impact of any centralized clearance of arrears following the verification completed in April 2015.

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

Contracting or guaranteeing of external debt on nonconcessional terms

15. 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 contracting and guaranteeing external nonconcessional debt is continuous and applies throughout the year.

16. Government debt is considered nonconcessional if the grant element is lower than 35 percent, computed using a discount rate of 5 percent. 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

17. 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 13 and 14.

III. ADJUSTERS

Net international reserves

18. The end-of-quarter quantitative targets for the change in the BoT's net international reserves will be adjusted downward by the amount in U.S. dollars of any shortfalls in (a) foreign program assistance and (b) external nonconcessional borrowing (ENCB) financing of the government budget in U.S. dollars (up to a limit equivalent to TSh 500 billion at the program exchange rate).

19. The shortfalls will be calculated relative to projections for foreign program assistance shown in table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Polices of the Government of Tanzania titled "Quantitative Assessment Criteria, and

[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, National Development Corporation; National Housing Corporation; and Tanzania Airport Authority.

Indicative Targets under the Policy Support Instrument". For purposes of the adjuster, ENCB is measured excluding any non-concessional financing contracted for the gas pipeline.

20. Each quarterly shortfall will be converted from U.S. dollars to Tanzanian shillings using the program exchange rate (paragraph 3). 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

21. The end-of-quarter quantitative limits on the net domestic financing of the Government of Tanzania will be adjusted upward for any shortfalls in the combined total of foreign program assistance and ENCB financing of the government budget in U.S. dollars (up to a limit of TSh 500 billion). The shortfalls will be calculated relative to projections for foreign program assistance and ENCB financing shown in the Table on "Quantitative Assessment Criteria and Indicative Targets under the PSI" attached to the MEFP. For purposes of the adjuster, ENCB is measured excluding any non-concessional financing contracted in for the gas pipeline. Each quarterly shortfall will be converted from U.S. dollars to Tanzanian shillings using the program exchange rate (paragraph 17). The cumulative shortfall will be the sum of all quarterly shortfalls in Tanzanian shillings from the beginning of the fiscal year up to the date of assessment.

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

23. The end-2014/15 limit will be adjusted upward for any amount of expenditure arrears cleared during the fiscal year in excess of the amount included in the baseline projection (TSh 170 billion). The limit will be adjusted downward for any shortfalls compared to the same amount. The amount of expenditure arrears cleared during the fiscal year will be confirmed by the report from the CAG, to be prepared no later than September 30, 2015.

24. The end-of-quarter limits in 2015/16 will be adjusted upward by the amount of arrears to pension funds cleared from the beginning of the fiscal year. This adjuster will be capped by the total amount of arrears identified in the strategy to clear arrears to pension funds.

IV. DATA REPORTING REQUIREMENTS

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
Daily excess reserves of commercial banks	BoT	Weekly	1 week
Daily data on transactions trough IFEM by exchange rate and volume, separating BoT and commercial bank transactions	BoT	Weekly	1 week
Daily data on reserve money and its components	BoT	Daily	1-day
Consumer price index.	NBS	Monthly	2 weeks
The annual national account statistics in current and constant prices.	NBS	Annually	6 months
The quarterly national account statistics in constant prices.	NBS	Quarterly	3 months
Balance sheet of the BoT (1SRF) and the currency composition of official foreign assets and official foreign liabilities.	BoT	Monthly	1 week
Consolidated accounts of other depository corporations and the depository corporations survey (2SRF and the DCS).	BoT	Monthly	4 weeks
Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor.	MoF	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; and (v) net international	BoT and MoF	Monthly	4 weeks

Information	Reporting Institution	Frequency	Submission Lag
reserves.[1]			
Amount of arrears outstanding that are overdue by more than 30 days for goods and services and more than 90 days for contract works as set out in the government's Circular No 9 of 8th December 2014 for all government ministries.	MoF/AGD	Quarterly	4 weeks
The flash report on revenues and expenditures.	MoF/AGD	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 ENCB, 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 14 of the TMU during the period including terms and conditions according to loan agreements.	MoF	Quarterly	4 weeks
Quarterly report on loans and advances to government by pension funds and other public entities not covered by the central government accounts	MoF	Quarterly	4 weeks
Report on priority social spending	MoF	Quarterly	6 weeks

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