May 2011
IMF Country Report No. 11/105

United Republic of Tanzania: 2011 Article IV Consultation and Second Review Under the Policy Support Instrument—Staff Report; Debt Sustainability Analysis; Informational Annex; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the United Republic of Tanzania.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2011 Article IV consultation with Tanzania and Second Review Under the Policy Support Instrument, the following documents have been released and are included in this package:

- The staff report for the combined 2011 Article IV consultation and Second Review Under the Policy Support Instrument, prepared by a staff team of the IMF, following discussions that ended on March 16, 2011, with the officials of Tanzania on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 21, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- Debt Sustainability Analysis.

- Informational Annex.

- A Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its May 6, 2011, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- A statement by the Executive Director for Tanzania.

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

Letter of Intent sent to the IMF by the authorities of Tanzania*
Memorandum of Economic and Financial Policies by the authorities of Tanzania*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

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INTERNATIONAL MONETARY FUND

UNITED REPUBLIC OF TANZANIA

Staff Report for the 2011 Article IV Consultation and Second Review Under the Policy Support Instrument

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

Approved by Saul Lizondo and Dominique Desruelle

April 21, 2011

- **Fund relations:** A new 3-year PSI-supported program was approved by the Executive Board on June 4, 2010. The first review was completed on a lapse of time basis on December 3, 2011.

- **Staff team:** Martine Guerguil (head), Frank Lakwijk, Matthew Gaertner (all AFR), Abdoul Wane (FAD), Chris Papageorgiou (SPR), and John Wakeman-Linn (senior resident representative).

- **Discussions:** Held in Dar es Salaam during March 3–16. The team met with the Minister for Finance, Mr. Mkulo; the Governor of the Bank of Tanzania, Professor Ndulu; the Permanent Secretary of the Prime Minister, Mr. Lyimo; the Permanent Secretary of the Treasury, Mr. Khijjah; other senior officials; and representatives of the private sector, civil society, development partners, and the press. Mr. Ndyeshobola (OED) participated in the discussions.

- **Review:** All continuous and end-December 2010 assessment criteria were met and progress was made in implementing structural reforms. Staff recommends completion of the second review under the PSI, modification of the end-June 2011 assessment criterion on international reserves, and re-phasing of structural benchmarks.

- Tanzania joined the Fund on June 10, 1962, and accepted the obligations of Article VIII, Sections 2, 3 and 4 on July 15, 1996. Tanzania maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. Tanzania has a floating exchange rate arrangement.

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Appendix

Executive Summary

- **The economic rebound has leveled off**. Tanzania weathered the impact of the global financial crisis relatively well, with growth in 2010 estimated at 7 percent. However, activity may now be softening under the impact of below-normal rainfall. Consumer price inflation is rising largely due to supply factors. The economy should rebound quickly once the weather situation normalizes and return to an annual growth rate of 7-7½ percent over the medium term.

- **Large investments are expected to increase the weight of commodity sectors in Tanzania's output and exports.** Policies should aim to preserve the competitiveness of non-commodity sectors, including emerging manufacturing exports, through forceful efforts to improve the business environment (including governance), also in a regional context.

- **Rapid population growth is putting pressure on the delivery of public services, far outpacing the growth of domestic revenue and foreign aid.** A combination of spending rationalization, tax policy reforms and enhanced public financial management will be called for to maintain fiscal balance. Although an effective reform of tax and spending policies requires time, there is some urgency in providing a signal to investors and donors of the authorities' intentions at the time of the 2011/12 budget. The authorities are committed to embark on a path of fiscal consolidation and more realistic budgets. Staff recognizes, however, that next year's spending containment plans are ambitious in view of the need to safeguard priority spending. Attainment of the authorities' budget targets may be challenging if the risk of donor aid shortfalls and higher international fuel prices were to materialize.

- **Revenue collection in 2010/11 is falling short of ambitious budget targets, partly because of the adverse weather situation.** In spite of recent spending cuts, a financing gap may remain. The authorities are determined to align spending with available resources while strictly enforcing commitment controls to prevent a further accumulation of arrears.

- **Staff recommends the completion of the second review under the PSI.** All quantitative assessment criteria have been met and structural reforms are advancing, even if with some delays. Staff supports the authorities' request for modification of the end-June 2011 assessment criterion on international reserves and re-phasing of structural benchmarks.

I. BACKGROUND

1. **The economy has performed strongly over the past decade and progress has been made towards the MDGs.** Tanzania's tradition of peaceful elections has provided a solid basis for private sector development. Growth has averaged 7 percent since 2000. The country's abundant natural resources have spurred a robust expansion in exports, and opportunities remain plentiful. The authorities have implemented wide-ranging policy reforms over the past decades and recently were able to use the fiscal space accumulated in better years to mitigate the impact of the global financial crisis.

2. **However, Tanzania faces formidable challenges.** Per capita income is about US$550, reflecting earlier decades of stagnation and high population growth. Poverty declined only slightly over the last decade and remains widespread, with one in three living below the poverty line.[1] Tanzania is highly dependent on foreign aid, projected to peak at 10 percent of GDP this year.[2]

3. **The new poverty-reduction strategy (MKUKUTA II) was recently launched.**[3] While seeking to consolidate recent advances in the coverage and delivery of social services, the new strategy envisages greater focus on agriculture and private sector development in order to accelerate the decline in income poverty.

4. **The PSI, which was approved by the Executive Board in June 2010, supports efforts to reduce poverty within a stable macroeconomic environment.** Its objectives include maintaining a strong fiscal position, low inflation, and low risk of debt distress, while rebuilding fiscal buffers. The PSI-supported program also aims to create fiscal space for infrastructure investment—critical for accelerated growth—together with the consolidation of social sector gains, in line with MKUKUTA II. Structural reforms seek to enhance the returns to public spending and deepen the financial sector.

II. RECENT DEVELOPMENTS AND ECONOMIC OUTLOOK

5. **Tanzania weathered the adverse shocks of recent years relatively well.** Activity slowed in the aftermath of the global financial crisis but rebounded in the second half of

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[1] Poverty fell from 35.6 percent of the population in 2001 to 33.3 percent in 2007 and indications are that it has changed little since then.

[2] Tanzania is the fourth largest foreign aid recipient in the world in terms of total flows (excluding Iraq and Afghanistan).

[3] The new National Strategy for Growth and Reduction of Poverty (MKUKUTA II) was approved in September 2010 and launched in January 2011 ("Tanzania: Poverty Reduction Strategy Paper," Country Report No. 11/17, January 2011); it covers the period 2010/11 to 2014/15 and is discussed in "United Republic of Tanzania—Poverty Reduction Strategy Paper—Joint Staff Advisory Note."

2009, thanks in part to supportive fiscal and monetary policies (Figure 1). Consumer price inflation fell into single digits as good harvests pushed down food prices. Financial market indicators remained sound overall.

6. **The economic rebound has leveled off**. Growth in 2010 is estimated at 7 percent with continued strong performance in manufacturing, construction, and communications and a more subdued expansion in agriculture and gold mining. Credit to the private sector gained steam through the year, expanding by 22 percent (year-on-year) in January 2011 as confidence returned following the global financial crisis. The external current account widened slightly in 2010 as a broad-based pickup in imports offset strong growth in traditional and manufacturing exports, while the impact of rising gold prices did not match higher oil prices. The reserve cover remained comfortable at 4.7 months of imports at end-2010. Consumer price inflation was 5½ percent in December 2010 but rose to 7½ percent in February 2011, largely due to supply factors—namely, a rise in food prices after lower-than-expected rainfall in Tanzania and neighboring Kenya, as well as higher energy prices. Core inflation (which excludes food and energy prices) has risen little and was 5 percent in February, in line with the authorities' medium-term inflation objective.

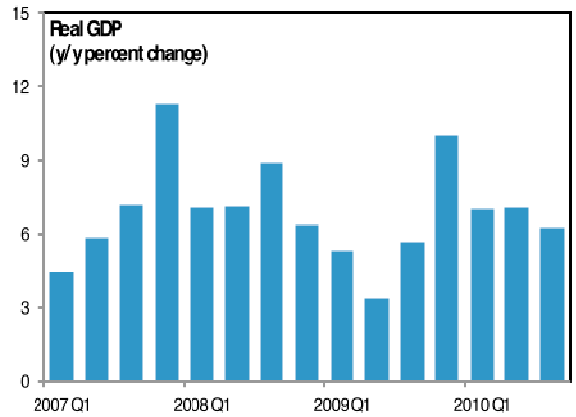
7. **Revenue collection for 2010/11 has fallen short of targets, constraining public spending and contributing to the emergence of arrears** (Figure 2).[4] Spending was cut by 1 percent of GDP (with respect to budgeted levels) in the context of the mid-year budget review. The cuts were spread across a range of departments and agencies, but priority programs were spared. Expenditure was also reallocated to make room for a higher wage bill (amounting to ½ percent of GDP, partly reflecting hires in the education and health sectors) and to bring on-budget ¾ percent of GDP in previously unbudgeted arrears related to road construction. The authorities identified these arrears in the context of the mid-year budget review through a focused investigation of unpaid claims reported by ministries and agencies. Additional unpaid claims are to be paid, once verified, through the normal cash budgeting procedures. Steps were taken to tighten spending commitment controls, including through the stricter application of administrative sanctions.

8. **Monetary policy has become less accommodative.** Growth in reserve money slowed, in line with the PSI program's targets for December and March, as foreign aid was disbursed and the government repaid central bank advances. Short-term interest rates rose from mid-2010 lows of 3 percent to 5¼ percent in mid-March 2011 as bank lending and government debt issuance increased, although they remain negative in real terms. The

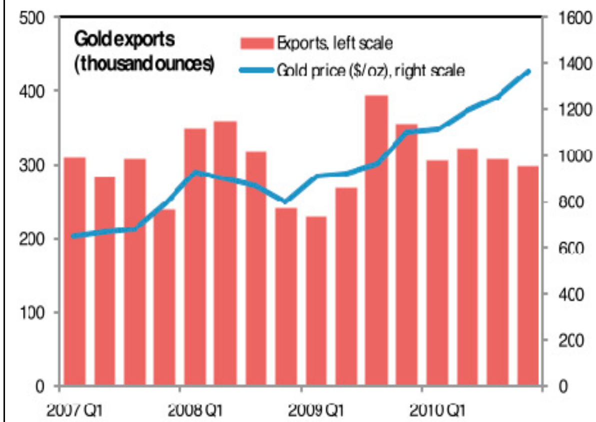
[4] The fiscal year ends June 30.

Figure 1. Real Sector Developments

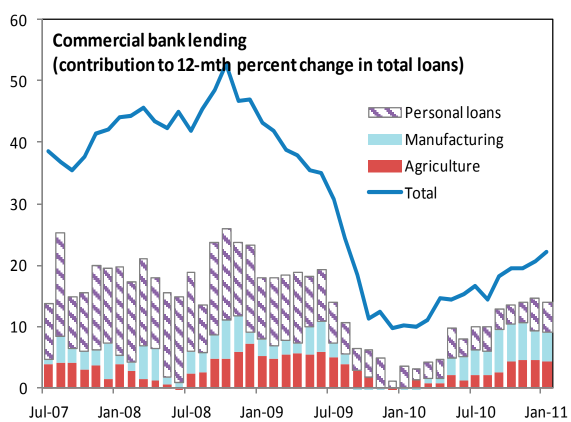
Real GDP growth rebounded in 2010 from the slowdown in the first half of 2009…



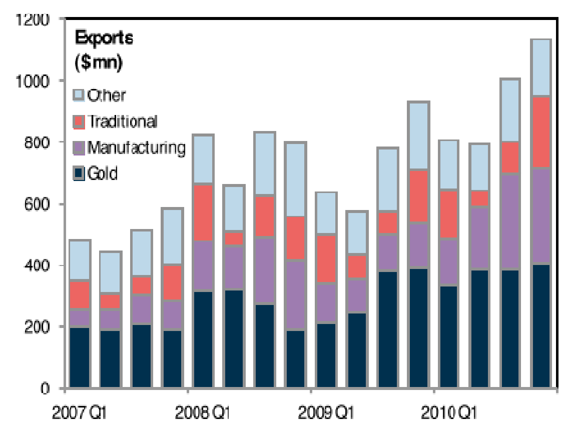
…despite a decline in gold production.



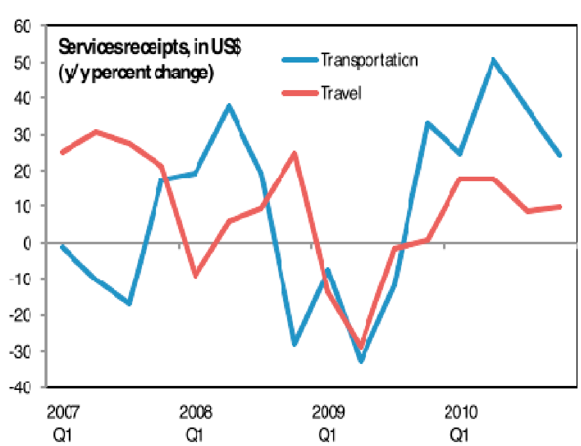
The non-mining economy has been supported by an acceleration in credit growth …



… with an increase in both traditional and manufacturing exports ….



… and a strong rebound in services receipts.



Inflation eased considerably during 2010, but rising food and fuel costs pushed up prices in early 2011.

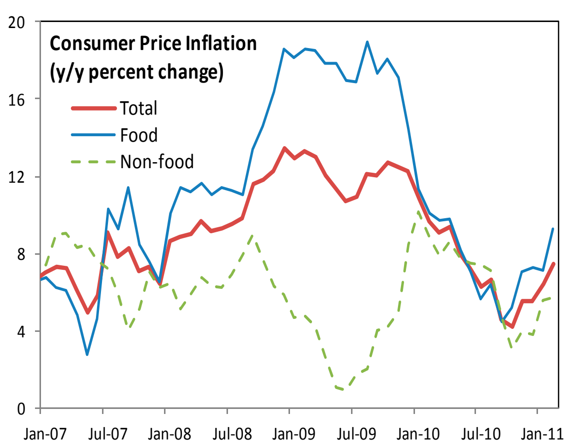
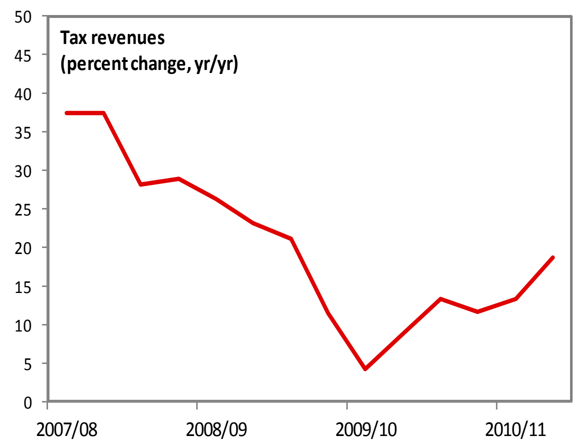
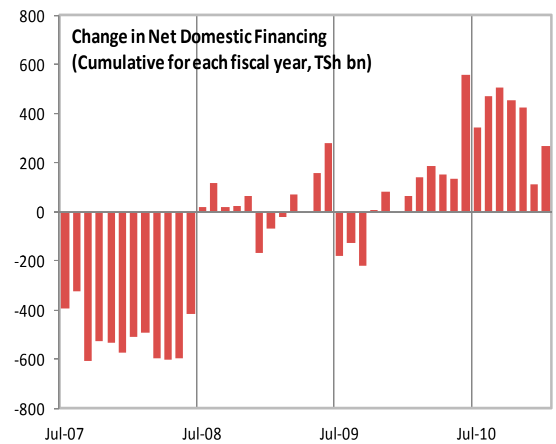


Figure 2. Recent Fiscal and Monetary Developments

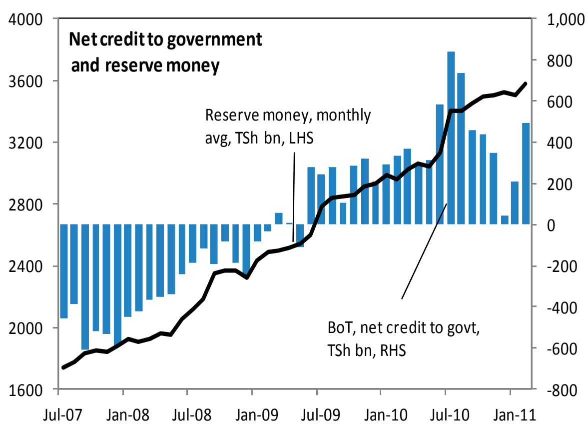
H1 tax revenues showed relatively strong growth, but still fell short of target.



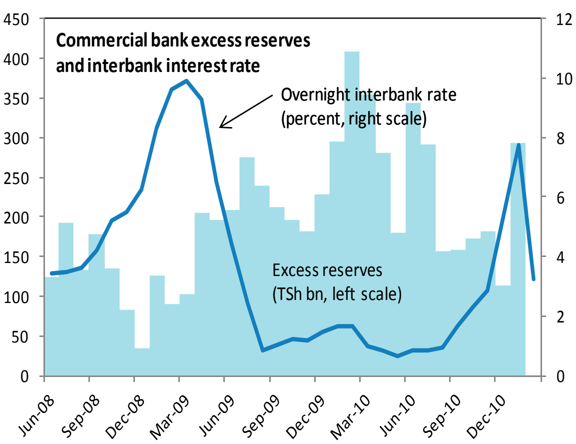
NDF declined in December but increased again in January ...



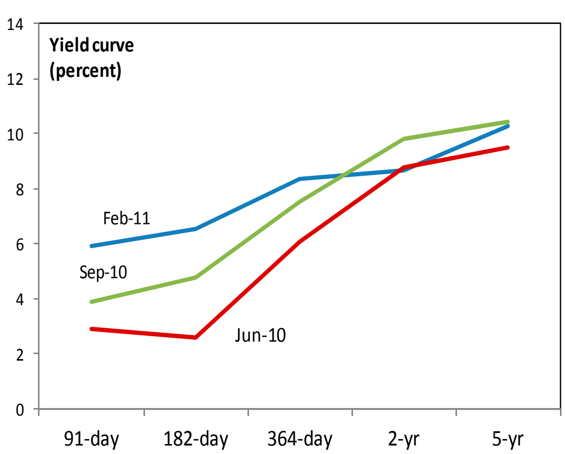
… reflecting renewed use of BoT credit to the government in early 2011.



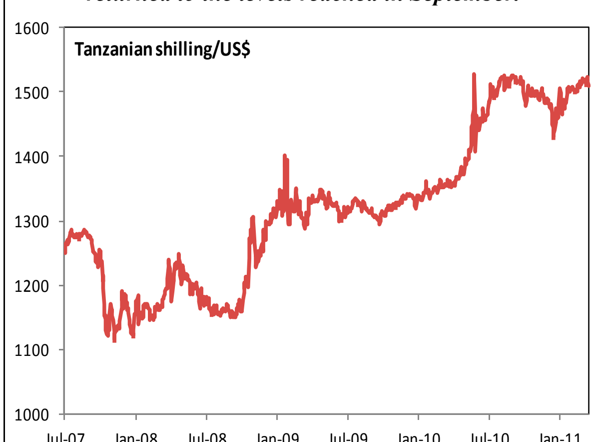
Interbank rates spiked briefly as banks' excess reserves fell at the end of 2010…



… while yields on shorter-term government securities have risen since mid-2010.



The shilling appreciated briefly in Q4 2010, but has since returned to the levels reached in September.



exchange rate has been stable in recent months reflecting relatively modest inflation differentials and rising domestic interest rates. Non-performing loans remained at manageable levels after jumping in the second half of 2010, largely reflecting deterioration in personal loans, which expanded significantly in recent years.

9. **Looking ahead, there are indications that activity may be softening under the impact of adverse weather and international fuel price conditions.** Poor rainfall late in 2010 disrupted domestic electricity generation. The lower output from hydro sources, combined with fast-rising demand for electricity and lagging investment, has led to widespread power rationing and taken some edge off growth, particularly in the trade and manufacturing sectors. The rising price of fuel is adding to the cost of replacement power generation for the private and public sectors alike. The drought could also adversely affect the 2011 food harvest.

10. **The near-term economic outlook is subject to a higher-than-average degree of uncertainty with a rising risk of donor aid shortfalls and higher international fuel prices.** Real GDP growth is projected to decline in the coming months but rebound by the end of the year, provided power provision returns to near normal levels; annual growth would dip to 6 percent in 2011 and return to 7 percent in 2012. The extent of spring rains and related speed of power restoration bear significantly on the 2011 growth projection, carrying both upside and downside risks through their effect on agriculture and activity in general. Other adverse risks include a shortfall in donor aid, based on early indications by development partners, and continued high international oil prices above recent projections. Over the medium term, growth could gradually rise to 7½ percent thanks to large investments in mining and continued growth in the non-mining economy. Inflation will likely spike above 7½ percent in 2011 as hikes in international fuel prices are feeding through, but return to around 5 percent quickly thereafter as international food and fuel price pressures ease.

III. Performance Under the PSI

11. **All continuous and end-December quantitative assessment criteria were met** (Table 7). Net international reserves and reserve money were comfortably within their respective limits. Net domestic financing of the government fell below its program ceiling by a significant margin, due in large part to early disbursement of foreign official assistance.

12. **Implementation of the structural reform program has slowed** (Table 8). Only two of the seven structural benchmarks due for the second review under the PSI have been met, in the areas of public financial management (reporting on unpaid claims) and price statistics (introduction of a measure of core inflation). Noticeable progress was made towards most other benchmarks, but capacity constraints and changes following the October 2010 elections often delayed implementation. The authorities are requesting a re-phasing of the relevant benchmarks.

- The preparation of a new medium-term debt management strategy is well advanced and should be completed shortly.

- The draft proposal for the establishment of a national social protection framework is being updated at the request of the new Cabinet; it is expected to be submitted for consideration in the coming months.

- Finalization of both the pension fund investment guidelines and the index tracking poverty-reduction spending has been hampered by technical capacity limitations but should be completed before year-end with the help of additional technical support from development partners.

- On the financial side, a range of measures have been introduced (also supported by extensive technical assistance) to ensure the adequate provision of liquidity to banks in case of crises. Efforts are now focusing on establishing a more comprehensive crisis resolution framework, also with technical assistance, and the structural benchmark could be dropped.

IV. Medium-Term Opportunities and Challenges

13. **The Tanzanian economy is undergoing far-reaching changes.** Partly reflecting shifts in the composition and direction of global demand, commodity sectors are expected to further increase their weight in output and exports as planned investments are rolled in. At the same time, manufacturing exports, mostly directed to the East African common market, are gaining strength—a promising trend given their higher productivity and employment generation potential. On the demand side, rapid population growth is putting pressure on the delivery of public services in the infrastructure and social areas, far outpacing the growth of domestic revenue or foreign aid. These emerging trends could have significant implications for macroeconomic policy design. Against this background, the medium-term policy discussions focused on the need to enhance competitiveness and the role of fiscal policy.

A. Enhancing Competitiveness

Sources and level of growth

14. **The Tanzanian economy is becoming more diversified.** The exploitation of Tanzania's underground resources is accelerating at the same time as other non-traditional sectors are blossoming; tourism remains a mainstay. International financial and trade linkages, such as with China, are intensifying (Box 1).

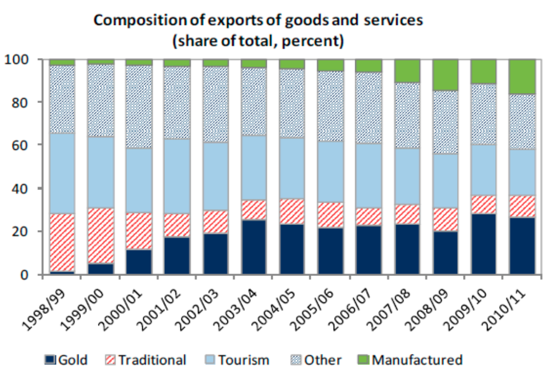
15. **The mining sector is expanding and attracting potentially large flows of FDI.** Gold exports have increased from negligible 10 years ago to around US$ 1½ billion currently (a quarter of exports of goods and services). Considerable exploration has taken place in nickel, uranium, and gas, all of which are believed to have significant potential, with a large

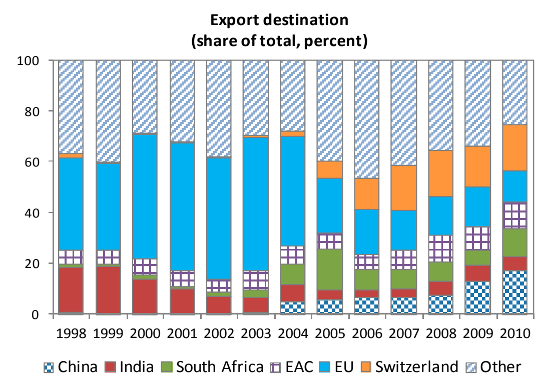
investment in uranium expected to move forward by mid-2012. In addition, a Chinese firm has recently won the tender for a US$3 billion investment in an iron ore and smelting project and related coal field.

Box 1. Sustaining Tanzania's High Growth Path Through Exports

The composition of exports has changed. Traditional exports—cash crops such as cotton, coffee, and tea that were the basis of the colonial economy—have declined while gold now constitutes 40 percent of goods exports, making Tanzania the fourth largest gold exporter in Africa. Tourism has grown steadily and manufacturing exports have surged since 2005. Overall, however, the weight of exports in the economy remains relatively limited (25 percent of GDP in 2010) although trade reforms in the mid 1990s substantially reduced the level and dispersion of tariffs and non-tariff barriers.

Tanzania's main trading partners have also changed. Exports have shifted from the EU to Switzerland, China, and South Africa (reflecting gold trade) as well as the East African Community (EAC).





Rising commodity demand provides an opportunity. Tanzania has received large FDI into the gold sector, and significant flows are expected to develop other commodities—iron ore, coal, gas, and uranium. Experience across countries has shown that investment in extractive sectors can quickly lift output, but that it is a challenge to add higher value added activities and avoid damage to other tradables sectors resulting from upward exchange rate pressures. One channel to benefit from commodity exports is to translate them into higher revenue collection and, aided by good public financial management, effective government spending.

The emerging manufacturing exports can be a key ingredient of Tanzania's structural transformation into an emerging market economy. At present, manufacturing exports are mostly destined for the EAC common market where strengthening demand provides opportunities. To allow full exploitation of comparative advantages remaining non-tariff barriers need to be eliminated and regional norms and investment rules harmonized.

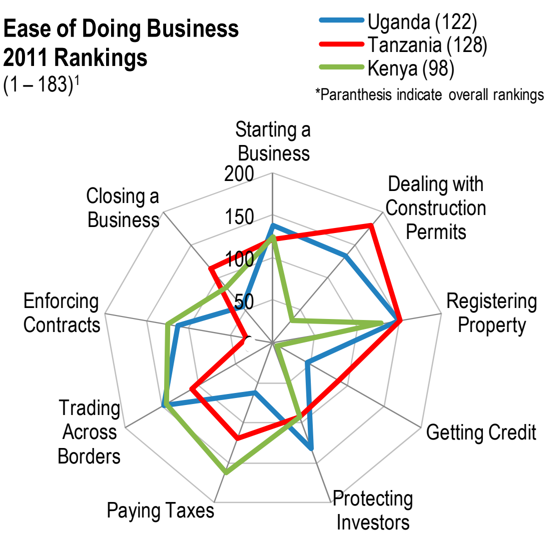
16. **At the same time, manufacturing exports have recently shown signs of dynamism.** Earnings from the export of manufactured goods are exceeding US$1 billion a year (twice the level of traditional exports) following a sharp increase after the global financial crisis. Much of the expansion is reportedly in paper products, fertilizers, and apparel.

Policy implications and discussions

17. **The floating shilling has supported the diversification of Tanzanian exports and will be maintained.** An exchange rate assessment by staff suggests that the currency, while slightly on the strong side, remains broadly in line with fundamentals (Box 2), a conclusion the authorities shared. The exchange rate will continue to be determined by market forces, with only sporadic official intervention to smooth out excessive volatility.

18. **Increases in FDI and commodity exports raise well-known challenges for the competitiveness of other sectors.** The authorities acknowledged that the inflows could lead to exchange rate appreciation and reduce the competitiveness of tradables sectors such as manufacturing that are important for employment creation. Export processing zones and special economic zones have been established, supported by favorable tax regimes, to encourage production with an eye to the regional market.[5] Staff noted that boosting competitiveness will require more forceful steps to improve the business environment (including governance), which is by most measures poor. Tax collection and public investment systems may also have to be strengthened to ensure that proceeds from commodity exports are successfully intermediated into other sectors of the economy.

Ease of Doing Business 2011 Rankings
(1 – 183)[1]



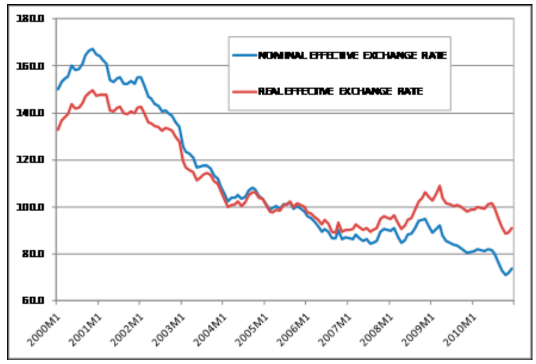
[1] A high ranking (i.e., a low number) on the ease of doing business index means the regulatory environment is conducive to the operation of business.
Source: World Bank

19. **The potential lumpiness of FDI flows in the context of Tanzania's relatively thin financial markets could exacerbate exchange rate volatility.** New instruments (such as currency swaps) and liquidity management policies could be developed to mitigate the disruptive impact of excessive volatility on exporters. Over the longer term, the modalities of exchange rate and reserve management will need to be adapted to the shift from official to private sources of foreign exchange. The authorities looked forward to engaging further with staff on these issues.

[5] The authorities are exploring, with World Bank support, the scope for institutional improvements in the zones, including lower reliance on fiscal incentives.

Box 2. Exchange Rate Assessment

The Tanzanian shilling remained relatively stable during the global financial crisis, reflecting in part Tanzania's limited exposure to international capital flows. Like in other countries in the region, the currency appreciated prior to the global financial crisis but depreciated thereafter. The faster depreciation in mid-2010 was due in part to low domestic interest rates.[1]



The Tanzanian shilling is estimated to be broadly in line with economic fundamentals. The three standard complementary staff approaches suggest only a mild potential overvaluation, well within error margins:[2]

Exchange Rate Valuation Assessment
(in percent)

Methodology	Current Account/GDP		REER
	Norm	Underlying CA	Degree of overvaluation
Macroeconomic Balance	-6.4	-7.8	2.5
External Sustainability	-4.1	-7.8	6.7
Equilibrium Real Exchange Rate	…	…	4.2

- **The Macroeconomic Balance approach suggests the shilling is near equilibrium.** A depreciation of 2.5 percent is estimated to be required to reduce the underlying current account deficit to the "norm" of 6.4 percent of GDP (given an estimated current account elasticity of -0.55).

- **The External Sustainability approach also suggests that the shilling is close to equilibrium.** To shrink the current account deficit to the net foreign liability stabilizing deficit (estimated at 4.1 percent of GDP), a depreciation of 6.7 percent would be required (given an estimated current account elasticity of -0.55).

- **The Equilibrium Real Exchange Rate approach, which models the exchange rate directly, indicates the shilling is close to equilibrium as well**. The estimated overvaluation is 4.2 percent.

[1] See ¶7 in "United Republic of Tanzania: First Review Under the PSI," IMF Country Report No. 10/351, December 2010.
[2] See M. Opoku-Afari and S. Dixit, 2010, "Exchange rate assessment in the EAC countries", draft Working Paper, for an application of the three methodologies in EAC countries.

B. The Role of Fiscal Policy

20. **Significant challenges are also emerging in the fiscal area.** With rapid population growth, demand for public services is expanding, particularly in the social and infrastructure areas. Without explicit policy action, however, revenue growth can be expected to lag behind. The authorities agreed that with little prospects of increases in foreign aid, maintaining fiscal balance would call for an in-depth reassessment of the current fiscal policy framework.

Government revenue and spending trends

21. **Tax revenues have stalled.** After years of gains, they have stabilized near 15 percent of GDP, well below potential (Box 3). Limited progress has been made to bring the informal sector into the tax base and several budgeted tax reforms have been postponed. The growing mining sector has so far had little net fiscal impact and this is unlikely to change in the coming years, partly because of large embedded tax holidays.

Box 3. Renewing Reform Efforts in Tax Policy and Administration

The authorities implemented major revenue-enhancing reforms over the last decade. In tax administration, a common taxpayer identification number was introduced, the VAT registration threshold was raised, and a Large Taxpayers Unit created. Electronic fiscal devices were recently introduced to reduce VAT evasion. The customs department was modernized and risk assessment improved. In tax policy, the number of brackets of the personal income tax was reduced and the top rate cut to equate it with the corporate income tax rate. VAT loopholes were minimized and excise rates automatically adjusted to inflation. The reforms improved the business climate by reducing red tape in paying taxes and raised annual tax revenue by about 6 percentage points of GDP.

Progress has stalled in recent years, and tax revenues have remained broadly unchanged as a share of GDP over the last four years. The emphasis has shifted to administrative measures which, however, face decreasing returns over time. Efforts to reduce some tax exemptions ran into stiff opposition and were not successful.

Domestic resource mobilization has significant room for improvement. It is estimated that actual revenue collection (on the basis of the existing tax structure) fell short of potential by an estimated 6 percent of GDP in 2008, compared to a shortfall of 2 percent of GDP in Kenya.[1] Tanzania's tax performance lags behind comparators in nearly all categories: corporate income tax collection is only half as good as in the rest of sub-Saharan Africa, VAT compliance is substantially lower, and excise tax rates are lower than in other EAC countries.

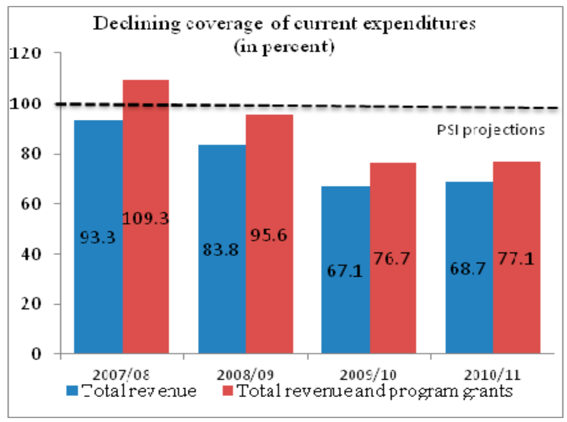
Tax exemptions are not well monitored and cost the government 3½ percent of GDP per year. Room exists to reduce VAT, import duty, and excise tax exemptions and exercise more rigorous control over them.

[1] See "Domestic Resource Mobilization for Poverty Reduction in East Africa: Tanzania Case Study," African Development Bank, December 2010.

22. **Expenditures are rising.** They are largely driven by current outlays, which increased from 14.9 percent of GDP in 2007/08 to 18.8 percent of GDP two years later. This partly reflects the counter-cyclical response to the global financial crisis. However, even before the recent stimulus package current spending was rising.

23. **Wages have doubled relative to GDP over the last decade and now absorb 40 percent of tax revenue.** The increase is due to a combination of salary hikes and new hires, including in the social sectors. The wage bill does not capture the full cost of public compensation, as per diems, allowances, and pension contributions are reported under "other" goods and services, and in some cases wages are included in investment spending. Pressures on the wage bill are expected to continue given the need to recruit additional teachers and health workers to build on recent gains in education and health.

24. **The high level of current spending is crowding out investment.** Current outlays, which typically get funded first, exceed the reliable revenue sources (external budget support and domestic revenue) by over 20 percent. As a result, domestically-financed investment depends on the remaining, less stable resources, which leaves it vulnerable to unexpected, cost-increasing, cutbacks.



25. **The cash budgeting system has not prevented the emergence of domestic arrears.** Recent budgets were based on overly optimistic revenue projections that provided more spending room than was actually available. A shortage of resources combined with a high level of non-discretionary spending reduced space for short-term borrowing and insufficient commitment controls led to the accumulation of domestic arrears in early 2010/11.

Policy implications and discussions

26. **With unchanged policies, the fiscal deficit and the debt level would gradually approach unsustainable levels** (Box 4). Assuming that the share of aid is unchanged or declining, a high spending path with flat revenue would imply a growing dependence on non-concessional domestic or foreign borrowing and a higher public debt burden, an outlook the authorities did not dispute. Staff considers that the overall deficit (after grants) will need to be gradually narrowed to under 4 percent over the medium term to keep total public debt sustainable.

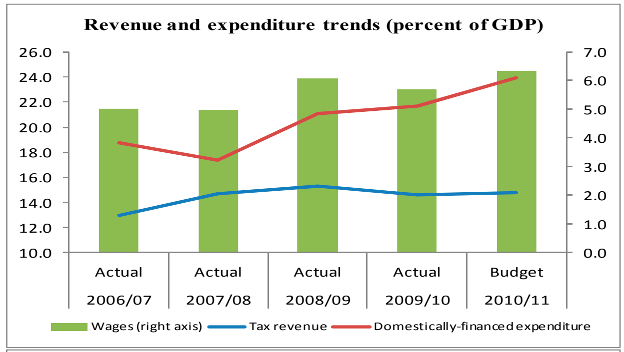
27. **In the staff's view, a combination of spending cuts, tax policy reforms, and enhanced public financial management would be advisable to restore fiscal balance.** Expenditure restraint would need to be carefully managed to leave room for spending in priority areas and high-yield infrastructure investment. Although the process can be spread

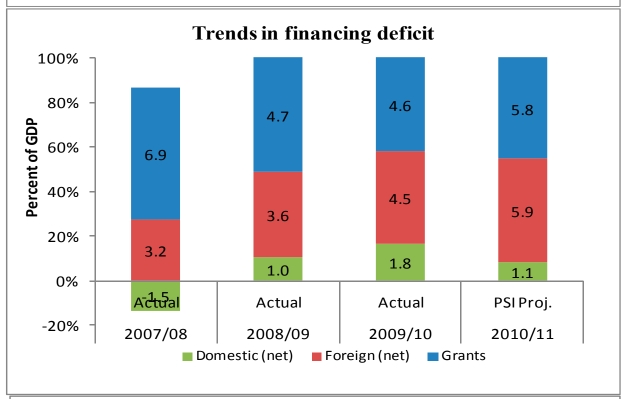
Box 4. Current Fiscal Trends Threaten Fiscal Sustainability

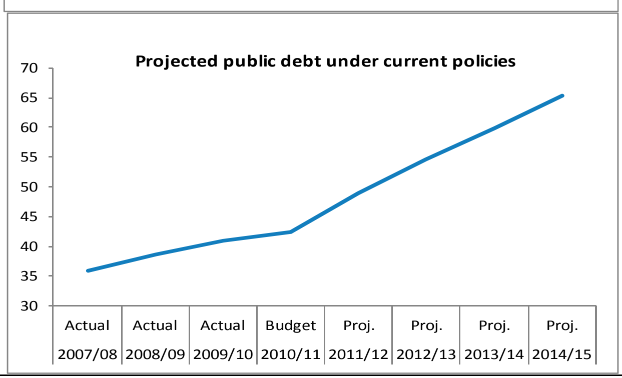
The rapidly increasing fiscal deficit has been financed with increasingly expensive resources. The deficit (excluding grants) rose from 1 percent of GDP in 2007/08 to 6.9 percent of GDP in 2009/10. Financing became less concessional, shifting from mostly grants to more use of (concessional) foreign loans as well as (nonconcessional) domestic financing.

Maintaining current policies could increase the deficit by some 3 to 4 percentage points of GDP by mid decade. The widening deficit would become increasingly costly to finance. Shallow local capital markets limit the scope for domestic financing, increasing reliance on non-concessional external financing. As a result, public debt would rise rapidly to 66 percent of GDP in 2014/15. Debt servicing costs would grow concomitantly.

Alternatively, keeping borrowing near current levels would require sizeable changes in revenue and spending policies. A projected deceleration in overall foreign aid in coming years is making the finding of solutions more urgent.







over a number of years, there would be strong benefits in initiating the effort with the 2011/12 budget, to raise public awareness and bolster credibility. The authorities broadly agreed with this approach and indicated that they will begin work to obtain the political support that is needed for fiscal restraint.

28. **There is scope for reducing and streamlining current spending.** In the staff's view, the 2009/10 fiscal stimulus needs to be unwound and spending on goods and services brought to their pre-crisis level, which was several percentage points of GDP lower. Existing subsidies (such as transfers to higher education students, subsidies to utility companies and to agricultural producers) could be better targeted. In addition, the growth in the wage bill must be stabilized while providing space for recruitments in social sectors. Determined efforts to increase spending efficiency, including for investment projects, are needed to make room for

necessary expenditures within the spending envelope. The authorities agreed on the direction of the needed changes. They indicated that a number of task forces have been established, including for example on wage policy, but have not yet reached final conclusions.

29. **The tax base could be expanded and excise tax rates raised.** Staff observed that exemptions have unduly multiplied, particularly for the VAT, and could be usefully scaled down. The authorities noted they were aware of the issue but had run into political difficulties when attempting to curtail exemptions. They indicated they were therefore putting the onus on tax administration reforms. Staff agreed there was scope for tighter enforcement of current tax laws, but noted that the yield would likely be diminishing after several years of advances in this area. The authorities indicated they would carefully study the recommendations of recent IMF TA on tax policy, which detailed the scope for reducing exemptions, suggested room for raising excise tax rates, and explored options regarding mining taxation.

30. **Revenues from the (mostly gold) mining sector are relatively small.** Annual gold exports have risen from US$ ½ billion to US$ 1½ billion (7 percent of GDP) in the last five years due to the rise in the price of gold. Meanwhile, government revenues from major gold mining companies have remained at around US$ 100 million a year (½ percent of GDP). They comprise mainly taxes on wages and some royalties as the terms of the 1998 mining act and agreements with mining companies have provided significant corporate income tax holidays. As a result, none of the existing gold projects have paid material income tax to date.

31. **Despite recent efforts, revenues from existing gold mines may not grow much.** With continued high gold prices, about ¼ percent of GDP in annual income tax may begin to be collected in the coming years from existing gold mines, and after mid decade this may rise to perhaps ¾ percent of GDP. However, net increases in revenue will be relatively small in the near term because of the offsetting impact of accumulated VAT and fuel tax refund claims. Stepped-up efforts to bring to resolution past—and highly contentious—tax disputes with existing gold mines, together with improvements in mining tax administration, as per the commendations of recent TA, could generate some additional revenue. A new mining act was passed in 2010 but existing gold mines remain governed by their respective agreements.

32. **Stronger budget procedures could increase the effectiveness of the cash-budgeting system.** Staff agreed with the authorities that the system had served Tanzania well and should be maintained. Staff noted, however, that the emergence of domestic arrears was a sign of its limitations and that a more realistic budget was needed to avoid overburdening it. The authorities are studying the recommendations of recent IMF TA to strengthen their cash-budgeting operations.

33. **Public investment management could be strengthened to improve prioritization**. The authorities envision developing a medium-term investment plan, setting up a capital

projects database, and establishing a capital investment unit in the Ministry of Finance. Staff welcomed these intended reforms and added that the institutional responsibilities for project appraisal had to be clarified, with the Ministry of Finance retaining a gatekeeper role.

V. Short-Term Policy Issues

34. **The threat of a protracted weather-related supply shock and rising international fuel prices puts additional pressure on near-term fiscal and monetary management.** The authorities were of the view that the impact would be relatively short-lived and thus did not call for modifications in program targets at this point. They are committed to preserving Tanzania's hard-won financial stability and expressed their readiness to tighten policies as needed.

Fiscal policy

35. **A financing gap of about 1 percent of GDP remains for 2010/11 after the mid-year revision of the budget.** With power shortages likely to put a damper on revenue growth during the second half of 2010/11, revenues are projected to rise to 16.1 percent of GDP. This is up from 15.8 percent of GDP in the previous year (partly because of administrative measures) but still short of the authorities' revised mid-year projection.

36. **The authorities are determined to compress actual spending to align it with available resources** (MEFP ¶13). To that end, they intend to downsize or delay lower-priority programs and projects while making room for exceptional expenditure related to the power crisis.[6] The authorities trust such spending restraint can be implemented without adverse impact on the delivery of social services or new arrears accumulation. In particular, they are confident that their recently-increased strategic grain reserve will allow them to alleviate any food shortage that could arise in case of a protracted drought. Staff stressed the importance of a well-prioritized approach that focuses on the control of discretionary recurrent spending while safeguarding high-priority investment and social programs.

37. **Staff strongly endorsed the authorities' intent to embark on a path of fiscal consolidation starting with the next budget.** The deficit (after grants) would be reduced to 6 percent of GDP in 2011/12 and gradually to below 4 percent of GDP thereafter (MEFP ¶27 and ¶29). The authorities are committed to increasing the realism of budget revenue forecasts to reduce the scope for underfunded spending commitments. Their baseline (unchanged policies) revenue projection of 16.3 percent of GDP for 2011/12 is consistent with staff's forecast. Staff welcomed the authorities' intent to include in the budget quantified estimates of the impact of any proposed tax measure. Staff also endorsed the plan to expand the contingent reserve to 5 percent of total expenditure (net of foreign-financed projects) so as to

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[6] The authorities are accelerating investment in two new thermal generators while stepping up fuel imports to make up for the shortfall in hydro power generation.

create a sufficient buffer for unexpected revenue, spending, or financing developments. The authorities and staff agreed that the expenditure containment plans for next year were ambitious. Attainment of the budget targets may be challenging if the risk of donor aid shortfalls and higher international fuel prices were to materialize.

38. **Existing spending commitment controls must be strictly enforced to help prevent the reemergence of arrears.** Staff welcomed the authorities' resolution to tighten oversight in this area and stressed the need for continued vigilance (MEFP ¶13). The newly-established regular monitoring of unpaid claims could help to identify pressure points early.[7] Additional actions could be considered, such as a strengthening of procurement procedures, or a thorough audit of the processes that led to the emergence of unpaid claims. The authorities agreed to consider possible options, taking as a starting point the recommendations of the recent PFM TA mission. Staff will closely monitor developments in this area, including to help make sure that arrears are not used as a source of financing outside the program.

39. **The authorities intend to make full use of the non-concessional borrowing agreed under the PSI** (US$525 million, or 2 percent of GDP, in 2010/11). Negotiations are reportedly well advanced, including for a loan tied to the construction of the two new power plants. The authorities are interested in obtaining a credit rating and placing a sovereign bond next year. Staff reiterated that non-concessional borrowing should be reserved for well-designed, growth-enhancing, infrastructure projects where economic/financial returns exceed borrowing costs.

40. **Tanzania's risk of debt distress remains low.** An updated DSA shows external debt indicators would remain below indicative country-specific thresholds even after borrowing under non-concessional terms the planned US$1.5 billion over three years.[8] However, scenario analysis indicates that the debt indicators are sensitive to further borrowing on expensive terms. This highlights that a sound debt management strategy, a conservative approach to non-concessional borrowing, and stronger capacity for public investment planning and execution are key for maintaining future debt and fiscal sustainability. As mentioned earlier, a continued widening of the fiscal deficit would also undermine sustainability, buttressing the importance of fiscal restraint.

41. **Debt management processes should be strengthened as a matter of urgency.** As Tanzania's debt is rising and its composition becomes more complex, its accurate tracking (including debt from state-owned enterprises) and assessment of embedded risks become critical inputs into policy design. Staff welcomed plans to unify debt monitoring and data

[7] Unpaid claims for all ministries and agencies will now be reported to the Fund on a quarterly basis with a lag of four weeks.

[8] See supplement.

recording responsibilities in a single unit (a structural benchmark for June 2011), in line with the recommendations of recent technical assistance (MEFP ¶18). The finalization and publication of a new debt management strategy should also receive priority (the authorities request the re-phasing of the relevant benchmark for June). Staff strongly encouraged the authorities to build up technical expertise in this area as soon as possible.

Monetary and financial sector policies

42. **The authorities are carefully monitoring inflation in the context of rising food and fuel prices.** While the first-round impact of these supply-side shocks must be accommodated, a tighter monetary policy stance would be needed were broader inflationary pressures to arise. Thus far the pick-up in inflation is largely contained to food and fuel prices. Nonetheless, the Bank of Tanzania will monitor core inflation closely and make necessary adjustments to ensure that the reserve money target is consistent with emerging demand, in line with program objectives. The authorities and staff view the recent increase in short-term market rates as appropriate given the direction of inflation. The Bank of Tanzania will maintain its regular foreign exchange sales while allowing the exchange rate to remain market-determined.

43. **Financial sector reforms are ongoing and aligned with recommendations from the recent FSAP.** The inaugural Financial Sector Stability report was published in December and progress is being made towards the establishment of a credit reference system (MEFP ¶35). A financial regulators forum has been created to coordinate financial sector oversight and crisis management. Staff encouraged the authorities to promptly finalize investment guidelines for pension funds so as to make the newly established regulator fully operational (the authorities request the re-phasing of the related benchmark to September 2011—MEFP ¶36).[9] The authorities are also encouraged to continue implementing their action plan to address strategic deficiencies in anti-money laundering and combating the financing of terrorism, particularly by reviewing the relevant legal framework. The authorities are also preparing, with support from development partners, including the World Bank, for Tanzania's integration in the EAC single market.

44. **The Bank of Tanzania is working on the establishment of a comprehensive crisis management framework.** Measures have been introduced to help identify impending liquidity shortfalls and facilitate access to emergency liquidity facilities in the event of a crisis (MEFP ¶32). Following FSAP recommendations, efforts are now focused on developing a broader crisis resolution framework, which will include different forms of liquidity support. As the related structural benchmark is no longer relevant, the authorities

[9] The authorities' efforts to reform the pension system are being supported by a multi-year World Bank program.

request that it be dropped. The development of the broader framework is likely to stretch well into 2012 and could be incorporated in the program once its timeline is clarified further.

45. **Staff noted the importance of continued vigilance regarding credit quality, especially given the sharp increase in the volume of lending in recent years.** While overall bank soundness indicators remain strong, non-performing loans rose from 6.6 percent of gross loans at end-2009 to 9.3 percent at end-2010, reflecting the impact of the global financial crisis in some sectors as well as higher delinquency in personal loans after their rapid growth over the past few years. The Bank of Tanzania has stepped up its oversight, particularly of provisioning levels, and is monitoring developments closely (MEFP ¶34).

Structural policies

46. **The recent slowing of progress with structural reforms may suggest the need to reassess structural priorities.** Institutional responsibilities are still being defined following the elections, with the newly-created Planning Commission expected to take a leading strategic role. In that context, it could attempt to better prioritize and coordinate structural reforms, taking due account of existing administrative and technical capacities. A main task of the Planning Commission will be the strengthening of public investment processes and improving links between medium-term investment plans and the budget. Consideration could be given at the time of the next review to including structural measures in this area in the program.

47. **Structural reforms directly related to poverty reduction programs could also benefit from new momentum.** The two remaining benchmarks under the PSI in this area have been repeatedly delayed. The new national social protection framework is expected to receive due consideration in the coming months. Staff strongly encouraged the authorities to develop an index for monitoring social spending on the basis of the recent reclassification of budget items. The authorities are requesting technical assistance to facilitate achievement of this goal.

VI. Program Monitoring

48. **The quantitative assessment criteria and structural benchmarks for end-June and end-December 2011 (the third and fourth review of the PSI) are presented in the authorities' Memorandum of Economic and Financial Policies (MEFP) (Attachment I to the Letter of Intent).** The assessment criteria for end-June 2011 (MEFP Table 3) are unchanged from the first review, except that the floor on net international reserves has been slightly raised to reflect projected changes in balance of payments flows. MEFP Table 4 presents the structural benchmarks that are proposed for the remainder of 2011.

VII. Staff Appraisal

49. **Ongoing changes in the global economy offer Tanzania opportunities to raise its economic growth and accelerate poverty reduction.** Tanzania has achieved strong growth over the past decade on the back of extensive market-oriented reforms and fiscal consolidation, but the impact of these efforts may be wearing off. The growing effect of electricity shortages on economic activity highlights the extent to which infrastructure deficiencies will increasingly weigh on medium-term growth if they remain unaddressed. The business environment (including governance) should be improved to boost economic competitiveness.

50. **Strong commitment to fiscal consolidation will be needed over the next several years.** The expansionary fiscal policies of the past several years need to be reined in, policy buffers restored, and preparations made for a likely deceleration in foreign aid. Tax policy measures as well as spending rationalization are needed to respond to the growing demand for public services. More realistic budgets and better spending commitment controls would help contain arrears. Strengthened debt management capacity and public financial management, in particular in investment, are also essential.

51. **Early evidence of the commitment to control the deficit is critical for investor and donor confidence.** Although an effective reform of tax and spending policies may require time, there is some urgency in providing quickly a signal of the authorities' intentions in this area. The 2011/12 budget in particular will be closely watched. Staff welcomes the authorities' public commitments to pursue fiscal restraint. Staff recognizes, however, that next year's spending containment plans are ambitious in view of the need to safeguard priority spending. Attainment of the authorities' budget targets may be challenging if the risk of donor aid shortfalls and higher international fuel prices were to materialize.

52. **The gradual shift to a less accommodative monetary policy has been an appropriate response to the recovery in economic activity.** The authorities will need to remain vigilant to the impact of rising food and energy prices.

53. **Staff recommends the completion of the second review under the PSI.** All quantitative assessment criteria have been met and structural reforms are advancing, even if with some delays. Staff supports the authorities' request for re-phasing of the structural benchmarks, elimination of the structural benchmark on a liquidity assistance framework, modification of the end-June 2011 assessment criterion on net international reserves, and setting of end-December 2011 assessment criteria.

54. **Staff recommends that the next Article IV consultation be held on a 24-month cycle, in accordance with Decision No. 14747-(10/96), 9/28/2010, as amended.**

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

.	2008/09	2009/10	2010/11		2011/12	2012/13	2013/14
			Prog.[5]	Proj.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)						
National income and prices							
Real GDP growth (calendar year)[1]	7.4	6.0	7.0	7.0	6.0	7.2	7.5
Real GDP growth (fiscal year)	6.7	6.5	7.1	6.5	6.6	7.4	7.5
Consumer prices (period average)	11.8	10.5	5.8	6.3	7.0	5.2	5.0
Consumer prices (end of period)	10.7	7.2	5.5	7.5	5.5	5.0	5.0
External sector							
Export, f.o.b (in millions of U.S. dollars)	3,268	3,754	4,269	4,683	5,188	5,711	6,336
Imports, f.o.b. (in millions of U.S. dollars)	-6,220	-6,570	-7,549	-7,873	-8,750	-9,452	-10,174
Export volume	8.3	6.4	7.7	9.9	6.9	8.9	9.6
Import volume	10.4	4.5	10.1	7.3	5.4	8.0	7.4
Terms of trade	7.5	8.4	0.1	0.3	-1.8	1.1	0.9
Nominal effective exchange rate (end of period; depreciation= -)	-3.7	-3.7	…	…	…	…	…
Real effective exchange rate (end of period; depreciation= -)	7.0	0.5	…	…	…	…	…
Money and credit							
Broad money (M3)	18.5	25.1	20.2	20.1	19.0	18.6	18.1
Net foreign assets	15.8	25.3	17.0	19.1	10.1	9.0	8.5
Net domestic assets	21.7	25.0	23.8	21.2	29.1	28.0	26.1
Credit to nongovernment sector	33.1	16.7	22.2	23.0	20.8	20.7	20.7
Velocity of money (GDP/M3; average)	3.6	3.4	3.2	3.2	3.1	2.9	2.8
Treasury bill interest rate (in percent; end of period)[2]	7.0	4.5	…	…	…	…	…
	(Percent of GDP)						
Public Finance							
Revenue (excluding grants)	16.2	15.8	16.3	16.1	16.3	16.5	16.7
Total grants	5.1	4.6	5.8	6.4	6.4	6.0	5.4
Expenditure	26.1	27.4	29.1	29.0	28.6	27.6	26.2
Overall balance (excluding grants)[3]	-9.9	-11.6	-12.8	-12.9	-12.4	-11.1	-9.4
Overall balance (including grants)[3]	-4.8	-6.9	-7.0	-6.5	-6.0	-5.2	-4.1
Domestic financing	0.8	1.8	1.0	1.0	1.0	1.0	1.0
Domestic debt stock (end of period)	12.2	13.1	12.4	12.4	11.9	11.5	11.2
Savings and investment[1]							
Resource gap	-11.9	-11.8	-11.9	-12.6	-12.3	-11.4	-10.4
Investment	29.0	28.7	29.1	28.8	29.0	29.3	29.4
Government	8.6	9.8	9.0	11.3	11.3	10.6	10.0
Nongovernment[4]	20.4	18.9	20.0	17.5	17.7	18.7	19.3
Gross domestic savings	17.0	16.9	17.2	16.2	16.6	17.9	18.9
External sector							
Current account balance (excluding current transfers)	-13.5	-11.4	-13.4	-12.6	-13.1	-12.3	-11.2
Current account balance (including current transfers)	-10.2	-8.6	-10.5	-9.5	-10.7	-10.1	-9.1
	(Millions of U.S. dollars, unless otherwise indicated)						
Balance of payments							
Current account balance (excluding current transfers; deficit= -)	-2,833	-2,578	-3,078	-2,944	-3,326	-3,430	-3,405
Gross official reserves (end of period)	2,930	3,483	3,774	3,831	4,133	4,430	4,685
In months of imports of goods and services (current year)	4.5	5.1	4.8	4.7	4.5	4.5	4.4
External debt stock (end of period; percent of GDP)	27.1	30.0	32.6	35.1	38.4	40.2	40.7

Sources: Tanzanian authorities and IMF staff estimates and projections.

[1] Data are on calendar year basis. For example, 2008/09 data are for calendar year 2008.

[2] End-year (June) monthly weighted-average yield of 35-, 91-, 182-, and 364-day treasury bills.

[3] Does not include adjustment to cash basis.

[4] Including change in stocks.

[5] From the first review under the PSI.

Table 2a. Tanzania: Central Government Operations, 2008/09–2013/14 [1]
(Billions of Tanzania Shillings)

	2008/09	2009/10	2010/11			2011/12	2012/13	2013/14
			Budget	Prog.[6]	Proj.[7]	Proj.	Proj.	Proj.
Total revenue	4,293	4,800	6,176	5,652	5,584	6,397	7,317	8,374
Tax revenue	4,044	4,428	5,639	5,223	5,154	5,904	6,718	7,689
Import duties	359	367	466	443	457	524	596	682
Value-added tax	1,231	1,390	1,861	1,629	1,613	1,847	2,102	2,406
Excises	762	838	1,063	988	885	1,014	1,154	1,320
Income taxes	1,229	1,334	1,642	1,574	1,623	1,859	2,115	2,421
Other taxes	463	499	606	589	576	660	751	860
Nontax revenue[2]	249	372	538	430	430	492	599	685
Total expenditure	6,907	8,312	10,770	10,093	10,044	11,260	12,255	13,105
Recurrent expenditure	4,681	5,700	6,951	6,464	6,269	6,690	7,409	7,975
Wages and salaries	1,609	1,723	2,205	2,164	2,363	2,481	2,803	3,160
Interest payments	243	249	364	354	287	469	544	587
Domestic	208	208	235	278	211	343	374	410
Foreign[3]	35	41	129	76	76	126	170	177
Goods and services and transfers[2]	2,830	3,728	4,381	3,946	3,619	3,740	4,061	4,228
Development expenditure	2,226	2,611	3,819	3,629	3,774	4,570	4,847	5,130
Domestically financed	906	1,005	1,366	1,366	1,366	1,573	1,778	2,006
Foreign financed	1,320	1,607	2,453	2,263	2,408	2,997	3,069	3,124
Overall balance before grants	-2,614	-3,512	-4,593	-4,441	-4,460	-4,864	-4,939	-4,731
Grants	1,340	1,405	2,021	2,008	2,219	2,499	2,649	2,683
Program (including basket grants)[4]	798	924	853	969	1,089	931	988	1,038
Of which: basket grants	194	258	222	285	345	392	414	435
Project	462	439	899	770	861	1,338	1,409	1,481
MDRI (IMF) grant relief	68	22	0	0	0	0	0	0
MCA funding	12	20	269	269	269	229	253	165
Overall balance after grants	-1,275	-2,107	-2,573	-2,432	-2,241	-2,365	-2,290	-2,048
Adjustment to cash[5]	60	167	0	0	0	0	0	0
Overall balance (cash basis)	-1,215	-1,940	-2,573	-2,432	-2,241	-2,365	-2,290	-2,048
Financing	1,215	1,940	2,573	2,432	2,241	2,365	2,290	2,048
Foreign (net)	956	1,380	1,943	2,056	1,864	1,972	1,845	1,547
Foreign loans	984	1,448	1,985	2,104	1,907	2,098	2,046	1,896
Program (including basket loans)[4]	495	752	446	608	479	545	539	566
Of which: basket loans	163	194	256	246	242	296	205	215
Project	489	696	808	692	692	741	789	829
Nonconcessional borrowing	0	0	731	804	736	812	719	501
Amortization	-27	-68	-42	-48	-43	-127	-201	-349
Domestic (net)	214	560	600	347	347	393	444	501
Bank financing	214	585	…	297	297	353	394	451
Nonbank financing	0	-25	…	50	50	40	50	50
Privatization proceeds	45	10	30	30	30	0	0	0
Memorandum items:								
Public domestic debt (in percent of GDP)	12.2	13.1	13.1	12.4	12.4	11.9	11.5	11.2
Recurrent expenditures (percent of total revenue)	109	119	113	114	112	105	101	95
Nominal GDP	26,497	30,321	34,750	34,652	34,656	39,336	44,446	50,112

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

[1] Fiscal year: July–June.

[2] In 2008/09, nontax revenue includes the recovery from a fraudulent payment made from the government's EPA account managed by the Bank of Tanzania. Local Government Authorities' own revenues (about 0.5 percent of GDP), and the equal amount of transfers, are included starting from FY2009/10.

[3] Some projected external debt obligations are under negotiation for relief with a number of creditors.

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

[5] Unidentified financing (+)/expenditure (-). Includes expenditure carryover from the previous year.

[6] From the first review under the PSI.

[7] The figure for project grants used in the Mid-Term Budget Review is TSh1325bn.

Table 2b. Tanzania: Central Government Operations, 2008/09–2013/14 [1]
(Percent of GDP)

	2008/09	2009/10	2010/11			2011/12	2012/13	2013/14
			Budget	Prog. [6]	Proj. [7]	Proj.	Proj.	Proj.
Total revenue	16.2	15.8	17.8	16.3	16.1	16.3	16.5	16.7
Tax revenue	15.3	14.6	16.2	15.1	14.9	15.0	15.1	15.3
Import duties	1.4	1.2	1.3	1.3	1.3	1.3	1.3	1.4
Value-added tax	4.6	4.6	5.4	4.7	4.7	4.7	4.7	4.8
Excises	2.9	2.8	3.1	2.9	2.6	2.6	2.6	2.6
Income taxes	4.6	4.4	4.7	4.5	4.7	4.7	4.8	4.8
Other taxes	1.7	1.6	1.7	1.7	1.7	1.7	1.7	1.7
Nontax revenue [2]	0.9	1.2	1.5	1.2	1.2	1.3	1.3	1.4
Total expenditure	26.1	27.4	31.0	29.1	29.0	28.6	27.6	26.2
Recurrent expenditure	17.7	18.8	20.0	18.7	18.1	17.0	16.7	15.9
Wages and salaries	6.1	5.7	6.3	6.2	6.8	6.3	6.3	6.3
Interest payments	0.9	0.8	1.0	1.0	0.8	1.2	1.2	1.2
Domestic	0.8	0.7	0.7	0.8	0.6	0.9	0.8	0.8
Foreign [3]	0.1	0.1	0.4	0.2	0.2	0.3	0.4	0.4
Goods and services and transfers [2]	10.7	12.3	12.6	11.4	10.4	9.5	9.1	8.4
Development expenditure	8.4	8.6	11.0	10.5	10.9	11.6	10.9	10.2
Domestically financed	3.4	3.3	3.9	3.9	3.9	4.0	4.0	4.0
Foreign financed	5.0	5.3	7.1	6.5	6.9	7.6	6.9	6.2
Overall balance before grants	-9.9	-11.6	-13.2	-12.8	-12.9	-12.4	-11.1	-9.4
Grants	5.1	4.6	5.8	5.8	6.4	6.4	6.0	5.4
Program (including basket grants) [4]	3.0	3.0	2.5	2.8	3.1	2.4	2.2	2.1
of which: basket grants	0.7	0.9	0.6	0.8	1.0	1.0	0.9	0.9
Project	1.7	1.4	2.6	2.2	2.5	3.4	3.2	3.0
MDRI (IMF) grant relief	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
MCA funding	0.0	0.1	0.8	0.8	0.8	0.6	0.6	0.3
Overall balance after grants	-4.8	-6.9	-7.4	-7.0	-6.5	-6.0	-5.2	-4.1
Adjustment to cash [5]	0.2	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (cash basis)	-4.6	-6.4	-7.4	-7.0	-6.5	-6.0	-5.2	-4.1
Financing	4.6	6.4	7.4	7.0	6.5	6.0	5.2	4.1
Foreign (net)	3.6	4.6	5.6	5.9	5.4	5.0	4.2	3.1
Foreign loans	3.7	4.8	5.7	6.1	5.5	5.3	4.6	3.8
Program (including basket loans) [4]	1.9	2.5	1.3	1.8	1.4	1.4	1.2	1.1
Of *which:* basket loans	0.6	0.6	0.7	0.7	0.7	0.8	0.5	0.4
Project	1.8	2.3	2.3	2.0	2.0	1.9	1.8	1.7
Nonconcessional borrowing	0.0	0.0	2.1	2.3	2.1	2.1	1.6	1.0
Amortization	-0.1	-0.2	-0.1	-0.1	-0.1	-0.3	-0.5	-0.7
Domestic (net)	0.8	1.8	1.7	1.0	1.0	1.0	1.0	1.0
Bank financing	0.8	1.9	…	0.9	0.9	0.9	0.9	0.9
Nonbank financing	0.0	-0.1	…	0.1	0.1	0.1	0.1	0.1
Privatization proceeds	0.2	0.0	0.1	0.1	0.1	0.0	0.0	0.0

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

[1] Fiscal year: July–June.

[2] In 2008/09, nontax revenue include the recovery from a fraudulent payment made from the government's EPA account managed by the Bank of Tanzania. Local Government Authorities' own revenues (about 0.5 percent of GDP), and the equal amount of transfers, are included starting from FY2009/10.

[3] Some projected external debt obligations are under negotiation for relief with a number of creditors.

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

[5] Unidentified financing (+)/expenditure (-). Includes expenditure carryover from the previous year.

[6] From the first review under the PSI.

[7] The figure for project grants used in the Mid-Term Budget Review is TSh1325bn.

Table 3. Tanzania: Monetary Accounts, 2008/09–2011/12
(Billions of Tanzania shillings, unless otherwise indicated; end of period)

	2008/09	2009/10	2010/11		2011/12
			Prog.[2]	Proj.	Proj.
Bank of Tanzania					
Net foreign assets	3,401	3,949	4,857	4,832	5,479
Net international reserves	3,464	4,336	5,307	5,285	5,948
(Millions of U.S. dollars)	2,666	3,143	3,435	3,477	3,779
Net non-reserve foreign assets	-63	-387	-450	-453	-469
Net domestic assets	-723	-580	-995	-1,044	-971
Credit to government	-712	-628	-494	-577	-577
Of which: Excluding counterpart of liquidity paper	278	581	606	373	373
Other items (net)	-11	48	-501	-467	-394
REPOs	-131	-117	-120	-30	93
Other items, excluding REPOs (net)	120	165	-380	-437	-487
Of which: Credit to nongovernment sector	40	89	92	91	91
Reserve money[1]	2,678	3,369	3,861	3,789	4,508
Currency outside banks	1,424	1,680	1,974	1,991	2,339
Bank reserves	1,255	1,689	1,887	1,797	2,169
Currency in banks	259	351	424	438	515
Deposits	996	1,338	1,463	1,359	1,654
Required reserves (calculated)[1]	787	994	1,334	1,165	1,489
Excess reserves (calculated)	209	344	129	194	165
Memorandum items:					
Stock of liquidity paper	990	1,209	1,100	950	950
Average reserve money	2,602	3,138	3,766	3,766	4,482
Monetary Survey					
Net foreign assets	4,203	5,266	6,162	6,273	6,908
Bank of Tanzania	3,401	3,949	4,857	4,832	5,479
Commercial banks	802	1,316	1,305	1,441	1,429
Net domestic assets	3,629	4,536	5,617	5,496	7,097
Domestic credit	4,580	5,908	7,358	7,401	9,086
Credit to government (net)	128	713	1,009	1,010	1,363
Credit to nongovernment sector	4,452	5,195	6,349	6,391	7,723
Other items (net)	-951	-1,372	-1,741	-1,905	-1,989
M3	7,832	9,801	11,779	11,769	14,005
Foreign currency deposits	2,064	2,522	3,004	3,295	3,922
M2	5,768	7,279	8,775	8,474	10,084
Currency in circulation	1,424	1,680	1,974	1,991	2,339
Deposits (TSh)	4,344	5,599	6,801	6,483	7,744
Memorandum items:	(12-month percent change, unless otherwise indicated)				
M3 growth	18.5	25.1	20.2	20.1	19.0
M3 (as percent of GDP)	29.6	32.3	34.0	34.0	35.6
Private sector credit growth	33.1	16.7	22.2	23.0	20.8
Average reserve money	26.7	20.6	20.0	20.0	19.0
Reserve money multiplier (M3/average reserve money)	3.0	3.1	3.0	3.1	3.1

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

[1] In January 2009 the reserve requirement on government deposits was increased to 20 percent (from 10 percent) and cash in banks was no longer counted towards required reserves. Previously, 50 percent of cash in banks was counted toward required reserves.

[2] From the first review under the PSI.

Table 4. Tanzania: Summary Accounts of the Bank of Tanzania, 2010-2011
(Billions of Tanzania shillings, unless otherwise indicated; end of period)

	2010				2011			
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
	Act.	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.
Net foreign assets	3,847	3,949	4,360	4,799	4,581	4,832	5,098	5,573
Net international reserves	4,230	4,336	4,797	5,224	5,032	5,285	5,554	6,034
(Millions of U.S. dollars)	3,180	3,143	3,233	3,594	3,321	3,477	3,622	3,901
Net non-reserve foreign assets	-384	-387	-437	-425	-451	-453	-457	-461
Net domestic assets	-726	-580	-926	-1,302	-931	-1,044	-1,134	-1,416
Credit to government	-808	-628	-493	-930	-437	-577	-627	-897
Of which: Excluding counterpart of liquidity paper	367	581	462	41	563	373	323	103
Other items (net)	82	48	-433	-372	-494	-467	-507	-519
REPOs	-109	-117	-106	-66	-64	-30	-59	-57
Other items, excluding REPOs (net)	190	165	-328	-306	-430	-437	-448	-462
Of which: Credit to nongovernment sector	87	89	92	96	91	91	91	91
Reserve money[1]	3,120	3,369	3,433	3,498	3,649	3,789	3,963	4,157
Currency outside banks	1,542	1,680	1,858	1,897	1,858	1,991	2,197	2,237
Bank reserves	1,578	1,689	1,576	1,601	1,791	1,797	1,767	1,920
Currency in banks	299	351	395	402	409	438	483	492
Deposits	1,279	1,338	1,181	1,199	1,382	1,359	1,283	1,428
Required reserves (calculated)	924	994	1,023	1,085	1,118	1,165	1,110	1,269
Excess reserves (calculated)	355	344	158	114	264	194	174	159
Memorandum items:								
Stock of liquidity paper	1,175	1,209	955	971	1,000	950	950	1,000
Average reserve money	3,026	3,138	3,451	3,524	3,632	3,766	4,106	4,193

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

Table 5. Tanzania: Monetary Survey, 2010-11
(Billions of Tanzania shillings, unless otherwise indicated; end of period)

	2010				2011			
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
	Act.	Act.	Act.	Act.	Proj.	Proj.	Proj.	Proj.
Net foreign assets	4,918	5,266	5,506	6,125	5,962	6,273	6,551	7,024
Bank of Tanzania	3,847	3,949	4,360	4,799	4,581	4,832	5,098	5,573
Commercial banks	1,071	1,316	1,147	1,326	1,382	1,441	1,454	1,451
Net domestic assets	4,158	4,536	4,842	4,888	5,260	5,496	5,850	6,142
Domestic credit	5,273	5,908	6,697	6,524	7,155	7,401	7,761	8,080
Credit to government (net)	418	713	1,273	807	1,199	1,010	1,122	1,150
Credit to nongovernment sector	4,855	5,195	5,424	5,717	5,956	6,391	6,639	6,930
Other items (net)	-1,115	-1,372	-1,855	-1,637	-1,895	-1,905	-1,911	-1,938
M3	9,075	9,801	10,349	11,013	11,222	11,769	12,401	13,166
Foreign currency deposits	2,201	2,522	2,732	2,992	3,142	3,295	3,472	3,687
M2	6,874	7,279	7,617	8,020	8,080	8,474	8,929	9,480
Currency in circulation	1,542	1,680	1,858	1,897	1,858	1,991	2,197	2,237
Deposits (Tanzania Sh)	5,332	5,599	5,759	6,123	6,221	6,483	6,732	7,242
Memorandum items:								
M3 growth (12-month percent change)	18.9	25.1	22.6	25.4	23.7	20.1	19.8	19.6
Credit to private sector (12-month percent change)	10.1	16.7	18.3	20.7	22.7	23.0	22.4	21.2
Average reserve money (12-month percent change)	21.2	20.6	21.3	20.0	20.0	20.0	19.0	19.0
Nonbank financing of the government (net) [1]	-102	-25	-53	15	50	50	10	20
Bank financing of the government (net) [1]	290	585	560	94	486	297	112	140
Bank and nonbank financing of the government (net) [1]	187	560	507	109	536	347	122	160

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

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

Table 6. Tanzania: Balance of Payments, 2008/09–2013/14
(Millions of U.S. dollars, unless otherwise indicated)

	2008/09	2009/10	2010/11		2011/12	2012/13	2013/14
			Prog.[4]	Proj.	Proj.	Proj.	Proj.
Current account	-2,130	-1,955	-2,427	-2,208	-2,720	-2,812	-2,775
Trade balance	-2,952	-2,816	-3,280	-3,190	-3,562	-3,741	-3,838
Exports, f.o.b.	3,268	3,754	4,269	4,683	5,188	5,711	6,336
Of which:							
Traditional agricultural products	510	457	549	610	518	573	633
Gold	925	1,493	1,693	1,668	2,097	2,252	2,443
Imports, f.o.b	-6,220	-6,570	-7,549	-7,873	-8,750	-9,452	-10,174
Of which: Oil	-1,485	-1,911	-2,287	-2,368	-2,642	-2,883	-3,120
Services (net)	163	237	229	239	266	358	489
Of which: Travel receipts	1,163	1,239	1,353	1,359	1,514	1,687	1,884
Income (net)	-75	-36	-68	-33	-71	-91	-101
Of which : interest on public debt	-28	-31	-51	-46	-82	-107	-108
Current transfers (net)	734	660	692	777	648	662	675
Of which : official transfers	703	623	651	736	606	618	631
Capital account	379	608	724	611	929	951	974
Of which : project grants[1]	317	545	691	579	865	882	900
Financial account	1,306	1,627	1,995	1,932	2,095	2,161	2,072
Foreign Direct Investment	408	424	445	442	542	666	716
Public Sector, net	719	1,058	1,347	1,274	1,274	1,155	940
Of which:							
Program loans	400	612	403	322	352	337	344
Non-concessional borrowing	0	0	525	525	525	450	305
Project loans	387	520	450	455	479	494	504
Scheduled amortization [2]	-21	-29	-32	-29	-82	-126	-212
Commercial Banks, net	-9	-320	100	-4	40	40	10
SDR allocation[3]	0	249	0	0	0	0	0
Other private inflows	188	216	103	219	239	300	406
Errors and omissions	463	198	0	0	0	0	0
Overall balance	18	478	292	335	305	300	271
Financing	-18	-478	-292	-335	-305	-300	-271
Change in BoT reserve assets (increase= -)	-264	-570	-292	-334	-302	-297	-255
Use of Fund credit	246	93	0	-1	-3	-3	-16
Memorandum items:							
Gross official reserves (BoT)	2,930	3,483	3,774	3,831	4,133	4,430	4,685
Months of imports of goods and services (current year)	4.5	5.1	4.8	4.7	4.5	4.5	4.4
Exports (percent of GDP)	15.6	16.6	18.5	20.1	20.4	20.5	20.8
Imports (percent of GDP)	-29.7	-29.0	-32.8	-33.8	-34.4	-34.0	-33.4
Current account deficit (percent of GDP)	-10.2	-8.6	-10.5	-9.5	-10.7	-10.1	-9.1
Foreign program and project assistance (percent of GDP)	8.6	10.1	9.5	9.0	9.1	8.4	7.8
Nominal GDP	20,956	22,671	23,038	23,295	25,428	27,824	30,453

Sources: Tanzanian authorities and IMF staff estimates and projections.

[1] An adjustment to the estimated outturn is made by BoT to reflect unreported project grants.
[2] Relief on some projected external debt obligations is being negotiated with a number of creditors.
[3] In 2009, Tanzania received SDR 147.4 million on August 28 and SDR 11.7 million on September 9 (equivalent to US$249 million in total).
[4] From the first review under the PSI.

Table 7. Tanzania: Quantitative Assessment Criteria and Indicative Targets, September–December 2010

	September				December			
	Indicative Targets	Adjusted Targets	Actual	Met?	Assessment Criteria	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]	250	449	507	X	465	465	109	✓
Average reserve money (upper bound) [3]	3,406	3,406	3,451	X	3,558	3,558	3,524	✓
Average reserve money target [3]	3,372				3,523			
Average reserve money (lower bound) [3]	3,338				3,488			
	(Millions of U.S. dollars; end of period)							
Net international reserves of the Bank of Tanzania (floor) [4]	3,061	2,862	3,233	✓	3,262	3,262	3,594	✓
Accumulation of external payments arrears (ceiling)	0	…	0	✓	0	…	0	✓
Contracting or guaranteeing of external debt on nonconcessional terms (continuous ceiling) [5]	525	…	0	✓	525	…	0	✓
Memorandum item:								
Foreign program assistance (cumulative grants and loans) [1]	329	…	192		643	…	879	

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 year.

Table 8. Tanzania: Structural Benchmarks for 2010/11

Measure	Target Date	Status
Poverty Reduction Strategy		
Approval by Government of a new National Social Protection Framework.	End-March, 2011	In progress. Proposed re-phasing to end-June 2011.
Financial Sector		
Issuance of investment guidelines for pension funds.	End-March, 2011	In progress. Proposed re-phasing to end-September 2011 to allow completion of ongoing actuarial assessment.
Establish framework for emergency liquidity assistance beyond day-to-day liquidity management and tools.	End-March, 2011	Not met. Proposed to be dropped in view of other actions taken to establish a comprehensive crisis management framework.
Fiscal		
Debt management: Prepare a Medium-Term Debt Strategy consistent with resource needs under the new PRS and reflecting contingent liabilities.	End-March, 2011	In progress, expected to be completed by end-June.
Develop an index for monitoring priority social spending.	End-December, 2010	In progress. Proposed re-phasing to end-December 2011 to incorporate requested technical assistance.
Prepare a report on payment claims outstanding over 30, 60, and 90 days in Ministries of Infrastructure, Health, and Home Affairs for end-June, 2010.	End-December, 2010	Met.
Statistics		
Develop core inflation index.	End-March, 2011	Met.

Table 9. Tanzania: Financial Soundness Indicators, 2007–2010
(Percent, end of calendar year)

			2009				2010			
	2007	2008	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
Capital adequacy										
Capital to risk-weighted assets	16.2	17.0	20.3	17.8	19.6	18.3	20.5	19.4	19.3	18.9
Capital to assets	8.1	10.1	11.6	10.6	10.9	10.9	11.9	11.0	11.1	10.9
Asset composition and quality										
Net loans and advances to total assets	41.2	50.6	50.3	48.8	46.0	46.3	45.2	44.8	44.6	44.1
Sectoral distribution of loans										
Trade	17.0	18.5	17.3	17.6	18.5	18.8	18.3	18.0	17.2	17.5
Mining and manufacturing	20.2	14.7	14.2	13.5	11.3	12.0	13.3	15.4	15.8	14.2
Agricultural production	11.9	10.4	10.5	10.9	12.2	10.2	10.2	11.3	13.3	13.1
Building and construction	5.1	4.9	4.8	4.5	5.1	5.0	4.9	5.6	7.0	6.1
Transport and communication	6.9	7.3	7.4	9.9	9.8	9.2	8.9	10.1	9.3	9.2
Foreign exchange loans to total loans	31.4	31.8	30.9	30.4	29.3	28.5	29.1	32.1	32.9	32.0
Gross nonperforming loans (NPLs) to gross loans	6.3	6.2	7.3	7.7	6.4	6.6	7.0	7.2	7.9	9.3
NPLs net of provisions to capital	22.0	22.0	23.5	25.8	46.0	17.6	15.4	17.3	19.4	24.3
Large exposures to total capital	183.5	199.4	155.4	197.2	139.6	54.4	93.7	161.5	98.5	104.2
Earnings and profitability										
Return on assets	4.7	3.8	4.0	3.6	3.4	3.2	2.7	2.9	2.9	2.3
Return on equity	29.0	23.2	22.6	21.2	20.1	18.4	15.3	16.4	16.1	12.1
Net interest margin	73.8	76.7	74.2	73.5	72.7	73.3	73.2	74.8	75.1	75.8
Noninterest expenses to gross income	42.5	48.8	44.6	45.3	46.6	47.6	53.5	52.5	52.9	54.5
Personnel expenses to noninterest expenses	40.5	40.6	44.6	45.2	43.7	42.6	43.6	42.5	41.5	40.5
Liquidity										
Liquid assets to total assets	48.0	37.6	36.5	37.8	41.1	40.5	40.5	40.8	39.7	40.4
Liquid assets to total short term liabilities	53.0	41.7	43.8	45.2	48.5	46.5	47.1	46.9	45.6	46.1
Total loans to customer deposits	57.6	68.4	66.9	65.5	61.2	61.6	60.0	59.1	59.6	58.9
Foreign exchange liabilities to total liabilities	33.8	32.5	31.5	31.1	29.7	29.7	29.1	30.5	32.0	31.8

Source: Bank of Tanzania

Appendix. Letter of Intent

Dar es Salaam
April 15, 2011

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

Dear Mr. Strauss-Kahn:

1. Tanzania has continued to record good progress in the implementation of its economic and financial programme under the Policy Support Instrument (PSI). The Government remains committed to maintain sound policies with the aim of sustaining macroeconomic stability and accelerating economic growth and poverty reduction.

2. Performance against PSI targets remained on track with all quantitative assessment criteria for December 2010 and all continuous assessment criteria being met, some with substantial margin. Similarly, progress has been made in implementing the structural reform program.

3. Based on the preliminary data on economic performance during the first nine months, and performance in some key indicators during the fourth quarter of 2010, GDP growth for 2010 is estimated to have reached 7.0 percent. Economic activity is projected to slow down during 2011 owing to the projected below normal rains and power shortages during the first half and higher international oil prices. Owing to the unexpected power crisis and the uncertainty regarding its length and severity, the GDP forecast is subject to higher than usual uncertainty. However, in the medium term, growth is projected to stabilise above 7 percent.

4. Annual headline inflation increased to 7.5 percent in February 2011 from 5.6 percent in December 2010 and 7.2 percent in June, 2010 mainly due to increases in the prices of food items and energy reflecting global trends, as well as the 18 percent rise in electricity tariff starting in January 2011. Going forward, and incorporating a number of cost push factors, inflation is targeted at 7.5 percent by end June 2011. Inflation is projected to decline to around 5 percent in the medium term.

5. The Government's policy framework will continue to focus on sustaining the macroeconomic stability, including fiscal sustainability, through implementation of appropriate fiscal and monetary policies, with the aim of powering the economy to its growth trajectory. The policy framework will include implementation of measures to increase revenue efficiency; and scaling up good-quality investment spending to address the infrastructure bottlenecks and sustain gains realized in social sectors, while containing growth in recurrent expenditure. In addition to financing infrastructure development through concessional and non–concessional borrowing, the Government will improve value for money of its infrastructure spending, including through Public Private Partnership (PPP) arrangements.

6. The Government is continuing with implementation of it structural reform agenda based on its four core reform programmes—the Public Sector Reform Programme, the Public Financial Reform Programme, the Local Government Reform Programme, and the Legal Sector Reform Programme—in order to enhance efficiency in resource utilization and service delivery. In addition, the Government is continually improving the business environment to support private sector led growth, through the Roadmap for Improving the Business Climate that was adopted by stakeholders in 2010.

7. 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 during the first half and the projected outturn for 2010/11, and describes the objectives and policies that the Government intends to pursue during the fiscal year 2011/12 and over the medium term.

8. The Government of Tanzania requests the completion of the second review under the PSI in support of good performance and 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 will, in further consultation with the Fund, take any appropriate measures for this purpose. We will regularly update the Fund on developments in our economic and financial policies, and provide the data needed for the monitoring of the programme. In addition, the Government will consult regularly with the Fund on any relevant developments at the initiative of the Government or the Fund.

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

Yours Sincerely,

/s/

Mustafa H. Mkulo

MINISTER FOR FINANCE
UNITED REPUBLIC OF TANZANIA

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

ATTACHMENT I. TANZANIA: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

April 15, 2011

Recent Macroeconomic Developments

1. Tanzania's economy has continued on a recovery path from a slowdown associated with the global economic downturn. Preliminary national accounts statistics indicate that real GDP (at market prices) grew by 6.7 percent in the first three quarters of 2010 compared with 4.8 percent in the corresponding period of 2009. The growth was contributed mostly by trade and services (22.2 percent), agriculture and fishing (20.7 percent), transport and communication (10.7 percent), and manufacturing (10.0 percent). Following good performance in the first three quarters, and an indication of good performance in key indicators in manufactured exports, and construction, the earlier projected GDP growth of 7.0 percent in 2010 is likely to be achieved.

2. Following favorable weather conditions in 2009/10, food supply improved in the East African region, leading to a reduction in inflationary pressures. Inflation took a downward trend in 2010, from 12.7 percent in October 2009 to 4.5 percent in September 2010. The National Bureau of Statistics (NBS) released the revised CPI series beginning October 2010. Based on this revision, inflation was 4.2 percent in October 2010, but started inching up from November 2010 to 5.6 percent in December 2010, mainly on account of an increase in prices of some food items and energy. In January 2011, the pressure was exacerbated by an 18 percent increase in electricity tariffs, and inflation rose in February to 7.5 percent.

3. The trade account for the year ending December 2010 experienced a widening deficit with imports increasing faster than exports partly due to high prices of oil in the world market, and partly due to substantial recovery of capital and intermediate goods imports. Imports of goods and services rose by about 19 percent in 2010 compared with a decline of 13 percent in the preceding year. Improvement in global demand also led to an increase in world commodity prices, resulting in improved export performance. Exports of goods and services rose by about 23 percent, with gold remaining dominant, largely due to the increase in export prices. In the first half of 2010/11, the current account deficit decreased by 9.9 percent to USD 798 million compared with a deficit of USD 886 million recorded in the corresponding period last year following a significant increase in official current transfers.

4. However, an upward trend in oil prices in the world market is taking place given the escalating instability in the Middle East and North Africa. This will in turn increase the import bill in the second half of 2010/11. In addition, hydro power generation has been substantially reduced due to inadequate short rains during 2010/11 season, leading to power rationing that may be exacerbated if the long rains in 2011 are below normal, as is projected. The ongoing power rationing is expected to negatively affect exports of manufactured goods in the second half of 2010/11. Consequently, the current account (excluding official current transfers) for 2010/11 is projected to record a deficit equivalent to 12.6 percent of GDP compared with 11.4 percent of GDP in 2009/10. On the other hand, the overall balance of

payments is projected to record a surplus of USD 334 million. Official gross reserves by end-June 2011 are estimated to increase to USD 3,831 million, sufficient to cover 4.7 months' imports of goods and services.

Performance under the program

5. Performance against PSI targets for end-December 2010 remained on track with all quantitative assessment criteria being met (Table 1). In particular, net international reserves amounted to USD 3,594 million, above the target by USD 332 million, while the net domestic financing of the Government budget was TSh 109 billion, which was below the ceiling by TSh 356 billion. The average reserve money closed at TSh 3,524 billion, below the target by TSh 34 billion.

6. Progress has been made in implementing the structural reform benchmarks, although slower than planned in some areas (Table 2). A report on outstanding payment claims as at end December 2010 was prepared and a core inflation index has been introduced, while the Medium Term Debt Strategy (MTDS) report will be published by end June 2011. However, while progress has been made on each of the remaining structural benchmarks, it was not possible to complete them yet, and thus the Government requests their re-phasing as discussed below.

Fiscal policy

7. Fiscal policy in the first half of the fiscal year remained within the PSI targets, thanks to a proactive management of spending. The deficit before grants stood at TSh 1,762 billion (5½ percent of GDP), or TSh 139 billion lower than programmed. External program financing exceeded PSI projections by TSh 321 billion, allowing the Government to meet the NDF target with a significant margin. The Government's cash-budgeting system helped contain monthly expenditure within available resources in order to meet the domestic financing target.

8. During the first six months of 2010/11, government revenue increased significantly but fell short of budget estimates. Total domestic revenue collection including Local Governments Authorities (LGAs)' own sources increased by 20 percent compared with last year. Revenue collection reached TSh 2,779 billion, exceeding PSI targets by about 4 percent, helped by the continuous implementation of measures outlined in the November 2010 MEFP to strengthen revenue collection. However, revenue collection fell significantly short (about 10 percent) of budget estimates, reflecting the ambitious revenue targets, including for VAT and excises. Large tax exemptions (about 1/3 of gross tax collections) continued to erode the tax base and hamper revenue collection performance.

9. Total cash expenditure for the first half of 2010/11 remained within the PSI envelope, but large unpaid claims have surfaced from infrastructure projects. The execution of expenditure during the first half was held to 91.3 percent of budget estimates, while

protecting priority sectors, including health and education, from budget cuts. Recurrent expenditure was in line with estimates, while development expenditure stood at 74 percent of the estimates. In addition, significant claims (TSh 255 billion or 0.7 percent of GDP) were accumulated because spending on long-term infrastructure projects went faster than anticipated under the budget, thus pushing total expenditure committed in the first half of the year above the target. Foreign financed development expenditure experienced delays in disbursement of project funds as well as delays in data reporting of direct-to-project funds.

10. Total grants for the first half of 2010/11 were TSh 1,000 billion, equivalent to 75 percent of estimate, reflecting delayed disbursement of foreign project funds and data reporting of project grants. Disbursements of budget grants were TSh 654 billion, while basket support funds amounted to TSh 243 billion. The higher than estimated disbursement of GBS and basket funds was mainly due to frontloading and exchange rate fluctuations. Total foreign financing of the deficit after grants was 8 percent above the budget estimate for the period, mainly due to higher than projected disbursement of general budget support and basket funds. On the other hand, net domestic financing was 23 percent below the estimated TSh 465 billion due to delays in execution of development projects.

Prospects for the reminder of FY2010/11

11. The Government has taken steps to accelerate the implementation of administrative revenue measures to improve revenue collection performance, but significant risks cloud the outlook to end June 2011. Data for end-February indicates some improvement in domestic revenue collection, but growing downside risks are emanating from the impact of the protracted power rationing on corporate activity and profits. As a result, revenue collection is projected to reach 16.1 percent of GDP for FY2010/11, slightly below the PSI targets and around 90 percent of budget estimates.

12. The Government has made progress in raising funds from external non-concessional borrowing. Negotiations with a reputable bank for USD 197.8 million are at advanced stage and the Mandate Letter has already been signed. The Government is currently reviewing the loan agreements to ensure suitability of loan terms. This loan will be used for the installation of 100MW gas fired plant in Dar es Salaam and 60MW heavy furnace oil power plant in Mwanza. The Government is also discussing a Mandate Letter for USD 250 million with a second bank, and the loan agreement is expected to be signed before end June, 2011. Taking into account commitment and insurance fees estimated at about USD 40 million, the total amount available from these two loans to finance expenditures in 2010/11 is expected to be about USD 408 million. The Government is cautiously scrutinizing additional proposals from these and other financial institutions to identify possible candidates to raise the remaining balance from the USD 525 million ceiling on non-concessional financing.

13. Spending will be adjusted to available resources while protecting key expenditure items including investment and priority social spending. Accordingly, the mid-year budget

review capped total expenditure at 95 percent of estimate and 29.6 percent of GDP. In addition, spending was reallocated to allow payment of TSh 255 billion in unpaid claims. The Government has halted the process of signing new contracts for infrastructure projects that are not funded. Given the severity of the power outage, it is essential to step up investment in electricity generation. In addition, further pressures could also arise in recurrent spending due to the need for increased fuel purchases to supply generators to maintain power availability in the very near term. Any increased expenditures related to the power crisis will be covered by reducing planned spending in other areas. In all, the revenue shortfall and additional power-related spending will call for a further adjustment in expenditure of about 1.1 percent of GDP. To cope with these additional shocks, the Government will focus cuts mainly on lower priority areas, and where possible delay the implementation of some projects.

14. The Government continues with the efforts to enhance the capacity of Cash Management Unit (CMU) in order to improve in-year cash flow projection and accordingly advise the cash management committee. This will include enhancing the capacity of CMU to perform detailed historical trend analysis as a basis for projecting and scrutinizing Ministries and Development Agencies (MDAs) submissions.

15. The Government has begun to compile outstanding payment claims from MDAs on a quarterly basis, while strengthening commitment control and expenditure tracking and monitoring. The Government monitors expenditure development arising from such claims to facilitate a more accurate projection of cash requirements. The claims once verified are incorporated and submitted for payment through the monthly cash budgeting committee, pending available resources. The Government ensures that such claims are settled before the end of the fiscal year to avoid accumulation of arrears in the following fiscal year. On a provisional basis, the unpaid claims of three ministries have been reported to the Fund. Now that the data is available for all MDAs, it will be shared with the Fund on a quarterly basis, with a four week lag.

16. The Government has developed the National Social Protection Framework (NSPF) through extensive consultation with key stakeholders. The NSPF establishes guidelines for stakeholders involved in the planning, funding, and provision of social protection measures in line with MKUKUTA II, and provides a mechanism for collective state-led measures implemented by the Government and its partners. However, the elections and formation of a new government have delayed the formal adoption of this framework. As a result, the Government requests a re-phasing of the related structural benchmark to end-June 2011. To further assist in meeting the goals of MKUKUTA II, an index for monitoring priority social spending is also being developed. However, this has proven technically more challenging than anticipated, and thus the Government requests a re-phasing of the related structural benchmark from end-March to end-December 2011. The Government is also seeking technical assistance from a development partner to accelerate the work and support capacity building in this important area.

17. Foreign assistance in the form of General Budget Support and basket funds are expected to be realized broadly within budget estimates. General budget support will be slightly higher than the approved budget especially due to fluctuations in the exchange rate, partly contributing to the narrowing of the resource gap emanating from domestic revenue shortfall. Thus, in 2010/11 foreign grants are expected to be 5.6 percent of GDP, while loans (including non-concessional borrowing) will be 5.5 percent.

18. The Government has, with the help of IMF-World Bank technical assistance, in January 2011 adopted a new tool to assist in formulating a Medium Term Debt Strategy (MTDS). The new tool incorporates non-concessional borrowing and contingent liabilities, including those arising from government guarantees. Significant progress has been made on developing an MTDS consistent with resource needs under the MKUKUTA II and reflecting contingent liabilities, but the process is not yet complete. Thus, the Government is requesting a re-phasing of the related benchmark from end-March 2011 to end-June 2011. The Government also intends to establish a unified data base of debt statistics, under a single monitoring unit, and proposes that this be added as a new structural benchmark to be completed by end-December 2011

19. According to the report on Debt Sustainability Analysis (DSA) published in December 2010, Tanzania's public debt is expected to remain sustainable. However, the Government recognizes that debt sustainability is sensitive to the terms of borrowing and its utilization, and is committed to contracting external debt only on reasonable terms, and to ensuring that all non-concessional debt is used to finance high-priority investment projects. The Government will continue to control the issuance of guarantees on loans to various public institutions in order to maintain sustainability of the public debt.

Monetary and exchange rate policies

20. The pace of credit to private sector growth continued to pick up in the first seven months of 2010/11, reflecting recovery of banks' confidence in the economy following easing of the global financial crisis. Credit to private sector grew by 21.5 percent in January 2011, far above the 9.8 percent recorded in the year ending January 2010. Consistent with this development, broad money (M3) grew by 25.4 percent, compared with 20.1 percent recorded in the year ending January 2010. The fastest growing component of M3 was foreign currency deposits following the strengthening of US dollar against major currencies and the shilling which led to higher demand for US dollars. The Shilling depreciated against the US dollar by 6.1 percent in the first seven months of 2010/11.

21. The Bank's policy rate remained unchanged. Nevertheless, as credit growth accelerated and banks' excess reserves declined, money market interest rates increased in the last quarter of 2010. The overall Treasury bill yield increased to 7.14 percent in January 2011, from 3.33 percent in June 2010, while the overnight interbank rate increased to 7.93 percent in January 2011, from 0.97 percent in June 2010. The same pattern was also

observed in the Treasury bond market, where average yields increased across all maturities. This began to reverse in mid February 2011, as Treasury securities tender sizes were reduced, coupled with build up of banks' reserves following seasonal repayment of agricultural credit. The overall weighted average Treasury bill yield fell to 5.70 percent by mid March 2011 and the overnight interbank rate fell to 2.0 percent.

Programme for 2011/12 and the Medium term

22. The Government will continue to focus on sustaining macroeconomic stability through implementation of prudent monetary and fiscal policies. Building on the MUKUTA II framework, the Government is in the process of developing a five year development plan for 2011/12 – 2015/16, whose main thrust is on unlocking Tanzania's growth potentials. The Plan will prioritize key interventions and orderly sequence in their implementation so that they can complement each other to enable effective and optimal resource allocation. Focus will be on key areas within agriculture, infrastructure, investment in human resources, environmental sustainability and land management. The Government will sustain achievements made in social sectors and improve value for money of its infrastructure program, including through private sector participation in infrastructure development.

23. The Government is continuing with implementation of its structural reform agenda based on four core reform programmes—the Public Sector Reform Programme, the Public Financial Reform Programme, the Local Government Reform Programme, and the Legal Sector Reform Programme— in order to enhance efficiency in resource utilisation and service delivery. In addition, the Government is continually improving the business environment to support private sector led growth, through a Roadmap for Improving the Business Climate that was adopted by stakeholders in 2010. The Roadmap identified several "quick wins" and short-term actions that the Government intends to implement quickly.

24. Real GDP growth is expected to slow in 2011 on account of the ongoing power rationing, projected lower than normal rains in the 2011 crop season and soaring international oil prices. As the global economy continues to recover and demand for exports improves, real GDP growth is expected to return to an average rate above 7 percent. Over the medium term, growth is expected to increase further. On the other hand, it is expected that the continued surge in world oil and food prices will increase headline inflation to 7.5 percent in June 2011. In the medium term, it is expected that inflationary pressures will ease, with inflation slowing to 5.5 percent in 2012 and remaining around 5 percent thereafter.

Fiscal policy

25. As a baseline projection, domestic revenue is expected to trend upward given the expected recovery in economic activities and continued efforts to strengthen tax administration, and implement measures to increase revenue efficiency and bring it in line with other countries in the East African region. Thus, in the baseline the revenue to GDP ratio is projected at 16.3 percent of GDP in 2011/12. The Government is committed to

including in the budget realistic estimates of the revenue impact of measures in the tax area that are not included in the baseline. This will ensure that the overall projection of revenues in the budget provides a reliable foundation for determining the level of spending in the budget.

26. Foreign grants and loans are projected to remain at 6.4 percent of GDP in 2011/12, with concessional loans also little changed from 2010/11 at 3.3 percent of GDP. Non-concessional foreign borrowing is projected at an additional 2.1 percent of GDP, with net domestic financing remaining at 1 percent of GDP. The Government will ensure that resources realized from non-concessional borrowing are utilized to address critical infrastructure gaps, including increasing capacity for energy generation and improving transportation networks, with borrowing decisions made in line with Government's commitment to sustaining macroeconomic stability consistent with the PSI programme.

27. Based on the available financing and the need to maintain fiscal sustainability, the deficit after grants will be reduced to 6 percent of GDP in 2011/12. Given this deficit and the baseline projection for revenues, total expenditure is projected to decline to 28.3 percent of GDP. Only realistically projected increases in baseline revenues on the basis of quantified estimates of policy changes will be reflected in total expenditure. Growth in the wage bill will be kept in line in nominal GDP to safeguard Tanzania's competitiveness. While making room for increases in priority spending, including in health and education, total spending on goods and services will be brought to their level relative to GDP prior to the global financial crisis. In addition, the Government will continue to improve the quality of public investment, and over the medium term will ensure that reported public investment refers only to actual accumulation of physical capital. In addition, the contingent reserve in the 2011/12 budget will be increased to five percent of total expenditure to create a sufficient buffer for unexpected developments on revenue, spending, or financing.

28. In the medium term, the Government will implement revenue policies aimed at improving tax administration and maximizing domestic revenue collection. The Government will undertake various reforms to strengthen domestic resource mobilization and limit tax leakages. This will be achieved through: (i) improving tax structure; (ii) widening the tax base by bringing the informal sector into the tax net, implementing the properties and businesses formalization programme and introducing National Identity Cards;
(iii) strengthening bloc management, supervision and managing performance;
(iv) intensifying enforcement of collection of tax arrears and tax compliance; and
(v) improving tax administration by implementing the Tanzania Revenue Authority's Third Five-year Corporate Plan. In addition, the Government will undertake policy reform measures in non tax revenue collection, and strengthen the management and control of tax exemptions.

29. The Government's medium-term fiscal policy will help to ensure fiscal sustainability. The overall deficit after grants is projected to gradually narrow from 6.5 percent estimated

for 2010/11 to below 4 percent by 2015/16, benefitting from the projected improvement in domestic revenue collection and decline in overall expenditure. The projected deficit is expected to be financed by both concessional and non-concessional loans. The proceeds from non-concessional borrowing are intended to be used to support development projects particularly infrastructure development. As a result, Tanzania's total public debt will remain below 45 percent of GDP over the medium-term.

Monetary and exchange rate policies

30. The Bank of Tanzania will continue to implement monetary policy that is consistent with low inflation, while providing room for private sector credit growth. Upside risk to inflation from the second round effect of tariff hikes, power rationing, and increasing global oil and food prices remain. The Bank of Tanzania will monitor inflation closely and make appropriate adjustments to monetary targets in the events that core inflation begins to exhibit indications of rising inflationary pressures. During 2011/12, the annual growth rate of average reserve money and M3 is targeted at 19 percent, which should provide room for private sector credit to grow by 21 percent in the year ending June 2012.

31. The exchange rate will remain market determined and the Bank of Tanzania will participate in the foreign exchange market with the main objective of implementing its monetary policy and smoothing short-term exchange rate volatility, while maintaining an adequate level of international reserves.

Financial sector stability

32. The Bank is committed to ensure stability and soundness of the financial sector. In this regard, the Bank has prepared an MOU to establish a financial regulators forum to assume joint responsibility of safeguarding the stability of the financial system, and coordinating crisis management and resolution. The Bank of Tanzania has also introduced new measures to ensure availability of liquidity to the banking system, should the need arise. Firstly, measures to recognize impending liquidity shortfalls have been stepped up by strengthening surveillance of the banking system. This is done on a daily basis by examining developments in a set of leading indicators. Secondly, access to emergency facilities at the Bank of Tanzania has been eased to allow commercial banks to have access to these facilities on short notice and at reasonable rates. In addition, a mission to develop further options for resolution of crises was concluded in February 2011 and a report containing recommendations is expected in the fourth quarter of 2010/11. The first published Financial Stability Report was issued in December 2010, and the next half year report will be published by May 2011. In light of the actions taken to date, the Government requests that the structural benchmark on the establishment of a framework for emergency liquidity management be dropped.

33. Efforts are underway to reform the Deposit Insurance Board (DIB). A final report and recommendations of the study on legal and operational framework for DIB has been

submitted by the consultant. A proposal for the reformed DIB will be considered by the Inter-Institutional Committee before approval by the Government.

34. Data on financial soundness indicators for end December 2010 indicate that the banking system continues to be sound and stable on the whole. However, there was a significant increase in non-performing loans (NPLs) in the second half of 2010. This was a result of targeted examination on some key banks which revealed that a number of loans, granted to sectors that had been affected by the global financial crisis, had not been properly reclassified and provided for as required for bad and doubtful debts. This was followed by full scope examination of those banks. The banks have been directed to strengthen their credit risk management systems to reduce the NPLs. According to self assessment on the 25 Basle I Core Principles for effective banking supervision, the Bank has fully complied with 8 Core Principles and largely complied with 16 Core Principles, but is materially not compliant with one Core Principle. This will be addressed in the context of preparation for the issuance of a sovereign bond.

35. Progress has been made in the establishment of a credit reference system. Credit Reference Bureau and Databank Regulations, were finalized and gazetted. The bidding documents for a databank solution provider have been finalized and interested vendors have been invited to purchase the same. The expected deadline for submission of bids is March 23, 2011. A public notice intended to entice interested and eligible private credit reference bureau operators to apply for a license has also been issued.

36. The National Social Security Authority has been formed and the CEO of the Authority was appointed in September 2010. The regulator is now working in consultation with the Bank of Tanzania to prepare investment guidelines for pension funds, and has initiated an actuarial review of the pension funds as part of this process. Issuance of the investment guidelines was a structural benchmark under the PSI for end-March 2011, but the Government is requesting a re-phasing of the benchmark to end-September 2011 in order to allow the actuarial review to be completed. Tanzania received technical assistance in February 2011 to assist in the implementation of a reporting system for the collection of data from insurance companies and pension funds. These reports will be compiled, disseminated, and reported to the Bank of Tanzania on a quarterly basis, beginning with the quarter ending June 2011.

37. Regarding the national payment system, the Bank has continued to support banks and mobile network operators in development of mobile banking through a mobile payment policy partnership. Mobile Payment Regulations have been drafted by the Bank to promote financial inclusion of the under-banked and unbanked. These will be reviewed by stakeholders before June 2011. In addition, utilization of TISS has continued to expand reaching 50.3 percent of total government expenditure by January 2011. It is expected that

once most ministries make payments through TISS, cheque capping for Government payments exceeding TSh 10 million will be implemented.

38. Following the ratification of the Common Market Protocol by all EAC Partner States in July 2010, EAC central banks have taken steps towards implementing a Cross Border Payment System, which will help to promote trade among the East Africa countries. Business and technical functional specifications for the development of the East African Payment System (EAPS) were agreed by all members and signed-off in September 2010. The EAPS regulatory framework is in the process of being finalized. In the meantime, the enhancement and testing of the system has commenced. The system will go live in the fourth quarter of 2010/11.

39. Measures to liberalize capital account continue to be implemented following their inclusion in the East African Common Market Protocol. A National Task Force which was formed to review national laws has identified a list of laws and regulations which need to be amended to facilitate removal of existing restrictions on capital and financial account transactions. In the meantime, the Bank has started reviewing the Foreign Exchange Act of 1992.

Statistical issues

40. Revision of the composition of the consumer basket was finalized by the National Bureau of Statistics (NBS) on the basis of results from the 2007 household budget survey (HBS) and the new CPI series was released as planned in November 2010. The rebased CPI follows the internationally recommended COICOP and has a lower weight for food and larger weights for communications and some other household expenditure items. The new classification incorporates a number of methodological improvements, including the use of geometric mean for compiling elementary index aggregates, the use of an improved index compilation system, and improved procedures for collecting and processing prices. The reference period was also changed from December 2001 to September 2010. The revision of CPI compilation makes it comparable to most other EAC member states. Work is now underway to develop a harmonized core inflation index for the EAC. In the meantime, the NBS is publishing a CPI measure excluding food and energy prices as a proxy for core inflation, thus meeting the related benchmark under the PSI.

Programme Monitoring

41. Progress in the implementation of the policies under this program will be monitored through assessment criteria (ACs), indicative targets (IT), and structural benchmarks (SBs) detailed in the attached Tables 3 and 4 and through semi-annual reviews. The modification of the end-June 2011 AC on net international reserves is being requested while ACs for end-December 2011 are being proposed, to be assessed respectively at the third and fourth reviews. The third review is expected to be completed by end-December 2011 and the fourth review by end-May 2012. The attached Technical Memorandum of Understanding contains definitions and adjustors.

Table 1. Tanzania: Quantitative Assessment Criteria and Indicative Targets, September–December 2010

	September				December			
	Indicative Targets	Adjusted Targets	Actual	Met?	Assessment Criteria	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]	250	449	507	X	465	465	109	✓
Average reserve money (upper bound) [3]	3,406	3,406	3,451	X	3,558	3,558	3,524	✓
Average reserve money target [3]	3,372				3,523			
Average reserve money (lower bound) [3]	3,338				3,488			
	(Millions of U.S. dollars; end of period)							
Net international reserves of the Bank of Tanzania (floor) [4]	3,061	2,862	3,233	✓	3,262	3,262	3,594	✓
Accumulation of external payments arrears (ceiling)	0	…	0	✓	0	…	0	✓
Contracting or guaranteeing of external debt on nonconcessional terms (continuous ceiling) [5]	525	…	0	✓	525	…	0	✓
Memorandum item:								
Foreign program assistance (cumulative grants and loans) [1]	329	…	192		643	…	879	

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 year.

Table 2. Tanzania: Structural Benchmarks for 2010/11

Measure	Target Date	Status
Poverty Reduction Strategy		
Approval by Government of a new National Social Protection Framework.	End-March, 2011	In progress. Proposed re-phasing to end-June 2011.
Financial Sector		
Issuance of investment guidelines for pension funds.	End-March, 2011	In progress. Proposed re-phasing to end-September 2011 to allow completion of ongoing actuarial assessment.
Establish framework for emergency liquidity assistance beyond day-to-day liquidity management and tools.	End-March, 2011	Not met. Proposed to be dropped in view of other actions taken to establish a comprehensive crisis management framework.
Fiscal		
Debt management: Prepare a Medium-Term Debt Strategy consistent with resource needs under the new PRS and reflecting contingent liabilities.	End-March, 2011	In progress, expected to be completed by end-June.
Develop an index for monitoring priority social spending.	End-December, 2010	In progress. Proposed re-phasing to end-December 2011 to incorporate requested technical assistance.
Prepare a report on payment claims outstanding over 30, 60, and 90 days in Ministries of Infrastructure, Health, and Home Affairs for end-June, 2010.	End-December, 2010	Met.
Statistics		
Develop core inflation index.	End-March, 2011	Met.

Table 3. Tanzania: Quantitative Assessment Criteria and Indicative Targets Under the Policy Support Instrument, June–December 2011

	June	September	December
	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]	347	122	160
Average reserve money (upper bound) [3]	3,804	4,147	4,235
Average reserve money target [3]	3,766	4,106	4,193
Average reserve money (lower bound) [3]	3,729	4,065	4,151
	(Millions of U.S. dollars; end of period)		
Net international reserves of the Bank of Tanzania (floor) [4]	3,477	3,622	3,901
Accumulation of external payment arrears (ceiling)	0	0	0
Contracting or guaranteeing of external debt on nonconcessional terms (continuous ceiling) [5]	525	525	525
Memorandum item:			
Foreign program assistance (cumulative grants and loans) [1]	1,058	299	690

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.

Table 4. Tanzania: Structural Benchmarks for 2011/12

Measure	Target Date	Macro criticality and status
Poverty Reduction Strategy		
Approval by Government of a new National Social Protection Framework.	End-June, 2011	Provides a reliable and comprehensive social safety net targeted to the most vulnerable. In progress. Rephased to end-June 2011.
Financial Sector		
Issuance of investment guidelines for pension funds.	End-September, 2011	Mitigates risk to the financial system and public finances of large, unregulated pension funds. Rephased to end-September 2011 to allow completion of ongoing actuarial assessment of pension funds.
Fiscal		
Debt management: Prepare a Medium-Term Debt Strategy consistent with resource needs under the new PRS and reflecting contingent liabilities.	End-June, 2011	Critical for ensuring sustainability of the government's borrowing strategy and for facilitating broader access to capital markets. In progress. Rephased to end-June 2011.
Establish a unified public debt statistics database under a single monitoring unit.	End-December, 2011	Critical for effective monitoring of debt obligations.
Develop an index for monitoring priority social spending.	End-December, 2011	Facilitates monitoring the implementation of social spending. In progress. Rephased to end-December 2011 to allow time for technical assistance mission.

ATTACHMENT II. TECHNICAL MEMORANDUM OF UNDERSTANDING ON SELECTED CONCEPTS AND DEFINITIONS USED IN THE MONITORING OF THE PSI-SUPPORTED PROGRAM

April 15, 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 and indicative targets 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 BoT's reserve assets, as defined in the IMF BOP manual (5^{th} edition) and elaborated in the reserve template of the IMF's special data dissemination standards (SDDS), include: (i) monetary gold; (ii) holdings of SDRs; (iii) the reserve position at the IMF; (iv) all holdings of foreign exchange; and (v) other liquid and marketable assets readily available to the monetary authorities. Reserve assets exclude assets pledged or otherwise encumbered, including but not limited to assets used as collateral or guaranteed for a third party external liability (assets not readily available). The BoT's reserve liabilities include: (i) all short-term foreign exchange liabilities to nonresidents, of original maturities less than one year; and (ii) outstanding purchases and loans from the IMF.

Reserve money and reserve money band

3. Reserve money is defined as the sum of currency issued by the BoT and the deposits of commercial banks with the BoT. The reserve money targets are the projected daily averages of March, June, September, and December within a symmetrical one percent band. The upper bound of the band serves as the assessment criterion or indicative target.

Net domestic financing of the Government of Tanzania

4. Net domestic financing of the Government of Tanzania (NDF) includes financing of the budget of the central (union) government of Tanzania ("government") by the banking system (BoT and commercial banks) and the nonbank public. NDF is calculated as the cumulative change since the beginning of the fiscal year in the sum of: (i) loans and advances to the government by the BoT and holdings of government securities and promissory notes (including liquidity paper issued by the BoT for monetary policy purposes), minus all government deposits with the BoT; (ii) all BoT accounts receivable due from the Government of Tanzania that are not included under (i) above; (iii) loans and advances to the

government by other depository corporations and holdings of government securities and promissory notes, minus all government deposits held with other depository corporations; and (iv) the outstanding stock of domestic debt held outside depository corporations, excluding: government debt issued for the recapitalization of the NMB and TIB; debt swaps with 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

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

External payments arrears

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

Contracting or guaranteeing of external debt on nonconcessional terms

7. The term "external debt" will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to External Debt (Executive Board's Decision No. 6230-(79/140), as amended by Decision No. 14416-(09/91), effective December 1, 2009). External debt will be determined on the basis of currency of denomination of the debt. Government external debt is outstanding debt owed or guaranteed by the Government of Tanzania, 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.

8. Government debt is considered nonconcessional if the grant element is lower than 35 percent, calculated using discount rates based on Organization for Economic Cooperation and Development (OECD) commercial interest reference rates (CIRR), adjusted as appropriate for different maturities. For maturities of less than 15 years, the grant element will be calculated based on 6-month averages of commercial interest rates. For maturities longer than 15 years, the grant element will be calculated based on 10-year averages. This PSI assessment criterion applies not only to debt as defined in Point 9 of the Guidelines

[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.

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.

9. **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. Foreign program assistance and program exchange rates for the period April 1, 2011 through December 31, 2011 are:

	Q4 End-June	Q1 End-September	Q2 End-December
Cumulative program assistance (US$ millions)	1058	299	690
TSh/US$ average	1517	1527	1540
TSh/US$ end-period	1520	1533	1547

III. ADJUSTERS

Net international reserves

12. The end-June, end-September and end-December 2011 quantitative targets for the BoT's net international reserves will be adjusted downward by the amount in U.S. dollars of any shortfall in foreign program assistance in U.S. dollars (up to a limit of TSh 250 billion), with each quarterly shortfall 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 up to the date of assessment, relative to projections shown in the Quantitative PSI Assessment Criteria and Indicative Targets Table attached to the applicable Letter of Intent and Memorandum of Economic and Financial Polices of the Government of Tanzania.

Net domestic financing

13. The end-June, end-September and end-December 2011 quantitative limits on the net domestic financing of the Government of Tanzania will be adjusted upward for any shortfall in foreign program assistance in U.S. dollars (up to a limit of TSh 250 billion), 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 up to the date of assessment.

IV. DATA REPORTING REQUIREMENTS

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

Table 1. Summary of Reporting Requirements

Information	Reporting Institution	Frequency	Submission Lag
Issuance of government securities.	BoT	Bi-weekly	1 week
Yields on government securities.	BoT	Bi-weekly	1 week
Consumer price index.	NBS	Monthly	2 weeks
The annual national account statistics in current and constant prices.	NBS	Annually	6 months
The quarterly national account statistics in constant prices.	NBS	Quarterly	3 months
Balance sheet of the BoT (1SR).	BoT	Monthly	1 week
Consolidated accounts of other depository corporations and the depository corporations survey (2SR and the DCS).	BoT	Monthly	4 weeks
Summary of stock of external debt, external arrears, and committed undisbursed loan balances by creditor.	BoT	Monthly	2 weeks
External trade developments.	BoT	Monthly	4 weeks
Balance of payments	BoT	Quarterly	4 weeks
Standard off-site bank supervision indicators for other depository corporations.	BoT	Quarterly	6 weeks
Financial Soundness Indicators for other depository corporations.	BoT	Quarterly	6 weeks

Information	Reporting Institution	Frequency	Submission Lag
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 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.

INTERNATIONAL DEVELOPMENT ASSOCIATION AND
INTERNATIONAL MONETARY FUND[1]

UNITED REPUBLIC OF TANZANIA

Joint World Bank/IMF Debt Sustainability Analysis

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

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Tanzania's risk of debt distress remains low even when taking into account government borrowing from both domestic and external sources, including on non-concessional terms. While the planned external non-concessional borrowing (USD1.5 billion over the three-year PSI period and 1 percent of GDP per year thereafter) increases the present value (PV) of debt-to-GDP and other indicators, it should not jeopardize long-term debt sustainability. However, alternative scenarios suggest that debt indicators would be sensitive to further borrowing on expensive terms. In addition, public debt sustainability analysis raises some concern under an alternative scenario of persistently large primary deficits. This highlights that a sound debt management strategy, a conservative approach to non-concessional borrowing, and commitment to fiscal discipline are important factors for maintaining debt and fiscal sustainability.

I. Background

1. **Tanzania's macroeconomic performance over the last decade has been strong.** Growth averaged 7 percent per year during 2002–09 which, together with a sharp increase in revenue collection and increased donor funding, provided room for a substantial expansion in public spending. Inflation was kept in check for much of this period, but accelerated in 2008 (13.5 percent at end year), driven mainly by the spike in international food and fuel prices. However, it slowed back to around 5 percent by 2009. Tanzania has coped well with the global crisis, in part thanks to supportive fiscal policies. Growth quickly rebounded to its pre-crisis level, reaching about 7 percent by end of 2010.

The positive overall economic outlook is tempered in the near term by below-normal rains and power rationing. Growth is projected to slow to 6 percent in the coming months but to

[1] Prepared by the IMF and World Bank staff in consultation with the authorities. This DSA replaces the previous one prepared in May 2010. Tables and figures are in fiscal years (July–June). For example, 2011 refers to fiscal year 2010/11.

rebound to an average of 6.6 percent in the next fiscal year, once the power situation normalizes, and 7.4 percent by 2012/13. Growth is expected to rise to 7.5 percent of GDP over the medium term, thanks to large investments in mining and continued growth in the non-mining economy. Higher international food and fuel prices could push up inflation in the second half of 2011 before it slows back down to 5 percent. Official international reserves are at a comfortable level (US$3.9 billion as of end-June 2011, more than 4.7 months of current year imports of goods and services), partly reflecting solid export growth, Fund balance of payments support under the Exogenous Shock Facility (ESF), and the SDR allocation.

2. **Tanzania has benefited from extensive debt relief.** HIPC and MDRI debt relief reduced Tanzania's debt burden sharply to US$3.4 billion, or 20.6 percent of GDP at end-June 2007. Debt policy has remained prudent since the provision of debt relief, and total external debt amounted to US$6.5 billion or 30 percent of GDP by end-June 2010.[2] In present value (PV) terms, the public and publicly guaranteed sector (PPG) external debt stood at about 22.7 percent of GDP at end-June 2010, or 90.5 percent of exports, while public external debt service was around 0.8 percent of exports.[3] 64 percent of PPG external debt was owed to multilateral (mainly IDA) and 15 percent to bilateral creditors. Tanzania's public domestic debt stood at TSh 3.96 trillion (13.1 percent of GDP) at end-June 2010, up slightly from the previous year. About half of the domestic debt is in short-term Treasury bills.

End-June 2010 Debt Stocks

External Debt (USD, Million)	6,558.3
By Creditor Category	
Multilateral Debt	4,204.8
Bilateral Debt	955.4
Commercial Debt	815.2
Other	582.9
Domestic Debt (USD, Million)	2841.7

3. **The authorities' medium-term policy is focused on stepping up public investment.** One of the thrusts of the new poverty reduction strategies (MKUKUTA II and MKUZA II) which cover 2010-2015, is to support growth through increased infrastructure spending, especially in transportation, power generation, and irrigation.[4] Inadequate infrastructure is considered a key constraint to capacity building, the business environment, productivity and subsequently higher growth in the country and in the region.[5] While concessional loans and grants will remain the main source of financing for development

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[2] The debt stock excludes about US$560 million in HIPC-eligible arrears, which are expected to be canceled upon conclusion of formal agreements on HIPC debt relief.

[3] Only refers to central government debt. Work is ongoing to broaden the coverage to include contingent liabilities, including government guarantees to state-owned enterprises.

[4] A Joint Staff Advisory Note (JSAN), reviews Tanzania's Second National Strategy for Growth and Reduction of Poverty (NSGRP-MKUKUTA II) which was made public in December 2010 (EBD/11/4, 28/1/2011).

[5] See IMF Working Paper 08/256 "Creating Sustainable Fiscal Space for Infrastructure: the Case of Tanzania," IMF Board paper "Public Investment and Fiscal Policy" (SM/04/93), and *Africa's infrastructure: a time for transformation* (World Bank, 2010).

spending, the authorities are currently exploring sources for semi-concessional and non-concessional external borrowing, as well as domestic funding sources.

II. Baseline Assumptions

4. **Changes in baseline assumptions are minimal from the previous DSA (Box 1).** The growth path (with medium-term growth at about 7.5 percent annually) is virtually unchanged. Similarly, inflation (GDP deflator) is projected at the Bank of Tanzania's medium-term objective of 5 percent; the real exchange rate is assumed to stay constant at 2009/10 levels throughout the projection period; and export/import price index deflators are assumed to grow 2 percent annually. The noninterest current account deficit is expected to increase in 2010–12 before improving steadily to below 6 percent of GDP in the long term, due to the supply response to the buildup in infrastructure.

Box 1. Comparison with the previous DSA

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

- **Growth:** Growth is projected at 7.5 percent over the medium- and long-term, slightly above the rate recorded prior to the global financial crisis on account of the stepping up of infrastructure.
- **Exports and imports:** Export growth is kept somewhat higher than import growth to reflect higher infrastructure spending and export-led growth.
- **Development spending:** Development spending increases from 8.6 percent of GDP in 2009/10 to an average of 9.8 percent during 2010–13, and thereafter 9.4 percent.
- **External non-concessional borrowing:** As in the previous DSA, non-concessional borrowing is assumed to increase by 1 percent of GDP a year after the PSI program period. The average interest rate has been lowered from 9 to 8 percent in line with prevailing market conditions.
- **Foreign concessional loans and grants:** External grants decline to about 3 percent of GDP by 2019/20 and thereafter, compared to 4.5 percent in the previous DSA. Foreign concessional loans also decline in percent of GDP to reflect a gradual reduction in aid dependency.
- **Fiscal financing gap:** The fiscal financing gap increased substantially in 2010/11 from the previous year. The alternative scenario whereby the primary deficit is fixed at 2010/11 level throughout the entire projection period shows substantial deterioration in all debt indicators.

5. **Borrowing assumptions are also largely unchanged.** Domestic and external non-concessional borrowing is expected to be used to finance infrastructure investment. This includes non-concessional external financing of US$1.5 billion over the PSI program period

(US$525 million in 2010/11 and 2011/12, and US$450 million in 2012/13) and 1 percent of GDP for the remainder of the projection period. Domestic financing is projected at about 1 percent of GDP for 2010/11–2014/15 and not exceeding 1 percent of GDP thereafter. The new domestic borrowing is assumed to be at an interest rate of 10 percent (with automatic rollover), while external borrowing is assumed to have an average interest rate of 8 percent, with a 1-year grace period and 10-years' maturity. The authorities are also considering issuance of a Eurobond, likely in 2011/12.

6. **Government revenues are assumed to increase as a percent of GDP while external grants and concessional loans will decline.** Domestic revenues grow from 16.1 percent of GDP in 2010/11 to about 20 percent of GDP by 2018/19 and then 21.4 percent by 2030/31—within IMF staff estimates of Tanzania's tax potential. On the other hand, external grants decline from 5.7 percent of GDP in 2010/11 to about 3 percent of GDP by 2019/20 and thereafter. External concessional loans (both program and project loans) would fall from 4 percent of GDP in 2010/11 to about 2.7 percent of GDP by 2030/31, consistent with a gradual reduction in Tanzania's aid dependency. Annual development spending is assumed to stabilize at 9.4 percent of GDP for the long term. Annual maintenance costs equal to 5 percent of the total value of the accumulated additional infrastructure spending—are added to government recurrent spending throughout the period.

7. **Work is underway to strengthen institutional mechanisms to ensure the quality of new infrastructure spending and an appropriate risk management strategy.** The authorities have developed a list of priority projects consistent with strategic planning documents, including the Medium Term Public Sector Investment Plan and the new PRS. The IMF and World Bank have recently provided technical assistance on debt management and institutional and legal frameworks for PPPs. Drawing on this assistance, the authorities have put in place a new medium-term debt strategy and a new PPP framework. Similarly, the President has approved a "roadmap" with recommendations to improve the business environment, and thus, the private sector response to scaled up infrastructure investment.

8. **Debt data revisions by the authorities reveal weaknesses in debt recording**. As Tanzania's debt is rising and its composition becoming more complex, it is crucial to be able to track all external debt accurately. The authorities are committed to improve their debt monitoring capacities (including through structural benchmarks in the context of the PSI-supported program). They would benefit greatly from technical assistance on properly collecting, compiling and maintaining debt data.[6]

[6] Currently, there are two parallel databases for the external debt, at the Debt Management Department of the BOT and the Accountant General's Office of the MOFEA. The MTDS TA mission recommended that consolidation of the debt database is a priority and capacity enhancements in this area are urgently needed.

III. External and Fiscal Debt Sustainability Analysis

9. **The risk of external debt distress remains low under the baseline scenario.** As a result of the planned non-concessional external borrowing, debt indicators rise but do not jeopardize long-run sustainability (Figure 1). Debt service indicators increase gradually throughout the projection period, but stay well below risk thresholds. The PV of public external debt-to-GDP ratio would increase from 26.6 percent of GDP in 2010/11 to 28.8 percent by 2015/16, before falling to 16.2 percent by the end of the projection period. The PV of debt-to-exports is expected to peak at 97.4 percent of GDP in 2012/13, before declining to 46.5 percent in 2030/31. The debt service-to-export and debt service-to-revenues ratios would reach 6.3 and 10.3 percent, respectively, by 2030/31.

10. **Alternative scenario and shock analysis indicate that Tanzania's debt dynamics is sensitive to the terms of external borrowing.** Tanzania's public external debt would remain below the relevant risk thresholds under the standard bound tests and extreme shocks.[7] However, an alternative scenario with less favorable financing terms (the interest rate on new borrowing is 2 percentage points higher than in the baseline) shows a much larger deterioration in most indicators (e.g. the PV of debt-to-GDP ratio increases from 27 percent in 2010/11 to 37 percent by 2020/21) before converging down to 32 percent in 2030/31.

11. **The path of total public debt, which includes external debt and domestic debt, also appears to be sustainable**. The PV of public debt-to-GDP ratio increases from 39 percent in 2010/11 to 41.2 percent by 2012/13, before declining to 19.2 percent by the end of the projection period. Similarly the PV of public debt-to revenue ratio peaks at 183.6 percent in 2012/13 before declining to 78 in 2030/31. Debt service-to-revenue increases from 6.8 percent in 2010/11 to 11.5 percent by end of the projection period (Figure 2).

12. **Public debt sustainability is particularly sensitive to the fiscal position (Figure 2).** As the 2010/11 fiscal financing gap increased substantially from the previous year, the alternative scenario whereby the primary deficit is fixed through the entire projection period shows substantial deterioration in all debt indicators. Under this scenario, the PV of debt-to-GDP ratio would accelerate from 39 percent to 69 percent (A2 in Table 4). The large fiscal deficit partly reflects the counter-cyclical response to the Global Financial Crisis (GFC). Restoring a more balanced fiscal position is an urgent requirement to prevent an unsustainable debt buildup. Given ambitious assumptions on revenue increases in the

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[7] Debt burden thresholds for Tanzania are PV of debt to GDP ratio of 50 percent, PV of debt-to-exports ratio of 200 percent, PV of debt-to-revenue ratio of 300 percent, debt-service-to-exports ratio of 25 percent, and debt-service-to-revenue ratio of 35 percent.

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

IV. CONCLUSION

13. **Based on the updated DSA, Tanzania's debt indicators are expected to remain below indicative, country-specific thresholds.** The additional borrowing to finance a stepping up of infrastructure investment over the medium term will increase the present value (PV) of debt-to-GDP and other indicators, but should not jeopardize long-term debt sustainability. While in general the downside scenarios and sensitivity analysis support the assessment of a low risk of debt distress, borrowing non-concessionally on expensive terms, and large and persistent primary deficits can reverse this outlook. Therefore a sound debt management strategy, a conservative approach to non-concessional borrowing, and commitment to fiscal discipline are key factors for maintaining debt and fiscal sustainability.

Table 1: External Debt Sustainability Framework, Baseline Scenario, 2008-2031 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical 0 Average	0 Standard Deviation	Projections									
	2008	2009	2010			2011	2012	2013	2014	2015	2016	2011-2016 Average	2021	2031	2017-2031 Average
External debt (nominal) 1/	**25.1**	**27.1**	**30.0**			**35.1**	**38.4**	**40.2**	**40.7**	**41.3**	**41.7**		**41.9**	**35.5**	
o/w public and publicly guaranteed (PPG)	20.9	22.4	24.6			28.7	31.3	32.8	33.1	33.3	33.3		31.1	23.8	
Change in external debt	4.5	2.1	2.9			5.1	3.4	1.8	0.5	0.6	0.3		-0.1	-0.8	
Identified net debt-creating flows	4.4	5.9	4.7			5.7	5.9	4.6	3.4	2.1	1.5		-0.5	-0.5	
Non-interest current account deficit	**11.0**	**9.9**	**8.5**	**6.9**	**3.1**	**9.1**	**9.7**	**8.9**	**8.0**	**7.0**	**6.8**		**5.4**	**5.8**	5.8
Deficit in balance of goods and services	14.2	13.3	11.4			12.7	12.6	11.6	10.6	9.6	9.3		7.5	7.2	
Exports	25.4	24.3	25.1			29.7	30.2	30.4	30.7	31.6	32.0		34.1	34.9	
Imports	39.7	37.6	36.5			42.4	42.8	42.1	41.3	41.2	41.2		41.5	42.1	
Net current transfers (negative = inflow)	-3.6	-3.5	-2.9	-3.1	1.2	-3.3	-2.6	-2.4	-2.2	-2.1	-2.0		-1.5	-0.9	-1.4
o/w official	-3.5	-3.4	-2.7			-3.2	-2.4	-2.2	-2.1	-2.0	-1.9		-1.4	-0.9	
Other current account flows (negative = net inflow)	0.3	0.1	0.0			-0.2	-0.3	-0.3	-0.4	-0.4	-0.5		-0.5	-0.5	
Net FDI (negative = inflow)	**-2.6**	**-2.0**	**-1.9**	**-3.4**	**1.1**	**-1.9**	**-2.3**	**-2.4**	**-2.6**	**-2.9**	**-3.3**		**-3.9**	**-4.6**	-4.1
Endogenous debt dynamics 2/	**-4.0**	**-2.0**	**-1.9**			**-1.5**	**-1.5**	**-1.9**	**-2.0**	**-2.0**	**-2.0**		**-2.0**	**-1.6**	
Contribution from nominal interest rate	0.1	0.3	0.2			0.4	0.6	0.7	0.7	0.8	0.8		0.8	0.8	
Contribution from real GDP growth	-1.2	-1.5	-1.6			-1.9	-2.1	-2.6	-2.8	-2.8	-2.8		-2.9	-2.5	
Contribution from price and exchange rate changes	-3.0	-0.8	-0.4			…	…	…	…	…	…		…	…	
Residual (3-4) 3/	**0.1**	**-3.8**	**-1.8**			**-0.6**	**-2.6**	**-2.8**	**-2.9**	**-1.5**	**-1.2**		**0.4**	**-0.3**	
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	28.1			33.0	35.8	37.1	37.1	37.2	37.2		36.0	27.9	
In percent of exports	...	...	112.2			111.1	118.5	121.9	120.7	118.0	116.3		105.8	79.9	
PV of PPG external debt	**...**	**...**	**22.7**			**26.6**	**28.7**	**29.6**	**29.5**	**29.2**	**28.8**		**25.3**	**16.2**	
In percent of exports	**...**	**...**	**90.5**			**89.5**	**95.0**	**97.4**	**96.0**	**92.6**	**90.0**		**74.2**	**46.5**	
In percent of government revenues	**...**	**...**	**143.6**			**165.0**	**176.2**	**180.0**	**176.5**	**163.5**	**154.5**		**123.9**	**75.9**	
Debt service-to-exports ratio (in percent)	**3.0**	**2.0**	**1.6**			**2.1**	**3.3**	**4.2**	**4.9**	**5.3**	**5.6**		**6.4**	**7.6**	
PPG debt service-to-exports ratio (in percent)	**0.8**	**0.9**	**0.8**			**1.4**	**2.6**	**3.5**	**4.3**	**4.7**	**4.9**		**5.6**	**6.3**	
PPG debt service-to-revenue ratio (in percent)	**1.2**	**1.4**	**1.3**			**2.5**	**4.8**	**6.5**	**7.9**	**8.3**	**8.4**		**9.3**	**10.3**	
Total gross financing need (Billions of U.S. dollars)	1.8	1.8	1.6			1.9	2.2	2.2	2.1	1.9	1.9		2.1	5.4	
Non-interest current account deficit that stabilizes debt ratio	6.5	7.8	5.6			4.1	6.4	7.1	7.5	6.4	6.5		5.6	6.5	
Key macroeconomic assumptions															
Real GDP growth (in percent)	7.3	6.7	6.5	7.0	0.4	6.4	6.6	7.4	7.5	7.5	7.5	7.2	7.5	7.5	7.5
GDP deflator in US dollar terms (change in percent)	16.7	3.3	1.7	2.1	6.3	-3.6	2.2	2.0	1.9	1.5	1.9	1.0	1.9	1.9	1.9
Effective interest rate (percent) 5/	0.8	1.3	0.7	0.7	0.4	1.3	1.8	1.9	2.0	2.1	2.1	1.9	2.1	2.5	2.3
Growth of exports of G&S (US dollar terms, in percent)	28.9	5.2	12.0	16.2	9.9	21.5	10.9	10.3	10.5	12.2	10.9	12.7	10.9	9.8	10.1
Growth of imports of G&S (US dollar terms, in percent)	32.7	4.4	5.1	15.4	11.4	19.3	10.2	7.5	7.6	8.7	9.6	10.5	9.6	9.6	9.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	18.6	22.1	24.5	29.9	29.5	29.1	25.6	26.9	24.5	26.1
Government revenues (excluding grants, in percent of GDP)	15.9	16.2	15.8			16.1	16.3	16.5	16.7	17.9	18.6		20.4	21.4	20.6
Aid flows (in Billions of US dollars) 7/	1.3	1.0	1.1			2.0	2.2	2.3	2.4	2.2	2.2		2.8	6.5	
o/w Grants	…	…	…			1.5	1.6	1.7	1.8	1.5	1.5		1.8	4.5	
o/w Concessional loans	…	…	…			0.5	0.6	0.6	0.6	0.7	0.7		0.9	2.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			7.4	7.5	7.1	6.9	5.6	5.3		4.1	3.9	4.1
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			63.5	64.4	67.0	72.3	68.2	67.2		63.4	64.7	64.2
Memorandum items:															
Nominal GDP (Billions of US dollars)	19.0	21.0	22.7			23.3	25.4	27.8	30.5	33.3	36.4		57.3	141.8	
Nominal dollar GDP growth	25.2	10.2	8.3			2.6	9.0	9.5	9.5	9.2	9.5	8.2	9.5	9.5	9.5
PV of PPG external debt (in Billions of US dollars)			4.9			6.1	7.2	8.1	8.9	9.6	10.3		14.3	22.7	
(PVt-PVt-1)/GDPt-1 (in percent)						4.9	4.7	3.8	2.6	2.4	2.2	3.4	1.5	0.6	1.3
Gross workers' remittances (Billions of US dollars)	…	…	…			…	…	…	…	…	…		…	…	
PV of PPG external debt (in percent of GDP + remittances)	...	...	22.7			26.6	28.7	29.6	29.5	29.2	28.8		25.3	16.2	
PV of PPG external debt (in percent of exports + remittances)	...	...	90.5			89.5	95.0	97.4	96.0	92.6	90.0		74.2	46.5	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	0.8			1.4	2.6	3.5	4.3	4.7	4.9		5.6	6.3	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that PV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2a.Tanzania: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2011-2031
(In percent)

	Projections							
	2011	2012	2013	2014	2015	2016	**2021**	2031
PV of debt-to GDP ratio								
Baseline	27	29	30	29	29	29	**25**	16
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	27	25	23	22	21	21	**25**	32
A2. New public sector loans on less favorable terms in 2011-2031 2	27	30	33	34	35	36	**37**	33
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	27	28	29	29	29	29	**25**	16
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	27	29	32	32	32	31	**27**	16
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	27	30	33	33	33	32	**28**	18
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	27	29	30	30	30	29	**25**	16
B5. Combination of B1-B4 using one-half standard deviation shocks	27	29	30	30	30	29	**26**	17
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	27	40	41	41	41	40	**35**	23
PV of debt-to-exports ratio								
Baseline	90	95	97	96	93	90	**74**	47
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	90	81	76	70	67	66	**74**	92
A2. New public sector loans on less favorable terms in 2011-2031 2	90	101	109	112	112	112	**107**	94
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	90	93	96	95	91	89	**73**	46
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	90	101	115	113	109	105	**85**	51
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	90	93	96	95	91	89	**73**	46
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	90	95	100	98	94	92	**75**	46
B5. Combination of B1-B4 using one-half standard deviation shocks	90	92	92	91	88	85	**71**	45
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	90	93	96	95	91	89	**73**	46
PV of debt-to-revenue ratio								
Baseline	165	176	180	177	164	155	**124**	76
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	165	151	140	129	118	113	**124**	150
A2. New public sector loans on less favorable terms in 2011-2031 2	165	187	202	206	198	193	**179**	153
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	165	173	178	175	162	153	**123**	75
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	165	180	197	192	177	167	**131**	77
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	165	185	201	197	183	173	**138**	84
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	165	177	184	180	166	157	**125**	75
B5. Combination of B1-B4 using one-half standard deviation shocks	165	176	184	180	167	158	**127**	79
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	165	245	251	246	228	215	**172**	105

Table 2b.Tanzania: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2011-2031 (continued)
(In percent)

Debt service-to-exports ratio

Baseline	1	3	4	4	5	5	**6**	6
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	1	3	3	4	4	4	**5**	8
A2. New public sector loans on less favorable terms in 2011-2031 2	1	3	2	3	3	4	**6**	8
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	1	3	4	4	5	5	**6**	6
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	1	3	4	5	5	6	**6**	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	1	3	4	4	5	5	**6**	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	1	3	4	4	5	5	**6**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	1	3	3	4	5	5	**5**	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	1	3	4	4	5	5	**6**	6

Debt service-to-revenue ratio

Baseline	2	5	7	8	8	8	**9**	10
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2011-2031 1/	2	5	6	7	7	7	**8**	13
A2. New public sector loans on less favorable terms in 2011-2031 2	2	5	4	6	6	6	**9**	14
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012-2013	2	5	7	8	8	8	**9**	10
B2. Export value growth at historical average minus one standard deviation in 2012-2013 3/	2	5	7	9	9	9	**10**	11
B3. US dollar GDP deflator at historical average minus one standard deviation in 2012-2013	2	5	7	9	9	10	**11**	12
B4. Net non-debt creating flows at historical average minus one standard deviation in 2012-2013 4/	2	5	7	8	8	9	**10**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	2	5	7	8	9	9	**10**	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	2	7	9	11	12	12	**13**	15
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	10	10	10	10	10	10	**10**	10

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3.Tanzania: Public Sector Debt Sustainability Framework, Baseline Scenario, 2008-2031
(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2008	2009	2010	Average	Standard Deviation	2011	2012	2013	2014	2015	2016	2011-16 Average	2021	2031	2017-31 Average
Public sector debt 1/	35.2	34.5	37.6			41.1	43.2	44.3	44.0	43.5	42.8		37.6	26.8	
o/w foreign-currency denominated	20.9	22.4	24.6			28.7	31.3	32.8	33.1	33.3	33.3		31.1	23.8	
Change in public sector debt	-3.4	-0.7	3.1			3.4	2.2	1.1	-0.4	-0.4	-0.7		-1.0	-1.2	
Identified debt-creating flows	-4.0	0.3	3.4			3.8	2.1	1.0	-0.4	-0.5	-0.8		-1.0	-1.2	
Primary deficit	-1.2	3.1	5.1	2.0	1.7	5.1	4.6	3.7	2.0	1.7	1.4	3.1	0.7	-0.1	0.4
Revenue and grants	22.8	21.2	20.7			22.5	22.7	22.4	22.5	22.4	22.8		23.6	24.6	
of which: grants	6.9	5.0	4.9			6.4	6.4	6.0	5.8	4.5	4.2		3.2	3.2	
Primary (noninterest) expenditure	21.7	24.3	25.8			27.6	27.2	26.1	24.5	24.1	24.2		24.3	24.5	
Automatic debt dynamics	-2.8	-2.6	-1.6			-1.3	-2.5	-2.7	-2.4	-2.2	-2.2		-1.6	-1.1	
Contribution from interest rate/growth differential	-3.6	-1.8	-1.6			-2.1	-2.3	-2.6	-2.5	-2.3	-2.2		-1.7	-1.1	
of which: contribution from average real interest rate	-1.0	0.4	0.5			0.1	0.3	0.4	0.6	0.8	0.8		1.0	0.8	
of which: contribution from real GDP growth	-2.6	-2.2	-2.1			-2.3	-2.5	-3.0	-3.1	-3.1	-3.0		-2.7	-1.9	
Contribution from real exchange rate depreciation	0.8	-0.8	0.0			0.8	-0.2	-0.1	0.0	0.1	0.0		...	...	
Other identified debt-creating flows	0.0	-0.2	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	-0.2	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	0.5	-1.0	-0.4			-0.3	0.1	0.1	0.0	0.0	0.0		0.0	0.0	
Other Sustainability Indicators															
PV of public sector debt	...	...	35.8			39.0	40.6	41.2	40.3	39.5	38.3		31.8	19.2	
o/w foreign-currency denominated	...	...	22.7			26.6	28.7	29.6	29.5	29.2	28.8		25.3	16.2	
o/w external	...	...	22.7			26.6	28.7	29.6	29.5	29.2	28.8		25.3	16.2	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	12.4	11.0	12.7			12.9	12.3	11.4	10.0	9.6	9.1		7.0	4.4	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	173.0			173.2	179.3	183.6	179.4	176.3	167.8		134.6	78.0	
PV of public sector debt-to-revenue ratio (in percent)	…	…	226.3			242.0	249.3	250.1	241.5	220.6	205.6		155.7	89.7	
o/w external 3/	…	…	143.6			165.0	176.2	180.0	176.5	163.5	154.5		123.9	75.9	
Debt service-to-revenue and grants ratio (in percent) 4/	5.2	8.6	8.3			6.8	7.6	8.8	10.5	11.4	11.7		12.7	11.5	
Debt service-to-revenue ratio (in percent) 4/	7.5	11.3	10.9			9.5	10.6	12.0	14.1	14.3	14.3		14.7	13.2	
Primary deficit that stabilizes the debt-to-GDP ratio	2.3	3.8	2.0			1.6	2.4	2.6	2.4	2.1	2.2		1.6	1.1	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.3	6.7	6.5	7.0	0.4	6.4	6.6	7.4	7.5	7.5	7.5	7.2	7.5	7.5	7.5
Average nominal interest rate on forex debt (in percent)	0.7	0.7	0.4	0.5	0.3	1.2	1.9	2.2	2.3	2.4	2.5	2.1	2.7	3.3	2.9
Average real interest rate on domestic debt (in percent)	-3.8	4.0	6.2	1.6	3.4	2.4	2.1	3.0	4.8	6.2	6.9	4.2	12.9	15.5	13.2
Real exchange rate depreciation (in percent, + indicates depreciation)	5.5	-4.0	0.1	0.6	7.1	3.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	9.5	8.7	7.5	6.8	1.8	7.3	6.3	5.4	4.9	4.6	5.0	5.6	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	18.6	22.1	24.5	29.9	29.5	29.1	25.6	26.9	24.5	...

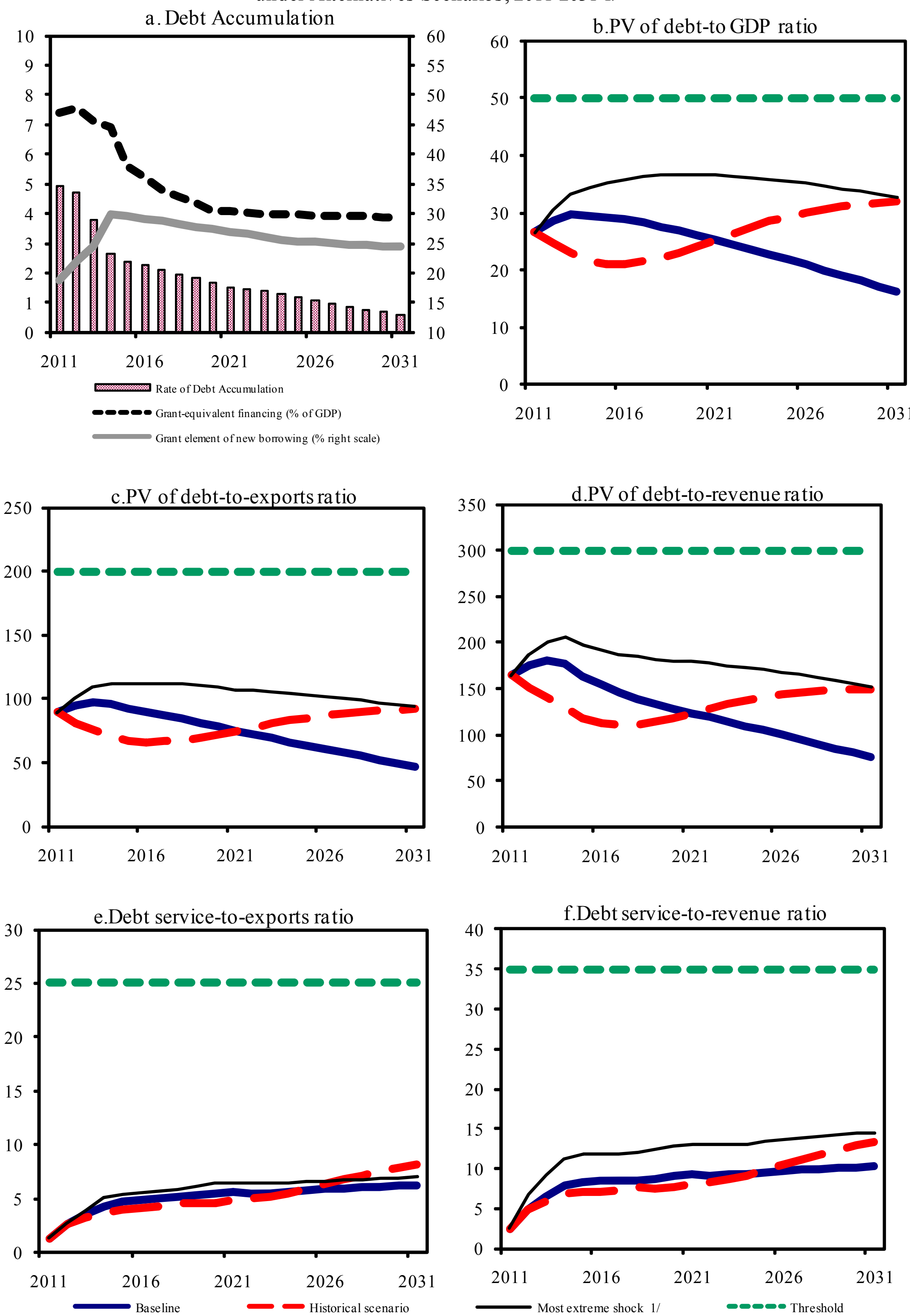
Sources: Country authorities; and staff estimates and projections.
1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues excluding grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 4.Tanzania: Sensitivity Analysis for Key Indicators of Public Debt 2011-2031

	Projections							
	2011	2012	2013	2014	2015	2016	2021	2031
PV of Debt-to-GDP Ratio								
Baseline	39	41	41	40	39	38	32	19
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	39	38	37	37	37	36	36	36
A2. Primary balance is unchanged from 2011	39	41	43	45	47	48	57	69
A3. Permanently lower GDP growth 1/	39	41	41	40	40	39	33	22
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012-2013	39	41	42	41	40	39	33	21
B2. Primary balance is at historical average minus one standard deviations in 2012-2013	39	40	41	40	39	38	31	19
B3. Combination of B1-B2 using one half standard deviation shocks	39	39	39	38	38	37	31	19
B4. One-time 30 percent real depreciation in 2012	39	52	51	50	48	46	38	25
B5. 10 percent of GDP increase in other debt-creating flows in 2012	39	50	50	48	47	46	37	22
PV of Debt-to-Revenue Ratio 2/								
Baseline	173	179	184	179	176	168	135	78
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	173	168	167	164	163	159	151	144
A2. Primary balance is unchanged from 2011	173	181	191	199	208	212	241	279
A3. Permanently lower GDP growth 1/	173	179	184	180	177	169	138	88
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012-2013	173	179	185	181	178	170	139	84
B2. Primary balance is at historical average minus one standard deviations in 2012-2013	173	176	181	177	174	165	133	77
B3. Combination of B1-B2 using one half standard deviation shocks	173	172	174	171	168	161	130	78
B4. One-time 30 percent real depreciation in 2012	173	228	228	220	214	203	161	101
B5. 10 percent of GDP increase in other debt-creating flows in 2012	173	219	222	216	211	200	158	90
Debt Service-to-Revenue Ratio 2/								
Baseline	7	8	9	10	11	12	13	12
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	7	8	8	10	11	11	13	16
A2. Primary balance is unchanged from 2011	7	8	9	11	12	13	18	25
A3. Permanently lower GDP growth 1/	7	8	9	10	11	12	13	12
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012-2013	7	8	9	11	12	12	13	12
B2. Primary balance is at historical average minus one standard deviations in 2012-2013	7	8	9	10	11	12	13	11
B3. Combination of B1-B2 using one half standard deviation shocks	7	8	9	10	11	11	12	11
B4. One-time 30 percent real depreciation in 2012	7	8	11	13	15	15	17	18
B5. 10 percent of GDP increase in other debt-creating flows in 2012	7	8	10	13	14	14	15	13

Sources: Country authorities; and staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.
2/ Revenues are defined inclusive of grants.

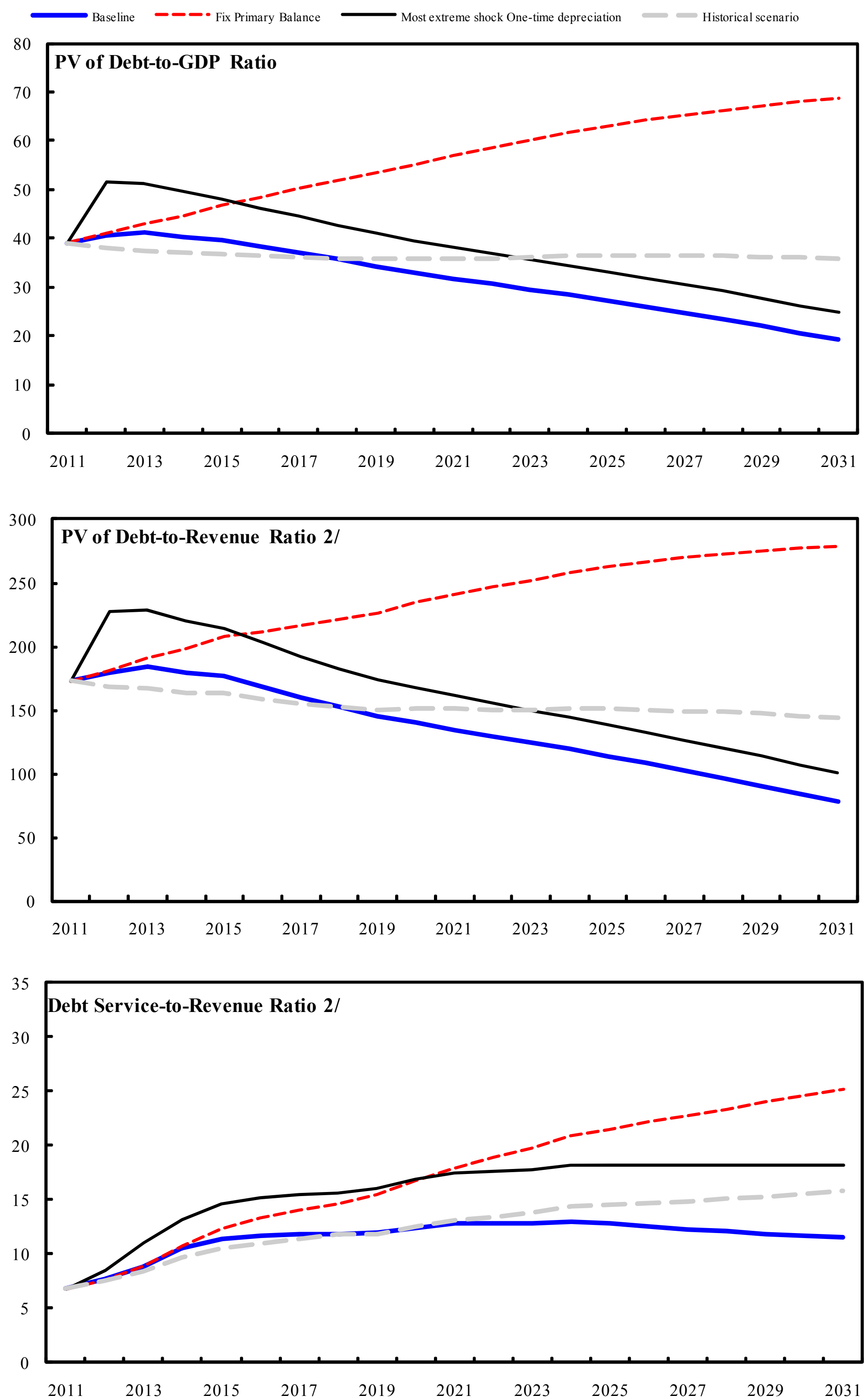
Figure 1. Tanzania: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2011-2031 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2021. In figure b. it corresponds to a One-time depreciation shock; in c. to a Exports shock; in d. to a One-time depreciation shock; in e. to a Exports shock; in f. to a One-time depreciation shock.

Figure 2.Tanzania: Indicators of Public Debt Under Alternative Scenarios, 2011-2031 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2021.
2/ Revenues are defined inclusive of grants.

INTERNATIONAL MONETARY FUND

UNITED REPUBLIC OF TANZANIA

2011 Article IV Consultation and Second Review Under the Policy Support Instrument—Informational Annex

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

April 21, 2011

- **Relations with the Fund.**
- **Joint Bank-Fund Work Program**. Describes Bank-Fund collaboration during March 2011–March 2012.

Contents Page

APPENDIX I. TANZANIA: RELATIONS WITH THE FUND
(As of February 28, 2011)

I. Membership Status: Joined: September 10, 1962; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	198.90	100.00
Fund holdings of currency	188.90	94.97
Reserve Tranche Position	10.00	5.03
Lending to the Fund		
Notes Issuance		
Holdings Exchange Rate		

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	190.51	100.00
Holdings	158.02	82.95

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
ESF Arrangements	218.79	110.00
ECF Arrangements	10.64	5.35

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESF	May 29, 2009	June 14, 2010	218.79	218.79
ECF[1]	Aug 16, 2003	Feb 26, 2007	19.60	19.60
ECF[1]	Apr 04, 2000	Aug 15, 2003	135.00	135.00

[1] Formerly PRGF.

VI. Projected Payments to Fund[1]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2011	2012	2013	2014	2015
Principal	1.12	1.96	2.24	18.15	43.73
Charges/Interest	0.11	0.71	0.70	0.70	0.62
Total	1.23	2.67	2.94	18.85	44.35

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Implementation of HIPC Initiative:

	Enhanced Framework
I. Commitment of HIPC assistance	
Decision point date	April 2000
Assistance committed by all creditors (US$ Million)[1]	2,026.00
Of which: IMF assistance (US$ million)	119.80
(SDR equivalent in millions)	88.95
Completion point date	November 2001
II. Disbursement of IMF assistance (SDR Million)	
Assistance disbursed to the member	88.95
Interim assistance	26.68
Completion point balance	62.27
Additional disbursement of interest income[2]	7.45
Total disbursements	96.40

[1] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts can not be added.

[2] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI):

I. MDRI-eligible debt (SDR Million)[1]	234.03
Financed by: MDRI Trust	207.00
Remaining HIPC resources	27.03

II. Debt Relief by Facility (SDR Million)

	Eligible Debt		
Delivery Date	**GRA**	**PRGF**	**Total**
January 2006	N/A	234.03	234.03

[1] The MDRI provides 100 percent debt relief to eligible member countries that qualified for the assistance. Grant assistance from the MDRI Trust and HIPC resources provide debt relief to cover the full stock of debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief.

IX. Safeguards Assessments:

Safeguards assessments of the Bank of Tanzania (BoT) were completed in December 2003, August 2008, and November 2009. The 2009 assessment found that, while the BoT had taken steps to strengthen its safeguards framework, risks remained due to delays in implementing certain priority recommendations from the 2008 voluntary assessment. The external audit and financial reporting continued to comply with international standards, but the audited results were published with significant delays. The assessment recommended a bank-wide risk assessment, outlined steps needed to modernize the internal audit function, and proposed measures to enhance transparency of financial, control and compliance matters. The BoT has since taken steps to improve the timeliness of its financial audits and the financial statements for 2009/10 were published within the statutory deadline. The implementation of other measures is in progress.

X. Exchange Rate Arrangement:

The currency of Tanzania is the Tanzania shilling. Under the revised classification methodology, Tanzania has a floating exchange rate arrangement. The official exchange rate is determined in relation to the rate established in the interbank market for foreign exchange. The weighted average rate in the interbank market was TSh 1,516.83 per U.S. dollar as of end-February 2011. The exchange system is free of restrictions on the making of payments and transfers for current international transactions.

XI. Article IV Consultation:

The most recent Article IV consultation was concluded on June 8, 2009 (Country Report No. 09/179).

XII. Resident Representative:

Mr. John Wakeman-Linn has been the Senior Resident Representative since August 2010.

APPENDIX II: TANZANIA—JOINT BANK-FUND WORK PROGRAM MARCH 2011–MARCH 2012

Title	**Products**	**Provisional timing of missions (if relevant)**	**Expected delivery date**
A. Mutual information on relevant work programs			
Key elements of World Bank work program in next 12 months	The work program will continue to concentrate on areas within the existing and new lending portfolio: primary, secondary, and higher education; health sector development; water and sanitation; social action fund; agriculture; agribusiness development (Southern Agricultural Growth Corridor (SAGCOT)); natural resource management including minerals ; environment; road and railway infrastructure; power sector restructuring; housing finance; statistical capacity; urban; fiscal decentralization; private sector competitiveness; and public sector reform. Increasing regional portfolio in agriculture, health, finance, power, and environment.		Continuous
	Public expenditure review with the focus on rapid budget analysis (RBA); Public Investment Management (PIM) Assessment; and Public Expenditure Review (PER) with new content on Value for Money in the education sector.		April 2011 (PIM Assessment); May 2011 (PER); and November 2011 (RBA)
	The new WBG Country Assistance Strategy (CAS) is under preparation and has a corporate review (Regional Operations Committee or ROC meeting) in April 2011. It will be presented to the Board in June 2011.		June 2011
	First operation of the new PRSC/thematic DPO series will be prepared to provide budget support for Tanzania's 2011/12 budget. It will be submitted for Board approval by December 2011.		December 2011
	First Pension Reform Programmatic DPO is under preparation for delivery during the first half of 2011/12.		December 2011

IMF work program in next 12 months	Second PSI Review and Article IV Consultation	March 2011	May 2011
	Third PSI Review	October 2011	December 2011
	Fourth PSI Review	March 2012	May 2012
B. Requests for work program inputs			
Fund requests to Bank	1. Assessment of key infrastructure projects and sectoral programs.		Continuous
	2. Assessment of financial health of pension funds.		Continuous
	3. Inputs on the design of a social protection framework.		Continuous
Bank requests to Fund	1. Monitoring of government contracting of non-concessional borrowing.		Continuous
	2. Monitoring of steps to strengthen corporate governance of the BoT		Continuous
	3. Sharing macro-framework updates.		Continuous
	4. Statement of fiscal risk and contingent liabilities.		Continuous
C. Agreement on joint products and missions			
Joint products in next 12 months	1. Collaborate on a joint DSA	March 2011	April 2011
	2. Collaborate together with other development partners on the annual review of general budget support (GBS AR 2011).	Early 2012	Early 2012
	3. Collaborate on PFM reform program in the context of multi-donor support of the Public Financial Management Reform Program.		Continuous

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/53
FOR IMMEDIATE RELEASE
May 9, 2011

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2011 Article IV Consultation with The United Republic of Tanzania

On May 6, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tanzania.[1]

Background

The economy has performed strongly over the past decade with average growth of 7 percent, a robust expansion in exports, and progress towards the MDGs. The authorities have implemented wide-ranging policy reforms over several decades and recently were able to use the fiscal space accumulated in better years to mitigate the impact of the global financial crisis. Nonetheless, challenges remain. Per capita income is about US$ 550 and poverty remains widespread, with one in three living below the poverty line. Tanzania is highly dependent on foreign aid, projected to peak at 10 percent of GDP this year.

Tanzania weathered the adverse shocks of recent years relatively well. Activity slowed in the aftermath of the global financial crisis but rebounded in the second half of 2009, thanks in part to supportive fiscal and monetary policies. Consumer price inflation fell into single digits as good harvests pushed down food prices and fuel prices were subdued. Financial market indicators remained sound overall.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The economic rebound has now leveled off. Growth in 2010 is estimated at 7 percent with continued strong performance in manufacturing, construction, and communications and a more subdued expansion in agriculture and gold mining. In recent months, power shortages after below-normal rainfalls have been taking a toll on activity. Growth is expected to decline to 6 percent in 2011 but rebound quickly once the weather situation normalizes. Consumer price inflation rose in early 2011 largely due to higher energy and food prices—the latter mainly weather-related.

The medium-term outlook is favorable but could raise significant policy challenges. Large projected investments in the commodity sectors could weigh on overall competitiveness and pose challenges for exchange rate management. It also needs to be ensured that these investments benefit other sectors of the economy. Rapid population growth will continue to put pressure on the delivery of public services, far outpacing the growth of domestic revenue or foreign aid.

The near-term fiscal situation is already challenging: revenue collection for 2010/11 is falling short of ambitious budget targets due in part to the adverse weather situation, constraining public spending and contributing to the emergence of arrears.[2] Spending was cut in the context of the mid-year budget review, and steps were taken to tighten commitment controls, but more spending restraint is likely to be needed.

Monetary policy has become less accommodative, and the exchange rate has been stable in recent months reflecting relatively modest inflation differentials and rising domestic interest rates. Non-performing loans remained at manageable levels after growing considerably in the second half of 2010, largely reflecting deterioration in personal loans, which expanded significantly in recent years.

Executive Board Assessment

Executive Directors commended the authorities for the continued strong performance despite the adverse shocks in recent years. While medium-term prospects remain favorable, Directors encouraged the authorities to press ahead with essential fiscal consolidation and structural reforms to sustain pro-poor growth and employment over the medium term.

Directors agreed that a prudent 2011/12 budget would be an important first step toward strengthening public finances. While recognizing that high fuel prices, weather-related supply shocks, and shortfalls in donor aid could complicate near-term fiscal management, they encouraged the authorities to continue to streamline current spending by trimming the wage bill, aligning spending more closely with available

[2] The fiscal year ends June 30.

resources, and tightening existing commitment controls to help prevent the reemergence of arrears. At the same time, it will be important to safeguard essential social spending and high-yielding infrastructure investment.

Directors stressed the importance of broadening the tax base, reducing tax exemptions, and strengthening public financial management. They considered that strengthening VAT compliance and enhancing the taxation of the mining sector will be key to boosting revenue mobilization.

Directors encouraged the authorities to expeditiously complete their debt management strategy and maintain a cautious approach to non-concessional borrowing to ensure debt sustainability over the medium term. In this context, they stressed the need to carefully select projects financed with nonconcessional borrowing through rigorous cost-benefit analysis.

Directors urged the authorities to monitor inflation developments closely and stand ready to further tighten monetary policy as needed. They noted the staff's assessment that the exchange rate appears broadly in line with fundamentals. Directors welcomed the overall soundness of the financial sector and the authorities' reform efforts, in line with the 2010 FSAP recommendations. They emphasized the importance of continued vigilance regarding credit quality, given the recent rise in non-performing loans and lending.

Directors stressed the importance of reinvigorating structural reforms and improving governance and the business environment. Further progress in these areas is critical to bolstering private sector confidence, increasing economic diversification, and preserving the competitiveness of non-commodity sectors, including emerging manufacturing exports.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

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

	2008/09	2009/10	2010/11	2011/12	2012/13
			Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)				
National income and prices					
Real GDP growth (calendar year)[1]	7.4	6.0	7.0	6.0	7.2
Consumer prices (period average)	11.8	10.5	6.3	7.0	5.2
Consumer prices (end of period)	10.7	7.2	7.5	5.5	5.0
External sector					
Export, f.o.b. (in millions of U.S. dollars)	3,268	3,754	4,683	5,188	5,711
Imports, f.o.b. (in millions of U.S. dollars)	-6,220	-6,570	-7,873	-8,750	-9,452
Export volume	8.3	6.4	9.9	6.9	8.9
Import volume	10.4	4.5	7.3	5.4	8.0
Terms of trade	7.5	8.4	0.3	-1.8	1.1
Nominal effective exchange rate (end of period; depreciation = -)	-3.7	-3.7	…	...	...
Real effective exchange rate (end of period; depreciation = -)	7.0	0.5	…	...	...
Money and credit					
Broad money (M3)	18.5	25.1	20.1	19.0	18.6
Net foreign assets	15.8	25.3	19.1	10.1	9.0
Net domestic assets	21.7	25.0	21.2	29.1	28.0
Credit to nongovernment sector	33.1	16.7	23.0	20.8	20.7
Velocity of money (GDP/M3; average)	3.6	3.4	3.2	3.1	2.9
Treasury bill interest rate (in percent; end of period)[2]	7.0	4.5	…	…	…
	(Percent of GDP)				
Public Finance					
Revenue (excluding grants)	16.2	15.8	16.1	16.3	16.5
Total grants	5.1	4.6	6.4	6.4	6.0
Expenditure	26.1	27.4	29.0	28.6	27.6
Overall balance (excluding grants)[3]	-9.9	-11.6	-12.9	-12.4	-11.1
Overall balance (including grants)[3]	-4.8	-6.9	-6.5	-6.0	-5.2
Domestic financing	0.8	1.8	1.0	1.0	1.0
Domestic debt stock (end of period)	12.2	13.1	12.4	11.9	11.5
Savings and investment[1]					
Resource gap	-11.9	-11.8	-12.6	-12.3	-11.4
Investment	29.0	28.7	28.8	29.0	29.3
Government	8.6	9.8	11.3	11.3	10.6
Nongovernment[4]	20.4	18.9	17.5	17.7	18.7
Gross domestic savings	17.0	16.9	16.2	16.6	17.9
External sector					
Current account balance (excluding current transfers)	-13.5	-11.4	-12.6	-13.1	-12.3
Current account balance (including current transfers)	-10.2	-8.6	-9.5	-10.7	-10.1
	(Millions of U.S. dollars, unless otherwise indicated)				
Balance of payments					
Current account balance (excluding current transfers; deficit = -)	-2,833	-2,578	-2,944	-3,326	-3,430
Gross official reserves (end of period)	2,930	3,483	3,831	4,133	4,430
In months of imports of goods and services (current year)	4.5	5.1	4.7	4.5	4.5
External debt stock (end of period; percent of GDP)	27.1	30.0	35.1	38.4	40.2

Sources: Tanzanian authorities and IMF staff estimates and projections.

[1] Data are on calendar year basis. For example, 2008/09 data are for calendar year 2008.

[2.] End-year (June) monthly weighted-average yield of 35-, 91-, 182-, and 364-day treasury bills.

[3] Does not include adjustment to cash basis.

[4] Including change in stocks.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 11/164
FOR IMMEDIATE RELEASE
May 6, 2011

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review Under Policy Support Instrument for Tanzania

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Tanzania's economic performance under the Policy Support Instrument (PSI). The Executive Board also concluded Tanzania's annual Article IV consultation, which will be covered in a subsequent Public Information Notice.

The Executive Board approved a three-year PSI for Tanzania on June 4, 2010 (see Press Release No. 10/227). The IMF's framework for PSIs is designed for low-income countries that may not need IMF financial assistance, but still seek close cooperation with the IMF in preparation and endorsement of their policy frameworks. PSI-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners. A country's performance under a PSI is reviewed bi-annually.

Following the Executive Board's discussion of Tanzania, Mr. John Lipsky, IMF First Deputy Managing Director and Acting Chair, said:

"Tanzania has shown continued strong macroeconomic performance as accommodating fiscal and monetary policies helped mitigate the impact of the global financial crisis. The authorities now rightly intend to rein in these expansionary policies, restore policy buffers, and prepare for a possible deceleration in foreign aid. The threat of a protracted weather-related supply shock and rising international fuel prices will also weigh on near-term fiscal and monetary management.

"Building on the tradition of solid budgetary policies, a prudent 2011/12 budget would be an important first step toward realigning spending with available resources. Such a positive signal of the commitment to fiscal consolidation would be critical for investment and donor confidence. Bolstering revenue mobilization through tax policy measures as well as spending rationalization are needed to respond to the growing demand for public services. More realistic revenue forecasts and better spending commitment controls would help contain arrears.

"Cautious macroeconomic policies have enabled Tanzania to mobilize non-concessional resources to finance infrastructure investment. It will be important to strengthen public investment and debt management processes in order to ensure value for money from these resources. Non-concessional borrowing should be allocated to well-designed growth-enhancing infrastructure projects that are the subject of a rigorous project evaluation process.

"The gradual shift to a less accommodative monetary policy has been an appropriate response to the recovery in economic activity. The authorities will need to be vigilant to rising inflationary pressures and the impact of further increases in food and energy prices.

"The authorities' structural reform agenda needs to be reinvigorated to improve governance and the business environment, which will help bolster private sector confidence, increase economic diversification, and preserve the competitiveness of non-commodity sectors."

Statement by Mr. Majoro, Executive Director
United Republic of Tanzania
May 6, 2011

1. My Tanzanian authorities' perseverance with prudent macroeconomic policies and deepened structural reforms enabled the economy to recover swiftly from the global economic crises. They remain determined to persevere with this macroeconomic framework as they face new global challenges of a second spike in commodity prices, and repetitive drought conditions. They are confident that with continued support of the Fund and the international community, they stand a good chance of mitigating the effects of the commodity price surge and the fallout from the sovereign debt risks in advanced economies. They, in that regard, stand ready to take appropriate measures to protect the country's macroeconomic stability.

2. My authorities appreciate the Fund's constructive engagement and support under the PSI and the related technical assistance packages. Going forward, they are determined to further strengthen their macroeconomic framework, and achieve key national and regional objectives set out in their PRSP—Mkukuta II—and East African single market protocols that are supported by the PSI.

3. To that end, and in view of the strong performance under the program—with all end-December 2010 quantitative performance/assessment criteria observed with good margins, and implementation of structural reforms on track—they request Directors' support for the completion of the second review of the PSI. They also request Director's support for the modification of the end-June 2011 assessment criterion on international reserves, and rephasing of structural benchmarks.

Recent economic developments and respective policy environment

4. Tanzania's strengthened economic fundamentals—policy-wise and the broadened economic base—helped the country weather the storm of the global economic downturn and return swiftly to a growth path. Real GDP growth that had declined from 7.4 percent in 2008 to 6.0 percent in 2009 as a result of the deterioration in the external environment, did recover to 7.0 percent in 2010. However, real GDP growth for 2011 is projected to decline to 6 percent, largely as a result of weather-induced power shortages and another round of deterioration of external environment—especially the effects of the surge in global energy and food prices and the decline in the inflow of development aid. The economy should, however, recover promptly once the government's investments in additional power generation kicks in later this year, weather conditions normalize, external shocks subside, and donor funding increase to pre-crisis levels.

5. The trade account of the balance of payments in 2010/11 recorded an improvement following higher growth in exports—in particular gold and tourist receipts—which offset the impact of the fuel-related increase in the import bill. Overall, exports—both traditional and non-traditional—expanded at a particularly rapid pace, with manufacturing exports nearly doubling through the year. Official gross reserves by end-June 2011are estimated to increase

to USD 3,816.2 million, sufficient to cover to about 4.7 months of import of goods and services. However, the recent assessment by the International Energy Agency that the current high oil prices may remain for a longer period due to surging demand and limited new supply could have a significant impact on the country's import bill and its official reserves.

6. My authorities' fiscal policy in the first half of the fiscal year remained within the PSI targets, mainly due to a proactive management of spending and improved revenue performance. The cash-budgeting system helped contain monthly expenditure within available resources and meet the domestic financing target. On the revenue front, data as of end-February indicates some improvement in domestic revenue collection and the full year performance is projected to exceed the outturn during the first half of the year. Nevertheless, the authorities concur with staff's assessment that growing downside risks emanating from the impact of the protracted power shortages on corporate activity and profits may affect the level of revenue collections in the near term. Notwithstanding the difficulties entailed in modifying the fiscal regime of the mining sector for existing agreements, the authorities remain focused on broadening the tax base, and strengthening customs and tax administration. They view the recent Fund TA recommendations on tax policy and public finance management as fundamental inputs into their reform effort, and they look forward to further engagement with the Fund in this area with the view of raising the revenue yield.

7. The thrust of government spending remained in line with the overall macroeconomic framework—maintaining the level of spending on the key MDG clusters and infrastructure. The authorities' modest fiscal stimulus—totaling about 2 percent of GDP and targeted at protecting employment and incomes, ensuring food security, and protecting investment in infrastructure and key social sectors—has a built-in sunset clause at the end of 2010/2011. In that regard, and in view of the projected shortfalls in general budget support by the country's development partners, the authorities agree with staff over the need for streamlining of spending while protecting priority services and investments.

8. The government has made progress in raising funds from external non-concessional borrowing. Negotiations are in progress with various banks and institutions. The authorities are confident that they will make use of the entire non-concessional borrowing window for this financial year to finance key infrastructure projects.

9. My authorities' monetary policy continued to support the overall macroeconomic framework with a low interest rate environment. Reemergence of inflationary pressures—mainly due to increases in the prices of food items and energy reflecting global trends—has raised new concerns. The Bank of Tanzania (BoT), in addition to strengthening the operation of its policy instruments for sterilization of liquidity and broadening of its monetary policy transparency, has adopted a tightened monetary policy stance to forestall the second round effects of the commodity price surge. They reaffirm that their flexible exchange rate policy has served the country very well also in supporting the diversification of exports.

10. The banking system has weathered the global crisis well, with continued strong capital base, but the authorities are mindful of the recent upturn in the level of non-performing loans (NPLs) and, in that regard, continue to monitor these aggregates carefully.

The authorities are aware that a key challenge facing Tanzania's financial sector today is to ensure that the pension funds are strong, and managed professionally, in the interests of the existing and prospective pensioners. In that regard, they have attached high priority to strengthening the operations of the new regulator, the National Social Security Regulatory Authority, with, *inter alia*, finalization of the investment guidelines for the social security funds.

Medium-term policy framework

Fiscal policy

11. My authorities will continue to actively use their fiscal policy to spur economic growth to its trajectory and to address the effects of repetitive internal and external shocks. To achieve these objectives, measures including sustaining budgetary spending levels for the priority services, modest scaling-up of investment in infrastructure and primary sectors to shore-up economic growth, and deepening structural reforms to improve the business environment will continue to be prioritized.

12. To maintain spending in these priority areas while embarking on a fiscal consolidation path, the authorities will continue to strengthen domestic and concessional resource mobilization in the medium term. Cognizant of the overall resource limitations, they intend to facilitate greater inflows of FDI and participation of the private sector through PPPs, and fully utilize the current three-year non-concessional financing window—about $1.5bn. They will especially remain vigilant of the contingent liabilities arising from greater use of FDI and PPPs, and debt sustainability implications of non-concessional funding. To that end, they are building capacities in these areas, and are grateful for the recent tripartite discussions with the Fund, the World Bank and the African Development Bank. Going forward, they will further explore the non-concessional lending facilities at the latter two institutions.

13. On the expenditure side, the authorities will pursue expenditure streamlining in line with the program. Going forward, they will seek to discuss with staff the various options and related implementation modalities during the subsequent staff missions. Additionally, they will take steps to strengthen budget execution, and improve the alignment between policy objectives and the budget through prioritization of public investment in line with their Medium-term Public Investment Plan (MPIP) and the forthcoming Medium-term Economic Development Plan.

Monetary and exchange rate policies

14. My authorities' monetary policy will continue supporting their macroeconomic framework through maintaining sufficient liquidity in the financial system, and low and stable inflation. They will remain vigilant of the inflation pressures arising from the resurgence of global commodity prices and domestic supply shocks. To achieve the objective of anchoring its monetary policy on low and stable inflation, the BoT will continue to bolster its open market operations, maintain a flexible exchange rate policy, rely substantially on

foreign exchange sales for sterilization of liquidity, and continue to improve liquidity forecasting. The BoT reaffirms its commitment to maintain the transparency of its policy stance and to promote orderly financial markets. The authorities will also seek to make progress in the preparation for and negotiations of the East African Monetary Union. To that end, the targeted support by the Fund in key relevant areas will be greatly appreciated by the EAC partners.

Financial sector

15. The BoT will continue to strengthen its supervisory and regulatory services to the financial institutions to stem the reemergence of exposure to concentration of loan portfolio and to contain the recent surge in NPLs. It will also continue to strengthen the regulatory framework for financial institutions consistent with the recommendations of the recent FSAP and further build on the recent inaugural Financial Stability Report. Following the operationalization of the National Social Security Regulatory Authority, the BoT will finalize the inaugural set of the investment guidelines for the pension funds.

Structural reforms

16. My authorities' commitment to the implementation of a wide range of reforms underpins the Mkukuta II objectives. Improving the stock and quality of infrastructure—from road and rail networks to energy and telecommunications and regional infrastructure projects—is a priority with the aim of enhancing productivity in the primary sectors and competitiveness of the country as a whole, and strengthening the East African single market. Additionally, the authorities' pursuit of agricultural transformation—Kilimo Kwanza—should inject the needed momentum in tackling poverty in a predominantly agrarian economy. The new national social protection framework would guide the authorities' policy thrust in other poverty-reduction programs.

Conclusion

17. Tanzania's macroeconomic fundamentals and the authorities' continued commitment to strong policies helped the economy to restore its growth momentum faster than earlier envisaged. They are aware of the reemerging risks and are, therefore, prepared to take appropriate measures to protect the gains in the country's macroeconomic stability. In the near term, and notwithstanding the need for fiscal consolidation, the authorities are determined to ensure that the program focuses on sustaining macroeconomic stability, enhancing domestic resource mobilization, promoting broad-based and pro-poor growth, and increasing investment in infrastructure, primary sectors and core MDG clusters. Going forward, they reaffirm that continued engagement with the Fund and the support of development partners will enable them achieve these goals.