BANK OF TANZANIA

FOREIGN EXCHANGE INTERVENTION POLICY

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Foreword

The primary objective behind the Bank of Tanzania ("the Bank") monetary policy is price stability, aiming to keep inflation low and stable, reach output levels near its potential value as well as preserve the financial and payment system stability. Exchange rate flexibility is regarded as fundamental to achieving these objectives.

In a floating exchange rate regime, the exchange rate can operate as an adjustment variable in response to the shocks the economy receives and reduce volatility in economic activity. Secondly, exchange rate flexibility allows for the independent use of the interest rate as an instrument to bring inflation and output closer to their desired values. Third, exchange rate flexibility reduces the incentives for excessive exchange rate risk-taking by economic agents, which is key to maintaining financial stability.

Since the introduction of a floating exchange rate system in 1993, the Tanzania economy has experienced large fluctuations in the exchange rates. The economy is prone to large external shocks that can affect the exchange rate and pose significant risks to the Bank objectives. To mitigate the negative influence of such fluctuations on the economy, foreign exchange market interventions (hereafter "foreign exchange interventions" or simply "interventions") have been conducted as needed. During the conduct of such interventions, the Bank does not limit exchange rate flexibility, nor seek to fix or achieve any particular level of the exchange rate.

In intervening in the foreign exchange market, the Bank shall pursue objectives compatible with the monetary policy strategy. Specifically, foreign exchange intervention by the Bank is intended to address disorderly market conditions and contain excessive fluctuations in the exchange rate; and increase the level of international reserves to reduce external vulnerability and improve access conditions to external funding. The Bank's decision on foreign exchange intervention considers its benefits, costs to the economy and effect on the Bank's financial results.

I trust that this Policy sets out a foundation as part of the Bank's commitment to enhance integrity, transparency, and effectiveness of the interbank foreign exchange market in line with global standards.

Emmanuel M. Tutuba
Governor

1. Intervention in the foreign exchange market

The Bank of Tanzania Act of 2006 mandates the Bank to maintain price stability, promote economic growth, and ensure stability of the financial system. Therefore, the Bank intervenes in the foreign exchange market to achieve various economic objectives, including accumulation of foreign exchange reserves, and monetary policy purposes.

2. Objectives of intervention

The Bank intervenes in the foreign exchange market to achieve the following objectives:

(i) Smoothen short-term excess volatility in the exchange rate of the Tanzanian Shilling against foreign currencies.
(ii) Accumulate foreign exchange reserves and maintain a sound buffer to deal with unexpected shocks.
(iii) Facilitate attainment of monetary policy objectives; and
(iv) Create an avenue for providing liquidity in the foreign exchange market.

The foreign exchange intervention will not be used to support an exchange rate that is misaligned with economic fundamentals.

3. Criteria for intervention

Intervention decisions are informed by a blend of quantitative and qualitative indicators as well as expert judgement, with the chosen mechanism being dependent on the nature of the market disorder. To this end, the Bank continuously monitors and evaluates a range of market functioning indicators.

Intervention in the foreign exchange market for monetary policy purposes will use the following criteria:

(i) The exchange rate should be characterised by excessive volatility.
(ii) The exchange rate should be unjustified by economic fundamentals.

(iii) Intervention should be consistent with the Bank's monetary policy objectives.

(iv) Market conditions should be opportune and allow intervention to have a reasonable chance of success.

4. Mechanisms of foreign exchange intervention

The Bank may intervene in the foreign exchange market using the following approaches:

(i) Purchase or sale of foreign currency at the best interbank foreign exchange market (IFEM) quotes with spot settlement.

(ii) Purchase or sale of foreign currency through competitive variable rate auctions.

(iii) Intervene in derivative markets, when needed to restore the functioning of the derivatives market.

5. Counterparty framework

Any licensed bank of good standing and subject to reserve requirements may be eligible as a counterparty for foreign exchange interventions.

6. Foreign exchange intervention disclosure

The Bank will publish pre and post intervention information through the official means to ensure transparency of foreign exchange market operations. The information will include:

(i) Intervention details and modality.

(ii) The intention to conduct any type of foreign exchange intervention to the market.

(iii) The outcome of foreign exchange market operations.

(iv) Any vital information relevant to foreign exchange market operations.

7. Governance framework

(i) The intervention policy is effective from the date of publication and shall be reviewed at least once in three years.

(ii) The level and modality of intervention shall be approved by the Governor.