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MONETARY POLICY STATEMENT

The Midterm Review

GOVERNOR
BANK OF TANZANIA

January 2007

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The Hon. Zakia Hamdani Meghji (MP),
Minister for Finance,
United Republic of Tanzania,
Dar es Salaam.

Dear Hon. Minister,

LETTER OF TRANSMITTAL

I hereby submit the mid-term review of the Annual Monetary Policy Statement of the Bank of Tanzania for the financial year 2006/07 in accordance with the Bank of Tanzania Act 2006, Section 21 Subsections (1) to (7).

The Statement reviews in detail the implementation of monetary policy in the first half of the year 2006/07, and describes the policy intentions of the Bank of Tanzania for the remainder of the year aimed at consolidating price stability and promoting sustainable growth in the country.

Yours sincerely,

Daudi. T.S. Ballali
Governor
Bank of Tanzania

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LIST OF ABBREVIATIONS AND ACRONYMS

BOT	Bank of Tanzania
GDP	Gross Domestic Product
IFEM	Interbank Foreign Exchange Market
MDRI	Multilaterial Debt Relief Initiative
MKUKUTA	Mkakati wa Kukuza Uchumi na Kupunguza Umaskini Tanzania
NSGRP	National Strategy for Growth and Reduction of Poverty
PBZ	Peoples Bank of Zanzibar
Repo	Repurchase agreement
SACCOS	Savings and Credit Co-operatives Societies
SDRs	Special Drawing Rights
The Bank	Bank of Tanzania
TIB	Tanzania Investment Bank
TZS	Tanzania Shilling
USD	US Dollar

PART I

1.0 INTRODUCTION

This statement reviews the monetary policy implementation during the first half of the financial year 2006/07, and presents the outlook of monetary policy implementation for the remainder of the year.

During the review period, the Bank succeeded in containing the monentary aggregates within the targets, but factors such as rising world oil prices coupled with the effects of drought on food supply and hydropower generation exerted strong pressure on inflation. In addition, demand for imports remained high, putting pressurure on the Shilling exchange rate against major currencies.

The statement is organised as follows: Part two revisits the macroeconomic framework for the year 2006/07, while Part three reviews monetary policy implementation and macroeconomic developments during the first half of the year. The last part of the report presents the outlook of monetary policy implementation during the remainder of the year.

The financial year for Tanzania starts on 1st July and ends on the 30th June.

PART II

2.0 MACROECONOMIC POLICY FRAMEWORK FOR THE YEAR 2006/07

2.1 Macroeconomic Policy Objectives of the Government

The thrust of government policy during the year 2006/07 is to ensure that objectives of the NSGRP (or MKUKUTA in Kiswahili) are achieved. These objectives are put under three broad clusters: accelerating economic growth and reduction of income poverty; improving quality of life and social well-being of Tanzanians; and strengthening good governance and accountability.

In line with this overriding objective, government policies during the year are geared towards maintenance of fiscal discipline through strengthening of domestic revenue mobilisation efforts and prudence in spending, maintaining a low and stable rate of inflation and improving the country's balance of payments position. Furthermore, the Government aims at increasing funds allocated to MKUKUTA related expenditures.

The following macroeconomic policy objectives have been therefore set as guiding policy objectives for the year 2006/07:

i. Achieve a real GDP growth of 5.9 percent in 2006, revised downwards from 7.0 percent projected earlier due to the foreseen impact of the drought experienced in the country towards the end of 2005, but with prospects of recovery to 7.3 percent in 2007.

ii. Attain a reduction of inflation rate to 4.0 percent in June 2007, from 6.8 percent in June 2006, facilitated by improved food supply and prudent fiscal and monetary policies.

iii. Increase domestic recurrent revenue to 14.5 percent of GDP from 14.1 percent of GDP in 2005/06.

iv. Limit government expenditure to 28.3 percent of GDP out of which 2.0 percent of GDP are to be financed by Multilateral Debt Relief Initiative (MDRI) resources.

v. Limit net domestic financing of the Government to 1.0 percent of GDP.

2.2 Monetary Policy Objectives

In support of the above macroeconomic policy objectives of the Government, the Bank intends to continue with its focus on sustaining price stability by maintaining an appropriate level of liquidity in the economy. Monetary policy measures are therefore aimed at decelerating the annual growth rate of monetary aggregates in order to dampen the inflationary pressures in the economy, while at the same time providing adequate financial resources to productive sectors of the economy. Specifically, the Bank aims at:

i. Limit annual growth rate of reserve money to 24 percent. Growth rates of other monetary aggregates are managed within the following limits:

   a. broad money supply, M2, at 23.4 percent and

   b. extended broad money, M3, at 24.2 percent

ii. Providing room for credit to the private sector to grow at an annual rate of 37 percent by end June 2007; and

iii. Maintaining an adequate level of foreign reserves to cover not less than six months of imports of goods and services.

These measures are expected to facilitate a decline in annual inflation rate from 6.8 percent in June 2006 to 4.0 percent by end June 2007. However, due to persistent rise in prices of petroleum products both at the world and domestic markets, coupled with the overhang of the effects of drought of 2005, the target for inflation rate for end June 2007 was revised upwards from 4.0 percent to 5.0 percent.

PART III

3.0 REVIEW OF MONETARY POLICY IMPLEMENTATION DURING THE FIRST HALF OF THE YEAR 2006/07

An Overview

During the first half of the year 2006/07, the Bank remained vigilant in controlling excess liquidity in the economy. Developments in monetary aggregates were broadly within targets, however, factors such as rising world oil prices coupled with effects of drought on food supply and hydropower generation exerted strong pressure on inflation. As a result, inflation rate has been above 5 percent since December 2005.

At the same time, low demand for government securities characterized open market operations of all auctions during most part of the period under review – save for the months of October and November 2006. Consistent with the low demand, interest rates on government securities edged upwards between July and October 2006, declining in November 2006, before rising again in December 2006.

The foreign exchange market, on the other hand, experienced a growing demand for foreign exchange to finance the extra requirements of oil and food imports induced by the effects of drought. This high demand for foreign exchange in the market caused the shilling to depreciate during most part of the review period.

3.1 Liquidity Management

During the first half of the year 2006/07, there was a considerable build up of liquidity in the economy. This was because most of the planned activities by the Government aimed at speeding up the implementation of MKUKUTA – which involved increased funds for poverty reduction projects, empowerment initiatives and improving civil service remuneration -commenced during the first half of the financial year. Concurrently, most of the development partners also disbursed most of their pledged financial support upfront during the same period. Moreover, the demand for cash for transactions was also high during the period under review, mainly associated with end-of-the year festivals and for seasonal crop marketing, particularly for cashew, cloves, cotton, coffee and some food crops. Continuing strong bank lending to private sector also stimulated further the expansion of liquidity in the economy. As all these developments generated excess liquidity in the economy, the Bank imposed restrictive monetary measures so that the monetary expansion would be unwound gradually without adversely hampering economic growth.

On the other hand, signs of inflationary pressures were evident, mainly emanating from rising domestic prices of petroleum products and prices of other imported non-oil consumer products. The increase in the prices of these imported items was attributed to the high demand for the items coupled with the depreciation of the shilling against the USD and currencies of other main trading partners.

In response to excess liquidity, as well as the inflationary pressures in the economy, the Bank adopted a tighter monetary policy stance for the year 2006/07. Monetary policy measures undertaken by the Bank during the first half of the year have been successful in reducing the growth rate of monetary aggregates and ensuring that the volume of money available in the economy is not a source of monetary instability. These measures included – increased tender sizes of government securities; stepped up the conduct of repo with commercial banks and increased sales of foreign exchange in the market to sterilize donor fund inflows.

It is noteworthy that although the central bank adopted a tighter monetary policy stance, which resulted into significant monetary contraction, the inflation rate has been on the rise since July 2007 when headline inflation was 5.4 percent, moving to 5.8 percent in September, 6.0 percent in October and edged to 6.7 percent in December 2006. This phenomenon underscores the fact that monetary policy can make its impact on inflation only with a time lag. Otherwise, as mentioned earlier, all monetary aggregates were contained within the targets set under the monetary policy framework for the year 2006/07 as highlighted in Table 3.1.

Table 3.1: Tanzania: Indicators of Monetary Policy Implementation Against Quarterly Targets (Billions of TZS)

	June 06		Sept-06		Dec-06	
	Target	Actual	Target	Actual	Target	Actual
Reserve Money 2/	1,348.0	1,296.5	1,455.0	1,429.0	1,551.0	1,557.0
Annual Growth of M2	27.0	24.5	26.7	20.1	24.1	13.7
Annual Growth of M3	27.0	31.6	31.3	28.7	25.0	21.9
Annual growth of Private Sector Credit	33.0	35.9	37.2	37.1	37.7	42.3
Net International Reserves (Mill. of USD)	1,616.0	1,927.5	2,113.0	2,128.9	1,919.0	2,171.1
Net Domestic Financing of Govt 1/	420.0	348.9	-199.0	-370.5	-9.0	-315.7

1/ Cumulative from the beginning of the fiscal year; +ve is a borrowing while –ve is a repayment
Source: Bank of Tanzania

3.2 Interest Rate Policy

Interest rates in Tanzania are determined by the market forces. However, interest rates applied by commercial banks in the country remain largely dictated by structural impediments, shallowness of the financial markets and risks associated with provision of credit and other banking services to the private sector. Nevertheless, the Bank expects to achieve more realistic (less distorted) market base interest rates gradually after full implementation of measures aimed at supporting competition in the banking system, deepening the financial markets and improving financial intermediation.

3.3 Credit Policy

The Bank of Tanzania credit policy aims at providing an environment for increased flow of credit to the private sector commensurate with the requirements of the growing economy, while maintaining price stability. The strategy involves restraining government borrowing from the banking system in order to provide more room for the banks to lend to the private sector. During the year 2006/07, monetary policy was set to allow private sector credit to grow at an annual rate of 37 percent, which translated into an increase of TZS 613 billion above the outstanding stock of June 2006.

Due to the remaining obstacles in the banking system, the current flow of credit to private sector is not as smooth as is required for the banking sector to make its optimal contribution to poverty alleviation initiatives. High interest rates, structural weaknesses such as less efficient legal system for property and creditor rights, and inadequate credit information on borrowers are some of the major impediments to smooth flow of loans to private sector.

The on-going measures and initiatives under the second generation financial sector reforms which are spearheaded by the Bank of Tanzania are aimed at - among others – increasing competition in the banking sector, removing the remaining impediments to efficient banking services and creating opportunities for banks to lend profitably at lower spreads and become competitive in their operations. The presence of credit guarantee schemes also helps to stimulate banks to lend to otherwise risk-prone but profitable enterprises such as exporters, and small to medium sized businesses.

3.4 Foreign Exchange Policy

The Bank of Tanzania exercises a freely floating exchange rate policy. This means the exchange rate of the shilling against foreign currencies is determined daily in the market depending on the supply of and demand for foreign currency against the domestic currency.

The Bank of Tanzania participates in the foreign exchange market mainly to smoothen out the fluctuations in the supply of, and demand for foreign exchange that could not be met by other market players and also to build up foreign exchange reserves to meet the targeted months of imports and other external obligations, while ensuring that Tanzania's external competitiveness is maintained.

During the reporting period, the demand for imports was much stronger than the inflow of export proceeds and this was reflected in the sharp deterioration in the trade account. Consequently, the Bank made relatively more sales of foreign exchange during the period under review compared to the corresponding period of the previous year.

4.0 REVIEW OF MACROECONOMIC DEVELOPMENTS DURING THE FIRST HALF OF THE YEAR 2006/07

4.1 Inflation Developments

The effects of drought continued to adversely affect food supply and hydropower generation during the first half of the year 2006/07. This resulted into high food prices and high cost of power generation. The situation was worsened by the persistent increase in oil prices, and excess liquidity in the economy that exerted upward pressure on domestic prices. As a result, annual headline inflation increased to 6.7 percent in December 2006 from 5.4 percent recorded in July 2006. The annual food inflation slowed significantly from the peak of 12.3 percent in May 2006 to 2.6 percent in August 2006, reflecting the harvest season, but picked up thereafter to over 6 percent in November and December. Non–food inflation evolved from below 4 percent and grew fast, reaching a high of 9.7 percent in August 2006, before slowing down to 6.8 percent in December 2006.

4.2 Monetary Developments

The Bank continued to implement monetary policy in a manner that would align the growth of money supply to macroeconomic objectives for the year 2006/07, and dampen inflationary expectations in order to preserve price stability over the short and medium term.

The Bank succeeded to slow down monetary expansion to levels below the targets set for the quarter ending December 2006. The annual growth rate of extended broad money supply (M3), which peaked at 31.6 percent at the close of the previous financial year in June 2006, was progressively brought down to 21.9 percent in December 2006, against the projected growth of 25 percent. Similarly, during the same period, the growth of broad money supply (M2) was reduced sharply from 24.5 percent to 13.5 percent against a projected growth of 24 percent (Table 4.1).

The slow down in monetary expansion during the period under review is associated with increased demand for foreign currency for importation, which was met by use of domestic currency to purchase the foreign exchange needed. In the end, the foreign currency was externalised thus reducing liquidity in the economy. In addition, restrictive monetary policy measures, including the scaling up of sales of liquidity papers undertaken by the Bank during the period under review, helped to mop up excess liquidity in the economy.

In terms of volume, the stock of M3 increased by TZS 499 billion between June 2006 and December 2006, with foreign currency deposits increasing from USD 1,080 million in June 2006 to USD 1,272 million, an increase of USD 192 million. Meanwhile, the stock of M2 rose by TZS 248 billion. As usual, the major stimulus to monetary growth continued to come from continuing strong private sector demand for credit as explained below.

Domestic Credit Developments

The banking system's volume of credit extended to private sector remained large during the period under review, increasing by an annual rate of about 36 percent in June 2006, at 37 percent in September 2006 and peaking at 42.3 percent in December 2006. This strong growth in credit in the reporting period is mainly associated with financing needs to address the power crisis in the country and a rebound of economic activity in response to favourable weather conditions. The outstanding stock of private sector credit stood at TZS 2,028 billion at the end of December 2006, equivalent to 13 percent of GDP. Most of the credit offered by commercial banks during the period went to agriculture (22 percent), transport and communication (18 percent), manufacturing (18 percent), and electricity generation (14 percent).

The Government financial operations, however, were contractionary on money supply since it accumulated deposits in the banking system to the tune of TZS 78 billion above banks' claims on Government by end-December 2006.

Table 4.1: Tanzania: Developments in Selected Monetary Aggregates
(Billions of TZS)

Item	2005		2006		Change		Annual Growth (%)	
	Jun	Dec	Jun	Dec	Jun-Dec 2005	Jun-Dec 2006	Jun-06	Dec-06
Extended Broad Money Supply (M3)	3,266	3,935	4,299	4,798	669	499	32	22
Broad Money Supply (M2)	2,366	2,808	2,946	3,194	442	248	24	14
Currency in Circulation	735	843	856	976	108	119	17	16
Demand Deposits	794	916	943	955	122	12	19	4
Time Deposits	329	422	455	469	94	14	38	11
Savings Deposits	509	627	692	794	118	102	36	27
Foreign Currency Deposits (FCD)	900	1,127	1,354	1,605	227	251	50	42
FCD in millions of US dollar	799	967	1,080	1,272	168	192	35	32
Private Sector Deposits in Commercial banks	2,532	3,092	3,443	3,823	560	380	36	24
Government Sector Deposits in Commercial banks	140	187	197	235	47	38	41	25
Total Deposits	2,672	3,279	3,640	4,057	608	417	36	24
Net Foreign Assets	2,279	2,561	3,073	3,566	282	493	35	39
Bank of Tanzania	1,666	1,780	2,212	2,517	114	304	33	41
Deposit Money Banks	613	780	861	1,049	167	188	40	34
Net Domestic Assets	1,511	1,983	1,835	1,841	472	6	21	-7
Domestic Credit	1,504	1,684	2,169	1,951	180	-219	44	16
Claims on Government (net)	285	259	513	-78	-26	-590	80	-130
Claims on Governments by the banking system	551	888	965	1,338	336	373	75	51
Government Deposits in the banking system	266	629	453	1,416	362	963	70	125
Claims on the private sector	1,219	1,425	1,657	2,028	206	371	36	42

Source: Bank of Tanzania.

Financial Market Developments

Consistent with the tight monetary policy taken by the Bank particularly towards the end of the review period, the supply of treasury bills was increased from a weekly average of TZS 40 billion in the first four months, to an average of TZS 60 billion and TZS 70 billion in November and December, respectively. Demand for treasury bills was low particularly in the first three months of the period under review as market players concentrated on purchasing foreign exchange to meet their customers' demand as well as for speculative motives in anticipation of a gain from further depreciation of the shilling. However, in October and November 2006 the demand surged, mainly reflecting a shift in demand away from foreign exchange, following the shilling appreciation towards the end of September. In December, demand for government securities shrunk again on account of a high demand for cash to facilitate payment of end-of-year tax obligations by market players.

In the face of relative weak demand for government securities, treasury bills rates trended upwards throughout the period, save for November, when demand shot up to its peak. The overall treasury bills rate rose from 9.2 percent in July to 15 percent in December 2006 (**Chart 4.1**).

Chart 4.1 Treasury Bills Market Developments

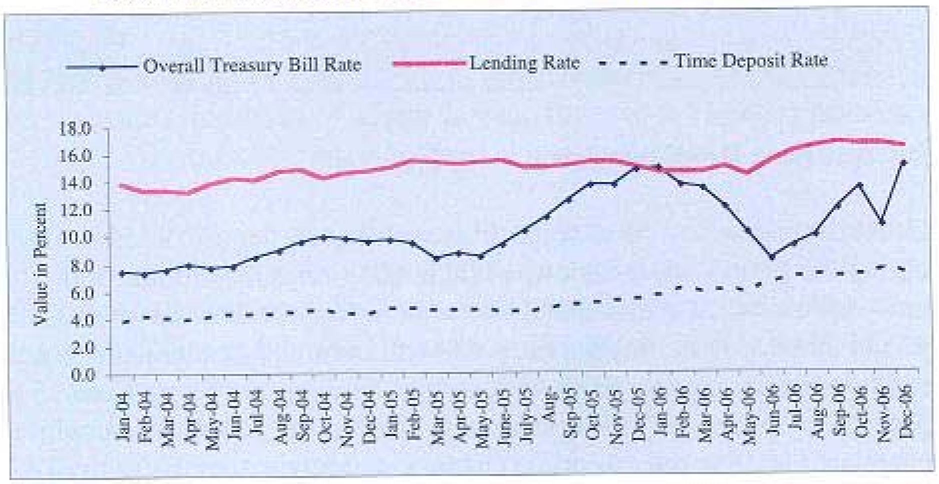
Interest Rate Developments

Generally, there has been some improvement in deposit interest rates during the period under review, while lending rates moved upwards. In line with the increase in demand for credit in the private sector during the period under review, interest rates on local currency denominated loans exhibited an increasing trend with overall lending rate rising from 15.4 percent in June to 16.4 percent in December 2006. Meanwhile, negotiated lending rates to prime customers dropped marginally from 11 percent to 10 percent during the period, suggesting increased competition for prime customers among banks.

Time deposits registered an increase from 6.6 percent to 7.4 percent during the period, while savings deposit rate remained nearly unchanged at 2.6 percent signifying its insensitivity to developments in the market. Unlike the negotiated lending rate, which took a downward trend throughout the review period, negotiated deposit rates remained broadly unchanged, between 9 and 10 percent.

With gradual removal of impediments to banking services and increased competition in the banking sector as seen by the increasing number of banks and their branches operating in the country, the Bank expects further improvements in interest rates in the near future. During the period under review, ten new branches were opened in various areas by five commercial banks, namely; NBC Ltd, CRDB bank, NMB, Exim bank, and the International Commercial bank (T) Ltd.

Chart 4.2: Tanzania: Developments in Selected Interest Rates



4.3 Foreign Exchange Operations

During the review period, the country continued to experience substantial growth in demand for foreign exchange to finance imports. As a consequence of this development, coupled with low supply of foreign currency from export proceeds, the shilling depreciated against

US dollar from an average of TZS 1,253 per USD in the first week of July 2006 to an average of TZS 1,337 per USD in the second week of September 2006, before maintaining a relative stable position between October and December 2006.

Responding to the high demand for foreign exchange during the period, the Bank of Tanzania sold in the IFEM - USD 304.4 million on net basis from July to December 2006, compared to a net sale of USD 81.5 million in a corresponding period of 2005.

Despite the substantial net sale of foreign exchange, the level of gross official reserves remained above USD 2 billion during the review period. This amount of reserves covers about 5 months of imports of goods and services – slightly lower than the targeted 6 months of imports. The Bank is expecting to continue gradually building up these reserves to achieve the target by end June 2007.

4.4 External Sector Developments

During July-November 2006, the current account deficit widened substantially to USD 587.9 million from a deficit of USD 322.2 million recorded in the corresponding period a year earlier. The weak performance in the current account was mainly attributed to a substantial increase in imports of goods and services that was not matched with increase in exports. The increase in imports is associated with increased demand for foods imports, higher oil import bill due to both increased demand for oil to facilitate thermal power generation and the rising prices in the world market.

Disbursements of official foreign assistance from development partners to the government increased by 6.3 percent to USD 377.2 million in

June-November 2006 from the amount recorded in the corresponding period last year.

Table 4.2: Tanzania's Current Account
(Millions of USD)

	Jul-Nov		Percentage Change
	2005	2006	
Goods Account (et)	**-624.5**	**-981.3**	57.1
Exports	751.7	723.1	-3.8
Imports	-1,376.2	-1,704.4	23.8
Services Account (Net)	**26.0**	**83.5**	220.8
Receipts	568.5	640.4	12.6
Payments	-542.5	-556.9	2.6
Goods and Services (Net)	**-598.5**	**-897.8**	50.0
Exports of Goods and Services	1,320.2	1,363.5	3.3
Imports of Goods and Services	-1,918.7	-2,261.3	17.9
Income Account (Net)	**-69.7**	**-56.8**	-18.6
Receipts	27.3	35.6	30.6
Payments	-97.0	-92.4	-4.7
Current transfers (Net)	**345.9**	**366.6**	6.0
Inflows	374.8	393.2	4.9
O/w General Government	354.7	377.2	6.3
Other Sector	20.1	16.0	-20.2
Outflows	-28.8	-26.6	-7.8
Current Account	**-322.2**	**-587.9**	82.4

Source: Bank of Tanzania

Exports

During July - November 2006 Tanzania exported goods and services worth USD 1,363.5 million, up from USD 1,320.2 million registered in the corresponding period in 2005. The increase in exports was an outcome of good performance in the services sector (mainly tourism) as merchandise exports recorded a decline. The decline in merchandise exports is partly attributed to effects of drought that affected both agriculture and industrial production.

Between July and November 2006, mineral exports amounted to USD 343.9 million, out of which gold continued to be dominant, accounting for 94 percent of total receipts. Manufactured goods exports, on the other hand, earned USD 80.1 million, while fish and fish products brought in USD 57.3 million and horticultural produce earned USD 7.2 million.

Traditional exports - coffee, cotton, cashew nuts, tea, tobacco, sisal and cloves - earned a total of USD 107.6 million, registering a decline of 38.7 percent from USD 174.6 million earned in the corresponding period in 2005. With the exception of tea, export volumes of all traditional exports declined. Despite the decline in export volumes the value of coffee exports recorded an increase on account of price increase. Other traditional exports recorded declines in both volumes and values. The dismal performance of traditional exports was mainly attributed to drought experienced during the year 2005/06.

Imports

During July – November 2006, imports of goods and services stood at USD 2,261.3 million, being a 17.9 percent increase over the level recorded in the corresponding period in 2005. The increase in imports emanated from high oil import bill, strong growth in importation of consumer goods, as well as capital and other intermediate goods.

Imports of intermediate goods amounted to USD 776.1 million in the review period, up by 27.9 percent from the level registered in a corresponding period in 2005. The oil import bill constituted 68.7 percent of intermediate goods, and accounted for the largest share of the increase. Capital goods imports amounted to USD 692.2 million, while consumer goods amounted to USD 404.8 million.

4.5 Economic Developments in Zanzibar

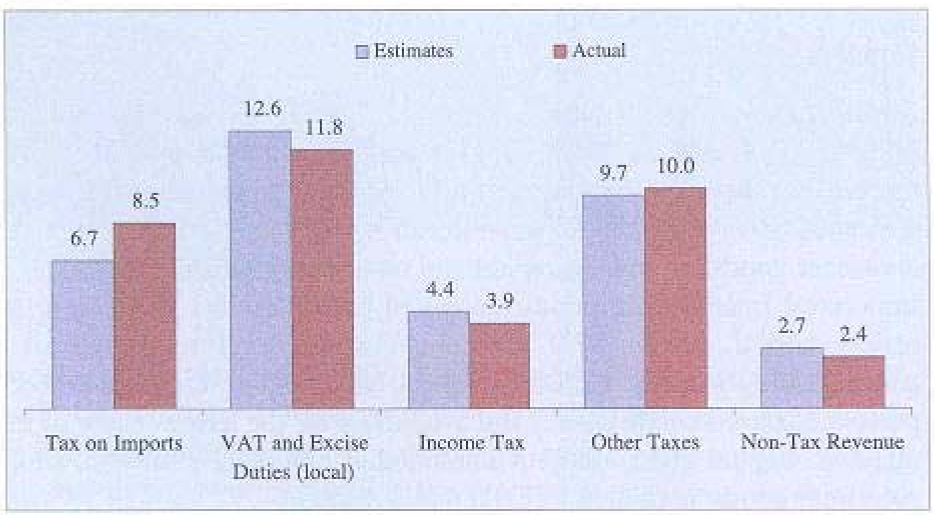
Government Budgetary Operations

During the first five months of the year 2006/07, Zanzibar government budgetary operations recorded an overall deficit before grants of TZS 19.4 billion. After considering grants amounting to TZS 20.7 billion, Zanzibar government budgetary operations registered a surplus of TZS 1.3 billion.

Revenue Performance

Revenue collections between July and November 2006 amounted to TZS 36.6 billion, which was in line with the target for the period. The good record in revenue collections is mainly attributed to increase in collections from import taxes **(Chart 4.3).**

Chart 4.3: Zanzibar Government Revenue Performance July-November 2006 (In TZS Billion)



Expenditure Performance

Zanzibar government expenditure during the review period amounted to TZS 56.0 billion, against the projected amount of TZS 73.2 billion. The underperformance is partly attributed to lower than expected disbursement of grants, which registered a shortfall of TZS 5.8 billion. Recurrent expenditure amounted to TZS 39.2 billion, while development expenditure amounted to TZS 16.8 billion.

Trade Developments

The Zanzibar current account balance during the period under review registered a surplus of USD 15.2 million compared to a deficit of USD 2.9 million recorded in the corresponding period in 2005. The improvement is largely attributed to an increase in service receipts and to a modest decline in imports **(Table 4.3).**

Table 4.3: Zanzibar Current Account
(Millions of USD)

ITEM	July-Nov 2005	July-Nov 2006	% Change Jul-Nov 2005-2006	2005	2006p	Annual %Change 2005-2006
Goods Account (net)	**-31.3**	**-21.7**	**-30.6**	**-71.8**	**-57.5**	**-19.9**
Exports	7.8	4.4	-43.8	12.1	8.4	-30.6
Imports (fob)	39.1	26.1	-33.2	83.9	65.9	-21.5
Services Account (net)	**7.5**	**15.2**	**103.4**	**20.4**	**25.7**	**26.0**
Receipts	34.5	44.3	28.5	73.3	81.4	11.1
Payments	27.0	29.1	7.7	52.9	55.6	5.1
Goods and Services (net)	**-23.8**	**-6.4**	**-73.1**	**-51.4**	**-31.8**	**-38.1**
Exports of Goods and Services	42.3	48.7	15.1	85.3	89.7	5.2
Imports of Goods and Services	66.1	55.2	-16.5	136.7	121.5	-11.1
Income Account (net)	**0.3**	**0.15**	**-42.0**	**0.42**	**0.21**	**-50.0**
Receipts	0.3	0.22	-15.0	0.43	0.27	-37.2
Payments	0.0	0.07	...	0.02	0.05	150.0
Current Transfers (net)	**26.4**	**21.5**	**-18.7**	**34.9**	**45.2**	**29.5**
Inflows	26.4	21.5	-18.7	34.9	45.2	29.5
Outflows	0.0	0	...	0	0	...
Current Account Balance	**2.9**	**15.2**	**422.7**	**-16.1**	**13.6**	**-184.5**

p= Provisional
Source: Tanzania Revenue Authority

Exports

For the period under review, total export earnings amounted to USD 48.7 million, up from USD 42.3 million registered in the corresponding period of the previous year. The services receipts mainly from tourism sector amounted to USD 44.3 million, representing almost 91 percent of total exports receipts.

Imports

Imports of goods and services were valued at USD 55.2 million compared to USD 66.1 million recorded in the corresponding period of 2005. Merchandise imports (f.o.b) amounted to USD 26.1 million, down from USD 39.1 million in the same period. Services payments however increased modestly during the period (Table 4.3).

5.0 THE OUTLOOK OF MONETARY POLICY IMPLEMENTATION IN THE SECOND HALF OF THE YEAR 2006/07

5.1 Liquidity management

The Bank of Tanzania will continue to implement monetary policy that is consistent with the macroeconomic objectives set for the year 2006/07. Mindful of the inflationary pressure observed in the first half of the year, the Bank will ensure that the measures that have been used in bringing down the growth rate of monetary aggregates are consolidated. One of the measures that the Bank will undertake during the remainder of the year in order to increase the effectiveness of monetary policy is putting in place liquidity forecasting framework to cover government financial flows. Implementation of this measure will improve a great deal liquidity management in the economy.

The mode of operations of the Treasury Bills Market will be reviewed in order to improve efficiency and effectiveness of the market as well as its response to monetary policy actions. On the other hand, the Bank will ensure that the liquidity impact of foreign exchange transactions is consistent with the realisation of the overall monetary policy objectives.

5.2 Inflation Outlook

Inflation is expected to ease in the coming months, mainly due to better harvesting of food crops associated with good rains, improvement in hydroelectricity generation and the anticipated slow down of oil prices in the world market. Given these expectations combined with the tight monetary policy stance that will be maintained by the Bank, the revised target of an annual inflation rate of 5 percent is likely to be achieved by the end of June 2007.

5.3 Credit Policy

The Bank aims at sustaining the current levels of credit growth to the private sector, which is necessary for supporting the projected economic growth. The Bank will thus continue to collaborate with the government in implementing measures to remove the remaining structural and institutional impediments, aimed at deepening financial intermediation. The ongoing reforms under the Second-Generation Financial Sector Reform Program are expected to enhance provision of credit to productive activities in the economy.

5.4 Interest Rate Policy

The Bank of Tanzania will continue to promote efficiency in the financial sector so that more realistic market determined interest rates are realized. The implementation of the ongoing second-generation financial sector reforms aims at, among other things, removal of the remaining bottlenecks to lending and improving access to financial services. It is therefore expected that as efficiency increases in the financial system, and lending risks to the private sector are minimized, the interest rates applied by commercial banks will reflect the opportunity cost of funds in the economy.

5.5 Foreign Exchange Policy

The exchange rate will continue to be market determined freely in the IFEM. In this regard, the main concern of the Bank will be to employ market-based interventions, in order to prevent un-orderly fluctuations in the exchange rate; to build up reserves to the required level of 6 months of imports; to raise resources to meet the country's external obligations as they fall due, and to ensure that external sector competitiveness is achieved and maintained.

6.0 CONCLUSION

The Bank is determined to attain its monetary policy objectives for the year 2006/07. The measures implemented during the first half of the year laid the ground for better prospects. If the progress made on the fiscal side is maintained, particularly with regard to increased revenue collection, matching of expenditure with expected resource availability, and improvement in public expenditure management, it should be possible to achieve all the macroeconomic objectives set by the Government for the year 2006/07.

APPENDICES

Table A1: Tanzania: Percentage Change in Consumer Price Index (All-Urban)

Period	Year -on-Year			Month-on-Month		
	Headline Inflation	Food Inflation	Non-Food Inflation	Headline Inflation	Food Inflation	Non-Food Inflation
2004 Jan	3.6	6.0	0.2	5.6	6.7	3.8
Feb	3.8	6.6	0.2	-0.3	0.3	-0.8
Mar	4.0	7.0	-0.1	-0.5	-0.2	-1.4
Apr	4.7	8.4	-0.5	0.5	1.1	-0.5
May	4.4	6.0	2.0	-0.5	-1.5	1.0
Jun	4.2	4.9	3.1	-0.5	-1.1	0.4
Jul	4.1	5.3	1.8	0.7	-0.1	1.4
Aug	4.1	5.9	1.5	-0.5	0.4	-1.2
Sep	4.0	4.6	3.2	0.2	-0.1	0.6
Oct	4.2	5.2	2.5	-0.1	-0.3	0.1
Nov	4.4	5.9	2.4	-0.3	0.1	-0.7
Dec	4.2	5.1	2.8	0.1	-0.1	0.2
2005 Jan	4.0	5.9	1.5	5.4	7.5	2.4
Feb	4.1	5.7	1.8	-0.2	0.1	-0.5
Mar	4.1	4.9	3.2	-0.5	-0.9	0.0
Apr	4.0	4.3	3.9	0.4	0.5	0.2
May	4.0	5.0	3.0	-0.5	-0.8	0.1
Jun	4.2	5.8	2.6	-0.3	-0.3	0.0
Jul	4.4	7.0	1.9	0.9	1.1	0.8
Aug	4.5	5.8	3.5	-0.4	-0.8	0.3
Sep	4.5	6.0	2.8	0.2	0.2	-0.1
Oct	4.7	6.7	2.8	0.1	0.3	0.0
Nov	4.8	6.7	3.7	-0.2	0.1	0.3
Dec	5.0	7.7	3.5	0.3	0.4	0.0
2006 Jan	5.4	9.1	1.3	5.8	9.3	0.2
Feb	5.8	9.4	1.7	0.2	0.4	-0.1
Mar	6.5	10.7	1.7	0.2	0.3	0.0
Apr	6.9	11.2	1.8	0.7	0.9	0.3
May	7.7	12.3	2.0	0.2	0.2	0.4
Jun	6.8	9.6	3.8	-1.1	-2.7	1.7
Jul	5.4	7.0	3.9	-0.5	-1.3	0.9
Aug	5.5	2.6	9.7	-1.0	-1.7	-0.1
Sep	5.8	3.6	9.0	0.2	-0.4	0.9
Oct	6.0	5.2	7.0	1.6	2.6	0.0
Nov	6.2	7.0	5.7	0.8	2.3	-0.6
Dec	6.7	6.5	6.8	2.1	2.9	0.4

Source: National Bureau of Statistics (NBS) and Bank of Tanzania

Note: Before Sep 2006, Base year 2001 = 100, from Sep 2006, Base year Dec 2001 = 100

Chart A1: Tanzania: Annual Headline, Food and Non-food Inflation

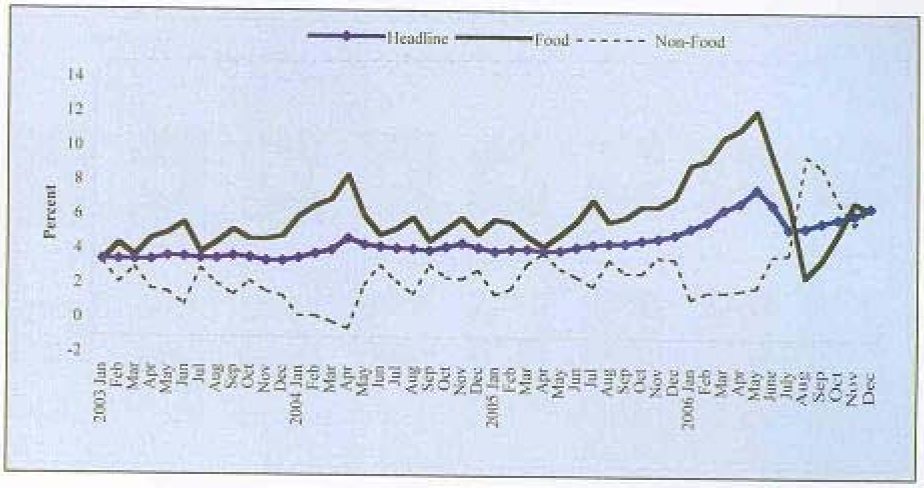


Chart A2: Tanzania: Annual Growth Rates of Monetary Aggregates

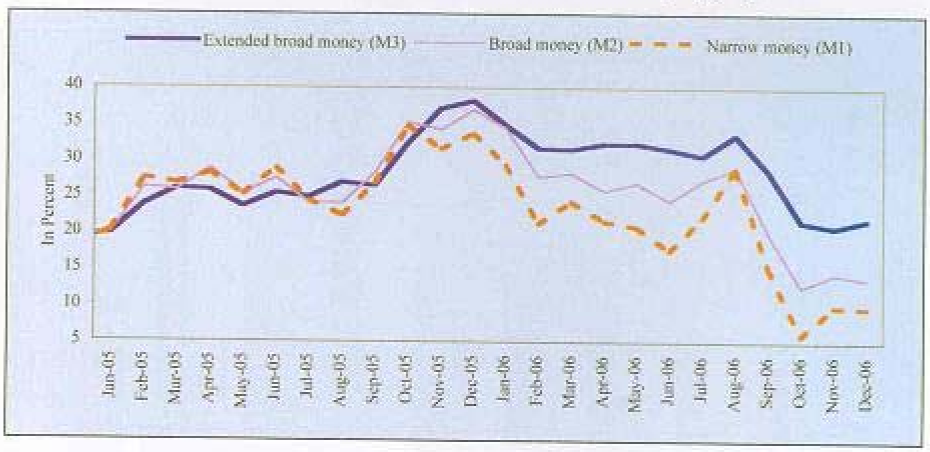


Chart A3: Tanzania: Components of Money Supply
(In percent)

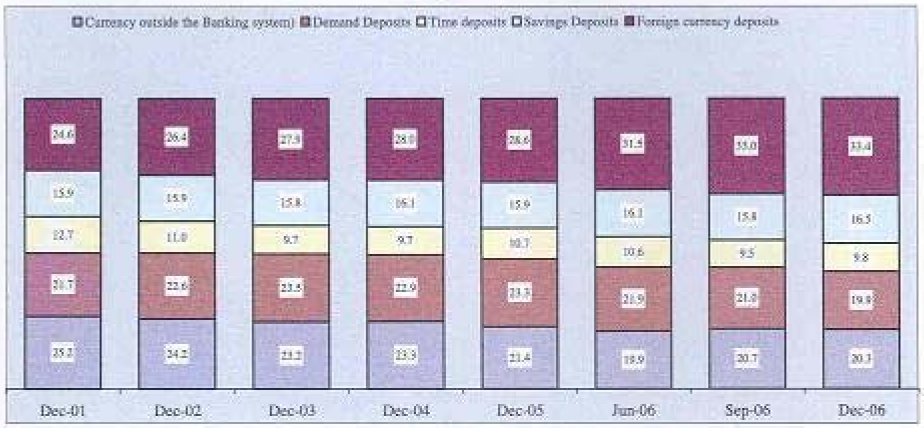
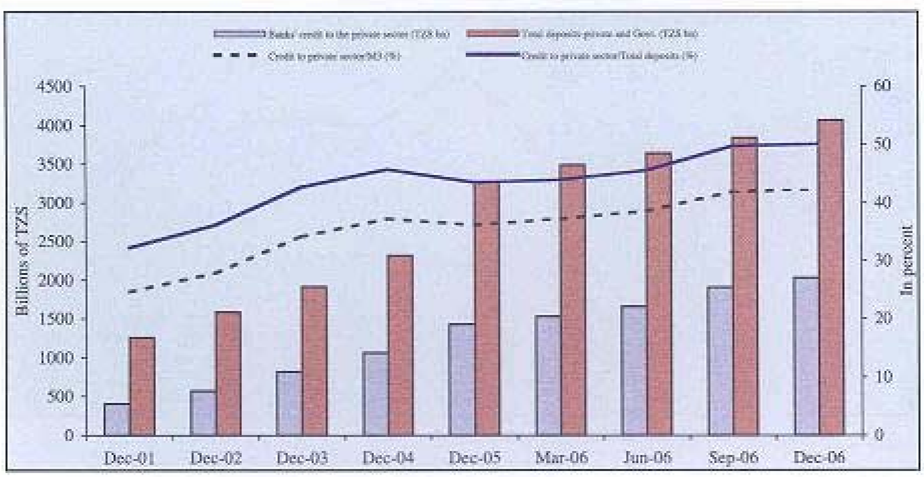


Chart A4: Tanzania: Commercial Banks Intermediation
(In billions of TZS)



BOX 1: BANK OF TANZANIA'S INFLATION CONTROL STRATEGY

- *The primary objective of the Bank of Tanzania is price stability. The Bank therefore, has the responsibility of ensuring that it establishes monetary conditions that are consistent with low and stable inflation.*

- *Low inflation allows the economy to function more efficiently, thereby contributing to a better overall economic performance.*

- *Inflation control is not an end in itself, but rather, the means by which monetary policy contributes to overall economic performance.*

- *Central Banks control inflation by influencing the growth of money supply. The Bank of Tanzania focuses on the growth of broad money- M2, which is defined as currency in circulation outside banks, and total deposits held by commercial banks, excluding foreign currency deposits. M2 is chosen because it is the monetary aggregate that is estimated to have closest relationship with the rate of inflation.*

- *To influence the growth of M2, the Bank targets reserve money, which is directly related to money supply through the money multiplier. Reserve money is defined as the liabilities of central bank, which include currency outside the central bank and deposit money banks' reserves held by the central bank.*

BOX 2: THE MODALITIES OF MONETARY POLICY IMPLEMENTATION

- *At the beginning of every fiscal year, the Bank of Tanzania sets annual monetary policy targets in its Monetary Policy Statement. The targets are reviewed at mid-year.*
- *The Monetary Policy Statement is submitted to the Minister for Finance, who submits it to the Parliament.*
- *The same procedure is followed in the submission of half-year review of monetary policy implementation.*
- *The Monetary Policy Committee of the Board of the Bank of Tanzania, chaired by the Governor, closely monitors monetary policy implementation on a monthly basis.*
- *The Monetary Policy sub-committee discusses, on weekly basis, progress on monetary policy implementation and plans for the subsequent week.*
- *A technical committee reviews liquidity developments daily and agrees on market intervention strategies.*

BOX 3: MONETARY POLICY INSTRUMENTS

- *The Bank of Tanzania uses indirect instruments of monetary policy to influence the level of money supply.*

- *The main instrument is Open Market Operations (OMO). OMO involves the sale or purchase of securities, e.g. treasury bills, by the Central Bank to withdraw or inject liquidity into the system, in order to influence the monetary base.*

- *Other indirect instruments include Foreign Exchange Market Operations (FEMO), the discount rate, statutory reserve requirements, and moral suasion.*

BOX 4: CONTROLLING THE RATE OF INFLATION

- *The objective of monetary policy is to achieve a low and stable rate of inflation.*
- *The Bank of Tanzania focuses on the Consumer Price Index (CPI) to measure inflation. The rate of change in the overall CPI is referred to as the HEADLINE INFLATION RATE.*
- *The inflation rate excluding food prices is often referred to as the NON-FOOD INFLATION RATE. It is a measure of price movements, which are largely influenced by policy factors, but can also be frequently affected by external factors.*
- *The Bank of Tanzania also monitors food prices and their index. This is because food prices are sometimes affected by non-monetary factors like drought and floods, which can affect inflation substantially, regardless of the stance of monetary policy. The rate of change in food price index is referred to as the FOOD INFLATION RATE.*

GLOSSARY

Currency in circulation outside banks

Notes and coins accepted as legal tender in the domestic economy, excluding amounts held by the banking system.

Discount rate

The rate of interest the Bank of Tanzania charges on loans it extends to commercial banks. At present, it is also the interest rate charged on government overdraft from the Bank of Tanzania.

Exchange rate

The price at which one currency can be purchased with another currency, e.g. TZS per USD.

Inflation

The rate of change of price index normally expressed as percent per annum. Inflation can be calculated on various types of price indices such as wholesale price index, consumer price index, and the implicitly GDP deflator. The inflation target that is pursued by monetary policy in Tanzania is based on consumer price index.

International Reserves, or Reserve Assets

Consist of external assets that are readily available to, and controlled by Central Bank for direct financing of balance of payments, and for indirectly regulating the magnitude of balance of payments imbalances through intervention in foreign exchange markets. For the case of Tanzania, international reserves comprise the Bank of Tanzania's holdings of monetary gold, SDRs, reserve position in the International

Monetary Fund, and foreign exchange resources, which can be made available to the Bank of Tanzania for meeting external financing needs.

M—Money Supply

The sum of currency in circulation outside the banks and deposits of residents with banks are defined in various levels of aggregation as money supply narrowly and broadly defined. That is narrow money (M1), broad money (M2), and extended broad money (M3).

M0—Reserve Money

The Bank of Tanzania's liabilities in the form of (1) currency in circulation outside the Bank of Tanzania, and (2) banks' reserves at the Bank of Tanzania.

M1—Narrow Money

Consists of currency in circulation outside banks and demand deposits of Tanzanian residents with banks.

M2—Broad Money

Is equivalent to narrow money (M1) plus time deposits and savings deposits of Tanzanian residents in banks.

M3—Extended Broad Money

Consists of broad money (M2) plus foreign currency deposits of Tanzanian residents in banks.

Non—Food Inflation Rate

This is a measure of price movements caused by factors other than food prices. It provides a better indication of the effectiveness of monetary policy on inflation since price movements in these items are caused largely by monetary policy.

Reserve Money Program

It is an operational framework used by the Bank of Tanzania to achieve money supply growth targets, through monitoring reserve money, which is the operational variable.

Statutory Minimum Reserves

These are balances which banks are required to keep with the Bank of Tanzania, determined as a percentage of their deposit liabilities, and their short-and medium-term borrowing..

Seasonally Adjusted Indicators

Seasonal movements or seasonal variations, refer to identical, or almost identical, patterns, which a time series appears to follow during corresponding months (quarters) of successive years. Such movements are due to recurring events, which take place annually, as for example, the harvest season. Seasonally adjusted indicators show the impact of non-seasonal influences on a time series, thus showing more clearly the underlying movements in the series.

Weighted Annualised Yields of Treasury Bills for all Maturities

This is the average yield of Treasury Bills, which is weighted by the volume, sold of 35-, 91-, 182-, and 364 - day Treasury Bills, expressed in percent per annum.

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