



# **FINANCIAL STABILITY REPORT**

**September 2011**



# FINANCIAL STABILITY REPORT

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## LIST OF ACRONYMS

AIG	- American International Group
ATM	- Automated Teller Machine
BOT	- Bank of Tanzania
CPI	- Consumer Price Index
DIB	- Deposit Insurance Board
DSA	- Debt Sustainability Assessment
EAC	- East African Community
ECH	- Electronic Clearing House
EAMU	- East African Monetary Union
EU	- European Union
FSR	- Financial Stability Report
GBP	- British Pound Sterling
GDP	- Gross Domestic Product
GFC	- Global Financial Crisis
GFSR	- Global Financial Stability Report
IMF	- International Monetary Fund
MAC	- Monetary Affairs Committee
MOF	- Ministry of Finance
MU	- Monetary Union
MOU	- Memorandum of Understanding
NPLs	- Non Performing Loans
SADC	- Southern African Development Community
SSRA	- Social Security Regulatory Authority
TCRA	- Tanzania Communications Regulatory Authority
TFRF	- Tanzania Financial Regulators Forum
TIRA	- Tanzania Insurance Regulatory Authority
TISS	- Tanzania Interbank Settlement System
TZS	- Tanzanian Shillings
UK	- United Kingdom
US/USA	- United States of America
USD	- United States Dollar

## GOVERNOR'S FOREWORD

The last five years have been a challenging period for financial sector regulators all over the world. The recent global financial crisis exposed regulatory gaps and weaknesses in the financial architecture both at international level and at national levels. The exposure necessitated a series of reform initiatives at international level, but with a spill-over effect to national regulatory systems as well. So far, the international regulatory reforms are focusing mainly on tightening of prudential criteria for individual financial institutions – a micro-prudential approach - mainly through larger and better quality capital and liquidity buffers; and broadening of the regulatory perimeter to include all important financial institutions. Another lesson learned from the GFC was that even the much improved micro-prudential regulatory approach will not bring about a stable financial system, unless it is complemented by a systemic approach or a macro-prudential oversight of the financial system – whereby potential systemic risks are identified at an early stage, so that pre-emptive and countermeasures can be deployed. As such, many countries are now striving to set-up an effective framework of macro-prudential policy to operate alongside the upgraded micro-prudential frameworks.

While safeguarding financial stability is a joint responsibility of all financial sector regulators, a macro-prudential oversight needs a designated authority to coordinate and promote the required initiatives and measures. In this regard, a number of countries have mandated central banks to provide the macro-prudential oversight of their financial systems. Accordingly, the Bank of Tanzania is also mandated to take the responsibility of a macro-prudential authority over the financial system, through the Bank of Tanzania Act, 2006 and the Banking and Financial Institutions Act, 2006. Moreover, under the same legislations, the Bank of Tanzania is also a micro-prudential regulator and supervisor for the banking sector, and provides prudential oversight to the national payment and settlement systems and financial markets operations.

Recognizing the need for coordinated domestic efforts to secure financial and overall macroeconomic stability in the country, the Bank is committed to facilitate the operations of the Tanzania Financial Regulators Forum (TFRF) to achieve its set objectives. The MOU stipulating the mode of operations in normal and crisis times, and the responsibilities of each member of the Forum has been prepared and reviewed by TFRF members (BOT, SSRA, TIRA, DIB and MOF) who held their first meeting in November 2011. The Forum is expected to be officially launched by June 2012. Nevertheless, consultations and exchange of information among financial regulators for financial stability analysis and reporting by the Bank of Tanzania is ongoing. Indeed, through these regular consultations, financial sector regulators are developing the needed understanding of interconnections in the financial system, both via the direct links between financial institutions and the indirect ones created in the financial markets. This understanding is very crucial for guiding our regulatory responsibilities of promoting measures that will safeguard the stability of the respective sub-sectors, without affecting the stability of the financial system or compromising the growth of the economy.

Since maintaining financial stability in the economy is a multi-dimensional challenge, it requires all stakeholders to work both independently and collaboratively to be effective. In this regard, while consultative efforts are gaining ground, there is still much to be done especially in terms of establishment of an effective and coordinated mechanism for crisis preparedness, management and resolution for the Tanzanian financial system. The process of establishing the envisaged macro-prudential framework is

being spearheaded by the Bank of Tanzania. The main objective of the framework is to establish clear lines of communication between the Bank and other financial regulators and to ensure that decision making in case of detection of any signs of systemic distress is promptly escalated from the BOT to respective TFRF members as and when appropriate. Across-borders, the Bank has established regulatory cooperation mechanism through MOUs with host country regulators in respect of Tanzanian banks with cross-border operations. The main objective of such MOUs is to exchange regulatory information on relevant financial institutions to facilitate identification of any emerging cross-border risks and prescribe pre-emptive measures with home regulators accordingly.

On domestic assessment of financial stability, this Report covers developments in the financial sector during the year ending September 2011, unless stated otherwise. Accordingly, the Bank's analysis based on economic and financial developments during the period under review indicate that financial stability was maintained despite the dynamic vulnerabilities in the global economy, as well as domestic challenges to macroeconomic stability. All the monitored financial soundness indicators of the banking system were within the desired benchmarks. Moreover, the results of the stress tests conducted for the quarter ending September 2011 indicated that the financial sector remained stable and resilient to adverse shocks applied during stress testing. Although, currently there is low contagion risk to financial stability, vigilance in macroprudential oversight of all segments of the financial system is still required, considering that global and domestic conditions are always subjected to unanticipated events with potential implications to domestic financial stability.

Besides assessing the performance of the banking system as a proxy of the financial system, this Report has covered for the first time the assessment of the impact of pension and insurance sectors' operations on financial stability. It is noteworthy that the size and the level of interconnections of these two sectors with the banking system and with the government fiscal operations are the major source of risk to financial stability. Pension and insurance sectors hold about 21 percent and 2 percent of total financial sector assets, respectively. Consequently, according to the significant size, the financial linkage of pension funds with other financial intermediaries, as well as with the Government becomes a necessary monitored indicator in financial stability assessment.

As usual, we expect this edition of the Financial Stability Report will continue to provide useful insights on financial stability in the country and future prospects. In particular, the Bank expects this Report will raise public understanding of the potential risks and challenges encountered in the financial system and thus prompt both financial sector regulators, financial institutions and business community to take advantage of the assessment as they plan ahead, in order to contribute towards a more stable and resilient financial system. Meanwhile, through the contacts provided on the back-cover of this Report, we welcome suggestions and comments from all interested parties with the aim to further improve this publication in subsequent editions.



Prof. Benno Ndulu  
Governor  
30<sup>th</sup> September 2011

## OVERVIEW

During the year ending September 2011, the Bank's assessment based on the monitored financial soundness indicators of the banking system and the results of stress tests conducted in the review period indicated that, the domestic financial sector remained stable and resilient to adverse shocks, despite the dynamic vulnerabilities in the global economy and the main domestic challenges of high inflationary pressures and exchange rate volatility. The limited direct linkages with institutions in Europe and USA, in part dampened the impact of exogenous shocks to domestic economy. Also, the prudential limit in net open position of banks to foreign exchange exposure; and a requirement to financial intermediaries to invest mostly in rated institutions, partly helped to provide a key anchor to foreign exchange risk. Indeed, by end September 2011, Tanzania banks had 96 percent of their foreign placements invested in "A" rated banks, 3 percent in "B" rated banks, while only 0.9 percent of their foreign exchange was placed in unrated banks. Furthermore, banks cautiously reduced their exposure to Euro securities as they became susceptible to the ongoing European sovereign debt crisis. Specifically, total investment tranche by Tanzanian banks in Euro securities dropped from 27.2 percent of total foreign placements recorded end June 2010 to 24.8 percent by end September 2011.

Despite the robust performance of the Tanzanian financial system over the years, there is still room for improving financial inclusion as the financial sector continues to deepen and mature with increasing number of competing financial institutions and innovative financial products and services. In recognition of the challenges of maintaining financial stability prospects, the Bank of Tanzania is committed to deploy regulatory and oversight measures in a bid to safeguard the macroeconomic stability and promote prudent performance in the financial system. The Bank will continue to enhance its daily surveillance of transactions in the domestic financial system, as well as its periodic monitoring of global developments, especially in the Tanzania's trading partners and assess their implications on financial stability. The promotion of prudent regulations and sound risk management practices in the financial system complemented with monitoring of contagion risks within the domestic financial sub-sectors and across-borders will continue to be the focus of the Bank's macroprudential engagements.

One major area of improving the stability and resilience of the financial system hinges on strengthening of the financial regulatory regimes, consolidation of risk management frameworks and coordination of financial sector policies and interventions so as to take into account systemic risks. The Bank of Tanzania has completed the establishment of the Tanzania Financial Regulators Forum (TFRF), which provides interagency coordination between financial sector regulators and the Government on issues of financial sector regulations, enforcement and market conduct in support of a safer, efficient and resilient financial system. Another important role of the Forum is to coordinate the development of an appropriate framework for crisis preparedness, crisis management and resolution for a Tanzanian financial system. While consultations and exchange of information for financial stability analysis started way back in 2010, the first official meeting of TFRF members was conducted in November 2011 to review the proposed MOU and members agreed on a plan of action to operationalize the Forum. It is envisaged that the Forum will be officially launched by June 2012.

On the international front, the year 2011 has been a challenging one for the world economy. The global environment is characterized by slow economic recovery; continuing banking and financial markets distress and the European sovereign debt crisis. Against this back-drop of lingering effects from the GFC,

significant challenges have risen in managing an increasingly complex macroeconomic stability in many countries around the world. The outcome of all the above vulnerabilities is the projected slowdown of global GDP growth for 2011 and in 2012 (**Table 1.1**), although for emerging economies and developing countries, growth prospects are mixed. For some countries, growth is projected downwards in the immediate future in order to contain the rising inflationary pressures. Yet for others, growth prospects remain robust as they take advantage of the underutilized capacity in their productive sectors and the prospective foreign capital inflows from developed world in search of higher returns.

The Tanzania economy will not stand immune to the emerging global economic and financial vulnerabilities, despite its partially opened capital account, which limits investors' involvement, including Tanzanian banks' placements abroad. Essentially, economic and financial prospects for Tanzania like all other countries will be affected by global developments, mainly through international trade and tourism, official current account transfers, remittances, and investment opportunities. As such, a prolonged slowdown in economic activity in the world economy and consumers' demand will have negative implications for Tanzania's external sectors' performance. For instance, as Europe remains one of the major destinations for the Tanzania exports accounting for about 25 percent of total exports, the European debt crisis coupled with weak credit extension in European economies will impact on foreign exchange inflows of both official and private nature. If this happens, it will have a subsequent effect on financial stability. To dampen the impact of international shocks, any opportunity to diversify and expand the boundary of trading partners, as well as reducing donor dependence is worth undertaking. In this regard, the strategic shift towards new trade partners namely, Asia and African regional markets for Tanzania exports is a timely move, as this development has at least cushioned Tanzania against potential trade shocks from the Euro-Zone.

Besides the relevance of global developments to Tanzanian economy through the trade and investment channels as highlighted above, developments in the Euro zone – especially the onset of the sovereign debt crisis offer a number of specific lessons for EAC member countries who are positioning themselves to form a similar monetary union with a single currency. While the single currency – the Euro has been a success story over the past 12 years, the financial crisis revealed a number of structural deficiencies which have necessitated further reflections by EU members. Indeed, the challenges of dealing with the global financial crisis in countries with single currency are worse than contagion effects of trade partners without monetary union. Therefore, the measures undertaken by the EU in addressing the sovereign debt crisis under the exposed deficiencies of the EU Monetary Union provide valuable lessons to the process of formulation of the envisaged EAMU. Amongst the major lessons include the need for establishment of a strong institutional framework to provide macroeconomic surveillance in the regional economy in order to detect structural developments within Member States that might be harmful to the rest of the MU; and also the need for an effective regional crisis management and resolution mechanism – since it is not possible to prevent crises entirely.

Looking ahead, the uncertainty surrounding global economic recovery and financial markets conditions combined with the macroeconomic challenges in the domestic economy will continue to have an impact on domestic financial stability. Nevertheless, the Bank of Tanzania is committed to address any emerging signs of instability in the financial system accordingly with a back-up of collaborative actions under the TFRF when the need arises.



## 1.0 Macroeconomic and Financial Environment

### 1.1 Developments in the Global Economy and Financial System

#### 1.1.1 Global Economic Growth

As the GFC moves into its fifth year, the uncertainty about economic recovery and prospects in the global economy has recently elevated, in contrast to what initially appeared to be an exceptionally rapid recovery. Indeed, the year 2010 had registered a strong recovery for the world economy. Globally, GDP growth was recorded at 5.1 percent, which is about as fast as the world economy ever grows. The strong growth was a result of countries around the world taking unprecedented measures in terms of both monetary and fiscal stimulus as they sought to recover from the 2008/09 recession.

As the year 2011 rolled in, global economic growth was projected to slowdown on account of disruptions to global supply chains particularly for oil, mainly due to geopolitical crisis in the Middle East and Northern Africa; and for the manufactured products from the Tsunami-hit Japan. As if that was not enough, the escalating sovereign debt crisis in Europe kicked-in causing unanticipated volatility in global financial markets with subsequent impact on business and consumer confidence, as well as credit availability to finance global economic activity. Moreover, preliminary estimates and projections also suggest a significant slowdown in world trade in the immediate future. The outcome of all these shocks is the projected anemic global growth for 2011 and few years beyond. Consequently to start with, forecasts for global growth in 2011 were scaled down from 5.1 percent to 4.0 percent.

*Table 1.1: World GDP Growth Rates*

	2009 Actual	2010 Actual	2011 Projection		2012 Projection	
			Jun 2011	Update Sep	Jun 2011	Update Sep 2011
			<b>World output</b>	<b>-0.7</b>	<b>5.1</b>	<b>4.3</b>
<b>Advanced economies</b>	<b>-3.7</b>	<b>3.1</b>	<b>2.2</b>	<b>1.6</b>	<b>2.6</b>	<b>1.9</b>
USA	-3.5	3.0	2.5	1.5	2.7	1.8
Euro area	-4.3	1.8	2.0	1.6	1.7	1.1
Japan	-6.3	4.0	-0.7	-0.5	2.9	2.3
United Kingdom	-4.9	1.4	1.5	1.1	2.3	1.6
<b>Emerging and Developing</b>	<b>2.8</b>	<b>7.3</b>	<b>6.6</b>	<b>6.4</b>	<b>6.4</b>	<b>6.1</b>
Sub-Saharan	2.8	5.4	5.5	5.2	5.9	5.8
Great lakes region	4.5	6.0	...	5.9	...	5.9
Tanzania	6.0	7.0	...	6.1	...	6.1
<b>Developing Asia</b>	<b>7.2</b>	<b>9.5</b>	<b>8.4</b>	<b>8.2</b>	<b>8.4</b>	<b>8.0</b>
China	9.2	10.3	9.6	9.5	9.5	9.0
India	6.8	10.1	8.2	7.8	7.8	7.5

**Note:** Great lakes region includes Burundi, DRC, Kenya, Rwanda, Tanzania & Uganda.

**Source:** World Economic Outlook (October 2009).

Looking beyond 2011, for most part of the developed world, growth is likely to remain subdued on account of the anticipated further market volatility; a further fall in consumer and business confidence, as well as the upward trend in unemployment rates in most advanced countries. Specifically, IMF forecast for growth in the US and the Euro area in 2011 were reduced to around 1.5 percent and 1.6 percent, respectively. Although growth forecasts for Asia and Latin America were also revised downwards somewhat, the forecast outcomes for these countries remained quite robust.

With regard to emerging economies and developing countries, the direction of growth is mostly downward. Some countries are projecting a modest GDP slowdown in order to contain the rising inflationary pressures - as these countries tighten their monetary policies. Yet for others, growth prospects remain robust as they take advantage of the underutilized capacity in their productive sectors and the prospective foreign capital inflows from developed world in search of higher returns.

### **1.1.2 Global Financial Developments**

The global financial environment remains mainly subjected to a high degree of risk and loss of confidence on the credibility of fiscal policy. Over the years, financial markets around the world have developed on the assumption that public debt was considered risk free. As such, the certainty that debt would be paid in full strongly anchored financial market investment decisions. However, this traditional view is now being questioned through the eyes of the European Sovereign debt crisis, and hence global financial market development rests on a more fragile and volatile ground.

With the above view in mind, even insurance against the default of the indebted countries has become significantly more costly and threatens the sustainability of sovereign debts around the world. As a result, borrowing spreads have risen significantly in the Euro zone. The sovereign debt crisis has indeed spread from debt markets to the European banks (which are now facing funding shortfalls). Subsequently, most of the EU countries need to implement fiscal adjustments to reduce deficits and sustain fiscal consolidation. Meanwhile, in the emerging and developing economies, where the need for fiscal adjustment is generally lower, the fiscal stance in some of these countries is nevertheless tight, in response to inflationary pressures and the rapid growth fueled in part by strong capital inflows. Therefore, going forward, significant policy challenges remain in the advanced, emerging and developing economies alike, due to downside risks to sustainable growth and macroeconomic stability.

### **1.1.3 Relevance of Global Developments to Tanzania**

The Tanzania economy will not stand immune to the above detailed global economic and financial developments, despite its partial liberalized capital account. In principle, the future growth prospects for Tanzania like all other countries will be affected by global developments, mainly through international trade and tourism, official current account transfers, remittances, and investment opportunities. Since about 30 percent of Tanzanian exports go to Europe, whereas, Italy, UK and USA are the top three source markets for tourism in Tanzania, a prolonged slowdown in economic activity and consumers' demand in these countries will have negative implications for Tanzania's economic growth prospects. However, following strategic promotions, there is a gradual shift towards new trade partners and tourism markets for Tanzania. The new niches include Asian and African regional markets. The new markets have been motivated by the faster economic growth recorded in these countries than in the advanced economies over the last decade. This development has somehow cushioned Tanzania against the adverse shocks of the Euro-Zone crisis. On the other hand, the unfolding European sovereign debt crisis specifically offers some lessons for EAC member countries who are positioning themselves to form a similar monetary

union with a single currency. Accordingly, the benefits, opportunities and challenges of the contagion effects in the European Union deserve some reflections as the EAC envision its own monetary integration.

Meanwhile, as interest rates in the major economies are expected to remain low for several years to come, this stance will affect Tanzania's returns to foreign investments in these countries. But, the same scenario of low interest rates in advanced economies will continue to motivate foreign capital inflows to emerging and developing countries including Tanzania. The capital inflows are expected to strengthen in line with any optimism over the global economic recovery. The anticipated capital flow to Tanzania will boost growth prospects as Tanzania is operating under capacity and there is extra room for foreign exchange absorption especially for infrastructure development, without causing currency appreciation beyond the fundamental level.

Looking ahead, the external economic and financial conditions are expected to be uncertain, or in the worst case scenario, unfavorable to economic growth for the near future. Specifically, the scale of fiscal imbalances in the Euro zone, coupled with the envisaged political stalemate in the run-up to the Presidential elections in the US will set-in a period of anemic global growth in the short term. As such, naturally, it implies that growth in Tanzania's traditional trading partners would continue to lag behind the more dynamic emerging market economies. Therefore, greater diversification of Tanzania's exports and investment incentives towards these new growth poles needs to be vigorously promoted and facilitated by the Government.

#### 1.1.4 The European Sovereign Debt Crisis: Lessons for the EAC

Countries around the world will continue to learn and take advantage of the lessons from the GFC and the unfolding European sovereign debt crisis to improve and consolidate their macroeconomic policy frameworks, in pursuit of sustainable economic growth. Fiscal policy in many countries was used as a pro-growth instrument to support the economic recovery from the impact of the GFC. In most countries, this move resulted in historically large fiscal deficits and higher public debt levels. Sooner than later, for some European countries, the GFC turned into the sovereign debt crisis of which the epicenter is the Euro zone – an economic area with a monetary union or a common currency. Accordingly, developments in the Euro zone following the onset of the sovereign debt crisis offer a number of lessons for EAC member countries who are positioning themselves to form a similar monetary union – East African Monetary Union (EAMU) with a single currency. It is against the above background, that this section highlights some of the salient lessons for the EAC as following:

- The ultimate responsibility and interest of a Member State in the monetary union should be to achieve the agreed convergence criteria not as a one-off event but as an on-going task.
- After entering the Monetary Union (MU), each Member State need to act in a way that guarantees the stability of the MU by indispensably complying and adhering at all times to all the economic pre-conditions that were identified as essential for the effective functioning of the MU.
- It is absolutely necessary to establish a strong institutional framework to provide macroeconomic surveillance in the regional economy in order to detect structural developments within Member States that might be harmful for the rest of the MU and hence, prescribe pre-emptive measures for enforcement.
- Since it is not possible to prevent crises entirely, there is need for an effective regional crisis management and resolution mechanism to be established.
- Harmonization of macroeconomic policies and accounting standards within the MU is also important for comparability and measuring compliance to agreed benchmarks.

## 1.2 Domestic Macroeconomic Developments

Macroeconomic developments have implications on financial stability through multiple channels. Therefore, understanding of the transmission mechanisms that exist between the financial system, the real sector and the external sector of the economy is critically important when assessing financial stability. In addition, the interactions between the financial system and the corporate, as well as the household sectors are equally important for financial stability assessment. However, at this juncture, the Bank of Tanzania is still building capacity in analyzing developments in the corporate and household sectors and their associated risks to financial stability. The following sections will therefore focus mainly on developments in the real and external sectors with potential impact on financial stability.

Essentially, a slowdown in economic activity or low production in the real sector can adversely affect household incomes and business earnings. As a result of the reduced personal and corporate incomes, there will be high chances of defaults by household and corporate borrowers. This in turn will affect the quality of banks' loan portfolios; weaken the position of banks' balance sheets; and the ability for banks to undertake effective intermediation in future. Alternatively, any shock that affects banks' balance sheet has the potential of increasing the cost and reducing availability of credit to the real sector through the interest rate channel. All of the above highlighted possible interactions between the real sector and the financial system will always have an impact on financial stability.

Real sector developments which are mainly relevant to financial stability include GDP growth, the fiscal position of the government and inflation developments. Specifically, GDP growth reflects the ability of the economy to create wealth (financial resources) and therefore any risk to GDP growth will have significant implications on financial stability. Meanwhile, the fiscal position of the government reflects the ability of the government to find financing for its expenses above its revenue. In the same vein, any risk associated with the ability of the Government to meet its financial obligations will spell the potential risk for financial stability – as is the case for the sovereign debt crisis for the Euro Zone countries. Finally, inflation developments may indicate risks to price stability in the economy – which in turn threatens the achievement and sustainability of financial stability.

Meanwhile, the conditions in the external sector as reflected by developments in exchange rates, foreign exchange reserves, and the current account balance are also important determinants of the stance of financial stability in the economy. The above externally driven variables can be a reflection of sudden changes in the direction of capital inflows, export competitiveness, and the sustainability of the foreign debt service, all of which have strong influence on financial stability.

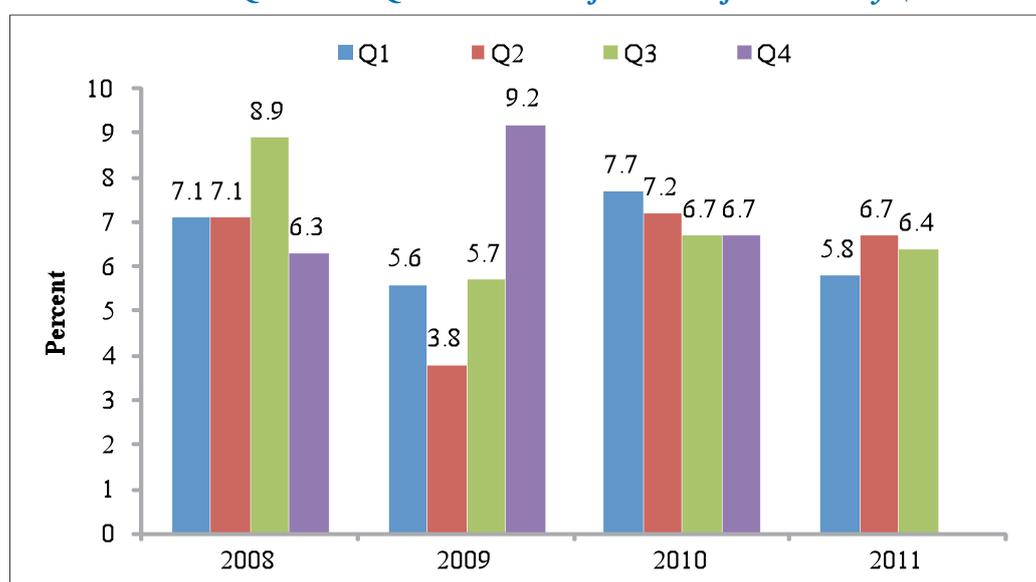
### 1.2.1 Economic Growth

Economic activity picked up strongly in 2010, whereas the real GDP growth rate improved from the low GDP growth rate of 6.0 percent recorded in 2009 at the height of the GFC to 7.0 percent. The major contributors to GDP growth were agriculture, manufacturing, construction, transport and communication activities. Besides the good weather, the improvement in GDP growth is associated with the result of the intentional relaxation of monetary and fiscal policies to pump-up economic activity which was affected by the second-round effects of the GFC during 2009. Indeed, banks lending to the private sector in 2010 was above levels recorded in 2009. The highest annual growth in bank lending during the year ending December 2010 (by order of magnitude) was recorded in mining activity, commercial agriculture, tourism

and manufacturing. The annual growth rates of lending to these activities were all above 35 percent. To cap it all, overall financial intermediation grew by 34.7 percent during the year 2010, compared to a contraction of 13.2 percent recorded in the year ending December 2009 (**Annex 1**).

Whilst, the Tanzanian economy rebounded to a GDP growth rate of 7.0 percent in 2010, the economic growth outlook for 2011 is however threatened by both domestic and external factors. On the domestic front, the negative factors mainly include the unreliable power supply experienced during the first three quarters of the year and the upward inflationary pressures that complicated production and investment decisions. On the international side, the slow growth in Europe and USA will impact on export demand for Tanzanian products and services, while the increase in international oil prices will exert further pressure on domestic inflation. In anticipation of these down-side factors, the Tanzanian economy is projected to slowdown to a GDP growth rate of 6.0 percent during 2011.

**Chart 1.1: Annual Quarter on Quarter GDP Performance of the economy (2007 -2011)**



**Source:** Bank of Tanzania

In general terms, there is a strong relationship between the direction and depth of credit to the productive sectors of the economy and sectors that drive the GDP growth. For instance during the year to September 2011, the sectors that received credit at robust annual growth rates include tourism (83.3%), trade (52.9%), agriculture (42.8%), mining (40.5%) and building and construction (30.9%). Conversely, these are the activities that are expected to drive the GDP growth in 2011.

### 1.2.2 Domestic Inflation Developments

Since the beginning of the year 2011, the Tanzanian economy like others in the region, has been experiencing upward pressures on consumer price index, emanating from depreciating local currencies, high imported prices and upward moving food prices. In Tanzania, the headline inflation rate crossed the targeted single digit level in June 2011 at a headline inflation rate of 10.9 percent. By September 2011, the annual headline inflation reached 16.8 percent. The main driving factors of the inflationary pressures are: the upward trend of food prices attributed to food shortages in some of the neighboring countries; and the rise in the global oil prices. Specifically, the rise in oil prices is a strong contributing factor to domestic inflation since its influence is felt through two major groups of items in the CPI basket (Fuel,

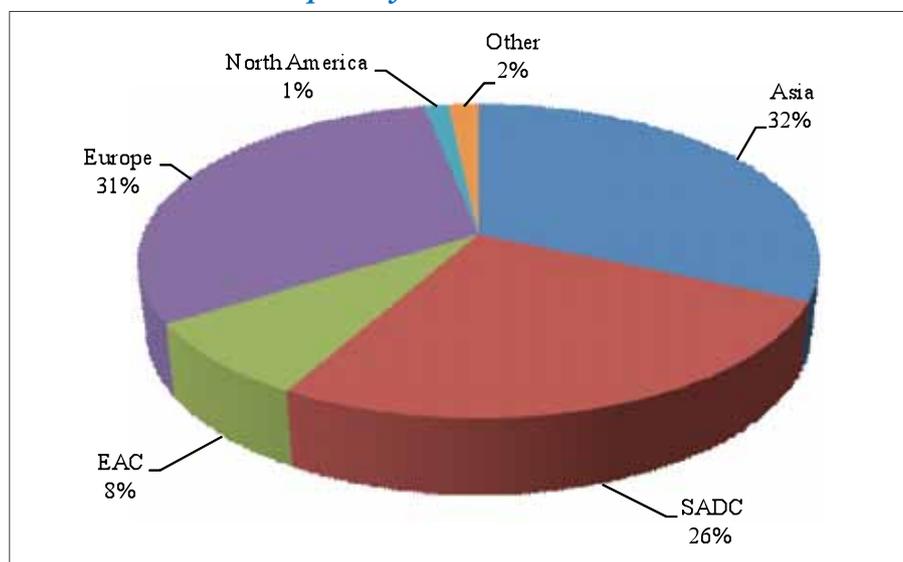
power and water; and Transportation) - whose combined weight is 18.7 percent in the CPI basket – and becomes the highest weighted group, only second to food weighing 47.8 percent.

Besides high inflationary pressures, the economy also experienced a depreciating trend on the domestic currency. The pressure on the exchange rate of the TZS against major currencies is mainly attributed to the widening of the current account deficit, mainly emanating from rapid expansion of the oil import bill and imports for infrastructure development, a slowdown in exports and currency speculation activities. Since excess volatility on the exchange rate or inflation poses a threat to macroeconomic stability, the Bank of Tanzania is committed to address the emerging challenges lest they become threats to financial stability. In recognition of the downside effects of high inflationary pressures and expectations, the Bank has recently taken measures to tighten its monetary policy stance; increased sales of foreign exchange in the interbank market, and raised the ceiling for net open foreign exchange position for banks. The Bank also enhanced monitoring of foreign exchange operations in the financial system as a whole in order to identify any signs of undue activities, so as to prescribe an appropriate intervention.

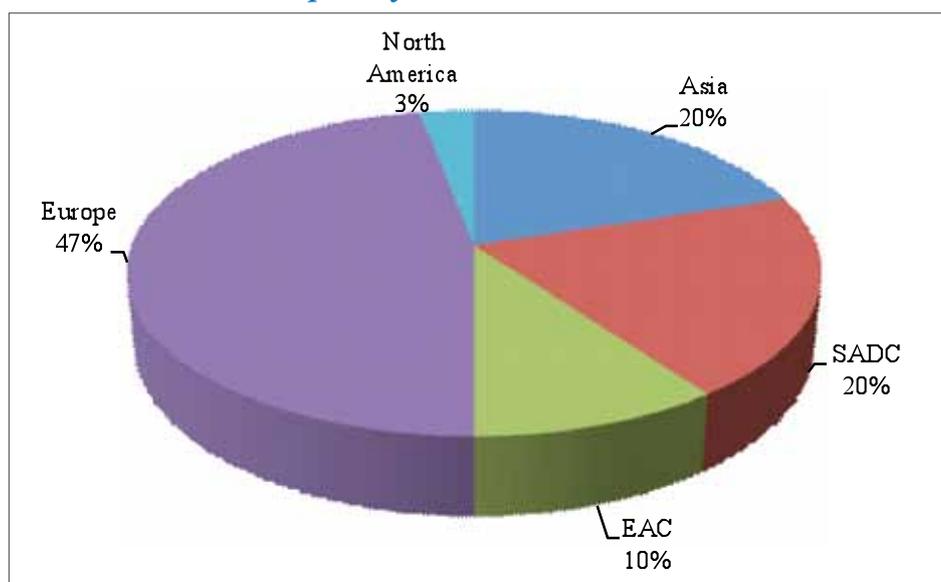
### 1.2.3 Performance of the Tanzania External Sector

Notwithstanding the relative importance of Europe as a major export destination for Tanzania's exports, there appears to be a gradual shift towards regional and Asian markets ([Chart 1.2a](#), [Chart 1.2b](#)). More exposure to fast-growing Asia, especially China and India has proven beneficial to the performance of the Tanzania external sector, which has continued to recover from the slowdown registered in the year 2009. Meanwhile, decisive efforts are being taken by the EAC Secretariat to promote intraregional trade liberalization and intraregional infrastructure development – the moves that will consolidate the gains on the external trade for Tanzania. Following strategic efforts to promote new markets, the share of Tanzania exports to Asia has risen from the average of 20 percent during 2004-2008 period to about 32 percent in 2011, while the share for Europe has fallen from around 47 percent to 30 percent during the same period. Indeed, the reduced share of Tanzanian exports to Europe has helped to dampen the impact of the Euro sovereign debt crisis on the domestic economy. Also, Tanzania exports in regional markets are gaining prominence. For instance, SADC market share has grown from 20 percent during 2004-2008 to about 26 percent during 2011.

*Chart 1.2a: Tanzania's exports by destination, 2011*



Source: Tanzania Revenue Authority and Bank of Tanzania computation.

**Chart 1.2b: Tanzania's exports by destination, 2004 - 2008**

**Source:** Tanzania Revenue Authority and Bank of Tanzania computation

**Table 1.2: Top 10 tourist source markets to Tanzania, 2011**

Country	Percent
Italy	17.3
United Kingdom	15.4
United States of America	11.0
Germany	8.1
Australia	5.2
Spain	4.3
France	4.3
South Africa	4.3
Netherlands	3.4
Canada	2.6

**Source:** Tanzania Tourism Sector Survey 2010.

Tanzania total exports grew by 30.8 percent during 2010, although the sluggish global macroeconomic conditions slowed the growth to 23 percent during 2011. On the other hand, during 2010, imports grew by 15 percent, while the growth accelerated to 30 percent during the year ending September 2011. All in all, the value of imported goods (USD 8,835 million) outweighed that of exports (USD 4,262 million) by far. This trade gap has partially contributed to the decline in official foreign reserves of the country as well as to the volatility in the exchange rate. Foreign exchange reserves declined from USD 3,550.2 million in September 2010 to USD 3,472.7 million at the end of September 2011, which was equivalent to 4.0 months of future imports of goods and services. However, at this level of reserves, the ability of the Tanzanian Government to service its foreign debt remains favorable, thereby reducing potential financial system instability.

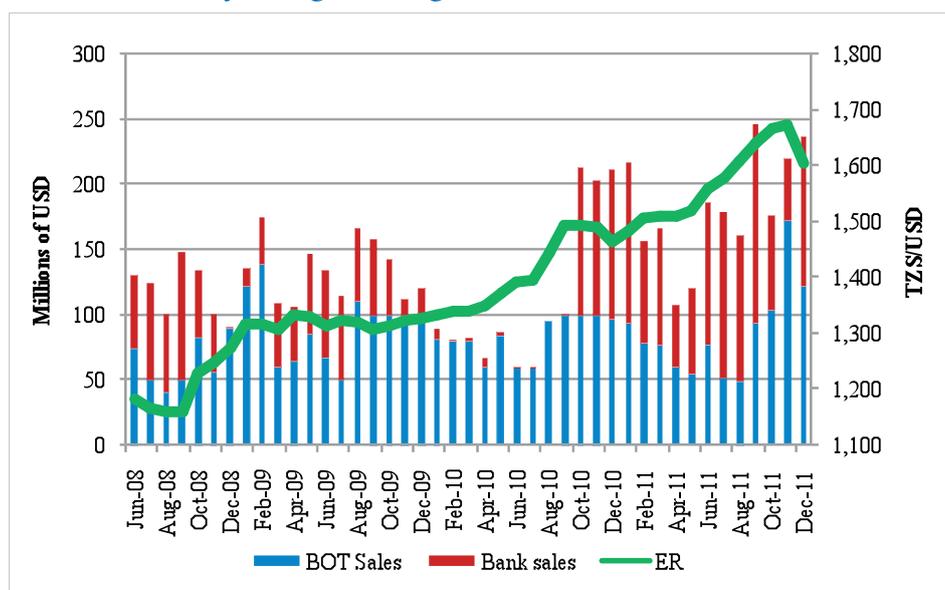
With continuation of external conditions that support a shift in investors' attention to emerging and developing market economies, Tanzania's external performance prospects remain solid. The adverse effects

of the economic slowdown in the traditional trading partners are expected to continue to be partially compensated by increased exports to new upcoming markets.

### 1.2.4 Exchange Rate Developments

During the year ending September 2011, the current account deficit widened significantly by 41.7 percent, mainly on account of widening gap in the trade account. The widening current account deficit contributed significantly to the volatility recorded in the exchange rate, especially during the quarter ending September 2011, as depicted in (Chart 1.3) below. The depreciation of the TZS against the USD as the main trading currency contributed to the inflationary pressures in the economy, particularly through the higher costs of imported goods and services, which is passed over to consumers through higher prices of consumer products as reflected by the high rate of inflation. In addition, volatility in the exchange rate has an impact on the valuation of foreign assets and liabilities – whose balances have implications to financial stability. To contain the potential threats to financial stability, the Bank of Tanzania continues to monitor closely the exchange rate movements and inflation developments for any deviations from tolerable levels, so as to act accordingly through its monetary policy actions.

*Chart 1.3: Monthly average Exchange rate obtained in the IFEM*



Source: Bank of Tanzania

## 1.3 Tanzania Sovereign Debt Developments

The on-going developments in the Euro-Zone have reminded that financial stability depends not only on the linkages between banks, other financial intermediaries and the corporate and household sectors, but also on their links with the Governments. The GFC experience also suggests that for the Governments to act as ultimate back-stoppers for the financial systems during financial crisis management, they should build adequate fiscal buffers during the good times. Otherwise, the sovereign can itself become a source of financial instability when it experiences credit risk to its public debt as the case is with the current sovereign debt crisis in the Euro Zone. It is therefore important for countries to have in place an effective mechanism of monitoring the developments in public debt and examine their implications on financial stability. The mechanism need to be deployed as part of the macro-prudential surveillance in pursuit of financial stability.

In this Section, the situation of Tanzania public debt is highlighted in relation to its impact on financial stability. The analysis of public debt situation is mainly based on the bi-annual Debt Sustainability Assessment (DSA) for Tanzania – which is facilitated by the Government in collaboration with the Bank of Tanzania. The latest DSA was conducted in 2010 and the next one is scheduled in 2012. Among others, the Bank uses the findings of the DSA to advise the Government on prudent debt management and fiscal policy in general.

According to the most current DSA conducted in 2010, the sovereign debt for Tanzania is still sustainable with significant headroom. Whilst the detailed Report on Debt Sustainability Assessment for Tanzania can be accessed on [www.mof.go.tz](http://www.mof.go.tz), the focus in this Report will be on currency composition of the external debt. The external debt is being analyzed by currency composition in order to monitor potential exogenous risks to financial stability associated with the exchange rate developments of major currencies given the global financial market developments. In principle, the Government's external borrowing policy requires that any new financing should consist of a grant element of at least 35 percent of the financing needs, while the rest could be obtained from non-concessional borrowing windows. This policy stance helps to keep a prudent lid on both fiscal deficit and the level of public debt.

As at end June 2010, Tanzania's medium to long-term external debt was largely denominated in USD and Euro – which accounted for 55 percent and 24 percent, respectively. This dominance of the two currencies in the debt portfolio is potentially a huge risk on the ability to service the respective loans as required, when the trend of exchange rate movements is towards depreciation of the TZS. However, maturity period and the terms for servicing the outstanding external debt are favorable enough to dampen both the credit risk, as well as the exchange rate risks. As of the end of June 2010, the average maturity period for public external debt was 37.2 years, while the average grace period for servicing the loans was 8.7 years, with average interest rate of 0.5 percent. It is therefore expected that during the grace period of 8 years, the desired long-run stability in the exchange rate as well as in the inflation rate will have to be achieved.

With regard to domestic public debt, the upward trajectory in government revenue collections has facilitated a steady and smooth schedule for domestic debt service. In addition, declining trend in interest rates of government debt securities has also helped to ease the debt service burden. For instance, during the year ending June 2010, the average interest rate for government debt was about 8 percent, while domestic debt servicing accounted for about 6.7 percent of the domestic revenue collected for the same year.

Going forward, Tanzania's sovereign debt remains sustainable on the basis of Net Present Value criteria. According to the projections covered by the DSA (2010), Tanzania will be able to effectively service her debt on due dates at least up to the year 2030. The projections were based on liquidity indicators as measured by debt service to exports and debt service to revenue, for external and domestic debt, respectively. In the worst case scenario, when the long-term outlook on debt sustainability takes into account a substantial increase in non-concessional borrowing (to finance infrastructure development), the sustainability indicators are still projected to be below thresholds up to the year 2030. However, the sensitivity analysis done under DSA (2010) showed that debt sustainability indicators were sensitive to persistent lower GDP growth, significantly reduced donor assistance and defaults of government guaranteed loans. Therefore, a prudent fiscal policy should have a built-in flexibility to allow for necessary adjustments in government spending, should key variables such as donor support or GDP growth rates

deteriorate excessively. This downside scenario to debt sustainability also highlights the importance of Government having a sound debt management strategy and a need for harmonization of those policies geared towards maintenance of macroeconomic and financial stability.

The Bank of Tanzania in collaboration with the Government will take initiatives to maintain the prudent borrowing stance for both external and domestic debt in line with the existing debt management strategy. On sustaining the debt service, the Government is committed to consolidate the gains of the fiscal policy thus far and continue to focus on broadening the tax base; improve tax administration and compliance; and providing incentives for export oriented investments to boost foreign exchange earnings.

**In conclusion**, the risk of debt distress for Tanzania continues to be low, taking advantage of the substantial debt relief received in recent years and the large build-up of official international reserves, which provides a strong shock absorber for external eventuality. Furthermore, a strong growth in tax revenues over the past decade has enabled limited recourse to domestic financing. Despite the positive outlook on debt sustainability, uncertainty over domestic and external macroeconomic developments will always remain. Learning from the on-going sovereign debt crisis, it is globally appreciated that fiscal prudence and the safeguarding of macroeconomic stability have to be an ongoing and constant endeavor. In addition, it is always difficult to apply fiscal discipline during an economic slowdown. It is on this basis that, the Bank of Tanzania will maintain vigilance in monitoring developments in the Tanzania public debt sustainability, in a bid to harmonize the anticipated outcome with its monetary policy stance and advise the Government accordingly.

## 2.0 Financial Sector Developments

### 2.1 Financial System Structure and Performance

While banks continue to dominate the Tanzanian financial landscape, pension funds and insurance companies are also growing significantly. On the other hand, mobile payment system is becoming the fastest growing segment of the financial system which is poised to make a significant shift in customer service in the financial system, but also in risk management mechanisms.

During the period under review, the Bank's assessment based on the monitored financial soundness indicators and the results of stress tests indicated that the financial sector remained stable and resilient to adverse shocks applied during stress testing. Despite the robust performance of the Tanzanian financial system over the years, there is room for improvement as the financial sector continues to deepen and mature with the prospects of increasing financial institutions and innovative financial products.

One major area of improving the performance of the financial system hinges on enhancement of the regulatory framework and risk management to support a safer, efficient and resilient financial system. On this regard, respective financial sector regulators are taking measures, including necessary reforms to improve the regulatory framework and risk management mechanisms in their respective financial sub-sectors, without stifling growth and innovation. Furthermore, arrangements are in the pipeline for the Bank of Tanzania in collaboration with other financial sector regulators under the auspices of TFRF to develop prudential benchmarks and thresholds which would characterize the behavior of the financial system in respect of operations during normal times and periods of stress. Subsequently, the assessment of financial stability and early warning indicators shall be measured against these thresholds. However, for the time being, the Bank of Tanzania analyzes the financial soundness indicators for the banking system to serve as a proxy of the assessment of the stability of the financial system as a whole. This is because banks hold a huge proportion (75%) of the total financial assets of the financial system. In addition, financial interaction among financial intermediaries and the impact on financial sector stability is also monitored by the Bank.

#### 2.1.1 Banking Sector Performance

During the period under review, the Bank of Tanzania through its prudential oversight continued to maintain confidence in the banking system, and thereby promoting financial stability. The maintenance of financial stability through banking sector oversight involves, among others:

- Maintaining adequate liquidity level to allow banks to meet customer withdrawals of cash, and to repay outstanding borrowings in the interbank markets when they fall due.
- Ensuring that banks are solvent, that is, at all times they have sufficient capital to cushion themselves from losses caused by unanticipated deterioration of financial conditions in the financial markets.
- Requiring banks to continuously improve risk management of their operations, particularly the intermediation process and also comply with prudential requirements.

The Tanzanian banking sector (**Table 2.1**) remains well capitalized with banks positioning themselves to the higher capital requirements recently introduced by the Bank of Tanzania to provide for enhanced capital buffers. The sector has continued to attract new entrants of both domestic and international banks. The total number of banking institutions as of 30th September 2011 stood at 45.

**Table 2.1: Financial Soundness Indicators of the banking system**

Indicators ( Percentage)	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
<b>1. CAPITAL ADEQUACY</b>					
Core Capital/TRWA+OBSE	19.1	18.2	18.8	17.7	16.8
Total capital/TRWA+OBSE	19.4	12.8	19.2	18.2	17.4
<b>2. LIQUIDITY</b>					
Liquid Assets/Demand Liabilities	46.9	45.2	44.3	43.2	41.9
Total Loans/Customer Deposits	40.8	58.9	38.8	38.2	37.6
<b>3. ACCESS TO BANK LENDING</b>					
Claims on non-government sector to GDP	18.7	20.9	18.8	20.4	22.4
Claims on the private sector to GDP	17.9	20.0	18.1	19.7	21.5
<b>4. EARNINGS AND PROFITABILITY</b>					
Net Interest Margin (NIM)	74.8	75.8	77.6	78.5	78.5
Non Interest Expenses/Gross Income	52.5	54.5	52.1	53.7	54.5
Return on Assets-ROA (PBT/Average Total Assets)	2.9	2.2	3.0	3.0	3.0
<b>5. ASSET COMPOSITION AND QUALITY</b>					
Foreign Exchange Loans to Total Loans	32.1	32.0	32.6	34.6	35.3
Gross Non-Performing Loans to Gross Loans	7.2	9.3	9.6	9.1	8.1
Large Exposures to Total Capital	161.5	108.4	95.0	110.9	122.3
Net Loans and advances to Total assets	44.8	44.1	44.8	45.9	47.3
<b>6. SENSITIVITY TO MARKET RISK</b>					
Forex Currency Denominated Assets/Total Assets	29.3	30.0	30.6	31.8	33.1
Forex Denominated Liabilities/Total Liabilities	32.0	31.9	33.3	33.9	36.0
Net Open Positions in FX/Total Capital	-4.6	-4.4	-4.6	3.7	-6.9

Source: Bank of Tanzania

Despite the increase in numbers, the banking sector continues to be highly concentrated, with the top four banks accounting for about 55 percent of both financial assets and deposits of the banking sector. Another factor which is likely to increase the concentration of the market share in fewer banks is the recent enhancement of capital requirements from TZS 5.0 billion to TZS 15.0 billion. This move is expected to promote entry of large banks and consolidation of small banking institutions in the economy. Consequently, the issue of how best to regulate the systemically important financial institutions (i.e. the too-big-to-fail institutions) in such a way as to avoid, among others, the moral hazard, is one of the agenda on the drawing board of the international as well as national regulatory authorities.

According to the monitored financial soundness indicators, the performance of the banking system remained robust and resilient to adverse shocks and market risks applied during the stress testing of aggregated balance sheet of top ten banks which represent about 80 percent of the market share as well as for the whole banking industry.

## Capital Adequacy

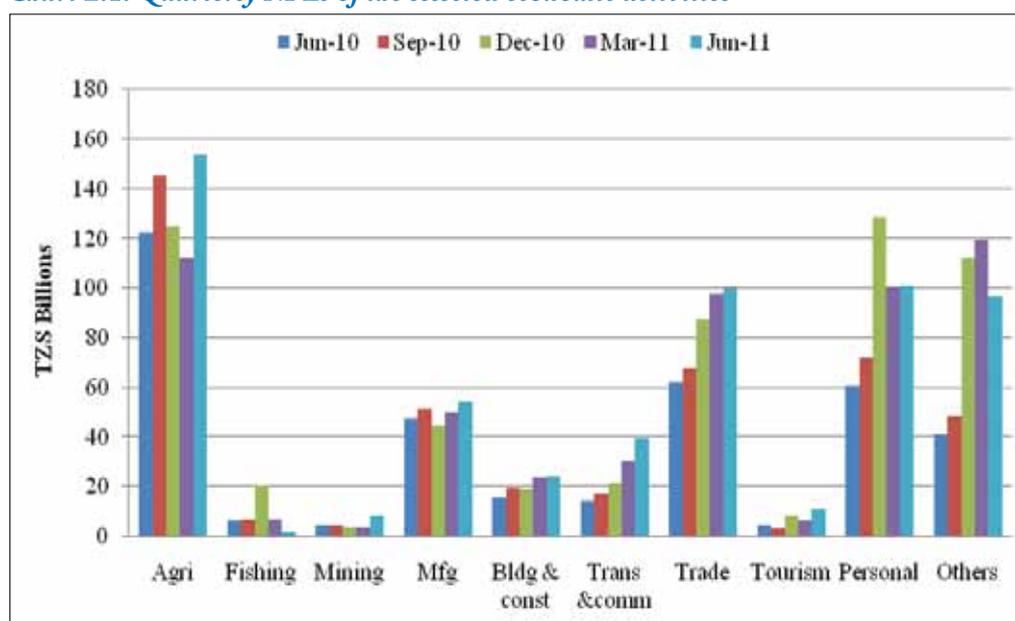
In aggregate terms, the banking sector continued to be adequately capitalized above the regulatory requirements. All banking institutions are required to maintain at all times a ratio of minimum core capital to total risk-weighted of 10 percent. This requirement is a tool to ensure that banks maintain adequate capital in relation to their risk assets thus protecting depositors' funds and promoting financial stability. By end September 2011, the industry ratio of core capital to total risk-weighted assets was 16.8 percent, being adequately above the minimum regulatory ratio of 10.0 percent.

## Asset Quality and Credit Concentration

The level of NPL is an important indicator in assessing the health of the financial system. In times of economic slowdown, loan repayments become constrained by limited incomes and cash flows and thus asset quality tends to deteriorate. As per regulatory requirements, this situation would require banks to make additional provisions which in turn have an impact on banks' capital. Normally, the reported NPLs in the banking system exhibit large variation among banks, partly reflecting different exposures to distressed sectors. Also, credit concentration has been one of the major causes of bank distress, especially when the sectors are exposed to shocks that affect their performance. It is therefore important to monitor both the concentration and quality of credit portfolios of banks to identify early signs of any credit risk.

During the period under review, the ratio of gross Non-Performing Loans to Gross Loans increased from 7.2 percent in September 2010 to 8.1 percent in September 2011. Higher levels of NPLs were recorded in agriculture, trade and personal loans. Otherwise, increased credit concentration is observed in trade, manufacturing and agricultural sectors, while personal loans are gradually losing prominence. To manage the asset quality within prudential levels, the Bank of Tanzania has directed banks with high NPLs to submit Action Plans for improving their portfolio performance.

*Chart 2.1: Quarterly NPLs of the selected economic activities*



Source: Bank of Tanzania

## Earnings and Profitability

Sustainable profits are important, as they enable banks to build up a sound capital base from retained earnings, which can strengthen resilience to unexpected shocks. Interest income remains the most important component of earnings in the banking industry. This high dependence on interest income reflects the vulnerability of banks to changes in interest rates and especially interest on government securities, of which they do not have much control. Besides interest income which accounts for about 50 percent of banks profits, other major sources of bank earnings include foreign exchange gain from exchange rate movements – contributing about 13 percent of total income, and interest income from investment in government securities – accounting for about 10 percent.

Generally, the banking sector continued to be profitable although the level of profitability has not recovered to pre-crisis levels. For the year ending June 2011, the banking sector recorded a decline of almost 50 percent in profits after tax. Specifically, profit after tax declined from TZS 104.6 billion in the year ending June 2010 to TZS 69.9 billion. The sharp decline in profitability in the banking industry can be associated with the increase in NPLs; narrowing of interest margin caused by the increasing competition; reduced earnings from foreign placements; and declining returns on government securities.

## Bank Liquidity

During the period under review, the banking sector recorded sufficient liquidity levels (**Table 2.1**). The ratio of liquid assets to demand liabilities averaged about 43 percent - which is way above the regulatory minimum limit of 20.0 percent. In specific terms, the maturity profile of the assets and liabilities of banks gives an indication of the level of liquidity in the banking system. Regulatory requirements such as minimum cash or liquid assets ratio are imposed to ensure that banks are, at all times, capable of meeting the average cash withdrawals at short notice. However, in the event of long or short positions, banks may have recourse either to inter-bank money market or the liquidity windows of the Bank of Tanzania.

## 2.2 Pension and Insurance Sectors' Impact on Financial Stability

The pension and insurance industry play an essential role in providing economic security to households across time. The sector usually channels a huge volume of savings into a wide range of financial markets, and plays a significant role in providing long-term funds to various sectors of the economy. Nevertheless, traditionally, pension funds and insurance companies have not been seen as being a significant potential source of systemic risk. Essentially, this is because they are not seen as interlinked to the same extent as banks are, for example, in the interbank markets and in the payment systems. Instead, these sectors are mostly regarded as relatively stable segments of the financial system. However, this traditional view is now being challenged, given the growing interactions between pension funds, insurers, financial markets, banks and other financial intermediaries within the financial system. In most countries, individual pension or insurance companies might not be systemically important in terms of their size, but their interconnections with other intermediaries within and beyond borders make them play an important role for the stability of the financial systems. For instance, the role played in the GFC by the collapse of the American International Group, Inc, (AIG) - a leading international insurance organization in the USA but serving customers in more than 130 countries – is a case in point of a significantly interconnected insurance company but with a modest corporate size.

One of the lessons gained from the GFC was the need for countries to broaden the financial systems' regulatory perimeter to include the oversight of financial intermediaries (including pension funds and insurers, hedge funds, etc), based on their sizes and interconnections within the financial system, in order to assess their potential impact on financial stability. In Tanzania, the macro-prudential oversight is provided by the Bank of Tanzania and for the time being it covers banks, pension funds and insurance companies.

Collectively in terms of size, pension and insurance companies are holding about 25 percent of total financial assets, which are distributed mainly as bank deposits, and in government securities. As such, based on the sheer size of their investment portfolio, any reallocation of funds or the unwinding of positions by these institutions may have the potential to move markets. In extreme cases, that could put at risk financial stability by triggering large swings in asset prices.

In terms of interconnectedness, pension funds and insurers have strong links with banks through substantial deposits, and with the Government through debt securities. It is noteworthy that, while enjoying implicit government guarantee, pension funds held about 22 percent of total outstanding Treasury bonds and stocks amounting to TZS 698 billion by end December 2011. This makes the pension sector extremely vulnerable to any sovereign debt default. Therefore, from a financial stability perspective, a good understanding of these linkages is needed in order to assess the potential transmission of problems from one sector to another. It is on this basis, that the Bank collects relevant data to examine the level of cross-sector interlinkages among the financial institutions within the domestic financial system and beyond borders; and establish the level of contagion risk to financial stability. Besides the size and the level of interconnections being the major determining factors of potential sources of financial instability, bankruptcy of financial institutions is also another important destabilizing shock. In the same token, pension funds and insurance companies can as well go bankrupt just like banks, and hence become a threat to financial stability.

Generally, the ideal investment situation for pension and insurance firms would be those investments that would ensure adequate liquidity at the time of contractual financial claims. However, under the current framework, most pension schemes have invested in real estate – which might be potentially risky in terms of meeting timely obligations to pensioners. It is against this backdrop, that the SSRA in collaboration with the Bank of Tanzania is conducting a comprehensive actuarial valuation combined with portfolio review of the existing pension funds in order to verify, among others, the viability and soundness of the pension sector, and thereafter prescribe the way forward.

## 2.3 Cross-sector Linkages in the Financial System

Given the existing and the growing inter-linkages among various components of the financial systems at national, regional and global levels, coordination is a central issue in the conduct of financial stability function. Financial stability reports (FSRs) are used to raise policymakers' and the public's awareness of financial stability issues across these levels. National authorities produce country's FSRs while regional blocs which are at advanced stages of integration such as the European Union produce regional FSRs. The IMF produces the Global Financial Stability Reports (GFSRs).

The following sections highlight the level of financial system interconnectedness among the financial system sub-sectors, as well as with the Government of Tanzania and also describe measures which are being implemented in order to mitigate emerging risks to financial stability in Tanzania. In addition, given the growing inter-linkages among the financial system sub-sectors and across the borders, a snapshot of the ongoing arrangements to coordinate financial stability initiatives in the domestic economy, as well as at the EAC regional level is also provided.

### 2.3.1 Inter-linkages among the Financial Intermediaries

The linkages between banking, pension funds and insurance companies are the most important in relation to financial stability in Tanzania. Problems arising in any of these three sectors can have an impact on overall financial stability and vice versa. As a result, supervisors in the three sectors must take into account the advantage in taking prompt supervisory actions to prevent or remedy problems in their respective supervised financial institutions. Furthermore, financial sector regulators and supervisors should ensure public confidence in their subsectors and in the financial sector as a whole.

Loss of confidence in the banking sector can create financial instability by resulting in a run on banks by depositors, with a subsequent systemic drain on systemic liquidity, which will affect the pension as well as the insurance sector. In recognition of the potential contagion effect of disruptions in banking sector to the rest of the financial sector and also across borders, the Bank of Tanzania closely monitors the inter-linkages of the financial institutions. At a national level, the Bank is providing a macroprudential surveillance of the financial system as a whole and is coordinating initiatives by domestic financial regulators which are aimed at safeguarding financial stability. The objective of these surveillance mechanisms is to assess the potential systemic risks and propose measures to mitigate their likely impact on financial stability.

*Table 2.2: Financial System Interconnectedness (Top Ten Banks)*

Amounts in TZS Billions	Jun-10	Dec-10	Jun-11
1. Placements with Banks Abroad	732.2	854.1	891.1
2. Inter-bank Placement/Lending to Domestic Banks	115.0	166.6	219.4
3. Banking System Deposits from Pension Funds	526.0	415.5	367.6
4. Banking System Deposits from Insurance Companies	111.3	97.1	131.7
5. Inter-bank Deposits/Borrowings from Domestic Banks	158.7	249.4	201.9
6. Inter-bank Deposits from Foreign Banks	17.1	22.2	85.4
7. Inter-bank Contingent Claims to Foreign Banks	259.6	113.2	295.8

Source: Bank of Tanzania

### 2.3.2 Linkages among Banks

The banking system linkage through interbank placements and borrowings continues to grow. In addition to supplying liquidity to the banking system, the inter-bank linkage facilitates the operations of the payments and settlement system. As of 30th June 2011, total placements with other banks abroad for the Top Ten Banks in Tanzania amounted to TZS 891.08 billion, representing 71.49 percent of placements of the banking sector. The volume of placements has been expanding due to the growth of international trade financing and due to the recovery of confidence in the global economy. The total aggregate placements by the whole banking system increased from TZS 1,202.92 billion in June 2010 to TZS 1,246.52 billion in June 2011. The main risks arising from offshore placements are associated with foreign exchange risks and

potential banking crisis in the foreign banks, especially among the international banking groups which are exposed to the sovereign debts among Euro zone economies.

The Bank of Tanzania has a framework which monitors foreign placements and foreign exchange risks. The prudential banking regulations require banks to diversify their placements abroad according to the credit rating in order to mitigate potential risks. Meanwhile, the volume of placements from foreign banks in the Tanzanian banking system has also been increasing. The volume of foreign banks placements in the top ten banks increased from TZS 17.09 billion in 30th June 2010 to TZS 85.41 billion in 30th June 2011. The main objective of placements is to facilitate the foreign banks payments in Tanzania. This is similar to the correspondent banking arrangement which domestic banks make with foreign banks to facilitate international payments.

### **2.3.3 Linkage between Banking and Pension sectors**

The pension sector is a significant source of liquidity to the banking system. The volume of banks deposits from the pension sector at end June 2011 in the top ten banks amounted to TZS 367.56 billion, representing 3.3 percent of private sector deposits in the banking system. The level of pension funds placements recorded a declining trend during the period under review, decreasing from TZS 526.01 billion in the end June 2010 to TZS 367.56 billion by the end of June 2011. The decline in the pension sector deposits in the banking system was attributed to the re-allocation of the investment portfolio to other sectors, particularly Government Securities and Real Estate. The total volume of pension sector investment in the Government Securities increased from TZS 587.49 billion in June 2010 to TZS 687.96 billion June 2011. The existing linkage creates a mechanism for transmission of shocks across the two sectors. As such, any distress in either sector will cause a proportionate shock to the other. In view of the strong linkage between the banking and pension sectors, collaboration between the respective regulators becomes imperative. A framework for sharing of the supervisory information among domestic regulators has been established, while bilateral MOUs could be established when necessary.

### **2.3.4 Linkage between Banking and Insurance sectors**

The total volume of insurance companies' deposits in the Top Ten Banks amounted to TZS 131.74 billion as at 30th June 2011, accounting for only 1.2 percent of banking system's total deposits. However, deposits of the insurance companies to the banking system accounted for about 50 percent of insurance sector investment portfolio, followed by investment in real estate accounting for about 20 percent, while holdings of Government Securities account for about 10 percent. The low level interconnectedness to the banking system makes insurance companies a non-threat to financial stability for the time being. Nevertheless, this stance does not make the Bank of Tanzania complacent in its surveillance of the insurance operations as part of prudential oversight of the financial system. With the introduction of banc-assurance in the pipeline, the interactions between the two sectors will definitely increase, thus calling for enhanced surveillance.

### **2.3.5 Linkage between Financial Intermediaries and the Government**

The on-going developments with regard to European debt crisis have reminded that financial stability does not only depend on the linkages among financial intermediaries and within financial markets, but also on the interconnections with Governments. The GFC experience also suggests that the governments can by themselves become a source of financial instability when they pose credit risk to public debt - as

the case is with the current sovereign debt crisis in the Euro Zone. In this Section, the linkages between banks, pension funds and insurance companies on one side with the Government debt instruments on the other are highlighted. The strong interconnection between financial intermediaries and the Government as described below call for a close monitoring of developments in public debt and the debt service capacity thereof to ensure appropriate interventions are undertaken before risks precipitate into a debt crisis.

As at end December 2011, total outstanding Treasury bills amounted to TZS 1,250 billion. Out of these, Pension funds held T-bills amounting to TZS 37 billion (0.03%), while insurance companies held TZS 127 billion, equivalent to about 10 percent of the total. On the other hand, outstanding stocks and bonds amounted to about TZS 3,216 billion, of which insurance companies held TZS 133 billion (0.04%), whereas TZS 698 billion was held by pension funds, which accounted for a significant 22 percent. Consequently, banks accommodate a major portion of government debt instruments. Specifically, about 78 percent of outstanding T-bills (TZS 979 billion) and 70 percent of stocks and bonds (TZS 2,253 billion) were held by banks as at end December 2011.

## **2.4 Coordination of Financial Regulators Actions**

### **2.4.1 Financial Stability Coordination at National Level**

The responsibility of monitoring and managing risks in the financial system resides with each financial sector regulator for the institutions under the respective jurisdictions, whereas the prudential oversight of the financial system as a whole is vested under the coordinating mandate of the Bank of Tanzania. To facilitate this function, a coordinated framework for crisis preparedness, crisis management and resolution for Tanzania is being developed by the Bank of Tanzania in collaboration with other financial sector regulators. When ready, the framework will be used to monitor and identify potential sources of threats to the stability of the domestic financial system and to prescribe and promote measures to mitigate the underlying systemic risks in order to safeguard financial stability. In times of financial distress when mitigation fails, the framework will also provide guidance on how to deal with a financial crisis by adopting coordinated responses by the specified authorities.

### **2.4.2 Coordination at Regional Level**

Financial stability issues at the EAC regional level are coordinated through the EAC Monetary and Financial Affairs Committee (MAC) under the Banking Supervision and Financial Stability sub-committee. The Bank of Tanzania like all EAC central banks is a member of the MAC and the respective sub-committees. The Bank has been asked to coordinate the development and harmonization of financial stability monitoring and reporting frameworks in the region.

Recent studies by the IMF on the EAC regional cross-border crisis management and stress testing observed that the level of financial sector integration in the region is too low to require a centralized crisis management and stress testing frameworks. As such, both studies recommended that for the time being more emphasis should be placed on enhancing national financial stability and monitoring, stress testing and national-based crisis preparedness and crisis management frameworks. Also, cross-border issues should be handled through individual country monitoring of the financial institutions with cross-border operations.

## 3.0 Financial System Infrastructure and Regulatory Developments

### 3.1 Developments in the National Payment and Settlement Systems

The Bank of Tanzania plays a pivotal role in the development, regulation and operation of critical payment systems in the country. In its capacity as a payment systems development agent, the Bank has initiated, facilitated and supported the market in development of modern retail payment systems and high value systems. The Bank's role of operator of critical payment systems involved managing the Tanzania Interbank Settlement System (TISS) and the Electronic Clearing House (ECH) for high and retail payments, respectively. The Bank's regulatory role is effectively applied in all payment systems to ensure that the systems operate efficiently and safely with the ultimate objective of maintaining financial stability. Meanwhile, payment instruments used in these systems include: direct debits, electronic transfers, cheques, mobile phone payments, and electronic cards. Other payment infrastructure includes point of sales (POS) and Automated Teller Machines (ATMs). The market operates most of these schemes and instruments, while the Bank oversees the same. During the reporting period, the above named payment and settlement systems, instruments and the regulatory framework have performed smoothly and effectively as per expectations.

Given the interconnections among the financial intermediaries and with financial markets, payment systems can be a strongest transmission channel of disturbances from one institution to another with an impact to financial and economic stability. It is on this basis, that one of the priority tasks of the Bank of Tanzania is to address the challenges emanating from the interdependence of payment systems in the financial system. In that regard, the Bank has adopted a pro-active and coordinated role in promoting initiatives that foster joint responsibility and prudent behavior among all participants in the payments system in such a way that minimizes systemic risks. Moreover, the Bank also works with relevant domestic and regional counterparts in collaborative oversight arrangements where appropriate.

As part of its oversight mandate, the Bank assesses payment systems against its international principles that prudent payment system operators should consider to ensure that the system is safe and robust. One of the core principles for systemically important payment systems is to have a well founded legal basis for it to operate and manage associated risks under all relevant jurisdictions. As such, the absence of a comprehensive National Payments System legislation creates some gaps in the oversight framework. To address the gaps, the Bank of Tanzania spearheaded the preparation of the proposed National Payment System Act, which is being reviewed by the Attorney General Chambers. On the other hand, technological developments seem to run ahead of regulation and legislation. It's on this basis, that the BOT is closely monitoring technological innovations in the payment systems in order to develop appropriate guidelines for effective oversight. The Bank of Tanzania is also keeping abreast of the international recommended approaches to dealing with innovations in the payment systems, such as mobile payment services, in order to adapt to its environment where appropriate. For instance, the committee on Payment and Settlement systems recently formulated the core Principles for Systemically Important Payment Systems aiming to prevent systemic crises that could arise due to the failure of one or more payment system participants. These principles have been taken into consideration as part of the Bank's oversight framework.

### 3.2 Developments in Mobile Payment Services

One of the most significant financial innovations in Africa over the past five to six years has been the ability to conduct financial transactions, such as payments and money transfers through mobile phones. Indeed, mobile phone technology has played a critical role in broadening financial access. In Tanzania, according to TCRA estimate, there are over 20 million mobile phone subscribers as at 30th September 2011 – representing about 50 percent of the population estimated to have access to mobile phones. However, according to estimates by the Bank of Tanzania, there were about 5 million users of mobile banking services by end of 2010. The number of users of mobile banking is poised to expand rapidly as efforts towards increasing financial inclusion by respective service providers gain speed.

It is noteworthy that, the absence of biometric national identification cards for Tanzanians, as well as limited access to debit and credit facilities reduces the speed of spread of mobile banking and electronic transfer facilities/services. It is noteworthy that all financial inclusion innovations bring-up the question of how best to manage the trade-off between promoting the spread of financial services, on the one hand, and limiting the potential financial stability risks from such innovation, on the other. The concern is justified because depending on the volume of transactions mobile phone payments could potentially account for a large part of the float in the payment, settlement and clearing systems. This situation could in turn affect liquidity management in the banking system and threaten the stability of the financial system.

The provision of mobile payment services in the country provide a regulatory challenge to the Bank, as this is an innovation where financial services providers who are traditionally not financial institutions could now offer financial services. On this basis, the development of an appropriate regulatory framework is necessary. On broader terms, the Bank of Tanzania is working closely with all counterparty regulators to provide the requisite regulatory oversight to ensure that financial access through new technologies does not conflict with financial stability objectives. For mobile banking services, the Bank in collaboration with the Tanzania Communication Regulatory Authority is preparing the joint regulatory framework to facilitate implementation of prudent risk management initiatives for this fast growing sector.

## 4.0 Financial System Resilience and Stability Outlook

### 4.1 Financial System Resilience

The advancement in technology coupled with enhanced governance and risk management practices, have strengthened the resilience of the financial sector over time. On the other hand, the gradual increase in the level of openness of the Tanzanian economy and the financial system, resulting in greater integration with the external sector makes the task of preserving the resilience of the financial sector more complex and challenging. This challenge could be amplified by the anticipated capital flows in the country following the envisaged greater capital account liberalization, coupled with seekers of higher returns on foreign investments. In recognition of the emerging challenges associated with maintenance of financial stability, the Bank will continue to monitor closely developments in the external and domestic financial systems that have relevance to the resilience of the Tanzanian financial system and financial stability outlook. In projecting financial stability outlook, the Bank takes into consideration the current state of resilience of the financial system as reflected by the results of the stress tests as the baseline scenario.

In assessing the resilience of the financial system, the Bank of Tanzania conducts on quarterly basis stress tests on the banking system balance sheet against extreme changes in the level of key risks to the soundness of the financial system. As such, stress tests are conducted to measure the resilience of bank capital against market risks associated with changes in asset quality, interest and exchange rates. Therefore, the results of a stress test show the current ability of the financial system to absorb adverse shocks from domestic and exogenous sources.

Generally, the results of the stress tests conducted during the quarter ending September 2011, showed that the Tanzanian banking system was resilient to adverse changes in interest rates, exchange rate, and quality of the loan portfolio of the banking industry. Essentially, the strong resilience of the banking sector was driven primarily by strong capital positions of almost all banks, which was sufficient to absorb the adverse shocks applied to their balance sheets without recourse to external sources of funding.

#### 4.1.1 Credit Risk

Credit risk is defined as the possibility that a bank's borrower will fail to meet its obligations according to agreed terms and is normally measured by the level of NPLs, especially in the highly concentrated sectors. Since credit risk has a significant bearing on banks' earnings and solvency, credit risk management is crucial for any bank. It is on this basis that, the Bank of Tanzania incorporates examination of risk management frameworks of banks during on-site examination of banks' operations. During the stress testing, the sectors with highest NPLs (i.e. agriculture, trade, and manufacturing) were again exposed to a sudden big jump in the level of their NPLs and therefore a proportionate increase in loss provisioning. The results were such that there was only a small margin above the minimum capital adequacy level for the industry, implying a need for additional capital. This stance has prompted the Bank of Tanzania to enhance its supervision and when appropriate recommending prompt corrective action to the potentially vulnerable banks. Generally, credit risk can be significantly mitigated by the use of proper collaterals and adequate loss provisioning.

### 4.1.2 Exchange Rate Risk

Exchange rate risk is defined as the possibility of incurring direct or indirect loss in the institution's cash flows, net profit and in the value of assets and liabilities emanating from an exchange rate movement. Specifically, a direct impact of the exchange rate risk would be felt by a financial institution holding a position in foreign currency, whereas an indirect loss would occur on the borrowers or counter-parties of the respective financial institution. However, the regulatory limit on foreign exchange net open position helps to cushion the banking sector from adverse effects of exchange rate volatility. Recently, the Bank of Tanzania has revised this regulatory limit upwards.

During the year ending September 2011, banks reduced their exposure to foreign currency, as reflected by the decline in the net open position from -4.6 percent recorded in September 2010 to -6.9 percent in September 2011 (Table 2.1). With this kind of limited exposure to foreign currency combined with the depreciating exchange rate, the stress tests simulated a strong TZS depreciation against the USD, Euro and GBP. The results showed that the impact would not cause the Capital Adequacy Ratio of the industry to fall below the 10 percent threshold. Hence, the resilience of bank capital in anticipation of further depreciation of the TZS from the current level is adequate.

### 4.1.3 Interest Rate Risk

Stress testing for interest rate risk attempts to determine the impact of changes in interest rates on bank capital and earnings. During the test, an assumed plausible change in interest rates above the levels of September 2011 across all financial assets and liabilities, including on government securities was made. Based on the results, bank capital is relatively resilient to the risk of higher interest rates on deposits and lower rates on assets. Nevertheless, greater sensitivity to the interest rates movements in line with maturity profile of treasury bonds needs to be closely monitored.

### 4.1.4 Liquidity Risk

Essentially, liquidity risk is attributed to the inability of a financial institution to meet its liquidity obligations as they become due even on short notice. The stress test done by the Bank examines the ability of banks to withstand the risk that customers would want to withdraw their most liquid deposits within 5 consecutive days. Based on the stress tests, no banks ran into liquidity difficulties in the event of non-core deposit withdrawal for 5 days in a row. In this context, most banks currently enjoy a ratio of liquid assets to demand liabilities of more than 40 percent.

## 4.2 Financial Stability Outlook

Taking into consideration all the indicators of financial system resilience as detailed under stress testing of the banking sector and the prevailing levels of financial soundness indicators, prospect for financial system stability is well projected at least for the coming six months to March 2012, when another assessment on the stability of the domestic financial system will be conducted. However, deteriorating conditions in the financial systems of advanced economies, particularly in the USA and Europe has the potential to further jeopardize global economic performance and subsequently impact on international trade, donor inflows, remittances and investment opportunities to Tanzania. Specifically, the projected slower economic growth of advanced economies will result in lower exports in the short term, but will accelerate the shift in exports towards more rapidly growing Asian and regional markets. Consequently, lower exports coupled with domestic challenges, including high inflationary pressures and exchange rate volatility could precipitate

uncertainty on domestic financial stability. On the other hand, the high debt level in the developed world and the European sovereign debt crisis may result in more credit contraction and reduced donor support to Tanzania – a situation that will impact negatively on the confidence of consumers and businesses in the real economy.

On a possible positive front, the quantitative easing in the USA which have persisted since last year 2010 and crisis resolution measures undertaken by the European Union for troubled countries are expected to encourage excess liquidity in the US and EU financial markets, respectively. This in turn might propagate foreign capital flows to emerging and developing economies, including Tanzania. Capital inflows will mostly have a positive impact on financial stability through stabilization of the exchange rate as supply of foreign exchange increases to compensate for lower exports. In addition, the solid economic growth of 6.5 percent projected for 2012, coupled with projected capital flows and implementation of prudent monetary policy and fiscal measures to contain inflationary pressures, will further support prospects for financial sector stability.

Going forward, the Bank will continue to develop early warning indicators of financial instability and their respective benchmarks to facilitate prompt identification of any deviation from normality and subsequent appropriate responses. The Bank shall also continue to build on the power of collective action by all domestic financial sector regulators in the identification of potential risks to financial stability in their respective jurisdictions and subsequent adoption of appropriate measures of mitigation so as to achieve the desired financial stability outlook.

### 4.3 Measures to Safeguard Financial Stability

Financial instability can kick in just when things seem to be going very well in economic dimensions and at a time when some of the conventional warning indicators such as financial soundness indicators are not flashing. In recognition of these challenges to financial stability prospects, the Bank of Tanzania is committed to deploy all measures in its toolkit in a bid to safeguard the macroeconomic stability and promote prudent performance in the banking system. This potentiality emphasizes the need for sustained vigilance in monitoring the interactions among financial institutions and market forces; enhanced surveillance of developments in the domestic financial system as well as in the global economy, especially in the Tanzania's trading partners; and promotion of sound risk management practices by respective financial sector regulators. Indeed, there should be no letting – up or complacency based on promising financial soundness indicators and satisfactory results of stress testing of the banking sector. Furthermore, the Bank of Tanzania will continue to combine quantitative assessment with qualitative information obtained from financial intermediaries, and financial sector regulators in monitoring financial stability. In spite of the vigilant surveillance of the financial system, the Bank is cognizant of the fact that risk of instability will always remain. It is for this reason that, the Bank in collaboration with other financial sector regulators is developing a national framework for crisis preparedness, and crisis management and resolution to be used in case mitigation measures fail. In the meantime, consultation and exchange of relevant information among financial sector regulators are the main instruments used to promote pre-emptive measures to reduce vulnerabilities in the financial system.

In pursuit of its role of providing macroprudential oversight, the Bank continues to engage a set of measures to increase the resilience of the financial sector. The measures include the following:

- **Prudent monetary policy:** The Bank of Tanzania has designed its monetary policy stance for the financial year 2011/12 to contain monetary growth at relatively lower levels than in the previous year. The tightening of monetary policy stance is a necessary response against the heightening inflationary pressures in the economy.
- **Adequate facilitation of credit growth:** Without jeopardizing price stability, the adopted tight monetary policy stance remains adequately supportive of the envisaged growth of the economy. Consequently, the Bank has continued to target its reserve money at levels sufficient to provide room for private sector credit growth.
- **Maintenance of adequate foreign exchange reserves:** This measure plays well to cushion the economy against exchange rate risk, partly through increased foreign exchange sales by the central bank. In this regard, the Bank has targeted to maintain at all times, the level of foreign exchange reserves measured in months of imports at above the IMF benchmark of 3 months.
- **Daily surveillance of financial transactions in the banking sector:** The Bank remains pro-active in monitoring all salient financial transactions in the banking sector and through the payment and settlement systems so as to detect any early signs of instability. The daily surveillance signals areas that need prompt corrective actions or otherwise, as appropriate.
- **Prudential regulations and supervision:** The Bank keeps abreast of international regulatory reform agenda in order to adapt the relevant recommendations to domestic environment. In this way, domestic standards are being brought closer to international best practices in both micro and macro-prudential oversight of the financial system to ensure financial stability. The Bank has adopted risk based regulatory approach, whereby more attention and scrutiny is given to identified banks with potential risks and appropriate action taken to mitigate the problems.
- **Limited exposure to foreign assets:** The prudential regulation of foreign exchange net open position, as well as the limits on the extent of exposure to foreign assets by institutional investors and banks helps to cushion the domestic economy from foreign risk.
- **Subsidiary structure and listing requirements:** Registered banks have to be subsidiaries of domestic or foreign parent company, so their assets and liabilities are ring-fenced even when the parent company is in distress.
- **Monitoring of financial interlinkages:** The Bank has enhanced the monitoring of financial interlinkages between the banking system and pension funds and insurance companies for any potential contagion risk to financial stability. Starting this financial year 2011/12, the Bank is conducting quarterly assessment of the cross linkages among financial system players in a bid to identify any early warning signals of systemic risks and prescribe pre-emptive measures accordingly.
- **Monitoring of cross-border financial operations:** The Bank of Tanzania has signed enabling MOU's with other central banks in relevant countries for information sharing and consolidated supervisory coordination of cross-border operations of the respective financial institutions. The Bank is also playing a pivotal role in the development of a regional framework for crisis preparedness and crisis management for the East African Community.

Annex 1: Annual Growth of Commercial Banks' Lending by Activity (Percent)

End of Period	Agriculture	Financial Intermediaries	Mining and Quarrying	Manufacturing	Building and Construction	Transport and Communication	Trade	Tourism	Hotels and Restaurants	Electricity	Personal
Jun-09	74.6	33.7	-43.1	37.1	1.2	56.2	49.1	5.1	29.1	9.8	42.1
Jul-09	53.9	29.6	-50.1	18.0	13.6	46.9	54.0	14.4	26.4	5.2	32.0
Aug-09	39.4	36.1	-64.4	11.4	-4.4	57.3	45.6	7.0	12.6	1.1	25.5
Sep-09	26.2	19.9	-56.2	-4.7	-11.4	41.1	37.7	59.5	-1.4	0.5	17.8
Oct-09	17.5	-14.7	-61.0	-16.6	-14.9	13.5	7.6	44.4	40.5	1.9	21.8
Nov-09	-1.0	-24.2	-56.1	-16.5	-8.3	38.1	17.5	30.3	33.8	0.2	23.9
Dec-09	-9.5	-13.2	-49.8	-7.7	4.0	42.7	25.7	-7.1	24.0	5.5	5.6
Jan-10	3.2	4.0	-45.3	-4.6	1.8	35.9	19.8	-8.3	16.8	6.8	10.1
Feb-10	14.5	21.2	-27.7	-4.1	8.4	17.4	12.8	8.0	7.4	7.5	10.0
Mar-10	8.4	27.0	-28.4	4.5	12.8	34.8	17.8	8.5	12.0	4.8	11.1
Apr-10	8.9	7.6	-29.4	5.7	10.5	38.2	21.9	3.1	16.6	1.8	14.6
May-10	22.1	36.9	-17.2	20.7	0.4	32.1	18.3	2.9	10.7	-0.9	23.0
Jun-10	12.0	23.0	138.7	28.5	33.3	23.7	16.6	7.0	20.9	0.2	14.6
Jul-10	18.9	21.1	39.8	34.7	6.9	19.5	29.8	1.4	14.0	-5.0	18.5
Aug-10	19.0	32.6	79.8	32.1	8.4	8.4	11.6	12.7	27.3	-5.5	19.1
Sep-10	22.4	11.4	81.9	62.1	48.0	18.4	7.0	8.0	37.8	-17.9	16.4
Oct-10	39.1	32.8	87.2	52.5	29.7	17.1	10.4	8.7	34.4	-19.0	14.2
Nov-10	45.0	38.9	99.1	53.6	40.7	22.8	7.8	31.4	42.9	-19.2	19.5
Dec-10	48.0	34.7	79.3	39.0	22.4	16.7	9.4	39.0	40.5	-19.2	16.9
Jan-11	44.1	51.7	195.9	38.9	23.2	3.8	34.6	45.3	43.0	-23.4	22.7
Feb-11	54.8	23.2	132.5	43.3	26.6	29.6	17.9	55.4	53.2	-22.7	39.0
Mar-11	56.6	10.3	98.9	25.9	34.0	27.4	22.4	69.1	45.8	-19.3	21.5
Apr-11	51.9	40.4	53.3	24.2	34.1	22.7	15.2	79.4	42.5	-17.1	25.5
May-11	33.4	7.3	50.9	10.6	44.1	19.7	30.7	96.5	44.8	-15.1	27.6
Jun-11	51.7	9.8	-7.0	7.1	44.6	-2.3	34.6	77.5	35.2	-14.8	36.2
Jul-11	51.1	5.0	35.3	6.7	42.5	-6.5	14.9	93.5	36.7	-15.0	44.7
Aug-11	24.0	-0.5	36.0	-2.1	62.3	-0.1	36.8	91.3	36.5	-12.7	22.1
Sep-11	42.8	21.4	40.5	9.0	30.9	10.0	52.9	83.3	36.6	-16.7	44.1

Source: Bank of Tanzania

## GLOSSARY

*A **Financial System** is made up of three components namely; (i) financial intermediaries (including banks, insurers, pension funds, etc), (ii) financial markets (as alternative sources of finance and as links between financial institutions), and (iii) financial system infrastructures including clearance, payment and settlement, as well as legal, regulatory and supervisory infrastructures.*

***Financial stability:** can be defined as a condition in which the financial system is capable of sustaining critical financial services including provision of credit, payment and settlement services and insurance against risks, and be able to withstand shocks on financial intermediation process.*

***Financial instability:** can be started by disruptions from within or from outside the financial system. Instability could manifest through banking failures, extreme asset-price volatility or a collapse of market liquidity and disruption in the payment and settlement system. However, disturbances in individual financial institutions need not necessarily constitute financial instability if they do not impair the overall functioning of the financial system.*

***Financial stability assessment:** involves a systematic identification and analysis of the sources of risk and vulnerability that could impinge on stability of the financial system as a whole, distinguishing between endogenous sources of risk that are present within the financial system and exogenous sources of risk that might emanate from outside the financial system.*

***Systemic Risks:** Are those risks imposed by inter-linkages and inter-dependencies in a system or market, where the failure of a single entity or cluster of entities can cause cascading failures leading to bankruptcies, or bring down an entire financial system or market.*

***Macroprudential Policy Framework:** Involves development of appropriate responses to the financial system for safeguarding the stability and efficiency of the financial sector as a whole, rather than focusing on individual institutions or certain economic measures in isolation.*

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