MONETARY POLICY STATEMENT
The Midterm Review

GOVERNOR
BANK OF TANZANIA

January 2003

January, 2003

LETTER OF TRANSMITTAL

Dear Minister,

In accordance with Section 6 Subsection (1) to (4) of the Bank of Tanzania Act 1995, I hereby submit the mid-term review of the Monetary Policy Statement for the year 2002/2003.

Yours sincerely,

The Hon. Basil P. Mramba (MP)	Daudi. T. S. Ballali
Minister for Finance	Governor
Dar es Salaam	Bank of Tanzania

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BANK OF TANZANIA'S INFLATION CONTROL STRATEGY

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

- Low inflation allows the economy to function more efficiently, thereby contributing to better economic performance over time.

- The Bank of Tanzania achieves the inflation targets by controlling the growth of money supply. The Bank controls the growth of broad money, M2, defined as total deposit liabilities held by commercial banks, excluding foreign currency deposits, because it is the monetary aggregate, estimated to have closest relationship with the rate of inflation, as well as extended broad money, M3, which includes foreign currency deposits.

- To influence broad money (M2), the Bank targets and controls the growth in reserve money, defined as currency in circulation outside the banking system and deposit money banks' with the Bank, because it is the main influence in the growth in the money supply.

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

MONETARY POLICY IMPLEMENTATION

- The Bank of Tanzania sets annual monetary policy targets at the beginning of every fiscal year in its monetary policy statement. The targets are reviewed at mid-year.

- The Monetary Policy Statement is submitted to the Minister for Finance, who tables it to the Parliament.

- The same procedure is followed in the submission of half-year review of monetary policy implementation.

- The Standing Committee, also known as the Monetary Policy Committee, of the Board of the Bank of Tanzania, chaired by the Governor, closely monitors monetary policy implementation on monthly basis.

- The Bank's internal committee receives, on weekly basis, progress on monetary policy implementation and makes plans for the following week.

- Technical committees consult daily to review liquidity developments and agree on market intervention strategies.

THE MONETARY POLICY INSTRUMENTS

- The Bank of Tanzania uses indirect instruments of monetary policy to influence the growth in reserve money and the money supply.

- This is mainly achieved through Open Market Operations (OMO). OMO takes place when the Bank sales or buys Government securities, and other securities in the open market, in order to influence the reserve money.

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

MONITORING INFLATION

- The Bank of Tanzania focuses on the Consumer Price Index (CPI), particularly on the index excluding food prices. This is because food prices can often be affected by non-monetary factors like droughts, floods etc. which are beyond the control of monetary policy.

- The level of inflation excluding food prices is also referred to as **non-food inflation rate**, while the overall CPI is referred to as **headline inflation rate.**

1.0 INTRODUCTION

1.1 The Bank of Tanzania Act, 1995 and the Bank's Primary Mission

The primary mission of the Bank, as stated in Section 5 subsection (3) of the Bank of Tanzania Act, 1995 is "… to formulate and implement monetary policy, directed to the economic objective of maintaining price stability, conducive to a balanced and sustainable growth of the national economy of Tanzania". In other words, it is the **primary responsibility of the Bank of Tanzania to establish monetary conditions that will generate low and stable inflation over time**. Low and stable inflation enhances confidence conducive to efficiency in the mobilisation and allocation of resources. Currently the long-term policy objective is to achieve an annual inflation rate which is close to the average rate of inflation of Tanzania's major trading partners.

2.0 MACROECONOMIC OBJECTIVES FOR 2002/2003

The thrust of government policy objectives for 2002/2003 is directed towards maintaining macroeconomic stability in particular higher GDP growth, improved fiscal deficit, maintenance of low and stable inflation rate, and improvement in the overall balance of payments.

In this regard, the major macroeconomic objectives of the Government for 2002/2003 are as follows:

(i) to attain a real GDP growth rate of 5.9 percent in the year 2002 and 6.3 percent during 2003;

(ii) to control and maintain inflation at not more than 4.5 percent by end-June 2003; and

(iii) to limit fiscal deficit (before grants) at TZS 1,073.5 billion.

2.1 MONETARY POLICY OBJECTIVES FOR 2002/2003

The monetary policy objectives of the Bank are geared towards supporting the broader macroeconomic objectives by maintaining monetary and financial stability that generate low and stable rate of inflation. In light of this, the Bank seeks to:

(i) containing the expansion of extended broad money supply (M2) within a band of 12.0 to 13.0 percent[1] and extended broad money supply (M3) within a band of 12.0 to 14.0 percent[1];

(ii) allowing credit to private sector to grow by not less than 21.5 percent at end-June 2003 from the level attained in June 2002; and

(iii) maintaining official reserves of external assets of at least four months of imports of goods and non- factor services during the year to end June-2003.

3.0 REVIEW OF MONETARY POLICY IMPLEMENTATION DURING JULY-DECEMBER 2002.

The objective of maintaining prudent monetary policy continued during the first half of 2002/2003. Developments in several monetary and financial indicators, such as money supply, inflation, interest rates, and exchange rate were generally encouraging.

3.1 Liquidity Management

Liquidity management continued to be the main thrust of monetary policy with reserve money as the operational target. Open market instruments, in particular, Treasury bills and Treasury bonds were central in keeping liquidity to desired levels. During the review period, the Bank introduced 7-year and 10-year

Treasury bonds, which are listed in the Dar Es Salaam Stock Exchange (DSE) to enhance liquidity management and lengthened the maturity profile for government debt. The open market operations were supplemented by foreign exchange market operations.

3.2 Credit Policy

During July 2002-December 2002, the Bank continued to implement its credit policy drive to increase banks' credit directed towards the private sector in order to support economic growth. To achieve this, the Bank continued with efforts to remove the remaining impediments to lending by banks to the private sector. Notable in this endeavour was the launch of the Credit Guarantee Scheme that was to initially cater for selected traditional exports. During the period under review, the Government and the Bank contributed TZS 6.6 billion for the scheme. Efforts towards instituting a regulatory and supervisory framework for micro-finance institutions and measures to create an enabling environment to facilitate the provision of long-term finance to productive sectors are still in progress. A bill for legal and regulatory framework for micro-financing has been drafted and is awaiting Parliament approval.

During the period under review, the government was expected to have a net borrowing of TZS 123.1 billion from the banking system, but by end-December 2002 it over-performed with a net borrowing of TZS 6.4 billion, hence providing more resources for credit expansion to the private sector. However, owing to the limited instruments to mop up excess liquidity envisaged during the second half of 2002/2003, the Bank securitized the non-tradable government external payment arrears into long-term bonds of 5-year, 7-year and 10-year

[1] Revised projections based on Poverty Reduction Growth Facility (PRGF)

Treasury bonds. These bonds are listed in the Dar Es Salaam Stock Exchange (DSE).

3.3 Interest Rate Policy

Interest rates continued to be market determined, with the Treasury bills market acting as an anchor. In order to maintain realistic levels of interest rates during the review period, the Bank collaborated in several initiatives aimed at removing the remaining structural impediments in the economy that contribute to a wide spread between deposit and lending rates. In this regard the Bank played a role in efforts to amend the 1999 Land Act to ensure that land can be used as a viable collateral for bank borrowing and the measures aimed at improving the land registry. The Bank was also supportive to measures of enhancing the capacity of the commercial court. Restructuring of the remaining state owned banks and non-bank financial institutions, will increase efficiency through increased competition. In addition, the ongoing restructuring of the state owned utilities, is expected to reduce banks' operating costs and therefore complement efforts towards realizing realistic interest rates.

3.4. Foreign Exchange Operations and Reserve Management

Foreign exchange operations were guided by the need to realize a stable market determined exchange rate. In this respect, passive interventions by the Bank in the IFEM were sought to smoothen short-term fluctuations in the exchange rate, which were inconsistent with economic fundamentals. The exchange rate depreciated by 3.1 percent to TZS 976.7 per USD in December 2002 from TZS 946.9 per USD in June 2002. Reserves accumulation was largely guided by the need to maintain reserves of not less than four months imports of goods and non-factors services, but without prejudice to the primary objective of price stability and also appreciating the factor of increased donor and debt relief resource inflows under the HIPC initiative. Consequently, gross reserves of the Bank of Tanzania at end-December 2002 reached USD 1,528.4 million, equivalent to 8.0 months of imports of goods and non-factor services, the highest level in more than two decades.

During the reporting period, the Bank of Tanzania in collaboration with the Government and Capital Markets and Securities Authority (CMSA), undertook measures to ensure that appropriate safeguards towards achieving full capital account liberalization of the balance of payments were in place. In this regard, modalities that will guide participation of foreign investors in the DSE are in progress, together with measures aimed at the establishment of institutional arrangements for monitoring capital flows.

4.0 REVIEW OF MACROECONOMIC DEVELOPMENTS DURING THE FIRST SIX MONTHS OF 2002/2003 (JULY-DECEMBER 2002)

4.1 Introduction

The country's macroeconomic performance continued to improve during the first half of 2002/2003 despite unfavourable external conditions characterised by deterioration in the terms of trade and the general slowdown of the world economy. Developments in real GDP growth rate, inflation rate, money supply growth, and fiscal deficit were encouraging.

4.2 Output Developments

According to preliminary statistics, aggregate supply as measured by GDP at constant 1992 prices, grew by 5.2 percent during the first half of 2002, compared with a growth rate of 5.0 percent recorded in the similar period a year ago. During the first half of 2002, higher growth rates were recorded in secondary and tertiary economic activities namely, construction, trade, hotels and restaurants (including tourism), transport and communication, financial and business services, and public administration and other services.

Table 1: Semi-Annual Growth Rates of GDP by Sectors (January – June)

Percent

Economic Activity	2000	2001	2002
Agriculture	2.0	4.7	4.5
Mining and Quarrying	10.4	10.7	10.5
Manufacturing	4.6	4.7	4.7
Electricity and Water	6.6	1.8	2.0
Construction	7.8	6.8	9.3
Trade, Hotels and Restaurants	5.9	6.0	6.6
Transport and Communication	5.9	5.0	5.5
Finance and Business Services	4.5	3.6	4.0
Public Administration and Other Services	3.8	3.7	4.0
Total GDP	**4.0**	**5.0**	**5.2**

Source: National Bureau of Statistics

The good performance was on account of increased private sector participation in economic activities, particularly in construction and provision of commercial services such as financial, transport and communication services.

It is noteworthy that the contribution of the agricultural sector to GDP, which is about 50.0 percent, is normally highest during the second half of calendar year (July – December). Consequently, given the expected higher contribution of agricultural sector to GDP during the second half of 2002, and the improved performance in almost all other sectors of the economy, it is likely that the 5.9 percent and 6.3 percent real GDP growth rates for December 2002 and June 2003, respectively, will be attained.

4.3 Price Developments

4.3.1 Headline Inflation

The annual headline inflation, as measured by changes in the consumer price index (CPI), averaged at 4.5 percent between June 2002 and December 2002, despite increases in prices of fuel and drinks and above average expansion in liquidity during the review period. Given the satisfactory level of food supply in the country, and the expected slowdown in non-food inflation later in the year especially after April 2003, when the impact of adjustment of electricity tariff will be neutralized, the targeted inflation rate of 4.5 percent by end-June 2003 is likely to be attained.

4.3.2 Non-Food Inflation

The annual non-food inflation rate has been persistently increasing, particularly after April 2002, following a one-time adjustment on electricity tariffs and continuous increases in fuel prices. Non-food inflation rose from 1.5 percent in March 2002 to 6.0 percent in April 2002, and 6.6 percent in June 2002, before accelerating further to 9.0 percent in December 2002.

4.3.3 Food Inflation

The annual food inflation has been declining throughout the period under review, following improved food supply situation. Food inflation declined from 5.9 percent in January 2002 to 3.8 percent in June 2002 and further down to 2.9 percent in December 2002. As no inflationary pressure is expected from food prices, the annual rate of food inflation is likely to remain at about the current level over the remaining half of the year.

4.4 Monetary and Credit Developments

During June 2002 to December 2002, growth in monetary aggregates was kept under relatively good control. Broad money supply, M2, rose by TZS 173.9 billion or 13.0 percent from end June 2002 level of TZS 1,333.5 billion to TZS 1,507.4 billion at end December 2002. On annual basis, M2 grew by 22.2 percent in December 2002 compared with 21.3 percent in the year ending June 2002. Comparing with PRGF program target of TZS 1,484.0 billion for end December 2002, M2 was above the target by TZS 23.4 billion.

The expansion in money supply was attributed to strong growth in net international reserves (NIR) of the Bank of Tanzania, increased credit to private sector by commercial banks, and an increase in net claims on government by banks. Components of M2 (**See Appendix Chart 2**) show that net foreign assets of the banking system (adjusted to exclude foreign currency deposits) expanded by TZS 189.1 billion or 22.8 percent to TZS 1,018.3 billion in December 2002. Net international reserves of the Bank, grew by 39.9 percent to TZS 1,022.2 billion in December 2002 on account of donor funds inflows and a net purchase of foreign exchange from the IFEM. Conversely, net foreign assets of commercial banks dropped by 4.8 percent from TZS 563.2 billion in June 2002 to TZS 536.4 billion largely due to a net sale of foreign exchange in the IFEM.

Domestic credit increased from TZS 684.9 billion in June 2002 to TZS 835.3 billion in December 2002, representing TZS 150.4 billion or 21.9 percent growth. In comparison with PRGF targets of TZS 590.0 billion for end June 2002 and TZS 523.4 billion for December 2002, the actual outturns were above the program targets. Both government and private sector demand drove the expansion in domestic credit. In particular, net claims on government grew strongly by TZS 61.7 billion or 30.4 percent during the first half 2002/2003 compared with a 15.2 percent decline recorded in the second half of 2001/2002, mainly on account of sale of government securities. Commercial banks' credit to the private sector grew by TZS 88.6 billion or 18.4 percent to TZS 570.7 billion as of end-December 2002 after having grown by 19.5 percent in the previous half-year to June 2002. The increased growth in credit to private sector reflects the sustained recovery in private sector money demand, driven by the steady improvements in real estate, manufacturing, transport and telecommunication, business services, and wholesale and retail trade. Despite this outturn, the proportion of private sector credit to total domestic credit declined to 68.3 percent in December 2002 from 70.4 percent recorded in June 2002 (**See Appendix Chart 3**).

Extended broad money supply, (M3) which includes foreign currency deposits, grew by TZS 249.8 billion or 13.9 percent to TZS 2,047.7 billion in December 2002. The growth in M3 was relatively higher than a 9.9 percent increase during the six months to June 2002, reflecting the seasonality for money demand. The annual growth rate of M3 reached 25.1 percent in December 2002, up from 22.1 percent during the year ending June 2002. Commercial banks' foreign currency deposits expanded by TZS 75.9 billion to TZS 540.3 billion over the review period. This was above the PRGF target of TZS 496.5 billion for the quarter ending December 2002. The proportion of foreign currency deposits to M3 reached 26.4 percent in December 2002, slightly higher than 25.8 percent recorded at end-June 2002, while the proportion of foreign currency deposits to total deposits was 34.8 percent, higher than 33.9 percent recorded in June 2002

Meanwhile, total deposits of commercial banks by 13.4 percent between June 2002 and December 2002, compared with an increase of 11.7 percent between December 2001 and June 2002. The steady growth in deposits is attributed to appropriate safeguards by the Bank that have increased public confidence in the banking system and increased deposit mobilization by commercial banks particularly opening of new branches by commercial banks, the introduction of new products in banking such as Automatic Teller Machines, debit cards, improved banking services, new marketing strategies and opening of new branches by commercial banks.

Reserve money rose to TZS 695.7 billion in December 2002, up by TZS 122.6 billion or 21.4 percent from TZS 573.1 billion recorded in June 2002. During the year ending December 2002, reserve money grew by 19.1 percent compared with 13.1 percent registered in the year ending June 2002 (**See Appendix Chart 4**). The level of reserve money recoded at end-December 2002 was below the PRGF target of TZS 706.6 billion, by TZS 10.9 billion, reflecting concerted efforts by the Bank to contain liquidity over the period.

The growth in reserve money is explained by net purchase of foreign exchange in the Inter-bank Foreign Exchange Market (IFEM) by the Bank, as well as donor inflows. Consequently, net foreign assets of the Bank of Tanzania increased by TZS 303.2 billion, from TZS 695.9 billion in June 2002 to TZS 999.1 billion in December 2002. However, a decline of TZS 124.0 billion in net domestic credit of the Bank following securitisation of EPA stock and a surge in government deposits at the Bank coupled with the increase liquidity papers, reduced significantly the impact of increase in foreign assets on reserve money.

4.5 Interest Rate Developments

In addition to keeping the monetary aggregates on target, the Bank continued to facilitate the realization of favourable levels of domestic interest rates by strengthening financial markets. Interest rates on domestic currency denominated deposits fell across the board between June 2002 and December 2002. Saving deposit rate fell from 3.5 percent in June 2002 to 3.1 percent in December 2002, and overall time deposit rate fell from 4.0 percent to 3.4 percent in the same period. Comparing with the inflation rate of 4.4 percent for December 2002, deposit rates were negative in real terms.

Interest rates on domestic currency denominated credits also assumed a down ward trend except for Short-term lending rates (up to 1 year) and Term loans rates (over 5 years) which rose from 14.8 percent and 18.4 percent in June 2002 to 15.9 percent and 19.8 percent in December 2002, respectively. The rates for medium term 1-2 year, 2-3 year and long term 3-5 year loans dropped from 16.6 percent, 15.0 percent and 17.2 percent to 15.8 percent, 13.8 percent and 13.2 percent, respectively. Consequently, the overall lending rate fell from 16.4 percent in June 2002 to 15.7 percent in December 2002. During the period under review the margin between deposit and lending rates declined from 12.4 percentage points in June 2002 to 12.3 percentage points in December 2002 (**See Appendix Chart 5**).

4.6 Budget Performance

Fiscal performance during the first half of 2002/2003 was fairly impressive. The budget (on cheques issued basis) recorded an overall deficit of TZS 170.2 billion before grants, against the projected deficit of TZS 519.9 billion. However, the budget recorded a surplus of TZS 44.9 billion after considering grants amounting to TZS 215.0 billion.

During the period July-December 2002, revenue collection reached TZS 594.8 billion compared with the target of TZS 559.0 billion. Out of the total collection, tax revenue amounted to TZS 545.4 billion, while non-tax revenue was TZS 49.4 billion. The good revenue performance came from a higher income tax, which exceeded the target by 22.6 percent, as a result of salary increase to civil servants and an upward adjustment to tax rates from the minimum marginal rate of 7.5 percent to 17.5 percent.

Total government expenditure, excluding amortization, amounted to TZS 765.1 billion, representing 70.9 percent of the estimated expenditure of TZS 1,078.9 billion for the period. Recurrent expenditure amounted to TZS 627.0 billion, while development expenditure was TZS 138.1 billion. Government expenditure lagged behind, mainly on account of lower than expected foreign inflows for development projects, which amounted to TZS 87.5 billion equivalent to 28.0 percent of the budgeted TZS 312.2 billion. Grants were below the target as well, amounting to TZS 215.0 billion compared to the target of TZS 320.7 billion.

During July-December 2002, the Government registered an overall deficit (adjusted for float and other items) amounting to TZS 38.5 billion. The deficit was financed by local and foreign loans amounting to TZS 32.3 billion and TZS 6.2 billion, respectively.

4.7 Debt Developments

The overall total debt stock, (external and domestic debt) as at end December 2002, stood at USD 8,276.3 million. External debt was USD 7,384.7 million or 89.2 percent and domestic debt was USD 891.6 million or 10.8 percent. Total debt stock decreased by USD 52.2 million or 0.6 percent when compared with USD 8,328.5 million registered at end-June 2002. The decrease in the overall debt stock is explained by a substantial fall in the external debt stock following external debt cancellations under Paris Club VII. During the months of July 2002 to December 2002, the government continued the implementation of Paris Club VII Agreed minute. In this respect Belgium, Canada, and Italy concluded bilateral agreements with the government and cancelled debt worth EUR 32.3 million, CAD 83.6 million and USD 132.0 million, respectively. For Non Paris Club, Kuwait has accepted to reschedule debt amounting to KWD 9.4 million.

The second and final closing of the Debt Buyback Scheme took place on November 30, 2002 and is expected to retire debts worth USD 31.5 million (principal and interest) at a discount cost of USD 1.7 million, that is 12.0 percent of the principal tendered, amounting to USD 14.3 million. Interest is forgiven under the Scheme. All creditors of the second closing are to be paid in January 2003.

4.7.1 External Debt Position

Total external debt committed, as at the end of December 2002 was USD 8,029.9 million. The amount committed decreased by USD 2.9 million or 0.04 percent when compared with USD 8,032.8 million committed as at end of June 2002. The decrease in total external debt committed was attributed to cancellation of Paris Club VII. Out of the total amount committed, disbursed outstanding debt (DOD) was USD 6,413.4 million or 79.9 percent and committed undisbursed debt (CUB) was USD 1,16.5 million or 20.1 percent.

When interest arrears of USD 971.3 million are taken into account, total disbursed debt stock as at end December 2002 rises to USD 7,384.7 million. There was a decrease of USD 79.3 million in debt stock or a 1.1 percent decline when compared with USD 7,464.0 million recorded at the end of June 2002. The decrease in debt stock was attributed by external debt cancellations under Paris Club VII.

4.7.2 Domestic Debt Position

On domestic debt side, the government launched the 7- year and 10 year fixed rate marketable Treasury bonds with the view to smoothen the yield-curve and restructure debt. The bonds were consequently listed on the Dar Es Salaam Stock Exchange (DSE). The government through the Bank of Tanzania continued to convert the non-tradable External Payment Arrears (EPA) stock into marketable securities for monetary policy purposes. EPA stock worth TZS 120.0 billion was converted into marketable securities at end December 2002, thus reducing the government's indebtedness to Bank of Tanzania by the same magnitude. The government also purchased the National Social Security Fund (NSSF) Mabibo hostel thereby creating additional debt of TZS 16.5 billion.

4.8 External Sector Developments

During the year ending December 2002, the performance of the current account of the balance of payments improved by recording a 17.3 percent decrease in the deficit to USD 450.4 million from a deficit of USD 544.7 million recorded a year earlier. The improvement was largely on account of increase in goods exports coupled with a decrease in imports of both goods and services. Consequently, the ratio of current account deficit (including official current transfers) to GDP decreased to 4.8 percent from 6.2 percent recorded during the previous year. As a result of these developments, gross international reserves accumulated to USD 1,528.4 million in December 2002, equivalent to 8.0 months of imports of goods and services compared with USD 1,212.7 million that was equivalent to 6.4 months of imports in June 2002.

During the July-December 2002 period, the deficit in the trade account declined by 33.5 percent to a deficit of USD 264.2 million from a deficit of USD 379.2 million recorded during the corresponding period a year earlier. The improvement was on account of a 17.5 percent increase in exports coupled with a 7.2 percent decrease in imports.

4.8.1 Exports

Total exports reached USD 495.9 million during July - December 2002 compared with USD 422.1 million recorded during the same period a year earlier, following improved performance in both traditional and non-traditional exports. During the review period, traditional exports increased by 10.9 percent to USD 134.4 million mainly due to substantial increase in export volumes of tea, tobacco and cashew nuts. The increase in the volume of tea exports was largely due to favourable weather, whereas the increase in the volume of cashwenuts exports was due to buyers agreeing to offer price levels of between TZS 290/= and TZS 360/= per kg, the indicative prices set by the Cashwenuts Board of Tanzania (CBT) for 2002/03. With the exception of sisal, unit prices for most traditional exports remained depressed on account of the slowdown in the global economy and increased supply of the commodities in the world market.

Likewise, non-traditional exports increased by 20.1 percent to USD 361.5 million during the first six months of 2002/03 compared with USD 300.9 million recorded during the corresponding period of the previous year largely due to increase in exports of minerals, manufactured goods and other exports. The increase in mineral exports is mainly attributed to surge in exports of gold by 9.1 percent following increase in gold prices in the world market and commissioning of the gold mining operations of Afrika Mashariki Gold Mining Company in September 2002. The surge in other exports is largely attributed to the increase in exports of maize, oil seeds and vegetables. The surge in maize exports is attributed to food shortages in Malawi and Zambia following dry weather.

4.8.2 Imports

During July - December 2002, total imports (f.o.b.) decreased by 7.2 percent, to USD 760.1 million, from USD 819.3 million registered during the corresponding period in 2001. With the exception of consumer good imports that increased marginally by 0.3 percent, all other major categories of imports namely capital goods and intermediate goods declined by 5.8 percent and 17.3 percent, respectively. Capital goods import decreased on account of a decline in building and construction equipment, and machinery imports. The development is partly associated with the completion of construction work by big mining companies operating in the country. Intermediate goods import decreased mainly on account of decline in volume of oil imports from 502,780 tons imported in July-December 2001 to 377,076 tons in July-December 2002.

4.9 Foreign Exchange Operations and Exchange Rate Movement.

During July-December 2002, the Bank continued to intervene in the Inter-bank Foreign Exchange Market (IFEM) to smoothen short-term fluctuations in the exchange rate, and build reserves without prejudice to the primary objective of achieving an inflation rate of 4.5 percent by end-June 2003. During the reporting period, the Bank sold USD 37.5 million in the inter-bank foreign exchange market (IFEM) while purchases amounted to USD 169.4 million. This implies a net purchase of USD 131.9 million, which emanated from seasonal export proceeds. The amount purchased for the six months to December by the Bank was 34.3 percent of USD 494.4 million traded in the IFEM, while the amount sold was 7.6 percent of the total volume traded.

During the period, the shilling depreciated against the US dollar by 3.1 percent from TZS 946.9 per USD at end-June 2002 to TZS 976.7 per USD at end-

December 2002. This compares with depreciation of 3.5 percent during corresponding period in 2001.

5.0 MONETARY POLICY FOR THE SECOND HALF OF 2002/2003

In accordance with the Bank of Tanzania Act, 1995, monetary policy will continue to focus on maintaining price stability, mirrored in a low and stable rate of inflation while remaining supportive of macroeconomic objectives of the government. In order to achieve this objective, the Bank will continue to pursue its monetary targets, in particular, the growth of reserve money which is the operating variable. In this connection, the Bank of Tanzania will continue to monitor closely liquidity developments in the economy in order to avoid inflationary pressure.

5.1 Liquidity Management

The Bank will continue to observe closely the developments in both the domestic economy and the external sector in order to guide the conduct of appropriate monetary policy stance. Liquidity management will be targeted towards ensuring that growth in monetary aggregates is consistent with program targets. In view of the recent increase in the demand for money daily reserve money tracking will be strengthened to sharpen liquidity management techniques while avoiding market distortions. Open market operations will remain the main monetary policy instrument, supplemented by foreign exchange market interventions. During the remaining part of the year, the main challenge of the Bank will be to control the high liquidity that emanate from foreign inflows, including foreign direct investment resources. The Bank in collaboration with the Government will continue to devise long-term instruments in order to help efforts to control liquidity position in the economy.

5.2 Credit Policy

The Bank's credit policy will continue to be directed towards increasing credit to the private sector which is the engine of economic growth. In this respect, the Bank is collaborating with the government to implement measures directed towards removing impediments to bank lending. Accordingly, problems inherent in the land law, collateral enforcement, inconsistencies in the existing legal framework, coupled with weak regulatory and supervisory mechanisms are currently being reviewed. The Bank will also work towards completion of a regulatory and supervisory framework for micro-finance institutions.

The recently established Export Credit Guarantee Scheme, which caters for traditional exports will be enhanced thereby augmenting efforts towards increased export earnings. The Bank will work towards the introduction of more diverse range of products available to borrowers by putting in place an enabling environment to facilitate the provision of long-term finance to the productive sector. Proposals for the establishment of institutions, which will provide long-term financing for agriculture, industry and housing will be submitted to the government during the second half of 2002/2003. These institutional measures, along with supportive monetary policy and structural measures are expected to increase resource flows to the private sector.

5.3 Interest Rate Policy

The prevailing widespread between deposit and lending rates coupled with negative real interest rates on deposits are among the major challenges facing the Bank of Tanzania. Narrowing the deposit-lending margin and achieving real rates will continue to be a priority to the Bank.

In view of this, efforts by the Bank will continue to be directed to promoting efficiency in the money market, by among others spearheading measures aimed at removing the remaining institutional and structural impediments in the economy. Difficulties in the collection of the banks' loans from borrowers, problems in the land law, inefficient legal procedures regarding the collection of collateral, high risk and cost of doing business will be addressed during the next six month of 2002/2003. Notably, the Bank will impress the government to amend inefficient laws relating to the financial sector as well as to enhance the capacity of the commercial court. The Bank will also spearhead efforts towards quick restructuring of the remaining state owned banks and non-banks financial institutions.

5.4 Foreign Exchange Operations

During the second half of 2002/2003, the Bank of Tanzania will continue to maintain a market determined exchange rate while intervening from time to time to smoothen transitory fluctuations in the exchange rate, which are inconsistent with economic fundamentals. In this regard, interventions by the Bank will be passive and neutral so that market forces play a greater role in determining the exchange rate. The Bank will also seek to maintain adequate gross reserves of not less than four months of imports of goods and non-factor services, without compromising its primary objective of price stability.

In the course of the next six months to June 2003, the Bank will continue taking measures to quicken the process of liberalizing the capital account, so as to enhance capital flows into the country. Appropriate safeguards for foreign investors' dealings, designed by the Bank in collaboration with the Capital

Markets and Securities Authority (CMSA) are being examined by the Government.

5.5 Banking Supervision

Recent technological advancement in the banking industry and increasing number of licensed banks and non-bank financial institutions require an effective and efficient supervisory capacity. In order to guarantee efficiency and stability of the financial system, the Bank will continue to strengthen its supervisory capacity while closely monitoring both internal and external banking dynamics so as to keep abreast with dynamic technological advances in e-banking, e-commerce, complex futures and options, etc.

6.0 CONCLUSION

The monetary policy implemented during the first half of 2002/2003 was broadly supportive of macroeconomic objectives of the government. Despite a 13.0 percent growth in money supply during the six months to December 2002, all other variables were in line with the program targets. The rate of inflation remained low at 4.4 percent in December 2002 while gross reserves position remained strong, reaching USD 1,528.4 million equivalent to 8.0 months of imports of goods and services compared with USD 1,212.7 million (6.4 months of imports) recorded in June 2002. The budget recorded a deficit (before grants) of TZS 170.2 billion against the projected deficit of TZS 519.9 billion for the period under review. In light of the recent macroeconomic developments and favourable economic conditions, real GDP growth target of 5.9 percent for the year to June 2003 is likely to be achieved.

In the second half 2002/2003, the economy is expected to improve owing to improvements in several sectors of the economy. While the Government is expected to continue to consolidate the progress that has been achieved in the macroeconomic area, the Bank of Tanzania will observe closely developments in both the domestic economy and the external sector in order to guide the conduct of appropriate monetary policy stance. The Bank will maintain its vigilance in keeping monetary aggregates and other financial indicators on track so as to keep inflationary pressures at bay. In this regard, the Bank will sustain open market operations and continue with the close coordination with the government to enhance the credible anti-inflationary stance of the Bank.

APPENDIX 1: PERFORMANCE AGAINST PRGF TARGETS

	December 2002 IMF Performance Criteria		
	Program Target	Program Adjusted	Actual
In billions of Tanzania shillings; end of period			
Net domestic assets of the Bank of Tanzania (ceiling)	-328.3	-205.4	- 295.9
Net domestic financing of the government of Tanzania (ceiling)	0.0	123.1	6.4
Central government recurrent revenue (floor, benchmark only)	559.0	559.0	594.8
Increase in extra-budgetary expenditure	0.0	0.0	0.0
Accumulation of budgetary arrears (ceiling, benchmark only)	0.0	0.0	0.0
Reserve money (ceiling)	706.6	706.6	695.7
In millions of U.S. dollar; end of period			
Net international reserves of the Bank of Tanzania (floor)	1,110.3	984.7	1,058.5
Accumulation of external payment arrears (ceiling)	0.0	0.0	0.0
Contracting of guaranteeing of external debt on non-concessional terms (ceiling)	0.0	0.0	0.0
Memorandum item:			
Foreign program assistance (grants and loans) /1		267.8	142.3

/1 Cumulative from the beginning of the fiscal (July 1) ($)

APPENDIX 2: GRAPHICAL PRESENTATIONS

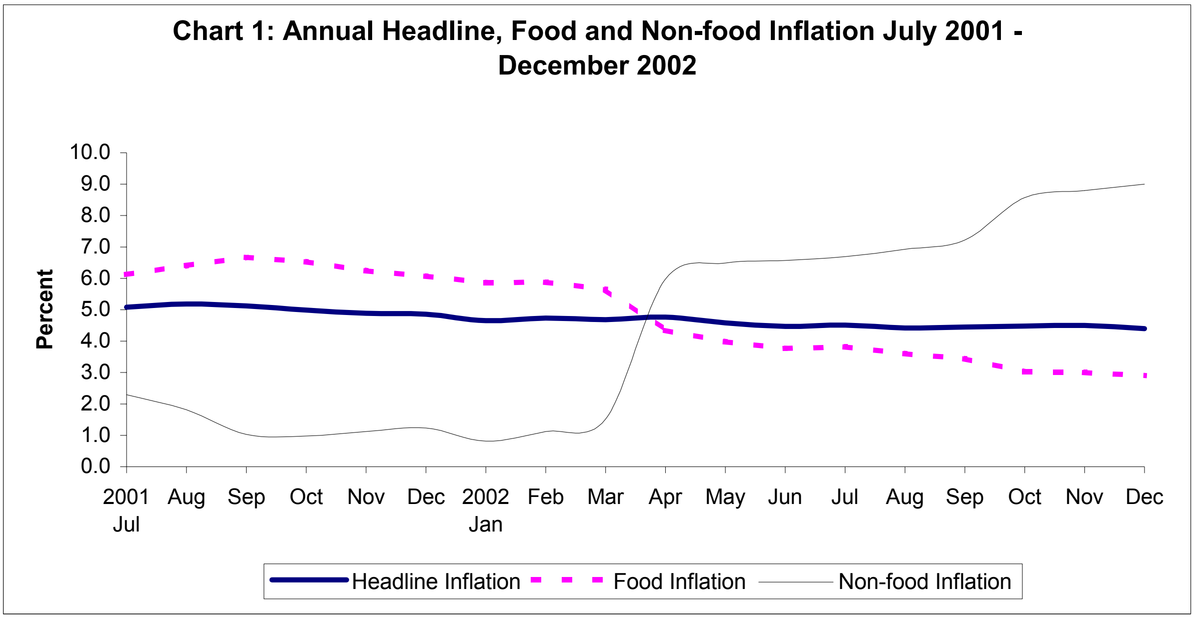
Chart 1: Annual Headline, Food and Non-food Inflation July 2001 - December 2002
Percent
10.0
9.0
8.0
7.0
6.0
5.0
4.0
3.0
2.0
1.0
0.0
2001 Jul
Aug
Sep
Oct
Nov
Dec
2002 Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Headline Inflation
Food Inflation
Non-food Inflation

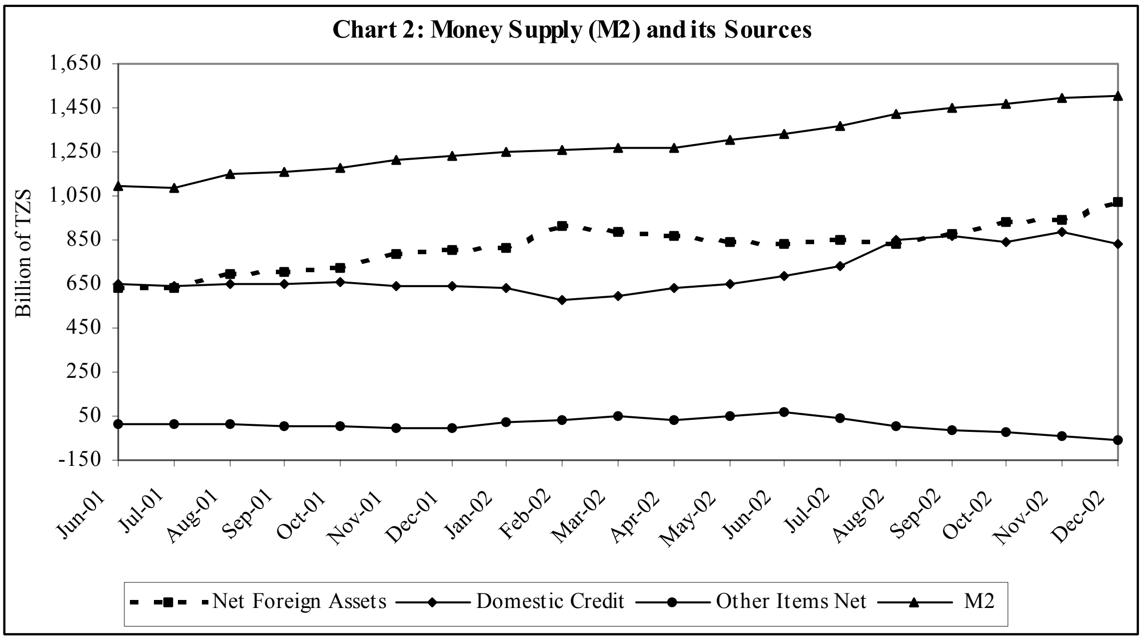
Chart 2: Money Supply (M2) and its Sources
Billion of TZS
1,650
1,450
1,250
1,050
850
650
450
250
50
-150
Jun-01
Jul-01
Aug-01
Sep-01
Oct-01
Nov-01
Dec-01
Jan-02
Feb-02
Mar-02
Apr-02
May-02
Jun-02
Jul-02
Aug-02
Sep-02
Oct-02
Nov-02
Dec-02
Net Foreign Assets
Domestic Credit
Other Items Net
M2

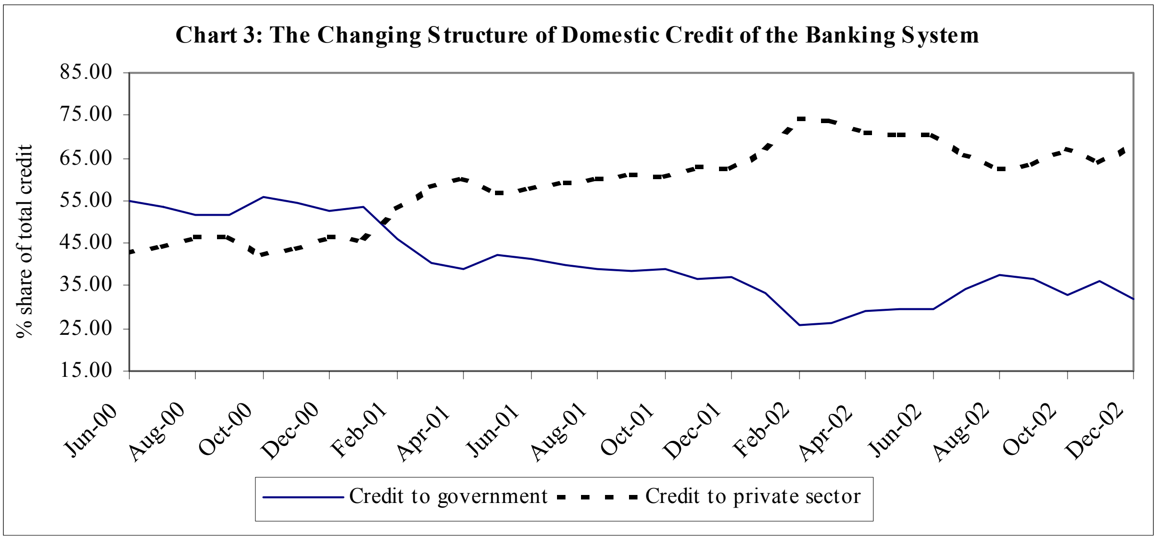
Chart 3: The Changing Structure of Domestic Credit of the Banking System
% share of total credit
85.00
75.00
65.00
55.00
45.00
35.00
25.00
15.00
Jun-00
Aug-00
Oct-00
Dec-00
Feb-01
Apr-01
Jun-01
Aug-01
Oct-01
Dec-01
Feb-02
Apr-02
Jun-02
Aug-02
Oct-02
Dec-02
Credit to government
Credit to private sector

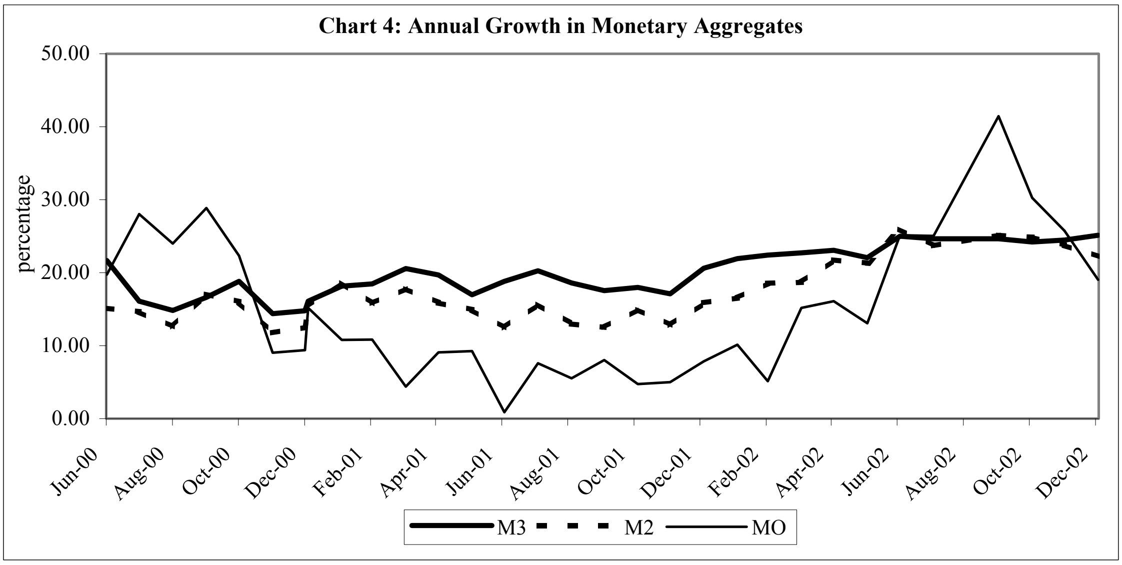
Chart 4: Annual Growth in Monetary Aggregates
percentage
50.00
40.00
30.00
20.00
10.00
0.00
Jun-00
Aug-00
Oct-00
Dec-00
Feb-01
Apr-01
Jun-01
Aug-01
Oct-01
Dec-01
Feb-02
Apr-02
Jun-02
Aug-02
Oct-02
Dec-02
M3
M2
MO

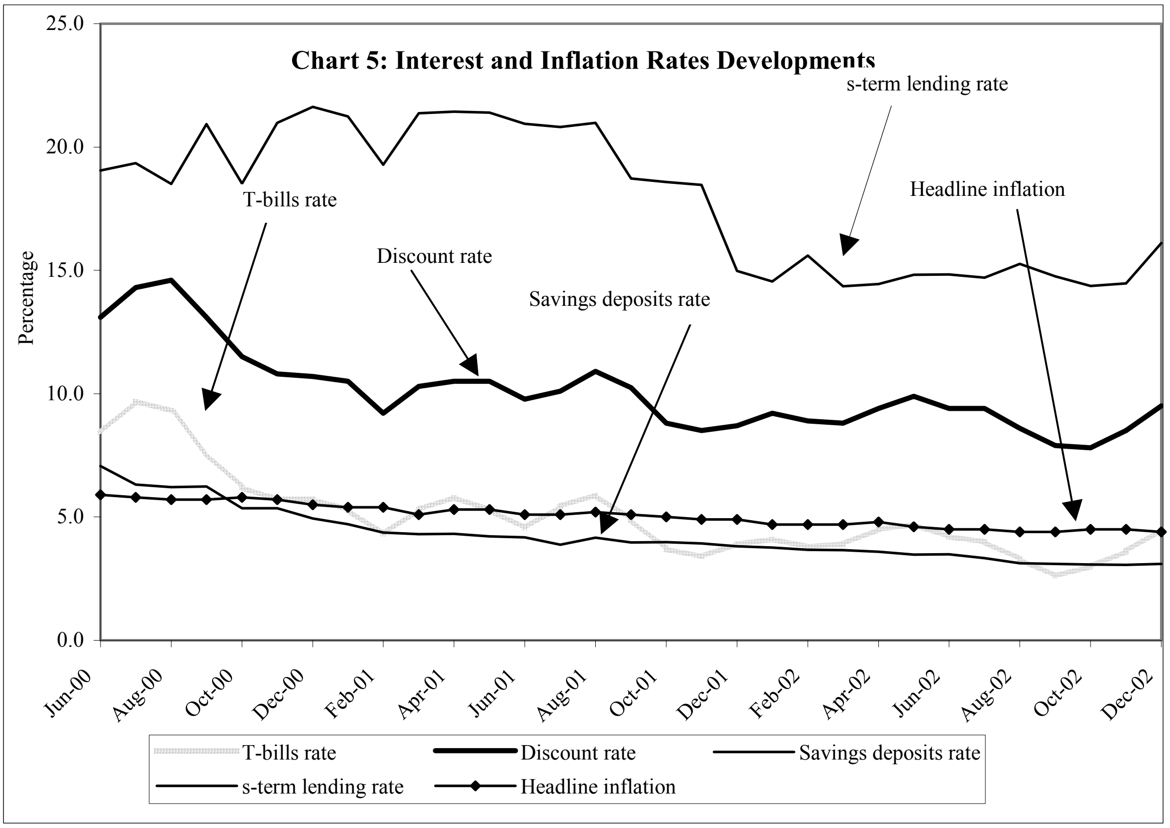
Chart 5: Interest and Inflation Rates Developments
25.0
20.0
15.0
10.0
5.0
0.0
Percentage
s-term lending rate
Headline inflation
T-bills rate
Discount rate
Savings deposits rate
Jun-00
Aug-00
Oct-00
Dec-00
Feb-01
Apr-01
Jun-01
Aug-01
Oct-01
Dec-01
Feb-02
Apr-02
Jun-02
Aug-02
Oct-02
Dec-02
T-bills rate
Discount rate
Savings deposits rate
s-term lending rate
Headline inflation

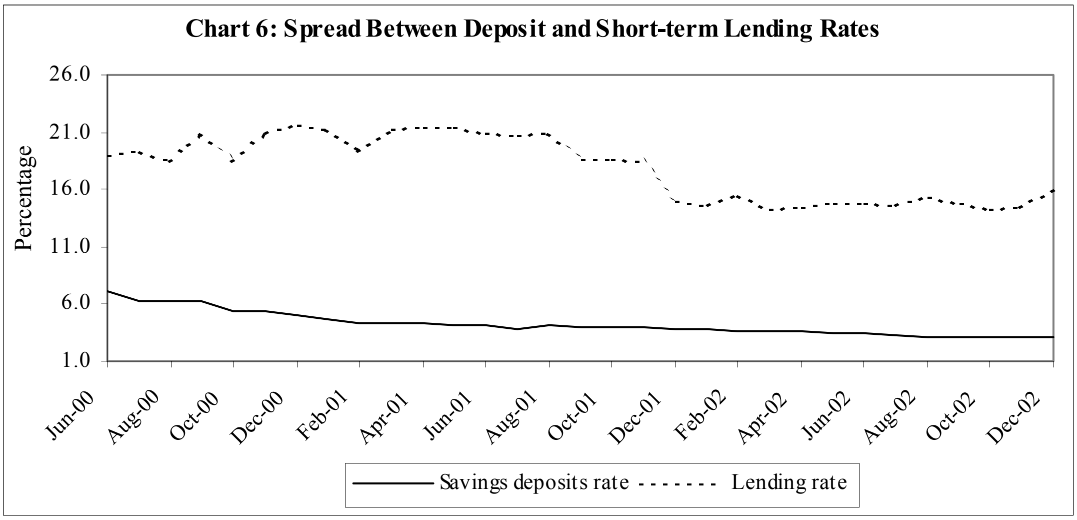
Chart 6: Spread Between Deposit and Short-term Lending Rates
26.0
21.0
16.0
11.0
6.0
1.0
Percentage
Jun-00
Aug-00
Oct-00
Dec-00
Feb-01
Apr-01
Jun-01
Aug-01
Oct-01
Dec-01
Feb-02
Apr-02
Jun-02
Aug-02
Oct-02
Dec-02
Savings deposits rate
Lending rate

APPENDIX 3: TANZANIA MONETARY SURVEY

	Jun-01	Dec-01	Jun-02	Dec-02 Prov.
Net foreign assets of the banking system (NFA)	**1,001,411.7**	**1,209,820.4**	**1,293,645.0**	**1,558,627.2**
Bank of Tanzania: Net international reserves	513,659.5	686,927.5	730,488.3	1,022,247.6
Foreign assets	872,887.8	1,059,767.9	1,148,306.1	1,492,748.5
Foreign liabilities	359,228.3	372,840.3	417,817.8	470,500.9
Commercial banks (DMBs): Net foreign assets	487,752.2	522,892.9	563,156.7	536,379.6
Net domestic assets of the banking system (NDA)	**662,472.9**	**643,344.7**	**750,101.5**	**775,290.8**
Domestic credit	**647,341.9**	**643,713.7**	**684,920.4**	**835,276.9**
Claims on Government (net)	268,919.6	239,201.4	202,879.0	264,608.6
Claims on government BoT (net)	-1,102.3	-27,181.5	-35,023.0	-69,209.3
Claims on government BoT	146,618.1	146,618.1	145,595.9	141,265.6
Government deposits at BoT	147,720.4	173,799.6	180,619.0	210,474.8
Claims on government DMBs (net)	270,021.9	266,382.9	237,902.0	333,817.9
Claims on government DMBs	300,498.5	295,702.9	267,025.3	364,637.6
Deposits at DMBs	30,476.6	29,320.0	29,123.3	30,819.8
Claims on other public sector	3,644.4	1,018.1	0.0	0.0
Claims on the private sector	374,777.9	403,494.2	482,041.4	570,668.3
Other Items Net (OIN)	**15,131.0**	**-369.0**	**65,181.2**	**-59,986.1**
Valuation account	**148,808.5**	**174,522.9**	**203,962.1**	**244,411.4**
Extended broad money (M3) = M2+5	**1,472,904.0**	**1,636,730.7**	**1,797,889.9**	**2,047,683.1**
Broad money (M2) = M1+3+4	**1,099,036.1**	**1,233,667.0**	**1,333,524.2**	**1,507,386.5**
Narrow money (M1) = 1+2	**691,254.6**	**766,019.9**	**815,576.3**	**958,786.6**
1.Currency in circulation (outside the Banking system)	375,044.9	411,638.9	429,383.9	495,445.6
2.Demand Deposits	316,209.6	354,381.0	386,192.4	463,340.9
Quasi Money	781,649.4	870,710.8	982,313.6	1,088,896.5
3.Time deposits	171,597.7	208,101.4	218,602.1	223,898.7
4.Savings Deposits	236,183.8	259,545.7	299,345.8	324,701.3
5.Foreign currency deposits	373,867.9	403,063.7	464,365.7	540,296.5
Proportion of foreign deposits to M3	25.4	24.6	25.8	26.4
Reserve money (MO)	**506,847.8**	**584,369.1**	**573,088.0**	**695,701.2**
Annual growth rates of monetary aggregates (%):				
M3	17.0	17.1	22.1	25.1
M2	14.9	12.8	21.3	22.2
M1	15.0	10.2	18.0	25.2
MO	**9.3**	**5.0**	**13.1**	**19.1**

TZS/USD exchange rate	**888.0**	**919.5**	**946.9**	**976.7**
In millions of USD				
Net International Reserves	578.4	747.0	771.5	1,046.7
Foreign currency deposits	421.0	438.3	490.4	553.2
Net International Reserves (without IMF liabilities)	902.5	1,086.4	1,144.2	1,448.1
BoT Gross Reserves	982.9	1,152.5	1,212.7	1,528.4

GLOSSARY

Average Rate of Inflation

This is calculated as the average of the inflation rates during the fiscal year, or the calendar year.

Non-Food Inflation Rate

This is a measure of price movements caused by factors other than food prices. It is an important measure, which monitors the effectiveness of Monetary Policy on Inflation since price movements in these items are caused largely by policy factors.

Seasonally Adjusted Indicators

To enhance the vigilance of monetary policy, i.e., to be able to make intra-year comparisons (e.g., month-to-month), it is necessary to carry out seasonal adjustment. Seasonal movements or seasonal variations, refer to identical, or almost identical, patterns, which a time series appears to follow during corresponding months (quarters) of successive years. Such movements are due to recurring events, which take place annually, as for example, the harvest season. Therefore seasonally adjusted indicators show the impact of non-seasonal influences.

Base Money, Monetary Base, or Reserve Money (M0)

The Central Bank's liabilities in the form of (1) Currency in Circulation Outside Bank of Tanzania, and (2) Bankers' Reserves (deposit money banks' domestic cash in vaults plus their required and free deposits with the Central Bank) is refered to as Base money, or the monetary base or reserve money.

Money Supply, M

The sum of Currency in Circulation Outside the Banks and deposits are defined in various concepts of Money Supply in the narrower and broader sense, i.e., Narrow Money (M1), Broad Money (M2), and Extended Broad Money (M3).

Narrow Money, M1
It consists of Currency in Circulation Outside Banks and demand deposits.

Broad Money, M2
It is equivalent to Narrow Money (M1) plus time deposits plus savings deposits.

Extended Broad Money, M3
It consists of Broad Money (M2) plus foreign currency deposits.

Currency in Circulation Outside Banks
Notes and coin accepted as legal tender in the domestic economy, excluding amounts held by the monetary system.

Discount Rate
The rate of interest the Central Bank charges on loans it extends to commercial banks. At present, it is also the interest rate charged on government overdraft at the Bank of Tanzania. It is derived from the weighted avarege yield of treasury bills of all maturities plus fine percentage points.

International Reserves, or Reserve Assets
They consist of those external assets that are readily available to and controlled by Central Banks for direct financing of balance of payments imbalances, for indirectly regulating the magnitude of such imbalances through intervention in exchange markets to affect the currency exchange rate, and/or for other purposes. Included are monetary gold, SDRs, reserve position in the Fund, foreign exchange assets (consisting of currency, deposits, and securities), and other claims.

Reserve Money Program

It is an Operational Framework used by the Central Bank to achieve Money Supply Growth Targets, through monitoring Reserve Money, which is the Operational Variable.

Reserve Requirement

These are balances which banks are required to hold as a specified percentage of their liabilities (minimum reserve ratio) arising from demand deposits, savings deposits, time deposits, and foreign currency deposits, as well as from short-and medium-term borrowing, as balances on current accounts with the Central Bank.

Repurchase Agreement (Repo)

These are agreements to purchase/sale by the Bank government securities from/to financial institutions at agreed rate for a specified period, with an understanding that the financial institutions will repurchase/resell the securities to the Bank at the end of the period. The Bank introduced Repo operations in July 1997. This new monetary policy instrument has enhanced the efficacy of monetary policy, since it can be applied in a flexible manner depending on short term liquidity developments in the economy.

Weighted Annualised Yields of Treasury Bills of all Maturities

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

Exchange Rate

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

Nominal Exchange Rate

It is the price at which actual transactions in foreign exchange markets occur.

Nominal Effective Exchange Rate (NEER)

This is the measure of the value of a currency against a weighted average of several foreign currencies, usually from the main trading partners. The NEER is often expressed as an index of the change in the exchange rate, relative to some base period.

Real Effective Exchange Rate

Is the nominal exchange rate index divided by measures of relative price change or other measures of relative competitiveness. Under this approach, Consumer Price Indices (CPI) of our main trading partners relative to Tanzania's CPI are used to construct relative prices. The REER is commonly used as a general analytical tool for measuring relative over-valuation or under-valuation of a currency.