MONETARY POLICY STATEMENT

GOVERNOR
BANK OF TANZANIA

JUNE 2005

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LETTER OF TRANSMITTAL

Dear Hon. Minister,

I hereby submit the Monetary Policy Statement (MPS) of the Bank of Tanzania for the year 2005/06 in accordance with the Bank of Tanzania Act 1995, Section 6 Subsection (1) to (4), as amended in 2003.

The Statement reviews in detail the implementation of monetary policy pursued in 2004/05, and describes the objectives and strategy of the monetary policy stance the Bank of Tanzania intends to pursue during the fiscal year 2005/06, in order to consolidate price stability and promote sustainable growth in the country.

Yours sincerely,

Daudi T.S. Ballali
Governor
Bank of Tanzania

The Hon. Basil P. Mramba (MP)
Minister for Finance
United Republic of Tanzania
Dar es Salaam

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BANK OF TANZANIA'S INFLATION CONTROL STRATEGY

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

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

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

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

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

MONETARY POLICY IMPLEMENTATION

- *At the beginning of every fiscal year, the Bank of Tanzania sets annual monetary policy targets in its Monetary Policy Statement. The targets are reviewed at mid-year.*

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

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

- *The Monetary Policy Committee of the Board, chaired by the Governor, closely monitors monetary policy implementation on a monthly basis.*

- *The Monetary Policy sub-committee discusses, on weekly basis, progress on monetary policy implementation and plans for the subsequent week.*

- *A technical committee reviews liquidity developments daily and agrees on market intervention strategies.*

MONETARY POLICY INSTRUMENTS

- *The Bank of Tanzania uses indirect instruments of monetary policy to influence the level of money supply.*
- *The main instrument is Open Market Operations (OMO). OMO involves the sale or purchase of securities, e.g. treasury bills, by the Central Bank to withdraw or inject liquidity into the system, in order to influence the monetary base.*
- *Other indirect instruments include Foreign Exchange Market Operations (FEMO), the discount rate, statutory reserve requirements, and moral suasion.*

CONTROLLING THE RATE OF INFLATION

- *The objective of monetary policy is to achieve a low and stable rate of inflation.*

- *The Bank of Tanzania focuses on the Consumer Price Index (CPI) to measure inflation. The rate of change in the overall CPI is referred to as the* HEADLINE INFLATION RATE.

- *The inflation rate excluding food prices is often referred to as the* NON-FOOD INFLATION RATE. *It is a measure of price movements, which are largely influenced by policy factors, but can also be frequently affected by external factors.*

- *The Bank of Tanzania also monitors food prices and their index. This is because food prices are sometimes affected by non-monetary factors like drought and floods, which can affect inflation substantially, regardless of the stance of monetary policy. The rate of change in food price index is referred to as the* FOOD INFLATION RATE.

1.0 INTRODUCTION

1.1 Bank of Tanzania'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". Thus, the primary responsibility of the Bank of Tanzania is to establish monetary conditions that will generate low and stable inflation over time, with a long-term objective of reducing inflation to less than 5 percent, a rate that is competitively in line with the average inflation rate of Tanzania's major trading partners. A low and stable rate of inflation enhances efficiency in mobilization and allocation of resources in an economy.

1.2 Central Bank Policy Objectives

In conducting its monetary policy, the Bank of Tanzania seeks to achieve the following objectives:

i. A steady and acceptable rate of increase in money supply, consistent with the inflation target and demands of the economy,
ii. A rate of increase in domestic bank credit that is consistent with money supply objectives and which will not place undue demand pressure on resources,

iii. Market determined positive real interest rates;

iv. An adequate level of official foreign reserves, geared towards achieving the requirement of the Bank of Tanzania Act, as well as enabling the country to meet unexpected foreign exchange requirements in the event of balance of payments difficulties, while allowing the market to establish a realistic and stable exchange rate;

v. Stability in the banking and financial system, through effective enforcement of prudential regulations, promoting well functioning financial markets and an efficient national payments system.

While the spectrum of monetary policy objectives is intricately linked, price stability remains the most important policy objective. To achieve these objectives, the Bank uses its available monetary policy instruments in managing liquidity within the appropriate levels for the given period of time.

2.0 MACROECONOMIC POLICY FRAMEWORK FOR 2004/05

2.1 Macroeconomic Objectives for 2004/05

The thrust of government policies during 2004/05, as set out in the National Strategy for Growth and Reduction of Poverty (NSGRP), were to promote broad based growth and strengthen poverty reduction initiatives, while consolidating and maintaining macroeconomic stability. To attain these objectives, the Government aimed at:

i. A real GDP growth of 6.3 percent in 2004 and 6.5 percent in 2005;
ii. An inflation rate of 4.0 percent by end-June 2005;
iii. Domestic recurrent revenue equivalent to 13.8 percent of GDP;
iv. Overall budget deficit of 5.2 percent of GDP and Government domestic bank borrowing of 1.8 percent of GDP; and,
v. Maintain minimum official foreign reserves equivalent to seven months of imports of goods and services.

2.2 Monetary Policy Objectives for 2004/05

The monetary policy objectives of the Bank of Tanzania focused on maintaining an appropriate level of liquidity in the economy, while supporting the broader macroeconomic objectives of the Government. During the year, the projected increase in credit to the private sector, and the strong foreign exchange inflows, which could not be adequately absorbed in the economy resulted in high liquidity conditions. Thus, in order to maintain an appropriate level of liquidity in the economy the Bank aimed at:

i. Containing the expansion of reserve money (**M0**) within a band of 20 to 23 percent between end-June 2004 and June 2005;
ii. Limiting the growth of broad money supply (**M2**) and the extended broad money supply (**M3**), within a band of 20 to 24 percent;
iii. Attaining an inflation rate of 4.0 percent by end-June 2005;
iv. Allowing commercial banks' credit to the private sector to grow by not less than 34 percent by end-June 2005, from the stock of end June 2004; and,
v. Maintaining official foreign reserves of not less than seven months of imports of goods and services.

3.0 REVIEW OF MONETARY POLICY IMPLEMENTATION DURING 2004/05

3.1 Liquidity Management

A steady inflow of foreign assistance during the period under review, coupled with HIPC debt relief, and a modest increase in exports and tourism earnings translated into substantial build up of liquidity in the economy. Because of the high liquidity conditions in the economy, the Bank had to intensify its efforts to bring down liquidity to the targeted levels, offering bigger tender sizes of its instruments in the open market operations. This move led to an upward pressure on interest rates for domestic debt instruments.

The situation was compounded by the low demand for domestic debt instruments, as primary investors shifted their preference in favour of other investment avenues including, real estate and lending to private sector for commercial banks. However, the Bank continued to exercise vigilance in its monetary policy actions so as to keep reserve money on track. Besides the regular instruments used by the Bank of Tanzania to manage liquidity (i.e. Government securities, and repurchase agreements), the Bank intervened in the foreign exchange market to sell foreign exchange to complement OMO when necessary. On the other hand, the Government practiced effective expenditure management, coupled with increased revenue collections mostly above targets – a move that helped to reduce excess liquidity in the economy.

The above monetary and fiscal policy measures enabled Tanzania to achieve all the quantitative benchmarks and performance criteria set under the Poverty Reduction and Growth Facility (PRGF) Program arrangement with the International Monetary Fund (IMF) for the fiscal year 2004/05.

3.2 Credit Policy

The Bank of Tanzania implemented its credit policy in a manner consistent with the targeted increase in banks' credit to private sector in order to support the anticipated growth rate of GDP and the inflation target.

During the year 2004/05, the Bank of Tanzania anticipated that commercial banks credit to the private sector would expand by 34 percent by end June 2005, from the level recorded at end June 2004. Meanwhile, the Government was expected to reduce its domestic debt with commercial banks, so as to release more resources for lending to the private sector.

By end of April 2005, the Government made substantial debt repayments to the banking system, amounting to about TZS 57 billion. This partly facilitated commercial banks to extend to the private sector credit of about TZS 186 billion between June 2004 and April 2005. On annual basis, credit to the private sector grew by 34 percent during the year ending April 2005, being well within the targeted growth.

During the period under review, the Bank continued to support the Government in its measures to remove the remaining structural impediments to commercial banks' lending to the private sector, including the establishment of credit guarantee schemes to reduce the risk on private sector lending, enhancing competition by privatizing the remaining state owned banks, and improving the business environment so as to reduce the cost of doing business in Tanzania.

Notable achievements during the review period included the launching of the Small and Medium Enterprises Credit Guarantee Scheme (SMEs-CGS) on 24th, May 2005, which is expected to address the risk factor of lending to SMEs and thus, motivate banks to extend more credit to the qualifying businesses. In the 2004/05 Budget, the capital base of the SMEs-CGS was enhanced from TZS 0.5 billion to TZS 2.0 billion.

The Bank of Tanzania also continued to manage, on behalf of the Government, the Export Credit Guarantee Scheme (ECGS). As at end April 2005, loans worth TZS 18.85 billion were guaranteed, mostly through the Cooperatives, to support marketing of agricultural exports, including tobacco, cashew, and bee products, as well as for flowers and horticultural production. Guarantees were also extended to manufacturing activities for export. The ECGS has performed relatively well as most borrowers show high prospects of repaying their loans timely as scheduled.

With the objective of filling the vacuum of medium and long-term credit to productive sectors of the economy, Government is in the process of introducing a Development Finance Guarantee Facility (DFGF) to offer guarantees to commercial banks for lending to targeted export projects. The Bank, in collaboration with the World Bank, is finalizing the operational guidelines for the scheme. It is envisaged that the scheme will start its operations in the next financial year with a capital base of about TZS 50 billion.

3.3 Interest Rate Policy

Interest rates are market determined in Tanzania, although interest rates applied by commercial banks are still influenced by the remaining structural impediments in the economy that contribute to excessive risks in providing banking services. The momentum towards narrowing the spread between commercial banks' lending and deposit rates, as well as maintaining positive real interest rates is still not adequate, and speeding it up remains a challenge to be addressed by the on-going reforms in the financial sector.

Measures are being taken to improve efficiency in the banking system, and to operationalise the legal framework governing the use of land as collateral. The second generation financial sector reforms to be launched this year will bring about more competition in the banking sector, resulting in downward pressure on the interest rate structure.

3.4 Foreign Exchange Operations and Reserve Management

The Bank of Tanzania continued to exercise a free-floating exchange rate policy with limited interventions for liquidity management and to smoothen fluctuations in the supply and demand of foreign exchange in the market. In addition, the Bank conducted foreign exchange operations in a manner that would facilitate the achievement of the Government objective of attaining official foreign reserve target of not less than seven months of imports of goods and services by end June 2005. The outcome as at end April 2005, was the accumulation of official foreign reserves of about 8 months of imports of goods and services.

4.0 REVIEW OF MACROECONOMIC DEVELOPMENTS IN 2004/05

4.1 Gross Domestic Product (GDP)

During the calendar year 2004, Tanzania recorded a rebound in economic activity, mainly supported by improved weather conditions and the subsequent recovery in agricultural production. According to preliminary National Accounts data, real GDP grew by 6.7 percent in 2004 up from the growth of 5.7 percent recorded in 2003, whose performance was adversely affected by drought (**Table** 1).

Output in the agricultural sector grew strongly by 6.0 percent compared to a growth of 4.0 percent registered in 2003, and contributing about 46 percent of domestic product. Other sectors of the economy also recorded strong growth of between 8 percent and 11 percent. Performance in the manufacturing sector improved to a growth rate of 8.6 percent from 8 percent in the previous year, while construction expanded strongly by 11 percent, the same as in 2003.

Table 1: Annual Growth Rates and Share to Real GDP by Sectors (2002 - 2004)

In Percent

Economic Activity	2002		2003		2004	
	Growth Rate	Share	Growth Rate	Share	**Growth Rate**	Share
Agriculture	5.0	47.5	4.0	46.8	**6.0**	46.4
Mining and Quarrying	15.0	2.7	17.0	3.0	15.6	3.2
Manufacturing	8.0	8.4	8.6	8.6	**8.6**	8.8
Electricity and Water	3.1	1.6	4.9	1.6	**4.7**	1.6
Construction	11.0	5.0	11.0	5.2	**11.0**	5.5
Wholesale and Retail Trade, Hotel and Restaurants	7.0	16.6	6.5	16.7	**8.0**	17.0
Transport and Communication	6.4	5.5	5.1	5.5	**6.2**	5.4
Financial and Business Services	4.8	10.0	4.4	10.0	**4.5**	9.7
Public Administration and Other Services	4.1	7.3	4.1	7.2	**4.5**	7.1
Less Financial Services Indirectly Measured	2.8	-4.7	3.5	-4.6	**8.0**	-4.6
Total GDP	6.2	100.0	5.7	100.0	**6.7**	100.0

Source: National Bureau of Statistics

Higher growth rates were also recorded in other economic activities such as trade, hotels and restaurants, transport and communication, financial and business services. The good performance of the economy is driven mostly by gains in efficiency emanating from macroeconomic and structural reforms pursued by the Government to improve the business environment and enhance productivity growth.

4.2 Inflation Developments

Reflecting the impact of rising oil prices, increase in electricity tariffs and to some extent the upward pressure on food prices associated with food shortages in some parts of the country, annual headline inflation rose sharply from 4.1 percent in July 2004 to 4.4 percent in November 2004, while annual food inflation moved from 5.3 percent to 5.9 percent, and non-food inflation went up from 2.2 percent to 2.4 percent.

However, with the improvement in domestic food supply from good harvests in the regions that received adequate rains, annual headline inflation slowed to 4.0 percent in April 2005, with food inflation going down to 4.3 percent and non-food inflation easing to 3.9 percent.

Although there are indications of food shortages in some locations in the country, where rainfall is inadequate, implying a potential threat on food inflation, measures are being taken by the Government to ensure availability of food in deficit areas, through distribution of subsidized maize from SGR stocks and sensitising trade between surplus and deficit areas. This move is expected to dampen the pressure on food prices, and hence on overall inflation. It is therefore expected that the inflation rate will maintain its downward trajectory to enable the Bank to achieve its inflation target of 4.0 percent at end June 2005.

4.3 Monetary and Credit Developments

Money Supply

During the year 2004/05, the Bank continued to implement tight monetary policy, consistent with the overall objectives of reducing the growth of money supply and hence further bring down inflation. According to provisional monetary statistics for April 2005, the growth of reserve money was within the target at 23.4 percent. However, extended broad money, M3 grew at about 26 percent, while broad money –M2 grew at about 29 percent, both being above the target.

The expansion in money supply is largely explained by the sharp increase in net claims on the business sector, whose stock of outstanding loans went up by TZS 186 billion between June 2004 and April 2005. In addition, the substantial increase in holdings of foreign exchange in the banking system during the review period also contributed to the rise in monetary growth. Specifically, reflecting the strong inflow of donor funds during the period under review, Net International Reserves of the Bank of Tanzania increased sharply by US$ 245 million from US$ 1,326.5 million in June 2004 to US$ 1,571.3 million in April 2005, although commercial banks' holdings of foreign exchange went down slightly from US$ 600.8 million to US$ 562.2 million over the same period.

Credit Developments

Commercial banks credit to private sector remained strong, reaching an average annual growth rate of 39 percent during 2004, and an annual growth rate of about 34 percent during the year ending April 2005. The sustained strong growth of credit to the private sector is attributed to increased competition in the banking sector and the increase in the number of credit-worthy borrowers and the existence of negotiated lending rates.

The outstanding credit to private sector reached a stock of TZS 1,151 billion, representing an increase of TZS 186 billion during the ten months to April 2005. This development is consistent with the desired goal of increasing the flow of resources to the private sector to support the envisaged economic growth. The private sector currently enjoyed 92 percent of the total credit to the economy, a significant improvement from a share of 85 percent absorbed in June 2004. The sectors that benefited from domestic lending include manufacturing (20 percent), trading (22 percent) and agricultural production (12 percent).

4.4 Interest Rate Developments

In line with the increase in demand for credit in the private sector during the period under review, interest rates on local currency denominated loans exhibited an increasing trend, with the overall lending rate rising from 14.23 percent in June 2004 to 15.21 percent in April 2005. Likewise, the average negotiated lending rate to prime customers rose from 9.36 percent in June 2004 to 10.33 percent in April 2005.

Deposit rates remained almost stagnant with savings rate at around 2.5 percent throughout the period, while the weighted average time deposit rate was around 4.53 percent in April 2005. With the inflation rate of 4.0 percent for the year ending April 2005, the deposit rates are barely positive. However, the average negotiated deposit rate stood at 8.61 percent in April 2005, and it is substantially positive in real terms. The existence of positive negotiated deposit rates along side stagnant deposit rates reflects the continued existence of excess liquidity.

These developments translated to an increase in the margin between the overall time deposit rate and the overall lending rate from 9.88 percentage points in June 2004 to 10.68 percentage points in April 2005. Wide interest rate spread remains a challenge in the country, which the Bank has endeavoured to tackle through the ongoing second-generation financial sector reform initiatives that are expected to contribute to reduction of the various risks associated with lending to the private sector.

4.5 Government Budgetary Operations

The performance of the government budget during 2004/05 was affected by the commencement of the gradual implementation of the East African Custom Union Protocol, in which taxes on imports for the three East African member States were harmonized. In the process, three agreed bands (0%, 10% and

25%) were adopted, whereas tax rates on some items such as crude oil were reduced from 10 percent to zero rate. Nevertheless , taxes on second hand clothes (which are outside the three band items) were increased from 25 percent to 50 percent. On a net basis, these measures impacted negatively on the performance of tax revenue collections from imports.

Despite the above event, total revenue collections surpassed the targets, primarily on account of higher collections from VAT, income taxes, as well as a sharp increase in non-tax revenue. Provisional data show that total revenue collected from July 2004 to April 2005 amounted to TZS 1,460 billion, exceeding the target by about TZS 25 billion. This outcome suggests that the revenue target of 13.8 percent of GDP for 2004/05 is likely to be achievable.

On the expenditure side, the Government ensured that expenditures on priority sectors for poverty reduction were protected, recurrent expenditure was kept on track and development spending was in line with the budget. Government expenditure during the ten months of 2004/05 stood at TZS 2,318.1 billion, representing 20.2 percent of GDP, out of which, TZS 1,432.2 billion was recurrent expenditure and TZS 886.0 billion constituted development expenses. Development expenditure was above the target by TZS 125.3 billion, mainly because of early disbursements of donor funds that enabled timely implementation of development projects.

During the ten months of 2004/05, the government recorded an overall budget deficit of TZS 409 billion, which was wholly financed by foreign resources amounting to TZS 490.6 billion, while the balance of TZS 81.4 billion was used to reduce government's domestic obligations.

4.6 Debt Developments

The overall total debt stock as at end April 2005, comprised of about US$ 8,207 million in external debt and about TZS 1,029 billion in domestic debt.

External Debt Position

As at end-April 2005, total external debt committed was US$ 8,614 million, representing an increase of US$ 525.8 million from US$ 8,088.3 million recorded at end-June 2004. The increase emanated from new borrowings and accumulation of interest arrears.

Debt Relief Under Paris and Non Paris Club Members

During the period under review, the Government continued to receive debt relief under Paris Club arrangement bringing total debt relief (including cancellations) from Paris Club creditors to US$ 858.7 million as at end April 2005. The countries that offered debt relief are Austria, Belgium, Canada, France, Germany, Italy, and Norway. Others are the Netherlands, United Kingdom, USA, Russia, and Japan. With regard to Non-Paris Club members, only Bulgaria, India and Kuwait had offered debt relief in line with the HIPC framework. The Government is however continuing discussions with Abu Dhabi

Fund, Hungary, Libya and Iran regarding further debt relief, although no firm commitments have been offered.

Multilateral Debt Relief Under HIPC

Multilateral creditors including, the World Bank, International Monetary Fund, African Development Bank, European Investment Bank and Nordic Development Fund, continued to offer debt relief in the form of debt service reduction since 1999/00, thus resulting in reduced debt service payments for the country. By the end April 2005, total debt relief received from multilateral creditors under the HIPC arrangement stood at US$ 357.0 million.

Domestic Debt Position

Consistent with the objective of repayment of its domestic debt to the banking sector so that more resources become available for lending to the private sector, the Government made a net repayment of TZS 16.2 billion between July 2004 and April 2005. Meanwhile, its domestic debt went up only slightly by 5 percent during the same period. The Government domestic debt was TZS 1,029.43 billion at end April 2005, having increased by TZS 49 billion from the stock registered at end-June 2004, mainly in the form of government securities.

4.7 External Sector Developments

During period under review, Balance of Payments developments were characterized by substantial growth in both imports and exports. The external accounts improved as a result of large inflows of external assistance and growth in the mining exports, a recovery in traditional exports and tourism receipts. On annual basis, the current account improved modestly to a deficit of US$ 299 million in April 2005, from a deficit of US$ 420.6 million recorded during the previous year. The major driving force behind the improvement is the increase in government official transfers from US$ 432.9 million recorded in the corresponding period of 2003/04 to US$ 626.3 million, reflecting development partners' commitments to support the Government's poverty reduction initiative.

Exports

Between July 2004 and April 2005, Tanzania exported goods and services worth US$ 2,062.0 million, being a 28 percent increase from US$ 1,610 million recorded in the same period of the pervious year. The recovery of traditional exports, particularly cotton and coffee, on account of improved weather conditions in 2004 was the main source of improved export performance. The volume of cotton exports more than doubled to 83,500 metric tons at the end of April 2005, up from 32,400 metric tons exported in the corresponding period in 2003/04. Likewise, the volume of exported coffee increased substantially to 44,400 metric tons from 32,000 metric tons recorded in the corresponding period a year earlier.

Non-traditional exports also increased during the review period earning US$ 929.6 million compared to US$ 798.6 million of the preceding year. Sizeable increases were recorded in exports of gold, manufactured goods, fish fillets, and horticultural products. In order to enhance the country's export base, the government is continuously improving the environment for foreign direct investments, particularly in the Export Processing Zones (EPZs), which facilitate manufacturing for exports that target the AGOA and EBA markets.

Table 2: Current Account Balance

Millions of US$

	July - April P		
	2003/04	2004/05	% Change
Goods Account (net)	**-757.7**	**-794**	4.79
Exports	1,000.7	1,235.8	23.49
Imports	1,758.4	2,029.8	15.43
Services Account (net)	**-64**	**-85.6**	**33.75**
Receipts	608.9	826.2	35.69
Payments	673	911.7	35.47
Goods and services (net)	**-821.7**	**-879.6**	**7.05**
Exports of goods and services	1,609.6	2062	28.11
Imports of goods and services	2,431.4	2,941.6	20.98
Income Account (net)	**-36.6**	**-50.4**	**37.70**
Receipts	77.2	54.9	-28.89
Payments	113.9	105.3	-7.55
Current Transfers (net)	**437.8**	**630.6**	**44.04**
Inflows	489.4	686.2	40.21
o/w General Government	432.9	626.3	44.68
Outflows	51.6	55.6	7.75
Current Account Balance	**-420.60**	**-299.30**	**-28.84**

Notes:
P= Provisional
Totals may not add up due to rounding of figures
Source: Bank of Tanzania

During the period under review, services receipts, mainly from tourism rose from US$ 609 million recorded in 2003/04 to US$ 826 million, as tourism activities picked over time. Travel receipts alone stood at US$ 576.4 million at end April 2005. This is a result of payoff from promotion efforts undertaken by the Government and other stakeholders in marketing Tanzania as a unique and safe destination for tourism.

Imports

Imports of goods and services rose by 21 percent during the period under review to US$ 2,942 million at end April 2005. Capital and intermediate goods (mainly oil and fertilizers) accounted for the bigger part of the increase, thus reflecting the expansion in economic activities. During the review period, capital and intermediate goods imports were worth US$ 1,418 million, and accounting for 49 percent of total imports.

Fertilizer imports went up tremendously during the year from US$ 27 million in 2003/04 to US$ 64 million, reflecting the positive response towards the Government subsidy on transport cost of fertilizers. The value of oil imports went up to US$ 387 million from US$ 343 million recorded in the previous year, on account of the increase of oil prices in the world market. The price of white products increased sharply to US$ 430 per ton from US$ 189 per ton recorded in the previous corresponding period.

4.8 Foreign Exchange Operations

During the period under review, the operations of the Bank in the foreign exchange market were mainly directed at smoothening the supply and demand in the market and building up foreign reserves. On this basis, during the ten months ending April 2005, the Bank sold on net basis, US$ 112.6 million, out of US$ 683.3 million traded in the Inter-bank Foreign Exchange Market (IFEM).

Due to steady inflow of donor funds in support of government budget, gross official reserves increased by US$ 238.2 million to US$ 2,116.2 million at end April 2005, equivalent to eight months of imports of goods and services. The nominal exchange rate appreciated slightly from TZS 1,112.56 per US dollar at end June 2004 to TZS 1,105.60 per US dollar at end-April 2005.

5.0 FINANCIAL SECTOR DEVELOPMENTS DURING 2004/05

5.1 Financial Sector Assessment Program (FSAP)

The financial sector assessment undertaken in 2003/04 indicated that despite the significant achievements of the financial sector reforms in Tanzania, the sector's role in the economy is nonetheless still limited. This signified a need to undertake further financial sector reforms aimed at consolidating the achievements of the on-going economic reforms, deepening financial intermediation, modernize the financial system, and making the financial sector play a more significant role in facilitating economic growth and poverty reduction in the country.

On the basis of the FSAP assessment, the Government formed an inter-institutional committee under the chairmanship of the Governor of the Bank of Tanzania, and drawing members from relevant institutions both from Mainland and Zanzibar. The main task of this committee is to oversee the preparation of an Action Plan for the implementation of the envisaged second-generation financial sector reforms necessary to achieve the envisioned financial system for Tanzania.

The broad based second generation financial sector reforms will address impediments that limit the developmental role of commercial banks, financial markets, micro finance institutions, pension funds, insurance companies and other non-bank financial institutions in the economy, so as to optimise their contribution towards poverty reduction and the achievement of Millennium Development Goals for Tanzania.

The final document on the second-generation financial sector reforms implementation plan will soon be submitted to Government for consideration and adoption.

5.2 Banking Supervision

The Bank of Tanzania continued with the preparations that will lead to adoption of a risk based supervisory framework that will enhance its supervisory effectiveness and efficiency. The Bank has already developed Risk Management Guidelines and is currently working on Risk Based Supervision Methodology, which is expected to be completed in 2005/06. In line with this move, the Bank will continue to enhance and improve its Banking Supervision Information System (BSIS) and to review all prudential regulations and seculars with a view to relax constraining regulations and tighten loopholes. The Bank will also continue to develop new prudential regulations on areas of cross border supervision, consolidated supervision, credit reference system, anti-money laundering and combating financing of terrorism.

While the current Bank of Tanzania Act, 1995 and the Banking and Financial Institutions (BFIA) Act, 1991, already cover many important areas for a clear framework for central banking operations and banking supervision, respectively, the Government considered it necessary to amend the two Acts, with the aim of enhancing the Bank's autonomy, transparency and accountability of its operations, as well as modernizing its regulatory framework consistent with best practices.

5.3 Micro-finance

During the period under review, the Bank of Tanzania continued to coordinate the work of the National Task Force on the development of the regulatory and supervisory framework for micro-finance operations in Tanzania. The micro-finance regulations, based on international best practices, were approved by the Government on 23rd March 2005, and will soon be printed in the Government Gazette, after which the regulations will become operational.

In a bid to improve the operational performance of SACCOS in the country, the Bank in collaboration with the Ministry of Cooperatives and Marketing (MCM) undertook a study to review comprehensively both operational and policy issues with a view to determine the way forward based on best practice. The Report, which included the proposed amendments to by-laws and code of conduct for SACCOS, was adopted by the MCM in December 2004.

5.4 National Payment Systems (NPS)

The Bank of Tanzania continued with the implementation of National Payment Systems (NPS) reforms and modernization project, which aims at improving safety and efficiency in payments, clearing and settlement operations in the country, in line with international standards, best practices and regional harmonization initiatives.

The Bank also continued operating and monitoring performance of the Tanzania Inter-bank Settlement System (TISS). The TISS Real Time Gross Settlement (RTGS) system for large value and time critical payments became operational on April 8th 2004. TISS has improved safety, efficiency and minimised risks in the payments system through elimination of settlement time lag for bulky and time critical payments.

To enhance performance of the RTGS system the Bank of Tanzania made available, to participants in the system, intra-day and overnight settlement credit facilities. The system has also been extended to the Tanzania Revenue Authority (TRA), where government revenue are remitted and received on real time basis.

During the period under review, the Bank also implemented the Inter-bank Electronic Fund Transfer (EFT), a system that facilitates clearing of low value inter-bank credit payments and continued to monitor the operations of the Cheque clearing system and implementation of other non-cash retail payment instruments and services.

6.0 MACROECONOMIC POLICY FRAMEWORK FOR 2005/06

6.1 Government Macroeconomic Objectives for 2005/06

The Government is committed to reducing the incidence of poverty in Tanzania through the continued implementation of sound economic and financial reforms and policies necessary for sustained economic growth and macroeconomic stability. The Government policies during 2005/06 will therefore continue to focus on the promotion of broader based growth and poverty reduction, whilst consolidating the gains from macroeconomic stability. The Government intends to attain the following macroeconomic objectives during 2005/06:

i. A real GDP growth of 6.9 percent in 2005 and 7.0 percent in 2006;
ii. To maintain the inflation rate at 4.0 percent until end-June 2006;
iii. Domestic recurrent revenue equivalent to 13.8 percent of GDP;
iv. Overall budget deficit of 7.2 percent of GDP, with Government domestic borrowing targeted at 1.1 percent of GDP; and,
v Maintaining minimum official foreign reserves equivalent to six months of imports of goods and services.

6.2 Monetary Policy Objectives for 2005/06

Monetary policy objectives of the Bank of Tanzania in support of the broader macroeconomic objectives of the Government for the fiscal year 2005/06 are:

i. Containing the expansion of reserve money (M0) at 26.6 percent between end-June 2005 and end-June 2006;
ii. Limiting the growth rates of both broad money supply, M2 and extended broad money, M3 at 27 percent;
iii. Maintain an inflation rate of about 4.0 percent until end-June 2006;
iv. Allow commercial banks credit to the private sector to grow by an annual rate of 33 percent by end-June 2006; and,
v. Maintain an adequate level of foreign reserves to cover not less than six months of imports of goods and services.

7.0 MONETARY POLICY IMPLEMENTATION IN 2005/06

7.1 Liquidity Management

During the fiscal year 2005/06, the primary objective of monetary policy will continue to be directed towards maintaining appropriate level of liquidity in the economy to ensure low and stable inflation. In recognizing the challenges of liquidity management against the backdrop of continued strong inflows of donor funds, the Bank of Tanzania will put in place adequate measures to ensure that the evolving liquidity situation does not re-ignite inflation.

The measures will include, introducing new instruments, improving the efficacy of the existing ones, and improving liquidity forecasting framework both at the Bank and at the Ministry of Finance in response to the challenges of monetary policy implementation.

7.2 Credit Policy

Credit to private sector is expected to grow stronger, as efforts to improve credit accessibility continue to be undertaken under the second-generation financial sector reforms. Restructuring and privatisation of NMB and other remaining state owned banks would also bring about more competition and efficiency in the banking system. The commencement of the credit guarantee schemes will reduce the risks of lending to the private sector, and subsequently improve the availability of resources in support of the envisaged higher growth rates, needed for effective poverty reduction.

7.3 Interest Rate Policy

The Treasury bill market will continue to be the anchor for market determined interest rates. Thus, to enhance effectiveness of the anchor the Bank will continue to observe its commitments towards promoting efficiency in the money market and the banking system in general. It is also expected that as competition in the financial system continues and risk to lending to the private sector is reduced as a result of ongoing reforms, the interest rates applied by commercial banks will move close to Treasury bill yields, and the spread between the deposit and lending rates will continue to decline.

7.4 Foreign Exchange Operations

The Bank of Tanzania will continue to execise a free floating exchange rate policy with limited interventions for liquidity management and to smoothen out fluctuations in the supply and demand of foreign exchange in the market. The Bank will conduct its foreign exchange operations in a manner that would also facilitate the achievement of its foreign reserve target.

8.0 CONCLUSION

Substantial progress has been attained in maintaining price stability in the economy, despite considerable pressure exerted on liquidity from donor funds inflows on one hand and increasing oil prices on the other. To consolidate these achievements, the Bank of Tanzania will maintain prudence in monetary policy so as to achieve monetary, as well as broader macroeconomic objectives set for 2005/06 and in the medium term.

The Bank will continue to collaborate with the Government in taking measures that will facilitate availability of credit to the private sector, include measures to reduce risks of lending to small and medium enterprises, and exporters; putting in place an enabling environment for provision of long-term finance to productive sectors; and reducing the cost of doing banking business.

In a bid to further reduce the spread between deposit and lending rates and also the cost of borrowing, the Bank will collaborate with other stakeholders in addressing the high risk of doing banking business in the economy, so as to lower lending rates, improve deposit rates, and narrow the interest rate spread. These measures are also expected to stimulate savings and growth of deposits in the banking system.

APPENDICES

Chart 1. Annual Headline, Food and Non-food Inflation (In percent)

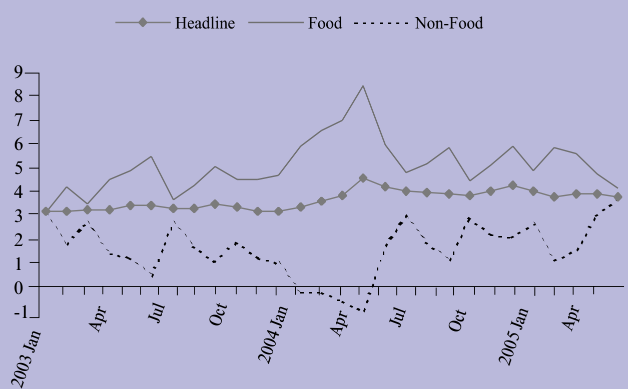

Table 1: Interest Rates Structure (Percent per Annum)

	2004			2005			
	Jun	Sep	Dec	Jan	Feb	Mar	Apr
Savings deposits rate	2.42	2.45	2.60	2.61	2.59	2.61	2.61
Overall Time deposits rate	**4.35**	**4.58**	**4.39**	**4.73**	**4.72**	**4.56**	**4.53**
1-month	**3.47**	**3.78**	**3.19**	**2.92**	**3.48**	**3.30**	**2.64**
35-day T-bill yield	6.74	8.23	8.13	8.23	7.76	6.51	5.75
3-months	**3.96**	**3.88**	**5.35**	**5.50**	**4.78**	**5.03**	**4.59**
91-day T-bill yield	7.67	9.31	9.63	9.64	8.82	8.16	8.12
6-months	**5.02**	**4.97**	**5.85**	**6.08**	**5.32**	**5.35**	**5.09**
182-day T-bill yield	8.03	9.89	9.87	10.22	9.82	9.38	9.37
12-months	**5.77**	**6.11**	**5.81**	**5.90**	**5.50**	**6.03**	**6.16**
364-day T-bill yield	8.22	10.40	10.67	10.84	10.38	9.81	9.81
Overall Lending rates	**14.23**	**14.90**	**14.80**	**14.99**	**15.56**	**15.40**	**15.21**
Up to 1-year	15.72	15.60	14.23	15.06	16.23	15.98	15.77
2-3 years	11.89	13.75	15.32	15.18	15.13	15.43	15.87
Negotiated rates							
Deposits	6.79	6.40	8.77	8.79	8.78	8.84	8.61
Lending	9.36	12.92	11.05	11.33	10.29	10.32	10.33

Source: Commercial banks and Bank of Tanzania computations

Chart 2. The Margin Between 1-Year Lending Rate and 12-Month Deposit Rate (In Percent)

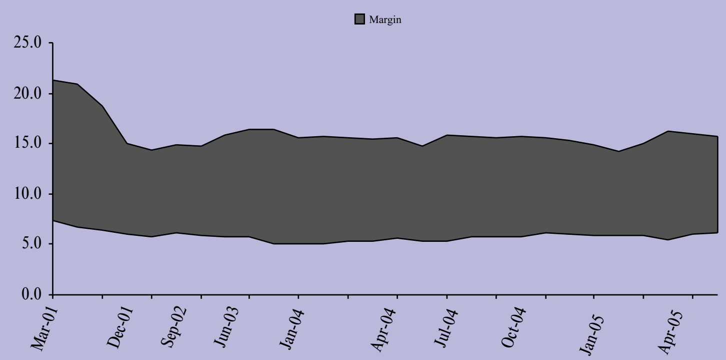

Chart 3. Credit to Private Sector and Net Claims on Government by Banks (Billions of TZS)

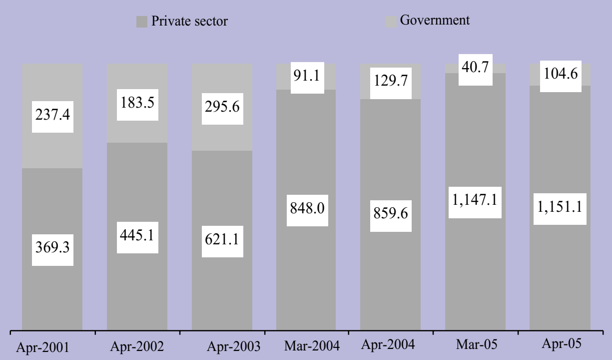

Table 2: Tanzania Monetary Survey

(Millions of TZS)

Item	Dec-00	Dec-01	Dec-02	Dec-03	Jun-04	Dec-04	Jan-05 Prov	Feb-05 Prov	Mar-05 Prov	Apr-05 Prov
FOREIGN ASSETS (NET)	842,755.0	1,209,820.4	1,558,627.1	2,182,072.0	2,134,182.7	2,379,909.3	2,408,352.9	2,482,058.1	2,462,099.7	2,357,490.8
Bank of Tanzania	435,928.0	686,927.5	1,022,247.6	1,503,460.3	1,468,873.6	1,715,285.8	1,697,242.3	1,795,501.5	1,748,415.8	1,736,266.2
Net International Reserves	435,928.0	686,927.5	1,022,247.6	1,503,460.3	1,468,873.6	1,715,285.8	1,697,242.3	1,795,501.5	1,748,415.8	1,736,266.2
Foreign Assets	782,669.9	1,059,767.9	1,492,748.5	2,167,408.1	2,079,549.7	2,394,759.1	2,416,676.3	2,424,583.8	2,347,122.1	2,338,385.6
Of which: Gold	25,352.6	29,013.3	26,926.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign Liabilities	346,741.9	372,840.3	470,501.0	663,947.8	610,676.1	679,473.3	719,434.0	629,082.2	598,706.2	602,119.4
Foreign Exchange Liabilities	86,480.3	60,795.1	78,454.8	208,727.6	150,444.3	239,810.3	262,970.6	181,148.3	156,031.7	157,742.2
Use of Fund Credit	260,261.6	312,045.3	392,046.2	455,220.2	460,231.8	439,663.0	456,463.4	447,933.9	442,674.6	444,377.3
Net Foreign Assets(DMBs)	406,827.0	522,892.9	536,379.6	678,611.8	665,309.1	664,623.5	711,110.5	686,556.6	713,683.9	621,224.6
Net Foreign Exchange	406,827.0	536,012.9	566,029.8	679,166.4	665,442.9	664,623.5	711,812.8	686,657.0	719,311.2	625,682.5
Foreign assets	410,990.3	539,062.6	571,572.6	685,488.3	669,296.2	683,665.6	726,807.8	699,942.8	741,383.7	642,920.4
Foreign Liabilities	4,163.2	3,049.7	5,542.9	6,321.9	3,853.4	19,042.1	14,995.0	13,285.8	22,072.4	17,238.0
Other Foreign Liabilities	0.0	13,120.0	29,650.2	554.6	133.7	0.0	702.3	100.4	5,627.4	4,457.8
Borrowing from abroad	0.0	1,810.1	1,146.1	554.6	133.7	0.0	702.3	100.4	5,627.4	4,457.8
Foreign Liabilities	0.0	11,310.0	28,504.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
MEDIUM TERM FOREIGN LIABILITIES	43,328.4	41,911.5	41,823.5	41,672.5	41,133.4	39,063.7	39,063.7	39,063.7	38,974.9	38,974.9
Bank of Tanzania	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9
Total Blocked Accounts	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9	32,458.9
Less: Other Foreign Liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
National Bank of Commerce	10,869.6	9,452.6	9,364.6	9,213.6	8,674.5	6,604.8	6,604.8	6,604.8	6,516.1	6,516.1
NBC Deposits Against EPA	10,869.6	9,452.6	9,364.6	9,213.6	8,674.5	6,604.8	6,604.8	6,604.8	6,516.1	6,516.1
DOMESTIC ASSETS (NET)	701,057.1	643,344.7	775,290.8	660,235.0	962,900.4	932,533.3	1,100,805.2	1,180,232.0	1,191,841.3	1,259,315.8
Domestic Credit	715,774.0	643,713.7	835,276.9	830,062.2	1,123,587.8	1,012,357.6	1,178,796.1	1,212,893.3	1,187,725.5	1,255,735.9
Claims on Government (net)	375,146.0	239,201.4	264,608.6	12,937.0	157,606.9	-47,719.7	61,685.6	80,373.5	40,615.4	104,593.7
Claims on Government BOT (net)	-2,527.3	-27,181.5	-69,209.3	-227,637.5	-126,865.1	-250,798.2	-142,745.5	-149,535.4	-204,513.8	-134,163.2
Claims on Government BOT	146,618.1	146,618.1	141,265.6	142,010.9	139,738.5	139,019.7	139,019.7	139,019.7	139,019.7	139,019.7
Government Deposits BOT	149,145.4	173,799.6	210,474.8	369,648.4	266,603.6	389,817.9	281,765.2	288,555.1	343,533.6	273,182.9
Claims on Government DMBs (net)	377,673.2	266,382.9	333,817.9	240,574.4	284,472.0	203,078.5	204,431.1	229,908.9	245,129.2	238,756.9
Claims on government DMBs	403,759.8	295,702.9	364,637.6	322,407.4	375,500.0	338,541.5	350,035.1	371,629.9	382,799.2	385,782.9
Deposits	26,086.5	29,320.0	30,819.8	81,833.0	91,028.0	135,463.0	145,604.0	141,721.0	137,670.0	147,026.0
Claims on other public sector	7,363.8	1,018.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cooperatives	4,383.5	2.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ind & Comm Parastatals	2,980.3	1,015.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Claims on the private sector	333,264.3	403,494.2	570,668.3	817,125.2	965,980.9	1,060,077.3	1,117,110.4	1,132,519.9	1,147,110.1	1,151,142.2
Other Items Net	-14,716.9	-369.0	-59,986.1	-169,827.1	-160,687.4	-79,824.3	-77,990.9	-32,661.3	4,115.8	3,579.9
M3: MONEY AND QUASI MONEY = M2+5	1,397,688.8	1,636,730.7	2,047,683.1	2,388,316.1	2,602,934.8	2,848,120.0	2,980,591.4	3,093,363.7	3,124,580.9	3,084,320.1
M2: BROAD MONEY = M1+3+4	1,093,610.9	1,233,667.0	1,507,386.5	1,721,109.9	1,856,326.3	2,050,886.0	2,089,035.9	2,200,544.9	2,212,298.9	2,229,853.1
M1: NARROW MONEY = 1+2	695,006.5	766,019.9	958,786.6	1,113,379.1	1,186,063.1	1,315,739.4	1,342,836.9	1,415,829.4	1,390,861.7	1,403,047.4
1.Currency in circulation (outside the Banking system)	392,404.2	411,638.9	495,445.6	553,045.8	590,441.0	664,148.0	636,932.2	632,085.7	645,241.4	650,298.8
Currency outside the Bank of Tanzania	443,050.9	456,205.6	546,615.4	606,592.5	644,009.5	727,785.3	715,023.4	711,833.3	728,358.8	724,792.7
Vault cash with DMBs	50,646.7	44,566.7	51,169.8	53,546.7	53,568.5	63,637.3	78,091.2	79,747.6	83,117.4	74,493.9
2.Demand Deposits	302,602.3	354,381.0	463,340.9	560,333.3	595,622.1	651,591.3	705,904.7	783,743.7	745,620.2	752,748.7
Quasi Money	702,682.3	870,710.8	1,088,896.5	1,274,937.0	1,416,871.7	1,532,380.7	1,637,754.4	1,677,534.4	1,733,719.2	1,681,272.7
3.Time deposits	170,051.6	208,101.4	223,898.7	230,958.8	269,132.9	276,396.4	287,300.0	318,741.5	342,297.6	342,175.1
4.Savings Deposits	228,552.8	259,545.7	324,701.2	376,771.9	401,130.3	458,750.2	458,898.9	465,974.0	479,139.7	484,630.6
5.Foreign currency deposits	304,077.9	403,063.7	540,296.5	667,206.2	746,608.5	797,234.1	891,555.5	892,818.9	912,281.9	854,467.0
VALUATION ACCOUNT (June 94 exch)	102,794.9	174,522.9	244,411.4	412,318.5	453,014.9	425,258.8	489,503.0	529,862.7	490,385.2	493,511.6
Memorandum Item:										
MO: RESERVE MONEY	556,430.9	584,369.1	695,701.2	783,309.0	800,399.6	967,776.0	960,140.8	1,001,798.5	977,283.9	993,432.3
Annual growth rates in percent										
Extended broad money (M3)	14.8	17.1	25.1	16.6	18.0	19.3	19.9	23.9	26.1	25.9
Broad money (M2)	12.5	12.8	22.2	14.2	19.1	19.2	20.0	26.3	25.9	28.9
Narrow money (M1)	9.9	10.2	25.2	16.1	20.9	18.2	20.2	27.5	26.8	28.3
Reserve money (M0)	9.4	5.0	19.1	12.6	25.1	23.5	24.8	34.7	21.7	23.4
The ratio of FCD to M3	21.8	24.6	26.4	27.9	28.7	28.0	29.9	28.9	29.2	27.7
M3 multiplier	2.5	2.8	2.9	3.0	3.3	2.9	3.1	3.1	3.2	3.1
M2 multiplier	2.0	2.1	2.2	2.2	2.3	2.1	2.2	2.2	2.3	2.2
TZS/USD exchange rate (end of period)	803.3	919.5	976.7	1,063.6	1,107.3	1,043.0	1,102.0	1,117.6	1,104.3	1,105.0
In millions of USD										
FCD	378.6	438.3	553.2	627.3	674.2	764.4	809.0	798.9	826.1	773.3
NIR	542.7	747.0	1,046.7	1,413.6	1,326.5	1,644.6	1,540.1	1,606.6	1,583.3	1,571.3
Gross official reserves	974.4	1,152.5	1,528.4	2,037.8	1,878.0	2,296.1	2,192.9	2,169.5	2,125.5	2,116.2
Gross official reserves in months of imports	3.7	4.4	5.8	7.8	7.2	8.8	8.4	8.3	8.1	8.1

Source: Bank of Tanzania

GLOSSARY

Average Inflation Rate

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

Currency in Circulation Outside Banks

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

Discount Rate

The rate of interest the Bank of Tanzania charges on loans it extends to commercial banks and government overdraft. It is derived from the weighted average yield of treasury bills of all maturities plus five-percentage points.

Exchange Rate

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

International Reserves, or Foreign Exchange Reserves

These consist of the financial assets under the control of the Central Bank that are readily available for direct financing of balance of payments imbalances.

M, Money Supply

The sum of currency in circulation outside banks and commercial banks 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).

M0, Monetary Base, Base Money, or Reserve Money

The Central Bank's liabilities in the form of (1) Currency in Circulation Outside Bank of Tanzania, and (2) Commercial banks' deposits with the Bank of Tanzania are reffered to, as Base money, the monetary base or reserve money.

M1, Narrow Money

It consists of currency in circulation outside banks and demand deposits.

M2, Broad Money

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

M3, Extended Broad Money

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

Nominal Exchange Rate

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

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 monetary policy.

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