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Medium Term Debt Management Strategy, 2019

The United Republic of Tanzania

Ministry of Finance

THE UNITED REPUBLIC OF TANZANIA

MINISTRY OF FINANCE AND PLANNING

MEDIUM TERM DEBT MANAGEMENT STRATEGY

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1.0 INTRODUCTION

1. The Government borrowing and debt management is guided by the Government Loans Guarantees and Grants Act Cap. 134 and its Regulations. The Act requires the Government to prepare the Medium Term Debt Management Strategy and Annual Borrowing Plan consistent with the overall fiscal framework for the purpose of ensuring Macroeconomic stability over the medium term. The main objectives of the Government Debt Management as stipulated in the Act are to ensure that the financing needs of the Government are met at a minimum cost and an acceptable level of risks.

2. In achieving the above objectives, the Government has developed the Medium-Term Debt Management Strategy (MTDS), which covers Central Government debt for a period of five (5) years (2019-2023). The MTDS is formulated using the MTDS Analytical Tool developed by the World Bank and IMF. The Tool assesses the cost and risk characteristics of the existing debt and alternative financing strategies. The 2018 MTDS was prepared by the Ministry of Finance and Planning (URT) in collaboration with the Bank of Tanzania and Ministry of Finance and Planning Zanzibar, with the technical assistance from the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI).

3. The formulation of the 2018 MTDS is aligned with the Five-Year Development Plan (FYDP II) whose theme is nurturing industrialization for economic transformation and Human development. As such, considerable public investments in key infrastructure projects continue to be of cardinal importance in order to spur growth and facilitate economic transformation. However, such public investments require reliable funding at low costs and a prudent degree of

risk to ensure that the new borrowing is within the overall fiscal and debt sustainability objectives.

4. The recent changes International financing landscape has necessitated access to non-concessional sources to complement the limited concessional financing. Nonetheless, the current Government policy is to maximize concessional financing and when necessary non concessional financing to projects with higher rate of economic returns.

   The 2018 MTDS provides guidance on the financing mix between and within external and domestic sources. Amongst the external sources, preference will be on semi concessional loans and where possible, fixed rate commercial loans aimed at mitigating interest rate risk. On the domestic sources, the strategy aims at lengthening maturities of domestic debt securities with a view to mitigating refinancing risks.

2.0 REVIEW OF EXISTING DEBT AS AT END JUNE 2018

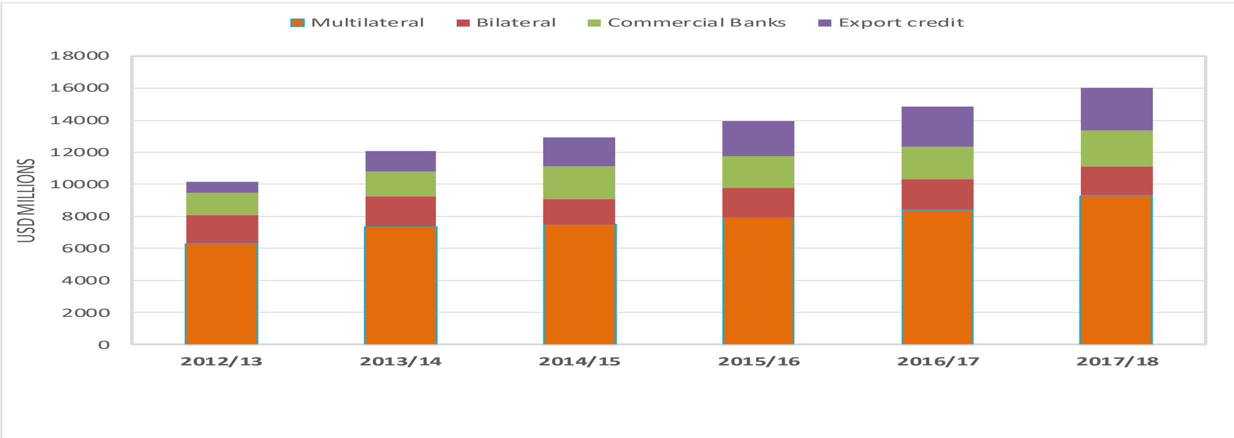
2.1 Evolution of Government Debt

5. The Central Government debt stock recorded at end June 2018 was USD 23,136.3 million, equivalent to 39.7 percent of GDP. The stock comprises USD 16,668.2 million external debt and USD 6,468.10 million domestic debt.

2.1.1 External Debt

6. As at end June 2018 external debt stock stood at TZS 36,041.34 billion equivalent to 27.9 percent of GDP. The proportion of debt from commercial and Export Credit sources, mainly non-concessional loans, increased to 30.7 percent of total debt as at end of June 2018 from 20.6 percent end of June 2017. During the same period, the proportion of concessional multilateral and bilateral debt declined from 62.0 percent and 17.4 percent to 58.0 percent and 11.3 percent, respectively. This development reflects the recent change in the financing landscape for the country whereby concessional sources of financing are gradually declining and are being replaced by non-concessional loans (**Chart 1**)

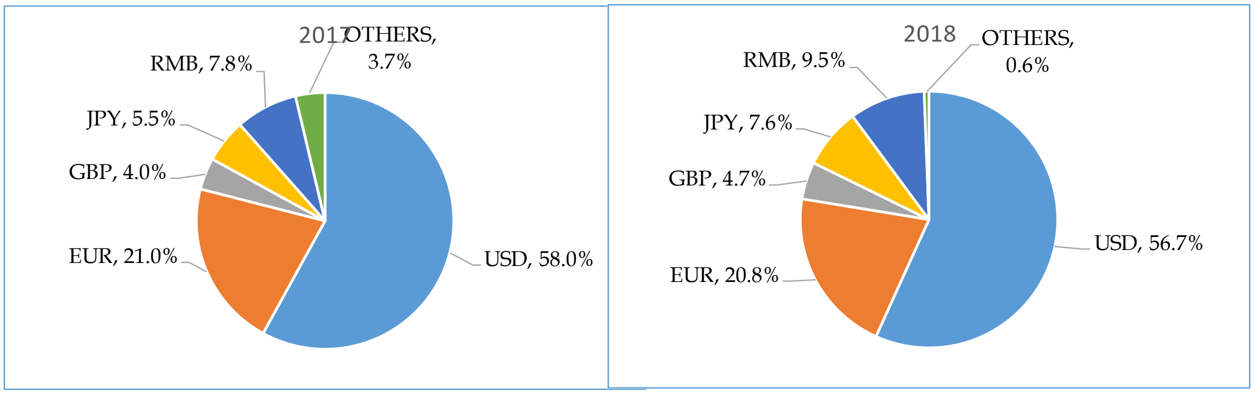
Chart 1: External Debt by Creditor Category as end June 2018



Source: Ministry of Finance and Planning

7. The currency composition of outstanding external public debt shows that a large proportion of debt was denominated in USD, at 56.7 percent in June 2018 compared to 58.0 percent recorded in June 2017. The proportion of debt denominated in Euro and Chinese Yuan was 20.1 percent and 9.5 percent, respectively (**Chart 2**). The total debt portfolio exposure to risk is mainly driven by USD and EUR exchange rate fluctuations.

Chart 2: External Debt by Currency Composition as end June 2018



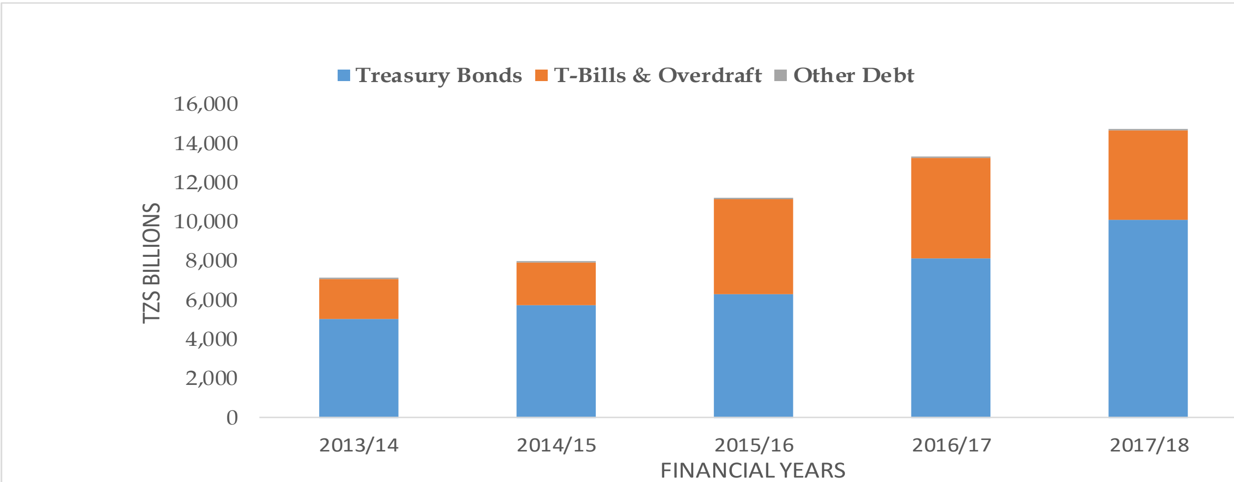
Source: Ministry of Finance and Planning

2.1.2 Domestic debt

8. As at end June, 2018 domestic debt stock[1] stood at TZS 14,732.45 billion, equivalent to 11.8 percent of GDP compared to TZS 13,947.4 billion, equivalent to 13 percent of GDP. Treasury bonds accounted for the largest share of domestic debt at 68.7 percent while Treasury bills including overdraft was 31.2 percent and other debts 0.1 percent (**Chart 3**).

[1] Government securities comprises of 364 days Treasury bills and Treasury bonds of different maturities (2, 5,7,10 and 15 Year), whereas overdraft facility is per Bank of Tanzania Act, with the limited period not exceeding 180 days.

Chart 3: Evolution of Domestic Debt



Source: Ministry of Finance and Planning

2.2 Implementation of the 2017 MTDS

Cost and Risk Indicators for Existing Debt as at end 2017/18

9. The 2018 MTDS focused on maximizing absorption of external semi-concessional source of funding while continuously reducing the growth of short-term domestic debt and lengthening maturity of domestic securities in order to reduce refinancing risk. The cost and risk characteristics of the debt portfolio as at the end of June 2018 are as summarized in **Table 1**.

Interest payment: The overall interest payment was 1.8 percent of GDP, of which external debt is 0.6 percent and domestic debt 1.2 percent.

The Weighted Average Interest Rate: The total debt portfolio weighted average interest rate was 4.4 percent. The weighted average interest rate for external debt was at 2.1 percent relatively low compared to 9.8 percent of domestic debt.

Average Time to Maturity: The average time to maturity for external debt portfolio was 14.2 percent while that of domestic was 5 percent. ATM of external debt profile has slightly declined compared to previous MTDS due to growth of the short tenure commercial debt while there is improvement in domestic portfolio. The ATM for the total debt portfolio is 11.5 years.

Debt Maturing in 1 year: As at the end of June 2018, the total debt stock maturing in a year was 10.7 percent. The share of domestic debt maturing in a year was 25.4 percent compared to 4.5 percent of external debt.

Interest Rate Risk: Fixed interest loans, mostly include debt owed to multilateral and bilateral, which accounted for a large proportional of external debt. About 18.2 percent of external debt is expected to be re-fixed within one year due to the relatively small proportional of variable–rated external loans in the debt portfolio, while domestic debt re-fixing within 1 year is 25.4 percent.

Foreign Exchange Risk: More than half of the total debt portfolio (70.4%) is exposed to exchange rate risk. The main exposure of the external debt portfolio is to the USD and EUR.

Table 1: Cost and risk indicators for existing debt as at end June 2018

Risk Indicators		External debt	Domestic debt	Total debt
Amount (in millions of TZS)		34,482,532.2	14,530,223.6	49,012,755.9
Amount (in millions of USD)		15,139.1	6,379.3	21,518.4
Nominal debt as % GDP		27.9	11.8	39.7
PV as % of GDP		18.0	11.8	29.8
Cost of debt	Interest payment as % GDP	0.6	1.2	1.8
	Weighted Av. IR (%)	2.1	9.8	4.4
Refinancing risk	ATM (years)	14.2	5.0	11.5
	Debt maturing in 1yr (% of total)	4.5	25.4	10.7
	Debt maturing in 1yr (% of GDP)	1.3	3.0	4.3
Interest rate risk	ATR (years)	13.9	5.0	11.2
	Debt refixing in 1yr (% of total)	18.2	25.4	20.3
	Fixed rate debt (% of total)	82.8	100.0	87.9
FX risk	FX debt (% of total debt)			70.4
	ST FX debt (% of reserves)			12.5

Source: Ministry of Finance and Planning

3.0 AN OVERVIEW OF THE ECONOMIC PERFORMANCE

3.1 Recent economic Development

10. In 2018, the Government through the National Bureau of Statistics in collaboration with other stakeholders conducted the GDP rebasing exercise. The aim was to ensure international comparability in accordance with the United Nations System of National Accounts (SNA) 1993 and the revised SNA 2008 version. The rebasing updated the national accounts base year from 2007 to 2015, to better reflect changes in the economy due to social, technological and economic transformations. Following the revisions, the nominal GDP value for the base year 2015 has been revised upward by 3.8 percent to TZS 94,346,316 million from TZS 90,854,208 million in 2007 base year. The increase is mainly due to the

improved coverage and measurement of gross output of previously underestimated activities.

11. The rebased real GDP recorded lower growth rates compared with 2007 base year. Nonetheless, Tanzania has enjoyed robust macroeconomic performance over the recent past. GDP grew by an average of 6.3 percent (post rebased) over the past decade compared with 6.6 percent (pre-rebased). In 2018, the growth rate was 7.0 using 2015 base year compared with a growth rate of 6.8 percent recorded in 2017. Real growth was almost maintained in the same pattern with small deviations.

12. Headline inflation eased to an average of 3.5 percent in the year ending December 2018 from 5.3 percent recorded in the year ending December 2017. The slowdown was driven by stability in food supply in the country and the Eastern and Southern Africa region, as well as implementation of prudent fiscal and monetary policies.

13. The stock of extended broad money supply (M3) increased by 4.5 percent in the year ending December 2018 compared to 8.0 percent recorded during the corresponding period in 2017. The slowdown in the growth of money supply was mainly driven by decline in the Net Foreign Assets (NFA) of the banking system. Annual growth of credit to the private sector continued to recover, reaching 7.5 percent in January 2019 compared with 2.1 percent registered in January 2018.

14. The growth of credit to private sector reflects sustained accommodative monetary policy pursued by the Bank of Tanzania, efforts by commercial banks to improve

credit risk management including use of credit reference system in loan approvals, as well as regulatory reforms by the Government to improve business environment through implementation of the recommendations of "Blueprint for Regulatory Reforms".

15. Budget implementation for 2018/19 continues to be based on resource availability. The Government continues with efforts towards domestic resource mobilization and continued to execute the budget on cash basis, while implementing expenditure control measures in a bid to make sure that the available funds are channelled to the most productive expenditures.

16. The current account deficit widened by 45.2 percent to USD 2,730.4 million in 2018 compared to USD 1,880.7 million in 2017. This was mainly explained by the increase in imports of goods and services that offset the improvements in exports of goods and services coupled with a surge in payments of primary income, particularly interest payments. Gross official reserves amounted to USD 5,044.6 million at the end of December 2018 sufficient to cover about 4.9 months of projected import of goods and services.(compare with IM)

3.2 Baseline Macroeconomic Projections and Assumptions (compare with DSA)

17. Macroeconomic assumptions are premised on successful implementation of Government policies under the FYDP II. Real GDP is projected at 7.1 percent in 2019 and maintain an upward trend above 7.0 percent per annum in the medium term. Inflation is projected to increase slightly to 4.0 percent by June 2020 and

stabilize at 4.5 percent in the medium term owing to uncertainty surrounding global oil prices and food production in the region.

18. Tax revenue is projected at 13.1 percent of GDP in 2019/20 and increase to annual average of 13.3 percent in the medium term. Fiscal deficit is projected to widen from 1.8 percent in 2017/18 to 2.3 percent of GDP in 2019/20 owing to Government commitment to execute infrastructure projects.

3.3 Potential factors to medium term outlook

(a) **General macroeconomic risks:** Projections depend on assumptions about several variables such as investment, interest rate, exchange rate, commodity prices, weather condition, money supply and revenue. Negative shock to any of those will have impact on other variables and affect projections.

(b) **Structural risks:** Existence of large informal and agricultural sector. Despite its increased contribution to GDP growth, agriculture still harbors large informal activities. This has a negative impact on the contribution of the sector to revenue collections. The ongoing efforts by the Government to modernize the agriculture sector under ASDP II will be sustained to maximize the contribution of agriculture to the economy.

(c) **Commercial borrowing risks:** (short term maturity, high interest rates, tied up loans and availability/accessibility). The declining trend in the flow of concessional loans and grants implies that the Government will have to rely more on commercial borrowing to finance priority projects. The Government is mindful of the risks associated with increased commercial borrowing due to higher costs of debt servicing.

(d) **Debt risks** – According to recent debt sustainability analysis, the Tanzania's debt remains at low risk of debt distress and that the debt outlook in the medium to long term is sustainable both under baseline and alternative scenarios.

4.0 POTENTIAL FINANCING SOURCES

19. In the medium term, a mix of concessional mostly from Export Credit Agencies (ECAs) and non-concessional loans remain the potential external sources of financing development. With regards to domestic debt financing, all maturities will be used with preference on the long-term bonds, particularly the 15 and 20 year Treasury bonds. This is premised on the assumption that the current investors' appetite towards long term government securities will persist in the medium term. In the medium term, the strategy assumes payments of the outstanding principal arrears of bilateral creditors starting from the sixth year to outer years pending the conclusion of bilateral agreements with the respective creditors with a view of securing HIPC comparable treatments.

20. The financing from domestic sources assumes that investors' appetite towards long term government securities will persist and that the financing will be through marketable instruments.

5.0 DEBT MANAGEMENT STRATEGIES

5.1 Alternative Financing Strategies

21. In the process of identifying an optimal medium term financing strategy, four (4) alternative borrowing strategies were considered in order to ensure Government financing need are met at lowest possible cost with prudent degree of risk. These strategies vary by the mix of borrowing between domestic and external sources, as well as composition of financing sources within domestic and external sources. Key financing terms such as maturity and grace periods, fixed and variable interest rates and currency are the elements considered in the mix of financing options. The alternative strategies were premised on the assumption that concessional sources will continue to decline as the country trends towards attainment of low middle income country status in the medium term.

5.1.2 Status quo (The Current Financing Strategy - S1)

22. This strategy represents the current status; it assumes continuation of the likely outturn of 2018/19 whereas 58 percent will be from external gross financing, before declining to 40 percent in the subsequent years. Commercial sources will contribute about 50 percent of total external financing and Treasury bills will be maintained at 67 percent of domestic financing.

5.1.3 Strategy 2 (S2) Domestic Debt Market Development:

23. Broadly, strategy (S2) assumes a gradual reduction in the share of short-term debt securities from 63.9 percent of the domestic borrowing in 2018/19 to 50.0 percent by 2022/23. A gradual increase in the proportion of domestic financing is assumed, from 42 percent in 2018/19 to about 65 percent by 2022/23. This

strategy aims at mitigating refinancing risk emanating from short term domestic borrowing and exchange rate risks associated with foreign currency fluctuations.

5.1.4 Strategy 3 (S3): Eurobond

24. The strategy intends to mitigate interest rate and refinancing risk by reducing commercial variable instrument and issuing a 10 year Eurobond at fixed interest rate. The strategy assumes issuance of Eurobond of about USD 750 million in 2020/21 and USD 800 million in 2022/23. Although the Eurobond may be favorable in raising substantial amounts at single issuance, this option may pose higher refinancing risks as it is bullet repayment.

5.1.5 Strategy 4 (S4): Increase Semi-Concessional/ECA

25. The strategy aims at reducing financing cost and risk in the medium term. It assumes an increase in the share of fixed rate semi-concessional borrowing and proportionate decline of variable rate commercial borrowing. In case of commercial borrowing, preference will be on fixed interest rate wherever possible.

5.1.6 Cost Risk Analysis of the Alternative Strategies

26. The cost and risk indicators under each strategy are assessed by comparing the outcomes under the baseline and the shock scenarios. In terms of cost, the Nominal debt and Present value of the debt as percent of GDP; Strategy 4 has low cost compared to other three strategies (**Table 2**). In addition, Strategy 4 has the lowest interest payment as percent of GDP and implied interest rate compared to other three strategies.

Refinancing risk

27. The results depict significant improvement on Average Time to Maturity for domestic debt portfolio across all three strategies compared to the current period (2018). Overall analysis indicates that Strategy 4 has the highest Average Time to Maturity compared to other alternative strategies (**Table 2**).

Market Risks – Interest Rate

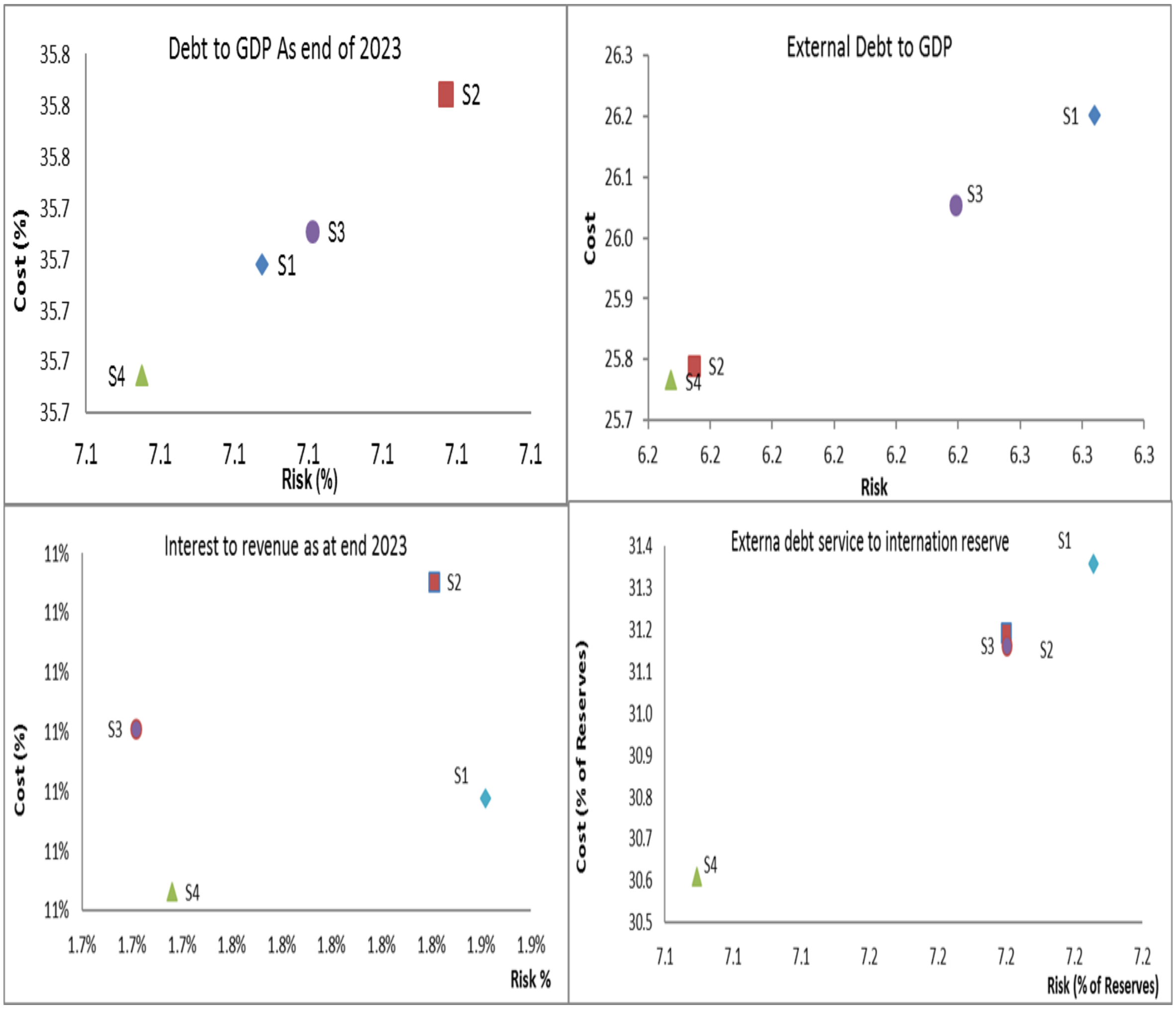
28. Fixed interest rate debt as a percentage of the total Central Government debt in Strategy 4 is projected at 88.6 percent as at end 2023, which is higher compared to other alternative strategies, implying low risk to the debt portfolio.

29. Strategy 4 has the highest Average Time to Re-fixing (ATR) compared to other alternative strategies.

Table 2: Cost and Risk Indicators of Alternative Strategies

Risk Indicators		2018	As at end 2023			
		Current	S1	S2	S3	S4
Nominal debt as % of GDP		39.7	35.57	35.69	35.72	35.51
Present value debt as % of GDP		29.8	27.76	28.06	28.53	27.64
Interest payment as % of GDP		1.8	1.75	1.83	1.84	1.70
Implied interest rate (%)		4.4	5.24	5.46	5.50	5.09
Refinancing risk	Debt maturing in 1yr (% of total)	10.7	12.87	11.35	10.57	12.68
	Debt maturing in 1yr (% of GDP)	4.3	4.58	4.05	3.78	4.50
	ATM External Portfolio (years)	14.2	12.83	12.84	12.36	13.38
	ATM Domestic Portfolio (years)	5.0	6.12	7.32	7.29	6.15
	ATM Total Portfolio (years)	11.5	11.08	11.26	10.97	11.49
Interest rate risk	ATR (years)	11.2	10.69	10.91	10.66	10.99
	Debt refixing in 1yr (% of total)	20.3	26.39	23.63	21.53	22.10
	Fixed rate debt (% of total)	87.9	84.10	85.43	87.02	88.58
FX risk	FX debt as % of total	70.4	71.84	69.19	70.52	71.75
	ST FX debt as % of reserves	12.5	20.17	19.74	18.36	19.40

Chart 4: Cost and Risk Trade-off of alternative financing Strategies



5.1.7 Proposed Strategy

30. Based on the analysis, Strategy 4 minimizes cost and most of the risks. Strategy 2 also supports the development of domestic debt market. Therefore, the Government will adopt a combination of Strategy 4 and Strategy 2.