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Monetary policy performance in Tanzania (1961-2014): a review

Abstract

This paper provides an overview of Tanzania's monetary policy reforms and the associated economic performance – since its independence in 1961. It also explores the challenges facing the performance of monetary policy. Tanzania has undergone a number of reforms since its independence – shifting from direct monetary policy to indirect monetary policy – for monetary targeting in the 1990s. Socialist macro-economic policies, coupled with domestic and global shocks in the 1970s, led to the economic crisis in the late 1970s to mid-1980s. While the indirect monetary targeting regime has delivered strong macroeconomic performance, demonstrated by the high growth rates and the low inflation, as in many other developing countries, the country's monetary policy has encountered a number of challenges. These include, amongst others, the Central Bank's pursuance of multiple objectives, the huge foreign-aid inflows and the global fuel and food price shocks.

Keywords: Tanzania, monetary policy, economic performance.

JEL Classification: E42, E52, E58.

Introduction

Monetary policy effectiveness is weaker in most low-income countries (LICs) compared to the high-income countries (HICs) (Mishra et al., 2010; Mishra and Montiel, 2012). The strength of monetary transmission mechanisms depends *inter alia* on: the independence of the central bank, the nation's financial landscape – including the financial linkages with international financial markets, the choice of monetary policy instruments, and the exchange rate regime.

However, most LICs have small and illiquid financial markets with limited integration with external markets. The financial sector is often small and dominated by less competitive banking sector. While most central banks have *de jure* independence, they lack *de facto* independence. These factors arguably tend to weaken the monetary transmission mechanisms in LICs (Mishra et al., 2010; Montiel et al., 2012). In addition, a number of studies have found weak transmission mechanisms in Tanzania (Monteil et al., 2012; Davoodi et al., 2013; Berg et al., 2013).

The Tanzanian economy – which attained political independence in 1961 – adopted socialist macroeconomic policies in 1967 (Nyerere, 1997). These policies coupled with a series of overlapping domestic and external shocks plunged the economy into an economic crisis in the late 1970s to mid-1980s (Mchallo, 1994). The associated poor performance is exhibited by the dismal to negative real GDP growth rates in the early 1980s; double-digit inflation; negative real interest rates; huge fiscal deficits, funded largely by domestic financing and the printing of money; an overvalued Tanzanian shilling; and a thriving parallel foreign exchange market – in addition to the rationing of foreign exchange (Ndulu,1987).

The initial IMF/WB attempts to move the State away from socialist policies in the early 1980s were not fully successful until 1986, when a comprehensive structural adjustment program was adopted aimed at enhancing the structural reforms and the restoration of macroeconomic stability (Ndulu, 1987). These reforms graduated into full implementation from the early to the mid-1990s: with liberalization of the interest rates, and exchange rates, as well as the transition to the indirect monetary policy of monetary targeting (Nord et al., 2009).

Prudent macroeconomic policies including Monetary policy have, since 1995, delivered remarkably strong macroeconomic performance: real GDP growth increased to an average of 7 per cent in the 2000s, from 3.7 per cent in 1995; and inflation declined to an average of 10 per cent in the 2000s, from 35 per cent in 1994 (BoT, 2011). The improvement in price stability was in part due to a deceleration in the growth of the money supply (M2) to an annual average of 17.5 per cent since 1995 compared to the annual average of 33 per cent a decade before (BoT, 2011).

Financial deepening decelerated in the late 1990s; but it picked up again in the 2000s – to match the levels achieved in the early 1990s. Domestic credit to the private sector, as a share of GDP, increased from just 6.65 per cent in 1995 to 16 per cent in 2010. However, while M2 as a share of GDP at 25 per cent in 2010 compares favorably to the 1995 share of GDP, it is much less than the annual average of 38 per cent a decade before 1995 (BoT, 2011).

The objective of this paper is therefore, to provide a detailed review of the monetary policy reforms and the associated economic performance in Tanzania since its independence in 1961. It also provides an overview of financial landscape, and highlights the challenges to the performance of monetary policy in

Tanzania. This is achieved by reviewing the relevant monetary policy literature in Tanzania. The analysis adopts data from various sources, in particular from Bank of Tanzania, World Bank and the IMF. The study extends the scope beyond the few studies that have explored the monetary policy performance.

The rest of this paper is divided into four (4) sections. Section 1 outlines the main features of Tanzania's monetary policy regime, and the associated economic performance between 1961 to date (2014).

The financial structure is presented in section 2. Section 3 highlights the challenges to the effective performance of monetary policy in Tanzania. The final section provides the conclusions reached by the study.

1. Monetary policy reforms and economic performance: 1961-2014

1.1. Monetary policy reforms and economic performance: 1961-1986. Tanzania (then Tanganyika) attained its political independence from British Colonial rule in 1961. The East Africa Currency board, which was set up in 1919, controlled the pre-independence monetary policy in Kenya, Uganda and Tanzania; and it continued to control money supply in three countries – until its final demise in 1966. This led to the setting up of the Bank of Tanzania in June 1966, by the Bank of Tanzania Act 1965, with the mandate of executing the primary roles of the Central bank (BoT, 2011).

The Arusha declaration[1] passed in 1967 emphasized the State ownership and nationalization of foreign-owned enterprises; and the production thereafter was to be controlled by the State. All the private banks were nationalized in February 1967 (Nyerere, 1977). In addition, interest rates from 1967 were administratively fixed throughout to the 1970s; for example, the deposit rate was fixed at 3.5% until 1973, when it was marginally raised to 4% until 1978.

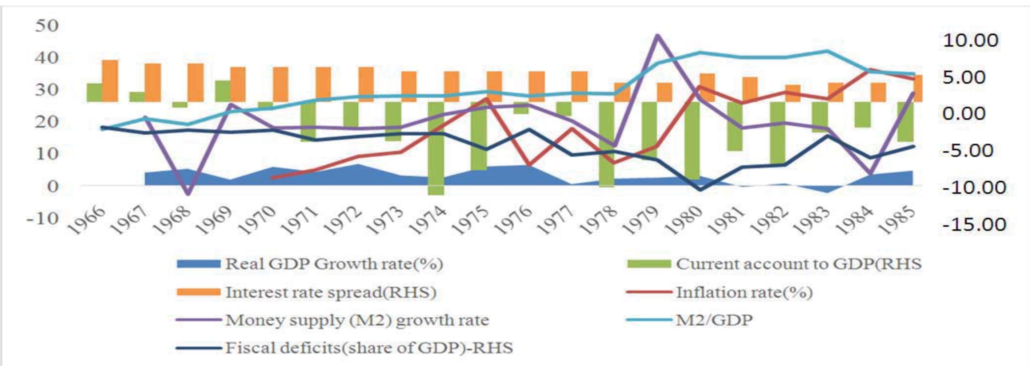
Nominal Treasury-bill rate remained fixed at 5% until 1977, adjusted subsequently to 6%, and thereafter maintained until 1986 (Odhiambo, 2011).

The Tanzanian economy, however, encountered a number of economic shocks – both domestic and external in the 1970s. These include: the oil crisis in 1973-74, coupled with drought; the 1974-75 global recession; the coffee-price boom 1975/76; and the second oil crisis in 1979 (Mchallo, 1994). The oil crisis led to the 350% rise in world prices; the recession led to a 10% reduction in world trade, and a significant reduction in export prices for most commodities; and the second oil crisis accelerated by 130% (Mchallo, 1994).

The domestic shocks include, but are not limited to the drought in 1973, the collapse of the East African Community in 1977, and the 1978/79 war with Uganda (Mchallo, 1994).

The prevailing policies, together with the overlapping shocks in late 1970s, plunged Tanzania into an economic crisis. This was manifested by the deteriorating economic performance in terms of worsening terms of trade, double-digit inflation, and slow growth rates (Ndulu, 1987). The growth, that was 5.8% in 1970, decelerated to negatives in the early 1980s; while the inflation rate, that was near 2%, accelerated to 30% in 1980. The fiscal deficits excluding grants that averaged 3.7% in the first five years after independence, increased to an average of 8.1% between 1977 and 1982 (BoT, 2011).

The latter is attributed to the excessive government borrowing and printing of money to bail out insolvent banks, which in part saw the money supply (broad) grow at an annual average of 24% over the same period (see Figure 1).



Source: Bank of Tanzania (Various annual issues).

Fig. 1. Selected economic indicators (1966-1985)

[1] A policy of Socialism and Self-reliance aimed at creating an egalitarian society focusing on poverty alleviation and guaranteeing social services to the citizens.

The early 1980s marked the beginning of negotiations with the IMF and the World Bank to transform the Tanzanian economy away from its socialist macro-economic policy failures to a free-market economy – by trade liberalization and privatization of the public sector (Ndulu, 1987).

The pre-1984 structural reform program were aimed at increasing the domestic resources, the restoration of the pre-crisis output, the reduction of fiscal deficits, the reduction in the money supply, and creating a sustainable external balance. Yet, they did not yield fruition, due to the failure in meeting the credit ceilings and lack of sufficient foreign inflows to finance its current account deficits (Mchalla, 1994; Ndulu, 1987).

In 1984, a partial devaluation and import liberalization were initiated; allowing individuals to import without declaring the source of their foreign exchange; and exporters were allowed to retain a share of their earnings (Ndulu, 1987).

The economic crisis persevered into the early of mid-1980s, recording negative real growth in the early 1980s, a worsening trade balance, high and increasing inflation, and widespread shortages as well as high parallel-market spreads (see Figure 1). Imports declined from 25 per cent of GDP in the 1970s to 12 per cent of GDP in 1983 and 1984; and exports declined from 17 per cent to 6 per cent of GDP in the same period (Maehle et al., 2013). Growth, however, that was negative in 1983, picked up to 3.4% and 4.6% in 1984 and 1985, respectively. Fiscal deficit – excluding grants that had been reduced from double digits in 1980 to 7% in 1985, as well the proportion funded through bank borrowing, reduced (see Figure 1; Ndulu, 1987).

Until 1985, monetary policy operated through direct controls of credit and interest rates; while exchange rates were administered. Government securities were issued directly to State-owned institutions; and fiscal policy prevailed predominantly over the monetary policy (Nord et al., 2009). The exchange rate remained practically unchanged, with the parallel market premium increasing from around 40 per cent in 1970, to about 250 per cent in 1980-1985, finally peaking at over 700 per cent in March 1986 (BoT, 2011; Maehle et al., 2013).

1.2. Monetary policy framework and economic performance: 1986-2014. A comprehensive Economic Recovery Programme (ERP) was agreed on with the IMF and the World Bank in 1986, aimed at accelerating structural reforms and restoring economic stability. In particular, the main aim was to liberalize the internal and external trade, unify the exchange rate, revive exports, stimulate domestic saving, and restore fiscal sustainability. A three-year Economic and Social Action Plan (ESAP) was adopted in 1989, in order to further efforts liberalization, as well as to include reforms in the banking sector, agricultural marketing, the parastatal sector, government administration, and the social sectors (Nord et al., 2009).

Financial reforms started in 1987, with interest rate adjustments designed to move real interest rates into positive territory. The enactment of the Banking and Financial Institution Act (BFIA) in 1991 set the basis for private banking. In 1991, there were only six deposit-taking financial institutions. With the entry of new private banks, BoT has since undertaken a number of further institutional and regulatory reforms including the set-up of the bank supervision department (Nord et al., 2009).

Following the adoption of the crawling-peg exchange-rate regime in 1986, the real-effective exchange-rate system was depreciated by more than 60% for two consecutive years between 1987 and 1989 (Nord et al., 2009). A Foreign-Exchange Rate Act was passed in 1992, allowing for the introduction of bureaux in the same year; and the weekly auction of foreign exchange in 1993 ultimately leading to the unification of the bureaux, commercial banks and an official exchange rate (BoT, 2011).

The Interbank Foreign Exchange Market (IFEM) subsequently replaced the auction markets in 1994. The exchange rate has since 1996 been allowed to float freely (BoT, Maehle et al., 2013).

The establishment of capital markets commenced in the 1990s, with the enactment of the Capital Market and Security Act, of 1994 – subsequently leading to the establishment and operationalization of the Dar es Salaam Stock Exchange and the interbank money market by 1998. Tanzania has retained the quantitative controls on the capital account (BoT, 2011).

The treasury bill auction was introduced in 1993, with treasury bills of shorter term (35 and 91 days) being introduced, and the longer-term treasury bills of 182 and 365 days being introduced in 1994. The positive real deposit-rate requirement, liquidity-asset ratio and the credit ceiling on lending to commercial banks were abolished in 1994, 1995 and 1996, respectively (Odhiambo, 2011). Two-year bonds were introduced in 1997; while the longer-term bonds of 5,7 and 10 years, respectively, were subsequently introduced in 2002 (BoT, 2011).

In addition, the 1990s became the epoch of monetary policy reform, moving to indirect monetary policy with the adoption of a monetary-targeting framework in 1993 (Nord et al., 2011). The reserve money and the broad money (M2)[1] policies became operational

[1] This is the sum of currency outside banks, demand deposits other than those of the central government, and the time-savings deposits; while M3 is M2 plus any foreign-currency deposits of resident sectors, other than the Central Government.

and intermediate targets, respectively. The BoT act was further amended in 1995, providing a narrowed mandate of price stability. The bank has since then used a number of indirect monetary policy instruments. The open market operations have been in operation since the first auction of government securities in 1993/94; and the BoT has since 1993 participated in the foreign exchange market, in an effort to stabilize the exchange rate.

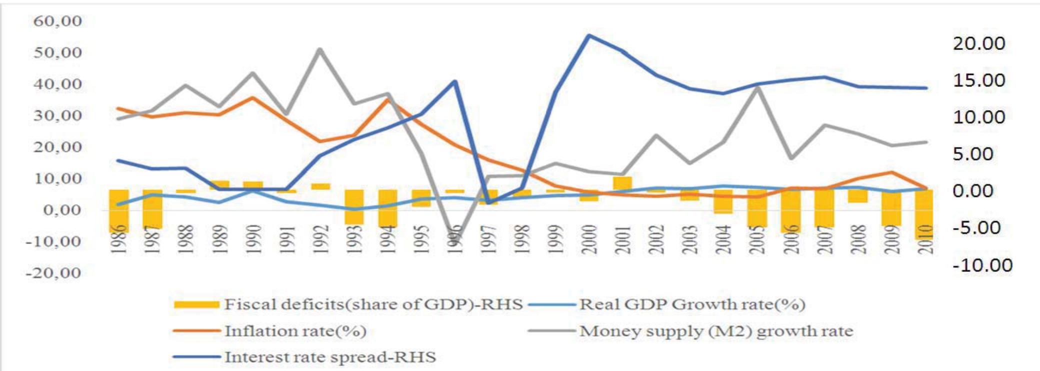
The standby credit discount window and Lombard facility were initiated in 2003. The minimum statutory requirements were introduced later in the 1990s; and these remained in place until 2009, when reserve requirements on central government deposits of 20% were introduced (BoT, 2011). Repurchase agreements (Repos) with maturity of 1-21 days were introduced in 2007. Moral suasion is also used as a monetary instrument. Monetary targets were set using end-period money stocks until 2006; and thereafter, an average reserve money policy was adopted (BoT, 2011).

In 2006, parliament approved the Bank of Tanzania Act, 2006, thereby enhancing the Central Bank's autonomy and political independence (Nord et al., 2009). While Tanzania is a member of (SADC), which aims to attain a monetary union by 2016; it has also signed the East African Monetary Union Protocol in November 2013, and has been the first country to ratify the protocol in June 2014 (BoT, 2014). The Protocol sets a 10-year road map for single currency; and all the countries are expected to implement the economic policies in line with the agreed performance criteria with effect from 2021.

Performance convergence criteria require a headline-inflation target of a maximum 8%, a fiscal deficit, including grants as a percentage of GDP of 3%, present value of public debt, as a per cent of GDP of an utmost 50%, and a foreign-exchange reserve cover of at least 4.5 months of import value. From 2024 onwards, a single currency was mandated to be adopted, provided that at least three partner States had met the performance target for at least three consecutive years (BoT, 2014).

The prudent economic policies, including the monetary policy adopted in the 1990s, have yielded tremendous macroeconomic performance. Real GDP growth rate nearly doubled, from 3.7% in 1995 to 7% in 2010; while inflation dwindled from 27% in 1995 to single digits for most of the 2000s (See Figure 2). The latter is attributed to the respective tight monetary policy, with the money supply (M2) growth rate easing to an annual average of 9.6% between 1996 and 2000 (BoT, 2011).

Current account deficit as a share of GDP also eased from double digits to single digits (BoT, 2011). However, the interest rate spread has since increased. The fiscal deficit, excluding grants, has increased from just 2% in 1995 to 6% in 2010. Domestic credit to the private sector, as a share of GDP, increased from just 6.65 per cent in 1995 to 16 per cent in 2010 (BoT, 2011). In addition, M2/GDP and M3/GDP, eased in the last 1990s and early 2000s; but it has since risen to levels of the early 1990s (see Figure 1).



Source: BoT statistics.

Fig. 2. Economic indicators (in per cent)

In the recent past, Tanzania has remained resilient to the global shocks that include the food and fuel price shocks of 2007/08, the financial crisis in 2007-09, and the recent food and fuel price shocks of 2011/12. The real GDP has averaged 7% over the past decade; and inflation, which had risen to 20% in December 2011, has since eased to single digits in 2014, owing to the subdued growth rate in money supply and private sector credit (IMF, 2014).

Despite the economic progress over the last two decades, Tanzania remains an LIC. According to the World Bank Indicators of 2011, it has a Real GNI *per capita* of 540 USD. It also exhibits many characteristics of LICs, and has a high percentage of rural population, high dependency on aid, its exports are dominated by commodity exports; and imports of goods and services account for a significant share of GDP (Berg et al., 2013).

2. Financial structure and the exchange rate regime.

The financial sector in Tanzania, which is composed of banking, insurance, microfinance and the pension sector, is dominated by the banking sector. As of March 2014, the banking sector assets, which stood at 37.9% of GDP, accounted for about 70 per cent of the total assets of the financial sector (BoT, 2014). The banking sector remains highly liquid, adequately capitalized, and profitable. In addition, according to the stress tests on the balance sheet, the banking sector is resilient to the shocks in exchange rate, interest rate, and credit (BoT, 2014).

The impressive financial and monetary developments from the early 1980s, notwithstanding, Tanzania's financial development remains nevertheless relatively low. As of 2012, M2 as a share of GDP – a common proxy of financial deepening – stood at 32% compared to the low-income country average of 45.8%, and bank credit to the private sector, as a share of GDP, remains comparatively low. In addition, the stocks traded, and the market capitalization indicators as a percentage of GDP compare unfavourably with those in the LICs and HICs (Berg et al., 2013).

In addition, according to the IMF *(AREAER* 2013), the Tanzanian exchange rate is classified as a floating exchange rate. The BoT, however, is a dominant player in the exchange rate market for liquidity management and smoothening of the exchange rate volatility. The BOT announces the amount to be sold in the market *via* the dealing system on a monthly basis (IMF, 2013).

According to the 2012, *de jure* Chinn Ito index of capital-account openness, Tanzania has enjoyed limited financial integration. For example, in 2012 the country's index was -1.75, compared with Burundi's -1.87 and Uganda's 2.42 (see Table 2). The Chinn-Ito index (*KAOPEN*) uses a maximum value of 2.5, for the most financially open economies, and a minimum of -1.9 for the least financially open. The findings in part reflect Tanzania's maintenance of quantitative controls on its capital account (Montiel et al., 2012). Table 2 shows the trends of the Chinn Ito index of capital account openness in Tanzania, as compared to some of the other Eastern Africa countries.

Table 2. Chinn Ito index (2008-2012)

Year	Tanzania	Uganda	Kenya	Rwanda	Burundi
2008	-1.17503	2.421764	1.110897	-1.17503	-1.87502
2009	-1.17503	2.421764	1.110897	-1.17503	-1.87502
2010	-1.17503	2.421764	1.110897	-0.91286	-1.87502
2011	-1.17503	2.421764	1.110897	-0.65068	-1.87502
2012	-1.17503	2.421764	1.110897	0.839695	-1.87502

Source: Chinn-Lto index database, 2012.

3. Challenges of monetary policy

Tanzania has an independent central bank[1]; it operates a floating exchange rate system; it maintains a closed-capital account[2]; and increasingly, it has a deepening level of bank competition (Nord et al., 2009). These factors in part indicate a substantial degree of monetary policy autonomy (Monteil et al., *2012*). The performance of monetary policy in any country remains unnerving, given that monetary policy is a short-term stabilization mechanism against domestic and external shocks. The challenges *inter alia* are institutional, technical and structural.

The primary role of the BoT is price stability. However, this should be attained while boosting economic growth and ensuring financial stability (Berg et al., 2013). As mentioned, the BoT continues to play a significant role in determining the path and stability of the exchange rate. In addition to the non-monetary roles, the Central Bank remains at the risk of an Impossible Trilemma[3] – especially in the awake of huge gas discoveries (BoT, 2011). The latter are frequently associated with huge capital inflows. According to the UNCTAD World Investment Report 2013, Tanzania has in the recent past attracted relatively high levels of FDI by volume in the EAC, and was only overtaken by Uganda in 2012.

In addition, Tanzania continues to receive significant levels of aid flows (IMF, 2014). These arguably lead to changes in reserve money being erratic (Batini et al., 2005). These inflows risk reducing the autonomy of the monetary policy, as they often increase foreign exchange reserves, which could be used

[1] Using the Central Bank Independence Unweighted (CBIU) and Central Bank Independence Index Weighted (CBIW) is the 34th most independent central bank of 88 banks, scoring 0.58 and 0.56, respectively. The index uses 0 for the lowest and 1 for the highest levels of independence, respectively.

[2] According to Rey (2013), Independent monetary policies are only possible if – and only if – the capital account is properly managed.

[3] It states that no country beyond the short run can simultaneously maintain an open account target-exchange rate and maintain an independent monetary policy.

for domestic financing. The associated fiscal expansion often leads to inflation and increased sterilization challenges, thereby leading to the crowding out of the private sector (Berg et al., 2010).

Aid flows also lead to short-run real movements in the exchange rate, and a shift of resources from the traded to the non-traded goods sector (Fielding and Gibson, 2012). It is also worth noting that Tanzania's financial sector is still relatively small, and is dominated by the banking industry. The domestic debt market is dominated by commercial banks, accounting for 48%, followed by the BoT at 28%, and pension funds at 16% (IMF, 2013). In addition, the liberalization of the banking sector has not led to a reduction in the interest rates. To some extent, this could be attributed to the low levels of bank competition (Mlachila et al., 2013).

Limited bank competition weakens the bank interest rate channel; and any policy changes may not be transmitted to the lending and deposit rates. The perseverance of high intermediation costs is partly due to the institutional and regulatory weakness, which inexorably heightens the financial intermediation costs and limits the transmission of monetary policy actions (Monteil et al., 2012). According to the IMF (2014), Tanzania faces institutional and regulatory weaknesses, which relate mainly to regulations, access to land, taxation and fees, corruption, labor laws, contract enforcement, and law and order.

According to Finscope (2013), Tanzania still has more than a quarter of its population excluded from financial access, with even a higher proportion in the rural areas at 83%. It also has a high proportion of the population who use non-bank financial services. The latter is consistent with the rapid growth in mobile money over the years, to over 50% of the population using mobile money by 2013. Also by September 2013, the mobile money transactions by value stood at USD 12.3 million, with 714,930,074 transactions since its launch (Di Cashi and Gidvani, 2014).

The rapid growth in mobile money, coupled with other financial innovations[1], tends improve financial efficiency; but it also tends to complicate the performance of monetary policy in the transitional period. This is often associated with the instability of money multiplier, velocity and money demand, as well as the tendency to alter the financial behavior of economic agents (Noyer, 2007; Nyamongo and Ndirangu, 2013).

Tanzania also has high levels of dollarization, with foreign deposits accounting for 33% of the total deposits, and net foreign assets accounting for 45% of M3, as of March 2012 (BoT, 2013). The dollarization in part explains the great substitution within M3 (Adam et al., 2010). Greater dollarization weakens the monetary autonomy, especially when the monetary target is that of M2, as it is in Tanzania. The foreign deposits and the excess reserves tend to be invested in government securities, as opposed to the private sector, ultimately weakening the bank credit-lending channel (Saxegaard, 2006).

Dollarized deposits increase the likelihood of asset booms; since they are susceptible to cross-border spillovers, as banks become even more reliant on parent groups and are increasingly exposed to uncertainty in the foreign currency markets (Szpunar and Głogowski, 2012). The Tanzanian economy also remains largely a cash economy, with currency in circulation accounting for about 23% of the broad money (M2) supply, which impairs the effectiveness of monetary policy (BoT, 2011).

The global environment in the recent past has made monetary policy in developing countries more complex. These economies, including that of Tanzania, have been susceptible to recent shocks: the food and fuel price shocks of 2007/08; the financial crisis of 2007/09; and the recent food and fuel price shocks of 2011/12 (Berg et al., 2013). The global shocks seem to have overlapped with the rising inflation in Tanzania (IMF, 2014).

In addition, the Tanzanian economy remains largely rural; and like many developing economies, it is likely to encounter dominant supply shocks over the demand shocks. The supply shocks tend to increase the probable conflict between output and inflation (Adam et al., 2010). Monetary targeting is tailored to control core inflation; but this may be flawed, given that the weight of food prices in the CPI accounts for 47 % (Berg et al., 2010). The targeting of core inflation, when food and fuel are dominant drivers of headline inflation, so often leads to unpredictable inflationary outcomes (Hammond et al., 2009).

Fiscal policy is essential for effective monetary policy. In the recent past, Tanzania has encountered rising fiscal deficits, which rose to 11.4% in 2010/11. The fiscal deficit, however, eased to 8.5% in 2013/14. The total public debt has, however, increased from 42.6% in 2010/11 to 47.1% by the end of June 2013. There is also a growing trend in the expenditure floats[2] to the tune of 1.3% of GDP in 2012/13 (IMF, 2014). The huge gas discoveries[3], and the expected huge investments in the medium term, together with the expectation of reducing aid dependency, indicate that the fiscal deficit is likely to increase. In such a case, the markets tend to perceive the outlook with

[1] In narrow sense, it is defined as solely to the introduction of new financial instruments (Nyamongo and Ndirangu, 2013).

[2] This refers to the payment orders issued in a given financial year, and subsequently drawn from the banking system during the next financial year.

[3] The estimates of discoveries indicate recoverable offshore gas resources of at least 24-26 trillion cubic feet and total development phase investment cost of USD 20-40 billion (IMF, 2014).

bulging fiscal problems, huge capital outflows and the associated inflation. Fiscal deficits tend to impact negatively on the economy's growth *via* the interest rate channel, as higher interest rates crowd out domestic investments.

Expansionary fiscal policies also tend to crowd out the monetary autonomy, at the peril of the Central Bank's credibility, at the extreme, forcing the Central Bank to abandon the price stability, and to adopt the role of keeping the interest rates low (Hammond et al., 2009).

As mentioned before, Tanzania is a member of SADC and EAC. It is committed to the convergence criteria of both regional monetary unions, which are not necessarily coordinated with each other. Tanzania is the first country to ratify the EAC monetary union protocol. The overlapping commitment will also put a strain on the limited BoT resources, human or otherwise (Morales, 2012). As of December 2013, Tanzania meets partially the EAC performance criteria indicators (BoT, 2014).

Furthermore, the transition to a monetary union in East Africa will eventually require much closer exchange rate management on the part of the BoT, in order to control and limit bilateral movements in the exchange. This will require the Central Banks's attention on its exchange rate target at some point during the transition to monetary union (Mutebile, 2010).

Conclusion

Following the set of the Bank of Tanzania in 1966, Tanzania adopted socialist macroeconomic policies underlined by the 1967 Ujaama policy. This paper provides a retrospective standpoint on the respective monetary policy reforms and the related macroeconomic performance, since independence. It also highlights the related challenges to the performance of monetary policy. Until 1985, fiscal policy prevailed predominantly over monetary policy, with heavy borrowing from the commercial banks, coupled with the excessive printing of money, in order to finance the deficits, as well as bail out illiquid banks. In addition, direct controls on interest rates, exchange rates and credit were maintained until the early 1990s. The socialist policies, coupled with domestic and external shocks in the 1970s, led the economy into an economic crisis in the late 1970s to early 1980s, with an acute shortage of foreign exchange, double-digit inflation, negative-growth rates, negative real-interest rates and a worsening balance of payments. The financial and economic reforms kick-started in 1986, and were actualized in the 1990s, with the full liberalization of interest rates, the exchange rate and the adoption of an indirect monetary policy. Tanzania, however, retained quantitative controls on the capital account, until recently, when it permitted freer movement of capital within the EAC. The *de jure* monetary framework has prevailed from the mid-1990s to date; and it has delivered remarkable results in terms of low inflation and high growth rates. However, the performance of monetary policy in Tanzania, as in other developing countries, has faced a number of challenges. These include the Central Bank's pursuance of multiple objectives, the huge foreign-aid inflows, and the global fuel and food price shocks.

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