

Persistent fluctuation and depreciation of the Tanzanian Shilling (TZS) versus the US Dollar (USD) and other major world currencies- TPSF Policy Brief, April 2011.

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Synopsis of this Policy Brief

It was back in August 2010 when TPSF organized a breakfast meeting on the challenges of persistent exchange rate fluctuations of the Tanzanian Shilling (TZS) versus the US Dollar (USD) and other major world currencies. It was in the midst of these persistent fluctuations and depreciating trend of the TZS that TPSF received numerous concerns aired by members of the business community regarding the negative impacts these were having on their businesses and on the country's investment climate.

The meeting was attended by many members of the business community and the wider public, and the Bank of Tanzania (BoT) Governor, Professor Benno Ndulu, was the guest speaker. Members of the business community had the chance to air their concerns and have their questions answered on the persistent fluctuations and depreciation of the TZS versus the USD and other major world currencies. They also had concerns regarding the increasing trend of 'dollarization' in the economy. There was a fruitful discussion whereby Private Sector stakeholders were able to ask their questions related to the meeting's topic and the Governor of Tanzania's Central Bank responded.

Eight months on from that breakfast meeting, TPSF is revisiting this important topic to see if trends have changed for the better for the business community and if not- to explore potential ways forward. As a lobbying and advocacy driven organization, TPSF has been following trends of the TZS versus major world currencies since the breakfast meeting, particularly versus the US Dollar, and the views of the business community. Focus of this brief is placed on the TZS's exchange rate versus the USD as the latter remains the major foreign currency which the former is traded against, and the one which the large section of the business community has been particularly impacted by. Within this analysis, the related issue of 'dollarization' is also looked at.

This policy brief will commence with a background section, followed by a section on current TZS versus USD trends, followed by a section on views from members of the business community, and conclude with a conclusion and ways forward section.

Background

TPSF organized the breakfast meeting in August 2010 in the midst of persistent fluctuations and depreciating trend of the TZS versus the USD and other major world currencies. TPSF had received numerous concerns aired by members of the business community regarding negative impacts the persistent fluctuations and depreciation of the TZS were having on their businesses and the investment climate in the country.

During the month of August 2010 the weighted average exchange rate of the TZS had depreciated to 1,445.23 TZS per USD from TZS 1,394.72 per USD recorded in the preceding month (Bank of Tanzania 2010). The rates in the foreign exchange bureaus were hovering around the 1500 TZS per one USD mark, demonstrating the depreciating trend of the TZS versus the USD in the market.

As the USD is the main foreign currency the TZS is traded against, businesses faced a number of impacts. The following are some of the impacts which members of the business community mentioned they had experienced due to the persistent fluctuations and depreciation of the TZS:

- Higher costs of production as most of these inputs are imported. These include raw materials, capital goods and machinery amongst other inputs. As Tanzania is a net importer, a depreciation of the TZS does more harm to importers.
- Unpredictable fluctuations made it difficult for manufacturers to predict their costs of production.
- Local consumption is affected as the relative value of the TZS decreases.
- In an attempt to accommodate the fluctuating exchange rates firms were compelled to plan for higher profit margins, resulting in the frequent changes in prices of commodities.
- Loss of customers due to reduced purchasing power.
- Reduced, fluctuating, and unpredictable profits which also significantly affect business confidence.

- Private investors who offer mortgage and project financing in USD worry about their clients' abilities to repay loans with the dramatic fluctuations of the TZS versus the USD.
- Dollarization of the economy.
- Loss of confidence in the country's legal tender.

In his talk, the BoT Governor, Professor Ndulu, attempted to ease off the concerns of the members of the business community. Professor Ndulu responded to the concerns by talking about some of the following points:

- Depreciation of the TZS can be beneficial for providers of export services such as entities in the tourism industry and transit trade, as well as net exporters of goods such as sisal, cotton, coffee, cashew nuts, tea, tobacco, flowers, fish, minerals, and manufactured exports, amongst others. Trends in Tanzania show that when the TZS depreciates net exporters gain therefore it isn't always a negative phenomenon.
- Most seasonal foreign currency inflows come in the second half of the calendar year and therefore the TZS should stabilize and even strengthen in the coming months.
- A large part of the urban population constitutes net importers who lose out when the TZS depreciates hence there is more noise when this occurs as opposed to the currency's appreciation.
- Depreciation causes the TZS value of Overseas Development Assistance (ODA) inflows to increase and since this is larger than imports it results in a net gain to the government.
- Market determination of the exchange rate is the best mechanism to prevent the currency from being overvalued which may adversely affect the country's trade competitiveness. Only occasionally does the BoT intervene in the Inter-bank Foreign Exchange Market to manage short term fluctuations and discourage speculative practices. The BoT does not have an exchange rate target and only essentially aims for price stability.
- Although the TZS consistently depreciated against the USD from November 2009 to July 2010, it had on average appreciated against the Sterling Pound during that period. The composite index of the three major currencies had reflected a general appreciation of the TZS during that period.
- On the issue of dollarization Professor Ndulu said the government would not restrict the number of USDs in the market as this would result in a black market with worse impacts.

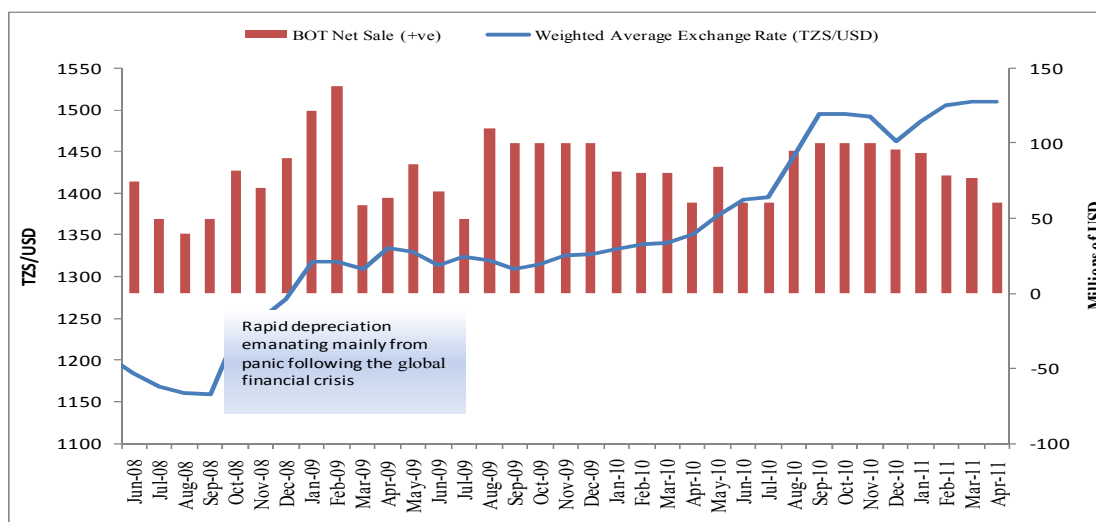
Current TZS vs. USD Trends

Eight months on since the breakfast meeting trends show that the TZS has continued to weaken against the USD. The March 2011 Bank of Tanzania Monthly Economic Review (Bank of Tanzania 2011, pg13) states that the TZS; “depreciated to an average of TZS 1,505.41 per USD in February 2011 from TZS 1,485.44 per USD in January 2011, and TZS 1,338.41 per USD recorded in the corresponding month a year before.” According to Business Monitor International’s Tanzania Business Forecast Report (Business Monitor International 2011, pg 19), the TZS reached “its historic low level of TZS 1,525.00/US\$ in the third quarter of the year.”

In commercial banks and bureau de changes in April 2011 one USD was sold at an average of over 1520 TZSs. Since August 2010 it was only for a brief period in December 2010 that the TZS made relatively significant gains vs. the USD. Furthermore, not only has the TZS weakened against the USD but it has also lost ground versus the Sterling Pound, the Euro, and the South African Rand. This shows that it isn’t always the case that a depreciation of the TZS versus one major world currency is offset by an appreciation of the TZS versus another major world currency. As Elinaza (2011, pg ii) states; “The shilling depreciation is still a big headache as there is no immediate measure to rescue it from sliding.”

In his recent newspaper article, Mghenyi (2011, pg13) states that; “Donor inflows, tourism receipts, seasonal earnings from mainly agricultural exports and Bank of Tanzania intervention were inadequate to strengthen the shilling for a considerable period.” In the same article Mghenyi (2011) mentions a trend that continues to be seen and that is rising importers demand for foreign exchange whilst its supply remains low. Other business writers like Mghenyi have also observed and highlighted the TZS’s relentless depreciation.

The graph below shows the trends of the TZS versus the USD from June 2008 to April 2011:



Source: Bank of Tanzania

The TZS’s depreciating trend has contributed to the increasing demand for foreign currency in the local banking system which creates further pressure on the already weakened TZS. More and more savers are inclined to keep savings in foreign currency and this is largely contributed the perceived strength of foreign currencies, especially the USD, and the fear of depreciation of the TZS (Mbani 2011). Together with this, many prices in the service sector (main in tourism and housing) are quoted in USDs, despite the government’s discouragement. This has led to the increasing ‘dollarization’ of the economy and has created an artificial demand for the USD which puts more pressure on the TZS. As the Country Treasurer of Barclays Bank Tanzania Limited, Aziz Chacha (cited in Mbani 2011, page 1) states; “Our (Tanzania’s) economy is highly dollarized”.

Views from Members of the Business Community

As part of our analysis, TPSF has been gathering views from members of the business community in order to find out what impact the TZS’s depreciation versus the USD is currently having on their businesses and what they feel should be done going forward.

Not surprisingly, in terms of the depreciation’s impact on businesses these have remained of the same nature as the time when TPSF conducted the breakfast meeting in August 2010. As these have been written in the background section of this brief there is no need to re list them. What clearly emerged from our research with members of the business community is that they feel something needs to be done by the government in order reverse the current trends of the TZS

depreciation. The pursuant paragraphs document some of the contributions given by members of the business community interviewed by TPSF.

Members of the business community said that being able to use both TZSs and USDs makes the TZS weaker. One of them said; “I don’t think anything in Tanzania should be billed, priced, paid for, or traded in foreign currency. There should be a policy which instructs that all foreign currency be converted into TZSs before one can buy any goods or services.” This argument suggests that its implementation will boost demand of the TZS and make its value stronger. Its effective implementation would require regulations to prohibit billings, payments, and trading in foreign currency, with the aim of halting further TZS depreciation versus the USD due to speculation and increasing demand for foreign currency. As the BoT discourages speculative practices, it would be wise for it to consider this idea as a policy to put in place.

Another widely shared view amongst members of the business community TPSF interviewed is that as much as the BoT insists on letting market forces determine the exchange rate, at times like this it should appropriately intervene in order to rescue the TZS from further demise. The success of intervention of such nature was seen briefly at one point during the first quarter of 2011. It was in describing this success that the Business Monitor International Tanzania Business Forecast Report (Business Monitor International 2011, page 19) states; “We believe that the shilling’s recent turnaround is less a result of a change in fundamentals and has more to do with increased central bank participation in the market.” The article backs this statement with the fact that the BoT released US\$ 3.8 million on its Interbank Foreign Exchange Market in the period between January to August 2010, and US\$8.2 million between September and December 2010. It was during that second period mentioned when the TZS’s decline was halted and its value appreciated.

The appreciation in value of the TZS makes imports relatively cheaper and as many Tanzanian businesses rely on imported inputs this is a good occurrence for them. Imported inputs such as machinery help industries in the manufacturing process and can be useful in other sectors which require machinery inputs such as the agricultural sector. The growth of these sectors in turn boosts output and GDP.

Another factor a number of members of the business community raised is in relation to Tanzania's mining sector. They feel that the way the mining sector is currently run significantly contributes to the weakening of the TZS as the majority of export earnings of mining companies are not repatriated to Tanzania. The business people feel that this issue should be addressed in the mining industry and that mining companies should be obliged to repatriate a significant percentage of their export earnings to Tanzania. The viewpoint is also shared by the Chairman of the Presidential Committee on the Mining Sector, Judge Mark Bomani, who recently said; "the Government should take immediate measures to rescue the shilling by ordering mining companies to repatriate to Tanzania at least seventy per cent of their export earnings." (Bomani cited in Makangale 2011, page 2).

The members of the business community who raised this issue of the mining sector said that the demand for USDs is greater than the supply due to the repatriation exemptions currently enjoyed by gold mining companies. Repatriating 70% of their earnings as recommended by the Presidential Committee two years ago would significantly increase the supply of USDs in the country and boost BoT reserves. Higher foreign exchange inflows would boost the value of the TZS versus the USD and make it cheaper to import business activity inputs such as machinery, spare parts, and petroleum, amongst others. This would be of considerable benefit to the Tanzanian economy. As the central authority for foreign exchange in the country, members of the business community felt the BoT should press for this issue of repatriation.

TPSF also spoke to members of the business community who are exporters. As stakeholders who are always impacted by changes in the value of the TZS they had a longer term outlook with regards to Tanzania's export strategy. They said that rather than relying on imported inputs whose price is always susceptible to variations in foreign exchange rates, Tanzania should focus more on importing inputs which would support exports. With this, there should be an export strategy which focuses on Tanzania's comparative and competitive advantages, with branding, the development of value chains, and capacity building as three of its key components. Exporters also said Tanzania must train its people to become self-sufficient and develop its industries so that it can produce what it needs and have competitive exports. Policies with focus on the use of local raw materials in production should be designed and implemented, and this would go a long way in easing the demand for imports.

Exporters felt that a good exports strategy would help Tanzania's development as at present the country still imports many things which can potentially be produced locally such as milk and juice. The more Tanzania can produce within the country for exporting purposes the more likely it is to gain in terms of the exchange rate movements. As the country is still rather dependent on international trade for local consumption, its people indirectly become poorer when the value of the TZS depreciates, which also increases the costs of living and production. As part of an export strategy a way needs to be devised to assist local producers who use local raw materials. A supportive business environment is required for local producers which would help strengthen the economy and hence boost the value of the TZS.

Another view from members of the business community was with regards to the need for a good investment climate in Tanzania. Members of the business community were of the view that strong inflows of foreign currency into Tanzania's capital and financial accounts would offset the impact of depreciation from the current account. A good investment climate is required in the country in order to provide an incentive to foreign investors to invest in Tanzania. As part of its strategy for development the government needs to consider this factor in relation to how it deals with the exchange rate situation.

Members of the business community were also skeptical of dependence on Overseas Development Assistance (ODA) in terms of its link to the exchange rate patterns and gains as the level of ODA is not always constant. Donors recently aired their concerns with regards to the slow pace of economic and political reforms in Tanzania and made their intentions clear with respect to releasing funds. The clear message from members of the business community is that Tanzania should not be dependent on gains made from ODA following depreciation of the TZS.

Conclusion and Ways Forward

It is clear from this brief that fluctuation and depreciation of the TZS versus the USD and other major currencies does have significantly negative impacts on Tanzania's business community (the majority of who are net importers) and the overall economy. It is also clear that some of the factors which are relied on to mitigate the circumstances following a depreciation of the TZS, such as higher exports of primary commodities such as coffee, are not real safety nets as they will not have the required offsetting impact.

What has emerged from the entire analysis in a nutshell is that work needs to be done in order to come up with better ways and policies of mitigating factors related to the fluctuation and depreciation of the TZS versus the USD and other major world currencies. A supportive business environment for both local and overseas investors and work on the issue of dollarization are both crucial components of the way forward. Without any action from the BoT the TZS is likely to continue to weaken versus currencies of major trading partners, and this will result in further negative impacts on the business community in Tanzania.

From TPSF's point of view the government needs to give the views of the business community serious consideration and devise ways of working on them. They should involve the Private Sector in this work and we envision and hope that this will result in constructive and mutually beneficial Public Private Dialogue.

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