

**EXECUTIVE
BOARD
MEETING**

SM/18/260

Correction 1

November 15, 2018

To: Members of the Executive Board

From: The Secretary

Subject: **United Republic of Tanzania—Financial System Stability Assessment**

Board Action: The attached correction to SM/18/260 (11/5/18) has been provided by the staff:

**Factual Errors Not
Affecting the
Presentation of
Staff's Analysis or
Views**

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Questions:

Mr. Catalan, MCM (ext. 34372)

Banks' Resilience to Stress

20. Six banks are currently undercapitalized (Table 6). 37 out of 45 banks exhibit varying degrees of under-provisioning at end-2017. Correcting for this reduces the total capital ratio of the system by 2.1 percentage points, to 18.1 percent, and the total capital ratios of six banks representing 10 percent of assets in the system fall below the 12 percent regulatory threshold.

Baseline scenario

21. The system-wide capital ratio rises to 18.9 percent, driven by profitability of Peer 1 private banks, although the solvency positions of Peer 2–3 private banks and government-owned banks decline and five additional banks become undercapitalized. NPL ratios (before write-offs) are projected to remain at current levels over the next three years. Due to widespread NPL and pre-impairment profitability problems, the capital ratios of many banks decline over time. The five additional banks, which become undercapitalized represent 1.8 percent of banking assets.⁹ Overall, under the baseline, 11 banks representing 12.8 percent of assets in the system are undercapitalized at some point during the period 2018–20.

The banking system would exhibit significant fragility under tail risk conditions

22. Solvency stress tests reveal that 22 banks, representing 32 percent of banking assets would become undercapitalized in the tail risk scenario. The combined effects of sharply declining real GDP growth, rising interest rates, and depreciation of the T Sh reduce banks' profitability and capital ratios, mostly through their impact on credit losses and net interest income—direct gains/losses due to T Sh depreciation play only a minor role as net open FX positions are small (Figure 9). NPL ratios rise from 10.4 percent to 22.7 percent, driven by the economic slowdown.¹⁰ Sharply rising NPLs also drive down net interest incomes of most banks which also weighs significantly on bank solvency.

23. Interbank exposures exacerbate system-wide vulnerabilities. Contagion analysis reveals that bank failures could propagate through the system. In the solvency tests described above, nine of the ~~32~~ 22 undercapitalized banks exhibit negative capital under the tail risk scenario. Defaults by these banks would trigger knock-on effects on other banks, with five additional banks representing 5½ percent of system assets also ending up with negative capital and an additional bank (1½ percent of system assets) becoming undercapitalized (Figure 10).

⁹ Any potential increase in NPL ratios would exacerbate the undercapitalization problem under the baseline scenario. The capital ratio of one bank which is currently undercapitalized after adjustment for under-provisioning, increases over time in the baseline scenario, and is above the 12 percent threshold by 2020. Counting this bank as undercapitalized increases the total number of undercapitalized banks in the baseline to 11, and their share of assets in the system is 12.8 percent.

¹⁰ The slowdown in real GDP growth accounts for about 90 percent of the increase in the aggregate NPL ratio over the period 2018–20 in the tail risk scenario—the interest rate and T Sh depreciation effects on NPL ratios are estimated to be small.