INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/203

TUNISIA

July 2017

FIRST REVIEW UNDER THE EXTENDED FUND FACILITY, REQUEST FOR WAIVERS OF NONOBSERVANCE OF PERFORMANCE CRITERIA AND REPHASING OF ACCESS—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR TUNISIA

In the context of the First Review Under the Extended Fund Facility, Request for Waivers of Nonobservance of Performance Criteria and Rephasing of Access, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 12, 2017, following discussions that ended on April 18, 2017, with the officials of Tunisia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on May 30, 2017.
- A **Statement by the Executive Director** for Tunisia.

The documents listed below have been or will be separately released:

Letter of Intent sent to the IMF by the authorities of Tunisia*
Memorandum of Economic and Financial Policies by the authorities of Tunisia*
Technical Memorandum of Understanding*
*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release No. 17/217
FOR IMMEDIATE RELEASE
June 12, 2017

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review under the Extended Fund Facility (EFF) Arrangement with Tunisia

- The government's reform program supported by the EFF aims at reducing the fiscal deficit to stabilize public debt below 70 percent of GDP by 2020 while raising investment and social spending.
- Monetary tightening and greater exchange rate flexibility will help contain inflation, improve competitiveness, and preserve international reserves.
- To achieve a growth-friendly and socially-conscious fiscal consolidation, it will be critical to implement the 2018 tax package and the new Large Taxpayers Unit, which will both increase tax fairness.

On June 12, 2017, the Executive Board of the International Monetary Fund (IMF) completed the first review of Tunisia's economic program supported by an arrangement under the Extended Fund Facility (EFF). The completion of the review allows the authorities to draw the equivalent of SDR 227.2917 million (about US$314.4 million), bringing total disbursements under the arrangement to the equivalent of SDR 454.5837 million (about US$628.8 million).

The four-year EFF arrangement in the amount of SDR 2.045625 billion (about US2.83 billion, 375 percent of Tunisia's quota) was approved by the Executive Board on May 20, 2016 (see Press Release No. 16/238). The government's reform program supported by the EFF aims at reducing the fiscal deficit to stabilize public debt below 70 percent of GDP by 2020 while raising investment and social spending, and more exchange rate flexibility combined with maintaining inflation below 4 percent. It also aims at ensuring pension sustainability and better protecting vulnerable households, as well as accelerating reforms to improve governance and foster private sector-led, job-creating growth. In completing the review, the Executive Board approved the authorities' request for waivers for non-observance of performance criteria on net international reserves, net domestic assets, and the primary fiscal deficit. The Executive Board also approved the authorities' request for re-phasing of remaining access into six semi-annual installments.

Following the Executive Board discussion on Tunisia, Mr. Mitsuhiro Furusawa, Deputy Managing Director, and Acting Chair, said:

"The Tunisian authorities remain firmly committed to macroeconomic stability and sustainable increases in youth employment and improvement in standards of living of Tunisia's population. They plan to intensify their policy effort to overcome slower growth and delays in policy implementation. Their fiscal plans aim to achieve gradual debt reduction and increase spending on investment and social programs. Continued tightening of monetary policy and exchange rate flexibility will help contain inflation, improve competitiveness, and preserve international reserves. Reforms to restructure public banks, enhance governance, and improve the business climate will strengthen the foundation for inclusive growth and strong job creation.

"To achieve a growth-friendly and socially-conscious fiscal consolidation, it will be critical to adopt and implement the 2018 tax package and make the new Large Taxpayers Unit operational, which will increase revenues as well as fairness. The authorities intend to re-apply the fuel price adjustment mechanism to avoid regressive subsidies, move ahead quickly with civil service reform to improve service quality and reduce the wage bill, and enact comprehensive reforms to ensure pension sustainability and establish an effective safety net for vulnerable households. There is also room for improving the management of public enterprises.

"The Central Bank of Tunisia recently increased its policy interest rate. Further hikes may be warranted if inflationary pressures persist. The implementation of the FX auction mechanism will improve the operation and transparency of the FX market.

"The authorities have made important progress in restructuring public banks. Next steps include changes in the regulatory and legal frameworks to support the reduction of non-performing loans. It will also be important to implement further bank supervision measures, such as the start of the resolution committee's operations.

"The authorities are committed to enhancing governance and improving the business environment. The establishment of the high anti-corruption authority, new institutions such as the planned one-stop shop for investors, and Tunisia's participation in the G20 Compact with Africa will support these objectives. The continued support of the donor community for Tunisia's reform efforts remains crucial."

Tunisia: Selected Economic and Financial Indicators, 2015–18 1/

	2015	2016		2017		2018
	Prel.	Prog.	Proj.	Prog.	Proj.	Proj.
Production and income (percent change)						
Real GDP	1.1	2.0	1.0	3.0	2.3	3.0
GDP deflator	3.6	5.1	5.7	3.3	5.3	4.2
Consumer price index (CPI), average	4.9	3.9	3.7	3.9	4.5	4.4
Consumer price index (CPI), end of period	4.1	4.0	4.2	3.9	4.5	4.1
Gross national savings (in percent of GDP)	12.5	14.1	13.5	15.3	13.6	15.1
Gross investment (in percent of GDP)	21.4	21.8	22.5	22.3	22.1	23.2
Central government (percent of GDP, unless otherwise indicated) 1/						
Total revenue (excluding grants)	23.2	23.9	22.6	24.1	24.0	24.5
Total expenditure and net lending	28.8	28.5	28.7	28.0	30.2	30.1
Wage Bill 2/	13.6	14.1	14.5	13.8	14.1	14.8
Social expenditures 3/	1.6	1.7	1.6	1.6	1.6	1.9
Central government overall balance (including grants)	-5.3	-4.4	-5.9	-3.5	-5.9	-5.4
Structural fiscal balance 4/	-4.6	-4.0	-5.6	-3.3	-6.1	-4.3
Central government debt (foreign and domestic)	57.2	54.6	62.9	54.5	69.1	72.1
Foreign currency public debt (percent of total debt)	61.7	68.0	64.1	68.6	67.8	70.6
Total external debt						
External debt (in billions of US$)	27.0	29.3	27.0	30.7	29.0	30.6
External debt (in percent of GDP)	64.9	69.0	70.0	71.4	76.9	80.7
Debt service ratio (percent of exports of GNFS)	10.1	12.8	12.2	16.7	18.4	16.2
Money and credit (percent change)						
Credit to the economy	6.2	7.1	9.7	7.3	7.2	7.4
Broad money (M3 of the financial system)	5.3	6.5	8.1	6.8	10.0	8.3
Velocity of circulation (GDP/M2)	1.4	1.5	1.4	1.5	1.4	1.4
External sector (percent change)						
Exports of goods, f.o.b. (in billions of US$)	-15.9	-2.6	-3.6	5.8	-1.5	0.4
Imports of goods, f.o.b. (in billions of US$)	-18.4	-4.3	-3.8	3.9	-2.6	-0.6
Exports of goods, f.o.b. (volume)	-2.8	1.6	0.2	5.5	2.4	6.8
Import of goods, f.o.b. (volume)	-2.5	3.5	2.3	2.1	4.5	4.8
Trade balance (in percent of GDP)	-11.7	-10.4	-11.4	-10.1	-11.3	-11.1
Current account (in percent of GDP)	-8.9	-7.7	-9.0	-7.0	-8.5	-8.1
Foreign direct investment, net (in percent of GDP)	2.6	2.1	2.0	2.2	2.4	2.8
Terms of trade (- = deterioration)	3.3	3.7	2.3	-1.5	3.1	-0.9
Official reserves						
Gross official reserves (in billions of US$, e.o.p)	7.4	8.3	5.9	8.5	7.3	8.2
In months of next year's imports of goods and services, c.i.f.	4.1	4.6	3.4	4.5	4.3	4.6
Memorandum items:						
GDP at current prices (TD millions)	84,656	91,658	90,376	97,495	97,397	104,603
GDP at current prices (in billions of US$)	43.2	44.0	42.1	44.4	39.9	39.3

Sources: Tunisian authorities; and IMF staff estimates and projections.

1/ Excludes social security accounts, public enterprises, and local governments.

2/ The 2018 wage bill includes a cost of 0.6 percent of GDP for the voluntary departure packages.

3/ Public capital expenditures of key ministries and social transfers and programs.

4/ Excludes one-off revenues and costs, and corrects for the GDP cycle.

INTERNATIONAL MONETARY FUND

TUNISIA

May 30, 2017

FIRST REVIEW UNDER THE EXTENDED FUND FACILITY, REQUEST FOR WAIVERS OF NONOBSERVANCE OF PERFORMANCE CRITERIA AND REPHASING OF ACCESS

EXECUTIVE SUMMARY

A fragile economy in a complex socio-political environment. Tunisia's political transition advanced, but social discontent remains elevated. After almost stagnating over 2015–16, growth will pick up in 2017 to 2.3 percent helped by tourism and phosphates. Structural deficiencies, an overvalued real exchange rate and weak confidence after the 2015 attacks continue to weigh on investment. Exogenous shocks and policy slippages contributed to widen the current account deficit by more than 10 percent of GDP in the first quarter of 2017. The dinar depreciated by 23 percent in nominal effective terms since end-2015; this and a broad-based rise in prices led the Central Bank to increase its policy interest rate by 75 bps to 5 percent over the last month to contain inflation below 5 percent in 2017.

Strong actions to correct slippages will help reach broad EFF objectives. Most Quantitative Performance Criteria (QPCs) for end-December 2016 were missed and all Structural Benchmarks (SBs) through March 2017 were delayed. Since coming into power in August 2016, the government of national unity recovered ground. Its ambitious yet feasible agenda includes (i) reducing the fiscal deficit to 3 percent of GDP by 2020 to stabilize public debt below 70 percent of GDP (20 percentage points above the initial target due to weaker growth, stronger dinar depreciation, and higher deficits), while raising investment and social spending; (ii) increasing exchange rate flexibility combined with maintaining inflation below 4 percent through improved monetary transmission channels; (iii) ensuring pension sustainability and better protecting the vulnerable; and (iv) accelerating reforms to improve governance and foster private sector-led, job-creating growth. Most delayed SBs, including on private sector legislation, performance contracts for public banks, the civil service strategy, and the large taxpayers unit are now completed. The remaining ones will be achieved by end-2017.

In light of the recently improved program performance and the authorities' commitment to strong corrective actions, staff recommends the completion of the EFF review and supports the authorities' request for rephasing of access and waivers of nonobservance of end-December QPCs for the targets on NIR, NDA, and the primary fiscal deficit.

Approved By
Daniela Gressani and Vitaliy Kramarenko

Discussions took place in Tunis during October 27-November 10, 2016, and April 7–18, 2017. The mission team comprised Björn Rother (head), Gomez Agou, Andrea Gamba, Maria Mendez (MCD), Amr Hosny (SPR), and Franck Dupont (MCM). Robert Blotevogel (Resident Representative), Adnen Lassoued (local economist), and Monia Saadaoui (OED) participated in discussions. Staff met with the Head of Government, the Governor of the Central Bank, the Minister of Finance, the Minister of Development and International Cooperation, the Minister of Energy, the Minister of Social Affairs, the Ministers charged of Economic and Social Affairs at the Office of the Head of Government, and other senior officials, representatives of the workers' union, the corporate and banking sector, the donor community, and parliament.

Greg Auclair, Samira Kalla, Harifetra Prevost, and Geraldine Cruz provided excellent assistance.

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ECONOMIC IMBALANCES IN A TOUGH ENVIRONMENT

1. **A fragile socio-political environment has taken a toll on reform progress.** Reform efforts slowed and fiscal slippages emerged in 2016 before the new government of national unity took office in August 2016. While starting with an ambitious economic strategy and broad parliamentary support (*Pacte de Carthage*), the limits of the authorities' margin of manoeuver came to the fore in December 2016: its efforts to delay wage increases and raise taxation of liberal professions were derailed by strong opposition (Annex III). Strikes and street protests have continued and intensified into 2017, notably in the interior regions plagued by high unemployment. Conflicts in the Middle Eastern region continue to weigh on security.

2. **The economy remained weak in 2016 and early 2017** (Figure 1)**.**

- Growth disappointed again in 2016, after an already weak 2015. It picked up to 2.1 percent in the first quarter of 2017, supported by tourism and phosphates. Foreign Direct Investment (FDI) reached a new low of 2 percent of GDP in 2016, total unemployment remained elevated at 15 percent in March 2017 (double this share for the youth and women), and the informal economy accounted for about half of total activity.[1]

- Headline inflation was contained below 4 percent in 2016 due to the weak economy and a good season in important agricultural sectors. Core inflation increased beyond 5 percent in March 2017, fueled by exchange rate depreciation, wage increases and credit growth that accelerated to about 10 percent at end-2016, mainly for working capital and consumption.

- The external current account deficit further widened exceeding an annualized 10 percent of GDP in the first quarter of 2017. Gross international reserves declined to US$5.8 billion at end-March, covering 3.4 months of imports.

- The dinar depreciated by 18 percent in nominal effective terms between May 2016 (program approval) and April 2017. The most volatile episodes occurred in mid-2016 and since April 2017, when the interbank market froze due to political uncertainties and strong FX demand for energy imports.

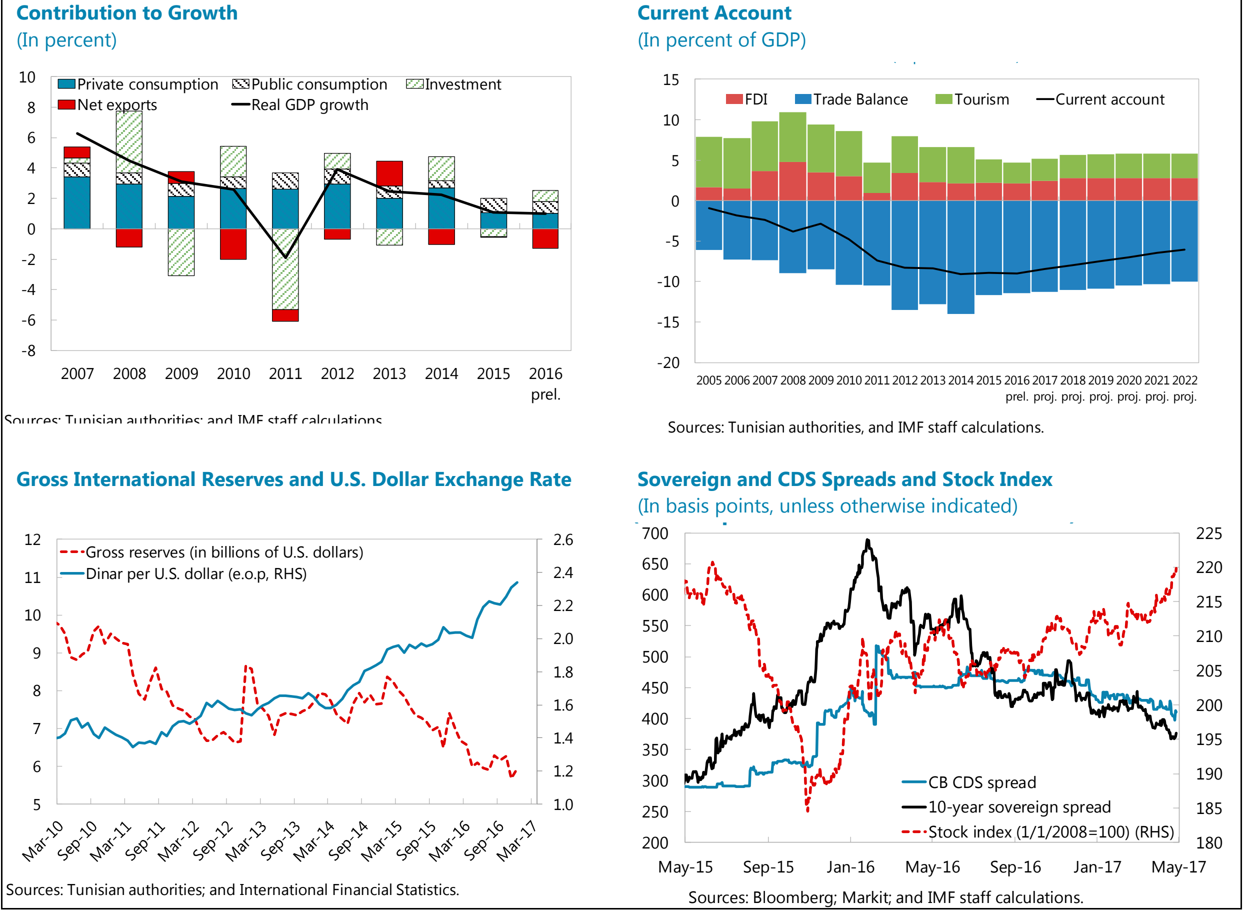
- Lower-than-expected growth and policy slippages caused the fiscal deficit to widen to 5.9 percent of GDP in 2016 from 5.3 percent of GDP in 2015. Public debt stood at 63 percent of GDP at end-2016, compared with a projected 55 percent at program inception.[2]

- Financial markets have remained calm. Thanks to improved security, sovereign spreads decreased while the stock exchange index remained broadly flat since May 2016.

[1] *The Informal Sector Challenges in the Middle East*, World Bank (2011).

[2] The difference can be attributed to the higher deficit (about 2 percent of GDP), the dinar's depreciation (2 to 3 percent of GDP), and a reclassification of post office deposits as central government debt (4 percent of GDP).

Figure 1. Tunisia: Recent Economic Developments



Contribution to Growth
(In percent)

Sources: Tunisian authorities; and IMF staff calculations.

Current Account
(In percent of GDP)

Sources: Tunisian authorities, and IMF staff calculations.

Gross International Reserves and U.S. Dollar Exchange Rate

Sources: Tunisian authorities; and International Financial Statistics.

Sovereign and CDS Spreads and Stock Index
(In basis points, unless otherwise indicated)

Sources: Bloomberg; Markit; and IMF staff calculations.

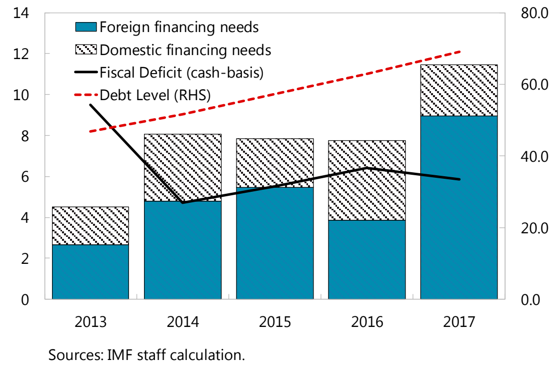
3. Program performance improved recently after a disappointing 2016.

- **All but one of the end-December QPCs were missed**. Net International Reserves (NIR) fell short of their target due to larger-than-expected FX sales by the CBT. Commercial banks' strong reliance on CBT liquidity, partially to finance the growing fiscal deficit, caused an overshooting of the NDA ceiling. The primary fiscal deficit criterion was missed by a large margin due to revenue shortfalls on VAT and non-tax receipts. The ceiling on current primary spending was met as cuts in goods and services offset wage overruns. The indicative target on social spending was missed slightly as pension transfers crowded out social programs.

- **Most delayed Structural Benchmarks (SBs) are now met.** All SBs for June 2016–March 2017 were delayed, but the pace of reform implementation accelerated in recent months (see MEFP Table 2). Work on the outstanding SBs will be completed before end-2017, including on the law on lending rates, bank inspections, performance contracts for the five largest public enterprises (SOEs), the functional reviews for key ministries, the Organic Budget Law, the high anti-corruption authority, and the databank on vulnerable households.

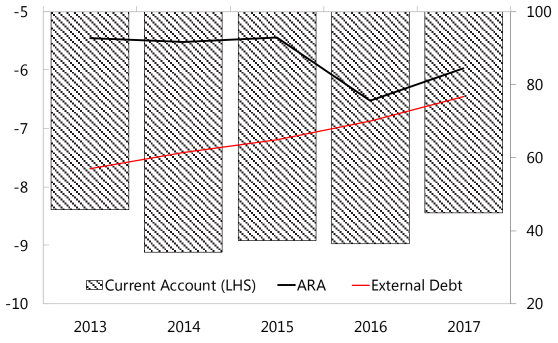
4. Economic vulnerabilities are high, but there is still time to adjust in a gradual way. Large external financing needs, chronically low FX liquidity, and CBT interventions have slightly reduced reserve cover; and large budget and external deficits combined with low growth and accelerated exchange rate depreciation caused a rapid deterioration of public and external debt ratios (text table). The Debt Sustainability Analyses in Annexes I and II indicate high vulnerability of the debt stocks, especially to further exchange rates depreciation. However, the relatively closed capital account and the still-comfortable reserve position reduce the risk of abrupt exchange rate adjustment; the strong financing outlook for the central government over the next 12 months will allow for gradual fiscal consolidation to begin debt reduction; and the low FX exposures of banks, firms, and households reduce the impact of exchange rate depreciation on balance sheets outside the public sector.

Fiscal Vulnerability Indicators
(In percent of GDP)



Source: IMF staff calculations.

External Vulnerability Indicators
(In percent of GDP)



Source: IMF staff calculations.

A FRAGILE OUTLOOK

5. Growth will recover gradually. Projections were revised down to 2.3 percent in 2017 (from 3.0 percent at program inception) and 3.0 percent in 2018 (from 3.7 percent), reflecting delays in implementing structural reforms and still-low private investment notwithstanding an improved external environment. The impact of tax revenue measures and monetary tightening would be mitigated through the recovery of phosphates and tourism, higher public investment, and wage increases. Over time, a pick-up in investment underpinned by capital inflows will allow GDP to increase towards potential (Annex V).

6. Inflation will remain moderate owing to a gradual monetary tightening and the persistence of a negative output gap over 2017–18. Improved monetary operations (Paragraph 20), low commodity prices, and wage moderation should contribute to keeping inflation below 4 percent over the medium term.

Tunisia: Selected Economic Indicators, 2015–22

	Est.	Prel.	Proj.					
	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth (in percent)	1.1	1.0	2.3	3.0	3.5	4.1	4.3	4.3
Consumer price index (CPI), (period average, in percent)	4.9	3.7	4.5	4.4	4.0	3.8	3.6	3.5
Current account (percent of GDP)	-8.9	-9.0	-8.5	-8.1	-7.5	-7.1	-6.5	-6.1
Gross official reserves (US$ billions, eop)	7.4	5.9	7.3	8.2	8.5	9.1	9.5	9.8
Gross official reserves (months of next year's imports)	4.1	3.4	4.3	4.6	4.6	4.7	4.7	4.7

Sources: Tunisian authorities; and IMF staff estimates and projections.

7. **The external position is expected to improve over time**. The recovery of phosphates and tourism as well as stronger manufacturing exports supported by the more competitive dinar should gradually strengthen exports (Annex VII). Import demand for consumer and capital goods would adjust to higher prices after a lag of 6–12 months.

8. **Sizeable risks remain** (Annex IV). On the domestic side, the fragile socio-political environment, especially in the run-up to the local elections in December 2017 and under the impression of higher import prices as well as monetary and fiscal tightening, will likely continue to weigh on confidence and reform implementation. Security risks remain significant, despite recent improvements. On the external front, slower growth in Europe and tighter global financial conditions could exacerbate external and fiscal vulnerabilities. Continued conflicts in the Middle East could affect Tunisia through immigration flows, confidence shocks, or weaker social cohesion.

POLICY DISCUSSIONS

9. **Achieving macroeconomic stability and inclusive growth.** The authorities and staff agreed that Tunisia's economic transition requires a shift from the public sector towards a competitive private sector as the main engine of growth and job creation. At the same time, the country faces high and rising twin deficits and debt levels, as well as inflationary pressures, which all disproportionally affect the most vulnerable: space becomes more limited for growth-enhancing investment and social programs, rising inflation erodes the purchasing power of the poor, and excessive reliance on imports means lower job-creation at home.

10. **The authorities intend to address this challenge with a strategy relying on three pillars.** First, the authorities will introduce strong corrective macroeconomic policies to address policy slippages and reduce fiscal deficits, stabilize debt, and improve budget structure. Greater exchange rate flexibility and monetary policy tightening would improve the external current account deficit, mitigate inflationary pressures, and increase international reserve cover. Second, measures to strengthen the financial health of the social security funds and build better targeted social safety nets will help to maintain adequate social protection. Finally, accelerated progress with comprehensive structural reforms will support higher and more inclusive growth.

POLICIES FOR MACROECONOMIC STABILITY

A. Reducing Fiscal Deficits and Improving Budget Structure

Background

11. **A revenue shortfall of 1.4 percent of GDP caused a sharp deficit increase in 2016** (MEFP, ¶5)**.** This shortfall occurred due to lower growth and weaknesses in revenue collection in broadly equal proportions. Higher-than-expected wages (0.2 percent of GDP) also contributed to the deficit, which reached 5.9 percent of GDP compared with the expected 4.4 percent (see text tables).

2016 Fiscal Developments Compared to Program

Costs		Savings	
Revenue loss	1.3	Goods and services	0.4
Grants	0.1	Other current spending	0.4
Wage bill 1/	0.4		
Interest bill	0.2		
Capital expenditure	0.3		
Net lending	0.2		
Sub-total	**2.4**	**Sub-total**	**0.9**
Change in deficit (compared to program)			**1.6**

Source: Tunisia authorities.
1/ Related to bilateral agreements with security forces (Interior and Defense Ministries) and the Ministry of Education.

2017 Overview Compared to Program

Costs		Savings	
Revenue base loss (2016)	1.3	Tax measures (2017)	1.3
Grants	0.1	Goods and services	0.5
Wage bill	0.7	Net lending	0.1
One-month increase	0.1	Unallocated spending	0.1
Base effect	0.2		
PIT credit	0.3		
Energy subsidies	1.3		
Interest bill	0.2		
Pension transfers	0.6		
Capital expenditure	0.1		
Sub-total	**4.2**	**Sub-total**	**2.0**
Change in deficit (compared to program)			**2.3**

Sources: Tunisia authorities; and IMF staff estimates

12. **The deficit will remain unchanged in 2017, despite a one-off tax hike** (MEFP, ¶17)**.** The deficit is programmed at 5.9 percent of GDP, substantially higher than the 3.5 percent of GDP envisaged in May 2016. This reflects wage increases[3], higher energy subsidies including due to the failure to apply the fuel price adjustment mechanism since June 2016, and an unanticipated transfer to the public pension fund (see Text Table below). Strong and mostly exceptional revenue measures, as well as cuts in current expenditure, will contribute to containing these pressures. In particular, a one-off levy of 7.5 percent on corporate profits (rather than measures to broaden the tax base as foreseen in the authorities' May 2016 tax strategy) is expected to yield 0.9 percent of GDP in 2017.

[3] In December 2017, and after initial efforts to delay application of the agreement signed in 2015 to 2019, the new government agreed with the UGTT public sector union on phasing in the 2017 wage increases. Specifically, the agreement stipulates: (i) payment of 50 percent of wage increases for January to November 2017 as 2017 tax credits (0.4 percent of GDP); (ii) payment of one month of salary increase in December 2017 (0.1 percent of GDP);
(iii) payment of the other half of 2017 wage increases as tax credits in the first quarter of 2018 (0.4 percent of GDP); and (iv) permanent application of the annual increases from 2018 (0.4 percent of GDP).

Tunisia: Selected Fiscal Indicators, 2016–22

(In percent of GDP)

	2016		2017		2018	2019	2020	2021	2022
	Prog.	Est.	Prog.	Proj.			Proj.		
Total revenue and grants	24.1	22.8	24.4	24.3	24.7	24.5	24.6	24.6	24.6
Total revenue (excluding grants)	23.9	22.6	24.1	24.0	24.5	24.3	24.3	24.4	24.4
Of which: Tax revenue	21.7	20.7	22.2	22.2	22.6	22.8	22.8	22.9	22.9
Non-tax revenue	2.2	1.9	1.9	1.9	1.8	1.5	1.5	1.5	1.5
Expenditure and net lending	28.5	28.7	28.0	30.2	30.0	28.7	27.5	26.6	26.4
Of which: Current Expenditure	23.5	23.3	22.3	24.6	24.3	22.8	21.3	20.2	19.7
Wages and salaries	14.1	14.5	13.8	14.1	14.8	13.1	12.1	11.7	11.7
Goods and services	2.4	1.9	2.0	1.5	1.5	1.4	1.4	1.4	1.3
Transfers and subsidies	4.9	4.6	4.5	6.7	5.5	5.5	5.1	4.4	4.2
Capital expenditure	5.0	5.3	5.5	5.6	5.8	5.9	6.2	6.4	6.7
Net lending	-0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Public banks' recapitalization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central government overall deficit (-) (excl. grants)	-4.0	-6.1	-3.9	-6.1	-5.6	-4.4	-3.2	-2.2	-2.0
Central government overall deficit (-) (incl. grants)	-4.4	-5.9	-3.5	-5.9	-5.3	-4.1	-2.9	-2.0	-1.8
Float and other statistical discrepancies [1/]	0.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Structural fiscal balance	-3.6	-5.6	-3.2	-6.1	-4.3	-3.9	-2.9	-2.1	-2.0
Central government debt	54.6	62.9	54.5	69.1	72.1	71.6	70.2	67.7	65.3
Memorandum item:									
Central government deficit (-), (excl. grants, cash basis; QPC) [2/]	*-4.6*	*-6.6*	*-3.9*	*-6.1*	*-5.6*	*-4.4*	*-3.2*	*-2.2*	*-2.0*
Nominal GDP [3/]	*91,658*	*90,376*	*97,495*	*97,397*	*104,603*	*112,404*	*121,225*	*130,610*	*140,721*

Sources: Tunisian authorities; and IMF staff estimates.

1/ Difference between the cash and accrual overall deficit calculated at end-period. For actual data, this line also includes ordered payments not yet withdrawn from treasury accounts. A negative sign implies higher cash spending than ordered (i.e. higher required financing).

2/ The program QPC follows the cash-basis overall deficit (excluding grants). For 2016, this reflect a higher deficit on account of 2015 expenditures ordered during the normal complementary period (January 1–20, 2016) and authorized security costs not approved in th 2016 budget.

3/ Nominal GDP has been revised down from 2015–16, reflecting final numbers of the national accounts publication by the National Institute of Statistics.

13. **Public wages and pensions represent serious medium-term fiscal challenges.** The wage bill grew from 10.7 percent of GDP in 2010 to 14.5 percent of GDP in 2016 and, absent measures, would increase to 15 percent of GDP in 2018. Moreover, the consolidated deficit of the social security system reached 1 percent in 2017 and would continue to increase without reforms. Arrears from the pension funds to the health fund (that otherwise could cover its costs) jeopardize the provision of basic public services.

Tunisia: Pension and Health Care Funds Financial Situation

(In percent of GDP)

	2017 cash need	Stock of arrears at end-2016
CNRPS (public)	0.5	1.2
CNSS (private)	0.5	0.8
CNAM (public health fund)	…	0.5

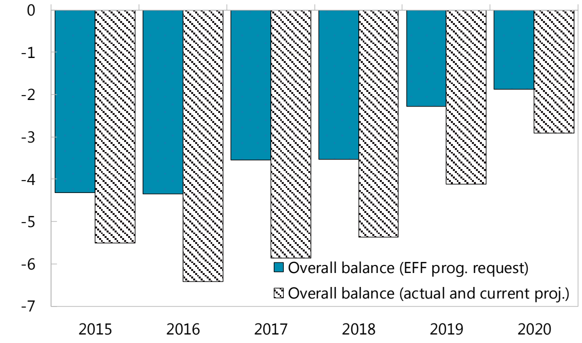
Sources: IMF staff calculations; and Tunisian authorities.

Policy discussions

14. A stronger adjustment effort and more financing will be required. Given lower growth and higher deficits, the adjustment effort through 2020 will have to be more ambitious to maintain macroeconomic stability: the authorities envisage the overall fiscal deficit to improve by 3 percent of GDP over 2017-20 (about 0.5 percent of GDP more than under the original program). Even then, the public debt-to-GDP ratio will remain substantially higher than predicted at EFF inception: by 2020, and after peaking at 72 percent in 2018, it is now expected to stand at 70 percent (MEFP, ¶15), compared with the originally targeted 50 percent. Larger-than-expected donor support would cover the higher financing needs (Annex I).

Overall Balance

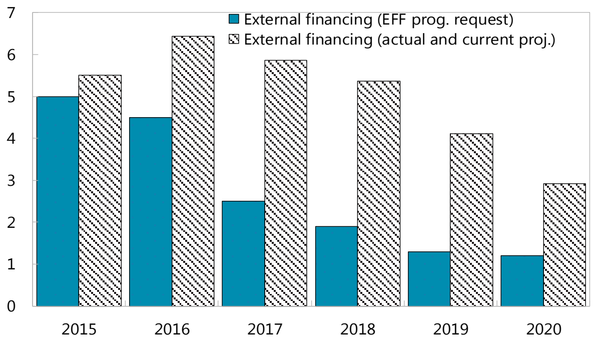
(As a percent of GDP)



Source: IMF staff calculations.

External Financing

(As a percent of GDP



Source: IMF staff calculations.

15. Ensuring achievement of 2017 deficit targets. Budget outturns through March signal that the targets remain realistic. Moreover, the authorities have identified contingency measures, including a 0.4 percent of GDP spending cut, in case larger-than-expected transfers to the pension funds are needed (MEFP, ¶17).

16. Starting sustainable deficit reduction in 2018 (MEFP, ¶18). A strong package of measures would reduce the overall deficit to 5.4 percent of GDP from 5.9 percent in 2017, and the underlying structural deficit to 4.3 percent of GDP from 6.1 percent in 2017.

- **Tax measures to shift the burden towards indirect taxation** (Table 4; MEFP ¶18)**.** The package worth 1.3 percent of GDP (Text Table) is partially based on the May 2016 tax strategy. The shift towards indirect taxation encourages investment and slows consumption. The package also improves fairness by widening the tax base, increasing VAT rates on services of liberal professions, and raising excises on goods and services prevalently consumed by higher-earning households. Staff emphasized the need to target financial profits, rather than transactions, to avoid a negative impact from the financial activities taxes on financial development.

- **Stronger revenue collection through improved tax administration** (MEFP, ¶18)**.** Encouraging progress with arrears collection in the first quarter of 2017 suggests that the authorities' multi-year program could yield important results, estimated at 0.3 percent of GDP in 2018. The timely implementation of the Large Taxpayers Unit (LTU) will be critical.

- **Voluntary headcount reduction in the civil service** (MEFP, ¶20)**.** These policies are part of the comprehensive civil service strategy adopted in April 2017 (see Paragraph 28).

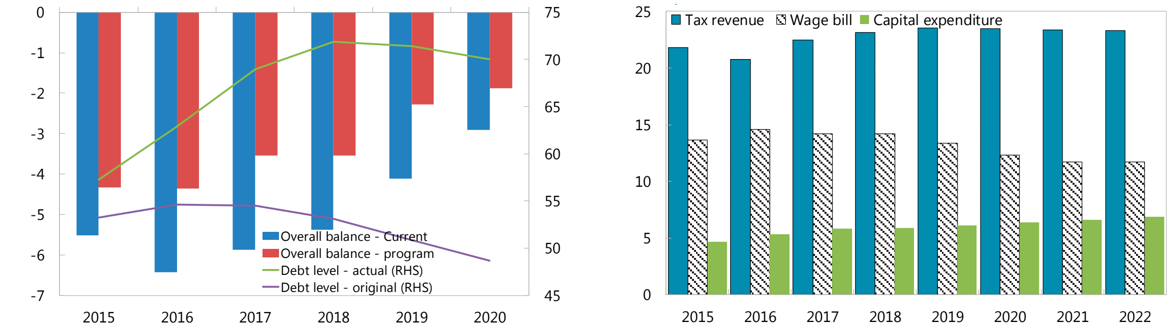
- **Comprehensive pension reform** (MEFP, ¶21)**.** Swift implementation of the reform would help containing transfers to social security to 0.5 percent of GDP in 2018 (Paragraph 23).

17. Progressing with further fiscal consolidation through 2020. The focus on revenue measures would be replaced over time by the fruits of civil service and social security reforms (MEFP, ¶14). Strengthened SOE performance (Paragraph 31) and, in the outer years, additional subsidy reform would also improve budget outcomes.

Tunisia: Authorities' Proposed Fiscal Measures for 2018

	Millions of TD	As a percentage of GDP
Indirect taxes	1,116.0	1.1
Direct taxes	60.0	0.1
Other measures	138.0	0.1
Collection efforts (including tax arrears)	300.0	0.3
Total	**1,666.0**	**1.6**
Memorandum item:		
Nominal GDP	*104,603*	

Source: Tunisian authorities.



Fiscal Consolidation Path
(As a percent of GDP)

Tax Revenue and Spending Composition
(As a percent of GDP)

Source: IMF staff calculations.

B. Preserving Monetary Stability with a More Flexible Exchange Rate

Background

18. Inflationary pressures have increased. Inflation has already started to move upwards from the 4 percent level that the CBT has been implicitly targeting over the past few years. The pick-up in prices is broad-based and includes the non-tradeable sectors, raising concerns of second-round effects stemming from exchange rate depreciation, and oil price and past wage increases. Additional forward risks arise from exchange rate depreciation combined with the large import share in the consumption basket, upcoming wage increases, and prospective adjustments to VAT and fuel prices.

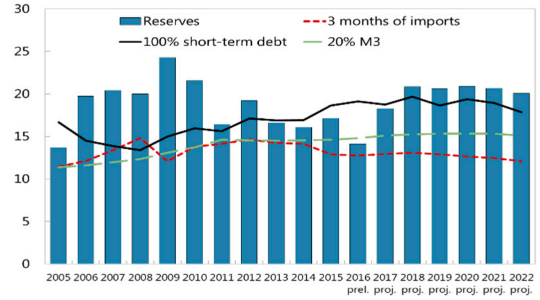
19. The real exchange rate remains overvalued based on the current account gap in 2016. Standard EBA exchange rate assessment methodologies suggest that the external position was substantially weaker than implied by fundamentals and desirable policies in 2016. That said, the recent episode of dinar depreciation reduced the size of the estimated misalignment.[4] Gross International Reserves are considered adequate per traditional measures and are at the lower limit of the adequacy range suggested by the composite ARA metric.[5] The authorities broadly agree with staff's assessment of the external position.

[4] Standard EBA models use annual data as inputs and focus on cross-country consistency more than on the time-series element in the underlying regressions.

[5] Traditional measures include months of imports, ratio to money supply, or ratio to short-term debt, while the ARA metric is a risk-weighted measure of different potential sources of balance-of-payments pressure. The suggested adequacy range is between 100–150 percent of the metric. Gradual capital account liberalization during the program period would keep the reserve level close to the lower limit of the suggested adequacy range.

Traditional Metrics of Reserve Coverage

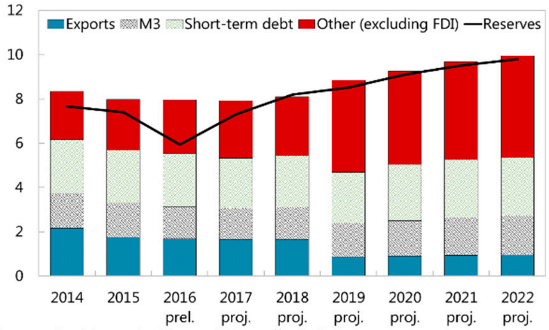
(In percent of GDP)



Sources: Tunisian authorities; and IMF staff calculations.

ARA Metrics Decomposition (Adjusted 1/)

(In billions of US. Dollars)

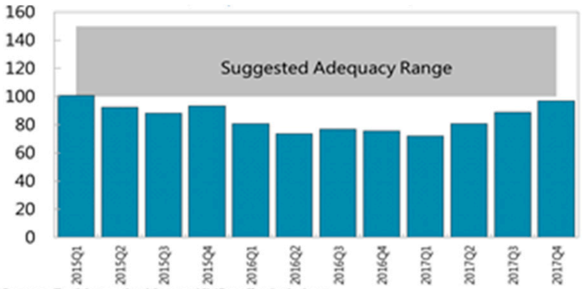


Sources: Tunisian authorities; and IMF staff calculations.

/1 The adjusted metric assumes a floating exchange rate regime and lifting of capital controls in 2019 onwards.

Reserve Adequacy (Adjusted 1/)

(as a percent ARA metric)



Sources: Tunisian authorities; and IMF staff calculations.

/1 The adjusted metric assumes a floating exchange rate regime and lifting of capital controls in 2019 onwards.

Exchange Rate Assessment Using EBA Methodology

(In percent)

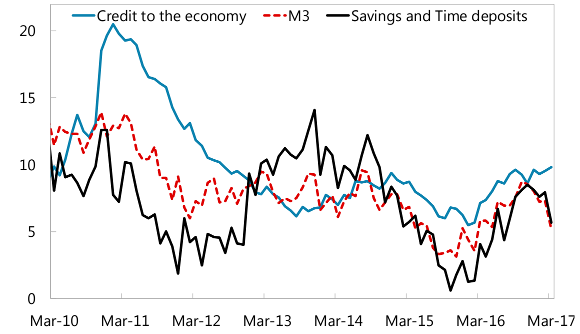
Current Account			
Actual 2016 CA	-9.0	CA Gap	-7.3
CA Norm	-2.6	Contribution of identified Policy Gaps	1.4
CA Fitted	-4.0	Unexplained residual	-8.7
REER misalignment 1/	16.7		
External Sustainability			
2016 NFA/GDP	-117.8	Adjusted medium-term CA/GDP	-6.1
Benchmark NFA/GDP	-32.8	CA/GDP Stabilizing NFA at Benchmark	-2.2
REER misalignment 1/	10.7	ES CA/GDP Gap	-3.9

1/ Overvaluation (+); undervaluation (-)

Policy discussions

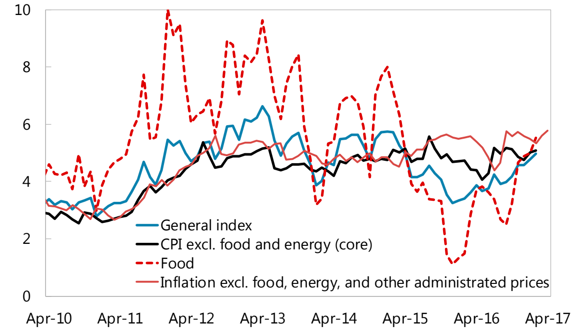
20. Containing inflation (MEFP, ¶26, ¶29)**.** The authorities tightened monetary policy and increased the policy interest rate by a cumulative 75 bps in April and May to 5 percent. The authorities agreed to a further tightening of monetary policy if inflationary pressures continue to rise or reserves deviate from the programmed path. The authorities also intend to tighten liquidity provision through their lending facility to amplify the interest rate impulse. In a medium-term perspective, they agreed with staff that improvements in monetary policy operations are crucial to ensure better transmission of monetary policy to the real economy.

Private Sector Credit and Deposit Growth
(Y-o-y growth, in percent)



Sources: Tunisian authorities, and IMF staff calculations.

Inflation
(Y-o-y growth, in percent)



Sources: Tunisian authorities; and IMF staff calculations.

21. Using an auction mechanism to support more exchange rate flexibility (MEFP, ¶¶27-28)**.** The CBT has reactivated an FX auction mechanism in May while reaffirming its commitment to respect a limited intervention budget through the rest of 2017. The mechanism's regular application (new SB, August 2017) should create more transparency and competition in the interbank FX market, reduce the likelihood of disorderly market conditions, and facilitate a gradual correction of the dinar's remaining overvaluation in real effective terms (see also Annex VI).

ENSURING ADEQUATE SOCIAL PROTECTION

A. Restoring the Financial Health of Social Security

Background

22. The pension system is structurally underfunded. The generous defined benefit schemes (replacement income of up to 80 percent of salaries) are financially unsustainable with current contribution levels as life expectancy increases. An attempt to increase retirement age in the civil service was abandoned in 2016 after resistance from social partners. Cash needs are exacerbated by chronic payment difficulties of ailing SOEs (Paragraph 30).

Policy discussions

23. Starting comprehensive reforms of the public and private pension funds (MEFP, ¶21). The authorities and their social partners have started a dialogue on pension reform, with specific recommendations expected by summer 2017. Based on these, the government envisages submitting to Parliament a reform law for all pension funds by September 2017 (new SB). This would allow for making the first reforms effective by January 1, 2018 (0.2 percent of GDP in savings are currently expected for the CNRPS). Staff recommended adopting a comprehensive package of parametric reforms, which could be developed in consultation with the World Bank and other partners. The pension system should not be subsidized through general taxation, such as the earmarking of a share of VAT revenue.

B. Better Targeting Social Assistance to the Vulnerable

Background

24. **There is significant scope for better targeting social policies.** Poverty and unemployment have remained elevated since the revolution, and large disparities remain across regions and population segments. Existing support programs tend to disproportionately benefit the better off and exclude a significant part of those who are poor, employed in the informal sector, or reside in the interior regions.[6]

Policy discussions

25. **Improving the targeting of social assistance.** The authorities have started work to overhaul the social assistance framework with help from the ILO. Staff urged the authorities to accelerate the process of laying the foundations for better targeting of social assistance, notably by establishing a databank on vulnerable household (reprogrammed SB, December 2017) and by integrating existing beneficiary data. This will facilitate a quick roll-out of the unique social identifier and electronic cards to reach a larger segment of the poor (MEFP ¶38).

26. **Continuing with subsidy reforms.** The authorities intend to apply the automatic adjustment mechanism for the three main fuels monthly starting in July 2017 (MEFP, ¶17). It could also be gradually extended to other energy categories. Staff welcomed the revision of electricity tariffs in 2017, including the decision to maintain unchanged the lifeline tariff for poor households, and suggested further increases to progress towards cost recovery.

POLICIES FOR HIGHER AND INCLUSIVE GROWTH

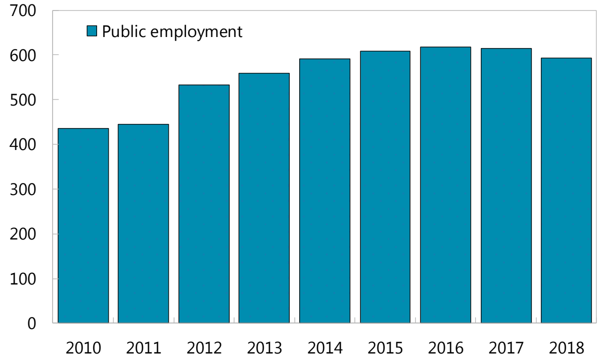
A. Reforming the Civil Service

Background

27. **The public wage bill is too high, and service provision remains uneven across regions.** Decentralized wage agreements, uncontrolled recruitments and generalized wage increases have allowed the wage bill to reach unsustainable levels. In 2016, it accounted for about half of total expenditure and two-thirds of tax revenue, and was about three times the size of public investment. When scaled against GDP, the wage bill is among the highest in the world. At the same time, civil service efficiency suffers from inadequate performance management and rigid redeployment rules that prevent the strengthening of public services particularly in the interior regions.

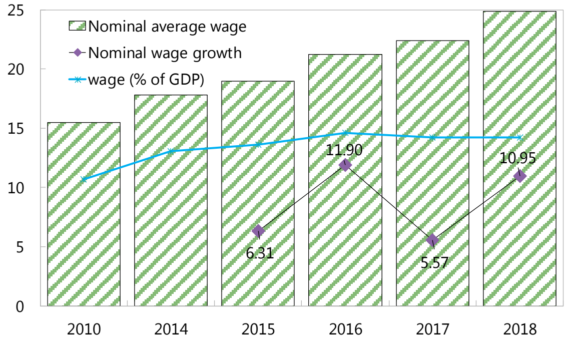
[6] For example, energy subsidies benefit rich households up to 30 times more than those with lower income; and cash and health transfer programs for low-income families cover only about 12 percent of Tunisia's poor.

Public Employment
(In thousands)



Sources: IMF staff calculation and Tunisian authorities.

Average Nominal Wage and Growth Rate, 2010–18

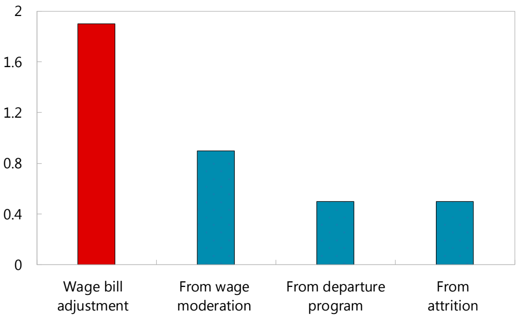


Sources: IMF staff calculations.

Policy discussions

28. Starting civil service reform (MEFP, ¶20)**.** The ambitious strategy adopted by the Council of Ministers in May 2017 aims to improve recruitment and performance management, including for strategic positions (*haute function publique*), and to modernize IT infrastructure. Voluntary separation schemes, strict limits on new hiring, and no additional wage increases beyond those already agreed would stabilize the wage bill-to-GDP ratio at 14 percent in 2018 and reduce it to 12 percent by 2020. The functional reviews of the four largest ministries, delayed to end-September 2017, will help identify redeployment needs.

Wage Bill Reform



Source: IMF staff calculations.

29. Ensuring strong reform implementation to minimize risks. The authorities have emphasized that wage increases over the next years could only be envisaged if GDP growth outperforms current baseline expectations; and have started work with social partners on a wage setting formula to provide guidance for future negotiations based on the evolution of inflation, productivity, and growth. They will work with the World Bank on the design of separation packages (the use of early retirement should be minimized in favor of voluntary departure packages to avoid undermining pension reform) and on safeguards in eligibility rules to minimize any impact from employee departures on public service quality. In addition, the authorities have strengthened monitoring competencies for civil service recruitment in the Office of the Head of Government, have set hiring limits for 2017 and 2018 supported by a new SB (October 2017), and are working on regulations to facilitate redeployment.

B. Better Managing State-Owned Enterprises

Background

30. SOEs represent a significant fiscal risk. Central government contingent liabilities stemming from SOEs are estimated at more than 12 percent of GDP and represent a major fiscal risk, exacerbated by poor performance and frequent budgetary transfers to cover cash shortfalls. However, performance monitoring by the Ministry of Finance (MoF) and line ministries remains inadequate.

Policy discussions

31. Improving monitoring and management of SOEs (MEFP, ¶22). Staff welcomed progress on the performance contracts with four major SOEs and an interim contract for Tunisair, and urged the authorities to quickly complete this work (reprogrammed SB, July 2017). Moreover, the MoF will adopt a more effective monitoring system for the 20 largest SOEs. Closer cooperation between SOE oversight and debt management functions should improve monitoring of public guarantees.

C. Reducing Financial Sector Vulnerabilities

Background

32. Financial sector reforms have progressed, but remain incomplete (MEFP, ¶31). Following the recapitalization and management changes of the three public banks, the viability of their restructuring plans now hinges on improvements in the banks' ability to resolve their legacy NPLs, but the required legislative changes are now seriously delayed. Non-Performing Loans (NPLs), notably among public banks, continue to stand at elevated levels despite a slight reduction of their share in total loans to 15.6 percent in 2016 from 16.5 percent in 2015. This contributes to inadequate access to finance, which remains a key growth constraint.[7]

Policies

33. Improving the framework for NPL resolution (MEFP, ¶33)**.** Staff urged the authorities to introduce the much-delayed measures to remove the discrimination against public banks in managing NPL portfolios (new SB, October 2017). The authorities acknowledged the delays but reiterated their commitment to modernize legislation and judicial processes to facilitate NPL resolution.

34. Further strengthening bank resolution and supervision. The resolution committee will start operations in June 2017 with the long-delayed orderly liquidation of Banque Franco Tunisienne (BFT). The deposit guarantee fund will become effective in September 2017 (MEFP, ¶35). Several innovations were achieved in banking supervision; five bank inspections out of a total of seven are

[7] See Selected Issues, IMF Country Report 16/47.

completed and indicate adequate provisioning. Going forward, better rating and scoring tools will allow for improved assessment of commercial banks' credit risk policies (MEFP, ¶36).

35. Advancing towards deeper and more inclusive financial markets. The new financial sector reform committee will enhance reform coordination across stakeholders (MEFP, ¶¶32-33). A new financial inclusion strategy is also being developed to further strengthen microfinance, digital finance, and credit to SMEs, including by allowing private credit bureaus. Staff regretted delays in reforming the excessive lending rate[8] (reprogrammed SB, September 2017; MEFP, ¶41), but welcomed the development of a yield curve to support financial market development (MEFP, ¶26). Public ownership of banks should be reviewed in light of the elevated costs associated with the recent recapitalization of the Tunisian Foreign Bank (TFB).

D. Improving Governance and the Business Environment

Background

36. Business legislation has improved, but more progress is needed. Staff welcomed the approval of the laws and implementing decrees on competition, Public-Private Partnerships and the investment code. However, Tunisia still fares poorly in business environment and governance rankings.[9]

Policies

37. Continuing efforts to strengthen governance and transparency. The draft law for establishing the anti-corruption authority was submitted to Parliament in March 2017, and the authorities are committed to making the authority operational by early 2018. This entails the adoption of implementation decrees and the appointment of the head of the institution, as well as the allocation of adequate budget resources in the 2018 budget law (new SB, November 2017; MEFP, ¶39). Parliament also adopted the law on whistle blowers in April 2017. Strengthening the AML/CFT framework in line with international standards and its effective implementation could further bolster anti-corruption efforts. Delays in approving the Organic Budget Law (reprogrammed SB, September 2017) will postpone the implementation of performance-based budgeting to 2019, which is critical for improved accountability of public services (MEFP, ¶23).

38. Strengthening Tunisia as a place for doing business (MEFP, ¶40, ¶42)**.** Building on recent legislative and regulatory reforms, the next steps to improve the business climate include setting-up implementation agencies envisaged under the investment code, the adoption of the economic emergency law that seeks to accelerate the approval and the implementation of significant investment projects, and a Public Investment Management Assessment.

[8] The lending rate in Tunisia cannot exceed the average bank lending rate by more than 20 percent. The authorities plan to increase this limit to 33 percent and eventually remove the cap altogether, starting with lending to firms.

[9] World Economic Forum, Global Competitiveness Report (2017).

PROGRAM MODALITIES

39. The authorities request a rephasing of access and making it available to the budget. Considering the delay in completing the First Review, the authorities request a reduction in the number of reviews and a rephasing of remaining access, starting in 2018, to align purchases with reform progress (see Table 10). Given large budget financing needs, staff supports making all funds available for budget support.

40. Staff supports the authorities' request for waivers of nonobservance of end-December QPCs, based on corrective action. The authorities have taken appropriate corrective actions to (i) improve the accumulation of NIR and increase exchange rate flexibility by setting up regular FX auctions that will help limit interventions going forward; (ii) tighten monetary policy and liquidity provision to limit the NDA; and (iii) implement strong fiscal consolidation that will replace low-quality temporary measures with permanent ones of higher quality.

41. QPCs and SBs support the authorities' main policy objectives. (MEFP Tables 1–2)

- The new QPCs set for June 2017 and December 2017 support adequate reserve coverage through ambitious NIR targets, containment of inflationary pressures through NDA targets consistent with a slowing growth of the monetary base, and stabilization of the fiscal deficit in 2017 through the primary balance and the current spending targets. The indicative target on social spending will ensure adequate expenditure on sectors such as health and education, and help protect vulnerable households. QPCs definitions will remain unchanged.

- Five new SBs will help ensure strong implementation of already started reforms, including improving the NPL resolution framework for public banks, making operational the large taxpayers unit and the high anti-corruption authority, pursuing civil service reform, and re-establishing the fuel price mechanism. One SB focuses on establishing a more transparent FX intervention mechanism for the CBT. One SB supports pension reform as a major new area of the authorities' efforts. Delayed Benchmarks have been reprogrammed.

42. The program is fully financed. In combination with the EUR 850 million Eurobond in February, the recent Qatar rollover loan, and firmly committed donor flows, the purchases under the First Review will ensure adequate financing over the next 12 months (text table). Prospects for continued adequate financing through the program period are good. The authorities envisage another international bond issuance for early 2018.

Tunisia: Fiscal External Financing, 2016–18

(In millions of US dollars)

	2016	2017					2018				
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4
Total grants and loans	1,807	3,781	1,003	1,490	852	437	2,933	1,369	600	370	594
Grants	60	108	-	-	48	59	100	25	25	25	25
Loans	1,747	3,674	1,003	1,490	803	378	2,833	1,344	575	345	569
Bilateral	-	998	-	998	-	-	-	-	-	-	-
Qatar	-	998	-	998	-	-	-				
Multilateral	835	1,438	-	415	715	308	1,416	233	475	233	475
AfDB	478	-	-	-	-	-	-	-	-	-	-
IMF (budget support)	316	615	-	308	-	308	737	-	369	-	369
World Bank Group	42	500	-	-	500	-	466	233	-	233	-
EU	-	323	-	108	215	-	213	-	107	-	107
Other and market financing	912	1,238	1,003	77	88	70	1,417	1,111	100	112	94
Market issuance with US guarantee	497	-	-	-	-	-	-	-	-	-	-
Project aid (no donor breakdown)	301	256	64	64	64	64	350	88	88	88	88
Sukuk and other market financing	-	915	915	-	-	-	1,000	1,000	-	-	-
Loan transfers to SOEs	114	67	24	13	24	6	67	24	13	24	6
Memorandum items:											
Grants details:											
EU	*51*	*108*	-	-	*48*	*59*	*100*	*25*	*25*	*25*	*25*
Other	*1*	-	-	-	-	-	-				

Source: IMF staff calculations.

43. Tunisia has the capacity to repay the Fund, although subject to significant risks. Credit outstanding to the Fund would peak in 2020 at 372 percent of quota before declining. Obligations to the Fund would peak at 1.4 percent of GDP in 2018, representing seven percent of gross international reserves.

44. An updated safeguards assessment was completed in May 2016. The CBT has strengthened its safeguards framework, including operationalizing its Audit Committee. While the adoption of the new CBT law in April 2016 enhanced independence and introduced a lender of last resort mechanisms (LOLR), gaps remain with good international practices. Recommendations include adopting more transparent financial reporting practices and operationalization of the LOLR framework. Since the assessment, the CBT has enhanced its FY2016 financial statements disclosures. Other items remain pending, particularly the operationalization of the LOLR (expected in September 2017, MEFP ¶30).

45. The program carries significant risks, as discussed in Paragraph 8 and Annex IV. Continued strong donor support is critical to help Tunisia complement its political transition with an effective economic one.

STAFF APPRAISAL

46. Tunisia's democracy weathered many challenges, but economic transition is delayed. Sustainable increases in employment and standards of living for Tunisia's young population will only be possible by transforming the country's economic model, which relies on unsustainable levels of public consumption—including for wages and subsidies—as well as on inefficient legal and regulatory frameworks that limit competition and discourage formal private sector activity. In this process, maintaining macroeconomic stability is critical. This will require accelerated efforts to compensate for external shocks as well as for the delays and slippages that occurred around last year's change in government. Even with stronger efforts, however, some of the EFF's original objectives were recalibrated given the extent of deviations from initial program assumptions. Nevertheless, the recalibrated program is sufficiently ambitious and benefits from renewed commitment to critical structural reforms and sound macroeconomic policies.

47. Ambitious medium-term objectives will only be achievable with a strong policy mix. The authorities have already acted to contain, albeit at a high level, the fiscal deficit in 2016 and arrest its further growth in 2017. Monetary tightening is now necessary even in the presence of weak growth, as structural deficiencies, exchange rate depreciation, and higher administered prices and taxes increase inflation risks. To gradually achieve debt reduction and create more fiscal space for investment and social policies, it is important to hold the course on structural reforms in critical areas such as civil service, pensions, and public enterprises. The success of the next phase of public bank restructuring will depend on more determined measures to help banks reduce their sizeable NPL portfolios. Governance and business environment reforms will be crucial for private sector development and jobs growth. This ambitious multi-year strategy, which maintains the broad strategic objectives under the EFF, will challenge interest groups and test administrative capacity. It will require strong ownership, building on the resolve demonstrated in recent months; its implementation should proceed without further delay.

48. Fiscal consolidation can proceed in a growth-friendly and socially-conscious way. Staff supports the authorities' policies for 2017-18 and beyond that are ambitious but also strike a reasonable balance between the feasible and the desirable in a difficult socio-political environment. The permanent tax measures for the 2018 budget will shift the burden from direct towards indirect taxation and increase fairness albeit more could have been done to strengthen progressivity. The new LTU and other steps to reinforce revenue administration will help more effective collection of sizeable tax and customs arrears (totaling 6 percent of GDP). The expected improvements in expenditure policies are credible conditional on the implementation of the reforms discussed in Paragraphs 50-52 and the re-application of the fuel price adjustment mechanism.

49. Staff supports more exchange rate flexibility and a tightening of monetary policy. Maintaining the exchange rate in line with evolving fundamentals is crucial to restore competitiveness and increase reserves. The FX auction mechanism for CBT interventions is a major positive policy step allowing to smooth excessive daily volatility in the interbank market and increase the role of market forces. Staff also commends the recent increases in the CBT's policy interest rate and encourages further interest hikes over the next months if inflation pressures continue to build up.

50. Deep reform of the civil service will improve service quality and create fiscal space. Staff especially welcomes the authorities' efforts to reduce the public wage bill, which is among the highest in the world.[10] The reduction hinges on avoiding further new wage increases through 2020; and on successful voluntary departure programs for the public workforce in combination with strict and continued controls over future recruitments. Donor support for this strategy would make it easier for Tunisia to shoulder the upfront investment.

51. Efforts to maintain adequate social protection are critical for a successful transition. Staff welcomes the recent steps taken to ensure adequate financing for social security in the short term and urges the authorities and social partners to proceed quickly with equitable and sustainable pension reforms. Finalizing the database of vulnerable households is crucial to respond to the needs of the poor and the vulnerable in a cost-effective way.

52. There is scope for improved management of contingent risks from public enterprises. The performance contracts for SOEs will require strong ownership from the side of the authorities to be effective. Improving financial information and upgrading the capacity of the Ministry of Finance to monitor performance and apply sanctions are also important.

53. The financial sector requires accelerated reforms. The restructuring plans and performance contracts for public banks constitute a major step in strengthening the financial sector and improving credit availability in the economy. Their effective implementation depends on overhauling the framework for the treatment of NPLs, which will be instrumental for completing the Second Review. Work on BFT liquidation should start in the Fall of 2017 as losses continue to accumulate; and work on financial market development should proceed faster.

54. Further governance and business environment reforms will support the private sector. Staff urges the authorities to follow through with their plans to make the high anti-corruption authority fully operational by end-2017. To improve Tunisia's attractiveness as an investment destination and support the associated efforts in the context of the Tunisia 2020 Conference and the G20 Compact with Africa, it is important to achieve a regulatory and legal framework for private sector development that is clear and predictable.

55. Program risks remain elevated. Recent experience has demonstrated the difficulties of keeping the macroeconomic program and the structural reform agenda on track in the presence of weak growth and large exogenous shocks (notably, the violent attacks in 2015 and spillovers from regional conflicts). These challenges will continue to require close program monitoring and flexibility in the policy frameworks to react to new developments without losing sight of the fundamental objectives of higher job-creating growth and deficit reduction. A relatively favorable growth outlook for Tunisia's European trading partners, a more flexible exchange rate combined with still comfortable levels of international reserves, and an adequate cushion of central government financing should help Tunisia navigate this task, in combination with sustained external financing and technical assistance from external partners, including the Fund.

[10] Tunisia's wage bill is the third-highest among emerging markets (14 percent of GDP compared with an average of 8 percent of GDP).

56. In view of Tunisia's recent efforts to strengthen program performance and a comprehensive set of corrective measures, staff supports the authorities' request for completion of the First Review. Staff supports (i) rephasing of access in line with reform implementation; (ii) waivers of nonobservance of end-December QPCs on the basis of corrective action on net domestic assets, net international reserves and the primary fiscal balance; and (iii) the setting of new end-June and end-December 2017 QPCs. Staff supports making all funds available for budget support.

Table 1. Tunisia: Selected Economic and Financial Indicators, 2015–18 1/

	2015	2016		2017		2018
	Prel.	Prog.	Proj.	Prog.	Proj.	Proj.
Production and income (percent change)						
Real GDP	1.1	2.0	1.0	3.0	2.3	3.0
GDP deflator	3.6	5.1	5.7	3.3	5.3	4.2
Consumer price index (CPI), average	4.9	3.9	3.7	3.9	4.5	4.4
Consumer price index (CPI), end of period	4.1	4.0	4.2	3.9	4.5	4.1
Gross national savings (in percent of GDP)	12.5	14.1	13.5	15.3	13.6	15.1
Gross investment (in percent of GDP)	21.4	21.8	22.5	22.3	22.1	23.2
Central government (percent of GDP, unless otherwise indicated) 1/						
Total revenue (excluding grants)	23.2	23.9	22.6	24.1	24.0	24.5
Total expenditure and net lending	28.8	28.5	28.7	28.0	30.2	30.1
Wage Bill 2/	13.6	14.1	14.5	13.8	14.1	14.8
Social expenditures 3/	1.6	1.7	1.6	1.6	1.6	1.9
Central government overall balance (excluding grants)	-5.6	-4.6	-6.1	-3.9	-6.1	-5.6
Central government overall balance (including grants)	-5.3	-4.4	-5.9	-3.5	-5.9	-5.4
Central government overall balance (including grants) (cash basis)	-5.5	-4.4	-6.4	-3.5	-5.9	-5.4
Structural fiscal balance 4/	-4.6	-4.0	-5.6	-3.3	-6.1	-4.3
Central government debt (foreign and domestic)	57.2	54.6	62.9	54.5	69.1	72.1
Foreign currency public debt (percent of total debt)	61.7	68.0	64.1	68.6	67.8	70.6
Total external debt						
External debt (in billions of US$)	27.0	29.3	27.0	30.7	29.0	30.6
External debt (in percent of GDP)	64.9	69.0	70.0	71.4	76.9	80.7
Debt service ratio (percent of exports of GNFS)	10.1	12.8	12.2	16.7	18.4	16.2
Money and credit (percent change)						
Credit to the economy	6.2	7.1	9.7	7.3	7.2	7.4
Broad money (M3 of the financial system)	5.3	6.5	8.1	6.8	10.0	8.3
Velocity of circulation (GDP/M2)	1.4	1.5	1.4	1.5	1.4	1.4
External sector (percent change)						
Exports of goods, f.o.b. (in billions of US$)	-15.9	-2.6	-3.6	5.8	-1.5	0.4
Imports of goods, f.o.b. (in billions of US$)	-18.4	-4.3	-3.8	3.9	-2.6	-0.6
Exports of goods, f.o.b. (volume)	-2.8	1.6	0.2	5.5	2.4	6.8
Import of goods, f.o.b. (volume)	-2.5	3.5	2.3	2.1	4.5	4.8
Trade balance (in percent of GDP)	-11.7	-10.4	-11.4	-10.1	-11.3	-11.1
Current account (in percent of GDP)	-8.9	-7.7	-9.0	-7.0	-8.5	-8.1
Foreign direct investment, net (in percent of GDP)	2.6	2.1	2.0	2.2	2.4	2.8
Terms of trade (- = deterioration)	3.3	3.7	2.3	-1.5	3.1	-0.9
Official reserves						
Gross official reserves (in billions of US$, e.o.p)	7.4	8.3	5.9	8.5	7.3	8.2
In months of next year's imports of goods and services, c.i.f.	4.1	4.6	3.4	4.5	4.3	4.6
Memorandum items:						
GDP at current prices (TD millions)	84,656	91,658	90,376	97,495	97,397	104,603
GDP at current prices (in billions of US$)	43.2	44.0	42.1	44.4	39.9	39.3

Sources: Tunisian authorities; and IMF staff estimates and projections.

1/ Excludes social security accounts, public enterprises, and local governments.

2/ The 2018 wage bill includes a cost of 0.6 percent of GDP for the voluntary departure packages.

3/ Public capital expenditures of key ministries and social transfers and programs.

4/ Excludes one-off revenues and costs, and corrects for the GDP cycle.

Table 2. Tunisia: Balance of Payments, 2015–22

(In millions of US dollars)

			Projections													
	2015	2016	2017					2018					2019	2020	2021	2022
	Annual	Annual	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual				
Current account	-3,849	-3,776	-1,331	-1,073	-688	-303	-3,395	-780	-1,024	-671	-700	-3,176	-3,112	-3,074	-3,018	-2,990
Trade balance	-5,029	-4,806	-1,411	-1,280	-1,284	-554	-4,530	-920	-1,255	-1,226	-968	-4,368	-4,514	-4,615	-4,795	-4,913
Exports	14,073	13,568	3,270	3,487	2,966	3,637	13,359	3,397	3,458	3,032	3,523	13,411	13,890	14,462	15,076	15,530
Energy	1,013	765	104	176	175	344	799	224	168	180	239	810	814	831	859	872
Non-energy	13,061	12,804	3,165	3,311	2,791	3,294	12,561	3,174	3,290	2,852	3,284	12,600	13,076	13,631	14,217	14,659
Of which: Nonfood	11017	11368	2,791	2,929	2,531	2,967	11217	2,781	2,896	2,581	2,946	11204	11616	12092	12593	12970
Imports	-19,102	-18,374	-4681	-4767	-4250	-4192	-17,890	-4317	-4713	-4258	-4491	-17,779	-18,404	-19,077	-19,872	-20,443
Energy	-2,742	-2,024	-618	-565	-562	-422	-2,167	-549	-589	-584	-511	-2,232	-2,308	-2,429	-2,583	-2,712
Non-energy	-16,361	-16,351	-4,064	-4,202	-3,688	-3,769	-15,722	-3,769	-4,124	-3,674	-3,980	-15,547	-16,096	-16,648	-17,289	-17,731
Of which: Nonfood	-14,452	-14,567	-3,557	-3,778	-3,276	-3,371	-13,982	-3,299	-3,706	-3,255	-3,524	-13,783	-14,170	-14,683	-15,280	-15,674
Services and transfers (net)	1,180	1,030	81	208	596	252	1,135	140	230	555	267	1,192	1,401	1,542	1,777	1,923
Nonfactor	303	242	-38	32	342	27	365	6	35	287	-5	323	375	418	428	446
Of which: Tourism	1,231	1,082	155	231	469	223	1,078	192	271	436	258	1,157	1,251	1,353	1,425	1,501
Factor Services and Transfers (net)	877	788	118	175	253	224	771	134	195	268	272	869	1,027	1,124	1,349	1,477
Of which: Workers' remittances	1,971	1,802	372	402	500	433	1,707	371	398	511	404	1,686	1,732	1,816	1,907	2,002
Interest payments on external debt	-556	553	-157	-140	-156	-132	-585	-173	-135	-170	-61	-538	-477	-435	-394	-388
Capital and financial account	4,248	3,244	1,216	1,488	1,195	897	4,795	1,762	620	817	877	4,075	3,419	3,661	3,437	3,274
Capital account	225	95	7	-3	46	55	105	-3	-3	43	51	89	89	89	89	89
Financial account	4,024	3,149	1,209	1,491	1,149	841	4,690	1,764	623	773	825	3,986	3,330	3,572	3,348	3,186
Direct investment and portfolio (net)	1,118	832	165	249	204	330	955	213	280	255	343	1,094	1,236	1,308	1,385	1,469
Medium- and long-term loans (net)	2,362	963	817	593	499	32	1,942	1,225	-39	98	282	1,567	1,034	919	306	531
Disbursement	3,572	2,442	1,089	1,573	923	498	4,084	1,443	673	441	664	3,220	2,847	2,386	2,336	2,538
Amortization	-1,210	-1,479	-272	-980	-424	-466	-2,142	-218	-711	-343	-381	-1,653	-1,813	-1,467	-2,031	-2,007
Short-term capital	543	1,353	227	302	349	314	1,192	224	275	326	37	862	893	1,189	1,517	1,044
of which: change in NFA of commercial banks	158	461	14	210	59	76	359	56	51	48	73	229	82	75	64	62
Valuation changes	…	0	0	347	97	158	601	103	106	94	160	463	167	156	140	141
Errors and omissions 1/	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Overall Balance	399	-532	-115	415	507	594	1,400	981	-404	146	176	899	307	587	419	284
Memorandum items:																
Current account balance/GDP (percent)	-8.9	-9.0	-3.3	-2.7	-1.7	-0.8	-8.5	-2.0	-2.6	-1.7	-1.8	-8.1	-7.5	-7.1	-6.5	-6.1
Reserves (in billions of US$)	7.4	5.9	5.8	6.3	6.8	7.3	7.3	8.3	7.9	8.0	8.2	8.2	8.5	9.1	9.5	9.8
Reserves in months of imports of goods and services 2/	4.1	3.4	3.4	3.6	3.9	4.3	4.3	4.7	4.4	4.5	4.6	4.6	4.6	4.7	4.7	4.7
Reserves/total short term external debt (percent) 3/	112.7	100.5	96.6	107.5	115.6	125.4	125.2	141.2	133.3	134.7	138.7	138.5	136.6	141.9	141.5	146.2
External medium- and long-term debt (billions of US$)	20.5	21.1	22.1	22.7	23.2	23.2	23.2	24.4	24.4	24.5	24.7	24.7	25.9	26.9	27.1	27.5
External medium- and long-term debt/GDP (percent)	49.2	54.7	53.1	57.9	60.1	61.4	61.4	61.1	61.9	63.0	65.1	65.1	64.8	63.7	60.7	58.1
External short-term debt (billions of US$)	6.6	5.9	6.0	5.8	5.8	5.8	5.8	5.9	5.9	6.0	5.9	5.9	6.2	6.4	6.7	6.7
External short-term debt/GDP (percent)	15.8	15.3	14.5	14.8	15.1	15.5	15.5	14.7	15.0	15.3	15.6	15.6	15.6	15.2	15.1	14.2
Debt service ratio (as percent XGS, including IMF)	10.1	12.2	10.8	26.5	14.5	12.7	18.4	9.6	20.1	12.7	9.2	16.2	15.5	11.6	13.5	13.5
Imports (percent of GDP)	44.3	43.7	44.3	47.1	43.6	43.9	44.8	42.9	47.6	43.6	46.8	45.2	44.6	43.8	43.1	41.9
Exports (percent of GDP)	32.6	32.2	30.9	34.5	30.4	38.1	33.5	33.8	34.9	31.0	36.7	34.1	33.6	33.2	32.7	31.8
National GDP in USD	43,156	42,074	10,570	10,119	9,747	9,551	39,927	10,057	9,910	9,776	9,604	39,336	41,284	43,579	46,078	48,797

Sources: Tunisian authorities; and IMF staff estimates and projections.

1/ Differs from zero in current and future years because of stocks valuation effects.

2/ End-of-year reserves over next year imports.

3/ Short-term defined as one year or less remaining maturity.

Table 3. Tunisia: External Financing Needs, 2015–22

(In millions of US dollars)

		Projections														
	2015	2016	2017					2018					2019	2020	2021	2022
	Year	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Year	Year	Year	Year
Total financing requirements	11,904	11,832	8,192	8,458	7,456	6,675	11,444	7,045	7,555	6,860	6,919	10,667	10,852	10,774	11,462	11,726
Current account deficit	3,849	3,776	1,331	1,073	688	303	3,395	780	1,024	671	700	3,176	3,112	3,074	3,018	2,990
Amortizations	1,209	1,492	272	980	424	463	2,139	218	711	343	380	1,653	1,813	1,467	2,031	2,007
Central government 1/	599	640	139	713	309	277	1,438	106	558	248	223	1,135	1,401	1,093	1,682	1,664
Central Bank 2/	85	375	24	30	20	28	101	19	17	4	3	42	4	0	0	0
Corporate 3/	525	477	109	238	96	158	601	94	136	91	155	476	408	374	348	342
Short-term debt 4/	6,846	6,565	6,589	6,405	6,344	5,909	5,909	6,046	5,819	5,847	5,838	5,838	5,926	6,233	6,413	6,729
Total financing sources	11,904	11,833	8,192	8,458	7,456	6,675	11,444	7,045	7,555	6,860	6,918	10,667	10,852	10,774	11,462	11,726
Direct investment and portfolio (net)	1,118	832	165	249	204	330	955	213	280	255	343	1,094	1,236	1,308	1,385	1,469
Disbursements	3,558	2,396	1,089	1,573	923	534	4,119	1,443	673	441	682	3,220	2,847	2,386	2,336	2,538
Central government 1/	2,771	1,766	1,003	1,490	803	416	3,712	1,344	575	345	587	2,833	2,455	1,987	1,928	2,119
Central Bank 2/	25	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Corporate 3/	762	629	87	83	120	118	408	99	98	96	95	387	392	399	409	419
Short-term debt	6,565	5,909	6,046	5,819	5,847	5,838	5,838	5,871	5,914	5,960	5,926	5,926	6,233	6,413	6,729	6,708
Other flows net (incl. drawdown in commercial banks NFA)	1,063	2,163	776	1,232	988	567	1,932	499	284	350	143	1,326	843	1,254	1,429	1,296
Drawdown in gross reserves	-399	532	115	-415	-507	-594	-1,400	-981	404	-146	-176	-899	-307	-587	-419	-284
Financing gap	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Of which: Multilateral (excluding IMF), bilateral and budget grants	1,370	577	0	108	764	55	927	233	107	279	159	779	850	1,300	1,300	1,300
Financial Market Access and other	88	611	939	1,011	24	6	1,980	1,024	13	24	6	1,417	968	418	419	919
Fund credits, net 5/	301	282	-17	235	-97	186	308	-133	235	-117	252	238	366	198	-77	-184
Purchases	301	316	0	308	0	307	615	0	369	0	369	737	737	369	0	0
Repurchase	0	34	17	72	97	121	307	133	133	117	117	499	371	171	77	184
Memorandum items:																
Gross international reserves (in millions of U.S. dollars)	7,401	5,941	5,838	6,254	6,760	7,320	7,308	8,289	7,885	8,030	8,220	8,207	8,513	9,100	9,519	9,803
Government rollover rates (in percent)	467	276	721	209	260	150	258	1,271	103	139	263	250	175	182	115	127
Corporate rollover rates (in percent)	145	132	79	35	125	75	68	106	72	106	61	81	96	107	117	122

Sources: Tunisian authorities; and IMF staff projections.

1/ Central government includes IMF purchase made available for budget support.

2/ Central Bank includes IMF purchase made available for BOP support.

3/ Includes public and private entreprises.

4/ Stock of short-term debt outstanding at end of previous year.

5/ Under the proposed schedule of purchases during the EFF.

Table 4. Tunisia: Central Government Fiscal Operations, 2015–18

(In millions of dinars)

	2015	2016	2017					2018				
	Annual	Annual	Annual	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4
	Est.	Prel.			Proj.					Proj.		
Total revenue and grants	19,945	20,568	23,671	5,418	6,022	6,112	6,119	25,852	5,966	6,525	6,657	6,705
Revenue	19,653	20,438	23,409	5,418	6,022	5,992	5,978	25,586	5,966	6,525	6,534	6,561
Tax revenue	18,487	18,702	21,598	5,185	5,489	5,305	5,619	23,683	5,723	5,965	5,812	6,184
Direct taxes	7,816	7,577	9,184	2,054	2,584	2,274	2,273	8,889	1,987	2,501	2,201	2,199
Trade taxes	825	640	700	172	162	147	219	800	196	185	168	250
VAT	5,057	5,138	5,871	1,433	1,324	1,472	1,642	6,891	1,682	1,555	1,727	1,927
Excise	1,773	2,174	2,418	619	583	607	609	2,874	735	693	721	724
Other taxes	3,016	3,174	3,425	908	835	805	877	4,229	1,121	1,031	994	1,083
Tax measures to be identified	…	…	0	…	…	…	…	0	…	…	…	…
Nontax revenue	1,162	1,725	1,807	230	531	687	359	1,901	242	559	723	378
Of which: ETAP and STIR 1/	150	130	335	…	…	…	…	333	…	…	…	…
Grants	292	130	262	0	0	121	141	266	0	0	123	143
Total expenditure and net lending	24,395	25,930	29,383	7,277	6,673	6,357	9,076	31,473	8,090	7,170	6,921	9,292
Total expenditure	23,675	25,839	29,418	7,336	6,684	6,329	9,069	31,460	8,087	7,167	6,918	9,289
Current expenditure	19,732	21,040	23,947	6,258	5,383	5,025	7,280	25,416	6,774	5,769	5,496	7,377
Wages and salaries	11,542	13,117	13,775	4,222	3,277	3,308	2,969	15,525	4,758	3,693	3,728	3,346
Of which: one-off civil service reform costs	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*796*	*199*	*199*	*199*	*199*
Of which: Ministry of Defense and Interior	*2,752*	3,100	3,238	…	…	…	…	3,380	…	…	…	…
Goods and services	1,682	1,737	1,445	498	212	210	526	1,519	523	223	221	552
Interest payments	1,644	1,986	2,190	672	591	472	455	2,576	791	689	564	532
Transfers and subsidies	4,864	4,200	6,527	867	1,301	1,032	3,328	5,796	702	1,164	984	2,946
CGC (Food)	1,530	1,581	1,720	101	401	430	789	1,670	98	389	418	766
Energy subsidies (gross) 1/	918	197	1,427	0	150	150	1,127	1,276	0	134	134	1,008
Other (including CNRPS and BFT)	2,001	1,989	3,380	766	750	452	1,412	2,370	537	526	317	990
Other expenditure (non-allocated)	0	0	10	0	3	3	3	0	0	0	0	0
Capital expenditure	3,943	4,798	5,471	1,077	1,301	1,304	1,789	6,044	1,313	1,398	1,422	1,911
Net lending	720	91	-35	-59	-11	28	7	13	3	3	3	3
Of which: Public banks' recap. and restructuring	*647*	0	0	0	0	0	0	0	0	0	0	0
Central government overall balance (excluding grants)	-4,743	-5,492	-5,974	-1,859	-651	-365	-3,098	-5,887	-1,832	-642	-360	-3,053
Central government overall balance (including grants)	-4,451	-5,362	-5,712	-1,859	-651	-244	-2,957	-5,621	-1,829	-641	-241	-2,910
Float 2/	-216	-446	0	0	0	0	0	0	0	0	0	0
Central government overall balance (excluding grants, cash basis)	-4,958	-5,938	-5,974	-1,859	-651	-365	-3,098	-5,887	-1,832	-642	-360	-3,053
Central government overall balance (including grants, cash basis)	-4,666	-5,808	-5,712	-1,859	-651	-244	-2,957	-5,621	-1,829	-641	-241	-2,910
Financing, net	4,666	5,808	5,712	1,859	651	244	2,957	5,621	1,829	641	241	2,910
Foreign	4,285	2,479	5,449	1,989	1,870	1,236	353	4,516	3,220	45	259	992
Drawings	5,462	3,861	8,962	2,310	3,585	2,007	1,060	7,533	3,495	1,518	922	1,599
Amortization	1,177	1,382	3,513	320	1,714	771	707	3,017	275	1,472	662	607
Domestic financing	382	3,329	263	-130	-1,219	-991	2,604	1,104	-1,391	595	-19	1,918
Debt	590	2,059	1,279	476	208	270	325	484	420	75	-247	236
Drawings	2,381	3,889	2,490	539	411	1,091	449	2,400	519	396	1,052	433
Amortization	1,792	1,830	1,211	63	203	821	125	1,916	100	321	1,298	197
Non-debt	-249	1,271	-1,016	-606	-1,427	-1,262	2,279	620	-1,810	520	228	1,682
Government Deposits (+= drawing / -= accumulation)	-319	744	-1,216	-606	-1,427	-1,362	2,179	420	-1,810	520	128	1,582
Privatization proceeds and sale of confiscated assets 3/	70	527	200	0	0	100	100	200	0	0	100	100
Financing gap	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:												
Social expenditures 4/	1,335	1,411	1,533	487	255	255	102	2,033	624	368	368	146
Central government primary balance (excluding grants, cash basis)	-3,314	-3,951	-3,784	-1,187	-60	107	-2,643	-3,311	-1,041	48	204	-2,521
Structural fiscal balance 5/	-3,934	-5,078	-5,954	…	…	…	…	-4,536	…	…	…	…
Central government debt 6/	48,465	56,830	67,316	…	…	…	…	75,370	…	…	…	…
Nominal GDP	84,656	90,376	97,397	24,349	24,349	24,349	24,349	104,603	26,151	26,151	26,151	26,151

Sources: Tunisian authorities; and IMF staff estimates.

1/ Energy subsidies used to be accounted as expenses net of revenue streams from utilities and fuel companies. The series has been revised to report gross flows of revenues from the commercialization of fuel of Entreprise Tunisienne d'Activités Pétrolières (ETAP) and from operational surplus of Société Tunisienne des Industries de Raffinage (STIR). Revenues beyond 2016 are not forecasted. A smoothing fuel mechanism is expected to be implemented on May 1, 2017, to bridge the gap between domestic and international prices; surplus dividends linked to this mechanism are not expected.

2/ Difference between the cash and accrual central government overall deficit calculated at the end of the period. For actual data, this line also includes items for which payment has been ordered but the corresponding amounts have not been withdrawn from the treasury accounts. A negative sign implies higher cash spending than ordered (i.e. higher required financing).

3/ Includes mostly the sale of confiscated assets.

4/ Public capital expenditures of key ministries and social transfers and programs.

5/ Excludes one-off revenues and costs, and corrects for the GDP cycle.

6/ Gross debt.

Table 5. Tunisia: Central Governmental Fiscal Operations, 2015–22

(In percent of GDP)

	2015	2016		2017		2018	2019	2020	2021	2022
	Est.	Prog.	Proj.	Prog.	Proj.			Proj.		
Total revenue and grants	23.6	24.1	22.8	24.4	24.3	24.7	24.5	24.6	24.6	24.6
Revenue	23.2	23.9	22.6	24.1	24.0	24.5	24.3	24.3	24.4	24.4
Tax revenue	21.8	21.7	20.7	22.2	22.2	22.6	22.8	22.8	22.9	22.9
Direct taxes	9.2	8.9	8.4	9.1	9.4	8.5	8.5	8.6	8.6	8.6
Trade taxes	1.0	0.6	0.7	0.7	0.7	0.8	0.8	0.7	0.7	0.7
VAT	6.0	6.2	5.7	6.5	6.0	6.6	6.4	6.4	6.5	6.6
Excise	2.1	2.5	2.4	2.6	2.5	2.7	2.9	2.9	2.9	2.9
Other taxes	3.6	3.5	3.5	3.2	3.5	4.0	4.2	4.1	4.1	4.1
Tax measures to be identified	...	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue	1.4	2.2	1.9	1.9	1.9	1.8	1.5	1.5	1.5	1.5
Of which: ETAP and STIR *1/*	0.2	0.5	...	...	...	...	...	...	...	...
Grants	0.3	0.2	0.1	0.3	0.3	0.3	0.2	0.2	0.2	0.2
Total expenditure and net lending	28.8	28.5	28.7	28.0	30.2	30.1	28.6	27.5	26.6	26.4
Total expenditure	28.0	28.5	28.6	27.8	30.2	30.1	28.6	27.5	26.6	26.4
Current expenditure	23.3	23.5	23.3	22.3	24.6	24.3	22.8	21.3	20.2	19.7
Wages and salaries	13.6	14.1	14.5	13.8	14.1	14.8	13.1	12.1	11.7	11.7
Of which: One-off civil service reform costs	0.0	0.0	0.0	0.0	0.0	0.8	0.0	0.0	0.0	0.0
Of which: Ministry of Defense and Interior	3.3	3.4	3.4	3.3	3.3	3.2	3.1	3.0	2.9	2.8
Goods and services	2.0	2.4	1.9	2.0	1.5	1.5	1.4	1.4	1.4	1.3
Interest payments	1.9	2.0	2.2	2.1	2.2	2.5	2.5	2.5	2.6	2.5
Transfers and subsidies	5.7	4.9	4.6	4.5	6.7	5.5	5.5	5.1	4.4	4.2
CGC (Food)	1.8	1.7	1.7	1.7	1.8	1.6	1.5	1.4	1.3	1.2
Energy subsidies (gross) 1/	1.1	0.2	0.2	0.2	1.5	1.2	1.2	1.1	1.1	1.1
Other (including CNRPS and BFT)	2.4	3.0	2.2	2.6	3.5	2.3	2.4	2.1	1.5	1.5
Other expenditure (non-allocated)	0.0	0.1	0.0	0.0	0.0	0.0	0.2	0.2	0.2	0.0
Capital expenditure	4.7	5.0	5.3	5.5	5.6	5.8	5.9	6.2	6.4	6.7
Net lending	0.9	-0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Public banks' recap. and restructuring	*0.8*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Central overall government balance (-) (excluding grants)	-5.6	-4.6	-6.1	-3.9	-6.1	-5.6	-4.4	-3.1	-2.2	-2.0
Central overall government balance (-), (including grants)	-5.3	-4.4	-5.9	-3.5	-5.9	-5.4	-4.1	-2.9	-2.0	-1.8
Float 2/	-0.3	0.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central government overall balance (-), (excluding grants, cash basis)	-5.9	-4.6	-6.6	-3.9	-6.1	-5.6	-4.4	-3.1	-2.2	-2.0
Central government overall balance (-), (including grants, cash basis)	-5.5	-4.4	-6.4	-3.5	-5.9	-5.4	-4.1	-2.9	-2.0	-1.8
Financing, net	5.5	4.4	6.4	3.5	5.9	5.4	4.1	2.9	2.0	1.8
Foreign	5.1	4.5	2.7	2.5	5.6	4.3	2.6	2.1	0.5	0.9
Domestic	0.5	-0.2	3.7	1.1	0.3	1.1	1.6	0.9	1.5	0.8
Of which: Privatization proceeds and sale of confiscated assets 3/	0.1	0.2	0.6	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Social expenditures 4/	1.6	1.7	1.6	1.6	1.6	1.9	...	...	...	...
Central government primary balance (excluding grants, cash basis)	-3.7	-2.5	-3.9	-1.8	-3.9	-3.2	-1.9	-0.6	0.4	0.5
Structural fiscal balance 5/	-4.6	-4.0	-5.6	-3.3	-6.1	-4.3	-3.9	-2.9	-2.1	-2.0
Change in the structural fiscal balance (+: improvement)	-0.2	0.3	-1.0	0.7	-0.5	1.8	0.4	1.0	0.8	0.1
Central government debt 6/	57.2	54.6	62.9	54.5	69.1	72.1	71.6	70.2	67.8	65.3

Sources: Tunisian authorities; and IMF staff estimates.

1/ Energy subsidies used to be accounted as expenses net of revenue streams from utilities and fuel companies. The series has been revised to report gross flows of revenues from the commercialization of fuel of Entreprise Tunisienne d'Activités Pétrolières (ETAP) and from operational surplus of Société Tunisienne des Industries de Raffinage (STIR). Revenues beyond 2016 are not forecasted. A smoothing fuel mechanism is expected to be implemented on July 1, 2017, to bridge the gap between domestic and international prices; surplus dividends linked to this mechanism are not expected.

2/ Difference between the cash and accrual central government overall deficit data calculated at the end of the period. For actual data, this line also includes payments for which payment has been ordered but the corresponding amounts have not been withdrawn from the treasury accounts. A negative sign implies higher cash spending than ordered (i.e. higher required financing).

3/ Includes mostly the sale of confiscated assets.

4/ Public capital expenditures of key ministries and social transfers and programs.

5/ Excludes one-off revenues and costs, and corrects for the GDP cycle.

6/ Gross debt.

Table 6. Tunisia: Monetary Survey, 2015–18

(In millions of dinars)

	2015	2016	2017					2018
	Annual	Annual	Q1	Q2	Q3	Q4	Annual	Annual
	Est.		Proj.					Proj.
Net foreign assets (NFA)	1,686	-949	-1,276	-1,376	-15	705	705	1,810
Foreign assets	17,849	16,644	16,110	17,263	18,571	20,063	20,063	22,635
Central bank	15,075	13,932	13,666	14,670	15,936	17,362	17,362	19,753
Foreign liabilities	-16,162	-17,592	-17,386	-18,639	-18,587	-19,358	-19,358	-20,824
Central bank	-5,991	-6,404	-6,434	-7,017	-6,773	-7,254	-7,254	-7,910
Net domestic assets (NDA)	60,213	67,832	67,341	69,391	69,833	72,866	72,866	77,888
Domestic credit	80,448	91,365	91,510	91,878	92,307	97,800	97,800	106,222
Credit to the government (net)	14,355	18,892	17,283	16,727	16,015	20,080	20,080	22,712
Central bank net credit	688	3,992	2,206	1,540	179	4,560	4,560	6,975
Commercial banks	7,199	8,649	8,846	8,955	9,604	9,288	9,288	9,506
Other	6,468	6,251	6,231	6,231	6,231	6,231	6,231	6,231
Credit to the economy	66,093	72,472	74,227	75,151	76,292	77,720	77,720	83,510
Other items (net)	-20,235	-23,533	-24,168	-22,487	-22,473	-24,934	-24,934	-28,334
Money plus quasi-money (M2)	58,828	63,660	62,792	63,717	66,713	69,709	69,709	75,515
Money (M1)	24,444	26,409	26,130	26,219	27,676	28,919	28,919	31,327
Currency	8,418	9,749	9,726	10,002	10,216	10,675	10,675	11,564
Demand deposits	16,026	16,661	16,404	16,218	17,460	18,244	18,244	19,763
Quasi-money	34,384	37,251	36,662	37,498	39,038	40,791	40,791	44,188
Long-term deposits (M3-M2)	3,071	3,223	3,273	4,297	3,105	3,862	3,862	4,183
Broad money (M3)	61,899	66,883	66,065	68,015	69,818	73,571	73,571	79,699
(Annual rate of change in percent)								
Net foreign assets	-22.4	-156.3	-2,628.7	-3.0	-98.4	-174.3	-174.3	156.9
Net domestic assets	6.3	12.7	7.3	6.7	6.8	7.4	7.4	6.9
Domestic credit	7.5	13.6	8.9	5.0	4.0	7.0	7.0	8.6
Credit to government (net)	13.8	31.6	5.0	-5.4	-11.7	6.3	6.3	13.1
Credit to the economy	6.2	9.7	9.8	7.7	8.1	7.2	7.2	7.4
Money and quasi-money (M2)	5.2	8.2	5.1	5.5	8.8	9.5	9.5	8.3
Broad money (M3)	5.3	8.1	5.1	7.0	8.4	10.0	10.0	8.3
(Annual growth rates, in percent of broad money)								
Net foreign assets	-0.8	-4.3	-2.1	0.1	1.5	2.5	2.5	1.5
Net domestic assets	6.1	12.3	7.3	6.9	6.9	7.5	7.5	6.8
Domestic credit	9.6	17.6	11.9	6.9	5.5	9.6	9.6	11.4
Credit to the government (net)	3.0	7.3	1.3	-1.5	-3.3	1.8	1.8	3.6
Credit to the economy	6.6	10.3	10.6	8.4	8.9	7.8	7.8	7.9
Other items (net)	-3.5	7.8	4.9	5.2	8.4	9.0	9.0	-4.6
Memorandum items:								
GDP (in millions of dinars)	84,656	90,376					97,397	104,603

Sources: Tunisian authorities; and IMF staff estimates and projections.

Table 7. Tunisia: Central Bank Survey, 2015–18

(In millions of dinars)

	2015	2016	2017					2018
	Annual	Annual	Q1	Q2	Q3	Q4	Annual	Annual
Net Foreign Assets	9,084	7,528	7,232	7,653	9,163	10,108	10,108	11,844
Assets	15,075	13,932	13,666	14,670	15,936	17,362	17,362	19,753
of which: proceeds of FX swaps	606	524	524	524	524	524	524	524
Liabilities	5,991	6,404	6,434	7,017	6,773	7,254	7,254	7,910
Net Domestic Assets	1,924	5,094	5,351	5,550	4,337	3,834	3,834	3,412
Domestic credit (net)	4,897	9,483	9,692	9,909	8,193	8,261	8,261	8,926
Net credit to government 1/	688	3,993	2,206	1,541	180	3,152	3,152	5,567
Credit to Banks	4,209	5,490	7,486	8,367	8,014	5,109	5,109	3,359
Other items net	-2,973	-4,389	-4,341	-4,359	-3,856	-4,427	-4,427	-5,514
Reserve Money 2/	11,009	12,622	12,583	13,203	13,500	13,942	13,942	15,256
Memorandum items:								
FX swap operations	606	524	524	524	524	524	524	524
Total refinancing of banks by the CBT (except OMPs)	4,815	6,014	8,010	8,891	8,538	5,633	5,633	3,883

Sources: Central Bank of Tunisia; and IMF staff estimates.

1/ Includes subscription to IMF/AMF.

2/ Excludes deposits of other financial institutions, individuals, and nonfinancial enterprises.

Table 8. Tunisia: Financial Soundness Indicators of the Banking Sector, 2010–16

(In percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016
Regulatory capital to risk-weighted assets	11.6	11.9	11.8	8.2	9.4	12.0	11.6
Tier 1 capital to risk weighted assets	10.2	10.0	9.5	6.6	7.6	9.3	8.8
Capital to assets	8.4	8.5	7.8	5.6	6.2	7.8	8.2
Asset quality							
Sectoral distribution of loans to total loans							
Industry	30.5	28.6	27.9	27.8	27.2	27.3	26.9
Agriculture	2.9	2.9	2.8	2.8	2.8	2.6	2.6
Commerce	15.0	16.0	15.4	15.1	15.6	15.8	15.9
Construction	5.9	5.6	5.4	5.5	5.7	6.2	6.2
Tourism	7.3	7.3	6.9	6.5	6.1	6.2	5.8
Households	22.1	23.4	25.4	26.2	26.2	26.6	26.3
Other	16.3	16.3	16.2	16.0	16.5	15.4	16.3
FX-loans to total loans	5.3	5.1	4.8	4.8	5.5	5.8	5.7
Credit to the private sector as a percentage of GDP 1/	70.6	67.4	67.7	73.7	73.8	73.5	73.7
Nonperforming Loans (NPLs) to total loans	13.0	13.3	14.9	16.5	15.8	16.6	15.6
Specific provisions to NPLs	-	48.6	45.7	56.4	58.0	56.9	59.0
NPLs, net of provisions, to Tier 1 capital	60.3	66.2	86.3	111.6	90.3	78.8	68.2
Specific provisions to total loans	7.6	7.6	8.0	10.3	10.1	10.5	10.2
General provisions to total loans	-	0.4	0.5	0.6	0.6	0.6	0.6
Profitability							
Return on assets (ROA)	0.9	0.6	0.6	0.3	0.9	0.9	-
Return on equity (ROE)	10.2	5.9	7.2	3.0	11.2	10.9	-
Interest rate average spread (between loans and deposit	3.5	3.0	3.0	3.3	3.1	3.0	2.9
Interest return on credit	6.2	5.7	5.4	5.9	6.4	6.3	6.0
Cost of risk as a percent of credit	1.7	1.2	1.2	1.9	1.1	1.1	0.9
Net interest margin to net banking product (PNB)	58.6	57.2	58.1	58.9	57.2	54.6	50.9
Operating expenses to PNB	46.5	51.1	50.3	47.3	48.5	49.2	48.5
Operating expenses to total assets	1.6	1.7	1.6	1.6	1.7	1.7	1.7
Personnel expenses to non-interest expenses	59.1	62.6	61.5	60.8	59.3	60.1	58.7
Trading and other non-interest income to PNB	21.8	22.5	20.9	21.6	22.4	24.3	29.5
Liquidity							
Liquid assets to total assets 2/	29.8	26.5	28.2	28.4	28.2	5.6	5.6
Liquid assets to short-term liabilities	104.1	89.4	89.2	92.6	96.6	83.8	94.4
Deposits to loans	94.6	87.4	89.5	89.6	88.8	87.4	86.8
Deposits of state-owned enterprises to total deposits	13.8	12.6	13.2	13.0	11.7	9.5	7.8
Sensitivity to market risk							
FX net open position to Tier 1 Capital	1.35	1.94	2.3	3.1	2.2	3.3	4.9

Source: Central Bank of Tunisia.

1/ Coverage of private sector credit may differ from that of Table 6.

2/ The definition of the liquidity ratio was modified in 2015. Liquid assets now include only treasury bills and cash. Using the new definition, the end-December 2014 liquidity ratio would have been 6 percent.

Table 9. Tunisia: Illustrative Medium-Term Growth Scenario, 2012–22

						Proj.					
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
						(Change in percent)					
Real GDP growth	3.9	2.4	2.3	1.1	1.0	2.3	3.0	3.5	4.1	4.3	4.3
Total consumption	4.6	3.3	3.6	2.3	2.0	3.1	1.7	3.0	3.1	4.2	4.3
Private consumption	4.4	3.0	4.0	1.6	1.5	4.6	0.2	6.2	4.9	5.2	4.5
Public consumption	5.2	4.3	2.6	4.8	3.8	-1.9	7.3	-7.6	-3.7	0.4	3.7
Investment	5.3	-5.4	8.5	-2.6	4.0	4.5	5.5	6.3	7.0	7.5	7.5
Gross fixed capital formation	6.1	0.2	-2.6	-2.5	4.0	4.5	5.5	6.3	7.0	7.5	7.5
Exports of goods and nfs 1/	6.8	2.6	4.2	-2.8	0.2	2.4	6.8	4.5	4.7	4.4	4.4
Imports of goods and nfs 1/	8.3	4.9	2.6	-2.5	2.3	4.5	4.8	4.4	4.1	4.9	5.1
Inflation (annual average)	5.1	5.8	4.9	4.9	3.7	4.5	4.4	4.0	3.8	3.6	3.5
						(In percent of GDP)					
Gross national savings	16.1	14.4	14.0	12.5	13.5	13.6	15.1	16.2	17.3	18.3	19.3
Central government 2/	1.0	-2.4	1.2	0.3	-0.5	-0.3	0.4	1.8	3.3	4.4	5.0
Rest of the economy	15.2	16.7	12.8	12.3	14.1	13.9	14.7	14.4	14.0	13.9	14.3
Gross investment	24.4	22.7	23.2	21.4	22.5	22.1	23.2	23.7	24.4	24.8	25.4
Central government	6.7	5.0	4.3	4.7	5.3	5.6	5.8	5.9	6.2	6.4	6.7
Rest of the Economy	17.8	17.8	18.8	16.8	17.2	16.5	17.4	17.8	18.2	18.4	18.7
Total consumption	85.0	86.8	87.8	89.6	89.0	88.9	87.8	87.0	85.9	85.6	85.0
Private consumption	66.8	68.1	69.1	70.0	68.3	69.3	67.3	68.7	68.9	69.2	68.7
Public consumption	18.2	18.6	18.7	19.6	20.7	19.6	20.5	18.3	17.0	16.4	16.3
Savings-investment gap	-8.3	-8.4	-9.1	-8.9	-9.0	-8.5	-8.1	-7.5	-7.1	-6.5	-6.1
Central government	-5.7	-7.3	-3.1	-4.4	-5.8	-5.9	-5.4	-4.1	-2.9	-2.0	-1.7
Rest of the economy	-2.6	-1.0	-6.0	-4.5	-3.1	-2.6	-2.7	-3.4	-4.2	-4.6	-4.4
Memorandum items											
Nominal GDP at current prices (TD millions)	70,354	75,152	80,816	84,656	90,376	97,397	104,603	112,404	121,225	130,610	140,721
Central government debt in percent of GDP	47.7	46.8	51.6	57.2	62.9	69.1	72.1	71.6	70.2	67.8	65.3
External debt in percent of GDP	53.0	57.0	61.4	64.9	70.0	76.9	80.7	80.4	78.9	75.8	72.3
Central government balance in percent of GDP 3/	-5.7	-7.4	-4.4	-5.6	-6.1	-6.1	-5.6	-4.4	-3.1	-2.2	-2.0
Current account balance in percent of GDP	-8.3	-8.4	-9.1	-8.9	-9.0	-8.5	-8.1	-7.5	-7.1	-6.5	-6.1
Credit to the economy (yoy growth, percent)	8.8	6.8	9.4	6.2	9.7	7.2	7.4	7.9	8.2	8.3	8.1
Social expenditures (in percent of GDP) 4/	2.1	1.7	1.5	1.6	1.6	1.6	1.9	…	…	…	…

Sources: Tunisian authorities; and IMF staff estimates.

1/ Goods and nonfactor services.

2/ Excludes social security, public enterprises, and local governments.

3/ Including grants and excluding privatization.

4/ Public capital expenditures of key ministries and social transfers and programs.

Table 10. Tunisia: Schedule of Purchases Under the Extended Fund Facility, 2016–20

Review	Availability Date	Action	Purchase		Disbursements
			Millions of SDRs	Percent of quota 1/	Millions of U.S. dollars 2/
	May 24, 2016 3/	Board approval of the EFF	227.2920	41.690	315.901
First Review	September 30, 2016	Observance of end-December 2016 performance criteria, completion of the first review	227.2917	41.690	307.540
Second Review	September 30, 2017	Observance of end-June 2017 performance criteria, completion of the second review	227.2917	41.690	307.540
Third Review	March 31, 2018	Observance of end-December 2017 performance criteria, completion of the third review	272.7500	50.028	368.608
Fourth Review	September 30, 2018	Observance of end-June 2018 performance criteria, completion of the fourth review	272.7500	50.028	368.608
Fifth Review	March 31, 2019	Observance of end-December 2018 performance criteria, completion of the fifth review	272.7500	50.028	368.626
Sixth Review	September 30, 2019	Observance of end-June 2019 performance criteria, completion of the sixth review	272.7500	50.028	368.626
Seventh Review	March 31, 2020	Observance of end-December 2019 performance criteria, completion of the seventh review	272.7496	50.028	368.603
Total			2,045.625	375.206	2,774.052

Source: IMF staff projections.

1/ Quota is SDR 545.2 million.

2/ Indicative amount based on the program exchange rate.

3/ The EFF Board approval date was May 20, 2016. The disbursement date was May 24, 2016.

Table 11. Tunisia: Indicators of Fund Credit, 2015–22

	2015	2016	2017	2018	2019	2020	2021	2022
Existing and prospective Fund credit (millions of SDR)								
Disbursement	215.0	227.3	454.6	545.5	545.5	272.8	-	-
Stock	1,002.8	1,205.3	1,432.9	1,609.2	1,880.3	2,026.6	1,969.8	1,833.5
Obligations	-	39.0	249.8	401.2	316.8	181.1	118.9	195.0
Repurchase	-	24.7	227.0	369.3	274.4	126.4	56.8	136.4
Charges and surcharges	-	14.3	22.8	31.9	42.5	54.8	62.1	58.6
Stock of existing and prospective Fund credit								
In percent of quota	350.0	221.1	262.8	295.1	344.9	371.7	361.3	336.3
In percent of GDP	3.3	4.0	4.9	5.5	6.2	6.3	5.8	5.1
In percent of exports of goods and services	8.0	9.9	11.7	13.1	14.8	15.3	14.3	12.9
In percent of gross reserves	19.0	28.2	26.5	26.5	29.8	30.1	27.9	25.2
Obligations to the Fund from existing and prospective Fund arrangements								
In percent of quota	-	7.1	45.8	73.6	58.1	33.2	21.8	35.8
In percent of GDP	-	0.1	0.8	1.4	1.0	0.6	0.3	0.5
In percent of exports of goods and services	-	0.3	2.0	3.3	2.5	1.4	0.9	1.4
In percent of gross reserves	-	0.9	4.6	6.6	5.0	2.7	1.7	2.7

Source: IMF staff estimates.

Annex I. Public Debt Sustainability Analysis

Tunisia's public debt remains sustainable but is increasing at a fast pace. Central government[1] debt is expected to peak at 72 percent of GDP in 2018 (from an average of 45 percent 2010–14) before declining in the later years of the program following strong fiscal consolidation (the "baseline" scenario). Gross financing needs are expected to average 13 percent of GDP through 2022, reflecting high deficits and, over the medium-term, rollover needs. The debt level breaches the emerging markets debt burden benchmark of 70 percent of GDP under the baseline, but Tunisia continues to benefit from long maturities and a stable creditor base with a high share of debt owed to IFIs and bilateral donors. Stress scenarios confirm the sustainability of debt, but also identifies significant risks from contingent liabilities and exchange rate depreciation, especially if combined with permanently lower growth.[2]

Baseline and realism of projections[3]

- **Growth and prices.** Growth has remained sluggish since the 2015 attacks, and weak tourism and low investor confidence will weigh on the recovery. Forecast errors show that past projections of growth were optimistic, but these were mainly driven by exogenous shocks (the revolution in 2011 and the terror attacks in 2015). The track record of deflator forecasting is good; low commodity prices and a prudent monetary policy are expected to keep inflation around 4 percent over the medium term.

- **Debt level and fiscal adjustment.** The looser fiscal stance, weaker-than-expected growth, a change in the classification of certain debt components,[4] and exchange rate depreciation in particular have pushed the debt-to-GDP ratio to an estimated 63 percent at end-2016. The fiscal deficit will be stabilized in 2017, with consolidation starting in 2018 that will reduce the debt-to-GDP ratio to 65 percent in 2022 from a peak of 72 percent of GDP in 2018. The three-year adjustment of the cyclically-adjusted primary balance (CAPB) is just within the top quartile, but its average level is in line with peers.

- **Sovereign yields.** Tunisia's effective interest rate is projected to decline to its lowest level in the next three years thanks to the large proportion of concessional or guaranteed debt and the

[1] See definition of central government in the Technical Memorandum of Understanding (¶7).

[2] State guarantees (12 percent of GDP) are excluded from the baseline stock of debt because the low probability of being called; the contingent liability shock provides a reliable estimate of the impact of most such guarantees being called simultaneously.

[3] The DSA framework is described at http://www.imf.org/external/np/pp/eng/2013/050913.pdf

[4] The reclassification pertains to government deposits that sued to be netted out of public debt; in line with good practice, they are now included in the debt stock. End-2015 stock of debt in the previous DSA stood at 53.2 percent of GDP (see *Annex II. Public Debt Sustainability Analysis,* IMF Country Report No. 16/138).

repayment of the 2017 Eurobond, despite a recent debt downgrade.[5] However, projected market issuance in the outer years will start lifting effective rates in the medium term. Domestic yields have increased in recent months and might increase further in the next two years, before stabilizing in the medium term thanks to declining risk premium as reforms bear fruit.

- **Maturity and rollover.** Tunisia enjoys relatively long maturities in both foreign and domestic debt (with an average above three years for domestic debt and low amounts of short-term commercial paper issued). Gross public financing needs will peak after 2021 (just under 15 percent of GDP), due to the maturing of recent market issuances.[6] The high share of foreign currency-denominated public debt leaves debt vulnerable to exchange rate fluctuations, although the debt profile has recently improved with higher reliance on domestic sources of financing.

Stress test and heat map

Public debt dynamics remain sustainable under all scenarios, but risks are increasing and conditions could deteriorate significantly relative to baseline. Tunisia's debt to GDP ratio is above the emerging market debt burden benchmark, and financing needs risks closely approach it. This emphasizes the need for urgent fiscal consolidation, as highlighted by the heat map. Tunisia is most vulnerable to foreign investor sentiment risks and growth and real exchange rate shocks. Debt profile risks are more benign as public debt is generally of long maturity. Risks are elevated but provided fiscal consolidation begins as programmed, debt dynamics remain sustainable.

- The most severe individual shocks point to higher but still-sustainable debt in the medium term. The realization of a one-off 10 percent of GDP fiscal contingent liability, which could come in the form of callable state guarantees, public bank bailouts, or ailing SOEs, would increase debt to 86 percent of GDP.[7] In this case, the debt trajectory remains sustainable even if 90 percent of existing contingent liabilities are called, although debt levels and gross financing risks are high, as evidenced in the heat map. A one-time 30 percent real depreciation would increase the public debt-to-GDP ratio to about 82 percent of GDP before it declines to 74 percent by 2022, because of the high share of FX-denominated debt. Under the other alternative scenarios, the public debt-to-GDP ratio would initially worsen to a maximum between 72 and 86 percent of GDP and then decline to 65 and 78 percent of GDP in 2022.

[5] On February 3, 2017 Fitch Ratings downgraded Tunisia's long-term foreign sovereign credit rating by one notch to 'B+' from 'BB-.

[6] Add detail here on 2015, 2016 US guarantee, and 2017 Eurobond.

[7] The one-off 10 percent of GDP shock to contingent liabilities reflects an additional three percent of GDP in bank recapitalization costs and the realization of about 7 percent of GDP of government's contingent liabilities from public enterprises (these represent about 70 percent of government's existing contingent liabilities).

- As expected, a combined macro-fiscal shock (to real growth and the primary balance) would have a larger impact than an isolated event and raise public debt to 97 percent of GDP by 2019. The results of the asymmetric fan chart (see below) reinforce the need for fiscal adjustment to prevent debt approaching an unsustainable level.

Tunisia: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP unless otherwise indicated)

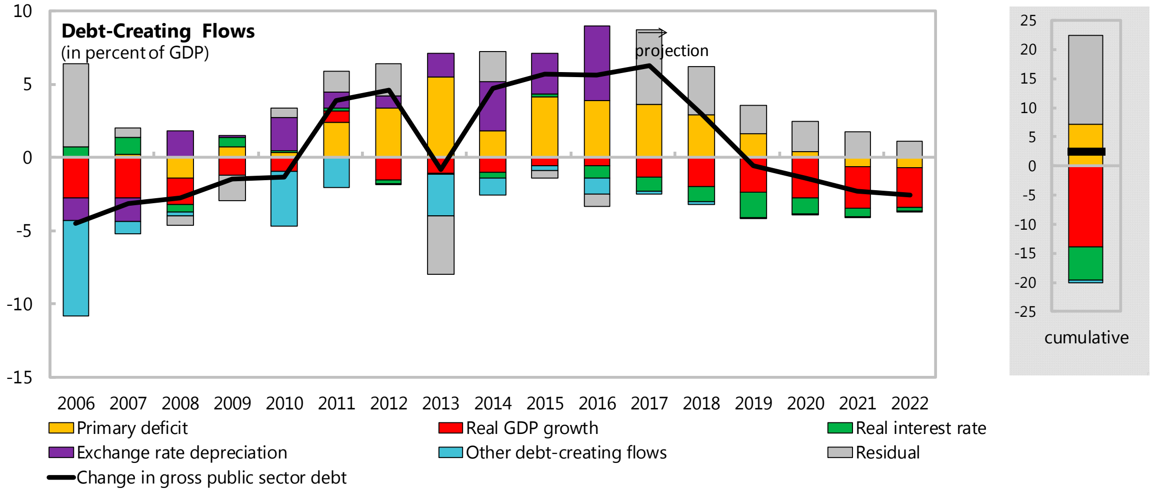
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2006-2014 [2]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	44.9	57.2	62.9	69.1	72.1	71.6	70.2	67.8	65.3
Public gross financing needs	4.0	5.4	5.6	10.7	11.0	11.9	11.7	14.9	14.9
Real GDP growth (in percent)	3.2	1.1	1.0	2.3	3.0	3.5	4.1	4.3	4.3
Inflation (GDP deflator, in percent)	4.3	3.6	5.7	5.3	4.2	3.8	3.6	3.3	3.3
Nominal GDP growth (in percent)	7.6	4.8	6.8	7.8	7.4	7.5	7.8	7.7	7.7
Effective interest rate (in percent) [4]	4.8	3.9	4.1	3.9	2.7	1.4	2.0	2.5	3.1

As of April 29, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		157
5Y CDS (bp)		416
Ratings	Foreign	Local
Moody's	Ba3	Ba3
S&Ps	...	...
Fitch	B+	B+

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	-0.1	5.7	5.6	6.2	3.0	-0.6	-1.4	-2.3	-2.6	2.4	
Identified debt-creating flows	-0.8	6.2	6.5	1.1	-0.3	-2.5	-3.5	-4.1	-3.7	-12.9	
Primary deficit	1.4	4.2	3.9	3.6	2.9	1.6	0.4	-0.6	-0.7	7.2	-2.9
Primary (noninterest) revenue and grants	23.8	23.6	22.8	24.3	24.7	24.5	24.6	24.6	24.6	147.4	
Primary (noninterest) expenditure	25.3	27.7	26.6	27.9	27.6	26.1	25.0	24.0	23.9	154.6	
Automatic debt dynamics [5]	-0.3	2.4	3.7	-2.3	-3.0	-4.1	-3.9	-3.4	-2.9	-19.6	
Interest rate/growth differential [6]	-1.2	-0.4	-1.4	-2.3	-3.0	-4.1	-3.9	-3.4	-2.9	-19.6	
Of which: real interest rate	0.2	0.1	-0.9	-0.9	-1.1	-1.7	-1.1	-0.6	-0.2	-5.6	
Of which: real GDP growth	-1.4	-0.5	-0.5	-1.4	-2.0	-2.4	-2.7	-2.8	-2.7	-13.9	
Exchange rate depreciation [7]	0.9	2.8	5.1	...	...	...	...	...	...	...	
Other identified debt-creating flows	-1.9	-0.3	-1.1	-0.2	-0.2	0.0	0.0	0.0	0.0	-0.6	
CG: Privatization Proceeds (negative)	-1.1	-0.1	-0.6	-0.2	-0.2	0.0	0.0	0.0	0.0	-0.6	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8]	0.7	-0.5	-0.9	5.1	3.3	2.0	2.1	1.8	1.1	15.3	



Source: IMF staff.

[1] Public sector is defined as central government.

[2] Based on available data.

[3] Long-term bond spread over U.S. bonds.

[4] Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

[5] Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

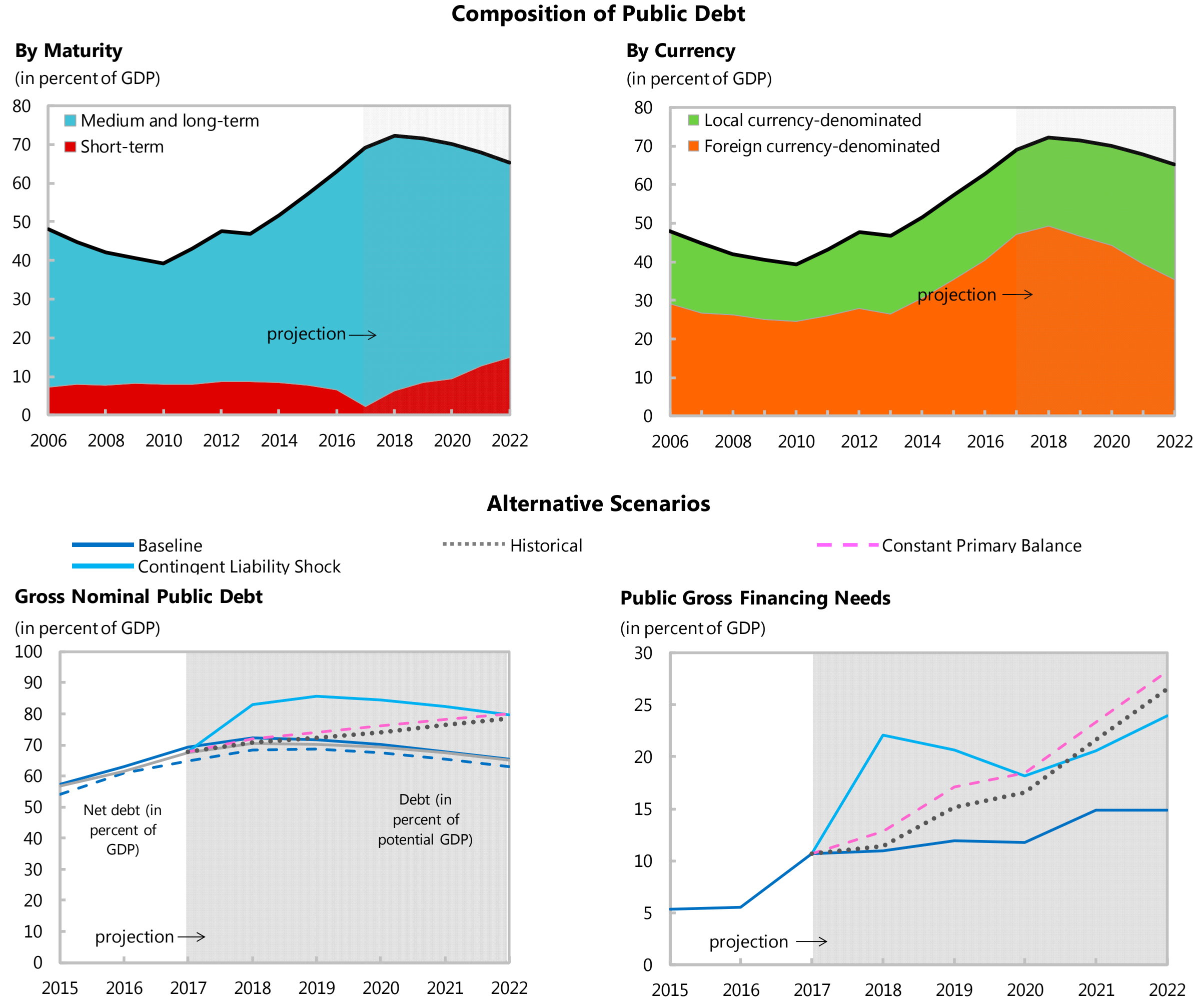
[6] The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as -g.

[7] The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

[8] Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

[9] Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Tunisia: Public DSA—Composition of Public Debt and Alternative Scenarios



Composition of Public Debt

By Maturity
(in percent of GDP)

By Currency
(in percent of GDP)

Alternative Scenarios

Gross Nominal Public Debt
(in percent of GDP)

Public Gross Financing Needs
(in percent of GDP)

Underlying Assumptions

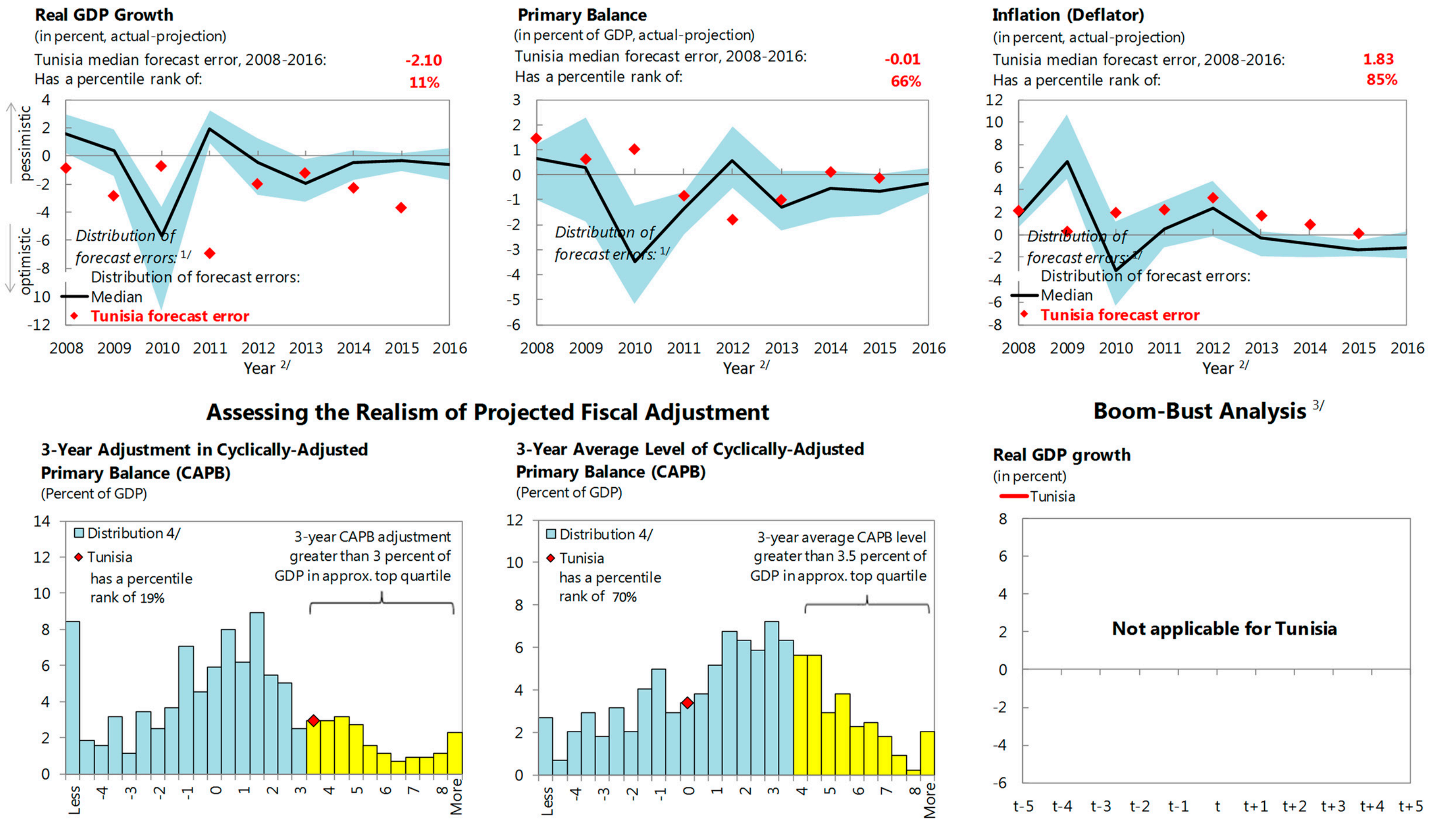
(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.3	3.0	3.5	4.1	4.3	4.3
Inflation	5.3	4.2	3.8	3.6	3.3	3.3
Primary Balance	-3.6	-2.9	-1.6	-0.4	0.6	0.7
Effective interest rate	3.9	2.7	1.4	2.0	2.5	3.1
Constant Primary Balance Scenario						
Real GDP growth	2.3	3.0	3.5	4.1	4.3	4.3
Inflation	5.3	4.2	3.8	3.6	3.3	3.3
Primary Balance	-3.6	-3.6	-3.6	-3.6	-3.6	-3.6
Effective interest rate	3.9	2.7	1.3	2.1	2.7	3.4

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	2.3	2.5	2.5	2.5	2.5	2.5
Inflation	5.3	4.2	3.8	3.6	3.3	3.3
Primary Balance	-3.6	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	3.9	2.7	1.5	2.5	3.2	4.1
Contingent Liability Shock						
Real GDP growth	2.3	0.8	1.3	4.1	4.3	4.3
Inflation	5.3	3.7	3.2	3.6	3.3	3.3
Primary Balance	-3.6	-12.5	-1.6	-0.4	0.6	0.7
Effective interest rate	3.9	2.9	2.4	2.7	3.1	3.6

Source: IMF staff.

Tunisia: Public DSA—Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes program countries, percentile rank refers to all countries.

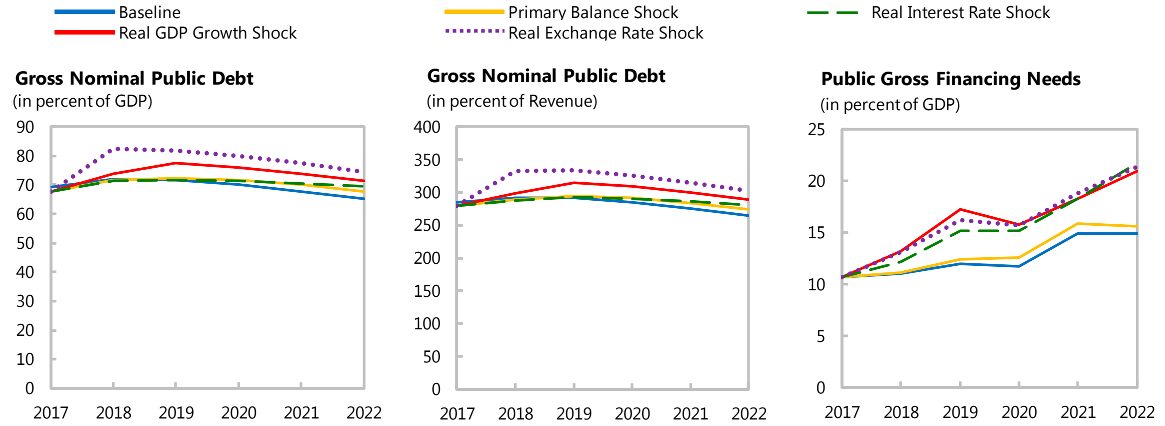
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Tunisia, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Tunisia: Public DSA—Stress Tests

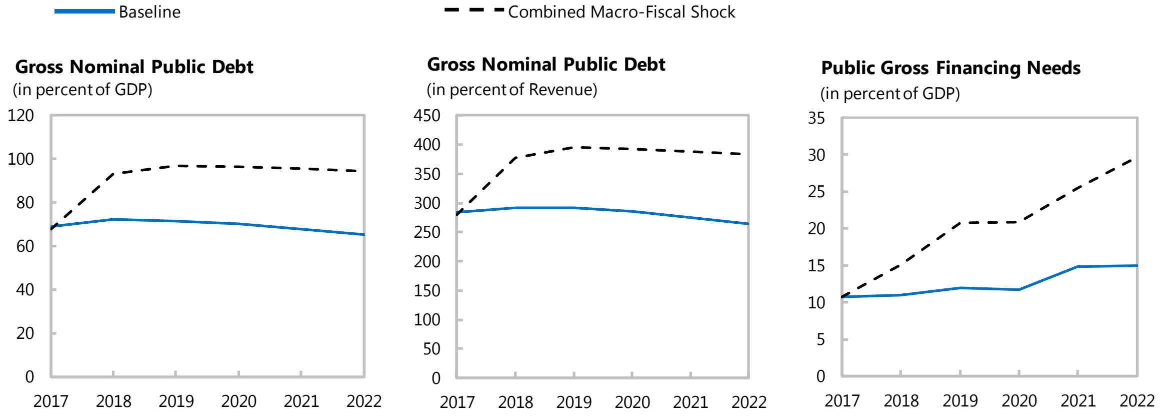
Macro-Fiscal Stress Tests


Gross Nominal Public Debt (in percent of GDP)

Gross Nominal Public Debt (in percent of Revenue)

Public Gross Financing Needs (in percent of GDP)

Additional Stress Tests


Gross Nominal Public Debt (in percent of GDP)

Gross Nominal Public Debt (in percent of Revenue)

Public Gross Financing Needs (in percent of GDP)

Underlying Assumptions

(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	2.3	3.0	3.5	4.1	4.3	4.3
Inflation	5.3	4.2	3.8	3.6	3.3	3.3
Primary balance	-3.6	-3.3	-2.3	-1.0	0.1	0.7
Effective interest rate	3.9	2.7	1.4	2.1	2.6	3.3
Real Interest Rate Shock						
Real GDP growth	2.3	3.0	3.5	4.1	4.3	4.3
Inflation	5.3	4.2	3.8	3.6	3.3	3.3
Primary balance	-3.6	-2.9	-1.6	-0.4	0.6	0.7
Effective interest rate	3.9	2.7	2.0	3.3	4.3	5.4
Combined Shock						
Real GDP growth	2.3	0.8	1.3	4.1	4.3	4.3
Inflation	5.3	3.7	3.2	3.6	3.3	3.3
Primary balance	-3.6	-3.7	-3.1	-1.0	0.1	0.7
Effective interest rate	3.9	3.2	2.0	3.3	4.2	5.4

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	2.3	0.8	1.3	4.1	4.3	4.3
Inflation	5.3	3.7	3.2	3.6	3.3	3.3
Primary balance	-3.6	-3.7	-3.1	-0.4	0.6	0.7
Effective interest rate	3.9	2.7	1.4	2.2	2.6	3.2
Real Exchange Rate Shock						
Real GDP growth	2.3	3.0	3.5	4.1	4.3	4.3
Inflation	5.3	14.2	3.8	3.6	3.3	3.3
Primary balance	-3.6	-2.9	-1.6	-0.4	0.6	0.7
Effective interest rate	3.9	3.2	1.3	1.9	2.4	3.0

Source: IMF staff.

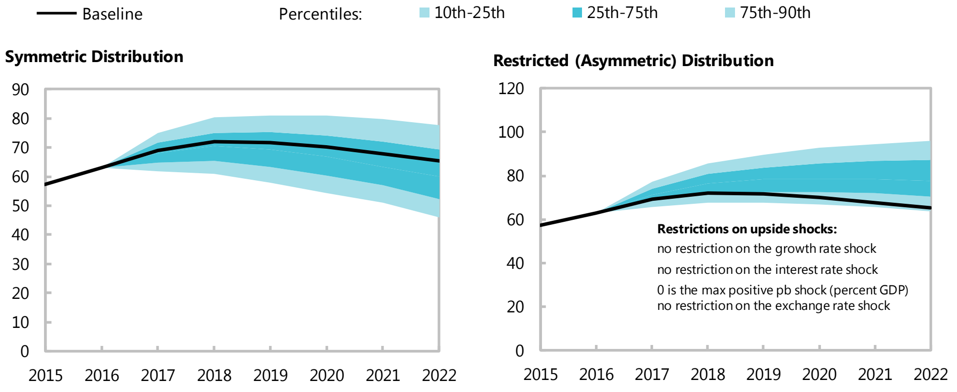
Tunisia: Public DSA Risk Assessment

Heat Map

Debt level [1/]	🟥 Real GDP Growth Shock	🟥 Primary Balance Shock	🟥 Real Interest Rate Shock	🟥 Exchange Rate Shock	🟥 Contingent Liability Shock
Gross financing needs [2/]	🟨 Real GDP Growth Shock	🟨 Primary Balance Shock	🟨 Real Interest Rate Shock	🟨 Exchange Rate Shock	🟨 Contingent Liability Shock
Debt profile [3/]	🟨 Market Perception	🟥 External Financing Requirements	🟩 Change in the Share of Short-Term Debt	🟥 Public Debt Held by Non-Residents	🟥 Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

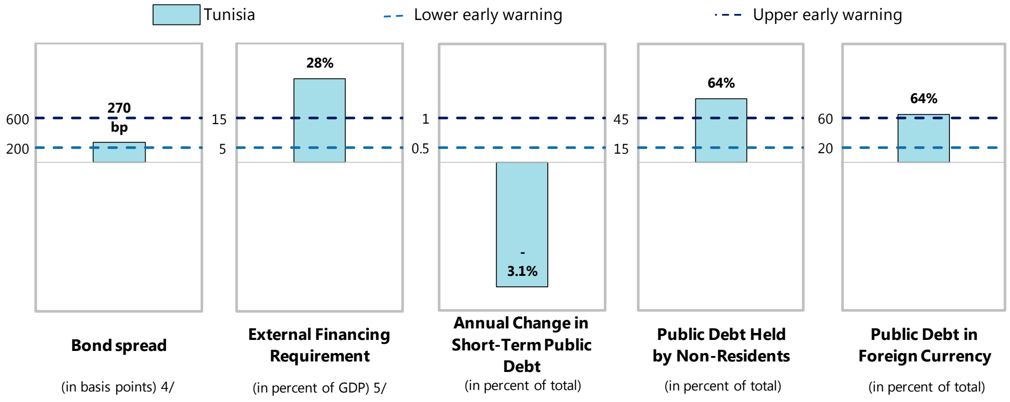
(in percent of GDP)



Restrictions on upside shocks:
no restriction on the growth rate shock
no restriction on the interest rate shock
0 is the max positive pb shock (percent GDP)
no restriction on the exchange rate shock

Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Source: IMF staff.

[1/] The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

[2/] The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

[3/] The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

[4/] Long-term bond spread over U.S. bonds, an average over the last 3 months, 29-Jan-17 through 29-Apr-17.

[5/] External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Annex II. External Debt Sustainability Analysis

Tunisia's external debt has been rising since 2011. External debt declined sharply in recent years from over 61 percent of GDP in 2002 to 49 percent of GDP at end-2010. The revolution, however, represented a turning point. The external debt-to-GDP ratio increased sharply from 51 percent in 2011 to 70 percent by end-2016, reflecting higher fiscal and current account deficits following a series of external shocks and rising social pressures. Most of the new debt commitments are either with official creditors or backed by a third-party guarantee, except for a US$1 billion Eurobond issued in January 2015 and a €850 million Eurobond in February 2017.

External debt would peak at 81 percent of GDP in 2018 before declining gradually.[1] The external debt-to-GDP ratio is expected to increase from 70 percent in 2016 to 77 percent in 2017, on the back of the recent Eurobond and continued official funding. It would continue its increase into 2018, driven by multilateral financing—including the Fund's EFF—and international market access. Improving current account dynamics would then lead to a gradual decline towards 72 percent of GDP by end-2022 (Annex, Table 1).

External debt would remain resilient to shocks, except for exchange rate depreciation. Tunisia's debt profile (low average interest rate, relatively long maturities, and relatively large proportion of concessional debt) makes it robust to most shocks, except for a large real exchange rate depreciation. DSA results suggest that the external debt-to-GDP ratio would remain below 84 percent of GDP throughout the projection period under all but the FX depreciation scenario. For example, a combo negative shock to real interest rate, growth and the current account would increase the debt ratio to 78 percent of GDP by end-2022 compared to 72 percent under the baseline. However, a sharp real exchange rate depreciation (one-time 30 percent in the second year of projection) would propel the external debt ratio to 113 percent of GDP in 2018 before declining to 101 percent at the end of the projection horizon (Annex, Figure 1).

[1] For more details, see IMF (2008) "Staff Guidance Note on Debt Sustainability Analysis for Market Access Countries," IMF Policy Paper, www.imf.org.

Tunisia: External Debt Sustainability Framework, 2012–22

(In percent of GDP, unless otherwise indicated)

	Actual					10-Year	10-Year	Projections						
	2012	2013	2014	2015	2016	Historical Average	Standard Deviation	2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
Baseline: External debt	53.0	57.0	61.4	64.9	70.0			**76.9**	**80.7**	**80.4**	**78.9**	**75.8**	**72.3**	**-6.3**
Change in external debt	1.7	4.0	4.4	3.6	5.1			6.9	3.8	-0.2	-1.5	-3.2	-3.5	
Identified external debt-creating flows (4+8+9)	5.4	4.5	5.2	12.8	8.7			4.5	3.0	1.9	0.9	0.4	0.1	
Current account deficit, excluding interest payments	6.9	7.2	7.9	7.6	7.7			7.0	6.7	6.4	6.1	5.7	5.3	
Deficit in balance of goods and services	9.2	9.3	11.0	11.0	10.8			10.4	10.3	10.0	9.6	9.5	9.2	
Exports	49.4	47.7	45.6	40.7	40.2			41.4	42.1	41.6	41.0	40.3	39.2	
Imports	58.6	57.1	56.6	51.6	51.0			51.8	52.4	51.6	50.6	49.8	48.4	
Net non-debt creating capital inflows (negative)	-3.9	-2.5	-2.3	-2.6	-2.0			-2.4	-2.8	-3.0	-3.0	-3.0	-3.0	
Automatic debt dynamics 1/	2.4	-0.2	-0.4	7.7	3.0			-0.1	-0.9	-1.5	-2.1	-2.3	-2.3	
Contribution from nominal interest rate	1.5	1.2	1.2	1.4	1.4			1.6	1.4	1.2	1.0	0.9	0.8	
Contribution from real GDP growth	-2.0	-1.3	-1.2	-0.7	-0.7			-1.7	-2.4	-2.7	-3.1	-3.2	-3.1	
Contribution from price and exchange rate changes 2/	2.9	-0.1	-0.4	7.1	2.3			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets 3/	-3.7	-0.5	-0.8	-9.2	-3.7			2.4	0.8	-2.1	-2.4	-3.5	-3.6	
External debt-to-exports ratio (in percent)	107.2	119.3	134.7	159.7	174.3			185.9	191.6	193.5	192.6	187.9	184.3	
Gross external financing need (in billions of US dollars) 4/	10.9	11.6	12.2	11.9	11.8			11.4	10.7	10.9	10.8	11.5	11.7	
in percent of GDP	24.2	25.1	25.5	27.6	28.1			28.7	27.1	26.3	24.7	24.9	24.0	
A. Scenario with key variables at their historical averages 5/								**76.9**	**76.9**	**78.5**	**79.8**	**79.9**	**79.9**	**-2.4**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	3.9	2.4	2.3	1.1	1.0	2.5	2.2	2.3	3.0	3.5	4.1	4.3	4.3	
GDP deflator in US dollars (change in percent)	-5.4	0.2	0.7	-10.3	-3.5	-0.3	6.4	-7.3	-4.4	1.4	1.4	1.4	1.5	
Nominal external interest rate (in percent)	2.9	2.4	2.2	2.1	2.0	2.9	0.7	2.2	1.9	1.6	1.4	1.2	1.1	
Growth of exports (US dollar terms, in percent)	-9.9	-0.8	-1.8	-19.1	-3.7	1.8	16.5	-2.2	0.3	3.6	4.1	4.0	3.0	
Growth of imports (US dollar terms, in percent)	1.9	0.0	2.0	-17.3	-3.6	3.7	15.9	-3.6	-0.4	3.3	3.6	4.0	2.9	
Current account balance, excluding interest payments	-6.9	-7.2	-7.9	-7.6	-7.7	-5.0	2.9	-7.0	-6.7	-6.4	-6.1	-5.7	-5.3	
Net non-debt creating capital inflows	3.9	2.5	2.3	2.6	2.0	2.9	1.1	2.4	2.8	3.0	3.0	3.0	3.0	
B. Bound Tests														
B1. Nominal interest rate is at historical average plus one standard deviation								**76.9**	**80.9**	**81.0**	**79.7**	**76.8**	**73.5**	**-6.1**
B2. Real GDP growth is at historical average minus one standard deviations								**76.9**	**81.9**	**82.8**	**82.2**	**79.9**	**77.0**	**-5.5**
B3. Non-interest current account is at historical average minus one standard deviations								**76.9**	**82.1**	**83.3**	**83.2**	**81.3**	**79.0**	**-6.6**
B4. Combination of B1-B3 using 1/2 standard deviation shocks								**76.9**	**81.9**	**82.9**	**82.5**	**80.4**	**77.8**	**-6.1**
B5. One time 30 percent real depreciation in 2016								**76.9**	**112.5**	**112.2**	**110.1**	**105.7**	**100.8**	**-8.7**

Source: IMF staff.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

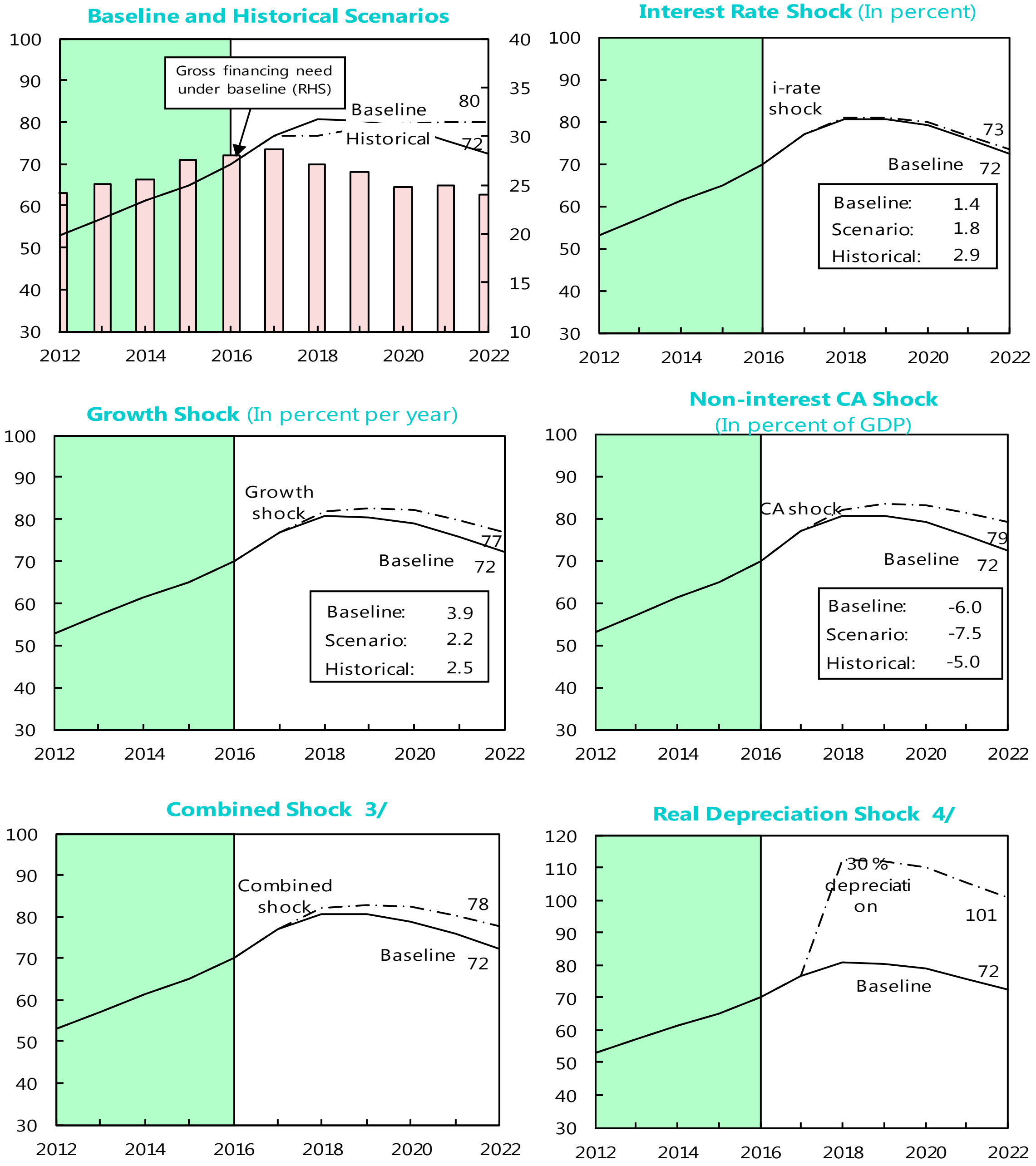
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Tunisia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)

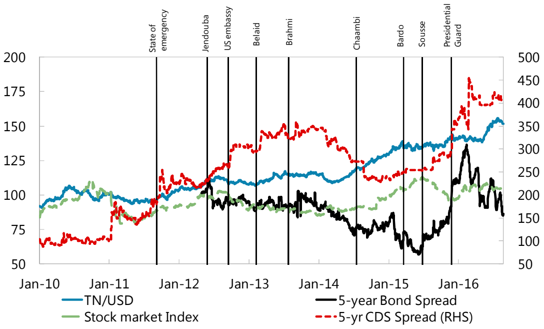


Sources: IMF, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks (except for growth which is a 3/4th standard deviation). Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2018.

Annex III. What Is the Economic Cost of Instability in Tunisia?

Instability over the past several years has had significant economic ramifications. Political, social, and security-related instability has inflicted large costs on the Tunisian economy. It has dealt a blow to the tourism industry, deterred investment and sapped confidence, slowing job creation and exacerbating fiscal and external vulnerabilities. This box attempts to measure the economic costs of this instability. An event study quantifies the impact of security shocks on stock, bond and FX markets. At the micro level, firm-level survey data confirm the negative relationship between perception of political instability and firm performance.

High Frequency Indicators and Security Incidences (Index 100 = Jan. 01, 2011)

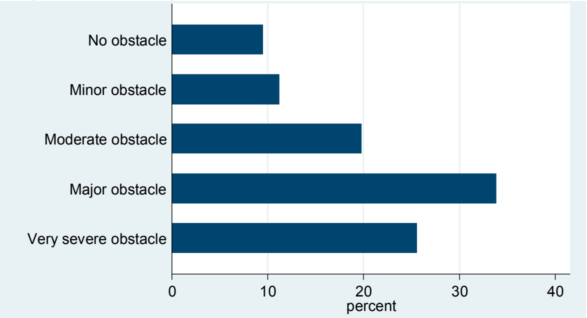


Source: IMF staff calculations.

An event study analysis shows significant impact on financial markets. Specifically, comparing price changes in a three-day window around the days of a security incident with all other three-day time periods from January 2011–August 2016 reveals a cumulative impact of: (i) a 150 basis points increase in Tunisia's international bond premium; (ii) an 8 percent decline in Tunisia's main stock market index (Tunindex); and (iii) a 3 percent decline in the dinar against the U.S. dollar.

At the micro level, political instability is perceived as a severe obstacle. In a recent joint EBRD/EIB/WB survey, around half of the 592 Tunisian firms interviewed cited political instability as the top obstacle to their business operations, especially for export-oriented and smaller-sized firms. This was followed by informality, an inadequately educated labor force, access to finance, and corruption. Obstacles such as corruption and access to finance are highly correlated with responses on political instability.

To What Degree Is Political Instability an Obstacle to Firm Operations?
(In percent, 592 private firms)



Source: Author's calculations based on MENA ES

Does political instability affect firm performance? Regressions suggest that, on average, political instability has been associated with significantly lower growth in sales and employment over the sample period.

Annex IV. Risk-Assessment Matrix[1]

Source of Risk and Relative Likelihood	Expected Impact and Recommended Policy Response
Domestic Risks	**Domestic Risks**
High **Slow reform implementation and consensus building**, due to government reshuffle and push back from vested interests. ***High*** **A deteriorating security situation** due to unexpected terrorist activity, spillovers and/or increased refugee inflows from the crisis in Libya.	***High*** Slow consensus building may jeopardize reforms under the agreed EFF timetable, delaying external donor support tied to progress with the upcoming review. Worsened security would affect the government's ability to undertake pressing economic policy reforms. Strengthening public buy-in to the economic reform agenda through continuous communication is essential.
External Risks	**External Risks**
High **Policy and geopolitical uncertainties,** due to (i) difficult-to-predict policies and global spillovers from the US; (ii) uncertainty associated with post-Brexit arrangements in Europe; and (ii) intensification of risks of fragmentation/security dislocation in the Middle East, Africa and Europe.	***High*** Growth may fall due to lower confidence and investment, weaker international policy coordination, increased security spending, and/or sharp increases in oil prices. Large refugee inflows from Libya would weigh on the budget. Authorities should (i) rebuild fiscal and external buffers; and (ii) accelerate economic and structural reforms.
Medium **Tighter or more volatile global financial conditions,** triggered by (i) significant strengthening of US dollar and/or higher interest rates; and/or (ii) European bank distress amid a weak profitability outlook.	***Medium*** Economic activity in partner countries could be disturbed, and financing costs as well as capital account pressures could increase. Recommended policy responses include: (i) creating fiscal space by containing the wage bill and mobilizing more domestic revenue; (ii) countercyclical monetary policy, if inflationary pressures are not present; and (iii) completion of banking reforms.
Medium **Lower than expected global growth,** driven by structural weaknesses in Europe, and slowdown in major emerging economies due to lower trend productivity.	***High*** Growth would be adversely affected through trade, remittances, and investment channels, especially from Europe. Authorities should accelerate structural reforms to improve productivity and competitiveness.
Low **Lower energy prices,** as production cuts by OPEC and other major producers may not materialize as agreed, while other sources of supply could increase production.	***High*** Lower energy prices would ease external and fiscal pressures. Authorities should (i) re-implement the symmetric automatic fuel price adjustment formula; and (ii) save any external windfalls from lower oil prices.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly

Annex V. The Tunisia 2020 Investor Conference

The Investor Conference in November 2016 gave an important psychological boost to Tunisia. It was attended by IFIs, bilateral donors, and private sector participants, and was generally regarded as a success.

The Conference resulted in pledges of up to US$15 billion. Two-thirds of these would be in the form of budget support or on-budget project financing from IFIs and bilateral donors; the rest would consist of FDI or loans to private entities, mostly backed by multilateral donors. Considering existing commitments, these pledges should increase external support over the next five years to about US$17 billion.

Staff has been conservative in incorporating pledges into the macroeconomic framework. Given uncertainties regarding their modalities, staff projects only about half of total pledges to be effectively disbursed; and assumes inflows only from 2018. This would still represent a sizeable increase in available medium-term external financing.

Tunisia. Donor and Investor Pledges Made at the Tunisia 2020 Conference

(In million US dollars)

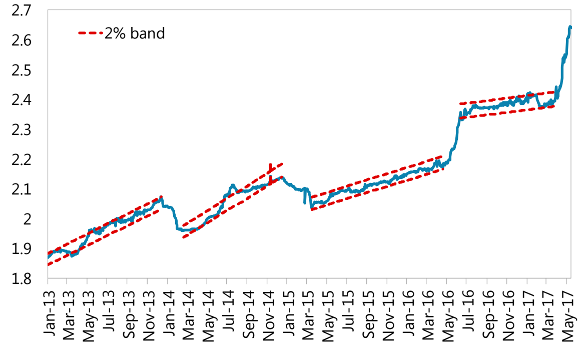
	Total	2017	2018	2019	2020	2021
Grants	**210**	**100**	**110**	**-**	**-**	**-**
Saudi	100	100	-	-	-	-
Switzerland	110	-	110	-	-	-
Budgetary/CBT loans	**7,372**	**1,426**	**1,306**	**1,476**	**1,332**	**1,332**
African Development Bank	2,099	616	343	476	332	332
Kuwait	500	-	-	-	-	-
World Bank	4,560	810	750	1,000	1,000	1,000
European Union	213	-	213	-	-	-
Project loans/FDI/Private loans	**9,867**	**1,973**	**1,973**	**1,973**	**1,973**	**1,973**
France (Agence Française de Développement (AFD))	266	-	-	-	-	-
Saudi Arabia	575	125	100	125	100	125
Germany (KFW)	431	-	-	-	-	-
Italy	595	-	-	-	-	-
Turkey	100	-	-	-	-	-
Arab Fund for Economic and Social Development	1,500	-	-	-	-	-
Canada	24	24	-	-	-	-
FADES	1,500	300	300	300	300	300
Banque Européenne d'Investissement (BEI)	2,657	-	-	-	-	-
IFC	300	-	-	-	-	-
EBRD	669	-	-	-	-	-
Qatar (nature to be confirmed)	1,250	1,050	50	50	50	50
Conference pledges grand total	**17,449**	**3,499**	**3,389**	**3,449**	**3,305**	**3,305**

Source: Press reports; donor contacts; Tunisian authorities; and IMF staff calculations.

Annex VI. Understanding CBT's Interventions in the FX Market

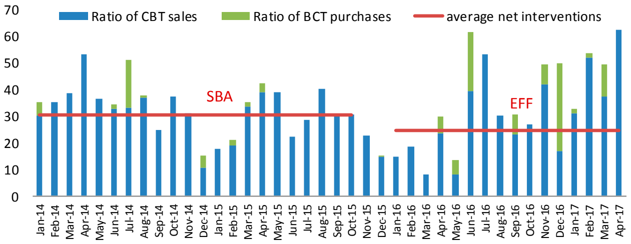
The CBT's exchange policy aims at facilitating external adjustment while ensuring an adequate level of reserves. The CBT has typically intervened in the FX market to satisfy unmet FX demand and smooth excessive fluctuations in the exchange rate, rather than targeting a certain path or level of the dinar. This policy has enabled a gradual correction of the real overvaluation of the dinar to better reflect its macroeconomic fundamentals, while also maintaining an adequate level of international reserves. Historically, the dinar has followed a crawl-like behavior against the euro and the US dollar, depreciating around a narrow 2 percent band over time. More recently, the dinar witnessed two episodes of faster-than-normal depreciation reflecting heightened pressures in the FX market.

Tunisian Dinar to Euro—US$ Basket Exchange Rate
(Index, higher values = depreciation)



Source: IMF staff calculations. Weights based on currency of trade transactions.

Ratio of CBT Net Interventions to Interbank Transactions
(In percent)

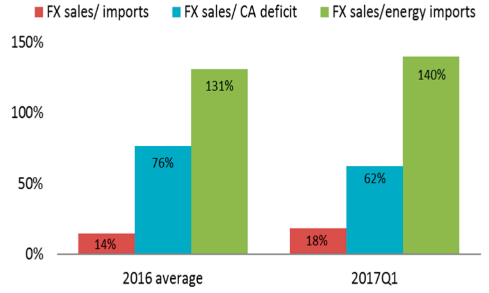


Source: IMF staff calculations.

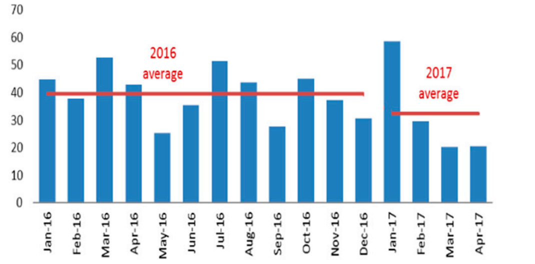
Higher-than-usual interventions in the first quarter of 2017 maintained the exchange rate at a level not reflective of its fundamentals. FX interventions by the CBT in 2017Q1where exceptionally high due to the record trade deficit, but were still comparable to the 2016 average as a ratio of imports or the current account deficit. Moreover, for the month of April 2017, although FX sales as a ratio of interbank transactions was the highest ever since Jan2014, FX sales as a ratio of FX demand by banks was the lowest since January 2016. Heightened market pressure in this period, as evidenced by decreasing daily interbank transactions and short FX positions by commercial banks, pushed the CBT to intervene in the FX market to at least finance essential energy and food imports. That said, such interventions led to an artificial stabilization in the exchange rate in nominal effective terms over the first quarter of 2017. Besides not allowing an appropriate reflection of pressures in the FX market, this discretionary strategy of interventions consumed gross international reserves, which stood at around only 3.3 months of imports at the end of 2017Q1—lower than their coverage at end-2016 despite the February Eurobond issuance.

CBT interventions tend to increase at times of rising trade deficits, and financial or political pressures. A simple VAR model confirms that higher energy trade deficits are associated with higher net FX interventions, which in turn are associated with lower country risk and a stronger exchange rate. Moreover, heightened perceptions of risk—measured by the ICRG composite risk index summarizing various dimensions of the country's financial, political and economic risks—seem to be associated with increased CBT interventions in the FX market.

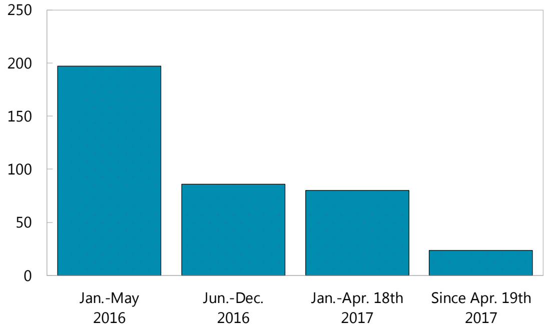
FX Net Interventions
(BCT sales – purchases)



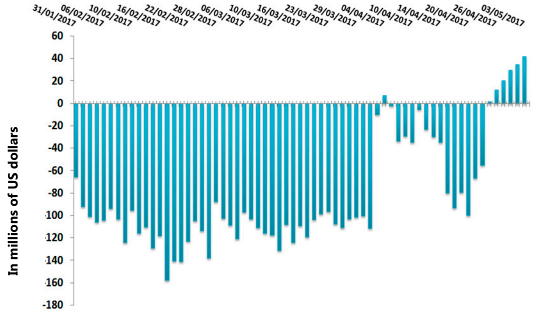
Ratio of CBT FX Sales to FX Demand by Banks
(In percent)



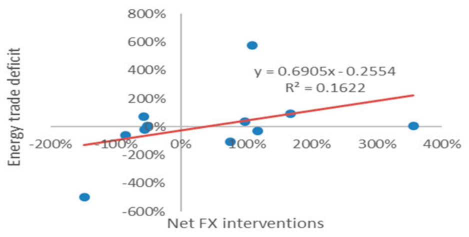
Average Daily Transactions of the Interbank Market (In millions of USD)



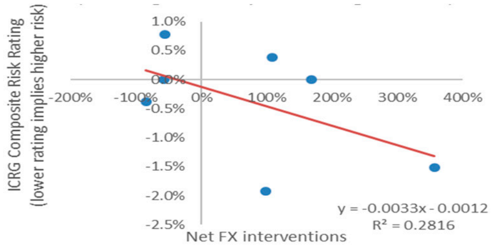
Evolution of the Aggregate Net Open FX Position of the Banking System (In millions of US dollars)



Net FX Interventions and Energy Trade Deficit
(Percent change, January–December 2016)

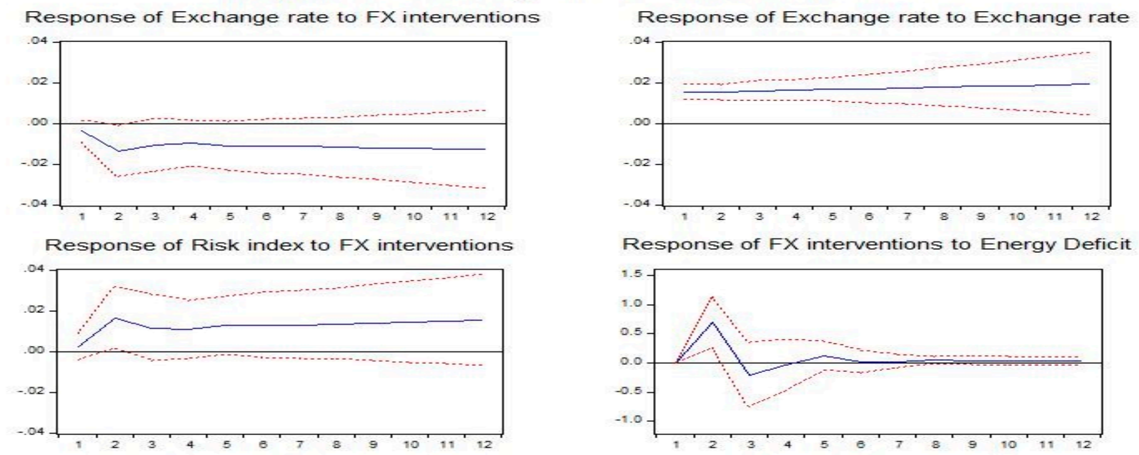


Net FX Interventions and Composite Risk
(Percent change, January–August 2016)



Source: Tunisian authorities; and IMF staff calculations.

Response to Cholesky One S.D. Innovations ±2 S.E.



Note: Estimation period 2014M01-2016M12, using 4 endogenous variables in the following order: FX intreventions, average dinar/USD exchange rate, energy trade deficit, and ICRG composite risk index

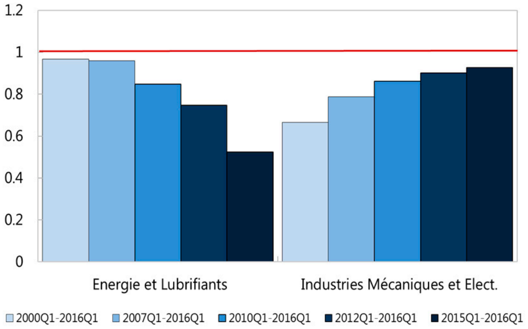
Annex VII. Exchange Rate Changes and the Trade Balance

Using industry level export and import data, we find that more than ¾ of Tunisia's trading industries would benefit from a depreciation in the long run due to dominating volume effects, although the trade balance may initially worsen in the short-term due to price effects.

Tunisia's comparative advantage is changing toward more value-added industries over time. We use an index of revealed comparative advantage (RCA) originally introduced by Balassa (1965): RCAi = (Xi / X) / (Mi / M) = (Xi / Mi) / (X / M) where Xi is Tunisian exports of industry i, Mi is Tunisian imports of industry i. X and M represent total exports and imports of all industries, respectively. Comparative advantage industries are defined to be those with an index above unity. Tunisian comparative advantage industries are moving away from traditional low-value added industries (energy) to manufacturing high value-added industries (mechanic and electric) with higher technology and job content.

Shifting Comparative Advantages

(RCA index)



Sources: IMF staff calculations

Because of adjustment lags, the trade balance of a country could initially deteriorate in the short run, before improving in the long-term, resulting in a pattern known as the J-Curve phenomenon. Results of a model regressing trade balance on real exchange rate among other variables over 2000Q1-2016Q4 indicate that the "textiles" and "mechanical and electric" industries, which together represent the bulk of Tunisia's trade in goods, would benefit from a depreciation in the long-term, while there can be negative short-term effects on net exports of "mechanical and electric" industry up to three quarters.

The elasticity approach to balance of payments postulates that currency depreciation can improve the trade balance of a country in the long-term if the sum of import and export demand price elasticities exceed unity; the Marshall-Lerner (ML) condition. This method empirically estimates import and export demand equations, and the ML condition will be met if the sum of price elasticities is greater than one. Results indicate that the ML condition is met in "textiles", "mechanical and electric" and "other manufacturing" industries, representing more than ¾ of Tunisia's trade.

Appendix I. Letter of Intent

Tunis, May 29, 2017

Madame Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, NW
Washington, D.C. 20431
USA

Madame Managing Director,

1. A new government of national unity has taken office on August 27th 2016. Supported by a broad range of the political spectrum and the main social partners, the government is strongly committed to implementing the "Pacte de Carthage", the reform priorities that emerged from this broad political consensus. Accelerating growth, containing fiscal balances, and making social policies more effective are at the heart of our reform program. Indeed, the moment the new government took office, it committed to implementing reforms. It used its first months in office to declare a state of economic emergency and announce exceptional fiscal measures, including those aimed at controlling the wage bill and strengthening government revenue. The 2017 Budget Law expresses the willingness to provide a new stimulus to the economy to create more jobs and raise the standard of living while preserving the sustainability of public finances.

2. Our participation in the G20 initiative "Compact with Africa" aims to unleash the large potential of the Tunisian economy and thus represents the continuity of our international investor conference "Tunisia 2020", which we successfully organized last November. We are currently working on a new vision for Tunisia's economic future—a promising, prosperous future with more opportunities for all citizens. We also welcome that all our international partners have reaffirmed their steadfast commitment to supporting the reform agenda expressed in the "Pacte de Carthage", which is fully consistent with the reform program supported by the IMF's Extended Fund Facility. This support will be necessary to overcome a difficult economic situation and to tackle the structural vulnerabilities that weaken the Tunisian economy.

3. The IMF's Executive Board approved in May 2016 a financial arrangement in the form of a four-year Extended Fund Facility (EFF) in support our reform program, which has sent a strong signal to our people and the international community that we are determined to meet the challenges of making growth stronger and more inclusive. However, last year's performance under the program has been characterized by some implementation delays due to the change in government and the time it took for the new government to operationalize its short-term priorities in a difficult national, regional and international political context. We are now firmly committed to accelerating the pace of implementation of the reforms supported by the EFF. The performance so far has been mixed,

especially considering that growth last year was below expectations. We accelerated some of the reform implementation delays (cf. MEFP).

4. In view of the macroeconomic policies implemented to achieve the main objectives of the reform program and ongoing efforts to implement the agreed structural reform agenda, the government requests the completion of the First Review of the program supported by the Extended Fund Facility (EFF) as well as the disbursement of SDR 227 million. We also request that from the Third Review the remaining amount of the overall program envelope will be spread evenly over the remaining tranches. This will bring the amount of disbursements from the third review to SDR 273 million. Based on corrective measures taken, the government also requests a waiver of non-observance for the quantitative performance criteria on Net International Reserves, Net Domestic Assets, and the primary balance at end-December 2016, which have not been met. Furthermore, the government would like to propose new performance criteria for June and December 2017, as well as a new timetable for prior actions and structural benchmarks as described in the MEFP (Tables 1 and 2) and the attached Technical Memorandum of Understanding (TMU).

5. This Letter of Intent is based on the previous Letter of Intent (LOI) and MEFP dated May 2, 2016. The attached MPEF outlines the key components of the reform agenda and the policies that the government and the Central Bank of Tunisia intend to put in place during the 2017-2020 period. We remain committed to the rigorous implementation of our program, while recognizing the challenges of the national, regional and international context.

6. We are confident that the policies described in the attached MEFP are appropriate to achieve the objectives of our economic program as arising from the "Pacte de Carthage". We will consult with IMF staff on the adoption of these measures and in advance of any revision of the macroeconomic policies contained in this MEFP, in accordance with the IMF's policies on such consultations. All information and data necessary for program monitoring, as well as for technical assistance missions requested under the EFF, will be provided to IMF staff within the agreed timeframe.

7. We authorize the staff of the IMF to publish this Letter of Intent and the accompanying documents (MEFP, Tables 1 and 2) as well as the related staff report.

Best regards,

/s/
Youssef Chahed
Head of Government

/s/
Chedly Ayari
Governor of the Central Bank

Attachment I. Memorandum of Economic and Financial Policies

1. The government is committed to placing Tunisia onto a path that offers greater opportunities for economic growth and employment. Once in office, the new government underlined the important potential of the country, but also promoted a frank discussion of Tunisia's difficult economic situation. We are strongly convinced that open and clear communication on the challenges we face will enable us to establish a broad consensus on the difficult but also inevitable reform measures, highlighting that all segments of society will contribute to the required adjustment. The Carthage Agreement (Pacte de Carthage) constitutes the government's road map for the timely prioritization of reforms. We have embarked on the resolute implementation of this program to send a signal of confidence to the Tunisian people as well as to the international community. Our actions will help us resume the path toward stronger growth for all.

2. Our economic strategy aims to unleash the strong potential of the Tunisian economy. At the Tunisia 2020 conference, which was a notable success, and through our participation in the Compact with Africa initiative of the G20 countries, we put forward our overall strategy for modernizing the Tunisian economy; it is also reflected in the Five-Year Development Plan recently adopted by Parliament. This approach bore its first fruits with US$15 billion of financing pledged at the Tunisia 2020 conference, underscoring the renewed attractiveness of Tunisia. At the same time, we are conscious that resource mobilization is only one element of a comprehensive strategy to realize Tunisia's strong potential. The reform program supported by the IMF's Extended Fund Facility (EFF) reflects our firm resolve, made explicit during these occasions, to prepare Tunisia for a stronger role in the international economic system while maintaining macroeconomic stability.

3. This memorandum lays out the main elements of our reform program, which aims at promoting stronger and more inclusive growth while maintaining macroeconomic stability.

I. SIGNIFICANT IMBALANCES IN A DIFFICULT CONTEXT

4. Preliminary estimates point to a lower-than-expected growth rate of 1.0 percent in 2016. We are fully aware that the 2.3 percent growth rate expected for 2017 and the medium-term growth path (an average 3.6 percent between 2018 and 2020) will likely be insufficient to meet the aspirations of the Tunisian people, especially those of the youth. The coming years would need to see higher growth to create the productive jobs needed to absorb unemployment, which slightly dropped from 15.5 percent in the fourth quarter of 2016 to 15.3 percent during the first quarter of 2017. After inflation slowed down in 2016, price pressures have reemerged with core inflation exceeding 5 percent in April 2017.

5. Public finances in a difficult situation. The budget deficit reached 6 percent of GDP last year, an exceptionally high level. This deterioration is due to a fall in revenues, reflecting weak economic activity and poor payment discipline, but also an increase in current expenditure, particularly on the wage bill. The agreement between the government and its social partners in December of last year, which was necessary to maintain social peace, places a heavy burden on the fiscal accounts in 2017 and 2018. Public debt has risen sharply over the last five years, having reached a peak of 63 percent of GDP in 2016. As a result, the rating agencies have recently reduced Tunisia's sovereign debt rating, affecting the cost of the recent EUR 850 million Eurobond issuance.

6. **Pressures on the external accounts.** Alongside the budget deficit, the external current account deficit reached 9 percent of GDP last year, giving rise to twin deficits at historic levels. The ongoing weakness of tourist flows as well as excess demand for consumer goods imports are the main factors driving the high external deficit. Capital inflows have been insufficient to cover the trade deficit. These imbalances led the foreign exchange reserves of the Central Bank of Tunisia (CBT) to decline by US$1,800 million since the start of 2016.

7. **Significant risks and uncertainties.** A worsening of socio-political tensions could harm the climate of confidence that we need to undertake structural reforms. Conflict and violence in the region also continue to pose a major risk. We are also affected by the tightening of monetary and financial conditions in the advanced countries, and notably in the United States, which makes external financing more expensive for emerging countries.

8. **An agenda of ambitious and necessary reforms.** Faced with these challenges, the government is calling upon the entire Tunisian society to mobilize and participate in the adjustment effort. Emergency measures to address macroeconomic pressures, especially on the budget, are presented in the next section of this document (Section III). We also outline the measures required to achieve stronger growth that generates more employment, above all in the regions, and can thus raise the standards of living of all Tunisians (Section IV). The impact of these measures will only be felt in the medium term, but they still need to be implemented without delay.

II. REINVIGORATING THE EFF ARRANGEMENT

9. Performance under the program was mixed, notably due to a more difficult-than-expected political transition and weaker-than-expected growth.

- The **Net International Reserves** (NIR) targets were missed at end-June and end-December 2016 (Quantitative Performance Criterion). The deviation can be explained through the deterioration of the trade balance and larger-than-expected foreign exchange interventions to meet commercial banks' strong demand for foreign currency. The deterioration of the trade balance—mainly the balance in energy products—continued in the first quarter of this year, weakening the foreign exchange positions of the banks. The NIR target was therefore also missed at end-March (indicative target).

- The **Net Domestic Assets** (NDA) target at end-December (Quantitative Performance Criterion) was missed due to the increased and sustained use by commercial banks of the CBT's refinancing window, due mainly to the widening of the twin deficits. That led both to interventions by the central bank on the foreign exchange market to smooth the exchange rate and to a significant volume of purchases of Treasury bills by the banks (the end-June Criterion was met).

- The targets for the **central government primary balance** at end-June and at end-December (Quantitative Performance Criterion) were not met due to overspending on investment and wages. The ceiling for **primary current expenditures** was met at end-June and end-December (Quantitative Performance Criterion) with savings on goods and services compensating for the higher wage bill.

- **The indicative targets on social expenditures**, which are crucial to assure an adequate level of basic services, were slightly missed at end-June and end-December.

10. We have largely caught up the delays in achieving Structural Benchmarks (SBs) incurred during the second half of 2016.

- **Achieved Structural Benchmarks.** We have caught up the delay in meeting the SB relating to the finalization of the restructuring plans for public banks by the approval of performance contracts by the banks' boards of directors in line with these plans. Further regarding the banking sector, we have started systematically applying the risk-based supervision manual and we have finalized the first implementation decrees of the banking law, thereby opening the way to creating a deposit guarantee fund and a resolution committee for financial institutions. Similarly, to strengthen fiscal institutions, the Council of Ministers has adopted in March a comprehensive civil service reform strategy and a medium-term debt strategy. We have also adopted the decree for the establishment of a modern Large Taxpayers Unit (LTU) that assumes formal responsibility for the major tax and enforcement functions (return processing, taxpayer advisory services, and audit); and have set an implementation timetable, which will be guided by a task force in charge of its monitoring. To enhance the business climate, we have published with a slight delay the implementation decrees relating to the laws on competition, public-private partnerships (PPPs), and the investment code.

- **Reprogrammed Structural Benchmarks.** The delayed SBs will be achieved as soon as possible. Despite substantial progress, the completion of the inspections of the seven largest private banks will be reprogrammed for end-September. The delay is essentially due to a lack of staff within banking supervision, which we will resolve by means of accelerated recruitment (see below, Section IIIC). The signature of performance contracts for the five public enterprises is also delayed, but work is at an advanced stage for four of them and all five will be completed by July. Following the government's request, the discussions at the Assembly of the People's Representatives (ARP), the Tunisian Parliament, will be accelerated on the Organic Budget Law, the law creating the high anti-corruption authority, and the law on the excessive lending rate (*taux d'intérêt global excessif*). Publication of these laws in the *Journal Officiel de la République Tunisienne (JORT),* Tunisia's official gazette, is expected by end-September. The current functional reviews of four key ministries (finance, education, health, and public infrastructure (*équipement*) conducted with the support of the European Union have been delayed due to the processes that were required to meet public procurement standards. These reviews will be finalized by end-August 2017. Finally, it was not possible to conduct the survey aimed at identifying vulnerable households by the agreed deadlines due to a strike by the social workers in charge of this operation. We continue work on completing the survey, which will enable us to set up the database of targeted households by December 2017.

11. A clear lesson learned for our future engagement in the context of the EFF arrangement is that there is a need for better coordination and close program monitoring. Close consultation and cooperation within the government since the start of 2017 was instrumental in achieving faster reform implementation and in taking critical decisions on macroeconomic policies. The Office of the Head of the Government and all the departments involved in the reforms are constantly and meticulously monitoring the progress on our commitments to ensure appropriate and timely action. The establishment of four commissions at the office of the Head of the Government to monitor the major reforms in the areas of civil service, public enterprises, social security, and the financial sector will allow for better reform design in a coordinated manner, and accelerate reform implementation. More effective communication with the signatories of the Carthage Agreement through the creation of five joint commissions with the government covering the major reform areas has also accelerated progress. The government has also stepped-up its efforts to explain to the Tunisian people the need for and the benefit of the envisaged economic reforms. We are firmly convinced that this approach needs to be maintained and strengthened throughout the remainder of the program period.

III. MAINTAINING MACROECONOMIC STABILITY IN THE CONTEXT OF WEAK GROWTH

12. In the short term, our economic policies aim at maintaining the stability of the main macroeconomic aggregates. Sustainable fiscal and external deficits and stable prices are the prerequisites for growth and for attracting new investors. Fiscal consolidation will decrease the overall budget deficit to about 3 percent of GDP by 2020. Together with the gradual correction of the dinar overvaluation, this consolidation will reduce the current account deficit to 6 percent of GDP in the medium term. The improvement of the current account, a recovery in foreign direct investment (FDI) on the back of a better business climate, and significant external financing will strengthen foreign exchange reserves, which will cover more than 3.5 months of imports from 2017 onward. To further reduce financial sector vulnerabilities, we are committed to implementing measures to resolve non-performing loans.

13. The EFF arrangement’s main objectives remain relevant, as set forth in Sections A–C.

A. Reducing Fiscal Deficits and Improving Budget Structure

14. Immediately initiating a structural improvement in fiscal balances. The medium-term anchors of our fiscal policy include a strengthening of tax revenues that emphasizes more fairness, measures to maintain the sustainability of public debt, and a reorientation of current expenditure toward public investment and social spending. The fiscal deficit will thus be maintained at 6 percent of GDP in 2017 before falling from 2018. The structural fiscal deficit (correcting for the economic cycle and excluding one-off measures) will decline by almost 2 percent of GDP in 2018 alone and by a total of 3 percent of GDP between now and 2020 as a result of the impact of structural reforms. This exceptional adjustment is needed following the weak fiscal performance in 2016 and 2017. The government is strongly committed to manage risks to the budget by a close monitoring of expenditure execution and by the implementation of the structural reform agenda, notably in the areas of the civil service, the social security funds, and state-owned enterprises (SOEs).

15. Stabilizing public debt. After seven years of sharp increases, public debt is expected to reach its peak of 72 percent of GDP in 2018 before falling from 2019. Large financing needs will be covered mainly by support from the International Financial Institutions (IFIs) and financing raised on international markets at favorable terms. Our short-term financing program is based on conservative assumptions in view of the significant risks on budget execution and on donors' disbursement timetables. Concerning the medium term, and as part of the implementation of the debt strategy, we are committed to improving our debt's maturity and currency structure. We are also committed to achieving better issuance strategies, including through a strong use of concessional financing. In coordination with the Central Bank, we will also explore opportunities to deepen the domestic debt market to pursue an optimal mix of domestic and foreign borrowing.

16. A fiscal adjustment that is fair and that supports employment. Achieving higher growth in Tunisia to generate more employment necessarily depends on a substantial increase in social and investment spending, which are important objectives of our medium-term fiscal strategy. Public investment will increase by 1 percent of GDP to reach 6.2 percent of GDP in 2020. We are committed to pursuing structural reforms such as civil service and pension reforms. Modernizing Tunisia's tax policy and tax administration to reduce distortions and to expand the tax base will also be important.

17. Stabilizing the fiscal deficit in 2017. The 2017 Budget Law (LF2017) contains urgent measures that require sacrifices that we wanted to distribute equally across the population. Due to this exceptional effort, the overall deficit will be maintained at 5.9 percent of GDP (2.4 percentage points higher than expected in May 2016). The main measures in the budget law and in our action plans for the year include the following:

- **Strengthening tax and arrears collection.** Drawing on the recommendations of recent IMF technical assistance, we will immediately and throughout the course of the year, implement swift measures to improve collection of tax arrears that weigh heavily on public finances. We have already started monitoring the largest recipients of tax incentives in cooperation with customs, and have focused our recovery efforts on the most recent claims. Based on these actions, the government is firmly committed to collect additional revenue of an average of TD 75-100 million per quarter this year relative to last year's effort, including from the accumulated stock of tax arrears at end-2016 (TD 2.4 billion of recoverable arrears).

- **Containing the wage bill.** The overrun of 0.2 percent of GDP in the first quarter will be compensated. The overrun reflects the regularization of treasury advances for various allowances paid to civil servants and will be offset by reducing other items included in the wage bill, such as food allowances (0.05 percent of GDP) and overtime pay for certain positions (0.03 percent of

GDP). We will also eliminate half of the remaining 20 percent of wage subsidies for public entities (about 0.1 percent of GDP) and centralize the approval of promotion decisions at the Office of the Head of the Government.

- **Reapplication of the automatic fuel price adjustment mechanism** (*New Structural Benchmark, September 2017*). We will reestablish the quarterly adjustment mechanism for gasoline and diesel prices (regular and 50), which will be adjusted monthly starting in January 2018. In addition, to reduce subsidies, the 2017 budget includes an increase in the prices of electricity (5 percent) and gas (7 percent), while keeping the social tariffs unchanged.

- **Managing pressures arising from the social security funds.** The government will transfer 0.5 percent of GDP to the public pension fund (CNRPS) to meet its liquidity needs in 2017. The expected deficit of the private pension fund (CNSS) is 0.6 percent of GDP in 2017, taking into account its transfer obligations toward the national healthcare insurance fund (CNAM). This deficit will be financed by arrears clearance from the central government (0.1 percent of GDP), other public entities that have the capacity to pay (0.2 percent of GDP), and public enterprises (0.2 percent of GDP). In addition, the CNSS will intensify its collection efforts (0.1 percent of GDP). To avoid new arrears accumulation in the social security system, the government will submit to the ARP by June 2017 a law stipulating direct transfer of public sector contributions to the health insurance (CNAM). This will effectively end the practice of passing transfers for CNAM through the CNRPS public pension fund. The government stands ready to submit a supplementary budget law that would make available a transfer or advance to the CNSS in case the fund cannot meet its liquidity needs or in case CNAM is no longer able to meet its obligations to the central pharmacy or health service providers.

18. Implementing a major adjustment in 2018 while protecting priority expenditures. The main objective of our fiscal policy for 2018 is to stabilize public debt by an adjustment of 0.5 percent of GDP in the overall fiscal deficit compared to 2017. This effort is the result of strong actions on taxes (tax administration and policy) and on current expenditures, while allowing for an increase in public investment and in social spending.

- **Strengthening taxation with durable and more equitable measures that reduce distortions.** The 2018 tax strategy, adopted by the Council of Minister, was presented to the signatories of the Pacte de Carthage on May 26, 2017. The measures aim to replace the 2017 exceptional levy on businesses (on the order of 0.9 percent of GDP in 2017) with more sustainable measures that do not hamper employment and investment, but expand the tax base and reorient the tax burden from direct taxation (which affects employment) towards indirect taxation that affects consumption (this is necessary also in view of Tunisia’s external imbalances). In addition, by means of this package of fiscal measures, the government calls upon the responsibility of all taxpayers to meet their obligations, including the liberal professions (VAT increase from 12 to 18 percent), owners of capital (increase in tax on dividends), and consumers of products such as tobacco, alcohol, luxury goods, and private cars (Table 1). This package of measures, or any other new measures conducive to strengthening tax revenue, will be included in the 2018 budget law after consultation with IMF staff and will be adjusted upward or downward depending on the needs of the EFF program's macroeconomic framework and of the fiscal position for 2018.

- **Modernizing tax administration.** We remain committed to establishing a LTU to include formal responsibility for the major tax and enforcement functions (return processing, taxpayer advisory services, and audit). In this context, the monitoring task force for the reform of the LTU (DGE) will update our tax administration reform strategy and prepare annual plans with concrete steps and an implementation timetable, which will be reported to the Minister of Finance by June 2017. To resume the tax administration reform, emanating from the comprehensive dialog held during the 2014 National Conference on Taxation (Assises Nationales de la Fiscalité), we are planning the following:

  i. **Operationalizing a Large Taxpayers Unit (DGE) by January 2018 in line with best practice.** Based on the preparatory work on the DGE (adoption of the decree for its establishment, launch of a monitoring task force, and submission of the timetable for its implementation), we will give priority this year to meeting the agreed timetable. By October 2017, we will transfer the control functions (in-depth verification) and tax arrears management for large enterprises' arrears within the DGE (*New Structural Benchmark*). We will build on this milestone and achieve the full transfer of the collection responsibilities for tax revenues of large enterprises from the DGCPR to the DGE by end-March 2018.

  ii. **Strengthening monitoring and verification.** Given the importance of expanding the tax base, the Ministry of Finance will conduct, with the help of USAID, a systematic and centralized exercise to ensure the integrity and compliance of enterprises benefitting from tax incentives by end-March 2018.

19. Supporting fiscal consolidation from 2018 with strong medium-term reforms. The government is committed to undertaking strong reforms to ensure fiscal sustainability and to enhance the quality of public services. These reforms will produce a tangible impact on fiscal balances from 2018. Their full potential will unfold over the medium term.

Table 1. Tunisia: Tax Policy Measures for 2018

Tax Policy	Impact in 2018 (in TD millions)
Indirect Taxes	1,116.0
Direct Taxes	60.0
Other Measures to Mobilize Additional Resources	138.0
Recovery	300.0
Total	**1,666.0**

20. Reforming the civil service, including by implementing a voluntary separation program. The government has adopted, in March 2017, a strategy to reform the civil service; a revised version was produced in April 2017. It will be communicated transparently to the key stakeholders of the reform, including the unions, civil servants, and civil society. This strategy aims at improving the provision of public services and at reducing the wage bill from 14.1 percent of GDP in 2017 to about 12.1 percent of GDP in 2020. Achieving the wage bill objective rests on three key pillars: (i) no further wage increases will be granted unless growth substantially exceeds the baseline projections (for 2019-2020) and unless the wage bill reduction path can be maintained as envisaged; (ii) a restrictive recruitment policy that will enforce a limited replacement rate for the employees departing from service (25 percent from 2018); and (iii) voluntary departure programs, which would mainly rely on negotiated departures rather than early retirements.

- **Enhancing the quality of public services** by identifying the needs of the public administration, building capacity, and efficiently allocating employees in response to public service needs. Specifically, these measures include functional reviews and the establishment of a high civil service. The ongoing functional review of four ministries (finance, education, public infrastructure, and health) will be finalized by end-August 2017 (*Delayed Structural Benchmark*). These reviews will be extended to other ministries by end-June 2017 at the latest. The government intends to strengthen the managerial and technical capacity of public administration with the establishment of a high civil service, which would involve about 1 civil servant for each 1,000 public employees. Due to its small size, this new entity would not generate significant fiscal costs.

- **Undertaking voluntary civil service separation programs.** As part of the ambitious civil service reform, we are planning to implement an early retirement program by the end of 2017 and a negotiated departures program by end-January 2018. Priority will be given to negotiated departures over early retirements, which will include a bonification factor reflecting the remaining years of non-completed service. An implementation decree for the early retirement law will specify the early-retirement bonification factor with the assistance of the World Bank. The early retirement program will target between 5,000 and 7,000 employees and the negotiated departure program between 15,000 and 18,000 employees. The government has submitted the draft law on the early retirement program to the ARP in April 2017, and expects its adoption by end-June 2017. After the adoption of the law, a three-month window for civil servants to volunteer for early retirement will be opened during the third quarter. Regarding the negotiated departure program, the government intends to submit the draft law for its implementation to the ARP by end-September 2017.

  i. **Managing risks of the departure programs.** With the assistance of the World Bank, we will work on mitigating risks related to the departure programs. To preserve civil service quality, we have established two committees to review departure requests at the level of the line ministries and at the Office of the Head of the Government. With this, we will identify critical sectors and will exclude critical positions that will not be eligible to participate in the departure programs to protect the quality of public services. The government will propose a technical design for an optimal financial compensation, with the assistance of the World Bank, to achieve the planned number of departures while preserving fiscal sustainability. We will also make a call on our development partners for financial contributions to the departure programs.

ii. **Strictly limiting recruitment.** To strengthen the process for monitoring the controls on hiring, a decree will eliminate the recruitment responsibility by line ministers based on the budget law and will transfer back to the Office of the Head of the Government the competence to review and authorize any hiring within the central government (adoption, by the Council of Ministers, of a decree giving the authority to the Office of the Head of the Government to review and exclusively authorize recruitments and setting the maximum recruitments into the civil service at 3,000 equivalent to a 25 percent replacement rate, for 2018 while confirming the number of 7,500 for 2017 ; *New Structural Benchmark*, October 2017). Furthermore, the government will review the legal framework for redeployment to help enforce the limits on new hires and to strengthen the provision of public services in the interior regions.

- **Managing the risks to the civil service strategy.** The government will take all necessary additional measures to achieve the targeted wage bill path in case the current strategy produces weaker-than-expected results. Under such a scenario, the government will seek additional fiscal savings through streamlining wages and allowances (simplification of which will start in the near future), further recruitment streamlining, faster redeployment, and other measures. In addition, the government is committed to introducing by mid-2018, in consultation with the social partners, a mechanism to better anchor wage negotiations and achieve consistency with the government's objectives on the public wage bill and on fiscal sustainability.

21. Putting the social security system on a sustainable path. A tripartite commission is tasked to review and propose changes to the parameters defining the retirement system in Tunisia. It will be assisted by the World Bank, the International Labour Organization (ILO), and the United Nations Economic and Social Commission for Western Asia (ESCWA). Specifically, the commission will analyze contribution rates, alignment of pensions with economic indicators (péréquation), the reference wage for calculating the pension, retirement age, and the bonification factor for early retirements to determine the list of parameters and the timing of the desired changes. Moreover, the government will consider the introduction of a social VAT, which will be a fungible fiscal resource (in addition to the measures already set forth in Table 1) to diversify the sources of financing of social security in the context of the pension reform. This social VAT will be discussed at the time of the adoption of the 2018 budget law. The tripartite commission will finalize the comprehensive pension reform strategy for adoption by the Council of Ministers by end-September 2017 (*New Structural Benchmark*). The implementation of the pension reform is expected for January 1, 2018 to address the needs of the funds in 2018 and over the medium term.

22. Ensuring better management of public enterprises. Their performance needs to improve and they will be closely monitored.

- **Performance contracts.** As part of our efforts to manage fiscal risks, we will sign performance contracts with the five largest public enterprises, namely Tunisair, the electricity and gas companies STEG and STIR, the Office des Céréales, and the national Régie des Tabacs (*Delayed Structural Benchmark, July 2017*). The contract with Tunisair will be of shorter duration as the finalization of a restructuring plan in 2017 will inform a new performance contract. The performance contracts contain a set of performance indicators and will be monitored closely by the department of government holdings (DGP) within the Ministry of Finance. From now on, a performance assessment of the executives (Chairman of the Board or Executive Officer) of the five enterprises will be based partly on the indicators set in the performance contracts. This assessment will be used to set up a variable remuneration system in the future.

- **Improved monitoring.** The DGP has prepared a table for monitoring the public enterprises, including the basic financial indicators that will provide a real-time fiscal risk assessment. By September 2017, a preliminary assessment of the financial performance of the enterprises will be conducted and shared with the supervising ministries. For the public banks, and to build the capacity of the Ministry of Finance to play its role as shareholder and actively monitor the performance contracts, the ministry will hire senior experts from the banking sector by September 2017. As part of the government's strategy to disinvest its holdings in seven nonstrategic financial institutions, an investment bank will be appointed by December 2017 to carry out the first transactions

23. Improving public financial management. The Organic Budget Law is expected to be published in the official journal in September 2017 (*Delayed Structural Benchmark*). The law, expected to be implemented in 2019, will improve expenditure management and facilitate the initiatives related to civil service reform. Moreover, coordination between the General Directorate of Debt, the Treasury, and the other departments of the Ministry of Finance will be improved to achieve better cash management and transparency of government financing. Cash management will be strengthened by starting to monitor by end-2017 the part of the Treasury Single Account (TSA) that will regroup together all the central government accounts. The management procedures for the Account will follow IMF technical assistance recommendations.

24. Continuing the tax policy and tax administration reforms started in 2018.

- **Continuing the modernization of tax administration.** We will, with the assistance of USAID, conduct an in-depth review of the DGE's management procedures to increase the unit's efficiency by December 2018. These efforts will go hand in hand with the computerization of procedures that are already at an advanced stage. We will also explore ways to subject exempted enterprises to a reporting regime at least as strict as the regime followed by non-exempted enterprises to ensure compliance with tax rules.

- **Pursuing the implementation of the taxation strategy of May 2016.** Based on the strategy, we continue work to streamline resource earmarking with the integration of the Special Treasury Funds (FSTs) and the review of the various taxes, whether specifically earmarked or not, outside the scope of the FSTs. A joint study conducted this year with USAID will provide a better assessment of the financial and economic aspects of the FSTs to gradually reduce them by 2019.

B. Reinvigorating Monetary and Foreign Exchange Policies

25. The high external and budget deficits, mainly structural in nature, require closer coordination between monetary policy and foreign exchange policy. The twin deficits reflect strong demand, stemming from excessive consumption that underpins a continuous rise in imports not offset by the recovery of exports that remain weaker-than-expected. This difficult situation has led to an increase in the CBT's refinancing of commercial banks along with significant interventions by the Central Bank on the foreign exchange market to meet the banks' fx needs and to smooth exchange rate fluctuations. Credit to the economy has performed well with an annualized growth rate of 9.8 percent at end-March 2017.

26. Mitigating inflationary pressures. In view of the visible pressures from domestic prices and those expected from a more flexible exchange rate, the Central Bank raised its policy rate from 4.25 percent in April 2017 to 4.75 percent, equivalent to a 50 basis points increase. This was followed by another increase on May 23, 2017 of 25 basis points, taking the policy rate to 5 percent. These changes (the first since 2015) should ease inflationary pressures and support the dinar. Furthermore, the CBT stands ready to use all monetary instruments available to mitigate further inflationary pressures during 2017.

27. Allowing for greater exchange rate flexibility. The CBT has reduced its interventions on the foreign exchange market over the course of the EFF program (net sales were on average 22 percent of total transactions on the market), compared to the Stand-By Arrangement with an average of 30 percent. Our interventions have also become bidirectional through the practice of buying foreign currency whenever possible. In this context, we reiterate our commitment to limiting strictly our monthly average net sales of foreign currencies on the exchange markets to the financing of critical imports at the average interbank rate of the transaction day and to smooth excessive fluctuations in the exchange rate. Implementing this approach will put us into a position to respect the average monthly ceiling for interventions agreed in the program, and in line with the cyclicality of foreign exchange inflows. This will increase the flexibility of the dinar. Moreover, we are committed to:

- Buying foreign exchange when market conditions permit.
- Continuing clear communications to help align market expectations.
- Immediately conducting close consultation with IMF staff on monetary policies in case the Central Bank's FX interventions exceed the budgeted amounts indicated above in any given month.

28. Reactivating the auction mechanism for FX sales to preserve international reserves and increase exchange rate flexibility. The reform envisages allocating foreign exchange within the program ceilings agreed for interventions based on an auction that reflects competitive price offers. The reactivation of the mechanism, which has already started with several auctions held since mid-May, intends to achieve: (i) a more transparent allocation of foreign exchange supplied by the Central Bank during its interventions, based on the best bidder; (ii) an optimal level of interventions by the Central Bank based on the overall foreign exchange liquidity position of the market, leading to optimal reserves management; and (iii) the reduction of operational costs and risks associated with interventions. After the current test phase, the Central Bank will implement a full foreign exchange auction mechanism based on clear intervention rules at the latest by August 2017 (*New Structural Benchmark*).

29. Improving monetary policy transmission. The CBT (i) has established the lender of last resort framework in December 2016 to separate normal refinancing operations from refinancing operations for illiquid banks, and (ii) adopted the monetary policy operations manual in March 2017 with the assistance of the Banque de France and the IMF. To follow up on these actions, the Central Bank will establish the committee overseeing the lender of last resort framework, which will (i) set the criteria to assess the eligibility of banks to access the framework, (ii) determine eligible collateral and interest rates, and (iii) evaluate the business plans as a basis for restoring the banks' liquidity as well as the maximum time window of support (September 2017).

30. Reducing the risks on the CBT's balance sheet. As opposed to past practice, a discount rate, similar to private assets, will be applied—varying between 0.75 percent and 7.5 percent depending on maturity—on treasury bills used as collateral in the context of bank refinancing once adopted by the Central Bank board (expected for July 2017). In addition, the financial authorities, with the assistance of the European Bank for Reconstruction and Development, will finalize the yield curve (June 2017) and the establishment of a central information point for eligible assets to facilitate the valuation of collateral eligible for refinancing. A comprehensive list of collateral instruments eligible for refinancing and their respective discount rates will be published on the Central Bank website and internally through the central information point (September 2017).

C. Reducing Financial Sector Vulnerabilities

31. We have continued the reforms to strengthen public banks, financial regulation, and supervision. The restructuring plans and performance contracts of the three public banks were adopted. They set annual operational and financial targets, including on nonperforming loans and on improving risk management. The banking law and the associated first implementation decrees have been adopted. Banking supervision has been strengthened with the adoption of several reforms regarding operational risk, exposure to related parties, and the adoption of the risk-based supervision manual. The 2015/12 circular that allows to postpone the downgrading of nonperforming loans in the tourist sector has expired. The renewal of this circular is under review.

32. Setting up a reform committee to accelerate financial reforms. We have created a financial sector reform committee that has been meeting monthly since April 2017 to coordinate and monitor progress of the various reforms. This committee led by the Ministry of Finance involves not only the Central Bank but also other ministries, such as the Ministry of Justice.

33. Reducing the share of public banks' nonperforming loans to prudent levels. The banks' share of nonperforming loans in total loans improved from 16.5 percent in December 2015 to 15.6 percent in December 2016, while the share of NPLs covered by provisions and through suspended interest accrual (agios réservés) improved to 65.5 percent. Nevertheless, these indicators remain much weaker than those of other emerging countries with prudent levels. To address this structural obstacle that hampers the banks' ability of providing credit to the Tunisian economy, we are committed to vigorously pursuing our financial sector reforms.

- On public banks, to achieve greater flexibility for renegotiating their loans and on a par with private banks, we will take the following actions by October 2017 (*New Structural Benchmark*):

    i. The adoption of a law to make it possible for public banks to abandon claims on credits like their private peers (both in the context of the insolvency law and outside of this context) is envisaged by October 2017. This law will allow the bank boards to approve policies, arbitrage provisions and reconciliation conventions the amounts of which will be set by the bank boards.

    ii. By June 2017, we will adopt a government decree concerning the creation of a permanent committee that will grant an assent (avis conforme) to the Ministry of Finance for all measures concerning debt settlement of the State, local collectivities and public establishments. This is necessary with regard to the new insolvency law, in application of Article 474 of the commercial code. The decree will specify that claims of public banks will not be within the purview of the permanent committee.

    iii. Write-off rules will be simplified. In particular, it will not be necessary to obtain a final judgment to write off a claim.

- With the technical assistance of the EBRD, the authorities are working to amend the law to improve the efficiency of debt collection companies by December 2017, specifically to enable the companies to contact their debtors and write off nonperforming claims.

- To strengthen the skills and knowledge base of the legal experts supporting judges, the Ministry of Justice has reviewed the necessary conditions to appoint legal experts. By June 2017, the Ministry of Justice will determine the registration periods for inclusion into the list of experts. This reform will enable the appointment of banking sector experts capable of facilitating and accelerating the work of judges in cases of dispute involving credit institutions. By September 2017, the Ministry of Justice will also assess, in consultation with the supreme court, the possibility of training judges specializing in banking disputes.

34. Finalizing the inspections of the remaining two private banks. The CBT will complete these inspections focusing specifically on credit risk and provisioning policy, to achieve the inspections of the seven largest private banks by September 2017 (*Delayed Structural Benchmark*).

35. Finalizing the implementation of the resolution framework for credit institutions. By June 2017, we will set up the resolution committee so that it can start operations. Once set up, it will organize the resolution of Banque Franco Tunisienne (BFT) based on the CBT's report. The deposit guarantee fund will be operational by September 2017.

36. Continuing with the strengthening of banking supervision. By June 2017, we will adopt two circulars setting forth the reporting obligations of financial institutions (applicable in 2018) related to market risk. The Central Bank has also started the process of hiring a dozen new supervisors, which should be finalized by June 2017. By December 2017, a manual will be implemented for on-site supervisors covering the assessment of provisions for risk management based on internal ratings. By June 2018, the Central Bank will strengthen its expertise with IMF technical assistance on the establishment of scoring and rating tools in banks. This will take place through training of teams and supervisors. Training needs will be identified so that the Central Bank can monitor and assess the quality of the processes set up in the banks. As part of the preparation of the financial sector for the International Financial Reporting Standards (IFRS), the Central Bank will assess by March 2018 the possibility of establishing a transition phase for the definition of prudential provisions, in particular for provisions applied to guarantees in compliance with circular 2013/15. We are also committed to preparing the transition toward consolidated supervision. Specific annexes covering the assessment of risks associated with banking groups have already been prepared and will be incorporated in the new reporting arrangements that will be published by a circular at end-June 2017.

IV. TOWARD STRONG AND EQUITABLE GROWTH

37. In a medium-term perspective, we continue to aim at growth driven by the private sector to create more jobs and promote greater fairness. In this context, protecting vulnerable families remains a key priority of the government.

38. Developing better targeted social protection for low-income households. As part of the reform of the general equalization fund (*caisse générale de compensation*), the implementation of the new unique social identification number with the establishment of a database on vulnerable households (*Delayed Structural Benchmark*, December 2017) have been postponed due to delays with the social survey that is required to provide information, although significant technical progress has been achieved regarding the inclusion of beneficiaries already identified through the social security funds. This critical system for social protection is expected to be established by end-2017. On that basis, the government is committed to speeding up, from 2018 onward, the technical work for the transition from the system of universal subsidies to needs-based targeting of vulnerable households, for example through a conditional cash transfer system. We are committed to presenting a concrete strategy in June 2018, which will support the 2019-20 efforts to adjust budget deficits.

39. Fighting corruption and supporting good governance. The law on the protection of whistle-blowers for reporting misconduct in the public sector was adopted in April 2017, enabling us to create a legal framework underpinning the civic duty to report wrongdoing. The law creating the independent high anti-corruption and good governance authority is expected to be adopted in September by the ARP (*Delayed Structural Benchmark*). This law provides for the election of members to the authority by the ARP following a public call for candidates. The independence of this high authority is enshrined in law. The dismissal of members is only possible with a two-third majority vote of the members of the ARP. The president of the high authority will be appointed by a vote of two thirds of its members. In addition, it will be given powers of self-referral and investigation on all issues of corruption and good governance in both the public and the private sectors. Key milestones are expected after the approval of the law, including: (i) signature of the decree appointing the members of the high anti-corruption and good governance authority; (ii) signature of the decree specifying the remuneration of its members; and (iii) submission of its budget in the context of the 2018 budget law preparation (*New Structural Benchmark, November 2017*).

40. Improving the business climate and boosting private sector investment. The draft economic emergency law adopted by the Council of Ministers in 2016 will be adopted by the ARP by end-2017 to accelerate the implementation of major investment projects. In the meantime, the streamlining of administrative procedures to improve the business climate continues with the simplification of 372 procedures in 2017, which target multiple sectors. The government continues to promote the investment code as illustrated by the Tunisia forum held in April 2017, focusing on the presentation of the new legal framework for investment. This effort will maintain its momentum with the establishment of the entities envisaged in the investment code to facilitate and incentivize investment, especially the one-stop shop scheduled for December 2017. Moreover, the government will seek to maximize the use of its international relations for investment, notably through the Compact with Africa. This G20 countries' initiative reflects our continued efforts started with the Tunisia 2020 Investor Conference, which has allowed us to enter into a new dynamic partnership with all the countries with which Tunisia maintains friendly relationships.

41. Supporting the development of the financial sector. Under the auspices of the financial sector reform committee, by December 2017, we will work with the main stakeholders (such as insurance companies, banks, and the financial markets authority) to identify measures aimed at developing the Tunisian financial market. This will also help us diversify domestic sources of government finance. To promote financial inclusion and develop credit to small and medium-sized companies (SMEs), we will increase the cap on the excessive lending rate to at least the 2009 level by September 2017 (*Delayed Structural Benchmark*). The ceiling for professionals will increase to 33 percent above the average rate observed, compared with 20 percent at present. However, the ceiling for individuals will remain unchanged at 20 percent above the average rate observed. By

June 2018, we will have conducted a full review of the excessive rate legislation to revise the rate for individuals and potentially to segment the ceiling for professionals by type of enterprise.

42. Improving the efficiency of public investment. We remain strongly committed to improving the efficiency of our public investment and to reaching 6.2 percent of GDP in 2020. With the support of the World Bank, we will identify the strategic directions that will be retained as firm priorities in the context of a Public Investment Management Assessment (PIMA) by end-2017. We will also work with help from the World Bank on strengthening the information system regarding the status of projects and the implementation of appropriations..

43. Reforming the system for data production, dissemination, and access. The implementing decrees relating to the organic law on access to information have been finalized and presented to the administrative court for consultation before publication In addition, a national EGov plan has been prepared and has set out in detail the action plan presented to the various ministries.

Table 1. Tunisia: Quantitative Performance Criteria and Indicative Targets 1/2/

	Cumulative flows since beginning of 2015 (unless otherwise specified)	Cumulative Flows Since Beginning 2016 (unless otherwise specified)										Cumulative flows since beginning of 2017 (unless otherwise specified)				Cumulative flows since beginning of 2018 (unless otherwise specified)
	December 2015	June 2016				September 2016		December 2016				March 2017	June 2017	September 2017	December 2017	March 2018
	Prel.	Program	Adjusted Target	Act.	Target status	Indicative Target	Act.	Prog.	Adjusted Target	Prel.	Target status	Indicative target	Proposed target	Indicative target	Proposed target	Indicative target
Quantitative Performance Criteria																
1. Floor on the primary balance of the central government (cash basis excl. grants; million of Tunisian dinars)	-3,246	-1,209		-1,832	Not Met	-1,699	-2,951	-2,326		-3,951	Not Met	-1,187	-1,247	-1,141	-3,784	-1,041
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock; million of Tunisian dinars)	1,924	4,887	5,998	4,633	Met	3,498	5,282	2,191	4,368	5,094	Not Met	5,351	5,550	4,337	3,834	2,557
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock; million of US dollars)	4,488	3,599	3,099	3,017	Not Met	4,261	3,232	4,762	3,759	3,335	Not Met	3,105	2,906	3,311	2,937 #	3,634
4. Ceiling on Current Primary Expenditure (million of Tunisian dinars)	18,088	9,539		9,658	Not Met	14,497	13,798	19,724		19,054	Met	5,586	10,379	14,932	21,757	5,983
Continuous Performance Criteria																
5. Ceiling on the accumulation of new external debt payment arrears by the central government	0	0		0	Met	0	0	0		0	Met	0	0	0	0	0
Quantitative Indicative Targets																
Floor on Social Spending 3/ (million of Tunisian dinars)	1,335	626		844	Met	926	1,082	1,534		1,411	Not Met	487	965	1,226	1,533	489
Ceiling on the accumulation of new domestic arrears	0	0		0	Met	0	0	0		0	Met	0	0	0	0	0
Program assumptions on which adjusters are calculated in case of deviations																
External financing of the central government on a cumulative basis (in US$ million) 4/	1,507	341		226		1,388	855	2,477		1,431		1,017	2,200	3,007	3,078	1,344
of which: Multilateral (excluding IMF), bilateral and budget grants (in US$ million)	1,370	159		17		626	17	1,635		577		0	108	871	927	233
Public external debt service (interest and amortization) on a cumulative basis (in US$ million)	961	487		511			771	1,113		930		265	1,055	1,481	1,823	243
Bank recapitalization and civil service reform costs (in million TD)	647	0		0			0	0		0		0	0			
Privatization receipts in FX (in US$ million)	0	0		0			0	0		0		0	0			
Resident deposits at the BCT (in US$ million) 5/	969	969		660			995	969		908		960	960	960	960	960
Foreign exchange swaps between the CBT and commercial banks (in million TD) 5/	603	603		499			476	603		445		453	453	453	453	453
Foreign exchange swaps between the CBT and commercial banks (in US$ million)	299	299		248			237	299		221		225	225	225	225	225
Program exchange rate TD/ U.S. dollars	2.01285	2.01285		2.01285			2.01285	2.01285		2.01285		2.01285	2.01285	2.01285	2.01285	2.01285

Source: IMF staff estimates.

1/ Quantitative performance criteria and structural benchmarks are described in the Technical Memorandum of Understanding.

2/ For purposes of calculating program adjusters, foreign currency amounts will be converted at program exchange rates.

3/ Public capital expenditures on social sectors and programs.

4/ Disbursment, includes project loans and capital market access but excludes IMF.

5/ At program exchange rate.

Table 2. Tunisia: Prior Actions and Structural Benchmarks

Prior Actions	Objective	Status
Approval, by the board of Directors of public banks (STB, BH, and BNA), of performance contracts in line with their new restructuring plans.	*Financial sector stability*	Met
Approval, by the Council of Ministers, of a revised civil service reform strategy.	*Fiscal sustainability and fairness*	Met
Adoption, by the Council of Ministers, of the decree for the establishment of a Large Taxpayers Unit to include formal responsibility for the major tax and enforcement functions (return processing, taxpayer advisory services, and audit), the setting of an implementation timetable, and the establishment of a monitoring task force. The implementation will be in line with the recommendations of the IMF Technical Assistance of April 2017.	*Fiscal sustainability and fairness*	Met
Adoption, by the Council of Ministers, of the 2018 tax strategy and its presentation to the "Pacte de Carthage" signatories.	*Fiscal sustainability and fairness*	Met

Structural Benchmarks	Objective	Date	Reprogrammed Date	Status
I. Financial sector reform				
Approval, by the board of Directors of public banks (STB, BH, and BNA), of performance contracts in line with their new restructuring plans.	*Financial sector stability*	Jun-16		Not met. Replaced by Prior Action.
Increase of the cap on lending rates to, at least, the 2009 level.	*Financial sector stability*	Dec-16	Sep-17	Not met. Draft law in Parliament.
Systematic use, by the supervisors, of the new manual on risk-based supervision.	*Financial sector stability*	Dec-16		Met
Inspection of the seven largest private banks in line with the best standards and with IMF Technical Assistance as agreed with the CBT.	*Financial sector stability*	Mar-17	Sep-17	Not met. Inspection of five banks completed in May 2017.
Approval, by the board of Directors of STB and BNA, of revised business plan ensuring regulatory compliance throughout the restructuring period and in line with the principles detailed in the MEFP. 1/	*Financial sector stability*	Jul-16		Met
Approval of secondary legislation to address some of the weaknesses in the banking law regarding the bank resolution framework through the (i) adoption of a government decree to implement the framework of the Bank Deposit Guarantee Fund that includes a least cost test for resolution with an exception for systemic cases; and (ii) adoption of a bylaw of the Resolution Committee providing a short timeframe to determine resolution measures for systemic cases. 1/	*Financial sector stability*	Aug-16		Met
NEW 1/7: Adoption of: i) a law to make it possible for public banks to abandon claims on credits like their private peers (both in the context of the insolvency law and outside of this context); ii) a government decree creating a permanent committe that will grant an assent to the Ministry of Finance for all measures concerning debt settlement of the State, local collectivities and public establishments; the decree will specify the claims of public banks will not be within the purview of the permanent committee; and iii) simplified rules to write-off claims, eliminating the requirement for a final judgment.	*Financial sector stability*	Oct-17		

1/ See Supplementary Memorandum of Economic and Financial Policies, IMF Country Report No. 16/138.

Table 2. Tunisia: Prior Actions and Structural Benchmarks (concluded)

II. Monetary and exchange rate policies				
NEW 2/7: Implementation of a full foreign exchange auction mechanism by the Central Bank of Tunisia.	*Exchange rate flexibility and price stability*	Aug-17		
III. Budget Policy and Reforms of Public Institutions				
Approval, by the Council of Ministers, of a comprehensive strategy on civil service reform.	*Fiscal sustainability and fairness*	Sep-16		Not met. Replaced by Prior Action.
Signature of performance contracts for the five largest public enterprises (Office des Céréales, Régie des Tabacs, STIR, STEG et TUNISAIR).	*Better monitoring of fiscal risks*	Sep-16	Jul-17	Not met. At an advanced stage of implementation.
Completion of the functional review of four ministries (Health, Education, Finance, and Infrastructure).	*Fiscal sustainability and quality public services*	Dec-16	Aug-17	Not met. At an advanced stage of implementation.
Publication, in the official journal, of the Organic Budget Law.	*Fiscal sustainability and fairness*	Dec-16	Sep-17	Not met. Draft law in Parliament.
Establishment of a Large Taxpayers Unit to include formal responsibility for the major tax and enforcement functions (return processing, taxpayer advisory services, and audit).	*Fiscal sustainability and fairness*	Dec-16		Not met. Replaced by Prior Action.
Adoption of a medium-term debt strategy.	*Debt sustainability and deepening of financial markets*	Dec-16		Met
NEW 3/7: Transfer of control (in-depth verification) and tax arrears management functions for large enterprises to the Large Taxpayers Unit (DGE) and their operationalization.	*Fiscal sustainability and fairness*	Oct-17		
NEW 4/7: Adoption, by the Council of Ministers, of a decree giving the authority to the Prime Minister's office to review and exclusively authorize recruitments and setting the maximum recruitments into the civil service at 3,000 for 2018 while confirming the number of 7,500 for 2017.	*Fiscal sustainability and fairness*	Oct-17		
NEW 5/7: Reapplication of the automatic fuel price adjustment mechanism.	*Fiscal sustainability and fairness*	Sep-17		
NEW 6/7: Adoption, by the Council of Ministers, of the comprehensive pension reform strategy to ensure financial sustainability.	*Fiscal sustainability and fairness*	Sep-17		
IV. Sectoral reforms/private sector development				
Adoption of the implementation decrees for the new law on competition, law on PPPs, and new investment code.	*Inclusive growth and job creation*	Sep-16		Met
Creation of an independent, high anti-corruption authority.	*Good governance and fairness*	Dec-16	Sep-17	Not met. Draft law in Parliament.
Establishment of a databank on vulnerable households.	*Social protection and fairness*	Mar-17	Dec-17	Not met. In progress.
NEW 7/7: Signature of the decree appointing the members of the high anti-corruption and good governance authority; signature of the decree specifying the remuneration of its members; and submission of its budget in the context of the 2018 budget law preparation.	*Good governance and fairness*	Nov-17		

Attachment II. Technical Memorandum of Understanding

1. This Memorandum establishes the agreement between the Tunisian authorities and IMF staff concerning the definition of the quantitative performance criteria and indicative targets under the program supported by the Extended Fund Facility. It also sets out the content and frequency of data reporting to IMF staff for program monitoring purposes.

2. The quantitative criteria and targets are defined in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated May 29, 2017. For program purposes, all assets, liabilities, and flows denominated in foreign currencies will be valued at the "program exchange rate," as defined below, with the exception of items affecting the government's budgetary accounts, which will be measured at current exchange rates. For program purposes, the exchange rate corresponds to the accounting exchange rate of the CBT prevailing on December 31, 2015, as shown in the table below. For the SDR, the program exchange rate is 1 SDR = 2.797590 Tunisian dinars.

Program Exchange Rates, Tunisian Dinars per FX Currency at End-December 2015

(Accounting exchange rate of the CBT)

Currency	Exchange rate
AED	0.54802
BHD	5.3373
CAD	1.45005
CHF	2.0322
DKK	0.2947335
DZD	0.01878
EUR	2.1993
GBP	2.9837
JPY	0.0167135
KWD	6.63225
LYD	1.44535
MAD	0.203175
NOK	0.228923
QAR	0.552815
KRW	0.001707098
CNY	0.31020
SAR	0.53634
SEK	0.23918
USD	2.01285

3. Monetary gold assets will be valued, against the corresponding value in Dinar (at the program exchange rate) at the price of 2,138.15 dinar per ounce of gold in the international market on 12/31/2015 (London morning fixing). The stock of gold is 4.13 tons (4,129,806 grams) on December 31, 2015.

4. For data reporting purposes, the Ministry of Economy and Finance (MoF), the Ministry of Planning and Economic Cooperation (MDCI), the National Institute of Statistics (INS), and the Central Bank of Tunisia (CBT) will follow the rules and the format considered appropriate for data reporting as covered by this technical memorandum of understanding, unless otherwise agreed with IMF staff.

DEFINITION OF PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Performance Criteria and Indicative Targets

5. The quantitative performance criteria and indicative targets specified in Table 1 of the MEFP are:

Performance criteria

- A performance criterion (**floor**) on the net international reserves of the Central Bank of Tunisia.
- A performance criterion on the net domestic assets **(ceiling)** of the Central Bank of Tunisia.
- A performance criterion (**floor**) on the primary balance of the central government, excluding grants.
- A performance criterion (**ceiling**) on total primary current expenditure of the central government.
- A continuous performance criterion on the accumulation of new external debt payment arrears (**zero ceiling**).

Indicative targets

- An indicative target (**ceiling**) on accumulation of new domestic arrears.
- An indicative target (**floor**) on capital expenditures in priority social sectors and social programs.

6. Measurement of criteria. The performance criteria on net international reserves and net domestic assets are measured on a stock and semi-annual basis. The performance criteria on the central government deficit on the total primary current expenditure of the central government are measured on a semi-annual basis and cumulatively from the end of the previous year. Adjustment factors will also be applied to some of these criteria. The performance criterion on the accumulation of new external arrears is measured on a continuous basis. Indicative criteria will be monitored on a quarterly basis.

B. Institutional Definition

7. The **central government** comprises all ministries and agencies subject to central budgetary administration in accordance with the organic law on the government budget. Regional governments and municipalities subject to central budgetary administration are part of the central government.

8. The authorities will inform Fund staff of any new entity and any new program or special budgetary or extra-budgetary fund created during the period of the program to carry out operations of a budgetary nature. Such funds or new programs will be included in the definition of the central government.

C. Floor on the Net International Reserves of the Central Bank of Tunisia

9. The **net international reserves (NIR)** of the Central Bank of Tunisia (CBT) are defined as the difference between the CBT's reserve assets and its liabilities in foreign currency to nonresidents.[1]

10. The **CBT's reserve assets** are the foreign assets immediately available and under the CBT control, as defined in the fifth edition of the IMF *Balance of Payments Manual*. They include gold, SDR assets, reserve position at the IMF, convertible foreign currencies, liquid balances held outside Tunisia, and negotiable foreign securities and bills purchased and discounted.

11. The **CBT's liabilities in foreign currency** to nonresidents include any commitment to sell foreign currencies associated with financial derivative transactions (such as swaps, futures, options), any portion of the CBT's assets (gold, for example) used as collateral, IMF and Arab Monetary Fund (AMF) credits outstanding, and deposits at the CBT of international organizations, foreign governments, and foreign bank and nonbank institutions. The government's foreign currency deposits at the CBT are not included in the liabilities, nor is any SDR allocation received after March 31, 2017.

[1] Deposits of residents in foreign currency (excluding government deposits) at the CBT are a form of external liability of the CBT; for operational and accounting purposes, and because of legal considerations related to the regulation of foreign exchange, the CBT includes residents' foreign currency deposits in the monetary base. To preserve the accounting consistency of the CBT's accounts and be in line with the standard definition of NIR within the framework of IMF programs, it is agreed: (i) to retain the accounting definition of external liabilities used in the CBT balance at December 31, 2015; (ii) to adopt the principle of adjusting NIR (in the opposite direction of the net domestic assets of the CBT) on the basis of the variation in the residents' deposits in foreign currency from end-December of the previous year. It also agreed that the residents' deposits in foreign currency at the CBT include the following components of reserve money: intervention/monetary market in foreign currency, foreign currency of aggregate intermediaries, non-negotiable placement of foreign currencies, and all other items operations in foreign currency (including deposits and derivatives products) created or included in reserve money and resulting in a liability of the Central Bank to residents. At end-March 2017, the value of the stock of deposits in foreign currencies of residents at the CBT was US$960.1 million at the program exchange rate.

12. All debt instruments issued in foreign currency by the CBT on behalf of the government after May 15, 2013 will be treated as **CBT liabilities**, unless the offering documents (prospectus) state clearly that (i) the CBT is acting as an agent to execute all sovereign debt instruments issued in foreign currency raised through the international markets for general budgetary purposes of the Republic of Tunisia (ii) debt is a liability of the central government; and (iii) a protocol between the CBT and the Ministry of Finance provides clearly that the CBT is authorized to pay all expenses and costs pertaining to the implementation of this issue as well as the interest and principal of the issue sum through direct deduction from the Treasury's current account established in the CBT's books.

13. The value of CBT reserve assets and liabilities in foreign currency will be calculated using program exchange rates (see Table above). On March 31, 2017, the value of the stock of net international reserves was US$3,105.2 million, with the stock of reserve assets equal to $6,197.5 million and the stock of CBT liabilities in foreign currency equal to US$3,092.4 million (at program rates).

D. Ceiling on Net Domestic Assets

14. The **CBT's net domestic assets** are defined as the difference between the monetary base and the net foreign assets of the CBT.

15. The **monetary base** includes: (i) fiduciary money (money in circulation excluding cash balances of banks and the Treasury); (ii) deposits of banks at the central bank (including foreign currency and deposit facility); and (iii) deposits of all other sectors at the central bank (i.e., other financial enterprises, households, and companies).

16. The **CBT's net foreign assets** are defined as the difference between the CBT's gross foreign assets, including foreign assets that are not part of the reserve assets, and all foreign liabilities of the CBT. Net foreign assets are valued at the program exchange rate defined in the above table.

E. Floor on the Primary Balance of the Central Government (Excluding Grants)

17. Under the program, the **primary fiscal balance of the central government (excluding grants, on a cash basis)** is measured on a financing basis and will be the negative sum of: (i) total net external financing; (ii) privatization receipts; (iii) net domestic bank financing; (iv) net domestic nonbank financing; *plus* (v) interest on domestic and external debt paid by the central government and *less* external budgetary grants received by the central government.

18. **Total net external financing** is defined as net external loans of the government, that is: new loan disbursements, *less* repayments of the principal. Project and budgetary loans of the central government are included, as well as any form of debt used to finance central government operations.

19. **Privatization receipts** are the government receipts from the sale of any government asset. This includes revenues from the sale of government shares in public and private enterprises, sales of nonfinancial assets, sales of licenses, and the sale of confiscated assets, excluding the confiscation of bank accounts. For the adjustor in NIR (see below), only receipts in foreign currency are included.

20. **Net domestic bank financing of the central government** is the sum of: the change in net bank loans to the central government (in Tunisian dinars and foreign currency) and the change in central government deposits at the CBT (this includes all central government accounts at the CBT, in particular (i) Treasury current account excluding the sub accounts N-bis, those related to Public Administrative Entities (EPA) and to local governments; (ii) Tunisian government account (miscellaneous dinar accounts); (iii) loan accounts; (iv) grant accounts; (v) FONAPRA-FOPRODI accounts; (vi) special accounts of the Tunisian government in foreign currency; (vii) accounts in foreign currency pending dinarization (subaccount: "mise a disposition"); (ix) and any other account that may be opened by the central government at the CBT or banks. Following the unification of government accounts at the CBT into a Single Treasury Account, government accounts are consolidated in two categories ("Compte Central du Government "and "Comptes Spéciaux du Government") on the CBT's balance sheet (liabilities side).

21. **Net government borrowing from the banking system** is defined as the change in the stock of government securities (Treasury bills and bonds) held by banks and any other central government borrowing from banks, less repayments.

22. **Net domestic nonbank financing** includes: the change in the stock of government securities (Treasury bills and bonds) held by nonbanks (including social security funds) and any other central government borrowing from nonbanks, less repayments. In particular, any use of cash from non-banking institutions (including La Poste) to finance the Treasury would be counted as domestic non-bank financing. Total Treasury bills and other public debt instruments to be taken into consideration are calculated at the nominal/face value shown on the institutions' balance sheet and does not include accrued interest.

F. Ceiling on Central Government Primary Current Expenditure (Excluding Interest Payments on Public Debt)

23. Under the program, central government primary current expenditure is defined as the sum of central government expenditure on: (i) personnel wages and salaries; (ii) goods and services; (iii) transfers and subsidies; (iv) other unallocated current expenditure[2].

[2] The methodologies used to measure current expenditure categories for the central government are those used to design the table of central government financial operations presented in the macroeconomic framework.

G. Ceiling on the Accumulation of External Arrears

24. **Arrears on external debt payment** are defined as late payments (principal and interest) on external debt or guarantees as defined in *External Debt Statistics: Guide for compilers*[3] by the central government or the CBT from the due date or the expiration of the applicable grace period.

H. Indicative Ceiling on the Accumulation of Domestic Arrears

25. For program purposes, arrears on **domestic debt payment** are defined as amounts owed to domestic financial and commercial creditors that are 90 days or more overdue with respect to a specific maturity date (or as defined in the contractual grace period, if any). If no maturity date is specified, arrears are defined as amounts owed to domestic creditors that remain unpaid beyond 90 days or more after the date on which the contract was signed or upon receipt of the invoice.

I. Indicative Floor on Social Expenditures

26. **Social expenditures** are defined as capital expenditures (development expenditures) on education, health, social transfers to low-income families, the AMAL employment training program (and university scholarships), UTSS indemnities, family allocation as well as development expenditures of the Ministries of Women and Family Affairs, Youth and Sports and Social Affairs, and all new targeted cash transfers in support of vulnerable groups; all current expenditures ("dépenses de gestion") of the above-mentioned sectors and programs, as well as food and energy subsidies, are excluded.

J. Adjustment Factors for the Program Performance Criteria

27. The **NIR** targets are adjusted upward (downward) if the cumulative sum of net external financing of the central government, the sum of budgetary grants, privatization receipts received in foreign currency, the increase (decrease) in the residents' foreign currency deposits at the CBT (including FX swaps) are greater (lower) than the levels observed in the table below. The NIR targets

[3] The definition of debt set forth in *External Debt Statistics: Guide for Compilers* reads as the outstanding amount of those actual current, and not contingent, liabilities, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to nonresidents by residents of an economy. Debts owed to nonresidents can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property.

will be also adjusted upward (downward) if the total amount of cash payments on external debt service of the government is lower (greater) than the levels included in the table below.

28. The net domestic assets (NDA) targets will be adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the cumulative sum of net external financing of the central government, the sum of budgetary grants, privatization receipts received in foreign currency, the increase (decrease) in residents' foreign currency deposits at the CBT are lower (greater) than the levels indicated in the table below. The NDA targets are also adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the total amount of cash payments on external debt service are greater (lower) than the levels included in the table below. The NDA targets are also adjusted upward (downward) based on downward (upward) change in the stock of foreign currency swaps between the central bank and the commercial banks compared to the level on March 31, 2017 (US$225.3 million, 453.4 million Tunisian dinars). The NDA ceiling will be converted into Tunisian dinars at the program exchange rate.

Program Assumptions on Adjustment Factors for the Quantitative Performance Criteria

(In millions of US dollars)

	2017					2018				
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Official External Financing	1,017	1,491	807	378	3,693	1,344	578	345	572	2,838
Project loans	64	64	64	64	256	88	88	88	88	350
Multilateral donors	-	417	719	308	1,443	233	478	233	478	1,422
AFDB	-	-	-	-	-	-	-	-	-	-
IMF (budget support starting 2017) 1/	-	308	-	308	615	-	369	-	369	737
World Bank Group	-	-	500	-	500	233	-	233	-	466
European Union	-	109	219	-	328	-	109	-	109	219
Bilateral donors	-	-	-	-	-	-	-	-	-	-
Financial Market Access and other	952	1,011	24	6	1,994	1,024	13	24	6	1,067
Sukuk and other market financing	929	998	-	-	1,927	1,000	-	-	-	1,000
Market issuance with US Treasury guarantee	-	-	-	-	-	-	-	-	-	-
Loan Transfers to SOEs	24	13	24	6	67	24	13	24	6	67
Budget Grants	-	27	49	38	115	25	25	25	25	100
Privatization Receipts	-	-	-	-	-	-	-	-	-	-
Government External Debt Service	265	791	426	342	1,823	243	645	382	297	1,568
Amortization	139	713	309	277	1,438	106	558	248	223	1,134
Interest	126	78	117	65	386	137	87	135	74	434
Bank recapitalization and one-off costs linked to the civil service reform	-	-	-	-	-	-	-	-	-	-
FX swaps between the CBT and the commecial banks	225	225	225	225	225	225	225	225	225	225
FX swaps between the CBT and the commecial banks (in million of Tunisian dinars)	453	453	453	453	453	453	453	453	453	453
Resident deposits at the BCT, including FX swaps 2/	1,185	1,185	1,185	1,185	1,185	1,185	1,185	1,185	1,185	1,185

Sources: Tunisian authorities and IMF staff estimates.

1/ The SDR/USD exchange rate used for the conversion of IMF disbursements is 0.7391 in 2017 anmd 0.7399 in 2018.

2/ End-March 2017 reference level for resident deposits was estimated at USD 960.1 million; FX swaps at USD 225.3 million.

29. The ceilings on the **NDA of the CBT** will also be adjusted downward or upward based on the amount of CBT reserves released/mobilized because of a possible decrease/increase in the reserve requirement.

30. The floor on the primary balance of the central government, excluding grants, will be adjusted upward/downward based on the amount used to recapitalize the public banks and all amount used to finance the severance pay of the voluntary departures which may be part of the civil service reform.

K. Monitoring and Reporting Requirements

31. Performance under the program will be monitored using data supplied to the IMF by the Tunisian authorities as outlined in the table below, consistent with the program definitions above. The authorities will promptly transmit to the IMF staff these data and any data revisions previously transmitted to the IMF Resident Representative's office in Tunisia.

Information to Be Reported in the Context of the Program

Type of Data and Description	*Periodicity* *Daily (d)* *Weekly (w)* *Monthly (m)* *Quarterly (q)*	*Delay in days*	*Responsible department*
GDP: Supply and demand at current, constant, and the previous year's prices, including sectoral indices.	*q*	*45*	*INS*
Inflation: Including the underlying inflation of non-administered and administered prices.	*m*	*14*	*INS*
Fiscal Sector			
Tax and nontax revenue of the central government decomposed on the basis of main tax and nontax revenues items	*m*	*30*	MoF
Total expenditures: current and capital, transfers and subsidies.	*m*	*30*	MoF
Capital expenditure: by type of financing: domestic and external (differentiating loans and grants), and by main sectors and projects (agriculture, social, infrastructure).	*m*	*45*	MoF
Current expenditure: by type of expenditure: wages, goods and services, transfers.	*m*	*45*	MoF
Social expenditure	*q*	*45*	MoF
Domestic and foreign debt			MoF
Stock of domestic and foreign debt: of the central government and debt guaranteed by the government, with breakdown by instrument and type of currency (in dinars and foreign currency with the equivalent in domestic currency).	*q*	*30*	MoF
Stock of domestic arrears as per TMU, as well the stock of accounts payable that correspond to expenditures committed/ payment ordered more than 90 days before (and by type of expenditures),	*q*	*45*	MoF
Disbursement of foreign loans: Breakdown into project loans and budgetary loans by principal donor and identifying the most important projects to be financed in the original currency and its equivalent in Tunisian dinars converted at the current exchange rate at the time of each transaction. **Domestic borrowing from banks and nonbanks:** including bonds, Treasury bills, and other issued securities.	*m*	*30*	MoF

Debt guaranteed by the government: by instrument and type of currency (in dinars and in foreign currencies and its equivalent in national currency) **External and domestic debt service:** amortization and interest.	*m*	*60*	MoF
External payment arrears: external debt contracted and guaranteed by the government.	*q*	*30*	MoF/ CBT
Debt rescheduling: possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	*q*	*45*	MoF
Consolidated accounts of the central government at the CBT: The stock of deposits will be broken down as follows: (i) Treasury current account; detailed by sub accounts of the central government, N BIS, outstanding payments, Public administrative entities (EPA), and local governments (ii) special account of the Tunisian government in foreign currency and its equivalent in dinars; (iii) miscellaneous dinar accounts; (iv) loan accounts; (v) grant accounts; (vi) FONAPRA-FOPRODI accounts; and (vii) Foreign exchange accounts pending adjustment in dinars (available).	*m*	*30*	*CBT* MoF/TGT for sub-account
External Sector			
Imports of Petroleum Products: average import price and volume of main petroleum products.	*m*	*30*	*CBT*
Deposits: Stock of foreign currency deposits, according to the residence of the holder.	*m*	*14*	*CBT*
External debt:			
Debt service (amortization and interest) of institutional agents by type of currency (in foreign currency and its equivalent in dinars).	*q*	*30*	*CBT*
Stock of external debt of institutional agents by type of currency (in foreign currency and its equivalent in dinars).	*q*	*90*	
Overall net external position of Tunisia (in conformity with our obligations under SDDS).	*A*	*180*	
Balance of payments: Prepared by the CBT	*q*	*30*	*CBT*
Monetary and Financial Sector			
CBT accounts at the current exchange rate: detailed table including the monetary system.BT	*m*	*30*	*CBT*

Foreign exchange market operations, Interbank market, retail market and wire transfers for CBT purchases on the retail market: CBT Interventions (sales and purchases) on the foreign exchange market in million of dinars (and equivalent in US million) including total market transactions, foreign exchange sales to energy companies and all exchange rates for all such transactions, total FX demand by banks, total FX positions of banks, stock of CBT currency swap (provide details on direction of transactions (TND/FX or FX/TND), amounts of principal, spot exchange rate in swaps agreement, interest rate applied on FX counterpart), detailed information on other BCT's forward foreign exchange operations, including outright forward sales of Tunisian dinar. The terms and conditions of any new transactions (including the extension or renewal of existing terms and conditions) will also be provided. CBT foreign exchange reserves, breakdown by currency and by instrument.	*w*	*1*	*CBT*
IMF Account statements: Monthly consolidated statements of the IMF No. 1, No. 2, and Securities Account.	*m*	*30*	*CBT*
Banks' financial soundness ratios: Indicators of financial soundness and regulatory capital adequacy ratios of the banking system, including the quality of assets and the profitability of banks. The indication of the different banks is optional.	*m*	*30*	*CBT*
Direct refinancing of commercial banks by the CBT: Breakdown by bank.	*m*	*14*	*CBT*
NPLs: Stock of banking sector NPLs, and breakdown by commercial banks.	*q*	*60*	*CBT*
Balance sheets of commercial banks, including detailed income statements, in accordance with "Uniform Bank Performance Reporting" agreed with Fund staff.	*q*	*60*	*CBT*
Other information to be reported			
Information on Fiscal, Monetary, and Financial Policy: Decrees or circulars newly adopted or revised concerning changes in tax policy, tax administration, foreign exchange market regulations, and banking regulations. A copy of official notices of changes in gas and electricity rates and any other surcharge (automatic or structural), as well as the prices of petroleum products and levies/surcharges on gas and petroleum.	*d*	*3*	*CBT/MoF*
The price structure of the petroleum products and the needed data to monitor the automatic adjustment mechanism (formulas and data).	*d*	*15*	*Min. of Energy*

Statement by Mr. Jaffar Mojarrad, Execcutive Director for Tunisia, Mr. Abedlali Jbili, Senior Advisor, and Ms. Monia Saadaoui, Advisor June 12, 2017

On behalf of our Tunisian authorities, we thank Mr. Rother and his team for the constructive and valuable discussions for the first review under the four-year Extended Fund Facility (EFF). The authorities agree with staff analysis and policy recommendations. They also wish to express their appreciation for the provision of technical assistance.

Overview

Program implementation has run against headwinds stemming from weak growth in Tunisia's major European partners, security problems and terrorism, and spillovers from the political instability in the region. These, together with a more difficult political transition, have hindered the recovery of the key tourism sector, undermined investment and growth, and exacerbated macroeconomic imbalances.

The new government of national unity that took office in September 2016 has firmly moved to tackle mounting economic and social challenges within the road map and reform priorities set in "The Carthage Initiative", which has been agreed with the major political parties and the social partners. This road map, which is also consistent with the Fund-supported program under the EFF, and with Tunisia's more recent commitments under the G-20 initiative "Compact with Africa", seeks to unleash Tunisia's potential to achieve high and job-rich growth and strengthen macroeconomic and financial stability. In its few first months in office, the new government has taken steps to move the reform process forward, while effectively reaching out to social partners and the population at large to mobilize support for deeper reforms and build broader political consensus.

While most end-December 2016 quantitative targets were missed and structural benchmarks have been implemented with delay or re-phased, corrective actions have been taken, and all four prior actions for this review have been met. The authorities have also re-confirmed their commitment to implement their reform program as now recalibrated for the remainder of the EFF arrangement. They request Executive Board approval of waivers of nonobservance of end-December 2016 quantitative performance criteria, a reduction in the number of reviews, and a re-phasing of remaining purchases starting in 2018 to align them with reform progress. They also request making all funds available for budget support to meet large financing needs.

Recent Economic Developments and Outlook

Tunisia's overall economic situation in 2016 remained weak. Growth slowed down to 1.0 percent, or half the program estimate, unemployment remained high at 15½ per cent, but inflation was relatively contained at below 4 percent. In the absence of recovery of the tourism sector, and given sustained import flows, the current account deficit widened, with attendant pressure on foreign exchange and a significant depreciation of the dinar.

A modest improvement is foreseen for 2017, with growth estimated at 2.3 percent, still lower than estimated under the EFF. This is confirmed for the first quarter of 2017 with GDP growing at 2.1 percent compared with the same quarter of 2016. Although inflation picked up in March 2017 under the effect of the exchange rate depreciation, it is expected to remain moderate owing to tight monetary policy and the persistence of a negative output gap. The fiscal and current account deficits are projected to remain high.

The revised medium-term outlook envisages a gradual recovery of growth from a range of 2.3-3.5 percent in 2017-19 to slightly above 4 percent in 2020-22, supported by improvement in the external environment and acceleration of structural reform implementation.

Fiscal Policy

Fiscal consolidation remains critical to maintain macroeconomic stability and enhance policy credibility. The authorities' strategy combines short-term measures to contain the recent fiscal deterioration with more permanent steps and fiscal structural reforms that would reduce the public debt as a ratio to GDP to a sustainable level. In 2016, spending pressure related to an early wage agreement concluded between the former government and labor unions, combined with a fall in revenues due to lower growth, contributed to a significant deterioration of the fiscal deficit with the end-December primary fiscal deficit criterion being missed. To avoid further fiscal deterioration and restore confidence, the 2017 Budget Law introduced a series of exceptional measures aimed at maintaining the overall fiscal deficit (including grants) at 5.9 percent of GDP. These include one-off levy on corporate profits (with expected yield of 0.9 percent of GDP), strengthened tax collection, and measures to contain the wage bill and manage pressure from social security funds (MEFP ¶17).

For 2018, the authorities are determined to pursue a growth-friendly fiscal consolidation while protecting social spending. In this regard, a package of tax and expenditure measures has been submitted by the Head of Government to the signatories of the "Pact of Carthage". The package aims to replace the 2017 one-off levy with more permanent measures, shift the tax burden from direct to indirect taxes, strengthen tax collection, and reduce exemptions (Table 1 of the MEFP). These measures will be incorporated in the draft 2018 Budget Law.

The authorities attach high importance to structural fiscal reforms that will bring about lasting improvement in the fiscal situation and the delivery of public services. Efforts to modernize tax administration, which started with the National Conference on Taxation in 2014, are being stepped up with the Large Taxpayers Unit expected to be operational in January 2018, and plans are at an advanced stage to enhance monitoring and verification.

The authorities are mindful that the large increase in the wage bill in recent years has reduced space for public investment and social spending, but this development must be seen in the context of Tunisia's political transition and social discontent at that time. They have adopted a comprehensive reform strategy for civil service reform involving tight control of wages increases, a restrictive recruitment policy, and a voluntary separation program. Implementation of this complex retirement program will be carried out with World Bank assistance and will be preceded by extensive consultations with the social partners. As detailed in MEFP ¶20, the planned civil service reform goes beyond reducing the wage bill and seeks to enhance the quality of public service and strengthen efficiency.

Equally important is the comprehensive reform of public and private pensions, which is under active preparation in cooperation with the World Bank, ILO, and the United Nations Economic and Social Commission for Western Africa (ESCWA). The reform is to be adopted by end-September 2017 (Structural Benchmark) with implementation scheduled for January 2018.

Monetary and Exchange Rate Policy

The Central Bank of Tunisia (CBT) has responded to inflationary pressure by increasing its key rate twice so far this year, while meeting the banks' increased liquidity needs through refinancing operations, and standing ready to tighten further if needed to achieve inflation and reserves objectives. CBT interventions in the foreign exchange market have helped satisfy unmet foreign exchange demand and smooth exchange rate fluctuations, including when an exceptionally high trade deficit in Q1 2017 caused the dinar to depreciate by 18 percent in nominal effective terms. The CBT's intervention helped ensure orderly financing of energy and food imports and restored market confidence by avoiding panic in the foreign exchange market.

The authorities agree that exchange rate flexibility and monetary policy tightening would help contain the large current account deficit and rebuild reserves. For this purpose, the CBT has started to apply the auction mechanism as a transparent and more competitive instrument of intervention in the foreign exchange market. It also seeks to improve the transmission of monetary policy, including through implementation of the lender of last resort mechanism adopted in December 2016, and effective use of the Manuel of Monetary Procedures adopted in March 2017 with assistance from the IMF and the Banque de France.

Financial Sector

Progress has been made in addressing the vulnerabilities of the financial sector by upgrading the legislative and regulatory framework and enhancing supervision. Following the recapitalization of three state-owned banks, their restructuring plans and performance contracts have been adopted, including setting annual financial and operational targets, improving the treatment of non-performing loans (NPLs) and enhancing risk supervision. In addition, the Banking Act and its first implementing decrees have been adopted. Banking supervision was strengthened with the adoption of several reforms related to operational risk, exposure to related parties, and the adoption of the risk-based supervision manual. The authorities remain committed to further reforms to strengthen public banks, improve inter-agency coordination, and foster financial inclusion by strengthening microfinance and digital finance.

Structural Reforms

As detailed in the MEFP, Tunisia's structural reform agenda covers many sectors and activities, including civil service, public and private pensions, the banking sector, competition, public and private partnerships, the investment code, governance and fight against corruption, and more generally, the business climate. Carrying out these reforms simultaneously within relatively optimistic timetables has at times been difficult to achieve. Nonetheless, despite delays, the reforms continue to move forward as evidenced by the number of draft laws that are currently with parliament, those that are in an advanced stage of preparation, and those for which technical assistance is being sought. The authorities appreciate the flexibility shown by staff in adapting the timetable of structural benchmarks to changing circumstances.

Sustained efforts are underway to streamline administrative procedures, including the establishment of one-stop shop scheduled for December 2017. The new investment law adopted by the parliament in September 2016 provides more clarity to the investment framework, including equal treatment of domestic and foreign investors and the separation between fiscal and financial incentives in line with international best practices. The reform momentum in these areas will be strengthened through the follow up on the Tunisia 2020 Investor Conference as well as the G-20 Compact with Africa.

Social Policies

Enhancing the effectiveness of social policies remains a key priority of the government program, including transitioning from a system of universal subsidies to one based on targeted assistance to vulnerable households. In this regard, work is underway to complete the data base on vulnerable households (structural benchmark for end-December 2017), and reform the general equalization fund (Caisse générale de compensation). Meanwhile, lifeline electricity tariffs for poor households have remained unchanged. In parallel with the reform of energy subsidies, the authorities intend to apply the automatic adjustment mechanism for the three main fuel products starting in July 2017.

Conclusion

The progress achieved by Tunisia in implementing an ambitious reform agenda against adverse conditions attests to the economy's resilience and the authorities' commitment to see the economy through these difficult times. The authorities are confident that the recalibrated agenda under the EFF will facilitate completion of the many reforms already launched and those that are under active preparation. They thank Executive Directors and management for their continued support and look forward to continued close cooperation with the Fund and increased support from the international community.