

**Tunisia: 2010 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Tunisia**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2010 Article IV consultation with Tunisia, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on June 15, 2010, with the officials of Tunisia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 4, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its August 27, 2010 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Tunisia.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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## TUNISIA

### Staff Report for the 2010 Article IV Consultation

Prepared by the Staff Representatives for the 2010 Consultation with Tunisia

Approved by Patricia Alonso-Gamo and Dominique Desruelle

August 4, 2010

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**Tunisia weathered the global crisis well.** Tunisia entered the crisis with strong fundamentals due in large part to past prudent policies. The authorities' timely and adequate policy response contributed to mitigate the impact of lower external demand in 2009. Since mid-2009, Tunisia's growth has accelerated, but this was accompanied by a significant widening of the current account deficit and a decline in reserves, which remain relatively high. Tunisia remains highly dependent on European partners, and their recovery is projected to be modest and subject to significant downside risks. Tunisia will need more dynamic sources of growth to make a significant dent in unemployment, which remains high, especially among the youth.

**Focus of the consultation.** Discussions centered on policies needed to accompany the recovery in an uncertain international environment, and to support the emergence of new sources of growth in the medium term.

**Key policy issues.** Staff viewed the fiscal stance in 2010 as striking the right balance between supporting growth and preserving the significant gains achieved in bringing public debt down. Tunisia still has some fiscal space available to cushion a deterioration in external demand in the event that downside risks in its main partners materialize. Monetary and exchange rate policies should be geared toward avoiding the build-up of inflationary pressures and ensuring that the recent weakening of the external balance does not persist. Medium-term prospects will hinge on the authorities' reform agenda to further strengthen and develop the financial sector, continue liberalizing external transactions, enhance the business climate and competitiveness, and support economic diversification. This agenda should be underpinned by a gradual fiscal consolidation to maintain investors' confidence and the scope for countercyclical fiscal policy, and by modernizing the monetary policy operational framework toward an inflation targeting regime.

**Exchange rate regime.** The exchange rate regime is classified as stabilized management. Tunisia accepted the obligations of Article VIII Sections 2(a), 3 and 4 and maintains an exchange system that is essentially free of restrictions on the making of payments and transfers for current international transactions (informational annex).

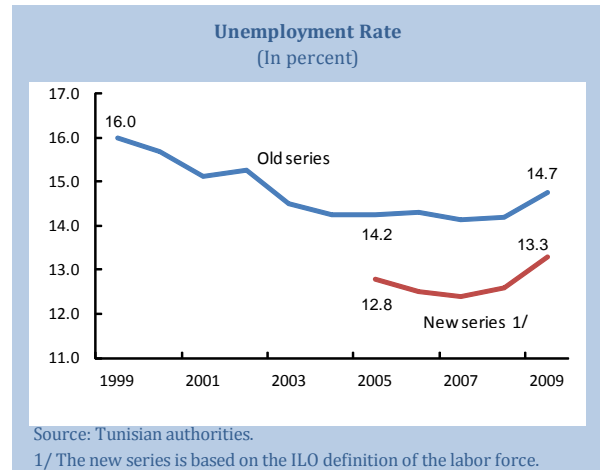
**Mission.** A staff team comprising Mr. Toujas-Bernaté (head), Ms. Bhattacharya, and Messrs. Florea, Gijon and De Bock (all MCD) conducted the discussions in Tunis during June 2-15, 2010. Mr. Rouai (OED) also participated in the discussions. Staff and the authorities held additional discussions on July 14, 2010.

Contents	Pages
I. Background: Tunisia’s Resilience to the Crisis .....	3
II. Short-Term Outlook and Policies: Supporting the Recovery in an Uncertain Global Environment .....	7
III. Medium-Term Challenges and Reforms: Developing new Sources of Growth as Traditional Markets Would be Less Buoyant.....	11
IV. Staff Appraisal .....	17
Figure	
Recent Economic and Financial Indicators.....	19
Tables	
1. Selected Economic and Financial Indicators, 2008–15 .....	20
2. Balance of Payments, 2008–15.....	21
3. Central Government Financial Operations, 2008–15 .....	22
4. Monetary Survey (Financial System), 2006–10 .....	24
5. Illustrative Medium-Term Growth Scenario, 2008–15 .....	25
Appendices.....	26
Draft Public Information Notice .....	1

## I. BACKGROUND: TUNISIA'S RESILIENCE TO THE CRISIS

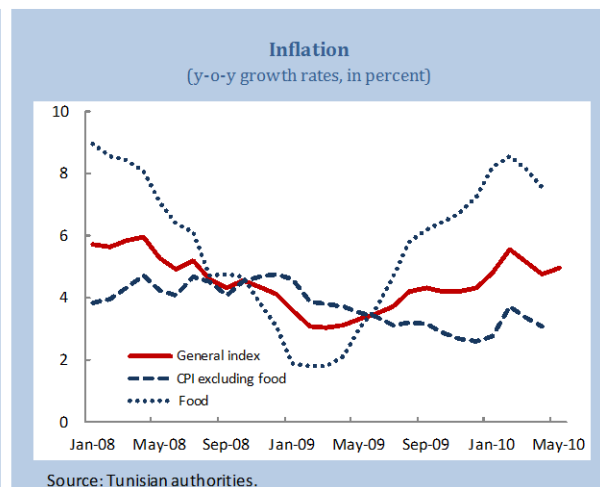
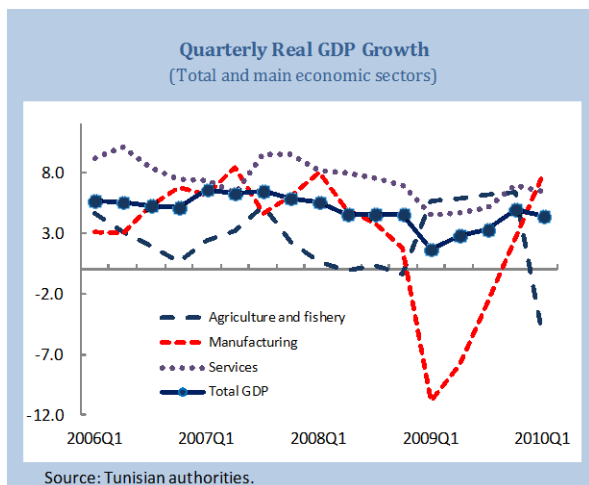
**1. Over the last two decades, Tunisia has carried out a wide ranging reform program based on improving the competitiveness of the economy, enhancing the business environment and increasing trade openness.**

Tunisia signed an Association Agreement with the European Union (EU) in 1995, which led to buoyant export growth and made the EU Tunisia's largest trading partner. This process has been underpinned by prudent macroeconomic management which, combined with the structural reform agenda, has reduced fiscal and external vulnerabilities and created room to respond to shocks. Real GDP growth reached almost 5 percent during the last decade on average, and unemployment declined by about 2 percent, but began to rise again in the aftermath of the global crisis. The unemployment rate remains relatively high, in particular among educated youth.



**2. Tunisia weathered the international crisis relatively well.**

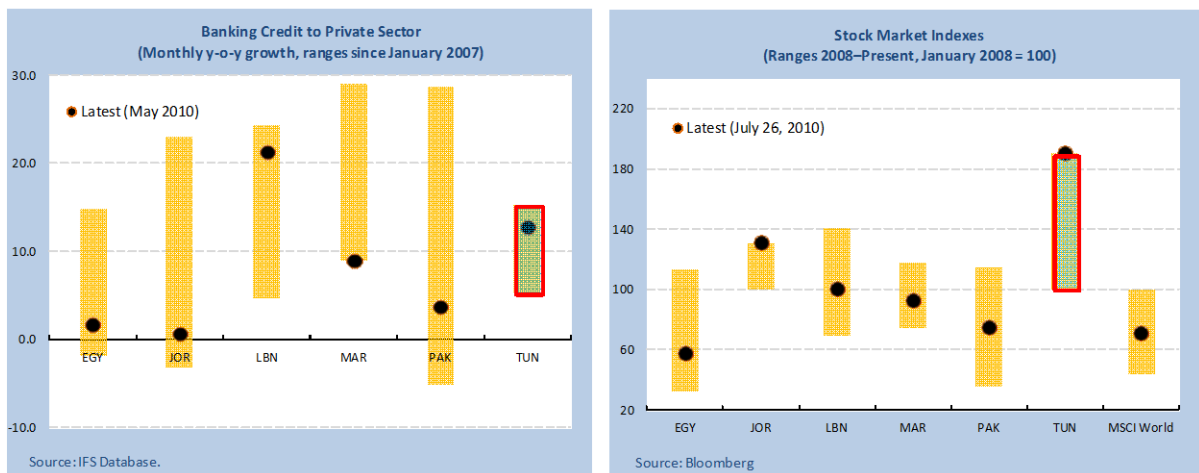
**Real GDP growth slowed down moderately in 2009 to 3.1 percent.** After declining to 1.8 percent (y-o-y) in the first quarter of 2009, growth has accelerated and reached 4.5 percent (y-o-y) in the first quarter of 2010, following a strong recovery in demand for manufacturing exports (mostly mechanical and electric industries, and textiles). This increase was partially offset by a decline in production in the energy and agriculture sectors. Domestic demand was sustained by buoyant consumption fueled by rising per capita income.



**Inflation edged up slightly but remains moderate.** Overall CPI inflation (period average) was 3.7 percent in 2009 and rose to 4.5 percent in May 2010 (5.0 percent y-o-y), due to rising food

prices. Nonfood CPI inflation hovered around 3 percent, reflecting an appropriate monetary policy stance, with moderate increases in other sectors (housing, transport and services).

**The financial sector's performance remained strong despite the international financial crisis.** Banks do not rely on external financing and have benefited from a healthy growth in deposits (13 percent in 2009). Moreover, they had little exposure to the export sectors most affected by the crisis which are primarily offshore financed. The financial soundness indicators continued to improve. In this context, credit growth has remained solid and stable, in contrast to other countries in the region. The Tunis stock exchange index also experienced exceptional growth, reflecting strong earnings of listed companies—most notably banks—as well as abundant liquidity in an economy with relatively limited alternatives for financial investment. Despite recent increases, market capitalization of 21 percent of GDP at end-2009 remains small relative to other stock exchanges in the region and the impact of a potential correction in stock prices would likely be limited.

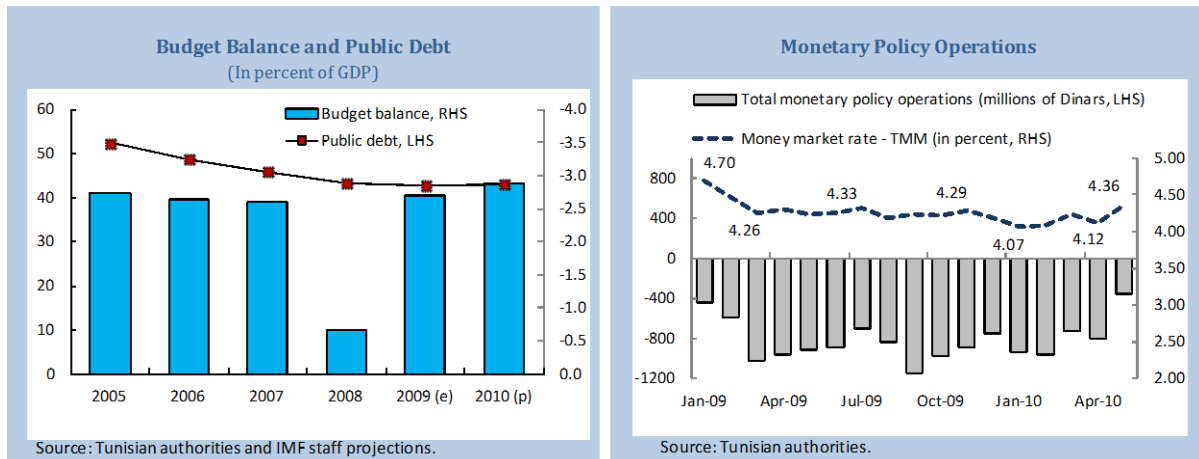


### 3. Tunisia's proactive policy response limited the impact of the crisis.

**The government implemented a fiscal stimulus in response to the crisis.** The stimulus entailed accelerating the implementation of public investment projects and providing direct support to exporting firms affected by the crisis. As a result, while current transfers and subsidies declined, total expenditure and net lending rose by 1 percent of GDP in 2009.<sup>1</sup> At the same time, receipts from direct and import taxes, as well as nontax revenues declined, contributing to a decline in total revenues of 1 percent of GDP. Consequently, the overall fiscal deficit (excluding grants and privatization receipts) rose by 2.0 percentage points of GDP to 3.0 percent of GDP, and was financed almost entirely from domestic sources (external budgetary grants remained stable at 0.3 percent of GDP). Despite the widening fiscal deficit, the public debt ratio continued to fall in 2009 from 43.3 percent of GDP in 2008 to 42.8 percent of GDP in 2009.

<sup>1</sup> Ratios to GDP are based on new national accounts series, according to which nominal GDP is about 10 percent higher than previous calculations (Appendix 5).

**The Central Bank of Tunisia (Banque Centrale de la Tunisie, BCT) kept interest rates lower than pre-crisis levels while sterilizing the abundant liquidity.** The BCT lowered the required reserves ratio in end-2008 and reduced its key policy rate by 75 basis points in February 2009. Since then, it has maintained its key policy rate constant and increased its money-market operations to absorb the excess liquidity in the banking system. As liquidity was still abundant and credit growth was edging up in early 2010, the BCT increased the reserve requirement ratio twice—from 7.5 percent to 10 percent on March 1<sup>st</sup>, 2010, then to 12.5 percent on May 1<sup>st</sup>, 2010. These actions, combined with a decline in foreign exchange reserves, have significantly reduced excess liquidity in the banking system.

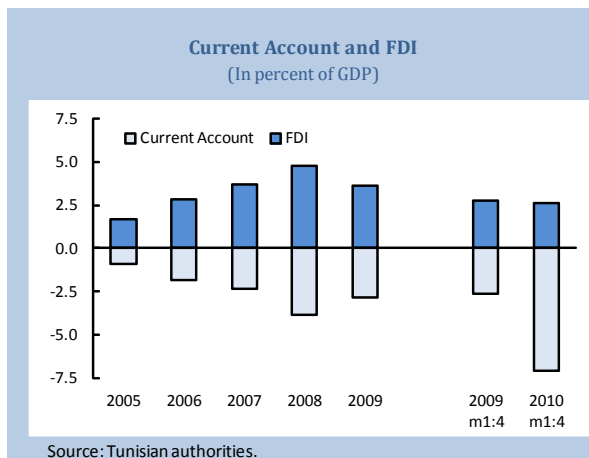
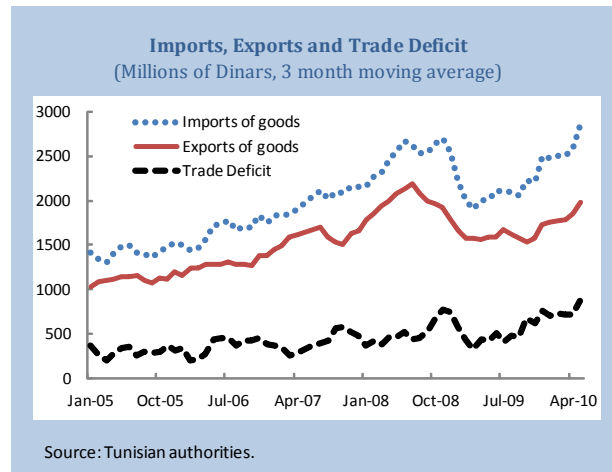


### Past Consultations

In recent consultations, the authorities and the staff have agreed on the broad policy priorities. In line with staff's advice during the 2009 Article IV Consultation, which was concluded on a lapse of time basis, the authorities loosened fiscal policy in 2009, mostly through accelerating the implementation of public investment projects while containing current spending, including subsidies. The authorities remain committed to a medium-term fiscal policy consistent with a steady decline in the public debt-to-GDP ratio. The BCT also reacted cautiously to the global financial crisis in easing monetary policy in the first half of 2009, and since then has been proactive in absorbing excess liquidity in the banking system to contain inflationary pressures. Continued efforts to strengthen the banking sector led to a gradual improvement in financial sector indicators, and some progress, albeit still slow, was achieved to modernize the monetary policy framework and instruments.

**4. The current account deficit contracted in 2009 but widened significantly in early 2010 due to a worsening of the trade balance, leading to a decline in external reserves.**

The fall in the prices of raw materials and lower imports of intermediate goods, combined with solid exports of services and inflows of remittances, brought the current account deficit down to 2.9 percent of GDP in 2009. During the first four months of 2010, exports improved significantly owing to the recovery of external demand, but the trade balance worsened as imports increased even more. A pick-up in re-export activity and higher investment as well as one-off large imports of transport equipment led to a sharp rise in intermediate and capital goods imports. As tourism receipts and remittances stagnated, the current account deficit deteriorated significantly, financed in part by a 5 percent increase in FDI in dinar terms. Gross official reserves have been declining steadily since the end of 2009 but remained relatively high at around \$ 8.8 billion at end-June 2010 (5½ months of projected imports).



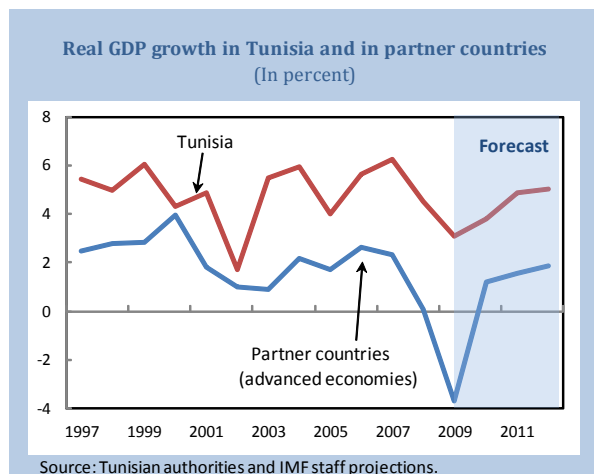
## II. SHORT-TERM OUTLOOK AND POLICIES: SUPPORTING THE RECOVERY IN AN UNCERTAIN GLOBAL ENVIRONMENT

**5. While the global recovery has been stronger than expected so far, growth in Tunisia's main partners is expected to be modest and subject to significant downside risks.**

The EU is by far Tunisia's largest partner, accounting for more than three quarters of exports of goods, tourism receipts, workers' remittances and FDI. Growth in Tunisia's partners is projected at 1.2 percent in 2010 and 1.5 percent in 2011, compared to about 4½ percent projected for the global economy.

Moreover, the downside risks to the prospects for a gradual recovery in Europe have risen significantly. These risks entail a possible escalation of financial stress and contagion in Europe, prompted by rising concerns over sovereign risk, and a more

severe impact than currently expected of the planned fiscal consolidation on a still weak domestic demand. On the positive side, the recent depreciation of the euro could boost global exports from the euro area, with feedback effects on Tunisian export sectors such as electrical and mechanical industries.



**6. Tunisia's growth could reach 3.8 percent in 2010 if global growth recovers as expected.**

Tunisia's financial sector was not affected by the recent financial stress in the euro area (Appendix 1). The gradual rebound in overall real GDP observed in Tunisia since mid-2009 is expected to continue, supported by a recovery in industrial activity and investment. Following a strong growth in imports of capital and intermediate goods during the first two quarters of 2010, the resumption of (re-)exports is expected to become stronger in the second part of the year. Furthermore, unlike other countries in the region, Tunisia's revenues from tourism and remittances from Tunisians abroad have remained broadly stable. On the negative side, performance of the agriculture sector will likely be weaker in 2010. Furthermore, in light of developments in the first part of this year, the current account deficit is expected to widen substantially in 2010 (to 4½ percent of GDP), while many emerging economies are expected to reduce their current account deficits in 2010 and 2011.

**7. Facing a modest and uncertain recovery in its main partners, Tunisia's policies should aim at continuing to support growth while standing ready to adapt to changes in the international environment.**

Having successfully mitigated the impact of the global crisis on growth and unemployment in 2009, macroeconomic policies should continue to be geared, in the short term, toward

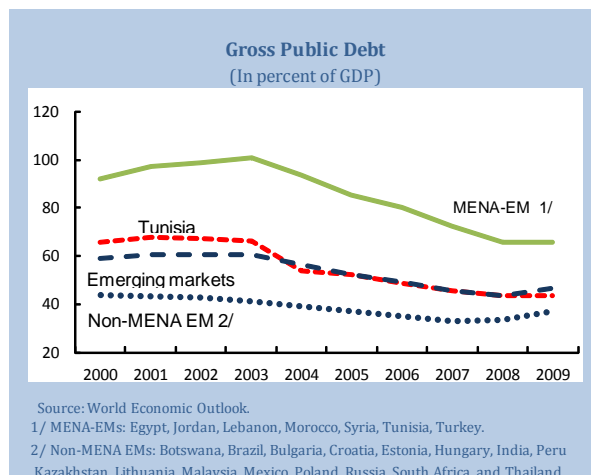


supporting the gradual economic recovery. Thanks to prudent macroeconomic management in the past, Tunisia still has some leeway to deal with potential external risks, in particular with respect to fiscal policy. At the same time, the authorities should remain vigilant about risks of potential inflationary pressures and growing external imbalances.

## Fiscal policy

### 8. Prudent fiscal policy in 2010 can be geared towards supporting growth and mitigating the impact of the weak global environment.

The 2010 Budget Law maintains a supportive fiscal policy to ensure that the current economic recovery is not undermined by an early withdrawal of the fiscal stimulus measures introduced in 2009. Staff projects the deficit to remain at 3.0 percent of GDP in 2010. Based on conservative revenue projections, the expected decline in revenue performance would be offset by lower net lending. The enhanced public investment effort launched in 2009 will be maintained to further improve infrastructure. Current expenditure would remain stable as a ratio to GDP. In particular, subsidies will stay at their lower 2009 level, despite an increase in international commodity prices. This reflects continued implementation of the domestic petroleum products prices adjustment mechanism introduced in early 2009. As in 2009, the central government deficit is expected to be entirely financed through domestic sources, while new loans from official creditors would cover the repayment of external debt. General government debt is projected to increase slightly by about ½ percentage points to 43.1 percent of GDP, mostly on account of the valuation effect on external debt of a projected appreciation of the dollar and the yen against the dinar.



### 9. Some fiscal space remains available to address the risks associated with the fragile recovery.

The public debt ratio has fallen significantly over the past decade and is now slightly below the average for comparable emerging markets. In the event that downside risks materialize and cause a deterioration in economic activity and budget revenue, the staff saw scope for a small additional widening of the fiscal deficit of up to ½ percent of GDP in 2010. This could allow accommodating additional job creating programs and higher social spending to cushion the impact of slower growth on the most vulnerable groups in the population. Moreover, based on the revenue performance in the first four months of 2010, and other things being equal, revenue for the whole year could be stronger than currently projected, which could provide further room for maneuver if needed.

### **Authorities' views**

**10. Fiscal prudence remains an overarching priority for the authorities, who also see the need for maintaining a supportive fiscal policy in 2010 in the current international environment.** Efforts in the last decade to bring down the public debt ratio significantly should not be jeopardized by a too lax fiscal policy. The authorities are committed to firmly control current expenditure, including subsidies, to make as much room as possible for public investment, which they see as most effective for supporting current and future growth. They agreed that the weak prospects for Tunisia's main partners do not warrant a premature withdrawal of the fiscal stimulus. Nevertheless, with a gradual recovery under way, several support measures adopted in 2009 for sectors most affected by the crisis were suspended in 2010 for lack of use.

**11. The authorities remain vigilant and stand ready to make the necessary fiscal policy adjustments should the global environment worsen.** They emphasized their quick response to mitigate the impact of the global crisis in end-2008 and 2009. They underlined that a Ministerial Monitoring Committee was established in May 2010 to monitor international developments closely and evaluate possible changes in macroeconomic policies in response to adverse shocks. With this in mind, the 2010 budget has built in additional flexibility with a total amount of unallocated expenditure equivalent to 1½ percent of GDP that could be used if needed in the second half of 2010 (only half of that amount is projected to be used).

### **Monetary and exchange rate policies**

**12. The BCT will need to pursue its efforts to avoid the build-up of inflationary pressures and ensure that the recent weakening in the external balance does not persist.**

Following the recent increases in the reserve requirement ratios, BCT's market interventions for absorbing banks' liquidity were substantially reduced. Nevertheless, in the context of low real interest rates, accelerating credit growth, and exceptional increases in the stock market index, the BCT should maintain a close watch to ward off the risks of emergence of inflationary pressures, real estate and stock market bubbles, or excessive credit growth. While no further policy change seems warranted now, the BCT should stand ready to use all monetary policy instruments at its disposal, including interest rates, in case of a significant rise in core inflation, further acceleration in credit growth, or a sustained further fall in reserves. A further deepening of the money market would help enhance monetary policy transmission. Moreover, the BCT will need to continue coordinating closely with the Treasury, which is expected to increase bond issuances in the second part of the year.

**13. The exchange rate policy should continue to be guided by the medium-term objective of a freely-floating exchange rate.**

BCT's interventions have been relatively small in 2009 and early 2010, and occurred in both directions, with the primary objective of providing adequate liquidity in the foreign exchange market. Staff noted the importance of maintaining neutral and minimal interventions and closely monitoring developments in official reserves. The exchange rate policy resulted in a

relatively stable real effective exchange rate, which remains broadly in line with fundamentals (Appendix 2).

#### **Authorities' views**

**14. The authorities remain vigilant, seeking to contain any build up of inflationary pressure, and continue to improve the conduct of monetary policy operations.** The authorities highlighted the balance they had to strike between not undermining domestic demand and absorbing the abundant liquidity. This led to the recent policy mix of keeping interest rates constant while increasing the reserves requirements ratio. At the same time, liquidity management as well as tools for money market interventions improved. In particular, the introduction in early 2009 of new facilities for deposits and borrowing by banks allowed for increased flexibility of the money market rate. The authorities aim at further deepening the money market to enhance monetary policy transmission and the effectiveness of changes in the policy interest rate.

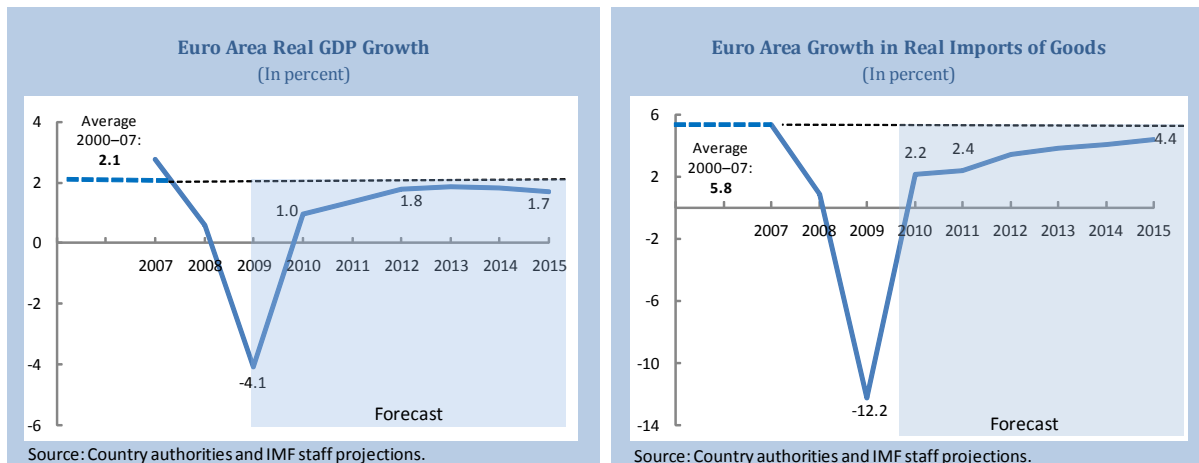
**15. The authorities will maintain the exchange rate policy stance to smooth fluctuations of and provide adequate liquidity to the foreign exchange market, consistent with a real effective exchange rate in line with its fundamentals.** The conduct of exchange rate policy was recently complicated by the high volatility between the main international currencies. The authorities see the recent decline in reserves, which they are monitoring very closely, as partly reflecting seasonal factors and a usual trade pattern during recoveries, which should stabilize in the second part of the year so that reserves could remain at a comfortable level. They remain committed to preserve the competitiveness of the Tunisian economy and maintain external sustainability.

### III. MEDIUM-TERM CHALLENGES AND REFORMS: DEVELOPING NEW SOURCES OF GROWTH AS TRADITIONAL MARKETS WOULD BE LESS BUOYANT

#### Medium-term outlook

**16. Medium-term growth in Tunisia's traditional partners is expected to be moderate (1 ½ to 2 percent) and to be a less robust source of external demand for Tunisia.**

According to the latest World Economic Outlook (WEO), import demand from the euro area in the coming years could be half of its pre-crisis level. In this challenging environment, Tunisia's growth could increase gradually and reach an average of about 5 percent over 2010–14, provided that policies and reforms planned by the authorities aimed at enhancing Tunisia's competitiveness, developing new markets and supporting new sources of growth in sectors with high added value, could bear fruit quickly.



**17. The highly uncertain international environment poses risks to these projections.**

Downside risks to global growth have risen significantly. Beyond the near-term risk of escalating financial stress and contagion in Europe, growth prospects in Tunisia's main partners could suffer if fiscal consolidation needed to address the concerns about sovereign risks turns out to be more severe than currently projected. In turn, a weaker domestic demand in European partners could reduce the demand for Tunisian exports. Moreover, lower incomes and a rise in unemployment among European partners could lead to decreased tourism revenues and remittances from Tunisians abroad.

#### Authorities' views

**18. The authorities are well aware of the challenges posed by the post-crisis international environment, and will implement the needed policies to achieve their ambitious growth objectives.** Given the Tunisian economy's size and its ability to exploit buoyant niches, the authorities are convinced that dynamic sources of growth can be tapped despite a weaker global environment in the main partners. Building on past successes, new

*reforms are being launched, with the support of international development institutions, to facilitate innovation, development of a knowledge-based economy, and a better match between supply of and demand for skilled labor. Specific action plans are targeting the development of services sectors, including in the financial area. All these reforms will be supported by sustained public investment to continue to upgrade infrastructures. On this basis, the authorities foresee Tunisia's growth to increase gradually over the medium term up to 6½ percent by 2015, which will help reduce unemployment.*

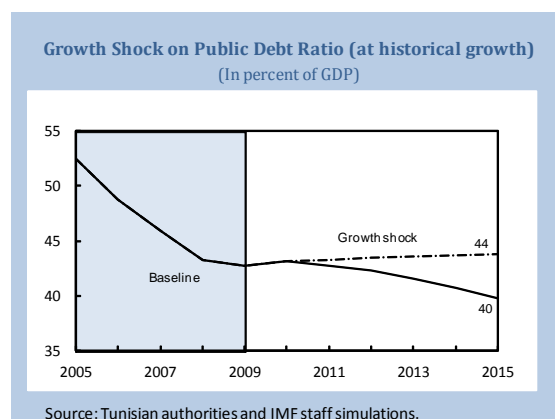
## Medium-term fiscal consolidation and fiscal reforms

### 19. As the economy picks up, the need for fiscal stimulus will wane, and fiscal adjustment should resume with the 2011 budget.

Although Tunisia's public debt-to-GDP ratio has been declining rapidly in recent years, it still remains higher than in other emerging market economies outside the MENA region with similar sovereign credit ratings. Continuing with fiscal consolidation to reduce public debt from 43 percent of GDP— its current level— to below 40 percent by 2015 will be important for ensuring sufficient fiscal space to mitigate the impact of possible future shocks to external demand. To that end, the authorities should aim at lowering the central government deficit (excluding grants and privatization proceeds) gradually to close to 2.0 percent of GDP by 2015. This would need to be complemented with early repayment of external debt using remaining privatization receipts, as done in the last few years. In the case where growth would not reach the projected levels over the medium term, a more ambitious fiscal consolidation path would be required to achieve the same public debt reduction objective.

### 20. An important component of fiscal consolidation over the medium term should be the streamlining of food and fuel subsidies.

Following the implementation of a petroleum product prices adjustment mechanism in early 2009, budget expenditure related to subsidized prices for a few staple food products (wheat and oil), petroleum products, and transport became less subject to shocks to international commodity prices. Nevertheless, further reforms could be explored to improve the targeting of subsidies and transfers towards the most vulnerable groups of the population.



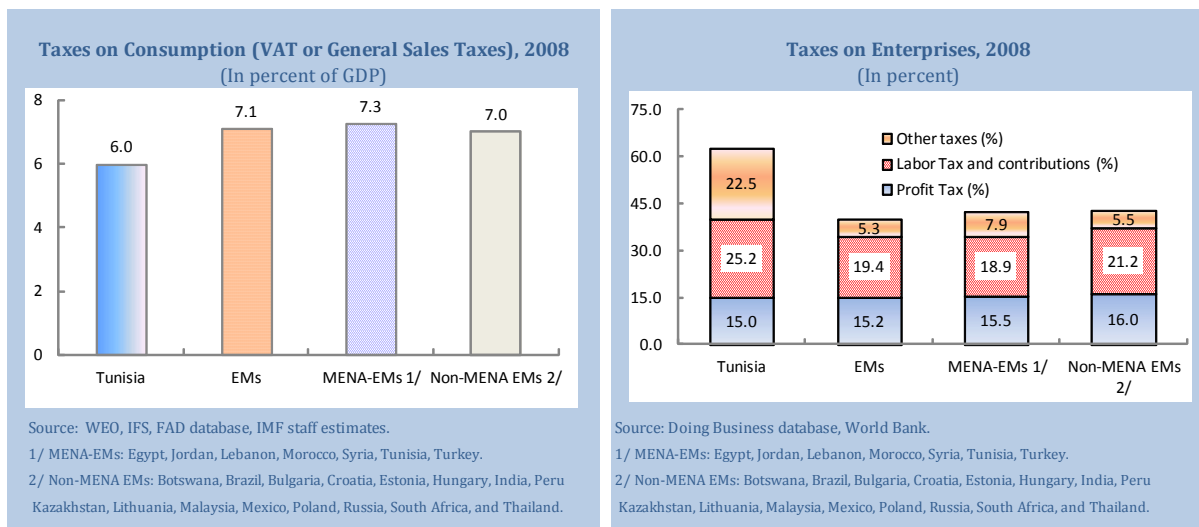
### 21. Key to containing expenditure pressures over the medium term is a reform of the social security system.

In the absence of reforms, demographic developments would result in a deterioration of the social security's financial position. Adjustments in key parameters such as the retirement age and contribution rates will be needed to ensure that the pension system is financially

sustainable over the next twenty years and can meet its financial obligations without general tax increases or transfers from the central government budget.

## 22. The tax regime could become more business-friendly.

International comparisons with other emerging market economies show that the tax burden on businesses is relatively high in Tunisia, and that there is scope to increase the yield from taxes on consumption. Thus, a reduction in profit tax rates offset by an increase in the standard VAT rate and an expansion of the tax base through the elimination of exemptions could benefit growth. Staff welcomed the authorities plan to continue with reform of customs duties to bring them more in line with international standards, by further reducing the levels and number of rates.



## 23. Fiscal consolidation efforts will be supported by various structural reform measures to strengthen public finance management.

These measures include adopting program budgeting in stages, and implementing international accounting standards for the presentation of the budget, the fiscal accounts and the medium-term expenditure framework. The authorities also intend to set up a “Caisse des Dépôts” to better leverage savings deposited with the Treasury for supporting public investment, and envisage setting up a specialized agency in the Treasury to manage public debt and minimize the cost of public borrowing.

### Authorities' views

**24. The authorities are resolutely committed to reverting to medium-term fiscal consolidation as growth firms up.** To reduce the overall deficit by about 0.2 percent of GDP per year from 2011 onwards, they intend to impose a nominal cap on total subsidies, ensure a wage bill growth lower than nominal GDP, and lower the public debt interest burden via active debt management. They have started preparing a pension reform, to buttress the financial sustainability of the pension system, and plan to present a new pension law to Parliament around

end-2010. These reforms will allow the public debt-to-GDP ratio to decline below 40 percent by 2015.

**25. Fiscal reforms will constitute an important component of the authorities' growth strategy.** They are preparing an overall tax reform, which should be ready in the coming months, to make the tax structure more businesses-friendly. The envisaged reforms to strengthen public financial management will improve the efficiency of public spending, while protecting the public investment effort.

### **Enhancing the monetary policy framework in the context of capital account liberalization**

**26. The authorities plan to achieve the convertibility of the dinar and capital account liberalization by 2014.**

These are important reforms which, while increasing potential risks of financial spillovers from abroad, would enhance Tunisia's growth potential. Staff supported the gradual approach envisaged by the authorities. First, key prior conditions will need to be met, including a strengthening of the banking system and further deepening of the foreign exchange market. In a second stage, restrictions on capital account transactions could be lifted, while maintaining a number of safeguards to avoid potentially destabilizing capital movements. It will be necessary to move forward on several fronts very soon in order to facilitate the emergence of market instruments to allow banks and companies to adapt to the new environment.

**27. In this context, modernization of the monetary policy framework should proceed toward the medium-term objective of eventually adopting an inflation-targeting regime.**

The BCT's efforts are currently focused on deepening the understanding of monetary policy transmission mechanisms under an inflation-targeting regime, as well as building the required information systems and the necessary analytical capacity about other operational aspects. In this regard, several twinning projects with European central banks are under way. Staff noted that this could be complemented by improving BCT's communication tools, such as publishing periodic monetary policy and financial system stability reports, to align market's expectations.

### **Authorities' views**

**28. The authorities' commitment to liberalize the capital account, achieve the convertibility of the dinar, and modernize the monetary policy framework has been firmly anchored.** Preparatory work has been accelerated to adapt policy tools and further deepen the money and foreign exchange markets. The BCT will continue to build the needed capacity with the assistance of other institutions, including possibly the Fund.

### **Further strengthening the financial system**

**29. Financial sector indicators continued to improve in 2009.**

In 2009, the NPL ratio decreased further to 13.2 percent and loans' provisioning has been brought to an average of 58 percent. The improvement in the NPL ratio reflects tighter risk

assessment by both regulators and banks, as well as more effective actions on the NPL portfolio, in the context of sustained credit growth. Large differences in situations from one bank to another persist, though. Despite the remarkable progress achieved since 2003, with an 11 percentage point decline in the NPL ratio, sustained efforts to further reduce NPLs will be needed, as they still remain relatively high. The authorities should also continue to monitor closely the credit quality for each bank and by sector in order to ensure that the robust credit growth does not generate new NPLs in the near future.

#### Banking system soundness indicators

	2003	2004	2005	2006	2007	2008	2009
Capital adequacy ratio	9.3	11.6	12.4	11.8	11.6	11.7	12.4
Private banks	8.4	12.4	13.5	12.1	9.7	11.0	11.6
Public banks	10.8	10.1	10.0	9.3	9.9	9.6	10.9
Former development banks	54.3	55.3	50.3	46.0	38.5	36.2	31.6
NPLs (in percent of total loans) 1/	24.2	23.6	20.9	19.3	17.6	15.5	13.2
Private banks	21.6	20.4	20.0	19.0	18.1	15.3	12.5
Public banks	26.7	27.4	22.1	19.7	17.3	15.9	14.1
Former development banks	29.6	21.5	21.0	19.6	16.0	15.0	12.7
Provisions (in percent of NPLs)	44.1	45.1	46.8	49.0	53.2	56.8	58.3
Private banks	39.9	43.5	45.9	48.4	52.0	55.0	59.2
Public banks	46.2	47.6	49.1	50.2	55.0	58.1	57.1
Former development banks	62.3	23.0	28.5	42.9	48.1	63.1	60.2
Return on assets	0.5	0.5	0.6	0.7	0.9	1.0	1.0
Return on equity	4.6	4.8	5.9	7.0	10.1	11.2	11.7

Source: BCT and Fund staff estimates.

1/ International comparisons of NPL ratios should be interpreted with caution since methods may vary from one country to another. In the case of Tunisia, international standards for classification of NPLs are strictly observed. The ratio is calculated in percent of gross assets (including some off balance sheet items).

### **30. Further strengthening the financial system is a key objective of the presidential program over 2010-14.**

The program is articulated around four major components: consolidation of the fundamentals, enhancing banks' role in the economy, restructuring the public banking system, and promoting the presence of Tunisian banks abroad (Appendix 3). This program includes in particular an increase in the minimum capital requirements for banks to 100 million dinars and the reduction of the NPLs ratio below 7 percent by 2014. The authorities have also decided to implement the Basel II framework, beginning with the standardized approach, as well as creating a deposits insurance scheme financed by the banks. Staff considered that more systematic stress-testing and a forward looking approach to risk assessment would be highly beneficial.



### *Authorities' views*

**31. Modernizing and strengthening the financial sector is a key pillar of the authorities' strategy to achieve higher growth.** Preparation for implementation of the presidential program in this area is under way. Already, redefined banking supervision and financial stability departments in the BCT will ensure more efficient surveillance of credit institutions. In particular, individualized approaches are being implemented for achieving the NPLs reduction objective by 2014.

### **Continued opening of the economy and diversification efforts**

**32. Despite the economic crisis, Tunisia still considers trade liberalization and openness the key policy drivers to achieve sustained high growth.**

The objective of the authorities is to expand trade and reduce Tunisia's economic dependency on the European Union. In this context, Tunisia has signed a preferential trade agreement with the West African Economic and Monetary Union (WAEMU) and is currently negotiating free trade agreements with the Central African Economic and Monetary Community (CAEMC), as well as with certain countries in Africa and in the MENA region. Bilateral negotiations with the European Union are under way to extend the Association agreement to services, agricultural products and processed food. Tunisia is also actively involved in the Maghreb integration process. Staff encouraged the authorities to continue with these initiatives to boost trade and tap new sources of growth, in parallel with the above-mentioned reform of customs duties.

**33. The medium-term reform program aims at further improving the business climate.**

Improvements in customs procedures have reduced custom clearance time and will advance further with the new customs code adopted in 2009. Two new programs to improve business climate and competitiveness have been financed by the World Bank, the African Development Bank, and the European Commission, and should increase Tunisia's attractiveness for FDI.

**34. Tunisia's economic diversification strategy relies on the development of high value-added services, making a better use of the skilled labor force.**

To develop these sectors, the authorities have initiated a reform of the university system to train more students in science and technology. The reform of the educational system is part of a broader plan to develop high value-added services in the areas of information technologies, health, logistics and business services. This effort will be supported by a World Bank program to strengthen the competitiveness of Tunisian companies in the service sector. The authorities are backing this modernization process with an infrastructure development program, which will facilitate the entry of new foreign investment.

#### IV. STAFF APPRAISAL

**35. Tunisia weathered the global crisis well, but faces a modest recovery outlook in its main partners, subject to significant downside risks.**

Tunisia entered the global crisis with strong fundamentals thanks to sound policies and reforms implemented over the years. The authorities' timely and adequate policy response contributed to mitigate the impact of lower external demand in 2009. On the back of a recovery of exports and strong domestic demand, Tunisia's growth has accelerated through the first quarter of 2010, but this was accompanied by a significant widening of the current account deficit and a decline in reserves. Tunisia remains highly dependent on its main European partners, and their recovery is projected to be modest and subject to significant downside risks. Tunisia will need more dynamic sources of growth to make a significant dent in unemployment, which remains high, especially among the youth.

**36. Fiscal policy in 2010 strikes the right balance between supporting growth and preserving the significant gains achieved in the last decade in bringing public debt down.**

The recovery under way should not be undermined by an early withdrawal of the fiscal stimulus package. The still available fiscal space could be used to cushion a deterioration in external demand in the event that downside risks materialize. Staff welcomes the continued vigilance of the authorities in that regard. At the same time, current expenditure should continue to be firmly controlled to make as much room as possible for efficient public investment to support current and future growth.

**37. Monetary and exchange rate policies should be geared toward avoiding the build-up of inflationary pressures and ensuring that the recent weakening of the external balance does not persist.**

The authorities should sustain their efforts to sterilize the abundant liquidity and ward off excessive credit growth with all policy instruments at their disposal. In particular, they should stand ready to tighten the policy stance in case of a significant rise in core inflation, further acceleration in credit growth, or a sustained further fall in reserves. Continued deepening of the financial markets will be important for enhancing monetary policy transmission. The exchange rate continues to be broadly aligned with fundamentals. Exchange rate policy should continue to be guided by the medium-term objective of a freely-floating exchange rate, while ensuring that the level of reserves remains comfortable.

**38. Staff welcomes the authorities' resolute commitment to revert to medium-term fiscal consolidation as growth firms up, to further reduce the public debt-to-GDP ratio.**

This will help to maintain investors' confidence and the scope for countercyclical fiscal policy in the future. Key pillars should include complementing the oil price adjustment mechanism with better targeting of transfers and subsidies to the most needy; adjusting the parameters of the pension system to make it financially sustainable over the medium to long term; and

implementing further improvements in public finance management. The tax structure could also be made more conducive to private investment and growth.

**39. The authorities' medium-term objectives to implement inflation targeting, convertibility of the dinar and liberalization of the capital account will enhance Tunisia's growth potential.**

Staff supports the gradual approach envisaged by the authorities, while stressing that it will be necessary to make resolute progress on several fronts soon to encourage the emergence of the market tools needed to enable economic agents to adapt to the future environment.

**40. The progress achieved in strengthening the financial system should be sustained.**

Financial sector indicators continued to improve in 2009, but the NPL ratio remains relatively high. Reducing this ratio by almost half by 2014 as planned by the authorities will require pursuing resolute efforts by supervisory authorities and banks. More forward-looking risk assessment procedures—particularly in the context of the adoption of Basel II standards, more systematic stress-testing, and developing new indicators for identifying potential risks would be highly beneficial. Staff welcomes the planned implementation of the financial sector component of the 2010–14 presidential program, which will underpin further strengthening of the financial sector.

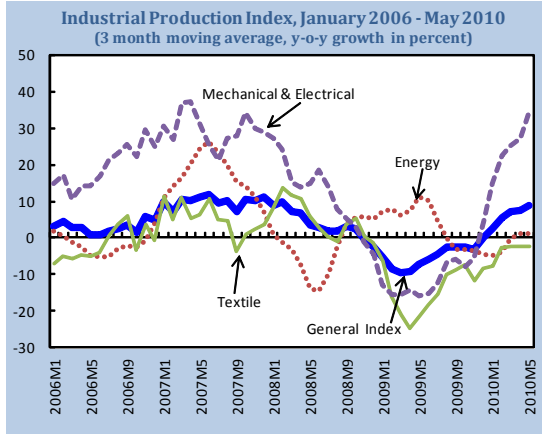
**41. Staff welcomes the new impetus to structural reforms to achieve higher growth.**

Plans to further enhance business climate and competitiveness, including through continued liberalization and openness, to develop high value-added services, to make better use of the unemployed skilled labor force, and to diversify export markets, are key in developing new sources of growth. Staff encourages the authorities to implement the underpinning reforms with the same steadfastness and pragmatism demonstrated in the recent past.

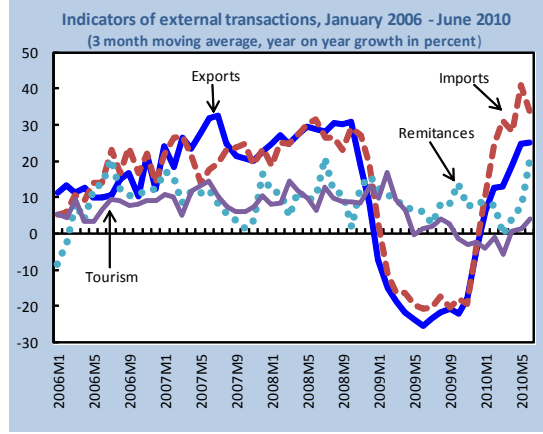
**42. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.**

Tunisia: Recent Economic and Financial indicators

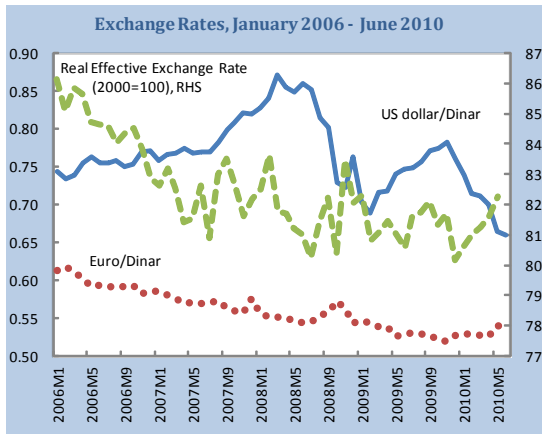
After falling through most of 2009, industrial production has been growing at an accelerating rate in the first five months of 2010.



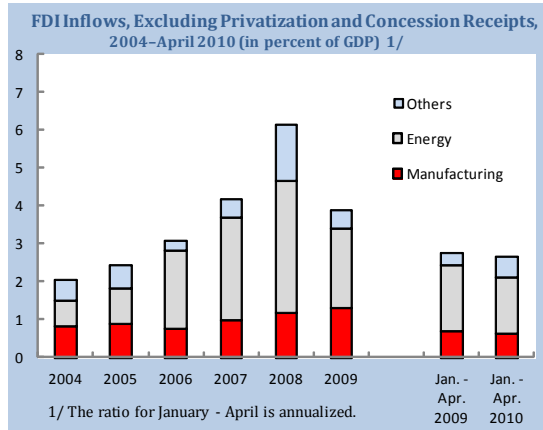
After dropping sharply in early 2009, exports and imports have picked up. Tourism receipts have been flat in recent months while worker remittances have increased again.



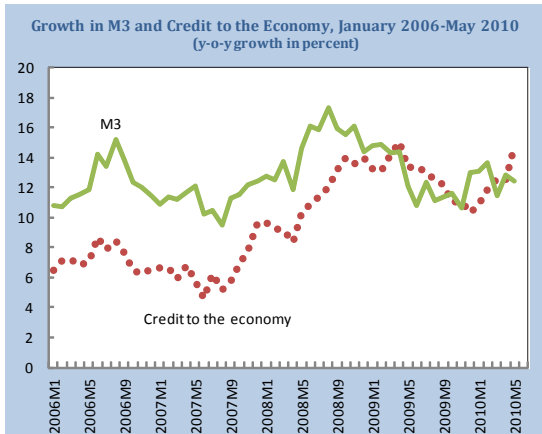
The real effective exchange rate has been fairly stable since mid-2007.



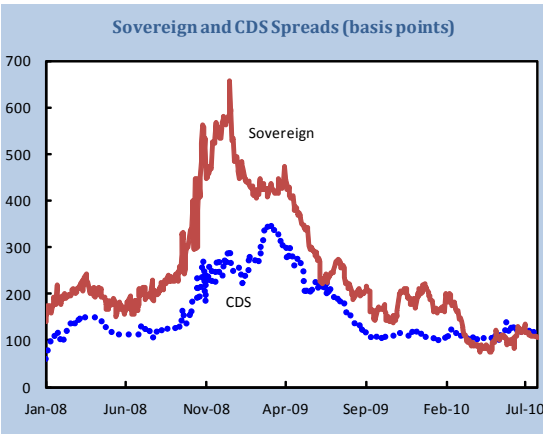
FDI inflows, after rising steadily as a share of GDP in 2004–08, fell in 2009, in particular in the energy sector.



Growth in credit to the economy and broad money have remained.



Sovereign and CDS spreads have been fairly stable over the last few months, at below their levels in early 2008.



Source: Tunisian authorities and INS calculations.

Table 1. Tunisia: Selected Economic and Financial Indicators, 2008–15

	2008	2009	Projections					
			2010	2011	2012	2013	2014	2015
Production and income (percent change)								
Nominal GDP	10.9	6.3	10.0	8.0	8.3	8.6	8.6	8.5
Real GDP	4.5	3.1	3.8	4.8	5.0	5.6	5.7	5.8
GDP deflator	6.1	3.1	5.9	3.1	3.2	2.8	2.7	2.5
Consumer price index (CPI), average	5.0	3.7	4.8	3.5	3.3	3.1	3.0	3.0
Gross national savings (in percent of GDP)	22.1	21.8	23.1	23.3	24.0	24.4	24.6	24.6
Gross investment (in percent of GDP)	25.9	24.8	27.6	27.4	27.8	27.8	27.6	27.3
External sector (percent change)								
Exports of goods, f.o.b. (in \$)	26.6	-24.8	1.7	4.6	6.2	5.7	5.4	6.1
Imports of goods, f.o.b. (in \$)	28.7	-21.9	7.1	3.0	5.1	5.0	4.8	5.2
Exports of goods, f.o.b. (volume)	4.3	-9.1	2.6	3.2	3.4	3.4	3.2	4.9
Import of goods, f.o.b. (volume)	6.9	1.2	3.6	2.9	2.5	3.1	3.1	3.9
Trade balance (in percent of GDP)	-8.9	-8.5	-10.9	-10.4	-10.0	-9.7	-9.4	-9.0
Current account, excluding grants (in percent of GDP)	-3.8	-2.9	-4.5	-4.1	-3.7	-3.3	-3.0	-2.7
Foreign direct investment (percent of GDP)	5.7	3.3	3.3	3.9	4.0	4.0	4.0	4.0
Terms of trade (deterioration -)	0.8	8.0	-4.1	1.3	0.1	0.4	4.5	3.0
Real effective exchange rate (depreciation -) 1/	-0.6	-0.6	...	...	...	...	...	...
Central government (percent of GDP, unless otherwise indicated) 2/								
Total revenue, excluding grants and privatization	23.8	22.8	21.7	21.7	21.5	21.3	21.1	21.1
Total expenditure and net lending	24.8	25.8	24.8	24.5	24.1	23.8	23.4	23.3
Central government balance, excluding grants and privatization	-1.0	-3.0	-3.0	-2.8	-2.6	-2.5	-2.3	-2.1
Central government balance, including grants, excluding privatization	-0.7	-2.7	-2.9	-2.5	-2.4	-2.4	-2.2	-2.0
Total government debt (foreign and domestic)	43.3	42.8	43.1	42.7	42.3	41.6	40.7	39.7
Foreign currency public debt (percent of total debt)	60.8	58.5	56.1	53.2	50.1	47.4	44.7	42.3
Money and credit (percent change)								
Credit to the economy	14.0	10.3	11.3	...	...	...	...	...
Broad money (M3) 3/	14.4	13.0	11.7	...	...	...	...	...
Velocity of circulation (GDP/M3)	1.62	1.52	1.50	...	...	...	...	...
Interest rate (money market rate, in percent, e.o.p) 4/	4.90	4.10	4.05	...	...	...	...	...
Official reserves								
Gross official reserves (US\$ billions, e.o.p)	9.0	10.6	10.1	10.6	11.2	11.9	12.7	14.0
In months of imports of goods and services, c.i.f. 5/	4.4	6.7	6.0	6.1	6.1	6.2	6.3	6.6
Total external debt								
External debt (US\$ billions)	20.6	21.4	19.9	20.2	20.3	20.4	20.4	20.8
External debt (in percent of GDP)	48.8	48.1	47.9	46.4	44.4	42.2	39.7	37.8
Debt service ratio (percent of exports of GNFS)	8.6	11.9	10.7	11.6	10.5	9.6	9.0	8.7
Financial market indicators								
Stock market index 6/	2,892	4,292	...	...	...	...	...	...
Memorandum items:								
GDP at current prices (TD millions)	55,296	58,768	64,624	69,782	75,590	82,101	89,153	96,698
GDP at current prices (US\$ billions)	44.9	43.5	43.5	44.7	46.9	49.6	52.7	56.1
GDP per capita (US\$)	4,346	4,171	4,125	4,195	4,359	4,562	4,790	5,051
Unemployment rate (in percent) 7/	12.6	13.3	...	...	...	...	...	...
Population (millions)	10.3	10.4	10.5	10.7	10.8	10.9	11.0	11.1
Exchange rate: dinar/US\$ (average)	1.23	1.35	...	...	...	...	...	...

Sources: Tunisian authorities; and staff estimates and projections.

1/ Information Notice System.

2/ Excludes the social security accounts.

3/ Financial system (deposit money banks and development banks).

4/ 2010 data is the money market rate at end-June.

5/ End of year reserves over current year imports of goods and services.

6/ TUNINDEX (1000 = 4/1/1998).

7/ New series based on the ILO definition of the labor force.

Table 2. Tunisia: Balance of Payments, 2008–15

(In millions of U.S. dollars, unless otherwise indicated)

	2008	Prel.	Projections					
		2009	2010	2011	2012	2013	2014	2015
Current account	-1,711	-1,275	-1,957	-1,822	-1,758	-1,657	-1,575	-1,527
Trade balance	-4,010	-3,699	-4,740	-4,640	-4,702	-4,822	-4,952	-5,033
Exports	19,184	14,419	14,662	15,342	16,296	17,232	18,159	19,270
Energy	3,311	1,953	2,485	2,627	2,767	2,899	3,045	3,216
Nonenergy	15,872	12,465	12,176	12,715	13,529	14,332	15,114	16,054
Imports	-23,194	-18,117	-19,401	-19,983	-20,999	-22,054	-23,111	-24,303
Energy	-3,988	-2,066	-2,441	-2,643	-2,795	-2,928	-3,075	-3,233
Nonenergy	-19,206	-16,051	-16,961	-17,339	-18,204	-19,125	-20,036	-21,070
<i>Of which: Nonfood</i>	-17,095	-14,878	-15,810	-16,178	-17,011	-17,894	-18,761	-19,742
Services and transfers (net)	2,299	2,424	2,783	2,819	2,944	3,165	3,377	3,506
Nonfactor	2,644	2,525	2,418	2,378	2,470	2,610	2,776	2,932
<i>Of which: Tourism</i>	2,751	2,571	2,383	2,404	2,470	2,592	2,725	2,877
Factor Services and Transfers (net)	-345	-101	365	440	475	555	601	575
<i>Of which: Workers' remittances</i>	1,977	1,965	1,875	1,908	1,987	2,076	2,173	2,286
Interest payments on external debt	-742	-686	-598	-634	-605	-600	-597	-621
Capital and financial account	3,374	2,893	2,134	2,283	2,325	2,425	2,350	2,840
Excluding grants	3,292	2,747	2,033	2,183	2,224	2,323	2,247	2,734
Capital account	79	144	98	97	98	99	101	103
Financial account	3,295	2,750	2,036	2,186	2,227	2,326	2,250	2,737
Direct foreign investment (net)	2,558	1,447	1,417	1,726	1,884	1,993	2,120	2,266
Medium- and long-term loans (net)	-10	316	327	199	71	60	-145	-84
Disbursement	1,416	1,995	1,885	1,985	1,775	1,692	1,476	1,566
Amortization	-1,426	-1,679	-1,558	-1,786	-1,704	-1,632	-1,621	-1,650
Short-term capital	747	987	293	261	272	273	275	556
Errors and omissions	0	0	0	0	0	0	0	0
Overall balance	1,662	1,619	177	461	566	768	775	1,313
Changes in gross reserves 1/	-1,027	-1,623	452	-456	-565	-762	-766	-1,289
Memorandum items:								
Current account balance/GDP (in percent)	-3.8	-2.9	-4.5	-4.1	-3.7	-3.3	-3.0	-2.7
Reserves (in billions of US\$)	9.0	10.6	10.1	10.6	11.2	11.9	12.7	14.0
Reserves in months of imports of goods 2/	4.4	6.7	6.0	6.1	6.1	6.2	6.3	6.6
Reserves in months of imports of goods and services 2/	4.0	6.0	5.4	5.5	5.5	5.6	5.7	6.0
Reserves/total short term external debt (percent) 3/	207.2	220.5	229.8	233.5	239.3	247.9	254.9	257.1
Excluding nonresidents deposits	462.1	477.1	497.3	505.4	517.9	536.3	810.1	817.2
Reserves/short-term debt (on remaining maturity basis) (in percent)	158.1	162.3	171.8	168.8	176.5	186.2	193.3	198.3
Excluding nonresidents deposits	273.2	268.7	287.4	276.1	292.4	312.5	402.7	420.4
External medium- and long-term debt (in billions of \$)	16.3	16.6	15.5	15.7	15.6	15.6	15.4	15.3
External medium- and long-term debt/GDP (in percent)	38.5	37.3	37.3	35.9	34.2	32.3	30.0	27.9
External short-term debt (in billions of \$)	4.3	4.8	4.4	4.5	4.7	4.8	5.0	5.4
External short-term debt/GDP (in percent)	10.3	10.8	10.6	10.4	10.2	9.9	9.7	9.9
Debt service ratio (as percent XGS, including IMF)	8.6	11.9	10.7	11.6	10.5	9.6	9.0	8.7
Goods export real growth (in percent)	4.3	-9.1	2.6	3.2	3.4	3.4	3.2	4.9
Nonenergy	5.3	-9.4	2.2	3.3	3.8	3.5	3.2	5.2
Goods import real growth (in percent)	6.9	1.2	3.6	2.9	2.5	3.1	3.1	3.9
Nonenergy	5.9	3.8	3.6	2.9	2.4	3.1	3.2	3.9

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

1/ Differs from the overall balance because of valuation effects.

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

3/ Short term defined as 1 year and less.

Table 3. Tunisia: Central Government Financial Operations, 2008–15 1/

	2008	Prel. 2009	Projections					
			2010	2011	2012	2013	2014	2015
(In millions of dinars)								
Total revenue and grants and privatization	13,504	13,575	14,356	15,392	16,495	17,657	19,016	20,635
Total revenue	13,165	13,392	14,056	15,142	16,245	17,457	18,816	20,435
Tax revenue	11,331	11,685	12,025	13,050	13,987	15,019	16,159	17,540
Direct taxes	4,561	4,646	4,918	5,374	5,746	6,158	6,687	7,282
Trade taxes	585	520	515	570	618	597	583	653
VAT	3,309	3,400	3,476	3,826	4,070	4,404	4,787	5,156
Domestic	1,627	1,714	1,775	1,815	1,890	2,053	2,265	2,456
Imports	1,682	1,685	1,702	2,011	2,180	2,351	2,522	2,699
Excise	1,465	1,596	1,540	1,535	1,663	1,806	1,962	2,128
Domestic	884	945	940	977	1,058	1,150	1,248	1,354
Imports	581	652	600	558	605	657	713	774
Other taxes	1,412	1,524	1,576	1,745	1,890	2,053	2,140	2,321
Domestic	1,288	1,372	1,482	1,675	1,814	1,971	2,051	2,224
Imports	124	151	94	70	76	82	89	97
Nontax revenue	1,826	1,702	2,021	2,082	2,248	2,428	2,647	2,885
Capital income	8	5	10	10	10	10	10	10
Total expenditure and net lending	13,724	15,164	16,020	17,070	18,243	19,516	20,875	22,504
Total expenditure	13,676	14,510	15,920	16,970	18,143	19,416	20,775	22,404
Current expenditure	10,495	10,644	11,660	12,306	13,052	13,840	14,725	15,832
Wages and salaries	5,732	6,269	6,795	7,339	7,926	8,560	9,245	9,985
Goods and services	881	1,010	1,125	1,186	1,315	1,396	1,551	1,605
Interest payments	1,143	1,180	1,240	1,279	1,257	1,268	1,273	1,370
Domestic	563	561	625	646	681	711	737	824
External	579	619	615	633	577	557	535	546
Transfers and subsidies	2,740	2,186	2,335	2,362	2,402	2,451	2,478	2,679
CGC	1,048	800	730	738	751	766	775	837
Petroleum subsidies	806	430	550	556	566	577	584	631
Other	886	956	1,055	1,067	1,085	1,108	1,120	1,211
Other expenditure (nonallocated)	0	0	165	140	151	164	178	193
Capital expenditure	3,181	3,866	4,260	4,665	5,091	5,577	6,050	6,572
Direct investment	1,538	1,862	2,000	2,254	2,419	2,710	2,942	3,192
Capital transfers and equity	1,643	2,004	1,685	1,836	2,071	2,217	2,407	2,631
Other expenditure (nonallocated)	0	0	575	575	600	650	700	750
Net lending	47	654	100	100	100	100	100	100
Central government deficit (-) (excluding grants and privatization)	-559	-1,771	-1,964	-1,929	-1,997	-2,060	-2,059	-2,070
Grants	192	183	100	150	150	100	100	100
Privatization proceeds 2/	147	0	200	100	100	100	100	100
Central government deficit (-) (including grants and privatization)	-220	-1,589	-1,664	-1,679	-1,747	-1,860	-1,859	-1,870
Financing	220	1,589	1,664	1,679	1,747	1,860	1,859	1,870
Foreign	131	-25	-227	-198	-249	-162	-269	-236
Domestic	89	1,613	1,891	1,877	1,997	2,021	2,128	2,105
Memorandum items:								
Balance of the central government (including grants, excluding private)	-367	-1,589	-1,864	-1,779	-1,847	-1,960	-1,959	-1,970
Central government primary balance	922	-409	-424	-400	-490	-591	-587	-500
Central government primary balance (excluding grants and privatization)	584	-591	-724	-650	-740	-791	-787	-700
General government debt 3/	23,967	25,139	27,863	29,827	31,970	34,164	36,300	38,408
Of which: Domestic	9,407	10,428	12,227	13,966	15,947	17,954	20,067	22,157
External	14,560	14,710	15,637	15,861	16,023	16,210	16,233	16,250
Nominal GDP	55,297	58,768	64,633	69,791	75,601	82,113	89,166	96,712
Nominal nonagricultural GDP	50,944	53,972	59,708	64,540	70,013	76,174	82,853	90,002
Oil price (\$/barrel)	97.0	61.8	75.3	77.5	80.3	82.0	83.5	85.5

Sources: Tunisian authorities; and staff estimates.

1/ Includes special funds, fonds de concours. Does not include the social security system (CSS).

2/ Privatization receipts from Tunisie Telecom (TT) were about TD 3000 millions. Only about TD 1069 millions have been used in 2006 (of which TD 919 millions from TT receipts), and about TD 415 millions in 2007 (of which TD 365 millions from TT).

3/ Gross debt: includes debt held by social security funds (CSS); excludes debt of public enterprises.

Table 3. Tunisia: Central Government Financial Operations, 2008–15 1/ (concluded)

	2008	Prel.	Projections					
		2009	2010	2011	2012	2013	2014	2015
	(In percent of GDP)							
Total revenue and grants and privatization	24.4	23.1	22.2	22.1	21.8	21.5	21.3	21.3
Total revenue	23.8	22.8	21.7	21.7	21.5	21.3	21.1	21.1
Tax revenue	20.5	19.9	18.6	18.7	18.5	18.3	18.1	18.1
Direct taxes	8.2	7.9	7.6	7.7	7.6	7.5	7.5	7.5
Trade taxes	1.1	0.9	0.8	0.8	0.8	0.7	0.7	0.7
Trade taxes (in percent of non-oil imports)	2.2	2.2	1.9	1.9	1.9	1.7	1.6	1.6
VAT	6.0	5.8	5.4	5.5	5.4	5.4	5.4	5.3
Domestic	2.9	2.9	2.7	2.6	2.5	2.5	2.5	2.5
Imports	3.0	2.9	2.6	2.9	2.9	2.9	2.8	2.8
Imports (in percent of non-oil imports)	6.2	7.1	6.1	6.7	6.7	6.7	6.7	6.7
Excise	2.6	2.7	2.4	2.2	2.2	2.2	2.2	2.2
Domestic	1.6	1.6	1.5	1.4	1.4	1.4	1.4	1.4
Imports	1.1	1.1	0.9	0.8	0.8	0.8	0.8	0.8
Imports (in percent of non-oil imports)	2.1	2.8	2.2	2.2	2.2	2.2	2.1	2.1
Other taxes	2.6	2.6	2.4	2.5	2.5	2.5	2.4	2.4
Domestic	2.3	2.3	2.3	2.4	2.4	2.4	2.3	2.3
Imports	0.2	0.3	0.1	0.1	0.1	0.1	0.1	0.1
Imports (in percent of non-oil imports)	0.5	0.6	0.3	0.2	0.2	0.2	0.2	0.2
Nontax revenue	3.3	2.9	3.1	3.0	3.0	3.0	3.0	3.0
Capital income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	24.8	25.8	24.8	24.5	24.1	23.8	23.4	23.3
Total expenditure	24.7	24.7	24.6	24.3	24.0	23.6	23.3	23.2
Current expenditure	19.0	18.1	18.0	17.6	17.3	16.9	16.5	16.4
Wages and salaries	10.4	10.7	10.5	10.5	10.5	10.4	10.4	10.3
Goods and services	1.6	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Interest payments	2.1	2.0	1.9	1.8	1.7	1.5	1.4	1.4
Domestic	1.0	1.0	1.0	0.9	0.9	0.9	0.8	0.9
External	1.0	1.1	1.0	0.9	0.8	0.7	0.6	0.6
Transfers and subsidies	5.0	3.7	3.6	3.4	3.2	3.0	2.8	2.8
CGC	1.9	1.4	1.1	1.1	1.0	0.9	0.9	0.9
Petroleum subsidies	1.5	0.7	0.9	0.8	0.7	0.7	0.7	0.7
Other	1.6	1.6	1.6	1.5	1.4	1.3	1.3	1.3
Other expenditure (nonallocated)	0.0	0.0	0.3	0.2	0.2	0.2	0.2	0.2
Capital expenditure	5.8	6.6	6.6	6.7	6.7	6.8	6.8	6.8
Direct investment	2.8	3.2	3.1	3.2	3.2	3.3	3.3	3.3
Capital transfers and equity	3.0	3.4	2.6	2.6	2.7	2.7	2.7	2.7
Other expenditure (nonallocated)	0.0	0.0	0.9	0.8	0.8	0.8	0.8	0.8
Net lending	0.1	1.1	0.2	0.1	0.1	0.1	0.1	0.1
Central government deficit (-), (excluding grants and privatization)	-1.0	-3.0	-3.0	-2.8	-2.6	-2.5	-2.3	-2.1
Grants	0.3	0.3	0.2	0.2	0.2	0.1	0.1	0.1
Privatization proceeds 2/	0.3	0.0	0.3	0.1	0.1	0.1	0.1	0.1
Central government deficit (-), (including grants and privatization)	-0.4	-2.7	-2.6	-2.4	-2.3	-2.3	-2.1	-1.9
Financing	0.4	2.7	2.6	2.4	2.3	2.3	2.1	1.9
Foreign	0.2	0.0	-0.4	-0.3	-0.3	-0.2	-0.3	-0.2
Domestic	0.2	2.7	2.9	2.7	2.6	2.5	2.4	2.2
Memorandum items:								
Balance of the central government (including grants, excluding privatization)	-0.7	-2.7	-2.9	-2.5	-2.4	-2.4	-2.2	-2.0
Central government primary balance	1.7	-0.7	-0.7	-0.6	-0.6	-0.7	-0.7	-0.5
Central government primary balance (excluding grants and privatization)	1.1	-1.0	-1.1	-0.9	-1.0	-1.0	-0.9	-0.7
General government debt 3/	43.3	42.8	43.1	42.7	42.3	41.6	40.7	39.7
Of which: Domestic	17.0	17.7	18.9	20.0	21.1	21.9	22.5	22.9
External	26.3	25.0	24.2	22.7	21.2	19.7	18.2	16.8

Sources: Tunisian authorities; and staff estimates.

1/ Includes special funds, fonds de concours. Does not include the social security system (CSS).

2/ Privatization receipts from Tunisie Telecom (TT) were about TD 3000 millions in 2006.

3/ Gross debt: includes debt held by social security funds (CSS); excludes debt of public enterprises.



Table 4. Tunisia: Monetary Survey (Financial System), 2006–10

	2006	2007	2008	<u>Prel.</u> 2009	<u>Proj.</u> 2010
(In millions of dinars)					
Foreign assets (net)	5,798	6,654	8,250	9,704	11,706
Foreign assets	10,230	11,715	13,529	16,138	17,843
BCT	8,837	9,719	11,773	13,978	15,803
Foreign liabilities	-4,433	-5,060	-5,279	-6,434	-6,137
Net domestic assets	20,748	23,199	25,898	28,892	31,352
Domestic credit	31,321	33,770	37,903	42,185	46,374
Credit to the government (net)	5,165	5,089	5,214	6,118	6,271
Central bank net credit	-243	-256	-326	-337	-337
Commercial banks	2,609	2,818	2,501	3,075	3,642
Credit to the economy	26,157	28,681	32,689	36,067	40,103
Other items (net)	-10,573	-11,149	-12,564	-13,910	-15,023
Money plus quasi-money (M2)	24,834	28,197	32,294	36,501	41,977
Money (M1)	9,871	11,083	12,392	14,271	16,412
Currency	3,873	4,099	4,400	5,010	6,156
Demand deposits	5,998	6,984	7,993	9,261	10,255
Quasi-money	14,963	17,115	19,901	22,230	25,565
Long-term deposits (M3-M2)	1,712	1,656	1,854	2,094	1,081
Broad money (M3 ) 1/	26,546	29,853	34,148	38,596	43,058
(Annual rate of change in percent)					
Foreign assets (net)	94.9	14.8	24.0	17.6	20.6
Domestic credit	9.1	7.8	12.2	11.3	9.9
Credit to government (net)	24.0	-1.5	2.5	17.3	2.5
Credit to the economy	6.6	9.7	14.0	10.3	11.2
Money and quasi-money (M2)	12.2	13.5	14.5	13.0	15.0
Broad money (M3 )	11.4	12.5	14.4	13.0	11.6
(Changes in percent of initial stock of M3)					
Foreign assets (net)	11.9	3.2	5.3	4.3	5.2
Domestic credit	11.0	9.2	13.8	12.5	10.9
Credit to the government (net)	4.2	-0.3	0.4	2.6	0.4
Credit to the economy	6.8	9.5	13.4	9.9	10.5
Other items (net)	-11.4	-2.2	-4.7	-3.9	-2.9
Memorandum items:					
Velocity (GDP/M3)	1.72	1.67	1.62	1.52	1.50
Multiplier (M3/M0)	4.87	4.75	4.29	4.30	4.28
GDP	45,756	49,874	55,297	58,768	64,538
Nominal GDP growth	9.3	9.0	10.9	6.3	9.8

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

1/ M2 plus long term deposits.

Table 5. Tunisia. Illustrative Medium-Term Growth Scenario, 2008–15

	2008	2009	2010	2011	2012	2013	2014	2015
Real GDP growth	4.5	3.1	3.8	4.8	5.0	5.6	5.7	5.8
Agriculture 1/	-0.7	6.0	-2.0	3.0	3.0	3.1	3.2	3.2
Nonagriculture	5.0	2.8	4.3	4.9	5.1	5.8	5.9	6.0
Unemployment rate 2/	12.6	13.3	...	...	...	...	...	...
Inflation	5.0	3.7	4.8	3.5	3.3	3.1	3.0	3.0
Real export growth 3/	11.2	8.5	2.3	4.2	4.2	4.7	4.5	5.6
Gross national savings	22.1	21.8	23.1	23.3	24.0	24.4	24.6	24.6
Consolidated government 4/	5.1	4.0	3.8	4.2	4.3	4.5	4.6	4.8
Rest of the economy	17.1	17.8	19.4	19.1	19.7	20.0	20.0	19.8
Gross investment	25.9	24.8	27.6	27.4	27.8	27.8	27.6	27.3
Consolidated government	5.8	6.6	6.6	6.7	6.8	6.8	6.8	6.8
Rest of the economy	20.1	18.2	21.0	20.6	21.0	20.9	20.8	20.5
Savings-investment gap	-3.8	-2.9	-4.5	-4.1	-3.7	-3.3	-3.0	-2.7
Consolidated government	-0.7	-2.6	-2.9	-2.5	-2.4	-2.4	-2.2	-2.0
Rest of the economy	-3.1	-0.3	-1.6	-1.6	-1.3	-1.0	-0.8	-0.7
Memorandum items:								
Balance of the consolidated government	-0.7	-2.6	-2.9	-2.5	-2.4	-2.4	-2.2	-2.0
External current account	-3.8	-2.9	-4.5	-4.1	-3.7	-3.3	-3.0	-2.7
Gross fixed capital formation	23.5	23.9	26.7	26.4	26.8	26.8	26.6	26.3

Sources: Tunisian authorities; and staff estimates.

1/ Based on average growth of agricultural output from 2001 onwards.

2/ New series based on the ILO definition of the labor force.

3/ Goods and nonfactor services.

4/ Includes social security, excludes privatization receipts.



INTERNATIONAL MONETARY FUND

## TUNISIA

### Staff Report for the 2010 Article IV Consultation

## Appendices

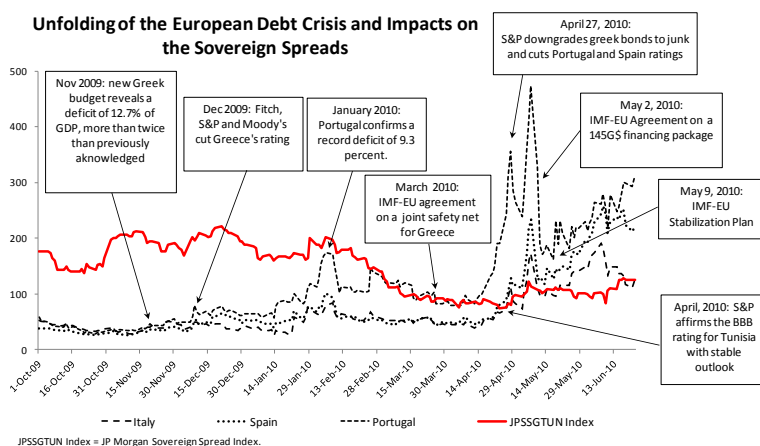
	<b>Contents</b>	<b>Pages</b>
1. Spillovers from the Debt Crisis in Europe into Tunisia.....		27
2. Exchange Rate Assessment.....		29
3. Financial Sector Reform Program .....		30
4. External and Public Debt Sustainability Analysis .....		31
5. Tunisia's New National Accounts.....		38

## Appendix 1: Spillovers from the Debt Crisis in Europe into Tunisia

### Limited financial impact in the short term, thanks to sound macroeconomic policies and limited financial links with international markets

The debt crisis in Europe has had a very limited impact on Tunisia so far. Financial markets' reaction appears relatively muted when compared to the European countries. Moreover, recognizing the strong track record of prudent macroeconomic policies, Standard & Poor's confirmed in April 2010 its BBB long-term foreign credit rating for Tunisia, with stable outlook. The banking system has limited links with international markets and its activities are funded in large part by domestic deposits (80 percent of banks' resources).

If the European debt crisis was to worsen, indistinctive risk aversion could affect Tunisia sovereign spreads, similar to what happened in 2009 during the global financial crisis.



In this event, with a public debt to GDP ratio which has steadily declined to 42½ percent and a deficit under control (3.0 percent of GDP projected in 2010), Tunisia is relatively insulated from potential short-term negative effects. Indeed, Tunisia has virtually no need to borrow on international capital markets in 2010 (gross public external borrowing needs are

estimated at \$0.3 billion in 2010 and \$0.4 billion in 2011). The government plans to finance its deficit entirely on the domestic market, which is very liquid, and from international institutional lenders (World Bank, ADB, EC).

### In the medium term, a slowdown in Europe will affect Tunisia through real channels

Tunisia's exposure to Europe through the real channels is significant. France is the most important partner, with 29 percent of exports, 25 percent of tourism receipts, and 48 percent of remittances. Among the countries from the vulnerable Southern Europe group, the most important export destination is Italy (21 percent of exports).

At this juncture, the potential dampening effect on growth of recent financial stress is highly uncertain. The latest WEO update (July 2010) assumes a modest negative effect on growth in the euro area, which is projected to grow at 1.0 percent in 2010 and 1.3 percent in 2011. However, the downside risks to global growth, in particular in Europe, have risen sharply. These risks entail a possible escalation of financial stress and contagion, prompted by rising concern over sovereign risk. In addition, growth prospects in advanced economies could suffer if more severe than expected fiscal consolidation stifles still weak domestic demand.

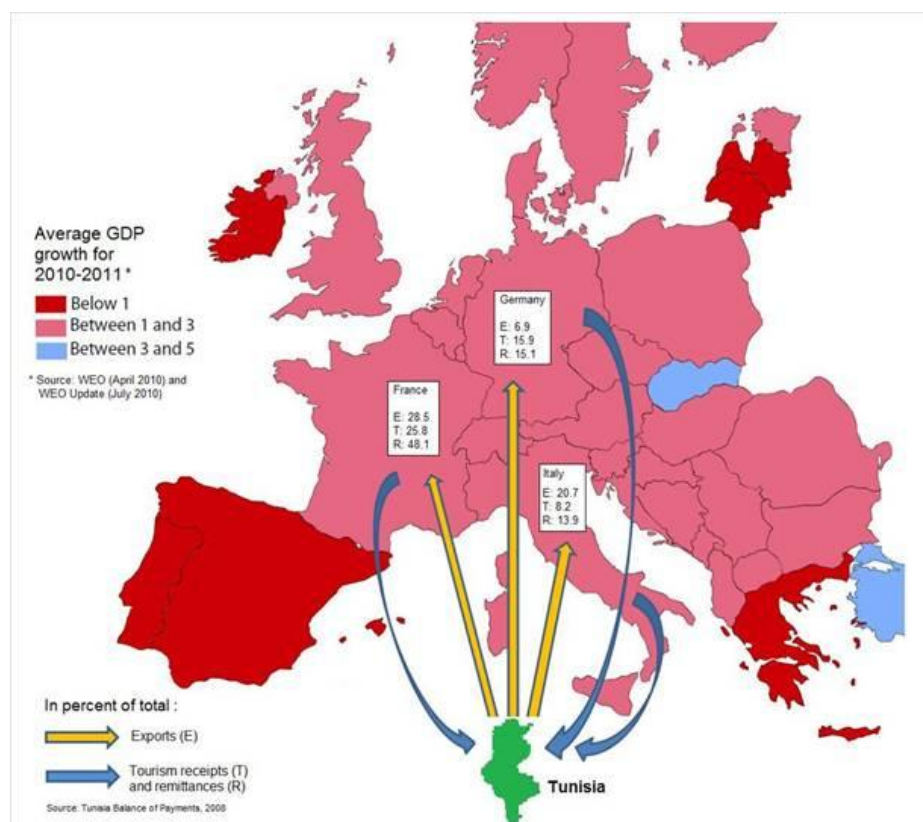
Given the above mentioned channels, Tunisia's economic growth will be affected if growth in Europe was to become weaker than currently projected. This was already the case in 2009, when Tunisian exports dropped by nearly 25 percent (in nominal terms) in response to the European slowdown (the Euro area real GDP contracted by 4.1 percent in 2009). Empirical estimates, based on vector auto regressive models, suggest that one percentage point change in European Union real GDP could lead to a 0.6 percentage point change in Tunisia real GDP.

#### Shares of Europe and of countries from the Southern group, 2008

In Percent of Total GDP	Europe	from which :				Other
		Italy	Spain	Portugal	Greece	
Exports	<b>74.2</b>	20.7	5.0	0.3	0.2	<b>25.8</b>
Tourism	<b>83.2</b>	8.2	2.1	0.3	0.2	<b>16.8</b>
Remittances	<b>88.3</b>	13.9	0.5	0.0	0.0	<b>11.7</b>
FDI	<b>85.0</b>	10.6	2.9	0.3	0.0	<b>15.0</b>

Source: Tunisia Balance of Payments, 2008.

#### Direction of Tunisian External Receipts from Europe



## Appendix 2: Exchange Rate Assessment

An analysis using the CGER methodology suggests that the current level of the real effective exchange rate (REER) is broadly in line with fundamentals.

- The macroeconomic balance (MB) approach implies a current account (CA) norm higher than the projected underlying CA balance, implying an overvaluation of 6.5 percent.
- The external sustainability suggests an undervaluation of 4.6 percent.

Exchange rate assessment using CGER panel estimates  
(In percent)

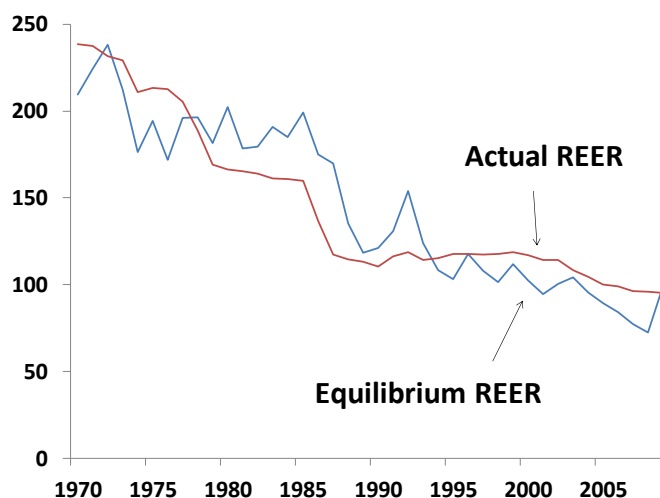
	Underlying CA balance	CA norm	REER misalignment
MB approach	-2.7	-0.5	6.5
ES approach	-2.7	-4.3	-4.6

Overvaluation (+); undervaluation (-)

A country-specific long-run cointegration relationship was also estimated for the reduced form Equilibrium Real Effective Exchange Rate (EREER). Under this specification, the EREER is determined by the terms of trade (*ToT*), trade openness (*open*), and the evolution of output per worker in Tunisia (*tunprod*) and in the partner countries (*partprod*) (t-stats between parentheses):

$$\ln(EREER) = 11.72 + \underset{(11.57)}{0.56\ln(ToT)} - \underset{(6.42)}{1.03\ln(open)} + \underset{(3.60)}{0.97\ln(tunprod)} - \underset{(11.64)}{2.05\ln(partprod)}.$$

The results suggest that the REER has remained broadly in line with fundamentals. In the past decade, increased productivity gains vis-à-vis trading partners have been more than balanced out by negative terms of trade shocks and increased openness. Calculating the EREER using the medium-run WEO projections for the explanatory variables implies a small overvaluation of 3 percent, suggesting that the REER is still broadly in line with fundamentals.



## **Appendix 3: Financial Sector Reform Program**

### **"Tunisia - Banking services hub and a regional financial market"**

An important component of the presidential program for the next five years aims at transforming Tunisia into a banking services hub and a regional financial market. In this context, the authorities are committed to continue their efforts to further strengthen the financial soundness of the banking sector, to promote the consolidation of the banking institutions and to improve the quality of financial services in order to reach a level consistent with international standards.

On June 11, 2010, a ministerial council adopted the following program of measures:

#### **Consolidation of financial fundamentals of the banking sector:**

- Increasing the minimum capital of banks to 100 million dinars by the end of 2014.
- Lowering the NPL ratio to less than 7 percent by 2014, through a more efficient collection and a dynamic management of the NPLs portfolio.

#### **Increasing banks' presence in the economy and enhancing banking services:**

- Meet the target of one bank branch for every 7,000 inhabitants by establishing 400 new branches.
- Improve the quality of banking services and build stronger relations between banks and their customers by stepping up the use of new communication technologies.
- Develop remote services, including mobile phone banking.

#### **Restructuring of the public banking sector:**

- Creation of a public banking hub "Tunisia Holding." The mission of the hub consists of devising strategies and monitoring the activities of the affiliated public banks.
- Creation of a financial institution specialized in financing small- and medium-sized enterprises (Al Moubadara). This financial institution will be entrusted to manage government equity holdings in the *Bank for Financing Small- and Medium-sized Enterprises* (BFPME), and the Tunisian Guarantee Company (SOTUGAR), as well as in regional investment companies, while safeguarding the financial and legal autonomy of these entities. The aim of creating this institution is to provide a one-stop-shop offering a complete range of services, including financing, equity holdings, and guarantees, as well as providing financing in the form of leasing and short-term loans for working capital.

#### **Strengthening the presence of Tunisian banks abroad and promoting Tunisia as a regional financial center:**

- Convert the Union of Tunisian Banks into a new banking institution "Tunisian Foreign-Bank," through a restructuring and extension of its branch network in Europe. In a first

stage, the authorities will proceed to a consolidation of the ownership into three major banks, including the BCT. In a second stage, the BCT will sell its participation to a strategic investor.

- Consolidate the presence of Tunisian banking institutions in the Maghreb area and in Africa.
- Attract internationally reputable banking institutions by promoting Tunisia's modern regulatory framework and available logistical resources.



## Appendix 4: External and Public Debt Sustainability Analysis

### A. Public Debt<sup>2</sup>

**With unchanged policies, Tunisia's gross public debt to GDP ratio is projected to decline slowly, from 43 percent in 2009 to below 40 percent by 2015.** This assumes a primary deficit of 0.9 percent of GDP over the period 2010–15, with the average nominal interest rate on public debt declining from 4.9 percent to 3.8 percent over the same period. The public debt profile is in line with the government's objective to reduce the ratio to GDP to below 40 percent over the medium term.

**At the same time, the government is intending to undertake major fiscal reforms over the medium term, but this is not likely to result in a noticeably different path for the public debt-to-GDP ratio.** In particular, the authorities are proceeding with a major reform of the tax system, while maintaining strict controls over public spending, as outlined in the main text of the staff report. As a result the central government deficit (excluding grants and privatization receipts) is projected to decline from 3.0 percent of GDP in 2009 to just over 2.0 percent of GDP by 2015. Moreover, the authorities intend to submit a draft law to the Parliament in the coming months that will guarantee the financial viability of pension schemes by changing their main parameters.

If key assumptions are held over the next five years at their historical averages, the general government primary deficit would be on average slightly lower than the implied primary deficit underlying the government's current fiscal strategy. This mainly reflects conservative revenue projections in the context of the government's intended tax reform measures. Thus, under the scenario with the key variables at their historical averages, the decline in public debt would be somewhat more rapid and reach just over 38 percent of GDP by 2015.

**The debt outlook is moderately vulnerable to adverse shocks.**

Standard bound tests reveal the following (Figure 1):

- As almost 60 percent of public debt is denominated in foreign currency, a 30 percent real exchange rate depreciation would increase the public debt-to-GDP ratio by around 9½ percentage points of GDP relative to the baseline in 2015.
- With a contingent liabilities shock, the debt path would also increase throughout the projection period, raising the gross public debt-to-GDP ratio by around 9 percentage points of GDP above the baseline scenario.

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<sup>2</sup> Public debt includes the debt of the central government and the debt held by the social security funds but excludes the debt of public enterprises.

- A one-half standard deviation shock to real GDP growth over the projection period will add just over 4 percentage points to the public debt-to-GDP ratio relative to the baseline projection by 2015.
- Smaller shocks—including individual one-half standard deviation shocks to interest rates and to the primary balance, and a combined one-fourth standard deviation shock— would all result in a public debt-to-GDP ratio of under 42 percent by the end of the projection period.

## **B. External Debt**

**External debt sustainability risks have been reduced substantially in recent years and appear contained in the period ahead.**

- External debt declined sharply from over 60 percent of GDP in 2004 to around 48 percent of GDP in 2009.
- Under the baseline scenario, external debt is projected to decline further to around 38 percent of GDP by 2015.

**The composition and relatively moderate size of Tunisia’s external debt makes it relatively resilient to most types of adverse external shocks, with the exception of a significant nominal exchange rate depreciation.**

- The external debt ratio remains below 42 percent of GDP by the end of the projection period under all alternative scenarios and each of the bound tests, with the exception of the exchange rate shock scenario (Figure 2). For example, a persistent adverse shock to the current account would only raise the projected path of external debt to 41 percent of GDP by 2015.
- However, the external debt profile is highly vulnerable to exchange rate shocks. The simulation results suggest that a 30 percent real depreciation of the exchange rate in 2011 relative to the baseline scenario would raise the external debt-to-GDP ratio to above 50 percent by 2015.

Table 1. Tunisia: Public Sector Debt Sustainability Framework, 2005-2015  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 9/ -1.5	
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015		
<b>Baseline: Public sector debt 1/</b>	65.0	52.5	48.8	45.9	43.3	42.8	<b>43.1</b>	<b>42.8</b>	<b>42.3</b>	<b>41.7</b>	<b>40.8</b>	<b>39.8</b>	
<i>Of which: foreign-currency denominated</i>		33.5	29.0	26.7	26.3	25.0	24.3	22.8	21.3	19.8	18.3	16.9	
Change in public sector debt		-1.2	-3.7	-2.9	-2.6	-0.6	0.4	-0.4	-0.4	-0.7	-0.9	-1.0	
Identified debt-creating flows (4+7+12)		3.0	-9.7	-3.7	-2.2	0.2	-1.3	-0.8	-1.0	-1.1	-1.2	-1.3	
Primary deficit		0.3	0.4	0.4	-1.3	0.6	0.9	0.7	0.8	0.8	0.8	0.6	
Revenue and grants		26.5	26.6	27.4	29.9	29.3	28.4	28.5	28.2	27.9	27.8	27.8	
Primary (noninterest) expenditure		26.7	27.0	27.8	28.6	30.0	29.4	29.1	29.0	28.7	28.5	28.4	
Automatic debt dynamics 2/		3.2	-3.5	-3.3	-0.6	-0.4	-1.9	-1.3	-1.6	-1.8	-1.9	-1.8	
Contribution from interest rate/growth differential 3/		-1.4	-2.0	-1.7	-2.4	-0.6	-1.9	-1.3	-1.6	-1.8	-1.9	-1.8	
<i>Of which: contribution from real interest rate</i>		0.6	0.7	1.1	-0.6	0.7	-0.5	0.6	0.3	0.4	0.3	0.4	
<i>Of which: contribution from real GDP growth</i>		-2.0	-2.7	-2.8	-1.9	-1.3	-1.5	-1.9	-2.0	-2.2	-2.2	-2.2	
Contribution from exchange rate depreciation 4/		4.5	-1.6	-1.6	1.8	0.1	...	...	...	...	...	...	
Other identified debt-creating flows		-0.4	-6.5	-0.8	-0.3	0.0	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	
Privatization receipts (negative)		-0.4	-6.5	-0.8	-0.3	0.0	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	
Recognition of implicit or contingent liabilities		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/		-4.2	6.0	0.8	-0.4	-0.8	1.7	0.4	0.5	0.4	0.3	0.3	
Public sector debt-to-revenue ratio 1/		198.2	183.7	167.4	144.9	145.8	151.7	150.4	150.0	149.2	146.8	143.1	
<b>Gross financing need 6/</b>		5.4	6.7	5.7	2.3	4.6	5.1	5.2	4.9	4.5	4.2	3.9	
in billions of U.S. dollars		1.8	2.3	2.2	1.0	2.0	2.2	2.3	2.3	2.2	2.2	2.2	
<b>Scenario with key variables at their historical averages 7/</b>							<b>43.1</b>	<b>42.1</b>	<b>41.2</b>	<b>40.2</b>	<b>39.2</b>	<b>38.1</b>	<b>-1.0</b>
<b>Scenario with no policy change (constant primary balance) in 2010-2015</b>							<b>43.1</b>	<b>41.6</b>	<b>41.4</b>	<b>40.9</b>	<b>40.2</b>	<b>39.6</b>	<b>-1.5</b>
<b>Key Macroeconomic and Fiscal Assumptions Underlying Baseline</b>													
Real GDP growth (in percent)		4.0	5.7	6.3	4.5	3.1	3.8	4.8	5.0	5.6	5.7	5.8	
Average nominal interest rate on public debt (in percent) 8/		5.1	5.1	5.3	5.0	4.9	4.9	4.6	4.2	4.0	3.7	3.8	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)		1.4	1.7	2.7	-1.1	1.8	-1.0	1.6	1.0	1.1	1.0	1.3	
Nominal appreciation (increase in US dollar value of local currency, in percent)		-12.0	5.1	6.3	-6.8	-0.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)		3.7	3.4	2.6	6.1	3.1	5.9	3.0	3.2	2.8	2.7	2.5	
Growth of real primary spending (deflated by GDP deflator, in percent)		4.0	6.6	9.6	7.4	8.0	1.8	4.0	4.4	4.7	4.8	5.3	
Primary deficit		0.3	0.4	0.4	-1.3	0.6	0.9	0.7	0.8	0.8	0.8	0.6	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $\alpha\varepsilon(1+r)$ .

5/ For projections, this line includes exchange rate changes.

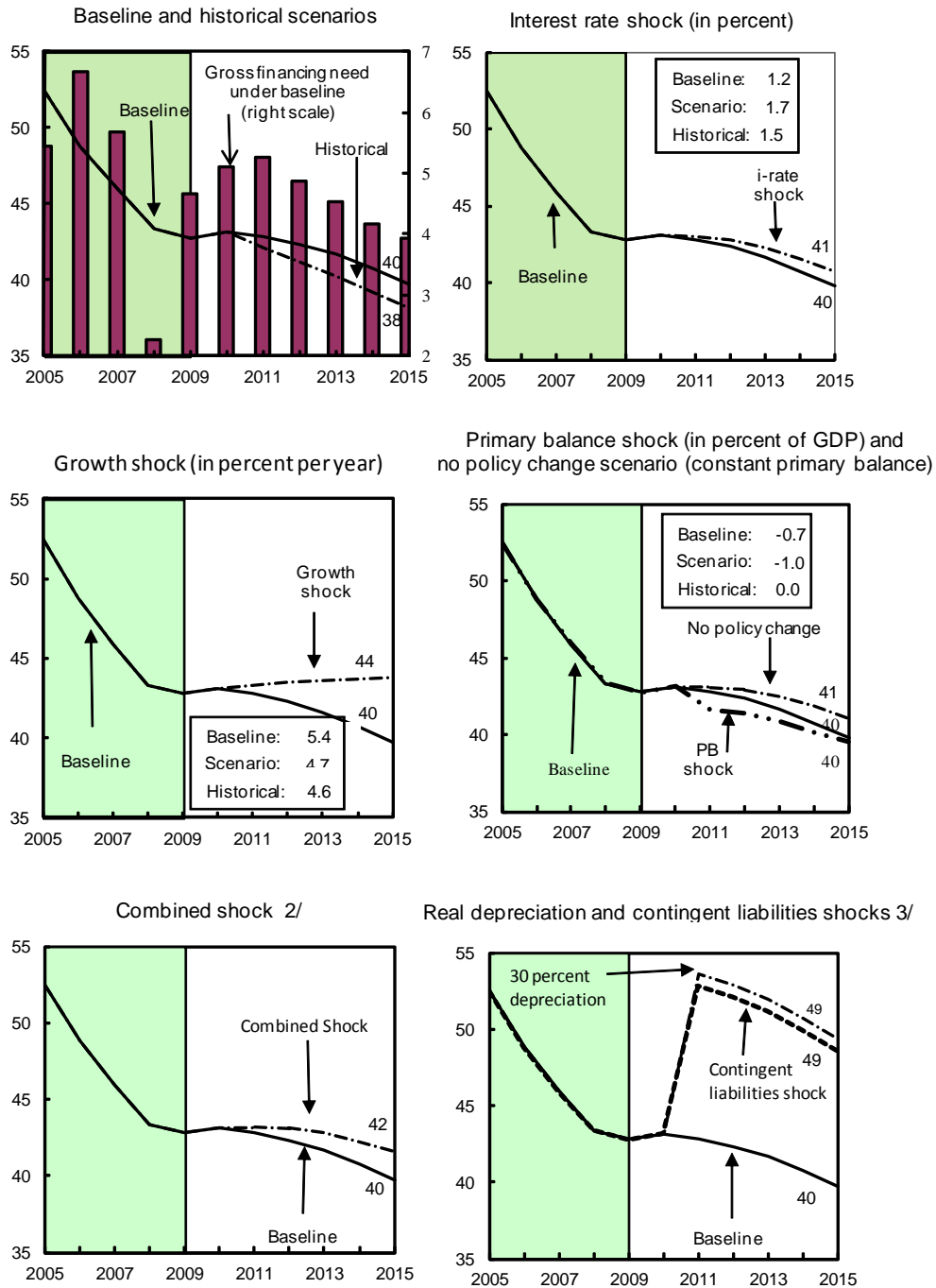
6/ Defined as public sector deficit, plus amortization of medium-and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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.

Figure 1. Tunisia: Public Debt Sustainability: Bound Tests 1/  
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.  
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.  
 3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 2. Tunisia: External Debt Sustainability Framework, 2005-2015  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -5.4
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
<b>Baseline: External debt</b>	58.9	52.5	49.3	48.8	48.1	<b>48.1</b>	<b>46.5</b>	<b>44.5</b>	<b>42.4</b>	<b>39.8</b>	<b>38.0</b>	
Change in external debt	-1.4	-6.3	-3.2	-0.5	-0.7	0.0	-1.6	-2.0	-2.2	-2.6	-1.8	
Identified external debt-creating flows (4+8+9)	1.9	-15.2	-8.7	-3.6	-3.0	-0.7	-2.0	-2.5	-3.1	-3.3	-3.5	
Current account deficit, excluding interest payments	-1.2	-0.2	0.5	2.3	1.3	3.3	2.7	2.5	2.2	1.9	1.7	
Deficit in balance of goods and services	0.4	1.9	1.9	3.2	2.6	5.6	5.2	4.9	4.6	4.3	3.9	
Exports	47.7	45.3	49.1	59.7	44.6	48.5	48.1	48.4	48.2	47.8	47.5	
Imports	48.1	47.2	51.0	62.9	47.2	54.1	53.3	53.3	52.8	52.1	51.4	
Net non-debt creating capital inflows (negative)	-2.4	-9.4	-3.8	-6.1	-3.2	-3.4	-4.0	-4.1	-4.1	-4.1	-4.1	
Automatic debt dynamics 1/	5.5	-5.6	-5.4	0.2	-1.1	-0.5	-0.7	-0.9	-1.1	-1.1	-1.0	
Contribution from nominal interest rate	2.2	2.0	1.8	1.8	1.5	1.4	1.5	1.3	1.2	1.2	1.1	
Contribution from real GDP growth	-2.5	-2.9	-2.8	-2.2	-1.4	-2.0	-2.2	-2.2	-2.4	-2.3	-2.2	
Contribution from price and exchange rate changes 2/	5.8	-4.7	-4.3	0.6	-1.2	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-3.3	8.9	5.5	3.1	2.3	0.7	0.4	0.5	0.9	0.8	1.7	
External debt-to-exports ratio (in percent)	123.4	115.9	100.4	81.7	107.8	99.2	96.8	92.1	87.8	83.2	79.9	
<b>Gross external financing need (in billions of US dollars) 4/ in percent of GDP</b>	5.1 16.6	6.0 17.0	6.2 15.1	7.1 16.9	7.3 16.3	8.3 20.1	8.2 18.9	8.2 18.0	8.2 16.9	8.2 16.1	8.4 15.4	
<b>Scenario with key variables at their historical averages 5/</b>						<b>48.1</b>	<b>43.8</b>	<b>39.8</b>	<b>36.4</b>	<b>33.1</b>	<b>30.8</b>	<b>-4.9</b>
<b>Key Macroeconomic Assumptions Underlying Baseline</b>												
Real GDP growth (in percent)	4.0	5.7	6.3	4.5	3.1	3.8	4.8	5.0	5.6	5.7	5.8	
GDP deflator in US dollars (change in percent)	-8.8	8.7	9.0	-1.1	2.5	-10.6	0.0	0.1	0.2	0.6	0.8	
Nominal external interest rate (in percent)	3.5	3.9	3.9	3.7	3.3	2.8	3.2	3.0	3.0	2.9	3.0	
Growth of exports (US dollar terms, in percent)	11.3	9.1	25.5	25.6	-21.0	0.8	3.9	5.7	5.6	5.4	6.0	
Growth of imports (US dollar terms, in percent)	5.7	12.7	25.0	27.5	-20.7	6.2	3.3	5.0	5.0	4.8	5.2	
Current account balance, excluding interest payments	1.2	0.2	-0.5	-2.3	-1.3	-3.3	-2.7	-2.5	-2.2	-1.9	-1.7	
Net non-debt creating capital inflows	2.4	9.4	3.8	6.1	3.2	3.4	4.0	4.1	4.1	4.1	4.1	

1/ Derived as  $[r - g - r(1+g) + \alpha(1+r)] / (1+g+r+gr)$  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,  $\alpha$  = nominal appreciation (increase in dollar value of domestic currency), and  $\alpha$  = share of domestic-currency denominated debt in total external debt.

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

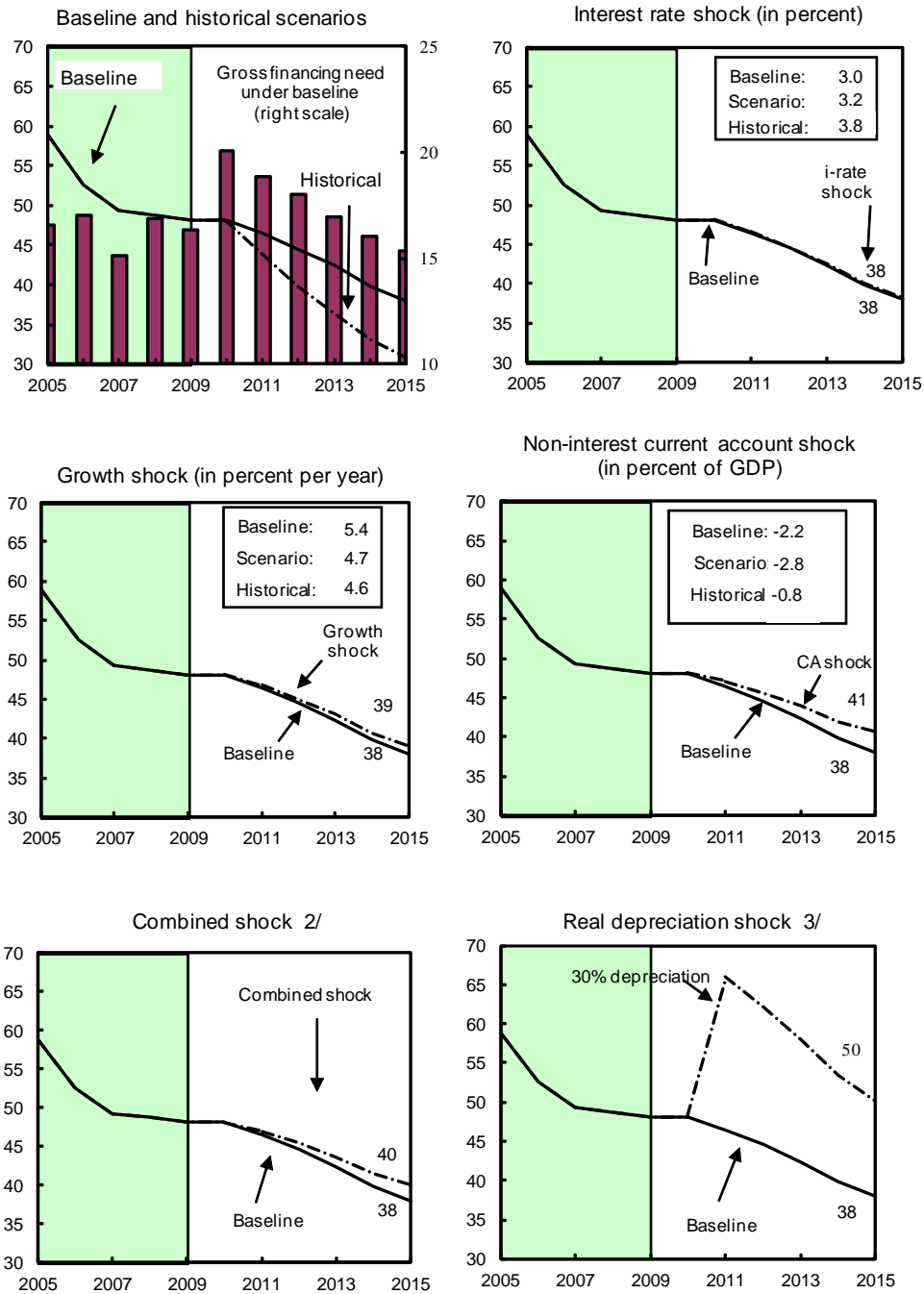
3/ For projection, line includes the impact of price and exchange rate changes.

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) of the last projection year.

Figure 2. Tunisia: External Debt Sustainability: Bound Tests 1/  
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

3/ One-time real depreciation of 30 percent occurs in 2010.

## Appendix 5: Tunisia's New National Accounts

**In early 2010, the Tunisian authorities adopted a new national accounts system for the period 1997–2008 to comply with the 1993 United Nations national accounts system.**

The main goal is to improve the national accounts methodology to reflect better income levels and economic developments. The new system has revalued current price figures of the main macroeconomic aggregates (i.e., GDP, fixed gross capital formation, consumption, investment, savings, etc.). The total effect of the introduction of new system has been an increase of around 10 percent in nominal GDP figures each year.

**Constant price aggregates are now calculated based on last year's prices.**

This allows better reflecting the evolving structure of the economy in calculating overall real GDP growth. On the other hand, when one calculates GDP series with a fixed base year using the chained growth rates, sector components series do not add up to the total real GDP series.

Some selected macroeconomic aggregates are now as follows:

### Selected macroeconomic aggregates with the new and old GDP series, 2002–08

	2002	2003	2004	2005	2006	2007	2008
<b>Nominal GDP in billions of TND</b>							
Old GDP	29,923.6	32,170.1	35,192.0	37,766.7	41,407.8	45,628.7	50,324.9
New GDP	32,901.2	35,373.3	38,838.5	41,871.0	45,756.1	49,874.3	55,296.4
<b>Real GDP growth, percent change</b>							
Old GDP (in 1990 prices)	1.5	5.9	6.1	4.1	5.7	5.8	5.0
New GDP	1.7	5.5	6.0	4.0	5.7	6.3	4.5
<b>Budget deficit, percent of GDP</b>							
Old GDP	-3.5	-3.4	-2.8	-3.2	-3.0	-2.9	-1.1
New GDP	-3.1	-3.1	-2.6	-2.9	-2.8	-2.7	-1.0
<b>Current Account, percent of GDP</b>							
Old GDP	-5.0	-3.8	-3.4	-1.3	-2.6	-3.3	-5.2
New GDP	-4.6	-3.5	-3.0	-1.2	-2.4	-3.0	-4.7
<b>Total Government Debt, percent of GDP</b>							
Old GDP	74.1	73.0	59.3	58.2	53.9	50.2	47.6
New GDP	67.4	66.4	53.7	52.5	48.8	45.9	43.3
<b>Total External Debt, percent of GDP</b>							
Old GDP	91.4	83.4	80.5	80.8	74.1	66.6	62.7
New GDP	83.1	75.8	73.0	72.8	67.0	60.9	57.1

Source: Tunisian authorities

**The main methodological changes include:**

- i. Financial intermediation services are split between institutional sectors to make a better assessment of the actual consumption of these services;
- ii. the consumption of fixed capital by public administrations was increased due a new method to calculate the gross operating surplus;

- iii. military expenses in goods which could have civil use are now included in gross fixed capital formation and are not considered as intermediate consumption anymore;
- iv. expenditure for research, and mining and petroleum prospection, previously considered as intermediate consumption are now included in gross fixed capital formation; and
- v. the production coverage was broadened to include activities such as certain rentals, domestic services and the production of certain non-profit organizations.





INTERNATIONAL MONETARY FUND

## TUNISIA

### Staff Report for the 2010 Article IV Consultation

#### Informational Annex

Prepared by the Staff Representatives for the 2010 Consultation with Tunisia

August 4, 2010

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	Contents	Page
I. Fund Relations .....		2
II. World Bank Relations .....		5
III. Statistical Issues .....		8

**Annex I. Tunisia: Fund Relations**  
**As of May 31, 2010**

I. **Membership Status:** Joined: 04/14/1958; Article VIII

<b>II. General Resources Account:</b>	<u>SDR Million</u>	<u>%Quota</u>
Quota	286.50	100.00
Fund holdings of currency	266.27	92.94
Reserve position in Fund	20.25	7.07

<b>III. SDR Department:</b>	<u>SDR Million</u>	<u>%Allocation</u>
Net cumulative allocation	272.78	100.00
Holdings	241.78	88.64

IV. **Outstanding Purchases and Loans:** None

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	07/25/1988	07/24/1992	207.30	207.30
Stand-by	11/04/1986	05/31/1988	103.65	91.00

VI. **Projected Obligations to Fund:** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2010	2011	2012	2013	2014
Principal					
Charges/Interest	0.04	0.08	0.08	0.08	0.08
Total	0.04	0.08	0.08	0.08	0.08

## **Exchange Rate Arrangement and Exchange System**

Tunisia accepted the obligations of Article VIII Sections 2(a), 3, and 4 effective January 6, 1993, and maintains an exchange system that is free of restrictions on executing payments and transfers on current international transactions, except that Tunisia maintains (a) a multiple currency practice resulting from honoring exchange rate guarantees extended prior to August 1988 to development banks, which will automatically expire after maturity of existing commitments (total loans covered by these guarantees amount to about \$20 million); and (b) certain restrictions relating to Iraq and the Federal Republic of Yugoslavia (Serbia and Montenegro), pursuant to UN Security Council Resolutions, which are subject to notification to the Fund in accordance with Decision 144 (52/51).

Since March 1, 1994, the market rates are determined in an interbank foreign exchange market. On July 14, 2010, the interbank rate of the dinar vis-à-vis the dollar was \$1=TD 1.4827, equivalent to SDR 1= TD 2.2313.

### **Article IV Consultation**

Tunisia is on the 12-month cycle. The last discussions of the Article IV consultation were held in Tunis from June 10 to June 24, 2009, and the consultation was concluded by the Executive Board on September 1, 2009.

### **Technical Assistance**

January 31–February 14, 1996: FAD—assessment of revenue impact of Association Agreement with EU.

March 31–April 4, 1997: STA—introduction of new methodological guidelines according to fifth edition of *Balance of Payments Manual*.

September 9–12, 1998: MAE—monetary management and development of the money market.

May 11–21, 1999: STA—quarterly national accounts.

May 13–18, 1999: STA—SDDS.

October 12–15, 1999: MAE—debt management practices.

October 17–27, 2000: STA—quarterly national accounts.

October 25–31, 2000; STA—SDDS meta data finalization.

December 17–21, 2001: MAE—management of central bank liquidity.

December 12–19, 2003: LEG—AML/CFT.

May 18–19, 2004: MFD—technical assistance needs assessment.

July 1–15, 2004: STA—government finance statistics.

January 24–February 5, 2005: FAD—tax policy.

April 7–22, 2005: STA—ROSC, data module.

September 8–21, 2005: FAD—tax administration.

January 16–31, 2006: MFD—FSAP update (mission 1).

March 27–31, 2006: MFD—FSAP update (mission 2).

February 5–15, 2007: MCM—monetary policy.

February 4–7, 2008: LEG—AML/CFT supervisory training of the financial market supervision authority and the stock exchange.

**Resident Representative:** None

## **Annex II. Financial Relations with the World Bank**

### **(As of June 8, 2010)**

#### **Country Partnership Strategy**

**The Country Partnership Strategy (CPS) for Tunisia was discussed at the Board in December 2009.** The strategy is aligned in timing and substance with the National Development Plan (NDP) update, and reflects the selectivity of the client because the Tunisian Government has been very clear where it wants the Bank to provide support and where it does not. The experience in Tunisia is that the Government only requests IBRD financing when it has carefully weighed the pros and cons of all alternatives and where it assesses that the Bank can add most value. The three strategic pillars of the CPS are: (i) Growth, Competitiveness and Employment; (ii) Sustainable Development and Climate Change; and (iii) Improving the Quality of Service Delivery.

#### **Lending Volumes**

**The IBRD lending program for FY10 is well advanced with three projects scheduled for Board approval before the end of the fiscal year for a combined amount of about \$146 million.** All is on track for delivery of the 3 FY10 projects—Employment DPL (\$50 million), Community Based Integrated Rural Development (\$36 million) and the Northern Tunis Waste Water project (\$60 million). Beyond FY10, specific amounts for projects are not yet known with precision but the volume of the IBRD envelope for FY11 is expected to be around \$500 million, half of which would be delivered through development policy lending. For years beyond FY11, the Government has not asked for a specific annual lending amount as they continue to monitor their overall macro situation and assess the NDP implementation.

#### **On-Going Portfolio**

**The portfolio has continually remained large** with 17 projects and grants under implementation, yearly disbursements averaging \$123 million and total commitments of \$836 million. The portfolio performance is satisfactory with no long-term problem projects, good pro-activity and realism indicators, and an average disbursement ratio for FY05–09 of 21.4 percent, close to the Bank's average. However, there are some operational factors that dog the Bank's program and which are, for the most part, linked with procurement weaknesses. The cumbersome procurement procedures lead to slow disbursements and repeated extension of projects. The Bank's team and the authorities are working on addressing these procurement issues through intensive technical assistance.

### CPS Lending Program and Other Operations

	<b>Pillar 1: Growth, Competitiveness and Employment</b>	<b>Pillar 2: Sustainable Development and Climate Change</b>	<b>Pillar 3: Improving the Quality of Service Delivery</b>
FY10	Employment DPL 1	Northern Tunis Wastewater 1	
	Community Based Integrated Rural Development		
FY11	Integration and Competitiveness DPL 2		Municipal Development 4
	Agriculture/Climate Change		Health Services Strengthening
	Export Development 3		Education 3
	Skills Development		
	Regional Energy Inter-Connection		
	North West Development 4		
	Competitiveness Poles		Cultural Heritage 2
FY12	Employment DPL 2	Solid Waste Management 2	
	Higher Education 2		
	Energy Efficiency 2		
FY13	Integration and Competitiveness DPL 3	Water Sector 3	
		Northern Tunis Wastewater 2	

**Tunisia: Financial Relations with the World Bank**  
**(As of June 2010)**

	Total Net Commitments	Undisbursed Balance
17 active loans		
-MPT Ozone Depleting Subs.	5.12	0.9
-Cultural Heritage	17.0	1.5
-Transport Sector Invt. II	33.3	0.0
- Avian Flu Preparedness	0.7	0.6
-Municipal Devt. III	78.4	0.0
-Export Development II	41.8	5.8
-Education PAQSET II	130.3	10.7
-ICT Sector Development	9.8	3.0
-GEF Energy Efficiency Program/Indust.	8.5	3.2
-GEF Gulf of Gabes	6.3	3.3
- Urban Water Supply	38.0	23.2
- Higher Education Reform Support II	76.0	63.5
- Sustainable Solid Waste Management	22.0	5.3
- Tunis West Sewerage	66.8	38.3
- Integration Competitiveness DPL	250.0	125.0
- Water Sector Investment II	30.6	27.0
- Energy Efficiency	55.0	55.0

## Annex III. Tunisia: Statistical Issues (as of July 15, 2010)

### I. Assessment of Data Adequacy for Surveillance

**General:** Data provision is adequate for surveillance.

**Real Sector Statistics:** The authorities have recently published a revised national accounts series covering the period 1997–2009 based on SNA 1993 (instead of, as before, SNA 1968), and applying a chained-index approach to estimating real GDP growth. The authorities are working on publishing a quarterly GDP series consistent with these revisions. These improvements are welcome, and should provide a better indication of economic activity developments and trends in Tunisia. Surveillance would benefit from the collection and dissemination of higher frequency data on employment, unemployment, and wages. Tunisia utilizes a periodicity and timeliness flexibility option for the labor market data category under the SDDS. Currently, annual employment and unemployment data are disseminated with a timeline of seven months.

**External sector statistics:** Are generally adequate for surveillance, although greater detail on the financial account would be desirable.

### II. Data Standards and Quality

Subscribed to the Special Data Dissemination Standard (SDDS) June 20, 2001.

A data ROSC was published on the IMF website on August 9, 2006.

### III. Reporting to STA (Optional)

Data are being reported for publication in the *International Financial Statistics (IFS)*, *Government Finance Statistics Yearbook*, *the Direction of Trade Statistics*, and *the Balance of Payments Statistics Yearbook*.



## Table of Common Indicators Required for Surveillance

### As of July 15, 2010

	Date of latest observation	Date received	Frequency of Data <sup>7</sup>	Frequency of Reporting <sup>7</sup>	Frequency of Publication <sup>7</sup>	Memo Items:	
						Data Quality – Methodological soundness <sup>8</sup>	Data Quality – Accuracy and reliability <sup>9</sup>
Exchange Rates	Current	Current	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	Jun. 2010	Jul. 2010	M	M	M		
Reserve/Base Money	May 2010	Jun. 2010	M	M	M	LO, O, LO, LO,	LO, O, O, O, LO
Broad Money	May 2010	Jun. 2010	M	M	M		
Central Bank Balance Sheet	May 2010	Jul. 2010	M	M	M		
Consolidated Balance Sheet of the Banking System	May 2010	Jul. 2010	M	Q	Q		
Interest Rates <sup>2</sup>	Current	Current	D	D	D		
Consumer Price Index	May 2010	Jun. 2010	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	2009	Mar. 2010	A	A	A	LO, LO, LO, O	O, O, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	Apr. 2010	Jun. 2010	M	M	I		
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	Q4 2009	Mar. 2010	Q	Q	Q		
External Current Account Balance	Q3 2010	Mar. 2010	Q	Q	Q	LO, O, LO, LO	O, O, O, O, LO
Exports and Imports of Goods	Jun. 2010	Jul. 2010	M	M	M		
GDP/GNP	Q1 2010	Jun. 2010	Q	Q	Q	LO, O, LNO, LNO	LO, O, LO, O, LNO
Gross External Debt	2009	Mar. 2010	A	A	A		
International Investment Position <sup>6</sup>	2008	Jun. 2009	A	A	A		

<sup>1</sup> Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

<sup>2</sup> Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup> The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Includes external gross financial asset and liability positions vis-à-vis nonresidents.

<sup>7</sup> Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).

<sup>8</sup> Reflects the assessment provided in the data ROSC Substantive Update (published on August 9, 2006, and based on the findings of the mission that took place during April 7–22, 2005) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

<sup>9</sup> Same as footnote 7, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.



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## **IMF Executive Board Concludes 2010 Article IV Consultation with Tunisia**

On August 27, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tunisia.<sup>1</sup>

### **Background**

Tunisia entered the global crisis with strong fundamentals thanks to sound policies and reforms implemented over the years. The authorities' timely and adequate policy response contributed to mitigate the impact of lower external demand in 2009. Moreover, the financial sector was not affected by the global financial crisis, as banks continued to rely on steady domestic resources. As a result, real GDP growth exceeded 3 percent in 2009. With solid exports of services and remittances as well as lower imports, the current account deficit declined and external reserves increased to the equivalent of 6 months of imports of goods and services by end-2009. Inflation remained moderate at 3.7 percent on average.

Economic growth has gathered momentum since mid-2009, on the back of the recovery in exports and solid domestic demand. At the same time, with even stronger import growth, the current account deficit widened significantly and external reserves declined

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

during the first part of 2010, while remaining at a comfortable level. For the year as a whole, as the recovery in Tunisia's main partners is expected to be modest, Tunisia's real GDP growth is projected to reach 3.8 percent, supported by a rebound in industrial activity and investment, while agricultural performance will likely be weaker than last year. Inflation edged up slightly at 5.0 percent (y-o-y) in May 2010, due to rising food prices, but non-food price increases have remained very moderate at around 3 percent.

Risks to the outlook are related to the significant downside risks to growth in Tunisia's European partners, entailing a possible escalation of financial stress and contagion and a more severe impact than currently expected of the planned fiscal consolidation on a still weak domestic demand. The strength of the recovery in Europe will determine to a large extent the pace of Tunisian exports growth, tourism receipts and remittances. On the positive side, the recent depreciation of the euro could boost exports of the euro area, and could benefit Tunisian exports in sectors such as electrical and mechanical industries. The medium-term outlook is subject to similar risks, with Tunisia's traditional partners expected to be a less buoyant source of external demand than prior to the crisis.

### **Executive Board Assessment**

Executive Directors noted that Tunisia weathered the global crisis well, largely reflecting its sound macroeconomic management and structural reforms over the last decade, and timely policy responses since the onset of the crisis. Nonetheless, Directors observed that risks to the outlook remain on the downside given the economy's high dependence on trade with Europe. Amid continued uncertainties for the external environment, they emphasized the need to maintain macroeconomic policies that support the recovery and to intensify structural reforms that would enhance competitiveness, diversify exports, and promote job creation.

Directors agreed that the fiscal stance in 2010 strikes the right balance between supporting growth and preserving the significant gains achieved in reducing the level of public debt. They welcomed the commitment to resume fiscal consolidation, starting with the 2011 budget, and to further bring down the public debt. This will help maintain investors' confidence and retain sufficient fiscal space to mitigate the impact of possible future shocks. To that end, Directors stressed the importance of following through with plans to expand the tax base, reform the social security system, and contain public spending on wages and food and fuel subsidies, while maintaining public investment on infrastructure.

Noting that credit to the economy continues to grow strongly, Directors concurred that monetary and exchange rate policies should be geared toward avoiding a build-up of inflationary pressures and ensuring that the recent weakening of the external balance does not persist. They considered that the authorities' medium-term objectives to move to inflation targeting, full convertibility of the dinar, and an open capital account could

help the economy to adapt better to changes in the external environment. At the same time, Directors stressed that significant preparatory measures are still needed, particularly continued strengthening of the banking system, further deepening of the foreign exchange market, and improving the effectiveness of monetary policy transmission. While noting the progress achieved in strengthening the financial system, Directors encouraged the authorities to move forward with plans for further improvements, including measures that would lead to a continued reduction in the level of non-performing loans and strengthen financial sector supervision.

Directors stressed that continued structural reforms remain critical to boost growth, enhance competitiveness and address the problem of persistent high unemployment, particularly among the young. They welcomed the envisaged measures to increase productivity by improving the business environment, reforming labor market policy, increasing capital investment, and modernizing and strengthening the financial sector.

**Public Information Notices (PINs)** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

## Tunisia: Selected Economic and Financial Indicators, 2005–11

	2005	2006	2007	2008	Projections		
					2009	2010	2011
<b>Production and income (percent change)</b>							
Nominal GDP	7.8	9.3	9.0	10.9	6.3	10.0	8.0
Real GDP	4.0	5.7	6.3	4.5	3.1	3.8	4.8
Consumer price index (CPI), average	2.0	4.5	3.1	5.0	3.7	4.8	3.5
Gross national savings (in percent of GDP)	20.8	21.6	21.5	22.1	21.8	23.1	23.3
Gross investment (in percent of GDP)	21.7	23.4	23.8	25.9	24.8	27.6	27.4
<b>External sector (percent change)</b>							
Exports of goods, f.o.b. (in \$)	9.8	9.9	29.6	26.6	-24.8	1.7	4.6
Imports of goods, f.o.b. (in \$)	3.4	12.8	26.9	28.7	-21.9	7.1	3.0
Trade balance (in percent of GDP)	-6.1	-7.3	-7.4	-8.9	-8.5	-10.9	-10.4
Current account, excluding grants (in percent of GDP)	-0.9	-1.8	-2.4	-3.8	-2.9	-4.5	-4.1
Foreign direct investment (percent of GDP)	2.2	9.6	4.0	5.7	3.3	3.3	3.9
Terms of trade (deterioration -)	-2.3	-3.6	-2.0	0.8	8.0	-4.1	1.3
Real effective exchange rate (depreciation -) 1/	-4.2	-0.8	-2.8	-0.6	-0.6	...	...
<b>Central government (percent of GDP, unless otherwise indicated) 2/</b>							
Total revenue, excluding grants and privatization	21.3	21.2	21.8	23.8	22.8	21.7	21.7
Total expenditure and net lending	24.2	24.0	24.5	24.8	25.8	24.8	24.5
Central government balance, excluding grants and privatization	-2.9	-2.8	-2.7	-1.0	-3.0	-3.0	-2.8
Central government balance, including grants, excluding privatization	-2.7	-2.6	-2.6	-0.7	-2.7	-2.9	-2.5
Total government debt (foreign and domestic)	52.5	48.8	45.9	43.3	42.8	43.1	42.7
<b>Money and credit (percent change)</b>							
Credit to the economy	6.3	6.6	9.7	14.0	10.3	11.4	...
Broad money (M3) 3/	11.0	11.4	12.5	14.4	13.0	11.7	...
Velocity of circulation (GDP/M3, deposit money banks)	1.76	1.72	1.62	1.52	1.50	1.45	...
Interest rate (money market rate, in percent, e.o.p) 4/	5.00	5.33	5.10	4.90	4.10	4.05	...
<b>Official reserves</b>							
Gross official reserves (US\$ billions, e.o.p)	4.4	6.8	7.9	9.0	10.6	10.1	10.6
In months of imports of goods and services, c.i.f. 5/	4.0	5.4	5.0	4.4	6.7	6.0	6.1
<b>Total external debt</b>							
External debt (US\$ billions)	18.1	18.5	20.1	20.6	21.4	19.9	20.2
External debt (in percent of GDP)	58.9	52.5	49.3	48.8	48.1	47.9	46.4
Debt service ratio (percent of exports of GNFS)	14.5	18.4	13.2	8.6	11.9	10.7	11.6
<b>Memorandum items:</b>							
GDP at current prices (US\$ billions)	32.3	34.4	38.9	44.9	43.5	43.5	44.7
GDP per capita (US\$)	3,218	3,394	3,807	4,346	4,171	4,125	4,195
Unemployment rate (in percent) 6/	12.8	12.5	12.4	12.6	13.3	...	...
Population (millions)	10.0	10.1	10.2	10.3	10.4	10.5	10.7
Exchange rate: dinar/US\$ (average)	1.30	1.33	1.28	1.23	1.35	...	...

Sources: Tunisian authorities; and staff estimates and projections.

1/ Information Notice System.

2/ Excludes the social security accounts.

3/ Financial system (deposit money banks and development banks).

4/ 2010 data is the money market rate at end-June.

5/ End of year reserves over current year imports of goods and services.

6/ New series based on the ILO definition of the Labor force

**Statement by Mohammed Daïri, Alternate Executive Director for Tunisia  
and Sadok Rouai, Senior Advisor to the Executive Director  
August 27, 2010**

1. **We thank staff for a well-written and innovative report. We would also like to convey to Management and the Executive Board our Tunisian authorities' appreciation for the high quality relationship with the Fund.** Since staff has adequately covered recent developments and medium-term challenges and reforms, and faithfully reflected the authorities' view, **we will focus our statement on the strategy put into action by Tunisia to deal with the fall out of the global crisis.**

2. **Tunisia weathered the global crisis relatively well** (Staff Report ¶2). The country entered the crisis with strong fundamentals following sustained implementation of sound macroeconomic policies and broad structural reforms. By end-2007, both the budget and the current account deficits declined to about 2½ percent of GDP, external debt fell under 50 percent of GDP, and gross international reserves reached the equivalent of five months of imports. 2007 was also the final year of the phasing in of the Association Agreement with the European Union (EU).

3. **As a small, open, export-oriented economy, Tunisia remains vulnerable to external shocks, but it has also gained experience in crisis-prevention.** While recent gains in macroeconomic and financial stability have strengthened the economy's resiliency, the authorities remain vigilant in their macroeconomic management and ready to implement preventive measures.

4. **Soon after the early signs of the financial crisis in the summer of 2007, a crisis-prevention unit was set up in the central bank in late 2007. After the financial crisis became global, in the aftermath of the Lehman Brothers' bankruptcy, with spillover to the real sector in advanced economies, a National Commission, chaired by the Prime Minister, was created in September 2008** with the objective of closely monitoring global economic and financial developments, assessing their potential spillover to the Tunisian economy, and designing a comprehensive crisis-prevention strategy. This strategy focused on the following:

- **Safeguarding foreign reserves** including through the initiation of an active asset management policy of official reserves held by the central bank and a comprehensive audit of the reserves held by banks.
- **Relying mainly on long-term lending from Multilateral Development Banks, in particular the World Bank, and refraining from accessing international capital markets in 2008, 2009, and 2010;** and encouraging local companies to rely on the domestic forex market for the coverage of their needs in foreign currency.

- **Closely monitoring developments in the stock market** and promoting the creation of two funds by public banks to stabilize prices, if needed, and ensure market stability and confidence.
- **Adopting in December 2008 a number of temporary measures** to support local exporters affected by the crisis, including through partial and temporary exemptions from social security contributions, as well as limited fiscal incentives and credit guaranties.
- **Loosening monetary policy**, benefiting from declining inflation, through a reduction in reserves requirement from 10 percent to 7.5 percent at end-2008, followed by a 75 percentage point reduction in the key policy rate in February 2009. At the same time, two new facilities for deposits and borrowing by banks were established in order to improve banks' liquidity management.

5. **The authorities maintained close contacts with Fund management and staff. These contacts were particularly helpful in designing an appropriate fiscal stimulus to counter the depressed external environment.** In this connection, a staff visit in March 2009 was focused on the assessment of the impact on Tunisia of the global crisis. The candid discussions with staff were helpful to the authorities in reaching their decision to implement, in mid-2009, a fiscal stimulus package of 1.4 percent of GDP aimed, in particular, at increasing public investment expenditure and expanding direct support to the export sector.

6. **In April 2009, the issue of Tunisia's access to the newly created FCL was also discussed by staff and the authorities.** The authorities welcomed the new facility and agreed that it could contribute to safeguarding market confidence in the policies and prospects of eligible countries. Nonetheless, they expressed concern about its short duration, which covered only 12 months. Given the above, and because of the absence of any pressing need to borrow on international capital markets, as well as Tunisia's limited exposure to international financial markets, the authorities felt confident that the potential impact of the crisis would be manageable in 2009 because of the high degree of crisis preparedness and the country's relatively comfortable reserves position. However, at that time, the authorities were concerned with the growing spillover of the crisis to Europe and felt that, because of Tunisia's strong linkages with the EU (Staff Report – Appendix 1), the country could be affected by a slowdown in external demand.

7. **In the event, Tunisia's proactive policy response limited the impact of the crisis** (Staff Report ¶¶2, 3). For 2010, real GDP growth is projected to increase by 3.8 percent, benefiting from a strong recovery in demand for manufacturing exports. The budget includes an amount of unallocated expenditure equivalent to 1½ of GDP that could be used, if needed, to provide further support to the economy, with the budget deficit projected to remain at 3.0 percent of GDP. While the current account deficit is projected to grow to 4½ of GDP, the authorities emphasize that a large part of the increase is due to higher investment, one-off imports of transport equipment, and to a pick-up in re-export activity, and is largely covered by FDI.

8. **Going forward, the authorities remain vigilant.** After the inception of the sovereign debt crisis, a Ministerial Monitoring Committee was established in May 2010 to assess any risk of contagion and make the necessary policy adjustments. The authorities are cognizant that the post-crisis international environment will add to the challenges facing Tunisia as an emerging market economy. However, they are comforted by the recent inclusion of Tunisia in the Fund's Financial Transaction Plan. They are confident that the 2010–2014 Development Plan, recently approved by Parliament, will reinforce the fundamentals of the Tunisian economy. The Development Plan targets important reforms, in particular in the financial sector (Staff Report – Appendix 3), and in the pension and tax systems, while aiming at further diversification of the economy and liberalization of the capital account and the services sector.