

**Tunisia: Request for a Stand-By Arrangement—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Tunisia.**

In the context of Tunisia’s Request for a Stand-By arrangement, the following documents have been released and are included in this package:

- The staff report on Tunisia’s request for a Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on April 15, 2013, 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 May 24, 2013. 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 Press Release summarizing the views of the Executive Board as expressed during its June 7, 2013 discussion of the staff report that completed the request.
- A statement by the Executive Director for Tunisia.

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

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

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

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**International Monetary Fund  
Washington, D.C.**



# TUNISIA

## REQUEST FOR A STAND-BY ARRANGEMENT

May 24, 2013

### EXECUTIVE SUMMARY

**Background.** After the sharp economic decline following the revolution, the Tunisian economy has embarked on a moderate recovery in 2012 while facing a challenging international economic environment and persistent domestic and social tensions. The deteriorating current account deficit—caused partly by falling demand from Europe—has been financed by sustained donor financing, strengthened FDI and market access, which helped increase reserves (but to a level still below 2010). Fiscal space has been reduced to meet pressing social and investment needs, although public debt remains at sustainable levels. A fragile banking sector, widespread social and economic disparities, and high youth unemployment are key challenges. Addressing these challenges in the midst of a political transition remains demanding.

**The authorities' program.** The priorities under the program were first set in the post-revolution government's medium-term economic agenda, which aimed at achieving short-term stabilization goals while laying the foundations for stronger growth and social cohesion. Key elements of the strategy are to: (i) build up fiscal and external buffers with appropriate fiscal, monetary, and exchange rate policies; (ii) lay building blocks to support growth by addressing critical vulnerabilities in the banking sector and improving the investment climate through reforms of the tax and investment regimes; and (iii) strengthen social safety nets to protect the vulnerable.

**SBA Request.** In support of their program, the Tunisian authorities have requested a two-year Stand-By Arrangement in the amount of SDR 1.15 billion (400 percent of quota, about US\$1.75 billion), with 34 percent of quota available upon Board's approval. The size and timing of disbursements should ensure that the arrangement provides enough buffers in case external shocks materialize.

**Risks.** The program carries substantial risks linked to a deterioration of the international economic environment, a worsening of the security situation, setbacks in the political transition, or delays in external financing. Quarterly reviews would allow for early remedial actions in case of slippages.

Prepared By  
**the Middle East and  
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Approved By  
**Daniela Gressani and  
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The team comprised Amine Mati (head), Giorgia Albertin, Karsten Junius, Lorraine Ocampos (all MCD); Jean Frederic Noah Ndela Ntsama (SPR), Khaled Abdelkader (COM), and Joaquin Gutierrez Garcia (MCM). The mission was joined by Abdelali Jbili and Moez Ben Hassine (OED). During January 15-February 4 and April 8–15, 2013, Staff met with the Governor of the Central Bank, the Minister of Finance, the Minister of Development and International Cooperation, the Minister of Commerce, the Minister of Industry, the Minister of Labor, the Minister of Social Affairs, other senior officials, and representatives of workers' unions, of the corporate and banking sector, of the diplomatic and donor community, political parties, civil society, academia, media, and Parliament (including members of the opposition).

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## BACKGROUND AND POLITICAL CONTEXT

1. **The economic crisis following the January 2011 revolution and a variety of external shocks increased vulnerabilities of the Tunisian economy.** Real GDP contracted by 2 percent in 2011, with foreign direct investment (FDI) and tourism receipts declining by more than 30 percent year-on-year. The economic downturn—coupled with the return of Tunisians from Libya—brought unemployment to record levels and weakened an already fragile financial sector. In response, the authorities implemented an expansionary fiscal and monetary policy mix—including higher wages and subsidies, lower policy rates and reserve requirements, and relaxed regulatory forbearance measures—to mitigate the effects of the recession on households and respond to social demands. A wider current account deficit, coupled with a defense of the exchange rate, resulted in a 20 percent loss in reserves in 2011, despite important bilateral and multilateral budget support.
2. **Tunisia has moved forward with its political transition.** Since the overthrow of former President Ben Ali, Tunisia successfully held its first democratic elections for a National Constituent Assembly in October 2011, and has had two coalition governments since, both led by the once-banned Islamic Ennahda party. The appointment of independents at the head of sovereign ministries has contributed to reducing political tensions that followed the assassination of a well-known opposition politician last February. That political crisis was the main driver of the latest rating downgrades, taking Tunisia's debt rating below investment grade. Since then, a draft of the new constitution was completed and is expected to be approved by the Constituent Assembly in July. Agreement appears to have been reached on a mixed parliamentary/presidential system and a consensus is emerging on the holding of elections before the end of the year.
3. **Widespread social and economic disparities and high youth unemployment remain key challenges.** While Tunisia's pursuit of relatively prudent fiscal and monetary policies and open trade policies over the past two decades allowed it to record the highest per capita real GDP growth among MENA oil importers, its macroeconomic management relied on extensive state intervention and fostered the development of an export-oriented, low-value added industry that is intensive in unskilled labor. This model—characterized also by an inefficient banking sector, pervasive price and capital controls, directed lending, weak governance, and rigid labor markets—led to high structural unemployment (particularly among the youth where it was averaging 30 percent in 2010), unfair distribution of economic gains among the population, and widespread disparities across regions.
4. **Tunisia's pursuit of reforms in the middle of a political transition process faces important risks.** Comprehensive economic reforms are needed in the immediate future to overcome Tunisia's structural rigidities and promote inclusive growth. Many of these reforms will generate resistance from vested interests, requiring time and effort for building broad political support. Moreover, these reforms may not yield benefits immediately despite the high aspirations of the population following the January 2011 revolution. As a result, the reform process faces both the risk of delayed implementation and increased social tensions. Other sources of risk include escalation of domestic tensions from political uncertainty—for instance, through a delayed electoral

process—or security concerns. Continuous vigilance by the authorities, coupled with steady support from the international community, will be needed to carry the implementation of the reform agenda through the political transition process.

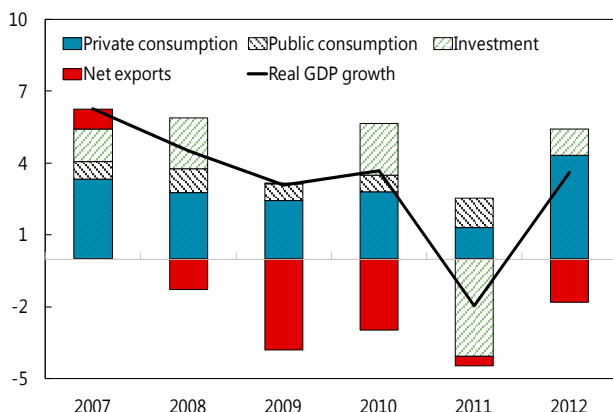
## RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

**5. After the sharp decline in 2011, the Tunisian economy has embarked on a moderate recovery in 2012, despite a challenging international environment and persistent domestic security and social tensions** (MEFP, ¶1–6, Tables 1–6, and Figures 1–2).

- Helped by base effects early in the year, tourism and FDI have rebounded (a 34 percent and 28 percent y-o-y increase), pushing 2012 overall real GDP growth to 3.6 percent. The overall unemployment rate improved, narrowing from 18.9 percent at end-2011 to 16.7 percent at end-2012, but youth and female unemployment remained high at 33 and 24 percent, despite new public-sector jobs and the government’s insertion programs for the unemployed.

**Contribution to Growth, 2007-12**

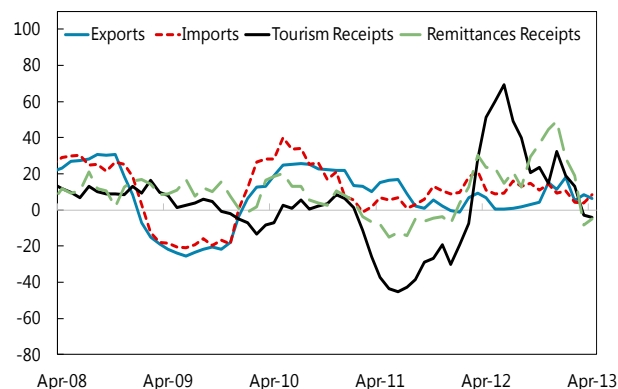
(In percent)



Sources: Tunisian authorities; and IMF staff estimates.

**Key Indicators of Economic Activity**

(y-o-y growth, 3-month average, in percent)



Source: Tunisian authorities.

- After having reached 5.9 percent y-o-y at end-2012, headline CPI inflation rose further to 6.4 percent at end-April 2013, mainly a reflection of increasing food prices, constraints in the distribution system, and additional demand originating from neighboring countries. However, core inflation (excluding food and energy) remained stable over the past nine months (below 5 percent since September 2012), reflecting decelerating credit growth and the Central Bank of Tunisia (CBT)’s move towards a tighter monetary stance (see below).

### Box 1. Tunisia: A Rise in Inflation as Food Prices Decoupled from International Prices

**The increase in headline inflation from 5.1 percent in January 2012 to 6.4 percent in April 2013 is mainly explained by higher food and energy prices.** For energy, all of the increase reflects recent rises in administered prices of petroleum products and energy tariffs, while food price rises reflect increases in non-administered prices. Overall, administered prices remained more subdued over the period (4.3 percent y-o-y) than non-administered prices (7.3 percent y-o-y).

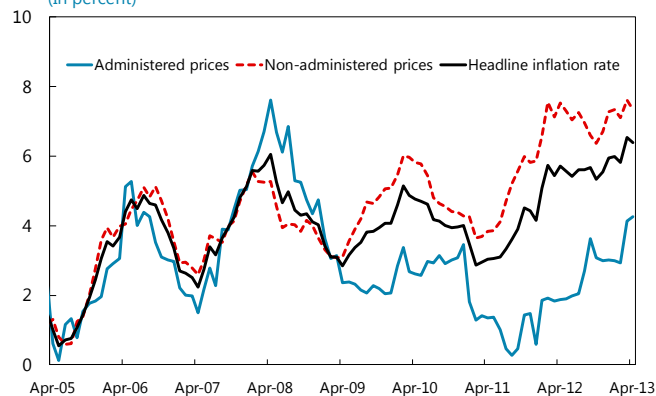
#### Domestic factors explain the increase in food prices in Tunisia, which have decoupled from international prices.

Between end-2004 and end-2010, Tunisian prices of agricultural goods and processed food products moved in tandem, increasing between 30 and 32 percent in total. Correlation with international prices was high, with non-administered food prices in Tunisia increasing by 0.58 percent for each percentage point increase in agricultural raw material prices and by 0.36 percent for each percentage point increase in international food prices. The relationship broke after the revolution, with international food prices increasing by merely 1 percent over the past two years, while non-administered food prices in Tunisia increased by 17 percent. This divergence is even more striking because world market prices for agricultural raw materials declined by 10 percent during the period. Three factors have likely contributed to these asymmetric developments:

- A large number of refugees and returning Tunisian migrant workers who fled the civil war in Libya have boosted domestic demand for food products;
- Intensified informal trade with neighboring countries that have higher food prices reduced the supply in Tunisia;
- The control mechanism over the distribution system of food products broke down.

#### Inflation Rates

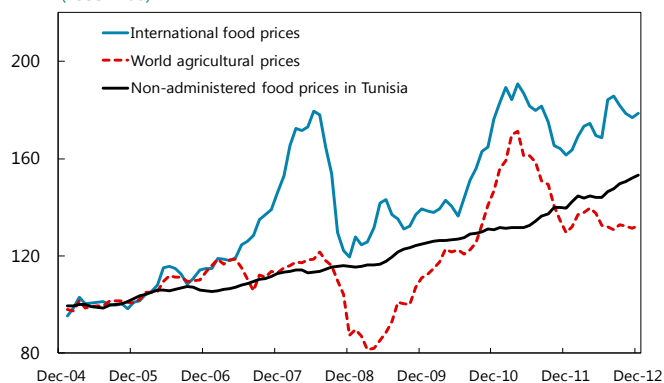
(In percent)



Sources: Tunisian authorities; and IMF staff estimates.

#### Food prices and world market prices

(1995=100)

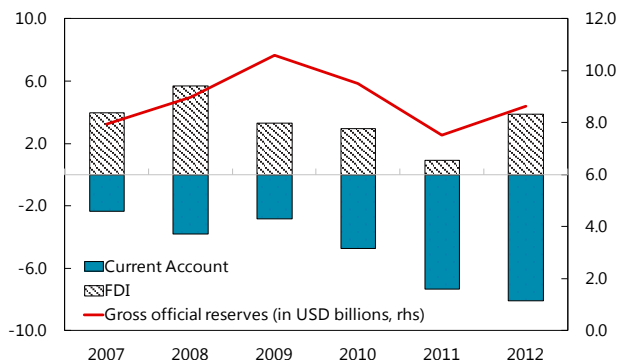


Sources: Tunisian authorities ; and IMF staff estimates.

- The current account deficit worsened to about 8.1 percent of GDP in 2012, driven by falling demand from Europe and an across the board increase in imports (except food products), which overshadowed the recovery in tourism and remittance receipts (by 34 percent y-o-y and 22 percent y-o-y, respectively) and despite some exchange rate depreciation (about 3 percent in real effective terms). Strengthened FDI inflows, sustained multilateral and bilateral loans, and access to capital markets (with U.S. Treasury and Japan Bank for International Cooperation (JBIC) guarantees) boosted reserves to about \$8.6 billion in 2012 (i.e., 3.8 months of imports, but still 20 percent below 2010 levels).

**Current Account, FDI and Reserves**

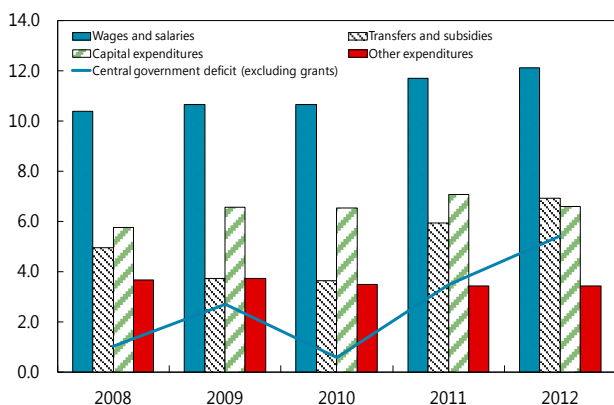
(In percent of GDP)



Sources: Tunisian authorities; and IMF staff estimates.

- Higher current expenditures—mostly subsidies and wages—and lower non tax revenues characterize a looser fiscal policy in 2012. As a result, the overall fiscal deficit increased to 5.4 percent of GDP—2 percentage points higher than in 2011—though lower than planned in the supplementary budget. The lower-than-budgeted deficit was mostly due to stronger tax collection, arrears accumulation (due to delays in processing payments owed to energy companies), and under-execution of capital spending linked to capacity constraints at the regional level and delayed adoption of the revised budget law. The deficit was largely financed by bilateral and multilateral loans, with public debt levels remaining broadly constant at 44 percent of GDP, helped by favorable growth dynamics.

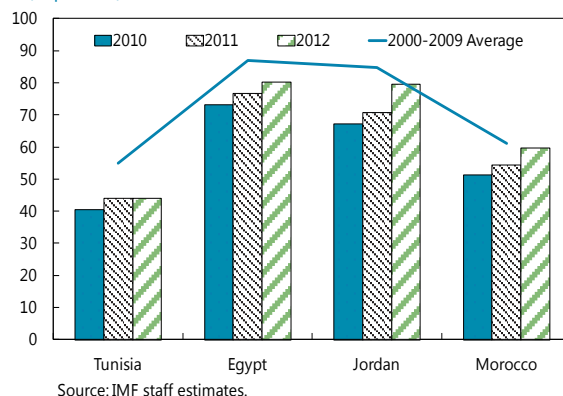
**Central Government Budget Deficit and Expenditures, 2008–12**



Source: IMF staff estimates and projections.

**Public Debt, 2010–12**

(In percent)



Source: IMF staff estimates.

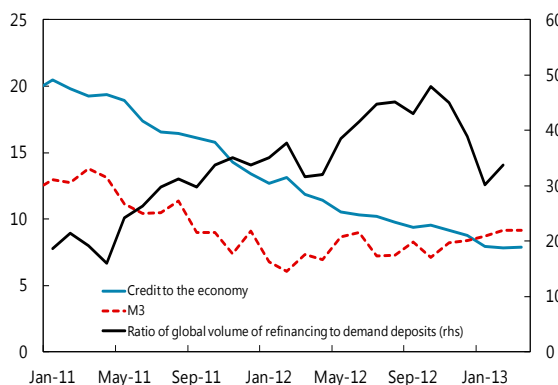
- CBT monetary policy remains accomodative, in line with the current environment of a large negative output gap and relatively stable core inflation. However, having stepped up its



refinancing of banks for most of 2012 (a 53 percent y-o-y increase in the first 10 months of 2012), the CBT has tightened monetary policy recently. As a result, the CBT reduced its direct refinancing of banks by 36 percent during the October 2012–April 2013 period and responded to rising inflation by: (i) increasing its benchmark policy rate by 50 bps since August 2012 (to 4 percent), which still implies a negative real interest rate of -2.4 percent; (ii) modifying the interest corridor for the 24-hour standing facilities from +/-50 bps around the policy rate to +75/-25 bps and letting the interbank rate increase to 70 bps above the policy rate; and (iii) implementing tighter reserve requirements for consumer credit.

**Growth in M3 and Credit to the Economy, 2011-13**

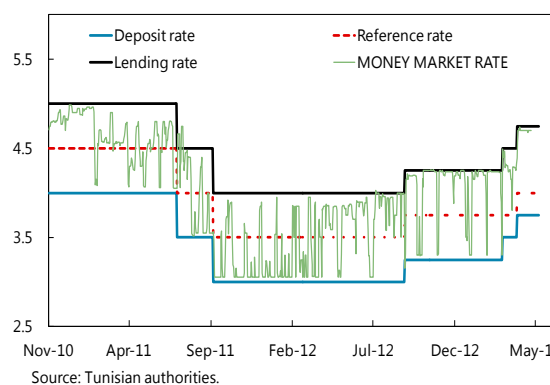
(y-o-y growth, in percent)



Source: Tunisian authorities.

**Money Market and CBT Policy Rates**

(In percent)



Source: Tunisian authorities.

- Deteriorating loan quality and profitability exacerbate existing bank vulnerabilities (Table 6). Lack of reliable and regularly reported data limits staff's ability to fully assess the current condition of the banking system. However, preliminary estimates indicate that end-2012 nonperforming loans (NPLs) likely rose to 17–18 percent of total loans to account for the reclassification of loans rescheduled in 2011 as overdue loans (end-September data indicate that NPLs were at 13.5 percent of total loans). At 12.3 percent, capital adequacy ratios appear sound, but could prove to be inadequate because average bank provisioning (about 57 percent) is low. Deposit growth has only recently picked up (4 percent q-o-q in the first quarter of 2013), reducing the need for central bank refinancing, and improving liquidity ratios that were often below prudential norms over the past two years. Banking sector intermediation margins are coming under pressure from increased competition and tighter consumer lending regulation.

## THE SBA-SUPPORTED PROGRAM

*The authorities' program priorities were set in the post-revolution government's medium-term economic agenda established in close cooperation with the World Bank and other budget support partners. In light of these priorities, it was essential that the Fund-supported program preserve macroeconomic stability while supporting growth and social cohesion. This allowed staff and the*

*authorities to quickly reach consensus on the main objectives of the program and a two-year macroeconomic and financing framework. Discussions focused on the pace of reforms and program modalities. To allow for more flexibility and to remain prudent in external financing assumptions, the focus of the discussions turned from a precautionary to a disbursing SBA.*

**6. The overriding goals of the Fund-supported program** are to address short-term stabilization goals while laying foundations to support growth and protect the vulnerable. The program combines a package of strong policy measures and structural reforms, coupled with external financing support; together these are expected to reduce the vulnerabilities arising from the difficult international economic environment and the ongoing political transition, and to provide the foundation for a return of investor confidence. Key elements of the strategy are to:

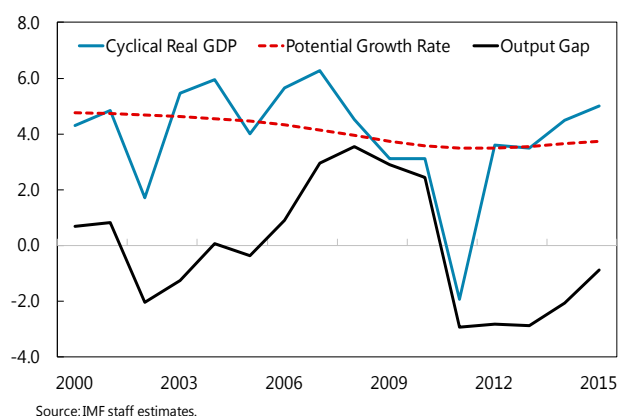
- **Strengthen fiscal and external buffers** that were eroded by the global crisis and the uncertain post-revolutionary political environment. Key measures include: (i) an appropriate fiscal policy that creates space for one-off costs (such as banking recapitalization) and investment spending while avoiding crowding out private-sector credit; (ii) a prudent monetary policy aimed at containing inflation; and (iii) greater exchange rate flexibility to preserve reserves in the face of important exogenous shocks.
- **Lay the building blocks for growth** by first addressing critical vulnerabilities in the banking sector that were accumulated after years of directed and insider lending, substandard norms, and weak banking supervision. Second, engaging in a medium-term fiscal consolidation that allows for a better composition of expenditures—including sustained public investments—will contribute to laying the foundations for stronger and more inclusive growth. Finally, an ambitious structural reform agenda will allow for rebuilding Tunisia’s economic model by promoting private-sector development, lowering regional disparities, and reducing pervasive state intervention.
- **Protect the most vulnerable** by strengthening social assistance mechanisms and undertaking a systematic assessment of the social impact of the envisaged reforms. These measures, in addition to the improved composition of public expenditures, will contribute to reducing income disparities.

## A. Macroeconomic Framework

**7. Staff and the authorities agreed that the program’s macroeconomic framework should be built on a robust and sustainable growth path, declining inflationary pressures, a narrowing current account deficit and a reserve buildup.** A key assumption is that investor confidence will strengthen once elections are held and a more predictable political environment emerges after the election.

- Growth.* For 2013, economic growth is boosted to 4 percent by a return of industrial production towards pre-crisis levels, especially in the mining sector, and a continuation of the recovery in the tourism sector. Private and public consumption, which are benefitting from strong wage increases and a decline in unemployment rates, will be the major driving force for growth, along with the realization of public investment programs. Import growth will remain subdued, with high demand for machinery and intermediate inputs compensating somewhat slower consumer goods imports. By 2014, growth is expected to pick up in line with a post-elections environment that should considerably lessen investor uncertainty. As FDI and domestic demand pick up, growth overshoots in 2015, allowing the output gap to close by 2016 (text chart). The implementation of structural reforms in the financial sector and labor markets, and an improved business environment would boost private investment and push potential output growth in the medium term upwards to slightly above the average of 4.5 percent observed in the 10 years preceding the revolution.
- Inflation.* For 2013, headline inflation is expected to remain elevated, peaking slightly above 6.5 percent by mid-year following increases in administered fuel prices, before declining to 5.3 percent by end-year. Core inflation (CPI excluding food and energy) will remain around 4.5 percent. In the medium term, staff and the authorities expect CPI inflation to gradually converge to 4 percent thanks to a prudent monetary policy.
- External position.* Over the next year, the current account deficit will narrow to about 7.5 percent of GDP, and will stabilize to around 5 percent of GDP in 2015. Weak but slowly improving demand from the euro zone, and the resumption of mining production, will increase exports. In the medium term, the current account deficit will contract further, reflecting stronger exports, tourism, and remittance inflows, and lower commodity prices. Moreover, private capital inflows and FDI are expected to improve significantly over the program period, thereby keeping gross reserves at above three-month import coverage. Under staff's scenario, Fund resources will keep the 2013 import coverage to 2012 levels, and will boost it above four months during the course of the program, thus allowing sufficient cushions in case of shocks and providing the needed confidence to markets (see below).

Output Gap and Potential Growth



Tunisia: Selected Economic Indicators, 2009–15

	2009	2010	2011	Prel. 2012	Est. 2013	Proj. 2014	Proj. 2015
Real GDP growth (percent)	3.1	2.8	-1.9	3.6	4.0	4.5	5.0
CPI inflation (period average, percent)	3.5	4.4	3.5	5.6	6.0	4.7	4.7
Current account balance (percent of GDP)	-2.8	-4.8	-7.3	-8.1	-7.5	-6.0	-5.1
Gross official reserves (US\$ billions, eop)	10.6	9.5	7.5	8.6	9.0	10.8	11.9
Gross official reserves (in months of next year's imports)	5.2	4.4	3.4	3.8	3.8	4.2	4.5

Sources: Tunisian Authorities; and IMF staff estimates.

**8. Growth and balance of payments risks are tilted to the downside, but inflation risks are more balanced.** An escalation of domestic social tensions, increasing political uncertainty ahead of the elections, or domestic and regional security concerns would impede domestic and foreign investment. Also, stalled or incomplete delivery of Euro area policy commitments or depressed world demand, would add another drag on growth and the external position. On the upside, the authorities point out that the setting of a clear political calendar and increased public investment, coupled with the credibility associated with a Fund-supported program, could rapidly restore consumer and investor confidence. Risks to the inflation outlook are more balanced. Further wage rises would boost headline inflation, while a normalization of distribution channels and the political environment in neighboring countries could reduce inflation more than expected.

## B. Short-Term Goals: Restoring Fiscal and External Buffers

*Staff and the authorities agreed on the need to strike the right balance in the short term between supporting the recovery and improving fiscal and external buffers.*

### Fiscal policy

**9. Important banking recapitalization needs and repayment of arrears require a wider fiscal deficit in 2013, while the underlying fiscal stance remains broadly constant.** The 2013 budget had planned on a modest adjustment relative to 2012 and an improvement in the underlying fiscal balance, which is not materializing on account of the lower-than-budgeted deficit in 2012. That said, staff considers that the fiscal stance underlying the 2013 budget remains appropriate because it accommodates high social spending and investment needs—against the background of large unemployment rates and regional disparities—taking due account of financing constraints and debt sustainability considerations.

Tunisia: Selected Fiscal Indicators  
(In percent of GDP)

	Rev. Budget 2012	Prel. 2012	Budget 2013	Est. 2013
Revenue	23.6	23.1	23.3	23.8
<i>Of which:</i> Tax revenue	20.4	21.1	21.3	21.8
Expenditure	31.5	29.0	30.4	30.8
<i>Of which:</i> Transfers and subsidies	6.4	6.9	7.3	7.2
Repayment of arrears	0.0	0.0	0.0	0.9
Capital expenditure	8.8	6.6	6.7	6.4
Public banks' recapitalization	0.0	0.0	0.1	0.6
Central government deficit (-) (excl. grants)	-8.1	-5.4	-7.1	-7.3
Structural fiscal balance	...	-4.7	...	-5.0
General government debt	44.8	44.0	46.8	45.3

Sources: Tunisian authorities; and IMF staff estimates.

At 7.3 percent of GDP, the 2013 overall deficit remains close to the budget target, with a structural fiscal balance at about 5 percent of GDP and a better spending composition. Staff and the authorities agreed that in case of revenue shortfall, offsetting measures to attain the fiscal target will concentrate on nonessential current spending and revenue measures, while preserving capital and social expenditures (MEFP, ¶12). Maintaining the 2013 fiscal stance required additional measures to compensate for one-off additional spending not planned in the 2013 budget:

- Banking recapitalization needs and arrears repayment:** These amount to 1.5 percent of GDP, and are mostly compensated through savings in unallocated budget expenditures, lower nonessential current spending and higher-than-budgeted revenues, which reflected a wider tax base coming from increased tax revenue collection in 2012.
- Financing.** Financing needs will mostly be met through deposit drawdown (following a large accumulation of deposits at the end of 2012) and external financing, mainly through access to international markets and multilateral loans. Domestic bond issuance will be lower than budgeted to avoid crowding out private-sector credit growth. Banking recapitalization needs will be financed through non-negotiable bonds.

Tunisia: Financing Needs, 2013  
(In percent of GDP)

	Budget	Est.
Central government deficit (excluding grants)	7.1	7.3
Amortization on external debt	2.0	2.0
Amortization on domestic debt	1.7	1.8
Financing needs	10.7	11.1
Financing	10.7	11.1
Privatization	1.5	1.9
External financing	5.6	5.1
Grants	0.5	0.5
DPL	1.6	1.6
Project financing	0.9	0.9
Samurai bonds and other market financing	1.3	0.8
Sukuk	0.8	0.8
Domestic financing	3.7	4.1
Of which: Bond issuance	2.3	1.8
Recapitalization bonds	0.1	0.6

Sources: Tunisian authorities; and IMF staff estimates.

## Monetary and exchange rate policy

**10. Monetary policy will continue to aim at containing inflationary pressures.** The authorities are working on the prerequisites needed to move towards an inflation-targeting framework. In the meantime, broad money growth remains the intermediate monetary target of the CBT. Given low private-sector credit growth rates and the negative output gap, both staff and the authorities consider the CBT policy rate to be at an appropriate level. However, to ensure that the CBT policy rate remains an effective signaling tool, staff considers it important that CBT interventions in the interbank market keep the money market rate in line with the policy rate and not consistently close to the upper limit of the corridor, as is the case today. Staff and the authorities agreed that the CBT should stand ready to tighten monetary policy to restrain stronger inflationary pressures and better anchor inflation expectations, particularly if wages and core inflation rise more rapidly than expected. The setting up of a monetary policy committee last January is facilitating the forward-looking assessment of inflationary pressures.

**11. A gradual unwinding of liquidity injections has been initiated, while banks' financial situation is being carefully monitored.** The banking sector has been facing significant structural liquidity needs since the beginning of the revolution, when the demand for cash increased, asset quality deteriorated, and a sizable amount of deposits were withdrawn from the banking system. Over the past few months, the CBT has reduced banks' dependence on direct central bank

refinancing, including through providing liquidity directly through its outright purchase of government bonds in the secondary market, which improved interbank money transactions. Demand for central bank refinancing has been reduced by increasing consumer deposits spurred by the retirement of old dinar notes. It might decrease further as the ceilings on deposit rates have been eliminated (MEFP, ¶15). Improvements in the liquidity framework will also entail:

- **Establishing a sound collateral management framework to minimize risks to the CBT balance sheet and encourage banks to manage their liquidity in a more forward-looking way** (Box 2). This would involve progressively increasing the share of borrowings collateralized by government securities to a minimum of 20 percent for each bank by the end of 2013, and to 40 percent in 2014. In parallel, a haircut system for bank loans eligible for CBT refinancing will be introduced. A lender of last resort facility, charging penalty interest rates, will also be launched to accompany these reforms and ensure that illiquid but solvent banks still have access to CBT refinancing.
- **Improving liquidity forecasts.** The CBT will successively increase the forecast period, analyze reasons for deviation, and strengthen coordination with the Ministry of Finance through weekly committee meetings.

**12. More exchange rate flexibility is crucial for maintaining external buffers and reducing liquidity injections.** The modification, earlier in 2012, of the CBT's mode of intervention, and the setting of a reference exchange rate quoted in the interbank market instead of a fixed currency basket, gave new flexibility to the exchange rate. This modified form of intervention helped reduce reserve losses (US\$2 billion in the first four months of 2012), and led to a 5 percent depreciation of the dinar vis-à-vis the dollar so far in 2013. However, the exchange rate remained stable following CBT intervention in the days immediately following the February 2013 political crisis and a series of rating downgrades. The CBT argues that those interventions (on the sell side) were necessary to smooth out large foreign exchange fluctuations that would have resulted at a time when there were large current account transaction needs. Staff also noted that the real exchange rate is modestly overvalued according to latest CGER methodologies (see text charts). The authorities agreed that the exchange rate was moderately overvalued by March 2013 but judged that the recent depreciation of the exchange rate helped correct part of the overvaluation.

Exchange Rate Assessment Using CGER Panel Estimates

	Underlying CA		REER misalignment
	balance 1/	CA norm	
MB approach 2/	-5.1	-1.0	13.4
ERER approach	...	...	5.3
ES approach	-5.1	-3.2	6.1

Overvaluation (+); undervaluation (-)

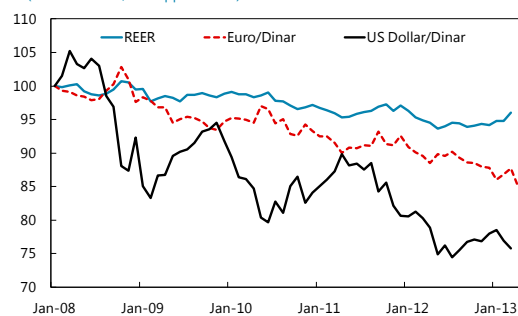
Source: IMF staff calculations.

1/ In 2018 corrected from program adjustment.

2/ Based on an elasticity of the CA/GDP with respect to the REER of -0.30.

Exchange Rates, 2008-13

(Jan. 2008=100, + = appreciation)



Sources: Tunisian authorities; and IMF staff estimates.

### Box 2. Tunisia: Monetary Policy Framework: Collateral Policy and Lender of Last Resort

The CBT uses a number of instruments to guide market conditions consistent with its short-term interest rate operating target: reserve requirements, an interest rate corridor (standing lending and deposit facilities), weekly refinancing operations, and outright Open Market Operations (OMOs). The CBT has successfully used these instruments to manage liquidity conditions during the global financial crisis and in the challenging domestic environment. However, there are aspects of the design and use of these instruments that: (i) undermine the incentives for banks to manage their risks, (ii) expose the CBT's balance sheet to credit, market, and liquidity risks, and (iii) create impediments to the functioning of the money market.

**Refinancing operations are open to all banks, with the CBT accepting a wide range of collateral on equal terms, at face (not market) value and without a haircut.** The CBT Law grants the CBT general authority for lending to meet credit distribution or monetary policy goals, but it does not distinguish between these two objectives; nor does it explicitly mention any liquidity support for temporarily illiquid banks.

**At the end of April 2013, TND 2.7 billion was extended to banks through the direct refinancing of banks (excluding OMOs amounting to about TND 930 million), of which about 52 percent was covered by bank loans.** The CBT accepts government securities and certain loan categories as eligible collateral. The CBT accepts the highest grade of performing loans, ensuring there is a sufficiently large amount of eligible collateral to refinance credit to the economy. The CBT differentiates on the basis of sectors: for example, tourism loans are accepted, while housing mortgages are not, even though mortgages may be of better credit quality.

**A sound collateral framework is needed to minimize risks to the CBT's balance sheet, while encouraging banks to manage their liquidity prudently.** Key focus should be to introduce a haircut system for loans used as collateral in the CBT's refinancing operations, while requiring an increasing share of government securities used as collateral by each bank. By doing so, the CBT will: (i) protect its balance sheet; (ii) encourage the banking sector to better manage its liquidity, market, and credit risks; and (iii) promote differentiated assets on the basis of credit risks.

**A new collateral framework should be accompanied by a Lender of Last Resort Facility.** The CBT does not consider its function as lender of last resort (to solvent but temporarily illiquid banks) separately from its monetary operations. Under the current arrangements, banks have little incentive to restructure their balance sheets. However, progressively increasing haircuts for eligible collateral for standard refinancing operations may impel some banks to look for alternate funding sources. This lender of last resort facility should: (i) be for solvent but illiquid banks; (ii) be structured so that there is incentive for banks to first seek funding from all other sources; and (iii) be more expensive than other CBT operations. However, care is needed to ensure that the arrangements do not push otherwise illiquid but solvent banks into insolvency.

**13. Staff and the authorities agreed on key reforms needed to strengthen the functioning of the foreign exchange market.** The first key measure is to put in place a computer connecting platform among banks and a market maker agreement, which will allow a move towards a weekly foreign exchange auction system by 2014 (MEFP, ¶16). At the same time, the CBT is limiting its interventions to smoothing excessive exchange rate fluctuations.

**14. Measures introduced in 2012 to limit the deterioration of the current account deficit are being phased out.** Concerns about a deteriorating current account deficit prompted the Tunisian authorities to introduce restrictions on consumer lending (e.g., a 50 percent reserve requirement was imposed on banks that have higher levels of consumer loans outstanding than at end-September 2012 levels). The authorities argue that these measures had the desired impact of slowing down consumer loans, although staff did not consider these as the main cause of the deteriorating current account deficit (they only account for 10 percent of imports). Both staff and the authorities agree that these measures should be used primarily for financial stability reasons, because they are distortionary and unlikely to be effective in the long term. As a result, the authorities have already reduced the additional reserve requirement to 30 percent and have announced a clear phase out criteria (linked to coverage ratio of consumer goods imports) to reassure private operators that the measure is temporary. The authorities confirmed that they will only impose import surcharges if absolutely necessary and subject to a clear phase-out criterion.

### C. Laying the Foundations for Supporting Growth

*The program aims at addressing deep-rooted vulnerabilities of the banking sector to ensure it can play its proper financial intermediation role, introducing building blocks for growth-supporting fiscal consolidation, facilitating the restructuring of the economy, and improving the business environment.*

#### Financial sector reforms

**15. Remediating the critical vulnerabilities of the banking sector is crucial to strengthen banks' capacity to support the recovery of the Tunisian economy.** A vast reform agenda has been initiated to align banking practices with international norms. Measures already introduced or announced (MEFP, ¶18)

include the introduction of collective provisioning, tighter credit concentration ratios, higher capital adequacy ratios for the next two years, a new governance framework for all banks (supported by World Bank technical assistance). Staff and the authorities

agreed that reforms should aim at ensuring that the banking system plays its proper financial intermediation role, including efficient credit allocation and careful monitoring of credit, liquidity, and profitability risks. Over the next two years, the authorities' program in this area has four critical components:

- **Addressing vulnerabilities of public banks.** Tunisia's three public banks, representing about 40 percent of total banking system assets, have been hampered by weak lending practices, governance issues, and exposure to a tourism sector that has been severely affected by the impact of the revolution after January 2011. Mindful of these ongoing risks,

Tunisia: Key Indicators of the Banking Sector (September 2012)

	Public Banks	Private Banks
Nonperforming loans (NPL) in percent of total loans	17.8	10.6
NPL net of provisions in percent of total loans	9.1	4.3
Provisions and reserves in percent of NPL	53.4	62.4
Liquid assets in percent of short-term liabilities 1/	84.9	91.5
Return on assets (ROA) 1/ 2/		0.8
Return on equity (ROE) 1/ 2/		10.9

Source: Tunisian authorities.

1/ Data per end-December 2012.

2/ Data for public and private commercial banks.



the authorities commissioned a strategic and financial audit of public banks that is expected to start in June 2013. The authorities will use the preliminary audit report to decide by mid-September on the business model to be retained for these banks. The authorities are ready to provide the needed financial resources to meet any recapitalization needs. At this stage, the amount planned for the next two years represents the latest estimates for public banks (2.6 percent of GDP) detailed in the latest FSSA, assuming that private shareholders of public banks (about 49 percent) are not contributing. The final recapitalization amount will be revised up or down depending on the strategy chosen. Staff encourages the authorities to consider all options when designing the strategy, including options to merge banks, keep as is and recapitalize, reduce state participation or bank resolution. Higher recapitalization costs could also arise as data quality improves and prudential norms move to international standards. Resolving the issue of NPLs in the tourism sector, an issue of particular importance for one of the large public banks, is also a priority (MEFP ¶119; Box 3).

- **Strengthening banking supervision.** The CBT has started rigorously applying sanctions on banks in breach of prudential norms and is substantially increasing the financial and human resources allocated to banking supervision. Such resources will allow for a full onsite inspection of a large bank by end-year (the first since 2006) and four credit risk inspections, which, along with an updated stress test of the banking system, will update the financial situation of the banking system, last identified in last year's FSSA. The Central bank is also working on improving compliance with existing liquidity prudential norms, which are expected to become even more stringent once international standards are applied. A study on the impact on banks of changing mandatory liquidity ratios to international standards will be prepared by end-December (structural benchmark). Fund technical assistance will also help in strengthening onsite and offsite inspections.
- **Improving poor data quality and provision.** A new data reporting system covering all accounting, financial and institutional aspects of banks will be designed by August 2013. The implementation of such a system is essential to ensure that bank monitoring is done accurately, regularly, and promptly enough to allow the banking supervisor to take appropriate corrective actions. In the same vein, the modernization of the Public Credit Registry has been initiated and the implementation of a Deposit Insurance Scheme is being programmed by the CBT.
- **Setting up a banking resolution mechanism,** with IMF technical assistance (TA). The Tunisian banking system has not had a systemic financial crisis. However, there are no crisis contingency plans in place, either at the CBT or at the Ministry of Finance, to deal with a banking failure. This would be important as four (of which two are state-owned) out of 21 banks control 50 percent of the banking system assets; the failure of one bank could possibly affect depositors' confidence in the system. The program envisages putting in place such a mechanism in the forthcoming revision of the banking law, scheduled to be performed within a year.

### Box 3. Tunisia: Tourism Debt and Asset Management Company

*The authorities are drafting a law to establish an Asset Management Company (AMC) whose goal is to resolve the problem debts of the tourism sector and restore its profitability. After examining various debt restructuring options, an AMC approach was preferred to a creditor-led approach because of need to have a strong entity with fast track powers to resolve the debt and a preference for a centralized mechanism.*

**Tourism sector.** It plays a key role in Tunisia's economy, contributing 7 percent of GDP and employing about 400,000 people directly or indirectly (about 15% of total employment in Tunisia). Over the past decade, the sector started suffering from structural weaknesses as the initial low-cost "all-inclusive" model became more saturated, combined with an overreliance on debt, a dependence on state-owned banks for financing, and weak corporate governance. Although tourism inflows have recovered from the uncertainty immediately following the revolution, revenues are still 35 percent below 2010, keeping the industry's financial situation precarious.

**Banks' exposure.** Out of 21 commercial banks, 15 are exposed to the tourism sector, with one main state-owned bank being by far the largest credit provider. Loans to the tourism sector represent slightly less than 10 percent of the banking system's total loan portfolio, but account for about 25 percent of the banking sector's NPLs. Moreover, after growing by 25 percent over the past year, NPLs in the tourism sector make up close to 40 percent of the total tourism sector loan portfolio. These numbers will rise further when tourism loans that were rescheduled in 2011 are reclassified as nonperforming.

**Rationale for an AMC.** Establishing an AMC would help dispose of nonperforming bank assets, improve the viability of participating banks and their ability to refocus on lending activities, and allows for a centralized organized approach to recovering a higher share of the loan amounts. Country cases showed that the success of an AMC is contingent on good governance policies, transparency, purchase of loans at prices allowing swift resolution, and the realization of losses in banks whenever the transfer price is below the net book value.

**AMC modalities.** The AMC will buy bad assets in exchange for government-guaranteed bonds, which will remain within the guarantee ceiling included in the budget. The initial capital, expected to be small, will come through direct capital injection, which will be necessary as working capital and to pay interest on the bonds issued. A draft law on the AMC is currently under review by an inter-institutional committee including, *inter alia*, the Ministry of Finance and the CBT. The committee is deliberating on a number of key legal and operational design options, based on suggestions made by a group of expert advisors led by the World Bank, which is assisting the authorities in the legal drafting and setting of the AMC, including adapting international experience to Tunisian law. The committee must also carefully consider the design of the bonds issued by the AMC, as well as the valuation process and its methods for the debts acquired.

**Key components of the draft AMC Law.** The experts recommend expanding the AMC's general powers to resolve obstacles of the judicial system, including controlling mechanisms to mitigate abuse of powers and arbitrariness. Moreover, the AMC will need a number of special powers to be assigned in the law, allowing it to, *inter alia*, appoint special administrators, foreclose on collateral, or bid its debts in auction.

**Timeline.** The draft AMC law is expected to be completed by June 2013. Design and introduction of the AMC will have to take into account the government strategy for public banks (e.g., recapitalization needs) and will need to be further discussed with the "hotel businessmen association" who have recently expressed some strong opposition. There are currently no plans to extend the AMC to troubled loans in other sectors.

## A better composition of public expenditures to support growth

**16. A better composition of public expenditures will be required to achieve the needed medium-term fiscal consolidation and restore fiscal space while supporting growth.** Over the medium term, the program is anchored in the authorities' objective of bringing the central government deficit to around 2.5 percent of GDP by 2018, thereby maintaining the debt-to-GDP ratio at 44 percent in the medium term while creating space for large banking recapitalization costs during the program period (up to 2.6 percent of GDP over 2013–14) and for priority spending. The fiscal consolidation strategy relies largely on subsidy reduction and containment of the wage bill.

- **Subsidy reduction.** The authorities agreed to gradually phase out highly regressive and budgetary-costly energy subsidies while putting in place well-targeted social safety nets and needed compensatory measures, for better protection of the vulnerable parts of the population affected by the reform (see section III. D). In March 2013, the authorities increased the prices of gasoline and diesel products, and electricity tariffs, by an average of 7–8 percent. This measure complements the 7 percent increase effected on the same products in September 2012, and is expected to generate the subsidy savings included in the 2013 Budget Law (savings of about 0.5 percent of GDP) (MEFP, ¶12). Staff and the authorities agreed on the need to keep subsidies at budgeted levels in 2013. These subsidies will be further reduced in 2014–15 through additional price adjustments and lower international commodity prices.
- **Control of the wage bill.** The wage bill rose significantly in recent years following the authorities' response to rising unemployment rates. At 12.4 percent of GDP in 2013 (or equivalent to more than 50 percent of tax revenues), the authorities agreed with staff that the wage bill and new recruitments need to remain at budgeted levels. Over the medium term, keeping the wage bill at a sustainable level will require maintaining wage increases within the available fiscal space and in line with productivity increases. Undertaking a civil service reform, starting with a more transparent and merit-based contracting system, will also be important.

**17. Savings generated by wage bill containment and subsidy reform will create space for higher investment and social spending.** The negative impact of lower subsidies on private consumption and growth will be mitigated by growth-supporting public investment—which has a larger fiscal multiplier (see *MCD Regional Economic Outlook*, Fall 2012)—and higher social expenditures, including education, health, and employment programs. The government plans to increase public investment above 7 percent of GDP by 2015 (a 0.6 percent of GDP increase). An assessment of the impact of existing investment projects, particularly in regions of the interior, is ongoing and will help in the review of current needs and priorities. The expansion of existing social safety nets, combined with better-targeted cash transfer schemes, will also be essential (section III. D).

**18. The authorities have initiated a reform of the revenue system that will widen the tax base, improve equity, and strengthen transparency.** Even though tax collection in Tunisia is

relatively favorable in terms of GDP and in comparison to similar countries, the tax system is highly complex and distortive, and consequently limiting the development of the private sector. The authorities are putting in place working groups to assess different reform needs, and plan to hold national consultations (“*assises nationales*”) over the next few weeks to discuss avenues for reforms. Key areas for reform would include:

- **Tax policy.** The introduction of new consumption taxes on alcoholic beverages and stamp duties came into effect earlier this year. A more comprehensive tax reform is being designed. The immediate priority is to rationalize tax benefits/incentives in a revenue-neutral way, in line with the World Bank’s work on the new investment code, which should help level the playing field for the onshore and offshore sectors (see ¶18 and Box 4). The reform would also have to address the regressivity of the current income tax system (which favors households with highest revenues or imposes no taxes on company dividends) as well as the complexity of the indirect tax system (particularly excises).
- **Tax administration.** A modernization program will be put in place to address a fragmented revenue collection process and complex procedures, which are often stated by companies as a key constraint to doing business. Key priorities in the near term include unifying most tax functions within a large taxpayer unit and strengthening valuation and control mechanisms in both tax and customs administration (MEFP, ¶13).

**19. The authorities are focusing their expenditure management reforms on improving the efficiency of existing public investment projects.** The simplification of current procurement and control procedures, starting in June 2013, will boost investment and support growth. There is also a need to improve cash management procedures, which should include greater coordination with the central bank. Also, arrears accumulation, as in 2012, will need to be closely monitored to ensure that future liabilities are not incurred and to generate better cash management (an indicative target on no new domestic arrears is part of program monitoring).

**20. Staff and the authorities agree that fiscal risks arising from potential contingent liabilities of public enterprises and pension funds need to be closely monitored.** There is limited comprehensive information on all liabilities and financial flows of the 104 public enterprises included in the government portfolio. These companies, which are particularly dominant in energy and telecommunications while employing around 120,000 persons, are often characterized by limited transparency, weak state ownership function and corporate governance mechanisms, and poor service that combine to constrain private-sector growth. To start identifying and remedying key weaknesses in the sector, the government is working, with the assistance of the World Bank, on improving the governance framework of public enterprises and is initiating audits of the largest enterprises, starting with the electricity and oil refinery companies (end-December 2013 structural benchmark). The government is also monitoring the stock of government debt guarantees (about 8.5–10 percent of GDP over the past three years) and rising pension deficits, unsustainable over the long term, and which could amount to 2 percent of GDP by 2018 (see Section III.D; MEFP ¶13).

#### Box 4. Tunisia: The Reform of the Investment Code

**The current investment code—which dates back to 1994—is complex, incomplete, and opaque, and creates an atmosphere of uncertainty for investors.** The code is accompanied by a system of incentives that has been amended numerous times over the years, heightening the system’s inefficiency in several ways. It is characterized by a high degree of procedural complexity while it fails to grant guarantees for investors, market access, and governance rule. A key priority of the government is to address these weaknesses by reforming the “incentives code” into an “investment” code—which is being prepared with World Bank Group assistance—and should aim at:

- **Clearer market access rules:** This involves more emphasis on the right to freedom of investment, moving from a positive list to a negative list, migrating from an authorization system to a declaration system, spelling out the role of the State, and limiting discretionary powers.
- **Affirming rights and guarantees for investors:** Such guarantees do not exist under the current code, and are dispersed among various bilateral and multilateral agreements. The new code should affirm within one text these guarantees and strengthen them in accordance with international standards.
- **Reviewing the system of tax and financial incentives:** The new code will be aligned with Tunisia’s priorities, and incentives need to be significantly simplified to avoid complexities of the past—focus on incentives that encourage R&D or highly educated personnel should be encouraged. It will also be more efficient to leave the tax provisions out of the investment code and include them in the tax code. More importantly, the reform of the existing incentives needs to be accompanied by a corporate tax reform to ensure a gradual convergence of the onshore–offshore tax rates.
- **Evaluating the institutional framework for investment:** Functions and roles among institutions will be clearly coordinated so as to facilitate investments within a friendly business climate.

**To accelerate the process, the government is taking the following steps:** (i) creating an inter-ministerial council for setting the main aspects of the new code as well as key regulations for market access related to authorization procedures, foreign investment limits, hiring of foreign workers, and real estate acquisition; (ii) coordinating closely with the CBT for revising and simplifying procedures related to investment guarantees (e.g., dividends and capital repatriation); and (iii) organizing several discussions on the draft code with government agencies and other stakeholders; meetings are also planned in the next few weeks. It is also (i) working on the corporate income tax regime and the timeline for convergence of the onshore and offshore regimes; and (ii) planning for the Council of Ministers to adopt the investment code by July 2013; with a view to presenting it to Parliament by end-September 2013.

### Structural reforms

#### 21. The authorities’ program includes an ambitious structural reform agenda aimed at creating the foundations to boost private-sector growth and create high-value added jobs.

Three key factors constrain the development of the Tunisian economy. First, the Tunisian development model has been characterized by a dichotomy between the offshore and onshore sectors. This duality has exacerbated regional disparities between an offshore sector—concentrated in the coastal areas that have benefitted from fiscal and regulatory incentives—and an onshore sector, mostly in the less developed interior that are isolated from the rest of the economy and subject to excessive tax and labor regulations. Second, the zero-tax regime for offshore companies has attracted mostly assembly-type investments in low-value added industries, with limited transfer

of knowhow into the economy and resulting in a mismatch between high demand for low-quality labor and the supply of an educated workforce. Thirdly, lack of transparency, cronyism, and complex regulatory procedures led to rent-seeking and anticompetitive behavior which discouraged entrepreneurship and private investment. To address these challenges, the authorities' program (MEFP, ¶13 and ¶20) plans to:

- **Reform the investment code and the existing corporate income tax system** (Box 4). The reform will aim at streamlining fiscal and regulatory incentives to create a more level playing field. This implies lower tax benefits for exporting firms, less discretionary power for the government (e.g., in providing licensing to new businesses), and more equal treatment of onshore and offshore sectors. Reform of the investment code—which is being elaborated with World Bank TA—will only be successful if it is accompanied by a reform of the corporate income tax system that will lead to a convergence of the offshore and onshore tax rates (currently at 0 percent and 30 percent, respectively), starting with 2014 (structural benchmark). Simulation work on appropriate tax rates is ongoing, with World Bank and IMF TA, to assess the revenue implications of a possible convergence calendar for corporate tax rates which will be announced by end-2013. Staff and the authorities both agree that keeping the reform revenue neutral will require offsetting measures, which could include taxing corporate dividends or increasing the rate of the minimum tax on turnover.
- **Reviewing and streamlining existing regulations.** A regulatory simplification process has been ongoing in the area of tax and customs, resulting in a recommendation to eliminate 8 percent of the identified procedures, and significantly simplifying an additional 85 percent. The same approach is being applied, with help from World Bank Group TA—to business formalities in nine additional ministries.
- **Reforming the existing competition law.** Preliminary World Bank estimates indicate that an increase in the level of competition intensity that translates into 5 percentage point lower markups in the manufacturing sector would increase labor productivity growth by nearly 6 percentage points. Reducing discretionary application of business regulations and ensuring that all private operators have access to the same opportunities should be a key focus of the ongoing work on the competition law.

**22. Removing constraints to the efficient functioning of the labor market is part of the government strategy.** Labor market rigidities and skill mismatches between labor demand and supply are key challenges that must be addressed in the medium term. Staff and the authorities agree that a broad debate should be initiated within civil society on the specific reforms needed to design a comprehensive labor market strategy, to leverage reforms of the investment code, competition law, and corporate taxation, and achieve more rapid job creation. A good beginning on that dialogue was the national tripartite social contract, signed in January 2013, between the government, workers' unions, and business representatives. The Fund-supported program could be enriched in the second year of the arrangement by specific measures in this area once a full diagnostic is completed and clear policy measures have been identified.

**23. The authorities are conscious of the importance of strengthening statistics to improve decision-making and to orient policy decisions.** They plan to improve methods used and, with World Bank TA, have started regularly and comprehensively publishing all survey data, including complete data from household budget and labor force surveys. Fund TA will support the authorities' efforts to strengthen national accounts, monetary, and balance of payment statistics.

#### **D. Protecting the Most Vulnerable**

*The short-term stabilization agenda and the measures aimed at supporting growth are accompanied by a social agenda that ensures not only a better composition of public expenditures and a reduction in regional disparities, but also effective protection for the most vulnerable population. Technical assistance, particularly from the World Bank, is helping the authorities assess the best way to move forward. Continuous dialogue with stakeholders is also necessary.*

**24. The authorities and staff both agree on the importance of strengthening the social assistance mechanisms for the poor and vulnerable.** Over the past year, the government has taken a decision to improve the existing cash transfer system for the poor (PNAFN) through the creation of a unified registry and an improved targeting system. The existing PNAFN system provides cash transfers and free health cards to 9 percent of the population (an estimated 235,000 households), but the latest World Bank estimates (using the 2005 household survey) indicate leakage to non-poor of around 60 percent. Despite those leakages, this system is still the primary means to reach the poor, with transfers increasing by 50 percent over the past year. A national dialogue on subsidy reform and social protection will be launched to define the reform priorities.

**25. The authorities' focus on improving the targeting of the social safety net is critical as subsidy reforms for energy products are under preparation** (Box 5). Both the authorities and staff recognize that any future ad-hoc increases in energy prices need to be accompanied by compensating measures for the poor and vulnerable, even though the new registry or its accompanying targeting system may not yet be in place. The authorities—with World Bank and Fund TA—are currently analyzing the welfare and social impact of reforms for each energy product, and are working on designing a strategy to support households during subsidy reform (structural benchmark for August 2013, see Box 5). Staff stressed the importance of having a strong public communication plan to explain the benefits of the energy subsidy reform, which is necessary to create space for public investment spending (increasing to 7.1-7.5 percent of GDP over the medium term) and social spending. A recent survey has shown that, in case of subsidy reforms, most of the population would support using savings from the removal of diesel subsidies on programs for the poor or on healthcare and education programs (see text table). In parallel, and as part of the generalized energy subsidy reduction strategy, the government is revising the fuel price adjustment formula, which will be adopted in August 2013 (structural benchmark) and could be implemented in 2014 or sooner if domestic retail prices are close to international levels.

Tunisia: Subsidy Survey

	Egypt	Jordan	Lebanon	Tunisia
Question: If the government were to remove the subsidy on the price of diesel, should the government...?				
	(In percent)			
Distribute that money to the poor	32	50	32	38
Distribute that money to all families except the wealthy	3	19	11	6
Distribute that money to all families including the wealthy	2	3	1	1
Distribute a portion of that money to the poor and spend the rest on healthcare and education programs for all	57	10	56	50
Don't know/refused (volunteered response)	7	19	1	4

Source: World Bank MENA Development Report, "Inclusion and Resilience. The Way forward for Social Safety Nets in the Middle East and North Africa. Data collected September-December 2012.

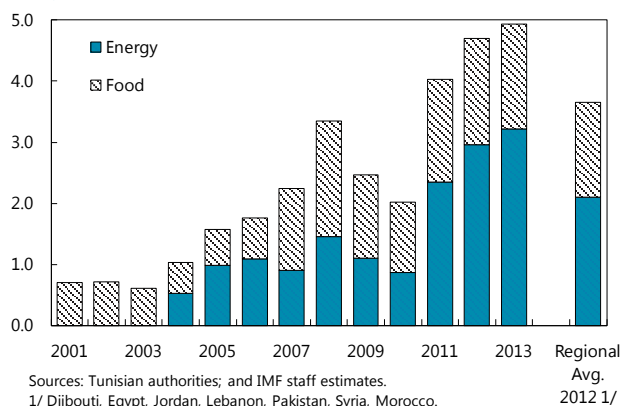
### Box 5. Tunisia: Energy Subsidies: Costs and the Way Forward

**Price subsidies on basic food, oil products, electricity, and transport approximate 5 percent of GDP, larger than the regional peer average.** The cost of energy subsidies tripled from an average of 0.9 percent of GDP before 2010 to 2.8 percent in 2012, mainly reflecting the incomplete pass-through of international oil prices to domestic retail prices. LPG and heavy fuel have had the highest subsidy levels, while gasoline and diesel have had the lowest.

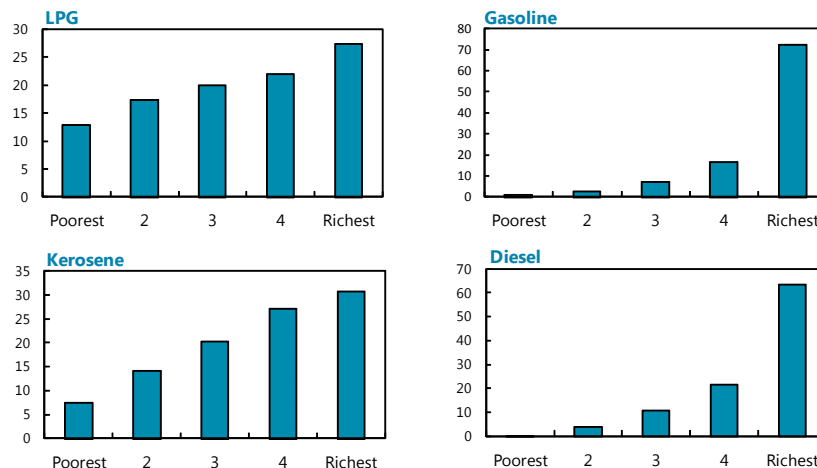
**The benefits of energy subsidies accrue mostly to high-income households.** The highest-income households benefit almost 40 times more from energy subsidies than do the lowest-income ones. As an example, the combined cost of gas and gasoline subsidies to the richest quintile (10 percent of the population) is equivalent to the cash transfer program that benefits 133,000 poor families. This leakage of subsidies to the non-poor makes the existing system not only costly but also inequitable and inefficient as a social protection tool.

#### Food and Energy Subsidies

(In percent of GDP)



#### Distribution of Subsidy Incidence Across Consumption Categories (Petroleum Products)



Source: World Bank.



### Box 5. Tunisia: Energy Subsidies: Costs and the Way Forward (concluded)

**The government's medium-term objective is to replace generalized price subsidies with a well-targeted social safety net, starting explicitly with the most regressive energy subsidies.** As a first step, it increased fuel and electricity prices by around 14 percent between September 2012 and March 2013, which has generated 1 percent

of GDP in annual budgetary savings. They also plan to revise and reinstate an automatic price setting mechanism (at least for petroleum and diesel products) by early 2014 or when retail prices are close to international prices. These increases should be accompanied by a new household compensation (and targeting) strategy for selected products, to be approved in

August, and which can be introduced in 2014 along with needed price increases (while waiting for the new more comprehensive registry that corrects for leakages).

**The household compensation strategy supports subsidy reform and paves the way for a more sustainable safety net system.** The strategy could be adjusted depending on the phasing and the magnitude of the subsidy reform envisaged. In any case, the household compensation strategy—which is benefitting from World Bank TA support—should include the following:

- the profile of target beneficiaries, or households most likely to be affected by reforms;
- the type and, in the case of cash transfers, the amount of the transfer that will be required to mitigate the effects of higher prices on household welfare;
- the targeting mechanism that will be adopted. Key options to be considered include: (i) categorical criteria, where administered data are used to identify vulnerable groups, such as households not connected to natural gas and using LPG; (ii) criteria for self-targeting, whereby beneficiary enrolment requirements and the amount of the transfer preclude higher-income groups from registering for assistance; (iii) variations of means-tested or proxy-means-tested targeting using information contained in existing social security, social assistance, and other databases; and (iv) a combination of the above mechanisms;
- the payment delivery mode in the case of cash transfers, with either the existing wire transfers through the postal service or through a debit/smart card system having been proposed by the authorities;
- a monitoring and evaluation system, for assessing the impact of each reform and adjusting any subsequent phases of the reform as needed.
- a proper communication mechanism, for consulting with and informing the public and target beneficiaries prior to and during the reforms.

Tunisia: Subsidy Level for Energy Products, 2012

Products	Weight of total consumption of energy products (in percent)	Total Subsidy (in MD)	Subsidy Level in Retail Price (in percent)	Share of Total Compensation Needed to Reach (in percent)	Price Increase International Prices (in percent)
Gasoline	11	215	21	6	24
Diesel (0,2%)	29	731	31	22	40
Heavy Fuel Oil	5	170	62	5	147
LPG	13	464	70	14	223
Kerosene	1	21	37	1	87
Electricity	n/a	1,671	27 / 50	50	n/a
Total	63	3,354	n/a	100	n/a

Source: World Bank, March 2013.

**26. The authorities plan to introduce equity considerations in the design of their reforms.**

The newly launched tax reform process would look at correcting the regressive nature of existing taxes (e.g., personal income tax) while keeping the impact revenue-neutral. The authorities' program also includes plans to increase spending in the poorer regions of the interior, building on the ongoing assessment of the effectiveness of investment programs in those regions. Regarding the pension system, the Ministry of Social Affairs has launched an actuarial study, supported by the World Bank, to review the sustainability of the pension system. The short-term plans are to assess different social security reform scenarios and their social and budgetary implications, and then launch a national dialogue to discuss policy options. As for food subsidy reform, given the importance of food subsidies for poorer households and despite existing leakages (e.g., to hotels or industry), the government will assess at a later stage how to reform these, and may be able to use lessons from the energy subsidy reform to design compensatory measures.

## PROGRAM MODALITIES

### A. Access

**27. Tunisia will face moderate balance of payment needs over the next 24 months.** Under staff's baseline assumptions, gross financing needs of US\$28 billion will produce a financing gap of approximately US\$1.7 billion, owing to increasing food and energy imports and the need to strengthen reserve buffers (to at least 100 percent with the new risk-weighted metric—see Box 6). For 2014–15, the gap will narrow following a more sustained recovery in exports, driven by improved competitiveness and global demand. Reserve adequacy in Tunisia is modest (see Box 6). Both Staff and the authorities estimate that the reserve coverage should remain throughout the program period at above a minimum three months import cover, with Fund financing used to build reserve buffers closer to the 4.5 months of imports reserve figure (above 120 percent with the new risk weighted metric).

**28. Multilateral and bilateral support is expected to cover most of the financing needs.**

Financing assurances have been provided by bilateral and multilateral partners who have linked future disbursements to progress in the reform agenda. From the Fund, access of 400 percent of quota (about \$1.75 billion, SDR 1.15 billion) will be needed to help build reserve buffers. Half of the Fund resources will be used for each year, with the phasing adjusted according to BOP need. However, close to half of the first year's disbursement is expected in the fourth quarter of 2013 to ensure that reserve coverage

	Year	2013			
		Q1	Q2	Q3	Q4
Total	2239.1	100.1	309.8	109.8	1471.4
Bilateral	200.0		200.0		0.0
IFIs	800.0				800.0
AfDB	300.0				300.0
World Bank Group	500.0				500.0
Other	1,239.1	100.1	109.8	109.8	919.4
Samurai bonds and other market financing	399.9				399.9
Project aid w/o donor breakdown	439.1	100.1	109.8	109.8	119.4
Sukuk	400.0				400.0
Memorandum Item:					
Grants	248.0				248.0
IMF Financing (BOP Support)	650.1		150.1	149.8	350.2

Sources: Tunisian authorities; and IMF staff estimates.

remains above the minimum of three months of imports, even if financial markets cannot be tapped as planned (e.g., the issuance of sukuks in December 2013 is still dependent on the passing of the appropriate legislative framework). Staff assesses that a 24-month SBA is appropriate given the strength of the authorities' program. It provides enough time to address the immediate challenges of macroeconomic stabilization and of locking in growth-supporting policies that would catalyze donor financing and restore investor confidence.

### Box 6. Tunisia: Assessment of Reserve Adequacy

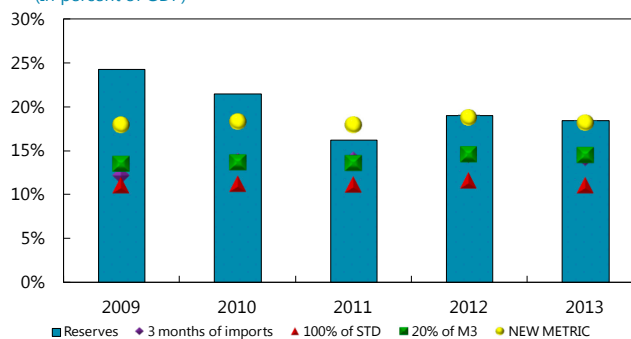
**An assessment based on the composite reserve metric indicates that the reserve level in 2013 would be able to cover Tunisia's "risk weighted liability stock."** This significant improvement in reserve

coverage mostly represents build-up arising from the Fund's financing support, without which reserve coverage would be at 82 percent of Tunisia's risk-weighted liability stock—below the 100 percent recommended minimum levels. Traditional metrics also show that reserves should provide full coverage against selected idiosyncratic shocks, specifically, for reserve cover at: (i) short-term debt at remaining maturity which mitigates rollover risks on short-term debt from a drop in investors' appetite; and (ii) three months of next-year imports, which could alleviate constraints on import financing if export receipts drop suddenly. Risks of significant capital flight would remain limited, thanks to the regulation in place on the capital account.

**The non-synchronization of current account receipts and payments will continue to pose challenges to reserve management.** Seasonal factors show that export receipts barely offset import payments each quarter. Remittance and tourism receipts, usually lower in the first and second quarters, reach peaks in the third quarter, which generally induces a significant drawdown in reserves in the first half of the year. Increasing exchange rate flexibility, while allowing the exchange rate to be an important shock absorber, could mitigate risks from non-synchronized current account receipts and payments.

#### Reserve Coverage Based on Alternative Metrics: New and Traditional Metrics, 2009-13

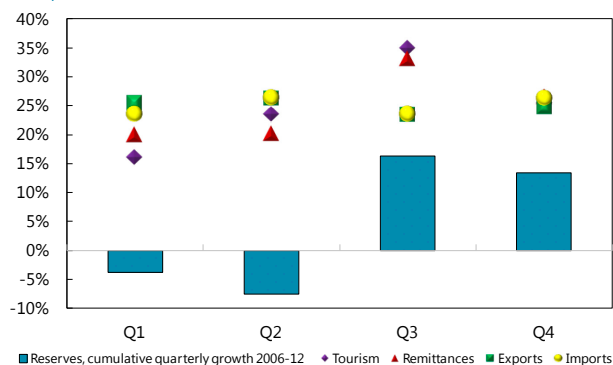
(In percent of GDP)



Sources: Tunisian authorities; and IMF staff estimates.

#### Seasonal Factors of Current Account Flows and Reserve Variations

(In percent)



Sources: Tunisian authorities; and IMF staff estimates.

<sup>1</sup> The "risk weighted liability stock" is computed as the sum of a 10 percent drop in exports, a 30 percent reduction in short-term debt, a 15 percent reduction in other liabilities, and a 5 percent of broad money for capital flight.

<sup>2</sup> The new metric suggests that coverage between 100 and 150 of the "risk-weighted liability stock" might be regarded as adequate; the projected reserves level in 2013 would be at the low end, covering 102 percent of Tunisia's risk-weighted liability stock.

**29. At this stage, the authorities anticipate that Fund resources will be used solely for balance of payments support.** However, the use of Fund resources for fiscal support may be considered during the program. To that end, a Memorandum of Understanding regarding the respective responsibilities of the Ministry of Finance and of the CBT for servicing charges and obligations to the Fund has been finalized.

## **B. Capacity to Repay the Fund and Risks to the Program**

**30. Tunisia's capacity to repay the Fund is expected to be strong.** Fund credit outstanding would reach a maximum of 6.3 percent of GDP and 14.5 percent of gross reserves in 2015, while debt service to the Fund would remain below 2.4 percent of exports of goods and non-factor services (Table 9). Total public debt is expected to remain below 50 percent of GDP, with public external debt peaking at 34 percent of GDP in 2015. Total external debt is expected to peak at 55 percent of GDP in 2015, falling thereafter as the external position continues to improve on the back of improving tourism and remittance inflows and renewed access to international markets (see Annex 1). Moreover, the Tunisian authorities' strong commitment to the IMF-supported program and its excellent track record in servicing its external obligations, provide some additional reassurances that Tunisia will fulfill its financial obligations to the Fund in a timely manner.

**31. Notwithstanding these assurances, the program carries substantial risks.** The growth outlook could fall short of projections, particularly if the external economic environment deteriorates further, impacting tourism and remittance inflows, as well as exports of goods and services that have started to grow again. Also, setbacks in the political transition—such as delays in organizing the elections—could reduce political commitment to economic reforms, and increase investors' wait-and-see attitude. Renewed bouts of social unrest or security issues—could impact confidence in the economy, discourage tourism, and reduce access to international markets. Risks to program objectives could also come from higher commodity prices, which could add pressures on the fiscal and external positions. Risks could also come from additional losses from public enterprises. Delays in official external financing pledged to support Tunisia's reform program, or lack of market access, could also increase the financing gap, causing a reconsideration of the appropriate policies.

**32. The program is designed to mitigate risks in program implementation and in Tunisia's capacity to repay the Fund.** The authorities' commitment to the Fund-supported reform program is strong, as shown by strong inter-ministerial ownership of the economic reform agenda and the setting of an inter-ministerial committee at both the policy and technical levels to monitor progress under the Fund-supported program. The authorities have also expressed their commitment to adjust policies as needed to achieve the targets under their program. To mitigate risks to the budget target, the authorities increased energy prices early in the year, and quarterly fiscal targets would help detect deviations early on and identify corrective measures if needed. More generally, quarterly reviews (see below) would allow for adjusting the framework and taking early remedial actions in case of slippage. TA from the Fund and other donors would help support the authorities in their reform agenda.

## C. Program Modalities

**33. The SBA will run over 24 months from June 2013 to June 2015, with Fund resources available in nine installments** (Box 7). The size and timing of disbursements should ensure that the arrangement can support Tunisia's economic policies during the political transition and provide additional buffers in case external shocks materialize. The program will initially be monitored through quarterly reviews. However, depending on evolving risks and the performance over the first year, semi-annual reviews could be considered during the second year of the program. Test dates for the quantitative targets are the last day of each quarter, starting June 2013. Quantitative performance criteria (Box 7, MEFP Table 1) focus on fiscal, monetary and external objectives. They are complemented by indicative targets to monitor domestic arrears and preserve social spending. Structural benchmarks (Box 7, MEFP Table 2) will focus on maintaining macroeconomic stability, strengthening the monetary policy framework, reducing banking system fragilities, and strengthening social safety nets.

**34. The first-time safeguards assessment of the CBT found an adequate control environment for the day-to-day operations, but oversight, autonomy, and transparency need strengthening.** The CBT publishes its audited financial statements, but disclosure information should be enhanced. Action is needed to mitigate risks to the CBT balance sheet that would result from a significant increase in liquidity lending operations. Development of the internal audit function will need capacity-building and oversight by the newly established Audit Committee. The CBT confirmed its commitment to implementing the recommendations of the safeguards assessment, some of which—such as the improvement of its collateral framework—are already part of its reform agenda.

### Box 7. Tunisia: Stand-By Arrangement

**Access:** SDR 1,15 billion (400 percent of quota, equivalent to about US\$1.75 billion).

**Length:** 24 months, starting June 2013.

**Phasing:** There are eight program reviews and nine disbursements. Disbursements will be 200 percent of quota for each year. For the first year, 34 percent of quota will be made available upon the Board's approval of the arrangement, followed by 34 percent in the first review, 80 percent the second review, and 51 percent in the third review.

#### Quantitative Performance Criteria

- Ceiling on the primary balance of the central government, excluding grants
- Ceiling on net domestic assets of the central bank
- Floor on net international reserves of the central bank

#### Continuous Performance Criterion

- Ceiling on the accumulation of new external debt payment arrears by the central government

#### Quantitative Indicative Targets

- Floor on social spending
- Ceiling on the accumulation of new domestic arrears

#### Structural Benchmarks

- Approval by the Council of Ministers in a convergence of the corporate taxes for the year 2014, *July 2013*
- Adoption of the Investment Code, *July 2013*
- Announcement of a haircut on all loans used as collateral for refinancing operations at the central bank, *July 2013*
- Ensure proportions of refinancing volumes at the CBT are backed by government securities (*10 percent for end-August; 20 percent for end-year*)
- Adoption of new automatic fuel pricing formula, *August 2013*
- Submission to the Council of Ministers of a new targeted household support program, *August 2013*
- Approval of a new reporting system covering bank-related accounting, financial, and institutional functions, *August 2013*
- Adoption of strategic vision on future government's role in banks, *mid-September 2013*
- Merge at the level of the large taxpayer unit the management, collection, and control of large enterprises, *September 2013*
- Implementation of an electronic bank interlinking platform and launch of the Market Makers Agreement, *October 2013*
- Conduct one general onsite bank inspections and four credit risk inspections, *December 2013*
- Present to the CBT Board a study of the impact on banks of liquidity ratio changes along international standards, *December 2013*
- Finalize the audit of the electricity company (STEG) and the petroleum products distribution company (STIR), *December 2013*

## STAFF APPRAISAL

**35. Tunisia's macroeconomic situation has recovered from the post-revolution trough, but fiscal and external buffers have been eroded.** After a sharp decline in 2011, the Tunisian economy has embarked on a moderate recovery, despite a challenging international environment and persistent domestic security and social tensions. Inflation has been rising, mostly reflecting increasing food prices, with core inflation remaining stable. Falling demand from Europe has contributed to a worsening current account deficit that has been financed by strengthened FDI inflows and sustained multilateral and bilateral loans that increased gross reserves above the 2011 trough. Fiscal buffers, accumulated through the prudent policies of the past, were eroded to meet pressing social and investment needs.

**36. Tunisia's outlook depends on the unfolding of the political transition and is vulnerable to shocks.** The economy is expected to continue recovering despite external and fiscal imbalances over the short term. The setting of a clear political calendar—which lessens investors' wait-and-see attitude—underpins the positive outlook. However, an escalation of domestic social tensions, increasing political uncertainty, and security concerns could impede domestic and foreign investment. Additionally, renewed turbulence in Europe or depressed world demand would add a drag on growth and the external position. Delays in official external financing pledged to support Tunisia's reform program could increase the external financing gap and hinder progress in the reforms necessary to boost growth.

**37. The challenges to the short-term outlook are also accompanied by vulnerabilities arising from widespread social and economic disparities and high youth unemployment.** Tunisia's development has been exacerbated by the duality of the economy that favors an offshore sector, in which low-value added industries employ low-skilled workers. Private-sector growth and the creation of high-value added jobs have been hampered by complicated regulatory procedures, inappropriate supervision, rent-seeking and anticompetitive behavior, particularly in the banking sector. These structural rigidities—which will take time to address—have to be balanced with the population's expectations of quick dividends from the Tunisian revolution.

**38. The authorities' home-grown economic reform agenda appropriately aims at addressing these challenges through short-term stabilization goals while laying the foundations for supporting growth and protecting the most vulnerable.** It centers first on using an appropriate mix of fiscal, monetary, and exchange rate policies to restore fiscal and external buffers and to contain inflation. Second, it lays building blocks for supporting growth by addressing critical vulnerabilities of the banking sector—particularly state-owned banks—and by pursuing structural reforms to boost private sector-led growth. Against this background, protecting the most vulnerable from the impact of fiscal consolidation and structural reforms remains a key priority. Fund financial assistance will help support program implementation and catalyze donor support.

**39. Staff welcomes the authorities' commitment to maintaining an appropriate fiscal stance while making space for critical spending priorities and repayments of arrears.** The authorities' objective of keeping the 2013 deficit target close to the budget target is commendable given the new expenditures that have materialized. Staff urges the authorities to move quickly in creating the fiscal space necessary to meet banking recapitalization needs, which is essential to restoring investors' confidence in the authorities' commitment to address banking sector vulnerabilities, and to strengthening banks' capacity to support the recovery. At the same time, a strong commitment is needed to contain energy subsidies and wage bills to budgeted levels. Staff welcomes the authorities' intention to preserve social and investment spending in case mitigating measures are needed to address any budgetary shortfalls. Fiscal risks from contingent liabilities should also be closely monitored.

**40. Prudent management of monetary policy in the context of a more flexible exchange rate regime will prove crucial to the short-term macroeconomic stabilization goals and will build external buffers.** Staff supports the recent tightening of the monetary policy stance, and welcomes the gradual unwinding of liquidity injections that has been initiated. Staff welcomes the creation of a monetary policy committee and urges the authorities to continue improving the existing monetary policy framework, including through a better collateral framework and improved liquidity forecasts. Staff commends the authorities for the shift towards a more flexible exchange rate arrangement, which will help strengthen reserve buffers and provide additional scope for monetary policy. Moving towards a weekly foreign exchange auction system will further improve the functioning of the foreign exchange market.

**41. Addressing critical vulnerabilities of the banking system will lay foundations for stronger economic growth.** The banking system's vulnerabilities, as exhibited by deteriorating asset quality, need to be addressed quickly, particularly when lack of reliable and regularly reported data increases uncertainties about the true condition of the banking system. The recent actions taken by the authorities are commendable and an important step in the right direction. However, staff emphasizes the importance of moving quickly and decisively in addressing banking system fragilities, starting with the audits of public banks, which will allow the authorities to design the appropriate business model, assess public bank recapitalization needs, and improve the banks' ability to support the economy. In parallel, the CBT should continue assessing the risks of the banking system, strengthen banking supervision—particularly through more frequent onsite and offsite inspections and a better data reporting system—and align its prudential norms with international standards. The authorities' plans to set up an AMC for the NPLs of the tourism sector are welcome, but care should be taken to ensure that the AMC conforms with best valuation, governance, and transparency practices.

**42. Implementation of an ambitious structural reform agenda will be necessary to boost growth and create high value-added jobs.** Streamlining fiscal and regulatory incentives through a new investment code coupled with a corporate tax reform will help balance the disparities between the onshore and offshore sectors and strengthen domestic sources of growth. Structural fiscal reforms—including more unified tax administration and more simplified procedures—along with



less “red tape”—are essential to strengthening the business environment. Reforming the labor market will also be important.

**43. Strengthening social safety nets is an integral part of the authorities’ reform agenda.**

Subsidy reform, along with wage bill containment, is the cornerstone of the medium-term fiscal consolidation agenda aimed at creating fiscal space for priority capital and social spending. To accompany that, savings from the reform should be oriented towards establishing a well-targeted social safety net for the poor and vulnerable parts of the population. To that end, staff welcomes the authorities’ plan to revise existing cash transfer mechanisms and design a household compensation program that can be put in place to accompany future energy price increases. Staff urges the authorities not to wait for the new comprehensive registry of vulnerable people (or the perfect targeting system) to compensate the neediest during various phases of subsidy reduction. Proactive communication and social consensus building will be needed for the envisaged reforms, with greater equity being a key design consideration.

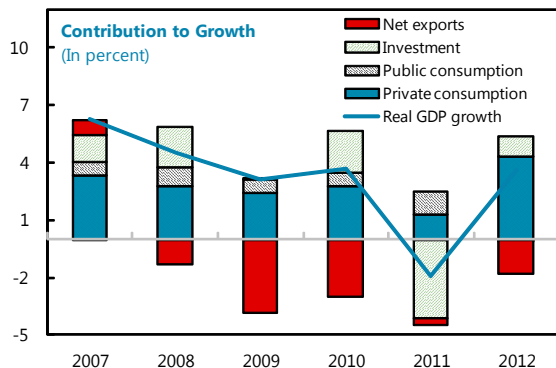
**44. Statistical data should be further strengthened to guide policies.** In this respect, improved data on national accounts, monetary statistics, and the balance of payments are a priority.

**45. Significant risks remain under the program.** The measures in the authorities’ program address the areas of greatest vulnerability, and their strong commitment to their reform agenda should ensure reasonable prospects of success. However, a prolonged period of political uncertainty, a worsening of the security situation, a deterioration of the international economic environment could all delay the economic recovery, stop progress in the reform agenda, and affect confidence. The level of access under the program should provide enough financial buffers to mitigate the immediate impact of an exogenous shock on the population. To reduce risks further, continued and careful program monitoring and ongoing policy dialogue with the Fund will be essential.

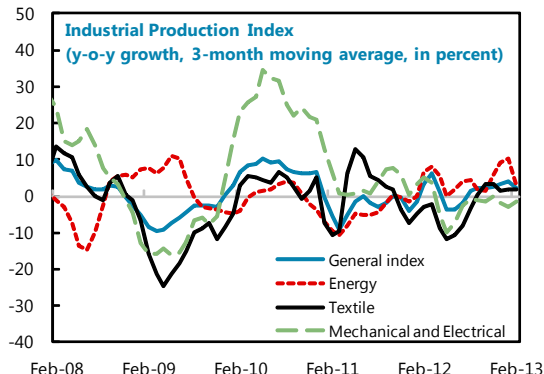
**46. In view of Tunisia’s balance of payment needs and the strong policies proposed by the authorities, Staff supports their request for a 24-month SBA for the amount of SDR 1.14600 billion (400 percent of quota).**

**Figure 1. Tunisia: Recent Economic Developments**

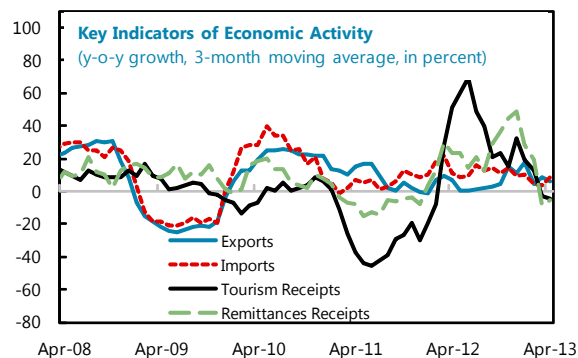
After a severe recession in 2011, a moderate recovery started in 2012 despite adverse international and domestic environments.



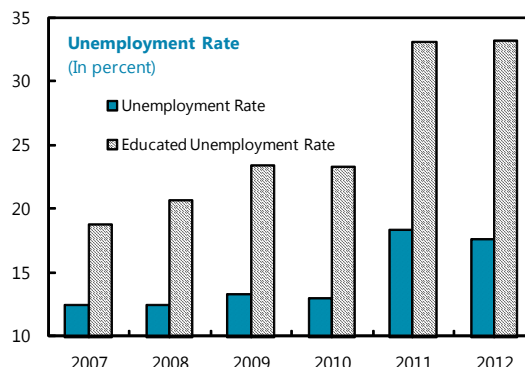
Industrial Production is slowly recovering led by the energy sector, while the mechanical and electrical sectors remain relatively flat.



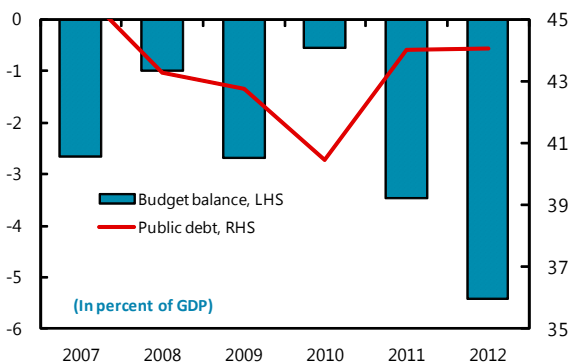
Tourism and remittances receipts have improved despite high uncertainties



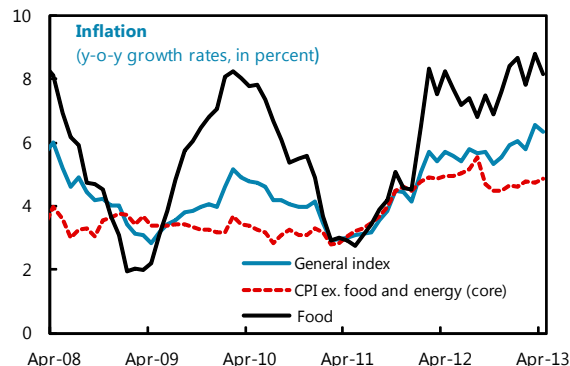
Unemployment has started to subside but remains high particularly among university graduates.



To counteract the still weak economy and high unemployment, the fiscal stance has been looser but debt levels remain stable.



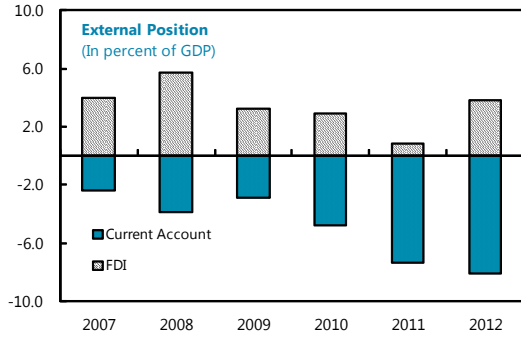
Inflation rate has increased reflecting higher food prices.



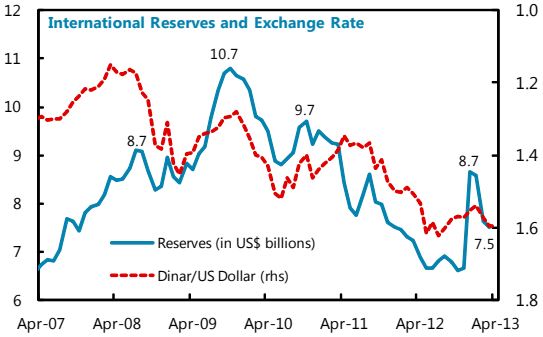
Source: Tunisian authorities.

**Figure 2. Tunisia: External and Financial Indicators**

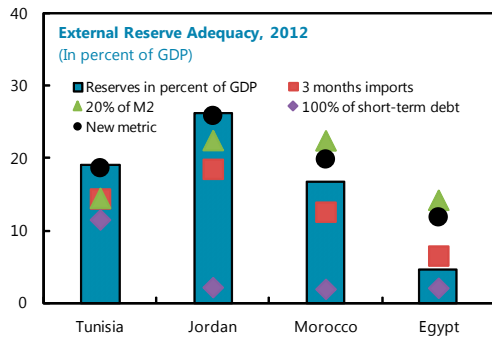
The current account deficit remains high and FDI flows are not fully recovering.



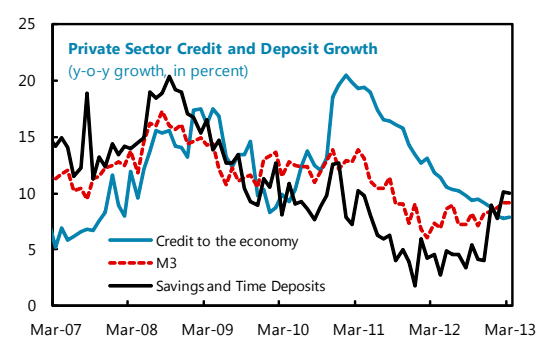
As a result international reserves have been declining while the exchange rate has depreciated moderately ...



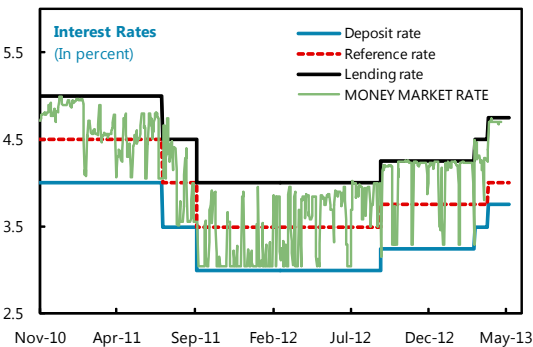
... but at end-2012, ratios of reserve were adequate.



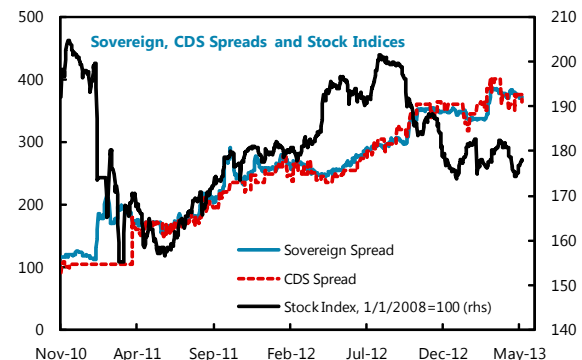
Credit to the economy has been declining but deposits are picking up ...



... while interest rates have been increasing.



The stock index has been falling since last year and sovereign spreads are rising.



Sources: Tunisian authorities; and IMF staff estimates.

Table 1. Tunisia: Selected Economic and Financial Indicators, 2009–15

	2009	2010	2011	Prel.		Proj.	
				2012	2013	2014	2015
<b>Production and income (percent change)</b>							
Real GDP	3.1	2.8	-1.9	3.6	4.0	4.5	5.0
GDP deflator	3.3	4.7	5.1	5.3	5.6	4.4	5.2
Consumer price index (CPI), average	3.5	4.4	3.5	5.6	6.0	4.7	4.7
Consumer price index (CPI), end of period	4.0	4.1	4.2	5.9	5.3	5.0	4.5
Gross national savings (in percent of GDP)	22.1	21.8	16.5	17.3	17.3	19.0	20.2
Gross investment (percent of GDP)	24.9	26.6	24.1	25.4	24.7	25.0	25.3
<b>Central government (percent of GDP, unless indicated otherwise 1/)</b>							
Total revenue (excl. grants)	23.1	23.3	24.2	23.1	23.8	24.0	24.0
Total expenditure and net lending	25.8	23.9	27.7	28.5	31.1	30.3	27.7
Central government balance (excl. grants)	-2.7	-0.6	-3.5	-5.4	-7.3	-6.4	-3.6
Structural fiscal balance 2/	-2.3	-1.1	-2.9	-4.7	-5.0	-3.8	-3.3
General government debt (foreign and domestic)	42.8	40.4	44.0	44.0	45.3	49.5	49.1
Foreign currency public debt (percent of total debt)	58.4	60.7	58.0	62.7	65.7	68.5	69.8
<b>Total external debt</b>							
External debt (US\$ billions)	21.5	21.4	22.1	23.3	25.0	27.6	29.2
External debt (percent of GDP)	49.4	48.3	47.8	51.6	51.1	54.5	54.8
Debt service ratio (percent of exports of GNFS)	11.9	10.5	11.9	12.0	9.5	9.2	7.2
<b>Money and credit (percent change)</b>							
Credit to the economy	10.3	19.6	13.4	8.7	10.8	11.7	11.1
Broad money (M3 of the financial system)	13.0	12.1	9.1	8.4	12.6	12.0	13.5
Velocity of circulation (GDP/M3)	1.53	1.47	1.38	1.39	1.36	1.32	1.29
<b>External sector (percent change)</b>							
Exports of goods, f.o.b. (in \$)	-24.8	14.0	8.5	-5.2	6.5	5.6	10.5
Imports of goods, f.o.b. (in \$)	-21.9	15.9	7.7	1.5	5.1	3.7	7.1
Exports of goods, f.o.b. (volume)	-9.7	6.6	-0.4	1.0	5.7	5.2	9.9
Import of goods, f.o.b. (volume)	1.0	-1.9	-6.2	9.4	5.8	6.1	9.0
Trade balance (percent of GDP)	-8.5	-10.3	-10.3	-13.4	-12.6	-11.9	-10.9
Current account (percent of GDP)	-2.8	-4.8	-7.3	-8.1	-7.5	-6.0	-5.1
Foreign direct investment (percent of GDP)	3.3	3.0	0.9	3.9	2.1	2.5	3.0
Terms of trade (deterioration -)	7.7	-9.6	-5.2	1.2	1.4	2.5	1.9
<b>Official reserves</b>							
Gross official reserves (US\$ billions, e.o.p)	10.6	9.5	7.5	8.6	9.0	10.8	11.9
In months of next year's imports of goods and services, c.i.f.	5.2	4.4	3.4	3.8	3.8	4.2	4.5
<b>Memorandum items:</b>							
GDP at current prices (TD millions)	58,883	63,397	65,370	71,332	78,334	85,465	94,406
GDP at current prices (US\$ billions)	43.6	44.3	46.4	45.4	48.9	50.6	53.3
Population (millions)	10.4	10.5	10.7	10.8	10.9	11.1	11.2
GDP per capita (US\$)	4,177	4,199	4,350	4,212	4,483	4,576	4,757
Unemployment rate (percent, ILO)	13.3	13.0	18.9	16.7	...	...	...
Exchange rate: dinar/US\$ (average)	1.35	1.43	1.41	1.57	...	...	...
Real effective exchange rate (percent change, depreciation -) 3/	-1.2	-0.5	-1.7	0.0	...	...	...
Interest rate (money market rate, in percent, e.o.p)	4.10	4.12	3.53	3.30	...	...	...
Stock market TUNINDEX (12/31/1997=1000)	4,292	5,113	4,722	4,580	...	...	...
Sources: Tunisian authorities; and IMF staff estimates and projections.							
1/ Excludes the social security accounts.							
2/ Excludes banking recapitalization costs and one-off arrears payments for energy subsidies.							
3/ Information Notice System.							

**Table 2. Tunisia: Balance of Payments, 2009–15**  
(In millions of U.S. dollars, unless otherwise indicated)

	2009	2010	2011	Prel. 2012	Projections					2014	2015
					2013						
					Q1	Q2	Q3	Q4	Year		
Current account	-1,234	-2,105	-3,402	-3,671	-867	-1,130	-815	-835	-3,647	-3,046	-2,717
Trade balance	-3,699	-4,575	-4,799	-6,069	-1,139	-1,666	-1,494	-1,851	-6,151	-6,035	-5,813
Exports	14,419	16,431	17,824	16,895	4,682	4,790	4,233	4,281	17,985	18,987	20,989
Energy	1,953	2,315	2,592	2,832	789	807	713	721	3,029	3,165	3,531
Non-energy	12,465	14,116	15,231	14,063	3,893	3,983	3,520	3,560	14,956	15,823	17,458
Imports	-18,118	-21,006	-22,623	-22,964	-5,821	-6,456	-5,727	-6,132	-24,136	-25,022	-26,802
Energy	-2,066	-2,653	-3,409	-4,076	-1,026	-1,138	-1,010	-1,081	-4,256	-4,235	-4,260
Non-energy	-16,052	-18,353	-19,214	-18,888	-4,795	-5,318	-4,718	-5,051	-19,880	-20,788	-22,542
Of which: Nonfood	-14,879	-16,810	-17,339	-17,409	-4,405	-4,885	-4,334	-4,629	-18,265	-19,299	-21,005
Services and transfers (net)	2,465	2,470	1,397	2,398	272	537	679	1,016	2,503	2,989	3,096
Nonfactor	2,525	2,460	1,552	1,935	447	517	631	455	2,050	2,557	2,801
Of which: Tourism	2,571	2,461	1,680	2,019	339	513	703	510	2,065	2,491	2,739
Factor Services and Transfers (net)	-60	10	-154	462	-175	20	47	560	453	432	296
Of which: Workers' remittances	1,964	2,063	1,990	2,222	474	474	768	596	2,312	2,344	2,414
Interest payments on external debt	-685	-632	-654	-605	-171	-203	-148	-140	-662	-722	-732
Capital and financial account	2,465	1,343	1,309	4,822	-140	776	843	2,042	3,520	3,961	3,680
Excluding grants	2,297	1,252	1,142	4,371	-206	711	779	1,981	3,264	3,713	3,443
Capital account	164	82	154	439	64	63	63	60	250	242	231
Financial account	2,300	1,260	1,155	4,383	-204	712	780	1,982	3,270	3,719	3,450
Direct foreign investment (net)	1,437	1,309	417	1,761	261	316	364	451	1,391	1,603	1,838
Medium- and long-term loans (net)	339	145	652	1,596	-420	133	48	1,677	1,438	1,847	1,107
Disbursement	2,019	1,845	2,707	3,643	258	468	262	2,011	2,999	3,439	2,351
Amortization	-1,679	-1,700	-2,055	-2,046	-678	-335	-215	-334	-1,561	-1,592	-1,244
Short-term capital	525	-193	86	1,226	-27	282	392	-19	627	453	689
Errors and omissions 1/	392	-316	108	-31	-119	-24	-13	24	-132	-25	-28
Overall balance	1,623	-1,078	-1,984	1,120	-1,126	-378	14	1,231	-259	890	936
Reserve liabilities (Fund credits)					0	150	150	350	650	870	216
Changes in gross reserves	-1,623	1,078	1,984	-1,120	1,126	228	-164	-1,581	-391	-1,760	-1,152
<i>Memorandum items:</i>											
Current account balance/GDP (percent)	-2.8	-4.8	-7.3	-8.1	-1.7	-2.3	-1.7	-1.8	-7.5	-6.0	-5.1
Reserves (in billions of US\$)	10.6	9.5	7.5	8.6	7.5	7.3	7.5	9.0	9.0	10.8	11.9
Reserves in months of imports of goods 2/	5.7	4.8	3.7	4.1	3.5	3.4	3.4	4.1	4.1	4.6	4.8
Reserves in months of imports of goods and services 2/	5.2	4.4	3.4	3.8	3.2	3.1	3.2	3.8	3.8	4.2	4.5
Reserves/total short term external debt (percent) 3/	219.0	191.3	146.0	165.0	166.9	194.7	198.2	201.7	166.9	194.7	198.2
Excluding nonresidents deposits	470.0	402.5	303.3	342.7	346.6	648.5	659.8	671.5	346.6	648.5	659.8
Reserves/short-term debt (on remaining maturity basis) (percent)	161.5	142.7	106.3	118.3	130.1	151.9	164.7	169.4	130.1	151.9	164.7
Excluding nonresidents deposits	266.4	234.5	170.6	188.2	218.2	334.4	393.7	410.8	218.2	334.4	393.7
External medium- and long-term debt (billions of US\$)	16.7	16.4	16.9	18.1	17.4	17.7	17.9	19.6	19.6	22.1	23.1
External medium- and long-term debt/GDP (percent)	37.3	37.2	38.9	39.4	35.5	36.4	37.1	40.7	40.7	44.4	44.1
External short-term debt (billions of US\$)	4.8	5.0	5.2	5.2	5.2	5.3	5.3	5.4	5.4	5.5	6.0
External short-term debt/GDP (percent)	10.8	11.3	11.8	11.4	10.6	10.8	11.0	11.3	11.3	11.1	11.5
Debt service ratio (as percent XGS, including IMF)	11.9	10.5	11.9	12.0	14.4	8.6	6.3	8.5	9.5	9.2	7.2
Goods export real growth (percent)	-9.7	6.6	-0.4	1.0	-4.2	-5.0	-3.4	-7.6	5.7	5.2	9.9
Non-energy	-10.1	9.0	2.3	0.5	-2.4	-1.3	-0.5	-0.1	5.2	4.6	9.0
Goods import real growth (percent)	1.0	-1.9	-6.2	9.4	9.7	10.0	10.7	10.3	5.8	6.1	9.0
Non-energy	3.6	-2.1	-6.6	8.2	8.5	-4.0	-1.8	-3.2	5.7	6.3	9.5

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

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

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

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

**Table 3. Tunisia: External Financing Needs, 2010–15**  
(In millions of U.S. dollars)

	2010	2011	Prel. 2012	Proj.					2014	2015
				2013						
				Q1	Q2	Q3	Q4	Year		
Total financing requirements	9,226	10,596	9,258	6,924	6,508	5,998	6,119	9,970	9,611	9,193
Current account deficit - Capital transfers	2,022	3,248	3,232	803	1,066	753	775	3,397	2,804	2,486
Current account deficit	2,105	3,402	3,671	867	1,130	815	835	3,647	3,046	2,717
Capital account	82	154	439	64	63	63	60	250	242	231
Amortizations	6,887	7,456	5,995	6,002	5,417	5,232	5,368	6,441	6,782	6,680
General government	1,017	1,419	1,226	524	182	116	150	972	1,014	674
Banks	48	45	58	11	11	7	13	42	41	40
Corporate 1/	5,822	5,992	4,711	5,467	5,224	5,109	5,205	5,428	5,727	5,965
Short-term debt	5,187	5,402	3,949	5,324	5,082	5,017	5,031	4,880	5,190	5,436
Long-term debt	635	591	762	143	142	91	174	547	537	529
Net errors and omissions	316	-108	31	119	24	13	-24	132	25	28
Total financing sources	9,226	10,596	9,258	6,924	6,358	5,849	5,769	9,320	8,741	8,977
FDI (net)	1,309	417	1,761	261	316	364	451	1,391	1,603	1,838
Disbursements (debt)	6,791	8,600	8,953	5,455	5,938	5,668	7,265	8,304	9,074	8,468
General government	798	1,778	3,144	102	314	110	1,713	2,239	2,906	1,750
Banks	74	66	35	11	11	11	11	43	38	43
Corporate 1/	5,919	6,756	5,774	5,341	5,613	5,547	5,541	6,022	6,130	6,675
Short-term debt	4,946	5,893	5,310	5,197	5,470	5,405	5,401	5,457	5,634	6,117
Long-term debt	973	863	464	144	143	142	140	565	495	558
Other portfolio flows net (Incl. Drawdown in commercial banks NFA)	48	-406	-336	83	-124	-20	-365	15	-176	-177
Drawdown in gross reserves	1,078	1,984	-1,120	1,126	228	-164	-1,581	-391	-1,760	-1,152
Financing gap	0	0	0	0	150	150	350	650	870	216
Fund credits 2/	0	0	0	0	150	150	350	650	870	216
Purchases	0	0	0	0	150	150	350	650	870	216
Repurchase	0	0	0	0	0	0	0	0	0	0
<i>Memo items</i>										
Gross international reserves (in millions of U. S. dollars)	9,509	7,525	8,645	7,519	7,291	7,454	9,036	9,036	10,795	11,947
In percent of short-term debt at remaining maturity	142.7	106.3	118.3	130.1	151.9	164.7	169.4	130.1	151.9	164.7
Government rollover rates (in percent)	78	125	256	20	173	95	1,145	230	287	260
Banks rollover rates (in percent)	153	146	61	101	101	155	80	103	92	105
Corporate rollover rates (in percent)	102	113	123	98	107	109	106	111	107	112

Sources: Tunisian authorities; and IMF staff projections.  
1/ Includes public and private enterprises.  
2/ Under the proposed schedule of purchases during SBA.

Table 4a. Tunisia: Central Government Financial Operations, 2009–15 1/

	(in millions of dinars)											
				Prel.	Budget	Q1	Q2	Q3	Q4	Est.	Proj.	
	2009	2010	2011	2012	2013					2014	2015	
Total revenue and grants	13,762	14,823	16,055	17,117	18,655	4,625	4,785	4,638	4,961	19,009	20,876	23,000
Revenue	13,584	14,769	15,847	16,484	18,255	4,592	4,785	4,638	4,594	18,609	20,476	22,700
Tax revenue	11,685	12,699	13,668	15,038	16,650	4,230	4,425	4,245	4,200	17,100	18,829	20,882
Nontax revenue	1,899	2,070	2,172	1,446	1,596	360	358	391	391	1,500	1,637	1,808
Capital income	0	0	8	0	9	2	2	2	3	9	10	10
Grants	178	54	207	633	400	33	0	0	367	400	400	300
Total expenditure and net lending	15,164	15,125	18,118	20,344	23,808	4,921	5,308	5,515	8,603	24,348	25,931	26,119
Total expenditure	14,510	15,417	18,378	20,694	23,806	4,972	5,348	5,531	8,244	24,096	24,235	26,019
Current expenditure	10,645	11,274	13,762	16,003	18,529	4,607	4,606	4,094	5,771	19,079	18,363	19,278
Wages and salaries	6,269	6,755	7,648	8,624	9,747	2,545	2,301	2,332	2,538	9,717	10,273	11,059
Goods and services	1,010	1,059	1,050	1,167	1,229	394	160	200	455	1,209	1,282	1,322
Interest payments	1,180	1,152	1,190	1,272	1,360	419	396	382	223	1,420	1,467	1,564
Domestic	561	557	592	686	695	236	185	228	106	755	742	814
External	619	595	598	587	665	183	211	154	117	665	725	750
Transfers and subsidies	2,186	2,308	3,874	4,940	5,699	1,249	1,000	1,180	2,250	5,679	5,342	5,334
Other expenditure (non-allocated)	0	0	0	0	495	0	750	0	305	1,055	0	0
of which: repayment of arrears 2/										700		
Capital expenditure	3,866	4,144	4,616	4,692	5,276	365	742	1,436	2,473	5,016	5,871	6,741
Net lending	654	-293	-259	-351	102	-52	-40	-15	359	252	1,697	100
of which: public banks' recapitalization				41	100	0	0	0	500	500	1,722	0
Central government deficit (-) (excl. grants)	-1,580	-356	-2,271	-3,860	-5,553	-329	-523	-877	-4,010	-5,738	-5,456	-3,419
Central government deficit (-) (incl. grants)	-1,402	-302	-2,064	-3,227	-5,153	-296	-523	-877	-3,643	-5,338	-5,056	-3,119
Float	-1,874	-1,362	-463	-420	0	-89	0	0	89	0	0	0
Central government deficit (-) (excl. grants, cash basis)	294	1,006	-1,808	-3,440	-5,553	-240	-523	-877	-4,099	-5,738	-5,456	-3,419
Central government deficit (-) (incl. grants, cash basis)	472	1,060	-1,600	-2,807	-5,153	-207	-523	-877	-3,732	-5,338	-4,719	-3,119
Financing	-472	-1,060	1,600	2,807	5,153	207	523	877	3,732	5,338	4,719	3,119
Foreign	-25	-230	398	2,497	2,462	-660	209	-10	2,490	2,028	3,195	1,906
Drawings	1,163	1,225	2,396	4,423	4,017	160	496	176	2,752	3,583	4,907	3,100
Amortization	1,189	1,455	1,998	1,926	1,555	820	287	186	262	1,555	1,712	1,194
Domestic	-447	-830	819	-83	1,491	805	-318	787	516	1,790	1,124	813
Drawings	1,036	635	1,335	1,518	1,800	347	508	164	363	1,381	1,214	2,441
Amortization	873	1,010	421	926	1,305	421	134	56	817	1,428	1,755	1,750
Government Deposits (+ = drawing / - = accumulation)	-598	-455	-95	-675	..	879	-691	679	470	1,337	-57	122
Bonds recapitalization	..	..	..	..	..	0	0	0	500	500	1,722	..
Privatization proceeds 3/	..	..	383	394	1,200	62	632	100	726	1,520	400	400
Financing gap	0	0	0	0	..	0	0	0	0	0	0	0
<i>Memorandum items:</i>												
Central government primary balance (cash basis)	-222	850	-874	-1,535	-3,793	212	-128	-495	-3,509	-3,918	-3,253	-1,555
Central government primary balance (excl. grants, cash basis)	-400	796	-1,081	-2,168	-4,193	90	-128	-495	-3,786	-4,318	-3,989	-1,855
Cyclically adjusted fiscal balance	-1,373	-669	-1,928	-3,390	..	..	..	..	..	-5,140	-4,975	-3,136
Structural fiscal balance	-1,373	-669	-1,928	-3,349	..	..	..	..	..	-3,940	-3,254	-3,136
General government debt 4/	25,190	25,641	28,779	31,418	36,658	17,454	23,651	29,583	35,453	35,453	42,342	46,397
Nominal GDP	58,883	63,397	65,370	71,332	78,308	19,584	19,584	19,584	19,584	78,334	85,465	94,406
Nominal nonagricultural GDP	54,004	58,743	60,019	65,488	..	18,035	18,035	18,035	18,035	72,140	78,785	87,202
Oil price (\$/barrel)	61.8	79.0	104.0	105.0	..	105	103	102	101	102.6	97.6	93.3
Sources: Tunisian authorities; and IMF staff estimates.												
1/ Includes special funds, <i>fonds de concours</i> . Does not include the social security system (CSS).												
2/ Arrears on energy subsidies payments accumulated in 2012.												
3/ Privatization receipts for 2013 include TD 300 million from privatization proceeds (mostly telecom) and sale of confiscated assets.												
4/ Gross debt: excludes debt of public enterprises.												

Table 4b. Tunisia: Central Government Financial Operations, 2009–15 1/

(In percent of GDP)

	2009	2010	2011	Prel.	Budget	Est.	Proj.	
				2012	2013	2014	2015	
Total revenue and grants	23.4	23.4	24.6	24.0	23.8	24.3	24.4	24.4
Revenue	23.1	23.3	24.2	23.1	23.3	23.8	24.0	24.0
Tax revenue	19.8	20.0	20.9	21.1	21.3	21.8	22.0	22.1
Nontax revenue	3.2	3.3	3.3	2.0	2.0	1.9	1.9	1.9
Grants	0.3	0.1	0.3	0.9	0.5	0.5	0.5	0.3
Total expenditure and net lending	25.8	23.9	27.7	28.5	30.5	31.1	30.3	27.7
Total expenditure	24.6	24.3	28.1	29.0	30.4	30.8	28.4	27.6
Current expenditure	18.1	17.8	21.1	22.4	23.7	24.4	21.5	20.4
Wages and salaries	10.6	10.7	11.7	12.1	12.4	12.4	12.0	11.7
Goods and services	1.7	1.7	1.6	1.6	1.6	1.6	1.5	1.4
Interest payments	2.0	1.8	1.8	1.8	1.7	1.8	1.7	1.7
Transfers and subsidies	3.7	3.6	5.9	6.9	7.3	7.2	6.2	5.7
Other expenditure (non-allocated)	0.0	0.0	0.0	0.0	0.6	1.3	0.0	0.0
Of which: repayment of arrears 2/						0.9		
Capital expenditure	6.6	6.5	7.1	6.6	6.7	6.4	6.9	7.1
Net lending	1.1	-0.5	-0.4	-0.5	0.1	0.3	2.0	0.1
Of which: public banks' recapitalization					0.1	0.6	2.0	
Central government deficit (-) (excl. grants)	-2.7	-0.6	-3.5	-5.4	-7.1	-7.3	-6.4	-3.6
Central government deficit (-), (incl. grants)	-2.4	-0.5	-3.2	-4.5	-6.6	-6.8	-5.9	-3.3
Float	-3.2	-2.1	-0.7	-0.6	..	0.0	0.0	0.0
Central government deficit (-), (excl. grants, cash basis)	0.5	1.6	-2.8	-4.8	-7.1	-7.3	-6.4	-3.6
Central government deficit (-), (incl. grants, cash basis)	0.8	1.7	-2.4	-3.9	-6.6	-6.8	-5.5	-3.3
Financing	-0.8	-1.7	2.4	3.9	6.6	6.8	5.5	3.3
Foreign	0.0	-0.4	0.6	3.5	3.1	2.6	3.7	2.0
Domestic	-0.8	-1.3	1.3	-0.1	1.9	2.3	1.3	0.9
Privatization proceeds 3/	0.0	0.0	0.6	0.6	1.5	1.9	0.5	0.4
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum items:</i>								
Central government primary balance (cash basis)	-0.4	1.3	-1.3	-2.2	-4.8	-5.0	-3.8	-1.6
Central government primary balance (excl. grants, cash basis)	-0.7	1.3	-1.7	-3.0	-5.4	-5.5	-4.7	-2.0
Cyclically adjusted fiscal balance	-2.3	-1.1	-2.9	-4.8	...	-6.6	-5.8	-3.3
Structural fiscal balance	-2.3	-1.1	-2.9	-4.7	...	-5.0	-3.8	-3.3
General government debt 4/	42.8	40.4	44.0	44.0	46.8	45.3	49.5	49.1
Domestic	17.8	15.9	18.5	16.4	17.8	15.5	15.6	14.9
External	25.0	24.5	25.5	27.6	29.0	29.7	33.9	34.3

Sources: Tunisian authorities; and IMF staff estimates.

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

2/ Arrears on energy subsidies payments accumulated in 2012.

3/ Privatization receipts for 2013 include TD 300 million from privatization proceeds (mostly telecom) and sale of confiscated assets.

4/ Gross debt: excludes debt of public enterprises.



**Table 4c. Tunisia: Statement of Central Government Operations, 2009-15 1/  
GFSM 2001 Presentation**

	2009	2010	2011	Prel. 2012	2013	Proj. 2014	2015
(In millions of dinars)							
<b>Revenue (a)</b>	<b>13,762</b>	<b>14,823</b>	<b>16,055</b>	<b>17,117</b>	<b>19,009</b>	<b>20,876</b>	<b>23,000</b>
Taxes	11,685	12,699	13,668	15,038	17,100	18,829	20,882
Taxes on income, profits and capital gains	4,646	5,033	5,936	6,133	7,095	7,863	8,685
Taxes on goods and services	4,996	5,313	5,330	6,080	6,971	7,544	8,431
Taxes on international trade and transactions	520	564	564	716	755	828	933
Other taxes	1,524	1,789	1,839	2,110	2,279	2,594	2,832
Grants	178	54	207	633	400	400	300
Other revenue	1,899	2,070	2,179	1,446	1,509	1,647	1,818
<b>Expenditure (b)</b>	<b>14,510</b>	<b>15,417</b>	<b>18,378</b>	<b>20,694</b>	<b>24,169</b>	<b>24,235</b>	<b>26,019</b>
Expense (b.1)	12,975	13,666	16,613	18,631	21,635	21,158	22,431
Compensation of employees	6,269	6,755	7,648	8,624	9,717	10,273	11,059
Goods and services	1,010	1,059	1,050	1,167	1,209	1,282	1,322
Interest payments	1,180	1,152	1,190	1,272	1,420	1,467	1,564
Domestic	561	557	592	686	755	742	814
External	619	595	598	587	665	725	750
Subsidies	1,230	1,280	2,636	3,353	3,870	3,333	2,974
Grants and Social Assistance Benefits	956	1,028	1,238	1,587	1,809	2,008	2,360
Capital transfers	2,330	2,393	2,851	2,628	2,482	2,795	3,153
Other expenditure non allocated	0	0	0	0	1,129	0	0
Net acquisition of nonfinancial assets (b.2)	1,536	1,751	1,765	2,064	2,534	3,077	3,587
<b>Gross operating balance (a-b.1)</b>	<b>788</b>	<b>1,156</b>	<b>-558</b>	<b>-1,514</b>	<b>-2,626</b>	<b>-282</b>	<b>568</b>
<b>Net lending/borrowing (a-b)</b> (Overall balance)	<b>-748</b>	<b>-595</b>	<b>-2,323</b>	<b>-3,578</b>	<b>-5,160</b>	<b>-3,359</b>	<b>-3,019</b>
<b>Net acquisition of financial assets</b>	654	-293	-643	-745	-1,268	1,297	-300
Domestic	654	-293	-643	-745	-1,268	1,297	-300
Loans (net lending by the treasury)	654	-293	-259	-351	252	1,697	100
Shares and other equity 2/	0	0	-383	-394	-1,520	-400	-400
<b>Net incurrence of liabilities</b>	-472	-1,060	1,217	2,413	3,818	4,319	2,719
Domestic	-447	-830	819	-83	1,790	1,124	813
Loans	-447	-830	819	-83	1,790	1,124	813
Foreign	-25	-230	398	2,497	2,028	3,195	1,906
Loans	-25	-230	398	2,497	2,028	3,195	1,906
<b>Memorandum items:</b>							
Primary balance	432	557	-1,133	-2,306	-3,740	-1,893	-1,455
General government debt 3/	25,190	25,641	28,779	31,418	35,453	42,342	46,397
Of which: Domestic	10,474	10,089	12,078	11,704	12,157	13,338	14,029
External	14,716	15,551	16,701	19,714	23,296	29,003	32,367
(In percent of GDP)							
<b>Revenue (a)</b>	<b>23.4</b>	<b>23.4</b>	<b>24.6</b>	<b>24.0</b>	<b>24.3</b>	<b>24.4</b>	<b>24.4</b>
Taxes	19.8	20.0	20.9	21.1	21.8	22.0	22.1
Grants	0.3	0.1	0.3	0.9	0.5	0.5	0.3
Other revenue	3.2	3.3	3.9	2.6	3.9	2.4	2.3
<b>Expenditure (b)</b>	<b>24.6</b>	<b>24.3</b>	<b>28.1</b>	<b>29.0</b>	<b>30.7</b>	<b>28.4</b>	<b>27.6</b>
Expense (b.1)	22.0	21.6	25.4	26.1	27.5	24.8	23.8
Compensation of employees	10.6	10.7	11.7	12.1	12.4	12.0	11.7
Goods and services	1.7	1.7	1.6	1.6	1.6	1.5	1.4
Interest payments	2.0	1.8	1.8	1.8	1.8	1.7	1.7
Subsidies	2.1	2.0	4.0	4.7	4.9	3.9	3.2
Grants and social assistance benefits	1.6	1.6	1.9	2.2	2.3	2.4	2.5
Capital transfers	4.0	3.8	4.4	3.7	3.1	3.3	3.3
Other expenditure non allocated	0.0	0.0	0.0	0.0	1.4	0.0	0.0
Net acquisition of nonfinancial assets (b.2)	2.6	2.8	2.7	2.9	3.2	3.6	3.8
<b>Gross operating balance (a-b.1)</b>	<b>1.3</b>	<b>1.8</b>	<b>-0.9</b>	<b>-2.1</b>	<b>-3.3</b>	<b>-0.3</b>	<b>0.6</b>
<b>Net lending/borrowing (a-b)</b> (Overall balance)	<b>-1.3</b>	<b>-0.9</b>	<b>-3.6</b>	<b>-5.0</b>	<b>-6.5</b>	<b>-3.9</b>	<b>-3.2</b>
<b>Net acquisition of financial assets</b>	1.1	-0.5	-0.4	-0.5	0.3	2.0	0.1
Loans (net lending by the treasury)	1.1	-0.5	-0.4	-0.5	0.3	2.0	0.1
<b>Net incurrence of liabilities</b>	-0.8	-1.7	1.9	3.4	4.9	5.1	2.9
Domestic	-0.8	-1.3	1.3	-0.1	2.3	1.3	0.9
Foreign	0.0	-0.4	0.6	3.5	2.6	3.7	2.0
Sources: Tunisian authorities; and IMF staff estimates.							
1/ Includes special funds, fonds de concours. Does not include the social security system (CSS).							
2/ Includes privatization receipts.							
3/ Gross debt: includes debt held by social security funds (CSS); excludes debt of public enterprises.							

Table 5. Tunisia: Monetary Survey (Financial System), 2009–15

	2009	2010	2011	2012	1Q 13	Proj.				
						2Q 13	3Q 13	2013	2014	2015
	(Millions of dinars)									
Net foreign assets (NFA)	9,631	9,078	5,749	7,159	5,758	4,988	5,065	7,189	9,141	11,279
Foreign assets	16,138	16,023	12,893	15,453	14,028	13,852	14,265	16,812	20,768	23,812
Central bank	13,978	13,705	11,315	13,455	12,035	11,776	12,169	14,748	18,594	21,542
Foreign liabilities	-6,508	-6,946	-7,143	-8,294	-8,271	-8,864	-9,200	-9,624	-11,627	-12,533
Central bank	-616	-623	-782	-1,134	-1,131	-1,426	-1,689	-2,227	-3,839	-4,398
Net domestic assets (NDA)	28,960	34,190	41,454	44,007	46,702	48,766	50,953	50,447	55,403	61,953
Domestic credit	39,703	46,370	53,577	57,993	60,864	62,541	64,973	65,566	72,851	81,132
Credit to the government (net)	3,643	3,227	4,659	4,795	6,142	5,722	6,566	6,600	6,966	7,950
Central bank net credit	-2,812	-3,250	-3,355	-3,461	-2,207	-2,898	-2,219	-2,124	-2,182	-2,059
Commercial banks	3,060	2,937	3,568	3,690	3,660	3,809	3,852	3,671	3,455	3,731
Other	4,012	4,189	5,086	5,265	5,386	5,508	5,630	5,751	6,391	6,977
Credit to the economy	36,061	43,144	48,918	53,198	54,722	56,820	58,407	58,966	65,885	73,182
Other items (net)	-10,743	-12,181	-12,123	-13,987	-14,162	-13,775	-14,020	-15,119	-17,448	-19,180
Money plus quasi-money (M2)	36,497	40,854	44,652	48,288	49,534	50,781	52,962	54,521	61,056	69,274
Money (M1)	14,266	15,862	19,007	20,063	20,710	21,358	22,005	22,652	25,368	28,782
Currency	5,010	5,518	6,814	6,550	6,761	6,972	7,184	7,395	8,281	9,396
Demand deposits	9,256	10,344	12,192	13,513	13,949	14,385	14,821	15,257	17,086	19,386
Quasi-money	22,231	24,992	25,646	28,225	29,136	30,047	30,957	31,868	35,688	40,492
Long-term deposits (M3-M2)	2,094	2,414	2,551	2,877	2,925	2,972	3,055	3,115	3,488	3,958
Broad money (M3)	38,591	43,267	47,203	51,165	52,459	53,753	56,018	57,635	64,544	73,232
	(Annual rate of change in percent)									
Net foreign assets	17.8	-5.7	-36.7	24.5	14.3	-6.3	0.6	0.4	27.2	23.4
Net domestic assets	11.5	18.1	21.2	6.2	9.0	12.7	14.0	14.6	9.8	11.8
Domestic credit	10.4	16.8	15.5	8.2	9.6	11.9	12.9	13.1	11.1	11.4
Credit to government (net)	11.0	-11.4	44.4	2.9	11.0	9.2	18.1	37.6	5.5	14.1
Credit to the economy	10.3	19.6	13.4	8.7	9.4	10.6	11.4	10.8	11.7	11.1
Money and quasi-money (M2)	13.0	11.9	9.3	8.1	9.7	10.7	12.8	12.9	12.0	13.5
Broad money (M3)	13.0	12.1	9.1	8.4	9.5	10.6	12.7	12.6	12.0	13.5
	(Annual growth rates, in percent of broad money)									
Foreign assets (net)	4.3	-1.4	-7.7	3.0	1.5	-0.7	0.1	0.1	3.4	3.3
Net domestic assets	8.8	13.6	16.8	5.4	8.0	11.3	12.6	12.6	8.6	10.1
Domestic credit	10.9	17.3	16.7	9.4	11.1	13.7	14.9	14.8	12.6	12.8
Credit to the government (net)	1.1	-1.1	3.3	0.3	1.3	1.0	2.0	3.5	0.6	1.5
Credit to the economy	10.3	19.6	13.4	8.7	9.8	11.2	12.0	11.3	12.0	11.3
Other items (net)	-2.2	-3.7	0.1	-3.9	-3.1	-2.4	-2.3	-2.2	-4.0	-2.7
<i>Memorandum items:</i>										
GDP (millions of dinars)	58,883	63,397	65,370	71,332	...	...	...	78,334	85,465	94,406
Nominal GDP growth (percent)	6.5	7.7	3.1	9.1	...	...	...	9.8	9.1	10.5
Reserve money (millions of dinars)	9,753	8,415	9,406	10,989	...	...	...	11,437	12,808	14,532
Velocity (GDP/M3)	1.53	1.47	1.38	1.39	...	...	...	1.36	1.32	1.29
Multiplier (M2/M0)	3.74	4.86	4.75	4.39	...	...	...	4.77	4.77	4.77

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

**Table 6. Tunisia Financial Soundness Indicators of the Banking Sector, 2006–2012**  
(In percent, unless indicated otherwise)

	2006	2007	2008	2009	2010	2011	Prel. 2012
Regulatory capital	2922.4	3153.9	3812.2	4436.2	4945.3	5,370	5,858
Regulatory capital to risk-weighted assets	11.8	11.6	11.7	12.2	11.6	11.9	12.3
Tier 1 capital to risk weighted assets	11.2	10.8	10.6	10.7	10.2	10.0	10.3
Capital to assets	8.0	7.6	8.1	8.5	8.4	8.5	8.3
<b>Asset quality</b>							
Sectoral distribution of loans to total loans							
Industry	32.8	31.6	31.3	30.0	30.5	28.6	27.9
Agriculture	4.0	3.8	3.6	3.4	2.9	2.9	2.8
Commerce	16.7	14.9	17.3	17.4	15.0	16.0	15.4
Construction	4.9	3.2	4.5	4.9	5.9	5.6	5.4
Tourism	11.2	10.4	9.1	8.2	7.3	7.3	6.9
Households	18.1	18.8	20.1	21.6	22.1	23.4	25.4
Other	12.3	17.2	14.3	14.4	16.3	16.3	16.2
FX-loans to total loans	2.4	2.5	3.9	4.5	5.3	5.1	4.8
Credit to the private sector to total loans	75.1	73.6	71.6	70.4	70.6	67.4	67.7
Nonperforming Loans (NPLs) to total loans 1/	19.3	17.6	15.5	13.2	13.0	13.3	13.5
Specific provisions to NPLs 1/	49.0	53.2	56.8	58.3	58.5	57.3	57.3
NPLs, net of provisions, to Tier 1 capital	102.1	90.4	71.1	57.9	60.3	66.3	66.8
Specific provisions to total loans	9.5	9.4	8.8	7.7	7.6	7.6	7.7
General provisions to total loans	-	-	-	-	-	0.4	-
<b>Profitability</b>							
Return on assets (ROA)	0.7	0.9	1.0	1.0	0.9	0.6	0.8
Return on equity (ROE)	7.0	10.1	11.2	11.7	10.2	6.6	9.9
Interest rate average spread (b/w loans and deposits)	3.51	3.64	3.60	3.49	3.53	3.03	3.02
Interest return on credit	6.87	7.07	7.01	6.35	6.24	5.67	5.36
Cost of risk as a percent of credit	2.3	2.2	1.4	1.2	1.7	1.2	1.0
Net interest margin to net banking product (PNB)	57.9	58.2	58.6	58.8	58.6	57.2	58.3
Operating expenses to PNB	51.0	48.3	45.4	47.2	46.5	50.7	50.0
Operating expenses to total assets	1.8	1.7	1.6	1.6	1.6	1.7	1.7
Personnel expenses to non-interest expenses	62.6	59.4	60.4	61.4	59.1	62.3	60.1
Trading and other non-interest income to PNB	21.8	22.1	21.7	22.1	21.8	22.6	21.7
<b>Liquidity</b>							
Liquid assets to total assets	29.8	29.9	31.6	32.1	29.8	26.5	28.2
Liquid assets to short-term liabilities	120.8	121.9	124.0	119.1	104.1	89.4	89.2
Deposits to loans	94.4	98.6	98.9	100.9	94.6	87.4	89.7
Deposits of state-owned enterprises to total deposits	12.8	15.6	13.8	14.8	13.8	12.6	13.1
<b>Sensitivity to market risk</b>							
FX net open position to Tier 1 Capital	1.02	1.05	1.40	1.53	1.35	1.94	2.3
Source: Central Bank of Tunisia.							
1/ For 2012, as of September.							

Table 7. Tunisia: Illustrative Medium-Term Growth Scenario, 2009–18

	2009	2010	2011	Prel.		Proj.				
				2012	2013	2014	2015	2016	2017	2018
	(Change in percent)									
Real GDP growth	3.1	2.8	-1.9	3.6	4.0	4.5	5.0	4.8	4.8	4.8
Agriculture	6.0	-2.0	9.2	3.9	0.0	3.0	3.0	3.0	3.0	3.0
Nonagriculture	2.9	4.3	-2.8	3.6	4.4	4.6	5.2	4.9	4.9	4.9
Total consumption	4.0	4.5	3.2	5.1	4.6	2.0	3.6	3.0	4.7	6.3
Private consumption (residual)	3.9	4.5	2.0	6.6	4.4	2.1	3.8	3.3	5.1	7.2
Public consumption	4.2	4.4	7.6	2.7	5.5	1.4	2.6	2.0	3.1	2.5
Investment	0.1	8.5	-15.5	4.9	3.9	5.4	6.8	4.9	5.8	5.9
Gross fixed capital formation	4.6	3.1	-15.5	5.0	4.0	5.5	7.0	5.0	6.0	6.0
Change in stocks	-43.5	169.4	-16.0	3.0	3.0	4.5	5.0	4.0	4.0	4.0
Exports of goods and nfs 1/	-7.6	12.6	-4.4	6.7	4.9	10.0	10.7	9.0	5.7	4.2
Imports of goods and nfs 1/	-7.2	17.5	-3.2	9.2	5.6	6.0	8.8	6.2	5.9	6.5
Inflation (annual average)	3.5	4.4	3.5	5.6	6.0	4.7	4.7	4.2	4.0	4.0
	(Percent of GDP)									
Gross national savings	22.1	21.8	16.5	17.3	17.3	19.0	20.2	21.3	22.0	22.0
Consolidated government 2/	4.3	6.1	4.1	2.2	-0.2	1.1	4.0	4.6	5.1	5.8
Rest of the economy	17.8	15.7	12.4	15.1	17.5	17.9	16.2	16.8	16.9	16.3
Gross investment	24.9	26.6	24.1	25.4	24.7	25.0	25.3	25.4	25.5	25.2
Consolidated government	6.6	6.6	7.1	6.6	6.4	6.9	7.2	7.2	7.5	7.6
Rest of the economy	18.3	20.0	17.0	18.8	18.3	18.1	18.1	18.1	18.0	17.5
Total consumption	78.0	78.9	83.2	83.7	83.6	81.9	80.4	79.2	78.7	78.9
Private consumption	61.8	62.7	65.5	66.2	65.8	64.5	63.5	62.8	62.6	63.3
Public consumption	16.2	16.3	17.6	17.5	17.8	17.3	16.9	16.4	16.1	15.5
Savings-investment gap	-2.8	-4.8	-7.6	-8.1	-7.5	-6.0	-5.1	-4.0	-3.5	-3.1
Consolidated government	-2.3	-0.4	-3.0	-4.4	-6.7	-5.8	-3.2	-2.6	-2.4	-1.9
Rest of the economy	-0.5	-4.3	-4.6	-3.7	-0.8	-0.2	-1.9	-1.4	-1.1	-1.2
<i>Memorandum items</i>										
Nominal GDP at current prices (TD millions)	58,883	63,397	65,370	71,332	78,334	85,465	94,406	102,838	112,671	124,214
General government debt in percent of GDP	42.8	40.4	44.0	44.0	45.3	49.5	49.1	48.5	46.7	43.9
External government debt in percent of GDP	25.0	24.5	25.5	27.6	29.7	33.9	34.3	33.6	31.4	28.8
Central government balance 3/	-2.7	-0.6	-3.5	-5.4	-7.3	-6.4	-3.6	-3.0	-2.8	-2.3
Current account balance in percent of GDP	-2.8	-4.8	-7.6	-8.1	-7.5	-6.0	-5.1	-4.0	-3.5	-3.1
Sources: Tunisian authorities; and IMF staff estimates.										
1/ Goods and nonfactor services.										
2/ Includes social security, excludes privatization receipts.										
3/ Excluding grants and privatization, in percent of GDP.										

Table 8. Tunisia: Schedule of Proposed Purchases Under the SBA Arrangement, 2013–15

Review	Availability Date	Action	Purchase		Disbursements
			Millions of SDRs	Percent of quota 1/	Millions of US\$ 2/
	June 7, 2013	Board approval of the SBA	98.800	34	150.089
First Review	September 15, 2013	Observance of end-June 2013 performance criteria, completion of the first review	98.600	34	149.786
Second Review	December 15, 2013	Observance of end-September 2013 performance criteria, completion of the second review	230.520	80	350.188
Third Review	March 15, 2014	Observance of end-December 2013 performance criteria, completion of the third review	145.080	51	219.526
Fourth Review	June 15, 2014	Observance of end-March 2014 performance criteria, completion of the fourth review	143.250	50	216.757
Fifth Review	September 15, 2014	Observance of end-June 2014 performance criteria, completion of the fifth review	143.250	50	216.757
Sixth Review	December 15, 2014	Observance of end-September 2014 performance criteria, completion of the sixth review	143.250	50	216.757
Seventh Review	March 15, 2015	Observance of end-December 2014 performance criteria, completion of the seventh review	71.625	25	108.121
Eighth Review	May 15, 2015	Observance of end-March 2015 performance criteria, completion of the eighth review	71.625	25	108.121
Total			1146.000	400	1,736.102
Source: IMF staff projections.					
1/ Quota is SDR 286.5 million.					

**Table 9. Tunisia: Indicators of Fund Credit, 2012–18**  
(Millions of SDR)

	2012	2013	2014	2015	2016	2017	2018
<b>Existing and prospective Fund credit</b>							
Disbursement	0	428	575	143	0	0	0
Stock 1/	0	428	1,003	1,146	1,109	787	278
Obligations	0	3	9	16	53	340	524
Repurchase	-	-	-	-	37	322	509
Charges	0.02	2.72	8.94	16.22	16.22	17.97	14.7
<b>Stock of existing and prospective Fund credit</b>							
In percent of quota	0.0	149.4	350.0	400.0	387.1	274.7	97.0
In percent of GDP	0.0	1.3	3.0	3.2	3.0	2.0	0.7
In percent of exports of goods and services	0.0	2.8	6.1	6.3	5.7	3.8	1.3
In percent of gross reserves	0.0	7.2	14.1	14.5	12.8	8.3	2.6
<b>Obligations to the Fund from existing and prospective Fund arrangements</b>							
In percent of quota	0.0	0.9	3.1	5.7	18.6	118.7	182.8
In percent of GDP	0.0	0.0	0.0	0.0	0.1	0.9	1.3
In percent of exports of goods and services	0.0	0.0	0.1	0.1	0.3	1.6	2.4
In percent of gross reserves	0.0	0.0	0.1	0.2	0.6	3.6	4.9

Source: IMF staff estimates.

1/ End of period. Calculated based on the assumption of a new SBA of 400 percent of quota conditional upon Board approval of the SBA.

## Annex. Public and External Debt Sustainability Analysis

### Public debt

**An expansionary fiscal policy in the aftermath of the revolution, combined with a decline in economic activity, increased public debt.** After having declined from an average of 60 percent of GDP in the 1990s to 40.4 percent of GDP in 2010, the debt-to-GDP ratio increased in 2011 to 44 percent of GDP. By the end of 2012, favorable growth dynamics kept the debt-to-GDP ratio constant at 44 percent, a relatively comfortable level that is lower than in similar countries in the region, and achieved despite a wider fiscal deficit.

**Under the baseline scenario, public debt is expected to increase by 5 percentage points of GDP in the short term and to progressively decline over the medium term to about 44 percent.** Increased backing of recapitalization costs and a wider deficit will contribute to increasing the debt-to-GDP ratio to 49 percent by 2015, despite favorable growth dynamics. The debt-to-GDP ratio is expected to gradually decline thereafter, reaching about 44 percent by end-2018, slightly below its 2010 level. This favorable debt dynamic reflects the fiscal consolidation envisaged by the authorities (an overall deficit declining to 2.3 percent of GDP in 2018) and higher medium-term real growth rates (4.6 percent on average during 2013–18).

**The public debt dynamics are very vulnerable to adverse shocks and could deteriorate significantly compared to the baseline, remaining close to or above 50 percent of GDP.** Under an adverse scenario in which the medium-term fiscal consolidation is not implemented, public debt would be on an increasing path and would reach 60 percent of GDP by 2018. In addition, the public debt dynamic would worsen under most bound tests. Under a permanent negative shock to real growth (3.2 percent during 2013–18, on average), public debt would remain on an increasing path, reaching about 55 percent of GDP by end-2018. Debt dynamics would also not remain stable under a primary deficit at current or historical levels. In addition, public debt would reach about 60 percent of GDP as a result of a one-off 10 percent of GDP shock to contingent liabilities, slightly declining to about 53 percent of GDP by 2018.<sup>1</sup> Finally, as more than 60 percent of public debt is denominated in foreign currency, a one-time 30 percent depreciation would increase the public debt-to-GDP ratio to about 63 percent and then decline to 56 percent by 2018. On the other hand, the public debt dynamics would be relatively resilient to an interest rate shock, staying at around 50 percent over the medium term.

<sup>1</sup> The one-off 10 percent of GDP shock to contingent liabilities reflects an additional 3 percent of GDP bank recapitalization costs and the realization of about 7 of GDP of government's contingent liabilities from public enterprises (these represent about 70 percent of existing government's contingent liabilities).

## External debt

*After a decade of steady decline, external debt (in percent of GDP) has increased moderately as a result of the post-revolution fiscal expansion and a widening current account deficit. Notwithstanding this increase, external debt will remain sustainable under the baseline and under most shocks, although it would be vulnerable to a large exchange rate shock.*

**Tunisia's external debt is relatively low and has been stable in recent years.** External debt declined sharply in recent years, from more than 65 percent of GDP in 2002 to 48 percent of GDP at end-2011, on the back of a strong fiscal adjustment and moderate current account deficits. The authorities have followed prudent borrowing policies, refraining from accessing international capital markets and opting instead for concessional resources from multilateral and development banks.<sup>2</sup>

**Under the baseline projections, external debt is projected to increase to 55 percent of GDP in 2015 before declining following favorable current account dynamics.** As a result, Tunisia's external debt sustainability risks appear contained in the period ahead. The analysis assumes that Tunisia's government will implement a significant fiscal consolidation in the medium term and continue to pursue cautious external borrowing policies. After declining in 2013 following large privatization receipts, the external debt-to-GDP ratio is expected to rise in 2015 before slightly declining to around 49.2 percent by end-2018.

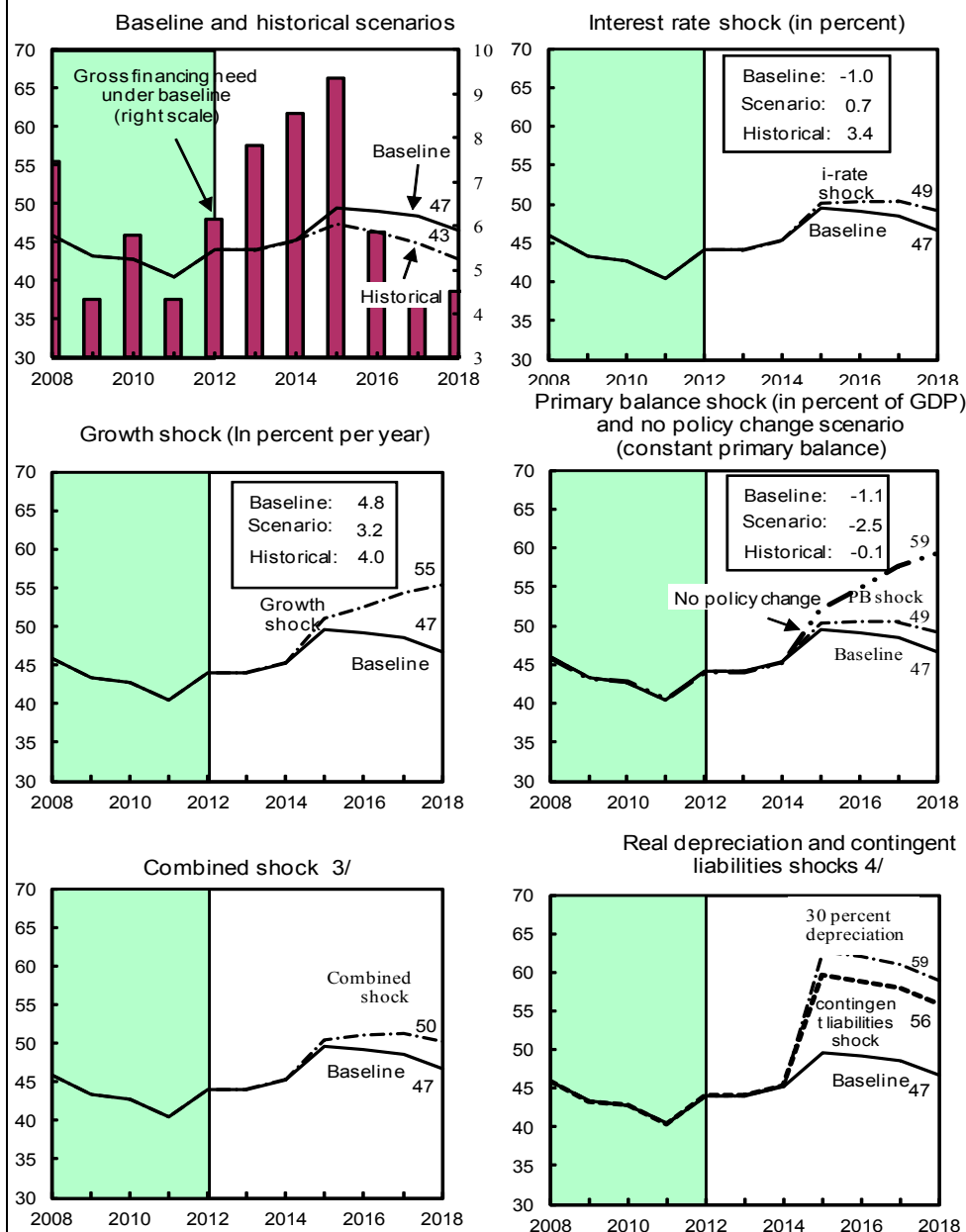
**The external debt ratio is resilient to most types of adverse external shocks (except large exchange rate depreciation).** The relatively low level and the profile (low average interest rate and relatively long maturity) of Tunisia's debt make it robust to most shocks, with the exception of large real exchange rate depreciation. The external debt ratio remains below 58 percent of GDP throughout the projection period under all but one alternative scenario and all bound tests. For example, a permanent negative shock to growth or to the current account would only raise the debt ratio to 55–58 percent of GDP, while an increase in the average interest rate would have a much lower impact.<sup>3</sup> However a sharp real depreciation (one-time 30 percent) of the exchange rate in 2013 relative to the baseline would raise the debt ratio to almost 80 percent of GDP.

<sup>2</sup> Prior to last year's international bond issuances with U.S. and Japanese guarantees, the last international bond issuance was in 2007. The first maturing international bond is due in 2017.

<sup>3</sup> The size of each shock is half a standard deviation, except for the growth rate, which is reduced by  $\frac{3}{4}$  of one standard deviation.



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



Sources: IMF, country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks and a 1/2 of standard deviation growth shock. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

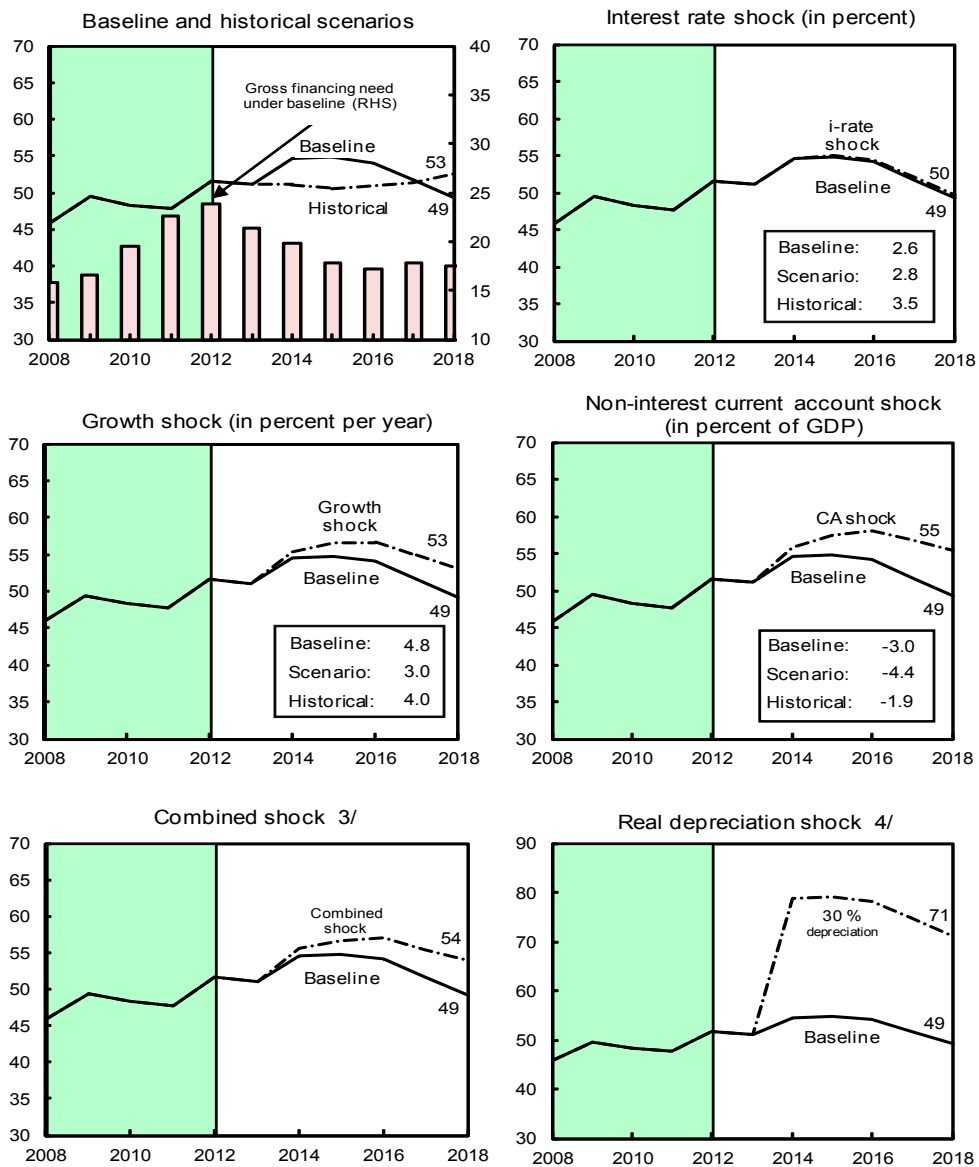
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2013, 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 1. Public Sector Debt Sustainability Framework, 2008-2018**  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 10/	
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018		
<b>1 Public sector debt 1/</b>	43.3	42.8	40.4	44.0	44.0	<b>45.3</b>	<b>49.5</b>	<b>49.1</b>	<b>48.5</b>	<b>46.7</b>	<b>43.9</b>		
o/w foreign-currency denominated	26.3	25.0	24.5	25.5	27.6	29.7	33.9	34.3	33.6	31.4	28.8	<b>-1.0</b>	
2 Change in public sector debt	-2.7	-0.5	-2.3	3.6	0.0	1.2	4.3	-0.4	-0.7	-1.8	-2.8	0.0	
3 Identified debt-creating flows (4+7+12)	-1.1	1.3	1.5	2.7	3.5	1.6	1.1	-0.5	-0.3	-0.9	-0.8	0.0	
4 Primary deficit	-1.4	-0.8	-0.9	1.6	3.1	4.5	2.1	1.4	0.9	0.8	0.3	<b>1.0</b>	
5 Revenue and grants	29.9	29.6	30.0	31.2	30.7	30.9	31.1	31.0	30.9	30.9	30.8		
6 Primary (noninterest) expenditure	28.5	28.8	29.1	32.8	33.8	35.5	33.2	32.4	31.9	31.7	31.1		
7 Automatic debt dynamics 2/	0.6	2.1	2.4	1.7	0.9	-1.6	-0.5	-1.5	-1.0	-1.5	-1.7	-1.6	
8 Contribution from interest rate/growth differential 3/	-1.3	2.0	0.1	0.6	-1.9	-2.1	-2.1	-3.0	-2.4	-2.7	-2.8	-2.7	
9 Of which contribution from real interest rate	0.6	3.3	1.3	-0.2	-0.4	-0.5	-0.2	-0.8	-0.3	-0.6	-0.8	-0.7	
10 Of which contribution from real GDP growth	-1.9	-1.3	-1.2	0.8	-1.5	-1.6	-1.9	-2.2	-2.2	-2.1	-2.0	-1.9	
11 Contribution from exchange rate depreciation 4/	1.9	0.2	2.3	1.1	2.8	0.5	1.5	1.5	1.4	1.2	1.1	1.0	
12 Other identified debt-creating flows	-0.3	0.0	0.0	-0.6	-0.6	-1.3	-0.5	-0.4	-0.2	-0.2	0.6	0.6	
13 Privatization receipts (negative)	-0.3	0.0	0.0	-0.6	-0.6	-1.9	-0.5	-0.4	-0.2	-0.2	-0.2	-0.2	
14 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	0.8	0.8	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3)	-1.5	-1.8	-3.8	0.9	-3.5	-0.4	3.2	0.1	-0.4	-1.0	-2.0	0.0	
Public sector debt-to-revenue ratio 1/	144.6	144.6	134.6	141.0	143.7	146.3	159.4	158.4	156.9	151.1	142.2		
<b>Gross financing need 5/</b>	4.3	5.8	4.3	6.1	7.8	8.6	9.4	5.9	4.5	4.5	3.5		
in billions of U.S. dollars	1.9	2.5	1.9	2.9	3.6	4.2	4.7	3.1	2.5	2.6	2.2		
<b>Key Macroeconomic and Fiscal Assumptions</b>						Historical Average	10-Year Standard Deviation					For debt stabilization	Projected Average
Real GDP growth (in percent)	4.5	3.1	2.9	-1.9	3.6	4.0	2.4	4.0	4.5	5.0	4.8	4.8	4.8
Average nominal interest rate on public debt (in percent) 6/	5.0	4.9	4.6	4.6	4.4	4.7	0.4	4.5	4.1	3.7	3.5	3.5	3.6
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.6	7.6	3.3	-0.5	-0.9	3.4	2.8	-1.1	-0.3	-1.5	-0.4	-1.1	-1.6
Nominal appreciation (increase in US dollar value of local currency, in percent)	-6.8	-0.6	-8.4	-4.1	-10.4	-2.0	7.6	-1.8	-5.2	-4.7	-4.2	-3.7	-3.7
Inflation rate (GDP deflator, in percent)	3.4	-2.6	1.3	5.1	5.3	1.3	2.6	5.6	4.4	5.2	3.9	4.5	5.2
Growth of real primary spending (deflated by GDP deflator, in percent)	12.8	10.4	7.6	10.6	6.5	9.1	2.2	9.3	-2.3	2.6	3.0	4.2	2.9
Primary deficit	-1.4	-0.8	-0.9	1.6	3.1	0.1	1.3	4.5	2.1	1.4	0.9	0.8	0.3
													1.1
<b>A. Alternative Scenarios</b>													
A1. Key variables are at their historical averages in 2013-2018 7/								<b>45.3</b>	<b>47.4</b>	<b>46.4</b>	<b>45.0</b>	<b>42.9</b>	<b>40.5</b>
A2. No policy change (constant primary balance) in 2013-2018								<b>45.3</b>	<b>52.0</b>	<b>54.7</b>	<b>57.5</b>	<b>59.2</b>	<b>60.2</b>
<b>B. Bound Tests</b>													
B1. Real interest rate is at baseline plus one standard deviations								<b>45.3</b>	<b>50.1</b>	<b>50.4</b>	<b>50.4</b>	<b>49.1</b>	<b>46.9</b>
B2. Real GDP growth is at baseline minus one-half standard deviation								<b>45.3</b>	<b>51.0</b>	<b>52.5</b>	<b>54.3</b>	<b>55.4</b>	<b>55.9</b>
B3. Primary balance is at baseline minus one-half standard deviation								<b>45.3</b>	<b>50.2</b>	<b>50.5</b>	<b>50.5</b>	<b>49.2</b>	<b>47.0</b>
B4. Combination of B1-B3 using one-quarter standard deviation shocks								<b>45.3</b>	<b>50.5</b>	<b>51.0</b>	<b>51.2</b>	<b>50.2</b>	<b>48.2</b>
B5. One time 30 percent real depreciation in 2014 9/								<b>45.3</b>	<b>62.7</b>	<b>61.9</b>	<b>61.0</b>	<b>58.8</b>	<b>55.6</b>
B6. 10 percent of GDP increase in other debt-creating flows in 2014								<b>45.3</b>	<b>59.5</b>	<b>58.8</b>	<b>58.0</b>	<b>55.9</b>	<b>52.7</b>
Sources: IMF Country desk data; and staff estimates.													
1/ General government gross debt including public pension fund.													
2/ Derived as $[(r - p(1+g) - g + ae(1+r))/(1+g+p+gp)]$ times previous period debt ratio, with $r$ = interest rate; $p$ = growth rate of GDP deflator; $g$ = real GDP growth rate; $a$ = share of foreign-currency denominated debt; and $e$ = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).													
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 $ae(1+r)$ .													
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.													
6/ Derived as nominal interest expenditure divided by previous period debt stock.													
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.													
8/ The implied change in other key variables under this scenario is discussed in the text.													
9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).													
10/ 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 2. Tunisia: External Debt Sustainability: Bound Tests 1/ 2/**  
(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 (except for growth which is a 3/4th standard deviation). Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2014.



## Appendix. Letter of Intent

Tunis, May 24, 2013

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

Dear Ms. Lagarde:

1. Following the Revolution of January 14, 2011, Tunisia resolutely began its transition to democracy. The democratic election of a Constituent Assembly in October 2011 was followed by the appointment of a new government in December 2011. The government's immediate priority was to jump-start economic activity and create an environment of stability and trust that would revitalize investment and the role of the private sector in the economy, at a time when fiscal and external buffers were rapidly eroding. In view of the major development challenges facing Tunisia, and in conjunction with the emergency measures it was forced to take, the government adopted a program to support growth, address high unemployment, and reduce regional disparities.
2. The implementation of this program helped to support Tunisia's economic recovery in 2012, though the recovery remains subject to major exogenous shocks as well as to uncertainties surrounding the democratic transition process. The Tunisian economy will be negatively affected by any further deterioration of the situation in Europe, which could widen the current account deficit, reduce foreign direct investment inflows, and increase sovereign risk. Moreover, domestic vulnerabilities linked to the uncertainties surrounding any political transition could jeopardize our employment and growth objectives. The aim of our policy and structural reform program is to minimize these vulnerabilities and weaknesses, preserve macroeconomic stability, and promote more inclusive growth.
3. We request the support of the International Monetary Fund (IMF) for a Stand-by Arrangement backed by a two-year program in the amount of SDR 1.1460 billion (400 percent of quota). This arrangement would signal that Tunisia is implementing appropriate macroeconomic policies, reduce Tunisia's vulnerability to exogenous shocks and contribute to restoring investors' confidence.

4. The attached Memorandum of Economic and Financial Policies (MEFP) outlines the main components of the government's economic program and the policies of the Central Bank of Tunisia, which we plan to implement during the 2013–15 period. It also describes the macroeconomic objectives, structural reforms, and indicators for the first year of the program. We plan to implement our program firmly, notwithstanding the difficulties we face in the domestic, regional, and international context.

5. Our program will be monitored through quarterly reviews with quantitative performance criteria and structural benchmarks, as described in the attached MEFP and in the Technical Memorandum of Understanding (TMU). There will be eight reviews to monitor progress in program implementation and to agree on additional corrective measures to achieve the program objectives. The first, second, and third reviews of Tunisia's performance under the stand-by arrangement will be concluded no later than September 30, 2013, December 31, 2013, and March 30, 2014, respectively .

6. We are confident that the policies described in the attached MEFP are appropriate to achieving the objectives of our economic program, but we stand ready to take any additional measures that may be necessary to attain those objectives. We will consult with IMF staff on the adoption of these measures, and in advance of any revision of the macroeconomic policies contained in this MEFP, in accordance with the IMF's policies on such consultations. All information and data necessary for program monitoring will be provided to IMF staff.

7. In accordance with the usual terms and conditions for this type of arrangement, a safeguards assessment of the Central Bank of Tunisia has been conducted. In this context, we have prepared a technical memorandum of understanding between the Central Bank of Tunisia and the Ministry of Finance to clarify responsibilities related to the financial obligations associated with IMF resources, which will be deposited at the Central Bank of Tunisia in case of the need for budget support .

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

Sincerely yours,

/s/

Mr. Chedly Ayari  
Governor of the Central Bank of Tunisia

/s/

Mr. Elyes Fakhfakh  
Minister of Finance

## Attachment I. Memorandum of Economic and Financial Policies

### Recent Economic and Financial Developments

- 1. The Tunisian economy began to recover in 2012, despite a difficult international and domestic environment.** Helped by base effects, real GDP growth rose by 3.6 percent on account of rebounding tourism and foreign direct investment flows. This growth performance and our programs to foster employment have allowed us to reduce the unemployment rate, which, however, remains high (16.5 percent in March 2013), notably among graduates (about 33 percent).
- 2. Overall inflation has increased recently, driven by higher food prices, but underlying inflationary pressures remain contained.** Overall CPI inflation rose from 4.2 percent at end-2011 to 6.4 percent in April 2013 (year-on-year), mostly reflecting higher food and energy prices, temporary constraints to the distribution system, and the pick-up in demand from Libya. Nevertheless, underlying inflation (inflation excluding energy and food products) remained relatively stable below 5 percent over the past few months, thanks to a tighter monetary policy and measures introduced to curb the excessive growth of banks' consumer loans.
- 3. The external current account deficit widened, despite the improvement in tourism revenues and remittances.** Economic problems in the euro area continue to depress the demand for Tunisian goods (especially textiles and industrial goods), while imports have increased in most sectors, with transport and energy equipment growing by 27 percent in 2012. As a result, the current account deficit widened from 7.4 percent of GDP in 2011 to approximately 8.1 percent in 2012, notwithstanding the strong performance of tourism revenues and the remittances of Tunisians working abroad (30.4 percent and 23.7 percent, respectively) and exchange rate depreciation (roughly 2.4 percent in real effective terms in 2012). The increase in foreign direct investment inflows, bilateral and multilateral loans, and access to financial markets (with guarantee of the United States Treasury and the Japan Bank for International Cooperation (JBIC) allowed us to increase our foreign exchange reserves to \$8.6 billion in 2012 (equivalent to 3.8 months of imports, still below the 2010 levels).
- 4. The budget execution in 2012—centered on an increase in capital expenditures—was less expansionary than expected.** Delays in adopting the supplementary budget law, capacity constraints at the regional level and in procurement led to an under-execution of the investment budget, which recorded an execution rate of 75 percent in 2012. This under-execution and the higher-than-expected tax revenues (mostly due to the good performance of indirect taxes) offset

the larger-than-expected increase in subsidy payments (30 percent year-on-year, despite the accumulation of arrears of about 1 percent of GDP on energy subsidies) and wages. The 2012 fiscal deficit is thus estimated at 5.3 percent of GDP (excluding grants, privatization receipts, and sales of confiscated assets), about 2 percentage points of GDP lower than projected in the 2012 supplementary budget law (this deficit corresponds to 5 percent of GDP after including sales of confiscated assets as nontax revenues). This fiscal deficit was financed with domestic bond issuances and bilateral and multilateral loans, with public debt reaching 44 percent of GDP (the same level as in 2011).

5. **The tightening of monetary policy helped contain the rise in overall inflation.** After increasing its refinancing of banks, which rose by 53 percent in the first ten months of 2012, the Central Bank of Tunisia has reduced it by 35 percent and has responded to the rise in inflation by: (i) raising its policy rate to 4 percent (an increase of 50 basis points during the past six months), which still implies a negative real interest rate (-2.4 percent at end-April 2013); (ii) allowing the average monthly interbank rate to stay close to the upper band of the interest corridor (50 basis points until February 2013); (iii) adopting an asymmetric interest corridor of 100 basis points defined as 75 basis points above the policy rate for the lending facility and 25 basis points below for the deposit facility; and (iv) adopting a reserve requirement of 50 percent for the increase of consumer loans above the end-September 2012 level (reduced to 30 percent in April 2013). The replacement of banknotes curtailed the thesaurisation impact and allowed banks to attract more deposits, which reduced the need for direct CBT refinancing.

6. **Deteriorating loan quality continues to accentuate banks' existing weaknesses.** At end-September 2012, the nonperforming loan ratio remained at a persistently high level (13.5 percent of total loans); however the initial estimates indicate that this ratio could be 3 to 4 percentage points higher at end-December, in view of the forthcoming reclassification of loans rescheduled in 2011 as overdue loans. The capital adequacy ratios, averaging 12 percent at end-December 2012 for the banking system as a whole, could prove insufficient, especially because the average bank provisioning rate (slightly below 57.3 percent in September 2012) remains low. Moreover, the increase in bank deposits did not keep pace with growth in lending, which explains the banks' dependence on central bank's refinancing. Thus, liquidity ratios fell and some banks failed to comply with the liquidity prudential requirements in 2011/12. Furthermore, intermediation margins will remain under pressure from the combined effect of greater competition on deposit interest rates and restrictions on consumer lending.



## Key Components of the Economic Program

7. **Our reform program will focus on addressing the critical vulnerabilities of the Tunisian banking sector and strengthening fiscal and external buffers.** The significant vulnerability of the financial sector and the worsening of fiscal and external imbalances are the main short-term challenges facing Tunisia. A priority of the government will be to implement a series of measures to mitigate banks' weaknesses that were accumulated during years of favoritism, inadequate standards, and weak banking supervision. For this purpose, and in line with tightened prudential regulations and measures to improve loan quality, we plan to generate additional fiscal space—through a modest fiscal loosening and better spending composition—to meet the possible recapitalization needs of public banks, which will depend on the choice made regarding the future role of government in those banks. This action will contribute to restoring domestic and foreign investors' confidence, spur foreign direct investment and other capital flows, and strengthen the banks' capacity to support the recovery of the Tunisian economy.

8. **Our reform program will promote the implementation of an appropriate policy mix to preserve macroeconomic stability.** A rebalancing of fiscal policy to support growth will be initiated, in particular by progressively containing energy subsidies while putting in place a better targeted social safety net and growth-supporting public investments. A prudent monetary policy will aim at containing inflation and preserving the stability of the banking sector. Greater exchange rate flexibility—in addition to structural reforms to improve the competitiveness of the economy and tighter fiscal policy—will contribute to strengthening Tunisia's external position and rebuilding foreign exchange reserve buffers.

9. **A final element of the strategy—to be pursued simultaneously with sound macroeconomic policies—is the implementation of structural reforms to promote more inclusive growth.** Reforms will aim at promoting private-sector development and reducing regional disparities.

### A. Macroeconomic Framework

10. **The proposed program will be based on the following macroeconomic assumptions:**
- We based our program objectives on a growth rate of 4 percent in 2013, which will remain dependent on exogenous shocks, notably the outlook in Europe and the smooth unfolding of the political transition process. This growth performance will be sustained by the recovery of the tourism sector, and the recovery of industrial activity (notably in the phosphates

sector) and private consumption. The increase in public and private investment will have a positive impact on economic activity, although net exports will only recover slowly. Growth is expected to pick up considerably in 2014, making it possible to close the output gap in 2016. The implementation of reforms aimed at improving the business climate and the financial sector will help foster investment and push growth in the medium term toward its potential.

- Headline inflation (year-on-year) could peak slightly above 6.5 percent in mid-2013, before slowing to 5.3 percent at the end of the year (year-on-year), thanks to a prudent monetary policy and despite some adjustment in administered prices. Inflation will converge to about 4 percent in the medium term.
- In the coming year, the current account deficit will remain high, at approximately 7.2 percent of GDP. Weak growth in Europe will continue to hinder export recovery, while a rebounding domestic demand will continue to spur imports. In the medium term, the current account deficit will narrow, thanks to recovering exports and workers' remittances. In addition, private capital inflows are expected to improve considerably during the program, thereby contributing to maintaining gross reserves above three-months of import coverage.

## B. Fiscal Policy

11. **Fiscal policy will need to strike the right balance between supporting the ongoing economic recovery and the need for medium-term fiscal consolidation.** To that end, fiscal policy will aim at creating fiscal space—including through reforming the tax system—to: (i) meet social and infrastructure financing needs; (ii) protect the most vulnerable among the population; and (iii) address potential contingent liabilities (arising from banking recapitalization needs and higher deficits of the social security funds). In the medium term, debt sustainability will continue to anchor our program, which will reduce the overall fiscal deficit to 2.5 percent of GDP by 2018, thus keeping the debt-to-GDP ratio below 42 percent of GDP, even after accounting for bank recapitalization costs during the program period.

12. **A rebalancing towards more fiscal consolidation has been initiated in the 2013 budget law, while priority spending is preserved.** We continue facing pressing social needs and remain vulnerable to exogenous shocks, which made it necessary to increase budget appropriations for the wage bill (a 14 percent increase relative to 2012) and in transfers and subsidy payments (7.3 percent of GDP). We have also responded to the population's aspirations by increasing investment in the marginalized regions. On the revenue side, the adoption of new measures—such as higher stamp

duties and excises on alcoholic beverages—and a pick-up in economic activity would increase tax revenues to 21.8 percent of GDP. Consequently, the overall fiscal deficit (excluding grants) would reach 7.3 percent of GDP, and of 5.8 percent when including the sale of confiscated assets as nontax revenues, broadly in line with the budget target, and mostly financed by multilateral and bilateral external loans. This fiscal stance remains consistent with our objective of prudent fiscal policy since the structural deficit—which corrects for the economic cycle and one-off operations such as the recapitalization of public banks or arrears repayment—will be broadly stable at 5.1 percent of GDP, thanks to savings on non-allocated expenditures while preserving social expenditures. New offsetting measures, particularly cuts in nonessential spending or new revenues, will be identified to meet deviations from our fiscal target; capital and social spending will be preserved and will not be part of these measures. Key priorities for fiscal policy in 2013 are:

- **Banking recapitalization needs.** The recent Financial System Stability Assessment (FSSA) estimates that those needs could reach as much as 2.6 percent of GDP in the next two years. Accordingly, and as a precaution, a first tranche was included in the 2013 budget law, and we plan to allocate a second tranche reaching a maximum of 0.5 percent of GDP in the supplementary budget law, which will be introduced in the second half of 2013. The actual recapitalization needs will be determined based on the strategic orientation we will choose by mid-September 2013 (structural benchmark as part of the first program review), on the basis of the preliminary results of the public bank audit, which will examine all options (see Section D). Depending on the option chosen, this indicative amount may be revised upward or downward (or even eliminated). Recapitalization needs this year will be financed by the issuance of non-negotiable government securities.
- **Subsidy reform.** Our subsidy reform strategy is articulated on several key short- and medium-term measures. The 2013 budget already included TDN 400 million savings on energy subsidies. Accordingly, we have raised fuel prices (gasoline and diesel) and electricity tariffs in order to achieve the anticipated savings. This price increase was accompanied by the implementation of social programs already included in the government budget (including higher social spending on education and health and to promote employment) and an increase in cash transfers to households in need during 2012 and 2013 (the amount for each household was raised by 40 percent and by 10 percent during 2013). This reduction in energy subsidies will go hand in hand with our reform plan, which aims to progressively replace generalized subsidies with a better-targeted social safety compensation system:
  - *Strategy and targeting.* We took the decision in August 2012 to create a new register of households in need, which is an important and necessary step to ensure effective

targeting (the “leakages” to the non-poor in the existing systems are significant). An in-depth study of the impact of an increase in subsidized energy prices on vulnerable households and different productive sectors—conducted with the technical assistance of the World Bank—is under way. Following that study, the government plans to adopt in August 2013 a household compensation strategy to accompany the energy subsidy reform. This program will be accompanied by a broad public consultation and communication campaign.

- *Designing a new automatic fuel pricing formula.* A pricing mechanism was introduced in 2008 but then suspended in 2011, following large swings in international prices. An ongoing assessment of the best mechanism to follow is under way, and a new formula will be adopted in 2013, to be implemented in early 2014 (at least for gasoline, which will be relatively close to the international price).
- **Control of the wage bill.** In the short term, we will contain wage increases and new recruiting within the limits announced in the 2013 budget law. For the future, we are in the process of evaluating a multi-criteria system for personnel recruitment in order to achieve a better match between needs and qualifications.

13. **A better composition of public expenditures will be needed to achieve a growth-supporting medium term fiscal consolidation and restore fiscal space.** The gradual replacement of generalized subsidies with a better-targeted compensation system and wage bill containment will free budget resources for higher social expenditures and growth-supporting public investments. Keeping wages at a sustainable level and controlling recruitment as part of a civil service reform will be key to reducing the weight of the wage bill in the government budget. Additional increases in retail energy prices and the forecasted fall in international food and fuel prices will lead to subsidy savings in 2014 and over the medium term. We also plan to undertake reforms in the following structural areas:

- **Tax revenue mobilization.** We have embarked on a comprehensive program of reforms to boost tax revenue and improve the equity, the efficiency, and transparency of the tax system. This program will encompass several reforms:
  - *Tax policy.* A preliminary diagnosis points to multiple issues such as a complex tax system, an unequal distribution of the tax burden, and the existence of significant distortions. In this context, we plan to implement a structural reform of our tax system on the basis of a participatory process. The launch of the reform took place

on May 13, 2013 in the context of an enlarged National Fiscal Council. National tax consultations will be organized in October 2013 to finalize the work of the different working groups.

- ✓ One of our priorities is to rationalize tax benefits/incentives in a revenue-neutral way, by reforming the corporate income tax in parallel with the new investment code (scheduled for July 2013). This new investment code—which has benefited from the technical assistance of the World Bank and will be discussed in large consultation with the civil society—would contribute to reducing the dichotomy between the onshore and offshore sectors.
  - ✓ In the context of a comprehensive tax reform, we plan to review the convergence of corporate income tax (CIT) rate in the onshore and offshore sectors, and announce by end-December 2013 the convergence according to a clear calendar and gradually over the next few years. A first step of this convergence, concerning the year 2014, will be announced in July 2013 (structural benchmark). Revising the favorable treatment of re-investment, and introducing taxes on dividends and export activities, are some of the options we are studying through simulation analysis, to ensure that the impact of this convergence of the CIT will be revenue-neutral.
- *Tax administration.* A preliminary diagnostic of tax administration has been conducted, with the support of an IMF technical mission. Following this analysis we are planning to introduce a program of reforms to modernize tax administration (including setting up a unified fiscal administration) and strengthen the control and evaluation mechanisms in the customs administration. In the short term, we will unify the control and tax collection functions within a strengthened Large Taxpayer Unit (LTU) (end-September 2013 structural benchmark) and restructure fiscal activities of the LTU. We will also reinforce the selectivity of controls by establishing targeted criteria and objectives.
- **Assess and improve the effectiveness of capital expenditures.** We have started a study to assess the impact of public investments realized in 2012 on growth and the welfare of the population, particularly in the marginalized areas. The results of this study, expected in the next three months, will allow us to review and, if necessary, reprioritize our investments. In

cooperation with the World Bank, we launched a diagnostic analysis of public investments by analyzing the project cycle from project identification to impact assessment. In addition, the simplification of procurement procedures, planned for June 2013, will contribute to support investments in a more rapid and transparent way.

- **Public enterprises.** The financial situation of public enterprises, which are accumulating losses close to 4 percent of GDP, constitutes a major risk for the government finances. To remedy this situation, based on a study prepared with the World Bank in 2013, we plan to undertake a program of reforms to the governance of public enterprises and to initiate audits of two large public enterprises, starting with the electricity company (STEG), and the petroleum products refinery company (STIR), to be finalized by December 2013.
- **Pension system.** The pension and health insurance systems are considered to be financially unsustainable in the long term. If these systems are not reformed, the combined deficit could amount to 2 percent of GDP by 2018. To avoid this risk, the Tunisian government has begun analyzing different scenarios for reform of the pension and health insurance in order to ensure the viability of the system. A decision on the appropriate reform will require consultation to reach national consensus, which will be initiated in 2013.

### C. Monetary and Exchange Rate Policy

14. **The monetary policy objective for 2013–14 is to control inflation while preserving a healthy private-sector credit growth.** Pending the implementation of an inflation-targeting system, currently under development, the rate of growth of M3 remains the central bank's intermediate target. For 2013, M3 growth will reach 12.7 percent (year-on-year) with overall inflation at 6 percent (annual average) and credit to the private sector growing at about 11 percent. The central bank stands ready to further tighten monetary policy, including by raising the policy rate, to contain inflationary pressures, especially if core inflation rises rapidly. The establishment of a monetary policy committee, which met for the first time in January 2013, will increase the effectiveness of the assessment and communication of monetary policy. Monetary policy transmission will be strengthened by the reforms we plan to implement to promote the emergence of a reference yield curve.

15. **The Central Bank of Tunisia continues to closely monitor the liquidity needs of the banking sector.** A gradual exit strategy from massive liquidity injections has been started to reduce banks' reliance on central bank refinancing and eliminate an increasingly structural phenomenon. To solve this problem, we plan to:

- **Reinforce the current liquidity forecasting framework** by extending the liquidity forecasting horizon and analyzing forecasting discrepancies with budget data. We also plan to enhance coordinating mechanisms with fiscal policy by establishing a coordination committee that will meet weekly to discuss the liquidity situation for the week and the month ahead.
- **Establish a sound collateral management framework to minimize the risks to the CBT balance sheet, and encourage banks to manage their liquidity in a more forward-looking way.** Thus, we intend to put in place a haircut system for loans accepted as collateral in CBT's refinancing operations (an announcement will be made in July 2013, *structural benchmark*). The reform in the next two years would involve using only government securities as collateral. In the meantime, considering the current level of refinancing, the CBT will require that 40 percent of the banking system refinancing be, in general, guaranteed with government securities, with at least 10 percent for each bank starting from end-August. The ceiling for each bank will be raised to 20 percent by end-December 2013 and will be progressively increased during the next two years.
- **Establish a lender of last-resort facility.** As the range of eligible collateral is reduced, a lender of last resort facility should be established for solvent but illiquid banks. This facility—which will charge significant penalties—will keep illiquid but solvent banks from defaulting. Any bank using this facility will be required to present a plan to strengthen its balance sheet within six months and will be closely monitored. The creation of this facility will require the amendment of the banking law and the CBT organic charter law.
- **Step up outright purchases of government bonds in the secondary market in order to reduce the structural liquidity deficit.** We plan to increase the use of open market operations in 2013 (currently amounting to about TDN 950 million, compared to TDN 450 at end-September 2012), notably by purchasing longer-term government bonds. This will allow us to inject liquidity into the banking system, reduce weekly refinancing operations, and encourage interbank transactions.
- **Ease the existing interest rates ceilings with a view to eliminating them and improving the monetary transmission mechanism.** We eliminated in March 2013 the ceilings on creditor interest rates which had been introduced in December 2011; this was done for all maturities, will allow for more efficient allocation of capital, and will facilitate the development of the interbank market. We also plan to revise the legislation on excessive

interest rates on loans set by the Ministry of Finance aiming at eventually raising the threshold.

16. **The ongoing change in the exchange rate operational framework has resulted in a more flexible exchange policy.** The modification during 2012 in the CBT's mode of intervention on the foreign exchange market, on the basis of a fixing based on interbank rates instead of a reference rate calculated using a fixed basket of currencies, allowed the adoption of a more flexible exchange rate policy than in the past. A more flexible exchange rate regime will help preserve CBT foreign exchange reserves, facilitate external adjustment, and support demand for money by reducing the liquidity absorption due to interventions in the foreign exchange market. We plan to increase exchange rate flexibility further by:

- **Strengthening the market mechanism** by the adoption of an electronic bank interlinking platform and the adoption of the Market Makers Agreement (at this stage we have identified 12 candidate banks, on the basis of a survey, for the role of market maker and the setting up of the information and interconnection system, is expected by October 2013). These two actions will constitute an important prerequisite for introducing weekly auctions in the first months of 2014. Improving cash flow forecasts will also be a prerequisite to this reform.
- **Limiting CBT interventions** in the foreign exchange market to smoothing excessive exchange rate fluctuations. Our mode of intervention will continue to be in two currencies. This approach will later be revised towards intervening in a single currency vis-à-vis the dinar.

17. **The measures we introduced to limit the deterioration of the current account deficit led to a reduction in consumer lending but failed to sufficiently reduce consumer goods imports.** We are aware that maintaining these measures over the long term could create distortions and halt the development of the private sector. Thus, we defined and announced the criteria for the withdrawal of the measures, to reassure the private sector that they are temporary. Our development strategy will remain based on openness and free trade. In accordance with World Trade Organization rules, we will impose import surcharges only if necessary and subject to very clear criteria for phasing them out.

## D. Financial Sector Policies

18. **We have launched a comprehensive set of reforms to maintain the stability of the banking sector and reduce its vulnerabilities.** Notably, our focus was on aligning banking practices with international standards and strengthening bank supervision. These reforms led to:



(i) the introduction of collective provisioning to improve risk coverage; (ii) the tightening of risk concentration ratios, which will take effect at end-2013; (iii) a gradual increase and/or increases in the capital adequacy ratio from 8 percent to 9 percent at end-2013 and to 10 percent at end-2014, with a Tier 1 ratio of 6 percent at end-2013 and 7 percent at end-2014; (iv) the preparation of a circulaire decree aimed at improving the governance of credit institutions; and (v) the launch of an independent strategic audit of the three public banks (close to 40 percent of total banking sector assets). For the first time in Tunisia's history, we have prepared the annual report on bank supervision and intend to publish it in the next few weeks.

19. **We plan to continue the reform of the financial sector to further reduce its vulnerabilities.** Reforms will aim at ensuring that the banking system plays its proper financial intermediation role, including proper credit allocation and monitoring of risks to credit, liquidity and solvency. Our strategy is based on four pillars:

- **Improving banking data reporting.** With the support of the technical assistance of the IMF expert, we plan to correct data management deficiencies by designing the architecture of a new reporting system covering bank-related accounting, financial, and institutional functions by August 2013. This will help to establish a system with better controls and reliability of reporting.
- **Tackling the fragilities of public banks.** These banks were the victims of poor governance in the past that led to a significant accumulation of nonperforming loans. Thus, we launched the audit of the three public banks, which will be completed by December 2013. The interim report at end-August will allow us to decide the government's strategy by mid-September based on an assessment of all possible options, including whether we will need to:
  - (i) recapitalize them to address weak loan quality and absorb any future losses within the framework of the existing banking mechanisms; (ii) merge them; or (iii) reduce the participation of the State. In order to implement this strategy and reduce existing vulnerabilities, we plan to:
    - *Mobilize all necessary resources* for a possible recapitalization of the public banks in the next two years, which, according to FSSA estimates, could reach 2.6 percent of GDP. This amount may be reduced or increased, depending on the strategic orientation chosen and the final results of the audit.
    - *Solve the problem of the nonperforming loans of the tourism sector.* These loans are especially significant for one public bank and account for more than 20 percent of all

nonperforming loans in the banking system. On the basis of an in-depth study carried out jointly with the World Bank, the authorities decided to set up an Asset Management Company (AMC) to remove tourism-related nonperforming loans from the banking system and minimize their side effects on the real economy. We intend to consult extensively with all concerned partners, with a view to establishing a clear and transparent legal framework by end-July 2013 to guarantee the AMC's operational autonomy. We plan to update by June 2013 the amount of financial resources necessary for the conduct of AMC operations (which will require a cash contribution from the government to meet working capital needs and government guarantees for AMC bonds).

- *Ensure that public banks are subject to the same management rules as private banks.* To that end, by September 2013 we plan to exempt public banks from certain obligations imposed on them by the law on public enterprises, in order to give them greater freedom in the area of governance.
- **Strengthen the banking supervision and regulatory framework.** This will involve:
  - *From January 2013, rigorously applying sanctions on banks that are in breach of regulatory and prudential standards.*
  - *Update by end-September 2013 the situation of banks on the basis of the 2012 end-year results.* A report on banks' performance and solvency, including an update of the last stress testing, will be produced to identify the existing risks and identify banks that should be subject to inspection.
  - *Moving towards international prudential standards,* particularly with regard to prudential norms on collateral guarantees (a study on the haircut of guarantees will be finalized by December 2013), revising the liquidity ratio to include off-balance sheet transactions, adopting a more forward-looking approach, and establishing consolidated prudential rules.
  - *Strengthening banking supervision capacity by significantly increasing dedicated human and financial resources.* With these resources, we plan to undertake an on-site general inspection of at least one large local bank (the first since 2006), and at least four credit risk inspections in other banks. The methodology for onsite and offsite inspection will also be strengthened.

- **Develop a crisis management mechanism and a special bank resolution regime.** With the support of the technical assistance program, we plan to put in place a mechanism defining the respective roles and responsibilities of the CBT and the Ministry of Finance (MoF) in the event of a financial crisis. We also intend to create a special bank resolution regime. The draft banking law that we are currently preparing will describe in detail these new mechanisms.

## E. Structural Reforms

20. **Our structural reform program focuses on improving the business climate and promoting a competitive private sector that generates inclusive growth and reduces unemployment and regional disparities.** The development strategy pursued in the past has exacerbated regional disparities, with an offshore sector benefiting from fiscal and regulatory incentives while the onshore sector was neglected. Our plan is to gradually modify the existing development model by making it more inclusive and balanced and less dependent on low-value added goods exports that require unskilled labor. In addition to strengthening social safety nets (mentioned above), our structural reform priorities will focus on:

- **The business climate and competitiveness,** through the adoption of an investment code that will ensure greater equity between the onshore and offshore sectors, and will include the adoption of a simplified and transparent incentive system—(tax measures will be incorporated into the tax code in parallel with the adoption of the investment code— and in which freedom to invest is the norm. We also plan to reduce administrative constraints and authorization, limit discretionary decisions, and reduce monopolistic and oligopolistic behavior in order to guarantee the same opportunities for every private operator. A revised competition law will be adopted in 2013 to address these issues.
- **Regional development.** Sustained public investment will help substantially improve infrastructure projects in the marginalized regions, thus attracting the private investment needed for developing those regions. This increase in public investment will also be accompanied by the decentralization/deconcentration of the administration and the setting of objective criteria for selecting investment projects.

21. **We are committed to reducing the obstacles to the proper functioning of the labor market.** To that end, we signed a new social contract on January 14, 2013 with employers and trade unions, which will serve as a common social roadmap. The organization of a permanent council for a tripartite social dialogue in 2013 was agreed, as well as the establishment of an insurance fund to

cover loss of employment for economic reasons. A broad consultation is planned to discuss the new employment strategy currently under preparation. The main priorities for the medium term will consist, in particular, in reforming the labor code to promote greater flexibility and reduce the structural asymmetry of skills prevailing on the market.

22. **We are aware of the crucial role of reliable statistical information in the preparation, assessment, and monitoring of macroeconomic policies and the implementation of social programs.** To strengthen transparency, we will continue to publish regularly the results of our surveys on leading indicators and economic developments, employment and households. In this regard, we are currently involved with EUROSTAT in a full diagnostic of our statistical system, which will allow us to evaluate and reinforce the capacity of our national statistical system. With IMF technical assistance, we are also planning to strengthen national accounts data (notably the demand-side) and the balance of payments. Establishing a mechanism for improving and strengthening training in the statistical area will help buttress the statistical function in different ministries.

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

	Dec 2012	Cumulative Flows since the beginning of 2013		
	Prel.	Jun 2013 PC	Sep 2013 PC	Dec 2013 PC
<b>Quantitative Performance criteria</b>		(Millions of Tunisian Dinars)		
1. Floor on the primary balance of the central government excluding grants /3	-2,168	-37	-532	-4,318
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock)	-1,332	-829	-196	-1,084
		(Millions of US\$)		
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock) /4	7,937	6,667	6,751	8,066
<b>Continuous Performance criteria</b>		(Millions of Tunisian Dinars)		
4. Ceiling on the accumulation of new external debt payment arrears by the central government	...	0.0	0.0	0.0
<b>Quantitative Indicative Targets</b>		(Millions of Tunisian Dinars)		
5. Social Spending 5/	1,251	794	1,191	1,588
6. Ceiling on the accumulation of new domestic arrears	...	0.0	0.0	0.0
<b>Program assumptions on which adjusters are calculated in case of deviations</b>				
Disbursement of public external Financing on a cumulative basis (in millions of US\$)		410	520	2,239
Public Debt service (interest and amortization) on a cumulative basis (in millions of US\$)		956	1,169	1,387
Bank recapitalization (in millions of TD)				500
<b>Program exchange rate TD/ U.S. dollars</b>	1.55235			
1/ Quantitative performance criteria and structural benchmarks are described in the Technical Memorandum of Understanding.				
2/ For purposes of calculating program adjusters, foreign currency amounts will be converted at program exchange rates.				
3/ The floor on the primary fiscal balance of the central government excluding grants (cash basis) will be adjusted downward (upward) by the cumulative upward (downward) deviations in government budgeted bank recapitalization relative to program assumptions.				
4/ The floor on the stock of net international reserves of the BCT will be adjusted upward (downward) by the cumulative downward (upward) deviations in government external debt service, downward (upward) by the cumulative downward (upward) deviations in government external financing - excluding project loans and financing issued through international capital markets - relative to program assumptions, and upward (downward) by the cumulative upward (downward) deviations in resident deposits at the BCT from December 31, 2012 level.				
5/ Public capital expenditures on social sectors and programs.				

Table 2. Tunisia: Structural Benchmarks

	Objective	Date
<b>I. Financial sector</b>		
Adoption by the Council of Ministers of the strategic vision of the government's future role in banks, on the basis of the preliminary results from the audit of public banks.	<i>Financial sector stability</i>	<i>Mid-September 2013</i>
Approval of the new reporting system architecture covering bank-related accounting, financial, and institutional functions.	<i>Financial sector stability</i>	<i>Aug-13</i>
General on-site inspection of one major bank and inspection of the credit risks of four other banks.	<i>Financial sector stability</i>	<i>Dec-13</i>
Presentation to the board of the CBT of a study concerning the impact on banks of liquidity ratio changes toward international standards.	<i>Financial sector stability</i>	<i>Dec-13</i>
<b>II. Fiscal policy</b>		
Approval by the Council of Ministers of the corporate tax reform announcing the convergence of the tax rates of onshore and offshore sectors for 2014 and identification of countervailing measures to ensure a neutral impact on revenues.	<i>Minimization of distortions, and tax fairness and simplification</i>	<i>Jul-13</i>
Adoption of a Ministry of Industry decree approving a new automatic fuel pricing formula.	<i>Lower energy subsidies</i>	<i>Aug-13</i>
Submission to the Council of Ministers of a new targeted household support program to accompany the reform of generalized energy subsidies.	<i>Protection of society's most vulnerable segments</i>	<i>Aug-13</i>
Merge at the level of the large taxpayer unit the management, tax collection, and control of large enterprises.	<i>Broadening of the tax base</i>	<i>Sep-13</i>
Finalize the audit of the electricity company (STEG) and of the petroleum refinery company (STIR).	<i>Lower fiscal risks</i>	<i>Dec-13</i>
<b>III. Monetary and exchange rate policy</b>		
Publication of a circulaire by the CBT that announces a haircut on all loans used as collateral for refinancing operations at the central bank.	<i>Enhancement of the monetary transmission mechanism</i>	<i>Jul-13</i>
Ensure that the proportion of the refinancing volume at the CBT backed by government securities is at least 10 percent for each bank	<i>Enhancement of the monetary transmission mechanism</i>	<i>Aug-13</i>
Implementation of an electronic bank interlinking platform and launch of the Market Makers Agreement.	<i>Greater exchange rate flexibility</i>	<i>Oct-13</i>
Ensure that the proportion of the refinancing volume at the CBT that is backed by government securities is at least 20 percent for each bank	<i>Enhancement of the monetary transmission mechanism</i>	<i>Dec-13</i>
<b>IV. Structural reforms/private-sector development</b>		
Adoption of the Investment Code (tax measures will be referred to in the tax code).	<i>Support for balanced growth driven by the private sector</i>	<i>Jul-13</i>

## Attachment II. Technical Memorandum of Understanding

1. This Memorandum establishes the agreement between the Tunisian authorities and IMF staff concerning the definition of the quantitative performance criteria and indicative targets. It also sets out the content and frequency of data reporting to IMF staff for program monitoring purposes.
2. The quantitative criteria and benchmarks are defined in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated May 24, 2013. For program purposes, all assets, liabilities, and flows denominated in foreign currencies will be valued at the "program exchange rate," as defined below, with the exception of items affecting the government's budgetary accounts, which will be measured at current exchange rates. For program purposes, the exchange rate corresponds to the accounting exchange rate of the CBT prevailing on December 31, 2012, as shown in the table below. For the SDR, the program exchange rate is 1SDR = 2.38852 Tunisian dinars.

**Program Exchange Rates, Tunisian Dinar per FX Currency,  
(Accounting Exchange Rate of the CBT)  
December 31, 2012**

Currency	Units	Exchange rate
Algerian dinar	10	0.19860
Saudi riyal	10	4.13930
Canadian dollar	1	1.56175
Danish krone	100	27.44020
USA dollar	1	1.55235
British pound sterling	1	2.50510
Japanese yen	1000	18.02650
Moroccan dirham	10	1.83535
Norwegian krone	100	27.73730
Swedish krona	10	2.37995
Swiss franc	10	16.95450
Kuwaiti dinar	1	5.51955
United Arab Emirates dirham	10	4.22660
Euro	1	2.04725
Libyan dinar	1	1.23740
Mauritanian ouguiya	100	0.51230
Bahraini dinar	1	4.11770
Qatari riyal	10	4.26380

Source: Central Bank of Tunisia.

3. Monetary gold assets will be valued at the price of 0.6498 dinar per gram of gold as established in the decree No. 86-785 of August 18, 1986. The stock of gold is 6.73 tons (6739902 grams) on December 31, 2012.
4. For data reporting purposes, the Ministry of Finance, the Ministry of Development and International Cooperation, the National Institute of Statistics (INS), and the Central Bank of Tunisia

(CBT) will follow the rules and the format considered appropriate for data reporting as covered by this technical memorandum of understanding, unless otherwise agreed with IMF staff.

## DEFINITION OF PERFORMANCE CRITERIA AND INDICATIVE TARGETS

### A. Performance Criteria and Indicative Benchmarks

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

#### Performance criteria

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

#### Indicative benchmarks

- An indicative benchmark (ceiling) on total domestic arrears.
- An indicative benchmark (floor) on capital expenditures in priority social sectors and social programs.

6. **Measurement of criteria.** The performance criteria on net international reserves and net domestic assets are measured on a stock and quarterly basis. The performance criterion on the central government deficit is measured on a quarterly basis and cumulatively from the previous year. Adjustment factors will also be applied to some of these criteria. The performance criterion on the accumulation of external arrears is measured on a continuous basis.

### B. Institutional Definition

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

8. The authorities will inform Fund staff of any new entity and any new program or special budgetary or extra-budgetary fund created during the period of the program to carry out



operations of a budgetary nature. Such funds or new programs will be included in the definition of the central government.

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

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

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

11. The **CBT's liabilities in foreign currency** to nonresidents include any commitment to sell foreign currencies associated with financial derivative transactions (such as swaps, futures, options), any portion of the CBT's assets (gold, for example) used as collateral, IMF and Arab Monetary Fund (AMF) credits outstanding, and deposits at the CBT of international organizations, foreign governments, and foreign nonbank institutions. The government's foreign currency deposits at the CBT are not included in the liabilities, nor is any SDR allocation received after May 15, 2013.

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

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<sup>1</sup> Deposits of residents in foreign currency (excluding government deposits) at the CBT are a form of external liability of the CBT; for operational and accounting purposes, and because of legal considerations related to the regulation of foreign exchange, the CBT includes residents' foreign currency deposits in the monetary base. To preserve the accounting consistency of the CBT's accounts and be in line with the standard definition of NIR within the framework of IMF stand-by arrangements, it is agreed: (i) to retain the accounting definition of external liabilities used in the CBT balance at December 31, 2012; (ii) to adopt the principle of adjusting NIR (in the opposite direction of the net domestic assets of the CBT) on the basis of the variation in the residents' deposits in foreign currency. It also agreed that the residents' deposits in foreign currency at the CBT include the following components of reserve money: intervention/monetary market in foreign currency, foreign currency of aggregate intermediaries, non-negotiable placement of foreign currencies, and all other items of deposits in foreign currencies created or included in reserve money. At end-December 2012, the value of the stock of deposits in foreign currencies of residents at the CBT was US\$1,488.608 million at the program exchange rate.

13. The value of CBT reserve assets and liabilities in foreign currency will be calculated using program exchange rates (see Table above). On December 31, 2012, the value of the stock of net international reserves was US\$7.937 billion, with the stock of reserve assets equal to US\$8.645 billion and the stock of CBT liabilities in foreign currency equal to US\$730.399 million (at program rates).

#### D. Ceiling on Net Domestic Assets

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

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

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

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

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

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

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

20. **Net domestic bank financing of the central government** is the sum of: the change in net bank loans to the central government (in Tunisian dinars and foreign currency) and the change in central government deposits at the CBT (this includes all central government accounts at the CBT, in particular (i) Treasury current account; (ii) Tunisian government account (miscellaneous dinar accounts); (iii) loan accounts; (iv) grant accounts; (v) FONAPRA-FOPRODI accounts; (vi) special account of Tunisian government in foreign currency; (vii) current accounts of paying U.S. Treasury;

(viii) accounts in foreign currency pending adjustment (subaccount: available); (ix) and any other account that may be opened by the central government at the CBT).

21. **Net government borrowing from the banking system** is defined as the change in the stock of government securities (Treasury bills and bonds) held by banks and any other central government borrowing from banks, less repayments. The stock of nonnegotiable bonds issued to banks during the recapitalization of public banks, and which are serviced entirely by the government, is excluded from bank claims on the government.

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

## F. Ceiling on the Accumulation of External Arrears

23. **Arrears on external debt payment** are defined as late payments (principal and interest) on external debt or guarantees as defined in *External Debt Statistics: Guide for compilers*<sup>2</sup> by the central government or the CBT after 90 days from the due date or the expiration of the applicable grace period.

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<sup>2</sup> The definition of debt set forth in *External Debt Statistics: Guide for Compilers* reads as the outstanding amount of those actual current, and not contingent, liabilities, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to nonresidents by residents of an economy. Debts owed to nonresidents can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property.

## G. Indicative Ceiling on the Accumulation of Domestic Arrears

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

## H. Indicative Floor on Social Expenditures

25. **Social expenditures** are defined as capital expenditures (development expenditures) on education, health, social transfers to needy families, the AMEL employment training program (and university scholarships), UTSS indemnities, family allocation as well as development expenditures of the Ministry of Women and Family Affairs, Youth and Sports and Social Affairs; all current expenditures (“dépenses de gestion”) of the above-mentioned sectors and programs, as well as food and energy subsidies, are excluded.

## I. Adjustment Factors for the Program Performance Criteria

26. The **NIR** targets are adjusted upward (downward) if the cumulative sum of net external financing of the central government (excluding project loans and any access to capital markets), the sum of budgetary grants, privatization receipts received in foreign currency, the increase (decrease) in the residents’ foreign currency deposits at the CBT are greater (lower) than the levels indicated in the table below. The NIR targets will be also adjusted upward (downward) if the total amount of cash payments on external debt service of the government is greater (lower) than the levels included in the table below.

Assumptions on Adjustment Factors of Quantitative Performance Criteria  
(Millions of US dollars)

	31-Dec-12	2013				Year
		2013 Q1	2013 Q2	2013 Q3	2013 Q4	
Government external financing		100.1	309.8	109.8	1719.4	2239.1
Project loans		100.1	109.8	109.8	119.4	439.1
Multilateral donors		0.0	0.0	0.0	800.0	800.0
AFDB					300.0	300.0
World Bank Group					500.0	500.0
Bilateral donors		0.0	200.0	0.0	0.0	200.0
Turkish loan			200.0			200.0
Financial Market Access		0.0	0.0	0.0	799.9	799.9
Sukuk					400.0	400.0
Financial markets+additional Samurai bond issuance					399.9	399.9
Budget grant		21.1	0.0	0.0	227.1	248.1
Privatization receipts		0.0	50.0	50.0	100.0	200.0
Government external debt service		640.7	315.0	213.1	218.3	1387.2
Amortization		524.0	181.7	116.4	149.6	971.6
Interest		116.7	133.3	96.7	68.8	415.5
Resident deposits at the BCT	1,488.6					

27. The net domestic assets (NDA) targets will be adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the cumulative sum of net external financing of the central government (excluding project loans and any access to capital markets), the sum of budgetary grants, privatization receipts received in foreign currency, the increase (decrease) in residents' foreign currency deposits at the CBT are lower (greater) than the levels indicated in the following table. The NDA targets are also adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the total amount of cash payments on external debt service are greater (lower) than the levels included in the table below. The NDA ceiling will be converted into Tunisian dinars at the program exchange rate.

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

29. The floor on the primary balance of the central government, excluding grants, will be adjusted upward/downward based on the amount used to recapitalize the public banks. The recapitalization amounts for 2013 are assumed to be 500 million dinars (Q4 2013).

## J. Monitoring and Reporting Requirements

30. Performance under the program will be monitored using data supplied to the IMF by the Tunisian authorities as outlined in the table below, consistent with the program definitions above. The authorities will promptly transmit to the IMF staff any data revisions.

## INFORMATION TO BE REPORTED IN THE CONTEXT OF THE PROGRAM

<i>Type of Data and Description</i>	<i>Periodicity</i> <i>Weekly (w)</i> <i>Monthly (m)</i> <i>Quarterly (q)</i>	<i>Delay in days</i>
<b>GDP:</b> Supply and demand at current, constant, and the previous year's prices, including sectoral indices.	<i>q</i>	<i>45</i>
<b>Inflation:</b> Including the underlying inflation of non-administered and administered prices.	<i>m</i>	<i>14</i>
<b>Fiscal Sector</b>		
<b>Tax and nontax revenue of the central government decomposed on the basis of main tax and nontax revenues items</b>	<i>m</i>	<i>30</i>
<b>Total expenditures:</b> current and capital, transfers and subsidies.	<i>m</i>	<i>30</i>
<b>Capital expenditure:</b> by type of financing: domestic and external (differentiating loans and grants), and by main sectors and projects (agriculture, social, infrastructure).	<i>m</i>	<i>45</i>
<b>Current expenditure:</b> by type of expenditure: wages, goods and services, transfers.	<i>m</i>	<i>45</i>
<b>Social expenditure</b>	<i>q</i>	<i>45</i>

<b>Domestic and foreign debt</b>		
<b>Stock of domestic and foreign debt:</b> of the central government and debt guaranteed by the government, with breakdown by instrument and type of currency (in dinars and foreign currency with the equivalent in domestic currency).	<i>q</i>	30
<b>Disbursement of foreign loans:</b> Breakdown into project loans and budgetary loans by principal donor and identifying the most important projects to be financed in the original currency and its equivalent in Tunisian dinars converted at the current exchange rate at the time of each transaction.  <b>Domestic borrowing from banks and nonbanks:</b> including bonds, Treasury bills, and other issued securities.	<i>m</i>	30
<b>Debt guaranteed by the government: by instrument and type of currency (in dinars and in foreign currencies and its equivalent in national currency)</b>  <b>External and domestic debt service:</b> amortization and interest.	<i>m</i>	60
<b>External payment arrears:</b> external debt contracted and guaranteed by the government.	<i>q</i>	30
<b>Debt rescheduling:</b> possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	<i>q</i>	45
<b>Consolidated accounts of the central government at the CBT:</b> The stock of deposits will be broken down as follows: (i) Treasury current account; (ii) special account of the Tunisian government in foreign currency and its equivalent in dinars; (iii) miscellaneous dinar accounts; (iv) loan accounts; (v) grant accounts; (vi) FONAPRA-FOPRODI accounts; (vii) current accounts of the U.S. Treasury; and (viii) ordinary accounts and accounts pending adjustment (including in foreign currency pending allocation) with a breakdown between the amount in foreign currencies and its equivalent in domestic currency).	<i>m</i>	30

<b>External Sector</b>		
<b>Imports of Petroleum Products:</b> average import price of main petroleum products.	<i>m</i>	30
<b>Foreign trade:</b> imports and exports of goods, including volumes and prices, by sector.	<i>m</i>	30
<b>Deposits:</b> Stock of foreign currency deposits, according to the residence of the holder.	<i>m</i>	14
<b>External debt:</b>	<i>q</i>	30
Debt service (amortization and interest) of institutional agents by instrument and at type of currency (in foreign currency and its equivalent in dinars).	<i>m</i>	30
Stock of external debt of institutional agents by instrument and type of currency (in foreign currency and its equivalent in dinars) (in conformity with our obligations under SDDS).	<i>q</i>	90
Overall net external position of Tunisia (in conformity with our obligations under SDDS).	<i>q</i>	90
<b>Balance of payments:</b> Prepared by the CBT	<i>q</i>	30
<b>Monetary and Financial Sector</b>		
<b>CBT accounts at the current exchange rate:</b> detailed table including the monetary system.	<i>m</i>	30
<b>CBT accounts at the program exchange rate:</b> Including net international reserves.	<i>m</i>	30



<p><b>Foreign exchange market operations:</b> Interbank market, retail market and wire transfers for CBT purchases on the retail market, CBT sales and purchases on the foreign exchange market, foreign exchange operations and outright forward sales, stock of CBT foreign exchange operations, including foreign exchange operations and outright forward sales. The terms and conditions of any new transactions (including the extension or renewal of existing terms and conditions) will also be provided.</p> <p>CBT foreign exchange reserves, breakdown by currency and by instrument, and the institutions where such reserves are held.</p>	<i>m</i>	30
<p><b>Banks' financial soundness ratios:</b> Indicators of financial soundness and regulatory capital adequacy ratios of the banking system, including the quality of assets and the profitability of banks. The indication of the different banks is optional.</p>	<i>m</i>	30
<p><b>Direct refinancing of commercial banks by the CBT:</b> Breakdown by bank.</p>	<i>m</i>	14
<p><b>Interest rates:</b> Deposit rates, interbank rates, and lending rates.</p>	<i>w</i>	14
<p><b><i>Other information to be reported</i></b></p>		
<p><b>Information on Fiscal, Monetary, and Financial Policy:</b> Decrees or circulars newly adopted or revised concerning changes in tax policy, tax administration, foreign exchange market regulations, and banking regulations. A copy of official notices of changes in gas and electricity rates and any other surcharge (automatic or structural), as well as the prices of petroleum products and levies/surcharges on gas and petroleum.</p>	<i>d</i>	3



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FOR IMMEDIATE RELEASE  
June 7, 2013

International Monetary Fund  
Washington, D.C. 20431 USA

**IMF Executive Board Approves a 24-month US\$1.74 Billion Stand-By Arrangement with  
Tunisia**

The Executive Board of the International Monetary Fund (IMF) today approved a 24-month Stand-By Arrangement for an amount equivalent to SDR 1.146 billion ( US\$1.74 billion) with Tunisia to support the country's economic reform program during 2013-2015 aimed at strengthening fiscal and external buffers, and fostering higher inclusive growth. As a result of the Board's decision, an amount equivalent to SDR 98.8 million (about US\$150.2 million) is available for immediate disbursement, and the remaining amount will be phased in over the duration of the program, subject to eight program reviews. The Stand-By Arrangement entails regular access to IMF resources, amounting to 400 percent of Tunisia's quota.

Following the Executive Board discussion on Tunisia, Ms. Nemat Shafik, Deputy Managing Director, and Acting Chair, said:

“Tunisia has embarked on a moderate economic recovery while facing a challenging international economic environment and pursuing a political transition. A fragile banking sector, pressing social demands, widespread regional disparities, and high unemployment are key challenges, together with widening external and fiscal deficits.

“The Tunisian authorities have developed a comprehensive economic program to address these challenges. The program aims to strengthen fiscal and external buffers, while laying the building blocks for stronger growth and protecting the most vulnerable.

“The authorities have already taken important measures to reduce vulnerabilities, notably through tighter monetary policy, greater exchange rate flexibility, and reduced subsidy cost. Planned fiscal reforms focus on increasing fiscal space for critical investment and social spending through wage restraint and subsidy reform, while social safety nets will be strengthened. A comprehensive reform of tax policy and revenue administration will help broaden the tax base and improve equity.

“The authorities are taking decisive action to address banking system fragilities. Priorities in this area are the audit of public banks, strengthening banking supervision, and aligning prudential norms with international standards. Efforts will continue to improve data quality and develop a bank resolution mechanism.

“Structural reforms will be accelerated to support high and inclusive growth, boost employment, and reduce regional disparities. The authorities are committed to streamlining fiscal incentives and regulatory barriers, including through a new investment code and corporate tax reform, as well as a reduction in red tape.

“The authorities’ program—supported by a two-year Stand-by arrangement—will help strengthen investor confidence and the resilience of the economy. With full implementation of the program, Tunisia will be in a better position to respond to future shocks and meet the pressing needs of its population.”

## **ANNEX**

### **Recent Developments**

Tunisia faced economic difficulties and a series of external shocks following the January 2011 revolution. Due to a challenging international economic environment, as well as regional and domestic tensions, real GDP contracted by 2 percent in 2011, foreign direct investment (FDI) and tourism declined by more than 30 percent year-on-year, and unemployment rose to record levels. However, after the sharp economic decline, the Tunisian

economy began a moderate recovery in 2012. The deteriorating current account deficit—caused partly by falling demand from Europe—has been financed by sustained donor financing, strengthened FDI and market access, which helped increase reserves (but to a level still below 2010). Fiscal space has been reduced to meet pressing social and investment needs, although public debt remains at sustainable levels. A fragile banking sector, widespread social and economic disparities, and high youth unemployment are key challenges. Addressing these challenges in the midst of a political transition remains demanding.

### **Program Summary**

The authorities initiated a medium-term economic program with the overriding objective of stabilizing the economy while laying foundations to support growth and protect the vulnerable. The program combines a package of strong policy measures and structural reforms, coupled with external financing support. Together these are expected to reduce the vulnerabilities arising from the difficult international economic environment and the ongoing political transition, and to provide the foundation for a return of investor confidence.

Key elements of the Fund-supported program are to:

**Strengthen fiscal and external buffers.** Key measures include: (i) an appropriate fiscal policy that creates space for one-off costs (such as banking recapitalization) and investment spending while avoiding crowding out private-sector credit; (ii) a prudent monetary policy aimed at containing inflation; and (iii) greater exchange rate flexibility to preserve reserves in the face of important exogenous shocks.

**Lay the building blocks for growth** by first addressing critical vulnerabilities in the banking sector; second, engaging in a medium-term fiscal consolidation that allows for a better composition of expenditures—including sustained public investments; and third, implementing an ambitious structural reform agenda that helps to rebuild Tunisia's economic model by promoting private-sector development, lowering regional disparities, and reducing pervasive state intervention.

**Protect the most vulnerable** by strengthening social assistance mechanisms and undertaking a systematic assessment of the social impact of the envisaged reforms. These measures, in addition to the improved composition of public expenditures, will contribute to reducing income disparities.

### Tunisia: Selected Economic Indicators, 2009-14

Population: 10.7 million (2012)

Quota: SDR 286.5 million

Key export market: France, Italy

Main exports: textiles, electronic and mechanical goods, energy, tourism

Per capita GDP: US\$4232 (2012)

Poverty rate: 12 percent (2010)

Literacy rate: 78 percent (2011)

	2009	2010	2011	Prel. 2012	Proj. 2013	2014
(Percent Change, unless otherwise indicated)						
Production and income						
Real GDP	3.1	2.8	-1.9	3.6	4.0	4.5
GDP deflator	3.3	4.7	5.1	5.3	5.6	4.4
Gross national savings (percent of GDP)	22.1	21.8	16.5	17.3	17.3	19.0
Gross investment (percent of GDP)	24.9	26.6	24.1	25.4	24.7	25.0
Employment						
Unemployment rate (end of period)	13.3	13.0	18.9	16.7	...	...
Prices						
Consumer price index (CPI), average	3.5	4.4	3.5	5.6	6.0	4.7
Consumer price index (CPI), end of period	4.0	4.1	4.2	5.9	5.3	5.0
Central government finances (percent of GDP)						
Revenue (excl. grants)	23.1	23.3	24.2	23.1	23.8	24.0
Expenditure and net lending	25.8	23.9	27.7	28.5	31.1	30.3
Fiscal balance (excl. grants)	-2.7	-0.6	-3.5	-5.4	-7.3	-6.4
Structural fiscal balance 1/	-2.3	-1.1	-2.9	-4.7	-5.0	-3.8
Total government debt (foreign and domestic)	42.8	40.4	44.0	44.0	45.3	49.5
Money and credit						
Broad money (M3 of the financial system)	13.0	12.1	9.1	8.4	12.6	12.0
Credit to the economy	10.3	19.6	13.4	8.7	10.8	11.7
Money market rate (end of period) 2/	4.10	4.12	3.53	3.30	...	...
External sector						
Current account balance (percent of GDP, excl. grants)	-2.8	-4.8	-7.3	-8.1	-7.5	-6.0
Exports of goods, f.o.b. (in US\$)	-24.8	14.0	8.5	-5.2	6.5	5.6
Imports of goods, f.o.b. (in US\$)	-21.9	15.9	7.7	1.5	5.1	3.7
FDI (percent of GDP)	3.3	3.0	0.9	3.9	2.1	2.5
Gross official reserves (US\$ billions, end of period)	10.6	9.5	7.5	8.6	9.0	10.8
Gross reserves (months of imports) 3/	5.2	4.4	3.4	3.8	3.8	4.2
External debt (percent of GDP)	49.4	48.3	47.8	51.6	51.1	54.5
Exchange rate						
REER	-1.2	-0.5	-1.7	0.0	...	...
Memorandum items:						
GDP at current prices (TD millions)	58,883	63,397	65,370	71,332	78,334	85,465

Sources: Tunisian authorities and IMF staff estimates and projections.

1/ Excludes banking recapitalization costs and one-off arrears payments for energy subsidies.

2/ Latest data for current year.

3/ End-of-year reserves over next year's imports of goods and services.



**Statement by Jafar Mojarrad, Executive Director for Tunisia;  
and Moez Ben Hassine and Abdelali Jbili, Advisors  
June 7, 2013**

On behalf of our Tunisian authorities, we would like to express our gratitude to staff and management for their extensive effort and constructive dialogue during the Stand-by Arrangement (SBA) discussions. The authorities agree with the analysis and assessment, and are appreciative of the high quality engagement with staff.

The Tunisian authorities have prepared an ambitious and comprehensive economic reform program that addresses short-term stabilization goals while aiming at bolstering the economic recovery, addressing banking sector vulnerabilities, mitigating the effects of a challenging external environment and responding to pressing and legitimate social demands in the context of the political transition. To enhance the credibility and confidence in their program, the authorities are seeking Fund support through a two-year SBA, which would also catalyze broader international support to Tunisia.

The democratic transition in Tunisia is moving forward firmly, despite the many difficulties and challenges emanating from domestic, regional, and international conditions. The National Constituent Assembly, elected in October 2011, has prepared a first draft of the new constitution, which should strengthen national unity, the rule of law, good governance, and human rights protection, while promoting gender and regional equality and empowerment of the citizens. A more recent national dialogue about the road map for the democratic transition has helped build consensus about the future political system, and the holding of legislative and presidential elections by the end of this year. The proposed program has also been the subject of extensive debates among political parties and civil society; was presented to a full parliamentary session, and discussed extensively in inter-ministerial meetings. The debate among civil society was facilitated by a commendable staff outreach to key stakeholders. In this context, the new coalition government, which has been appointed in March 2013, is firmly committed to the reform program.

**Recent economic developments and outlook**

To mitigate the effect of the crisis in Europe and maintain social stability, the authorities used the policy space provided by the country's fiscal and foreign reserve buffers to manage the 2011 economic slowdown, and bolster a quick recovery and jobs creation in 2012. Indeed, despite a



difficult external and domestic environment, the economy recovered strongly with real GDP growth reaching 3.6 percent in 2012, and the unemployment rate declining to 16.5 percent at end-March 2013 from close to 19 percent a year earlier. This reflected a strong rebound in tourism and FDI, as well as the balanced policy approach toward supporting economic activity and preserving macroeconomic stability. While headline inflation increased due to constraints in the distribution system and a pick-up in demand from neighboring countries, core inflation remained moderate (less than 5 percent).

The fiscal deficit reached 5.4 percent of GDP, lower than the budget projection, reflecting higher-than-expected tax revenues and under-execution of investment projects due to delays in adopting the supplementary budget law and capacity constraints at the regional level. The moderate fiscal expansion in 2012, compared to the previous year, was motivated by the need to reinvigorate growth and respond to large social demands, and was afforded by the availability of bilateral and multilateral financing and Tunisia's relatively low public debt level (44 percent of GDP). Although tourism and remittances picked-up, the current account deficit widened to 8.1 percent of GDP due to weak external demand, but has been in part financed by a sharp increase in FDI. Pressure on the balance of payments eased somewhat and foreign exchange reserves increased to 3.8 months of imports by the end of 2012.

### **The economic program**

As clearly laid out in the staff report and the Memorandum of Economic and Financial Policies (MEFP), the authorities' program is built around maintaining macroeconomic stability in support of the political transition, and embarking on an ambitious structural reform agenda to sustain higher and more inclusive growth and employment creation, while preserving social cohesion. With the expected recovery of tourism and industrial activity, growth is projected to be around 4 percent in 2013, and move closer to its potential of 5 percent over the medium term (MEFP ¶ 10). This would help reduce unemployment and social and regional economic disparities. Inflation would stabilize around 4.5 percent, and external and fiscal buffers would be strengthened.

Wide-ranging reforms will support these objectives, including a comprehensive subsidy reform accompanied with strengthened social safety net, a reform of the tax system and the investment incentives, restructuring and recapitalization of public banks and strengthening of banking supervision and regulation, together with improvement of the monetary policy framework and a more flexible exchange rate system. Structural reforms in key areas will enhance economic

efficiency and competitiveness and improve the business climate, which will encourage domestic and foreign direct investment.

The authorities are committed to implementing their program notwithstanding the obstacles emanating from domestic or external conditions. The Tunisian program involves downside risks and challenges, as outlined in the report, but upside risks in connection with the return of confidence following the upcoming elections, cannot be ruled out either. The authorities are determined to meet the challenges and will seek to mitigate those risks that are under their control.

### **Fiscal policy**

The authorities are cognizant of the need to rebuild fiscal buffers over the medium term and have reiterated their commitment to resume fiscal consolidation to bring down the overall deficit to 2.5 percent of GDP by 2018 and the debt-to-GDP ratio to 44 percent, while increasing investment in infrastructure and pro-poor spending. In the meantime, the fiscal policy stance for 2013 had to remain supportive of the transition by responding to pressing social needs, allowing for budget financing of bank recapitalization and repayment of arrears (1.5 percent of GDP), and sustaining efforts to invest in the marginalized regions. While the overall fiscal deficit (excluding grants) could reach 7.3 percent of GDP, the structural deficit, which excludes on/off operations, will amount to 5 percent of GDP, or slightly lower than in 2012 (MEFP ¶ 12). The authorities stand ready to take appropriate actions, as needed, to meet any deviation from their fiscal target.

The authorities are aware that the current untargeted subsidy system is costly and inefficient and are working toward reforming it. Their reform strategy will be deployed along two tracks. The first one involves a progressive reduction of the budget cost of subsidies accompanied with a better targeted compensation system for the needy, in line with international experience. The recent increase in fuel prices and electricity tariffs by around 7 percent in March 2013, for the second time in six months, is estimated to generate total savings of about 1 percent of GDP, and was accompanied by an increase in cash transfers to low-income households. While recognizing the potential for significant leakages in the current cash transfer system, the authorities are preparing a new household compensation strategy, benefiting from World Bank technical assistance. The second track will involve broad public communication and national dialogue to build consensus on the reform of the subsidy system. Moreover, the authorities are designing a new automatic fuel pricing formula to be introduced in early 2014.

The authorities have launched a reform of the tax system, which includes broadening the tax base, rationalizing exemptions, reforming the corporate income tax in coordination with the ongoing work on a new investment code, and examining means of reducing the gap in corporate income tax between the onshore and off shore sectors in a revenue neutral way. In addition, building on a preliminary diagnostic of the tax administration, which has been carried out with Fund TA, the authorities will put in place a comprehensive program of modernization of the tax administration and improvement of its efficiency. A broad consultation process involving all stakeholders has been launched on the tax reform priorities.

The authorities are also firmly committed to containing current expenditure, including by limiting future public sector wage increases and reforming the subsidy system, as indicated above. They also plan to further strengthen public financial management and the budgetary framework to improve governance, transparency, and accountability. Studies on the viability of the pension system have been initiated, with a decision on the appropriate reform requiring close consultation with stakeholders.

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

Monetary policy has helped contain inflationary pressures, while supporting economic activity. In light of the recent pick-up in headline inflation, the CBT increased its reference interest rate from 3.5 to 4 percent between August 2012 and March 2013 in order to manage expectations. While the current policy rate remains appropriate given the negative output-gap, the CBT stands ready to further tighten the monetary stance if core inflation were to increase rapidly. In parallel, in conjunction with improved liquidity forecasting and management, the CBT is progressively phasing out the massive liquidity injection that had been used in the revolution aftermath to stabilize the financial sector.

To improve monetary policy transmission, the authorities eliminated in March 2013 the ceiling on creditor interest rates for all maturities and plan to revise the legislation on excessive lending rates. Additional steps will be taken to strengthen the monetary policy framework and reduce banks' reliance on central bank refinancing. These include introducing a new haircut system on bank loans eligible for CBT refinancing and increasing the share of government securities as collateral for banking system refinancing. Moreover, open market operations will be increased to improve the functioning of the interbank market and consideration will be given to establishing a lender of last-resort for solvent but illiquid banks.

The Tunisian authorities have moved toward a more market-determined exchange rate, which should help soften the impact of external shocks and strengthen buffers. In this regard, the CBT has changed its mode of intervention in the foreign exchange market to reflect the interbank exchange rates, instead of relying on a reference rate using a fixed basket of currencies, and is limiting its market interventions to smoothing excessive exchange rate fluctuations. Further steps are planned to strengthen the market infrastructure by introducing an electronic bank interlinking platform and adopting a market makers agreement. The authorities are committed to maintaining an adequate level of international reserves in conformity with the program objectives.

The authorities remain committed to their long-standing free trade and open economic system. In this regard, the temporary and exceptional measure of imposing a 50 percent reserve requirement on consumer loans outstanding, which was intended to curb the sharp rise in imports of consumer goods, has been reduced to 30 percent, and will be eliminated as circumstances permit.

### **Financial sector**

The authorities attach high priority to addressing the banking sector vulnerabilities, which will be an important building block in their reform strategy. Accordingly, they have embarked on a comprehensive strategy involving restructuring and recapitalization of banks, dealing with the problem on nonperforming loans, strengthening bank regulation and supervision in line with international best practices, and developing a crisis management mechanism and special bank resolution regimes (MEFP ¶ 19).

An independent strategic audit of three public banks, representing about 40 percent of the total banking system assets, has already started, and will help lay out restructuring strategies, including options to merge banks, keep them as they are, reduce state participation, or undergo bank resolution. The authorities have expressed their willingness to mobilize the necessary resources for recapitalization in the upcoming two years, which could represent 2.6 percent of GDP according to the 2012 FSSA estimates, assuming that the private shareholders of the interested banks are not willing to participate. It is clear that the final amount of recapitalization will depend on the option—or combination thereof—to be chosen by the authorities. Efforts will also be directed at solving the problem of nonperforming loans in the tourism sector, and the authorities have decided to create an Asset Management Company (AMC) to facilitate the cleaning up of banks balance sheets, and mitigate its impact on economic activity by

encouraging bank lending. The AMC's legal framework, which is being drawn up with World Bank assistance, is expected to conform to best international practices, and is to be submitted to the National Constituent Assembly after its endorsement by an inter-ministerial committee by end-July 2013.

The CBT is improving its banking supervision and regulation, including by requiring banks to introduce collective provisioning to enhance risk coverage and tightening risk concentration ratios, and increasing the minimum capital adequacy ratio from 8 to 10 percent by 2014. To this effect, the CBT has increased its human and financial resources, while Fund TA is being provided to strengthen the supervision department. It is also improving the quality of banking data reporting under a newly designed reporting system covering all accounting, financial and institutional functions of banks. The CBT and the Ministry of Finance are working toward establishing a crisis management and a special bank resolution regime, which will be included in the forthcoming revision of the banking law.

### **Structural reforms**

The authorities are adopting an ambitious program of structural reforms to promote employment and inclusive growth, including by addressing social and regional disparities. Wide-ranging reforms are being considered to improve the business environment by reviewing the investment code, which should include a simplified and more transparent incentive system and reduce the dichotomy between the onshore and offshore sectors; a reform of the competition law is expected to stimulate private initiative, and steps are underway to improve the governance of public enterprises and enhance SMEs' access to finance. The authorities are also committed to addressing longstanding obstacles to higher employment, especially among the youth, including by addressing skill mismatch, expanding vocational training, and improving infrastructure at the regional level. Building on a new social contract with labor unions, which was signed in early 2013, broader consultations with the social partners are planned to consider a reform of the labor code and future employment strategy.

### **Conclusion**

Despite the difficulties inherent in the process of democratic transition and an adverse external environment, the Tunisian economy is on a recovery path, underpinned by solid fundamentals and sound economic policies, in a new environment of democracy, freedom, and good governance. The authorities are courageously addressing the twin challenges of successfully completing the political transition, and restoring growth and employment in a difficult external

environment, and with pressing domestic social demands. The two challenges are necessarily linked and success in either one of them will reinforce the other. The authorities are committed to implementing their far-reaching reform agenda and are grateful to their partners for their support. They will remain closely engaged with the IMF for the successful implementation of their economic reform program.