



TUNISIA

THIRD REVIEW UNDER THE STAND-BY ARRANGEMENT, REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA AND WAIVERS OF APPLICABILITY

May 2014

In the context of Third Review under the Stand-By Arrangement, Request for Modification of Performance Criteria and Waivers of Applicability, the following documents have been released and are included in this package:

- The staff report prepared by a staff team of the IMF for the Executive Board's consideration on April 25, 2014, following discussions that ended on March 24, 2014, with the officials of Tunisia on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement. Based on information available at the time of these discussions, the staff report was completed on April 11, 2014.
- A **Press Release** including a statement by the Chair of the Executive Board summarizing the views of the Executive Board.
- A **Staff Statement** of April 25, 2014 updating information on recent developments.
- 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 publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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April 11, 2014

THIRD REVIEW UNDER THE STAND-BY ARRANGEMENT, REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA AND WAIVERS OF APPLICABILITY

EXECUTIVE SUMMARY

Context. On June 7, 2013, the Executive Board approved a 24-month SBA in an amount equivalent to 400 percent of quota (SDR 1.15 billion or about \$1.75 billion). To date, SDR 427.92 equivalent to \$659 million has been disbursed. The pillars of the program are to: (i) achieve short-term macroeconomic stability; (ii) lay the foundation for stronger and more inclusive growth; and (iii) protect the most vulnerable.

Background. The adoption of a new constitution and the formation of a new technocratic government in January 2014 led to greater confidence on political prospects and economic reforms. Growth has been moderate and remains insufficient to bring down unemployment significantly in the short term. At the same time, external and fiscal imbalances remain high, while demands for higher wages and additional jobs are rising.

The program is broadly on track. Two out of three 2013 end-December quantitative performance criteria (QPC) targets have been missed, but by a smaller margin than originally envisaged, and all end-March 2014 QPCs are expected to be met. Progress on the structural reform agenda has been slowed by last year's political crisis and the transition between governments.

Program strategy. Containing current expenditures, and pursuing prudent monetary policy and greater exchange rate flexibility are essential to contain high external and fiscal deficits and to build investors' confidence. Improved banking regulation, a strategic orientation of public banks, and strengthened supervision will help reduce banking sector fragilities, which are currently hampering private sector development. Scaling up public investments, reforming tax policy and revenue administration, accelerating public enterprise reform, and protecting the most vulnerable will help lay the foundations for more inclusive growth and level the playing field for investors.

Risks to program implementation are important. Main risks relate to regional and domestic security tensions, set-backs in the political transition, and weaker economic activity in major trading partners. Successful implementation of the Fund-supported program will be contingent on the government's ability to garner consensus among political parties backing it and on its capacity to push reforms through vested interests.

The completion of the third review will make SDR 145.08 million (about \$225 million) available.

Approved By

**Daniela Gressani and
Taline Koranchelian**

The team comprised Amine Mati (head), Lorraine Ocampos, Karsten Junius, and Carolin Geginat (all MCD); Jean Frederic Noah Ndela Ntsama (SPR), Nolvia Saca Saca (MCM), and Giorgia Albertin (Resident Representative). Ms. Wafa Amr (COM) and Daniela Gressani (MCD) joined the mission during March 17–19. The mission overlapped with a FAD Technical Assistance mission on tax policy and administration and a LEG/World Bank Technical Assistance on the banking resolution framework. Mr. Ben Hassine (OED) joined the discussions. During March 6–24, 2014, staff met with the Governor of the Central Bank, the Minister of Economy and Finance, the Minister of Industry, the Minister of Social Affairs, the Minister of Tourism, the Minister of Commerce, the Minister of Labor, the Minister in charge of Economic Affairs at the Prime Ministry, and other senior officials, and representatives of workers' unions, the corporate and banking sector, the diplomatic and donor community, political parties, civil society, academia, media, and Parliament.

Excellent assistance was provided by Desiree Amon, Shady Darrag, and Kia Penso (all MCD).

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BACKGROUND

- 1. After the political impasse of 2013, the adoption of a new constitution and the formation of a new technocratic government in January 2014 led to greater confidence on political prospects and economic reforms.** Markets responded positively to the latest political events. Investors are hopeful that the new technocratic government can continue to preserve macroeconomic stability and make progress on important structural reforms in the lead-up to the presidential and legislative elections expected to take place in the last quarter of this year.
- 2. The new government is determined in its efforts to advance the reform agenda supported by the SBA but is facing a difficult economic situation.** The protracted political stalemate of 2013 took a heavy toll on the economy and slowed progress on the economic agenda. In addition, social tensions continue to run high as expectations of better opportunities have not yet materialized, resulting in the continuation of numerous strikes and workers' demands.
- 3. Successful implementation of the Fund-supported program will not only depend on the government's strong commitment, but also on its ability to garner consensus from political parties backing it.** It will also be contingent on its capacity to push reforms past vested interests, including those within the administration. Communication on the need for reform and action—as done recently by the Tunisian Prime Minister in a speech in early March—could help mobilize the population behind necessary but sometimes difficult reforms. Important external financing, mostly from multilateral partners, will be needed this year to accompany the authorities in the implementation of their reform agenda and meet budget needs.
- 4. The third review focused on short-term macroeconomic stabilization objectives and in paving the way towards reducing banking sector vulnerabilities in the context of Tunisia's fragile economic situation and difficult social setting.** Economic indicators point to an economic recovery that continues to be weak and remains insufficient to make a significant dent in unemployment in the short term, even as demands for additional jobs and wage increases are rising. Measures in the near term center on containing vulnerabilities arising from high external and fiscal deficits by containing current expenditures, and pursuing a prudent monetary policy and greater exchange rate flexibility. Improvements in the banking regulatory environment and the finalization of the audits of public banks allow for an increased focus on banking sector fragilities that need to be tackled so that banks can play their proper financial intermediation role. Scaling up public investments, reforming tax policy and administration, improving governance of public enterprises, and protecting the most vulnerable will help lay foundations for inclusive growth and level the playing field for investors.

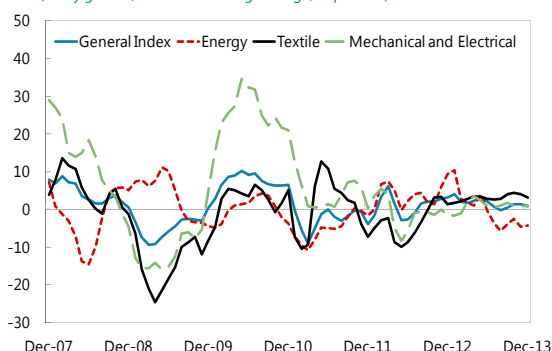
CONTEXT

A. Recent Developments

5. Growth has been moderate. Real GDP growth in 2013 was revised slightly downward to 2.6 percent, weighed down by a weak fourth quarter (-0.3 percent q-o-q) and plagued by a strike-weary manufacturing sector and moderate tourist activity. Agriculture and mining sectors have also been contracting, due in part to a weak harvest and enduring work disruptions. Services, particularly from the public sector, remained the main driver of growth. The unemployment rate fell to 15.3 percent in end-December 2013, and remains high among the young and graduates at about 32 percent.

Industrial Production Index, 2007–13

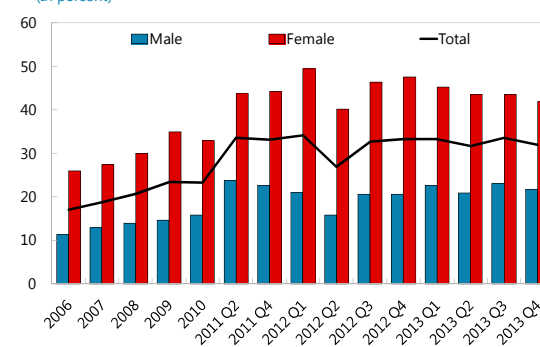
(Y-o-y growth, 3-month moving average, in percent)



Source: Tunisian authorities.

Unemployment Rate Among Graduates, 2006–2013 Q4

(in percent)



Source: Tunisian authorities.

6. Inflation has been slowly decelerating.

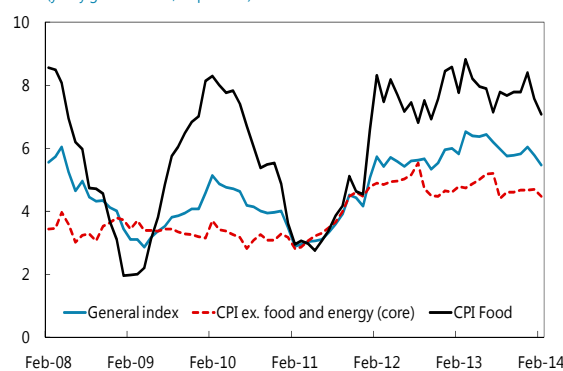
Over the past few months, smaller rises in food prices have led to a decline in headline inflation to 5.5 percent (y-o-y) in February 2014, down from 6 percent at end-2013. The recent increases in administrative energy prices and the depreciation of the exchange rate over the past year had limited impact on both headline and core inflation, with the latter also falling to 4.5 percent (from 4.7 percent in December 2013).

7. The current account deficit remains high in 2013, with lines of credit boosting reserves above the critical three months of import coverage.

The deficit deteriorated slightly to about 8.4 percent of GDP, driven by depressed demand for Tunisian manufactured goods, lower exports of energy and phosphate products, and weaker tourism and remittance receipts. Deposits at the Central Bank of Tunisia (CBT)—from the Qatari National Bank and a European commercial bank—helped keep reserves above three months of imports. Gold revaluation and some exchange

Inflation, 2008–14

(y-o-y growth rates, in percent)



Source: Tunisian authorities.

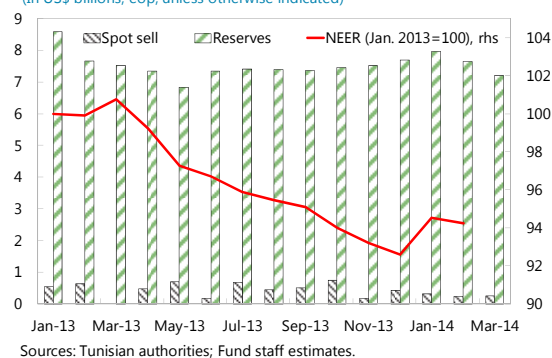
rate valuation gains increased reserves by an additional \$500 million to \$7.7 billion (about 3.5 months of imports).

8. Financial markets have benefited from a more promising and stable political environment.

Since the beginning of the year, spreads have declined overall, and the stock market rose but has been recently weighed down by banking stocks. Over the same period, the exchange rate has appreciated by 4 percent vis-à-vis the U.S. dollar and 5 percent against the euro, helped by a stricter implementation of existing regulation on holders of commercial foreign exchange accounts (Tunisia has “capital controls” and holders of FX can only use it for current account transactions) and continuing sales of foreign exchange by the CBT (see text chart). This has led to a reversal of almost half of last year’s depreciation.

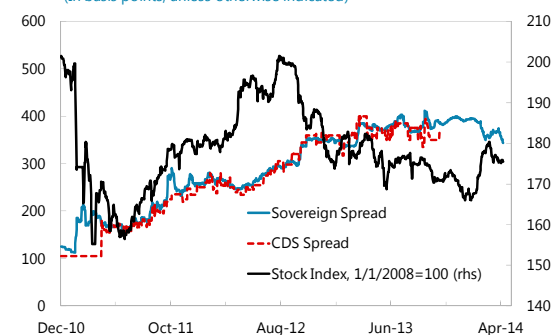
Reserves, Spot FX Interventions, and Exchange Rate

(In US\$ billions, eop, unless otherwise indicated)



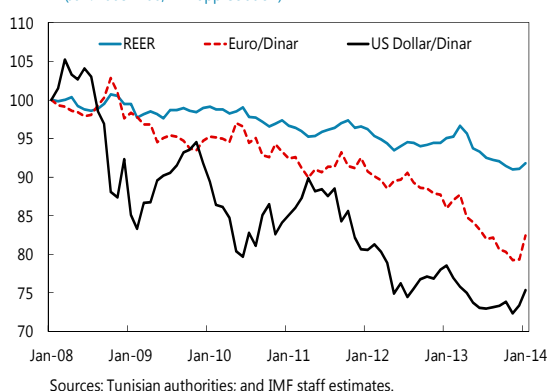
Stock Index and CDS Spreads, 2010–14

(In basis points, unless otherwise indicated)



Exchange Rates, 2008–14

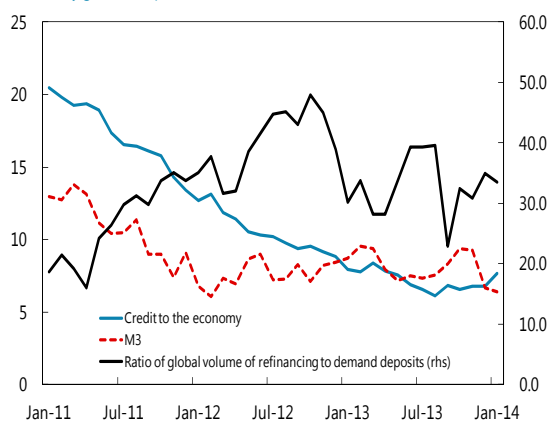
(Jan. 2008=100, + = appreciation)



9. Monetary policy remains accommodative. The 50 basis point increase in the policy rate in December 2013—combined with the narrowing of the interest rate corridor—left the effective money market rate unchanged at 4.75 percent, the top of the interest rate corridor (text chart). Despite lower reserve requirements, bank refinancing—mostly to the largest state-owned and private banks—has increased by an additional TD 504 million in January 2014 to more than TD 5 billion (including OMOs), its highest level since October 2012. Higher bank refinancing has mostly helped finance bank overdrafts and rollover of existing loans, and did not lead to higher private sector credit, which remained subdued at 8.1 percent y-o-y in January 2014.

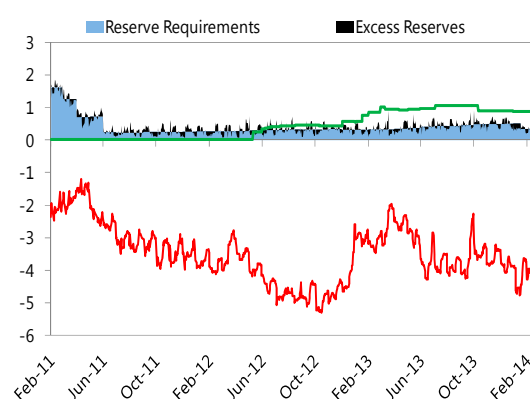
Growth in M3 and Credit to the Economy, 2011–13

(Y-o-y growth, in percent)



Source: Tunisian authorities.

Tunisia: Structural Liquidity Deficit of Banking System (In TND billions)

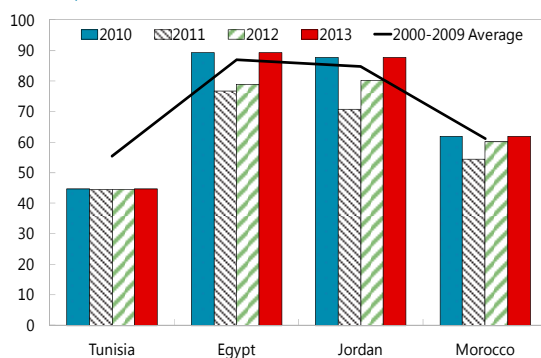


10. Bank vulnerabilities are increasingly coming to the fore (Table 7). As of end-December 2013, the overall capital adequacy ratio of the banking system declined from 11.8 percent in 2012 to about 9.2 percent in 2013, after the application of new conservative haircuts on the valuation of loan collateral (in line with the CBT's efforts to align its prudential norms with international standards), which also led to an increase in the provisioning ratio to about 60 percent (from 46 percent before). As a result, six banks—which cover 42 percent of banking assets—have fallen below the new minimum capital requirements, which increased from 8 percent to 9 percent this year. Profitability—which has so far remained positive—could decline further as intermediation margins come under pressure (banks competing for deposits) and new collateral requirements limit banks' ability to access CBT refinancing. Asset quality continued to be weak, with nonperforming loans (NPLs) remaining stable at about 15 percent of total loans, 20 percent once NPLs held by banks' affiliates are accounted for (MEFP, ¶15).

11. Inadequate budget composition led to a deterioration of the overall fiscal stance in 2013, but the underlying fiscal position improved after exceptional spending was taken into account (MEFP, ¶10). A decrease in capital expenditures to record low amounts of 4.9 percent of GDP, and increases in the wage bill and subsidies, led to a deterioration of the overall fiscal deficit to 6.1 percent of GDP, up from 5.7 percent of GDP in 2012. However, the underlying fiscal position (on a payment order basis)—correcting for the cycle and one-off exceptional payments (e.g., 1.1 percent of GDP in arrears repayment)—improved to 4.6 percent of GDP (from 5 percent of GDP in 2012). Delays in external financing in the last quarter of 2013 (about 2 percent of GDP) and the authorities' preference for maintaining cash buffers at the CBT (about 2.3 percent of GDP) instead of paying a large proportion of expenditures committed at the end of the year, limited the deterioration of the overall cash deficit in 2013 and resulted in an overperformance relative to the program target (see below). Public debt in 2013 remained broadly constant at 45 percent of GDP, with the share of foreign currency debt increasing to 64 percent.

Public Debt, 2010–13

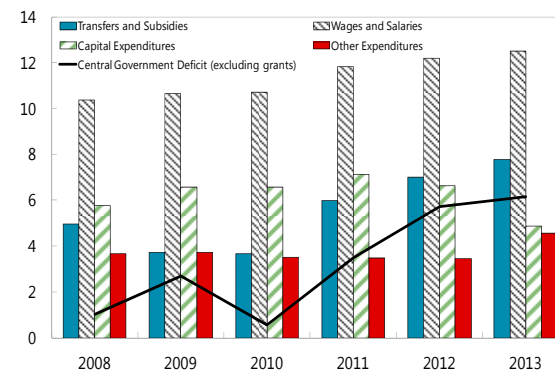
(In percent)



Source: IMF staff estimates.

Central Government Budget Deficit and Expenditures, 2008–13

(Percent of GDP)



Source: IMF staff estimates and projections.

B. Program Implementation

12. The program is broadly on track.

- Monetary target.** The end-December performance criterion (PC) on net domestic assets (NDA) was missed by a smaller margin than originally anticipated, because of lower credit to government linked to postponed budgetary payments and higher Treasury balances. The end-March PC on NDA is estimated to have been met by a large margin.
- Reserves.** End-December NIRs stood at \$ 5.5 billion, implying that the PC was missed by a smaller margin than estimated in January 2014. The end-March PC is expected to have been met by a small margin, after adjustment for the World Bank disbursement delayed to Q2 2014.
- Fiscal.** Latest data for central government operations from above and below the line confirm that the cash-basis primary balance for end-December was exceeded by a large margin relative to the program target, due to spending under-execution (of which 1.5 percent of GDP was from lower investment spending) and cash payments (about 3.3 percent of GDP) deferred to early 2014. It is estimated that the end-March target has been met.
- Indicative targets.** The indicative target on social spending was missed for all 2013 test dates, reflecting implementation capacity constraints. New social programs in 2014 are expected to increase expenditures in this area. The end-March ceiling on current spending is expected to be met by a large margin, due to lower than expected payments on energy subsidies in the first quarter of 2014 (these are not included in the program definition of social expenditures).

13. Progress on the structural reform agenda has been slowed by last year's political crisis and the transition between governments. As a result, only four out of eight end-March Structural Benchmarks (SBs) have been met (LOI ¶12; Tables 2a and 2b). The missed SBs include those

postponed from the last review. They are expected to be completed within the next few months: (i) the household targeting strategy for vulnerable households will be put in place before the July fuel price increase, and is a new SB for end-June 2014; (ii) decrees for the investment code await ratification by Parliament (new end-September structural benchmark); (iii) the CBT regulation on the new loan haircut has been issued but will only come into effect at end-June (reprogrammed as a new SB) when the lender of last resort facility is introduced; and (iv) the modernization plan for tax administration will be finalized over the next few weeks following the latest Fund TA (new end-June SB). The heavy legislative calendar of the National Constituent Assembly—which is now focused on elaborating the electoral law—could further delay approval of key legislation (Investment code, Bankruptcy law, Competition Law, Asset Management Company, Public Private Partnership).

C. Outlook and Risks

14. The macroeconomic framework forecasts moderate growth, despite a more favorable political environment. Against this backdrop, staff and authorities agreed on the following:

- **Growth.** Real GDP is projected to expand by 2.8 percent in 2014, before rising to its potential of 4.5 percent over the medium term. Preliminary indicators for the first two months of the year imply a modest pickup in activity, with investors still waiting for a clear political calendar and reduced security tensions before expanding capacity. A rebound in tourism and in the phosphate sector is expected to drive growth.
- **Inflation.** Inflationary pressures are expected to subside, with headline inflation declining to 5.3 percent (y-o-y) at end-2014, on the back of declining food price inflation and a prudent monetary policy.
- **External position.** The current account deficit is projected to narrow to 7.2 percent of GDP in 2014, and to 6.3 percent of GDP in 2015, driven by a recovery in trading partners' economies, phosphate exports, higher tourism receipts, and lower international commodity prices. Increasing foreign financing flows and a gradual recovery of FDI will help finance the current account deficit and increase international reserves.

Tunisia: Selected Economic Indicators, 2010–15

	2010	2011	2012	Est.	Proj.	
				2013	2014	2015
Real GDP growth (in percent)	2.6	-1.9	3.7	2.6	2.8	4.2
Consumer price index (CPI), (period average, in percent)	4.4	3.5	5.6	6.1	5.5	4.9
Current account (percent of GDP)	-4.8	-7.4	-8.2	-8.4	-7.2	-6.3
Gross official reserves (US\$ billions, eop)	9.5	7.5	8.7	7.7	9.0	10.1
Gross official reserves (months of next year's imports)	4.4	3.4	4.0	3.5	3.9	4.3

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

15. Risks to the outlook remain high. Increasing social tensions—including additional strikes or demonstrations—could slow down production further, weigh on firms' investment decisions, and delay much-needed reform implementation. Any renewed regional or domestic security tension

could dampen tourist activity. Delays in the political calendar would also weaken economic policy and reform implementation, with adverse effects on economic activity and job creation. Moreover, the Tunisian economy remains vulnerable to a weaker economic outlook in Europe (its main trading partner), higher commodity prices, or shortfalls in official external financing in case of important lags in reform implementation. Increased short-term debt from the offshore sector could also increase roll-over risk for corporate funding.

POLICY DISCUSSIONS

Discussions focused on additional fiscal measures to reduce fiscal and external vulnerabilities, greater exchange rate flexibility, and on strengthening the structural reform agenda, particularly on accelerating banking sector reforms. Discussions also centered on ways to enhance inclusive growth by scaling up public investments, improving governance of public enterprises, and protecting the most vulnerable.

A. Short-term Stabilization Goals

Fiscal policy

16. The authorities have identified new fiscal measures to limit the deterioration of the fiscal deficit in 2014. The approved 2014 budget incorporates a wage freeze (0.4 percent of GDP), and savings in energy subsidies (0.8 percent of GDP), but the need to reverse cuts in pro-growth expenditure still resulted in an important widening of the fiscal deficit. Against that background, the government committed earlier this year to savings in salaries (0.2 percent of GDP arising from deferred recruitment) and from lower unallocated expenditures (0.5 percent of GDP). Staff welcomed the implementation of these measures, which will limit the deterioration of the structural fiscal deficit to 5.3 percent of GDP (from 4.6 percent of GDP in 2013) while allowing for important social and investment spending, which is expected to recover following underexecution in 2013 (MEFP, ¶15-6). Further reduction of the fiscal deficit—which remains heavily dependent on external financing (8.5 percent of GDP)—is an important priority of the Fund-supported program and is essential to keep debt sustainable (see DSA Annex). As a result, the authorities have decided to further reduce the structural fiscal deficit this year, to 4.9 percent of GDP (which will nonetheless represent a doubling of the overall cash deficit over the last year) through:

- **New measures** (MEFP, ¶16), amounting to 0.4 percent of GDP, and almost exclusively on the revenue side. These include additional revenue from the telephone company following a recent tax control, a recovery of tax arrears awaiting judicial decision, a reduction in exemptions, and hikes in excises. A reduction in subsidies will be realized by bringing forward by one month the 10 percent electricity tariff increase planned in June for high and medium voltage users. Some of these measures will come into effect with a revised budget law to be adopted later this year (see text table). Staff would have preferred that these measures rely more on cuts in current expenditures (e.g., wages or subsidies), but recognizes that action in those areas may require additional consensus in view of the high social tensions. That said, staff considers the measures

identified to be of good quality as they improve the tax base and establish a clear precedent for simplified tax arrears recovery procedures.

- **Contingency actions.** In case of revenue shortfalls or delays in passing the revised budget law, the authorities agreed on contingency measures, relying mostly on cuts in nonessential current spending. Social and capital expenditures will be preserved.

Tunisia: Compensatory Measures for 2014

	Budget 2014		Jan-14		Mar-14		Revised Budget	Administrative
	in million	in percent	in million	in percent of	in million	in percent		
	Dn	of GDP	Dn	GDP	Dn	of GDP		
Revenue					260	0.3		
Tax Policy Measures					100	0.1		
Alcoholic Beverages: 8 percent Increase Excise Tax					20	0.0	√	
Tobacco: 10 percent Increase Excise Tax					50	0.1		√
No tax exemption for imported vehicles ^{1/}					30	0.0	√	
Tax Administration Measures					160	0.2		
Tunisie Telecom: enhanced tax control					110	0.1		√
Recovery of tax arrears awaiting judicial decision					50	0.1		√
Current Expenditure					40	0.0		
Wage bill Savings ^{2/}	335	0.4	154.0	0.2		0.0		√
Lower Unallocated Expenditures	150	0.2	416.4	0.5		0.0		√
Savings in Energy Subsidies ^{3/}	650	0.8			40	0.0		√
Total	1135	1.4	570.4	0.7	300	0.4		

^{1/} at the moment of resale for cars imported by tunisians leaving abroad

^{2/} the budget for 2014 does not include salary increases; in January it was agreed an additional wage bill saving.

^{3/} in Mar 2014: bringing forward the planned increase of tariffs to May 2014

17. Staff urged the authorities to resist undoing important policies already approved in the 2014 budget law, and which are essential to meet

program targets. In particular, staff stressed the need to continue containing the already high wage bill in the forthcoming revised budget by freezing salaries and limiting recruitments to those already announced in security, education, and health (recruitment increases on a net basis by 8,600 people this year,

half the level of 2011). Staff welcomed the authorities' commitment to reduce untargeted energy subsidies (MEFP, ¶15), by completing the elimination of subsidies to cement companies (these were halved already in January), further raising electricity tariffs to households and industrial users (a 10 percent tariff increase is planned for June, following the 10 percent increase implemented in January), and increasing fuel prices by 6 percent as of July 2014. Staff welcomed the authorities' plans to protect the vulnerable by introducing a lifeline electricity tariff (for households consuming less than 100 kwh) and through new social programs (see Part C).

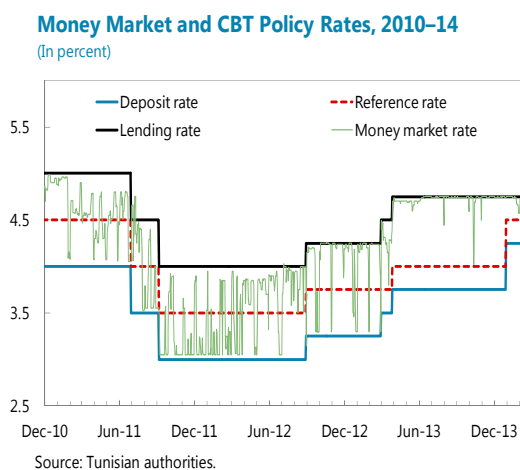
Tunisia: Selected Fiscal Indicators, 2012–14
(In percent of GDP)

	2012	2013		2014	
	Act.	Prog. 01/24/14	Est.	Prog. 01/24/14	Proj.
Revenue	23.1	23.4	23.6	22.6	23.1
of which: Tax revenue	21.0	21.1	21.3	21.3	21.8
Expenditure and net lending	28.8	29.5	29.7	29.7	29.9
of which: Wages and salaries	12.2	12.4	12.5	12.4	12.5
Transfers and subsidies	7.0	7.6	7.8	7.0	7.0
Capital expenditure	6.6	4.9	4.9	5.2	5.2
Net lending	-0.5	0.0	0.0	1.3	1.4
of which: Public Banks' recapitalization	0.1	0.0	0.0	1.2	1.2
Central government deficit (-) (excl. grants)	-5.7	-6.2	-6.1	-7.1	-6.8
Float	-0.7	-1.7	-1.6	1.8	1.8
Central government deficit (-), (excl. grants, cash basis)	-5.0	-4.5	-4.5	-8.9	-8.6
Structural fiscal balance	-5.3	-4.6	-4.6	-5.2	-4.9
General government debt	44.5	45.0	44.7	51.7	50.9

Sources: Tunisian authorities; and IMF staff estimates.

Monetary policy

18. The current monetary policy stance is justified by low inflationary pressures. Lower pressures on the exchange rate, the prevalence of capital controls, weak credit growth (see Box 1), a negative output gap (close to –2 percent), and stable core inflation justify keeping market rates at their current level. To ensure that the CBT policy rate remains an effective signaling tool for monetary policy, staff encouraged the authorities to increase it so that it is consistent with the CBT interventions that are keeping the money market rate unchanged at 4.75 percent. The CBT agreed that it should stand ready to tighten monetary policy further if core inflation rises more rapidly than expected or depreciation pressures rise (including those resulting from negative market real rates).



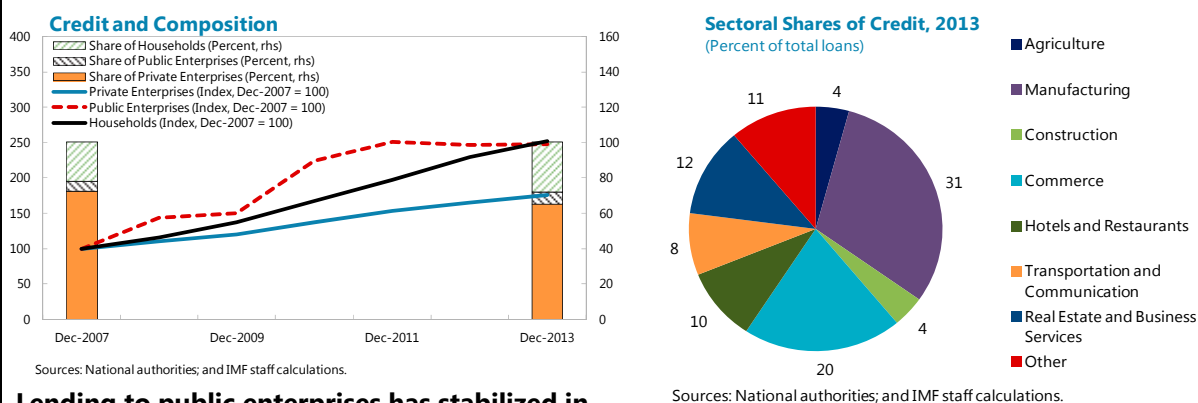
19. Ongoing steps to improve the collateral framework will ease the way for banks' gradual exit from dependence on CBT refinancing. The implementation of higher shares of refinancing through government securities (20 percent) and of a new haircut on loans (10 percent) used as collateral has been met by all banks, with some small banks having to re-balance their assets to ensure they retain access to the refinancing window. Staff and the authorities agreed that the timely implementation of the stronger collateral framework helps minimize risks to the CBT balance sheet and encourages banks to manage liquidity in a more forward-looking way. High liquidity provision also highlights the needs for moving ahead with restructuring NPLs. Tighter collateral requirement planned for March to access CBT refinancing (a 25 percent haircut on non-government loans) was postponed to June 2014 to ensure that banks that are solvent but temporarily illiquid can use a lender of last resort facility, which will be introduced in end-June 2014 (structural benchmark). Such a facility will charge penalty rates and will require banks to present a plan for exiting from continued access to CBT refinancing.

20. The tightly regulated lending rate continues to hamper both access to finance and the effective functioning of monetary policy (MEFP, ¶19). The preliminary study of the existing system—conducted with World Bank TA—showed that a removal of caps on lending to enterprises will not lead to an increase in rates to those companies, although competition for deposits could spur higher deposit rates in the future that would lead to higher lending rates. On the other hand, caps on consumer credit have been constraining lending, and removing caps would lead to rates increasing for most consumers. Staff urged the authorities to immediately remove the cap on lending to enterprises and to also move swiftly on removing caps in consumer loans if it is coupled with adequate supervision of risks. The CBT is currently assessing the recently concluded evaluation, and will commit to a course of action after additional consultations with relevant ministries (Economy and finance, Justice, and Commerce).

Box 1: Private Sector Credit Developments

Credit growth in Tunisia has slowed down considerably over the past three years. Credit to the economy, which grew by 14–20 percent in the years preceding the Tunisian revolution, is now growing at 8 percent a year (about 2 percent in real terms). During this period, deposits (over 70 percent of the banking system liabilities) stayed relatively stable, with their growth slowed by withdrawals of funds around the time of the revolution. Other funding sources, such as external lines of credit, also became more scarce, pushing Tunisia's banking system into intense competition for deposits and increasing banks' reliance on CBT refinancing to expand their balance sheets. Weak economic activity has also reduced demand from creditworthy companies, while tighter interest margins and growing NPLs have reduced banks' appetite for lending.

The lending pattern has changed over time. The share of credit to firms on total credit has declined from 72 percent in 2007 to about 65 percent in 2013, with the largest drop coming from the troubled tourism, transportation, and communications sectors. In contrast, over the same period, the share of private consumer and housing loans has increased from 20 percent to 30 percent of total credit. That corresponds to a doubling in consumer loans, driven by high returns (about 300 basis points higher than for companies) and collateral backed by individual housings or employee regular salaries (deposited at the bank). The increase in consumer loans has been slowed recently by a CBT regulation requiring additional reserve requirements of 30 percent for an increase in the stock of consumer loans above the end-September 2012 level.



Lending to public enterprises has stabilized in recent years, following growing NPLs in the sector. After growing by 20 percent a year, credit to public enterprises is now increasing by less than 8 percent a year and remains relatively low at 7 percent of total credit provided by banks. Credit to public enterprises is provided almost equally between private and public banks. However, of that credit, 70 percent of public banks' loans are to loss-making state-owned companies, while 70 percent of private bank credit goes to financially sound public enterprises.

21. Central bank independence will strengthen monetary policymaking. In line with recommendations of the last safeguards assessment, the forthcoming Fund TA on the Central Banking law (end-June structural benchmark) will help the authorities strengthen the autonomy of the CBT, including enhanced governance structure, full operational independence, and strengthened auditing functions.

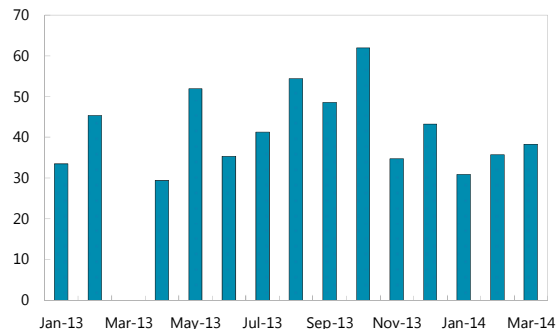
Exchange rate policy

22. Greater exchange rate flexibility is needed to increase external buffers and reduce CBT liquidity injections.

The recent appreciation of the currency is a temporary situation that does not reflect a short-term effect from higher supply of foreign exchange following a stricter implementation of existing foreign exchange regulations (linked to existing capital controls) and continued CBT FX sales, albeit in lower relative amounts than in the past (see text chart). Both staff and the authorities agreed that the exchange rate is not in line with fundamentals and about 5 percent to 10 percent overvalued. The depreciation of the

Tunisian dinar in 2013 somehow helped contain its overvaluation and preserve external buffers, though some valuation effects have affected sectoral balance sheets (Box 2). The authorities reiterated their commitment to limit interventions in the foreign exchange market to smooth excessive intra-day exchange rate fluctuations. They stressed that their interventions were mostly to meet shortfalls caused by demand from large energy operators, and that they had seized the opportunity to buy foreign exchange when possible. Staff urged the authorities to use the opportunity of higher FX in the market to buy FX, which will help build up cushions, and increase gross international reserves in 2014 above the 100 percent of Fund's risk weighted metric (four months of imports). In view of the existing overvaluation of the exchange rate, FX sales should be limited to smoothing excessive fluctuations in the foreign exchange market (MEFP, ¶13). Staff also welcomed the authorities' plans to allow banks to conduct FX swap operations with the CBT, without a requirement that this operation be initiated by the CBT.

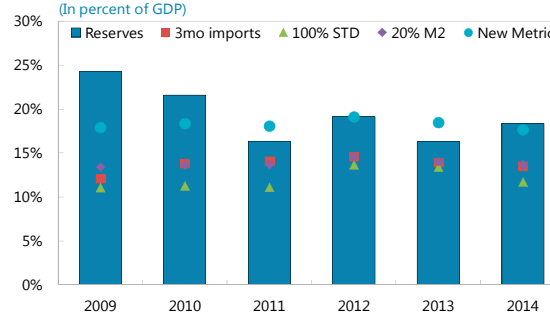
Share of CBT Sales in the Foreign Exchange Market
(In percent)



Source: Tunisian authorities.

Exchange Rate Assessment Using CGER Panel Estimates			
(In percent)			
	Underlying CA balance 1/	CA norm	REER misalignment
MB approach 2/	-4.9	-1.8	10.2
ERER approach	...	...	4.1
ES approach	-4.9	-2.6	7.8
Overvaluation (+); undervaluation (-)			
1/ In 2019 corrected from program adjustment.			
2/ Based on an elasticity of the CA/GDP with respect to the REER of -0.30.			

Reserve Coverage Based on Alternative Metrics:
New and Traditional Metrics, 2009–14
(In percent of GDP)



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

Box 2. Balance Sheet Effects from Exchange Rate Depreciation

Tunisia is a net debtor relative to the rest of the world. Tunisian's negative net international investment position (IIP) has increased slightly in recent years, reflecting the drawdown in foreign reserves and the faster buildup in external debt liabilities. The net international investment position has reached -111 percent of GDP in 2013, with net FDI at -71 percent of the GDP,¹ net debt (sum of debt assets minus debt liabilities) at -52 percent of the GDP, and reserve assets at 17 percent of GDP. The recent widening of the current account deficit has also induced a shift in the structure of foreign liabilities from non-debt-generating flows (FDI) to debt-generating flows (short-term, medium-term, and long-term liabilities).

Tunisia: International Investment Position
(In millions of dinars, unless otherwise indicated)

ASSETS						LIABILITIES					NET POSITION				
FDI 1/	Portfolio Investment Net 1/	Other Investments	Reserves	Total	Assets In percent of GDP	FDI 1/	Portfolio Investment Net 1/	Other Investments	Total	Liabilities in percent of GDP	in percent of GDP				
		ST debt (Financial+ commercial)	MLT (loans+ deposits)					ST debt (Financial+ commercial)	MLT (loans+ deposits)						
2012															
Private Non Financial Sector		1608.5		1608.5	2.3			8044.8	7220.3	15265.1	21.6	-13656.6	-19.3		
Financial Sector		1683.9		1683.9	2.4			1367.2	1595.9	2963.1	4.2	-1279.2	-1.8		
Public Sector				0	0.0				19889.3	19889.3	28.1	-19889.3	-28.1		
Monetary Authorities				13756.7	13756.7	19.5		191.3	726.5	917.8	1.3	12838.9	18.2		
Economy	471.8	103.3	3292.4	0	13756.7	17624.2	24.9	51800	2826.3	9603.3	29432	93661.6	132.6	-76037.4	-107.6
2013															
Private Non Financial Sector		1545.2		1545.2	2.0			8827.9	8188.9	17016.8	22.2	-15471.6	-20.2		
Financial Sector		2005.6		2005.6	2.6			1427.7	1668.2	3095.9	4.0	-1090.3	-1.4		
Public Sector				0	0.0				21512.4	21512.4	28.1	-21512.4	-28.1		
Monetary Authorities				12662.1	12662.1	16.5		157	1592.7	1749.7	2.3	10912.4	14.3		
Economy	500	106.7	3550.8	0	12662.1	16819.6	22.0	55259	3106.1	10412.6	32962.2	101739	132.9	-84919.8	-110.9

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

1/ A disaggregation of FDI and Portfolio Investment Net across sectors is not available

Currency and maturity mismatches vary across sectors and all sectoral agents:

- The private **nonfinancial sector** has a short foreign currency position and has liabilities to non-residents of about 22 percent of GDP²—of which close to one-fifth is short-term trade credit. Even without information about FDI sectoral distribution, it can be reasonably assumed that the sector's balance sheet would be affected by a large exchange rate depreciation. However, the impact would be partly attenuated by the windfall from resident foreign currency deposits held at the central bank.³
- The **financial sector** has lower mismatches than the non-financial sector because its foreign currency asset holdings partially balance its liabilities, which are mostly nonresident deposits. The impact of an exchange rate depreciation would also be reduced by commercial banks' ability to hedge.
- The maturity and currency mismatches of the **public sector** with regard to nonresidents are high; however, the public sector owns very little short-term debt, which limits its exposure to rollover risk, and most of its medium- and long-term debt liabilities are owed to multilaterals. A large exchange rate depreciation would have negative effect because it would raise public debt ratios and increase public external debt service.
- The **central bank** has a long foreign currency position and could benefit from valuation effects emanating from an exchange rate depreciation. Nonetheless, the increase in deposits from foreign counterparties, Fund borrowing, and a decline in foreign assets in recent years would reduce CBT's long FX position.

Box 2. Balance Sheet Effects from Exchange Rate Depreciation (concluded)

Quantifying the balance sheet effects from last year's exchange rate depreciation shows a negative impact, of which a large contribution came from public sector balance sheets. Using a methodology comparing changes in the balance sheets relative to values at constant exchange rate, staff found that the 9.4 percent cumulative depreciation of the NEER in 2013 led to a 2.4 percent worsening of Tunisia's short FX position. However, positive real effects from an exchange rate depreciation could emerge from an *expenditure-reducing and switching mechanism*, which would lower household consumption and imports, and increase exports (or at least keep its market share abroad in today's difficult international economic environment).

1/ FDI assets are less than 1 percent of the GDP

2/ The analysis does not account for FDI, given the lack of information about its sectoral distribution and also because FDI is generally long term in nature, with corporate capital denominated in local currency following Tunisia's regulation.

3/ Because of legal considerations related to the regulation of foreign exchange, deposits of residents in foreign currency (excluding government deposits) are included in central bank stocks of foreign assets and their counterpart into the monetary base, but holders of those deposits still enjoy the benefit of having foreign currency assets.

23. The functioning of the foreign exchange market is being strengthened. The newly installed electronic platform and market maker agreement (end-March structural benchmark) has introduced an institutional mechanism that will help the authorities to better control the volume of FX sales while letting the exchange adjust. It also sets the stage for the authorities' move towards a more flexible exchange rate system governed by weekly FX auctions (2014 end-December SB).

B. Laying the Foundations for Stronger, More Inclusive Growth

Reducing financial sector vulnerabilities

24. Minimum capital adequacy shortfalls should be addressed immediately (MEFP, ¶15).

The CBT's banking supervision department (DGSB) has required all six banks operating below the statutory minimum requirement (CAR of

9 percent this year but Basel II requirement of 10 percent by end-year) to prepare as soon as possible a detailed action plan to address their capital shortfall. These plans also concern four public banks. Public banks' weaknesses were further confirmed by the audits of the two largest ones, which found them weighed down by high operational costs, inadequate staffing, poor governance structure (internal and external), weak service quality, and

Tunisian Banks: Financial Indicators
(In percent, as of 2013*)

	Public Banks	Private Banks
CAR	5.2	10.9
Government bonds to total assets	2.5	6.3
Loans to assets	71.8	66.0
Deposits to loans	76.2	99.0
NPL	21.2	10.4

Source: Tunisian authorities

(*) Preliminary data

increasing NPLs. Moreover, the audit found contingent losses (of around 0.7 percent of GDP) that may need to be recognized. Priorities for the immediate future include:

- **Strategy for public banks** (MEFP, ¶17). The authorities recognize the importance of acting quickly on deciding the business model to be retained for public banks (a strategic orientation on the role of the State in at least two public banks is a Prior Action). Staff welcomed the authorities' intention to design such a strategy by mid-April for all nine banks in which the government has a stake, and encouraged the authorities to explore private sector solutions. The planned public presentation of the strategy by end-April 2014 will also help build consensus for the reform.
- **Restructuring plan and recapitalization** (MEFP, ¶17). Once the strategic orientation is decided, the authorities plan on finalizing restructuring plans (end-July structural benchmark) for the two main public banks that completed their audits (STB, BH—21 percent of total banking system assets). Staff urged the quick implementation of these plans—which should aim at strengthening banks' financial soundness, improve their governance and management, and enhance their human and operational capacities—and the speedy completion of the audit of the BNA (new end-July structural benchmark), the third remaining main public bank which was delayed because of technical difficulties with one of the auditing firms. Depending on the strategic vision of public banks and private sector participation (private shareholders own 44–49 percent equity in the three main public banks), the share of the public sector's recapitalization costs—to be initially financed by non-negotiable bonds—will have to be taken fully into account in the restructuring plans, debt sustainability analysis, and the 2014 supplementary budget. For illustration, using relatively conservative evaluation and collateral requirements, the audits for the two public banks estimated that at least 1.5 percent of GDP was needed to recapitalize them (without taking into account contingent costs, and assuming that the public sector kept its share). The budget has so far accounted for 1.2 percent of GDP, while FSSA estimated the needs at 2.6 percent of GDP for public banks.
- **Governance of public banks** (MEFP, ¶17), which needs to be improved in line with any public bank restructuring. To that end, the authorities have made a firm commitment to strengthen the management practices of public banks; this commitment includes implementing a new decree that allows banks to be managed on a fully commercial basis (e.g., no longer requiring Ministry of Finance approval for hiring decisions or opening branches).

25. Staff encouraged the authorities to accelerate measures to address weak asset quality.

A first priority is to establish an Asset Management Company (AMC) to remove tourism sector bad debt from banks' balance sheets (tourism NPLs represent about 54 percent of the sector's loan portfolio, and a quarter of the banking system's NPLs). This requires adoption by Parliament of a draft law—prepared with World Bank assistance—that assigns special resolution powers to the AMC (MEFP, ¶17). Such a draft is expected to be submitted to Parliament in June, and staff urged the authorities to move quickly in adopting it and finalizing the business plan that must accompany it

(the valuation method for eligible assets and the list of participating banks have yet to be completed). Staff and the authorities agreed that solutions should also be explored to resolve high NPLs in other areas (e.g. manufacturing). In parallel with the setting up of an AMC, it is imperative that the government strengthens creditor rights by calling for early adoption of the revised “bankruptcy law” currently in Parliament and by preparing a new law allowing existing “loan recovery” companies to approach debtors.

26. Staff is encouraged by the measures taken to align existing norms with international standards, but more needs to be done (MEFP, ¶16). Conservative application of haircuts on collateral used, implementation of tighter related-party and concentration risk ratios, and improvements in loan classification rules are welcome developments; however, loan classification could still be improved, including for public enterprises that benefit from an assumption of an implicit government guarantee. Plans to align required liquidity ratios with international standards are also progressing, with the impact study (2013 end-December structural benchmark) showing the need for a gradual approach in setting appropriate thresholds and moving to Basel III requirements. In the interim, staff urged the authorities to apply pecuniary sanctions to banks that do not respect the current liquidity ratio.

27. Impressive steps have been taken to improve banking data provision (MEFP, ¶19). The design of a Uniform Bank Performance Reporting system has been finalized and is expected to be implemented in June 2014, thereby allowing the supervisor to monitor bank performance regularly and banks to obtain a number of benchmark indicators. A full banking data and ratings reporting system—designed in September 2013 and covering all accounting, financial, and institutional aspects—is on track for coming online by end-year.

28. Banking supervision should continue to be strengthened. Staff welcomed the five inspections already completed. It encouraged the authorities to continue improving the offsite procedures and adopt the 2014 onsite inspection plan, which should be guided by risk-based methods. To properly assess and mitigate risks, staff urged the authorities to move quickly towards consolidated-based supervision and to require banks’ compliance with internal risk management framework required by the existing regulation (MEFP, ¶18). Success in banking supervision reforms would also require a substantial increase in human and financial resources allocated to it.

29. Plans to revise the financial system legal framework are advancing well. An IMF/WB LEG TA is assisting the authorities in revising the banking system laws with an emphasis on developing the proper banking resolution framework, including the clear identification of the agencies responsible for bank resolution and liquidation, the treatment of shareholders, and the tools of resolution. In parallel, a framework for a deposit insurance scheme is also being developed. While waiting for the full revision of the banking laws, staff encouraged the authorities to develop a crisis contingency plan based on the existing legislative framework. Forthcoming IMF LEG TA will help in this area.

Growth-enhancing fiscal reforms

30. The authorities have taken some early steps towards reforming public enterprises, which is essential to strengthen transparency and reduce the burden on the budget (MEFP, ¶124). A preliminary audit of the three energy companies' subsidy system has been completed (end-March 2014 structural benchmark), highlighting a complex system of cross-subsidies between these companies. One key priority will be to make all energy companies accountable for their own import bills, thus clarifying the degree of subsidization of each individual company. Staff is also encouraged by the authorities' efforts in reducing delays in transferring corresponding amounts for energy and food subsidies to public enterprises, which will help reduce their borrowing and associated costs. Monitoring of the financial situation of public enterprises will be enhanced by a newly created interdepartmental committee, which has also started assessing loss-making state-owned companies and will benefit from ongoing efforts to create a consolidated balance sheet of the 20 largest state-owned enterprises (end-June structural Benchmark). Improvements in the governance framework of public enterprises should include a review of the regulatory framework but also concrete actions, such as revamping the role of executive boards.

31. A number of initiatives are under way to improve the execution of capital expenditures, which remains low (MEFP, ¶126). Declining levels of capital investments are weighing on economic growth and not helping to reduce regional and income disparities, particularly in disadvantaged regions. The authorities are forcefully moving ahead to address weak execution of investment projects through: (i) the adoption of new procurement procedures which are expected to start in June 2014 (the decree was adopted in March 2014); (ii), a more decentralized project execution; (iii) greater determination to resolve property deed issues that arise during project preparation; and (iv) an acceleration of major projects, in disadvantaged regions, that are already in the pipeline.

32. Tax reform is essential to enhance revenue mobilization, increase efficiency, and improve equity (MEFP, ¶122). Staff and the authorities agree that major changes will only come into effect in FY 2015 once a new tax code is adopted (2014 end-September SB). Preparatory work should build on measures included earlier this year in the 2014 budget, which halved the corporate tax wedge between the onshore and offshore sectors, introduced a tax on dividends, and raised the tax exemption threshold for low-income individuals. National tax consultations planned for June 2014 should ensure coherence across various working group recommendations in the formation of a consensus on a comprehensive tax reform strategy that is based on a clear vision of taxation expected to come from labor and capital and a clear costing of measures proposed. As part of the global income tax reform, staff and the authorities agreed on the need to reform the presumptive tax system—which is encouraging tax evasion. Staff urged the authorities to design a calendar for the gradual elimination of the onshore and offshore corporate tax disparity as part of the income tax reform.

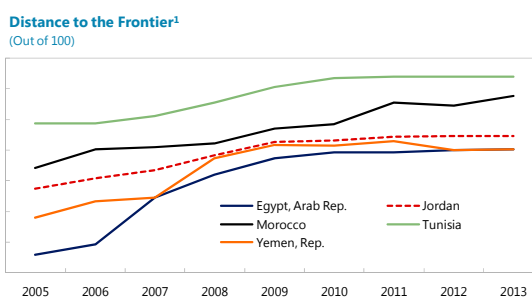
33. Revenue administration should be further strengthened (MEFP, ¶123). The unification of different functions at the large taxpayer unit (LTU) has been progressing and is a significant step in

the right direction; however, the adoption of a strategic plan for modernizing tax administration (end-March 2014 SB) will require additional time to ensure coherence across various working group recommendations on tax administration restructuring, taxpayer education and service, tax procedure and payment simplification, audit procedures and governance, and information systems. Staff welcomed the planned installation of a committee to pilot tax administration reforms, which is crucial to strengthening coordination across agencies and accelerate the reform process. On customs administration, a risk management unit has been set up, and strengthening border controls will help combat smuggling.

34. Progress in public financial management is encouraging (MEFP, ¶25). A Single Treasury Account has been created (end-March SB), regrouping all sub-accounts, with the exception of those linked to foreign-financed projects. The strict implementation of the complementary budget period, which has been substantially shortened to 20 days, provides greater transparency on budget management and appropriation. Staff welcomed the authorities' efforts to reconcile the discrepancy between the above and below the line budgetary information, often complicated by payment orders for public investments that are recorded as expenditures but not paid until later in the year when the project starts or bills materialize. The ongoing work on a new organic budget law will help streamline control procedures and introduce performance budgeting, which is already being prepared for nine ministries (about 70 percent of the budget). Moreover, budget transparency has been enhanced by the publication of a "citizens' budget" that can be understood by non experts and will be strengthened further by the adoption of a functional budget classification in June 2014.

Growth-enhancing structural reforms

35. Staff encouraged the authorities to make up for delays and swiftly implement business climate reforms (MEFP, ¶27). Staff noted delays in the legislative agenda, which pushed the adoption of implementation decrees for the investment code back to end-September 2014. The adoption of the competition law, the law on public-private partnership, as well as the bankruptcy law have been similarly delayed. The adoption of these laws is crucial if the burden of excessive regulation and government intervention in the economy is to be reduced. Along with the simplification of administrative procedures, these laws are essential to create a more level playing field with greater access to economic opportunities for a broader part of the society and to develop a more rules-based system that encourages private sector development and enhances competition. Moving with these reforms now will also allow Tunisia to keep ahead of its competitors who are fast improving their regulatory environment. Efforts to foster new trade agreements, including the one recently implemented with Algeria, could further simplify the import tariff barriers and foster fair competition (MEFP, ¶29).



Source: World Bank.

¹The frontier represents the highest performance observed across all the economies and across all the different Doing Business indicators that are included in the World Bank's annual Doing Business Report. An economy's distance to frontier is reflected on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier.

36. Focus on labor market reforms has been renewed. Tripartite commissions—regrouping representatives from labor, business, and government—have been revived to review the draft national employment strategy. However, to-date, no specific action has been taken and new measures will likely only be announced after the elections. In the meantime, the government’s priorities are employment creation programs, to be financed through microcredit, and a review of the education programs, to try to reduce the structural skills mismatch between existing employment opportunities and the educated workforce.

37. Plans to improve data on national accounts, monetary statistics, and the balance of payments should be stepped up, with help from Fund TA (MEFP, ¶38). Staff also urged the authorities to move swiftly in preparing a draft law that guarantees and protects the independence of the National Statistical Institute.

C. Protecting the Most Vulnerable

38. Improving the targeting of support for vulnerable households is critical to ensure the success of reforms (MEFP, ¶33). For this reason, the authorities have introduced new social housing programs for needy families, increased the income tax deduction for the poorest households, and established a new lifeline tariff to protect households that consume less than 100 kwh per month. They have also increased their efforts in moving towards a unified registry system for vulnerable households, and plan to introduce a unique social identification number over the next few months. In the interim, an evaluation of existing school assistance programs and of health benefits for needy families will be finalized by June 2014. The new targeted household strategy—which is now expected to be completed in June (new SB, postponed from end-March)—has been broadly identified. It will expand the number of beneficiary families in the existing cash transfer program from 220,000 to 250,000, broaden the definition of vulnerable households, and increase school allowances for children and university students by about 10 percent. To ensure the success of the energy subsidy reform, staff urged the authorities to adopt and implement the strategy ahead of the planned fuel price increase and in conjunction with a comprehensive communication campaign that explains the benefits of moving away from regressive energy subsidies that benefit mostly the well-off.

PROGRAM DESIGN AND MODALITIES

39. Program modalities remain broadly unchanged. The program continues to be responsive to Tunisia's unique political transition—including through delayed fiscal consolidation and slower implementation of the reform agenda—while ensuring vulnerabilities and risks are reduced by the end of the Fund-supported program. The new fiscal measures planned for this year—with continued containment of the wage bill and subsidy reduction—will drive fiscal consolidation and reduce underlying vulnerabilities in the fiscal area. Priority social spending will be preserved during fiscal consolidation (a floor on the level of social expenditures is an indicative target for the program). The reserve accumulation programmed, and the accompanying reform agenda, will ensure that buffers continue to be rebuilt during the program period while inclusive growth and job creation are supported. Technical assistance from the Fund and other donors—in monetary policy, banking, and fiscal areas—will help the authorities in achieving these objectives. An extension of the program could be considered later in the year should reforms take longer than envisaged, or fiscal consolidation not take place as expected.

40. Risks associated with the program remain significant. Further setbacks in the political transition, continued crowding of the legislative calendar of the Constituent assembly, and major strikes could put the attainment of program objectives at risk, delay the completion of structural benchmarks, and lead to policy reversals. A further deterioration in the international economic environment could also dampen economic activity and put pressure on the fiscal and external positions. Delays in official external financing pledged to support Tunisia's reform program, or lack of market access, could also create a financing gap. The new government's strong commitment to the reform agenda will help reduce program implementation risks, although successful reform implementation will depend on the ability of the new authorities to build consensus within the population and the administration.

41. Conditionality has been set to anchor program objectives and performance. Final data for all end-March quantitative performance criteria will only be available after April 30. A waiver of applicability is thus needed for all end-March PCs, which appear to have been met. Staff is proposing a modification of end-June QPCs in light of the end-March outturn and downward revisions to the balance of payments projections. It also proposes to set new PCs for end-September 2014 and new ITs for end-December 2014 as per the MEFP (Table 1). Three end-March structural benchmarks have been postponed to June to allow for delays caused by the transition process, and one was deferred to end-September to account for slow progress in the legislative agenda (Table 2b). The strategic orientation for two public banks is a Prior Action and two new structural benchmarks are proposed for end-July to reduce banking sector vulnerabilities.

42. The program is fully financed for the next 12 months. Financing assurances have been provided by multilateral and bilateral partners, who have linked future disbursements to progress in the reform agenda. From the Fund, all resources scheduled to be disbursed for 2014 will continue to be used for budget support. Market issuance of \$600 million is expected by the end of 2014, for which the authorities are seeking U.S. and Japanese guarantees. The issuance of a Sukuk bond—delayed from 2013 and now expected in the last quarter of the year—will cover remaining needs. Nonetheless, if there are early indications that projected financing will not be received, the authorities will consult with the Fund on alternative financing approaches and/or further policy adjustments.

Tunisia: Official External Financing					
(Millions of U.S. dollars)					
	2014				
	Proj.	Q1	Q2	Q3	Q4
Total	4,165.5	803.6	855.4	676.9	1,828.7
Bilateral	200.0	200.0	0.0	0.0	0.0
IFIs	2,449.3	507.5	738.0	603.4	600.4
AMF (Arab Monetary Fund)	43.4		43.4		
IMF (Budget Support)	1,393.9	507.5	444.6	220.9	220.9
World Bank Group	750.0		250.0	250	250.0
EU	262.0			132.5	129.6
Other	1,516.3	96.1	117.5	73.5	1,228.2
International Market (possible US guarantee)	300.0				300.0
International Market (possible Japan guarantee)	300.0				300.0
Project aid without donor breakdown	356.8	74.4	108.4	58.8	114.1
Sukuk and other external financing	500.0				500.0
Other (including Loan Transfers to SOEs)	59.5	21.7	9.0	14.7	14.1
Memorandum items:					
Grants	127.3				
EU	127.3		38.2	38.2	50.9
IMF Financing (incl. Budget Support)	1,393.9	507.5	444.6	220.9	220.9

Sources: Tunisian Authorities; and IMF staff estimates.

43. Tunisia has the capacity to repay the Fund. Tunisia has a strong record of payments to the Fund. Peak Fund access projections remain unchanged from the Stand-By Arrangement request (400 percent of quota). Standard indicators of Fund exposure will remain low, with Fund credit outstanding reaching a maximum of 3.5 percent of GDP in 2015 (about 17.7 percent of gross international reserves).

STAFF APPRAISAL

44. Tunisia is facing a challenging environment but progress in the political transition is a new opportunity for economic reform. Growth forecasts have been revised downwards, unemployment remains high, fiscal and external balances are elevated, and social tensions continue to burden economic activity. The favorable political developments provide, however, a general sentiment of optimism, and it is important that the new government seize this opportunity to accelerate reforms so that it can capitalize on renewed confidence.

45. Fiscal adjustment is progressing, but at a slower pace than originally envisaged under the program. The central government cash deficit target was met in 2013, but only because of deferred cash payments and record low levels of capital investment. For 2014, staff welcomes the authorities' commitment to contain the fiscal deficit, which is politically difficult given high existing social tensions, and supports the new measures they have identified. In case of shortfalls or delays in adopting the revised budget law, staff urges cuts in non-essential current spending, while preserving social and capital expenditures.

46. The quality of budget composition needs to be significantly improved. Reversing the increase in regressive energy subsidies and containing the high wage bill are important to create much needed fiscal space for priority spending. Staff welcomes the recent move towards more decentralized project execution and the adoption of streamlined procurement procedures, which will help scale up public investment. The acceleration of major projects in disadvantaged regions is a welcome development.

47. Revenue reforms should be pursued at a more rapid pace. Steps taken to reduce the corporate tax wedge between the onshore and offshore sectors, and to unify different functions at the Large Taxpayer Unit, are welcome and should be built upon. Staff welcomes the organization of national tax consultations in June 2014, which will help build consensus on a comprehensive tax reform strategy that fosters equity and removes complex and distortive measures. Ongoing efforts in reforming tax administration should be organized around an all-encompassing action plan that will help coordinate reforms across different tax administration functions and agencies.

48. The government should continue its efforts to reform public enterprises and strengthen public financial management. Staff welcomes the authorities' renewed focus on assessing the financial situation of public enterprises and improving data transparency and coverage. Efforts to make energy companies accountable for their own imports and timely transfers to public enterprises will increase transparency, and reduce costs and distortions. Staff urges rapid improvements in the governance framework of public enterprises. The introduction of a Single Treasury Account is welcome, and budgetary control procedures will be further simplified in the organic budget law currently being designed.

49. A prudent monetary policy remains necessary to contain inflationary pressures. Staff welcomes the authorities' readiness to increase the policy rate further if core inflation rises more rapidly than expected or if depreciation pressures rise. It commends the authorities for steps taken to tighten the collateral framework, and recommends further tightening once the lender of last resort facility is in place. Staff urges the quick revision and adoption of a new legislation removing the cap on lending rates, which is essential to improve the monetary policy transmission channel and access to finance.

50. Greater exchange rate flexibility will help increase external buffers, reduce CBT liquidity injections, and improve competitiveness. Staff welcomes the authorities' decision to limit intervention in the foreign exchange market to smoothing excessive intra-day exchange rate fluctuations. The newly established electronic platform and market maker agreement set the prerequisites needed for the establishment of weekly foreign exchange auctions, which will contribute to greater exchange rate flexibility.

51. Addressing vulnerabilities in the banking sector is critical to safeguarding banking sector stability, strengthening financial intermediation, and supporting private sector development. Staff welcomes the recent improvements implemented in the regulatory environment, banking supervision, governance of public banks, and the impressive steps taken to improve banking data reporting. Staff supports the plan to widen the authorities' strategic

orientation for public banks to encompass all banks in which the government has a stake. It urges the government to speedily complete the remaining bank audit and quickly design the restructuring plans for the two main public banks, which will need to allow for important recapitalization costs. The adoption of the draft law creating an AMC for troubled tourism debt should be accelerated as it is essential to repair public banks' balance sheets and spur private sector credit. Financial stability will need to be safeguarded by ensuring all banks are compliant with minimum adequacy ratios and prudential norms. Enhancing banking resolution and consolidated banking supervision would further reduce vulnerabilities and strengthen transparency.

52. The implementation of the structural reform agenda should be accelerated. Delays in the legislative agenda postponed the adoption of the investment code and its decrees, the bankruptcy law, and the law on public-private partnerships. It is important that the government bring forward these laws for parliamentary consideration as their implementation is crucial to provide investors with a level playing field, strengthen creditor rights, and foster private sector development. Efforts to streamline existing business regulations should be intensified.

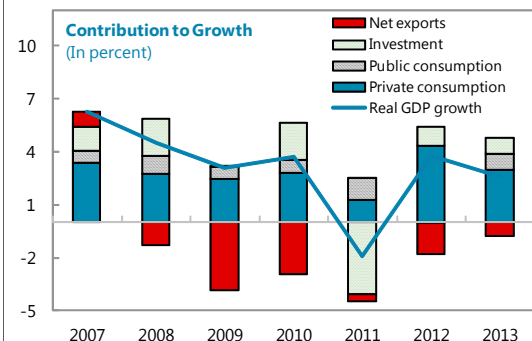
53. Initiatives taken to strengthen social safety nets are important. Progress made in introducing new social housing and in moving towards a unified social identification number for all vulnerable households is welcome. The authorities have also made important steps in identifying components of the long-delayed "household targeting strategy." Its adoption should be enacted quickly, and ahead of the planned fuel price increase so as to ensure the success of the energy subsidy reform. Staff also urges the authorities to step up social expenditures, which should not be used as an adjustment variable during fiscal consolidation.

54. The authorities' commitment to implement program policies will continue to be tested by a difficult social environment and will be essential to successfully tackle vested interests. Proactive communication on Tunisia's challenging economic situation and the need for reforms is required to explain to all stakeholders the rationale and benefits of necessary but difficult policies. Increasing social tensions, regional or domestic security tensions, and additional delays in the political transition represent important risks to program implementation.

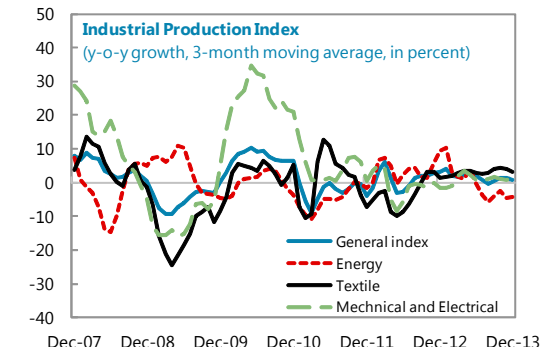
55. On the basis of Tunisia's performance under the SBA, and the government's policy commitments, staff supports the authorities' request for completion of the third review and a disbursement of SDR 145 million. Staff supports the authorities' request for waivers of applicability on the end-March QPCs on the primary fiscal balance, NIR, and NDA. It supports modification of end-June QPCs and recommends the establishment of new end-September PCs as proposed in the attached MEFP.

Figure 1. Tunisia: Recent Economic Developments

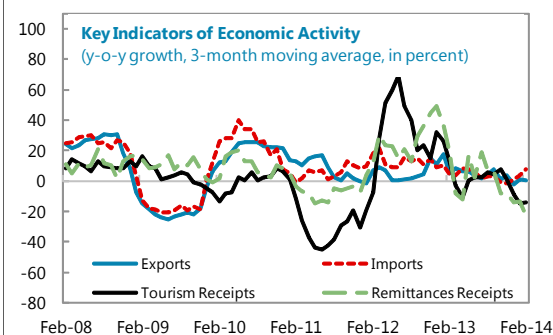
In 2013, growth was moderate, driven mostly by private consumption while investment has recovered from the sharp drop in 2011



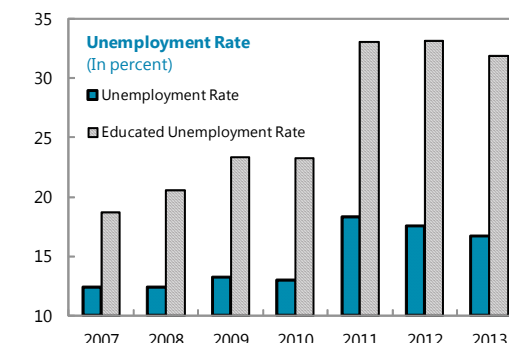
Industrial production is recovering only slowly, driven mostly by textile production, while energy production is declining



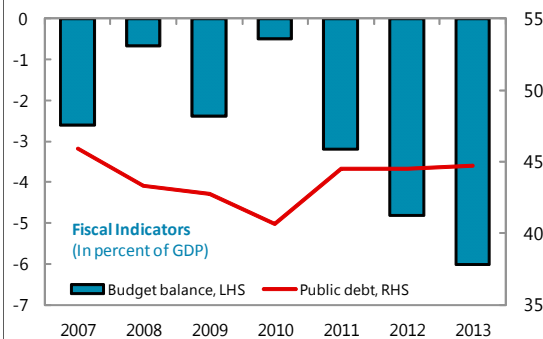
Tourism and remittances have declined further at the beginning of the year while imports have somewhat increased



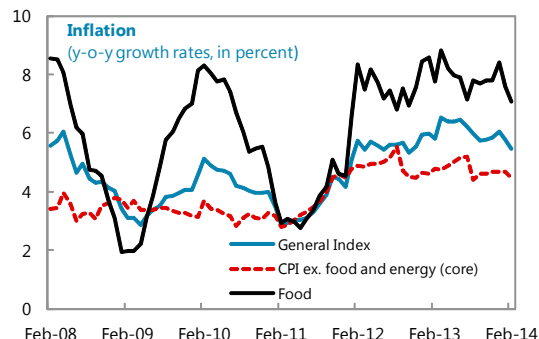
Unemployment has started to subside on the back of public sector hiring but remains high, particularly among university graduates.



To counteract the still-weak economy and high unemployment, the fiscal stance has been looser, while public debt has stabilized at around 45 percent of GDP



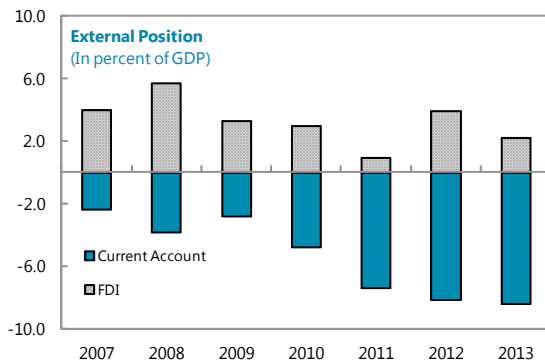
Inflation rate has subsided following lower food price inflation.



Source: Tunisian authorities.

Figure 2. Tunisia: External and Financial Indicators

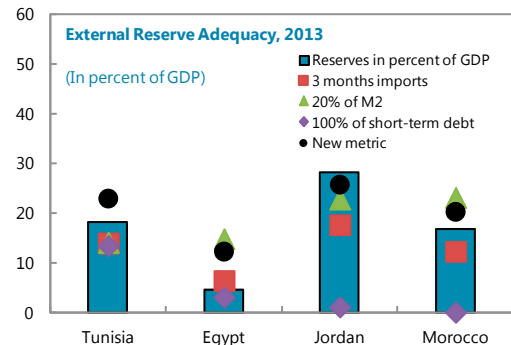
The current account deficit remains high and FDI flows weak.



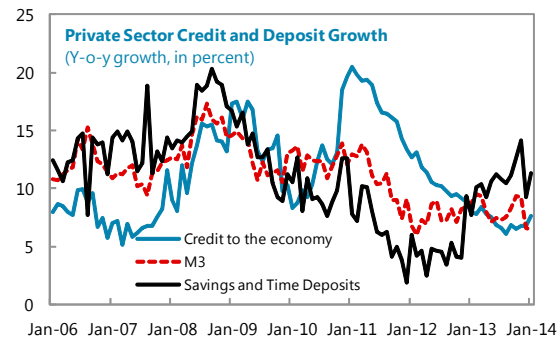
At the beginning of 2014, international reserves have increased and the exchange rate appreciated.



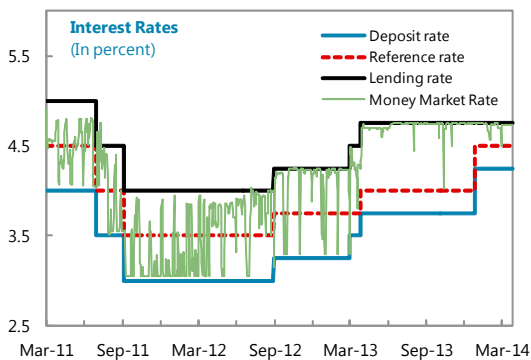
Reserve levels remain below the new metric.



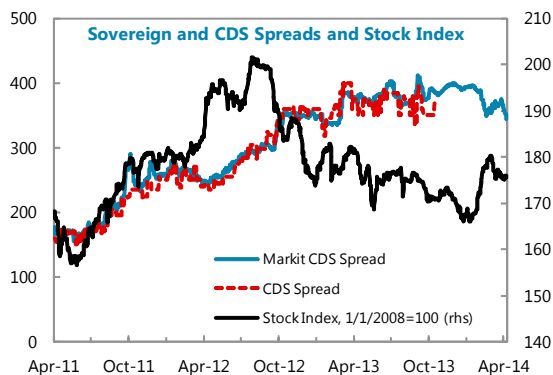
Credit to the economy remains weak although deposits are picking up.



The money market rate remains unchanged at 4.75 percent.



At the beginning of the year, sovereign spreads have decreased and the stock index has improved but has recently been weighed down by bank stocks.



Sources: Tunisian authorities; and IMF staff estimates.

Table 1. Tunisia: Selected Economic and Financial Indicators, 2010–15

	2010	2011	2012	2013			2014			2015
				Prog. 05/24/13	Prog. 01/24/14	Est.	Prog. 05/24/13	Prog. 01/24/14	Proj.	
Production and income (percent change)										
Real GDP	2.6	-1.9	3.7	4.0	2.7	2.6	4.5	3.0	2.8	4.2
GDP deflator	4.3	4.6	5.3	5.6	5.8	5.7	4.4	4.9	5.1	4.8
Consumer price index (CPI), average	4.4	3.5	5.6	6.0	6.1	6.1	4.7	5.5	5.5	4.9
Consumer price index (CPI), end of period	4.0	4.2	5.9	5.3	6.0	6.0	5.0	5.3	5.3	4.5
Gross national savings (in percent of GDP)	20.9	16.2	16.1	17.3	15.1	13.9	19.0	17.1	14.2	15.8
Gross investment (in percent of GDP)	25.7	23.6	24.3	24.7	23.3	22.3	25.0	23.8	21.5	22.1
Central government (percent of GDP, unless indicated otherwise 1/										
Total revenue (excluding grants)	23.4	24.5	23.1	23.8	23.4	23.6	24.0	22.6	23.1	23.2
Total expenditure and net lending	24.0	28.0	28.8	31.1	29.5	29.7	30.3	29.7	29.9	27.6
Central government balance (excluding grants)	-0.6	-3.5	-5.7	-7.3	-6.2	-6.1	-6.4	-7.1	-6.8	-4.4
Central government balance (excluding grants, cash basis)	1.6	-2.8	-5.0	-7.3	-4.5	-4.5	-6.4	-8.9	-8.6	-4.4
Structural fiscal balance 2/	-1.1	-3.0	-5.3	-5.0	-4.6	-4.6	-3.8	-5.2	-4.9	-4.0
General government debt (foreign and domestic)	40.7	44.5	44.5	45.3	45.0	44.7	49.5	51.7	50.9	52.6
Foreign currency public debt (percent of total debt)	60.7	58.0	62.8	65.7	64.9	64.3	68.5	70.9	70.1	70.1
Total external debt										
External debt (US\$ billions)	21.4	22.1	24.3	25.0	24.4	25.4	27.6	27.4	28.2	30.2
External debt (in percent of GDP)	48.5	48.0	53.8	52.0	51.9	53.9	55.5	56.9	57.3	59.8
Debt service ratio (percent of exports of GNFS)	10.5	11.9	12.0	9.5	9.4	9.5	9.2	8.6	9.3	7.0
Money and credit (percent change)										
Credit to the economy	19.6	13.4	8.8	10.8	9.2	6.8	11.7	6.0	8.5	7.6
Broad money (M3 of the financial system)	12.1	9.1	8.4	12.6	7.6	6.6	12.0	10.8	9.6	10.8
Velocity of circulation (GDP/M2)	1.54	1.45	1.46	1.36	1.48	1.48	1.32	1.45	1.46	1.44
External sector (percent change)										
Exports of goods, f.o.b. (in \$)	14.0	8.5	-4.6	6.5	3.8	0.3	5.6	3.0	1.7	4.5
Imports of goods, f.o.b. (in \$)	15.9	7.7	2.1	5.1	2.7	-0.5	3.7	1.7	1.4	3.2
Exports of goods, f.o.b. (volume)	5.6	-0.5	1.2	5.7	2.3	3.2	5.2	2.1	2.1	5.4
Import of goods, f.o.b. (volume)	-2.7	3.7	8.5	5.8	3.7	5.1	6.1	3.7	1.6	5.5
Trade balance (in percent of GDP)	-10.4	-10.4	-13.5	-12.6	-12.9	-12.6	-11.9	-12.3	-12.1	-11.7
Current account (in percent of GDP)	-4.8	-7.4	-8.2	-7.5	-8.2	-8.4	-6.0	-6.7	-7.2	-6.3
Foreign direct investment (in percent of GDP)	3.0	0.9	3.9	2.1	2.2	2.2	2.5	2.2	2.2	2.9
Terms of trade (deterioration -)	-9.4	4.9	0.0	1.4	2.5	2.7	2.5	3.7	-1.0	0.8
Official reserves										
Gross official reserves (US\$ billions, e.o.p)	9.5	7.5	8.7	9.0	6.8	7.7	10.8	9.1	9.0	10.1
In months of next year's imports of goods and services, c.i.f.	4.4	3.4	4.0	3.8	3.0	3.5	4.2	3.8	3.9	4.3
Memorandum items:										
GDP at current prices (TD millions)	63,059	64,690	70,658	78,334	77,072	76,570	85,465	83,281	82,728	90,350
GDP at current prices (US\$ billions)	44.1	46.0	45.2	48.9	47.0	47.1	50.6	48.2	49.2	50.5
Population (millions)	10.5	10.7	10.8	10.9	10.9	10.9	11.1	11.1	11.1	11.2
GDP per capita (US\$ millions)	4,177	4,305	4,198	4,483	4,303	4,317	4,576	4,354	4,449	4,509
Unemployment rate (in percent)	13.0	18.3	17.6	...	16.7	15.8	...	16.0	15.3	15.0
Exchange rate: dinar/US\$ (average)	1.43	1.41	1.56	...	...	1.62	...	...	...	...
Real effective exchange rate (percent change, depreciation -) 3/	-0.52	-1.77	-1.82	...	...	-1.28	...	...	...	...
Interest rate (money market rate, in percent, e.o.p)	4.1	3.5	3.3	...	...	...	...	...	...	...
Stock market TUNINDEX (12/31/1997=1000)	5,113	4,722	4,580	...	...	4,381	...	...	...	...
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, 2010–15
(In millions of U.S. dollars, unless otherwise indicated)

	2010	2011	2012	Prel. 2013	Projections					2015
					2014					
					Q1	Q2	Q3	Q4	Year	
Current account	-2,105	-3,401	-3,706	-3,963	-1,192	-997	-606	-769	-3,563	-3,186
Trade balance	-4,575	-4,799	-6,105	-5,937	-1,537	-1,666	-1,482	-1,281	-5,967	-5,919
Exports	16,431	17,824	16,997	17,050	4,240	4,613	4,021	4,458	17,332	18,118
Energy	2,315	2,592	2,849	2,591	608	661	577	639	2,485	2,460
Non-energy	14,116	15,231	14,147	14,459	3,632	3,952	3,444	3,819	14,847	15,659
Imports	-21,006	-22,623	-23,102	-22,987	-5,777	-6,279	-5,503	-5,739	-23,299	-24,037
Energy	-2,653	-3,409	-4,100	-4,172	-1,101	-1,197	-1,047	-1,132	-4,476	-4,358
Non-energy	-18,353	-19,214	-19,001	-18,815	-4,676	-5,082	-4,456	-4,608	-18,823	-19,679
Of which: Nonfood	-16,810	-17,339	-17,513	-16,633	-4,139	-4,498	-3,946	-4,056	-16,638	-17,703
Services and transfers (net)	2,470	1,398	2,399	1,974	346	669	877	513	2,404	2,732
Nonfactor	2,460	1,552	1,946	1,748	472	491	724	180	1,867	2,153
Of which: Tourism	2,461	1,680	2,031	1,988	309	502	770	527	2,109	2,352
Factor Services and Transfers (net)	10	-154	453	226	-127	178	153	333	537	579
Of which: Workers' remittances	2,063	1,990	2,235	2,267	441	555	813	601	2,411	2,453
Interest payments on external debt	-632	-653	-618	-571	-144	-168	-137	-124	-573	-541
Capital and financial account	1,343	1,309	4,866	2,861	267	353	948	1,878	3,445	3,931
Excluding grants	1,252	1,142	4,412	2,607	235	328	911	1,797	3,270	3,767
Capital account	82	154	442	247	31	23	35	79	168	158
Financial account	1,260	1,155	4,424	2,613	236	330	912	1,799	3,277	3,773
Direct foreign investment (net)	1,309	417	1,772	1,028	224	253	287	322	1,086	1,453
Medium- and long-term loans (net)	145	652	1,623	830	201	173	358	1,130	1,863	1,206
Disbursement	1,845	2,707	3,682	2,351	420	531	574	1,857	3,382	2,329
Amortization	-1,700	-2,055	-2,059	-1,521	-219	-359	-215	-726	-1,519	-1,123
Short-term capital	-193	85	1,232	932	-186	-82	287	485	504	1,282
Errors and omissions 1/	-316	108	-31	-13	-146	231	-3	-25	57	82
Overall balance	-1,078	-1,984	1,130	-1,115	-1,070	-413	339	1,084	-60	827
Reserve liabilities (Fund credits)	0	0	0	150	507	445	221	221	1394	223
Changes in gross reserves	1078	1984	-1130	965	563	-31	-560	-1307	-1334	-1050
<i>Memorandum items:</i>										
Current account balance/GDP (percent)	-4.8	-7.4	-8.2	-8.4	-2.3	-2.0	-1.2	-1.7	-7.2	-6.3
Reserves (in billions of US\$)	9.5	7.5	8.7	7.7	7.1	7.2	7.7	9.0	9.0	10.1
Reserves in months of imports of goods 2/	4.8	3.7	4.3	3.7	3.5	3.6	3.8	4.3	4.3	4.6
Reserves in months of imports of goods and services 2/	4.4	3.4	4.0	3.5	3.2	3.3	3.6	3.9	3.9	4.3
Reserves/total short term external debt (percent) 3/	191.3	147.2	139.7	121.6	132.5	126.6	128.8	154.1	156.3	165.2
Excluding nonresidents deposits	402.5	308.8	265.3	252.3	274.9	262.8	267.2	319.7	604.8	638.9
Reserves/short-term debt (on remaining maturity)	142.7	106.9	104.7	98.3	114.0	101.3	112.9	104.4	125.2	140.7
External debt service (in percent of exports of goods and non factor services), excluding non resident deposits	234.5	172.4	162.2	169.1	205.7	173.1	206.8	160.8	308.1	382.0
External medium- and long-term debt (billions of US\$)	16.4	16.9	18.1	19.1	20.0	20.6	21.2	22.5	22.4	24.1
External medium- and long-term debt/GDP (percent)	37.2	36.9	40.1	40.5	38.6	41.5	43.9	47.7	45.6	47.7
External short-term debt (billions of US\$)	5.0	5.1	6.2	6.3	5.4	5.7	6.0	5.9	5.8	6.1
External short-term debt/GDP (percent)	11.3	11.1	13.7	13.4	10.4	11.4	12.4	12.4	11.7	12.1
Debt service ratio (as percent XGS, including IMF)	10.5	11.9	12.0	13.6	6.7	8.9	6.3	15.1	8.3	6.5
Goods export real growth (percent)	5.6	-0.5	1.2	3.2	0.5	-4.7	-4.3	-4.1	2.1	5.4
Non-energy	7.8	2.3	0.9	2.7	-16.8	-3.1	-2.6	0.1	3.0	5.4
Goods import real growth (percent)	-2.7	3.7	8.5	5.1	9.7	3.4	3.6	3.6	1.6	5.5
Non-energy	-3.0	4.4	7.3	5.2	3.6	3.4	-12.1	7.1	1.0	5.8

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. dollar)

	2010	2011	2012	2013	2014					2015
					Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Annual Proj.	
Total financing requirements	9,226	10,551	10,270	10,727	7,109	6,928	6,621	7,001	10,455	9,247
Current account deficit - Capital transfers	2,022	3,247	3,264	3,715	1,160	974	570	690	3,394	3,028
Current account deficit	2,105	3,401	3,706	3,963	1,192	997	606	769	3,563	3,186
Capital account	82	154	442	247	31	23	35	79	168	158
Amortizations	6,887	7,412	6,975	6,999	5,803	6,185	6,048	6,286	7,117	6,301
General government	1,017	1,419	1,233	1,023	119	196	114	186	997	668
Banks	48	45	59	35	7	12	7	11	37	32
Corporate 1/	5,822	5,948	5,683	5,940	5,677	5,977	5,927	6,089	6,083	5,601
Short-term debt	5,187	5,357	4,916	5,477	5,584	5,826	5,833	5,943	5,598	5,178
Long-term debt	635	591	767	463	93	151	94	146	485	423
Net errors and omissions	316	-108	31	13	146	-231	3	25	-57	-82
Total financing sources	9,226	10,551	10,270	10,578	6,601	6,483	6,400	6,780	9,061	9,024.1
FDI (net)	1,309	417	1,772	1,028	224	253	287	322	1,086	1,453
Disbursements (debt)	6,791	8,555	10,037	8,891	5,747	6,389	6,690	7,726	9,508	8,819
General government	798	1,778	3,180	1,551	296	411	456	1,570	2,787	1,733
Banks	74	66	36	57	9	9	8	16	42	42
Corporate 1/	5,919	6,711	6,821	7,283	5,442	5,969	6,225	6,140	6,679	7,044
Short-term debt	4,946	5,848	6,355	6,540	5,327	5,857	6,116	5,928	6,126	6,491
Long-term debt	973	863	466	743	115	112	109	212	553	553
Other portfolio flows net (Including Drawdown in commercial banks NFA)	48	-406	-409	-307	67	-128	-16	39	-199	-199
Drawdown in gross reserves	1,078	1,984	-1,130	965	563	-31	-560	-1,307	-1,334	-1,050
Financing gap	0	0	0	150	507	445	221	221	1,394	223
Fund credits 2/	0	0	0	150	507	445	221	221	1,394	223
Purchases	0	0	0	150	507	445	221	221	1,394	223
Repurchase	0	0	0	0	0	0	0	0	0	0
Memo items										
Gross international reserves (in millions of U. S. dollars)	9,509	7,525	8,655	7,689	7,126	7,157	7,717	9,024	9,024	10,073
In percent of short-term debt at remaining maturity	142.7	106.9	104.7	98.3	114.0	101.3	112.9	104.4	125.2	140.7
Government rollover rates (in percent)	78	125	258	152	249	209	400	845	280	260
Banks rollover rates (in percent)	153	146	61	161	124	74	116	146	114	131
Corporate rollover rates (in percent)	102	113	120	123	96	100	105	101	110	126

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, 2012-15 1/

(In millions of dinars)

	2012		2013						2014						2015	
	Q1	Q2	Q3	Q4	Prog.	Annual	Prog.	Budget	Prog.	Q1	Q2	Q3	Q4	Annual	Proj.	
																Act.
Total revenue and grants	16,939	4,277	4,767	4,381	4,726	18,111	18,150	20,876	19,187	19,047	4,653	4,714	4,700	5,259	19,325	21,271
Revenue	16,310	4,244	4,765	4,339	4,691	18,001	18,039	20,476	18,973	18,833	4,621	4,692	4,657	5,141	19,111	20,957
Tax revenue	14,864	3,979	3,918	4,016	4,420	16,299	16,333	18,829	17,897	17,757	4,406	4,316	4,442	4,872	18,035	19,596
Nontax revenue	1,446	265	802	323	267	1,653	1,657	1,637	1,072	1,072	214	375	214	268	1,072	1,351
Capital income	0	0	45	0	4	49	49	10	4	4	1	1	1	1	4	10
Grants	629	33	1	42	34	110	110	400	214	214	32	21	43	118	214	314
Total expenditure and net lending	20,344	4,978	4,149	5,361	8,259	22,759	22,746	25,931	24,825	24,768	4,873	5,602	6,182	8,073	24,720	24,916
Total expenditure	20,694	4,956	4,201	5,290	8,301	22,764	22,747	24,235	24,325	23,648	4,853	5,602	5,892	7,263	23,600	24,816
Current expenditure	16,003	4,629	3,249	4,490	6,654	18,996	19,023	18,363	19,624	19,320	4,520	4,567	4,854	5,349	19,280	19,123
Wages and salaries	8,624	2,545	2,212	2,279	2,537	9,590	9,572	10,273	10,515	10,361	2,755	2,536	2,535	2,535	10,361	11,091
Goods and services	1,167	394	84	83	640	1,204	1,200	1,282	1,480	1,480	444	370	370	2,996	1,480	1,355
Interest payments	1,272	403	302	328	378	1,440	1,411	1,467	1,475	1,475	510	310	324	330	1,475	1,430
Transfers and subsidies	4,940	1,289	651	1,800	2,219	5,882	5,959	5,342	5,858	5,852	811	1,351	1,594	2,066	5,812	5,095
CGC (Food)	1,242	149	158	669	474	1,450	1,450	1,339	1,407	1,407	264	211	492	439	1,407	1,395
Energy subsidies	2,111	750	0	780	1,324	2,854	2,854	1,994	2,500	2,500	100	615	615	1,140	2,460	1,441
Other	1,587	390	493	352	421	1,578	1,655	2,008	1,945	1,945	447	525	486	486	1,945	2,259
Other expenditure (non-allocated)	0	0	0	0	880	880	880	0	296	152	0	0	30	122	152	152
Of which: repayment of arrears 2/	0	...	...	...	...	880	880	...	...	0	...	...	...	...	0	0
Capital expenditure	4,692	326	952	800	1,647	3,768	3,725	5,871	4,701	4,329	332	1,036	1,038	1,914	4,320	5,692
Net lending	-351	22	-52	71	-42	-5	-1	1,697	0	1,120	20	0	290	810	1,120	100
Of which: public banks' recapitalization	41	0	0	0	0	0	0	1,722	500	1,000	0	0	300	700	1,000	0
Central government deficit (-) (excluding grants)	-4,033	-734	617	-1,022	-3,567	-4,758	-4,707	-5,456	-5,852	-5,935	-252	-910	-1,525	-2,932	-5,609	-3,958
Central government deficit (-) (including grants)	-3,404	-701	618	-980	-3,533	-4,648	-4,596	-5,056	-5,638	-5,721	-219	-889	-1,482	-2,814	-5,395	-3,644
Float	-505	-474	1,325	407	-2,522	-1,303	-1,263	0	0	1,500	2,032	433	0	-1,000	1,465	0
Central government deficit (-) (excluding grants, cash basis)	-3,529	-260	-708	-1,429	-1,045	-3,455	-3,443	-5,456	-5,852	-7,435	-2,284	-1,343	-1,525	-1,932	-7,074	-3,958
Central government deficit (-) (including grants, cash basis)	-2,899	-228	-707	-1,387	-1,011	-3,345	-3,333	-4,719	-5,638	-7,221	-2,251	-1,322	-1,482	-1,814	-6,860	-3,644
Financing	2,899	228	707	1,387	1,011	3,345	3,333	4,719	5,638	7,221	2,251	1,322	1,482	1,814	6,860	3,644
Foreign	2,524	-651	-133	224	-45	-588	-605	3,195	4,288	6,002	1,091	1,105	942	2,816	5,955	1,906
Drawings	4,450	174	193	401	289	1,037	1,057	4,907	5,338	7,052	1,296	1,420	1,152	3,137	7,005	3,100
Amortization	1,926	825	327	177	334	1,625	1,662	1,712	1,050	1,050	205	315	209	321	1,050	1,194
Domestic	-18	817	838	1,157	647	3,409	3,459	1,124	850	819	1,160	156	480	-1,282	505	1,338
Drawings	1,582	365	444	471	564	1,840	1,843	1,214	2,500	1,541	861	227	227	227	1,541	2,441
Amortization	925	426	136	117	653	1,380	1,333	1,755	2,150	2,150	338	788	512	512	2,150	1,750
Government Deposits (+ = drawing / - = accumulation)	-675	879	530	803	737	2,949	2,949	-57	0	428	638	717	465	-1,696	114	647
Banks recapitalization	0	0	0	0	0	0	0	1,722	500	1,000	0	0	300	700	1,000	0
Privatization proceeds 3/	394	62	6	409	409	524	479	400	1,000	400	0	60	60	280	400	400
<i>Memorandum items:</i>																
Central Government Balance (incl. grants)	-3,404	-701	618	-980	-3,533	-4,648	-4,596	-5,056	-5,721	-219	-889	-1,482	-2,814	-5,395	-3,644	
Central government primary balance (including grants, cash basis)	-1,627	-595	883	-354	-2,612	-1,905	-1,922	-3,253	-5,746	229	-643	-1,085	-2,493	-5,385	-2,214	
Central government primary balance (excluding grants, cash basis)	-2,256	142	-406	-1,101	-667	-2,015	-2,032	-3,989	-2,461	-5,960	-1,773	-1,033	-1,201	-1,602	-5,599	-2,528
Cyclically adjusted fiscal balance	-3,774	...	...	...	...	-4,396	-4,385	-4,975	-5,485	...	...	...	...	...	-5,137	-3,619
Structural fiscal balance	-3,733	...	...	...	...	-3,516	-3,505	-3,254	-4,365	...	...	...	...	...	-4,017	-3,619
General government debt 4/	31,446	30,733	30,908	31,486	31,351	34,672	34,238	42,342	43,092	...	...	...	...	...	42,123	47,516
Nominal GDP	70,658	19,294	19,294	19,294	19,294	77,072	76,570	85,465	91,215	83,281	20,946	20,946	20,946	20,946	82,728	90,350

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/ It also includes sale of confiscated assets.

4/ Gross debt: excludes debt of public enterprises.

Table 4b. Tunisia: Central Government Financial Operations, 2012–15 1/

(In percent of GDP)

	2012	2013			2014				2015
		Prog. 05/24/13	Prog. 01/24/14	Est.	Prog. 05/24/13	Budget	Prog. 01/24/14	Proj.		Proj.
Total revenue and grants	24.0	24.3	23.5	23.7	24.4	22.5	22.9	23.4	23.5
Revenue	23.1	23.8	23.4	23.6	24.0	22.3	22.6	23.1	23.2
Tax revenue	21.0	21.8	21.1	21.3	22.0	21.0	21.3	21.8	21.7
Nontax revenue	2.0	1.9	2.1	2.2	1.9	1.3	1.3	1.3	1.5
Grants	0.9	0.5	0.1	0.1	0.5	0.3	0.3	0.3	0.3
Total expenditure and net lending	28.8	31.1	29.5	29.7	30.3	29.2	29.7	29.9	27.6
Total expenditure	29.3	30.8	29.5	29.7	28.4	28.6	28.4	28.5	27.5
Current expenditure	22.6	24.4	24.6	24.8	21.5	23.1	23.2	23.3	21.2
Wages and salaries	12.2	12.4	12.4	12.5	12.0	12.4	12.4	12.5	12.3
Goods and services	1.7	1.6	1.6	1.6	1.5	1.7	1.8	1.8	1.5
Interest payments	1.8	1.8	1.9	1.8	1.7	1.7	1.8	1.8	1.6
Transfers and subsidies	7.0	7.2	7.6	7.8	6.2	6.9	7.0	7.0	5.6
Other expenditure (non-allocated)	0.0	1.3	1.1	1.1	0.0	0.3	0.2	0.2	0.2
Of which: repayment of arrears 2/	0.0	0.9	1.1	1.1	...	0.0	0.0	0.0	0.0
Capital expenditure	6.6	6.4	4.9	4.9	6.9	5.5	5.2	5.2	6.3
Net lending	-0.5	0.3	0.0	0.0	2.0	0.6	1.3	1.4	0.1
Of which: public banks' recapitalization	0.1	0.6	0.0	0.0	2.0	0.6	1.2	1.2	0.0
Central government deficit (-) (excluding grants)	-5.7	-7.3	-6.2	-6.1	-6.4	-6.9	-7.1	-6.8	-4.4
Central government deficit (-), (including grants)	-4.8	-6.8	-6.0	-6.0	-5.9	-6.6	-6.9	-6.5	-4.0
Float	-0.7	0.0	-1.7	-1.6	0.0	0.0	1.8	1.8	0.0
Central government deficit (-), (excluding grants, cash basis)	-5.0	-7.3	-4.5	-4.5	-6.4	-6.9	-8.9	-8.6	-4.4
Central government deficit (-), (including grants, cash basis)	-4.1	-6.8	-4.3	-4.4	-5.5	-6.6	-8.7	-8.3	-4.0
Financing	4.1	6.8	4.3	4.4	5.5	6.6	8.7	8.3	4.0
Foreign	3.6	2.6	-0.8	-0.8	3.7	5.0	7.2	7.2	2.1
Domestic	0.0	2.3	4.4	4.5	1.3	1.0	1.0	0.6	1.5
Privatization proceeds 4/	0.6	1.9	0.7	0.6	0.5	1.2	0.5	0.5	0.4
<i>Memorandum items:</i>									
Central government primary balance (excluding grants, cash basis)	-3.2	-5.5	-2.6	-2.7	-4.7		-7.2	-6.8	-2.8
Structural fiscal balance	-5.3	-5.0	-4.6	-4.6	-3.8		-5.2	-4.9	-4.0
General government debt 5/	44.5	45.3	45.0	44.7	49.5		51.7	50.9	52.6

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/ Additional fiscal measures (mainly current expenditure cuts, but also revenue measures) that would be needed to keep the structural balance at sustainable levels.

4/ It also includes sale of confiscated assets.

5/ Gross debt: excludes debt of public enterprises.

Table 5. Tunisia: Monetary Survey (Financial System), 2010–15

(In millions of dinars)

	2010	2011	2012	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
				2013	1Q 14	2Q 14	3Q 14	2014	2015
(In millions of dinars)									
Net foreign assets (NFA)	9,078	5,749	7,054	3,887	2,278	1,355	1,992	4,655	6,418
Foreign assets	16,023	12,893	15,410	15,028	13,809	14,532	15,931	18,613	21,844
Central bank	13,705	11,315	13,455	12,701	11,568	12,118	13,448	16,084	19,125
Foreign liabilities	-6,946	-7,143	-8,357	-11,141	-11,531	-13,177	-13,938	-13,958	-15,426
Central bank	-623	-782	-1,134	-3,004	-3,696	-4,738	-5,260	-5,115	-5,921
Net domestic assets (NDA)	34,190	41,454	44,114	50,677	51,316	55,120	58,389	55,150	59,855
Domestic credit	46,370	53,577	58,022	65,629	66,372	70,298	74,168	71,886	77,940
Credit to the government (net)	3,227	4,659	4,791	8,792	9,691	10,815	11,575	10,203	11,545
Central bank net credit	-3,250	-3,355	-3,461	-175	463	1,180	1,645	-61	587
Commercial banks	2,937	3,568	3,686	4,109	4,589	4,995	5,290	4,866	5,142
Other	4,189	5,086	5,265	5,568	5,350	5,350	5,350	6,109	6,527
Credit to the economy	43,144	48,918	53,231	56,836	56,681	59,484	62,593	61,682	66,395
Other items (net)	-12,181	-12,123	-13,908	-14,951	-15,056	-15,178	-15,779	-16,736	-18,085
Money plus quasi-money (M2)	40,854	44,652	48,327	51,682	50,763	53,492	57,192	56,646	62,772
Money (M1)	15,862	19,007	20,007	20,874	20,503	21,606	23,100	22,879	25,354
Currency	5,518	6,814	6,559	7,236	7,107	7,489	8,007	7,931	8,789
Demand deposits	10,344	12,192	13,448	13,639	13,396	14,116	15,093	14,949	16,565
Quasi-money	24,992	25,646	28,320	30,808	30,260	31,887	34,092	33,767	37,418
Long-term deposits (M3-M2)	2,414	2,551	2,841	2,882	2,831	2,983	3,189	3,159	3,501
Broad money (M3)	43,267	47,203	51,168	54,564	53,594	56,475	60,381	59,805	66,273
(Annual rate of change in percent)									
Net foreign assets	-5.7	-36.7	22.7	-44.9	-62.4	-71.5	-55.8	19.8	37.9
Net domestic assets	18.1	21.2	6.4	14.9	10.8	16.1	18.3	8.8	8.5
Domestic credit	16.8	15.5	8.3	13.1	10.2	14.0	15.8	9.5	8.4
Credit to government (net)	-11.4	44.4	2.8	83.5	60.6	60.6	44.6	16.0	13.1
Credit to the economy	19.6	13.4	8.8	6.8	4.6	8.3	11.7	8.5	7.6
Money and quasi-money (M2)	11.9	9.3	8.2	6.9	2.4	8.4	12.1	9.6	10.8
Broad money (M3)	12.1	9.1	8.4	6.6	2.3	8.1	12.1	9.6	10.8
(Annual growth rates, in percent of broad money)									
Net foreign assets	-1.4	-7.7	2.8	-6.2	-7.2	-6.5	-4.7	1.4	2.9
Net domestic assets	13.6	16.8	5.6	12.8	9.5	14.6	16.8	8.2	7.9
Domestic credit	17.3	16.7	9.4	14.9	11.7	16.6	18.8	11.5	10.1
Credit to the government (net)	-1.1	3.3	0.3	7.8	7.0	7.8	6.6	2.6	2.2
Credit to the economy	18.4	13.3	9.1	7.0	4.7	8.7	12.2	8.9	7.9
Other items (net)	-3.7	0.1	-3.8	-2.0	-2.2	-1.9	-2.0	-3.3	-2.3
<i>Memorandum items:</i>									
GDP (in millions of dinars)	63,059	64,690	70,658	76,570	...	...	...	82,728	90,350
Nominal GDP growth (in percent)	7.1	2.6	9.2	8.4	...	...	...	8.0	9.2
Reserve money (in millions of dinars)	8,415	9,406	10,989	11,078	10,881	11,466	12,259	12,142	13,455
Velocity (GDP/M2)	1.54	1.45	1.46	1.48	...	...	...	1.46	1.44
Multiplier (M2/M0)	4.86	4.75	4.40	4.67	...	...	...	4.67	4.67

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

Table 6. Tunisia: Central Bank Balance Sheet, 2010–15

(In millions of dinars)

	2010	2011	2012	1Q 13	2Q 13	3Q 13	2013	1Q 14	2Q 14	3Q 14	2014	2015
Net Foreign Assets	13,082	10,533	12,321	10,969	10,182	10,211	9,696	7,872	7,380	8,188	10,969	13,204
Assets	13,705	11,315	13,455	12,035	12,176	12,155	12,701	11,568	12,118	13,448	16,084	19,125
Liabilities	623	782	1,134	1,066	1,994	1,945	3,004	3,696	4,738	5,260	5,115	5,921
Net Domestic Assets	-4,707	-1,189	-1,332	-1,757	-267	67	1,382	3,009	4,086	4,071	1,173	252
Domestic credit (net)	-2,673	222	248	-92	1,572	1,809	3,493	5,159	6,386	6,387	3,785	3,046
Net credit to government 1/	-3,250	-3,355	-3,461	-2,207	-1,639	-735	-175	463	1,180	1,645	-61	587
Credit to Banks	578	3,577	3,709	2,115	3,212	2,545	3,668	4,696	5,205	4,742	3,846	2,459
Other items net	-2,035	-1,412	-1,579	-1,665	-1,839	-1,742	-2,111	-2,150	-2,299	-2,316	-2,612	-2,794
Reserve Money 2/	8,415	9,406	10,989	9,212	9,915	10,278	11,078	10,881	11,466	12,259	12,142	13,455

Sources: Central Bank of Tunisia; and IMF staff estimates.
1/ Excludes subscription to IMF/AMF.
2/ Excludes deposits of other financial institutions, individuals, and nonfinancial enterprises.

Table 7. Tunisia: Financial Soundness Indicators of the Banking Sector, 2008–13						
(In percent, unless otherwise indicated)						
	2008	2009	2010	2011	2012	Dec-13 Prel.
Regulatory capital to risk-weighted assets	11.7	12.2	11.6	11.9	11.8	9.2
Tier 1 capital to risk weighted assets	10.6	10.7	10.2	10.0	9.4	7.6
Capital to assets	8.1	8.5	8.4	8.5	7.8	6.1
Asset quality						
Sectoral distribution of loans to total loans						
Industry	31.3	30.0	30.5	28.6	27.9	27.7
Agriculture	3.6	3.4	2.9	2.9	2.8	2.8
Commerce	17.3	17.4	15.0	16.0	15.4	15.4
Construction	4.5	4.9	5.9	5.6	5.4	4.2
Tourism	9.1	8.2	7.3	7.3	6.9	6.5
Households	20.1	21.6	22.1	23.4	25.4	26.2
Other	14.3	14.4	16.3	16.3	16.2	17.3
FX-loans to total loans	3.9	4.5	5.3	5.1	4.8	4.8
Credit to the private sector to total loans	71.6	70.4	70.6	67.4	67.7	26.2
Nonperforming Loans (NPLs) to total loans	15.5	13.2	13.0	13.3	14.9	14.9
Specific provisions to NPLs	-	-	-	48.5	45.9	60.3
NPLs, net of provisions, to Tier 1 capital	71.1	57.9	60.3	66.3	86.3	79.4
Specific provisions to total loans	8.8	7.7	7.6	7.6	8.0	9.9
General provisions to total loans	-	-	-	0.4	0.5	0.4
Profitability						
Return on assets (ROA)	1.0	1.0	0.9	0.6	0.6	0;7
Return on equity (ROE)	11.2	11.7	10.2	6.6	8.0	8.9
Interest rate average spread (between loans and deposits)	3.60	3.49	3.53	3.0	3.0	3.1
Interest return on credit	7.01	6.35	6.24	5.7	5.4	6.0
Cost of risk as a percent of credit	1.4	1.2	1.7	1.2	1.1	1.2
Net interest margin to net banking product (PNB)	58.6	58.8	58.6	57.2	58.1	57.6
Operating expenses to PNB	45.4	47.2	46.5	50.7	50.3	47.1
Operating expenses to total assets	1.6	1.6	1.6	1.7	1.7	1.6
Personnel expenses to non-interest expenses	60.4	61.4	59.1	62.3	61.3	58.1
Trading and other non-interest income to PNB	21.7	22.1	21.8	22.6	20.9	21.9
Liquidity						
Liquid assets to total assets	31.6	32.1	29.8	26.5	28.2	28.4
Liquid assets to short-term liabilities	124.0	119.1	104.1	89.4	89.2	92.6
Deposits to loans	98.9	100.9	94.6	87.4	89.7	89.6
Deposits of state-owned enterprises to total deposits	13.8	14.8	13.8	12.6	13.2	13.0
Sensitivity to market risk						
FX net open position to Tier 1 Capital	1.40	1.53	1.35	1.94	2.3	3.4
Source: Central Bank of Tunisia.						

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/ 2/	Millions of US\$ 2/
First Review	June 7, 2013	Board approval of the SBA	98.800	34.485	150.155
Second Review	September 15, 2013	Observance of end-June 2013 performance criteria, completion of the first review	98.600	34.415	152.037
Third Review	December 15, 2013	Observance of end-September 2013 performance criteria, completion of the second review	230.520	80.461	355.453
Fourth Review	March 15, 2014	Observance of end-December 2013 performance criteria, completion of the third review	145.080	50.639	223.708
Fifth Review	June 15, 2014	Observance of end-March 2014 performance criteria, completion of the fourth review	143.250	50.000	220.886
Sixth Review	September 15, 2014	Observance of end-June 2014 performance criteria, completion of the fifth review	143.250	50.000	220.886
Seventh Review	December 15, 2014	Observance of end-September 2014 performance criteria, completion of the sixth review	143.250	50.000	220.886
Eighth Review	March 15, 2015	Observance of end-December 2014 performance criteria, completion of the seventh review	71.625	25.000	111.517
Total	May 15, 2015	Observance of end-March 2015 performance criteria, completion of the eighth review	71.625	25.000	111.517
			1146.000	400.000	1,767.045

Source: IMF staff projections.
1/ Quota is SDR 286.5 million.
2/ Indicative amount based on the average annual exchange rate.

Table 9. Tunisia: Illustrative Medium-Term Growth Scenario, 2010–19

	2010	Prel.		Est.	Proj.					
		2011	2012	2013	2014	2015	2016	2017	2018	2019
(Change in percent)										
Real GDP growth	2.6	-1.9	3.7	2.6	2.8	4.2	4.5	4.5	4.5	4.5
Total consumption	4.2	4.0	5.1	4.6	4.0	4.0	3.7	3.5	3.5	4.5
Private consumption (residual)	4.2	4.0	4.7	4.1	3.8	5.0	4.4	3.9	3.7	4.9
Public consumption	4.5	4.1	6.8	6.2	4.7	0.2	1.3	2.1	2.6	2.6
Investment	7.5	-16.5	4.1	-11.1	-3.4	5.9	4.8	8.0	10.3	5.5
Gross fixed capital formation	4.1	-12.6	7.1	-1.1	1.6	5.0	5.0	5.0	5.0	5.0
Change in stocks	-216.0	100.3	-29.4	-91.5	-65.0	40.0	0.0	100.0	100.0	10.0
Exports of goods and nfs 1/	5.6	-0.5	1.2	3.2	2.1	5.4	4.8	5.1	5.4	6.3
Imports of goods and nfs 1/	-2.9	3.5	8.3	4.9	1.4	5.4	3.4	4.8	6.1	6.1
Inflation (annual average)	4.4	3.5	5.6	6.1	5.5	4.9	4.2	4.0	4.0	4.0
(In percent of GDP)										
Gross national savings	20.9	16.2	16.1	13.9	14.2	15.8	17.2	19.9	22.5	23.6
Consolidated government 2/	6.2	4.1	2.0	-0.9	-1.1	2.5	3.6	4.8	5.7	6.7
Rest of the economy	14.8	12.0	14.1	14.9	15.3	13.3	13.7	15.1	16.8	16.9
Gross investment	25.7	23.6	24.3	22.3	21.5	22.1	22.6	24.8	26.4	27.2
Consolidated government	6.6	7.2	6.7	4.9	5.3	6.3	7.2	7.5	7.7	8.1
Rest of the Economy	19.1	16.4	17.6	17.4	16.2	15.8	15.4	17.2	18.7	19.1
Total consumption	80.2	84.7	86.0	87.7	88.9	88.8	88.7	87.9	87.2	87.2
Private consumption	64.1	67.2	68.1	69.3	70.2	70.8	71.1	70.8	70.4	70.7
Public consumption	16.8	18.1	18.6	19.1	19.4	18.7	18.2	17.8	17.5	17.2
Savings-investment gap	-4.8	-7.4	-8.2	-8.4	-7.2	-6.3	-5.4	-4.9	-3.9	-3.7
Consolidated government	-0.4	-3.0	-4.7	-5.8	-6.4	-3.9	-3.7	-2.8	-2.1	-1.5
Rest of the economy	-4.3	-4.4	-3.5	-2.6	-0.9	-2.4	-1.7	-2.1	-1.9	-2.2
<i>Memorandum items</i>										
Nominal GDP at current prices (TD millions)	63,059	64,690	70,658	76,570	82,728	90,350	97,814	106,304	115,310	125,318
General debt in percent of GDP	40.7	44.5	44.5	44.7	50.9	52.6	53.6	53.4	52.1	51.3
External debt in percent of GDP	48.5	48.0	53.8	53.9	57.3	59.8	60.8	60.0	58.9	58.0
Central government balance in percent of GDP /3	-0.6	-3.5	-5.7	-6.1	-6.8	-4.4	-4.1	-3.2	-2.6	-2.0
Current account balance in percent of GDP	-4.8	-7.4	-8.2	-8.4	-7.2	-6.3	-5.4	-4.9	-3.9	-3.7
Sources: Tunisian authorities; and IMF staff estimates.										
1/ Goods and nonfactor services.										
2/ Includes social security, excludes privatization receipts.										
3/ Excluding grants and privatization.										

Table 10. Tunisia: Indicators of Fund Credit, 2012–19

	2012	2013	2014	2015	2016	2017	2018	2019
Existing and prospective Fund credit								
Disbursement	0	99	904	143	0	0	0	0
Stock	0	99	1,003	1,146	1,121	858	337	27
Obligations	0	3	8	17	43	279	529	313
Repurchase	0	0	0	0	25	263	521	310
Charges	0.02	2.72	8.24	16.99	18.79	16.39	8.05	2.43
Stock of existing and prospective Fund credit								
In percent of quota	0.0	34.5	350.0	400.0	391.4	299.6	117.6	9.4
In percent of GDP	0.0	0.3	3.1	3.5	3.4	2.5	1.0	0.1
In percent of exports of goods and services	0.0	0.7	6.9	7.5	7.0	5.1	1.9	0.1
In percent of gross reserves	0.0	2.0	17.1	17.7	16.0	11.4	4.2	0.3
Obligations to the Fund from existing and prospective Fund arrangements								
In percent of quota	0.0	0.9	2.9	5.9	15.2	97.5	184.8	109.1
In percent of GDP	0.0	0.0	0.0	0.1	0.1	0.8	1.5	0.9
In percent of exports of goods and services	0.0	0.0	0.1	0.1	0.3	1.7	3.0	1.7
In percent of gross reserves	0.0	0.1	0.1	0.3	0.6	3.7	6.5	3.7
Source: IMF staff estimates.								

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 40.7 percent of GDP in 2010, the debt-to-GDP ratio increased in 2011 to 44.5 percent and has remained practically unchanged until 2013. Notwithstanding this, the debt level continues to be comfortable and lower than in similar countries in the region, despite high deficit levels since the revolution.

Under the baseline scenario, public debt is expected to increase to 54 percent before declining over the medium term. Increased banking recapitalization costs, a wider deficit, and weaker-than-originally-expected growth dynamics will contribute to increasing the debt-to-GDP ratio to around 54 percent of GDP by 2016. The decline of the debt-to-GDP ratio has been somewhat delayed, and it is expected to start declining in 2017, reaching about 51 percent by end-2019, 10 percentage of GDP higher than the 2010 level. This debt dynamic reflects the fiscal consolidation envisaged by the authorities (an overall deficit declining to 2.5 percent of GDP by 2018) and real growth rates that start to pick up in 2015.

Public debt dynamics remain vulnerable to adverse shocks and could deteriorate significantly relative to the baseline. 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 around 61 percent of GDP by 2019. The public debt dynamic would initially worsen under all bound tests and then stabilize between 51 percent and 65 percent in 2019. As a result of a one-off 10 percent of GDP shock to contingent liabilities it would reach about 64 percent of GDP in 2016 and slightly decline to about 60 percent of GDP by 2019.¹ Under a permanent negative shock to real growth, public debt would remain on an increasing path, reaching about 64 percent of GDP by end-2019. Finally, as around 64 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 69 percent; before declining to 65 percent by 2019. On the other hand, public debt dynamics would be relatively resilient to an interest rate shock, with debt staying at around 53 percent of GDP over the medium term.

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

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 over 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.²

Under the baseline projections, external debt is projected to increase to 60.8 percent of GDP in 2016 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. Having remained steady in 2013 following a significant shortfall in external financing, the external debt-to-GDP ratio is expected to rise in 2014 to 57.3 percent, and will reach a maximum of 60.8 percent by 2016 before slightly declining to around 58 percent by end-2019.

The external debt ratio is resilient to most types of adverse external shocks except large exchange rate depreciation. The relatively low level of Tunisia's debt as well as its profile (low average interest rate and relatively long maturity) makes it robust to most shocks, with the exception of a large real exchange rate depreciation. The external debt ratio remains below 65 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 raise the debt ratio to 60–65 percent of GDP, while an increase in the average interest rate would have almost no impact.³ However a sharp real depreciation (one-time 30 percent) of the exchange rate relative to the baseline would raise the debt ratio to more than 84 percent of GDP.

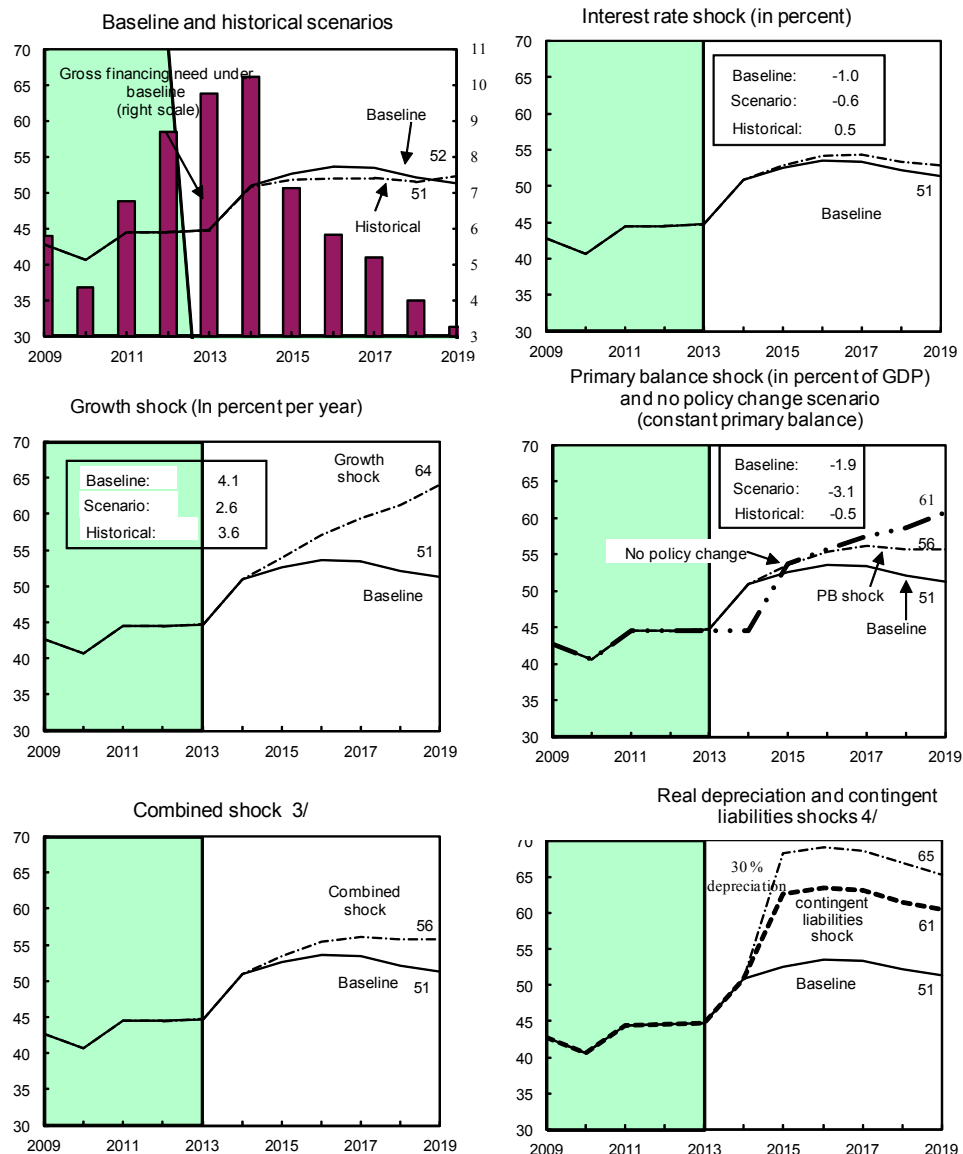
² Prior to 2012's international bond issuances with U.S. and Japanese guarantees, the last international bond issuance was in 2007. The first maturing international bond is due in 2017.

³ 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.

Table 2. External Debt Sustainability Framework, 2009-2019
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/	
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019		
						I. Baseline Projections							
1 External debt	49.3	48.5	48.0	53.8	53.9	57.3	59.8	60.8	59.9	58.8	58.0	-9.0	
2 Change in external debt	3.4	-0.8	-0.5	5.8	0.1	3.4	2.5	1.0	-0.9	-1.1	-0.8		
3 Identified external debt-creating flows (4+8+9)	0.5	3.2	4.8	3.3	3.1	1.7	0.1	-2.2	-4.6	-6.5	-7.2		
4 Current account deficit, excluding interest payments	1.3	3.3	6.0	6.8	7.2	6.1	5.2	4.5	3.6	2.0	1.8		
5 Deficit in balance of goods and services	2.7	4.8	7.1	9.2	8.9	8.3	7.5	5.9	4.8	5.1	5.3		
6 Exports	45.7	50.5	49.4	49.1	46.8	45.8	46.8	48.2	49.5	50.3	51.2		
7 Imports	48.4	55.3	56.4	58.3	55.7	54.2	54.3	54.1	54.3	55.4	56.5		
8 Net non-debt creating capital inflows (negative)	-3.7	-2.9	-0.6	-5.6	-3.1	-3.3	-4.7	-5.9	-6.8	-7.2	-7.5		
9 Automatic debt dynamics 1/	2.9	2.8	-0.6	2.1	-0.9	-1.1	-0.4	-0.8	-1.4	-1.4	-1.6		
10 Contribution from nominal interest rate	1.6	1.5	1.4	1.4	1.2	1.2	1.1	0.9	0.8	0.7	0.6		
11 Contribution from real GDP growth	-1.5	0.5	0.9	-1.8	-1.3	-1.4	-2.3	-2.6	-2.6	-2.6	-2.5		
12 Contribution from price and exchange rate changes 2/	2.8	0.8	-2.9	2.6	-0.8	-0.8	0.9	0.8	0.4	0.5	0.4		
13 Residual, incl. change in gross foreign assets (2-3)	3.0	-4.0	-5.4	2.5	-3.0	1.8	2.4	3.2	3.8	5.4	6.4		
Gross external financing need (in billions of US dollars) 3/	7.2	8.6	10.4	10.9	11.7	11.4	10.1	10.0	10.6	10.2	10.1		
in percent of GDP	16.6	19.6	22.7	24.0	24.8	23.2	20.0	19.2	19.6	18.2	17.3		
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation						Projected Average
Real GDP growth (in percent)	3.1	-1.1	-1.9	3.7	2.6	3.3	2.8	2.8	4.2	4.5	4.5	4.5	4.4
GDP deflator in US dollars (change in percent)	-5.7	-1.5	6.3	-5.1	1.6	2.0	5.4	1.6	-1.5	-1.4	-0.7	-0.9	-1.0
Growth of exports (US dollar terms, in percent)	-21.0	11.6	2.0	-2.0	-0.7	8.3	14.4	2.1	5.0	5.9	6.6	5.3	5.7
Growth of imports (US dollar terms, in percent)	-20.6	15.5	6.5	1.8	-0.5	9.3	14.1	1.4	2.9	2.6	4.2	5.7	5.9
Current account balance, excluding interest payments	-1.3	-3.3	-6.0	-6.8	-7.2	-2.6	3.1	-6.1	-5.2	-4.5	-3.6	-2.0	-1.8
Net non-debt creating capital inflows	3.7	2.9	0.6	5.6	3.1	4.1	2.6	3.3	4.7	5.9	6.8	7.2	7.5
						II. Stress Tests for External Debt Ratio							
A. Alternative Scenarios													
A1. Key variables are at their historical averages in 2014-2019 4/						57.3	57.1	57.6	58.6	61.0	64.2	-5.3	
B. Bound Tests													
B1. Nominal interest rate is at baseline plus one-half standard deviation						57.3	59.9	61.1	60.3	59.4	58.7	-8.9	
B2. Real GDP growth is at baseline minus one-half standard deviations						57.3	60.9	63.0	63.1	63.1	63.3	-8.7	
B3. Non-interest current account is at baseline minus one-half standard deviations						57.3	61.3	63.8	64.4	64.7	65.3	-9.2	
B4. Combination of B1-B3 using 1/4 standard deviation shocks						57.3	61.0	63.2	63.5	63.5	63.8	-8.9	
B5. One time 30 percent real depreciation in 2015						57.3	86.2	87.6	86.4	84.8	83.6	-13.0	
Sources: IMF Country desk data; and staff estimates.													
1/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.													
2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).													
3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.													
4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.													
5/ The implied change in other key variables under this scenario is discussed in the text.													
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.													

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



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

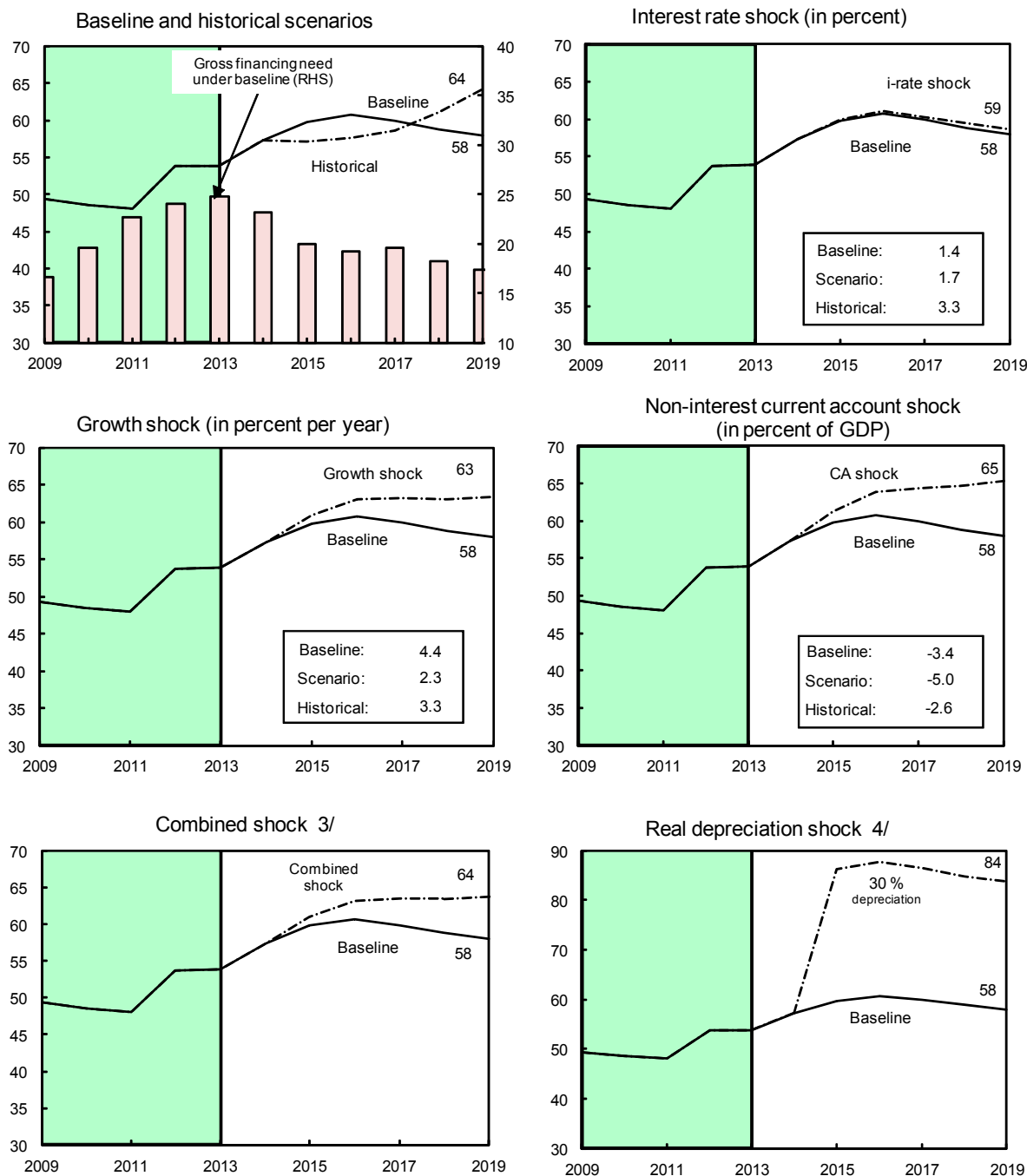
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks and a 1/2 of standard deviation growth shock. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average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

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



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

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks (except for growth which is a 3/4th standard deviation). Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

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

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

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

Appendix I. Letter of Intent

Tunis, April 10, 2014

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

Madame Managing Director,

1. The Tunisian authorities reiterate their firm commitment to the economic program supported by the IMF. Recent political developments have given the Tunisian people renewed confidence and have opened the way for the holding of free and democratic elections. The adoption of the Constitution and the appointment of the members of the Independent Electoral Commission (ISIE) are expected to be followed by the adoption of the electoral law, which will establish a clear and precise timetable for legislative and presidential elections. We hope that this important step will help bolster both national and international confidence and will also lessen the wait-and-see attitude of investors. Nevertheless, the economic situation remains fragile, with the country growing at a rate that is too low to meet the population's very high aspirations. We remain convinced, however, that implementing prudent macroeconomic policies and structural reforms will allow us to maintain macroeconomic stability and promote sustained and more inclusive growth that will support Tunisia's development.

2. Performance under the IMF-supported program has been positive overall, especially, given the difficult national and international environment that Tunisia had to contend with as the new government was taking office. Moreover, performance at end-December 2013 was better than was expected at the time of the previous review, and we expect all performance criteria at end-March 2014 to have been met. However, owing to the political crisis and the ensuing wait-and-see attitude of investors that followed the appointment of the new administration, the pace of reform was slower than expected. We are committed to make up for the delay in the next weeks.

- *Performance criteria and quantitative targets.* As initially anticipated, the quantitative criteria for Net International Reserves (NIR) and Net Domestic Assets (NDA) at end-December 2013 were not met; however, the deviation from the target is considerably lower than previously estimated during the last review. The performance criterion on the primary balance of the central government (on a cash basis) at end-December was met as expected, although this performance is mainly due to the deferral to early 2014 of payments authorized in 2013. We have throughout adhered to the zero ceiling on the accumulation of external arrears and the non-accumulation of domestic arrears. The quantitative indicative target for social

expenditures (which was missed in December 2013) and the ceiling on current expenditure at end-March 2014 are in line with projections.

- *Structural reforms.* Four of the eight structural benchmarks to be completed by March 2014 have been fully met (Table 2b). In particular, the electronic platform and the market makers agreement, which is now effective, have been implemented, a Treasury Single Account has been established, the impact study on the bank lending rate cap has been submitted to the CBT Board of Directors, and the preliminary audit report on state-owned enterprises' operations in the energy sector has been finalized. In turn, the benchmark concerning haircuts on all loans used as collateral has been partially met since the circular was issued but will only enter into force with effect from June 2014 after the lender of last resort facility is established. With regard to the benchmarks that have not been met: (i) the implementation decrees for the investment code will be finalized in September 2014 once the code has been approved by the National Constituent Assembly (NCA), which has a very full agenda; (ii) the targeted household support program, initially postponed to March 2014, is now scheduled for June 2014 and will be implemented ahead of the planned increase in fuel prices; (iii) a first draft of the tax administration modernization plan is ready, but the complete plan is only expected to be finalized in June 2014 following IMF technical assistance; and (iv) the strategic orientation for all banks with public participation (or at least for the STB and BH) will be approved by the Council of Ministers in mid-April 2014 (prior action). The strategy will then be presented to the public by end-April 2014.

3. As a result of the appropriate macroeconomic policies already implemented to achieve the key objectives of the program, and the ongoing implementation of the structural reform program (Tables 1 and 2a/2b), the government is requesting completion of the third review of the program supported by the stand-by arrangement as well as the disbursement of SDR 145.08 million. The government also requests a waiver of applicability for the quantitative performance criteria on NIR, NDA, and the primary balance at end-March 2014, which appear to have been met, but for which final data are not yet available. Further, the government would like to modify the performance criteria for NIR, NDA, and the primary balance at end-June 2014, and propose new criteria for September 2014, as well as new indicative targets, as described in the MEFP (Table 1) and the attached Technical Memorandum of Understanding.

4. This Letter of Intent is based on the previous Letter of Intent and Memorandum of Economic and Financial Policies (MEFP) approved on January 29, 2014. The attached MEFP outlines the key components of the government's program and the policies planned by the Central Bank of Tunisia, which we intend to implement during 2014. We remain determined to carry out our program with firm resolve, though mindful of the difficulties in the domestic, regional, and international environment.

5. We are confident that the policies described in the attached MEFP are appropriate to achieve the objectives of our economic program, which is designed to achieve short-term macroeconomic stabilization while laying the foundation for supporting growth and protecting vulnerable groups. We will remain vigilant and stand ready to take any additional measures that may

be necessary to attain these 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.

6. We authorize the IMF to publish this Letter of Intent and its attachments (MEFP, Tables 1, 2a, 2b, and 3) as well as the related staff report.

Sincerely yours,

/s/
Chedly Ayari
Governor of the Central Bank of Tunisia

/s/
Hakim Ben Hammouda
Minister of Economy and Finance

Attachment I. Memorandum of Economic and Financial Policies

I. RECENT DEVELOPMENTS AND MACROECONOMIC OUTLOOK

1. The recovery of the Tunisian economy remains tentative given the difficult national context and a challenging international environment. According to the latest data, economic growth in 2013—driven mainly by public and private services—amounted to around 2.6 percent year-on-year, with a downturn in the last quarter of 2013 (-0.3 percent on a quarterly basis). For 2014, despite the brighter outlook as a result of the return of confidence following the adoption of the Constitution and the formation of the new government, growth is expected to remain close to 2.8 percent, reflecting a relatively weak performance in the first two months of 2014 and the persistence of investors' wait-and-see attitude pending the outcome of the last phase of the political transition. There are also significant short-term risks related, in particular, to the possibility of a protracted political transition period, heightened social tensions, and a worsening of the economic outlook for Europe. Inflation (year-on-year) declined to 5.5 percent in February 2014, thanks to a slower rise in food prices and despite the electricity tariff increases of January 2014. Over the year, inflation is expected to remain contained at 5.6 percent, thanks to the slowing of food price rises, actions taken to control and monitor distribution channels, and a prudent monetary policy.

2. The current account deficit worsened during 2013. It reached 8.4 percent of GDP in 2013 (up from the initial program projected level of 7.5 percent of GDP), driven by weak exports of phosphates and energy, tourism revenues, and increase dividend transfers. On the other hand, the level of gross reserves in 2013, which was revised downwards during the previous review because of lower-than-expected external financial support, reached 7.7 billion dollars (3.5 months of imports of goods and services) following an increase in nonresidents' deposits, a valuation effect arising from exchange rate fluctuations, and the revaluation of the Central Bank of Tunisia's (CBT)'s gold holdings at market price. The higher confidence level seen in the last two months, ushered in by the adoption of the Constitution, also led to an initial rise in stock market activity and a lowering of the country risk premium for Tunisia. It also contributed to an appreciation of the exchange rate against the US dollar and the Euro, which was supported by strict enforcement of the exchange regulations and the intervention policy of the CBT.

II. PERFORMANCE UNDER THE PROGRAM AND STRATEGY

3. We are fully committed to the rigorous implementation of the program to maintain short-term macroeconomic stability and lay the foundation for more sustained and inclusive growth. The objectives of our program remain unchanged and we focused during this review on the following areas:

- **Preserving macroeconomic stability.** Controlling current expenditures, mobilizing revenues, and implementing a prudent monetary policy, coupled with limited CBT interventions in the foreign exchange markets, are needed to maintain macroeconomic stability.

- **Laying the foundations for inclusive growth.** Developing a strategic vision on the government's role in banks and reducing banking sector fragilities, improving the structure of the budget—underpinned by a better execution of public investment and growth-supporting fiscal reforms—as well as an ambitious structural reform agenda are needed to support private sector development, which is the main driver of growth.
- **Protecting the most vulnerable parts of the population** by strengthening social safety nets and systematically assessing the social impact of reforms.

A. Short-term Objectives: Restore Fiscal and External Buffers

Fiscal policy

4. In 2013, we achieved a primary deficit, on a cash basis, of 2.7 percent of GDP, which enabled us to meet the objective we set with a comfortable margin. The objective was met by implementing an active cash management strategy aimed at preserving part of the government's deposits in response to delays in the disbursement of donor financing (including the IMF). Further, the settlement of payment orders issued in FY2013 (up to January 31, 2014) was deferred to 2014 (around 3.3 percent of GDP) for payment within 90 days (except for public investments that remain linked to the execution of projects). In addition, savings on the wage bill and on social spending along with significant under-execution of investment spending (by around 1.5 percent of GDP compared to the budgeted amounts)—caused by absorptive capacity constraints at the regional level and unavoidable procurement delays—also contributed to this performance. Unfortunately, these absorptive capacity constraints were also responsible for the underperformance of social spending at end-December 2013, but the level set for end-March 2014 is expected to have been met.

5. The 2014 budget law—adopted in December 2013—is aimed at starting fiscal consolidation while preserving priority investment and development spending. The underlying fiscal position—as measured by the structural budget deficit—excluding the effects associated with the economic cycle and one-off transactions, such as bank recapitalization requirements or the repayment of arrears—was projected at 5.2 percent of GDP in 2014. At the time of the previous review, a deterioration of 0.6 percent of GDP compared to 2013 was observed, taking into account planned measures, including savings on unallocated expenditure (0.5 percent of GDP) and wages (0.2 percent of GDP, to offset the revenue shortfall from the suspension of the tax on vehicles included in the government's budget for 2014). The composition of the budget improved and fiscal pressures were further reduced by key elements included in the government budget:

- **Energy subsidy reform.** Our energy subsidy reform strategy is built around a multi-pronged approach and includes short- and medium-term measures:
 - Starting from January 1, 2014, we reduced energy subsidies extended to cement companies (gray cement) by raising the electricity rate and the price of natural gas for cement plants by 35 percent and 47 percent, respectively. On June 1, 2014, we plan to

introduce a second electricity and gas price adjustment aimed at eliminating all subsidies to producers of grey cement (a gain of 0.2 percent of GDP). The program for the gradual adjustment of electricity and gas rates for other industrial consumers—to be implemented over a period of three to six years—is also being finalized, with an initial 10 percent rate increase already having been introduced in January and a second 10 percent increase planned for June 2014. To protect the most disadvantaged segments of the population, a social tariff was introduced for customers that consume less than 100 kwh per month. We are also committed to raising fuel prices by 6 percent by July 1, 2014, which is expected to result in savings of 100 million dinars on energy subsidies. These measures will be implemented even in the face of declining oil prices on the international markets, a further appreciation of the exchange rate, or a renegotiation of commercial contracts on more favorable terms.

- The new fuel price adjustment formula is now in force but so far international prices have not yet reached the trigger of ten dinars per barrel in a quarter. Although the formula already provides assurances that the budgeted envelope will not be affected by any significant increases in international oil prices, a price smoothing mechanism is being considered to make it more resilient to large international price fluctuations.
- Price adjustment has been accompanied by the implementation of social programs, already included in the 2014 budget, and the creation of the Energy Transition Fund to support the development of renewable energy. Additional programs (see Section C)—as well as a new communication campaign to explain the subsidy reform—will be carried out prior to any new price increases.
- **Controlling the wage bill.** We are committed to containing the wage bill in 2014 as was envisaged in the context of the program. We are determined to continue to engage in discussions with our social partners to explain the need to control the wage bill under the present circumstances. New recruitment will be frozen—except in the security forces, and education, and health sectors—to reduce the size of the wage bill. With a view to improving the preparation of the 2015 budget, we are in the process of finalizing the report assessing all new hiring since 2011 and we have set up a civil service reform task force. In addition, with the technical assistance from the World Bank, an evaluation of the civil service hiring system and salary structure is to be conducted, the findings of which could form the basis for a comprehensive civil service reform. The evaluation of the civil service salary structure will be finalized in September 2014.

6. To address our financing constraints and reduce pressures on the balance of payments, we intend to prepare a supplementary budget law and make adjustments aimed at reducing the structural deficit to 4.9 percent of GDP. In that regard, we have identified measures aimed at generating an additional 300 million dinars through revenue measures and savings on expenditure (see table 3). We also remain committed to taking additional measures to correct any deviation from the budgetary target, including through limiting current expenditures (namely

subsidies and goods and services) that have in the past been a source of budget overruns (it is, however, important to note that we are on track to meet the end-March benchmark on current primary expenditure). Capital and social (which excludes subsidies) spending will be protected, and will not be constrained by our fiscal consolidation strategy.

Monetary and exchange rate policies

7. The growth in monetary aggregates remains contained and inflation is under control.

The money supply (M2) rose by 6.9 percent year-on-year in 2013; however, the criterion on net domestic assets at end-December 2013 was not met due to a rapid increase in net credit to the government. The refinancing of banks by the Central Bank reached a peak on January 15, 2014 (5.5 billion dinars)—due to the need to compensate the shortfall arising from seasonal withdrawals of oil company deposits—and has since dropped back to 4.2 billion dinars at end-February 2014 and we estimate that the NDA criterion for end-March 2014 will be met.

8. Monetary policy will continue to focus on containing inflation. The increase in the policy rate by 50 basis points to 4.5 percent in December 2013—coupled with the introduction of a symmetrical corridor of 25 basis points around the policy rate—made it possible to normalize the market rate and narrow the gap with the policy rate. Although the real interest rate remains negative, we do not consider it necessary to increase the policy rate immediately given a stable core inflation (at around 4.5 percent), a negative output gap, credit to the private sector contained at 8.1 percent (year-on-year at end-January 2014), and the recent appreciation of the exchange rate. However, we stand ready to increase the policy rate further to contain any additional inflationary pressures caused by an accommodating budgetary policy and/or a rapid depreciation in the dinar exchange rate.

9. The monetary policy transmission channel and access to financing will be strengthened by modifying the excessive lending rate system. In March 2013, we eliminated the ceiling on creditor interest rates for term deposits, which had been introduced in December 2011. With regard to bank lending rates, we have finalized the impact study—conducted with World Bank assistance—on the modification or elimination of the legislation on excessive bank lending rates and have presented it to the Board of Directors of the Central Bank (structural benchmark at end-March 2014). On the basis of the study and of these recommendations, the CBT Board has asked for wider consultations with relevant Ministerial departments, before revising this year the legislation on excessive bank lending rates so as to enable the banks to preserve their profit margins, apply a higher interest rate to higher-risk customers, and improve monetary policy transmission channels as well as access to credit for small and medium-sized enterprises.

10. We will continue to implement our gradual exit strategy from liquidity injections. To that end, we have launched a process aimed at gradually limiting commercial banks' dependence on central bank refinancing, by increasing the share of refinancing guaranteed by government securities (to 20 percent at end-December 2013), and by introducing a ten percent haircut on loans accepted as collateral. The entry into force of a haircut system of around 25 percent (structural benchmark at end-March 2014) justified by a differentiation based on past nonperforming loans was

postponed to June 2014 (the related circular will nonetheless be adopted by the CBT Board of Directors in March 2014). This will allow banks time to prepare for tightened liquidity conditions and to benefit from the implementation of a lender of last resort facility at end-June 2014 (structural benchmark). The facility will be established to ensure that the structural needs of solvent but illiquid banks are met at penalty rates and on the basis of a precise restructuring plan to improve the banks' liquidity position. Once the facility is in place, the share of government securities used as collateral in CBT refinancing operations will be increased to 40 percent (structural benchmark at end-December 2014). A study on the possibility of valuing government securities at market prices and not at their nominal value will be conducted by September 2014.

11. The work on the reform of the central bank law will begin in May 2014. In line with the recommendations of the safeguards assessment of the Central Bank of Tunisia, the provisions of the central bank law will be revised in order to strengthen the independence of the CBT, to improve its governance procedures, in general, and the modalities for the conduct of external audits as well as its internal audit and control functions, in particular. The revised draft law—prepared with the support of IMF technical assistance—will be submitted to the CBT Board of Directors in June 2014 (structural benchmark). It will be adopted by the government in September 2014.

12. The liquidity pressures that marked the foreign exchange market throughout 2013 eased in the first few months of 2014. Stricter enforcement of the existing regulations for the holders of professional accounts in foreign currency, the receipt of expected budget support, the confidence generated by the breakthrough in the political situation, and CBT interventions in the foreign exchange market all contributed to increasing supply of foreign exchange in the market. The dinar, therefore, appreciated against the dollar by 5 percent over the last three months compared to the Euro (and 4 percent against the US dollar), reducing by half the depreciation recorded in 2013. Nevertheless, the CBT continues to limit its interventions to ensuring the smooth processing of external payments. Currently, interventions only account for 30 percent of trades in the foreign exchange market (compared to 50 percent two months ago).

13. The exchange rate policy will continue to respect market rules. We have pursued our strategy of limiting CBT interventions in the foreign exchange market to smoothing excessive exchange rate fluctuations (intra-day), while allowing market forces to determine the trend of the exchange rate, which remains slightly overvalued (by around 7 percent). We are fully committed to using our intervention policy to strengthen our foreign exchange reserves, including through purchase of foreign exchange in the market when conditions would allow. This will also help reduce the structural liquidity deficit of banks. The additional supply of foreign currency in the market will give banks the possibility to engage in swaps without approval from the CBT. To facilitate a more flexible exchange rate system, we intend to introduce weekly foreign exchange auctions before the end of 2014 (structural benchmark at end-December). The prerequisites for such auctions—namely the implementation of the electronic platform allowing the interconnection with banks and the entry into force of the Market Makers Agreement—are now in place (structural benchmark at mid-March 2014). However, before introducing the auction mechanism, there is also a need to first establish an

efficient information system that would allow the CBT to centralize the flow of projected foreign currency payments and have a clearer overview of cash flows.

14. Our development strategy will remain open and based on free trade. In line with the rules of the World Trade Organization, we will impose new restrictions or surcharges on imports only as a last resort, after exhausting market solutions that preserve appropriate incentives and only with very clear and pre-announced criteria for their elimination.

B. Laying the Foundations for Inclusive Growth

Financial sector policies

15. The implementation of our policy to align Tunisia's prudential rules with international norms has shown that our banking sector remains fragile. The entry into force of the new prudential rules for the haircut of loan collateral has led to an increase in the provisioning rate (excluding accrued interests for nonperforming loans) in the banking system from 46 percent to 60 percent to cover risks from nonperforming loans (NPLs). In the wake of this change, the average capital adequacy ratio for the sector fell from 12 percent to 9.2 percent, with six banks below the 9 percent required by the new regulation in force. Although asset quality stabilized slightly in 2013, the situation remains fragile and the ratio of NPLs is 15 percent of total loans (20 percent with the inclusion of claims transferred to bank-affiliated asset management companies). Our gradual progression towards compliance with international standards—including a higher provisioning rate and a more stringent loan classification system—could show that current capital levels remain inadequate to support the excess risk in the system. However, the tightening of risk division and concentration norms—which entered into force at the end of 2013—have allowed a reduction of certain risks and continued progress towards international standards.

16. Bank compliance with prudential norms is essential. In that regard, we have requested all banks that fall below minimum capital requirements to prepare as soon as possible a detailed plan to raise capital to the required level (9 percent), which is scheduled to be increased by the end of the year to Basel II level (10 percent). We are also planning to adopt the same approach with regard to banks that are not in compliance with the liquidity ratio. A study assessing the impact of a new ratio—which will include off-balance sheet transactions and adopt a more forward-looking approach—was submitted to the CBT Board of Directors in February 2014 (structural benchmark at end-December 2013). The new ratio will be announced to banks through a CBT circular in September 2014, with a clear timetable for gradual implementation. In the interim, monetary sanctions will be applied for noncompliance with the prevailing liquidity ratio. Over the course of the year, we are also planning to move ahead with the implementation of consolidated-based prudential norms and to carry out regular monitoring of banks and their subsidiaries. We also plan to conduct a diagnostic study of internal risk rating systems for different segments and to put in place an action plan to deal with banks that fail to comply with the regulation in force by end-December 2014.

17. Reducing the vulnerabilities of public banks is our priority. We have improved the governance of public banks by giving them greater autonomy from the state, including with respect to hiring of staff and the appointment of Board members. We have completed the audits of two public banks (STB and BH), the results of which confirmed findings from the Financial Sector Stability Assessment (FSSA) and highlighted insufficient levels of equity, capital and provisions, a high level of nonperforming loans, excessive operating costs, personnel that lack the required skills and competencies, and weaknesses in the governance structure and quality of service. The audit of the Banque Nationale Agricole (BNA) had to be postponed because of a technical problem but will be finalized by July 2014 (new structural benchmark). Our action plan for the short term revolves around:

- **Strategy.** In view of the delays experienced with the audit of the BNA, the decision on the strategic approach to be adopted with regard to the role of the government in the national banking sector will be determined, among other elements, by the outcome of the audits of the two other public banks (STB and BH); and more particularly by the restructuring options for public banks proposed by the auditors. Possible options include: a new business model, possible merger, or the opening to further private partnerships. The strategy on the role of the state in all banks with public participation (or at least for the STB and BH) will be adopted by the Council of Ministers in mid-April 2014 (Prior Action). The strategy will be presented to the public at end-April. Following this, a restructuring plan for the two public banks (STB and BH) will be adopted in July 2014 (new structural benchmark) and funds for their recapitalization could be provided in the form of non-negotiable bonds. Depending on the strategy adopted and on the level of participation by the banks' private shareholders, the amount currently budgeted for bank recapitalization (1.2 percent of GDP) will be revised upwards or downwards (the amounts estimated by the audits of the two banks currently stands at 1.5 percent of GDP; while the FSSA estimated the needs of the public banks at 2.6 percent of GDP).
- **Asset Management Company (AMC).** In view of the urgency of the situation in our tourism sector (54 percent of the loans in the sector are nonperforming, with doubtful debts having doubled since 2009), we plan to submit a draft law on an AMC to the NCA in June 2014. The law will provide for the: (i) adoption of clear and transparent governance rules combined with financial and operational autonomy; and (ii) implementation of explicit power to speed up resolution of the debt issue. The capitalization of the AMC will be carried out in conformity with the business plan established with the support of the World Bank. This undertaking will be closely coordinated with the bank recapitalization program, in particular for public banks. In parallel to this project, work has started to identify a solution to the NPLs in other sectors (e.g. manufacturing industry). Further, during the course of this year, a revision of the law on asset recovery companies (Law 98) will be undertaken to make it possible for such companies to contact customers directly.

18. Progress on reforming banking supervision is continuing. We are in the process of introducing a formal risk-based banking supervision system—a three-year plan will be established

with IMF technical assistance—that would determine the frequency and scope of inspection missions. A first general inspection of a large bank (the first since 2006) and four credit inspections provided an opportunity for the staff of the General Directorate of Banking Supervision (DGSB) to improve the methodology for on-site inspections and also highlighted the need to improve the risk management, data, and loan classification system. For FY 2014, a risk based inspection plan has been adopted in March 2014. The plan has identified six credit institutions, including four banks, for inspection. To perform these tasks, we have recruited 12 new people in the DGSB, that is, a quarter of the envelope provided for 2012–2014, and plan to fill the remaining vacancies to acquire the needed additional resources as soon as possible.

19. Improvements in banking data reporting will enhance financial stability assessment and monitoring. The CBT has developed a benchmarking indicator for credit institutions (Uniform Bank Performance Reporting, UBPR)—used jointly by the DGSB and the DGSFPR—which will be available 60 days after the end of each quarter and is based on a very simplified risk rating system. This instrument will be complemented by the new accounting, financial, and institutional banking data system to be put in place in December 2014 (structural benchmark).

20. Efforts are underway to put in place a crisis management and bank resolution mechanism that is consistent with international best practices. Regarding the legal framework, a draft banking law has been prepared with technical assistance from the World Bank and the IMF to strengthen banking supervision and regulation in Tunisia and put in place a robust legal framework for the resolution of insolvent banks. The draft law will be presented to CBT management in June 2014. In addition, the modalities for developing the operational structure and appropriate legal framework for the setting up of a deposit guarantee fund are in the process of being drafted with technical assistance from the World Bank.

Fiscal reform

21. Improving the composition of public expenditures is needed to achieve growth-supporting medium-term fiscal consolidation and rebuild fiscal space. Our medium-term fiscal consolidation strategy will be coupled with fiscal reforms—tax policy, revenue administration, public financial management, public enterprise reform, effectiveness of public investment—which are all essential to support growth.

22. A number of fiscal policy measures, including the grouping of tax laws in a new tax code in 2014, will help to improve the equity, efficiency, and transparency of the tax system. On the basis of tax consultations that took place between June and November 2013, we have developed a report which forms the basis of a strategy for a simpler and fairer taxation system. This report will be discussed publicly at the national tax consultations planned for June 2014 and will be used as the basis for establishing a new tax code to be adopted by the Council of Ministers in September 2014 (structural benchmark). In the context of a comprehensive tax reform, we plan to continue revising the corporate income tax (CIT) to achieve gradual convergence in the off-shore and on-shore sectors over the next few years, and announce it according to a clear calendar (the difference between the tax rates in these two sectors was reduced by half in the context of the 2014

budget law). Further, a study is underway to modify the existing presumptive tax system, including for liberal professions.

23. The pace of tax administration reform will be stepped up through the implementation of a modernization plan. A diagnostic study on tax administration was conducted in February 2013, with the support of IMF technical assistance. Following the diagnostic, we set up an in-depth verifications unit and a claims monitoring committee within the Large Taxpayers Office (LTO). Along the lines of the regional centers, a debt collection center has been set up. In addition, we plan to pursue our efforts to strengthen and restructure the Large Taxpayer Unit (LTU), by including all tax functions, and to strengthen tax control by improving selectivity (establishment of targeted criteria and objectives). We have also decided to strengthen control of the presumptive tax rate system (BNC), using the data available in the health insurance and social security system and the available banking data. A plan to modernize tax administration will be finalized in June 2014 (end-March SB postponed to June 2014). It will aim at setting up a unified administration and strengthening control and evaluation mechanisms, in line with the IMF technical assistance recommendations and with the assistance of an IMF resident expert. A unit responsible for overseeing the modernization of the tax administration will be created in April 2014 within the General Directorate of Taxation to monitor the implementation of the plan (organization, instruments, and working methods). With regard to customs administration, we have set up the first risk management unit, which has made it possible to introduce targeted inspections in the customs offices. We remain determined in our fight against smuggling, which has spiraled since the revolution, and intend to further strengthen our border posts.

24. The performance of public enterprises places a heavy burden on the government's budget. Since March 2014, we have taken concrete measures to control the increasing losses of public enterprises, primarily in transportation (Tunisair), trade (Grain Board), and energy (STEG, STIR), by shortening the required timeframes for transferring the amounts due to the enterprises eligible for subsidies on energy and food products. To strengthen governance and ensure greater transparency in the system of energy subsidies, cross subsidization between the energy companies will be reduced by having STEG and STIR meet directly their energy import needs from June 2014, instead of going through ETAP (oil refinery). Furthermore, the General Financial Committee (*Comité Général des Finances*-CGF) has prepared a preliminary audit report on the operations of the three public enterprises in the energy sector (structural benchmark at end-March 2014). To save them expensive bank interest expenses, the Ministry of Finance is committed to providing enterprises that receive energy and food subsidies with advances on budget appropriations to reduce their recourse to bank loans (the share of public enterprises in total loans was around 10 percent in 2013, distributed almost evenly between public and private banks). To better assess the challenges facing the sector, we plan to:

- **Strengthen the monitoring of public enterprises.** A monitoring committee bringing together the DG for Holdings, the CBT's DGSFPR, and the Unit responsible for Monitoring the Productivity of Public Enterprises and Institutions (Office of the Head of Government) is looking into the financial, and organizational situation of a group of 28 enterprises

considered to be the most important in terms of their impact on the national budget and economy. This monitoring exercise will be further strengthened by the preparation of a consolidated balance sheet for the 20 largest public enterprises (structural benchmark at end-June 2014), to make it possible to have a more precise estimation of the real impact on the government budget. A preliminary report including financial ratios will be finalized in April 2014. A quarterly report on the financial situation and action plans for rehabilitating loss-making enterprises will be published for the first time in June 2014.

- **Improve the governance of public enterprises.** In parallel with the assessment of their financial situation, the strategy aimed at strengthening public enterprises will also include efforts to review the regulatory framework to enhance the role of their board of directors, set up audit committees, and increase the transparency of their operations.

25. Public Financial management has been strengthened. In the interest of transparency, the government published a “citizens’ budget” for the first time in its history and has strictly respected the budget execution procedures during the complementary period by respecting the time frame provided for under the law. Further, a first draft organic law that is expected to introduce greater flexibility in the management of appropriations (including in ex-ante controls) and greater accountability of managers was prepared by the Budget Directorate. The law was drafted with technical assistance from the European Union and France and will be presented to the Council of Ministers in September 2014. It is designed to introduce, over the medium term, an ambitious program of “performance budgeting” (at present nine ministries—around 70 percent of the budget—present their budget with performance objectives). To improve the management of the government’s cash position and reconcile the monetary and fiscal data on government financing, we have consolidated the government’s accounts, excluding project loan accounts, in a Treasury Single Account (structural benchmark at end-March 2014). We also intend to assess the exhaustiveness and quality of the budget documentation and prepare a report on financial risks. Immediate efforts will focus on the preparation of a new budgetary nomenclature consistent with international standards. The draft of the new functional classification of the budget will be finalized in June 2014.

26. Improving the execution and effectiveness of investment spending is needed to generate inclusive growth. In collaboration with the World Bank, a diagnostic study on public investments has highlighted the need to implement major critical projects that could have a real impact on disadvantaged regions. Moreover, we have simplified, improved, and considerably modernized our procurement procedures, consistent with the recommendations of the World Bank technical assistance program, which will be implemented in June 2014 (the decree was approved in March 2014). This will allow for a more rapid and transparent relaunch of investments. We have also strengthened the control of public investments so as to ensure that the current practice of transferring loans to the regions to finance investment expenditures, which are under-executed and consequently rolled over to subsequent fiscal years, is no longer the norm. For the regions, we have decentralized project execution by professionalizing the oversight of public projects, reinforcing the role of Governors and carrying out periodic visits by the central government. Furthermore, we have

also adopted procedures to address land deeds issues that lead to delays during the project preparation phase and in the execution of investment spending.

Structural reforms

27. Our structural reform agenda focuses on improving the business environment and promoting a competitive private sector that will generate inclusive growth. To this end, we have been working mainly on the implementation of a new investment code, a new competition law, the streamlining of regulations and procedures as well as on facilitating trade.

28. The implementation of certain reforms requires the enactment of new laws, and is, thus, dependent on the political calendar of the National Constituent Assembly, given the priorities related to the electoral law. Nonetheless, we are committed to moving forward with the legislative timetable to pass the following laws:

- **The investment code**—has been prepared with technical assistance from the World Bank and on the basis of consultations with civil society and the donor community. The code—which aims to encourage private investment through a more transparent and effective regulatory framework and the streamlining of incentives—was submitted for approval of the National Constituent Assembly (NCA) in November 2013, but will only be examined in June 2014, thus delaying the implementation of the implementation decrees (structural benchmark at end-March 2014). These decrees—which are needed to increase market access and reduce restrictions on investment—can only be finalized after June 2014 (new structural benchmark for end-September 2014).
- **The competition law.** The draft law—submitted to the NCA in 2013—will be examined by the NCA by June 2014. The final version of the competition law will be designed to reduce government intervention in the economy, reduce excessive regulations, and strengthen competition among enterprises.
- **The law on collective proceedings (Law 95).** In parallel with the reform of the banking law, we will step up our efforts to ensure that the new law on collective proceedings (bankruptcy procedures)—prepared with the World Bank assistance—is adopted. The law is aimed at modernizing and simplifying the process of restructuring firms and liquidating insolvent firms. We will ensure that the new legislation on bankruptcies establishes clear rules on the government's status as a preferred creditor as well as on granting private creditors the right to vote on recovery plans.

29. Closer integration of the Tunisian economy into the global economy is essential for generating more inclusive growth. We are committed to promoting trade, including by reducing tariff and non-tariff barriers and through the recently implemented free trade agreement with Algeria as well as by the deepening of trade agreements with neighboring and African countries. Negotiations for a Deep and Comprehensive Free Trade Area (ALECA) with the EU will be launched in 2014. To further enhance the integration of the Tunisian economy into the global economy, we

have developed an action plan to improve the logistics systems of the Rades port (Tunisia's main port) and build a new deep water port at Enfidha.

30. Work is ongoing on the simplification of administrative procedures, including in the area of tax collection and customs, to promote private sector development and limit space for the discretionary application of regulations. To this end, we have begun to phase out restrictive administrative procedures for the private sector in the transport, customs, and export sectors; and we are committed to continuing along these lines as we believe that significant benefits will arise for the business community from this regulatory clean-up campaign, including for procedures related to the VAT.

31. We are committed to reducing the obstacles to a proper functioning of the labor market. The practical implementation of the social contract signed on January 14, 2013 with the employers and trade unions has begun with the setting up of technical commissions (labor and professional relations, social protection, employment, regional development, and investment). Broad consultation is planned for discussion of the new employment strategy. This process is expected to culminate in labor reform, including an analysis of flexicurity in labor relations and a reduction of the structural skills mismatch. With respect to employment, promotion programs and micro project programs financed by loans from the solidarity bank and the employment fund will contribute to foster youth employment.

32. Reliable statistical information is crucial for the monitoring and assessment of macroeconomic policies and for the implementation of social programs. In that context, we are collaborating with Eurostat in conducting a comprehensive diagnostic study of our statistics system, and we also plan—with technical assistance from the IMF—to strengthen our institutional arrangements and production of the system of national accounts (particularly on the quarterly demand side), and the balance of payments. We will continue to expand on the regular publication of the results of surveys on current conditions, employment, and household living conditions. In parallel, work on the legislative framework guaranteeing the independence on the National Statistical Office has been initiated.

C. Protecting the Most Vulnerable

33. We are firmly committed to ensuring that fiscal consolidation and other reform projects fully take into account the impact these reforms might have on the most vulnerable and that they be accompanied by a simultaneous strengthening of the social protection system. In that context, the government's 2014 budget includes the following social measures: (i) a social housing program for needy families; (ii) an increase in the income tax deduction for the poorest households; and (iii) a tiered electricity rate system adapted to energy use, and which introduces a second social ("lifeline") electricity tariff (for households that consume less than 100 kwh per month). Over the course of 2014, we plan to enhance our information system by introducing a unique social identification number that will be used as a basis for creating a new register of families in need and ensuring a more efficient targeting of benefits (under the current system there is quite a significant amount of "leakages" of benefits going to the non-poor). While

waiting for the implementation of the new register, we have launched an evaluation of the school assistance programs (with the help of UNICEF) as well as an assessment of the families-in-need/health benefits card program, both of which should be finalized by June 2014. In view of the planned increase in fuel prices, we intend to set up a “household targeting strategy” that is expected to take effect on July 1, 2014 and will consist of the following measures: (i) expansion to 250,000 beneficiary families (from 220,000 at present) of the existing cash transfer program for needy families; (ii) broadening of the population groups eligible for one-off and temporary aid to mitigate the impact of the fuel price increases; targeting will use the databases of the STEG and social security or any new social identification numbers; and (iii) a 10-dinar (about 10 percent increase) in the social allowances for school children and university students at the start of the academic year.

34. The reform of the pension system remains a medium-term priority. The retirement and health insurance systems are considered financially unsustainable over the long term. If these systems are not reformed, the combined deficit could amount to 2 percent of GDP by 2018. To address this risk, the Tunisian government has begun analyzing scenarios for retirement and health insurance reform, in parallel with the implementation of a support and welfare program financed by the transition fund to ensure the viability of the system. A decision on the reform to be adopted will be taken on the basis of a national consensus reached through the consultative process that was already started with the launch of the social pact in January 2013.

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

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	Dec 2012	Cumulative flows since the beginning of 2013					Cumulative flows since the beginning of 2014							
		Dec 2013		Mar 2014			Jun 2014		Sep 2014	Dec 2014				
	Prog. 05/24/13	PC w/ adjusters	Prog. 01/24/14	Actual	PC Status	Prog. 01/24/14	PC w/ adjusters	Revised estimate	Prog. 01/24/14	Revised PC	PC	IT		
Quantitative Performance criteria	(Millions of Tunisian Dinars)													
1. Floor on the primary balance of the central government (cash basis excl. grants)	-2,256	-4,318	-3,818	-2,015	-2,032	Met	-2,796		-1,773	-3,119	-2,806	-4,007	-5,609	
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock)	-1,332	-1,084	417	3,510	1,382	Not Met	3,952	4,340	3,009	4,662	4,086	4,071	1,173	
	(Millions of US\$)													
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock)	7,937	8,066	7,099	5,439	5,710	Not Met	5,308	5,058	5,071	5,086	4,754	5,275	7,066	
Continuous Performance criteria	(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	0	0	0	
Quantitative Indicative Targets	(Millions of Tunisian Dinars)													
5. Ceiling on Current Primary Expenditure							4,253	4,253	4,010	8,432	8,267	12,796	17,815	
6. Floor on Social Spending 3/	1505	1,588		1,371	1,281	Not Met			229	...	562	900	1,350	
7. Ceiling on the accumulation of new domestic arrears	...	0		0	0	Met	0		0	0	0	0	0	
Program assumptions on which adjusters are calculated in case of deviations														
Disbursement of public external Financing on a cumulative basis (in US\$ million) 4/		2,239		845	859		544		296	984	707	1,163	2,771	
Public debt service (interest and amortization) on a cumulative basis (in US\$ million)		1,387		1,379	1,344		208.2		213	503	516	718	968	
Bank recapitalization (in million TD)		500		500	500		...		0	0	0	300	700	
Privatization receipts (in million USD)	394	41		39	39		...		0	0	0	0	0	
Resident deposits at the BCT (in million USD) 5/	1,490			1,852	1,854		...	1,854		1,854	1,854	1,854	1,854	
Program exchange rate TD/ U.S. dollars	1.55235			1.55235	1.55235		1.55235			1.55235	1.55235	1.55235	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/ Public capital expenditures on social sectors and programs.														
4/ Excludes IMF disbursements.														
5/ At program exchange rate.														

Table 2a. Tunisia: Structural Benchmarks for 2013

	Objective	Date	Comments
Structural Benchmarks			
I. Financial sector			
Approval of the new reporting system architecture covering bank-related accounting, financial and institutional functions.	<i>Financial sector stability</i>	<i>Aug-13</i>	MET, with delay. The reporting system was presented in September 2013. This report defines the main principles of the architecture and its conception as well as different phases of the risk model.
Adoption by the Council of Ministers of the strategic vision of the government's future role in banks on the basis of preliminary results from the audit of public banks.	<i>Financial sector stability</i>	<i>mid-September 2013</i>	NOT MET. Audit of the three banks started in July and September, which is delaying the decision on the strategic vision. The strategic vision has been pushed to March 2014.
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>	MET. A credit risk inspection at one bank was completed in September and three others were completed in December. The on-site inspection of one major bank was completed in December 2013.
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>	MET, with delay. The templates for collecting the data needed to conduct the impact study have been communicated to banks. The study has been presented to the CBT Board in February 24.
II. Fiscal policy			
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>	MET, with delay. The reduction of the on-shore corporate tax rate from 30 to 25 percent and the increase of the off-shore one from 0 to 10 percent was incorporated in the 2014 draft budget along with countervailing measures for the potential revenue loss. The draft budget has been approved by the Council of Ministers on November 18, 2013 and has been adopted by Parliament on December 30, 2013.
Adoption of a Ministry of Industry decree approving a new automatic fuel pricing formula.	<i>Lower energy subsidies</i>	<i>Aug-13</i>	MET, with delay. An automatic pricing mechanism was put in place allowing convergence to international prices, but does not allow smoothing for large price increases.
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>	Not MET. The technical work has been done. A decision on the beneficiaries and the compensating mechanism need to be taken.
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>	MET, with delay. The different functions have been put together in one unit.
Finalize the audit of the electricity company (STEG) and of the petroleum refinery company (STIR).	<i>Lower fiscal risks</i>	<i>Dec-13</i>	Not Met. The audit of the three energy companies (STEG, STIR, ETAP) have started. This benchmark has now been postponed to March 2014.
III. Monetary and exchange rate policy			
Publication of a circulaire by the CBT that announces haircuts 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>	MET. The circulaire, which was adopted at end-July, includes a general haircut of 10 percent.
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>	MET. The circulaire has been published and the SB has started.
Implementation of an electronic bank interlinking platform and launch of the Market Makers Agreement.	<i>Greater exchange rate flexibility</i>	<i>Oct-13</i>	NOT MET, because of technical delays. This is a new structural benchmark for mid-march 2014.
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>	MET. The CBT regulation has been published and implemented.
IV. Structural reforms/private-sector development			
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>	MET, with delay. The new code was approved by the Council of Ministers in November 2013. Next step in this area will be the drafting of the implementation decrees that should accompany ratification by Parliament.

Table 2b. Tunisia: 2014 Structural Benchmarks

	Objective	Date	New Date	Comments
Prior Action				
Adoption by the Council of Ministers of the strategic vision of the government's future role in banks (or at least in STB and BH) on the basis of preliminary results from the audit of public banks	Financial sector stability			
I. Financial sector				
Submission to the Management of the Central Bank of Tunisia of a banking resolution framework in line with international practices	Crisis management and financial sector stability	Jun-14		In progress. With help from WB and IMF technical assistance.
Submission to the Central Bank Board of a draft Central Banking law in line with international practices	Financial sector stability	Jun-14		In progress. An IMF technical assistance mission is planned for May 2014.
Completion of the financial audit of the Banque Nationale Agricole (BNA)	Financial sector stability	Jul-14		
Adoption by the Government of restructuring plans for the BH and STB	Financial sector stability	Aug-14		
Development and implementation of the new reporting system and bank classification system	Financial sector stability	Dec-14		
II. Fiscal policy				
Adoption by the Ministry of Finance of a plan to modernize tax administration	Enhance Revenue Collection	Mar-14	Jun-14	Not MET. Working groups have worked on a draft plan but an overall strategy still needs to be finalized. IMF TA is assisting the authorities.
Unification of government accounts into a Single Treasury Account (excluding accounts for project loans)	Public Financial Management	Mar-14		MET.
Finalize the audit of the electricity company (STEG) and of the petroleum refinery company (STIR)	Lower fiscal risks	Mar-14		MET. The First Report was submitted to the Government on March 30, 2014.
Submission to the Council of Ministers of a new targeted household support program to accompany the reform of generalized energy subsidies	Protection of society's most vulnerable segments	Mar-14	Jun-14	Not MET. Work is in progress and possible contents of the strategy have been identified. This program will be put in place prior to the planned increase in fuel prices.
Prepare a consolidated balance of 20 main public enterprises (2010-2012)	Improvement of budgetary control and reduce fiscal risks	Jun-14		
Government approval of a new tax code	Enhance Revenue Collection	Sep-14		
III. Monetary and exchange rate policy				
Implementation of an electronic bank interlinking platform and launch of the Market Makers Agreement.	Greater exchange rate flexibility	mid-Mar 2014		MET. The electronic platform allowing the interconnection with banks and the Market Makers Agreement are now in place.
Presentation to the Central Bank board of the impact study for removing the upper limit for excessive rates for enterprises and to modify it for consumers.	Financial system stability and better transmission of monetary mechanisms	Mar-14		MET. The impact study—done with help from the CBT and completed with WB assistance—was presented to the CBT Board on March 26, 2014.
Implement an increase of the haircut for loans used as collateral for refinancing operations to at least 25 percent.	Enhancement of the monetary transmission mechanism	Mar-14	Jun-14	Not MET. A new regulation has been adopted on March 25, 2014 and its application will be announced for June 2014.
Establishment of the lender of last resort facility	Financial system stability and better crisis management	Jun-14		In progress. IMF TA is providing assistance.
Ensure that the proportion of the refinancing volume at the CBT backed by government securities is at least 40 percent for each bank.	Enhancement of the monetary transmission mechanism	Dec-14		
Implementation of a weekly foreign exchange auction mechanism	Greater exchange rate flexibility	Dec-14		
IV. Structural reforms/private sector development				
Decree for implementing the new investment code in line with the objective of protecting market access, reducing restrictions on investments, and rationalizing of incentives.	Support for balanced growth driven by the private sector	Mar-14	Sep-14	Not Met. Implementation decrees will be finalized once the investment code is ratified by Parliament.

Table 3. Tunisia: Fiscal Compensatory Measures – March 2014

	In Million Dn	In Percent GDP
Fiscal Revenues	260	0.3
Tax Policy Measures	100	0.1
Alcoholic Beverages: 8 percent Increase Excise Tax	20	0.0
Tabac: 10 percent Increase Excise Tax	50	0.1
No tax exemption for imported vehicles 1/	30	0.0
Tax Administration Measures	160	0.2
Tunisie Telecom: enhanced tax control	110	0.1
Recovery of tax arrears awaiting judicial decision	50	0.1
Current Expenditures	40	0.0
Additional reduction of energy subsidies 2/	40	0.0
Total	300	0.4

1/ At the moment of resale for cars imported by tunisians leaving abroad.
2/ Bringing forward the planned increase of tariffs to May 2014.

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 targets are defined in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated April 10, 2014. 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 Economy and Finance, the National Institute of Statistics (INS), and the Central Bank of Tunisia (CBT) will follow the rules and the format considered

appropriate for data reporting as covered by this technical memorandum of understanding, unless otherwise agreed with IMF staff.

DEFINITION OF PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Performance Criteria and Indicative Targets

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

Performance criteria

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

Indicative targets

- An indicative target (ceiling) on total domestic arrears.
- An indicative target (ceiling) on total primary current expenditure of the central government.
- An indicative target (floor) on capital expenditures in priority social sectors and social programs.

6. **Measurement of criteria.** The performance criteria on net international reserves and net domestic assets are measured on a stock and quarterly basis. The performance criterion on the central government deficit is measured on a quarterly basis and cumulatively from the end of the previous year. Adjustment factors will also be applied to some of these criteria. The performance criterion on the accumulation of 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.¹

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

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

¹ Deposits of residents in foreign currency (excluding government deposits) at the CBT are a form of external liability of the CBT; for operational and accounting purposes, and because of legal considerations related to the regulation of foreign exchange, the CBT includes residents' foreign currency deposits in the monetary base. To preserve the accounting consistency of the CBT's accounts and be in line with the standard definition of NIR within the framework of IMF 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 from end-December of the previous year. It also agreed that the residents' deposits in foreign currency at the CBT include the following components of reserve money: intervention/monetary market in foreign currency, foreign currency of aggregate intermediaries, non-negotiable placement of foreign currencies, and all other items of deposits in foreign currencies created or included in reserve money. At end-December 2013, the value of the stock of deposits in foreign currencies of residents at the CBT was US\$1,852.07 million at the program exchange rate.

this issue as well as the interest and principal of the issue sum through direct deduction from the Treasury's current account established in the CBT's books.

13. The value of CBT reserve assets and liabilities in foreign currency will be calculated using program exchange rates (see Table above). On 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. Following the unification of government accounts at the CBT into a Single Treasury Account, government accounts are consolidated in two categories (“Compte Central du Government” and “Comptes Spéciaux du Government”) on the CBT’s balance sheet (liabilities side).

21. Net government borrowing from the banking system is defined as the change in the stock of government securities (Treasury bills and bonds) held by banks and any other central government borrowing from banks, less repayments. 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*² by the central government or the CBT after 90 days from the due date or the expiration of the applicable grace period.

² 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 Ceiling on Central Government Primary Current Expenditure (excluding Interest Payments on Public Debt)

25. Under the program, central government primary current expenditure is defined as the sum of central government expenditure on: (i) personnel wages and salaries; (ii) goods and services; (iii) transfers and subsidies; (iv) other unallocated current expenditure³.

I. Indicative Floor on Social Expenditures

26. 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.

³ The methodologies used to measure current expenditure categories for the central government are those used to design the table of central government financial operations presented in the macroeconomic framework.

Program Assumptions on Adjustment Factors for Quantitative Performance Criteria					
(Millions of US dollars)					
	2014				Year
	2014 Q1	2014 Q2	2014 Q3	2014 Q4	
Government External Financing	803.6	855.4	676.9	1828.7	4164.6
Project loans	74.4	108.4	58.8	114.1	355.8
Multilateral donors	507.5	738.0	603.4	600.4	2449.3
AMF (Arab Monetary Fund)	0.0	43.4	0.0	0.0	43.4
IMF (budget support)	507.5	444.6	220.9	220.9	1393.9
World Bank Group	0.0	250.0	250.0	250.0	750.0
European Union	0.0	0.0	132.5	129.6	262.1
Bilateral donors	200.0	0.0	0.0	0.0	200.0
Turkish loan	200.0	0.0	0.0	0.0	200.0
Financial Market Access	21.7	9.0	14.7	1114.1	1159.5
Sukuk	0.0	0.0	0.0	500.0	500.0
Market Financ. (with possible Japanese guarantee)	0.0	0.0	0.0	300.0	300.0
Market Financ. (with possible US Treasury guarantee)	0.0	0.0	0.0	300.0	300.0
Other (incl. Loan Transfers to SOEs)	21.7	9.0	14.7	14.1	59.5
Budget Grant	20.7	13.8	27.6	75.8	137.9
Privatization Receipts	0.0	0.0	0.0	0.0	0.0
Government External Debt Service	213.5	302.7	202.2	249.9	968.3
Amortization	118.9	196.3	114.1	185.7	615.1
Interest	94.5	106.4	88.1	64.2	353.2
Resident deposits at the BCT 1/					
Sources: Tunisian authorities and IMF staff estimates					
1/ End December 2013 is the reference level and was estimated at USD 1,852.07 million					

J. Adjustment Factors for the Program Performance Criteria

27. The **NIR** targets are adjusted upward (downward) if the cumulative sum of net external financing of the central government (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.

28. The net **domestic assets (NDA)** targets will be adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the cumulative sum of net external financing of the central government (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.

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

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

K. Monitoring and Reporting Requirements

31. Performance under the program will be monitored using data supplied to the IMF by the Tunisian authorities as outlined in the table below, consistent with the program definitions above. The authorities will promptly transmit to the IMF staff 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</i> <i>in days</i>
GDP: Supply and demand at current, constant, and the previous year's prices, including sectoral indices.	<i>q</i>	45
Inflation: Including the underlying inflation of non-administered and administered prices.	<i>m</i>	14
Fiscal Sector		
Tax and nontax revenue of the central government decomposed on the basis of main tax and nontax revenues items	<i>m</i>	30
Total expenditures: current and capital, transfers and subsidies.	<i>m</i>	30
Capital expenditure: by type of financing: domestic and external (differentiating loans and grants), and by main sectors and projects (agriculture, social, infrastructure).	<i>m</i>	45
Current expenditure: by type of expenditure: wages, goods and services, transfers.	<i>m</i>	45
Social expenditure	<i>q</i>	45
Domestic and foreign debt		
Stock of domestic and foreign debt: of the central government and debt guaranteed by the government, with breakdown by instrument and type of currency (in dinars and foreign currency with the equivalent in domestic currency).	<i>q</i>	30
Stock of domestic arrears as per TMU, as well the stock of accounts payable that correspond to expenditures committed/ payment ordered more than 90 days before (and by type of	<i>q</i>	45

expenditures),		
Disbursement of foreign loans: Breakdown into project loans and budgetary loans by principal donor and identifying the most important projects to be financed in the original currency and its equivalent in Tunisian dinars converted at the current exchange rate at the time of each transaction. Domestic borrowing from banks and nonbanks: including bonds, Treasury bills, and other issued securities.	<i>m</i>	30
Debt guaranteed by the government: by instrument and type of currency (in dinars and in foreign currencies and its equivalent in national currency) External and domestic debt service: amortization and interest.	<i>m</i>	60
External payment arrears: external debt contracted and guaranteed by the government.	<i>q</i>	30
Debt rescheduling: possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	<i>q</i>	45
Consolidated accounts of the central government at the CBT: 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; and (vii) accounts pending adjustment (including privatization receipts from Tunisia Telecom).	<i>m</i>	30
External Sector		
Imports of Petroleum Products: average import price of main petroleum products.	<i>m</i>	30
Foreign trade: imports and exports of goods, including volumes and prices, by sector.	<i>m</i>	30
Deposits: Stock of foreign currency deposits, according to the residence of the holder.	<i>m</i>	14

External debt:	<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 (preliminary).	<i>q</i>	90
Overall gross external debt position	<i>q</i>	90
Overall net external position of Tunisia (in conformity with our obligations under SDDS).	<i>A</i>	180
Balance of payments: Prepared by the CBT	<i>q</i>	30
<i>Monetary and Financial Sector</i>		
CBT accounts at the current exchange rate: detailed table including the monetary system.	<i>m</i>	30
CBT accounts at the program exchange rate: Including net international reserves.	<i>m</i>	30
Foreign exchange market operations, Interbank market, retail market and wire transfers for CBT purchases on the retail market: CBT spot sales and purchases on the foreign exchange market, , stock of CBT currency swap (provide details on direction of transactions (TND/FX or FX/TND), amounts of principal, spot exchange rate in swaps agreement, interest rate applied on FX counterpart), detailed information on other BCT's forward foreign exchange operations, including outright forward sales of Tunisian Dinar . The terms and conditions of any new transactions (including the extension or renewal of existing terms and conditions) will also be provided. CBT foreign exchange reserves, breakdown by currency and by instrument, and the institutions where such reserves are held.	<i>m</i>	30
Banks' financial soundness ratios: Indicators of financial soundness and regulatory capital adequacy ratios of the banking system, including the quality of assets and the profitability of banks. The indication of the different banks is optional.	<i>m</i>	30

Direct refinancing of commercial banks by the CBT: Breakdown by bank.	<i>m</i>	14
Interest rates: Deposit rates, interbank rates, and lending rates.	<i>w</i>	14
NPLs: Stock of banking sector NPLs, and breakdown by commercial banks.	<i>q</i>	60
Balance sheets of commercial banks , including detailed income statements, in accordance with “Uniform Bank Performance Reporting” agreed with Fund staff.	<i>q</i>	60
<i>Other information to be reported</i>		
Information on Fiscal, Monetary, and Financial Policy: Decrees or circulars newly adopted or revised concerning changes in tax policy, tax administration, foreign exchange market regulations, and banking regulations. A copy of official notices of changes in gas and electricity rates and any other surcharge (automatic or structural), as well as the prices of petroleum products and levies/surcharges on gas and petroleum.	<i>d</i>	3

Statement by the Staff Representative on Tunisia
Executive Board Meeting
April 25, 2014

This statement reports on implementation of the prior action since the Staff Report was issued on April 11, 2014. The information does not alter the thrust of the Staff Appraisal.

- 1. The prior action on the strategic orientation of the banking sector has been met.** The Council of Ministers has adopted—for the first time in Tunisia’s history—an overall banking strategy that was designed through a participatory approach in consultation with a broad range of stakeholders in the banking sector. It aims at limiting the role of the State to key sectors, reducing the number and weight of banks that have government participation (currently, 12), and developing the prerequisites needed for more Public-Private Partnerships in the sector.
- 2. The banking sector strategy consists of five pillars:** (i) clean-up of public banks’ balance sheets and recapitalization following a plan that improves governance, strengthens institutional capacities, and enhances performance; (ii) creation of an asset management company to deal with troubled debt; (iii) establishment of a pillar to fund development projects (e.g., through the “Caisse des Dépôts et Consignation”); (iv) focusing public intervention on SME funding; and (v) development of microfinance. Successful implementation of this strategy will require quick realization of the reforms under the program, including strengthened banking supervision, a new bankruptcy and banking law, modern collateral framework, and less restrictions on lending rates.
- 3. To support restructuring and recapitalization, the government will maintain in the near term its share in the three main public banks, which represent about 35 percent of banking assets.** Banking recapitalization costs borne by the government will have to be adjusted, depending on the extent to which the existing private sector shareholders of these banks participate in their recapitalization. These costs—potentially higher than the 2.6 percent of GDP estimated at the time of the last FSSA—will need to be included in the restructuring plans (planned for completion by end-July for STB and BH), debt sustainability analysis, and the 2014 supplementary budget. The broader strategy will be further discussed with the authorities as they develop the restructuring plans for STB and BH



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FOR IMMEDIATE RELEASE
April 25, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review Under the Stand-By Arrangement for Tunisia and Approves US\$225 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Tunisia's economic performance under a 24-month program supported by a Stand-By Arrangement (SBA). The completion of the review enables an immediate disbursement of SDR 145.08 million (about US\$225 million), bringing total disbursements to SDR 573 million (about US\$888.4 million).

The two-year SBA in the amount of SDR 1.146 billion (about US\$1.78 billion, or 400 percent of Tunisia's quota at the IMF) was approved by the Executive Board on June 7, 2013 ([See Press Release No. 13/202](#)).

In completing the third review, the Executive Board approved the authorities' request for modification of end-June 2014 performance criteria and granted waivers of applicability for the end-March 2014 performance criteria for which data are not yet available and for which there is no evidence they were not observed.

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

“The authorities have made progress on their Fund-supported economic program. End-March quantitative performance criteria appear to have been met, but progress on structural reforms has been slowed by last year's protracted political crisis.

“The adoption of a constitution and the formation of a new government led to greater confidence in political and economic prospects. Nonetheless, growth is moderate, unemployment remains high, and fiscal and external imbalances are elevated.

“Newly identified fiscal measures—coupled with those aimed at containing the high wage bill and reducing regressive energy subsidies— will help restrain the widening fiscal deficit in 2014. Revenue reforms, strengthened public financial management, and reform of public enterprises are necessary to improve the composition of fiscal consolidation. Improved procurement procedures and project execution are needed to reverse the under-execution in investment spending, which is important to promote inclusive growth. Social expenditures should continue to be preserved during fiscal consolidation.

“The current monetary policy stance is appropriate, but would need to be tightened if inflationary or exchange rate pressures arise. The removal of the lending rate cap is essential to strengthen monetary transmission channels and access to finance. Greater exchange rate flexibility would help rebuild external buffers, reduce liquidity injections, and improve competitiveness.

“Improved data reporting, strengthened supervision, and the new strategic vision for public banks are important steps taken to reduce banking sector fragilities. Priorities in the near term are to design bank restructuring plans, establish the asset management company for troubled tourism debt, address weak asset quality, and enhance resolution mechanisms.

“Accelerated implementation of structural reforms is crucial to ensure stronger and more inclusive growth. A well-targeted social safety net needs to accompany the energy subsidy reform so as to protect vulnerable households.”

**Statement by Jafar Mojarrad, Executive Director for Tunisia;
and Moez Ben Hassine and Abdelali Jbili, Advisors
April 25, 2014**

On behalf of our Tunisian authorities, we would like to express our appreciation of staff hard work and the constructive dialogue during the discussions of the Third Review under the Stand-by Arrangement. The authorities are also grateful to management and the Executive Board for their continued support.

Program implementation has continued to advance at a broadly satisfactory pace given the difficult domestic and international environment and the constraints and challenges related to the political transition. The authorities remain fully committed to the program objectives. A strategic orientation for all banks with public participation (prior action) was approved by the Council of Ministers. Two out of three end-December quantitative performance criteria (QPC) were missed by a smaller margin than originally estimated in the last review, and all end-march 2014 QPCs are expected to have been met. On the structural reforms, four out of eight benchmarks were realized, and progress has been made towards increasing haircuts for loans used as collateral for refinancing operations, as well as on the design of a plan to modernize tax administration. Moreover, additional fiscal adjustment of about 0.4 percent of GDP in 2014 was agreed during this review.

The democratic transition is gaining momentum within a firmly established consensus among political parties and civil society, and has received overwhelming expressions of support on the part of the international community. Following the adoption of the new constitution, and the formation of a new technocratic government, a road map for the last phase of the democratic transition has been agreed, involving inter alia, the appointment of members of the Independent High Electoral Commission and the expected adoption of the electoral law, thereby paving the way for holding free and democratic elections by year-end.

Recent economic developments and outlook

Economic performance in 2013 was mixed, given the persistent headwinds from the external environment and the still uncertain domestic context. Weak tourism activity, strikes in the mining and the manufacturing sectors, and a below average cereal harvest, adversely impacted the

pace of the recovery in 2013. Growth remained positive, however, at 2.6 percent, and unemployment was brought down from the peak of 18.3 percent in 2011 to 15.3 percent, even though it remains unacceptably high, in particular for young graduates and women. Headline CPI inflation eased to 5 percent in March 2014 from 6 percent in December 2013, while core inflation remained low at 4 percent. The overall fiscal deficit on a cash basis reached 6.1 percent of GDP at the end of 2013, in line with the estimate under the previous review. On the external side, however, weak demand from Europe, lower exports of phosphates, and the increase in the cost of energy imports exacerbated pressures on the current account, while significant shortfalls in external financing worsened the overall balance of payments outcome.

The outlook for 2014 is promising. With the transition expected to smoothly reach its final stage, and the firming up of the economic recovery in Europe, Tunisia's growth prospects are expected to improve on account of strengthened confidence, which will reverse investors' wait-and-see attitude. Exports and tourism activities are likely to rebound, and external financing is expected to be better than last year. Growth is projected to increase moderately to about 2.8 percent and inflation to decline to 5.3 percent on average. The current account is projected to narrow to 7.2 percent of GDP in 2014 and 6.3 percent in 2015. While downside risks remain, growth could possibly surprise on the upside, should confidence strengthen more than expected.

Fiscal policy and reforms

The 2013 fiscal deficit turned out to be lower than programmed. While revenue was higher than envisaged during the second program review, savings on the wage bill and under-execution of social and capital spending lowered the primary fiscal deficit on a cash basis to 2.7 percent of GDP, and the overall deficit to 6.1 percent of GDP, against a program target of 7.3 percent. As explained in the MEFP, the under-execution of capital and social spending reflected implementation capacity constraints at the regional level rather than a deliberate decision. Overall, the structural fiscal deficit, which is a better gauge of the underlying fiscal position, declined to 4.6 percent of GDP against 5 percent foreseen in the program.

The authorities are committed to continued fiscal adjustment, which will be gradual and will involve a combination of short-term measures and structural reforms. Since January, they have identified a package of additional fiscal measures of about 0.4 percent of GDP, including

mostly revenue measures, which will be included in a supplementary budget, with the objective of achieving a structural deficit of 4.9 percent of GDP in 2014. The authorities are determined to contain the wage bill through a wage freeze, which is already in place, and limited net recruitment in the civil service, except for the security, education, and health sectors. A civil service reform task force has been set up, and work is underway to carry out an evaluation of the civil service hiring system and salary structure with World Bank assistance by September 2014 (MEFP ¶5).

The energy subsidy reform is being implemented. First steps of this reform, which are estimated to yield budgetary savings of about 0.9 percent of GDP in 2014, consist of increases in prices of electricity and natural gas for cement companies by 35 percent and 47 percent, respectively, in addition to a 10 percent increase in electricity tariffs for household and industrial users. A second round of electricity and gas price adjustment is planned for June 2014 to fully eliminate subsidies for cement companies, while fuel prices will also be adjusted by 6 percent in July. The new formula for automatic adjustment of fuel prices, which was adopted early this year, should insulate the budget from the effects of large increases in international oil prices. Vulnerable groups will be protected from these increases through social programs already included in the 2014 budget, as well as through the recently introduced lifeline electricity tariff (for households consuming less than 100 kw/h per month). In addition, a household targeting strategy, expected to take effect on July 1, 2014, will increase the number of beneficiary families, broaden the population groups eligible for one-off and temporary aid to mitigate the impact of the fuel price increases, and raise social allowances for school children and university students (MEFP ¶33). To ensure broad support for the energy subsidy reform, the authorities intend to launch a new communication campaign ahead of price increases.

The authorities are taking steps to improve the execution of public investment projects and strengthen public financial management (PFM). A new public procurement decree was adopted, with implementation to start in June 2014, to strengthen public procurement and simplify the tendering process, while devolving more responsibilities to the regional authorities for project execution. This, together with improved oversight of public investment projects and better control of current spending, will improve the quality of expenditure. Important steps are being taken to strengthen PFM, including the setting of a single treasury account, the shortening of the

complementary budget period, the ongoing work on a new organic budget law, and the planned adoption of a functional budget classification in June 2014.

A comprehensive tax reform is under preparation to promote equity, efficiency, and transparency of the tax system. The authorities have already included some measures in the 2014 budget, which halved the corporate tax wedge between the on-shore and off-shore sectors, introduced a 10 percent tax on dividends, and raised tax exemption thresholds for low-income individuals. National consultations on the planned reform will take place in June 2014 to build consensus and pave the way for the adoption of a new tax code by the Council of Ministers in September 2014 (structural benchmark). On revenue administration, progress has been made on the unification of different functions of the large taxpayer unit (LTU), while a strategic plan for modernizing tax administration will be adopted in June 2014, based on the results of the IMF Technical assistance recommendations.

Monetary and exchange rate policies

The monetary policy stance remains appropriate. Staff and the authorities agree that following the December 2013 increase in the policy rate by 50 basis points, the current policy rate remains appropriate, given that core inflation is stable, headline inflation is declining, and a negative output gap remains. The CBT stands ready to further tighten the monetary stance, as needed. To further improve monetary policy transmission channel and facilitate access to credit by small and medium-sized enterprises, the authorities have completed a study with World Bank assistance on options for the modification or elimination of existing caps on banks' lending rates, and consultations are underway between the CBT and the relevant ministerial departments to this effect.

Steps are being taken to reduce commercial banks' reliance on central bank refinancing A new haircut of 10 percent on bank loans eligible for CBT refinancing has been introduced, and will be increased in June to 25 percent, in conjunction with the planned introduction of a lender of last resort facility (structural benchmark) to allow solvent, but illiquid, banks' use of the facility, as needed, at penalty rates. Furthermore, the share of government securities used as collateral for

central bank refinancing will be increased later this year to reduce risks to the CBT's balance sheet.

Exchange rate policy has remained flexible, to reflect market developments and to build international reserves. Earlier pressures on the exchange market eased in the first months of 2014, reflecting increased disbursement of budget support, stricter enforcement of existing regulations for the holders of professional accounts in foreign currency, and the confidence generated by the improvement of the political situation. The resulting appreciation of the Tunisian Dinar partly reversed the earlier depreciation in 2013. The CBT has limited its interventions in the market to smoothing excessive exchange rate fluctuations. An electronic bank interlinking platform was introduced which, together with the entry into force of the Market Maker Agreement, will facilitate the establishment of a weekly foreign exchange auction mechanism.

Financial Sector Issues

Addressing the vulnerabilities of the financial sector remains the authorities' key priority.

As detailed in the report and the MEFP, a multi-pronged strategy is being deployed aimed at: addressing capital adequacy shortfalls in six banks that fall below the statutory minimum requirement; aligning prudential rules with international norms; strengthening bank supervision, including improving offsite procedures and onsite inspections before moving to risk-based methods; and upgrading the reporting and ratings system. Adequate progress has been made in these areas, as indicated in the report.

A major undertaking will be the recapitalization and restructuring of public banks. The authorities have adopted a strategic orientation of the role of the state in public banks (a prior action for this review), which defines the objectives, guiding principles, and modalities of government intervention in the financial sector. Moreover, based on completed audit reports for two public banks, restructuring plans for these banks (STB and BH) will be approved in July 2014 and the necessary resources for bank recapitalization will be mobilized. The 2014 budget already incorporates an amount equivalent to 1.2 percent of GDP for this purpose. Efforts are also directed at the establishment of an Asset Management Company to address the NPL problem in the tourism

sector, with the necessary legal framework to be submitted to the National Assembly by June 2014.

Structural reforms

The authorities are cognizant of the need for a comprehensive reform strategy to improve the business climate. The National Assembly is reviewing the investment code, the competition law, and a law on public-private partnership, which should encourage private sector investment and growth and foster the development of disadvantaged regions. The authorities are also preparing a strategy to reform public enterprises. An audit of three energy companies has been completed and efforts are underway to improve their efficiency. On labor market reform, the tripartite dialogue between labor unions, the business association, and the government has been revived to review a draft national employment strategy, with the objective of adopting specific actions in this area after the elections.

Conclusion

Our Tunisian authorities are steadfastly moving forward in implementing their ambitious reform agenda, and are grateful to their partners for their reinvigorated support in difficult times. They thank Executive Directors and management for their keen interest in the Tunisian experience, as demonstrated during the recent visit to Washington by the Prime Minister, and continue to highly value their support and policy advice. As mentioned to the Managing Director by the Prime Minister during his visit, Tunisia is a ‘democracy start-up’ that needs to be supported by the international community.