INTERNATIONAL MONETARY FUND

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TUNISIA

December 2014

FIFTH REVIEW UNDER THE STAND-BY ARRANGEMENT, REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA, AND REPHASING OF ACCESS—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR TUNISIA

In the context of the fifth review under the Stand-By Arrangement, request for modification of performance criteria, and rephasing of access, 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 December 12, 2014, following discussions that ended on September 30, 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 December 5, 2014
- A **Staff Statement** of December 12, 2014 updating information on recent developments.
- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Statement** by the Executive Director for Tunisia.

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

Letter of Intent sent to the IMF by the authorities of Tunisia*
Memorandum of Economic and Financial Policies by the authorities of Tunisia*
Technical Memorandum of Understanding*

*Also included in Staff Report

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

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December 5, 2014

FIFTH REVIEW UNDER THE STAND-BY ARRANGEMENT, REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA, AND REPHASING OF ACCESS

EXECUTIVE SUMMARY

Context. On June 7, 2013, the Executive Board approved a 24-month Stand-By Arrangement in an amount equivalent to 400 percent of quota (SDR 1.146 billion or about $1.75 billion). To date, SDR 716.25 million, equivalent to $1.1 billion, has been disbursed.

Background. Tunisia is completing a successful political transition to democracy while navigating a challenging environment marked by high social and security tensions, slow growth in trading partners, and spillovers from regional conflicts. At the same time, large external and fiscal imbalances, high unemployment, and increased banking fragilities remain the main challenges.

Program implementation has been mixed. All quantitative performance criteria have been met. However, progress on the structural reform agenda has been slow, with considerable delays in the recapitalization of public banks and the legislative agenda on the tax, investment and bank asset recovery fronts.

Program strategy. The focus should continue to be on short-term macroeconomic stabilization and laying foundations for higher and more inclusive growth, including by moving forcefully on banking reforms. Prudent fiscal and monetary policy, along with improved budget composition and greater exchange rate flexibility, need to be directed to containing high imbalances and anchoring inflationary expectations. Recapitalizing public banks in line with good international practices is urgent in view of mounting risks to financial stability, and is also important in light of its impact on financial intermediation and growth. Progress on structural reforms is necessary to generate the conditions conducive to private sector–led and inclusive growth and protect the most vulnerable.

Risks to program implementation are important. The main risks relate to regional and domestic security tensions, delays in forming a new government, shortfalls in official and market financing, or a further deterioration of the international economic environment. The implementation of program policies will continue to be tested by opposition from vested interests; however, support for the reform agenda among the authorities and a broad spectrum of political parties represents a key risk-mitigating measure.

The completion of the fifth review will make SDR 71.625 million (about $110 million) available.

Approved By
Daniela Gressani and Taline Koranchelian

The team comprised Amine Mati (head), Lorraine Ocampos, Gomez Agou, and Andrea Gamba (all MCD); Jean Frederic Noah Ndela Ntsama (SPR), Nolvia Saca-Saca and Thierry Bayle (MCM), Giorgia Albertin (Resident Representative). From September 25 to 26, the mission overlapped with a Capability Assessment Program (CAP) for the Central Bank of Tunisia (CBT). Mr. Ben Hassine (OED) joined the discussions. During September 16–30, 2014, staff met with the Governor of the Central Bank, the Minister of Economy and Finance, the Minister of Energy, Industry, and Mines, the Minister of Social Affairs, the Minister of Tourism, the Minister of Transport, the Minister of Agriculture, the Minister in charge of Economic Affairs at the Prime Ministry, 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 Kadia Kebet, Rafik Selim, and Kia Penso.

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CONTEXT

1. **The legislative and presidential elections were free, fair, and peaceful by most accounts—representing yet another successful step toward establishing Tunisia's young democracy.** The October legislative elections resulted in the main secular party, Nidaa Tounes, securing the most seats in the new parliament, followed by the Islamist Ennahda party. Lacking an absolute majority, Nidaa Tounes must form a coalition to rule, with a government likely to be in place early next year, following the certification of the results of the second round of presidential elections that will be held in late December. The key challenge for the new government will be to build on Tunisia's economic resilience to give new impetus to economic and social reform, in view of the difficult economic and security challenges.

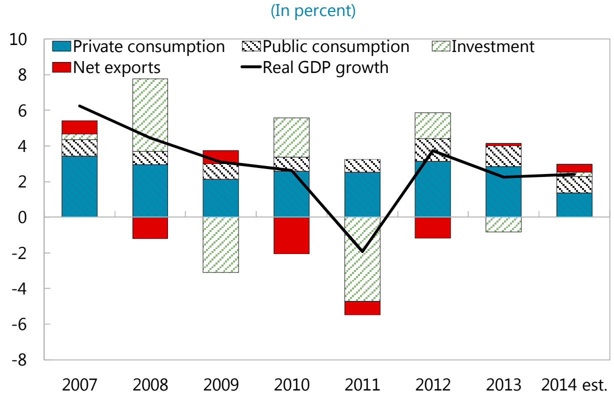
2. **Focus should continue to be on containing external imbalances and moving forcefully on banking reforms.** The five-year economic vision—presented at the September "Invest in Tunisia" conference and supported by a broad spectrum of Tunisia's political parties and society—rightly puts the emphasis on short-term macroeconomic stabilization, improving budget composition, reducing banking fragilities, enhancing business climate reforms, and protecting the most vulnerable. These priorities will continue to steer the Fund-supported reform agenda aimed at maintaining macroeconomic stability and generating stronger and more inclusive growth.

ECONOMIC DEVELOPMENTS, PROGRAM PERFORMANCE, AND OUTLOOK

A. Recent Developments

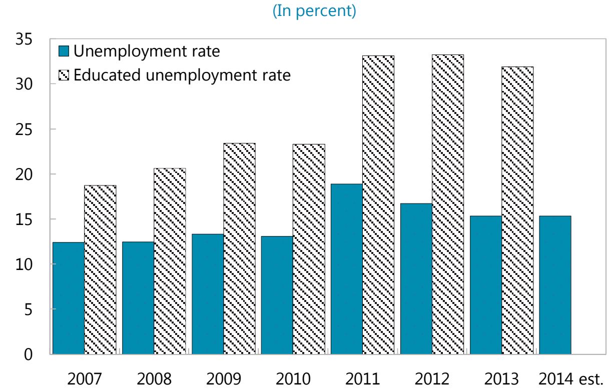
3. **Growth** stood at 2.1 percent y-o-y in the first half of 2014, helped by a good performance in services and agriculture. Unemployment for the period remains high, at close to 15.2 percent in aggregate but at 30 percent for youth and 21.5 percent for women.

Contribution to Growth
(In percent)



Sources: Tunisian authorities; and IMF staff calculations.

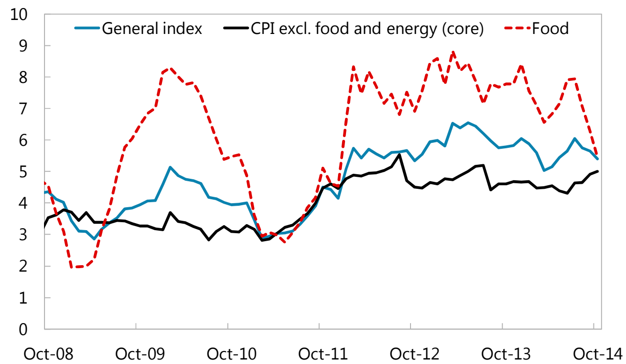
Unemployment Rate
(In percent)



Source: Tunisian authorities.

4. Headline inflation fell to 5.4 percent y-o-y in October, driven by lower food and energy prices. However, core inflation has increased slightly to 5.0 percent (y-o-y), reflecting rising prices of health services and clothing.

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

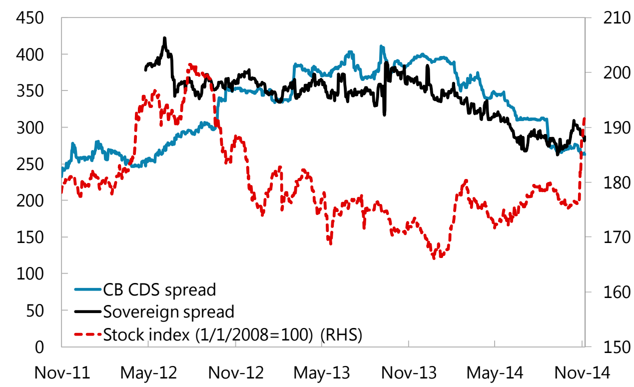


Sources: Tunisian authorities; and IMF staff calculations.

5. The current account deficit widened to 7 percent of GDP for the first three quarters of the year, mostly reflecting higher energy and food imports, stagnating tourism flows, and weaker demand from traditional export markets. Investors' wait-and-see attitude continues to hold back FDI, though external official financing flows have helped push gross official reserves to $7.7 billion, covering 3.4 months of imports.

6. Financial markets have improved, with positive developments in the political process narrowing spreads and increasing stock prices. Lower interventions in the FX market have contributed to a currency depreciation over the past six months, albeit with a slight appreciation uptick with respect to the euro more recently.

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



Sources: Markit; Bloomberg; and IMF staff calculations.

7. Vulnerabilities in the banking sector are rising. Banking data for June 2014 put the overall capital adequacy ratio (CAR) at 8.8 percent, with six banks—representing 42 percent of banking assets—below the 9 percent regulatory CAR. Asset quality continues to be weak, with nonperforming loans (NPLs) increasing to 16 percent in June 2014 (21 percent after accounting for banking affiliates, and of which 85 percent are from legacy loans). Net profits, however, have been rising with larger interest margins and fees.

B. Program Performance

8. Quantitative performance criteria for end-September have been met (LOI, ¶3):

- **Primary balance.** Strong revenue collection—driven by VAT and one-off revenues from oil companies—and spending under-execution helped keep the fiscal deficit below the program target (MEFP,¶5). While the indicative ceiling on current spending has been met, the floor on social expenditures has been missed because of lower-than-programmed transfers to vulnerable households, which are expected to recover by end-year.

Tunisia: Central Government Financing

(In millions of dinars)

	2014 until September Prog.	2014 until September Act./Est.
A. Central government deficit (-) (incl. grants)	-2,259	-750
B. Float and other statistical discrepancies 1/	2,462	2,647
C. Central government deficit (-) (incl. grants, cash basis)	-4,721	-3,398
C. Financing	4,721	3,398
Foreign	3,596	2,890
Drawings	4,325	3,579
Amortization	729	689
Domestic	1,035	508
Drawings	2,213	2,392
Amortization	-1,611	-1,977
Government Deposits (+ = drawing / - = accumulation)	133	93
Public Banks Recapitalization	300	0
Privatization proceeds	90	0
D. Grants	213	129
E. Interest Payments	1,140	1,141
F. Primary balance (excl. grants, cash basis) (F = C - D + E)	-3,793	-2,386

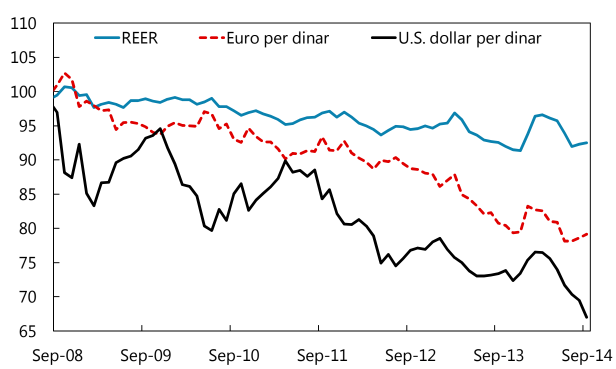
Sources: Tunisian authorities; and IMF staff estimates.

1/ Includes expenditures commited until end-December 2013 and to be paid during the complementary period in 2014 as well as commited expenditures of the current year budget to be paid in the following quarters.

- **Reserves.** NIRs stood at $5.0 billion, exceeding the adjusted program target by a slight margin, thanks to a $500 million U.S.-guaranteed Eurobond issuance, the halving of CBT FX sales to $200 million per month, and energy companies' increased use of their own FX resources.

Exchange Rates

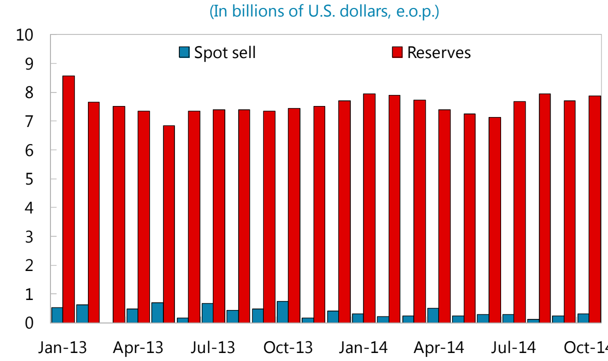
(Jan. 2008 = 100; +: appreciation)



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

Reserves and Spot FX Interventions

(In billions of U.S. dollars, e.o.p.)



Sources: Tunisian authorities; and IMF staff estimates.

- **Monetary.** The NDA target has been met by a comfortable margin, with timely government payments to public enterprises and a pick-up in deposits that lowered recourse to CBT refinancing relative to end-June. Credit to the private sector grew by 8.4 percent y-o-y at end-September, mostly driven by consumer lending.

9. Progress on the structural reform agenda has been slow with only two out of seven structural benchmarks (SBs) completed by end-November (LOI, ¶3, Table 2a). The new tax code and the audit of the BNA were approved by the government in October and November 2014, respectively. The need for consensus-building led to the postponement of the National Tax Consultation to mid-November 2014, thereby delaying approval of the tax reform strategy to December. On banking, the adoption of the BNA restructuring plan was delayed pending agreement on recapitalization modalities; the parliamentary recess delayed the adoption of the law on the Asset Management Company (AMC); and lengthy CBT procedures delayed further the much needed recruitment of bank supervisors. As for the investment code, the government is assessing the best way to replace the draft that was withdrawn from Parliament in June, while preparing measures to improve the investment climate (MEFP, ¶30).

C. Outlook and Risks

10. Macroeconomic projections continue to forecast moderate growth, declining inflation, and an improving external position:

- **Growth** projections for 2014 have been revised down, from 2.8 percent to 2.4 percent, on account of a weaker-than-expected outturn in the first half of the year. Growth is projected to pick up to 3 percent in 2015, one percentage point lower than programmed, reflecting worsening prospects in Europe, delayed implementation of the structural reform agenda, and investors' wait-and-see attitude pending the formation of a new government.

- **Inflation** is expected to continue on a downward trend, in view of declining international commodity prices, stable domestic food production, and a prudent monetary policy. Headline inflation is expected to moderate to 5 percent in 2015 and 4 percent in the medium term.

- The **current account deficit** will be contained at 7.9 percent of GDP in 2014 through greater exchange rate flexibility, lower global commodity prices, and a good agricultural harvest. Fiscal consolidation, improved price competitiveness, and stronger exports and tourism growth will improve the external position in 2015 and the medium term, with projected multilateral and bilateral inflows boosting reserve-to-import coverage above 4 months.

Tunisia: Selected Economic Indicators, 2010–15

	2010	2011	2012	2013	Est. 2014	Proj. 2015
Real GDP growth (in percent)	2.6	-1.9	3.7	2.3	2.4	3.0
Consumer price index (CPI), (period average, in percent)	4.4	3.5	5.6	6.1	5.6	5.0
Current account (percent of GDP)	-4.8	-7.4	-8.2	-8.3	-7.9	-6.4
Gross official reserves (US$ billions, eop)	9.5	7.5	8.7	7.7	7.8	10.1
Gross official reserves (months of next year's imports)	4.4	3.4	3.9	3.4	3.4	4.4

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

11. Risks to the outlook are high. Spillovers from the crisis in Libya—including increased security tensions and refugee inflows—an upsurge of social unrest, and delays in forming a new coalition government could weigh on reform implementation and hinder investment by prolonging investors' wait-and-see attitude. Further delays in banking recapitalization could also increase financial stability risks. A protracted period of weaker growth in Europe and other trading partners would further slow economic activity and exacerbate fiscal and external imbalances. On the upside, continued declines in international commodity prices would help narrow those imbalances.

POLICY DISCUSSIONS

Discussions focused on (i) reducing external vulnerabilities through fiscal consolidation and rebuilding buffers; and (ii) reform implementation, particularly in advancing the recapitalization and restructuring plans for public banks.

A. Short-Term Stabilization Goals

Fiscal policy—Toward consolidation while improving budget composition

12. Over-performance on the 2014 fiscal target comes with an inadequate spending composition. Strong tax collection—to be boosted in the fourth quarter of the year by an exceptional one-off contribution from employees and companies (0.4 percent of GDP)—and weak execution of the capital budget are expected to lower the 2014 structural fiscal deficit (i.e., the deficit corrected for cyclical fluctuations and excluding banking recapitalization costs) to 4.1 percent of GDP (from 4.7 percent of GDP under the program). The over-performance in the overall deficit on a cash basis—about 1.5 percentage points of GDP below target—also resulted mainly from delayed banking recapitalization. However, higher costs of goods and services associated with the issuance fees on the Samurai bond guarantee (0.2 percent of GDP) are expected to lead, for the second time this year, to an increase in the end-year program ceiling on current primary spending. The authorities stressed that budget ceilings on the wage bill and subsidies will be respected, with lower global oil prices helping offset the impact on subsidy payments of higher than expected exchange rate depreciation (MEFP, ¶5). As in past years, the authorities expect a 40 percent budget execution rate in the last quarter of 2014 to increase capital outlays (to about 90 percent rate for the year).

13. The draft 2015 budget—submitted to the outgoing Constituent Assembly in October—aims at further fiscal consolidation, while preserving priority spending (MEFP, ¶6-7). The 0.3 percentage points decline in the structural fiscal balance—shown in the 2015 budget to be adopted by the new parliament by end-December 2014 (SB)—is justified by high external imbalances, financing constraints, and the authorities' medium-term debt-reducing deficit target of 2.5 percent of GDP. Staff welcomed the emphasis on trying to improve budget composition by increasing capital spending—particularly in poorer regions—in line with absorption capacity. It also welcomed the authorities' commitment to save any net gains that would materialize if the average oil price for 2015 turns out to be lower than budgeted (see Box 1).

14. New measures to anchor the 2015 fiscal adjustment are mostly from the expenditure side. Revenue increases are limited to the full-year impact of 2014 measures (0.3 percent of GDP) and enhanced tax arrears collection (0.2 percent of GDP). The authorities stressed that new tax policy measures will only come into effect in 2016 following the adoption in 2015 of a comprehensive reform strategy following the National Tax Consultation that took place in November (see below). On the expenditure side, in addition to measures introduced in mid-2014, savings of 0.4 percent of GDP will be generated through increases in electricity and fuel prices, and with the signing of forward contracts guaranteeing oil price savings levels of at least 0.4 percent of GDP. Containing the wage bill through controlling promotions and limiting salary increases below inflation and pushing forward on civil service reform (MEFP, ¶6) will also be key.

Tunisia: Selected Fiscal Indicators, 2012–15

(In percent of GDP)

	2012	2013	2014		2015	
	Act.	Prel.	Prog. 08/29/14	Est.	Prog. 08/29/14	Proj.
Revenue	23.1	23.6	23.5	23.9	23.5	23.6
of which: Tax revenue	21.0	21.4	22.3	22.7	22.1	22.2
Expenditure and net lending	28.8	29.8	30.3	28.8	28.0	29.8
of which: Wages and salaries	12.2	12.5	12.6	12.7	12.4	12.5
Transfers and subsidies	7.0	7.8	7.2	7.2	5.7	6.5
Capital expenditure	6.6	4.9	5.2	4.8	5.9	5.3
Net lending	-0.5	0.0	1.6	0.2	0.7	1.6
of which: Public Banks' recap. + AMC operat.costs	0.1	0.0	1.4	0.0	0.6	1.6
Central government deficit (-) (excl. grants)	-5.7	-6.2	-6.7	-4.8	-4.5	-6.2
Float	-0.7	-1.7	1.8	2.2	0.0	0.0
Central government deficit (-), (excl. grants, cash basis)	-5.0	-4.5	-8.5	-7.1	-4.5	-6.2
Structural fiscal balance	-5.3	-4.5	-4.7	-4.1	-4.0	-3.8
General government debt	44.5	44.8	51.7	49.4	54.4	55.2

Sources: Tunisian authorities; and IMF staff estimates.

Measures for 2015 and Their Impact

	Full Year Impact in 2015 of Measures Taken in Mid-2014		New Measures for 2015	
	In millions of dinars	In percent of GDP	In millions of dinars	In percent of GDP
A. Tax revenue	239	0.3		
Direct Taxes	142	0.2		
Reduction disparity Corporate Tax + 10 percent on exports	21	0.0		
Distributed Profits (5 percent Taxation)	30	0.0		
Pressumptive Tax Reform	92	0.1		
Indirect Taxes	97	0.1		
Tobacco Excise (increase in rates of about 10-30 percent)	17	0.0		
Other (incl. Tourism tax)	80	0.1		
B. Energy subsidies	260	0.3	356	0.4
Electricity and gas	160	0.2	206	0.2
7 percent increase for Medium and Low voltage consumers by January			206	0.2
Fuel prices	100	0.1	150	0.2
Two increases of 3 percent by March and by September			150	0.2
Total	499	0.6	356	0.4

Sources: Tunisian authorities; and IMF staff estimates.

Box 1. Tunisia: The Near-Term Impact of Lower Oil Prices

The downward revisions in the WEO oil price baseline took place after the agreement of the program baseline scenario and the submission of the 2015 draft budget to Parliament (which assumes an average world oil price $95 per barrel). This Box assesses *the impact on the 2014-15 macroeconomic program of a $10 per barrel decline in international oil prices relative to the baseline (for 2015, this implies the WEO oil price average of $84 a barrel).*

The impact of lower oil prices on the 2014 program targets is limited. The decline in the last quarter of 2014 is already factored in the current account deficit under the program, which uses mostly actual data for the first three quarters of the year and accounts for import contracts already signed. On the fiscal side, the subsidy bill is expected to stay relatively constant as gains from lower oil prices are offsetting the impact of a weaker-than-originally programmed dinar. No immediate impact is expected on growth and inflation.

Tunisia: 2015 Impact of a Decrease in Oil Prices

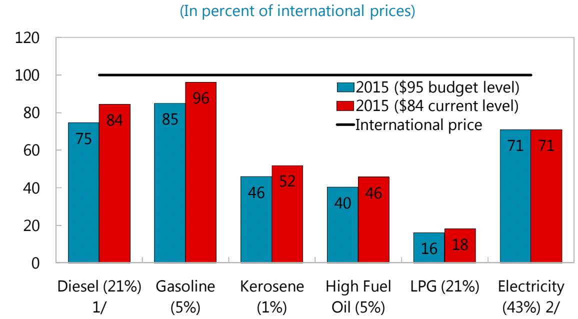
	Baseline	Scenario	Diff.
Growth (percent)	3.0	2.9	-0.1
Inflation (percent) 1/	5.0	5.0	0.0
Current account (percent of GDP)	-6.4	-6.2	0.2
Overall balance (percent of GDP)	-6.2	-5.7	-0.5
Energy subsidies	2.0	1.3	-0.7
Oil companies income tax and other revenues	2.2	2.0	0.2
Memo:			
End-2015 gross reserves (billions of US dollars)	10.1	10.2	0.1

Source: IMF staff estimates.
1/ CPI, average.

The positive impact in 2015 would be most felt in the second half of the year. The program baseline, which is consistent with the authorities' draft budget, assumed an average oil price of $95 per barrel. Since the authorities were expecting to lock in oil imports at $84 per barrel for the first half of 2015 through forward contracts (including contract costs for $2-3 per barrel), the impact of lower oil prices on the program baseline would be limited to the second half of 2015:

- **Growth** might suffer a marginal and short-lived decline due to the adverse impact on domestic oil producers (which account for about 2 percent of GDP).
- The **inflation** impact would be very small as domestic fuel prices are regulated and would not follow market fluctuations; a 10 percent decline in international prices (or even a more pronounced one) will not be sufficient to fully close the gap between international and domestic prices for most fuel products.
- The **current account deficit** would narrow further by about 0.2 percent of GDP, with most of that impact concentrated in the second half of the year, given forward contracts under consideration for the first six months of 2015. Gross reserves for 2015 would increase by $0.1 billion.
- The **fiscal deficit** will shrink by about 0.5 percent of GDP, as gains from lower subsidies (about 0.7 percent of GDP) would be partially offset by declining taxes from oil producing companies (about 0.2 percent of GDP). The authorities have agreed to save any gains from declines in oil prices.

Energy prices
(In percent of international prices)



Sources: Tunisian authorities; and IMF staff calculations.
1/ Between brackets: percentage of total subsidies under budget level.
2/ Electricity generation costs are not expected to be affected due to lags in the contracted gas price adjustments.

15. Additional domestic financing in 2014 will compensate for the postponement of international aid disbursements, which will constitute the bulk of financing for 2015. A tighter fiscal stance, domestic bond issuance, and use of readily available treasury balances are expected to replace lower disbursements from the IMF and World Bank, and no sukuk issuance in 2014. For 2015, the authorities plan to close the gap by tapping international markets, without resorting to sovereign guarantees, including through sukuk issuances. Official financing in 2015, particularly from the World Bank, would also depend on progress in restructuring public banks and passage of important laws necessary for private sector development. External and domestic financing is increasing public sector debt in 2014 to 49.4 percent of GDP and to 55.2 percent of GDP in 2015, but debt dynamics remain sustainable under most shocks (DSA annexes).

Tunisia: Official External Financing
(In millions of U.S. dollars)

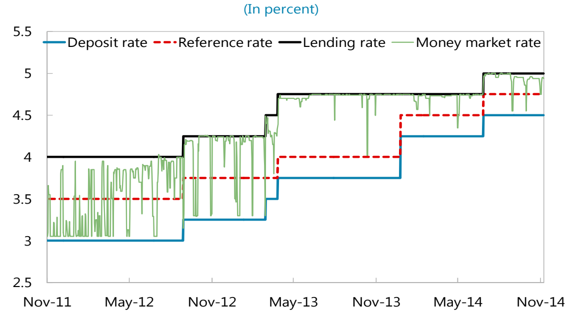
	2014				2015				
	Prog. 8/29/2014	Est.	S2-Prog. 8/29/2014	S2-Est.	Year	Q1	Q2	Q3	Q4
Total	4,046.1	3,058.3	2,963.1	2,057.7	2,821.0	1,223.3	511.5	504.7	581.6
Bilateral	300.0	300.0	100.0	100.0					
Algeria	100.0	100.0	100.0	100.0					
Turkey	200.0	200.0							
IFIs	2,455.0	1,479.9	1,724.1	748.3	1,895.4	957.1	338.4	200.0	400.0
AfDB					200.0			200.0	
AMF (Arab Monetary Fund)	43.5	41.5	43.5	41.5					
IMF (Budget support)	1,398.7	1,061.9	667.8	330.2	549.5	329.7	219.8		
World Bank Group	750.0	250.0	750.0	250.0	900.0	500.0			400.0
EU	262.8	126.5	262.8	126.5	245.9	127.4	118.6	0.0	0.0
Other	1,291.1	1,278.4	1,139.0	1,209.4	925.6	266.2	173.1	304.7	181.6
International market (US guarantee)	500.0	500.0	500.0	500.0					
International market (Japan guarantee)	300.0	463.7	300.0	463.7					
Project aid without donor breakdown	311.8	256.3	190.2	195.5	300.0	30.0	50.0	110.0	110.0
Sukuk and other market financing	120.0	0.0	120.0	0.0	565.6	226.2	113.1	169.7	56.6
Other (including Loan Transfers to SOEs)	59.3	58.4	28.8	50.2	60.0	10.0	10.0	25.0	15.0

Sources: Tunisian authorities; and IMF staff estimates.

Monetary policy—Containing inflation while improving the transmission mechanism

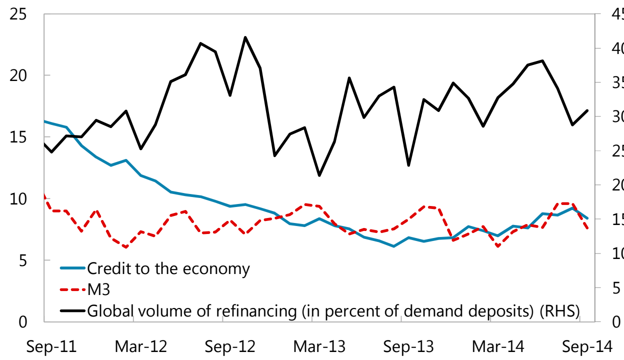
16. Additional increases in the policy rate are needed to contain inflationary pressures. A gradual tightening of monetary policy since December 2013 (a 75 basis point increase in the policy rate), coupled with a good harvest, have helped offset second-round effects from the July 2014 administered price increases. Staff urged the authorities to consider additional policy rate rises to keep core inflation stable and achieve positive real rates that would help stem depreciation pressures. This would also help align the money market rate—which consistently hovers at the upper bound of the interest rate corridor because of inefficient liquidity management—with the policy rate. The authorities reiterated that they stand ready to increase the policy rate further if core inflation or depreciation pressures rise (MEFP, ¶9-10). They agreed that real interest rates (currently at -0.5 percent) should be positive, but regard it as a longer term objective, because a negative output gap (-2 percent) continues to dampen inflation expectations. The effectiveness of the monetary policy transmission channel would also be strengthened by removing the cap on lending rates (MEFP, ¶13). The new governance and accountability provisions enshrined in the new draft central banking law (MEFP, ¶14) will strengthen the credibility of monetary policy.

Interest Rates
(In percent)



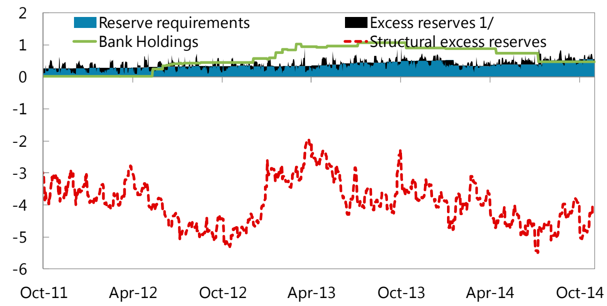
Source: Tunisian authorities.

M3 and Credit to the Economy, 2011–14
(Y-o-y growth, in percent, unless otherwise indicated)



Sources: Tunisian authorities; and IMF staff estimates.

Structural Liquidity Deficit of Banking System
(In billions of dinars)



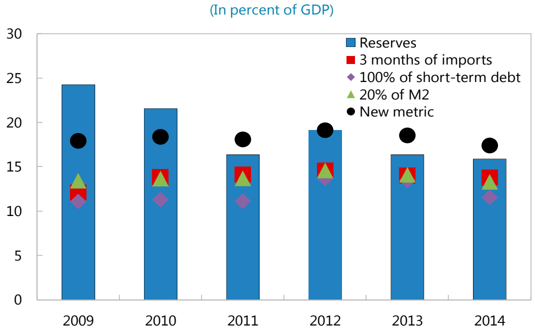
Sources: Tunisian authorities; and IMF staff estimates.
1/ This item captures spare liquidity arising from BCT injections, rather than proper excess reserves.

17. Banks' reliance on CBT refinancing has been reduced, but could rise because of delays in recapitalizing banks. Bond repayments, timely Treasury payments of public enterprises' bills, and tightened eligibility conditions on loan haircuts and collateral helped contain banks' direct recourse to CBT refinancing, which is still necessary to compensate for moderate deposit growth. However, to improve the conduct of monetary policy, staff urged the CBT to resume monthly Open Market Operations (OMO), which are necessary to ensure daily liquidity operations are not used to address structural liquidity issues. Staff noted that banks' liquidity needs could rise further if confidence is dampened by delays in recapitalizing and restructuring public banks, which would then have to be managed by the exceptional liquidity facility established in July as a precursor to the full-fledged lender-of-last-resort (LOLR) mechanism to be established by May 2015 (SB; MEFP, ¶11-12).

Exchange rate policy—Toward more flexibility

18. Reduced CBT interventions in the FX market helped preserve reserves (MEFP, ¶15). The authorities have limited FX sales to smooth excessive exchange rate fluctuations arising from large and lumpy energy imports. Staff agreed with this policy, but urged greater efforts to build reserves by taking advantage of periods of excess supply to buy FX in the market, particularly given delays in external official financing in the latter part of 2014. Both staff and the authorities agreed that the full operationalization of the interbank electronic platform and the market maker agreement (end-September SB) will contribute to making the exchange rate more flexible (Box 2). The overvaluation of the currency is currently estimated at about 5-10 percent.

External Reserve Adequacy
(In percent of GDP)



Sources: Tunisian authorities; and IMF staff estimates.

Exchange Rate Assessment Using CGER Panel Estimates
(In percent)

	Underlying CA balance 1/	CA norm	REER misalignment
MB approach 2/	-4.6	-1.8	9.1
ERER approach	...	...	2.2
ES approach	-4.6	-2.6	6.7

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.

Box 2. Tunisia Dinar: Toward More Flexibility

Tunisia's exchange rate has a "de jure" floating rate classification, but has "de facto" been operating as "crawl-like." Despite continued depreciation since 2012, fluctuations in Tunisia's nominal effective exchange rate remained within a narrow margin of 2 percent relative to the statistically identified trend, leading to a crawl-like classification for its arrangement.[1] Explanations for this are twofold: (i) the CBT continued to play a pivotal role in the foreign exchange market—with its interventions representing 40 percent of total FX transactions, mostly through sales averaging until recently about $400 million a month; and (ii) intervention amounts were not preannounced, with the volume dictated by daily market conditions—particularly, the payment of large energy bills. The "de facto" crawl-like arrangement persisted in 2013, even after the April 2012 introduction of the fixing arrangement (i.e., the average of market participants' quotes) to replace a "currency composite" as the reference rate published by the CBT, which helped stop the CBT from intervening as much as needed to keep the exchange rate within the boundaries of the indicative buying and selling rate.

Greater exchange rate flexibility has been observed over the past few months, but not on a sustained basis. Since March 2014, there was a move toward more flexibility as the exchange rate depreciated by 14 percent vis-à-vis the U.S. dollar and by 5 percent relative to the euro, with the CBT intervening in the FX market through bilateral transactions when market quotes deviated substantially from the daily fixing rate, with a view to smoothing excessive exchange rate fluctuations. The implementation of the market-maker agreement since September 2014 also improved market liquidity with interbank transactions increasing by 8 percent, thus helping minimize CBT interventions. The CBT reference rate now better reflects the market trends because quotes by banks are firm, and bids to the CBT might be rejected if the CBT considers that the resources are already available in the market or if banks' quotes deviate substantially from the reference rate. However, some stickiness remains in the market, as seen over the past month with the euro, mostly because the CBT remains focused on meeting fx needs on a bank-by-bank approach, instead of directly putting the market in competition for the resources. The weekly FX auction mechanism that is to be introduced by end-December 2014 will provide a better signal to the market through pre-announced FX interventions; price formation will improve because the CBT will trade on an aggregate basis and in a transparent manner, leading to more competitive bidding from banks and reduced CBT intervention.

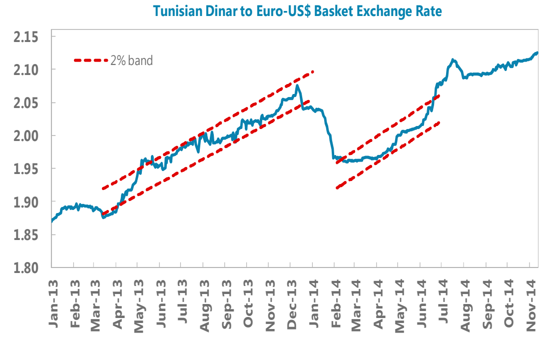
Daily market exchange rate statistics, period Jan-2012 to Nov-2014

Variable: $\Delta(\ln e_t)$ (+ = appreciation rate) 1/

	Before March 2014		Since March 2014	
	US$/TND	Euro/TND	US$/TND	Euro/TND
Mean	-0.009	-0.021	-0.088	-0.025
Std. Dev.	0.395	0.245	0.312	0.195
Skewness 2/	0.033	-0.244	-0.447	-0.861
Kurtosis 2/	0.908	2.269	2.658	5.772

1/ Refers to the interbank market exchange rate
2/ The skewness and kurtosis statistics are normalized

Tunisian Dinar to Euro-US$ Basket Exchange Rate



Source: IMF Staff Calculation.

[1] Usually, a minimum rate of change greater than allowed under a stabilized (peg-like) arrangement is required; however, an arrangement is considered crawl-like with an annualized rate of change of at least 1 percent, provided the exchange rate appreciates or depreciates in a sufficiently monotonic and continuous manner.

19. Ad-hoc import control measures to narrow the trade deficit should continue to be avoided. The authorities are considering special measures to control the trade deficit, but agreed with staff that a surcharge on imports is distortive and should only be introduced as a last resort and on a temporary basis (in line with WTO practices).

B. Laying the Foundations for Stronger, More Inclusive Growth

Reducing financial sector vulnerabilities (MEFP, ¶17-22)

20. The recapitalization of public banks has been delayed, requiring a further extension of regulatory forbearance until mid-2015. The authorities have not been able to implement recapitalization and restructuring plans in line with good international practices for the public banks that completed audits (STB, BH, and BNA) because they have lacked the legislative authority to use the recapitalization funds allocated in the 2014 budget, and because private shareholders have threatened to block bank recapitalization using their veto rights (the government and public enterprises own 51–64 percent of these banks' equity). As a result, out of the six banks still below the CAR, only the two private ones will be able to meet it by end-2014. For the three largest public banks (33 percent of banking assets), a period of regulatory forbearance will exist until no later than May 2015, with a waiver on the minimum capital requirement pending parliamentary approval of their recapitalization (a fourth small public bank—3 percent of assets—is under international litigation and a decision will be taken once a judgment has been issued). The authorities and staff agreed that the recapitalization should remain in line with good international practices (see MEFP, Annex I and ¶18), particularly to ensure that existing shareholders are not bailed out with public funds (Box 3). Staff stressed that the adequacy and comprehensiveness of the banks' restructuring and recapitalization plans on a consolidated basis will be essential to maintain confidence in the soundness of the banking system. Going forward, close monitoring of these plans will be needed.

21. Delays in recapitalization should not unduly postpone the operational bank restructuring. Building on the increased autonomy and accountability approved in the December 2013 governance decree, new "fit and proper" board members will be appointed by January 2015 (SB), new management will be named once a new government is in place, and performance contracts will be signed in March 2015 (SB). These performance contracts will be in line with the restructuring plans approved by the Board of Directors, but still contingent on the timing and modalities of the recapitalization plan. The fiscal impact of recapitalization could be larger than the 1.2 percent of GDP included in the 2014 budget, after allowing for operational restructuring costs, or if contingent costs linked to banks' subsidiaries are realized, or if losses linked to affiliated asset management companies materialize. In contrast to staff, the authorities argue that additional costs would have a limited budgetary impact, given the assets at banks' disposal and the expected participation of private sector shareholders in the recapitalization process.

Box 3. Banking Recapitalization: How Loss Allocation Prevents Bailouts

Sound financial governance requires that shareholders bear losses before new funds are injected to recapitalize a bank, thereby improving market discipline. In the case where the new funds are public, this prevents shareholder bail-out and limits moral hazard.

After losses have been recognized in its accounts—i.e. booked in negative retained earnings—a bank may need to be recapitalized, if only to comply with prudential requirements. If this requires the use of public funds, sound governance requires that the bank's capital be first written down up to the amount of negative retained earnings (through upfront loss allocation). It is only after this operation that the bank's capital can be viewed as a fair value of the institution in which the new shareholders can restart business. This entails a sequence of capital reduction and capital increases, commonly called *coup d'accordeon*.

The following example illustrates the different outcomes when losses are allocated upfront or not, where: Ci is initial capital before capital increase, L is recognized losses and Cn is new capital (the capital increase) needed to comply with prudential requirements.

(i) Upfront allocation of losses

- Capital is reduced to (Ci-L), then increased to (Ci-L+Cn), according to the *coup d'accordeon*:
  a. The existing shareholders, having been written down up to the amount of past losses, own (Ci–L)/(Ci-L+Cn) of the bank's capital.
  b. The new shareholders, by providing Cn, own Cn/(Ci –L+Cn) of the bank's capital.
- The new shareholders will not have to bear the past losses L and will fully benefit from the upside of their shares in the recapitalized bank.

(ii) No upfront allocation of losses

- Capital is increased to (Ci+Cn), with L posted as pending losses to be booked separately in negative retained earnings (potentially to be allocated later on):
  a. The existing shareholders own (Ci)/(Ci+Cn) of the bank's capital.
  b. The new shareholders, by providing Cn, own Cn/(Ci+Cn) of the bank's capital.
- All shareholders (existing and new ones) must still bear the losses L (not yet allocated), in proportion to their share in the recapitalized bank's capital.

22. **The creation of a fully operating Asset Management Company (AMC), which is an essential tool of the banking restructuring strategy, has been delayed further** (Box 4). The revised 2014 budget law envisaged the creation of the AMC (MEFP, ¶18). However, the law on the AMC, which is necessary to set up its legal and operational framework, is still pending parliamentary approval. Staff cautioned against a further deterioration in weak asset quality caused by further delays. It stressed that additional communication with stakeholders is needed to make a strong case that the AMC will address weak asset quality and revive the tourism sector, and is not a vehicle for confiscating assets or bailing out defaulted borrowers. Staff is encouraged by the authorities' decision to make the AMC law a priority in the next session of Parliament, and stressed the importance of avoiding any weakening in the AMC's loan resolution superpowers, governance framework, and transfer pricing standards.

Box 4. Asset Management Company (AMC): Structural, Organizational, and Operational Issues

Rationale. Loan workouts are part of normal banking business; but if the size of bad assets reaches systemic proportion, separate Asset Management Companies (AMCs) may be necessary. In Tunisia, 12 out of 22 banks have established individual AMCs as their subsidiaries to manage their nonperforming loans (NPLs). However, the length of the judicial proceedings, the obstacles to timely realization of collateral, and the difficulty of reaching out-of-court settlements have lengthened the average time period for recovering assets to more than 10 years. To get around these weaknesses, the authorities have been working for the past two years on a new bankruptcy law and on designing a state-owned and systemwide AMC endowed with the proper resolution and restructuring powers and managerial skills. Delays in setting up an AMC would jeopardize the cleanup of the banks' balance sheets, which bears on their profitability and, accordingly, affects their capacity to lend and support growth.

Creation of the AMC. The "2014 Revised Budget Law" created the AMC in August 2014 as a state-owned corporation with an initial capital of TD150 million, whose aim is to buy bad assets in exchange for government-guaranteed bonds. A draft law and operational decrees are needed to make the AMC fully operational. Key aspects include:

- **Appropriate resolution and restructuring powers**, which are needed to resolve obstacles to the judicial system, including controlling mechanisms to minimize abuses of power and arbitrariness. Moreover, it should be empowered to accelerate legal processes, to acquire legal title, to obtain approval for transferring real estate abroad, as well as to freeze bank accounts and stay collective actions. The exercise of such powers should not be prevented by the use of preemptive rights by the impaired debtors, which would foster moral hazard by enabling the impaired debtors to have part of the principal of their debt wiped out while keeping the upside in the underlying collateral.
- **The transfer of loans** has to be executed at fair market value, in order to prevent both artificial boosting of banks' capital (if transfer is priced above market value) and undue punitive resolution for banks (if transfer is priced below market value).
- **Proper calibration** of the funding policy, so that an appropriate balance between equity and debt ensures the company remains solvent.
- **Proper internal and external governance**—mainly through reliance on fit and proper project managers—is needed to assure operational independence, transparency, and accountability of the AMC.

Operationalization to the tourism sector. The AMC law envisages expanding the AMC to other asset types, but the immediate operationalization is expected in the tourism sector, which contributes to about 7 percent of GDP, employs 15 percent of Tunisia's workforce, and accounts for about 27 percent of the banking sector's NPLs. Tourism sector assets are also more suitable than others to centralized management because they are (i) large in size, including syndicated loans and loans to borrowers with multiple exposures to banks in the system; (ii) owed by corporate entities; and (ii) collateralized with (commercial) real estate.

23. Modifications to the banking resolution framework are key to a successful bank restructuring. A revised draft banking law, which benefitted from IMF and World Bank TA, is expected to be adopted by the new government when it comes into office and by Parliament by March 2015 (new SB). Staff urged the adoption of this law to provide the CBT with adequate bank restructuring and resolution powers, which will be complemented by the establishment of a proper LOLR framework and a Deposit Insurance Scheme.

24. Efforts to strengthen the regulatory and supervisory framework should be stepped up. Good progress is being made in introducing a uniform bank performance reporting system (end-December SB), and developing an in-house bank analysis and rating system. An important step has also been taken toward regulatory convergence with international norms through a new "forward-looking" liquidity ratio that will be implemented in January 2015 (MEFP,¶19). However, banking supervision is insufficiently risk-based, still on an unconsolidated basis, and remains hampered by a staffing shortage. The authorities agreed on the need for risk-based supervision and more staff, but pointed to delays from lengthy CBT human resource processes.

Growth-enhancing fiscal reforms—Moving from design to implementation

25. A more efficient tax system, stronger fiscal institutions, streamlined procedures, and better monitoring of public enterprises could enhance revenue, transparency, fairness and risk management (MEFP, ¶23-28):

- **Tax policy reforms should move more quickly.** National Tax Consultations held on November 12–13 marked the culmination of two years of technical work and consensus building on the reform of the tax system. Staff urged the authorities to finalize a comprehensive tax reform plan for making the system more transparent, efficient, and equitable. The plan should focus on further convergence between onshore and offshore tax rates, which should be specified according to a strict timeline (end-May SB), streamlining incentives and the number of VAT rates, and reforming excises. The consolidation of all tax provisions into a single code (end-September SB) is a good step toward greater transparency.

- **Tax administration reform has been progressing.** The tax agency powers were strengthened by: (i) removing bank secrecy provisions hampering tax collection; and (ii) enhancing cross-checking and tax verification of government suppliers. The move toward a unified tax administration is advancing at a slow pace, though unification of some tax functions has started and the authorities plan to create a category of "new tax collectors" (end-January SB) as a first move toward providing collection powers solely to the tax agency.

- **Public enterprise reform should be accelerated to reduce fiscal risks**. Staff urged the publication of the recently completed audit of energy companies, and the quick implementation of its recommendations. Monitoring of public enterprises will be strengthened by new performance contracts for the five largest companies and the design of a new strategy to monitor public enterprises (both end-April SB).

- **Public financial management reforms should be pursued more aggressively**. Staff welcomed the implementation of the new procurement law and decentralized project execution, which are expected to contribute to accelerating the implementation of investment projects. Streamlined budget procedures and greater transparency will result from the adoption of the organic budget law and double-entry accounting norms.

Growth-enhancing structural reforms—A need to accelerate the legislative process

26. Improvements in the business climate have been hampered by considerable delays in the legislative agenda (MEFP, ¶29-31). The authorities indicated that the National Constituent Assembly's focus on the electoral and anti-terrorism laws earlier this year did not allow a proper focus on economic legislation. The laws on competition, PPPs, and bankruptcy procedures—some of which have already been debated within parliamentary commissions—will be voted by the new Parliament and implemented in 2015, delaying further the reduction in the excessive regulation and government intervention that weigh on private sector development. Staff argued for quick action in revising the investment code that was withdrawn earlier this year from Parliament because it left too much room for discretion and was judged too complex by the authorities.

27. Labor market reforms should be tackled swiftly (MEFP, ¶32). The design and implementation of a comprehensive national employment strategy—aiming at reducing existing structural skills mismatches and labor market rigidities—is expected to be a top priority of the new government. Staff stressed that such a strategy should contain a clear roadmap.

28. The recently finalized assessment of the statistical system is welcome but needs to be acted upon quickly. Key priorities (MEFP, ¶33) include improving coordination among statistical bodies and the adoption of the Code of Conduct for Statistics.

C. Protecting the Most Vulnerable

29. Work on a new better-targeted social safety net is progressing (MEFP, ¶34). The recently completed evaluation of existing programs (vulnerable households, school allowances) shows fewer leakages to non-poor than previously estimated. Based on this information, and the introduction of a unique social identification number for 8.5 million Tunisians, a number of measures are being developed to allow the establishment of a new social safety net that should be in place to accompany the reduction in energy subsidies. Staff stressed that such a system should be introduced soon, and not be delayed until a unique social identification number is available to all.

30. The pension system is in urgent need of reform (MEFP, ¶35). The financial situation of the public sector retirement and social security fund (CNRPS) continues to deteriorate. Budget transfers—about 0.3 percent of GDP—are alleviating short-term cash needs to pay pensions. The authorities recognized the urgency of the situation, and identified increasing the retirement age among the key solutions that need to be discussed further with labor unions. In line with existing actuarial studies, staff also urged changes in contribution parameters and benefits to address the shortcomings of the underfunded pay-as-you go system.

D. Program Modalities

31. It is proposed that the purchases under the arrangement be rephased (Table 8). The fifth review took into account that the authorities' budget will bring about the programmed structural fiscal adjustment in 2015, while recognizing that recapitalizing public banks will take more time to materialize. To better align the program with the pace of reforms and performance to date, the authorities are requesting to rephase the remaining purchases under the arrangement. The purchases associated with the fifth review would be reduced by half, and the remainder of the scheduled purchases under the arrangement would become available subject to the completion of the sixth and seventh reviews (in light of delays in program implementation, the eighth review would be eliminated). The completion of the sixth Review will be contingent on parliamentary approval of the 2015 budget, sound public banks' recapitalization and restructuring plans, and a proper banking resolution framework. The seventh Review will cover end-March 2015 performance.

32. New conditionality continues to support program objectives. Staff is proposing a modification of end-December performance criteria (PCs) in light of the end-September outturn and new financing and fiscal projections. It also proposes to set new PCs and ITs for end-March 2015 as per the MEFP (Table 1). A number of delayed structural benchmarks (mostly in the banking sector and investment reform) have been reset to early 2015. New benchmarks on financial sector stability and fiscal sustainability have been introduced for 2015 (Table 2b).

33. The program is fully financed. Financing assurances have been provided by multilateral and bilateral partners for disbursements over the next 12 months; some of these are closely linked to progress on reforms that are part of the Fund-supported program. From the Fund, all resources scheduled to be disbursed for 2015 will continue to be used for budget support. Market issuance of about $600 million, including through sukuks—now that underlying assets have been identified—and Eurobonds without third-party guarantees, will cover remaining financing needs. If there are early indications that projected financing will not be received over the next six months, the authorities will consult with the Fund on alternative financing approaches and/or further policy adjustments.

34. Tunisia has the capacity to repay the Fund, but program risks remain significant. Tunisia has a strong record of payments to the Fund, and standard indicators of Fund exposure will remain low (Table 10). However, risks—notably delays in the formation of a new government, increasing social and security tensions, shortfalls in official and market financing, or further deterioration of the international economic environment—could jeopardize program objectives and erode repayment capacity. That said, program implementation risks are reduced by the government's reiterated commitment to the reform agenda, which is supported by a broad spectrum of political parties.

STAFF APPRAISAL

35. Tunisia is reaching the end of a successful three-year political transition while navigating a challenging environment. Tunisia's economy has been resilient in a context marked by high security and social tensions, slow growth in trading partners, and spillovers from regional conflicts. However, large external imbalances, high unemployment, and rising banking fragilities point to the need to forcefully move ahead with reform implementation—particularly on urgent bank recapitalization and restructuring.

36. Fiscal over-performance in 2014 continues to be overshadowed by inadequate budget composition. Preserving budget discipline by containing wages and subsidies is welcome while improved revenue collection needs to be sustained by relying on more permanent measures. The slow pace of capital and social spending in 2014 is regrettable, and the execution of the investment budget should be stepped up, including through strengthened procurement procedures, decentralized project execution, and better planning and prioritization.

37. The draft 2015 budget confirms the government's commitment to fiscal consolidation while preserving priority social spending. The declining deficit target is consistent with Tunisia's high external imbalances, financing constraints, and medium-term debt sustainability. Staff supports the envisaged energy subsidy reduction underlying the fiscal adjustment and the authorities' plans to save any net gains that would materialize from lower international oil prices. Planned increases in social and capital expenditures are welcome, especially in an environment of modest growth, and should be accompanied by better-targeted social safety nets and improvements in absorption capacity.

38. Medium-term fiscal consolidation should be accompanied by the implementation of growth-enhancing reforms. A unified tax administration will help enhance revenue collection. Staff welcomes the adoption of the new tax code, and urges the finalization of the tax reform strategy for a more transparent, efficient, and equitable system. Fiscal risk management would be improved by changes in public enterprises' governance framework and better monitoring. A stronger momentum is also needed in improving public financial management and pension reform.

39. Monetary policy should remain prudent. Staff welcomes the authorities' readiness to raise the policy rate if inflationary pressures increase, but urges moving quickly towards positive real interest rates so as to better anchor inflation expectations. Removing the cap on lending rates and the adoption of a central banking law would enhance the monetary policy framework.

40. Greater exchange rate flexibility is necessary to rebuild buffers and dampen rising external imbalances. Foreign exchange interventions should continue to be limited to smoothing large exchange rate fluctuations. Given Tunisia's vulnerabilities and heightened financing risks, reserve accumulation should be accelerated through foreign exchange purchases when feasible. Ad-hoc import control measures to narrow external imbalances should continue to be avoided.

41. Recapitalizing and restructuring public banks in line with good international practices is urgent in view of mounting risks to financial stability. The recapitalization should be complemented by bank restructuring plans that include early changes in the governance framework, the establishment of a proper AMC, and modifications of the banking resolution framework. Efforts to upgrade and strengthen the regulatory and supervision framework should be stepped up considerably.

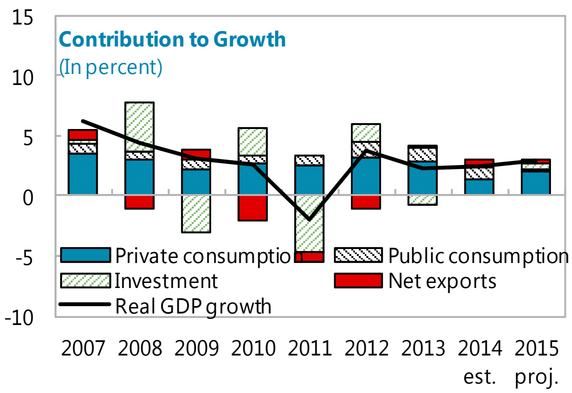
42. Progress in structural reforms should be accelerated. Staff regrets continued delays in adopting legislation crucial to fostering private sector development and providing a level playing field to investors. It welcomes the authorities' commitment to push the law on competition, investment code, bankruptcy, and public-private partnerships as key government priorities for the new Parliament's agenda.

43. Risks are high. Spillovers from regional unrest, further deterioration in the international economic environment, and delays in establishing a government remain the most important risks to program implementation. Moving forward with the reform agenda is essential to address vulnerabilities in Tunisia's economy and to ensure donor and market financing materializes.

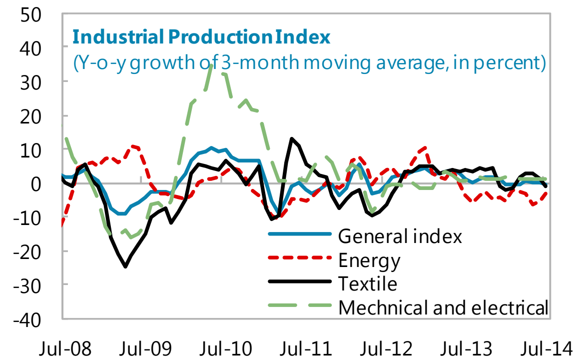
44. On the basis of Tunisia's performance under the SBA, and the government's forward-looking commitments, staff supports the completion of the fifth Review. Staff supports: (i) rephasing of access that allows better program alignment with the pace of reforms, particularly on the banking sector; and (ii) modification of end-December QPCs and the setting of end-March QPCs.

Figure 1. Tunisia: Recent Economic Developments, 2007–15

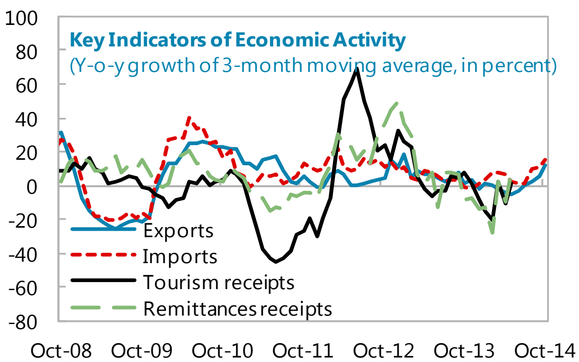
Growth continues to be moderate, driven mostly by private consumption while investment is recovering from the sharp drop in 2011



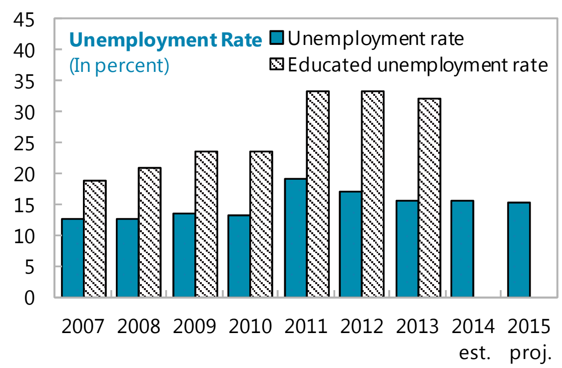
Industrial production has recovered in Q1-2014 but is still weak, driven mostly by textile production, while energy production has declined.



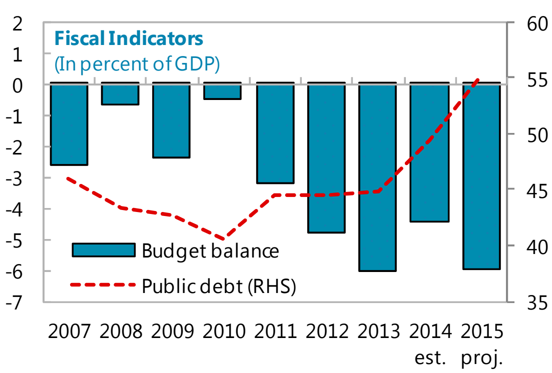
Imports are increasing, and exports have picked up in recent months.



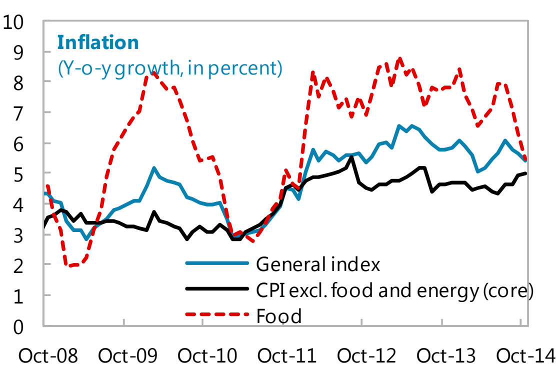
Unemployment has started to subside on the back of public sector hiring but remains high, particularly among university graduates.



Budget execution is estimated to over-perform in 2014 benefitting from low capital and no bank recapitalization spending



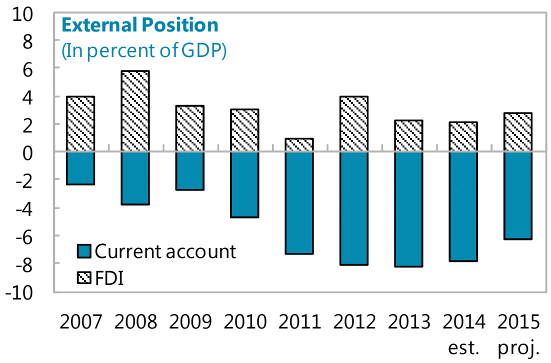
Inflation is subsiding due to lower food prices while core inflation is increasing slightly.



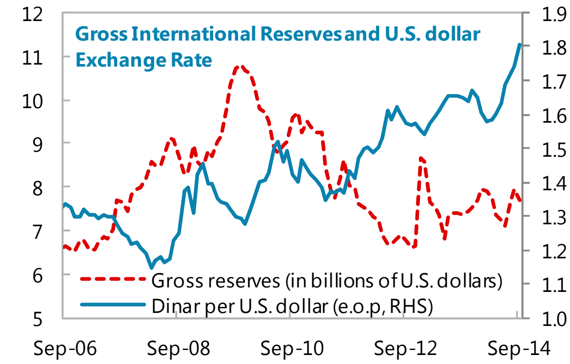
Sources: Tunisian authorities; and IMF staff calculations.

Figure 2. Tunisia: External and Financial Indicators, 2007–15

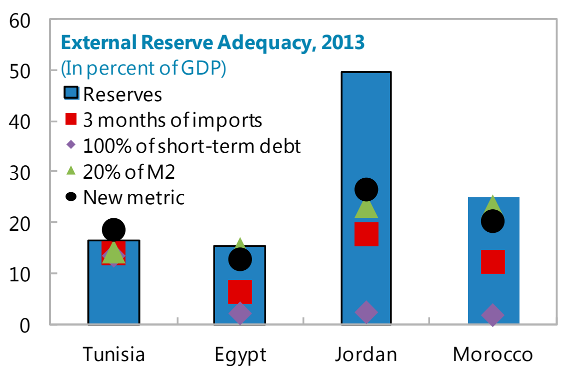
The current account deficit remains high and FDI flows weak but expected to improve in 2015.



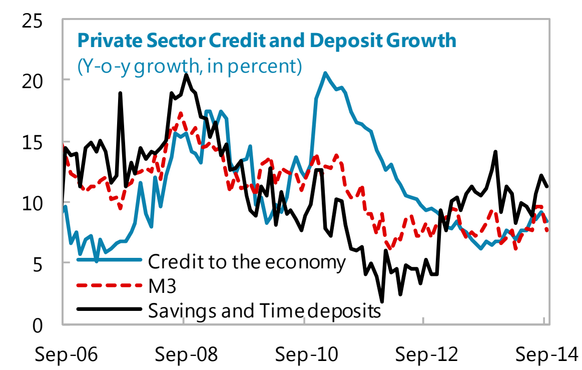
Reduced intervention in the FX market stabilized international reserves while the exchange has been depreciating.



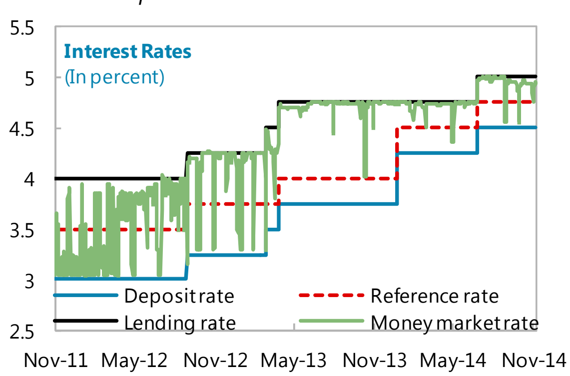
Reserve levels remain below the new metric.



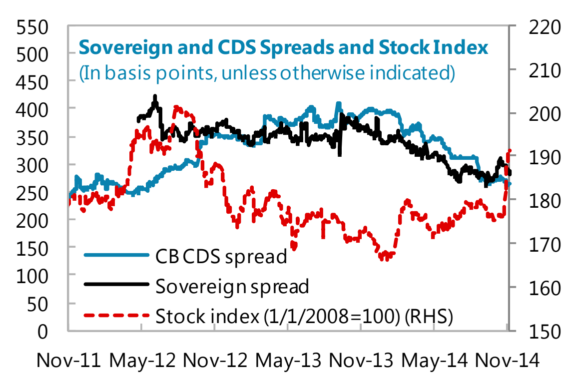
Credit to the economy is recovering as well as deposits.



The Central Bank policy rate remained stable after the last increase to 4.75 percent in June.



After the elections, sovereign spreads have decreased slightly while the stock index has been on the rise.



Sources: Tunisian authorities; International Financial Statistics; Markit; Bloomberg; and IMF staff calculations.

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

	2010	2011	2012	2013	2014		2015	
				Prel.	Prog. 08/29/14	Proj.	Prog. 08/29/14	Proj.
Production and income (percent change)								
Real GDP	2.6	-1.9	3.7	2.3	2.8	2.4	4.0	3.0
GDP deflator	4.3	4.6	5.3	5.7	5.7	5.7	4.8	4.8
Consumer price index (CPI), average	4.4	3.5	5.6	6.1	5.7	5.6	5.0	5.0
Consumer price index (CPI), end of period	4.0	4.2	5.9	6.0	5.5	5.5	4.5	4.5
Gross national savings (in percent of GDP)	20.9	16.2	16.1	13.7	12.9	12.7	14.5	14.2
Gross investment (in percent of GDP)	25.7	23.6	24.3	22.0	20.6	20.6	21.1	20.6
Central government (percent of GDP, unless indicated otherwise 1/								
Total revenue (excluding grants)	23.4	24.5	23.1	23.6	23.5	23.9	23.5	23.6
Total expenditure and net lending	24.0	28.0	28.8	29.8	30.3	28.8	28.0	29.8
Central government balance (excluding grants)	-0.6	-3.5	-5.7	-6.2	-6.7	-4.8	-4.5	-6.2
Central government balance (excluding grants, cash basis)	1.6	-2.8	-5.0	-4.5	-8.5	-7.1	-4.5	-6.2
Structural fiscal balance 2/	-1.1	-3.0	-5.3	-4.5	-4.7	-4.1	-4.0	-3.8
Central government debt (foreign and domestic)	40.7	44.5	44.5	44.8	51.7	49.4	54.4	55.2
Foreign currency public debt (percent of total debt)	60.7	58.0	62.8	64.3	69.1	68.3	69.1	68.3
Total external debt								
External debt (US$ billions)	21.4	22.1	24.3	25.4	28.2	26.6	30.7	29.8
External debt (in percent of GDP)	48.5	48.0	53.8	54.0	57.3	54.4	61.2	60.6
Debt service ratio (percent of exports of GNFS)	10.5	11.9	12.0	9.5	9.2	9.2	6.8	7.1
Money and credit (percent change)								
Credit to the economy	19.6	13.4	8.8	6.8	6.7	7.2	8.3	6.9
Broad money (M3 of the financial system)	12.1	9.1	8.4	6.6	10.2	8.7	10.0	10.5
Velocity of circulation (GDP/M2)	1.54	1.45	1.46	1.48	1.46	1.47	1.44	1.44
External sector (percent change)								
Exports of goods, f.o.b. (in $)	14.0	8.5	-4.6	0.3	2.0	1.1	4.5	3.9
Imports of goods, f.o.b. (in $)	15.9	7.7	2.1	-0.5	3.2	2.3	2.5	0.9
Exports of goods, f.o.b. (volume)	6.8	-0.4	1.4	3.3	2.1	2.3	5.2	4.6
Import of goods, f.o.b. (volume)	-1.8	3.7	8.5	5.1	2.3	2.6	4.6	3.1
Trade balance (in percent of GDP)	-10.4	-10.4	-13.5	-12.6	-12.9	-12.9	-12.2	-11.8
Current account (in percent of GDP)	-4.8	-7.4	-8.2	-8.3	-7.6	-7.9	-6.6	-6.4
Foreign direct investment (in percent of GDP)	3.0	0.9	3.9	2.2	2.1	2.1	2.7	2.8
Terms of trade (deterioration -)	-9.6	4.9	-0.1	2.6	-0.4	0.2	1.2	0.9
Official reserves								
Gross official reserves (US$ billions, e.o.p)	9.5	7.5	8.7	7.7	9.1	7.8	10.0	10.1
In months of next year's imports of goods and services, c.i.f.	4.4	3.4	3.9	3.4	3.9	3.4	4.2	4.4
Memorandum items:								
GDP at current prices (TD millions)	63,059	64,690	70,658	76,350	82,966	82,643	90,435	89,217
GDP at current prices (US$ billions)	44.1	46.0	45.2	47.0	49.2	48.9	50.2	49.3
Population (millions)	10.5	10.7	10.8	10.9	11.0	11.0	11.1	11.1
GDP per capita (US$)	4,177	4,305	4,198	4,317	4,472	4,442	4,522	4,436
Unemployment rate (in percent)	13.0	18.9	16.7	15.3	15.3	15.3	15.0	15.0
Exchange rate: dinar/US$ (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	4.8	...	...	...	...
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	Est. 2014 Q1	Est. 2014 Q2	Est. 2014 Q3	Projections 2014 Q4	Projections 2014 Prog. Annual 08/29/14	Projections 2014 Annual	Projections 2015 Q1	Projections 2015 Annual
Current account	-2,105	-3,401	-3,706	-3,904	-1,417	-1,295	-814	-341	-3,760	-3,866	-1,016	-3,132
Trade balance	-4,575	-4,799	-6,105	-5,937	-1,704	-1,728	-1,710	-1,144	-6,333	-6,285	-1,329	-5,832
Exports	16,431	17,824	16,997	17,050	4,278	4,295	3,887	4,775	17,397	17,236	4,726	17,903
Energy	2,315	2,592	2,849	2,591	621	539	532	667	2,485	2,360	647	2,259
Non-energy	14,116	15,231	14,147	14,459	3,656	3,756	3,355	4,108	14,913	14,876	4,079	15,644
Of which: Nonfood	-12824	-13896	-12497	-12772	3329	3390	2941	3381	-13038	-13040	3494	-13710
Imports	-21,006	-22,623	-23,102	-22,987	-5,981	-6,023	-5,597	-5,919	-23,730	-23,521	-6054	-23,735
Energy	-2,653	-3,409	-4,100	-4,172	-1,169	-1,083	-1,104	-1,303	-4,905	-4,658	-1,113	-4,604
Non-energy	-18,353	-19,214	-19,001	-18,815	-4,812	-4,940	-4,493	-4,617	-18,825	-18,862	-4,941	-19,131
Of which: Nonfood	-16,810	-17,339	-17,513	-16,633	-4,539	-4,894	-4,268	-4,312	-16,561	-18,013	-4,371	-17,174
Services and transfers (net)	2,470	1,398	2,399	2,033	287	433	896	802	2,573	2,419	312	2,700
Nonfactor	2,460	1,552	1,946	1,683	162	283	671	630	1,900	1,747	418	2,095
Of which: Tourism	2,461	1,680	2,031	1,988	340	471	742	536	2,110	2,089	273	2,309
Factor Services and Transfers (net)	10	-154	453	350	125	150	225	172	672	672	-105	605
Of which: Workers' remittances	2,063	1,990	2,235	2,291	523	552	788	541	2,410	2,403	393	2,424
Interest payments on external debt	-632	-653	-618	-571	-117	-167	-133	-145	-565	-561	-139	-534
Capital and financial account	1,343	1,309	4,866	2,802	1,110	222	1,126	468	3,679	2,926	1,369	4,844
Excluding grants	1,252	1,142	4,412	2,548	1,097	210	1,041	355	3,455	2,703	1,358	4,635
Capital account	82	154	442	247	12	10	83	112	218	217	11	202
Financial account	1,260	1,155	4,424	2,554	1,098	213	1,043	356	3,461	2,709	1,358	4,641
Direct foreign investment (net)	1,309	417	1,772	1,029	191	202	263	365	1,024	1,021	145	1,363
Medium- and long-term loans (net)	145	652	1,623	830	128	-209	814	396	1,745	1,129	782	2,393
Disbursement	1,845	2,707	3,682	2,351	348	151	1,022	1,118	3,259	2,639	1,015	3,517
Of which: Private	1,048	929	502	800	125	121	114	232	593	591	104	552
Amortization	-1,700	-2,055	-2,059	-1,521	-220	-360	-208	-722	-1,514	-1,510	-233	-1,124
Short-term capital	-193	85	1,232	872	802	234	-16	-287	866	733	545	1,049
Errors and omissions 1/	-316	108	-31	-13	-158	246	1	-131	92	-42	-249	35
Overall balance	-1,078	-1,984	1,130	-1,115	-465	-826	313	-4	11	-982	103	1,747
Reserve liabilities (Fund credits)	0	0	0	150	506	223	220	110	1399	1059	330	549
Changes in gross reserves	1078	1984	-1130	965	-41	603	-533	-106	-1410	-77	-433	-2296
Memorandum items:												
Current account balance/GDP (percent)	-4.8	-7.4	-8.2	-8.3	-2.7	-2.6	-1.7	-0.8	-7.6	-7.9	-2.1	-6.4
Reserves (in billions of US$)	9.5	7.5	8.7	7.7	7.7	7.1	7.7	7.8	9.1	7.8	8.2	10.1
Reserves in months of imports of goods 2/	4.8	3.7	4.3	3.7	3.9	3.6	3.9	3.7	4.2	3.7	4.3	4.7
Reserves in months of imports of goods and services 2/	4.4	3.4	3.9	3.4	3.5	3.3	3.5	3.4	3.9	3.4	3.9	4.4
Reserves/total short term external debt (percent) 3/	191.3	147.2	139.7	121.6	140.5	126.0	132.0	136.2	157.7	137.7	170.2	170.2
Excluding nonresidents deposits	402.5	308.8	265.3	252.3	291.5	261.6	274.0	282.6	600.4	526.4	651.0	651.0
Reserves/short-term debt (on remaining maturity)	142.7	106.9	104.7	98.3	120.9	100.9	115.7	92.3	126.4	110.3	144.7	144.7
External debt service (in percent of exports of goods and non	234.5	172.4	162.2	169.1	218.1	172.3	212.0	142.2	309.1	270.2	270.2	389.0
External medium- and long-term debt (billions of US$)	16.4	16.9	18.1	19.1	19.8	19.7	20.5	21.0	22.4	21.0	21.0	23.9
External medium- and long-term debt/GDP (percent)	37.2	36.9	40.1	40.6	37.4	39.7	43.9	45.7	45.6	42.9	46.3	48.6
External short-term debt (billions of US$)	5.0	5.1	6.2	6.3	5.5	5.7	5.8	5.7	5.8	5.6	5.6	5.9
External short-term debt/GDP (percent)	11.3	11.1	13.7	13.5	10.4	11.4	12.4	12.4	11.7	11.5	12.5	12.0
Debt service ratio (as percent XGS, including IMF)	10.5	11.9	12.0	13.4	6.3	9.6	6.3	14.1	8.2	8.2	9.2	6.4
Goods export real growth (percent)	6.8	-0.4	1.4	3.3	1.0	-4.3	-5.3	-4.0	2.1	2.3	0.3	4.6
Non-energy	9.2	2.3	1.0	2.8	-14.4	-3.7	-3.9	0.0	2.9	3.1	-19.0	5.7
Goods import real growth (percent)	-1.8	3.7	8.5	5.1	9.7	3.4	3.6	3.6	2.3	2.6	3.5	3.1
Non-energy	-2.0	4.4	7.3	5.2	3.7	3.5	-12.1	7.1	0.6	0.9	1.9	3.1

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

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

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

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

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

	2010	2011	2012	Prel. 2013	Est. 2014 Q1	Est. 2014 Q2	Est. 2014 Q3	Projections 2014 Q4	Projections 2014 Year	Projections 2015 Q1	Projections 2015 Year
Total financing requirements	9,226	10,551	10,270	10,728	6,413	6,928	6,866	6,373	10,559	7,251	9,350
Current account deficit - Capital transfers	2,022	3,247	3,264	3,656	1,404	1,285	731	229	3,649	1,006	2,929
Current account deficit	2,105	3,401	3,706	3,904	1,417	1,295	814	341	3,866	1,016	3,132
Capital account	82	154	442	247	12	10	83	112	217	11	202
Amortizations	6,887	7,412	6,975	7,059	4,850	5,890	6,136	6,012	6,868	5,996	6,455
General government	1,017	1,419	1,233	1,023	120	197	110	178	991	922	674
Banks	48	45	59	35	7	12	7	11	37	6	32
Corporate 1/	5,822	5,948	5,683	6,000	4,723	5,681	6,019	5,824	5,840	5,068	5,750
Short-term debt	5,187	5,357	4,916	5,538	4,630	5,530	5,928	5,685	5,358	4,984	5,332
Long-term debt	635	591	767	463	93	151	91	139	482	84	418
Net errors and omissions	316	-108	31	13	158	-246	-1	131	42	249	-35
Total financing sources	9,226	10,551	10,270	10,578	5,906	6,705	6,646	6,262	9,500	6,922	8,800.6
FDI (net)	1,309	417	1,772	1,029	191	202	263	365	1,021	145	1,363
Disbursments (debt)	6,791	8,555	10,037	8,905	6,183	6,043	6,931	6,151	8,710	6,693	9,912
General government	798	1,778	3,180	1,551	223	30	908	795	2,048	1,905	2,964
Banks	74	66	36	57	9	9	8	16	42	8	39
Corporate 1/	5,919	6,711	6,821	7,297	5,951	6,005	6,014	5,340	6,620	4,781	6,908
Short-term debt	4,946	5,848	6,355	6,554	5,835	5,892	5,909	5,138	6,071	4,679	6,395
Long-term debt	973	863	466	743	116	112	106	203	549	102	513
Other portfolio flows net (Including Drawdown in commercial banks NFA)	48	-406	-409	-320	-426	-143	-15	-148	-154	516	-179
Drawdown in gross reserves	1,078	1,984	-1,130	965	-41	603	-533	-106	-77	-433	-2,296
Financing gap	0	0	0	150	506	223	220	110	1,059	330	549
Fund credits 2/	0	0	0	150	506	223	220	110	1,059	330	549
Purchases	0	0	0	150	506	223	220	110	1,059	330	549
Repurchase	0	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	7,730	7,127	7,660	7,766	7,766	8,200	10,063
In percent of short-term debt at remaining maturity	142.7	106.9	104.7	98.3	120.9	100.9	115.7	92.3	110.3	144.7	144.7
Government rollover rates (in percent)	78	125	258	152	186	15	824	448	207	207	440
Banks rollover rates (in percent)	153	146	61	161	124	74	116	146	114	122	123
Corporate rollover rates (in percent)	102	113	120	122	126	106	100	92	113	94	120

Sources: Tunisian authorities; and IMF staff projections.

1/ Includes public and private entreprises.

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		
			Prog. Annual 08/29/14	S1 Act.	Q3 Act./Est.	Q4 Est.	Annual Est.	Prog. Annual 08/29/14	Q1 Proj.	Annual Proj.
Total revenue and grants	16,939	18,150	19,829	9,882	4,802	5,388	20,072	21,576	5,367	21,265
Revenue	16,310	18,039	19,531	9,881	4,674	5,220	19,774	21,263	5,366	21,054
Tax revenue	14,864	16,333	18,490	9,111	4,458	5,164	18,733	19,942	4,999	19,820
Nontax revenue	1,446	1,657	1,037	768	214	55	1,037	1,311	366	1,230
Capital income	0	49	4	2	1	1	4	10	1	4
Grants	629	110	298	1	128	169	298	313	1	211
Total expenditure and net lending	20,344	22,746	25,128	9,550	5,884	8,342	23,776	25,292	5,955	26,595
Total expenditure	20,694	22,747	23,828	9,635	5,804	8,188	23,626	24,692	5,955	25,175
Current expenditure	16,003	19,023	19,508	8,513	4,538	6,615	19,666	19,356	5,286	20,475
Wages and salaries	8,624	9,572	10,465	5,348	2,460	2,657	10,465	11,195	2,957	11,157
Goods and services	1,167	1,200	1,420	513	122	942	1,577	1,357	400	1,598
Interest payments	1,272	1,411	1,475	768	373	334	1,475	1,474	426	1,705
Transfers and subsidies	4,940	5,959	5,959	1,884	1,436	2,639	5,959	5,139	1,461	5,843
CGC (Food)	1,242	1,450	1,497	627	337	533	1,497	1,484	375	1,500
Energy subsidies	2,111	2,854	2,353	400	744	1,209	2,353	1,394	457	1,826
Other (including transfer to CNRPS)	1,587	1,655	2,109	857	355	897	2,109	2,261	629	2,517
Other expenditure (non-allocated)	0	880	190	0	147	43	190	190	43	172
Of which: repayment of arrears 2/	0	880	...	...	...	...	...	0	...	0
Of which: elections and other political institutions			120	0	48	72	120		72	100
Capital expenditure	4,692	3,725	4,320	1,122	1,266	1,573	3,960	5,336	669	4,700
Net lending	-351	-1	1,300	-85	81	154	150	600	0	1,420
Of which: public banks' recap. and restr. + AMC operat.costs	41	0	1,150	0	0	0	0	500	0	1,450
Central government deficit (-) (excluding grants)	-4,033	-4,707	-5,597	331	-1,211	-3,122	-4,002	-4,028	-588	-5,541
Central government deficit (-) (including grants)	-3,404	-4,596	-5,299	332	-1,082	-2,954	-3,704	-3,715	-588	-5,331
Float	-505	-1,264	1,465	2,647	0	-800	1,847	0	1,000	0
Central government deficit (-) (excluding grants, cash basis)	-3,529	-3,443	-7,062	-2,316	-1,211	-2,322	-5,849	-4,028	-1,588	-5,541
Central government deficit (-) (including grants, cash basis)	-2,899	-3,333	-6,764	-2,315	-1,082	-2,154	-5,551	-3,715	-1,588	-5,331
Financing	2,899	3,333	6,764	2,315	1,082	2,154	5,551	3,715	1,588	5,331
Foreign	2,524	-605	5,775	1,076	1,814	1,278	4,167	2,990	2,031	4,147
Drawings	4,450	1,057	6,825	1,591	1,988	1,659	5,237	4,100	2,245	5,367
Amortization	1,926	1,662	1,050	516	174	381	1,070	1,110	214	1,220
Domestic	-18	3,459	689	1,240	-732	776	1,284	525	-444	984
Drawings	1,582	1,843	2,213	2,245	147	446	2,837	2,065	986	2,065
Amortization	925	1,333	2,150	976	1,001	153	2,130	2,136	898	2,205
Government Deposits (+ = drawing / - = accumulation)	-675	2,948	-374	-29	122	484	577	96	-532	24
Banks recapitalization	0	0	1,000	0	0	0	0	500	0	1,100
Privatization proceeds 3/	394	479	300	0	0	100	100	200	0	200
Financing gap	0	0	0	0	0	0	0	0	0	0
Memorandum items:										
Central government primary balance (excluding grants, cash basis)	-2,256	-2,032	-5,587	-1,549	-837	-1,988	-4,374	-2,554	-1,162	-3,836
Cyclically adjusted fiscal balance	-3,774	-4,337	-5,059	...	...	...	-3,386	-3,587	...	-4,835
Structural fiscal balance	-3,733	-3,457	-3,909	...	...	...	-3,386	-3,587	...	-3,385
Central government debt 4/	31,446	34,238	42,903	...	...	...	40,785	49,230	...	49,218
Nominal GDP	70,658	76,350	82,966	41,892	20,946	20,946	82,643	90,435	22,304	89,217

Sources: Tunisian authorities; and IMF staff estimates.

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

2/ Payment of Arrears on energy subsidies accumulated in 2012.

3/ Mostly includes sale of confiscated assets.

4/ Gross debt.

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

(In percent of GDP)

	2012	2013	2014		2015		
		Prel.	Prog. 08/29/14	Est.	Prog. 08/29/14	Proj. Annual	Q1
Total revenue and grants	24.0	23.8	23.9	24.3	23.9	23.8	6.0
Revenue	23.1	23.6	23.5	23.9	23.5	23.6	6.0
Tax revenue	21.0	21.4	22.3	22.7	22.1	22.2	5.6
Nontax revenue	2.0	2.2	1.2	1.3	1.4	1.4	0.4
Grants	0.9	0.1	0.4	0.4	0.3	0.2	0.0
Total expenditure and net lending	28.8	29.8	30.3	28.8	28.0	29.8	6.7
Total expenditure	29.3	29.8	28.7	28.6	27.3	28.2	6.7
Current expenditure	22.6	24.9	23.5	23.8	21.4	22.9	5.9
Wages and salaries	12.2	12.5	12.6	12.7	12.4	12.5	3.3
Goods and services	1.7	1.6	1.7	1.9	1.5	1.8	0.4
Interest payments	1.8	1.8	1.8	1.8	1.6	1.9	0.5
Transfers and subsidies	7.0	7.8	7.2	7.2	5.7	6.5	1.6
CGC	1.8	1.9	1.8	1.8	1.6	1.7	0.4
Energy subsidies	3.0	3.7	2.8	2.8	1.5	2.0	0.5
Other (including transfer to CNRPS)	2.2	2.2	2.5	2.6	2.5	2.8	0.7
Other expenditure (non-allocated)	0.0	1.2	0.2	0.2	0.2	0.2	0.0
Of which: repayment of arrears 2/	0.0	1.2	0.0	0.0	0.0	0.0	0.0
Capital expenditure	6.6	4.9	5.2	4.8	5.9	5.3	0.7
Net lending	-0.5	0.0	1.6	0.2	0.7	1.6	0.0
Of which: public banks' recap. and restr. + AMC operating.costs	0.1	0.0	1.4	0.0	0.6	1.6	0.0
Central government deficit (-) (excluding grants)	-5.7	-6.2	-6.7	-4.8	-4.5	-6.2	-0.7
Central government deficit (-), (including grants)	-4.8	-6.0	-6.4	-4.5	-4.1	-6.0	-0.7
Float	-0.7	-1.7 ...	1.8	2.2	0.0	0.0	1.1
Central government deficit (-), (excluding grants, cash basis)	-5.0	-4.5	-8.5	-7.1	-4.5	-6.2	-1.8
Central government deficit (-), (including grants, cash basis)	-4.1	-4.4	-8.2	-6.7	-4.1	-6.0	-1.8
Financing	4.1	4.4	8.2	6.7	4.1	6.0	1.8
Foreign	3.6	-0.8	7.0	5.0	3.3	4.6	2.3
Domestic	0.0	4.5	0.8	1.6	0.6	1.1	-0.5
Privatization proceeds 3/	0.6	0.6	0.4	0.1	0.2	0.2	0.0
Memorandum items:							
Central government primary balance (excluding grants, cash basis)	-3.2	-2.7	-6.7	-5.3	-2.8	-4.3	-1.3
Structural fiscal balance	-5.3	-4.5	-4.7	-4.1	-4.0	-3.8	...
Central government debt 4/	44.5	44.8	51.7	49.4	54.4	55.2	...

Sources: Tunisian authorities; and IMF staff estimates.

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

2/ Payment of Arrears on energy subsidies accumulated in 2012.

4/ It includes mostly sale of confiscated assets.

4/ Gross debt.

Table 5. Tunisia: Monetary Survey (Financial System), 2010–15
(In millions of dinars)

				Prel.				Proj.		
	2010	2011	2012	2013	*1Q 14*	*2Q 14*	*3Q 14*	2014	*1Q 15*	2015
					(In millions of dinars)					
Net foreign assets (NFA)	9,078	5,749	7,054	3,865	2,375	1,648	2,799	2,432	3,050	5,962
Foreign assets	16,023	12,893	15,410	15,027	14,530	14,831	16,631	16,790	17,837	22,467
Central bank	13,705	11,315	13,455	12,701	12,265	12,060	13,929	14,224	15,302	19,710
Foreign liabilities	-6,946	-7,143	-8,357	-11,162	-12,155	-13,183	-13,831	-14,358	-14,787	-16,505
Central bank	-623	-782	-1,134	-3,004	-3,650	-4,296	-4,809	-5,361	-5,899	-6,836
Net domestic assets (NDA)	34,190	41,454	44,114	50,684	53,196	54,585	55,170	56,884	57,167	59,576
Domestic credit	46,370	53,577	58,022	65,660	68,513	71,357	72,644	74,342	74,093	80,816
Credit to the government (net)	3,227	4,659	4,791	8,794	10,510	11,618	11,918	13,368	13,756	15,610
Central bank net credit	-3,250	-3,355	-3,461	-175	574	835	1,065	1,940	1,607	2,369
Commercial banks	2,937	3,568	3,686	4,111	4,746	5,329	5,294	5,534	6,288	6,928
Other	4,189	4,447	5,265	4,858	5,190	5,454	5,559	5,894	5,862	6,312
Credit to the economy	43,144	48,918	53,231	56,866	58,003	59,739	60,726	60,974	60,336	65,206
Other items (net)	-12,181	-12,123	-13,908	-14,976	-15,316	-16,772	-17,474	-17,458	-16,925	-21,239
Money plus quasi-money (M2)	40,854	44,652	48,327	51,686	52,726	53,385	55,181	56,753	57,056	62,099
Money (M1)	15,862	19,007	20,007	20,877	21,391	21,835	22,512	22,924	23,148	25,083
Currency	5,518	6,814	6,559	7,236	7,219	7,459	8,110	7,945	7,812	8,693
Demand deposits	10,344	12,192	13,448	13,641	14,172	14,376	14,402	14,979	15,336	16,390
Quasi-money	24,992	25,646	28,320	30,809	31,335	31,550	32,669	33,829	33,908	37,016
Long-term deposits (M3-M2)	2,414	2,551	2,841	2,863	2,845	2,848	2,789	2,562	3,161	3,440
Broad money (M3)	43,267	47,203	51,168	54,549	55,572	56,233	57,969	59,315	60,217	65,539
					(Annual rate of change in percent)					
Net foreign assets	-5.7	-36.7	22.7	-45.2	-60.8	-65.4	-38.0	-37.1	28.4	145.2
Net domestic assets	18.1	21.2	6.4	14.9	14.8	15.0	11.8	12.2	7.5	4.7
Domestic credit	16.8	15.5	8.3	13.2	13.7	15.7	13.5	13.2	8.1	8.7
Credit to government (net)	-11.4	44.4	2.8	83.5	74.1	72.5	48.8	52.0	30.9	16.8
Credit to the economy	19.6	13.4	8.8	6.8	7.0	8.8	8.4	7.2	4.0	6.9
Money and quasi-money (M2)	11.9	9.3	8.2	7.0	6.4	8.2	8.2	9.8	8.2	9.4
Broad money (M3)	12.1	9.1	8.4	6.6	6.1	7.7	7.6	8.7	8.4	10.5
					(Annual growth rates, in percent of broad money)					
Net foreign assets	-1.4	-7.7	2.8	-6.2	-7.0	-6.0	-3.2	-2.6	1.2	6.0
Net domestic assets	13.6	16.8	5.6	12.8	13.1	13.6	10.8	11.4	7.1	4.5
Domestic credit	17.3	16.7	9.4	14.9	15.8	18.6	16.0	15.9	10.0	10.9
Credit to the government (net)	-1.1	3.3	0.3	7.8	8.5	9.3	7.3	8.4	5.8	3.8
Credit to the economy	18.4	13.3	9.1	6.8	7.0	8.8	8.4	7.2	4.0	7.1
Other items (net)	-3.7	0.1	-3.8	-2.1	-2.7	-5.0	-5.2	-4.6	-2.9	-6.4
Memorandum items:										
GDP (in millions of dinars)	63,059	64,690	70,658	76,350	…	…	…	82,643	…	89,217
Nominal GDP growth (in percent)	7.1	2.6	9.2	8.1	…	…	…	8.2	…	8.0
Reserve money (in millions of dinars)	8,415	9,406	10,989	11,078	11,072	11,136	11,963	12,050	12,114	13,185
Velocity (GDP/M2)	1.54	1.45	1.46	1.48	…	…	…	1.47	…	1.44
Multiplier (M2/M0)	4.86	4.75	4.40	4.67	…	…	…	4.71	…	4.71

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	*1Q 15*	2015
Net Foreign Assets	13,082	10,533	12,321	10,969	10,182	10,211	9,696	8,615	7,765	9,120	8,863	9,403	12,874
Assets	13,705	11,315	13,455	12,035	12,176	12,155	12,701	12,265	12,060	13,929	14,224	15,302	19,710
Liabilities	623	782	1,134	1,066	1,994	1,945	3,004	3,650	4,296	4,809	5,361	5,899	6,836
Net Domestic Assets	-4,707	-1,189	-1,332	-1,757	-267	67	1,382	2,457	3,371	2,842	3,187	2,711	311
Domestic credit (net)	-2,673	222	248	-92	1,572	1,809	3,493	4,467	5,573	5,296	5,448	5,160	2,766
Net credit to government 1/	-3,250	-3,355	-3,461	-2,207	-1,639	-735	-175	574	835	1,065	1,940	1,607	2,369
Credit to Banks	578	3,577	3,709	2,115	3,212	2,545	3,668	3,893	4,738	4,231	3,508	3,553	397
Other items net	-2,035	-1,412	-1,579	-1,665	-1,839	-1,742	-2,111	-2,011	-2,201	-2,453	-2,261	-2,449	-2,455
Reserve Money 2/	8,415	9,406	10,989	9,212	9,915	10,278	11,078	11,072	11,136	11,963	12,050	12,114	13,185

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

1/ Includes subscription to IMF/AMF.

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

Table 7. Tunisia: Financial Soundness Indicators of the Banking Sector, 2008–Jun. 2014

(In percent, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013 Prel.	Jun. 2014 Prel.
Regulatory capital to risk-weighted assets	11.7	12.2	11.6	11.9	11.8	8.9	8.8
Tier 1 capital to risk weighted assets	10.6	10.7	10.2	10.0	9.4	7.3	7.1
Capital to assets	8.1	8.5	8.4	8.5	7.8	6.0	5.8
Asset quality							
Sectoral distribution of loans to total loans							
Industry	31.3	30.0	30.5	28.6	27.9	27.8	27.1
Agriculture	3.6	3.4	2.9	2.9	2.8	2.8	2.8
Commerce	17.3	17.4	15.0	16.0	15.4	15.3	15.6
Construction	4.5	4.9	5.9	5.6	5.4	5.5	5.5
Tourism	9.1	8.2	7.3	7.3	6.9	6.5	6.3
Households	20.1	21.6	22.1	23.4	25.4	26.3	25.7
Other	14.3	14.4	16.3	16.3	16.2	15.7	17.1
FX-loans to total loans	3.9	4.5	5.3	5.1	4.8	4.8	5.1
Credit to the private sector to total loans	71.6	70.4	70.6	67.4	67.7	73.2	72.7
Nonperforming Loans (NPLs) to total loans	15.5	13.2	13.0	13.3	14.9	15.2	16.0
Specific provisions to NPLs	...	...	...	48.5	45.9	59.9	59.6
NPLs, net of provisions, to Tier 1 capital	71.1	57.9	60.3	66.3	86.3	84.3	93.5
Specific provisions to total loans	8.8	7.7	7.6	7.6	8.0	10.1	10.1
General provisions to total loans	...	...	...	0.4	0.5	0.5	...
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	8.1	...
Interest rate average spread (between loans and deposits)	3.60	3.49	3.53	3.0	3.0	3.1	2.9
Interest return on credit	7.01	6.35	6.24	5.7	5.4	5.9	6.1
Cost of risk as a percent of credit	1.4	1.2	1.7	1.2	1.1	1.3	...
Net interest margin to net banking product (PNB)	58.6	58.8	58.6	57.2	58.1	57.9	54.5
Operating expenses to PNB	45.4	47.2	46.5	51.1	50.3	47.3	47.1
Operating expenses to total assets	1.6	1.6	1.6	1.7	1.6	1.6	1.6
Personnel expenses to non-interest expenses	60.4	61.4	59.1	62.6	61.3	59.1	60.0
Trading and other non-interest income to PNB	21.7	22.1	21.8	22.5	20.9	21.8	23.9
Liquidity							
Liquid assets to total assets	31.6	32.1	29.8	26.5	28.2	28.4	28.0
Liquid assets to short-term liabilities	124.0	119.1	104.1	89.4	89.2	92.6	89.0
Deposits to loans	98.9	100.9	94.6	87.4	89.5	89.6	88.9
Deposits of state-owned enterprises to total deposits	13.8	14.8	13.8	12.6	13.2	13.0	12.8
Sensitivity to market risk							
FX net open position to Tier 1 Capital	1.40	1.53	1.35	1.94	2.3	3.4	3.2

Source: Central Bank of Tunisia.

Table 8. Tunisia: Access and Phasing Under the Stand-By Arrangement, 2013–15

Review	Availability Date	Action	Purchase		Total
			Millions of SDRs	Percent of quota 1/	Millions of U.S. dollars 2/
Approved phasing					
	June 7, 2013	Board approval of the SBA	98.800	34.485	150.155
First Review	September 15, 2013	Observance of end-June 2013 performance criteria, completion of the first review	98.600	34.415	151.539
Second Review	December 15, 2013	Observance of end-September 2013 performance criteria, completion of the second review	230.520	80.461	354.287
Third Review	March 15, 2014	Observance of end-December 2013 performance criteria, completion of the third review	145.080	50.639	222.974
Fourth Review	June 15, 2014	Observance of end-March 2014 performance criteria, completion of the fourth review	143.250	50.000	220.161
Fifth Review	September 15, 2014	Observance of end-June 2014 performance criteria, completion of the fifth review	143.250	50.000	220.161
Sixth Review	December 15, 2014	Observance of end-September 2014 performance criteria, completion of the sixth review	143.250	50.000	220.161
Seventh Review	March 15, 2015	Observance of end-December 2014 performance criteria, completion of the seventh review	71.625	25.000	109.896
Eighth Review	May 15, 2015	Observance of end-March 2015 performance criteria, completion of the eighth review	71.625	25.000	109.896
Total			1146.000	400.000	1,759.230
Proposed rephasing					
Fifth Review	November 15, 2014	Observance of end-September 2014 performance criteria, completion of the fifth review	71.625	25.000	110.081
Sixth Review	March 15, 2015	Observance of end-December 2014 performance criteria, completion of the sixth review	214.875	75.000	330.057
Seventh Review	May 15, 2015	Observance of end-March 2015 performance criteria, completion of the seventh review	143.250	50.000	219.792
Total to be rephased			429.750	150.000	659.929

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

			Prel.	Est.	Proj.					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	(Change in percent)									
Real GDP growth	2.6	-1.9	3.7	2.3	2.4	3.0	4.0	4.5	4.5	4.5
Total consumption	4.3	4.0	5.2	4.6	2.6	2.5	2.4	2.7	3.6	3.9
Private consumption (residual)	4.2	4.0	4.7	4.2	2.0	2.9	3.3	2.9	3.9	4.2
Public consumption	4.5	4.1	6.8	6.2	4.7	0.9	-0.8	2.0	2.5	2.6
Investment	9.3	-18.9	7.1	-3.9	1.2	2.1	3.5	5.0	5.0	5.0
Gross fixed capital formation	4.1	-12.6	7.1	-3.8	1.2	2.0	3.5	5.0	5.0	5.0
Change in stocks	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and nfs 1/	5.6	-7.7	7.2	2.6	3.9	7.7	9.4	10.3	6.5	7.0
Imports of goods and nfs 1/	-2.0	3.5	8.3	4.9	2.4	3.0	3.9	4.9	6.0	6.1
Inflation (annual average)	4.4	3.5	5.6	6.1	5.6	5.0	4.2	4.0	4.0	4.0
	(In percent of GDP)									
Gross national savings	20.9	16.2	16.1	13.7	12.7	14.2	15.5	18.1	20.2	21.6
Consolidated government 2/	6.2	4.1	2.0	-1.0	0.5	-0.5	2.7	4.1	5.0	6.0
Rest of the economy	14.8	12.0	14.1	14.7	12.2	14.8	12.7	14.0	15.2	15.6
Gross investment	25.7	23.6	24.3	22.0	20.6	20.6	20.5	22.2	23.5	24.8
Consolidated government	6.6	7.2	6.7	4.9	4.8	5.3	7.0	7.5	7.7	8.1
Rest of the Economy	19.1	16.4	17.6	17.1	15.7	15.3	13.5	14.7	15.8	16.6
Total consumption	79.4	83.9	85.1	87.2	87.5	87.2	86.4	84.9	84.4	83.9
Private consumption	62.8	65.9	66.7	68.2	67.9	68.0	68.0	66.9	66.7	66.5
Public consumption	16.6	17.9	18.4	19.0	19.6	19.2	18.4	18.0	17.7	17.4
Savings-investment gap	-4.8	-7.4	-8.2	-8.3	-7.9	-6.4	-5.0	-4.1	-3.3	-3.2
Consolidated government	-0.4	-3.0	-4.7	-5.9	-4.3	-5.8	-4.3	-3.5	-2.7	-2.1
Rest of the economy	-4.3	-4.4	-3.5	-2.4	-3.6	-0.5	-0.7	-0.7	-0.6	-1.1
Memorandum items										
Nominal GDP at current prices (TD millions)	63,059	64,690	70,658	76,350	82,643	89,217	96,126	104,470	113,320	123,156
General debt in percent of GDP	40.7	44.5	44.5	44.8	49.4	55.2	56.5	56.7	55.4	54.1
External debt in percent of GDP	48.5	48.0	53.8	54.0	54.4	60.6	62.2	61.5	60.6	59.8
Central government balance in percent of GDP 3/	-0.6	-3.5	-5.7	-6.2	-4.8	-6.2	-4.6	-3.8	-3.1	-2.5
Current account balance in percent of GDP	-4.8	-7.4	-8.2	-8.3	-7.9	-6.4	-5.0	-4.1	-3.3	-3.2

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 (millions of SDR)								
Disbursement	0	99	689	358	0	0	0	0
Stock	0	99	788	1,146	1,121	894	409	63
Obligations	0	3	0	15	42	243	494	349
Repurchase	0	0	0	0	25	227	486	346
Charges	0.02	2.72	0.36	15.30	17.76	15.50	8.07	2.91
Stock of existing and prospective Fund credit								
In percent of quota	0.0	34.5	275.0	400.0	391.4	312.1	142.6	21.9
In percent of GDP	0.0	0.3	2.5	3.6	3.4	2.7	1.2	0.2
In percent of exports of goods and services	0.0	0.7	5.4	7.5	7.0	5.2	2.3	0.3
In percent of gross reserves	0.0	2.0	15.6	17.5	15.1	11.0	4.5	0.7
Obligations to the Fund from existing and prospective Fund arrangements								
In percent of quota	0.0	0.9	0.1	5.3	14.8	84.6	172.3	121.8
In percent of GDP	0.0	0.0	0.0	0.0	0.1	0.7	1.4	1.0
In percent of exports of goods and services	0.0	0.0	0.0	0.1	0.3	1.4	2.8	1.9
In percent of gross reserves	0.0	0.1	0.0	0.2	0.6	3.0	5.5	3.6

Source: IMF staff estimates.

Annex I. Public Debt Sustainability Analysis

Despite high fiscal deficits since the start of the revolution, Tunisia's debt level remains sustainable and lower than in regional peers. With the fiscal path agreed under the program (the "baseline" scenario), public debt is expected to peak at 57 percent of GDP in 2017 before declining over the medium term. Gross financing needs are expected to peak below 10 percent of GDP in 2015 and to moderate to 5 percent of GDP by 2019, reflecting relatively long maturities and favorable conditions by official external creditors. Stress scenarios and the heat map broadly confirm the sustainability of debt dynamics, though some vulnerabilities arise from the large proportion of foreign debt.

Baseline and realism of projections[1]

- **Growth and prices.** Past projections of growth show some forecast errors tilted to the optimistic side, mainly driven by the large swing in 2011 GDP following the revolution; since then, forecast errors have been in line with other countries. Near-term growth prospects have been revised down following weaker economic activity in the first part of 2014. Past projections of inflation have been generally in line with other countries, though inflation since 2011 has generally been higher than initially projected. The current inflation forecast has remained unchanged compared to the last review, thanks to moderating food prices and limited second-round effects of administrated price increases.

- **Debt level and fiscal adjustment.** Increased banking recapitalization costs and weaker-than-originally-expected growth dynamics will contribute to increasing the debt-to-GDP ratio to around 57 percent of GDP by 2017. The gradual but steady fiscal consolidation and a pick-up in growth rates starting in 2015 would help reduce the debt-to-GDP ratio to about 54 percent by end-2019; this, however, would still be 13 percentage points of GDP higher than in 2010. The pace of the envisaged fiscal consolidation (with a cash deficit declining from 6 percent in 2015 to 2.5 percent of GDP by 2019) is in line with other countries.

- **Sovereign yields.** Tunisia's effective interest rate is projected to decline in the medium term thanks to the large proportion of concessional or guaranteed debt, and the redemption of the 2017 Eurobond. However, domestic yields might increase somewhat in the next three years from the current moderate levels, before stabilizing in the medium term thanks to a decline in risk premia, as reforms bear fruit.

- **Maturity and rollover.** Tunisia enjoys relatively long maturities in both foreign and domestic debt (with an average well above three years in the domestic market). Gross financing needs will remain moderate, but a large current account deficit and significant private sector external amortization will drive external financing needs up to 25 percent of GDP, exposing vulnerabilities to increased uncertainties in external flows.

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

Stress test and heat map

Public debt dynamics remain vulnerable to adverse shocks and could deteriorate significantly relative to the baseline, but would remain sustainable.

- Under most adverse scenarios, the public debt-to-GDP ratio would initially worsen and then stabilize between 56 percent and 68 percent in 2019. Scenarios include: a failure to implement medium-term fiscal consolidation; shocks to growth or to the real interest rate; and the realization of a one-off 10 percent of GDP fiscal contingent liability.[2]

- The most severe shocks point to higher but sustainable debt in the medium term. A one-time 30 percent depreciation would increase the public debt-to-GDP ratio to about 71 percent before it declined to 68 percent by 2019, because about 69 percent of public debt is denominated in foreign currency. A combined shock (to real growth and the primary balance) would raise public debt to 71 percent of GDP by the end of the outlook.

- Tunisia's relatively high reliance on foreign debt is a weakness (see Heat Map), making it more vulnerable to market perceptions and to volatile private sector flows. The emergence of important contingent liabilities could also increase financing needs significantly and above the high early warning threshold. On the upside, public debt is generally of long maturity and, provided fiscal consolidation continues as envisaged, debt dynamics will remain favorable.

[2] 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).

Tunisia Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

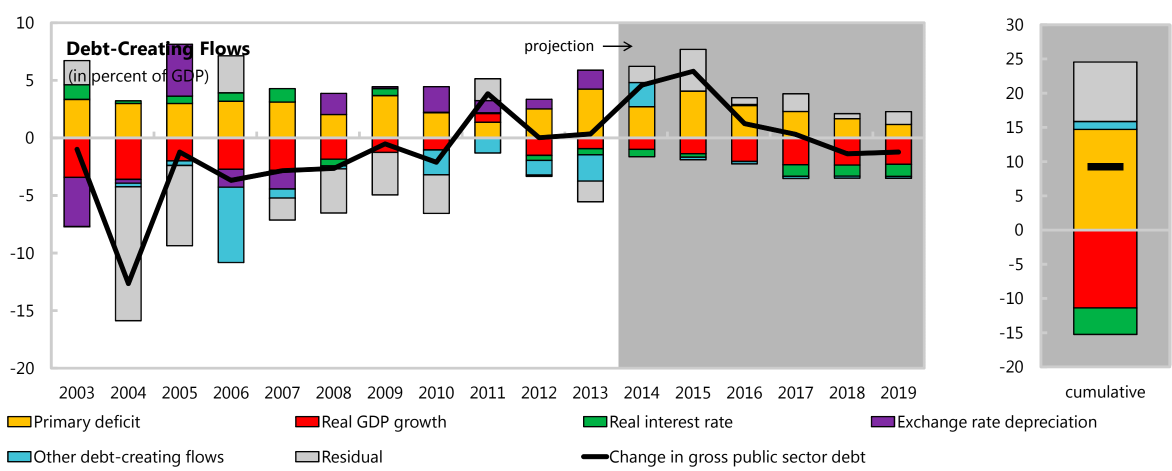
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	48.7	44.5	44.8	49.4	55.2	56.4	56.7	55.4	54.1
Public gross financing needs	7.4	8.4	9.9	8.4	10.8	9.0	10.2	7.8	7.9
Net public debt	46.1	37.8	42.5	48.0	53.9	56.4	56.7	55.4	54.1
Public debt (in percent of potential GDP)	49.2	43.7	43.7	47.8	53.3	54.8	55.6	54.7	54.0
Real GDP growth (in percent)	4.0	3.7	2.3	2.4	3.0	4.0	4.5	4.5	4.5
Inflation (GDP deflator, in percent)	3.7	5.3	5.7	5.7	4.8	3.6	4.0	3.8	4.0
Nominal GDP growth (in percent)	7.8	9.2	8.1	8.2	8.0	7.7	8.7	8.5	8.7
Effective interest rate (in percent) [4/]	4.8	4.4	4.5	4.3	4.3	3.9	2.3	2.1	2.1

As of October 15, 2014		
Sovereign Spreads		
EMBIG (bp) 3/		310
5Y CDS (bp)		287
Ratings	Foreign	Local
Moody's	Ba3	Ba3
S&Ps	...	...
Fitch	BB-	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.5	0.0	0.3	4.6	5.8	1.2	0.3	-1.4	-1.2	9.3	
Identified debt-creating flows	0.1	0.1	2.1	3.2	2.2	0.6	-1.2	-1.8	-2.3	0.6	
Primary deficit	2.8	2.5	4.2	2.7	4.1	2.8	2.3	1.7	1.2	14.7	-3.5
Primary (noninterest) revenue and grants	19.9	24.0	23.7	24.3	23.8	23.7	24.3	24.6	24.9	145.6	
Primary (noninterest) expenditure	22.6	26.5	27.9	27.0	27.9	26.5	26.6	26.3	26.1	160.3	
Automatic debt dynamics [5/]	-1.3	-1.1	0.2	-1.6	-1.7	-2.0	-3.3	-3.3	-3.4	-15.3	
Interest rate/growth differential [6/]	-1.5	-2.0	-1.5	-1.6	-1.7	-2.0	-3.3	-3.3	-3.4	-15.3	
Of which: real interest rate	0.5	-0.4	-0.5	-0.6	-0.3	0.1	-1.0	-1.0	-1.1	-3.9	
Of which: real GDP growth	-2.0	-1.5	-0.9	-1.0	-1.4	-2.0	-2.3	-2.4	-2.3	-11.4	
Exchange rate depreciation [7/]	0.2	0.8	1.6	...	...	...	...	...	...	...	
Other identified debt-creating flows	-1.3	-1.3	-2.3	2.1	-0.2	-0.2	-0.2	-0.2	-0.2	1.2	
CG: Privatization Proceeds (negative)	-1.0	-0.6	-0.6	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
CG: Float	-0.3	-0.7	-1.7	2.2	0.0	0.0	0.0	0.0	0.0	2.2	
Residual, including asset changes [8/]	-2.7	-0.1	-1.8	1.4	3.6	0.6	1.5	0.4	1.1	8.7	



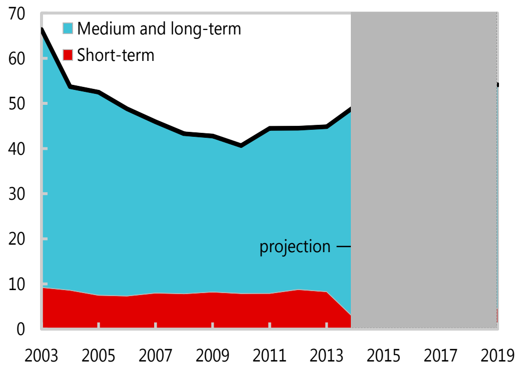
Source: IMF staff.
1/ Public sector is defined as central government.
2/ Based on available data.
3/ Long-term bond spread over U.S. bonds.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Tunisia Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

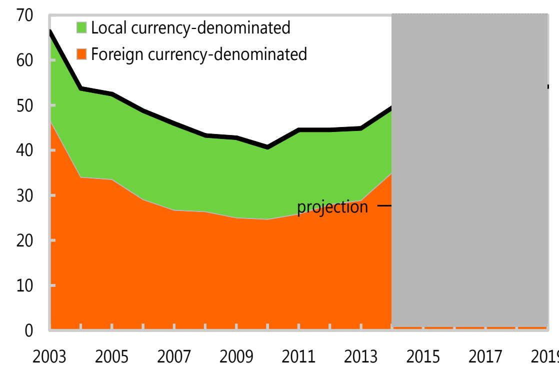
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

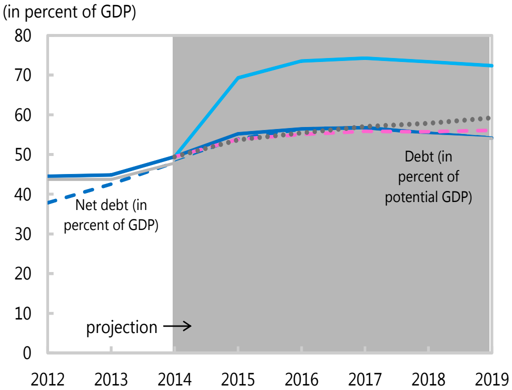


Alternative Scenarios

Baseline
Contingent Liability Shock
Historical
Constant Primary Balance

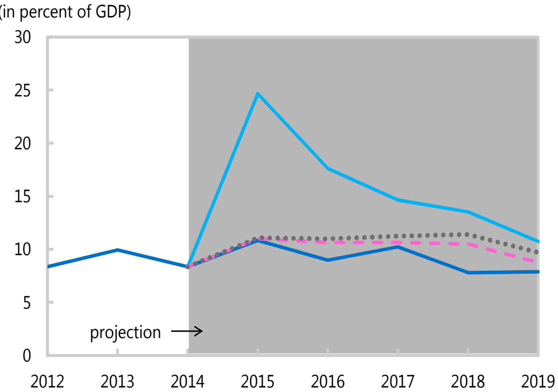
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

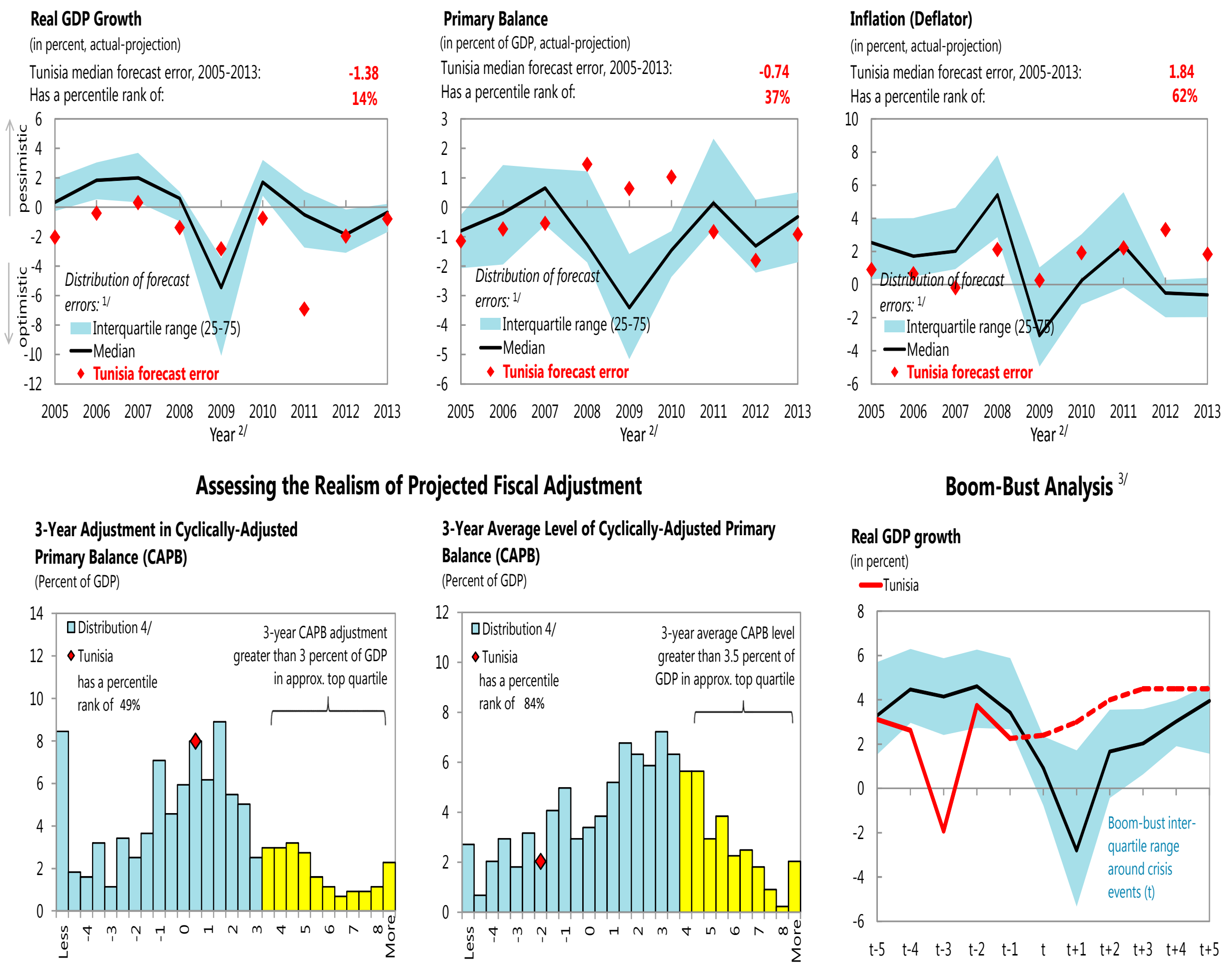
Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.4	3.0	4.0	4.5	4.5	4.5
Inflation	5.7	4.8	3.6	4.0	3.8	4.0
Primary Balance	-2.7	-4.1	-2.8	-2.3	-1.7	-1.2
Effective interest rate	4.3	4.3	3.9	2.3	2.1	2.1
Constant Primary Balance Scenario						
Real GDP growth	2.4	3.0	4.0	4.5	4.5	4.5
Inflation	5.7	4.8	3.6	4.0	3.8	4.0
Primary Balance	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7
Effective interest rate	4.3	4.3	3.9	2.1	2.0	2.0

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.4	3.6	3.6	3.6	3.6	3.6
Inflation	5.7	4.8	3.6	4.0	3.8	4.0
Primary Balance	-2.7	-2.8	-2.8	-2.8	-2.8	-2.8
Effective interest rate	4.3	4.3	4.2	2.6	2.7	2.8
Contingent Liability Shock						
Real GDP growth	2.4	0.6	1.6	4.5	4.5	4.5
Inflation	5.7	4.2	3.0	4.0	3.8	4.0
Primary Balance	-2.7	-15.9	-2.8	-2.3	-1.7	-1.2
Effective interest rate	4.3	4.8	5.2	3.2	3.0	2.8

Source: IMF staff estimates.

Tunisia Public DSA - Realism of Baseline Assumptions

Forecast Track Record, versus program countries



Source : IMF Staff.

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

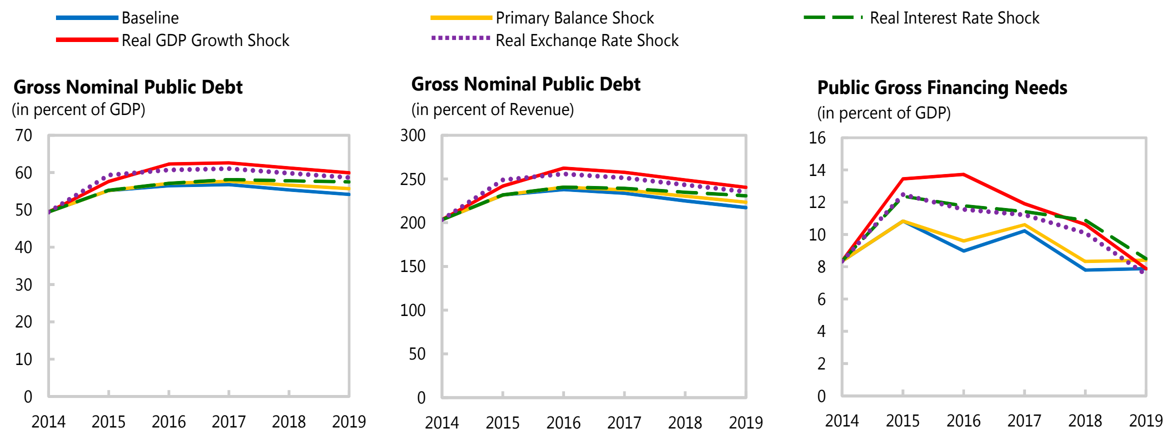
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Tunisia has had a positive output gap for 3 consecutive years, 2011-2013. For Tunisia, t corresponds to 2014; for the distribution, t corresponds to the first year of the crisis.

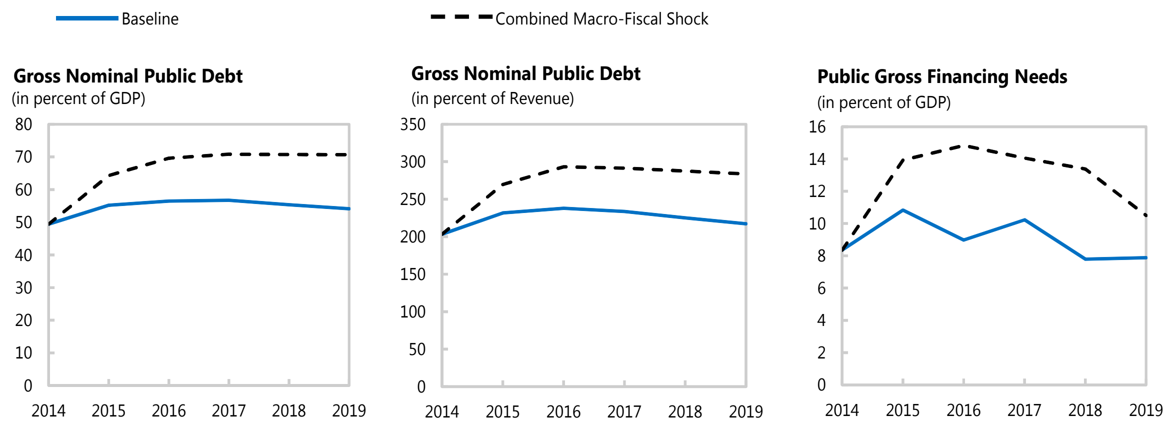
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Tunisia Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	2.4	3.0	4.0	4.5	4.5	4.5
Inflation	5.7	4.8	3.6	4.0	3.8	4.0
Primary balance	-2.7	-4.1	-3.4	-2.5	-2.0	-1.4
Effective interest rate	4.3	4.3	3.9	2.3	2.2	2.2
Real Interest Rate Shock						
Real GDP growth	2.4	3.0	4.0	4.5	4.5	4.5
Inflation	5.7	4.8	3.6	4.0	3.8	4.0
Primary balance	-2.7	-4.1	-2.8	-2.3	-1.7	-1.2
Effective interest rate	4.3	4.3	4.8	3.4	3.7	3.7
Combined Shock						
Real GDP growth	2.4	0.6	1.6	4.5	4.5	4.5
Inflation	5.7	4.2	3.0	4.0	3.8	4.0
Primary balance	-2.7	-4.9	-4.4	-2.5	-2.0	-1.4
Effective interest rate	4.3	4.6	4.5	3.5	3.7	3.8

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	2.4	0.6	1.6	4.5	4.5	4.5
Inflation	5.7	4.2	3.0	4.0	3.8	4.0
Primary balance	-2.7	-4.9	-4.4	-2.3	-1.7	-1.2
Effective interest rate	4.3	4.3	4.0	2.4	2.2	2.1
Real Exchange Rate Shock						
Real GDP growth	2.4	3.0	4.0	4.5	4.5	4.5
Inflation	5.7	9.4	3.6	4.0	3.8	4.0
Primary balance	-2.7	-4.1	-2.8	-2.3	-1.7	-1.2
Effective interest rate	4.3	4.6	3.6	2.2	2.0	2.0

Source: IMF staff.

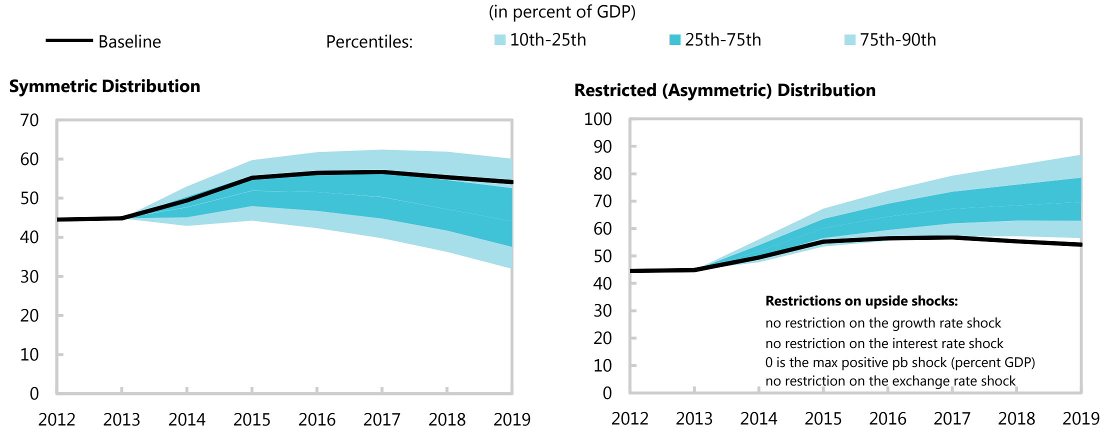
Tunisia Public DSA Risk Assessment

Heat Map

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

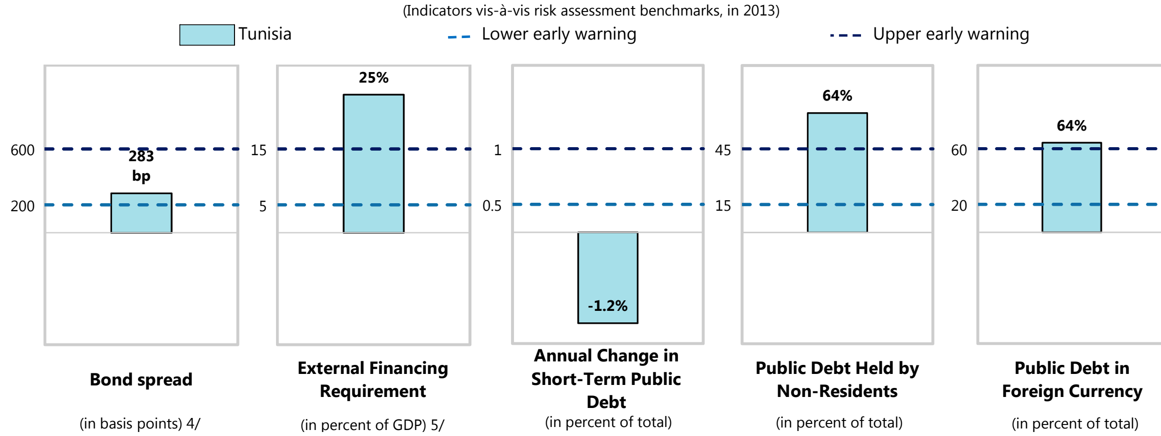
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: IMF staff.

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

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

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

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

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 17-Jul-14 through 15-Oct-14.

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

Annex II. External Debt Sustainability Analysis

Notwithstanding a recent increase, external debt will remain sustainable under the baseline and under most shocks, though it would be vulnerable to a large exchange rate shock.

After a decade of steady decline, external debt has increased moderately as a result of the post-revolution fiscal expansion and a widening current account deficit. External debt declined 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. Debt has subsequently increased to 54 percent of GDP by 2013, following a sizeable fiscal expansion and a sharp widening of the current account deficit.

The authorities' prudent borrowing policies have helped contain debt accumulation. The Tunisian government has refrained from accessing international capital markets (without guarantees), opting instead for concessional resources from multilateral and development banks.[1] As a result, the external debt-to-GDP ratio is expected to rise marginally to 54.4 percent in 2014 against the background of lower-than-expected multilateral disbursements

Tunisia's external debt sustainability risks appear manageable in the period ahead. Under the baseline projections, external debt is projected to increase to 62.2 percent of GDP in 2016 before declining to about 60 percent of GDP in 2019, following favorable current account dynamics. 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.

The external debt ratio is resilient to most types of adverse external shocks, with the exception of a 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 large real exchange rate depreciation. The external debt ratio remains below 67 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 65–67 percent of GDP, while an increase in the average interest rate would have almost no impact.[2] However, a sharp real depreciation (one-time 30 percent) of the exchange rate relative to the baseline would raise the debt ratio to 90 percent of GDP by 2016, before declining to 86 percent of GDP by 2019.

[1] 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.

[2] The size of each shock is half a standard deviation, except for the growth rate, which is reduced by ¾ of one standard deviation.

Annex II Table 1. External Sustainability Framework, 2009–19
(In percent of GDP, unless otherwise indicated)

	Actual 2009	2010	2011	2012	2013			Projections 2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
Baseline: External debt	49.3	48.5	48.0	53.8	54.0			**54.4**	**60.6**	**62.2**	**61.5**	**60.7**	**59.9**	**-8.8**
Change in external debt	3.4	-0.8	-0.5	5.8	0.3			0.4	6.1	1.6	-0.7	-0.8	-0.8	
Identified external debt-creating flows (4+8+9)	0.5	3.2	4.8	3.3	3.2			3.5	0.1	-3.1	-5.2	-6.3	-6.7	
Current account deficit, excluding interest payments	1.3	3.3	6.0	6.8	7.1			6.8	5.3	4.0	3.3	2.6	2.6	
Deficit in balance of goods and services	2.7	4.8	7.1	9.2	9.1			9.3	7.6	5.6	4.7	5.5	6.2	
Exports	45.7	50.5	49.4	49.1	47.0			45.9	47.4	48.9	50.8	51.4	52.1	
Imports	48.4	55.3	56.4	58.3	56.0			55.2	55.0	54.5	55.5	56.9	58.2	
Net non-debt creating capital inflows (negative)	-3.7	-2.9	-0.6	-5.6	-3.1			-3.1	-4.6	-5.7	-6.6	-6.9	-7.2	
Automatic debt dynamics 1/	2.9	2.8	-0.6	2.1	-0.8			-0.1	-0.5	-1.4	-1.9	-2.0	-2.0	
Contribution from nominal interest rate	1.6	1.5	1.4	1.4	1.2			1.1	1.1	1.0	0.8	0.7	0.6	
Contribution from real GDP growth	-1.5	0.5	0.9	-1.8	-1.2			-1.2	-1.6	-2.4	-2.7	-2.7	-2.6	
Contribution from price and exchange rate changes 2/	2.8	0.8	-2.9	2.6	-0.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	3.0	-4.0	-5.4	2.5	-2.9			-3.1	6.0	4.7	4.5	5.5	5.9	
External debt-to-exports ratio (in percent)	108.0	96.1	97.2	109.4	115.0			118.5	127.8	127.2	121.2	118.1	115.0	
Gross external financing need (in billions of US dollars) 4/	7.2	8.6	10.4	10.9	11.6			11.7	9.9	9.5	10.5	10.5	10.7	
in percent of GDP	16.6	19.6	22.7	24.0	24.7	10-Year	10-Year	23.9	20.1	18.8	20.1	19.5	19.1	
A. Scenario with key variables at their historical averages 5/								**54.4**	**56.6**	**57.5**	**58.5**	**60.2**	**62.4**	**-5.3**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Nominal GDP (US dollars)	43.6	44.1	46.0	45.2	47.0			48.9	49.3	50.4	52.2	53.9	55.9	
Real GDP growth (in percent)	3.1	-1.1	-1.9	3.7	2.3	3.3	2.8	2.4	3.0	4.0	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	-5.7	-1.5	6.3	-5.1	1.6	2.0	5.4	1.5	-2.1	-1.7	-1.0	-1.0	-0.8	
Nominal external interest rate (in percent)	3.3	2.9	3.1	2.8	2.3	3.3	0.5	2.2	2.0	1.6	1.4	1.2	1.0	
Growth of exports (US dollar terms, in percent)	-21.0	11.6	2.0	-2.0	-0.7	8.3	14.4	1.6	4.1	5.5	7.4	4.7	5.0	
Growth of imports (US dollar terms, in percent)	-20.6	15.5	6.5	1.8	-0.2	9.3	14.1	2.4	0.4	1.5	5.3	6.0	6.2	
Current account balance, excluding interest payments	-1.3	-3.3	-6.0	-6.8	-7.1	-2.6	3.1	-6.8	-5.3	-4.0	-3.3	-2.6	-2.6	
Net non-debt creating capital inflows	3.7	2.9	0.6	5.6	3.1	4.1	2.6	3.1	4.6	5.7	6.6	6.9	7.2	
B. Bound Tests														
B1. Nominal interest rate is at historical average plus one standard deviation								**54.4**	**60.7**	**62.5**	**62.0**	**61.3**	**60.6**	**-8.6**
B2. Real GDP growth is at historical average minus one standard deviations								**54.4**	**61.7**	**64.5**	**64.9**	**65.2**	**65.3**	**-8.4**
B3. Non-interest current account is at historical average minus one standard deviations								**54.4**	**62.1**	**65.2**	**66.0**	**66.6**	**67.2**	**-8.9**
B4. Combination of B1-B3 using 1/2 standard deviation shocks								**54.4**	**61.8**	**64.6**	**65.1**	**65.4**	**65.7**	**-8.6**
B5. One time 30 percent real depreciation in 2006								**54.4**	**86.8**	**89.1**	**88.2**	**87.0**	**85.8**	**-12.5**

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

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

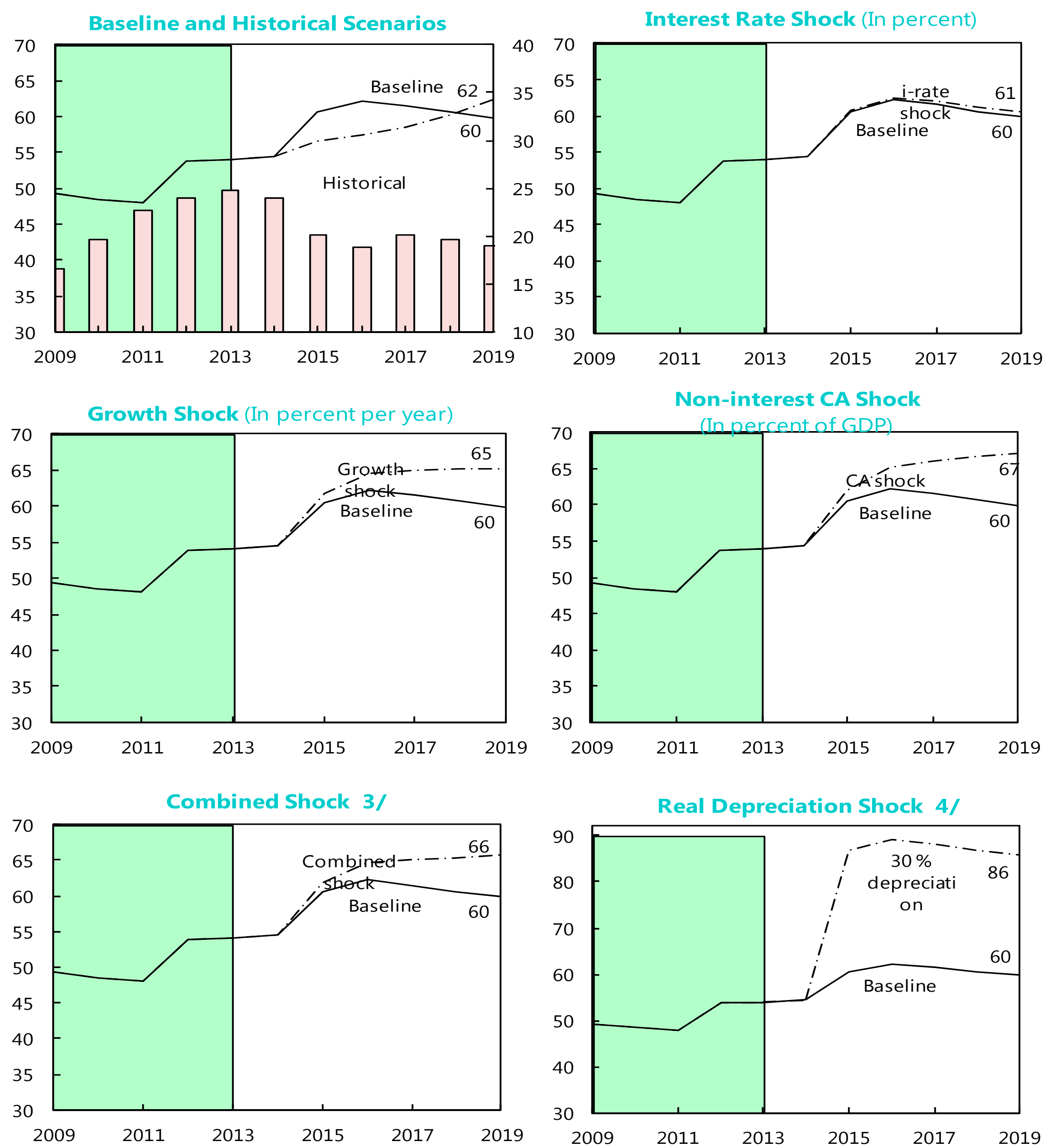
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Annex II. Figure 1. Tunisia: External Debt Sustainability: Bound Tests 1/ 2/



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. Letter of Intent

Tunis, December 3, 2014

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

Madame Managing Director,

1. The legislative and presidential elections—which were held free and fair—have successfully brought in the final phase of our political transition to democracy. This political transition was accompanied by the implementation of economic reforms that are incorporated in the medium-term vision developed by the government and supported by civil society and the majority of the political parties in the context of the national dialogue. This economic vision was presented in September 2014 during the international conference "Invest in Tunisia" and was hailed by private investors and our development partners, who reiterated their support and confirmed their confidence in Tunisia's proposed new development model. It is also fully consistent with the economic program and reforms supported by the IMF, to which we are firmly committed.

2. However, we are aware that the the post-electoral period will be subject to uncertainties related to the formation of a new government, while the Tunisian economy will continue to face significant challenges. In this regard, we remain convinced that the implementation of prudent macroeconomic policies and structural reforms should continue in order to preserve macroeconomic stability and promote stronger and more inclusive growth. This is particularly important because the economic recovery has yet to meet the expectations of the population and fiscal and external imbalances remain high.

3. Performance under the IMF-supported program remains broadly satisfactory, given the constraints associated with the national and international context in this final stage of the transition. Performance at end-September 2014 was in line with the program, and the implementation of structural reforms is moving ahead, albeit at a slower pace than originally envisaged.

- *Quantitative performance criteria and indicative targets* . The quantitative criteria at end-June 2014 and end-September 2014 for net international reserves (NIR), net domestic assets (NDA), and the central government primary balance (on a cash basis) have been met. We adhered to the continuous zero ceiling on accumulation of external arrears and the continuous indicator on non-accumulation of domestic arrears. The ceiling on current expenditure at end-September 2014 has been met. However, the floor on social spending has not been met, primarily because of programmed expenditures for vulnerable families were postponed to the fourth quarter of 2014.

- *Structural reforms.* Two of the seven structural benchmarks to be implemented by end-November 2014 were met (Table 2A). In particular, the final report of the financial audit of the Banque Nationale Agricole (BNA) was completed slightly behind schedule in November 2014, but the associated restructuring plan (end-November structural benchmark), which has already been presented to the Council of Ministers, will only be finalized in line with good international practices once the recapitalization modalities are defined. Regarding fiscal policy, the new proposed tax code was adopted by the government as planned and submitted to Parliament in October, but the tax reform plan – discussed at the National Tax Consultation in November 2014—will be approved by the government only in December. The Asset Management Company (AMC), was created under the 2014 supplemental budget with a capital of 150 million dinars (TND), but its creation will only be effective once the AMC law is adopted in April 2015. Also, the recruitment of banking supervisors will not be possible before 2015, following the organization of an external competitive process. With regards to the end-September benchmark on the implementation decrees of the new investment code, the code itself was withdrawn from the National Constituent Assembly, as discussed during the last review, in order to be simplified and replaced by May 2015.

4. In view of the macroeconomic policies implemented to achieve the program's main objectives and the progress in the structural reform agenda (Tables 1, 2a, and 2b), the government requests the completion of the fifth review of the program supported by the Stand-By Arrangement. The government agrees to the proposed modification of performance criteria for NIR, NDA, and the primary balance at end-December 2014, and the proposed new criteria for March 2015 as well as new indicative benchmarks, as described in the attached Memorandum of Economic and Financial Policies (MEFP, Table 1) and Technical Memorandum of Understanding (TMU). The government also requests a re-phasing of disbursements, with a tranche of SDR 71.625 million for the fifth review and the allocation of remaining amounts in two tranches: a disbursement of SDR 214.875 million to be made available on March 15, 2015 subject to completion of the sixth review, which will be based on end-December 2014 performance criteria; and a disbursement of SDR 143.25 million to be made available on May 15, 2015 subject to completion of the seventh review, on the basis of end-March 2015 performance criteria.

5. This Letter of Intent (LOI) is based on the previous LOI and MEFP dated August 14, 2014. The attached MEFP discusses the key components of the government's program and the measures planned by the Central Bank of Tunisia that we intend to implement during 2014 and 2015. We are determined to rigorously apply our program while mindful of the difficulties associated with the national, regional, and international environment.

6. We are confident that the policies described in the attached MEFP are appropriate to achieving the objectives of our economic program, which is designed to ensure short-term macroeconomic stability while laying the foundation needed to support growth and protect vulnerable groups. We will remain vigilant, and we stand ready to take any additional measures that may be necessary to achieve these objectives. We will consult with IMF staff on the adoption of such measures and prior to any revision of the macroeconomic policies described in the MEFP, in accordance with IMF's policies on such consultations. All information and data required for program monitoring will be provided to IMF staff.

7. We authorize the IMF staff to publish this Letter of Intent and the attachments (MEFP, Tables 1, 2a, 2b, and 3, and the accompanying IMF staff report).

Sincerely yours,

/s/
Chedly Ayari
Governor, Central Bank of Tunisia

/s/
Hakim Ben Hammouda
Minister of Economy and Finance

Attachment I: Memorandum of Economic and Financial Policies

Recent Developments and Macroeconomic Outlook

1. **Economic activity grew at a moderate rate, albeit slower than anticipated**. The recovery of services and a good cereal harvest could not offset lower oil and gas production, due to technical stoppages and a structural decline in reserves of production wells. As a result, the growth rate for the first six months of the year stood at 2.1 percent compared to 2.7 percent in our initial projections. For the rest of the year, a buoyant construction and public works sector and the acceleration of manufacturing industries (expected following the sharp increase in imports of intermediate products and capital goods) will allow the growth rate to increase to 2.4 percent for 2014. The growth rate will accelerate to 3 percent in 2015, as investors' wait-and-see attitude will diminish following the formation of the new government and the announcement of its program. Short-term risks remain significant, particularly in the event of renewed security tensions, delays in the formation of a new government after the elections, additional delays in reform implementation, or a deterioration in the economic outlook of our main partners in Europe.

2. **Inflation remains contained**. Increased food prices, particularly for fresh foods, and electricity tariffs pushed inflation (year on year) from 5 percent in March 2014 to 6 percent in July 2014 before decreasing to 5.4 percent in October 2014. Core inflation remains controlled but edged higher to 5.0 percent in October 2014 (compared to 4.3 percent at end-June 2014) following a rise in the prices of services. Inflation is projected at 5.5 percent for the end of the year, reflecting a slowdown in food and energy prices, favorable base effects, measures aimed at controlling and monitoring distribution channels, and monetary policy tightening.

3. **The current account deficit continues to widen, but this trend could reverse during the fourth quarter of 2014**. The deterioration of the current account deficit continues, reaching 7.1 percent of GDP at end-September. This continued underperformance is explained by a worsened trade balance, primarily the energy deficit associated mainly with the decline of national oil production and decreased volumes of gas transiting through the Algeria-Italy gas pipeline; these effects could not be offset by the slightly better than expected tourist flows and workers' remittances. For the rest of the year, lower commodity prices (food and energy), decreased volumes of food imports thanks to record domestic cereal and olive oil production, a more flexible exchange rate, and active promotion of our exports will help reverse this trend and contain the 2014 current account deficit at 7.9 percent of GDP. The deficit continues to be financed primarily by short-term flows, given that foreign direct investment has remained at 2013 levels. Disbursements of multilateral loans and a significant reduction in the Central Bank of Tunisia's (BCT) interventions on the exchange market increased gross reserves at end-September to $7.7 billion and will bring them to $7.8 billion at end-2014 (3.4 months of imports), below the program forecasts because of weaker than anticipated external budget support in the last quarter of 2014.

Performance Under the Program and Strategy

4. We are determined to rigorously implement our economic program in order to preserve short-term macroeconomic stability and lay the foundations for more sustained and inclusive growth. The objectives of our program remain unchanged, and in this review we are focused on the following areas:

- **Maintaining macroeconomic stability**. Mobilizing tax revenue, containing the wage bill and subsidies, and tightening monetary policy in conjunction with a more flexible exchange rate, combined with placing limits on interventions in the foreign exchange market, are needed to maintain macroeconomic stability.

- **Laying the foundation for inclusive growth**. Swiftly finalizing the bank restructuring plans and reducing the vulnerabilities of public banks, improving budget composition through the implementation of the tax reform and improved execution of public investments, and the implementation of an ambitious structural reform program are needed to support the development of the private sector as the main engine of inclusive growth in the future.

- **Protecting the vulnerable segments of the population**, by strengthening social protection mechanisms and conducting a systematic evaluation of the social impact of the programmed reforms.

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

Fiscal policy

5. Increased revenue mobilization will enable us to reduce the budget deficit in 2014 so as to contain pressures on the balance of payments and limit financing constraints. The end-September fiscal target was met by a significant margin, primarily owing to a gain in revenue (0.5 percent of GDP) from taxes on oil companies programmed for 2013 but received in 2014, and stronger VAT receipts (12 percent growth year on year). For the full year, we expect a reduction of the structural deficit—deficit excluding the effects associated with the economic cycle and the transactions linked to the recapitalization of banks—to 4.1 percent of GDP (compared to 4.5 percent of GDP in 2013 and 4.7 percent of GDP under the program). This will ease financing constraints (cf. below) resulting from reductions in contributions from the development partners, and will contain pressures on the balance of payments. The improved fiscal position comes despite constraints presented in the supplementary budget law in regard to transfers for the national retirement and pension fund (CNRPS), and additional payments for the elections, security personnel, and salaries following sectoral agreements concluded with various trade unions in 2011. For the remaining months, the deficit reduction will entail:

- **Revenue**. Tax revenue will represent 22.7 percent of GDP (compared to 22.3 percent under the program and despite weaker economic activity than anticipated), supported by increased collection efforts (including the new regulations requiring government suppliers to submit tax clearance certificates), and the implementation of the revenue measures included in the supplementary budget (Table 3). We are aware, however, that this revenue will only represent 22 percent of GDP if we exclude nonrecurring revenues (from oil companies and exceptional contributions from employees and enterprises).

- **Expenditure.** We will continue to contain the wage bill through a programmed reduction in net hiring—except for security forces, health and education—and control of promotions. We will keep our commitment to maintain energy subsidies at the programmed level, thanks to lower international oil prices, which have offset the greater than expected exchange rate depreciation in recent months. We continued to meet the threshold for social spending at end-June 2014, but were not able to do so at end-September because of a delay in expenditures for needy families, which will be recouped by year-end. The pace of execution of investment expenditures is expected to accelerate at year-end, bringing the execution rate close to 90 percent of the budgeted amount for 2014.

6. The fiscal adjustment started in 2014 will continue in 2015 to reduce financing requirements, maintain debt sustainability, and reduce pressures on the balance of payments. Fiscal consolidation—as spelled out in our 2015 budget, submitted to the Constituent Assembly in October 2014 and to be approved by Parliament by end-December 2014 (new structural benchmark)—is particularly necessary as our public debt becomes increasingly exposed to exogenous shocks. In this regard, we commit ourselves to reducing the structural deficit to 3.8 percent of GDP in 2015 while preserving the public investments and priority social expenditures needed to revive growth and protect the most vulnerable. The following measures detail our strategy:

- **Revenue**. Revenue register a further nominal increase of 6.5 percent, mostly reflecting the full year's effects of the tax measures (0.2 percent of GDP) implemented with the supplementary 2014 budget (Table 3); the efforts to recoup arrears (0.2 percent of GDP), and modernized tax administration (see Section B).

- **Reduction of energy subsidies**. The full-year effect of the the elimination of energy subsidies for cement companies, and the electricity rate and fuel price increases of 2014, will generate savings of 0.3 percent of GDP in 2015. In addition, new measures will be put in place as part of our policy of reducing generalized energy subsidies, i.e., a 7 percent electricity rate increase in January 2015 for industrial and low-voltage consumers; and a 3 percent fuel price increase by March 2015, followed by another one by September 2015. Those measures are expected to generate further savings of 0.4 percent of GDP, in addition to the savings resulting from lower international prices, which will be locked in through forward contracts that will ensure oil imports for the first six months of 2015 (savings of 0.4 percent of GDP price originally envisaged under the program). The measures will be accompanied by social programs (see Section C) and the most disadvantaged population groups will continue to be protected through the institution of a social tariff for households consuming less than 100 kWh per month.

- **Control of the wage bill**. Our commitment is to contain the wage bill to a nominal increase of 6.6 percent relative to 2014, by limiting salary increases to no more than inflation and freezing net hiring other than for security forces and teaching and healthcare personnel. To better control the wage bill, the Council of Ministers adopted in September 2014 a decree creating a civil service steering and monitoring commission, and will validate the recently completed World Bank report on the civil service career management and performance evaluation system. The report will serve as the basis for a civil service reform that will include proposals introducing greater mobility between the public and private sectors, and allowing the rationalization of civil servants. Technical support will be requested from the World Bank/European Union to analyze the government salary structure.

7. **We also remain committed to taking additional measures to correct any deviation from the budgetary targets under the program,** including reducing current expenditures (i.e., goods and services and subsidies) that were a source of budget overruns in the past. Public investment and social spending (excluding subsidies) will be preserved, and will not be constrained by our fiscal consolidation strategy. In light of uncertainties as to the evolution of international commodity prices, any oil price decline below the budgeted level ($95/barrel) will be saved to further reduce the budget deficit.

8. **Larger than planned domestic borrowing and international bond issuance will partially offset weaker external budget support by the end of the year**. The mobilization of TND 959 million at end-July 2014 through the national borrowing campaign, and of $1 billion through international bonds (issued with guarantees from the United States and Japan) will help offset the partial postponement to 2015 of the World Bank ($500 million)and European Union (EUR 100 million) budget support, the IMF disbursement planned for the last quarter of 2014 ($330 million), and of sukuks, given legal difficulties in the issuance process. Despite weaker contributions than anticipated, better fiscal performance and domestic borrowing will enable us to meet our financing needs.

Monetary policy

9. **Monetary aggregates remain broadly in line with program objectives**. The criterion on net domestic assets at end-September has been met (after adjustment), primarily owing to a substantial reduction of bank refinancing, which offset the larger than anticipated increase in net credit to the government. Central bank refinancing of banks currently represents TND 4.3 billion (TND 3.8 billion excluding open market operations, OMO) largely resulting from additional liquidity following the repayment of two maturities of T-bills (BTA) during 2014, tourist receipts combined with weaker demand for liquidity from public enterprises (e.g. the Office des Céréales), and the use of foreign currency/dinar swaps among banks, which enabled them to reduce their reliance on the CBT. In addition, credit to the private sector grew by 8.4 percent (end-September, year on year), driven in part by consumer credit (9.6 percent, year on year).

10. **Monetary policy tightening remains necessary to reduce future inflationary pressures**. In response to inflationary pressures arising from private sector salary increases and the minimum wage, the depreciation of the exchange rate, and increased electricity and fuel prices, we raised the policy rate last June by 25 basis points, to 4.75 percent. The recent rise of core inflation and the producer prices index raise concerns despite the negative output gap that still characterizes our economy. To this end, we will continue to improve our communication to better anchor inflation expectations and signal the need to gradually achieve a positive real interest rate that will maintain inflation below the 6 percent

threshold. We stand ready to raise the policy rate if inflationary pressures increase more than expected, especially in the event of worsening external imbalances.

11. The reform of the monetary policy framework is continuing. The CBT is continuing to reduce the risks to its balance sheet arising from refinancing operations and considers that all banks are prepared for the increase in the minimum share of government securities from 20 percent to 40 percent (structural benchmark at end-December 2014). Following the July implementation of a 25 percent haircut on loans accepted as collateral for CBT refinancing, we intend to improve the current haircut system through rating instruments, which will require a gradual approach and dedicated technical assistance. In addition, we will continue to reduce direct refinancing through the CBT by increasing the use of OMO, the outstanding balance of which recently declined by half to TND 477 million. The study on evaluating public securities at market price instead of their nominal value was completed, and the implementation of the valuation is planned by December 2014 (we anticipate a minimal impact, given current rates).

12. The implementation of a lender of last resort (LOLR) mechanism is needed to accompany the tightening of the eligibility criteria for CBT refinancing. The LOLR initially envisioned for end-June 2014 (structural benchmark) will not be completed until May 2015 (new structural benchmark), given the need to establish the eligibility criteria and implement the new legal and institutional framework for bank resolution. However, as indicated in the context of the fourth review, a new, temporary "exceptional facility" was put in place in July 2014 on the basis of collateral not commonly accepted by the CBT management and at a penalty rate.

13. Modifications to the system of excessive bank lending rates will enhance the monetary policy transmission channel and access to financing. The recent increase of the money market rate led to an increase of the overall effective rate (TEG) and eliminated restrictions on banking credit tied to the TEG in the short term. However, consultations will continue with the ministerial departments concerned, to assess and revise if needed, by December 2014, the text of the law on excessive lending rates, with a view to improving the channels of transmission of monetary policy and access to credit for small and medium-sized enterprises (SMEs).

14. The central bank law is under revision. A comprehensive set of amendments to the law are intended to provide the CBT with greater autonomy (in institutional, operational, staffing, and financial terms) and better define its mandate (through clarification of its objectives, missions, and tools) while strengthening its governance, transparency, and accountability. The draft law, prepared with IMF technical assistance, was presented to the CBT board of directors in June 2014 (structural benchmark) and will be adopted by the government by March 2015.

Exchange rate policy

15. Pressures on the foreign exchange market declined, reflecting a greater supply of currency from tourist receipts, transfers from migrant workers, and external budget support. Transactions in the foreign exchange market decreased by 40 percent between June and September 2014. The provision of foreign currency to banks also allowed a more active use of foreign currency swaps among banks, thereby reducing pressure on dinar liquidity.The CBT also reduced its interventions on the exchange market (foreign currency sales); these were halved (to $200 million per month), though they remain necessary to ensure settlement of external payments relating to energy imports. Thus our stock of reserves increased by $600 million during the third quarter, with the exchange rate following a downward trend and depreciating 14 percent against the U.S. dollar and 4 percent against the euro since mid-March 2014. Given the deterioration of the trade deficit and the need to reconstitute our foreign reserves, we will pursue our policy of a more flexible exchange rate by:

- **Continuing to limit CBT's interventions on the foreign exchange market**. We are commited to refraining from selling foreign currency on the exchange market except for smoothing fluctuations that may result if large orders related to energy transactions are not met. To preserve and build our foreign reserves, we intend to intervene by purchasing foreign currency on the market, particularly when there is no strong demand for foreign currency associated with energy imports.

- **Introducing weekly foreign currency auctions in December 2014** (structural benchmark). To this end, the launch of the electronic platform providing interconnection between banks and the entry into force of the market-maker agreement (eight banks having signed the agreement in September) will provide us with real-time information on the price quotations of different participants in the exchange market. However, the introduction of the auction mechanism will also require the implementation, with IMF technical assistance, of an effective information system enabling the CBT to centralize flows of projected foreign currency settlements and provide it with a clearer view of cash flows.

16. Our development strategy will remain open and based on free trade. We have taken measures to reduce the growing trade deficit by promoting our exports and rebalancing our energy mix. Following the World Trade Organization rules, we will not consider the introduction of new restrictions or import surcharges except as a last resort, after exhausting all market-based solutions that preserve adequate incentives, and only with very clear criteria, announced in advance, for removing them.

F. The Foundation for Inclusive Growth

Financial sector policies

17. The Tunisian banking system remains fragile despite indicators that continue to show profitability in a still-difficult domestic context. The end-June indicators show deteriorating asset quality, with nonperforming loans up from 14.9 percent in 2012 to 16 percent at end-June 2014 (roughly 21 percent if we include loans transferred to asset recovery agencies affiliated with the banks)—primarily in the sectors most affected by the continued anemic economic activity (tourism, manufacturing). At the same time, the more rigorous imposition of haircuts on collateral increased the provisioning rate for nonperforming loans from 45 percent in 2012 to nearly 60 percent at end-June 2014. On the other hand, the rise in financial fees and capital gains on government securities continues to support the growth of net banking income. In the prudential area, the capital adequacy ratio (CAR) fell to 8.8 percent (six banks remain below the minimum threshold required by the current regulation). In regard to liquidity, only eight of the 22 banks comply with the regulatory ratio of 100 percent.

18. The restructuring of the banking system—which will result in a refocusing of the government's role in public banks—remains an absolute priority. The restructuring plans for two public banks (STB and BH) were finalized based on the results of the audits on the 2012 financial statements and adopted by the government in August 2014 according to sound international practices. The plans are intended to ensure the banks' financial soundness, establish a new governance framework, provide the resources to write off nonperforming loans, build institutional capacities, and strengthen the legal framework. The audit of the Banque Nationale Agricole (BNA) has been finalized (with a slight delay relative to program commitments), and its associated restructuring plan has been presented to the Council of ministers, but will not be finalized in line with good international practices until recapitalization modalities are set (structural benchmark for end-November). In the short term, our action plan for the public banks is based on the following priorities – some of which are still contingent on banks' general assembly decisions and on the legislative calendar:

- **Strengthening of governance and operational restructuring**. The new governance decree grants public banks greater autonomy vis-à-vis the government. In accordance with the planned timetable, a joint committee adopted the terms of reference for the new selection and evaluation criteria for members of the board of directors, and we plan to overhaul directors' compensation and replace members of the board according to fit and proper criteria by end-January 2015 (new structural benchmark); a change in senior bank managers will follow suit. To ensure that public banks operate strictly on the basis of commercial criteria in accordance with sound management practices, we will prepare performance contracts to be finalized for the three public banks by March 2015 (new structural benchmark), but whose implementation remains contingent on the adoption of the recapitalization plans. The performance contracts will aim, inter alia, for the convergence of performance indicators toward the levels of private sector banks by 2016 (e.g., a cost-to-income ratio on the order of 40–45 percent) and on a consolidated basis for certain ratios. These performance contracts will be aligned with the restructuring plans adopted by banks' extraordinary assemblies, following good international practices and including the results of the audits (structural benchmark for end-March 2015).

- **The recapitalization of public banks**. The recapitalization plan approved by the government in August 2014 could not be implemented, given the lack of authority to use public funds already allocated for the recapitalization and because of the need to continue discussions with private shareholders with the aim of ensuring the recapitalization process is in line with sound international practices (see Annex). These include: (i) recapitalizing in one single step with the amount necessary to ensure compliance with prudential regulations, after allocating losses before any injections of capital or allowing for immediate dilution of private shareholders who do not take part in the capital increase; (ii) setting the size of the recapitalization on the basis of the audit results, and adding the cost of operational restructuring measures and measures to support the reduction of staff. In light of the delays in the implementation of the recapitalization plans, the three public banks will not meet the capital adequacy requirements (10 percent) before May 2015. Substantial cost—in addition to the 1.2 percent of GDP already allocated in the national budget—will also be assumed in 2015 to implement the rehabilitation program, including the required institutional and commercial investments. An extraordinary general assembly of the banks' shareholders will be held as soon as possible to ratify the plans in line with sound international practices.

- **Asset Management Company (AMC)**. The AMC was created in the 2014 supplementary budget law, which defines its objectives and authorizes the government to subscribe TND 150 million of its capital. The AMC's creation will not be effective nor considered operational until the AMC law is adopted by Parliament. This law, which will establish the key principles of the AMC and provide specific powers to expedite the resolution and restructuring of the transferred loans—could not be adopted in September 2014 and, with the current parliament in recess, will not be considered until the new Parliament is in place. The law will be accompanied by implementation decrees that will determine, inter alia, the rules of governance, the fair transfer price for loans, and the specific terms and procedures for financing the AMC operations, which will follow sound international practices (new structural benchmark for end-April 2015). Although the draft law provides for the creation of a universal AMC, the initial implementation phase will be limited to the tourism sector. Moreover, we will submit to the next Parliament some amendments to Law 98 on the existing credit recovery companies to enable them to act more effectively.

19. Ensuring banks' adherence to prudential standards remains an essential goal. To this end, banks that breached risk concentration rules have regularized their positions, except those for which a restructuring plan is in place. Private banks not meeting the minimum solvency ratio have submitted a recapitalization plan to ensure compliance with the applicable regulations at end-December 2014 (structural benchmark). This deadline has been postponed to May 2015 for public banks under a recapitalization plan duly approved by the CBT and subordinated to the legislative authority for using funds already allocated in the budget. We also promulgated a circular in October introducing a new liquidity ratio, calculated on an individual basis and including off-balance-sheet positions, to be implemented gradually according to a specific timetable announcing a minimum ratio of 60 percent applicable from January 2015, increased by increments of 10 percent per year up to 100 percent in 2019. It will be supplemented by qualitative requirements designed to align liquidity risk management with sound international practices.

20. Banking supervision reforms continue to be an absolute priority. In June 2014, with IMF technical assistance, we prepared a three-year plan (including prerequisites), adopted by CBT management in June 2014, for promoting risk-based banking supervision, assessed on an individual and consolidated basis. Our short-term priorities are to:

- **Strengthen the human resources of the Directorate General of Bank Supervision (DGSB)**. We are aware that the success of our action plan will depend on the personnel and financial resources provided to the DGSB. Accordingly, and given the urgency imposed by the loss of experienced staff, we intend to conduct a competitive recruitment to hire 12 new supervisors (end-November SB); we will not be able hire the new recruits by the end of 2014, as originally planned, but by March 2015 instead. A new code of ethics for supervisors will be designed and implemented by December 2014—particularly to prevent any conflict of interest for personnel leaving the DGSB.

- **Improve reporting**. In September 2014, the CBT completed work on the uniform bank performance reporting indicator (UBPR), which will be available 60 days after the end of each quarter and will be used jointly by the DGSB and the Directorate General of Financial Stability and Risk Prevention (DGSFPR). The UBPR will then be disseminated to banks, the first report being based on the banks' financial situation as of end-June 2014. In addition to this mechanism, a new reporting system of accounting, financial, and institutional data on banks will also be implemented with IMF technical assistance in December 2014 (structural benchmark) and automated in June 2015. These efforts will be complemented by the institution of a risk profile rating system for credit institutions, which will also be designed by December 2014 with IMF technical assistance.

- **Strengthen on-site inspections and integrate them into the banking supervision process**. We conducted one general inspection mission this year and could not meet our objective (four missions) because of a lack of resources. The DGSB's effectiveness will be enhanced by formalizing the competencies and responsibilities of the different DGSB divisional units and establishing a memorandum of understanding specifying the modalities of their cooperation—including cooperation between units responsible for on-site and off-site audits or surveillance—by April 2015 following technical assistance from the IMF. Coordination with other CBT units (in particular the DGSFPR) will also be strengthened and formalized. Weak banks will be identified and subject to heightened supervision based on criteria to be formalized by February 2015, and following additional technical assistance.

- **Strengthen the banks' internal controls**. On the basis of 2013 reports on internal control and risk management, the DGSB has analyzed the banks' credit risk management systems and has required those with inadequate systems to submit action plans by end-December 2014. These reports on internal controls expected in 2014 will also be closely examined, including with respect to risk exposure not addressed by quantitative prudential standards (notably operational risk, market risk, medium-term liquidity mismatch risk, overall rate risk).

- **Strenghten preventive surveillance of vulnerability factors**. The DGSB, in cooperation with the DGSFPR, will prepare by February 2015 a formal program of periodic stress tests designed to detect banks' vulnerability to extreme but plausible shocks, not only from the standpoint of credit risk but also in terms of liquidity, interest rate, and exchange rate risks.

21. A bank crisis and resolution management mechanism, in line with best international practices, is currently being finalized. A draft banking law was prepared with technical assistance from the World Bank and the IMF to strengthen banking supervision and regulation in Tunisia and establish a sound legal framework for the resolution of insolvent banks. The draft law, which was presented to the CBT board of directors in June 2014, will be adopted by Parliament in March 2015 (new structural benchmark). The proposed amendments to the proposed CBT law will also strengthen the banking resolution framework.

22. The implementation of a lender of last resort (LOLR) mechanism and deposit guarantee fund is necessary to ensure financial stability. With technical assistance from the World Bank, we are finalizing an overall plan to provide explicit guarantees for the deposits of the public. The mechanism will strengthen the stability of the banking sector. It will be presented to the CBT board of directors in January 2015. The deposit guarantee law will be presented to the Parliament in March 2015. The operational implementation is expected to take place in May 2015.

Fiscal reforms

23. Our medium-term fiscal consolidation strategy is accompanied by fiscal reforms to support inclusive growth. The reforms aim to overhaul tax policy, modernize tax administration, strengthen the governance of public enterprises, improve public expenditure management, and enhance the effectiveness of public investment.

24. The equity, efficiency, and transparency of the tax system continue to be the key pillars of our tax policy, together with revenuemobilization. All existing tax laws and codes were consolidated in a single tax code that was approved and presented to Parliament in October 2014 (structural benchmark for end-September), thereby enhancing the transparency of the tax system. The National Tax Consultations were held on November 2014, which delayed the Council of Ministers' adoption of the action plan to end-December 2014 (structural benchmark at end-October). In the context of the overall tax system reform, we intend to continue revising the corporate tax to achieve the gradual convergence of the offshore and onshore sector rates—the difference between the two rates was reduced by half in the 2014 budget law—which will be announced according to a clear timetable (structural benchmark at end-May 2015) and closely coordinated with the improvement of the tax administration. For the time being, we have improved equity by transferring a number of professions from the presumptive tax system to taxation based on actual earnings, aligning the treatment of liberal professions to their peers in the civil service.

25. The reform of the tax administration is moving forward. We have strengthened tax audits by lifting the provisions of the banking system that hinder the collection and use of information for the purpose of tax audits (including audits for taxpayers benefitting from the presumptive tax system), and have improved our collection efforts through the introduction of a tax clearance certificate for all government suppliers. These short-term actions are part of the new tax administration modernization plan we adopted in June 2014 that aims to establish a unified tax administration and strengthen the mechanisms of monitoring and evaluation. The implementation of the plan will benefit from the creation of a new unit within the General Directorate of Taxes (DGI) in charge of the modernization, and to be established with help from IMF technical assistance. For the end of the year, we expect to implement "selective audit procedures" and evaluate the DGI institutional framework to eliminate existing rigidities and facilitate reform implementation. To enhance the effectiveness of the tax administration, we plan to introduce in the 2015 budget law the legal framework allowing the creation of a new category of public accountants, called "tax collectors", by January 2015 (structural benchmark), with the aim of integrating the collection function from the General Directorate of Public Accounting and Collection (DGCPR) into the DGI. This change will be start at the Large Taxpayers Unit in the first half of 2015.

26. The monitoring of public enterprises' performance was strengthened. Measures to put companies on a sounder financial footing and restructuring plans—including a business plan and the social component accompanying the reduction in staff—were adopted for some of the most vulnerable national enterprises, particularly in the transport sector. These plans will improve the governance of these enterprises. The gains from this experience and that of public banks will be gradually extended to other public enterprises through the implementation of a new regulatory framework. In addition, monitoring of public enterprises, which started with the preparation of a report on the financial position of 28 public enterprises, will continue by instituting an early warning system to detect signs of financial difficulties and by the approval of performance contracts for the 5 largest companies posing fiscal risks (new structural benchmark for April 2015). It will also be improved by a better monitoring of public enterprises, including by a possible consolidation of entities charged with their monitoring, which will be decided in a strategy to be adopted by the government by April 2015 (new structural benchmark). For the enterprises in the energy sector, the priorities, as indicated in the audit report, which will be published in December 2014, will focus on the improvement of collection and expenditure management and the elimination, as of January 1, 2015, of cross-subsidies for STEG and STIR, which will meet their energy requirements by importing directly rather than going through the refinery company ETAP.

27. Efforts to improve public expenditure management continue. All 2013 expenditures authorized during the carryover period were paid. Moreover, to avoid slippages this year, the government decided to close all payment orders (with the exception of salaries, debt service and subsidies) on December 15, 2014 to ensure that effective payments are made in 2014, and to institute procedures to reduce the time required to close the accounts. The draft organic law, prepared with technical assistance from the European Union and France, will be approved by the Council of Ministers in December 2014, facilitating progress on all fronts: budget design, budget information (new functional nomenclature), expenditure control, and execution and control. The decree creating a National Board on Standards for Public Accounts to introduce double-entry bookkeeping based on international standards and a new budget and accounting nomenclature will be adopted by the government in December 2014 and will become operational in 2015. In addition, the reform on performance budgeting is moving ahead, with the third wave of ministries preparing their budgets according to the new programmatic nomenclature.

28. Our efforts to accelerate public investment continue. The new procurement procedures that took effect on June 1, 2014 will considerably simplify and modernize procedures and accelerate public investment in the regions. We are convinced that professionalization and decentralization of the management of regional public projects, and the implementation of procedures to remedy land deeds problems during project preparation will accelerate the pace of capital expenditures. In this context, a report on constraints to project implementation is being finalized, and a mechanism for close coordination between the governorates and the central administration was put in place to reduce constraints on important projects. In the medium term, and following the recommendations of IMF technical assistance, we plan to establish a national body in charge of directing investments and define a methodology for project evaluation and selection.

Structural reforms

29. Our structural reform program will continue to focus on improving the business climate and promoting a competitive private sector that can generate inclusive growth. The approval of the "economic" laws—initially deferred because of the NCA's heavy workload linked to approaching electoral deadlines—could not be achieved before the NCA's recess despite our efforts to push forward the the legislative calendar. These delays imply that the laws will not be approved until 2015, in the aftermath of the elections; thereby postponing the removal of constraints to private sector development to 2015:

- **The law on collective procedures (Law 95-34 on the recovery of enterprises in economic difficulty)**. In parallel with the reform of the banking law, we embarked on a process to adopt a new law on collective procedures prepared with World Bank assistance. The law will modernize and simplify the process of restructuring companies and liquidating insolvent companies. We are committed to ensuring that the new legislation provides clear rules with respect to the government's status as preferred creditor, and grant the right of private creditors to vote on reorganization plans.

- **The competition law**. The draft law, submitted to the NCA in 2013, was validated by the parliamentary committees and is awaiting to be reviewed by the full Assembly. The law aims at reducing government's intervention in the economy, lessen excessive regulation, and enhance competition between companies .

- **The law on public-private partnerships**. The draft law, which will facilitate private concessions, was reviewed by the parliamentary committees, and they have already submitted a favorable report. The law is expected to be debated by the full assembly when the legislative session resumes.

30. The investment code, prepared with World Bank technical assistance and following consultations with civil society and donors, was withdrawn from the NCA to be modified and simplified. The government concluded that the new code, which was intended to encourage private investment through a more transparent and efficient regulatory framework and rationalized incentives, was too complex and left too much discretion to the implementation decrees. Nonetheless, we remain convinced that a new, simplified investment code is necessary and have resumed efforts to revise it by May 2015 (structural benchmark). Accordingly, in September 2014 we introduced a list of measures to reduce restrictions on investments, which are designed to supplement the current code.

31. In parallel with the amendments to the relevant laws, the efforts to simplify administrative procedures continue. We have rationalized a number of administrative procedures that were hampering the private sector in the areas of transport, customs, and exports. We remain committed to continuing on this path, encouraged by the anticipated results of the regulatory "guillotine" project.

32. We are committed to reducing obstacles to a proper functioning of the labor market. We aimed at creating 50,000 jobs this year, particularly with programs favoring youths and residents of disadvantaged areas. Those programs include, among others, occupational training programs, programs to support SMEs (financed by the World Bank), and micro projects (financed through loans from the Solidarity Bank and the National Employment Fund), as well as the establishment of solidarity enterprises to support young graduates in disadvantaged areas. In regard to the national employment strategy, discussions on implementing the social contract signed on January 14, 2013 between employers and trade unions have begun; these, following extensive consultations, will lead to a new national employment strategy. A labor market reform will follow, including an evaluation of "flexsecurity" in labor relations and reduction of the structural skill mismatch that prevails in the market.

33. Reliable statistical information is essential to monitoring and evaluating macroeconomic policies and the implementation of social programs. In this context, a comprehensive diagnostic assessment of our statistics system was completed by Eurostat, and we plan, with IMF technical assistance, to strengthen our institutional mechanism and system of producing the national accounts (annual and quarterly), monetary statistics, and the balance of payments. We have also published the initial results of the 2014 census, which will constitute the foundation for revamping surveys on employment, consumption, and household living conditions. In parallel, a "National Statistics Charter" promoting good practices in statistics will be adopted by December 2014, and consideration is under way on a legal framework to ensure and protect the independence of the National Statistics Institute (INS).

G. Protecting the Most Vulnerable

34. Protecting the most vulnerable is a priority during the implementation of fiscal and structural reforms. To this end, and to continue improving our targeting systems, we completed an evaluation of school assistance programs that shows little leakage to non-targeted groups. The evaluation of the program of assistance to families in need (250,000 families) and health benefits cards (550,000), conducted based on a representative sample of 8,000 households, is currently being finalized and will provide, for the first time, information on the population working in the informal sector. The preliminary results indicate inclusion errors, but fewer than anticipated, in favor of the nonpoor, notably in the discounted health benefits card program (AMG2). We are aware that the reform of social protection policies should continue to move toward better-targeted programs. Until now, these policies were characterized was by specific household support programs (increasing existing transfers or expanding beneficiaries), but we are moving toward a complete reform of the social protection system based on the following priorities:

- We will accelerate our efforts on the unique social identifier, which is now finalized for 8.5 million individuals (persons covered by the different social security regimes and their beneficiaries). The identifier, cross-checked with data from the civil registry and the social security database, will be completed in the coming months as the "exclusion and inclusion errors" are corrected. The inclusion of social assistance beneficiaries (of cash transfers and health benefits cards) in the unique social identifier system is also planned.

- Specific measures for better targeting of energy subsidies to households, designed by an ad-hoc commission created in July 2014, are now under government review, and a reform scenario will be subsequently adopted.

- We will begin development, with World Bank technical assistance, of a communication strategy that will be put in place after the modalities of a new targeting program are established.

35. The deficit of the pension system calls for urgent reform. The national retirement and social security fund (CNRPS) is expected to post an annual deficit of TND 410 million (about 0.5 percent of GDP) in 2014 and currently has no available cash reserves. For this year, the government decided to provide a transfer of TND 250 million as a counterpart to receivables from certain public enterprises experiencing financial difficulties, in particular public transport companies. For 2015 and in the context of implementing the social contract, consultations with our social partners are under way to find urgent solutions including, in particular, increasing payroll contributions and delaying the retirement age. The adoption of these solutions should be part of a comprehensive reform of the retirement and health insurance system, in order to ensure the system's long-term sustainability.

Annex. Principles for Successful Restructuring of Public Banks

The best experiences with restructuring plans include **a clear, specific timetable and the following pillars:**

Financial restructuring

The purpose of financial restructuring is to restore solvency (net assets) by rehabilitating and strengthening banks' balance sheets.

- Existing and new fit-and-proper private shareholders should be asked to contribute to recapitalization through cash injection. Existing shareholders will bring the bank to solvency if needed, and public funds can be used to bring the bank back to minimum capital requirements once sources of private capital have been exhausted.
- Before any public funds are injected, the shares of existing shareholders have to be diluted or the overall loss has to be distributed amongst them.
- The government should seek authorization in a supplementary budget if the government's share of the recapitalization costs is higher than the budgeted amount.

Operational restructuring

Operational restructuring aims at creating the conditions for restoring banks' sustained solvency and profitability.

- To ensure good corporate governance, Bank Board members representing the State and bank managers are fit and proper and professionally suitable; and a relationship framework should be signed to govern the interaction between the Finance Ministry and each state-owned bank. The latter will help ensure no political interference in banks' commercial operations.
- To ensure effective governance and communication in the use of public funds for bank recapitalization and restructuring, the following requirements will need to be set:

    a. A high-level committee comprising the Minister of Finance and the CBT Governor should be established to coordinate the process, including approval of the overall strategy and monitoring of progress;

    b. The committee should appoint a spokesperson to be in charge of the communication strategy of the recapitalization and restructuring process, to ensure timely and consistent information to the public;

    c. The State's interest in the banks should be managed in a dedicated, specialized unit set up at the Ministry of Finance.

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

	Cumulative Flows Since the Beginning of 2014														
	Mar 2014			Jun 2014				Sep 2014				Dec 2014		Mar 2015
	Adjusted target	Actual	PC Status	Prog. 04/25/14	Adjusted target	Actual	PC Status	Prog. 08/29/14	Adjusted target	Actual	PC Status	Prog. 08/29/14	Revised PC	New PC
Quantitative Performance Criteria		(Millions of Tunisian Dinars)												
1. Floor on the primary balance of the central government (cash basis excl. grants)		-1,116	Met	-2,806		-1,549	Met	-3,793		-2,386	Met	-5,587	-4,374	-1,162
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock)	4,327	2,457	Met	4,086	4,903	3,371	Met	3,961	5,115	2,842	Met	1,466	3,187	2,711
		(Millions of US$)												
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock)	5,067	5,180	Met	4,754	4,228	4,342	Met	5,487	4,744	5,005	Met	6,877	5,709	6,058
Continuous Performance Criteria		(Millions of Tunisian Dinars)												
4. Ceiling on the accumulation of new external debt payment arrears by the central government		0	Met	0		0	Met	0		0	Met	0	0	0
Quantitative Indicative Targets		(Millions of Tunisian Dinars)												
5. Ceiling on Current Primary Expenditure		4,058	Met	8,267		7,745	Met	12,915		11,910	Met	18,033	18,191	4,860
6. Floor on Social Spending 3/		282	Met	562		624	Met	962		836	Not Met	1,412	1,412	310
7. Ceiling on the accumulation of new domestic arrears		0	Met	0		0	Met	0		0	Met	0	0	0
Program assumptions on which adjusters are calculated in case of deviations														
External Financing of the central government on a cumulative basis (in US$ million) 4/		230		707		269		1,438		1178		2,647	1996	894
of which: Multilateral (excluding IMF), bilateral and budget grants		201		528		201		812		524		1,534	884	628
Public debt service (interest and amortization) on a cumulative basis (in US$ million)		203		506		459		662		655		913	894	230
Bank recapitalization (in million TD)		0		0		0		300		0		700	0	0
Privatization receipts (in million USD)		0		0		0		0		0		0	0	0
Resident deposits at the BCT (in million USD) 5/		1,852		1,852		1,607		1,852		1,389		1,852	1,852	1852
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/ Disbursment, includes project loans and capital market access but excludes IMF budget support.
5/ At program exchange rate.

Table 2a. Tunisia: Structural Benchmarks for the Period July–December 2014

	Objective	Date	New Date	Comments
I. Financial sector				
Completion of the financial audit of the Banque National Agricole (BNA)	*Financial sector stability*	*Jul-14*	*Sep-14*	**Met** with delay in November 2014.
Creation of Asset Management Company (AMC) through the publication in the Official Journal of the Law on the AMC.	*Financial sector stability*	*Sep-14*	*Apr-15*	**Not met.** Reset to April 2015. The adoption of Article 4 of the supplementary budget defined the objectives of the AMC. The law granting juridical personality to the AMC could not be adopted before the parliamentary recess and will be adopted in 2015 in the next session of Parliament.
Adoption by the Government of the BNA restructuring plan.	*Financial sector stability*	*Nov-14*		**Not met.** The audit has been completed, and options for a sound restructuring are being assessed, and presented to the Board of Directors on November 11, 2014. The plan will follow sound international practices once the recapitalization modalities are defined and the restructuring option has been chosen.
Double the number of DGSB supervisors and revise the CBT hiring criteria to facilitate the hiring of qualified personnel.	*Financial sector stability*	*Nov-14*	*Mar-15*	**Not met.** Reset to March 2015.
All banks, including public banks, to comply with minimum solvency ratio required by the existing regulations (10 percent)	*Financial sector stability*	*Dec.-14*	*May-15*	**Not Met.** The minimum ratio will be met by private banks by end-December 2014, but delayed to May 2015 for public banks, which still have to be recapitalized.
Development and implementation of the new reporting and rating system for banks	*Financial sector stability*	*Dec-14*		**In progress.** Work on the new rating and reporting system is in progress with technical assistance from the IMF.
II. Fiscal policy				
Government approval of the new tax code	*Enhance transparency of the tax system*	*Sep-14*		**Met** with delay. All norms and regulations were consolidated in a single text submitted to the ANC in October 2014.
Following national consultations on taxation, adoption of a tax reform plan covering direct and indirect taxes by the Council of Ministers.	*Expand the tax base and improve equity*	*Oct.-2014*	*Dec.-2014*	**Not met.** The national consultations took place in November and validated a reform plan which will be adopted by the Government in December 2014.
Parliamentary Approval of the 2015 budget	*Fiscal sustainability*	*Dec-14*		
III. Monetary and exchange policies				
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*		**Met**. Circular issued in March 2014 and will take effect on January 1, 2015
Implementation of the weekly foreign exchange auction mechanism	*Greater exchange rate flexibility*	*Dec-14*		**In progress**. The hardware platform has been put in place, and the software will be put in place following IMF TA.
IV. Structural reforms/private sector development				
Decrees for implementing the new investment code, in line with the objective of protecting market access, reducing restrictions to investments and rationalizing incentives	*Support for balanced growth driven by the private sector*	*Sep-14*	*Delayed to May-2015*	**Not Met**. The decrees will not be submitted to Parliament because the government decided to withdraw the draft law on the investment code from parliament; a revised code will be prepared by May 2015.

Table 2b. Tunisia: Structural Benchmarks for the Period January–May 2015

	Objective	Date	Comments
I. Financial sector			
Designation of fit and proper Board members of the three public banks, with private sector experience.	*Financial sector stability*	*Jan-15*	
Adoption of recapitalization plans in line with sound international practices by the general assembly of the three public banks, following the criteria outlined in Annex 1 to the MEFP and based on the results of the audits.	*Financial sector stability*	*Mar-15*	
Approval by the Board of Directors of performance contracts in line with norms included in the bank restructuring plans for the STB, BH and BNA and subordinated to the approval of the respective recapitalization plans.	*Financial sector stability*	*Mar-15*	
Adoption by Parliament of the banking law (that includes a banking resolution framework) in line with sound international practices	*Financial sector stability*	*Mar-15*	
Publication, on the Official Gazette, of the law governing the functioning of the AMC in line with sound international practices, as well as Government adoption of the related implemetation decrees.	*Financial sector stability*	*Apr-15*	*Reset and reformulated from September 2014.*
All banks, including public banks, to comply with minimum solvency ratio required by the existing regulations (10 percent)	*Financial sector stability*	*May-15*	*Reset from December 2014*
II. Fiscal policy			
Creation of a new category of public accountants called "*tax collectors* "	Enhance transparency of the tax system and revenue collection	*Jan-15*	
Adoption by the Governmment of a strategy for a better monitoring of operations and financial performance of public enterprises	Reduce fiscal risks	*Apr-15*	
Signature of performance contracts for the 5 largest state-owned companies	Reduce fiscal risks	*Apr-15*	
Adoption by the government of a calendar for the total convergence of the tax rates of onshore and offshore sectors	Minimize distortions, and tax fairness and simplification	*May-15*	
III. Monetary and exchange policies			
Establishment of the lender of last resort mechanism	*Financial system stability and better crisis management*	*May-15*	*Reset from June 2014.*
IV. Structural reforms/private sector development			
Revision of the new investment code in line with the objective to protect market access, reduce investment restrictions, and rationalize exemptions.	*Support for balanced growth driven by the private sector*	*Apr-15*	*Reset and reformulated from September 2014.*

Table 3. Tunisia: Fiscal Measures included in Supplementary Budget 2014

	In Millions of TD	In Percent of GDP
Tax Revenue	460	0.55
Vehicle taxes	15	0.02
Tourism taxes	75	0.09
Stamp taxes	30	0.04
Other tax measures incl. exceptional taxation on revenues 1/	340	0.41
Current expenditure	7	0.01
Decreased energy subsidies	7	0.01
Total	467	0.56

1/ One-off tax contribution amounting to a total of 0.4 percent of GDP distributed as follows: (i) wages, contributing with 18 percent of the total amount through 1 to 6 days of wages depending on level of salaries; (ii) professionals, contributing with 9 percent of total amount through 15 percent of the sum of the second and third installments due in 2014; (iii) non-oil companies, contributing with 50 percent of the total amount through a minimum of 0.05 percent for installment of total domestic sales for 2014; and (iv) oil companies contributing with 23 percent of the total amount through 10 percent of the oil tax due in second half of 2013.

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 December 3, 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	Average 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

[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 $1,852.07 million at the program exchange rate.

of the central government; and (iii) a protocol between the CBT and the Ministry of Finance provides clearly that the CBT is authorized to pay all expenses and costs pertaining to the implementation of this issue as well as the interest and principal of the issue sum through direct deduction from the Treasury's current account established in the CBT's books.

13. The value of CBT reserve assets and liabilities in foreign currency will be calculated using program exchange rates (see Table above). On December 31, 2012, the value of the stock of net international reserves was $7.937 billion, with the stock of reserve assets equal to $8.645 billion and the stock of CBT liabilities in foreign currency equal to $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 expenditure.[3]

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.

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 observed at end December 2013. 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 above.

[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		2015				
	2014 Q4	Year	2015 Q1	2015 Q2	2015 Q3	2015 Q4	Year
Government External Financing	929.0	3,058.3	1,223.3	511.5	504.7	581.6	2,821.0
Project loans	84.5	256.3	30.0	50.0	110.0	110.0	300.0
Multilateral donors	278.1	1,479.9	957.1	338.4	200.0	400.0	1,895.4
AFDB	0.0	0.0	0.0	0.0	200.0	0.0	200.0
AMF (Arab Monetary Fund)	41.5	41.5	0.0	0.0	0.0	0.0	0.0
IMF (budget support)	110.1	1,061.9	329.7	219.8	0.0	0.0	549.5
World Bank Group	0.0	250.0	500.0	0.0	0.0	400.0	900.0
European Union	126.5	126.5	127.4	118.6	0.0	0.0	245.9
Bilateral donors	100.0	300.0	0.0	0.0	0.0	0.0	0.0
Algeria Budget support	100.0	100.0	0.0	0.0	0.0	0.0	0.0
Turkish loan	0.0	200.0	0.0	0.0	0.0	0.0	0.0
Financial Market Access and other	466.4	1,022.1	236.2	123.1	194.7	71.6	625.6
Sukuk and other market financing	0.0	0.0	226.2	113.1	169.7	56.6	565.6
Market issuance with Japanese guarantee	463.7	463.7	0.0	0.0	0.0	0.0	0.0
Market issuance with US Treasury guarantee	0.0	500.0	0.0	0.0	0.0	0.0	0.0
Loan Transfers to SOEs	2.7	58.4	10.0	10.0	25.0	15.0	60.0
Budget Grant	92.0	165.6	0.5	0.0	58.5	76.7	135.6
Privatization Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government External Debt Service	239.1	945.9	229.6	329.6	221.9	277.4	1,058.5
Amortization	177.6	604.7	142.7	234.5	140.5	221.2	738.9
Interest	61.4	341.2	86.9	95.1	81.4	56.2	319.6
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.

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 and restructure the public banks. The amounts for the last quarter of 2014 and first quarter of 2015 are assumed to be zero.

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

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

Debt guaranteed by the government: by instrument and type of currency (in dinars and in foreign currencies and its equivalent in national currency) **External and domestic debt service:** amortization and interest.	*m*	*60*
External payment arrears: external debt contracted and guaranteed by the government.	*q*	*30*
Debt rescheduling: possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	*q*	*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).	*m*	*30*
External Sector		
Imports of Petroleum Products: average import price of main petroleum products.	*m*	*30*
Foreign trade: imports and exports of goods, including volumes and prices, by sector.	*m*	*30*
Deposits: Stock of foreign currency deposits, according to the residence of the holder.	*m*	*14*
External debt:	*q*	*30*
Debt service (amortization and interest) of institutional agents by instrument and at type of currency (in foreign currency and its equivalent in dinars).	*m*	*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).	*q*	*90*
Overall net external position of Tunisia (preliminary).	*q*	*90*
Overall gross external debt position	*q*	*90*
Overall net external position of Tunisia (in conformity with our obligations under SDDS).	*A*	*180*
Balance of payments: Prepared by the CBT	*q*	*30*

Monetary and Financial Sector		
CBT accounts at the current exchange rate: detailed table including the monetary system.	*m*	*30*
CBT accounts at the program exchange rate: Including net international reserves.	*m*	*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.	*m*	*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.	*m*	*30*
Direct refinancing of commercial banks by the CBT: Breakdown by bank.	*m*	*14*
Interest rates: Deposit rates, interbank rates, and lending rates.	*w*	*14*
NPLs: Stock of banking sector NPLs, and breakdown by commercial banks.	*q*	*60*
Balance sheets of commercial banks, including detailed income statements, in accordance with "Uniform Bank Performance Reporting" agreed with Fund staff.	*q*	*60*
Other information to be reported		
Information on Fiscal, Monetary, and Financial Policy: Decrees or circulars newly adopted or revised concerning changes in tax policy, tax administration, foreign exchange market regulations, and banking regulations. A copy of official notices of changes in gas and electricity rates and any other surcharge (automatic or structural), as well as the prices of petroleum products and levies/surcharges on gas and petroleum.	*d*	*3*

Statement by the IMF Staff Representative on Tunisia
December 12, 2014

This statement reports on the latest economic data updates and political assurances from the main parties that won the legislative elections. The information does not alter the thrust of the Staff Appraisal.

1. **Recent indicators remain in line with staff's projections.** New agricultural and construction data led to a small upwards revision in growth to 2.3 percent for the first half of 2014 (up from 2.1 percent), and consistent with the 2.4 percent yearly forecast. Headline inflation fell to 5.2 percent y-o-y in November, while core inflation remained unchanged at about 5 percent.

2. **The government's reform agenda has broad support from the main political parties that won the majority of seats in the October legislative elections.** The economic vision deployed by the government in the September 2014 "Invest in Tunisia" conference was designed through a national dialogue and supported by a broad spectrum of political parties. The two main political parties, Nidaa Tounes—which secured 39 percent of the seats in the new Parliament and is in charge of forming the next government—and Ennahda—the party that came in second in the legislative elections with 31 percent of the votes—both communicated their commitment[1] to the policies and structural reforms of the outgoing government that are supported by multilateral donors (e.g., IMF and World Bank), including on fiscal consolidation. Nidaa Tounes specifically stated that it will support the adoption of the main aggregates and key parameters of the 2015 budget law and its underlying policies. On the basis of these assurances, staff expects the draft 2015 budget to be approved by parliament in line with the key objectives outlined in the outgoing government's Memorandum of Economic and Financial Policies.

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[1] This commitment was reiterated to staff through several verbal communications with Ennahda and Nidaa Tounes party officials. It was also noted publicly for the Nidaa Tounes party through an interview on December 4, 2014 in "Le Quotidien" by Mahmoud Ben Romdhane (a member of Nidaa Tounes's Executive Board and President of its Economic and Social Commission), and for the Ennahda party through an interview on December 7, 2014 in www.espacemanager.com by Ridha Saidi (Former minister in charge of economic affairs and current member of Ennahda's executive board, in charge of its socioeconomic program).

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FOR IMMEDIATE RELEASE
December 12, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fifth Review Under Stand-By Arrangement for Tunisia; Approves US$104.8 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fifth review of Tunisia's performance under an economic program supported by a Stand-By Arrangement (SBA). The completion of the fifth review enables the disbursement of SDR 71.6 million (about US$104.8 million), bringing total disbursements under the arrangement to SDR 787.87 million (about US$1.15 billion). The two-year SBA in the amount of SDR 1.1 billion (about US$1.68 billion, 400 percent of Tunisia's quota) was approved by the Executive Board on June 7, 2013 (see Press Release No. 13/202).

In completing the fifth review, the Executive Board approved the authorities' requests to re-phase purchases under the arrangement, and to modify end-December 2014 quantitative performance criteria on net international reserves, net domestic assets and the primary fiscal deficit.

Following the Executive Board's discussion on Tunisia, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair issued the following statement:

"Tunisia is completing a successful political transition while navigating a challenging domestic and external environment. Tunisia's economy has been resilient, although large external and fiscal imbalances, high unemployment and rising banking fragilities call for forcefully pushing ahead with reform implementation.

"Performance under the Fund-supported program has been good with the successful attainment of all quantitative performance criteria. However, structural reforms have been progressing slowly, with considerable delays in recapitalizing and restructuring public banks.

"Fiscal consolidation remains essential to reduce vulnerabilities. The 2015 budget appropriately aims at anchoring macroeconomic stabilization while preserving priority social and capital expenditures. Further reduction in energy subsidies and strict control of the public wage bill is welcome, as is the authorities' intention to save any gains from lower international oil prices. Growth-enhancing reforms, including of public enterprises and pensions, public financial management, and tax administration would help improve absorptive capacity, equity, efficiency, and risk management.

"A tighter monetary stance would help keep inflationary pressures in check, reduce exchange rate pressures, and eventually bring about positive real interest rates. Greater exchange rate flexibility—including through continuing to limit foreign exchange interventions to smoothing large fluctuations—will contribute to strengthening reserve buffers and correcting large external imbalances.

"Efforts to reduce financial sector vulnerabilities should be stepped up. Recapitalizing and restructuring public banks in line with good international practices is urgent, in view of increased financial sector vulnerabilities and the need to support growth. Modernization of the banking resolution framework, operationalization of the Asset Management Company, and an upgrade of the supervisory and regulatory framework would enhance financial stability and reduce moral hazard.

"Accelerated implementation of structural reforms is urgently needed to improve the investment climate and generate stronger and more inclusive growth. Legislative approval of the bankruptcy, competition, and public private partnerships laws are key priorities."

Statement by Jafar Mojarrad, Executive Director for Tunisia;
and Moez Ben Hassine, Advisor
December 12, 2014

On behalf of our Tunisian authorities, we thank staff for their hard work, and Management and the Executive Board for their support.

This fifth review of the two-year Stand-By Arrangement coincides with the political transition in Tunisia reaching its final phase, with the holding of open and transparent legislative elections in October and the first round of presidential elections held in November. Nidaa Tunes, the party that won the most seats in parliament, will form a new coalition government early in 2015, following the second round of the presidential elections in late December.

The incoming government is expected to address the many challenges facing Tunisia, including implementing the economic reforms that are incorporated in the medium term vision, which was supported by the majority of the political parties and civil society in the context of the national dialogue and was well received by Tunisia's development partners during the September 2014 international conference "Invest in Tunisia". Leaders of the two main political parties have confirmed their commitment to the economic program and reforms supported by the IMF.

Program implementation and modalities

Despite the challenging environment of the political transition, the domestic and regional security risks, and the weak growth in Tunisia's main trading partners, the authorities have kept the program on track. All the performance criteria have been met and progress was made on the structural reform agenda. The end-June and end-September performance criteria for net international reserves (NIR), net domestic assets (NDA), and central government primary balance were met, as were the indicative ceilings on current expenditure and accumulation of arrears. However, the indicative floor on social spending, which was met at end-June, was missed at end-September, but is expected to be achieved by the end of this year.

On structural reforms, while progress is assessed by staff to be slow judging by the number of missed structural benchmarks, considerable work has gone into the preparation of major reforms, such as the tax reform, the investment code, and the recapitalization and restructuring of public banks. Legislative approval by the outgoing National Constituent Assembly (*Assemblée Nationale Constitutive,* ANC) of the Asset Management Company (AMC) and the use of the recapitalization funds already included in the 2014 budget could not be secured in the period leading up to the legislative elections, which delayed completion of the related structural benchmark on AMC and compliance by public banks with the minimum solvency ratio. Completion of some other structural benchmarks was delayed mainly because consultations with stakeholders took longer than expected (adoption of the tax reform), or to improve on the original proposals (decrees on the new investment code, BNA restructuring). Nonetheless, such delays will be short, and the authorities remain committed to achieving their reform agenda and look forward to the opportunity offered by the end of the political transition early next year to decisively move forward with the approval and implementation of these reforms.

Against this background, while noting the proposed re-phasing of the remaining purchases under the SBA, and the justification provided in the report, namely "to allow better program alignment with the pace of reforms", we believe that maintaining the original disbursement under this review would have sent a better signal of the authorities' continued commitment to the program during this crucial phase of the political transition.

Recent economic developments and outlook

Macroeconomic developments in 2014 remain broadly in line with the program estimates and projections, attesting to the Tunisian economy's resilience. Real GDP growth is expected to reach 2.4 percent in 2014, reflecting a record domestic cereal and olive oil production, as well as recovery of manufacturing and services. The good performance in these sectors, however, was partly offset by lower oil and gas production due to technical stoppages and a decline in oil reserves. Headline inflation fell to 5.4 percent y-o-y in October, driven by lower food and energy prices, and is projected at 5.5 percent at the end of the year. Core inflation increased slightly to 4.9 percent, due to the rise in prices of services, but is under control. The current account deficit is projected at 7.9 percent of GDP in 2014, down from 8.3 percent in 2013, reflecting lower food imports and better-than-expected tourism receipts and worker remittances. Lower energy and commodity prices, together with active promotion of Tunisia's exports, will help reduce the current account deficit to 6.4 percent of GDP in 2015. Gross official reserves are expected to reach $7.8 billion at end-2014 (3.4 months of imports).

Tunisia's medium term economic outlook is promising. With the success of the democratic transition, and the expected formation of a new government early next year, the authorities believe that uncertainty will dissipate, leading to increased investment and further expansion of economic activity. Projections for 2015 are subject to downside risks from weak growth in Europe and regional uncertainties, but increased confidence and acceleration of reforms are key upside factors.

Fiscal policy

Fiscal performance has been better than projected. The end-September fiscal deficit target was met by a wide margin, primarily reflecting stronger revenue from taxes on oil companies (0.5 percent of GDP) and VAT receipts (12 percent y-o-y growth). For the full year, the structural deficit—excluding the effects of the economic cycle and the cost of the recapitalization of banks—is expected to reach 4.1 percent of GDP compared to 4.7 percent under the program. Current spending has been contained, and the related indicative ceiling has been observed. While the pace of execution of investment expenditures has been slow during the first half of the year, it is expected to accelerate during the last quarter, bringing the execution rate close to 90 percent by the end of 2014, which would be adequate given the security issues and weak capacity at the regional level. Staff advice to improve planning and prioritization and strengthen procurement procedures to enhance the execution of the investment budget is well taken.

Further fiscal adjustment is envisaged under the 2015 draft budget law, which should be approved by the new parliament by end-December 2014 (new SB). The proposed reduction in the structural fiscal deficit to 3.8 percent of GDP is in line with the authorities' objectives of reducing pressure on the balance of payments and containing growth of public debt. The bulk of fiscal consolidation will come from lower government spending, while revenue would increase to reflect the full-year effect of the tax revenue measures introduced in the supplementary 2014 budget and enhanced tax arrears collection (MEFP 6).

A comprehensive tax reform has already started. All the existing tax laws and codes were consolidated into a single tax code that was approved by the government and presented to the ANC in October (end-September SB), national tax consultations were held in November 2014, and a comprehensive tax reform plan is expected to be approved in December. Under this reform, the authorities are planning to revise the corporate income tax to achieve gradual convergence of the off-shore and on-shore sectors. In 2015, attention will continue to focus on reforming the VAT and excise taxes. The effect of the planned comprehensive tax reform is expected to materialize in 2016 and beyond. In parallel, sustained efforts are being made to reform administration, including strengthening tax agencies and moving towards a unified tax administration (MEFP 24-25).

On the expenditure side, the subsidy reform program will continue to be implemented in 2015. In addition to the full impact of the measures introduced in 2014 (0.3 percent of GDP), further increases in electricity tariffs for industrial and low-voltage consumers and upward adjustments in fuel prices are planned, which would generate savings of about 0.4 percent of GDP. The authorities also intend to save any net gains on oil import costs that would materialize if the average oil price for 2015 is lower than the budget assumption of $ 95 per barrel (a $ 10 per barrel difference between the WEO oil price and the budget price assumption will generate savings of 0.5 percent of GDP). The most disadvantaged population will be protected through social programs and preferential tariffs for households consuming less than 100 kw per month. Furthermore, efforts will be made to contain the wage bill by limiting salary increases and freezing net hiring except for security, education, and the health sectors. Preparatory work is underway with World Bank assistance to reform and rationalize the civil service.

Monetary and exchange rate policies

A gradual tightening of monetary policy since the beginning of the year has helped contain second round inflationary effects from administrative price increases. The NDA target was met with a comfortable margin, with credit to the private sector increasing by 8.4 percent y-o-y at end-September 2014. While inflation is expected to trend downward given the declining energy and commodity prices, the authorities will remain vigilant and stand ready to tighten monetary policy further as needed to contain inflation.

Increased exchange rate flexibility has allowed the dinar to more closely reflect market trends and helped build official reserves. The authorities are committed to continue to pursue a flexible exchange rate policy while smoothing excessive fluctuations resulting from large energy transactions. Establishment of an electronic bank interlinking platform, together with the implementation of the market maker agreement, will facilitate the establishment of a weekly foreign exchange auction mechanism by year-end (SB for end-December 2014).

The reform of the monetary policy framework is moving forward (MEFP 11-14). Specific actions and plans aim at: (i) reducing the risk to CBT balance sheet through increases of the haircut on the valuation of loans eligible for refinancing and by raising the share of government securities used as collateral from 20 percent to 40 percent (December 2014); (ii) reducing direct refinancing from the CBT through the use of OMO; and (iii) using an interim "exceptional facility", which was established in July 2014, to allow illiquid but solvent banks to access central bank resources at a penalty rate and subject to intrusive banking supervision. Wide-ranging amendments to the central bank law aimed at giving the CBT greater autonomy and better defining its mandate were presented to the CBT Board of Directors in June 2014 and are expected to be approved in March 2015.

Financial sector stability

The authorities are strongly committed to addressing financial sector vulnerabilities. Following the adoption by the government of restructuring plans of two public banks (STB and BH), the audit of the third bank (BNA) has been finalized and its restructuring plan was presented in November to the government for approval. New "fit and proper" board members will be appointed by January 2015, a new management will be named once the new government is in place, and performance contracts will be signed in March 2015, in line with the approved restructuring plans.

Recapitalization of public banks has been delayed for temporary and exceptional reasons, but the reform is still high on the authorities' agenda. While the authorities were not able to use the recapitalization funds already allocated in the 2014 budget (1.2 percent of GDP) because of legislative delays, the new parliament is expected to grant the related authorization at the beginning of the year. The authorities agree that bank recapitalization should remain in line with international best practices, and are engaging private shareholders to prevent their use of veto rights to block the recapitalization operation. A new banking law is under preparation with technical assistance from the IMF and the World Bank to strengthen banking supervision and regulation and establish a sound legal framework for the resolution of insolvent banks, including addressing the current issue of minority blocking rights of private shareholders in public banks.

Work has continued for the establishment of the AMC to address the NPL problem in the tourism sector. Despite strong resistance from the tourism industry, the AMC was created in the 2014 supplementary budget law, which defines its objectives and authorizes the government to subscribe TND 150 million of its capital. The AMC law, which will provide the legal and operational framework for the transfer and resolution of loans, pricing standards, and the AMC governance, is awaiting parliamentary approval, and the authorities have expressed their intention to make it a priority in the next session of the new parliament.

Structural reforms:

The authorities attach high importance to deepening structural reforms to improve the business climate, attract private sector investment, and foster efficiency and competitiveness. The heavy agenda of the ANC in the run up to the elections, including the focus on the electoral and anti-terrorism laws, has delayed the approval of important economic legislation, which is expected to be taken up by the new parliament, including the laws on competition, PPPs, and bankruptcy procedures. Nonetheless, restructuring plans to improve governance and financial soundness of vulnerable public enterprises, particularly in the transport sector, have been adopted. The authorities have also prepared a comprehensive strategy aimed at addressing labor market rigidities and reducing skills mismatches.

Conclusion:

The authorities' program is on track, all performance criteria and indicative targets (except one) have been met, and progress has been made toward advancing the reform agenda. Seen from the perspective of the challenges facing Tunisia during this critical phase of political transition, including intensive preparations of the legislative and presidential elections, and in view of the need to address domestic and regional terrorism risks, these achievements are commendable. The authorities remain committed to their reform strategy and look forward to the opportunity offered by completion of the political transition to accelerate implementation of their reform agenda, supported by the Fund and development partners.