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TUNISIA

October 2015

2015 ARTICLE IV CONSULTATION, SIXTH REVIEW UNDER THE STAND-BY ARRANGEMENT, AND REQUEST FOR REPHASING—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR TUNISIA

In the context of the 2015 Article IV Consultation, Sixth Review under the Stand-By Arrangement, and Request for Rephasing, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its September 30, 2015 consideration of the staff report on issues related to the Article IV Consultation and the Stand-By Arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 30, 2015, following discussions that ended on June 10, 2015, with the officials of Tunisia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on September 17, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Tunisia.

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

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

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

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International Monetary Fund
Washington, D.C.

Press Release No. 15/448
FOR IMMEDIATE RELEASE
September 30, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Sixth Review Under Stand-By Arrangement for Tunisia

The Executive Board of the International Monetary Fund (IMF) today completed the sixth review of Tunisia's economic performance under a 24-month program supported by a Stand-By Arrangement (SBA). The completion of the sixth review enables the immediate disbursement of SDR 214.875 million (about US$301.6 million), bringing total disbursements under the arrangement to SDR 1 billion (about US$ 1.41 billion).

The two-year SBA in the amount of SDR 1.146 billion (about US$1.61 billion, 400 percent of Tunisia's quota) was approved by the Executive Board on June 7, 2013 (See Press Release No. 13/202). On May 11, 2015, the Executive Board approved a 7-month extension of the SBA to December 31, 2015 to provide time for the Tunisian authorities to implement the policy measures needed to deliver forward-looking commitments – notably on the banking and fiscal reforms- which will help reduce vulnerabilities and spur higher and inclusive growth.

In completing the sixth review, the Executive Board approved the authorities' requests to re-phase purchases under the arrangement.

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

"Tunisia's economy has been resilient in a context marked by a prolonged political transition and a difficult international economic environment. All quantitative performance criteria under the Fund-supported program have been met. However, progress on structural reforms, including in the banking and fiscal areas, has been challenging. The successful completion of the political transition represents a good opportunity to press ahead with reform implementation and complete the unfinished agenda within the program timeline.

"The 2015 fiscal stance is appropriate to mitigate the economic fallout from the recent terrorist attacks, but a resumption of fiscal consolidation from 2016 remains essential to reduce vulnerabilities. Better budget composition—including through wage bill containment, energy subsidy reform, and a tax policy aimed at promoting greater equity and efficiency—is needed to create space for priority investment spending. Growth-friendly reforms, including

of public enterprises, public financial management, and tax administration will improve absorptive capacity, equity, and risk management.

"A prudent monetary policy would continue to contain inflationary pressures, preserve positive real interest rates and reduce exchange rate pressures. Greater exchange rate flexibility—including through limiting foreign exchange interventions to smoothing large fluctuations—would help strengthen reserve buffers and correct external imbalances.

"In order to strengthen the banking system and facilitate financial sector intermediation, it is important to recapitalize all three public banks and to update underlying business plans so as to ensure regulatory compliance throughout the restructuring period. A modernized banking resolution and supervisory framework and an effective bankruptcy framework are also key.

"Boosting growth and creating jobs requires an improved business environment. Faster implementation of the structural reform agenda, particularly to strengthen the investment climate and labor markets is encouraged."

INTERNATIONAL MONETARY FUND

Press Release No. 15/471
FOR IMMEDIATE RELEASE
October 14, 2015

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with Tunisia

On September 30, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation with Tunisia[1].

Tunisia's economy has been resilient throughout a protracted political transition and a difficult international economic environment. The country has been facing headwinds from security threats and social tensions, which are offsetting the benefits from the successful conclusion of the political transition, lower international oil prices, and a recovering Europe.

After successfully recovering from the trough of 2011, growth momentum has waned in early 2015, with GDP growth averaging 1.2 percent (y-o-y) for the first semester as activity in the manufacturing, tourism, and mining sectors slowed significantly. At the same time, unemployment has been persistently high. Headline inflation dropped to 4.2 percent in July, reflecting lower food prices and a prudent monetary policy.

External imbalances remain high. Weak tourism receipts, buoying imports (especially energy and capital goods imports), and declining oil and phosphate exports widened the current account deficit to 8.8 percent of GDP in 2014, its highest level since the 1980s. Exceptional olive oil exports and declining energy imports narrowed the deficit in the early part of 2015, but this improvement is not expected to last as tourism revenues—which were significantly impacted by the Bardo and Sousse attacks—are expected to drop this year. Reserve buffers are holding up, helped by a successful international bond issuance earlier in the year.

The fiscal situation improved, with the structural fiscal deficit declining to 3.3 percent of GDP in 2014 due to strong revenue collection. However, the budget composition weakened as public investment—which is necessary to sustain growth—has reached record lows of 4.2 percent of GDP while the wage bill—representing about 60 percent of revenues—rose. The 2015 revised budget accommodates the short-term fallout of the recent economic slowdown, including through increased security expenditures and transfers to SMEs.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

The banking system remains fragile, with the system's capital adequacy ratio below the minimum regulatory requirement. At 15.8 percent, non-performing loans of the banking sector continue to be high. Low deposit growth is keeping public banks structurally illiquid, increasing banks' recourse to CBT refinancing. Against this background, private sector credit growth remains modest, with its level well below potential.

The medium-term prospects remain favorable—with growth projected to increase to 4.7 percent by 2020. They hinge on reduced security risks and easing of social tensions, and the successful and quick implementation of comprehensive reforms that improve the business climate and foster private sector development.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for maintaining macroeconomic stability in the context of a prolonged political transition and a difficult international economic environment. While all quantitative performance criteria under the Fund-supported program have been met, progress on structural reforms has been challenging. Directors regretted the recent terrorist attacks, which weakened confidence and growth in 2015, and expressed their support for the authorities' response. Directors agreed that the successful completion of the political transition represents an opportunity for the authorities to press ahead with efforts to strengthen the fiscal position, complete financial sector reforms, and accelerate structural reforms to improve growth and employment prospects.

Directors considered the modest fiscal loosening to respond to weaker economic activity in 2015 to be appropriate, but stressed that a return to fiscal consolidation from 2016 onwards is needed. In this regard, Directors urged the authorities to improve budget composition by containing the growing wage bill through civil service reform and by reducing energy subsidies in a sustainable manner through the implementation of a new automatic fuel price formula. They also noted the importance of using fiscal space for priority social spending and stepping up the implementation of public investment from its currently low level.

Directors stressed the importance of growth-friendly fiscal reforms. They welcomed the government's commitment to adopt a tax reform that increases equity, efficiency and permanent revenues. Strengthening public financial management and public enterprise monitoring would help reduce fiscal risks. Directors also commended the authorities' commitment to pension reform.

Directors welcomed the authorities' prudent monetary stance. They were encouraged by the recent move towards positive real interest rates and the central bank's readiness to raise the policy rate further if inflationary pressures materialize. Directors looked forward to further efforts to strengthen the monetary policy framework and to the adoption of the central bank law

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

which will strengthen its independence and clarify its objectives. They supported the authorities' commitment to move toward greater exchange rate flexibility—supported by efforts to deepen the foreign exchange market—which will help strengthen reserve buffers and reduce imbalances.

Directors welcomed the steps being taken to modernize and strengthen the banking system and its governance. They called for the swift completion of the recapitalization of all public banks and stressed the importance of ensuring regulatory compliance throughout the restructuring period. They also emphasized the importance of modernizing the banking resolution framework, strengthening banking supervision and regulation, and introducing an effective bankruptcy law to support the resolution of nonperforming loans.

Directors stressed that a better business environment is key to bolster growth and job creation and strengthen competitiveness. They welcomed the adoption of the competition law, and called on the authorities to step up efforts to revamp the regulatory environment—including through adopting long-standing legislation on investment—and to initiate labor market reforms aimed at addressing the high levels of unemployment.

It is expected that the next Article IV consultation with Tunisia will be held in accordance with the Executive Board decision on consultation cycles for members with Fund arrangements.

Tunisia: Selected Economic and Financial Indicators, 2012–16

	2012	2013	2014 Fifth Rev. 12/12/14	2014 Prel.	2015 Fifth Rev. 12/12/14	2015 Proj.	2016 Proj.
Production and income (percent change)							
Real GDP	3.7	2.3	2.4	2.3	3.0	1.0	3.0
GDP deflator	5.3	5.7	5.7	5.7	4.8	4.8	3.6
Consumer price index (CPI), average	5.1	5.8	5.6	4.9	5.0	5.0	4.0
Consumer price index (CPI), end of period	5.9	5.7	5.5	4.8	4.5	4.4	4.0
Gross national savings (in percent of GDP)	16.1	13.8	12.7	12.2	14.2	13.0	14.6
Gross investment (in percent of GDP)	24.3	22.0	20.6	21.0	20.6	21.5	21.7
Central government (percent of GDP, unless indicated otherwise 1/							
Total revenue (excluding grants)	23.1	23.6	23.9	24.0	23.6	22.4	23.1
Total expenditure and net lending	28.8	29.8	28.8	28.1	29.8	28.4	27.4
Central government balance (excluding grants)	-5.7	-6.2	-4.8	-4.1	-6.2	-6.0	-4.3
Central government balance (excluding grants, cash basis)	-5.0	-4.5	-7.1	-6.7	-6.2	-6.0	-4.3
Structural fiscal balance 2/	-5.3	-4.5	-4.1	-3.3	-3.8	-3.5	-2.9
Central government debt (foreign and domestic)	44.5	44.3	49.4	50.0	55.2	54.0	56.3
Foreign currency public debt (percent of total debt)	62.8	63.9	68.3	68.0	68.3	68.0	75.0
Total external debt							
External debt (US$ billions)	24.3	25.4	26.6	27.4	29.8	28.5	30.1
External debt (in percent of GDP)	53.8	54.1	54.4	56.2	60.6	64.4	67.5
Debt service ratio (percent of exports of GNFS)	12.0	9.6	9.2	10.1	7.1	11.3	9.3
Money and credit (percent change)							
Credit to the economy	8.8	6.8	7.2	9.4	6.9	6.5	7.6
Broad money (M3 of the financial system)	8.4	6.6	8.7	7.8	10.5	6.9	7.6
Velocity of circulation (GDP/M2)	1.46	1.48	1.47	1.48	1.44	1.47	1.45
External sector (percent change)							
Exports of goods, f.o.b. (in $)	-4.6	0.3	1.1	-1.9	3.9	-11.3	5.1
Imports of goods, f.o.b. (in $)	2.1	-0.5	2.3	1.8	0.9	-15.1	1.1
Exports of goods, f.o.b. (volume)	1.4	4.7	2.3	1.4	4.6	4.8	3.7
Import of goods, f.o.b. (volume)	8.5	5.1	2.6	2.4	3.1	2.0	2.1
Trade balance (in percent of GDP)	-13.5	-12.6	-12.9	-13.7	-11.8	-11.4	-10.1
Current account (in percent of GDP)	-8.2	-8.3	-7.9	-8.8	-6.4	-8.5	-7.0
Foreign direct investment, net (in percent of GDP)	1.5	1.1	2.1	2.2	2.8	2.3	2.6
Terms of trade (deterioration -)	-0.1	1.2	0.2	-2.7	0.9	1.6	2.3
Official reserves							
Gross official reserves (US$ billions, e.o.p)	8.7	7.7	7.8	7.7	10.1	8.2	9.0
In months of next year's imports of goods and services, c.i.f.	3.9	3.4	3.4	4.0	4.4	4.3	4.6
Memorandum items:							
GDP at current prices (TD millions)	70,658	76,350	82,643	82,562	89,217	87,399	93,262
GDP at current prices (US$ billions)	45.2	47.0	48.9	48.6	49.3	44.3	44.6
Real effective exchange rate (percent change, depreciation -) 3/	-1.53	-1.84	...	0.03	...	...	...
Interest rate (money market rate, in percent, e.o.p)	3.3	4.8	...	4.7	...	...	...
Stock market TUNINDEX (12/31/1997=1000)	4,580	4,381	...	4,674	...	...	...

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.

INTERNATIONAL MONETARY FUND

TUNISIA

September 16, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION, SIXTH REVIEW UNDER THE STAND-BY ARRANGEMENT, AND REQUEST FOR REPHASING

EXECUTIVE SUMMARY

Context. Tunisia's economy has been resilient throughout a protracted political transition and a difficult international economic environment. The country is now facing headwinds from increasing security threats and social tensions, which are offsetting the benefits from the successful conclusion of the political transition, lower international oil prices, and a recovering Europe. High unemployment, large external imbalances, weak budget composition, and incomplete banking and business climate reforms remain the key challenges.

A challenging policy and reform agenda. A return to growth-supporting fiscal consolidation, a prudent monetary policy, and a more flexible exchange rate need to be pursued to contain high external and fiscal imbalances, and anchor inflationary expectations. Moving toward stronger and more inclusive growth requires a stronger push on structural reforms, which can no longer be postponed. Priorities include: (i) improving financial sector intermediation by completing the restructuring of public banks and strengthening banking regulations; (ii) improving budget composition through wage bill containment, tax and energy subsidy reform, and increased public investment; and (iii) generating a business climate more conducive to private sector development and investment by revamping the regulatory framework.

Program implementation has been mixed. All quantitative performance criteria for end-December 2014 and end-March 2015 have been met; one indicative target on social spending was not met. Progress on structural reforms continues to be slow, with three out of seventeen structural benchmarks expected to be met by end-September. The next and final review will focus on the completion of the unfinished agenda in banking and tax reform.

Risks continue to be high. Main risks relate to increasing regional and domestic security tensions, and weaker economic activity in major trading partners. A difficult social environment and opposition from vested interests could undermine support for the reform efforts.

The completion of the sixth review makes SDR 214.875 million (about $300 million) available.

Approved By
Daniela Gressani and Taline Koranchelian

The team comprised Amine Mati (head), Lorraine Ocampos, Andrea Gamba and Gomez Agou (all MCD); Amr Hosny (SPR), Nolvia Saca-Saca and Thierry Bayle (MCM); Giorgia Albertin (Resident Representative) and Adnen Lassoued (local economist). Ms. Saadaoui (OED) participated in the discussions. During the mission on May 28-June 10, 2015 and a follow-up staff visit on July 7-10, 2015 staff met with the Governor of the Central Bank, the Minister of Finance, the Minister of Development, Investment, and International Cooperation, 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, and other senior officials, and representatives of workers' unions, the corporate and banking sector, the diplomatic and donor community, political parties, civil society, academia, media, and parliament.

Excellent assistance was provided by Kadia Kebet, Geraldine Cruz, and Rafik Selim.

CONTENTS

CONTEXT: RESILIENCE IN A DIFFICULT POLITICAL TRANSITION AND A DETERIORATING SECURITY ENVIRONMENT 4

RECENT DEVELOPMENTS: WEAK ECONOMIC ACTIVITY AMID HIGH VULNERABILITIES 7

OUTLOOK FRAUGHT WITH RISKS 9

THE REFORM AGENDA 15

A. Achieving Macroeconomic Stability 15

B. Achieving Higher and More Inclusive Growth 21

C. Protecting the Most Vulnerable 29

PROGRAM ISSUES AND MODALITIES 30

STAFF APPRAISAL 32

BOXES

1. Tunisia's Journey: From the Arab Spring to a New Democracy 5
2. Authorities' Response to Policy Recommendations in Previous Article IV Consultations 6
3. Tourism Sector: Economic Impact of the Recent Terror Attacks 11

4. Tunisia's Potential Growth 12
5. Public Sector Employment and Wages 17
6. Inclusiveness and Growth Constraints 22
7. Why Focus on Public Banks ? 26

FIGURES

1. Recent Economic Developments, 2007–15 35
2. External and Financial Indicators, 2007–15 36

TABLES

1. Selected Economic and Financial Indicators, 2011–16 37
2. Balance of Payments, 2011–20 38
3. External Financing Needs, 2012–20 39
4a. Central Government Financial Operations, 2012–16 (In millions of dinars) 40
4b. Central Government Financial Operations, 2012–20 (In percent of GDP) 41
5. Monetary Survey (Financial System), 2010–16 42
6. Central Bank Balance Sheet, 2010–16 43
7. Financial Soundness Indicators of the Banking Sector, 2008–15 44
8. Access and Phasing under the Stand-By Arrangement, 2013–15 45
9. Illustrative Medium-Term Growth Scenario, 2011–20 46
10. Indicators of Fund Credit, 2012–20 47

ANNEXES

I. External Sector Assessment 48
II. Public Debt Sustainability Analysis 54
III. External Debt Sustainability Analysis 61
IV. Tunisia's Inclusiveness Issues 64
V. Fair Taxation in Tunisia 67

APPENDIX

I. Letter of Intent 72
Attachment I: Memorandum on Economic and Financial Policies 75
Attachment II. Technical Memorandum of Understanding 91

CONTEXT: RESILIENCE IN A DIFFICULT POLITICAL TRANSITION AND A DETERIORATING SECURITY ENVIRONMENT

1. **Tunisia's economy has been resilient during a prolonged political transition but has been weakened by deteriorating security conditions**. Over the past four years, Tunisia adopted a new constitution and successfully completed its democratic transformation with free and fair elections. During this process, the country experienced significant uncertainty, social unrest, and attacks by armed militants (Box 1). Throughout, it has successfully preserved macroeconomic stability in the face of a difficult international economic environment and increased regional turmoil. The tragic terrorist attacks at the Bardo Museum and in Sousse in the first half of 2015—which killed 60 western tourists—represent a severe blow to an economy already facing large external and fiscal imbalances.

2. **Economic policies have been broadly consistent with Fund advice**. During 2012, fiscal policy was loosened to deal with the immediate aftermath of the 2011 revolution, prior to turning to medium-term fiscal consolidation. Spending composition, however, worsened as public investment bore the brunt of the adjustment. The authorities have broadly followed recommendations of the 2012 Article IV staff report (Box 2) in the context of the two-year SBA approved in June 2013 and extended to December 2015, and whose aim was to achieve macroeconomic stabilization, higher and more inclusive growth and protect the most vulnerable. Progress on structural reforms—which have benefitted from strong donor support—has been slow.

3. **The successful conclusion of Tunisia's political transition and recent favorable external developments, represent an opportunity to accelerate reforms.** A broad-based coalition government—sworn in on February 5 and supported by a strong majority in parliament—provides the opportunity to push ahead on reform implementation, which will also benefit from increased policy space provided by the decline in international oil prices and a recovering Europe—Tunisia's main trading partner. The government's medium-term reform agenda will be laid out in its five-year economic vision, which will be finalized later this year ahead of an international donor conference planned in early 2016.

4. **Intensified security risks, social tensions, and coalition politics have complicated policy implementation.** Frustration at the lack of economic opportunities—through industrial unrest in the mining sector, a spike in strikes during the first semester (now banned by the introduction of a state of emergency in the aftermath of the Sousse attack), union pressures for higher wages—have been testing the new government's ability to undertake difficult reforms and reinforced investors' wait-and-see attitude. The two major terror attacks that occurred earlier this year are severely impacting the tourism industry and investor confidence, and may shift the government's limited resources to security issues and delay policy implementation.

Box 1. Tunisia's Journey: From the Arab Spring to a New Democracy

Dec. 2010: Tunisia's revolution is triggered by Mohamed Bouazizi setting himself on fire in protest against lack of voice and opportunity.

Jan. 2011: President Ben Ali is forced into exile by popular protests; Prime Minister Mohamed Ghannouchi heads a short-lived interim national unity Government that resigns in February 2011.

Feb. 2011: Beji Caïd Essebsi, former Minister and head of the Chamber of Deputies, is appointed new Prime Minister.

Oct. 2011: Elections for the Constituent Assembly are won by the moderate Islamist party Ennahda, with 41 percent of the seats.

Dec. 2011: A coalition government led by Hamadi Jebali from Ennahda is formed.

May 2012: Tunisia experiences its first post-revolution terrorist struggle, with clashes between Salafi extremists and security forces in Jendouba in the North Western region.

Aug. 2012: Restrictions of women rights in the first draft of the Constitution trigger massive protests.

Feb. 2013: Chokri Belaid, lawyer and opposition leader, is killed, leading to violent protests. PM Jebali resigns following his party's rejection of a technocratic government proposal. Ali Laarayedh of Ennahda becomes Prime Minister.

Jul. 2013: Mass protests follow the assassination of Mohamed Brahmi—a leader of the secular left. Eight soldiers are killed in a terrorist attack in the Chaambi area.

Jan. 2014: Adoption of the new Constitution and formation of a technocratic government led by Mehdi Jomaa (former Minister of Energy).

Jul. 2014: Militant groups kill 15 Tunisian soldiers and injure 20 in the Chaambi Mountain area.

Oct. 2014: Tunisia's first free and fair legislative elections are won by the main secular party Nidaa Tounes—with 39 percent of the seats, followed by Ennahda with 31 percent.

Dec. 2014: Beji Caïd Essebsi, leader of Nidaa Tounes, wins the presidential election.

Feb. 2015: The first post-transition government is formed—led by independent PM Habib Essid, and supported by a broad coalition comprising Nidaa Tounes, Ennahda, the centrist UPL party and the center-right Afek Tounes.

Mar. 2015. Terrorist attack at the Bardo Museum, in which 21 foreign tourists and one Tunisian policeman, were killed, and 52 wounded.

Jun. 2015: Terrorist attack on Sousse hotel beach, killing 38 European tourists and leaving 39 wounded, the deadliest attack in Tunisia's modern history and the most serious to the tourism sector since 2002.

Jul. 2015. State of emergency is declared and several countries issue advisories against traveling to Tunisia.

Box 2. Tunisia: Authorities' Response to Policy Recommendations in Previous Article IV Consultations

Macroeconomic policies have remained broadly consistent with staff advice...

- **Fiscal policy preserved short-term stability but did not support growth.** Staff noted that a loosening of the fiscal stance in 2012 should be followed by "growth friendly" consolidation. The fiscal consolidation that followed was driven by a worsening composition of the budget, with higher current expenditures (primarily the wage bill) and a significant under-execution of the capital budget. The authorities acknowledged the deteriorating spending composition but noted that the under-execution of capital expenditures reflects capacity absorption difficulties in the aftermath of the revolution and was not planned as an adjustment measure. They also noted the steps they took to reduce energy subsidies and increase transfers to the most vulnerable.

- **Monetary policy was tightened.** The authorities pointed to several measures taken to contain inflationary pressures, including through higher policy rates. They also noted the progress made in improving the institutional framework, including through strengthening collateral requirements and establishing a monetary policy committee—a key recommendation of the previous Article IV. They noted that weaker economic activity is maintaining liquidity tight, with banks remaining dependent on central bank refinancing. To further improve the monetary framework, revising caps on lending rates is also a priority.

- **Greater exchange rate flexibility.** The authorities confirmed that they are moving towards greater exchange rate flexibility by reducing their interventions, and by moving toward introducing a weekly auction mechanism albeit at a slower pace than initially envisaged. They noted that persistent sales of foreign exchange are necessary to smooth excessive fluctuations in the exchange rate arising largely from lumpy energy imports.

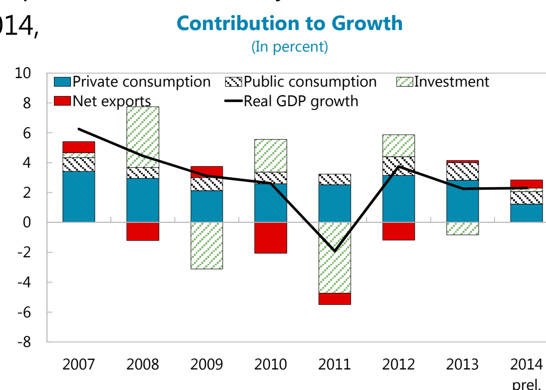
...and progress on the structural front has been mixed.

- **Reforms to modernize and strengthen the banking system are ongoing.** The authorities noted progress made in: (i) revamping regulations on loan classification, provisioning and liquidity; (ii) starting the public banks' restructuring process (including completion of audits and launching of the recapitalization process); (iii) improving the design of bank reporting; and (iv) developing a bank rating system. They acknowledged delays in banking reforms, but noted the acceleration of the reforms over the last six months, which should lead by the end of the year to: the effective restructuring of public banks, the elimination of regulatory forbearance, the strengthening of bank supervision, and the improvement of the legal framework, which is not fully in line with good international practices (approval of the new Banking and CBT laws are pending). The authorities attribute past delays to the late start of the international audit of public banks and legislative priorities (e.g., Constitution).

- **Reforms to improve governance and the business environment.** The authorities noted the recent adoption of the competition law, and all the preparatory technical work done to finalize the investment code and insolvency regime. The authorities view these reforms as priorities, and attribute the previous delays to a necessary focus by the legislative body on the new constitution and other legislation necessary for completing the political transition. A national employment strategy needs to be developed, and pension reform is at a very early stage. The authorities indicated that a broad consensus with social partners and the formation of a post-transition government will allow for the completion of the national employment strategy and pension reform.

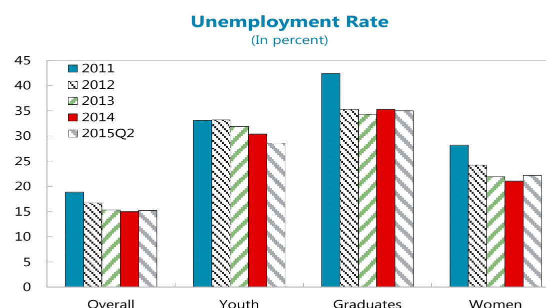
RECENT DEVELOPMENTS: WEAK ECONOMIC ACTIVITY AMID HIGH VULNERABILITIES

5. The expected rebound in economic activity has not materialized. After averaging 4.5 percent during 2000–10, real GDP contracted by 1.9 percent in 2011, the year of the revolution. Since then, it has picked up, reaching 2.3 percent in 2014, fueled by a recovery in services, but still well below potential. However, the growth momentum waned in early 2015, with GDP growth averaging 1.2 percent (y-o-y) for the first semester as activity in the manufacturing, tourism, and mining sectors slowed significantly. Strike activity, work stoppages in the mining industry, and a decline in tourism arrivals (already 30 percent down following the Bardo attack) explains this performance.



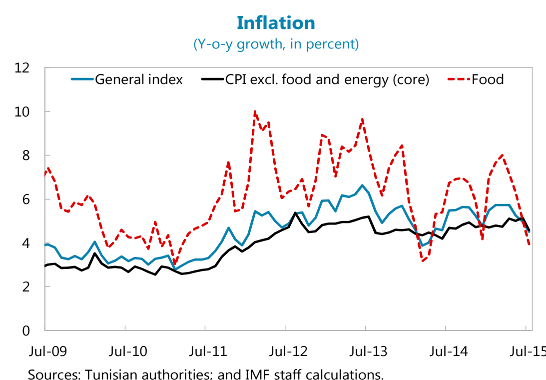
Sources: Tunisian authorities; and IMF staff calculations.

6. The overall unemployment rate has improved, but remains high. After rising from 13 percent in 2010 to 18.9 percent in 2011, the unemployment rate improved to 15.2 percent in Q2-2015, amid new public sector jobs and declining participation rates. Unemployment is even higher for women (22.2 percent), graduates (30 percent), and youth (35 percent).



Sources: Tunisian authorities; and IMF staff calculations.

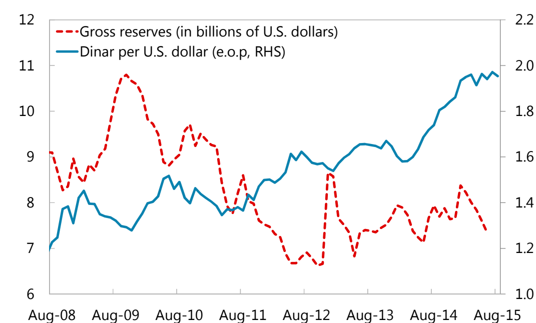
7. Inflation has been contained. After a peak of 6.6 percent in June 2013, headline inflation declined to 4.8 percent y-o-y by end-December 2014, as food price decline compensated for increases in administered energy prices. After increasing at the beginning of 2015, inflation rates have again been falling, reaching 4.2 percent in August following lower food and beverage prices. Core inflation followed a similar trend.



Sources: Tunisian authorities; and IMF staff calculations.

8. The current account deficit has deteriorated significantly, but started to narrow in early 2015. Weak tourism receipts, buoying imports (especially energy and capital goods imports), and declining oil and phosphate exports widened the current account deficit to 8.8 percent of GDP in 2014, its highest level since the 1980s. In the first half of 2015, exceptional olive oil exports and declining energy imports helped compensate the drop in tourism receipts, thereby narrowing the current account deficit to 4.6 percent of GDP in H1 2015 (relative to 5.3 percent of GDP in H1 2014). Foreign direct investments, mostly concentrated in the energy sector, have increased but are still at low levels. Official support and international market access—including the January 2015 issuance of a 10-year Eurobond ($1 billion at 5.875 percent), which for the first time since 2007 was completed without a third country guarantee—have helped keep Tunisia's reserve levels above four months of imports, but below 100 percent of the Fund's composite metric (Annex I).

Gross International Reserves and U.S. dollar Exchange Rate

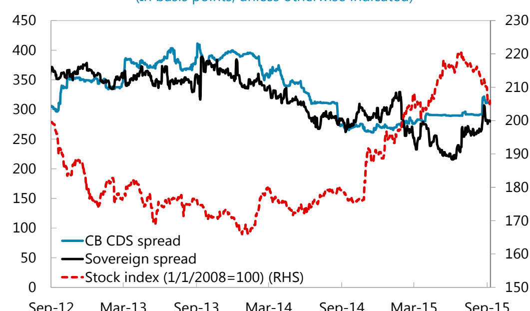


Sources: Tunisian authorities; and International Financial Statistics.

9. Financial markets have held up well. After peaking in mid-2012 at over 400bps, sovereign spreads narrowed significantly to 230bps following the completion of the political transition, although they widened again to 300bps following the Sousse attack. The Tunisian stock exchange—marred in the past by weak performance of public banks shares—has held up well amid limited turnover, even after coming down from record highs in the aftermath of the Sousse attack.

Sovereign and CDS Spreads and Stock Index

(In basis points, unless otherwise indicated)

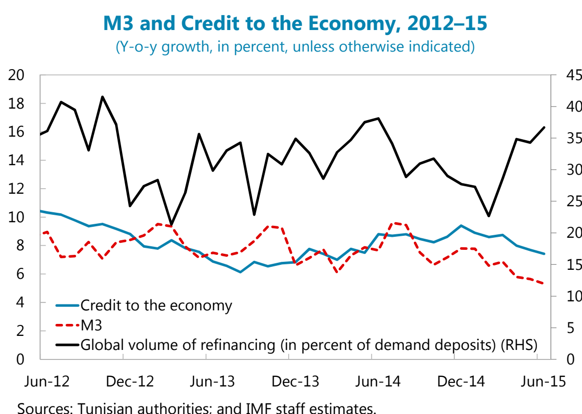


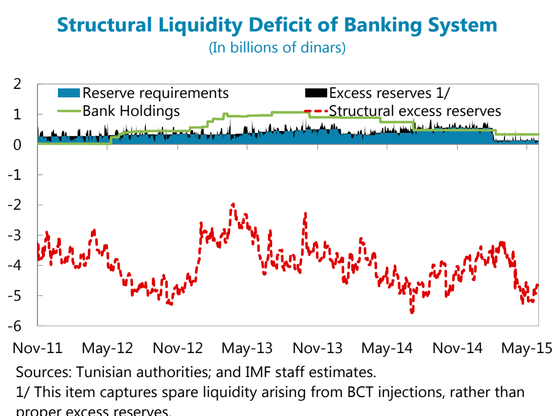
Sources: Markit; Bloomberg; and IMF staff calculations.

10. Following a significant deterioration during 2010–12, the fiscal stance improved, but at the expense of budget composition. The structural fiscal deficit—i.e., the deficit corrected for cyclical fluctuations and excluding banking recapitalization costs—improved from 5.3 percent of GDP in 2012 to 3.3 percent of GDP in 2014. This improvement came with strong revenue collection and a higher wage bill—which increased by 37 percent over the past three years, reaching 12.7 percent of GDP in 2014—while public investment declined from 6.6 percent of GDP in 2012 to a record low 4.2 percent of GDP in 2014. Public debt is on the rise, reaching 50 percent of GDP in 2014 (from 41 percent of GDP in 2010).

11. The CBT maintained a prudent monetary policy stance, by gradually increasing its policy rate to 4.75 percent in June 2014 (from 3.5 percent in 2012). However, low deposit mobilization—caused by weak economic activity and deposit drawdown by cash-strapped mining companies impacted by work stoppages—are keeping several Tunisian banks (mostly public) structurally

illiquid. As a result, banks have been increasingly dependent on direct CBT refinancing that amounted to TD 5.6 billion by end-July, despite the February 2015 elimination of required reserves on consumer loans. Dinar liquidity is further constrained by continued CBT interventions in the foreign exchange market. Private sector credit picked up in 2014, but has recently slowed down to 7.3 percent at end-June 2015, in line with weaker economic activity.

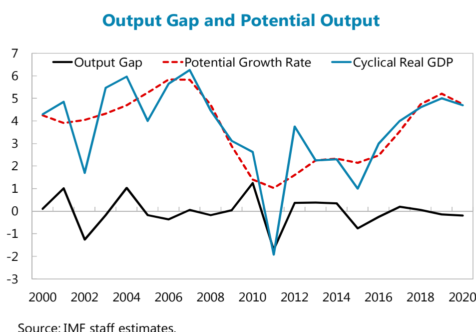




12. The fragility of the banking system remains a concern. At end-March 2015, banking sector capital adequacy ratios stood at 9.5 percent (3.5 percent for public banks and 12.7 percent for private), below the regulatory requirement of 10 percent and with one public bank deemed insolvent. The overall NPL ratio is high—reaching 15.8 percent of total loans in March 2015 (approximately 21 percent of total loans after including bank subsidiaries)—and three banks (of which one public) are in violation of the liquidity ratio. At the same time, the provisioning rate improved from 46 percent in December 2012 to 56.6 percent in March 2015 following the implementation of new prudential regulations in 2013. Given the burden of NPLs on net banking income, the profitability of the banking sector is low—particularly for public banks—but has improved in 2014, mainly due to an increase in commission fees and the reduction in provisioning.

OUTLOOK FRAUGHT WITH RISKS

13. Security challenges and social tensions cloud the near-term outlook, but a pickup in reform implementation improves medium-term prospects. The terrorism threat, highlighted by the tragic Bardo and Sousse attacks, and persisting social tensions will continue to weigh on the Tunisian economy over the following months, offsetting the improvement in confidence that has followed the completion of the political transition, falling global oil prices, and a modest rebound in Europe. The medium-term outlook hinges on reduced security and social tensions and the successful implementation of comprehensive reforms:



- **Growth** for 2015 has been revised down to 1 percent (from 3 percent under the program), reflecting the weak performance in H1 2015, work stoppages in the phosphate sector, and the strong impact of the terrorist attacks on an already beleaguered tourism sector that will likely trickle down to the broader economy and further deteriorate economic confidence (Box 3). The drag on economic activity will likely carry over to the first half of 2016, but relief measures and a gradual recovery in tourism flows will help improve growth prospects in the medium term, with Tunisia projected to reach its estimated potential of 4.7 percent by 2018 (Box 4). A moderate credit recovery, better resource allocation as financial sector reforms bear fruit, increasing public and private sector investment, and the reduction in input costs arising from declining oil prices will all contribute to the growth recovery. The recent blow to the tourism industry will increase unemployment rates in the coming months, but they will eventually decline as growth converges toward potential.

- **Headline inflation** would remain contained. Continued implementation of a prudent monetary policy and low food and energy prices should reduce inflation to 4.4 percent by end 2015 and to less than 4 percent over the medium term.

- **The current account deficit** would narrow only marginally to 8.5 percent of GDP in 2015, as the drop in tourism revenues (one-third of annual tourism receipts are typically generated during the summer) and low oil and phosphate exports offset gains seen earlier in the year from lower imports and exceptional exports of olive oil. A more significant improvement is expected over the medium term, driven by a rebound in tourism and remittances, a pickup in manufacturing, oil and phosphate exports, and reduced energy and food imports.

- **Reserve levels** will remain above four months of import coverage in 2015, helped by higher World Bank disbursements and renewed international market access. Over the medium term, greater exchange rate flexibility is assumed in the baseline to correct for an overvalued exchange rate, and gross reserves are expected to gradually improve and eventually cover 5.6 months of imports by 2020 (Annex I).

Tunisia: Selected Economic Indicators, 2014–20

	Prel.	Proj.					
	2014	2015	2016	2017	2018	2019	2020
Real GDP growth (in percent)	2.3	1.0	3.0	4.0	4.6	5.0	4.7
Consumer price index (CPI), (period average, in percent)	4.9	5.0	4.0	3.9	3.9	3.8	3.8
Current account (percent of GDP)	-8.8	-8.5	-7.0	-6.2	-5.0	-4.0	-3.5
Gross official reserves (US$ billions, eop)	7.7	8.2	9.0	9.1	10.0	11.1	12.3
Gross official reserves (months of next year's imports)	4.0	4.3	4.6	4.6	4.9	5.4	5.6

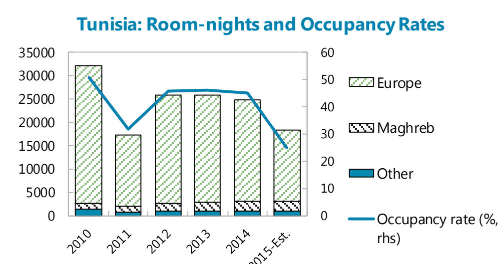
Sources: Tunisian authorities; and IMF staff estimates and projections.

Box 3. Tourism Sector: Economic Impact of the Recent Terror Attacks

Tourism is important for jobs and foreign exchange earnings in Tunisia. With annual turnover of about 3 billion dinars, it accounts for about 7 percent of Tunisian GDP and 10 percent of exports of goods and services. The sector directly employs people across the value chain of 230,000 hotel rooms and roughly 190 tour operators and travel agents. It accounts for 15 percent of employment—including jobs in a range of ancillary and supporting services, such as restaurants, taxis and associated retail and artisanal outlets. However, over the past decade, the sector has been crippled by structural failures, reflecting an outdated business model (relying on sun, sand, and sea), poor governance, and over-reliance on debt that was generously provided by state-owned banks and connected lenders.

Since 2011, a weak external environment worsened existing structural weaknesses. The uncertainty linked to the political transition and increased regional turmoil held back tourism flows, particularly from Europe; the latter account today for 45 percent of arrivals (from 70 percent in 2010) and represent close to 90 percent of room-nights. By 2014, tourism-linked foreign exchange inflows had started to recover from 2011 lows of $1.6 billion to $2.1 billion in 2014—but these were 16 percent below pre-revolution levels. By the end of the political transition in December 2014, tourist arrivals—with increasing numbers from the Maghreb and Eastern Europe replacing more traditional clients from Western Europe— and room-nights remained 15 and 22 percent below pre-revolution levels, respectively.

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



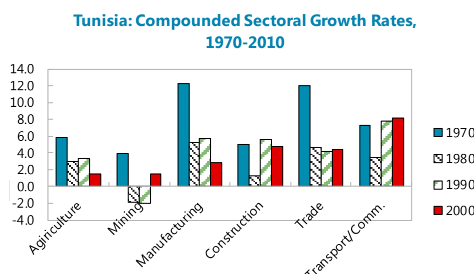
Sources: Tunisian authorities; and IMF staff estimates and projections.

Against this background, the impact of terror attacks has been devastating. The Bardo and the Sousse tragedies prompted a 45-50 percent cancellation of existing bookings to Tunisia, emptying hotels at the height of the summer season. Tourist arrivals from Europe declined by 70 percent (y-o-y) in July alone. Tunisia's National Tourism Office estimates that about 85-90 percent of the over 800 registered hotels are already experiencing financial difficulties or are in the process of shutting down. For the year as a whole, tourism inflows are expected to decrease by 45 percent (to about $1.1 billion) and arrivals will decline to less than 5 million people (from 6 million people in 2014), despite Maghreb tourist arrivals expected to increase or remain constant. The implications for the broader economy are significant:

- **Growth.** The drop in tourism receipts and employment will also impact the transport and artisanal industry—and is expected to reduce growth by an additional 0.6 percentage points (to about 1 percent). Domestic agricultural output (e.g. fresh fruits or vegetables) is also expected to be impacted by falling demand from hotels.
- **External.** The current account deficit will widen by 2.5 percent of GDP, putting additional pressures on the foreign exchange market.
- **Fiscal.** The direct impact from lower turnover in tourism establishments is limited as the related tax revenues are less than 0.1 percent of GDP. The general slowdown in economic activity will however translate into much larger revenue losses, which will be amplified by the relief measures introduced.
- **Banks.** Tourism sector loans represent less than 7 percent of the total loan portfolio, but NPLs are 25 percent of the banking sector and 40 percent of the tourism sector loan portfolio. The hotels' financial difficulties will likely feed into higher NPLs, thereby hitting banks earnings and liquidity (for comparison, in the year following the 2002 Djerba attack, NPLs as a share of total loans rose by 3 percent). Also, vulnerabilities at one large state-owned bank will increase in view of its large exposure to the tourism sector.

Box 4. Tunisia's Potential Growth

Tunisia enjoyed solid growth rates in the 30 years preceding the revolution. Rates averaged about 4.5 percent per year in 2000–10, after peaking at close to 5 percent in the 1990s, driven by manufacturing, transportation and communications. This performance was helped by a gradual liberalization of foreign trade and investment, with capital accumulation as the main growth driver while labor and productivity were lagging.

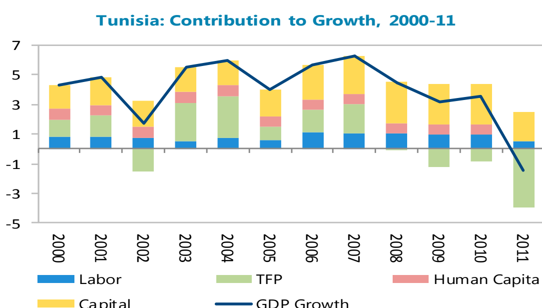


Source: IMF staff estimates.

Total Factor Productivity (TFP) has been declining, with its drop at the onset of the global financial crisis at the core of the slump in growth in 2008–10. The TFP decline was highest for agriculture and manufacturing, while government interference and connected lending stifled the development of financial and hospitality services. During that period, Tunisia failed to reallocate resources away from less productive sectors and into sectors with higher potential (i.e., high-value-added manufacturing and services). Staff's analysis shows instead that Tunisia moved toward low-value-added industries (e.g., textile, machinery assembly, mineral products).

Despite the contraction of GDP, there is no evidence of a reduction in potential growth following the revolution. Convergence of production factors to their pre-revolution trends would support a gradual recovery, with growth averaging about 3.3 percent per year until 2020 in a muddle-through no reform scenario. However, this growth performance would not be sufficient to make a significant dent in unemployment or raise living standards.

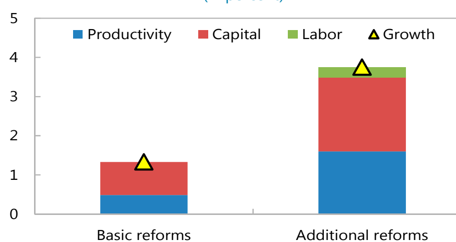
Structural reforms could significantly improve Tunisia's growth potential. Based on cross-country regressions, policies to remove the most binding constraints to growth—increasing access to finance, improving the business environment, and reducing macroeconomic risks—would push Tunisia's growth potential up by about 1.5 percent, and could raise average growth in 2015–20 to 4.3 percent (Staff's baseline scenario).



Source: IMF staff estimates.

Additional reforms, building on international best practices and tailored to the Tunisian situation, could further improve growth in the medium term. These include: improving labor regulations; promoting greater trade integration with fast-growing markets and with global value chains; raising infrastructure investment; and leveraging the large and successful Tunisian diaspora to acquire skills, business and finance. Implementing all these reforms would foster higher investment and boost productivity, with potential growth almost doubling.

Additional Growth If Underlying Structural Variables Reach EMDC Levels /1
(in percent)



Sources: World Economic Outlook; and IMFstaff calculations.
[1] Potential growth derived if each of the factors underlying potential productivity (e.g. business environment, modern production methods), capital (e.g. financial development, infrastructure, openness), and labor (e.g., labor market efficiency) are increased to average EMDC levels. For simulation details see Mitra et al. (forthcoming).

14. Risks are high, and tilted to the downside (RAM). Economic confidence in Tunisia will continue to hinge on improvements in the security situation, with terrorist threats and spillovers from the crisis in Libya—including refugee inflows—representing a key challenge. Tunisia's exposure to Europe—70 percent of its trade—makes it vulnerable to a protracted period of slower global growth and surges in global financial volatility. An upsurge in political instability—including through the inability to build consensus in a coalition government representing distinct political perspectives —or further social tensions could worsen the composition of the fiscal adjustment or delay structural reforms, exacerbating existing vulnerabilities and lowering the growth potential. Domestic risks to reforms—from vested interests—are also strong and will need to be mitigated by a strong outreach and communications campaign by the government.

15. The authorities broadly share staff's views on the economic outlook and risks. They saw upside potential for growth over the medium term as political stability is entrenched, security threats are controlled, Europe recovers, and reforms are implemented to transform the economy and help Tunisia move up the value chain. The authorities expect private demand to remain the main driver of growth, as banks restart playing their financial intermediation role. They agreed that macroeconomic and financial sustainability of Tunisia's growth path will require less reliance on consumption and imports. The authorities also agreed that risk mitigation measures will require a strong outreach campaign and overcoming administrative and legislative capacity constraints.

Tunisia: Risk Assessment Matrix*

Source of Risk and Relative Likelihood	Expected Impact and Recommended Policy Response
Domestic Risks	
High **Delays or reversals in structural reforms and program implementation,** due to slow progress on addressing banking sector fragilities, a deteriorating fiscal position, and a weakening business environment. ***High*** **Intensified terrorist activity,** triggered by regional conflicts in a context of high youth unemployment, lack of opportunities, and perceived corruption. ***High*** **Increased social tensions,** triggered by weaker economic activity, and growing public dissatisfaction with deteriorating purchasing power and government policies	***High*** Delays or reversals in structural reforms could lead to growth that is insufficient to reduce high unemployment rates and improve living standards for most. Heightened social tensions, renewed focus on security and loss of confidence would undermine economic activity and also affect the ability to take policy actions, negatively impacting investment and growth. Authorities should (i) improve budget composition by containing current spending, while increasing growth-enhancing capital expenditures; (ii) complete banking sector reforms; (iii) pass long-awaited economic legislation, including on PPP, bankruptcy, investment code, and tax reform; and (iv) build public confidence and ownership through continuous communication.
External Risks	
High **Tighter or more volatile global financial conditions, including through energy price volatility,** triggered by abrupt global monetary policy normalization, commodity price volatility, or geopolitical tensions.	***Medium*** Global financial and commodity price volatility could destabilize global recovery and financial markets, adversely affecting partner countries' economies, slowing FDI inflows, and increasing financing needs. Recommended policy responses include: (i) creating fiscal space by containing the wage bill, reforming energy subsidies and the tax system to make room for growth-enhancing priority spending; (ii) countercyclical monetary policy (assuming inflationary pressures are not present); and (iii) completion of banking reforms.
Medium **Structurally weak growth in key advanced and emerging economies,** driven by weak potential growth in Europe, and incomplete structural reforms and maturing of the cycle in emerging markets.	***Medium*** Growth would be adversely affected through trade, remittances, and investment channels. Authorities should (i) diversify export markets; (ii) pursue bolder and faster structural reforms to increase productivity and competitiveness; and (iii) let automatic fiscal stabilizers operate.
Medium **Increased geopolitical tensions in the Middle East,** driven by the intensification of ongoing conflicts, heightened risks of fragmentation, and dislocation in the region, leading to a sharp rise in oil prices with negative global spillovers.	***High*** Growth may fall on account of shaken investor confidence, increased security spending, sharp increases in oil prices, and tighter financing conditions. Authorities should (i) rebuild fiscal and external buffers; and (ii) accelerate economic and structural reforms.

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

THE REFORM AGENDA

Discussions focused on Tunisia's need to accelerate growth, make it more inclusive, and provide high-quality jobs. *This requires maintaining macroeconomic stability—through high-quality fiscal consolidation, prudent monetary policy, and greater exchange rate flexibility—in a context of high security threats, social demands, and downside risks. This pre-requisite to growth should be accompanied by the decisive and timely implementation of ambitious structural reforms to improve budget composition, strengthen the financial system, and improve the business environment. All these elements are essential to achieve higher and more inclusive growth and make a significant dent in unemployment.*

A. Achieving Macroeconomic Stability

High-quality fiscal consolidation

16. Fiscal consolidation has been delayed to 2016, following a modest loosening of the 2015 fiscal stance to support short-term growth. The revised 2015 budget law approved in August 2015 includes a package of urgent measures (amounting to about 0.5 percent of GDP, see text table) to help alleviate the short-term economic fallout linked to the Sousse attack and an increase in security spending (0.2 percent of GDP). Staff welcomed the countercyclical response to the attack, but warned that some measures—such as the VAT rate reduction to the hospitality sector—should be temporary. The revised budget also includes an increase in the public sector wage bill (equivalent to 0.8 percent of GDP) arising from recent agreements in the education sector and a 5 percent generalized salary increase. These higher expenditures were accompanied by a significant under-execution of capital spending (0.7 percent of GDP) and net savings from lower oil prices (1.6 percent of GDP decline in energy subsidies), which helped limit the structural fiscal deficit to 3.5 percent of GDP in 2015 (lower than programmed, but up from 3.3 percent of GDP in 2014). The authorities noted that the 2015 deficit would have been lower than in 2014 in the absence of the record (and unplanned) decline in public investment in 2014. They underlined their efforts at containing fiscal imbalances as the revised budget includes a 20 percent across the board cut in non-essential goods and services (MEFP ¶9).

Tunisia: Relief Measures Introduced After the Sousse Attack
(In percent of GDP)

To support Small and Medium Enterprises	0.19
Economic activity stimulus in regions	0.09
Loan Rescheduling	0.03
Credit line to finance regional enterprises	0.01
Exceptional guarantees for investment loans and regional enterprises	0.02
Enterprise creation program	0.01
Government's share of capital increase in S&M Enterprise Bank	0.03
To the Tourism Sector	0.25
Reduction of VAT from 12 to 6 percent	0.03
Elimination of Tourist exit Fee	0.17
Payment of Contributions to Social Security System	0.04
Guarantee mechanism for hotel loans	0.01
To Social Sectors (youth, women, children programs), Culture and Education	0.05
Total	0.50

Sources: National authorities; and IMF staff calculations.

Tunisia: Selected Fiscal Indicators, 2014–20

(In percent of GDP)

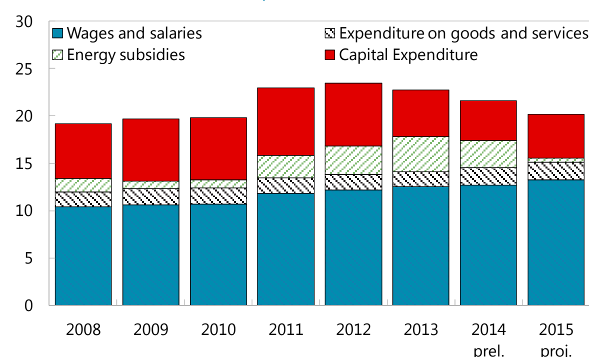
	2014		2015		2016	2017	2018	2019	2020
	Prog. 12/12/14	Prel.	Prog. 12/12/14	Est.			Proj.		
Revenue	23.9	24.0	23.6	22.4	23.1	23.4	23.9	23.9	24.0
of which: Tax revenue	22.7	22.5	22.2	21.2	21.7	22.0	22.3	22.4	22.4
Expenditure and net lending	28.8	28.1	29.8	28.4	27.4	26.8	26.6	25.7	25.0
of which: Wages and salaries	12.7	12.7	12.5	13.3	13.1	12.5	12.1	11.5	11.0
Transfers and subsidies	7.2	7.0	6.5	5.1	4.6	4.3	4.1	3.9	3.8
Capital expenditure	4.8	4.2	5.3	4.6	5.8	6.5	7.0	7.0	7.0
Net lending	0.2	0.5	1.6	1.4	0.1	0.1	0.1	0.1	0.1
of which: Public Banks' recap. + AMC operat.costs	0.0	0.0	1.6	1.3	0.0	0.0	0.0	0.0	0.0
Central government deficit (-) (excl. grants)	-4.8	-4.1	-6.2	-6.0	-4.3	-3.4	-2.7	-1.8	-1.0
Structural fiscal balance	-4.1	-3.3	-3.8	-3.5	-2.9	-2.1	-1.7	-1.1	-0.4
General government debt	49.4	50.0	55.2	54.0	56.3	57.0	57.4	55.6	53.4

Sources: Tunisian authorities; and IMF staff estimates.

17. The deteriorating composition of public spending needs to be reversed. Staff regretted that the net savings from lower fuel subsidies have been somewhat offset by a growing wage bill (Box 5). It stressed that controlling spending today is important to avoid a vicious cycle in which current spending increases are financed by cuts in capital spending, which in turn reduce future growth and revenues. The authorities noted that the fragile social and economic situation required action on wages to reduce social tensions, create a climate conducive to reforms, and act as a countercyclical policy that will boost demand. They agreed with staff on the need to contain the wage bill in the medium term (Section B). Staff urged the quick implementation of the tax reform package (see Section B), which would have helped compensate for the increasing wage bill through new permanent revenue measures. The authorities argued that the 2015 revised budget's main focus was to update key aggregates in view of the weaker economic outlook and introduce "emergency relief" measures in response to the Sousse attack. It stressed that a major tax policy reform would require more discussions, which can only be held in the context of the 2016 budget.

Key Spending Components

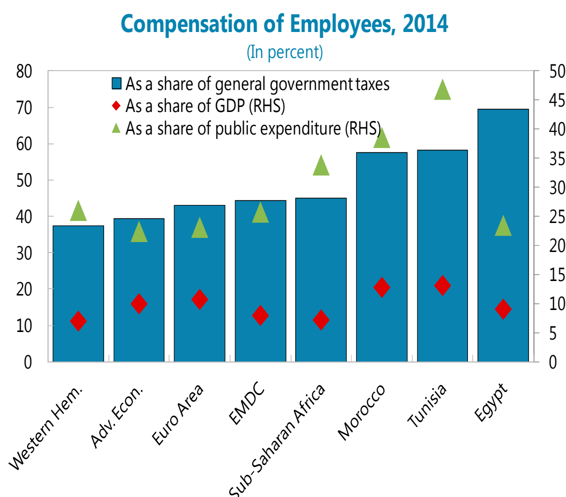
(In percent of GDP)



Source: IMF staff estimates and projections.

Box 5. Tunisia: Public Sector Employment and Wages

Public sector employment has increased sharply in the aftermath of the January 2011 revolution. Between 2010 and 2014, as a result of high unemployment and security needs, public sector employment rose by 20 percent to 615,000 workers. Of that increase, 40 percent was for security and defense personnel. The rest was mostly the regularization of contractual personnel—primarily in low skilled categories—that were made permanent. Total public employment—which includes a 30 percent increase in public enterprise workers over the last three years to about 180,000—is today at 795,000, corresponding to a ratio of total public employment to total employed workforce of about 24 percent—a level that is three times higher than in Morocco or emerging markets such as Chile or Mexico.

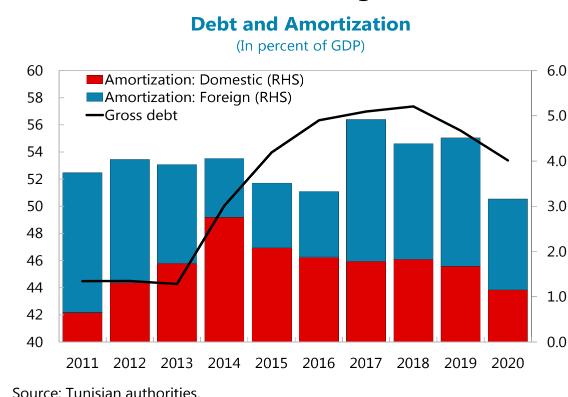


Public sector recruitment pushed the wage bill to record high, despite the government's earlier efforts to freeze wage increases and limit promotions. The wage bill increased from 10.7 percent of GDP in 2010 to 12.7 percent in 2014 and will increase to around 13.3 percent in 2015, a level higher than most comparator countries. This post-revolution increase reversed efforts to reduce the wage bill from 12.2 percent of GDP in 2002 to 10.4 percent in 2008. Currently, the wage bill absorbs 56 percent of tax revenues and amounts to close to 50 percent of total expenditures, ratios well above those of most countries in the world (text chart).

Pressures from labor unions to increase public sector wages stem from the perception that they lost ground since the revolution. However, this perception is not reflected in the data. Cumulative inflation was about 18 percent over 2012–14 whereas the average public sector salary increased by 14 percent and wages in the private sector increased by 6-12 percent. Wages of medium and lower public sector categories rose by 23 percent (the 6 percent increase in the minimum wage in 2013 had no impact on the public sector, as salaries for lower categories of civil servants are almost double the minimum wage). In addition, wages in the public sector are significantly higher than in the private sector, with public sector workers enjoying a 23 percent wage premium over private workers, especially for better-educated new labor market entrants.

Comprehensive civil service reform is urgent. The public sector salary system is a result of structural weaknesses, and not a new phenomenon. Past reform attempts—dating as far back as 1989—called for ending the proliferation of allowances, replacing the current index system with a base salary scale, raising recruitment standards, and strengthening the connection between performance and promotion. The functions and staffing levels of the public sector also need to be addressed. The success of any civil service reform will require strong ownership by the government and key stakeholders.

18. Staff and the authorities agreed that fiscal consolidation is necessary to reduce external imbalances, restore private sector confidence, and decrease financing constraints. A 3 percentage point adjustment in the structural fiscal deficit over the medium term—starting in 2016—will reduce public debt to 53.4 percent of GDP, from a peak of 57.4 percent in 2018, albeit substantial downside risks persist—especially with regards to a depreciating currency or permanent decline in growth (Annex II). The authorities also noted that large amortization payments due in 2017 (see text chart) require a sustained effort to reduce the fiscal deficits. They agreed that, civil service reform, energy subsidy reform, and revenue mobilization should be the main elements of the consolidation strategy, which should preserve public investment (see Section B).



Source: Tunisian authorities.

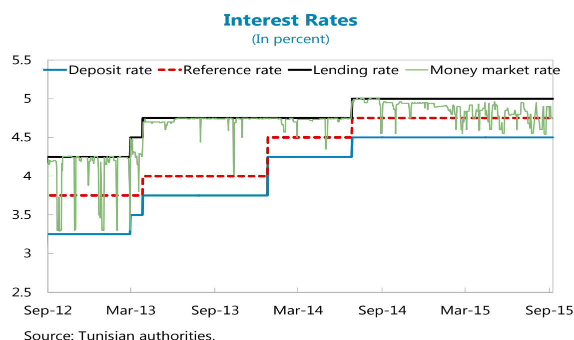
Tunisia: Yields of Main Revenue and Expenditure Measures Over the Medium Term
(In percent of GDP)

	2016	2017	2018
Tax Revenue	0.66	0.63	0.41
Direct taxation	0.14	0.18	0.18
Increase tax on dividends from 5 to 10%	0.05	0.04	0.04
Strengthen presumptive tax regime for liberal professions [1/]	0.03	0.05	0.05
Increase collection of property tax	0.10	0.09	0.09
Indirect taxation	0.85	0.55	0.32
VAT: General reform: Harmonize tax rates to two levels (6% and 18%), reduce exemptions [2/]	0.34	0.30	0.18
Exempted goods: Reduce list of exempted goods (0 rate) from 20 to 10 key items while liberalizing prices gradually	0.21	0.20	0.09
Liberal professions: increase VAT from 12% to 18%	0.13	0.10	0.09
Excises: Increase rates for alcoholic beverages while liberalizing retail prices [3/]	0.28	0.05	0.05
Customs duties: Eliminate Preferential treatment regime (tax at current rates) while rationalizing customs duties [4/]	0.22	0.20	0.09
Reduction of Earmarked Special Funds	-0.32	-0.10	-0.09
Expenditure Savings	0.43	0.55	0.37
Wage bill : Revision of salary benefits and indemnities and improving career incentives	0.21	0.40	0.27
Enhance cost effectiveness of Goods and Services	0.06	0.05	0.05
Energy subsidies (net impact of increasing electricity tariffs and adjusting oil product prices to international prices)	0.16	0.10	0.05

Sources: Tunisian authorities; and IMF staff estimates and projections.
1/ There are around 40,000 liberal professions but only 30,000 pay (corresponding to 60% of presumptive tax regime).
2/ Apply 18 % to all goods and services currently taxed at 12 %, and apply 6 % for agricultural and food products, except for fresh products.
3/ Harmonize taxation of all type and origin of beers.
4/ Around 1/3 of non energy imports benefit from this system

Monetary Policy—Containing inflation and improving the transmission channels

19. Monetary policy will continue to aim at containing inflation. Staff and the authorities agreed that the policy rate remains at an appropriate level in view of moderate headline and core inflation, slow credit growth, and economic activity well below potential. Staff welcomed the strengthening of the policy rate as an effective signaling tool through the recent convergence of the money market and policy rates, as well as the return of the real interest rates to positive levels (0.5 percent), which is necessary in view of low domestic savings. It also welcomed the authorities' readiness to tighten monetary policy, should inflationary pressures arise as a result of public wage increases or if depreciation pressures materialize (MEFP ¶13).



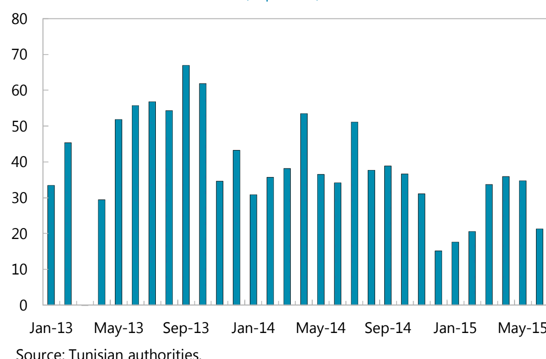
Source: Tunisian authorities.

20. Banks' continued dependence on CBT refinancing is a structural weakness that needs to be addressed and carefully monitored. The banking sector has been facing structural liquidity needs since the beginning of the revolution, with recent improvements negated by fresh deposit withdrawals from mining companies and increased FX interventions. As a result, banks have remained overly reliant on direct CBT refinancing. When completed, the ongoing recapitalization of public banks—which have been the main recipient of CBT resources—will help reduce refinancing needs and mitigate the structural liquidity deficit. The establishment of a full-fledged lender of last resort mechanism (November 2015 SB) which is expected to be introduced in the forthcoming CBT law will improve the resilience of the financial system and improve the conduct of monetary policy. Liquidity management will also be helped by ongoing improvements in the collateral framework, as the share of borrowings collateralized by government securities doubles from 20 percent in 2013 to 40 percent in 2014 (end-December 2014 SB). This will also minimize risks to the CBT's balance sheet.

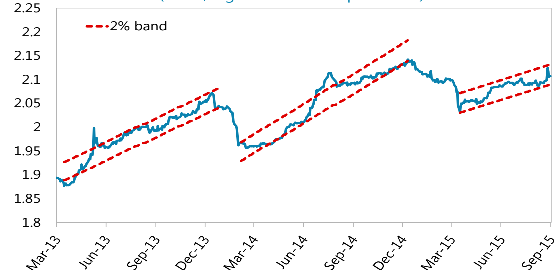
21. Staff welcomed plans to improve the monetary policy framework. Improvements in liquidity forecasts and deeper interbank markets—including through the establishment of a more mature repo market and a yield curve—are needed to strengthen the monetary policy framework and facilitate the medium-term move toward inflation targeting. Staff encouraged the authorities to speed up adoption of the CBT law, which will help reinforce CBT credibility through new institutional arrangements granting greater CBT independence and clarity of objectives—an important pre-requisite to successful inflation targeting. Staff stressed the importance of moving ahead with removing the existing "caps" on the lending rate, which hampers the monetary policy transmission channel. The authorities noted that consultations on that front, including with banks, are ongoing.

Toward more flexible exchange rates

22. The depreciation of the dinar over the last two years was halted in the first half of 2015. An appreciating dollar vis-à-vis the Euro and pressures on the dinar in May and June led to an increase in FX sales—double the previous monthly average—which contributed to the exchange rate appreciating by 5 percent vis-à-vis the US dollar and the Euro during the first six months of 2015 (MEFP ¶18). Staff noted that the exchange rate continues to remain within a narrow margin of 2 percent relative to the statistically identified trend, confirming the "de facto" crawl-like behavior of the exchange rate (Annex I).

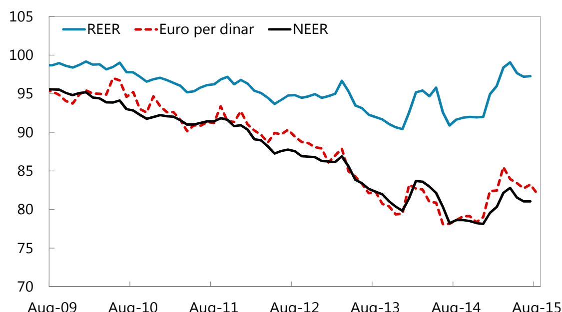


Source: Tunisian authorities.

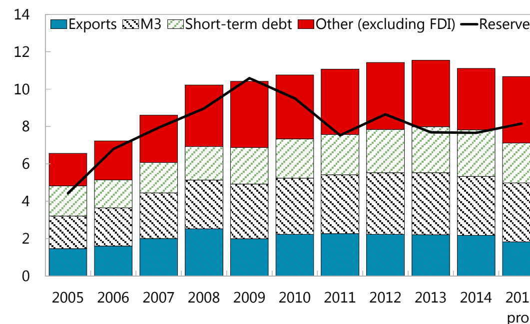


Source: IMF staff calculations. Weights based on currency of trade transactions.

23. Greater exchange rate flexibility would help reduce external imbalances and rebuild reserves. The authorities explained that their interventions in the FX market are not intended to manage or maintain a certain level of the exchange rate, but rather to smooth excessively large fluctuations that largely arise from lumpy FX demand from energy operators. The authorities consider that greater exchange rate flexibility is necessary to contain the current account deficit, rebuild buffers—as reserves are still below the Fund's ARA metric—and bring the dinar in line with fundamentals (text chart). To that end, they plan to limit their interventions in the FX market (MEFP¶18). Both staff and the authorities agree that the dinar is currently 5–15 percent overvalued (Annex I), although the authorities did not feel that the overvaluation represents a major drag on firms' competitiveness. To further rebuild buffers, staff urged the authorities to purchase FX during periods of excess supply.



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



Sources: Tunisian authorities; and IMF staff calculations.

24. A deeper market would facilitate a more flexible foreign exchange rate policy. Staff commends the authorities' plans—approved by the CBT's Board of Directors in May 2015—to deepen the foreign exchange market and provide the necessary liquidity for economic operators (MEFP ¶19), including through relaxing conditions governing exchange rate and interest rate hedging instruments. Staff regrets the delay in implementing weekly foreign exchange auctions, which is now scheduled for end-October 2015 (SB), but understands that reforms to deepen the market will facilitate its implementation.

25. Over the medium term, a gradual shift to full capital account convertibility is needed. A comprehensive reform of foreign exchange regulations—including current rules constraining the use of FX deposits or caps on foreign investment in bonds and stocks—could attract significant foreign capital flows and increase growth potential. The authorities agreed that more progress in entrenching macroeconomic stability and developing domestic financial institutions and upgrading their prudential supervision is needed before moving toward capital account convertibility. They also noted that the peculiarity of Tunisia's economy also calls for an in-depth study of capital flows linked to the off-shore sector.

B. Achieving Higher and More Inclusive Growth

26. Tunisia's old state-centered development model has shown its limits. Over the past two decades, state intervention has distorted product markets and held back the emergence of a dynamic private sector. The pre-revolution focus on an industrial policy based on selective incentives led to wide regional disparities and a predominance of low value-added activities that failed to create good jobs (Box 6). A broad home-grown reform agenda—focused on fiscal reforms, the financial sector, and the business environment—is needed to kick start growth and make it more inclusive (see Annexes IV and V for a discussion of inclusiveness issues and taxation fairness).

The key role of fiscal reforms

Fiscal consolidation needs to be accompanied by growth-enhancing structural fiscal reforms.

27. Staff supports the authorities' tax reform strategy aimed at promoting greater equity, simplification, and revenue mobilization. Following two years of consensus building and technical work that culminated in national tax consultations in November 2014, a new and ambitious tax reform strategy has been prepared by the Ministry of Finance, with support from Fund TA. It appropriately focuses on: (i) addressing the complexity of the indirect tax system by simplifying the VAT from three to two rates (6 and 18 percent); reducing exemptions, limiting excises to a selected list of products; rationalizing customs duties from seven to three levels (0, 20 and 36 percent, the latter for agricultural products); (ii) improving fairness, including through broadening the tax base, a gradual convergence of the on-shore and off-shore corporate tax rates, improving the progressivity of personal taxation, and simplifying the taxation for small enterprises; and (iii) reducing earmarked taxes. Tax reform—which will be implemented in 2016—is expected to help increase tax revenue by 1.5 percentage points of GDP over the medium term—with the magnitude of the increase, including in the first year, depending on how aggressive the tax package is in broadening the tax base.

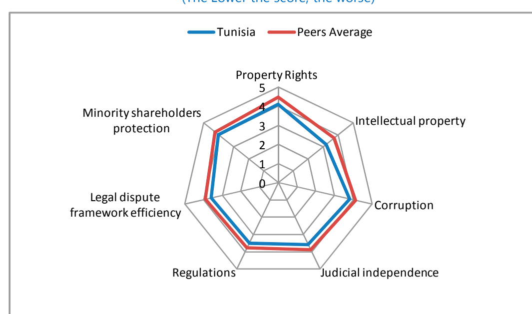
Box 6. Tunisia: Inclusiveness and Growth Constraints

The January 2011 revolution highlighted that growth benefits have not been evenly shared. Tunisia's old growth model—based on selective state intervention—led to unequal access to opportunities and job creation largely limited to low value-added industries. Regional disparities were very large: (i) average poverty rates remained 3 times as high in the interior of the country than in richer coastal "offshore" areas; (ii) at 25 percent, unemployment rates in the interior regions were double those of coastal areas; and (iii) only 13 percent of foreign firms were created in the interior regions.

A growth diagnostic approach applied to Tunisia highlights the following structural issues—mostly a legacy of past policies—as the most binding:

- **Lack of finance.** Access to credit has been cited by business entrepreneurs as the main obstacle to doing business over the past decade, while off shore and mining firms—the most successful in Tunisia—are generally not credit constrained. Local firms try to compensate for lack of credit access through self-financing. Lack of access to credit is driven by weak credit information, high perceived default risk, connected lending and lack of adequate bankruptcy laws, which are exacerbated by banks' structural liquidity problems.

Global Competitiveness Indicators, 2015
(The Lower the score, the worse)



Source: World Economic Forum: "The Global Competitiveness Report, 2014-15."

- **Lack of effective institutions to ensure public sector accountability.** Tunisia performs poorly on corruption, property protection, and judicial independence where it is below comparable peers. Regulatory barriers and anti-competitive practices limit growth, particularly through requirements for ministerial approval, prohibition of investment in certain sectors, and tolerance for abuse of market position. Wide-scale tax evasion, inefficient tax administration, and growing informality are also cited as causes of unfair competition.

- **Taxation.** Overall, taxation in Tunisia compares relatively well with similar countries, but relies on a very narrow tax base, because of tax incentives for offshore firms, VAT exemptions, and unequal treatment between wage and capital income. Corporate taxation and sales tax levels are in line with international norms, but high payroll and social security contributions represent a high burden for domestic firms.

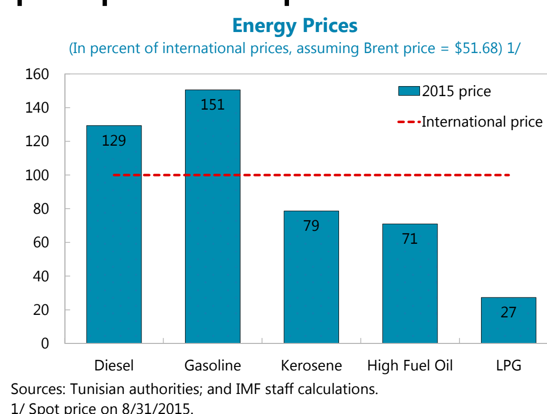
- **Labor market.** The 2014-15 Global Competitiveness Survey ranks Tunisia poorly on labor market efficiency, where it stands 129 out of 144 countries, driven by the low participation of women (134), rigid wage determination (119), lack of labor-employer cooperation (118), and rigid firing and hiring practices (97).

Interestingly, infrastructure was not seen as a binding constraint to growth. Tunisia's geography is an asset for growth, reflecting its direct access to the sea and its proximity to the European market. In spite of regional disparities in basic infrastructure, Tunisia's existing infrastructure appears to be an area of strength. Work force availability was also found to be appropriate, with Tunisian firms ranking work force education as only the 10th most problematic issue for doing business in 2014. Yet, improving the higher education curricula could help reduce the existing skill mismatches.

28. A successful tax reform requires an improved tax administration. The authorities confirmed their commitment to a three-year tax administration modernization program—aimed at establishing an integrated tax administration with improved systems and processes. They stressed their preference for a gradual approach by first improving compliance in the small business sector before expanding the process to large and medium-sized enterprises. The authorities argued that the creation of a category of "new tax collectors"(end-July SB), which would have helped provide collection powers solely to the tax agency, would take more time as they first want to proceed with moving existing functions in the same location but under current management structures. Staff urged the authorities to accelerate the process toward unifying tax administration functions, starting with improving the processes at the large taxpayer unit (80 percent of tax collection).

29. Staff and the authorities agreed that lower oil prices provide an important opportunity to depoliticize fuel prices and reduce energy subsidies in a sustainable manner. The 56 percent decrease in international oil prices since the beginning of 2014 has not yet translated in decreases in domestic retail fuel prices, which are, for some products, 30-50 percent above international levels (text chart), thus providing additional savings to the budget. More sustained subsidy reform would require:

Energy Prices
(In percent of international prices, assuming Brent price = $51.68) 1/



Sources: Tunisian authorities; and IMF staff calculations.
1/ Spot price on 8/31/2015.

- **A proper automatic fuel price formula.** Staff urged the quick revision of the existing asymmetric automatic fuel price adjustment formula—which is currently triggered only if there is a cumulative $6 a barrel increase within a quarter—into an automatic symmetric formula that will smooth large fluctuations in international prices and ensure full cost recovery and appropriate tax collection. The authorities agreed with this approach, but argued that such a revision would take time and can only be implemented in 2016. A well-designed communications campaign would also be needed to explain the formula and its use should global prices pick up again.

- **Adjustments in electricity tariffs**. Staff regrets the suspension of programmed increases in electricity tariffs, which are still heavily subsidized—20 percent below cost recovery even after last year's efforts to adjust tariffs for medium and low voltage industries and eliminate subsidies for cement companies. Staff urged further increases in electricity tariffs towards cost-recovery levels to continue reducing untargeted and regressive energy subsidies. The authorities argued that gains in overall energy subsidies from lower international oil prices do not justify increasing tariffs at this juncture.

30. Containing the wage bill is essential to make space for priority spending. Staff is encouraged by the authorities' determination to implement a comprehensive civil service reform, which will help reduce the wage bill to 11 percent of GDP over the medium term (MEFP ¶32). It urged the authorities to move quickly in designing an overall and comprehensive civil service reform

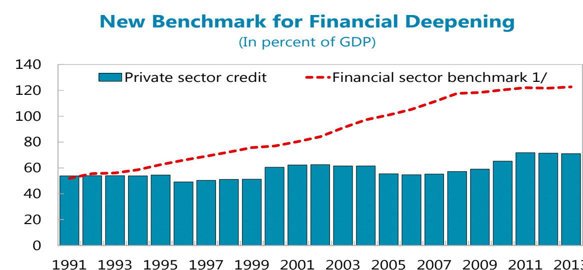
strategy that will review the organizational structure, revise salary benefits and indemnities, and strengthen career incentives.

31. Public financial management reforms are needed to strengthen budget execution, notably on investment projects (MEFP ¶10). Earlier steps to decentralize project execution and the adoption of the procurement code last year have not yet succeeded in accelerating capital spending, particularly in the first half of the year, where the budget execution rate was close to 30 percent. Better project selection and prioritization, closer coordination between central and regional administration, and better resolution of land rights—including through the implementation of newly issued decrees allowing expropriation when needed—are expected to contribute to accelerating the implementation of investment projects. Staff welcomed progress made in finalizing the new organic budget law—designed with TA assistance from the EU—which will be submitted to parliament in November. This law, along with the progress made in performance budgeting (MEFP ¶38)—will improve budget preparation, introduce medium-term budgeting, increase transparency, and streamline existing control procedures.

32. Strengthening management and control of public enterprises is necessary to reduce contingent liabilities and fiscal risks. The recent completion of a comprehensive assessment of auditing and internal control mechanisms of public enterprises (SOE) will serve as a basis for formulating a new public enterprise monitoring strategy (October 2015 SB), including through regrouping the various control bodies. Monitoring would also be improved by new performance contracts for the five largest SOEs (end-October 2015 SB), which should include indicators that cover financial performance. Staff urged the authorities to conduct a full assessment of fiscal risks arising from the operations of public enterprises, including from the issuance of new guarantees. The authorities stressed that over the last three years the outstanding stock of government guarantees has remained below 10 percent of GDP, and that a clear action plan to reduce fiscal risks will be established following forthcoming Fund TA on the topic.

A sound and efficient financial system

33. Restoring a sound banking system is a prerequisite for achieving higher and more inclusive growth. The old model, based on weak underwriting standards and widespread "connected lending," accompanied by weak regulation and supervisory forbearance fell short on financial intermediation, keeping private sector credit well below potential (text chart). A modern banking system, subject to strong supervision and competition, would improve credit allocation—removing a key constraint to economic growth.



Sources: Fayad, D., P. Garcia Martinez, A. Mati, "*Financial deepening in the Maghreb*" (forthcoming)
1/ The benchmark is calculated assuming that financial sector development depends on structural characteristics of a country, such as GDP per capita, and population and demographic factors.

34. Addressing vulnerabilities of public banks is a key priority of the authorities' reform agenda. Tunisia's three public banks (Box 7) have been hampered by weak lending practices and governance issues. Exposure to a tourism sector that has been severely affected by the impact of the January 2011 Revolution and, more recently, by the terrorist attacks that directly targeted the sector—is an additional factor. Progress on reforming public banks is under way albeit with some delay:

- **Recapitalization** is underway consistent with international practices (MEFP ¶23). The legislative authority to use the recapitalization funds allocated in the 2014 budget was granted by parliament in August 2015. The restructuring plans of the three banks (two of which were adopted in February and June) and the launch of the capital subscription process will allow one public bank (BH) to meet the 10 percent minimum solvency ratio by end-September. The recapitalization of the STB—14 percent of assets and currently insolvent— is expected to be completed in October at the end of the capital subscription process. Depending on the finalization of the audit results, which are still pending, the third public bank (BNA) might not need additional capital thanks to explicit state guarantees for SOE loans and planned asset sales. For all public banks, and in line with sound international practices, the government remains committed to cover any unsubscribed capital at the closing of the books, effectively diluting existing shareholders. Staff stressed that lower provisioning needs, justified in bank audits by the existence of sovereign guarantees for loans to SOEs, require the explicit commitment to renew those guarantees.

- **Business plans** underpinning the recapitalization of public banks will need to be updated to ensure regulatory compliance throughout the restructuring period (2015-19). Existing business plans (adopted prior to the Sousse attack) have become unrealistic as a result of a significant drop in tourism and weaker economic activity. Preliminary stress test findings point to a capital shortfall arising within a year (of about TD 50 to 100 million) under staff's baseline scenario (and no recovery of the tourism loan portfolio). The authorities agreed that updated plans should be approved by the Boards of the banks before the end of the year (MEFP ¶21). They fully expect that capital shortfalls could be met by banks' sales of non-strategic assets. Staff agreed this could be an acceptable strategy provided that sales are on an arms-length basis and not to banks' subsidiaries.

- **Operational restructuring** (MEFP ¶23). Staff welcomed the designation of new Board members in all three public banks, and urged continued progress on this front through a change in management (expected to be completed by October 2015) and the signing of performance contracts that will ensure proper bank monitoring during the restructuring period. Staff urged a monitoring on a consolidated basis but the authorities argued that their reporting system only allows that for certain indicators (e.g., cost-to-income ratio). Close supervisory scrutiny of public banks will also be needed throughout the restructuring period to ensure proper monitoring of regulatory compliance, adherence to sound lending policies, and proper internal governance and risk management.

Box 7. Tunisia: Why Focus on Public Banks?

The performance of the Tunisian banking system has long been hampered by the performance of the main three state-owned banks. These banks are systemic—currently representing 37 percent of banking assets and around 28 percent of banking sector deposits. The role of the State in these banks has diminished over the past decade but remains important as the latter is the main shareholder in all three state-owned banks: STB (51 percent); BH (57 percent), and BNA (65 percent). The performance of these public banks has been weaker than for the rest of the industry, weakening credit allocation and governance for the whole sector:

- **Solvency ratio**. Stricter prudential rules on classification of NPLs and provisioning ratios have highlighted the weaknesses of the state-owned banks, which no longer meet minimum regulatory solvency ratios. As a result, in the absence of recapitalization, the solvency ratio for public banks was four times less than the private sector, with two banks severely undercapitalized and one insolvent (but still operating because of forbearance).

- **Deterioration of asset quality.** NPLs in public banks are more than double the level of private banks, underlying the weak quality of public bank clients which account for a larger share of their loan portfolio (13 percent) than for private banks (8 percent) and insufficient loan recovery capacity. Weaker economic activity will weaken further loan quality—particularly for the STB which is heavily exposed to the tourism sector (54 percent of its loan portfolio).

Financial Soundness Indicators, March 2015

	Public banks	Private banks
NPLs (in percent of total loans)	23.9	9.9
NPLs, net of provisions	11.3	2.8
Provisions (in percent of NPLs)	52.2	68.9
Liquidity ratio	45.6	102.5
ROA 1/	0.5	1.1
ROE 1/	7.3	14.2
Capital adequacy ratio (CAR)	3.5	12.7
Tier 1 capital adequacy ratio (CAR)	2.0	10.7

Source: Tunisian authorities.
1/ Data is for 2014.

- **Profitability of public banks** is also half of private banks, mainly because of the bearing cost of NPLs but also related to a higher dependence of gross income on interest margins.

- **Refinancing**. Growth in deposits of public banks has been limited forcing public banks to become the largest users of the CBT refinancing facility (40 percent of total refinancing).

The state-owned banks also suffer from an unfavorable strategic positioning. They have for years followed strategic directions—in agriculture, housing, or hotel— that were not sustainable over the long term, particularly since these were often used for easy access to finance “connected parties”. As a result, their business model has seen a steady erosion of their market share vis-à-vis private banks. According to World Bank calculations, other things being equal, it was estimated that the loss of market share would have continued at a rate of 1 to 1.5 percent per year in the absence of a public bank restructuring.

35. Resolution of nonperforming loans is essential for bank restructuring. The creation of a system-wide Asset Management Company (AMC) to deal with distressed debt was envisaged in the revised 2014 budget—with an initial focus on tourism sector debt. Its effectiveness requires parliamentary adoption of the AMC law, which is likely to be delayed. Staff recommends adoption of the law as long as it remains in line with best international practices (such as with regards to loan resolution superpowers, fair transfer pricing, and governance) and is not a vehicle for bailing out defaulted borrowers. In the absence of a law meeting these prerequisites and helping address the high NPL issue, staff and the authorities agree that priority should be given to improving the management of NPLs by individual banks through swift adoption of the new bankruptcy law

strengthening creditor rights and an effective resolution framework. The passage of this law is expected in October 2015.

36. Well-designed measures to buttress viable tourist entities weakened by the fall in the sector will limit further build-up of NPLs. In response to the Sousse attack, a package of exceptional measures facilitated the rescheduling of new loans granted to active tourist establishments (MEFP ¶25). While concurring with most of the relief measures, staff warned against an indefinite moratorium on non-performing loans and advocated strict eligibility criteria. The authorities agreed with staff that the prudential treatment of the relief measures should be strictly time-bound, transparent and complemented with corrective action plans; otherwise they could result in regulatory forbearance and ever-greening of loans with the risks to be further extended to other sectors.

37. Strengthened regulations and improved banking supervision are essential to reduce the buildup of risks. Since the Revolution, new regulations on governance, solvency ratios, concentration risk norms, and liquidity ratio have been established. A further upgrading of these norms is required to ensure regulatory convergence toward international standards. Pending further hiring of experienced staff, major challenges lie in urgently enhancing supervisory intensity, both for public and private banks. Staff and the authorities concurred on the need for more risk-based supervision, which will be enhanced through the hiring of new bank supervisors (SB) and strict adherence to the sequencing detailed in the medium-term strategic plan designed with Fund TA (MEFP ¶29). Staff regretted delays in implementing the full bank reporting system designed last year with Fund TA, and welcomed the authorities' commitment to apply sanctions to banks violating existing prudential norms.

Major Prudential Regulations Adopted Since 2011

Governance: Strengthening of bank governance – *circular dated 20 May 2011.*

Solvency: Increase of the minimum capital adequacy ratio from 8 percent to 10 percent, strengthening of large exposures regulation—*circular dated 29 June 2012.*

Provisioning: Additional provisioning requirements based on NPL seniority—*circular dated 30 December 2013.*

Liquidity: Introduction of the new liquidity ratio—*circular dated 10 November 2014.*

38. Efforts to strengthen the banking resolution framework are progressing. The draft new banking law includes important improvements concerning deposit guarantees, bank governance, consolidated supervision, licensing, and the stronger resolution framework. Staff and the authorities agreed that additional changes concerning supervisory enforcement, early intervention, and resolution are needed to make sure the law is consistent with good international practices. Staff regretted delays in parliamentary approval of the law, and urged the authorities to accelerate the preparation process, recognizing that the consultation period with the banking industry and the stakeholders concerned by this legislation represent a risk for its timely adoption.

39. Reduced state intervention would help promote financial sector development in the medium term. Government's direct control of three main public banks and its minority participation in nine small banks (about 10 percent of banking assets) may continue to create distortions in the future if public banks continue financing loss-making state-owned enterprises, provide financing on non-commercial terms, or extend credit based on connections. The authorities noted that the State has a key role to play and that there are no plans to reduce state participation in the three state-owned banks, although the search for technical partners to help with the restructuring process of some banks is underway.

40. Further efforts to develop capital markets are needed. The absence of functioning secondary markets for bonds and low stock market capitalization (about 20 percent of GDP, and listings dominated by banks) means that capital markets continue to play a small role in allocating credit across economic sectors and maturities. Development of a yield curve—including through reduced emphasis on long maturities and a regular debt issuance program independent of seasonal cash fluctuations—the adoption of mark to market valuation, and the development of new corporate governance standards would create incentives to trade. The authorities agreed that non-bank financial sector development is also a priority that needs to be addressed to boost private sector development. An overall strategy in these areas will be developed over the next few months—with help from World Bank TA.

41. Access to finance could also be improved by strengthening microfinance institutions. Major steps forward were taken in 2011 through the adoption of the new microfinance law and the creation of a new supervisory authority. However, microfinance activities remain too low (loans of microfinance institutions only represent 0.3 percent of total loans by banks), with authorities' efforts focused initially on reinforcing the capacities of the supervisory authority. An upgrade of the regulatory and supervisory framework, removal of existing caps on lending rates, and appropriate accounting norms would also help in this area.

Boosting competitiveness through structural reforms

42. The absence of a business environment conducive to growth is among the top constraints to growth and private sector development in Tunisia. Distortions in the regulatory framework—through authorization requirements, investment restrictions, or fiscal advantages—provided privileged access to connected firms and limited the entry of new firms (e.g., sectors in which investment face restrictions account for over 50 percent of the Tunisian economy). To address the challenges and the heavy cost of bureaucracy, the authorities have over the last three years initiated a number of reforms, some of which are yet to be completed:

- **Reform of the investment code and existing regulations.** Staff regretted the delay in adopting the investment code (now expected in November 2015). It, however, welcomed the latest version of the code—which has been revised for a third time in three years—as it proposes to increase market access, simplify investment regulations, and rationalize complex incentives that used to expose different sectors to regulatory arbitrage (¶37). Staff welcomed the current proposals of moving all remaining tax incentives from the investment code to the tax code and

stressed the need to limit the number of "sectoral" decrees needed to implement the investment code. Staff also welcomed the authorities' continued determination to simplify administrative procedures (¶38).

- **Reforming the competition and bankruptcy laws.** Staff welcomed the passage of the new competition law, which would help remove discretionary application of business regulations and open up key product markets. The approval of the bankruptcy law—in parliament for the past two years—would strengthen creditor rights, and, as a consequence ease banks' reluctance to lend. The authorities reiterated their commitment to implementing these laws, which will be a cornerstone of Tunisia's new and more inclusive growth model.

- **A PPP framework.** Staff regretted delays in the final approval of the PPP law, currently in parliament, as the framework would mobilize significant private resources for public infrastructure investment. The authorities stressed the need for larger consultations to increase reform ownership, and avoid misconceptions of "privatization" associated with PPPs

43. Labor market reforms should be phased-in quickly. The structural unemployment problem in Tunisia—which is also characterized by important skills mismatches between labor demand and supply—requires changes in existing labor market rules and regulations that carefully balance better protection to workers with more flexibility to firms. To date, action in this area focused on scaling up training programs and SME support program. The tri-partite dialogue (between government, business and labor unions) process on this issue—started in 2013 during the political transition process—has yet to agree on a comprehensive National Employment Strategy (NES), which would be framed into a five-year horizon (MEFP ¶42). Staff urged the authorities to speed up completion of the NES through identification of specific measures to reform the labor market (including through reviewing the rigid hiring-firing policies, worker protection system, and public/private sector compensation).

44. Greater data transparency should accompany efforts to create a more inclusive society (MEFP ¶30 and 43). Staff urged the authorities to bring the existing AML/CFT regime in line with the 2012 FATF standards, notably with respect to implementing targeted financial sanctions. It also welcomed efforts to strengthen the institutional framework for statistics, including the imminent adoption of the Ethics Charter for Statistics. Fund TA will continue to support the authorities' efforts to strengthen the national accounts, fiscal and balance of payments statistics.

C. Protecting the Most Vulnerable

Strengthening and expanding social safety nets is necessary to ensure growth dividends reach a larger portion of the population.

45. The strengthening of existing social safety nets is progressing. The existing cash transfer system for the poor (PNAFN) has been expanded to cover 235,000 families (twice the level of 2010 and close to 60 percent of the estimated poor) and to provide more cash (average transfer has tripled to about 80 dollars per month). The evaluation study of the existing PNAFN program and

subsidized health program has identified fewer inclusion errors (leakages to non-poor) than previously estimated. Based on this finding, and the expansion of the unique social identification number (currently available for 8.5 million Tunisians), staff called for the quick adoption of a well-targeted social safety net (improving on the existing PNAFN) that could be fully functional by the end of the year.

46. Reforming the public pension system is needed to ensure its financial viability (MEFP ¶45). The public sector retirement and social security Fund (CNRPS) has been running deficits, and depleted its cash balances by 2011. Since then, budget transfers—about 0.4 percent of GDP in 2015—have been alleviating short-term cash needs to pay pensions. In view of its importance and social consequences, discussions with all stakeholders on a comprehensive reform have started but not yet concluded. In the meantime, the post-transition government has publicly announced a one-off voluntary increase in the retirement age to help alleviate short-term pressures. In line with existing actuarial studies, staff stressed that a sustainable long-term solution would also need to include changes in contribution parameters and pension benefits.

PROGRAM ISSUES AND MODALITIES

47. All quantitative performance criteria for end-December and end-March have been met (LOI, ¶3), though the inadequate composition of public expenditures continues to be a concern:

- **Fiscal.** The floor on the primary balance for end-December 2014 and end-March 2015 has been met by a wide margin, mostly because of spending under-execution of the capital budget. The indicative ceiling on current expenditure at end-December 2014 and end-March 2015 was met. The indicative floor on social spending was missed because of lower-than-programmed transfers to vulnerable households (reflecting issues in the delivery mechanism in remote regions).

- **Reserves.** The floor on NIRs at end-December 2014 and end-March 2015 has been met by comfortable margins, mainly driven by the successful issuance of international bonds.

- **Monetary.** The end-December 2014 and end-March 2015 PCs on NDA were met by comfortable margins, mainly driven by lower credit to government.

48. Progress on the structural reform agenda has been slow. Only three out of seventeen structural benchmarks expected by end-June 2015 have been completed. Slow progress over the past year reflected the need to build consensus on reforms, the establishment of a new government and parliament, and need for further technical analysis. Actions to complete all of the remaining benchmarks have been initiated—either through the drafting or submission of laws or through the ongoing banking recapitalization process. The authorities still plan to complete the large unfinished reform agenda underpinned by the program within the remaining program timeframe. This is challenging and will require moving ahead and obtaining parliamentary approval in a number of areas, including the investment code, the banking law, the lender-of-last-resort mechanism, banking

supervision, tax policy (and convergence), public enterprise reform, the Asset Management Company, banks reporting and rating system, and weekly FX auctions.

49. New conditionality continues to support program objectives. Staff is proposing new QPCs for end-September to account for weaker economic activity. To better monitor budget composition, the indicative ceiling on current primary expenditures was modified into a QPC. Concluding the current review hinges on the completion of the following prior actions: (i) recapitalization of at least one public bank (BH) and the completion of the first phase (reserved to existing shareholders) of the capital subscription process for a second bank (STB); and (ii) the renewal of state guarantees justifying lower recapitalization needs (Table 2).

50. It is proposed that the purchases under the arrangement be rephased (Table 8, LOI¶4). The authorities had requested a program extension in May 2015 to implement the policy measures needed to deliver on forward-looking commitments. Accordingly, the final purchase under the arrangement will be rephased and be contingent on completing the seventh and final review. The parliamentary adoption of the 2016 budget in line with program understanding (which includes the new tax reform that promotes equity and efficiency, and introduces permanent revenue measures that compensate for the wage increase), the update of the business plans of all three public banks, as well as their effective recapitalization, will be critical elements for the completion of that review.

51. The program is fully financed. Financing assurances have been provided by multilateral and bilateral partners for the remaining of the program period. Multilateral support remains strong, with the World Bank doubling and frontloading its disbursement (to $500 million) and the AfDB negotiating with the authorities to provide new budget support (about $200 million) this year. Additional tapping of international markets with or without sovereign guarantees is also planned during the last quarter of 2015.

Tunisia: Official External Financing

(In millions of U.S. dollars)

	2014		2015					
	Prog. 12/12/2014	Prel.	Prog. 12/12/2014	Year	Q1	Q2	Q3	Q4
Total	3,058.3	2,941.7	2821.0	3,287.2	1,053.6	158.8	1,038.2	1,036.5
Bilateral	300.0	300.0		100.0	0.0	0.0	100.0	0.0
Algeria	100.0	100.0		100.0			100.0	
Turkey	200.0	200.0						
IFIs	1,479.9	1,338.7	1895.4	1,528.1	42.1	108.4	801.5	576.1
AfDB			200.0	200.0				200.0
AMF (Arab Monetary Fund)	41.5	41.5		42.1	42.1			
IMF (Budget support)	1,061.9	1,047.2	549.5	502.6	0.0	0.0	301.5	201.0
World Bank Group	250.0	250.0	900.0	560.0		0.0	500.0	60.0
EU	126.5	0.0	245.9	223.4		108.4	0.0	115.1
Other	1,278.4	1,303.0	925.6	1,659.1	1,011.5	50.5	136.7	460.4
Market Issuances with US guarantee	500.0	500.0						
Market Issuances with Japan guarantee	463.7	463.7						
Project aid without donor breakdown	256.3	265.7	300.0	300.0	30.0	50.0	110.0	110.0
Sukuk and other market financing	0.0	0.0	565.6	1,308.5	978.5	0.0	0.0	330.0
Loan Transfers to SOEs	58.4	73.6	50.0	50.7	3.1	0.5	26.7	20.4
Memorandum items:								
Grants	176.9	216.8		154.6	4.1	50.0	100.5	0.0
EU	126.9	166.8		104.6	4.1		100.5	
Algeria	50.0	50.0		50.0		50.0		

Sources: Tunisian authorities; and IMF staff estimates.

52. Tunisia has the capacity to repay the Fund, but program risks remain significant. Tunisia has strong records of payments to the Fund, and standard indicators of Fund exposure will remain low (Table 10). However, these indicators do not take into account higher projected amortization payments in 2017–19. Moreover, risks—notably political uncertainty and increasing social or security tensions—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 and renewed pledges of international support following the recent attacks. A prolonged period of low international oil prices would help increase external buffers.

STAFF APPRAISAL

53. Economic conditions remain difficult in view of security risks and social tensions. Tunisia's economy has been resilient in a context marked by a protracted political transition and a difficult international economic environment. In 2015, the successful completion of the transition and the improved global outlook—with lower oil prices and a recovery in Europe—were expected to improve prospects for Tunisia. But, recent terror attacks have underscored the fragility of the economy: growth is weak, external imbalances persist, the budget composition is worsening, banking vulnerabilities are high, and job creation is low.

54. The successful end of the political transition and favorable external developments represent an opportunity to accelerate reforms. While some of these are likely to be difficult in view of opposition by vested interests, they can no longer be postponed. Inaction on reforms would risk putting Tunisia in a low growth path that will make it difficult to create jobs and meet the aspirations of Tunisia's population.

55. Staff welcomes the authorities' commitment to maintain an appropriate fiscal stance. The modest fiscal loosening in 2015 appropriately responds to weaker economic activity. Going forward, fiscal consolidation is needed to reduce external imbalances, restore private sector confidence, and ensure debt sustainability.

56. But fiscal adjustment needs to be accompanied by better budget composition. A growing wage bill has occupied the fiscal space created by lower international oil prices. Supporting growth would require creating fiscal space by containing the wage bill through civil service reform and reducing energy subsidies in a sustainable manner by implementing a new automatic fuel price formula. Resolving capacity absorption problems—including those linked to land rights—would help accelerate the pace of capital investment, which has reached record lows.

57. Tax reform is needed to underpin fiscal consolidation and improve equity. Staff welcomes the authorities' plans to adopt as part of the 2016 budget, a tax reform strategy that includes permanent base broadening measures, which would help raise revenue and promote greater efficiency, equity, and simplification. Efforts in improving tax administration, including by

unifying tax functions within a single administration, are necessary to complement tax policy changes.

58. Fiscal risks should be carefully monitored. Staff urges the authorities to accelerate the design of a monitoring mechanism for public enterprises and the implementation of performance contracts for the five largest public enterprises. It welcomes the authorities' commitment to pension reform, which is urgently needed to ensure financial viability of the system.

59. Reserve buffers should be strengthened. Foreign exchange interventions should continue to be limited to smoothing large exchange rate fluctuations. A move toward a weekly auction system and deeper FX markets will help promote greater exchange rate flexibility and improve banks' liquidity. This is critical in view of the high external current account deficit and rising external debt.

60. Monetary policy should remain prudent. Staff welcomes the recent move toward positive real interest rates and the authorities' readiness to raise interest rates should inflationary pressures increase. The monetary policy transmission mechanism would be greatly enhanced by removing the cap on lending rates and establishing a lender of last resort mechanism.

61. Banking sector reform needs to be completed. Staff welcomes the adoption of the recapitalization law and the designation of new bank board members. It regrets delays in recapitalizing public banks, which would have helped reduce financial stability risks. It stressed the importance of updating the business plans underpinning the recapitalization of public banks to ensure regulatory compliance throughout the restructuring period. Bank restructuring should be also complemented by the appropriate resolution of non-performing loans, through a proper AMC and a new bankruptcy law. Adoption of a proper resolution framework, strengthened banking regulations and improved banking supervision are also essential to reduce the buildup of risks.

62. The newly introduced measures to help the tourism sector should be carefully monitored. The prudential treatment in banks of the relief measures should be strictly time-bound, transparent and complemented with corrective action plans.

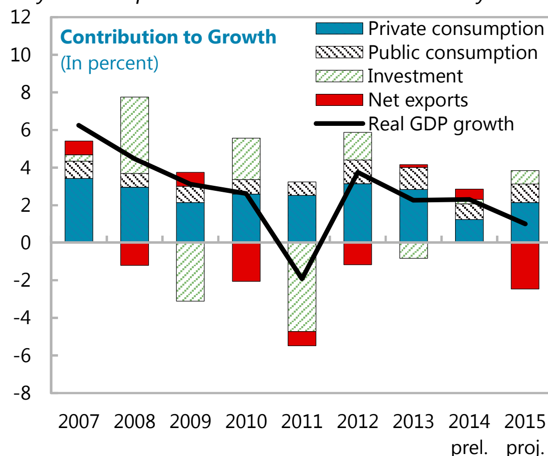
63. A better business environment is urgently needed to bolster growth and job creation. Staff welcomed the adoption of the competition law. Further tangible progress is needed to revamp the existing regulatory environment. Adopting long-standing legislation on the investment code, and public-private partnerships is critical for fostering private sector development and provide a level-playing field for investors. A national employment strategy should be urgently designed and implemented to address labor market inefficiencies that constrain youth and women unemployment.

64. Risks remain high. Spillovers from regional conflicts, security threats, lack of consensus amongst a coalition government, and opposition by vested interests remain the most important risks to reform implementation. A strong outreach campaign and greater involvement of all stakeholders to design and implement key reforms would help mitigate these risks.

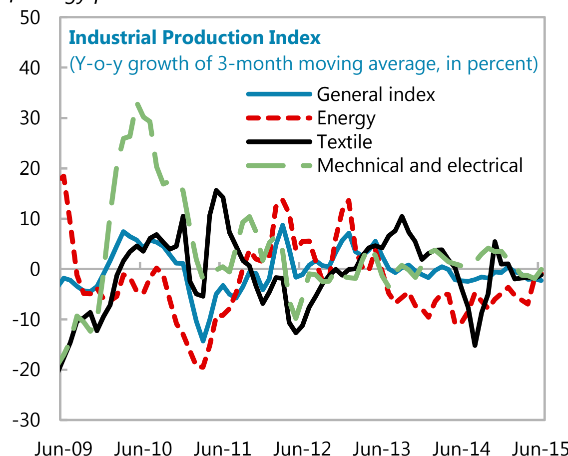
65. On the basis of Tunisia's performance under the SBA under its unusual and challenging operating environment, and with the expectation that the government completes its forward looking commitments within the program timeline, staff supports the completion of the sixth Review. Staff supports: (i) rephasing of access in line with the program extension; and (ii) the setting of a new performance criterion on current primary spending and new end-September 2015 QPCs. Staff proposes that the next Article IV consultation take place in accordance with the Decision on Article IV Consultation Cycles (Decision No. 14747(10/96), as amended).

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

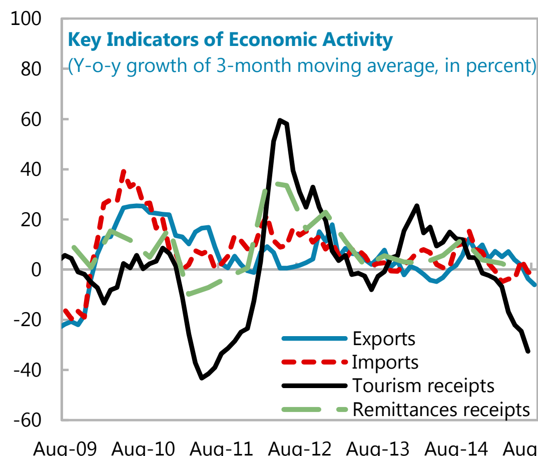
The terrorist attacks in the first half of 2015 have further delayed the expected rebound in economic activity.



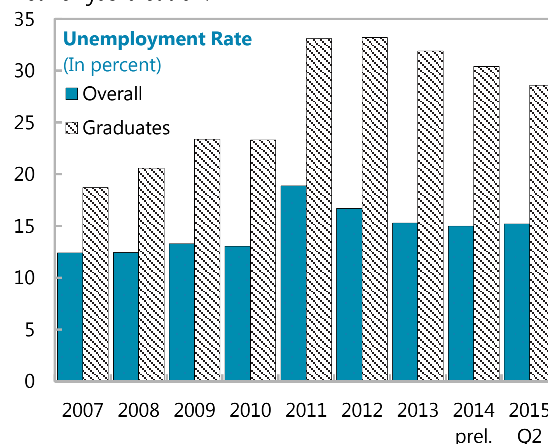
Industrial production is still weak despite certain recovery of energy production.



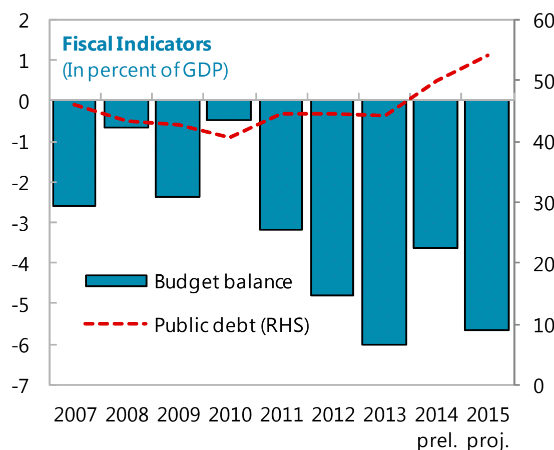
Tourism receipts are declining significantly while exports continue to be weak.



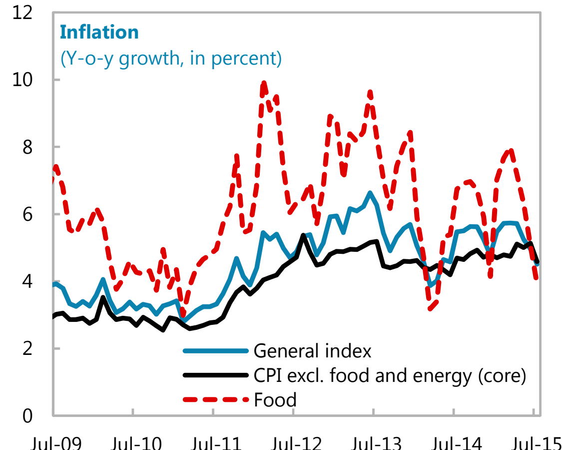
After the sharp increase in 2011, unemployment has been contained, but a declining economic activity in 2015 could weaken job creation.



The fiscal stance improved in 2014 but at the expense of budget composition and public debt is on the rise.



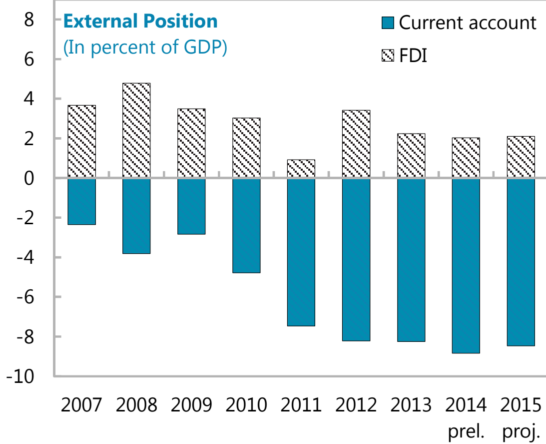
After picking up in early 2015, inflation decreased substantially in July due to lower food prices.



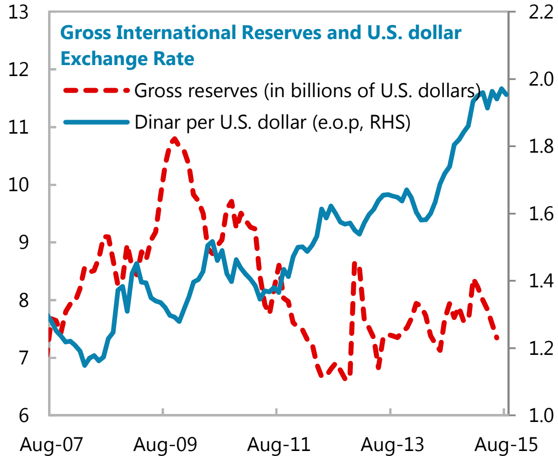
Sources: Tunisian authorities; and IMF staff calculations.

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

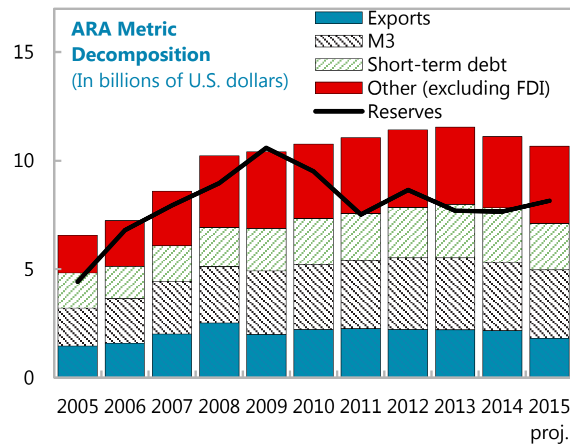
The current account deficit remains high and will only marginally improve in 2015 with declining tourism revenues and still weak FDI inflows.



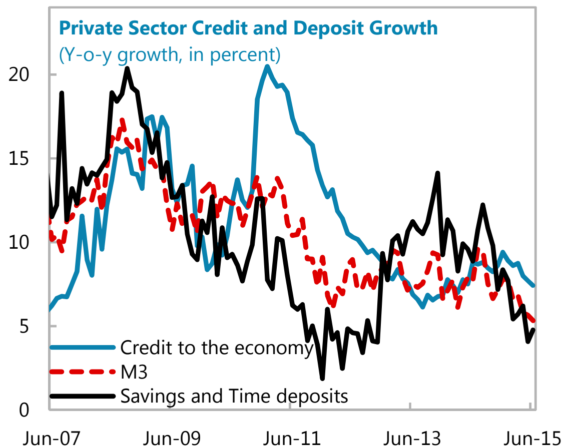
International reserves have recently declined while the exchange rate has depreciated with respect to the dollar, but not in effective terms.



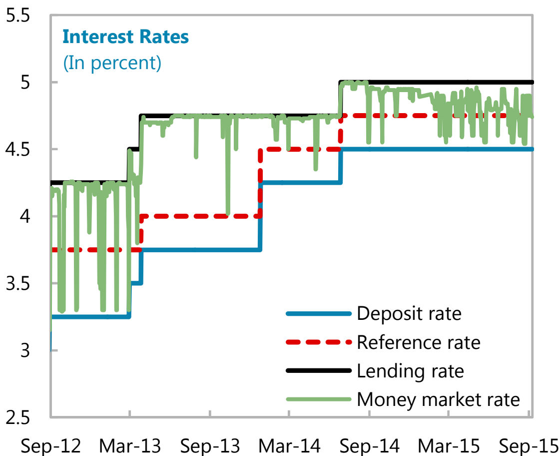
Reserve levels remain below the new metric.



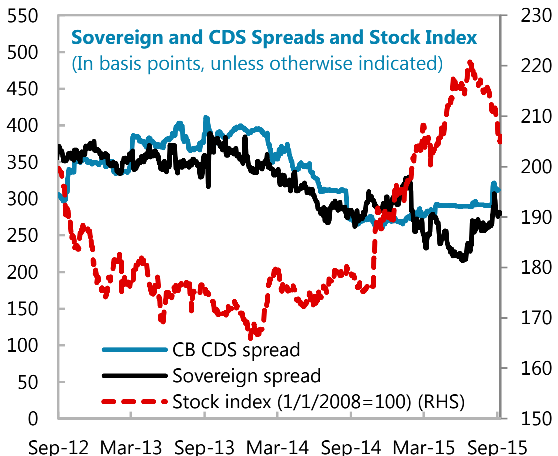
Credit to the economy is declining as well as deposit growth.



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



The stock exchange has held up from record highs even after coming down in the aftermath of the Sousse attack.



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

Table 1. Tunisia: Selected Economic and Financial Indicators, 2011–16

	2011	2012	2013	2014 Prog. 12/12/14	2014 Prel.	2015 Prog. 12/12/14	2015 Proj.	2016 Proj.
Production and income (percent change)								
Real GDP	-1.9	3.7	2.3	2.4	2.3	3.0	1.0	3.0
GDP deflator	4.6	5.3	5.7	5.7	5.7	4.8	4.8	3.6
Consumer price index (CPI), average	3.5	5.1	5.8	5.6	4.9	5.0	5.0	4.0
Consumer price index (CPI), end of period	3.9	5.9	5.7	5.5	4.8	4.5	4.4	4.0
Gross national savings (in percent of GDP)	16.1	16.1	13.8	12.7	12.2	14.2	13.0	14.6
Gross investment (in percent of GDP)	23.6	24.3	22.0	20.6	21.0	20.6	21.5	21.7
Central government (percent of GDP, unless indicated otherwise 1/								
Total revenue (excluding grants)	24.5	23.1	23.6	23.9	24.0	23.6	22.4	23.1
Total expenditure and net lending	28.0	28.8	29.8	28.8	28.1	29.8	28.4	27.4
Central government balance (excluding grants)	-3.5	-5.7	-6.2	-4.8	-4.1	-6.2	-6.0	-4.3
Central government balance (excluding grants, cash basis)	-2.8	-5.0	-4.5	-7.1	-6.7	-6.2	-6.0	-4.3
Structural fiscal balance 2/	-3.0	-5.3	-4.5	-4.1	-3.3	-3.8	-3.5	-2.9
Central government debt (foreign and domestic)	44.5	44.5	44.3	49.4	50.0	55.2	54.0	56.3
Foreign currency public debt (percent of total debt)	58.0	62.8	63.9	68.3	68.0	68.3	68.0	75.0
Total external debt								
External debt (US$ billions)	22.1	24.3	25.4	26.6	27.4	29.8	28.5	30.1
External debt (in percent of GDP)	48.0	53.8	54.1	54.4	56.2	60.6	64.4	67.5
Debt service ratio (percent of exports of GNFS)	11.9	12.0	9.6	9.2	10.1	7.1	11.3	9.3
Money and credit (percent change)								
Credit to the economy	13.4	8.8	6.8	7.2	9.4	6.9	6.5	7.6
Broad money (M3 of the financial system)	9.1	8.4	6.6	8.7	7.8	10.5	6.9	7.6
Velocity of circulation (GDP/M2)	1.45	1.46	1.48	1.47	1.48	1.44	1.47	1.45
External sector (percent change)								
Exports of goods, f.o.b. (in $)	8.5	-4.6	0.3	1.1	-1.9	3.9	-11.3	5.1
Imports of goods, f.o.b. (in $)	7.7	2.1	-0.5	2.3	1.8	0.9	-15.1	1.1
Exports of goods, f.o.b. (volume)	-0.4	1.4	4.7	2.3	1.4	4.6	4.8	3.7
Import of goods, f.o.b. (volume)	3.7	8.5	5.1	2.6	2.4	3.1	2.0	2.1
Trade balance (in percent of GDP)	-10.4	-13.5	-12.6	-12.9	-13.7	-11.8	-11.4	-10.1
Current account (in percent of GDP)	-7.5	-8.2	-8.3	-7.9	-8.8	-6.4	-8.5	-7.0
Foreign direct investment, net (in percent of GDP)	0.4	1.5	1.1	2.1	2.2	2.8	2.3	2.6
Terms of trade (deterioration -)	4.9	-0.1	1.2	0.2	-2.7	0.9	1.6	2.3
Official reserves								
Gross official reserves (US$ billions, e.o.p)	7.5	8.7	7.7	7.8	7.7	10.1	8.2	9.0
In months of next year's imports of goods and services, c.i.f.	3.4	3.9	3.4	3.4	4.0	4.4	4.3	4.6
Memorandum items:								
GDP at current prices (TD millions)	64,690	70,658	76,350	82,643	82,562	89,217	87,399	93,262
GDP at current prices (US$ billions)	46.0	45.2	47.0	48.9	48.6	49.3	44.3	44.6
Real effective exchange rate (percent change, depreciation -) 3/	-1.76	-1.53	-1.84	...	0.03	...	...	...
Interest rate (money market rate, in percent, e.o.p)	3.5	3.3	4.8	...	4.7	...	...	...
Stock market TUNINDEX (12/31/1997=1000)	4,722	4,580	4,381	...	4,674	...	...	...

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, 2011–20

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

						Projections										
	2011	2012	2013	2014		2015						2016	2017	2018	2019	2020
			Annual	Prog. 12/12/14	Annual	Q1	Q2	Q3	Q4	Prog. 12/12/14	Annual					
Current account	-3,430	-3,722	-3,879	-3,866	-4,302	-736	-1,299	-895	-822	-3,132	-3,752	-3,133	-2,806	-2,332	-2,007	-1,882
Trade balance	-4,799	-6,105	-5,931	-6,285	-6,670	-992	-1,573	-1,424	-1,040	-5,832	-5,030	-4,500	-4,443	-3,872	-3,629	-3,621
Exports	15	16,997	17,050	17,236	16,733	3,727	3,651	3,462	4,003	17,903	14,843	15,594	16,361	17,204	17,928	18,330
Energy	2,592	2,849	2,591	2,360	2,204	355	216	343	453	2,259	1,366	1,390	1,367	1,463	1,511	1,538
Non-energy	15,231	14,147	14,459	14,876	14,529	3,372	3,435	3,119	3,550	15,644	13,477	14,204	14,994	15,740	16,417	16,792
Of which: Nonfood	13390	12497	12772	13040	13176	2,711	2,830	2,854	3,296	13710	11690	12257	12921	13559	14134	14403
Imports	-22,623	-23,102	-22,981	-23,521	-23,403	-4719	-5224	-4886	-5043	-23,735	-19,873	-20,094	-20,804	-21,076	-21,557	-21,951
Energy	-3,409	-4,100	-4,172	-4,658	-4,348	-809	-779	-740	-701	-4,604	-3,029	-3,188	-3,352	-3,756	-4,077	-4,347
Non-energy	-19,214	-19,001	-18,809	-18,862	-19,055	-3,910	-4,445	-4,147	-4,342	-19,131	-16,844	-16,906	-17,451	-17,320	-17,480	-17,604
Of which: Nonfood	-17,339	-16,984	-16,627	-18,013	-17,035	-3,436	-3,911	-3,740	-3,891	-17,174	-14,977	-15,206	-15,821	-15,773	-16,022	-16,229
Services and transfers (net)	1,369	2,383	2,052	2,419	2,368	256	274	529	218	2,700	1,278	1,368	1,637	1,540	1,622	1,739
Nonfactor	1,523	1,955	1,622	1,747	1,442	173	76	209	-58	2,095	400	674	1,070	1,104	1,147	1,198
Of which: Tourism	1,680	2,033	1,983	2,089	2,136	295	317	349	214	2,309	1,175	1,308	1,422	1,454	1,533	1,618
Factor Services and Transfers (net)	-154	428	430	672	926	83	199	320	276	605	878	694	567	436	475	541
Of which: Workers' remittances	1,990	2,266	2,291	2,403	2,347	444	456	588	489	2,424	1,978	2,007	2,041	2,080	2,142	2,208
Interest payments on external debt	-653	-618	-571	-561	-544	-48	-128	-514	109	-534	-581	-566	-509	-456	-414	-377
Capital and financial account	-675	3,783	2,566	2,926	4,504	1,298	676	1,480	1,006	4,844	4,461	3,990	2,853	3,255	3,104	3,070
Capital account	184	450	115	217	287	3	52	107	84	202	246	232	219	207	203	198
Financial account	1,380	3,333	2,451	2,709	4,217	1,295	624	1,373	923	4,641	4,215	3,758	2,634	3,048	2,902	2,872
Direct investment and portfolio (net)	381	1,530	1,128	1,021	1,061	235	338	291	167	1,363	1,030	1,175	1,320	1,419	1,496	1,548
Medium- and long-term loans (net)	652	1,667	631	1,129	1,928	919	-53	932	552	2,393	2,349	1,251	223	614	641	618
Disbursement	2,707	3,717	2,172	2,639	3,575	1,147	285	1,164	1,228	3,517	3,823	2,424	2,494	2,626	2,506	1,999
Amortization	-2,055	-2,049	-1,541	-1,510	-1,647	-228	-338	-231	-676	-1,124	-1,474	-1,174	-2,271	-2,012	-1,864	-1,380
Short-term capital	347	136	691	733	1,228	142	173	206	173	1,049	693	875	637	593	582	515
of which: change in NFA of commercial banks	...	1,700	1,065	...	670	91	76	-28	11	...	149	209	197	193	78	74
Valuation changes	...	...	...	...	...	...	166	-55	31	...	142	458	454	422	182	190
Errors and omissions 1/	-162	1,069	348	-42	-232	-215	0	0	0	35	-215	0	0	0	0	0
Overall Balance	-4,267	1,130	-965	-982	-29	347	-623	585	184	1,747	494	858	47	924	1,097	1,189
Changes in gross reserves (+ = accumulation)	-1984	1130	-965	-77	-29	347	-623	585	184	-2296	494	858	47	924	1097	1189
of which: IMF (net)	0	0	150	1059	1047	0	0	302	201	549	503	-35	-322	-566	-497	-221
Memorandum items:																
Current account balance/GDP (percent)	-7.5	-8.2	-8.3	-7.9	-8.8	-1.7	-2.9	-2.0	-1.9	-6.4	-8.5	-7.0	-6.2	-5.0	-4.0	-3.5
Reserves (in billions of US$)	7.5	8.7	7.7	7.8	7.7	8.0	7.4	8.0	8.2	10.1	8.2	9.0	9.1	10.0	11.1	12.3
Reserves in months of imports of goods and services 2/	3.4	3.9	3.4	3.4	4.0	4.2	3.9	4.2	4.3	4.4	4.3	4.6	4.6	4.9	5.4	5.6
Reserves/total short term external debt (percent) 3/	147.2	139.7	117.0	137.7	111.9	126.6	154.9	140.0	150.1	170.2	136.7	144.5	137.7	143.5	149.8	165.3
External medium- and long-term debt (billions of US$)	16.9	18.1	18.9	21.0	20.5	19.9	20.1	21.4	22.5	23.9	22.5	23.9	24.5	25.2	25.8	26.7
External medium- and long-term debt/GDP (percent)	39.3	39.8	40.7	42.9	46.2	46.2	44.6	43.2	42.2	48.6	51.3	54.0	54.2	54.1	51.9	50.3
External short-term debt (billions of US$)	5.1	6.2	6.6	5.6	6.8	6.3	4.8	5.7	5.4	5.9	6.0	6.2	6.6	7.0	7.4	7.4
External short-term debt/GDP (percent)	11.8	13.6	14.2	11.5	15.4	15.4	14.2	10.2	11.2	12.0	13.6	14.1	14.5	14.9	14.9	14.0
Debt service ratio (as percent XGS, including IMF)	11.9	12.0	9.6	8.2	10.1	7.8	11.0	9.1	16.9	6.4	11.3	9.3	15.5	14.5	12.8	8.9
Imports (percent of GDP)	49.23	51.07	48.90		48.12	41.77	44.38	38.63	36.63		44.89	45.07	45.59	44.88	42.97	41.00
Exports (percent of GDP)	0.03	37.57	36.28		34.41	32.99	31.01	27.37	29.08		33.53	34.98	35.86	36.63	35.73	34.24
National GDP in USD	45951	45239	46995		48633	11299.3	11772.3	12650.5	13766.5		44272	44584	45629	46962	50171	53537

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, 2012–20

(In millions of U.S. dollars)

				Projections									
	2012	2013	2014	2015					2016	2017	2018	2019	2020
		Year	Year	Q1	Q2	Q3	Q4	Year					
Total financing requirements	10,881	11,613	12,520	7,791	8,592	8,056	8,340	12,068	10,271	11,315	10,921	10,828	10,656
Current account deficit	3,722	3,879	4,302	736	1,299	895	822	3,752	3,133	2,806	2,332	2,007	1,882
Amortizations	2,049	1,541	1,647	228	338	231	672	1,470	1,174	2,271	2,012	1,864	1,380
General government	1,234	1,032	611	103	198	106	194	602	646	1,431	1,200	1,425	1,076
Central Bank	0	0	519	33	3	31	339	406	92	419	427	96	0
Corporate 1/	815	509	517	92	137	94	139	462	436	421	385	344	304
Short-term debt 2/	5,110	6,193	6,572	6,827	6,955	6,930	6,846	6,846	5,965	6,237	6,578	6,957	7,394
Total financing sources	10,881	11,613	12,520	7,791	8,592	8,056	8,340	12,067	10,271	11,315	10,921	10,828	10,656
Direct investment and portfolio (net)	1,530	1,128	1,061	235	338	291	167	1,030	1,175	1,320	1,419	1,496	1,548
Disbursments (debt)	3,717	2,172	3,575	1,147	285	1,164	1,230	3,825	2,424	2,494	2,626	2,506	1,999
General government	3,060	1,296	2,898	1,095	159	1,038	1,029	3,320	1,914	2,025	2,191	2,134	1,642
Corporate 1/	657	876	677	52	126	125	201	504	510	470	435	372	357
Short-term debt	6,149	6,661	7,505	6,413	4,815	5,671	5,441	6,019	6,295	6,634	7,017	7,453	7,482
Other flows net (incl. drawdown in commercial banks NFA)	617	686	350	344	2,531	1,517	1,687	1,687	1,235	913	783	470	815
Drawdown in gross reserves	-1,130	965	29	-347	623	-585	-184	-494	-858	-47	-924	-1,097	-1,189
Financing gap	0	0	0	0	0	0	0	0	0	0	0	0	0
Of which: Fund credits 1/	0	150	1,047	0	0	302	201	503	-35	-322	-566	-497	-221
Purchases	0	150	1,047	0	0	302	201	503	0	0	0	0	0
Repurchase	0	0	0	0	0	0	0	0	-35	-322	-566	-497	-221
Memorandum items:													
Gross international reserves (in millions of U.S. dollars)	8,655	7,689	7,660	8,007	7,384	7,969	8,154	8,154	9,012	9,059	9,982	11,079	12,268
Government rollover rates (in percent)	248	126	474	1,058	80	981	529	552	296	141	183	150	152
Corporate rollover rates (in percent)	81	172	131	56	92	133	144	109	117	112	113	108	118

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, 2012–16 1/

(In millions of dinars)

	2012	2013	2014	2015						2016
			Prel.	Prog. Annual 12/12/14	Annual Proj.	Q1 Act.	Q2 Est./Act.	Q3 Proj.	Q4 Proj.	Proj
Total revenue and grants	16,939	18,150	20,190	21,265	19,896	5,345	4,811	4,828	4,912	21,762
Revenue	16,310	18,039	19,824	21,054	19,590	5,334	4,712	4,632	4,912	21,556
Tax revenue	14,864	16,333	18,580	19,820	18,510	5,010	4,378	4,445	4,678	20,218
Nontax revenue	1,446	1,657	1,240	1,230	1,076	324	333	186	233	1,335
Capital income	0	49	4	4	4	1	1	1	1	4
Grants	629	110	366	211	306	11	99	196	0	206
Total expenditure and net lending	20,344	22,746	23,206	26,595	24,864	5,167	5,395	6,859	7,444	25,534
Total expenditure	20,694	22,747	22,786	25,175	23,623	5,108	5,394	6,696	6,425	25,434
Current expenditure	16,003	19,023	19,291	20,475	19,593	4,598	4,537	5,401	5,057	20,025
Wages and salaries	8,624	9,572	10,502	11,157	11,591	3,159	2,709	2,898	2,825	12,173
Goods and services	1,167	1,200	1,489	1,598	1,611	430	190	403	588	1,679
Interest payments	1,272	1,411	1,513	1,705	1,750	483	399	456	411	1,745
Transfers and subsidies	4,940	5,959	5,787	5,843	4,490	488	1,201	1,607	1,194	4,277
CGC (Food)	1,242	1,450	1,417	1,500	1,530	153	398	559	420	1,427
Energy subsidies	2,111	2,854	2,353	1,826	392	0	150	212	30	239
Other (including transfer to CNRPS)	1,587	1,655	2,017	2,517	2,568	335	653	835	745	2,611
Other expenditure (non-allocated)	0	880	0	172	151	38	38	38	38	151
Capital expenditure	4,692	3,725	3,495	4,700	4,030	511	857	1,294	1,369	5,409
Net lending	-351	-1	420	1,420	1,241	59	1	163	1,018	100
Of which: public banks' recap. and restr. + AMC operat.costs	41	0	0	1,450	1,127	0	0	110	1,017	0
Central government deficit (-) (excluding grants)	-4,033	-4,707	-3,382	-5,541	-5,274	167	-682	-2,227	-2,532	-3,978
Central government deficit (-) (including grants)	-3,404	-4,596	-3,016	-5,331	-4,968	178	-583	-2,031	-2,532	-3,772
Float	-505	-1,264	2,128	0	0	-105	-187	0	292	0
Central government deficit (-) (excluding grants, cash basis)	-3,529	-3,443	-5,510	-5,541	-5,274	272	-495	-2,227	-2,824	-3,978
Central government deficit (-) (including grants, cash basis)	-2,899	-3,333	-5,143	-5,331	-4,968	283	-396	-2,031	-2,824	-3,772
Financing	2,899	3,333	5,143	5,331	4,968	-283	396	2,031	2,824	3,772
Foreign	2,524	-605	3,922	4,147	5,240	1,869	-68	1,818	1,620	2,623
Drawings	4,450	1,057	4,994	5,367	6,490	2,068	315	2,070	2,037	3,974
Amortization	1,926	1,662	1,072	1,220	1,250	199	383	251	417	1,351
Domestic	-18	3,459	1,129	984	-472	-2,152	464	133	1,084	949
Drawings	1,582	1,843	3,267	2,065	1,111	486	373	236	16	2,374
Amortization	925	1,333	2,278	2,205	1,820	713	81	101	925	1,753
Government Deposits (+ = drawing / - = accumulation)	-675	2,948	140	24	238	-1,925	172	-2	1,993	328
Banks recapitalization	0	0	0	1,100	0	0	0	0	0	0
Privatization proceeds 2/	394	479	92	200	200	0	0	80	120	200
Memorandum items:										
Central government primary balance (excluding grants, cash basis)	-2,256	-2,032	-3,997	-3,836	-3,524	756	-96	-1,771	-2,412	-2,233
Cyclically adjusted fiscal balance	-3,774	-4,337	-2,754	-4,835	-4,222	...	...	...	...	-2,741
Structural fiscal balance	-3,733	-3,457	-2,754	-3,385	-3,095	...	...	...	...	-2,741
Central government debt 3/	31,441	33,801	41,307	49,218	47,164	...	...	...	...	52,536
Nominal GDP	70,658	76,350	82,562	89,217	87,399	21,850	23,316	25,218	27,380	93,262

Sources: Tunisian authorities; and IMF staff estimates.

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

2/ Mostly includes sale of confiscated assets.

3/ Gross debt.

Table 4b. Tunisia: Central Government Financial Operations, 2012–20
(In percent of GDP)

	2012	2013	2014		2015		2016	2017	2018	2019	2020
			Prog. 12/12/14	Prel.	Prog. 12/12/14	Proj.			Proj.		
Total revenue and grants	24.0	23.8	24.3	24.5	23.8	22.8	23.3	23.7	24.0	24.1	24.1
Revenue	23.1	23.6	23.9	24.0	23.6	22.4	23.1	23.4	23.9	23.9	24.0
Tax revenue	21.0	21.4	22.7	22.5	22.2	21.2	21.7	22.0	22.3	22.4	22.4
Direct taxes	8.6	9.3	10.5	9.9	9.8	8.6	8.7	8.8	9.0	9.1	9.2
Trade taxes	1.0	1.0	1.0	1.0	1.0	0.9	1.0	1.0	1.0	1.0	1.0
VAT	6.2	5.8	5.9	6.2	6.1	6.1	6.5	6.8	7.0	7.1	7.1
Excise	2.3	2.0	2.1	2.0	2.1	2.1	2.4	2.4	2.4	2.4	2.4
Other taxes	3.0	3.3	3.3	3.4	3.2	3.4	3.1	3.0	2.9	2.8	2.8
Nontax revenue	2.0	2.2	1.3	1.5	1.4	1.2	1.4	1.4	1.5	1.5	1.5
Grants	0.9	0.1	0.4	0.4	0.2	0.3	0.2	0.2	0.2	0.2	0.2
Total expenditure and net lending	28.8	29.8	28.8	28.1	29.8	28.4	27.4	26.8	26.6	25.7	25.0
Total expenditure	29.3	29.8	28.6	27.6	28.2	27.0	27.3	26.7	26.5	25.7	24.9
Current expenditure	22.6	24.9	23.8	23.4	22.9	22.4	21.5	20.2	19.5	18.7	17.9
Wages and salaries	12.2	12.5	12.7	12.7	12.5	13.3	13.1	12.5	12.1	11.5	11.0
Goods and services	1.7	1.6	1.9	1.8	1.8	1.8	1.8	1.7	1.7	1.7	1.7
Interest payments	1.8	1.8	1.8	1.8	1.9	2.0	1.9	1.5	1.5	1.4	1.3
Transfers and subsidies	7.0	7.8	7.2	7.0	6.5	5.1	4.6	4.3	4.1	3.9	3.8
CGC	1.8	1.9	1.8	1.7	1.7	1.8	1.5	1.4	1.3	1.2	1.1
Energy subsidies	3.0	3.7	2.8	2.8	2.0	0.4	0.3	0.2	0.2	0.1	0.1
Other (including transfer to CNRPS)	2.2	2.2	2.6	2.4	2.8	2.9	2.8	2.8	2.6	2.6	2.6
Other expenditure (non-allocated)	0.0	1.2	0.2	0.0	0.2	0.2	0.2	0.1	0.1	0.1	0.0
Capital expenditure	6.6	4.9	4.8	4.2	5.3	4.6	5.8	6.5	7.0	7.0	7.0
Net lending	-0.5	0.0	0.2	0.5	1.6	1.4	0.1	0.1	0.1	0.1	0.1
Of which: public banks' recap. and restr. + AMC operating.costs	0.1	0.0	0.0	0.0	1.6	1.3	0.0	0.0	0.0	0.0	0.0
Central government deficit (-) (excluding grants)	-5.7	-6.2	-4.8	-4.1	-6.2	-6.0	-4.3	-3.4	-2.7	-1.8	-1.0
Central government deficit (-), (including grants)	-4.8	-6.0	-4.5	-3.7	-6.0	-5.7	-4.0	-3.2	-2.5	-1.6	-0.9
Float	-0.7	-1.7	2.2	2.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central government deficit (-), (excluding grants, cash basis)	-5.0	-4.5	-7.1	-6.7	-6.2	-6.0	-4.3	-3.4	-2.7	-1.8	-1.0
Central government deficit (-), (including grants, cash basis)	-4.1	-4.4	-6.7	-6.2	-6.0	-5.7	-4.0	-3.2	-2.5	-1.6	-0.9
Financing	4.1	4.4	6.7	6.2	6.0	5.7	4.0	3.2	2.5	1.6	0.9
Foreign	3.6	-0.8	5.0	4.8	4.6	6.0	2.8	0.6	1.0	0.5	0.7
Domestic	0.0	4.5	1.6	1.4	1.1	-0.5	1.0	2.3	1.4	1.0	0.0
Privatization proceeds 1/	0.6	0.6	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Memorandum items:											
Central government primary balance (excluding grants, cash basis)	-3.2	-2.7	-5.3	-4.8	-4.3	-4.0	-2.4	-1.9	-1.3	0.3	0.0
Structural fiscal balance	-5.3	-4.5	-4.1	-3.3	-3.8	-3.5	-2.9	-2.1	-1.7	-1.1	-0.4
Central government debt 2/	44.5	44.3	49.4	50.0	55.2	54.0	56.3	57.0	57.4	55.6	53.4

Sources: Tunisian authorities; and IMF staff estimates.
1/ It includes mostly sale of confiscated assets.
2/ Gross debt.

Table 5. Tunisia: Monetary Survey (Financial System), 2010–16

(In millions of dinars)

	2010	2011	2012	2013	2014	2015 Q1	2015 Q2	2015 Q3	2015	2016
					Prel.			Proj.		
					(In millions of dinars)					
Net foreign assets (NFA)	9,078	5,749	7,054	3,865	2,173	3,247	1,951	2,486	2,429	3,857
Foreign assets	16,023	12,893	15,410	15,027	16,764	18,099	16,947	18,064	18,438	20,376
Central bank	13,705	11,315	13,455	12,701	14,294	15,731	14,293	15,455	15,822	17,826
Foreign liabilities	-6,946	-7,143	-8,357	-11,162	-14,591	-14,852	-14,996	-15,578	-16,009	-16,519
Central bank	-623	-782	-1,134	-3,004	-5,043	-5,228	-5,347	15	-6,228	-6,154
Net domestic assets (NDA)	34,190	41,454	44,114	50,684	56,628	56,133	57,267	59,358	60,429	63,803
Domestic credit	46,370	53,577	58,022	65,660	74,851	74,314	75,679	80,263	80,889	86,675
Credit to the government (net)	3,227	4,659	4,791	8,794	12,641	11,233	11,501	11,709	14,632	15,402
Central bank net credit	-3,250	-3,355	-3,461	-175	1,264	-808	-562	35	2,434	2,762
Commercial banks	2,937	3,568	3,686	4,111	5,807	5,901	6,236	6,051	6,650	6,898
Other	4,189	4,447	5,265	4,858	5,570	6,140	5,827	5,623	5,548	5,742
Credit to the economy	43,144	48,918	53,231	56,866	62,210	63,081	64,178	68,554	66,257	71,273
Other items (net)	-12,181	-12,123	-13,908	-14,976	-18,222	-18,181	-18,411	-20,904	-20,459	-22,872
Money plus quasi-money (M2)	40,854	44,652	48,327	51,686	55,908	56,524	56,197	57,878	59,559	64,109
Money (M1)	15,862	19,007	20,007	20,877	22,542	23,263	23,052	23,626	24,015	25,849
Currency	5,518	6,814	6,559	7,236	8,084	8,066	8,152	8,561	8,612	9,270
Demand deposits	10,344	12,192	13,448	13,641	14,458	15,197	14,900	15,065	15,402	16,579
Quasi-money	24,992	25,646	28,320	30,809	33,366	33,261	33,145	34,252	35,545	38,260
Long-term deposits (M3-M2)	2,414	2,551	2,841	2,863	2,893	2,856	3,021	3,966	3,300	3,552
Broad money (M3)	43,267	47,203	51,168	54,549	58,802	59,380	59,218	61,845	62,859	67,660
					(Annual rate of change in percent)					
Net foreign assets	-5.7	-36.7	22.7	-45.2	-43.8	36.7	18.8	9.2	11.8	58.8
Net domestic assets	18.1	21.2	6.4	14.9	11.7	5.5	4.9	6.7	6.7	5.6
Domestic credit	16.8	15.5	8.3	13.2	14.0	8.5	6.0	10.4	8.1	7.2
Credit to government (net)	-11.4	44.4	2.8	83.5	43.7	6.9	-1.0	-1.9	15.8	5.3
Credit to the economy	19.6	13.4	8.8	6.8	9.4	8.7	7.4	12.8	6.5	7.6
Money and quasi-money (M2)	11.9	9.3	8.2	7.0	8.2	7.2	5.3	5.0	6.5	7.6
Broad money (M3)	12.1	9.1	8.4	6.6	7.8	6.9	5.3	6.8	6.9	7.6
					(Annual growth rates, in percent of broad money)					
Net foreign assets	-1.4	-7.7	2.8	-6.2	-3.1	1.6	0.5	0.4	0.4	2.3
Net domestic assets	13.6	16.8	5.6	12.8	10.9	5.3	4.8	6.4	6.5	5.4
Domestic credit	17.3	16.7	9.4	14.9	16.8	10.4	7.7	13.1	10.3	9.2
Credit to the government (net)	-1.1	3.3	0.3	7.8	7.1	1.3	-0.2	-0.4	3.4	1.2
Credit to the economy	18.4	13.3	9.1	6.8	9.4	8.7	7.4	12.8	6.9	8.0
Other items (net)	-3.7	0.1	-3.8	-2.1	-6.0	-5.1	-2.9	-6.6	-3.8	-3.8
Memorandum items:										
GDP (in millions of dinars)	63,059	64,690	70,658	76,350	82,562	...	...	...	87,399	93,262

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

Table 6. Tunisia: Central Bank Balance Sheet, 2010–16

(In millions of dinars)

	2010	2011	2012	2013	2014 Q1	2014 Q2	2014 Q3	2014	2015 Q1	2015 Q2	2015 Q3	2015	2016
Net Foreign Assets	13082	10533	12321	9696	8615	7765	9120	9251	10503	8946	9628	9595	11672
Assets	13705	11315	13455	12701	12265	12060	13929	14294	15731	14293	15455	15822	17826
Liabilities	623	782	1134	3004	3650	4296	4809	5043	5228	5347	5827	6228	6154
Net Domestic Assets	-4707	-1189	-1332	1382	2457	3371	2841	1688	1034	1959	3114	2059	871
Domestic credit (net)	-2673	222	248	3493	4467	5573	5279	4358	3611	4554	6320	5056	3926
Net credit to government 1/	-3250	-3355	-3461	-175	574	835	1048	1242	-828	-577	20	2412	2740
Credit to Banks	578	3577	3709	3668	3893	4738	4231	3116	4439	5131	6300	2644	1186
Other items net	-2035	-1412	-1579	-2111	-2011	-2201	-2438	-2669	-2577	-2595	-3205	-2997	-3054
Reserve Money 2/	8415	9406	10989	11078	11072	11136	11961	10939	11537	10906	12742	11653	12544

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, 2008–15

(In percent, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013	2014	2015Q1
							Prel.	
Regulatory capital to risk-weighted assets	11.7	12.2	11.6	11.9	11.8	8.2	9.4	9.5
Tier 1 capital to risk weighted assets	10.6	10.7	10.2	10.0	9.5	6.6	7.6	7.6
Capital to assets	8.1	8.5	8.4	8.5	7.8	5.6	6.2	6.3
Asset quality								
Sectoral distribution of loans to total loans								
Industry	31.3	30.0	30.5	28.6	27.9	27.8	27.2	27.0
Agriculture	3.6	3.4	2.9	2.9	2.8	2.8	2.8	2.8
Commerce	17.3	17.4	15.0	16.0	15.4	15.1	15.6	16.2
Construction	4.5	4.9	5.9	5.6	5.4	5.5	5.7	5.8
Tourism	9.1	8.2	7.3	7.3	6.9	6.5	6.1	6.1
Households	20.1	21.6	22.1	23.4	25.4	26.2	26.1	26.0
Other	14.3	14.4	16.3	16.3	16.2	16.0	16.7	16.1
FX-loans to total loans	3.9	4.5	5.3	5.1	4.8	4.8	5.5	5.4
Credit to the private sector to total loans	71.6	70.4	70.6	67.4	67.7	73.8	73.9	74.0
Nonperforming Loans (NPLs) to total loans	15.5	13.2	13.0	13.3	14.9	16.5	15.7	15.8
Specific provisions to NPLs	…	…	…	48.6	45.7	56.4	58.0	56.6
NPLs, net of provisions, to Tier 1 capital	71.1	57.9	60.3	66.2	86.3	111.8	89.6	92.4
Specific provisions to total loans	8.8	7.7	7.6	7.6	8.0	10.3	10.1	10.0
General provisions to total loans	…	…	…	0.4	0.5	0.5	0.6	0.5
Profitability								
Return on assets (ROA)	1.0	1.0	0.9	0.6	0.6	0.3	0.9	…
Return on equity (ROE)	11.2	11.7	10.2	5.9	7.2	3.0	11.2	…
Interest rate average spread (between loans and deposit	3.6	3.5	3.5	3.0	3.0	3.3	3.1	2.9
Interest return on credit	7.0	6.4	6.2	5.7	5.4	5.9	6.4	6.2
Cost of risk as a percent of credit	1.4	1.2	1.7	1.2	1.2	1.9	…	…
Net interest margin to net banking product (PNB)	58.6	58.8	58.6	57.2	58.1	58.9	57.2	…
Operating expenses to PNB	45.4	47.2	46.5	51.1	50.3	47.3	48.7	…
Operating expenses to total assets	1.6	1.6	1.6	1.7	1.6	1.6	1.7	…
Personnel expenses to non-interest expenses	60.4	61.4	59.1	62.6	61.5	60.8	59.0	…
Trading and other non-interest income to PNB	21.7	22.1	21.8	22.5	20.9	21.6	22.3	…
Liquidity								
Liquid assets to total assets 1/	31.6	32.1	29.8	26.5	28.2	28.4	28.2	5.3
Liquid assets to short-term liabilities	124.0	119.1	104.1	89.4	89.2	92.6	96.6	81.2
Deposits to loans	98.9	100.9	94.6	87.4	89.5	89.6	88.8	87.9
Deposits of state-owned enterprises to total deposits	13.8	14.8	13.8	12.6	13.2	13.0	11.7	11.5
Sensitivity to market risk								
FX net open position to Tier 1 Capital	1.4	1.5	1.4	1.9	2.3	3.1	2.2	3.4

Source: Central Bank of Tunisia.

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

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

Review	Availability Date	Action	Purchase		Disbursements
			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	149.848
Second Review	December 15, 2013	Observance of end-September 2013 performance criteria, completion of the second review	230.520	80.461	350.335
Third Review	March 15, 2014	Observance of end-December 2013 performance criteria, completion of the third review	145.080	50.639	220.491
Fourth Review	June 15, 2014	Observance of end-March 2014 performance criteria, completion of the fourth review	143.250	50.000	220.486
Fifth Review	September 15, 2014	Observance of end-June 2014 performance criteria, completion of the fifth review	143.250	50.000	217.705
Sixth Review	December 15, 2014	Observance of end-September 2014 performance criteria, completion of the sixth review	143.250	50.000	108.853
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	1,637.666
Rephasing Approved Dec-12-2014					
Fifth Review	November 15, 2014	Observance of end-September 2014 performance criteria, completion of the fifth review	71.625	25.000	108.853
Sixth Review	March 15, 2015	Observance of end-December 2014 performance criteria, completion of the sixth review	214.875	75.000	301.543
Seventh Review	May 15, 2015	Observance of end-March 2015 performance criteria, completion of the seventh review	143.250	50.000	201.029
Total to be rephased			429.750	150.000	611.425
Proposed Rephasing					
Seventh Review	November 15, 2015	Observance of end-September 2015 performance criteria, completion of the seventh review	143.250	50.000	201.029

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, 2011–20

	2011	2012	2013	2014	Proj. 2015	2016	2017	2018	2019	2020
					(Change in percent)					
Real GDP growth	-1.9	3.7	2.3	2.3	1.0	3.0	4.0	4.6	5.0	4.7
Total consumption	4.0	5.2	4.6	2.3	3.5	2.1	2.6	3.3	3.7	4.6
Private consumption	4.0	4.7	4.2	1.8	3.1	2.5	3.5	3.8	4.4	5.8
Public consumption	4.1	6.8	6.2	4.2	4.9	0.9	-0.4	1.4	1.0	0.3
Investment	-18.9	7.1	-3.9	1.2	3.6	4.0	5.0	6.5	7.0	7.5
Gross fixed capital formation	-12.6	7.1	-3.8	1.2	3.5	4.0	5.0	6.5	7.0	7.5
Exports of goods and nfs 1/	-7.9	7.0	3.5	3.9	-4.3	6.1	6.1	4.6	4.5	3.2
Imports of goods and nfs 1/	3.5	8.3	4.9	2.2	1.8	1.9	3.4	3.1	3.2	3.3
Inflation (annual average)	3.5	5.1	5.8	4.9	5.0	4.0	3.9	3.9	3.8	3.8
					(In percent of GDP)					
Gross national savings	16.1	16.1	13.8	12.2	13.0	14.6	15.7	17.3	18.6	19.6
Consolidated government 2/	4.1	2.0	-1.0	0.8	-0.9	2.0	3.5	4.8	5.7	6.1
Rest of the economy	12.0	14.0	14.7	11.4	13.9	12.7	12.2	12.5	12.8	13.5
Gross investment	23.6	24.3	22.0	21.0	21.5	21.7	21.9	22.2	22.6	23.1
Consolidated government	7.2	6.7	4.9	4.3	4.6	5.8	6.5	7.0	7.0	7.0
Rest of the Economy	16.4	17.6	17.1	16.7	16.8	15.8	15.3	15.2	15.6	16.1
Total consumption	83.9	85.1	87.2	87.4	89.7	89.3	88.1	87.0	85.8	85.6
Private consumption	65.9	66.7	68.2	67.9	69.4	69.3	69.0	68.5	68.0	68.6
Public consumption	17.9	18.4	19.0	19.5	20.3	20.0	19.1	18.6	17.8	17.0
Savings-investment gap	-7.5	-8.2	-8.3	-8.8	-8.5	-7.0	-6.2	-5.0	-4.0	-3.5
Consolidated government	-3.0	-4.7	-5.9	-3.5	-5.6	-3.9	-3.0	-2.3	-1.3	-0.9
Rest of the economy	-4.4	-3.6	-2.4	-5.3	-2.9	-3.2	-3.2	-2.7	-2.7	-2.7
Memorandum items										
Nominal GDP at current prices (TD millions)	64,690	70,658	76,350	82,562	87,399	93,262	100,872	109,522	119,598	130,226
General debt in percent of GDP	44.5	44.5	44.3	50.0	54.0	56.3	57.0	57.4	55.6	53.4
External debt in percent of GDP	48.0	53.8	54.1	56.2	64.4	67.5	68.1	68.5	66.2	63.8
Central government balance in percent of GDP 3/	-3.5	-5.7	-6.2	-4.1	-6.0	-4.3	-3.4	-2.7	-1.8	-1.0
Current account balance in percent of GDP	-7.5	-8.2	-8.3	-8.8	-8.5	-7.0	-6.2	-5.0	-4.0	-3.5
Credit to the economy (yoy growth, percent)	13.4	8.8	6.8	9.4	6.5	7.6	8.0	8.6	9.4	8.4

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, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
Existing and prospective Fund credit (millions of SDR)									
Disbursement	0	99	689	358	0	0	0	0	0
Stock	0	99	788	1,146	1,121	894	498	152	0
Obligations	0	3	0	4	42	243	404	350	153
Repurchase	0	0	0	0	25	227	396	346	152
Charges	0.02	2.72	0.36	4.34	17.61	15.52	8.28	3.91	1.18
Stock of existing and prospective Fund credit									
In percent of quota	0.0	34.5	275.0	400.0	391.4	312.1	173.9	53.1	0.0
In percent of GDP	0.0	0.3	2.5	3.6	3.5	2.8	1.5	0.4	0.0
In percent of exports of goods and services	0.0	0.7	5.5	8.8	8.2	6.3	3.4	1.0	0.0
In percent of gross reserves	0.0	2.0	15.6	19.7	17.5	14.0	7.1	2.0	0.0
Obligations to the Fund from existing and prospective Fund arrangements									
In percent of quota	0.0	0.9	0.1	1.5	14.8	84.6	141.1	122.1	53.5
In percent of GDP	0.0	0.0	0.0	0.0	0.1	0.8	1.2	1.0	0.4
In percent of exports of goods and services	0.0	0.0	0.0	0.0	0.3	1.7	2.8	2.3	1.0
In percent of gross reserves	0.0	0.1	0.0	0.1	0.7	3.8	5.8	4.5	1.8

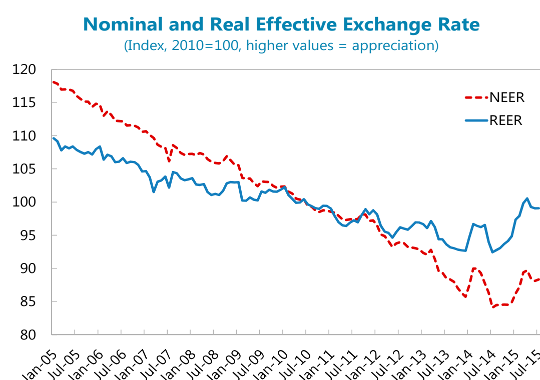
Source: IMF staff estimates.

Annex I. Tunisia: External Sector Assessment[1]

This Annex provides an assessment of Tunisia's external sector, including on exchange rates, reserve adequacy, and international competitiveness. Results suggest that (i) the Tunisian dinar remains overvalued by about 5-15 percent, (ii) reserves are expected to cover 4 months of imports, but remain under the suggested adequacy range of the IMF's new ARA metric, and (iii) Tunisia's international competitiveness is deteriorating relative to regional peers. These findings suggest a need to enhance exchange rate flexibility and revitalize structural reforms to increase competitiveness.

Exchange rate assessment

Tunisia's CPI-based real exchange rate has been on a depreciating trend, which has recently been reversed. Since 2005, the nominal and real effective exchange rates (weighed by trade partners) have depreciated by 27 and 10 percent, respectively. More recently, the strengthening US dollar vis-à-vis the euro, the main currency in Tunisia's basket, has led to a strong appreciation of the currency in real and effective terms (3 and 6 percent from August 2014, respectively). The nominal effective exchange rate appears to mimic movements in the nominal exchange rate, as price differentials appear to have played a minor role in explaining the trend. These findings are obtained using the currency denomination of trade transaction, rather than country partners, in the computation of effective rates.



The Tunisian dinar remains overvalued by about 5-15 percent:

- **Standard CGER methodologies suggest that, on average, the exchange rate is overvalued by about 7 percent,** with some variance in the findings (text table). First, the equilibrium real effective exchange rate (EREER) approach, which performs an assessment of the exchange rate based on a set of fundamentals in 2015, suggests that the REER is overvalued by about 9 percent. This reflects the impact of the recent appreciation of the Tunisian dinar, and is calculated as the percentage difference between the estimated equilibrium and the actual REER in 2015. Second, and

Exchange Rate Assessment Using CGER Panel Estimates
(In percent)

	Underlying CA balance 1/	CA norm	REER misalignment 2/
EREER approach	...	...	9.1
MB approach 3/	-3.5	-1.9	6.6
ES approach 3/	-3.5	-2.2	4.5

Source: IMF staff calculations.
1/ In 2020 corrected from program adjustment.
2/ Overvaluation (+); undervaluation (-)
3/ Based on an elasticity of the CA/GDP with the REER of -0.25.

[1] Prepared by Amr Hosny, SPR.

using projected 2020 data, the macro balance (MB) approach suggests an overvaluation of about 7 percent based on a calculated current account norm that should be higher than the underlying current account balance (CAB). Third, the external sustainability (ES) approach indicates that a slight adjustment of about 5 percent for the dinar is necessary to stabilize Net Foreign Assets (NFA) to GDP ratio over the medium-term at its 2010 level.[2]

- **The EBA methodology suggests a higher overvaluation of about 15 percent** (text table). The EBA methodology estimates the contribution of policy variables to assessments of exchange rates and external positions.[3] Estimations suggest that there is a large gap between the projected current account deficit in 2015 and its norm, pointing to a high REER overvaluation of around 15 percent. This current account gap is partially explained by some policy gaps, including fiscal policy, although the bulk can be attributable to a large unexplained residual. The latter likely reflects missing fundamentals, measurement errors, domestic shocks not captured by the regression, or potential policy distortions.

Macro Balance Approach Using EBA
(In percent)

CA Projected 2015	-8.5	CA Gap	-6.3
CA Norm	-2.3	Contribution of identified Policy Gaps	1.8
		Unexplained residual	-7.5
CA Fitted	-4.1		
REER misalignment 1/	15.7		

1/ Overvaluation (+); undervaluation (-).

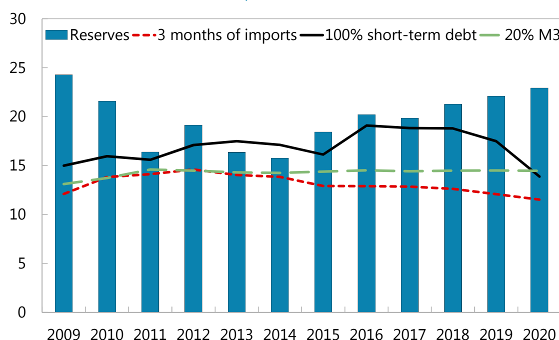
Assessment of reserve adequacy

Tunisia's gross reserves seem adequate based on traditional reserve coverage assessments, but still fall short of the IMF's new Adequacy Reserve Assessment (ARA) metric. Reserve coverage improved in 2015, boosted by the January issuance of a $1 billion Eurobond, and is expected to increase further in view of expected disbursements from multilateral and bilateral sources.

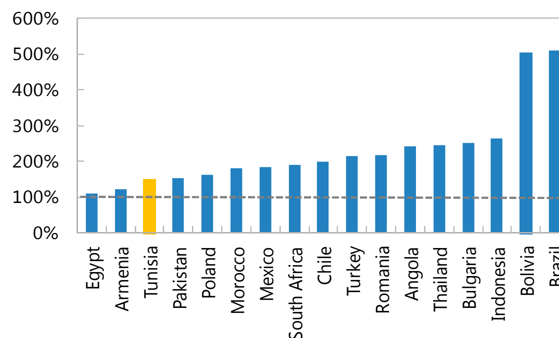
- *Reserves exceed common benchmarks in traditional reserve coverage indicators*, namely the coverage of: three months of imports, 100 percent of short-term debt, and 20 percent of money supply (text chart). Although reserves in 2015 are expected to be above 4 months of imports for the first time since 2010, they are still relatively low compared to most emerging economies (text chart).

[2] It is worth noting that the CGER MB and ES approaches find a more moderate overvaluation compared to the EREER approach because by using 2020 data, they implicitly assume that the variables that explain CA and exchange rate movements will be close to their medium-term equilibrium levels, whereas the ERRER approach uses 2015 data.

[3] IMF (2013) "The External Balance Assessment (EBA) Methodology," IMF WP 13/272 (Washington, D.C.: International Monetary Fund).

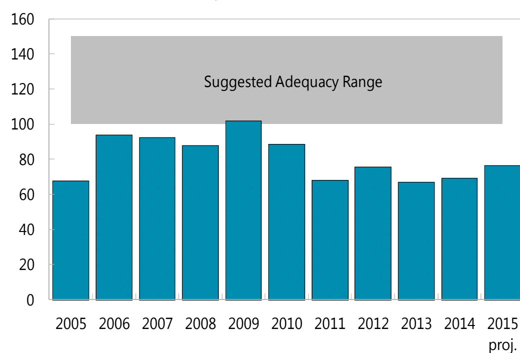


Sources: Tunisian authorities; and IMF staff calculations.

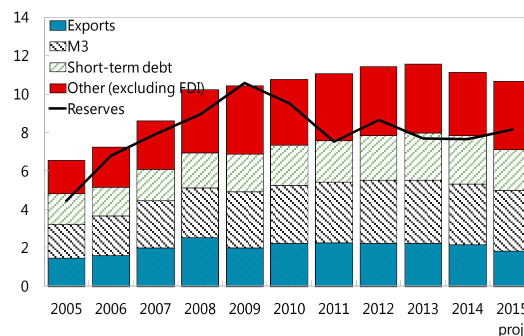


Sources: Authorities and IMF Staff Calculations

- *The IMF composite ARA metric[4] shows that gross reserves in 2015 would only cover about 75 percent of Tunisia's "risk weighted liability stock", whereas the suggested adequacy range is between 100-150 percent.* [5] Although the ARA metric this year is expected to be the highest since 2011, it still falls short of being within the suggested adequacy range of 100-150 percent last observed in 2009. In 2015, scenario analysis suggests that reserves could cover (i) around 115 percent of short-term debt at remaining maturity, thus mitigating rollover risks and strengthening investors' appetite to Tunisian assets; and (ii) more than four months of next year's imports of goods and services, which could effectively alleviate constraints on imports financing if export receipts remain subdued or drop suddenly. Risks of significant capital flight remain limited due to existing capital controls.



Sources: Tunisian authorities; and IMF staff calculations.



Sources: Tunisian authorities; and IMF staff calculations.

[4] For more details, see IMF (2014) "Assessing Reserve Adequacy—Specific Proposals," IMF Board paper (Washington, D.C.: International Monetary Fund).

[5] Given Tunisia's de facto exchange rate regime, a crawl-like arrangement, the "risk weighted liability stock" is computed as follows: ARA Metric = (10% × Exports) + (10% × Broad Money) + (30% × Short-term Debt) + (20% × Other Liabilities).

Assessment of international competitiveness

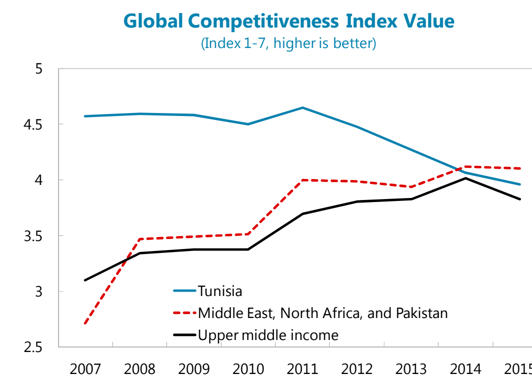
Across regions, Tunisia's overall competitiveness is comparable to similar emerging economies. A comparison of a number of structural areas—including labor, bureaucracy, infrastructure, trade, and regulations—shows that although the overall competitiveness of the Tunisian economy compares relatively well with other countries in the MENA region, it is still relatively low compared to other emerging and advanced market economies.[6]

Increasing Competitiveness Requires Bold Structural Reforms

Sources: IMF staff calculations based on data from the following indicators. For Labor: World Economic Forum (WEF); Corruption: PRS; Infrastructure: WEF; Trade: WEF; Education: WEF; Legal: WEF and World Bank Doing Business; Finance: WEF and World Bank Doing Business; Bureaucracy: PRS; Regulations: World Bank Worldwide Governance Indicators.

Over time, however, Tunisia's rank in the global competitiveness index (GCI)[7] has been declining. Looking at Tunisia's performance over time, we notice that although its ranking has been historically higher than the MENA and upper middle income averages, it has recently dropped below comparator levels (text chart). This deterioration calls for bolder and faster structural reforms efforts in a number of areas; most importantly in financial market development, technological readiness, and innovation.

Global Competitiveness Index Value
(Index 1-7, higher is better)

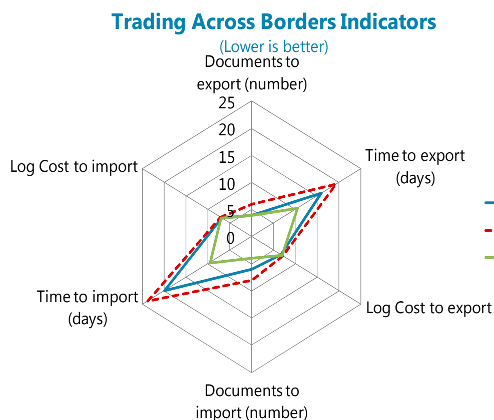


Source: World Economic Forum's Global Competitiveness Report.

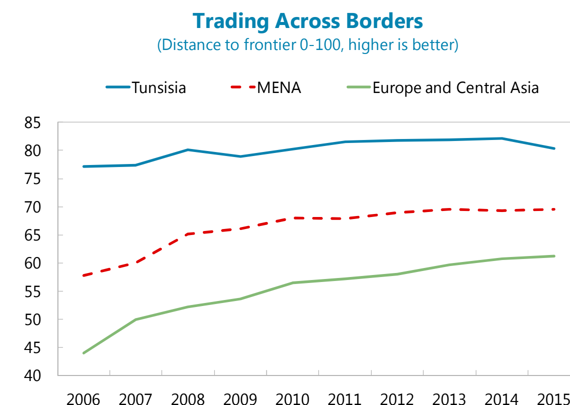
[6] Also see SIP on potential growth for more details on the estimated impact of structural reforms on potential growth in Tunisia.

[7] The GCI, published by the World Economic Forum, assesses the overall competitiveness landscape of more than 140 economies, providing insight into the set of institutions, policies and factors that determine the level of productivity of a country.

The same pattern is also observed for *trade-related* measures of competitiveness. The "trading across borders" database, part of the World Bank's Doing Business Report, ranks Tunisia slightly above the MENA average (text chart). Tunisia also fares relatively well relative to OECD countries in terms of costs to exports and imports, although the number of documents and days to export and import are lower in OECD countries. Overall, in a cross-sectional dimension, Tunisia appears to fare relatively well in terms of trade competitiveness. However, evidence suggests that Tunisia's performance stagnated over time while others improved more rapidly, allowing them to close the gap with frontier economies at a faster rate (text chart).



Source: World Bank's Doing Business Report, 2015.



Source: World Bank's Doing Business Report, 2015.

Competitiveness is a relative concept. The discussion above suggests that competiveness, whether in overall or trade-related terms, is a relative rather than an absolute concept, where a country can lose competiveness even if it improves slightly but not fast enough compared to other countries. A recent study by Behar and Calani (2015, forthcoming) substantiates this point[8] by showing that a typical small open economy can lose up to about 17 percent of its exports if it does not reduce its number of export documents while all other countries reduce it by one document. Similarly, a country can lose about 9 percent and 3 percent of its exports if it does nothing in terms of the cost and time to export while all other countries reduc13e them by $100 and one day, respectively.

Impact of Loss of Relative Competitiveness on Exports
(In percent)

Number of export documents (1 doc)	16.7
Non tariff cost (100 USD)	8.6
Time to export (1 day)	2.9

Source: Behar and Calani (2015, forthcoming).

[8] Behar, A. and M. Calani (2015, forthcoming) "The Cost of Policy Inertia: An Application to Exports in the Middle East and Central Asia", forthcoming IMF Working paper.

Bolder and faster structural reforms are therefore needed. The analysis above indicates that slow progress in areas that determine Tunisia's competiveness can have an adverse effect on the medium-term external sector performance of the country. The recently observed appreciation of the REER might also induce some competitiveness losses in the short-term. Therefore, bolder and faster structural reforms that simplify the ease of doing business, encourage innovation and technology, and upgrade logistics and customs procedures are urgently needed to boost competitiveness and productivity.

Annex II. Tunisia: 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 57.4 percent of GDP in 2018 before declining over the medium term. Gross financing needs are expected to peak close to 9.2 percent of GDP in 2015 and to moderate around 5.9 percent of GDP by 2019, reflecting relatively long maturities and favorable conditions by official external creditors. Stress scenarios and the heat map confirm the sustainability of debt dynamics, though substantial vulnerabilities arise from the large proportion of foreign debt and the impact of a permanent slow growth and/or a depreciating currency.

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 and the terrorist attacks in the first part of 2015 with a severe impact on the tourism sector. 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 54 percent of GDP by 2015. The gradual but steady fiscal consolidation and a pick-up in growth rates starting in 2016 would help control the debt-to-GDP ratio to a slightly lower level by end-2020; this, however, would still be 7.1 percentage points of GDP higher than the average of 2004–12. The pace of the envisaged fiscal consolidation (with a cash deficit declining from 5.7 percent in 2015 to below 1.0 percent of GDP by 2020) 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

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

external amortization will drive external financing needs up to 26 percent of GDP, exposing vulnerabilities to increased uncertainties in external flows.

Stress test and heat map

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

- Under most adverse scenarios, the public debt-to-GDP ratio would initially worsen and then stabilize between 56 percent and 63 percent in 2020. 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 40 percent depreciation would increase the public debt-to-GDP ratio to about 69 percent before it declines to 63.4 percent by 2020, because about 68 percent of public debt is denominated in foreign currency.

- A combined shock (to real growth and the primary balance) would raise public debt to 82.2 percent of GDP by 2018 before declining to 78.6 percent by the end of the outlook while a contingent liability shock will raise the public debt to 72.3 percent in 2018 before declining to 67.6 percent in 2020.

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)

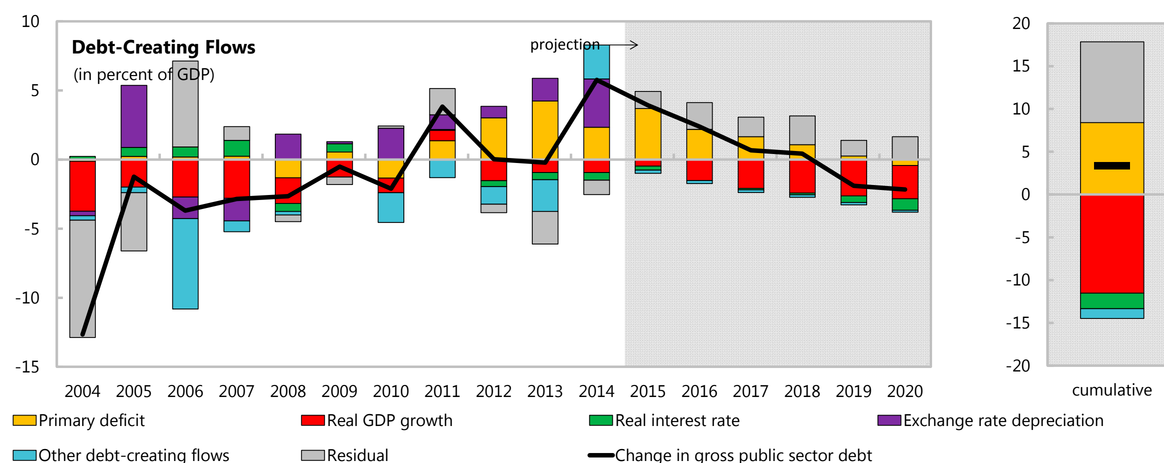
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	46.3	44.3	50.0	54.0	56.3	57.0	57.4	55.6	53.4
Public gross financing needs	6.3	9.9	8.2	9.2	8.2	8.1	8.1	5.9	5.9
Net public debt	42.9	41.9	48.0	52.3	55.2	57.0	57.4	55.6	53.4
Public debt (in percent of potential GDP)	46.3	44.4	50.2	53.5	56.2	57.1	57.5	55.5	53.3
Real GDP growth (in percent)	3.8	2.3	2.3	1.0	3.0	4.0	4.6	5.0	4.7
Inflation (GDP deflator, in percent)	4.1	5.7	5.7	4.8	3.6	4.0	3.8	4.0	4.0
Nominal GDP growth (in percent)	8.0	8.1	8.1	5.9	6.7	8.2	8.6	9.2	8.9
Effective interest rate (in percent) [4/]	4.8	4.5	4.5	4.2	3.7	4.0	3.7	3.3	2.6

As of August 05, 2015		
Sovereign Spreads		
EMBIG (bp) 3/		267
5Y CDS (bp)		293
Ratings	Foreign	Local
Moody's	Ba3	Ba3
S&Ps	...	...
Fitch	BB-	BB

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.4	-0.2	5.8	3.9	2.4	0.7	0.4	-1.9	-2.2	3.4	
Identified debt-creating flows	-1.9	2.1	6.8	2.7	0.5	-0.7	-1.7	-3.0	-3.8	-6.1	
Primary deficit	0.3	4.2	2.3	3.7	2.2	1.7	1.1	0.2	-0.4	8.4	-3.4
Primary (noninterest) revenue and grants	22.9	23.7	24.4	22.8	23.3	23.6	24.0	24.1	24.1	142.0	
Primary (noninterest) expenditure	23.2	27.9	26.8	26.4	25.5	25.3	25.1	24.4	23.7	150.4	
Automatic debt dynamics [5/]	-0.7	0.2	2.0	-0.8	-1.5	-2.2	-2.5	-3.1	-3.2	-13.3	
Interest rate/growth differential [6/]	-1.5	-1.5	-1.5	-0.8	-1.5	-2.2	-2.5	-3.1	-3.2	-13.3	
Of which: real interest rate	0.3	-0.5	-0.6	-0.3	0.0	-0.1	-0.1	-0.5	-0.8	-1.8	
Of which: real GDP growth	-1.8	-0.9	-0.9	-0.5	-1.5	-2.1	-2.4	-2.6	-2.4	-11.5	
Exchange rate depreciation [7/]	0.8	1.6	3.5	...	...	...	...	...	...	...	
Other identified debt-creating flows	-1.5	-2.3	2.5	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1	
CG: Privatization Proceeds (negative)	-1.1	-0.6	-0.1	-0.2	-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	-0.4	-1.7	2.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.6	-2.4	-1.0	1.2	1.9	1.4	2.1	1.1	1.7	9.4	



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.

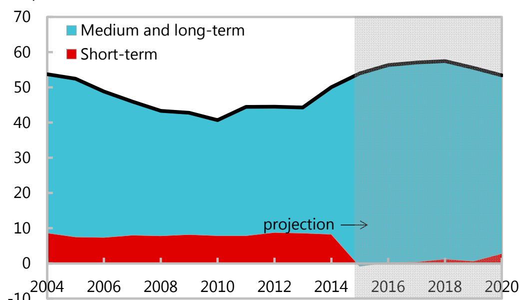
7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

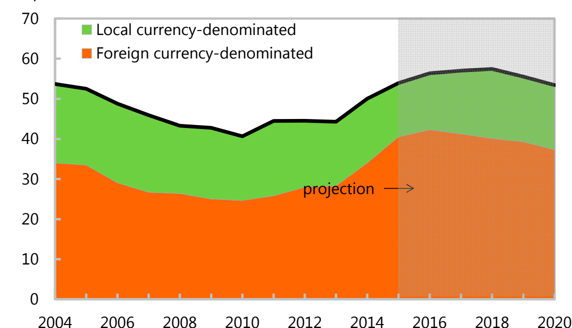
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

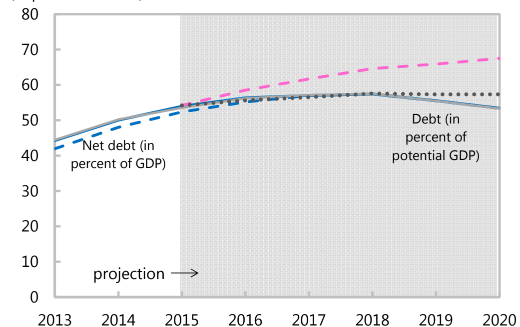
Composition of Public Debt

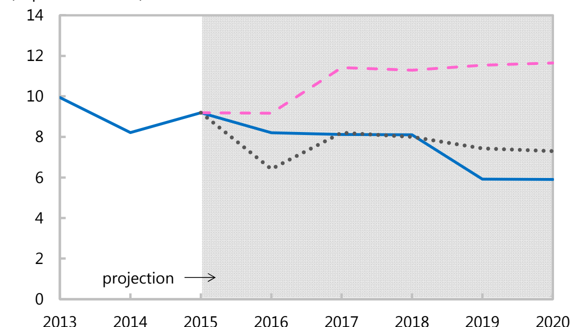




Alternative Scenarios

Baseline — Historical — Constant Primary Balance





Underlying Assumptions
(in percent)

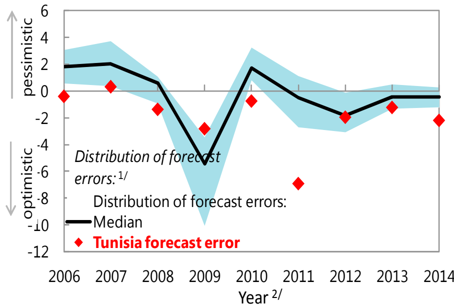
Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	1.0	3.0	4.0	4.6	5.0	4.7
Inflation	4.8	3.6	4.0	3.8	4.0	4.0
Primary Balance	-3.7	-2.2	-1.7	-1.1	-0.2	0.4
Effective interest rate	4.2	3.7	4.0	3.7	3.3	2.6
Constant Primary Balance Scenario						
Real GDP growth	1.0	3.0	4.0	4.6	5.0	4.7
Inflation	4.8	3.6	4.0	3.8	4.0	4.0
Primary Balance	-3.7	-3.7	-3.7	-3.7	-3.7	-3.7
Effective interest rate	4.2	3.7	4.0	3.8	3.5	3.0

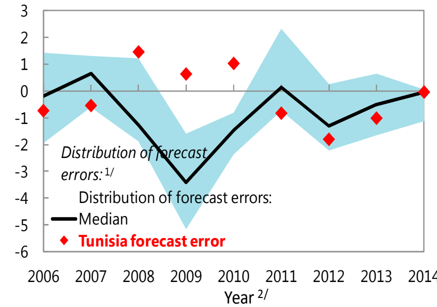
Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	1.0	3.2	3.2	3.2	3.2	3.2
Inflation	4.8	3.6	4.0	3.8	4.0	4.0
Primary Balance	-3.7	-0.9	-0.9	-0.9	-0.9	-0.9
Effective interest rate	4.2	3.7	4.1	3.9	3.5	2.9

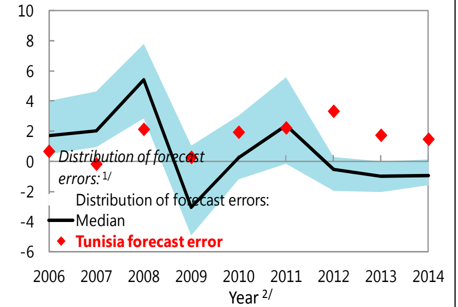
Source: IMF staff.

Tunisia Public DSA - Realism of Baseline Assumptions

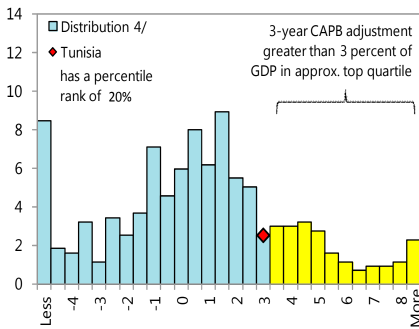
Forecast Track Record, versus program countries

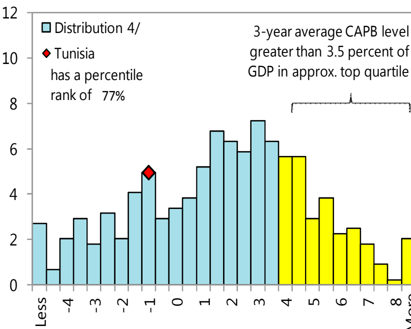




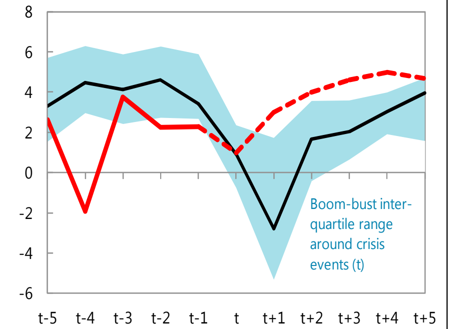


Assessing the Realism of Projected Fiscal Adjustment





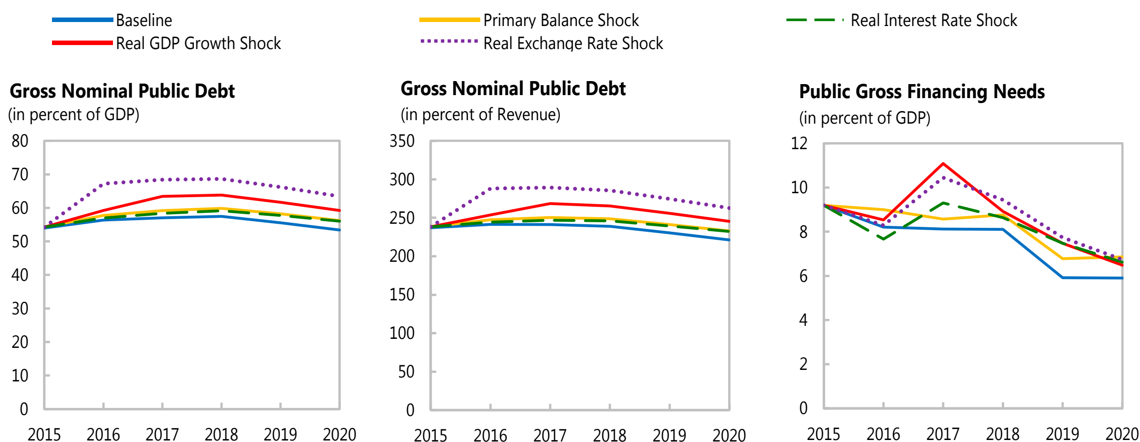
Boom-Bust Analysis 3/



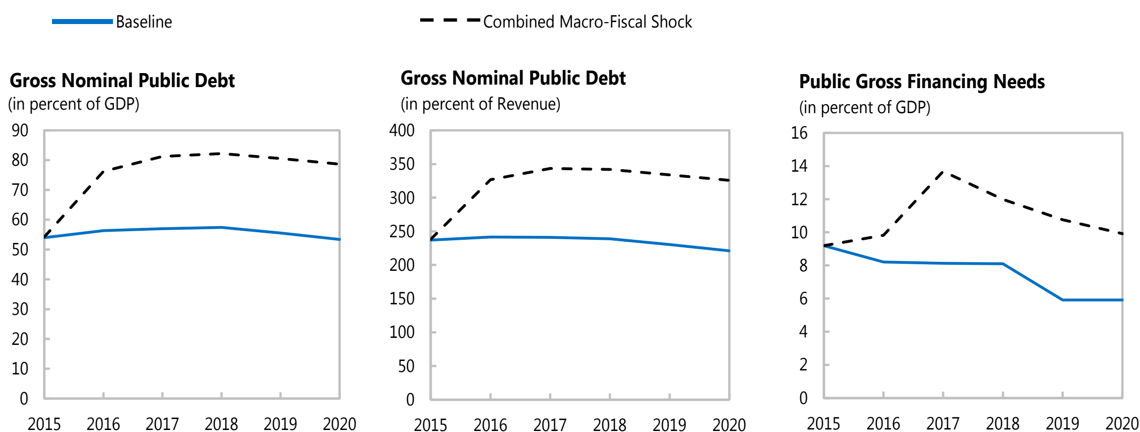
Source : IMF Staff.
1/ Plotted distribution includes program countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Tunisia has had a positive output gap for 3 consecutive years, 2012-2014. For Tunisia, t corresponds to 2015; for the distribution, t corresponds to the first year of the crisis.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Tunisia Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	1.0	3.0	4.0	4.6	5.0	4.7
Inflation	4.8	3.6	4.0	3.8	4.0	4.0
Primary balance	-3.7	-2.9	-1.9	-1.4	-0.7	0.1
Effective interest rate	4.2	3.7	4.0	3.8	3.4	2.7
Real Interest Rate Shock						
Real GDP growth	1.0	3.0	4.0	4.6	5.0	4.7
Inflation	4.8	3.6	4.0	3.8	4.0	4.0
Primary balance	-3.7	-2.2	-1.7	-1.1	-0.2	0.4
Effective interest rate	4.2	3.7	4.4	4.6	4.4	3.9
Combined Shock						
Real GDP growth	1.0	0.7	1.7	4.6	5.0	4.7
Inflation	4.8	3.0	3.4	3.8	4.0	4.0
Primary balance	-3.7	-2.9	-3.1	-1.4	-0.7	0.1
Effective interest rate	4.2	4.4	4.1	4.3	4.3	4.0

Real GDP Growth Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	1.0	0.7	1.7	4.6	5.0	4.7
Inflation	4.8	3.0	3.4	3.8	4.0	4.0
Primary balance	-3.7	-2.9	-3.1	-1.1	-0.2	0.4
Effective interest rate	4.2	3.7	4.0	3.9	3.4	2.7
Real Exchange Rate Shock						
Real GDP growth	1.0	3.0	4.0	4.6	5.0	4.7
Inflation	4.8	13.6	4.0	3.8	4.0	4.0
Primary balance	-3.7	-2.2	-1.7	-1.1	-0.2	0.4
Effective interest rate	4.2	4.4	3.7	3.4	3.2	2.6

Source: IMF staff.

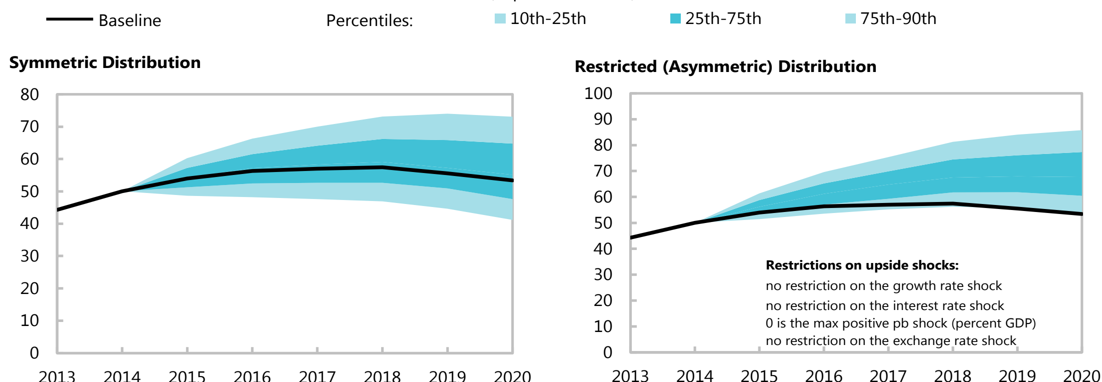
Tunisia Public DSA Risk Assessment

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

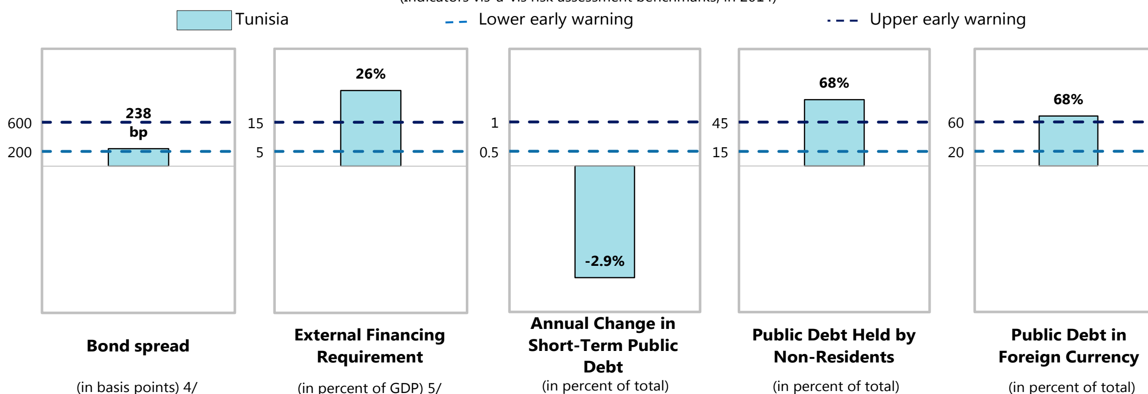
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2014)



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, 07-May-15 through 05-Aug-15.

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 III. Tunisia: External Debt Sustainability Analysis

Tunisia's external debt has been rising since 2011. External debt declined sharply in recent years from over 65 percent of GDP in 2002 to 48 percent of GDP at end-2011. The authorities have followed prudent borrowing policies, refraining, until recently, from accessing international capital markets and opting instead for concessional resources from multilateral and development banks. In the immediate period following the January 2011 revolution, the external debt to GDP ratio climbed back to around 54 percent, reflecting an expansionary fiscal stance and widening current account deficits. Most of the new borrowing originated from official creditors or through market access backed by a third party guarantee, with the exception of a $1 billion Eurobond issued in January 2015.

Under baseline projections,[1] external debt would continue increasing, peaking in 2018 before declining gradually over the medium term. The external debt-to-GDP ratio is expected to increase from 56.2 percent in 2014 to 64.4 percent in 2015, driven by the January 2015 issuance of a $1 billion Eurobond and external official financing in the second half of the year. It would peak at 68.5 percent of GDP in 2018, before converging to around 64 percent by 2020, following favorable current account dynamics (Table 1).

The external debt-to-GDP ratio is resilient to most types of adverse external shocks, with the exception of a large exchange rate depreciation shock. Tunisia's relatively low level of external debt as well as its profile (low average interest rate and relatively long maturity) makes it robust to most shocks, with the exception of a large real exchange rate depreciation shock. Specifically, results suggest that the external debt-to-GDP ratio would remain below 74 percent of GDP throughout the projection period under all but one shock scenario. For example, a permanent negative shock to growth or to the current account would raise the debt ratio to 71–73 percent of GDP, while an increase in the average interest rate would have almost no impact. However, a sharp real depreciation (one-time 30 percent) of the exchange rate relative to the baseline would raise the external debt ratio to around 97 percent of GDP in 2016 before declining to about 91 percent by 2020 (Figure 1).

[1] For more details, see IMF (2008) "Staff Guidance Note on Debt Sustainability Analysis for Market Access Countries," IMF Board Paper (Washington, D.C.: International Monetary Fund).

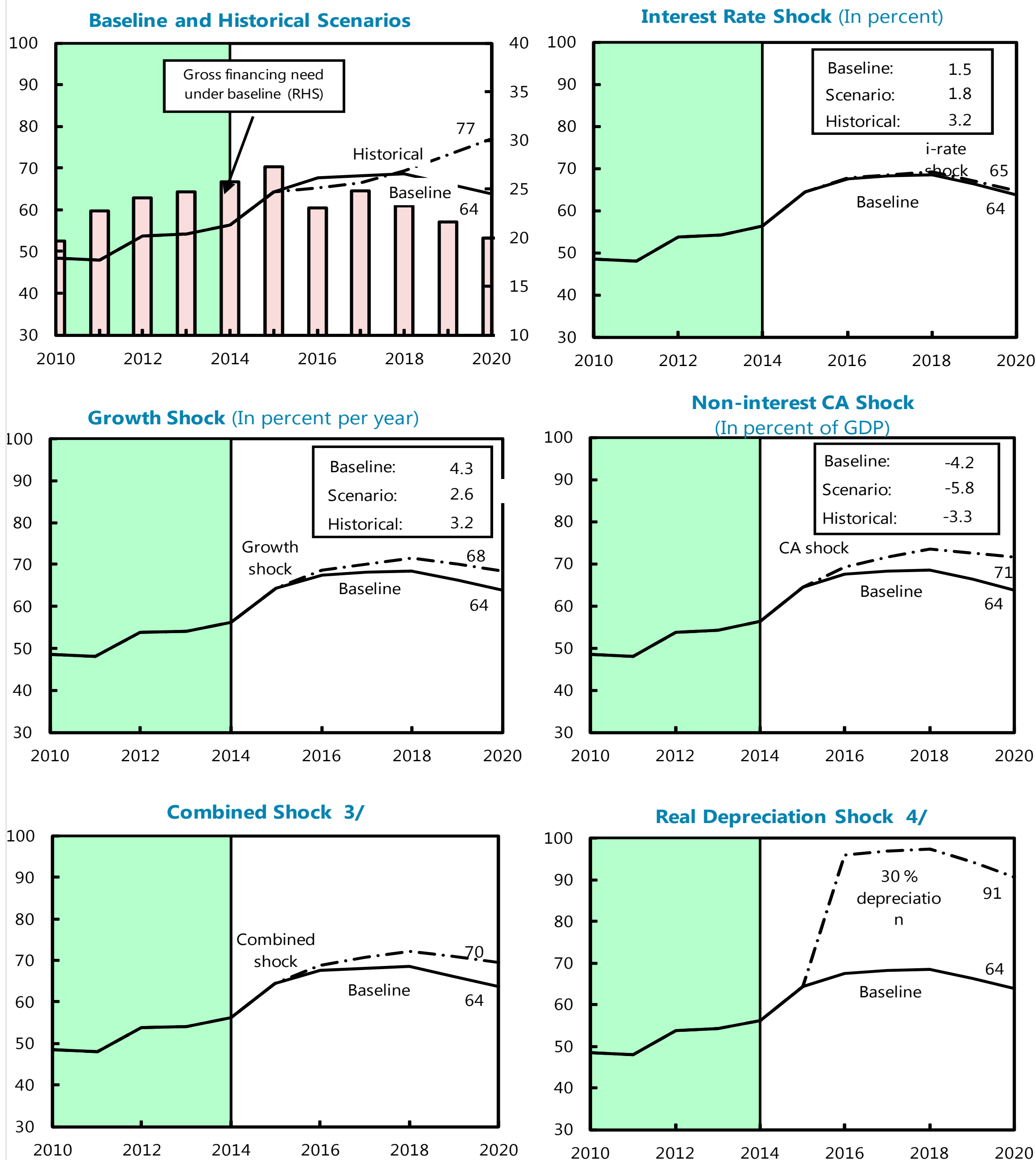
Table 1. Tunisia: External Debt Sustainability Framework, 2010–2020
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 6/
Baseline: External debt	48.5	48.0	53.8	54.1	56.2			**64.4**	**67.5**	**68.1**	**68.5**	**66.2**	**63.8**	**-10.1**
Change in external debt	-0.8	-0.5	5.8	0.4	2.1			8.1	3.2	0.6	0.4	-2.2	-2.5	
Identified external debt-creating flows (4+8+9)	1.3	5.0	4.2	2.6	3.5			3.6	-0.1	-2.6	-4.8	-6.0	-6.1	
Current account deficit, excluding interest payments	3.3	6.0	6.9	7.0	7.7			7.2	5.8	5.0	4.0	3.2	2.8	
Deficit in balance of goods and services	4.8	7.1	9.2	9.2	10.8			10.5	8.6	7.4	5.9	4.9	4.5	
Exports	50.5	49.4	49.2	47.0	44.6			41.2	43.0	44.0	44.6	43.3	41.5	
Imports	55.3	56.5	58.4	56.2	55.4			51.6	51.5	51.4	50.5	48.3	46.1	
Net non-debt creating capital inflows (negative)	-2.9	-0.5	-4.8	-3.7	-3.5			-4.3	-5.2	-6.1	-6.7	-6.8	-6.7	
Automatic debt dynamics 1/	0.9	-0.6	2.1	-0.8	-0.7			0.7	-0.6	-1.5	-2.1	-2.4	-2.2	
Contribution from nominal interest rate	1.4	1.4	1.4	1.2	1.1			1.3	1.3	1.1	1.0	0.8	0.7	
Contribution from real GDP growth	-1.3	0.9	-1.8	-1.2	-1.2			-0.6	-1.9	-2.6	-3.0	-3.2	-2.9	
Contribution from price and exchange rate changes 2/	0.8	-2.9	2.6	-0.8	-0.6			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-2.2	-5.5	1.6	-2.2	-1.4			4.5	3.3	3.2	5.2	3.8	3.7	
External debt-to-exports ratio (in percent)	96.1	97.2	109.4	115.2	126.1			156.4	157.2	154.9	153.7	152.8	153.5	
Gross external financing need (in billions of US dollars) 4/	8.6	10.5	10.9	11.6	12.5			12.1	10.3	11.3	10.9	10.8	10.7	
in percent of GDP	19.6	22.8	24.1	24.7	25.7	10-Year	10-Year	27.3	23.0	24.8	23.3	21.6	19.9	
A. Scenario with key variables at their historical averages 5/								**64.4**	**65.3**	**66.5**	**69.4**	**73.2**	**77.0**	**-4.3**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Nominal GDP (US dollars)	44.1	46.0	45.2	47.0	48.6			44.3	44.6	45.6	47.0	50.2	53.5	
Real GDP growth (in percent)	2.6	-1.9	3.7	2.3	2.3	3.2	2.3	1.0	3.0	4.0	4.6	5.0	4.7	
GDP deflator in US dollars (change in percent)	-1.6	6.3	-5.1	1.6	1.2	1.4	5.1	-9.9	-2.2	-1.6	-1.6	1.7	1.9	
Nominal external interest rate (in percent)	2.9	3.1	2.8	2.3	2.1	3.2	0.6	2.1	2.0	1.7	1.5	1.3	1.1	
Growth of exports (US dollar terms, in percent)	11.6	2.0	-1.9	-0.7	-1.8	6.0	13.9	-16.0	5.1	4.8	4.3	3.9	2.3	
Growth of imports (US dollar terms, in percent)	15.5	6.6	1.7	0.0	2.0	7.6	13.8	-15.1	0.6	2.0	1.1	2.2	1.8	
Current account balance, excluding interest payments	-3.3	-6.0	-6.9	-7.0	-7.7	-3.3	3.3	-7.2	-5.8	-5.0	-4.0	-3.2	-2.8	
Net non-debt creating capital inflows	2.9	0.5	4.8	3.7	3.5	3.2	1.4	4.3	5.2	6.1	6.7	6.8	6.7	
B. Bound Tests														
B1. Nominal interest rate is at historical average plus one standard deviation								**64.4**	**67.7**	**68.5**	**69.1**	**67.0**	**64.7**	**-9.9**
B2. Real GDP growth is at historical average minus one standard deviations								**64.4**	**68.6**	**70.2**	**71.5**	**70.1**	**68.3**	**-9.8**
B3. Non-interest current account is at historical average minus one standard deviations								**64.4**	**69.2**	**71.4**	**73.4**	**72.6**	**71.4**	**-10.5**
B4. Combination of B1-B3 using 1/2 standard deviation shocks								**64.4**	**68.8**	**70.7**	**72.3**	**71.1**	**69.6**	**-10.1**
B5. One time 30 percent real depreciation in 2006								**64.4**	**96.0**	**96.8**	**97.3**	**94.1**	**90.6**	**-14.3**

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

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

(External debt in percent of GDP)



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

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

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

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

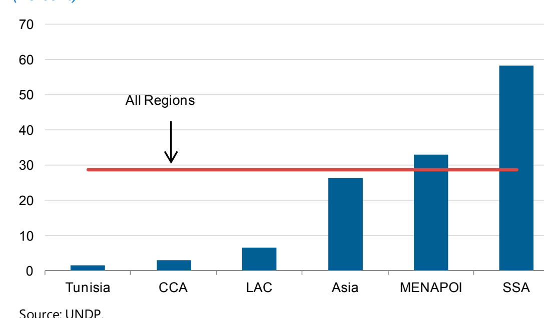
4/ One-time real depreciation of 30 percent occurs in 2015.

Annex IV. Tunisia's Inclusiveness Issues[1]

Tunisia's robust growth rates over the past decades have made significant progress in reducing poverty and inequality. However, inclusiveness is constrained by insufficient job creation, and significant economic and social regional disparities. A large informal sector also undermines inclusiveness in Tunisia.

Strong GDP growth reduced poverty incidence in Tunisia over the past decades. Tunisia's 4.4 percent growth rate over the 1980-2010 period helped halve the poverty rate—as measured by the international poverty line of $2 a day—from 19.7 percent in the 1990s to 10 percent in 2010. At the same time, Tunisia has been successful in raising the population's living standards, which helped develop a sizable middle class (about 80 percent of the population), and in providing widespread access to key services, such as education and health (as also shown through a very low multidimensional poverty index).[2] Income inequality has also improved over the same period, although it remains higher than the MENA average.

Population Living in Multidimensional Poverty, 2013
(Percent)



Source: UNDP.

The Size of the Middle Class Using Alternative Definitions
(Percent of population)
Regional averages weighted by population

	Ravallion [1]	Asian Dev. Bank [2]	AfDB		Ferreira [5]	Birdsall [6]
			"Lower Middle" [3]	"Upper Middle" [4]		
			1990s			
CCA	59.6	61.3	24.6	3.8	4.1	31.2
Asia	21.9	22.2	4.3	0.5	0.6	35.7
LAC	65.3	71.6	33.8	12.1	17.4	22.4
MENAPOI	39.4	40.2	12.4	1.8	2.2	41.6
SSA	22.2	22.8	6.3	1.2	1.7	26.9
All regions	29.0	30.1	9.0	2.1	2.9	33.3
Tunisia	74.5	78.1	36.8	7.9	10.0	27.2
			2000s			
CCA	83.2	86.3	44.7	7.5	8.7	36.4
Asia	51.5	53.4	20.0	4.2	5.2	31.2
LAC	67.9	78.4	39.2	20.0	28.6	22.6
MENAPOI	59.1	60.2	18.2	2.6	3.1	40.8
SSA	30.3	31.1	8.2	1.6	2.4	28.9
All regions	51.9	54.6	21.1	5.6	7.4	30.6
Tunisia	84.6	92.7	53.4	18.6	21.6	31.3

Source: IMF staff calculations based on World Bank Poverty database.
[1] Daily income between $2 and $13 in 2005 PPP$
[2] Daily income between $2 and $20 in 2005 PPP$
[3] Daily income between $4 and $10 in 2005 PPP$
[4] Daily income between $10 and $20 in 2005 PPP$
[5] Daily income between $10 and $50 in 2005 PPP$
[6] Income between 75% and 125% of the national median

[1] Prepared by Giorgia Albertin and Adnen Lassoued (Resident Representative's Office).

[2] The multidimensional poverty index includes 10 indicators to measure the degree of deprivation with respect to three key welfare dimensions: education, health and living standards, including access to cooking fuel, toilets, water, electricity, and assets.

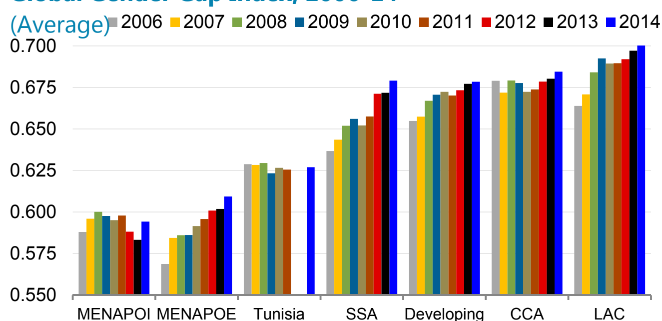
However, Tunisia's growth performance did not translate into equal opportunities for all. Growth did not succeed in reducing unemployment, which was in double digits during the past twenty years, and is averaging more than 15 percent in 2015 (after having increased to 19 percent in the immediate aftermath of the revolution). Economic opportunities also excluded:

- **Youth**. The unemployment rate for persons aged 15-24 averaged 35 percent in 2015, double the overall average. It is strikingly high among young graduates (67 percent in 2015). In particular, large graduate unemployment also reflects the existence of a structural mismatch in the labor market between the increasingly educated labor force and the demand for low-skilled labor given that the Tunisian economy remains concentrated in low value-added productive activities, and facilitated the growth of the informal economy.

- **Women**. The World Economic Forum gender gap index shows that gender inequality remains an issue in Tunisia, despite women being better integrated in the economy and in society than in the rest of the MENA region. The low female labor participation rate (28.5 percent in 2014) and high unemployment amongst women (22.2 percent in 2015 compared to 12.4 percent for men) points to significant gender disparity in Tunisia, which can be explained by high reservation wages, high costs of outsourcing domestic work, lack of good job opportunities, and social preferences.

Global Gender Gap Index, 2006-14

(Average)

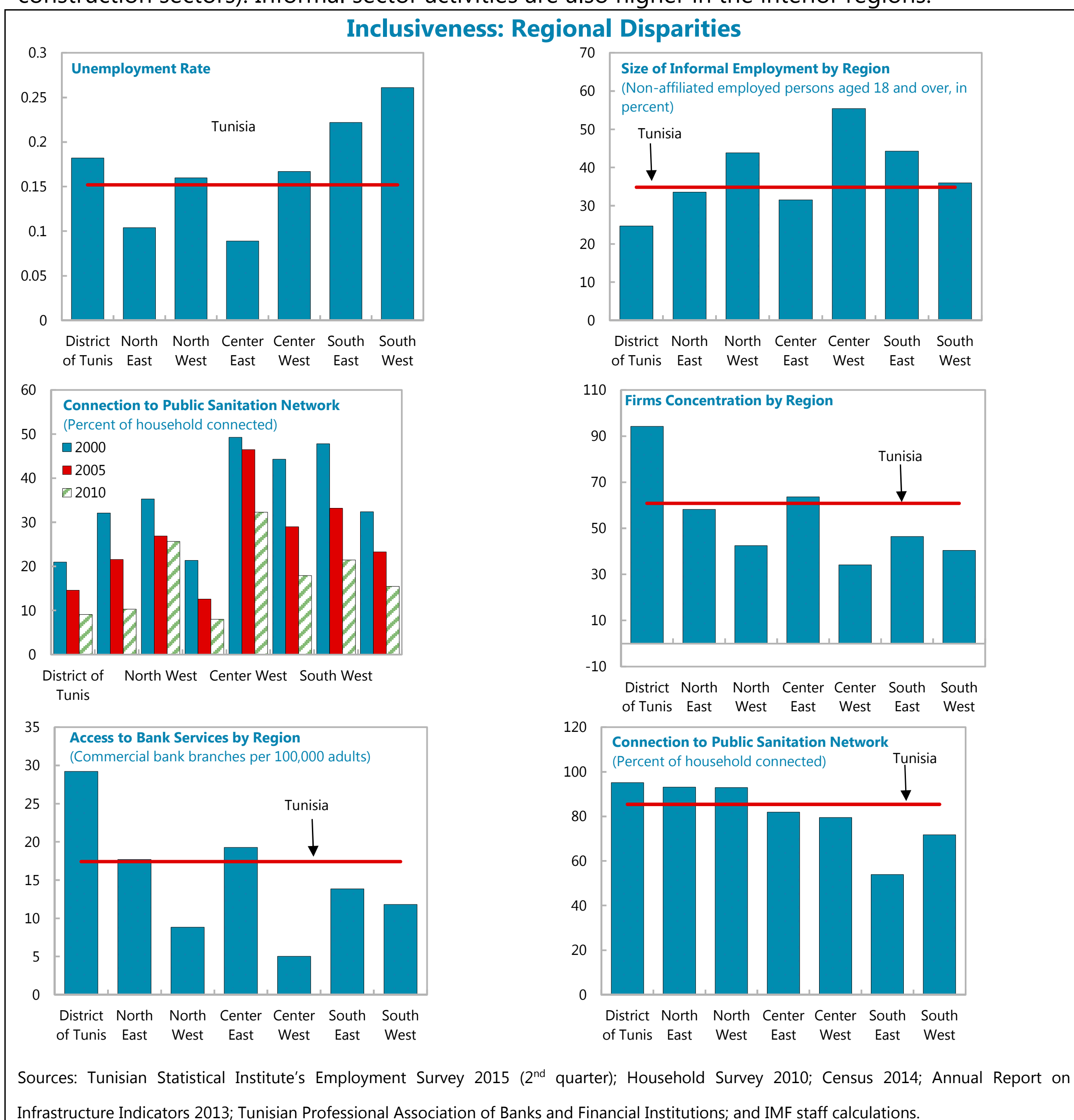


Source: World Economic Forum *Global Gender Gap Report (2014)*

- **Regions**. Economic activity in Tunisia remains mostly concentrated in the coastal areas, leading to an unemployment rate in the center-west and south regions that is three times the coastal one and a poverty rate in interior regions that is three times higher than in the coast. Moreover, the illiteracy rate is more than double the 12.5 percent rate registered in urban areas, six out of every ten households in interior regions have access to improved water source as opposed to almost universal coverage for the Tunis area, and the Tunis area has 6 times more bank branches per 100,000 adults than in the poorest and marginalized regions. An excessive tax and regulatory burden in interior regions, tax incentives for the off-shore sector mostly concentrated in the coastal areas, lack of infrastructure and labor rigidity are among key factors explaining these regional disparities.

The large size of the informal economy undermines inclusiveness in Tunisia. Using a MIMIC[1] model, the size of the Tunisian informal economy is estimated to reach about 30 percent as a share of GDP (IMF, 2011). Informality is also confirmed by widespread self-employment, as 85 percent of firms do not have paid employees, and lack of social protection (35 percent of the employed people do not have one, with lack of protection most prevalent in the agriculture and construction sectors). Informal sector activities are also higher in the interior regions.

Inclusiveness: Regional Disparities



Sources: Tunisian Statistical Institute's Employment Survey 2015 (2nd quarter); Household Survey 2010; Census 2014; Annual Report on Infrastructure Indicators 2013; Tunisian Professional Association of Banks and Financial Institutions; and IMF staff calculations.

[1]See International Monetary Fund, Regional Economic Outlook, October 2011. Looking at measurable indicators and drivers of the informal economy, the Multiple Indicator–Multiple Cause (MIMIC) model obtains an estimate of the informal economy by using currency as a fraction of broad money, and self-employment as a fraction of total employment; and measurable drivers used are indices capturing the tax burden, the regulatory burden in financial and product markets, labor rigidity, and institutional quality.

Annex V. Fair Taxation in Tunisia[1]

Taxation can play an important role in promoting fairness, as it helps define the relation between the citizen and the state in terms of equal treatment, burden-sharing, and economic opportunities.[2] This annex looks at the tax system in Tunisia, and assesses the fairness of its various taxes. It finds that indirect taxes are inefficient and biased toward the wealthy and that direct taxes favor capital income and offshore enterprises. Both could be modernized to improve efficiency and fairness, which is the aim of the tax reform that is being finalized by the Tunisian authorities following extensive national tax consultations.

Revenue mobilization in Tunisia is relatively high. At 22.5 percent of GDP, it is double the MENA average, and the highest in comparator countries (text table). Indirect taxes are the largest source of revenue, with revenues from VAT, excises, and other taxes on goods and services amounting to around 12 percent of GDP, about half of total revenue. The other large revenue component mostly originates from income taxes—equally shared between personal and corporate income—which are almost double the emerging market average (about 5.5 percent of GDP). Despite the high level of revenue mobilization, the level of collection efficiency and fairness of the tax system are low.

Tax Revenue by Category, Latest Available
(In Percent of GDP)

	Total	VAT	Excise	Personal Income	Corporate Income	Trade	Property	Goods and Services
Algeria	16.7	2.1	0.4	4.2	2.2	3.0	0.0	6.1
Egypt	13.0	2.6	1.7	1.6	4.5	0.9	0.9	4.6
Jordan	16.5	11.1	N/A	0.6	2.4	1.3	0.5	11.1
Lebanon	14.0	4.0	1.7	0.8	2.5	2.7	1.7	5.1
Morocco	22.2	8.2	2.7	3.8	4.5	0.9	1.5	11.0
Tunisia 1/	22.5	6.2	2.0	4.6	4.6	1.0	0.5	3.4
MENA Average	10.4	4.4	1.3	2.3	3.1	1.4	0.5	5.6

Source: National authorities; IMF staff calculations.
Note: Due to discrepancies between the latest data point across categories or incomplete information, components may not add up to the total.
1/ For Tunisia, Goods and Services include earmarked taxes to specific funds.

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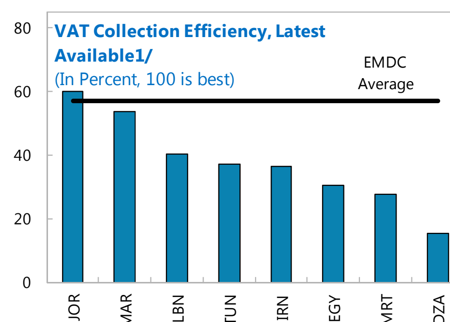
[1] Prepared by Lorraine Ocampos.

[2] See IMF (2015) "Fair Taxation in the Middle and North Africa", IMF Staff Discussion Note SDN/15/16, Washington, D.C.

Indirect taxes—relatively inefficient and biased toward the rich

Indirect taxes in Tunisia are inefficient and unfair. Tunisia's VAT collection efficiency (C-efficiency) ratio—which compares actual VAT yields to potential yields from the benchmark of a perfectly administered VAT levied at a uniform rate on all consumption—is two-thirds of the emerging markets average of 60 percent. This low performance is explained by high tax expenditures and complex regulations:



Sources: National authorities; and IMF staff calculations.
1/ Calculated as VAT revenue divided by the product of VAT rates and private consumption.

- **High tax expenditures.** The standard VAT rate in Tunisia is 18 percent, with two lower ones of 12 percent (for tourism and recreation), and 6 percent (health). In addition, several stages of the economic value chain are exempted. These tax expenditures—representing exemptions for wholesale agro-products, cultural activities, restaurants, and hotels, among other sectors—amount close to 4 percent of GDP.

- **Low VAT turnover registration thresholds**. Registration thresholds for Tunisia are low ($32,000) compared to regional and international standards, and are multiple, adding another layer of complexity to the system, which is generating an accumulation of VAT refunds due to enterprises.

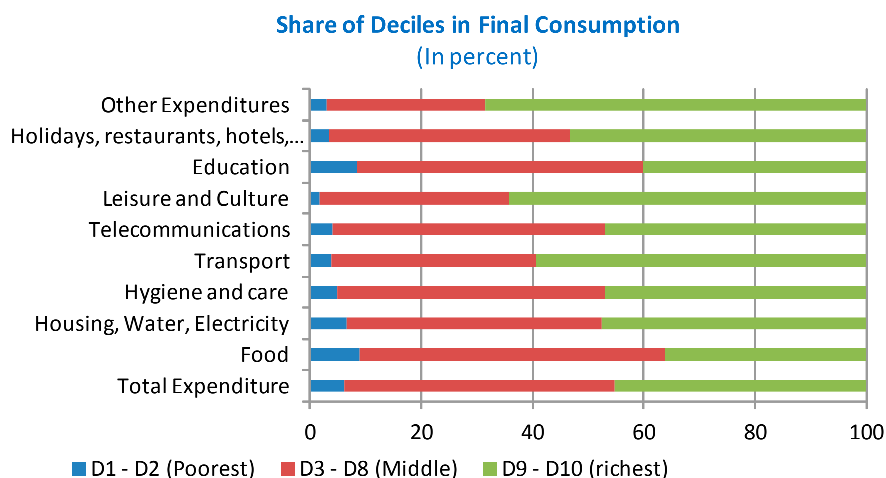
Tax expenditures make the VAT even less progressive as they benefit the wealthy relatively more. Staff analysis shows that VAT tax expenditures benefit mostly the rich. The top quintile of the income distribution reaps about 40 percent of the benefits from tax exemption as opposed to less than 10 percent for the bottom quintile. An analysis of the consumption of goods by various deciles shows that the poorest segments of the population have less than 10 percent of the final consumption of exempted goods and activities, whereas the 20 percent richest households consume 40–50 percent of the final consumption of these exempted goods.

Tunisia: Distributional Impact of VAT Tax Expenditures

(in percent)

Q1	Q2	Q3	Q4	Q5	Total
7.9	12.7	17.0	23.2	39.2	100.0

Source: 2010 household survey data from INS.



Source: 2010 household survey data from INS.

The excise system is also neither efficient nor particularly targeted to goods and services consumed by high income households. It is based on a complex regime with an extensive list of items that—apart from tobacco, alcoholic beverages, and vehicles—have a low yield and put an unnecessary burden on tax administration. In the case of tobacco and alcohol, excises are also used to protect local production.

Direct taxes—penalize wages, exclude capital, and excessively favor the off-shore sector

Personal income taxes (PIT) are mostly collected through wage withholding. The PIT system in Tunisia—representing more than twice the MENA average—is a schedular[3] system with a limited base. Wage incomes (salaries and pensions) represent around 80 percent of PIT collection, and are taxed progressively at rates ranging from 0 to 35 percent. However, the yield on personal income taxes—which reflect high personal income taxes—would have been higher if not for the:

Tunisia: Income Tax: Brackets and Tax Levels

Annual Net Taxable Brackets (in dinars)	Tax Level
0 - 1.500	0%
1.500 - 5.000	15%
5.000 - 10.000	20%
10.000 - 20.000	25%
20.000 - 50.000	30%
> 50.000	35%

Source: Tunisian authorities.

[3] A tax system is schedular when separate tax assessments are made on industrial and commercial profits, wages and salaries, income from securities and shares, income from land, etc.

- **Presumptive taxation (forfait) regime**. Non-wage income (i.e., through self-employment, including liberal professions such as doctors and lawyers) benefits from the existence of a regime in which taxes are levied based on a presumptive and estimated taxable base ("regime forfaitaire"). This system—primarily used by liberal professions and small enterprises—encourages underreporting and facilitates tax avoidance; particularly since the tax administration does not have adequate powers to verify income and accounts. As a result, more than 90 percent of taxpayers that are taxed under this regime declare annual turnovers lower than TD10,000 ($5,000) (Text Table), keeping the yield of this type of taxation to less than 1 percent of income taxes. Inaccurate taxpayer registries also contribute to the weakness of this system; for example, it took twenty years to update the number of registered taxpayers even though the minimum wage had increased above the "non-taxable" minimum threshold.

Tunisia: Forfait Regime, 2014

(In thousand of dinars)

Turn Over (TO) Bracket	Number of Tax Payers	% of Total	TO	Taxes to be Paid	% on TO
0 - 10	165,600	91.3	562,970	20,430	3.6
10- 50	14,978	8.3	292,850	5,696	1.9
50 - 100	842	0.5	58,699	1,080	1.8
Total	181,420	100.0	914,519	27,206	3.0

Source: Tunisian authorities.

- **Exclusion and, when taxed, low rates for capital earnings**. Capital income (dividends, interest, rents) are taxed at low rates or not at all. Dividend taxation has just been reintroduced in 2014, but at a low rate of 5 percent.

The corporate income tax (CIT) efficiency collection ratio is one of the lowest of the region (Text Table). It is currently half of the emerging market average, with its efficiency reduced primarily by tax exemptions and holidays and streamlined tax system to companies in off-shore regions. Some of the incentives—amounting to as much as two percent of GDP—given to the offshore sectors include:

- **Lower CIT rate**. There was a zero-profit tax regime for the first 10 years of operation in the off shore zones (whereas profits in the onshore/domestic sector were taxed at 30 percent). That disparity was halved in 2014, with the CIT rate in the off-shore sector increasing from 0 to 10 percent and decreasing from 30 to 25 percent in the on-shore sector.

- **Other incentives** include full tax deduction for reinvested profits.

CIT Collection Efficiency 1/

Country	
Jordan	14%
Djibouti	18%
Egypt	18%
Lebanon	17%
Morocco	16%
Mauritania	10%
GCC	18%
Tunisia	7%
Algeria	9%
Yemen	7%
Sudan	1%
Iraq	3%
EMDC Average	15%

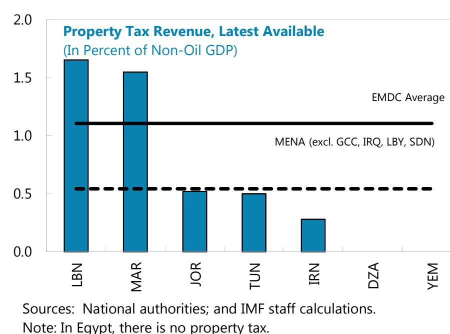
Sources: National Authorities; KPMG; IMF staff calculations.

1/ Calculated by dividing the CIT to GDP ratio by the standard CIT rate.

Other taxes—encourage tax avoidance, may overly favor the off-shore sector, and not efficient enough to capture the wealthy

The efficiency of international trade taxes in Tunisia is low—representing just 4 percent of revenues—and favor off-shore companies. With seven tariff rates, some at very high levels, custom duties encourage smuggling and complicate customs administration. They also tend to favor off-shore enterprises, which are exempted from paying import duties on all inputs and equipment if they export more than 70 percent of their imported inputs. Streamlined customs procedures in the offshore sector represented a significant cost-cutting in view of a complex and inefficient tax administration and red tape. In addition, an inadequate valuation system and discretionary application of the customs code encourages tax evasion through import valuation underreporting (estimated by the World Bank at about $1.2 billion dollars between 2002 and 2009 alone).

Property taxes play a small role. At 0.3 percent of GDP, they are below the regional average of 1 percent of GDP (1.5 percent of GDP in Morocco). Increasing their yield will help increase taxation on wealth, which is often held in real estate. Main issues to solve are linked to the erosion of the property tax base due to incomplete cadastre, and outdated valuation techniques despite a relatively well functioning computerized property registry.



Sources: National authorities; and IMF staff calculations.
Note: In Egypt, there is no property tax.

Reform agenda—what to do?

The incoming revisions of the Tunisian system intend to remedy the above-mentioned shortfalls in tax fairness. Key priorities are to: (i) reduce exemptions on VAT and eliminate preferential treatment for customs duties; (ii) address the complexity of the indirect tax system by simplifying VAT rates from three to two rates; limiting excises to a selected list of products while improving its targeting for tobacco and beverages; and rationalizing customs duties from seven to three levels (0, 20 and 36 percent); (iii) reform income taxation by taxing dividends, reducing further the tax dichotomy between the on-shore and off-shore CIT rates; and (iv) improve the progressivity of personal taxation by raising the threshold for exempted income and simplifying the tax system for small enterprises. Revamping tax and customs administration—including through strengthening the large taxpayer unit and introducing a risk-based compliance system—would need to accompany the changes in tax policy.

Appendix I. Letter of Intent

Tunis, September 15, 2015

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

Madame Managing Director:

1. Tunisia has successfully completed its political transition toward democracy and is now decisively turning a new page in its history. Following the results of historic elections at the end of 2014, the first government of the post transition period, appointed in February 2015 with the support of a vast majority in parliament, has quickly set its priorities. In addition to emphasizing improved security and anti-terrorism efforts—which are necessary for economic and social progress, especially following the deleterious impacts of the recent terrorist attacks on our economy and our people—it had identified 100 economic priorities. These were set under the paradigm of a new economic development model, which will be finalized within a medium-term strategic vision ahead of the international investment conference scheduled for early 2016. This vision, which seeks to reduce the vulnerabilities of the Tunisian economy and promote inclusive growth, is fully consistent with the economic program and reforms supported by the IMF, to which we are firmly committed.

2. The approval of the extension of the Stand-By Arrangement by the IMF Executive Board last May provides the flexibility needed to complete our reform program, which has been delayed by important challenges. Indeed, our government faced the task of implementing its economic program in the wake of a number of natural disasters (floods in the south of the country), security crises (such as the tragic attacks of the "Bardo museum" and in Sousse), and social tensions (through numerous strikes). However, 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.

3. Performance under the IMF-supported program remains broadly satisfactory, given the constraints associated with a difficult national, regional, and international climate. The performance at end-March 2015 was in line with our forecasts, and we were able to make up some of the delays in completing the reforms:

- *Performance criteria and indicative targets*. The quantitative criteria at end-December 2014 and end-March 2015 for Net International Reserves (NIR), Net Domestic Assets (NDA), and the central government primary balance (cash basis) have been met. We adhered to the

continuous zero ceiling on accumulation of external arrears and the continuous indicative target on non-accumulation of domestic arrears. The ceiling on current expenditure at end-December 2014 and end-March 2015 was met. However, the floor on social spending was not, primarily because of administrative delays in executing transfers for vulnerable families, which we intend to reduce during the remainder of the year.

- *Structural reforms*. Three of the seventeen structural benchmarks to be implemented by end-June 2015 were met (Table 2). Namely, these are the adoption of the 2015 budget, the reduction of risks related bank refinancing operations, and the appointment of new board members of the state-owned banks. We also adopted banking restructuring plans, which will result in the effective and adequate recapitalization of one state-owned bank by end-September and of a second one in October 2015. We are making every effort to ensure that all the public banks meet the prudential regulatory norms by no later than end-2015. We also intend to complete reforms in taxation and public enterprises, the investment code, the banking law, the lender-of-last-resort mechanism, banking supervision, and weekly auctions by the end of the year, in the context of the seventh and last review of the program.

4. In view of the macroeconomic policies implemented to achieve the main objectives of the program and the progress in the structural reform agenda (Tables 1 and 2), the government requests the completion of the sixth review under the Stand-By Arrangement and the disbursement of SDR 214.875 million. The government agrees to the proposed new performance criteria for NIR, NDA, primary balance and on primary current expenditure at end-September 2015, as well as a new timetable of prior actions and structural benchmarks, as described in the attached Memorandum on Economic and Financial Policies (MEFP, Tables 1 and 2), and Technical Memorandum of Understanding (TMU). The government also requests a rephasing of disbursements, with the final tranche of SDR 143.250 million to be made available on November 15, 2015, subject to completion of the seventh review, which will be based on end-September 2015 performance criteria.

5. This Letter of Intent (LOI) is based on the previous LOI and MEFP dated December 3, 2014. The attached MEFP discusses the key components of the government's program and the proposed measures the Central Bank of Tunisia intends to implement during 2015. We are determined to rigorously apply our program, mindful of the difficulties related to the national and regional environment.

6. We are convinced that the policies described in the attached MEFP are appropriate for achieving the objectives of our economic program, which is designed to ensure short-term macroeconomic stability while laying the foundations needed to support growth and protect vulnerable groups. We will remain vigilant and we stand ready to take any additional measures necessary to attain 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 the 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 and 2), as well as the accompanying IMF staff report.

Sincerely yours,

/s/ /s/

Chedly Ayari
Governor, Central Bank of Tunisia

Slim Chaker
Minister of Finance

Attachment I: Memorandum on Economic and Financial Policies

I. RECENT DEVELOPMENTS AND MACROECONOMIC OUTLOOK

1. **The rise in social and security tensions has taken a toll on the economy, which is weaker than envisaged.** The persistent strikes in the first six months of the year—including the near-complete stoppage of phosphate production for two months—reinforced private investors' wait-and-see attitude, while Tunisia's access to the international market and its higher credit rating since the successful political transition pointed to a better outlook. In addition, the tragic Bardo and Sousse attacks adversely affected tourism flows and investor confidence, while the drop in international oil prices and the incipient recovery in Europe would yield positive spillovers for the Tunisian economy**.**

2. **After a moderate recovery in 2014, particularly at the end of the year, lackluster growth is expected in 2015.** The steady decline in the value-added of nonmanufacturing industries and the growth slowdown of market services have contributed to the deceleration of economic growth in Tunisia, which stood at 1.2 percent for the first semester of the year (year on year), despite the exceptional performance of the agriculture and agro food sectors. The main indicators of the tourism sector, which are clearly trending downward with flows that are 50 percent lower than in 2014, along with planned investments, would point to an annual growth rate of about 1 percent for this year, provided social tensions decline. Short-term risks remain significant, particularly if security and social tensions increase, or if the economic outlook for Tunisia's main trading partners is revised downward.

3. **Inflation remains contained despite the recent increase in core inflation.** After a 5.7 percent year-on-year increase in the early months of the year, the headline inflation rate settled at 4.2 percent in August 2015, due mainly to decelerating food prices. For the end of the year, inflation is projected at 4.4 percent, helped by favorable base effects, the implementation of a prudent monetary policy, the planned freezing of administered prices for this year, and a drop in demand.

4. **The decline of world oil prices should result in a slightly lower current account deficit, which had deteriorated in 2014**. The growing energy deficit and the substantial increase in imports of manufactured and food products raised the current account deficit to 8.8 percent of GDP in 2014 (as opposed to a program target of 7.9 percent). This year, the decline in world oil prices and weak economic growth will result in a significant decline in imports, but this will only partially reduce the current account deficit to an expected 8.5 percent of GDP, in view of the significant reduction in tourism revenue (worsened by the Bardo and Sousse terrorist attacks) and the decline in phosphate and oil production. This slight improvement to the current account, together with the January 2015 international bond issuance of $1 billion over 10 years—without a third country guarantee, for the first time since 2007—and

with the disbursement of multilateral loans, would keep the level of gross reserves at more than four months of imports, by end-2015, for the first time since 2010.

II. PROGRAM PERFORMANCE AND STRATEGY

5. Despite the numerous exogenous shocks, we are determined to rigorously apply our economic program in order to preserve macroeconomic stability in the short term and lay the foundations for more sustainable and inclusive growth. The objectives of our program remain unchanged and we focused on the following areas in this review:

- **Maintaining macroeconomic stability.** The collection of tax revenues, control of the wage bill and subsidies, and a prudent monetary policy, together with a more flexible exchange policy, are key to preserving macroeconomic stability.

- **Laying the foundation for inclusive growth**. Reduction of the banking sector vulnerabilities, including through the restructuring of state-owned banks, improvement of the budget composition—building upon the implementation of tax reform and a better execution of public investment—and the implementation of our structural reform program are necessary for the development of the private sector, which is the main engine of future inclusive growth.

- **Protecting vulnerable people,** by strengthening social protection systems and by systematically evaluating the social impacts of the planned reforms.

A. Short-Term Objectives: Restoring Fiscal and External Buffers

Fiscal policy

6. The solid performance of tax revenue and the under-execution of investment spending significantly reduced the fiscal deficit in 2014. The criteria for the primary balance at end-December 2014 and end-March 2015 were largely met, due mainly to increased collection of revenue (in particular VAT and an exceptional income tax) and to the under-execution of public investment spending. This spending continuously declined to a record level of 4.2 percent of GDP in 2014, despite efforts to reduce the problems of project identification and absorption capacity, particularly in the regions. The structural deficit—excluding cyclical effects and bank recapitalization costs—stood at 3.3 percent of GDP in 2014, as opposed to the program target of 4.1 percent of GDP. The indicative ceiling on current primary expenditures at end-December 2014 and end-March 2015 was met, particularly because payments on social transfers and goods and services fell short of the budgeted amount. However, these developments resulted in the non-compliance of the floor on social spending; an under-execution due to administrative delays we expect to make up later in the year.

7. We are determined to continue a medium-term fiscal consolidation—with a high emphasis on growth—that will preserve the fiscal sustainability objective, and reduce external imbalances and financing needs. This fiscal policy will achieve a primary balance in the medium term, thereby containing public debt at 53.4 percent of GDP by 2020 (after peaking at 57.4 percent of GDP in 2018) and releasing the fiscal space necessary to increase social spending and public investment that are both essential for growth (see Section B).

8. The new supplementary budget Law for 2015 reflects the country's new economic outlook. This law—approved by parliament in August 2015—aims to support growth through stimulus measures, while preserving the fiscal balance as initially planned in the budget law of 2015. It takes into account the expected decline in economic activity; the depreciation of the exchange rate; the spillovers from world oil prices (savings of about 1.6 percent of GDP due to the reduction in energy subsidies), the drop of revenues due to oil production fall (a loss of 0.7 percent of GDP), and a reduction in the gas royalty from the Italy-Algeria pipeline (0.2 percent GDP).

9. The revised budget also supports an economy facing external shocks through a counter cyclical fiscal policy that remains in line with our debt strategy and financing constraints. Hence, we plan an increase of the structural fiscal deficit by 0.2 percent of GDP, which corresponds to a 3.5 percent of GDP structural fiscal deficit in 2015 (equivalent to an overall fiscal deficit of 6 percent of GDP). This objective reflects the impact of the new economic outlook (including savings from the drop in crude oil world prices), an update of the public investment envelope, and the following measures:

- **Emergency measures to address the new challenges** (net cost: 0.7 percent of GDP). They are the following: additional security spending (0.2 percent of GDP, in addition to the increase of 0.3 percent of GDP already planned in the 2015 budget law), new measures to support the tourism sector (0.2 percent of GDP, including the payment of the social contributions to CNSS and of unemployment "benefits"), and a stimulus program for SMEs (0.3 percent of GDP). We will also speed up public investment execution to boost employment and growth (See paragraph 10).

- **A revision of the wage bill** (net cost of 0.8 percent of GDP). The projected wage bill level in the 2015 budget could not be preserved due to major social demands for the regularization of past wage agreements and the strengthening of civil servants' purchasing power (general increase of 5 percent), which had to be met to prevent further strikes from threatening economic activity at a time marked by significant security challenges. However, mindful of the need to contain the wage bill at a sustainable level, we reduced the projected increase in wages to 0.8 percent of GDP (as opposed to 1 percent) by postponing the recruitments and the implementation of specific wage increases, which had been agreed upon but not yet implemented . These agreements will be reactivated as part of the general reform of the civil service (see Section B).

- **Reduction of non-essential non-wage expenditures** (savings of 0.1 percent of GDP), through a 20 percent cut of available, but not yet authorized, credits in July 2015 to all ministry departments (except those related to security).

10. We are committed to speeding up the execution of investment projects which remain under executed. The revised budget law shows a savings on capital expenditures of 0.5 percent of GDP compared to the budget law. This decrease only reflects an update of our execution rate to 30 percent at end-June, not a willingness to use the budget line as an "adjustment" post. Following the identification of the main constraints to the implementation of 580 investment projects, we are aiming at investment expenditures reaching 4.5 percent of GDP in 2015 (compared to 4.2 percent of GDP in 2014) through the following: (i) redirecting non initiated capital expenditures at end-July 2015 toward priority investment projects (such as infrastructure) which could be executed under the revised budget law; (ii) strengthening coordination between governorates and the central government; (iii) implementation of application decrees, in particular for new public procurement procedures; (iv) reducing land-related constraints through the recruitment of land experts and the revision of laws; and (v) prioritizing projects which should be in line with the medium-term vision of the government. The implementation of the information system on large investment projects will improve the monitoring of their execution, which will be enhanced in the medium term through a national body in charge of investment execution.

11. We remain firmly committed to taking additional measures to correct any slippage away from the program's fiscal objective, including through reducing primary current spending, a source of budget overruns in the past, which will be capped by the introduction of a new performance criterion (see TMU). Investment and social spending (excluding subsidies) will be preserved and will not be constrained by our fiscal consolidation strategy.

12. The international bond issuance in January 2015 will contribute to meeting our financial needs. We took advantage of the interest sparked by the success of Tunisia's political transition to gain access to the international market, with a bond issuance of $1 billion, with no third country guarantee for the first time since 2007, and at a very favorable rate with respect to sovereign risk. The external financing identified for the rest of the year includes mainly multilateral budget loans (totaling $1.5 billion), of which $216 million from the European Union. We also worked on mobilizing additional bilateral budget support, including planned debt conversion (Italy, France), budget support from Algeria ($150 million), and project financing. In addition, we plan an additional bond issuance through sukuks or with the U.S. guarantee.

Monetary policy

13. The monetary aggregates were largely in line with program objectives, but with increased pressure on bank liquidity. We met the criteria for net domestic assets at end-March 2015 and far exceeded the program objective, as a result of a significant increase in the net position of the government. However, the increase of CBT interventions in the foreign exchange market following the Bardo events and net issuance of treasury securities—as well as

the persistent weakness of certain banks—resulted in a net increase in the overall volume of refinancing, which rose to about 5.5 billion dinars at end-June 2015 (as opposed to 3.4 billion in February 2015). Notwithstanding this, the change in the money supply was lower than expected, because of the decline in deposits during the first semester of 2015 (due mainly to cash withdrawals from firms in the phosphate and petroleum sectors following a drop in production). A slight dip in credit to the private sector (7.3 percent year-on-year at end-June 2015, as opposed to 8.7 percent in March 2015) reflects the slowdown in economic activity.

14. The goal of monetary policy is still to control inflation. As a result of CBT intervention, the increasingly tight liquidity did not result in pressure on the interbank rate (which remained close to the policy rate – raised to 4.75 percent in June 2014). In light of the lackluster growth of the Tunisian economy and the limited increase of credit to the economy, the last CBT Board of Directors decided to maintain the rate at its current level. However, we stand ready to increase it to prevent any resurgence of inflationary pressures, particularly in the event of a steady increase in the pace of core inflation as a result of wage increases or the depreciation of the dinar. A better communication strategy will provide an anchor for inflationary expectations, including by maintaining a positive real interest rate.

15. The reform of the monetary policy framework continues. We increased the minimum proportion of government securities used as collateral for CBT refinancing from 20 percent to 40 percent (structural benchmark at end-December 2014) in order to reduce the risk incurred by the CBT in these refinancing operations. We intend to enhance our current framework of haircuts on debt eligible for CBT refinancing (introduced in July 2014) by using rating instruments, with IMF technical assistance. Since May 2015, we have also committed to a second twinning project (with the Bank of France as the main partner), aimed at modernizing the operational framework for monetary policy, in particular by improving the quality of liquidity forecasts, deepening the interbank market (including the introduction of a more mature repo and auction system that would give rise to a yield curve in the short run), and revamping the regulatory framework governing the market for private negotiable securities, while revising the conditions for collaterals.

16. We intend to strengthen the transmission channels of monetary policy and access to financing by changing the system of excessive bank lending rates (indexed to the TEG). The increase of the money market rate (TMM) over the previous year pushed up the TEG, thus easing the credit constraints related to the TEG in the short run. A CBT inspection mission was launched in July 2015 to prepare a review, if necessary, of the regulations on this matter, which could eventually result in the removal of the cap on the lending rate to enterprises (and a gradual increase of consumer cap lending rates). This review—which will also take into account the World Bank's recommendations—will improve competition among banks and the transmission channels of monetary policy as well as access to credit for small and medium enterprises.

17. The finalization of the Central Bank draft law is under way. We submitted the draft law on amending the statutes of the Central Bank to the Board of Directors in June 2015. This draft, prepared with technical assistance from the IMF, seeks to provide the CBT with greater autonomy (on institutional, functional, personnel, and financial matters), and to better define its mandate (by adding the goal of contributing to financial stability to its primary objective of ensuring price stability), while improving its governance, transparency, and accountability. This draft law will be approved by the government and presented to the parliament in October 2015 for its adoption.

Foreign exchange policy

18. Exchange rate flexibility is necessary to reduce external imbalances, build up our foreign exchange reserves, and reduce the overvaluation of the dinar. To that end, we continued to limit our interventions to smoothing excessive fluctuations in the exchange rate. Nonetheless, the amount of interventions doubled in March-April 2015—compared with a monthly average of $200 million since last October—to alleviate the pressure on the foreign exchange market after the Bardo attack and, in particular, following the decision by a number of foreign banks to close their foreign-exchange positions. These interventions—as well as the low exchange rate against the euro-dollar—led to an appreciation of the real exchange rate, which remains overvalued by 5-15 percent. In order to increase our foreign exchange reserves, we are committed to restricting our monthly foreign-exchange sales to no more than $200 million net and less than 20 percent of the total transactions of the market and to strictly limit our interventions to smoothing excessive fluctuations in the exchange rate. We also intend to intervene by purchasing foreign exchange on the markets whenever the opportunity arises.

19. We are continuing reforms to establish a more flexible foreign exchange policy and a deeper foreign exchange market. Thus, the CBT Board of Directors adopted a series of measures in May 2015 including: (i) strengthening the CBT's intervention tools, by introducing foreign exchange auctions to increase the exchange market role in setting the value of the dinar; (ii) removing the requirement for banks to back interbank foreign exchange transactions with commercial and financial operations from firms; and (iii) relaxing the conditions governing exchange rate and interest rate hedging instruments (forward contracts, swaps, foreign exchange options). All these reforms introduced in the summer of 2015 are part of the improvement to the overall framework of the foreign exchange market, which will facilitate the effective implementation of weekly foreign exchange auctions in October 2015 (structural benchmark), thus contributing to the smooth operation and development of the foreign exchange market.

20. Our development strategy will continue to be open and based on free foreign trade. In accordance with the rules of the World Trade Organization, we will only introduce import restrictions and surtaxes as a last resort—and after exhausting all market solutions that preserve the proper incentives—and only with very clear and preannounced withdrawal criteria.

B. Laying the Foundations for Inclusive Growth

Financial sector policies

21. The financial situation of the banking system remains fragile. At end-March 2015, the overall solvency ratio was 9.5 percent, below the regulatory 10 percent, with a ratio of 12.7 percent for private banks, of which one (the BFT) falls below the regulatory threshold, and 3.5 percent for state-owned banks. Asset quality remains weak, with the share of nonperforming loans deteriorating slightly from 15.7 percent in December 2014 to 15.8 percent of total loans at end-March 2015 (about 21 percent after including loans transferred to asset recovery agencies affiliated with banks). The average provisioning rate for nonperforming loans improved from 45.7 percent to 56.6 percent between December 2012 and March 2015. Furthermore, three banks (including one state-owned bank) still fail to comply with the new liquidity standards. The relative control of operating expenses and, in particular, the reduction by half in provisioning efforts compared with FY 2013, which had been marked by exceptional events (new regulations, audits), and an increase of commissions fees, enabled all the banks to generate profits, growing quickly at the global level.

22. Reforming the banking system is an absolute priority. Progress in this area encompasses the following three areas: (i) the recapitalization and operational restructuring of state-owned banks; (ii) the overhaul of the legislative framework with a view to introducing a bank resolution framework and a lender-of-last-resort mechanism; and (iii) strengthening banking supervision. The legislative debate for some of these reforms started in August 2015.

23. The restructuring of the banking system continues to be our priority. Between February and June 2015, the general shareholders' meetings of two state-owned banks (STB and BH) adopted recapitalization and restructuring plans in accordance with international good practices—including the principle of one-time recapitalization in an amount that would meet all the prudential rules on an individual basis as of closing accounts of March 31, 2015, fully taking into account the results of the independent audits conducted in 2013 and 2014. The implementation of the recapitalization plan is ongoing, as the capital subscription process has been initiated following the August 2015 parliamentary approval of the law authorizing the use of the allocated public funds for bank recapitalization. Our action plan is based on the following timetable and priorities:

- **Recapitalization of the three state-owned banks** thanks to the closing of the capital increase subscriptions (STB, BH) or after asset sale (BNA), which could amount up to 1 billion dinars (1 percent of GDP) for the three state-owned banks. According to international good practices, these operations will involve the dilution of existing private shareholders, who do not subscribe to the new capital increase (dilution of 84 percent taking into account issuance premium amounts and preferential subscription rights) or the allocation of losses to the reserves before any injection of public funds. The state is committed to providing the amounts to complete the recapitalization if private shareholders do not subscribe. According to the projected timetable, the effective recapitalization of the BH and the first phase of the

capital subscription of the STB will be completed in September 2015 (prior actions, see Table 2). The effective recapitalization of the STB and BNA will only be completed in October 2015. In conjunction with this recapitalization, the following measures will be taken:

- The government will renew, in 2015, and issue guarantees on BH's and STB's loans to public borrowers, which needed to be provisioned according to the audit conclusions (prior action, Table 2). The guarantees would be provided up to the amount which would enable the banks to meet prudential standards, and in line with the loan outstanding amount. This will also be provided to the BNA as soon as the restructuring plan is finalized. The government is committed to renewing these guarantees throughout the restructuring period.

- To ensure that the recapitalization amounts can alleviate the impact of slower economic activity than expected when the original business plans were made, the banks are planning to build up an additional capital buffer by selling their non-strategic assets, a sale that will be initiated by the end of this year. To account for the weaker economic environment than expected, and to ensure prudential norms are respected throughout the operational restructuring period, all three public banks' business plans will be updated and adopted by their boards by November 2015. Also, the 2015 revised budget law has granted greater authority for boards of public banks to forgive tourism-related debt, thereby allowing public banks to manage their nonperforming loans in a more dynamic manner, and to increase the possibility of restoring the solvency of some debts.

- **Strengthening governance and the operational restructuring of state-owned banks.** The revamping of the banks' governance framework, already initiated with the appointment of new board members representing the government (structural benchmark at June 2015) and the separation of the functions of the Chair of the Board of Directors from those of the Managing Director, is a prerequisite for any decisions on operational restructuring. Starting in June 2015, and in line with international practices, we also intend to define the roles of the Board of Directors, its affiliated committees, and executive management, and to appoint new heads to key areas, in particular risk, finance, compliance, and auditing. Also, tenders will be issued, in the course of the last quarter of 2015, for the selection of an investment bank to lead the process of acquiring a technical/strategic partner to invest in the banks' capital, which will be a step toward better governance and would provide the necessary expertise to improve risk management and assessment methods.

- **Constant bank monitoring.** In light of the risks inherent in the implementation of restructuring plans, we plan to subject the state-owned banks under restructuring to enhanced supervision by the DGSB, in order to monitor, on an ongoing basis, the implementation of their plans, the conditions under which their accounts are again balanced, and their degree of compliance with prudential requirements. At the same time, we will be signing performance contracts (structural benchmark at end-November 2015) targeting the convergence of the performance indicators for state-owned banks toward those of the

private sector by 2016, and on a consolidated basis for certain indicators (for example, cost-to-income ratio).

24. The recapitalization of state-owned banks is part of a broader reform of the banking sector, which must address nonperforming loans. Our strategy in this area is twofold. The priority is still to continue and accelerate work on the review of the bankruptcy law (Law 95-34) to make it more balanced with respect to creditors. Progress is ongoing: a draft law was submitted to the National Constituent Assembly in October 2014, and is now a priority of the new parliament and expected to be adopted by October 2015. However, alternatives are still being explored, particularly with regard to the Asset Management Company (AMC), established under the Supplementary Budget law of 2014. Its effective establishment and operational startup will only be completed when the law on the AMC is adopted by parliament (structural benchmark at November 2015)—in line with sound international practices concerning the AMC governance rules, superpowers, loan transfer price setting, and sound financing plans.

25. In addition to those structural measures, we took others—which will be subject to special prudential monitoring—to support the tourism sector following the Sousse attack. We decided to support hotel units—with no overdue loan repayments as December 31, 2014—who risk financial difficulties following the drop in tourism revenues in the aftermath of the attacks. These entail the possibility of: (i) a guarantee from SOTUGAR for any exceptional loan from a domestic bank that finances hotels' operations for 2015 and 2016, and (ii) postponing for two years the payments on outstanding loans due by hotel units in 2015 and 2016. These measures are not compulsory for banks which could decide, or not, to request the guarantee or to postpone repayments. The banks that provide the exceptional loans will be eligible for Central Bank refinancing and could freeze the classification of those loans through 2016, thereby avoiding two years of provisioning costs. To enhance market transparency and monitoring, banks will specify in their published documents, both the share of loans subject to the freeze in classification as well as the prudential ratios in the absence of such measures. In addition, a plan will be set up to ensure that prudential rules are enforced at end-2016 once those measures expire.

26. Compliance with prudential norms is crucial. To that end, after the recapitalization of the state-owned banks BH (September 2015), and STB and BNA (both in October 2015), and the regularization of the situation of one private bank, all the banks will be compliant with the solvency ratio. The only exception is the BFT, which is in litigation. Hence, any bank, apart from BFT, failing to comply with the prudential rules shall be required to regularize its situation as soon as possible and shall be subject to appropriate sanctions.

27. In addition to restructuring state-owned banks and consolidating nonperforming loan portfolios, we intend to establish an appropriate banking resolution framework. A draft banking law, including specific provisions for bank resolution and for the deposit guarantee fund, was submitted in May 2015 to broad consultation with the Ministry of Justice, the banking industry, and the accountants association. This draft law will be discussed within the Council of Ministers, with a view of having it approved by parliament in October 2015 (structural

benchmark). The law shall be aligned with sound international practices, in particular with regard to the institutional framework, the clarity of criteria for starting the resolution process, and the extent of the powers granted to the Resolution Committee, including the possibility of a bail-in of subordinated debts and those unsecured ones granted to legal entities.

28. We are finalizing our work on the lender of last resort mechanism, which should be completed with the adoption of the Central Bank law. The broad guidelines of this mechanism are reiterated in the draft law reforming the statutes of the Central Bank, which will be submitted to parliament in October 2015. These guidelines are consistent with international good practices, in particular with regards to the scope of the institutions eligible for last resort loans and their eligibility requirements. In addition to these broad guidelines, which fall under the law, we must complete our deliberations in order to clarify and document the operational procedures for their implementation by November 2015 (structural benchmark).

29. Reforming banking supervision remains an absolute priority. To that end, we adopted a three-year plan in June 2014 (including prerequisites)—prepared with technical assistance from the IMF—which seeks to promote risk-based banking supervision, assessed on an individual and a consolidated basis. We are determined to implement this plan, which was just updated in June 2015 by the CBT through 2020, and which represents our roadmap. Our priorities are as follows: (i) increase human resources at the DGSB, particularly for on-site supervision, by recruiting 20 new supervisors by November 2015 (structural benchmark at end-November 2014); (ii) implementation of the new reporting system for accounting, financial, and institutional data (structural benchmark at end-December 2014), the design of which was completed in early 2015 but the implementation of which will be postponed until end-November 2015, with the publication of the circular setting the new reporting procedures; (iii) effective use of the system for rating the risk profile of institutions and related indicators dashboard; and (iv) publication of a circular on liquidity risk management to complement the recent introduction of the new liquidity ratio.

30. We continue our efforts to improve our mechanism against anti-money laundering and the financing of terrorism. In addition to the annual questionnaires sent out to institutions, the reference guide on risk management circulated at the beginning of 2015 now includes additional information on these areas. A specific methodological guide was also prepared for on-site inspections. Several institutions' frameworks on anti-money laundering issues were assessed in 2014. We have scheduled a cross cutting survey on these issues in 2015. The banking draft law includes a number of provisions to strengthen the authority of the CBT in this area by establishing internal control and governance norms, giving it the normative power and sanctions power for noncompliance with the applicable legal and regulatory provisions.

Fiscal reform

31. Our medium-term fiscal consolidation strategy is accompanied by the implementation of fiscal reforms aimed at supporting more inclusive growth. These steps target civil service reform, tax policy, and tax administration modernization, and improvements to

the governance of public enterprises, public expenditure management, and public investment effectiveness.

32. We are convinced that a comprehensive civil service reform is necessary to modernize public administration and contain the growth of the wage bill on a sustainable basis. To that end, the government will establish a strategy for reforming the civil service, which will be discussed and agreed upon in the context of the National Council on Social Dialogue. This reform will be based on organizational audits, a study on the redeployment of staff among the ministries and to regions, a review of the structure of wages and "other compensations", and career mobility. This reform will also help to reduce the burden of the wage bill in the long term to about 11 percent of GDP (less than 35 percent of total expenditures), which will help create the fiscal space necessary for priority spending and to maintain debt sustainability.

33. An ambitious tax policy reform is being finalized. This reform—which was designed after the national conference in November 2014—introduced significant changes to simplify the existing system while improving revenue mobilization, equity, and transparency of the tax regime. These measures include a reduction in the number of customs tariffs (from 7 to 3), harmonization of VAT rates (from 3 to 2), a reduction in exemptions, and a lower and more progressive income tax rate following modifications in rebates and deductions. This strategy will be approved by the Council of Ministers in October 2015 (structural benchmark) and will be published so that economic stakeholders can be informed of the government's strategy; it will be effective in 2016. The streamlining of onshore and offshore regimes, including the gradual convergence toward a single corporate tax rate with a neutral impact on revenue, is part of the framework of this reform and will be announced with a clear timetable by end-October (structural benchmark).

34. The modernization of the tax administration is critical to the planned simplification of taxes. Our modernization plan, adopted in August 2014 and updated in May 2015, seeks to implement a unified tax administration and to strengthen control and assessment mechanisms. The first phase of implementation of this reform involves the creation of a collection unit within the Large Taxpayer Unit, which will substitute for the initial project aimed at creating a new category of public accountants called "tax collectors" (a structural benchmark at end-September 2014 not met). In addition to this reform toward a unified administration, our efforts will be focused on regularly updating taxpayer rolls, improving tax supervision by developing surveys and reports, and systematically mining the data collected as part of a risk analysis system.

35. The drop in international crude oil prices is an important opportunity that we intend to seize to hasten energy subsidy reform, which we already started, and could improve the purchasing power of the population in the short term. To that end, we will introduce—through the 2016 budget law—the reduction of domestic gasoline and diesel retail prices to the international level, effective from January 1, 2016. This decrease—which will help economic activity by reducing costs and improving purchasing power—will be accompanied by the implementation of a symmetric automatic fuel price formula which has a smoothing mechanism for large international price fluctuations, thus depoliticizing fuel pricing and ensuring

its sustainability. This mechanism would replace the asymmetric formula introduced in January 2014.

36. We intend to improve the monitoring of public enterprises and the accompanying institutional framework. The strategy for implementing a better model for monitoring the performance of public enterprises—including by bringing all responsible entities under a new agency in charge of monitoring public enterprises—will be completed in October 2015 (structural benchmark). This strategy will include recommendations from the recent evaluation of internal controls in public enterprises. In addition, performance contracts on the management of the five largest public enterprises (STEG, STIR, Cereals Office, Tunisair, and the National Tobacco Authority) are being prepared and will be followed by performance contracts with financial indicators (structural benchmark at end-October 2015). On the basis of the financial performance of public enterprises, we will draw up a clear timetable of audits of the loss-making public enterprises which, if necessary, will be followed by restructuring and recovery plans.

37. The fiscal risks—including the availability of guarantees and new supporting measures for the tourism sector—will be continuously assessed and monitored. Therefore, the impact of discounts in Tunis Air flights and guarantees—granted by SOTUGAR for exceptional loans to viable tourism establishments—will be assessed based on potential risks for the budget. Also, the ceiling for state guarantees—including those given to banks—will be limited to TD3 billion in 2015. In addition, a comprehensive evaluation of the fiscal risks related to public enterprises—ongoing with IMF technical assistance—will result in a clear action plan for reducing the risk stemming from those enterprises.

38. Reforms in public expenditure management are moving forward, with the preparation of a draft organic budget law—with technical assistance from the European Union and France—which will be submitted to parliament in November 2015. This new law will propose progress in all areas: budget design, budget reporting (new functional classification), expenditure control, execution, and supervision. Furthermore, performance-based budgeting continues as 18 ministries (85 percent of the budget) have already prepared their budgets using the new program classification and a multiyear framework. Better coordination between the Debt General Directorate and the Treasury will also contribute to better management of the government's cash flow.

Structural reforms

39. We are designing a new and comprehensive economic vision which will create jobs and promote a competitive private sector that can generate inclusive growth. This strategy, an initial outline of which was presented to the Council of Ministers in June, will serve as the basis for organizing all the country's economic policies and will determine the government's strategic orientation. It will translate into a five-year economic vision of social and economic development (2016-2020), which will be presented at an international conference in early 2016.

40. We are steadfastly continuing in moving forward towards completing the government's priority reforms. In this context, Parliament has adopted in September 2015 the Law on Competition, which will help reduce government intervention in the economy, lighten the burden on regulations, and enhance competition among enterprises. We also intend to complete the following reforms, including through legislative approval by end-2015:

- **Bankruptcy Law (Law 95-34 on the recovery of enterprises in economic distress)**. In addition to the reform of the banking law, we are committed to adopting a new bankruptcy law. The draft of this law, prepared with the World Bank assistance, has already been validated by the parliamentary committee and we anticipate that it will be adopted in October 2015 after discussions in plenary session. This law will contribute to the modernization, simplification, and acceleration of the process of voluntary and court-ordered restructuring of viable enterprises and the liquidation of insolvent ones.

- **Law on public-private partnerships** will facilitate private concessions under our public investment program. The draft law submitted to parliament is being discussed with civil society, and is expected to be adopted by December 2015.

41. The new investment code is being completely overhauled, with a view to being adopted in 2015. We have resumed work on completing the new investment code, which seeks to implement a simpler and more transparent regulatory framework, to increase investor protection and market access, and to streamline tax incentives (and refer to any that might still exist to the tax code). The draft Investment Code will be presented to the Council of Ministers in September 2015 and submitted to parliament in October 2015 in view of its adoption (along with relevant implementation decrees) by November 2015 (structural benchmark).

42. In addition to amending the legislation, we will continue to simplify administrative procedures. To that end, we have already streamlined certain burdensome administrative procedures for the private sector in the transport, customs, and export sectors. We remain committed to further simplifying administrative procedures, in particular on the basis of the results of the regulatory "guillotine."

43. We are committed to minimizing obstacles to the smooth functioning of the labor market. Based on the results of the broad based dialogue with civil society started in 2013, within the framework of the social contract, we have begun to reflect on the implementation of a five-year vision for the labor market targeting: (i) an improvement in the employability of job seekers; (ii) the development of an entrepreneurial culture; (iii) stimulation of labor demand; (iv) public service intermediation; and (v) the reform of vocational training to serve business. This vision will include a national employment strategy. Furthermore, we have already implemented programs for the youth and the underprivileged regions (including vocational training programs), for support to SMEs and microprojects (including microfinance), and for the creation of social enterprises for young graduates in underprivileged areas.

44. Reliable statistical information is essential for monitoring and assessing macroeconomic policies and implementing social programs. A comprehensive diagnosis of our statistical system was finalized by Eurostat and our national account statistics (annual and quarterly) as well as monetary and balance of payments statistics are being strengthened with technical assistance from the IMF. In addition, a "National Statistical Charter," prepared by the National Council of Statistics promoting good statistical practices, is being reviewed and will be adopted by the government, by the end of 2015. We are also committed to reducing the lag time for publishing the statistics necessary for implementing economic policies on employment or industrial production, or for compiling the annual national accounts. To that end, we published, in April 2015, the preliminary results of the population and housing census conducted in 2014, and are committed to meeting the deadline for executing and publishing the five-year household survey.

C. Protection of the Most Vulnerable Groups

45. The protection of vulnerable populations remains a priority for supporting the implementation of fiscal and structural reforms. To this end, we completed the evaluation of the program of assistance to vulnerable households (expanded to 235,000 families) and health benefit cards (550,000), conducted based on a representative sample of 8,000 households. The report will be published in October 2015 during a national conference aimed at developing the strategic recommendations for better targeted and governed social safety net. This evaluation—which revealed the inclusion and exclusion errors under the current system—and the finalization of the unique social identifier, expected to be in place for vulnerable households during the third quarter of this year, will contribute towards building a better targeted and, less fragmented, social protection system, including through the establishment of a new register of vulnerable households. We are aware that the reform of energy subsidies should be accompanied by a better targeting mechanism and by a decision on the targeting method to be used, including to identify vulnerable households.

46. The deficit of the pension system calls for urgent reform. The CNRPS (National Retirement and Social Security Fund) no available cash reserves and has posted an annual deficit of 0.4 percent of GDP in 2015. To address these problems, and in the context of implementing the social contract, including through the soon to be established National Council on Social Dialogue, a comprehensive reform of the system will be designed. This reform would initially propose that the retirement age be raised on a voluntary basis. This would be part of a comprehensive reform of the pension system, which will including a revision of the parameters for calculating pensions (for example, the replacement rate), the contribution rate, and the benefits.

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

	Cumulative Flows Since Beginning 2014				Cumulative Flows Since Beginning 2015					
	Dec 2014				Mar 2015				June 2015	September 2015
	Prog. 12/12/14	Adjusted target	Actual	PC Status	Prog. 12/12/14	Adjusted target	Act.	PC Status	Est.	Proposed target
Quantitative Performance Criteria										
1. Floor on the primary balance of the central government (cash basis excl. grants)	-4,374		-3,997	Met	-1,162		756	Met	659	-1,111
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock)	3,187	4,679	1,688	Met	2,711	4,325	1,034	Met	1,959	3,114
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock)	5,709	4,748	4,998	Met	6,058	5,018	5,745	Met	4,906	5,245
4. Ceiling on Current Primary Expenditure 3/	18,191		17,778	Met	4,860		4,114	Met	8,253	13,198
Continuous Performance Criteria										
5. Ceiling on the accumulation of new external debt payment arrears by the central government	0	0	0	Met	0		0	Met	0	0
Quantitative Indicative Targets										
6. Floor on Social Spending 4/	1,412		1,217	Not Met	310		268	Not Met	552	965
7. Ceiling on the accumulation of new domestic arrears	0		0	Met	0		0	Met	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) 5/	1,996		1894		894		1054		1212	1949
of which: Multilateral (excluding IMF), bilateral and budget grants	884		796		628		49		221	596
Public debt service (interest and amortization) on a cumulative basis (in US$ million)	894		897		230		207		519	733
Bank recapitalization (in million TD)	0		0		0		0		0	110
Privatization receipts (in million USD)	0		0		0		0		0	0
Resident deposits at the BCT (in million USD) 6/	1,852		982		1,852		1368		1368	1368
Program exchange rate TD/ U.S. dollars	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/ This was previously an IT and is only a PC for end-September.
4/ Public capital expenditures on social sectors and programs.
5/ Disbursment, includes project loans and capital market access but excludes IMF budget support.
6/ At program exchange rate.

Table 2. Tunisia: Prior Actions and Structural Benchmarks

Prior Actions	Objective	Comments
BH bank to comply with minimum solvency ratios required as of March 2015 (10 percent), and completion of the first phase of the capital subscribtion process for the STB bank.	*Financial sector stability*	*BH will meet prudential ratios. Existing shareholders of STB who wish to participate in the recapitalization will have done so.*
Issuance of explicit sovereign guarantees for STB and BH's loans to state-owned enterprises that support the lower provisioning, which is taken into account for determining the reduced recapitalization amount.	*Financial sector stability*	*This is needed to justify the recapitalization amounts.*

Structural Benchmarks	Objective	Date	Proposed new 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*		*Met with delay. New board members were appointed for all three banks.*
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*	*Nov-15*	*Not met. Contracts will be designed after the new banks' management is in place.*
Adoption of recapitalization plans in line with sound international practices by the general assembly of the three public banks, based on the results of the audits.	*Financial sector stability*	*Mar-15*	*Oct-15*	*Not met. The general assembly of two banks adopted a recapitalization plan. The recapitalization and restructuring plan of the third public bank is still under preparation. The revised business plans will be ready by November 2015.*
Adoption by Parliament of the banking law (that includes a banking resolution framework) in line with sound international practices	*Financial sector stability*	*Mar-15*	*Oct-15*	*Not met. A draft is being discussed within the government.*
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*	*Nov-15*	*Not met. The government is reworking on it to ensure appropriate governance provisions are in it.*
Double the number of DGSB supervisors and revise the CBT hiring criteria to facilitate the hiring of qualified personnel.	*Financial sector stability*	*Nov-14*	*Oct-15*	*Not met. External recruitment competition ongoing*
Development and implementation of the new reporting and rating system for banks	*Financial sector stability*	*Dec-14*	*Nov-15*	*Not met. The design of new rating and reporting system has been completed, but it has not been implemented.*
II. Fiscal policy				
Parliamentary Approval of the 2015 budget	*Fiscal sustainability*	*Dec-14*		*Met. Adopted on December 11.*
Creation of a new category of public accountants called "*tax collectors*"	Enhance transparency of the tax system and revenue collection	*Jan-15*		*Not met. A tax collection unit has been set up at the LTU instead.*
Adoption by the Government of a strategy for a better monitoring of operations and financial performance of public enterprises	Reduce fiscal risks	*Apr-15*	*Oct-15*	*Not met. Progress has been made in monitoring public enterprises, but a full fledged strategy is still under preparation.*
Signature of performance contracts for the 5 largest state-owned companies	Reduce fiscal risks	*Apr-15*	*Oct-15*	*Not met.*
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*	*Oct-15*	*Not met. Its adoption will follow the ongoing assesssment of the revenue impact.*
Adoption of a tax reform plan covering direct and indirect taxes by the Council of Ministers.	*Expand the tax base and improve equity*	*Dec-14*	*Oct-15*	*Not met. It will be adopeted in the context of the 2016 budget.*
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 has taken effect on January 1, 2015*
Implementation of the weekly foreign exchange auction mechanism	*Greater exchange rate flexibility*	*Dec-14*	*Oct-15*	*Not met. The hardware platform has been put in place and reforms to develop the market are under way to facilitate the implementation of this mechanism.*
Establishment of the lender of last resort mechanism	*Financial system stability and better crisis management*	*May-15*	*Nov-15*	*Not met.*
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*	*Nov-15*	*Not met. Its overhaul is ongoing and adoption by Parliament is expected in October 2015.*

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 September 15, 2015. 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 1 SDR = 2.38852 Tunisian dinars.

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

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

Source: Central Bank of Tunisia.

3. Monetary gold assets will be valued at the price of 0.6498 dinar per gram of gold as established in the decree No. 86-785 of August 18, 1986. The stock of gold is 6.73 tons (6739902 grams) on December 31, 2012.

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

DEFINITION OF PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Performance Criteria and Indicative Targets

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

Performance criteria

- A performance criterion (floor) on the net international reserves of the Central Bank of Tunisia.
- A performance criterion on the net domestic assets (ceiling) of the Central Bank of Tunisia.
- A performance criterion (floor) on the primary balance of the central government, excluding grants.
- A performance criterion (ceiling) on total primary current expenditure of the central government.
- 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 (floor) on capital expenditures in priority social sectors and social programs.

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

B. Institutional Definition

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

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

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

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

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

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

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

[1] Deposits of residents in foreign currency (excluding government deposits) at the CBT are a form of external liability of the CBT; for operational and accounting purposes, and because of legal considerations related to the regulation of foreign exchange, the CBT includes residents' foreign currency deposits in the monetary base. To preserve the accounting consistency of the CBT's accounts and be in line with the standard definition of NIR within the framework of IMF stand-by arrangements, it is agreed: (i) to retain the accounting definition of external liabilities used in the CBT balance at December 31, 2012; (ii) to adopt the principle of adjusting NIR (in the opposite direction of the net domestic assets of the CBT) on the basis of the variation in the residents' deposits in foreign currency from end-December of the previous year. It also agreed that the residents' deposits in foreign currency at the CBT include the following components of reserve money: intervention/monetary market in foreign currency, foreign currency of aggregate intermediaries, non-negotiable placement of foreign currencies, and all other items operations in foreign currency (including deposits and derivatives products) created or included in reserve money and resulting in a liability of the Central Bank to residents. At end-March 2015, the value of the stock of deposits in foreign currencies of residents at the CBT was $1,368.41 million at the program exchange rate.

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

13. The value of CBT reserve assets and liabilities in foreign currency will be calculated using program exchange rates (see Table above). On December 31, 2012, the value of the stock of net international reserves was $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 Central Government Primary Current Expenditure (excluding Interest Payments on Public Debt)

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

G. Ceiling on the Accumulation of External Arrears

24. Arrears on external debt payment are defined as late payments (principal and interest) on external debt or guarantees as defined in *External Debt Statistics: Guide for compilers*[3] by the central

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

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

(continued)

government or the CBT after 90 days from the due date or the expiration of the applicable grace period.

H. Indicative Ceiling on the Accumulation of Domestic Arrears

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

I. Indicative Floor on Social Expenditures

26. Social **expenditures** are defined as capital expenditures (development expenditures) on education, health, social transfers to 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 in the table below. The NIR targets will be also adjusted upward (downward) if the total amount of cash payments on external debt service of the government is greater (lower) than the levels included in the table below.

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.

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	823.7	2941.7	1053.6	158.8	1038.2	1036.5	3287.2
Project loans	91.4	265.7	30.0	50.0	110.0	110.0	300.0
Multilateral donors	150.4	1338.7	42.1	108.4	801.5	576.1	1528.1
AFDB	0.0	0.0	0.0	0.0	0.0	200.0	200.0
AMF (Arab Monetary Fund)	41.5	41.5	42.1	0.0	0.0	0.0	42.1
IMF (budget support)	108.9	1047.2	0.0	0.0	301.5	201.0	502.6
World Bank Group	0.0	250.0	0.0	0.0	500.0	60.0	560.0
European Union	0.0	0.0	0.0	108.4	0.0	115.1	223.4
Bilateral donors	100.0	300.0	0.0	0.0	100.0	0.0	100.0
Algeria Budget support	100.0	100.0	0.0	0.0	100.0	0.0	100.0
Turkish loan	0.0	200.0	0.0	0.0	0.0	0.0	0.0
Financial Market Access and other	481.9	1037.3	981.5	0.5	26.7	350.4	1359.1
Sukuk and other market financing	0.0	0.0	978.5	0.0	0.0	330.0	1308.5
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	18.2	73.6	3.1	0.5	26.7	20.4	50.6
Budget Grant	129.9	204.1	7.0	63.8	126.1	0.0	196.9
Privatization Receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Government External Debt Service	239.2	955.0	192.1	311.9	214.2	277.9	996.1
Amortization	177.8	610.4	134.2	221.9	135.6	221.6	713.3
Interest	61.5	344.6	57.9	90.0	78.6	56.3	282.8
Resident deposits at the BCT 1/							

Sources: Tunisian authorities and IMF staff estimates.

1/ End-March 2015 is the reference level and was estimated at USD 1,368.41 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 the public banks. The recapitalization amounts for Q3 2015 are assumed to be 110 million dinars.

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: Debt service (amortization and interest) of institutional agents by instrument and at type of currency (in foreign currency and its equivalent in dinars). 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). Overall net external position of Tunisia (preliminary). Overall gross external debt position Overall net external position of Tunisia (in conformity with our obligations under SDDS).	*q* *m* *q* *q* *q* *A*	*30* *30* *90* *90* *90* *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*

INTERNATIONAL MONETARY FUND

TUNISIA

September 16, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION, SIXTH REVIEW UNDER THE STAND-BY ARRANGEMENT, AND REQUEST FOR REPHASING—INFORMATIONAL ANNEX

Prepared By

The Middle East and Central Department (in Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND ____ 2

RELATIONS WITH THE WORLD BANK GROUP ____ 7

RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT ____ 9

STATISTICAL ISSUES ____ 11

RELATIONS WITH THE FUND

(As of July 31, 2015)

Membership Status
Joined: 04/14/1958; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	286.50	100.00
Fund holdings of currency	1,017.93	355.30
Reserve position in the Fund	56. 45	19.70

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	272.78	100.00
Holdings	164.85	60.43

Outstanding Purchases and Loans:

	SDR Million	Percent Quota
Stand-By Arrangement	787.88	275.00

Latest Financial Arrangements (In millions of SDR (07/31/15))

Type	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
Stand-by	Jun 07, 2013	Dec 31, 2015	1,146.00	787.88
EFF	Jul 25, 1988	Jul 24, 1992	207.30	207.30
Stand-by	Nov 04, 1986	May 31, 1988	103.65	91.00

Projected Payments to Fund: (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2015	2016	2017	2018	2019
Principal		24.70	227.00	369.24	166.94
Charges/Interest	4.20	8.32	7.54	4.29	0.93
Total	4.20	33.02	234.53	373.53	167.87

Safeguards Assessments

The first-time safeguards assessment of the Central Bank of Tunisia (CBT) was finalized in June 2013. The assessment found an adequate control environment for the day-to-day operations, but oversight, autonomy, and transparency needed strengthening. The CBT publishes its audited financial statements in a timely manner, but the assessment recommended that disclosure information be enhanced. The CBT balance sheet was exposed to risks resulting from liquidity lending operations. These were mitigated by subsequent program measures related to inter-alia the collateral framework. The assessment also recommended measures to strengthen the internal audit function and enhance the oversight by the CBT Audit Committee.

Exchange Rate Arrangement

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

The de jure exchange rate arrangement is floating as indicated on the Central Bank of Tunisia (CBT) web site. Effective April 18, 2012, a fixing (i.e. the average of market participants' quotes) replaced the currency composite as the reference exchange rate published by the CBT. Since then, the CBT intervened in the foreign exchange market through bilateral transactions when market quotes deviated substantially from the fixing rate of the day. Previously, the CBT intervened in the foreign exchange market to keep the exchange rate stable vis-à-vis a currency composite using its own rates in response to requests from banks for quotes. The rates quoted by the CBT were based on the currency composite and updated continuously to reflect the exchange rates prevailing in the international foreign exchange market. During the transition to the new operational framework, since September 2011, the CBT has adjusted the level of the exchange rates vis-à-vis the currency composite. However, the dinar has followed a depreciating trend vis-à-vis the U.S. dollar within a margin of less than 2 percent through December 2014. The de facto exchange rate arrangement is classified as to a crawl-like arrangement. The CBT posts, effective January 1, 2011, the volume of transactions between authorized intermediaries, and the volume of its daily interventions in the interbank foreign exchange market on its website."

On June 15, 2015, the interbank rate of the dinar vis-à-vis the dollar was $1=TD 1.937, equivalent to SDR 1=TD 2.7276

Article IV Consultation

Tunisia is under 31 month SBA program with quarterly reviews since June 2013. The last Article IV consultation was concluded by the Executive Board on July 25, 2012.

FSAP Participation and ROSCS

The last FSAP update was conducted during January 11-25, 2012. Tunisia participated in the Financial Sector Assessment Program (FSAP) in 2002 and an FSAP update was conducted in 2006.

AML/CFT Assessment

Tunisia's anti-money laundering and combating the financing of terrorism (AML/CFT) framework was assessed in 2006 against the AML/CFT standard, the Financial Action Task Force (FATF) Recommendations. The evaluation was conducted by the World Bank in the context of the FSAP update. The final report indicated that Tunisia had adopted an AML/CFT law, and the criminalization of money laundering and the financing of terrorism were broadly in line with international standards, nonetheless, some key weaknesses were identified. In line with the authorities' intention to strengthen their AML /CFT framework, a new assessment of the AML/CFT regime is currently being conducted.

Technical Assistance

Tunisia has received technical assistance (TA) by the Fund in several areas. The following list summarizes the TA provided by the Fund to Tunisia since 1996, with TA having substantially increased since 2011.

Monetary and Capital Markets Department

September 9–12, 1998: MAE—monetary management and development of the money market.
October 12–15, 1999: MAE—debt management practices.
December 17–21, 2001: MAE—management of central bank liquidity.
May 18–19, 2004: MFD—technical assistance needs assessment.
January 16–31, 2006: MFD—FSAP update (mission 1).
March 27–31, 2006: MFD—FSAP update (mission 2).
February 5–15, 2007: MCM—monetary policy.
November 21–December 2, 2011: MCM—Foreign Exchange Market and Central Bank Operations.
November 21–December 2, 2011: MCM—Banking Supervision.
January 11–25, 2012—FSAP update
April 25–May 7, 2012: MCM—Strengthening the Framework for Monetary Policy and Operations
May 2012–ongoing: MCM—Resident expert in banking supervision at the Central Bank of Tunisia
April 16–29, 2013: MCM—Central Bank Institutional Capacity Assessment
May 1–10 2013, MCM—Collateral framework and emergency liquidity assistance facility

March 24–April 3, 2014: MCM—Strengthening banking supervision
March 31–April 8, 2014: MCM—Emergency liquidity framework
September 15–29, 2014: MCM—Central Bank Institutional Capacity Assessment - follow-up (joint with ICD)
November 17–28, 2014: MCM—Introducing a foreign exchange auction

Fiscal Affairs Department

January 31–February 14, 1996: FAD—assessment of revenue impact of Association Agreement with EU.
January 24–February 5, 2005: FAD—tax policy.
September 8–21, 2005: FAD—tax administration.
December 6–19, 2012: FAD—tax policy
January 23–5 February, 2013: FAD—modernization of tax administration and reform of customs administration
22 August–4 September 2013: FAD—fuel price mechanism
28 August –10 July, 2013: FAD—public finance management
March 10 –19, 2014: FAD—tax policy reform and tax administration
June 11 –20, 2014: FAD—tax administration: developing the reform plan
June 12 –24, 2014: FAD—tax policy: indirect taxation
July 14 –25, 2014: FAD—public finance management
October 1, 2014: FAD—tax policy: consultation on tax reforms with private sector, IFIs and academia
November 10-14, 2014: FAD—tax policy: participation in National Tax Conference
December 18 –22, 2014: FAD—tax administration

Finance

February 19–28 2013, FIN—safeguard assessment

Statistics

March 31–April 4, 1997: STA—introduction of new methodological guidelines according to fifth edition of *Balance of Payments Manual*.
May 11–21, 1999: STA—quarterly national accounts.
May 13–18, 1999: STA—SDDS
October 17–27, 2000: STA—quarterly national accounts.
October 25–31, 2000; STA—SDDS meta data finalization.
July 1–15, 2004: STA—government finance statistics.
April 7–22, 2005: STA—ROSC, data module.
February 18 –27, 2013: STA—monetary and financial statistics
April 24–26, 2013: STA—statistical data and metadata (SDMX)
February 19–26, 2014: STA—monetary and financial statistics
December 1–12 2014: STA—external sector statistics

Legal Department

December 12–19, 2003: LEG—AML/CFT.
February 4–7, 2008: LEG—AML/CFT supervisory training of the financial market supervision authority and the stock exchange.
March 2–15, 2014: LEG—banking law and banking resolution framework
May 19–30, 2014: LEG—central banking law and banking law

Institute for Capacity Development

November 21–22. 2011: INS—identification of training needs of the Central Bank of Tunisia
September 15-29, 2014: ICD—Central Bank Institutional Capacity Assessment (follow-up; joint with MCM)

Tunisian officials have participated in courses in Washington and in several areas of macroeconomic analysis and management.

Resident Representative

Ms. Giorgia Albertin was appointed the IMF Resident Representative in Tunisia in January 2014 and a representative office was opened in Tunis.

RELATIONS WITH THE WORLD BANK GROUP

(As of May 18, 2015)

A new Interim Strategy Note (ISN, FY13-14) outlines the Bank Group support to post-revolution Tunisia. The new ISN was discussed by the World Bank Board of Executive Directors on July 3, 2012. The ISN updates a Country Partnership Strategy (CPS, FY10-13) which appeared inadequate to respond to the new country context. The new ISN has been prepared jointly with the IFC, with participation from MIGA, and it supported a program that promotes private sector-led recovery and job creation, with a focus on openness, opportunity and accountability. To achieve its overarching objective of supporting employment creation, the Bank Group framed its support within three Areas of Engagement: (i) Laying the Foundation for Renewed Sustainable Growth and Job Creation; (ii) Promoting Social and Economic Inclusion; and (iii) Strengthening Governance: Voice, Transparency and Accountability. The IFC has also strengthened its engagement and appointed a staff in Tunis. The World Bank has recently completed a Systematic Country Diagnostic, which reviews Tunisia's challenges in achieving both poverty reduction and inclusiveness. The upcoming development plan (2016-20) of the new Government—to be presented during the forthcoming donors' conference—will be the basis of the Country Partnership Framework jointly prepared by the World Bank, the IFC and MIGA.

Lending Volumes

Following the 2011 revolution, the Tunisia portfolio witnessed a sharp weakening of performance indicators which had eventually begun to recover FY14/FY15. While lending initially peaked in FY11 with the approval of the $500 million Governance & Opportunities DPL and a $50 million MSME Financing Facility, there were no new IBRD commitments in FY1 —the Bank was preparing a number of key operations during this period and presented an Interim Strategy Note in early July 2012, while Tunisia experienced a heightening of post-revolution political, economic and social challenges.

In FY2013, commitments began to climb again as the reform program moved forward and the Governance, Opportunities and Jobs DPL series came on line. By FY14, new investment lending operations were approved and in early FY15, a $300 million Urban Development and Local governance operation was approved by the Board, using the new program for results lending instrument.

On-Going Portfolio

Tunisia's current active portfolio, with a net commitment of $1.12 billion (as of May 2015), includes one $300 million Program for Results (P4R) operation supporting municipal services, approved in July 2014, one fully disbursed DPL operation of $250 million and nine Investment Project Financing (IPF) operations totaling US$519 million. In addition, it also includes 12 grants, representing a commitment of $50.3 million. The total undisbursed amount is $642 million (57 percent of the total commitment).

With the current active portfolio at over $1 billion, World Bank lending commitments to Tunisia are at their highest ever. However, disbursements for investment lending (IPFs) during FY14 were a modest $27.64 million and only reached $20.23 million for FY15. The investment lending disbursement ratio slowed from 20.1 percent in FY11 to 11.1 percent in FY12 and then peaked to reach 19.9 in FY13. In FY14, the disbursement ratio slowed down again and reached the level of 15.4 percent

The slower investment lending disbursement rate, delays in preparation of new small grants and some implementation issues can be attributed to disruptions caused by the revolution and political transition, including delays with decentralized entities and with the awarding of contracts for projects that required investor participation.

Lending Instrument	Proj ID	Project Name	Date, Board App	Closing	Net Comm Amt ($m)	Tot Undisb Bal ($m)
SIL	P086660	TN-Second Natural Resources Management	06/17/2010	12/31/2015	36.10	28.14
	P119140	TN-4th NW Mount & Forest Area Dev PNO4	12/20/2010	06/30/2017	41.60	23.42
	P104266	TN-Energy Efficiency	06/30/2009	06/30/2015	40.06	18.94
	P132381	TN-Third Export Development Project	06/16/2014	12/31/2020	50.00	50.00
	P064836	TN-Urban Water Supply	11/17/2005	06/30/2018	64.23	32.53
	P095847	TN- Water Sector Investment II	05/19/2009	03/31/2015	30.60	7.93
	P099811	TN-Tunis West Sewerage	07/06/2006	06/30/2015	66.80	12.75
	P117082	TN-Northern Tunis Wastewater	06/17/2010	06/30/2017	39.40	35.12
	P124341	TN-MSME Financing Facility	07/14/2011	01/31/2018	150.00	100.00
	9				**518.79**	**308.83**
P4R	P130637	TN-Urban Dev. and Local Governance	07/24/2014	12/31/2019	300.00	300.00
	1				**300.00**	**300.00**
DPL	P132709	TN - Governance Opportunities Jobs DPL-2	04/29/2014	06/30/2015	250.00	0.00
	1				**250.00**	**0.00**
GEF	P112568	TN:GEF Second Natural Resources Mgt	06/17/2010	12/31/2015	9.73	7.49
	P118131	TN-GEF Northern Tunis Wastewater	06/17/2010	12/31/2015	8.03	5.23
	P100478	TN:GEF Managing Healthcare Waste and PCB	07/26/2012	05/31/2017	5.50	4.71
	P120561	Tunisia: Ecotourism and B. Conservation	01/22/2013	07/31/2018	4.27	3.41

RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

(As of June 19, 2015)

Following the Arab Spring, Tunisia and three other countries of the Southern and Eastern Mediterranean region (Egypt, Morocco and Jordan) requested country of operation status at the EBRD in 2011. Tunisia became a member of the Bank in December 2011 and was granted recipient/country of operations status in June 2012.

The EBRD started its activities through technical assistance and policy dialogue, followed by investments. It opened its fully operational office in June 2013 and has built an investment portfolio of 18 transactions, committing a total of more than EUR 250 million, all in the private sector. Investments in the financial sector currently dominate the portfolio, focusing on supporting SMEs through credit lines to local banks and equity investments in private equity funds. In addition, the EBRD signed trade facilitation agreements with two local banks to facilitate foreign trade and support local banks import export transactions. The Bank has also financed directly a number of private corporates in agribusiness, automotive and telecommunication sectors and continues to pursue active business development and market efforts for investment opportunities.

There are presently 18 donor-funded technical assistance assignments in Tunisia supported by a €3 million donor funding, including such country-specific assignments as: a Transport Sector Review, an Assessment of the Sub-Sovereign Financing Framework, a Sustainable Energy Initiative study, an Environmental and Social Assessment, and a Country Law Assessment.

Tunisia is also benefiting from 41 regional assignments for about €33 million of approved funding. These include the Food Security Initiative in the region, the implementation of small business support (SBS) advisory services that provide tailored financial and managerial training for SMEs; local capital market development; the expansion of the Local Enterprise Facility and the Direct Company Assistance program for agribusiness companies.

The SBS program in Tunisia has provided direct technical assistance for nearly 150 SME for a total amount of €2 million of donor funds. The EBRD is scaling up its SBS activities with an extra €10 million funding received from EU under the Programme d'Appui a la Competitivite des Services (PACS Program), which will benefit services sectors, tourism and handicrafts. The agreement with the EU was signed in June 2015 and envisages the implementation over the next 5 years.

To support Tunisia in tackling its structural reform challenges, the EBRD plans to focus its operations along the following priorities, in coordination with other IFIs and bilateral agencies:

- **Financial sector.** The priority is to help bank restructuring and broaden financial sector access to support private sector development so as to address a number of structural deficiencies in

the sector, including the prevalence of weak state-owned banks and limited access to finance for SMEs as well as the lack of a functioning local capital market.

- **Modernization of industry through the private sector.** Tunisia's private sector requires support in order to promote higher value added production and sustainable job creation.
- **Power and energy sector.** The priority is to support energy efficiency and improve energy security and the development of a sustainable energy sector.
- **Infrastructure sector.** The EBRD plans to facilitate non-sovereign financing for infrastructure to provide wider access to better quality urban and more efficient public services

STATISTICAL ISSUES

(As of end-August 2015)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision is adequate for surveillance but it should be strengthen in the financial sector.	
National Accounts: In December 2010, the National Institute of Statistics (NSI) published a revised national accounts series covering the period 1997–2009 based on SNA 1993 (instead of, as before, SNA 1968). Following international guidelines, a chained-index approach is now used to estimating GDP growth. Quarterly GDP series consistent with this revision have been recently disseminated at constant prices and at current prices on the NSI website. These improvements are welcome, and should provide a better indication of economic activity developments and trends in Tunisia. Surveillance would benefit from the collection and dissemination of higher frequency data on employment, unemployment, and wages. Tunisia utilizes a periodicity and timeliness flexibility option for the labor market data category under the SDDS. Since end-2011, quarterly employment and unemployment data are disseminated with a timeline of three months.	
Government finance statistics: While Tunisia produces annual general government data and quarterly budgetary central government cash flow in the *GFSM 2001* framework, some areas for improvement remain. The depth of the budgetary central government should be improved to include one quarter timeliness and quarterly financial balance sheet information.	
Monetary statistics: The Central Bank of Tunisia (CBT) has not yet migrated to the Standardized Report Forms (SRFs) to report monetary and financial statistics. The CBT has started to develop the SRF 1SR (Standardized Report Form for the Central Bank) and is planning to request technical assistance from STA for reviewing and validating the 1SR and to provide recommendations on the migration to the SRF 2SR (Standardized Report Form for other depository corporations).	
Balance of payments: Are generally adequate for surveillance, although greater details for quarterly BOP and development of a quarterly IIP are needed. Improvements in key areas, which would also support transition to BPM6, are dependent on the development of additional source data including accessing the existing administrative databases at the CBT and other government agencies. Major expected changes from the adoption of BPM6 may broadly result in: (i) a larger goods balance deficit, mainly due to the removal of goods for processing gross flows; (ii) a relative increase in the services balance (addition of goods for processing fees, FISIM, repairs, etc.); (iii) a decline in the primary income balance (recording of reinvested earnings in the debits); (iv) changes in the financial account due to improvements in coverage and reclassification of transactions by functional category.	
Financial indicators: Financial indicators are available with significant lag and their accuracy is challenged by problems in the banking supervision information system and data base management.	
II. Data Standards and Quality	
Subscribed to the Special Data Dissemination Standard (SDDS) June 20, 2001.	A data ROSC was published on the IMF website on August 9, 2006.
III. Reporting to STA (Optional)	
Data are being reported for publication in the *International Financial Statistics (IFS)*, *Government Finance Statistics Yearbook, the Direction of Trade Statistics*, and *the Balance of Payments Statistics Yearbook*.	

Tunisia—Table of Common Indicators Required for Surveillance
(As of end-August 2015)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Current	Current	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jun. 2015	Aug 2015	M	M	M
Reserve/Base Money	Jun. 2015	Aug 2015	M	M	M
Broad Money	Jun. 2015	Aug 2015	M	M	M
Central Bank Balance Sheet	Jun. 2015	Aug 2015	M	M	M
Consolidated Balance Sheet of the Banking System	Jun. 2015	Aug 2015	M	M	M
Interest Rates[2]	Current	Current	D	D	D
Consumer Price Index	Jul 2015	Aug 2015	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2011	May 2012	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Jun. 2015	Aug 2015	M	M	I
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q2. 2015	Aug 2015	Q	Q	Q
External Current Account Balance	Q2 2015	Aug 2015	Q	Q	Q
Exports and Imports of Goods	Jul. 2015	Aug. 2015	M	M	M
GDP/GNP	Q2 2015	Aug. 2015	Q	Q	Q
Gross External Debt	Q2 2015	Aug 2015	A	A	A
International Investment Position[6]	2014	Aug 2015	A	A	A

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).

Statement by the IMF Staff Representative
September 30, 2015

This statement reports on the recent agreement to increase wages during 2016–18 and the implementation of the prior actions since the Staff Report was issued on September 17, 2015. The information does not alter the thrust of the Staff Appraisal.

1. **The Tunisian government and the main labor union signed an agreement for another round of public sector wage increases for 2016–18.** The authorities considered this agreement—which was signed on September 22, 2015—as essential to reduce social tensions during the next two years. Based on preliminary data, staff estimates that the annual 4–5 percent generalized salary increase in 2016 will add 0.4 percent of GDP to the wage bill in the absence of compensating measures. Staff regrets this latest increase—which will add to an already unsustainable wage bill and hurt competitiveness of the Tunisian economy. Staff urges the authorities to introduce compensating measures in the 2016 budget to contain wage increases within the existing wage bill. Moving quickly ahead with a comprehensive civil service reform is also essential to contain and eventually reduce the wage bill.

2. **The recapitalization of Banque de l'Habitat (BH) has been completed.** BH was recapitalized on September 12, with a capital injection of 110 million dinars. Existing shareholders—the state (with 57 percent) and private shareholders—both contributed in line with their initial shares. The capital injection, together with explicit state guarantees for BH related to claims outstanding on public enterprises (prior action) issued in September 2015, increased BH's end-March Tier 1 capital ratio to 7.2 percent and the capital adequacy ratio to about 10 percent. This meets the prior action on BH recapitalization, as verified by the bank's auditors.

3. **The Société Tunisienne des Banques (STB) has been recapitalized.** The first phase of the subscription process ended on September 14 (prior action), and all phases of the capital subscription—bringing total capital to 776.8 million dinars—were completed on September 18, about one month ahead of schedule. Interest in STB by existing private shareholders was modest, resulting in the government share increasing from 51 percent to close to 80 percent. Explicit guarantees for STB (prior action) were issued in a lesser amount than expected (about half), on grounds of smaller outstanding claims on public enterprises. The authorities expect this to be sufficient to bring Tier 1 capital above 7 percent as of end-June; this and the resulting level of total capital will be verified following the certification of the end-June accounts in October.

4. **Staff welcomes the actions taken to ensure banks meet prudential norms**. It stresses the importance of quickly completing the update of existing business plans, which will help ensure regulatory compliance throughout the restructuring period. Staff also urges the authorities to introduce strategic partners in STB and BH, including to help with the restructuring process.

**Statement by Jafar Mojarrad, Executive Director for Tunisia,
Mr. Mohammed Daïri, Alternate Executive Director,
Mr. Abdelali Jbili, Senior Advisor, and Ms. Monia Saadaoui, Advisor
September 30, 2015**

On behalf of our Tunisian authorities, we thank staff for the excellent report on the Article IV consultation and the sixth review under the Stand-By Arrangement. Our authorities appreciate the quality of engagement with Fund staff, which has been beneficial throughout the program period, and express their deep appreciation to Fund management and the Executive Board for their continued support during the difficult political transition. Staff analysis and policy recommendations are in line with the authorities' own assessment and policies.

Overview

Tunisia has successfully completed a political transition, which was long, arduous, and fraught with risks. But the outcome is highly positive as democratic institutions have been solidly anchored in dialogue and political consensus. As highlighted during the Managing Director's visit to Tunisia, resilience in the political, social, and economic fields has been the hallmark of this transition. The Tunisian authorities' perseverance in holding the line in the economic field are noteworthy, especially when their efforts are seen against the background of the tragic terrorist attacks, social unrest, conflict in a neighboring country, and depressed external demand. Despite these shocks, growth has remained positive, inflation is contained, pressure on the exchange rate has abated, and fiscal and external imbalances remain manageable.

The authorities share staff views about the outlook and potential risks, even though they expect some upside from continued recovery in Europe, low oil prices, and easing of social tensions. They are determined to do the utmost to mitigate these risks that are under their control. The current government, which took office in February 2015 with a five-year mandate, has expressed its determination to improve security and combat terrorism, further strengthen macroeconomic stability, accelerate the implementation of structural reforms to foster growth and employment, and continue to rely on dialogue, good governance, and communication in addressing social issues.

Looking ahead, the authorities are in the process of formulating a new vision for economic and social development, which will lay down the priorities and major strategic orientations through a development plan for the period 2016–2020. A first draft of this strategy was submitted to the Council of Ministers in June 2015 and is expected to be showcased at an international conference in early 2016.

Recent economic developments

The economic recovery has been derailed by the tragic terrorist attacks of the Bardo museum and Sousse, which severely affected tourism activity and investor confidence, with adverse impact on growth and the balance of payments. In addition, a significant increase in the number and duration of strikes in the first half of the year led to the complete cessation of phosphate production for two months and contributed to growth deceleration. Growth projections have now been revised down to 1 percent in 2015, or about half last year's level. However, inflation remains contained; it fell to 4.2 percent in August 2015 and is expected to reach 4.4 percent in December 2015, reflecting a continuation of the gradual tightening of monetary policy by the central bank of Tunisia (CBT) as well as lower energy and food prices. Unemployment has declined to 15.2 percent in the second quarter of 2015 but remains high, especially for youth and women.

Due to the fall in world oil prices and sluggish economic activity, which contributed to a significant decline of imports, the current account deficit is expected to improve slightly in 2015, but would remain elevated at 8 ½ percent of GDP. The US$1 billion international bond issue in January 2015 and disbursement of multilateral loans are expected to keep gross international reserves at the equivalent of 4 months of imports by the end-2015. Access to the international financial market without third party guarantee at relatively favorable terms attests to continued market confidence in Tunisia.

Program implementation

Program implementation has been adequate in light of Tunisia's exceptional circumstances and the challenges highlighted above. All quantitative performance criteria for end-December 2014 and end-March 2015 were met, most of them with comfortable margins. The floor on the primary fiscal balance was met with a wide margin, and the indicative ceiling on current expenditure was also met. However, the indicative ceiling on social spending was missed due to persistent difficulties in the delivery mechanism in remote regions. Continued under-execution of capital spending under the budget reflected capacity absorption difficulties in the post-revolution period, as recognized by staff, rather than an intended adjustment measure.

Implementation of the authorities' structural reform agenda has been more challenging than expected given the unsettled social environment during the political transition and the need to build consensus on major reforms and pieces of legislation. Nonetheless, significant progress has been made in a number of areas, including the adoption of bank restructuring plans.

Based on the performance under the SBA, the Tunisian authorities request completion of the sixth review, agree on the proposed new performance criteria for end-September 2015 and the timetable for structural benchmarks as described in the MEFP, and request a rephasing of disbursements, with the final tranche of SDR 143.25 million to be made available upon completion of the seventh and last review under the SBA.

Macroeconomic policies

Fiscal policy

Fiscal adjustment in 2014 was better than programmed. The central government structural deficit (excluding the effects of the economic cycle and the cost of bank recapitalization) stood at 3.3 percent of GDP at end 2014, against a program target of 4.1 percent of GDP and 5.3 percent in 2012. This has been achieved mainly due to increased revenue mobilization (including VAT and the exceptional contribution on income), leading to an increase in the revenue-to-GDP ratio, and a significant decline in expenditures, including from under-execution of public investment, as mentioned above.

Adverse developments in 2015 and a difficult international economic environment prompted the authorities to moderately ease fiscal policy to support growth and address the new security challenges. A supplementary budget law introduced measures aimed at increasing security expenditure, supporting the tourism sector, and strengthening programs for small and medium enterprises (MEFP ¶8-10). It also provided for a 5 percent general salary increase, including for regularization of past wage agreements, while deferring recruitments and implementation of specific wage increases concluded and not yet implemented. This measure was intended to ease mounting social tensions.

The authorities are firmly committed to take additional measures to attain their fiscal objectives in 2015, including through reduction of non-essential non-wage expenditure. They are committed to fiscal adjustment from 2016 onwards. In this regard, they intend to seize the opportunity of low international oil prices to accelerate the reform of energy subsidies. They will introduce in the 2016 budget an automatic oil price adjustment formula to replace the asymmetrical formula adopted in January 2014. In parallel, they are accelerating the preparation of major tax and public finance management reforms, which would bring about lasting improvements in the fiscal situation, improve equity, and reduce public debt. Plans are also underway to accelerate the execution of public investments through a series of measures to strengthen coordination between the governorates and the central government, implement new procurement procedures, and improve monitoring and execution.

A comprehensive reform of the civil service will be critical to modernize the public administration and contain the growth of the wage bill. To this effect, a strategy will be

formulated in consultation with the National Council of Social Dialogue, which will help gradually lower the wage bill to about 11 percent of GDP over the medium-term.

Despite the increase in the overall fiscal deficit since 2011, Tunisia's public debt remains sustainable and low in comparison with regional peers. Over the medium-term and under stress scenarios developed in the DSA, public debt is expected to remain sustainable. Tunisia has had an impeccable record of meeting its debt obligations.

Monetary and exchange rate policy

The gradual monetary policy tightening and declining international commodity prices has helped contain inflation. The central bank has kept the policy rate unchanged at a level which is considered adequate in view of the weak economic activity and sluggish credit demand. Moreover, with the convergence of the money market rate and the policy rate, the latter has become a more effective signaling tool. The CBT remains vigilant to address possible inflationary pressures from second round effects of wage increases or exchange rate depreciation.

The authorities continue to modernize and strengthen the monetary policy framework. Changes have been introduced to reduce risks to the central bank from refinancing operations, and work is underway in cooperation with the *Banque de France* to modernize the operational framework of monetary policy, including improving the quality of liquidity forecasts and deepening the interbank market. The draft law on the central bank was presented to the CBT's Board of Directors in June 2015, and is expected to be submitted for parliamentary approval in October 2015. The draft, which has benefited from Fund technical assistance, aims at granting the CBT greater autonomy and better definition of its mandate by adding financial stability to its goal of price stability while strengthening its governance, transparency, and accountability framework.

Exchange rate policy has appropriately responded to market developments, allowing the dinar to continue to reflect movements in fundamentals. Interventions in the foreign exchange market helped smooth excessive fluctuations following the Bardo attack. The authorities remain committed to further increasing exchange rate flexibility and deepening the foreign exchange market. To this effect, the Board of Directors of the CBT adopted in May 2015 a series of measures, including the introduction of foreign exchange auctions to give more weight to the market in determining the value of the dinar (MEFP19). Implementation of weekly foreign exchange auctions is to start in October 2015 (structural benchmark).

Financial sector stability

Financial sector stability remains a top priority, and progress has been made toward advancing the reform in many areas with a particular focus on: (i) recapitalization and restructuring of public banks, (ii) introduction of a bank resolution scheme, a deposit guarantee scheme, and lender-of-last resort mechanism, and (iii) strengthening of banking supervision.

Following legislative approval in August 2015, the recapitalization of the three public banks for up to 1 billion dinars (1 percent of GDP) is underway, consistent with international practices. Restructuring plans were approved for two banks, subscriptions to capital increases were closed for *Banque de l'Habitat* (BH), the *Société Tunisienne des Banques (*STB), and sale of non strategic assets for the *Banque Nationale Agricole* (BNA) are ongoing. Moreover, the government is committed to ensuring that the updated business plans of the recapitalized banks will be carried out in light of the changed economic environment. The CBT will also strengthen the supervision of public banks to ensure that they fully comply with prudential requirements. Performance contracts will be developed to ensure the convergence of public banks' performance indicators to those of the private sector, which will be done on a consolidated basis for selected indicators (structural benchmark for end November 2015). The authorities are actively working to address the NPL problem, including through a draft revised law on bankruptcy, which is expected to be approved by parliament in October 2015. In addition, exceptional and urgent measures have been taken to support the tourism sector following the Sousse attack. These measures will be subject to special prudential monitoring as detailed in MEFP ¶25.

In parallel, important steps have been taken to strengthen the governance of public banks and move ahead with their restructuring. New board members representing the government have been appointed, and the functions of chairman and CEO have been separated, while the role of the board, its committees, and senior management will be redefined. Moreover, to bring the necessary expertise in management and risk assessment, a tender will be launched in the last quarter of 2015 for the selection of an investment bank to help with the process of entry of technical/strategic partners in the capital of banks.

Medium-term structural reforms

Over the medium-term, the authorities plan to make decisive progress on wide-ranging structural reforms to improve the business climate, attract private sector investment, and enhance efficiency and competitiveness. A number of key reforms are already at an advanced stage of preparation, including a major overhaul of the tax system and modernization of tax administration, reform of the investment code, and the bankruptcy

law. Other reforms, which require further preparatory work and consultations, will be introduced in the 2016-20 development plan, including labor market reform, restructuring of public enterprises, public expenditure management, civil service reform, and pension reform.

The authorities appreciate the analytical work carried out by staff in the Selected Issues Paper on Tunisia's growth potential and take a positive note of the reforms needed to unleash this potential. They are aware of the impediments to the business environment, many of them are part of the legacy of the pre-revolution regime, and are determined to address them in close collaboration with stake holders and international partners.

Conclusion

Tunisia continues to face daunting challenges, exacerbated by the two terrorist attacks, but has shown resilience and firm determination to implement its reform agenda under the Fund-supported program. The authorities are committed to pursue a medium-term strategy focused on fostering growth and job creation while reducing macroeconomic imbalances. They look forward to continued close collaboration with the Fund and other partners toward achieving their objectives.