Tunisia: Fourth Review Under the Extended Fund Facility Arrangement and Request for Modification of Performance Criteria-Press Release; Staff Report; and Statement by the Executive Director for Tunisia

INTERNATIONAL MONETARY FUND

INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/291

TUNISIA

October 2018

FOURTH REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA —PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR TUNISIA

In the context of the Fourth Review Under the Extended Fund Facility Arrangement and Request for Modification of Performance Criteria, 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.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 28, 2018, following discussions that ended on September 10, 2018, with the officials of Tunisia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on September 17, 2018.
- A **Statement by the Executive Director** for Tunisia.

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

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

The 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
COMMUNICATIONS DEPARTMENT

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September 28, 2018

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Review Under the Extended Fund Facility (EFF) Arrangement for Tunisia

- The recovery is strengthening, but risks continue to weigh on the outlook.
- The government's program aims at reducing macroeconomic imbalances, while providing social protection, and encouraging private sector-led job creation.
- Fiscal and monetary policies seek to reduce debt, support inclusive growth, and curb inflation.

On September 28, 2018, the Executive Board of the International Monetary Fund (IMF) completed the Fourth Review of Tunisia's economic program supported by an arrangement under the Extended Fund Facility (EFF). The Board's decision makes available to Tunisia SDR 176.7824 million (about US$247 million), bringing total disbursements to SDR 984.9309 million (about US$1.4 billion). The four-year EFF arrangement in the amount of SDR 2.045625 billion (about US$2.9 billion, or 375 percent of Tunisia's quota at the time of approval of the arrangement) was approved by the Executive Board on May 20, 2016 (See Press Release No. 16/238).

Priorities of the government's economic reform program that is supported by the EFF arrangement include growth-friendly and socially conscious reforms. Fiscal policies aim at mobilizing revenue and containing current expenditure to reduce Tunisia's debt burden, and increase public investment and social spending to support sustainable and inclusive growth. Monetary policy focuses on curbing inflation, and continued exchange rate flexibility will help to strengthen international reserves. To maintain adequate social protection, the authorities have increased social transfers to vulnerable households, are working on the better targeting of social expenditure, and submitted a pension law proposal to Parliament. Structural reforms supported under the arrangement include strengthening governance, the business climate, fiscal institutions, and the financial sector.

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

"The Tunisian authorities' efforts to reduce macroeconomic imbalances are bearing fruit. Growth accelerated in the first half of 2018, but unemployment and inflation remain high. High oil prices continue to weigh on the external and fiscal balances, investment is weak, and international reserves cover less than three months of imports.

"Policy and reform implementation has improved further since the Third Review. The Tunisian authorities remain committed to the socially-balanced approach to macroeconomic adjustment supported by the four-year EFF arrangement.

"Strong efforts are required to achieve the agreed fiscal targets. Policy priorities include stronger revenue collection, regular energy price adjustments, strict wage bill management, and reforms to ensure the financial viability of pensions.

"Further monetary tightening is warranted to reduce inflation. The CBT demonstrated its commitment to price stability by policy rate hikes, but key interest rates remain negative in real terms. Thus, policy rate should increase further to avoid further erosion of the purchasing power of the local currency and anchor inflationary expectations.

"Reducing external imbalances hinges on a market-determined exchange rate. Competitive foreign exchange auctions, backed by effective communication, would support this strategy. Sustained tightening of macroeconomic policies will help to mitigate the impact of the exchange rate depreciation on debt.

"The authorities' reform agenda depends on maintaining adequate social protection. The recent decision to broaden coverage of vulnerable families benefiting from social transfers, also captured in the new QPC on social spending, should be implemented quickly. Completing the database of vulnerable households will be critical for better social targeting. Any changes in subsidies for food staples should only be considered once adequate safety nets are in place.

"Continued business climate, governance, and financial sector reforms are critical. The authorities should maximize the impact on growth of the new one-stop shop for investors, the negative list of investment authorizations, and the Start-up Act. The appointment of the members of the High Anti-Corruption Authority would be an important step to strengthen enforcement of existing laws and regulations. In the financial sector, the resolution of the BFT, further strengthening of supervisory framework, and progress on the AML/CFT regime are needed.

"Strong program implementation is necessary to reduce macroeconomic imbalance and foster inclusive growth in the difficult political and security environment. Continued support of the donor community is critical for Tunisia's successful transition."

INTERNATIONAL MONETARY FUND

TUNISIA

September 17, 2018

FOURTH REVIEW UNDER THE EXTENDED FUND FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

EXECUTIVE SUMMARY

The recovery continues in a difficult environment. The recovery has proceeded broadly as expected in the Third Review, notwithstanding elevated socio-political tensions and a further increase in oil prices. Growth accelerated to 2.8 percent in the second quarter driven by agriculture and tourism, inflation decelerated to 7.5 percent in August, and the current account deficit for the first half of the year improved by one percent of GDP. However, investment remains weak, unemployment is high especially among the youth and women, and the Tunisians' purchasing power is eroding. The fiscal deficit at end-July was lower than expected, reflecting the 2018 tax package and improved collection. The authorities met all Quantitative Performance Criteria and implemented two out of the three Structural Benchmarks due for the Fourth Review, notably the competitive central bank foreign exchange auctions.

Outlook and policy mix for the Fourth Review. In 2018, growth is on track to reach at least 2.6 percent, inflation would be contained to an average of 7.8 percent, external and fiscal deficits improve for the first time since 2014, and international reserves increase to 3.4 months of imports. Following through with the policies and reforms supported by the Fourth Review—notably energy subsidy reforms, strict controls on public sector hiring and remuneration, long-due progress with pension reform, further monetary tightening to contain inflation and high central bank refinancing, and steadfast implementation of the competitive FX auctions—will be essential to protect the ongoing recovery and firm up the stabilization in a difficult domestic and external environment.

Risks. Slippages in policy and reform implementation due to continued elevated socio-political tensions and a deterioration in security remain the key risks. External risks include the persistence of high oil prices, rising trade tensions, worsening sentiment vis-à-vis emerging markets, and tighter global financing conditions. These could weigh on external and fiscal accounts and jeopardize the forthcoming sovereign bond issuance.

Staff supports the authorities' request for completion of the Fourth Review under the EFF arrangement. This would make available SDR 176.7824 million (about US$257 million), increasing total disbursements to SDR 984.9309 million (about US$1.5 billion).

Approved By
Taline Koranchelian and Vitaliy Kramarenko

Discussions took place in Tunis during August 15-31, 2018, and continued from headquarters until September 10. The mission team comprised Björn Rother (head), Alexei Kireyev (advance team lead), Kerstin Gerling, Maria Mendez (all MCD), Olivier Basdevant (FAD), Mariam El Hamiani Khatat (MCM), Tim Willems (SPR), Robert Blotevogel (Resident Representative), and Adnen Lassoued (local economist). Monia Saadaoui (OED) participated in discussions. Staff met with the Governor of the Central Bank; the Minister of Finance; the Minister of Development, Investment and International Cooperation; the Minister in charge of Major Reforms; the Minister of Commerce; the Minister of Social Affairs; other senior officials; civil society; the corporate and banking sectors, and the diplomatic and donor community.
Samira Kalla, Ravaka Prevost, and Geraldine Cruz provided research and production assistance.

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STRENGTHENING RECOVERY, HIGH VULNERABILITIES

1. **Policy implementation continued steadily in a challenging environment.** The authorities have taken important measures to contain pressures on the fiscal and external accounts (Text Table 1). Notably, they raised energy prices further to mitigate the impact of the oil price shock and introduced competitive central bank foreign exchange (FX) auctions to facilitate exchange rate flexibility. These measures were taken despite heightened political tensions weighing on the unity government, a terrorist attack on a military convoy in July, and growing social discontent with rising prices and persistently high unemployment. Pressures for a less constraining central government budget for 2019, a major election year, are building.

Text Table 1. Tunisia: Key Reforms Implemented in 2018

Fiscal Policy	Monetary and Exchange Rate Policy	Structural Reforms
• An ambitious **revenue package** (2.2 percent of GDP), which helped to substantially improve tax collection in the first semester. • **Energy price increases:** - Fuel price adjustments in January, April, June, and September, and planned for November. Fuel prices remained about 25 percent below market prices in early September. - Energy and gas price hikes in May, August and September; and planned for October and November. • **Wage bill reforms**: Maintenance of the government's position: - not to grant new wage increases in 2018; and maintain a nominal wage bill freeze 2019; - limit new recruits to the civil service to 3,000 in 2018 and 2019 (25 percent replacement ratio); and - identify about 6,600 civil servants for departure from the service, of which 5,000 through the early retirement scheme and 1,600 through the voluntary separations.	• Two **policy rate increases** by an unprecedented 100 bps in June, following 75 bps in March. • **Broadening of the interest rate corridor** from +/- 25 basis points to +/- 100 basis points in January. • **Competitive FX auctions** starting in August. • Observance of **monthly FX intervention ceiling** (IT) from March through July; breach by a small margin of US$18 million in August (MEFP Table 1).	• Creation of a **one-stop shop for investors**. • Parliamentary passage of the **laws supporting public bank restructuring**. • Adoption of the **reform law for public pension fund** by the Council of Ministers, and commitment to seek parliamentary approval in October. • Completion of the **functional reviews of four key ministries**. • Extension of the National Program of **Assistance to Vulnerable Families** in January and June.

2. The recovery has strengthened but macroeconomic vulnerabilities remain elevated (Figures 1-5, MEFP¶¶3-9):

- ***GDP growth continued to improve.*** It reached an annualized 2.8 percent in the second quarter, up from 2.5 percent in the first, thanks to an exceptional harvest and tourist arrivals that reached levels last seen in 2010. The phosphate sector also recovered in the second quarter, although new production disturbances emerged in August. Strong consumption and slightly improved exports supported growth, while investment remained weak. Unemployment affected 15.4 percent of the total work force at end-June, and a much higher share of youth and women.

- ***Inflation plateaued at an annualized 7.5 percent in August, down from 7.8 in June.*** This deceleration reflected mainly a drop in food prices, while core inflation persisted at a higher level (7.7 percent). Inflation pressures remain broad-based and have only started to respond slowly to the monetary tightening that started in April 2017. The loss of purchasing power is widely felt, even if the most vulnerable households have been partly shielded as the authorities manage the prices for staples consumed mainly by the poor (Annex I).

- ***The monetary policy stance remains expansionary, even after the recent tightening.*** Policy interest rate hikes of a cumulative 250 basis points since April 2017 have made credit more expensive (as of August, on average, firms paid 8.1 percent for investment credits and households 9.4 percent for consumer credit), and credit and reserve money growth slowed in the second quarter to 13 percent and 15 percent, respectively. The money market rate, however, remains negative in real terms by about 50 basis points. In addition, central bank refinancing of commercial banks reached a record TD 17 billion at end-July in response to strong demand for foreign exchange and domestic currency during the summer and the harvest season, before declining to TD 16.4 billion in August.

- ***Fiscal performance through July was strong, but public debt will increase further.*** Tax revenue continued to perform strongly, supported by the 2018 tax package and reinforced tax and tax arrears collection. Non-tax revenue benefitted from higher profit transfers by the central bank and energy companies. Current expenditure remained below projections. Lower spending on separation packages (due to weak interest in the voluntary departure schemes) and containment of budget transfers to the CNRPS public pension fund through strong arrears collection have offset unanticipated pressures from a wage increase for military personnel and delays in pension reform. Energy price adjustments contained subsidy overruns to date. Social spending increased in real terms, including through higher cash transfers to the vulnerable. Because of the depreciation of the Tunisian dinar, public debt is projected to rise to about 72 percent of GDP in 2018, from 70.3 percent in 2017.[1]

- ***The recent real exchange rate appreciation is threatening the current account turnaround.*** Despite higher international oil prices, the current account deficit declined to 11 percent of GDP (y-o-y) at mid-year compared to 12 percent over the same period in 2017. Export volumes

[1] A 10 percent nominal depreciation increases the public debt-to-GDP ratio by about 7 points.

increased by more than import volumes (6.5 and 1.1 percent respectively), helped by the 17 percent real effective depreciation recorded over 2016–17. Tourism receipts and remittances improved by 37 and 9 percent, respectively. However, low exports of phosphates and robust import demand for consumption and energy products have continued to weigh on the external balance. Moreover, the real depreciation came to a halt in 2018 as the growing inflation differential with main trading partners overcompensated the 7 percent dinar depreciation against the Euro experienced since the start of the year (Annex II).

- ***International reserve coverage remains low, at 71 days of imports at end-August***. Reserves stood at only 75 percent of the IMF's reserve adequacy level, broadly unchanged since the Third Review, reflecting delays in both the sovereign Eurobond issuance and official loans (see ¶27).

- ***Financial markets continued to be resilient, notwithstanding international developments.*** The stock market index grew by 34 percent since January, reaching a record high in mid-August. Spreads on Tunisia's international bonds increased slightly, reflecting more volatile investor sentiment toward emerging markets, but remaining below levels seen in 2017.

3. The authorities recorded a strong performance on program conditionality.

- ***All end-June quantitative targets were met*** (MEFP¶10 and MEFP Table 1). The Quantitative Performance Criteria (QPCs) on the primary fiscal balance and total current primary expenditure were met by wide margins reflecting strong revenue collection, contained current expenditure, and slow execution of domestically financed capital expenditure. The QPCs on net international reserves (NIR) and on net domestic assets (NDA) were also met, with adjusters correcting for delays in external financing, especially the Eurobond issuance that was initially expected for the second quarter. In addition, the authorities met two out of three Indicative Targets (ITs), including on social spending. There was a small slippage on the monthly FX intervention ceiling in August.

- ***The authorities progressed on the Structural Benchmarks (SB) set for the Fourth Review*** (MEFP¶11 and MEFP Table 2). The two SBs on fuel price adjustments and the competitive central bank FX auctions were met. The SB on the resolution of the Banque Franco Tunisienne (BFT) would need to be reprogrammed (see ¶26). Other SBs set for future Reviews are on track, including the performance contract for TUNISAIR.

- ***A Prior Action (PA) on energy price hikes was implemented in September*** (MEFP¶14 and MEFP Table 2). To safeguard most of the savings agreed in the Third Review on the energy subsidy bill, the authorities implemented as a PA price increases for fuel, electricity, and gas effective September 1; and issued an administrative order announcing additional increases for electricity and gas in October and November.

IMPROVED OUTLOOK, MOSTLY DOWNSIDE RISKS

4. An improved macroeconomic outlook hinges on continued policy implementation. Real GDP growth is on track to reach 2.6 percent in 2018, driven by agriculture and tourism (Text Table 2). Growth would reach 4 percent over the medium term on the back of a strong recovery in mining, manufacturing and non-manufacturing industries, and construction; and supported by increasing public and private investment and exports. A tightened monetary policy stance would contain average inflation at 7.8 percent in 2018 and support a multi-year deceleration thereafter. With strong fiscal discipline to offset the impact of the oil price shock, the overall fiscal balance would decline to 5.2 percent of GDP in 2018, and—combined with sustained exchange rate flexibility—help reduce the current account deficit to 9.7 percent of GDP. Public debt would peak at 72 percent of GDP in 2018 (about 2 percentage points higher than projected in the Third Review, due to the higher exchange rate flexibility) and external debt at 93 percent of GDP in 2020, before starting to decline. International reserves would increase to four months of imports by 2020, or about 110 percent of the IMF's reserve adequacy metric providing that the dinar remains classified as a floating currency.[2]

Text Table 2. Tunisia: Selected Economic Indicators, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Proj.					
Real GDP growth (percent)	1.2	1.1	2.0	2.6	3.1	3.4	3.6	4.0	4.0
Consumer price index growth (period average, in percent)	4.9	3.7	5.3	7.8	7.0	5.7	5.2	4.5	4.0
Gross public debt (percent of GDP)	55.4	62.3	70.3	72.0	71.8	70.8	69.8	68.0	66.7
External debt (percent of GDP)	62.7	66.8	82.6	89.4	91.7	93.0	91.6	90.2	88.7
Current account balance (percent of GDP)	-8.9	-8.8	-10.2	-9.7	-8.5	-7.8	-7.0	-6.5	-6.0
Gross official reserves (billions of US$)	7.4	5.9	5.9	6.3	7.3	7.8	8.0	8.9	9.5
Gross official reserves (months of next year's imports of goods)	4.8	3.6	3.3	3.4	3.8	4.0	4.0	4.3	4.6

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

5. Risks to the program remain elevated (RAM, Annex III). Continued socio-political tensions, which could increase in the run-up to the 2019 presidential and parliamentary elections, and security threats remain the most important domestic risks. The external environment has also become more difficult. High oil prices, rising trade tensions, tight global financial conditions, and contagion from adverse market sentiment vis-à-vis other emerging market countries may put fiscal and external adjustment targets under pressure. Moreover, Tunisia has recently become the number one country of origin for illegal immigration into the European Union (EU), possibly fueling security pressures and brain drain.

[2] Since the Third Review, the de facto exchange rate arrangement has been reclassified to floating from a crawl-like arrangement (see AREAER, 2017).

URGENT MEASURES TO PROTECT THE RECOVERY

6. **The three-pillar policy framework supported by the EFF remains pertinent.** The authorities and staff agree on the need to continue to stabilize and strengthen the economy, including to absorb the oil price shock and higher uncertainty (Section A); ensure adequate social protection (Section B); and foster private sector-led, job-creating growth (Section C). The Fourth Review offers an opportunity to build on recent gains and consolidate efforts to deliver the envisaged gradual adjustment as a prerequisite for improved growth performance over the medium term. Continued discipline in policy and reform implementation will be critical to remain on course in a more difficult domestic and external environment, and to ensure that Tunisia enters the 2019 election year with higher policy buffers.

A. Reducing Macroeconomic Imbalances

Fiscal Policy

Background

7. **The agreed consolidation path for 2018–20 remains the fiscal anchor**. The authorities remain committed to reducing the overall deficit, excluding grants, to 2.7 percent of GDP by 2020, notwithstanding the higher-than-expected oil price forecasts for 2018–19. This will be essential to reduce the public debt and re-orient expenditure toward social sectors and investment. An adjustment of about 1 percent of GDP in 2018 remains possible with strong revenue performance, provided that discipline on current expenditure continues. Sustained rationalization of current expenditures will even become more important over 2019-20, as Tunisia's revenue take is already high relative to peers: the growth of the wage bill would continue to slow, budget outlays on energy subsidies fall, and pension transfers decline gradually. Managing contingent risks from state-owned enterprises (SOEs) also remains a priority.

8. **Mounting pressures on the 2018 budget continue to require immediate attention.** While revenue overperformed through July (see ¶2), budget pressures further increased. These pressures mainly reflect the continued increase in international oil prices (about 0.2 percent of GDP) and the delay in implementing the energy price adjustments agreed in the Third Review (0.6 percent of GDP) because of heightened political tensions (Text Table 3). In addition, the medium-term wage bill path is under threat: the authorities authorized a TD 70 million (0.1 percent of GDP) increase for the Ministry of Defense agreed in 2015 after the

Text Table 3. Tunisia: Changes in Fiscal Program, 2018
(Percent of GDP)

Overall deficit target (including grants)	**5.2**
Additional spending pressures	**1.1**
Higher energy subsidy bill	0.8
Energy price adjustments planned at Third Review	0.6
Higher international oil prices	0.2
Higher domestic and international food prices	0.2
Higher military wages	0.1
New adjustment measures	**1.1**
Energy price adjustments planned at Fourth Review	0.5
Higher tax revenue	0.3
Lower one-off costs for departure packages	0.1
Lower interest payments	0.1
Lower CNRPS transfers thanks to stronger arrears collection	0.1

Sources: Tunisian authorities and IMF staff calculations.

July 8 terrorist attack on a military convoy; and failed to elicit sufficient interest in the voluntary departure scheme. Absent further measures, these factors would lead the 2020 wage bill-to-GDP ratio to increase to about 12.9 percent. This level still represents a significant drop from the 15.5 percent of GDP in 2017 (after accounting for the wage increases administered to civil servants through tax credits rather than as part of the official wage bill) but would be higher than initially envisaged (12.4 percent by 2020). Third, Parliament delayed the consideration of the reform law for the CNRPS public pension fund that seeks to mobilize higher contributions from employers and employees while raising retirement age.

Policy Discussions

9. The authorities are taking urgent measures to achieve the 2018 deficit. Parliament is set to consider a supplementary budget law in October. This will facilitate budget re-orientation to accommodate a higher energy subsidy bill due to the oil price shock (the total energy subsidy budget would increase to TD 3 billion from TD 1.5 billion in the budget law, leaving another TD 1.5 billion need to be eliminated by energy price hikes and other measures). Relative to the Third Review, feasibility of the 2018 deficit target of 5.2 percent of GDP (corresponding to 5.5 percent of GDP excluding grants), depends on taking the measures discussed below, as well as on using the fiscal space created mainly by higher-than-expected collection of personal income tax and the lower-than-expected bill for financing volunteer separation packages for civil servants (Text Table 3):

- ***Energy prices adjustments.*** The authorities committed to remedy the slippages on energy price adjustments accumulated over the summer, supported by Prior Action (MEFP¶14 and Table 2). First, to replace the originally agreed monthly fuel price increases, they implemented an average 5.5 percent hike in fuel prices on September 1, to be followed by a similar increase in November. Staff would have preferred a monthly schedule of pre-set increases to depoliticize the adjustments, but the authorities argued that the quarterly schedule with ad hoc-adjustments would be better aligned with popular expectations. Second, more than two-thirds of the electricity and gas tariff adjustments committed under the Third Review were implemented in early September; and an administrative order stipulates further hikes in October and November. There was also progress on other energy sector measures, such as accelerated arrears clearance to the energy companies and product differentiation strategies, to contain the energy subsidy bill in 2018 and ensure that it does not exceed TD 3 billion even with higher-than-expected international oil prices through end-2018 (an average US$72 per barrel compared to US$70 at the time of the Third Review). The authorities and staff agreed on the need to protect vulnerable families from the energy price increases through adequate social transfers and the focus of the price hikes on corporate customers and upper-income households (see ¶¶20-21).

- ***Wage bill containment.*** Staff urged the authorities to strictly maintain their policy of abstaining from any new wage increases in 2018 and adhere to the agreed hiring limits. The authorities underlined that there would be no space for any wage increases in the budget; and that they will keep hiring to a minimum for the foreseeable future (a replacement ratio of no more than 25 percent; and no replacement for volunteer departures), even if the phasing in of the higher pension age over 2019-20 will work against natural attrition.

- ***Pension fund reform.*** The authorities indicated that delays in reforming the public (*Caisse National de Retraite et Prévoyance Sociale*, CNRPS) and private (*Caisse Nationale de Securité Sociale*, CNSS) pension funds will not create additional pressures for 2018 (see MEFP ¶¶21). They also confirmed that the reform of the private pension fund would be launched immediately after the approval of the reform law for the public fund expected in October, based on similar parameters.

10. The authorities and staff agreed on the broad contours of the 2019 budget law. Preparations for the budget law are still at an early stage, but the authorities reconfirmed their commitment to the objectives agreed at the Third Review (MEFP ¶16): the budget would target an overall fiscal deficit, excluding grants, of 3.9 percent of GDP. This entails a steady revenue take, reduced current spending, and increased social and capital spending. Priorities of the emerging budget draft to achieve these objectives and manage high risks include:[3]

- ***Revenue mobilization.*** The authorities see limited scope for further revenue measures, noting that the phasing out of tax credits for civil servants will increase revenues from personal income tax. They will, however, include two new measures in the 2019 Budget Law—with limited immediate revenue impact but importance for fairness. First, they plan to eliminate the preferential tax regime for offshore companies, first for new firms in 2019 and then for all firms in 2021 (*new December 2018 SB*). Moreover, the authorities will seek to increase the VAT rate for the services of liberal professions from 13 to 19 percent (*December 2018 SB*). In addition, they intend to further reinforce collection efforts and modernize tax administration. This will entail advancing the integration of all tax administration functions (administration, audit, and recovery) within one umbrella structure.

- ***Expenditure reorientation.*** The authorities remain focused on limiting current expenditure to some 24.2 percent of GDP. This will make room for increasing public investment to 5.4 percent of GDP and maintaining higher social spending. They agreed with staff that containing the wage bill to 14.0 percent of GDP in 2019 and reducing it to 12.4 percent of GDP by 2020 remains a priority that requires strict hiring limits and the non-granting of wage increases absent a significant—and unanticipated—change in broad macroeconomic parameters. Staff emphasized that the Fifth Review will focus on the 2019 budget and entail discussions on additional wage bill measures for 2019-20 that are necessary to correct for recent slippages and keep the wage bill on track towards its 2020 target level. The authorities and staff also agreed on the need to further reduce energy subsidies by proceeding with periodic energy price adjustments in 2019, flanked by efficiency measures targeting the public enterprises distributing fuel, electricity, and gas. Staff emphasized the benefits of moving from the current practice of ad hoc changes to more automatic, frequent price adjustments based on a transparent formula. The authorities concurred with staff's recommendations to urgently complete the first stage pension reform and move to the next stage quickly (see ¶¶20-21, MEFP¶21); advance the ongoing work on a better

[3] The authorities also agree that fiscal reforms in support of medium-term deficit consolidation need to continue, supported by technical assistance chiefly from the World Bank, *Agence Française de Développement* (AFD), European Union (EU), and the IMF.

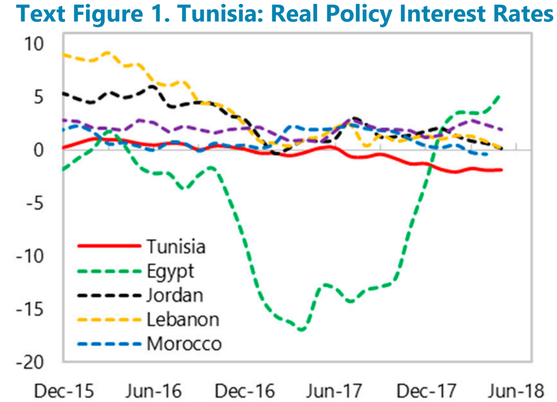
targeting system for social spending (see ¶¶20-21, MEFP¶21); and strengthen the oversight of SOEs and treasury cash management (MEFP¶25).

Monetary Policy

Background

11. Monetary policy remains expansionary, even if credit growth decelerated in July. The real money market rate (MMR) remains negative (Text Figure 1); and CBT refinancing of commercial banks remains elevated at a record level of TD 16.4 billion at end-August. This policy stance continues to fuel demand for credit as economic agents worry about inflation trends and the path of the dinar, albeit credit to the economy decelerated slightly in July. In turn, the mobilized credit increasingly translates into FX demand from importers to take speculative positions against the dinar in their FX accounts; and into increased import demand, notably for consumer durables.

Text Figure 1. Tunisia: Real Policy Interest Rates



Sources: National authorities, Haver, and IMF staff calculations.
Note: For Lebanon, the average deposit rate is used.

12. Transmission channels remain weak, creating long lags for policy tightening. The cumulative effect of past increases in the policy rate has started to slow credit growth, notably to households. However, the impact on inflation is not yet fully visible because of the slow transmission with delays of about 12–18 months, reflecting weak interest rate and credit channels. The strong and still increasing demand for cash—due to seasonal factors and strong informal sector activity—has been further complicating monetary policy, as it weakens the stability of reserve money as well as the money multiplier.

Policy Discussions

13. Continued monetary tightening remains essential to reduce inflation (MEFP ¶17). The CBT confirmed its commitment to fighting price pressures by increasing the policy rate to bring real interest rates firmly into positive territory, with the pace and timing being dependent on inflation outcomes and forecasts. Staff agreed with the data-driven strategy to observe upcoming inflation readings after a cumulative 250 basis points increase since 2017. It emphasized, however, that further tightening would likely be required soon, as underlying inflation accelerated in August and dinar depreciation has been continuing. Additional policy rate increase over the next months should help minimize any further loss of the population's purchasing power. Staff also suggested to the CBT to consider setting an explicit medium-term inflation objective (Annex IV) and communicate clearly its objectives, policies, and instruments by re-instating the practice of issuing quarterly monetary policy reports that could include medium-term projections of inflation and growth (*new June 2019 SB*).

14. Monetary policy transmission channels should be strengthened (MEFP ¶17). Staff urged the authorities to quickly raise the cap on lending rates for commercial banks from 20 percent to 33 percent and to adjust it more frequently than semi-annually. The authorities agreed but cautioned that the respective draft law has long been transmitted to Parliament, where it faces significant opposition (*December 2018 SB*). Staff encouraged the authorities to reach out to Parliamentarians on the importance of the law. Staff also advised to streamline CBT refinancing operations that have been fueling further FX demand, notably structural OMOs and FX swaps (Annex IV). The authorities agreed in principle, emphasizing the need for a gradual approach given tight liquidity conditions. To protect the central bank balance sheet, staff recommended a further tightening of CBT collateral policy in line with IMF MCM TA recommendations from October 2013. The authorities are considering these recommendations, as well as the introduction of a new regulation by end-2018 to reduce commercial banks' loan-to-deposit ratio. Staff also encouraged the CBT to continue work on upgrading its communications framework (Annex V).

15. Safeguards assessment recommendations should be implemented. A number of the 2016 safeguards recommendations remain outstanding. In particular, the central bank should complete the restructuring of its internal audit to align current practices with international standards and develop a risk management function through the establishment of a risk committee and the approval of a formal policy. Staff will continue to engage with the authorities on these issues.

Exchange Rate Policy

Background

16. Exchange rate flexibility remains key to strengthen the current account and reserves (MEFP ¶¶19-20). The depreciation of the real effective exchange rate over 2016–17 contributed to improving the current account and helped the build-up of international reserves in 2018—albeit these remain below comfortable levels. The authorities and staff agreed that enhanced exchange rate flexibility will be needed to facilitate further real exchange rate adjustment going forward, given Tunisia’s high inflation differential relative to trading partners that will only decline gradually over the next 2-3 years, and strengthen reserve coverage. The authorities also pointed to the distorting effect of large energy subsidies on import demand. They emphasized that the new Nawara gas field operations have the potential to reduce the energy import bill by up to 1 percent of GDP from 2019. The long-delayed Eurobond issuance (targeting up to US$ 1billion) is now expected for the fourth quarter of 2018. The authorities confirmed that the exchange rate restriction imposed in October 2017 (a ban on trade credit for non-essential imports) has only played a minor role in discouraging imports.

17. CBT’s FX auctions have become more competitive in August. The first two competitive FX auctions were conducted on August 1 and August 8, allocating FX to the highest bids (*met August 2018 S*B). This transition has triggered an accelerated depreciation of the dinar, which fell from 3.14 dinars to the Euro on July 31 to 3.21 dinars on August 31. At the same time, banks responded to the new practice by reducing their net open FX positions. To facilitate the transition to

the new mechanism and cover a maturing energy import bill during the transitory phase, the CBT intervened through one bilateral FX sale for a small amount (US$6 million).

Policy Discussions

18. Competitive FX auctions are expected to achieve more exchange rate flexibility (MEFP ¶¶19-20). The authorities and staff agreed that it will be essential to maintain the new auction practices in the months ahead, helped by effective communication on the new mechanism and past auction results to market-making commercial banks. This would reduce policy uncertainty. At the same time, the CBT expressed concerns about the ceiling on central bank FX interventions set under the program and argued in favor of more flexibility, especially in this critical transition phase. With reserve buffers still low, staff emphasized that there is currently no room to relax the intervention budget. It suggested, however, to reassess the issue as the CBT accumulates more experience with the competitive auctions. The authorities and staff agreed that these auctions will be critical for achieving more flexibility of the exchange rate, improving the current account, and strengthening Tunisia's international reserve to at least 3.4 months of imports by end-2018.

19. The October 2017 exchange restriction will be eliminated. The authorities confirmed their intention to remove the exchange restriction introduced last October by end-2018 (MEFP¶20). Capital account liberalization would only proceed in line with progress on developing domestic financial institutions and upgrading prudential supervision (MEFP¶24).

B. Ensuring Adequate Social Protection

Background

20. The authorities progressed with measures to ensure adequate social protection. Social spending will surpass the quarterly floors set at the Third Review (MEFP Table 1) for the new QPC, as the authorities have started to replenish Tunisia's main social programs adopted in January and June 2018 (the national assistance program to vulnerable families, and the free and subsidized health care support programs for vulnerable and low-income families). Supported by the World Bank, they have also continued to work toward better targeting social services through cash transfers, subsidized health services, and reform of energy and food subsidies (MEFP ¶21): crucially, the database of vulnerable households would cover 550,000 registrations by end-2018 (*December 2018 SB*), of which 85 percent are already processed; and evaluate effective targeting mechanisms. Pension reform remains stalled in Parliament, but the authorities did not foresee any additional budgetary impact thanks to the higher-than-expected arrears clearance by the two pension funds from their respective employer bases. A direct pass-through of contributions and arrears clearance has continued to improve the liquidity situation of the medical insurance fund (*Caisse Nationale d'Assurance-Maladie*, CNAM), eliminating the short-term need for further government support.

Policy Discussions

21. Further progress remains crucial to reduce hardship among the most vulnerable (MEFP ¶21). The authorities and staff strongly agreed on the need to continue the increase in social spending started in 2018, despite significant budget pressures. There was also consensus on the urgency of better targeting to enhance the efficiency of social policies, which could realistically start for the 2020 budget exercise. In this context, staff encouraged the authorities to accelerate the issuance of the unique social identifier (USI). On pensions, the authorities and staff agreed that the currently envisaged reforms remain insufficient to close the gap between benefit levels and resources. As at the Third Review, staff encouraged the authorities to continue their work with donors on the second stage of reforms that need to involve deeper parametric changes to ensure fiscal sustainability. The authorities explained that discussions with social partners on the next steps with pension reform could start after the adoption of the pension law for the CNRPS and the decree for the CNSS, which are now expected before the end of 2018.

C. Fostering Inclusive Growth, Fairness, and Better Governance

Business Climate and Governance

Background

22. The agenda has not changed significantly since the Third Review. The one-stop shop for investors, the negative list of investment authorizations, and the Start-up Act are welcome reforms. It is now important to follow through with implementing these and other reforms that can quickly change the experience for firms in Tunisia. Broadly consistent with the staff analysis in the 2017 Article IV on constraints to growth, clear opportunities exist (Table 13)—for example, in the areas of the tax regime and access to credit—to improve the attractiveness of Tunisia as a business location. On governance, the operational start of the High Anti-Corruption Authority is still affected by the delays in Parliament consideration of the shortlist of its potential Board members (*December 2018 SB*).

Policy Discussions

23. Progress on business climate and governance remain critical for inclusive growth (MEFP ¶¶22-23). Staff urged the authorities to build on recent momentum and move ahead with business climate reforms and energy sector restructuring, supported by the World Bank and others. On governance, the authorities and staff discussed possible enhancement in policy frameworks (for example, more resources and stronger investigative powers for the High Authority relative to the current interim institution of about 70 staff; better donor coordination in helping governance-related projects targeting customs, the health sector, municipalities, and security services; as well as stronger enforcement of existing laws and regulations, including the asset declaration system). Both sides reconfirmed the importance of establishing the Board of the High Authority by end-2018.

Financial Sector Policy

Background

24. The banking sector remains stable and financial sector reforms advanced. Most banks are observing prudential ratios on a continued basis, and non-performing loans represented 13.9 percent of total loans in the first quarter of 2018, down from the peak of 16.6 percent in 2015. Although still high, the NPL ratio is expected to fall further as public banks are making progress with their problem loan workouts, supported by the recently adopted legislation on write-off and resolution and better internal processes. At the same time, the vote by the resolution committee on the BFT had to be postponed allowing for adequate information provision to the committee but is legally required by November (*missed August 2018 SB, reset programmed for November 2018*). On banking supervision, the authorities issued a circular on new capital adequacy standards to account for market risk and advanced plans for a modern collateral registry to improve access to credit. Finally, on the Anti-Money Laundering/Combatting the Financing of Terrorism (AML/CFT) agenda, recent achievements include the reinforcement of the Tunisian Financial Analysis Commission and the adoption of several legislative texts to enhance transparency and accountability for key sectors and persons of interest. The authorities' follow-up report requests re-ratings on 17 recommendations, including risk management, and is due for evaluation in October 2018.

Policy Discussions

25. Urgent priorities include improving access to credit and tackling AML/CFT issues (MEFP ¶24). Staff encouraged the authorities to advance with plans to improve access to credit, especially for SMEs that suffer from weak capacity and exposure to elevated risk premia. In this context, staff highlighted the importance of adopting pending legislation, such as that on credit bureaus, a modern collateral registry, and collective procedures. Upgrading the payments system is also crucial as it would enhance efficiency and help with the authorities' de-cashing strategy. New measures to improve the AML/CFT framework (e.g., preventive measures, entity transparency, and targeted financial sanctions) should aim at completing the action plan set out by FATF, due for evaluation in October. The adoption by Parliament of the organic law on money laundering is particularly important. The authorities and staff agreed on the need to further strengthen financial sector supervision and regulation to ensure reliable and timely information on the health of financial institutions in the context of monetary tightening and more exchange rate flexibility.

PROGRAM ISSUES AND MODALITIES

26. Strong and focused conditionality continues to guide program implementation. The quarterly review framework remains adequate for program monitoring.

- ***Quantitative targets*** (MEFP Table 1). Staff proposes to (1) set new targets for end-June 2019 and (2) revise the QPCs for end-September, end-December 2018, and end-March 2019:

  (i) the floor on the primary balance would be slightly tightened for 2018 and 2019;

(ii) the ceilings on primary expenditures would be increased to accommodate higher energy subsidies;

(iii) the end-September floor on social spending would be slightly reduced due to a reprogramming of the seasonal pattern of these expenditures;

(iv) the ceiling on NDA will be increased due to lower-than-programmed money velocity and multipliers; and

(v) the floor on NIR will be reduced to reflect the large shortfall in expected FX flows.

- ***Structural benchmarks*** (MEFP Table 2)**.** Staff also proposes to reprogram the SB on the BFT vote to November 2018, and to set two new SBs on: (1) the 2019 budget law eliminating the preferential tax regime for off-shore companies; and (2) the publication of quarterly monetary policy reports by the CBT from June 2019 at the latest.

- ***Budget support.*** As before, all funds would be made available for budget support.

Text Table 4. Tunisia: Cumulative External Financing of the Central Government Budget, 2016–20
(In millions of U.S. dollars)

	2016	2017	2018				2019				2020
	Q4	Q4	Q1	Q2	Q3 Proj.	Q4 Proj.	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Q4 Proj.
Total budget grants and loans	**1,872**	**3,748**	**488**	**830**	**1,759**	**3,439**	**488**	**970**	**1,945**	**3,548**	**3,019**
Budget grants	**57**	**89**	**0**	**0**	**64**	**90**	**0**	**0**	**38**	**86**	**82**
o/w EU	57	89	0	0	64	85	0	0	38	86	82
Budget loans	**1,814**	**3,659**	**488**	**830**	**1,695**	**3,349**	**488**	**970**	**1,908**	**3,462**	**2,936**
Multilateral	835	1,260	395	518	1,269	1,694	423	712	1,510	1,758	1,282
African Development Bank (AfDB)	477	144	150	150	150	150	0	0	0	0	55
Arab Monetary Fund (AMF)	0	0	0	120	120	120	0	40	40	40	0
European Union (EU)	0	345	0	0	0	174	175	175	175	175	176
IMF	316	315	245	245	496	747	248	497	745	994	500
World Bank	42	456	0	3	503	503	0	0	550	550	550
Bilateral	0	1,000	0	119	119	235	0	117	117	234	235
G7	0	0	0	119	119	235	0	117	117	234	235
o/w Germany	0	0	0	119	119	235	0	117	117	234	235
Other	0	1,000	0	0	0	0	0	0	0	0	0
Market issuance and other	979	1,399	94	193	307	1,420	65	142	281	1,469	1,420
Market issuance	497	905	0	0	0	1,000	0	0	0	1,050	1,100
Project loans	356	405	64	149	200	253	53	119	188	256	272
Multilateral	0	0	52	114	164	218	53	119	188	256	272
Bilateral	356	405	12	35	35	35	0	0	0	0	0
Loan transfers to SoEs	126	89	30	44	108	167	12	23	93	164	48
Multilateral	126	89	25	35	41	43	12	23	34	46	48
Bilateral	0	0	5	8	66	124	0	0	59	117	0
Other (sukuk)	0	0	0	0	0	0	0	0	0	0	0

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

27. **The program remains fully financed, but risks are extremely high**. Financing assurances from donors and the Eurobond issuance will cover financing needs for 2018–20 (Text Table 4). However, this financing will be US$825 million lower in 2018 than programmed at the Third Review, mainly because of the lower volumes sought on markets (-US$500 million), delays in donors' budget support (-US$280 million), and lower grants (-US$45 million). The outlook over the medium term is clouded as some donors run into headroom issues (including the World Bank and African Development Bank) or ponder lower engagement levels for other reasons, including budget

pressures. Staff will continue to work closely with Tunisia's other external partners to ensure adequate financial support throughout the critical adjustment phase.

28. Tunisia maintains the capacity to repay the IMF. Credit outstanding to the IMF will peak at 372 percent of quota in 2020. Obligations to the IMF will reach a maximum of 1.4 percent of GDP or 22 percent of external debt service in 2018. In a more adverse scenario, these ratios could rise considerably, but Tunisia's capacity to repay would remain adequate.

STAFF APPRAISAL

29. The recovery has strengthened further, but risks weigh on the outlook. Growth accelerated in the first half of 2018, supported by agriculture, tourism, and services. Investment, however, has remains weak and export performance subdued in the critical mining sector. Higher oil prices, other fiscal pressures, accommodating monetary policy, and structural challenges continue to fuel macroeconomic imbalances—notably high inflation, low international reserves, and high twin deficits. The potential for persistently high socio-political tensions in the run-up to the 2019 elections as well as for further security incidents, and the more skeptical investor sentiment vis-à-vis emerging market countries also weigh on the outlook.

30. The authorities' efforts to reduce macroeconomic imbalances are bearing fruit. The fiscal consolidation for 2018 remains on track after a strong first semester, but risks to the budget targets remain elevated. The recent series of interest rate increases may be about to start affecting monetary conditions, but high core inflation and persistently strong credit growth suggest that real interest rates are still too low. The transition to competitive central bank FX auctions was critical to facilitate a current account turnaround and the build-up of reserves. Continued strong policy and reform implementation—building on the performance demonstrated for the Third and Fourth Reviews—will be critical to maintain macroeconomic stability, protect social spending, and foster more inclusive growth to reduce high unemployment especially among the youth and women. It will also facilitate the important Eurobond issuance, now expected for the fall.

31. Continuously strong fiscal efforts are required to achieve the 2018-19 budget targets. This is particularly true with the expected higher international oil prices for 2019 and recent slippages on the wage bill. Staff welcomes the strong revenue performance recorded in the first half of 2018. It encourages the authorities to (1) press ahead with measures to recover the set-backs incurred by delays in the energy price hikes agreed at the Third Review; (2) refrain from granting any new public sector wage increases over 2018-20 and continue with a strict control on hiring; and (3) seek swift approval of the reform law for the public pension fund and proceed quickly with the respective decree for the private pension fund. Priorities for the draft 2019 budget law include the maintenance of strong revenues; restraint of current spending through continued energy subsidy reforms and strict management of the wage bill, including through additional measures; higher social spending; and an increase in investment as a share of GDP. Maintaining adequate social safety nets will be paramount for social cohesion and smooth reform implementation.

32. Further monetary tightening before end-2018 is warranted to reduce inflation. Monetary conditions are still expansionary with the policy rate remaining below inflation. Additional increases in the policy rate are thus warranted before end-2018 to avoid continuous erosion of the purchasing power, especially with increased exchange rate flexibility. It will also be critical to swiftly increase the cap on lending rates and update it more frequently. Unwinding instruments that are not essential for the functioning of the interest rate mid-corridor system, including FX swaps, would help streamline refinancing operations. To protect its balance sheet, it is critical for the CBT to further tighten its collateral policy in line with IMF MCM previous TA recommendations. Finally, re-launching quarterly monetary policy reports with forward-looking guidance on inflation projections will be important to better anchor expectations.

33. Reducing external imbalances hinges on a market-determined exchange rate. The current account deficit remains high and reserves should increase urgently to provide a buffer amid high uncertainty regarding the macroeconomic and political outlook, as well as rising global risks. These objectives are inconsistent with the halt of the real depreciation path observed in recent months. Staff hence welcomes the CBT's more competitive FX auctions, whose steadfast implementation over the coming months, together with effective communication, would reduce commercial banks' doubts about the central bank's exchange rate strategy. A sustained tightening of macroeconomic policies will help mitigate the impact of the exchange rate depreciation on debt ratios by reducing financing needs.

34. The authorities' reform agenda depends on maintaining adequate social protection. Staff very much supports the broader coverage of vulnerable families benefiting from social transfers, which is also captured in the new QPC on social spending. This augmented support should be fully implemented as soon as possible. Swiftly completing the database of vulnerable households will be critical for better social targeting, but staff calls on the authorities to proceed carefully with any changes in subsidies for basic food staples and only in line with progress on adequate safety nets. Swift adoption of the legislation necessary for the reforms of the public and private pension funds is critical to maintain their financial viability.

35. Continued business climate, governance, and financial sector reforms are critical. The appointment of the members of the High Anti-Corruption Authority before end-2018, as well as an adequate budget for the institution for 2019, would provide important signals that widespread concerns about corruption are addressed at a structural level. An important next step on financial sector reforms involves the resolution committee taking a vote on the BFT restructuring. Another priority is the further strengthening of supervisory and regulatory frameworks to better monitor risks to financial stability amid ongoing monetary tightening and more exchange rate flexibility. Staff also encourages the authorities to modernize the payments system; improve financial inclusion; and progress on the AML/CFT regime.

36. The continuation of strong donor support is critical for Tunisia's successful transition. Sizeable fiscal financing from external partners—including in the form of grants or highly concessional loans—is indispensable to help cover Tunisia's financing needs. Staff is concerned about potential donor fatigue, as commitments for 2019 and beyond remain below levels

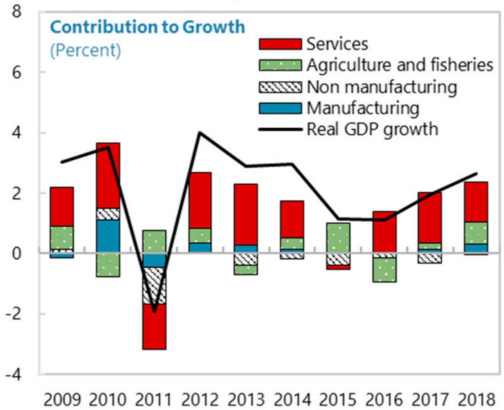
experienced in the past. Continued TA engagement remains critical to help overcome capacity constraints in upgrading policy frameworks and economic institutions.

37. Program risks remain exceptionally high. Political stalemate over reforms and security incidents are the key risks that continue to threaten Tunisia's adjustment path, especially as the country moves closer to important elections in 2019. Tunisia's external and fiscal balances are also exposed to high international oil prices, rising trade tensions, tightening of global financial conditions, and adverse shifts in investor sentiment. The authorities' continued commitment to the program, close monitoring through quarterly reviews, and the maintenance of adequate donor engagement will be essential to mitigate these risks.

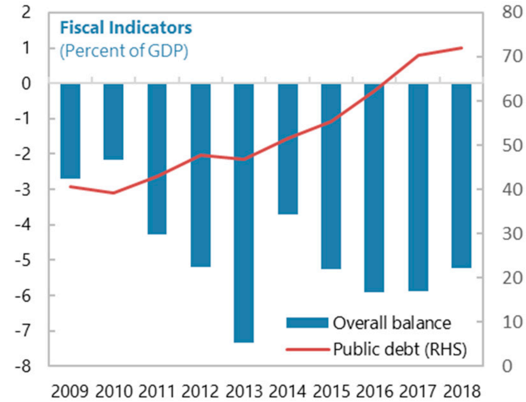
38. Staff supports the authorities' request for the completion of the Fourth EFF Review. It also supports (1) setting revised quantitative targets for end-September, end-December 2018, and end-March 2019, as well as new targets for end-June 2019; and (2) making all funds available for budget support.

Figure 1. Tunisia: Recent Economic Developments, 2009–18

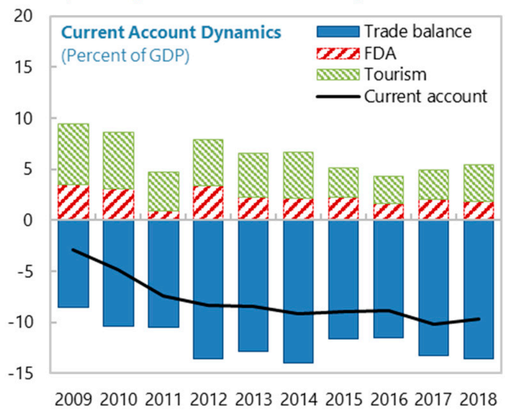
A strengthening recovery unfolds on the back of agriculture, manufacturing, and tourism.



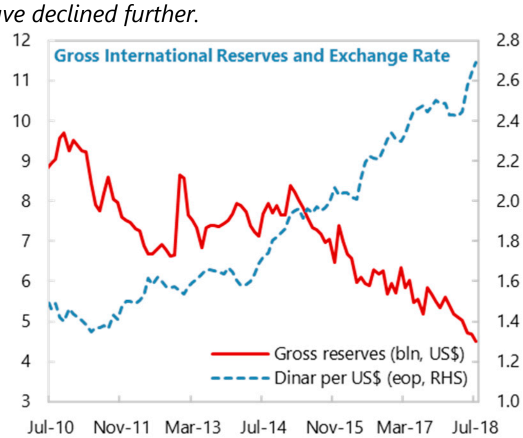
Fiscal performance is on track toward a reduced deficit in 2018, the first consolidation since 2014.



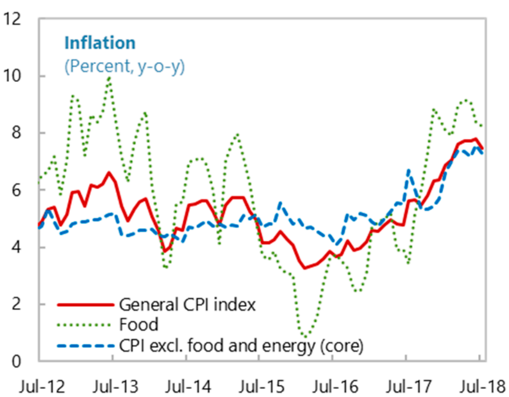
The current account is expected to improve slightly in 2018, despite higher international oil prices.



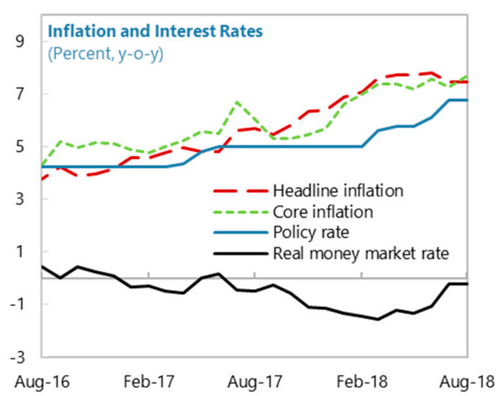
The dinar has depreciated while International reserves have declined further.



Accelerating inflation is broad-based.



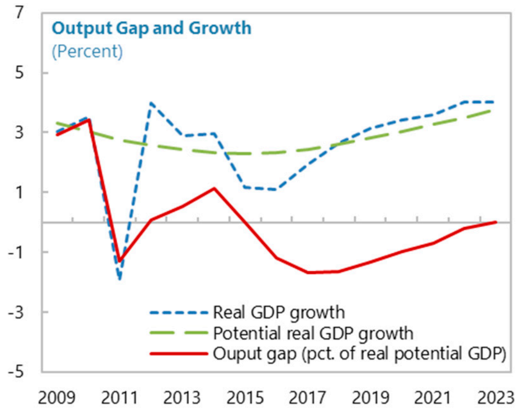
The policy rate was raised four times since early 2017, and the corridor was widened.



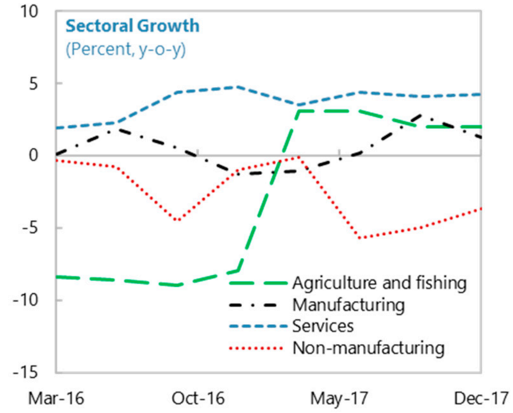
Sources: Tunisian authorities; IMF IFS; and staff calculations.

Figure 2. Tunisia: Real Sector Developments, 2009–23

A more robust recovery is underway.

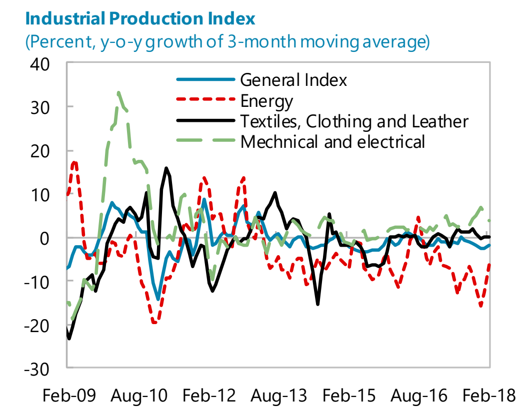


The recovery has been supported by most sectors.

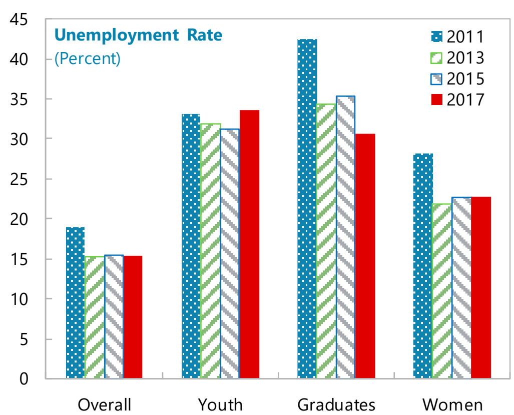


Tourism as measured by tourist arrivals continues its recovery from the shock of the 2015 terrorist attacks.

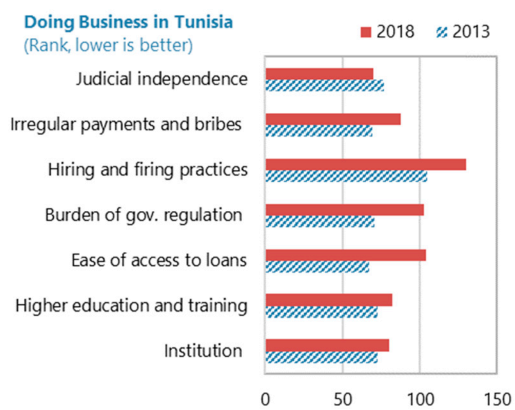
Industrial production has somewhat improved outside the extractive industries.



Unemployment remains high, especially among graduates, the youth, and women.



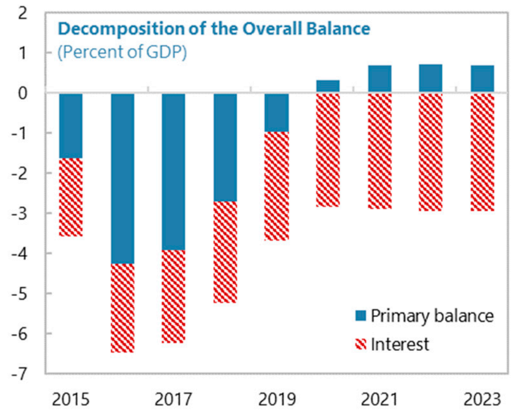
Structural reforms will help improve the business climate.



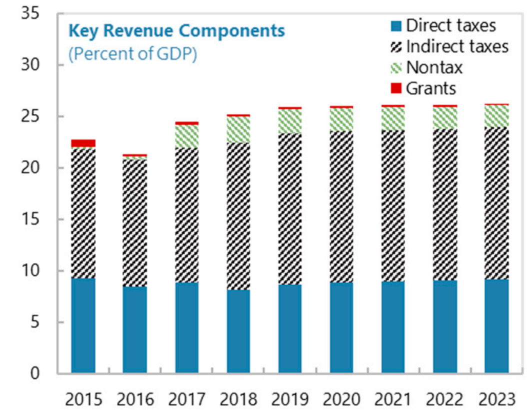
Sources: Tunisian authorities; IMF IFS; World Bank Doing Business Indicators; and staff calculations.

Figure 3. Tunisia: Fiscal Developments and Projections, 2015–23

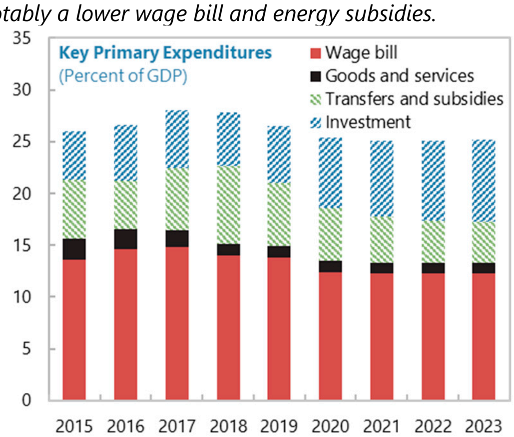
Fiscal adjustment aims at achieving a primary surplus.



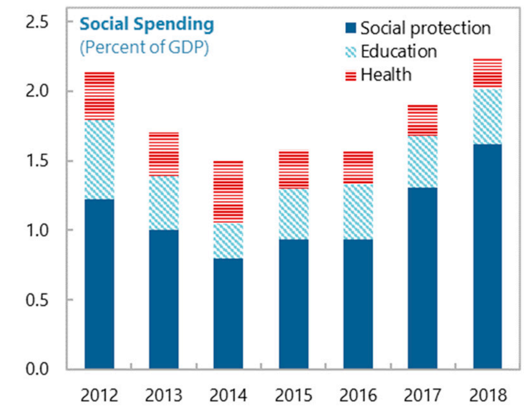
Revenues are projected to increase through 2020, helped by comprehensive tax reforms.



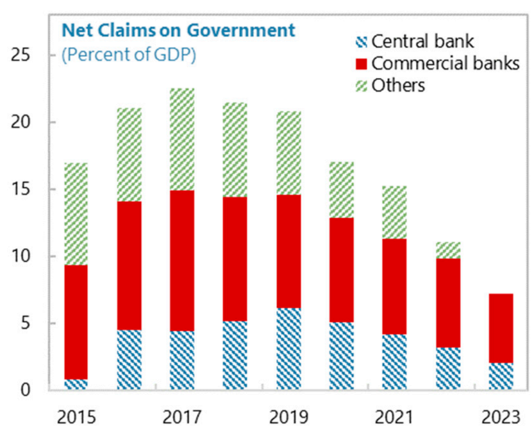
The adjustment would largely come from expenditures, notably a lower wage bill and energy subsidies.



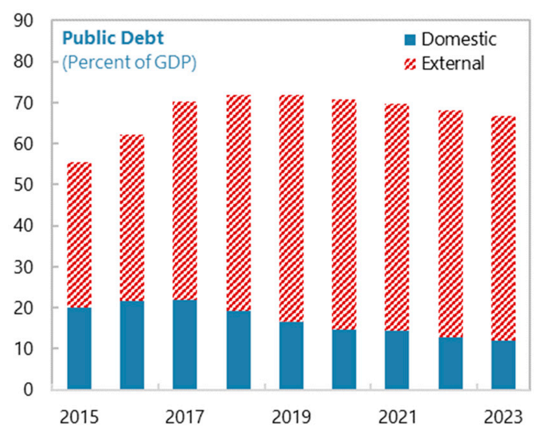
The envisaged adjustment will leave room for increased social spending.



Public debt levels put pressure on banks' balance sheets, but are set to decline....



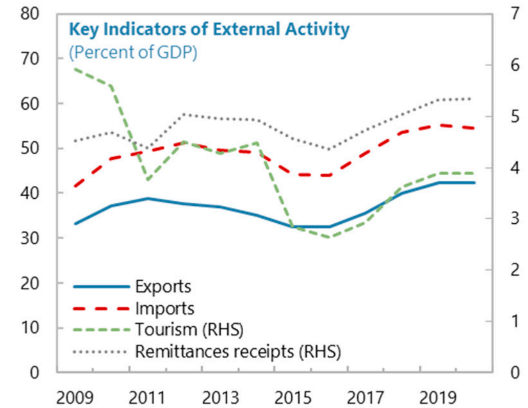
...while external borrowing stabilizes.



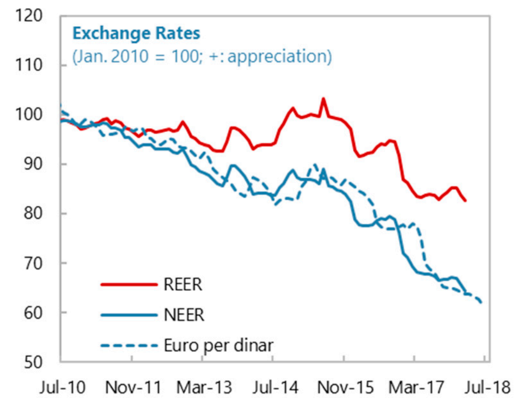
Sources: Tunisian authorities; IMF IFS; and staff calculations.

Figure 4. Tunisia: External Sector Developments, 2009–20

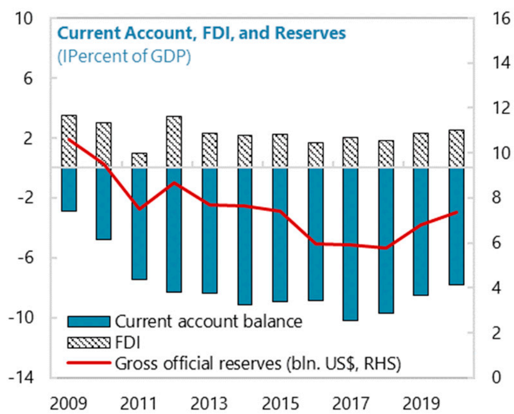
Growth of exports and tourism accelerate in 2018.



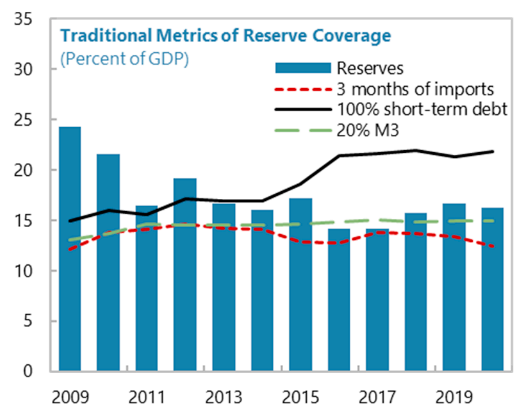
The dinar depreciated noticeably in nominal and real terms since 2016.



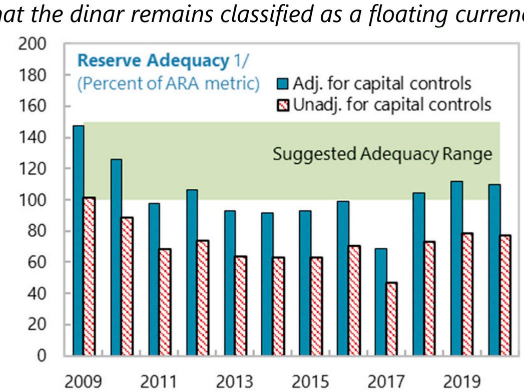
Dinar depreciation helps stabilize the current account and slow reserve losses.



Under the baseline, reserve coverage would improve gradually and…

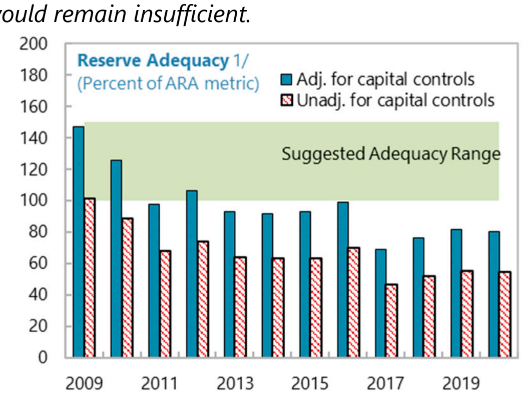


…return to the IMF's adequacy range by 2019, provided that the dinar remains classified as a floating currency.



1/ The metric reflects a floating exchange rate regime as of 2018.

Without exchange rate flexibility, the reserve coverage would remain insufficient.

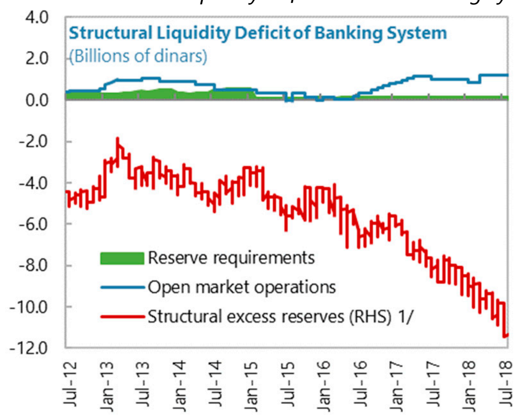


1/ The metric reflects a non-floating exchange rate regime as of 2017.

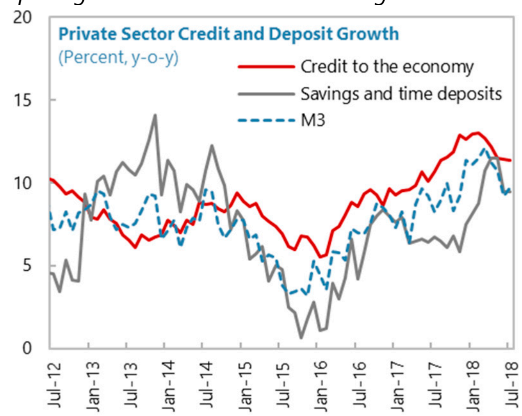
Sources: Tunisian authorities; IMF IFS; and staff calculations.

Figure 5. Tunisia: Monetary and Financial Indicators, 2012–18

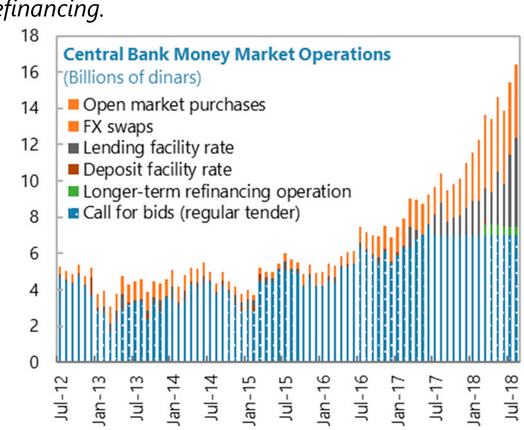
There are structural liquidity deficits in the banking system.



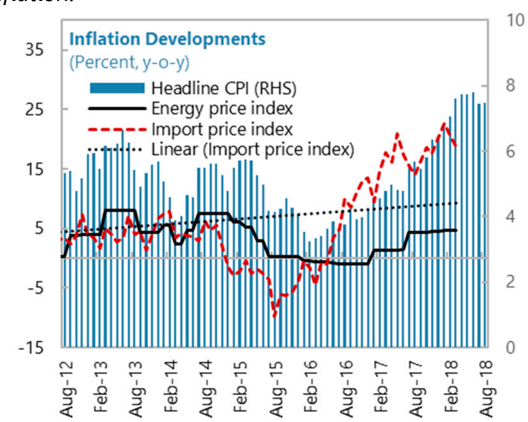
Deposit growth remains below credit growth.



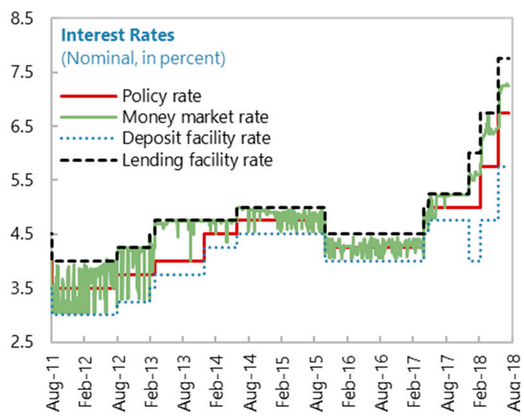
Credit growth was facilitated by record-level CBT bank refinancing.



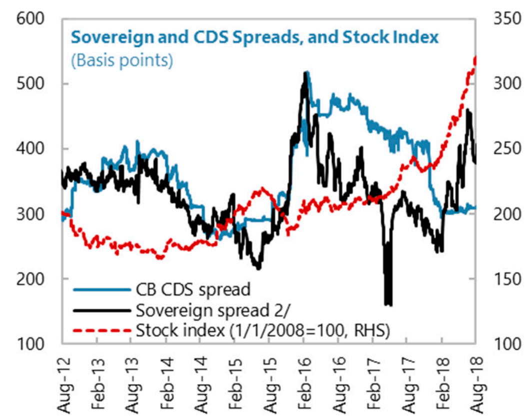
Which, combined with other drivers, has fueled inflation.



In response, the CBT raised the policy rate several times and widened the interest rate corridor.



Spreads are down and the stock market is up.



Sources: Tunisian authorities; Bloomberg; Markit; IMF IFS; and staff calculations.
1/ Deposit facility minus reserve requirements.
2/ Between the Tunisian and US' five-year bonds. The decrease in yields during the first half of 2017 is a result of the April refinancing of the US$-denominated 5-year Qatari-backed bond and increases in Federal Reserve fund rates.

Table 1. Tunisia: Selected Economic and Financial Indicators, 2015–23

	2015	2016	2017	2018		2019		2020	2021	2022	2023
				Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.			
Production and income	(Annual percentage change)										
Real GDP	1.2	1.1	2.0	2.6	2.4	3.1	2.9	3.4	3.6	4.0	4.0
GDP deflator	3.5	4.9	5.6	6.9	7.3	6.8	7.0	5.2	4.1	4.8	4.0
CPI inflation (average)	4.9	3.7	5.3	7.8	8.1	7.0	7.5	5.7	5.2	4.5	4.0
CPI inflation (eop)	4.1	4.2	6.4	8.5	8.9	6.0	6.2	5.5	4.9	4.2	3.9
Saving investment balance											
Gross national savings	11.0	9.6	9.6	10.1	13.4	12.1	14.6	15.2	16.9	18.2	18.9
of which: central government	-0.6	-2.1	-0.4	-0.1	0.0	1.7	2.4	4.2	5.1	5.4	5.7
Gross investment	20.0	18.4	19.8	19.8	23.1	20.7	23.1	23.0	24.0	24.7	24.9
of which: central government	4.7	5.3	5.5	5.2	5.3	5.4	6.1	6.7	7.3	7.7	7.9
Central government operations 1/	(Percent of GDP, unless otherwise indicated)										
Total revenue (excl. grants)	22.1	21.2	24.2	24.9	24.5	25.7	25.4	25.8	25.9	25.9	26.1
Total expenditure and net lending	28.8	28.9	30.3	30.4	30.1	29.6	29.3	28.5	28.3	28.3	28.5
of which: wage bill	13.6	14.6	14.8	14.0	14.0	14.0	14.0	12.4	12.2	12.2	12.2
of which: energy subsidies	1.1	0.2	1.6	2.8	2.5	1.8	0.8	0.9	0.3	0.0	0.0
of which: social expenditures 2/	1.6	1.6	1.9	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Overall balance	-5.3	-5.9	-5.9	-5.2	-5.2	-3.7	-3.7	-2.5	-2.2	-2.2	-2.2
Change in the overall balance ("+": improvement)	-1.5	-0.7	0.0	0.7	0.7	1.6	1.5	1.2	0.3	0.0	0.0
Gross public debt	55.4	62.3	70.3	72.0	70.5	71.8	70.0	70.8	69.8	68.0	66.7
of which: share in foreign currency	35.3	40.5	48.4	52.8	52.7	55.3	53.6	56.1	55.4	55.2	54.8
Money and credit	(Annual percentage change, unless otherwise indicated)										
Credit to the economy	6.2	9.7	12.7	10.1	7.6	6.9	5.6	7.0	7.1	7.4	7.0
Broad money	5.3	8.1	11.4	9.0	7.5	8.7	6.6	7.4	7.9	9.0	8.2
Velocity of circulation (GDP/M3)	1.4	1.3	1.3	1.3	1.3	1.3	1.4	1.3	1.3	1.3	1.3
External sector											
Trade balance (pct. of GDP)	-11.7	-11.5	-13.3	-13.6	-13.3	-12.9	-12.1	-12.1	-11.6	-11.1	-10.6
Exports of goods (value)	-15.9	-3.6	4.9	13.4	20.6	5.4	-1.4	4.2	3.3	3.3	3.2
Imports of goods (value)	-18.4	-3.8	6.3	10.6	16.2	2.6	-3.0	2.7	2.7	2.9	2.7
Exports of goods (volume)	-2.8	0.2	4.6	6.5	6.2	5.1	4.6	3.5	4.0	3.3	3.3
Import of goods (volume)	-2.5	2.3	2.8	1.1	-1.0	0.6	1.7	2.1	3.3	3.3	4.1
Terms of trade (pct. change, "-": deterioration)	3.3	2.3	-3.1	-1.8	-2.2	-1.4	-1.3	0.4	0.0	0.4	1.2
Current account balance (pct. of GDP)	-8.9	-8.8	-10.2	-9.7	-9.6	-8.5	-8.6	-7.8	-7.0	-6.5	-6.0
Foreign direct investment (net, pct. of GDP)	2.2	1.7	2.0	1.8	2.0	2.3	2.5	2.5	2.4	2.4	2.4
Reserve coverage (months of next year's imports of goods)	4.8	3.6	3.3	3.4	3.5	3.8	3.8	4.0	4.0	4.3	4.6
Gross official reserves (eop, billions of US$)	7.4	5.9	5.9	6.3	6.4	7.3	7.0	7.8	8.0	8.9	9.5
Net international reserves (eop, billions of US$)	4.5	3.3	3.1	2.8	3.2	3.2	3.2	3.4	3.7	4.7	5.6
External debt (pct. of GDP)	62.7	66.8	82.6	89.4	86.4	91.7	88.9	93.0	91.6	90.2	88.7
External debt service (pct. of exports of GNFS)	10.1	12.3	19.1	17.8	17.1	18.3	18.9	15.3	17.0	13.3	13.5
Memorandum items:											
Population (millions)	11.3	11.4	11.5	11.7	11.7	11.8	11.8	11.9	12.0	12.1	12.2
Nominal GDP (millions of TD)	84,648	89,804	96,664	106,159	106,159	116,898	116,898	127,201	137,248	149,635	161,845
Nominal GDP (billions of US$)	43.2	41.8	40.0	...	...	...	...	...	...	...	...
GDP per capita (US$)	3,828	3,666	3,465	3,463	3,573	3,401	3,587	3,508	3,645	3,842	4,032
Unemployment rate (pct.)	15.4	15.5	15.5	...	...	...	...	...	...	...	...
Exchange rate (TD/US$, average)	2.0	2.1	2.4	...	...	...	...	...	...	...	...
Oil price (Brent, US$ per barrel)	52.4	44.0	54.4	71.9	70.0	72.3	60.7	69.4	66.8	65.0	63.9

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

1/ Excludes social security accounts, public enterprises, and local governments.

2/ Social spending includes social transfers and programs as well as key ministries' capital expenditures. Its coverage was expanded in 2017.

Table 2. Tunisia: Real Sector, 2015–23

(In percent)

	2015	2016	2017	2018	2019	2020	2021	2022	2023
						Proj.			
Real GDP growth									
Chain index method 1/	1.2	1.0	1.9	2.6	3.1	3.4	3.6	4.0	4.0
Constant 2010 prices	1.2	1.1	2.0	2.6	3.1	3.4	3.6	4.0	4.0
Per capita	0.0	0.0	0.8	1.5	2.1	2.4	2.6	3.1	3.1
Inflation									
CPI (eop)	4.1	4.2	6.4	8.5	6.0	5.5	4.9	4.2	3.9
CPI (average)	4.9	3.7	5.3	7.8	7.0	5.7	5.2	4.5	4.0
GDP deflator	3.5	4.9	5.6	6.9	6.8	5.2	4.1	4.8	4.0
Contributions to growth (supply; constant 2010 prices)									
Total added value	**1.0**	**0.8**	**1.6**	**2.4**	**2.8**	**3.1**	**3.3**	**3.6**	**3.6**
Sectors	**0.4**	**0.3**	**1.5**	**2.1**	**3.0**	**2.5**	**2.6**	**2.9**	**2.9**
Agriculture	1.0	-0.8	0.2	0.7	0.0	0.3	0.3	0.3	0.3
Manufacturing	0.0	0.0	0.1	0.3	0.6	0.5	0.5	0.6	0.6
Non-manufacturing	-0.4	-0.2	-0.3	0.0	0.5	0.3	0.3	0.3	0.3
of which: oil and gas extraction	-0.2	-0.2	-0.4	-0.1	0.2	0.1	0.1	0.1	0.1
Services	-0.2	1.4	1.7	1.3	2.0	1.5	1.6	1.7	1.7
of which: hotels and restaurants	-0.5	0.1	0.3	0.4	0.2	0.1	0.1	0.2	0.2
of which: transport	-0.2	0.3	0.4	0.3	0.4	0.3	0.3	0.3	0.3
Intermediary consumption (in - terms)	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Public administration	**0.6**	**0.4**	**0.1**	**0.1**	**-0.1**	**0.6**	**0.6**	**0.7**	**0.7**
Indirect taxes net of subsidies	**0.2**	**0.3**	**0.4**	**0.3**	**0.4**	**0.3**	**0.3**	**0.4**	**0.4**
Contributions to growth (demand; constant 2010 prices)									
Consumption	**2.9**	**2.7**	**1.6**	**...**	**...**	**...**	**...**	**...**	**...**
Private	1.8	1.5	0.9	...	...	...	...	...	...
Public	1.1	1.2	0.7	...	...	...	...	...	...
Investment	**-1.9**	**-0.3**	**-0.3**	**...**	**...**	**...**	**...**	**...**	**...**
Private	-0.2	-0.3	-0.2	...	...	...	...	...	...
Public	-0.1	-0.1	-0.1	...	...	...	...	...	...
Change in stocks	-1.7	0.0	0.0	...	...	...	...	...	...
Net exports	**0.2**	**-1.2**	**0.6**	**...**	**...**	**...**	**...**	**...**	**...**
Exports	-1.3	0.0	2.0	...	...	...	...	...	...
Imports	-1.5	1.2	1.5	...	...	...	...	...	...

Sources: Tunisia authorities, and IMF staff projections.

1/ Output measured using current and previous year prices.

Table 3. Tunisia: Balance of Payments, 2015–19 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2015	2016	2017	2018						2019					
	Annual	Annual	Annual	Q1	Q2	Q3 Proj.	Q4 Proj.	Annual Proj.	Annual 3rd Rev.	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Annual Proj.	Annual 3rd Rev.
Current account balance	**-3,849**	**-3,694**	**-4,074**	**-1,177**	**-1,137**	**-755**	**-839**	**-3,909**	**-4,010**	**-782**	**-1,026**	**-672**	**-936**	**-3,415**	**-3,616**
Trade balance	-5,029	-4,806	-5,308	-1,187	-1,430	-1,534	-1,323	-5,473	-5,544	-1,058	-1,410	-1,486	-1,215	-5,170	-5,096
Exports	14,073	13,568	14,231	4,176	3,899	3,865	4,195	16,135	17,158	4,393	4,300	3,866	4,445	17,004	16,916
Energy	1,013	765	846	235	213	215	320	983	1,037	296	222	238	316	1,072	924
Non-energy	13,061	12,804	13,384	3,941	3,686	3,650	3,875	15,152	16,121	4,098	4,078	3,629	4,129	15,933	15,992
of which: non-food	11,017	11,368	11,844	3,270	3,151	3,288	3,556	13,265	14,131	4,098	4,078	3,629	4,129	14,051	13,870
Imports	-19,102	-18,374	-19,538	-5,363	-5,329	-5,399	-5,518	-21,609	-22,702	-5,452	-5,710	-5,352	-5,660	-22,174	-22,012
Energy	-2,742	-2,024	-2,513	-802	-672	-834	-933	-3,242	-3,479	-723	-776	-768	-676	-2,942	-3,143
Non-energy	-16,361	-16,351	-17,025	-4,561	-4,657	-4,564	-4,585	-18,367	-19,224	-4,729	-4,934	-4,584	-4,984	-19,232	-18,868
of which: non-food	-14,452	-14,567	-15,101	-4,025	-4,163	-4,036	-4,048	-16,272	-17,096	-4,729	-4,934	-4,584	-4,984	-16,835	-16,492
Services and transfers (net)	1,180	1,112	1,234	10	292	779	484	1,565	1,534	277	385	815	279	1,755	1,480
Services	303	320	305	-51	101	446	152	648	619	79	133	444	32	689	558
of which: tourism	1,231	1,105	1,170	233	278	607	346	1,464	1,373	273	356	587	341	1,560	1,452
Transfers (net)	877	792	929	61	192	333	332	917	915	197	251	370	247	1,065	922
of which: workers' remittances	1,945	1,794	1,861	430	404	589	571	2,006	2,005	460	503	626	511	2,102	2,008
of which: interest payments on external debt	-556	561	-641	-239	-156	-173	-225	-794	-743	-226	-230	-218	-222	-896	-874
of which: IMF	0	16	25					33	34					52	55
Capital and financial account	**4,252**	**3,163**	**4,078**	**551**	**1,134**	**806**	**1,664**	**4,225**	**4,464**	**1,076**	**1,260**	**1,013**	**1,084**	**4,433**	**4,248**
Capital account balance	225	95	183	5	3	60	10	77	125	-4	-4	34	7	32	72
Financial account balance	4,027	3,068	3,895	546	1,132	746	1,654	4,147	4,339	1,080	1,264	979	1,077	4,401	4,176
Direct investment and portfolio (net)	1,122	638	746	169	192	137	224	723	812	191	230	223	315	958	1,061
Medium- and long-term loans (net)	2,362	1,035	2,572	168	-43	607	1,088	1,891	2,636	426	405	409	386	1,627	1,288
Disbursements	3,572	2,514	4,861	658	446	1,056	1,690	3,920	4,717	1,030	1,015	1,000	986	4,030	3,750
of which: private	763	645	954	144	134	130	163	571	589	145	143	141	139	566	558
Amortization	-1,210	-1,479	-2,289	-490	-489	-448	-602	-2,029	-2,082	-603	-609	-591	-600	-2,403	-2,462
Short-term capital	543	1,395	578	209	982	1	342	1,534	891	463	629	348	376	1,816	1,827
Errors and omissions 2/	**-17**	**42**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Overall balance	**385**	**-489**	**4**	**-626**	**-3**	**50**	**825**	**316**	**454**	**295**	**234**	**342**	**148**	**1,019**	**633**
Changes in gross reserves ("+": accumulation)	**385**	**-489**	**4**	**-626**	**-3**	**50**	**825**	**316**	**454**	**295**	**234**	**342**	**148**	**1,019**	**633**
of which: IMF credit (net)	299	282	0	113	-141	127	127	229	234	152	152	152	152	608	633
Purchases	301	316	315	256	0	248	247	753	771	248	248	249	249	994	1,035
Repurchases	0	34	315	137	137	119	119	524	537	97	97	97	97	386	402
Financing gap	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Memorandum items:															
Current account balance (pct. of GDP)	-8.9	-8.8	-10.2	-2.9	-2.8	-1.9	-2.1	-9.7	-9.6	-2.0	-2.6	-1.7	-2.3	-8.5	-8.6
Capital and financial account balance (pct. of GDP, excl. grants)	9.3	7.3	9.7	1.4	3.0	1.8	4.1	10.4	10.4	2.6	3.1	2.5	2.7	10.9	9.8
Imports (pct. of GDP)	44.3	43.9	48.9	54.3	55.9	52.7	54.7	54.4	54.7	53.2	56.6	53.8	57.7	55.3	52.1
Goods import real growth (pct.)	-2.5	2.3	2.8	0.3	4.2	2.9	-2.5	1.1	-1.0	-1.2	1.3	-2.3	4.5	0.6	1.7
of which: non-energy (pct.)	-1.9	5.0	2.1	-3.6	2.3	-2.3	-7.8	-2.9	-2.3	0.0	0.0	0.0	0.0	1.9	1.6
Exports (pct. of GDP)	32.6	32.5	35.6	42.3	40.9	37.7	41.6	40.6	41.3	42.9	42.6	38.9	45.3	42.4	40.0
Goods export real growth (pct.)	-2.8	0.2	4.6	12.9	4.7	6.7	3.0	6.5	6.2	6.7	3.4	-2.0	12.2	5.1	4.6
of which: non-energy (pct.)	0.0	1.7	4.2	10.0	7.8	8.8	2.4	6.9	7.1	5.2	3.4	0.5	10.1	4.9	4.8
Gross reserves (billions of US$)	7.4	5.9	5.9	5.3	5.3	5.4	6.2	6.3	6.4	6.5	6.8	7.1	7.3	7.3	7.0
Reserve coverage (months of next year's imports of goods)	4.8	3.6	3.3	2.9	2.9	2.9	3.3	3.4	3.5	3.5	3.7	3.9	3.9	3.8	3.8
Reserve coverage (months of next year's imports of GNFS)	4.1	3.1	2.9	2.5	2.5	2.5	2.9	2.9	3.0	3.1	3.2	3.4	3.4	3.3	3.3
Reserve coverage (pct. of short-term external debt) 3/	112.7	88.8	80.5	75.7	73.9	73.3	83.3	84.6	93.5	94.4	87.5	97.5	95.6	95.6	97.1
Reserve coverage (pct. of short-term debt, on remaining maturity)	95.7	73.8	58.2	56.8	51.4	50.4	53.4	65.9	71.2	58.5	61.7	0.0	0.0	78.0	78.0
Net international reserves (eop, billions of US$)	n.a.	3.7	3.1	2.4	2.2	2.1	2.8	2.8	3.2	2.9	3.0	3.2	3.2	3.2	3.2
External medium- and long-term debt (billions of US$)	20.5	21.3	25.6	26.8	25.7	26.1	27.2	27.2	28.9	27.7	28.2	28.7	29.2	29.2	30.5
External medium- and long-term debt (pct. of GDP)	47.5	50.8	64.1	61.5	63.1	65.9	71.2	71.1	69.0	67.5	69.8	72.1	74.5	72.7	71.4
External short-term debt (billions of US$)	6.6	6.7	7.4	7.0	7.2	7.3	7.4	7.4	6.8	6.9	7.7	7.3	7.6	7.6	7.2
External short-term debt (pct. of GDP)	15.2	16.0	18.5	16.1	17.6	18.5	19.4	18.3	17.4	16.9	19.2	18.4	19.4	19.0	17.5
External debt service ratio (incl. IMF, pct. of exports of GNFS)	10.1	12.3	19.1	18.6	17.8	15.4	7.0	17.8	17.1	18.3	18.5	18.4	17.9	18.3	18.9
Nominal GDP (millions of US$)	43,152	41,808	39,957	…	…	…	…	…	…	…	…	…	…	…	…

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

1/ In accordance with the Fifth Edition of the Balance of Payments and Investment Position Manual (BPM5).

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

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

Table 4. Tunisia: External Financing Needs, 2015–19

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

	2015	2016	2017	2018					2019				
	Annual	Annual	Annual	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
						Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total financing requirements	**11,904**	**11,751**	**13,048**	**7,975**	**8,089**	**7,926**	**8,810**	**13,312**	**8,397**	**8,810**	**8,573**	**8,921**	**13,197**
Current account deficit	3,849	3,694	4,074	1,177	1,137	755	839	3,909	782	1,026	672	936	3,415
Amortizations	1,209	1,492	2,280	490	489	448	597	2,029	603	609	591	600	2,396
Central government 1/	599	640	1,486	314	282	285	380	1,264	461	455	448	442	1,805
Central Bank 2/	85	375	105	23	20	6	4	51	4	0	0	0	4
Corporate 3/	525	477	690	154	186	158	213	714	138	155	143	158	588
Short-term debt 4/	6,846	6,565	6,694	6,308	6,463	6,723	7,374	7,374	7,012	7,175	7,311	7,386	7,386
Total financing sources	**11,904**	**11,750**	**13,048**	**7,975**	**8,089**	**7,926**	**8,810**	**13,312**	**8,397**	**8,810**	**8,573**	**8,921**	**13,197**
Foreign direct investment and portfolio (net)	1,122	638	746	169	192	137	222	723	191	230	223	315	958
FDI (net)	969	695	810	169	192	137	224	742	191	230	223	315	936
Disbursements	3,558	2,463	4,871	658	446	1,056	1,690	3,920	1,030	1,015	1,000	986	4,030
Central government 1/	2,771	1,834	3,607	514	312	925	1,528	3,349	885	872	859	847	3,463
Central Bank 2/	25	0	317	0	0	0	0	0	0	0	0	0	0
Corporate 3/	762	629	948	144	134	130	162	571	145	143	141	139	566
Short-term debt 4/	6,565	6,694	7,374	7,012	7,175	7,311	7,386	7,386	6,930	7,745	7,306	7,601	7,601
Other flows net (incl. drawdown in commercial banks NFA)	1,062	1,424	61	-490	272	-527	338	1,600	541	55	386	168	1,626
Drawdown in gross reserves	-399	532	-4	626	3	-50	-825	-316	-295	-234	-342	-148	-1,019
Financing gap	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
of which: multi- and bilateral budget support (excl. IMF)	1,419	576	2,020	151	242	564	318	1,277	175	157	588	128	1,087
of which: financial market access and other	388	979	1,399	94	99	114	1,113	1,420	65	77	139	1,189	1,469
of which: IMF credit (net) 5/	301	282	0	119	-137	128	128	229	151	151	151	152	608
Purchases	301	316	315	256	0	248	247	753	248	248	249	249	994
Repurchase	0	34	315	137	137	119	119	524	97	97	97	97	386
Memorandum items:													
Gross international reserves (eop)	7,401	5,941	5,934	5,309	5,305	5,355	6,154	6,251	6,545	6,780	7,121	7,269	7,269
Government rollover rates (pct.)	467	287	264	164	111	325	403	70	186	186	0	0	0
Corporate rollover rates (pct.)	145	132	137	93	72	83	76	80	105	92	98	88	96

Sources: Tunisian authorities; and IMF staff projections.

1/ Central government includes IMF purchases made available for budget support.

2/ Central Bank includes IMF purchases made available for BOP support.

3/ Includes public and private entreprises.

4/ Stock of short-term debt outstanding at the end of the previous year.

5/ Under the proposed schedule of purchases during the EFF.

Table 5. Tunisia: Central Government Fiscal Operations, 2015–19
(In millions of dinars, cumulative flow since the beginning of the year)

	2015	2016	2017	2018					2019				
	Annual	Annual	Annual	Q1	Q2	Q3 Proj.	Annual Proj.	Annual 3rd Rev.	Q1 Proj.	Q2 Proj.	Q3 Proj.	Annual Proj.	Annual 3rd Rev.
Total revenue and grants	**19,263**	**19,137**	**23,616**	**6,665**	**13,600**	**19,977**	**26,723**	**26,426**	**7,508**	**15,015**	**22,634**	**30,286**	**29,948**
Revenue	18,679	19,006	23,396	6,663	13,598	19,804	26,474	26,061	7,508	15,015	22,523	30,031	29,699
Tax revenue	18,487	18,702	21,187	5,801	12,208	18,081	23,837	23,459	6,819	13,637	20,456	27,274	27,013
Direct taxes	7,816	7,577	8,560	2,146	4,717	7,200	8,613	8,277	2,524	5,048	7,572	10,096	10,415
Trade taxes	825	640	742	245	562	780	1,207	1,286	351	701	1,052	1,403	1,395
VAT	5,057	5,138	6,092	1,634	3,454	5,170	7,173	7,081	2,030	4,061	6,091	8,121	7,546
Excise	1,773	2,174	2,493	646	1,369	2,100	2,916	3,051	828	1,655	2,483	3,310	3,404
Other indirect taxes	3,016	3,174	3,300	1,130	2,106	2,831	3,928	3,765	1,086	2,172	3,258	4,345	4,252
Nontax revenue	188	293	2,209	862	1,390	1,723	2,637	2,602	689	1,378	2,067	2,757	2,682
of which: Energy sector	150	0	1,183	3,248	5,236	6,491	1,511	1,148	2,358	4,716	7,074	1,536	1,081
Capital income	4	11	0	0	0	0	0	0	0	0	0	0	4
Grants	584	131	221	2	2	173	249	365	0	0	111	256	249
Total expenditure and net lending	**24,395**	**25,930**	**29,303**	**7,745**	**15,303**	**24,564**	**32,277**	**31,999**	**8,647**	**17,207**	**25,767**	**34,590**	**34,287**
Total expenditure	23,675	25,839	29,342	7,503	15,283	24,318	32,337	32,059	8,660	17,232	25,805	34,640	34,303
Current expenditure	19,732	21,040	23,997	6,107	12,419	19,708	26,779	26,403	7,087	14,086	21,086	28,348	27,141
Wages and salaries	11,542	13,117	14,352	3,864	7,461	11,182	14,903	14,846	4,096	8,193	12,289	16,385	16,400
of which: one-off civil service reform costs	0	0	0	0	0	0	87	95	0	0	0	0	428
of which: Ministry of Defense and Interior	*2,752*	3,209	3,536	...	...	...	3,984	3,531	...	...	...	4,678	3,796
Goods and services	1,682	1,737	1,498	292	441	795	1,150	1,150	325	650	975	1,300	1,266
Interest payments	1,644	1,986	2,259	922	1,632	2,168	2,696	2,787	793	1,585	2,378	3,170	3,011
Domestic	687	821	1,255	464	931	1,168	1,297	1,537	309	618	928	1,237	1,159
External	957	1,165	1,004	458	701	1,000	1,399	1,250	483	967	1,450	1,934	1,853
Transfers and subsidies	4,864	4,200	5,888	1,029	2,884	5,562	7,930	7,550	1,760	3,521	5,281	7,042	6,029
Subsidies	2,863	2,211	3,492	520	1,810	3,903	5,233	4,726	1,098	2,196	3,294	4,392	3,304
Food	1,530	1,581	1,494	173	745	1,273	1,800	1,570	450	900	1,350	1,800	1,931
Energy subsidies (gross)	918	197	1,550	220	790	2,230	2,983	2,706	535	1,071	1,606	2,142	878
Other	415	433	448	127	275	400	450	450	113	225	338	450	496
Transfers (incl. CNRPS, social protection, and BFT)	2,001	1,989	2,395	510	1,074	1,659	2,698	2,824	663	1,325	1,988	2,650	2,725
Other current expenditure (non-allocated)	0	0	0	0	1	1	100	70	113	138	163	450	434
Capital expenditure	3,943	4,798	5,345	1,396	2,864	4,610	5,559	5,656	1,573	3,146	4,719	6,292	7,163
Net lending	720	91	-39	242	20	246	-60	-60	-13	-25	-38	-50	-16
Overall balance	**-4,451**	**-5,311**	**-5,687**	**-1,080**	**-1,703**	**-4,587**	**-5,554**	**-5,573**	**-1,140**	**-2,192**	**-3,133**	**-4,303**	**-4,339**
Errors and omissions	2,103	985	-345	42	300	0	0	0	0	0	0	0	0
Financing (net)	**3,029**	**5,808**	**6,031**	**1,039**	**1,403**	**4,587**	**5,554**	**5,573**	**1,140**	**2,192**	**3,133**	**4,303**	**4,339**
Foreign financing	4,284	2,631	5,070	489	566	2,287	5,482	7,228	1,208	2,417	3,625	4,834	3,760
Domestic financing	-1,254	3,176	962	550	837	2,300	72	-1,655	-69	-225	-492	-531	580
Debt	590	2,059	1,552	797	530	1,989	-778	-2,255	-505	-516	-267	-1,081	-30
Non-debt	-1,844	1,118	-590	-247	307	312	850	600	436	291	-226	550	610
Financing gap	0	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:													
Overall balance (excl. grants)	-4,743	-5,441	-5,907	-1,083	-1,705	-6,252	-5,803	-5,938	-1,140	-2,192	-3,244	-4,559	-4,588
Overall balance (cash basis)	-3,029	-5,808	-6,031	-1,039	-1,403	-4,587	-5,554	-5,573	-1,140	-2,192	-3,133	-4,303	-4,339
Overall balance (excl. grants, cash basis)	-3,613	-5,939	-6,252	-1,041	-1,405	-6,252	-5,803	-5,938	-1,140	-2,192	-3,244	-4,559	-4,588
Structural balance	-3,357	-4,768	-3,943	...	...	...	-3,480	-3,912	...	...	...	-1,981	-2,262
Cyclically-adjusted structural balance	-3,989	-6,709	-6,520	...	...	...	-5,319	-5,743	...	...	...	-4,190	-4,077
Total current primary expenditure	18,088	19,054	21,738	5,185	10,787	17,540	24,083	23,616	6,294	12,501	18,708	25,177	24,129
Social expenditures 1/	1,335	1,411	1,844	735	1,397	1,692	2,382	2,382	656	1,311	1,967	2,623	2,623
Gross public debt	46,920	55,922	67,982	...	...	...	76,434	74,854	...	...	...	83,954	81,826
Domestic	17,028	19,508	21,155	...	...	...	20,389	18,861	...	...	...	19,308	19,194
External	29,892	36,414	46,828	...	...	...	56,046	55,993	...	...	...	64,646	62,632
Stock of government deposits	2,676	1,683	2,535	3,104	1,595	1,283	2,035	2,435	1,599	1,307	1,533	1,535	1,875
Nominal GDP	84,648	89,804	96,664	26,540	26,540	26,540	106,159	106,159	29,225	29,225	29,225	116,898	116,898

Sources: Tunisian authorities; and IMF staff estimates.

1/ Social spending includes social transfers and programs as well as key ministries' capital expenditures. The definition was expanded in 2017.

Table 6. Tunisia: Central Government Fiscal Operations, 2015–23
(In percent of GDP)

	2015	2016	2017	2018		2019		2020	2021	2022	2023
				Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.			
Total revenue and grants	**22.8**	**21.3**	**24.4**	**25.2**	**24.9**	**25.9**	**25.6**	**26.0**	**26.1**	**26.1**	**26.2**
Revenue	22.1	21.2	24.2	24.9	24.5	25.7	25.4	25.8	25.9	25.9	26.1
Tax revenue	21.8	20.8	21.9	22.5	22.1	23.3	23.1	23.6	23.7	23.8	24.0
Direct taxes	9.2	8.4	8.9	8.1	7.8	8.6	8.9	8.8	9.0	9.0	9.2
Trade taxes	1.0	0.7	0.8	1.1	1.2	1.2	1.2	1.2	1.2	1.2	1.2
VAT	6.0	5.7	6.3	6.8	6.7	6.9	6.5	7.0	7.0	7.1	7.2
Excise	2.1	2.4	2.6	2.7	2.9	2.8	2.9	2.8	2.8	2.8	2.8
Other indirect taxes	3.6	25.7	3.4	3.7	3.5	3.7	3.6	3.7	3.7	3.7	3.7
Nontax revenue	0.2	0.3	2.3	2.5	2.5	2.4	2.3	2.3	2.2	2.1	2.1
of which: Energy sector	0.2	0.0	1.2	1.4	1.1	1.3	0.9	1.2	1.1	1.1	1.0
Capital income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.7	0.1	0.2	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Total expenditure and net lending	**28.8**	**28.9**	**30.3**	**30.4**	**30.1**	**29.6**	**29.3**	**28.5**	**28.3**	**28.3**	**28.5**
Total expenditure	28.0	28.8	30.4	30.5	30.2	29.6	29.3	28.5	28.3	28.3	28.5
Current expenditure	23.3	23.4	24.8	25.2	24.9	24.2	23.2	21.8	21.0	20.7	20.6
Wages and salaries	13.6	14.6	14.8	14.0	14.0	14.0	14.0	12.4	12.2	12.2	12.2
of which: one-off civil service reform costs	0.0	0.0	0.0	0.1	0.1	0.0	0.4	0.0	0.0	0.0	0.0
Goods and services	2.0	1.9	1.5	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Interest payments	1.9	2.2	2.3	2.5	2.6	2.7	2.6	2.8	2.9	2.9	2.9
Domestic	0.8	0.9	1.3	1.2	1.4	1.1	1.0	0.9	0.8	0.8	0.7
External	1.1	1.3	1.0	1.3	1.2	1.7	1.6	1.9	2.1	2.1	2.2
Transfers and subsidies	5.7	4.7	6.1	7.5	7.1	6.0	5.2	5.1	4.4	4.0	4.0
Subsidies	3.4	2.5	3.6	4.9	4.5	3.8	2.8	2.8	2.1	1.8	1.7
Food	1.8	1.8	1.5	1.7	1.5	1.5	1.7	1.5	1.5	1.4	1.3
Energy subsidies (gross)	1.1	0.2	1.6	2.8	2.5	1.8	0.8	0.9	0.3	0.0	0.0
Other	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Transfers (incl. CNRPS, social protection, and BFT)	2.4	2.2	2.5	2.5	2.7	2.3	2.3	2.3	2.3	2.3	2.3
Other current expenditure (non-allocated)	0.0	0.0	0.0	0.1	0.1	0.4	0.4	0.4	0.3	0.3	0.3
Capital expenditure	4.7	5.3	5.5	5.2	5.3	5.4	6.1	6.7	7.3	7.7	7.9
Net lending	0.9	0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**-5.3**	**-5.9**	**-5.9**	**-5.2**	**-5.2**	**-3.7**	**-3.7**	**-2.5**	**-2.2**	**-2.2**	**-2.2**
Errors and omissions	2.5	1.1	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing (net)	**3.6**	**6.5**	**6.2**	**5.2**	**5.2**	**3.7**	**3.7**	**2.5**	**2.2**	**2.2**	**2.2**
Foreign financing	5.1	2.9	5.2	5.2	6.8	4.1	3.2	3.4	1.7	2.9	2.5
Domestic financing	-1.5	3.5	1.0	0.1	-1.6	-0.5	0.5	-0.9	0.5	-0.6	-0.3
of which: privatization and sale of confiscated assets	0.1	0.6	0.2	0.3	0.5	0.3	0.5	0.3	0.3	0.3	0.3
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:											
Overall balance (excl. grants)	-5.6	-6.1	-6.1	-5.5	-5.6	-3.9	-3.9	-2.7	-2.4	-2.4	-2.4
Overall balance (cash basis)	-3.6	-6.5	-6.2	-5.2	-5.2	-3.7	-3.7	-2.5	-2.2	-2.2	-2.2
Overall balance (excl. grants, cash basis)	-4.3	-6.6	-6.5	-5.5	-5.6	-3.9	-3.9	-2.7	-2.4	-2.4	-2.4
Structural balance	-5.9	-7.4	-5.6	-5.0	-5.5	-3.5	-3.8	-2.4	-2.2	-2.3	-2.4
Cyclically-adjusted structural fiscal balance (CASFB)	-6.0	-7.4	-6.6	-4.9	-5.4	-3.5	-3.5	-2.4	-2.2	-2.3	-2.4
Total current primary expenditure	21.4	21.2	22.5	22.7	22.2	21.5	20.6	19.0	18.1	17.7	17.6
Social expenditures 1/	1.6	1.6	1.9	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Gross public debt	55.4	62.3	70.3	72.0	70.5	71.8	70.0	70.8	69.8	68.0	66.7
Domestic	20.1	21.7	21.9	19.2	17.8	16.5	16.4	14.7	14.4	12.9	11.9
External	35.3	40.5	48.4	52.8	52.7	55.3	53.6	56.1	55.4	55.2	54.8
Nominal GDP (billions of TD)	84.6	89.8	96.7	106.2	106.2	116.9	116.9	127.2	137.2	149.6	161.8

Sources: Tunisian authorities; and IMF staff estimates.

1/ Social spending includes social transfers and programs as well as key ministries' capital expenditures. The definition was expanded in 2017.

Table 7. Tunisia: Monetary Survey, 2015–19
(In millions of dinars, end-of-period stocks

	2015	2016	2017	2018					2019				
	Annual	Annual	Annual	Q1	Q2	Q3	Annual	Annual	Q1	Q2	Q3	Annual	Annual
						Proj.	Proj.	3rd Rev.	Proj.	Proj.	Proj.	Proj.	3rd Rev.
					(Millions of Tunisian dinars)								
Net foreign assets (NFA)	**1,686**	**-949**	**-2,385**	**-4,484**	**-5,388**	**-6,329**	**-4,940**	**-1,267**	**-4,027**	**-3,972**	**-3,600**	**-3,797**	**-1,751**
Foreign assets	17,849	16,644	16,420	14,526	15,056	14,634	17,401	19,302	18,324	18,721	19,437	21,416	21,571
Central bank	15,075	13,932	13,932	12,406	12,407	12,542	14,764	15,493	15,604	16,283	17,286	17,727	17,233
Foreign liabilities	-16,162	-17,592	-18,805	-19,010	-20,444	-20,963	-22,342	-20,569	-22,351	-22,694	-23,037	-25,213	-23,322
Central bank	-5,991	-6,404	-5,758	-6,001	-6,242	-6,288	-7,136	-7,123	-7,254	-7,374	-7,494	-9,447	-9,277
Net domestic assets (NDA)	**60,213**	**67,832**	**76,869**	**79,428**	**81,249**	**84,070**	**86,129**	**80,577**	**86,928**	**87,732**	**88,887**	**92,047**	**86,335**
Domestic credit	80,448	91,365	103,434	106,171	109,626	109,533	112,552	110,154	113,316	116,047	115,937	119,143	118,509
Credit to the government (net)	14,355	18,893	21,786	22,681	23,990	23,252	22,746	22,336	23,552	24,150	22,002	24,333	25,774
Central bank net credit	688	3,993	4,255	4,625	6,241	6,081	5,487	6,302	6,381	6,978	6,431	7,175	9,740
Commercial banks	7,199	8,649	10,096	10,622	10,401	9,824	9,824	9,307	9,824	9,824	9,824	9,824	9,307
Other	6,468	6,251	7,435	7,434	7,348	7,348	7,435	6,727	7,348	7,348	5,748	7,335	6,727
Credit to the economy	66,093	72,472	81,648	83,490	85,636	86,281	89,894	87,819	89,764	91,898	93,935	96,097	92,736
Other items (net)	-20,235	-23,534	-26,565	-26,743	-28,377	-25,463	-26,424	-29,576	-26,388	-28,315	-27,050	-27,095	-32,174
Broad money (M3)	**61,899**	**66,883**	**74,485**	**74,944**	**75,861**	**77,741**	**81,188**	**79,310**	**82,901**	**83,760**	**85,287**	**88,251**	**84,583**
Money plus quasi-money (M2)	58,828	63,660	71,086	71,571	72,558	74,356	77,653	75,754	79,291	80,113	81,574	84,408	80,791
Money (M1)	24,444	26,409	30,865	30,724	31,137	31,908	33,323	32,317	34,026	34,378	35,005	36,222	34,465
Currency	8,418	16,661	19,682	19,544	19,752	20,241	21,138	20,301	21,584	21,808	22,206	22,977	21,650
Demand deposits	16,026	9,749	11,182	11,180	11,385	11,667	12,184	12,016	12,442	12,570	12,800	13,244	12,815
Quasi-money	34,384	37,251	40,221	40,847	41,422	42,448	44,330	43,438	45,265	45,735	46,569	48,187	46,326
Long-term deposits (M3-M2)	3,071	3,223	3,399	3,373	3,303	3,385	3,535	3,556	3,609	3,647	3,713	3,842	3,792
					(Annual percentage change)								
Net foreign assets	**-22.4**	**-156.3**	**151.4**	**231.5**	**137.5**	**140.0**	**107.2**	**-46.9**	**-10.2**	**-26.3**	**-43.1**	**23.2**	**-38.2**
Net domestic assets	**6.3**	**12.7**	**13.3**	**16.5**	**13.3**	**14.4**	**12.0**	**5.8**	**9.4**	**8.0**	**5.7**	**6.9**	**7.1**
Domestic credit	7.5	13.6	13.2	15.6	13.1	10.9	8.8	7.2	6.7	5.9	5.8	5.9	7.6
Credit to the government (net)	13.8	31.6	15.3	27.4	19.4	16.1	4.4	6.0	3.8	0.7	-5.4	7.0	15.4
Credit to the economy	6.2	9.7	12.7	12.7	11.4	9.6	10.1	7.6	7.5	7.3	8.9	6.9	5.6
Broad money (M3)	**5.3**	**8.1**	**11.4**	**12.1**	**9.2**	**9.7**	**9.0**	**7.5**	**10.6**	**10.4**	**9.7**	**8.7**	**6.6**
					(Growth in percent of broad money)								
Net foreign assets	**-0.8**	**-4.3**	**-2.1**	**-4.7**	**-4.5**	**-5.2**	**-3.4**	**1.5**	**0.6**	**1.9**	**3.5**	**1.4**	**-0.6**
Net domestic assets	**6.1**	**12.3**	**13.5**	**16.8**	**13.7**	**14.9**	**12.4**	**6.0**	**10.0**	**8.5**	**6.2**	**7.3**	**7.3**
Domestic credit	9.6	17.6	18.0	21.4	18.3	15.2	12.2	10.1	9.5	8.5	8.2	8.1	10.5
Credit to the government (net)	3.0	7.3	4.3	7.3	5.6	4.6	1.3	1.7	1.2	0.2	-1.6	2.0	4.3
Credit to the economy	6.6	10.3	13.7	14.1	12.7	10.7	11.1	8.4	8.4	8.3	9.8	7.6	6.2
Broad money (M3)	**5.3**	**8.1**	**11.4**	**12.1**	**9.2**	**9.7**	**9.0**	**7.5**	**10.6**	**10.4**	**9.7**	**8.7**	**6.6**
Memorandum items:													
Nominal GDP	84,648	89,804	96,664				106,159	106,159				116,898	116,898

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

Table 8. Tunisia: Central Bank Survey, 2015–19
(In millions of dinars, end-of-period stocks)

	2015	2016	2017	2018					2019				
	Annual	Annual	Annual	Q1	Q2	Q3 Proj.	Annual Proj.	Annual 3rd Rev.	Q1 Proj.	Q2 Proj.	Q3 Proj.	Annual Proj.	Annual 3rd Rev.
	(Millions of Tunisian dinars)												
Net foreign assets	**9,084**	**7,528**	**8,174**	**6,404**	**6,165**	**6,254**	**7,628**	**8,370**	**8,350**	**8,908**	**9,792**	**8,280**	**7,955**
Assets	15,075	13,932	13,932	12,406	12,407	12,542	14,764	15,493	15,604	16,283	17,286	17,727	17,233
of which: proceeds of FX swaps	606	507	1,491	2,838	2,809	2,809	2,809	2,838	2,809	2,809	2,809	2,809	2,838
Liabilities	5,991	6,404	5,758	6,001	6,242	6,288	7,136	7,123	7,254	7,374	7,494	9,447	9,277
Net domestic assets	**1,924**	**5,094**	**7,062**	**8,247**	**9,732**	**11,425**	**8,929**	**6,855**	**7,427**	**7,557**	**7,192**	**8,205**	**6,482**
Domestic credit (net)	4,897	9,483	12,739	14,072	16,082	18,570	16,899	14,681	16,054	16,855	17,174	18,889	16,773
Net credit to government 1/	688	3,993	4,255	4,625	6,241	7,227	7,173	5,850	8,318	9,329	9,833	10,572	9,272
Credit to banks 2/	4,209	5,490	8,484	9,447	9,841	11,343	9,726	8,831	7,736	7,526	7,341	8,317	7,501
Other items net	-2,973	-4,389	-5,677	-5,826	-6,350	-7,144	-7,971	-7,826	-8,626	-9,298	-9,982	-10,684	-10,291
Reserve money 3/	**11,009**	**12,622**	**15,236**	**14,651**	**15,897**	**17,679**	**16,557**	**15,225**	**15,777**	**16,465**	**16,984**	**16,485**	**14,438**
	(Annual percentage change)												
Net foreign assets	**-1.8**	**-17.1**	**8.6**	**-10.5**	**-19.6**	**-23.5**	**-6.7**	**2.4**	**35.4**	**42.4**	**56.6**	**8.5**	**-5.0**
Assets	5.5	-7.6	0.0	-9.5	-11.9	-10.0	6.0	11.2	25.8	29.8	37.8	20.1	11.2
of which: proceeds of FX swaps 4/	...	-16.3	194.1	456.5	482.8	234.0	88.4	90.3	-1.0	0.0	0.0	0.0	0.0
Liabilities	18.8	6.9	-10.1	-8.4	-2.7	9.2	23.9	23.7	16.2	17.3	19.2	32.4	30.2
Net domestic assets	**14.0**	**164.7**	**38.6**	**24.2**	**43.9**	**61.8**	**26.4**	**-2.9**	**-23.7**	**-33.9**	**-37.0**	**-8.1**	**-5.4**
Domestic credit (net)	12.4	93.6	34.3	17.4	32.2	45.8	32.7	15.2	-0.2	-9.2	-7.5	11.8	14.2
Net credit to government 1/	-44.6	480.1	6.6	4.8	41.3	69.8	68.6	37.5	33.3	29.1	-3.9	47.4	58.5
Credit to Banks 2/	35.1	30.4	54.5	24.7	27.0	33.7	14.6	4.1	-21.4	-33.7	-35.3	-14.5	-15.1
Other items net	11.4	47.6	29.3	8.9	17.4	25.8	40.4	37.8	35.8	30.1	39.7	34.0	31.5
Reserve Money 3/	**0.6**	**14.7**	**20.7**	**16.4**	**15.2**	**22.5**	**8.7**	**-0.1**	**7.7**	**3.6**	**-3.9**	**-0.4**	**-5.2**
Memorandum items:													
Open market purchases (OMPs)	112	804	982	1,207	1,202	1,202	1,207	1,207	1,202	1,202	1,202	1,207	1,207
FX swap operations 4/	606	507	1,491	2,838	2,809	2,809	2,809	2,838	2,809	2,809	2,809	2,809	2,838
Total CBT refinancing of banks (excl. OMPs)	4,815	5,997	9,975	12,285	12,650	14,152	12,535	11,669	10,545	10,335	10,150	11,126	10,339
Total CBT refinancing of banks	4,927	6,801	10,957	13,492	13,852	15,354	13,742	12,876	11,747	11,537	11,353	12,333	11,546

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

1/ Includes subscription to the IMF and the AMF.

2/ Includes the main refinancing facility (appel d'offres) and the lending and deposit facilities.

3/ Excludes deposits of other financial institutions, individuals, and non-financial enterprises.

4/ Introduced at end-2014.

Table 9. Tunisia: Financial Soundness Indicators of the Banking Sector, 2010–18

(Percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018 Mar. (Prel.)
Regulatory capital									
Regulatory capital to risk-weighted assets	11.6	11.9	11.8	8.2	9.4	12.0	11.6	11.9	11.8
Tier 1 capital to risk weighted assets	10.2	10.0	9.5	6.6	7.6	9.3	8.8	8.9	8.9
Capital to assets	8.4	8.5	7.8	5.6	6.2	7.8	8.2	8.4	8.4
Asset quality									
Sectoral distribution of loans to total loans									
Industry	30.5	28.6	27.9	27.8	27.2	27.3	26.9	27.6	27.8
Agriculture	2.9	2.9	2.8	2.8	2.8	2.6	2.6	2.6	2.7
Commerce	15.0	16.0	15.4	15.1	15.6	15.8	15.9	16.0	16.2
Construction	5.9	5.6	5.4	5.5	5.7	6.2	6.2	5.8	5.7
Tourism	7.3	7.3	6.9	6.5	6.1	6.2	5.8	5.3	5.2
Households	22.1	23.4	25.4	26.2	26.2	26.6	26.3	25.8	25.8
Other	16.3	16.3	16.2	16.0	16.5	15.4	16.3	16.8	16.6
FX-loans to total loans	5.3	5.1	4.8	4.8	5.5	5.8	5.7	5.1	4.5
Credit to the private sector (pct. of total loans) 1/	70.6	67.4	67.7	73.7	73.8	73.5	73.7	74.5	74.3
Nonperforming Loans (NPLs) to total loans	13.0	13.3	14.9	16.5	15.8	16.6	15.6	13.9	13.9
Specific provisions to NPLs	-	48.6	45.7	56.4	58.0	56.9	59.0	63.3	63.7
NPLs, net of provisions, to tier 1 capital	60.3	66.2	86.3	111.6	90.3	78.8	68.2	61.8	57.3
Specific provisions to total loans	7.6	7.6	8.0	10.3	10.1	10.5	10.2	8.8	8.8
General provisions to total loans	-	0.4	0.5	0.6	0.6	0.6	0.6	0.6	0.6
Profitability									
Return on assets (ROA)	0.9	0.6	0.6	0.3	0.9	0.9	1.0	1.2	-
Return on equity (ROE)	10.2	5.9	7.2	3.0	11.2	10.8	11.4	13.9	-
Interest rate average spread (btw. loans and deposits)	3.5	3.0	3.0	3.3	3.1	3.0	2.9	3.2	3.3
Interest return on credit	6.2	5.7	5.4	5.9	6.4	6.3	6.0	6.5	6.9
Cost of risk (pct. of credit)	1.7	1.2	1.2	1.9	1.1	1.1	0.9	0.9	-
Net interest margin to net banking product (PNB)	58.6	57.2	58.1	58.9	57.2	54.6	50.9	49.7	-
Operating expenses to PNB	46.5	51.1	50.3	47.3	48.5	49.2	48.5	47.6	-
Operating expenses to total assets	1.6	1.7	1.6	1.6	1.7	1.7	1.7	1.8	-
Personnel expenses to non-interest expenses	59.1	62.6	61.5	60.8	59.3	60.1	58.7	59.1	-
Trading and other non-interest income to PNB	21.8	22.5	20.9	21.6	22.4	24.3	29.5	29.2	-
Liquidity									
Liquid assets to total assets 2/	29.8	26.5	28.2	28.4	28.2	5.6	5.6	5.6	6.1
Liquid assets to short-term liabilities	104.1	89.4	89.2	92.6	96.6	83.8	94.4	91.7	103.9
Deposits to loans	94.6	87.4	89.5	89.6	88.8	87.4	86.8	85.4	84.8
Deposits of state-owned enterprises to total deposits	13.8	12.6	13.2	13.0	11.7	9.5	7.8	6.8	6.3
Sensitivity to market risk									
FX net open position to tier 1 capital	1.4	1.9	2.3	3.1	2.2	3.3	4.9	6.4	9.6

Source: Central Bank of Tunisia.

1/ Coverage of private sector credit may differ from that of Table 7.

2/ 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.

- = not yet available.

Table 10. Tunisia: Illustrative Medium-Term Outlook, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
						Proj.			
	(Annual percentage change)								
Real GDP	**1.2**	**1.1**	**2.0**	**2.6**	**3.1**	**3.4**	**3.6**	**4.0**	**4.0**
Total consumption	**3.3**	**3.0**	**1.8**	**-0.7**	**-1.0**	**-0.5**	**1.9**	**3.0**	**4.2**
Private consumption	2.6	2.1	1.3	-1.2	-0.3	1.5	1.8	2.8	4.2
Public consumption	5.8	6.0	3.6	1.2	-3.4	-7.5	2.1	4.0	4.0
Investment	**-8.6**	**-1.7**	**-1.3**	**5.4**	**10.3**	**15.6**	**8.2**	**7.0**	**5.0**
Gross fixed capital formation	-1.2	-1.7	-1.3	5.4	10.1	15.7	8.3	7.1	5.0
Change in stocks	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1
Trade balance	**-0.3**	**-2.0**	**1.8**	**5.3**	**4.5**	**1.4**	**0.6**	**0.0**	**-0.8**
Exports of goods and non-factor services	-2.8	0.2	4.6	6.5	5.1	3.5	4.0	3.3	3.3
Imports of goods and non-factor services	-2.5	2.3	2.8	1.1	0.6	2.1	3.3	3.3	4.1
Inflation (annual average)	**4.9**	**3.7**	**5.3**	**7.8**	**7.0**	**5.7**	**5.2**	**4.5**	**4.0**
	(Percent of GDP)								
Gross national savings	**11.0**	**9.6**	**9.6**	**10.1**	**12.1**	**15.2**	**16.9**	**18.2**	**18.9**
Central government 1/	-0.6	-2.1	-0.4	-0.1	1.7	4.2	5.1	5.4	5.7
Rest of the economy	11.6	11.7	10.0	10.2	10.5	11.0	11.8	12.7	13.3
Gross investment	**20.0**	**18.4**	**19.8**	**19.8**	**20.7**	**23.0**	**24.0**	**24.7**	**24.9**
Central government 1/	4.7	5.3	5.5	5.2	5.4	6.7	7.3	7.7	7.9
Rest of the economy	15.3	13.1	14.3	14.6	15.3	16.3	16.7	17.0	17.0
Total consumption	**90.9**	**92.3**	**92.6**	**92.1**	**90.4**	**87.1**	**85.5**	**84.2**	**83.4**
Private consumption	71.4	71.8	71.8	71.5	71.2	69.9	68.6	67.3	66.5
Public consumption	19.6	20.5	20.8	20.5	19.2	17.2	16.9	16.9	16.9
Savings-investment balance	**-8.9**	**-8.8**	**-10.2**	**-9.7**	**-8.5**	**-7.8**	**-7.0**	**-6.5**	**-6.0**
Central government 1/	-5.2	-7.5	-5.9	-5.3	-3.7	-2.5	-2.2	-2.2	-2.2
Rest of the economy	-3.7	-1.4	-4.3	-4.4	-4.8	-5.3	-4.8	-4.2	-3.7
Memorandum items:									
Nominal GDP (in millions of TD)	84,648	89,804	96,664	106,159	116,898	127,201	137,248	149,635	161,845
Overall fiscal balance (pct. of GDP) 2/	-5.6	-6.1	-6.1	-5.5	-3.9	-2.7	-2.4	-2.4	-2.4
Social expenditures (pct. of GDP) 3/	1.6	1.6	1.6	1.9	…	…	…	…	…
Gross public debt (pct. of GDP)	55.4	62.3	70.3	72.0	71.8	70.8	69.8	68.0	66.7
Current account balance (pct. of GDP)	-8.9	-8.8	-10.2	-9.7	-8.5	-7.8	-7.0	-6.5	-6.0
External debt (pct. of GDP)	62.7	66.8	82.6	89.4	91.7	93.0	91.6	90.2	88.7
Credit to the economy (yoy growth, pct.)	6.2	9.7	12.7	10.1	6.9	7.0	7.1	7.4	7.0

Sources: Tunisian authorities; and IMF staff estimates.

1/ Excludes social security, public enterprises, and local governments.

2/ Including grants and excluding privatization.

3/ Public capital expenditures of key ministries and social transfers and programs.

Table 11. Tunisia: Schedule of Purchases Under the Extended Fund Facility, 2016–20

Review	Availability Date	Action	Purchase: Millions of SDRs	Purchase: Percent of quota 1/	Total Purchases: Millions of US$ 2/
	May 20, 2016	Board approval of the EFF	227.2920	41.6897	315.9052
First Review	September 30, 2016	Observance of end-Dec. 2016 performance criteria, completion of the first review	227.2917	41.6896	315.9048
Second Review	September 30, 2017	Observance of end-Dec. 2017 performance criteria, completion of the second review	176.7824	32.4252	245.7036
Third Review	June 15, 2018	Observance of end-Mar. 2018 performance criteria, completion of the third review	176.7824	32.4252	245.7036
Fourth Review	September 17, 2018	Observance of end-Jun. 2018 performance criteria, completion of the fourth review	176.7824	32.4252	245.7036
Fifth Review	December 17, 2018	Observance of end-Sep. 2018 performance criteria, completion of the fifth review	176.7824	32.4252	245.7036
Sixth Review	March 18, 2019	Observance of end-Dec. 2018 performance criteria, completion of the sixth review	176.7824	32.4252	245.7036
Seventh Review	June 17, 2019	Observance of end-Mar. 2019 performance criteria, completion of the seventh review	176.7824	32.4252	245.7036
Eight Review	September 18, 2019	Observance of end-Jun. 2019 performance criteria, completion of the eighth review	176.7824	32.4252	245.7036
Ninth Review	December 18, 2019	Observance of end-Sep. 2019 performance criteria, completion of the ninth review	176.7824	32.4252	245.7036
Tenth Review	April 29, 2020	Observance of end-Dec. 2019 performance criteria, completion of the tenth review	176.7821	32.4252	245.7033
Total			2,045.6250	375.2063	2,843.1425

Source: IMF staff projections.
1/ Quota is SDR 545.2 million.
2/ Indicative amounts based on the program exchange rate.

Table 12. Tunisia: Indicators of Fund Credit, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
				Proj.					
Existing and prospective Fund credit (millions of SDR)									
Disbursement	215.0	227.3	227.3	530.3	707.1	353.6	-	-	-
Stock	1,002.8	1,205.3	1,205.6	1,366.7	1,799.5	2,026.6	1,969.8	1,879.3	1,516.3
Obligations	-	39.0	249.4	397.2	323.3	190.9	129.1	159.6	264.0
Repurchase	-	24.7	227.0	369.3	274.4	126.4	56.8	90.5	245.9
Charges and surcharges	-	14.3	22.3	28.0	48.9	64.5	72.2	69.1	18.1
Stock of existing and prospective Fund credit									
In percent of quota	350.0	221.1	221.1	250.7	330.1	371.7	361.3	344.7	278.1
In percent of GDP	3.3	4.0	4.2	4.8	6.3	6.9	6.4	5.7	4.4
In percent of exports of goods and services	8.0	9.9	9.5	9.7	12.0	13.1	12.3	11.4	8.9
In percent of gross reserves	19.0	28.2	28.2	31.0	34.8	36.6	34.9	30.2	22.8
Obligations to the Fund from existing and prospective Fund arrangements									
In percent of quota	-	7.1	45.7	72.9	59.3	35.0	23.7	29.3	48.4
In percent of GDP	-	0.1	0.9	1.4	1.1	0.6	0.4	0.5	0.8
In percent of external debt service		3.8	13.1	22.2	12.9	8.0	4.3	6.8	11.9
In percent of exports of goods and services	-	0.3	2.0	2.8	2.2	1.2	0.8	1.0	1.6
In percent of gross reserves	-	0.9	5.8	9.0	6.3	3.4	2.3	2.6	4.0

Source: IMF staff estimates.

Table 13. Tunisia: Inclusive Growth Trends

	Tunisia		EMDE
	Trend	Indicator	Average
Growth			
GDP per capita growth (percent; 2015-17 average)	↘	-0.2	1.4
Gross Fixed Capital Formation (percent of GDP; 2015-17 average)	↘	20.2	23.8
Poverty and Inequality			
Poverty headcount ratio at $3.20/day (percent of population; 2011	↘	9.1	33.1
Multidemensional poverty (percent of population)		1.5	31.2
Prevalence of stunting (% of children under 5, 2012)	↗	10.1	23.8
GINI Index (2010)	↘	35.8	39.7
Child mortality (per 1,000, 2015)	↘	14.0	39.7
Growth in mean consumption (growth, %, bottom 40th percentile)		n.a.	2.4
Human Development and Access to Services			
Human Development Index (2015)	↗	0.7	0.6
Life expectancy at birth (years, 2016)	↗	75.7	69.4
Access to electricity (% of population, 2016)	↗	100.0	78.0
Net school enrollment, secondary, total (% population, 2016)	↗	n.a.	62.9
Individuals using internet (% population, 2016)	↗	49.6	40.6
Literacy rate (% population, 2014)	↗	79.0	78.1
Government			
Commitment to reducing inequality index (2017)		0.47	0.35
Government spending on social safety net programs (percent of GDP, 2018)		0.8	1.6
Coverage of social safety net programs in poorest quintile (% population, 2010)		19.8	15.4
Government expenditure on education, total (% GDP, 2015)	↗	6.6	4.7
Health expenditure, domestic general government (% of GDP, 2015)	↗	3.8	2.9
Access to finance			
Account at a financial institution (% age 15+, 2017)	↗	36.8	43.0
Domestic credit to private sector (% GDP, 2016)	↗	77.0	38.9
Loans to SMEs (% of GDP, 2016)		n.a.	7.8
Financial Inclusion Index (IMF, 2017)		0.2	0.3

	Tunisia		EMDE
	Trend	Indicator	Average
Labor markets			
Unemployment rate (% of total labor force, 2017)	↘	15.2	8.2
Female unemployment rate (% of female labor force, 2017)	↘	21.5	9.8
Youth unemployment rate (% of total labor force ages 15-24, 2017)	↘	35.8	17.7
Labor force participation (% of total population ages 15+, 2017)	↘	46.9	62.6
Female labor force participation (% of female population ages 15+, 2017)	↘	24.3	51.7
Youth labor force participation (% of population ages 15-24, 2017)	↗	34.3	43.5
Business environment			
Ease of Doing Business (DTF, 2018)	↘	63.6	56.2
Registering property (DTF, 2018)	↘	63.2	57.4
Enforcing Contracts (DTF, 2018)	↘	59.3	52.4
Paying Taxes (DTF, 2018)	↘	60.1	63.8
Getting electricity (DTF, 2018)	↘	82.3	60.0
Trading across borders (DTF, 2018)	↘	60.1	62.8
Getting credit (DTF, 2018)	↗	45.0	47.7
Global Competitiveness Index (2018)	↘	3.9	3.9
Governance			
Global Competitiveness Index - Institutions Index (2017)	↘	3.8	3.6
Government Effectiveness (WGI, 2016)	↘	-0.2	-0.5
Regulatory Quality (WGI, 2016)	↘	-0.5	-0.4
Rule of Law (WGI, 2016)	↗	0.0	-0.4
Control of Corruption (WGI, 2016)	↘	-0.1	-0.3
Gender			
Account at a financial institution (female vs male, %), 2014		60.2	79.6
Female employment to population ratio (%, 2017)	↗	19.0	47.2
Literacy rate (female vs male, %, 2014)	↗	83.9	86.1
Net school enrollment, secondary (female vs male, %, 2016)	↗	111.1	97.3
Gender Gap Index		n.a.	0.7

Sources: WB Development Indicators, WB Doing Business, WB Health Nutrition and Population Statistics Database, IMF World Economic Outlook, World Economic Forum, WB Governance Indicators, Transparency International, UNDP, Oxfam International.

Recent trend improving ↗ (green) — Better than EMDE average (green)

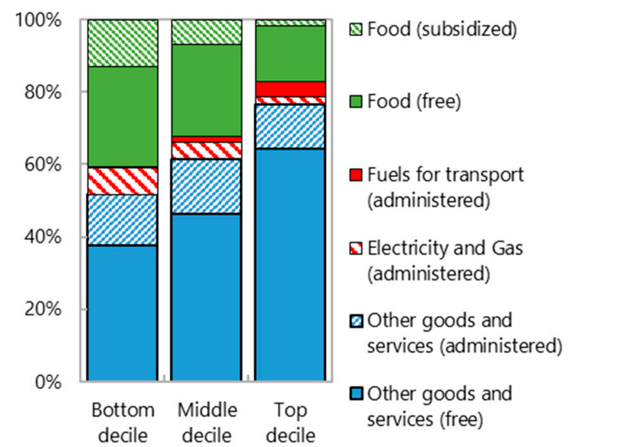
Recent trend worsening ↘ (red) — Worse than EMDE average (pink)

Annex I. Inflation Across the Spending Distribution[1]

Inflation in Tunisia has risen more rapidly for households that are in the top decile of consumer spending than for households in the bottom decile. Households with few resources have been somewhat shielded from inflation because of the higher share of products with subsidized and administered prices in their consumption basket. Targeted subsidies for food staples and differentiated energy subsidies for poorer households have played a crucial role in limiting the impact of inflation on the purchasing power of the vulnerable.

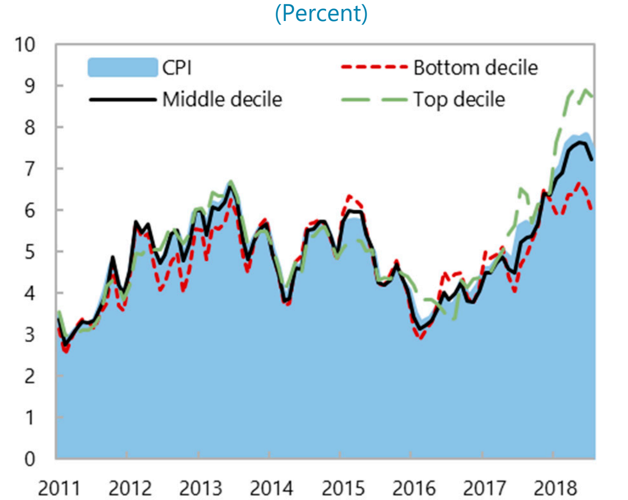
1. **Households in each decile of the spending distribution face their own individual rate of inflation.** Tunisia's *2010 Households Expenditure, Consumption, and Living Standards Survey* contains information about households' individual consumption baskets by spending decile. These baskets vary significantly between households that spend little, presumably because of low incomes, and those that spend a lot, presumably because of high incomes (Figure 1). For example, the bottom decile consumes a significant share (35 percent) of good and services that are either outright subsidized or whose price are administered in some way. The top decile, in contrast, spends about 80 percent of their expenditure on good and services whose prices are free. Another significant difference concerns the share of food in total expenditure: the bottom decile spends about 40 percent on food, whereas the top decile spends less than 20 percent.

Figure 1. Tunisia: Consumption Baskets by Decile, 2010



Sources: Tunisian authorities; and IMF staff calculations.

Figure 2. Tunisia: Headline Inflation, 2011-18
(Percent)



Sources: Tunisian authorities; and IMF staff calculations.

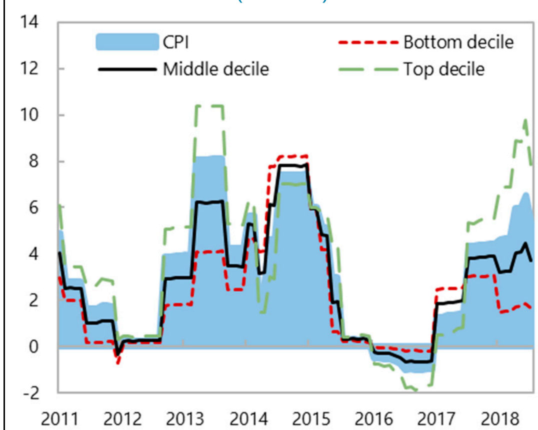
2. **The inflation rate of households varies with their consumption patterns.** Average inflation approached 8 percent in mid-2018, following a period of relative stability around 5 percent in 2012–15. But Tunisian households experienced the recent inflationary episode rather differently depending on their consumption pattern

[1] Prepared by Adnen Lassoued (IMF) and Nejib Haouech (Tunisian National Institute of Statistics).

(Figure 2). In June, with headline inflation reaching 7.8 percent, its highest level since 1991, inflation peaked at 8.9 percent for households in the top decile, but it stood at a lower 6.5 percent for households in the bottom decile. The difference in inflation of 2.4 percentage points is the largest gap between the top and the bottom deciles in recent history. Similarly, the drop of annual inflation in July to 7.5 percent benefitted more the bottom decile, for which inflation declined to 6 percent, where inflation remained stable at 8.8 percent for the top decile. On average since early 2017, inflation for the top decile has been 1.2 percentage points higher than for the bottom decile.

3. **Different consumption baskets are the main reason behind the inflation differential.** Households in the top decile consume relatively more products with rapidly rising prices and relatively less products with slower rising prices. For example, the households in the top decile spends 18 percent (of their consumption) on car purchases and maintenance, and gasoline, compared with only one percent in the bottom decile. The prices in this product group rose by more than 12 percent in the first half of 2018. Conversely, the bottom decile spends 13 percent on subsidized food relative to 2 percent in the top decile. Prices of subsidized foods have hardly moved in the first half of this year, helping to contain inflation for the poor.

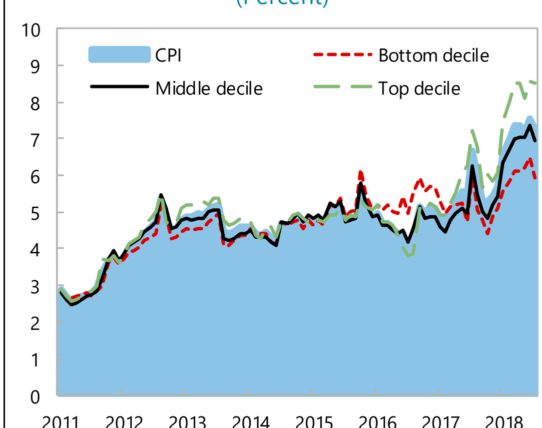
Figure 3. Tunisia: Energy Inflation, 2011-18
(Percent)



Sources: Tunisian authorities; and IMF staff calculations.

4. **Energy price inflation has also varied substantially across households** (Figure 3). Although the overall share of energy in total expenditure does not change as households move up the spending distribution, the individual energy mix does change. Specifically, the bottom decile consumes relatively more of electricity and Liquefied Petroleum Gas (accounting for about 95 percent of their total energy consumption), products whose prices have remained relatively stable. In contrast, the top decile has had to confront the 11 percent increase in prices of fuels that account for 66 percent of their energy consumption.

Figure 4. Tunisia: Core Inflation, 2011-18
(Percent)



Sources: Tunisian authorities; and IMF staff calculations.

5. **Imported inflation has also affected households unevenly**. The depreciation of the dinar seems to have affected mainly better-off households, as they spend more on imported consumer goods with prices directly linked to the exchange rate. Higher prices for imported consumer goods have led to a higher rate of core inflation for the top decile (Figure 4). Core inflation measures the increase in prices of all goods and services except food and energy.

6. Policy choices of the Tunisian government have contributed to diverging inflation across households. The authorities' policies have helped to shield the poor from inflationary pressures and share more fairly the burden of the economic adjustment. For example, subsidies for basic food staples and the energy subsidy reform, aimed at energy products consumed by the better-off, seem to have been effective tools in stabilizing the purchasing power of the poor and vulnerable. Moreover, the depreciation of the dinar, whose benefits in terms of competitiveness have an inflationary cost in the short run, seems to mainly affect groups of the population who have the resources to hedge themselves from inflation.

7. A full cost-benefit analysis of food and energy subsidies is complex and beyond the scope of this Annex. The analysis above does not attempt to quantify how households' overall welfare changes with higher inflation nor the effects of inflation on producers and the budget. Inflation affects the real value of assets, liabilities and income. It has been shown in comparable countries that better-off households are better positioned to protect the real value of their assets and income than the middle class and poorer households. Similarly, subsidies have budgetary and supply-side implications, which can be significant, especially over the longer run.

Annex II. Exchange Rate Policy—Impact of Depreciation

1. **Dinar depreciation facilitates reducing Tunisia's elevated current account deficit.** Since 2016 the Tunisian dinar has depreciated relative to most (but not all) currencies of its trading partners (see Figure 2.a)—contributing to a more competitive international price for Tunisian goods and services.

2. **The exact impact of depreciation however depends on the invoicing currency of trade flows.** Export and import prices can be set in (1) the exporter's currency (producer currency pricing); (2) the importer's currency (local currency pricing); or (3) a common "vehicle" currency, irrespective of the currencies used by the exporter and importer (dominant currency pricing).[1]

3. **The effects of exchange rate changes on the current account varies across cases. Consider the example of trade between Tunisia and Turkey.**

- ***Under producer currency pricing***, Tunisian (Turkish) exporters set their prices in dinars (lira). Here, a depreciation of the dinar vis-à-vis the lira will have a strong, positive effect on the current account by (i) making Tunisian export cheaper for importers in Turkey (boosting Tunisian export volumes), while (ii) making imports from Turkey more expensive for Tunisians (inducing expenditure switching, leading to a contraction in import volumes). The depreciation will also increase the value of imports (given volumes), but as the Marshall-Lerner condition seems to be satisfied in the Tunisian case,[2] the depreciation will still improve the current account in nominal terms.

- ***Under local currency pricing***, the exchange rate tends to have a weaker impact on the current account. Now, prices in local currencies are fixed and a depreciation has zero impact on the prices that importers face. There is no contraction in import volumes—nor is there an increase in export volumes. Still, Tunisian exporters will see their export revenues go up in local currency, as the same export volume (priced in lira) is now worth more when converted into dinars at the depreciated exchange rate.

- ***With dominant currency pricing***, both Tunisian and Turkish exporters set their prices in a common "vehicle" currency (say US dollars). In this case, only the exchange rate of the Tunisian dinar vis-à-vis the US dollar matters. When the dinar depreciates relative to the dollar, Tunisian importers will see the local currency value of their import bills go up—giving rise to a reduction in import volumes. Similarly, Tunisian exporters will see the local currency value of their exports go up (as given revenues in US dollars are now worth more in dinars). What happens to export volumes depends on the value of the lira relative to the US dollar: if the lira depreciates relative to the US dollar: if the lira depreciates relative to the dollar as well, Turkey will face higher import

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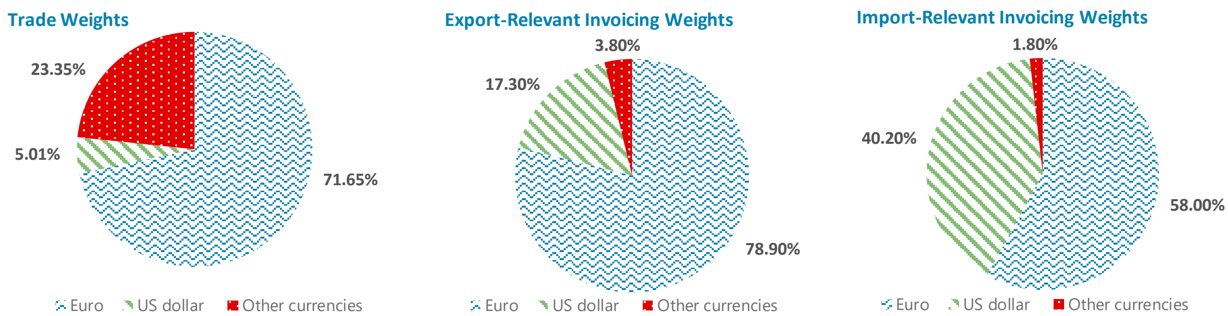
[1] See Casas, Diez, Gopinath, and Gourinchas (2017), "Dominant currency paradigm: a new model for small open economies", mimeo, Harvard University.

[2] See CBT (2018), "Elasticité du volume des échanges commerciaux de la Tunisie par rapport au taux de change réel du dinar", Working Paper, Banque Central de Tunisie.

prices when converted into liras and demand less—leading to a contraction in Tunisian export volumes.

Figure 1. Tunisia: Trade and Invoice Currency Weights, 2018



Sources: Tunisian authorities; and IMF staff calculations.

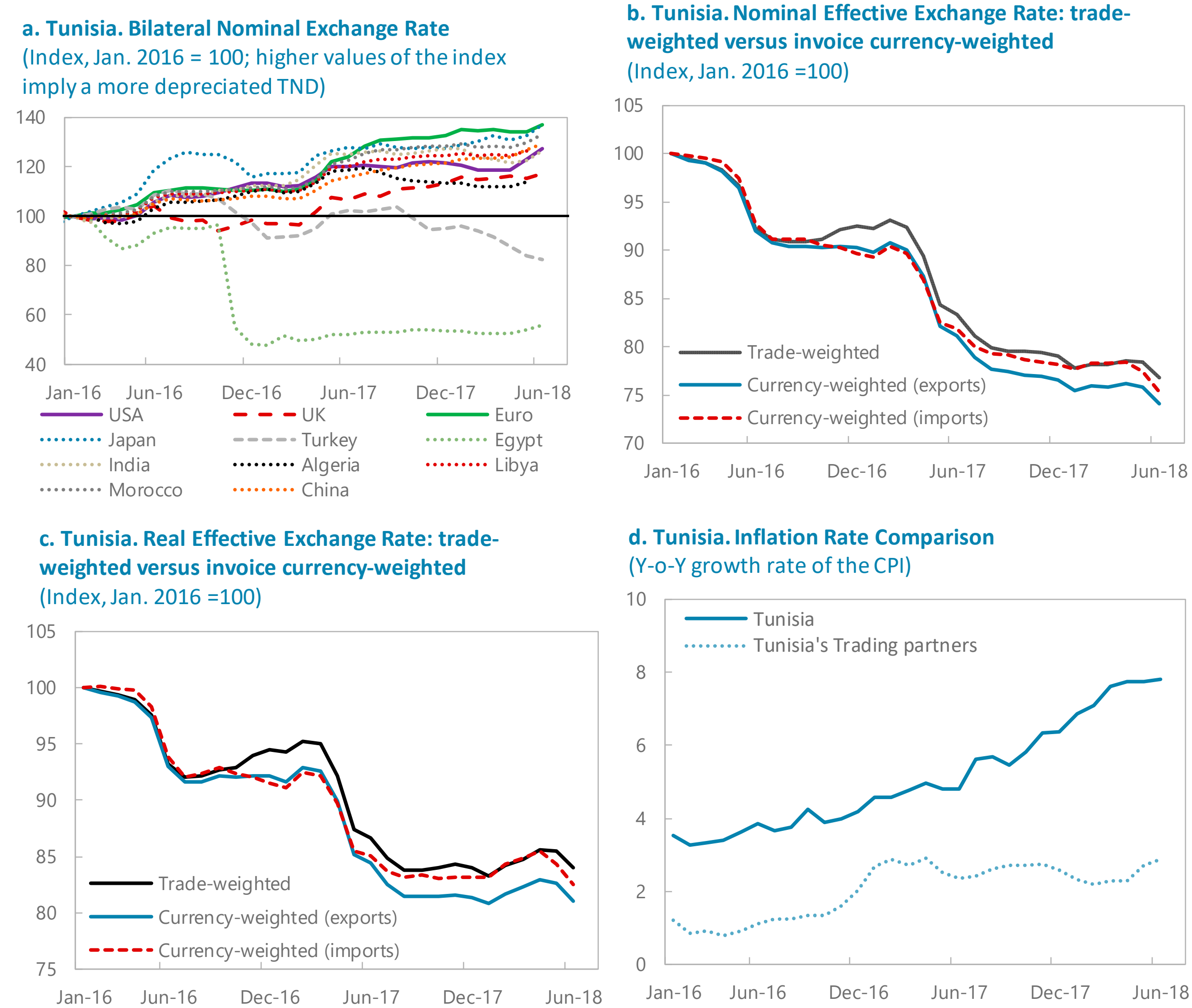
4. **Calculating Tunisia's effective exchange rate, confirms that the Tunisian economy has become more competitive since 2016** (Figure 2.b-c). This result is obtained by taking the standard trade-weighted approach, but comes out even stronger from the analysis follows even more so if one takes proper account of the currency of invoicing (which suggests an improvement in competitiveness that is about 2 percent stronger). This is because the appreciation of the dinar vis-à-vis the Egyptian pound and Turkish lira (visible in Figure 2.a) is not directly relevant, as most trade with these countries is invoiced in US dollars (against which the Tunisian dinar has depreciated).

5. **The exchange rate which is relevant for exports, has fallen by more than that for the imports**. The reason is that the Euro plays a larger role in invoicing on the export-side, with the dinar having depreciated more vis-à-vis the Euro since 2016 than vis-à-vis the dollar. At the same time, the implied appreciation of the Euro vis-à-vis the US dollar since 2016 is likely to have boosted Tunisian exports towards Europe (as part of it is these are priced in US dollars, which have become cheaper for importers in the Eurozone). Supported by these trends, Tunisian export volumes have increased by 9.3 percent since 2016, with import volumes increasing by only 2.6 percent.

6. **Beyond trade of goods, depreciation of the dinar can help to boost other current account inflows.** For example, tourists coming to Tunisia pay their bills in Tunisian dinars, while Tunisian tourists traveling to (say) Europe are charged in Euros. As a result, the depreciation of the dinar relative to the Euro can be expected to improve the tourism balance—both through increased tourism revenues in Tunisia, as well as through lower tourism expenditures abroad. Similar considerations apply to remittances.

7. **In recent months however, the real depreciation achieved by Tunisia in the past is endangered by increases in Tunisia's** overall price level (Figure 2.d). Tunisia's inflation rate has long stood above average inflation levels experienced by its trading partners, but recently the difference has widened. As a result, real depreciation has undershot nominal depreciation since 2016—and has come to a near-halt since the beginning of 2018.

Figure 2. Tunisia: Nominal and Real Exchange Rate Developments, 2016–18



Sources: Tunisian authorities; and IMF staff calculations.

Annex III. Risk Assessment Matrix (RAM)[1]

Domestic Risks	
High **Slow reform implementation**, due to continued political uncertainty, social tensions, and opposition to reforms from vested interests. *High* **A deteriorating security situation**, including due to spillovers from Libya and other conflicts in the region. These could take the form of major refugee flows, increased illicit economic activity including smuggle trade, and violent attacks.	*High* Growth may fall and macroeconomic stability may be impaired by a halt of structural reforms and stability-focused macroeconomic policies, lower confidence and investment, and diversion of growth-enhancing expenditures to security-related items. Budget financing could be affected by delays in support from IFIs and bilateral donors. Mitigation strategies include (i) effective communication to generate broad buy-in to reforms; (ii) measures to rebuild fiscal and external buffers, including growth-friendly fiscal consolidation and sustained exchange rate flexibility; (iii) acceleration of structural reforms, including to increase the resilience of the financial sector; and (iv) close cooperation with external partners.
External Risks	
High (ST, MT) **Rising protectionism and retreat from multilateralism.** Global imbalances and fraying consensus about the benefits of globalization lead to escalating and sustained trade actions and spreading isolationism. This threatens the global trade system, regional integration, labor mobility, as well as global and regional policy and regulatory collaboration. In the short term, increased uncertainty about growth triggered by escalating trade tensions leads to increased financial market volatility. Negative consequences for growth are, in turn, exacerbated by adverse changes in market sentiment and investment.	*Low* Growth may fall due to lower confidence and investment; lower demand for Tunisia's exports in Europe; the impact of protectionism on trade and finance flows; and increased security spending. Mitigation strategies are the same as above.
High (ST) **Sharp tightening of global financial conditions** causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn. Tighter financial conditions could be triggered by a sharper-than-expected increase in U.S. interest rates (prompted by higher-than-expected inflation) or the materialization of other risks.	*Medium* Sovereign refinancing risks and debt service would increase, but Tunisia's strong reliance on debt to official creditors would limit the impact. In addition, a worsening of investor sentiment toward Emerging Market Countries could affect the envisaged sovereign bond issuance. Pressures on international reserves could also intensify, even if the capital account remains relatively closed. Mitigation strategies are the same as above, with an additional focus on debt management and measures to ensure financial sector stability. Moreover, the Financial Action Task Force's (FATF) and the European Union's recent inclusion of Tunisia to lists of jurisdictions with significant AML/CFT deficiencies increases the risk of a loss of correspondent banking services (CBS). This would hurt cross-border payments, trade finance, and remittances. To mitigate this risk, the authorities are working with the FATF and MENA-FATF to strengthen the effectiveness of their AML/CFT regime.
Medium (ST, MT) **Sizeable deviations from baseline energy prices.** Risks to oil prices are broadly balanced. Prices could rise sharply due to steeper-than-anticipated export declines in some producers, possibly prompted by political disruptions, amid supply bottlenecks. Prices could drop significantly if downside global growth risks materialize or supply exceeds expectations, possibly due to faster-than-expected U.S. shale production growth, or, over the medium term, higher OPEC/Russia production. While, on aggregate, lower oil prices would benefit global growth, they would negatively affect oil exporters.	*High* In case of a sizeable increase of international oil prices, Tunisia's fuel subsidies would exceed the budgeted level and put fiscal consolidation at risk. Mitigation strategies include following through with adjustments of pump prices, further hikes in electricity and gas tariffs for firms, and other measures to reduce consumption of subsidized fuels.
Medium (MT) **Weaker-than-expected global growth, in particular in the Euro Area.** Progress on fiscal adjustment, on addressing legacy banking-sector problems, and on other structural reforms slows or reverses, raising debt sustainability concerns, steadily pushing up borrowing costs, and undermining medium-term growth prospects.	*Low* Tunisia's growth would be adversely affected through trade, remittances, and investment channels, especially from Europe. Mitigation strategies are similar to above, with a strong focus on competitiveness reforms.

[1] 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. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex IV. Macro Imbalances and the Central Bank Balance Sheet

The CBT's balance sheet expansion reflects broader macroeconomic imbalances and its own liquidity management. While historically the balance sheet expansion reflected mainly accumulation of FX reserves, since 2010 it has been driven by increasing domestic credit, initially to banks, and more recently, after 2016, also to the government. This change in the sources of the balance sheet expansion reflects the growing macro-economic imbalances and the CBT's policy of accommodating banks' demand for refinancing. Further streamlining of monetary operations and clarification of the monetary policy framework would allow the CBT to improve the management of its balance sheet in support of reducing inflation.

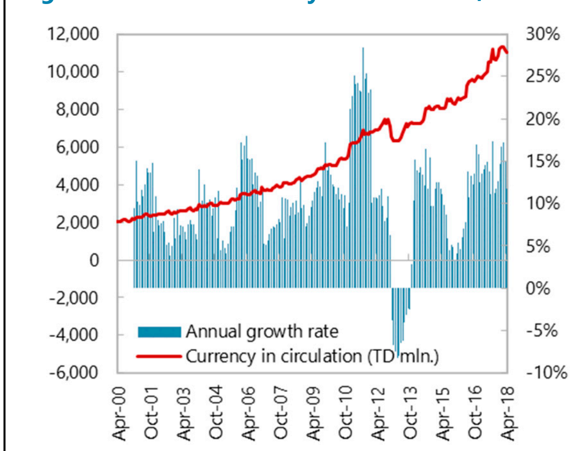
1. The CBT's balance sheet has expanded since 2011:

- **Before 2011, the balance sheet expansion reflected mainly NFA accumulation.** Stable FX inflows from traditional goods and services exports (olive oil, phosphates, petroleum, tourism), as well as stable remittances, underpinned this trend.

- **After 2011, the CBT has started to loosen NFA, while demand for reserve money has been increasing.** The reversal of the long-standing trend of NFA accumulation reflected a strong decline in petroleum and phosphate exports, unstable tourism-related inflows with lower tourist arrivals due to the violent attacks and regional instability, as well as lower remittances from the diaspora as a result of the downturn in Europe. To meet banks' demand for reserve money, the CBT offset NFA outflows with domestic liquidity injections. Nevertheless, the size of the CBT balance sheet remained broadly stable until 2015 (Figure 2).

- **Since 2016, as the losses of NFA accelerated, the public demand for cash also started increasing.** The demand for cash reflected mainly the growing informal economy (Figure 1). As a result, credit to the banking sector, excluding FX swaps, more than doubled from TD 4 billion in December 2015 to TD 10 billion in June 2018. This trend also reflected growing liquidity strains in the banking sector, as deposits declined. In addition, net credit to the government—that was negative in early 2015—increased from TD 0.7 billion in December 2015 to over TD 6 billion in June 2018, mainly due to IMF disbursements. At the same time, the share of the NFA in CBT total assets contracted to 25 percent, reflecting increasing current account deficits and weak capital inflows.

Figure 1. Tunisia: Currency in Circulation, 2000–18

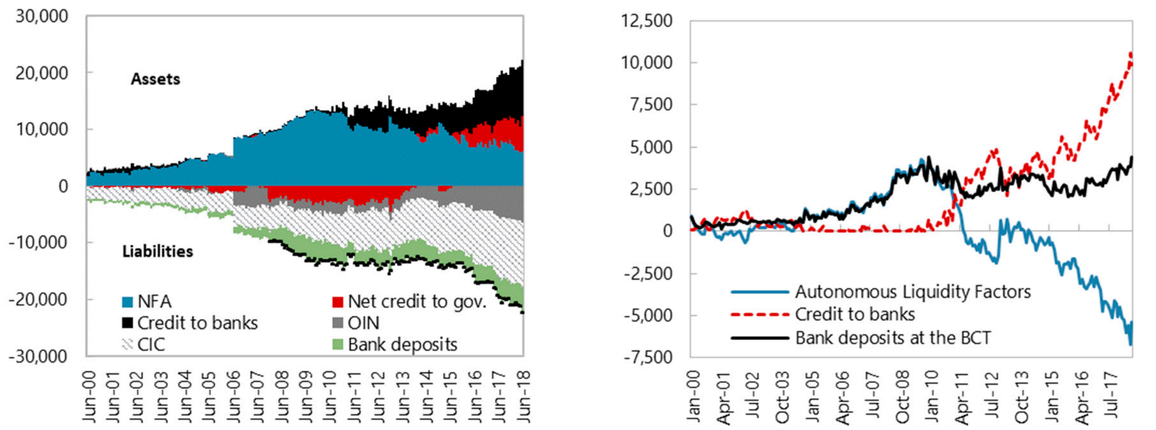


Sources: Tunisian authorities; and IMF staff calculations.

Figure 2. Tunisia: Central Bank of Tunisia Balance Sheet, 2000–18

a. Central Bank Analytical Sheet

b. Autonomous Liquidity Factors, Bank Deposits, and CBT Monetary Operations



Source: Central Bank Survey and IMF staff calculations.

2. **The balance sheet expansion has likely contributed to inflation and dinar depreciation:**

- **Despite increasing liquidity injections, local currency liquidity has remained tight.** The money market rate often traded at the corridor ceiling, in part reflecting the TD 7 billion cap on the main refinancing operations introduced in 2017. Despite the cap, the aggregated volume of all CBT liquidity injections continued to grow, even at a faster pace than before (Figure 3). Injections through FX swaps, structural OMOs, and the overnight lending facility have increased significantly.

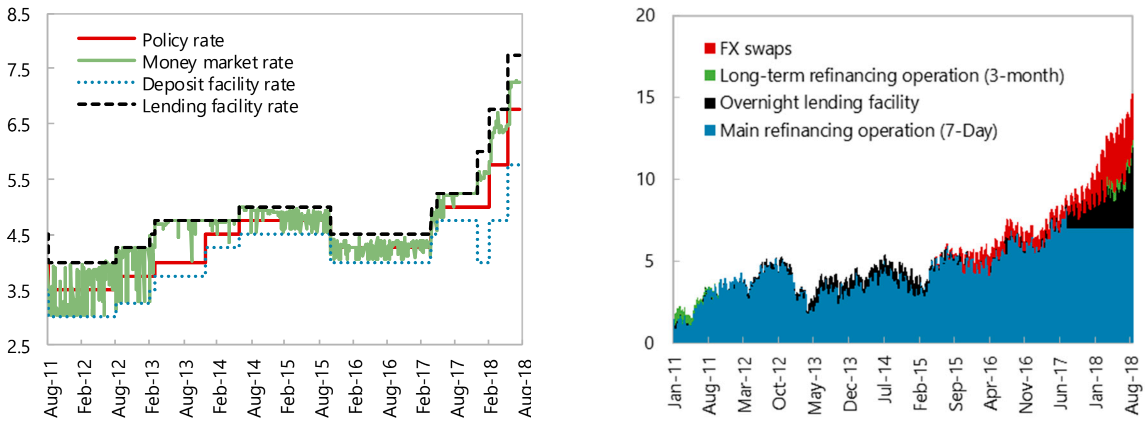
- **The CBT's balance sheet expansion has likely fueled inflation.** In response, the CBT increased its key policy rate by 250 basis points in 2017-18. Nevertheless, its balance sheet continued to expand until July 2018.

- **In an environment of increasing exchange rate flexibility, the balance sheet expansion prompted currency substitution**. While bank reserves in local currency dropped significantly since 2011, bank reserves denominated in FX increased from TD 0.9 billion in January 2011 to TD 2.2 billion in March 2018, also reflecting. the effect of the exchange rate depreciation of the dinar between 2011 and 2018.

Figure 3. Tunisia: Central Bank of Tunisia Monetary Operations and Interest Corridor, 2011–18

a. Interest Rates
(Nominal, in percent)

b. CBT Reserve Liquidity Injection Operations
(TD billions)



Source: Central Bank Survey and IMF staff calculations.

3. Monetary tightening requires a determined policy response:

While the expansion of the balance sheet reflects broader macroeconomic imbalances, containing inflationary and foreign exchange pressures requires steadfast implementation of a comprehensive set of policies and reforms:

- **Addressing macroeconomic imbalances.** Reducing large current account and fiscal deficit is critical to alleviate pressures on the exchange rate, the domestic price level, and central bank refinancing.

- **Gradually unwinding liquidity injections and streamlining the CBT's liquidity management framework.** The liquidity management framework should be streamlined, especially through gradually winding down FX swaps and structural open market operations. Liquidity needs of illiquid and insolvent banks should be addressed through the emergency liquidity assistance (ELA) framework.

- **Better protecting the CBT's balance sheet against risks.** The CBT should increase the share of government bonds accepted as collateral for CBT refinancing and apply discounts[1] on the value of government bonds presented for collateral.

- **Strengthening the interest rate channel of monetary transmission.** Increasing the cap on lending rates and updating it more frequently will ease the transmission of policy rate changes to lending rates.

[1] Currently, haircuts of 30 percent are applied to private sector paper.

- **Clarifying the monetary policy framework and consider setting an explicit medium-term inflation objective.** Maintaining a clear nominal anchor is essential to guide inflation expectations and achieve the CBT's price stability mandate (IMF, 2015).

- **Strengthening monetary policy communication and accountability (see also Annex V).** Effective communication, including through the publication of regular monetary policy reports, would help reduce uncertainty and build accountability and credibility. As the CBT's credibility is consolidated, communication can substitute to some degree for stronger policy actions (IMF, 2015).

Annex V. Monetary Policy Communication[1]

1. **Strengthening the CBT's communications strategy is critical to better anchor inflation expectations.** Sound practices of central banks' communication cover the monetary policy framework, analysis of economic conditions, including the outlook for growth and inflation, and the major risks to that outlook, as well as a clear explanation of monetary policy decisions. Communication should also ensure the transparency of the central bank monetary policy operational framework. Effective communication helps reduce uncertainty, improves monetary policy transmission, and facilitates accountability, thereby building credibility.

2. **There is room to further strengthen clarity regarding the CBT's monetary policy anchor.** Now that the exchange rate is no longer the main anchor for monetary policy, and that the CBT is preparing to gradually evolve to inflation targeting by upgrading its analytical and forecasting tools, communication will also need to evolve toward the standards of inflation targeters.

3. **A monetary policy report should become one of the main vehicles of CBT's communication**. The inflation report/monetary policy report presents the central bank's assessment of economic conditions and its view on prospects for inflation and growth, including its projections for these variables. The main upside and downside risks to the projections and alternative scenarios are often included. One of the main purposes of such a report is to explain the rationale behind the monetary policy decisions.

4. **The CBT is in a good position to publish a monetary policy report.** The CBT macro-forecasting tools include short-term forecasting models as well as a medium-term Quarterly Projection Model (QPM). The report on "*Evolution Economic et Monétaires et Perspectives à Moyen Terme*" published on the CBT website already has many elements of a monetary policy report and could be upgraded and published on a regular basis (for example, quarterly). The monetary policy report should include the central bank medium-term projections of inflation and growth as well as a clear explanation of its policy decisions.

5. **The CBT can use other tools for more effective communication.** Such tools include press conferences, regular meetings with banks and financial market analysts, and research papers to further support the communications effort with background information on specific topics. Clear communication should ensure that the various communication tools send signals that are consistent with each other and well-coordinated. With a variety of communication tools available—the website, monetary policy reports, press releases, interviews, webinars—coordination of the main message across the individual tools is crucial.

[1] Also see International Monetary Fund. 2015. "Evolving Monetary Policy Frameworks in Low-Income and Other Developing Countries", October. Adrian, Tobias, Douglas Laxton, and Maurice Obstfeld, eds. 2018. "Advancing the Frontiers of Monetary Policy," Washington, DC: International Monetary Fund. Gill Hammond. 2012. "State of the Art in Inflation Targeting", Bank of England.

6. **The CBT is encouraged to prepare a monetary policy communications strategy**. The strategy should be complemented by an implementation plan that would structure and sequence work on strengthening CBT's communications capacity, including regarding its website, press conferences, and research papers.

Appendix I. Letter of Intent

Tunis, September 14, 2018

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

Madame Managing Director,

1. The economic recovery strengthened during the first half of 2018, thanks to a good agricultural and tourist season. To be sustainable though, it must rely on more robust growth drivers. Only a stronger recovery of exports and investment are the guarantors of sustainable growth, which will also create jobs. At the same time, macroeconomic vulnerabilities remain a concern. The improvement in the current account, for example, remains insufficient to tangibly affect foreign exchange (FX) reserves that persist at levels that are too low. Inflation remains high, irrespective of the recent deceleration at the end of the summer. The persistence of rising international oil prices is putting a lot of pressure on the energy subsidy bill in the budget. All these factors warrant the greatest vigilance and promptness in action to preserve macroeconomic stability.

2. Our economic prosperity is intimately linked to a healthy social climate. The inflationary pressures persisting over the last few months endanger the social appeasement that we saw after years of protests. In this delicate context, it was difficult for us to fully implement the programmed fuel price and utility tariffs adjustments over the summer. We remain, however, determined to continue our efforts to contain the energy subsidy bill by rapidly implementing the necessary adjustments, whilst considering the imperative of protecting the most vulnerable.

3. The recent joint mission of the European Union and International Financial Institutions (IFIs)—including the IMF—has enabled us to reassure our key development partners of our resolve to strengthen the implementation of major reforms. The document at hand gives us another opportunity to assure our partners of our full commitment to continuous reform. We can thus confirm that the 2019 budget will be developed in accordance with the agreed priorities of: (1) a further significant reduction of the deficit, based on a continued reduction in the wage bill-to-GDP ratio and significant savings on energy subsidies; (2) an increase in public investment to support growth; and (3) increased social spending to protect the most vulnerable. Monetary tightening and exchange rate flexibility will continue to curb inflation, strengthen the competitiveness of the external sector, and protect international reserves.

4. Performance under the Extended Fund Facility (EFF) arrangement continues to improve. As expected, we achieved all quantitative criteria at end-June. More specifically, we met all four Quantitative Performance Criteria (QPC): (1) the floor on the primary balance of the central government (cash basis, excluding grants); (2) the ceiling on the total current primary expenditure of the central government; (3) the ceiling on net domestic assets (NDA) of the Central Bank of Tunisia (CBT); and (4) the floor on the net international reserves (NIR) of the CBT. We also complied with the continuous performance criterion (CPC) on the zero ceiling on the accumulation of new external debt arrears by the central government and two out of the three quantitative indicative targets (ITs): the zero ceiling on the accumulation of new domestic payment arrears; and the floor on social spending (in line with our commitment to strengthen the protection of the most vulnerable social groups). In addition, we respected the monthly ceiling on net FX interventions by the CBT for the period from March to July but recorded a small breach in August after the transition to the competitive foreign exchange (FX) auctions significantly reduced the size of the FX interbank market. On the structural reform front, we have completed a Prior Action (PA) and two of the three Structural Benchmarks (SBs) due for the Fourth Review. We hence request to reprogram one SB, whilst making substantial progress on many others.

5. In view of both the macroeconomic policies implemented to achieve the main quantitative program objectives and the progress on the agreed structural reforms, we request the approval of the Fourth Review under the EFF arrangement and the disbursement of SDR 176.7824 million. We also commit to implement the measures listed in the schedule of PA and SBs, as described in the attached Memorandum of Economic and Financial Policies (MEFP, including Tables 1 and 2) and the Technical Memorandum of Understanding (TMU).

6. This Letter of Intent (LOI) and the attached MEFP supplement and modify the previous LOI and MEFP dated June 22, 2018. The attached MEFP outlines the main elements of the reform agenda and policies of the Government and CBT, which we intend to put in place during the period 2018–20. We remain committed to applying our program rigorously, while being aware of the challenges posed by the national, regional, and international context.

7. We are convinced that the policies described in the attached MEFP are appropriate for achieving the objectives of our economic program. In addition, we remain vigilant and ready to take any additional measures that may be necessary to achieve these objectives. In line with the IMF's consultation policies, we will discuss with IMF staff the adoption of these measures prior to any revision of the macroeconomic policies contained in this MEFP. All information and data necessary for the monitoring of the program, as well as for the IMF’s technical assistance (TA) missions, will be provided to IMF staff within the agreed deadlines.

8. We authorize IMF staff to publish this LOI and its attachments (i.e. the MEFP, including Tables 1 and 2; and the TMU) as well as the related IMF staff report.

Very truly yours,

/s/

Marouane El-Abassi

Gouverneur de la Banque Centrale de Tunisie

/s/

Mohamed Rida Chalghoum

Ministre des Finances

Attachments (2):

1. Memorandum on Economic and Financial Policies (MEFP)
2 Technical Memorandum of Understanding (TMU)

Attachment I. Memorandum of Economic and Financial Policies

This memorandum describes the main features of our reform program, which aims at maintaining macroeconomic stability while promoting a fairer and inclusive economy.

1. **The political and economic transition continues despite the difficulties.** We remain committed to addressing macroeconomic imbalances and deep economic reform to prepare Tunisia and its citizens for a better future. The first benefits are finally visible: the economy recovers, the tourist season has been a success, and budget deficits are under control. However, our resolve is daily tested by a difficult social climate, a political landscape in perpetual motion, and an external environment less favorable than in the past. Accelerating reforms is our only option to boost investment, exports, and private initiative. In the same vein, we remain committed to maintaining stable public finances and external balances. This mission has become more difficult this year due to the significant and unexpected surge in international energy prices, which have increased by more than 50 percent over the last twelve months. Our policy choices are difficult, but crucial. We are therefore redoubling our efforts to publicly explain their implications.

2. **The Government is committed to implementing its reform plan.** A new reform momentum has developed since the end of last year. To reap its benefits, we continue to accelerate the reform process—both through the adoption of legal and regulatory texts, and the effective implementation of concrete reform proposals. From now until year-end, our focus will be on three priorities: (1) reducing energy subsidies; (2) preparing a 2019 Budget Law in line with the commitments made under the EFF arrangement, particularly regarding containing current expenditure, increasing public investment, and protecting social spending; and (3) continuing tightening of monetary policy and increasing exchange rate flexibility.

I. THE RECOVERY IS FIRMING UP, BUT ELEVATED VULNERABILITIES PERSIST

3. **The recovery firms up in 2018.** The good economic performance in the first quarter continued through the second, with a growth rate of 2.8 percent compared to the same quarter of last year (year-on-year). In fact, growth has been improving over the last three quarters, signaling a certain robustness of the economic recovery. This pick-up in growth is due to the agricultural sector (+9 percent) and service sector (+3.6 percent). The Tunisian economy has continued to post an encouraging performance in the tourism, transport and financial services sectors. Noteworthy is also the pick-up of chemical industries on the back a recovery in phosphate production, after a sharp decline during the previous quarter. Consolidating this upward trend in growth will inevitably depend on diversifying the sources of growth toward investments and exports, which so far have shown mixed results.

4. **Fiscal consolidation starts to pay off.** At end-June 2018, budget execution is in line with our commitment made in the 2018 Budget Law to consolidate the budget deficit. Tax revenues are up significantly compared to the first half of 2017, by about 15 percent. Current expenditure

decreased by 1 percent, with the wage bill (excluding tax credits) down by 2 percent. Consistent with our objective of redirecting spending to public investment, capital spending increased by 14 percent. Notwithstanding the containment of the fiscal deficit, public debt rose to 71.5 percent of GDP at end-June 2018 (compared to 67.9 percent of GDP in the same period of 2017), mainly on the back of the depreciation of the dinar and budgetary financing needs in line with the 2018 Budget Law. Our medium-term fiscal anchor remains a downward path for public debt to preserve our ability to finance our budgetary needs. In addition, we need more fiscal space to increase public investment and social spending. These increases will sustain the recovery and create more jobs for all Tunisians, including young people, graduates and women.

5. **Inflationary pressures remain worrying.** Inflation slowed for the first time since September 2017 to 7.5 percent in July and August, after reaching a record 7.8 percent in June. Nevertheless, this rate remains high and worrisome. To mitigate the risk of an inflationary spiral, the CBT raised its policy interest rate by 100 basis points to 6.75 percent in June, which in turn increased the money market rate (MMR) to 7.25 percent. Despite this decision, the dinar continued to depreciate against key foreign currencies, in particular because of the rising inflation differential with our main trading partners. In addition, higher policy rates have not yet brought the real MMR back to positive territories. CBT refinancing of commercial banks has reached new records to exceed TD 16 billion in mid-August 2018 before showing some decline. These indicators show that the transmission channels of monetary policy work slowly. More time will be necessary for monetary policy to show its full effect. However, if the recent slowdown in the growth of credit to the economy continues, it should attenuate inflation in the months ahead. Gradually reducing inflation to the average levels experienced in the past will remain the CBT's major objective in the future.

6. **The current account and FX reserves remain under pressure.** The current account improved slightly during the first 7 months of 2018, generating an annualized deficit of 11 percent of GDP (compared to 12 percent of GDP for the same period in 2017). This result is due to improvements in exports, which increased by 23 percent at end-July 2018. Exports from agriculture and agri-food industries, but also from the manufacturing sector performed well. Moreover, continued improvements in the security situation and the depreciation of the dinar boosted tourism receipts and remittances, which grew significantly at 44 percent and 15 percent, respectively. On the other hand, imports also increased significantly at 21 percent at end-July 2018, mainly due to costlier energy imports. The slight improvement in the current account did not have the expected effect on our FX reserves. In fact, FX reserves stood at 70 days of imports in mid-August, mainly because of the high current account deficit, significant debt service, and delays with our planned Eurobond issuance. We are fully aware that higher international oil prices for the remainder of the year—together with low domestic energy production and strong consumption—will put significant pressure our external balances.

7. **The banking sector remains resilient.** The banking sector posted encouraging results during the first half of this year. The aggregate capital adequacy ratio (CAR) remained at around 12 percent at end-June 2018, supported by solid profitability that resulted from strong corporate credit demand. On the other hand, non-performing loans (NPLs) persisted at high levels,

representing around 14 percent of total loans at end-March 2018. The provisioning rate for NPLs stood at 58 percent (excluding accrued interest). Deposit mobilization has also remained insufficient to ease pressures on banks' liquidity. Strong demand for cash—partly related to speculation and the seasonal effect of strong demand for bank notes during the summer period—is leading banks to overly rely on the CBT's bank refinancing window.

8. The business climate remains affected by the socio-political situation. We have implemented many reforms aimed at making the country more attractive for domestic and foreign investors, including the new investment law, the "StartUp Act ", and a new framework for public-private strategic partnerships (PPP). With the assistance of the International Finance Corporation (IFC) and the European Bank for Reconstruction and Development (EBRD), we are organizing a high-level international forum on PPP projects in September. In addition, our participation in the G20's "Compact with Africa" initiative will be a good platform to highlight our progress in improving the business climate to potential new investors. Despite these advances, though, investors still seem concerned about the uncertain socio-political environment. We recognize that political stability, as well as a reduction of macroeconomic imbalances, are necessary to allow the improvements in the business climate develop their full impact. However, we would also like to emphasize that moments of uncertainty are not atypical for young democracies on the move.

9. Our top priority remains to accelerate reforms. The Government is more than ever convinced of the need for adjustment to strengthen economic fundamentals under the impression of the acute pressures and the fragility of the macroeconomic situation. Promoting macroeconomic stability, by containing fiscal and external balances and thus debt, will be essential to facilitating sustainable and inclusive growth. Our efforts will intensify in the coming months, which present an opportunity to strengthen economic buffers and the main pillars of the Tunisian economy ahead of next year's elections.

II. ACCELERATING CRITICAL REFORMS WILL HELP THE MACROECONOMIC ADJUSTMENT AND THE ECONOMIC RECOVERY

10. Our program performance has continued to improve in the first half of this year, which allowed us to meet all the quantitative program criteria at end-June 2018:

Quantitative Performance Criteria (QPCs)

- We observed the floor on the **primary balance** of the central government (cash basis, excluding grants), thanks to strong (tax and non-tax) revenue collection and disciplined expenditure execution.

- We observed the ceiling on **total current primary expenditure** of the central government, as we took measures to contain the wage bill and energy subsidies—including the increases in fuel prices on January 1, April 1, and June 23; and electricity and natural gas tariffs in May.

- We observed the ceiling on **net domestic assets** (NDA) of the CBT. Despite persistent pressures on commercial banks' liquidity, we managed to regulate the CBT's refinancing volume to commercial banks through the main 7-day refinancing operation. However, the increase in liquidity injections through FX swaps and the 24-hour loan facility remain a concern.

- We observed the floor on **net international reserves** (NIR) of the CBT, mainly on account of two factors: (1) the slight improvement in the current account deficit in the second quarter (linked to the good performance of exports and remittances); and (2) our efforts to better coordinate with state-owned enterprises (SoEs) on their FX payments.

Continuous Performance Criteria

- We observed the zero ceiling on the accumulation of new **external debt payment arrears** by the central government.

Quantitative Indicative Targets

- We observed the zero ceiling on the accumulation of new **domestic arrears**.

- We observed the ceiling on **net FX interventions** by the CBT from March through July, but slightly missed it by US$18 million in August. This overrun occurred due to the transition to the competitive FX auctions that significantly reduced the size of the FX interbank market.

- We observed the floor on **social spending** at end-June, in line with our commitment to strengthen the protection of the most vulnerable.

11. We have also implemented two of the three SBs due for the Fourth Review:

Met Structural Benchmarks

- **Fiscal policy and reforms of public institutions.** We continued with quarterly fuel price adjustments on June 23 (*met continuous SB*). The June increase was larger than what the automatic formula would have indicated, with respect to both the range of affected petroleum products (i.e. price increases for all types of fuels and not only of those captured by the formula) and magnitude of the individual price increases (i.e. on average 75 millimes after taxes, corresponding to 5 percent).

- **Foreign exchange policies.** We have been implementing competitive multiple-price auctions since August 1 (*met August SB*). As a result, almost all of CBT's interventions in the FX market were made through a competitive bidding process leading to a better allocation of the FX on offer by the CBT.

Reprogrammed Structural Benchmarks

- **Financial sector reforms.** The resolution committee held its first meeting on June 28, when it started discussions on the *Banque Franco Tunisienne* (BFT) based on information from the CBT.

However, the committee requested additional information to make the report richer on substance. Hence, a new report will be submitted to the resolution committee ahead of its next meeting in September 2018 as a basis for its decision to open the resolution procedure in November 2018 (*reprogrammed SB for November 2018*)—in compliance with the legal deadlines of four to six weeks provided by Tunisian law.

A. Maintaining Macroeconomic Stability

12. Strengthening the recovery relies on steadfastly implementing economic reforms. The Tunisian economy's solid performance in the second quarter translates into an expected growth rate of 2.6 percent for the entire year of 2018, slightly above our forecast of 2.4 percent in June. However, our fragile external position, high public, and inflationary pressures represent significant risks and call for accelerating economic reforms. Besides, our international environment, marked by financial markets' greater risk aversion toward emerging-market economies and high oil prices, has become much less favorable than at the beginning of the year. We intend to use the coming months to anchor macroeconomic stability, sustain the ongoing recovery, and improve the social climate. Our economic policies will thus focus on: (1) a well-targeted fiscal consolidation; (2) further tightening of monetary policy to avoid unhinging inflation expectations; and (3) further enhancing exchange rate flexibility.

Fiscal Policy

13. Our key fiscal policy objective remains fiscal consolidation. The path of fiscal deficits agreed at the Third Review remains pertinent, irrespective of this year's new spending pressures. We will continue to gradually reduce the fiscal deficit (excluding grants) from 2018 to shrink it to about 2.7 percent of GDP in 2020. The cornerstones of this strategy are a further containment of current spending, fairer and more efficient taxation, as well as sufficient public investment and social spending. To ensure adequate budget financing, we are counting on mobilizing external resources, notably by issuing a Eurobond in international markets in September or October of this year. Domestic financing will be consistent with the parameters established in the 2018 Budget Law.

14. Urgent measures will help achieve our 2018 deficit target of 5.5 percent of GDP (excluding grants). The first half of this year saw significant pressures on subsidies (especially energy, food, and transfers to pension funds), requiring a Supplementary Budget Law for this year to reflect our fiscal objectives consistent with our commitments under the EFF arrangement. More specifically, the Supplementary Budget Law, as well as the draft 2019 Budget Law, will be based on:

- ***Containing the wage bill***. Two developments will lead to a lower-than-expected reduction of the wage bill. First, while the early retirement program produced meaningful results (with more than 5,000 staff members participating), interest in the voluntary departure program remained below expectations (with only about 1,600 officials interested, compared to about 10,000 to 15,000 envisaged initially). This translated into a lower-than-programmed permanent saving in the wage bill. The gradual reduction in the wage bill will therefore primarily depend on strictly limiting recruitment and on containing wages. Second, salary increases in the Ministry of

Defense, the application of which was delayed since 2015, will have an annualized cost of TD 200 million. Nonetheless, we remain committed to our wage bill adjustment strategy by strictly ensuring that recruitment will be limited to the defense and security sectors as well as to national training schools, without exceeding a replacement rate of one out of four staff in 2018-19. With respect to wage negotiations, we reaffirm our commitment not to grant any additional wage increases in 2018 and 2019, unless growth surprises on the upside compared to our current forecasts for the period 2019–20, and without affecting the planned adjustment path of the wage bill to 12.4 percent of GDP in 2020. For the sake of fiscal transparency, we will eliminate the use of tax credits from 2019. Finally, we will identify additional measures to achieve our key objective of a wage bill of 12.4 percent of GDP in 2020 to address the slippages that occurred this year. In the current economic environment and with Tunisia's difficult public and external debt sustainability outlook, we do not see any scope for changes to this policy, especially regarding wage increases.

- ***Containing energy subsidies***. The sharp rise in international oil prices since early 2018 has put considerable pressure on the energy subsidy envelope. Nonetheless, we retain the budget allocation for energy subsidies at about TD 2,700 million (compared to an initial TD 1,500 million in the 2018 Budget Law), while (1) avoiding the carry-forward of additional expenses for the fiscal year 2019 and (2) keeping a margin in unallocated current expenditure to be able to cover a total subsidy bill of up to TD 3 billion. To contain this expense, we take measures consistent with our commitments during the Third Review. We have already: (1) adjusted fuel prices on a quarterly basis, with a price hike in June (*met continuous SB* at end-June), following the hikes on January 1 and April 1; and (2) increased electricity and gas tariffs in May and August. To sustain our adjustment efforts, we will undertake additional strong price and tariff adjustments to save: (1) an additional TD 125 million on fuel subsidies, based on price increases in September and November; and (2) TD 308 million on electricity and natural gas subsidies, based on tariff increases in September (see Text Table 1), October and November. In addition, we have started to implement other measures to save at least an additional TD 250 million in 2018, based on restricting the supply of the most subsidized fuels, collecting arrears to the electricity company (STEG), and improving its management.

Text Table 1. Tunisia: Energy Price Adjustments, 2018

	Sept. 1	
	Adjust. (millimes/%)	2018 Impact (TD mio.)
TOTAL		**252**
Fuel products (STIR)		**85**
Essence premium	60 mil.	...
Gasoil premium	60 mil.	...
Super lead free	60 mil.	17
Unleaded	60 mil.	11
Regular	75 mil.	51
Heavy fuel	60 mil.	5
Industriel fuel	60 mil.	1
Tariffs (STEG)		**167**
Electricity		**132**
High tension	23 %	6
Middle tension	23 %	106
Low tension	12 %	25
Gas		**35**
High pressure	23 %	11
Middle pressure	23 %	19
Low pressure	12 %	5

Source: Tunisian authorities.

- ***Limiting transfers to social security funds.*** The reform bill on the public pension fund CNRPS was submitted to Parliament in June and is currently awaiting its adoption in October. Contrary to earlier expectations, the law will have no retroactive effect in 2018. There will be, however, no budgetary pressure, as the cost of this delay will be compensated by a stronger-than-expected collection of arrears by the social security funds. The adoption of the law is a first step toward restoring the financial sustainability of the social security funds, which will need to be complemented by more comprehensive reforms in the years to come (also see Paragraph 21).

15. Strong revenue mobilization remains a top priority. The 2019 Budget Law will eliminate the preferential tax regime for "off-shore" companies, first for new firms in 2019 and then for all firms in 2021 (*new SB for December 2018*). This decision will also support our request to permanently remove Tunisia from European Union's (EU) list of non-cooperative tax jurisdictions. Moreover, we will submit to Parliament a 2019 Budget Law that includes a VAT reform for liberal professions. Taking effect in 2019, it will raise the applicable VAT rate from 13 to 19 percent to improve equity of our reforms (December 2018 SB). In the realm of tax administration, we are continuing the integration of the audit and recovery functions through a merger of the respective departments (i.e, the *Direction Générale des Impôts*, DGI, and the *Direction Générale de la Comptabilité Publique et du Recouvrement*, DGCPR), in line with the model of the French tax administration. To this end, we have initiated large-scale TA and capacity building programs.

16. The 2019 Budget Law that we will present to Parliament in mid-October will be based on an overall deficit (excluding grants) of 3.9 percent of GDP. Revenue (tax and non-tax) will continue to perform strongly to reach 25.9 percent of GDP. We will limit current spending to 24.2 percent of GDP through our efforts on the wage bill and energy subsidies, whilst protecting social spending. Capital expenditures will continue to increase, mainly on the back of better-than-

expected revenues, to around 5.4 percent of GDP. Based on the macroeconomic parameters underlying the LDF 2019, there will be no space to accommodate wage increases. In the event of a significant improvement in these parameters, we would consider salary increases only to the extent that they remain fully compatible with our path of budget deficits under the EFF arrangement, which ultimately aims at improving the sustainability of our public finances.

Monetary Policy

17. Accelerating inflation warrant further monetary policy tightening. Despite slightly easing in July 2018, inflation remains at an elevated level. Several factors will likely continue to fuel inflation in the remainder of the year—most notably the significant increase both in international oil prices, together with continued dinar depreciation and expected adjustments in administered prices (related to our efforts to contain energy subsidies). That said, the impact of previous steps to tighten monetary policy is just starting to affect demand for credit. Since the beginning of the year, we have been witnessing a slowdown in the growth rate of money and credit. Necessarily, elevated inflation levels negatively affect the Tunisians' purchasing power, especially that of the middle and wealthy classes who consume more imported products. Inflation also reduces the positive effect of gaining competitiveness through dinar depreciation. It also feeds social tensions. Our anti-inflation strategy rests on the following key elements:

- ***Bringing the real money market rate (TMM) into positive territory.*** The CBT remains fully determined to deliver on its core mandate of maintaining price stability and to raise the policy interest rate to move the TMM firmly into positive territory. The time that will be required to close the policy rate-to-inflation gap will depend on how inflation evolves in the coming months—any negative surprise on inflation would require a faster and more determined response on the policy rate to affirm the vigilance of the CBT.

- ***Continuing to improve transmission channels of monetary policy.*** To this aim, we attach foremost importance to the law that loosens interest rate caps on business loans. Although with Parliament for a while, we hope that the law will be adopted—together with the implementation decree—by the end of the year (*December 2018 SB*). Coupled with a more frequent update of the base rates used in calculating the interest rate cap, this law is critical to increase access to credit for small and medium-sized enterprises (SMEs); and to make banks' lending activities more responsive to interest rate adjustments. Similarly, we will start surveying the inflation expectations of economic agents. These surveys will allow us to closely monitor the anchoring of expectations and refine our inflation projections. The envisaged reduction in commercial banks' reliance on CTB refinancing will prompt more vigorous activity in the interbank market, which will strengthen transmission channels.

- ***Enhancing the forward-looking communication of monetary policy.*** To strengthen the credibility of monetary policy, we plan to: (1) clarify the objectives of the operational framework of monetary policy; (2) clarify the link between the price stability mandate and the overall strategy of monetary policy; (3) start publishing a quarterly monetary policy report, including medium-term projections of inflation and growth (*new SB for June 2019*). In this regard, it should

be noted that a reinforcement of human resources and logistics will be necessary to prepare this report. Better anchoring inflation expectations will lower the cost of any adjustment needed to bring inflation back to its historical average over the medium term.

- ***Improving bank liquidity management.*** Despite policy rate increases and the quantitative limit of TD 7 billion on 7-day tenders with commercial banks (in place since July 2017), the CBT's refinancing of the banking sector continues to increase. It reached new records to exceed TD 16 billion in mid-August 2018. The effectiveness of limiting the amount of the 7-day main refinancing operation has, in fact, been mixed as the supply of liquidity from other instruments has steadily increased—especially through FX swaps for monetary policy purposes, structural operations (outright purchases of treasury bills), the overnight lending facility, and long-term operations. We will also act on the overall volume of the CBT's liquidity injections to reduce it. We are committed to reducing liquidity injections from outstanding FX swaps and from structural operations. Although we are witnessing a slowdown in credit growth to the economy, related to past monetary policy tightening, we remain concerned about the ongoing increase in the overall volume of bank refinancing.

- ***Improving the monitoring of balance sheet effects and management of macro-prudential risks***. We will continue to study the impact of any planned monetary tightening and greater exchange rate flexibility. To date, our analysis suggests that monetary tightening would not create a major risk to both the solvency and liquidity of banks, businesses, and households. Interest charges for the average firm, for example, are only 2 to 3 percent of total expenses. Similarly, the overall profitability of the banking system was 1.2 percent in terms of Return on Assets (ROA) and 13.9 percent in terms of Return on Equity (ROE) last year and the exposure to FX risk remains low (around 8 percent of assets). However, we will develop new analytical capabilities to better understand balance sheet effects, particularly with respect to new supervisory tools, as well as banking supervisors' skills and competencies.

18. To achieve our monetary policy objectives, we are committed to modernizing and strengthening the management and governance of the CBT. The following actions will help us identify work priorities and strengthen the governance framework of the CBT:

- ***Establishing a strategic vision.*** The CBT has started to develop its first three-year strategic plan for 2019-21 based on extensive internal consultations. We aim at establishing strategic priorities for the next three years that correspond to the CBT's mandate set out by the new 2016 Central Bank Law and a general new vision for the future. This exercise seeks to produce a frame of reference with clear choices, priorities, and scope for coordination. We have already established a timetable for the following actions: (1) undertake a strategic SWOT and PESTEL analysis; (2) identify the stakes related to our priorities; (3) establish an action plan for the implementation of strategic objectives into operational objectives; and (4) prioritize the actions and resources needed in view of the portfolio of selected projects. To take this initiative ahead, we hope to benefit from strong TA support from the IMF.

- ***Improving the CBT safeguards framework.*** We will focus on implementing the outstanding recommendations of the 2016 Safeguards Report, especially regarding the external evaluation of the quality of the internal audit function. In the context of our strategic planning exercise, we will proceed with the restructuring of the CBT's General Control Department and the implementation of a preliminary self-assessment before resorting to an external evaluation. We will also request TA from a qualified international partner.

Exchange Rate Policy

19. The exchange rate plays a key role in our efforts to rebalance our external position. Significant external imbalances suggest that the role of the exchange rate in absorbing macroeconomic shocks should be further strengthened. Despite the significant depreciation vis-à-vis the Euro since early 2018, the value of the dinar in real terms has even slightly appreciated on the back of an accelerating inflation. The inflation differential between Tunisia and its main trading partners remains significant, pointing to the vital role of monetary policy in stabilizing the exchange rate.

20. A more competitive dinar in real terms would boost exports—especially in industries with significant costs in local currency—and curb excessive import demand. The expected improvement in the current account deficit would have a positive impact on the stock of FX reserves, which remain below the levels experienced by many of Tunisia's peers among middle-income countries. Lower demand for energy imports would also have a beneficial effect on public finances by reducing energy subsidies. In the short term, we are committed to:

- ***Continuing to hold competitive FX auctions.*** We held the first two competitive FX auctions on August 1 and 8, 2018 (*met SB*). Competitive auctions will now be our main means of intervention in the FX market.

- ***Continuing to limit FX interventions.*** We have strictly adhered to the net FX intervention ceiling agreed under the EFF arrangement from April through July. We only slightly missed it by US$18 million in August due to the low volume of the FX interbank market after the critical transition to competitive FX auctions early that month. This achievement has helped to maintain a flexible trajectory for the dinar and further increase the role of market forces in determining its value.

- ***Eliminating the 2017 exchange restriction.*** We reaffirm the CBT's commitment to withdraw the circular no, 2018-01 (replacing the initial circular no, 2017-09) by end-2018, which limits access to financing for imports of non-priority goods. We concluded that the effect of this measure on imports was mixed and that its introduction created uncertainty for economic operators about the prospects for exchange rate regulation in the years to come.

B. Providing Adequate Social Protection

21. Strengthening the scope of social protection remains a crucial pillar of our reform agenda:

- ***Improving the targeting of the social safety net.*** We have made considerable progress in creating a comprehensive database of all poor and low-income households: 476,000 have been registered, of which 213,000 have already been verified and validated in field surveys. The database will be well established by the end of the year, with registration expected for 550,000 families (*December 2018 SB*). This will allow us to focus on next steps, including: (1) investigating and validating candidate households in the field; (2) implementing measures to encourage people who have not yet registered to do so; (3) testing our optimal targeting model for poor and vulnerable populations; (4) developing and operationalizing the remaining modules flanking the database (including the systemic connection with other databases from the CNAM, CNRPS and CNSS; development of the scoring formula; and management of detected fraud); and (5) transitioning to using electronic cards as a basis for administering medical care and cash transfers. Once in place, this system will enable us to target all our social programs more effectively to poor and low-income households to support them with cash transfers and access to public health services.

- ***Executing social expenses.*** The execution of social expenditures has so far been in line with our objectives under the EFF arrangement (now supported by the new QPC on this spending), despite significant budgetary pressures. In June, we even increased the budget envelope for social expenditures by an annualized TD 200 million. We have expanded the National Assistance Program for Families in Need (*Programme National d'Aide aux Familles Nécessiteuses*, PNAFN) in terms of both the number of beneficiaries and allocation per beneficiary. By 2019, the program will cover 285,000 households with a minimum transfer of TD 180 per month. In addition, we now also provide financial support for the education of pupils and students from vulnerable families. We have also exceptionally awarded two re-entry allowances to vulnerable families: a bonus for new graduates and a general bonus for the new school year.

- ***Continuing social security reform***. The reform law for the CNRPS public pension fund is under examination in Parliament. We hope that the ARP will pass the law by October, which will then also serve as a blueprint for a decree on the reform of the CNSS private sector pension fund. The main components of the pension reform are: (1) an adjustment of key parameters, notably a two-step increase in the mandatory retirement age from 60 to 62 (and to 65 on a voluntary basis), an increase in contribution rates and a new pension indexation formula; (2) a reform of the governance of the social security funds; and (3) the implementation of reinforced arrears collection strategies for CNRPS, CNSS, and CNAM. However, these steps are in themselves insufficient to ensure the financial sustainability of the social security system due to a large structural gap between benefits (for example, pensions can reach more than 80 percent of wages) and the financial resources available to the funds. We therefore acknowledge that the current reform bill is only a first step, which needs to be followed by a more comprehensive

reform of the system involving more ambitious parametric changes to restore medium- and long-term financial viability.

C. Creating More Opportunities for the Private Sector

Business Climate and Governance

22. Boosting the business climate remains a priority. To enhance Tunisia's competitiveness, we set up a task force dedicated to improving Tunisia's ranking in the World Bank's "Doing Business" report. Our goal is to feature among the top 50 countries in the world and top 3 countries in Africa by 2020. A set of 50 measures has been identified, including some aimed at reducing the time needed to both create a company and obtain a building permit; and others aimed at facilitating access to credit and protecting minority investors. We also intend to finalize the digitalization of all export and import procedures and connection of all the institutional parties involved in trade to the "Tunisia Trade Net" platform by early 2019. Finally, we are about to draft an overarching reform law aimed at improving the business climate, which will include amendments to several areas of current legislation.

23. Strengthening good governance and fighting against corruption remains critical. In this area, we organize our efforts along three main pillars:

- ***Implementing our national strategy against money laundering and terrorist financing.*** This strategy will enable us to strengthen correspondent banking relationships between Tunisia and international financial institutions, and ultimately convince the Financial Action Task Force (FATF) to reclassify Tunisia as a cooperative jurisdiction. More concretely, as part of our FATF action plan, we have strengthened the capacities of the Tunisian Commission for Financial Analysis (*Commission Tunisienne des Analyses Financières*, CTAF) through the recruitment of 12 financial analysts in June 2018 and the implementation of two new technical solutions: Go-AML and Go-INTEL financial analysis. Furthermore, the CTAF has issued six decisions on the guiding principles for designated non-financial professions in the detection and reporting of suspicious transactions. In parallel, we have continued to strengthen our legal framework against money laundering and terrorist financing through the publication of (1) a government decree on freezing terrorists' assets in accordance with resolutions of the Security Council in January 2018; and (2) four ministerial decrees on the detection of suspicious transactions and their declaration to the CTAF in the sectors of casinos, precious metals, real estate, and notary services in April 2018. The Accountants Association has also published professional standards on accountants' obligations in the fight against money laundering and the financing of terrorism. Finally, we have submitted to Parliament an amendment to the Organic Law on Money Laundering, which will allow to apply specific financial sanctions to combat the proliferation of weapons of mass destruction. This amendment should be approved by October.

- ***Operationalizing the High Anti-Corruption and Good Governance Authority (HACGGA) and intensifying the fight against corruption.*** Our main instrument remains the HACGGA, which is about to being created by transitioning the current National Anti-Corruption Authority

(*Instance Nationale de la Lutte Contre la Corruption*, INLCC). The next crucial step will be the appointment of the members of the HACGGA's board of directors, which is expected by the end of this year (*December 2018 SB*). In parallel, INLCC continues to investigate cases of potential corruption on its own initiative and has already transferred about 400 cases to the judicial system. It has also been benefiting from close cooperation with the tax administration, both in terms of capacity building and information provision on tax compliance of individuals under investigation.

- ***Declaration of assets***. The recent approval of the Law on Declaration of Heritage and Combating Illicit Enrichment and Conflict of Interest in the Public Sector in July will enable the HACGGA to monitor the wealth of senior officials of the State. This enhanced transparency will help improve citizens' confidence in the good governance of public affairs, as well as limit the risk of corruption and illicit enrichment.

Financial Sector

24. The pursuit of financial sector reforms continues. Overhauling the financial sector is a major focus of our reform agenda. The modernizing of the sector involves improving the quality of credit portfolios, strengthening banks' financial stability and liquidity, solidifying banking supervision, and improving access to finance.

- ***Resolving non-performing loans (NPLs).*** We are making progress in strengthening the quality of banks' loan portfolios, especially those of public banks:

  - Regarding NPL resolution, public banks are progressing with their internal restructuring and balance sheet repair, following the adoption of the two respective laws that put public banks on an equal footing with their private peers. On abandoning claims, the three public banks expect their boards of directors to validate their proposals for internal resolution structures by end-September. Regarding write-offs, the Directorate General of Tax Legislation at the Ministry of Finance published a guidance note on applying the law on August 6, 2018, following the publication of the law in the Official Gazette. The National Tax Council also approved the guidance note. The Ministry of Finance, as a shareholder, continues to follow the targets established in the three major public banks' performance contracts (BH, BNA, STB). All key performance indicators (KPIs) were met in the last quarter. This trend is set to continue. Finally, on qualitative indicators, the three public banks have made progress in setting up internal risk management structures and rating systems, which are expected to be operational by end-2018.

  - The decree stipulating that public banks are not subject to the assent of the Commission created by Article 474 of the Commercial Code has been delayed. It is now waiting for the signature of the Prime Minister. We hope to publish this decree at end-November 2018.

  - On the training of judges in the fields of banking and finance, the Ministry of Justice—in collaboration with the Ministry of Finance—had already requested TA from the United

Kingdom. In this context, the London Institute of Banking sent a mission to Tunis during September 3 to 7, 2018, to assist in creating a dedicated training program.

- The Ministry of Tourism—in collaboration with the *Agence Foncière Touristique*, the Banking Association and the Federation of Hoteliers—is continuing to work on a mechanism to reprofile hotels whose sustainability is not assured. The objective is to allow these businesses to restructure their debts and upgrade the level of Tunisia's touristic services. We remain committed to proposing concrete actions by September 2018.

- The draft law on debt collection companies remains delayed. We are still working on the text to refine the details of its Article 19 related to the protection of debtors. Parliamentary adoption is expected by December 2018.

- The Ministry of Finance and the Financial Sector Reforms Committee (*Comité des Réformes du Secteur Financier*, COREFI) continue to prepare a comprehensive strategy on NPL treatment and resolution in the banking sector, which will be published in December 2018.

- ***Implementing the resolution framework for fragile banks and financial institutions.*** Following extensive inter-ministerial consultations on the litigation process that opposes the Tunisian State and ABCI (the former majority shareholder of the BFT), the resolution committee (constituted last December) had its first meeting on June 28 to examine the case of the BFT, as presented by the CBT. As requested, the CBT will resubmit an enhanced report on the BFT ahead of the resolution committee's upcoming meeting in September 2018. The committee will then decide on initiating the resolution procedures against the BFT in accordance with the legal deadline (which is one month, but extendable by 15 days) in November 2018 (*reprogrammed SB for November 2018*).

- ***Pursuing the modernization of banking supervision.*** Supported by a strategic planning exercise to identify human resources needs, the CBT's General Directorate of Banking Supervision will recruit a dozen supervisors by end-December 2018. We will continue to work closely with the IMF's Middle East Regional Technical Assistance Center (METAC) to develop tools put in place by Pillar II of the Basel Accord aimed at better monitoring market and interest rate risks, as well as at assessing the capital adequacy of commercial banks. These initiatives include: (1) continuing to strengthen the CBT's internal capacity to implement ICAAP; (2) implementing the standards set out in the new capital adequacy circular based on the Basel II guidelines for measuring and managing market risks; (3) clarifying the CBT's regulatory framework for interest rates (IRRB), concentration and strategic risks. We are also continuing our efforts to move to consolidated supervision by the second half of 2019. Similarly, we continue to monitor the strategy for resolving NPLs in the tourism sector (based on the white paper adopted in February 2018). This includes the loans with a granted exemption from the contagion principle.

- ***Facilitating access to finance.*** The Ministry of Finance and COREFI have made considerable progress toward the National Financial Inclusion Strategy, which was adopted by a Restricted

Ministerial Council on June 25, 2018. We continue to develop financial inclusion indicators based on a survey (with the assistance of the European Investment Bank, EIB) to be finalized by end-2018. These indicators should be regularly published to monitor financial inclusion in Tunisia. We are also awaiting the adoption of the law on the regulation for credit bureaus (pending its discussion in Parliament). This law aims to improve financial access by collecting and sharing financial data. Finally, with the assistance of the German *Kreditanstalt für Wiederaufbau* (KfW), we are exploring a strategy to increase financial access for Small and Medium-sized Enterprises (SMEs).

- ***Implementing the de-cashing strategy.*** De-cashing has gained importance because of the liquidity pressures in the financial system. The objective of reducing money in circulation and moving toward innovative payment services (such as online and mobile payments) is part of the fight against the parallel economy and tax evasion. The strategy's action plan, adopted in March 2018, aims to limit cash payments by the Public Administration and adopt the regulatory framework governing electronic payments before end-2018. The first concrete results are noticeable: the interoperability between the various platforms (*Société Monétique Tunisi*e, *La Poste*, and telephone operators) has been technically implemented and has been operational for money transfers since April 2018. We also started technical work on commercial payments and expect to publish a circular on companies facilitating payments in October 2018.

Use of Public Resources

25. Reforms in support of fiscal consolidation advance.

- ***Improving the transparent use of public resources.*** The Organic Budget Law (OBL) should be adopted by Parliament before end-2018 (*December 2018 SB*). It will improve budget preparation and transparency by giving citizens access to more information on the budget (including through a new functional classification). As a result, it will help monitoring budget execution and enforcing spending discipline. It will also support the implementation of performance-based budgeting in all Ministries. These have already prepared their budget proposals for 2019 according to the new functional classification in a multi-year framework.

- ***Better managing SOEs.*** We continue to closely monitor the financial situation of our main SOEs, helped by the performance contracts signed in mid-2017 with four of our largest SOEs (i.e. the *Office des Cereals, Régie des Tabacs*, STIR, and STEG) and the dashboard of balance sheet information and key financial ratios for about 30 of our most important SOEs. We are also working on strengthening our financial oversight of the social security funds and public banks. In the coming months, we will monitor the evolution of the largest 30 SEOS' financial statements on a quarterly and forward-looking basis, to improve information sharing by SOEs with the departments in charge of developing and implementing the central government budget. We are also moving ahead with the TUNISAIR performance contract, which will be signed by the end of the year (*December 2018 SB*).

Table 1. Quantitative Performance Criteria and Indicative Targets 1/
(Cumulative flow since the beginning of the year, unless otherwise indicated)

	2018																					2019						
	Mar.				Apr.		May		Jun.				Jul.		Aug.		Sep.		Oct.	Nov.	Dec.		Jan.	Feb.	Mar.		Apr.	May	Jun.
	Prog.	Adj. prog.	Act.	Prog. status	Ind.	Act.	Ind.	Act.	Prog.	Adj. prog.	Act.	Prog. status	Ind.	Act.	Ind.	Act.	3rd Rev. prog.	Revised prog.	Ind.	Ind.	3rd Rev. prog.	Revised prog.	Ind.	Ind.	3rd Rev. prog.	Revised prog.	Ind.	Ind.	Prog.
Quantitative Performance Criteria																												
• Floor on the primary balance of the central government (cash basis, excl. grants, millions of TD)	-1,722	-1,722	-119	Met	...	...	...	...	-2,961	-2,961	227	Met	...	...	...	...	-2,760	-2,592	...	...	-3,151	-3,108	...	...	-394	-347	...	...	-607
• Ceiling on total current primary expenditure of the central government (millions of TD)	6,237	6,237	5,185	Met	...	...	...	...	11,517	11,517	10,787	Met	...	...	...	...	17,566	17,540	...	...	23,616	24,083	...	...	6,032	6,294	...	...	12,501
• Floor on social spending (millions of TD) 2/	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	1,766	1,692	...	...	2,382	2,382	...	...	656	656	...	...	1,311
• Ceiling on net domestic assets of the Central Bank of Tunisia (end of period stock, millions of TD)	9,374	9,379	8,247	Met	...	...	...	...	8,150	10,082	9,732	Met	...	...	...	...	7,387	11,425	...	...	6,855	8,929	...	...	6,602	7,427	...	...	7,557
• Floor on net international reserves of the Central Bank of Tunisia (stock, millions of US$)	2,352	2,350	2,408	Met	...	...	...	...	2,966	2,006	2,184	Met	...	...	...	...	3,075	2,103	...	...	3,153	2,770	...	...	3,186	2,914	...	...	2,997
Continuous Performance Criteria																												
• Ceiling on the accumulation of new external debt payment arrears by the central government (millions of US$)	0	...	0	Met	...	...	...	...	0	...	0	Met	...	...	...	...	0	0	...	...	0	0	...	...	0	0	...	...	0
Quantitative Indicative Targets																												
• Ceiling on the accumulation of new domestic arrears (millions of TD)	0	...	0	Met	...	...	...	...	0	...	0	Met	...	...	...	...	0	0	...	...	0	0	...	...	0	0	...	...	0
• Floor on social spending (millions of TD) 2/	721	...	735	Met	...	...	...	...	1,144	...	1,397	Met	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Program assumptions on which adjusters are calculated in case of deviations (at program exchange rates)																												
• External financing of the central government (excluding IMF, millions of US$)	209		220						1,640		544						2,400	1,263			3,506	2,692			104	240			473
• External debt service of the central government (interest and amortization, millions of US$)	466		479						994		858						1,353	1,216			1,789	1,697			635	631			1,243
• Bank recapitalization and civil service reform costs (millions of TD)	0		0						0		0						0	0			0	0			0	0			0
• Privatization receipts in FX (millions of US$)	0		0						0		0						0	0			0	0			0	0			0
• Program exchange rate TD/US$	2.01285		2.01285						2.01285		2.01285						2.01285	2.01285			2.01285	2.01285			2.01285	2.01285			2.01285

Source: Tunisian authorities; and IMF staff estimates.

1/ Quantitative performance criteria and adjusters are described in the Technical Memorandum of Understanding (TMU). "..." represents "not applicable."

2/ Social spending includes social transfers and programs as well as key ministries' capital expenditures. Its coverage was expanded in 2017. Besides, the quantitative indicative target on social spending will be converted into a quantitative performance criterion from September 2018 onwards.

Table 2. Tunisia: Prior Actions and Structural Benchmarks

Prior Action	*Objective*			
√ **Energy price hikes.** Signature of ministerial orders ("arrêtés") stipulating the increase in (i) fuel prices in September and (ii) electricity/gas tariffs (as specified in the MEFP Text Table 1); and implementation of the September 1 price hikes for fuels, electricity, and gas (as specified in the MEFP Text Table 1).	*Fiscal sustainability and fairness*			Met
Structural Benchmarks	***Objective***	**Date**	**Revised Date**	**Status**
I. Sectoral reforms/private sector development				
• **High anti-corruption and good governance authority (HACGGA).** Signature of the decree appointing the members of the HACGGA.	*Good governance and fairness*	Dec-18		
• **Social policy.** Establishment of a databank on vulnerable households.	*Social protection and fairness*	Dec-18		
II. Financial sector reform				
• **Banque Franco Tunisienne (BFT).** Vote of the resolution committee on the orderly resolution of the BFT.	*Financial sector stability*	Aug-18	Nov-18	The committee met in late June, but requested more information.
• **Maximum lending rate.** Adoption by Parliament of a law and decree on increasing the maximum lending rate for corporates and SMEs from +20 percent above the average lending rate to +33 percent.	*Financial sector stability*	Dec-18		Draft law in Parliament.
III. Fiscal policy and reforms of public institutions				
√ **Fuel prices.** Quarterly application of the automatic fuel price adjustment mechanism.	*Fiscal sustainability and fairness*	Mar-18 until end of program		Met at end-June.
• **Tax regime.** Adoption of a 2019 Budget Law that eliminates the preferential tax regime for "off-shore" companies.	*Fiscal sustainability and fairness*	Dec-18		
• **Value-added tax (VAT).** Adoption of a 2019 Budget Law that increases the VAT rate for liberal professions from 13 to 19 percent.	*Fiscal sustainability and fairness*	Dec-18		
• **State-owned enterprises (SOEs).** Signature of a performance contract for TUNISAIR.	*Better monitoring of fiscal risks*	Dec-18		
• **Organic budget law.** Publication, in the official journal, of the Organic Budget Law.	*Fiscal sustainability and fairness*	Dec-18		Draft law in Parliament.
IV. Monetary and exchange rate policies				
√ **Foreign exchange auctions.** Implementation of a full foreign exchange auction mechanism by the Central Bank of Tunisia.	*Exchange rate flexibility*	Aug-18		Met.
• **Communication of monetary policy decisions.** Start publishing quarterly monetary policy reports including medium-term projections of inflation and growth.	*Monetary policy effectiveness*	Jun-19		

Attachment II. Technical Memorandum of Understanding

1. This Technical Memorandum of Understanding (TMU) establishes the agreement between the Tunisian authorities and IMF staff concerning the definition of the **quantitative criteria and targets** under the program supported by the Extended Fund Facility (EFF). They are listed in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated June 22, 2018.

2. This TMU also sets out the **content and frequency of data reporting** to IMF staff for program monitoring purposes. To this aim, the Ministry of Economy and Finance (MoF), the Ministry of Planning and Economic Cooperation (MDCI), 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 TMU, unless otherwise agreed with IMF staff.

DEFINITION OF PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Performance Criteria and Indicative Targets

3. The **quantitative criteria and targets** specified in MEFP Table 1 are:

- ***Quantitative Performance Criteria (QPC):***
  - (quarterly floor) on the **primary balance** of the central government (cash basis, excluding grants);
  - (quarterly ceiling) on total **current primary expenditure** of the central government;
  - (quarterly floor) on **social spending** (starting from end-September 2018);
  - (quarterly ceiling) on **the net domestic assets** (NDA) of the CBT;
  - (quarterly floor) on **the net international reserves** (NIR) of the CBT; and
  - (quarterly ceiling) on **net foreign exchange interventions** of the CBT (starting from end-September 2018).
- ***Continuous Performance Criterion (CPC):***
  - (zero ceiling) on the **accumulation of new external debt payment arrears**.
- ***Indicative Targets (IT):***
  - (quarterly ceiling) on **accumulation of new domestic payment arrears**;
  - (monthly ceiling) on **net foreign exchange interventions** of the CBT; and
  - (quarterly floor) on **social spending** (through end-June 2018).

4. **Measurement of criteria**. The QPCs on the central government's (1) primary balance (cash basis, excluding grants), (2) total current primary expenditure, and (3) social spending are measured

on a quarterly basis and cumulatively from the end of the previous year. The QPCs on the CBT's (1) NDA and (2) NIR are measured on a quarterly and stock basis. The QPC on the CBT's net foreign exchange interventions is measured on a quarterly and non-cumulative basis. The CPC on the accumulation of new external debt payment arrears is measured on a continuous basis. The IT on the CBT's net foreign exchange interventions is measured on a monthly and flow basis. The other ITs on (1) the accumulation of new domestic payment arrears and (2) social spending are measured on a quarterly and cumulative basis. Adjustment factors will apply to some of these criteria.

5. **Valuation.** For program purposes, all assets, liabilities, and flows denominated in foreign currencies will be valued at the "program exchange rate" (as defined below)—except for items affecting the government's budgetary accounting and assessment of the performance criteria related to the budget (which will be calculated using current exchange rates). The program exchange rates correspond to the CBT's accounting exchange rates that prevailed on December 31, 2015 (see table below). For the special drawing rights (SDR), the program exchange rate is 1 SDR = 2.797590 Tunisian dinars (TD). Moreover, monetary gold assets will be valued at the US$/TD program exchange rate applied to the price of 2,138.15 Tunisian dinars per ounce of gold in the international market on December 31, 2015 (London morning fixing). The stock of gold was 4.13 tons (4,129,806 grams) on December 31, 2015.

Program Exchange Rates: Tunisian Dinars per FX Currency at End-December 2015
(Accounting exchange rate of the CBT)

Currency	Exchange rate	Currency	Exchange rate
AED	0.54802	KWD	6.63225
BHD	5.3373	LBP	0.00133465
CAD	1.45005	LYD	1.44535
CHF	2.0322	MAD	0.203175
CNY	0.3099	NOK	0.228923
DKK	0.2947335	QAR	0.552815
DZD	0.01878	SAR	0.53634
EGP	0.25705	SDR	2.79759
ESP	0.0132186	SEK	0.23918
EUR	2.1993	SNP	2.9837
GBP	2.9837	TRY	0.6902
JPY	0.0167135	ULP	2.9837
KRW	0.001707098	US$	2.01285

B. Institutional Definition

6. 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. The authorities will inform IMF 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 Primary Balance of the Central Government (Cash Basis, Excluding Grants)

7. Under the program, the **primary balance of the central government (cash basis, excluding grants)** is measured on a financing basis and will be the negative sum of the following: (1) total net external financing; (2) privatization receipts; (3) net domestic bank financing; (4) net domestic nonbank financing; *plus* (5) interest on domestic and external debt paid by the central government; and *less* (6) external budgetary grants received by the central government.

8. **Net external financing** is defined as net external loans of the central government, i.e. new loan disbursements *less* repayments of the principal. Also included are project and budgetary loans of the central government, and any form of debt used to finance central government operations.

9. **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.

10. **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 deposits of the central government at the CBT. The latter includes all central government accounts at the CBT, in particular: the (1) Treasury current account excluding the sub accounts N-bis, those related to Public Administrative Entities (EPA) and to local governments; (2) Tunisian government account (miscellaneous dinar accounts); (3) loan accounts; (4) grant accounts; (5) accounts of *Fond National de Promotion de l'Artisanat et des Petits Métiers* and *Fonds de Promotion et de Décentralisation Industrielle* ("FONAPRA-FOPRODI account"); (6) special accounts of the Tunisian government in foreign currency; (7) accounts in foreign currency pending dinarization (subaccount: "mise à disposition"); (8) and any other account that may be opened by the central government at the CBT or banks. Following the unification of government accounts at the CBT into a Single Treasury Account, government accounts are consolidated in two categories (*Compte Central du Gouvernement* and *Comptes Spéciaux du Gouvernement*) on the CBT's balance sheet (liabilities side).

11. **Net government borrowing from the banking system** is defined as the change in the stock of government securities (i.e. Treasury bills and bonds) held by banks and any other central government borrowing from banks, less repayments.

12. **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. In particular, any use of cash from non-banking institutions (including La Poste) to finance the Treasury would be counted as domestic non-bank financing. 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 do not include accrued interest.

D. Ceiling on Total Current Primary Expenditure of the Central Government (Excluding Interest Payments on Public Debt)

13. Under the program, **total current primary expenditure of the central government** is defined as the sum of its expenditure on the following items: (1) personnel wages and salaries; (2) goods and services; (3) transfers and subsidies; and (4) other unallocated current expenditure.[1]

E. Floor on Social Spending

14. Under the program, **social spending** is defined as capital expenditures (development expenditures) on education; health; social transfers to low-income families, employment training programs (and university scholarships), *Union Tunisienne de Solidarité Sociale* (UTSS) indemnities; family allocation as well as development expenditures of the Ministries of Women and Family Affairs, Youth and Sports and Social Affairs; and all new targeted cash transfers in support of vulnerable groups. Excluded are All current expenditures ("dépenses de gestion") of the above-mentioned sectors and programs, as well as food and energy subsidies.

F. Ceiling on Net Domestic Assets of the CBT

15. Under the program, the **CBT's net domestic assets** (NDA) are defined as the difference between the monetary base and the net foreign assets of the CBT.

16. The **monetary base** includes the following: (1) fiduciary money (i.e. money in circulation excluding cash balances of banks and the Treasury); (2) deposits of banks at the CBT (including foreign currency and deposit facility); and (3) deposits of all other sectors at the CBT (i.e. other financial enterprises, households, and companies).

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

18. The Directorate General of Statistics (i.e. Directorate of Monetary and Financial Statistics) will be responsible for **monthly forecasts of reserve money** and will calculate NDA projections for the next six months. These projections will be submitted to IMF staff, after consultation with the Directorate General of Monetary Policy.

[1] 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.

G. Floor on the Net International Reserves of the CBT

19. Under the program, the **CBT's net international reserves (NIR)** are defined as the difference between the its reserve assets and its liabilities in foreign currency to nonresidents.

20. The **CBT's reserve assets** are the foreign assets immediately available and under 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.

21. The **CBT's liabilities in foreign currency** to nonresidents include any commitment to sell foreign currencies associated with financial derivative transactions (e.g., swaps, futures, options); any portion of the CBT's assets (e.g., gold) 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. Those liabilities do neither include the government's foreign currency deposits at the CBT, nor any SDR allocation received after March 31, 2017.

22. 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 (1) 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; (2) debt is a liability of the central government; and (3) a protocol between the CBT and the MoF provides clearly that the CBT is authorized to pay all expenses and costs pertaining to the implementation of this issue as well as the interest and principal of the issue sum through direct deduction from the Treasury's current account established in the CBT's books.

23. The value of **CBT reserve assets and liabilities** in foreign currency will be calculated using program exchange rates (Table above). On December 31, 2017, the value of the stock of NIR reserves was US$3,120.2 million, with the stock of reserve assets equal to US$5,480.6 million and the stock of CBT liabilities in foreign currency equal to US$2,360.4 million (at program exchange rates).

H. Ceiling on Net Foreign Exchange Interventions of the CBT

24. Under the program, the CBT's **net foreign exchange interventions** are defined as the difference between outright foreign exchange sales (including conversions) and outright foreign exchange purchases (including conversions), via the following channels: Reuters, auctions, and the interbank market. The computation of net sales may also include CBT net sales in other formal or informal markets (or instruments) that the CBT may choose to substitute for outright net sales (e.g., transactions in derivatives). Transactions of the CBT with the central government in the context of budget operations of the central government are not considered net sales (unless they take place through one of the channels mentioned above). In this respect, purchases of the foreign currency proceeds of a potential Eurobond or other official financing cannot be interpreted as CBT purchases of foreign exchange for the computation of the CBT net sales total.

I. Ceiling on the Accumulation of External Arrears

25. Under the program, **arrears on external debt payment** are defined as late payments (principal and interest) on external debt or guarantees as defined in *External Debt Statistics: Guide for compilers*[2] by the central government or the CBT from the due date or the expiration of the applicable grace period.

J. Ceiling on the Accumulation of Domestic Arrears

26. Under the program, **arrears on domestic payments** 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 beyond 90 days or more after the date on which the contract was signed or upon receipt of the invoice.

K. Adjustment Factors for the QPCs

27. The **primary fiscal balance** targets (cash basis, excluding grants) are adjusted upward/downward based on the amount used to (1) recapitalize public banks and (2) finance the severance pay of the voluntary departures which may be part of the civil service reform.

28. The **NDA** targets are adjusted upward (downward) if (1) the cumulative sum (at the program exchange rate) of external budget financing (including grants and loans, excluding from the IMF) and privatization receipts received by the central government in foreign currency is lower (greater) than the levels indicated in MEFP Table 1. The NDA targets are also adjusted upward (downward) if (2) the total amount of cash payments on external debt service of the central government (at the program exchange rate) are greater (lower) than the levels included in MEFP Table 1. The NDA ceiling will be converted into Tunisian dinars at the program exchange rate specified in the table above and adjusted downward (upward) based on (3) the amount of CBT reserves released (mobilized) because of a possible decrease (increase) in the reserve requirement.

[2] The definition of debt set forth in *External Debt Statistics: Guide for Compilers* reads as the outstanding amount of those actual current, and not contingent, liabilities, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to nonresidents by residents of an economy. Debts owed to nonresidents can take a number of forms, the primary ones being as follows: (1) 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); (2) 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 (3) leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property.

29. The **NIR** targets are adjusted upward (downward) if (1) the cumulative sum (at the program exchange rate) of external budget financing (including grants and loans, excluding from the IMF) and privatization receipts received by the central government in foreign currency is greater (lower) than the levels observed in MEFP Table 1. The NIR targets will also be adjusted upward (downward) if (2) the total amount of cash payments on external debt service of the central government (at the program exchange rate) is lower (greater) than the levels included in MEFP Table 1.

L. Monitoring and Reporting Requirements

30. Performance under the program will be **monitored** using data supplied to the IMF by the Tunisian authorities as outlined in the table below, consistent with the program definitions above. The authorities will promptly transmit to the IMF staff these data and any data revisions previously transmitted to the IMF Resident Representative's office in Tunisia.

Table 1. Tunisia: Information to Be Reported in the Context of the Program

Type of Data and Description	Periodicity	Delay (in days)	Responsible Department
Real Sector			
• **GDP:** supply and demand at current, constant, and the previous year's prices, including sectoral indices.	quarterly	45	INS
• **Inflation:** including the underlying inflation of non-administered and administered prices.	monthly	14	INS
Fiscal Sector			
• **Total revenue of the central government:**			
○ ***Tax and nontax revenue,*** with breakdown of main tax and nontax revenues items.	monthly	30	MoF
○ ***Disbursement of foreign grants***, with breakdown into budgetary and project grants received by the central government—by donor, amounts in the original currency, and their equivalent in Tunisian dinars converted at the current exchange rate at the time of each transaction.	monthly	45	MoF/CBT
• **Total expenditures of the central government:**	monthly	30	MoF
○ ***Current expenditure***, by type of expenditure: wages, goods and services, transfers and subsidies.	monthly	45	MoF
○ ***Capital expenditure***, by type of financing: domestic and external (differentiating loans and grants), and by main sectors and projects (agriculture, social, infrastructure).	monthly	45	MoF
○ ***Social expenditure.***	quarterly	45	MoF
• ***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 FX with the equivalent in domestic currency).	quarterly	30	MoF
○ ***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).	quarterly	45	MoF
○ ***Disbursement of foreign loans***, with breakdown into budgetary and project loans—by donor, amounts in the original currency and their equivalent in Tunisian dinars (converted at the current exchange rate at the time of each transaction).	monthly	45	MoF/CBT
○ ***Domestic borrowing from banks and nonbanks,*** including bonds, Treasury bills, and other issued securities.	monthly	30	MoF
○ ***Debt guaranteed by the government***, by instrument and type of currency (in dinars and in FX and its equivalent in national currency).	monthly	60	MoF
○ ***Debt service of the central government:***			
- *Domestic debt service* (amortization and interest).	monthly	45	MoF
- *External debt service* (amortization and interest, by FXs).	monthly	45	MoF/CBT

Table 1. Tunisia: Information to Be Reported in the Context of the Program (continued)

Type of Data and Description	Periodicity	Delay (in days)	Responsible Department
○ ***External payment arrears***, on external debt contracted and guaranteed by the government.	quarterly	30	MoF/CBT
○ ***Debt rescheduling***, incl. possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	quarterly	45	MoF
• **Consolidated accounts of the central government at the CBT:** with a breakdown of the stock of deposits as follows: (i) Treasury current account; detailed by sub accounts of the central government, N BIS, outstanding payments, Public administrative entities (EPA), and local governments (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) Foreign exchange accounts pending adjustment in dinars (available).	monthly	30	CBT MoF/TGT for sub-account
External Sector			
• **Imports of petroleum products:** average import price and volume of main petroleum products.	monthly	30	CBT
• **Deposits:** stock of FX deposits, according to the residence of the holder.	monthly	14	CBT
• **External debt:**			
○ ***Debt service*** (amortization and interest) of institutional agents by type of currency (in FX and its equivalent in dinars).	quarterly	45	CBT
○ ***Total disbursements*** of external debt of institutional agents by type of currency (in FX with its equivalent in dinar).	quarterly	45	CBT
○ ***Stock*** of external debt of institutional agents by type of currency (in FX and its equivalent in dinars).	quarterly	90	CBT
○ ***Overall net external position*** of Tunisia (in conformity with our obligations under SDDS).	annually	180	CBT
• **Balance of payments:** prepared by the CBT.	quarterly	30	CBT
• **FX market operations, interbank market, retail market and wire transfers for CBT purchases on the retail market:**			
○ ***CBT FX reserves***, with breakdown by currency and instrument.	monthly	7	CBT
○ ***CBT interventions*** (sales and purchases) on FX market in millions of dinars (and equivalent in US$ million) including total market transactions, FX sales to energy companies and all exchange rates for all such transactions, total FX demand by banks, total FX positions of banks, 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 CBT's forward FX 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.	monthly	7	CBT

Table 1. Tunisia: Information to Be Reported in the Context of the Program (continued)

Type of Data and Description	Periodicity	Delay (in days)	Responsible Department
Monetary and Financial Sector			
• **CBT accounts at the current exchange rate:** monthly situation of the Central Bank by sector (figures at the end of the period).	monthly	15	CBT
• **Reserve money and net domestic assets (NDA):** monthly forecast.	monthly	15	CBT
• **Monetary policy operations and liquidity factors**: daily and monthly balances. Detailed table including: (i) intervention on the money market of the central bank (Dinars); (ii) deposit facility; (iii) ordinary tenders; (iv) loan facility; (v) overnight lending; (vi) repo at 1-7 days and 3 months; vii) FX swap exchange; (viii) open market operations; (ix) minimum reserves; and (x) excess reserves.	monthly	15	CBT
• **Monetary survey at the current exchange rate**: monthly balance of the banking sector, counterparts of broad money, leasing banks, and resources of the resident financial system; preliminary (30 days) and definitive (45 days).	monthly	30 and 45 days	CBT
• **Interest rates of financial operations:** detailed tables on lending and savings rates and effective global tariffs produced by the Observatory of Financial Inclusion.	monthly	30	CBT
• **Credit data:** monthly data on credit distribution by sector (private/public); credit to enterprises (by economic sector); and credit to individuals (by purpose).	monthly	30	CBT
• **IMF account statements:** monthly consolidated statements of the IMF No. 1, No. 2, and Securities Account.	monthly	30	CBT
• **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.	monthly	30	CBT
• **Direct refinancing of commercial banks by the CBT:** breakdown by bank.	monthly	14	CBT
• **NPLs:** stock of banking sector NPLs and breakdown by commercial banks.	quarterly	60	CBT
• **Balance sheets of commercial banks**, including detailed income statements, in accordance with "Uniform Bank Performance Reporting" agreed with Fund staff.	quarterly	60	CBT

Table 1. Tunisia: Information to Be Reported in the Context of the Program (concluded)

Type of Data and Description	Periodicity	Delay (in days)	Responsible Department
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.	daily	3	CBT/MoF
• **Petroleum:** price structure of the petroleum products and the needed data to monitor the automatic adjustment mechanism (formulas and data).	daily	15	Min. of Energy

Statement by Mr. Jafar Mojarrad, Executive Director for Tunisia, Mr. Cyrus Sassanpour, Senior Advisor, and Ms. Monia Saadaoui, Advisor
September 28, 2018

Our Tunisian authorities thank the staff team for a well-written and balanced report and for the candid and constructive policy dialogue. They highly value staff's assessment and policy advice. They are also grateful to the Executive Directors and Management for their continued support.

Overview

The economic recovery has gained further momentum and program implementation has continued to strengthen under the Fourth EFF Review, despite the persistence of heavy headwinds. Rising international oil prices, in particular, exceeded program assumptions, pressuring prices, external balances, and the budget position. The global trade tensions, hardening financial conditions and growing risk aversion abroad, and the regional refugee crisis continue unabated and pose significant risks to the outlook. On the domestic front, there is widespread social discontent with the slow pace of improvement in living conditions and the political landscape is yet to stabilize. The success of the program ultimately hinges on its socio-political acceptability.

Sustained efforts ensured that all the quantitative performance criteria (QPC) for end-June 2018 were met; the continuous performance criterion and all the quantitative indicative targets were also observed; and two of the three structural benchmarks were met—the third (on resolution of *Banque Franco Tunisienne*—BFT), a carryover from the Third Review, was reprogrammed for November.

The green shoots of economic recovery are giving rise to early optimism that the authorities' efforts are starting to pay off and that there is light at the end of the tunnel. At the same time, the authorities recognize that there is no room for complacency—especially given the challenging environment—and are determined to redouble their efforts to restore sound macroeconomic fundamentals and promote inclusive growth, with employment and social protection at its core.

Recent Economic Developments

The economic recovery is firming and growth is now expected to reach 2.6 percent in 2018—the highest rate since 2014—on the back of a good harvest and a strong rebound in tourism. Inflation, however, has remained stubbornly high, reflecting a number of factors, including the pass-through of nominal *dinar* depreciation, fuel and electricity price adjustments, and the slow response of liquidity growth to the monetary tightening that began in early 2017. The demand pressure was contained by tight monetary policy and strong fiscal outturn through mid-year but public debt increased as a percent of GDP due to the exchange rate depreciation. Despite the more recent real *dinar* appreciation,

reflecting the unfavorable inflation differential between Tunisia and its main trading partners, and the sharp increase in oil imports, the current account deficit as percent of GDP was lower by one percentage point at mid-year compared to 2017, reflecting stronger export volumes in response to the real depreciation since 2016 and a strong recovery in tourism and remittances, and reserve losses slowed, even though they remained low due to large debt amortization. The 37 percent increase in tourism receipts during the first half of 2018 is a clear sign of the strong recovery of Tunisia's beleaguered tourist industry, a major backbone of the economy and a key source of employment for its youth.

Fiscal Policy

The authorities consider fiscal retrenchment the core of their macroeconomic stabilization program and are committed to the 2018-2020 consolidation path of 1 percent of GDP per year reduction in the overall deficit (excluding grants) to reach 2.7 percent of GDP by 2020. In 2018, despite strong revenue performance and containment of current expenditure, the deficit target of 5.5 percent of GDP (excluding grants) has come under pressure, mainly because of the larger-than-anticipated increase in international oil prices and political tensions that delayed energy price adjustments agreed under the Third Review. Also, military salaries were increased—as a part of a 2015 agreement that had been delayed—and voluntary departures of civil servants under the government's early retirement scheme fell well short of expectations resulting in a wage bill-to-GDP ratio higher than anticipated.

The authorities have agreed with staff to take compensating measures, through a supplementary budget law in October, to bring the fiscal program back on track and achieve the 2018 deficit target. First and foremost, the government will lower fuel subsidies through price increases in September and November (decree already issued), and electricity and natural gas subsidies by raising tariffs in three consecutive months starting in September. Combined with better targeting and improved efficiency and arrears collection, these measures will cut the energy subsidy bill by 0.5 percent of GDP during the last four months of the year—a budget effort equivalent to about 1.5 percent of GDP on an annual basis. The authorities remain committed to their 2020 wage bill target of 12.4 percent of GDP by strictly enforcing a replacement ratio of 25 percent for departing workers, excluding those in defense and security services. More importantly, there will be no wage increases in 2018-2019 unless the economy surprises significantly on the upside, but even then the 2020 target will continue to be binding. Parliamentary approval of the reform bill on the public pension fund CNRPS that had been delayed is now expected in October. However, the law will not be applied retroactively to July 2018, as expected earlier, and the cost to the budget from the delay will be offset by reinforced efforts to collect arrears by social security funds.

The 2019 Budget Law—to be presented to Parliament in mid-October—will target an overall deficit (excluding grants) of 3.9 percent of GDP, consistent with the 2018-2020 consolidation plan. Revenues will benefit from the expected pick up in economic activity (3.1 percent growth GDP compared to 2.6 percent in 2018) and the phasing out of tax credits for civil servants. Moreover, it is intended to eliminate the preferential tax regime for "offshore" companies in steps starting in 2019, and to increase the VAT rate for "liberal professions" (including lawyers, doctors and accountants) from 13 to 19 percent. The revenue impact of these two measures is not significant, but the measures are important for equity and fairness and should improve overall tax compliance. Tax collection efforts will also be strengthened, including through efficiency gains from the consolidation of tax administration functions under the same administrative umbrella and large-scale TA and capacity building programs underway.

With limited revenue gains expected, the focus of the 2019 Budget Law will be on current expenditure restraint, while increasing capital and social spending. As mentioned earlier, through a combination of wage restraint and strict employment, the plan is to reduce the wage bill to 13.6 percent of GDP in 2019 (excluding one-off civil service reform cost), from 13.9 percent of GDP in 2018. The authorities are committed to undertake periodic price adjustments along with other efficiency measures to reduce energy subsidies. Other expenditure saving initiatives will include a stronger oversight of SOEs and better cash management. Pension reforms will continue as the ongoing initial first steps will be followed by a comprehensive reform program with more ambitious parametric changes, with restoring medium- and long-term financial viability of the social security system as the ultimate objective.

Social Protection

Protection of vulnerable groups is one of the key pillars of the authorities' reform program and a critical requirement for its public acceptance. As the Board was informed during the Third Review, the indicative target on social spending floor was elevated to a QPC as of end-September, and the new floor is likely to be surpassed as the authorities have started replenishing the main social programs set up in 2018. With the assistance of the World Bank, work is also progressing to improve the targeting of social services and service delivery through cash transfers, subsidized health services, and reform of energy and food subsidies. Considerable progress has also been made in expanding the data base of poor and low-income households—476,000 households have already been registered with the expectation to reach 550,000 families by end-December. The database will be mapped against the databases of the two main pension funds and the medical insurance fund to ensure consistency and improve coverage.

Monetary and Exchange Rate Policy

Bringing down inflation to more acceptable levels has proved difficult because of persistent cost-push factors (notably increasing oil prices) and slow monetary transmission that has limited the impact of monetary policy tightening. The high inflation (relative to trading partners) has also buffeted the effectiveness of exchange rate policy and is taxing the purchasing power of all Tunisians. Although progress has been slow and uneven, fighting inflation remains a key mandate for the Central Bank of Tunisia (CBT) and, to that end, the CBT is committed to further tighten monetary policy to contain inflationary expectations and preserve its credibility. It also intends to adopt a more forward looking and well-communicated monetary strategy to anchor inflation expectations better. The CBT is determined to raise the policy rates sufficiently to lift the real money market rate (TMM) firmly into positive territory. It will monitor inflation developments closely, especially in light of fuel price adjustments and exchange rate movements, and will react accordingly and speedily to any upside inflation surprises. A positive real TMM will also help reduce CBT bank refinancing and encourage banks to seek deposits more actively. The effectiveness of monetary policy is further constrained by interest rate caps on lending rates. The authorities expect that the enabling legislation to loosen the caps, that has been pending with Parliament for some time, will be approved along with the implementation decree by the end of the year. Modernizing and strengthening the management and governance of the CBT is another important objective for which the authorities will be seeking Fund TA.

As regards the exchange rate policy, the CBT held three successful competitive FX auctions in August and September. Competitive auctions are anticipated to be the main means of FX market interventions, which in any event will be limited to smoothing excessive market volatility. Observance of program targets on net foreign exchange sales by the CBT since May (notwithstanding a small miss in August during the transition to competitive FX auctions) has helped keep the *dinar* on a flexible path and preserve foreign reserves. As a matter of policy, the CBT is committed to increasing the role of market forces in determining the exchange rate. It is also committed to eliminate, by end-2018, the exchange restriction arising from access limits on financing non-priority imports, which had created market uncertainties regarding the CBT's future exchange rate regulations.

Financial Sector Stability

The banking sector remains stable, and NPLs have declined and are expected to fall further as public banks are making progress with their internal restructuring and balance sheet repair, the resolution framework is being reinforced, and banking supervision is being modernized. The banking resolution committee's decision on BFT is expected in November. The legal framework on AML/CFT is being strengthened by the issuance of a series of decrees on detection of suspicious transactions and on freezing of assets and, as a part of the FATF action plan, the capacities and the reach of the Tunisian Commission

for Financial Analysis (CTAF) are being boosted. Further, amendments to the Organic Law on Money Laundering, to apply financial sanctions to combat the proliferation of weapons of mass destruction, are expected to be approved by Parliament in October. Expectations are that these measures will strengthen Tunisia's corresponding banking relationships and will ultimately convince the FATF to reclassify Tunisia as a cooperative jurisdiction.

Creating Opportunities for the Private Sector

Improving Tunisia's competitiveness and business climate is another pillar of the authorities' reform program, and to that end they have set up a dedicated task force to formulate a strategy with the goal of placing Tunisia among the top 50 countries globally and the top 3 in Africa by 2020 in the World Bank's "Doing Business" ranking. To this end, a set of 50 measures has already been identified covering a broad range of issues and areas. The establishment in 2018 of a "one-stop shop" for investors, and limiting mandatory prior investment authorization to a short negative list comprising eight-sectors are important steps in cutting red tape and speeding up approvals. Good governance and fighting corruption are also priorities. The Board of directors of the High Anti-Corruption and Good Governance Authority is expected to be appointed by Parliament by year end, following further consultations among political parties.

Conclusion

Tunisia has turned the corner in its path toward macroeconomic stabilization and sustained economic recovery, despite a myriad of domestic and external challenges. Despite the recent successes, the authorities are under no illusion that the task is complete. They remain committed to staying on track with program implementation with the ultimate objective of securing high rates of sustainable economic growth that will benefit all Tunisians. The Fund has been a reliable partner in this endeavor and Tunisia has benefitted immensely from Fund policy advice and financial as well as technical support for which the authorities are grateful. They also wish to thank their other partners, both bilateral and multilateral, for their continued financial and technical assistance. They look forward to Board approval of their request for completion of the Fourth Review and modification a performance criteria.