BACKGROUND AND POLITICAL CONTEXT

1. **Political upheaval and security tensions led to a protracted political crisis that has taken a toll on the economy and slowed progress on the reform agenda.** Longstanding political tensions came to the fore again in July 2013, triggered by the assassination of a secular opposition politician—the second such tragic event in 2013—which polarized Tunisia's society. As a result, the adoption of the draft Constitution and the holding of elections in 2013—a key assumption underlying the economic outlook at the inception of the Fund-supported program in June 2013—had been held up. Such delays—coupled with several security incidents—worsened investors' wait-and-see attitude and contributed to ratings downgrades. They also slowed the implementation of the authorities' reform agenda, particularly in those areas requiring wide popular buy-in and legislative approval. Resistance by vested interests also contributed to delayed reform implementation.

2. **The political transition is moving forward again**. After months of negotiations between the ruling coalition government, the opposition, and representatives of civil society, an agreement was reached in October 5, 2013 on a roadmap for handing over political power. This led to the appointment on January 9, 2014 of Mehdi Jomaa, the former Minister of Industry, as a nonpartisan prime minister, which has opened the way for the formation of a new technocratic government, the nomination of a new electoral commission, and the forthcoming adoption of the long-awaited Constitution by the National Constituent Assembly, which is expected by end-January 2014. These developments are necessary to pave the way for new elections in the second half of 2014 and achieve the objective of a more stable democracy that meets the aspirations of the population. They also augur well for a greater focus on economic stabilization and an acceleration of the structural reform agenda.

3. **Performance under the program has been mixed.** The 2013 end-June and end-September NIR and NDA quantitative performance criteria have been met, but are estimated to have been missed by end-December because of lower external market financing and high liquidity needs in the banking sector. Weaker economic activity increased the fiscal deficit, which, together with lower volumes of gas transiting from Tunisia and additional expenditures linked to payments made during the extended budgetary complementary period, resulted in a breach of the end-June and end-September PC on the central government primary deficit. The end-December PC on the primary balance appears to have been met by a significant margin, though most of the overperformance is due to weak budget execution and deferred cash payments to 2014. The implementation of structural reforms has been progressing, albeit with some delays linked to building a consensus during the political crisis and to technical difficulties (e.g., in starting the audits of public banks on time).

4. **The first and second reviews focused on keeping short-term macroeconomic stabilization on track during a period of unexpected shocks, while laying foundations for sustained reforms that will reduce economic vulnerabilities.** A weaker economic outlook and

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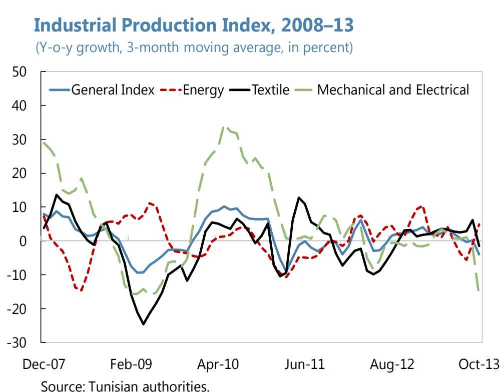
high external and fiscal deficits—combined with a shortfall in external financing in the last quarter of 2013—have increased existing vulnerabilities. The difficult political transition has delayed fiscal consolidation, though underlying measures to contain subsidies and the wage bill will help anchor medium-term fiscal consolidation. Despite some accommodation of fiscal policy in 2014, prudent monetary policy and greater exchange rate flexibility will allow international reserves to rise significantly, although these will remain highly dependent on an increase in external disbursements. Structural reforms—including reducing fragilities in the banking system—will aim at boosting private sector–led growth and reducing unemployment.

RECENT ECONOMIC AND FINANCIAL DEVELOPMENTS

5. Domestic tensions and a difficult international economic environment contributed to weaker growth, while inflation was contained and the current account deficit worsened relative to program objectives.

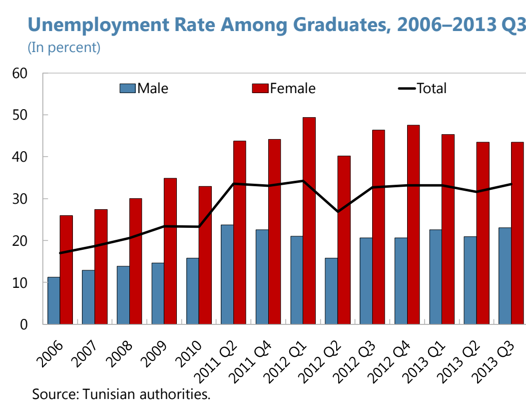
- **Economic activity is recovering at a slower pace than envisaged**. Real GDP grew by 2.4 percent year-on-year through September 2013—against 4 percent expected for the year under the program—driven mostly by public and private services (trade, transport, telecommunications, and financial services), despite stagnation in strike-weary industrial manufacturing and lower agricultural production. Public services remain the main contributor to growth, with hiring by the public sector and state-owned enterprises (SOEs) contributing to a fall in the overall unemployment rate to 15.7 percent in September 2013 (from 18.9 percent in 2011). Unemployment remains especially high among young graduates and women.

Industrial Production Index, 2008–13
(Y-o-y growth, 3-month moving average, in percent)



Source: Tunisian authorities.

Unemployment Rate Among Graduates, 2006–2013 Q3
(In percent)



Source: Tunisian authorities.

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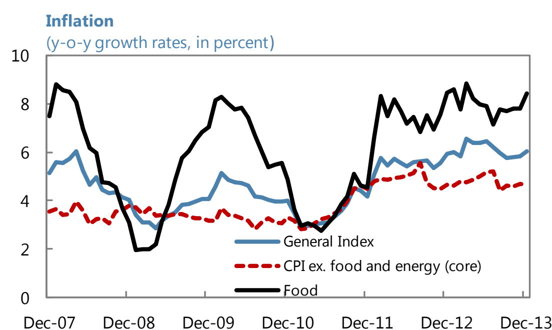
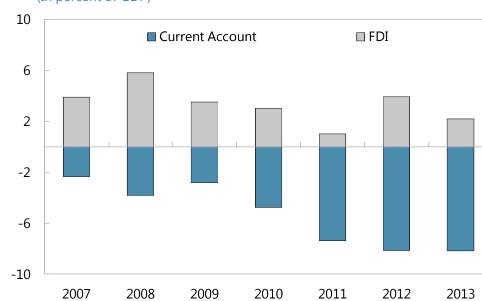
- **The negative output gap has kept underlying inflationary pressures at bay, despite a recent uptick in headline inflation.** After peaking at 6.5 percent year-on-year in March 2013, headline inflation declined to 5.8 percent in November before rising again to 6.0 percent in December 2013. Non-administered food prices (10.0 percent year-on-year at end-December) remain the principal driver of inflation, reflecting a bad harvest and strong demand from neighboring countries and Libyan refugees. Core inflation (excluding food and energy) remains relatively stable at around 4.7 percent since fall 2012, reflecting the negative output gap, low producer prices (PPI inflation below 3 percent) and weak credit growth. Administered prices, which make up a third of the CPI basket, are also helping mitigate overall inflationary pressures.



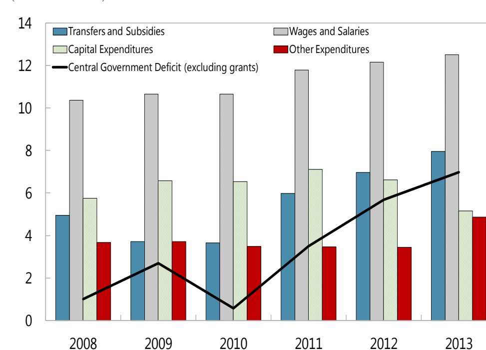
Source: Tunisian authorities.

- **The current account deficit stayed in line with projections through end-September, but is projected to be slightly worse than programmed by end-year.** Despite lower private sector imports of capital goods and raw materials, weaker tourism receipts and workers' remittances, combined with depressed demand for Tunisian goods and higher-than-anticipated dividend repatriation, are expected to result in a current account deficit that remains at 8.2 percent of GDP in 2013, stable relative to 2012, but 0.5 percentage points of GDP worse than programmed.



Sources: Tunisian authorities; IMF staff estimates.

- **Inadequate budget composition led to a lower-than-expected fiscal deficit.** Data that became available in January 2014 indicate that capital expenditures at end-2013 are likely to have reached record low amounts of 4.9 percent of GDP because of weak budget execution, particularly at regional levels. Moreover, social expenditures were 0.3 percent of GDP lower than expected. This low investment and social spending—combined with the authorities' efforts aimed at containing the wage bill and goods and services, delaying planned recruitments in 2013 or stopping the commitment of new expenditures earlier in December (LOI,



Source: IMF staff estimates and projections.

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MEFP)—fully offset weaker tax collection (mostly VAT) and the higher subsidy payments necessitated by lower gas volumes transiting through Tunisia from Algeria to Italy (about 0.6 percent of GDP for the year). As a result, the structural fiscal deficit in 2013 improved to 4.6 percent of GDP (from 5.2 percent of GDP in 2012, and 5 percent under the program).

- **Financing the fiscal deficit required using cash buffers at a rapid pace and deferring payments to 2014.** External financing dropped less than 30 percent of programmed levels in 2013, with no external budgetary disbursements in the last quarter of 2013 from the World Bank (deferred in light of delays in progress on key reforms), the African Development Bank (because of risk management guidelines linked to the AfDB's high exposure to North Africa), and Turkey. In addition, samurai bond issuance was slighly lower than expected, implementation delays hampered sukuk issuance, and proceeds from confiscated assets were less than expected (about 1.5 percent of GDP lower). Against this backdrop, the authorities reduced their stock of government deposits held at the Central Bank of Tunisia (CBT) from about 6 percent of GDP at end-December 2012 to an estimated 2.3 percent of GDP by end-2013. These developments amounted to increased domestic borrowing to compensate for the financing shortfalls, and led to substantial accumulation of payment orders at end-2013—mostly, transfers to public enterprises of about 1.4 percent of GDP and capital expenditures of about 1.3 percent of GDP—that will be paid in the first quarter of 2014.

Tunisia: Official External Financing

(Millions of U.S. dollars)

	2013	
	Prog.	Prel./Act.
Total	2,239.1	640.6
Bilateral	200.0	0.0
IFIs	800.0	58.2
AfDB	300.0	0.0
AMF (Arab Monetary Fund)		58.2
World Bank Group	500.0	0.0
Other	1,239.1	582.4
International Market Financing	153.0	
International Market Financing (possible Japan guarantee)	246.9	197.6
Project aid without donor breakdown	439.1	310.7
Sukuk	400.0	
Other (including Loan Transfers to SOEs)		74.1
Memorandum items:		
Grants	248.0	68.0
IMF Financing	650.1	150.1

Sources: Tunisian Authorities; and IMF staff estimates.

- **Monetary policy remains accomodative.** Following a 25 basis point increase in the policy rate in March 2013, the CBT increased its policy rate by 50 basis points to 4.5 percent in December 2013, while narrowing the interest rate corridor to +/-25 basis points—which effectively leaves the overnight borrowing rate constant at 4.75 percent (most monetary operations were conducted close to the overnight rate because of the existing structural liquidity deficit). Moreover, the CBT lowered the required reserve ratio from 2 percent to 1 percent of domestic deposits, which reduced refinancing needed by banks by an additional 200–300 million dinars (from a total of about 4.6 billion dinars by end-December).

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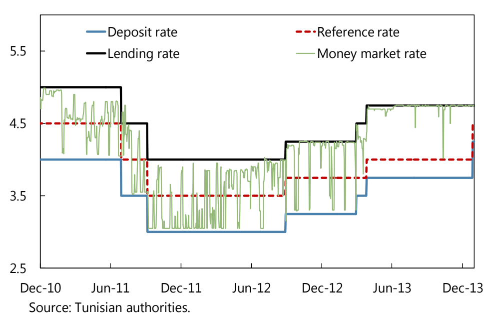
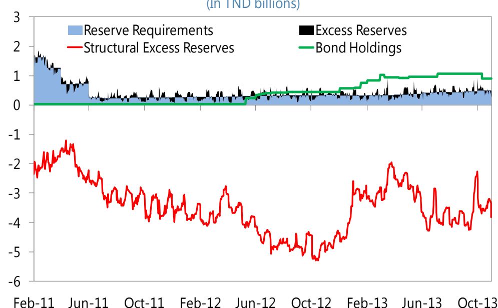
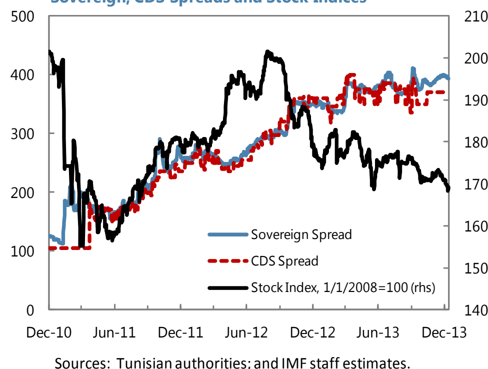
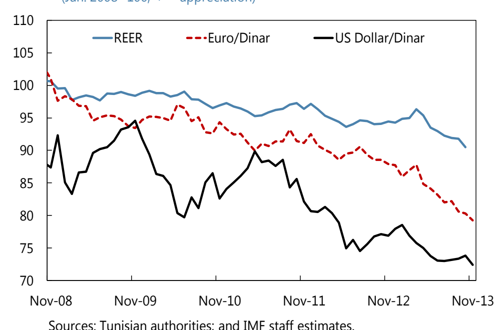




- **Financial markets in Tunisia remain relatively stable despite pressures on the exchange rate throughout the year.** Notwithstanding the deterioration of the domestic and regional political climate and ratings downgrades, CDS spreads trended sideward after having increased in the first quarter of 2013. The stock market is trading about 5 percent weaker than at the beginning of the year, with notably lower volatility than last year.





PROGRAM REVIEW AND POLICY DISCUSSIONS

A. Program Review and Policy Implementation

6. Performance criteria on NDA and NIR were met at end-June and end-September, but are estimated to have been missed for end-December. While performance criteria on the primary balance appears to have been met at end-December after having being missed in June and September. The indicative target on social spending has been missed for each test date (MEFP, Table 1).

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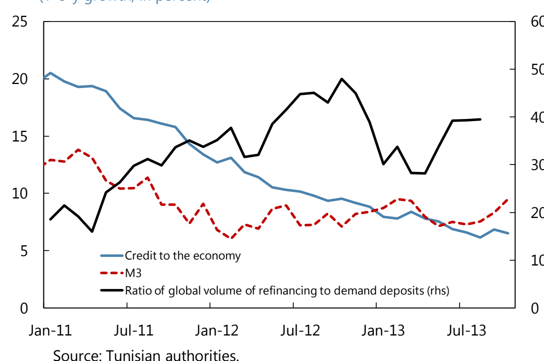
- **End-June and end-September NDA performance criteria were met**, once adjustors on residents' foreign exchange deposits at the Central Bank of Tunisia (CBT) and shortfalls in budget loans (a $200 million budget loan from Turkey has been delayed) are taken into account. However, an increase in net credit to government—driven by larger-than-programmed government deposit withdrawals—has not been compensated by lower bank refinancing, thus increasing end-December NDA beyond the program objective.

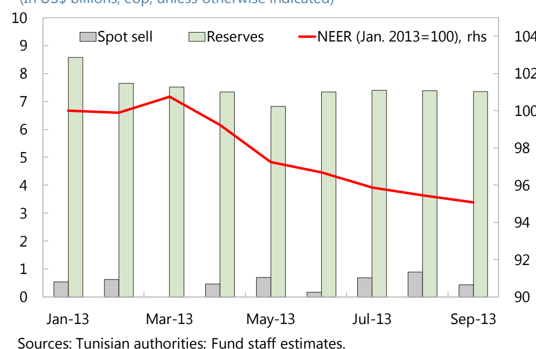
Growth in M3 and Credit to the Economy, 2011–13
(Y-o-y growth, in percent)



Source: Tunisian authorities.

- **Shortfalls in external financing weighed on the 2013 reserve targets.** The NIR target—which was met at end-June and end-September after adjustors on multilateral loans and fx deposits were taken into account—appears to have been missed at end-December as private capital inflows were not enough to compensate for the shortfall in sukuk/samurai bond issuances and the heavy intervention in the foreign exchange market to respond to pressures on a depreciating exchange rate. That said, gross international reserves are expected to remain at around three months of imports at end-2013, despite the delay in IMF disbursement, as a result of lines of credit from a European commercial bank (Euro 300 million) and the Qatar National Bank deposit at the Central Bank of Tunisia, received last November ($500 million).

Reserves, Spot FX Interventions, and Exchange Rate
(In US$ billions, eop, unless otherwise indicated)



Sources: Tunisian authorities; Fund staff estimates.

Tunisia: Central Government Financing, 2013
(In millions of dinars)

	Annual Prog.	Annual Prel./Act.
A. Central government deficit (-) (incl. grants)	-5,338	-4,648
B. Float and other statistical discrepancies	0	-1,303
C. Central government deficit (-) (incl. grants, cash basis)	-5,338	-3,345
C. Financing	5,338	3,345
Foreign	2,028	-588
Drawings	3,583	1,037
Amortization	1,555	1,625
Domestic	1,790	3,409
Drawings	1,381	1,840
Amortization	1,428	1,380
Government Deposits (+ = drawing / - = accumulation)	1,337	2,949
Public Banks Recapitalization	500	0
Privatization proceeds	1,520	524
D. Grants	400	110
E. Interest Payments	1,420	1,440
F. Primary balance (excl. grants, cash basis) (F = C - D + E)	-4,318	-2,015

Sources: Tunisian authorities; and IMF staff estimates.

- **The fiscal performance criterion, as measured from below the line, appears to have been met** by a significant margin at end-December, after having been missed for end-June and end-September. The end-September primary balance was missed by one percentage point of GDP because of higher subsidy payments and additional "unidentified"

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- expenditures, possibly linked to payments made during the extended budgetary complementary period early in 2013 (about 1 percent of GDP). Preliminary data that became available in January 2014 indicate that the end-year primary balance target (on a cash basis)—adjusted for lower than expected banking recapitalization costs—appears to have been met by a significant margin, thanks primarily to deferred cash payments to 2014 (about 3 percent of GDP). Staff does not expect major changes to these results when final data become available later in the year, because the financing data are almost final and new payment orders were stopped during the complementary period on January 20, 2013 (LOI, ¶3; MEFP, ¶5).

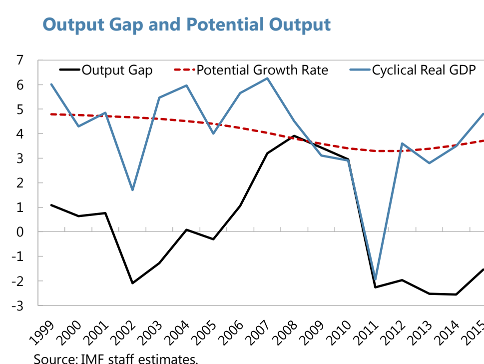
- **The indicative target on social spending was missed for all test dates**, owing to implementation capacity constraints and expenditure cuts at the end of the year caused by financing constraints.

7. Progress on structural reforms has continued, but at a slower pace than envisaged. Of the 14 structural benchmarks expected to be completed by end-December, nine have been met, albeit with delays for some (MEFP, Table 2a). Of the remainder: (i) the study on the impact of changes in the liquidity ratio is expected to be completed in January 2014 with a one-month delay; (ii) the bank interlinking platform and market makers agreement are being finalized following technical problems, with implementation now scheduled for March 2014 (delayed from October 2013); (iii) the audits of public enterprises—which will now cover one more enterprise than originally programmed—will be finalized by March 2014 (delayed from end-December 2013); (iv) the household targeting strategy has been delayed to March 2014 pending further work on identifying beneficiaries and the mode of distribution; and (v) the strategic orientation for public banks—which is dependent on the completion of bank audits that have started with a significant delay because of procurement procedures—is now expected to be finalized in March 2014 (compared to December 2013 under the original timeline).

B. Outlook and Risks

8. The macroeconomic framework remains predicated on a stable political and security environment and a return of investor confidence following elections in 2014. Against this backdrop, staff and authorities agreed on the following:

Output Gap and Potential Output



Source: IMF staff estimates.

- **Growth.** Real GDP growth in 2013 is estimated at 2.7 percent, with difficulties in the political transition weighing on tourism and investor confidence during the last quarter of 2013. For 2014, the authorities see the possibility of growth averaging as high as 4 percent, following the confidence boost arising from the adoption of the Constitution, reduced security tensions, and a technocratic government pursuing reforms

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ahead of elections, which are expected in the second half of 2014. The authorities, however, recognized the dangers of shocks that can accompany any political transition, and agreed that a 3 percent growth rate for 2014—which still assumes a strong pick-up in industrial production, trade, and tourism in the second half of 2014—would better underpin the program's macroeconomic framework during a period of uncertainty. Reduced investor uncertainty in a post-election environment will continue to boost output, which will overshoot its potential in 2015, helping to narrow the negative output gap.

- **Inflation.** Inflationary pressures are expected to subside, with headline inflation declining from 6 percent at end-2013 to 5.3 percent at end-2014 on the back of declining food price inflation. A prudent monetary policy will strengthen the credibility of the CBT, keeping core inflation at about 4.5 percent year-on-year in 2014 and inflationary expectations in check.

- **External position**. The current account deficit is projected to narrow to about 5.5 percent of GDP in 2015, driven by a recovery in trading partners' economies and lower international commodity prices. Better prospects in the phosphate sector, and higher tourism receipts and workers' remittances will also support the current account improvement in the medium term.

Tunisia: Selected Economic Indicators, 2010–15

				Est.	Proj.	
	2010	2011	2012	2013	2014	2015
Real GDP growth (in percent)	2.9	-1.9	3.6	2.7	3.0	4.5
Consumer price index (CPI), (period average, in percent)	4.4	3.5	5.6	6.1	5.5	4.8
Current account (percent of GDP)	-4.7	-7.4	-8.2	-8.2	-6.7	-5.5
Gross official reserves (US$ billions, eop)	9.5	7.5	8.6	6.8	9.1	10.6
Gross official reserves (months of next year's imports)	4.4	3.4	3.9	3.0	3.8	4.3

Sources: Tunisian authorities and IMF staff estimates and projections.

9. **The outlook remains subject to significant downside risks.** Additional delays in the political calendar would weigh on investment prospects, job creation, and capital inflows. Increased security tensions would limit the recovery in tourism and FDI inflows, and deepen investors' "wait-and-see" attitude. A weaker economic outlook in Europe and other trading partners, or higher commodity prices, would add another drag on growth and the external and fiscal positions.

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POLICY DISCUSSIONS

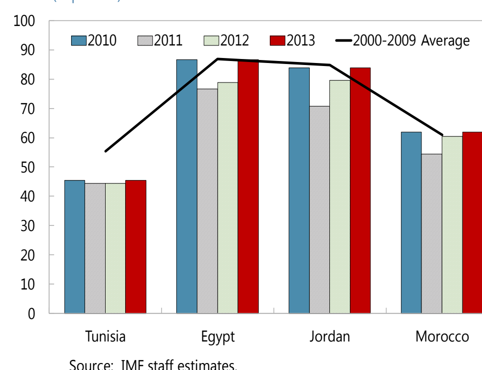
Discussions centered on the appropriate fiscal and monetary policy stance for 2014 that will strike the right balance between supporting economic growth and rebuilding fiscal and external buffers. The review also strengthened the structural reform agenda, with a view to enhancing inclusive growth through scaling up public investments, public enterprise reform, and protecting the most vulnerable from the potential adverse impacts of reforms.

A. Short-term Stabilization Goals

Fiscal policy

10. The fiscal consolidation path envisaged at the start of the program will require more time. Delays in the political transition and rising social tensions have led the authorities to opt for a more gradual fiscal adjustment. The authorities agree, however, that the fiscal deficit path should remain anchored on a medium-term deficit target of about 2.5 percent of GDP by 2018. Energy subsidy reform, wage bill containment, and revenue-enhancing measures will continue to form the core of the fiscal consolidation effort. Compensatory measures to mitigate the impact on the most vulnerable will accompany the reform efforts.

11. Fiscal consolidation over the medium term is essential to ensure that the debt level remains sustainable. Tunisia's debt—the lowest among oil-importing Arab Countries in Transition (see text chart)—remains sustainable under the baseline scenario, increasing to 53.2 percent of GDP in 2015 before stabilizing at 52.2 percent of GDP by 2018 (See DSA annex). However, this debt path is more elevated than initially programmed because of more conservative macroeconomic assumptions and a more gradual fiscal adjustment than was envisaged at the start of the program. Financing needs over the next few years will mostly be met through external sources, thus increasing the share of share of foreign currency debt to about 73 percent of total debt in 2015 (from 58 percent in 2011).



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12. Reversing the deterioration of pro-growth expenditures underpins the 2014 fiscal stance (MEFP, ¶9). The authorities had initially planned on a reduction in the overall fiscal deficit in 2014. However, the latest information on payment orders and budget execution in 2013 resulted in a higher-than-expected fiscal balance, implying a 0.6 percent of GDP deterioration in the structural fiscal balance in 2014 relative to 2013 (instead of the small improvement planned when the 2014 draft budget was approved on December 31, 2013). Staff would have preferred a more rapid reduction in vulnerabilities through stronger fiscal adjustment and a budget composition aligned towards higher investment spending, with a particular emphasis on reducing high levels of current expenditures—as wages and subsidies continue to represent close to 86 percent of revenues (close to the 2012 levels). The authorities argued that any additional expenditure or revenue measures would be difficult at a time when civil society buy-in is hard to achieve, particularly ahead of the formation of a technocratic government. In light of these difficulties, staff agreed that keeping the structural fiscal balance constant relative to 2012—a year with a more regular budget execution pattern—is necessary to reverse the cut in pro-growth expenditures that materialized in 2013. However, staff cautioned that a more ambitious path for 2014—including additional measures—may need to be revisited in the future, in view of the rising debt and possible financing constraints. The authorities agreed to explore the possibility of additional measures later this year.

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

	2012	2013		2014	
	Act.	Prog.	Prel./Act.	Prog.	Proj.
Revenue	23.0	23.8	23.4	24.0	22.6
of which: Tax revenue	21.0	21.8	21.1	22.0	21.3
Expenditure and net lending	28.7	31.1	29.5	30.3	29.7
of which: Wages and salaries	12.2	12.4	12.4	12.0	12.4
Transfers and subsidies	7.0	7.2	7.6	6.2	7.0
Capital expenditure	6.6	6.4	4.9	6.9	5.2
Net lending	-0.5	0.3	0.0	2.0	1.3
of which: Public Banks' recapitalization	0.1	0.6	0.0	2.0	1.2
Central government deficit (-) (excl. grants)	-5.7	-7.3	-6.2	-6.4	-7.1
Float	-0.7	0.0	-1.7	0.0	1.8
Central government deficit (-), (excl. grants, cash basis)	-5.0	-7.3	-4.5	-6.4	-8.9
Structural fiscal balance	-5.2	-5.0	-4.6	-3.8	-5.2
General government debt	44.3	45.3	45.0	49.5	51.7

Sources: Tunisian authorities; and IMF staff estimates.

13. Revenue enhancing measures and expenditure cutting measures support the 2014 structural fiscal deficit target, which is projected at 5.2 percent of GDP, after savings in unallocated expenditures (0.5 percent of GDP) and the following budgeted measures (MEFP, ¶7):

- **Tax revenues (MEFP, ¶9).** New measures expected to yield 0.3 percent of GDP include, mostly, higher property taxes (0.2 percent of GDP) and lower customs exemptions (0.05 percent of GDP). Additional tax measures will follow the National Tax Consultations scheduled to be held in March 2014, and will likely only be implemented as part of a revised budget.

- **Wage Containment.** Staff welcomed the politically sensitive step—accepted by key stakeholders—of freezing public sector wages in 2014. Despite this measure, the wage bill—estimated at about 12.4 percent of GDP—would still rise by 8 percent in 2014 because of net new recruitments—limited to security forces, teachers, and health workers—and bonuses. The authorities argued that, as in 2013, some savings will naturally arise because of deferred recruitment—but that most of the hiring was agreed to in the aftermath of the revolution, when an aggressive and exceptional public recruitment program was initiated. Staff underscored that these savings would be temporary; the impact on the wage bill would be

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permanent and fully observed starting next year. Staff therefore argued for a hiring freeze, and stressed the need to avoid the creation of unnecessary public jobs, which is a very costly and inefficient strategy for reducing unemployment. Staff urged the authorities to move towards a more transparent merit-based hiring system.

- **Energy Subsidies**—Staff welcomed planned savings of 0.8 percent of GDP arising from reducing energy subsidies, of which more than 90 percent will come from electricity tariff and natural gas price increases: (i) electricity subsidies to cement companies were reduced by half as of January 1st 2014, with a view to eliminating them by June 2014; and (ii) tariff and natural gas prices were also increased by in a two-step process that started for medium- and low-voltage consumers with a 10 percent rate hike as of January 1st 2014, while lifeline tariffs (i.e., tariffs for households consuming less than 100 kwh) are preserved to protect the poorest segments of the population (Box 1). The authorities indicated their commitment to increase fuel prices by 6 percent in July 2014, which will generate savings of 100 million dinars for the year. A targeted household scheme (to be designed by March 2014—see Section C) will precede the planned fuel price increase. Moreover, a new automatic fuel price formula has been designed, allowing convergence to international prices over time, but without a smoothing mechanism for increases higher than US$6 per barrel, and with lags for smaller price increases. Staff urged the authorities to continue working on improving the formula to ensure that the price formula is not abandoned and remains sustainable in the event of large increases in international prices.

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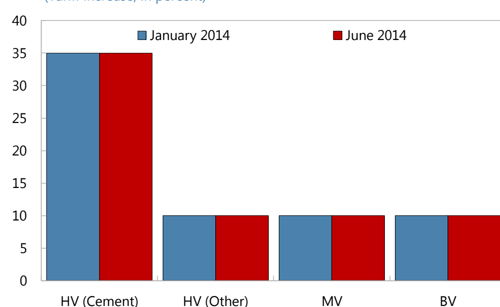
Box 1. Tunisia: Reform of the Energy Sector

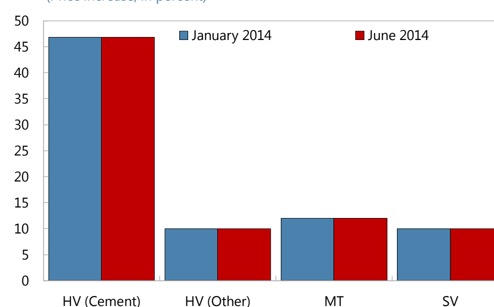
The authorities have announced a series of energy tariff increases aimed at progressively eliminating subsidies in the electricity sector. The strategy consists of a series of electricity tariff and gas price increases, which will yield 0.7percent of GDP in savings, over 2014:

- **Electricity Tariffs** (savings of 0.5 percent of GDP in 2014). Tariffs for cement companies have been increased by 35 percent as of January 1st, 2014, effectively halving subsidies to these companies. A complete elimination of electricity subsidies for cement companies is planned for June 2014 through another 35 percent tariff increase. A gradual reduction of the electricity subsidy is planned over a three- to six-year period for high and medium voltage, with tariffs to other industrial users and households rising twice by 10 percent over 2014.

- **Natural Gas** (savings of 0.2 percent of GDP planned for 2014). A 47 percent increase in gas prices will reduce subsidies to cement companies by half, before they are eliminated completely through another 47 percent increase in June 2014. A new rate was created for large consumers of low voltage, while the subsidy for other high-voltage customers is to be reduced over a period of six years.



Source: Tunisian authorities.



Source: Tunisian authorities.

The tariff increases are part of a number of initiatives included in the authorities' recently adopted medium-term energy sector strategy. These include:

- **Protecting the most vulnerable,** by maintaining the lifeline tariffs for households with monthly consumption below 50kwh, and introducing a social tariff for households with monthly consumption below 100kwh.

- **Encouraging energy efficiency,** by creating new consumption bands with disincentive pricing aimed at reducing energy consumption by large consumers.

- **Increasing incentives for the development renewable energy.** A new law that will allow private and public operators to produce electricity using new forms of energy (solar, wind, etc.,) has recently been submitted to Parliament. Over the medium term, investment in these areas—which will be facilitated by the creation of an investment fund—will help reduce costs that have so far been dependent on expensive and very volatile fossil fuel prices.

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Monetary policy

14. Inflation remains above the comfort zone of the CBT despite weak credit growth and the large negative output gap (MEFP, ¶12). Staff welcomed the recent increase of the policy rate as this helps restore it as the key signaling instrument of monetary policy. But staff was disappointed that the effect on the interbank rate was offset by narrowing the interest corridor for the 24 hour standing facilities by 50 basis points. Together with the reduction in the reserve requirement ratio, this results in a monetary policy that remains somewhat accommodative. Staff would have preferred a stronger commitment to a tighter monetary policy, as it remains concerned about money market real rates in negative territory (close to -2 percent), capital misallocation (SMEs often find it difficult to obtain credit), expectations of a depreciating exchange rate, and pressures on the exchange rate from loose liquidity conditions. The CBT, however, was of the view that the large negative output gap, sluggish credit growth, and the need to preserve financial stability did not warrant, at this stage, a significant tightening in monetary policy. That said, with the risk of inflationary pressures and higher inflation expectations becoming entrenched, staff and the authorities agree that the CBT should stand ready to tighten monetary policy further if core inflation rises more rapidly than expected. Staff is also concerned that a lower rate of required reserves might not be adequate for prudential reasons.

15. Several steps have been taken by the CBT to implement a stronger collateral framework (MEFP, ¶13). New haircuts for loans used for central bank refinancing and higher shares of refinancing through government securities, are being implemented as of January 1st, 2014. Staff stressed the importance of continuing these reform efforts and welcomed the authorities' plans to raise haircuts higher and earlier than previously planned or to further increase the share of refinancing through government securities (structural benchmarks). The timely implementation of the stronger collateral framework would help reduce risks to the CBT's balance sheet and encourage banks to manage liquidity in a more forward-looking way. However, staff and the authorities agreed on postponing additional tightening of the collateral framework until after a lender of last resort facility is established—with IMF TA—in June 2014 (structural benchmark). Such a facility will be necessary to make sure illiquid but solvent banks can still access CBT resources on a temporary basis.

16. Caps on bank lending rates hamper the monetary transmission mechanism and should be removed. Staff urged the authorities to remove the existing caps as soon as possible. The authorities first plan to assess the impact of such actions or any modification through a study (end-March structural benchmark), which they plan to undertake with World Bank assistance. Changes in this regulation would strengthen the interest rate transmission channel of monetary policy and enhance financial sector deepening (Box 2; MEFP, ¶12).

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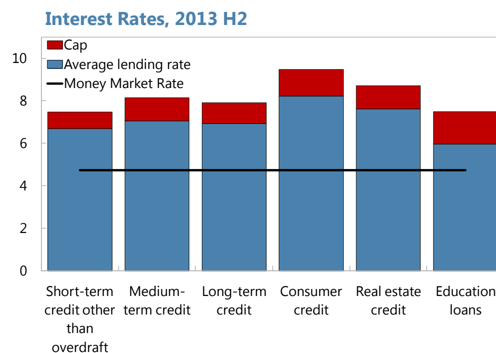
Box 2. Tunisia: Reform of the Lending Rate Cap System

Lending rates in Tunisia are tightly regulated under a cap system (*taux excessif*). This system sets maximum lending rates for nine different sectors, depending on the average sectoral interest rate—called the *taux effective global* (TEG), which represents the average rate of the first five months of the past semester. Any interest rate that exceeds this average by more than 20 percent would be considered as excessive—for example, if the past sectoral average was 8 percent, then the maximum lending rate would be 9.6 percent (see chart for current TEG).



Sources: Tunisian authorities; and IMF staff calculations.

Reforming the overly tight regulation governing lending rates is essential to improve access to finance, make growth more inclusive, and strengthen the effective functioning of monetary policy. Direct benefits of an overhaul of existing regulation include:

- **Strengthening banks' incentives to price credit according to risk-return considerations.** Without risk-based pricing, proper internal risk controls have no role to play—which partly explains the underdeveloped functioning of internal audits/risk management functions in banks. In such situations, banks will resort to rationing credit instead of properly pricing and monitoring riskier credits. This in turn results in increased lending to well-connected, large, and established creditors, and constrains the credit available to SMEs, start-ups and households, who all complain about low access to financing. Additionally, it prevents the development of a microfinance market and effectively increases financing costs for those potential borrowers who do not receive bank credit under the current interest regulation and who have to rely on much more costly equity or alternative informal ways of financing.
- **Strengthening the monetary policy transmission mechanism.** Current regulations imply that lending rates today are a function of past interest rates. As a result, the lag with which the interest rate channel of monetary policy influences the real economy and inflation is very long. In cases where monetary policy is tightened quickly, margins of banks shrink because of banks' limited ability to pass on higher refinancing costs to borrowers. As a consequence, credit will be rationed rather than made more expensive. This might also lead to a sub-optimal growth-inflation outcome.
- **Increase competition for deposits.** With lending rates capped, banks have few incentives to compete for deposits, as this would reduce their margins (and hence limit the impact of eliminating caps on deposit rates last March). Removing the cap on lending rates would enhance deposit growth and financial sector deepening, and would contribute to a reduction in the structural liquidity deficit.

As a first step in reforming the existing regulation, the authorities are conducting a full assessment of the existing system. Such an evaluation—to be undertaken with World Bank assistance—will help in assessing the impact of existing regulations on debtors' protection, firms' access to finance, and credit risk management practices.

External and exchange rate policy

17. The dinar depreciation in 2013 has reduced the overvaluation of the exchange rate. The exchange rate has depreciated by about 8 percent in nominal effective terms (9.5 percent vis-à-vis the euro) in 2013, helping to narrow staff's estimated overvaluation of the exchange rate to about 5 percent. The Qatar National Bank deposit at the central bank in Q4-2013 partially eased pressures on the exchange rate at the end of year; however, over the next few months, pressures could re-emerge as the result of a low seasonal supply of foreign exchange, high energy trade

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deficit, or further delay in external financing. Additionally, the holders of special foreign exchange (FX) accounts increasingly prefer to keep their FX receipts in their accounts rather than converting them in the official market, as is indicated by existing regulations on the use of FX (Tunisia has "capital controls," and holders of FX can only use them for current account transactions). The current context of negative interest rate and delays in implementing fiscal measures could also cause further deterioration of the fragile external position and exacerbate pressures on the foreign exchange market.

18. Exchange rate flexibility remains crucial to preserving external buffers (MEFP, ¶14). The authorities are committed to limiting CBT interventions in the foreign exchange market to smooth excessive exchange rate fluctuations. They stressed that the shallow FX market still makes the CBT the main holder of foreign exchange, and that some of the interventions earlier in the year were to meet large shortfalls caused by seasonal foreign exchange receipts and a drop in foreign exchange from the phosphate sector (a previously strong source of foreign exchange). To preserve external buffers, staff and the authorities agreed that the NIR target should be increased to $7.4 billion in 2014, boosting gross reserves above the Fund's risk-weighted metric, with the exchange rate used as an absorber for possible shocks that threaten the minimum three-month import cover. Moreover, to raise liquidity on the exchange rate market and rebuild external buffers the authorities have: (i) introduced currency swap operations between commercial banks and the central bank; (ii) agreed to speed up progress towards introducing the institutional mechanisms necessary to the development of a weekly foreign exchange auction mechanism by end-2014 (end-December structural benchmark); and (iii) published a CBT circular stipulating strict application of the regulation on special FX accounts. The authorities note that application of the new regulations is already bearing fruit by increasing FX available in the foreign exchange market.

Exchange Rate Assessment Using CGER Panel Estimates

(In percent)

	Underlying CA Balance 1/	CA Norm	REER Misalignment
MB approach 2/	-4.3	-1.9	8.2
ERER approach	...	...	3.3
ES approach	-4.3	-2.9	4.8

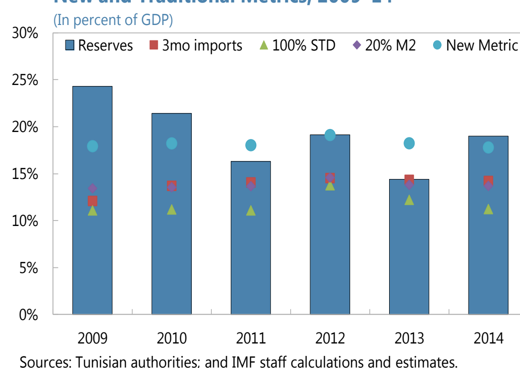
Overvaluation (+); undervaluation (-)

1/ In 2018 corrected from program adjustment.

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

Reserve Coverage Based on Alternative Metrics: New and Traditional Metrics, 2009–14

(In percent of GDP)



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

19. Staff welcomes the authorities' decision to refrain from introducing new restrictions or surcharges on imports and/or limitations to special FX accounts (*comptes professionels en devises*), which could yield short-term relief by limiting currency speculation but come at the cost of market distortions.

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B. Laying the Foundations for Stronger, More Inclusive Growth

Reducing financial sector vulnerabilities

20. Weaknesses in supervisory reporting and data provision indicate higher banking sector vulnerabilities than reported (MEFP, ¶16). Financial soundness indicators for end-June 2013 show sound capital adequacy, but nonperforming loans (NPLs) grew from 13 percent of total loans in 2010 to 15.2 percent as of June 2013 (Table 7). This figure is likely to be an understatement of the true condition of banks' asset quality, particularly because many of the tourism loans rescheduled in 2011 have reportedly become overdue. Moreover, provisioning of NPLs is low in comparison with international best practices, indicating that existing buffers may be inadequate to cover an excess of risk in the system. Credit risk is amplified by weak supervision, inadequate norms, and poor enforcement of existing regulations. Although problems are mainly concentrated in public banks, the difficult economic situation is likely to have worsened private banks' balance sheets as well.

Tunisian Banks: Financial Indicators

(In percent, as of June 2013)

	Public Banks	Private Banks
CAR	10.2	11.9
Government bonds to total assets	2.0	5.6
Loans to assets	74.2	66.8
Deposits to loans	74.1	95.6
NPL	21.0	11.2
ROA	0.4	1.1
ROE	5.2	13.5

Source: Central Bank of Tunisia

21. Remedying the vulnerabilities of the banking sector—including through strengthened regulation and transparency—is a key priority for the Tunisian authorities (MEFP, ¶18). Following several FSSA recommendations, the CBT has tightened its concentration and connected lending norms, increased the regulatory CAR; conducted a general inspection of a commercial bank for the first time since 2006, finalized four credit inspections of banks, and published a bank supervisory report for the first time in its history. Additional steps are needed to reduce vulnerabilities arising from public banks, align banking practices with international prudential norms, and strengthen banking supervision practices.

22. Reducing the fragility of public banks is essential to addressing the vulnerabilities of the banking sector. Preliminary audit reports of the public banks—established using uniform criteria and conservative valuation of collateral—are now available for two of the three banks, making it possible for the authorities to define their strategy—including the business model to be retained for these entities—by March 2014 (new structural benchmark, deferred from the original timeline envisaged under the program because of delays in launching the audits, which were beyond the control of the authorities). Staff encouraged the authorities to consider all options when designing the strategy and to ensure that private sector solutions are also explored. The authorities noted that the strategy will only be finalized once the audits are completed, with solutions that

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could include reduced state intervention, including through public-private partnerships. The authorities remain ready to provide the financial resources necessary to meet any recapitalization needs. The FSSA estimates these needs amount to 2.6 percent of GDP; the authorities estimate that 1.2 percent of GDP over 2013–14 represents a sufficient amount, which could be raised or reduced—therefore potentially impacting significantly debt dynamics—depending on the business strategy chosen and the role of the private sector. In the interim, steps taken to improve the governance of public banks are a welcome development that should help put them on equal footing with their private sector counterparts (MEFP, ¶17).

23. A number of initiatives are being taken to improve regulatory norms and reduce risks from weak asset quality. The authorities are reviewing loan classification rules, and have introduced conservative collateral appraisal standards for the first quarter of 2014, which would make higher provisioning necessary (MEFP, ¶17). The authorities are also taking steps to address asset quality in the tourism sector, which has the highest NPL ratio (54 percent of the sector's total debt), through the establishment of an asset management company (AMC), which has seen its implementation delayed. Staff encouraged the authorities to finalize the draft law and business plan for the establishment of the AMC as soon as possible, in order to improve the viability of exposed banks and refocus their ability to lend. The authorities concur that the AMC is the way to proceed, but argue that more time is needed to build the consensus necessary for its implementation, particularly with the hotel industry. On the regulatory front, plans to align the liquidity ratio with international norms are progressing, with the impact study about to be finalized.

24. A formal risk-based supervision approach is being implemented (MEFP, ¶17). As a first step, the authorities have designed the architecture for a new reporting and bank risk profile whose implementation—expected with Fund TA—has been advanced by one year to end-2014 (structural benchmark). In the meantime, and as a bridge solution for regularly and comprehensively evaluating the financial situation of banks, a uniform bank performance reporting system (UBPR) will be put in place by early March 2014 with data to be provided on a quarterly basis and no more than 60 days after the end of each quarter, starting with Q4 2013. The authorities have also increased resources to the banking supervision department, and plan to step up both onsite and offsite inspections in 2014.

25. Addressing banking system vulnerabilities will require strong upfront measures to enhance crisis preparedness. Specifically, the bank resolution framework (new structural benchmark) will be strengthened by the revamping of the draft bank resolution law and the banking law; as well as revising the law and corporate insolvency debt recovery regime so as to modernize and simplify the process of restructuring firms and liquidating insolvent firms. At the same time, the authorities are working—with World Bank TA—on the establishment of a deposit insurance scheme that could be put in place by June 2014.

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Growth-enhancing fiscal reforms

26. Revenue reform is essential to remove the complex and distortive measures that limit the development of the private sector (MEFP, ¶19). The first phase-in of the convergence of the corporate tax rate, new tax on dividends (which were previously untaxed), and an increase in thresholds for lowest-income households were incorporated in the 2014 budget. National tax consultations are planned by March 2014 to identify ways to rationalize tax incentives, simplify the complex tax system (particularly indirect taxation), make it less regressive, and remove significant distortions. As part of the global income tax reform, staff has encouraged the authorities to design a calendar for the complete elimination of the onshore and offshore corporate tax disparity. On revenue administration, staff welcomed steps taken towards a unified large taxpayer unit, and encouraged the authorities to swiftly design and implement their modernization plan (end-March structural benchmark). A high priority is the strengthening of control and evaluation mechanisms, including the forfeit system used for small businesses.

27. The execution and composition of the budget should be significantly improved (MEFP, ¶19). Capital expenditures in 2013 have reached record lows, and staff stressed the concern that the low level of investment spending will have a significant negative impact on growth. Staff welcomed the new simplified and modernized procurement procedures, which should help speed up investment. Staff encouraged the authorities to prioritize projects with the highest impact on growth, and urged the implementation of better control procedures to avoid the current practice of transferring unused investment allocations to regions to circumvent carryover restrictions. The authorities explained that the political situation has disrupted regional administrations and delayed project implementation, but that improvements have been observed in recent months.

28. Reform of public enterprises is necessary to improve service delivery and reduce losses, thus creating additional fiscal space through lower transfers (Box 3, MEFP, ¶19). To assess the risks from the sector, the authorities have initiated audits of large energy companies, and plan to assess the fiscal situation of the 20 main public enterprises by March 2014 (structural benchmark). In the meantime, transfers to public enterprises now require stricter control and monitoring, which includes a new interdepartmental monitoring committee and more careful budget appropriation. Additional initiatives include a revamping of the legislative governance framework.

29. Public Financial Management reforms are progressing, following Fund TA recommendations. There is a need to improve cash management by consolidating bank accounts (excluding project accounts) at the CBT into one treasury Single Account, which will allow for better visibility of cash amounts and reconcile the discrepancies between monetary and fiscal statistics. A better expenditure control mechanism has also been initiated by keeping the complementary budget period within the strict limits of the law. Broadening the coverage and quality of fiscal reports—including the adoption of a functional budget classification—will be key objectives for 2014 (MEFP, ¶19).

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Box 3. Tunisia: Public Enterprises: Contingent Liabilities, Fiscal Risks, and Reform Agenda

Tunisia has 104 state-owned enterprises (SOEs) that employ 120,000 people (3 percent of Tunisia's active population). The SOEs are in a variety of sectors such as banking, transport, basic services (communications, electricity, and water), mining (phosphate), and industry (oil production and refinery, cement, chemical, paper, sugar). In terms of earnings, the largest enterprises are the oil refinery company (STIR), the electricity company (STEG), the chemical group (GCT), and the telecommunications company.[1]

The largest 28 enterprises represent more than 70 percent of employment in public enterprises. STEG has the largest number of employees (10,000), followed by the Post Office and the Transport Company (Transtu). Between 2010 and 2011, these enterprises increased employment by more than 10,000, with the Chemical Group, STEG, and Transtu responsible for more than half of it. In some cases, employment in some state-owned companies increased by 50 percent over the past three years.

The consolidated balance for the 20 largest public enterprises has reportedly deteriorated from a surplus of 1 percent of GDP in 2010 to a deficit of 0.2 percent of GDP in 2012. The largest deficits in 2012 originated from four public enterprises (STEG, Tunisair, Transtu, and the Cereal Distributing Company (OC)) which were responsible for a consolidated deficit of 0.8 percent of GDP. Increasing costs from higher employment and more expensive inputs (fuel), combined with strikes in some sectors that significantly affected revenues (a drop of 40 percent for the chemical group), explain the worsening deficits. On the positive side, the oil production company (ETAP), which also benefits from the cross-subsidy system among energy companies, had a surplus of 0.8 percent of GDP.

Preliminary data for 2013, not yet complete, indicate that liabilities of public enterprises are high and rising:

- External debt from public enterprises (financial and nonfinancial) guaranteed by the government amounts to Dn 8 billion (10 percent of GDP or 34 percent of the total external government debt). STEG accounts for 40 percent of that amount.
- Public enterprise borrowing from the banking system represents about 4.8 percent of GDP, and is almost twice the 2006 level. The concentration ratio in a few enterprises is somewhat worrisome: (i) 80 percent of the debt portfolio is within 10 enterprises; (ii) 70 percent of credits of public banks to public enterprises are to financially difficult ones (e.g. OC, Tunisair, STEG), while 70 percent of private banks' credit to public enterprises are to the financially healthiest public enterprises.

In this context, the government is committed to improving data reporting, transparency, and governance of public enterprises. Fiscal risks will be better monitored through a limit to government guarantees, an audit of the largest energy companies, the consolidation of the financial situation of the 20 largest public enterprises, and more regular reporting requirements. At the same time, the government is establishing inter-ministerial monitoring committees, and is reviewing the governance framework of public enterprises, including new regulations on the role of executive boards. The authorities' intention to make the energy subsidy scheme more transparent—including through making every company responsible for its own operational costs (including import transactions)—is an important step towards improved transparency and reduced fiscal risks.

[1]This excludes about 106 *établissements publics à caractère non administrative* (EPNA) which are not considered as public enterprises by Law 89-9 of 1989 and are budget-dependent agencies.

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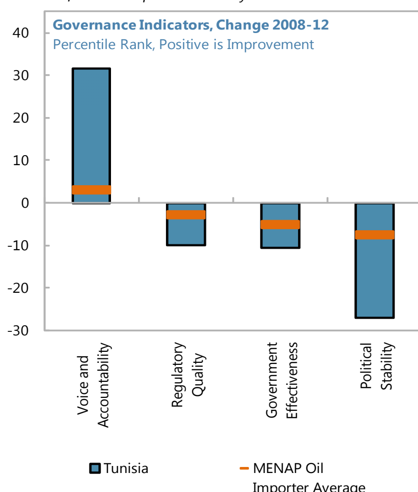
Growth-enhancing structural reforms

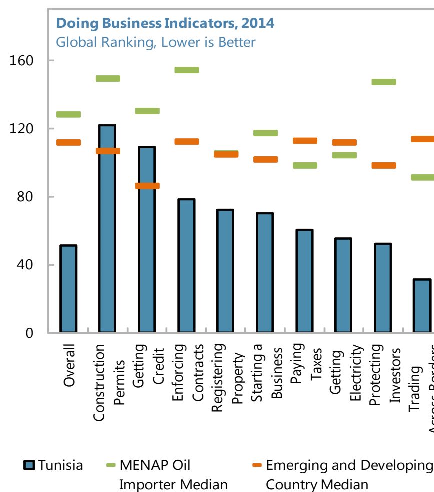
30. Improving the business climate is essential to promoting a competitive private sector, without which the employment challenge will not be addressed (MEFP, ¶20). Economic policies should aim at: (i) creating a more level playing field with greater access to economic opportunities for a broader part of society; (ii) developing an economic system that is based more on rules than on discretion and opportunities for rent seeking; and (iii) encouraging economic and social mobility, rewarding merit rather than connections. Fostering regional trade would also help to reap economies of scale that are necessary for competing in international markets. In this context, the authorities decided to adopt a new investment code and simplify administrative procedures (MEFP, ¶20). Although the latest Doing Business Survey indicators still rank Tunisia above its comparators, the deterioration in the regulatory quality and government effectiveness perception calls for urgent implementation of the authorities' plans to further streamline regulations and introduce new investment code decrees (end-March structural benchmark) that grant clearer market access rules (MEFP, ¶20). A revised draft completion law—aiming at reducing the discretionary application of business regulation—has been finalized and is expected to be submitted to Parliament soon.

Tunisia: Governance and Competitiveness

Although voice and accountability have increased greatly in recent years, government quality and effectiveness have decreased in the context of decreased political stability.



Despite increased instability, Tunisia outperforms most regional comparators in the World Bank's Doing Business Indicators.



Sources: World Bank; and IMF staff calculations.

31. Labor market reforms are still at the core of the government strategy (MEFP, ¶20). Little progress has been made in designing a comprehensive labor market strategy, which still requires a consensus within society on how to address labor market rigidities and skill mismatch that hamper the functioning of the labor market. Discussion between the labor union, the business union, and government have been initiated, but clear policy measures in this area will likely only be announced in a post-elections environment later in 2014.

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32. The quality and transparency of statistical data continue to be priorities. Staff welcomes the new draft law on the independence of the statistical office, which has been submitted to parliament. Plans to improve data on national accounts, monetary statistics and the balance of payments should be stepped up, with help from Fund TA (MEFP, ¶22).

C. Protecting the Most Vulnerable

33. Improving the targeting of the social safety net is critical for energy subsidy reform. Staff and the authorities agree that the creation of a unified registry of vulnerable households—which will help address leakages to non-poor of nearly 60 percent of the existing cash transfer program (PNAFN)—will take time to finalize. Staff expressed regret about delays in identifying the beneficiaries and mode of delivery that would allow for an interim "targeted household transfer" strategy (2013 end-August structural benchmark postponed to March 2014). The authorities have benefitted from extensive technical work from the World Bank on this issue but believe that additional work is needed to identify the neediest. Staff has urged that fuel price increases be accompanied by the implementation of a household compensation mechanism. In parallel, staff has urged the authorities to step up their communication campaign ahead of any fuel price increase.

34. Reform of the pension system is needed in the medium term. Staff and the authorities agree that the social security regime is not viable in the long term. Staff urged the authorities to carefully assess ongoing actuarial scenario analysis, and start engaging all stakeholders in a discussion of reform options through the "national consensus dialogue" initiated in January 2013.

PROGRAM DESIGN AND MODALITIES

35. The program has been modified to allow for delayed fiscal adjustment. The delay of fiscal consolidation until after 2014 is justified by the need to reverse significant cuts in social and capital expenditures that materialized at the end of 2013. The authorities are fully aware of the importance of keeping fiscal consolidation on track, and of ensuring that vulnerabilities are addressed by the end of the program. The structural fiscal deficit is now expected to improve in 2015, which would ensure that underlying vulnerabilities in the fiscal area are considerably reduced. Any slippage in the fiscal area or further delay in fiscal consolidation could lead to debt increasing on an unsustainable path (see DSA Annex). Staff and the authorities agreed to discuss, in the context of the next review, the possibility of additional budgetary measures for 2014—possibly amounting to 0.6 percent of GDP—or of a program rephasing/extension to allow more time to attain program objectives (LOI, ¶3). The reserve accumulation programmed, and the strong reform agenda, will ensure that buffers are rebuilt during the program, and that growth and equity objectives continue to be met. Fund technical assistance—coordinated with other donors—will help achieve these objectives.

36. Risks associated with the program remain significant and could increase further over the next months. Further setbacks in the political transition, or security flare-ups, could put the

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attainment of program objectives at risk, delay the completion of structural benchmarks, lead to policy reversals, adversely affect confidence, and further increase investors' "wait-and-see" attitude. Resistance by vested interests could further slow the implementation of the authorities' reform agenda. A further deterioration in the international economic environment could also dampen economic activity and put pressure on the fiscal and external positions. Delays in official external financing pledged to support Tunisia's reform program, or lack of market access, could create a financing gap.

37. **Waivers of nonobservance are being requested for the slippages in NIR and NDA at end-December on the basis of corrective actions taken; waivers of applicability will be needed for the end-December fiscal target.** These slippages were linked to weaker economic activity, exogenous shocks, and lower private inflows resulting from a loss in confidence following the political tensions in the latter part of 2013. The NIR and NDA performance criteria were met at end-June and September but appear to have been missed for end-December because of lower external financing and higher market liquidity needs. The performance criterion on the primary fiscal balance appears to have been met for end-December, mostly because of deferred cash payments; a waiver of applicability will be needed for this target as final data will only be available after January 30, 2014. The authorities' commitment to achieve program objectives remains strong. They are taking corrective actions by increasing NIR targets in 2014 towards the optimal coverage, implementing greater exchange rate flexibility, improving cash management procedures, implementing measures to keep the structural fiscal balance in 2014 at 2012 levels, and pursuing their structural reform agenda.

38. **Conditionality has been set to anchor program objectives and performance.** The PCs for end-March and end-June 2014 and new ITs for end-September and end-December 2014 are proposed to be set as per MEFP (Table 1). A new indicative ceiling to monitor current primary spending has been introduced for the remainder of the program. New structural benchmarks focus on the financial sector, monetary and exchange rate policy, and revenue and public financial management reforms, which are all macro-critical.

39. **The program is fully financed for the next 12 months**. Financing assurances have been provided by multilateral partners, with some linking future disbursements to progress in the reform agenda (e.g., the World Bank had linked it to reforms in bankruptcy law, AMC, and implementation of the investment code). From the Fund, all resources scheduled to be disbursed for 2014 will be used for budget support, with respective charges and responsibilities for the Ministry of Finance established according to a

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

	2014				
	Proj.	Q1	Q2	Q3	Q4
Total	4,134.5	1,267.9	659.0	1,458.3	749.2
Bilateral	200.0	200.0	0.0	0.0	0.0
IFIs	2,429.0	974.2	544.8	586.2	323.8
AMF (Arab Monetary Fund)	76.0		76.0		
IMF (Budget Support)	1,380.5	724.2	218.8	218.8	218.8
World Bank Group	750.0	250.0	250.0	250.0	
UE	222.5			117.4	105.0
Other	1,505.5	93.7	114.2	872.1	425.4
International Market Financing (possible US guarantee)	300.0				300.0
International Market Financing (possible Japan guarantee)	300.0			300.0	
Project aid without donor breakdown	346.9	72.6	105.5	57.7	111.1
Sukuk	500.0			500.0	
Other (including Loan Transfers to SOEs)	58.6	21.2	8.8	14.4	14.3
Memorandum items:					
Grants	125.5				

Sources: Tunisian Authorities; and IMF staff estimates.

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Memorandum of Understanding. Additional market issuance of $600 million is expected by the end of 2014, for which the authorities are seeking U.S. and Japanese guarantees. The issuance of a Sukuk bond—delayed from 2013 and now expected in the second half of the year—will cover remaining needs. Nonetheless, if there are early indications that projected financing will not be received, the authorities will consult with the Fund on alternative financing approaches and further policy adjustments.

40. Tunisia has the capacity to repay the Fund. Tunisia has a strong record of payments to the Fund. Peak Fund access projections remain unchanged from the Stand-By Arrangement request (400 percent of quota). Standard indicators of Fund exposure will remain low, with Fund credit outstanding reaching a maximum of 3.5 percent of GDP in 2015 (about 17 percent of gross international reserves). Tunisia is expected to maintain international capital market access.

41. The authorities continue to address the recommendations of the Safeguards Assessment. A review of the central bank law will focus on enhancing the central bank's independence and improving its governance and accountability framework. External audit arrangements will be defined, and the independence of the internal audit and control functions strengthened and modernized.

STAFF APPRAISAL

42. Tunisia is going through a complex transition and is facing a challenging environment. Growth has remained moderate despite rising political, social, and security tensions. Fiscal and external buffers have been eroded to stabilize the economy at a time when external financing has been scarce and the uncertainty surrounding the political transition has weakened economic activity. Meanwhile, subdued external demand from Tunisia's main trading partners is aggravating Tunisia's economic difficulties.

43. The implementation of the structural reform agenda is progressing, albeit with some delays. The authorities' reform efforts have been slowed by the protracted political crisis, particularly for those measures that required building a consensus and legislative approval. Resistance by vested interests and technical difficulties also weighed on reform implementation.

44. Against this backdrop, fiscal consolidation is progressing at a slower pace than initially programmed. The government met the end-year budget target at the cost of a weak budget composition, notably a reduction in pro-growth expenditures that should be gradually reversed to ensure improvements in the structural fiscal balance are sustained. Staff supports the authorities' commitment to reduce the fiscal deficit in the medium term, which will be necessary to ensure that debt remains sustainable. A concomitant pursuit of structural reforms will be essential to promote private sector development and generate inclusive growth that will reduce unemployment.

45. Further fiscal consolidation is needed to reduce existing vulnerabilities. A neutral fiscal stance relative to 2012 will ensure that pro-growth expenditures are incorporated in the 2014

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budget and will remain compatible with existing debt sustainability considerations and financing constraints; however, a stronger fiscal adjustment—through lower regressive energy subsidies and wage bill containment—would have helped to strengthen fiscal buffers while creating space for pro-growth expenditures in an environment of scarce external financing.

46. Strengthening budget composition is fundamental to generate fiscal space and foster inclusive growth. Staff welcomes the recent electricity and gas price increases, and urges the authorities to step up their plans to reduce regressive energy subsidies while strengthening existing cash transfer mechanisms. In this context, it notes the design of a new fuel pricing formula that will help domestic prices converge to international prices, but urges the authorities to continue improving it to ensure its sustainability in case of large price increases. The wage bill should also continue to be contained, and staff encourages the authorities to carefully monitor recruitment and avoid the creation of unnecessary jobs in the public sector. All efforts should be made to ensure that the budget composition does not deteriorate further through under-execution of public investment and social expenditures. The recent adoption of new streamlined and modernized procurement procedures should help in that regard.

47. Moving forward with revenue reform is essential to remove the complex and distortive measures that limit the development of the private sector. Staff welcomes the first phase-in of the convergence of the corporate tax rate, and encourages the authorities to initiate further steps that—together with the simplification of regulatory procedures and incentive schemes—will help reduce the dichotomy between the onshore and offshore sectors. Ongoing efforts on tax administration are encouraging, and would need to be ramped up through a comprehensive modernization program.

48. Reforming public enterprises and strengthening public financial management will improve service delivery and the credibility of fiscal policies. Efficiency gains, reduced fiscal costs, and better governance are key benefits of public enterprise reforms. Staff regrets the delay in conducting the audit of public enterprises, but welcomes the authorities' intention to improve transparency, data coverage, and governance of public enterprises. Timely transfers to public enterprises related to food and energy subsidies are necessary to avoid distortions and costly financing. Introducing a Single Treasury Account at the central bank will be essential to improve cash management practices and reconcile existing discrepancies between monetary and fiscal statistics.

49. Macroeconomic stabilization requires a prudent monetary policy and greater exchange rate flexibility. The recent increase in the policy rate is a step in the right direction, though staff regrets that its effect on the money market rate was reduced by a narrowing of the interest corridor while the recent decrease in the required reserve ratio kept monetary policy somewhat accommodative. Staff welcomes the authorities' readiness to further increase the policy rate if core inflation starts to rise or if depreciation pressures persist. Staff commends the authorities for the steps taken to improve the CBT refinancing collateral framework. Greater exchange rate flexibility is needed to strengthen reserve buffers and correct structural external imbalances over the

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medium term. Staff welcomes the authorities' decision to limit interventions in the foreign exchange market to smoothing excessive exchange rate fluctuations.

50. Addressing vulnerabilities in the banking sector will improve confidence, increase credit supply to the private sector, and foster investment spending and employment creation. Staff welcomes recent measures to improve financial data reporting, strengthen banking supervision, and reform the governance of public banks. It regrets the delay in articulating a new business strategy for public banks, and urges the authorities to provide the financial resources necessary to recapitalize public banks once the strategy is developed. The establishment of an AMC for the management of NPLs to the tourism sector should be completed quickly, to improve banks' liquidity and their ability to issue new credit to the private sector. Development and implementation of a new bank resolution framework will further advance structural change in the sector.

51. The implementation of the structural reform agenda should be accelerated to make a dent in unemployment and inequality. Staff welcomed the submission of a new investment code to Parliament, and urges its adoption together with accompanying decrees aimed at clearer market access rules and limited discretionary powers. Progress on the regulatory simplification process is welcome, but additional streamlining is needed. Staff urges the authorities to speed up structural reforms within the difficult context of the political transition, to ensure that early results are visible and that the foundations for stronger and more inclusive growth are rapidly put in place.

52. The establishment of a well-targeted social safety net is essential to protect the poor and vulnerable. Staff urges the authorities to quickly design and implement the long-delayed "household targeting strategy" to mitigate the impact of future fuel price rises on the poor. In parallel, staff encourages the authorities to continue improving the existing social safety net mechanisms. Proactive communication of the need to reform the current subsidy system and other structural reforms will be needed to build a social consensus for some painful reforms.

53. The authorities' commitment to implement program policies will be tested in the still difficult economic and political environment. The adoption of a new Constitution and the setting of a clear political calendar should strengthen business sentiment and attract investors; however, new security tensions, renewed social unrest, or political setbacks ahead of the elections could have major repercussions on the economy and policy implementation. Further delays in external financing would generate additional financing needs. Commitment to program objectives will be tested by resistance to some necessary but not always popular reforms, which will need to be managed through further consultations and proactive communication with all stakeholders. Staff welcomes the new government's commitment to discuss the possibility of additional fiscal measures or an extension/rephasing of the arrangement in the context of the next review, which will help ensure that program objectives are met at the end of the arrangement.

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54. On the basis of reforms taken in the context of this review, and the government's policy commitments forward, staff supports the authorities' request for completion of the combined first and second review and a disbursement of SDR 329.12 million. Staff supports the authorities' request for waivers of nonobservance of the performance criteria on net domestic assets and net international reserves, and a waiver of applicability on the primary fiscal balance.

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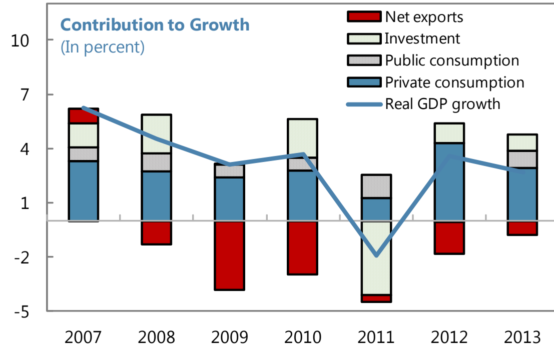
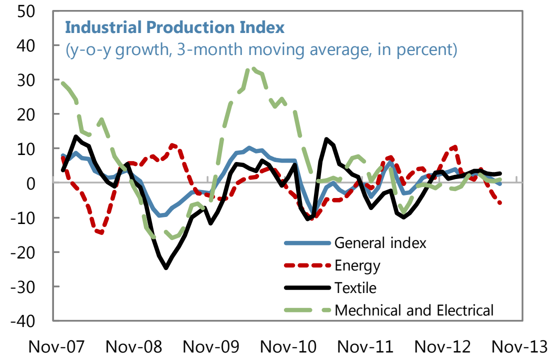
Figure 1. Tunisia: Recent Economic Developments

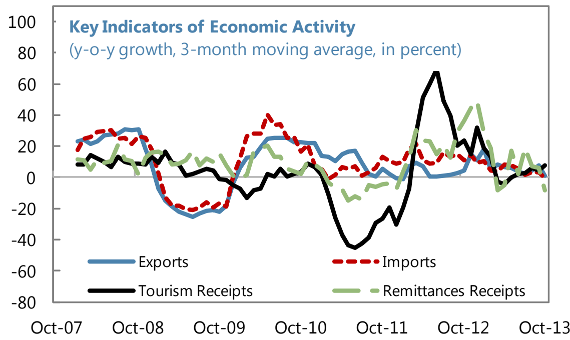
Moderate recovery continued in 2013 despite adverse international and domestic environments.



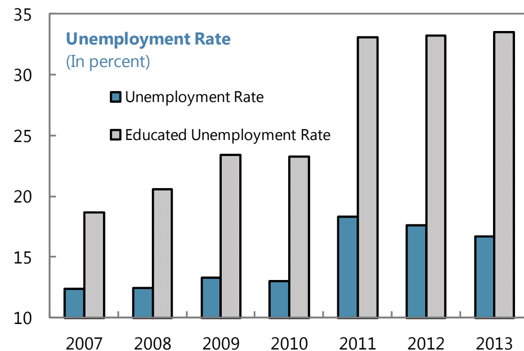
Industrial Production is recovering only slowly.



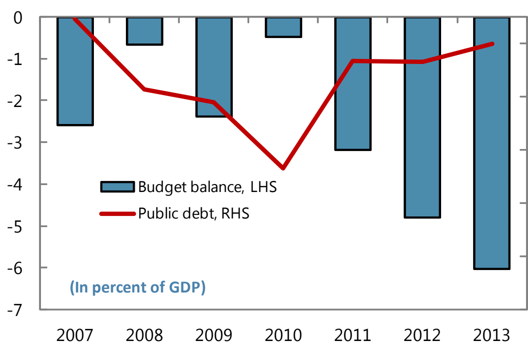
Tourism and remittances receipts are reflecting the high political uncertainties



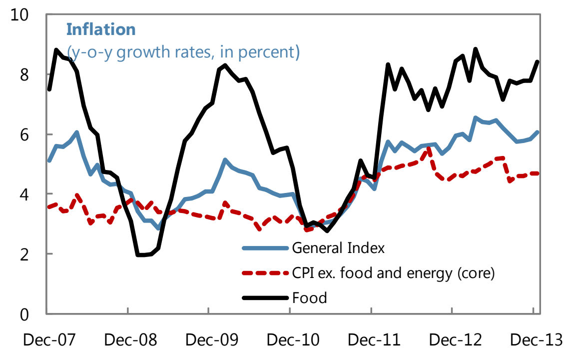
Unemployment has started to subside on the back of public sector hiring but remains high particularly among university graduates.



To counteract the still weak economy and high unemployment, the fiscal stance has been looser leading to somewhat higher debt levels.



Inflation rate has increased together with higher food prices.



Source: Tunisian authorities.

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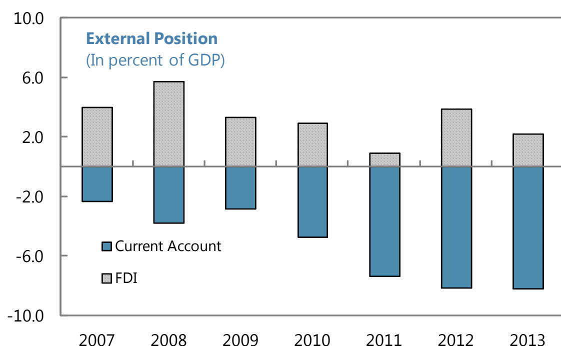
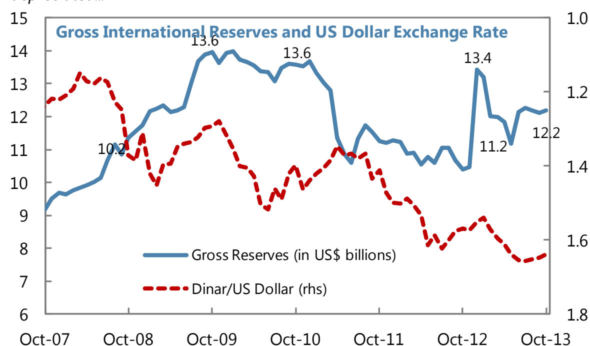
Figure 2. Tunisia: External and Financial Indicators

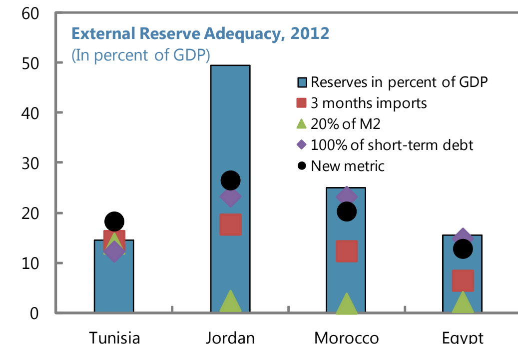
The current account deficit remains high and FDI flows weak.



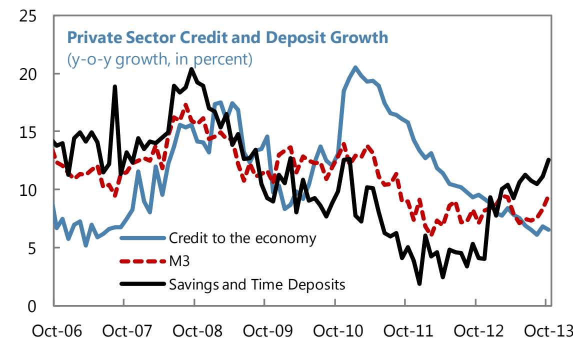
International reserves have been declining while the exchange rate has depreciated...



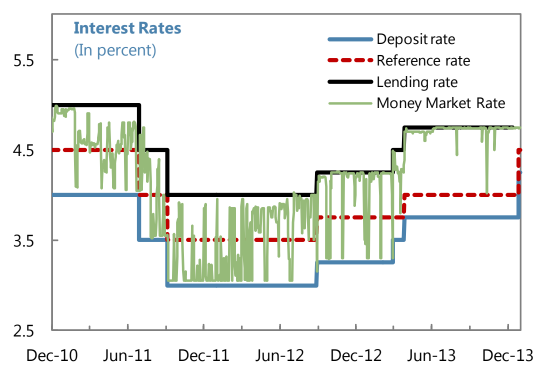
... but at end-2012, ratios of reserve were adequate.



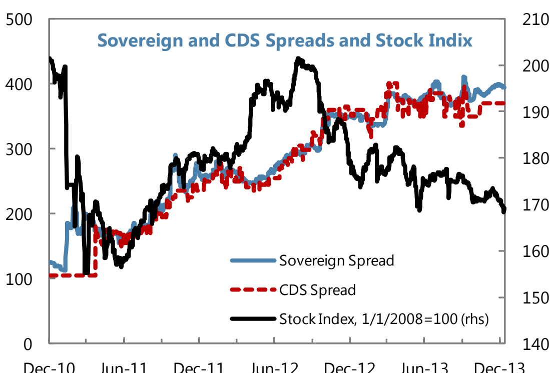
Credit to the economy has been declining but deposits are picking up ...



Key interest rates were increased gradually.



In 2013, the stock index has been falling and sovereign spreads rising moderately.



Sources: Tunisian authorities; and IMF staff estimates.

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

				2013		2014		2015	
	2010	2011	2012	Prog.	Est.	Prog.	Proj.	Prog.	Proj.
Production and income (percent change)									
Real GDP	2.9	-1.9	3.6	4.0	2.7	4.5	3.0	5.0	4.5
GDP deflator	1.6	4.1	5.5	5.6	5.8	4.4	4.9	5.2	4.8
Consumer price index (CPI), average	4.4	3.5	5.6	6.0	6.1	4.7	5.5	4.7	4.8
Consumer price index (CPI), end of period	4.0	4.2	5.9	5.3	6.0	5.0	5.3	4.5	4.5
Gross national savings (in percent of GDP)	21.7	16.9	17.4	17.3	15.1	19.0	17.1	20.2	19.1
Gross investment (in percent of GDP)	26.5	24.3	25.5	24.7	23.3	25.0	23.8	25.3	24.6
Central government (percent of GDP, unless indicated otherwise 1/									
Total revenue (excl. grants)	23.2	24.4	23.0	23.8	23.4	24.0	22.6	24.0	23.2
Total expenditure and net lending	23.8	27.9	28.7	31.1	29.5	30.3	29.7	27.7	27.5
Central government balance (excl. grants)	-0.6	-3.5	-5.7	-7.3	-6.2	-6.4	-7.1	-3.6	-4.4
Central government balance (excl. grants, cash basis)	1.6	-2.8	-5.0	…	-4.5	…	-8.9	…	-4.4
Structural fiscal balance 2/	-1.1	-3.0	-5.2	-5.0	-4.6	-3.8	-5.2	-3.3	-4.0
General government debt (foreign and domestic)	40.3	44.4	44.3	45.3	45.0	49.5	51.7	49.1	53.2
Foreign currency public debt (percent of total debt)	60.7	58.0	62.8	65.7	64.9	68.5	70.9	69.8	70.9
Total external debt									
External debt (US$ billions)	21.4	22.1	24.3	25.0	24.4	27.6	27.4	29.2	29.4
External debt (in percent of GDP)	48.1	47.8	53.8	52.0	51.9	55.5	56.9	55.6	58.6
Debt service ratio (percent of exports of GNFS)	10.5	11.9	12.0	9.5	9.4	9.2	8.6	7.2	5.9
Money and credit (percent change)									
Credit to the economy	19.6	13.4	8.8	10.8	9.2	11.7	6.0	11.1	8.8
Broad money (M3 of the financial system)	12.1	9.1	8.4	12.6	7.6	12.0	10.8	13.5	12.4
Velocity of circulation (GDP/M2)	1.56	1.45	1.47	1.36	1.48	1.32	1.45	1.29	1.41
External sector (percent change)									
Exports of goods, f.o.b. (in $)	14.0	8.5	-5.1	6.5	3.8	5.6	3.0	10.5	6.0
Imports of goods, f.o.b. (in $)	15.9	7.7	1.6	5.1	2.7	3.7	1.7	7.1	4.4
Exports of goods, f.o.b. (volume)	6.5	-0.4	1.4	5.7	2.3	5.2	2.1	9.9	6.0
Import of goods, f.o.b. (volume)	-2.0	-6.2	9.4	5.8	3.7	6.1	3.7	9.0	6.1
Trade balance (in percent of GDP)	-10.3	-10.4	-13.4	-12.6	-12.9	-11.9	-12.3	-10.9	-11.7
Current account (in percent of GDP)	-4.7	-7.4	-8.2	-7.5	-8.2	-6.0	-6.7	-5.1	-5.5
Foreign direct investment (in percent of GDP)	2.9	0.9	3.9	2.1	2.2	2.5	2.2	3.0	2.9
Terms of trade (deterioration -)	-9.6	-5.1	0.8	1.4	2.5	2.5	3.7	1.9	1.1
Official reserves									
Gross official reserves (US$ billions, e.o.p)	9.5	7.5	8.6	9.0	6.8	10.8	9.1	11.9	10.6
In months of next year's imports of goods and services, c.i.f.	4.4	3.4	3.9	3.8	3.0	4.2	3.8	4.5	4.3
Memorandum items:									
GDP at current prices (TD millions)	63,591	64,887	70,950	78,334	77,072	85,465	83,281	94,406	91,215
GDP at current prices (US$ billions)	44.4	46.1	45.2	48.9	47.0	50.6	48.2	53.3	50.2
Population (millions)	10.5	10.7	10.8	10.9	10.9	11.1	11.1	11.2	11.2
GDP per capita (US$ millions)	4,212	4,318	4,194	4,483	4,303	4,576	4,354	4,757	4,481
Unemployment rate (in percent)	13.0	18.3	17.6	...	16.7	...	16.0	…	15.0
Exchange rate: dinar/US$ (average)	1.43	1.41	1.57	…	…	…	…	…	…
Real effective exchange rate (percent change, depreciation -) 3/	-0.49	-1.78	-1.80	...	...	...	...	…	...
Interest rate (money market rate, in percent, e.o.p)	4.1	3.5	3.3	…	…	...	...	…	...
Stock market TUNINDEX (12/31/1997=1000)	5,113	4,722	4,580	…	…	…	…	…	…

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

1/ Excludes the social security accounts.

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

3/ Information Notice System.

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Table 2. Tunisia: Balance of Payments, 2010–15

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

			Prel.	Projections										
	2010	2011	2012	2013					2014					2015
				Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	
Current account	-2,105	-3,401	-3,687	-967	-1,171	-830	-879	-3,847	-940	-964	-750	-558	-3,212	-2,757
Trade balance	-4,575	-4,799	-6,076	-1,233	-1,565	-1,489	-1,760	-6,047	-1,553	-1,678	-1,487	-1,208	-5,926	-5,884
Exports	16,431	17,824	16,914	4,461	4,432	4,103	4,564	17,560	4,438	4,816	4,237	4,592	18,083	19,177
Energy	2,315	2,592	2,836	593	700	698	995	2,986	773	838	738	799	3,148	3,164
Non-energy	14,116	15,231	14,079	3,867	3,732	3,405	3,569	14,574	3,666	3,977	3,499	3,793	14,935	16,013
Imports	-21,006	-22,623	-22,990	-5694	-5997	-5592	-6324	-23,607	-5991	-6494	-5724	-5800	-24,010	-25,061
Energy	-2,653	-3,409	-4,081	-917	-1,043	-988	-1,246	-4,193	-1,035	-1,122	-991	-1,047	-4,196	-4,129
Non-energy	-18,353	-19,214	-18,909	-4,777	-4,954	-4,604	-5,078	-19,414	-4,956	-5,372	-4,733	-4,753	-19,814	-20,932
Of which: Nonfood	-16,810	-17,339	-17,429	-4,143	-4,461	-4,237	-4,668	-17,855	-4,600	-4,986	-4,393	-4,373	-18,373	-19,584
Services and transfers (net)	2,470	1,398	2,388	267	394	659	881	2,200	613	715	737	649	2,714	3,127
Nonfactor	2,460	1,552	1,938	274	531	640	656	2,101	690	611	628	314	2,242	2,530
Of which: Tourism	2,461	1,680	2,022	314	476	695	572	2,057	353	523	713	514	2,103	2,355
Factor Services and Transfers (net)	10	-154	451	-7	-137	18	224	99	-77	104	110	335	472	597
Of which: Workers' remittances	2,063	1,990	2,224	455	540	747	523	2,265	487	476	767	591	2,321	2,371
Interest payments on external debt	-632	-653	-615	-135	-146	-131	-237	-649	-140	-163	-134	-118	-555	-457
Capital and financial account	1,343	1,309	4,839	-65	787	796	416	1,934	743	545	1,861	992	4,142	3,939
Excluding grants	1,252	1,142	4,387	-88	782	759	230	1,683	712	521	1,825	914	3,972	3,777
Capital account	82	154	440	22	3	35	185	245	31	22	35	76	164	155
Financial account	1,260	1,155	4,399	-87	784	761	232	1,689	713	523	1,827	916	3,978	3,783
Direct foreign investment (net)	1,309	417	1,763	237	307	314	162	1,020	220	247	283	312	1,063	1,436
Medium- and long-term loans (net)	145	652	1,616	-311	249	169	494	602	470	185	1,172	-56	1,771	1,258
Disbursement	1,845	2,707	3,664	297	575	407	839	2,118	683	534	1,384	647	3,247	2,292
Amortization	-1,700	-2,055	-2,049	-607	-326	-238	-344	-1,516	-213	-349	-212	-703	-1,476	-1,034
Short-term capital	-193	85	1,221	1	250	299	-308	242	25	104	391	794	1,313	1,255
Errors and omissions 1/	-316	108	-31	-95	52	51	-119	-111	-61	232	16	-125	61	69
Overall balance	-1,078	-1,984	1,120	-1,126	-332	16	-582	-2,024	-258	-187	1,127	309	991	1,250
Reserve liabilities (Fund credits)	0	0	0	0	150	0	0	150	724	219	219	219	1381	220
Changes in gross reserves	1078	1984	-1120	1126	183	-16	582	1874	-466	-32	-1346	-528	-2372	-1471
Memorandum items:														
Current account balance/GDP (percent)	-4.7	-7.4	-8.2	-2.0	-2.5	-1.8	-2.2	-8.2	-1.9	-2.0	-1.6	-1.1	-6.7	-5.5
Reserves (in billions of US$)	9.5	7.5	8.6	7.5	7.3	7.4	6.8	6.8	7.2	7.3	8.6	9.1	9.1	10.6
Reserves in months of imports of goods 2/	4.8	3.7	4.2	3.6	3.5	3.5	3.2	3.2	3.4	3.4	4.1	4.3	4.1	4.6
Reserves in months of imports of goods and services 2/	4.4	3.4	3.9	3.4	3.2	3.2	3.0	3.0	3.1	3.2	3.8	4.0	3.8	4.3
Reserves/total short term external debt (percent) 3/	191.3	147.2	138.9	137.9	127.3	124.7	118.0	118.0	144.5	134.7	158.3	173.8	169.0	185.3
Excluding nonresidents deposits	402.5	308.8	262.4	260.4	240.4	235.5	222.9	222.9	273.0	254.4	298.9	328.2	601.6	659.3
Reserves/short-term debt (on remaining maturity)	142.7	106.9	104.2	95.9	103.8	107.4	94.6	94.0	124.4	107.8	137.6	115.1	134.7	158.8
External debt service (in percent of exports of goods and non factor services), excl. non resident deposits	234.5	172.4	161.1	142.7	168.4	180.5	151.8	150.3	209.1	172.9	232.7	167.3	315.3	414.1
External medium- and long-term debt (billions of US$)	16.4	16.9	18.1	17.3	17.9	18.1	18.2	18.7	20.2	20.7	22.1	22.2	22.0	23.7
External medium- and long-term debt/GDP (percent)	36.9	36.8	40.1	35.8	38.4	38.7	39.9	39.7	41.9	43.6	47.1	49.0	45.7	47.1
External short-term debt (billions of US$)	5.0	5.1	6.2	5.5	5.8	5.9	5.7	5.7	5.0	5.4	5.5	5.3	5.4	5.7
External short-term debt/GDP (percent)	11.2	11.1	13.8	11.3	12.4	12.6	12.6	12.2	10.4	11.4	11.6	11.6	11.2	11.4
Debt service ratio (as percent XGS, including IMF)	10.5	11.9	12.0	13.3	8.2	6.6	9.3	13.3	6.2	8.2	6.0	13.8	8.2	6.6
Goods export real growth (percent)	6.5	-0.4	1.4	-6.1	-6.1	-5.5	-4.4	2.3	1.3	-4.1	-5.0	-4.8	2.1	6.0
Non-energy	9.0	2.3	0.9	-3.8	-5.2	-3.7	0.0	1.8	-16.7	-3.1	-2.6	0.5	1.3	5.9
Goods import real growth (percent)	-2.0	-6.2	9.4	8.3	8.3	9.9	9.9	3.7	9.6	3.3	3.5	3.5	3.7	6.1
Non-energy	-2.2	-6.6	8.2	6.6	-3.1	-0.3	-2.0	3.7	2.1	1.6	-2.9	-0.3	3.8	6.3

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

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

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

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

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Table 3. Tunisia: External Financing Needs, 2010–15

(In millions of U.S. dollar)

	2010	2011	Prel. 2012	Projections 2013 Q1	Q2	Q3	Q4	Year	2014 Q1	Q2	Q3	Q4	Year	2015
Total financing requirements	9,226	10,551	10,261	7,205	6,956	6,578	7,070	10,922	6,423	6,542	6,139	6,539	8,937	8,525
Current account deficit - Capital transfers	2,022	3,247	3,248	944	1,168	795	695	3,602	909	942	715	482	3,048	2,602
Current account deficit	2,105	3,401	3,687	967	1,171	830	879	3,847	940	964	750	558	3,212	2,757
Capital account	82	154	440	22	3	35	185	245	31	22	35	76	164	155
Amortizations	6,887	7,412	6,982	6,166	5,840	5,834	6,256	7,209	5,453	5,832	5,440	5,932	5,950	5,991
General government	1,017	1,419	1,227	527	197	139	149	990	116	191	112	188	969	657
Banks	48	45	58	6	9	7	16	37	7	11	7	11	36	27
Corporate 1/	5,822	5,948	5,697	5,633	5,633	5,688	6,092	6,182	5,330	5,630	5,320	5,733	4,945	5,308
Short-term debt	5,187	5,357	4,933	5,559	5,513	5,596	5,888	5,693	5,240	5,484	5,228	5,585	4,474	4,958
Long-term debt	635	591	763	75	120	92	204	489	90	147	93	148	471	350
Net errors and omissions	316	-108	31	95	-52	-51	119	111	61	-232	-16	125	-61	-69
Total financing sources	9,226	10,551	10,260	7,205	6,806	6,578	7,069	10,773	5,700	6,323	5,920	6,321	7,556	8,304.9
FDI (net)	1,309	417	1,763	237	307	314	162	1,020	220	247	283	312	1,063	1,436
Disbursments (debt)	6,791	8,555	10,022	5,754	6,446	6,298	6,221	8,012	5,920	6,230	6,999	6,260	9,061	8,529
General government	798	1,778	3,165	111	503	243	164	1,539	544	440	1,240	530	2,727	1,706
Banks	74	66	35	13	5	12	12	41	10	7	10	11	37	42
Corporate 1/	5,919	6,711	6,822	5,630	5,938	6,043	6,045	6,432	5,366	5,783	5,749	5,719	6,297	6,781
Short-term debt	4,946	5,848	6,358	5,458	5,871	5,891	5,893	5,894	5,237	5,696	5,615	5,580	5,814	6,237
Long-term debt	973	863	464	172	67	152	153	538	129	87	134	140	483	544
Other portfolio flows net (Incl. Drawdown in commercial banks NFA)	48	-406	-405	88	-129	-19	104	-134	26	-123	-15	276	-196	-189
Drawdown in gross reserves	1,078	1,984	-1,120	1,126	183	-16	582	1,874	-466	-32	-1,346	-528	-2,372	-1,471
Financing gap	0	0	0	0	150	0	0	150	724	219	219	219	1,381	220
Fund credits 2/	0	0	0	0	150	0	0	150	724	219	219	219	1,381	220
Purchases	0	0	0	0	150	0	0	150	724	219	219	219	1,381	220
Repurchase	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Memo items														
Gross international reserves (in millions of U. S. dollars)	9,509	7,525	8,645	7,519	7,336	7,352	6,770	6,770	7,236	7,268	8,628	9,142	9,142	10,613
In percent of short-term debt at remaining maturity	142.7	106.9	104.2	95.9	103.8	107.4	94.6	94.0	124.4	107.8	137.6	115.1	134.7	158.8
Government rollover rates (in percent)	78	125	258	21	255	175	110	155	469	231	1,106	282	281	260
Banks rollover rates (in percent)	153	146	61	231	56	165	75	110	144	59	145	95	103	155
Corporate rollover rates (in percent)	102	113	120	100	105	106	99	104	101	103	108	100	127	128

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

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

(in millions of dinars)

	2012	2013						2014						2015
		Annual Prog.	Q1 Actual	Q2 Actual	Q3 Est.	Q4 Est.	Annual Est.	Annual Prog.	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Annual Proj.	Annual Proj.
Total revenue and grants	16,939.3	19,009.3	4,276.7	4,766.6	4,380.8	4,687.2	18,111.3	20,875.6	4,595.7	4,659.5	4,636.8	5,155.1	19,047.0	21,439.3
Revenue	16,310.2	18,609.3	4,244.0	4,765.4	4,338.6	4,653.2	18,001.2	20,475.6	4,563.6	4,638.1	4,594.0	5,037.4	18,833.0	21,125.3
Tax revenue	14,864.4	17,100.3	3,978.9	3,918.2	4,015.9	4,386.2	16,299.2	18,829.1	4,348.2	4,261.9	4,378.6	4,768.4	17,757.0	19,667.6
Nontax revenue	1,445.8	1,500.0	265.1	802.2	322.7	263.0	1,653.0	1,636.5	214.4	375.2	214.4	268.0	1,072.0	1,447.8
Capital income	0.0	9.0	0.0	45.0	0.0	4.0	49.0	10.0	1.0	1.0	1.0	1.0	4.0	10.0
Grants	629.1	400.0	32.7	1.2	42.2	34.1	110.2	400.0	32.1	21.4	42.8	117.7	214.0	314.0
Total expenditure and net lending	20,343.7	24,347.5	4,978.2	4,148.7	5,360.7	8,271.8	22,759.4	25,931.3	5,369.8	5,271.3	6,145.4	7,981.6	24,768.1	25,097.2
Total expenditure	20,694.4	24,095.5	4,955.9	4,200.8	5,289.5	8,318.2	22,764.4	24,234.8	5,349.8	5,271.3	5,855.4	7,171.6	23,648.1	24,997.2
Current expenditure	16,002.6	19,079.4	4,629.5	3,248.8	4,489.9	6,628.2	18,996.4	18,363.4	4,763.0	4,488.9	4,814.9	5,252.8	19,319.6	19,068.3
Wages and salaries	8,623.9	9,716.6	2,544.6	2,211.6	2,278.8	2,555.0	9,590.0	10,273.3	2,486.6	2,486.6	2,486.6	2,901.0	10,360.9	11,159.4
Goods and services	1,167.1	1,208.5	393.7	83.6	82.8	644.3	1,204.4	1,282.0	443.9	369.9	369.9	295.9	1,479.7	1,277.0
Interest payments	1,272.1	1,420.0	402.6	302.4	328.1	406.9	1,440.0	1,466.6	510.2	310.1	324.3	330.5	1,475.0	1,313.9
Transfers and subsidies	4,939.5	5,679.2	1,288.6	651.2	1,800.2	2,142.0	5,882.0	5,341.5	1,322.3	1,322.3	1,603.7	1,603.7	5,852.0	5,165.9
CGC (Food)	1,242.0	1,350.0	148.7	158.4	668.6	474.3	1,450.0	1,339.0	211.1	211.1	492.5	492.5	1,407.0	1,396.2
Energy subsidies	2,111.0	2,520.0	750.0	0.0	780.0	1,324.0	2,854.0	1,994.1	625.0	625.0	625.0	625.0	2,500.0	1,489.4
Other	1,586.5	1,809.2	389.9	492.8	351.6	343.7	1,578.0	2,008.4	486.3	486.3	486.3	486.3	1,945.0	2,280.4
Other expenditure (non-allocated)	0.0	1,055.1	0.0	0.0	0.0	880.0	880.0	0.0	0.0	0.0	30.4	121.6	152.0	152.0
of which: repayment of arrears 2/	0.0	700.0	…	…	…	…	880.0	…	…	…	…	…	0.0	0.0
Capital expenditure	4,691.8	5,016.1	326.4	952.0	799.6	1,690.0	3,768.0	5,871.4	586.8	782.4	1,040.5	1,918.8	4,328.5	5,929.0
Net lending	-350.7	252.0	22.3	-52.1	71.2	-46.4	-5.0	1,696.5	20.0	0.0	290.0	810.0	1,120.0	100.0
of which: public banks' recapitalization	41.0	500.0	0.0	0.0	0.0	0.0	0.0	1,721.5	0.0	0.0	300.0	700.0	1,000.0	0.0
Compensatory measures to be identified (-)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Central government deficit (-) (excl. grants)	-4,033.5	-5,738.2	-734.2	616.7	-1,022.1	-3,618.6	-4,758.2	-5,455.7	-806.2	-633.2	-1,551.5	-2,944.2	-5,935.1	-3,971.9
Central government deficit (-) (incl. grants)	-3,404.4	-5,338.2	-701.5	617.9	-979.9	-3,584.6	-4,648.1	-5,055.7	-774.1	-611.8	-1,508.7	-2,826.5	-5,721.1	-3,657.9
Float	-504.9	0.0	-473.8	1,325.0	350.3	-2,504.5	-1,303.0	0.0	2,500.0	0.0	0.0	-1,000.0	1,500.0	0.0
Central government deficit (-) (excl.grants, cash basis)	-3,528.5	-5,738.2	-260.4	-708.3	-1,372.4	-1,114.2	-3,455.2	-5,455.7	-3,306.2	-633.2	-1,551.5	-1,944.2	-7,435.1	-3,971.9
Central government deficit (-) (incl. grants, cash basis)	-2,899.5	-5,338.2	-227.7	-707.1	-1,330.2	-1,080.1	-3,345.1	-4,719.2	-3,274.1	-611.8	-1,508.7	-1,826.5	-7,221.1	-3,657.9
Financing	2,899.5	5,338.2	227.7	707.1	1,330.2	1,080.1	3,345.1	4,719.2	3,274.1	611.8	1,508.7	1,826.5	7,221.1	3,657.9
Foreign	2,523.8	2,028.4	-651.0	-133.3	172.2	24.2	-587.8	3,195.4	1,891.7	810.1	2,317.9	982.5	6,002.2	1,906.0
Drawings	4,449.9	3,583.4	174.0	193.2	401.1	268.8	1,037.2	4,907.4	2,096.3	1,124.8	2,527.3	1,303.6	7,052.2	3,100.0
Amortization	1,926.1	1,555.0	825.0	326.5	228.9	244.6	1,625.0	1,712.0	204.6	314.7	209.4	321.2	1,050.0	1,194.0
Domestic	375.6	1,789.8	817.1	838.0	1,151.6	602.1	3,408.7	1,123.8	1,382.5	-258.3	-869.2	564.0	819.0	1,351.9
Drawings	1,582.1	1,381.1	364.9	444.0	465.5	565.7	1,840.0	1,214.3	385.3	385.3	385.3	385.3	1,541.0	2,440.8
Amortization	925.1	1,428.0	426.5	135.6	117.3	700.6	1,380.0	1,754.7	75.8	879.4	597.5	597.5	2,150.0	1,750.0
Government Deposits (+ = drawing / - = accumulation)	-675.4	1,336.7	878.7	529.6	803.4	737.0	2,948.7	-57.3	1,073.0	235.8	-957.0	76.2	428.0	661.1
Banks recapitalization	0.0	500.0	0.0	0.0	0.0	0.0	0.0	1,721.5	0.0	0.0	300.0	700.0	1,000.0	0.0
Privatization proceeds 3/	394.0	1,520.0	61.6	6.3	453.8	453.8	524.2	400.0	0.0	60.0	60.0	280.0	400.0	400.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:														
Central Government Balance (incl. grants)	-3,404.4	-5,338.2	-701.5	617.9	-979.9	-3,584.6	-4,648.1	-5,055.7	-774.1	-611.8	-1,508.7	-2,826.5	-5,721.1	-3,657.9
Central government primary balance (incl. grants, cash basis)	-1,627.4	-3,918.2	-595.5	883.3	-308.9	-2,618.4	-1,905.1	-3,252.6	-326.4	-302.1	-1,184.9	-2,496.8	-5,746.1	-2,344.0
Central government primary balance (excl. grants, cash basis)	-2,256.4	-4,318.2	142.2	-405.9	-1,044.3	-707.3	-2,015.3	-3,989.1	-2,796.1	-323.1	-1,227.2	-1,613.7	-5,960.1	-2,658.0
Cyclically adjusted fiscal balance	-3,740.0	-5,139.6	…	…	…	…	-4,395.5	-4,975.4	…	…	…	…	-5,485.4	-3,680.0
Structural fiscal balance	-3,699.0	-3,939.6	…	…	…	…	-3,515.5	-3,253.9	…	…	…	…	-4,365.4	-3,680.0
General government debt 4/	31,446.4	35,453.0	30,733.8	30,908.8	31,429.2	31,318.5	34,671.7	42,341.6	0.0	0.0	0.0	0.0	43,091.7	48,523.2
Nominal GDP	70,949.5	78,334.3	19,294.0	19,294.0	19,294.0	19,294.0	77,072.2	85,464.9	20,945.9	20,945.9	20,945.9	20,945.9	83,281.1	91,215.0

Sources: Tunisian authorities; and IMF staff estimates.

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

2/ Arrears on energy subsidies payments accumulated in 2012.

3/ It also includes sale of confiscated assets.

4/ Gross debt: excludes debt of public enterprises.

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Table 4b. Tunisia: Central Government Financial Operations, 2012–15 1/
(in percent of GDP)

	2012	2013		2014		2015
		Prog.	Est.	Prog.	Proj.	Annual Proj.
Total revenue and grants	23.9	24.3	23.5	24.4	22.9	23.5
Revenue	23.0	23.8	23.4	24.0	22.6	23.2
Tax revenue	21.0	21.8	21.1	22.0	21.3	21.6
Nontax revenue	2.0	1.9	2.1	1.9	1.3	1.6
Grants	0.9	0.5	0.1	0.5	0.3	0.3
Total expenditure and net lending	28.7	31.1	29.5	30.3	29.7	27.5
Total expenditure	29.2	30.8	29.5	28.4	28.4	27.4
Current expenditure	22.6	24.4	24.6	21.5	23.2	20.9
Wages and salaries	12.2	12.4	12.4	12.0	12.4	12.2
Goods and services	1.6	1.6	1.6	1.5	1.8	1.4
Interest payments	1.8	1.8	1.9	1.7	1.8	1.4
Transfers and subsidies	7.0	7.2	7.6	6.2	7.0	5.7
Other expenditure (non-allocated)	0.0	1.3	1.1	0.0	0.2	0.2
of which: repayment of arrears 2/	0.0	0.9	1.1	…	0.0	0.0
Capital expenditure	6.6	6.4	4.9	6.9	5.2	6.5
Net lending	-0.5	0.3	0.0	2.0	1.3	0.1
of which: public banks' recapitalization	0.1	0.6	0.0	2.0	1.2	0.0
Compensatory measures to be identified (-) 3/	0.0	…	0.0	…	0.0	0.0
Central government deficit (-) (excl. grants)	-5.7	-7.3	-6.2	-6.4	-7.1	-4.4
Central government deficit (-), (incl. grants)	-4.8	-6.8	-6.0	-5.9	-6.9	-4.0
Float	-0.7	0.0	-1.7	0.0	1.8	0.0
Central government deficit (-), (excl. grants, cash basis)	-5.0	-7.3	-4.5	-6.4	-8.9	-4.4
Central government deficit (-), (incl.grants, cash basis)	-4.1	-6.8	-4.3	-5.5	-8.7	-4.0
Financing	4.1	6.8	4.3	5.5	8.7	4.0
Foreign	3.6	2.6	-0.8	3.7	7.2	2.1
Domestic	0.5	2.3	4.4	1.3	1.0	1.5
Privatization proceeds 4/	0.6	1.9	0.7	0.5	0.5	0.4
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:						
Central government primary balance (excl.grants, cash basis)	-3.2	-5.5	-2.6	-4.7	-7.2	-2.9
Structural fiscal balance	-5.2	-5.0	-4.6	-3.8	-5.2	-4.0
General government debt 5/	44.3	45.3	45.0	49.5	51.7	53.2

Sources: Tunisian authorities; and IMF staff estimates.

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

2/ Arrears on energy subsidies payments accumulated in 2012.

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

4/ It also includes sale of confiscated assets.

5/ Gross debt: excludes debt of public enterprises.

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

	2010	2011	2012	*1Q 13*	*2Q 13*	*3Q 13*	Est. 2013	Proj. *1Q 14*	Proj. *2Q 14*	Proj. *3Q 14*	Proj. 2014	Proj. 2015
(In millions of dinars)												
Net foreign assets (NFA)	9,078	5,749	7,054	6,051	4,758	4,512	2,752	2,460	1,827	3,890	5,390	8,117
Foreign assets	16,023	12,893	15,410	14,200	14,318	14,382	13,643	14,765	15,140	17,729	19,283	23,449
Central bank	13,705	11,315	13,455	12,035	12,176	12,155	11,530	12,619	12,887	15,454	16,961	20,959
Foreign liabilities	-6,946	-7,143	-8,357	-8,149	-9,560	-9,870	-10,891	-12,305	-13,312	-13,839	-13,893	-15,332
Central bank	-623	-782	-1,134	-1,066	-1,994	-1,945	-3,088	-4,379	-4,991	-5,438	-5,317	-6,137
Net domestic assets (NDA)	34,190	41,454	44,114	46,321	47,473	49,347	52,299	53,693	56,010	55,972	55,622	60,466
Domestic credit	46,370	53,577	58,022	60,248	61,651	64,025	67,303	68,995	71,603	72,166	72,762	78,599
Credit to the government (net)	3,227	4,659	4,791	6,035	6,735	8,007	9,195	9,240	9,186	10,712	11,157	11,588
Central bank net credit	-3,250	-3,355	-3,461	-2,207	-1,639	-735	2	430	-130	1,003	430	-130
Commercial banks	2,937	3,568	3,686	3,192	3,412	3,599	3,870	4,054	4,560	4,953	4,626	4,902
Other	4,189	5,086	5,265	5,748	5,672	5,854	6,033	5,466	5,466	5,466	6,812	7,526
Credit to the economy	43,144	48,918	53,231	54,213	54,917	56,018	58,108	59,755	62,418	61,454	61,605	67,011
Other items (net)	-12,181	-12,123	-13,908	-13,927	-14,178	-14,679	-15,004	-15,302	-15,594	-16,194	-17,141	-18,133
Money plus quasi-money (M2)	40,854	44,652	48,327	49,560	49,343	51,010	51,995	53,035	54,626	56,538	57,624	64,775
Money (M1)	15,862	19,007	20,007	20,406	20,216	21,436	21,525	21,956	22,615	23,406	23,856	26,816
Currency	5,518	6,814	6,559	6,350	6,652	7,065	7,057	7,198	7,414	7,673	7,820	8,791
Demand deposits	10,344	12,192	13,448	14,057	13,564	14,372	14,469	14,758	15,201	15,733	16,035	18,025
Quasi-money	24,992	25,646	28,320	29,154	29,127	29,573	30,469	31,079	32,011	33,131	33,768	37,958
Long-term deposits (M3-M2)	2,414	2,551	2,841	2,812	2,888	2,849	3,057	3,118	3,211	3,324	3,388	3,808
Broad money (M3)	43,267	47,203	51,168	52,372	52,231	53,858	55,052	56,153	57,837	59,861	61,012	68,583
(Annual rate of change in percent)												
Net foreign assets	-5.7	-36.7	22.7	20.2	-10.6	-10.4	-61.0	-59.3	-61.6	-13.8	95.8	50.6
Net domestic assets	18.1	21.2	6.4	8.1	9.7	10.4	18.6	15.9	18.0	13.4	6.4	8.7
Domestic credit	16.8	15.5	8.3	8.4	10.3	11.2	16.0	14.5	16.1	12.7	8.1	8.0
Credit to government (net)	-11.4	44.4	2.8	9.1	28.5	44.0	91.9	53.1	36.4	33.8	21.3	3.9
Credit to the economy	19.6	13.4	8.8	8.4	6.9	6.8	9.2	10.2	13.7	9.7	6.0	8.8
Money and quasi-money (M2)	11.9	9.3	8.2	9.7	7.6	8.7	7.6	7.0	10.7	10.8	10.8	12.4
Broad money (M3)	12.1	9.1	8.4	9.4	7.5	8.3	7.6	7.2	10.7	11.1	10.8	12.4
(Annual growth rates, in percent of broad money)												
Net foreign assets	-1.4	-7.7	2.8	2.1	-1.2	-1.1	-8.4	-6.9	-5.6	-1.2	4.8	4.5
Net domestic assets	13.6	16.8	5.6	7.2	8.7	9.4	16.0	14.1	16.3	12.3	6.0	7.9
Domestic credit	17.3	16.7	9.4	9.8	11.9	13.0	18.1	16.7	19.1	15.1	9.9	9.6
Credit to the government (net)	-1.1	3.3	0.3	1.0	3.1	4.9	8.6	6.1	4.7	5.0	3.6	0.7
Credit to the economy	18.4	13.3	9.1	8.7	7.3	7.2	9.5	10.6	14.4	10.1	6.4	8.9
Other items (net)	-3.7	0.1	-3.8	-2.6	-3.2	-3.6	-2.1	-2.6	-2.7	-2.8	-3.9	-1.6
Memorandum items:												
GDP (in millions of dinars)	63,591	64,887	70,950	…	…	…	77,072	…	…	…	83,281	91,215
Nominal GDP growth (in percent)	8.0	2.0	9.3	…	…	…	8.6	…	…	…	8.1	9.5
Reserve money (in millions of dinars)	8,415	9,406	10,989	9,212	9,915	10,278	11,953	12,192	12,558	12,997	13,247	14,891
Velocity (GDP/M3)	1.56	1.45	1.47	…	…	…	1.48	…	…	…	1.45	1.41
Multiplier (M2/M0)	4.86	4.75	4.40	…	…	…	4.35	…	…	…	4.35	4.35

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

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Table 6. Tunisia: Central Bank Balance Sheet, 2010-15
(In millions of dinars)

	2010	2011	2012	*1Q 13*	*2Q 13*	*3Q 13*	2013	*1Q 14*	*2Q 14*	*3Q 14*	2014	2015
Net Foreign Assets	13,082	10,533	12,321	10,969	10,182	10,211	8,443	8,240	7,895	10,016	11,644	14,822
Assets	13,705	11,315	13,455	12,035	12,176	12,155	11,530	12,619	12,887	15,454	16,961	20,959
Liabilities	623	782	1,134	1,066	1,994	1,945	3,088	4,379	4,991	5,438	5,317	6,137
Net Domestic Assets	-4,707	-1,189	-1,332	-1,757	-267	67	3,510	3,952	4,662	2,981	1,603	69
Domestic credit (net)	-2,673	222	248	-92	1,572	1,809	4,405	4,851	5,608	3,936	3,066	1,748
Net credit to government 1/	-3,250	-3,355	-3,461	-2,207	-1,639	-735	2	1,075	1,311	354	430	-130
Credit to Banks	578	3,577	3,709	2,115	3,212	2,545	4,403	3,777	4,298	3,582	2,636	1,878
Other items net	-2,035	-1,412	-1,579	-1,665	-1,839	-1,742	-895	-899	-946	-955	-1,463	-1,680
Reserve Money 2/	8,415	9,406	10,989	9,212	9,915	10,278	11,953	12,192	12,558	12,997	13,247	14,891

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

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Table 7. Tunisia: Financial Soundness Indicators of the Banking Sector, 2008–13

(In percent, unless otherwise indicated)

	2008	2009	2010	2011	2012	Prel. Jun-13
Regulatory capital to risk-weighted assets	11.7	12.2	11.6	11.9	11.8	11.6
Tier 1 capital to risk weighted assets	10.6	10.7	10.2	10.0	9.4	9.4
Capital to assets	8.1	8.5	8.4	8.5	7.8	7.9
Asset quality						
Sectoral distribution of loans to total loans						
Industry	31.3	30.0	30.5	28.6	27.9	27.8
Agriculture	3.6	3.4	2.9	2.9	2.8	2.7
Commerce	17.3	17.4	15.0	16.0	15.4	15.4
Construction	4.5	4.9	5.9	5.6	5.4	5.8
Tourism	9.1	8.2	7.3	7.3	6.9	6.7
Households	20.1	21.6	22.1	23.4	25.4	25.9
Other	14.3	14.4	16.3	16.3	16.2	15.6
FX-loans to total loans	3.9	4.5	5.3	5.1	4.8	4.7
Credit to the private sector to total loans	71.6	70.4	70.6	67.4	67.7	65.7
Nonperforming Loans (NPLs) to total loans 1/	15.5	13.2	13.0	13.3	14.9	15.2
Specific provisions to NPLs 1/	56.8	58.3	58.5	57.3	54.4	54.9
NPLs, net of provisions, to Tier 1 capital	71.1	57.9	60.3	66.3	86.3	88.0
Specific provisions to total loans	8.8	7.7	7.6	7.6	8.0	8.3
General provisions to total loans	-	-	0.4	0.5	-	-
Profitability						
Return on assets (ROA)	1.0	1.0	0.9	0.6	0.6	0.8
Return on equity (ROE)	11.2	11.7	10.2	6.6	8.0	10.1
Interest rate average spread (between loans and deposits)	3.60	3.49	3.53	3.0	3.0	2.9
Interest return on credit	7.01	6.35	6.24	5.7	5.4	5.6
Cost of risk as a percent of credit	1.4	1.2	1.7	1.2	1.1	1.1
Net interest margin to net banking product (PNB)	58.6	58.8	58.6	57.2	58.1	57.4
Operating expenses to PNB	45.4	47.2	46.5	50.7	50.3	47.7
Operating expenses to total assets	1.6	1.6	1.6	1.7	1.7	1.7
Personnel expenses to non-interest expenses	60.4	61.4	59.1	62.3	61.3	61.0
Trading and other non-interest income to PNB	21.7	22.1	21.8	22.6	20.9	22.9
Liquidity						
Liquid assets to total assets	31.6	32.1	29.8	26.5	28.2	27.3
Liquid assets to short-term liabilities	124.0	119.1	104.1	89.4	89.2	86.0
Deposits to loans	98.9	100.9	94.6	87.4	89.7	88.2
Deposits of state-owned enterprises to total deposits	13.8	14.8	13.8	12.6	13.2	12.3
Sensitivity to market risk						
FX net open position to Tier 1 Capital	1.40	1.53	1.35	1.94	2.3	2.7

Source: Central Bank of Tunisia.

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

Review	Availability Date	Action	Purchase		Total
			Millions of SDRs	Percent of quota 1/	Millions of US$ 2/
	June 7, 2013	Board approval of the SBA	98.800	34.485	149.592
First Review	September 15, 2013	Observance of end-June 2013 performance criteria, completion of the first review	98.600	34.415	150.581
Second Review	December 15, 2013	Observance of end-September 2013 performance criteria, completion of the second review	230.520	80.461	352.048
Third Review	March 15, 2013	Observance of end-December 2013 performance criteria, completion of the third review	145.080	50.639	221.565
Fourth Review	June 15, 2014	Observance of end-March 2014 performance criteria, completion of the fourth review	143.250	50.000	218.770
Fifth Review	September 15, 2014	Observance of end-June 2014 performance criteria, completion of the fifth review	143.250	50.000	218.770
Sixth Review	December 15, 2014	Observance of end-September 2014 performance criteria, completion of the sixth review	143.250	50.000	218.770
Seventh Review	March 15, 2015	Observance of end-December 2014 performance criteria, completion of the seventh review	71.625	25.000	110.154
Eighth Review	May 15, 2015	Observance of end-March 2015 performance criteria, completion of the eighth review	71.625	25.000	110.154
Total			1146.000	400.000	1,750.404

Source: IMF staff projections.

1/ Quota is SDR 286.5 million.

2/ Indicative amount based on the average annual exchange rate

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Table 9. Tunisia: Illustrative Medium-Term Growth Scenario, 2010–18

			Prel.	Est.		Proj.			
	2010	2011	2012	2013	2014	2015	2016	2017	2018
				(Change in percent)					
Real GDP growth	2.9	-1.9	3.6	2.7	3.0	4.5	4.5	4.5	4.5
Agriculture	-3.3	13.5	3.0	3.1	3.2	3.2	3.2	3.2	3.2
Nonagriculture	7.1	1.8	-1.4	2.7	3.0	4.6	4.6	4.6	4.6
Total consumption	4.5	3.2	4.7	3.4	2.7	2.9	1.7	1.6	4.3
Private consumption (residual)	4.5	2.1	5.6	3.0	2.3	3.5	1.6	1.4	5.0
Public consumption	4.4	7.6	1.7	5.1	4.3	0.6	1.9	2.2	1.6
Investment	8.5	-15.5	4.9	0.9	3.5	5.5	5.0	5.0	5.0
Gross fixed capital formation	3.1	-15.5	5.0	1.0	3.5	5.5	5.0	5.0	5.0
Change in stocks	127.9	-15.9	3.3	0.1	3.5	5.5	5.0	5.0	5.0
Exports of goods and nfs 1/	4.9	-4.4	7.3	3.1	3.9	8.4	9.3	8.6	4.5
Imports of goods and nfs 1/	10.0	-3.2	9.2	3.5	3.5	5.9	5.0	4.5	4.4
Inflation (annual average)	4.4	3.5	5.6	6.1	5.5	4.8	4.2	4.0	4.0
				(In percent of GDP)					
Gross national savings	21.7	16.9	17.4	15.1	17.1	19.1	20.8	23.0	23.7
Consolidated government 2/	6.1	4.1	1.9	-1.0	-1.5	2.6	3.7	4.9	5.7
Rest of the economy	15.6	12.8	15.4	16.1	18.6	16.5	17.1	18.2	17.9
Gross investment	26.5	24.3	25.5	23.3	23.8	24.6	25.5	26.6	26.8
Consolidated government	6.6	7.1	6.6	4.9	5.2	6.5	7.2	7.5	7.6
Rest of the Economy	19.9	17.1	18.9	18.3	18.5	18.1	18.3	19.0	19.1
Total consumption	79.5	84.6	85.0	86.0	84.7	82.9	80.4	78.1	77.2
Private consumption	63.7	67.4	67.9	68.2	66.6	65.5	63.4	61.4	61.0
Public consumption	16.4	17.9	17.8	18.4	18.7	18.0	17.7	17.3	16.8
Savings-investment gap	-4.7	-7.4	-8.2	-8.2	-6.7	-5.5	-4.7	-3.6	-3.1
Consolidated government	-0.4	-3.1	-4.7	-5.9	-6.8	-3.9	-3.5	-2.7	-1.9
Rest of the economy	-4.3	-4.3	-3.5	-2.3	0.1	-1.6	-1.2	-0.9	-1.2
Memorandum items									
Nominal GDP at current prices (TD millions)	63,591	64,887	70,950	77,072	83,281	91,215	98,813	107,509	116,509
General debt in percent of GDP	40.3	44.4	44.3	45.0	51.7	53.2	54.1	53.7	52.3
External debt in percent of GDP	48.1	47.8	53.8	51.9	56.9	58.6	58.9	57.9	55.7
Central government balance in percent of GDP /3	-0.6	-3.5	-5.7	-6.2	-7.1	-4.4	-3.9	-3.0	-2.3
Current account balance in percent of GDP	-4.7	-7.4	-8.2	-8.2	-6.7	-5.5	-4.7	-3.6	-3.1

Sources: Tunisian authorities; and IMF staff estimates.

1/ Goods and nonfactor services.

2/ Includes social security, excludes privatization receipts.

3/ Excluding grants and privatization

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Table 10. Tunisia: Indicators of Fund Credit, 2012–18
(In millions of SDR)

	2012	2013	2014	2015	2016	2017	2018
Existing and prospective Fund credit							
Disbursement	0	99	904	143	0	0	0
Stock	0	99	1,003	1,146	1,121	840	319
Obligations	0	3	10	17	41	300	537
Repurchase	0	0	0	0	25	281	521
Charges	0.02	2.72	10.30	16.77	16.77	18.56	16.05
Stock of existing and prospective Fund credit							
In percent of quota	0.0	34.5	350.0	400.0	391.4	293.3	111.3
In percent of GDP	0.0	0.3	3.2	3.5	3.3	2.4	0.9
In percent of exports of goods and services	0.0	0.7	6.5	7.0	6.4	4.6	1.7
In percent of gross reserves	0.0	2.2	16.7	16.6	14.6	9.8	3.4
Obligations to the Fund from existing and prospective Fund arrangements							
In percent of quota	0.0	0.9	3.6	5.9	14.5	104.5	187.6
In percent of GDP	0.0	0.0	0.0	0.1	0.1	0.9	1.5
In percent of exports of goods and services	0.0	0.0	0.1	0.1	0.2	1.6	2.8
In percent of gross reserves	0.0	0.1	0.2	0.2	0.5	3.5	5.7

Source: IMF staff estimates.

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Annex. Public and External Debt Sustainability Analysis

Public debt

An expansionary fiscal policy in the aftermath of the revolution, combined with a decline in economic activity, increased public debt. After having declined from an average of 60 percent of GDP in the 1990s to 40.3 percent of GDP in 2010, the debt-to-GDP ratio increased in 2011 to 44.4 percent. By the end of 2012, favorable growth dynamics kept the debt-to-GDP ratio constant at 44 percent and reached 45 percent of GDP in 2013 due to lackluster economic growth. Notwithstanding this, the debt level continues to be comfortable and lower than in similar countries in the region, despite high deficit levels since the revolution.

Under the baseline scenario, public debt is expected to increase to 54 percent before declining over the medium term. Increased banking recapitalization costs, a wider deficit, and weaker-than-originally expected growth dynamics will contribute to increasing the debt-to-GDP ratio to 54 percent of GDP by 2016. The decline of the debt-to-GDP ratio had been somewhat delayed, and it is expected to decline after 2017, reaching about 52 percent by end-2018, 12 percentage of GDP higher than its 2010 level. This debt dynamic reflects the fiscal consolidation envisaged by the authorities (an overall deficit declining to 2.5 percent of GDP in 2018) and real growth rates that start to pick up in 2015, but that remain below the pre-revolution growth potential.

Public debt dynamics remain vulnerable to adverse shocks and could deteriorate significantly compared to the baseline, remaining close to or above 65 percent of GDP. Under an adverse scenario in which the medium-term fiscal consolidation is not implemented, public debt would be on an increasing path and would stabilize at 60 percent of GDP by 2018. The public debt dynamic would initially worsen under all bound tests and then stabilize between 55 and 65 percent in 2018. As a result of a one-off 10 percent of GDP shock to contingent liabilities it would reach about 63.5 percent of GDP in 2016 and slightly decline to about 61 percent of GDP by 2018.[1] Under a permanent negative shock to real growth, public debt would remain on an increasing path, reaching about 65 percent of GDP by end-2018. Finally, as more than 73 percent of public debt is denominated in foreign currency, a one-time 30 percent depreciation would increase the public debt-to-GDP ratio to about 66.8 percent and then decline to 64 percent by 2018. On the other hand, the public debt dynamics would be relatively resilient to an interest rate shock, staying at around 55 percent over the medium term.

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

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External debt

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

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

Under the baseline projections, external debt is projected to increase to 58.9 percent of GDP in 2016 before declining following favorable current account dynamics. As a result, Tunisia's external debt sustainability risks appear contained in the period ahead. The analysis assumes that Tunisia's government will implement a significant fiscal consolidation in the medium term and continue to pursue cautious external borrowing policies. Having remained steady in 2013 following a significant shortfall in external financing, the external debt-to-GDP ratio is expected to rise in 2014 to 56.9 percent, and will reach a maximum of 58.9 percent by 2016 before slightly declining to around 55.7 percent by end-2018.

The external debt ratio is resilient to most types of adverse external shocks except large exchange rate depreciation. The relatively low level of Tunisia's debt as well as its profile (low average interest rate and relatively long maturity) makes it robust to most shocks, with the exception of large real exchange rate depreciation. The external debt ratio remains below 63 percent of GDP throughout the projection period under all but one alternative scenario and all bound tests. For example, a permanent negative shock to growth or to the current account would raise the debt ratio to 60–62 percent of GDP, while an increase in the average interest rate would almost have no impact.[3] However a sharp real depreciation (one-time 30 percent) of the exchange rate relative to the baseline would raise the debt ratio to more than 80 percent of GDP.

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

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

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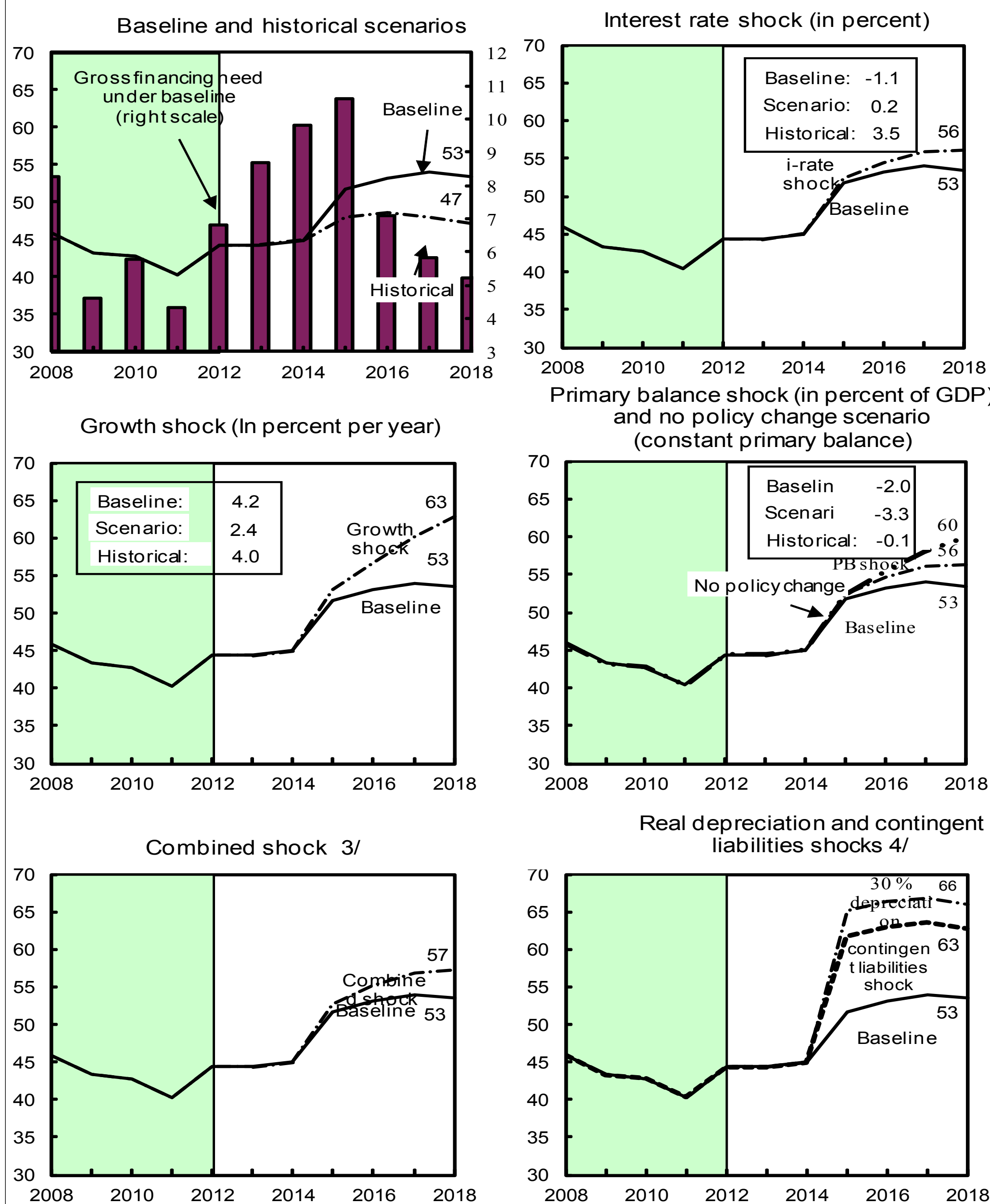
Figure 1. Tunisia: Public Debt Sustainability: Bound Tests 1/ 2/
(Public debt in percent of GDP)



Sources: IMF, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks and a 1/2 of standard deviation growth shock. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2013, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

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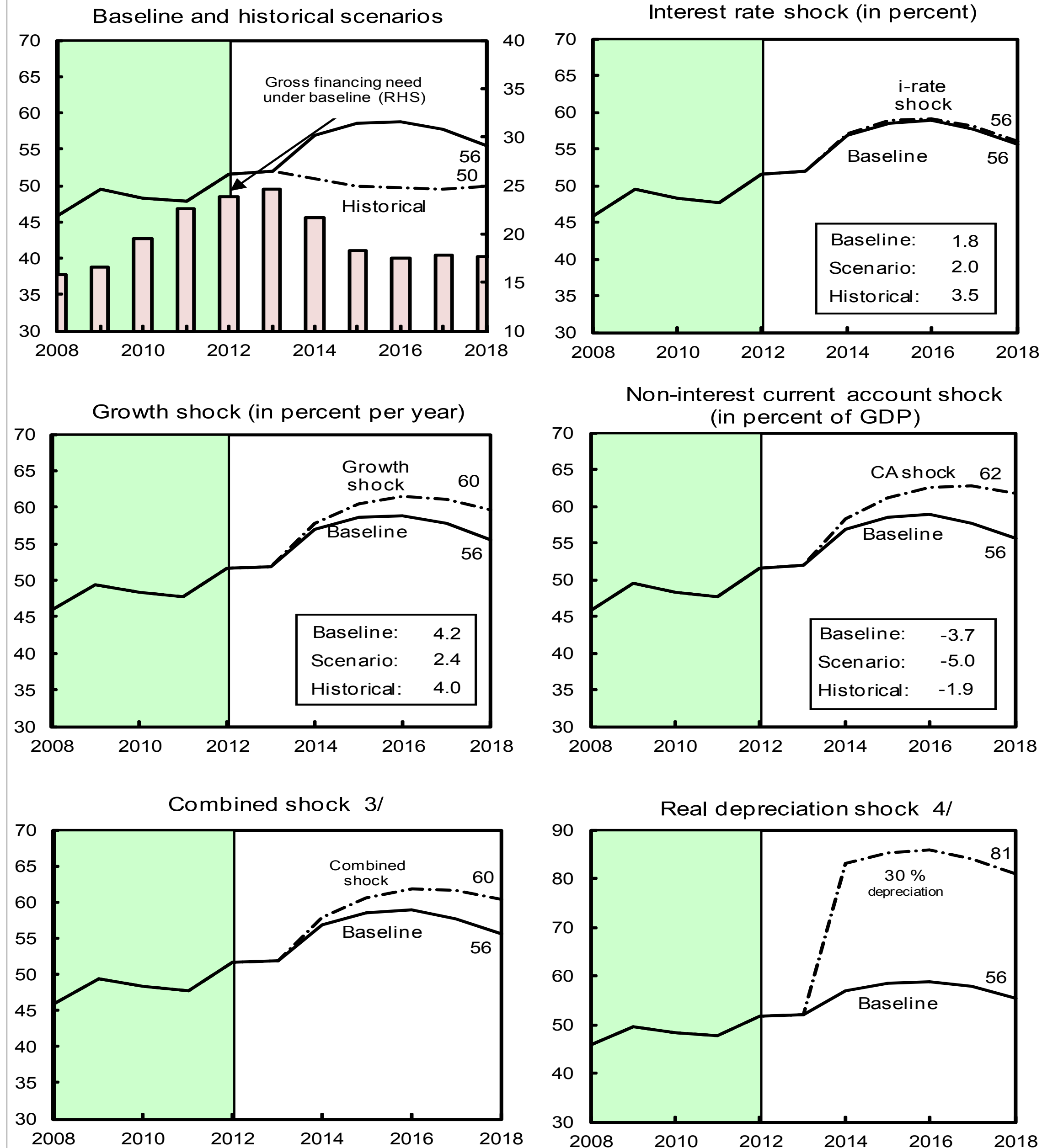
Figure 2. Tunisia: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks (except for growth which is a 3/4th standard deviation). Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2014.

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Table 1. Tunisia: Public Sector Debt Sustainability Framework, 2008-2018

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2008	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	Debt-stabilizing primary balance 9/
1 **Public sector debt 1/**	43.3	42.8	40.3	44.4	44.3			**45.0**	**51.7**	**53.2**	**54.0**	**53.5**	**52.2**	**-1.7**
o/w foreign-currency denominated	26.3	25.0	24.5	25.7	27.8			29.2	36.7	38.7	39.4	38.4	37.0	
2 Change in public sector debt	-2.7	-0.5	-2.5	4.0	0.0			0.7	6.8	1.5	0.8	-0.5	-1.3	
3 Identified debt-creating flows (4+7+12)	-1.0	2.4	0.9	2.8	3.2			2.9	5.7	0.7	0.8	0.0	-1.3	
4 Primary deficit	-1.4	-0.8	-0.9	1.7	3.4			4.1	3.7	2.3	2.2	1.5	0.4	
5 Revenue and grants	29.9	29.6	29.9	31.4	30.5			30.1	29.7	30.3	30.5	31.0	31.4	
6 Primary (noninterest) expenditure	28.5	28.8	29.0	33.0	33.9			34.2	33.3	32.7	32.7	32.5	31.8	
7 Automatic debt dynamics 2/	0.6	2.1	2.3	2.1	0.8			-0.5	-0.1	-1.3	-1.3	-1.4	-1.6	
8 Contribution from interest rate/growth differential 3/	-1.3	2.0	0.0	1.0	-2.0			-1.7	-1.6	-3.1	-2.7	-3.1	-2.6	
9 Of which contribution from real interest rate	0.6	3.3	1.2	0.3	-0.5			-0.6	-0.3	-0.9	-0.5	-0.9	-0.3	
10 Of which contribution from real GDP growth	-1.9	-1.3	-1.2	0.8	-1.5			-1.1	-1.2	-2.1	-2.2	-2.2	-2.2	
11 Contribution from exchange rate depreciation 4/	1.9	0.2	2.3	1.1	2.8			1.2	1.5	1.7	1.4	1.7	1.0	
12 Other identified debt-creating flows	-0.2	1.1	-0.4	-1.0	-1.0			-0.7	2.1	-0.3	-0.1	-0.1	-0.1	
13 Privatization receipts (negative)	-0.2	1.1	-0.4	-1.0	-1.0			-0.7	0.9	-0.3	-0.1	-0.1	-0.1	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	1.2	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3)	-1.6	-2.9	-3.4	1.3	-3.2			-2.3	1.1	0.8	0.1	-0.5	0.0	
Public sector debt-to-revenue ratio 1/	144.6	144.6	134.6	141.3	145.3			149.3	174.4	175.3	177.2	172.6	165.9	
Gross financing need 5/	4.6	5.8	4.3	6.8	8.7			9.8	10.6	7.1	5.8	5.2	4.0	
in billions of U.S. dollars	2.1	2.5	1.9	3.1	3.9			4.6	5.1	3.6	3.0	2.8	2.3	
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	4.5	3.1	2.9	-1.9	3.6	4.0	2.4	2.7	3.0	4.5	4.5	4.5	4.5	4.2
Average nominal interest rate on public debt (in percent) 6/	5.0	4.9	4.6	4.6	4.4	4.7	0.4	4.6	4.3	3.0	2.8	2.5	3.2	3.1
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.6	7.6	3.0	0.6	-1.1	3.5	2.7	-1.2	-0.7	-1.8	-0.9	-1.6	-0.5	-1.1
Nominal appreciation (increase in US dollar value of local currency, in percent)	-6.8	-0.6	-8.4	-4.1	-10.3	-2.0	7.6	-4.3	-5.1	-4.8	-3.7	-4.5	-2.6	-4.1
Inflation rate (GDP deflator, in percent)	3.4	-2.6	1.6	4.1	5.5	1.3	2.5	5.8	4.9	4.8	3.7	4.1	3.7	4.2
Growth of real primary spending (deflated by GDP deflator, in percent)	12.8	10.4	7.2	11.7	6.4	9.1	2.3	3.6	0.4	2.4	4.7	3.7	2.4	2.7
Primary deficit	-1.4	-0.8	-0.9	1.7	3.4	0.1	1.4	4.1	3.7	2.3	2.2	1.5	0.4	2.0
A. Alternative Scenarios														Debt-stabilizing primary balance 9/
A1. Key variables are at their historical averages in 2013-2018 7/								**45.0**	**48.1**	**48.5**	**48.1**	**47.3**	**46.4**	**-0.4**
A2. No policy change (constant primary balance) in 2013-2018								**45.0**	**52.2**	**55.4**	**58.0**	**59.9**	**62.1**	**-1.9**
B. Bound Tests														
B1. Real interest rate is at baseline plus one standard deviations								**45.0**	**52.3**	**54.4**	**55.9**	**56.0**	**55.4**	**-1.1**
B2. Real GDP growth is at baseline minus one-half standard deviation								**45.0**	**53.2**	**56.7**	**60.2**	**62.8**	**65.1**	**-1.0**
B3. Primary balance is at baseline minus one-half standard deviation								**45.0**	**52.5**	**54.6**	**56.1**	**56.2**	**55.6**	**-1.8**
B4. Combination of B1-B3 using one-quarter standard deviation shocks								**45.0**	**52.7**	**55.1**	**56.9**	**57.3**	**56.9**	**-1.1**
B5. One time 30 percent real depreciation in 2014 8/								**45.0**	**65.2**	**66.3**	**66.8**	**65.9**	**64.2**	**-2.0**
B6. 10 percent of GDP increase in other debt-creating flows in 2014								**45.0**	**61.7**	**62.9**	**63.5**	**62.7**	**61.1**	**-1.9**

Sources: IMF Country desk data; and staff estimates.
1/ General government gross debt including public pension fund.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

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Table 2.Tunisia: External Debt Sustainability Framework, 2008-2018

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2008	2009	2010	2011	2012			2013	2014	2015	2016	2017	2018	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	45.9	49.4	48.3	47.8	51.6			**51.9**	**56.9**	**58.6**	**58.8**	**57.7**	**55.5**	**-8.7**
2 Change in external debt	-5.9	3.6	-1.2	-0.5	3.9			0.3	5.0	1.6	0.3	-1.1	-2.2	
3 Identified external debt-creating flows (4+8+9)	-9.1	0.6	0.5	2.9	4.6			3.8	1.7	-1.8	-3.7	-5.8	-6.4	
4 Current account deficit, excluding interest payments	2.2	1.3	3.3	5.9	6.7			6.8	5.5	4.6	3.9	2.9	1.8	
5 Deficit in balance of goods and services	3.0	2.7	4.8	7.0	9.1			8.4	7.7	6.7	5.1	3.9	3.2	
6 Exports	56.1	45.8	50.2	49.0	48.5			49.0	49.2	50.2	51.4	52.6	51.7	
7 Imports	59.2	48.5	55.0	56.0	57.5			57.4	56.9	56.9	56.6	56.5	54.9	
8 Net non-debt creating capital inflows (negative)	-6.1	-3.7	-3.4	-2.4	-4.1			-3.1	-3.4	-4.8	-5.9	-6.8	-7.0	
9 Automatic debt dynamics 1/	-5.2	3.0	0.6	-0.7	2.0			0.1	-0.4	-1.5	-1.7	-1.9	-1.1	
10 Contribution from nominal interest rate	1.7	1.6	1.4	1.4	1.3			1.4	1.2	0.9	0.8	0.7	1.3	
11 Contribution from real GDP growth	-2.0	-1.5	-1.5	0.9	-1.7			-1.3	-1.5	-2.5	-2.5	-2.5	-2.5	
12 Contribution from price and exchange rate changes 2/	-4.8	2.9	0.7	-3.0	2.4			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	3.2	3.0	-1.7	-3.4	-0.7			-3.5	3.2	3.4	3.9	4.7	4.2	
External debt-to-exports ratio (in percent)	81.7	108.0	96.1	97.4	106.5			106.1	115.6	116.7	114.4	109.6	107.4	
Gross external financing need (in billions of US dollars) 4/	7.1	7.2	8.6	10.4	10.9			11.6	10.4	9.2	9.2	9.7	10.1	
in percent of GDP	15.9	16.6	19.5	22.5	23.8	10-Year	10-Year	24.7	21.6	18.3	17.6	17.9	17.6	
Scenario with key variables at their historical averages 5/								**51.9**	**50.8**	**50.0**	**49.6**	**49.6**	**49.9**	**-5.8**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	4.5	3.1	3.1	-1.9	3.6	4.0	2.4	2.5	3.0	4.5	4.5	4.5	4.5	
GDP deflator in US dollars (change in percent)	10.3	-5.9	-1.3	6.6	-4.8	3.1	6.4	0.5	-0.5	-0.2	-0.1	-0.5	1.0	
Nominal external interest rate (in percent)	3.7	3.3	2.9	3.1	2.8	3.5	0.4	2.8	2.3	1.7	1.4	1.2	2.4	
Growth of exports (US dollar terms, in percent)	25.6	-21.0	11.6	2.0	-2.6	9.8	14.2	4.1	3.1	6.2	7.0	6.4	3.7	
Growth of imports (US dollar terms, in percent)	27.5	-20.6	15.5	6.5	1.2	10.7	13.8	2.7	1.7	4.2	3.8	3.9	2.6	
Current account balance, excluding interest payments	-2.2	-1.3	-3.3	-5.9	-6.7	-1.9	2.6	-6.8	-5.5	-4.6	-3.9	-2.9	-1.8	
Net non-debt creating capital inflows	6.1	3.7	3.4	2.4	4.1	4.0	2.4	3.1	3.4	4.8	5.9	6.8	7.0	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,

ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

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

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

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

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

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Appendix. Letter of Intent

Tunis, January 28, 2014

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

Dear Madame Lagarde:

1. The political transition process towards new elections is moving forward again. After having experienced during the past few months one of the most difficult periods in our democratic transition process, Tunisia has once again re-established a clear political roadmap. Thanks to the efforts of all political parties and from civil society that were part of the "National Dialogue," a consensual solution was found in which a new apolitical government is emerging, members of the electoral commission (ISIE) have been nominated, and a new constitution is to be adopted before the end of January. We remain convinced that these developments will pave the way for free and democratic elections that will return Tunisia back on the path to strong and sustained economic growth.

2. The different steps of the political transition process—combined with exogenous shocks—had a negative impact on the implementation of the government's economic program. Moreover, a difficult international economic environment—together with less financial support from our development partners than originally envisaged—increased the pressures on the external and fiscal position. These developments—coupled with unprecedented security tensions—dampened, despite our best efforts, Tunisia's short-term economic outlook through weaker economic activity and a slower pace of reforms.

3. Despite these unfavorable circumstances, our economy was able to withstand these shocks, allowing us to meet most of our program targets through September 2013. Our quantitative performance criteria (PC) for end-December Net Domestic Assets (NDA) and Net International Reserves (NIR) appear to have been missed because of lower external financing and higher banking liquidity needs, while the PC for the primary balances was met::

- *Performance criteria and quantitative indicators*. We met the quantitative criteria on net international reserves (NIR) and net domestic assets (NDA) for end-June and end-September, and met the continuous zero ceiling on accumulating external arrears. Our end-December NIR and NDA criteria appear to have been missed because of lower external market financing and high liquidity needs in the banking sector. The performance criterion

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on the primary balance of the central government (cash basis) at end-December appears to have been met, because of : (i) measures stopping all current expenditure commitments effective December 15, 2013, except with regard to wages and debt interest; (ii) shortening the complementary period for 2013 to January 20; and (iii) delays in mobilizing external resources leading to liquidity constraints that deferred some payments scheduled for end 2013 to early 2014. The quantitative indicative target for social expenditures appears to have been missed for all test dates owing to implementation constraints, although social spending and the amount of transfers to needy households was close to levels in the revised budget law. The continuous indicative target on no accumulation of domestic arrears was met.

- *Structural reforms*. Despite some delays in their implementation, nine of the fourteen structural benchmarks established for implementation by end-December 2013 were attained (Table 2a). The new targeted household support program to accompany the reduction of energy subsidies and protect society's most vulnerable segments, slated for end-August, will only be ready by March 2014 given the need to identify the proper mechanism to reach the targeted group. Administrative procedures have delayed the audit of public enterprises, for which we have broadened coverage to one more public enterprise, and intend to complete by end-March 2014.. All monetary policy and financial sector benchmarks were met, with the exception of the benchmarks on: (i) the liquidity ratio which will be ready by end-January 2014; (ii) the interconnecting banking platform and market maker agreement; which was delayed by technical difficulties; and (iii) the preparation of the strategic orientation for public banks, which could not be observed because of delays in the audit firm selection process. The structural benchmarks on reducing the corporate tax dichotomy, merging the functions of the Large Taxpayer Unit, and the automatic fuel pricing formula were all met, albeit with a slight delay. As to the investment code, the project was approved in November 2013 by the Council of Ministers and submitted to the National Constituent Assembly for ratification. The relevant implementing decrees will be drawn up and published as soon as the code is ratified.

- In view of the appropriate policies taken to attain the main program objectives set for the first nine months of 2013, and of the strong progress in implementing our ambitious structural reform agenda through December (Tables 1 and 2a), the government requests conclusion of the first and second reviews of the program supported by the stand-by arrangement as well as the disbursement of SDR 329.12 million. In light of the corrective actions taken, the government also requests waivers for nonobservance of the end-December quantitative performance criteria on the NIR and NDA and a waiver of applicability on the performance criterion on the primary fiscal balance, which appears to have been met, but for which final data is not yet available. The government also proposes new performance criteria for end-March 2014 and end-June 2014, new indicative targets for 2014 end-September and end-December as well as a new indicative target for primary current expenditure, as described in the MEFP (Table 1) and the attached Technical Memorandum of Understanding. Over the next few months, and to provide more flexibility

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to meet the program objectives, the government also intends to discuss with staff in the next review the possibility of additional fiscal measures or for rephasing/extending the arrangement.

4. This Letter of Intent is based on the preceding Letter of Intent (LOI) and the Memorandum of Economic and Financial Policies (MEFP) dated May 24, 2013. The attached MEFP outlines the main components of the government's program and the policies of the Central Bank of Tunisia, which we plan to implement in 2014. It also describes the structural reforms and indicators for the second year of the program. We are determined to implement our program diligently, notwithstanding the difficulties we face in the domestic, regional, and international context.

5. We are confident that the policies described in the attached MEFP are appropriate for achieving the objectives of our economic program, which aim at addressing short-term stabilization goals while laying foundations to support growth and protect the vulnerable. We will remain vigilant and stand ready to take any additional measure that may be necessary to attain those objectives. We will consult with IMF staff on the adoption of these measures, and in advance of any revision of the macroeconomic policies contained in this MEFP, in accordance with the IMF's policies on such consultations. All information and data necessary for program monitoring will be provided to IMF staff.

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

Sincerely yours,

/s/	/s/
Chedly Ayari Governor of the Central Bank of Tunisia	Hakim Ben Hammouda Minister of Finance

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Attachment I. Memorandum of Economic and Financial Policies

Tunisia is coping with an external environment marked by the economic crisis in our principal partner countries and a particularly difficult transition to democracy, striving to achieve progress through dialogue and consensus. This has resulted in an economic slowdown that has narrowed our scope for fiscal and external flexibility. To meet those challenges and keep our fiscal and international reserve positions at sustainable levels, we have initiated a process aimed at containing current expenditures, further tightened monetary policy, maintained a more flexible exchange rate along with measures to ensure stricter enforcement of existing regulations, and implemented reforms aimed at strengthening the banking sector and its regulatory framework. We remain committed to promoting a competitive private sector capable of sustaining inclusive growth, while taking the measures necessary to preserve social cohesion and protect vulnerable population groups.

Macroeconomic Context and Outlook

1. **Several exogenous shocks and difficulties in the transition to democracy have created severe challenges for the Tunisian economy.** The lengthy consultation process to complete the political transition—and the unprecedented upsurge of insecurity— have shaken confidence in the Tunisian economy. This has led to a slowdown in economic growth, a delay in the implementation of planned reforms, and persistence of the wait-and-see attitude of local and foreign investors. In addition, new exogenous shocks have occurred, such as the reduced volume of Algerian natural gas headed to Italy and transiting through Tunisia, which has increased the national economy's dependence on foreign sources of energy and led to a hike in budget subsidies through additional energy imports in the first quarter of 2013. Moreover, the financing necessary to support the Tunisian budget, as well as funds to be mobilized through external financial markets, did not materialize as programmed.

2. **Despite the difficult international economic environment and national context, Tunisia's macroeconomic performance remains generally positive.** Economic growth for 2013 remains below the initial forecasts of 4 percent but will still be close to 2.7 percent year-on-year—driven by private and public services and despite a decline in agribusiness and stagnation in manufacturing. After reaching 6.5 percent year-on-year in March 2013, overall CPI inflation fell to 6 percent at end-2013, primarily as a result of the slowdown in the increase in food prices and weak credit to the private sector (6.8 percent year-on-year at end-December 2013). Despite lower-than-expected volumes of imported capital goods and raw materials, weak tourism receipts and workers' remittances, combined with depressed external demand for Tunisian goods and lower dividend transfers for telecom company Tunisiana (about DT500 million), are expected to keep the current account deficit in 2013 at 8.2 percent of GDP, which is the same level as in 2012 but higher than the initial projection under the program (7.5 percent of GDP). This deterioration of the external position was financed by foreign direct investments, a deposit from the Qatar National Bank, and a new commercial line of credit granted to the Central Bank of Tunisia, which helped ease the impact of

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lower-than-forecast budget support and helped the overall balance of payments to remain consistent with the projections under the program.

3. **The economic program and reforms will be based on the following macroeconomic framework:**

- **Growth.** For 2014, the Tunisian government still expects 4 percent growth for the year as a possibility, but to be prudent—and considering the uncertainties associated with the political transition, the postponement of elections, and a still-difficult international situation—the macroeconomic program was based on a growth rate of 3.0 percent year-on-year (compared to 4.5 percent under the initial program approved in June 2013). The prospects for growth should improve after the elections, particularly during the second half of 2014, which will considerably reduce the uncertainty and wait-and-see attitude on the part of economic operators, thus allowing growth to exceed the potential in 2015 and reduce the negative output gap.

- **Inflation.** Inflationary pressures should continue to diminish in 2014, reaching 5.3 percent at the end of the year. A prudent monetary policy will reinforce the Central Bank's credibility and further anchor inflationary expectations.

- **External position:** In 2014 and over the medium term, the current account deficit should narrow to 5.5 percent of GDP by 2015, following the anticipated economic recovery in Tunisia's trading partners and lower international commodity prices.

Objectives and Performance under the Program

4. **The key objectives of our economic program and reform agenda remain unchanged: to preserve macroeconomic stability over the short term while laying the foundations for higher and more inclusive growth that protects the most vulnerable population groups.** Our program continues to revolve around the following three pillars:

- **Preserving macroeconomic stability.** We will continue to implement appropriate macroeconomic policies to reduce the vulnerabilities of our economy, particularly by containing current expenditures in 2014, and implementing a prudent monetary policy and more flexible exchange rate.

- **Laying the foundations for inclusive growth.** Our priorities are to reduce the banking sectors' significant vulnerabilities, improve the composition of the budget through fiscal and budgetary structural reforms, and adopt an ambitious program of structural reforms to improve the business climate and attract larger volumes of foreign direct investment.

- **Protecting vulnerable groups in the population** by strengthening social safety nets and proceeding with a systematic evaluation of the social impact of reforms.

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A. Performance under the Program

5. The economic policies that have been implemented helped to offset the exogenous shocks that—according to our estimates—were the main contributors to not meeting the performance criteria at end-December. This will be confirmed during the third review when the data will become available (Tables 1 and 2a) :

- **The performance criterion for Net Domestic Assets (NDA) at end-December appears to have been missed,** although we met the criteria for June and September after application of adjustors related to residents' foreign currency deposits and the lower level of the government's external loans compared to the projections (particularly payments on a US$200 million loan granted by Turkey, which was postponed to Q1 2014). The NDA target for end-December appears to have been missed, primarily because of an increase in net credit to the government.

- **The performance criteria on net international reserves (NIR) at end-June and September were met but will fall far short of the targets at end-December 2013.** For the year as a whole, lower official budgetary loans and the delayed issuance of sukuks—as well as significant interventions on the foreign exchange market in response to needs for current account transactions—could not be offset by the 300 million euro commercial line of credit and a $500 million deposit from the Qatar National Bank granted to the Central Bank of Tunisia. These amounts also increased the CBT's external liabilities, resulting in a decline in Net International Reserves (NIR) to $5.5 billion at end-December 2013, compared to an adjusted target of $7.1 billion. Gross international reserves at end-December 2013 will cover the three months of imports which we consider as our minimum threshold.

- **The performance criterion for the central government's primary balance (on a cash basis) was missed for end-June and end-September, but appears to have been met for end-December.** The fiscal stance deteriorated through end-September due to higher energy subsidies (0.6 percent) as well as additional expenditures corresponding to the budget for 2012, but paid for during the complementary period (extended to April 2013). However, this was reversed by end-year, with the end-December primary fiscal deficit estimated at 2.6 percent of GDP (on a cash basis, excluding grants and privatization revenues) relative to 4.9 percent under the program (after adjustments for banking recapitalization), most because of deferred cash payments from 2013 to 2014 (about 3.2 percent of GDP). Savings in wages and social spending (about 0.6 percent of GDP) at the end of the year and an under-execution of capital spending (about 1.5 percent of GDP lower than programmed)—associated with constraints on absorption capacity at the regional level and procurement procedures rather than a deliberate decision to reduce development expenditures—also help explain this performance, which was obtained in an environment of scarce external financing. On the tax front, our efforts to collect tax arrears and dividends from public enterprises helped offset lower weaker indirect taxation.

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- **The indicative target for social expenditures has been missed for all test dates,** due to capacity constraints, although social spending and the amount of transfers to needy households was close to levels in the revised budget law.

6. **We have combined our macroeconomic policies with the implementation of an ambitious structural reform agenda in the following areas:**

- **Monetary and foreign exchange policy.** Considerable progress has been made thanks to the adoption of new measures with respect to collateral requirements in refinancing operations for the banks. Technical problems have delayed the implementation of the electronic platform which will allow interlinking with banks, and the adoption of the Market Makers Agreement. This measure, necessary for the introduction of a system of weekly foreign currency auctions will be completed by mid-March 2014 (new structural benchmark).

- **The financial sector**. We have set up the architecture of the new reporting system, completed the inspection reports of five banks as provided under the program, and prepared an impact study on the new liquidity ratio that we will present to the Bank's Board of Directors in January 2014. As for the strategic approach the government plans to take to reduce the weaknesses of the public banks, the solution is contingent upon completing the audit work on the three major public banks—related work has been delayed due to constraints in the procurement procedures for selecting the auditing firms. So far, the interim audits on two public banks have been completed and we anticipate the new business strategy to be defined by March 2014 (new structural benchmark).

- **Government finances.** Halving the difference in the corporate income tax (CIT) rate between the onshore and offshore sectors, and other related compensatory measures, were included in the government's budget for 2014. We have also merged the tax units within the Directorate of Large Companies, and designed a new automatic fuel price formula. As for the audits of public enterprises, we have initiated the audit of an additional enterprise and we plan to complete this work by March 2014. The new household support program to protect the most vulnerable groups in the population from a reduction in energy subsidies will be finalized by March 2014 due to needed delays for determining the right targeting mechanism.

- **Development of the private sector**. The new investment code, recently adopted by the government as agreed under the program, has been submitted to the National Constituent Assembly for approval and will later be supplemented by implementation decrees aiming at defining market access and restrictions on investments.

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B. Short-term Objectives: Reestablishing Fiscal and External Buffers

Fiscal policy

7. **We made a firm commitment to reduce the pressures on the government's budget that arose in 2013 and considerably reduced the available cash flow buffers.** Thus, we kept the wage bill for 2013 at the budgeted level, and made savings on non-allocated expenditures in 2013 (0.1 percent of GDP). We also limited the complementary period by stopping commitments earlier than usual, through a circular sent to ministries by December 15, 2013. Excluded from this measure are commitments related to salaries, and capital expenditures that could stop later in the year. For more transparency, the supplementary budget law, which has just been adopted by Parliament, also accounted for the repayment of outstanding arrears (1.2 percent of GDP), which is done before the end of the year 2013.

8. **A rebalancing toward more fiscal consolidation was initiated under the 2014 budget law while protecting priority and development expenditures.** We are firmly committed to rebalancing our fiscal policy by maintaining the structural budget balance—excluding the effects associated with the economic cycle and one-off operations, such as bank recapitalization requirements or arrears repayment—at the same level as 2012, or 5.2 percent of GDP. The government's 2014 budget also incorporates significant measures in the area of social equity—such as increasing the tax exemption threshold for the poorest groups in the population and the tax exemption with respect to gains on land sales associated with the social housing program. We also plan to increase capital expenditures by about 15 percent compared to 2013.

9. **The measures recommended to reduce the fiscal deficit are included within a framework of medium-term reforms aiming at reducing vulnerabilities through:**

- **Revenue mobilization.** While awaiting the comprehensive tax reform, we included new measures in the budget law intended to: (ii) reduce some tax exemptions on customs duties and the VAT (gain of 0.05percent of GDP); (iii) introduce new taxes on the sale of properties and secondary residences (0.16 percent of GDP); (iv) increase the minimum tax from 0.1 percent to 0.2 percent on domestic turnover (0.04 percent of GDP); (v) remove the ceiling on royalties of 1 percent on salaries (0.02 percent of GDP); and (vi) regulate cash transactions. We have also decided to strengthen control of the forfeit system, including for the liberal professions, using the data available in the social insurance system and banking system (as permitted by current law). Moreover, we took measures to fight tax evasion including through streamlining cash commercial operations.

- **Reform of energy subsidies.** Our subsidy reform strategy rests on several pillars involving short- and medium-term measures.

  - For 2014, and in conjunction with the implementation of the strategy for reducing the country's energy deficit, the 2014 budget law has included savings valued at 650 million dinars on energy subsidies. To this end, we have reduced as of

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January 1st electricity subsidies intended to cement companies, and intend to completely eliminate them for these companies as of June 2014. We also plan to proceed with a gradual adjustment of energy tariffs/prices that consist of keeping the social rate for the most disadvantaged segments of the population and creating new consumer tranches at prices that act as a deterrent, so as to gradually lighten the weight of subsidies and encourage energy savings. The implementation of this reform—which is supposed to generate DT 550 millions—has already led to a 10 percent increase in tariff rates and gas prices of some clients by 10 percent as of January 2014 (for clients in high, medium, and low voltage), except for those who consume less than 100kwh whose rates will be preserved. In addition, fuel prices will be increased by around 6 percent on July 1, 2014, which will allow us to obtain our remaining savings in energy savings for the year (i.e., DT 100 millions).

- We have also adopted a new formula for automatic determination of fuel prices, which will adjust gasoline prices by 0.1 dinar/liter once international prices have a cumulative increase of DT 10 per barrel (i.e., 0.67 dinar/liter) in a quarter. This formula will ensure that the budgetary envelope will not be affected in the event of a large increase in international prices. Meanwhile, we will continue assessing a sustainable formula that can introduce a smoothing system that will allow fuel prices to be aligned with international prices.

- Fuel price adjustment will be accompanied by the implementation of social programs already included in the government's budget and the implementation of an Energy Transition Fund for all energy-saving actions and for the development of renewable energy.

- **Control of the wage bill.** The salary freeze announced for 2014 will allow the country to contain the increase in the wage bill at 12.4 percent of GDP. However, this will still represent an 8 percent increase due to new hiring scheduled since 2011 and the full year effect of new hiring in 2012–13. In the short term, by the end of March 2014, we will conduct an audit of the payroll management system—an exercise that we expect to carry out every year. We also plan to proceed with an evaluation of the civil service hiring system, seeking better alignment between qualification requirements and the structure of government salaries. To this effect, a draft project will be submitted to the Council of Ministers in June 2014. Subsequently, the control of hiring in the context of civil service reform will be crucial for reducing the weight of salaries in the government's budget.

10. **Additional measures not included in the government's budget are needed to maintain the structural deficit constant relative to 2012.** In that context, we are committed to significantly reducing non-allocated expenditures included in the government's budget, of about 0.5 percent of GDP (with one-third coming from current expenditures). We also remain committed to taking additional measures to correct for any deviation from the budget target, including through limiting current expenditures—goods and services, subsidies and transfers—that have in the past been a

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source of budget overruns. To this end, a benchmark ceiling on primary current expenditures will be part of the indicative targets included under the program (Table 1). Priority social and investment expenditures will be preserved, and will not be cut as part of the fiscal consolidation strategy.

Monetary and foreign exchange policy

11. **The structural liquidity deficit has increased pushing the CBT to increase its intervention in the monetary markets to respond to bank liquidity requirements.** Thus, CBT refinancing went from 3 billion dinars in March 2013 to nearly 4.6 billion dinars in December 2013 (one billion dinars of which was an outright purchase of government bonds on the secondary market—OMOs). We still maintain a prudent monetary policy, since this refinancing—while higher than in earlier months—is still lower than the demand coming from banks, which depends on the level of foreign exchange operations, Treasury bill purchases, and financing of the overdrafts of some public enterprises. However, very little of this demand is linked to increased credit to the private sector, which remains anemic due to healthy companies' very limited interest in increasing their productive investments, and owing to the regulatory ceiling on lending rates granted by the banks, which does not encourage the financing of high-risk investments such as SMEs.

12. **Although the objective of monetary policy continues to be controlling inflation while ensuring a healthy credit growth to the private sector, the pressures generated by external imbalances argue for the introduction of a more prudent monetary policy.** As a result, we have decided to take the following measures:

- **Increase the policy rate by 50 basis points.** Such an adjustment—combined with the introduction of a 25 basis points symmetrical corridor around the policy rate—will help to normalize the current situation by bringing the policy rate closer to the money market rate (nearly 4.75 percent, or the credit facility rate) and thus reduce, although only partially, the negative interest rate (with the inflation rate at 6 percent), facilitating a better allocation of productive resources. Moreover, we stand ready to raise this rate further to contain any additional inflationary pressure caused by an accommodating fiscal policy and/or a rapid depreciation of the exchange rate.

- **Modify the excessive borrowing rate by removing the ceiling for loans to businesses and increasing it for loans to private consumers.** In March 2013 we eliminated the ceiling on deposit rates for term deposits that had been introduced in December 2011. We expect to do the same with regard to lending rates by amending the legislation on the excessive interest rate, which will be eliminated for companies and initially increased for individuals. This will allow the banks to mobilize more deposits without harming their profitability margins and to apply a higher interest rate to high-risk clients, thus improving monetary policy transmission channels. To this end, an impact study—to be conducted with World Bank TA—will be finalized by March 2014 (structural benchmark).

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13. **The CBT's monetary policy continues to hold to its gradual strategy of reducing liquidity injections, which will allow the banks to better manage their liquidity and minimize the risks to the CBT's balance sheet.** To this end, we have tried to reduce the structural liquidity deficit by reducing the reserve requirement rate by 100 basis points and abandoning the current rule that penalizes banks that do not meet the liquidity ratio by imposing an automatic and proportional increase in their required reserves. At the same time, we have limited the banks' dependence on CBT refinancing, by increasing the share of refinancing guaranteed by government securities (10 percent at end-August 2013; 20 percent at end-December 2013) and introducing a 10 percent haircut on loans accepted as collateral as of January 1, 2014. In order to further reduce these injections and better manage risks, we plan to:

- Increase to 40 percent by December 2014 (new structural benchmark), the share of government securities used as collateral in the CBT's refinancing operations. A study on the possibility of valuing government securities at market prices and not at their nominal value will be conducted by September 2014.

- Revise the haircut system on loans according to a differentiation based on past nonperforming loans, which would correspond to a haircut rate of about 25 percent. Exhaustive preparatory work was done and the new haircut rate will be introduced as of June 2014 (structural benchmark).

- Implement a "lender of last resort" facility for solvent but illiquid banks. This facility (end-June structural benchmark) should include significant penalties, and a bank that requires emergency liquidity must submit a plan to reestablish its liquidity position, with restrictions imposed on new loans and dividend payments suspended for a certain period of time. IMF technical assistance in Q1 2014 is requested to help develop this project.

14. **In recent months, the depreciation of the dinar has reduced the overvaluation of the exchange rate to a moderate level.** We intervened in May to calm pressures on the exchange market in a context marked by a high volume of current account transactions and delays in the disbursement of external financing. Despite these interventions, the exchange rate depreciated by about 9.5 percent against the euro and 5.8 percent against the dollar during the course of the year, which helped to bring back to 5 percent the estimated overvaluation of the exchange rate, according to IMF evaluations. However, the current context, marked by limited external flows (whether from private capital or foreign assistance), negative interest rates, and a fiscal policy that has at times been more accommodating than expected, will increase pressures on the foreign exchange market. To address these pressures, in addition to more restrictive budgetary and monetary policies, we plan to:

- Continue to further limit the CBT's interventions in the foreign exchange market to smoothing excessive exchange rate fluctuations, while ensuring the smooth processing of foreign payments.

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- *Introduce swap operations between the CBT and commercial banks* in the monetary market, as of January 1st, 2014. This will allow banks with excess FX to obtain Tunisian dinars, and vice versa. This measure will also help strengthen the monetary policy framework and allow for a better management of banking liquidity. All prudential norms on FX positions will be respected by all participant banks.

- Promulgate as of October 2013 a circular that seeks to implement current regulations on those holding accounts in foreign currency, imposing ex post controls on the use of funds from accounts in foreign currency and requiring banks to make any operation to purchase foreign currency for someone holding a foreign currency account contingent on that person's not having additional liquid foreign currency in that account.

- Accelerate the introduction of external mechanisms needed to introduce weekly foreign exchange auctions, starting in 2014. In this context, the Market Makers Agreement and the electronic platform will take effect as of March 2014 (structural benchmark at end-October 2013). After that, we plan to introduce a weekly foreign currency auction mechanism before the end of 2014. This would allow us to control the volume of foreign currency sales while allowing the exchange rate to adjust freely. However, a prerequisite to the introduction of an auction mechanism is the introduction of an efficient information system that will allow the CBT to centralize the flow of projected foreign currency payments. To this end, we request IMF assistance to improve the quality of projections on foreign currency flows.

15. **Our development strategy will remain open and based on free trade.** Consistent with World Trade Organization rules, we will only introduce new restrictions or surcharges on imports as a last resort, after having exhausted market solutions that preserve appropriate incentives, and only with very clear and pre-announced phase-out criteria.

C. Laying the Foundations for Inclusive Growth

Financial sector policies

16. **To address the vulnerabilities in the banking sector, we have launched a comprehensive set of reforms.** Here our specific focus was on aligning banking practices with international standards and strengthening bank supervision. The reforms allowed for: (i) the introduction of collective provisioning to improve risk coverage and financial buffers (although the provisioning rate remains low at about 47 percent after suspended interests); (ii) the tightening of standards on the division and risk concentration ratios, which took effect as of end-2013; (iii) a gradual increase in the capital adequacy ratio from 8 percent to 9 percent at end-2013 and 10 percent at end-2013, with a Tier 1 ratio set at 6 percent at end-2013 and 7 percent at end-2014; (iv) the introduction of a circular intended to improve the governance of credit institutions; and (v) further raising risk coverage to levels seen in similar countries by introducing a new haircut for non performing loans that are older than 3 years— that go from 40 percent higher provisioning for NPLs of 3 to 5 years, 70 percent for those assets that are 6 to 7 years old; and 100 percent for assets of 8 years or more In order to improve transparency regarding the banking sector's situation, we have

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prepared and published an annual report on bank supervision—an exercise we plan to carry out every year.

17. **We plan to continue with the reform of the financial sector in order to further reduce its vulnerabilities**. Reforms will aim to ensure that the banking system plays its proper financial intermediation role, including proper credit allocation and strict monitoring of credit, liquidity, and solvency risks. To that end, our strategy will center on the following actions:

- **Tackling the fragilities of public banks.** The interim audit reports on the public banks were completed before the end of 2013 for two of the banks, and will be completed in March 2014 for the third public bank. Given the procedural delay in initiating the public banks' audits, we will only be able to make a decision on the government's strategic role in this area in March 2014 (structural benchmark report of September 2013). In the meantime, however, and to prevent the public banks' situation from deteriorating further, we have introduced the following actions:

  - Adoption of a uniform criterion for loan analysis and prudent evaluation of collateral for the audits of public banks;

  - *Publication in December 2013* of a decree strengthening the governance of public banks by excluding them from the scope of the law governing public enterprises, so that they are subject to the same rules as private banks. Among other things, this will allow the management of public banks to include senior banking staff and boards of directors with skills coming from the private sector.

  - *Inclusion in bank restructuring costs* of a second tranche of 0.6 percent of GDP, in the 2014 budget law, in addition to the 0.6 percent of GDP included in the 2013 supplementary budget law; but that will only be paid in 2014 once the banks' audits are completed. These amounts are still lower than what is needed for the possible recapitalization of the public banks, which, according to FSSA estimates, could be about 2.6 percent of GDP. As a result, the costs of bank recapitalization may be reduced or increased under a supplementary budget law, based on the strategic orientation chosen and the results of the audits that will propose a series of potential solutions: recapitalization, merger, or reduction of the government's share, including through public-private partnerships. Bank recapitalization needs for 2014 will be financed through the issuance of non-marketable Treasury bills—with medium-term maturities—with the exception of additional requirements to finance the Asset Management and Recovery Company (AMC). The use of these Treasury bills will increase the capital of the banks involved but not their refinancing capacity. These bills could be replaced by marketable securities once a restructuring plan for the banks is introduced.

- Create an asset management company responsible for removing from the banking system nonperforming loans in the tourism sector. These loans—representing one-fourth of total

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nonperforming loans, or the public banks' largest portfolio of nonperforming loans—have reached 54 percent in this sector. We have held several meetings regarding the AMC, and prepared and then submitted to a ministerial council a draft law on the creation of the new company. In view of the urgency of the situation in our tourism sector, we will endeavor to implement an AMC in June 2014, through (i) adoption of a draft law on the AMC—prepared thanks to technical assistance provided by the World Bank; (ii) adoption of clear and transparent governance rules combined with financial and operational autonomy; and (iii) implementation of a business plan on the financing model, the costs of which will be closely coordinated with any bank recapitalization program.

- Strengthen bank supervision and the transparency of the banking system. We are engaged in introducing a formal bank supervision system based on risks assessment and a related method that would determine the frequency and intensity of inspection missions. Moreover, since January 2013 we have begun to impose monetary and disciplinary sanctions on banks that are in breach of prudential standards. We are also firmly committed to:

  - *Improving the reporting of banking data*. With technical assistance from IMF staff, we have submitted the overall architecture of a new system of bank accounting, financial, and institutional data (structural benchmark), the introduction of which will be spread over one year (up to December 2014—new structural benchmark). In the interim, by March 2014 we plan to set up detailed quarterly data for the development of a Uniform Bank Performance Report for all commercial banks, available 60 days after the end of each quarter, that will facilitate risk monitoring and reconciliation with the data included in the information system (*centrale des risques*). To ensure continuous and regular monitoring, these data as well as all banking data received will be utilized jointly by the DGSB and the DGSF.

  - *Moving toward international prudential standards*, revising the liquidity ratio to include off-balance-sheet transactions, and adopting a more forward-looking approach, introducing prudential standards on a consolidated basis. An impact study on the new liquidity ratio is now being completed and will be submitted to the Central Bank's Board of Directors in January 2014 (structural benchmark at end-December 2013). We also plan to announce regulations to be introduced in September 2014 to strengthen the prudential standards: these will require banks to introduce an internal risk rating system for different client segments. In parallel, we are going to do an assessment on prudential regulations for credit to public enterprises so as to closely assess credit risks and the financial situation of banks. *Strengthening bank supervision capacity. Resourc*es in terms of new hiring—including IT specialists—were made available to the DGSB. Thanks to these new resources and other additional human resources that we plan to provide to the DGSB during the course of 2014, we will be in a position to accelerate our onsite inspection activities in 2014, in addition to the general inspection of a large local bank (a first since 2006) and four non-routine inspections on credit risks that we have just completed, the

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results of which will be submitted to the CBT Board of Directors in January 2014. The methodology for onsite and offsite inspection wil*l also be strengthened, including incre*ased interaction, with technical assistance from the IMF that will also allow us to improve the procedures used.

- **Introduce an improved crisis management and bank resolution regime.** A preliminary version of the new law on commercial bankruptcy was prepared, to modernize and simplify the process of restructuring companies and liquidating insolvent companies. We are determined that the new legislation on bankruptcy will define clear rules regarding the government's status as a preferred creditor, as well as on granting private creditors the right to vote on recovery plans. With assistance from the World Bank, we have also begun work on the bank deposit guarantee system, a project that could be implemented starting in June 2014. In the context of bank resolution, we also plan to:

  - *Clarify the existing regulatory framework with respect to banking management and crisis resolution*. For this purpose, and with the assistance of the IMF and the World Bank, we plan to conduct a study of Tunisian banking laws during the first half of 2014 and subsequently propose the necessary modifications to provide a solid regulatory framework with respect to banking management and crisis resolution, consistent with best international practices. This proposal will be submitted to the management of the BCT in June 2014.

18. **A draft law on the reform of the CBT will be submitted to the Board of Directors at the end of the first half of 2014**. Following recommendations of the CBT's safeguard assessment, the new law (end-June structural benchmark) will cover strengthening the independence of the CBT, improving its governance and methods for conducting external audits, and modernizing the audit and internal control functions.

Budgetary reforms

19. **A better composition of public expenditures will be needed to achieve a growth-supporting medium-term fiscal consolidation and restore fiscal space.** The gradual replacement of generalized subsidies with a better-targeted compensation system, and the control of the wage bill, will free up budget resources for higher social expenditures and growth-supporting public investments over the medium term. Our reforms will also seek to:

- Improve the equity, efficiency, and transparency of the tax system. This program will encompass several reforms:

  - *Tax policy*. Consultations on taxation at the national level were organized during the month of November 2013 to finalize the work of the different working groups on establishing a simpler and more equitable taxation system; this will be discussed at the national conferences planned for March 2014, from which will emerge a new tax code adopted by a Council of Ministers in September 2014 (structural benchmark).

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In the context of comprehensive tax reform, we plan to revise the corporate income tax (CIT) to achieve gradual convergence in the onshore and offshore sectors over the next few years, and announce it according to a clear calendar in the context of the plan for adopting comprehensive reform. The convergence planned for 2014 was incorporated in the draft budget for that year, through a one-half reduction in the onshore/offshore difference in CIT taxes (structural benchmark at end-September 2013). Revising the favorable treatment reserved to re-investment, taxing earnings and income from export activities, and taxing dividends are some of the steps we plan to implement gradually to ensure that the impact on tax receipts will be neutral throughout the entire process of reform.

- *Tax administration*. A preliminary diagnosis of the current tax administration situation was done, with support from an IMF mission. Following this diagnosis, we brought together the control and recovery functions within a strengthened DGE (structural benchmark at end-September 2013); in the short term we plan to restructure all tax functions and reinforce the selectivity of controls by establishing targeted criteria and objectives. A program of reforms to modernize the tax administration will be adopted by the Ministry of Finance in March 2014 (structural benchmark). This plan will aim at implementing a unified fiscal administration and will strengthen control and evaluation mechanisms in customs administration.

- **Improve the management and performance of public enterprises.** The increasing losses of the public enterprises, primarily in transportation (Tunisair), trade (Grain Board), and energy (STEG, STIR) will be controlled by imposing stricter limitations on transfers to the appropriations included in the government's budget. To ensure higher transparency and strengthen governance of public enterprises, we also intend to simplify the existing system of cross-subsidies between companies, by having the STEG and STIR import directly their energy needs, instead of having to go through the petroleum company (ETAP). To avoid expensive bank penalties, the Ministry of Finance is committed to providing companies that have the benefit of subsidies for energy or food products with advances on budgeted appropriations in order to reduce these enterprises' bank borrowing (the share of public enterprises in total commercial loans has been reduced from 11.4 percent in January 2012 to 9.3 percent at end-September 2013). In order to better assess the challenges facing the sector, we plan:

  - To finalize the first audit reports of the three large public enterprises in the area of energy (STEG, STIR, ETAP) by March 2014 (structural benchmark) and to strengthen the control of these enterprises through *periodic monitoring* of the invoices sent to the offices of the Ministry of Finance.

  - To strengthen the monitoring of public enterprises by preparing, by March 2014, a consolidated balance sheet of the 20 largest public enterprises (end-March 2014 structural benchmark); these will also be classified by sector, allowing for a more

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accurate estimate of the real impact on the government's budget. A monitoring committee that brings together the DG of "Public Participation", the CBT's DGSF, and the Unit for Monitoring the Productivity of Public Enterprises and Institutions (Office of the Prime Minister) will be set up to produce a quarterly report on the financial situation and proposed reorganization of these enterprises.

- To improve the governance of these enterprises, particularly through an overhaul of the legislative framework in order to strengthen the role of the Board of Directors and establish audit committees, while improving the transparency of their operations with improved transmission of information and regular assessment of budgetary risks.

- **Strengthen the management of public expenditures.** In the short term, we are committed to consolidating the government's accounts, excluding special accounts for loan projects, in a Single Treasury Account (new structural benchmark for March 2014). This will allow for better knowledge of the government's financial situation and a better understanding of the gaps between the monetary data and budgetary data related to government financing. We are also committed to examining the exhaustiveness and quality of the budget documentation, and to developing a report on financial risks. Immediate efforts will focus on the preparation of a new budgetary nomenclature in line with international standards and the modernization of the methods for controlling commitments. Over the medium term, we are committed to an ambitious program of "budgetary management by objectives" which should lead to a revision of the organic law and to simplifying a priori and strengthening of ex-post controls.

- **Assess and improve the effectiveness of investment expenditures.** An assessment on the management of public investments, produced in collaboration with the World Bank, indicates the need to set up large scale high-return projects that could have a definite impact on disadvantaged regions. Moreover, we have simplified, improved, and considerably modernized the procurement procedures, consistent with the recommendations from the World Bank's technical assistance program, which will take effect in January 2014. This will allow for a more rapid and transparent revamping of investments. We have also undertaken procedures to strengthen the control of public investments so as to ensure that the current practice of transferring loans to the regions to finance investment expenditures, which are under-executed and thus deferred to later years, is no longer the norm.

Structural reforms

20. **Our structural reform program focuses on improving the business climate and promoting a competitive private sector that can generate inclusive growth and reduce unemployment and regional disparities.** To this end, we have:

- **Adopted a new Investments Code in November 2013**—developed with technical assistance from the World Bank and following consultations with civil society and the

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donors. The code seeks to encourage private investments with the introduction of a more transparent and more effective regulatory framework and the rationalization of incentives. Its effective implementation remains dependent on new implementation decrees that will be ready by March 2014 (new structural benchmark) and will adhere to the principles of liberalized access to the markets, reduced restrictions on investment, simplification of the rules for repatriating capital, and the rationalization of exemptions. Moreover, the law on competition is being finalized and will reduce state intervention in the economy, relaxing excessive regulations, and strengthening competition among companies.

- **Accelerated our efforts toward simplification of administrative procedures**, in the area of taxation and customs, among others, in order to promote the private sector and limit the use of discretion in applying the regulations. To this end, following a report on the procedures to be simplified/eliminated in nine ministries, we have reduced restrictive administrative procedures for the private sector in the areas of transportation, customs, and exports and we are committed to continuing along this route, including for procedures related to the VAT.

21. **We are committed to reducing the obstacles to the proper functioning of the labor market.** To this end, we signed a new social contract on January 14, 2013 with employers and trade unions, which will serve as a common social roadmap. Agreement was reached on introducing a permanent council for tripartite social dialogue, as well as the establishment of an insurance fund to cover loss of employment for economic reasons. A broad consultation will be planned to discuss the new employment strategy now being prepared. The main priorities for the medium term will consist, in particular, of reforming the labor code to promote flexicurity in labor relations and to reduce the structural asymmetry of skills prevailing on the market.

22. **Aware of the crucial role of reliable statistical information and the monitoring of macroeconomic policies and implementation of social programs, we prepared a draft law that guarantees and protects the independence of the INS**. This law will be adopted by Parliament by March 2014. We will continue to expand on the regular publication of the results of surveys on economic conditions, employment, and household living conditions. In this context, we are engaged with EUROSTAT in a complete assessment of our statistics system, which will allow us to evaluate and improve its capacities. We also plan—with technical assistance from the IMF—to strengthen our institutional mechanism and the national accounts production system (particularly on the demand side), and the balance of payments system. The introduction of advanced and ongoing training in the area of statistics will make it possible to strengthen the statistical function within the various ministries.

D. Protection for the Most Vulnerable Groups

23. **We are determined that the pursuit of a budgetary consolidation and the introduction of reforms will fully take into account the impact of these reforms on vulnerable population groups, including strengthening of the social protection system.** In this context, in August 2012 we made the decision to create a new register of needy households in , which is an important and

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necessary step to ensure effective targeting ("leakages" to the non-poor in the existing systems are significant). In the interim, we are committed to implement a household supporting program. This program, initially planned for end-August 2013, will be operational in March 2014, which will allow us to better identify the targeted population and the distribution mechanism. The launch of this program will accompany the reduction in energy subsidies planned for this year. Following the projected increase in fuel prices and electricity rates on January 1, 2014 and other price increases planned for this year, the government has meanwhile included in the 2014 budget some social measures, such as a second social tariff to compensate poorer household for increases in electricity tariffs as well as a social housing program.

24. **The government continues to give absolute priority to the reform of the pension schemes.** The pension and health insurance systems are considered financially unsustainable over the long term. By 2018, and in the absence of any reform, the combined deficit could reach 2 percent of GDP. To address this risk, the Tunisian government has begun to analyze scenarios for reform of retirement and health insurance, in order to ensure the viability of the system. A decision on the reform to be followed will necessitate consultation to achieve national consensus, already initiated with the launch of the social pact in January 2013.

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

	Dec 2012	Mar 2013	Jun 2013				Set 2013				Dec 2013				Mar 2014	Jun 2014	Sep 2014	Dec 2014
		Cumulative Flows since the beginning of 2013													Cumulative Flows since the beginning of 2014			
		Actual	PC Program	PC w/ adjusters	Actual	PC Status	PC Program	PC w/ adjusters	Actual	PC Status	PC Program	PC w/ adjusters	Prel.	PC Status	PC	PC	IT	IT
Quantitative Performance criteria									(Millions of Tunisian Dinars)									
1. Floor on the primary balance of the central government (cash basis excl. grants)	-2,256	142	-37	-37	-264	Not Met	-532	-532	-1,308	Not met	-4,318	-3,818	-2,015	Met / TBC	-2,796	-3,119	-4,346	-5,960
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock)	-1,332	-1,757	-829	-97	-267	Met	-196	622	67	Met	-1,084	417	3,510	Not Met	3,952	4,662	2,981	1,603
									(Millions of US$)									
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock)	7,937	7,066	6,667	6,196	6,302	Met	6,751	6,224	6,267	Met	8,066	7,099	5,439	Not Met	5,308	5,086	6,452	7,501
Continuous Performance criteria									(Millions of Tunisian Dinars)									
4. Ceiling on the accumulation of new external debt payment arrears by the central government	...	0	0	0	0	Met	0	0	0		0		0		0	0	0	0
Quantitative Indicative Targets									(Millions of Tunisian Dinars)									
5. Ceiling on Current Primary Expenditure															4,253	8,432	12,922	17,845
6. Floor on Social Spending 3/	1505	207	794	794	618	Not met	1,191	1,191	957	Not Met	1,588		1,371	Not Met / TBC				
7. Ceiling on the accumulation of new domestic arrears	...	0	0	0	0	Met	0	0	0	Met	0		0	Met	0	0	0	0
Program assumptions on which adjusters are calculated in case of deviations																		
Disbursment of public external Financing on a cumulative basis (in US$ mill)		111	410		438		520		681		2,239		845					
Public debt service (interest and amortization) on a cumulative basis (in US$ mill.)		633	956		931		1,169		1,146		1,387		1,379		208.19	502.64	701.20	954.39
Bank recapitalization (in mln TD)											500		500					
Privatization receipts (in mln USD)	394	39	50		39		100		39		41		39		0	0	0	0
Resident deposits at the BCT (in mln USD) 4/	1,489	1,348			1,268				1,232				1,852					
Program exchange rate TD/ U.S. dollars	1.55235		1.55235				1.55235		1.55235				1.55235					

1/ Quantitative performance criteria and structural benchmarks are described in the Technical Memorandum of Understanding.
2/ For purposes of calculating program adjusters, foreign currency amounts will be converted at program exchange rates.
3/ Public capital expenditures on social sectors and programs.
4/ At program exchange rat.

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Table 2a. Tunisia: Structural Benchmarks for 2013

	Objective	*Date*	Comments
Structural Benchmarks			
I. Financial sector			
Approval of the new reporting system architecture covering bank-related accounting, financial and institutional functions.	*Financial sector stability*	*Aug-13*	MET, with delay. The reporting system was presented in September 2013. This report defines the main principles of the architecture and its conception as well as different phases of the risk model.
Adoption by the Council of Ministers of the strategic vision of the government's future role in banks on the basis of preliminary results from the audit of public banks.	*Financial sector stability*	*mid-September 2013*	NOT MET. Audit of the three banks started in July and September, which is delaying the decision on the strategic vision. The strategic vision has been pushed to March 2014.
General on-site inspection of one major bank and inspection of the credit risks of four other banks.	*Financial sector stability*	*Dec-13*	MET. A credit risk inspection at one bank was completed in September and three others were completed in December. The on-site inspection of one major bank was completed in December.
Presentation to the Board of the CBT of a study concerning the impact on banks of liquidity ratio changes toward international standards.	*Financial sector stability*	*Dec-13*	NOT MET. The templates for collecting needed data for conducting the impact study have been communicated to banks. This is expected to be completed by end-January 2014.
II. Fiscal policy			
Aproval by the Council of Ministers of the corporate tax reform announcing the convergence of the tax rates of onshore and offshore sectors for 2014 and identification of countervailing measures to ensure a neutral impact on revenues.	*Minimization of distortions, and tax fairness and simplification*	*Jul-13*	MET, with delay. The reduction of the on-shore corporate tax rate from 30 to 25 percent and the increase of the off-shore one from 0 to 10 percent was incorporated in the 2014 draft budget along with countervailing measures for the potential revenue loss. The draft budget has been approved by the Council of Ministers on November 18, 2013 and has been adopted by Parliament on December 30, 2013.
Adoption of a Ministry of Industry decree approving a new automatic fuel pricing formula.	*Lower energy subsidies*	*Aug-13*	MET, with delay. An automatic pricing mechanism was put in pace allowing convergence to international prices, but does not allow smoothing for large price increases.
Submission to the Council of Ministers of a new targeted household support program to accompany the reform of generalized energy subsidies	*Protection of society's most vulnerable segments*	*Aug-13*	Not MET. The technical work has been done. A decision on the beneficiaries and the compensating mechanism need to be taken.
Merge at the level of the large taxpayer unit the management, tax collection, and control of large enterprises.	*Broadening of the tax base*	*Sep-13*	MET, with delay. The different functions have been put together in one unit.
Finalize the audit of the electricity company (STEG) and of the petroleum refinery company (STIR).	*Lower fiscal risks*	*Dec-13*	Not Met. The audit of the three energy companies (STEG, STIR, ETAP) have started. Thisbenchmark has now been pushed to March 2014.
III. Monetary and exchange rate policy			
Publication of a circulaire by the CBT that announces haircuts on all loans used as collateral for refinancing operations at the Central Bank.	*Enhancement of the monetary transmission mechanism*	*Jul-13*	MET. The circulaire, which was adopted at end-July, includes a general haircut of 10 percent.
Ensure that the proportion of the refinancing volume at the CBT backed by government securities is at least 10 percent for each bank.	*Enhancement of the monetary transmission mechanism*	*Aug-13*	MET. The circulaire has been published and the SB has started.
Implementation of an electronic bank interlinking platform and launch of the Market Makers Agreement.	*Greater exchange rate flexibility*	*Oct-13*	NOT MET, becdause of technical delays. Work is ongoing and this is a new structural benchmark for mid-march 2014.
Ensure that the proportion of the refinancing volume at the CBT that is backed by government securities is at least 20 percent for each bank.	*Enhancement of the monetary transmission mechanism*	*Dec-13*	MET. The circulaire has been adopted, and the SB will be met at the time of its implementation.
IV. Structural reforms/private-sector development			
Adoption of the Investment Code (tax measures will be referred to in the tax code).	*Support for balanced growth driven by the private sector*	*Jul-13*	MET, with delay. The new code was approved by the Council of Ministers in November 2013. Next step in this area will be the drafting of the implementation decrees that should accompany ratification by Parliament.

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Table 2b. Tunisia: Proposed 2014 Structural Benchmarks

	Objective	*Date*
I. Financial sector		
Adoption by the Council of Ministers of the strategic vision of the government's future role in banks on the basis of preliminary results from the audit of public banks.	*Financial sector stability*	*Mar-14*
Submission to the Management of the Central Bank of Tunisia of a banking resolution framework in line with international practices	*Crisis management and financial sector stability*	*Jun-14*
Submission to the Central Bank Board of a draft Central Banking law in line with international practices.	*Financial sector stability*	*Jun-14*
Development and implementation of the new reporting system and bank classification system.	*Financial sector stability*	*Dec-14*
II. Fiscal policy		
Implementation by the Ministry of Finance of a plan to modernize tax administration.	Enhance Revenue Collection	Mar-14
Unification of government accounts into a Single Treasury Account (formulation to be revised for project loans)	Public Financial Management	Mar-14
Finalize the audit of the electricity company (STEG) and of the petroleum refinery company (STIR).	Lower fiscal risks	Mar-14
Submission to the Council of Ministers of a new targeted household support program to accompany the reform of generalized energy subsidies	*Protection of society's most vulnerable segments*	Mar-14
Prepare a consolidated balance of 20 main public enterprises (2010-2012)	*Improvement of budgetary control and reduce fiscal risks*	*Jun-14*
Government approval of a new tax code	Enhance Revenue Collection	*Sep-14*
III. Monetary and exchange rate policy		
Implementation of an electronic bank interlinking platform and launch of the Market Makers Agreement.	*Greater exchange rate flexibility*	*mid-Mar 2014*
Presentation to the Central Bank board of the impact study for removing the upper limit for excessive rates for enterprises and to modify it for consumers.	*Financial system stability and better transmission of monetary mechanisms*	*Mar-14*
Implement an increase of the haircut for loans used as collateral for refinancing operations to at least 25 percent.	*Enhancement of the monetary transmission mechanism*	*Mar-14*
Establishment of the lender of last resort facility	*Financial system stability and better crisis management*	*Jun-14*
Ensure that the proportion of the refinancing volume at the CBT backed by government securities is at least 40 percent for each bank.	*Enhancement of the monetary transmission mechanism*	*Dec-14*
Implementation of a weekly foreign exchange auction mechanism	*Greater exchange rate flexibility*	*Dec-14*
IV. Structural reforms/private sector development		
Decree for implementing the new investment code in line with the objective of protecting market access, reducing restrictions on investments, and rationalizing of incentives.	*Support for balanced growth driven by the private sector*	*Mar-14*

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Attachment II. Technical Memorandum of Understanding

1. This Memorandum establishes the agreement between the Tunisian authorities and IMF staff concerning the definition of the quantitative performance criteria and indicative targets. It also sets out the content and frequency of data reporting to IMF staff for program monitoring purposes.

2. The quantitative criteria and benchmarks are defined in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated January 23, 2014]. For program purposes, all assets, liabilities, and flows denominated in foreign currencies will be valued at the "program exchange rate," as defined below, with the exception of items affecting the government's budgetary accounts, which will be measured at current exchange rates. For program purposes, the exchange rate corresponds to the accounting exchange rate of the CBT prevailing on December 31, 2012, as shown in the table below. For the SDR, the program exchange rate is 1SDR = 2.38852 Tunisian dinars.

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

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

Source: Central Bank of Tunisia.

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

4. For data reporting purposes, the Ministry of Finance, the Ministry of Development and International Cooperation, the National Institute of Statistics (INS), and the Central Bank of Tunisia

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

DEFINITION OF PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Performance Criteria and Indicative Benchmarks

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

Performance criteria

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

Indicative benchmarks

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

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

B. Institutional Definition

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

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

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

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

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

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

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

[1] Deposits of residents in foreign currency (excluding government deposits) at the CBT are a form of external liability of the CBT; for operational and accounting purposes, and because of legal considerations related to the regulation of foreign exchange, the CBT includes residents' foreign currency deposits in the monetary base. To preserve the accounting consistency of the CBT's accounts and be in line with the standard definition of NIR within the framework of IMF stand-by arrangements, it is agreed: (i) to retain the accounting definition of external liabilities used in the CBT balance at December 31, 2012; (ii) to adopt the principle of adjusting NIR (in the opposite direction of the net domestic assets of the CBT) on the basis of the variation in the residents' deposits in foreign currency from end-December of the previous year. It also agreed that the residents' deposits in foreign currency at the CBT include the following components of reserve money: intervention/monetary market in foreign currency, foreign currency of aggregate intermediaries, non-negotiable placement of foreign currencies, and all other items of deposits in foreign currencies created or included in reserve money. At end-December 2013, the value of the stock of deposits in foreign currencies of residents at the CBT was US$1,852.07 million at the program exchange rate.

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

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

D. Ceiling on Net Domestic Assets

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

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

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

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

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

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

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

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

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

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

F. Ceiling on the Accumulation of External Arrears

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

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

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G. Indicative Ceiling on the Accumulation of Domestic Arrears

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

H. Indicative Ceiling on Central Government Current Expenditure (excluding Interest Payments on Public Debt)

25. Under the program, central government primary current expenditure is defined as the sum of central government expenditure on: (i) personnel wages and salaries; (ii) goods and services; (iii) transfers and subsidies; (iv) other unallocated current expenditure[3].

I. Indicative Floor on Social Expenditures

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

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

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Assumptions on Adjustment Factors of Quantitative Performance Criteria

(millions of U.S. dollars)

	2014				
	Year	Q1-Act	Q2-Act	Q3-Est	Q4-Est
Total External Financing	4134.5	1267.9	659.0	1458.3	749.2
Bilateral	200.0	200.0	0.0	0.0	0.0
Multilateral Financing	2429.0	974.2	544.8	586.2	323.8
AMF (Arab Monetary Fund)	76.0		76.0		
IMF (Budget Support)	1380.5	724.2	218.8	218.8	218.8
World Bank Group	750.0	250.0	250.0	250.0	
UE	222.5			117.4	105.0
Financial Market	1100.0	0.0	0.0	800.0	300.0
Market Financ. (possible US guarantee)	300.0				300.0
Market Financ. (possible Japan Guarantee)	300.0			300.0	
Sukuk	500.0			500.0	
Project Loans	346.9	72.6	105.5	57.7	111.1
Other (incl. Loan Transfers to SOEs)	58.6	21.2	8.8	14.4	14.3
Grants	137.9				137.9
Privatisation Receipts	0.0				
External debt service	954.4	208.2	294.5	198.6	253.2
Amortization	607.1	116	191	112	188
Interests	347.2	92	104	86	65
Residents Foreign Currency deposits at the BCT 1/					

Sources: Tunisian Authorities; and IMF staff estimates.

1/ as of end December 2013 estimated at USD 1,852.07 millions

J. Adjustment Factors for the Program Performance Criteria

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

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

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are greater (lower) than the levels included in the table below. The NDA ceiling will be converted into Tunisian dinars at the program exchange rate.

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

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

K. Monitoring and Reporting Requirements

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

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INFORMATION TO BE REPORTED IN THE CONTEXT OF THE PROGRAM

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

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Domestic and foreign debt		
Stock of domestic and foreign debt: of the central government and debt guaranteed by the government, with breakdown by instrument and type of currency (in dinars and foreign currency with the equivalent in domestic currency).	*q*	*30*
Stock of domestic arrears as per TMU, as well the stock of accounts payable that correspond to expenditures committed/ payment ordered more than 90 days before (and by type of expenditures),	*q*	*45*
Disbursement of foreign loans: Breakdown into project loans and budgetary loans by principal donor and identifying the most important projects to be financed in the original currency and its equivalent in Tunisian dinars converted at the current exchange rate at the time of each transaction. **Domestic borrowing from banks and nonbanks:** including bonds, Treasury bills, and other issued securities.	*m*	*30*
Debt guaranteed by the government: by instrument and type of currency (in dinars and in foreign currencies and its equivalent in national currency) **External and domestic debt service:** amortization and interest.	*m*	*60*
External payment arrears: external debt contracted and guaranteed by the government.	*q*	*30*
Debt rescheduling: possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	*q*	*45*

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Consolidated accounts of the central government at the CBT: The stock of deposits will be broken down as follows: (i) Treasury current account; (ii) special account of the Tunisian government in foreign currency and its equivalent in dinars; (iii) miscellaneous dinar accounts; (iv) loan accounts; (v) grant accounts; (vi) FONAPRA-FOPRODI accounts; and (vii) accounts pending adjustment (including privatization receipts from Tunisia Telecom).	*m*	*30*
External Sector		
Imports of Petroleum Products: average import price of main petroleum products.	*m*	*30*
Foreign trade: imports and exports of goods, including volumes and prices, by sector.	*m*	*30*
Deposits: Stock of foreign currency deposits, according to the residence of the holder.	*m*	*14*
External debt:	*q*	*30*
Debt service (amortization and interest) of institutional agents by instrument and at type of currency (in foreign currency and its equivalent in dinars).	*m*	*30*
Stock of external debt of institutional agents by instrument and type of currency (in foreign currency and its equivalent in dinars) (in conformity with our obligations under SDDS).	*q*	*90*
Overall net external position of Tunisia (in conformity with our obligations under SDDS).	*q*	*90*
Balance of payments: Prepared by the CBT	*q*	*30*

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

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

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