INTERNATIONAL MONETARY FUND

TUNISIA

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

July 9, 2012

KEY ISSUES

Context: Since the revolution of early 2011, Tunisia's political transition is moving ahead. The new authorities are facing a legacy of social and economic challenges and increased vulnerabilities. The previous regime's state-centered development model delivered for several years high growth and stability but favored a few privileged, and left unemployment at a high level, substantial economic and social disparities across regions, and a sense of denied opportunities. In 2011, amid domestic and regional turmoil, Tunisia experienced a severe recession, its external position deteriorated and unemployment reached unprecedented levels. The authorities tried to mitigate the effects of the recession on households and businesses with an increase in current public spending and a large monetary injection. However, these also led to the buildup of increased vulnerabilities in the financial sector, some inflationary pressures, and losses in foreign reserves.

Near-term outlook and risks: Real GDP growth could start recovering in 2012, with a gradual rebound in tourism and FDI inflows and a sizable growth-supporting fiscal expansion. However, a deteriorated situation in Europe, Tunisia's main trading and investment partner, coupled with ongoing social tensions and political uncertainties, substantial weaknesses in the financial sector, and a wait-and-see attitude of investors, will weigh on Tunisia's near-term growth outlook. Risks to the outlook are large and tilted to the downside.

Main policy recommendations: A rebalancing of the policy mix is needed to support Tunisia's short-term growth while preserving macroeconomic stability. The fiscal stimulus will have to be better oriented toward public investment, and current spending will need to be contained. A gradual tightening of the monetary policy stance will help contain inflationary pressures, while greater exchange rate flexibility could help to stabilize foreign reserves. Reinforcing banks' solvency and strengthening banking supervision are required to preserve financial stability. Finally, fiscal consolidation will have to be resumed in the medium term to preserve fiscal sustainability.

Medium-term prospects: Tunisia's medium-term economic growth potential remains favorable but unleashing it will require a comprehensive package of structural reforms to foster private investment. Achieving higher and more inclusive growth over the medium term will be critical to reducing high unemployment, especially among the youth, and addressing social and regional disparities.

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INTRODUCTION: A NEW HISTORICAL PHASE WITH PRESSING SOCIAL CHALLENGES

1. **The January 2011 revolution marked the beginning of a historical era for Tunisia.** Following the overthrow of President Ben Ali, Tunisia has moved steadily forward with its political transition. The successful elections for a Constituent Assembly in October 2011 resulted in a new coalition government, led by the once-banned Islamic Party (Ennahda) with two secular parties. The Constituent Assembly is now preparing a new constitution and will exercise legislative power until new general elections take place in March 2013. While such a progress is remarkable, the political and institutional framework remains understandably fluid and a source of uncertainty.

2. **The new authorities inherited from the previous regime a state-centered development model, which favored a privileged few and led to substantial economic and social challenges**. Macroeconomic management relied on extensive state intervention in the economy to foster the development of export-oriented and low value-added industries, intensive in unskilled labor. It was based on a dual approach favoring the offshore sector with various incentives while the onshore sector was under tight control. The economy was characterized by price controls, a tightly managed exchange rate, capital controls, and interventions in the banking system to channel credit to strategic sectors, in particular tourism. This model delivered for several years high growth and stability but also led to the building of substantial challenges, which were at the root of the revolution. Economic gains were not fairly shared among the population, and there were economic and social disparities across regions. Insufficiently high growth and labor market impediments kept unemployment high (13 percent in 2010), especially among the youth (about 30 percent in 2010). In addition, weak governance and favoritism fueled a sense of denied opportunities and depressed economic potential.

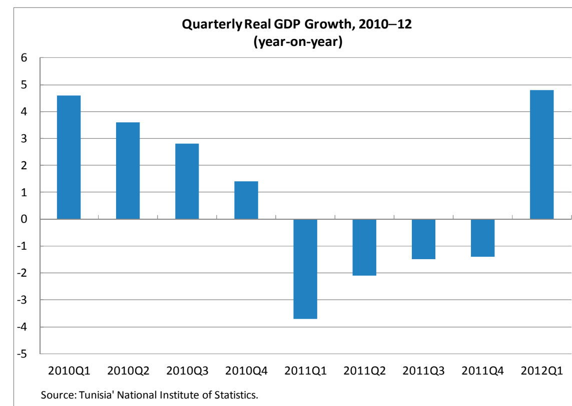
3. **The economic crisis following the revolution and a variety of external shocks led to increased vulnerabilities.** Domestic social unrest and the conflict in neighboring Libya contributed to a severe recession, which brought unemployment to unprecedented levels and further weakened the financial sector. In response, the focus of the authorities has been largely directed toward appeasing social demands by mitigating the effects of the recession on households and businesses with expansionary fiscal and monetary policies. However, the fiscal expansion relied too much on current expenditures which will be difficult to bring back down. The monetary expansion is postponing the recognition of losses in the financial sector, has likely contributed to an increase in inflation and, together with the defense of the exchange rate has resulted in a steep decline in foreign reserves. On the structural side, progress has been made to improve governance, but revisiting the overall development model still lies ahead.

4. **To address old and newer economic and social challenges, the authorities will need to establish strong foundations for higher and more inclusive growth.** As signs of an economic rebound emerged, the authorities need to re-instill confidence of the population and investors in the future of the economy so that they can look beyond short-term difficulties. This will first require supporting the economic recovery in the short term with an investment-oriented fiscal expansion while preserving macroeconomic and financial stability against a difficult external environment and a still-volatile political and social domestic situation. Monetary and financial sector policies should aim at containing inflation, preserving foreign reserves, and strengthening the banking sector. It will be equally important for the authorities to develop, early on, a new vision for the Tunisian economy and to identify priority reforms, which could respond to the great hope brought about by the revolution for a better economic and social future, with opportunities for all. In particular, concrete solutions to the underdevelopment of the inner regions and to the high youth unemployment will be essential.

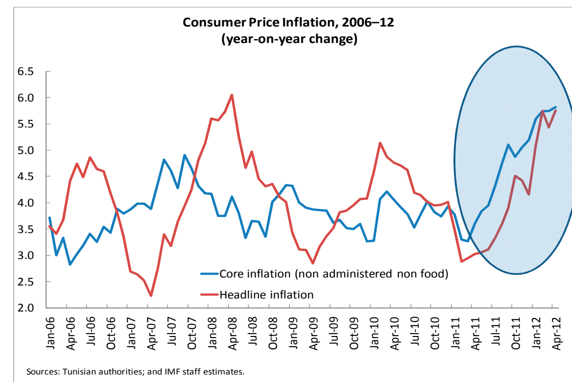
ECONOMIC CONTEXT, OUTLOOK, AND RISKS

A. The 2011 Economic Crisis, Policy Response and Early Signs of Recovery

5. **Tunisia experienced a severe recession in 2011 but signs of a rebound have emerged.** Economic activity in Tunisia was severely affected in 2011 by the repercussions of the domestic events as well as the conflict in neighboring Libya. Real GDP contracted by an estimated 1.8 percent, with a sharp decline in tourism and other sectors affected by strikes. In contrast, the agricultural sector recorded a growth rate of 9 percent. Private investment declined sharply while private consumption was resilient, due to the fiscal expansion contributing to support incomes. As a result of the economic downturn and the return of Tunisian workers from Libya, unemployment reached 19 percent in 2011, with youth unemployment at 42 percent. However, in the first quarter of 2012, real GDP rebounded by 4.8 percent (y-o-y), with tourism and FDI picking up and industrial production strengthening. After decelerating to 3.5 percent in 2011, inflation accelerated to 5.7 percent in April 2012 (y-o-y), reflecting higher food prices due to



Source: Tunisia' National Institute of Statistics.



Sources: Tunisian authorities; and IMF staff estimates.

demand from Libya, constraints in the distribution system, and the possible inflationary impact of the large liquidity injection. In particular, growth in nonfood and non-administered prices, which is the most relevant indicator for core inflation, steadily increased in recent months to 5.8 percent in April (y-o-y), its highest level since 1996.[1]

6. Tunisia's external position weakened significantly. The current account deficit widened substantially to 7.3 percent of GDP in 2011, because of lower tourism receipts (–33 percent) and other nonfactor services. The resilience of exports and the drop in demand for imports averted an even stronger deterioration. FDI inflows also declined sharply (-26 percent) owing to the wait-and-see attitude of foreign investors.[2] Despite larger external disbursements, international reserves declined to US$7.5 billion at end-2011 (equivalent to 3.8 months of imports) from US$9.5 billion at end-2010. During January-April 2012, despite a significant rebound in tourism (+33 percent), the current account continued to deteriorate because of strong import growth and slowing exports, reflecting the negative effects of developments in Europe. Although FDI started to recover (+28 percent), reserves further declined to US$6.7 million in end-June (equivalent to 3.1 months of imports), a level which leaves Tunisia more vulnerable to external shocks (Appendix I).

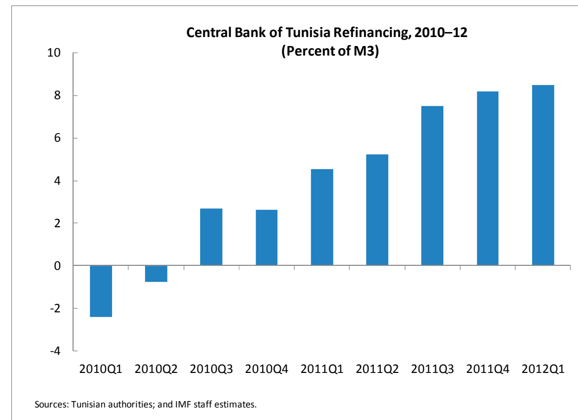
7. In the context of the crisis, the authorities raised current budget spending to address social demands. The overall fiscal deficit widened to 3.7 percent of GDP in 2011 from 1.1 percent in 2010, reflecting a 4 percent of GDP increase in public spending—of which about ¾ was allocated to current expenditures—partly offset by stronger tax revenues and exceptional nontax revenues. The wage bill increased significantly, food and energy subsidies almost doubled to offset higher international prices, and new social measures were implemented, including revamped youth unemployment programs.[3] The public investment program, however, was under-executed because of capacity constraints. Budget revenue increased by 1.7 percent of GDP in 2011, with larger direct taxes and increased nontax revenues reflecting the Central Bank of Tunisia's (CBT) exceptional transfer of dividends for 2008–10 and higher oil revenues. After having declined over the past decade through 2010 to 40 percent of GDP, public debt increased to 44.4 percent of GDP at end-2011. In the first quarter of 2012, the overall fiscal balance was in small surplus, reflecting strong tax revenues and new delays in the execution of the 2012 public investment plan.

[1] Administered prices represent about 30 percent of Tunisia's CPI basket.

[2] Net FDI declined by 69 percent in 2011, also reflecting TND 840 million outflows due to the purchase by a member of President Ben Ali's family of shares in the Telecom company Tunisiana, from a foreign stakeholder.

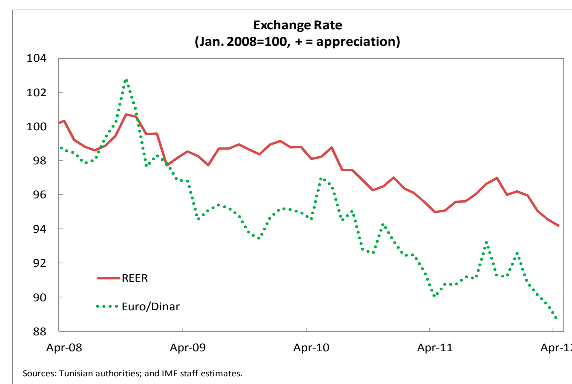
[3] The public-sector wage bill increased by 14 percent in 2011 due to the recruitment of 20,000 new employees (on a net basis), a 4.7 percent average wage increase, and additional benefits provided to security forces. New social measures included broadened coverage of social transfers to disadvantaged families, compensation to households affected by the turmoil, and allowances to the families of the martyrs of the revolution. Spending for the revamped youth employment programs was classified under capital transfers.

8. Monetary policy has been supportive of bank credit, which decelerated nevertheless. The CBT stepped up its monetary easing to support banking sector liquidity and credit to the economy. It reduced the reserve requirement ratio from 12.5 to 2 percent, decreased its reference interest rate from 4.5 to 3.5 percent, and stepped up its refinancing of banks (6 percent of GDP in April 2012). These injections offset the decline in foreign reserves, and helped banks to address their short-tem needs in an environment of declining asset performance. As a result, credit growth, although decelerating, remained strong at 13½ percent in 2011 and still largely exceeded growth in deposits.



9. The quality of the banks' portfolio deteriorated in 2011 because of losses from the economic downturn, and banks liquidity became tight. The economic downturn, particularly in the tourism sector, deteriorated banks' portfolio. The CBT relaxed its regulatory requirements, authorizing banks to reschedule loans falling due in 2011 for companies affected by the economic downturn and lifting banks' obligation to reclassify rescheduled loans.[4] As those loans have not been classified so far, reported nonperforming loans (NPLs) remained stable at 13 percent in 2011. Significant provision needs may emerge in 2012 depending on the performance of the rescheduled loans. Liquidity in the banking system deteriorated, with the regulatory liquidity ratio declining to 89 percent. Most banks became heavily dependent on CBT refinancing.

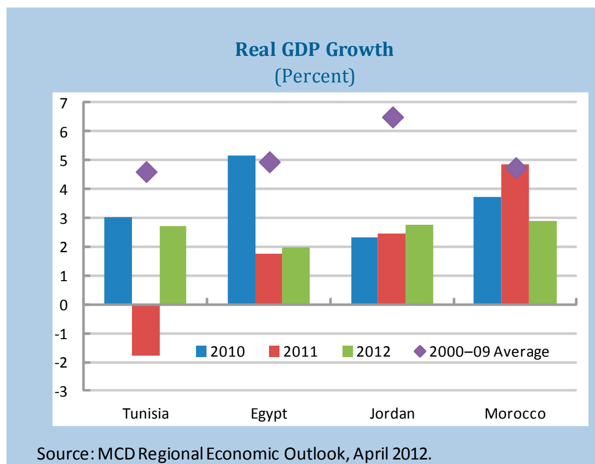
10. With a sizable deterioration in the current account, the CBT supported the exchange rate through substantial foreign exchange interventions. The CBT sold US$2 billion in 2011 and US$700 million during January–April 2012. The real effective exchange rate was relatively stable and broadly in line with fundamentals (Appendix II), with a 3 percent nominal depreciation through March 2012 (y-o-y) offsetting the inflation differential with partners.

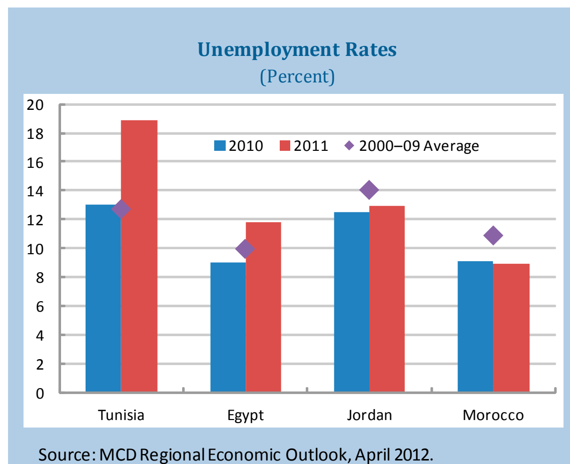


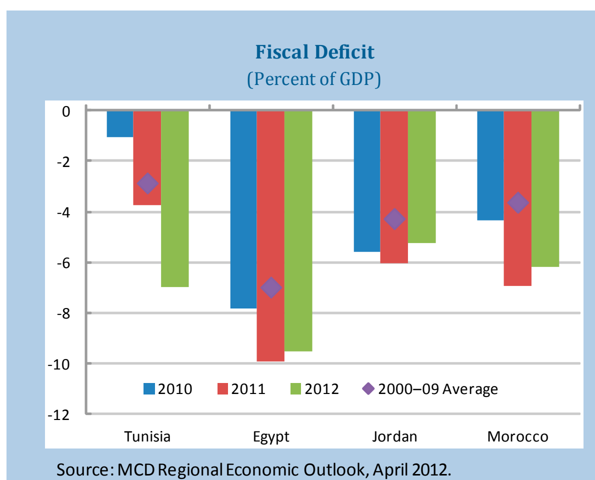
[4] Banks rescheduled about TND 690 million loan payments due in 2011 related to a total underlying portfolio of about TND 5 billion (7½ percent of GDP).

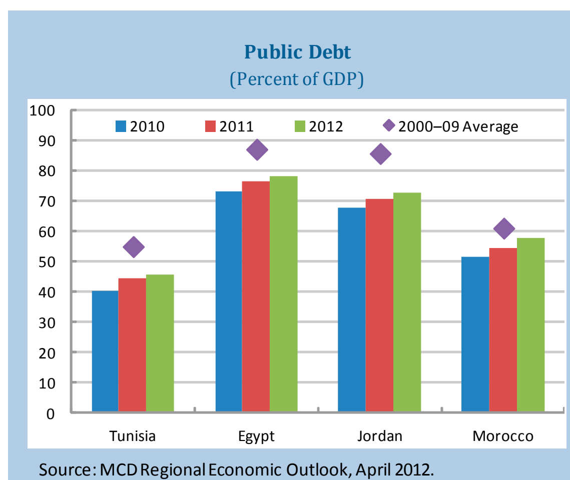
Tunisia and Other Arab Countries in Transition

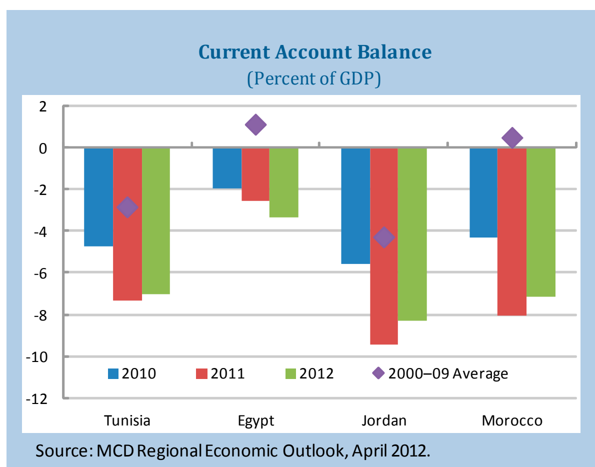
In 2011, compared with other Arab countries in transition (Egypt, Jordan, and Morocco), Tunisia had the lowest fiscal deficit and public debt ratio, but was the only one to record a recession, had the highest unemployment rate, and the lowest level of external reserves.

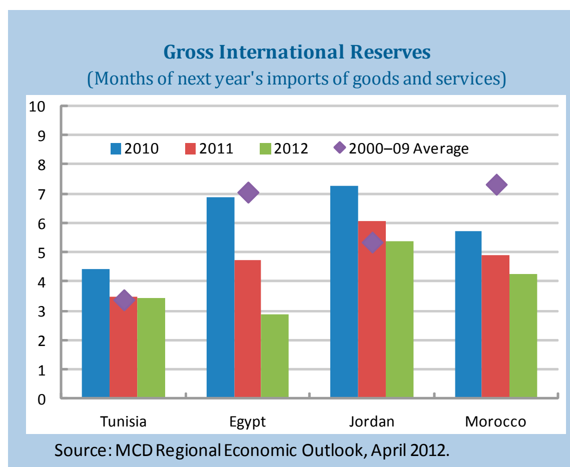












B. Near-term Outlook: A Gradual Recovery with Large Downside Risks

11. Tunisia's growth outlook for 2012 will depend in part on developments in Europe, the domestic social and political situation, and actions by the government. An anticipated recession in Europe, coupled with a wait-and-see attitude of investors, will weigh on Tunisia's near-term prospects. Nevertheless, real GDP growth could reach 2.7 percent in 2012, thanks to a gradual rebound in tourism and FDI inflows, as observed in the first quarter of the year, and a sizable growth-supporting fiscal expansion tilted toward public investment. Nevertheless, the output gap would widen slightly further. Unemployment would remain high, with new job creation only partially absorbing new labor market entrants. Inflation would increase to 5 percent, reflecting the factors at play since late 2011 and the expected adjustment in petroleum products prices. Credit to the economy would decelerate as banks strive to improve their liquidity. Tunisia's external position would remain weak, with the current account deficit at 7 percent of GDP in 2012. With about US$3.2 billion of expected external budget support, reserves would increase slightly to US$8.2 billion at end-2012 (equivalent to 4.1 months of imports).

12. Risks to Tunisia's near-term outlook are large and tilted to the downside (Appendix III). A worse-than-anticipated recession in Europe would hurt Tunisia's short-term growth prospects by further depressing exports and hampering the rebound in tourism and FDI inflows. An escalation of domestic social tensions along with still-evolving institutions and political uncertainties could hamper foreign and domestic investment. Capacity constraints and delays in identified financing could curb the envisaged growth-supporting fiscal stimulus. Investors sentiment may be affected by downgrades of Tunisia's sovereign ratings, such as the one issued by Standard & Poor's in May 2012. In addition, inflationary pressures may rise in the event of large wage increases in the public sector, a substantial depreciation of the exchange rate, or increasing monetary injection. On the upside, a rapid stabilization of the situation in Libya could bolster bilateral trade and investors' confidence. Under a pessimistic scenario with a ½ percent deeper recession in Europe and a smaller fiscal expansion due to the under-execution of public investment, the recovery would be weaker, with real growth at about 1 percent in 2012.

13. Risks arising from weaknesses in the financial sector could undermine macrofinancial stability. Continued liquidity injection to compensate for banks' weakening asset performances would put further pressure on foreign reserves and inflation. In this event, given recent large losses in foreign reserves, a further decline in reserves could ultimately force a large exchange rate adjustment or substantial monetary policy tightening, potentially resulting in either additional inflationary pressures or a credit crunch. Moreover, if banks' solvency issues are not addressed rapidly and adequately, the banking sector's contribution to medium-term growth would be undermined, and needs for bank recapitalization could become much larger down the road, with a negative impact on public debt beyond what is expected under the baseline scenario. Mitigating these risks requires restraining CBT refinancing to banks and early actions to address under-provisioning and capital shortfall in parts of the banking system.

14. The authorities expect a rebound in 2012 stronger than projected by staff. They project GDP growth to reach 3.5 percent in 2012, on the back of a sizable growth-supporting fiscal stimulus and a rebound in private investment thanks to the improved security situation. They are nevertheless concerned by the important downside risks from a possible further deterioration in Europe.

Box 1. Possible Spillovers from the Debt Crisis in Europe into Tunisia

Tunisia's banking sector is relatively well insulated against a deterioration in the international financial environment. Tunisian banks are mostly financed on the local market in nonconvertible dinars. Foreign exchange regulations substantially limit the exchange rate risk that residents may take.

However, Tunisia's exposure to Europe through real channels is significant. France is the most important partner, with 29 percent of exports, 26 percent of tourism receipts, and 47 percent of remittances. Among Southern European countries, the main export destination is Italy.

A slowdown in Europe would affect Tunisia substantially through real channels. A more pronounced deterioration in growth in Europe will have negative consequences on economic growth in Tunisia. Empirical estimates, based on vector autoregressive models, suggest that a 1 percentage point change in real GDP in the European Union could lead to a 0.6 percentage point change in Tunisia's real GDP in the short term, and a change of nearly 2 points in the long term. Moreover, empirical estimates based on short-term growth models suggest that the external variables (particularly trade) explain approximately 30 percent of the deviation between Tunisia's real and potential GDP levels. The impact on trade could be more muted as a drop in exports to the euro area would be mitigated by a significant drop in imports (given that a large share of imports is used in the production of export goods). Previous episodes of crisis in Europe, in particular in 2008–09, have resulted only in a modest increase in the current account deficit.

Tunisia: Shares of European Trading Partners, 2010

	Europe, *of which:*							Other
		France	Germany	Italy	Spain	Portugal	Greece	
Exports	79.1	28.7	8.5	19.9	3.9	0.4	0.1	20.9
Tourism	81.1	26.4	14.9	6.7	1.9	0.4	0.1	18.9
Remittances	87.1	47.3	15.1	13.6	0.5	0.0	0.0	12.9
FDI	72.1	12.4	0.8	15.3	6.3	0.5	0.0	27.9

Source: Balance of Payments, Tunisia, 2010.

THEME 1: REBALANCING THE POLICY MIX TO SUPPORT SHORT-TERM ECONOMIC GROWTH WHILE PRESERVING MACROECONOMIC STABILITY

15. Rebalancing the policy mix is needed to support Tunisia's short-term growth while preserving macroeconomic stability. In light of a difficult international environment and wait-and-see attitude of investors, a better-targeted countercyclical fiscal expansion, more tilted toward public investment than in 2011, will be necessary to support short-term growth and job creation. With fiscal policy playing the key role in supporting growth, a gradual tightening of the monetary policy stance will help contain inflationary pressures. Furthermore, greater exchange rate flexibility will be necessary to stabilize international reserves.

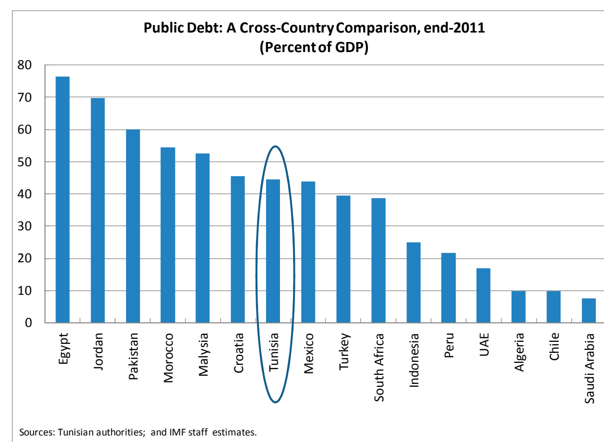
Fiscal policy

16. The authorities envisage a large growth-supporting fiscal expansion which would substantially widen the fiscal deficit in 2012. On the basis of the supplementary budget law adopted in May 2012, staff expects the overall fiscal deficit (before grants and privatization receipts) to widen from 3.7 percent of GDP in 2011 to 7.0 percent in 2012. Current expenditure would increase by 1.6 points of GDP, owing to a 14 percent increase in the wage bill, larger social transfers to households and to the regions, and other expenditures not yet identified ("unallocated" spending).[5] Energy subsidies would be contained with increases in domestic prices of some petroleum products and electricity which are expected in the second half of 2012. Public direct investment would increase by 1 percent of GDP in 2012 to support economic growth and job creation, in particular in the disadvantaged regions, to the extent that execution of investment projects picks up strongly. Revenues would decline due to a base effect which included exceptional nontax revenue in 2011 and the lag effect of last year's recession. Receipts from past privatization (TDN 900 million) and sales of confiscated assets would help cover about one quarter of the deficit.[6] Nevertheless, public debt would increase again, to 45½ percent of GDP by end-2012.

[5] The public-sector wage bill will increase in 2012 owing to the recruitment of about 12,000 new employees (on a net basis), and the full-year impact of the recruitments and wage increases which took place in 2011.

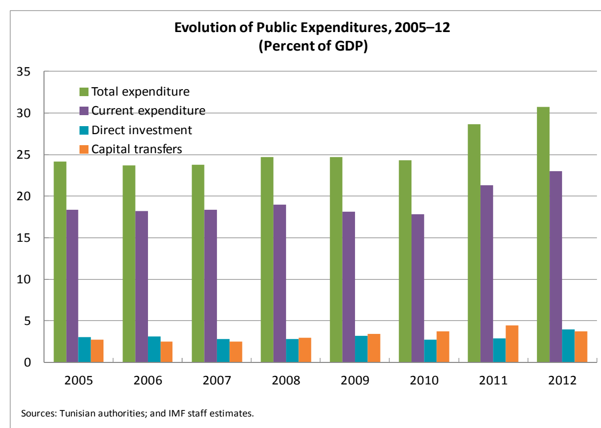
[6] The sale of the assets confiscated from the previous regime will likely face substantial legal hurdles and may take time. Staff expects revenues from these sales of only TND 300 million in 2012, out of the TDN 1.2 billion envelope included in the Supplementary Budget Law. Staff anticipates the remaining TDN 900 million to be recovered during 2013–15.

17. Tunisia has some fiscal room to accommodate the envisaged short-term fiscal expansion, to the extent that it is used effectively, is embedded in a sustainable medium-term framework and can be financed. Owing to prudent past fiscal policy, Tunisia has a relatively comfortable public debt position. Public debt is expected to pick up in the short term, reflecting the fiscal stimulus and the expected recapitalization of public banks. Based on a gradual fiscal consolidation strategy envisaged by the authorities (see Theme 3) and a pick-up in GDP growth, public debt could then progressively decline to 46½ percent of GDP over the medium term. Under this baseline scenario, public debt would remain around a sustainable level, but the public debt dynamics would deteriorate significantly in the event of lower real growth or lack of fiscal consolidation (Appendix VIII).



18. Implementing a well-targeted fiscal expansion will be crucial to support short-term growth and job creation. A countercyclical fiscal expansion, relying more on a pick-up in public investment than on public consumption in contrast to what was done in 2011, will be needed to mitigate the negative repercussions on the Tunisian economy of a deteriorated external environment. Staff estimates that the anticipated fiscal stimulus of about 1.7 percent of GDP would contribute to about 1 percent of real growth in 2012 (Appendix IV).

19. Executing the envisaged public investment plan and adopting measures to contain current expenditures are key. Significant delays were recorded in the first quarter of 2012 in the execution of the public investment plan envisaged in the Supplementary Budget Law. The authorities are aware that starting to execute planned public investment, especially projects which could support job creation in the undeveloped regions, will be key to supporting economic growth and addressing pressing social demands. Furthermore, staff encouraged the authorities to take measures to contain current expenditures within the envelope adopted in the supplementary budget law. In this context, staff stressed the need to control the increase in the wage bill through wage moderation to avoid an increase in permanent expenditure which would weigh on the medium-term fiscal position, and to adjust energy prices upwards, as envisaged, to contain subsidies. In the absence of the anticipated energy prices increase, the overall fiscal deficit could reach about 7½ percent of GDP in 2012.



20. Large external financing will be needed to implement the growth-supporting fiscal expansion without crowding out domestic banks' financing. Tunisia's gross budgetary financing needs would reach about US$4.2 billion in 2012. The authorities indicated that about US$3.2 billion of external budget support was secured but with about half of it expected to be disbursed only toward the end of 2012.[7] Staff highlighted that the magnitude of the fiscal stimulus is predicated on external financing being mobilized and disbursed in a timely manner, and that fixed investment should be preserved by limiting the execution of unallocated current expenditure in case of an external financing shortfall.

21. The effective implementation of a sizable fiscal stimulus, with the full execution of the public investment plan envisaged in the Supplementary Budget Law, is a priority for the authorities. They are focusing their efforts to move rapidly ahead with the execution of the planned public investment projects; these efforts include streamlining public procurement rules and implementing budgetary reforms to reduce redundant controls that have hampered spending execution in the past. The authorities also indicated that they did not consider financing constraints as a risk for budget execution, but were nevertheless ready to use the amount of unallocated current expenditures included in the supplementary budget law (about TDN 700 million, or 1 percent of GDP) as a buffer in order to preserve public investment, in the event of a shortfall or delays in external financing.

22. The authorities recognized the need to contain current expenditures. They agreed that the recent increase in the wage bill, if sustained, would result in substantially higher permanent expenditures that would weigh on medium-term fiscal sustainability. Thus, they indicated their intention to limit the increase in public-sector wages in 2012 to contain the wage bill within the envelope presented in the supplementary budget law. However, they argued that the exceptional recruitment in the public sector during 2011–12 was a necessary measure to contain unemployment at a very difficult moment for the Tunisian population. The authorities also indicated their intention to adjust the energy prices upwards, without which subsidies could be higher than anticipated in the supplementary budget law, but would take into account the social environment when deciding about the magnitude and timing of this measure.

Monetary and exchange rate policy

23. In view of current inflationary pressures, staff welcomed the CBT's recent move to start tightening monetary policy. Since January 2012, the CBT has changed its interventions in the interbank money market to allow the monthly average interbank rate to increase by about 0.5 percent. The increase in the monthly average interbank rate should help to reduce inflationary

[7] Tunisia has already received in 2012 a US$500 million loan from Qatar, a US$130 million loan from the French Development Agency, and US$100 million grant from the United States. In addition, the authorities expect to receive a US$200 million grant from the EU, are negotiating a new reform support loan of US$500 million from the World Bank and US$350–500 million from the African Development Bank, and expect to borrow about US$850 million on the international capital markets with guarantees from the U.S. Treasury and the World Bank. Tunisia would also receive about US$500 million of project aid.

pressures, including those possibly arising in the context of a more flexible exchange rate regime. Furthermore, it should also encourage the mobilization of banks' deposits and moderate credit growth, thus reducing the banking sector's financing needs. Staff encouraged the authorities to enshrine its recent actions in an increase in its policy rate, to continue to closely monitor inflation developments, and to stand ready for further tightening in case inflationary pressures do not subside.

24. The institutional framework for formulating monetary policy needs to be strengthened. Currently, the Central Bank Board decides on the policy rate based on fairly general and backward-looking indicators. Establishing a monetary policy committee would help filling a gap with regard to critically assessing forward-looking inflationary pressures based on a wider set of data, including monetary aggregates and inflation in non-administered and non-food prices. The committee would formulate more explicitly the desired monetary policy stance for the Board's consideration, and improve the communication on monetary policy decisions. Finally, it could also contribute to improving the coordination between monetary and exchange rate policies.

25. The CBT recently changed its exchange rate policy operational framework to make the rate more flexible. Since April 2012, the CBT has computed its reference exchange rate based on the average exchange rate on the interbank market instead of a fixed currency basket, and intervened in the foreign exchange market through bilateral transactions when market quotations deviate substantially from the fixing rate of the day. Staff welcomed these changes, in line with recent Fund TA recommendations, as a more flexible exchange rate management will help preserve the CBT's foreign reserves and support demand for money by reducing liquidity absorption due to foreign exchange interventions. Staff noted that the exchange rate was broadly in line with medium-term fundamentals projected in staff's baseline scenario, albeit slightly overvalued based on CGER methodologies. In the context of greater exchange rate flexibility, monetary and exchange rate policy will need to be closely coordinated.

26. The monetary authorities indicated their readiness to tighten monetary policy further if inflationary pressures were to persist. However, they expect inflation to stabilize and do not see the inflationary pressures as stemming mainly from the expansionary stance of monetary policy since 2011. If needed, a monetary policy tightening would be gradual since the authorities are concerned about the repercussions on NPLs due to the indexation of credit interest rates to the interbank rate. The authorities were also willing to consider creating a monetary policy committee to enhance the monetary policy institutional framework.

27. While allowing more exchange rate flexibility, the authorities remain cautious in view of the inherent risks involved. The authorities believe that moving toward more exchange rate flexibility will help to stabilize the CBT's foreign reserves and improve the liquidity of the financial sector. However, they expressed concerns about the repercussions on inflation of a possible depreciation of the exchange rate. Furthermore, the authorities doubt that the response of the current account to changes in the exchange rate could be large in Tunisia.

THEME 2: URGENT NEED FOR REFORMS IN THE FINANCIAL SECTOR

28. The financial sector reforms undertaken during the decade prior to the revolution were not sufficient to modernize and strengthen the banking system. Overall, the ratio of NPLs (13 percent of total loans) remained high and capital buffers were inadequate at end-2010. To maintain profitability in the face of weak asset performance, some banks provisioned less than recommended by international standards and invested less than necessary for modern banking operations, especially with regard to information systems. Moreover, access to finance remains limited, representing a major constraint in several regions and for some categories of the population.

29. Adding to these weaknesses, banking supervision was not developed adequately and fell short of international standards. As identified in the most recent Financial System Stability Assessment (FSSA), important supervision shortfalls concern loan classification, collateral valuation, and provisioning, which make the emergence of additional provisioning needs likely when practices will meet international standards. Banking sector data management has deficiencies which undermine the accuracy of financial sector indicators. Onsite inspections were also insufficient and banks' internal controls were poor. Finally, the CBT needs to amend the CBT Act in order to establish an effective framework for its autonomy and accountability, including transparent hiring and dismissal rules for the governor and board members.

30. The authorities recently made commendable strides in strengthening banking supervision and improving banks' solvency, but further significant efforts are needed. Staff welcomed the measures taken by the authorities in early 2012 to introduce generic provisioning, enhance the corporate governance regime for commercial banks, improve banks' compliance with prudential regulations, and reinforce CBT's banking supervision capacity. In addition, the authorities started the recapitalization of a major public bank representing about 14 percent of total bank assets and intend to conduct an audit which will serve as a basis for completing this bank's restructuring. Staff encouraged the authorities to strengthen the reforms until banking supervision fully meets international standards, which could take several years (Appendix V). Long-term IMF technical assistance in banking supervision, as requested by the authorities, together with training of professional staff, will help to achieve this key objective.

31. The significant challenges facing the banking sector in terms of potentially large recapitalization needs and the tight liquidity situation will need to be addressed forcefully. As the overall banking sector recapitalization needs could reach 3-7 percent of GDP (3.2–7½ percent of total banks assets) after two years under various scenarios, banks should take pre-emptive action

and begin setting aside additional capital.[8] A large state-owned bank, with large unrealized loan losses, has started to be recapitalized and will need to be restructured, based on a separation of good from bad assets followed by state recapitalization to cover any balance sheet shortfall. The CBT will need to develop an exit strategy for gradually unwinding its large liquidity support to banks, which has increased risk to the central bank and contributed to a substantial decline in reserves. In doing so, while continuing to meet banks' liquidity needs, the CBT should align its collateral requirements to international practices to preserve its balance sheet and introduce a "lender of last resort" facility to manage banks with insufficient eligible collateral. At the same time, corporate insolvency and vulnerabilities will need to be addressed in order to minimize fiscal costs of banks resolution later.

32. The authorities were confident that vulnerabilities in the banking sector could be addressed quickly. They are of the view that solvency problems are confined to one large public bank. They also consider that most of the loans rescheduled in 2011 will be performing because the beneficiary companies were assessed as solvent, although their remaining so will depend on the economic recovery in 2012, particularly in the tourism sector. In addition, the authorities highlighted the significant improvements in banking supervision which are under way and which should allow adequate standards to be met fairly quickly.

33. In the medium term, state intervention in the financial sector should be streamlined to promote financial development. The government directly controls three major public banks and several small mixed banks, whose contribution to financial development is questionable. The major public banks have mobilized local savings to finance specific sectors—tourism, agriculture, and housing—based on political rather than economic motives. To these direct interventions, numerous indirect interventions have been added, such as interest rate controls, guarantees, and special funds, without a consolidated and transparent strategy for the sector. Several reforms should be implemented to support financial development (Box 2). Removing distortions in the financial sector will also help to enhance the effectiveness of monetary policy.

34. Measures are needed to develop capital markets. Funds raised on the capital markets are about 2 percent of GDP, stock issuances are not frequently used for long-term investments, and stock exchange listings, dominated by banks, do not reflect the structure of the Tunisian economy. The establishment of a credible yield curve, and improving banks' risk management, would contribute to further developing the capital markets. This would require more regular issuances of reference maturities by the Treasury and some degree of liberalization in exchange rates and the regulatory framework for derivatives.[9] A reform of the pension system would also contribute to building a long-term investment demand.

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[8] Possible recapitalization needs were estimated with stress tests under various scenarios, assuming potential negative growth shock and a downward revision in the value of collateral assigned to NPLs and provisioning. Data gaps, classification issues, and rescheduling may mask further needs. Separately increasing the capital adequacy ratio from 8 to 10 percent would require 1.3 percent of GDP of additional recapitalization needs.

[9] The Treasury should manage its liquidity actively on the market to reduce the opportunity cost of regular issuances.

35. The authorities consider that the state has a key role to play in the financial sector. They acknowledged the need to further improve the governance of public financial institutions, but they do not envisage reducing the state's stake in the banking sector. The authorities have recently established the *Caisse des depots*, a new public financial institution, with the aim of addressing market failures and supporting investments, following the examples of other countries.

Box 2. Reform Strategy for Development of the Financial Market

- **Competition should be guaranteed:** Effective banking supervision must ensure uniform application of prudential rules and prompt resolution of solvency problems to promote fair competition and market contestability. Interventions that potentially involve financial repression or market distortion, such as interest rate ceilings or floors, should be avoided.

- **Market failures need to be addressed:** Public intervention may be necessary to facilitate access to credit for small enterprises and individuals. However, it is essential that public institutions have complete management independence and a clear, limited, and exclusive mandate (governance). Against this backdrop, postal banks, for example, can help in mobilizing deposits and in providing a limited range of financing services in rural or remote areas. The *Caisse de dépôts*, emulating practices in France, Italy, or Morocco, might help in financing certain strategic sectors (high value-added industries, for example) or participate in regional and municipal project financing. In doing so, proper risk management should be ensured for all institutions under the same regulatory norms.

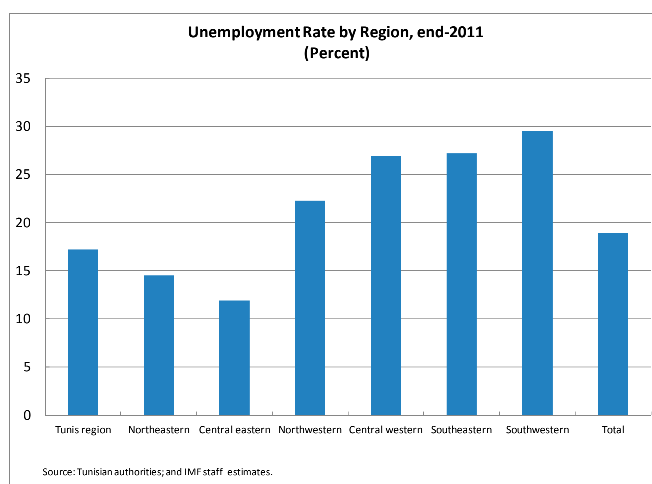
- **Preference should be given to indirect targeted interventions:** Funds that intervene through commercial banks by subsidizing certain types of instruments or by providing partial guarantees should be favored, rather than direct financing through public institutions.

- **Access to finance should be improved:** The microfinance law passed in October 2011 constitutes a major step forward. Microfinance activities should be broadened and their supervision transferred to the banking supervision authority. Improvements in tools for credit risk assessment are essential. The potential for better using the Post Office capacity to extend the range of financial services in remote regions should be explored.

THEME 3: ACHIEVING HIGHER AND MORE INCLUSIVE GROWTH TO TACKLE UNEMPLOYEMENT

A. Medium-Term Outlook and Key Challenges

36. Tunisia's key medium-term challenges are to reduce high unemployment, especially among the youth, and to address regional economic disparities. Achieving higher and more inclusive medium-term growth will be necessary to generate sustainable and non-artificial job creation, especially for the youth and the educated, to reverse the trend of declining youth employment over the past decade. Staff's estimates indicate that the unemployment rate would remain above 19 percent over the medium term if Tunisia continues to grow at its historical growth rate. Reaching a real GDP growth of about 5 percent (on average during 2012–17) and making employment more responsive to growth would allow Tunisia to reduce the unemployment rate to 13 percent over the next five years (Appendix VI). For this, early adoption of reforms to increase labor market flexibility will be needed.



37. Tunisia could achieve a higher and more inclusive medium-term growth if obstacles to private investment are eliminated and external financing is mobilized. Real growth could reach 6 percent in 2017 despite the envisaged medium-term fiscal consolidation, if structural reforms to foster private investment are implemented, and about US$5 billion (including FDI inflows, borrowing by the government and the nongovernment corporate sector) is mobilized every year. Maintaining macroeconomic stability, improving governance and the business environment, ensuring a more balanced playing field for companies, and reforming the labor market and education system, in addition to reforming the banking system will be needed to foster domestic investment and attract foreign investments.

B. Resuming Fiscal Consolidation to Preserve Medium-Term Sustainability

38. Fiscal consolidation will need to be resumed over the medium term to preserve fiscal sustainability. As the Tunisian economy recovers over the medium term, the need for a growth-supporting fiscal stimulus will wane, allowing fiscal consolidation. In addition, Tunisia will need to maintain fiscal space to face potential contingent liabilities including deficits of pension funds, and

lower external financing. Staff stressed the need to implement a gradual fiscal consolidation bringing the fiscal deficit to about 2 percent of GDP by 2017 to maintain public debt below 50 percent of GDP. Without fiscal consolidation, public debt would increase to more than 60 percent over the medium term (Appendix VIII).

39. Containing public expenditures will be a key component of a medium-term fiscal consolidation plan. Controlling the public-sector wage bill through wage moderation and limiting new recruitments to replace retiring civil servants will be needed. Furthermore, a gradual reduction of food and energy subsidies, while putting in place appropriate social safety nets to protect the poor, would be necessary from a budget perspective. It will also be desirable from a social equity perspective because food and energy subsidies benefit more the richest segments of the population (Appendix VII). In this context, staff welcomes the authorities' intention to adjust energy prices upwards in 2012 and gradually reintroduce the automatic price adjustment mechanism for petroleum product prices that was suspended in early 2011.

40. Tax reforms would strengthen Tunisia's budgetary revenues over the medium term. Staff welcomed the authorities' plan to implement a comprehensive program of tax reforms to mobilize larger revenues, improve the equity and transparency of the tax system, foster investments in high-value-added sectors, and encourage job creation. This would include reducing tax benefits for exporting companies, rationalizing tax incentives in line with a revision of the investment code, enlarging the tax base, and strengthening tax administration.

41. Furthermore, reforming the social security system will help to contain expenditure pressures over the medium term. The two main pension funds in Tunisia, the CNRPS and CNSS, have recently started to record deficits while their reserves have decreased. In particular, the authorities indicated that the CNRPS (the pension fund for public employees) has depleted its reserves. In view of the demographic developments, the key parameters of the Tunisian pension system—retirement age, contributions rates, and retirement benefits—will need to be adjusted to maintain the financial viability of the funds and avoid transfers from the central government budget.

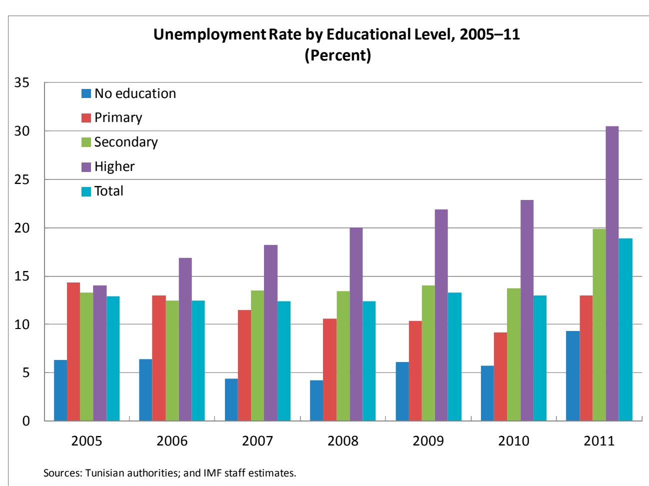
42. The authorities are committed to preserving medium-term fiscal sustainability and concurred broadly with staff analysis. They expressed their commitment to resuming a gradual fiscal consolidation as soon as the economy is on a sustained recovery path, with the objective of reducing public debt back to 40 percent of GDP over the medium term. Their consolidation strategy would entail containing the wage bill, better targeting food and energy subsidies, and tax reforms. The authorities have started to review existing social transfers to limit benefits leakages and to prepare the ground for introducing additional social safety nets to compensate for the impact of subsidy reform on the poor. Work on tax reform is being initiated, with the objectives of strengthening revenue, making the tax system more equitable and transparent, and supporting investment and growth. Finally, the authorities have started consultations to reform the Tunisian pension system to preserve its financial viability. However, most of these important but socially sensitive reforms will not be launched before the general elections in early 2013.

C. Structural Reforms

43. Tunisia's development model will need to be revisited to achieve higher and more inclusive growth. Exports are an important source of growth; preserving export competitiveness and diversifying Tunisia's export markets will be essential. However, Tunisia's development model was based on low-value-added industries, intensive in unskilled labor. Labor costs were kept low by means of the authorities' tight control over wage negotiations, extensive price controls, and occasional adjustments in the exchange rate. As a result, Tunisia's economy became excessively exposed to the tourism sector and economic conditions in Europe. The development model will have to be revisited to improve the value-added content of Tunisia's exports and support growth of higher-value-added industries to absorb skilled labor.

44. The authorities will need to reassess their intervention in the economy to improve the investment climate. Dual economic management contributed to exacerbating regional disparities. The offshore sector, concentrated in the coastal area, benefitted from fiscal and regulatory incentives that allowed the sector to attract substantial foreign investments and operate mostly free of state intervention. On the other hand, the onshore sector was subject to pervasive government intervention, excessive regulation, and limited competition. Government interventions were particularly pervasive in the financial and distribution sectors (price, market, and distribution controls), and likely contributed to the current difficulties in both sectors. A more balanced approach, including a gradual reduction of fiscal incentives for the offshore sector, would ensure a level playing field for all companies, allow the onshore sector to catch up, and contribute to reducing regional disparities.

45. There is a need for more attention to the skills mismatches in the labor market. The authorities have invested significant resources in the education system and have managed to significantly increase the share of the population with a higher degree. However, this was done with little regard for the needs of the labor market, especially because the authorities supported the development of low value-added labor-intensive industries. The result is a skill mismatch between labor demand and supply, with high unemployment among the educated workforce. Enhancing vocational training would help to address this skill mismatch. The limited access to finance and the constraints to private investment compounded the issue by reducing opportunities for educated youth to develop their own businesses.



46. **Addressing pockets of poverty and implementing targeted policies to protect the most vulnerable groups in the population will be needed.** Revised poverty estimates indicate that poverty rates and inequality are higher than previously stated, in particular in the underdeveloped regions of the interior. Reducing unemployment and regional disparities would also contribute to mitigate against poverty. In addition, targeted policies, including strengthening social safety nets, will be needed to protect the most vulnerable segments of the population through the economic transformation process.

47. **The authorities consider a new development model necessary to tackle high unemployment and regional disparities.** They have developed an ambitious reform program. The authorities have started discussing the reform of the investment code and the streamlining of fiscal and regulatory incentives to create a more level playing field. In addition, they plan to use public-private partnerships to foster investments, especially in the underdeveloped regions, and develop high-value-added industries. They also aim to improve the business climate by greater transparency and better governance in the economy.

STAFF APPRAISAL

48. **As Tunisia undergoes its historical transition since the January 2011 revolution, it is facing even more pressing economic and social challenges.** While the political transition has moved ahead relatively well so far, Tunisia experienced a severe economic recession in 2011, which brought the already high unemployment to a record level, especially for the youth. The authorities tried to mitigate the recession with large monetary and fiscal expansions, but these led to the buildup of vulnerabilities in the financial sector, inflationary pressures, and losses in foreign reserves. The authorities' challenge is to deal with persistent social tensions and spillovers from a possible worsening of the recession in Europe in the short term while preserving macroeconomic stability and enhancing potential for inclusive and higher growth in the medium term. A rebalancing of the policy mix is called for in the short term, with fiscal policy as the main policy tool to support economic growth, monetary policy directed toward containing inflationary pressures, and greater exchange rate flexibility helping to stabilize international reserves. Moreover, a new vision for the Tunisian economy and priority reforms will need to be identified early on so that the population and investors can regain confidence in the economic future and look beyond the short-term difficulties.

49. **Staff supports a well-targeted fiscal expansion to support short-term growth, to the extent that medium-term fiscal sustainability can be preserved.** Given a deteriorated environment in Europe, Tunisia's main trading partner, and the lingering wait-and see attitude of investors, a well-targeted countercyclical fiscal expansion, built on a pickup in public investment, will be necessary to support short-term economic growth and job creation. The still-reasonable level of public debt, together with the large external financing identified by the authorities for 2012, allow for such a fiscal stimulus this year. To that effect, staff urges the authorities to overcome execution capacity constraints and start effectively implementing their ambitious public investment plan,

particularly in favor of disadvantaged regions. At the same time, following a large increase in 2011, and in order to preserve medium-term fiscal sustainability, current spending should be contained through wage bill moderation and increases in energy prices to cap subsidies.

50. It is important for the authorities to firm up their plans for gradual fiscal consolidation over the medium term as growth picks up. The authorities' strategy appropriately aims at containing medium-term public expenditures and implementing tax reforms to strengthen budgetary revenues and make the tax system more equitable and growth-supportive. In particular, staff urges the authorities to take steps to control the wage bill by containing wage increases and new recruitment. Staff also encourages the authorities to develop a clear subsidy reform strategy, in consultation with stakeholders, and to move ahead with the reform of the pension system to ensure its medium-term financial viability.

51. There is a need for monetary policy tightening to contain inflationary pressures. While the accommodative stance of monetary policy implemented since 2011 has supported bank credit to the economy, inflationary pressures have been building up. The recent increase in the money market rate induced by the authorities' liquidity management will need to be accompanied by an increase in the policy rate if inflation does not subside. Staff also encourages the authorities to strengthen the institutional framework for formulating monetary policy by creating a monetary policy committee, with a view to enhancing a forward-looking focus on the inflation objective and improving the coordination between monetary and exchange rate policies.

52. Staff supports the introduction of a more flexible foreign exchange arrangement. Greater exchange rate flexibility will help to preserve CBT's foreign exchange reserves and increase the scope for monetary policy. Staff welcomes CBT's recent changes in its exchange rate policy operational framework. However, it will be essential that the CBT formalize the rules for its intervention in the foreign exchange market to allow the exchange rate to reflect market forces. Transparency could also be improved with the publication of the average exchange rates and the amount of interventions of the CBT in the foreign exchange market.

53. Staff urges moving forcefully ahead in addressing the vulnerabilities of the banking sector to safeguard financial stability. Recent measures to strengthen the very weak banking supervision and improve banks' solvency will need to be broadened and reinforced. Staff encourages the authorities to conduct audits of all public banks, define a calendar to discontinue regulatory forbearance, align banking supervision with international standards, and address decisively the resolution of high NPLs and banks' solvency issues. The CBT should develop an exit strategy to unwind gradually its large liquidity support to banks, which raises risks for the central bank balance sheet, while continuing to meet banks' liquidity needs. In doing so, the CBT should align its collateral requirements to international practices to protect its balance sheet, and should introduce a "lender of last resort" facility to deal with banks with insufficient eligible collateral.

54. It is necessary that the authorities lay the ground for a comprehensive set of reforms to achieve higher and more inclusive growth and reduce unemployment in a sustainable way. Fostering private investment is needed to put Tunisia on a higher medium-term growth path. Improving governance and the business environment, reforming the labor market and education system, and a comprehensive reform of the financial system are key. Furthermore, setting a more level playing field for all sectors, and targeting state intervention to develop high-value-added sectors, would strengthen domestic sources of growth and help to absorb skilled labor.

55. It is proposed that the next Article IV consultations take place on the standard 12–month cycle.

Figure 1. Tunisia: Recent Economic and Financial Indicators

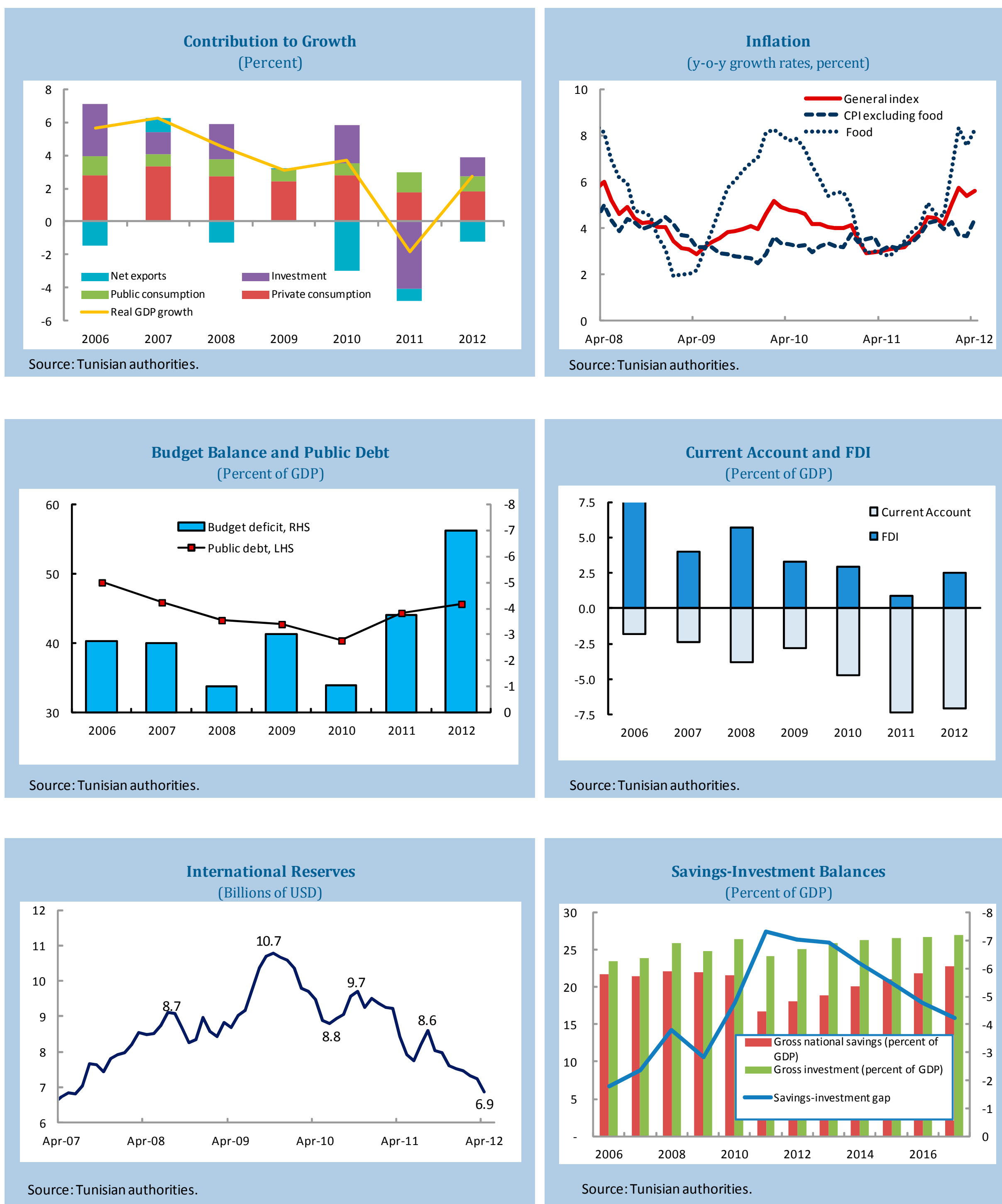
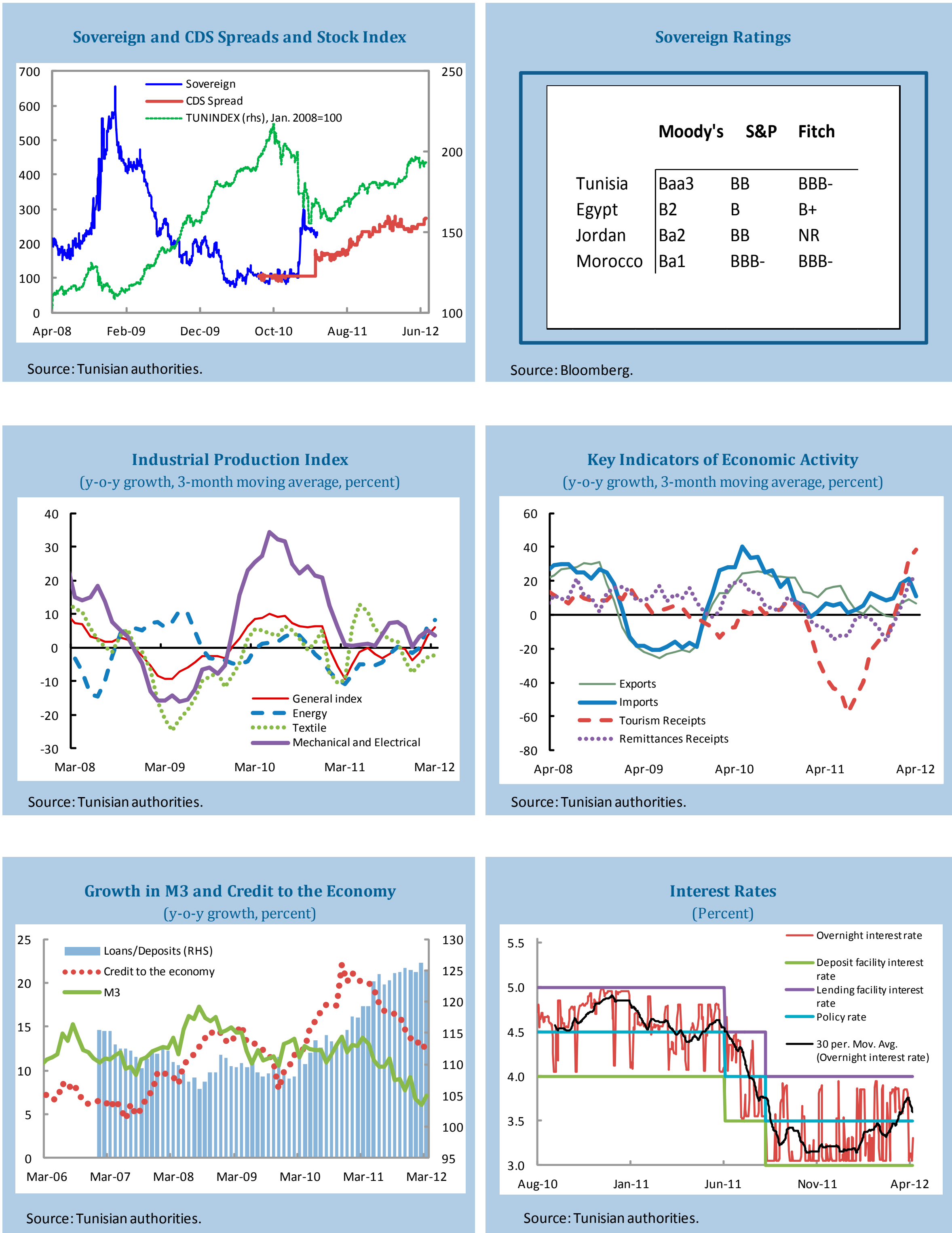


Figure 2. Tunisia: Selected Economic and Financial Indicators



	Moody's	S&P	Fitch
Tunisia	Baa3	BB	BBB-
Egypt	B2	B	B+
Jordan	Ba2	BB	NR
Morocco	Ba1	BBB-	BBB-

Table 1. Tunisia: Selected Economic and Financial Indicators, 2008–17

	2008	2009	2010	Est. 2011	Projections 2012	2013	2014	2015	2016	2017
Production and income (percent change)										
Nominal GDP	10.9	6.3	7.8	2.2	8.6	8.2	7.7	8.5	8.6	9.4
Real GDP	4.5	3.1	3.0	-1.8	2.7	3.5	4.1	5.3	5.5	6.0
GDP deflator	6.1	3.1	4.7	4.1	5.8	4.6	3.5	3.0	2.9	3.2
Consumer price index (CPI), average	4.9	3.5	4.4	3.5	5.0	4.0	3.5	3.5	3.5	3.5
Gross national savings (percent of GDP)	22.1	21.9	21.6	16.8	18.1	18.9	20.1	21.0	21.9	22.8
Gross investment (percent of GDP)	25.9	24.8	26.4	24.1	25.1	25.9	26.2	26.5	26.7	27.0
External sector (percent change)										
Exports of goods, f.o.b. (in $)	26.6	-24.8	14.0	8.5	0.9	5.3	7.5	9.3	9.8	10.6
Imports of goods, f.o.b. (in $)	28.7	-21.9	15.9	7.7	2.2	5.6	5.2	6.7	7.3	8.3
Exports of goods, f.o.b. (volume)	5.5	-9.6	6.7	-1.5	-1.5	4.8	7.7	9.7	9.3	9.6
Import of goods, f.o.b. (volume)	7.3	1.0	-1.8	-6.0	5.0	6.5	7.0	7.9	7.8	8.3
Trade balance (in percent of GDP)	-8.9	-8.5	-10.3	-10.4	-11.1	-11.4	-10.7	-9.8	-9.0	-8.2
Current account, excluding grants (percent of GDP)	-3.8	-2.8	-4.8	-7.3	-7.0	-6.9	-6.2	-5.5	-4.8	-4.2
Foreign direct investment (percent of GDP)	5.7	3.3	3.0	0.9	2.5	2.8	3.2	3.7	4.2	4.6
Terms of trade (deterioration -)	0.1	7.6	-9.6	-4.0	5.1	1.4	0.5	0.0	3.7	4.0
Real effective exchange rate (depreciation -) 1/	-0.7	-1.1	-0.5	-1.8	…	…	…	…	…	…
Central government (percent of GDP, unless otherwise indicated) 2/										
Total revenue, excluding grants and privatization	23.8	22.8	22.8	24.5	23.8	23.0	23.1	23.2	23.5	23.7
Total expenditure and net lending	24.8	25.8	23.9	28.2	30.8	28.1	27.2	26.5	26.1	25.7
Central government balance, excluding grants and privatization	-1.0	-3.0	-1.1	-3.7	-7.0	-5.1	-4.0	-3.4	-2.6	-2.0
Central government balance, including grants, excluding privatization	-0.7	-2.7	-1.0	-3.4	-6.4	-5.0	-3.9	-3.3	-2.5	-1.9
Total government debt (foreign and domestic)	43.3	42.8	40.4	44.4	45.7	50.5	50.7	49.9	48.7	46.4
Foreign currency public debt (percent of total debt)	60.8	58.5	60.7	58.0	61.4	58.5	59.5	59.7	60.3	61.5
Money and credit (percent change)										
Credit to the economy	14.0	10.3	19.6	13.5	5.3	…	…	…	…	…
Broad money (M3) 3/	14.4	13.0	12.1	9.2	10.8	…	…	…	…	…
Liquidity aggregate (M4)	14.2	12.7	12.2	9.2	10.8	…	…	…	…	…
Velocity of circulation (GDP/M3)	1.62	1.52	1.46	1.37	1.34	…	…	…	…	…
Interest rate (money market rate, percent, e.o.p) 4/	4.90	4.10	4.12	3.05	…	…	…	…	…	…
Official reserves										
Gross official reserves (US$ billions, e.o.p)	9.0	10.6	9.5	7.5	8.2	8.7	9.4	10.4	11.7	13.5
In months of imports of goods and services, c.i.f. 5/	4.4	6.6	5.1	3.8	4.0	4.0	4.2	4.3	4.5	4.8
Total external debt										
External debt (US$ billions)	20.6	21.5	21.4	22.0	24.2	26.1	27.7	29.1	30.2	31.3
External debt (percent of GDP)	48.8	48.2	48.5	51.0	53.7	55.8	56.9	56.9	56.1	54.8
Debt service ratio (percent of exports of GNFS)	8.6	11.9	10.5	11.7	10.4	9.8	9.1	8.5	7.6	6.8
Financial market indicators										
Stock market index 6/	2,892	4,292	5,113	4,722	4,984	…	…	…	…	…
Memorandum items:										
GDP at current prices (TD millions)	55,296	58,768	63,380	64,802	70,402	76,182	82,053	89,027	96,684	105,787
GDP at current prices (US$ billions)	44.9	43.5	44.3	46.0	46.1	48.0	49.9	52.4	55.1	58.5
GDP per capita (US$)	4,346	4,171	4,199	4,320	4,284	4,409	4,542	4,715	4,909	5,156
Unemployment rate (percent) 7/	12.6	13.3	13.0	18.9	…	…	…	…	…	…
Population (millions)	10.3	10.4	10.5	10.7	10.8	10.9	11.0	11.1	11.2	11.3
Exchange rate: dinar/US$ (average)	1.23	1.35	1.43	1.41	…	…	…	…	…	…

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

1/ Information Notice System.
2/ Excludes the social security accounts.
3/ Financial system (deposit money banks and development banks).
4/ 2011 data is the money market rate on 10/17/2011.
5/ End-of-year reserves over current year imports of goods and services.
6/ TUNINDEX (1000 = 12/31/1997), with 2012 data at 06/30/2012.
7/ New series based on the ILO definition of the labor force.

Table 2. Tunisia: Balance of Payments, 2008–17

(Millions of U.S. dollars, unless otherwise indicated)

	2008	2009	2010	Est. 2011	Projections 2012	2013	2014	2015	2016	2017
Current account	-1,712	-1,234	-2,105	-3,371	-3,245	-3,328	-3,077	-2,867	-2,630	-2,474
Trade balance	-4,010	-3,699	-4,575	-4,799	-5,141	-5,484	-5,321	-5,131	-4,954	-4,818
Exports	19,184	14,419	16,431	17,824	17,976	18,931	20,356	22,257	24,442	27,029
Energy	3,311	1,953	2,315	2,592	2,973	3,084	3,174	3,395	3,668	4,050
Non-energy	15,872	12,465	14,116	15,231	15,003	15,847	17,182	18,862	20,774	22,979
Imports	-23,194	-18,118	-21,006	-22,623	-23,117	-24,415	-25,677	-27,388	-29,396	-31,847
Energy	-3,988	-2,066	-2,653	-3,409	-3,748	-3,792	-3,725	-3,751	-3,846	-4,021
Non-energy	-19,206	-16,052	-18,353	-19,214	-19,369	-20,623	-21,951	-23,637	-25,550	-27,826
Of which: Nonfood	-17,095	-14,879	-16,810	-17,339	-17,648	-18,856	-20,145	-21,798	-23,685	-25,925
Services and transfers (net)	2,298	2,465	2,470	1,428	1,896	2,156	2,244	2,264	2,324	2,345
Nonfactor	2,643	2,525	2,460	1,552	1,867	2,319	2,629	2,930	3,107	3,215
Of which: Tourism	2,751	2,571	2,461	1,680	1,916	2,223	2,515	2,860	3,072	3,215
Factor Services and Transfers (net)	-345	-60	10	-124	29	-163	-385	-666	-784	-870
Of which: Workers' remittances	1,977	1,964	2,063	1,990	2,033	2,062	2,127	2,205	2,295	2,393
Interest payments on external debt	-742	-685	-632	-623	-655	-720	-745	-765	-764	-757
Capital and financial account	3,378	2,867	1,913	1,673	3,911	3,858	3,798	3,887	3,956	4,403
Excluding grants	3,296	2,699	1,822	1,506	3,751	3,698	3,637	3,725	3,794	4,239
Capital account	79	164	82	154	148	148	149	149	150	152
Financial account	3,299	2,702	1,831	1,519	3,763	3,710	3,650	3,737	3,806	4,251
Direct foreign investment (net)	2,562	1,437	1,309	417	1,166	1,337	1,621	1,946	2,319	2,706
Medium- and long-term loans (net)	-10	339	145	659	2,166	1,794	1,422	1,080	742	720
Disbursement	1,416	2,019	1,845	2,679	3,910	3,494	3,092	2,754	2,364	2,293
Amortization	-1,426	-1,679	-1,700	-2,020	-1,744	-1,700	-1,670	-1,674	-1,621	-1,573
Short-term capital	747	926	377	442	431	580	607	711	744	825
Errors and omissions	0	0	0	0	0	0	0	0	0	0
Overall balance	1,666	1,633	-192	-1,698	666	530	721	1,020	1,326	1,929
Changes in gross reserves 1/	-1,027	-1,623	1,078	1,984	-653	-523	-700	-989	-1,283	-1,868
Financing gap	…	…	…	…	0	0	0	0	0	0
Memorandum items:										
Current account balance/GDP (percent)	-3.8	-2.8	-4.8	-7.3	-7.0	-6.9	-6.2	-5.5	-4.8	-4.2
Reserves (in billions of US$)	9.0	10.6	9.5	7.5	8.2	8.7	9.4	10.4	11.7	13.5
Reserves in months of imports of goods 2/	4.4	6.6	5.1	3.8	4.0	4.0	4.2	4.3	4.5	4.8
Reserves in months of imports of goods and services 2/	4.0	6.0	4.7	3.5	3.7	3.8	3.9	4.0	4.2	4.5
Reserves/total short term external debt (percent) 3/	207.2	219.0	191.4	151.5	157.8	157.0	158.1	161.1	167.4	178.8
Excluding nonresidents deposits	462.1	470.0	401.4	327.6	341.2	339.4	537.6	548.0	569.2	608.2
Reserves/short-term debt (on remaining maturity basis) (percent)	158.1	161.5	142.8	109.6	118.8	120.8	124.1	128.6	136.4	148.7
Excluding nonresidents deposits	273.2	266.4	234.1	179.4	199.5	206.1	278.3	294.4	321.3	360.0
External medium- and long-term debt (billions of US$)	16.3	16.7	16.4	17.1	19.0	20.5	21.8	22.6	23.2	23.7
External medium- and long-term debt/GDP (percent)	38.5	37.4	37.2	39.5	42.1	43.9	44.7	44.3	43.1	41.5
External short-term debt (billions of US$)	4.3	4.8	5.0	5.0	5.2	5.5	5.9	6.4	7.0	7.6
External short-term debt/GDP (percent)	10.3	10.8	11.3	11.5	11.5	11.8	12.2	12.6	13.0	13.3
Debt service ratio (as percent XGS, including IMF)	8.6	11.9	10.5	11.7	10.4	9.8	9.1	8.5	7.6	6.8
Goods export real growth (percent)	5.5	-9.6	6.7	-1.5	-1.5	4.8	7.7	9.7	9.3	9.6
Nonenergy	6.6	-10.0	9.2	0.5	-2.1	4.3	7.4	9.2	8.9	9.1
Goods import real growth (percent)	7.3	1.0	-1.8	-6.0	5.0	6.5	7.0	7.9	7.8	8.3
Non-energy	6.3	3.6	-2.0	-6.4	5.6	6.6	7.2	8.1	7.9	8.4

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

1/ Differs from the overall balance because of valuation effects.
2/ End-of-year reserves over current year imports.
3/ Short-term defined as one year or less.

Table 3a. Tunisia: Central Government Financial Operations, 2008–17 1/

	2008	2009	2010	Est. 2011	LFC 2012	2012	2013	Projections 2014	2015	2016	2017
	(Millions of dinars)										
Total revenue and grants and privatization	13,504	13,575	14,504	16,438	19,504	18,480	18,033	19,482	21,110	22,911	25,296
Total revenue	13,165	13,392	14,450	15,847	17,904	16,741	17,533	18,982	20,610	22,711	25,096
Tax revenue	11,331	11,685	12,699	13,668	14,566	14,653	15,849	17,249	18,820	20,768	22,970
Direct taxes	4,561	4,646	5,033	5,936	6,302	6,238	6,780	7,385	7,968	8,895	9,902
Trade taxes	585	520	564	564	585	589	630	687	760	844	944
VAT	3,309	3,400	3,750	3,818	4,154	4,177	4,591	5,008	5,489	6,030	6,677
Domestic	1,627	1,714	1,730	1,865	2,070	2,013	2,209	2,380	2,582	2,804	3,068
Imports	1,682	1,685	2,020	1,953	2,084	2,163	2,382	2,629	2,907	3,226	3,609
Excise	1,465	1,596	1,563	1,512	1,580	1,559	1,866	2,035	2,270	2,465	2,698
Domestic	884	945	793	815	842	820	1,067	1,173	1,335	1,450	1,587
Imports	581	652	770	697	738	739	800	862	935	1,015	1,111
Other taxes	1,412	1,524	1,789	1,839	1,945	2,091	1,981	2,133	2,333	2,533	2,750
Domestic	1,288	1,372	1,617	1,675	1,851	1,971	1,752	1,887	2,065	2,243	2,433
Imports	124	151	173	164	94	120	229	246	267	290	317
Nontax revenue	1,826	1,702	1,736	2,172	2,130	2,080	1,676	1,723	1,781	1,934	2,116
Capital income	8	5	15	8	8	8	8	10	10	10	10
Total expenditure and net lending	13,724	15,164	15,125	18,275	22,472	21,667	21,415	22,301	23,623	25,247	27,177
Total expenditure	13,676	14,510	15,417	18,552	22,458	21,620	21,315	22,201	23,523	25,147	27,076
Current expenditure	10,495	10,644	11,274	13,816	16,206	16,175	16,028	16,663	17,736	18,862	20,242
Wages and salaries	5,732	6,269	6,755	7,659	8,618	8,614	9,140	9,518	10,327	11,215	12,271
Goods and services	881	1,010	1,059	1,093	1,078	1,151	1,219	1,231	1,335	1,479	1,619
Interest payments	1,143	1,180	1,152	1,190	1,300	1,285	1,410	1,657	1,733	1,821	1,882
Domestic	563	561	557	592	645	645	720	932	983	1,046	1,092
External	579	619	595	598	655	640	690	725	750	775	790
Transfers and subsidies	2,740	2,186	2,308	3,874	4,531	4,524	3,809	3,807	3,891	3,896	4,021
CGC	1,048	800	730	1,100	1,242	1,244	1,219	1,100	1,077	1,064	1,059
Energy subsidies	806	430	550	1,536	1,688	1,688	1,143	1,149	1,122	1,093	1,058
Other	886	956	1,028	1,238	1,601	1,592	1,447	1,559	1,692	1,740	1,904
Other expenditure (non-allocated)	0	0	0	0	679	600	450	450	450	450	450
Capital expenditure	3,181	3,866	4,144	4,735	6,252	5,446	5,287	5,539	5,787	6,284	6,834
Direct investment	1,538	1,862	1,751	1,884	2,491	2,806	2,590	2,790	3,027	3,287	3,597
Capital transfers and equity	1,643	2,004	2,393	2,852	3,036	2,640	2,697	2,749	2,760	2,997	3,237
Other expenditure (non-allocated)	0	0	0	0	726	0	0	0	0	0	0
Net lending	47	654	-293	-277	14	46	100	100	100	100	101
Central government deficit (-) (excluding grants and privatization)	-559	-1,771	-675	-2,428	-5,768	-4,925	-3,883	-3,320	-3,013	-2,536	-2,081
Grants	192	183	54	207	600	438	100	100	100	100	100
Privatization proceeds 2/	147	0	0	383	2,200	1,300	400	400	400	100	100
Central government deficit (-) (including grants and privatization)	-220	-1,589	-621	-1,837	-2,968	-3,187	-3,383	-2,820	-2,513	-2,336	-1,881
Financing	220	1,589	621	1,837	2,968	3,187	3,383	2,820	2,513	2,336	1,881
Foreign	131	-25	-230	458	2,511	2,574	2,127	1,630	1,180	1,186	1,186
Drawings		1,163	1,225	2,465	4,330	4,403	3,889	3,399	3,016	3,022	3,022
Amortization		1,188	1,455	1,986	1,829	1,829	1,762	1,769	1,836	1,836	1,836
Domestic	89	1,613	851	1,379	457	613	3,922	1,190	1,333	1,149	695
Drawings		1,024	635	1,335	1,427	1,373	3,822	1,190	1,333	1,149	694
Amortization		874	1,010	421	960	960	200	200	200	200	200
Other		1,466	1,226	465	0	200	300	200	200	200	201
Contingent liabilities 4/		0	0	0	0	0	-2,666	0	0	0	0
Financing gap		0	0	0	0	0	0	0	0	0	0
Memorandum items:											
Balance of the central government (including grants, excluding private)	-367	-1,589	-621	-2,220	-5,168	-4,487	-3,783	-3,220	-2,913	-2,436	-1,981
Central government primary balance	922	-409	531	-647	-1,668	-1,901	-1,973	-1,163	-780	-514	0
Central government primary balance (excluding grants and privatization)	584	-591	477	-1,238	-4,468	-3,640	-2,473	-1,663	-1,280	-714	-200
General government debt 3/	23,967	25,143	25,620	28,766	31,934	32,171	38,456	41,585	44,432	47,042	49,130
Of which: Domestic	9,407	10,428	10,069	12,076	12,317	12,405	15,941	16,845	17,885	18,677	18,935
External	14,560	14,715	15,551	16,690	19,617	19,766	22,515	24,741	26,547	28,365	30,195
Nominal GDP	55,296	58,768	63,380	64,802	69,512	70,402	76,182	82,053	89,027	96,684	105,787
Nominal nonagricultural GDP	50,944	53,883	58,743	59,559	..	64,737	70,109	75,572	82,111	89,304	97,911
Oil price ($/barrel)	97.0	61.8	79.0	104.0	110.0	114.7	110.0	102.8	97.2	93.3	91.0

Sources: Tunisian authorities; and IMF staff estimates.

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

2/ Privatization receipts from Tunisie Telecom (TT) in 2006 were about TD 3000 millions. Only about TD 430 millions have been used in 2006 and about TD 336 millions in 2007, with about TD 2500 millions remaining available at end-2011. IMF-staff projections for privatization receipts in 2012 include TD 300 million from the confiscated assets while the authorities' projections include TD 1200 million.

3/ Gross debt: includes debt held by social security funds (CSS); excludes debt of public enterprises.

4/ Contingent liabilities in 2013 refer to the expected recapitalization of public banks. This preliminary estimate could be revised upwards.

Table 3a. Tunisia: Central Government Financial Operations, 2008–17 1/ (concluded)

	2008	2009	2010	Est. 2011	LFC 2012	Projections 2012	2013	2014	2015	2016	2017
					(Percent of GDP)						
Total revenue and grants and privatization	24.4	23.9	22.9	25.4	28.1	26.2	23.7	23.7	23.7	23.7	23.9
Total revenue	23.8	22.8	22.8	24.5	25.8	23.8	23.0	23.1	23.2	23.5	23.7
Tax revenue	20.5	19.9	20.0	21.1	21.0	20.8	20.8	21.0	21.1	21.5	21.7
Direct taxes	8.2	7.9	7.9	9.2	9.1	8.9	8.9	9.0	9.0	9.2	9.4
Trade taxes	1.1	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.9	0.9	0.9
Trade taxes (percent of non-oil imports)	2.2	2.2	1.9	1.8	1.7	1.8	1.7	1.7	1.7	1.7	1.7
VAT	6.0	5.8	5.9	5.9	6.0	5.9	6.0	6.1	6.2	6.2	6.3
Domestic	2.9	2.9	2.7	2.9	3.0	2.9	2.9	2.9	2.9	2.9	2.9
Imports	3.0	2.9	3.2	3.0	3.0	3.1	3.0	3.2	3.3	3.3	3.4
Imports (percent of non-oil imports)	6.2	7.1	7.0	6.4	6.2	6.4	6.4	6.5	6.5	6.5	6.5
Excise	2.6	2.7	2.5	2.3	2.3	2.2	2.5	2.5	2.6	2.6	2.6
Domestic	1.6	1.6	1.3	1.3	1.2	1.2	1.4	1.4	1.5	1.5	1.5
Imports	1.1	1.1	1.2	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Imports (percent of non-oil imports)	2.1	2.8	2.7	2.3	2.2	2.3	2.3	2.7	2.7	2.7	2.7
Other taxes	2.6	2.6	2.8	2.8	2.8	3.0	2.6	2.6	2.6	2.6	2.6
Domestic	2.3	2.3	2.6	2.6	2.8	2.8	2.3	2.3	2.3	2.3	2.3
Imports	0.2	0.3	0.3	0.3	0.1	0.2	0.3	0.3	0.3	0.3	0.3
Imports (percent of non-oil imports)	0.5	0.6	0.6	0.5	0.1	0.6	0.6	0.6	0.6	0.6	0.6
Nontax revenue	3.3	2.9	2.7	3.4	3.1	3.0	2.2	2.1	2.0	2.0	2.0
Capital income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	24.8	25.8	23.9	28.2	32.3	30.8	28.1	27.2	26.6	26.2	25.9
Total expenditure	24.7	24.7	24.3	28.6	32.3	30.7	28.0	27.1	26.5	26.1	25.8
Current expenditure	19.0	18.1	17.8	21.3	23.3	23.0	21.0	20.3	20.0	19.6	19.3
Wages and salaries	10.4	10.7	10.7	11.8	12.4	12.2	12.0	11.6	11.6	11.6	11.6
Goods and services	1.6	1.7	1.7	1.7	1.6	1.6	1.6	1.5	1.5	1.5	1.5
Interest payments	2.1	2.0	1.8	1.8	1.9	1.8	1.9	2.0	1.9	1.9	1.8
Domestic	1.0	1.0	0.9	0.9	0.9	0.9	0.9	1.1	1.1	1.1	1.0
External	1.0	1.1	0.9	0.9	0.9	0.9	0.9	0.9	0.8	0.8	0.7
Transfers and subsidies	5.0	3.7	3.6	6.0	6.5	6.4	5.0	4.6	4.4	4.0	3.8
CGC	1.9	1.4	1.2	1.7	1.8	1.8	1.6	1.3	1.2	1.1	1.0
Petroleum subsidies	1.5	0.7	0.9	2.4	2.4	2.4	1.5	1.4	1.3	1.1	1.0
Other	1.6	1.6	1.6	1.9	2.3	2.3	1.9	1.9	1.9	1.8	1.8
Other expenditure (non-allocated)	0.0	0.0	0.0	0.0	1.0	0.9	0.6	0.6	0.6	0.6	0.6
Capital expenditure	5.8	6.6	6.5	7.3	9.0	7.7	6.9	6.8	6.5	6.5	6.5
Direct investment	2.8	3.2	2.8	2.9	3.6	4.0	3.4	3.4	3.4	3.4	3.4
Capital transfers and equity	3.0	3.4	3.8	4.4	4.4	3.8	3.5	3.4	3.1	3.1	3.1
Other expenditure (non-allocated)	0.0	0.0	0.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	0.1	1.1	-0.5	-0.4	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Central government deficit (-), (excluding grants and privatization)	-1.0	-3.0	-1.1	-3.7	-8.3	-7.0	-5.1	-4.0	-3.4	-2.6	-2.0
Grants	0.3	0.3	0.1	0.3	0.9	0.6	0.1	0.1	0.1	0.1	0.1
Privatization proceeds 2/	0.3	0.0	0.0	0.6	3.2	1.8	0.5	0.5	0.4	0.1	0.1
Central government deficit (-), (including grants and privatization)	-0.4	-2.7	-1.0	-2.8	-4.3	-4.5	-4.4	-3.4	-2.8	-2.4	-1.8
Financing	0.4	2.7	1.0	2.8	4.3	4.5	4.4	3.4	2.8	2.4	1.8
Foreign	0.2	0.0	-0.4	0.7	3.6	3.7	2.8	2.0	1.3	1.2	1.1
Domestic	0.2	2.7	1.3	2.1	0.7	0.9	5.1	1.5	1.5	1.2	0.7
Contingent liabilities 4/	0.0	0.0	0.0	0.0	0.0	0.0	-3.5	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:		`									
Balance of the central government (including grants, excluding privatization)	-0.7	-2.7	-1.0	-3.4	-7.4	-6.4	-5.0	-3.9	-3.3	-2.5	-1.9
Central government primary balance	1.7	-0.7	0.8	-1.0	-2.4	-2.7	-2.6	-1.4	-0.9	-0.5	0.0
Central government primary balance (excluding grants and privatization)	1.1	-1.0	0.8	-1.9	-6.4	-5.2	-3.2	-2.0	-1.4	-0.7	-0.2
General government debt 3/	43.3	42.8	40.4	44.4	45.9	45.7	50.5	50.7	49.9	48.7	46.4
Of which: Domestic	17.0	17.7	15.9	18.6	17.7	17.6	20.9	20.5	20.1	19.3	17.9
External	26.3	25.0	24.5	25.8	28.2	28.1	29.6	30.2	29.8	29.3	28.5

Sources: Tunisian authorities; and IMF staff estimates.

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

2/ Privatization receipts from Tunisie Telecom (TT) in 2006 were about TD 3000 millions. Only about TD 430 millions have been used in 2006 and about TD 336 millions in 2007, with about TD 2500 millions remaining available at end-2011. IMF-staff projections for privatization receipts in 2012 include TD 300 million from the sale of confiscated assets while the authorities' projections include TD 1200 million.

3/ Gross debt: includes debt held by social security funds (CSS); excludes debt of public enterprises.

4/ Contingent liabilities in 2013 refer to the expected recapitalization of public banks. This preliminary estimate could be revised upwards.

Table 3b. Tunisia: Statement of Central Government Operations GFSM 2011 Presentation, 2008–17 1/

			Est.	Projections						
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
					(Millions of dinars)					
Revenue (a)	**13,357**	**13,575**	**14,504**	**16,055**	**17,180**	**17,633**	**19,082**	**20,710**	**22,811**	**25,196**
Taxes	11,331	11,685	12,699	13,668	14,653	15,849	17,249	18,820	20,768	22,970
Taxes on income, profits and capital gains	4,561	4,646	5,033	5,936	6,238	6,780	7,385	7,968	8,895	9,902
Taxes on goods and services	4,774	4,996	5,313	5,330	5,736	6,458	7,043	7,759	8,496	9,374
Taxes on international trade and transactions	585	520	564	564	589	630	687	760	844	944
Other taxes	1,412	1,524	1,789	1,839	2,091	1,981	2,133	2,333	2,533	2,750
Grants	192	183	54	207	438	100	100	100	100	100
Other revenue 2/	1,834	1,707	1,751	2,179	2,088	1,684	1,733	1,791	1,944	2,126
Expenditure (b)	**13,676**	**14,510**	**15,417**	**18,552**	**21,620**	**21,315**	**22,201**	**23,523**	**25,147**	**27,076**
Expense (b.1)	12,139	12,648	13,666	16,668	18,815	18,725	19,412	20,496	21,860	23,479
Compensation of employees	5,732	6,269	6,755	7,659	8,614	9,140	9,518	10,327	11,215	12,271
Goods and services	881	1,010	1,059	1,093	1,151	1,219	1,231	1,335	1,479	1,619
Interest payments	1,143	1,180	1,152	1,190	1,285	1,410	1,657	1,733	1,821	1,882
Domestic	563	561	557	592	645	720	932	983	1,046	1,092
External	579	619	595	598	640	690	725	750	775	790
Subsidies	1,854	1,230	1,280	2,636	2,932	2,362	2,248	2,199	2,156	2,117
Grants	886	956	1,028	1,238	1,592	1,447	1,559	1,692	1,740	1,904
Capital transfers	1,643	2,004	2,393	2,852	2,640	2,697	2,749	2,760	2,997	3,237
Net acquisition of nonfinancial assets (b.2)	1,538	1,862	1,751	1,884	2,806	2,590	2,790	3,027	3,287	3,597
Gross operating balance (a-b.1)	1,218	927	837	-613	-1,635	-1,093	-330	214	952	1,716
Net lending/borrowing (a-b) (Overall balance)	**-320**	**-935**	**-914**	**-2,497**	**-4,441**	**-3,683**	**-3,120**	**-2,813**	**-2,336**	**-1,880**
Net adquisition of financial assets	-100	654	-293	-660	-1,254	2,366	-300	-300	0	1
Domestic	-100	654	-293	-660	-1,254	2,366	-300	-300	0	1
Loans (net lending by the treasury)	47	654	-293	-277	46	2,766	100	100	100	101
Shares and other equity 2/	-147	0	0	-383	-1,300	-400	-400	-400	-100	-100
Net incurrence of liabilities	220	1,589	621	1,837	3,187	6,049	2,820	2,513	2,336	1,881
Domestic	89	1,613	851	1,379	613	3,922	1,190	1,333	1,149	695
Loans	89	1,613	851	1,379	613	3,922	1,190	1,333	1,149	695
Foreign	131	-25	-230	458	2,574	2,127	1,630	1,180	1,186	1,186
Loans	131	-25	-230	458	2,574	2,127	1,630	1,180	1,186	1,186
Memorandum items:										
Primary balance	823	245	238	-1,307	-3,155	-2,273	-1,463	-1,080	-514	1
General government debt 3/	23,967	25,143	25,620	28,766	32,171	38,456	41,585	44,432	47,042	49,130
Of which: Domestic	9,407	10,428	10,069	12,076	12,405	15,941	16,845	17,885	18,677	18,935
External	14,560	14,715	15,551	16,690	19,766	22,515	24,741	26,547	28,365	30,195
					(Percent of GDP)					
Revenue (a)	**24.4**	**23.9**	**22.9**	**25.4**	**26.2**	**23.7**	**23.7**	**23.7**	**23.7**	**23.9**
Taxes	20.5	19.9	20.0	21.1	20.8	20.8	21.0	21.1	21.5	21.7
Grants	0.3	0.3	0.1	0.3	0.6	0.1	0.1	0.1	0.1	0.1
Other revenue	3.6	2.9	2.8	4.0	4.8	2.7	2.6	2.5	2.1	2.1
Expenditure (b)	**24.7**	**24.7**	**24.3**	**28.6**	**30.7**	**28.0**	**27.1**	**26.5**	**26.1**	**25.8**
Expense (b.1)	22.0	21.5	21.6	25.7	26.7	24.6	23.7	23.1	22.7	22.4
Compensation of employees	10.4	10.7	10.7	11.8	12.2	12.0	11.6	11.6	11.6	11.6
Goods and services	1.6	1.7	1.7	1.7	1.6	1.6	1.5	1.5	1.5	1.5
Interest payments	2.1	2.0	1.8	1.8	1.8	1.9	2.0	1.9	1.9	1.8
Subsidies	3.4	2.1	2.0	4.1	4.2	3.1	2.7	2.5	2.2	2.0
Grants	1.6	1.6	1.6	1.9	2.3	1.9	1.9	1.9	1.8	1.8
Capital transfers	3.0	3.4	3.8	4.4	3.8	3.5	3.4	3.1	3.1	3.1
Net acquisition of nonfinancial assets (b.2)	2.8	3.2	2.8	2.9	4.0	3.4	3.4	3.4	3.4	3.4
Gross operating balance (a-b.1)	2.5	2.4	1.3	-0.4	-0.5	-0.9	0.0	0.6	1.0	1.6
Net lending/borrowing (a-b) (Overall balance)	**-0.3**	**-0.8**	**-1.4**	**-3.3**	**-4.5**	**-4.3**	**-3.4**	**-2.8**	**-2.4**	**-1.8**
Net adquisition of financial assets	0.1	1.1	-0.5	-0.4	0.1	0.1	0.1	0.1	0.1	0.1
Loans (net lending by the treasury)	0.1	1.1	-0.5	-0.4	0.1	0.1	0.1	0.1	0.1	0.1
Net incurrence of liabilities	0.4	2.7	1.0	2.8	4.5	7.9	3.4	2.8	2.4	1.8
Domestic	0.2	2.7	1.3	2.1	0.9	5.1	1.5	1.5	1.2	0.7
Foreign	0.2	0.0	-0.4	0.7	3.7	2.8	2.0	1.3	1.2	1.1
Memorandum items:										
Primary balance	1.7	-0.7	0.8	-1.0	-2.7	-2.6	-1.4	-0.9	-0.5	0.0
General government debt 3/	43.3	42.8	40.4	44.4	45.7	50.5	50.7	49.9	48.7	46.4
Of which: Domestic	17.0	17.7	15.9	18.6	17.6	20.9	20.5	20.1	19.3	17.9
External	26.3	25.0	24.5	25.8	28.1	29.6	30.2	29.8	29.3	28.5

Sources: Tunisian authorities; and staff estimates.

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

2/ Includes privatization receipts; in 2006 from Tunisie Telecom (TT) of about TD 3000 millions.

3/ Gross debt: includes debt held by social security funds (CSS); excludes debt of public enterprises.

Table 4. Tunisia: Monetary Survey (Financial System), 2007–12

	2007	2008	2009	2010	Est. 2011	Proj. 2012
	(Millions of dinars)					
Foreign assets (net)	6,592	8,176	9,631	9,078	5,779	7,253
Foreign assets	11,715	13,528	16,138	16,023	12,913	14,487
Central Bank of Tunisia	9,719	11,773	13,978	13,705	11,316	12,825
Foreign liabilities	-5,123	-5,352	-6,508	-6,946	-7,134	-7,234
Net domestic assets	23,262	25,971	28,960	34,190	41,473	45,113
Domestic credit	34,355	38,471	42,795	49,710	57,006	60,017
Credit to the government (net)	5,675	5,782	6,735	6,566	8,050	8,462
Central bank net credit	-256	-326	-337	-560	-605	-544
Commercial banks	2,817	2,501	3,060	2,937	3,568	3,758
Other	3,114	3,607	4,012	4,189	5,086	5,249
Credit to the economy	28,681	32,689	36,061	43,144	48,956	51,555
Other items (net)	-11,094	-12,499	-13,835	-15,520	-15,533	-14,904
Money plus quasi-money (M2)	28,197	32,294	36,497	40,854	44,687	49,331
Money (M1)	11,083	12,392	14,266	15,862	19,061	21,042
Currency	4,099	4,400	5,010	5,518	6,816	7,361
Demand deposits	6,984	7,993	9,256	10,344	12,246	13,681
Quasi-money	17,115	19,901	22,231	24,992	25,626	28,289
Long-term deposits (M3-M2)	1,656	1,854	2,094	2,414	2,565	3,035
Broad money (M3) 1/	29,853	34,148	38,591	43,267	47,252	52,366
	(Annual rate of change in percent)					
Foreign assets (net)	13.7	24.0	17.8	-5.7	-36.3	25.5
Domestic credit	9.7	12.0	11.2	16.2	14.7	5.3
Credit to government (net)	9.9	1.9	16.5	-2.5	22.6	5.1
Credit to the economy	9.6	14.0	10.3	19.6	13.5	5.3
Money and quasi-money (M2)	13.5	14.5	13.0	11.9	9.4	10.4
Broad money (M3)	12.5	14.4	13.0	12.1	9.2	10.8
	(Annual growth rates, percent of broad money)					
Foreign assets (net)	3.0	5.3	4.3	-1.4	-7.6	3.1
Domestic credit	11.4	13.8	12.7	17.9	16.9	6.4
Credit to the government (net)	1.9	0.4	2.8	-0.4	3.4	0.9
Credit to the economy	9.5	13.4	9.9	18.4	13.5	5.5
Other items (net)	-2.0	-4.7	-3.9	-4.4	0.0	1.3
Memorandum items:						
Velocity (GDP/M3)	1.67	1.62	1.52	1.46	1.37	1.34
Multiplier (M3/M0)	4.75	4.29	4.28	5.31	4.57	4.89
GDP	49,874	55,296	58,768	63,380	64,802	70,402
Nominal GDP growth	9.0	10.9	6.3	7.8	2.2	8.6

Sources: Tunisian authorities; and IMF staff estimates and projections.
1/ M2 plus long-term deposits.

Table 5. Tunisia. Illustrative Medium-Term Growth Scenario, 2010–17
(Percent of GDP, unless otherwise indicated)

		Est.	Projections					
	2010	2011	2012	2013	2014	2015	2016	2017
Real GDP growth (percent change)	3.0	-1.8	2.7	3.5	4.1	5.3	5.5	6.0
Agriculture 1/	-2.0	9.2	2.9	3.1	3.1	3.1	3.1	3.1
Nonagriculture	4.3	-2.7	2.7	3.5	4.2	5.5	5.7	6.3
Unemployment rate 2/	13.0	18.3	…	…	…	…	…	…
Inflation	4.4	3.5	5.0	4.0	3.5	3.5	3.5	3.5
Real export growth 3/	4.9	-4.8	2.9	7.8	9.6	11.1	9.3	8.8
Gross national savings	21.6	16.8	18.1	18.9	20.1	21.0	21.9	22.8
Consolidated government 4/	5.6	4.0	1.5	2.1	3.0	3.4	4.2	4.8
Rest of the economy	16.0	12.7	16.6	16.8	17.1	17.7	17.7	17.9
Gross investment	26.4	24.1	25.1	25.9	26.2	26.5	26.7	27.0
Consolidated government	6.6	7.3	7.8	7.0	6.8	6.5	6.5	6.5
Rest of the economy	19.8	16.8	17.3	18.9	19.5	20.0	20.1	20.5
Total consumption	79.0	83.0	82.0	80.7	79.1	77.7	76.7	75.8
Private consumption	62.7	65.0	63.4	62.5	61.5	60.0	59.0	58.1
Public consumption	16.3	18.0	18.6	18.3	17.7	17.7	17.7	17.7
Savings-investment gap	-4.8	-7.3	-7.0	-6.9	-6.2	-5.5	-4.8	-4.2
Consolidated government	-0.9	-3.3	-6.3	-4.9	-3.8	-3.2	-2.4	-1.6
Rest of the economy	-3.8	-4.0	-0.8	-2.1	-2.3	-2.3	-2.4	-2.6
Real GDP (percent change) 5/	3.0	-1.8	2.7	3.5	4.1	5.3	5.5	6.0
Total consumption	4.5	3.8	3.2	2.5	2.0	2.9	3.6	4.4
Private consumption (residual)	4.5	2.8	2.7	2.5	2.4	2.3	3.2	4.1
Public consumption	4.4	7.6	6.9	2.3	0.7	5.1	4.9	5.5
Investment	9.3	-15.5	5.3	5.1	6.3	6.5	8.4	9.7
Gross fixed capital formation	4.1	-16.0	5.5	5.2	6.5	6.7	8.7	10.0
Change in stocks	156.0	-9.8	2.7	3.5	4.1	4.6	5.5	6.0
Exports of goods and nfs	12.6	-4.8	2.9	7.8	9.6	11.1	9.3	8.8
Imports of goods and nfs	17.5	-3.0	4.8	6.3	6.8	7.7	7.6	8.1
Memorandum items:								
Balance of the consolidated government	-0.9	-3.3	-6.3	-4.9	-3.8	-3.2	-2.4	-1.6
External current account	-4.8	-7.3	-7.0	-6.9	-6.2	-5.5	-4.8	-4.2
Gross fixed capital formation	24.3	22.0	23.0	23.7	24.1	24.4	24.6	25.0

Sources: Tunisian authorities; and IMF staff estimates.

1/ Based on average growth of agricultural output from 2001 onwards.
2/ New series based on the ILO definition of the labor force.
3/ Goods and nonfactor services.
4/ Includes social security, excludes privatization receipts.
5/ Real growth rate.

APPENDIX I. TUNISIA: RESERVE ADEQUACY

While the level of reserves at end-2011 remains adequate based on traditional metrics, it has been declining rapidly over the past two years (a cumulative 30 percent decline). Using standard rules of thumb, it appears that the current reserve level can provide a sufficient buffer against risks emanating from current account shocks (three-month import coverage), short-term liabilities (100 percent cover of short-term debt), and risks of capital flight (20 percent of broad money).[1]

However, a broader-based measure of reserve adequacy suggests that the recent decline in reserves has left Tunisia more vulnerable to shocks. Looking at a composite reserve adequacy (RA) metric that combines risks based on short-term debt, other portfolio liabilities, broad money and export earnings, it appears that the current level of reserves has fallen below the range considered safe from a precautionary perspective. Specifically, a recent IMF study suggests that a level of reserves covering between 100 and 150 percent of the RA metric provides adequate buffers for crisis prevention or for mitigating the effects of a crisis.[2] In the case of Tunisia, the coverage was only around 77 percent at end-2011. Comparatively, Tunisia's level of reserves in percent of the RA metric is lower than those of other Arab countries in transition (see figure below).

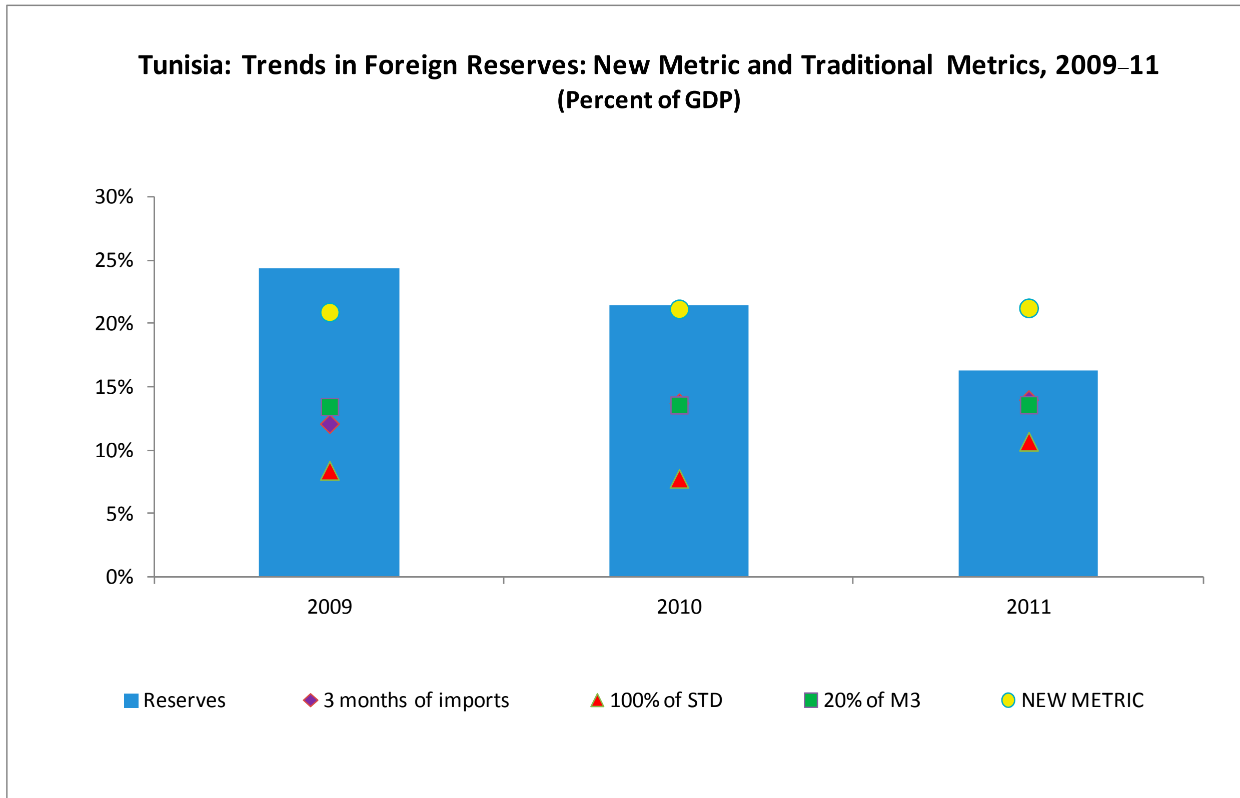
Tunisia: Reserve Adequacy Measures, 2009–12

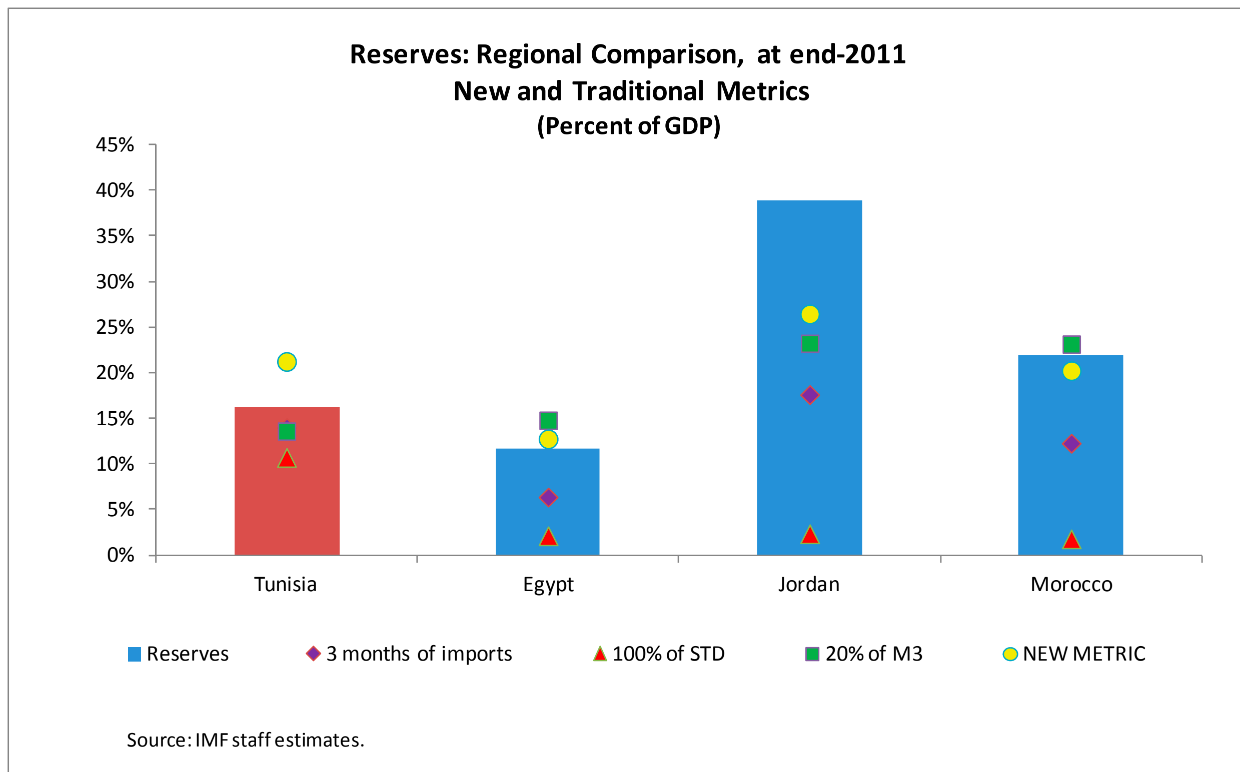
	2009	2010	2011	2012
Reserves in:				
Percent of GDP	24.3	21.5	16.3	17.7
Months of imports	6.6	5.1	3.8	4.0
Percent of short-term debt	219.0	191.4	151.5	157.8
Excluding nonresidents deposits	470.0	401.4	327.6	341.2
Percent of short-term debt (remaining maturity)	161.5	142.8	109.6	118.8
Excluding nonresidents deposits	266.4	234.1	179.4	199.5
Percent of broad money	39.2	33.3	23.7	25.3
Percent of RA indicator	116.2	101.4	76.5	…

Source: IMF staff estimates.

[1] Broad money is used to represent the stock of liquid domestic assets that could be sold or transferred into foreign assets in the event of a crisis (assuming that deposits included in broad money are largely domestic local currency deposits).

[2] Assessing Reserve Adequacy, February 14, 2011 (http://www.imf.org/external/pp/longres.aspx?id=4547).





Source: IMF staff estimates.

APPENDIX II. TUNISIA: EXCHANGE RATE AND EXTERNAL STABILITY ASSESSMENT

Tunisia's equilibrium real effective exchange rate has been following a decreasing trend, reflecting an increase in openness and a deterioration in the terms of trade which have more than offset gains in productivity relative to trading partners.

Staff analysis points to the Tunisian dinar being slightly overvalued but broadly in line with medium-term fundamentals. These results are based on the three CGER methods, namely the macroeconomic balance (MB), the equilibrium real exchange rate (ERER), and the external sustainability (ES) approaches. They take into account medium-term projections under staff's baseline scenario, which assumes a gradual but steady improvement in the external and fiscal positions. This analysis, therefore, does not preclude possible pressures on the exchange rate in the short term which could stem from a deterioration in the external environment.

The MB approach implies a current account (CA) norm that is lower than staff's projected medium-term CA balance (-2.2 vs. -4.2 percent of GDP). To close the gap between the two, the real effective exchange rate (REER) would need to depreciate by about 7 percent.

Exchange Rate Assessment Using CGER Panel Estimates
(Percent)

	Underlying CA balance 1/	CA norm	REER misalignment
MB approach 2/	-4.2	-2.2	6.7
ERER approach	…	…	5.1
ES approach	-4.2	-4.0	0.9

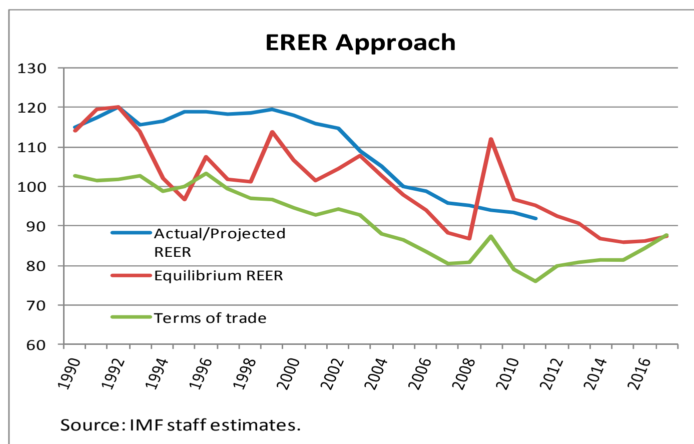
Overvaluation (+); undervaluation (-)

Source: IMF staff estimates.

1/ In 2017.

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

The ES approach indicates an exchange rate close to equilibrium. To stabilize Tunisia's net foreign asset position at its precrisis (2010) position, the REER would need to depreciate by less than 1 percent.



Source: IMF staff estimates.

ERER estimates suggest an overvaluation of about 5 percent. This result is based on a country-specific long-run co-integration relationship estimated for the reduced-form ERER. The ERER is determined by the terms of trade (*ToT*), trade openness (*open*), and the evolution of output per worker in Tunisia (*tunprod*) and in its partner countries (*partprod*):

$$\ln(ERER) = 10.38 + 0.39\ln(ToT) - 0.70\ln(open) + 1.26\ln(tunprod) - 2.21\ln(partprod)$$

APPENDIX III. TUNISIA: RISK ASSESSMENT MATRIX

Tunisia: Risk Assessment Matrix[1]

	Up/down side	Risk	Impact/Policy response
Risks to the economic outlook			
Strong intensification of the euro zone crisis	↓	M	**Impact**: High. Europe accounts for 80 percent of exports, and tourism receipts and over 70 percent of FDI. **Policy response**: Allow more flexibility in the exchange rate to stabilize foreign reserves; more external financing may be needed.
Escalation of domestic social tensions and delayed political transition	↓	M	**Impact:** High. Social unrest and prolonged political uncertainties would hamper foreign and domestic investment. **Policy response**: Use fiscal policy supportively and re-orient public expenditures composition to respond to more pressing social demands.
Shortfall in external financing	↓	M	**Impact**: High. A significant shortfall in external financing would constrain implementation of growth-supporting fiscal stimulus. **Policy response**: Adjust public expenditures to available financing while preserving well-targeted capital spending.
Oil price hike	↓	L	**Impact**: Low. Tunisia's net hydrocarbon external balance is relatively small, as it both imports and exports hydrocarbon products. **Policy response**: Adjust upwards petroleum products prices to reduce budgetary impact of subsidies.
Rapid stabilization of situation in Libya	↑	M	**Impact:** High. This would improve significantly trade between the two countries and bolster investor's confidence. **Policy response:** Revise downwards the magnitude of envisaged growth-supporting fiscal stimulus.
Risks to the financial sector			
Banks insolvency	↓	M/H	**Impact**: High. Would result in much larger bank recapitalization needs, increased public debt and would undermine the banking sector's contribution to growth. **Policy response**: Accelerate restructuring and recapitalization of insolvent banks, with public funding when needed.

Source: IMF staff.

1/ The Risk Assessment Matrix shows events that could materially alter the baseline path—the scenario most likely to materialize in the view of staff.

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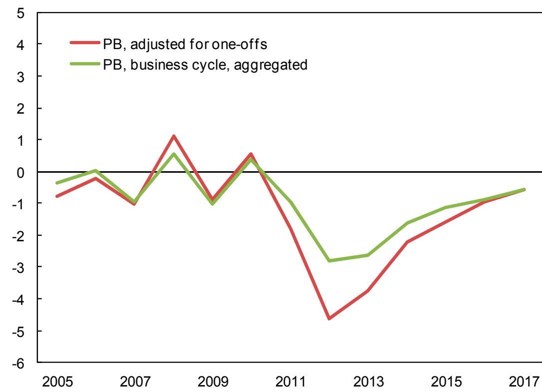
APPENDIX IV. TUNISIA: FISCAL IMPULSE AND ITS EFFECT ON GROWTH

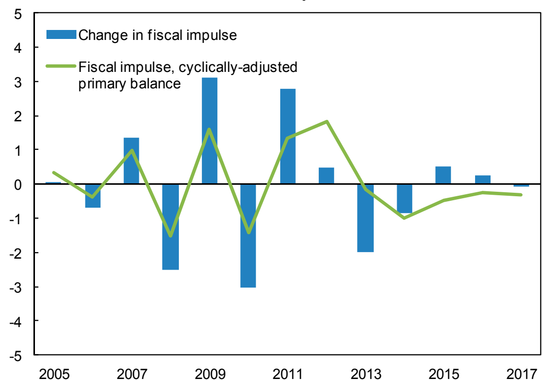
The 2012 budget law envisages a continuation of the fiscal expansion adopted during 2011 to support economic activity in the aftermath of the crisis. In 2011, the authorities implemented a large fiscal expansion to support private income and public investment; this expansion resulted in a primary fiscal deficit of 1.9 percent of GDP (excluding privatization proceeds and grants) from a primary surplus of 0.8 percent of GDP in 2010. For 2012, the budget law envisages a further expansion in capital spending that adds to a projected primary fiscal deficit of 5.2 percent of GDP.

It is important to quantify the underlying fiscal impulse based on estimation of the structural budget position. Estimation of structural budget balances involves three steps: (i) estimation of underlying potential output and the associated output gap, (ii) identification and quantification of one-off revenue (and expenditure) sources and of the cyclical component of expenditures and revenues; and (iii) subtraction of one-off and cyclical components from their observed levels, which then allows the calculation of the structural budget balance.[1] Potential output is estimated based on the Hodrick-Prescott (HP) times-series filtering method. The cyclical component of expenditures and revenues is obtained by adjusting observed revenue using unity elasticities for the major tax items and taking into account the gap between actual and potential output.

Figure 1. Tunisia: Primary Balance



Fiscal Impulse



The adopted fiscal expansion in Tunisia resulted in a significant fiscal impulse in 2011. The projected fiscal impulse will be maintained during 2012, then withdrawn gradually in the medium-term. The fiscal impulse is defined as the opposite of the change in the ratio of the adjusted primary budget balance to potential GDP, and thus a positive fiscal impulse should be interpreted as an expansionary fiscal stance. The cyclically-adjusted primary balance for 2011 is estimated at –1.0 percent of potential output, implying a fiscal impulse of 1.2 percent of GDP[2] (Figure 1). Also for 2012, the projected cyclically-adjusted primary balance indicates a positive fiscal impulse of 1.7 percent of GDP. The fiscal impulse is then projected to be withdrawn

[1] Hagemann, R., 1995, "The Structural Budget Balance: The IMF's Methodology," IMF Working Paper 99/95; and Fedelino, A., A. Ivanova, and M. Horton, 2005, "Computing Cyclically-Adjusted Balances and Automatic Stabilizers," IMF Technical Notes and Manuals 09/05.

[2] Based on the Template to compute cyclically adjusted and structural fiscal balances developed by the Fiscal Affairs Department, IMF.

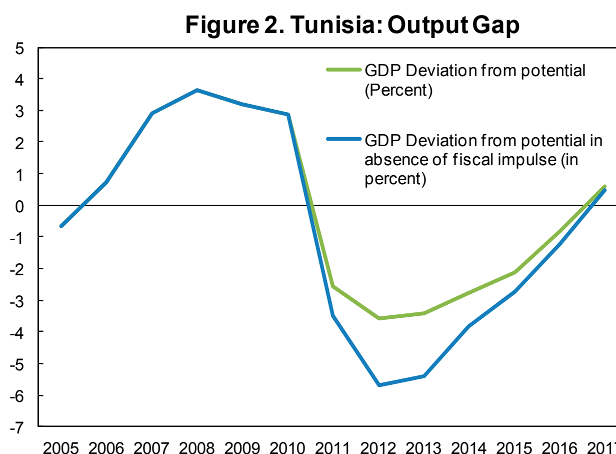
gradually starting in 2013, reflecting a gradual fiscal consolidation over the medium term to reduce the overall fiscal deficit to about 2 percent in 2017. In particular, the public sector wage bill is expected to be contained, and food and energy subsidies gradually reduced over the medium term.

Also highly relevant in the current environment is the short-term impact of fiscal policy on economic activity. One possible way to quantify the impact is the fiscal multiplier, typically defined as the ratio of a change in output to an exogenous change in fiscal deficit with respect to their respective baselines.[3] While recent literature suggests average first-year fiscal multipliers of about 0.6 for advanced economies in events of fiscal expansion, this may be closer to unity in times of fiscal consolidation. Also multipliers may differ depending on the nature of fiscal policies adopted. First-year multipliers are found to be about 0.8 for spending and 0.3 for revenue measures.[4]

The envisaged fiscal stimulus in Tunisia should thus contribute significantly to economic activity in the short term. Based on previous estimates of multipliers,[5] the fiscal impulse adopted during the period 2011 may have contributed to GDP growth by 0.5 to 0.7 percent in 2011. Similarly, the envisaged fiscal stimulus for 2012 could contribute to GDP growth by up to 1 percent, thereby helping narrow the projected output gap in the medium term (Figure 2).

The fiscal stimulus should prioritize capital spending as its multiplier on economic activity appears to be larger than those on other spending and revenue components. Preliminary estimates for Tunisia find a multiplier on capital spending of about 0.3, while that on current spending is about half of that. The multiplier on tax revenue is found to be close to 0.2.

Figure 2. Tunisia: Output Gap



Source: IMF staff estimates.

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[3] Spilimbergo, A., S. Symansky, and M. Schindler, 2009, "Fiscal Multipliers," IMF Staff Position Note, SPN/09/11, May, and Eyraud, L. and A. Weber, 2012, Fiscal Monitor.

[4] Baunsgaard, T., A. Mineshima, M. Poplawski-Ribeiro, and A. Weber, 2012, "Fiscal Multipliers," in Post-Crisis Fiscal Policy, C. Cottarelli, P. Gerson, and A. Senhadji (eds.) (forthcoming; Washington, International Monetary Fund).

[5] A preliminary estimate points to the fiscal multiplier for Tunisia lying between 0.5 and 0.7 based on an IV model for real GDP growth using the estimated fiscal impulse as explanatory variable, for years in which the latter was positive.

APPENDIX V. TUNISIA: STRENGTHENING THE REFORMS UNDERTAKEN IN THE BANKING SECTOR

The authorities took the following measures to better align practices with international standards, strengthen supervision, and to phase out regulatory tolerance:

Provisioning. A circular from the CBT assigns banks responsibility for placing collective provisions in 2011 on performing claims and to subjecting outstanding interest on consolidated claims to reserves. The CBT intends to perpetuate collective provisions so that the provisioning rate, which is below international standards, can be improved in the long term.

Governance. The CBT called upon banks to appoint at least two independent directors in respect of the shareholders, to create a decentralized management unit to monitor risks, and to improve transparency in financial information.

Solvency. The authorities undertook the recapitalization of a major public bank to bring its capital up to the minimum regulatory level by the end of the year (not including revaluation of collateral). The authorities are planning an audit during the latter half of 2012 to serve as a basis for completing the final restructuring activities. The other public banks will also be subject to institutional and financial audits at a later date. Last, a steering committee for the CBT, the finance ministry, and the proprietary banks was established to devise a resolution strategy for a small insolvent bank under temporary administration.

Prudential rules. Banks and banking supervision authorities agreed on a schedule for making banks compliant with prudential regulations governing liquidity and risk concentration. The CBT also plans to increase the CBT debt-to-equity ratio to 10 percent, to expand the concept of related companies, and to reduce the limits exposure rates and the deduction of banks' holdings in capital and reserves in other financial institutions.

Strengthening of supervision personnel. The CBT plans to hire 23 professional staff, including seven inspectors, in July 2012.

These reforms undertaken in the banking sector should be strengthened:

- The audit of other banks should be undertaken as soon as possible, and safeguard supervision measures should be formally introduced, such as a limit to credit growth, a limit to network expansion, and close supervision for banks subject to recapitalization pending final restructuring, potentially entailing substantial recapitalization requirements.

- A schedule should be implemented, using a gradual but expeditious approach to align the prudential regulations with international standards, and to apply new rules, including increasing the core capital ratio from 4 to 7 percent and the solvency ratio from 8 to 10 percent, and strengthening the rules for classification of NPLs, assessment of collateral, and provisioning for restructured loans. The current shortcomings, which have been tolerated to date, including

elimination of regulatory privileges granted to certain banks in difficulty, should be eliminated to ensure fair competition between the market players.

- Senior supervisors with international experience should be hired, and information systems for bank supervision should be improved. Long-term technical assistance in banking supervision, which the authorities have requested from IMF staff, along with training for CBT professional staff, should be helpful in this area.

- Cases of insolvency should be settled quickly and effectively to show the authorities' commitment and capacity to finding an effective solution to bank insolvency.

- The problem of NPLs in the tourism sector could be addressed through an asset management structure having extended powers, specifically for the stock of old nonperforming claims.

FSSA's Findings and Recommendations

The banking sector faces significant challenges owing to a weak domestic economy, and from the legacy of some policies of the previous regime. Banks' financial statements point to deteriorating loan quality, solvency, and profitability, and vulnerabilities could be much higher than reported. The supervisory framework suffers from deficiencies and weak reporting practices; reported figures are not compiled in line with international best practices, suffer from gaps, and exhibit inconsistencies. The mission urged the authorities to address the serious weaknesses in data management, including by creating a uniform database and standardized template to allow frequent and broad bank-by-bank performance monitoring.

The banking sector may face large recapitalization needs. These stem from existing weaknesses in loan quality, which appear to be under-estimated, and from potential future losses. Therefore, banks should immediately begin setting aside additional capital, since recapitalization needs could exceed 5 percent of GDP after two years. Thus, a core conclusion of the assessment is the need for pre-emptive action by all banks to raise capital. To assist in this process, the authorities are encouraged to increase the minimum capital adequacy ratio (CAR) from 8 percent to 10 percent by 2013, and impose higher solvency requirements on individual banks with higher risk profile.

Starting from an extremely weak position, the Central Bank of Tunisia (CBT) has made commendable strides in strengthening banking supervision. A medium-term plan to build effective banking supervision was initiated in February 2012, including a new organization, and reassignment and recruitment of staff. The CBT also adopted a new corporate governance regime for commercial banks to increase the role and independence of their boards.

Nonetheless, bank supervision and regulation need significant further strengthening. Banks must apply international best practices for loss reporting, collateral valuation and classification, and provisioning of nonperforming loans (NPLs).

The current circumstances provide an opportunity to revisit the rationale for and the modes of state intervention. Public banks have been used to support nonviable state-owned enterprises and activities, their governance arrangements have been weak and sometimes contradictory, and they have been staffed mainly with civil servants with no banking experience. In addition to addressing these issues, the major state-owned banks should be subject to in-depth audits by international firms, including assessments of their viability if recapitalization needs are identified.

Crisis management arrangements need to be developed. In the past, distressed institutions have been accommodated rather than being required to exit the market or restructure. Going forward, a special bank resolution regime and preparation for an eventual deposit insurance scheme are needed in order to facilitate the inevitable structural change in the sector.

The CBT should develop an exit strategy to unwind gradually its large liquidity support to banks. Liquidity injections in 2011 supported strong credit growth but significantly increased credit risk exposure of the central bank and led to a significant decline of foreign reserves. This strategy should be implemented gradually in order to allow banks time to adjust their funding needs and enhance the functioning of the interbank market.

A comprehensive capital market reform is needed to support long-term investment. The Capital Market Authority needs to strengthen its oversight of investment markets. A reliable yield curve should be developed, and the confiscated assets of the old regime could be sold to jumpstart markets.

Banking sector reform should improve access to finance for individuals, and small and medium-sized enterprises. This should be supplemented by swift implementation of the 2011 microfinance law.

The CBT has established an FSAP working group to monitor the implementation of the FSAP recommendations. The working group includes key financial sector stakeholders and would meet quarterly.

APPENDIX VI. TUNISIA: IMPACT OF REFORM ON UNEMPLOYMENT OVER THE MEDIUM TERM

Due to the recent crisis, unemployment has increased drastically in Tunisia. Total unemployment increased from 13 percent in 2010 to almost 19 percent at the end of 2011. Unemployment among the youth (42½ percent) deteriorated even more and remains at extremely high levels (see Table below). While the number of youth entering the labor force has been shrinking, on average by 0.7 percent a year during 2000–10, the economy has eliminated youth employment at a faster pace (–1.5 percent), contributing to a steady increase in youth unemployment. In 2011, the crisis led to a 17 percent decline in youth employment, while the youth labor force declined by 2 percent owing to a lower participation rate. Also unemployment among females (28 percent) has increased, and unemployment among people with high education (33 percent) remains significantly higher than unemployment among people without education (4 percent).

Unemployment in Tunisia

	2008	2009	2010	2011
	(Unemployment rate, percent)			
Total	12.4	13.3	13.0	18.9
Male	11.2	11.3	10.9	15.4
Female	15.9	18.8	18.9	28.2
Youth (15–24 years)	28.4	30.9	29.4	42.4
High education	26.0	28.5	32.0	32.9
No education	3.6	4.8	4.5	4.1

Source: Tunisia's National Institute of Statistics.

Tunisia needs stronger growth to absorb new entrants into the labor force. The unemployment rate would increase further, remaining above 19 percent in the medium term under a growth scenario in which Tunisia maintains the same average real GDP growth that it had during the period 2001–10 (about 4.4 percent)[1] (Figure 1). Based on staff projections, Tunisia would need an average annual GDP growth rate of 4.7 percent only to absorb new entrants into the labor force.

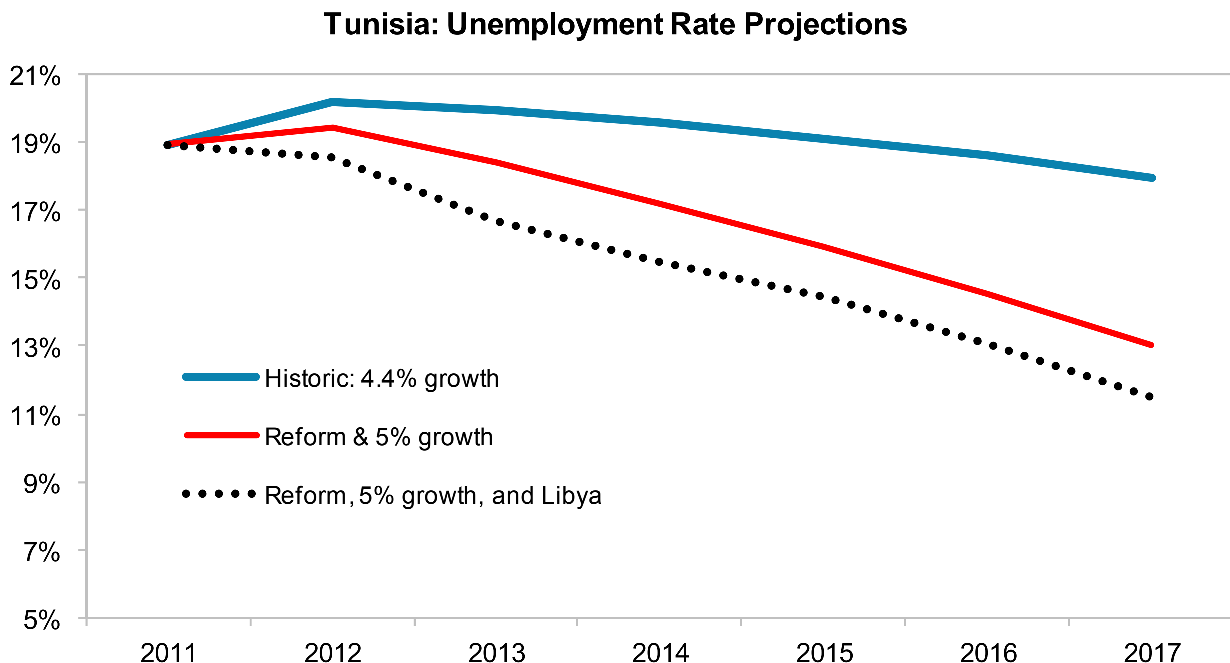
The adoption of reforms aimed at increasing labor and product market flexibility can help reduce unemployment in the medium term. Recent literature argues that increasing labor and product market flexibility has a significant impact on employment intensity of growth,[2] contributing to more rapid growth in employment for a given growth in economic activity. Increased labor market flexibility includes among others, efforts in reducing the cost of hiring and dismissal,

[1] All projections made with help of the Employment Template developed by staff in the Middle East and Central Asia Department, IMF. Based on ILO's projection of an annual increase in the labor force of about 1.5 percent, on average, for the period 2012-2017, and staff estimates of the elasticity of employment to economic growth of 0.45.

[2] Crivelli, E., D. Furceri, and J. Toujas-Bernaté, "Can Policies Affect Employment Intensity of Growth? A Cross-Country Analysis," IMF Working Paper (forthcoming).

reduction of minimum wages, and facilitating recruitment. Product market flexibility is achieved by reducing bureaucracy costs, eliminating price controls, facilitating business activity, limiting licensing restrictions, and reducing the cost of tax compliance.

Labor and product market reform could indeed contribute to a significant dent in unemployment in Tunisia. In addition, Tunisia could benefit from the normalization of economic activity in Libya. Assuming labor and product market flexibility increase the employment elasticity by 30 percent (from 0.45 to 0.6), and taking baseline annual real GDP growth projections of about 5 percent, on average, the unemployment problem in Tunisia could improve over the medium term, to reach 13 percent in 2017 (its precrisis level) (Figure 1). Additionally, reconstruction work in Libya could allow a gradual return of Tunisians who used to work in Libya in the past.[3] All in all, higher growth, implementation of reforms, and the improvement in the economic situation in Libya could contribute to a reduction in unemployment to as low as 11½ percent in 2017.



Source: IMF staff projections based on MCD Employment Template.

[3] It is estimated that about 60,000 Tunisian workers (about 1.6 percent of Tunisia's labor force) left Libya in 2011.

APPENDIX VII. TUNISIA: THE ROLE AND IMPLICATIONS OF SUBSIDIES[1]

The structure of subsidies in Tunisia

Significant price subsidies on food and energy products are provided in Tunisia. Indirect price subsidies are provided for several staple foods and energy products, including refined petroleum products, natural gas, and electricity.[2] Price subsidies in Tunisia are universal, i.e. they are provided on an unrestricted basis to all consumers. In particular, staple foods and energy products are provided to consumers at an administered price set by the Tunisian government at a level below their actual costs of production or importing.

The Tunisian government started to implement a universal food subsidies scheme in 1970 and reformed it in the early 1990s to improve the targeting of subsidies to the poor. The food subsidies scheme implemented in the early 1970s had extensive coverage. In the early 1990s food subsidies were narrowed to products mostly consumed by lower-income groups. Staple foods included in the current subsidies scheme cover cereals—durum wheat, bread wheat, barley, and corn—and milk, sugar, tomato sauce, and cooking oils (excluding olive oil).

The *Caisse Generale de Compensation* (CGC), a governmental agency, has the primary responsibility to administer food subsidies.[3] Staple goods, either produced locally or imported, are sold at an administered price set below production or importing costs so that food subsidies are provided as a direct price reduction to consumers. The CGC pays to the operators the difference between the actual costs of producing or importing and below-market price to consumers. In turn, the CGC receives direct budget transfers from the government.

Furthermore, energy prices are administered by the Tunisian government. Energy prices are set at all levels of the energy market, including transactions among public enterprises, margins of private operators, and final prices to consumers. End-consumer prices of all petroleum products and natural gas are set by the government, independently of the prices on the international markets. Furthermore, electricity tariffs are below the overall costs of recovery.

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[1] This Appendix draws from the forthcoming IMF working paper "Tunisia: The Role and Implications of Subsidies," by Giorgia Albertin and Ernesto Crivelli.

[2] Government price subsidies are also provided for school transportation. The government compensates the difference between the actual costs incurred by the transportation company and the price paid for transport by the beneficiary.

[3] The CGC also provides subsidies on other nonfood items, school supplies, and fertilizers.

The impact of subsidies in Tunisia

Food and energy price subsidies have contained inflationary pressures in Tunisia. The presence of price subsidies has contained inflationary pressures in Tunisia by limiting the pass-through from international commodity prices to domestic consumer prices. Tunisia presents a very low oil prices pass-through effect compared to both developed and emerging economies.

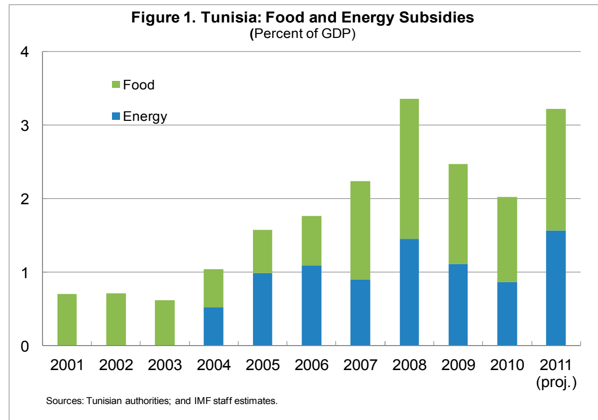

Figure 1. Tunisia: Food and Energy Subsidies
(Percent of GDP)
Sources: Tunisian authorities; and IMF staff estimates.

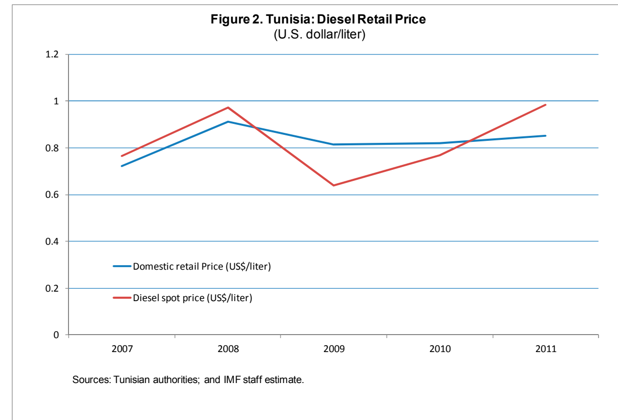

Figure 2. Tunisia: Diesel Retail Price
(U.S. dollar/liter)
Sources: Tunisian authorities; and IMF staff estimate.

However, subsidies have a significant impact on the government budget. Food and energy subsidies in Tunisia doubled to 4 percent of GDP in 2011, from 2 percent of GDP in 2010, reflecting the authorities' decision to delink domestic prices from international food and oil prices hikes. Furthermore, some staple foods—milk and sugar—were re-introduced in the scheme in the aftermath of the revolution.

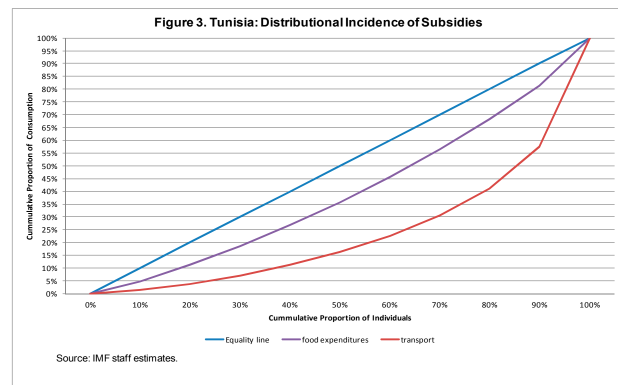

Figure 3. Tunisia: Distributional Incidence of Subsidies
Source: IMF staff estimates.

Food and energy subsidies in Tunisia are regressive, benefiting more the richest segments of the population. In particular, the highest-income households benefit almost four times more from food subsidies than do the lowest-income ones. Similarly the highest-income households would benefit almost 40 times more from energy products subsidies than the lowest-income ones.[4]

Reforming the subsidies system in Tunisia would reduce budgetary costs and better protect the poor. Progressively removing current generalized price subsidies and implementing appropriate social safety nets—such as a system of price subsidies targeted to the most vulnerable segments of the population or direct cash transfers to poor households or individuals—would provide better protection for those in need. Furthermore, it would reduce budgetary costs and free additional fiscal resources which could be used for priority spending—i.e., infrastructure, health, and education—thereby better addressing social demands.

[4] Data from the 2005 Household Survey in Tunisia indicate that expenditure of the households in the lowest income decile is less than 5 percent of the overall food expenditures and about 20 percent for the highest income households. Transport expenditures of the households in the lowest income decile is 1 percent of the overall transport expenditures while the share of the highest income households is more than 40 percent.

APPENDIX VIII. PUBLIC AND EXTERNAL DEBT SUSTAINABILITY ANALYSIS

Public debt

Tunisia's public debt declined significantly in recent years but it increased in 2011, in the aftermath of the revolution. Reflecting the authorities' prudent fiscal policies and consolidation efforts, public debt declined from over 67 percent of GDP in 2001 to 40½ percent of GDP at end-2010. However, public debt increased in 2011 as a result of the expansionary fiscal policy in 2011 (an overall fiscal deficit reaching 3.7 percent of GDP) implemented in the aftermath of the revolution to support economic growth and address social demands as well as the contraction in real growth. At end-2011, public debt stood at 44½percent of GDP, still a relatively comfortable level.

Under a baseline scenario, public debt is expected to increase considerably in the short term but then progressively decline over the medium term. Public debt would significantly increase in the short term, peaking at about 51 percent of GDP in 2014, as a result of the sizable fiscal stimulus (an overall fiscal deficit of about 7 percent in 2012) and the anticipated recapitalization of public banks (3½ percent of GDP). However, the debt to GDP ratio is expected to then gradually decline in the medium term, reaching about 46½ percent by end-2017. This favorable debt dynamic reflects the fiscal consolidation envisaged by the authorities (an overall fiscal deficit declining to about 2 percent of GDP in 2017) and higher medium-term growth (5 percent on average during 2012–17). However, the public debt ratio would remain well above its end-2010 level (40 percent of GDP).

The public debt dynamics are very vulnerable to adverse shocks and could deteriorate significantly compared to the baseline, remaining close to or above 60 percent of GDP. Under an alternative scenario in which the medium-term fiscal consolidation is not implemented, public debt would be on an increasing path and would reach about 62 percent of GDP in 2017. In addition, the public debt dynamic would worsen under most of the bound tests. Under a permanent negative shock to real growth (3 percent during 2012–17, on average), public debt would remain on an increasing path, reaching about 59 percent of GDP by end-2017. In addition, public debt would reach about 60½ percent as a result of a one-off 10 percent of GDP shock to contingent liabilities, slightly declining to about 55½ percent of GDP by 2017.[1] Finally, as almost 60 percent of public debt is denominated in foreign currency, a one-time 30 percent depreciation would increase public debt to about 63½ percent and then decline to 58½ percent of GDP at end-2017. On the other hand, the public debt dynamics would be relatively resilient to an interest rate shock, reaching around 49 percent over the medium term.

[1] The one-off 10 percent of GDP shock to contingent liabilities reflects about 3½ percent of GDP expected recapitalization of public banks and the realization of about 6½ of GDP of government's contingent liabilities from public enterprises (about 70 percent of existing government's contingent liabilities from public enterprises).

External Debt

After a decade of steady decline, external debt (in percent of GDP) is projected to increase moderately over the next few years as a result of the post-revolution fiscal expansion. 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 2003 to 48 percent of GDP at end-2011, on the back of a strong fiscal adjustment. 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 moderately increase in the short term owing to a declining-but-still large current account deficit. The recent slowdown in economic activity, along with the fiscal expansion in support of the recovery, has led to a worsening of the debt outlook relative to the previous debt sustainability analysis (which projected an external debt ratio below 40 percent in the medium term).[3] Nevertheless, Tunisia's external debt sustainability risks appear contained in the period ahead. The analysis assumes that Tunisia will implement some fiscal consolidation in the medium term and continue to pursue cautious external borrowing policies. The external debt-to-GDP ratio is expected to peak at 55 percent in 2015 before slightly declining to around 53 percent by end-2017.

The external debt ratio is resilient to most types of adverse external shocks (except a large exchange rate depreciation). The relatively low level of Tunisia's debt as well as its profile (low average interest rate and relatively long maturity) makes it robust to most shocks, with the exception of a large real exchange rate depreciation. The external debt ratio remains below 60 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 only raise the debt ratio to 57–58 percent of GDP, while an increase in the average interest rate would almost have no impact.[4] However a sharp real depreciation (one-time 30 percent) of the exchange rate in 2013 relative to the baseline would raise the debt ratio to almost 80 percent of GDP.

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[2] The last international bond issuance was in 2007. At end-2011, there were nine international bonds outstanding with remaining maturities ranging from less than one year to 20 years.

[3] SM/10/217 (August 2010).

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

Table 1. Tunisia: Public Sector Debt Sustainability Framework, 2007–17

(In percent of GDP, unless otherwise indicated)

	Actual							Projections					
	2007	2008	2009	2010	2011			2012	2013	2014	2015	2016	2017
								I. Baseline Projections					
1 **Public sector debt 1/**	45.9	43.3	42.8	40.4	44.4			**45.7**	**50.5**	**50.7**	**49.9**	**48.7**	**46.4**
of which foreign-currency denominated	26.7	26.3	25.0	24.5	25.8			28.1	29.6	30.2	29.8	29.3	28.5
2 Change in public sector debt	-2.9	-2.6	-0.6	-2.4	4.0			1.3	4.8	0.2	-0.8	-1.3	-2.2
3 Identified debt-creating flows (4+7+12)	-2.9	-1.1	1.7	1.8	3.3			2.9	-1.7	0.6	-0.4	-0.9	-1.9
4 Primary deficit	-0.4	-1.4	-0.5	-0.4	1.9			4.4	2.9	1.7	1.1	0.4	-0.2
5 Revenue and grants	27.4	29.9	29.3	29.5	31.4			31.1	29.8	29.9	29.9	30.3	30.5
6 Primary (noninterest) expenditure	27.1	28.5	28.8	29.1	33.3			35.4	32.7	31.6	31.0	30.6	30.3
7 Automatic debt dynamics 2/	-1.7	0.6	2.2	2.3	2.0			0.4	-0.5	-0.6	-1.0	-1.2	-1.6
8 Contribution from interest rate/growth differential 3/	0.0	-1.3	2.0	0.0	0.9			-1.7	-1.6	-1.6	-2.0	-2.1	-2.4
9 *Of which* contribution from real interest rate	2.9	0.6	3.4	1.3	0.2			-0.6	-0.1	0.3	0.5	0.5	0.3
10 *Of which* contribution from real GDP growth	-2.9	-1.9	-1.3	-1.3	0.7			-1.1	-1.5	-1.9	-2.5	-2.5	-2.7
11 Contribution from exchange rate depreciation 4/	-1.7	1.9	0.2	2.3	1.1			2.1	1.1	1.0	1.0	0.9	0.9
12 Other identified debt-creating flows	-0.8	-0.3	0.0	0.0	-0.6			-1.8	-4.0	-0.5	-0.4	-0.1	-0.1
13 Privatization receipts (negative)	-0.8	-0.3	0.0	0.0	-0.6			-1.8	-0.5	-0.5	-0.4	-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	-3.5	0.0	0.0	0.0	0.0
16 Residual, including asset changes (2-3)	0.0	-1.4	-2.2	-4.2	0.6			-1.6	6.5	-0.4	-0.4	-0.4	-0.3
Public sector debt-to-revenue ratio 1/	167.4	144.9	145.8	136.8	141.2			147.1	169.3	169.4	166.8	160.8	152.4
Gross financing need 5/	7.5	4.3	6.1	4.8	6.4			8.4	6.9	5.7	5.0	4.4	3.5
in billions of U.S. dollars	2.9	1.9	2.7	2.1	3.0	10-Year Historical Average	10-Year Standard Deviation	3.9	3.3	2.9	2.6	2.4	2.0
Key Macroeconomic and Fiscal Assumptions													
Real GDP growth (in percent)	6.3	4.5	3.1	3.1	-1.8	3.8	2.5	2.7	3.5	4.1	5.3	5.5	6.0
Average nominal interest rate on public debt (in percent) 6/	5.3	5.0	4.9	4.6	4.6	4.7	0.4	4.5	4.4	4.3	4.2	4.1	4.0
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	6.1	1.6	7.8	3.1	0.5	4.1	2.2	-1.3	-0.2	0.8	1.1	1.2	0.8
Nominal appreciation (increase in US dollar value of local currency, in percent)	6.3	-6.8	-0.6	-8.4	-4.1	0.1	7.8	-7.8	-3.9	-3.4	-3.3	-3.1	-3.0
Inflation rate (GDP deflator, in percent)	-0.8	3.4	-2.8	1.5	4.1	0.6	2.1	5.8	4.6	3.5	3.0	2.9	3.2
Growth of real primary spending (deflated by GDP deflator, in percent)	11.4	12.8	10.7	7.4	12.5	9.4	2.3	9.2	-4.5	0.6	3.4	4.1	4.7
Primary deficit	-0.4	-1.4	-0.5	-0.4	1.9	-0.2	0.9	4.4	2.9	1.7	1.1	0.4	-0.2
								II. Stress Tests for Public Debt Ratio					
A. Alternative Scenarios													
A1. Key variables are at their historical averages in 2012-2017 7/								**45.7**	**49.2**	**49.2**	**49.3**	**49.7**	**50.1**
A2. No policy change (constant primary balance) in 2012-2017								**45.7**	**52.0**	**54.9**	**57.3**	**59.8**	**61.8**
B. Bound Tests													
B1. Real interest rate is at baseline plus one standard deviations								**45.7**	**51.0**	**51.7**	**51.4**	**50.7**	**48.9**
B2. Real GDP growth is at baseline minus one-half standard deviation								**45.7**	**51.9**	**54.2**	**55.9**	**57.7**	**59.0**
B3. Primary balance is at baseline minus one-half standard deviation								**45.7**	**50.9**	**51.5**	**51.2**	**50.3**	**48.5**
B4. Combination of B1-B3 using one-quarter standard deviation shocks								**45.7**	**51.2**	**52.2**	**52.2**	**51.6**	**50.1**
B5. One time 30 percent real depreciation in 2013 9/								**45.7**	**63.6**	**63.6**	**62.6**	**61.0**	**58.4**
B6. 10 percent of GDP increase in other debt-creating flows in 2013								**45.7**	**60.5**	**60.6**	**59.6**	**58.1**	**55.6**

1/ Indicates coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency-denominated debt; and ε = 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 $r - \pi (1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

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.

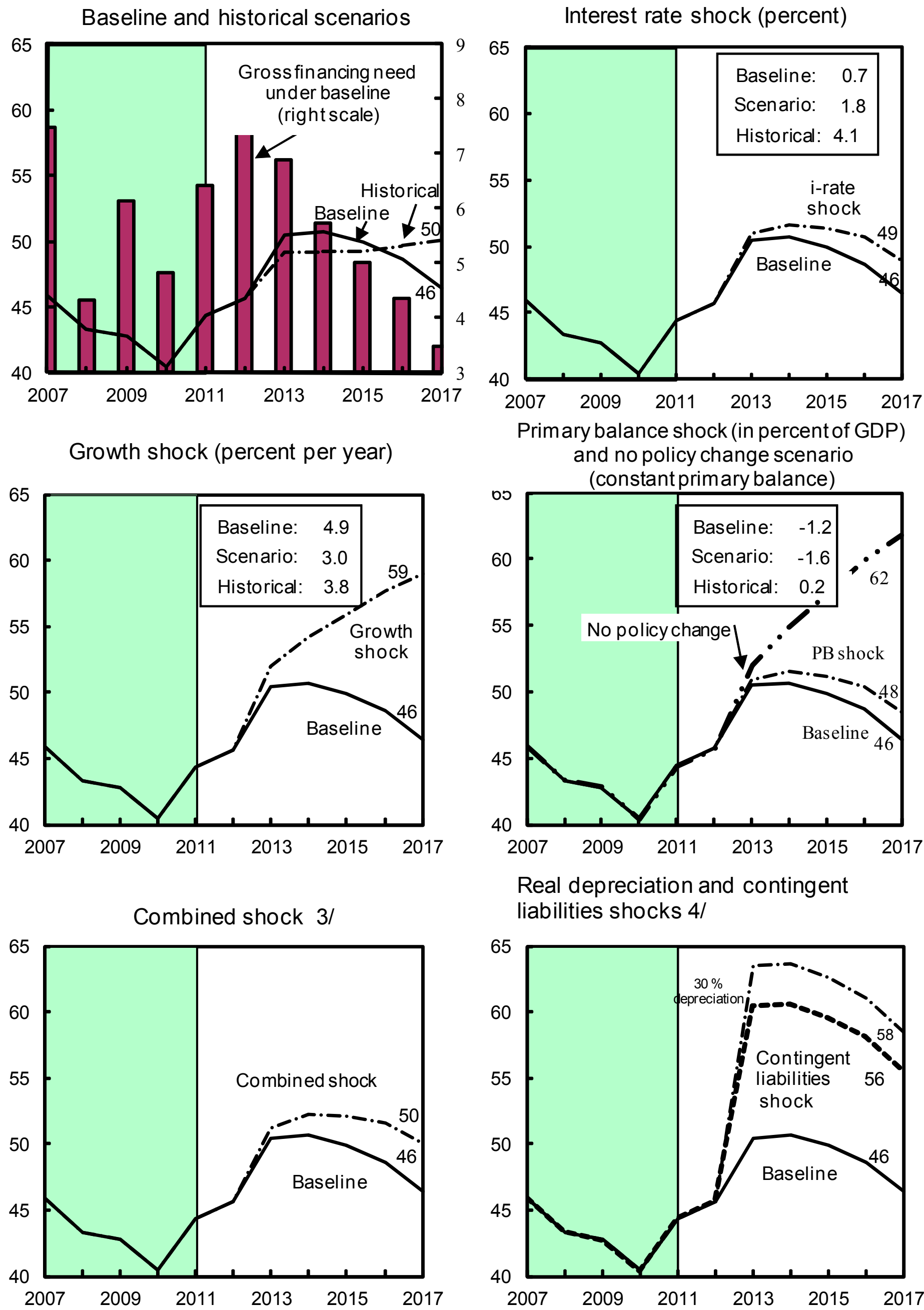
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ The implied change in other key variables under this scenario is discussed in the text.

9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

10/ 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.

Figure 1. Tunisia: Public Debt Sustainability: Bound Tests 1/ 2/
(Public 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 and a 3/4 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 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 2. Tunisia: External Debt Sustainabiity Framework, 2007–17

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2007	2008	2009	2010	2011			2012	2013	2014	2015	2016	2017	
								I. Baseline Projections						Debt-stabilizing non-interest current account 6/
External debt	51.8	45.9	49.4	48.6	48.0			**52.0**	**54.0**	**55.1**	**55.1**	**54.3**	**53.1**	**-6.7**
Change in external debt	-2.2	-5.9	3.5	-0.8	-0.6			4.0	2.0	1.1	0.0	-0.8	-1.2	
Identified external debt-creating flows (4+8+9)	-8.2	-9.1	0.6	0.6	3.5			3.9	1.8	0.4	-1.2	-2.5	-3.8	
Current account deficit, excluding interest payments	0.6	2.2	1.1	3.2	6.1			5.6	5.5	4.7	4.0	3.4	2.9	
Deficit in balance of goods and services	2.0	3.0	2.5	4.8	7.0			7.0	6.5	5.3	4.2	3.3	2.7	
Exports	51.5	56.1	45.6	49.5	48.7			49.6	50.8	52.5	54.6	56.5	58.3	
Imports	53.5	59.2	48.1	54.3	55.7			56.7	57.4	57.9	58.8	59.8	61.0	
Net non-debt creating capital inflows (negative)	-4.2	-6.1	-3.7	-3.4	-2.2			-2.8	-3.1	-3.6	-4.0	-4.5	-4.9	
Automatic debt dynamics 1/	-4.5	-5.2	3.1	0.7	-0.3			1.1	-0.6	-0.7	-1.2	-1.4	-1.8	
Contribution from nominal interest rate	1.8	1.6	1.7	1.5	1.4			1.3	1.4	1.4	1.4	1.4	1.3	
Contribution from real GDP growth	-3.0	-2.0	-1.5	-1.5	0.8			-1.3	-1.7	-2.1	-2.8	-2.9	-3.1	
Contribution from price and exchange rate changes 2/	-3.3	-4.8	2.9	0.6	-2.6			1.1	-0.3	0.0	0.2	0.2	-0.1	
Residual, incl. change in gross foreign assets (2-3)	6.0	3.2	2.9	-1.4	-4.1			0.0	0.2	0.7	1.2	1.7	2.6	
External debt-to-exports ratio (in percent)	100.4	81.7	108.2	98.1	98.4			104.7	106.2	104.8	100.9	96.1	91.1	
Gross external financing need (in billions of US dollars) 3/	9.3	11.1	11.6	13.5	15.7			15.1	15.6	16.1	16.7	17.4	18.2	
in percent of GDP	23.8	24.7	26.6	30.5	33.8	10-Year Historical Average	10-Year Standard Deviation	32.5	32.3	32.0	31.6	31.3	30.9	Projected Average
Key Macroeconomic Assumptions														
	38.9	44.9	43.5	44.3	46.0			46.1	48.0	49.9	52.4	55.1	58.5	
Real GDP growth (in percent)	6.3	4.5	3.1	3.1	-1.8	3.8	2.5	2.7	3.5	4.1	5.3	5.5	6.0	4.9
Exchange rate appreciation (US dollar value of local currency, change in percent)	3.9	4.0	-8.7	-5.7	1.7	0.4	5.6	-7.8	-3.9	-3.4	-3.3	-3.1	-3.0	-3.3
GDP deflator in US dollars (change in percent)	6.6	10.3	-5.9	-1.3	5.6	3.8	5.7	-2.2	0.5	0.0	-0.4	-0.3	0.1	0.0
Nominal external interest rate (in percent)	3.8	3.6	3.6	3.2	2.9	3.5	0.3	2.8	2.7	2.8	2.7	2.6	2.5	2.7
Growth of exports (US dollar terms, in percent)	25.5	25.6	-21.2	10.3	3.0	10.0	14.0	2.3	6.5	7.6	9.0	8.9	9.4	8.3
Growth of imports (US dollar terms, in percent)	25.0	27.5	-21.2	14.9	7.3	10.4	14.1	2.1	5.3	5.0	6.5	7.1	8.1	6.4
Current account balance, excluding interest payments	-0.6	-2.2	-1.1	-3.2	-6.1	-1.4	2.0	-5.6	-5.5	-4.7	-4.0	-3.4	-2.9	-4.1
Net non-debt creating capital inflows	4.2	6.1	3.7	3.4	2.2	4.0	2.4	2.8	3.1	3.6	4.0	4.5	4.9	4.0
								II. Stress Tests for External Debt Ratio						Debt-stabilizing non-interest current account 6/
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2012-2017 4/								**52.0**	**47.6**	**43.7**	**40.5**	**37.9**	**36.1**	**-5.4**
B. Bound Tests														
B1. Nominal interest rate is at baseline plus one-half standard deviation								**52.0**	**54.0**	**55.2**	**55.3**	**54.6**	**53.4**	**-6.6**
B2. Real GDP growth is at baseline minus one-half standard deviations								**52.0**	**54.8**	**56.8**	**57.6**	**57.6**	**57.0**	**-6.3**
B3. Non-interest current account is at baseline minus one-half standard deviations								**52.0**	**55.0**	**57.1**	**58.1**	**58.2**	**57.8**	**-6.8**
B4. Combination of B1-B3 using 1/4 standard deviation shocks								**52.0**	**54.8**	**56.7**	**57.5**	**57.5**	**56.9**	**-6.6**
B5. One time 30 percent real depreciation in 2013								**52.0**	**79.2**	**80.9**	**80.9**	**79.8**	**77.9**	**-9.8**

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 U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

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

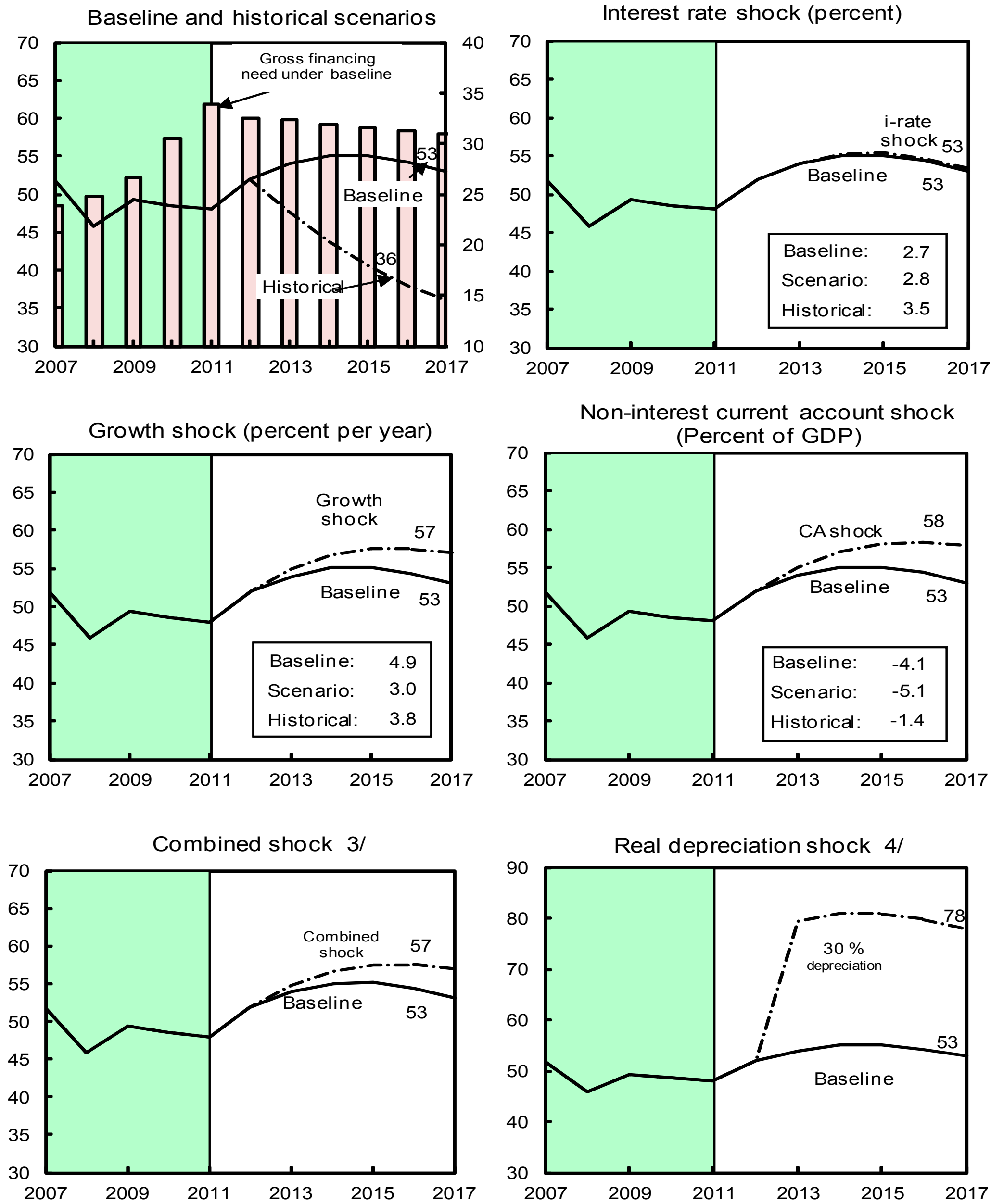
3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

5/ The implied change in other key variables under this scenario is discussed in the text.

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

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 2013.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Appendix IX. Draft Public Information Notice

Public Information Notice (PIN) No. 10/xx
FOR IMMEDIATE RELEASE
[Month, dd, yyyy]

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

IMF Executive Board Concludes 2012 Article IV Consultation with Tunisia

On [Month, dd, yyyy], the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tunisia.[1]

Background

The January 2011 revolution marked the beginning of an historical era for Tunisia. Following the overthrow of the former President, Tunisia has moved steadily forward with its democratic transition. The successful elections of a Constituent Assembly in October 2011 were a milestone. A new coalition government, led by the Islamic Party (Ennahda) with two secular parties, was formed. The constituent assembly is now preparing a new constitution, on the basis of which new general elections are scheduled to take place in March 2013.

While the political transition has continued to progress, Tunisia experienced a severe recession in 2011 amid domestic and regional turmoil. Real GDP contracted by 1.8 percent, reflecting a sharp decline in tourism and foreign direct inflows. As the result of the economic downturn and the return of Tunisian workers from Libya, unemployment

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

soared to 19 percent in 2011, with youth unemployment at 42 percent. Tunisia's external position weakened, with the current account deficit widening substantially to 7.3 percent of GDP in 2011 and official reserves declining from US$9.5 billion at end-2010 to US$7.5 billion at end-2011. After decelerating to 3.5 percent in 2011, inflation accelerated to 5.7 percent in April 2012 (y-o-y).

The authorities implemented an expansionary policy mix to address social demands and support the economy. With an increase in current budget spending owing to an increase in the wage bill, larger food and energy subsidies, and new social measures, the overall fiscal deficit widened to 3.7 percent of GDP in 2011 from 1.1 percent in 2010. As a result, following a decline in the last decade to 40 percent of GDP in 2010, the public debt ratio increased to 44.5 percent of GDP at end-2011. Monetary policy has been supportive of bank credit, with large liquidity injection and a reduction in the policy interest rate.

The economic downturn, particularly in the tourism sector, deteriorated the quality of the banks' portfolio. In response, the central bank relaxed its regulatory requirements to allow banks to reschedule loans for companies affected by the recession and injected large amount of liquidity in the banking system to help banks in an environment of declining assets performance. As a result, most banks became heavily dependent on central bank's refinancing.

Signs of a rebound have emerged in early 2012, with real GDP increasing by 4.8 percent (y-o-y) in the first quarter and tourism and FDI picking up. A recovery in real GDP growth would also be supported by a sizable growth-supporting fiscal expansion. However, risks to the short-term outlook are large and tilted to the downside, including a worse-than-anticipated recession in Europe which would depress exports, an escalation of domestic social tensions which would hamper foreign and domestic investment, and capacity constraints and delays in financing which could curb the envisaged growth-supporting fiscal stimulus. On the upside, a rapid stabilization of the situation in Libya could bolster investors' confidence.

Tunisia's medium-term economic growth potential remains favorable, but unleashing it requires a comprehensive package of structural reforms to foster private investment. Achieving higher and more inclusive growth over the medium term will be necessary to reduce high unemployment, especially among the youth, and address social and regional disparities. Real growth would gradually reach 6 percent by 2017 in a baseline scenario which assumes continued macroeconomic stability, improvement in governance and the business environment, reforms of the labor market and education system to address the labor skills mismatches, and a strengthening of the financial sector. Achieving higher growth will also require that large external financing, including FDI inflows and borrowing by the government and corporate sectors, can be mobilized.

Executive Board Assessment

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Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Tunisia: Selected Economic and Financial Indicators, 2008–17

				Est.	Projections	
	2008	2009	2010	2011	2012	2013
Production and income (percent change)						
Nominal GDP	10.9	6.3	7.8	2.2	8.6	8.2
Real GDP	4.5	3.1	3.0	-1.8	2.7	3.5
GDP deflator	6.1	3.1	4.7	4.1	5.8	4.6
Consumer price index (CPI), average	4.9	3.5	4.4	3.5	5.0	4.0
Gross national savings (percent of GDP)	22.1	21.9	21.6	16.8	18.1	18.9
Gross investment (percent of GDP)	25.9	24.8	26.4	24.1	25.1	25.9
External sector (percent change)						
Exports of goods, f.o.b. (in $)	26.6	-24.8	14.0	8.5	0.9	5.3
Imports of goods, f.o.b. (in $)	28.7	-21.9	15.9	7.7	2.2	5.6
Exports of goods, f.o.b. (volume)	5.5	-9.6	6.7	-1.5	-1.5	4.8
Import of goods, f.o.b. (volume)	7.3	1.0	-1.8	-6.0	5.0	6.5
Trade balance (percent of GDP)	-8.9	-8.5	-10.3	-10.4	-11.1	-11.4
Current account, excluding grants (percent of GDP)	-3.8	-2.8	-4.8	-7.3	-7.0	-6.9
Foreign direct investment (percent of GDP)	5.7	3.3	3.0	0.9	2.5	2.8
Terms of trade (deterioration -)	0.1	7.6	-9.6	-4.0	5.1	1.4
Real effective exchange rate (depreciation -) 1/	-0.7	-1.1	-0.5	-1.8	…	…
Central government (percent of GDP, unless otherwise indicated) 2/						
Total revenue, excluding grants and privatization	23.8	22.8	22.8	24.5	23.8	23.0
Total expenditure and net lending	24.8	25.8	23.9	28.2	30.8	28.1
Central government balance, excluding grants and privatization	-1.0	-3.0	-1.1	-3.7	-7.0	-5.1
Central government balance, including grants, excluding privatization	-0.7	-2.7	-1.0	-3.4	-6.4	-5.0
Total government debt (foreign and domestic)	43.3	42.8	40.4	44.4	45.7	50.5
Foreign currency public debt (percent of total debt)	60.8	58.5	60.7	58.0	61.4	58.5
Money and credit (percent change)						
Credit to the economy	14.0	10.3	19.6	13.5	5.3	…
Broad money (M3) 3/	14.4	13.0	12.1	9.2	10.8	…
Liquidity aggregate (M4)	14.2	12.7	12.2	9.2	10.8	…
Velocity of circulation (GDP/M3)	1.62	1.52	1.46	1.37	1.34	…
Interest rate (money market rate, percent, e.o.p) 4/	4.90	4.10	4.12	3.05	…	…
Official reserves						
Gross official reserves (US$ billions, e.o.p)	9.0	10.6	9.5	7.5	8.2	8.7
In months of imports of goods and services, c.i.f. 5/	4.4	6.6	5.1	3.8	4.0	4.0
Total external debt						
External debt (US$ billions)	20.6	21.5	21.4	22.0	24.2	26.1
External debt (percent of GDP)	48.8	48.2	48.5	51.0	53.7	55.8
Debt service ratio (percent of exports of GNFS)	8.6	11.9	10.5	11.7	10.4	9.8
Financial market indicators						
Stock market index 6/	2,892	4,292	5,113	4,722	4,984	…
Memorandum items:						
GDP at current prices (TD millions)	55,296	58,768	63,380	64,802	70,402	76,182
GDP at current prices (US$ billions)	44.9	43.5	44.3	46.0	46.1	48.0
GDP per capita (US$)	4,346	4,171	4,199	4,320	4,284	4,409
Unemployment rate (percent) 7/	12.6	13.3	13.0	18.9	…	…
Population (millions)	10.3	10.4	10.5	10.7	10.8	10.9
Exchange rate: dinar/US$ (average)	1.23	1.35	1.43	1.41	…	…

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

1/ Information Notice System.
2/ Excludes the social security accounts.
3/ Financial system (deposit money banks and development banks).
4/ 2011 data is the money market rate on 10/17/2011.
5/ End-of-year reserves over current year imports of goods and services.
6/ TUNINDEX. (1000 = 12/31/1997), with 2012 data at 06/30/2012.
7/ New series based on the ILO definition of the labor force.