



TUNISIA

March 2018

2017 ARTICLE IV CONSULTATION, SECOND REVIEW UNDER THE EXTENDED FUND FACILITY, AND REQUEST FOR WAIVERS OF NONOBSERVANCE OF PERFORMANCE CRITERIA, AND REPHASING OF ACCESS

In the context of the 2017 Article IV Consultation and Second Review Under the Extended Fund Facility, and Request for Waivers of Nonobservance of Performance Criteria, and Rephasing of Access, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 23, 2018 consideration of the staff report that concluded the Article IV consultation with Tunisia.
- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 23, 2018, following discussions that ended on December 13, 2017, with the officials of Tunisia on economic developments and policies underpinning the IMF arrangement. Based on information available at the time of these discussions, the staff report was completed on March 14, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Tunisia.

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

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

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

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INTERNATIONAL MONETARY FUND



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IMF Executive Board Concludes 2017 Article IV Consultation with Tunisia

On March 23, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV Consultation with Tunisia.¹

Economic growth almost doubled to 1.9 percent in 2017, as confidence strengthened on the back of improved security and the unity government's early progress with policy and reform implementation. Investment and exports remained sluggish, however. Growth is expected to reach 2.4 percent in 2018, helped by a good agricultural season and a pickup in manufacturing and tourism. The unemployment rate remains high at 15 percent, especially affecting the youth, women, and the population of the interior regions.

Inflation accelerated to an annualized 7.1 percent in February 2018, driven by dinar depreciation (10 percent real depreciation in 2017), wage hikes in the public and the private sector, and increases in administrative prices. In response, the authorities widened the interest rate corridor to 200 basis points in January and increased the policy interest rate by 75 basis points to 5.75 percent in March.

The current account deficit deteriorated to a record 10.1 percent of GDP at the end of 2017. Exports remained sluggish, while imports increased due to high domestic energy needs, strong consumption demand underpinned by rapid credit growth, and the impact of the dinar depreciation on import prices. Trade data for early 2018 show an improvement in export performance, while import growth is slowing. This favorable trend is expected to continue throughout the remainder of the year, supported by a more favorable real exchange rate. International reserves declined to 2.5 months of imports in March 2018, including due to higher-than-programmed central bank foreign exchange sales and delayed external financing.

Public and external debt further increased, reaching 71 percent of GDP and 80 percent of GDP at the end of 2017, respectively. These trends reflect the combined impact of high fiscal and current

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.

account deficits, the dinar depreciation, and lower-than-envisaged growth. Public and external debt are projected to reverse their upward trend starting in 2020, helped by a three-percent-of-GDP reduction in the fiscal deficit over 2018-20 and a sustained recovery of growth. This outlook relies on strong implementation of the authorities' fiscal plans that seek to spread the adjustment burden equitably across society. Their plans include new tax measures worth 2.2 percent of GDP in 2018, quarterly adjustments of fuel prices to contain the growth of energy subsidies, civil service reform based on voluntary separations and strict hiring limits, and pension reform. In parallel, the authorities are developing a better targeted social safety net to protect the most vulnerable from the impact of fiscal adjustment.

The banking sector remains stable but suffers from structurally low liquidity as savings remain weak. The recent inspections of the seven largest private banks showed no major vulnerabilities. The banking sector's foreign currency exposure remains low, credit risk is mitigated by the recovery in growth, and interest margins remain comfortable.

Medium-term prospects for Tunisia's economy remain favorable, with growth projected to reach 4 percent by 2022. This outlook hinges on sustained reforms aimed at improving governance and the business climate, broadening access to finance, and modernizing fiscal institutions to improve service delivery while making them more efficient. Recent progress with the establishment of the High Anti-Corruption Authority, the creation of the one-stop shop for investors, the performance contracts for public banks and state-owned enterprises, and the laws to facilitate banks' NPL reduction is supporting this agenda.

Executive Board Assessment²

They noted that Tunisia faces economic and socio-political challenges. Adverse shocks combined with policy slippages and delays in structural reforms have hindered economic recovery and increased macroeconomic vulnerabilities. Noting weak program implementation and high risks to the program, Directors urged the authorities to strengthen their commitment to the program and take urgent and decisive action to put public finances on a more sustainable path, address rising inflation and falling reserves, and ensure macroeconomic stability. Directors generally agreed that moving to quarterly reviews would facilitate implementation of the Fund-supported program.

Directors advised the authorities to press ahead with fiscal consolidation. To increase investment and social expenditure, they underscored that adjustment efforts should focus on increasing tax revenue and reigning in current spending. Directors called for continued emphasis on

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

strengthening tax collection, implementing the voluntary separations for civil servants, curtailing new wage increases unless growth surprises significantly, and enacting quarterly fuel price increases. They supported the authorities' efforts to maintain adequate social protection, including through equitable and sustainable pension reforms. Directors also highlighted the importance of targeted programs for the most vulnerable.

Directors welcomed the recent increase in the policy interest rate. They underscored that further tightening of monetary policy will be necessary to reduce inflation. Directors stressed that reducing foreign exchange interventions and increasing exchange rate flexibility would help improve the current account and rebuild international reserves.

Directors saw need for further financial sector reforms. They encouraged the authorities to build on recent achievements, including the establishment of the High Anti-Corruption Authority, and accelerate steps such as the one-stop shop for investors and the legislation to facilitate the reduction of banks' NPL portfolios. Directors noted that enhancements to the AML/CFT regime will help address Tunisia's deficiencies in this area.

Directors noted the advancements made in implementing structural reforms. They encouraged the authorities to accelerate efforts to complete the civil service reform, strengthen the selection and efficiency of public investment projects, and improve the management of SOEs. Directors also emphasized that priority needs to be given to reforming the energy sector, including addressing subsidies. They encouraged the authorities to build on the progress made in improving the business environment, especially streamlining the regulatory environment, and promoting good governance and transparency.

Tunisia: Selected Economic Indicators, 2013–2019

Population (2017): 11.5 million
 Quota: SDR 545.20 million
 Main exports: textiles, electronic and mechanical goods, energy, tourism
 Key export markets: France, Italy

Per capita GDP:
 US\$ 4232 (2012)

Per-capita GDP:
 US\$3,496 (2017)

Literacy rate (2014): 79%

Poverty rate (2015, national poverty line): 15%

	2013	2014	2015	2016	2017	2018	2019
					Prel.	Proj.	
Output							
Real GDP growth (%)	2.4	2.3	1.1	1.0	1.9	2.4	2.9
Employment							
Unemployment (end of period, %)	15.3	15.3	15.4	15.5	15.3	15.0	14.8
Prices							
Inflation (eop, %)	5.7	4.8	4.1	4.2	6.4	6.5	5.9
Central government finances (percent of GDP)							
Total revenue (excl. grants, % of GDP)	25.0	25.4	23.2	22.7	24.0	24.6	25.7
Total expenditure and net lending (% of GDP)	32.4	29.8	28.8	28.7	30.2	30.1	29.3
Overall balance (incl. grants, % of GDP)	-7.3	-3.7	-5.3	-5.9	-6.0	-5.2	-3.4
Cyclically-adjusted structural balance (% of GDP)	-6.4	-4.5	-4.7	-5.7	-6.7	-4.3	-3.1
Gross public debt (% of GDP)	46.8	51.6	54.8	61.2	71.3	73.1	73.3
Money and credit							
Broad money (% change)	6.6	7.8	5.3	8.1	9.8	7.4	9.1
Credit to the private sector (% change)	6.8	9.4	6.2	9.7	13.2	9.0	8.7
Balance of payments							
Current account (% of GDP)	-8.4	-9.1	-8.9	-8.8	-10.1	-9.2	-7.8
Foreign direct investment (% of GDP)	2.3	2.2	2.2	1.7	1.8	2.0	2.5
Reserve coverage (months of next year's imports of GNFS)	3.4	4.1	4.1	3.2	3.1	3.4	3.7
External debt (% of GDP)	57.0	61.4	64.9	72.2	80.1	83.7	85.5
Exchange rate							
REER (% change, "-": depreciation)	-1.9	-0.2	5.1	-4.7	-10.7	...	...

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



INTERNATIONAL MONETARY FUND



Press Release No. 18/104
FOR IMMEDIATE RELEASE
March 23, 2018

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review under the Extended Fund Facility (EFF) Arrangement for Tunisia

- The government's reform program supported by the EFF arrangement aims at reducing high and growing macroeconomic imbalances, ensuring adequate social protection, and fostering private sector-led, job-creating growth.
- Growth-friendly and socially-conscious reforms will help stabilize public debt below 73 percent of GDP by 2020 and raise investment and social spending.
- Continued monetary tightening and greater exchange rate flexibility help contain inflation, improve competitiveness, and rebuild international reserves.

On March 23, 2018, the Executive Board of the International Monetary Fund (IMF) completed the second review of Tunisia's economic reform program supported by an arrangement under the Extended Fund Facility (EFF). The completion of the review allows the authorities to draw an amount equivalent to SDR 176.7824 million (about US\$257.3 million), bringing total disbursements under the arrangement to the equivalent of SDR 631.3661 million (about US\$919 million).

In completing the review, the Executive Board approved the authorities' request for moving towards quarterly reviews from the current semi-annual schedule. Overall disbursements available throughout the program remain unchanged. The Board also approved the authorities' request for waivers of non-observance of end of December performance criteria on net international reserves, net domestic assets, the primary fiscal deficit, and current primary spending; and the non-observance of the continuous performance criterion on imposing or intensifying restrictions on the making of payments and transfers for current international transactions. It also granted approval for the retention of an exchange restriction barring trade credit for certain non-essential imports until December 31, 2018.

The four-year EFF arrangement in the amount of SDR 2.045625 billion (about US\$2.98 billion, 375 percent of Tunisia's quota) was approved by the Executive Board on May 20, 2016 ([see Press Release No. 16/238](#)). The government's reform program supported by the EFF aims at reducing macroeconomic vulnerabilities, ensuring adequate social protection, and fostering private sector-led, job-creating growth. Priorities include growth-friendly and socially-conscious fiscal consolidation to stabilize public debt below 73 percent of GDP by 2020 while raising investment and social spending, reversing the recent trend of accelerating inflation, and achieving more exchange rate flexibility to support exports and strengthen international reserve coverage. Structural reforms supported under the arrangement focus on improving governance, the business climate, fiscal institutions, and the financial sector.

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

Tunisia has experienced a modest recovery in 2017, but continues to face elevated macroeconomic vulnerabilities, and unemployment remains high. Debt has continued to increase, inflation has accelerated, and international reserve cover is now less than three months of imports. It is important to sustain macroeconomic stability with further decisive steps.

The authorities have begun to address these challenges through a deficit-reducing budget for 2018, monetary policy tightening, and a renewed commitment to a flexible exchange rate. Structural reforms have started to improve governance, strengthen the business environment, modernize the civil service and pensions, and restructure public banks.

Successful fiscal adjustment will require strong policy implementation. It will be critical to increase tax revenue in a fair way and reign in current spending to reduce debt and increase investment and social expenditure. The 2018 priorities are to strengthen tax collection, implement the voluntary separations for civil servants, not grant new wage increases unless growth surprises significantly, and enact quarterly fuel price hikes. It will be as important to distribute the adjustment burden equally across society and protect the vulnerable. Public-private partnerships should only proceed with adequate legal and regulatory frameworks.

The Central Bank of Tunisia has demonstrated its commitment to low inflation through a widening of the interest corridor followed by a strong policy rate increase. Further hikes will be needed to move real interest rates into positive territory unless inflation quickly subsides.

“Building on the real exchange rate depreciation in 2017, a move to greater exchange rate flexibility will be critical to correct the remaining overvaluation of the real exchange rate, improve the current account deficit, and rebuild reserves. This will require adherence to the FX intervention budget and more competitive FX auctions.

The authorities have increased near-term financing for social security. This should be followed by equitable and sustainable pension reforms. Finalizing the database of vulnerable households, which is critical for the targeting of social assistance, will help preserve the social contract.

The authorities have made considerable progress on structural reforms. They established the High Anti-Corruption Authority and are building institutions in support of the investment code, including the one-stop shop. The legislation to facilitate the reduction of NPL portfolios will help public bank restructuring. Ongoing enhancements to the AML/CFT regime will address Tunisia's deficiencies in this area.

Strong program implementation, supported by quarterly reviews, and the continued support of the donor community for Tunisia's reform efforts will be critical in the time ahead.



TUNISIA

March 14, 2018

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION, SECOND REVIEW UNDER THE EXTENDED FUND FACILITY, AND REQUEST FOR WAIVERS OF NONOBSERVANCE OF PERFORMANCE CRITERIA, AND REPHASING OF ACCESS

EXECUTIVE SUMMARY

A consumption-led, timid recovery has increased macroeconomic vulnerabilities.

Growth almost doubled to 1.9 percent in 2017, but record fiscal spending and strong credit growth, combined with dinar depreciation, pushed inflation to 7.1 percent in February 2018. The current account deficit widened to 10.1 percent of GDP over 2017 and reserve cover fell to 2.6 months of imports in early March 2018. Public and external debt finished 2017 at 71 percent and 80 percent of GDP, respectively. Discontent about economic conditions and the residual impact of several shocks—notably the 2015 terrorist attacks, political uncertainty, and spillovers from the Libyan conflict—continue to weigh on confidence and policy implementation.

Program performance has been weak, despite recent implementation progress.

The authorities are implementing a deficit-reducing budget for 2018 with strong revenue measures, voluntary departures of civil servants, and strict hiring limits. They also increased the policy interest rate by 75 basis points and advanced structural reforms, including through five Prior Actions for this review. All Quantitative Performance Criteria set under the four-year Extended Fund Facility (EFF) arrangement for December 2017 were missed and two of 14 Structural Benchmarks were met.

Accelerated reforms and decisive policies are needed to stabilize the economy.

Growth could pick up to 2.4 percent in 2018 and then gradually approach its potential of 4 percent. Tighter fiscal and monetary policies are needed to reduce inflation and debt—with continued exchange rate flexibility—to rebuild international reserves. Efforts to spread the adjustment burden more equally and protect the vulnerable should continue. Accelerated structural reforms and higher public investment will further boost confidence, improve fairness, and support job creation. Higher social spending and better targeting of assistance are critical to maintain adequate social protection. The two biggest risks remain a security incident and resistance to reforms.

Staff supports completion of the review based on strong corrective measures, but program risks are exceptionally high. It would make available SDR 176.7824 million (US\$246 million) and catalyze much-needed disbursements from other official partners.

Approved By
**Adnan Mazarei and
 Vitaliy Kramarenko**

Discussions took place in Tunis during November 29 to December 13, 2017; and continued from headquarters until March 9. The mission team comprised Björn Rother (head), Gomez Agou, Kerstin Gerling, Maria Mendez (MCD), Olivier Basdevant (FAD), Franck Dupont (MCM), Tim Willems (SPR), Robert Blotevogel (advance team lead, Resident Representative) and Adnen Lassoued (local economist). Monia Saadaoui (OED) participated in discussions. Staff met with the Head of Government, the Governor of the Central Bank, the Minister of Finance, the Minister of Development, Investment and International Cooperation, the Minister in charge of Major Reforms, the Minister of Tourism, and other senior officials, representatives of the employers' association, the corporate and banking sector, the diplomatic and donor community, civil society, academia, media, political parties and Parliament.

Greg Auclair, Samira Kalla, Ravaka Prevost, and Geraldine Cruz provided excellent assistance.

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Glossary

AFD	Agence Française de Développement
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ARA	Assessment of Reserve Adequacy
AREAER	Annual Report on Exchange Arrangements and Exchange Restrictions
ARP	Assembly of the People's Representatives
BEPS	Base Erosion and Profit Shifting
BFT	Banque Franco Tunisienne
bps	basis points
CA	Current Account
CBT	Central Bank of Tunisia
CIT	Corporate Income Tax
CMR	Council of Ministers
CNAM	Caisse Nationale d'Assurance-Maladie
CNRPS	Caisse Nationale de Retraite et de Prévoyance Sociale
CNSS	Caisse Nationale de Sécurité Sociale
COREFI	Comité de Réforme du Secteur Financier
CPI	Consumer Price Index
DGE	Direction des Grandes Entreprises
DGP	Direction Générale des Participations
DSA	Debt Sustainability Analysis
EFF	Extended Fund Facility
ELA	Emergency Liquidity Assistance
EM	Emerging Market
EMP	Exchange Market Pressure
EPA	Établissement Public Administratif
EU	European Union
FAD	Fiscal Affairs Department
FATF	Financial Action Task Force
FONAPRA	Fond National de Promotion de l'Artisanat et des Petits Métiers

FOPRODI	Fonds de Promotion et de Décentralisation Industrielle
FX	Foreign Exchange
GDP	Gross Domestic Product
HACGGA	High Anti-Corruption and Good Governance Authority
IFC	International Finance Corporation
IFI	International Financial Institutions
ILO	International Labor Organization
IMF	International Monetary Fund
INLCC	Instance Nationale de Lutte Contre la Corruption
INS	Institut National de la Statistique
IT	Indicative Target
LOI	Letter of Intent
LOLR	Lender of Last Resort
LPG	Liquefied Petroleum Gas
LTU	Large Taxpayer Unit
MCD	Middle East and Central Asia Department
MCM	Monetary and Capital Markets Department
MDCI	Ministère du Développement et de la Coopération Internationale
MEFP	Memorandum of Economic and Financial Policies
MENAFATF	Middle East and North Africa Financial Action Task Force
MOF	Ministry of Economy and Finance
MPCC	Monetary Policy Consultation Clause
NDA	Net Domestic Assets
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Assets
NIR	Net International Reserves
NPL	Non-Performing Loan
OECD	Organization for Economic Cooperation and Development
OED	Office of the Executive Director
OPL	Other Portfolio Liabilities
PC	Performance Criterion

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PPP	Public-Private Partnership
QPC	Quantitative Performance Criterion
RAM	Risk Assessment Matrix
REER	Real Effective Exchange Rate
SB	Structural Benchmark
SME	Small- and Medium-Sized Enterprise
SOE	State-Owned Enterprise
SPR	Strategy, Policy, and Review Department
STD	Short-Term Debt
STEG	Société Tunisienne de L'Electricité et du Gaz
STIR	Société Tunisienne des Industries de Raffinage
TA	Technical Assistance
TD	Tunisian Dinar
TFP	Total Factor Productivity
TMU	Technical Memorandum of Understanding
TSA	Treasury Single Account
UGTT	Union Générale Tunisienne du Travail
US\$	US Dollar
UTICA	Union Tunisienne de l'Industrie, du Commerce et de l'Artisanat
UTSS	Union Tunisienne de Solidarité Sociale

TUNISIA'S FRAGILE TRANSITION CONTINUES

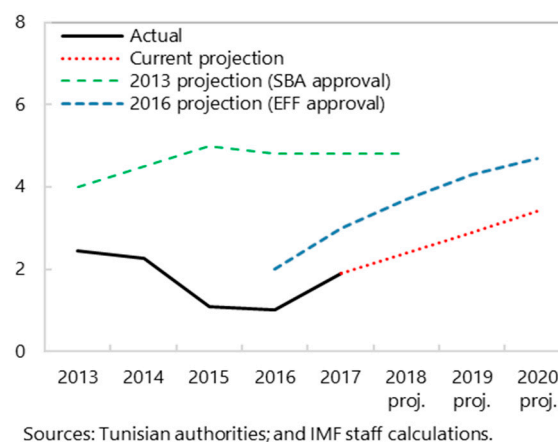
1. Policy and reform implementation has remained weak, despite some recent progress.

Since taking office in July 2016, the unity government has set out to accelerate reforms, contain the budget deficit, and maintain social peace through dialogue. While following broadly the recommendations of the 2015 Article IV report (Annex I), the road has been bumpy. An early attempt to delay wage increases was given up after significant resistance; the full application in 2017 of incompletely costed legacy commitments on wages has further disrupted efforts to slow the growth of the public wage bill; and political resistance has delayed progress with a large taxpayer unit (LTU) critical for tax collection. The implementation of an ambitious budget for 2018 constitutes the government's main response to address these challenges. It relies on strong tax measures and voluntary departures of civil servants to contain public debt and, over time, facilitate increased investment and social spending. The authorities have also taken steps to fight corruption, limit the growth of energy subsidies, improve the liquidity of pension funds, and advance public bank restructuring. After protests in January 2018, they adopted welcome increases in transfers to the most vulnerable. These steps signal progress, but more efforts are urgently needed to stabilize the economy.

2. A fragile environment continues to weigh on the economy. Macroeconomic stability has

been broadly maintained since the revolution, but several years of low confidence, especially in the aftermath of the 2015 terrorist attacks, have taken a toll on economic performance (Text Figure 1). Recurrent protests and political fragility show that many Tunisians remain frustrated about their unfulfilled economic aspirations and a perceived lack of fairness. Political uncertainty can be expected to persist as the country prepares for the upcoming election cycle (municipal elections in May 2018, parliamentary and presidential elections in 2019). Tunisia also continues to be vulnerable to spillovers from conflicts in Libya and elsewhere in the region, especially regarding security, migration flows, and illicit economic activity.

Text Figure 1. Growth Realizations and Projections, 2013–20
(Percent)



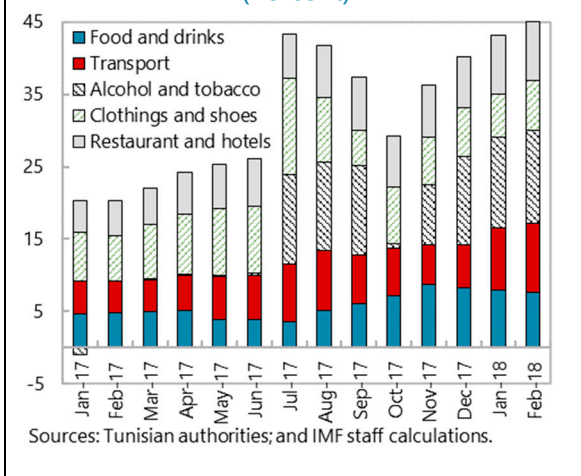
3. A consumption-driven, timid recovery has increased macroeconomic vulnerabilities (MEFP 1113-10).

- Growth improved to 1.9 percent in 2017 from 1 percent over 2015–16.** As in previous years, strong public and private consumption supported this pick-up, while investment and exports remained significantly below average historical levels since the 1970s. Tourism-related services, agriculture, and phosphates were the key sectors underpinning the growth acceleration.

- **Unemployment continues to plague 15 percent of the labor force.** More worrisome, it affects 1 out of 5 women and 1 in 4 graduates. The informal sector remains large, accounting for at least one-third of the economy.
- **CPI inflation accelerated to an annualized 7.1 percent in February 2018.** Dinar depreciation, wage hikes in the public and private sectors, and an increase in some administered prices (including fuels, alcohol, tobacco, and telecommunication) as well as those for fresh food were the main underlying drivers (Text Figure 2).

Price pressures were accommodated by broad money expansion above nominal GDP growth. Central bank refinancing of commercial banks reached a record TD 13 billion at the beginning of March 2018 after having more than doubled in 2017. This was partly owed to net foreign asset (NFA) outflows from the financial system in 2017 of about TD 3 billion that drained dinar liquidity. In response to these preoccupying trends, the Central Bank of Tunisia (CBT) widened its interest rate corridor from 50 basis points (bps) to 200 bps in December 2017, and raised the policy interest rate by 75 bps to 5.75 percent in March 2018.

Text Figure 2. Inflation Drivers, 2017-18
(Percent)



- **The current account deficit deteriorated to a record 10.1 percent of GDP over 2017.** This deterioration reflected an increased import bill, while exports remained sluggish. Data on January and February 2018 suggest that the lagged positive effect of the real exchange rate depreciation of 10 percent over 2017 is starting to materialize: export values grew by 47 percent year-on year (16.4 percent for January in volume terms), about twice as strongly as imports (23 percent in value terms and, for January, 1.6 percent in volume terms). International reserves declined to 2.6 months of imports in early March 2018. This reflects sizeable central bank FX sales to cover energy imports of state-owned enterprises (SOEs) and delays in external budget financing.
- **The fiscal deficit ended 2017 at 6 percent of GDP, broadly in line with First Review projections.** This said, spending quality was weaker-than- envisaged. The underlying wage bill—including wage components paid out as tax credits to public sector workers—grew by 0.5 percent of GDP to reach 15.0 percent (14.7 percent excluding tax credits). Meanwhile, public investment increased only moderately by 0.2 percent of GDP, to reach 5.5 percent.
- **Public and external debt ratios worsened.** They reached 71 percent of GDP and 80 percent of GDP at end-2017, respectively. Dinar depreciation, lower-than-anticipated growth, and large fiscal financing needs (adding US\$3.6 billion to public external debt) were the main drivers.

- **Financial markets remained calm, despite Moody's downgrade in August (to B1 from Ba3).** The weaker dinar has not significantly affected bank profitability due to generally low FX exposure on the balance sheets of banks and their corporate and household customers. Liquidity and solvency ratios have been generally well respected. At the same time, little progress was made with reducing bank holdings of non-performing loans (NPLs).
- 4. Program performance was weaker than expected** (MEFP Tables 1, 2):
- **Fiscal policy.** The end-December Quantitative Performance Criteria (QPCs) on the primary balance computed on a cash basis and the total current primary expenditure were missed slightly. This reflects the impact of advances made to ease the cash situation of social funds. The Indicative Target (IT) on social expenditure was met.
 - **Monetary and exchange rate policy.** The end-December QPC on the floor of net international reserves (NIR) was missed by 15 percent. This was due to larger-than-programmed FX sales to facilitate energy imports from state-owned enterprises in the context of an illiquid FX interbank market and an elevated current account deficit reflecting strong import growth, including for consumption goods. The QPC on net domestic assets (NDA) was missed by a large margin as the low interest rate cost and a persistent lack of bank liquidity triggered record-level CBT refinancing operations.
 - **Structural Benchmarks (SBs).** The authorities only met two of the 14 Structural Benchmarks (SBs) for the Second Review and one additional one with delay. They created the High Anti-Corruption and Good Governance Authority (HACGGA), adopted a decree on hiring controls, and completed the inspections of the seven largest private banks. To improve performance, they successfully undertook five Prior Actions for the Second Review (MEFP Table 2). The outstanding SBs, some of which saw significant progress, were reprogrammed.

IMPROVING OUTLOOK, MAINLY DOWNSIDE RISKS

- 5. The economy will continue to improve with the implementation of strong policies** (Text Table 1).

- **The recovery is expected to continue in 2018 and over the medium term** (MEFP ¶14). Growth is projected to strengthen to 2.4 percent in 2018. A pick-up in partner-country growth and improved cost competitiveness would benefit manufacturing and tourism-related services, while the climatic conditions already augur a stronger agricultural season, especially in olive oil production. Lower strike activity would benefit the mining sector. GDP growth would further accelerate through the medium term to reach its potential of around 4 percent by 2022, supported by a gradual shift in demand from consumption to investment and exports. This welcome trend would occur more slowly and less forcefully compared with earlier expectations (Text Figure 1), reflecting higher residual political uncertainty, delays with structural reforms, and difficulties in regaining lost markets for phosphates and tourism. Moreover, public investment

will increase more slowly than envisaged earlier (¶13), and tighter monetary and fiscal policies will dampen consumption growth.

- ***Inflation will peak in 2018 prior to a gradual normalization.*** A tightening of macroeconomic policies in 2018 would mitigate the impact of the pass-through of dinar depreciation, tax increases, and price hikes. Inflation would be contained at around 7 percent before easing over the medium term.

Text Table 1. Selected Economic Indicators, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
							Proj.		
Real GDP growth (in percent)	1.1	1.0	1.9	2.4	2.9	3.4	3.6	4.0	4.2
Consumer price index growth (period average, in percent)	4.9	3.7	5.3	7.0	6.1	5.2	4.3	4.0	3.9
Current account balance (in percent of GDP)	-8.9	-8.8	-10.1	-9.2	-7.8	-7.2	-6.4	-6.0	-5.8
Gross official reserves (end of period, in billions of US\$)	7.4	5.9	5.7	6.3	7.0	7.1	7.4	8.0	8.6
Gross official reserves (end of period, in months of next year's imports)	4.1	3.2	3.1	3.4	3.7	3.7	3.7	4.0	4.2

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

- ***The current account will improve in line with competitiveness gains, helping reserves.*** Benefiting from further gains in price and non-price competitiveness, the current account deficit is projected to narrow to 9.2 percent of GDP in 2018 and to 7.2 percent of GDP in 2020, from 10.1 percent of GDP in 2017. Tourism, phosphates, energy, and manufacturing would lead the export recovery. Gross reserve coverage would increase from 3.1 months of imports in December 2017 to 3.7 months by 2020 or 107 percent of the ARA metric (MEFP ¶21).
- ***Negative external and public debt dynamics will reverse.*** Public and external debt ratios are expected to peak in 2019 at, respectively, 73 percent and 86 percent of GDP (compared with a peak of 72 percent and 81 percent in 2018 expected at the time of the First EFF Review). They would then assume a downward trend toward 69 percent and 80 percent of GDP by 2023 in response to fiscal consolidation and higher growth. Debt sustainability analyses (Annexes IV and V) signal a high vulnerability of the debt stocks to shocks, notably to the exchange rate, growth, and the fiscal balance (Annexes 1 and 2).

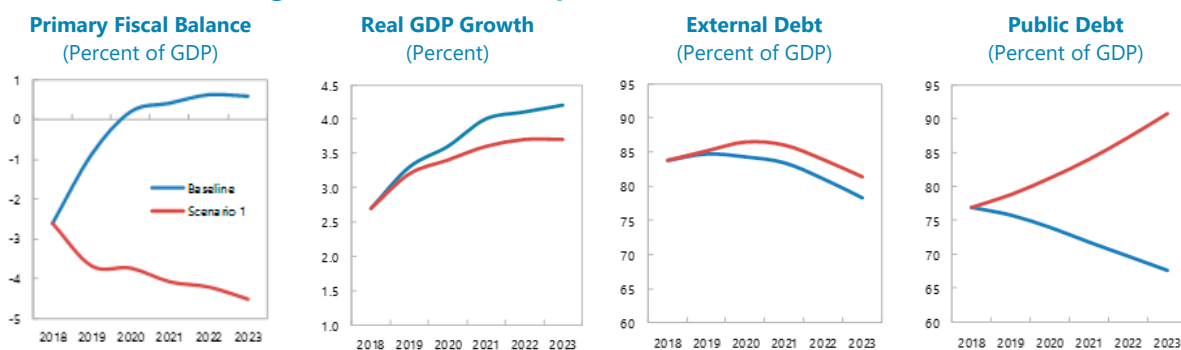
6. Exceptionally high risks persist that could undermine domestic and external stability.

There are upside risks to the outlook, especially stronger-than-expected growth in Europe and higher investment if the private sector responds quickly to improving confidence. However, the balance of risks remains tilted to the downside. The authorities and staff agreed that two risks, political stalemate and a security incident, would have a particularly worrisome impact if they were to occur (RAM, Annex II):

- ***Political stalemate over adjustment and structural reforms.*** This risk scenario assumes that efforts to tighten fiscal and monetary policies as well as structural reforms would not bear fruit over the medium term, as the authorities fail to mobilize sufficient political support in Parliament and society for their reform program (Text Figure 3). Even with improved external economic conditions, fiscal deficits would continue to increase as revenues from taxes and SOEs remain

subdued while major spending categories (wage bill, energy subsidies, pensions, as well as debt service) continue to grow in line with latest trends. Growth would remain lackluster as confidence remains depressed, unemployment rises, inflation shifts upward, and international reserves would continue to fall. By 2020, public and external debt reach 80 percent and 87 percent of GDP, respectively. This illustrates the importance of building on the recent policy momentum to avoid, in just a few years, a situation where disorderly adjustment would become likely.

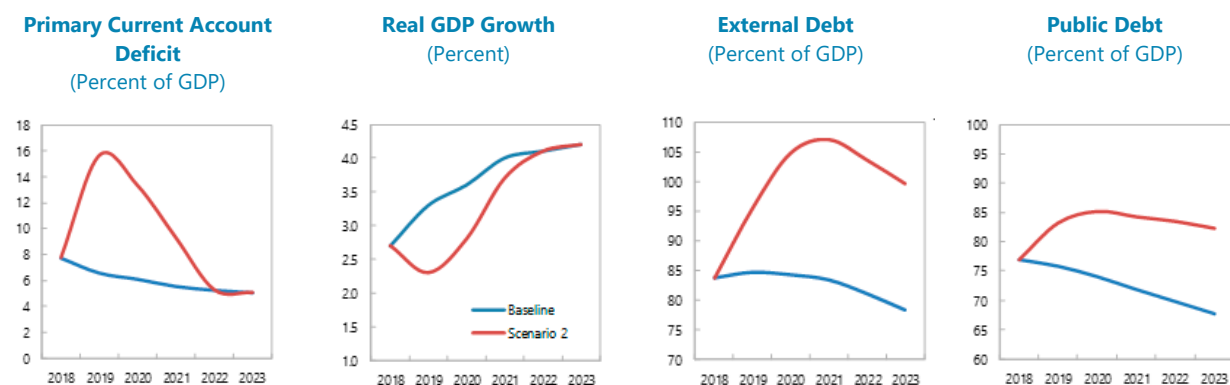
Text Figure 3. Scenario 1: Impact of Political Stalemate, 2018–23



Source: Tunisian authorities, and IMF staff projections.

- A major security incident triggering a renewed confidence shock.** Such an incident would have an impact on investor and business confidence similar to the one observed after the 2015 terrorist attacks. Growth would fall precipitously as investment and tourism falter, in turn inducing a higher fiscal deficit as revenues decline and anti-cyclical spending increases (Text Figure 4). Public and external debt would also increase and reserve cover decline significantly, requiring that the authorities implement strong adjustment measures. This scenario shows how important it is to continue with measures to improve security (security spending, which has significantly increased since 2015, currently accounts for 5–6 percent of GDP). It also underlines the importance of reducing debt and strengthening reserves quickly to build buffers that could be used for a policy response to a negative event.

Text Figure 4. Scenario 2: Impact of a Major Security Incident, 2018–23



Source: Tunisian authorities, and IMF staff projections.

POLICIES TO TURN HIGH ASPIRATIONS INTO INCLUSIVE GROWTH

7. Tunisia's economy needs strong reforms that work in a fragile socio-political context.

The authorities and staff agreed that policies should focus on growth-friendly and socially-balanced macroeconomic tightening and on moving back toward a de facto floating exchange rate regime (Section A), maintaining adequate social protection, especially for the most vulnerable (Section B), and structural reforms to support private sector-led, inclusive growth (Section C). The authorities emphasized the need for reforms to take Tunisia's political constraints into account—especially its preference for an inclusive style of decision making.

A. Maintaining Macroeconomic Stability Amid High Vulnerabilities

8. **The policy mix pursued over recent years has contributed to large imbalances.** Tunisia's economy has suffered from major shocks since the revolution (especially the 2015 terrorist attacks, but also the prolonged political transition and spillovers from conflicts in Libya and elsewhere in the region). At the same time, the authorities' policy mix has also contributed to elevated vulnerabilities.

- **Fiscal policy.** High deficits and quickly accelerating debt levels have emerged from a growing gap between expenditures and resources, partially due to delays in critical structural reforms. Revenue suffered from low growth and governance issues, while expenditure on wages and subsidies responded to strong counter-cyclical pressures. The expansionary fiscal stance fueled the current account deficit, in part through a wage channel.
- **Monetary and exchange rate policy.** Central bank FX sales have been large relative to FX inflows, gradually reducing international reserves. Monetary policy has sterilized a sizeable contraction of NFA and accommodated fiscal expansion as well as robust credit growth. This has contributed to price pressures and strong import demand weighing on the dinar. Key interest rates remain negative in real terms even after recent tightening.
- **Structural reforms.** Measures to address key constraints to growth have progressed, but have not yet created sufficient momentum to improve business confidence in a sustained way.

9. **Maintaining domestic and external stability requires policy tightening.** The authorities and staff agreed on the need for strong measures to support growth acceleration and reduce elevated vulnerabilities that could lead to significant pressures on the dinar or on public and external debt. This entails a tightening of fiscal and monetary policies, mindful of social impact, to slow consumption growth and reorient demand toward exports and investment. Given that this may dampen growth in the short run, especially if confidence remains subdued, it will be critical to move ahead in parallel with structural reforms to help improve the competitiveness of Tunisian firms, generate new business opportunities, and demonstrate to all Tunisians that the country is on track toward achieving more economic fairness and prosperity.

Debt-reducing Fiscal Adjustment that Minimizes Harm to Growth and Preserves Fairness

Background

10. In 2017, the fiscal deficit remained high, without an increase in pro-growth spending.

The unity government had to absorb major unanticipated wage increases in the 2017 budget that drove spending to a record 30.3 percent of GDP, while investment increased only marginally. In response, the authorities took emergency measures on the wage bill and increased revenue collection beyond budgeted levels, mainly through a more aggressive pursuit of tax arrears (MEFP ¶15). This allowed them to remain within the envisaged budget envelope agreed at the time of the First EFF Review from a commitment perspective, but the cash-based fiscal QPC for December 2017 were missed slightly (¶14).

11. The authorities aim at gradual deficit reduction to reverse adverse debt dynamics. The programmed fiscal effort is anchored on an improvement of 1.9 percent of GDP in the cyclically-adjusted structural fiscal balance over 2018–20, up from the target of 1.5 percent of GDP agreed at the time of the First EFF Review (Figure 6). After steadily increasing deficits since 2015, the first year of modest consolidation will be 2018, with the overall deficit, including grants, falling to 5.2 percent of GDP from 6.0 percent in 2017. This initial adjustment will rely mainly on a strong tax revenue package to generate 2.2 percent of GDP in additional yield. Efforts to contain current spending growth will also show early effects, and will produce a deeper impact in subsequent years. This program will reverse recent rapid debt accumulation (public debt would fall below 70 percent of GDP by 2023) and at the same time leaves space for increasing public investment and social spending over the medium term, which is essential to support growth and social cohesion.

12. The 2018 budget programs a modest consolidation based on bold reforms. The revenue package covers all areas of taxation and emphasizes reinforced tax collection (MEFP ¶19). The regressive distributional impact of indirect taxes will be lowered by higher excises on products and services mostly consumed by the better-off, as well as by leaving VAT exemptions for basic food items unchanged. Furthermore, the authorities expect no significant net increase in the direct tax burden of most firms and households when the new measures are seen in conjunction with the simultaneous phasing out of the 2017 exceptional corporate tax on firms (a reduction of 0.9 percent of GDP in the tax burden) and the tax savings provided to lower-earning households in the context of the 2017 reform of the income tax thresholds and associated rules for tax deduction (Text Table 2). Regarding expenditure (MEFP ¶19), the budget prioritizes the following: (1) containment of energy subsidies at 2.0 percent of GDP; (2) implementation of the civil service reform; (3) reduced transfers to the pension funds (¶134; and

Text Table 2. Change in Tax Revenue, 2017–18

	Percent of GDP
2017 tax revenue	21.7
Expiration of measures	
2017 one-off measures	-0.9
2017 tax credits	0.3
Phase-in of new measures	
2018 tax package	2.2
2018 tax credits	-1.0
Additional 2018 tax revenue from oil sector	0.1
2018 tax revenue	22.4
Sources: Tunisian authorities; and IMF staff projections.	

MEFP ¶19); (4) liquidation of the Banque Franco-Tunisienne (BFT); and (5) more support to vulnerable families and households with low pensions, estimated to cost 0.2 percent of GDP. Public investment will remain unchanged from 2017 in nominal terms, generating about half of the total deficit adjustment from 2017 to 2018.

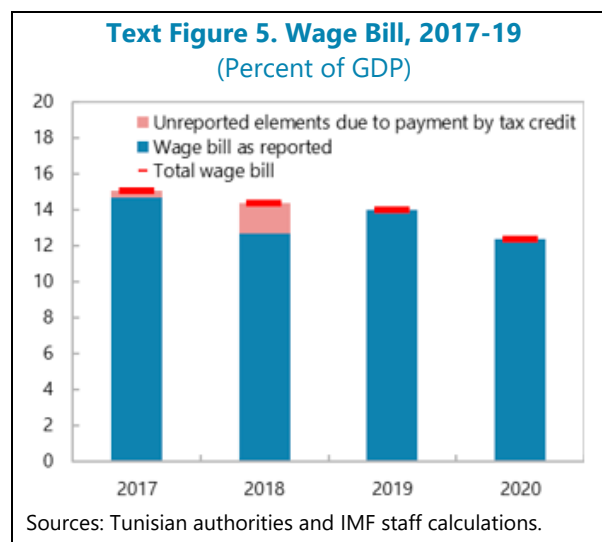
Policy Discussions

13. Need for strong policy implementation in 2018 and firmer plans for the medium term.

The intended medium-term adjustment path needs to be better articulated, supported by continued technical assistance (TA) from the IMF, the World Bank, the Agence Française de Développement (AFD) and others. A swift adoption of the Organic Budget Law, which still awaits a vote in Parliament, will facilitate this agenda by introducing multi-year and results-based budgeting (reprogrammed SB for December 2018, MEFP ¶12). The authorities and staff concurred on the importance of further strengthening Tunisia's fiscal institutions with the following measures:

- **Sustained efforts regarding tax fairness and tax collection.** Staff welcomed the tax package for 2018, but called on the authorities to further improve fairness going forward—and create space to lower tax rates—by (1) increasing taxation on the services of liberal professions (new SB for December 2018, MEFP ¶25); (2) reducing VAT tax exemptions; (3) rationalizing corporate income tax (CIT) incentives by reducing related tax expenditures; (4) moving the tax burden towards consumption rather than labor to support job creation, with the impact on the poor being mitigated by targeted social assistance; (5) raising taxes on incomes other than salaries and wages (especially dividends and real estate); and (6) making progress with the convergence of the tax regimes for the onshore and the offshore sectors. The authorities confirmed that the 2018 increase in customs duties is consistent with Tunisia's WTO obligations and was implemented primarily for budget reasons. Both sides agreed that achieving the ambitious revenue targets for 2018 will require stronger tax administration. There was a setback in the creation of the LTU (MEFP ¶¶12, 25), but—after merging the audit and tax arrears recovery functions by mid-year (new SB for July 2018)—it will be fully operational by year-end (reprogrammed SB for December 2018).
- **Steadfast civil service reform to reduce the growth of the wage bill.** This reform aims at better service quality and a reduction in the underlying wage bill-to-GDP ratio from 14.7 percent in 2017 to 12.4 percent in 2020 (Text Figure 5). As agreed at the time of the First Review under the EFF, wage bill containment will rely on: (1) strict limits on new hiring, supported by a decree that sets the maximum number of recruitments for 2018 at 3,000 (met SB, October 2017, MEFP ¶12); (2) implementation of a voluntary early retirement scheme (targeting 6,400 staff) and voluntary separations for civil servants (targeting about 10,000 staff); and (3) not granting new wage increases over 2018–20 unless the programmed path in the wage-bill-to-GDP ratio could be retained, which would require a major positive surprise to GDP growth. Additional measures, including a potential further call for volunteers in 2019, may be needed to stay on the planned

wage bill trajectory, depending on the outcome of the 2018 program. Staff encouraged the authorities to quickly move ahead with the voluntary departure scheme and to advertise it effectively to achieve a strong budget impact in 2018. Staff also reached out to donors to secure funding support for the packages. The functional reviews already completed for three ministries could help ensure adequate service quality as staff leaves by indicating options for redeployment (reprogrammed SB for June 2018, MEFP ¶¶112, 25). Staff emphasized the detrimental impact of any new wage increases on the budget, inflation, and the current account.



- Reduction of energy subsidies to shield the budget from oil price increases.** The authorities initially planned a 1.6 percent of GDP envelope for the energy subsidy budget, assuming an oil price for 2018 of US\$54 per barrel. They applied an ad-hoc price increase of 3 percent on average for the three main fuel categories in December 2017 and intend to apply four more price adjustments in 2018 (reprogrammed SB, continuous from March 2018 until the end of the program, MEFP ¶¶112, 19). Staff was concerned that the rise in international oil prices in early 2018 and delays already incurred in administering the envisaged price hikes may make it impossible to stay within the envisaged envelope. As a result, noting the difficult political environment, it was agreed to pre-emptively change the fiscal program under the EFF arrangement to increase the energy subsidy bill to 2.0 percent of GDP. It was further agreed to correspondingly raise the deficit target for 2018 to 5.2 percent of GDP from the 4.8 percent of GDP envisaged in the budget law (after also accounting for 0.2 percent of GDP in new social transfers for vulnerable sectors adopted in January, and higher-than-budgeted nontax revenue from the CBT and energy firms). The authorities are committed to implement further price adjustments as needed to contain the energy budget to the agreed level.
- Further reforms of social security funds to ensure their financial viability.** The authorities have made some progress with social partners on reforming the CNRPS public pension fund and the CNSS private pension fund, notably through higher employer and employee contributions. Staff emphasized that the initial reform ideas are only a first step toward longer-term financial viability of the pension funds. More efforts will be needed to increase the retirement age and align benefit levels with affordability (Section 3.B).
- Better management of fiscal risks emanating from State-owned Enterprises** (MEFP ¶¶112, 25). The authorities have included financial indicators in the performance contracts of four of the five largest SOEs, which allows for closer and more timely monitoring of results. A performance

contract for Tunisair is advancing (reprogrammed SB for December 2018). They also indicated their intention to continue working with AFD and others on improving SOE management.

- Increased and more efficient public investment and social spending.** The authorities explained that some public investment projects suffer from low efficiency due to inadequate cost-benefits analyses, weak project monitoring, and limited implementation capacity especially at the regional level. They did not anticipate a major negative impact on growth emanating from their decision to freeze 2018 capital spending, in nominal terms, at 2017 levels. The authorities intend to rely more on public-private partnerships (PPPs), for which they see major potential in Tunisia. Staff offered IMF TA on investment management in close cooperation with the World Bank, and underlined the criticality of increasing capital spending from 2019 to support growth. Staff also underscored the need to follow up the adoption of the PPP law in September 2016 by putting in place upgraded frameworks to contain fiscal risks before proceeding with PPPs, which could benefit from World Bank expertise. Both sides agreed on the importance of gradually increasing social spending and on introducing a QPC in support of this objective (this will be monitored starting at the Fourth Review).

Preserving Monetary Stability and Improving the Monetary Policy Framework

Background

14. Monetary policy has started to tighten, but has not avoided record bank refinancing.

Supported by low-cost central bank refinancing, commercial banks have continued to buy large amounts of treasury bills with attractive, risk-free yields and increased credit to firms and households at a rate of 13 percent in 2017, well above nominal GDP. This has contributed to fueling inflation and—via import demand—a higher current account deficit as well as dinar depreciation. In response, the CBT increased its policy interest rate by 75 bps to 5.75 percent in March and enforced a quantitative limit of TD 7 billion for seven-day tender auctions with commercial banks since July 2017, with any excess demand driven to the more expensive 24-hour lending rate. The CBT also broadened the interest corridor around the policy rate from 50 bps to 200 bps in early January 2018. As a result, the cost of liquidity has started to increase: the interbank rate rose from 5.4 percent at end-December to 5.8 at the beginning of March. Commercial bank rates for prime borrowers stand in the 8 to 12 percent range.

15. Transmission channels remain weak despite upgrades in monetary policy operations. The authorities have worked on updates to the monetary policy framework, with TA from the Banque de France and the IMF. This has resulted in stronger rules on collateral eligible for refinancing and improvements in liquidity factor forecasting. The CBT has also started to publish a yield curve for treasury bonds in December 2017, facilitated by assistance from the European Bank for

Text Figure 6. Cash in Circulation, 2007-17
(Percent of GDP)



Sources: Tunisian authorities and IMF staff calculations.

Reconstruction and Development. At the same time, monetary policy transmission channels remain weak. First, a growing demand for currency in circulation linked to the informal economy reduces the money multiplier (Text Figure 6). Second, credit demand has so far shown little elasticity to interest rate changes. Finally, low levels of capital account openness impact the strength of the exchange rate channel.

16. The CBT has made progress in implementing safeguards recommendations. In addition to the now operational lender of last resort (LOLR) framework, work is underway to modernize the CBT's risk management unit through the establishment of a risk committee. The CBT is also reviewing its internal audit function to strengthen and align current practices with international standards (MEFP ¶24).

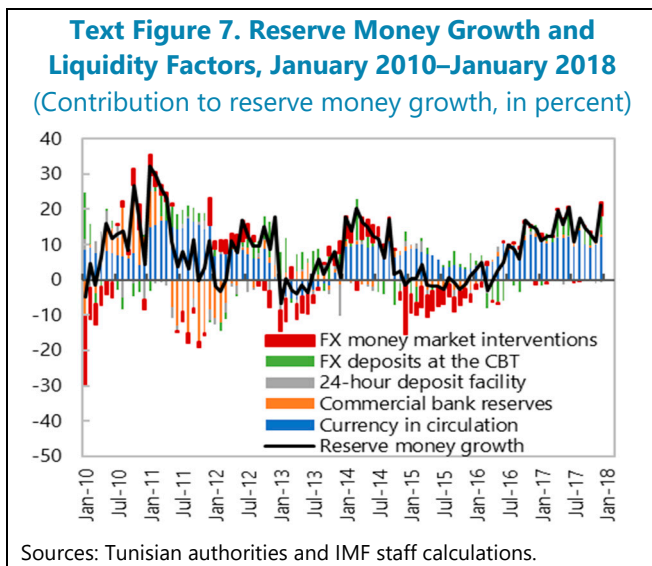
Policy Discussions

17. Monetary tightening is critical to support much-needed disinflation (MEFP ¶20). The authorities and staff concurred on the need to contain the growth of monetary aggregates to gradually reduce inflation to the low- to mid-single digits. Lower CBT refinancing of commercial banks will be particularly important in limiting credit growth to the economy to nominal GDP growth. Both sides also agreed that: (1) the recent increase in the policy interest rate in combination with the widening of the corridor will send a strong signal of the CBT's commitment to fight against accelerating inflation; and (2) further interest rate increases will be needed if inflation—and especially core inflation that excludes volatile food and energy prices—does not decelerate and key interest rates—in real terms—remain in negative territory.¹ To strengthen the effectiveness of monetary policy, the CBT agreed to assess the evolution of net domestic assets with staff on a monthly basis. At the same time, the CBT cautioned that it would take three to four months for credit to react to interest rate changes, and still more time to see the full impact on inflation. Furthermore, the case for further monetary tightening would have to be carefully assessed in the context of Tunisia's fragile growth and banks' liquidity needs (¶13).

18. The CBT will continue efforts to increase monetary policy effectiveness (MEFP ¶20). Staff welcomed the recent improvements to liquidity and collateral frameworks, and encouraged the authorities to increase maximum lending rates as soon as possible to broaden access to credit (the law still awaits Parliament consideration; reprogrammed SB for May 2018, MEFP ¶¶12, 24). The authorities and staff shared the concern about the recent increase in currency in circulation and its contribution to the monetary base (Text Figure 7). Its reversal would require steps to address informality and improve confidence, including through continued progress with financial sector reforms (Section 3.B). The authorities highlighted their intent to quickly replace the management of monetary aggregates with inflation targeting and a Monetary Policy Consultation Clause (MPCC) in

¹ Different specifications of a Taylor rule suggest a policy rate in the range of 6–8 percent as a plausible target. Staff interprets these results as an upper bound of a feasible corridor for rate setting, given the impact of interest rates on debt and growth.

the program. Staff cautioned that a transition would be risky in the current environment, and would require more exchange rate flexibility as well as the exclusion of fiscal considerations from monetary policy decisions. Staff encouraged the CBT to continue acting decisively in the face of strong inflation pressures to buttress the credibility of its intended regime change towards inflation targeting. The establishment of a Treasury Single Account (TSA) would improve cash management and thereby reduce fiscal pressures on the central bank.



More Exchange Rate Flexibility to Facilitate External Sector Recovery

Background

19. Tunisia’s external position remains substantially weaker than warranted by fundamentals. Despite recent depreciation, staff analysis suggests that the real effective exchange rate (REER) was overvalued by 10–20 percent at end-2017 (Annex III). Exchange rate-based methodologies (assessing the discrepancy between the actual REER and the REER aligned with fundamentals) suggest a slightly larger degree of overvaluation (15–20 percent) than the external sustainability approach (computing the current account balance that would bring the NFA position to a sustainable level) which indicates an overvaluation of about 10 percent. This assessment is consistent with further evidence:

- **An unsustainable current account position.** Tunisia’s record current account deficit of 10.1 percent of GDP in 2017 suggests the need for a further correction of the real exchange rate gap through a change in the policy mix, of which the exchange rate is typically a major ingredient. A tightening of monetary and fiscal policies in support of domestic disinflation can also support this objective, but the scope for these policies has limits in Tunisia’s environment of low growth and high unemployment.
- **Sustained loss of reserve cover.** The CBT has intervened significantly above the limits agreed under the EFF arrangement in the FX market: its net FX sales between the start of 2017 and end-January 2018 amounted to US\$3.1 billion—the equivalent of 7.7 percent of GDP or more than three quarters of total 2017 inflows from official external partners—mainly to finance energy imports in the context of an illiquid interbank FX market. This practice has contributed to an erosion of reserves: NIR fell by US\$215 million over the course of 2017, and reserve cover of imports decreased from 110 days at end-2016 to 78 days in early March 2018. Daily trading volumes on the interbank FX market remain low, suggesting that market participants do not think that the dinar has reached its equilibrium value.

- **Introduction of exchange restrictions.** In October 2017, the CBT introduced legislation that bars trade credit for certain non-essential imports. The authorities stated that the main objective of this measure was macro-prudential and emphasized that it only applies to a limited list of non-essential goods whose import remains unrestricted when not financed with credit. Notwithstanding this reasoning, since the measure restricts access to short-term financing for current international transactions that was customarily available, it constitutes an exchange restriction inconsistent with the IMF's Article VIII, Section 2(a) and resulted in the non-observance of the continuous PC against the imposition of exchange restrictions (Section 4).²

20. The new FX auction mechanism has not yet led to fully competitive practices. To increase the transparency of intervention practices and provide better guidance to market participants on its intentions, the CBT adopted a new auction mechanism. This mechanism has become the exclusive tool for interventions. At the same time, the implementation of the mechanism has not yet met standards of competitive auctions—no bid was ever rejected, and all bids were subjected to similar pro-rating regardless of their attractiveness (reprogrammed SB for June 2018, MEFP ¶12).

Policy Discussions

21. The authorities disagreed with staff on the magnitude of REER overvaluation. They saw only a modest residual real exchange rate overvaluation, which would be gradually corrected over the medium term. At the same time, they accepted that the REER could be overvalued by more than their current estimate. They remained cautious about the impact of a more competitive real exchange rate on exports and imports, pointing to structural deficiencies, residual concerns over security, and social activities hampering production in the phosphate and energy sectors as main impediments to stronger export growth. Staff reiterated its assessment that the real exchange rate remained overvalued by about 10–20 percent at the start of 2018, after the welcome depreciation in 2017. The exchange rate regime should quickly return to a de facto floating regime from what has evolved over recent months into a crawl-like regime. Staff also pointed to the favorable evolution of exports and imports in the first two months of 2018 as an encouraging sign that could reflect the start of a current account reversal to a more sustainable level.

22. Lower intervention is vital to rebuild reserves and support exchange rate flexibility. The authorities and staff agreed on the need to quickly return to tighter FX intervention limits to protect reserve cover (MEFP ¶21). The CBT highlighted, however, that it would need to continue facilitating lumpy energy imports until volumes on the FX interbank market increased sufficiently through a stronger recovery of tourism and phosphate exports. The CBT stressed that increasing domestic energy production, which suffered from significant disruptions in 2017, will be critical to sustainably reducing the need for FX sales in support of energy imports. Staff emphasized the need

² The IMF's Article VIII, Section 2(a) requires members not to impose restrictions on the making of payments and transfers for current international transactions without the Fund's approval, and the continuous PC under the EFF arrangement for Tunisia requires Tunisia not to impose or intensify restrictions on the making of payments and transfers for current international transactions during the period of the arrangement.

to restore adequate reserve coverage as soon as possible to shore up investor confidence and provide a more comfortable cushion in case of unanticipated shocks. It also stressed that energy-related interventions should be transparent and at market-determined rates. The authorities reiterated their commitment to meet the average monthly net intervention budget. This is consistent with providing a part of the FX resources needed to facilitate energy imports and increasing reserve cover to 3.4 months of imports at end-2018. Both sides saw an urgent need to undertake energy sector reforms.

23. Agreement on proceeding with caution on exchange and capital account measures.

The authorities indicated their intention to remove the recently introduced exchange restriction by the end of 2018; and agreed to take timely steps to make the FX auction mechanism more competitive. The authorities and staff agreed that the current fragile environment is not an opportune time to proceed with further capital account liberalization, which would risk promoting sudden capital outflows. At the same time, such liberalization will remain an important medium-term objective that would be pursued in line with progress on developing domestic financial institutions and upgrading their prudential supervision.

B. Ensuring Adequate Social Protection as Key Part of the Social Contract

24. Modernizing the social protection system is critical to Tunisia's stability. Economic and social inclusion has not progressed strongly since the revolution, as corroborated by persistent demands from lower- and middle-income households, and from residents of the interior regions for better livelihoods and more jobs. Poverty has remained elevated in the absence of comprehensive reforms of social protection, including with regard to its coverage. This has nourished widespread social discontent and risks to undermine trust in the government's reform efforts.

Background

25. Existing social support programs suffer from inefficiency, fragmentation, and inequity.

The National Development Plan 2016–21 calls for moving towards a three-tier universal coverage system advocated by the International Labor Organization (ILO).³ However, in the current context of limited fiscal space, progress has been slow. Most existing social protection programs are underfunded; tend to disproportionately benefit the better-off; and fail to cover a significant part of the poor and informal sector employees.

- **Social security has a narrow beneficiary base and remains underfunded.** According to the World Bank, only about a third of Tunisians contribute to the pension system, and only half are covered by health insurance. A national unemployment insurance scheme does not exist. Moreover, the authorities and staff established that the social security system is burdened by significant deficits. The consolidated cash needs of the public and private pension funds (CNRPS

³ Tier 1 involves minimum income and minimum health coverage for all citizens, at a cost of 3.5 percent of GDP as estimated by the ILO; Tier 2 involves a mandatory contributory system with a ceiling on benefits; and Tier 3 would be an optional or compulsory complementary system.

and CNSS) and the public health fund (CNAM) amounted to 0.7 percent of GDP at end-2017 (which is a net figure, accounting for budget transfers of 0.5 percent of GDP to CNRPS and 0.1 percent of GDP to CNSS in 2017) and are set to reach 1.5 percent of GDP in 2018 (Text Table 3). The pension system is financially unsustainable due to a large structural gap between benefits levels (replacement income of up to 80 percent of salaries) and financial resources mobilized by contributions. The situation is likely to worsen in the years ahead with growing life expectancy and the weak cash flow of many SOEs that may affect contributions. Moreover, the pension funds' arrears to the health fund, which otherwise could cover its costs, undermine the provision of basic public services.

Text Table 3. Financial Situation of the Social Security System
(Percent of GDP, end of period)

	Stock of arrears		Cash needs	
	2016	2017 Prel.	2017 Prel.	2018 5/ Proj.
Pension Funds				
Public (Caisse Nationale de Retraite et de Prévoyance Sociale, CNRPS) 1/ 2/	1.52	1.60	0.13	0.99
Private (Caisse Nationale de Sécurité Sociale, CNSS) 2/ 3/	0.55	1.57	-	0.47
Health Fund				
Public (Caisse Nationale d'Assurance Maladie, CNAM) 4/	0.87	1.48	0.68	0.04

Source: Tunisian authorities.

(1) Arrears are mainly receivables due to CNRPS for the benefit of CNAM.

(2) Cash needs exclude receivables due to the CNRPS and the CNSS for the benefit of the CNAM, and the 2017 budget transfers to the CNRPS of 0.5 percent of GDP and to CNSS of 0.1 percent of GDP.

(3) Arrears include receivables due to the CNSS for the benefit of CNAM.

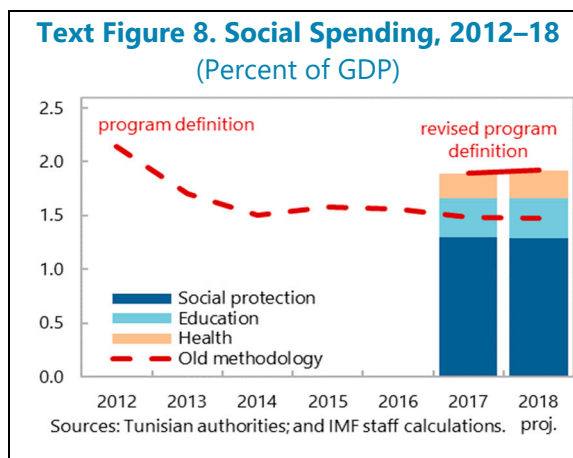
(4) Arrears include mainly receivables due to the CNAM for the benefit of public and private healthcare providers.

(5) Underlying assumptions are: (i) social security contributions for the pension system increasing by 3 percentage points in the private and public sector; (ii) CNSS transferring in full CNAM's share of the contributions; (iii) improved CNSS collection efforts by 12 percent; (iv) excluding the revenue from the social solidarity contribution (0.2 percent of GDP); (v) excluding other parametric measures provided for in the pension reform; and (vi) excluding receivables due to the state and SOEs for the benefit of the social security funds.

- **Spending on social programs has increased only recently to levels targeted under the EFF.** Expenditures on social programs have been stagnating over recent years at a level of 1.5 percent of GDP (or 2 percent of GDP under a recently revised definition, Text Figure 8).⁴ Currently, two-thirds of these expenditures support social protection (mainly cash transfers to vulnerable families and retraining programs), two-fifths help with education (mainly university scholarships), and the small remainder goes to health services. The last big reform dates to 2015, when the government expanded the low-income cash transfer program, doubling the number of families and tripling the average transfer amounts.

⁴ As defined under the program, social expenditures consist of social transfers and programs as well as key ministries' capital expenditures.

- The social safety net remains poorly targeted, largely regressive, and fragmented.** The World Bank has estimated that nearly a quarter of Tunisians are net beneficiaries of rather generous social transfers (that represent up to one-fifth of total income). However, only 2 in 5 of these beneficiaries live below the national poverty line. Sizeable subsidies on food and energy (together amounting to 3.1 percent of GDP in 2017), which mainly accrue to the better-off, largely explain this poor targeting. For example, energy subsidies benefit rich households up to 30 times more than those with lower income; and cash and health transfer programs for low-income families cover only about 12 percent of Tunisia's poor. Poorly-designed procedures compromise targeting; and the fragmentation in the administration of cash transfers and labor and housing programs further complicates reaching those who are most in need of public support.



Policy Discussions

26. The authorities and staff agreed that Tunisia's welfare system needs urgent reform.

Staff welcomed the authorities' vision for a broad-based social protection system, but emphasized the need to focus on ensuring financial sustainability while adequately supporting the most vulnerable.

- Ensuring the financial viability of social security through ambitious pension reforms.** After a long consultation process, a consensus is emerging between the authorities and social partners on the elements of a public pension reform (reprogrammed SB for April 2018, MEFP ¶¶12, 26). For the CNRPS public pension fund, the discussion focuses on parametric reforms, including a stepwise increase of the retirement age; contribution rates; and the level of permanent transfers from the budget. Staff emphasized that the measures currently under consideration could be an entry point into reform, but that more needs to be done over the medium term to close the gap between benefit levels and resources. The CNSS private pension fund is also working on improving collection of contributions and starting reforms. To ameliorate the financial position of the CNSS, the authorities have recently taken steps to clear arrears of public entities to the fund (with a first tranche of TD 200 million completed in February 2017, MEFP ¶¶12, 19). This will in turn allow the CNSS to clear arrears vis-à-vis the CNAM health fund to help the latter meet its obligations towards the central pharmacy and health service providers. The government stands ready to submit a supplementary budget law in case a budget transfer to the CNSS or the CNAM were needed to maintain their operations.
- Gradually increasing social spending.** Staff welcomed the allocation of more resources (TD 200 million) for transfers to vulnerable families and low-income pensioners in the 2018 budget and the efforts to review social spending classifications that will allow for a more

effective tracking going forward. Staff encouraged the authorities to continue with gradual increases in outlays for health services, education, and social protection.

- **Better targeting of social assistance.** The authorities acknowledged that a better-targeted social safety net is crucial to responding to the needs of the most vulnerable in an efficient way and with a tight budget. They will accelerate work on a census to identify vulnerable households (reprogrammed SB for December 2018, MEFP ¶¶12, 26) and on integrating existing beneficiary data across programs. Staff urged the authorities to closely align these reforms with their efforts to recalibrate the welfare system from universal fuel subsidies to more efficient, targeted transfers (including those that improve skills and stimulate job creation); streamline the design and delivery of welfare and active labor market programs; and strengthen institutional capacity, including by rolling out a unique identification system.

C. Creating More Opportunity for the Private Sector

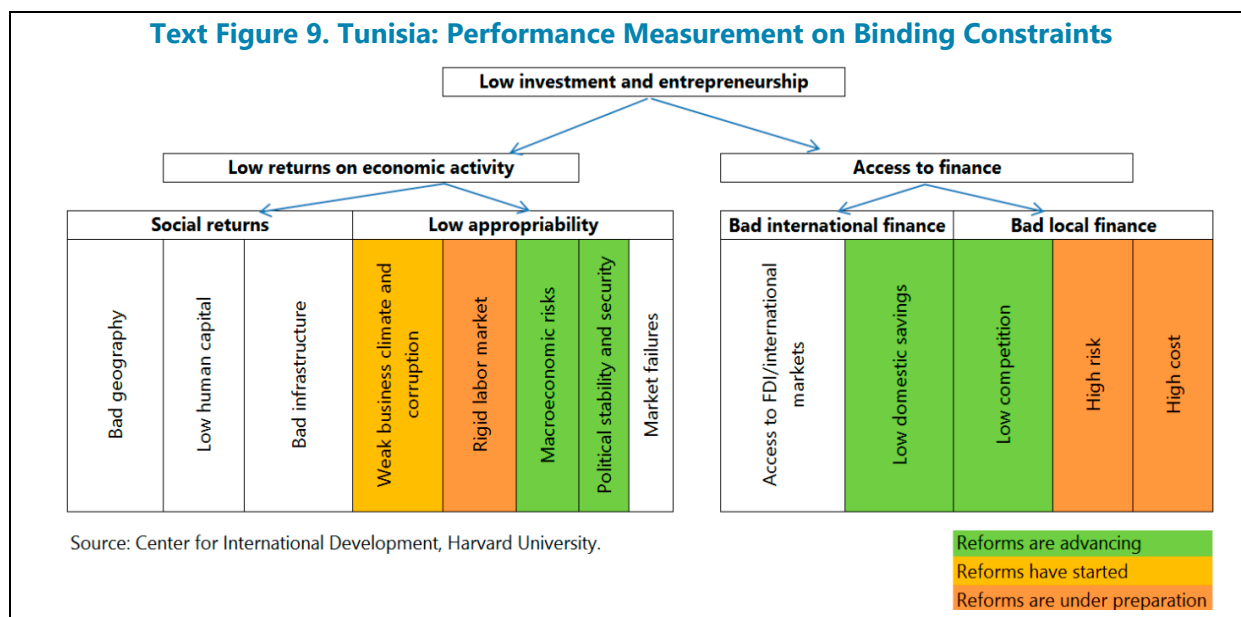
27. Tunisia needs to grow at a speed far above current rates to make a dent in high unemployment. Creating sufficient jobs for Tunisia's labor force that absorbs a strong influx of job seekers each year remains a daunting challenge for the country's economy: a simple analysis suggests that it would require about five years of 5 percent growth just to reduce the unemployment rate by a quarter from 15 percent to 11 percent. This compares to a reality where GDP growth has been cut in half to an average 1.7 percent in 2010–17 from 4.6 percent in the 2000s, with investment and total factor productivity (TFP) showing significant declines (Box 1).

Text Table 4. Growth Drivers, 2005–16
(Average growth rates, in percent)

	2005–08	2009–10	2011–12	2013–14	2015–16
Total					
Real GDP	5.1	2.9	1.0	2.4	1.0
Demand Side					
Consumption	4.9	4.1	4.6	3.4	2.2
Private	4.9	3.9	4.3	3.5	1.6
Public	4.9	4.9	5.6	3.4	4.3
Investment	11.8	-1.4	-8.1	1.5	0.1
Exports	15.5	11.7	1.9	-0.8	-9.7
Supply Side					
Agriculture	1.8	44.9	-5.1	0.6	-3.9
Energy	8.6	-6.9	-4.5	-9.5	-20.9
Phosphates	-15.6	233.6	-13.1	4.2	3.4
Textiles	1.6	44.9	-5.1	0.6	-3.9
Mechanic	18.3	68.4	5.1	0.0	2.7

Source: Tunisian authorities; and IMF staff estimates.

28. Continuing with strong and well-prioritized reforms will be critical. Lifting growth in a sustained way can only be achieved through substantial increases in investment and total factor productivity (Box 1). This will entail overcoming structural deficiencies that have played a role in discouraging businesses from investing and expanding activities, often related to crossing the formality threshold (Text Figure 9). The priorities identified at the time of the 2015 Article IV Consultation remain pertinent and have been broadly corroborated by many competitiveness rankings (Annex V): Tunisia should continue to prioritize measures to strengthen the business environment, reform rigid labor market regulations and practices, and improve access to finance. Despite important progress (see below), more remains to be done. In addition, in terms of sectoral reforms, the energy sector has become a priority given its importance in the production cycle and the impact of energy prices on the fiscal and external accounts.



Text Table 5. Cross-Country Comparison
(Latest data available, rounded numbers)

	Tunisia	Morocco	Turkey	Jordan
Public Governance				
Voice and accountability ranking (higher is better)	56	29	29	25
Political stability ranking (higher is better)	13	35	5	26
Government effectiveness ranking (higher is better)	36	39	43	47
Business regulations quality ranking (higher is better)	24	32	51	45
Rule of law ranking (higher is better)	46	37	34	57
Fiscal Policy				
Central government size (in percent of GDP)	29	25	24	29
Total taxation of firms (in percent of commercial profits)	60	49	41	27
Public wage bill (in percent of GDP)	15	12	8	5
Subsidies and transfers (in percent of expenditures)	20	5	n.a.	27
Doing Business				
Global competitiveness ranking (lower is better)	95	71	53	65
Credit to private sector (in percent of GDP)	81	65	70	75
Control of corruption ranking (higher is better)	53	52	50	64
Social Indicators				
Gini index (higher is more equitable)	35	41	41	33
Informal sector (in percent of GDP)	40	38	33	20
Poverty headcount ratio (in percent of population)	20	9	2	14

Source: World Development Indicators; and IMF Staff Reports.

Private Sector Development and Sectoral Reforms

Background

29. The main production and export sectors have struggled in recent years. Growth performance of most sectors has weakened since the revolution. Services, which represent about 45 percent of the economy, have experienced the worst impact due to declines in tourism and transport activities. Industry has also suffered: its growth declined from an average of 1.6 percent from 2008–10 to an average of 0.8 percent over 2014–17. Moreover, labor productivity and total factor productivity have declined, including due to weakened industry know-how.⁵ Production in the mining and energy sectors has been affected to varying degrees by strikes, diminishing natural reserves, and new competition in global trade. The evolution of investment and exports is consistent with this picture. The growth of private investment fell to an average 1.6 percent over 2014–17 from an average 4.6 percent over 2008–10; the share of exports in GDP dropped to 42.9 percent in 2017 compared with 49.5 percent in 2010.

30. New firm creation requires a more nurturing environment. Tunisia has promising potential for firm creation, given its young workforce, high educational achievement, and proximity to the large European market. At the same time, starting a business remains difficult. Inadequate access to financing is one hurdle. Banks lend mostly to well established customers and require high collateral. Moreover, there is a paucity of financial information due to the lack of credit bureaus. Once created, business climate deficiencies can turn into an important obstacle. For example, it takes more than two months to get electricity and more than three months to get a construction permit.⁶

Policy Discussions

31. Recent achievements offer a good basis to continue with reforms.

- **Governance** (MEFP ¶¶12, 22). The Tunisian government has made ambitious strides to tackle corruption and enhance transparency in both the private and public sectors (MEFP ¶22). After the adoption of the law creating the HACGGA by Parliament (met SB for September 2017), the new body is now almost operational following the adoption of a budget, a remuneration grid, and a call for nomination of its members. Next steps involve the appointments of its members by Parliament (reprogrammed SB for June 2018) as well as building the necessary infrastructure to investigate high-level or complex corruption cases (for example, access to databases including asset declarations of public officials and mechanisms for information sharing with other agencies).

⁵ See, for example, Tunisia's declining readings between 2010 and 2016 on the economic complexity index published by the Observatory of Economic Complexity from MIT; and [ILO 2018](#).

⁶ See World Bank, Doing Business Indicators (2018).

- **Business climate.** Staff welcomed the adoption of a new law to improve competition (January 2017) and an investment code that reduces uncertainty and aims to lower barriers to entry (September 2016). The authorities highlighted recent progress with the creation of the Tunisian Investment Authority overseeing investment policy, which will operate as a one-stop shop for large investors to reduce regulatory complexity (new SB for May 2018, MEFP ¶123). They will also reduce the number of economic sectors requiring authorizations for opening a business by decree, and intend to continue with steps to facilitate access to finance for SMEs and startups.
- **Labor market.** The authorities and staff concurred that labor market reforms should receive more attention going forward, including measures to reduce skill mismatches and strengthen incentives to hire into formal sector jobs. The authorities confirmed that the national employment strategy will be the vehicle to advance this agenda over the next three years. A milestone of this strategy was the adoption of the start-up act in February, which will facilitate job creation in the Information and Technology sector. If successful, this initiative could be broadened to other sectors.
- **Energy sector.** The authorities and staff agreed on the need for a comprehensive sector strategy. A priority is to gradually eliminate energy subsidies through price increases and, eventually, achieve an automatic passthrough of international prices and unit costs onto retail prices. In addition, the authorities are working with the World Bank and other partners on: (1) more efficient protection of the most vulnerable from price increases; (2) the supply of domestic energy production; and (3) improved performance of the public energy company.
- **Data quality and transparency.** Staff welcomed ongoing efforts to strengthen national accounts and fiscal and balance of payments statistics, with the help of IMF TA.

Financial Sector Reforms

Background

32. The banking sector remains stable but suffers from low liquidity. On average, banks do not have major liabilities to foreign partners, and net open FX positions are small relative to capital. Credit risk remains a concern due to banks' exposure to interest rate-linked household debt and corporates with uncertain earning potential, but the improving growth outlook should mitigate against deteriorating credit quality. This generally benign view was confirmed by inspections of the seven largest private banks (SB met with delay in January 2018, MEFP ¶12, 24), which revealed no major vulnerabilities. This said, the sector suffers from low liquidity due to large NFA outflows and as bank deposits remain insufficient relative to private and public credit demand.

33. Financial sector reforms have progressed. The Council of Ministers recently adopted important legislation that, once passed by Parliament, will allow public banks to become more proactive in renegotiating and reducing their sizeable holdings of NPLs (20 percent on average of their total assets). There was also progress in other areas of public bank restructuring, including on credit risk management, social plans, and organizational redesign. To strengthen banking supervision, a

text that regrouped all capital rules was published in February 2018. The authorities also established a Financial Sector Reform Committee overseen by the office of the Head of Government, which will coordinate financial sector reforms more efficiently among the stakeholders involved, including to address NPLs (June 2018); improve funding of small- and medium-sized enterprises; and strengthen bank liquidity (December 2018). In addition, they started to review financial market regulations to promote new instruments and market participants; and have made progress with their divestment strategy, which envisages selling their participation in one non-strategic bank in 2018.⁷

34. Money laundering and financing of terrorism issues have become prominent. In November 2017, the Financial Action Task Force (FATF) added Tunisia to its gray list of jurisdictions with significant Anti-Money Laundering and Combating the Financing of Terrorism framework (AML/CFT) deficiencies and issued recommendations to address these issues. The EU Parliament echoed this decision by putting Tunisia on a similar EU list of countries with serious risks on money laundering and financing of terrorism. These actions carry significant risks for Tunisia and call for immediate remedial action to avoid a deterioration of investor confidence and a loss of correspondent banking services.

Policy Discussions

35. The authorities are committed to accelerating financial sector reforms (MEFP ¶24).

- **Public bank restructuring.** The authorities and staff agreed on the importance of public banks' NPL reduction to strengthen confidence and allow the banks to raise new capital or find strategic partners. This will increase lending capacity. Staff emphasized the importance of swift adoption by Parliament of several laws, including on (MEFP ¶¶12, 24): increasing the maximum lending rate (reprogrammed SB for May 2018); allowing public banks to abandon claims and to simplify write-off rules (reprogrammed SB for June 2018, after adoption by the Council of Ministers in February 2018); and improving the functioning of recovery firms (September 2018). In addition, the Ministry of Justice will train judges on banking matters and will identify judicial chambers specializing in banking conflicts (March 2018). The Ministry of Tourism committed to reviewing a rule that prevents failing hotels from changing their vocation, which could give impetus to successful real estate loan workouts (April 2018). The CBT is also working on a circular to establish a framework for out-of-court debt resolution.
- **Improving and consolidating bank supervision.** The authorities have finalized the operationalization of the deposit guarantee fund in January 2018. The resolution committee (appointed in December 2017) was set up and will take its first resolution decision on the BFT (new SB for May 2018, MEFP ¶24). The authorities also remain committed to starting consolidated supervision in 2019, with IMF TA assistance.
- **Strengthening the AML/CFT regime.** Tunisia's action plan with the FATF and MENAFATF aims at addressing the identified shortcomings in the AML/CFT regime with the help of the IMF and

⁷ In total, the state has 14 bank participations (strategic and non-strategic).

other TA-providing institutions. Specifically, the authorities have increased recruitment and staff training for the financial intelligence unit, are establishing a framework for targeted financial sanctions, and are preparing an AML/CFT supervisory manual that will facilitate entity transparency and risk-based supervision.

- **Improving financial sector liquidity.** The CBT has tasked a commission to develop a strategy on reducing cash in the Tunisian economy, including through an upgrade of the payments system.

36. A financial inclusion strategy is under preparation (MEFP ¶24). The authorities intend to formulate a strategy by March 2018 that builds on financial inclusion data by the Financial Inclusion Observatory, the development of digital finance, and other inputs. They are also confident that the law regulating credit bureaus will be adopted before April 2018, helping to improve access to finance by better collection and transmission of financial data.

PROGRAM ISSUES AND MODALITIES

37. Staff supports the authorities' request for waivers of nonobservance of end-December QPCs and of the PC related to the exchange restriction based on appropriate corrective actions. As corrective actions, the authorities: (1) adopted a 2018 budget law with a lower deficit thanks to strong tax measures, civil service headcount reduction, and energy price hikes, while increasing social spending; (2) tightened monetary policy by increasing the policy rate by 75 bps in March 2018 and adopting a framework for the monthly monitoring of NDA outturns to assess the need for further policy measures; (3) reaffirmed their desire to move back to a de facto floating exchange rate arrangement by accepting lower 2018 FX intervention targets that are consistent with a modest accumulation of gross reserves; and (4) agreed to phase out the exchange restriction inconsistent with Article VIII, Section 2(a) by end-2018. Staff supports the approval of the exchange restriction until end-2018, as the measures giving rise to this restriction are maintained for Balance of Payments reasons, are not discriminatory, and are temporary.

38. Moving towards a quarterly review schedule will facilitate program implementation. The authorities and staff agreed on the authorities' request of moving to quarterly reviews from the current semi-annual schedule, as macroeconomic vulnerabilities—notably accelerating inflation and low reserve cover—remain elevated. To facilitate monitoring of reserve cover, a new monthly Indicative Target (IT) on net central bank FX interventions will be established. The authorities and staff also agreed on the request to rephase remaining access under the program from this review onwards as suggested in Table 10.

39. Strong conditionality continues to guide program implementation:

- **Quantitative targets.** New QPCs for the end of March, June, September and end of December 2018 (MEFP Table 1) will support the reduction of the fiscal deficit in 2018, contain inflationary pressures through a deceleration of base money growth, and support adequate reserve

coverage. The QPCs on the primary balance and on current primary expenditure will be adjusted for expenditures associated with the envisaged BFT liquidation in 2018 (TMU ¶118, 24). The QPC on the NIR will integrate residents' FX swaps with commercial banks and residents' FX deposits into the NIR definition, as these remain under the control of the CBT (TMU ¶128). A new QPC on the floor of social spending will be set at the time of the Third Review, replacing the current IT.

- **Structural benchmarks.** Staff proposes to re-program the delayed SBs and set four new SBs on critical next steps for already ongoing reforms (MEFP Table 2). These include a one-stop shop for investors, the launch of the resolution process for the BFT, VAT rate migration for liberal professions, and operationalization of the new umbrella structure for tax administration created by the 2018 budget law.

40. The program remains fully financed (Text Table 6). Donors' financing assurances and the authorities' plans for international bond issuances will cover financing needs over the next twelve months.

	2016	2017				2018				2019	2020	2021	2022	2023
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			Proj.		
				Proj.	Proj.	Proj.	Proj.	Proj.	Proj.					
Total grants and loans	1,866	992	2,512	3,073	3,718	349	1,901	2,877	3,984	3,433	2,721	3,366	2,666	2,366
Grants	52	0	0	14	78	0	12	49	92	100	100	100	100	100
EU	51	0	0	0	78	0	0	0	92	100	100	100	100	100
Other	1	0	0	14	0	0	12	49	0	0	0	0	0	0
Loans	1,814	992	2,512	3,059	3,640	349	1,889	2,828	3,893	3,333	2,621	3,266	2,566	2,266
Bilateral	0	0	1,000	1,000	1,118	0	0	0	116	100	100	100	100	100
G7	0	0	0	0	118	0	0	0	116	100	100	100	100	100
Germany	0	0	0	0	118	0	0	0	116	100	100	100	100	100
Other	0	0	1,000	1,000	1,000	0	0	0	0	0	0	0	0	0
Qatar	0	0	1,000	1,000	1,000	0	0	0	0	0	0	0	0	0
Multilateral	835	0	425	881	1,260	245	681	1,516	1,861	1,767	1,005	750	750	750
AfDB	477	0	0	0	144	0	0	0	91	200	200	200	200	200
IMF	316	0	315	315	315	245	499	752	1,006	1,017	255	0	0	0
World Bank	42	0	0	456	456	0	0	400	400	550	550	550	550	550
EU	0	0	110	110	345	0	182	364	364	0	0	0	0	0
Other	979	992	1,086	1,178	1,263	104	1,208	1,312	1,916	1,466	1,516	2,416	1,716	1,416
Market issuance	497	905	905	905	905	0	1,000	1,000	1,500	1,050	1,100	2,000	1,300	1,000
Project aid	356	0	0	0	287	0	0	0	350	350	350	350	350	350
Other (sukuk)	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Loan transfers to SOEs	126	0	0	0	70	0	0	0	66	66	66	66	66	66

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

41. Tunisia has the capacity to repay the IMF, but risks remain exceptionally high. Credit outstanding to the IMF will peak at 372 percent of quota in 2020 and obligations to the IMF will reach 1.4 percent of GDP in 2018 (Table 11) or 25 percent of external debt service. Moreover, exceptionally high risks, especially political stalemate over reforms and a renewed security incident (¶16), could jeopardize program objectives and erode repayment capacity. Strong commitment by the authorities to the agreed reforms and the strengthened framework for program monitoring,

including quarterly reviews and the new monthly IT on central bank net FX interventions, will be essential as mitigation strategies.

STAFF APPRAISAL

42. Tunisia's young democracy faces an urgent need to address economic imbalances.

Confidence has improved since 2017 but still suffers from the lasting impact of major negative shocks, most importantly the 2015 terrorist attacks, persistent spillovers—in the form of violence, informality, and migration—from the conflicts in Libya and elsewhere in the region, and elevated political uncertainty as Tunisia's democratic institutions evolve to intermediate voter interests. These factors have combined with policy slippages and delays in structural reforms to increase macroeconomic vulnerabilities, notably rapidly increasing public and external debt levels, accelerating inflation, and decreasing international reserve coverage.

43. The authorities have begun to tackle deficiencies in policy and reform implementation.

They have started a multi-annual fiscal adjustment with their 2018 budget after several years of fiscal expansion. They have begun to tighten monetary policies and allow the exchange rate to fluctuate more in response to demand and supply. Critical structural reforms in support of governance, the business environment, access to finance, and the financial viability of fiscal institutions show early results. Initiatives against widespread corruption were also courageous. This said, social unrest and strong interest group pressure have led deviations from policy objectives to maintain political stability. This has come at the cost of increased macroeconomic vulnerabilities and reduced policy space for higher job creation and investment.

44. Changing Tunisia's growth pattern is the only realistic way to raise living standards.

Growth has relied excessively on public and private consumption, while investment and exports remained depressed. This contributed in 2017 to accelerating inflation, a large fiscal deficit, and record trade and current account deficits, which in turn fueled dinar depreciation. Changing this pattern in favor of more private-sector driven investment and exports will help raise living standards and create jobs, maintain affordable fiscal and external deficits that are consistent with Tunisia's limited space for additional resource mobilization, and curb inflation. Expectations have to be managed carefully. Even under the active, ambitious policy scenario underlying this report, the doubling of annual growth anticipated through 2023 will likely not suffice to bring more than one out of five unemployed into a job.

45. Fiscal consolidation requires strict adherence to agreed policies over the medium term.

Staff supports the authorities' strategy of increasing tax revenue in a fair way and reining in current spending. This will reduce the fiscal deficit by more than 3 percent between end-2017 and 2020, while creating space for more public investment and expenditure on health and education. This socially-conscious adjustment plan, which seeks to minimize harm to growth, is consistent with breaking the trend of rapidly increasing debt ratios and strengthening confidence. Fiscal adjustment is a challenge in an environment of low growth and strong demands for better standards of living. This said, the path to a better future starts with urgent and decisive action to entrench fiscal and, by

extension, external stability. For 2018, it will be critical to achieve the authorities' objectives of strengthening tax collection, not granting new wage increases in 2018 unless growth surprises significantly on the upside, quickly implementing the voluntary separation programs for civil servants, and enacting fuel price hikes to contain energy subsidies in the context of rising oil prices. It will be as important to distribute the burden of adjustment equally across society and shield the most vulnerable from its impact. To mitigate fiscal risks, staff recommends that the authorities do not proceed with PPP projects before adequate legal and regulatory frameworks are in place.

46. Tighter monetary policy is needed to curb inflation, the number one threat in 2018.

A higher cost of liquidity is critical to complement fiscal adjustment in breaking the trend of accelerating inflation. Staff supports the CBT's decision in January to widen the interest corridor followed by a substantial policy rate increase in March. Unless inflation subsides quickly, further tightening will be needed to bring interest rates firmly into positive territory in real terms and achieve a reduction in consumption. Without urgent and strong tightening, staff sees a risk that higher inflation expectations get entrenched and create second-round effects on the back of the strong price increases in recent months. Inflation could increase to 8 percent or more in 2018 in the absence of an adequate response, which would erode purchasing power, especially, of the poor.

47. Exchange rate flexibility will protect reserves and support exports. Staff welcomes that the CBT has allowed the exchange rate to evolve more in line with fundamentals over 2017, which already contributed to a desirable change in export and import growth in early 2018. A fast move back towards a de facto floating exchange rate arrangement would help correct the substantial residual real overvaluation, which current inflation trends will likely aggravate. Without accepting further correction, including through a more competitive implementation of its new FX auction mechanism, the CBT would need to continue with large interventions that are costly and unsustainable in view of its declining stock of international reserves.

48. Maintaining adequate social protection remains critical as part of the social contract. Staff welcomes the recent steps taken to help ensure adequate near-term financing for social security, and urges the authorities and social partners to proceed quickly with equitable and sustainable pension reforms. It also supports the recent increase in transfers to vulnerable families and low-income pensioners as part of a strategy to gradually increase social spending. Finalizing the database of vulnerable households will be crucial to respond to the needs of the poor and the vulnerable in a targeted way, especially regarding those who today remain outside the formal sector.

49. Business environment and governance reforms are critical to boost the private sector. Staff welcomes the establishment of the High Anti-Corruption and Good Governance Authority and encourages fast implementation of additional anti-corruption reforms. To improve confidence, the authorities have also made welcome efforts to build institutions in support of the new investment code. There is an urgent need for a bold strategy for the energy sector, covering both pricing policies and productivity, to address the impact of high energy costs on other sectors as well as fiscal and external balances.

50. Further financial sector reforms will entrench stability and facilitate access to finance.

The new legislation to facilitate the reduction of NPL portfolios is critical to advance the restructuring of public banks and strengthen the financing of the economy, and notably of SMEs. Staff commends the authorities for having established the bank resolution framework, which should be applied without delay by resolving the BFT that weighs on the budget. Enhancements to the AML/CFT regime will facilitate Tunisia's exit from the FATF and EU lists of countries with deficiencies in this area.

51. Program risks remain elevated and require close monitoring. Elevated political uncertainty and the threat of a major security incident remain the main risks to Tunisia's economic outlook (they are also critical impediments to investment). Close program monitoring, progress with rebuilding external and fiscal buffers, and flexibility in implementing policy frameworks will remain crucial to react to unanticipated shocks. Even then, however, it will be important not to lose sight of the overarching program objectives of promoting macroeconomic stabilization, job-creating growth, and fairness. A favorable growth outlook for Tunisia's key trading partners, improved price and non-price competitiveness, and the gains from fiscal consolidation should help Tunisia navigate this task.

52. Tunisia will continue to depend on strong engagement by its international partners.

Sustained sizeable financing from external partners—including in the form of grants or highly concessional loans—will remain indispensable to avoid disorderly adjustment, allow for tighter macroeconomic policies, and advance structural reforms at a pace that is consistent with the country's fragile socio-political context. Through its contribution to macroeconomic stability, this financing will also help mitigate the security and migration risks that Tunisia faces. Furthermore, continued TA engagement remains critical to help overcome capacity constraints in upgrading the country's policy frameworks. The G20 Compact with Africa could provide an effective forum for coordinating support and reform priorities between the authorities and its external partners.

53. Staff supports the authorities' request for completion of the Second EFF Review. In view of Tunisia's recent efforts to strengthen program performance and implement a comprehensive set of corrective measures, staff supports the: (1) waivers of non-observance of all end-of-December 2017 QPCs and of the continuous PC related to the exchange restriction based on corrective action; and (2) approval of the exchange restriction until the end of 2018. To facilitate program implementation in the context of elevated macroeconomic vulnerabilities, staff supports: (1) a quarterly review schedule starting for the end-March 2018 test dates; (2) rephrasing of remaining access consistent with the new review schedule; (3) the setting of new QPCs for end-March, end-June, end-September, and end-December 2018; and (4) a new monthly IT on central bank net FX interventions starting in March 2018. Staff also supports altering adjusters for the QPCs on the primary fiscal balance, current primary expenditure, NDA, and NIR, as well as making all funds available for budget support.

54. It is proposed that the next Article IV consultation with Tunisia takes place on the 24-month cycle in accordance with the Executive Board decision on the consultation cycles for members with Fund arrangement.

Box 1. The Challenge of Raising Growth to Reduce Unemployment

Cutting unemployment by one-fourth requires 5 percent real GDP growth, sustained over five years.

This estimate shows the order of magnitude of Tunisia's economic most important challenge. This challenge is made harder by the country's strong labor force growth (projected at an annual 1.5 percent of GDP by the Tunisia Statistic Institute) and a comparatively low elasticity of jobs creation to growth (assumed in a range between 0.36 and to 0.50, with the boundaries being the values for Morocco and the MENA region, respectively).

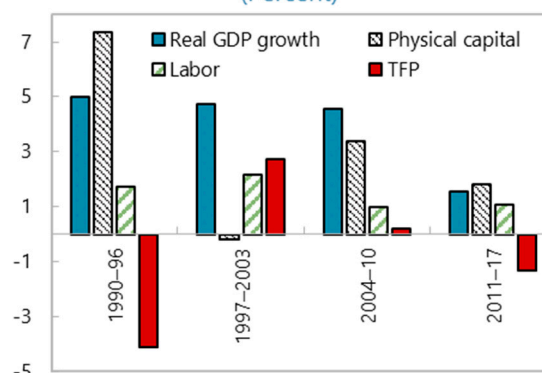
However, the country's main drivers of growth are showing signs of weakness. A growth accounting exercise reveals that total factor productivity (TFP), a measure of the technology that can support production, as well as capital investment have remained depressed after the revolution in early 2011 (Box Figure 1). The contribution of TFP to growth was close to zero already in the years before, but dragged growth down by an average 1.5 percentage points over 2011–17. Declining TFP is a problem in many countries, but the Tunisian trajectory is extreme. The closing of export firms in the aftermath of the revolution and Euro crisis may have contributed to this outturn. As dramatically, the contribution of capital to growth has halved between the pre- and the post-2010 periods, reflecting the impact of a persistent shock to confidence.

A major effort on investment and technology is

needed to reverse these trends. Assuming constant labor force growth, TFP and investment would need to improve by a combined 4 percentage points of GDP to achieve the desired 5 percent real GDP growth rate. Even with a strong recovery in investment to its pre-2011 levels, this would require TFP in Tunisia to increase to levels that Morocco and Turkey enjoyed in the early 2010s (about 0.5 percent).

This outlook calls for accelerated structural reforms, building on the authorities' early successes. The 2015 Article IV report identified poor access to credit, a weak business climate, and labor market rigidities as main structural constraints to growth. Some progress has been made since. Regarding the financial sector, the authorities adopted restructuring plans for public banks and tied these to performance contracts for the banks' new management. The authorities are also progressing with legislation to facilitate the restructuring of NPLs to strengthen the banks' capacity to provide credit to the economy. To improve the business climate, Parliament adopted laws on competition, public-private partnerships, and the investment code. In addition, governance is being strengthened through the establishment of the High Anti-Corruption and Good Governance Authorities. Little progress was achieved on labor market reforms. The government and staff agreed to place a continued focus on these priorities, which should combine with reduced political and policy uncertainty, as well as improved security, to help support investment and technological change.

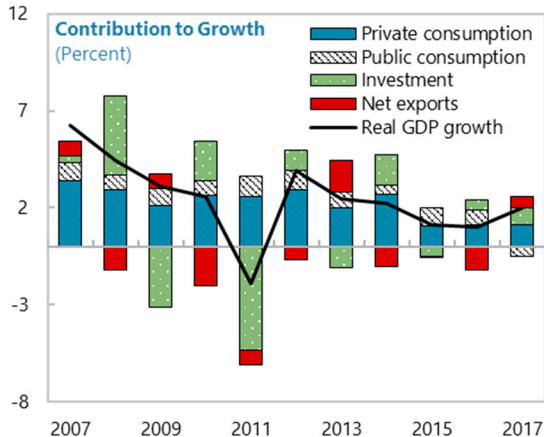
Box Figure 1. Growth Decomposition
(Percent)



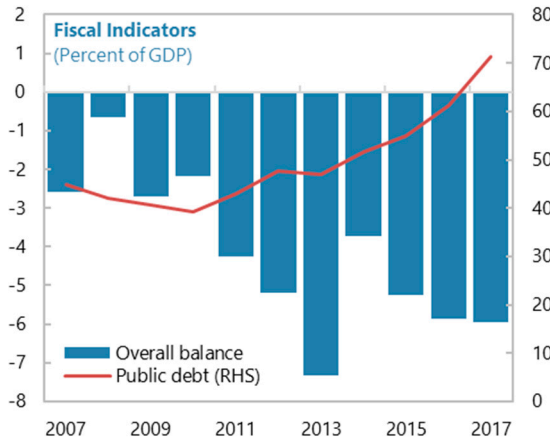
Sources: Tunisian authorities; and IMF staff calculations.

Figure 1. Tunisia: Recent Economic Developments, 2007–17

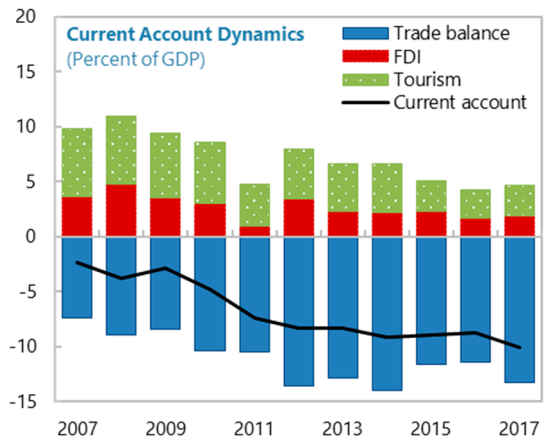
A modest growth recovery unfolds on the back of strong private consumption fueled by wage hikes.



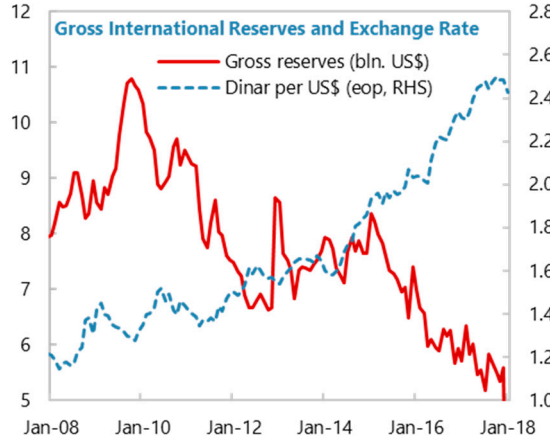
Fiscal deficits remain high, driving up public debt levels.



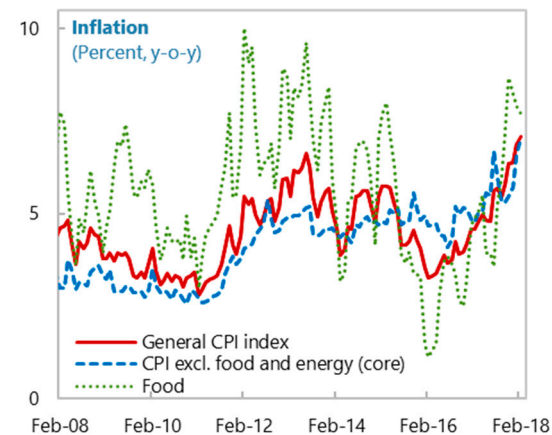
The current account deficit has widened to a record level, reflecting strong import growth.



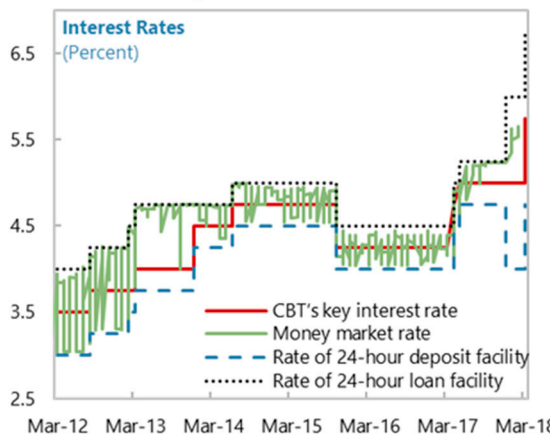
International reserves declined despite strong dinar depreciation.



Accelerating inflation is signaled by several indicators.



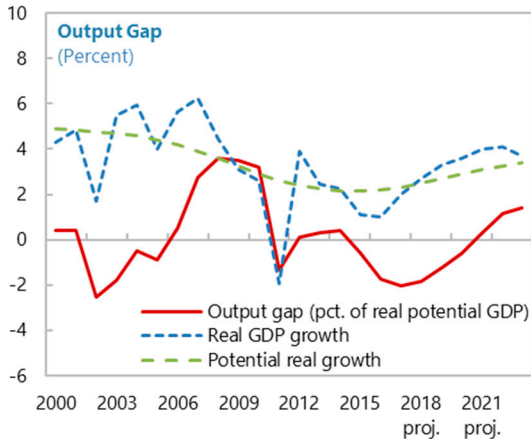
Despite three increases in the policy rate since early 2017, real interest rates remain negative.



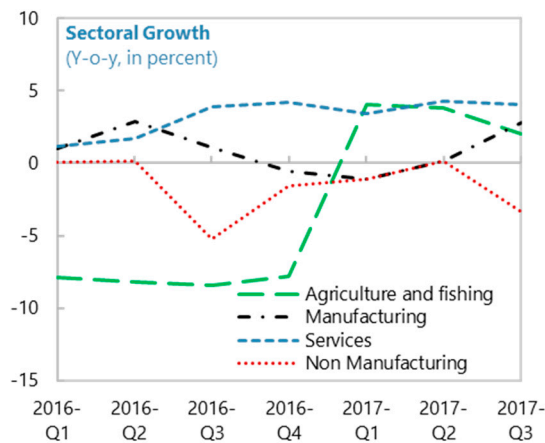
Source: Tunisian authorities; IMF IFS, and staff calculations.

Figure 2. Tunisia: Real Sector Developments, 2000–23

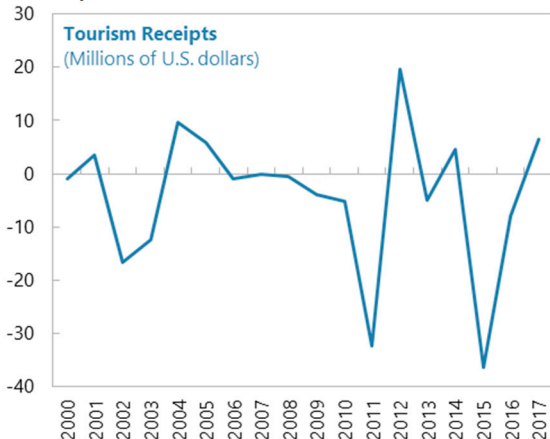
A robust growth recovery is expected to close the output gap by 2020.



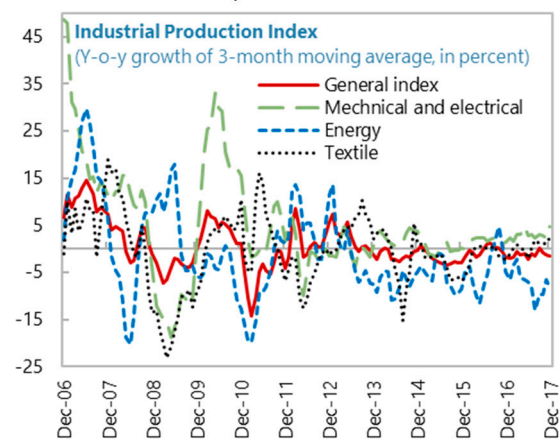
The recovery has been supported by most sectors.



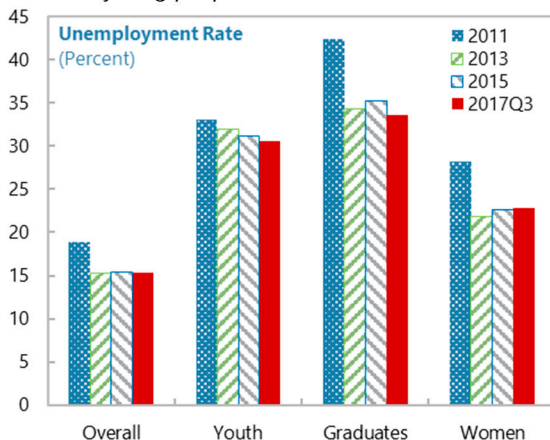
Tourism as measured by tourist arrivals continues its recovery from the shock of the 2015 terrorist attacks.



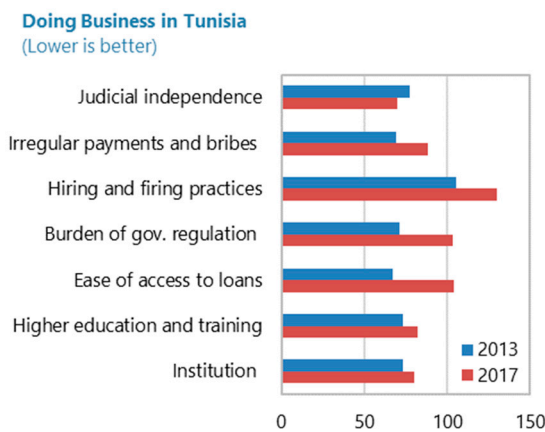
Industry remains weak, but the mechanical and electrical sector has improved.



Unemployment remains high, especially among graduates, young people, and women.



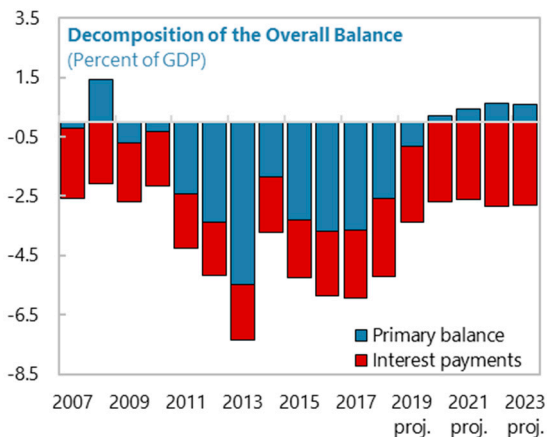
Structural reforms are urgently needed.



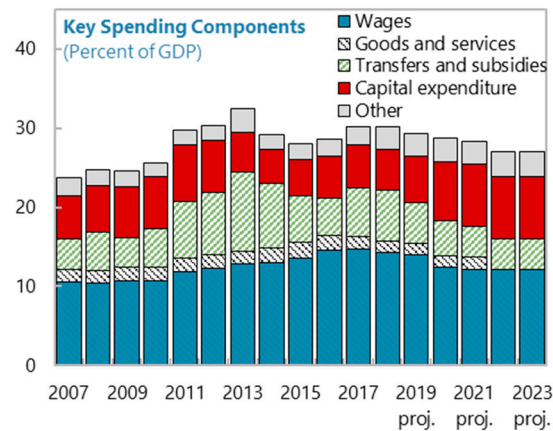
Source: Tunisian authorities; IMF IFS; and staff calculations.

Figure 3. Tunisia: Fiscal Developments, 2007–23

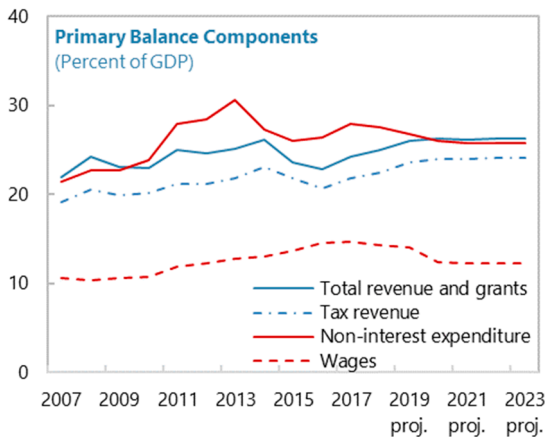
Fiscal deficits have widened since the revolution.



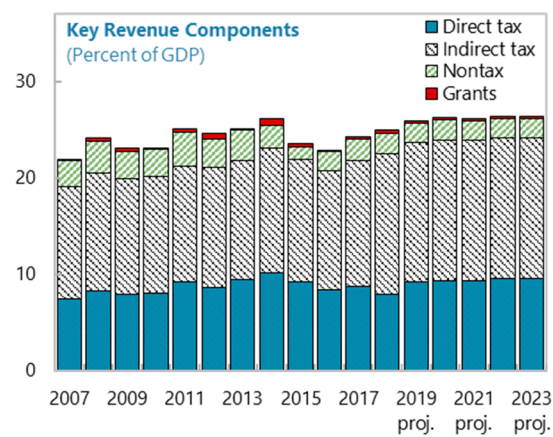
Higher spending is mainly driven by the increase in the public wage bill.



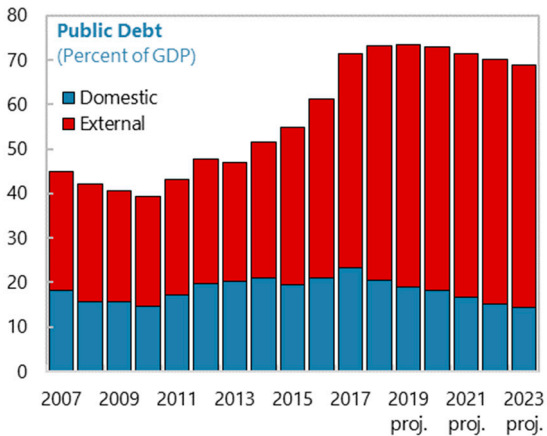
The wage bill now absorbs about two thirds of tax revenues.



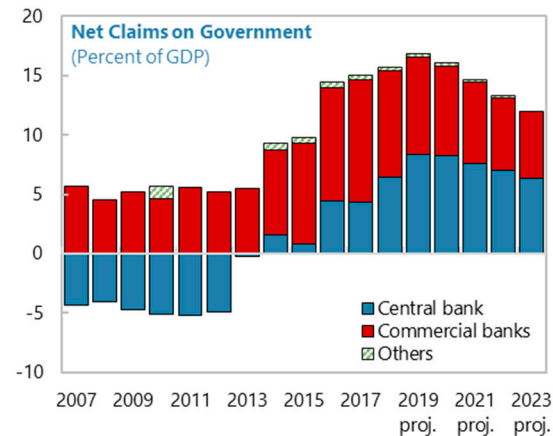
Revenue collection is set to recover from weak growth and slippages after the 2015 terrorist attacks.



Public debt, and especially external public debt, has increased strongly.



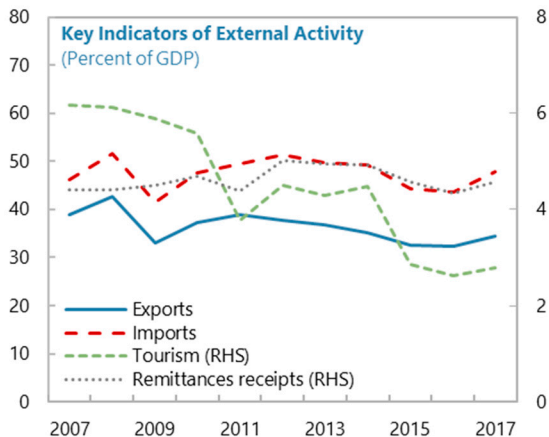
Net claims on the government, fueled by strongly increasing CBT refinancing, have been on the rise.



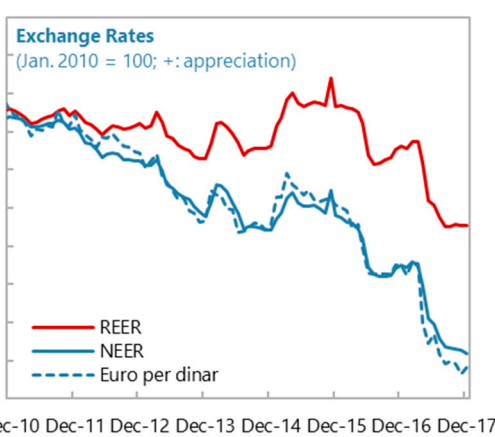
Source: Tunisian authorities; IMF IFS; and staff calculations.

Figure 4. Tunisia: External Sector Developments, 2005–20

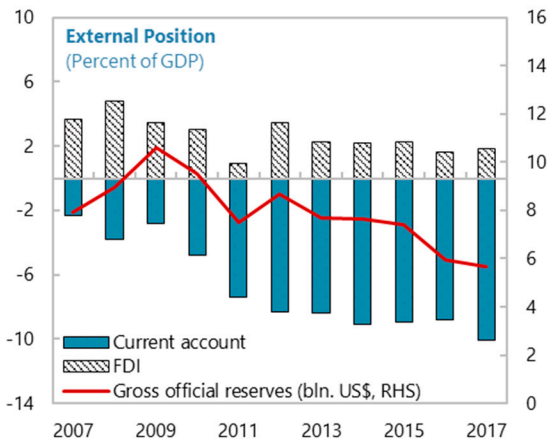
Imports grew faster than exports in 2017, but tourism experienced a timid recovery.



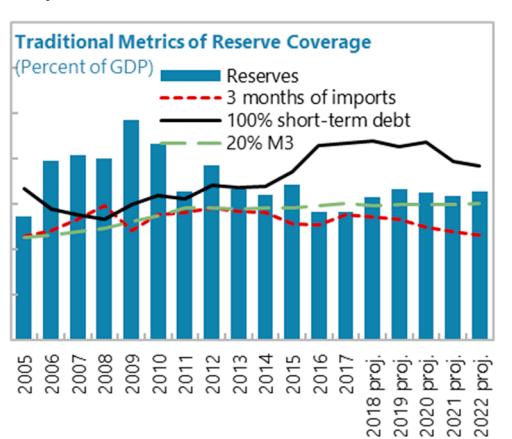
The dinar depreciated noticeably in nominal and real terms over 2017.



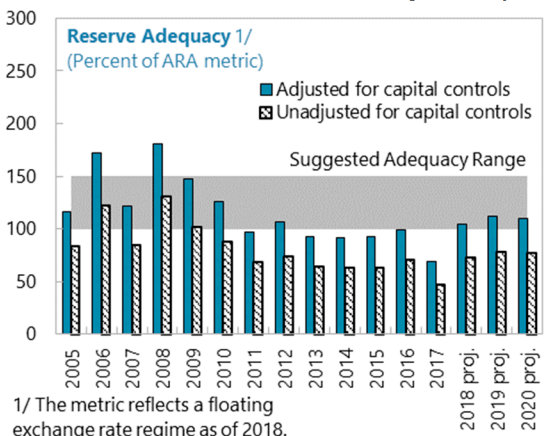
Dinar depreciation has not yet improved the current account, but reserve losses slowed.



Under the baseline, reserve coverage would improve gradually and...

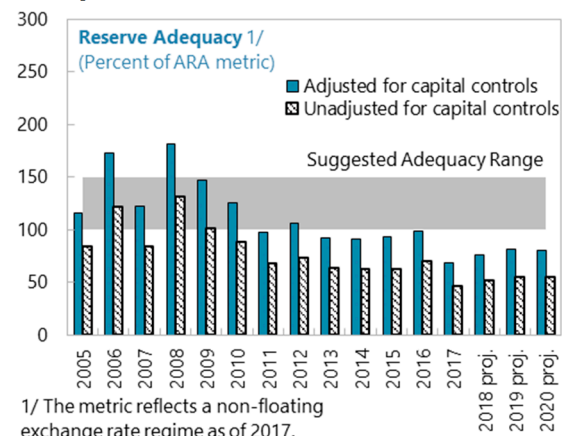


...return to the IMF's adequacy range by 2019, provided that the dinar remains is reclassified as a floating currency.



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

If it continues to be classified as crawl-like, reserve coverage remains insufficient.

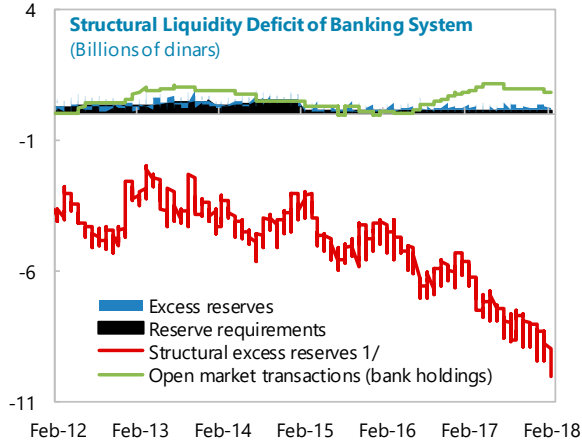


1/ The metric reflects a non-floating exchange rate regime as of 2017.

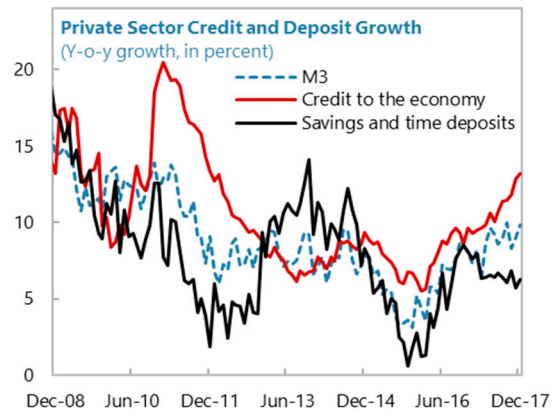
Source: Tunisian authorities; IMF IFS, and staff calculations.

Figure 5. Tunisia: Monetary and Financial Indicators, 2008–17

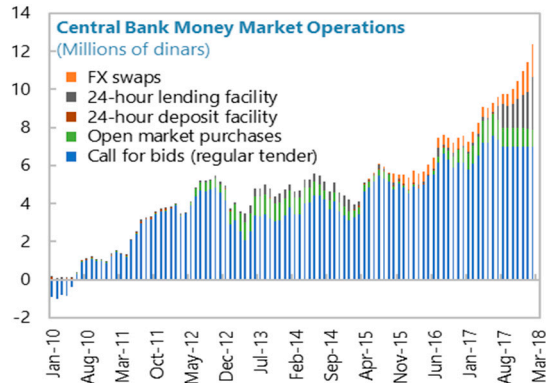
Banks are illiquid, due to weak economic activity and CBT interventions in the FX market.



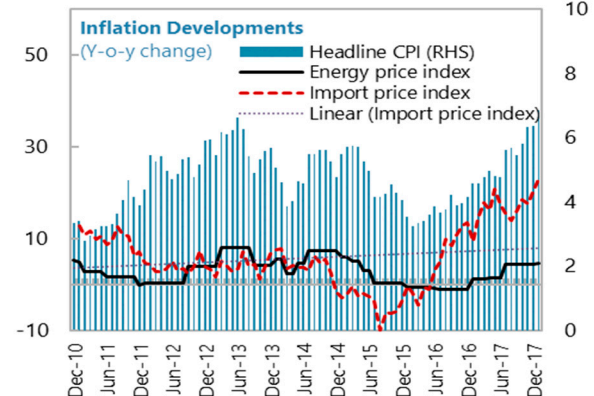
Deposit mobilization is also lower; however, private credit has increased.



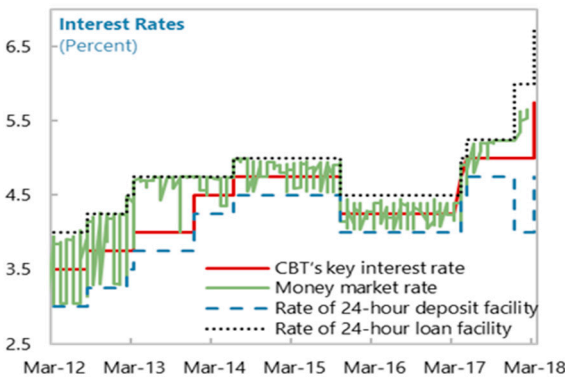
This was possible thanks to cheap and record-high CBT bank refinancing.



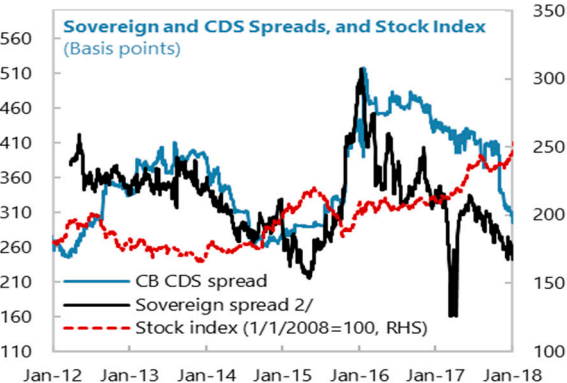
Which, added to other drivers, has fueled higher inflation.



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

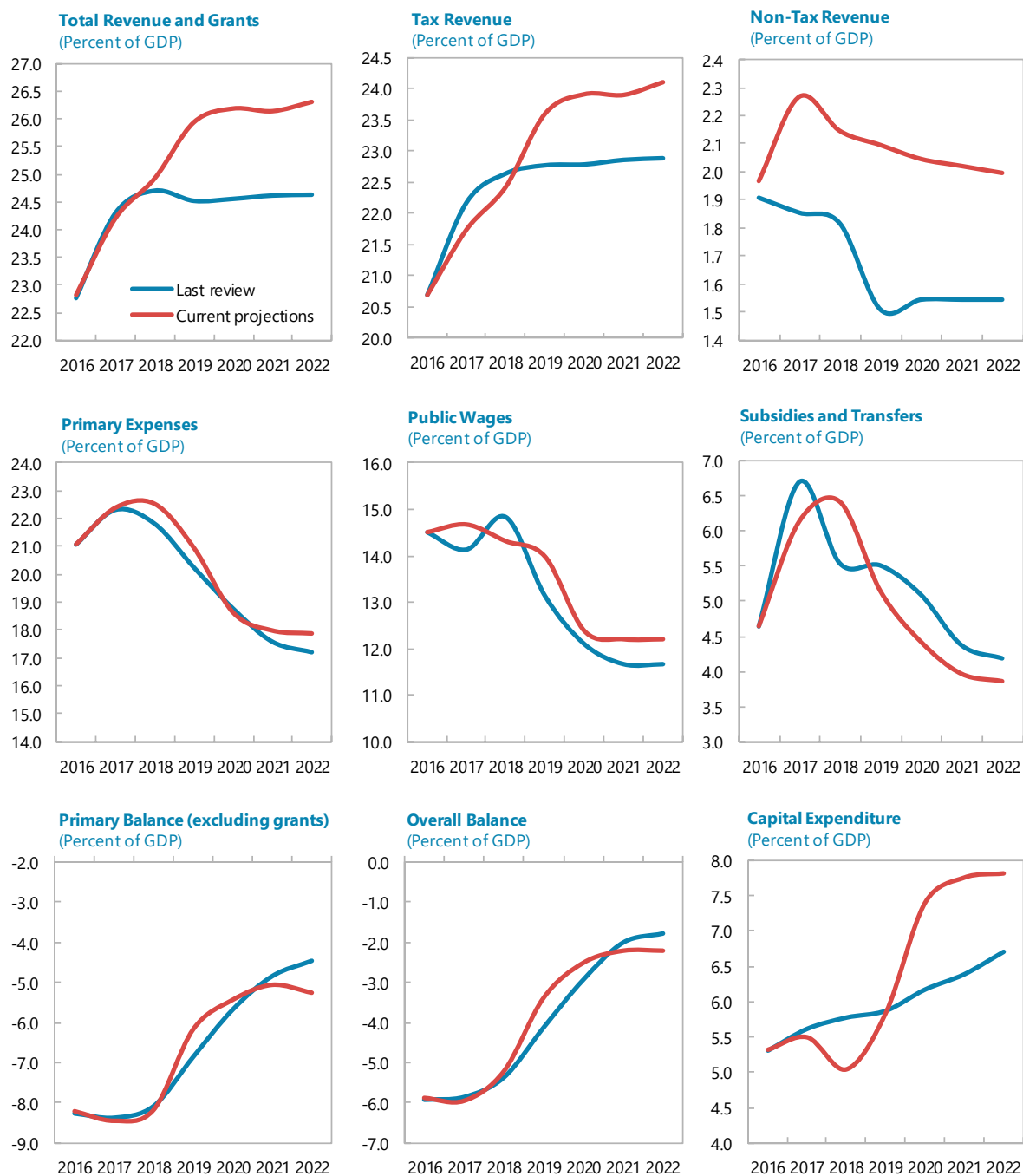


On the upside, spreads are down and the stock market is up.



Source: Tunisian authorities; Bloomberg; Markit; IMF IFS; and staff calculations.

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

Figure 6. Tunisia: Revised Projections Against First Review Targets and Objectives, 2016–22

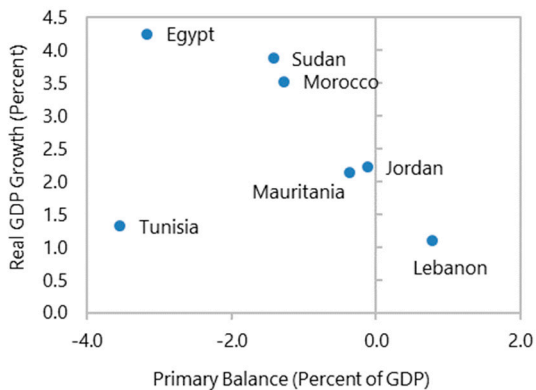
Sources: Tunisian authorities and IMF staff estimates and projections.

Figure 7. Tunisia: Challenges of Fiscal Consolidation in MENA Oil Importers

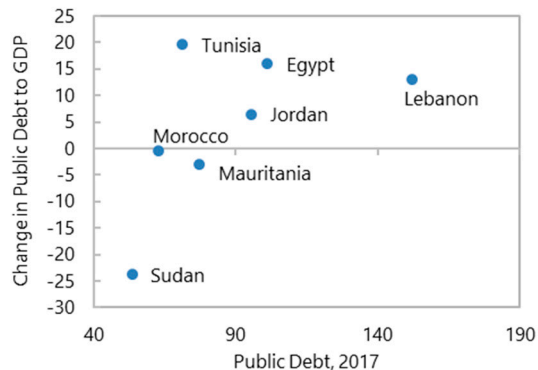
Tunisia's macro-fiscal framework is weaker than its regional peers', owing to adverse security factors.

Tunisia's public debt has increased rapidly, although it remains lower than many of its peers'.

Primary Balance and Growth, 2015–17



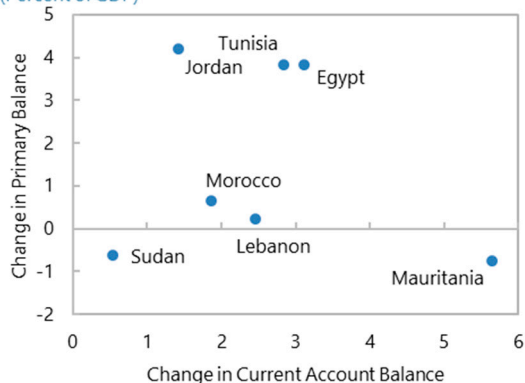
Public Debt Accumulation, 2015–17
(Percent of GDP)



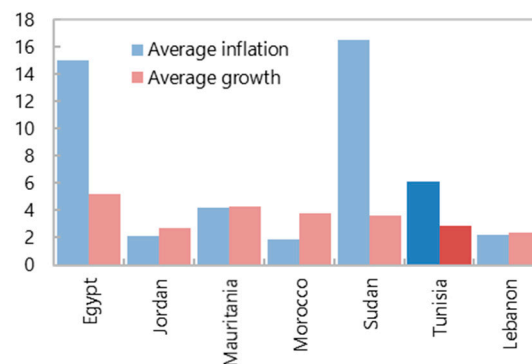
Tunisia is committed to a strong fiscal adjustment, which could also rebalance its external sector.

The adjustment could be supported by a growth recovery and low and stable inflation.

Current Account and Primary Balance, 2017–20
(Percent of GDP)



Average Inflation and Growth, 2017–20
(Percent)



Source: IMF WEO and staff calculations.

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

	2015	2016	2017		2018		2019	2020	2021	2022	2023
			Prog.	Prel.	Prog.	Proj.					
Production and income											
	(Annual percentage change)										
Real GDP	1.1	1.0	2.3	1.9	3.0	2.4	2.9	3.4	3.6	4.0	4.2
GDP deflator	3.6	5.7	5.3	5.8	4.2	6.4	5.6	4.5	4.3	3.8	3.7
CPI inflation (average)	4.9	3.7	4.5	5.3	4.4	7.0	6.1	5.2	4.3	4.0	3.9
CPI inflation (end of period)	4.1	4.2	4.5	6.4	4.1	6.5	5.9	4.7	4.0	4.0	4.0
Saving investment balance											
	(Percent of GDP)										
Gross national savings	12.5	13.4	13.6	12.4	15.1	14.0	15.7	16.6	18.0	18.9	19.4
Gross investment	21.4	22.2	22.1	22.5	23.2	23.1	23.5	23.8	24.4	24.9	25.3
Central government operations 1/											
	(Percent of GDP, unless otherwise indicated)										
Total revenue (excl. grants)	23.2	22.7	24.0	24.0	24.5	24.6	25.7	26.0	25.9	26.1	26.1
Total expenditure and net lending	28.8	28.7	30.2	30.2	30.1	30.1	29.3	28.7	28.3	28.5	28.5
of which: wage bill	13.6	14.5	14.1	14.7	14.8	14.3	14.0	12.4	12.2	12.2	12.2
of which: social expenditures 2/	1.6	1.6	1.6	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Overall balance	-5.3	-5.9	-5.9	-6.0	-5.4	-5.2	-3.4	-2.5	-2.2	-2.2	-2.2
Cyclically-adjusted structural fiscal balance (CASFB)	-4.7	-5.7	-6.1	-6.7	-4.3	-4.3	-3.1	-2.4	-2.2	-2.3	-2.4
Change in the CASFB ("+" : improvement)	-0.2	-1.0	-0.5	-1.0	1.8	2.4	1.1	0.8	0.2	-0.2	-0.1
Gross public debt	54.8	61.2	69.1	71.3	72.1	73.1	73.3	72.9	71.4	70.1	68.8
of which: share in foreign currency (percent of gross public debt)	64.4	65.8	67.8	67.4	70.6	72.0	74.2	75.2	76.8	78.2	79.2
Money and credit											
	(Annual percentage change, unless otherwise indicated)										
Credit to the economy	6.2	9.7	7.2	13.2	7.4	9.0	8.7	8.1	8.1	8.5	9.3
Broad money (M3 of the financial system)	5.3	8.1	10.0	9.8	8.3	7.4	9.1	8.3	8.4	8.5	8.0
Velocity of circulation (GDP/M2)	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4
External sector											
Exports of goods (value)	-15.9	-3.6	-1.5	2.6	0.4	-1.0	3.4	3.3	1.2	3.6	3.4
Imports of goods (value)	-18.4	-3.8	-2.6	4.9	-0.6	-1.3	1.9	2.3	1.0	3.1	3.7
Exports of goods (volume)	-2.8	0.2	2.4	4.1	6.8	8.9	4.6	3.5	4.3	3.8	3.8
Import of goods (volume)	-2.5	2.0	4.5	2.2	4.8	-1.1	1.6	2.3	3.3	3.3	4.3
Trade balance (percent of GDP)	-11.7	-11.4	-11.3	-13.3	-11.1	-13.0	-12.2	-11.6	-11.1	-10.6	-10.5
Current account balance (percent of GDP)	-8.9	-8.8	-8.5	-10.1	-8.1	-9.2	-7.8	-7.2	-6.4	-6.0	-5.8
Foreign direct investment (net, percent of GDP)	2.2	1.7	2.4	1.8	2.8	2.0	2.5	2.7	2.9	3.1	3.2
Terms of trade (percentage change, "-" : deterioration)	3.3	2.3	3.1	-4.2	-0.9	-8.3	-1.7	5.3	-0.7	0.1	0.2
Gross official reserves (end of period, billions of US\$)	7.4	5.9	7.3	5.7	8.2	6.3	7.0	7.1	7.4	8.0	8.6
Reserve coverage (in months of next year's imports of GNFS)	4.1	3.2	4.3	3.1	4.6	3.4	3.7	3.7	3.7	4.0	4.2
Net international reserves (end of period, billions of US\$)	4.5	3.3	...	3.1	...	3.2	3.2	3.3	3.6	4.4	5.2
External debt (percent of GDP)	64.9	72.2	76.9	80.1	80.7	83.7	85.5	84.5	83.5	81.2	78.5
External debt service (percent of exports of GNFS)	10.1	12.2	18.4	16.0	16.2	16.0	18.8	15.0	16.7	11.6	10.8
Memorandum items:											
Nominal GDP (millions of TD)	84,656	90,376	97,397	97,435	104,603	106,179	115,386	124,678	134,721	145,434	157,149
Nominal GDP (billions of US\$)	43.2	42.1	39.9	40.3	...	...	...	...	...	...	...
Population (millions)	11.1	11.4	11.3	11.5	11.5	11.6	11.8	11.9	12.0	12.1	12.2
GDP per capita (US\$)	3,884	3,690	3,521	3,496	3,434	3,463	3,569	3,691	3,855	4,037	4,234
Unemployment rate (percent)	15.4	15.5	15.3	15.3	15.0	15.0	14.8	14.6	14.2	14.0	13.8
Exchange rate (TD/US\$, average)	2.0	2.1	...	2.4	...	...	...	...	...	...	...
Oil price (Brent, US\$ per barrel) 3/	52.4	44.0	56.3	54.4	55.9	62.0	63.9	61.1	59.6	59.1	59.0

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

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

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

3/ Oil price based on future contract prices as of February 14, 2018.

Table 2. Tunisia: Balance of Payments, 2015–18 1/
(In millions of U.S. dollars)

	2015		2016				2017				2018				
	Annual	Annual	Q1	Q2	Q3	Q4	Annual	Annual	Q1	Q2	Q3	Q4	Annual		
						Prel.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.		
Current account balance	-3,849.0	-3,694.2	-1,344.3	-1,027.5	-629.9	-1,046.7	-4,048.4	-987.7	-859.6	-689.9	-1,151.6	-3,688.8			
Trade balance	-5,029.0	-4,806.0	-1,411.5	-1,230.2	-1,326.3	-1,381.8	-5,349.8	-1,181.8	-1,109.3	-1,489.8	-1,455.0	-5,235.8			
Exports	14,073.4	13,568.5	3,269.8	3,522.3	3,471.8	3,654.5	13,918.5	3,446.8	3,644.4	3,305.5	3,387.3	13,784.0			
Energy	1,012.6	764.9	104.4	250.3	299.1	218.5	872.3	287.3	212.1	225.2	297.7	1,022.4			
Non-energy	13,060.9	12,803.6	3,165.4	3,272.0	3,172.7	3,436.0	13,046.2	3,159.5	3,432.4	3,080.2	3,089.6	12,761.6			
of which: non-food	11,017.2	11,368.5	2,790.5	2,900.0	2,870.0	3,102.3	11,662.9	2,747.0	3,025.7	2,802.3	2,748.5	11,323.5			
Imports	-19,102.5	-18,374.5	-4,681.3	-4,752.5	-4,798.1	-5,036.4	-19,268.3	-4,628.6	-4,753.7	-4,795.3	-4,842.3	-19,019.8			
Energy	-2,741.5	-2,023.6	-617.7	-547.8	-623.1	-572.0	-2,360.6	-614.9	-649.2	-637.4	-553.7	-2,455.2			
Non-energy	-16,361.0	-16,350.8	-4,063.6	-4,204.7	-4,175.0	-4,464.4	-16,907.7	-4,013.6	-4,104.5	-4,157.9	-4,288.6	-16,564.6			
of which: non-food	-14,452.5	-14,567.2	-3,557.2	-3,732.8	-3,756.2	-4,020.3	-15,066.4	-3,503.5	-3,658.2	-3,713.8	-3,810.3	-14,685.7			
Services and transfers (net)	1,180.0	1,111.7	67.2	202.6	696.4	335.1	1,301.3	194.1	249.7	799.9	303.4	1,547.0			
Services	303.0	320.1	-50.6	88.3	340.2	79.8	457.7	13.8	44.9	484.8	-11.6	531.9			
of which: tourism	1,230.8	1,104.9	161.0	211.9	532.5	220.8	1,126.2	151.6	208.8	580.9	224.3	1,159.7			
Transfers (net)	877.0	791.7	117.8	114.4	356.1	255.3	843.6	180.3	204.8	315.1	315.0	1,015.1			
of which: workers' remittances	1,971.4	1,821.2	371.7	396.2	622.3	453.3	1,843.5	420.2	450.8	554.8	453.0	1,878.8			
of which: interest payments on external debt	-556.1	561.0	-159.3	-142.3	-166.8	-187.4	-655.8	-178.2	-181.0	-166.7	-76.8	-602.7			
of which: IMF	0.0	16.2					24.9					32.9			
Capital and financial account	4,251.6	3,162.7	1,216.1	1,041.5	807.4	711.7	3,776.7	328.4	1,722.9	1,026.1	1,255.9	4,333.3			
Capital account balance	224.7	94.7	6.9	12.3	15.4	56.6	91.3	-4.4	-4.2	12.2	117.6	121.1			
Financial account balance	4,027.0	3,068.0	1,209.2	1,029.1	792.0	655.0	3,685.4	332.7	1,727.1	1,013.9	1,138.4	4,212.1			
Direct investment and portfolio (net)	1,122.1	638.3	173.5	146.0	237.4	147.8	704.9	167.2	167.1	204.0	253.8	795.8			
Medium- and long-term loans (net)	2,361.5	1,034.6	818.1	1,065.4	369.0	-24.8	2,227.6	-20.0	1,163.4	645.1	620.0	2,408.6			
Disbursements	3,571.8	2,513.5	1,095.4	2,059.1	832.9	548.0	4,535.4	500.9	1,697.4	1,126.6	1,150.6	4,475.5			
of which: private	763.1	645.1	147.0	290.0	84.7	98.3	620.0	151.8	147.2	143.8	140.1	583.0			
Amortization	-1,210.3	-1,479.0	-277.3	-993.8	-463.8	-572.8	-2,307.8	-520.9	-533.9	-481.5	-530.5	-2,066.9			
Short-term capital	543.3	1,395.2	217.6	-182.2	185.6	503.1	724.2	-10.3	270.8	60.7	116.2	437.4			
of which: change in commercial banks' NFA	157.7	461.0	46.2	341.3	20.5	12.0	419.9	136.3	103.4	74.0	78.7	392.4			
Valuation changes	...	0.0	0.0	0.0	0.0	28.8	28.8	195.8	125.8	104.1	144.6	570.3			
Errors and omissions 2/	-3.9	-0.5	12.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
Overall balance	398.8	-532.1	-115.2	14.0	177.5	-335.0	-271.7	-659.3	863.3	336.2	104.3	644.5			
Changes in gross reserves ("+" : accumulation)	385.3	-488.8	-115.2	14.0	177.5	-348.0	-271.7	-659.3	863.3	336.2	104.3	644.5			
of which: IMF credit (net)	299.0	281.6	-16.7	238.6	-100.9	-126.3	0.4	112.2	112.3	130.1	130.1	484.6			
Purchases	300.6	315.9	0.0	312.1	0.0	0.0	315.1	253.2	253.5	253.7	253.8	1,014.2			
Repurchases	0.0	34.3	17.1	74.2	99.3	124.1	314.7	136.5	136.5	119.4	119.4	529.6			
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			
<i>Memorandum items:</i>															
Current account balance (percent of GDP)	-8.9	-8.8	-3.3	-2.6	-1.6	-2.6	-10.1	-2.5	-2.1	-1.7	-2.9	-9.2			
Capital and financial account balance (percent of GDP, excl. grants)	9.3	7.3	2.9	2.5	2.0	1.7	9.1	0.8	4.4	2.4	2.7	10.4			
Imports (percent of GDP)	44.3	43.7	44.3	47.3	48.4	51.5	47.8	46.6	48.9	46.2	47.0	47.2			
Exports (percent of GDP)	32.6	32.2	30.9	35.1	35.0	37.4	34.6	34.7	37.5	31.8	32.9	34.2			
Goods export real growth (percent)	-2.8	0.2	-4.1	5.4	15.9	-0.4	4.1	6.4	6.4	6.3	6.5	8.9			
of which: non-energy	0.0	1.7	-0.1	-1.6	7.8	6.2	3.3	6.5	6.8	6.7	6.7	9.4			
Goods import real growth (percent)	-2.5	2.0	7.0	-4.6	7.8	-4.0	2.2	-0.9	-4.9	6.7	-0.5	-1.1			
of which: non-energy	-1.9	5.0	6.0	-3.7	6.9	-5.7	1.7	-0.1	-4.5	8.8	0.5	-0.3			
Gross reserves (in billions of US\$)	7.4	5.9	5.8	5.9	6.0	5.7	5.7	5.0	5.9	6.2	6.3	6.3			
Reserve coverage (months of next year's imports of GNFS)	4.1	3.2	3.2	3.2	3.3	3.1	3.1	2.7	3.2	3.3	3.4	3.4			
Reserve coverage (percent of short-term external debt) 3/	112.7	88.8	85.2	88.1	89.3	85.7	85.5	76.7	90.3	95.3	98.6	98.8			
Reserve coverage (percent of short-term debt, on remaining maturity)	95.7	73.8	73.5	52.6	66.3	60.1	63.8	52.4	60.8	64.8	63.8	80.9			
Net international reserves (end of period, billions of US\$)	n.a.	3.6	3.1	3.0	3.1	3.1	3.1	2.4	3.1	3.3	3.2	3.2			
External medium- and long-term debt (billions of US\$)	20.5	21.2	22.3	24.2	25.5	24.8	24.8	25.2	26.4	27.1	25.7	25.7			
External medium- and long-term debt (percent of GDP)	49.2	54.9	53.4	60.9	64.7	63.2	63.2	61.1	65.8	68.8	67.0	67.0			
External short-term debt (billions of US\$)	6.6	6.7	6.9	6.6	6.8	6.7	6.7	6.6	6.5	6.5	6.4	6.4			
External short-term debt (percent of GDP)	15.8	17.3	16.4	16.8	17.1	17.0	17.0	15.9	16.3	16.6	16.7	16.7			
External debt service ratio (incl. IMF, percent of exports of GNFS)	10.1	12.2	11.0	26.3	13.6	12.2	18.8	16.7	16.1	14.3	10.3	18.5			
Excl. nonresidents deposits	167.6	122.5	125.1	75.3	106.3	93.6	99.3	82.5	95.2	103.0	99.7	127.6			
Nominal GDP (millions of US\$)	43,156	42,074	10,574	10,047	9,907	9,783	40,275	...	...	...	...	...

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

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

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

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

Table 3. Tunisia: External Financing Needs, 2015–18
(In millions of U.S. dollars)

	2015	2016	2017					2018				
	Annual	Annual	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
						Prel.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
Total financing requirements	11,623	11,880	8,210	8,426	7,437	8,300	13,040	8,359	8,039	7,924	8,340	12,413
Current account deficit	3,849	3,694	1,344	1,028	630	1,047	4,048	988	860	690	1,152	3,689
Amortizations	1,209	1,492	277	994	464	560	2,298	521	534	482	531	2,067
Central government 1/	599	640	139	726	312	325	1,502	343	332	324	317	1,315
Central Bank 2/	85	375	24	29	20	29	101	19	17	4	3	43
Corporate 3/	525	477	115	238	132	207	695	159	185	153	211	709
Short-term debt 4/	6,565	6,694	6,589	6,405	6,344	6,694	6,694	6,851	6,646	6,753	6,657	6,657
Total financing sources	11,909	11,751	8,197	8,380	7,404	8,262	12,888	8,359	8,028	7,881	8,276	12,413
Foreign direct investment and portfolio (net)	1,122	638	174	146	237	148	705	167	167	204	254	796
Disbursements	3,558	2,463	1,095	2,012	800	527	4,435	501	1,687	1,083	1,067	4,475
Central government 1/	2,771	1,833	948	1,405	715	310	3,379	349	1,539	940	927	3,893
Central Bank 2/	25	0	0	317	0	117	434	0	0	0	0	0
Corporate 3/	762	629	147	290	85	100	622	152	147	144	141	583
Short-term debt 4/	6,565	6,694	6,851	6,646	6,753	6,657	6,657	6,564	6,528	6,542	6,397	6,410
Other flows net (incl. drawdown in commercial banks NFA)	1,063	1,424	-38	-410	-208	594	853	468	510	388	663	1,377
Drawdown in gross reserves	-399	532	115	-14	-177	335	259	659	-863	-336	-104	-644
Financing gap	-286	129	0	0	0	0	0	0	0	0	0	0
of which: multi- and bilateral budget support (excl. IMF)	1,370	576	0	1,110	470	558	2,138	0	182	598	324	1,109
of which: financial market access and other	88	979	992	94	91	85	1,263	104	1,104	104	604	1,916
of which: IMF credit (net) 5/	301	282	-17	238	-99	-124	0	117	117	134	134	485
Purchases	301	316	0	312	0	0	315	253	253	254	254	1,014
Repurchase	0	34	17	74	99	124	315	137	137	119	119	530
<i>Memorandum items:</i>												
Gross international reserves (end of period)	7,401	5,941	5,838	5,852	6,030	5,703	5,691	5,032	5,895	6,231	6,310	6,336
Government rollover rates (in percent)	467	287	682	244	240	143	262	102	467	303	312	296
Corporate rollover rates (in percent)	145	132	128	122	64	49	90	96	80	94	67	82

Sources: Tunisian authorities; and IMF staff projections.

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

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

3/ Includes public and private enterprises.

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

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

Table 4. Tunisia: Central Government Fiscal Operations, 2015–18
(In millions of dinars)

	2015	2016	2017					2018				
			Q1	Q2	Q3	Annual Prel.	Annual Prog.	Q1 Proj.	Q2 Proj.	Q3 Proj.	Annual Proj.	Annual Prog.
Total revenue and grants	19,945	20,619	5,416	11,203	16,669	23,583	23,671	5,643	11,850	18,224	26,466	25,852
Revenue	19,653	20,489	5,416	11,203	16,635	23,396	23,409	5,643	11,850	18,180	26,101	25,586
Tax revenue	18,487	18,702	5,185	10,586	15,631	21,187	21,598	5,406	11,218	17,163	23,821	23,683
Direct taxes	7,816	7,577	2,055	4,545	6,500	8,560	9,184	1,987	4,101	6,195	8,457	8,889
Trade taxes	825	640	172	349	537	742	700	267	543	836	1,304	800
VAT	5,057	5,138	1,433	2,818	4,356	6,092	5,871	1,428	3,212	5,039	7,139	6,891
Excise	1,773	2,174	619	1,169	1,796	2,493	2,418	768	1,451	2,228	3,101	2,874
Other indirect taxes	3,016	3,174	906	1,704	2,442	3,300	3,425	955	1,910	2,865	3,820	4,229
Nontax revenue	1,162	1,776	231	617	1,005	2,209	1,807	237	631	1,017	2,276	1,901
of which: ETAP and STIR 1/	150	0	949	2,534	4,124	500	335	891	2,378	3,833	600	333
Capital income	4	11	0	0	0	0	4	0	0	0	4	3
Grants	292	130	0	0	34	187	262	0	0	43	365	266
Total expenditure and net lending	24,395	25,930	7,266	14,203	21,257	29,382	29,383	8,313	15,431	22,856	32,001	31,473
Total expenditure	23,675	25,839	7,317	13,892	20,380	29,421	29,418	8,345	15,137	22,005	32,061	31,460
Current expenditure	19,732	21,040	6,240	11,569	16,479	24,076	23,947	7,185	13,037	18,705	26,718	25,416
Wages and salaries	11,542	13,117	4,223	7,597	10,929	14,302	13,775	4,545	7,837	11,274	15,204	15,525
of which: one-off civil service reform costs	0	0	0	0	0	0	0	0	0	0	803	796
of which: Ministry of Defense and Interior	2,752	3,100	...	...	...	3,265	3,238	...	...	...	3,493	3,380
Goods and services	1,682	1,737	498	740	1,007	1,541	1,445	531	794	1,083	1,550	1,519
Interest payments	1,644	1,986	667	1,286	1,777	2,253	2,190	948	1,638	2,183	2,787	2,576
Domestic	957	1,165	381	780	953	1,249	1,255	636	1,013	1,245	1,537	1,426
External	687	821	286	505	823	1,004	2	313	625	938	1,250	1,150
Transfers and subsidies	4,864	4,200	853	1,946	2,766	5,980	6,527	1,012	2,525	3,830	6,808	5,796
Subsidies	2,863	2,211	0	0	0	3,498	...	453	1,225	2,330	4,109	...
CGC (food)	1,530	1,581	0	0	0	1,500	1,720	200	400	793	1,570	1,670
Energy subsidies (gross) 1/	918	197	0	0	0	1,550	1,427	140	600	1,200	2,089	1,276
Other (mainly transport)	415	433	0	0	0	448	...	113	225	338	450	...
Transfers (incl. CNRPS, social protection, and BFT)	2,001	1,989	0	0	0	2,482	...	559	1,300	1,500	2,699	...
Other current expenditure (non-allocated)	0	0	0	0	0	0	10	150	242	335	369	0
Capital expenditure	3,943	4,798	1,077	2,323	3,902	5,345	5,471	1,159	2,100	3,300	5,343	6,044
Net lending	720	91	-51	311	876	-39	-35	-32	294	851	-60	13
Overall balance	-4,451	-5,311	-1,849	-3,000	-4,588	-5,799	-5,712	-2,670	-3,581	-4,632	-5,535	-5,621
Float 2/	1,421	-511	1,091	-1,408	-23	-226	0	0	0	0	0	0
Financing (net)	3,029	5,822	758	4,408	4,611	6,025	5,712	2,670	3,581	4,632	5,535	5,621
Foreign financing	4,284	2,631	1,865	3,625	4,698	4,757	5,449	16	3,195	4,952	6,791	4,516
Drawings	5,461	4,013	2,185	5,706	7,546	8,413	8,962	883	4,927	7,551	10,256	7,533
Amortization	1,177	1,382	320	2,081	2,847	3,656	3,513	866	1,733	2,599	3,465	3,017
Domestic financing	-1,254	3,191	-1,106	783	-88	1,268	263	2,654	387	-320	-1,256	1,104
Debt	590	2,059	476	662	360	1,528	1,279	525	100	-114	-1,156	484
Drawings	2,382	3,889	539	926	1,389	2,681	2,490	1,000	900	386	744	2,400
Amortization	1,792	1,830	63	264	1,028	1,153	1,211	475	800	500	1,900	1,916
Non-debt	-1,844	1,132	-1,583	121	-448	-260	-1,016	2,129	287	-206	-100	620
Deposits ("+"= drawing / "-"= accumulation)	-1,914	605	-1,583	121	-448	-260	-1,216	2,129	287	-206	-100	420
Privatization and sale of confiscated assets 3/	70	527	0	0	0	0	200	0	0	0	0	200
Financing gap	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:												
Social expenditures 4/	1,335	1,411	589	1,132	1,502	1,844	1,533	721	1,021	1,534	2,041	2,033
Overall balance (excl. grants)	-4,743	-5,440	-1,849	-3,000	-4,621	-5,986	-5,974	-2,670	-3,581	-4,676	-5,900	-5,887
Overall balance (excl. grants, cash basis)	-3,321	-5,952	-758	-4,408	-4,644	-6,212	-5,974	-2,670	-3,581	-4,676	-5,900	-5,887
Primary balance	-2,806	-3,325	...	...	...	-3,546	...	...	...	...	-2,748	...
Structural balance	-4,451	-5,311	...	...	...	-6,755	...	...	...	...	-4,683	...
Cyclically-adjusted structural balance	-3,989	-5,123	...	...	...	-6,507	-5,954	...	...	...	-4,522	-4,536
Nominal GDP	84,656	90,376	24,359	24,359	24,359	97,435	97,397	26,545	26,545	26,545	106,179	104,603

Sources: Tunisian authorities; and IMF staff estimates.

1/ Energy subsidies used to be accounted as expenses net of revenue streams from utilities and fuel companies. The series has been revised to report gross flows of revenues from the commercialization of fuel of Entreprise Tunisienne d'Activités Pétrolières (ETAP) and from operational surplus of Société Tunisienne des Industries de Raffinage (STIR). Revenues beyond 2016 are not forecasted. A smoothing fuel mechanism is expected to be implemented on May 1, 2017, to bridge the gap between domestic and international prices; surplus dividends linked to this mechanism are not expected.

2/ End-period difference between the cash and accrual central government overall deficit. Actuals also include payments for which payment has been ordered, but the corresponding amounts have not been withdrawn from the treasury accounts yet. A negative sign implies higher cash spending than ordered (i.e. higher required financing).

3/ Includes mostly the sale of confiscated assets.

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

Table 5. Tunisia: Central Government Fiscal Operations, 2015–23
(In percent of GDP)

	2015	2016	2017		2018		2019	2020	2021	2022	2023
			Prog.	Prel.	Prog.	Proj.					
Total revenue and grants	23.6	22.8	24.3	24.2	24.7	24.9	25.9	26.2	26.1	26.3	26.3
Revenue	23.2	22.7	24.0	24.0	24.5	24.6	25.7	26.0	25.9	26.1	26.1
Tax revenue	21.8	20.7	22.2	21.7	22.6	22.4	23.6	23.9	23.9	24.1	24.1
Direct taxes	9.2	8.4	9.4	8.8	8.5	8.0	9.2	9.3	9.4	9.5	9.5
Trade taxes	1.0	0.7	0.7	0.8	0.8	1.2	1.2	1.2	1.2	1.2	1.2
VAT	6.0	5.7	6.0	6.3	6.6	6.7	6.5	6.6	6.6	6.6	6.7
Excise	2.1	2.4	2.5	2.6	2.7	2.9	3.0	3.0	3.0	3.0	3.0
Other indirect taxes	3.6	3.5	3.5	3.4	4.0	3.6	3.7	3.8	3.8	3.8	3.8
Nontax revenue	1.4	2.0	1.9	2.3	1.8	2.1	2.1	2.0	2.0	2.0	2.0
of which: ETAP and STIR 1/	0.2	0.0	...	0.5	...	0.6	0.5	0.5	0.5	0.5	0.4
Capital income	0.0	0.0	...	0.0	...	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.3	0.1	0.3	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Total expenditure and net lending	28.8	28.7	30.2	30.2	30.1	30.1	29.3	28.7	28.3	28.5	28.5
Total expenditure	28.0	28.6	30.2	30.2	30.1	30.2	29.3	28.7	28.4	28.5	28.5
Current expenditure	23.3	23.3	24.6	24.7	24.3	25.2	23.5	21.3	20.6	20.7	20.6
Wages and salaries	13.6	14.5	14.1	14.7	14.8	14.3	14.0	12.4	12.2	12.2	12.2
of which: one-off civil service reform costs	0.0	0.0	0.0	0.0	0.8	0.8	0.5	0.0	0.0	0.0	0.0
Goods and services	2.0	1.9	1.5	1.6	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Interest payments	1.9	2.2	2.2	2.3	2.5	2.6	2.5	2.7	2.6	2.8	2.8
Domestic	1.1	1.3	1.3	1.3	1.4	1.4	1.0	0.9	0.8	0.8	0.7
External	0.8	0.9	1.0	1.0	1.1	1.2	1.5	1.8	1.8	2.0	2.1
Transfers and subsidies	5.7	4.6	6.7	6.1	5.5	6.4	5.1	4.4	4.0	3.9	3.8
Subsidies	3.4	2.4	...	3.6	...	3.9	3.0	2.3	1.9	1.7	1.6
CGC (food)	1.8	1.7	1.8	1.5	1.6	1.5	1.5	1.5	1.4	1.3	1.2
Energy subsidies (gross) 1/	1.1	0.2	1.5	1.6	1.2	2.0	1.1	0.4	0.0	0.0	0.0
Other (mainly transport)	0.5	0.5	...	0.5	...	0.4	0.4	0.4	0.4	0.4	0.4
Transfers (incl. CNRPS, social protection, and BFT)	2.4	2.2	...	2.5	...	2.5	2.1	2.1	2.1	2.1	2.1
Other current expenditure (non-allocated)	0.0	0.0	0.0	0.0	0.0	0.3	0.4	0.4	0.3	0.3	0.3
Capital expenditure	4.7	5.3	5.6	5.5	5.8	5.0	5.8	7.4	7.7	7.8	7.9
Net lending	0.9	0.1	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Overall balance	-5.3	-5.9	-5.9	-6.0	-5.4	-5.2	-3.4	-2.5	-2.2	-2.2	-2.2
Float 2/	1.7	-0.6	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing (net)	3.6	6.4	5.9	6.2	5.4	5.2	3.4	2.5	2.2	2.2	2.2
Foreign financing	5.1	2.9	5.6	4.9	4.3	6.4	3.6	2.5	2.6	2.7	2.4
Domestic financing	-1.5	3.5	0.3	1.3	1.1	-1.2	-0.2	0.0	-0.4	-0.5	-0.2
of which: privatization and sale of confiscated assets 3/	0.1	0.6	0.2	0.0	0.2	0.0	0.0	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
<i>Memorandum items:</i>											
Social expenditures 4/	1.6	1.6	...	1.9	...	1.9	1.9	1.9	1.9	1.9	1.9
Overall balance (excl. grants)	-5.6	-6.0	-6.1	-6.1	-5.6	-5.6	-3.6	-2.7	-2.4	-2.4	-2.4
Overall balance (excl. grants, cash basis)	-3.9	-6.6	-6.1	-6.4	-5.6	-5.6	-3.6	-2.7	-2.4	-2.4	-2.4
Primary balance (excl. grants, cash basis)	-2.0	-4.4	-3.6	-4.1	-2.9	-2.9	-1.1	0.0	0.2	0.4	0.4
Structural primary balance	-4.7	-5.7	...	-6.7	...	-4.3	-3.1	-2.4	-2.2	-2.3	-2.4
Cyclically-adjusted structural balance	-4.7	-5.7	-5.6	-6.7	-5.1	-4.3	-3.1	-2.4	-2.2	-2.3	-2.4
Overall balance (cash basis)	-3.6	-6.4	-5.9	-6.2	-5.4	-5.2	-3.4	-2.5	-2.2	-2.2	-2.2
Primary balance (cash basis)	-3.3	-3.7	1.6	-3.6	1.9	-2.6	-0.8	0.2	0.4	0.6	0.6
Change in the structural balance ("+" improvement)	-0.2	-1.0	-6.1	-1.0	-4.3	2.4	1.1	0.8	0.2	-0.2	-0.1
Gross public debt	54.8	61.2	69.1	71.3	72.1	73.1	73.3	72.9	71.4	70.1	68.8
Domestic	19.5	20.9	22.7	23.3	21.6	20.5	18.9	18.1	16.6	15.3	14.3
External	35.3	40.3	47.3	48.0	51.4	52.6	54.4	54.8	54.8	54.8	54.4
Nominal GDP (in billions of TD)	84.7	90.4	97.4	97.4	104.6	106.2	115.4	124.7	134.7	145.4	157.1

Sources: Tunisian authorities; and IMF staff estimates.

1/ Energy subsidies used to be accounted as expenses net of revenue streams from utilities and fuel companies. The series has been revised to report gross flows of revenues from the commercialization of fuel of Entreprise Tunisienne d'Activités Pétrolières (ETAP) and from operational surplus of Société Tunisienne des Industries de Raffinage (STIR). Revenues beyond 2016 are not forecasted. A smoothing fuel mechanism is expected to be implemented on July 1, 2017, to bridge the gap between domestic and international prices; surplus dividends linked to this mechanism are not expected.

2/ End-period difference between the cash and accrual central government overall deficit. Actuals also include payments for which payment has been ordered, but the corresponding amounts have not been withdrawn from the treasury accounts yet. A negative sign implies higher cash spending than ordered (i.e. higher required financing).

3/ Includes mostly the sale of confiscated assets.

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

Table 6. Tunisia: Monetary Survey, 2015–18
(In millions of dinars)

	2015		2016		2017					2018				
	Annual	Annual	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual		
						Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.		
(Millions of Tunisian dinars)														
Net foreign assets (NFA)	1,686	-949	-1,352	-2,269	-2,637	-2,433	-2,433	-4,098	-2,412	-2,063	-2,528	-2,528		
Foreign assets	17,849	16,644	15,955	16,469	16,488	16,436	16,436	14,935	17,267	18,222	18,518	18,518		
Central bank	15,075	13,932	13,666	13,703	14,084	13,932	13,932	12,040	14,293	15,190	15,406	15,406		
Foreign liabilities	-16,162	-17,592	-17,307	-18,737	-19,126	-18,869	-18,869	-19,033	-19,679	-20,285	-21,046	-21,046		
Central bank	-5,991	-6,404	-6,434	-6,548	-6,412	-5,758	-5,758	-6,274	-6,571	-6,921	-7,328	-7,328		
Net domestic assets (NDA)	60,213	67,832	68,183	71,722	73,513	75,903	75,903	77,510	78,584	79,794	81,459	81,459		
Domestic credit	80,448	91,365	91,881	96,927	98,737	102,966	102,966	105,503	107,645	111,385	112,398	112,398		
Credit to the government (net)	14,355	18,892	17,802	20,087	20,034	20,928	20,928	23,167	24,124	24,602	22,994	22,994		
Central bank net credit	688	3,992	2,206	4,415	4,417	4,255	4,255	7,015	7,972	8,450	6,842	6,842		
Commercial banks	7,199	8,649	8,839	9,006	8,960	10,022	10,022	9,502	9,502	9,502	9,502	9,502		
Other	6,468	6,251	6,757	6,665	6,657	6,651	6,651	6,651	6,651	6,651	6,651	6,651		
Credit to the economy	66,093	72,472	74,079	76,840	78,703	82,038	82,038	82,335	83,521	86,782	89,404	89,404		
Other items (net)	-20,235	-23,533	-23,697	-25,205	-25,224	-27,064	-27,064	-27,993	-29,061	-31,590	-30,938	-30,938		
Money plus quasi-money (M2)	58,828	63,660	63,519	66,113	67,531	70,148	70,148	69,993	73,652	74,480	75,198	75,198		
Money (M1)	24,444	26,409	26,519	28,094	28,015	29,101	29,101	29,743	30,554	30,898	31,195	31,195		
Currency	8,418	9,749	9,753	10,497	10,838	11,225	11,225	11,113	11,820	11,918	12,033	12,033		
Demand deposits	16,026	16,661	16,766	17,597	17,177	17,876	17,876	18,629	18,734	18,980	19,163	19,163		
Quasi-money	34,384	37,251	37,000	38,019	39,516	41,047	41,047	40,250	43,098	43,582	44,002	44,002		
Long-term deposits (M3-M2)	3,071	3,223	3,311	3,341	3,345	3,321	3,321	3,419	2,520	3,252	3,734	3,734		
Broad money (M3)	61,899	66,883	66,831	69,454	70,876	73,469	73,469	73,412	76,172	77,732	78,932	78,932		
(Annual percentage change)														
Net foreign assets	-22.4	-156.3	-2,779.5	59.8	171.9	156.5	156.5	203.0	6.3	-21.8	3.9	3.9		
Net domestic assets	6.3	12.7	8.6	10.3	12.4	11.9	11.9	13.7	9.6	8.5	7.3	7.3		
Domestic credit	7.5	13.6	9.3	10.8	11.3	12.7	12.7	14.8	11.1	12.8	9.2	9.2		
Credit to the government (net)	13.8	31.6	8.2	13.6	10.4	10.8	10.8	30.1	20.1	22.8	9.9	9.9		
Credit to the economy	6.2	9.7	9.6	10.1	11.5	13.2	13.2	11.1	8.7	10.3	9.0	9.0		
Money and quasi-money (M2)	5.2	8.2	6.3	9.4	10.2	10.2	10.2	10.2	11.4	10.3	7.2	7.2		
Broad money (M3)	5.3	8.1	6.4	9.2	10.0	9.8	9.8	9.8	9.7	9.7	7.4	7.4		
(Annual growth rates, in percent of broad money)														
Net foreign assets	-0.8	-4.3	-2.2	-1.3	-2.6	-2.2	-2.2	-4.1	-0.2	0.8	-0.1	-0.1		
Net domestic assets	6.1	12.3	8.6	10.6	12.6	12.1	12.1	14.0	9.9	8.9	7.6	7.6		
Domestic credit	9.6	17.6	12.5	14.9	15.5	17.3	17.3	20.4	15.4	17.8	12.8	12.8		
Credit to the government (net)	3.0	7.3	2.1	3.8	2.9	3.0	3.0	8.0	5.8	6.4	2.8	2.8		
Credit to the economy	6.6	10.3	10.3	11.1	12.6	14.3	14.3	12.4	9.6	11.4	10.0	10.0		
Other items (net)	-3.5	7.8	6.0	9.0	9.7	9.7	9.7	9.7	10.9	9.8	6.9	6.9		
<i>Memorandum items:</i>														
Nominal GDP	84,656	90,376					97,435					106,179		

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

Table 7. Tunisia: Central Bank Survey, 2015–18
(In millions of dinars)

	2015		2016		2017			2018				
	Annual	Annual	Q1	Q2	Q3	Q4	Annual	Q1 Proj.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Annual Proj.
(In millions of Tunisian dinars)												
Net Foreign Assets	9,084	7,528	7,232	7,155	7,672	8,174	8,174	5,767	7,722	8,269	8,078	8,078
Assets	15,075	13,932	13,666	13,703	14,084	13,932	13,932	12,040	14,293	15,190	15,406	15,406
<i>of which: proceeds of FX swaps</i>	606	507	510	482	841	1,491	1,491	1,491	1,491	1,491	1,491	1,491
Liabilities	5,991	6,404	6,434	6,548	6,412	5,758	5,758	6,274	6,571	6,921	7,328	7,328
Net Domestic Assets	1,924	5,094	5,351	6,640	6,761	7,062	7,062	9,374	8,131	7,652	7,497	7,497
Domestic credit (net)	4,897	9,483	9,692	11,988	12,168	12,739	12,739	15,826	15,220	15,381	15,999	15,999
Net credit to government 1/	688	3,993	2,206	4,415	4,417	4,255	4,255	7,015	7,972	8,450	6,842	6,842
Credit to Banks 2/	4,209	5,490	7,486	7,573	7,751	8,484	8,484	8,812	7,249	6,931	9,157	9,157
Other items net	-2,973	-4,389	-4,341	-5,348	-5,407	-5,677	-5,677	-6,452	-7,089	-7,729	-8,502	-8,502
Reserve Money 3/	11,009	12,622	12,583	13,795	14,433	15,236	15,236	15,141	15,853	15,921	15,575	15,575
(Annual percentage change)												
Net Foreign Assets	-1.8	-17.1	6.4	-2.0	1.9	8.6	8.6	-19.4	0.7	1.2	-1.2	-1.2
Assets	5.5	-7.6	4.4	0.4	1.1	0.0	0.0	-12.1	1.5	9.0	10.6	10.6
<i>of which: proceeds of FX swaps 4/</i>	...	-16.3	-10.5	-10.4	60.8	194.1	194.1	192.4	209.3	77.3	0.0	0.0
Liabilities	18.8	6.9	2.3	3.1	0.1	-10.1	-10.1	-4.2	2.5	20.2	27.3	27.3
Net Domestic Assets	14.0	164.7	15.5	25.7	32.7	38.6	38.6	41.2	20.3	8.3	6.2	6.2
Domestic credit (net)	12.4	93.6	8.8	24.9	28.3	34.3	34.3	32.0	25.1	20.7	25.6	25.6
Net credit to government 1/	-44.6	480.1	-36.6	21.8	10.6	6.6	6.6	58.9	80.5	98.6	60.8	60.8
Credit to Banks 2/	35.1	30.4	37.9	26.8	41.2	54.5	54.5	16.4	-6.5	-18.3	7.9	7.9
Other items net	11.4	47.6	1.5	23.9	23.2	29.3	29.3	20.6	31.1	36.1	49.7	49.7
Reserve Money 3/	0.6	14.7	10.1	9.6	14.3	20.7	20.7	9.8	9.8	4.5	2.2	2.2
<i>Memorandum items:</i>												
Open market purchases (OMPs)	112	804	1,032	1,174	987	982	982	982	982	982	982	982
FX swap operations 4/	606	507	510	482	841	1,491	1,491	1,491	1,491	1,491	1,491	1,491
Total CBT refinancing of banks (IMF definition, excl. OMP)	4,815	5,997	7,996	8,055	8,592	9,975	9,975	10,303	8,740	8,422	10,648	10,648
Total CBT refinancing of banks	4,927	6,801	9,028	9,229	9,579	10,957	10,957	11,284	9,721	9,403	11,630	11,630

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

1/ Includes subscription to the IMF and the AMF.

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

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

4/ Introduced at end-2014.

Table 8. Tunisia: Financial Soundness Indicators of the Banking Sector, 2010–17
(Percent, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017 Sep.
Regulatory capital								
Regulatory capital to risk-weighted assets	11.6	11.9	11.8	8.2	9.4	12.0	11.6	11.1
Tier 1 capital to risk weighted assets	10.2	10.0	9.5	6.6	7.6	9.3	8.8	8.2
Capital to assets	8.4	8.5	7.8	5.6	6.2	7.8	8.2	8.1
Asset quality								
Sectoral distribution of loans to total loans								
Industry	30.5	28.6	27.9	27.8	27.2	27.3	26.9	27.5
Agriculture	2.9	2.9	2.8	2.8	2.8	2.6	2.6	2.6
Commerce	15.0	16.0	15.4	15.1	15.6	15.8	15.9	16.2
Construction	5.9	5.6	5.4	5.5	5.7	6.2	6.2	6.0
Tourism	7.3	7.3	6.9	6.5	6.1	6.2	5.8	5.5
Households	22.1	23.4	25.4	26.2	26.2	26.6	26.3	26.4
Other	16.3	16.3	16.2	16.0	16.5	15.4	16.3	15.8
FX-loans to total loans	5.3	5.1	4.8	4.8	5.5	5.8	5.7	5.4
Credit to the private sector (in percent of GDP) 1/	70.6	67.4	67.7	73.7	73.8	73.5	73.7	73.6
Nonperforming Loans (NPLs) to total loans	13.0	13.3	14.9	16.5	15.8	16.6	15.6	15.0
Specific provisions to NPLs	-	48.6	45.7	56.4	58.0	56.9	59.0	58.1
NPLs, net of provisions, to tier 1 capital	60.3	66.2	86.3	111.6	90.3	78.8	68.2	69.1
Specific provisions to total loans	7.6	7.6	8.0	10.3	10.1	10.5	10.2	9.7
General provisions to total loans	-	0.4	0.5	0.6	0.6	0.6	0.6	0.6
Profitability								
Return on assets (ROA)	0.9	0.6	0.6	0.3	0.9	0.9	-	-
Return on equity (ROE)	10.2	5.9	7.2	3.0	11.2	10.9	-	-
Interest rate average spread (btw. loans and deposits)	3.5	3.0	3.0	3.3	3.1	3.0	2.9	3.0
Interest return on credit	6.2	5.7	5.4	5.9	6.4	6.3	6.0	6.2
Cost of risk as a percent of credit	1.7	1.2	1.2	1.9	1.1	1.1	0.9	-
Net interest margin to net banking product (PNB)	58.6	57.2	58.1	58.9	57.2	54.6	50.9	-
Operating expenses to PNB	46.5	51.1	50.3	47.3	48.5	49.2	48.5	-
Operating expenses to total assets	1.6	1.7	1.6	1.6	1.7	1.7	1.7	-
Personnel expenses to non-interest expenses	59.1	62.6	61.5	60.8	59.3	60.1	58.7	-
Trading and other non-interest income to PNB	21.8	22.5	20.9	21.6	22.4	24.3	29.5	-
Liquidity								
Liquid assets to total assets 2/	29.8	26.5	28.2	28.4	28.2	5.6	5.6	4.9
Liquid assets to short-term liabilities	104.1	89.4	89.2	92.6	96.6	83.8	94.4	87.4
Deposits to loans	94.6	87.4	89.5	89.6	88.8	87.4	86.8	84.6
Deposits of state-owned enterprises to total deposits	13.8	12.6	13.2	13.0	11.7	9.5	7.8	7.1
Sensitivity to market risk								
FX net open position to tier 1 capital	1.4	1.9	2.3	3.1	2.2	3.3	4.9	5.8

Source: Central Bank of Tunisia.

1/ Coverage of private sector credit may differ from that of Table 6.

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

Table 9. Tunisia: Illustrative Medium-Term Growth Scenario, 2013–23

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
					Prel.					Proj.	
	(Annual percentage change)										
Real GDP growth	2.4	2.3	1.1	1.0	1.9	2.4	2.9	3.4	3.6	4.0	4.2
Total consumption	3.3	3.6	2.3	2.1	0.6	-1.7	1.0	2.5	3.0	3.1	4.4
Private consumption	3.0	4.0	1.6	1.6	1.5	0.3	0.7	4.9	3.0	2.9	4.4
Public consumption	4.3	2.6	4.8	3.8	-2.4	-8.6	1.9	-6.6	2.8	4.1	4.2
Investment	-5.4	8.5	-2.6	2.8	4.5	5.0	5.0	6.0	6.5	6.5	5.0
Gross fixed capital formation	0.2	-2.6	-2.5	2.8	4.5	5.0	5.0	6.0	6.5	6.5	5.0
Trade											
Exports of goods and non-factor services	2.6	4.2	-2.8	0.2	4.1	8.9	4.6	3.5	4.3	3.8	3.8
Imports of goods and non-factor services	4.9	2.6	-2.5	2.0	2.2	-1.1	1.6	2.3	3.3	3.3	4.3
Inflation (annual average)	5.8	4.9	4.9	3.7	5.3	7.0	6.1	5.2	4.3	4.0	3.9
	(Percent of GDP)										
Gross national savings	14.4	14.0	12.5	13.4	12.4	14.0	15.7	16.6	18.0	18.9	19.4
Central government 1/	-2.4	1.2	0.3	-0.5	-0.5	-0.2	2.4	4.9	5.5	5.6	5.7
Rest of the economy	16.7	12.8	12.3	13.9	12.9	14.2	13.3	11.7	12.5	13.3	13.7
Gross investment	22.7	23.2	21.4	22.2	22.5	23.1	23.5	23.8	24.4	24.9	25.3
Central government 1/	5.0	4.3	4.7	5.3	5.5	5.0	5.8	7.4	7.7	7.8	7.9
Rest of the economy	17.8	18.8	16.8	16.9	17.0	18.1	17.7	16.4	16.7	17.1	17.3
Total consumption	86.8	87.8	89.6	89.1	88.3	86.6	85.1	84.4	83.8	83.2	81.0
Private consumption	68.1	69.1	70.0	68.4	67.8	66.8	65.7	67.1	66.6	66.1	63.8
Public consumption	18.6	18.7	19.6	20.7	20.4	19.8	19.4	17.4	17.2	17.2	17.2
Savings-investment gap	-8.4	-9.1	-8.9	-8.8	-10.1	-9.2	-7.8	-7.2	-6.4	-6.0	-5.8
Central government 1/	-7.3	-3.1	-4.4	-5.8	-6.0	-5.3	-3.4	-2.5	-2.2	-2.2	-2.2
Rest of the economy	-1.0	-6.0	-4.5	-3.0	-4.1	-3.9	-4.4	-4.7	-4.2	-3.8	-3.6
<i>Memorandum items:</i>											
Nominal GDP (in millions of TD)	75,152	80,816	84,656	90,376	97,435	106,179	115,386	124,678	134,721	145,434	157,149
Overall fiscal balance (in percent of GDP) 2/	-7.4	-4.4	-5.6	-6.0	-6.1	-5.6	-3.6	-2.7	-2.4	-2.4	-2.4
Social expenditures (in percent of GDP) 3/	1.7	1.5	1.6	1.6	1.6	1.9	...	...	...	...	...
Gross public debt (in percent of GDP)	46.8	51.6	54.8	61.2	71.3	73.1	73.3	72.9	71.4	70.1	68.8
Current account balance (in percent of GDP)	-8.4	-9.1	-8.9	-8.8	-10.1	-9.2	-7.8	-7.2	-6.4	-6.0	-5.8
External debt (in percent of GDP)	57.0	61.4	64.9	72.2	80.1	83.7	85.5	84.5	83.5	81.2	78.5
Credit to the economy (yoy growth, in percent)	6.8	9.4	6.2	9.7	13.2	9.0	8.7	8.1	8.1	8.5	9.3

Sources: Tunisian authorities; and IMF staff estimates.

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

2/ Including grants and excluding privatization.

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

Table 10. Tunisia: Schedule of Purchases Under the Extended Fund Facility, 2016–20

Review	Availability Date	Action	Purchase		Total
			Millions of SDRs	Percent of quota 1/	Disbursements Millions of US\$ 2/
	May 20, 2016	Board approval of the EFF	227.2920	41.6897	315.9052
First Review	September 30, 2016	Observance of end-Dec. 2016 performance criteria, completion of the first review	227.2917	41.6896	315.9048
Second Review 3/	September 30, 2017	Observance of end-Dec. 2017 performance criteria, completion of the second review	176.7824	32.4252	245.7036
Third Review	June 15, 2018	Observance of end-Mar. 2018 performance criteria, completion of the third review	176.7824	32.4252	245.7036
Fourth Review	September 17, 2018	Observance of end-Jun. 2018 performance criteria, completion of the fourth review	176.7824	32.4252	245.7036
Fifth Review	December 17, 2018	Observance of end-Sep. 2018 performance criteria, completion of the fifth review	176.7824	32.4252	245.7036
Sixth Review	March 18, 2019	Observance of end-Dec. 2018 performance criteria, completion of the sixth review	176.7824	32.4252	245.7036
Seventh Review	June 17, 2019	Observance of end-Mar. 2019 performance criteria, completion of the seventh review	176.7824	32.4252	245.7036
Eight Review	September 18, 2019	Observance of end-Jun. 2019 performance criteria, completion of the eighth review	176.7824	32.4252	245.7036
Ninth Review	December 18, 2019	Observance of end-Sep. 2019 performance criteria, completion of the ninth review	176.7824	32.4252	245.7036
Tenth Review	April 29, 2020	Observance of end-Dec. 2019 performance criteria, completion of the tenth review	176.7821	32.4252	245.7033
Total			2,045.6250	375.2063	2,843.1425

Source: IMF staff projections.
1/ Quota is SDR 545.2 million.
2/ Indicative amounts based on the program exchange rate.
3/ Given the Board meeting for the Second Review is scheduled for March 2018, end-December 2017 performance criteria will be applied to this review.

Table 11. Tunisia: Indicators of Fund Credit, 2015–23

	2015	2016	2017	2018	2019	2020	2021	2022	2023
							Proj.		
Existing and prospective Fund credit (millions of SDR)									
Disbursement	215.0	227.3	227.3	707.1	707.1	176.8	-	-	-
Stock	1,002.8	1,205.3	1,205.6	1,543.5	1,976.2	2,026.6	1,969.8	1,864.6	1,516.3
Obligations	-	39.0	249.4	397.1	320.7	187.7	125.9	171.3	264.0
Repurchase	-	24.7	227.0	369.3	274.4	126.4	56.8	105.2	245.9
Charges and surcharges	-	14.3	22.4	27.9	46.4	61.3	69.1	66.0	18.1
Stock of existing and prospective Fund credit									
In percent of quota	350.0	221.1	221.1	283.1	362.5	371.7	361.3	342.0	278.1
In percent of GDP	3.3	4.0	4.1	5.5	6.8	6.7	6.1	5.5	4.2
In percent of exports of goods and services	8.0	9.9	9.6	12.8	15.9	15.9	15.3	14.0	11.0
In percent of gross reserves	19.0	28.2	29.4	34.9	40.7	40.9	38.5	33.5	25.5
Obligations to the Fund from existing and prospective Fund arrangements									
In percent of quota	-	7.1	45.7	72.8	58.8	34.4	23.1	31.4	48.4
In percent of GDP	-	0.1	0.9	1.4	1.1	0.6	0.4	0.5	0.7
In percent of exports of goods and services	-	0.3	2.0	3.3	2.6	1.5	1.0	1.3	1.9
In percent of gross reserves	-	0.9	6.1	9.0	6.6	3.8	2.5	3.1	4.4

Source: IMF staff estimates.

Annex I. Recommendations from the 2015 Article IV Consultation

Staff Advice	Staff Evaluation
Overall Context	
Policy priorities	The authorities have started to address economic reform priorities in line with IMF advice, but at a slower-than-envisaged pace. Fiscal consolidation has started with the 2018 budget, monetary policy was tightened, and there was some progress with structural reforms--notably on public bank restructuring and private sector legislation.
Expectations versus outcomes	Contrary to expectations at the time of the last Article IV Consultation in 2015, Tunisia is still in the midst of economic transition. It continues to face elevated political uncertainty, social tensions, threats to security (even if no major attack occurred since 2015), and a difficult regional situation. This environment makes it difficult to move quickly towards higher and more inclusive growth through a comprehensive reform effort.
Fiscal Policy	
Fiscal consolidation	Deficits continued to grow in 2017, mainly due to difficulties in containing the growth of the public wage bill. The increasing fiscal deficits have worsened debt sustainability, affected confidence, and fueled external imbalances through their impact on imports. The authorities are implementing strong revenue measures in 2018 and are moving forward with voluntary schemes to reduce public sector headcount, strict hiring limits, and energy price increases.
Growth-focused re-orientation of expenditures	Spending composition has deteriorated, with higher current expenditures and under-execution of the capital budget. Modest progress was made with reducing energy subsidies, while work on a better targeted social safety net has met major implementation delays.
Tax reform	The authorities' 2018 tax package (more than 2 percent of GDP) includes many elements of the 2016 tax strategy that called for increasing revenue and promoting greater efficiency, equity, and simplification. Some progress has been made with improving tax administration, but the creation of a large taxpayer unit (LTU) is delayed.
Better management of fiscal risks	The authorities intend to start reform pensions in 2018 (mostly relying on an increase in contributions) to improve the financial viability of the social security funds. Performance contracts were signed for the three largest public banks and four of the largest public enterprises.
Monetary and Exchange Rate Policy	
Prudent monetary policy	The authorities have increased the policy rate and broadened the interest corridor, but real interest rates remain negative and inflation has accelerated recently. The authorities achieved some improvements in their monetary policy framework, notably the lender of last resort mechanism.
FX interventions	The real exchange rate remains overvalued and central bank FX interventions have remained sizeable, leading to falling reserve cover as exports remain sluggish.
Structural Reforms	
Governance and business climate reforms	Tunisia adopted a new competition law, investment code, and PPP law, but there were delays in follow-up measures. The High Anti-Corruption and Good Governance Authority is close to being operational. Little progress has been made with implementing the national employment strategy.
Banking sector reforms	Banking sector reforms have advanced, but at a slower-than-expected pace. Progress was made on public bank restructuring and risk-based supervision.

Source: IMF staff.

Annex II. Risk Assessment Matrix¹

Source of Risk and Relative Likelihood	Expected Impact and Recommended Policy Response
Domestic Risks	
<p><i>High</i></p> <p>Slow reform implementation, due to continued political uncertainty, social tensions, and opposition to reforms from vested interests.</p> <p><i>High</i></p> <p>A deteriorating security situation, due to spillovers from Libya and other conflicts in the region. These could take the form of major refugee flows, increased illicit economic activity including smuggle trade, and violent attacks.</p>	<p><i>High</i></p> <p>Growth may fall and macroeconomic stability may be impaired by a halt of structural reforms and stability-focused macroeconomic policies, lower confidence and investment, and diversion of growth-enhancing expenditures to security-related items. Budget financing could be affected by delays in support from IFIs and bilateral donors. Mitigation strategies include (i) effective communication to generate broad buy-in to reforms, (ii) measures to rebuild fiscal and external buffers, including growth-friendly fiscal consolidation and a move back towards a de facto floating exchange rate arrangement, (iii) acceleration of structural reforms, including to increase the resilience of the financial sector, and (iv) close cooperation with external partners.</p>
External Risks	
<p><i>High</i></p> <p>Policy and geopolitical uncertainties, due to (i) two-sided risks to U.S. growth; (ii) uncertainty associated with negotiating post-Brexit arrangements in Europe and associated market fragmentation risks; (iii) evolving political processes weighing on the whole on global growth; and (iv) an intensification of risks of fragmentation and security dislocation in the Middle East, Africa, and Europe that could lead to socio-economic disruptions, including a sharp rise in migrant flows.</p> <p><i>High</i></p> <p>Tighter and changing global financial conditions, triggered by (i) an abrupt change in global risk appetite against the backdrop of continued monetary policy normalization and increasingly stretched valuations across asset classes; and/or (ii) further pressure on traditional bank business models.</p> <p><i>High</i></p> <p>Weaker-than-expected global growth, driven by (i) low productivity growth in advanced economies (U.S., the Euro Area, and Japan); and/or (ii) a significant U.S. slowdown and its spillovers.</p>	<p><i>Medium</i></p> <p>Growth may fall due to lower confidence and investment; the impact of protectionism on trade and finance flows; higher international oil prices weighing on the budget, the current account, and other economic sector; and increased security spending. Large refugee inflows from Libya could weigh on the budget and on already strained housing and labor markets. Finally, there could be significant social, economic, and political dislocation in case refugee flows from or via Tunisia to Europe accelerated (Tunisia's coast is at a shorter distance from Italy than that of Libya). Mitigation strategies are the same as above.</p> <p><i>Low</i></p> <p>Sovereign refinancing risks and debt service would increase, but Tunisia's strong reliance on debt to official creditors would limit the impact. Pressures on international reserves could also intensify, even if the capital account remains relatively closed. Mitigation strategies are the same as in the case of policy and geopolitical risks, with an additional focus on debt management and measures to ensure financial sector stability. Moreover, the Financial Action Task Force's (FATF) and the European Union's recent addition of Tunisia to lists of jurisdictions with significant AML/CFT deficiencies increases the risk of a loss of correspondent banking services (CBS). This would hurt cross-border payments, trade finance, and remittances. To mitigate this risk, the authorities are working with the FATF and MENA-FATF to strengthen the effectiveness of their AML/CFT regime.</p> <p><i>High</i></p> <p>Tunisia's growth would be adversely affected through trade, remittances, and investment channels, especially from Europe. Risk mitigation strategies are similar to above, with a strong focus on competitiveness reforms.</p>

¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short-term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex III. Public Debt Sustainability Analysis

Tunisia's public debt remains sustainable but is increasing at a fast pace. Central government¹ debt is expected to peak at 72 percent of GDP in 2018 (from an average of 45 percent from 2010–14) before declining following strong fiscal consolidation. Gross financing needs are expected to average 13 percent of GDP through 2022, reflecting high deficits and rollover needs. The debt level breaches the emerging markets debt burden benchmark of 70 percent of GDP under the baseline, but Tunisia continues to benefit from long maturities and a stable creditor base with a high share of debt owed to international financial institutions (IFIs) and bilateral donors. Stress scenarios confirm the sustainability of debt, but identify risks from contingent liabilities and exchange rate depreciation, especially if combined with permanently lower growth.² Strong policy implementation will be critical to mitigate these risks that are to a significant extent beyond the control of government.

A. Background: Continued Access to Financing, But Rapidly Rising Debt

1. Public debt vulnerabilities continued to increase in 2017. Public debt reached 71 percent of GDP in 2017, from 61 percent in 2016 and about 53 percent of GDP at the start of the program in June 2016. The increase has been driven by elevated fiscal deficits (5.9 percent of GDP in 2016, 6.0 percent of GDP in 2017), currency depreciation (about 25 percent against the Euro since early 2016), and weaker-than-expected growth. The gross borrowing requirement remained elevated in 2017 at 11.4 percent of GDP. Further, even though Tunisia's creditor structure limits its rollover risks, debt service costs remained quite high, notably with gross borrowing requirement of 11 percent of GDP in 2017.

2. Despite vulnerabilities, Tunisia maintained access to financing at a low cost. Tunisia's debt remains characterized by relatively long maturities and a large share is in foreign currency. Half of external debt (62 percent of total debt) is mainly owed to multilateral institutions. Bilateral official donors account for an additional 20 percent of total debt. The remaining part consists of E-bond issuances on international financial markets, with maturities ranging from 5 to 18 years. Most of these issuances are covered by third-party sovereign guarantees. Domestically, Tunisia has issued government bonds that represent 38 percent of total debt and have maturities of five years or more. Tunisia has continued to benefit from low interest rates, in large part owing to favorable terms from official creditors. For 2017, the implicit interest rates were 6.7 percent on domestic debt (1.4 percent in real terms), 2.7 percent on external debt (-3.6 percent in real terms), and 4.1 percent for total debt (-1.2 percent in real terms). Inflationary pressures and risks regarding Tunisia's rating and exchange

¹ See definition of central government in the Technical Memorandum of Understanding (TMU ¶17).

² State guarantees (12 percent of GDP) are excluded from the baseline stock of debt due to a low probability of being called; the contingent liability shock provides a reliable estimate of the impact of most such guarantees being called simultaneously.

rate path could translate into higher cost of financing in the coming years. Containing macroeconomic vulnerabilities by tightening the macroeconomic policy mix, therefore is a priority.

B. Baseline: Strong Upfront Fiscal Adjustment to Reduce Debt

3. Public debt will fall below 70 percent of GDP by 2023. In the baseline scenario, growth recovers to about 4 percent over the medium term, inflation decelerates, and gradual fiscal adjustment improves the primary balance by 4.3 percent throughout 2023. This would also help improve Tunisia's sovereign debt ratings, and thus facilitate access to international capital markets. The public debt-to-GDP ratio would decline from 71 percent in 2017 to 68 percent in 2023. Forecast errors analysis suggest that these projections are in line with past experience (Table 3). This scenario depends on steadfast implementation of fiscal and monetary tightening, as well as accelerated structural reforms to support the private sector.

4. This outlook is consistent with low rollover risk and only slight interest rate increases. The gross borrowing requirement would decline to 6 percent of GDP by the end of the projection horizon. Currency composition and maturity of Tunisia's debt stock would remain broadly unchanged, while the effective interest rate increases moderately to 4.2 percent in line with slightly increased reliance on market financing. However, potential interest rates risks could emerge over the medium to long term with Tunisia gradually relying more on market financing, in turn increasing its exposure to hikes in global interest rates.

C. Risk Mitigation Through Buffers and Contingency Planning

5. A series of plausible stress tests highlights risks to debt sustainability. Tunisia's debt to GDP ratio stands above the emerging market debt burden benchmark, which signals the need for cautious policies to maintain investor confidence. Stress tests confirm the vulnerability of the country's public debt to interest rate risk, a growth shock, and real exchange rate depreciation. Several standard tests plus two customized scenarios—one highlighting the impact of maintaining loose fiscal and monetary policies due to strong political pressure; the other analyzing the impact of a major security incident similar to the 2015 terrorist attacks, but starting from weaker initial conditions—signal that the debt-to-GDP ratio could significantly deteriorate relative to the baseline and, in some cases, push it above 90 percent. Moreover, the test including contingent liabilities³ highlights risks emanating from government guarantees, mostly to SOEs, which amount to about 12 percent of GDP.

6. The analysis underscores the need to proceed with strong policy implementation. Most importantly, the current fiscal program should be considered as a minimum level of desirable fiscal effort considering the significant economic risks that Tunisia faces. Moreover, contingency planning could help fiscal and monetary policymakers to respond quickly in case a negative shock occurs.

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

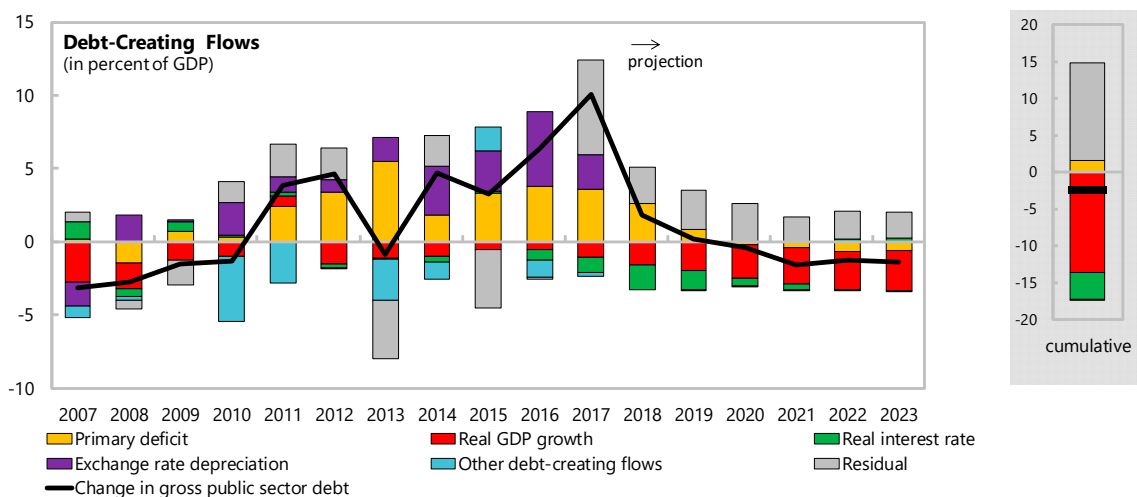
Finally, the contingent liability scenario highlights the need to improve the monitoring and, if needed, management of the financial health of SOEs, social security funds, and local governments.

Table 1. Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario
(Percent of GDP unless otherwise indicated)

	Actual		Projections							As of February 24, 2018	
	2007-2015 ^{2/}	2016	2017	2018	2019	2020	2021	2022	2023	Sovereign Spreads	
Nominal gross public debt	45.6	61.2	71.3	73.1	73.3	72.9	71.3	70.1	68.7	10Y spread (bp) 3/	382
Public gross financing needs	7.8	9.5	10.8	10.3	8.7	7.9	7.8	6.7	5.8	5Y CDS (bp)	304
Real GDP growth (in percent)	2.7	1.0	1.9	2.4	2.9	3.4	3.6	4.0	4.2	Ratings	Foreign Local
Inflation (GDP deflator, in percent)	4.3	5.7	5.8	6.4	5.6	4.5	4.3	3.8	3.7	Moody's	B1 B1
Nominal GDP growth (in percent)	7.1	6.8	7.8	9.0	8.7	8.1	8.1	8.0	8.1	S&Ps	... ..
Effective interest rate (in percent) ^{4/}	4.7	4.3	4.1	4.0	3.8	3.9	3.8	4.2	4.2	Fitch	B+ B+

Contribution to Changes in Public Debt

	Actual		Projections							cumulative	debt-stabilizing primary balance ^{9/}
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023		
Change in gross public sector debt	0.8	6.4	10.1	1.8	0.2	-0.4	-1.6	-1.2	-1.4	-2.5	
Identified debt-creating flows	1.0	6.5	3.6	-0.7	-2.5	-3.0	-3.3	-3.1	-3.1	-15.8	
Primary deficit	1.8	3.8	3.6	2.6	0.8	-0.2	-0.4	-0.6	-0.6	1.6	-2.5
Primary (noninterest) revenue and grants	24.1	22.8	24.2	24.9	25.9	26.2	26.1	26.3	26.3	155.8	
Primary (noninterest) expenditure	25.9	26.6	27.8	27.5	26.8	26.0	25.7	25.7	25.7	157.4	
Automatic debt dynamics ^{5/}	0.3	3.9	0.3	-3.2	-3.3	-2.8	-2.9	-2.5	-2.5	-17.2	
Interest rate/growth differential ^{6/}	-1.0	-1.3	-2.1	-3.2	-3.3	-2.8	-2.9	-2.5	-2.5	-17.2	
Of which: real interest rate	0.1	-0.8	-1.0	-1.7	-1.3	-0.5	-0.4	0.2	0.2	-3.6	
Of which: real GDP growth	-1.1	-0.5	-1.1	-1.6	-2.0	-2.3	-2.4	-2.6	-2.7	-13.6	
Exchange rate depreciation ^{7/}	1.4	5.1	2.4	...	...	...	...	...	...	...
Other identified debt-creating flows	-1.2	-1.1	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	
CG: Privatization Proceeds (negative)	-0.3	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes ^{8/}	-0.2	-0.1	6.4	2.5	2.7	2.6	1.7	1.9	1.8	13.2	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+grt)]$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

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

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

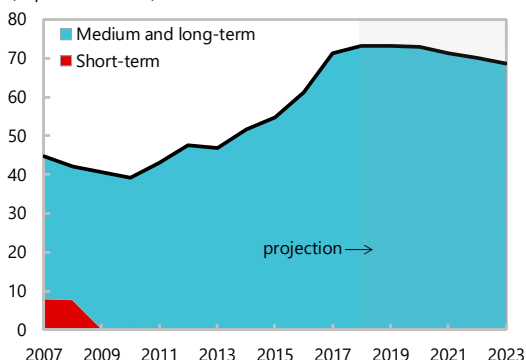
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 2. Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

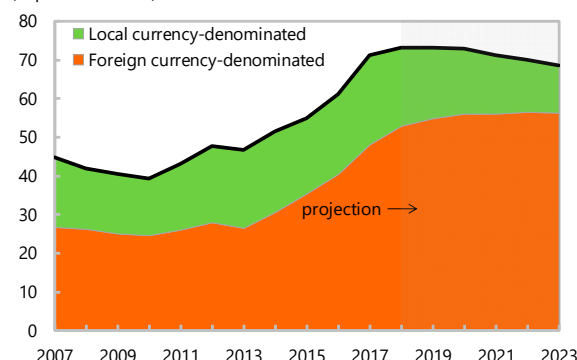
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

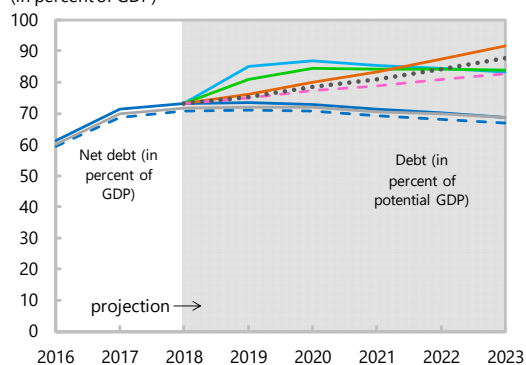


Alternative Scenarios

- Baseline
- Contingent Liability Shock
- Historical
- Security Shock
- Constant Primary Balance
- No Fiscal Reforms

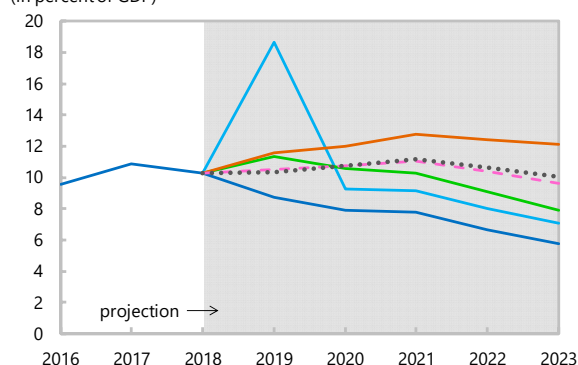
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



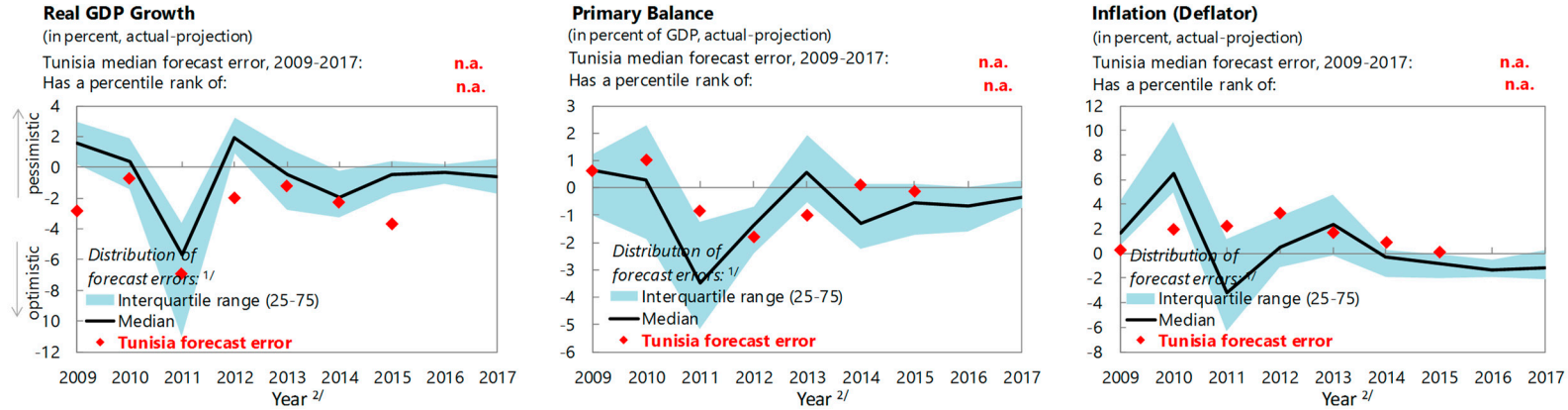
Underlying Assumptions

(in percent)

	2018	2019	2020	2021	2022	2023
Baseline Scenario						
Real GDP growth	2.4	2.9	3.4	3.6	4.0	4.2
Inflation	6.4	5.6	4.5	4.3	3.8	3.7
Primary Balance	-2.6	-0.8	0.2	0.4	0.6	0.6
Effective interest rate	4.0	3.8	3.9	3.8	4.2	4.2
Constant Primary Balance Scenario						
Real GDP growth	2.4	2.9	3.4	3.6	4.0	4.2
Inflation	6.4	5.6	4.5	4.3	3.8	3.7
Primary Balance	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6
Effective interest rate	4.0	3.8	4.0	3.9	4.3	4.3
Historical Scenario						
Real GDP growth	2.4	2.1	2.1	2.1	2.1	2.1
Inflation	6.4	5.6	4.5	4.3	3.8	3.7
Primary Balance	-2.6	-2.3	-2.3	-2.3	-2.3	-2.3
Effective interest rate	4.0	3.8	4.0	4.0	4.5	4.5
Contingent Liability Shock						
Real GDP growth	2.4	1.1	1.6	3.6	4.0	4.2
Inflation	6.4	5.2	4.1	4.3	3.8	3.7
Primary Balance	-2.6	-10.4	0.2	0.4	0.6	0.6
Effective interest rate	4.0	4.0	4.6	4.4	4.8	4.7

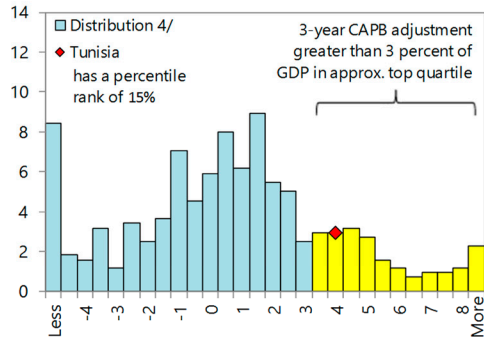
Source: IMF staff.

Table 3. Public DSA—Realism of Baseline Assumptions

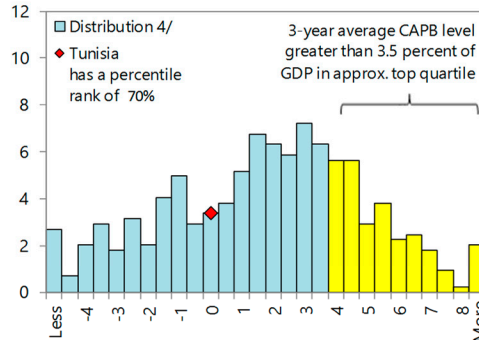


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)

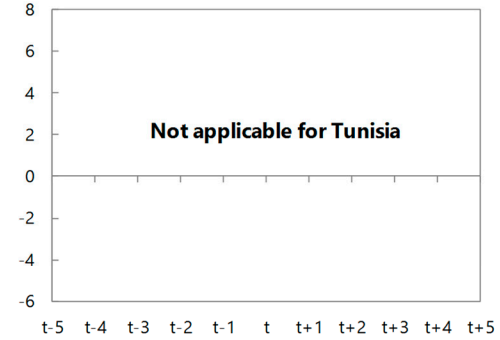


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis^{3/}

Real GDP growth
(in percent)



Source : IMF Staff.

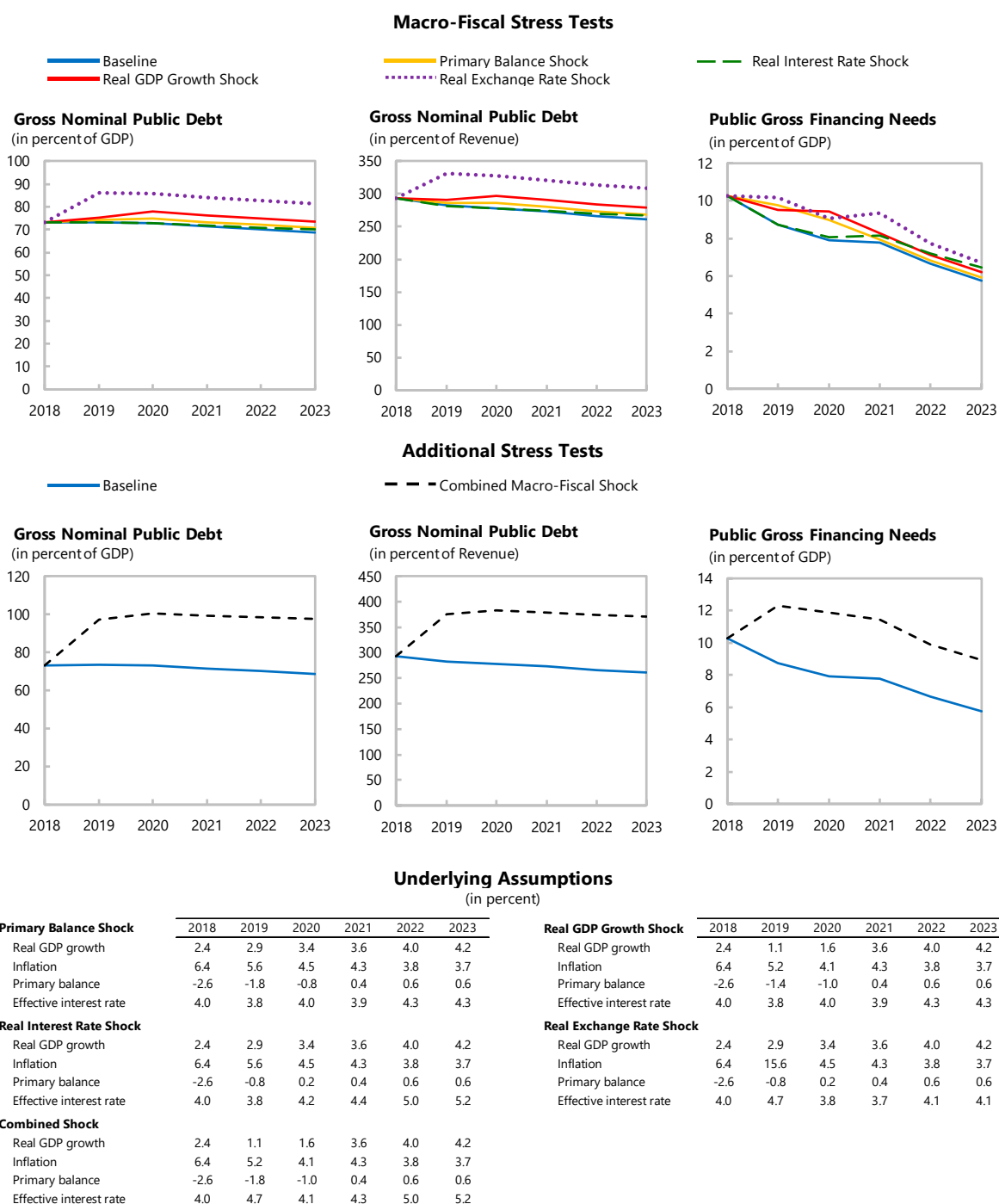
1/ Plotted distribution includes program countries, percentile rank refers to all countries.

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

3/ Not applicable for Tunisia, as it meets neither the positive output gap criterion nor the private credit growth criterion.

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

Table 4. Public DSA—Stress Tests



Source: IMF staff.

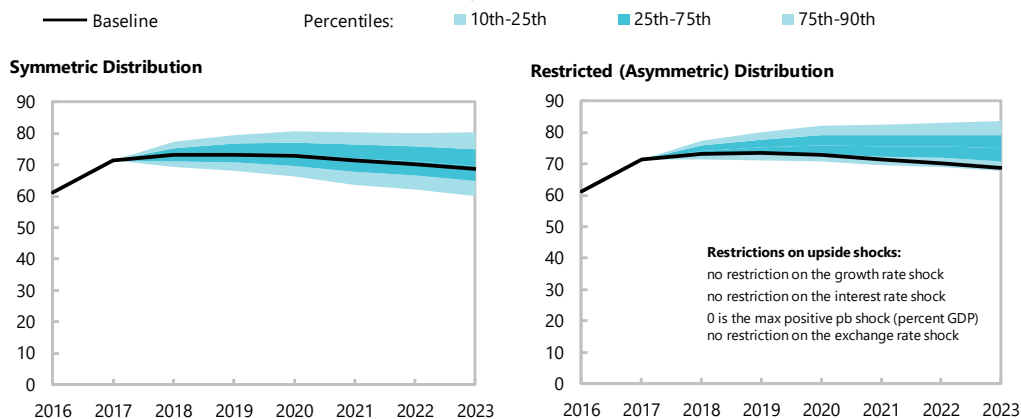
Table 5. Public DSA Risk Assessment

Heat Map

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

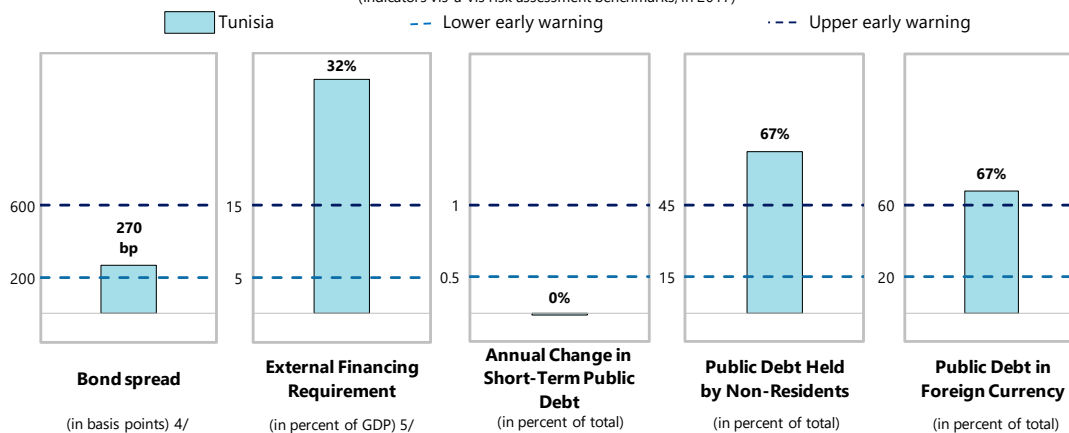
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2017)



Source: IMF staff.

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

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

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

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

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 29-Jan-17 through 29-Apr-17.

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

Annex IV. External Debt Sustainability Analysis

1. Tunisia's external debt has been rising since 2011. While external debt declined sharply during the 2000s (from 61 percent of GDP in 2002 to 49 percent of GDP at end-2010), the trend changed after the revolution. The external debt-to-GDP ratio increased from 51 percent in 2011 to 80 percent at end-2017, reflecting dinar depreciation, lower-than-expected growth, and higher fiscal and current account deficits following a series of external shocks and rising social pressures. Most of the new debt commitments are either with official creditors or backed by a third-party guarantee, except for a US\$1 billion Eurobond issued in January 2015 and a € 850 million Eurobond in February 2017.

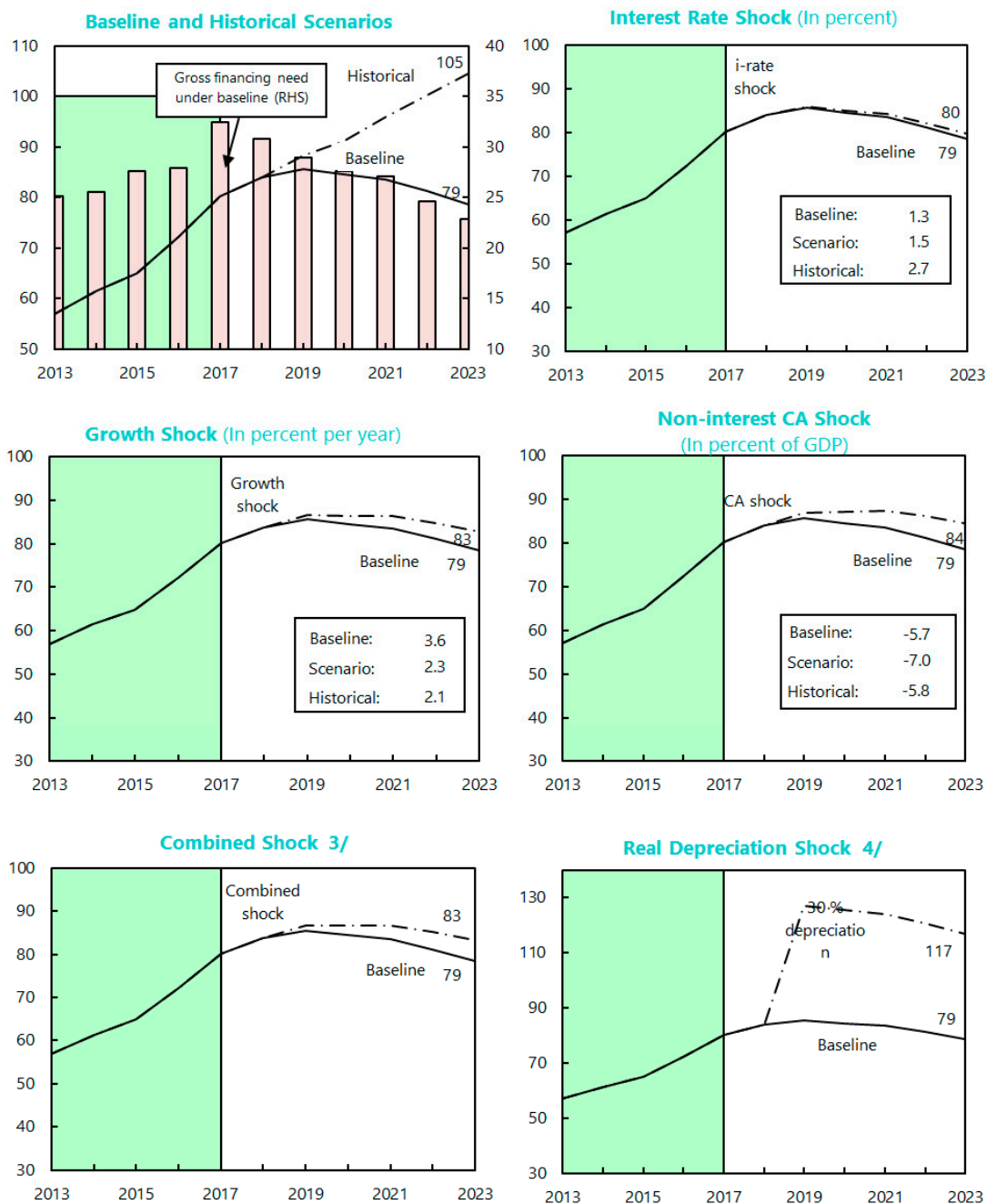
2. External debt will continue to increase. It is expected to rise to 83.8 percent of GDP in 2018 from 80.1 percent of GDP at end-2017 on the back of a planned Eurobond issuance and continued official funding. External debt would continue to increase marginally into 2019 (when the external debt ratio is expected to peak at 85.5 percent), driven by multilateral financing—including the IMF's EFF—and international market access. Improving current account dynamics would then lead to a gradual decline below 80 percent of GDP by the end of 2023 (Annex Table 1).

3. External debt would remain resilient to shocks, except for exchange rate depreciation. Tunisia's debt profile (low average interest rate, relatively long maturities, and a substantial share of concessional debt) makes the debt robust to most shocks, except for a large real exchange rate depreciation. The DSA results suggest that the external debt-to-GDP ratio would remain below 90 percent of GDP throughout the projection period under all but the FX depreciation scenario. For example, a negative combined shock to the real interest rate, growth and the current account would increase the debt ratio to 83.4 percent of GDP by the end of 2023 compared to 78.5 percent under the baseline. However, a sharp real exchange rate depreciation (one-time 30 percent in the second year of projection) would propel the external debt ratio to 127.2 percent of GDP in 2019 before declining to 116.8 percent at the end of the projection horizon (Annex Figure 1).

Table 1. External Debt Sustainability Framework, 2012–23
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -7.1		
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023			
Baseline: External debt	57.0	61.4	64.9	72.2	80.1	83.8	85.5	84.5	83.5	81.2	78.5			
Change in external debt	4.0	4.4	3.6	7.3	8.0	3.7	1.7	-1.0	-1.0	-2.3	-2.7			
Identified external debt-creating flows (4+8+9)	4.3	4.6	12.2	8.8	11.4	5.0	2.9	1.6	0.5	-0.5	-0.8			
Current account deficit, excluding interest payments	7.2	7.9	7.6	7.4	8.4	7.7	6.6	6.2	5.5	5.2	5.1			
Deficit in balance of goods and services	9.3	11.0	11.0	10.7	12.1	11.7	10.8	8.1	7.7	7.5	7.4			
Exports	47.7	45.6	40.7	40.4	43.2	42.9	42.6	41.8	40.1	39.1	38.1			
Imports	57.1	56.6	51.6	51.0	55.4	54.6	53.4	49.8	47.8	46.6	45.5			
Net non-debt creating capital inflows (negative)	-2.7	-2.9	-3.1	-1.7	-2.0	-2.3	-2.7	-2.9	-3.1	-3.3	-3.5			
Automatic debt dynamics 1/	-0.2	-0.4	7.7	3.0	5.0	-0.4	-1.0	-1.7	-1.9	-2.3	-2.4			
Contribution from nominal interest rate	1.2	1.2	1.4	1.4	1.8	1.5	1.3	1.1	0.9	0.8	0.8			
Contribution from real GDP growth	-1.3	-1.2	-0.7	-0.7	-1.4	-1.9	-2.3	-2.8	-2.9	-3.2	-3.2			
Contribution from price and exchange rate changes 2/	-0.1	-0.4	7.1	2.3	4.7	...	...	...	...	...	...
Residual, incl. change in gross foreign assets 3/	-0.3	-0.2	-8.7	-1.5	-3.5	-1.3	-1.2	-2.7	-1.5	-1.8	-1.8			
External debt-to-exports ratio (in percent)	119.3	134.7	159.7	178.8	185.4	195.3	201.0	202.1	208.3	207.6	205.8			
Gross external financing need (in billions of US dollars) 4/	11.6	12.2	11.9	11.7	13.0	12.4	12.1	12.1	12.5	12.0	11.8			
in percent of GDP	25.1	25.5	27.6	27.9	32.4	30.8	28.9	27.6	27.1	24.6	22.8			
A. Scenario with key variables at their historical averages 5/						83.8	88.2	91.0	95.8	100.2	104.5	-0.8		
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	2.4	2.3	1.1	1.0	1.9	2.1	1.8	2.4	2.9	3.4	3.6	4.0	4.2	
GDP deflator in US dollars (change in percent)	0.2	0.7	-10.3	-3.5	-6.1	-1.5	6.1	-2.3	1.2	1.1	1.8	1.7	1.7	
Nominal external interest rate (in percent)	2.4	2.2	2.1	2.1	2.4	2.7	0.6	1.9	1.6	1.4	1.2	1.1	1.0	
Growth of exports (US dollar terms, in percent)	-0.8	-1.8	-19.1	-3.2	2.5	-0.5	14.3	-0.7	3.2	2.6	1.2	3.2	3.4	
Growth of imports (US dollar terms, in percent)	0.0	2.0	-17.3	-3.6	3.9	1.6	14.0	-1.4	1.8	-2.4	1.1	3.1	3.6	
Current account balance, excluding interest payments	-7.2	-7.9	-7.6	-7.4	-8.4	-5.8	2.6	-7.7	-6.6	-6.2	-5.5	-5.2	-5.1	
Net non-debt creating capital inflows	2.7	2.9	3.1	1.7	2.0	3.0	1.2	2.3	2.7	2.9	3.1	3.3	3.5	
B. Bound Tests														
B1. Nominal interest rate is at historical average plus one standard deviation								83.8	85.8	84.9	84.1	82.0	79.5	-7.0
B2. Real GDP growth is at historical average minus one standard deviation								83.8	86.6	86.5	86.3	84.8	82.7	-6.5
B3. Non-interest current account is at historical average minus one standard deviation								83.8	86.8	87.0	87.2	86.0	84.4	-7.4
B4. Combination of B1-B3 using 1/2 standard deviation shocks								83.8	86.6	86.6	86.6	85.2	83.4	-7.0
B5. One time 30 percent real depreciation in 2016								83.8	127.2	125.7	124.2	120.7	116.8	-10.6
1/ Derived as $[r - g - r(1+g) + ea(1+r)]/(1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.														
2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)]/(1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).														
3/ For projection, line includes the impact of price and exchange rate changes.														
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.														
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.														
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.														

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



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

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

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

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

4/ One-time real depreciation of 30 percent occurs in 2018.

Annex V. External Sector Assessment

The external position of Tunisia in 2017 was substantially weaker than suggested by fundamentals and desirable policies. Since the start of 2017, the dinar depreciated by about 20 percent vis-à-vis the Euro, bringing about a REER depreciation of 10 percent and putting the valuation of the dinar closer to its equilibrium. This said, falling FX reserves and the large current account gap suggest persistent overvaluation and underline the need for a move back to a de facto floating exchange rate arrangement, renewed efforts at structural reforms, and a tighter policy mix.

A. Overview

1. External sector vulnerabilities have recently intensified (Annex Table 1). External debt has continued to grow and is now above 80 percent of GDP, while the current account deficit reached a record 10.1 percent of GDP in 2017. Meanwhile, international reserves are falling. This said, recovery is on the horizon as the recent depreciation has brought the exchange rate closer in line with its fundamentals.

Table 1. External Sector Vulnerabilities

Situation	Evaluation
Overall assessment	At the end of 2017, Tunisia's external position remains weak. Dinar depreciation has improved the real exchange rate, but it remains overvalued. Sustained FX reserve losses underline the need for additional adjustment in the policy mix and highlight the benefits of transitioning back towards a de facto floating exchange rate regime. In February 2018, there are early signs of welcome current account reversal.
Current account: large deficit, but some recovery on the horizon	Background. The current account deficit reached a record 10.1 percent of GDP in 2017, driven by a large trade deficit. External sector performance, weak since 2010, deteriorated through the impact of the 2015 terrorist attack on tourism and FDI, and social tensions affecting the phosphate and energy Assessment. The current account is expected to improve going forward. Exports would benefit from a pickup in tourism, phosphates and energy, and manufacturing in response to a more competitive real exchange rate. Import growth is expected to fall due to higher prices, notably for consumption goods.
Real exchange rate: overvalued, but moving towards fundamentals	Background. Significant dinar depreciation (the dinar lost 25 percent against the Euro since the start of 2016) led to a 10 percent correction of the overvaluation in 2017, but the real exchange rate remains overvalued by 15-20 percent. Assessment. Further depreciation is expected going forward, and could be accentuated by a move back towards a de facto floating exchange rate arrangement and success with containing inflation.
Capital and financial account: medium- and long-term borrowing plays key role in financing current account deficits	Background. Direct and portfolio investment fell by more than half after 2010. Medium- and long-term borrowing, mainly by the government, has increased strongly. The capital and financial account surplus reached 9.4 percent of GDP in 2017. Assessment. Further sizeable surpluses will be needed over the medium term to finance declining but still sizeable current account deficits. The share of FDI in inflows will gradually increase as confidence continues to strengthen.
FX assets/reserves: marginally adequate and falling	Background. Tunisia's stock of FX reserves has been declining due to large exchange rate interventions, mainly to finance large energy import needs in the context of a shallow local FX market. Assessment. Standing slightly below 3 months of imports, Tunisia's stock of reserves does currently not meet important benchmarks: it remains below 100 percent of short-term debt and 20 percent of the stock of broad money. It will be important to limit FX interventions going forward and improve export performance.

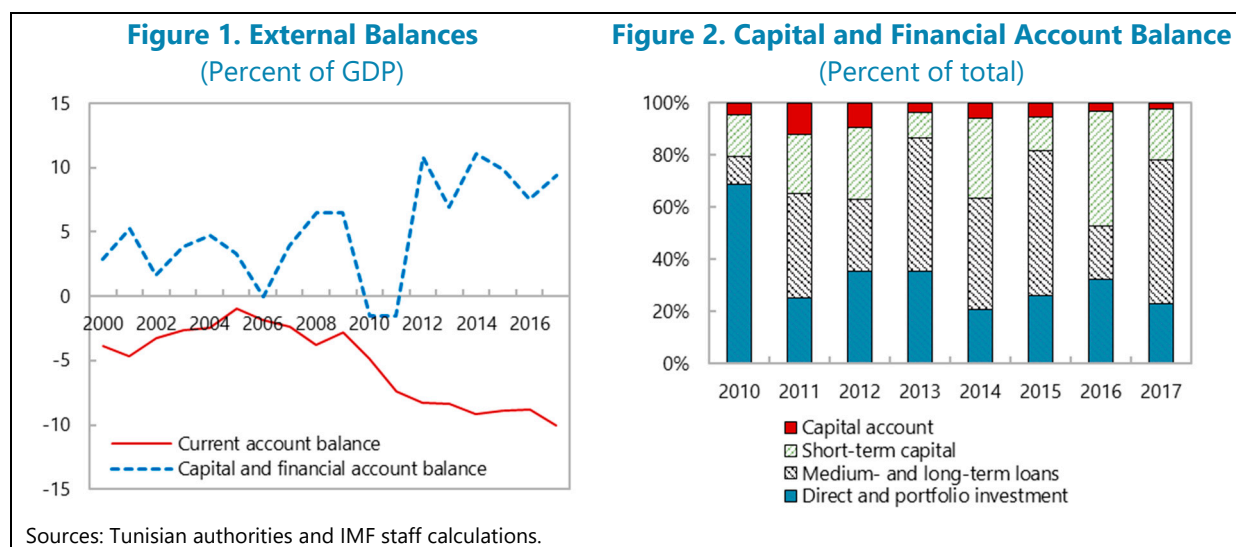
Source: IMF staff.

B. Balance of Payments

2. The current account deficit reached a record level in 2017. At 10.1 percent of GDP (Figure 1), it was almost two percentage points higher than the post-2011 average of 8.5 percent of GDP. A negative trade balance (-13.3 percent of GDP in 2017) was the main driver of the deficit, only marginally offset by the positive balance in services and transfers (+3.2 percent of GDP). Large energy imports are a major underlying problem and have combined with disruptions in domestic energy production to create a deficit in the energy balance amounting to 3.7 percent of GDP.

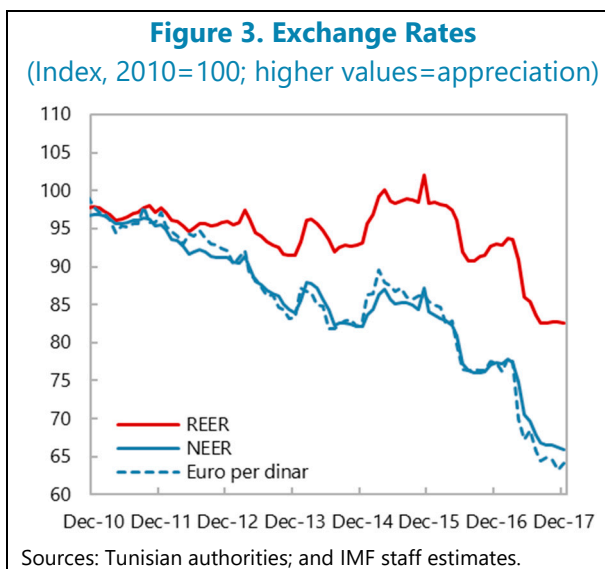
3. The current account is expected to improve in 2018 and over the medium term. Recent data suggest increases in tourism receipts and a recovery in energy and mining exports that have been suffering from obstructions to production and transportation facilities. In addition, the volume-effect of the recent dinar depreciation, especially for manufactured goods exports and consumption imports, will start to show more strongly (Section C below).

4. Elevated and mostly stable capital inflows are financing the current account deficit. Since 2011, the surplus on the capital and financial account has improved to an average of 9.3 percent of GDP. A similar turnout (9.4 percent of GDP) is expected for 2017 (Annex Figure 1). Inflows primarily take the form of medium- and long-term loans (Annex Figure 2). In terms of creditor composition, it is important to note that in most years, more than half of these loans originate from international financial institutions or bilateral official creditors. In addition, there is a substantial portion of bonded debt covered by U.S. sovereign guarantees. This composition reduces the vulnerability of Tunisia to sudden stops triggered by abrupt changes in market sentiment. Direct and portfolio investment have slowed since 2010, but still represents about 25 percent of total flows.



C. Exchange Rate

5. The depreciation of the dinar has accelerated since April 2017 (Annex Figure 3). The CBT increased the dinar’s flexibility and abandoned the crawling trend within a 2 percent band against the US\$/Euro basket, which led to a reclassification of the de jure exchange rate arrangement in the upcoming 2017 Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) report to floating from crawl-like, effective May 12, 2016. However, the fact that the dinar has subsequently remained within a 2 percent band against the Euro has resulted in the de facto exchange rate being reclassified back to crawl-like, effective May 19, 2017. Since the end of 2016, the nominal effective exchange rate (NEER, weighed by trade partners) has depreciated by about 11.6 percent, with the real effective exchange rate (REER) depreciating by 9.7 percent. These developments should improve Tunisia’s current account balance, even though the short-run impact might be negative due to the J-curve effect (as the immediate effect of a depreciation is to increase the import bill expressed in dinars, while the positive effect on export volumes might take longer to materialize).



6. However, analysis still suggests a real exchange rate overvaluation of 15–20 percent. The IMF’s EBA and EBA-light methodologies first establish the gap between a country’s actual current account position and its level (i.e. norm) that would be consistent with the country’s policies and fundamentals based on a panel regression. The outcome of this exercise is then mapped back to the real exchange rate by applying the real exchange rate elasticity of the current account. The current account gap (*CA gap*) is determined as follows:

$$CA\ gap = actual\ CA - CA\ norm$$

$$CA\ norm = fitted\ CA - policy\ gap$$

Here, *fitted CA* is the level of the current account that is predicted given Tunisia’s policies and fundamentals. The variable *policy gap* corrects the fitted value of the current account for any unsustainable policies.

- The **EBA-methodology** suggests an REER overvaluation of about 21 percent at end-2017, based on a CA gap of -7.9 percent of GDP (Table 2, left column). The large unexplained residual of -8.6 percent however suggests that the EBA-model does not provide a good fit for Tunisia. Therefore, as a second check, the same analysis is performed using the EBA-lite methodology that uses an identical underlying approach but replacing public health spending (due to data limitations) with aid and remittances.

- The **EBA-lite-methodology** suggests a CA gap of -5.6 percent of GDP at end-2017, giving rise to a REER overvaluation of 16 percent (Annex Table 2, right column). Looking at the identified policy gaps suggests that the remaining overvaluation is related to Tunisia's continued loss of FX reserves: 2.3 percentage points of Tunisia's total current account gap of -5.6 percent of GDP is attributed to the deviation of Tunisia's FX reserves from their recommended position.

Table 2. Exchange Rate Assessment Using Current Account Methodology, end-2017

EBA		EBA-lite	
Actual CA/GDP (a)	-10.1%	Actual CA/GDP (a)	-10.1%
Cyclical contributions (b)	0.8%	Cyclical contributions (b)	0.5%
Cyclically adjusted CA/GDP (c=a-b)	-10.9%	Cyclically adjusted CA/GDP (c=a-b)	-10.6%
<i>Cyclically adjusted CA/GDP norm (d)</i>	-3.0%	<i>Cyclically adjusted CA/GDP norm (d)</i>	-5.0%
<i>Contribution of policy gaps</i>	0.7%	<i>Contribution of policy gaps</i>	-1.5%
<i>o/w fiscal</i>	0.7%	<i>o/w fiscal</i>	0.6%
<i>o/w health expenditures</i>	-0.1%	<i>o/w health expenditures</i>	n/a
<i>o/w Δ(reserves)</i>	-0.3%	<i>o/w Δ(reserves)</i>	-2.3%
<i>o/w private credit</i>	0.0%	<i>o/w private credit</i>	0.3%
<i>o/w capital controls</i>	0.5%	<i>o/w capital controls</i>	0.0%
<i>Unexplained residual</i>	-8.6%	<i>Unexplained residual</i>	-4.1%
CA/GDP gap (c-d)	-7.9%	CA/GDP gap (c-d)	-5.6%
Assumed CA/REER Elasticity	0.37	Assumed CA/REER Elasticity	0.37
REER gap (positive is overvaluation)	21.4%	REER gap (positive is overvaluation)	16.2%

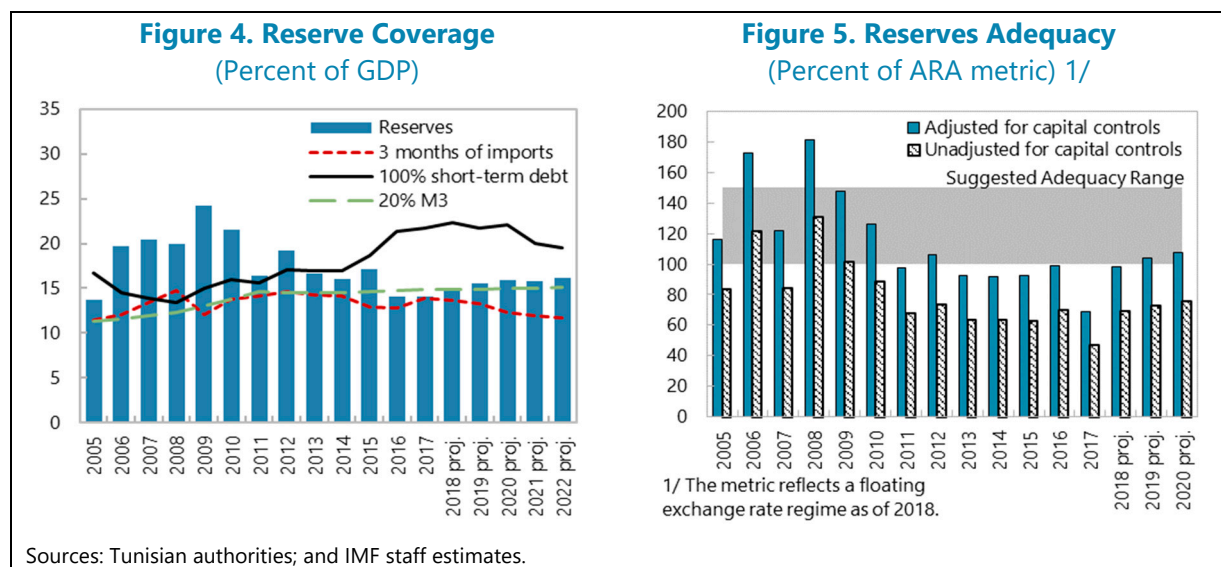
Source: Tunisian authorities; and IMF staff calculations.
Note: The CA/REER elasticity is based upon an elasticity of 0.71 for exports and 0.92 for imports, adjusted by the share of exports and imports in GDP.

7. Assessing the real exchange rate by analyzing Tunisia's external asset position, points to an overvaluation of around 11.2 percent. The external sustainability ("ES") approach assesses the current account balance by comparing the current account-to-GDP ratio expected to prevail in the medium run, with that balance which would bring the NFA position at a specified benchmark value. Assuming that Tunisia wants to bring its current net international investment position (at -119.4 percent of GDP) back to its historical average of -100 percent of GDP by the end of the program, suggests a degree of REER overvaluation that lies just above 10 percent (with a current account gap of -3.6 percent of GDP). This said, the level of the net international investment position (NIIP) of -100 percent of GDP may not be a suitable medium-term benchmark for an emerging market economy.

D. Reserve Adequacy

8. Reserve cover fell in recent years to low levels, but should recover over time. FX reserves have continued a downward trend that has been observable since 2010 (Annex Figure 4). In early March 2018, the stock of FX reserves stood at just 2.6 months of imports, which is below most other target levels used to analyze reserve adequacy: it falls short of 100 percent of short-term debt and the ARA EM metric (Annex Figure 5), while only just exceeding 20 percent of broad

money.¹ Reserves are projected to recover to the ARA EM adequacy range over the program period (albeit close to its lower margin), provided that Tunisia moves back to a de facto floating exchange rate arrangement. If the dinar continues to be classified as a crawl-like, the increase in reserve coverage that is currently projected is insufficient to arrive in the ARA adequacy range.



9. Sizeable FX interventions are costly but have not prevented strong depreciation. The strong dinar depreciation since 2016 suggests that past FX interventions were not very effective in defending the value of the currency, even if they had a high cost (between the start of 2017 and end of January 2018, net FX interventions amounted to US\$3.1 billion, which is the equivalent of 7.7 percent of 2017 GDP or nearly 85 percent of total 2017 inflows from external official partners).

E. Non-Price Competitiveness

10. Tunisia's rankings in competitiveness rankings exercises have often deteriorated.

- **Business climate.** In the World Bank's *Doing Business* indicators, Tunisia ranks eighty-eighth out of 188 countries—the second highest ranking in the region after Morocco (Annex Figure 6.a). Underlying this positive message, however, lies a negative trend: Tunisia fell from the forty-second in 2012 to eighty-eighth in 2018. The World Economic Forum's *Global Competitiveness* report shows a similar dynamic, with Tunisia slipping from the top-40 before 2011 to ninety-fifth place in 2018 (Annex Figure 6.b).

¹ The ARA EM metric is based upon analyses of historical episodes of significant drains on reserves during periods of exchange market pressure (EMP). Drains can stem from reductions in export income, a flight of domestic liquid assets (proxied by broad money, M2), and a failure to roll-over short term debt (STD) or other portfolio liabilities (OPL). Taking the 10th percentile of historical outflows during EMP events as a suggestive indicator of outflows during future EMP episodes has produced an adequacy metric that is composed of 30 percent of STD + 10 percent of OPL + 5 percent of M2 + 5 percent of export revenues.

- **Governance and corruption.** The World Bank's *Worldwide Governance Indicator* illustrates that Tunisia performs well along several dimensions relative to its peers, but that "regulatory quality" and "government effectiveness" leave scope for improvement (Annex Figure 7). Perceived public sector corruption is average compared with other countries in the region, but has failed to improve since the regime change in 2011. (Annex Figure 6.c).
- **Paying Taxes.** Tunisia has performed poorly, as indicated by its one hundred and fortieth rank by the World Bank's Doing Business report. On this front, the report highlights the 2017 exceptional corporate income tax explicitly as a policy change that has made payment of taxes costlier.

11. Labor productivity remains below that of other countries in the region. Labor productivity is second-lowest in the region, possibly because of the bottlenecks identified above (Annex Figure 7d). This suggests the presence of underutilized potential that Tunisia could mobilize as constraints are alleviated.

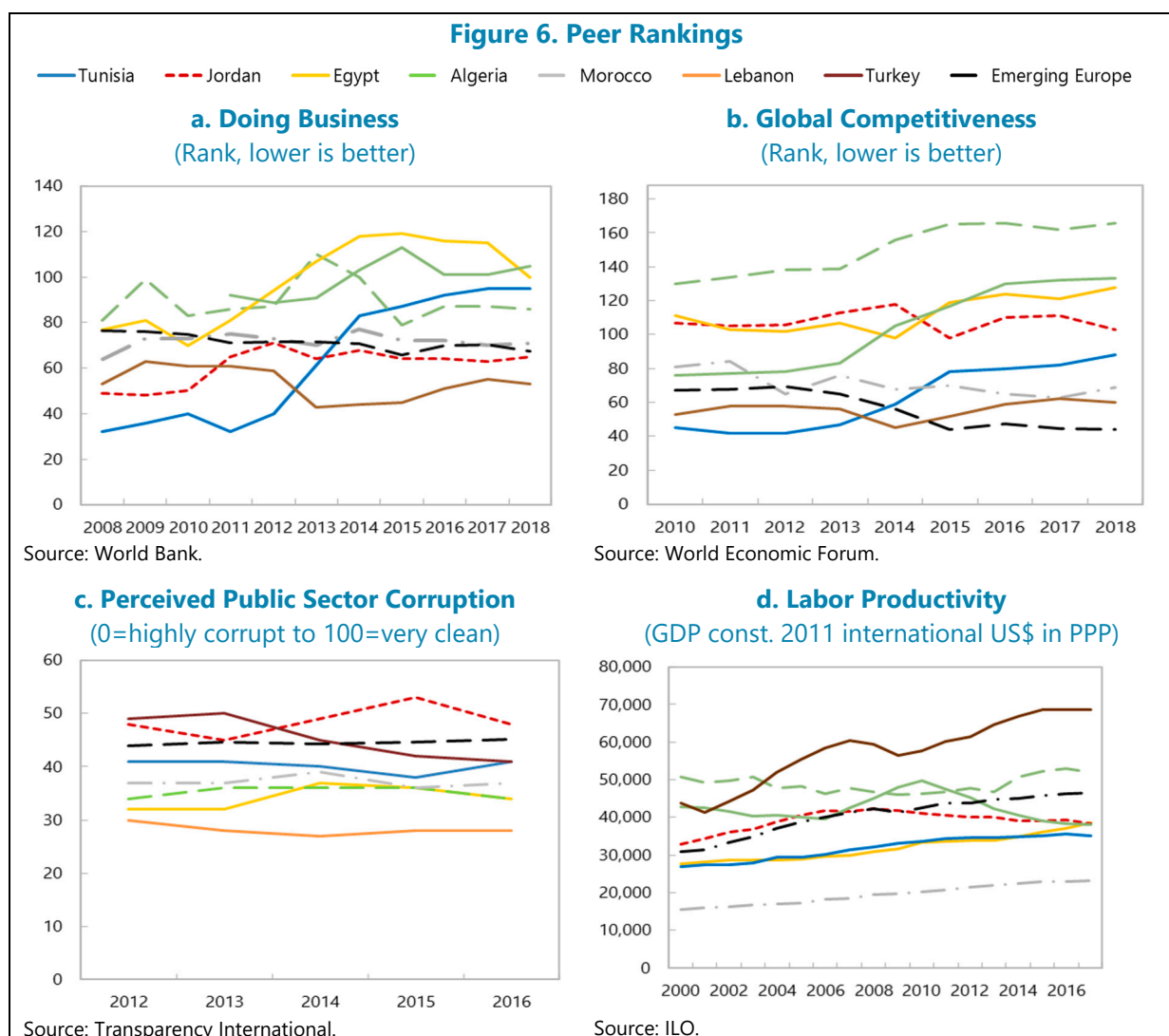
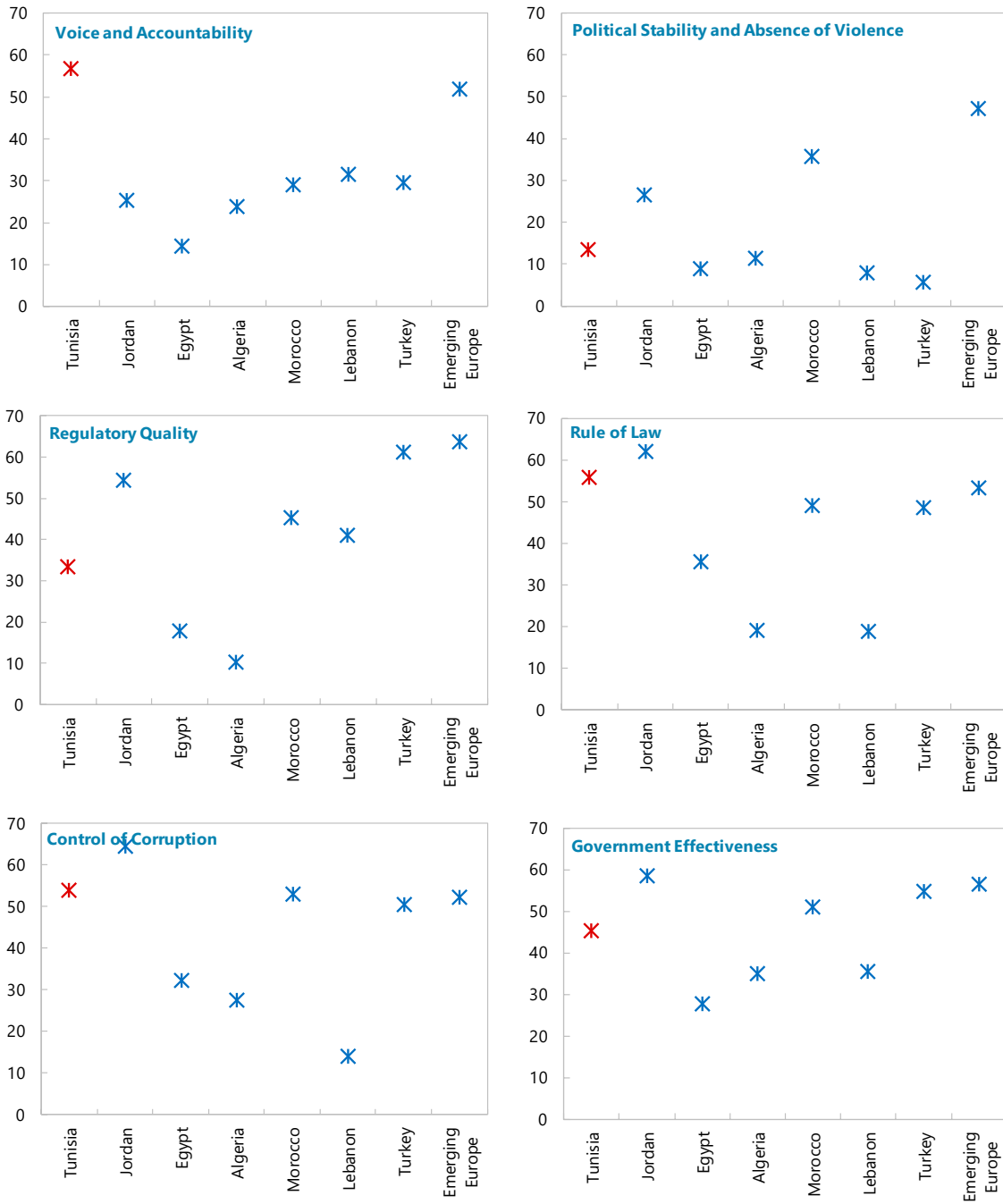


Figure 7. Worldwide Governance Indicators
(Rank, the higher the better)



Source: World Bank.

Appendix I. Letter of Intent

Tunis, March 14, 2018

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

Madame Managing Director,

1. Economic results in 2017 were generally positive. After two years of low growth, activity improved and growth reached 1.9 percent. This result was not only due to an improved security situation, but also to a rebound in confidence among Tunisians and our foreign partners. Investment intentions reached their highest levels since 2011, and tourist arrivals were up sharply, close to the levels of 2010. Today, the government is more determined than ever to reform the Tunisian economy into one that is dynamic and creates opportunity for all Tunisians. Our recovery program is based on a new concept of the government's role in the economy: support the economy and create the conditions for a favorable environment, allowing the private sector to fully play its role in generating economic growth. The courageous 2018 Budget Law seeks to rebalance public finances, while at the same time supporting macroeconomic growth and enhancing fairness. The Central Bank of Tunisia (CBT) increased its policy interest rate by 75 basis points in early March to mitigate inflation pressures that accelerated over recent months; the CBT stands ready to continue with monetary tightening in case inflation does not slow.

2. We have made important progress on structural reforms. We created an investment framework under the new Investment Code, which went into effect on April 1, 2017 and established the Strategic Investment Council and the Tunisian Investment Authority. The latter will operate as the one-stop shop for new investors in Tunisia. Economic reforms have already started to produce results. However, the implementation of structural reforms needs to be faster, especially of those that the IMF's Extended Fund Facility (EFF) arrangement supports. To better achieve this objective, the government has a new ministerial post in charge of major economic reforms, which will improve oversight of these critical economic and social measures.

3. Even if the political transition may sometimes appear slow and difficult, we reassure our friends and partners that Tunisia's choice for democracy is irrevocable. The upcoming municipal elections will be one more step to the establishment of democratic institutions. Moreover, the economic transition continues in its efforts to meet the legitimate expectations of our fellow countrymen. To accomplish this mission, we know that we can count on our international friends and partners for support. In this respect, the partnership with the IMF continues to be the main

anchor for our economic reforms. Beyond financial support, technical assistance (TA) from the IMF and other partners is a significant contribution towards implementing the types of policies that will modernize our economy. Our participation in the G20 initiative *Compact with Africa* is part of this approach and enables us to mobilize more foreign support, including private foreign investment as well as budget support and TA.

4. Performance under the four-year EFF arrangement has been mixed. As expected, we missed all four end-December 2017 Quantitative Performance Criteria (QPC): the floor on the primary balance, the ceiling on net domestic assets (NDA), the floor on net international reserves (NIR), and the ceiling on the total current primary expenditure. At end-June 2017, however, we had met the targets for the NIR and total current primary expenditure, but missed the ones on the primary balance and NDA. We observed the continuous Performance Criterion (PC) on the ceiling on the non-accumulation of new external arrears, but missed that on the non-imposition of exchange restrictions, as the CBT introduced temporary legislation that bars trade credit for certain non-essential imports. The Indicative Target (IT) on social expenditures was met in June and December 2017. As to the structural reform agenda, we met five Prior Actions for the Second Review and, by end-February, completed two of the 14 agreed Structural Benchmarks (SBs) on time and one with delay. Substantial progress was made on many others.

5. To facilitate program implementation and address macroeconomic vulnerabilities, the government requests a shift towards quarterly reviews of the EFF arrangement, supported by the proposed new QPCs for March, June, September, and December 2018; a new monthly Indicative Target on the ceiling of the CBT's net FX interventions; and a rephrasing of remaining access consistent with the new schedule. We agree with the new timetable for SBs as described in the Memorandum of Economic and Financial Policies (MEFP Tables 1 and 2) and the attached Technical Memorandum of Understanding (TMU). Finally, regarding our recent *Circulaire* that restricts bank financing for import activities of certain products, we request (i) a waiver of non-observance of the continuous PC related to the exchange restriction, based on the corrective actions taken, and (ii) an approval of the exchange restriction, as the measures giving rise to this exchange restriction are maintained for Balance of Payments reasons, are not discriminatory, and are temporary.

6. Based on the implementation of our macroeconomic policies aimed at achieving the main objectives of the program and ongoing progress with the agreed structural reforms, the government is requesting the completion of the Second Review under the four-year arrangement under the EFF and the purchase of an amount equivalent to SDR 176.7824 million under the new phasing of purchases. We are also requesting a waiver for non-observance of the QPCs on the primary balance, total current primary spending, NDA, and NIR for end-December 2017 based on corrective measures that have since been taken.

7. This Letter of Intent is based on the previous Letter of Intent and MEFP dated May 29, 2017. The attached MEFP outlines the main points of our reform agenda and the policies of the government, as well as those of the CBT, which we plan to implement over the period 2018–20. We are determined to rigorously implement this program, notwithstanding the complex national, regional and international context that we are facing.

8. We are confident that the policies described in the attached MEFP are appropriate for achieving the objectives of our economic program consistent with the *Pacte de Carthage*. In addition, we remain vigilant and stand ready to take any additional measures that may be necessary to achieve our objectives. In accordance with the IMF consultations policy, we will consult with IMF staff on the adoption of these measures and before making any revisions to the macroeconomic policies contained in the MEFP. All information and data necessary for program monitoring and TA missions requested under the EFF-supported program will be provided to the IMF within the agreed timeframes.

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

Very truly yours,

/s/

Mohamed Ridha Chalghoum
Minister of Finance

/s/

Marouane El Abassi
Governor of the Central Bank

Attachments (2):

1. Memorandum on Economic and Financial Policies
2. Technical Memorandum of Understanding

Attachment I. Memorandum of Economic and Financial Policies

This memorandum describes the main features of our reform program, which aims to promote stronger and inclusive growth while maintaining macroeconomic stability.

1. Accelerating growth and job creation for all Tunisians is an overarching objective that we, in Tunisia, put above all political differences. The *Pacte de Carthage* remains at the heart of our reform agenda, which is built on consensus around the necessary reforms to bolster the ongoing recovery through investment, exports and private-sector dynamism. In addition to economic objectives, these priorities are necessary for the democratic transition to succeed. Our progress may seem slow, but we are forging ahead. Sometimes we must make difficult choices, but no compromise we reach will ever jeopardize socioeconomic stability. We are keenly aware of the necessity to maintain the good health of public finances and external balances. Stabilizing debt will avoid excessively penalizing future generations and create the necessary fiscal space to finance infrastructure, education, public health, and reduce unemployment. This strategy will put Tunisia on the right track for the near and distant future.

2. Support from our international partners will remain essential. We are determined to seize the opportunity offered to us to reinvigorate our reform agenda, mainly through Tunisia's participation in the G20 initiative Compact with Africa. However, this ambition will also depend on the willingness of the international community to support Tunisia's democratic transition, an experience that could serve as a model for other countries in the region. The reform program supported under the IMF's Extended Fund Facility (EFF) arrangement is a concrete example of this mutual trust and demonstrates our resolve to strengthen Tunisia's integration into the global economy, particularly through sound macroeconomic management.

A. A Nascent but Fragile Recovery

3. A nascent recovery. Economic growth reached 1.9 percent in 2017, twice as high as in the two previous years. A recovery in manufacturing—thanks to a more favorable environment in Europe, stronger phosphate production, and a good touristic season—facilitated by a more stable security situation, were the drivers of the recovery. However, even at this higher level, growth still falls short of our ambitions and the expectations of our fellow citizens, particularly young graduates looking for jobs. In terms of demand, consumption remained the main driver of growth, while investment (private and public) is yet to reach satisfactory levels. We are fully aware that consumption-based growth will not be sustainable in the medium term, given Tunisia's debt constraints and rising macroeconomic pressures.

4. A difficult social situation. Inflation accelerated to reach 7.1 percent in February 2018, driven by significant wage increases, the depreciation of the dinar, and the unavoidable increase in several administered prices. At the same time, unemployment remains a major concern for all Tunisians, with the nationwide unemployment rate at 15.5 percent at end-2017. Moreover, unemployment is distributed unevenly, despite our efforts for more equity. It continues to

particularly affect the young, university graduates, and women. Regional disparities are also a major concern, with unemployment rates that range from less than 10 percent in the coastal regions of eastern Tunisia to over 25 percent in the interior regions of the south and west.

5. An expansionary fiscal policy. In 2017, the budget deficit (excluding grants) reached 6.1 percent of GDP, in line with the 2017 Supplementary Budget Law. Wage bill overruns (+0.5 percent) were offset by slightly higher tax revenue (+0.1 percent), mainly due to the collection of arrears (about TD 300 million, or 0.3 percent of GDP), and a significant recovery in nontax revenue mostly from the oil sector (about TD 600 million, or 0.6 percent of GDP). This deficit had an impact on public debt, which reached TD 69 billion (71 percent of GDP) at end-2017. This level of debt strains our public finances and exacerbates the burden for future generations. One of our main objectives is to lower public debt to obtain the fiscal space necessary to support growth and reduce poverty.

6. External sector under pressure. The current account deficit continued to worsen in 2017, reaching the record level of 10.1 percent of GDP, despite a recovery in manufacturing exports and a better tourist season. Demand for imports has remained strong, especially for consumer goods, even if import volumes seemed to be slowing down in the last quarter of 2017. Consequently, the foreign exchange (FX) reserves of the Central Bank of Tunisia (CBT) dropped by US\$215 million over the course of 2017. The interbank market for foreign exchange experienced a serious liquidity squeeze due to the persistently high current account deficit, but also due to a wait-and-see attitude among banks and some economic actors. This development coincided with a considerable increase in foreign currency holdings in the “professional foreign currency accounts.”

7. Adjusting monetary and exchange policies. To protect the CBT’s FX reserves and improve the persistent current account deficit, we chose to introduce greater flexibility in our exchange market. Reflecting market forces of supply and demand for foreign currencies, the dinar depreciated 10 percent on a real basis in 2017. At the same time, we have started to tighten monetary policy to ward off inflationary pressures originating from the depreciation. We raised the policy rate at three instances by 150 basis points in total since early 2017, bringing it to 5.75 percent today. Further, we widened the interest rate corridor around the policy rate by an additional 150 basis points to 200 basis points. Despite policy rate increases and a quantitative limit of TD 7 billion for seven-day tender auctions with commercial banks enforced since July 2017, banking sector refinancing with the CBT has reached a record level and exceeded TD 12 billion in January 2018. This reflects strong pressures on commercial bank liquidity.

8. Tensions in the banking sector. A growing shortage of liquidity characterizes the banking sector. Deposit mobilization in 2017 improved, but still remained insufficient to alleviate growing pressures on commercial bank liquidity related to a set of liquidity-draining autonomous factors, including high demand for government financing, which contributed to the excessive use of the central bank refinancing facilities. Likewise, structural difficulties persist in resolving non-performing loans (NPLs). The capital adequacy ratio of the banking sector remained broadly unchanged at about 11 percent, supported by bank profits. But the ratio of NPLs remains high: roughly 15 percent of total assets are non-performing, covered by a 65 percent provisioning rate. Moreover, access to

credit continues to be an obstacle for small- and medium-sized enterprises (SMEs). Total private-sector credit, which stood at about 80 percent of GDP at the end of 2017, consists primarily of loans to large enterprises as well as to households.

9. Persistent uncertainty. Encouraged by considerable progress in the political transition, Tunisians have legitimate economic expectations. They expect tangible improvements in their standard of living in the short term. At the same time, it will take time for the structural reforms that we are now putting in place to have their desired effects. Our efforts to overhaul the economy may therefore face a new spell of uncertainty. However, postponing the necessary reforms will be even more costly, further exacerbating macroeconomic imbalances and deterring external financing. Similarly, in a different area and despite the considerable progress made by security forces, terrorism continues to pose risks to our security environment.

10. Inevitable reforms for the benefit of all Tunisians. The remainder of this document presents the government's plans to stabilize public finances, improve external balances, contain debt, and boost growth. Priority areas include efforts to reduce fiscal deficits and combat inflationary pressures (Section C). At the same time, structural reforms will create more opportunities for Tunisians, in terms of jobs as well as in terms of creating wealth (Section D). With stronger and more inclusive growth, Tunisia will honor the promise of the Revolution.

B. Strengthening the Implementation of the EFF Arrangement

11. Only some of the program's quantitative objectives were met, reflecting the political and social constraints that affected economic performance in 2017:

- After meeting the end-June 2017 target, the end-December 2017 Quantitative Performance Criterion (QPC) on **net international reserves** (NIR) was missed. This was due to the sluggish performance of the current account with a higher-than-envisaged deficit, reflecting mainly higher-than-expected energy imports and the absent recovery of phosphate exports. To keep the exchange market in good working order, the CBT carried out substantially more net FX interventions than planned, which generated additional pressure on the stock of reserves.
- The end-December 2017 QPC and end-June 2017 target on **net domestic assets** (NDA) were missed. The pressure on commercial bank liquidity persisted, leading banks to make up for their liquidity shortfall by resorting to record levels of refinancing from the central bank. To better manage commercial bank liquidity, we limited the liquidity offered in the weekly tender to TD 7 billion since July 2017, encouraging banks to reduce their recourse to central bank refinancing through using other money market instruments.
- The end-December 2017 QPC and end-June 2017 target on the **fiscal deficit** were missed, mainly due to unanticipated overruns in the wage bill that could not be fully offset by corrective measures taken on the wage bill (hiring limits) and on nonpriority investments.

- The end-December 2017 QPC on **total current primary expenditures** was missed, while the end-June 2017 target had been met.
- The IT on **social spending** was met in June and December 2017.
- The continuous performance criterion (PC) on the **non-imposition of new exchange restrictions** was not observed due to the CBT's decision to restrict bank financing for certain products in October 2017.

12. We implemented crucial Structural Benchmarks (SBs) and reprogrammed delayed SBs.

Met SBs:

- *Governance and private sector development.* More than ever, we are determined to fight corruption and impunity. Given this irrevocable commitment of the government, we published the statute establishing the High Anti-Corruption and Good Governance Authority in September 2017.
- *Financial sector reform.* With delay, we completed the inspections of the seven largest private banks. As a result, the risk management capacity of the banking supervision department has improved significantly in January 2018. We also adopted a decree under Article 474 of the Commercial Code, creating a standing committee to guide the Minister of Finance on measures to settle debts of the central government, local governments and public establishments.
- *Budgetary policy and reforms of public institutions.* The circular that set off the preparation of the 2018 Budget Law, published last May, limited new recruiting into the civil service to the graduates of state training schools. Consistent with the civil service reform strategy and our objective to contain the wage bill, hiring will be capped below 3,000 civil servants for 2018.

Reprogrammed Delayed SBs:

Governance/Private Sector Development

- To make the new High Anti-Corruption and Good Governance Authority fully operational, after their selection by the Assembly of the People's Representatives (ARP), the members will take oath before the President of Republic, followed by the signature of the appointment decree (*reprogrammed SB*, June 2018). The other steps required under this SB have already been completed as a Prior Action (PA) for the Second Review under the EFF, notably: (i) adequate resources for the High Authority in the 2018 Budget Law; (ii) the call for applications for the members of the High Authority's executive board; and (iii) a government decree fixing their remuneration. This PA also included the finalization of the performance contracts with four of the five largest public enterprises (STEG, STIR, Office des Céréales, and Régie des Tabacs), which now incorporate in their annexes indicators of the companies' financial performance.

- ii. The survey that aims at identifying vulnerable households made considerable progress. It was completed for 450,000 households. The full survey for 900,000 households will be completed by the end of 2018 (*reprogrammed SB*, December 2018). The implementation of a targeting system remains a priority for the government to reduce the fragmentation of social assistance programs and improve resource allocation in a context of significant resource constraints.

Financial Sector Reform

- iii. The Council of Ministers (CMR) passed a new legal framework to facilitate the resolution of NPLs in public banks in February 2018 as a PA for this Review under the EF. We will make members of Parliament aware of the economic and social importance of these draft laws and are working to publish them in the Official Journal of the Republic of Tunisia after their adoption (*reprogrammed SB*, June 2018).
- iv. The ARP is expected to adopt the new law on the lending rate ceiling in the first half of the year (*reprogrammed SB*, May 2018).

Budgetary Policy and Reforms of Public Institutions

- v. The reform of the social security system is a major challenge. In Tunisia, all stakeholders are aware of the urgency of the situation and they share the same assessment: without reform, the financial stability of social security funds is at risk. The dialogue on the parametric components of the reform is in progress and the revised schedule provides for the draft law to be approved by the CMR in the coming months (*reprogrammed SB*, April 2018). However, the reform agreed upon by social partners only covers some of the components necessary to ensure the medium-term sustainability of the social security funds. Therefore, the tripartite committee consisting of the government, the UGTT public sector union and the UTICA employers' federation will continue its work to review the impact of the reform measures that were taken and propose others as necessary to ensure the medium- and long-term financial stability of the funds. To improve the financial viability of social security in the short run, we transferred TD 200 million of public sector liabilities to the CNSS pension fund as a PA for the Second Review under the EFF, and will continue to clear arrears throughout 2018.
- vi. The functional reviews of the Ministries of Education, Health and Finance were completed in December 2017. The review of the Ministry of Public Works was delayed due to the lengthy procurement process and the identification of suitable experts for conducting the review but will be concluded in the first half of 2018 (*reprogrammed SB*, June 2018).
- vii. The preparation of the contract for TUNISAIR has yet to be completed due to labor negotiations that are underway as part of the restructuring process. This contract should incorporate the financial performance indicators and will be signed before the end of 2018 (*reprogrammed SB*, December 2018).

- viii. The financial commission of the Parliament started reviewing the Organic Budget Law and will transfer the draft to the plenary session for approval (*reprogrammed SB*, December 2018).
- ix. The purpose of the General Taxation, Public Accounting and Recovery Committee, whose organization will be established by decree, is to create a unified administration that performs the roles of the two general directorates (particularly control and arrears recovery). The processes will be entirely integrated to ensure greater efficiency. In the umbrella organization, the large taxpayer unit (LTU), a pillar of the umbrella structure, is partly operational. The next to make it fully operational will be to bring together the audit and recovery functions within the LTU (*reprogrammed SB*, December 2018). Pending the full implementation of the LTU, the objective to unify tax functions will be achieved by merging the audit functions (in-depth verification) and tax arrears recovery (collection) in the new committee, which is the umbrella structure for the tax administration created by the 2018 Budget Law (*new SB*, July 2018). At the end of this process, the *Direction des Grandes Entreprises* (DGE) will be the sole contact point for 200 large enterprises regarding tax matters.
- x. In 2017, the social context was not conducive to the repeated application of the automatic fuel price adjustment mechanism. Nevertheless, we implemented an *ad-hoc* increase greater than the increase prescribed by the mechanism in July 2017 (about 6½ percent) to partially catch up the distance from fuel prices at the pump relative to what would have been prescribed by the mechanism if applied consistently through the end of the first quarter of 2017. Moreover, we implemented another increase in January 2018 as a PA for the Second Review under the EFF. But to soften the simultaneous impact of the VAT increase rate in the difficult social context that we witnessed in January, the increase remained below what the formula would have called for. We remain however committed to apply quarterly adjustments to reduce the elevated energy subsidy bill (*continuous reprogrammed SB*, from March 2018). We are also determined to make additional adjustments to other energy products, such as electricity, gas and Liquefied Petroleum Gas (LPG), as needed to stay on budget.

Monetary policy

- xi. We have started to use an auction mechanism to implement the central bank's FX interventions in August 2017. So far, however, auctions have not been executed in a fully competitive fashion. Going forward, we will improve the auction mechanism, potentially seeking IMF technical assistance (TA) (*reprogrammed SB*, June 2018).

Trade Policy

13. Entrenching economic openness through free trade. Since independence, Tunisia has always strived to be fully integrated into the global economy, and trade has always been a strategic source of income for Tunisians. We are determined to preserve this economic asset, especially during this difficult period. In the interest of promoting trade and observing our commitments to the international community, we will phase out by the end of 2018 the Circular No. 2017/09, which limits access to bank credit for financing imports of certain non-priority goods.

C. Dealing with the Macroeconomic Vulnerabilities

14. Economic activity should continue to pick up in 2018. The strength of the ongoing recovery continues to depend on containing internal and external imbalances and implementing reforms on time. Without reforms, uncertainty would prevent a sustainable improvement in investment. Consequently, our efforts aim at protecting short- and medium-term macroeconomic stability, a prerequisite for growth. The growth path should improve, reaching 2.4 percent in 2018 and 3.4 percent in 2020, mainly due to strong performance of the phosphate sector and upstream chemical industries, but also agriculture on the back of a favorable olive harvest. Export industries and tourism should also be sources of growth in 2018 and beyond.

Text Table 1. Decomposition of GDP Growth, 2017–20

	2017		2018		2019		2020	
	Growth contribution	GDP share	Growth contribution	GDP share	Growth contribution	GDP share	Growth contribution	GDP share
Real GDP growth	1.9	100.0	2.4	100.0	2.9	100.0	3.4	100.0
Sectors	1.8	80.9	2.3	80.9	2.7	81.1	3.2	82.3
Agriculture	0.3	10.0	0.4	10.3	0.2	10.0	0.4	10.0
Manufacturing	0.2	16.6	0.7	16.6	0.7	16.6	0.6	16.8
Non-manufacturing	-0.4	9.3	0.1	9.3	0.3	9.5	0.4	9.7
Services	1.7	45.0	1.1	44.6	1.4	44.9	1.8	45.9
Public administration	0.2	19.1	0.1	19.1	0.2	18.9	0.2	17.7

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

15. Our strategy for addressing elevated vulnerabilities is based on three priorities. Given recent unsustainable trends of public finances and external accounts, an adjustment is unavoidable. Our choice is to achieve this adjustment in an orderly way with the burden shared fairly across society, and with view to protect the vulnerable members of society. If we do not decide to adjust today, we run the risk of continuing the status quo, which could lead to an economic crisis with even higher costs than the policies needed today for maintaining macroeconomic stability. Our strategy will center on the following priorities: (i) proactive and well-designed fiscal consolidation; (ii) tighter and adequate monetary policy to decelerate inflation; and (iii) continued exchange policy flexibility.

16. Our medium-term fiscal strategy is to lower the deficit excluding grants to no more than 3.0 percent of GDP by 2020 and the wage bill to 12.4 percent. Our strategy is based on the following pillars: (i) a gradual reduction in the number of civil servants, mainly through negotiated voluntary departures, voluntary early retirement, and strict limits on hiring to take advantage of natural attrition; (ii) no further salary increases over 2018–20 unless growth substantially improves relative to baseline projections and provided the wage-bill-to-GDP ratio can be maintained on a downward trajectory towards 12.4 percent of GDP; (iii) a decrease in energy subsidies through quarterly automatic price adjustments with the goal of eliminating these subsidies in the medium term (*reprogrammed SB*, from March onwards); (iv) comprehensive social security reform, including continued parametric reform of pensions; and (v) revenue mobilization. Regarding the latter, we expect to obtain considerable budget support from our multilateral partners over the period

2018–20, including from the World Bank (US\$1,500 million), the European Union (US\$650 million), the African Development Bank (US\$490 million), and bilateral partners.

17. This fiscal strategy is not free of risk. The risks are primarily related to uncertainties regarding growth, external developments (especially international oil prices), and Tunisia’s political and social context, which remains difficult. To contain these risks, we decided to implement deep reforms starting in 2018, based on the priorities described in the paragraph above. In addition, we have started a dialogue with civil society on the necessity of having everyone share in the efforts, and, as indicated below, we have designed measures that are socially equitable.

18. There will be a major effort to mobilize revenue in 2018. The 2018 Budget Law contains a set of tax and other revenue measures that will yield additional revenue of about 2.2 percent of GDP. These measures include an increase in the VAT rates of 6 percent, 12 percent, and 18 percent to 7 percent, 13 percent, and 19 percent, respectively. We also raised excise taxes on some goods, such as tobacco, alcohol and automobiles. Some import duties were increased as well for fiscal reasons. These tax measures are permanent and will replace the temporary 2017 measure on corporate taxation (0.9 percent of GDP). They were designed to limit the negative impact on growth and job creation. Overall, the tax burden on businesses will not change, and the emphasis placed on VAT will reduce any negative effect on investment. Moreover, we will implement a catalogue of 10 measures that were already adopted in the 2014–17 Budget Laws to increase collection of tax revenue, especially from liberal professions,¹ but were so far not enforced. The increase in oil prices has generated additional nontax revenue. Transfers from public oil companies to the central government should increase by about TD 300 million compared with the projections retained in the 2018 Budget Law.

¹ Those are professions that derive profit from intellectual activity.

Text Table 2. Revenue Measures, 2018

	Millions de DT	Pourcentage du PIB
Total permanent revenue measures	2,288.0	2.2
Direct taxes	138.0	0.1
Introduction of a 5 percent duty on the profits of financial institutions	71.0	0.1
Increase in the dividend tax rate from 5 to 10 percent	58.0	0.1
Increase in CIT to 10 percent for selected firms	6.0	0.0
Increase on taxes in non-resident bank interest	3.0	0.0
Indirect taxes	395.0	0.4
Increase of one point in the 18 and 6 percent VAT rates	313.0	0.3
VAT exemption removal	3.0	0.0
Impact of the revision of customs duties and consumption tax on VAT receipts	50.0	0.0
Introduction of a tax on freight containers	29.0	0.0
Excise tax	320.0	0.3
Other measures	935.0	0.9
Solidarity contribution on the income of natural persons	300.0	0.3
Increase in the customs duties of certain agricultural and food products	242.0	0.2
Increase in the advance payment on imported consumer products from 10 to 15 percent in 2018 and 2019	114.0	0.1
Introduction of a customs duty on the export of edible oils	3.0	0.0
Increase in internet card surcharges	96.0	0.1
Increase in the tobacco price	65.0	0.1
Introduction of a tourist tax in hotels of 3 dinars per day	51.0	0.0
Increase in stamp duty on certain documents	25.0	0.0
Increase in chancellery fees	13.0	0.0
Increase in the single insurance tax rate from 5 and 10 to 6 and 12 percent, resp	26.0	0.0
Collection efforts (including tax arrears)	500.0	0.5
Memorandum item:		
Nominal GDP	106,178.6	...

Source: Tunisian authorities.

19. Prudent expenditure management will be necessary:

- **Wage bill.** After the adoption of the law on negotiated voluntary departures in January 2018, we are targeting the departure of 20,000 civil servants as follows: 10,000 negotiated voluntary separations; 6,400 voluntary early retirements; and the rest would come from natural attrition. Based on the expected cohort of volunteers, the total budget savings from the 10,000 negotiated voluntary separations will be about TD 280 million. An additional effort to bring the number of voluntary separations to 15,000 civil servants would generate about TD 420 million of savings on an annual basis. Due to the departure schedule, only a share of these savings (TD 320 million) will be realized in 2018, with the remainder occurring from 2019. To finance the volunteer financial packages, we are now talking to our external partners about dedicated budget support. At the same time, about 6,400 civil servants have expressed an interest for early retirement, which will generate additional savings of TD 120 million per year. As a result of the departures (negotiated and early retirement), an equivalent number of positions in the civil service will be eliminated. Redeployment of existing personnel will provide a way to

avoid disrupting the quality of public services. Finally, with hiring limited to 3,000 persons in 2018, we will obtain another net decrease in the wage bill through natural attrition on top of the effect of the two aforementioned programs. Through centralized negotiations starting this year, mainly through the 5+5 committee with the mandatory presence of the Ministry of Finance, we will be able to avoid any decentralized salary negotiations. This will strengthen the link between productivity and wage increases. In the interest of budget transparency, we will eliminate the use of tax credits entirely starting in 2019.

- Energy subsidies.** Effective January 1, 2018, we raised the price of hydrocarbons at the pump by 50 millimes per liter and 300 millimes per bottle. This amounts to an *ad-hoc* increase of 4.1 percent for gas oil and gas bottles, 3.3 percent for gas oil without sulfur, and 2.9 percent for unleaded premium. To cushion the impact of the simultaneous application of the higher price of oil and the measures in the 2018 Budget Law (particularly the increase in the VAT rate), we decided to remain below the five percent price increase indicated by the fuel price adjustment mechanism. For 2018, we are committed to containing the total spending on energy subsidies at TD 2,108 million. The 2018 Budget Law was based on TD 1,500 million, underpinned by an oil price of US\$54 per barrel. This remains our point of reference. However, under the assumption of a price of US\$62, we will likely not be able to maintain the same objective without proceeding with price increases that would undoubtedly jeopardize social cohesion and the stability of the country. As a result, we decided to increase the maximum budget allocation for energy subsidies by TD 608 million. Based on total spending of 2,108 million and a price of US\$62 per barrel, the required energy price increases for 2018 will amount to an average 13 percent. We will make gradual adjustments every quarter to meet this ceiling of TD 2,108 million (*continuous reprogrammed SB*, from March 2018). If average oil prices were above US\$62, then we would make additional price adjustments as needed. A "task force" was set up, under the chairmanship of the Minister of Major Reforms, to monitor the fiscal risks associated with fluctuations in oil prices and to propose measures necessary for strict compliance with the budgetary target under the program.
- Social security funds.** Our general strategy is to restore the financial viability of the public (CNRPS) and private (CNSS) pension funds. Achieving financial balance will enable them to honor their contributions to the medical insurance fund (CNAM), thus also restoring its financial viability. For 2018, the CNRPS's financial needs will in part be covered by implementing a reform of contribution rates (+1 point for employees and +2 points for employers) as well as by additional revenue generated by the new social welfare tax (CSS). According to our estimates, there will still be a gap of roughly TD 150 million, which will be filled from the budget's unallocated expenditures (this buffer amounts to a total of TD 400 million). The CNSS is co-managed with social partners. The effort to restore its financial soundness must be decided by the government and social partners. The central government will contribute indirectly to restoring its financial balance through a plan to clear the arrears of public entities to the CNSS. We already recovered about TD 200 million of arrears by February 2018, even if this remains below the target of TD 600 million set at the time of the First Review under the EFF. The CNSS should improve collection, governance and, if feasible, sell some of its assets to close the

financial deficit in 2018. We agree to ensure the financial sustainability of the social protection and health system (including the CNRPS, CNSS, CNAM, and the central pharmacy) and, if needed, stand ready to prepare a supplementary budget law that would make necessary transfers or advances to the various funds.

- **Contingency measures were identified to deal with unexpected shocks.** We budgeted about TD 400 million in unallocated expenditures to prevent us from missing program targets. In addition, we strengthened the oversight of public enterprises. In addition, a buffer could come from a series of tax measures in the 2016, 2017 and 2018 budget laws. The potential impact of those provisions on tax revenue has yet to be evaluated, notably those aimed at strengthening tax audits of companies and at improving tax compliance by liberal professions.
- **Strengthened tax controls.** We have intensified audits of financial services providers that operate under the offshore regime to proactively prevent possible tax fraud. Also, with support from USAID, we will perform a comprehensive integrity check of companies that take advantage of tax incentives by the end of May 2018.

20. Monetary policy will focus on controlling inflation. Price stability remains the CBT's main objective. The increase in inflation is a major driver of lower real income, including of vulnerable populations. Inflation also affects negatively the competitiveness of the Tunisian economy. For 2018, despite the negative output gap, inflation risks are growing due to the planned adjustments of fuel prices, the implementation of the 2018 Budget Law, and the pass-through of the dinar's depreciation. However, we think that inflation expectations will remain well-anchored, thanks to the following developments: (i) proactive policy actions by the CBT (see below); and (ii) the expectation of no new wage increases over the next two years. More specifically, we are taking the following actions to facilitate a gradual return of inflation to the low- to mid-single digits:

- **Tightening monetary conditions.** The CBT already raised the policy rate by an unprecedented 75 basis points on March 5, 2018 to 5.75 percent, for a cumulative increase of 150 basis points since early 2017. It stands ready to continue with policy rate increases in case inflation (especially core inflation) does not decelerate sufficiently fast and key interest rates (in real terms) remain in negative territory. The aim is to bring real interest rates back into positive territory to smooth the path of consumption. Moreover, the CBT has significantly widened the interest rate corridor used for money market operations. Market forces of supply and demand for liquidity will therefore play a stronger role.
- **Better monitoring of monetary aggregates.** The CBT intends to contain the increase in credit to the economy, and particularly consumer credit, to nominal GDP growth. To achieve this, the CBT will ensure that net domestic assets (NDA), including bank refinancing, are contained through close monitoring on a monthly basis. The IMF will support us with TA to refine the instruments we currently use to monitor liquidity factors and monetary aggregates. The CBT agrees to consult IMF staff whenever the monthly NDA outturns do not meet the path agreed under the EFF arrangement.

- **Improving transmission channels.** The full impact of the 2017 interest rate hike will be felt in 2018, when it will affect credit to the economy and consumption. Moreover, to facilitate the transmission of changes in the monetary policy stance, the CBT will contain the regular refinancing operations with the banking sector and will continue to limit the level of liquidity available for tender. Finally, the lender of last resort facility, initiated in December 2016 and made operational in July 2017, has become effective following the implementation of a new collateral framework and the creation of a credit committee. The facility is an essential tool to distinguish regular bank refinancing operations from those that originate from banks with a structural deficit in liquidity. There has been significant progress in implementing the IMF's recommendations from the 2016 TA report, in particular regarding the operational arrangement for the lender of last resort (LOLR) facility and the credit committee charged with granting emergency liquidity assistance (ELA). That said, in addition to these findings and recommendations, the CBT reiterates its unequivocal commitment to implement the IMF's recommendations, consistent with past and ongoing reforms and the new central bank and banking sector laws.

21. Exchange rate policies will contribute to maintaining adequate reserve coverage. The CBT faced a current account deficit that was higher than projected and contributed to severe liquidity shortages on the FX market. In 2017, the dinar depreciated by about 20 percent against the Euro. Notwithstanding this trend, foreign currency demand (including for debt service) increased in the FX market, mainly driven by energy imports (up 23.4 percent to a total of US\$ 3.283 billion, compared with US\$2.660 billion in 2016). This led the CBT to increase its net interventions by 53 percent to US\$2.866 billion in 2017 versus US\$1.872 billion in 2016. For 2018, the CBT is strongly committed to adhere strictly to a net intervention budget, facilitated by the recovery in tourism and in exports of phosphates and manufacturing. The intervention budget would help meet the demand for foreign currency by STEG and STIR, regarding their energy demand. The factors that enable the CBT to gradually reduce its interventions include the following: (i) a recovery in exports due to competitiveness gains of the Tunisian economy; (ii) the beginning of exploration of the "Nawara" gas project, which will reduce energy import needs; and (iii) price adjustments of oil products, which will slow demand. In addition, in the short term, we will request TA from the AFD to improve the cash management of STEG and STIR. This TA will fine-tune the recommendations that the CBT presented in its January 2018 guide for the public enterprises on how to manage market risk. In the same vein, we will hold monthly meetings with both companies to better project their FX demand.

D. Consolidating the Recovery to Lay the Ground for Sustainable Growth

Governance and the Business Environment

22. Fighting corruption. Corruption is a challenge that undermines citizens' trust, stymies strong and equitable growth, and pollutes the business environment. Last September, we established by law the High Anti-Corruption and Good Governance Authority, which will be the main tool in our mission to eradicate this evil. To make this new effort fully operational, the 2018 Budget Law included sufficient allocations for the High Authority. We also published a call for candidates for membership on the executive committee, and the CMR passed a governmental decree that specifies the remuneration of the executive board. Parliament is expected to elect the members of the executive committee by March 2018, with the respective decree expected by June 2018 (*reprogrammed SB*, June 2018). Once appointed, the executive committee of the High Authority can rely on the staff and resources of the current National Authority to Fight Corruption (INLCC).

23. Improving the business environment. Following the adoption of crucial reforms to improve the business environment, the government has started implementing these measures to strengthen their impact on investment decisions.

- The implementation of the new investment law started with the adoption of a decree that specifies the list of activities that require authorization (including the short list of activities not subject to the rule of "silence is deemed to be consent") and the implementation of the Tunisia Investment Authority:
 - i. It will be a one-stop shop for investors. It will provide a single point of access for all investors who wish to invest in Tunisia. Also, for domestic and foreign investors alike, it will facilitate the procedures required to create new companies and conduct business, lower transaction costs, and increase transparency in making investment decisions. The government has already put in place its management and employees and has allocated a budget for its operations (*new SB*, May 2018).
 - ii. It is currently reviewing a list of authorizations necessary for investments with the aim of making recommendations for streamlining this list. Furthermore, it will propose—and begin to execute before March 2018—a plan to simplify regulations over the next two years. We are receiving TA from the International Finance Corporation (IFC) in this endeavor. After this step, we will begin to revise and, if necessary, eliminate authorizations to access certain sectors.
- The government plans to take advantage of its international relations to stimulate investment, particularly through Tunisia's participation in the G20's "Compact with Africa" initiative.
- Furthermore, the government intends to strengthen the quality of public investments. Following the approval of the law on public-private partnerships (PPP), we will operationalize the framework for their management. Supported by the new framework, the use of PPPs will

increase to complement public investment from 2018. PPPs will be subject to a strict pre-assessment of the budgetary risks they may entail.

Financial Sector

24. Financial sector reforms. We are committed to reinforcing financial stability by improving the quality of bank loan portfolios, continuing to strengthen bank supervision, and preparing a strategy to reduce banks' liquidity deficits. We will also strengthen the quality of financing to the economy by improving access to financing for SMEs that create jobs. The government will continue to pursue its strategy to exit nonstrategic banking institutions, while continuing the process of selling off two banks in 2018 by June 2018 we will finalize a divestiture program for 2019:

- **The measures necessary to strengthen the quality of loan portfolios will be taken promptly, especially for the public banks.** Public banks are still subject to specific legal constraints that limit their ability to reduce their volume of NPLs, which makes it difficult for them to achieve the objectives of the restructuring plans. All banks suffer from restrictive rules on writing off NPLs, and collection companies are subject to many operating constraints.
 - i. In January 2018 the CMR passed a series of measures to deal with these problems, which include the following: (i) the draft law that allows public banks to abandon NPLs loans just like private banks; (ii) the draft law that streamlines the rules for write-offs so that a final definitive judgment is not necessary; (iii) the decree that provides that public banks are not subject to the assent of the committee established by Article 474 of the Commercial Code; and (iv) a white paper that sets forth the strategy to eliminate delinquent claims in the tourism sector. We expect Parliament to adopt these draft laws (i) and (ii) (*modified SB*, June 2018).
 - ii. In May 2018 the CMR will pass the draft law on collection companies, which allows them to canvass clients. Parliament will adopt it by September 2018.
 - iii. By March 2018, the Ministry of Justice, in collaboration with the Ministry of Finance, the CBT and the bank association, will put in place a program to train specialized judges for bank conflicts as part of the professional development of magistrates, supervised by the High Institute of Magistrates/Academy of Banks and Finance. The Ministry of Justice will identify the commercial courts that will specialize in bank conflicts.
 - iv. By April 2018, the Ministry of Tourism, in conjunction with other ministries, will propose solutions to change the tourism focus of hotels whose sustainability is not assured to restructure their debts and upgrade the level of tourism opportunities offered in Tunisia.
 - v. By June 2018, the Financial Sector Reform Committee (Comité de Réforme du Secteur Financier, COREFI) will prepare a comprehensive strategy to improve the treatment of NPLs, covering the judicial system, the change of vocation of hotels, taxation, land use registration, supervision, and other relevant areas.

- **The CBT will continue to strengthen bank supervision.** The inspection of the seven largest private banks (*SB met with delay* in January 2018) resulted in the identification, for one bank, of internal control weaknesses and the need for provisioning this bank, which will be met by raising capital from its own sources. No unexpected risks for the six other banks were found. In February 2018, the CBT published a new circular that consolidates all the rules on capital requirements, including the new requirements related to market risk. Consolidated supervision will be operational by the second half of 2019. In the white paper that establishes a strategy to eliminate NPLs in the tourism sector, the CBT is planning to provide an exemption from the contagion principle for new loans to clients whose debt has been renegotiated, subject to certain prerequisites. The CBT will ensure that the exemptions to the contagion principle are supervised and limited, and it will review the implementation of exemptions if there are abuses. The staff of the General Directorate of Bank Supervision at the CBT will be increased by a dozen employees in the first half of 2018 to strengthen its capabilities.
- **The resolution framework for institutions in difficulty will be made operational promptly for the BFT.** The resolution committee was appointed in December 2017. The CBT will submit its analysis of BFT's situation to the resolution committee as soon as the committee is created, and the committee will issue a decision regarding the orderly resolution of BFT (*new SB*, May 2018). The resolution process will begin immediately after that. The operationalization of the deposit guarantee fund (scheduled for September 2017) was finalized in January 2018.
- **By December 2018, COREFI will prepare a comprehensive strategy to fight against the liquidity shortages in the Tunisian financial system** to enable it to fully play its role in financing the economy. The topics studied will include the following issues: de-cashing, fighting the informal economy, digitization, financial inclusion, controlling the budget deficit, fighting the current account deficit, money market reform, revitalizing the bond market, and stock market reform.
- **COREFI will prepare a strategy to improve financing for SMEs and the law on the ceiling of the maximum lending rate will be adopted promptly.** COREFI will prepare by September 2018 a strategy to review the modalities of providing financial support to SMEs—through the SME Financing Bank BFPME, the Tunisian Guarantee Company SOTUGAR, and the Tunisian Solidarity Bank BTS, among others—to simplify the various existing programs and provide guarantee tools and/or lines of financing in partnership with the banks. The strategy will also include a module to assist SMEs in collaboration with private banks in preparing business and financial plans. The CBT will strengthen its corporate information center (Centrale des Bilans) by consolidating national statistics, mainly by creating a data exchange system with the Ministry of Finance. Parliament will adopt the law that sets the interest rate ceiling (*reprogrammed SB*, May 2018). The ceiling for corporates and SMEs will be increased from +20 percent above average to +33 percent. The averages are differentiated for each category of borrowers (retail, corporates). Contrary to original intentions though, the ceiling for individuals will remain at 20 percent above the average rate, because there is less need to differentiate risks among

borrowers in this segment. The law that covers the operation and supervision of the credit bureau will be adopted by April 2018.

- **The Minister of Finance/COREFI will validate the financial inclusion strategy by March 2018.** It will especially focus on the development of digital finance, microinsurance, refinancing microfinance, the social and solidarity economy, and financial education. By June 2018, the CBT financial inclusion observatory will identify the indicators that will be put in place.
- **The CMR approved in November 2017 the measures listed in the FATF action plan that Tunisia needs to implement.** This plan will be monitored continuously in the context of improving compliance with the standards. The significant improvement in Tunisia's technical compliance rating, decided at the MENA-FATF plenary meeting from December 2 to 7 in Bahrain, demonstrates the progress Tunisia has made in having its AML/CFT system converge with international standards.
- **Progress has been made in implementing the recommendations of the IMF's safeguards assessment mission** to further anchor the independence and performance of the CBT's internal audit function. In this context, we took the following steps: (i) drafted an action plan for the risk management unit and a legal text to create a risk committee, which will be submitted to the CBT's Supervisory Board for approval as soon as possible; and (ii) issued new regulation on the lender of last resort framework in December 2016. In order to reinforce internal controls of lending operations, the Bank has drawn up and published a circular for the implementation of monetary policy in March 2017. Regarding an external evaluation of the internal audit function, the General Control Department of the CBT will undertake a preliminary self-assessment before resorting to an external evaluation, following our request for IMF TA.

Use of Public Resources

25. The reforms in support of fiscal consolidation are progressing:

- **Modernization of tax administration.** The Large Taxpayer Unit (LTU), established and put in place in 2008, lacked national jurisdiction and did not have the entire suite of tax-related activities under its purview, hence the importance of the two governmental decrees (2017-1156 and 2017-1157) adopted on October 27, 2017. These decrees strengthen the scope of the LTU and task it with tax audits for large taxpayers and a mandate to cover all Tunisian territory effective January 2, 2018. The LTU now has a tax monitoring and verification unit alongside the records management unit and a task force in charge of risk management and programming, as well as another group in charge of reporting. Several new auditors have joined the LTU as of January 2, 2018, after they received special training. In parallel, the umbrella entity, established by the 2018 Budget Law, has begun operations. This umbrella entity will oversee control and collection, which will allow the merger of these two crucial tax administration functions, including for large enterprises (*new SB*, July 2018).

- Tax reform.** As part of our effort to strengthen revenue mobilization and lower the fiscal deficit, we are working with IMF staff to build tax administration capacity and move ahead with tax policy reform. In this regard, we will introduce changes in the VAT for the services of liberal professions (by raising the rate from 13 percent to 19 percent) to boost the fairness of ongoing tax reforms in 2019 (*new SB*, December 2018). In the past, our policy of giving tax incentives has helped Tunisia's economic development. Today, we believe that there are high costs associated with this system in terms of foregone tax revenue. Tax incentives are also inconsistent with our overall tax policy strategy in which fairness plays a key role. We therefore remain committed to gradually reducing the gap between the onshore and offshore tax regimes consistent with our agreements with the European Union, our largest trading partner. Through considerable communication and diplomatic efforts, we have demonstrated to the European Union that Tunisia has a transparent tax system and that it is committed to adopting the full set of measures in the Base Erosion and Profit Shifting project (BEPS) of the Organization for Economic Cooperation and Development (OECD). Tunisia is in full compliance with its commitment to the automatic exchange of information with the Global Forum on Transparency and Exchange of Information for Tax Purposes. Thanks to this measure, Tunisia has been removed from the European Union's list of uncooperative tax jurisdictions.
- Improving the supervision of SOEs.** Monitoring and oversight will be further strengthened for the four SOEs that have already signed performance contracts. For each contract, we have also requested annexes that amend the performance contracts to incorporate financial performance indicators. We will also establish a performance contract with TUNISAIR that reflects the commitments the company made in its restructuring plan (*modified SB*, December 2018). In parallel, and supported by the AFD, we will overhaul the entire governance structure for SOEs. As a result, we will be better positioned to manage contingent liabilities arising from SOE activities. The General Directorate of Government Holdings (DGP) in the Ministry of Finance will monitor a complete set of performance indicators on a quarterly basis (financial statements, in particular) of the 30 biggest SOEs by April 2018.
- Leveraging the results of the functional reviews.** With support from the European Union, we completed three of the four functional reviews in the key ministries of the Tunisian administration. The last review, now in progress at the Ministry of Public Works, will soon be completed (*reprogrammed SB*, June 2018). We will use the results to identify additional measures needed to ensure that the wage bill remains on track to reach 12.4 percent of GDP in 2020.

26. The reforms to make our social policies more effective and better targeted are in progress:

- Make the pension system sustainable.** The reform of the social security funds, which we plan to adopt soon (*reprogrammed SB*, April 2018), will enable us to limit the deficits of the social security funds in the coming years. This reform is largely based on parametric pension reform. It is expected to result in a gradual increase in the retirement age by two years, an increase in contributions, and a change in the indexing mechanism for pensions. However, we will need additional reforms to restore long-term financial viability to ensure that the funds are on a

sustainable basis for the younger generations of Tunisians. A high council for financing social security will be put in place. Alongside the tripartite committee, it will continue to monitor the ongoing reform and propose any new corrective measures to ensure the financial sustainability of the social funds.

- **Better-targeted social assistance.** We plan to put in place the new unique social identifier in December 2018, which uses a new database of vulnerable households (*reprogrammed SB*, December 2018). Beginning in January 2019, we will accelerate the technical work to move from the universal subsidy system to targeting households in need. This could take the form of a system of conditional money transfers.

Transparency and International Relations

27. Transparency and sharing information. We are convinced that transparency is a basic pillar of good governance. Since 2011, our approach in this regard has been to strengthen the institutional and regulatory framework to bring it in line with best international practices. Thus, the National Authority for Access to Information has been fully operational since Parliament elected the members of the authority on July 18, 2017. Likewise, efforts to revamp the national statistics system have led to the CMR adopting a draft law on statistics on December 8, 2017.

28. We are improving coordination for the implementation of the EFF-supported program. To simplify information sharing and facilitate interaction with IMF technical staff, we appointed two focal points in the Ministry of Finance and the CBT charged with coordinating the program. Therefore, we reiterate our commitment to submit data on a timely basis to formulate and review our economic policies and to improve information sharing with the IMF and other international institutions.

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

	2016		2017											
	Dec.		Mar.		Jun.			Sep.			Dec.			
	Act.	Prog.	Ind.	Act.	Prog.	Adj.	Act.	Prog.	Ind.	Act.	Prog.	Adj.	Act.	Prog.
Quantitative Performance Criteria 2/														
1. Floor on the primary balance of the central government (cash basis excl. grants, in millions of TD) 3/	-3,951	Not Met	-814	-92	-1,247	n.a.	-3,123	Not Met	-1,141	-2,868	-3,784	n.a.	-3,959	Not Met
2. Ceiling on net domestic assets of the Central Bank of Tunisia (stock, in millions of TD) 4/	5,094	Not Met	2,363	5,351	5,500	5,605	6,640	Not Met	4,337	6,761	3,834	1,684	7,062	Not Met
3. Floor on net international reserves of the Central Bank of Tunisia (stock, in millions of US\$) 5/	3,335	Not Met	4,773	3,105	2,906	2,884	2,951	Met	3,311	3,117	2,937	3,660	3,120	Not Met
4. Ceiling on total current primary expenditure of the central government (in millions of TD) 3/	19,054	Met	5,244	5,574	10,379	n.a.	10,284	Met	14,932	14,702	21,757	n.a.	21,823	Not Met
Continuous Performance Criteria														
5. Ceiling on the accumulation of new external debt payment arrears by the central government (in millions of US\$)	0	Met	0	0	0	n.a.	0	Met	0	0	0	n.a.	0	Met
Quantitative Indicative Targets														
6. Floor on social spending (in millions of TD) 6/	1,411	Not Met	285	589	965	n.a.	1,132	Met	1,226	1,502	1,533	n.a.	1,844	Met
7. Ceiling on the accumulation of new domestic arrears (in millions of TD)	0	Met	0	0	0	n.a.	0	Met	0	0	0	n.a.	0	Met
Program assumptions on which adjusters are calculated in case of deviations														
• External financing of the central government on a cumulative basis (in millions of US\$) 7/	1,498		475	1,016	2,200		2,217		3,007	2,765	3,078		3,224	
• of which: multilateral (excluding IMF) and bilateral budget grants (in millions of US\$)	576		400	0	108		1,110		871	1,580	927		2,138	
• Public external debt service (interest and amortization) on a cumulative basis (in millions of US\$)	930		270	263	1,055		1,067		1,481	1,493	1,823		1,855	
• Bank recapitalization and civil service reform costs (in millions of TD)	0		0	0	0		0		0	0	0		0	
• Privatization receipts in FX (in millions of US\$)	0		0	0	0		0		0	0	0		0	
• Estimated cost of liquidating the Banque Franco Tunisienne (BFT, in millions of TD) 3/	n.a.		n.a.	n.a.	n.a.		n.a.		n.a.	n.a.	n.a.		n.a.	
• Residents' FX deposits at the Central Bank of Tunisia (in millions of US\$) 5/ 8/	908		-1,269	960	960		963		960	963	960		1,224	
• FX swaps between the Central Bank of Tunisia and commercial banks (in millions of TD) 5/ 8/	445		603	453	453		393		453	594	453		1,147	
• FX swaps between the Central Bank of Tunisia and commercial banks (in millions of US\$) 5/	221		299	225	225		195		225	295	225		570	
• Program exchange rate TD/US\$	2,01285		2,01285	2,01285	2,01285		2,01285		2,01285	2,01285	2,01285		2,01285	

Source: IMF staff estimates.

1/ Quantitative performance criteria and adjusters are described in the Technical Memorandum of Understanding. Further, for purposes of calculating program adjusters, foreign currency amounts will be converted at program exchange rates.

2/ From 2018 onwards, the test dates for quarterly QPCs will be end-March, end-June, end-September, and end-December.

3/ From 2018 onwards, a new adjuster on bank liquidation applies.

4/ End of period. From 2018 onwards, the adjuster on FX swaps between the Central Bank of Tunisia and commercial banks will no longer apply.

5/ From 2018 onwards, the adjuster on FX swaps between the Central Bank of Tunisia and commercial banks, and that on residents' FX deposits at the Central Bank of Tunisia will no longer apply.

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

7/ Disbursement, includes project loans and capital market access, but excludes IMF.

8/ At program exchange rate.

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

	2018									
	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
	Prog.	Prog.	Prog.	Prog.	Prog.	Prog.	Prog.	Prog.	Prog.	Prog.
Quantitative Performance Criteria 2/										
1. Floor on the primary balance of the central government (cash basis excl. grants, in millions of TD) 3/	-1,722	n.a.	n.a.	-1,943	n.a.	n.a.	-2,493	n.a.	n.a.	-3,113
2. Ceiling on net domestic assets of the Central Bank of Tunisia (stock, in millions of TD) 4/	9,374	n.a.	n.a.	8,131	n.a.	n.a.	7,652	n.a.	n.a.	7,497
3. Floor on net international reserves of the Central Bank of Tunisia (stock, in millions of US\$) 5/	2,352	n.a.	n.a.	3,099	n.a.	n.a.	3,301	n.a.	n.a.	3,245
4. Ceiling on total current primary expenditure of the central government (in millions of TD) 3/	6,237	n.a.	n.a.	11,399	n.a.	n.a.	16,522	n.a.	n.a.	23,931
Continuous Performance Criteria										
5. Ceiling on the accumulation of new external debt payment arrears by the central government (in millions of US\$)	0	n.a.	n.a.	0	n.a.	n.a.	0	n.a.	n.a.	0
Quantitative Indicative Targets										
6. Floor on social spending (in millions of TD) 6/	721	n.a.	n.a.	1,021	n.a.	n.a.	1,534	n.a.	n.a.	2,041
7. Ceiling on the accumulation of new domestic arrears (in millions of TD)	0	n.a.	n.a.	0	n.a.	n.a.	0	n.a.	n.a.	0
Program assumptions on which adjusters are calculated in case of deviations										
• External financing of the central government on a cumulative basis (in millions of US\$) 7/	209	n.a.	n.a.	1,422	n.a.	n.a.	2,108	n.a.	n.a.	3,029
• of which: multilateral (excluding IMF) and bilateral budget grants (in millions of US\$)	0	n.a.	n.a.	182	n.a.	n.a.	780	n.a.	n.a.	1,105
• Public external debt service (interest and amortization) on a cumulative basis (in millions of US\$)	466	n.a.	n.a.	904	n.a.	n.a.	1,325	n.a.	n.a.	1,726
• Bank recapitalization and civil service reform costs (in millions of TD)	0	n.a.	n.a.	0	n.a.	n.a.	0	n.a.	n.a.	0
• Privatization receipts in FX (in millions of US\$)	0	n.a.	n.a.	0	n.a.	n.a.	0	n.a.	n.a.	0
• Estimated cost of liquidating the Banque Franco Tunisienne (BFT, in millions of TD) 3/	0	n.a.	n.a.	0	n.a.	n.a.	0	n.a.	n.a.	400
• Residents' FX deposits at the Central Bank of Tunisia (in millions of US\$) 5/ 8/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
• FX swaps between the Central Bank of Tunisia and commercial banks (in millions of TD) 5/ 8/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
• FX swaps between the Central Bank of Tunisia and commercial banks (in millions of US\$) 5/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
• Program exchange rate TD/US\$	2.01285	n.a.	n.a.	2.01285	n.a.	n.a.	2.01285	n.a.	n.a.	2.01285

Source: IMF staff estimates.

1/ Quantitative performance criteria and adjusters are described in the Technical Memorandum of Understanding. Further, for purposes of calculating program adjusters, foreign currency amounts will be converted at program exchange rates.

2/ From 2018 onwards, the test dates for quarterly QPCs will be end-March, end-June, end-September, and end-December.

3/ From 2018 onwards, a new adjuster on bank liquidation applies.

4/ End of period. From 2018 onwards, the adjuster on FX swaps between the Central Bank of Tunisia and commercial banks will no longer apply.

5/ From 2018 onwards, the adjuster on FX swaps between the Central Bank of Tunisia and commercial banks, and that on residents' FX deposits at the Central Bank of Tunisia will no longer apply.

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

7/ Disbursement, includes project loans and capital market access, but excludes IMF.

8/ At program exchange rate.

Table 2. Prior Actions and Structural Benchmarks

Due for the Second Review		
Prior Actions	Objective	
√ 2018 budget. Adoption of a satisfactory 2018 budget law by Parliament.	<i>Fiscal sustainability</i>	Met
√ Governance. (i) <i>High Anti-Corruption and Good Governance Authority</i> (HACGGA): publication of a call for candidature for the members of the HACGGA, signature of the decree specifying the remuneration of its members, and submission of its budget in the context of the 2018 budget law preparation; (ii) <i>Performance contracts</i> : signature of annexes with financial performance indicators for four of the five largest SOEs (i.e. Office des Céréales, Régie des Tabacs, STIR and STEG).	<i>Good governance and fairness</i>	Met
√ Fuel prices. Significant ad-hoc increase of fuel prices.	<i>Fiscal sustainability and fairness</i>	Met
√ Caisse Nationale de Sécurité Sociale (CNSS). Start of arrears clearance with a first tranche of TD 200 million by public sector entities.	<i>Fiscal sustainability and fairness</i>	Met
√ Portfolio quality. Adoption by the Council of Ministers of (i) a draft law allowing public banks to abandon claims on credits like their private peers; (ii) a draft law simplifying write-off rules so that a final judgment is not necessary; (iii) a decree stipulating that public banks are not subject to the consent of a committee for the renegotiation of receivables in the context of insolvency proceedings; and (iv) the white book defining the strategy for the elimination of outstanding debts in the context of insolvency proceedings in the tourism sector.	<i>Financial sector stability</i>	Met

Table 2. Prior Actions and Structural Benchmarks (Continued)

Due for the Second Review				
Structural Benchmarks	Objective	Date	Revised Date	Status
I. Sectoral reforms/private sector development				
√ High anti-corruption and good governance authority (HACGGA). Creation of an independent, high anti-corruption authority.	<i>Good governance and fairness</i>	Dec-16	Sep-17	Met
• High Anti-Corruption and Good Governance Authority (HACGGA). (i) Signature of the decree appointing the members of the HACGGA; (ii) signature of the decree specifying the remuneration of its members; and (iii) submission of its budget in the context of the 2018 budget law preparation.	<i>Good governance and fairness</i>	Nov-17		Not met. Replaced by Prior Action and reprogrammed Structural Benchmark.
• High anti-corruption and good governance authority (HACGGA). Signature of the decree appointing the members of the HACGGA.	<i>Good governance and fairness</i>	Nov-17	Jun-18	Not met
• Social policy. Establishment of a databank on vulnerable households.	<i>Social protection and fairness</i>	Dec-17	Dec-18	Not met. In progress.
II. Financial sector reform				
√ Supervision. Completion of the reports on the inspection of the seven largest private banks in line with the best standards and with IMF Technical Assistance as agreed with the BCT.	<i>Financial sector stability</i>	Sep-17		Met with delay.
• Portfolio quality. Adoption of: (i) a law to make it possible for public banks to abandon claims on credits like their private peers (both in the context of the insolvency law and outside of this context); (ii) a government decree creating a permanent committee that will grant an assent to the Ministry of Finance for all measures concerning debt settlement of the State, local collectivities and public establishments; the decree will specify the claims of public banks will not be within the purview of the permanent committee; and (iii) simplified rules to write-off claims, eliminating the requirement for a final judgment.	<i>Financial sector stability</i>	Oct-17		Partly met with delay: (ii) met, (i) and (iii) are replaced by a Prior Action and a reprogrammed Structural Benchmark.
• Portfolio quality. Adoption by Parliament of (i) a law to make it possible for public banks to abandon claims on credits like their private peers (both in the context of the insolvency law and outside of this context); and (ii) a law simplifying write-off rules, eliminating the requirement for a final judgment.	<i>Financial sector stability</i>	Oct-17	Jun-18	Not met
• Maximum lending rate. Adoption by Parliament of a law and decree on increasing the maximum lending rate for corporates and SMEs from +20 percent above the average lending rate to +33 percent.	<i>Financial sector stability</i>	Sep-17	May-18	Not met. Draft law in Parliament. Augmentation limited to +20% for individuals.

Table 2. Prior Actions and Structural Benchmarks (Concluded)

Due for the Second Review (Concluded)				
Structural Benchmarks	Objective	Date	Revised Date	Status
III. Fiscal policy and reforms of public institutions				
<ul style="list-style-type: none"> ✓ Civil service. Adoption, by the Council of Ministers, of a decree giving the authority to the Prime Minister's office to review and exclusively authorize recruitments and setting the maximum recruitments into the civil service at 3,000 for 2018 while confirming the number of 7,500 for 2017. 	<i>Fiscal sustainability and fairness</i>	Oct-17		Met
<ul style="list-style-type: none"> • Pensions. Adoption, by the Council of Ministers, of the comprehensive pension reform strategy to ensure financial sustainability. 	<i>Fiscal sustainability and fairness</i>	Sep-17	Apr-18	Not met. At an advanced stage of implementation.
<ul style="list-style-type: none"> • Functional review. Completion of the functional review of four ministries (Health, Education, Finance, and Infrastructure). 	<i>Fiscal sustainability and quality public services</i>	Aug-17	Jun-18	Not met. At an advanced stage of implementation.
<ul style="list-style-type: none"> • State-owned enterprises (SOEs). Signature of performance contracts for the five largest SOEs (i.e. Office des Céréales, Régie des Tabacs, STIR, STEG and TUNISAIR). 	<i>Better monitoring of fiscal risks</i>	Jul-17		Not met. Replaced by Prior Action; except for TUNISAIR (reprogrammed Structural Benchmark).
<ul style="list-style-type: none"> • State-owned enterprises (SOEs). Signature of a performance contract for TUNISAIR. 	<i>Better monitoring of fiscal risks</i>	Jul-17	Dec-18	Not met
<ul style="list-style-type: none"> • Organic budget law. Publication, in the official journal, of the Organic Budget Law. 	<i>Fiscal sustainability and fairness</i>	Sep-17	Dec-18	Not met. Draft law in Parliament.
<ul style="list-style-type: none"> • Large Taxpayers Unit (DGE). Transfer of control (in-depth verification) and tax arrears management (recovery) functions for large enterprises to the DGE and their operationalization. 	<i>Fiscal sustainability and fairness</i>	Oct-17	Dec-18	Not met
<ul style="list-style-type: none"> • Fuel prices. Quarterly application of the automatic fuel price adjustment mechanism. 	<i>Fiscal sustainability and fairness</i>	Sep-17	Mar-18 until end of program	Not met
IV. Monetary and exchange rate policies				
<ul style="list-style-type: none"> • Foreign exchange auctions. Implementation of a full foreign exchange auction mechanism by the Central Bank of Tunisia. 	<i>Exchange rate flexibility and price stability</i>	Aug-17	Jun-18	Not met
Due for Future Reviews				
Structural Benchmarks	Objective	Date	Revised Date	Status
I. Sectoral reforms/private sector development				
<ul style="list-style-type: none"> • NEW 1/4: Operationalization of the investment code. Establishment of a one-stop investment agency. 	<i>Private sector development</i>	May-18		
II. Financial sector reform				
<ul style="list-style-type: none"> • NEW 2/4: Banque Franco Tunisienne (BFT). Vote of the resolution committee on the orderly resolution of the BFT. 	<i>Financial sector stability</i>	May-18		
III. Fiscal policy and reforms of public institutions				
<ul style="list-style-type: none"> • NEW 3/4: Value-added tax (VAT). Increase of the VAT rate for liberal professions from 13 to 19 percent. 	<i>Fiscal sustainability and fairness</i>	Dec-18		
<ul style="list-style-type: none"> • NEW 4/4: Large Taxpayers Unit (DGE). Operationalization of the transfer, and merger, of control (in-depth verification) and tax arrears management (recovery) functions into the new umbrella structure for tax administration (created by the 2018 budget law). 	<i>Fiscal sustainability and fairness</i>	Jul-18		

Attachment II. Technical Memorandum of Understanding

1. This Memorandum establishes the agreement between the Tunisian authorities and IMF staff concerning the definition of the Quantitative Performance Criteria (QPCs) and Indicative Targets (ITs) under the program supported by the Extended Fund Facility (EFF). It also sets out the content and frequency of data reporting to IMF staff for program monitoring purposes.
2. The quantitative criteria and targets are defined in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) attached to the Letter of Intent dated March 13, 2018. For program purposes, all assets, liabilities, and flows denominated in foreign currencies will be valued at the “program exchange rate,” as defined below, except for items affecting the government’s budgetary accounts, which will be measured at current exchange rates. For program purposes, the exchange rate corresponds to the accounting exchange rate of the CBT prevailing on December 31, 2015, as shown in the table below. For the SDR, the program exchange rate is 1 SDR = 2.797590 Tunisian dinars.

Program Exchange Rates: Tunisian Dinars per FX Currency at End-December 2015 (Accounting exchange rate of the CBT)	
Currency	Exchange rate
AED	0.54802
BHD	5.3373
CAD	1.45005
CHF	2.0322
DKK	0.2947335
DZD	0.01878
EUR	2.1993
GBP	2.9837
JPY	0.0167135
KWD	6.63225
LYD	1.44535
MAD	0.203175
NOK	0.228923
QAR	0.552815
KRW	0.001707098
CNY	0.3102
SAR	0.53634
SEK	0.23918
US\$	2.01285

3. Monetary gold assets will be valued against the corresponding value in Tunisian dinar (at the program exchange rate) at the price of 2,138.15 Tunisian dinar per ounce of gold in the international

market on 12/31/2015 (London morning fixing). The stock of gold is 4.13 tons (4,129,806 grams) on December 31, 2015.

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

DEFINITION OF PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Performance Criteria and Indicative Targets

5. The Quantitative Performance Criteria and Indicative Targets specified in MEFP Table 1 are:

- **Performance Criteria:**

- A Performance Criterion (**floor**) on **the net international reserves (NIR)** of the CBT.
- A Performance Criterion (**ceiling**) on **the net domestic assets (NDA)** of the CBT.
- A Performance Criterion (**floor**) on the **primary balance of the central government**, excluding grants.
- A Performance Criterion (**ceiling**) on total **current primary expenditure of the central government**.
- A continuous Performance Criterion (**zero ceiling**) on the **accumulation of new external debt payment arrears**.

- **Indicative Targets:**

- An Indicative Target (**ceiling**) on accumulation of new domestic arrears.
- An Indicative Target (**floor**) on capital expenditures in priority social sectors and social programs.
- An Indicative Target (**ceiling**) on **net foreign exchange interventions of the CBT**.

6. **Measurement of criteria.** The Performance Criteria on net international reserves and net domestic assets are measured on a stock and quarterly basis. The Performance Criteria on the central government primary balance and on the central government total current primary expenditure are measured on a quarterly basis and cumulatively from the end of the previous year. Adjustment factors will also be applied to some of these criteria. The Performance Criterion on the accumulation of new external arrears is measured on a continuous basis. The Indicative Target on

net foreign exchange interventions will be monitored on a monthly basis and measured on a monthly flow basis. All other Indicative Targets will be monitored on a quarterly basis.

B. Institutional Definition

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

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

C. Floor on the Net International Reserves of the CBT

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

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

11. The **CBT's liabilities in foreign currency** to nonresidents include any commitment to sell foreign currencies associated with financial derivative transactions (such as swaps, futures, options), any portion of the CBT's assets (gold, for example) used as collateral, IMF and Arab Monetary Fund (AMF) credits outstanding, and deposits at the CBT of international organizations, foreign governments, and foreign bank and nonbank institutions. The government's foreign currency deposits at the CBT are not included in the liabilities, nor is any SDR allocation received after March 31, 2017.

12. All debt instruments issued in foreign currency by the CBT on behalf of the government after May 15, 2013 will be treated as **CBT liabilities**, unless the offering documents (prospectus) state clearly that (i) the CBT is acting as an agent to execute all sovereign debt instruments issued in foreign currency raised through the international markets for general budgetary purposes of the Republic of Tunisia (ii) debt is a liability of the central government; and (iii) a protocol between the CBT and the Ministry of Finance provides clearly that the CBT is authorized to pay all expenses and costs pertaining to the implementation of this issue as well as the interest and principal of the issue sum through direct deduction from the Treasury's current account established in the CBT's books.

13. The value of **CBT reserve assets and liabilities** in foreign currency will be calculated using program exchange rates (Table above). On December 31, 2017, the value of the stock of NIR

reserves was US\$3,120.2 million, with the stock of reserve assets equal to US\$5,480.6 million and the stock of CBT liabilities in foreign currency equal to US\$2,360.4 million (at program rates).

D. Ceiling on Net Domestic Assets of the CBT

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

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

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

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

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

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

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

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

21. **Net domestic bank financing** of the central government is the sum of: the change in net bank loans to the central government (in Tunisian dinars and foreign currency) and the change in central government deposits at the CBT (this includes all central government accounts at the CBT, in

particular (i) Treasury current account excluding the sub accounts N-bis, those related to Public Administrative Entities (EPA) and to local governments; (ii) Tunisian government account (miscellaneous dinar accounts); (iii) loan accounts; (iv) grant accounts; (v) FONAPRA-FOPRODI accounts; (vi) special accounts of the Tunisian government in foreign currency; (vii) accounts in foreign currency pending dinarization (subaccount: “mise a disposition”); (ix) and any other account that may be opened by the central government at the CBT or banks. Following the unification of government accounts at the CBT into a Single Treasury Account, government accounts are consolidated in two categories (“Compte Central du Government” and “Comptes Spéciaux du Government”) on the CBT’s balance sheet (liabilities side).

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

23. Net domestic nonbank financing includes the change in the stock of government securities (Treasury bills and bonds) held by nonbanks (including social security funds) and any other central government borrowing from nonbanks, less repayments. In particular, any use of cash from non-banking institutions (including La Poste) to finance the Treasury would be counted as domestic non-bank financing. Total Treasury bills and other public debt instruments to be taken into consideration are calculated at the nominal/face value shown on the institutions’ balance sheet and does not include accrued interest.

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

24. Under the program, **total current primary expenditure of the central government** is defined as the sum of central government expenditure on the following items: (i) personnel wages and salaries; (ii) goods and services; (iii) transfers and subsidies; and (iv) other unallocated current expenditure.¹

¹ The methodologies used to measure current expenditure categories for the central government are those used to design the table of central government financial operations presented in the macroeconomic framework.

G. Ceiling on the Accumulation of External Arrears

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

H. Indicative Ceiling on the Accumulation of Domestic Arrears

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

I. Indicative Floor on Social Expenditures

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

J. Indicative Ceiling on Net Foreign Exchange Interventions of the CBT

28. The CBT’s **net foreign exchange interventions** are defined as the difference between outright foreign exchange sales (including conversions) and outright foreign exchange purchases (including conversions), via the following channels: Reuters, auctions, and the interbank market. The computation of net sales may also include CBT net sales in other formal or informal markets (or instruments) that the CBT may choose to substitute for outright net sales (e.g., transactions in

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

derivatives). Transactions of the CBT with the Central Government in the context of budget operations of the Central Government are not considered net sales (unless they take place through one of the channels mentioned above). In this respect, purchases of the foreign currency proceeds of a potential Eurobond or other official financing cannot be interpreted as CBT purchases of foreign exchange for the computation of the CBT net sales total.

29. The value of **non-US\$ denominated transactions** will be calculated using program exchange rates (Table above).

K. Adjustment Factors for the Program Performance Criteria

30. The **NIR** targets are adjusted upward (downward) if the cumulative sum of net external financing of the central government, the sum of budgetary grants, and privatization receipts received in foreign currency than the levels observed in the table below. The NIR targets will be also adjusted upward (downward) if the total amount of cash payments on external debt service of the government is lower (greater) than the levels included in the table below.

31. The **NDA** targets will be adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the cumulative sum of net external financing of the central government, the sum of budgetary grants, and privatization receipts received in foreign currency are lower (greater) than the levels indicated in the table below. The NDA targets are also adjusted upward (downward) based on the downward (upward) adjustment of the NIR floor if the total amount of cash payments on external debt service are greater (lower) than the levels included in the table below. The NDA ceiling will be converted into Tunisian dinars at the program exchange rate, and also adjusted downward/upward based on the amount of CBT reserves released/mobilized because of a possible decrease/increase in the reserve requirement.

32. The **primary fiscal balance** targets, excluding grants, will be adjusted upward/downward based on the amount used to recapitalize the public banks and all amount used to finance the severance pay of the voluntary departures which may be part of the civil service reform. It will also be adjusted downward in an amount equal to the estimated cost of liquidating the BFT.

33. The **total current primary expenditures** targets will be adjusted upward in an amount equal to the estimated cost of liquidating the BFT.

Program Assumptions on Adjustment Factors for the Quantitative Performance Criteria
(In millions of U.S. dollars)

	2017					2018					2019				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
Official External Financing	1,016	1,517	547	556	3,636	349	1,467	940	1,174	3,930	358	558	908	1,408	3,233
Project loans	72	72	72	72	287	88	88	88	88	350	88	88	88	88	350
Multilateral donors	-	424	456	362	1,243	245	363	836	454	1,898	254	454	804	254	1,767
AFDB	-	-	-	144	144	-	-	-	91	91	-	200	-	-	200
IMF (budget support starting 2017) 1/	-	315	-	-	315	245	254	254	254	1,006	254	254	254	254	1,017
World Bank Group	-	-	456	-	456	-	-	400	-	400	-	-	550	-	550
European Union	-	109	-	219	328	-	109	182	109	401	-	-	-	-	-
Bilateral donors	-	998	-	109	1,107	-	-	-	116	116	-	-	-	-	-
Germany	-	-	-	109	109	-	-	-	116	116	-	-	-	-	-
Qatar	-	998	-	-	998	-	-	-	-	-	-	-	-	-	-
Turkish loan	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Financial Market Access and other	944	22	19	13	999	17	1,017	17	517	1,566	17	17	17	1,067	1,116
Sukuk and other market financing	929	-	-	-	929	-	1,000	-	500	1,500	-	-	-	1,050	1,050
Market issuance with US Treasury guarantee	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Loan Transfers to SOEs	15	22	19	13	70	17	17	17	17	66	17	17	17	17	66
Budget Grants	-	27	49	38	115	25	25	25	25	100	25	26	27	28	106
Privatization Receipts	n.a.	n.a.	n.a.	n.a.	-	n.a.	n.a.	n.a.	n.a.	-	n.a.	n.a.	n.a.	n.a.	-
Government External Debt Service	263	817	420	415	1,914	466	452	442	432	1,791	608	603	598	594	2,403
Amortization	139	726	312	325	1,502	343	332	324	317	1,316	449	445	442	438	1,774
Interest	124	91	108	90	413	124	120	117	114	475	159	158	156	155	628
Bank recapitalization and one-off costs linked to the civil service reform	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Estimated cost of liquidating the Banque Franco Tunisienne (in millions of TD)	...	...	...	...	...	-	-	-	400	400	-	-	-	-	-
FX swaps between the CBT and the commercial banks 2/	225	195	295	570	570	...	...	...	...	...	...	...	...	...	...
FX swaps between the CBT and the commercial banks (in millions of TD) 2/	453	393	594	1,147	1,147	...	...	...	...	...	...	...	...	...	...
Resident deposits at the BCT, including FX swaps 2/	1,185	1,158	1,391	1,794	1,794	...	...	...	...	...	...	...	...	...	...

Sources: Tunisian authorities and IMF staff estimates.

1/ The SDR/USD exchange rate used for the conversion of IMF disbursements is 0.7391 in 2017 and 0.7399 in 2018.

2/ From 2018 onwards, the adjuster on FX swaps between the Central Bank of Tunisia and commercial banks, and that on residents' FX deposits at the Central Bank of Tunisia will no longer apply.

L. Monitoring and Reporting Requirements

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

Information to Be Reported in the Context of the Program

Type of Data and Description	Periodicity	Delay (in Days)	Responsible Department
	Weekly (w)		
	Monthly (m)		
	Quarterly (q)		
Real Sector			
GDP: Supply and demand at current, constant, and the previous year's prices, including sectoral indices.	q	45	INS
Inflation: Including the underlying inflation of non-administered and administered prices.	m	14	INS
Fiscal Sector			
Tax and nontax revenue of the central government, decomposed on the basis of main tax and nontax revenues items.	m	30	MoF
Total expenditures: current and capital, transfers and subsidies.	m	30	MoF
Capital expenditure: by type of financing: domestic and external (differentiating loans and grants), and by main sectors and projects (agriculture, social, infrastructure).	m	45	MoF
Current expenditure: by type of expenditure: wages, goods and services, transfers.	m	45	MoF
Social expenditure.	q	45	MoF
Domestic and foreign debt:			
Stock of domestic and foreign debt: of the central government and debt guaranteed by the government, with breakdown by instrument and type of currency (in dinars and foreign currency with the equivalent in domestic currency).	q	30	MoF
Stock of domestic arrears as per TMU, as well the stock of accounts payable that correspond to expenditures committed/payment ordered more than 90 days before (and by type of expenditures).	q	45	MoF
Disbursement of foreign loans: Breakdown into project loans and budgetary loans by principal donor and identifying the most important projects to be financed in the original currency and its equivalent in Tunisian dinars converted at the current exchange rate at the time of each transaction.	m	30	MoF
Domestic borrowing from banks and nonbanks: including bonds, Treasury bills, and other issued securities.	m	30	MoF
Debt guaranteed by the government: by instrument and type of currency (in dinars and in foreign currencies and its equivalent in national currency).	m	60	MoF
External and domestic debt service: amortization and interest.	m	60	MoF
External payment arrears: external debt contracted and guaranteed by the government.	q	30	MoF/CBT
Debt rescheduling: possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	q	45	MoF
Consolidated accounts of the central government at the CBT: with a breakdown of the stock of deposits as follows: (i) Treasury current account; detailed by sub accounts of the central government, N BIS, outstanding payments, Public administrative entities (EPA), and local governments (ii) special account of the Tunisian government in foreign currency and its equivalent in dinars; (iii) miscellaneous dinar accounts; (iv) loan accounts; (v) grant accounts; (vi) FONAPRA-FOPRODI accounts; and (vii) Foreign exchange accounts pending adjustment in dinars (available).	m	30	CBT MoF/TGT for sub-account

Information to Be Reported in the Context of the Program (continued)

External Sector				
Imports of petroleum products: average import price and volume of main petroleum products.	m	30	CBT	
Deposits: Stock of foreign currency deposits, according to the residence of the holder.	m	14	CBT	
External debt:				
Debt service (amortization and interest) of institutional agents by type of currency (in foreign currency and its equivalent in dinars).	q	30	CBT	
Total disbursements of external debt of institutional agents by type of currency (in foreign currency with its equivalent in dinar)	q	30	CBT	
Stock of external debt of institutional agents by type of currency (in foreign currency and its equivalent in dinars).	q	90	CBT	
Overall net external position of Tunisia (in conformity with our obligations under SDDS).	a	180	CBT	
Balance of payments: Prepared by the CBT.	q	30	CBT	
Monetary and Financial Sector				
CBT accounts at the current exchange rate: Monthly situation of the Central Bank by sector (figures at the end of the period).	m	15	CBT	
Reserve money and net domestic assets (NDA): Monthly forecast.	m	15	CBT	
Monetary policy operations and liquidity factors: Daily and monthly balances. Detailed table including: i) intervention on the money market of the central bank (Dinars); (ii) deposit facility; iii) ordinary tenders iv) loan facility; (v) overnight lending; vi) repo at 1-7 days and 3 months; vii) FX swap exchange; viii) open market operations; (ix) minimum reserves; and x) excess reserves.	m	15	CBT	
Monetary survey at the current exchange rate: Monthly balance of the banking sector, counterparts of broad money, leasing banks, and resources of the resident financial system; preliminary (30 days) and definitive (45 days).	m	30 and 45 days	CBT	
Interest rates of financial operations: Detailed tables on lending and savings rates and effective global tariffs produced by the Observatory of Financial Inclusion.	m	30	CBT	
Credit data: Monthly data on credit distribution by sector (private/public); credit to enterprises (by economic sector); and credit to individuals (by purpose).	m	30	CBT	
Foreign exchange market operations, interbank market, retail market and wire transfers for CBT purchases on the retail market:	w	1	CBT	
<p>CBT interventions (sales and purchases) on the foreign exchange market in million of dinars (and equivalent in US million) including total market transactions, foreign exchange sales to energy companies and all exchange rates for all such transactions, total FX demand by banks, total FX positions of banks, stock of CBT currency swap (provide details on direction of transactions (TND/FX or FX/TND), amounts of principal, spot exchange rate in swaps agreement, interest rate applied on FX counterpart), detailed information on other BCT's forward foreign exchange operations, including outright forward sales of Tunisian dinar. The terms and conditions of any new transactions (including the extension or renewal of existing terms and conditions) will also be provided.</p> <p>CBT foreign exchange reserves, breakdown by currency and by instrument.</p>				

Information to Be Reported in the Context of the Program (concluded)

Type of Data and Description	Periodicity Weekly (w) Monthly (m) Quarterly (q)	Delay (in Days)	Responsible Department
IMF account statements: Monthly consolidated statements of the IMF No. 1, No. 2, and Securities Account.	m	30	CBT
Banks' financial soundness ratios: Indicators of financial soundness and regulatory capital adequacy ratios of the banking system, including the quality of assets and the profitability of banks. The indication of the different banks is optional.	m	30	CBT
Direct refinancing of commercial banks by the CBT: Breakdown by bank.	m	14	CBT
NPLs: Stock of banking sector NPLs and breakdown by commercial banks.	q	60	CBT
Balance sheets of commercial banks, including detailed income statements, in accordance with "Uniform Bank Performance Reporting" agreed with Fund staff.	q	60	CBT
Other Information to Be Reported			
Information on fiscal, monetary, and financial policy: Decrees or circulars newly adopted or revised concerning changes in tax policy, tax administration, foreign exchange market regulations, and banking regulations. A copy of official notices of changes in gas and electricity rates and any other surcharge (automatic or structural), as well as the prices of petroleum products and levies/surcharges on gas and petroleum.	d	3	CBT/MoF
Petroleum: Price structure of the petroleum products and the needed data to monitor the automatic adjustment mechanism (formulas and data).	d	15	Min. of Energy



TUNISIA

March 14, 2018

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION,
SECOND REVIEW UNDER THE EXTENDED FUND FACILITY,
AND REQUEST FOR WAIVERS OF NONOBSERVANCE OF
PERFORMANCE CRITERIA, AND REPHASING OF ACCESS—
INFORMATIONAL ANNEX

Prepared By

The Middle East and Central Department (in consultation
with other departments)

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RELATIONS WITH THE FUND

(As of March 2018)

Membership Status:

Date of membership: April 14, 1958

Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	545.20	100.00
Fund holdings of currency	1017.93	186.71
Reserve position in the Fund	56.45	10.35

SDR Department

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

Outstanding Purchases and Loans

	SDR Million	Percent Quota
EFF	454.5833667	83.37919418

Latest Financial Arrangements

(SDR million)

Type	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
EFF				
Stand-by	June 7, 2013	December 31, 2015	1,146.00	787.88
EFF	July 25, 1988	July 24, 1992	207.3	207.3
Stand-by	November 4, 1986	May 31, 1988	103.65	91

Projected Payments to Fund 1/

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming			
	2017	2018	2019	2020
Principal	30.26	292.06	274.38	126.38
Charges/Interest	5.51	22.8	34.79	39.63
Total	35.77	314.86	309.17	166.01

1/ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Safeguards Assessments

The first-time safeguards assessment of the Central Bank of Tunisia (CBT) was finalized in June 2013 and an update assessment was completed in May 2016. The assessment found that the CBT had made some progress in strengthening its safeguards framework, including operationalizing its audit committee (AC), drafting amendments to the Central Bank law that include a lender of last resort (LOLR) provision, and establishing internal audit as a separate unit. In addition, the CBT's external audit arrangements continued to be sound and the audited financial statements were published on a timely basis. However, risks remained and steps were needed to address prior recommendations to strengthen the autonomy provisions in the Central Bank law, implement a risk-based internal audit methodology, and adopt more transparent financial reporting practices.

Exchange Rate Arrangement

Tunisia accepted the obligations of Article VIII Sections 2(a), 3, and 4 effective January 6, 1993. Tunisia maintains the following measures subject to Fund approval under Article VIII, Sections 2(a) and 3: (a) an exchange restriction arising from the measures that restricts access to short-term financing for current international transactions that was customarily available; and (b) a multiple currency practice resulting from honoring exchange rate guarantees extended prior to August 1988 to development banks, which will automatically expire after maturity of existing commitments (total loans covered by these guarantees amount to about US\$20 million).

The de facto exchange rate arrangement is classified as crawl-like, and the de jure exchange rate arrangement is floating. In April 2012, the CBT replaced its currency composite by a fixing (i.e. the average of market participants' quotes) as the reference exchange rate. Since then, the CBT has been intervening in the foreign exchange (FX) market through bilateral transactions when market quotes deviated substantially from the fixing rate of the day. The rates quoted by the CBT had been based on the currency composite and updated continuously to reflect the exchange rates prevailing in the international FX market.

Article IV Consultation

Since June 2016, Tunisia has been under a four-year EFF program with semiannual reviews. The last Article IV consultation was concluded by the Executive Board on September 30, 2015.

FSAP Participation and ROSCS

The last Financial Sector Assessment Program (FSAP) was conducted in 2002, and subsequently updated in 2006 and January 2012.

AML/CFT Assessment

Tunisia is on the Financial Action Task Force (FATF) list of countries that have been identified as having strategic anti-money laundering and countering the financing of terrorism (AML/CFT) deficiencies. The last FATF Mutual Evaluation Report on the implementation of AML/CFT standards from 2016 rated Tunisia low or moderate in all eleven criteria for effectiveness (immediate outcomes). However, owing to the lack of sufficient progress in improving the its AML/CFT regime, the FATF included Tunisia in its November 2017 “gray list” of jurisdictions with significant AML/CFT deficiencies. The authorities are currently implementing an action plan agreed with the FATF to address significant AML/CFT shortcomings. The IMF is providing capacity development to assist the Tunisian authorities in strengthening the AML/CFT framework.

Capacity Development

IMF capacity development activities have continued to grow since 2011, both from the IMF and the Middle East Regional Technical Assistance Center (METAC).¹ Tunisia has been receiving IMF technical assistance (TA, see list below) and sent officials to participate in courses (at the IMF Headquarters in Washington, D.C., USA, and METAC in Beirut, Lebanon) in several areas of macroeconomic analysis and management.

Resident Representative

The representative office was opened in Tunis in January 2014. Mr. Robert Blotevogel was appointed the IMF Resident Representative in Tunisia in January 2016.

¹ Tunisia joined METAC in May 2016.

Tunisia: Technical Assistance, January 1996–January 2018

Purpose	Date
Finance Department (FIN)	
• Safeguards assessment	Feb. 2013, Jan. 2016
Fiscal Affairs Department (FAD)	
• Assessment of the revenue impact of the Association Agreement with the European Union	Jan. 1996
• Reform of the tax system	Jan. 2005
• Modernization of the tax administration	Sep. 2005
• Tax policy diagnosis, including of the oil regime	Dec. 2012
• Modernization of the tax administration and reform of the customs administration	Jan. 2013
• Modernization of public finance management (PFM)	Aug. 2013
• Fuel price mechanism	Aug. 2013
• Follow-up on tax administration reform	Mar. 2014
• Budget execution and control	Jun. 2014
• Development of a reform plan for the tax administration	Jun. 2014
• Refinement of the tax reform strategy, especially indirect taxation	Jun. 2014
• Accounting and fiscal reporting	Jul. 2014
• Engagement with new authorities and support for the tax administration reform program	Mar. 2015
• Personal income taxation, esp. proposals for the 2016 budget	May 2015
• Recent trends in the civil service wage bill and the factors contributing to the trend	Jan. 2016
• Cash management, SOE oversight, and fiscal risks management (jointly with METAC)	Oct. 2016
• Review of proposed revenue measures for the 2018 budget and assessment of their compatibility with the envisaged broader tax reform	Mar. 2017
• Support for the Tunisian authorities' tax administration reform program	Mar. 2017
• Treasury Single Account (TSA) and cash management (jointly with FAD)	Sep. 2017, Jan. 2018
• Review of the medium-term tax policy reform	Dec. 2017
• Public Investment Management Assessment (PIMA)	Jan. 2018
Institute for Capacity Development (ICD)	
• Identification of training needs of the Central Bank of Tunisia (CBT)	Nov. 2011
• Institutional capacity assessment of the CBT (jointly with MCM)	Sep. 2014
Legal Affairs Department (LEG)	
• Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT)	Dec. 2003
• AML/CFT supervisory training of the financial market supervision authority and the stock exchange	Feb. 2008
• Banking law and banking resolution framework	Mar. 2014
• Central banking law and banking law	May 2014
• Strengthening the framework for combating the financing of terrorism (CFT)	Jan. 2018
Middle East Regional Technical Assistance Center (METAC)	
• Cash management, SOE oversight, and fiscal risks management (jointly with FAD)	Oct. 2016
• Review of the banking regulatory and supervisory framework (jointly with MCM)	Jan. 2017
• National Accounts Statistics	Jan. 2017
• Establishing an internal rating tool for the assessment of bank loans (jointly with MCM)	Mar. 2017
• Treasury Single Account (TSA) and cash management (jointly with FAD)	Sep. 2017, Jan. 2018
• Managing the fiscal risk from state-owned enterprises	Sep. 2017
• Consolidated banking supervision (jointly with MCM)	Nov. 2017
• Strengthening of the Large Taxpayers Office (LTO)	Nov. 2017
• Review of the banking regulatory and supervisory framework (jointly with MCM)	Jan. 2018

Tunisia: Technical Assistance, January 1996–January 2018 (concluded)

Purpose	Date
Monetary and Capital Markets Department (MCM)	
• Accounting and auditing	Oct. 2003
• Monetary operations (non-resident acquisition of treasury bills)	Oct. 2003
• TA needs assessment	May 2004
• Financial supervision	Sep. 2004
• TA needs assessment	Feb. 2006
• Monetary operations	Feb. 2007
• Foreign exchange (FX) market operations	Nov. 2011
• Monetary policy	Apr. 2012
• Arab Debt Market Development Initiative (ADMDI)	Jul. 2012
• Bank supervision	Feb. 2013
• Institutional capacity assessment of the CBT	Apr. 2013
• Collateral framework	Apr. 2013
• Bank supervision	May-Sep. 2013
• Bank supervision	Mar. 2014
• Establishing an emergency liquidity framework	Mar. 2014
• Bank supervision (long-term expert)	Sep. 2014–Sep.
• Institutional capacity assessment of the CBT (jointly with ICD)	Sep. 2014
• Introducing a FX auction	Nov. 2014
• Risk-based supervision framework	Apr. 2015
• Emergency liquidity assistance	Nov. 2015
• Bank restructuring	Dec. 2015
• Bank restructuring	Feb. 2016
• Preparation of an emergency liquidity assistance (ELA) master agreement and monetary policy operational manual	Apr. 2016
• Supervision of money laundering risks	May 2016
• Project assessment and management	Oct. 2016
• Bank supervision and regulations (long-term expert)	Nov. 2016–Jan. 2018
• Review of the banking regulatory and supervisory framework (jointly with METAC)	Jan. 2018
Statistics Department (STA)	
• Balance of Payments methodological guidelines according to <i>BMP5</i>	Mar. 1997
• Quarterly National Accounts Statistics	May 1999
• Special Data Dissemination Standard (SDDS) assessment	May 1999
• SDDS assessment	Jul. 2000
• Quarterly National Accounts Statistics	Oct. 2000
• Government Finance Statistics	Jul. 2004
• Report on Observance of Standards and Codes (ROSC)	Apr. 2005
• Standardized Report Forms (SRFs) data development	Feb. 2013
• Monetary data reported in SRFs and Financial Soundness Indicators (FSI)	Feb. 2014
• Balance of Payments Statistics	Dec. 2014
• National Accounts Statistics	Jun. 2015
• Government Finance Statistics (jointly with FAD)	Nov. 2015
• Prices and index numbers	Oct. 2016
• National Accounts Statistics	Jan. 2017
• Residential property price index	May 2017
• Monetary data reported in Standardized Report Forms (SRFs)	Jan. 2018
• National Accounts Statistics	Jan. 2018

RELATIONS WITH THE WORLD BANK GROUP

(As of January 2018)

Country Strategy

A Country Partnership Framework (CPF) outlines the World Bank Group's (WBG) support to post-revolution Tunisia. Jointly prepared by the International Bank for Reconstruction and Development (IBRD), International Finance Cooperation (IFC), and Multilateral Investment Guarantee Agency (MIGA), it covers FY16 through FY20. It anchors on the Tunisian government's "Note d'Orientation Stratégique" from September 2015 and the WBG's Strategy for the Middle East and North Africa Region from October 2015. WBG analytics underpin the CPF, including the Systematic Country Diagnostic (SCD) from June 2015. It outlines Tunisia's post-revolution development challenges and identifies the deep-rooted causes of social unrest that are threatening stability and cohesion. The CPF focuses on three areas: (i) jobs, to restore a business environment conducive to sustainable economic growth and private-sector-led job creation; (ii) lagging regions, to reduce regional disparities; and (iii) vulnerability, to increase social inclusion. In addition, governance and gender equity issues will be integral parts of all WBG initiatives under the CPF.

A mid-term review of the CPF is currently ongoing. After concluding in FY19, the review may lead to an extension of the CPF for an additional year through FY21. The CPF left open the programming for FY19 and FY20. A Risk and Resilience Assessment (RRA) identified the following constraints: (i) a fundamental lack of trust in public institutions and toward the state because of the delay of the renewal of the social contract; (ii) a weak performance of the state and overall weak reform implementation; (iii) a serious level of political exclusion with difficult access to politicians/political activity and the administration, which contrasts with easy access to social and religious activity; (iv) serious problems related to the access to economic activity/employment, constraints of the private sector, limited development of the value chain and connectivity, difficult access to financing and administrative process; (v) continuous significant regional disparities, with issues of social exclusion and stigmatization; and (vi) the persistence of regional security threats.

Recent Lending Activity

The WBG has committed to ramping up its support to Tunisia. Following his visit to Tunisia in 2016, World Bank President Kim reaffirmed the WBG's readiness and willingness to "help and to support the country's leadership in tackling economic challenges especially for young people" and to implement reforms. He announced a lending of US\$5 billion over a five-year period.

Lending commitments are at their highest ever. They stand at US\$1,552 million in early 2018. The lending volume for FY18 alone covers 6 projects with commitments of US\$930.81 million. Besides, the Advisory Services and Analytics (ASA) comprises 33 activities with cumulative expenses estimated at US\$9.05 million, planned in FY18.

Current Portfolio

Tunisia's current active portfolio contains loans and grants. Totalling 14 projects and net loan commitments of US\$1,567 million, the portfolio includes: (i) eight Investment Project Financing (IPF) operations totaling US\$752 million; (ii) a Program for Results (P4R) operation supporting municipal services with US\$300 million; (iii) a fully disbursed Development Policy Financing (DPF) operation of US\$500 million; and (iv) four grants amounting to US\$16 million. Altogether, US\$632 million remain undisbursed (40 percent of the total commitment), with an average project age of 3.9 years.

Especially IPF commitments have seen an increase. Total disbursements stand at US\$243 million (or roughly one third of the commitment). However, standing at 8.9 percent, the current annual IPF disbursement ratio lags both the December FY18 target of 20 percent and the December 2017 target of 9.9 percent. This mainly owes to delays in the following projects: Urban and Water Supply AF, Northern Tunis Wastewater, Tertiary Education for Employability, Road Transports Corridors, the MSME Financing facility and the Third Export Development Project. Among the grants two have been extended: DTF Social Protection Reforms Support and Tunisia Social Accountability.

Several lending operations are in the pipeline, currently projected at US\$641 million in the second half of FY18 and US\$530 million in the first half of FY19.

Tunisia: WBG—Active Portfolio
(In US dollars)

Lend. inst.	Proj. ID	Project Name	Board app.	Rev. closing	Net comm. amt.	Tot. disb.	Undisb. bal.	Tot. undisb. (begin FY)
IPF	P132381	TN-Third Export Development Project	6/16/2014	12/31/2020	50	12	36	37
	P064836	TN-Urban Water Supply	11/17/2005	6/30/2018	64	44	23	25
	P117082	TN-Northern Tunis Wastewater	6/17/2010	12/31/2019	57	25	32	37
	P151059	TN-Tertiary Education for Employability	2/25/2016	12/31/2021	70	4	65	65
	P151030	Integrated Landscapes Management Project	3/15/2017	3/29/2024	100	0	100	100
	P158138	Youth Economic Inclusion Project	9/11/2017	1/31/2024	60	-	60	-
	P146502	TN-Road Transport Corridors	7/14/2015	12/31/2020	200	46	154	162
	P124341	TN-MSME Financing Facility	7/14/2011	1/31/2018	150	112	18	24
	8				752	243	487	450
P4R	P130637	TN-Urban Dev. and Local Governance	7/24/2014	12/31/2019	300	132	138	163
	1				300	132	138	163
DPF	P158111	TN Business Environment&Entrepreneurship	6/13/2017	12/31/2018	500	537	-	536
	1				500	537	-	536
GEF	P120561	Tunisia: Ecotourism and B. Conservation	1/22/2013	7/31/2018	4	3	1	2
	P132157	TN-DELP Oases Ecosystems and Livelihoods	6/11/2014	11/30/2019	6	4	2	2
	P144674	DTF:TN Social Protection Reforms Support	10/23/2013	5/31/2019	5	2	3	3
GPSA	P150877	Tunisia -SAcc	11/27/2014	11/27/2018	1	0	1	1
	4				16	9	7	7
Total	14	IBRD and Trust Funds			1,567	921	632	1,156

Source: World Bank.

Tunisia: WBG—Project Pipeline for FY2018-19
(In US dollars)

Lend. inst.	Proj. ID	Proj. name	Commitments	Decision meeting	Negot.	Bank approval
FY18 Q3						
IPF	P164625	Tunisia-Italy Power Interconnector - Project Preparation TA	13	31-Jan-18	5-Feb-18	28-Feb-18
FY18 Q4						
IPF	P160245	Tunisia Irrigated Agriculture Intensification Project	128	22-Feb-18	27-Mar-18	17-May-18
DPF	P161483	Tunisia DPF 2018	400	17-Apr-18	3-May-18	18-Jun-18
IPF	P162297	Strengthening Foundations for Learning Project	100	13-Feb-18	26-Mar-18	22-May-18
FY19 Q1						
PforR	P162165	Tunisia Water Sector Reform Project	150		30-May-18	27-Sep-18
IPF	P162957	Tunisia Sanitation PPP Support Project	130	22-Jan-18	5-Feb-18	TBD
FY19 Q2						
PforR	P151011	Tunisia State-Owned Banks Restructuring P4R	250	18-Sep-18	8-Oct-18	8-Nov-18

Source: World Bank.

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK

(As of January 2018)

Country Strategy

The African Development Bank (AfDB) approved a new Country Strategy Paper (CSP) in June 2017. Covering 2017–21, it builds on lessons learned from interim CSPs since 2011 and aligns with the Tunisian government’s Five-Year Development Plan 2016–20. In view of the strategic directions of the AfDB’s 2013–22 long-term strategy and its High Five priorities (High 5s), the goal of the CSP is to support Tunisia in implementing its Sustainability Development Plan 2016–20 through two pillars: (i) industrialization and value chains development; and (ii) improvement of the quality of life for people in lagging regions. Pending the sustainability of the macroeconomic environment, the AfDB plans to invest between US\$700 million and US\$1.5 billion in support of this strategy.

Recent Lending Activity

AfDB lending to Tunisia picked up recently. Net loan commitments currently reach UAC 1,604 million.² Since 2016 alone, the AfDB approved new 12 operations worth UAC 899 million: three in finance (UA 283 million), two in agriculture (UA 33 million), one in communication (UA 60 million), one in transport (UA 103 million), two in water and sanitation (UA 166), and three in the social area (UA 315 million). All these operations are merely loans with a maturity period of five years.

Current Portfolio

The performance of the Tunisia’s global portfolio is overall satisfactory. It totals UAC 1.6 billion, mainly in loans (98.8 percent) and an average age of 2.9 years. Operations mainly focus on the public sector (85 percent) and the areas of transport (27 percent), finance (25 percent), and social issues (19 percent). The global disbursement rate of 68 percent owes to a higher disbursement rate in the private sector (95 percent) than in the public sector (58 percent). Besides, technical assistance grants represent 1 percent of grants and 99 percent of loans in the global portfolio. Mainly financed out of the Trust Fund for Countries in Transition (TFCT) and Trust Fund for Countries in Transition (TFT), their disbursement rate stands at 21 percent.

² The AfDB’s Unit of Account (UAC) is equivalent to one IMF Special Drawing Right (SDR).

Tunisia: AfDB—Active Portfolio (In Unit of Account)

Proj. name	Sector	Approval date	Curr.	Net loan	Disb. ratio	Disb. amount	Planned proj. completion date
Total				1,604,068,232	73%	1,173,605,259	
ETUDE-GESTION DES RISQUES ET MISE EN PLACE D'UN SYSTEME D'AS	Agriculture	8/2/2016	UAC	325,000	2	6,270	12/31/2018
PROJET DE DEVELOPPEMENT AGRICOLE INTEGRE DU NORD DE GAFSA	Agriculture	2/13/2013	UAC	18,623,628	41	7,712,212	6/30/2019
PROJET DE DEVELOPPEMENT AGRICOLE INTEGRE (PDAI) DE GABES II	Agriculture	11/26/2014	UAC	17,391,597	33	5,680,377	6/30/2020
DON MIC POUR LA PREPARATION DU PDAI DE ZAGHOAUN	Agriculture	10/27/2014	UAC	390,000	45	176,938	12/31/2018
PROJET DE VALORISATION DES PI A TRAVERS LE DEVELOPPEMENT DES	Agriculture	10/25/2017	UAC	23,745,442	0	0	6/30/2023
PROJET DE VALORISATION DES PI A TRAVERS LE DEVELOPPEMENT DES	Agriculture	10/25/2017	UAC	8,782,538	0	0	6/30/2023
TRANSFORMATION STRUCTURELLE ET APPUI AUX CRENEAUX PORTEURS	Ind./Min./Quar.	8/14/2015	UAC	798,310	5	37,714	2/28/2018
PROJET D'APPUI A LA MISE EN PLACE D'UNE POLITIQUE INDUSTRIEL	Ind./Min./Quar.	8/14/2015	UAC	791,380	0	0	8/31/2017
ETUDE DU PLAN DIRECTEUR NATIONAL DES TRANSPORTS A L'HORIZON	Ind./Min./Quar.	7/14/2014	UAC	800,000	33	264,576	6/30/2017
ENFIDHA AIRPORT PROJECT	Transport	1/14/2009	UAC	57,209,209	100	57,209,209	1/1/2023
CONSTRUCTION LIAISON AUTOROUTIERE GABES-RAS-JEDIR	Transport	6/21/2011	UAC	115,657,659	47	54,528,228	10/31/2019
PROJET DE MODERNISATION DES INFRASTRUCTURES ROUTIERES (PMIR)	Transport	10/28/2015	UAC	121,266,221	18	22,190,034	12/31/2020
PROJET DE MODERNISATION DES INFRASTRUCTURES ROUTIERES (PMIR)	Transport	10/28/2015	UAC	38,838,876	19	7,284,395	12/31/2020
PROJET DE MODERNISATION DES INFRASTRUCTURES ROUTIERES (PMIR)	Transport	10/28/2015	UAC	1,200,000	0	0	12/31/2020
PROJET D'APPUI A LA CONNECTIVITE ROUTIERE DANS LE NORD-EST D	Transport	11/22/2017	UAC	102,739,438	0	102,739,438	12/31/2023
PROGRAMME D'AEP EN MILIEU RURAL (AEP R)	Water Sup/Sanitary	10/12/2011	UAC	79,850,438	89	71,070,118	12/31/2018
PROGRAMME D'APPROVISIONNEMENT EN EAU POTABLE EN MILIEU RURAL	Water Sup/Sanitary	9/6/2016	UAC	104,171,053	4	4,210,633	12/31/2021
PROGRAMME D'APPROVISIONNEMENT EN EAU POTABLE EN MILIEU RURAL	Water Sup/Sanitary	9/6/2016	UAC	842,127	10	84,213	12/31/2021
SYSTEME D'INFORMATION SUR L'EAU DE LA TUNISIE	Water Sup/Sanitary	12/22/2009	UAC	1,661,516	100	1,661,516	6/30/2017
ELABORATION DE LA VISION ET DE LA STRATEGIE EAU 2050 DE LA T	Water Sup/Sanitary	6/20/2016	UAC	1,132,660	0	0	12/31/2019
PROJET D'AMELIORATION DE LA QUALITE DES EAUX EPUREES	Water Sup/Sanitary	1/11/2012	UAC	27,327,006	41	11,149,412	12/31/2018
PROJET DE DEVELOPPEMENT DU RESEAU DE TRANSPORT ET DE DISTRIB	Power	4/1/2015	UAC	41,592,630	0	0	12/31/2017
SOUTH TUNISIAN GAZ PIPELINE - TUNISIA	Power	6/26/2014	UAC	52,663,732	100	52,663,732	8/19/2027
APPUI A LA MISE EN ŒUVRE DU PLAN NATIONAL STRATEGIQUE (PNS)	Communications	11/8/2017	UAC	60,262,575	0	60,262,575	12/31/2019
II ^e LIGNE DE CREDIT A LA BANQUE DE L'HABITAT	Finance	2/27/2002	UAC	24,000,606	100	24,000,606	12/31/2006
BANQUE HABITAT TUNISIE - LOC II	Finance	7/21/2003	UAC	67,370,123	100	67,370,123	3/31/2008
SME APEX FACILITY TUNISIA	Finance	7/13/2011	UAC	35,109,154	70	24,726,125	7/22/2021
LIGNE DE CREDIT POUR LE FINANCEMENT DU COMMERCE POUR LA BH T	Finance	10/19/2016	UAC	50,527,592	100	50,527,592	8/27/2020
PROGRAMME PMES AFRICAINES - LOC HANNIBAL LEASE	Finance	7/14/2017	UAC	6,737,012	0	6,737,012	7/8/2018
PROGRAMME D'APPUI A LA MODERNISATION DU SECTEUR FINANCIER	Finance	7/13/2016	UAC	225,689,912	100	225,689,912	12/31/2017
PROGRAMME D'APPUI AU DEVELOPPEMENT DES COMPETENCES TECHNIQUE	Social	12/4/2017	UAC	60,633,111	0	60,633,111	12/31/2022
PROGRAMME D'APPUI AU DEVELOPPEMENT REGIONAL INCLUSIF (PADRI)	Social	11/2/2016	UAC	151,582,777	100	151,582,777	12/31/2017
PROGRAMME D'APPUI AU DEVELOPPEMENT REGIONAL INCLUSIF PADRI I	Social	11/3/2017	UAC	102,739,438	100	102,739,438	12/31/2018
MIC - PROJET D'APPUI A LA PROMOTION DES INVESTISSEMENTS ET D	Social	6/3/2015	UAC	296,373	0	0	6/30/2018
PROJET D'APPUI A L'OPERATIONALISATION DU PLAN D'ACTION DE L	Multi-Sector	12/27/2013	UAC	530,100	41	219,455	6/30/2019
OPERATIONALISING PPPS IN TUNISIA (PPP ADVISORY)	Multi-Sector	6/14/2013	UAC	789,000	57	447,520	6/30/2018

Source: African Development Bank

Tunisia: AfDB—Total Grant Projects for Technical Assistance (In Unit of Account)

No.	Proj. name	SD	Approved amount	Disb. rate	Disb. amount
Total			13,871,215	22%	3,076,638
1	AMELIORATION DES BAD PROJETS (MENA)	RDGN0	351,312	86	300,723
2	APPUI PME - FIN NON BANCAIRE (MENA)	RDGN3	1	0	
3	PROMOTION DE L'EMPLOI EN TUN (MENA)	AHWS1	66,000	90	59,664
4	SOUK ATTANMIA (MENA)	RDGN0	647,000	89	577,836
5	SOUK AT-TANMIA II (MENA)	RDGN0	1,675,102	78	1,301,387
6	SYSTEME D'ASSISTANCE SOCIALE (MENA)	AHWS1	249,000	88	218,273
7	DESIGN & IMPL ECON & SOC REF (TFCT)	RDGN0	1,830,000	0	-
8	ENHANCING DOMESTIC RM(TFCT)	ECGF	2,843,900	19	550,295
9	ENHANCNG GOVERN & ECO GROWTH(TFCT)	RDGN0	2,298,900	0	-
10	OPERATIONALIZING PPPS(TFCT)	PESDO	1,400,000	5	68,460
11	WORK READINESS PROJECT(TFCT)	RDGN0	2,460,000	0	-
12	RESULTS REPORTING CONSULTANT(KOREA TF)	ORRU0	50,000	0	-

Source: African Development Bank

RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

(As of January 2018)

Country Strategy

The European Bank for Reconstruction and Development (EBRD) is operating in Tunisia under the country assessment operational priorities approved in August 2013. The first country strategy will be prepared in the first half of 2018. The country assessment priorities are as follow:

- *restructuring and strengthening the financial sector* to support private-sector development;
- *financing private enterprises*, with a focus on small- and medium-size enterprises (SMEs), to boost the creation of high-quality private sector jobs and develop a resilient and diverse economy;
- *supporting energy efficiency and the development of a sustainable energy sector* to improve energy security, sustainability and economic competitiveness; and
- *facilitating non-sovereign financing for infrastructure development* to provide wider access to better quality urban and efficient public services.

Recent Lending Activity

The EBRD is accelerating its engagement in Tunisia. In 2017, it invested a record Euro 325 million (compared to Euro 61 million in 2016) across 12 projects. Those included 11 projects in the private sector, doubling to Euro 650 million its cumulated financing since it started its operations in 2013.

Current Portfolio

EBRD operations support three key areas:

- *restructuring and strengthening of the financial sector.* The EBRD provided several micro, small and medium enterprise (MSME) credit lines and trade finance facilities to local banks, microfinance and leasing institutions, for a total of Euro 75 million in 2017, including two lines in local currency. It also supported the modelling of a dynamic sovereign benchmark yield curve reflecting market activity, intending to align the local bond market with international standards and provide a transparent and efficient benchmark for pricing of sovereign and corporate bonds. In coordination with the IMF, the EBRD also provided assistance to the CBT on the preparation of the law and decree creating the Deposit Guarantee Fund. It is also assisting the Ministry of Finance to further develop Tunisia's legal framework, including by amending a law to improve the efficiency of debt collection companies.

- *development of the corporate and SME sector.* The EBRD provided a Euro 15 million senior loan to aircraft parts manufacturer Figeac Aero to finance the expansion of its subsidiaries in Tunisia, which also includes an apprenticeship program for young technicians. It provided a Euro 25 million senior loan to software company Vermeg to support its bid on a UK listed company, a landmark (on-going) mergers and acquisition (M&A) transaction in Tunisia. It continued to provide financing to olive oil operators to develop Tunisian-branded olive oil, and to work with Food and Agriculture Organization (FAO) on strengthening value chains and innovation in the sector. It also supported 200 SMEs through business advisory, trained 200 women entrepreneurs, and delivered training to 1000 SMEs in the regions on using the new electronic public procurement platform.
- *infrastructure and energy.* Given the absence of PPPs in recent years and the credit profile of public utilities, the EBRD continues to lend on a sovereign basis. The EBRD signed its first transport project in Tunisia, through a Euro 160 million loan with the public rail company Société Nationale des Chemins de Fer Tunisiens (SNCFT), to upgrade and renovate two key routes in Tunisia's railway infrastructure (Tunis-Kasserine and Moknine-Mahdia), and enhance the network's capacity and performance. This is expected to reduce CO2 emissions by 14,000 tons per year and better integrate the North West and Center West governorates with the capital. The EBRD also provides advisory to the Ministry of Energy on the investment framework for its small scale renewable energy program.

Tunisia: EBRD—Active Portfolio

Indicator	Amounts
Portfolio	Euro 544 million
Number of active portfolio projects	31
Private sector (share of portfolio, 5-y rolling average)	66 percent
Debt share of portfolio	90 percent
Equity share of portfolio	10 percent
Financial institutions (share of portfolio)	Euro 167 million (31 percent)
Industry, commerce, agribusiness (share of portfolio)	Euro 126 million (23 percent)
Energy (share of portfolio)	Euro 72 million (13 percent)
Infrastructure (share of portfolio)	Euro 180 million (33 percent)

Source: EBRD.

STATISTICAL ISSUES

(As of March 2018)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision is adequate for surveillance but should be further strengthened.	
National Accounts: In December 2010, the National Institute of Statistics (NSI) published a revised national accounts series based on System of National Accounts 1993 (SNA 1993). Surveillance would benefit from the collection and dissemination of higher frequency data on employment, unemployment, and wages. Tunisia utilizes a periodicity and timeliness flexibility option for the labor market data category under the Special Data Dissemination Standard (SDDS). Since end-2011, quarterly employment and unemployment data are disseminated with a lag of three months.	
Government finance statistics: Tunisia produces annual and quarterly central government data applying the Government Finance Statistics Manual 1986 (GFSM1986). Data coverage should be improved by moving gradually to a general government concept, notably through the inclusion of social security. Timeliness of data availability and an update to the GFSM2014 statistical framework also remain priorities.	
Monetary statistics: The Central Bank of Tunisia (CBT) has not yet migrated to the Standardized Report Forms (SRFs) for monetary and financial statistics.	
Balance of payments: Statistics are generally adequate for surveillance, although greater details are needed for quarterly BOP data releases and development of a quarterly IIP.	
Financial indicators: Financial indicators are only available with significant lags and their accuracy is challenged by problems in the banking supervision information system and data base management.	
II. Data Standards and Quality	
Subscribed to the Special Data Dissemination Standard (SDDS) June 20, 2001.	A Report on the Observance of Standards and Codes (ROSC) was published on the IMF website on August 9, 2006.
III. Reporting to STA (Optional)	
Data are being reported for publication in the <i>International Financial Statistics (IFS)</i> , <i>Government Finance Statistics Yearbook</i> , <i>the Direction of Trade Statistics</i> , and the <i>Balance of Payments Statistics Yearbook</i> .	

Tunisia: Table of Common Indicators Required for Surveillance
(As of February 2018)

Data	Date of Latest		Frequency of 1/		
	Observation	Reception	Data	Reporting	Publication
National accounts					
• GDP/GNP	Oct. 2017	Dec. 2017	Q	Q	Q
• Consumer price index	Jan. 2018	Feb. 2018	M	M	M
Fiscal sector					
• General government /2: revenue, expenditure, balance and composition of financing /3	NA	NA	NA	NA	NA
• Central government: revenue, expenditure, balance and composition of financing/3	Dec. 2017	Feb. 2018	M	M	I
• Central government: Stocks of debt and guaranteed debt 4/	Dec. 2017	Feb. 2018	Q	Q	Q
External sector					
• External current account balance	Oct. 2017	Dec. 2017	Q	Q	Q
• Exports and imports of goods	Oct. 2017	Dec. 2017	M	M	M
• Gross external debt	Dec. 2017	Jan. 2018	A	A	A
• International investment position /5	NA	NA	A	A	A
• Exchange rates	Current	Current	D	D	D
• International reserve assets and reserve liabilities of the monetary authorities /6	Dec. 2017	Jan. 2018	M	M	M
Monetary sector					
• Reserve/base money	Dec. 2017	Feb. 2018	M	M	M
• Broad money	Dec. 2017	Feb. 2018	M	M	M
• Central Bank balance sheet	Dec. 2017	Feb. 2018	M	M	M
• Consolidated balance sheet of the banking system	Dec. 2017	Feb. 2018	M	M	M
• Interest rates /7	Current	Current	D	D	D

1/ Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I), and not available (NA).

2/ The general government consists of the central government (i.e. budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.

3/ Includes foreign, domestic bank, and domestic nonbank financing.

4/ Includes currency and maturity composition.

5/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

6/ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency, but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency, but settled by other means.

7/ Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

**Statement by Mr. Jafar Mojarrad, Executive Director for Tunisia,
Mr. Abdelali Jbili, Senior Advisor, and Ms. Monia Saadaoui Advisor
March 23, 2018**

On behalf of our Tunisian authorities, we thank Mr. Rother and his team for their hard work and the constructive discussions held in December 2017 during the Article IV consultation and the Second Review of the EFF-supported program. The Authorities concur with staff assessment and policy recommendations, which are broadly in line with their own reform agenda aimed at strengthening macroeconomic and financial stability and reviving growth and employment. They are also grateful to the Executive Board and management for their continued guidance and support.

Overview

Tunisia's economic and socio-political challenges, exacerbated by the legacy of the terrorist acts of 2015 and spillovers from the conflict in Libya, have not materially eased. While the new government that took office in August 2016 has shown determination to tackle these challenges, and has moved decisively in many areas, more time was needed to garner further political and social support in line with Tunisia's consensus-based decision-making process, which is necessary to nurture the young democracy, but has the drawback of slowing the pace of reforms. This factor, which is specific to countries in political transition, has largely contributed to the weak performance under this review, as evidenced by the missed quantitative performance criteria (QPC) and the completion of only two out of 14 structural benchmarks (SBs). However, considering the relatively good performance under the first review, the five prior actions that have been met for this review, the corrective policies that have been taken, and the strong actions agreed to by the unity government, the authorities see the overall performance since the inception of the program as encouraging, and are confident that delays and temporary setbacks will not sway them from pursuing their reform agenda.

The authorities are determined to restore macroeconomic stability and deepen structural reforms to achieve high inclusive growth that will generate increased employment and improve the well-being of the population. The policies outlined in the MEFP are geared to achieving these objectives, through fiscal consolidation, tight monetary policy to reduce inflation, a flexible exchange rate to bring down the large current account deficit and strengthening reserve buffer, banking sector reform to support growth and reduce financial sector vulnerabilities, and structural reforms to invigorate growth and employment.

Against this background, the authorities request a waiver of non-observance of all end-of-December 2017 QPCs and of the continuous PC related to the exchange restriction, approval of the exchange restriction until the end of 2018, as well as the quarterly review schedule, as indicated in the report, and completion of the second review under the EFF, and disbursement of an amount equivalent to SDR 176.7824 million.

Program Modalities

As highlighted in the report and MEFP, changes in program modalities and monitoring are proposed, shifting toward quarterly, instead of six-monthly reviews, the establishment of new monthly indicative targets on the ceiling of the CBT's net foreign exchange interventions, in addition to new quarterly quantitative performance criteria for March, June, September, and December 2018, with a re-phasing of access that has reduced the amount to be drawn upon completion of the current review. While in the staff view, this should address the risks of high inflation and loss of reserves going forward, the authorities hope that program modalities will revert to where they were at its inception as soon as meaningful progress is made on the macroeconomic and structural fronts to preserve ownership and policy credibility.

Recent Economic Developments and Outlook

The economic recovery firmed up in 2017, with real GDP growth reaching 1.9 percent, or almost twice the 2016 level. This was mainly the result of significant improvement in the security situation, renewed investor confidence, as well as good performance of agriculture and tourism-related services, underpinned by the recovery in Europe. However, growth is still too low to bring down the high unemployment rate of 15 percent and meet the population's expectations of improved living conditions.

Macroeconomic imbalances, however, deteriorated in 2017 with an elevated fiscal deficit, a rising current account deficit, a pickup of inflation, reflecting the combined effects of exchange rate depreciation, increases of domestic and world commodity prices, and lower than-expected growth. The tax rate adjustments introduced in the 2018 budget also exacerbated inflationary pressures. In response to these developments, the Central Bank of Tunisia (CBT) increased its key policy rate by 75 basis points, the third such an increase following those of 25 and 50 basis points in April and May 2017, respectively. The continued high import of consumer products and rising oil prices have had a significant impact on the balance of payments with a net decline in international reserves, which prompted the authorities to allow the dinar to depreciate by more than 10 percent in 2017.

The recovery is expected to gather pace in 2018 and the medium-term, gradually moving toward Tunisia's potential of about 4 percent. Buoyant growth in Tunisia's trading partners, increased investor confidence, and delayed positive effects of the exchange rate depreciation are likely to boost economic activity. Already exports have surged by 47 percent year-on-year in January 2018, or more than twice the growth of imports, which bodes well for better than expected balance-of-payment outcome this year. Obviously, this favorable outlook hinges on many factors, including steadfast implementation of reforms, and how the balance of risks will play out in a still uncertain global environment. In this regard, while the authorities appreciate the staff reference to upside risks, they find the Risk Assessment

Matrix shown in Annex II to be pessimistic, including the high risk associated with a deterioration of the security situation.

Fiscal Policy

The authorities are aware that strong and lasting fiscal consolidation is more than ever needed to achieve debt sustainability and create space for investment and social spending to support inclusive growth. Their medium-term consolidation strategy involves wide-ranging tax revenue measures, including a broadening of the tax base, reduction of tax incentives and exemptions, a gradual convergence of the tax regimes of the off-shore and on-shore sectors, and improvement in taxpayer identification and strengthened tax administration.

Sustained efforts will be directed at containing current spending, together with wide-ranging fiscal structural reforms, including civil service reform, subsidy reform, and efforts to strengthen the implementation capacity and efficiency of public investment projects. The authorities have adopted comprehensive plans to reform the civil service and the social security fund with assistance respectively from the US AID and the World Bank, and are pressing ahead with a reform of state-owned enterprises (SOEs). These efforts will go hand-in-hand with steps to strengthen social protection and improve the provision of basic social services.

The 2018 budget has made a good start on this front by introducing a package of tax revenue measures estimated to yield about 2.2 percent of GDP, comprising a rise in the VAT rates, increased excise duties for certain goods and services—mostly consumed by well-to-do categories of the population—and increases in certain import duties for budgetary reasons. These measures were designed to limit any negative impact on growth and job creation and will keep the overall tax burden on businesses and households practically unchanged since the exceptional tax measures introduced in 2017 were phased out (MEFP ¶19). Strengthened tax collection and reduction of exemptions will also help raise the tax revenue-to GDP ratio to 22.4 percent, a level broadly in line with peers. Non-tax revenue will be slightly above the programmed level, reflecting the positive impact of higher oil prices on oil sector profits. The authorities remain committed to applying the quarterly adjustment in energy prices in line with oil markets developments, and will make additional price adjustments to other energy products as needed to limit energy subsidies to 2 percent of GDP.

Sustained implementation of this fiscal strategy is expected to gradually reduce the overall fiscal deficit from 6 percent of GDP in 2017 to about 3.0 percent of GDP by 2020, and the wage bill to 12.4 percent of GDP from its current level of 14.7 percent. This will also help bring down public debt from 71 percent of GDP in 2017 to 63 percent by 2023. Moreover, the new public-private partnership (PPP) law will provide a framework for greater private sector participation in infrastructure investment while limiting contingent liabilities, and will reduce the need for budget financing.

Monetary and Exchange Rate Policy

The CBT has pursued a tight monetary policy stance since April 2017 to contain inflationary pressures. In addition to the three policy rate increases indicated above, in December 2017 the CBT widened the corridor around the key rate from 50 basis points to 200 basis points, and established in July 2017 a limit of 7 billion dinars on 7-day tenders with commercial banks. Moreover, to counter the persistent pressure on the current account balance emanating from higher imports of energy and consumer products, and to preserve the international reserve cover, it opted for greater exchange rate flexibility by allowing the dinar to depreciate in 2017. The authorities interpret staff assessment of the REER overvaluation of 10-20 percent as the upper bound of their own estimates.

Going forward, the CBT will remain vigilant, closely monitoring developments in monetary aggregates and liquidity and standing ready to further tighten monetary policy as needed to contain inflationary pressure. It will also continue to closely monitor the transmission mechanism to enhance monetary policy effectiveness while paying close attention to the need to support the ongoing fragile economic recovery. In pursuing a more flexible exchange rate policy, the CBT will strike the right balance between on the one hand containing the large current account deficit and rebuilding reserves, and on the other ensuring orderly conditions in the foreign exchange market while facilitating strategic imports of energy and food. The foreign exchange intervention budget agreed under the program, reflects key assumptions in these areas, including a recovery in exports and tourism.

Financial Sector

The authorities agree with staff's assessment that the banking sector is stable with limited foreign liabilities and small net open foreign exchange positions. The recent inspections of the seven largest private banks have confirmed the absence of major vulnerabilities. The current low liquidity across the banking system may be linked to the large increase in cash holding in the Tunisian economy, which the CBT is seeking to address, including through an upgrade of the payment system. Going forward, the growth recovery and the improvement in the regulatory and supervisory environment will further enhance the quality of bank balance sheets.

Further advances have been made in the restructuring of public banks, and other steps are planned (subject to SBs), including improving their risk management and facilitating a reduction of their non-performing loans (NPLs). Several laws, now waiting parliament approval, aim at simplifying write-off rules and improving the functioning of recovery firms. The authorities remain committed to strengthening financial sector stability, and have established a Financial Sector Reform Committee overseen by the Office of the Head of Government to coordinate financial sector reforms across sectors. They are also focused on promoting financial inclusion by improving access to finance for job-creating small and medium enterprises.

The Tunisian authorities are pressing ahead with reforms to fully comply with international the AML/CFT standards. In this regard, on March 11, 2018, the Government approved an action plan to address the deficiencies identified in November 2017 by the Financial Action Task Force (FATF) and MENAFATF, and echoed by the European Parliament in January 2018. The measures set out in the action plan, which will be implemented by end- June 2018 with IMF assistance, include: implementing risk-based AML/CFT supervision of the financial sector; maintaining comprehensive and updated commercial registries; increasing the efficiency of reporting suspicious transactions; establishing a fully functional terrorism-related financial sanctions regime; and suitably monitoring the NGO sector. Moreover, the authorities have strengthened the staffing and training of the financial intelligence unit and are preparing an AML/CFT supervisory manual.

Structural Reforms

Despite the continued fragile political and social situation, and the adverse regional environment, the authorities have remained committed to advancing their reform agenda under the EFF, even though delays have been difficult to avoid. As detailed in the MEFP, the reform agenda will continue to focus on modernizing and enhancing the efficiency of the tax system, completing the civil service reform, reforming energy subsidies, strengthening the selection and efficiency of public investment projects, improving the management of SOEs, ensuring the viability and sustainability of the pension system, and achieving appropriately targeted social protection. The authorities continue to give priority to improving the business environment, and have already initiated a number of measures to streamline the regulatory environment, and promote governance and transparency. They have started to implement the new investment code and established the Investment Advisory Council and the Tunisian Investment Authority as a one-stop shop for investors.

The fight against corruption announced by the Government in May 2017 remains a priority. In this regard, a High Anti-Corruption and Good Governance Authority was established by Law last September, and its budget has been included in the 2018 Finance Law. This agency will be operational by end of June 2018, upon election by the Parliament of its Executive Board.

Conclusion

Tunisia has been pursuing simultaneously a dual path of democratization and economic reform to fulfill the aspirations of the population in the new era of freedom and political inclusion. The two paths have not always advanced in sync and have at times collided, slowing the pace of economic reform without however, weakening the authorities' resolve in this area. The external environment has not been supportive either, although some improvement is on the horizon. Against this background, the authorities are trying their best to strike the right balance between accelerating the pace of macroeconomic stabilization and structural reform, and preserving social stability and a consultative process with all

stakeholders. They are confident that the EFF-supported program is well aligned with their own economic reform strategy, and reiterate their strong commitment to its full implementation. They thank Executive Directors and management for their continued support, and appreciate the technical assistance provided by the Fund and other partners.