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Tunisia: 2006 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Tunisia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2006 Article IV consultation with Tunisia, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 19, 2005, with the officials of Tunisia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 10, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of May 18, 2006 updating information on recent developments.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 24, 2006 discussion of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Tunisia.

The document listed below has been or will be separately released.

Selected Issues Paper

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TUNISIA

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the 2006 Consultation with Tunisia

Approved by Amor Tahari and Scott Brown

May 10, 2006

- Discussions for the 2006 Article IV consultation were held in Tunis from December 5 to 19, 2005. The staff team consisted of Mr. Fanizza (head), Ms. Koranchelian, Messrs. Bouhga-Hagbe, Senhadji, and Söderling (all MCD). Mr. Tahari (MCD) joined part of the mission.

- The mission met with Governor Baccar (Central Bank of Tunisia), Minister Kechiche (Finance), other cabinet members, and government officials. The staff also met with the main trade union, the private business association, and with representatives from the banking sector. Mr. Rouai, Senior Advisor to the Executive Director, attended most of the meetings. A press conference was held at the end of the mission.

- Joint Fund-Bank missions to update the 2002 Financial Sector Assessment Program (FSAP) took place in January and March 2006.

- After exiting Fund-supported programs in the early 1990s, Tunisia has maintained a close dialogue with Fund staff. Over the years, the Fund has played the role of a trusted policy advisor, and the authorities have retained full ownership of the economic reform program. In recent years, the policy dialogue has focused on three major areas: (a) reforming the macroeconomic framework, in part to support the authorities' plans to liberalize the external capital account; (b) addressing banking sector weaknesses, most recently through the 2006 FSAP update, which should contribute to sharpening their strategy to deal with high nonperforming loans; and (c) accelerating structural reforms.

- Tunisia accepted the obligations of Article VIII, sections 2(a), 3, and 4, in 1993. The *de facto* exchange rate regime is a managed float with no pre-determined path.

- The principal authors of this report are Ludvig Söderling and Domenico Fanizza.

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Executive Summary

- The Tunisian economy continues to show strength and the outlook is favorable. Real GDP growth remained relatively strong in 2005, the external current account deficit narrowed significantly—helped by further real exchange rate depreciation—and international reserves continued to increase. Growth is expected to accelerate in 2006, as agricultural productions recover and the service and industry sectors remain strong.

- While increased financial inflows present a challenge for monetary policy, the current macroeconomic stance remains appropriate and inflation subdued. However, should these inflows persist, it will be essential to accompany monetary policy with a more ambitious fiscal consolidation plan, additional external debt repayments, accelerated trade liberalization, and increased exchange rate flexibility.

- The fiscal deficit widened somewhat in 2005, due to the impact of high oil prices on subsidies, but is expected to return to 3 percent of GDP in 2006. The authorities continue to raise retail petroleum prices, with a view to fully liberalizing these prices in the coming years. On the revenue side, they are undertaking tax policy and administration reforms, following FAD technical assistance in 2005. The medium-term objective is to bring public debt below 50 percent of GDP, from 60 percent currently.

- Tunisia is in the process of gradually opening up the external capital account and moving to a floating exchange rate. Significant further progress needs to be underpinned by banking sector reform, debt reduction, full implementation of the new broad money targeting framework, and deeper money and exchange markets.

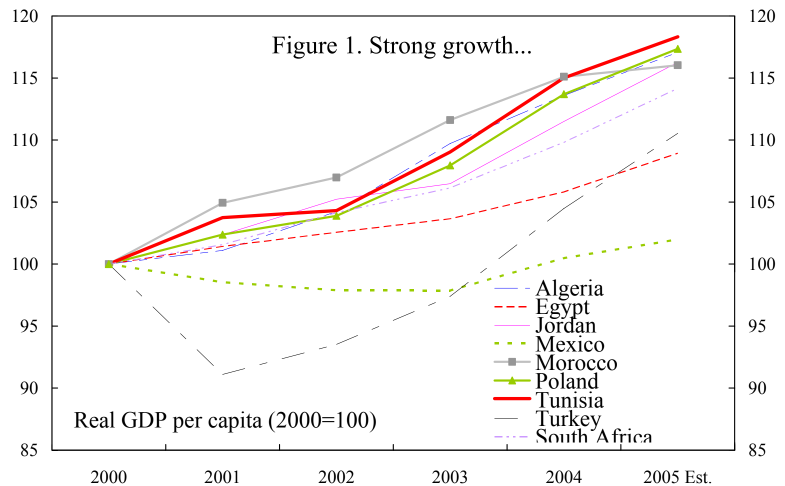
- Tackling financial sector weaknesses, already started by the authorities, is the most pressing reform priority. Although banking sector indicators improved significantly in 2005, nonperforming loans (NPLs) remain high (about 21 percent of total loans) and provisioning low (47 percent of NPLs). While not of systemic proportions, banking sector vulnerabilities constitute a drag on growth and hinder any substantial advance on the capital account liberalization agenda. The recent FSAP update should contribute to enhancing the reform strategy.

- Reducing external debt (68 percent of GDP) is another policy priority. The partial privatization of Tunisie Télécom in 2006 (valued at $2.3 billion, or 7½ percent of GDP) provides a unique opportunity in this regard. Over the medium term, continued fiscal consolidation will be crucial to strengthen Tunisia's external position.

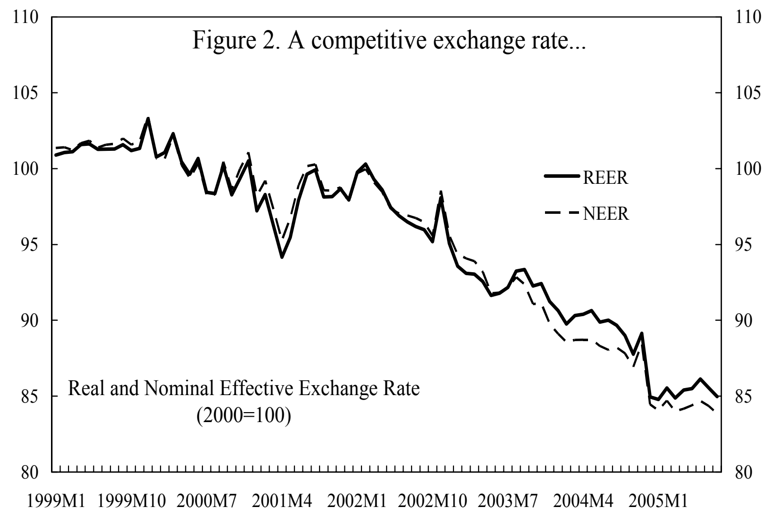
- Improving growth prospects will also require enhancing labor market flexibility and improving the business climate.

I. Background and Key Challenges

1. **Over the past decade, market-oriented reforms have contributed to placing Tunisia's economic performance among the best in the region.** Prudent fiscal and monetary policies have ensured macroeconomic stability. Meanwhile, the Central Bank of Tunisia (BCT) has managed the exchange rate of the dinar flexibly in a context of restricted external capital flows (see Box 1). Outward orientation has been a key component of Tunisia's development strategy, notably through an Association Agreement with the EU (AAEU), signed in 1995. Gradual structural reforms combined with a trend depreciation of the real effective exchange rate (REER) since 2000 have supported competitiveness and export growth. Strong real GDP growth, averaging 5 percent over the past decade, coupled with social policies and, recently, declining unemployment rates has resulted in a sharp reduction in the poverty incidence.[1]



Source: World Economic Outlook and IMF staff estimates.



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[1] The latest available poverty indicators from the World Bank show that the incidence of extreme poverty was cut in half (to 4 percent of the population) between 1995 and 2000, while the share of economically vulnerable fell from 9 to 6 percent of the population during the same period. These indicators are likely to have improved further in recent years due to an acceleration in growth and a reduction in unemployment.

Box 1. Tunisia: Exchange Rate Regime[1]

- Until around 2000, Tunisia targeted the Real Effective Exchange Rate (REER). The country avoided the potential risks associated with REER targeting thanks to prudent monetary and fiscal policies (for details see IMF Country Report No. 02/120 and WP/02/190).
- Since 2000, in accordance with Fund advice, the BCT has reduced its intervention in the foreign exchange market and allowed for more flexibility in the exchange rate, in effect leading to a trend real depreciation.
- The current managed float is an intermediate step toward a floating exchange rate regime.

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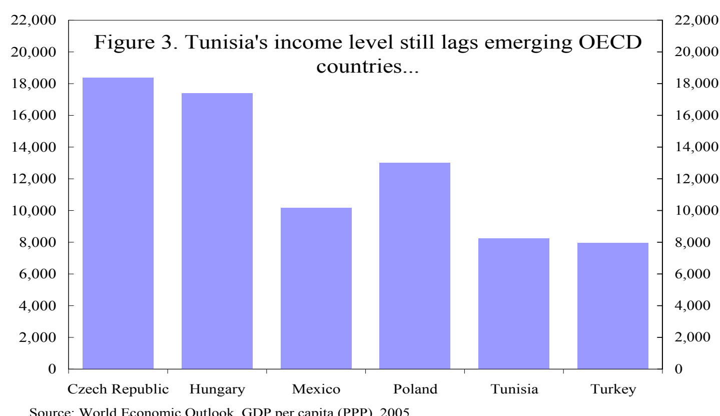
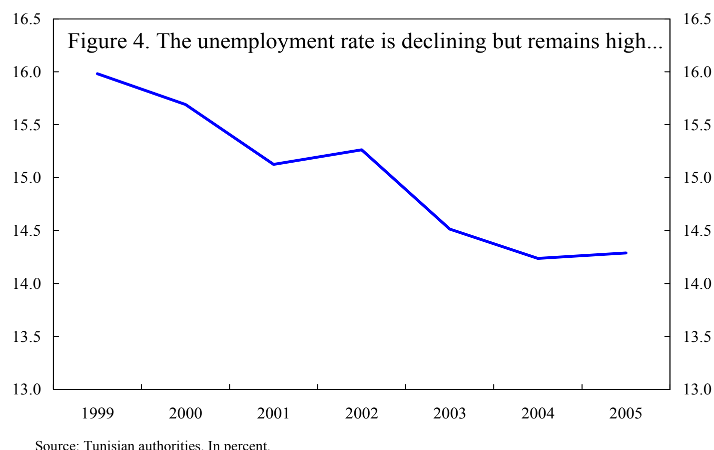
[1]Tunisia maintains a multiple currency practice resulting from exchange rate guarantees extended prior to 1988, which will expire shortly.

2. **Nevertheless, the authorities' objectives of approaching emerging market OECD standards of living and substantially reducing the unemployment rate have not yet been achieved.** Bridging the per-capita income gap in PPP terms with countries such as Mexico or Poland within a decade would require a growth differential of 2-4 percentage points in favor of Tunisia – at least 1-1½ percentage points higher than in the recent past. Moreover, despite recent improvements, the unemployment rate remains high (14 percent) and increasingly affects university graduates.





3. **Tunisia has reached a point where reforms may need to accelerate to maintain the growth momentum, while ensuring a successful integration into the regional and global economy.** Indeed, recent Fund surveillance has focused on the need to step up structural reform and to strengthen the macroeconomic policy framework. While trade liberalization has already subjected the country to foreign competition, the authorities recognize that a significant margin remains for improving the competitiveness and flexibility of the economy. To remedy high unemployment among graduates, the authorities agree that the structural transformation of the economy must accelerate, to increase the weight of skill-intensive sectors. This would

in turn lead to higher productivity growth, the engine for sustainable economic growth. To address these challenges, the authorities, in collaboration with the Fund, have developed a growth strategy encompassing continued structural reforms, combined with a gradual move toward an open external capital account and a floating exchange rate (Box 2).[2]

Box 2. Tunisia's Medium-Term Reform Strategy

<table>
<tr><th>Objective</th><th>Strategy</th><th>Policies</th><th>Supporting reforms</th></tr>
<tr><td rowspan="5">Reach emerging market OECD countries' income levels and reduce unemployment</td><td>Gradually move toward an open capital account</td><td>• Gradually move toward a floating exchange rate regime
• Establish a new framework for macroeconomic policies</td><td>• Banking sector reform (FSAP update)
• Fiscal consolidation (tax policy and administration)
• New monetary policy framework (broad money targeting)
• Money and exchange market development</td></tr>
<tr><td rowspan="4">Accelerate structural reforms aimed at promoting private sector activity through</td><td>Trade liberalization and promotion of regional integration</td><td>• Multilateral tariff reduction
• Streamlining customs procedures</td></tr>
<tr><td>Improve the business climate</td><td rowspan="2">Economic Competitiveness Development Policy Loan (World Bank), and the New Neighborhood Policy initiative (EU). FSAP update.</td></tr>
<tr><td>Strengthen and develop the financial sector</td></tr>
<tr><td>Labor market liberalization</td><td>Relax firing restrictions.</td></tr>
</table>

4. **Moreover, to improve the chance of success of this strategy, Tunisia needs to address two main vulnerabilities:**

- **A high external debt.** Significant foreign borrowing by the government (two-thirds of total public debt) has contributed to bring external debt to about 68 percent of GDP in 2005[3] – a high ratio compared to lower-tier OECD countries and other emerging economies with similar sovereign credit ratings as Tunisia. External vulnerability tests

[2] A detailed plan for capital account liberalization in Tunisia has been laid down in the Selected Issues Paper for the 2002 Article IV Consultation (IMF Country Report No. 02/120; 06/17/2002).

[3] Since the last Article IV consultation, the authorities have revised their short-term external debt figures to include commercial debt (adding about 6 percentage points to the external debt-to-GDP ratio). For details, see the preliminary conclusions for the 2006 Article IV consultation mission, at http://www.imf.org/external/np/ms/2006/012006.htm.

indicate that Tunisia's external debt/GDP ratio is sensitive to currency fluctuations.[4] Nevertheless, the external current account has strengthened significantly in the past three years, private capital inflows have surged, official reserves have doubled,[5] and the external debt-to-GDP ratio has remained stable despite a significant real depreciation of the dinar. During this time, the external current account deficit has increasingly been financed by foreign direct investment (FDI). In addition, Tunisia has enjoyed investment grade sovereign debt ratings since 1994 and is perceived by investors as among the safer emerging market borrowers.

- **Banking sector weaknesses.** The BCT has maintained considerable influence on credit extended to the private sector, through commercial banks' dependence on central bank refinancing. In the past, the BCT used this power not only to keep credit growth and inflation in check but also to promote credit to certain sectors regarded by the authorities as priority sectors, such as tourism. This led to a weak credit culture, especially among government-owned banks, and large nonperforming loans (NPLs) emerged as a result. Vulnerabilities were exacerbated by shocks to the tourism sector in 2001 and 2002, and by ongoing trade liberalization putting competitive pressure on the industrial sector.[6] While banking sector weaknesses do not amount to systemic risks in the short term,[7] they remain serious. In fact, banking sector vulnerabilities not only constitute a bottleneck that could negatively affect the growth outlook, but also hinder any substantial advance on the capital account liberalization agenda.[8]

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[4] However, the vulnerability exercise reveals only limited sensitivity to shocks to growth, interest rates, and the current account balance.

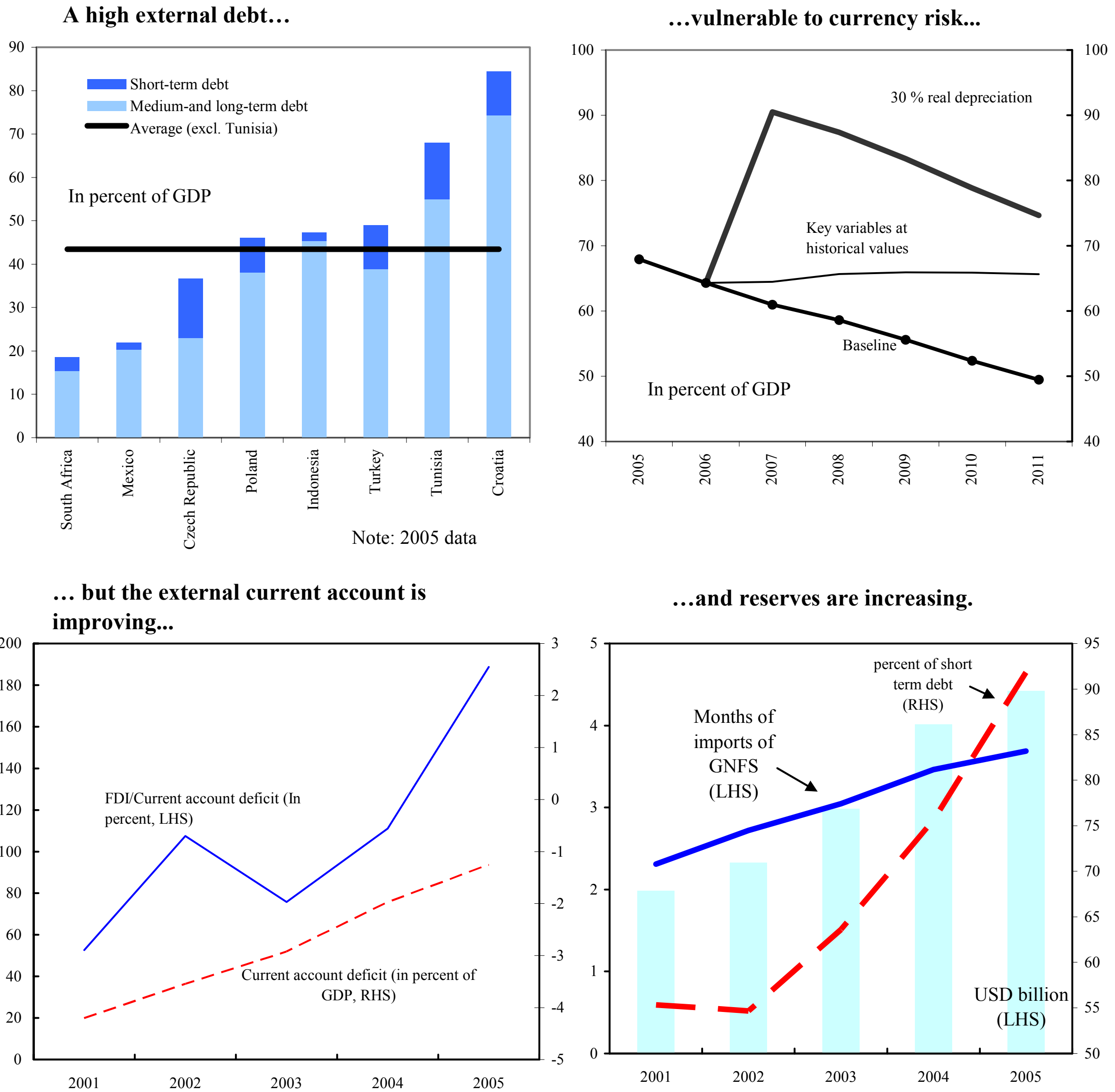
[5] Regarding the adequacy of official reserves, see the Selected Issues Papers for the 2004 Article IV Consultation (IMF Country Report No. 04/359; 11/12/2004).

[6] Banks' direct exposure to exchange and interest rate fluctuations is limited, since their open positions are small and their lending rates are generally linked to the money market interest rate. Regarding the latter, however, increases in interest rates could have negative effects on the corporate sector, and hence the quality of banks' loan portfolios.

[7] Stress tests from the 2006 FSAP update estimate the cost of ensuring sufficient capitalization in public banks at around 2 percent of GDP under the most severe scenario, i.e. if: (a) performing loans become NPLs (provisioned at 70 percent) at the same rate as during 2001-2003; and (b) there is a 50 percent write-off of NPLs backed by real estate collateral. Meanwhile, the fiscal sustainability analysis shows the public debt declining significantly in the medium term even if the government assumes a 10 percent of GDP contingent debt (see Figure 6 below).

[8] See Tunisia's Financial System Stability Assessment (IMF Country Report No. 02/119; 6/17/2002), and the 2006 FSAP update, forthcoming.

Figure 5. External indicators



Sources: World Economic Outlook and IMF staff estimates and projections.

Commercial Banks Financial Soundness Indicators

	2000	2001	2002	2003	2004	2005
Capital adequacy ratio of commercial banks	11.3	11.1	10.2	9.9	10.5	10.7
Private banks	10.6	10.5	10.3	8.6	10.2	10.6
Public banks	11.8	11.8	10.1	11.5	10.8	10.7
Gross nonperforming loans (percent of gross loans)	21.6	19.2	20.9	24.0	23.7	20.9
Private banks	15.4	16.1	18.1	21.6	20.4	20.0
Public banks	26.8	22.8	24.3	26.7	27.4	22.1
Provisions (percent of nonperforming loans)	49.2	47.4	43.9	43.1	45.8	46.4
Private banks	54.7	47.7	44.9	39.9	43.5	46.4
Public banks	46.6	47.1	42.9	46.2	47.6	46.3
Liquidity ratio (Liquid assets/liquid liabilities)	...	97.2	103.1	105.0	113.1	117.8
Net open position in foreign exchange (percent of capital)	0.1	0.4	0.4	0.7	0.8	0.9
Management Soundness						
Return on Assets	1.3	1.1	0.7	0.6	0.4	0.6
Return on equity	14.5	13.2	7.6	7.3	5.1	6.9

Source: Tunisian authorities.

II. Policy Discussions

5. **The policy discussions focused on short and medium-term policies to reduce the external debt and address banking sector weaknesses,** with a view to create proper conditions for higher growth. Regarding the banking sector, the overriding issue is to sharpen the strategy to tackle high NPLs, in the short term by cleaning up the existing stock of long-standing NPLs and, going forward, by promoting sound credit policies. Concerning external debt, the key short-term issue is the utilization of privatization receipts, while continued fiscal consolidation will dictate the medium-term success.

A. Short-Term outlook and Macroeconomic Policy Challenges

6. **The Tunisian economy continues to show strength and resilience to shocks.** Real GDP growth remained respectable in 2005 (4¼ percent), while the external current account deficit narrowed to about 1.3 percent of GDP (from 2 percent the year before), notwithstanding unfavorable agricultural conditions, the expiration of the Agreement on Textiles and Clothing (ATC), and continued tepid demand in Europe, Tunisia's main trading partner. The sharp increase in oil prices had little effect on the balance of payments, since Tunisia's oil exports broadly match imports. International reserves continue to increase, now covering more than 3¾ months of imports of goods and services. Growth should accelerate to about 5¾ percent in 2006, with the return to normal agricultural production levels and continued strength in services and industrial production. The external current account balance is projected to remain broadly unchanged. The external debt-to-GDP ratio should decline considerably in 2006, given the projected strong growth and assuming that part of

expected substantial privatization receipts is used to reduce the external debt burden. At the same time, international reserves accumulation will likely accelerate both due to the privatization proceeds and continued strong other private inflows.

7. **Increased external inflows present a challenge to monetary and exchange rate policies.** The BCT has so far aptly sterilized part of the excess liquidity generated by these inflows,[9] with broad money growing 10¾ percent in 2005. This has left inflation subdued, while permitting credit to the economy to grow in line with economic activity. The authorities agreed that these efforts need to continue, and perhaps be stepped up in view of any excess liquidity generated by foreign financial inflows. However, in the event that these inflows persist, it will be essential to accompany monetary policy with a more ambitious fiscal consolidation plan, additional external debt repayments, and accelerated trade liberalization. Furthermore, it is important to provide more scope for market forces to determine the exchange rate and allow increased flexibility in both directions. In this regard, the real effective exchange rate continued to depreciate in 2005 (by 4½ percent on average). Although there are no obvious signs of an exchange rate misalignment (Box 3) and the depreciation has not created inflationary pressures so far, the BCT will continue to closely monitor developments in this area.

8. **Fiscal consolidation remains broadly on track, despite the sharp increase in oil prices in 2005.** To limit the impact on petroleum consumption subsidies, the authorities continued to raise retail prices by a cumulative 15 percent in 2005 and the 2006 budget law envisages further increases. In addition, the authorities took measures to contain other spending in 2005, and tax revenue collection increased by ½ percentage point of GDP, despite the secular decline in trade taxes. Nevertheless, wage increases and net new hiring did result in a slight increase in the wage bill relative to GDP. All told, the central government deficit widened somewhat in 2005, to 3.2 percent of GDP (excluding grants and privatization receipts), but the public debt-to-GDP ratio declined by about ¾ percentage points to 59 percent. The 2006 budget law, based on an oil price assumption of $60 per barrel, implies a ½ percentage point of GDP increase in the deficit. However, the authorities considered a deficit below 3 percent of GDP feasible, even without additional expenditure cuts, because the revenue projections in the 2006 budget law – implying a substantial drop in tax buoyancy – appear conservative. This lower deficit would help achieve their medium-term objective of bringing the public debt-to-GDP ratio below 50 percent. Concerning the financing of the deficit in 2006, the authorities intended to keep domestic bonds the principal source, notwithstanding substantial privatization revenues, in order not to complicate monetary management.

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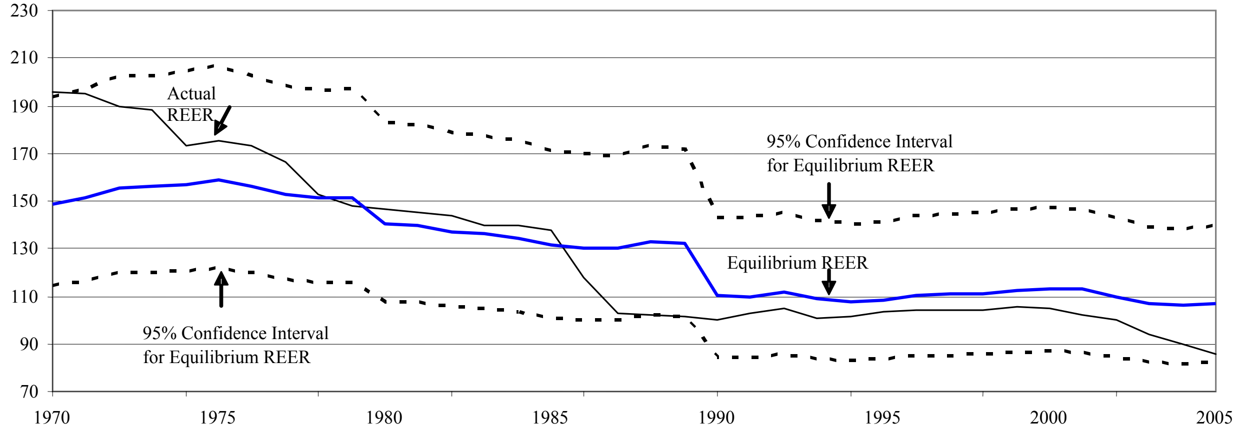
[9] The BCT withdrew the equivalent of about 1 percent of broad money through open market operations in the second half of 2005.

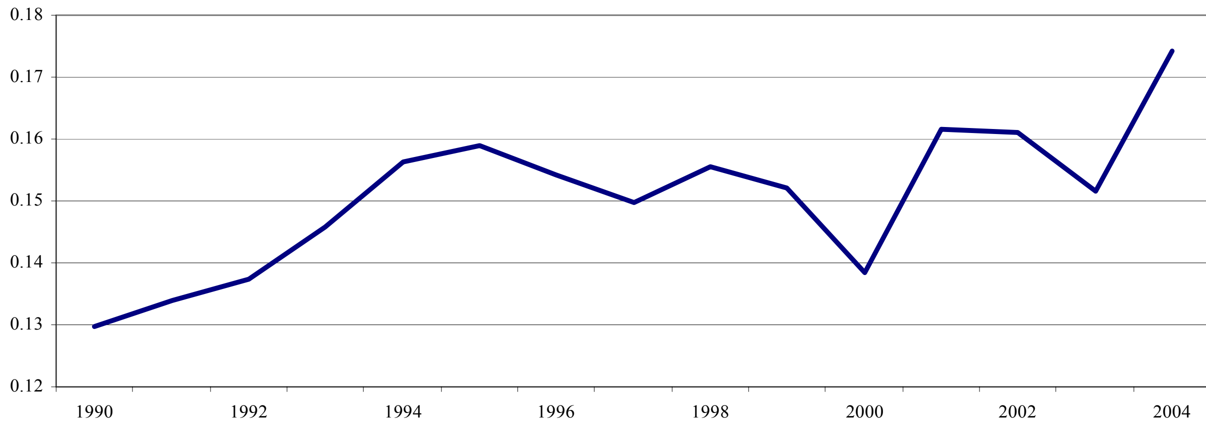
Box 3. Tunisia: Long-Term Trend in the Real Effective Exchange Rate

There is no clear evidence of a significant misalignment of the dinar. Although an econometric analysis suggests that the depreciation of the REER in recent years has resulted in an undervaluation of the dinar, this conclusion is not statistically significant (Box Figure 1).[1] Moreover, the model does not take into account ongoing trade liberalization efforts in Tunisia, notably in the context of the AAEU, likely to translate into a depreciation of the equilibrium REER. The currency appears competitive, however, as seen by the gain in export market share since the early 1990s.

Box Figure 1: Actual and Estimated Equilibrium Real Exchange Rates, 1970-2005 (1990=100)



Box Figure 2: Tunisian Export Market Shares with respect to Main Trade Partners[2], 1990-2004 (in percent)



1/ Following the approach developed by P. Lane and G.M. Milesi-Ferretti in WP/99/158 and WP/100/123, the staff estimates of the equilibrium exchange rates are based on panel data analysis of fundamental variables including terms of trade, net liabilities, and GDP per capita. See Selected Issues paper (IMF COUNTRY REPORT NO. 02/120) for details.

2/ Belgium, Egypt, France, Germany, Italy, Japan, the Netherlands, Spain, the United Kingdom and the United States account for more than 90 percent of Tunisian exports.

9. **The partial privatization of Tunisie Télécom in 2006 dominates the short-term outlook and has major implications for macroeconomic management.** The operation, valued at $2.3 billion (7½ percent of GDP), is Tunisia's largest privatization to date.[10] The discussions highlighted the need to quickly establish a clear strategy for the use of the proceeds from this privatization, so as to maximize their benefits for the Tunisian economy, while limiting their impact on monetary aggregates. In this regard, the authorities considered taking advantage of this opportunity to significantly reduce external debt. However, they noted that, following efforts over recent years to retire expensive external debt, the scope for further debt pre-payment was limited without incurring penalties or high refinancing costs. Moreover, they noted that while Tunisia's external reserves have reached a comfortable level, they remain lower than those of many comparable emerging market economies. Hence, the trade-off between reducing external debt and increasing reserves needs to be carefully weighed.

10. **Banking sector indicators improved in 2005.** The share of NPLs in total loans declined by 2¾ percentage points, to about 21 percent, helped by the strong performance in the tourism sector. Provisioning increased by ¾ percentage points, to 46½ percent, in part reflecting stricter implementation of provisioning rules by the BCT. The authorities noted that ongoing efforts to further improve collection and provisioning of NPLs should provide significant results in 2006, especially in light of the favorable economic outlook.

B. Medium-Term Strategy to Accelerate Growth and Structural Change

11. **The remainder of the policy discussions focused on the authorities' efforts to strengthen the economy's growth potential and capacity to absorb a growing supply of skilled labor.** The authorities are convinced that achieving these goals will require a continued transformation of the Tunisian economy, founded on higher private investment and accelerated productivity growth (see box 4 for the main medium-term assumptions). In addition, it will be crucial to reduce Tunisia's two main vulnerabilities, i.e. the high external debt and banking sector weaknesses. In this context, the following priority areas were emphasized: (a) financial sector reform; (b) strengthening macroeconomic policies; and (c) improving the business climate and enhancing labor market flexibility.

[10] The winning bid (3.05 billion dinars) was presented in March 2006. The macroeconomic framework assumes full payment in 2006, with all funds raised abroad.

Box 4. Tunisia: 2006–11 Macroeconomic Framework

The medium-term macroeconomic framework projects an average annual real GDP growth of 6 ¼ percent over 2006–11, consistent with a continued significant decline in unemployment. This growth objective would require an increase in private investment of about 1 percentage points of GDP over the medium term and a ½ percentage point increase in average annual total factor productivity growth compared to the past five years.

The external current account deficit is projected to narrow slightly from the current 1.3 percent of GDP. Underlying this projection are the following main assumptions: (a) an average annual real non-oil export growth of about 4½ percent, somewhat outpaced by imports as domestic demand picks up; (b) sustained growth in tourism receipts; and (c) a decline in non-fuel commodity import prices over the medium term after a sharp increase in 2006 (following the latest WEO assumptions).

Net external borrowing is assumed to decline sharply in 2006 and resume its previous trend thereafter. The main underlying assumption is that the government uses some of its privatization receipts to reduce the external debt burden. This would allow the total external debt-to-GDP ratio to decline from 68 percent in 2005 to 50 percent in 2011, while official reserves would increase substantially, from 3¾ months of imports of goods and non-factor services in 2005 to over 5½ months in 2011.

The central government deficit is projected to fall from 3.2 percent of GDP in 2005 to 1.8 percent in 2011 (excluding grants and privatization receipts). As a result, the consolidated government debt would fall from 59 percent of GDP at end-2005 to 45 percent at end-2011.

The main risks to this scenario are (a) a delayed impact of the expiration of the ATC as temporary countervailing measures disappear; (b) absence of a recovery in Europe, Tunisia's main trading partner; (c) negative effects of sustained high oil prices on domestic demand; (d) new shocks to the tourism sector. Furthermore, the outcome of this scenario hinges critically on efforts by the authorities to accelerate structural reforms and further strengthen macroeconomic policies.

Financial sector reform

12. **The authorities believe that tackling financial sector weaknesses is perhaps the most pressing reform priority, to reduce vulnerabilities and improve growth prospects.** The recent FSAP update mission maintained the view that although banking sector weaknesses are not of immediate systemic proportions, they constitute a drag on growth by contributing to higher costs of capital and inefficient allocation of resources. Moreover, there are no reasonable prospects of integrating the Tunisian financial sector internationally without first remedying these weaknesses, especially the high level of NPLs.

13. **The authorities have adopted a number of measures recently, aimed at improving the credit culture, promoting good governance, and strengthening the legal framework for banks.** Some banks distributed little or no dividends in 2005, as a result of the recent ban on such distributions for banks with insufficient provisioning. The authorities

consider this ban a powerful tool to create the right incentives for banks to improve their credit appraisal methods. In addition, provisioning was made fully tax deductible in 2005. Legal procedures to realize collateral through court-ordered sales have also been streamlined. A new law on financial security was enacted in 2005, aimed at guaranteeing the transparency and reliability of accounting. This law obligates companies of a certain size and characteristics to appoint external auditors, and tightens financial reporting requirements. A new draft amendment to the banking law should improve governance by expanding the authority of banks' Boards of Directors and requiring the establishment of an executive credit committee answerable to it. In addition, the sale of the government's remaining shares in *Banque du Sud* was finalized. Regarding supervision, the FSAP update Basle Core Principle assessment noted significant improvements since the 2002 FSAP. Regarding the law against money laundering and financing of terrorism, the FSAP update noted that customer due diligence and supervision and filing of suspicious transaction reports require strengthening.

Box 5. Tunisia: Main NPL-related Recommendations of the 2006 FSAP Update

- Require 70 percent provisioning for all NPLs, regardless of existing collateral;
- Reduce by 2009 the NPL ratio to 10 percent through a proactive policy of loan restructuring, including partial write-offs, accompanied by measures to avoid moral hazard;
- Develop a strategy for restructuring NPLs to the tourism sector, on the basis of a realistic assessment of debt repayment capacity of borrowers;
- Reduce delays in judicial proceedings and increase reliance on out-of-court settlements;
- Allow full tax deductibility for partial write-offs;
- Strengthen management of public commercial banks and consider privatization and mergers of former development banks;
- Promote establishment of private credit bureaus.

14. While the mission was encouraged by recent progress, it suggested that the gradual reform strategy followed so far by the authorities may need to make way for a more forceful approach. The quality of banks' credit portfolios is highly vulnerable to economic downturns, as shown by the steep increase in NPLs in 2003 following shocks to the tourism sector. To accelerate the resolution of the NPL problem, the staff suggested: (a) strengthening public bank management, to ensure better governance and operation on a commercial basis; (b) ensuring strict application of provisioning rules and sanctions; and (c) taking stronger measures to deal with the existing stock of NPLs, through write-offs and credit restructuring based on the ongoing study by the BCT on longstanding NPLs. Regarding the latter, the FSAP update mission favored adopting an explicit target for NPLs (reducing the ratio to 10 percent by 2009, see box 5), to free resources for new lending. In this context, debt workouts will increasingly need to rely on out-of-court settlement, to limit judicial delays. While broadly agreeing, the authorities noted that most of the key recommendations of the 2002 FSAP have been implemented and that more time is needed to

assess their impact before reconsidering the current strategy. They intend to focus on bringing the provisioning ratio up to 70 percent, while targeting an explicit NPL ratio of 15 percent in 2009 and 12 percent in 2011. The staff also suggested considering recapitalizing public banks with sizeable impaired loan portfolios, once management has been strengthened and safeguards have been put in place to avoid new accumulation of NPLs. However, the authorities were reluctant to this idea, due to moral hazard concerns. Instead, they emphasized the need to enforce collection of NPLs, to avoid condoning bad behavior.

Strengthening Macroeconomic Policies

15. **To maximize the benefits of Tunisia's global and regional integration, while containing risks, the authorities and the Fund are collaborating to strengthen macroeconomic policies.** A key component of this strategy is to gradually liberalize external capital flows. The authorities agree that, in addition to significant improvements in the banking sector, this strategy needs to be supported by a move to a floating exchange rate, a strengthened monetary policy framework, deeper and more modern money and exchange markets, a solid fiscal position, and lower external debt.

External Capital Account Liberalization

16. **The authorities pressed ahead in 2005 with their gradual liberalization of external capital flows.**[11] Notably, further scope was given to nonresidents to participate in the local Treasury bill market; borrowing abroad was fully liberalized for rated financial institutions and restrictions were eased on rated nonfinancial institutions; and authorizations were abolished on most foreign acquisitions of securities carrying voting rights in Tunisian companies. The first of three phases in the capital liberalization strategy developed in collaboration with Fund staff is hence close to completion, save for some remaining restrictions on inward FDI. Abolishing those restrictions will not only contribute to enhancing knowledge transfers from abroad, but it will also allow FDI to play a more prominent role in financing Tunisia's current account deficit. The next phase, involving liberalization of Tunisian investment abroad and full liberalization of inward portfolio investment, can be completed only once the financial sector is modernized and strengthened, a floating exchange rate regime has been adopted, and the new monetary policy framework is firmly in place.

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[11] See also the Selected Issues Paper "Tunisia: Potential Growth-Enhancing Effects of Further Capital Account Liberalization and Supporting Reforms", forthcoming. The paper suggests that capital account liberalization can contribute to promote growth and FDI.

Monetary and Exchange Rate Policy

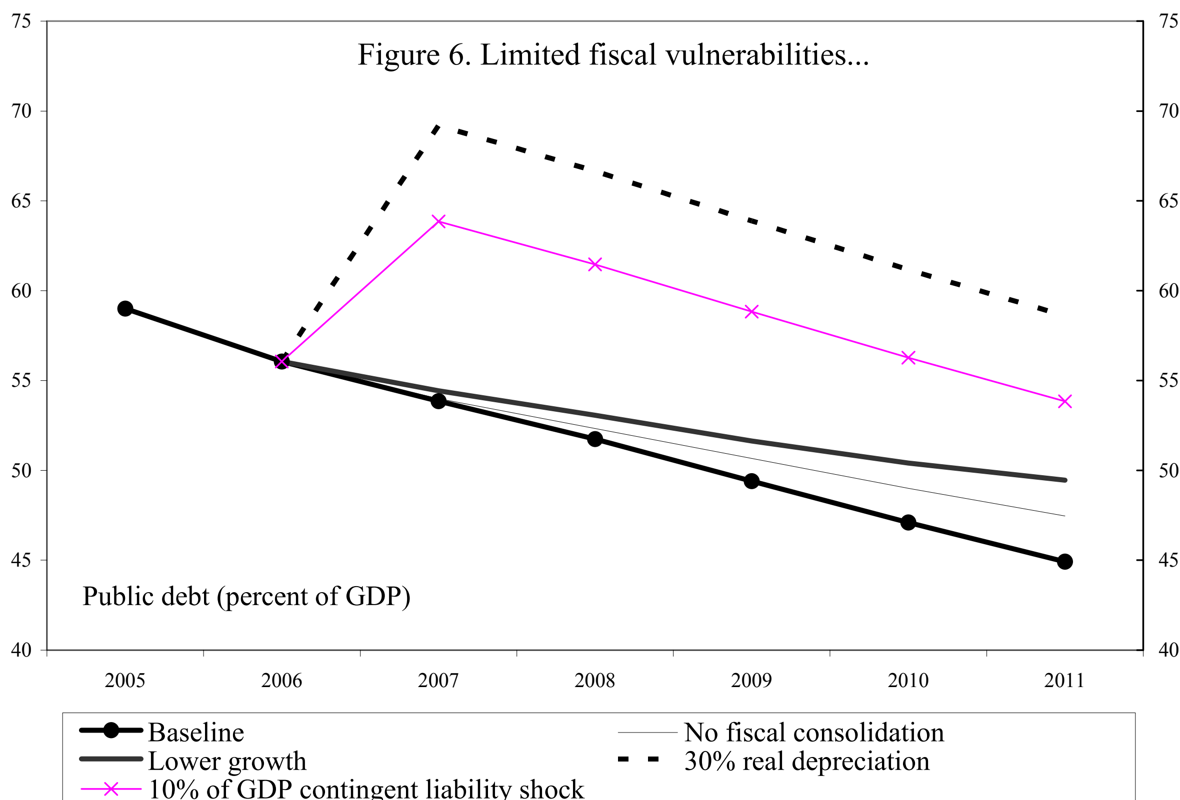
17. **The BCT has made significant progress toward implementing the new broad money targeting framework, with base money as the operating target.** This framework, an intermediate step toward inflation targeting, has been run in parallel for the past year with the existing framework, which focuses on maintaining private credit growth in line with nominal GDP growth. The objective of implementing inflation targeting in the future has taken on increased significance with the new draft Central Bank law, which defines price stability as the key objective of the BCT.

18. **However, substantial progress toward a floating exchange rate supported by inflation targeting requires deeper money and exchange markets.** In this context, it is necessary that the Treasury remain present along a wide maturity range, to deepen the money market and build a full yield curve. Accordingly, issuance of short-term Treasury bills resumed in March 2005, although it was again discontinued in October. In addition, the elimination of the ceiling for BCT purchases of Treasury bills in the new central bank law will facilitate building a securities portfolio for monetary policy operations, which should help develop the secondary market for such securities. Furthermore, the BCT has reduced its role as provider of liquidity, allowing the volume of transactions on the interbank market to increase significantly. Moreover, surrender requirements on foreign exchange receipts were eliminated in 2005, which should contribute to deepening the foreign exchange market. However, the authorities agree that the requirement that banks transfer end-of-day foreign exchange balances to the BCT (*nivellement*) and the BCT's practice of quoting daily exchange rates remain the main obstacles for foreign exchange market development. Accordingly, they are preparing to eliminate the *nivellement* and they are considering quoting exchange rates only ex post. Staff further emphasized the importance for market development of allowing greater exchange and interest rate flexibility, and eliminating restrictions on forward operations and foreign exchange options. This would provide market incentives for developing the appropriate hedging instruments and facilitate the transition to a floating exchange rate and a more dynamic monetary policy.

Fiscal Reform

19. Although the fiscal position is sustainable and steadily improving, the authorities recognize the need to accelerate fiscal reform. They appropriately aim at bringing public debt below 50 percent of GDP in the medium term, from the current level of 59 percent. Fiscal consolidation would advance two main goals: (a) reducing the external debt; and (b) enhancing flexibility in fiscal policy. An auxiliary objective is to facilitate monetary and exchange rate policy reform by cementing low inflation expectations and eliminating any potential fiscal considerations from the central bank's interest rate decision process. The

standard public debt sustainability analysis shows that vulnerabilities are limited, except to currency fluctuations. The latter reflects the high share of public debt owed to foreigners.



20. **The authorities plan to step up ongoing efforts to improve tax collection.** Tax buoyancy has proven somewhat fickle in the recent past and is destined to weaken in the future, short of reforms. The increasing share of less-taxed sectors (mainly for exports), falling profit transfers from soon-to-be privatized public enterprises, and decreasing customs revenues all constitute fiscal challenges. Tunisia received technical assistance from the Fund's Fiscal Affairs Department in 2005, advising it to simplify tax legislation, limit tax exemptions, and modernize tax administration. Accordingly, the authorities presented plans to: (a) expand the corporate income tax base, while reducing its rate; (b) simplify the VAT by reducing the number of rates; (c) revise tax incentives, especially for off-shore activities; and (d) reorganize the tax administration and increase computerization to enhance effectiveness and improve services to tax payers. Furthermore, they plan to eliminate limits on reimbursements of VAT credits, which should reduce distortions and improve the relations between tax authorities and the private sector. Nevertheless, other remaining tax rules, such as VAT withholdings at the source, undermine efficiency by breaking the chain of the VAT and by weakening the basic principle of self-assessment. While the authorities are aware of these issues, they see some value in these type of measures to limit tax delinquency and fraud.

21. **On the expenditure side, key reforms are under way to limit the fiscal costs of energy subsidies, although the wage bill will remain high in the medium term.** The authorities indicated that they are planning to phase out petroleum consumption subsidies and fully liberalize retail prices in the coming years. Meanwhile, they are in the process of implementing a comprehensive strategy for more efficient use of energy, which should alleviate the impact of potentially higher retail prices on households and firms. Regarding the wage bill (12 percent of GDP), the authorities indicated that the scope for reduction is limited over the medium term because: (a) health and education personnel account for a large share of outlays and investment in human capital has been crucial for Tunisia's economic performance; and (b) efforts to upgrade the quality of the civil service necessitate hiring more qualified, higher paid, personnel.

Business Climate and Labor Market Flexibility

22. **The authorities are convinced that a more dynamic private sector is essential for moving Tunisia to a higher growth path within an increasingly globalized economy.** In this context, it is key to improve the business climate to increase the level and quality of private investment, including FDI. Accelerating multilateral trade liberalization and continuing the customs reform would contribute to reduce firms' cost of production. In this regard, the ongoing streamlining of customs procedures through computerization, selectivity in customs inspections, and simplification of administrative procedures are positive developments, as are the plans to modernize the customs code. Furthermore, the ongoing process of simplifying administrative procedures for businesses is commendable and should be intensified.

23. **There is a need to further enhance labor market flexibility to facilitate labor reallocation in response to structural changes in the economy.**[12] Increased flexibility would encourage the creation of skilled jobs, thereby improving productivity. It would also contribute to reducing the impact of the expiration of the ATC on employment in the medium term. The authorities share these concerns and have taken measures to enhance labor market flexibility at the recruitment level (temporary jobs). However, the mission argued that increasing hiring flexibility without relaxing the complex dismissal rules could hamper the creation of permanent jobs. Recent staff analysis indicates that the decline in unemployment over the past years has coincided with less frictions in the labor market, although some of this gain has been offset by a decline in private investment relative to GDP.[13]

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[12] The issue of labor market rigidities was analyzed in the Selected Issues Papers for the 2004 Article IV (IMF Country Report No. 04/359; 11/12/2004) and WP/05/92.

[13] See the Selected Issues Paper "Business Cycle Accounting in Tunisia", forthcoming.

C. Other Issues

24. **Tunisia cooperates with neighboring countries to enhance economic integration in the Maghreb region.** This initiative was initiated by a conference on trade facilitation among Algeria, Morocco and Tunisia in 2005.

25. **A mission for a new Report on the Observance of Standards and Codes (ROSC)—Data Module was conducted in 2005.** Tunisia has subscribed to the Special Data Dissemination Standard (SDDS) since 2001. Tunisia is also part of a pilot project on the transition to the Government Financial Statistics Manual 2001.

III. Staff Appraisal

26. **Tunisia's strong economic performance and resilience to adverse shocks show the benefits of sustained sound macroeconomic policies and market-oriented reforms.** Tunisia has made strides toward its goal of approaching lower OECD per-capita income levels, but the gap remains substantial, leaving no room for complacency. In fact, at this juncture, losing economic reform momentum could put Tunisia's significant achievements at risk, as increased global competition requires increased flexibility on both the macroeconomic and structural fronts. Two remaining vulnerabilities – a high level of external debt and banking sector weaknesses – may jeopardize the reform strategy. Strong macroeconomic conditions and the favorable outlook present a window of opportunity to advance the reform agenda and address these vulnerabilities.

27. **Monetary and exchange rate policies** have so far dealt effectively with increased external inflows. As a result, inflation has remained subdued and the dinar appears appropriately valued. However, these inflows may intensify in the future, not only because of substantial privatization proceeds but also due to increased market confidence in Tunisia's economic performance more broadly. In that event, sterilization by the BCT may not be sufficient and will need to be complemented by fiscal tightening, accelerated trade liberalization, and increased exchange rate flexibility. It is encouraging that the authorities are considering using part of the coming privatization proceeds to repay external debt. Devoting a substantial part of these proceeds for this purpose will facilitate monetary management, reduce external-debt vulnerabilities, and strengthen the fiscal position.

28. **The authorities should be commended for not allowing the steep rise in international oil prices to derail fiscal consolidation.** Bringing the fiscal deficit below 3 percent of GDP appears within reach in 2006, particularly if the authorities continue their policy of gradually reducing subsidies on petroleum products. This would help achieve the

authorities' medium-term public debt-reduction target. Were fiscal pressures from high oil prices to ease, the authorities should seize the opportunity to further reduce the deficit.

29. **Banking sector vulnerabilities constitute a drag on growth and an obstacle toward macroeconomic policy reform**. It is encouraging that the authorities have put in place most of the key recommendations of the 2002 FSAP and that they have sharpened their strategy to reduce the burden of NPLs in the context of the 2006 FSAP update. The measures taken by the authorities are already yielding results as shown by the decline in the NPL ratio and the increased provisioning in 2005. The favorable economic outlook augurs well for a further reduction in 2006, but efforts need to be stepped up to ensure a substantial improvement in banks' portfolio over the next three-year horizon.

30. **The authorities medium-term macroeconomic reform program has progressed well,** with focus on: (a) gradually liberalizing the external capital account; (b) establishing a new broad-money targeting framework as an intermediate step toward inflation targeting; and (c) broad fiscal reform.

31. **The first phase of the authorities' plan for external capital account liberalization has almost been completed**, but further substantial progress needs to wait for improved banking sector conditions. In this regard, the authorities need to monitor the potential emergence of new risks and adapt supervision accordingly. The benefits from fully integrating Tunisia in international financial markets may be substantial in term of access to foreign saving, portfolio diversification, increased foreign direct investment, and improved efficiency of the financial markets.

32. **The implementation of the new broad money targeting framework** should help to deepen the money market by allowing more interest rate flexibility and improve the monetary policy transmission mechanism, necessary conditions for eventually adopting inflation targeting. The new central bank law will constitute a significant step toward clarifying the monetary policy objective, strengthening central bank independence, and providing instruments for the conduct of monetary policy.

33. **The progress in capital account liberalization and elimination of the surrender requirements should translate into a deeper foreign exchange market,** needed to eventually float the dinar. However, the *nivellement* still constitutes a significant obstacle to market development that should be removed as soon as possible. Greater two-way exchange rate flexibility would also favor a deepening of the market.

34. **On the fiscal side**, determined implementation of the authorities' tax reform plans is essential not only to improve tax buoyancy, but also to improve the business climate by

simplifying regulations and limiting the scope for discretion in the relation with tax payers. Fiscal consolidation will, however, also require curbing expenditure growth. In this sense the authorities' intention to gradually phase out subsidies on petroleum products and eventually fully liberalize their price is welcome. Over the medium term, action will also be needed to reduce the weight of the wage bill, which constitutes a significant fiscal rigidity.

35. **Increased momentum in structural reforms is essential** to create a business-friendly environment, to raise productivity and private investment, and bring Tunisia to a higher-growth path. Priority areas are trade and labor market liberalization.

36. **Tunisia has substantially opened up to foreign trade** in the context of the association agreement with the EU. Multilateral and regional trade liberalization needs to complement the bilateral dimension to fully reap the benefits of broad and more integrated markets. It is encouraging that the authorities plan to streamline customs procedures and the mission welcomes the authorities' interest in Fund technical assistance in this area. Tunisia's active participation in efforts to increase economic integration in the Maghreb is also commendable.

37. **Although declining, Tunisia's unemployment rate remains unacceptably high,** particularly among the skilled segments of the labor force. Thus, there is a need to increase the employment content of growth by continuing to liberalize the labor market. In this sense the authorities should consider easing both hiring and firing restrictions.

38. **Staff commends the authorities for their continued commitment to transparency of economic policies.** Tunisia has published the concluding statements of Fund missions and routinely publishes staff reports of Article IV consultations and FSAPs.

39. It is proposed that the next Article IV consultation take place on the standard 12 month cycle.

Table 1. Tunisia: Selected Economic and Financial Indicators, 2004–11

	2004	Est. 2005	Proj. 2006	Proj. 2007	Proj. 2008	Proj. 2009	Proj. 2010	Proj. 2011
Production and income (percent change)								
Nominal GDP	8.8	6.2	8.4	8.5	8.5	8.5	8.7	8.5
Real GDP	6.0	4.2	5.8	6.0	6.2	6.4	6.5	6.5
GDP deflator	2.6	1.9	2.4	2.4	2.2	2.0	2.0	1.9
Consumer price index (CPI), average	3.6	2.0	3.0	2.0	2.0	2.0	2.0	2.0
Gross national savings (in percent of GDP)	22.2	22.7	22.7	23.0	23.3	23.4	23.7	23.7
Gross investment (in percent of GDP)	24.2	23.9	24.1	24.2	24.4	24.5	24.7	25.1
External sector (percent change)								
Exports of goods, f.o.b. (in $)	20.6	8.4	4.5	4.9	4.7	5.1	5.8	5.9
Imports of goods, f.o.b. (in $)	17.6	2.8	6.0	4.3	4.1	5.2	5.5	6.6
Exports of goods, f.o.b. (volume)	10.6	1.2	2.8	3.9	4.2	4.5	4.9	4.9
Import of goods, f.o.b. (volume)	7.3	-5.7	0.9	5.0	5.4	5.6	5.7	5.7
Trade balance (in percent of GDP)	-8.7	-6.8	-7.6	-7.1	-6.6	-6.4	-6.2	-6.2
Current account, excl. grants (in percent of GDP)	-2.0	-1.3	-1.4	-1.2	-1.1	-1.1	-1.1	-1.3
Foreign direct investment (percent of GDP)	2.1	2.5	9.5	1.9	1.9	1.9	1.9	1.9
Terms of trade (deterioration -)	-0.5	-1.8	...	...	...	...	...	...
Real effective exchange rate (depreciation -) 1/	-3.4	-4.5	...	...	...	...	...	...
Central government (percent of GDP, unless otherwise indicated) 2/								
Total revenue, excluding grants and privatization	23.9	24.0	23.6	23.4	23.2	23.1	23.1	23.1
Total expenditure and net lending	26.8	27.2	26.7	26.2	25.6	25.1	25.0	24.9
Central government balance, excl. grants and privatization	-2.9	-3.2	-3.0	-2.8	-2.4	-2.0	-1.9	-1.8
Central government balance, incl. grants, excl. privatization	-2.6	-3.0	-2.8	-2.6	-2.2	-1.8	-1.8	-1.6
Total government debt (foreign and domestic)	59.7	59.0	56.1	53.9	51.8	49.4	47.1	44.9
Foreign currency public debt (percent of total debt)	63.2	63.9	60.5	58.4	57.9	56.7	55.1	53.6
Money and credit (percent change)								
Credit to the economy	5.3	7.5	6.9	...	...	...	...	...
Broad money (M3) 3/	10.3	10.8	10.4	...	...	...	...	...
Velocity of circulation (GDP/M3)	1.63	1.56	1.54	...	...	...	...	...
Interest rate (money market rate, in percent, e.o.p)	5.00	5.00	...	...	...	...	...	...
Official reserves								
Gross official reserves (US$ billions, e.o.p)	4.0	4.4	6.5	6.9	7.7	8.3	8.8	9.2
In months of imports of goods & services, c.i.f.	3.5	3.7	5.1	5.2	5.6	5.7	5.7	5.6
Total external debt								
External debt (US$ billions)	19.8	18.5	18.7	19.3	20.2	20.8	21.2	21.8
External debt (in percent of GDP)	67.8	67.9	64.3	61.0	58.6	55.6	52.4	49.5
Debt service ratio (percent of exports of GNFS)	16.2	14.5	17.9	16.4	14.5	15.7	15.9	15.0
Financial market indicators								
Stock market index 4/	1,332	1,615	1,867	…	…	…	…	…
Memorandum items:								
GDP at current prices (TD millions)	35,035	37,202	40,322	43,761	47,495	51,539	56,007	60,754
GDP at current prices (US$ billions)	29.2	27.3	29.1	31.6	34.4	37.3	40.6	44.0
GDP per capita (US$)	2,942	2,713	2,859	3,065	3,289	3,524	3,780	4,052
Unemployment rate (in percent)	14.2	14.3	13.9	13.4	12.7	12.1	11.4	10.8
Population (millions)	9.9	10.1	10.2	10.3	10.5	10.6	10.7	10.9
Poverty rate (World Bank, "core poverty", 2000)	4.1	...	...	...	...	...	...	...
Exchange rate: dinar/US$ (average)	1.25	1.30	...	...	...	...	...	...

Sources: Tunisian authorities and staff estimates and projections

1/ Information Notice System.
2/ Excludes the social security accounts.
3/ Financial system (Deposit money banks and Development banks)
4/ TUNINDEX. (1000 = 4/1/1998). 2006 data from April 7, 2006.

Table 2. Tunisia: Balance of Payments, 2003–11

	2003	2004	Est. 2005	Projections 2006	2007	2008	2009	2010	2011
	(In millions of U.S. dollars, unless otherwise indicated)								
Current account	-730	-555	-360	-403	-375	-363	-411	-427	-593
Trade balance	-2,270	-2,435	-1,963	-2,234	-2,254	-2,270	-2,398	-2,497	-2,751
Exports	8,027	9,679	10,489	10,966	11,508	12,053	12,672	13,406	14,195
Energy	801	924	1,354	1,602	1,697	1,741	1,772	1,803	1,826
Non-energy	7,226	8,755	9,135	9,364	9,811	10,312	10,900	11,603	12,369
Imports	-10,297	-12,113	-12,452	-13,200	-13,762	-14,323	-15,069	-15,902	-16,946
Energy	-1,130	-1,331	-1,748	-2,027	-2,126	-2,160	-2,177	-2,194	-2,201
Non-energy	-9,166	-10,782	-10,704	-11,173	-11,636	-12,163	-12,892	-13,709	-14,745
Services and Transfers (net)	1,539	1,880	1,603	1,831	1,879	1,907	1,987	2,070	2,158
Nonfactor	1,362	1,679	1,656	1,695	1,710	1,735	1,760	1,788	1,822
o/w Tourism	1,477	1,839	1,976	2,048	2,115	2,206	2,296	2,395	2,499
Factor Services and Transfers (net)	177	201	-53	137	170	172	227	282	336
o/w Workers' remittances	1,250	1,431	1,404	1,404	1,459	1,523	1,588	1,654	1,721
o/w Interest payments on external debt	-572	-641	-707	-811	-821	-845	-883	-909	-931
Capital and financial account	1,115	1,528	1,305	2,427	774	1,187	1,003	902	1,005
Excluding grants	1,049	1,415	1,209	2,318	666	1,079	894	794	896
Capital account	59	107	86	104	103	103	103	103	103
Financial account	1,056	1,421	1,219	2,323	671	1,084	899	799	901
Direct foreign investment (net)	553	616	679	2,780	597	649	705	766	831
Medium and long term loans (net)	823	947	360	-237	240	550	325	211	246
Disbursement	1,891	2,437	1,700	1,591	1,951	2,041	2,100	2,151	2,155
Amortization	-1,068	-1,490	-1,340	-1,828	-1,712	-1,491	-1,775	-1,940	-1,909
Short term capital	-289	-103	45	-220	-166	-115	-130	-178	-175
Errors and omissions	-32	-39	135	0	0	0	0	0	0
Overall balance	385	974	945	2,024	399	824	592	475	412
Changes in gross reserves 1/	-653	-1033	-409	-2033	-419	-842	-605	-487	-424
Use of IMF resources	0	0	0	0	0	0	0	0	0
Other assets, net (increase -)	-653	-1033	-409	-2033	-419	-842	-605	-487	-424
Memorandum items:									
Current account balance/GDP (in percent)	-2.9	-2.0	-1.3	-1.4	-1.2	-1.1	-1.1	-1.1	-1.3
Reserves (in billions of $)	3.0	4.0	4.4	6.5	6.9	7.7	8.3	8.8	9.2
Reserves in months of imports of goods	3.3	3.8	4.0	5.5	5.7	6.1	6.3	6.3	6.2
Reserves in months of imports of goods &services	3.0	3.5	3.7	5.1	5.2	5.6	5.7	5.7	5.6
Reserves/total short term external debt (percent) 2/	84.0	106.7	124.9	170.7	174.3	188.2	194.6	197.3	197.0
excluding non-residents deposits	123.8	153.7	174.8	231.7	233.3	248.8	254.0	254.2	250.5
Reserves/short term debt including current amortization (percent)	63.6	75.6	91.8	115.5	121.5	138.0	137.5	137.5	140.0
excluding non-residents deposits	84.1	96.5	116.2	140.5	147.6	168.0	164.7	163.0	165.0
External medium-and long-term debt (in billions of $)	14.4	16.0	15.0	14.9	15.3	16.1	16.5	16.8	17.1
External medium-and long-term debt/GDP (in percent)	53.9	54.9	54.9	51.3	48.5	46.7	44.1	41.4	38.8
External Short-term debt (in billions of $)	3.6	3.8	3.5	3.8	3.9	4.1	4.3	4.5	4.7
External short-term debt/GDP (in percent)	13.3	12.9	13.0	13.0	12.5	11.9	11.5	11.0	10.6
Debt Service Ratio (as percent XGS, incl IMF)	15.1	16.2	14.5	17.9	16.4	14.5	15.7	15.9	15.0
Real goods export growth (in percent)	7.2	10.6	1.2	2.8	3.9	4.2	4.5	4.9	4.9
Non-energy	5.4	10.4	0.8	2.8	4.0	4.4	4.8	5.2	5.2
Real goods import growth (in percent)	3.4	7.3	-5.7	0.9	5.0	5.4	5.6	5.7	5.7
Non-energy	0.6	7.8	-5.5	0.9	5.5	5.9	6.1	6.1	6.1

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

1/ Differs from the overall balance because of valuation effects.

Table 3. Tunisia: Central Government Financial Operations, 2004–11 1/

	2004	Est. 2005	LdF 2006	Projections 2006	2007	2008	2009	2010	2011
	(In millions of dinars)								
Total revenue and grants and privatization	8,577	9,152	9,640	12,620	10,454	11,238	12,134	13,157	14,275
Total revenue	8,379	8,929	9,396	9,526	10,225	11,009	11,905	12,928	14,046
Tax revenue	7,253	7,926	8,282	8,438	9,119	9,856	10,705	11,679	12,722
direct taxes	2,385	2,886	3,022	3,023	3,292	3,585	3,942	4,311	4,677
trade taxes	557	506	560	539	520	501	485	468	475
VAT	2,257	2,301	2,488	2,534	2,794	3,062	3,374	3,753	4,185
domestic	1,139	1,189	1,226	1,289	1,464	1,660	1,879	2,154	2,458
imports	1,119	1,112	1,262	1,245	1,330	1,402	1,494	1,599	1,727
excise	1,150	1,212	1,290	1,330	1,417	1,523	1,622	1,756	1,879
domestic	700	741	794	803	862	946	1,015	1,116	1,197
imports	451	471	496	527	555	577	607	640	682
other taxes	904	1,021	922	1,011	1,095	1,185	1,283	1,391	1,507
domestic	842	949	870	931	1,010	1,096	1,190	1,293	1,403
imports	62	72	52	81	85	88	93	98	104
Nontax revenue	1,117	997	1,106	1,080	1,107	1,153	1,200	1,248	1,324
Capital income	9	6	8	8	0	0	0	0	0
Total expenditure and net lending	9,378	10,109	10,831	10,753	11,446	12,149	12,941	14,004	15,133
Total expenditure	9,411	10,083	10,783	10,705	11,397	12,101	12,893	13,956	15,085
Current expenditure	6,983	7,688	8,302	8,277	8,740	9,194	9,700	10,471	11,289
Wages and salaries	4,222	4,559	4,898	4,898	5,316	5,770	6,261	6,804	7,380
Goods and services	699	708	676	666	766	832	903	981	1,064
Interest payments	989	1,062	1,150	1,150	1,211	1,285	1,349	1,411	1,477
domestic	418	473	521	521	587	645	680	725	778
external	571	589	629	629	624	640	669	686	699
Transfers and subsidies	1,073	1,359	1,442	1,442	1,447	1,307	1,187	1,275	1,368
CGC	200	240	258	258	268	278	288	298	308
Petroleum subsidies	203	414	500	500	415	200	0	0	0
Other	670	705	684	684	764	829	899	977	1,060
Other expenditure (non allocated)	0	0	136	120	0	0	0	0	0
Capital expenditure	2,428	2,395	2,481	2,428	2,657	2,908	3,194	3,485	3,795
Direct investment	1,346	1,245	1,379	1,379	1,584	1,743	1,930	2,111	2,305
Capital transfers and equity	1,082	1,150	988	989	1,073	1,165	1,264	1,373	1,490
Other expenditure (non allocated)	0	0	114	60	0	0	0	0	0
Net lending	-33	26	48	48	48	48	48	48	48
Central Govt deficit (-), excl grants and privatization	-999	-1,180	-1,435	-1,226	-1,220	-1,140	-1,036	-1,076	-1,087
Grants	73	63	94	94	94	94	94	94	94
Privatization Proceeds	125	161	150	3000	135	135	135	135	135
Central Govt deficit (-), incl grants and privatization	-801	-957	-1,191	1,868	-991	-911	-807	-847	-858
Financing	801	957	1,191	-1,868	991	911	807	847	858
Foreign	207	294	-106	-750	-57	366	117	29	28
Domestic	595	663	1,297	-1,118	1,048	545	690	818	830
Memorandum items:									
Balance of the central Gov., (incl. grants, excl priv.)	-926	-1,118	-1,341	-1,132	-1,126	-1,046	-942	-982	-993
Central government primary balance	188	105	-41	3,018	220	374	541	564	619
Central govt primary balance (excl. grants and priv.)	-10	-118	-285	-76	-9	145	312	335	390
General government debt 2/	20,916	21,949	24,357	22,605	23,566	24,579	25,463	26,380	27,292
o/w domestic	7,707	7,923	9,958	8,931	9,810	10,342	11,022	11,836	12,664
external	13,209	14,026	14,399	13,673	13,755	14,237	14,441	14,545	14,628
Nominal GDP	35,035	37,202	40,305	40,322	43,761	47,495	51,539	56,007	60,754
Nominal nonagricultural GDP	30,585	32,868	35,778	35,778	38,941	42,382	46,114	50,253	54,650
Oil price ($/barrel)	37.8	53.4	60.0	61.3	63.0	62.8	62.0	61.3	60.3
Imports	15,087	16,155	18,087	18,087	19,041	19,789	20,805	21,957	23,387

Table 3 (continued). Tunisia: Central Government Financial Operations, 2004–11 1/

		Est.	LdF	Projections					
	2004	2005	2006	2006	2007	2008	2009	2010	2011
				(In percent of GDP)					
Total revenue and grants and privatization	24.5	24.6	23.9	31.3	23.9	23.7	23.5	23.5	23.5
Total revenue	23.9	24.0	23.3	23.6	23.4	23.2	23.1	23.1	23.1
Tax revenue	20.7	21.3	20.5	20.9	20.8	20.8	20.8	20.9	20.9
direct taxes (% of GDP)	6.8	7.8	7.5	7.5	7.5	7.5	7.6	7.7	7.7
trade taxes (% of GDP)	1.6	1.4	1.4	1.3	1.2	1.1	0.9	0.8	0.8
trade taxes (% of imports)	*3.7*	*3.1*	*3.1*	3.0	*2.7*	*2.5*	*2.3*	*2.1*	*2.0*
VAT (% of GDP)	6.4	6.2	6.2	6.3	6.4	6.4	6.5	6.7	6.9
domestic (% of GDP)	3.3	3.2	3.0	3.2	3.3	3.5	3.6	3.8	4.0
imports (% of GDP)	3.2	3.0	3.1	3.1	3.0	3.0	2.9	2.9	2.8
imports (% of imports)	*7.4*	*6.9*	*7.0*	*6.9*	*7.0*	*7.1*	*7.2*	*7.3*	*7.4*
excise (% of GDP)	3.3	3.3	3.2	3.3	3.2	3.2	3.1	3.1	3.1
domestic (% of GDP)	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
imports (% of GDP)	1.3	1.3	1.2	1.3	1.3	1.2	1.2	1.1	1.1
imports (% of imports)	*3.0*	*2.9*	*2.7*	*2.9*	*2.9*	*2.9*	*2.9*	*2.9*	*2.9*
other taxes (% of GDP)	2.6	2.7	2.3	2.5	2.5	2.5	2.5	2.5	2.5
domestic (% of GDP)	2.4	2.6	2.2	2.3	2.3	2.3	2.3	2.3	2.3
imports (% of GDP)	0.2	0.2	0.1	0.2	0.2	0.2	0.2	0.2	0.2
imports (% of imports)	*0.4*	*0.4*	*0.3*	*0.4*	*0.4*	*0.4*	*0.4*	*0.4*	*0.4*
Nontax revenue	3.2	2.7	2.7	2.7	2.5	2.4	2.3	2.2	2.2
Capital income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	26.8	27.2	26.9	26.7	26.2	25.6	25.1	25.0	24.9
Total expenditure	26.9	27.1	26.8	26.5	26.0	25.5	25.0	24.9	24.8
Current expenditure	19.9	20.7	20.6	20.5	20.0	19.4	18.8	18.7	18.6
Wages and salaries	12.1	12.3	12.2	12.1	12.1	12.1	12.1	12.1	12.1
Goods and services	2.0	1.9	1.7	1.7	1.8	1.8	1.8	1.8	1.8
Interest payments	2.8	2.9	2.9	2.9	2.8	2.7	2.6	2.5	2.4
domestic	1.2	1.3	1.3	1.3	1.3	1.4	1.3	1.3	1.3
external	1.6	1.6	1.6	1.6	1.4	1.3	1.3	1.2	1.1
Transfers and subsidies	3.1	3.7	3.6	3.6	3.3	2.8	2.3	2.3	2.3
CGC	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5
Petroleum subsidies	0.6	1.1	1.2	1.2	0.9	0.4	0.0	0.0	0.0
Other	1.9	1.9	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Other expenditure (non allocated)	0.0	0.0	0.3	0.3	0.0	0.0	0.0	0.0	0.0
Capital expenditure	6.9	6.4	6.2	6.0	6.1	6.1	6.2	6.2	6.2
Direct investment	3.8	3.3	3.4	3.4	3.6	3.7	3.7	3.8	3.8
Capital transfers and equity	3.1	3.1	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Other expenditure (non allocated)	0.0	0.0	0.3	0.1	0.0	0.0	0.0	0.0	0.0
Net lending	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Central Govt deficit (-), excl grants and privatization	-2.9	-3.2	-3.6	-3.0	-2.8	-2.4	-2.0	-1.9	-1.8
Grants	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Privatization Proceeds	0.4	0.4	0.4	7.4	0.3	0.3	0.3	0.2	0.2
Central Govt deficit (-), incl grants and privatization	-2.3	-2.6	-3.0	4.6	-2.3	-1.9	-1.6	-1.5	-1.4
Financing	2.3	2.6	3.0	-4.6	2.3	1.9	1.6	1.5	1.4
Foreign	0.6	0.8	-0.3	-1.9	-0.1	0.8	0.2	0.1	0.0
Domestic	1.7	1.8	3.2	-2.8	2.4	1.1	1.3	1.5	1.4
Memorandum items:									
Balance of the central Gov., (incl. grants, excl priv.)	-2.6	-3.0	-3.3	-2.8	-2.6	-2.2	-1.8	-1.8	-1.6
Central government primary balance	0.5	0.3	-0.1	7.5	0.5	0.8	1.1	1.0	1.0
Central govt primary balance (excl. grants and priv.)	0.0	-0.3	-0.7	-0.2	0.0	0.3	0.6	0.6	0.6
General government debt 2/	59.7	59.0	60.4	56.1	53.9	51.8	49.4	47.1	44.9
o/w domestic	22.0	21.3	24.7	22.2	22.4	21.8	21.4	21.1	20.8
external	37.7	37.7	35.7	33.9	31.4	30.0	28.0	26.0	24.1

Source: Tunisian authorities and staff estimates.

1/ Includes special funds, fonds de concours. Does not include the social security system (CSS).
2/ Gross debt: includes debt held by social security funds (CSS); excludes debt of public enterprises.

Table 4. Tunisia: Monetary Survey (Financial System), 2001–06

	2001	2002	2003	2004	2005	2006
	(In millions of dinars)					
Foreign assets (net)	1,597	1,909	2,279	3,126	4,146	7,010
Foreign assets	3,811	4,154	4,547	5,802	7,356	10,291
BCT	2,935	3,134	3,629	4,843	6,060	8,967
Foreign liabilities	-2,214	-2,246	-2,268	-2,675	-3,210	-3,281
Net Domestic Assets	15,805	16,392	17,178	18,340	19,642	19,257
Domestic credit	22,311	23,744	24,669	26,366	28,379	30,235
Credit to the government (net)	2,674	2,790	2,758	3,283	3,574	3,729
Central bank net credit	-244	-290	-504	-597	-636	-636
Commercial banks	1,546	1,642	1,746	2,180	2,274	2,429
Credit to the economy	19,637	20,954	21,911	23,084	24,805	26,506
Other items (net)	-6,506	-7,352	-7,491	-8,026	-8,737	-10,978
Money plus quasi-money (M2)	16,052	16,681	17,859	19,846	22,085	24,388
Money (M1)	6,745	6,618	6,992	7,686	8,600	9,496
Currency	2,378	2,518	2,663	2,968	3,292	3,635
Demand deposits	4,367	4,100	4,328	4,718	5,308	5,862
Quasi-money	9,307	10,063	10,868	12,161	13,485	14,891
Long-term deposits (M3-M2)	1,350	1,619	1,598	1,620	1,703	1,880
Broad Money (M3) 1/	17,402	18,301	19,457	21,467	23,788	26,268
	(Annual rate of change in percent)					
Foreign assets (net)	13.4	19.5	19.4	37.2	32.6	69.1
Domestic credit	8.4	6.4	3.9	6.9	7.6	6.5
Credit to Government (net)	-3.6	4.4	-1.2	19.0	8.9	4.3
Credit to the economy	10.3	6.7	4.6	5.3	7.5	6.9
Money and quasi-money (M2)	10.3	3.9	7.1	11.1	11.3	10.4
Broad Money (M3)	11.3	5.2	6.3	10.3	10.8	10.4
	(Changes in percent of initial stock of M3)					
Foreign assets (net)	1.2	1.8	2.0	4.4	4.7	12.0
Domestic credit	11.1	8.2	5.1	8.7	9.4	7.8
Credit to the government (net)	-0.6	0.7	-0.2	2.7	1.4	0.7
Credit to the economy	11.7	7.6	5.2	6.0	8.0	7.2
Other items (net)	-1.0	-4.9	-0.8	-2.8	-3.3	-9.4
Memorandum items:						
Velocity (GDP/M3)	1.65	1.64	1.66	1.63	1.56	1.54
Multiplier (M3/M0)	5.52	5.70	5.74	5.65	5.13	5.36
GDP	28,757	29,933	32,212	35,035	37,202	40,322
Nominal GDP growth	7.8	4.1	7.6	8.8	6.2	8.4

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

1/ M2 plus long term deposits

Table 5. Tunisia: Medium-Term Growth Scenario, 2003–11

	2003	2004	2005	2006	2007	2008	2009	2010	2011
					(In percent)				
Real GDP growth	5.6	6.0	4.2	5.8	6.0	6.2	6.4	6.5	6.5
Agriculture 1/	21.5	10.1	-5.0	3.0	4.0	4.0	4.0	4.0	4.0
Nonagriculture	3.6	5.4	5.6	6.2	6.3	6.5	6.7	6.8	6.8
Unemployment rate	14.5	14.2	14.3	13.9	13.4	12.7	12.1	11.4	10.8
Inflation	2.8	3.6	2.0	3.0	2.0	2.0	2.0	2.0	2.0
Real export growth 2/	0.1	7.8	2.5	3.8	3.9	4.1	4.3	4.6	4.6
					(In percent of GDP)				
Gross national savings	22.2	22.2	22.7	22.7	23.0	23.3	23.4	23.7	23.7
Consolidated government 3/	4.0	4.5	3.5	3.3	3.6	4.0	4.4	4.5	4.7
Rest of the economy	18.2	17.7	19.1	19.4	19.4	19.3	19.0	19.1	19.1
Gross investment	25.1	24.2	23.9	24.1	24.2	24.4	24.5	24.7	25.1
Consolidated government	7.2	7.0	6.5	6.1	6.1	6.2	6.3	6.3	6.3
Rest of the economy	17.9	17.2	17.4	18.0	18.0	18.2	18.2	18.4	18.8
Savings-investment gap	-2.9	-2.0	-1.3	-1.4	-1.2	-1.1	-1.1	-1.1	-1.3
Consolidated government	-3.1	-2.5	-3.0	-2.7	-2.5	-2.2	-1.8	-1.7	-1.6
Rest of the economy	0.2	0.5	1.7	1.4	1.3	1.1	0.7	0.7	0.3
Memorandum items:									
Balance of the consolidated government	-3.1	-2.5	-3.0	-2.7	-2.5	-2.2	-1.8	-1.7	-1.6
External current account	-2.9	-2.0	-1.3	-1.4	-1.2	-1.1	-1.1	-1.1	-1.3
Gross fixed capital formation	23.4	22.6	22.6	22.7	22.8	23.1	23.2	23.4	23.8

Source: IMF staff estimates from 2003.

1/ Based on average growth of agricultural output from 2001 onwards.
2/ Goods and nonfactor services.
3/ Includes social security, excludes privatization receipts.

Table 6. Tunisia: External Debt Sustainability Framework, 2001-11
(In percent of GDP, unless otherwise indicated)

	2001	2002	2003	2004	2005	Projections 2006	2007	2008	2009	2010	2011	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	65.8	67.6	67.2	67.8	67.9	**64.3**	**61.0**	**58.6**	**55.6**	**52.4**	**49.5**	**-4.3**
2 Change in external debt	6.7	1.8	-0.4	0.6	0.1	-3.6	-3.3	-2.4	-3.0	-3.2	-2.9	
3 Identified external debt-creating flows (4+8+9)	1.1	-8.6	-10.1	-6.2	3.5	-12.0	-4.4	-4.4	-4.4	-4.3	-3.8	
4 Current account deficit, excluding interest payments	2.0	1.1	0.7	-0.2	-0.9	-0.9	-0.9	-0.9	-0.8	-0.8	-0.3	
5 Deficit in balance of goods and services	4.2	3.7	3.4	2.6	1.1	1.9	1.7	1.6	1.7	1.7	2.1	
6 Exports	48.3	42.1	40.7	45.1	51.6	50.5	48.7	46.9	45.4	44.1	43.0	
7 Imports	52.5	45.8	44.1	47.6	52.8	52.3	50.4	48.5	47.1	45.9	45.1	
8 Net non-debt creating capital inflows (negative)	-2.2	-3.6	-2.1	-2.2	-2.6	-9.6	-2.0	-2.0	-2.0	-2.0	-2.0	
9 Automatic debt dynamics 1/	1.3	-6.2	-8.6	-3.8	7.0	-1.4	-1.4	-1.5	-1.5	-1.5	-1.4	
10 Contribution from nominal interest rate	2.3	2.2	2.1	2.1	2.2	2.3	2.1	2.0	1.9	1.8	1.7	
11 Contribution from real GDP growth	-2.9	-1.0	-3.2	-3.7	-3.1	-3.7	-3.5	-3.5	-3.5	-3.3	-3.1	
12 Contribution from price and exchange rate changes 2/	1.9	-7.4	-7.5	-2.2	7.8	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	5.6	10.4	9.7	6.8	-3.4	8.3	1.0	2.0	1.4	1.0	0.9	
External debt-to-exports ratio (in percent)	136.0	160.4	165.2	150.5	131.5	127.4	125.3	124.9	122.5	118.6	115.0	
Gross external financing need (in billions of US dollars) 4/	3.3	4.5	4.9	5.6	5.5	5.8	5.9	5.8	6.3	6.6	7.0	
in percent of GDP	16.6	20.0	18.3	19.2	20.0	19.8	18.6	16.9	16.8	16.4	15.8	
Scenario with key variables at their historical averages 5/						**64.3**	**64.5**	**65.7**	**65.9**	**65.9**	**65.6**	**-3.1**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.9	1.7	5.6	6.0	4.2	5.8	6.0	6.2	6.4	6.5	6.5	
GDP deflator in US dollars (change in percent)	-3.1	12.7	12.6	3.3	-10.4	0.9	2.5	2.4	2.0	2.0	2.0	
Nominal external interest rate (in percent)	4.0	3.8	3.6	3.5	3.1	3.6	3.5	3.5	3.5	3.5	3.5	
Growth of exports (US dollar terms, in percent)	10.7	-0.2	14.7	21.4	7.0	4.4	4.8	4.7	5.1	5.6	5.8	
Growth of imports (US dollar terms, in percent)	12.0	-0.2	14.4	18.4	3.4	5.9	4.6	4.5	5.5	5.8	6.7	
Current account balance, excluding interest payments	-2.0	-1.1	-0.7	0.2	0.9	0.9	0.9	0.9	0.8	0.8	0.3	
Net non-debt creating capital inflows	2.2	3.6	2.1	2.2	2.6	9.6	2.0	2.0	2.0	2.0	2.0	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

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

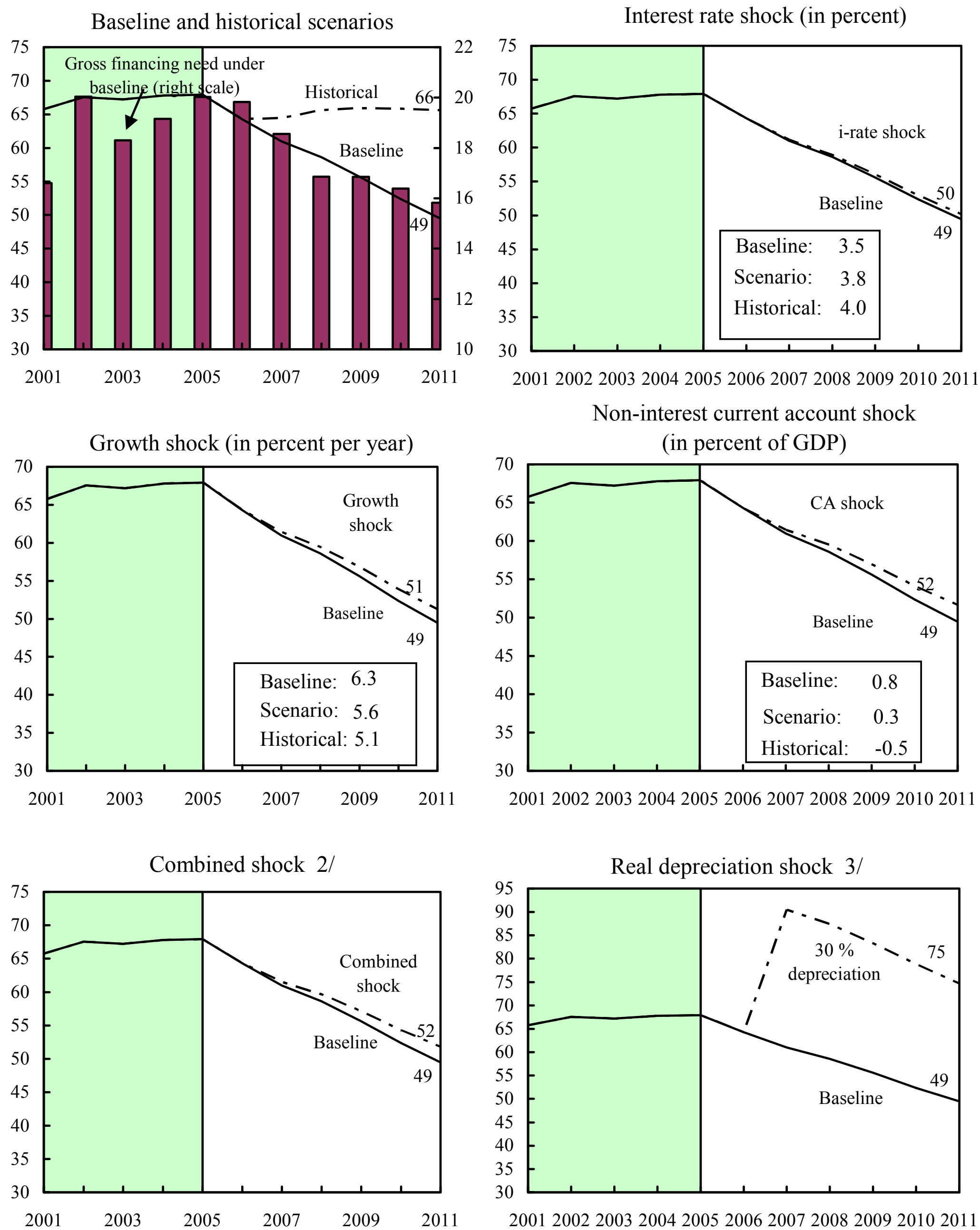
3/ For projection, line includes the impact of price and exchange rate changes. The volatility of the residual is exaggerated by the calculation of the exchange rate effect, which assumes that all foreign debt is denominated in U.S. dollars. This effect is particularly pronounced in 2003 when the Tunisian dinar appreciated against the U.S. dollar, while depreciating against all other major currencies.

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



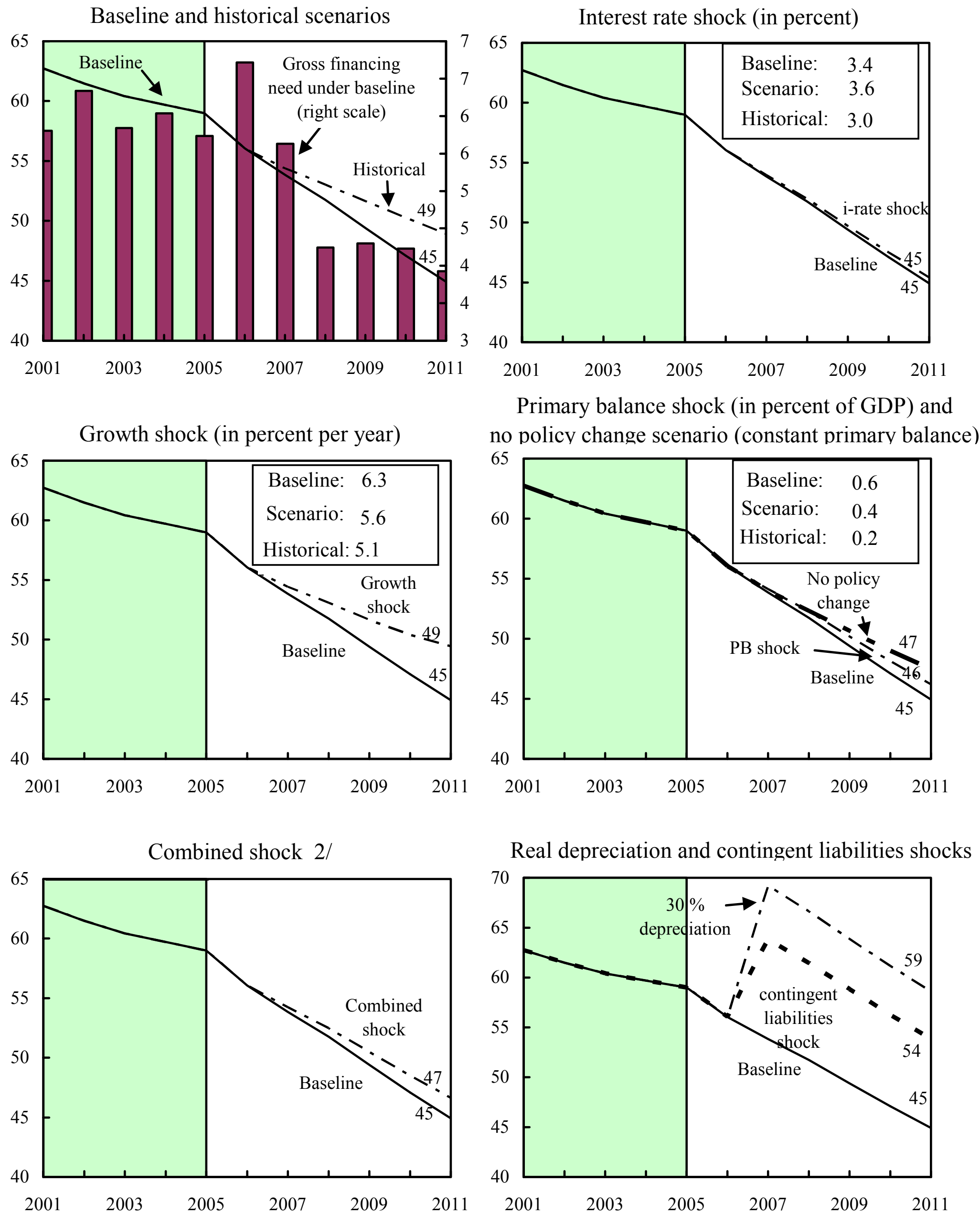
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2006.

Table 7. Tunisia: Public Sector Debt Sustainability Framework, 2001–11
(In percent of GDP, unless otherwise indicated)

		Actual					Projections						
		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Debt-stabilizing primary balance 9/
1	**Baseline: Public sector debt 1/**	62.7	61.5	60.4	59.7	59.0	**56.1**	**53.9**	**51.8**	**49.4**	**47.1**	**44.9**	**1.9**
	o/w foreign-currency denominated	39.2	39.0	38.9	37.7	37.7	33.9	31.4	30.0	28.0	26.0	24.1	
2	Change in public sector debt	1.9	-1.2	-1.1	-0.7	-0.7	-2.9	-2.2	-2.1	-2.3	-2.3	-2.2	
3	Identified debt-creating flows (4+7+12)	0.5	-4.4	-4.8	-3.0	4.1	-9.3	-2.2	-2.3	-2.5	-2.4	1.0	
4	Primary deficit	-0.4	-0.3	0.3	-0.3	0.1	-0.1	-0.2	-0.5	-0.8	-0.8	-0.8	
5	Revenue and grants	29.8	30.3	29.7	30.0	29.9	29.7	29.4	29.2	29.1	29.1	29.1	
6	Primary (noninterest) expenditure	29.4	30.1	30.0	29.6	30.1	29.6	29.2	28.7	28.3	28.3	28.3	
7	Automatic debt dynamics 2/	0.8	-3.0	-5.1	-2.3	4.4	-1.7	-1.6	-1.5	-1.4	-1.4	-1.2	
8	Contribution from interest rate/growth differential 3/	-1.4	0.6	-1.5	-2.0	-0.6	-1.7	-1.6	-1.5	-1.4	-1.4	-1.2	
9	Of which contribution from real interest rate	1.4	1.6	1.6	1.3	1.8	1.4	1.5	1.5	1.6	1.5	1.6	
10	Of which contribution from real GDP growth	-2.8	-1.0	-3.2	-3.4	-2.4	-3.2	-3.1	-3.1	-3.1	-3.0	-2.8	
11	Contribution from exchange rate depreciation 4/	2.2	-3.6	-3.6	-0.3	5.1	...	...	...	...	...	...	
12	Other identified debt-creating flows	0.0	-1.1	0.0	-0.4	-0.4	-7.4	-0.3	-0.3	-0.3	-0.2	3.1	
13	Privatization receipts (negative)	0.0	-1.1	0.0	-0.4	-0.4	-7.4	-0.3	-0.3	-0.3	-0.2	-0.2	
14	Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.6	
15	Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.6	
16	Residual, including asset changes (2-3) 5/	1.5	3.2	3.8	2.3	-4.8	6.3	0.0	0.2	0.2	0.1	-3.2	
	Public sector debt-to-revenue ratio 1/	210.6	202.7	203.4	199.2	197.0	188.6	183.0	177.1	169.6	161.9	154.3	
	Gross financing need 6/	5.8	6.3	5.8	6.0	5.7	6.7	5.6	4.2	4.3	4.2	3.9	
	in billions of U.S. dollars	1.2	1.3	1.5	1.7	1.6	2.0	1.8	1.5	1.6	1.7	1.7	
	Scenario with key variables at their historical averages 7/						**56.1**	**54.4**	**53.0**	**51.6**	**50.3**	**48.9**	**2.2**
	Scenario with no policy change (constant primary balance) in 2005-2010						**56.1**	**54.0**	**52.3**	**50.7**	**49.0**	**47.5**	**1.8**
	Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
	Real GDP growth (in percent)	4.9	1.7	5.6	6.0	4.2	5.8	6.0	6.2	6.4	6.5	6.5	
	Average nominal interest rate on public debt (in percent) 8/	5.5	5.1	4.9	5.1	5.1	5.2	5.4	5.5	5.5	5.5	5.6	
	Average real interest rate (nominal rate minus change in GDP deflator, in percer	2.6	2.7	3.0	2.5	3.2	2.8	3.0	3.2	3.5	3.5	3.7	
	Nominal appreciation (increase in US dollar value of local currency, in percent)	-5.7	10.1	10.4	0.7	-12.0	...	...	...	...	...	...	
	Inflation rate (GDP deflator, in percent)	2.8	2.4	2.0	2.6	1.9	2.4	2.4	2.2	2.0	2.0	1.9	
	Growth of real primary spending (deflated by GDP deflator, in percent)	5.0	3.9	5.4	4.6	5.7	4.3	4.4	4.4	5.0	6.5	6.5	
	Primary deficit	-0.4	-0.3	0.3	-0.3	0.1	-0.1	-0.2	-0.5	-0.8	-0.8	-0.8	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currenc denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ The volatility of the residual is exaggerated by the calculation of the exchange rate effect, which assumes that all foreign debt is denominated in U.S. dollars. This effect is particularly pronounced in 2003 when the Tunisian dinar appreciated against the U.S. dollar, while depreciating against all other major currencies.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
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.

Figure 8. Tunisa. Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data.Individual shocks are permanent one-half standard deviation shocks. 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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2006, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Tunisia: Fund Relations

As of March 31, 2006

I. **Membership Status:** Joined: 04/14/1958; Article VIII

II. **General Resources Account:**	SDR Million	%Quota
Quota	286.50	100.0
Fund Holdings of Currency	266.28	92.94
Reserve position in Fund	20.25	7.07

III. **SDR Department:**	SDR Million	%Allocation
Net cumulative allocation	34.24	100.0
Holdings	1.35	3.93

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	07/25/1988	07/24/1992	207.30	207.30
Stand-by	11/04/1986	05/31/1988	103.65	91.00

VI. **Projected Obligations to Fund:** (SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal					
Charges/Interest	0.85	1.14	1.14	1.14	1.14
Total	0.85	1.14	1.14	1.14	1.14

Exchange Rate Arrangement and Exchange System

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

Since March 1, 1994, the market rates are determined in an interbank foreign exchange market. On April 20, 2006, the interbank rate of the dinar vis-à-vis the U.S. dollar was US$1=TD 1.3360, equivalent to SDR 1=TD 1.943.

Article IV Consultation

Tunisia is on the 12-month cycle. The last discussions of the Article IV consultation were held in Tunis from June 16 to July 1, 2004 and the consultation was concluded by the Executive Board on October 27, 2004.

Technical Assistance

January 31–February 14, 1996: FAD—assessment of revenue impact of Association Agreement with EU.

March 31–April 4, 1997: STA—introduction of new methodological guidelines according to fifth edition of *Balance of Payments Manual*.

September 9–12, 1998: MAE—monetary management and development of the money market.

May 11–21, 1999: STA—quarterly national accounts.
May 13–18, 1999: STA—SDDS.
October 12–15, 1999: MAE—debt management practices.
October 17–27, 2000: STA—quarterly national accounts.
October 25–31, 2000; STA—SDDS meta data finalization.
December 17–21, 2001: MAE—management of central bank liquidity.
December 12–19, 2003: LEG—AML/CFT.
May 18–19, 2004: MFD—technical assistance needs assessment.
July 1-15, 2004: STA—Government Finance Statistics.
January 24-February 5, 2005: FAD—Tax Policy.
April 7-22, 2005: STA—ROSC, Data Module.
September 8-21, 2005: FAD —Tax Administration.
January 16-31,2006: MFD —FSAP update (mission 1).
March 27-31,2006: MFD —FSAP update (mission 2).

Resident Representative: None

TUNISIA: FINANCIAL RELATIONS WITH THE WORLD BANK

(As of March 31, 2006)

1. The World Bank's portfolio in Tunisia has a total of 16 active operations and 117 closed loans, of which 10 International Development Agency (IDA) credits amounting to US$75.2 million net of cancellations. Cumulative net commitments represent US$5.1 billion. Of this total, US$3.4 billion has been repaid. Net commitments for the 16 current investment operations amount to about US$0.8 billion.

2. A new Country Assistance Strategy (CAS) was approved by the Board on June 3, 2004. It proposes to assist the Government of Tunisia in addressing three key challenges: (a) strengthen the business environment to support the development of a more competitive, internationally integrated private sector and improve competitiveness of the Tunisian economy; (b) enhance skills and employability of graduates and labor force in a knowledge economy; and (c) improve the quality of social services through enhanced efficiency of public expenditures.

3. Bank lending is a mix of long-term investments in infrastructure and social sector financing, and development policy lending to support reforms at the sector and macroeconomic levels. Recent loans include an Urban Water Supply project ($38.0 million) approved by the Board on November 17, 2005, and a development policy loan – ECAL IV ($150.0 million) approved by the Board on June 9, 2005. One GEF , Tunisia Africa Stockpile Programme ($4.0 million) was also approved on September 8, 2005.

4. Preparation is ongoing for the following projects: Second Higher Education Reform Support ($140.0 million) scheduled for Board consideration in June 2006; Tunis West Sewerage ($60.0 million); and Sustainable Management of Municipal Waste ($20.0 million), both scheduled for FY07 Board approval. This latter project is the first of its kind in Tunisia which will incorporate, as part of a Bank investment project, a component on carbon emission reduction and provide Bank assistance in accessing the emerging global market of carbon finance under the Clean Development Mechanism of the Kyoto Protocol.

5. Despite the fact that the quality of the portfolio is satisfactory, cumbersome procurement procedures and slow implementation pace - especially in the rural development portfolio - are affecting the portfolio performance. A Country Portfolio Performance Review (CPPR) was carried out in May 2005 with special focus on procurement issues. An action plan was designed to address the key constraints identified and is being implemented jointly by the Bank and counterpart teams.

6. Recent analytical work includes studies of employment challenges, poverty trends, private participation in infrastructure, public debt management, and tourism. A Development Policy Review was prepared in 2003 in order to assess Tunisia's key challenges and policy priorities in the years ahead. This provided the analytical basis for the new Country Assistance Strategy and is intended to inform the Government's thinking on the next five-

year plan (2007–2011). Other recent work includes Country Financial Accountability and Procurement Assessments, a Report on the Observance of Standards and Codes (ROSC), audit and accounting module, and analytical work in specific sectors such as education, health and agriculture. An update of the Financial Sector Assessment Program (FSAP) conducted jointly with the IMF has just been completed. A strategy on education and training and an investment climate assessment (ICA) are ongoing. Three sub-regional Maghreb studies (covering Tunisia, Morocco and Algeria) are ongoing. These studies focus on: (i) the textiles and clothing sector and the impact of MFA dismantling; (ii) economic diversification; and (iii) a sub-regional study on Maghreb regional economic integration and on the link between policy reforms in the service sectors and economic performance in the region. Future work will include a study on service liberalization and export competitiveness.

7. In addition, the World Bank is providing technical assistance on a regular basis on issues such as public debt management, performance-based budgeting, the promotion of the knowledge-based economy and productivity analysis. The Bank also provides multi-year support on employment and labor market issues as part of a Programmatic Economic and Sector Work.

Tunisia: Financial Relations with the World Bank

(As of March 31, 2006)

	Total Net Commitments	Undisbursed Balance
	(In million of US dollars)	
IBRD lending operations		
117 loans closed [1/]	4,250.9	
16 active loans		
-MP Ozone Depleting Subs.	3.8	0.26
-Agric. Support Services	18.1	14.66
-Water Sector Invt. Project	103	28.83
-GEF Protected Areas Mgmt.	5.1	4.13
-Cultural Heritage	17	18.87
-Education PAQSET I	99	11.98
-Transport Sector Invt. II	37.6	29.79
-NW Mountainous & Forestry Areas Devt.	34	35.16
-Municipal Devt. III	78.4	42.63
-Export Development II	35.8	30.67
-Education PAQSET II	130.3	94.87
-ICT Sector Development	13.1	10.99
-ECAL IV	150	70.41
-GEF Energy Efficiency Program/Indust.	8.5	7.27
-GEF Gulf of Gabes	6.3	5.67
- Urban Water Supply	38.0	37.6
Total active loans	778.1	443.8
Repayments [2/]	3449.08	
Debt outstanding [2/]	1595.0	

	2000	2001	2002	2003	2004	2005	2006
Net lending by the World Bank (by fiscal year) [3/]							
Commitments	202	75.9	252.5	112.4	166.3	163.1	38.0
Disbursements	147.1	174.6	226.7	142.5	238.6	119.4	163.3
Debt service	246.5	223.1	229.8	258.0	305.1	303.1	208.4
Principal	163.1	146.3	149.6	175.9	224.8	230.5	165.9
Interest [5/]	83.4	76.8	80.2	82.1	80.3	72.6	42.5
Net transfer [6/]	-99.4	-48.5	-3.1	-115.5	-66.5	-183.7	-45.1

1/ Less cancellations, includes adjustment lending, does not include guarantees.
2/ As of March 31, 2006
3/ Fiscal years start July 1 and end June 30.
4/ Does not include US$184 million for guarantee on Jorf Lasfar electricity project
5/ Includes charges.
6/ Equal to disbursement minus debt service.

TUNISIA: STATISTICAL ISSUES

1. Overall, available economic and financial data are adequate for surveillance and have generally been provided to the Fund on a regular and timely basis. Most of those data are also made available to the wider public. Tunisia subscribed to the SDDS in June 2001 and its metadata are posted on the Dissemination Standards Bulletin Board (DSBB). A data ROSC is under preparation, following a mission that took place in April 2005.

Real Sector

2. IFS coverage of data on real sector developments is satisfactory and most data are reported in a timely manner, although export and import price and volume indices are reported with a long lag. Data on employment, unemployment, and wages should be collected and reported on a more frequent basis.

3. Data on GDP by economic sector are disseminated at current and constant prices. Although the *System of National Accounts 1968* (*1968 SNA*) is broadly followed, significant conceptual elements of the *System of National Accounts 1993* (*1993 SNA*) have been implemented (including institutional sector accounts and estimates of the unrecorded economy). Work is underway toward full adoption of the *1993 SNA*. Statistical techniques are adequate for the annual accounts but need some refinement for the quarterly estimates. Source data for the quarterly national accounts could be further diversified to improve coverage. Currently, an outdated base year (1990) is used for the constant price series. A new series using 2000 as base year is expected to be released in the near future

Government Finance

4. In addition to the information reported in the SDDS, government finance data are collected by the staff at the time of the Article IV consultation mission. Regarding data for publication, GFS cash data up to 2005 have been published in the *Government Finance Statistics Yearbook 2005.* Data cover budgetary central government and consolidated central government. Tunisia does not report monthly or quarterly data for publication in IFS.

Balance of Payments

5. Statistics for balance of payments (BOP) and international investment position (IIP) are compiled by the Central Bank of Tunisia (CBT), following the methodology of the fifth edition of the *Balance of Payments Manual,* (*BPM5)*. The BOP statistics are prepared on a quarterly basis and the IIP on an annual basis, complying with SDDS requirements. However, Tunisia does not report quarterly data for redissemination in IMF publications. The

CBT issues preliminary monthly statistics, mostly prepared on the basis of banks' settlements with nonresidents. BOP statistics are generally adequate for annual surveillance, although greater detail on the financial account would be desirable. However, the recent ROSC mission noted that remittances of Tunisian workers abroad are classified as income instead of current transfers, and that reinvested earnings of foreign direct investments are not recorded in the balance of payments. As an SDDS subscriber, Tunisia reports reserves data following the *International Reserves and Foreign Currency Liquidity—Operational Guidelines* (*Reserves Template*) since June 2001.

Monetary and Financial Statistics

6. Monetary statistics compiled by the CBT are broadly based on the *1984 Guide to Money and Banking Statistics in International Financial Statistics*. Tunisia's monetary statistics meet SDDS requirements. However, there is room for improvement. For example, banks' claims on the rest of domestic sector (other than central government and financial corporations) are not fully sectorized; monetary gold is valued at a fixed price; and accrued interest on deposits is not included in the outstanding value of these deposits. The CBT has initiated a plan to migrate to the methodology recommended in the *Monetary and Financial Statistics Manual* (2000).

TUNISIA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

AS OF APRIL 27, 2006

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	Mar. 2006	4/6/06	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Mar. 2006	Apr. 2006	M	M	M
Reserve/Base Money	Mar. 2006	4/14/06	M	M/V	M
Broad Money	Feb. 2006	4/14/06	M	M/V	M
Central Bank Balance Sheet	Mar. 2006	4/14/06	M	M/V	M
Consolidated Balance Sheet of the Banking System	Feb. 2006	4/14/06	M	Q	Q
Interest Rates[2]	Mar. 2006	4/14/06	D	D	D
Consumer Price Index	July 2004Sept 2005	Aug 2004Oct 2005	M	M/V	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]					
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Sept 2005		M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]					
External Current Account Balance	Q1 2004	Apr 2004	Q	Q/V	Q
Exports and Imports of Goods and Services					
GDP/GNP	Q4 Q1 20032005	Apr 2004Aug 2005	Q	Q/V	Q
Gross External Debt	Q4 2003	Apr 2004	Q	V	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I); and not available (NA).

WORK PROGRAM

I. Article IV Consultation

Staff visit	October 2006.
Article IV Consultation Discussion	Early 2007.

Statement by the IMF Staff Representative on Tunisia
May 24, 2006

This statement provides information on developments since the issuance of the staff report, and does not change the thrust of the staff appraisal. The Tunisian authorities recently announced that (a) the banking law amendment has been promulgated and the new central bank law has been passed by parliament; and (b) consistent with Fund advice, they intend to use two-thirds of the proceeds from the partial privatization of *Tunisie Télécom* ($2.3 billion) to retire external debt – substantially more than assumed in the staff report.

Impact on macroeconomic projections due to higher external debt repayment:

- **Total external debt projections shift downward by about 2-2½ percentage points of GDP** from 2007 onward (the bulk of the additional external debt repayment is assumed to occur in 2007). Accordingly, the external debt-to-GDP ratio is projected to decline from 68 percent in 2005 to 47½ percent in 2011.
- **Public debt projections shift downward by the same amount**. Hence, the public debt ratio falls from 59 percent of GDP in 2005 to 43 percent in 2011.
- **Projected international reserves are lower** by an equivalent amount. The import coverage (goods and non-factor services) stabilizes slightly above 5 months in the medium term.
- **There is no appreciable effect on the central government's deficit, nor on the external current account**. In fact, lower interest payments on public external debt are broadly offset by lower earnings on international reserves.
- **There is no impact on key monetary aggregates**, since the proceeds were anyway assumed to be sterilized.

Table 1. Tunisia: Revised Projections, 2005-11

	Est.	Proj.					
	2005	2006	2007	2008	2009	2010	2011
		(Percent of GDP, unless otherwise indicated)					
New projections							
Total external debt	67.9	64.1	58.4	56.2	53.3	50.3	47.5
Total public debt	59.0	55.8	51.3	49.3	47.1	45.0	42.9
Gross official reserves (US$ billions, e.o.p)	4.4	6.4	6.1	6.9	7.5	8.0	8.4
In months of imports of GNFS	3.7	5.0	4.6	5.0	5.1	5.2	5.1
Staff report projections							
Total external debt	67.9	64.3	61.0	58.6	55.6	52.4	49.5
Total public debt	59.0	56.1	53.9	51.8	49.4	47.1	44.9
Gross official reserves (US$ billions, e.o.p)	4.4	6.5	6.9	7.7	8.3	8.8	9.2
In months of imports of GNFS	3.7	5.1	5.2	5.6	5.7	5.7	5.6

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

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

International Monetary Fund
700 19th Street, NW
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Public Information Notice (PIN) No. 06/62
FOR IMMEDIATE RELEASE
June 8, 2006

IMF Executive Board Concludes 2006 Article IV Consultation with Tunisia

On May 24, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tunisia.[1]

Background

Over the past decade, market-oriented reforms and prudent macroeconomic policies have contributed to placing Tunisia's economic performance among the best in the region. The authorities have managed the exchange rate flexibly in a context of restricted external capital flows. Outward orientation has been a key component of Tunisia's development strategy, notably through an Association Agreement with the EU, signed in 1995. Gradual structural reforms combined with a flexible exchange rate policy since 2000 have supported competitiveness and export growth.

The Tunisian economy continues to show strength and the outlook is favorable. Real GDP growth remained relatively strong in 2005 and the external current account deficit narrowed significantly, notwithstanding unfavorable agricultural conditions, the expiration of the Agreement on Textiles and Clothing, and continued tepid demand in Europe. Growth is expected to accelerate in 2006, as agricultural production recovers and the service and industry sectors remain strong. While increased financial inflows present a challenge for monetary policy, the current macroeconomic stance remains appropriate and inflation subdued.

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

The external debt-to-GDP ratio remained broadly unchanged in 2005, at 68 percent, but is expected to decline substantially in 2006, owing to high growth and large privatization proceeds.

The central government deficit widened somewhat in 2005 (to 3.2 percent of GDP, excluding privatization receipts and grants) due to the impact of high oil prices on subsidies, but is expected to return to about 3 percent in 2006. The authorities continue to raise retail petroleum prices. On the revenue side, they are undertaking tax policy and administration reforms. The medium-term objective is to bring public debt from 59 percent GDP to below 50 percent.

Banking sector indicators improved in 2005. The share of non-performing loans (NPLs) in total loans declined significantly (to about 21 percent) and provisioning increased somewhat. While not of systemic proportions, banking sector vulnerabilities increase the cost of capital and hinder macroeconomic reform. The recent Financial Sector Assessment Program update should contribute to sharpening the authorities' reform strategy.

Over the medium term, the authorities are aiming to achieve the standard of living of emerging market OECD countries and transform Tunisia's economic structure to absorb the rapidly increasing supply of skilled labor. This will require: (i) strengthening the financial sector by accelerating the resolution of the high NPLs; (ii) advancing macroeconomic policy reforms; (iii) improving the investment climate; and (iv) increasing labor market flexibility.

Tunisia continues to improve the quality and dissemination of statistical data and increase the transparency of its economic policies. Tunisia has published all Executive Board documents and staff mission statements in recent years and intend to publish the 2006 Article IV Staff Report and Selected Issues papers.

Executive Board Assessment

Executive Directors commended Tunisia's strong economic performance and resilience to adverse shocks, reflected in robust growth, subdued inflation, strengthened reserves, and increasing capital inflows, which underscored the benefits of sustained sound macroeconomic policies and market-oriented reforms. Directors stressed, however, that growth will need to accelerate in order to meet Tunisia's objective of reaching lower-tier OECD income levels and reducing unemployment, and encouraged the authorities to speed up macroeconomic and structural reforms, to take full advantage of global and regional integration.

Directors welcomed the authorities' continued efforts to contain the fiscal impact of high oil prices, including recent adjustments in retail petroleum prices, within the framework of a comprehensive strategy for more efficient energy use. These measures, combined with ongoing tax reforms and efforts to improve tax collection will support continued fiscal consolidation and targeted reductions in public debt over the medium term. Nonetheless, Directors viewed that the weight of the wage bill will need to be reduced over the medium-term in order to enhance fiscal policy flexibility.

Directors noted that, faced with increased external capital inflows, monetary and exchange rate policies had effectively contained inflation while maintaining strong growth. They

encouraged the authorities to remain vigilant against price pressures and, if needed, complement monetary policy with fiscal tightening, accelerated trade liberalization, and increased exchange rate flexibility, in particular, if capital inflows persist.

Directors welcomed the phased liberalization of the external capital account, and the associated integration of Tunisia's economy with international markets, and urged timely action on the steps required for advancing to the next stages. They emphasized that the associated transition to a floating exchange rate regime will need to be supported by a deepening of money and exchange markets. In this regard, they were encouraged by the progress towards the implementation of Tunisia's new monetary policy framework and, in particular, by the new central bank law and its focus on price stability as a key objective. Directors underscored the importance of increased interest and exchange rate flexibility for market development. They welcomed the authorities' commitment to eliminate, in the near future, the requirement that banks transfer end-of-day foreign exchange balances to the Central Bank of Tunisia, and emphasized that improved banking sector conditions are prerequisite for sustaining further substantial advancement.

Directors were encouraged that the authorities have put in place most of the key recommendations of the 2002 FSAP and welcomed Tunisia's participation in the 2006 FSAP update, which will help in addressing the remaining weaknesses in the banking sector, including by sharpening the strategy for reducing NPLs, and tackling vulnerabilities. In this regard, they welcomed the authorities' intention to publish a report on banking supervision and financial stability. Given the favorable economic outlook, efforts to improve banking indicators over the next three-year period should be stepped up, by increasing provisioning, improving the quality of new credit, and dealing decisively with the existing stock of NPLs. They stressed that public banks should be operated on a strictly commercial basis, and that provisioning rules and sanctions should be fully enforced.

Directors welcomed the authorities' decision to use most of the proceeds from the partial privatization of *Tunisie Télécom* to retire external debt, which will facilitate monetary management, contribute to reducing the high external debt, and strengthen the fiscal position.

Directors noted that accelerating structural reforms will be key to enhancing the economy's adaptability to a changing global environment and strengthening Tunisia's attractiveness as a destination for private investment. In this regard, improving the business climate and further increasing labor market flexibility are priorities that would also help to address Tunisia's high unemployment, increasingly concentrated among university graduates. Directors, while acknowledging that Tunisia has been a pioneer in the region's trade integration vis-à-vis the European Union, urged the intensification of multilateral and regional integration efforts. They welcomed ongoing customs reforms, and the authorities' interest in Fund technical assistance in this area. Directors also lauded Tunisia's active participation in efforts to increase economic integration within the Maghreb region.

Directors welcomed the completion of the AML/CFT Report on the Observance of Standards and Codes, and noted that the key challenge going forward will be to bring implementation, enforcement, and supervision of financial sector compliance in line with AML/CFT

requirements. They commended the authorities' commitment to transparency and welcomed their continuous efforts to improve the quality of data.

Public Information Notices (PINs) are issued, (a) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (b) following policy discussions in the Executive Board at the decision of the Board.

Table 1. Tunisia: Selected Economic Indicators, 2001–06
(Quota: SDR 286.5 million)
(Population: 9.9 million; 2004)
(Per capita GDP: US$2,838; 2004)
(Poverty rate: 4.1 percent; 2000)
(Main export: textiles, electronic and mechanical goods, tourism; 2004)

	2001	2002	2003	2004	2005	2006
					Est.	Proj.
Output and Prices	(Annual percentage change)					
Real GDP (market price)	4.9	1.7	5.6	6.0	4.2	5.8
Consumer prices (end of period)	3.0	1.8	4.4	1.2	3.9	3.0
Consumer prices (period average)	1.9	2.8	2.8	3.6	2.0	3.0
Investment and Saving	(In percent of GDP)					
Gross capital formation	27.9	25.7	25.1	24.2	23.9	24.1
of which: Non-government	20.1	18.2	17.9	17.2	17.4	18.0
Gross national savings	23.7	22.2	22.2	22.2	22.7	22.7
of which: Non-government	18.7	17.4	18.2	17.7	19.1	19.4
Public Finances	(In percent of GDP)					
Revenue (including grants)	24.3	24.8	23.9	24.1	24.2	23.9
Expenditure	27.8	27.8	27.0	26.8	27.2	26.7
Budget balance (including grants)	-3.5	-3.1	-3.2	-2.6	-3.0	-2.8
Primary balance (including grants)	-0.4	0.0	-0.4	0.2	-0.1	0.0
Total government debt	62.7	61.5	60.4	59.7	59.0	56.1
Monetary Sector	(Annual percentage change, unless otherwise indicated)					
Credit to the private sector	10.3	6.7	4.6	5.3	7.5	6.9
Base money	18.3	1.8	5.5	12.2	21.9	10.4
Broad money	11.3	5.2	6.3	10.3	10.8	10.4
Velocity of broad money	1.7	1.6	1.7	1.6	1.6	1.5
Three-month treasury bill rate (period average, in percent) 1/	6.3	6.2	N/A	N/A	5.1	...
External Sector	(In percent of GDP, unless otherwise indicated)					
Exports of goods (in US$, percentage change)	13.6	3.4	17.1	20.6	8.4	4.5
Imports of goods (in US$, percentage change)	11.2	-0.2	14.7	17.6	2.8	6.0
Merchandise trade balance	-11.8	-10.1	-9.1	-8.7	-6.8	-7.6
Current account excluding official transfers	-4.2	-3.5	-2.9	-2.0	-1.3	-1.4
Current account including official transfers	-3.9	-3.2	-2.7	-1.6	-0.9	-1.0
Foreign direct investment	2.2	3.6	2.1	2.1	2.5	9.5
Total external debt	65.8	67.6	67.2	67.8	67.9	64.3
Gross reserves (in millions of U.S. dollars)	2.0	2.3	3.0	4.0	4.4	6.5
In months of next year imports of goods and services	2.3	2.7	3.0	3.5	3.7	5.1
In percent of short-term external debt (on remaining maturity basis)	55.3	54.7	63.6	75.6	91.8	115.5
Memorandum Items:						
Nominal GDP (in US$ billions)	20.0	22.4	26.7	29.2	27.3	29.1
Unemployment rate (in percent)	15.1	15.3	14.5	14.2	14.3	13.9
Net imports of petroleum products (in millions of US dollars)	275.0	221.7	328.8	407.1	393.4	425.0
Local currency per U.S. dollar (period average)	1.4	1.4	1.3	1.2	1.3	...
Real effective exchange rate (annual average, percentage change)	-2.4	-0.2	-5.0	-3.4	-4.5	...
Stock market index 2/	1267.0	1119.2	1250.2	1331.8	1615.1	1866.9

Sources: Tunisian authorities and IMF staff estimates.

1/ There was no outstanding short-term government debt in 2003, 2004, or end-2005. 2005 refers to October.

2/ TUNINDEX. (1000 = 4/1/1998). 2006 data from April 7, 2006.

Statement by Abbas Mirakhor, Executive Director for Tunisia
May 24, 2006

We thank staff for the well-written and concise report on the 2006 Article IV consultation, supported by relevant background studies, and for the well-balanced FSSA update. Additional documents, to be issued shortly, include AML/CFT and data ROSCs, and a detailed assessment of observance of the Basel Core Principles. Our Tunisian authorities are grateful for the effective Fund support received over the years and appreciate staff work and policy advice as well as Directors' contribution to the continuous strengthening of the relations between the Fund and Tunisia.

As reflected in the staff report, Tunisia has achieved and maintained macroeconomic stability and has built enough resilience in the economy to withstand various external shocks as evinced in recent years. This resilience has been reflected, in 2005, in a further narrowing of the current account deficit to 1.3 percent of GDP and in a minor increase in the budget deficit to 3.2 percent of GDP despite the impact of high international oil prices. The authorities are determined to sustain the hard-won stability gains and, in this regard, are implementing a comprehensive energy strategy which, inter alia, includes increases in domestic petroleum retail prices—already increased five times since 2005; proactive substitution policy to encourage the use of alternative and renewable energy; introduction of a mandatory energy audit in the industrial sector to promote efficiency; and extensive public awareness campaign focused on the importance of energy conservation and the burden of energy subsidies on the budget.

While macroeconomic stability will be preserved, the staff report correctly suggests that accelerated reforms are needed to place the economy on a higher growth trajectory, in order to reduce unemployment and raise per capita income to a high enough level, at least, to bridge the existing gap with lower-tier OECD countries within a decade. As the staff report suggests, the latter requires at least 1–1.5 percentage points higher growth rates than achieved in recent years. Fully aware of this challenge, the authorities have developed a medium-term growth strategy—well summarized in Box 2 of the staff report—which focuses on a gradual liberalization of the capital account, in consultation with the Fund, as detailed in the Selected Issues paper, and a private sector-oriented reform program supported by the World Bank. The immediate challenges to a successful implementation of this strategy, identified by the authorities and staff, are further reforming the banking sector and improving debt indicators.

The authorities consider that a sound financial system is critical for the achievement of higher economic growth and a prerequisite for smooth integration of the country into the global economy. In recent years, financial sector reform was cast within the 2002 FSAP recommendations, and Table 1 of the FSSA details progress in their implementation.

Furthermore, the 2006 amendments of the Banking and the Central Bank Laws, together with the 2005 law on financial security, include measures to strengthen credit culture, enhance transparency and governance, improve creditor rights, and strengthen bank regulation and supervision. In addition, the authorities have implemented a number of corrective measures to deal with the adverse impact on the banking sector of the 2001-02 terrorism events and four consecutive years of droughts. These include an effective ban imposed by the central bank on the distribution of dividends in 2005 and 2006 by banks with shortfalls in provisioning and its requirement that, by 2009, banks have to achieve a provisioning ratio of NPLs of 70 percent, regardless of existing collateral. Moreover, the authorities have made provisioning fully tax-deductible and have streamlined the legal procedures for the realization of collateral. As a result, the financial soundness indicators of commercial banks have improved markedly. The authorities are confident of continued strengthening of the financial system; nevertheless, they recognize that acceleration of the financial sector reform would allow a faster pace of implementation of their medium-term growth strategy. To better identify financial sector vulnerabilities and chart out an accelerated course of reforms, they requested an update to the 2002 FSAP. Our authorities broadly agree with staff recommendations, which include a policy objective of reducing NPLs ratio to total loans, strengthening management and governance of the remaining public banks, and accelerating the restructuring of bank loans to the tourism sector.

The authorities recognize that the level of external debt is relatively high, compared to other emerging market economies with similar ratings. To reduce this vulnerability, they have decided to allocate US$1.6 billion or two-third of the proceeds from the partial privatization of Tunisie Telecom to debt reduction operations. When completed, these operations will contribute to a significant improvement in debt indicators and in the country's external position. The authorities consider that continued fiscal consolidation, supported by the ongoing tax reform, will also contribute to improving debt indicators. Recent policy announcements in this area include a reduction in the corporate income tax rate from 35 percent to 30 percent, a cut in the number of VAT rates from 4 to 3, as well as measures to modernize tax administration.

Staff and the authorities have also discussed other policy priorities, in particular measures to enhance labor market flexibility and to improve the business and investment climate. The Selected Issues paper offers some interesting insights and conclusions.

Finally, after completing broad consultation with stakeholders, the authorities are now in the process of finalizing their strategy for the period 2007-2016. The main objectives of this strategy are reducing unemployment to 10 percent and doubling per capita income by 2016. Staff will have the opportunity to report back to the Board on the progress in the implementation of this strategy.