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TUNISIA

September 2014

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

In the context of the fourth review under the Stand-By Arrangement and request for modification of performance criteria, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 29, 2014, following discussions that ended on June 24, 2014, with the officials of Tunisia on economic developments and policies underpinning the IMF arrangement under the Stand-By Arrangement. Based on information available at the time of these discussions, the staff report was completed on August 14, 2014.
- A **Staff Statement** of August 29, 2014 updating information on recent developments.
- A **Press Release** including a statement by the Chair of the Executive Board.
- A **Statement by the Executive Director** for Tunisia.

The following documents have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Tunisia*
Memorandum of Economic and Financial Policies by the authorities of Tunisia*
Technical Memorandum of Understanding*

*Also included in Staff Report

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

TUNISIA

August 14, 2014

FOURTH REVIEW UNDER THE STAND-BY ARRANGEMENT AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA

EXECUTIVE SUMMARY

Context. On June 7, 2013, the Executive Board approved a 24-month Stand-By Arrangement in an amount equivalent to 400 percent of quota (SDR 1.146 billion or about $1.75 billion). To date, SDR 573 million equivalent to $877 million has been disbursed. The pillars of the program are to: (i) achieve short-term macroeconomic stability; (ii) lay the foundation for stronger and more inclusive growth; and (iii) protect the most vulnerable.

Background. Progress in the political transition is leading to increased donor support this year, including from regional partners. On the economic front, growth remains timid, headline inflation has increased, and rising external imbalances have continued to put pressure on foreign reserves.

Program implementation has been satisfactory. All quantitative performance criteria have been met. On the structural reform agenda, the authorities have made up for some key delays in areas that include reforming public banks, setting up a household support program, and the tax administration modernization agenda.

Program strategy. Prudent fiscal policy, tighter monetary policy, and greater exchange rate flexibility need to be sustained and intensified to contain high external and fiscal deficits, anchor inflationary expectations, and bolster the still lackluster investors' confidence. Important steps have been taken to strengthen the financial system, notably with the design of public bank restructuring plans, but implementation will be key. Progress on structural reforms—in particular, to improve the business climate—is critical for improving the conditions for private sector-led and inclusive growth.

Risks to program implementation are important. Main risks relate to regional and domestic security tensions, setbacks in the political transition, and weaker economic activity in major trading partners. The implementation of program policies will continue to be tested by a difficult social environment and opposition from vested interests.

The completion of the fourth review will make SDR 143.25 million (about $220 million) available.

Approved By
Daniela Gressani and Taline Koranchelian

The team comprised Amine Mati (head), Lorraine Ocampos, Carolin Geginat, and Hamid Reza Tabarraei (all MCD); Jean Frederic Noah Ndela (SPR), Nolvia Saca Saca (MCM), Giorgia Albertin (Resident Representative) and Laurent Gonnet (World Bank Senior Financial Expert). The mission overlapped with a FAD Technical Assistance mission on tax policy and administration. Mr. Ben Hassine (OED) joined the discussions. During June 10–24, 2014, staff met with the Governor of the Central Bank, the Minister of Economy and Finance, the Minister of Energy, Industry and Mines, the Minister of Social Affairs, the Minister of Tourism, the Minister in charge of Economic Affairs at the Prime Ministry, and other senior officials, and representatives of workers' unions, the corporate and banking sector, the diplomatic and donor community, political parties, civil society, academia, media, and Parliament.

Excellent assistance was provided by Hélène Thompson, Kadia Kebet, Cecilia Pineda, Rafik Selim, Greg Auclair, and Kia Penso.

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BACKGROUND

1. **After three years of uncertainty following the revolution, Tunisia is set to complete its political transition.** The adoption of a new constitution and electoral law led to a clear timetable for legislative and presidential elections that are to be held in the last quarter of 2014. Progress in the political transition is leading to increased donor support this year, including from regional partners. An "Investing in Tunisia" conference—co-organized with the French government—is scheduled to be held in September 2014 to showcase Tunisia's achievements and to galvanize foreign investors. However, new financing commitments for 2015 are likely to be firmed up only after the formation of a post-elections government.

2. **The authorities continue to actively build consensus among stakeholders for the Fund-supported reform agenda.** Over the past few months, the government has made efforts to raise public awareness about the difficult economic situation the country is facing, notably the state of its public finances. To consolidate the necessary support among stakeholders, the government has made public statements about the need for economic sacrifices by all, and discussed with key members of Tunisia's society—including representatives of all political parties—the difficult economic policies and reforms that need to be implemented over the next few months.

3. **Program implementation has been satisfactory, despite the challenging economic environment.** All quantitative performance criteria have been met, albeit with a slight deterioration in the composition of spending. On the structural reform agenda, the authorities have made up for some key delays, including on reforming public banks, setting up a household support program, and on the tax administration modernization agenda. These results have been achieved in the context of public dissatisfaction with the economic situation, high social tensions, and security risks.

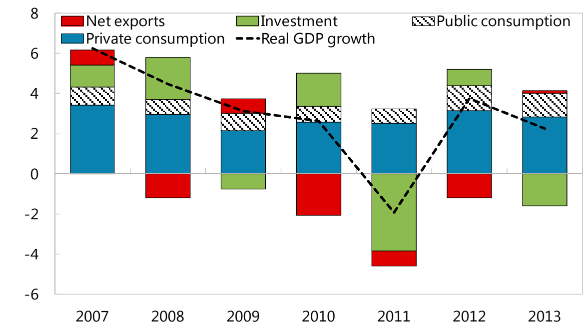
4. **The Fourth review's main focus was on macroeconomic stabilization and banking sector reforms.** Rising external imbalances have continued to put pressure on reserves, and recent efforts to contain them through prudent fiscal policy, tighter monetary policy, and greater exchange rate flexibility need to be sustained and intensified. Important steps have been taken to put in place the conditions for private sector–led growth, notably with the design of public bank restructuring plans in line with international best practices, but implementation will be key. Progress on the delayed business climate reform agenda and improved composition of public expenditures will be essential to complement these steps and generate higher and more inclusive growth.

CONTEXT

A. Recent Developments

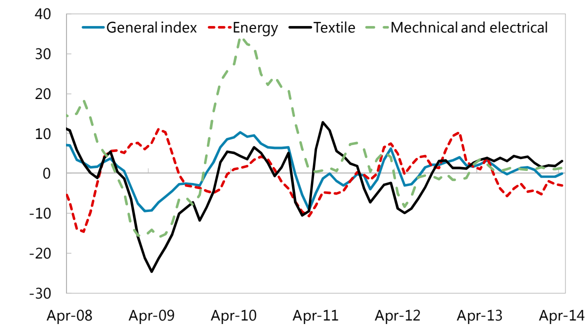
5. **The economic recovery remains timid.** Growth for 2013 was revised down to 2.3 percent following corrections in agricultural data. A rebound in chemical and mining production and in agriculture compensated weaker performance in the tourism sector, thus contributing to a 2.2 percent y-o-y growth in Q1 2014, in line with expectations.

Contribution to Growth
(In percent)



Sources: Tunisian authorities; and IMF staff estimates.

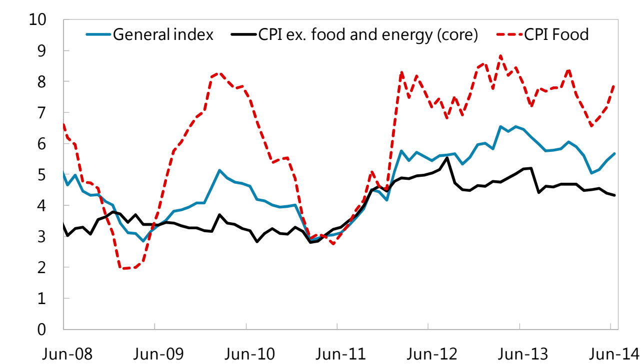
Industrial Production Index
(Y-o-y growth, 3-month moving average, in percent)



Sources: Tunisian authorities; and IMF staff estimates.

6. **After having declined to 5 percent in March 2014, headline inflation rebounded back to 5.7 percent in June 2014.** This increase—which is in line with expectations—reflects higher food and beverage prices, and the impact of higher administered energy prices. However, core inflation remains on a downward trend and is contained at 4.3 percent in June, while PPI is close to 3 percent.

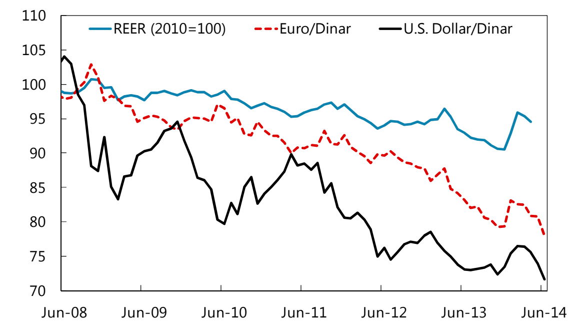
Inflation
(Y-o-y growth rates, in percent)



Source: Tunisian authorities.

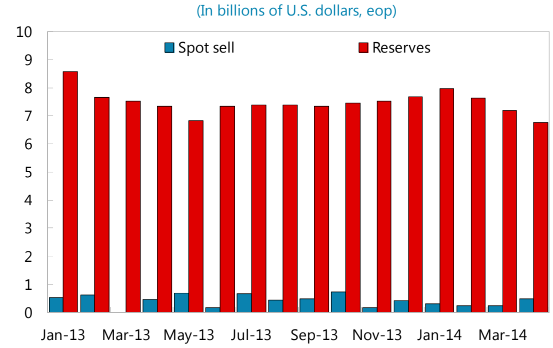
7. **External imbalances have been increasing, with reserves recently stabilizing.** The deterioration of the current account deficit continued over the first few months of the year, driven by a worsening energy deficit (see Box 1) that mostly reflects exogenous events (lower gas volume transiting from Algeria to Italy) and transitory factors (oil production falling below potential). As a result, the current account deficit is expected to reach 5.5 percent of GDP by end-June. The financial account over the first half of the year has been weaker than anticipated, as the World Bank Development Policy Loan (about $250 million) is only expected to be disbursed in Q3 2014. Inflows from FDI, tourism, and remittances have been low but in line with estimates. Since mid-March, however, the exchange rate vis-à-vis the U.S dollar has depreciated by 8.6 percent. Gross official reserves have stabilized at 3.2 months of imports of goods and services by end-June.

Exchange Rates, 2008–14
(+= appreciation)



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

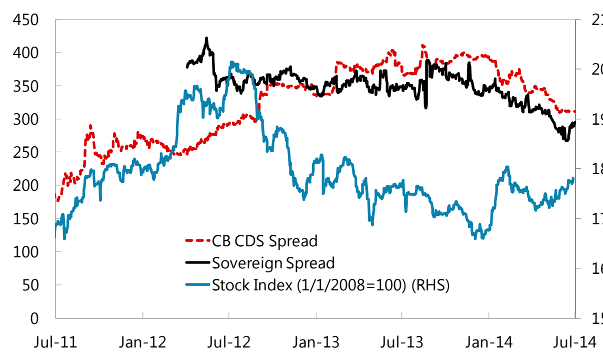
Reserves and Spot FX Interventions
(In billions of U.S. dollars, eop)



Sources: Tunisian authorities; and IMF staff estimates.

8. **Financial market indicators remained broadly stable.** In the aftermath of the adoption of a new constitution in January 2014, sovereign spreads have declined, although the authorities still consider this level too high to issue eurobonds without guarantee. The stock market index has also stabilized.

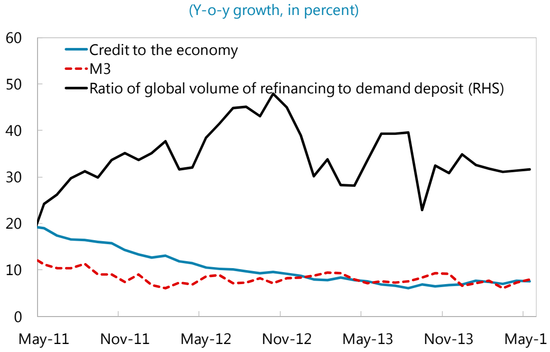
Sovereign and CDS Spreads and Stock Index
(In basis points, unless otherwise indicated)



Sources: Tunisian authorities; Bloomberg; and Markit.

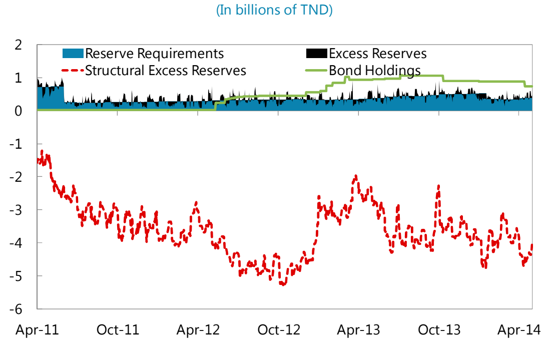
9. **Monetary policy was recently tightened.** In anticipation of pressures on prices arising from the increase in minimum wages (an average 6 percent increase impacting 600,000 retirees and 300,000 private sector employees but not the public sector), a depreciating exchange rate, and rises in energy administered prices, the CBT increased in June its policy rate by another 25 basis points—a cumulative 75 basis points since the beginning of the year—to 4.75 percent, although the rate remains negative in real terms (-1 percent). Weak deposit growth kept monetary aggregates in check, with broad money increasing by 8 percent y-o-y as of May 2014. Credit to the private sector grew modestly at 7.6 percent y-o-y, with the increase in CBT bank refinancing—which reached record high amounts of TD 4.7 billion at end-June (excluding OMOs)—mostly used by banks to roll over existing loans or for overdrafts.

Growth in M3 and Credit to the Economy, 2011–14
(Y-o-y growth, in percent)



Sources: Tunisian authorities; and IMF staff estimates.

Structural Liquidity Deficit of Banking System
(In billions of TND)

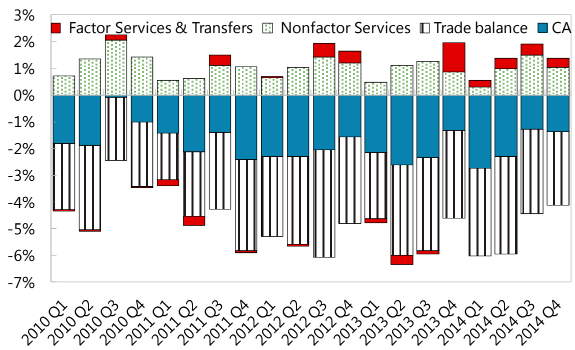


Sources: Tunisian authorities; and IMF staff estimates.

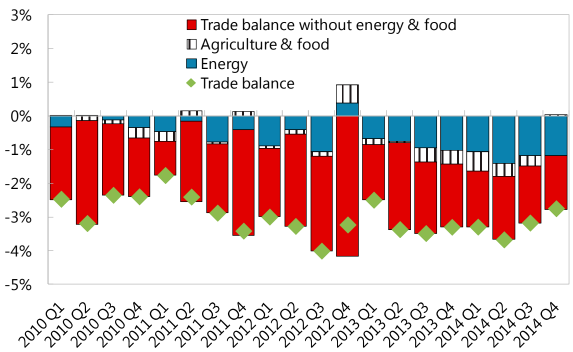
Box 1. Tunisia: Recent Current Account Deterioration and Energy Balance

Tunisia's current account deficit has widened significantly since 2010, driven largely by the trade deficit. After averaging 2.8 percent of GDP from 1995 to 2009, the current account deficit tripled to about 8.4 percent of GDP by 2013, with improvements over the past two years in net services and transfers insufficient to reverse a worsening trade balance. This deterioration reflects a shift in both composition and size of the trade balance. Whereas in the past the deficit was mostly a reflection of the country's need to import raw materials and capital goods, the share of energy has been increasing, accounting for more than a third of the trade deficit. This is exacerbated by a slowdown in export growth due to a deceleration in external demand from the Euro area (Tunisia's main trade partner) and negative supply shocks in the phosphate and agriculture sectors.

Decomposition of CA Deficits
(In percent of GDP)



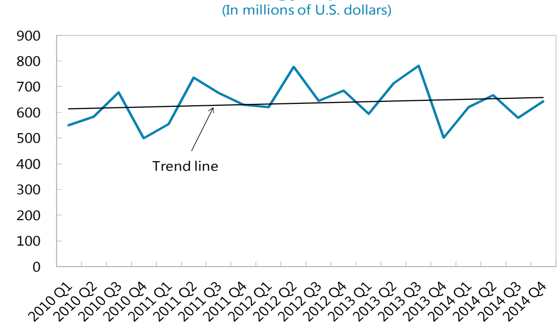
Decomposition of Trade Deficits
(In percent of GDP)



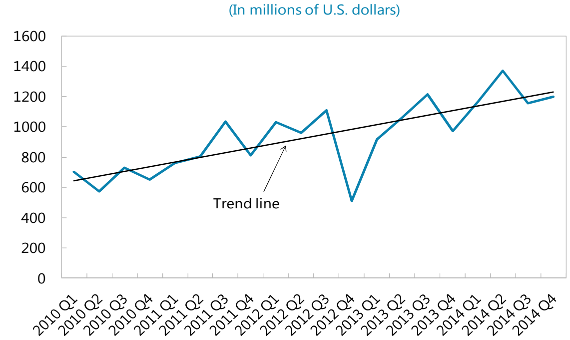
Sources: Tunisian authorities; and IMF staff calculations.

The recent increase in the energy trade deficit reflects cyclical dynamics, but the underlying energy trends suggest growing long-term energy imbalances. The widening energy trade deficit reflects a fall in oil production, due in part to fewer permits for oil exploration and exploitation, thus lowering exports below trend and raising energy imports above trend—the latter aggravated by lower gas volumes transiting through Tunisia from the Algeria-Italy pipeline (thus reducing availability of cheaper gas). Aside from the cyclical dynamics, long-term trends suggest that oil consumption will exceed production. As noted in the government strategy, there is an urgent need to slow the deterioration of the energy trade deficit by raising long-term oil production, reducing energy consumption and improving its efficiency. These efforts could be complemented by policies reversing the slowdown in export-related sectors (e.g., phosphates and tourism) and improving the trade balance by rebalancing demand for domestic and foreign goods. In this regard, gradually moving domestic energy prices towards international levels, greater exchange rate flexibility, trade openness, and a sound investment climate will contribute to the adjustment.

Energy Exports
(In millions of U.S. dollars)



Energy Imports
(In millions of U.S. dollars)



Sources: Tunisian authorities; and IMF staff calculations.

10. **The banking sector continues to be vulnerable.** As of March 2014, the overall capital adequacy ratio (CAR) of the banking system improved slightly to 9.4 percent—against 8.9 percent at end-2013, but down from 11.8 percent in 2012, following the stricter regulation on valuation of collateral, which was introduced in December 2013 and led to an increase in the provisioning ratio to 60 percent (from 46 percent in 2012). Six banks—four public and two private, representing 42 percent of banking assets—are still below the 9 percent regulatory CAR. Asset quality continues to be weak, with NPLs remaining at 15 percent of total loans (21 percent for public banks) at end-March 2014, concentrated mainly in the tourism and industrial sectors. Net profits have been rising, mostly because of financial commissions, but these could come under pressure following a weak demand for loans and higher funding costs.

11. **Fiscal performance in the first quarter of 2014 was better than expected.** The overall fiscal deficit improved by 0.5 percent of GDP, thanks to additional tax revenues from petroleum companies and higher-than-anticipated VAT revenue collection. Total expenditures were in line with expectations, with a slight wage overrun compensated by lower payments on energy subsidies that were to be paid in April. The execution of capital spending remains in line with projections (7 percent of the budgeted amount by end-March).

B. Program Performance

12. All end-March PCs and end-June PCs were met, though the inadequate composition of public expenditures continues to be a concern:

- **Primary balance.** The end-March PC on the cash-basis primary balance was exceeded by a wide margin, with a lower than estimated float arising from committed capital expenditures at end-March that were paid in Q2 2014. As a result, the end-June PC on a cumulative basis has also been met.

- **Reserves.** End-March and June NIRs exceeded the adjusted program target, and stood at \$5.2 billion and \$4.3 billion, respectively. Higher-than-expected short-term capital flows compensated for lower long-term inflows (due to delays in multilateral donors' disbursements) and weak FDI flows, thereby helping keep reserves in line with program projections.

Tunisia: Central Government Financing, First Semester 2014

(In millions of dinars)

	Q1 Prog.	Q1 Prel./Act.	S1 Prog.	S1 Act./Est.
A. Central government deficit (-) (incl. grants)	-219	223	-1,108	-416
B. Float and other statistical discrepancies [1/]	2,032	1,768	2,465	2,462
C. Central government deficit (-) (incl. grants, cash basis)	-2,251	-1,545	-3,573	-2,878
C. Financing	2,251	1,545	3,573	2,878
Foreign	1,091	965	2,197	1,205
Drawings	1,296	1,156	2,716	1,725
Amortization	205	191	519	519
Domestic	1,160	580	1,317	1,673
Drawings	861	988	1,088	2,213
Amortization	-338	-361	-1,126	-1,072
Government Deposits (+ = drawing / - = accumulation)	638	-47	1,355	532
Public Banks Recapitalization	0	0	0	0
Privatization proceeds	0	0	60	0
D. Grants	32	1	54	64
E. Interest Payments	510	442	820	787
F. Primary balance (excl. grants, cash basis) (F = C - D + E)	-1,773	-1,104	-2,806	-2,155

Sources: Tunisian authorities; and IMF staff estimates.

[1/] Includes expenditures commited until end-December 2013 and to be paid during the complementary period in 2014 as well as commited expenditures of the current year budget to be paid in the following quarters.

- **Monetary target.** The end-March and end-June PCs on NDA were met by a comfortable margin, mainly driven by a lower-than-projected net credit to government.

- **Indicative targets**. The end-March and end-June target on social spending has been met because of larger-than-programmed cash transfers and family allowances, the effect of an increase in the number of beneficiaries and student allowances. The ceiling on current primary spending has been met, with lower spending on subsidies and goods and service, compensating for the wage overrun observed in Q1 2014.

13. **Seven out of nine structural benchmarks (SB) expected to be completed by end-July—including three postponed from end-March— have been met** (LOI, ¶3). The end-June SB to adopt the tax modernization plan has been met in August with a slight delay and the end-July SBs for the government adoption of bank restructuring plans will be met in August (Prior action for completing the fourth Review). The SB for the establishment of the lender-of-last-resort facility has been postponed to early 2015, following the adoption of new liquidity norms and of a new banking resolution framework; in the interim, a new exceptional facility has been created (¶24, and MEFP ¶11). The audit for the BNA, previously scheduled for end-July, will only be completed in September as it has a delayed start in June (MEFP, ¶17).

C. Outlook and Risks

14. **Macroeconomic projections continue to forecast moderate growth, declining inflation, and some improvement in the external position.**

- **Growth** is expected to reach 2.8 percent this year, with the forecast unchanged from April estimates, as higher agricultural production and services are expected to offset a more modest tourist season than expected, and because of some stagnation in the mechanical and electrical industries. In view of the seasonal pattern observed so far this year and the ongoing modest recovery of Tunisia's trading partners, economic growth for 2015 has been revised down to 4 percent (from 4.2 percent). Nevertheless, provided stability improves in a post-electoral environment, and as the vital European market recovers, investment is expected to pick up (also helped by recent improvements in the public procurement framework) and contribute to growth in 2015. Nonetheless, robust growth beyond 2015 will continue to be contingent on the accelerated implementation of the growth-enhancing structural reform agenda.

- **Inflation.** Average inflation is expected to reach 5.7 percent for the year, reflecting inflation developments for the first half of the year, a depreciation of the currency, and a rise in administered energy prices and minimum wages. Anchored by a prudent monetary policy and a strong agricultural season, inflation will decline in the latter part of 2014, and average 5 percent in 2015.

- **External Position.** A tighter monetary policy, more active promotion of Tunisia's exports (e.g., in the phosphate sector), and greater exchange rate flexibility, will contribute to containing the current account deficit at 7.6 percent of GDP in 2014. In the medium term, tighter macroeconomic policies, better prospects in Tunisia's trading partners, and a recovery in tourism and the phosphate industries will contribute to an improved external position. In view of uncertain financing in the latter part of 2015, gross reserve buffers are being reconstituted in 2014 and will cover almost four months of imports by end-year.

Tunisia: Selected Economic Indicators, 2010–15

				Prel.	Proj.	
	2010	2011	2012	2013	2014	2015
Real GDP growth (in percent)	2.6	-1.9	3.7	2.3	2.8	4.0
Consumer price index (CPI), (period average, in percent)	4.4	3.5	5.6	6.1	5.7	5.0
Current account (percent of GDP)	-4.8	-7.4	-8.2	-8.4	-7.6	-6.6
Gross official reserves (billions of U.S. dollars, eop)	9.5	7.5	8.7	7.7	9.1	10.0
Gross official reserves (months of next year's imports)	4.4	3.4	4.0	3.4	3.9	4.2

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

15. **Risks to the outlook remain high**. Increasing social tensions—including strikes and demonstrations—could further slow down production and delay much-needed reform implementation. Security tensions have abated, but the risk remains high, partly because of sporadic terrorist incidents or turmoil in the region (particularly Libya). Despite a clearer political calendar since the last review, political tensions ahead of elections later this year could weigh on the technocratic government's ability to implement economic policies and could further delay important reforms. The balance of global risks remains tilted to the downside. While side-effects from global financial conditions might have a negligible impact on the Tunisian economy in view of existing capital controls, a protracted period of slower growth in advanced and emerging economies—particularly in Europe and other trading partners—or higher commodity prices (including oil) would be another drag on growth and on the external and fiscal positions.

POLICY DISCUSSIONS

Discussions focused on maintaining macroeconomic stability and advancing the structural reform agenda. Particular attention was given to: (i) keeping the 2014 fiscal program on track while protecting the most vulnerable; (ii) a tighter monetary policy stance and an exchange rate path that is consistent with building up external buffers; and (ii) banking sector reforms—particularly the design of public bank restructuring plans that are in line with best international practices and accounted for appropriately in the budget.

A. Short-Term Stabilization Goals

Fiscal policy

16. **The authorities remain committed to achieving the program's end-year fiscal target, albeit with a slight deterioration in the quality of budget composition** (MEFP, ¶5)**.** The 2014 revised budget law—approved by parliament on August 8, 2014—envisages an overall fiscal balance in line with program objectives, and a structural

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

	2012	2013	2014	
	Act.	Prel.	Prog. 04/25/14	Proj.
Revenue	23.1	23.6	23.1	23.5
of which: Tax revenue	21.0	21.4	21.8	22.3
Expenditure and net lending	28.8	29.8	29.9	30.3
of which: Wages and salaries	12.2	12.5	12.5	12.6
Transfers and subsidies	7.0	7.8	7.0	7.2
Capital expenditure	6.6	4.9	5.2	5.2
Net lending	-0.5	0.0	1.4	1.6
of which: Public Banks' recap. + AMC operat.costs	0.1	0.0	1.4	1.4
Central government deficit (-) (excl. grants)	-5.7	-6.2	-6.8	-6.7
Float	-0.7	-1.7	1.8	1.8
Central government deficit (-), (excl. grants, cash basis)	-5.0	-4.5	-8.6	-8.5
Structural fiscal balance	-5.3	-4.5	-4.9	-4.7
General government debt	44.5	44.8	50.9	51.7

Sources: Tunisian authorities; and IMF staff estimates.

fiscal balance (excluding one-off banking recapitalization costs) improving to 4.7 percent of GDP (against 4.9 percent expected under the program). This improvement is the result, on one hand, of tax policy measures that go beyond those agreed at the time of the Third Review, and the revenue overperformance observed in Q1 2014; and, on the other hand, of efforts to reduce untargeted energy subsidies (eliminating all energy subsidies to cement companies, increasing electricity tariffs for industrial and household users by a cumulative 20 percent since the beginning of the year, and raising fuel prices by 6 percent as of July 2014, see MEFP, 5¶) accompanied by programs to support the most vulnerable (see Section C). However, higher current spending, reflecting one-off election costs, increased security personnel, salary payments agreed by previous governments, food subsidies, and one-off transfers and advances to pension funds was only partly offset by new expenditure measures freezing promotions and recruitment, and reduced spending on goods and services. This led to a deterioration in the composition of the budget, with the end-year indicative ceiling in current primary spending increasing by 0.3 percent of GDP to accommodate the new spending.

Tunisia: Compensatory Measures for 2014 Included in Supplementary Budget

	Mar-14				Jun-14		
	In Million TD	In Percent of GDP	Included in LFC	Status	In Million TD	In Percent of GDP	Included in LFC
Revenue	260	0.3					
Tax policy measures	100	0.1			130	0.2	
Alcoholic beverages: 8 percent increase excise tax	20	0.0					
Tobacco: 10 percent increase excise tax	50	0.1		implemented			
Tax on vehicles 1/	30	0.0	√		15	0.0	√
Tourism tax					75	0.1	√
Stamp duty					30	0.0	√
Other measures incl. exeptional taxation					10	0.0	√
Tax administration measures	160	0.2					
Tunisie Telecom: enhanced tax control	110	0.1		implemented			
Recovery of tax arrears awaiting judicial decision	50	0.1	√				
Current expenditure	40	0.0			7	0.0	
Savings in energy subsidies 2/	40	0.0		implemented	7	0.0	
Total	300	0.4			137	0.2	

1/ In March: at the moment of resale for cars imported by tunisians leaving abroad.
2/ in March: bringing forward the planned increase of tariffs to May 2014.

Tunisia: Expenditure Increase and Compensatory Measures, June 2014

	In Millions of TD	In Percent of GDP
Expenditure Increases	**648**	**0.78**
Wage bill	218	0.26
Security Forces	104	0.13
Honor past salary agreements	114	0.14
Pension Fund	250	0.30
Contributions from Transport Company	100	0.12
Advances to CNRPS	150	0.18
Food Subsidies	90	0.11
Election Costs	60	0.07
AMC additional operational costs 1/	30	0.04
Compensatory Measures	**331**	**0.40**
Wage bill: promotion and further recruitment freeze	114	0.14
Lower goods and services	60	0.07
Energy Subsidy: saving FX appreciation gain Q1 and other	107	0.13
Additional measures	50.0	0.06

1/ In addition to the TD 120 million or 0.14 percent of GDP already included, bringing AMC operational costs to a total of TD 150 million or 0.18 percent of GDP.

17. **Staff welcomed the improvement in the underlying fiscal balance, but stressed its preference to save fully the revenue over-performance and to tighten further the fiscal stance.** This is necessary to contain growing external imbalances and limit the crowding out of private sector credit. The authorities argued, however, that achieving the programmed fiscal target when facing strong social pressures should remain the main goal, with scope for additional policy action limited to saving any future revenue overperformance and containing spending to budgeted levels. In case of revenue shortfalls or higher expenditure, the authorities will continue to preserve social and capital expenditures, and will implement contingency measures that focus on cuts in nonessential current spending.

18. **Additional external budget financing and the authorities' "national borrowing campaign" will compensate for the expected shortfall from lower sukuk issuance.** Stronger donor support than expected—including the issuance of a 7-year $500 million U.S.-guaranteed international bond at a yield of 2.45 percent (35 basis points above U.S. treasuries of the same maturity and 4.5 times oversubscribed), and unexpected support from Algeria ($250 million, of which $150 million is direct budget support through grant and highly concessional loan)—will help compensate for lower sukuk issuance (the IsDB is expected to guarantee $120 million, $380 million less than originally programmed). In addition, the issuance of bonds under the "national borrowing campaign" was oversubscribed, and managed to mobilize TD955 million, almost double the amount envisaged, of which 40 percent was bought by domestic banks. To avoid further credit crowding out, and in light of the financing expected, no additional domestic bond issuance is planned for the rest of the year. External and domestic financing is increasing public sector debt in 2014 to 51.7 percent of GDP, but debt dynamics remain sustainable under most shocks (See DSA annex).

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

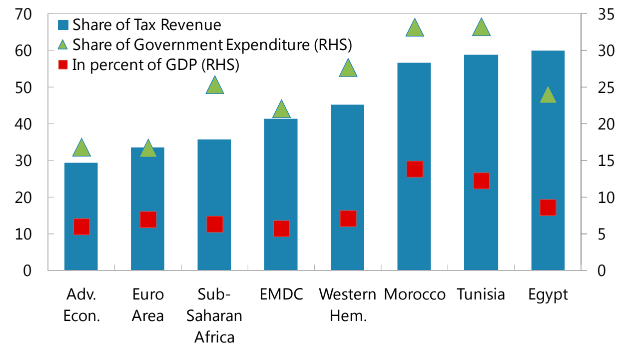
	2014					
	Prog.	Rev. Est.	Q1-Act.	Q2-Est.	Q3-Est	Q4-Est.
Total	4,165.5	4,046.1	739.2	343.8	1,532.1	1,431.0
Bilateral	200.0	300.0	200.0	0.0	100.0	0.0
Algeria		100.0			100.0	
Turkey	200.0	200.0	200.0			
IFIs	2,449.3	2,455.0	509.3	221.7	829.0	895.1
AMF (Arab Monetary Fund)	43.4	43.5				43.5
IMF (Budget Support)	1,393.9	1,398.7	509.3	221.7	446.1	221.7
World Bank Group	750.0	750.0			250.0	500.0
EU	262.0	262.8			132.9	129.9
Other	1,516.3	1,291.1	30.0	122.1	603.1	535.9
International Market (US guarantee)	300.0	500.0			500.0	
International Market (possible Japan guarantee)	300.0	300.0				300.0
Project aid without donor breakdown	356.8	311.8	21.8	99.8	88.4	101.8
Sukuk and other external financing	500.0	120.0				120.0
Other (including Loan Transfers to SOEs)	59.5	59.3	8.1	22.4	14.7	14.1
Memorandum items:						
Grants	127.3	176.9	0.0	38.1	88.1	50.7
EU	127.3	126.9		38.1	38.1	50.7
Algeria		50.0			50.0	

Sources: Tunisian authorities; and IMF staff estimates.

Box 2. Tunisia: The Wage Bill and the Need for Public Sector Salary Reform

The wage bill in Tunisia is high and rising. It increased from 10.7 percent of GDP in 2010 to 12.5 percent of GDP in 2013, a level higher than most comparators. This increasing wage bill—due to about 70,000 new hires who entered the public sector between 2010 and 2012, particularly in low skill categories, and a 13 percent average increase in salaries—currently absorbs almost 60 percent of tax revenues and more than 30 percent of total expenditures, ratios well above those of most countries in the world.

Central Government Spending on Wages, 2012
(In percent)



Source: IMF staff estimates.

Three factors characterize Tunisia's public employment and salary structure:

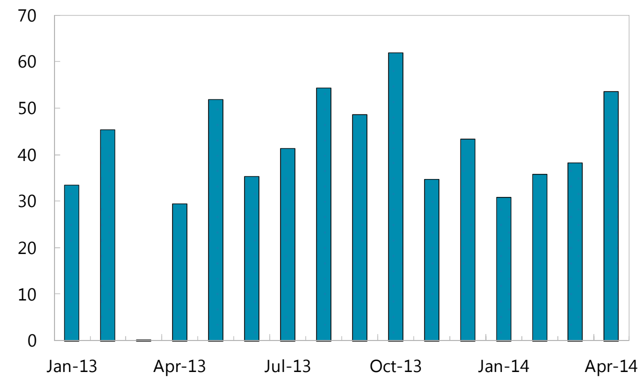
- **Overstaffed public sector**. With 795,000 public employees (of which 180,000 are from public enterprises), the ratio of public employment to total employed work force in Tunisia is around 24 percent. This level is three times higher than that of Morocco, or countries such as Chile, Mexico, and Brazil.
- **Relatively high wages at the lower salary scale**. The annual salary for civil servants averages around \$7,800, which is 75 percent above the GDP per capita, and well above the corresponding average in Egypt and Jordan (but well below the one in Morocco where this indicator is five times higher). The average monthly salary for the lowest categories—which represent a third of the public sector workforce—at around \$470 is twice the minimum salary (except for a small portion of construction workers). This wage premium makes the public sector more attractive than the private sector after controlling for education and other benefits, particularly for new labor market entrants.
- **Low salary differentiation**. The salary differentiation among various salary categories (compression ratio) decreased between 2010 and 2012 from 3.4 to 2.6. This is well below the level (between 4 and 10) considered adequate for promoting the right work incentives. This deterioration has been mainly attributed to the large salary increase for the lowest categories (34 percent), while the salary for top categories (excluding productivity bonus) at a monthly average of around \$1,200, remained unchanged in nominal terms.

Addressing the high level of the wage bill and the shortcomings of the salary structure are key to fiscal sustainability and higher productivity of the public sector. Assessing the structure of public sector salaries and the ways to implement a public sector salary reform over the medium term should help alleviate the heavy burden of the wage bill on public finances and leave more room for social and investment expenditures while increasing public sector productivity. The reform of the public sector salary system should encompass the following main elements: (i) reducing redundant workers through a voluntary departure incentive system and implementing safety-net protection through micro employments and capacity building; (ii) relieving shortages in high-skilled areas; (iii) improving the competitiveness of civil service pay, particularly at higher levels. With World Bank support, the authorities have started to assess the public sector salary structure and the hiring system that will form the basis for a comprehensive civil service reform.

Exchange rate policy

19. **Staff welcomed the authorities' commitment to continue rebuilding external buffers.** CBT foreign exchange (fx) sales have been reduced to $290 million in June (about 34 percent of all fx sold, and from $400 million in previous months), contributing to the exchange rate depreciating by 3 percent vis-à-vis the U.S. dollar and the Euro in the month of June and helping stabilize gross reserves at $7.1 billion. The authorities argued that fx sales are only there to smooth excessive fluctuations when large and lumpy fx demand from energy operators (about $340 million on average a month) arise, and that the recent depreciation of the dinar (8.6 percent vis-à-vis the dollar since mid-March) shows that currency movements follow the market. Staff agreed that large fluctuations should be smoothed, but urged the authorities to continue reducing sales of foreign exchange or purchase foreign exchange during periods of excess supply, so as to build up buffers, particularly since financing for the latter part of 2015 remains uncertain. Staff and the authorities both consider exchange rate flexibility necessary to contain the current account deficit, rebuild buffers, and bring the dinar in line with fundamentals. Both Staff and the authorities agreed that the currency is currently about 5–10 percent overvalued in real terms.

Share of CBT Sales in the Foreign Exchange Market
(In percent)



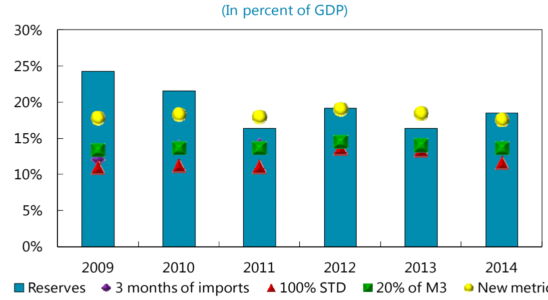
Source: Tunisian authorities.

Exchange Rate Assessment using CGER Panel Estimates
(In percent)

	Underlying CA balance 1/	CA norm	REER misalignment
MB approach 2/	-4.8	-1.8	9.8
ERER approach	...	...	3.4
ES approach	-4.8	-2.6	7.4

Overvaluation (+); undervaluation (-)
1/ In 2019 corrected from program adjustment.
2/ Based on an elasticity of the CA/GDP with respect to the REER of -0.30.

Reserve Coverage Based on Alternative Metrics: New and Traditional Metrics, 2009–14
(In percent of GDP)



Sources: Tunisian authorities; and IMF staff estimates.

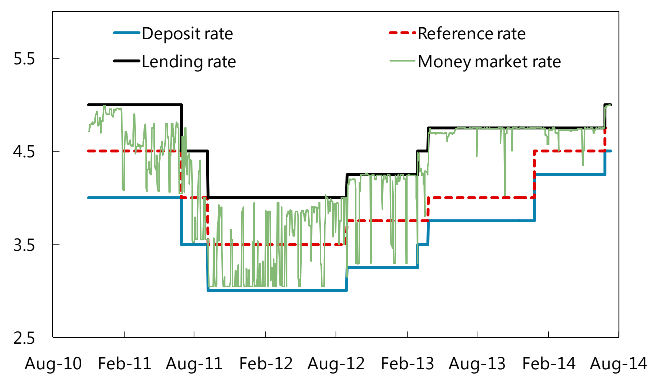
20. **The functioning of the fx market should be further strengthened.** The operationalization of the electronic platform and the implementation of the market-maker agreement have contributed to more accurate information on interbank flows and quotations. This sets the stage for moving towards a weekly foreign exchange auction mechanism (end-December 2014 SB), which will benefit from Fund TA. The mission also urged the authorities to quickly change the regulation to allow banks (long in fx position) to engage in fx swap operations with the CBT, which will help provide temporary relief from the imbalances in the foreign exchange and money markets.

21. **Staff reiterated that macroeconomic policies—in particular through exchange rate or fiscal policies—are more appropriate tools for controlling the widening trade deficit than ad hoc measures restricting imports.** Staff argued that a surcharge on imports is distortive and should only be introduced as a last resort and on a temporary basis (in line with WTO practices and with clear forward guidance to be phased out). The authorities agreed, but argued that surcharge might be the only option left if the adjustment takes longer than expected. Staff urged the authorities to intensify their efforts to design sustainable solutions that address long-term energy imbalances and underscored that a determined strategy for reviving export-related sectors such as phosphates and tourism will be instrumental to improving the trade balance.

Monetary policy

22. **A tight monetary policy stance is warranted in light of anticipated pressures on inflation.** Staff welcomed the increase in the policy rate in response to pressures that may materialize from higher administered energy prices, a depreciating exchange rate, and an increase in minimum wages. However, staff urged the authorities not to blur the important signal sent by the policy rate increase by letting the money market rate deviate consistently from the policy rate, due to inefficient interbank liquidity management and the authorities' preference for keeping it at the upper end of the interest rate corridor. The authorities agreed that additional tightening of the policy rate over the next few months will be needed if core inflation rises more rapidly than expected or depreciation pressures rise. Staff urged the authorities to consider additional policy rate rises not only to keep inflation on a downward trend, but also to achieve positive real rates, which will help stem depreciation pressures on the currency. It would also reduce reliance on CBT refinancing by increasing funding costs and banks' ability to mobilize deposits.

Money Market and CBT Policy Rates, 2010–14
(In percent)



Source: Tunisian authorities.

23. **The CBT is making good progress in tightening the collateral framework, which would help incentivize the interbank market and protect the CBT's balance sheet.** The haircut on the valuation of loans eligible for CBT refinancing has been raised from 10 percent in December 2013 to 25 percent by June 2014 (structural benchmark), with very limited impact on liquidity so far as banks have anticipated such a move by adjusting their balance sheet to ensure they can meet their historical financing needs. The collateral framework will be tightened further in December 2014 when the share of refinancing through government securities increases to 40 percent (up from 20 percent). However, further actions are needed, notably enhancing the current loan collateral framework through forward-looking credit scoring techniques or rating tools, and by valuing government bonds at market value instead of historical costs.

24. **The introduction of an exceptional facility will help address potential liquidity risks stemming from a tighter collateral framework pending the establishment of a lender-of-last-resort (LOLR) facility.** The authorities introduced in July 2014 a new "exceptional facility" to allow (at the discretion of the CBT) illiquid but solvent banks to access central bank liquidity with collateral of lesser quality but at a punitive rate (200 basis points above the money market rate) and under more intrusive banking supervision. A full-fledged LOLR mechanism—building on the exceptional facility—will be completed by end-March 2015. Prerequisites for its introduction include new liquidity norms, a clear definition of solvent banks, a more comprehensive definition of counterparty eligibility criteria, and the implementation of the new banking resolution framework (see MEFP, ¶11).

25. **Staff raised concerns regarding the tightly regulated lending rate, which hampers the proper functioning of monetary policy.** The authorities argued that the consultation process with various ministries on the evaluation of the existing "lending cap" system—prepared with World Bank assistance—is still ongoing. Staff stressed the need to avoid further delaying the removal of the cap on lending to enterprises and to modify the cap on consumer loans (or remove it totally if coupled with adequate supervision of risks) so as to strengthen the transmission channel of monetary policy (see EBS/14/5). The authorities noted that a modification will also depend on the legislative process, which could be lengthy.

26. **The ongoing revisions of the central banking law will strengthen the monetary policy framework.** New draft provisions grant the CBT more independence (institutional, functional, financial, and with respect to financial resources), a clearer mandate, and a new governance framework. Accordingly, a new draft law was presented to the CBT Board (end-June SB) and is expected to be approved by the Government in September 2014.

B. Laying the Foundations for Stronger, More Inclusive Growth

Reducing Financial Sector Vulnerabilities

27. **The authorities are speeding up the process to address capital shortfalls in the banking system.** Of the seven banks undercapitalized at end-December 2013 (44 percent of banking assets), three private banks (9 percent of banking assets) have been fully capitalized by end-July with financing from new and existing private shareholders, and all other banks—of which three are majority state-owned (34 percent of banking assets)—will be at the 10 percent regulatory minimum level by end-December 2014 (structural benchmark). The capital shortfall for public banks is currently estimated at 1.2 percent of GDP, to be financed by nonnegotiable bonds. Time-bound action plans—derived from the banking strategy adopted in April—will include the following important steps:

- **Bank restructuring.** Restructuring plans for the two public banks that completed audits (STB and BH) have been finalized and will be adopted by the government in August (end-July SB and prior action for completing the fourth Review); the design followed by the authorities is in line with best international practices (Annex I of MEFP). The next step is to have it adopted by end-September by the board of each bank. Staff urged the authorities to quickly consult existing private sector shareholders (about 46–49 percent equity stake in the main public banks) on the extent of their participation in recapitalizing these banks, or to dilute their share otherwise. The new auditor for the remaining public bank (BNA)—which was recruited following expedited procedures—started its work in June and will only complete the audit of the BNA by September (initially an end-July SB), with restructuring plans expected to be completed by end-November 2014 (new SB), and the bank fully recapitalized by end-year.

- **Governance of public banks.** Operational restructuring needs to be stepped up immediately to ensure that sustained solvency and profitability will be restored. In line with the decree approved in December 2013, staff and the authorities agreed that banks should be managed on a fully commercial basis, with bank management and board members meeting "fit and proper" criteria. To that end, the recruitment of "independent" Board members and a more performance-based salary structure are planned by end-September.

- **Divesting.** There are no plans at this stage to reduce state participation in the three main state-owned banks; however, the authorities plan to explore options to reduce the size of the government in the banking sector, by focusing initially on the nine banks (about 10 percent of banking assets) in which it has a minority share. Sale of these could help finance any additional recapitalization costs.

28. **Setting up an asset management company (AMC) is needed to address weak asset quality and ensure successful restructuring of the banking system.** The authorities attempted to speed up the process of establishing an AMC by including its main provisions in the revised budget law, but the National Assembly decided that this should be examined under a separate law in August. Furthermore, the authorities have broadened the mandate of the AMC law beyond the tourism sector's distressed assets to ensure that the legislative framework is in place in case the mechanism is extended to other loans. Staff emphasized that assets best suited to centralized management are: (i) large in size, including syndicated loans and credits to borrowers with multiple exposures to banks in the system; (ii) owed by corporate entities; and (ii) collateralized with (commercial) real estate. The authorities agreed that such characteristics are best matched in the tourism sector, for which an in-depth strategic study has already been completed, and plan to initially limit the AMC operation to the tourism sector. Staff urged a careful evaluation of the fiscal implications before extending the AMC experience to other sectors. The success of the AMC will very much depend on its governance structure that will need to include internal (legal protection for employees, internal audit) and external aspects (oversight and supervision, operational independence and public accountability, external audit and reporting). It is expected that the AMC will be created by October 2014 (new structural benchmark).

29. **An effective resolution framework is key to a successful bank restructuring.** The authorities—with WB/IMF TA—have drafted a new banking law that ensures a clear identification of the agencies responsible for bank resolution and liquidation and proper resolution tools and powers for the CBT. Staff welcomed the design of this new law and framework (end-June 2014 SB), and urges its quick submission and adoption by government. In parallel, staff urged the authorities to

strengthen creditor rights by calling for an early adoption of the "bankruptcy law" which has been stalled in Parliament over the past year. Crisis containment and safety nets are being developed through the drafting of a new deposit insurance law and new LOLR, which should be implemented once the banking resolution framework is in place.

30. **Staff supported ongoing efforts to upgrade the regulatory and supervisory framework** (MEFP, ¶19). The authorities have adopted a three-year plan—established with IMF technical assistance—aimed at implementing a risk-based supervision framework, which is building on reforms that are already in train. As part of that action plan, staff welcomed progress made in designing a uniform bank performance reporting system. This will lead to a full reporting and ratings system that will cover all accounting, financial, and institutional data (end-December 2014 SB). Staff and the authorities agreed on the need to rapidly increase human resources at the supervision directorate, particularly for onsite inspections (new end-November SB), strengthen coordination within banking supervision departments, and establish clear and formal risk-based criteria to conduct banking supervision. Plans to align regulatory norms with international standards are also progressing, although loan classification rules could be tightened further (e.g., to cover public enterprises). Staff urged the authorities to put in place the new liquidity ratio by September 2014, and agreed with the authorities that sanctions should be applied in the interim to those not respecting the existing ratio.

Growth-enhancing fiscal reforms

31. **Implementation capacity for investment projects is being strengthened** (MEFP, ¶26). The new procurement law implemented in June is expected to modernize and streamline the bidding process, thereby accelerating the implementation of public investment in the regions. Decentralized project execution and new procedures to resolve constraints arising from land deeds, particularly at the regional level, will also contribute. A full assessment of project implementation at the regional level is being finalized, and staff urged that its recommendations be quickly adopted to ensure that gains materialize soon on the ground. Staff also supported the ongoing reform of the organic budget law—prepared with EU assistance, and to be adopted later in 2014—which will help remove redundant and cumbersome procedures that delay overall budget implementation. Notwithstanding these ongoing reforms, and given a level of budget implementation in line with last year's (20 percent of budgeted amount by end-May), staff and the authorities estimate that several months will be needed before a substantial shift in the speed of project execution is observed.

32. **A comprehensive tax reform based on a more transparent, efficient, and equitable tax system is needed.** As a first step, all the new permanent tax measures implemented in the last two years—including the halving of the corporate tax difference between the onshore and offshore sectors and modification/simplification of the presumptive tax system—will be included in the new tax code (2014 end-September SB). The authorities have recognized that many measures included in the revised budget law are temporary and not part of the longstanding reform they want to implement. The participatory process that began in 2013 will culminate in the presentation of a comprehensive tax reform strategy during the national tax consultations that will be held in

September. A clear time-bound action plan to implement the strategy—which aims at fostering equity and mobilizing revenue—will be adopted by the Council of Ministers by end-October (new structural benchmark). Key priorities include: (i) simplifying the presumptive tax system; (ii) reforming the VAT (fewer rates, broader base, little or no withholding); and (iii) simplifying and improving the targeting of excises while enhancing their revenue yield. Staff reiterated the importance of including a timetable for the full convergence of the offshore and onshore corporate tax rates, which should also be linked to improvements in tax administration.

33. **Revenue administration reform will be guided by the execution of the newly approved modernization plan.** The main priority of the plan (end-June SB) is to transfer all tax functions within the tax administration, including management, control, arrears collection, and interpretation of the tax legislation. A first step in this direction is the merger of most functions under the large taxpayer unit (LTU), which is complemented by the introduction of new risk-based audit procedures. Staff also welcomed enhanced powers granted to the tax agency through the modification of the bank secrecy laws, but recommended that these be accompanied by adequate safeguards to protect taxpayers. Staff also urged the authorities to disseminate the reform plan widely within the ministry so as to ensure full ownership within the administration and avoid unnecessary resistance.

34. **Reform of public enterprises has been initiated, but steps taken so far were mostly limited to an assessment of the financial situation.** The audit report on energy companies—which was presented to the Council of Ministers in August—has shown a complex system of cross-subsidies; these will be reduced from 2015 onwards by making every energy public company accountable for its own import bill. To further reduce losses and borrowing costs, staff and the authorities agreed that budgeted funds should be transferred regularly and in a timely manner to food and energy public companies, with ex-post control procedures performed only once financial accounts are finalized at the end of the year. The authorities have started to monitor more regularly the position of the largest state-owned companies (SOEs) by producing key financial ratios and an aggregated fiscal position of the 28 state-owned enterprises (end-June SB), which will have to be extended to 2013. Following this evaluation, restructuring plans for the most vulnerable enterprises—such as TUNISAIR—are being prepared (MEFP, ¶24). Staff urged quick action on changes in the governance framework to bring greater independence and responsibility to SOEs' boards and management. The authorities also need to address the existing fragmentation in the structure and financial oversight of public enterprises and autonomous bodies (EPNA/EPS/EPA) and the lack of consolidated information on financial support provided by the government to these entities.

35. **Public financial management is improving** (MEFP, ¶25). Efforts to reconcile the discrepancy between the above-and below-the-line budgetary information are encouraging, with regular monitoring of expenditures from budget commitment to payment order, and to actual payments. Nonetheless, the reconciliation is limited to flows and the treasury balances are still not systematically reconciled. The practice of the complementary period and the procedure related to the externally-financed projects still delay the closure of annual accounts and open the scope for reclassifying data into either fiscal year n or n-1. Closing the accounts within one month of the end

of the fiscal year is a priority in the short term, while staff recommended abolishing the complementary period in the medium term. The creation of a National Public Accounting Standards Board is welcome and should be operationalized soon so as to help the authorities move towards international norms, including through the introduction of double entry bookkeeping. For greater transparency and comprehensiveness in budget preparation, staff urged the authorities to quickly complete the introduction of a functional classification (now scheduled for September). The adoption of the new organic law will also help, by introducing greater flexibility in managing budget appropriations.

36. **The public sector pension system is in need of urgent reforms** (MEFP, ¶35)**.** The financial situation of the public sector retirement and social security Fund (CNRPS) has deteriorated significantly over the past few years, and its treasury balances have been depleted. To ensure the payments of pensions this year, the government will transfer around 0.3 percent of GDP to the CNRPS, of which 0.1 percent is a transfer to cover arrears from the transport public company. Staff urged the authorities to adopt in the 2015 budget the recommendation of the CNRPS to increase the retirement age to 62 (and optional to 65) so as to avoid having to cover an annual deficit of around 0.5 percent of GDP. More substantial reforms will be needed, including changes in contribution parameters and benefits, so as to address the main shortcomings of the pay-as-you-go system (e.g., an aging population, early retirement age, and generous parameters for calculating pension benefits).

Growth-enhancing structural reforms

37. **Efforts to adopt important reforms that will strengthen the business climate are lagging.** Staff reiterated the need to move quickly and forcefully on explaining to parliament and various stakeholders the merits of adopting laws—on competition, public private partnerships, bankruptcy, and investment code—which are crucial to reduce the burden of excessive regulation and government intervention while encouraging private sector development and fostering competition. The authorities remain determined to pursue quick parliamentary approval of these laws, but argue that this is part of the lengthy legislative process that also requires consensus building. In addition, with respect to the investment code, the current version in Parliament is judged too cumbersome because it tried to satisfy too many stakeholders and left important decisions to future decrees. The authorities are working on replacing it with streamlined "quick win" measures that will reduce restrictions on investment and guarantee investor rights. Given various ongoing negotiations on regional trade agreements, greater market access will no longer be a priority of the "investment code" and will be left instead to individual trade negotiations. Staff urged the authorities to design and implement the new "investment facilitation" measures quickly, and to avoid introducing tax incentives, which could be distortionary and not conducive to creating a more level playing field for investors.

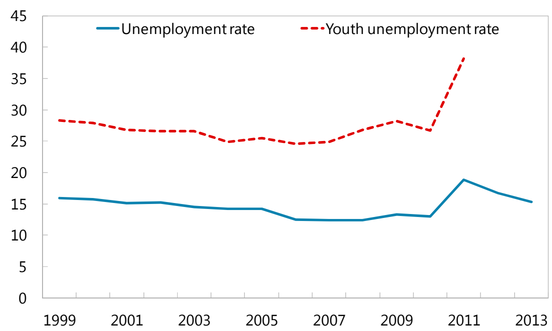
38. **Labor market reforms are somewhat stalled, with key measures to be initiated following a consensus that will likely emerge after the elections.** Tripartite working commissions—including representatives from government, business, and labor unions—have renewed the dialogue envisaged in the "Social Pact" signed in January 2013, which outlined a broad framework for reforms. Discussions on the national employment strategy, including how to address the structural skills mismatch and reduce labor market rigidities—are still at the initial stage, and new measures are only expected to be announced after the elections. However, while important structural reforms are not yet in the cards, unemployment remains high (Box 3), and a number of job creation initiatives have been launched or are under preparation, particularly for the youth. These include examples of "virtual workplaces" to give unemployed university graduates a forum to hone their skills while searching for formal employment, a reform of professional training, incentives for university graduates to establish companies in disadvantaged regions, and programs to increase financing for SMEs (including through World Bank assistance).

39. **An assessment of the statistical system—conducted with help from EUROSTAT—needs to be finalized** (MEFP, ¶33). Staff urged the quick adoption of a national reform plan to address weaknesses in the statistical system, notably to strengthen the coordination of various statistical bodies, enhance the quality of statistics and training. Staff welcomed the focus on strengthening national accounts, and progress made towards implementing the methodology of the Monetary Financial Statistics Manual (MFSM). Staff welcomed the authorities' intention to adopt a Code of Conduct for all statistical agencies, and reiterated the importance of new legislation guaranteeing the independence of the National Statistical Office.

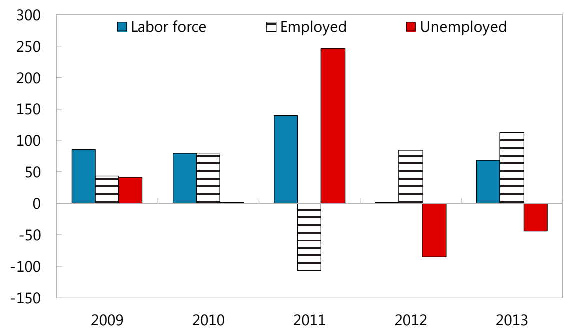
Box 3. Causes of the Rise and Fall in Tunisia's Unemployment Rate

Tunisia's unemployment rate increased significantly in the aftermath of the revolution, rising from 13 percent in 2010 to 18.9 percent in 2011, while youth unemployment rose from 27 percent to 38 percent during the same period. Job losses mainly took place in agriculture, tourism, and mining as a result of protracted strikes, reduced tourism due to security concerns, and closing of firms linked to the previous regime. However, during that period, unemployment was also high because the number of people newly registered as unemployed was twice as high as those losing jobs, reflecting a temporary monthly unemployment transfer scheme and a one-time increase in the maximum age for those taking public service exams.

Unemployment
(In percent of labor force)



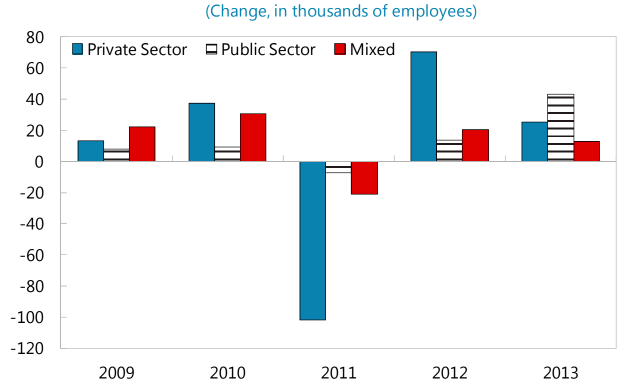
Labor Force
(Change, in thousands of people)



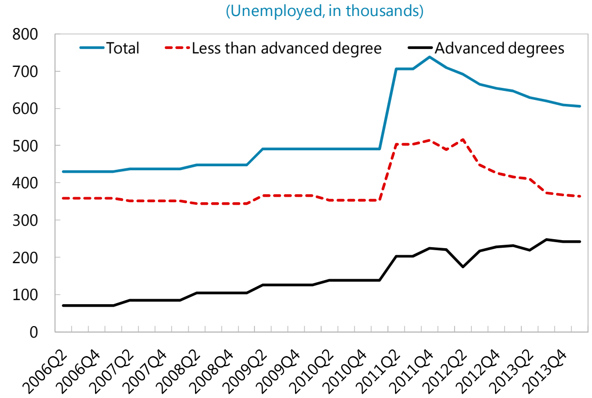
Recent improvements in Tunisia's unemployment rate have been predominantly the result of a reversal in the number of registered unemployed. By the end of 2013, Tunisia's unemployment rate had improved to 15.3 percent, which remains amongst the highest in the region (North Africa and the Middle East have an average unemployment rate of 12.2 percent and 10.9 percent, respectively). As unemployment benefits were made conditional on the family income of jobseekers, reductions in registered unemployment contributed by at least two-thirds to a reduction in the unemployment rate in the past two years. The remaining third was the result of new jobs, 36 percent of which were created in public sector services such as education, health, administration, and the mining sector. In the private sector, additional jobs were mainly created in the food, chemical, mechanical, and electricity sectors.

Job seekers without university degrees are the main beneficiaries of renewed job growth. During the revolution job losses were particularly pronounced among those without a university

Employment
(Change, in thousands of employees)



Unemployment Amongst University Graduates
(Unemployed, in thousands)



Box 3. Causes of the Rise and Fall in Tunisia's Unemployment Rate (concluded)

education; the same group is currently gaining the most from renewed job growth. Among university graduates, the most uninterrupted increase in unemployment numbers has been observed amongst those with science degrees. While they only represented 16 percent of all unemployed with university degrees in 2006, they now account for 30 percent of the total. They are also the main group that has not benefitted from renewed job creation in the past two years. Unemployment amongst university graduates in Tunisia is nearly twice as high as in comparable countries such as Jordan, Egypt or Morocco.

Future increases in the minimum wage should be considered carefully so as to not add to unemployment. Recent increases in the minimum wage of 6–10 percent are not expected to have an adverse effect on employment in Tunisia in the short run. However, future minimum wage increases should be considered carefully against the trend of falling labor productivity observed in the last decade. Also, there is evidence that existing youth minimum wages are not respected and that, instead, the youth receive the regular minimum wage, which is relatively high given the lower productivity of youth. Increases in the regular minimum wage could therefore lead to further increases in youth unemployment.

C. Protecting the Most Vulnerable

40. **Programs to support vulnerable segments of the population during reform implementation continue to be important.** Staff welcomed actions taken to protect the poor, such as a new social housing program for those in need, and a lifeline electricity tariff to protect households that consume less than 100 kwh while electricity subsidies are being reduced. Staff was also encouraged by the introduction of a household support program (2014 end-June SB) that increased transfers to vulnerable households by 10 percent, broadened the number of beneficiary families in the existing cash transfer program from 220,000 in 2013 to 235,000 in July 2014 (and 250,000 by end-year), provided a temporary transfer of 80 dinars for about 285,000 families in June/July when fuel prices were increased (and during Ramadan), and provided an additional transfer of TD 10 per month per child to vulnerable families with schoolchildren (up to three per family) (MEFP, ¶34). In addition to these interim steps, the authorities are working on finalizing the unique social identification number, which is already available for 7.5 million citizens, and which could be used as a basis for the new registry of vulnerable households. Staff urged the authorities to start improving their targeting system using the current registry and the results of the ongoing evaluation of the cash transfer scheme, and not to wait until a unique social identification number is available to all.

PROGRAM DESIGN AND MODALITIES

41. **Program modalities remain broadly unchanged, and new benchmarks are mostly on the financial sector.** All end-March and end-June PCs have been met. Staff is proposing a modification of end-September performance criteria (PCs) in light of the end-June outturn and new BOP projections. It also proposes to set new PCs for end-December 2014 and new ITs for end-March 2015 as per the MEFP (Table 1). Regarding structural benchmarks (MEFP, Table 2b), the adoption by the government of STB and BH restructuring plans in line with best international practices is a prior action for completing the fourth review, the audit of the BNA has been delayed to September 2014, five new benchmarks have been introduced to anchor program objectives in the banking sector area, and one new benchmark on tax policy. The end-September structural benchmark on the investment code will be reviewed in the context of the next review, given the authorities' intention to propose "streamlined measures" as an alternative. Although the authorities are not favoring an extension of the program at this stage, this could be considered later in the year should reforms take longer than envisaged, fiscal consolidation not take place as expected, or rebuilding external buffers require more time than envisaged.

42. **The program is fully financed, but financing after the completion of the Fund program in June 2015 has yet to be identified.** Financial assurances have been provided by multilateral and bilateral partners for disbursements over the next 12 months; some of these are closely linked to progress on reforms that are part of the Fund-supported program. From the Fund, all resources scheduled to be disbursed for 2014 will continue to be used for budget support. Market issuance of $1.1 billion will cover remaining financing needs for the rest of 2014. If there are early indications that projected financing will not be received over the next six months, the authorities will consult with the Fund on alternative financing approaches and/or further policy adjustments. For the part of 2015 not covered by a Fund program, greater recourse to international market issuances and/or greater policy adjustment would be warranted in case new bilateral/multilateral financing commitments for 2015 do not materialize after the elections.

43. **Tunisia has the capacity to repay the Fund, but risks to the program remain significant.** Tunisia has a strong record of payments to the Fund. Standard indicators of Fund exposure will remain low, with Fund credit outstanding reaching a maximum of 3.6 percent of GDP in 2015 (about 17.9 percent of gross international reserves). However, risks (¶15)—notably delays in the political agenda, increasing social and security tensions, delays in official financing, major structural constraints including a weak investment climate, or further deterioration of the international economic environment—could jeopardize program objectives and potentially erode repayment capacity. That said, the government's reiterated strong commitment to the reform agenda helps reduce program implementation risks.

STAFF APPRAISAL

44. **The important progress made in the political transition provides a window of opportunity to advance reforms and galvanize investors, but macroeconomic conditions remain difficult.** Rising external imbalances are putting pressures on both the exchange rate and reserves. Social tensions remain high, and security incidents represent a threat that continues to dampen the investment climate and burden economic activity. Higher growth dividends will continue to require steadfast reform implementation.

45. **Fiscal consolidation remains key to the success of the program, and should be accompanied by an improved budget composition.** Staff welcomes the government's efforts to identify new measures to offset spending pressures that emerged, thereby allowing the authorities to remain on track to meet the end-year deficit target. However, staff regrets the end-year increase in current primary spending that was not offset by permanent cuts in nonessential current expenditures, and urges the authorities to contain the wage bill at program levels and to speed up the execution of the investment budget, which should be preserved during the fiscal adjustment. A tighter fiscal stance—including through saving any revenue over-performance—will be essential to contain external imbalances and reduce crowding out of the private sector.

46. **The authorities' efforts to deliver on their commitment to subsidy reform should be commended.** Electricity tariffs were raised, fuel prices were increased, and all electricity subsidies for energy companies were removed. These are important steps taken at a difficult time to reduce regressive energy subsidies and create fiscal space for priority spending. Recent initiatives to strengthen the social safety net in conjunction with the subsidy reform—including the implementation of new social programs and the introduction of the long delayed "household targeting strategy"—are welcome.

47. **Moving forward with comprehensive revenue reform is essential to establish a more efficient, transparent, and equitable tax system.** Staff welcomes the authorities' adoption of new measures to combat tax evasion and of the tax modernization plan, which should be quickly implemented so as to show quick gains in efficiency, equity, and simplification. Enhanced powers to the tax agency, through a modification of bank secrecy laws, are welcome, but they should be balanced by ensuring taxpayers' rights are protected. Staff welcomes the ongoing work on the tax code, and urges the adoption of the new tax reform strategy that includes permanent base-broadening measures, of which some should be proposed in the 2015 budget.

48. **Strengthening public financial management and reforming public enterprises is important to improve governance, enhance the credibility of fiscal policies, and strengthen service delivery.** The implementation of streamlined procurement procedures and decentralized project execution—together with revised budget procedures that are to be enshrined in the new organic budget law—will also help scale up investment. Staff urges the authorities to move quickly on these reforms: they are the base for promoting investment and economic growth. Staff supports

the increased monitoring of public enterprises, and urges quick action on designing restructuring plans for enterprises in difficulty.

49. **A tight monetary policy is necessary to anchor inflationary expectations.** Staff welcomes the recent increase in the policy rate, and the authorities' readiness to increase the rate further if inflationary pressures materialize. Staff urges moving towards a positive real interest rate as the best way to keep inflation down and reduce exchange rate pressures. Staff commends the authorities on efforts taken to tighten the collateral framework, and urges quick conclusion of the ministerial consultation process so as to move speedily towards revising the legislation capping interest rates, which is hampering the effectiveness of the monetary policy transmission mechanism. The establishment of a LOLR facility will also enhance the monetary framework.

50. **The CBT should focus on rebuilding its foreign reserve buffers, including through increased exchange rate flexibility.** Staff welcomes the recent reduction in CBT foreign exchange sales, and the depreciation of the exchange rate, which is needed to correct large external imbalances. Staff supports the authorities' policy to smooth excessive exchange rate fluctuations, and encourages them to step up purchases during periods of excess fx supply (or lower pressure on the exchange rate). A move towards a weekly auction system will help promote greater exchange rate flexibility.

51. **Important steps have been taken to reduce financial sector vulnerabilities.** Staff welcomes the authorities' adoption of public bank restructuring plans, and urges their quick implementation by the boards of these banks, including those plans related to recapitalization and governance requirements. Staff welcomes the authorities' efforts to speed up the establishment of an Asset Management Company, which should first address distressed tourism assets, and which, together with the implementation of a new bankruptcy law, is essential to addressing banks' weak asset quality. Staff regrets the delay in launching the audit of the remaining large public bank, and urges its rapid completion so that the bank can be restructured quickly. Enhancing the banking resolution framework, as well as continued efforts to upgrade the regulatory and supervisory framework, is essential to safeguard banking stability.

52. **Structural reforms remain critical for improving the investment climate and generate more inclusive growth.** Staff regrets delays in moving forward with the legislative agenda—such as the competition law, investment code and the law on public-private partnerships—which are crucial to fostering private sector development and provide a level playing field for investors. Staff encourages the authorities to avoid introducing new tax incentives to foster investment, and to further reduce the difference between tax rates in the onshore and offshore sectors by taking additional steps towards a gradual convergence of rates in these two sectors and simplifying regulatory procedures.

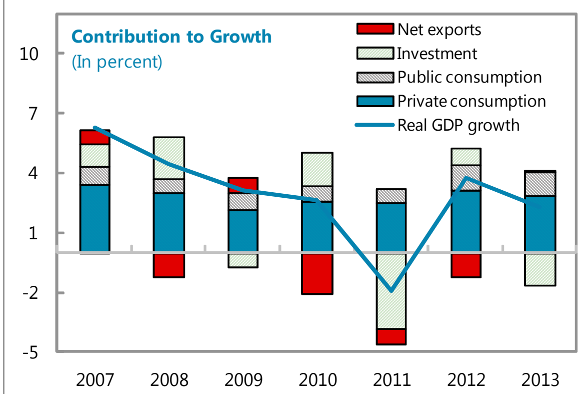
53. **Reforming the public sector pension system is a priority in view of its mounting deficits.** While substantial reforms may take time to materialize, staff urges the authorities to take quick actions to reduce the pension system's annual deficit and help it move towards financial viability.

54. **The authorities' sustained commitment to reform implementation during the political transition phase remains crucial.** The implementation of program policies will continue to be tested by a difficult social environment and vested interests. Staff welcomes the government's conscious effort to communicate on its policies and explain the need for the difficult economic reforms which are necessary to bring lasting benefits to the Tunisian economy.

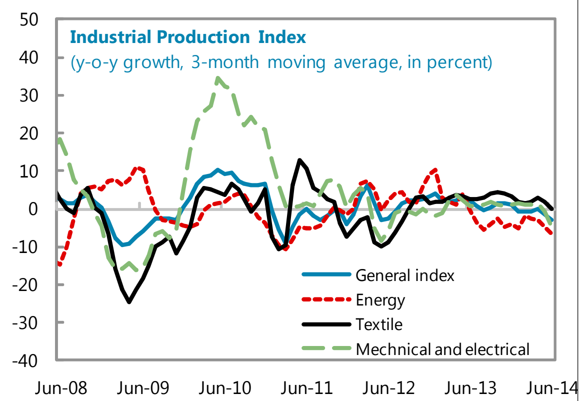
55. **On the basis of Tunisia's performance under the SBA, and the government's forward-looking policy commitments, staff supports the authorities' request for completion of the fourth review and a disbursement of SDR 143.25 million.** Staff supports the modification of end-September QPCs and recommends the establishment of new end-December PCs as proposed in the attached MEFP.

Figure 1. Tunisia: Recent Economic Developments

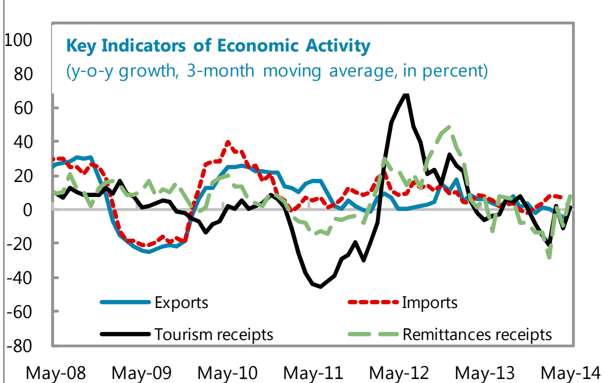
Growth continues to be moderate, driven mostly by private consumption while investment is recovering from the sharp drop in 2011



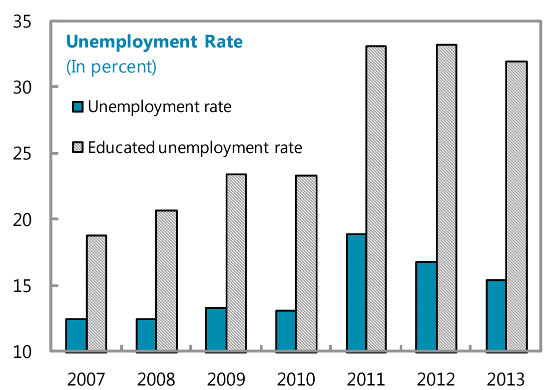
Industrial production has recovered in Q1-2014, driven mostly by textile production, while energy production is still weak



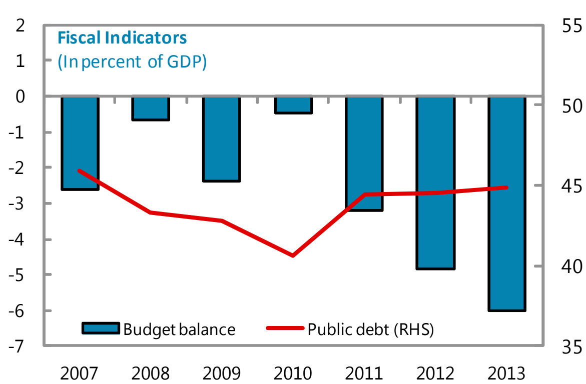
Tourism and remittances are recovering slowly while exports are declining



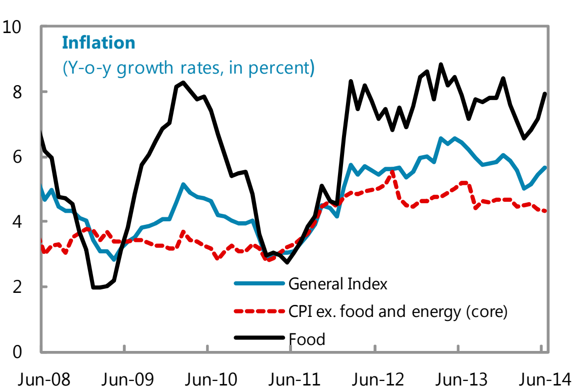
Unemployment has started to subside on the back of public sector hiring but remains high, particularly among university graduates.



In 2013, to counteract the still-weak economy and high unemployment, the fiscal stance has been looser, while public debt has stabilized at around 45 percent of GDP.



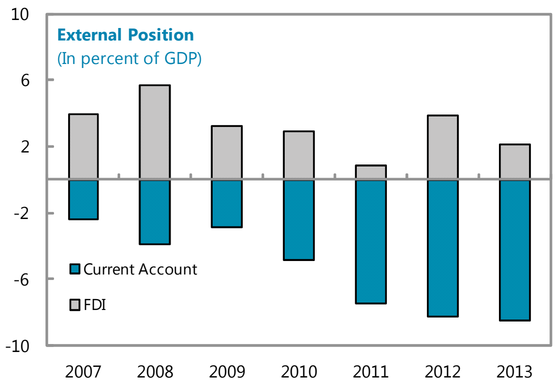
Inflation is on the rise due to higher food prices while core inflation is declining.



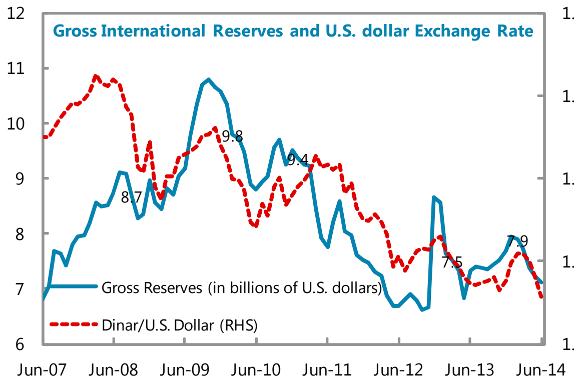
Source: Tunisian authorities.

Figure 2. Tunisia: External and Financial Indicators

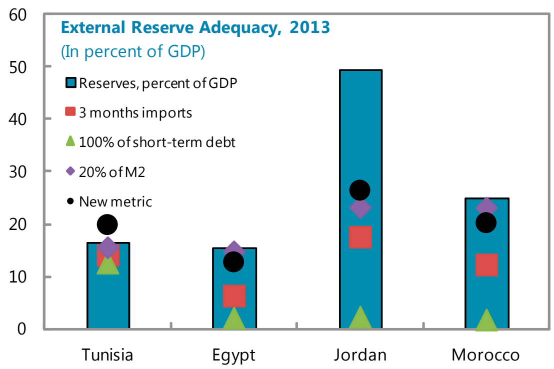
The current account deficit remains high and FDI flows weak.



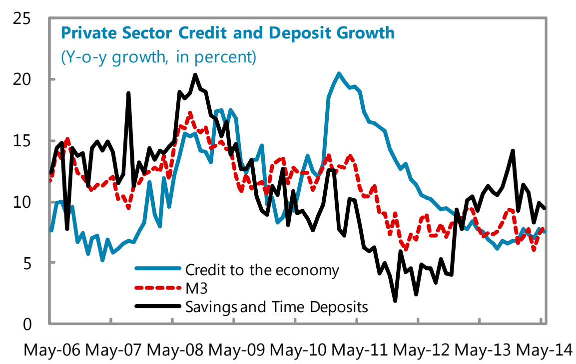
Reduced intervention in the FX market stabilized international reserves while the exchange has been depreciating.



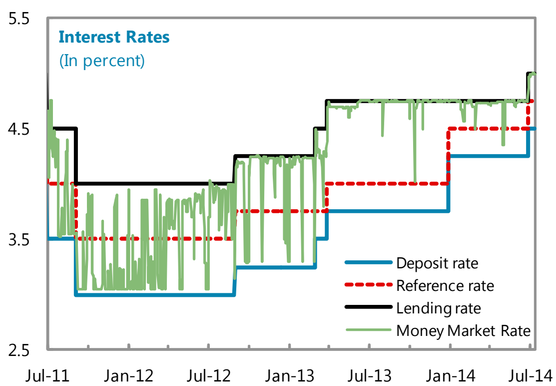
Reserve levels remain below the new metric.



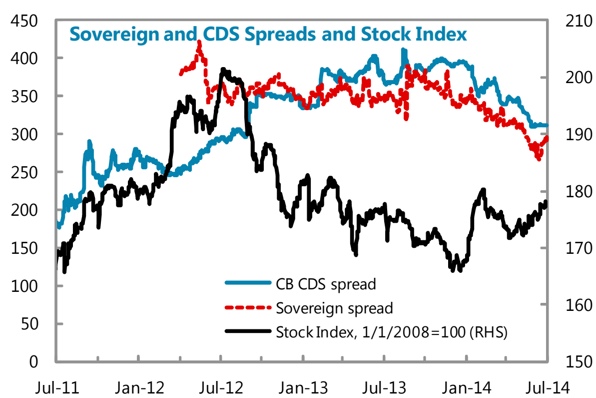
Credit to the economy continues to be lackluster while deposits have been falling.



The Central Bank Policy Rate increased by another 25 basis points in June to 4.75 percent.



Sovereign spreads have decreased and the stock index has improved but has been weighed down by bank stocks.



Sources: Tunisian authorities; and IMF staff estimates.

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

	2010	2011	2012	2013 Prog. 05/24/13	2013 Prel.	2014 Prog. 05/24/13	2014 Prog. 04/25/14	2014 Proj.	2015 Proj.
Production and income (percent change)									
Real GDP	2.6	-1.9	3.7	4.0	2.3	4.5	2.8	2.8	4.0
GDP deflator	4.3	4.6	5.3	5.6	5.7	4.4	5.1	5.7	4.8
Consumer price index (CPI), average	4.4	3.5	5.6	6.0	6.1	4.7	5.5	5.7	5.0
Consumer price index (CPI), end of period	4.0	4.2	5.9	5.3	6.0	5.0	5.3	5.5	4.5
Gross national savings (in percent of GDP)	20.9	16.2	16.1	17.3	13.6	19.0	14.2	12.9	14.5
Gross investment (in percent of GDP)	25.7	23.6	24.3	24.7	22.0	25.0	21.5	20.6	21.1
Central government (percent of GDP, unless indicated otherwise 1/									
Total revenue (excluding grants)	23.4	24.5	23.1	23.8	23.6	24.0	23.1	23.5	23.5
Total expenditure and net lending	24.0	28.0	28.8	31.1	29.8	30.3	29.9	30.3	28.0
Central government balance (excluding grants)	-0.6	-3.5	-5.7	-7.3	-6.2	-6.4	-6.8	-6.7	-4.5
Central government balance (excluding grants, cash basis)	1.6	-2.8	-5.0	-7.3	-4.5	-6.4	-8.6	-8.5	-4.5
Structural fiscal balance 2/	-1.1	-3.0	-5.3	-5.0	-4.5	-3.8	-4.9	-4.7	-4.0
General government debt (foreign and domestic)	40.7	44.5	44.5	45.3	44.8	49.5	50.9	51.7	54.4
Foreign currency public debt (percent of total debt)	60.7	58.0	62.8	65.7	64.3	68.5	70.1	69.1	69.1
Total external debt									
External debt (US$ billions)	21.4	22.1	24.3	25.0	25.4	27.6	28.2	28.2	30.7
External debt (in percent of GDP)	48.5	48.0	53.8	52.0	54.0	55.5	57.3	57.3	61.2
Debt service ratio (percent of exports of GNFS)	10.5	11.9	12.0	9.5	9.5	9.2	9.3	9.2	6.8
Money and credit (percent change)									
Credit to the economy	19.6	13.4	8.8	10.8	6.8	11.7	8.5	6.7	8.3
Broad money (M3 of the financial system)	12.1	9.1	8.4	12.6	6.6	12.0	9.6	10.2	10.0
Velocity of circulation (GDP/M2)	1.54	1.45	1.46	1.36	1.48	1.32	1.46	1.46	1.44
External sector (percent change)									
Exports of goods, f.o.b. (in $)	14.0	8.5	-4.6	6.5	0.3	5.6	1.7	2.0	4.5
Imports of goods, f.o.b. (in $)	15.9	7.7	2.1	5.1	-0.5	3.7	1.4	3.2	2.5
Exports of goods, f.o.b. (volume)	6.6	-0.4	1.3	5.7	3.2	5.2	2.1	2.1	5.2
Import of goods, f.o.b. (volume)	-1.9	3.7	8.5	5.8	5.1	6.1	1.6	2.3	4.6
Trade balance (in percent of GDP)	-10.4	-10.4	-13.5	-12.6	-12.6	-11.9	-12.1	-12.9	-12.2
Current account (in percent of GDP)	-4.8	-7.4	-8.2	-7.5	-8.4	-6.0	-7.2	-7.6	-6.6
Foreign direct investment (in percent of GDP)	3.0	0.9	3.9	2.1	2.2	2.5	2.2	2.1	2.7
Terms of trade (deterioration -)	-9.6	4.9	0.0	1.4	2.6	2.5	-1.0	-0.4	1.2
Official reserves									
Gross official reserves (US$ billions, e.o.p)	9.5	7.5	8.7	9.0	7.7	10.8	9.0	9.1	10.0
In months of next year's imports of goods and services, c.i.f.	4.4	3.4	4.0	3.8	3.4	4.2	3.9	3.9	4.2
Memorandum items:									
GDP at current prices (TD millions)	63,059	64,690	70,658	78,334	76,350	85,465	82,728	82,966	90,435
GDP at current prices (US$ billions)	44.1	46.0	45.2	48.9	47.0	50.6	49.2	49.186	50.2
Population (millions)	10.5	10.7	10.8	10.9	10.9	11.1	11.1	11.0	11.1
GDP per capita (US$)	4,177	4,305	4,198	4,483	4,317	4,576	4,449	4,472	4,522
Unemployment rate (in percent)	13.0	18.9	16.7	...	15.3	...	15.3	15.3	15.0
Exchange rate: dinar/US$ (average)	1.43	1.41	1.56	...	1.62	...	...	...	...
Real effective exchange rate (percent change, depreciation -) 3/	-0.52	-1.77	-1.82	...	-1.28	...	...	...	...
Interest rate (money market rate, in percent, e.o.p)	4.1	3.5	3.3	...	4.8	...	4.7	...	...
Stock market TUNINDEX (12/31/1997=1000)	5,113	4,722	4,580	...	4,381	...	...	...	...

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

1/ Excludes the social security accounts.

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

3/ Information Notice System.

Table 2. Tunisia: Balance of Payments, 2010–15
(In millions of U.S. dollars, unless otherwise indicated)

				Prel.	Projections					
					2014					
	2010	2011	2012	2013	Q1	Q2	Q3	Q4	Year	2015
Current account	-2,105	-3,401	-3,706	-3,961	-1,417	-1,144	-568	-632	-3,760	-3,302
Trade balance	-4,575	-4,799	-6,105	-5,937	-1,704	-1,840	-1,550	-1,239	-6,333	-6,135
Exports	16,431	17,824	16,997	17,050	4,278	4,663	4,060	4,397	17,397	18,189
Energy	2,315	2,592	2,849	2,591	621	666	580	618	2,485	2,502
Non-energy	14,116	15,231	14,147	14,459	3,656	3,997	3,480	3,780	14,913	15,686
Imports	-21,006	-22,623	-23,102	-22,987	-5981	-6503	-5610	-5636	-23,730	-24,324
Energy	-2,653	-3,409	-4,100	-4,172	-1,169	-1,370	-1,154	-1,211	-4,905	-4,860
Non-energy	-18,353	-19,214	-19,001	-18,815	-4,812	-5,132	-4,456	-4,424	-18,825	-19,464
Of which: Nonfood	-16,810	-17,339	-17,513	-16,633	-4,190	-4,437	-3,871	-3,958	-16,561	-17,411
Services and transfers (net)	2,470	1,398	2,399	1,976	287	696	982	607	2,573	2,833
Nonfactor	2,460	1,552	1,946	1,750	162	503	737	498	1,900	2,170
Of which: Tourism	2,461	1,680	2,031	1,988	340	506	775	489	2,110	2,350
Factor Services and Transfers (net)	10	-154	453	226	125	193	245	109	672	663
Of which: Workers' remittances	2,063	1,990	2,235	2,267	523	559	817	511	2,410	2,450
Interest payments on external debt	-632	-653	-618	-571	-117	-169	-138	-142	-565	-538
Capital and financial account	1,343	1,309	4,866	2,859	1,106	72	645	1,856	3,679	3,898
Excluding grants	1,252	1,142	4,412	2,605	1,093	21	546	1,794	3,455	3,688
Capital account	82	154	442	247	12	48	98	60	218	204
Financial account	1,260	1,155	4,424	2,612	1,094	24	547	1,796	3,461	3,694
Direct foreign investment (net)	1,309	417	1,772	1,029	191	202	273	358	1,024	1,376
Medium- and long-term loans (net)	145	652	1,623	830	116	-117	988	758	1,745	1,764
Disbursement	1,845	2,707	3,682	2,351	337	243	1,204	1,476	3,259	2,833
Amortization	-1,700	-2,055	-2,059	-1,521	-220	-360	-216	-718	-1,514	-1,069
Short-term capital	-193	85	1,232	929	810	-48	-694	798	866	718
Errors and omissions 1/	-316	108	-31	-13	-158	247	-5	8	92	81
Overall balance	-1,078	-1,984	1,130	-1,115	-468	-825	72	1,232	11	677
Reserve liabilities (Fund credits)	0	0	0	150	509	222	446	222	1399	224
Changes in gross reserves	1078	1984	-1130	965	-41	603	-518	-1454	-1410	-901
Memorandum items:										
Current account balance/GDP (percent)	-4.8	-7.4	-8.2	-8.4	-2.7	-2.3	-1.2	-1.5	-7.6	-6.6
Reserves (in billions of US$)	9.5	7.5	8.7	7.7	7.7	7.1	7.6	9.1	9.1	10.0
Reserves in months of imports of goods 2/	4.8	3.7	4.3	3.7	3.7	3.5	3.8	4.2	4.2	4.6
Reserves in months of imports of goods and services 2/	4.4	3.4	4.0	3.4	3.5	3.2	3.5	3.9	3.9	4.2
Reserves/total short term external debt (percent) 3/	191.3	147.2	139.7	121.6	140.5	126.0	127.6	156.3	157.7	164.4
Excluding nonresidents deposits	402.5	308.8	265.3	252.3	291.5	261.6	264.8	324.3	600.4	625.8
Reserves/short-term debt (on remaining maturity)	142.7	106.9	104.7	98.3	120.9	100.9	111.9	105.9	126.4	141.0
External debt service (in percent of exports of goods and non factor services), excluding non resident deposits	234.5	172.4	162.2	169.1	218.1	172.3	204.9	163.1	309.1	383.7
External medium- and long-term debt (billions of US$)	16.4	16.9	18.1	19.1	19.8	19.9	21.4	22.4	22.4	24.7
External medium- and long-term debt/GDP (percent)	37.2	36.9	40.1	40.6	37.3	40.1	44.4	47.8	45.6	49.1
External short-term debt (billions of US$)	5.0	5.1	6.2	6.3	5.5	5.7	6.0	5.8	5.8	6.1
External short-term debt/GDP (percent)	11.3	11.1	13.7	13.5	10.4	11.4	12.4	12.4	11.7	12.1
Debt service ratio (as percent XGS, including IMF)	10.5	11.9	12.0	13.4	6.3	8.8	6.2	15.0	8.2	6.4
Goods export real growth (percent)	6.6	-0.4	1.3	3.2	1.0	-4.2	-4.4	-4.3	2.1	5.2
Non-energy	9.0	2.3	0.9	2.7	-15.0	-4.3	-4.4	-0.1	2.9	5.2
Goods import real growth (percent)	-1.9	3.7	8.5	5.1	9.7	3.4	3.6	3.6	2.3	4.6
Non-energy	-2.1	4.4	7.3	5.2	4.0	3.4	-12.1	7.1	0.6	4.8

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

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

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

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

Table 3. Tunisia: External Financing Needs, 2010–15
(In millions of U.S. dollars)

	2010	2011	2012	Prel. 2013	Projections 2014 Q1	Q2	Q3	Q4	Year	2015
Total financing requirements	9,226	10,551	10,270	10,728	6,405	7,022	7,521	6,867	10,216	9,819
Current account deficit - Capital transfers	2,022	3,247	3,264	3,714	1,404	1,096	470	571	3,542	3,099
Current account deficit	2,105	3,401	3,706	3,961	1,417	1,144	568	632	3,760	3,302
Capital account	82	154	442	247	12	48	98	60	218	204
Amortizations	6,887	7,412	6,975	7,001	4,842	6,173	7,046	6,304	6,766	6,801
General government	1,017	1,419	1,233	1,023	120	197	114	186	994	617
Banks	48	45	59	35	7	12	7	11	37	32
Corporate 1/	5,822	5,948	5,683	5,943	4,715	5,965	6,925	6,106	5,735	6,153
Short-term debt	5,187	5,357	4,916	5,480	4,621	5,813	6,830	5,960	5,251	5,732
Long-term debt	635	591	767	463	93	151	94	146	483	420
Net errors and omissions	316	-108	31	13	158	-247	5	-8	-92	-81
Total financing sources	9,226	10,551	10,270	10,578	5,896	6,798	7,078	6,645	8,817	9,594.8
FDI (net)	1,309	417	1,772	1,029	191	202	273	358	1,024	1,376
Disbursments (debt)	6,791	8,555	10,037	8,905	6,192	6,138	7,335	6,888	9,416	9,315
General government	798	1,778	3,180	1,551	212	122	1,086	1,209	2,666	2,278
Banks	74	66	36	57	9	9	8	16	42	39
Corporate 1/	5,919	6,711	6,821	7,297	5,971	6,008	6,241	5,663	6,707	6,998
Short-term debt	4,946	5,848	6,355	6,554	5,855	5,895	6,132	5,450	6,156	6,482
Long-term debt	973	863	466	743	116	112	109	213	551	516
Other portfolio flows net (Including Drawdown in commercial banks NFA)	48	-406	-409	-320	-446	-145	-13	853	-213	-196
Drawdown in gross reserves	1,078	1,984	-1,130	965	-41	603	-518	-1,454	-1,410	-901
Financing gap	0	0	0	150	509	224	443	222	1,399	224
Fund credits 2/	0	0	0	150	509	224	443	222	1,399	224
Purchases	0	0	0	150	509	224	443	222	1,399	224
Repurchase	0	0	0	0	0	0	0	0	0	0
Memo items										
Gross international reserves (in millions of U. S. dollars)	9,509	7,525	8,655	7,689	7,730	7,127	7,645	9,100	9,100	10,000
In percent of short-term debt at remaining maturity	142.7	106.9	104.7	98.3	120.9	100.9	111.9	105.9	126.4	141.0
Government rollover rates (in percent)	78	125	258	152	177	62	949	649	268	369
Banks rollover rates (in percent)	153	146	61	161	124	74	116	146	114	123
Corporate rollover rates (in percent)	102	113	120	123	127	101	90	93	117	114

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

Table 4a. Tunisia: Central Government Financial Operations, 2012–15 1/
(In millions of dinars)

	2012	2013	2014								2015
		Prel.	Budget	Prog. 04/25/14	Q1 04/25/14	Q1 Act.	Q2 Est.	Q3 Proj.	Q4 Proj.	Annual Rev.Proj.	Proj.
Total revenue and grants	16,939	18,150	19,271	19,325	4,653	5,041	4,755	4,805	5,228	19,829	21,576
Revenue	16,310	18,039	18,973	19,111	4,621	5,040	4,692	4,657	5,142	19,531	21,263
Tax revenue	14,864	16,333	17,897	18,035	4,406	4,730	4,316	4,442	5,002	18,490	19,942
Nontax revenue	1,446	1,657	1,072	1,072	214	309	375	214	139	1,037	1,311
Capital income	0	49	4	4	1	1	1	1	1	4	10
Grants	629	110	298	214	32	1	63	149	86	298	313
Total expenditure and net lending	20,344	22,746	24,825	24,720	4,873	4,818	5,394	6,648	8,268	25,128	25,292
Total expenditure	20,694	22,747	24,325	23,600	4,853	4,849	5,372	6,380	7,226	23,828	24,692
Current expenditure	16,003	19,023	19,624	19,280	4,520	4,500	4,371	5,183	5,454	19,508	19,356
Wages and salaries	8,624	9,572	10,515	10,361	2,755	2,894	2,420	2,539	2,613	10,465	11,195
Goods and services	1,167	1,200	1,480	1,480	444	400	385	385	250	1,420	1,357
Interest payments	1,272	1,411	1,475	1,475	510	442	345	353	335	1,475	1,474
Transfers and subsidies	4,940	5,959	5,858	5,812	811	764	1,222	1,869	2,103	5,959	5,139
CGC (Food)	1,242	1,450	1,407	1,407	264	265	225	524	484	1,497	1,484
Energy subsidies	2,111	2,854	2,500	2,460	100	0	543	740	1,070	2,353	1,394
Other	1,587	1,655	2,129	1,945	447	499	455	605	550	2,109	2,261
Other expenditure (non-allocated)	0	880	296	152	0	0	0	38	152	190	190
Of which: repayment of arrears 2/	0	880		0		...	...	...	...	...	0
Of which: elections and other political institutions			60	60						120	
Capital expenditure	4,692	3,725	4,701	4,320	332	349	1,001	1,197	1,773	4,320	5,336
Net lending	-351	-1	0	1,120	20	-32	22	268	1,042	1,300	600
Of which: public banks' recap. + AMC operat.costs	41	0	500	1,120	0	0	0	115	1,035	1,150	500
Central government deficit (-) (excluding grants)	-4,033	-4,707	-5,852	-5,609	-252	222	-702	-1,991	-3,126	-5,597	-4,028
Central government deficit (-) (including grants)	-3,404	-4,596	-5,553	-5,395	-219	223	-639	-1,843	-3,040	-5,299	-3,715
Float	-505	-1,263	0	1,465	2,032	1,768	694	0	-997	1,465	0
Central government deficit (-) (excluding grants, cash basis)	-3,529	-3,443	-5,852	-7,074	-2,284	-1,546	-1,396	-1,991	-2,129	-7,062	-4,028
Central government deficit (-) (including grants, cash basis)	-2,899	-3,333	-5,553	-6,860	-2,251	-1,545	-1,332	-1,843	-2,043	-6,764	-3,715
Financing	2,899	3,333	5,553	6,860	2,251	1,545	1,332	1,843	2,043	6,764	3,715
Foreign	2,524	-605	4,288	5,955	1,091	965	240	2,391	2,179	5,775	2,990
Drawings	4,450	1,057	5,338	7,005	1,296	1,156	569	2,600	2,500	6,825	4,100
Amortization	1,926	1,662	1,050	1,050	205	191	328	209	321	1,050	1,110
Domestic	-18	3,471	850	505	1,160	580	1,092	-638	-346	689	525
Drawings	1,582	1,843	2,500	1,541	861	988	1,225	0	0	2,213	2,065
Amortization	925	1,333	2,150	2,150	338	361	712	539	539	2,150	2,136
Government Deposits (+ = drawing / - = accumulation)	-675	2,961	0	114	638	-47	579	-399	-507	-374	96
Banks recapitalization	0	0	500	1,000	0	0	0	300	700	1,000	500
Privatization proceeds 3/	394	479	1,000	400	0	0	0	90	210	300	200
Memorandum items:											
Central government primary balance (excluding grants, cash basis)	-2,256	-2,032	-3,304	-5,599	-1,773	-1,104	-1,051	-1,638	-1,794	-5,587	-2,554
Cyclically adjusted fiscal balance	-3,774	-4,337		-5,137	...	...	...	...	...	-5,059	-3,587
Structural fiscal balance	-3,733	-3,457		-4,017	...	...	...	...	...	-3,909	-3,587
General government debt 4/	31,446	34,238		42,123		...	...	...	...	42,903	49,230
Nominal GDP	70,658	76,350	83,281	82,728		20,946	20,946	20,946	20,946	82,966	90,435

Sources: Tunisian authorities; and IMF staff estimates.
1/ Includes special funds, *fonds de concours* . Does not include the social security system (CSS).
2/ Arrears on energy subsidies payments accumulated in 2012.
3/ It also includes sale of confiscated assets.
4/ Gross debt: excludes debt of public enterprises.

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

(In percent of GDP)

	2012	2013	2014			2015
		Prel.	Budget	Prog. 04/25/14	Rev. Proj.	Proj.
Total revenue and grants	24.0	23.8	23.1	23.4	23.9	23.9
Revenue	23.1	23.6	22.8	23.1	23.5	23.5
Tax revenue	21.0	21.4	21.5	21.8	22.3	22.1
Nontax revenue	2.0	2.2	1.3	1.3	1.2	1.4
Grants	0.9	0.1	0.4	0.3	0.4	0.3
Total expenditure and net lending	28.8	29.8	29.8	29.9	30.3	28.0
Total expenditure	29.3	29.8	29.2	28.5	28.7	27.3
Current expenditure	22.6	24.9	23.6	23.3	23.5	21.4
Wages and salaries	12.2	12.5	12.6	12.5	12.6	12.4
Goods and services	1.7	1.6	1.8	1.8	1.7	1.5
Interest payments	1.8	1.8	1.8	1.8	1.8	1.6
Transfers and subsidies	7.0	7.8	7.0	7.0	7.2	5.7
Other expenditure (non-allocated)	0.0	1.2	0.4	0.2	0.2	0.2
Of which: repayment of arrears 2/	0.0	1.2	0.0	0.0	0.0	0.0
Of which: elections and other political institutions			0.1	0.1	0.1	
Capital expenditure	6.6	4.9	5.6	5.2	5.2	5.9
Net lending	-0.5	0.0	0.6	1.4	1.6	0.7
Of which: public banks' recap. + AMC operating.costs	0.1	0.0	0.6	1.4	1.4	0.6
Central government deficit (-) (excluding grants)	-5.7	-6.2	-7.0	-6.8	-6.7	-4.5
Central government deficit (-), (including grants)	-4.8	-6.0	-6.7	-6.5	-6.4	-4.1
Float	-0.7	-1.7	0.0	1.8	1.8	0.0
Central government deficit (-), (excluding grants, cash basis)	-5.0	-4.5	-7.0	-8.6	-8.5	-4.5
Central government deficit (-), (including grants, cash basis)	-4.1	-4.4	-6.7	-8.3	-8.2	-4.1
Financing	4.1	4.4	6.7	8.3	8.2	4.1
Foreign	3.6	-0.8	5.1	7.2	7.0	3.3
Domestic	0.0	4.5	1.0	0.6	0.8	0.6
Privatization proceeds 4/	0.6	0.6	1.2	0.5	0.4	0.2
Memorandum items:						
Central government primary balance (excluding grants, cash basis)	-3.2	-2.7		-6.8	-6.7	-2.8
Structural fiscal balance	-5.3	-4.5		-4.9	-4.7	-4.0
General government debt 5/	44.5	44.8		50.9	51.7	54.4

Sources: Tunisian authorities; and IMF staff estimates.

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

2/ Arrears on energy subsidies payments accumulated in 2012.

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

4/ It also includes sale of confiscated assets.

5/ Gross debt: excludes debt of public enterprises.

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

	2010	2011	2012	Prel. 2013	Prel./Act. *1Q 14*	Proj. *2Q 14*	Proj. *3Q 14*	Proj. 2014	Proj. 2015
					(In millions of dinars)				
Net foreign assets (NFA)	9,078	5,749	7,054	3,865	2,343	1,238	1,408	4,273	5,739
Foreign assets	16,023	12,893	15,410	15,027	14,530	14,556	15,899	18,870	21,880
Central bank	13,705	11,315	13,455	12,701	12,265	12,062	13,331	16,315	19,130
Foreign liabilities	-6,946	-7,143	-8,357	-11,162	-12,187	-13,318	-14,491	-14,597	-16,141
Central bank	-623	-782	-1,134	-3,004	-3,650	-3,918	-4,813	-5,639	-6,499
Net domestic assets (NDA)	34,190	41,454	44,114	50,684	53,199	55,328	57,621	55,840	60,385
Domestic credit	46,370	53,577	58,022	65,660	68,518	70,905	73,615	72,589	78,972
Credit to the government (net)	3,227	4,659	4,791	8,794	10,512	11,555	11,747	11,938	13,317
Central bank net credit	-3,250	-3,355	-3,461	-175	574	1,392	1,369	1,253	1,743
Commercial banks	2,937	3,568	3,686	4,111	4,748	5,523	5,739	5,286	5,757
Other	4,189	5,086	5,265	5,568	5,900	5,350	5,350	6,109	6,527
Credit to the economy	43,144	48,918	53,231	56,866	58,006	59,350	61,867	60,651	65,655
Other items (net)	-12,181	-12,123	-13,908	-14,976	-15,319	-15,577	-15,994	-16,748	-18,587
Money plus quasi-money (M2)	40,854	44,652	48,327	51,686	52,697	53,488	55,906	56,958	62,653
Money (M1)	15,862	19,007	20,007	20,877	21,391	21,517	24,110	23,006	25,307
Currency	5,518	6,814	6,559	7,236	7,219	7,262	8,137	7,974	8,771
Demand deposits	10,344	12,192	13,448	13,641	14,172	14,255	15,973	15,033	16,536
Quasi-money	24,992	25,646	28,320	30,809	31,306	31,490	35,285	33,951	37,346
Long-term deposits (M3-M2)	2,414	2,551	2,841	2,863	2,845	3,078	3,122	3,155	3,471
Broad money (M3)	43,267	47,203	51,168	54,549	55,542	56,566	59,029	60,113	66,124
					(Annual rate of change in percent)				
Net foreign assets	-5.7	-36.7	22.7	-45.2	-61.3	-74.0	-68.8	10.6	34.3
Net domestic assets	18.1	21.2	6.4	14.9	14.8	16.5	16.8	10.2	8.1
Domestic credit	16.8	15.5	8.3	13.2	13.7	15.0	15.0	10.6	8.8
Credit to government (net)	-11.4	44.4	2.8	83.5	74.2	71.6	46.7	35.7	11.6
Credit to the economy	19.6	13.4	8.8	6.8	7.0	8.1	10.4	6.7	8.3
Money and quasi-money (M2)	11.9	9.3	8.2	7.0	6.3	8.4	9.6	10.2	10.0
Broad money (M3)	12.1	9.1	8.4	6.6	6.1	8.3	9.6	10.2	10.0
					(Annual growth rates, in percent of broad money)				
Net foreign assets	-1.4	-7.7	2.8	-6.2	-7.1	-6.7	-5.8	0.7	2.4
Net domestic assets	13.6	16.8	5.6	12.8	13.1	15.0	15.4	9.5	7.6
Domestic credit	17.3	16.7	9.4	14.9	15.8	17.7	17.8	12.7	10.6
Credit to the government (net)	-1.1	3.3	0.3	7.8	8.5	9.2	6.9	5.8	2.3
Credit to the economy	18.4	13.3	9.1	7.1	7.2	8.5	10.9	6.9	8.3
Other items (net)	-3.7	0.1	-3.8	-2.1	-2.7	-2.7	-2.4	-3.2	-3.1
Memorandum items:									
GDP (in millions of dinars)	63,059	64,690	70,658	76,350	...	...	...	82,966	90,435
Nominal GDP growth (in percent)	7.1	2.6	9.2	8.1	...	...	...	8.7	9.0
Reserve money (in millions of dinars)	8,415	9,406	10,989	11,078	11,072	11,137	12,479	12,142	13,356
Velocity (GDP/M2)	1.54	1.45	1.46	1.48	...	...	...	1.46	1.44
Multiplier (M2/M0)	4.86	4.75	4.40	4.67	...	...	...	4.69	4.69

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

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

	2010	2011	2012	*1Q 13*	*2Q 13*	*3Q 13*	2013	*1Q 14*	*2Q 14*	*3Q 14*	2014	2015
Net Foreign Assets	13,082	10,533	12,321	10,969	10,182	10,211	9,696	8,615	8,142	8,518	10,676	12,631
Assets	13,705	11,315	13,455	12,035	12,176	12,155	12,701	12,265	12,062	13,331	16,315	19,130
Liabilities	623	782	1,134	1,066	1,994	1,945	3,004	3,650	3,918	4,813	5,639	6,499
Net Domestic Assets	-4,707	-1,189	-1,332	-1,757	-267	67	1,382	2,457	2,995	3,961	1,466	725
Domestic credit (net)	-2,673	222	248	-92	1,572	1,809	3,493	4,467	5,573	6,557	3,915	3,359
Net credit to government 1/	-3,250	-3,355	-3,461	-2,207	-1,639	-735	-175	574	835	812	1,253	1,743
Credit to Banks	578	3,577	3,709	2,115	3,212	2,545	3,668	3,893	4,738	5,746	2,662	1,616
Other items net	-2,035	-1,412	-1,579	-1,665	-1,839	-1,742	-2,111	-2,011	-2,578	-2,597	-2,449	-2,634
Reserve Money 2/	8,415	9,406	10,989	9,212	9,915	10,278	11,078	11,072	11,137	12,479	12,142	13,356

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

Table 7. Tunisia: Financial Soundness Indicators of the Banking Sector, 2008–March 2014

(In percent, unless otherwise indicated)

	2008	2009	2010	2011	2012	2013 Prel.	Mar. 2014 Prel.
Regulatory capital to risk-weighted assets	11.7	12.2	11.6	11.9	11.8	8.9	9.4
Tier 1 capital to risk weighted assets	10.6	10.7	10.2	10.0	9.4	7.3	7.7
Capital to assets	8.1	8.5	8.4	8.5	7.8	6.0	6.2
Asset quality							
Sectoral distribution of loans to total loans							
Industry	31.3	30.0	30.5	28.6	27.9	27.8	27.1
Agriculture	3.6	3.4	2.9	2.9	2.8	2.8	2.8
Commerce	17.3	17.4	15.0	16.0	15.4	15.3	15.4
Construction	4.5	4.9	5.9	5.6	5.4	5.5	5.5
Tourism	9.1	8.2	7.3	7.3	6.9	6.5	6.5
Households	20.1	21.6	22.1	23.4	25.4	26.3	26.3
Other	14.3	14.4	16.3	16.3	16.2	15.7	16.5
FX-loans to total loans	3.9	4.5	5.3	5.1	4.8	4.8	4.8
Credit to the private sector to total loans	71.6	70.4	70.6	67.4	67.7	73.2	72.4
Nonperforming Loans (NPLs) to total loans	15.5	13.2	13.0	13.3	14.9	15.2	15.1
Specific provisions to NPLs	-	-	-	48.5	45.9	59.9	60.4
NPLs, net of provisions, to Tier 1 capital	71.1	57.9	60.3	66.3	86.3	84.3	79.6
Specific provisions to total loans	8.8	7.7	7.6	7.6	8.0	10.1	10.1
General provisions to total loans	-	-	-	0.4	0.5	0.5	-
Profitability							
Return on assets (ROA)	1.0	1.0	0.9	0.6	0.6	0.7	-
Return on equity (ROE)	11.2	11.7	10.2	6.6	8.0	8.1	-
Interest rate average spread (between loans and deposits)	3.60	3.49	3.53	3.0	3.0	3.1	2.9
Interest return on credit	7.01	6.35	6.24	5.7	5.4	5.9	6.1
Cost of risk as a percent of credit	1.4	1.2	1.7	1.2	1.1	1.3	-
Net interest margin to net banking product (PNB)	58.6	58.8	58.6	57.2	58.1	57.9	58.2
Operating expenses to PNB	45.4	47.2	46.5	51.1	50.3	47.3	47.2
Operating expenses to total assets	1.6	1.6	1.6	1.7	1.6	1.6	1.6
Personnel expenses to non-interest expenses	60.4	61.4	59.1	62.6	61.3	59.1	58.7
Trading and other non-interest income to PNB	21.7	22.1	21.8	22.5	20.9	21.8	20.8
Liquidity							
Liquid assets to total assets	31.6	32.1	29.8	26.5	28.2	28.4	27.7
Liquid assets to short-term liabilities	124.0	119.1	104.1	89.4	89.2	92.6	90.6
Deposits to loans	98.9	100.9	94.6	87.4	89.5	89.6	89.7
Deposits of state-owned enterprises to total deposits	13.8	14.8	13.8	12.6	13.2	13.0	13.2
Sensitivity to market risk							
FX net open position to Tier 1 Capital	1.40	1.53	1.35	1.94	2.3	3.4	2.0

Source: Central Bank of Tunisia.

Table 8. Tunisia: Schedule of Proposed Purchases Under the Stand-By Arrangement, 2013–15

Review	Availability Date	Action	Purchase		Disbursements
			Millions of SDRs	Percent of quota 1/	Millions of U.S. dollars 2/
	June 7, 2013	Board approval of the SBA	98.800	34.485	150.155
First Review	September 15, 2013	Observance of end-June 2013 performance criteria, completion of the first review	98.600	34.415	152.569
Second Review	December 15, 2013	Observance of end-September 2013 performance criteria, completion of the second review	230.520	80.461	356.697
Third Review	March 15, 2014	Observance of end-December 2013 performance criteria, completion of the third review	145.080	50.639	224.491
Fourth Review	June 15, 2014	Observance of end-March 2014 performance criteria, completion of the fourth review	143.250	50.000	221.659
Fifth Review	September 15, 2014	Observance of end-June 2014 performance criteria, completion of the fifth review	143.250	50.000	221.659
Sixth Review	December 15, 2014	Observance of end-September 2014 performance criteria, completion of the sixth review	143.250	50.000	221.659
Seventh Review	March 15, 2015	Observance of end-December 2014 performance criteria, completion of the seventh review	71.625	25.000	112.077
Eighth Review	May 15, 2015	Observance of end-March 2015 performance criteria, completion of the eighth review	71.625	25.000	112.077
Total			1146.000	400.000	1,773.042

Source: IMF staff projections.

1/ Quota is SDR 286.5 million.

2/ Indicative amount based on the average annual exchange rate.

Table 9. Tunisia: Illustrative Medium-Term Growth Scenario, 2010–19

	2010	2011	Prel. 2012	Est. 2013	Proj. 2014	2015	2016	2017	2018	2019
	(Change in percent)									
Real GDP growth	2.6	-1.9	3.7	2.3	2.8	4.0	4.5	4.5	4.5	4.5
Total consumption	4.2	4.0	5.1	4.6	2.7	1.8	1.1	1.0	2.9	3.6
Private consumption (residual)	4.2	4.0	4.7	4.2	2.6	2.1	1.0	0.7	3.1	3.9
Public consumption	4.5	4.1	6.8	6.2	3.3	0.6	1.3	2.0	2.5	2.6
Investment	7.5	-16.5	4.1	-8.1	-1.0	4.7	4.7	5.3	7.3	5.3
Gross fixed capital formation	4.1	-12.6	7.1	-3.8	1.5	5.0	5.0	5.0	5.0	5.0
Change in stocks	216.0	-100.3	-29.4	-42.7	-30.0	0.0	0.0	10.0	50.0	10.0
Exports of goods and nfs 1/	5.5	-7.7	7.2	2.7	3.9	8.4	9.0	10.4	7.3	7.1
Imports of goods and nfs 1/	-2.1	3.5	8.3	4.9	2.1	4.5	3.2	4.8	6.1	6.1
Inflation (annual average)	4.4	3.5	5.6	6.1	5.7	5.0	4.2	4.0	4.0	4.0
	(In percent of GDP)									
Gross national savings	20.9	16.2	16.1	13.6	12.9	14.5	16.2	18.9	21.4	22.9
Consolidated government 2/	6.2	4.1	2.0	-1.0	-1.0	2.0	3.4	4.7	5.6	6.6
Rest of the economy	14.8	12.0	14.1	14.6	13.9	12.6	12.8	14.2	15.8	16.2
Gross investment	25.7	23.6	24.3	22.0	20.6	21.1	21.7	23.5	24.7	26.0
Consolidated government	6.6	7.2	6.7	4.9	5.2	5.9	7.2	7.5	7.7	8.1
Rest of the Economy	19.1	16.4	17.6	17.1	15.3	15.2	14.5	15.9	17.0	17.8
Total consumption	80.2	84.7	86.0	88.1	88.2	86.5	84.1	81.3	80.3	79.6
Private consumption	64.1	67.2	68.1	69.6	69.4	68.3	66.4	64.0	63.2	62.9
Public consumption	16.8	18.1	18.6	19.2	19.5	18.9	18.4	18.0	17.7	17.3
Savings-investment gap	-4.8	-7.4	-8.2	-8.4	-7.6	-6.6	-5.5	-4.6	-3.4	-3.1
Consolidated government	-0.4	-3.0	-4.7	-5.9	-6.2	-4.0	-3.8	-2.8	-2.1	-1.5
Rest of the economy	-4.3	-4.4	-3.5	-2.6	-1.4	-2.6	-1.7	-1.8	-1.2	-1.6
Memorandum items										
Nominal GDP at current prices (TD millions)	63,059	64,690	70,658	76,350	82,966	90,435	97,907	106,405	115,419	125,437
General debt in percent of GDP	40.7	44.5	44.5	44.8	51.7	54.4	55.6	55.8	54.8	53.9
External debt in percent of GDP	48.5	48.0	53.8	54.0	57.3	61.2	62.6	62.1	61.5	61.0
Central government balance in percent of GDP /3	-0.6	-3.5	-5.7	-6.2	-6.7	-4.5	-4.2	-3.3	-2.6	-2.1
Current account balance in percent of GDP	-4.8	-7.4	-8.2	-8.4	-7.6	-6.6	-5.5	-4.6	-3.4	-3.1

Sources: Tunisian authorities; and IMF staff estimates.

1/ Goods and nonfactor services.

2/ Includes social security, excludes privatization receipts.

3/ Excluding grants and privatization.

Table 10. Tunisia: Indicators of Fund Credit, 2012–19

	2012	2013	2014	2015	2016	2017	2018	2019
Existing and prospective Fund credit								
Disbursement	0	99	904	143	0	0	0	0
Stock	0	99	1,003	1,146	1,121	876	355	27
Obligations	0	3	6	16	43	261	529	331
Repurchase	0	0	0	0	25	245	521	328
Charges	0.02	2.72	5.80	16.24	17.99	15.72	7.81	2.41
Stock of existing and prospective Fund credit								
In percent of quota	0.0	34.5	350.0	400.0	391.4	305.9	123.9	9.4
In percent of GDP	0.0	0.3	3.2	3.6	3.4	2.6	1.0	0.1
In percent of exports of goods and services	0.0	0.7	6.9	7.6	7.0	5.1	2.0	0.1
In percent of gross reserves	0.0	2.0	17.1	17.9	15.9	11.5	4.2	0.3
Obligations to the Fund from existing and prospective Fund arrangements								
In percent of quota	0.0	0.9	2.0	5.7	14.9	91.0	184.7	115.4
In percent of GDP	0.0	0.0	0.0	0.1	0.1	0.8	1.5	0.9
In percent of exports of goods and services	0.0	0.0	0.0	0.1	0.3	1.5	3.0	1.8
In percent of gross reserves	0.0	0.1	0.1	0.3	0.6	3.4	6.2	3.6

Source: IMF staff estimates.

Annex. Public and External Debt Sustainability Analysis

Public debt

An expansionary fiscal policy in the aftermath of the revolution, combined with a decline in economic activity, increased public debt. After having declined from an average of 60 percent of GDP in the 1990s to 40.7 percent of GDP in 2010, the debt-to-GDP ratio increased in 2011 to 44.5 percent and remained practically unchanged until 2013, though it is expected to increase to about 7 percentage points of GDP to 51.7 percent of GDP by end-2014. Notwithstanding the increasing debt, the level continues to be relatively comfortable and lower than in similar countries in the region, despite high deficit levels since the revolution.

Under the baseline scenario, public debt is expected to increase to 56 percent before declining over the medium term. Increased banking recapitalization costs, a wider deficit, and weaker-than-originally-expected growth dynamics will contribute to increasing the debt-to-GDP ratio to around 56 percent of GDP by 2017. The decline of the debt-to-GDP ratio has been somewhat delayed, and it is expected to start declining in 2018, reaching about 54 percent by end-2019, 13 percentage points of GDP higher than in 2010. This debt dynamic reflects the fiscal consolidation envisaged by the authorities (an overall deficit declining to 2.0 percent of GDP by 2019) and real growth rates that start to pick up in 2015.

Public debt dynamics remain vulnerable to adverse shocks and could deteriorate significantly relative to the baseline. Under an adverse scenario in which the medium-term fiscal consolidation is not implemented, public debt would be on an increasing path and would reach around 62 percent of GDP by 2019. The public debt dynamic would initially worsen under all bound tests and then stabilize between 56 percent and 68 percent in 2019. As a result of a one-off 10 percent of GDP shock to contingent liabilities it would reach about 66 percent of GDP in 2016 and slightly decline to about 63 percent of GDP by 2019.[1] Under a permanent negative shock to real growth, public debt would remain on an increasing path, reaching about 67 percent of GDP by end-2019. Finally, as around 69 percent of public debt is denominated in foreign currency, a one-time 30 percent depreciation would increase the public debt-to-GDP ratio to about 71 percent before it declined to 68 percent by 2019. On the other hand, public debt dynamics would be relatively resilient to an interest rate shock, with debt staying at around 56 percent of GDP over the medium term.

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

External debt

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

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

Under the baseline projections, external debt is projected to increase to 62.6 percent of GDP in 2016 before declining following favorable current account dynamics. As a result, Tunisia's external debt sustainability risks appear contained in the period ahead. The analysis assumes that Tunisia's government will implement a significant fiscal consolidation in the medium term and continue to pursue cautious external borrowing policies. Having remained steady in 2013 following a significant shortfall in external financing, the external debt-to-GDP ratio is expected to rise in 2014 to 57.3 percent, and will reach a maximum of 62.6 percent by 2016 before slightly declining to around 61 percent by end-2019.

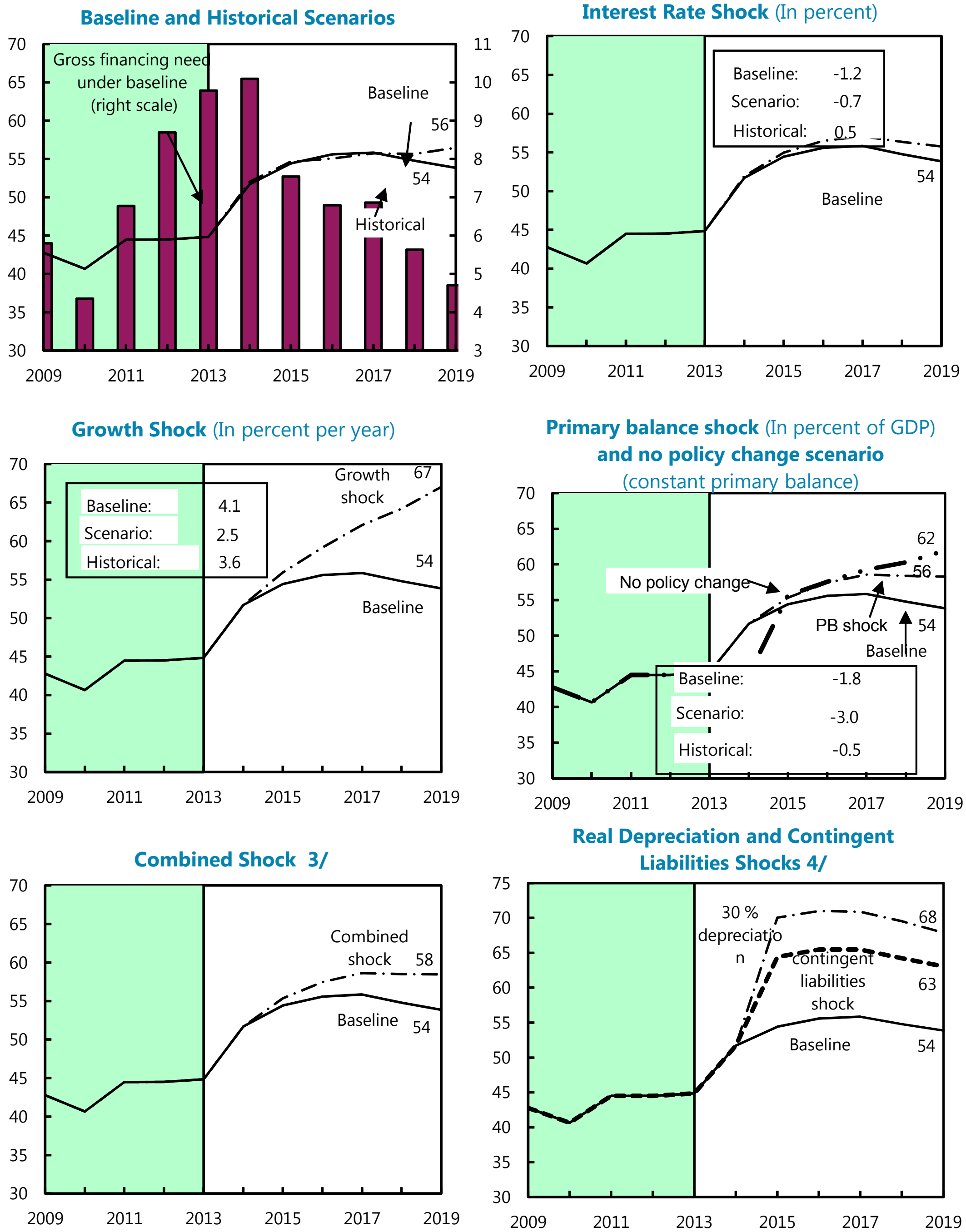
The external debt ratio is resilient to most types of adverse external shocks except large exchange rate depreciation. The relatively low level of Tunisia's debt as well as its profile (low average interest rate and relatively long maturity) makes it robust to most shocks, with the exception of large real exchange rate depreciation. The external debt ratio remains below 68 percent of GDP throughout the projection period under all but one alternative scenario and all bound tests. For example, a permanent negative shock to growth or to the current account would raise the debt ratio to 67–68 percent of GDP, while an increase in the average interest rate would have almost no impact.[3] However a sharp real depreciation (one-time 30 percent) of the exchange rate relative to the baseline would raise the debt ratio to more than 90 percent of GDP and then declined to 88 percent by 2019.

[2] Prior to 2012's international bond issuances with U.S. and Japanese guarantees, the last international bond issuance was in 2007. The first maturing international bond is due in 2017.

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

Annex Figure 1. Tunisia: Public Debt Sustainability: Bound Tests 1/ 2/

(Public debt in percent of GDP)



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

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks and a 1/2 of standard deviation growth shock. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

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

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

4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2013, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Annex. Table 1. Tunisia: Public Sector Debt Sustainability Framework, 2009–19

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	Debt-stabilizing primary balance 9/
1 **Public sector debt 1/**	42.8	40.7	44.5	44.5	44.8			**51.7**	**54.4**	**55.6**	**55.8**	**54.8**	**53.9**	**-1.3**
o/w foreign-currency denominated	25.0	24.7	25.8	27.9	28.8			35.7	39.3	40.7	40.0	39.0	38.5	
2 Change in public sector debt	-0.5	-2.1	3.8	0.0	0.3			6.9	2.7	1.2	0.2	-1.1	-0.9	
3 Identified debt-creating flows (4+7+12)	-0.2	-0.2	2.5	3.0	3.0			4.6	2.2	1.4	0.1	-0.6	-1.3	
4 Primary deficit	-0.8	-0.9	1.6	3.4	4.0			2.9	1.7	2.2	1.4	0.7	0.2	
5 Revenue and grants	29.6	30.2	31.5	30.7	30.5			30.6	30.6	30.6	31.1	31.4	31.7	
6 Primary (noninterest) expenditure	28.7	29.3	33.1	34.0	34.5			33.5	32.2	32.8	32.5	32.1	31.9	
7 Automatic debt dynamics 2/	-0.5	1.2	1.9	0.7	-0.4			-0.8	-0.4	-0.7	-1.2	-1.2	-1.4	
8 Contribution from interest rate/growth differential 3/	-0.7	-1.0	0.8	-2.0	-1.5			-1.8	-2.6	-2.6	-3.1	-3.0	-3.1	
9 Of which contribution from real interest rate	0.6	0.0	0.1	-0.4	-0.5			-0.6	-0.7	-0.4	-0.8	-0.7	-0.9	
10 Of which contribution from real GDP growth	-1.3	-1.0	0.8	-1.5	-0.9			-1.2	-1.9	-2.3	-2.3	-2.3	-2.3	
11 Contribution from exchange rate depreciation 4/	0.1	2.2	1.1	2.7	1.1			1.0	2.2	1.9	1.9	1.8	1.7	
12 Other identified debt-creating flows	1.1	-0.4	-1.0	-1.1	-0.6			2.4	1.0	-0.1	-0.1	-0.1	-0.1	
13 Privatization receipts (negative)	1.1	-0.4	-1.0	-1.1	-0.6			1.2	0.4	-0.1	-0.1	-0.1	-0.1	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			1.2	0.6	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3)	-0.3	-2.0	1.3	-3.0	-2.7			2.3	0.5	-0.2	0.2	-0.4	0.4	
Public sector debt-to-revenue ratio 1/	144.6	134.6	141.1	145.1	147.2			169.0	178.1	181.7	179.3	174.3	169.7	
Gross financing need 5/	5.8	4.4	6.8	8.7	9.8			10.1	7.5	6.8	6.9	5.6	4.7	
in billions of U.S. dollars	2.5	1.9	3.1	3.9	4.6			5.0	3.8	3.5	3.7	3.1	2.7	
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	3.1	2.6	-1.9	3.7	2.3	3.6	2.4	2.8	4.0	4.5	4.5	4.5	4.5	4.1
Average nominal interest rate on public debt (in percent) 6/	4.9	4.6	4.6	4.4	4.5	4.8	0.4	4.3	3.4	3.0	2.6	2.6	2.5	3.2
Average real interest rate (nominal rate minus change in GDP deflator, in pe	1.6	0.2	0.0	-0.9	-1.2	0.5	1.3	-1.4	-1.4	-0.6	-1.4	-1.2	-1.5	-1.2
Nominal appreciation (increase in US dollar value of local currency, in perce	-0.6	-8.4	-4.1	-9.9	-3.9	-3.4	6.2	-3.7	-6.3	-5.0	-4.7	-4.6	-4.5	-4.8
Inflation rate (GDP deflator, in percent)	3.3	4.3	4.6	5.3	5.7	4.3	1.1	5.7	4.8	3.6	4.0	3.8	4.0	4.4
Growth of real primary spending (deflated by GDP deflator, in percent)	4.1	4.5	11.0	6.6	3.6	6.3	2.5	-0.2	0.0	6.3	3.7	3.2	3.8	2.6
Primary deficit	-0.8	-0.9	1.6	3.4	4.0	0.5	1.9	2.9	1.7	2.2	1.4	0.7	0.2	1.8
A. Alternative Scenarios														**Debt-stabilizing primary balance 9/**
A1. Key variables are at their historical averages in 2014-2019 7/								**52.1**	**54.7**	**55.1**	**55.7**	**55.7**	**56.5**	**-0.1**
A2. No policy change (constant primary balance) in 2014-2019								**51.7**	**55.7**	**57.6**	**59.2**	**60.3**	**61.9**	**-1.3**
B. Bound Tests														
B1. Real interest rate is at baseline plus one standard deviations								**51.9**	**55.0**	**56.5**	**57.1**	**56.4**	**55.8**	**-1.0**
B2. Real GDP growth is at baseline minus one-half standard deviation								**51.7**	**55.9**	**59.2**	**62.1**	**64.2**	**67.0**	**-0.5**
B3. Primary balance is at baseline minus one-half standard deviation								**51.7**	**55.4**	**57.4**	**58.6**	**58.4**	**58.3**	**-1.4**
B4. Combination of B1-B3 using one-quarter standard deviation shocks								**51.7**	**55.4**	**57.5**	**58.6**	**58.5**	**58.5**	**-0.9**
B5. One time 30 percent real depreciation in 2015 8/								**51.7**	**70.0**	**71.0**	**70.9**	**69.5**	**67.9**	**-1.6**
B6. 10 percent of GDP increase in other debt-creating flows in 2015								**51.7**	**64.4**	**65.5**	**65.5**	**64.2**	**63.0**	**-1.5**

Sources: IMF Country desk data; and staff estimates.

1/ General government gross debt including public pension fund.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

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

5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

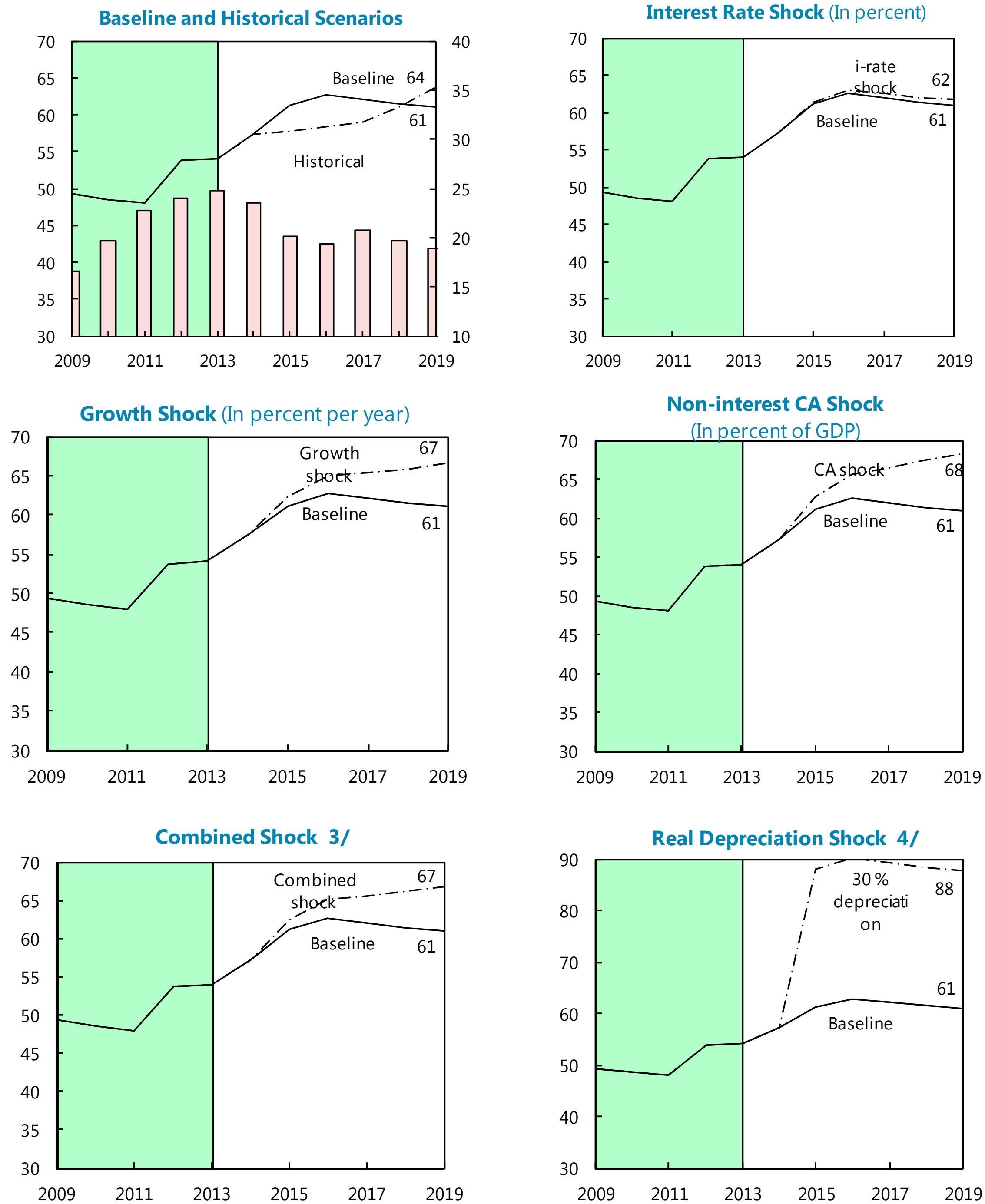
6/ Derived as nominal interest expenditure divided by previous period debt stock.

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

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

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

(External debt in percent of GDP)



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

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

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

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

4/ One-time real depreciation of 30 percent occurs in 2014.

Annex. Table 2. External Debt Sustainability Framework, 2009-2019

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	
								I. Baseline Projections						Debt-stabilizing non-interest current account 6/
1 **External debt**	49.3	48.5	48.0	53.8	54.0			**57.3**	**61.2**	**62.6**	**62.0**	**61.4**	**61.0**	**-8.8**
2 Change in external debt	3.4	-0.8	-0.5	5.8	0.3			3.3	3.9	1.5	-0.6	-0.6	-0.4	
3 Identified external debt-creating flows (4+8+9)	0.5	3.2	4.8	3.3	3.3			2.1	0.8	-1.8	-4.1	-5.6	-6.3	
4 Current account deficit, excluding interest payments	1.3	3.3	6.0	6.8	7.2			6.5	5.5	4.6	3.8	2.7	2.5	
5 Deficit in balance of goods and services	2.7	4.8	7.1	9.2	8.9			9.0	7.9	6.2	5.2	5.5	6.1	
6 Exports	45.7	50.5	49.4	49.1	47.0			46.0	47.2	48.6	50.4	51.4	52.1	
7 Imports	48.4	55.3	56.4	58.3	55.9			55.0	55.1	54.8	55.6	56.9	58.2	
8 Net non-debt creating capital inflows (negative)	-3.7	-2.9	-0.6	-5.6	-3.1			-3.1	-4.5	-5.6	-6.6	-6.9	-7.2	
9 Automatic debt dynamics 1/	2.9	2.8	-0.6	2.1	-0.8			-1.3	-0.2	-0.8	-1.4	-1.4	-1.6	
10 Contribution from nominal interest rate	1.6	1.5	1.4	1.4	1.2			1.1	1.1	0.9	0.8	0.7	0.6	
11 Contribution from real GDP growth	-1.5	0.5	0.9	-1.8	-1.2			-1.4	-2.2	-2.7	-2.7	-2.7	-2.7	
12 Contribution from price and exchange rate changes 2/	2.8	0.8	-2.9	2.6	-0.8			-1.0	1.0	1.0	0.5	0.6	0.4	
13 Residual, incl. change in gross foreign assets (2-3)	3.0	-4.0	-5.4	2.5	-3.0			1.2	3.0	3.3	3.5	5.0	5.9	
Gross external financing need (in billions of US dollars) 3/	7.2	8.6	10.4	10.9	11.7			11.6	10.1	10.0	11.1	10.9	10.9	
in percent of GDP	16.6	19.6	22.7	24.0	24.8			23.6	20.2	19.4	20.7	19.7	18.9	
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	3.1	-1.1	-1.9	3.7	2.3	3.3	2.8	2.8	4.0	4.5	4.5	4.5	4.5	4.4
GDP deflator in US dollars (change in percent)	-5.7	-1.5	6.3	-5.1	1.6	2.0	5.4	1.8	-1.8	-1.6	-0.8	-0.9	-0.7	-1.2
Growth of exports (US dollar terms, in percent)	-21.0	11.6	2.0	-2.0	-0.7	8.3	14.4	2.5	4.9	5.9	7.4	5.5	5.2	5.8
Growth of imports (US dollar terms, in percent)	-20.6	15.5	6.5	1.8	-0.5	9.3	14.1	3.1	2.3	2.3	5.1	5.9	6.1	4.4
Current account balance, excluding interest payments	-1.3	-3.3	-6.0	-6.8	-7.2	-2.6	3.1	-6.5	-5.5	-4.6	-3.8	-2.7	-2.5	-3.8
Net non-debt creating capital inflows	3.7	2.9	0.6	5.6	3.1	4.1	2.6	3.1	4.5	5.6	6.6	6.9	7.2	6.2
								II. Stress Tests for External Debt Ratio						Debt-stabilizing non-interest current account 6/
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2014-2019 4/								**57.3**	**57.7**	**58.3**	**59.0**	**61.0**	**63.7**	**-5.3**
B. Bound Tests														
B1. Nominal interest rate is at baseline plus one-half standard deviation								**57.3**	**61.3**	**62.9**	**62.5**	**62.0**	**61.8**	**-8.7**
B2. Real GDP growth is at baseline minus one-half standard deviations								**57.3**	**62.3**	**64.9**	**65.4**	**65.8**	**66.5**	**-8.4**
B3. Non-interest current account is at baseline minus one-half standard deviations								**57.3**	**62.7**	**65.7**	**66.5**	**67.4**	**68.3**	**-9.0**
B4. Combination of B1-B3 using 1/4 standard deviation shocks								**57.3**	**62.4**	**65.1**	**65.6**	**66.2**	**66.9**	**-8.7**
B5. One time 30 percent real depreciation in 2015								**57.3**	**88.0**	**90.1**	**89.2**	**88.3**	**87.7**	**-12.6**

Sources: IMF Country desk data; and staff estimates.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

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

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

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

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

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

Appendix I. Letter of Intent

Tunis, August 14, 2014

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

Madame Managing Director,

1. The efforts of our government and the national dialogue process have led to the announcement of a clear calendar for the legislative and presidential elections that will complete the last phase of our political transition to democracy before the end of 2014. We are convinced that the announcement will help reduce investors' uncertainty and "wait-and-see" attitude, and strengthen the support of our development partners which will manifest itself in the "Invest in Tunisia" conference that will be held in the fall of 2014. With this renewed confidence, the Tunisian authorities remain firmly committed to implementing the economic program and reforms supported by the IMF.

2. Tunisia's economic situation is still fragile, with significant fiscal and external imbalances and a growth rate that is too low to reduce unemployment and meet the Tunisians' pressing expectations. In response to the situation, we conducted an extensive outreach campaign to make the public aware of the difficult financial constraints the country faces and the reforms and sacrifices needed to reduce vulnerabilities. To this end, we consolidated the consensus around our economic program by holding a national economic consultation among the representatives of the different political parties, trade unions, and civil society. We remain convinced that the implementation of prudent macroeconomic policies and structural reforms will preserve macroeconomic stability and promote higher and more inclusive growth.

3. The performance under the IMF-supported program was positive, with results in certain areas exceeding the targets despite the difficult national and international context during the transition period. Performance at end-March and end-June 2014 was in line with the projections from the last review. We accelerated the implementation of the programmed reforms and also made up for some delays accumulated during the political crisis that preceded the formation of the current government.

- *Quantitative performance criteria and indicative targets*. As initially projected, the quantitative criteria at end-March and end-June 2014 for net international reserves (NIR), net domestic assets (NDA) and the central government primary balance (on a cash basis) were met. We adhered to the continuous zero ceiling on accumulation of external arrears and the indicative target for the non-accumulation of domestic arrears. The quantitative indicative target for social spending and the ceiling on current spending at end-March and end-June 2014 were met.

- *Structural reforms*. Six of the seven structural benchmarks (SB) for end-June 2014 were met (Table 2a). In particular, a new haircut system was implemented for loans used by banks as collateral in refinancing operations at the Central Bank of Tunisia (CBT), the proposed new organic law of the CBT was presented to its Board of directors, a new banking resolution framework consistent with international practices was submitted to CBT management, the tax administration modernization plan was finalized, the consolidated balance of the 28 largest public enterprises was completed, and the household support program to accompany the reform of energy product subsidies was put in place (structural benchmark originally set for August 2013). The lender-of-last-resort facility (end-June benchmark that was not completed) was delayed to March 2015 to allow its alignment with the new banking resolution framework. In the interim, an "exceptional and temporary emergency liquidity" mechanism was adopted. The end-July benchmark (Table 2b) for the Banque de l'Habitat (BH) and Société Tunisienne de Banque (STB) restructuring plans will be adopted by the government in August 2014 (Prior Action for completing the fourth review) in accordance with international best practices. Regarding the audit of Banque Nationale Agricole (BNA) (end-July SB), delays on the part of the auditor pushed the completion date back to September 2014.

4. In view of the sound macroeconomic policies already implemented to achieve the main program objectives and the ongoing implementation of the structural reform program (Tables 1, 2a, and 2b), the government requests the completion of the fourth review of the program supported by the Stand-By Arrangement and the disbursement of SDR 143.250 million. The government would also like to modify the performance criteria for NIR, NDA, and the primary balance at end-September 2014 and propose new criteria for December 2014, as well as new indicative targets, as described in the attached Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU)

5. This Letter of Intent is based on the previous Letter of Intent (LOI) and MEFP approved on April 25, 2014. The attached MEFP outlines the key components of the government's program and the measures planned by the Central Bank of Tunisia that we intend to implement during 2014. We remain determined to rigorously implement our program, though mindful of the difficulties in the domestic, regional, and international environment.

6. We are confident that the policies described in the attached MEFP are appropriate to the objectives of our economic program, which is designed to achieve short-term macroeconomic

stability while laying the necessary foundations for supporting growth and protecting vulnerable groups. We will remain vigilant, and we stand ready to take any additional measures that may be necessary to achieve these objectives. We will consult with IMF staff on the adoption of these measures and in advance of any revision of the macroeconomic policies contained in this MEFP, in accordance with the IMF's policies on such consultations. All information and data necessary for program monitoring will be provided to IMF staff.

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

Sincerely yours,

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

Attachment I. Memorandum of Economic and Financial Policies

I. Recent Developments and Macroeconomic Outlook

1. **Timid growth and contained inflation mark Tunisia's economic performance in a difficult national and international context**. A downward revision of the economic growth estimate for 2013 from 2.6 percent to 2.3 percent—and solid performance of the chemical and mining sectors and a slight improvement in the agricultural sector—contributed to 2.2 percent growth (y-o-y) in Q1 2014. For 2014, the annual growth rate is projected at 2.8 percent, with a better agricultural season offsetting weaker-than-anticipated growth in the mechanical and electrical industries (IME) and the tourism sector. The announcement of a clear election calendar will help overcome investors' "wait and see" attitude, but the short-term risks remain substantial, particularly in the event of renewed security tensions, rising commodity prices, or a deterioration of key European partners' economic prospects. The increase in food prices and electricity tariffs drove inflation (on a year-on-year basis) up from 5 percent in March 2014 to 5.7 percent in June 2014, but core inflation remained contained, declining to 4.3 percent at end-June 2014. For the rest of the year, inflation will reach a high of 6 percent in September and then slow to 5.5 percent at end year, reflecting a slowdown of food product prices, actions aimed at controlling and monitoring distribution channels, and a tightening of monetary policy.

2. **The current account deficit continues to deteriorate**. The current account deficit widened to a record 8.4 percent of GDP in 2013, and downside risks remain high in 2014, with a current account deficit of 2.7 percent of GDP in the first quarter of 2014 and estimated at 2.3 percent of GDP in the second quarter. The widening deficit is attributable to increased energy imports due to a decline in national oil production and reduced volumes of gas transiting through the Algeria-Italy gas pipeline. Increased food imports following last year's weak agricultural production, weak exports of phosphates and energy byproducts, and tepid recovery of tourist revenue added further to the deficit. The implementation of tighter macroeconomic policies, a more flexible exchange rate, and the active promotion of our exports will help reverse this trend and reduce the current account deficit to 7.6 percent of GDP for 2014. On the other hand, gross reserves remain above the program target and represented $7.1 billion (3.5 months of imports) at end-June 2014. During the past three months, and in line with the external imbalance observed, the value of the dinar (TD) vis-à-vis the euro and U.S. dollar has declined, with a 8.6 percent depreciation of the exchange rate during this period, eliminating the appreciation observed during the first two months of the year.

II. Performance Under the Program and Strategy

3. We are fully determined on the rigorous implementation of our economic program in order to preserve short-term macroeconomic stability and lay the foundation for more sustained and inclusive growth. The objectives of our program remain unchanged, and we focus during this review on the following areas:

- **Maintaining macroeconomic stability**. Mobilizing resources, controlling current expenditures, and tightening monetary policy, coupled with limited interventions in the foreign exchange market, are needed to maintain macroeconomic stability.

- **Laying the foundation for inclusive growth**. Defining the bank restructuring plans and reducing weaknesses in the banking sector, an improved budget structure supported by the implementation of tax reforms, more effective execution of public investment, and an ambitious program of structural reforms are needed to support the development of the private sector, the key engine of future growth.

- **Protecting vulnerable segments of the population** by strengthening social protection mechanisms and systematically assessing the social impact of the programmed reforms.

A. Short-Term Objectives: Restore Fiscal and External Buffers

Fiscal policy

4. **Despite a difficult economic situation, we achieved by a wide margin the 2014 end-March and end-June fiscal objectives**. The primary deficit (cash basis) at end-March 2014 stood at 1.3 percent of GDP (compared to 2.1 percent of GDP projected under the program), primarily to the effect of revenue overperformance (0.5 percent of GDP) from taxes collected from oil companies (originally programmed for 2013 but received in 2014), higher VAT revenues, and dividends from non-oil public companies. At the same time, the wage bill at end-March exceeded the programmed level by 0.2 percent of GDP due to the impact of new hiring in late 2013 that was not originally planned; the wage bill will return to the programmed level during 2014 by containing the pace of recruitment and controlling promotions. The 2014 end-March and end-June targets for social spending were achieved, thanks to an increase in the number of beneficiaries covered by the "families-in-need" program and increased educational assistance. Available information on "below-the-line" financing confirms that the 2014 end-June target will be achieved by a wide margin.

5. **To reduce pressures on the balance of payments and address our financing constraints, a rigorous fiscal policy continues to be necessary while investment and development spending retain priority.** The underlying fiscal position—as measured by the structural fiscal deficit— excluding the effects associated with the economic cycle and exceptional transactions, such as bank recapitalization requirements or the repayment of arrears—was revised to 4.7 percent of GDP in 2014 (compared to a program projection of 4.9 percent of GDP). This

improvement of the fiscal position was achieved despite new constraints associated with transfers of 0.3 percent of GDP to the National Retirement and Social Security Fund (CNRPS), additional payments for security personnel (0.1 percent of GDP), additional spending for the elections (0.1 percent of GDP), and additional salaries originating from the sectoral agreements with the various trade unions, finalized in 2011, that had not yet been implemented (0.1 percent of GDP). The improved fiscal position was possible thanks to the savings target set in January 2014 in the execution of the 2014 budget, including savings in unallocated spending (0.5 percent of GDP) and salaries (0.2 percent of GDP). Additional improvements come from increased revenue mobilization achieved during the first semester of 2014, and the implementation of measures already incorporated in the 2014 budget or programmed in the revised budget law adopted in July 2014:

- **Reduction of energy subsidies**. We have gradually eliminated the energy subsidies provided to cement companies (through a cumulative 70 percent increase in electricity tariffs and a 94 percent increase in the price of gas over six months) for a budgetary gain of TD 180 million (0.2 percent of GDP). We also increased electricity rates for industrial and low-voltage consumers by 10 percent in both January and May 2014. The most vulnerable segments of the population were protected from the impact of this measure through the introduction of a second social ("lifeline") tariff for customers consuming less than 100 kWh per month. The price of fuels (gasoline and diesel) also increased by about 6 percent on July 1, 2014, allowing us to generate the TD 100 million of savings envisaged in the 2014 budget law. Additional savings (0.1 percent of GDP) are expected through exchange rate valuation gains (from a greater-than-expected appreciation of the exchange rate in the first half of the year) and a reduction in energy subsidies extended to brick and glass producers. The energy subsidy reduction was accompanied by the implementation of social programs, a household support program, and an increase in the minimum salary (see section C).

- **Control of the wage bill**. We are committed to containing the wage bill to the level planned under the program. A salary and promotion freeze this year will offset the additional spending provided under the 2014 supplementary budget law. To reduce the wage bill, we froze new hiring—except for security forces and the education and health sectors—and hiring that was not completed in the year, but had been budgeted for, will not be carried over to next year's budget. To better prepare the 2015 budget, the Council of Ministers will adopt a decree in August 2014 creating a civil service monitoring and steering committee, and will validate the recently finalized report on the structure of public sector salaries. This report will serve as the basis for a complete reform of the civil service that will include proposals introducing increased mobility between the public and private sector, thereby facilitating the rationalization of public officials' salaries and control of the wage bill. Technical support will be requested from the World Bank/European Union to refine the evaluation and the recommendations of the report.

- **Revenue**. In view of our financing constraints, the additional revenue achieved in the first quarter of 2014 will be saved, bringing the total amount of revenue to 23.5 percent of GDP (0.4 percent of GDP above the programmed amount). This target will benefit from the measures identified during the third review and of new ones adopted in the LFC (Table 3) to further reduce our financing requirements. These measures support the efforts we have made to revise the presumptive tax regime and combat tax evasion (see Section B).

6. **We also remain committed to taking additional measures to correct any deviation from the budgetary objective,** including reducing current spending (i.e., goods and services and subsidies), which was a source of budget overruns in the past. Investment expenditure and social spending (excluding subsidies) will be preserved, and will not be constrained by our fiscal consolidation strategy.

7. **The "new national borrowing campaign" and additional external budgetary support will serve to offset lower-than-anticipated external financing at the end of the year**. The national borrowing campaign—initiated in May 2014 with government securities of small denominations – resulted in large subscriptions by the public and banks and mobilized TD955 million. Greater donor support than expected— agreement on a U.S. guarantee allowing a $500 million international market issuance (i.e., $200 million more than initially programmed) and bilateral support from Algeria ($250 million, of which $150 million is in direct budgetary support)—will help offset lower sukuk issuance (the Islamic Development Bank is expected to guarantee $120 million, i.e., $380 million less than initially programmed).

Monetary policy

8. **The growth of monetary aggregates remains broadly in line with the program targets.** The money supply (M2) increased by 8.5 percent (year on year) during the first five months of 2014 due to weak mobilization of deposits. The criterion for net domestic assets at end-March and end-June 2014 was met by a wide margin, primarily due to a more than expected reduction of net credit to the government during the quarter. However, bank refinancing from the CBT increased and remains high at end-June (TD 4.8 billion excluding open market operations (OMO)—primarily reflecting seasonal cash withdrawals and a worsening current account deficit and its restrictive impact on banks' liquidity.

9. **An immediate tightening of monetary policy is crucial to reduce future inflationary pressures**. Until now, controlled core inflation, a negative output gap (2 percent), and anemic credit to the private sector (7.6 percent year on year at end-May) justified the central bank's current policy, which normalized the market rate at roughly 4.75 percent (25 basis points above the policy rate). However, the increase in the minimum salary, which impacts 900,000 Tunisians (including retirees), combined with the increase in electricity and fuel prices, a negative real interest rate, and the depreciation of the exchange rate observed in recent months indicate that Tunisia is facing increasing inflationary pressures. To this end, we have raised the CBT' benchmark policy rate by 25 basis points (to 4.75 percent) on June 25, 2014 to contain inflationary pressure, and we are prepared to raise it further if pressures persist, including due to a larger external imbalance.

10. **We will continue our strategy of reforming the monetary policy framework**. The CBT continues to reduce the risk to the CBT's balance sheet by increasing from 10 percent to 25 percent the haircut on the valuation of loans used as collateral, which will take effect in July 2014, and

increasing the share of government securities used as collateral from 20 percent to 40 percent (structural benchmark at end-December 2014). We plan to further strengthen the guarantee system by improving the current haircut system through the use of rating instruments. We have also begun a study on valuing government securities at market price instead of nominal value; the study will be completed by September 2014.

11. **The implementation of a lender-of-last-resort facility is needed to accompany the tightening of the eligibility criteria for CBT refinancing.** The lender-of-last-resort facility initially envisioned for end-June 2014 (structural benchmark) cannot be completed until March 2015 in view of the need to define further the eligibility criteria and liquidity standards, and to establish the new legal and institutional banking resolution framework. In the interim, a new "exceptional facility" was implemented on July 1, 2014; it will enable any solvent institution that is unable to provide top-tier collateral to access the facility by providing second-tier collateral, but at a penalty rate (200 basis points above the lending facility), while being subject to more intrusive banking supervision and to a precise restructuring plan—approved by the CBT—for improving the bank's liquidity position.

12. **The monetary policy transmission channel will be strengthened and access to financing improved by modifying the excessive lending rate system.** Following the recommendations of the study on the impact of amending the law on excessive bank lending rates—conducted with World Bank assistance—the CBT Board has launched a broad consultation with the relevant ministerial departments to amend the law, if needed, by December 2014. This policy change will strengthen the monetary policy transmission channel and facilitate access to credit for small and medium-sized enterprises.

13. **The central banking law of the CBT is currently under revision**. A comprehensive set of new amendments will confer greater autonomy on the CBT (including institutional, operational, human resources, and financial autonomy), define its mission more clearly (by clarifying its objectives, mission, and instruments), and improve its governance, transparency, and accountability for. The revised draft law—which benefited from IMF technical assistance—was presented to the CBT board of directors in June 2014 (structural benchmark) and will be adopted by the government by September 2014.

Exchange rate policy

14. **The widening of the current account deficit increased pressures for a depreciation of the exchange rate**. The 8.6 percent depreciation of the dinar since March eliminated the appreciation seen at the beginning of the year, which had resulted from an improved political situation and the rigorous implementation of regulations governing holders of professional accounts in foreign currency. This initial appreciation occurred despite CBT interventions (currency sales), which were substantial (50 percent of the foreign currency supplied to the foreign exchange market in May and reduced to $290 million in June 2014) and necessary to ensure that external payments for energy imports were properly and regularly executed. In view of the wider current

account deficit and need to preserve our official reserves, we will continue our policy of a more flexible exchange rate by:

- **Further limiting CBT interventions on the foreign exchange market**. We are committed to refraining from selling foreign currency to the exchange rate market, except for smoothing substantial exchange rate fluctuations that would result if large orders related to energy transactions were not satisfied. To preserve and strengthen our official reserves, we expect to intervene by buying foreign currencies on the market, particularly during periods when there is less demand associated with energy imports. These purchases will allow us to rebuild our reserves, reduce the overvaluation of the exchange rate (7 percent to 10 percent) and the banks' structural liquidity deficit.

- **Increasing swap transactions.** To increase the supply of foreign exchange in the market, we will revise the functioning of the swap market to allow banks to initiate swaps with the dinars and other currencies with the CBT.

- **Introducing weekly foreign currency auctions in December 2014** (structural benchmark). In this regard, the implementation of the electronic platform providing interconnection between banks and the entry into force of the market-maker-agreement provide us with real-time information on the quotations of the different participants in the exchange market. However, the introduction of the auction mechanism also requires the implementation of an efficient information system enabling the CBT to centralize flows of projected settlements in foreign currency and providing a clearer view of cash flows.

15. **Our development strategy will remain open and based on free trade**. We have adopted measures aimed at reducing the widening trade deficit through increased promotion of our exports and a rebalancing of our energy mix. As provided by World Trade Organization rules, we will not consider new restrictions or import surcharges except as a last resort, after exhausting market solutions that preserve adequate incentives, and only with very clear criteria, announced in advance, for removing them.

B. Laying the Foundation for Inclusive Growth

Financial sector policies

16. **The condition of the Tunisian banking system remains fragile**. Although the indicators at end-March 2014 shows an increase in banks' net profits (12 percent year on year), primarily attributable to financial fees and interest margins, the increased cost of deposits and weak demand for new credit could reduce further banks' profitability. Our gradual transition to international standards, including a more rigorous application of haircuts on loan collateral, contributed to a 14 percentage point increase in the provisioning rate, and a reduction of the capital adequacy ratio to 9 percent by end-December 2013, and pushed seven banks below minimum capital requirements required by regulations (six banks are below that threshold since end-March 2014). Asset quality continued to deteriorate slightly, with the ratio of nonperforming loans increasing from 14.9 percent

of total loans at end-2012 to 15.2 percent at end-December 2013 and 15.1 percent at end-March 2014 (or 20 percent, if we include loans transferred to bank-affiliated asset management companies).

17. **The banking strategy adopted by the Tunisian government calls for refocusing the government's role on its principal mission, and rationalizing the number and influence of publicly held banks in the banking sector.** This strategic approach, which was presented to banks and civil society in April 2014, is based on the need to guarantee universal public banks' financial soundness, establish a new governance framework, strengthen institutional capacities, and improve the legal framework. Based on this strategy, the plans for restructuring the banks—for which the audits were completed (STB, BH)— will be finalized and adopted by the government in August 2014 (Prior Action), in line with international best practices as described in Annex I. The audit of the Banque Nationale Agricole (BNA) could not begin until June 2014 because of the need to find a new auditor; the audit will only be completed by September 2014 (rather than July as anticipated in the program), with a restructuring plan based on international best practices finalized in November 2014 (new structural benchmark). For the time being, our action plan for the public banks is based on:

- **strengthened governance**. The implementation of the new decree allowed greater autonomy with respect to the role of the State, including in the recruitment and appointment of "competent" members for the board of directors. We plan to change the compensation system of banks' board members in September 2014 and ensure that public banks are operating on a commercial basis and follow best management practices.

- **recapitalization of public banks**. This amount will come first from private shareholders, and public funding will be used only after the losses have been distributed among the existing shareholders (private and public). The public funds for the recapitalization of banks would be provided in the form of non-negotiable bonds (which would not be eligible for central bank refinancing). For the BNA, its capital will be at the level required by applicable regulations by end-2014. The plan for restructuring of the STB and BH will ensure that both banks will meet the minimum capital requirement of 10 percent in December 2014. These would imply total recapitalization costs of TD 1 billion (1.2 percent of GDP), which is the amount already budgetized.

- **creating an Asset Management Company (AMC)**. Technical consultations on the proposed law—which was prepared with World Bank technical assistance—are at the final stage and we will submit the draft law in line with international best practices with the expectation to be adopted by the National Constituent Assembly in September 2014 (new structural benchmark), which will help ensure creation of the AMC in 2014. The new proposed law, which was initially conceived for the tourist sector, will provide for the creation of a universal AMC with clear eligibility criteria that will limit the contours of its mandate (e.g., amount of commitments, loans guaranteed by collateral). This law will be aligned with international best practices through: (i) the adoption of clear, transparent governance rules accompanied by financial and operational autonomy; and (ii) the implementation of specific powers to accelerate the resolution and restructuring of nonperforming loans. In view of the importance of the tourist sector and its financial difficulties (its share of nonperforming loans has doubled since 2009, to about 54 percent of the total), we plan initially to limit AMC operations to tourist loans. The capitalization of the SGA—estimated at TD 150 million in the supplementary budget law—will adhere to the business plan prepared with support from the World Bank, and will be closely coordinated with the bank recapitalization program, in particular of public banks. We will not expand the AMC operations to other sectors until an in-depth study on the potential budget costs has been completed. Moreover, in December 2014, we will submit to the Constituent Assembly amendments to the law on asset recovery companies, which would enable them to be more effective in their actions.

18. **Banks compliance with prudential standards is essential**. In this regard, three of the seven banks that do not comply with the solvency ratio have submitted recapitalization plans that would bring their solvency ratio to the level required by end-December 2014. The other banks, which are all publicly owned, will comply with the regulations by end-December2014 (new structural benchmark), in line with the restructuring plan. Also, we have imposed monetary sanctions on all banks that fail to comply with the current liquidity ratio pending the adoption of a new liquidity ratio (which will include off-balance-sheet operations) that was announced to the banks in March 2014 and will take effect in September 2014. The Directorate General of Bank Supervision (DGSB) will establish new procedures during 2014 to ensure that "fragile" banks are subject to tightened supervision and more frequent monitoring.

19. **The reform of banking supervision continues to be an absolute priority**. With technical assistance from the IMF, we have prepared in June 2014 a three-year plan (including prerequisites), adopted by CBT management, to establish a system of banking supervision that is based on an assessment of risks based on an individual and a consolidated basis. Our short-term priorities are to:

- **Strengthening DGSB human resources**. We are aware that the success of our action plan will depend on the human and financial resources provided to the DGSB. Accordingly, we hired 12 individuals in 2013, representing about one-fourth of the envelope expected for 2012–14, and we plan to double this figure in 2014 and change the BCT hiring criteria to allow the hiring of experienced, qualified personnel (new structural benchmark), above all to strengthen on-site inspection. The DGSB's effectiveness will be further strengthened by formalizing its powers and responsibilities as soon as possible and by instituting clear rules on relations between the different organizational units within the DGSB by March 2015.

- **Improving reporting**. By June 2014, the CBT, with the support of IMF technical assistance, will finalize the Uniform Bank Performance Reporting (UBPR) benchmarking indicator—used jointly by the DGSB and the Directorate General of Financial Stability and Risk Prevention (DGSFPR)—which will be available 60 days after the end of each quarter and provide a simplified risk rating system by December 2014. In addition to this mechanism, the new system of accounting, financial, and institutional data of banks will be put in place—with IMF TA assistance—in December 2014 (structural benchmark) and automated in June 2015.

- **Strengthening inspections and integrating on-site inspections into the banking supervision process**. Our inspection plan provided for 14 inspections this year (compared to five in the previous year), and we plan to implement formal procedures by December 2014 which will define the criteria for the inspection plan and structure of teams. The coordination between the different units of the DGSB—particularly between on-site and off-site inspection—and with other areas of the CBT (e.g., DGSFPR) will also be strengthened.

- **Strengthening the internal control of banks**. Following articles 52 and 53 of Circular 2006–19 on internal control, the DGSB asked credit institutions to provide it with reports on internal control and risk management, in accordance with applicable regulations. Based on the reports submitted for 2013, the DGSB will conduct a diagnostic assessment of the credit institutions' rating systems and ask institutions with weak systems to submit action plans by end-September 2014.

20. **A banking crisis and resolution management mechanism in line with international best practices is being finalized**. A draft banking law was prepared with technical assistance from the World Bank and IMF to strengthen bank supervision and regulation in Tunisia and establish a sound legal framework for the resolution of insolvent banks. The proposed law was submitted and presented to the CBT management in June 2014 (structural benchmark) and will be adopted by the government in September 2014. The proposed amendments to the draft central bank law, including the establishment of a lender of last resort facility, will strengthen the banking resolution framework. In addition, the provisions on an operational structure and legal framework appropriate to the establishment of a deposit guarantee fund are being drafted with technical assistance from the World Bank.

Fiscal reform

21. **The structure of public expenditure must be improved to support medium-term growth and rebuild fiscal buffers**. In addition, our medium-term fiscal consolidation strategy will be accompanied by fiscal reforms—tax policy, tax administration, public expenditure management, reform of public enterprises, effectiveness of public investment—which remain essential to support growth.

22. **The equity, efficiency, and transparency of the tax system—and the mobilization of revenues—continue to be the key pillars of our tax policy**. All the existing tax laws and codes will be consolidated into a single tax code in September 2014 (structural benchmark) so as to increase the transparency of the tax system. Following consultations held in 2013 and discussions in the 2014 national economic dialogue, the government's tax policy strategy will be presented at the National Tax Consultations to be held in September 2014; an action plan will be adopted by the Council of Ministers in October 2014 (new structural benchmark). In the context of a comprehensive tax reform, we plan to continue revising the corporate tax (CIT) to achieve gradual convergence of the off-shore

and on-shore sectors over the coming years, and announce it according to a clear timetable and in line with improvements in tax administration (the difference between the tax rates in these two sectors was reduced by half in the 2014 budget). For the time being, and for the 2015 budget law, our actions will focus—with IMF technical assistance—on reforming the VAT and excise tax and simplifying the existing presumptive tax system.

23. **The reform of the tax administration will be governed by the implementation of the new modernization plan**. This plan, which was adopted by the Ministry of Economy and Finance on August 7, 2014 (structural benchmark of end-June), aims to establish a unified tax administration and strengthen audit and evaluation mechanisms. The implementation of the plan will be aided by the creation of a new unit responsible for modernization within the General Directorate of Taxes (DGI), and supported by IMF technical assistance. The strengthening and restructuring of the Large Taxpayers Unit (LTU) is ongoing, with the integration of all tax units and the adoption of a selective approach to tax audits (preparation of targeted criteria and objectives). The tax audit function will be strengthened by lifting bank secrecy provisions that currently hinder the tax administration's communication rights and the collection and use of information for tax audit purposes (including for the presumptive tax system), while protecting taxpayers' rights and recouping information collected from the health insurance and social security system. We are determined to combat tax evasion through new regulations requiring that large transaction amounts be paid by check, introducing a tax certificate for transactions with the government (provision of goods and services), and strengthening the risk management unit within the customs administration.

24. **The monitoring of public enterprise performance was improved**. The final report prepared by the Public Enterprise Monitoring Committee on the financial position of 28 public enterprises—representing 80 percent of the public sector's turnover—indicates a substantial financial deterioration of the sector between 2010 and 2012, with a deficit of 1.2 percent of GDP (including 24 enterprises in a deficit position). In response to this evaluation, rehabilitation measures have been identified for the most vulnerable public enterprises (i.e., Tunisair) and are being examined on a case by case basis, depending on needs. In addition, we are developing elements of a new regulatory framework for the governance of public enterprises, which would provide greater independence and responsibilities to their boards of directors and management. For the enterprises receiving subsidies for energy and food products, the government is committed to regularly provide budget appropriations and conduct ex-post verification once financial accounts are closed. Following the recommendations of the audit report for the energy companies presented to the Council of Ministers in August 2014, the priorities for the energy companies will focus on improving recovery and management of expenditures and, in the context of the 2015 budget, eliminating cross-subsidies for the Société Tunisienne de l'Électricité et du Gaz (STEG) and the Société Tunisienne des Industries de Raffinage (STIR), which will import their energy requirements directly instead of going through the refinery company Entreprise Tunisienne d'Activites Petroliere (ETAP).

25. **Efforts to improve public expenditure management continue**. All payment orders authorized during the carryover period for 2013 were paid, and the budget execution statements we plan to prepare—with IMF technical assistance—will facilitate more regular reconciliation of

authorized, budgeted, and disbursed expenditures. The draft of the new functional budget classification was completed in September 2014, facilitating greater transparency and comprehensiveness in the budget preparation. We also plan to review the completeness and quality of budget documentation and are requesting technical assistance from the IMF staff for a report on financial and fiscal risks. Our immediate efforts led to the creation of a National Public Accounting Standards Board to introduce double-entry bookkeeping and focus on the new budget nomenclature (programmatic, budgetary, and accounting). Also, the draft organic law, prepared with technical assistance from the European Union and France, will be presented to the Council of Ministers in September 2014, and will lead to greater flexibility in managing appropriations (including in the control a priori) and greater accountability of managers.

26. **Improved execution and effectiveness of public investments is needed to generate inclusive growth**. Public investment continues at the rate observed during the past two years with a budget execution rate of 7 percent during the first quarter of 2014. The new procurement rules, which are consistent with the recommendations of the World Bank technical assistance program, took effect on June 1, 2014 and will considerably simplify and modernize procedures and accelerate public investments in the regions. We remain convinced that the professionalization and decentralized management of public projects in the regions and the implementation of procedures to remedy land deeds issues in the project preparation phase will help speed the execution of public investments. In that context, following the visit of 24 governorates, the regional project monitoring committee will present its recommendations on the main constraints to the implementation of regional investment projects to the government in July 2014.

Structural reforms

27. **Our structural reform program will continue to focus on improving the business climate and promoting a competitive private sector that can generate inclusive growth.** To this end, we will step up our efforts, inter alia, to simplify and clarify regulations for investments, promote competition, and facilitate trade.

28. **The investment code, prepared with technical assistance from the World Bank following consultations with civil society and donors, was withdrawn from the Constituent Assembly for revision and its further simplification.** The government considered the new code—which was intended to encourage private investment through a more transparent and efficient regulatory framework and the rationalization of incentives—as too complex and as leaving too much discretion to the implementation decrees. Nonetheless we remain convinced that a new, simplified investment code is needed. Accordingly, we plan to introduce a list of measures in September 2014—intended to supplement the current code—to reduce restrictions on investments. These measures—approved by the Council of Ministers—will be added to the current code in December 2014.

29. **The passage of "economic" laws—deferred due to the ANC's busy schedule, which focused on the electoral calendar—is a priority for our government.** We are committed to

taking the necessary measures to advance the legislative calendar to pass the following laws in particular:

- **The collective proceedings law (Law 95)**. In parallel with the reform of the banking law, we have embarked on a process to pass a new law on collective proceedings (commercial bankruptcy proceedings) —prepared with World Bank assistance. The law will modernize and simplify the process of restructuring companies and liquidating insolvent companies. We are committed to ensuring that the new law sets out clear rules regarding the government's status as preferred creditor and to grant rights to private creditors to vote on reorganization plans.

- **The competition law**. The proposed law—submitted to the Constituent Assembly in 2013—will be reviewed by the Assembly during the summer of 2014. The final version of the competition law is intended to reduce the government's intervention in the economy, reduce excessive regulation, and increase competition between companies.

- **The Public-Private Partnership Law.** The proposed law—which will facilitate private concessions—is now being reviewed by the parliamentary committees and will be adopted as early as possible in 2014.

30. **In parallel with the amendment of the relevant laws, we are continuing to simplify administrative procedures**. To this end, we have rationalized a number of administrative procedures that burdened the private sector in the areas of transport, customs, and exports. We remain committed to continue on this path based on the expected outcomes of the regulatory "guillotine" project.

31. **The integration of Tunisia's economy in the global economy is essential to generating more inclusive growth**. We remain committed to promoting trade, including the reduction of tariff and nontariff barriers and enhancement of commercial agreements with neighboring and African countries. Discussions were initiated with the European Union in 2012 in the context of negotiating a comprehensive free trade agreement (DFTCA). To further improve the integration of Tunisia's economy into the global economy, the action plan developed as part of the export development program (supported by the World Bank PDE III program) will allow, inter alia, to improve the logistics at the Radès port (Tunisia's main port) and build a new deep-water port at Enfindha.

32. **We are committed to reducing obstacles to a proper functioning of the labor market**. The technical committees (work and professional relations, social protection, employment, regional development, and investment) established to implement the social contract signed on January 14, 2013 with employers and trade unions, have begun their work, which will be presented during the national economic dialogue. A broad consultation will be held to discuss the new employment strategy, which is expected to culminate in labor market reforms, including an evaluation of "flexi-security" in labor relations, and to reduce the structural asymmetry of skills prevailing on the market. In regard to programs to promote jobs, the support programs for small and medium-sized enterprises financed by the World Bank and the micro-project programs financed by the Banque Tunisienne de Solidarité and the Fonds National de l'Emploi will create jobs for

young Tunisians. We have also started developing a professional training program for unemployed university graduates, and an initiative that provides incentives for firm creation in disadvantaged regions.

33. **Reliable statistical information is critical to monitoring and evaluating macroeconomic policies and implementing social programs**. In this context, we are undertaking a comprehensive diagnostic assessment of our statistics system in cooperation with Eurostat, and we plan—with the support of IMF technical assistance—to strengthen our institutional mechanism and the system used to produce the national accounts (particularly the quarterly demand side), monetary statistics and the balance of payments. This will enable us to expand the regular publication of the results of surveys on current economic, employment, and household living conditions. In parallel, we started working on a legal framework to ensure and protect the independence of the National Statistics Institute (INS).

C. Protecting the Most Vulnerable

34. **Protecting the most vulnerable is our absolute priority in implementing fiscal and structural reforms.** In addition to the measures already included in the 2014 budget law (a social housing program, increase in the income tax deduction for the poorest households, and the introduction of an additional lifeline electricity rate), the agreement with trade unions will increase the guaranteed minimum salary (SMIG and SMAG) by about 6 percent, effective retroactively from May 1, 2014. This increase will benefit 900,000 individuals (primarily private sector workers, including roughly 600,000 retirees). In order to further improve our targeting system for social benefits, we completed an evaluation of school assistance programs which showed a 25 percent “leakage” to non-poor; we will present the conclusions of the evaluation of the needy families/health benefits card program in September 2014. We accelerated the pace of work on the unique social identifier, which is now available to 7.5 million Tunisians and will be used to create a new “targeting system” that will be refined over the coming months as “exclusion and inclusion errors” are corrected. In the meantime, in view of the imminent fuel price increase and Ramadan, we put in place the following household support program (end-June structural benchmark):

- expansion of the existing program of assistance to families in need (PNAFN) from 220,000 in 2013 to 250,000 beneficiaries in 2014; the system currently benefits 235,000 individuals;

- increase of TD 10 for all beneficiaries of the PNAFN (representing a 10 percent increase) to an amount of TD 120 month/family. Families having children at schooling age will receive an additional TD 10 per month per child (up to three children per family);

- provision of one-time, temporary assistance of TD 80 (TD 40 in June and TD 40 in July) for the 235,000 PNAFN beneficiary households and for an additional 50,000 poor households identified by the regional committees; and

35. **The deficit of the pension system calls for urgent action. The national retirement and social security fund (CNRPS) shows an annual deficit of TD 450 million (about 0.5 percent of**

GDP) in 2014 and currently has no cash reserves. To address this deficit, the government decided to provide a TD 250 million transfer in the 2014 revised budget law 2014. In the context of the social pact, we will review long-term scenarios for reform of the retirement and health insurance system in order to ensure the system's long-term sustainability. These studies will be supported by a support program and technical assistance financed through the transition fund.

Annex. Principles for Successful Restructuring of Public Banks

The best experiences with restructuring plans include **a clear, specific timetable and the following pillars:**

Financial restructuring

The purpose of financial restructuring is to restore solvency (net assets) by rehabilitating and strengthening banks' balance sheets.

- Existing and new fit-and-proper private shareholders should be asked to contribute to recapitalization through cash injection. Existing shareholders will bring the bank to solvency if needed, and public funds can be used to bring the bank back to minimum capital requirements once sources of private capital have been exhausted.

- Before any public funds are injected, the shares of existing shareholders have to be diluted or the overall loss has to be distributed amongst them.

- The government should seek authorization in a supplementary budget if the government's share of the recapitalization costs is higher than the budgeted amount.

Operational restructuring

Operational restructuring aims at creating the conditions for restoring banks' sustained solvency and profitability.

- To ensure good corporate governance, Bank Board members representing the State and bank managers are fit and proper and professionally suitable; and a relationship framework should be signed to govern the interaction between the Finance Ministry and each state-owned bank. The latter will help ensure no political interference in banks' commercial operations.

- To ensure effective governance and communication in the use of public funds for bank recapitalization and restructuring, the following requirements will need to be set:

    a. A high-level committee comprising the Minister of Finance and the CBT Governor should be established to coordinate the process, including approval of the overall strategy and monitoring of progress;

    b. The committee should appoint a spokesperson to be in charge of the communication strategy of the recapitalization and restructuring process, to ensure timely and consistent information to the public;

    c. The State's interest in the banks should be managed in a dedicated, specialized unit set up at the Ministry of Finance.

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

	Cumulative Flows Since the Beginning of 2014												
	Mar 2014				Jun 2014				Sep 2014		Dec 2014		Mar 2015
	Prog. 01/24/14	PC w/ Adjusters	Actual	PC Status	Prog. 04/25/14	Est. PC w/ Adjusters	Est./Act.	PC Status	Prog. 04/25/14	Revised PC	Prog. 04/25/14	New PC	IT
Quantitative Performance Criteria	(Millions of Tunisian Dinars)												
1. Floor on the primary balance of the central government (cash basis excl. grants)	-2,796		-1,104	Met	-2,806		-2,155	Met/TBC	-4,007	-3,793	-5,609	-5,587	-1,233
2. Ceiling on net domestic assets of the Banque Centrale de Tunisie (Stock)	3,952	4,327	2,457	Met	4,086	4,840	2,995	Met/TBC	4,071	3,961	1,173	1,466	2,549
	(Millions of US$)												
3. Floor on net international reserves of the Banque Centrale de Tunisie (Stock)	5,308	5,067	5,180	Met	4,754	4,268	4,342	Met/TBC	5,275	5,487	7,066	6,877	6,579
Continuous Performance Criteria	(Millions of Tunisian Dinars)												
4. Ceiling on the accumulation of new external debt payment arrears by the central government	0		0	Met	0		0	Met	0	0	0	0	0
Quantitative Indicative Targets	(Millions of Tunisian Dinars)												
5. Ceiling on Current Primary Expenditure	4,253		4,058	Met	8,267		8,085	Met/TBC	12,796	12,915	17,815	18,033	4,638
6. Floor on Social Spending 3/	229		282	Met	562		624	Met	900	962	1,350	1,412	310
7. Ceiling on the accumulation of new domestic arrears	0		0	Met	0		0	Met	0	0	0	0	0
Program assumptions on which adjusters are calculated in case of deviations													
External Financing of the central government on a cumulative basis (in US$ million) 4/	544		230		707		352		1,163	1438	2,771	2647	
of which: Multilateral (excluding IMF), bilateral and budget grants	450		201		528		241		718	812	968	1534	
Public debt service (interest and amortization) on a cumulative basis (in US$ million)	213		203		506		459		708	662	958	913	
Bank recapitalization (in million TD)	0		0		0		0		0	300	0	700	
Privatization receipts (in million USD)	0		0		0		0		0	0		0	
Resident deposits at the BCT (in million USD) 5/	1,854		1,852		1,852		1,607		1,607	1,607	1,607	1,607	
Program exchange rate TD/ U.S. dollars					1.55235		1.55235		1.55235	1.55235	1.55235	1.55235	

1/ Quantitative performance criteria and structural benchmarks are described in the Technical Memorandum of Understanding.
2/ For purposes of calculating program adjusters, foreign currency amounts will be converted at program exchange rates.
3/ Public capital expenditures on social sectors and programs.
4/ Disbursment, includes project loans and capital market access but excludes IMF budget support.
5/ At program exchange rate.

Table 2a. Tunisia: Structural Benchmarks for the Period January–June 2014

	Objective	Date	New Date	Comments
Structural benchmarks				
I. Financial sector				
Submission to the management of the Central Bank of Tunisia of a banking resolution framework in line with international practices	*Crisis management and financial sector stability*	*Jun-14*		MET. A new banking law was prepared with technical assistance from the IMF and World Bank and submitted to CBT management.
Submission to the CBT board of the draft of the new central banking law in line with best international practices	*Financial sector stability*	*Jun-14*		MET. A new central banking law in line with international practices was prepared with technical assistance from the IMF and presented to the CBT board on June 25, 2014
II. Fiscal policy				
Adoption by the Ministry of Finance of a plan to modernize tax administration	*Expand tax base*	*Mar-14*	*Jun-14*	MET with delay. A plan to modernize tax administration was completed with technical assistance from the IMF and adopted by the Ministry of Finance in August 2014.
Unification of all public accounts into a Single Treasury Account (excluding accounts for project loans) at the CBT	*Better monitoring of the fiscal management*	*Mar-14*		MET. All accounts of the government (excluding accounts for project loans) were consolidated in a Single Treasury Account.
Finalize the audit of the electricity company (STEG) and of the petroleum refinery company (STIR)	*Lower fiscal risks*	*Mar-14*		MET. The first report on the two companies' operations was submitted to the government on March 30, 2014
Submission to the Council of Ministers of a new targeted household support program to accompany the reform of the generalized energy subsidies	*Protecting the most vulnerable*	*Mar-14*	*Jun-14*	MET. A household support program was put in place July 2014 ahead of the fuel price increase.
Prepare a consolidated balance sheet for the 20 main public enterprises (2010-12).	*Better assessment of risks*	*Jun-14*		MET. A report with the balance sheet for the 28 largest firms was prepared.
III. Monetary and exchange rate policies				
Implementation of an electronic bank interlinking platform and launch the Market Makers Agreement	*Greater exchange rate flexibility and increase of the banking liquidity on foreign exchange*	*mid-Mars 2014*		MET. The electronic platform is online and the market maker agreement is effective.
Presentation to the Central Bank board of the impact study for removing the upper limit of excessive rates for enterprises and to modify it for consumers	*Financial sector stability and better transmission of monetary mechanisms*	*Mar-14*		MET. The impact study, conducted with support from the World Bank, was presented to the CBT board March 26, 2014.
Implement an increase of the haircut for loans used as collateral for refinancing operations to at least 25%.	*Enhancement of the monetary transmission mechanism*	*Mar-14*	*Jun-14*	MET. A new regulation was put in place March 28, 2014 and communicated to the banks. The haircut system is effective since July 1, 2014
Establishment of the lender of last resort facility	*Financial system stability and better crisis management*	*Jun-14*	*Mar-15*	**NOT MET**. An interim, "exceptional" system was adopted June 25, 2014. The lender of last resort facility – in line with the bank resolution framework – will be put in place in March 2015.

Table 2b. Tunisia: Prior Actions and Structural Benchmarks for the Period July–December 2014

	Objective	Date	New Date	Comments
Prior Action				
Adoption by the government of the restructuring plans for BH and STB in line with international best practices as described in Annex I	*Financial sector stability*			
Structural Benchmarks				
I. Financial sector				
Completion of the financial audit of the Banque Nationale Agricole (BNA)	*Financial sector stability*	*Jul-14*	*sept.-14*	In progress. The selection of a new auditor delayed the completion of the BNA audit to end-September 2014.
Creation of Asset Management Company (AMC) through the publication in the Official Journal of the Law on the AMC	*Financial sector stability*	*Sep-14*		
Adoption by the Government of the BNA restructuring plan	*Financial sector stability*	*Nov-14*		
Double the number of DGSB supervisors hired in 2013 and revise the CBT hiring criteria to facilitate the hiring of qualified personnel	*Financial sector stability*	*Nov-14*		
All banks, including public banks, to comply with minimum solvency ratio required by the existing regulations (10 percent)	*Financial sector stability*	*Dec.-14*		
Development and implementation of the new reporting and rating system for banks	Financial sector stability	*Dec-14*		In progress. Work on the new rating and reporting system is in progress with technical assistance from the IMF.
II. Fiscal policy				
Government approval of the new tax code	Enhance transparency of the tax system	*Sep-14*		In progress.All new rules will be included into the new code.
Following national consultations on taxation, adoption of a tax reform plan covering direct and indirect taxes by the Council of Ministers.	Expand the tax base and improve equity	*Oct.-2014*		
III. Monetary and exchange policies				
Ensure that the proportion of the refinancing volume at the CBT backed by government securities is at least 40 percent for each bank	*Enhancement of the monetary transmission mechanism*	*Dec-14*		Completed. Circular issued in March 2014 and will take effect on January 1, 2015
Implementation of the weekly foreign exchange auction mechanism	*Greater exchange rate flexibility*	*Dec-14*		
IV. Structural reforms/private sector development				
Decrees for implementing the new investment code, in line with the objective of protecting market access, reducing restrictions to investments and rationalizing incentives	*Support for balanced growth driven by the private sector*	*Sep-14*		The decrees will not be submitted to Parliament because the government decided to withdraw the draft law on the investment code from parliament; New measures for investment promotion will be taken. They will eventually be included in the new code.

Table 3. Tunisia: Compensatory Fiscal Measures, March/June 2014

	Mar-14		Jun-14	
	In Millions of TD	In Percent of GDP	In Millions of TD	In Percent of GDP
Revenue	**260**	**0.31**	**130**	**0.16**
Tax policy	100	0.12	130	0.16
Alcoholic beverages: 8 percent increase excises taxes	20	0.02		
Cigarettes: 10 percent increase excise taxes	50	0.06		
Vehicle taxes 1/	30	0.04	15	0.02
Tourism taxes			75	0.09
Stamp taxes			30	0.04
Other tax measures incl. exceptional taxation on revenues			10	0.01
Tax administration	160	0.19		
Tunisie Telecom: enhanced tax control	110	0.13		
Expedite judiciary procedures	50	0.06		
Current expenditure	**40**	**0.05**		
Decreased energy subsidies 2/	40	0.05	7	0.01
Total	**300**	**0.36**	**130**	**0.16**

1/ In March: at the moment of resale for cars imported by tunisians leaving abroad.

2/ in March: bringing forward the planned increase of tariffs to May 2014.

Attachment II. Technical Memorandum of Understanding

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

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

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

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

Source: Central Bank of Tunisia.

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

4. For data reporting purposes, the Ministry of Economy and Finance, the National Institute of Statistics (INS), and the Central Bank of Tunisia (CBT) will follow the rules and the format considered

appropriate for data reporting as covered by this technical memorandum of understanding, unless otherwise agreed with IMF staff.

DEFINITION OF PERFORMANCE CRITERIA AND INDICATIVE TARGETS

A. Performance Criteria and Indicative Targets

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

Performance criteria

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

Indicative targets

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

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

B. Institutional Definition

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

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

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

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

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

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

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

13. The value of CBT reserve assets and liabilities in foreign currency will be calculated using program exchange rates (see Table above). On December 31, 2012, the value of the stock of net

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

international reserves was $7.937 billion, with the stock of reserve assets equal to $8.645 billion and the stock of CBT liabilities in foreign currency equal to $730.399 million (at program rates).

D. Ceiling on Net Domestic Assets

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

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

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

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

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

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

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

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

consolidated in two categories ("Compte Central du Government "and "Comptes Spéciaux du Government") on the CBT's balance sheet (liabilities side).

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

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

F. Ceiling on the Accumulation of External Arrears

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

G. Indicative Ceiling on the Accumulation of Domestic Arrears

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

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

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

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

I. Indicative Floor on Social Expenditures

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

J. Adjustment Factors for the Program Performance Criteria

Program Assumptions on Adjustment Factors for Quantitative Performance Criteria

(Millions of US dollars)

	2014				
	2014 Q1	**2014 Q2**	**2014 Q3**	**2014 Q4**	**Year**
Government External Financing	**739.2**	**343.8**	**1532.1**	**1431.0**	**4046.1**
Project loans	21.8	99.8	88.4	101.8	311.8
Multilateral donors	509.3	221.7	829.0	895.1	2455.0
AMF (Arab Monetary Fund)	0.0	0.0	0.0	43.5	43.5
IMF (budget support)	509.3	221.7	446.1	221.7	1398.7
World Bank Group	0.0	0.0	250.0	500.0	750.0
European Union	0.0	0.0	132.9	129.9	262.8
Bilateral donors	200.0	0.0	100.0	0.0	300.0
Algeria Budget support	0.0	0.0	100.0	0.0	100.0
Turkish loan	200.0	0.0	0.0	0.0	200.0
Financial Market Access	8.1	22.4	514.7	434.1	979.3
Sukuk	0.0	0.0	0.0	120.0	120.0
Market Financ. (with possible Japanse guarantee)	0.0	0.0	0.0	300.0	300.0
Market Financ. (with possible US Treasury guarantee)	0.0	0.0	500.0	0.0	500.0
Other (incl. Loan Transfers to SOEs)	8.1	22.4	14.7	14.1	59.3
Budget Grant	**0.7**	**40.7**	**87.5**	**49.0**	**177.9**
Privatization Receipts	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Government External Debt Service	**207.7**	**303.9**	**202.8**	**250.6**	**965.0**
Amortization	119.9	197.0	114.4	186.2	617.6
Interest	87.9	106.8	88.3	64.4	347.4
Resident deposits at the BCT 1/					

Sources: Tunisian authorities and IMF staff estimates

1/ End December 2013 is the reference level and was estimated at USD 1,852.07 million

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

27. The **NIR** targets are adjusted upward (downward) if the cumulative sum of net external financing of the central government (excluding project loans and any access to capital markets), the sum of budgetary grants, privatization receipts received in foreign currency, the increase (decrease) in the residents' foreign currency deposits at the CBT are greater (lower) than the levels observed at end December 2013. The NIR targets will be also adjusted upward (downward) if the total amount of cash payments on external debt service of the government is greater (lower) than the levels included in the table above.

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

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

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

K. Monitoring and Reporting Requirements

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

Information to be Reported in the Context of the Program

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

Stock of domestic arrears as per TMU, as well the stock of accounts payable that correspond to expenditures committed/ payment ordered more than 90 days before (and by type of expenditures),	*q*	*45*
Disbursement of foreign loans: Breakdown into project loans and budgetary loans by principal donor and identifying the most important projects to be financed in the original currency and its equivalent in Tunisian dinars converted at the current exchange rate at the time of each transaction. **Domestic borrowing from banks and nonbanks:** including bonds, Treasury bills, and other issued securities.	*m*	*30*
Debt guaranteed by the government: by instrument and type of currency (in dinars and in foreign currencies and its equivalent in national currency) **External and domestic debt service:** amortization and interest.	*m*	*60*
External payment arrears: external debt contracted and guaranteed by the government.	*q*	*30*
Debt rescheduling: possible rescheduling of debts contracted and guaranteed by the government, agreed with creditors.	*q*	*45*
Consolidated accounts of the central government at the CBT: The stock of deposits will be broken down as follows: (i) Treasury current account; (ii) special account of the Tunisian government in foreign currency and its equivalent in dinars; (iii) miscellaneous dinar accounts; (iv) loan accounts; (v) grant accounts; (vi) FONAPRA-FOPRODI accounts; and (vii) accounts pending adjustment (including privatization receipts from Tunisia Telecom).	*m*	*30*

External Sector		
Imports of Petroleum Products: average import price of main petroleum products.	*m*	*30*
Foreign trade: imports and exports of goods, including volumes and prices, by sector.	*m*	*30*
Deposits: Stock of foreign currency deposits, according to the residence of the holder.	*m*	*14*
External debt: Debt service (amortization and interest) of institutional agents by instrument and at type of currency (in foreign currency and its equivalent in dinars). Stock of external debt of institutional agents by instrument and type of currency (in foreign currency and its equivalent in dinars) (in conformity with our obligations under SDDS). Overall net external position of Tunisia (preliminary). Overall gross external debt position Overall net external position of Tunisia (in conformity with our obligations under SDDS).	*q* *m* *q* *q* *q* *A*	*30* *30* *90* *90* *90* *180*
Balance of payments: Prepared by the CBT	*q*	*30*
Monetary and Financial Sector		
CBT accounts at the current exchange rate: detailed table including the monetary system.	*m*	*30*
CBT accounts at the program exchange rate: Including net international reserves.	*m*	*30*
Foreign exchange market operations, Interbank market, retail market and wire transfers for CBT purchases on the retail market: CBT spot sales and purchases on the foreign exchange market, , stock of CBT currency swap (provide details on direction of transactions (TD/FX or FX/TD), amounts of principal, spot exchange rate in swaps agreement, interest rate applied on FX counterpart), detailed information on other BCT's forward foreign exchange operations, including outright forward sales of Tunisian Dinar . The terms and conditions of any new transactions (including the extension or renewal of existing terms and conditions) will also	*m*	*30*

be provided. CBT foreign exchange reserves, breakdown by currency and by instrument, and the institutions where such reserves are held.		
Banks' financial soundness ratios: Indicators of financial soundness and regulatory capital adequacy ratios of the banking system, including the quality of assets and the profitability of banks. The indication of the different banks is optional.	*m*	*30*
Direct refinancing of commercial banks by the CBT: Breakdown by bank.	*m*	*14*
Interest rates: Deposit rates, interbank rates, and lending rates.	*w*	*14*
NPLs: Stock of banking sector NPLs, and breakdown by commercial banks.	*q*	*60*
Balance sheets of commercial banks, including detailed income statements, in accordance with "Uniform Bank Performance Reporting" agreed with Fund staff.	*q*	*60*
Other Information to be Reported		
Information on Fiscal, Monetary, and Financial Policy: Decrees or circulars newly adopted or revised concerning changes in tax policy, tax administration, foreign exchange market regulations, and banking regulations. A copy of official notices of changes in gas and electricity rates and any other surcharge (automatic or structural), as well as the prices of petroleum products and levies/surcharges on gas and petroleum.	*d*	*3*

Statement by the IMF Staff Representative on Tunisia
August 29, 2014

This statement reports on the latest economic data updates and implementation of the prior action since the Staff Report was issued on August 15, 2014. The information does not alter the thrust of the Staff Appraisal.

1. **Recent indicators remain in line with staff's projections.** The headline inflation rate at end-July was 6 percent y-o-y, in line with expectations, while core inflation remains contained at around 4.5 percent. At 5.3 percent of GDP, the end-June current account deficit was slightly lower than estimated, reflecting some revisions in 2013 data and lower food imports. At the same time, gross reserves at end-June remain unchanged, covering 3.2 months of imports of goods and services.

2. **The 2014 end-June fiscal target was met by a wider margin than previously reported.** Final information on Treasury balances indicates that the primary fiscal deficit reached 1.7 percent of GDP at end-June, almost one percentage point of GDP lower than envisaged (and 1.7 percent of GDP lower than programmed). Underexecution in both current and capital outlays and strong revenue collection —particularly from indirect taxes—explain the overperformance.

3. **The prior action on the adoption of the restructuring plans of the Société Tunisienne des Banques (STB) and Banque de l'Habitat (BH) has been met**. The reform of public banks has been stalling for several years, and the adoption of these restructuring plans—in line with best international practices—represents a remarkable milestone toward reducing banking sector fragilities. Implementation of these plans, which will be adopted by the Board of the respective banks in September 2014, is essential to safeguard financial stability and strengthen financial sector intermediation.

4. **The restructuring plans for the STB and BH include the following steps**: (i) a recapitalization scheme that ensures banks meet prudential norms this year; (ii) a dilution of private shareholders if they choose not to inject new capital; (iii) convergence toward key performance indicators of private sector banks by 2016; and (iv) an enhanced governance framework, including via new management and board of directors at the banks. The plans also call for a communication strategy and the establishment of a committee to follow up on implementation. The creation of a public asset management company to deal with troubled debt, and the adoption of new bankruptcy and banking laws, will be important to support the successful implementation of these plans.

Press Release No. 14/400
FOR IMMEDIATE RELEASE
August 29, 2014

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes the Fourth Review Under the Stand-By Arrangement for Tunisia and Approves US$217.5 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Tunisia's economic performance under a 24-month program supported by a Stand-By Arrangement (SBA). The completion of the review enables an immediate disbursement of SDR 143.25 million (about US$217.5 million), bringing total disbursements to SDR 716.25 million (about US$1.1 billion).

The two-year SBA in the amount of SDR 1.146 billion (about US$1.74 billion, or 400 percent of Tunisia's quota at the IMF) was approved by the Executive Board on June 7, 2013 (See Press Release No. 13/202).

In completing the fourth review, the Executive Board approved the authorities' request for modification of the end of September 2014 performance criteria.

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

"Tunisia is set to complete its political transition with the advent of elections in the last quarter of 2014. Progress in the transition is helping galvanize support from development partners.

"Nonetheless, the economic situation remains difficult. Growth is timid, unemployment remains high, and rising external imbalances are putting pressures on the exchange rate and reserves.

"Program implementation has been strong. All quantitative performance criteria have been met. In spite of the challenging domestic and regional environment, structural reforms have been progressing, and the authorities have made up for earlier delays in some areas.
"Fiscal performance for the first half of the year has been strong, and continued fiscal consolidation remains essential to anchor macroeconomic stabilization. Fiscal measures to offset spending pressures are welcome, and recent increases in energy prices—together with

the implementation of new programs to protect the poor— will help reduce vulnerabilities. Energy subsidy reform and a strict control of the wage bill will improve budget composition, which will also benefit from increased social and investment expenditures. Comprehensive revenue reforms, strengthened public financial management, and reform of public enterprises will support fiscal consolidation and help generate more inclusive growth.

"A tighter monetary policy would help counter inflationary pressures and reduce exchange rate pressures. Further exchange rate flexibility would help rebuild foreign reserve buffers, correct large external imbalances, and improve competitiveness.

"Important steps have been taken to reduce financial sector vulnerabilities, including through the historic adoption of public bank restructuring plans, which should be quickly implemented. Banking sector fragilities will be reduced further through the establishment of an asset management company, adoption of the bankruptcy law, completion of public bank audits, and upgrade of the regulatory framework.

"Accelerated implementation of structural reforms is needed to improve the investment climate and generate a stronger and more inclusive growth. Moving ahead with the competition law and the public private partnerships framework will help foster private sector development. The upcoming "Invest in Tunisia" conference should play an important role in this regard."

**Statement by Jafar Mojarrad, Executive Director for Tunisia;
and Moez Ben Hassine and Abdelali Jbili, Advisors
August 29, 2014**

Our Tunisian authorities are appreciative of staff hard work and dedication, and are grateful to management and the Executive Board for their continued support.

Tunisia is moving decisively on the parallel tracks of completing the political transition and accelerating economic reforms, despite the many challenges. Through dialogue and national consensus, the political transition process has moved toward final stage, with legislative and presidential elections set to take place before the end of 2014. At the same time, broad political support to the authorities' policies has helped energize the momentum of economic reform to restore macroeconomic stability and strengthen the foundations of high and more inclusive growth. The authorities are confident that successful completion of the political transition will eliminate uncertainty, which hinders private investment, and pave the way for higher foreign direct investment and support from development partners. In this regard, they look forward to the September 2014 conference "Investing in Tunisia" to foster private sector investment.

Program implementation under this fourth review has been strong, notwithstanding the social constraints and security challenges. All quantitative performance criteria for end-March and end-June have been met, as have the indicative targets for social spending and current spending. As expected, the pace of implementation of structural reforms has accelerated, making up for earlier delays, especially on banking reform. Six out of seven structural benchmarks (SB) for end-June 2014 were met, and the lender-of-last resort facility (seventh SB) was delayed to end-March 2015 to allow its alignment with the new banking resolution framework, while an interim exceptional facility was introduced (see below). Restructuring plans for two public banks have been adopted as a prior action for this review, and the audit of a third one will be completed in September 2014, instead of end-July, owing to delays caused by the auditor.

Recent economic developments and outlook

Except for growth performance, macroeconomic developments in 2013 and the outlook for 2014 remain broadly in line with the earlier estimates and projections for the third review (April 2014). Weak external demand, including in the tourism sector, has led to slightly lower growth in 2013 (2.3 percent instead of 2.6 percent) and continues to weigh down on growth in 2014. Despite a rebound in agriculture, and strong performance of the chemical and mining sectors, real GDP growth in 2014 is projected at 2.8 percent, with risks tilted to the downside in connection with weak economic prospects in Europe, regional security challenges, and possible rise in commodity prices. Strengthened confidence following the elections, and increased external financing could improve the outlook, although the effects would be felt mainly in 2015 and beyond.

Headline inflation rose during the first half of 2014, reflecting the increase in food prices and electricity tariffs, as well as the depreciation of the currency, but is expected to moderate for the remainder of the year as a result of tight monetary policy and improved agricultural production, with CPI inflation for the year as a whole estimated at 5.7 percent, or below the 2013 level. Core inflation remains contained (4.3 percent in June) and is on a downward trend. On the external side, weak demand from Europe, lower exports of phosphates, and high energy imports, due mainly to falling oil production and lower volume of gas transiting from Algeria to Italy, exacerbated pressures on the current account deficit during the first half of the year. With the depreciation of the exchange rate (8.6 percent since mid-March), and tight monetary policy, as well as the rebound in phosphate exports, the current account deficit is expected to decline to 7.6 percent of GDP in 2014, albeit by less than foreseen earlier. Gross official reserves stood at the equivalent of 3.2 months of imports of goods and services at end-June 2014.

Fiscal policy

Fiscal adjustment has gained momentum in 2014, with the end-March and end-June fiscal targets being achieved with a comfortable margin. Improved tax collection from oil companies, higher VAT revenues, and dividends from non-oil companies helped bring down the primary cash fiscal deficit in Q1 2014 to 1.3 percent of GDP compared to 2.1 percent projected under the program. Total spending was in line with the program objective, including capital expenditure, and social spending targets for end-March and end-June have been achieved.

The authorities are committed to continued fiscal consolidation, which will be gradual and will involve a combination of short-term measures and structural reforms**.** The 2014 revised budget, which was approved by the National Constituent Assembly in August, envisages an overall fiscal deficit in line with the program target, and a structural deficit of 4.7 percent of GDP (against 4.9 percent projected in the program). This will be achieved through a series of revenue measures included in the revised budget and efforts to contain current spending, including the wage bill. In this regard, the authorities have decided to freeze promotions and recruitment to compensate for the recent increase in current expenditure and to save the revenue over-performance achieved during the first half of the year.

Commendable progress has been made in reducing energy subsidies, including through the elimination of subsidies to cement companies and increases in electricity tariffs for industrial and low-voltage consumers. Moreover, on July 1, 2014, gasoline and diesel prices were raised by 6 percent, thereby bringing total savings on subsidies to about 0.9 percent of GDP this year. The energy subsidy reduction was accompanied by social programs to protect the most vulnerable groups of the population, as highlighted in MEFP (¶ 34).

A comprehensive tax reform is under preparation to promote equity, efficiency, and transparency of the tax system, building on the high level national conference**.** All the existing tax laws and codes will be consolidated into a single tax code in September 2014 and, following extensive consultations, an action plan to implement the government tax reform strategy will be adopted in October 2014. As part of this strategy, the authorities are planning to revise the corporate income tax to achieve gradual convergence of the off-shore and on-shore sectors. For the coming fiscal year, attention will continue to focus on reforming the VAT and excise taxes and simplifying the existing presumptive tax system. In parallel, sustained efforts are being made to reform tax administration along the lines of the plan adopted by the Ministry of Economy and Finance on August 7, 2014 (MEFP ¶23).

Monetary and exchange rate policies

The Central Bank of Tunisia (BCT) has preemptively tightened its monetary policy stance in view of pressures arising from the adjustment of energy prices, the recent depreciation of the dinar, and the increase in minimum wages**.** The policy rate was raised by 25 basis points in June 2014, bringing the cumulative increase this year so far to 75 basis points. The BCT remains committed to further policy tightening, as needed, and will continue to be vigilant in monitoring inflation developments.

Growth of credit to the private sector has remained moderate, reflecting weak demand, even though central bank refinancing has been adequate. The BCT has taken further steps to reduce the risk to its balance sheet by increasing from 10 to 25 percent the haircut on the valuation of loans eligible for its refinancing (July 2014) and by increasing the share of government securities used as collateral from 20 percent to 40 percent (effective as of December 2014). Pending the introduction of a lender-of-last resort facility (March 2015), an interim “exceptional facility” was established on July 1, 2014 to allow illiquid but solvent banks to access BCT resources at a penalty rate and subject to intrusive banking supervision.

Increased exchange rate flexibility has allowed the dinar to more closely reflect market developments, as evidenced by the recent currency depreciation, and helped build official reserves. The authorities are committed to pursuing a flexible exchange rate policy, while smoothing excessive fluctuations resulting from large energy transactions. Establishment of an electronic bank interlinking platform, together with the implementation of the market maker agreement, will facilitate the introduction of a weekly foreign exchange auction mechanism by year-end (SB for end-December 2014).

Financial stability

Addressing the vulnerabilities of the financial sector remains one of the authorities’ key priorities**.** As detailed in the report and the MEFP, a multi-pronged strategy is being deployed aimed at: addressing capital adequacy shortfalls in seven banks that fall below the statutory minimum requirement; aligning prudential rules with international norms; strengthening bank supervision, including improving offsite procedures and onsite inspections before moving to risk-based methods; and upgrading the reporting and ratings system. Adequate progress has been made in these areas, as indicated in the report.

A major undertaking will be the recapitalization and restructuring of public banks. Of the seven banks undercapitalized at end-December 2013, three private banks have been fully capitalized by end-July with financing from private shareholders. The recapitalization of the remaining four public banks will be carried out in the context of the banking strategy adopted in April, involving public resources estimated at 1.2 percent of GDP, which have been already included in the 2013 and 2014 budgets. Moreover, the authorities have taken an important step by adopting restructuring plans for the *Banque de l'Habitat (BH)* and the *Societe Tunisienne de Banque (STB),* for which independent audits have been completed, in line with international best practices (prior action for this review), while restructuring of the *Banque Nationale Agricole (BNA)* will be carried out following completion of its audit in September 2014. The next step is to have the restructuring plans adopted by end-September by the board of each bank.

Work has continued for the establishment of an Asset Management Company (AMC) to address the NPL problem in the tourism sector, with the necessary legal framework being prepared with World Bank technical assistance in line with international best practices. The draft law on the AMC will be submitted to the National Constituent Assembly with expected approval in September 2014. Further steps are being taken to strengthen bank supervision, improve reporting of banking indicators, and strengthen banking crisis and resolution management mechanisms, as detailed in the MEFP (¶19).

Structural reforms

The authorities attach high importance to deepening structural reforms to improve the business climate, attract private sector investment, and foster efficiency and competitiveness. Wide-ranging initiatives have been taken in several areas, including the investment code, the competition law, and a law on public-private partnership, which are being reviewed by the National Constituent Assembly (MEFP ¶29-30). The authorities are also working on improving the functioning of the labor market, reducing the skill mismatch of the labor force, and supporting small- and medium-sized enterprises. Moreover, as indicated during the third review, the monitoring of public enterprises is being strengthened, and a strategy to reform SOEs is under preparation. These major reforms require consensus building and time for preparation and legislative approval. While the authorities are steadfastly moving in this direction, the process is expected to accelerate in the period after the upcoming legislative elections.

Conclusion

With strong program implementation under this review, despite very difficult circumstances, Tunisia has once more demonstrated that political transition and economic reform can go hand-in-hand. Patience and perseverance on the part of the authorities, the population, and the business community have started to pay off. The authorities are grateful to the IMF and their development partners for their sustained support and look forward to continued fruitful cooperation.