

Describes the preliminary findings of IMF staff at the conclusion of certain missions (official staff visits, in most cases to member countries). Missions are undertaken as part of regular (usually annual) consultations under [Article IV](#) of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, and as part of other staff reviews of economic developments.

Tunisia—Preliminary Conclusions of the Staff Visit

January 16, 2008

A. Introduction

1. The IMF mission that visited Tunis since January 8 thanks the authorities for their excellent cooperation, their warm hospitality, and the high quality of the discussions.

2. The Tunisian economy is continuing to exhibit resilience, posting an appreciable growth rate in 2007, despite an unfavorable external environment.

However, significant challenges remain to sustain this growth rate and further reduce unemployment while maintaining macroeconomic stability. The staff visit focused on short-term macroeconomic issues in the context of rising world prices for oil and basic commodities, as well as the likely slowdown in global economic growth resulting from the crisis in the US real estate sector.

B. Recent Economic Developments

3. Growth gathered momentum in 2007. The growth rate is estimated to have risen from 5.5 percent in 2006 to 6.3 percent in 2007, the highest level in the last ten years, due to the favorable performance of the agricultural, energy, manufacturing, and services sectors. The mechanical and electrical sector remained the driving force behind manufacturing growth, and the textiles and clothing sector experienced a substantial upturn. The surge in oil prices triggered a supply side response, as some oil wells with high operating costs became profitable. On the demand side, growth was driven both by vigorous exports and the favorable performance of domestic demand. Strong growth in the electrical and mechanical industry raised the sector's share in total goods exports to 27 percent in 2007, allowing greater diversification of the Tunisian manufacturing industry. Hence, the unemployment rate fell from 14.3 percent in 2006 to 14.1 percent in 2007.

4. Owing to effective monetary policy, average inflation declined from 4.5 percent in 2006 to 3.1 percent in 2007, although inflationary pressures have

reemerged. On a year-on-year basis, inflation fell from 5.3 percent in May 2006—after the surge in the prices of oil and basic commodities—to 2 percent in April 2007. More recently, following a new episode of oil and commodity price increases, year-on-year inflation once again climbed to 5.3 percent in December 2007. Sizable flows of foreign direct investment (FDI) and the depreciation of the dinar relative to the euro may also have contributed to inflation. Assessing that contribution would inform the conduct of monetary and exchange rate policy. The Central Bank of Tunisia (BCT) responded to resurgent inflationary pressures by raising its required reserves ratio from 3.5 percent to 5 percent at end-November 2007.

5. In 2007, the Tunisian dinar recorded an average depreciation of 4.5 percent with respect to the euro and an appreciation of 4 percent with respect to the US dollar, mirroring the appreciation of the euro on foreign exchange markets. In real effective terms, the dinar recorded a slight depreciation of about 3 percent, on the basis of the index calculated by the IMF. This primarily reflects a deterioration in the terms of trade, the persistent yet sustainable current account deficit, and tariff reductions resulting from trade liberalization.

6. Tunisia's external position continued to strengthen despite a slight rise in the current account deficit.

Exports and imports recorded strong growth in 2007. Imports were heavily weighted towards intermediate and capital goods, supporting the rapid pace of growth. Energy exports grew by more than 50 percent as a result of the upsurge in oil prices and its positive impact on local oil production, temporarily reversing the deficit in the energy trade balance. However, the current account deficit, while sustainable, widened slightly from 2 percent of GDP in 2006 to 2.5 percent in 2007, due to declining terms of trade. This deficit was offset by substantial inflows of FDI. International reserves increased by US\$1 billion in 2007 to reach US\$7.8 billion, representing 4.6 months of imports of goods and services. Tunisia strengthened its external position through early repayments financed by privatization proceeds, and thereby reduced its total external debt—including short-term debt—from 58.3 percent of GDP in 2006 to 55.6 percent of GDP in 2007.

7. The budget deficit is expected to have remained broadly the same as in 2006, notwithstanding the increase in world commodity prices. A cautious fiscal policy curbed the deficit to 3 percent of GDP, below the 3.1 percent target set in the 2007 budget law. Record prices of oil and commodities prompted the authorities to adopt a supplemental budget in December, which provided for raising subsidies for the Caisse Générale de Compensation (CGC) by 0.6 percent of GDP, bringing the total to 1.3 percent. The increase in prices at the pump in May and October 2007 kept oil subsidies as budgeted at 1 percent of

GDP. Higher revenues from oil companies, nontax receipts, and customs duties—on account of the substantial increase in imports—should offset the additional expenditures. Early repayments are expected to have reduced public debt from 53.9 percent of GDP in 2006 to 51.5 percent of GDP in 2007.

8. The strong growth recorded in 2007 helped enhance the profitability of the banking sector. The available indicators, although incomplete, point to an improvement in bank profitability in 2007. Some institutions—such as Amen Bank and BIAT—used this opportunity to recapitalize. The improvement in bank profitability should allow banks to continue strengthening their balance sheets and improving their prudential indicators. Following significant gains in 2006, the TUNINDEX stock market index increased by 12.1 percent in 2007, generating an overall market return of 3 percent.

C. Economic Outlook for 2008

9. Growth is expected to remain robust at 5.7 percent. The slight slowdown is attributable to the exceptional growth in the energy sector in 2007, the likely slowdown in Europe, the expiry of EU quotas on Chinese exports of certain textile products, and a restrictive monetary policy. Strong growth momentum and major investment projects should limit the extent of this growth deceleration.

10. Inflationary pressures—particularly imported inflation—are likely to continue in 2008. However, cautious monetary policy—the BCT has already raised its required reserves ratio—and the BCT's intention to take further action if necessary, are expected to keep inflation down to 4 percent on average. This forecast also takes into account the probable increase in the price of administered products if world prices remain high.

11. The 2008 budget law envisages a cautious budget policy. The budget deficit is set at 3 percent of GDP—the same as the deficit observed in 2007—based on oil prices of US\$75 per barrel. However, subsidies could overshoot their budgeted levels if international oil and commodity prices remain high with limited pass-through on to consumers.

12. In 2008, the current account may record a slight deterioration if oil and basic commodity prices remain in the vicinity of their recent record levels. Exports are projected to taper off, particularly on account of the global slowdown. Imports are likely to experience relatively strong growth due to persistently high oil and commodity prices and substantial demand for capital goods and raw materials. Consequently, the current account is forecast to deteriorate slightly to 2.7 percent of GDP in 2008. Nonetheless, external debt will continue to decline,

reaching 52.9 percent of GDP in 2008.

13. The risks associated with the economic outlook for 2008 are primarily related to the international economic environment. The likely slowdown in growth in Europe and further increases in oil and commodity prices could hamper growth and accelerate inflation. There are also uncertainties surrounding the effect of the dismantling of EU quotas on Chinese exports of certain textile products, although order books for the first quarter of 2008 do not indicate a slowdown in exports of the textiles and clothing sector.

D. Economic Policy Issues

14. Given the liquidity overhang and the growing inflationary pressures, the mission supports the restrictive monetary policy pursued by the central bank. Faced with the excess liquidity and the inflationary pressures that reemerged during the second half of 2007, the BCT withdrew liquidity and ultimately raised the required reserves ratio. The authorities stand ready to further tighten monetary policy if necessary. Given the time lags involved in the adjustment of the economy to shifts in monetary policy, it is important to persevere in fine-tuning forecasting tools so as to better anticipate inflationary pressures and take timely action. Concerning the development of the money market, the interest rate applied to special savings accounts will no longer be capped, allowing the rate of remuneration on savings with banks to be market determined. The mission encouraged the authorities to eliminate also, in due time, the minimum rate and to de-index banks savings rates from the money market interest rate (TMM).

15. The exchange rate policy remains anchored to the medium-term objective of a floating exchange rate regime. With the growing openness of the Tunisian economy, exchange rate policy is becoming central to macroeconomic management. Coordination between monetary and exchange policies should therefore be enhanced. In particular, further exchange rate flexibility could contribute to price stability.

16. The mission supports Tunisia's cautious budget policy which has successfully maintained a 3 percent deficit despite a challenging international environment. Faced with mounting inflationary pressures, budget policy should target a deficit below 3 percent to support the restrictive monetary policy and enhance the flexibility of fiscal policy. While the mission lauds the energy saving strategy actively pursued by the authorities, it recommends considering alternative options, less costly than subsidies to the CGC, for protecting the purchasing power of low-income households. Concerning major investment projects, the authorities should ensure that

such projects entail no new contingent liabilities that would add to the current stock of 8.9 percent of GDP in 2007.

17. Banking sector reforms are in progress. Strong economic growth accompanied by vigilant supervision should strengthen the financial position of banks. In this favorable environment, it is important to pursue efforts to reduce nonperforming loans. Banking sector reforms are continuing, with the recent privatization of Banque Tuniso-Koweitienne on favorable terms. Other banks may follow suit. However, the Tunisian banking sector remains fragmented and of limited size, and its consolidation would be beneficial given heightened competitive pressures. The quality of banking services, which was instituted as a legal obligation, has improved and the authorities are committed to bring it to international standards. Furthermore, banks prepare for the transition to Basel II by 2010, and several measures aimed at energizing the banking sector were recently adopted or will be adopted shortly. The requirement that banks transfer their end-of-day foreign exchange balances to the BCT (*nivellement*) has been abolished and banks are now authorized to manage 20 percent of residents' foreign exchange holdings not subject to surrender requirements, thereby promoting the interbank exchange market. In addition, there are plans to delegate to banks the authority to quote and execute transactions involving exchange rate and interest rate hedging instruments, as well as to lengthen the maturity of such instruments. Finally, listed credit institutions are no longer limited by a cap on their foreign borrowing.

18. Current account and capital account liberalization continued in 2007. Remaining ceilings on the allocation of foreign exchange for current account transactions have been raised, and the exchange authorization requirement for nonresident investments in Tunisia—apart from retail trade—has been abolished. The constraints affecting equity and investment flows between nonresident and resident individuals or firms will be eased. Proceeds from exports of professional services may be placed in a foreign exchange account subject to a ceiling. In addition, a foreign exchange amnesty was proclaimed in 2007. The mission encouraged the Tunisian authorities to pursue their efforts to achieve gradual liberalization in all sectors of the economy, including the services sector, which has a key role to play in improving the business climate and promoting private investment.

19. Trade liberalization—a major factor in opening up the Tunisian economy—is well under way. Total exports and imports of goods increased from 74 percent of GDP in 1995 to 98 percent of GDP in 2007, with a significant improvement in the import cover ratio which moved from 70 percent to 90 percent. FDI, in percent of GDP, virtually doubled during the same period. These trends reflect Tunisia's trade liberalization policy,

particularly in the context of the Association Agreement with the EU that culminated in free trade in 2008, with zero tariffs on industrial products from the EU, down from an average of 19 percent in 1999. The tariff simplification program continues: the number of rates was reduced from 14 to 9 in two years and the maximum rate was reduced from 73 percent to 60 percent. The relaxation of customs formalities advances, with the average length of time spent by goods in customs declining from 11 days in 2005 to 7 days in 2007. Further simplification and reduction of multilateral customs tariffs are needed in order to prevent trade diversion and to enhance the geographical diversification of trade.

20. Tunisia is continuing to play an active role in Maghreb integration. It hosted the third regional conference on the Role of the Private Sector in Economic Development and Regional Integration in the Maghreb in November 2007. The action plan prepared during the conference aims at improving the business climate and promoting partnerships between private investors across the countries in the region. Concerning intra-Maghreb trade, Tunisia adopted in 2008 the mutual recognition of certificates of conformity to technical standards with Libya.

E. Other Issues

21. The mission welcomes the authorities' decision to publish this aide-mémoire, as usual.

22. It was agreed that the next Article IV mission would take place in early June 2008.

Table 1. Selected Economic and Financial Indicators, 2002-08

	2002	2003	2004	2005	2006	Est. 2007	Proj. 2008
Production and income (percent change)							
Nominal GDP	4.1	7.5	9.4	7.0	9.4	8.9	8.3
Real GDP	1.7	5.6	6.0	4.0	5.5	6.3	5.7
GDP deflator	2.3	1.9	3.2	2.9	3.7	2.4	2.5
Consumer price index (CPI), average	2.7	2.7	3.6	2.0	4.5	3.1	4.0
Gross national savings (in percent of GDP)	22.1	22.1	22.5	20.9	21.8	22.3	22.3
Gross investment (in percent of GDP)	25.7	25.0	24.5	22.0	23.9	24.8	25.0
External sector (percent change)							
Exports of goods, f.o.b. (in \$)	3.8	17.1	20.6	8.4	9.5	30.3	17.7
Imports of goods, f.o.b. (in \$)	-1.9	14.7	17.6	2.9	12.4	27.1	17.8
Exports of goods, f.o.b. (volume)	1.9	7.2	15.2	1.6	6.3	20.3	10.6
Import of goods, f.o.b. (volume)	-2.4	3.4	7.3	-5.7	5.2	11.4	8.5
Trade balance (in percent of GDP)	-10.1	-9.1	-8.6	-6.8	-8.2	-8.2	-8.5
Current account, excluding grants (in percent of GDP)	-3.6	-2.9	-2.0	-1.1	-2.0	-2.5	-2.7
Foreign direct investment (percent of GDP)	3.6	2.1	2.1	2.6	10.4	3.0	3.4

Terms of trade (deterioration -)	1.3	-1.5	-4.5	-2.3	-3.6	-5.0	...
Real effective exchange rate (depreciation -)	-0.2	-5.0	-3.4	-4.5	-0.8	-2.9	...
Central government (percent of GDP, unless otherwise indicated) 1/							
Total revenue, excluding grants and privatization	24.4	23.7	23.8	23.6	23.8	24.0	23.5
Total expenditure and net lending	27.8	27.1	26.6	26.9	26.6	27.0	26.5
Central government balance, excluding grants and privatization	-3.5	-3.4	-2.8	-3.2	-2.9	-3.0	-3.0
Central government balance, including grants, excluding privatization	-3.1	-3.2	-2.6	-3.0	-2.8	-2.9	-2.8
Total government debt (foreign and domestic)	61.5	60.5	59.4	58.3	53.9	51.5	50.8
Foreign currency public debt (percent of total debt)	63.5	64.4	63.2	63.9	59.8	57.5	53.6
Money and credit (percent change)							
Credit to the economy	6.7	4.6	5.3	6.3	6.6	7.9	...
Broad money (M3) 2/	5.2	6.3	10.3	11.0	11.4	9.9	...
Velocity of circulation (GDP/M3, deposit money banks)	1.8	1.8	1.8	1.8	1.8	1.8	...
Velocity of circulation (GDP/M3)	1.6	1.7	1.6	1.6	1.6	1.5	...
Interest rate (money market rate, in percent, e.o.p) 3/	5.91	5.00	5.00	5.00	5.26	5.26	...
Official reserves							
Gross official reserves (US\$ billions, e.o.p)	2.3	3.0	4.0	4.4	6.8	7.8	8.7
In months of imports of goods and services, c.i.f.	2.7	3.0	3.5	3.7	5.0	4.6	4.4
Total external debt							
External debt (US\$ billions)	15.1	17.8	19.5	18.1	18.5	20.3	20.7
External debt (in percent of GDP)	67.5	66.8	66.5	65.4	58.3	55.6	52.9
Debt service ratio (percent of exports of GNFS)	17.3	15.4	16.4	14.8	18.8	13.3	9.3
Financial market indicators							
Stock market index 4/	1,119	1,250	1,332	1,615	2,331	2,614	2,675
Memorandum items:							
GDP at current prices (TD millions)	29,924	32,170	35,192	37,664	41,211	44,861	48,564
GDP at current prices (US\$ billions)	22.4	26.6	29.3	27.6	31.8	36.6	39.2
GDP per capita (US\$)	2,293	2,695	2,955	2,751	3,123	3,548	3,752
Unemployment rate (in percent)	14.9	14.3	13.9	14.2	14.3	14.1	14.0
Population (millions)	9.8	9.9	9.9	10.0	10.2	10.3	10.4
Exchange rate: dinar/US\$ (average)	1.42	1.29	1.25	1.30	1.33	1.30	...

Sources: Tunisian authorities; and staff estimates and projections.

1/ Excludes the social security accounts.

2/ Financial system (Central Bank, universal banks, leasing companies, Postal Savings Center (CCP) and Postal Leasing Center (CEP)).

3/ The rate for 2007 is the average money market rate for December.

4/ TUNINDEX. (1000 = 4/1/1998). 2008 data from January 11, 2008.