

## CHAPTER 4 – MONEY, CREDIT AND MONETARY POLICY

While remaining steadfast about achieving its overriding objective of preserving price stability<sup>1</sup>, the monetary policy carried out by the Central Bank in 2010 focused on support to the economy in a context of external demand adversely affected by recession in the economies of Tunisia's main partner countries.

The analytical framework of this policy, previously based on monitoring of trends in money aggregate of reference and in credit, was enriched by indicators tied to inflation such as the output gap<sup>2</sup> and core inflation<sup>3</sup>. Furthermore, given the prospective nature of monetary policy, the Central Bank got involved in a twinning initiative in the framework of a programme to support the association agreement with the European Union. This is meant to achieve more in-depth analysis of transmission channels for monetary policy and establish a mechanism to analyse and project inflation and economic growth that will serve as a basis for decision-making in this area, which would be a transparent means of transmitting relevant information to the public.

2010 was marked by raising in March and May of the reserve requirement rates, meant to avoid further pressure on inflation and faster growth on loans to the economy in a context of excess liquidity. Despite this increase, the outstanding balance of loans as of closing for the year was relatively high compared to previous years. This was attributable to the fact that a major portion of these loans served to finance imports, thus making up for the gap in external financing of the current deficit. Modification of reserve requirement rates along with the restrictive effect of certain autonomous factors had by June put an end to a period of excess liquidity that had lasted for three years.

On the operational front, the Central Bank in 2010 pursued its policy of regulation on the money market by means of intervention, mainly calls for bids, meant to reduce the volatility of the money market rate against the key rate.

The profound political changes that took place at **the beginning of 2011** seek to set up a democratic system that will create better prospects for the Tunisian economy. This will be done in a climate of transparency that guarantees equal opportunity for all investors and re-establishes confidence among economic operators. The events that have taken place in connection with this transition, fallout from conditions in the region, and higher world prices for commodities and energy weighed heavily on Tunisia's economy and led the Central Bank to ease its monetary policy by making substantial reductions in reserve requirement rates and by decrease its key rate from 4.5% to 4%, thanks to lower inflation.

### SECTION 1 – MONEY, CREDIT AND INFLATION IN 2010

#### 1. Growth and inflation

Despite a modest agricultural season, the economy performed well in 2010, with a non agricultural growth rate of 4% following a difficult year when the equivalent growth rate was 2.7%.

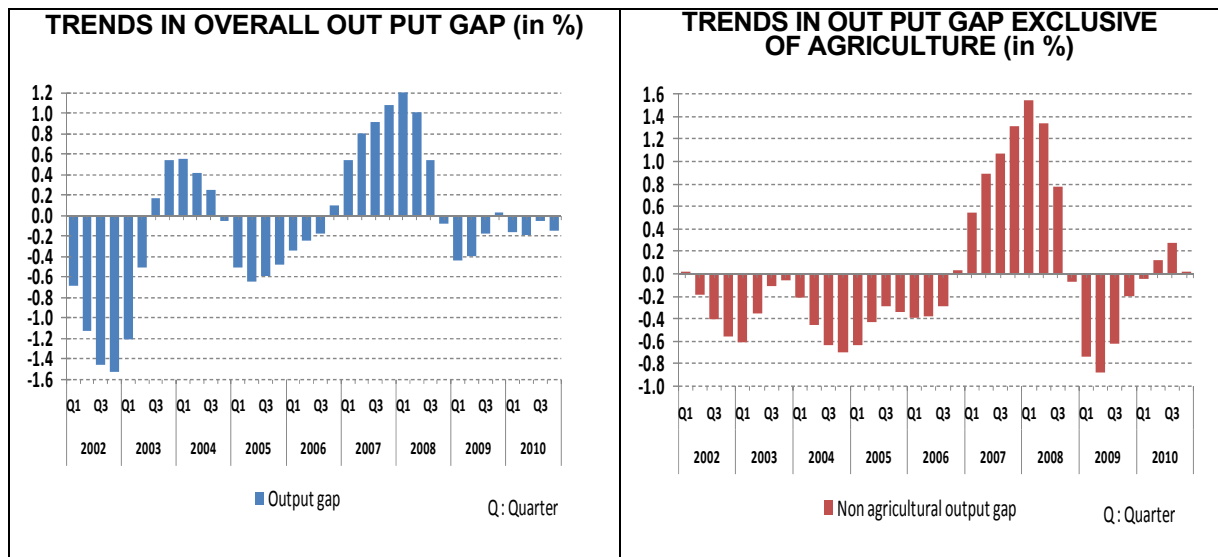
The output gap reached a positive level in most sectors (exclusive of agriculture), marking an increase (tied though it may be to circumstances) in pressure on production capacity.

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<sup>1</sup> Article 33 of law n°2006-26 of 15 May 2006 modifying law n°58-90 of 19 September 1958, pertaining to the creation and organisation of the Central Bank of Tunisia.

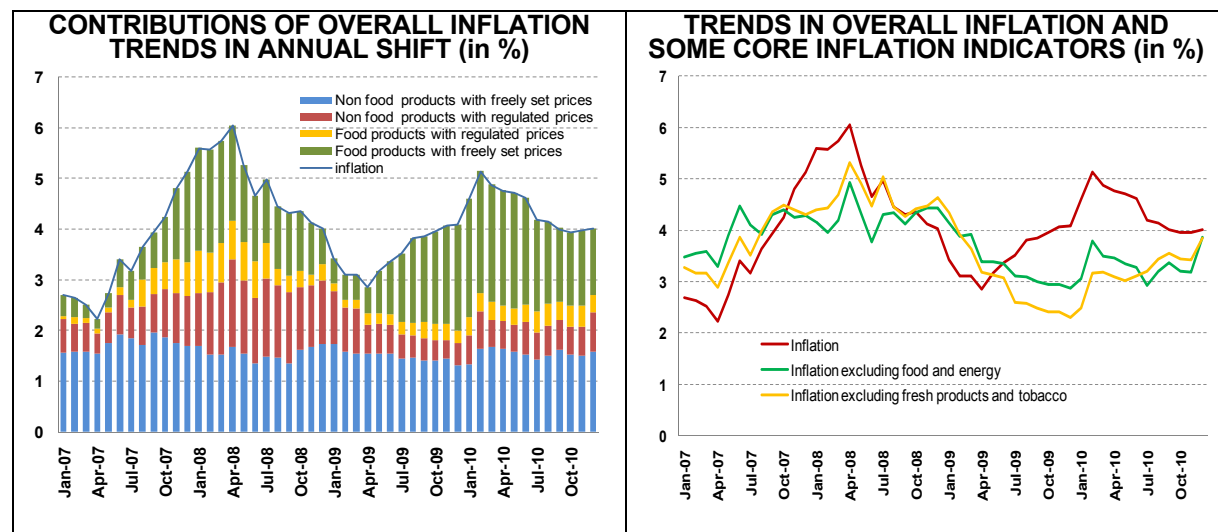
<sup>2</sup> This corresponds to the difference in terms of percentage between the effective GDP and the potential GDP, the latter being defined as the maximum sustainable (non inflationary) level of production that can be obtained by existing levels of labour and capital in the economy thanks to current technologies.

<sup>3</sup> This is a measure that helps detect deep-seated price trends. It can be calculated using statistical methods or by simply excluding the prices of products that are regulated (energy, tobacco...) or products with volatile prices (fresh products, dairy products, meats...) that have been affected by very variable movements due to weather or pressure on world markets.



As for consumer prices, after reaching a peak of 5.1% in February 2010, inflation began to gradually fall, stabilising at 4% over the last four months of the year under review, an average increase of 4.4% compared to 3.5% a year earlier. This trend was evident in the price of food (6.8% vs. 4.3%), while prices for the other components of the Tunisian basket went up at about the same rate as the year before (3.2%).

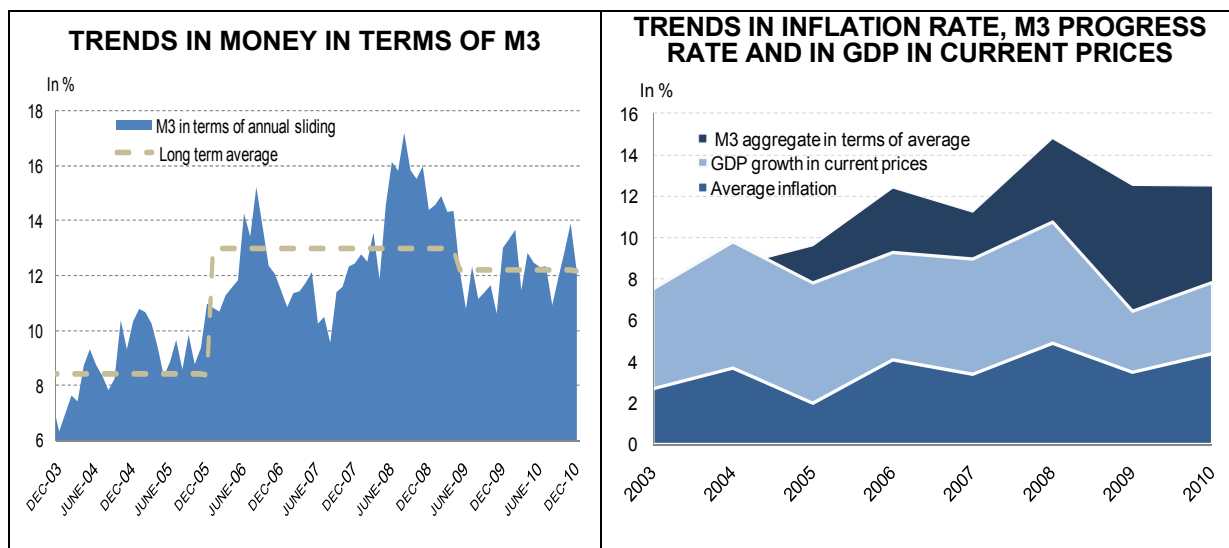
Indicators for core inflation, which go back over basic price trends, posted levels in 2010 that were below overall inflation, marking reappearance of inflationary pressure starting the second half of the year.



## 2. Money, credit and other sources of money creation

### 2-1. Money

On the monetary front, the M3 aggregate went up in 2010 at a sustained but slightly slower pace compared to the figures posted the previous two years. This increase was the result mainly of sharp growth in financing of the economy, which would have been greater if it had not been for a drop in State indebtedness to banks but also and especially to the sharp drop in net claims abroad. A high share of loans from banks in 2010 served to finance imports, notably transport material.



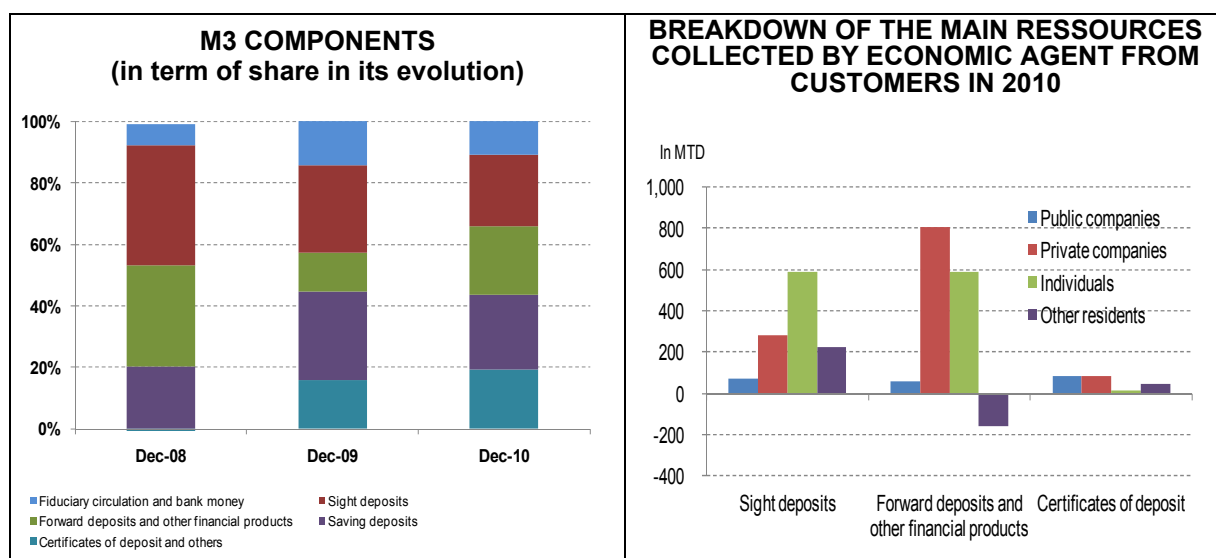
Sources : BCT and Ministry of Planning and International Cooperation

Furthermore, although it is going down, the gap between the increase in M3 money supply and growing economic activity (GDP) remained high in 2010, in line with a drop in the velocity of money as measured by the ratio between GDP and the M3 money aggregate (1.55 vs. 1.61).

As for the components of M3 money aggregate, conflicting trends were evident for the most part in adjustments to the portfolio structure of economic agents. In effect, dynamic monetary placement reflects (aside from gaps in remuneration) great distortion in application of reserve requirement rates between short term and longer term deposits in dinars, bringing about a substitution movement between the above-mentioned categories of deposits, all the more so since there were relatively few investment opportunities available, mainly because of the low volume of Treasury bond issues in 2010.

Trends led to reallocation within M3 money aggregate of sight deposits in favour of quasi money, posting 12.4% faster growth. This compares to 11.7%, essentially in forward deposits at the expense of M1 money aggregate, for which growth slowed considerably (11.2% vs. 15.1%).

After sustained growth in 2009, reflecting the preference of non financial agents for holding liquid assets (a preference influenced by the impact of international conditions on Tunisia's economy) M1 money supply posted slower growth in 2010, mainly in the fiduciary compartment (10.1% vs. 13.9%) and sight deposits at banks (14.5% vs. 17.8%). Trends in sight deposits in 2010 reflected diverging movements varying from considerable slowing of growth in deposits in dinars (10.7% vs. 17.8%) and growth at a significantly faster pace for deposits in foreign currency (27.3% vs. 12.9%). Private individuals, private companies and one-man businesses remain the main depositors.



Faster growth in quasi money over the year under study was influenced by greater increase in forward deposits and other financial products (11.3% or 1041 MTD vs. 6.5% or 565 MTD). This trend led to a change in the behaviour of certain non financial agents, particularly private companies, which posted high growth in their forward deposits (+807 MTD in 2010 vs. +33 MTD in 2009). Private individuals participated in this increase to the tune of 587 MTD, compared to 403 MTD a year earlier. The highest increase in these deposits was recorded in April 2010 (+538 MTD), following reimbursement of a high volume of Treasury bonds along with a low volume of issues of State securities.

#### TRENDS IN THE MAIN RESOURCES COLLECTED WITH RESPECT TO CLIENTS

(Figures of end of period)

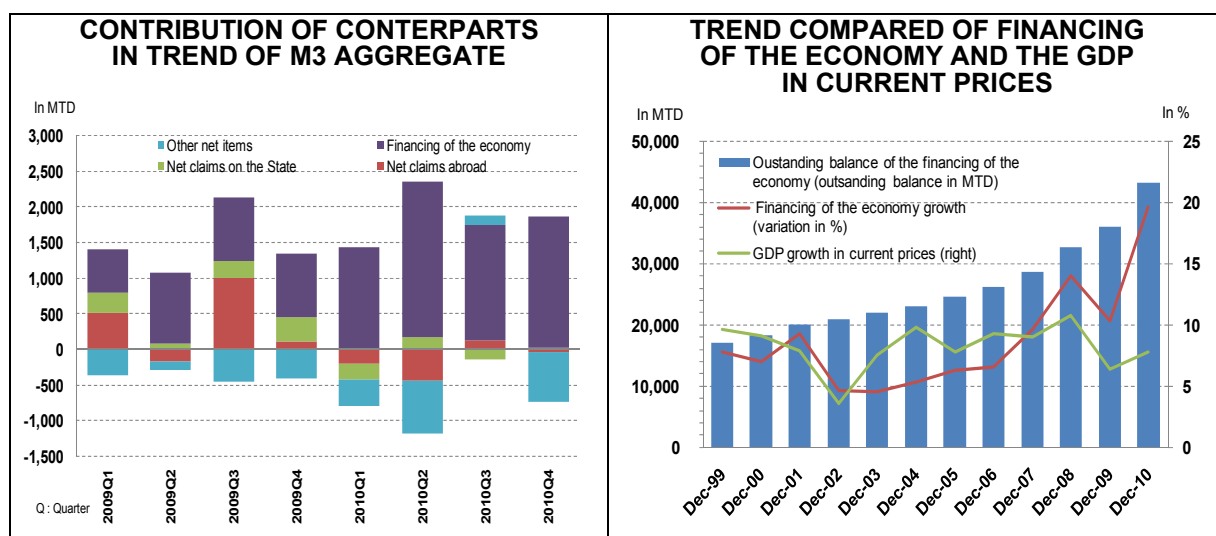
Description	2009	2010	Variat. 2009/2008 in %	Variat. 2010/2009 in %
Sight deposits at banks	8,227	9,420	17.8	14.5
Sight deposits at the postal current account	1,004	896	2.3	-10.8
Forward deposits and other financial products	9,191	10,232	6.5	11.3
Certificates of deposits	1,729	1,952	29.7	12.9
Savings accounts at banks	8,788	9,664	12.3	10.0
Savings at the postal savings account	2,367	2,635	15.0	11.3

Savings accounts experienced slowing growth compared to 2009, a trend attributable partially to the higher cost of living, as illustrated by faster growing average inflation (4.4% vs. 3.5%). This slower pace applied to both special savings accounts opened at banks (+812 MTD vs. +870 MTD) and those opened at the postal savings centre (+268 MTD vs. +309 MTD).

For the third straight year, the growth rate for long term savings, mainly in the form of debenture loans, grew at a faster pace, up from 29.2% in 2009 to 34.2% in 2010. This trend was provoked by concern on the part of lending institutions about providing better balance between uses and resources.

#### 2-2. Loans and other sources of monetary creation

Despite modest growth in economic activity (3% vs. 3.1%), loans to the economy posted an exceptionally higher increase in 2010 (19.6% vs. just 10.3% in 2009), largely because of loans to finance imports, notably transport material but also goods for final consumption.



Sources : BCT and National Statistics Institute

Trends for these loans were influenced in particular by the increase in loans in foreign currency. This increase was due in part to commitment on the part of certain lending institutions to finance major initiatives, mainly construction of a new oil refinery by the Tunisian refining industries company *STIR* and expansion of the maritime and airline fleets by the Tunisian navigation company *CTN* and *Tunisair* respectively. Another factor was price increases on international markets for imported energy and food products.

Net external assets closed for 2010 with a 553 MTD drop, compared to an increase of 1455 MTD a year earlier, under the influence of a widening of the current deficit, which the surplus in the balance of capital and financial transactions was not high enough to offset. Indeed, the surplus was slightly below the level of the previous year, due in particular to the high level of outlays to draw down external debt.

The drop in net assets in foreign currency would have been greater if it had not been for the exchange effect (335 MTD). This effect had no impact on trends in money supply in 2010, given that the relevant amount was recorded in the Issuing Institution's pending accounts.

Net claims on the State marked a 168 MTD drop in 2010, compared to a 953 MTD increase a year earlier. Their evolution was still marked by the high level of the outstanding balance of Treasury bonds in bank portfolio, which after growing substantially in 2009 (+488 MTD) fell by 115 MTD in 2010. In effect, the Treasury did not find it opportune to raise funds on the domestic market, considering the flush state of its cash position on the one hand and, on the other, the high rates proposed by economic agents.

## SECTION 2 - LIQUIDITY AND MONETARY POLICY OPERATIONS IN 2010<sup>1</sup>

The strong cash position at banks that characterised 2009 continued in the early months of 2010, leading the Central Bank to tighten its monetary policy. In effect, after experiencing a high increase in 2009, the surplus in liquidity was contracted in 2010, leading to a tighter cash position at banks. This trend was caused mainly by an increase in banknotes and coins in circulation (569 MTD) and a drop in the net balance of public administration (108 MTD), the restrictive effect of which was somewhat mitigated by the expansive effect of net assets abroad.

<sup>1</sup> This analysis is made on the basis of the database, expressed in terms of averages.