

Mr. President of the Republic,

I have the honour of presenting to you the fiftieth annual report of the Central Bank of Tunisia, which analyses the main economic and financial developments on both the international and national scenes and presents the Bank's financial statements and results for the 2008 financial year.

Mr. President,

The year 2008 commemorates the 50th anniversary of the founding of the Central Bank of Tunisia, an event that was notably marked by setting up of a money museum and of a centre for financial and monetary studies as well as organisation of an international symposium on the theme «central banks and new challenges», with the participation of the Governors of the central banks of most Arab and Mediterranean countries.

The celebration of this 50th anniversary has, under your auspices, provided an opportunity for assessing achievements relating to our country's monetary and financial sovereignty and consolidating the foundations of our economy.

These achievements have since the new era began on 7 November 1987 been considerable, leading to deep-seated change, and continued to improve thanks to the reforms you have enhanced and to development policy that has a global outlook. This has led to modernisation of the national economy, improved living standards, and Tunisia's ascension to the ranks of emerging countries confidently on the road to joining advanced nations.

Mr. President,

The past year has been marked at the international level by the worsening financial and economic crisis that shook the very foundations of the financial system and confounded the world economy.

In effect, starting the summer of 2007, a severe financial crisis broke out in the United States, spawned by high risk subprime mortgage loans and leading to bankruptcy at major financial institutions, especially those highly implicated in financing of the real estate sector that made excessive use of operations to securitize receivables.

By the end of 2008 the financial crisis had spread to an unprecedented extent, affecting the financial markets of other developed as well as emerging and developing markets. The crisis became a worldwide phenomenon that adversely affected all sectors, representing a serious threat to the world economic and financial system and constituting the most serious crisis since the 1930s.

Thus, there was a drying up of liquidity, tightening of credit, higher margins and dysfunctions on monetary and financial markets, which shook confidence in the world banking and financial system and which very nearly resulted in a global systemic crisis.

Stock markets throughout the world were greatly disrupted and there was an overall drop in indexes, bringing about the loss of more than a third of worldwide capitalisation.

These developments had repercussions on foreign exchange markets, which in turn experienced high volatility. The US dollar appreciated significantly over the second half of 2008, after dropping sharply to a low of \$1.60 to the euro. Facing this situation, monetary authorities and governments, especially in advanced countries, rushed to intervene both individually and collectively, injecting massive amounts of liquidity in the financial system, lowering interest rates, buying high risk assets, widening the field for guaranteeing banking deposits and loans, and contributing massively to recapitalisation at banks. These first-time-ever measures constituted a precedent in liberal economic policies.

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It was in this context that a common decision was taken on 8 October 2008 by six major central banks (including the US Federal Reserve, the European Central Bank, and the Bank of England) to lower their key rate by 50 base points. There was further easing of monetary policy, bringing key rates at the end of 2008 to previously unknown levels of between 0 and 0.25% in the United States, 2.5% in the euro zone, and 0.10% in Japan.

But despite their importance, these measures were not enough to restore calm on financial markets and investor confidence. On the contrary, the crisis spread to the real economy, leading to recession in industrialised countries starting the third quarter of 2008. This made it necessary to introduce widespread economic recovery programmes in order to prop up financial systems and boost the economy.

Thus the world economy experienced net slower growth in 2008, coming to just 3.2% (vs. 5.2% in 2007), the pace of world trade was down and foreign direct investment flows fell significantly, with overall volume dropping by some 15% compared to 2007.

Public finance also deteriorated considerably, especially in developed countries. In effect, compared to 2007, the budget deficit came to 6.1% of GDP in the United States (vs. 2.9%), 1.8% in the euro zone (vs. 0.7%) and 5.6% in Japan (vs. 2.5%).

As for inflation, there were two contrasting phases in 2008. In the first half of 2008 inflationary pressure rose under the influence of higher commodity prices, while in the second half there was a downward trend, which generated real fears that the world economy would enter a period of deflation.

Given these various developments, after a period in which a restrictive approach was in general applied to counter inflationary pressure, monetary policy in most developed countries was marked by an expansionary approach.

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*Economic recession which hit advanced countries and slowing activity in emerging and developing countries meant higher unemployment and worsening social conditions throughout the world. The unemployment rate in the United States shot up to 5.8% of the working population (compared to 4.6% a year earlier) and rose from 7.5% to 7.6% in the euro zone, although the **impact of the crisis on economic activity and employment was only just beginning to be felt. Analysis of trends in the financial and economic crisis yields a number of findings.***

The first is that the financial crisis began in the wake of policy favouring expansion of credit that neglected to take into consideration the extent of risk and the solvency of borrowers. Besides, the spread of these risks worldwide occurred through complex financial instruments and virtual dissociation between the real economy and the financial economy, which uses a wide range of unsupervised instruments with no direct link to productive sectors.

The second finding concerns the limited role of national regulatory authorities and rating agencies in the area of supervision, oversight and assessment of derivative financial products and securitization operations, as well as the carrying out of a large number of financial operations outside organised markets that do not provide even a minimum of transparency.

*The third finding is that **the risks inherent in transactions on a given financial market are no longer limited (because of market globalisation) to that market's financial economy, but rather spread to various financial centres and the real economy, thereby accentuating the risk of systemic crises and constituting a threat to the real economy overall and to the fruit of long years of costly structural reforms, especially in emerging and developing countries.***

Speculative operations, which feed on conjunctural bubbles on financial markets, also convey enormous risks that threaten market stability.

This situation puts pressure on the international community to implement decisions already made regarding an effective regulatory and oversight system that uses regulatory, operational mechanisms capable of guaranteeing transparency and security on financial markets and the required level of balance between free circulation of capital and creation of innovative financial instruments on the one hand and protecting the economic activity from the impact of dangerous financial aberrations on the other.

*And although the international community has established financial facilities in order to support many of the emerging and developing countries that encountered difficulty after liquidity dried up and to increase resources at the International Monetary Fund (thus enabling IMF to help these countries recover economically), **many countries -including advanced economies- adopted conservation measures of a protectionist nature in the fields of foreign trade, foreign direct investment, and exchange rate policy.***

Mr. President,

Experience with financial markets acquired since 1994 and close monitoring of trends on these markets have helped Tunisia become one of the first countries to realise how serious the situation was, starting with the first signs of trouble. It was in this context that you decided at the end of 2007 to set up a watch-over unit at the Central Bank of Tunisia. This unit is mandated to follow up trends on international financial markets and possible effects of the crisis on the national economy. This will help to be ready for change and to make timely decisions about the measures that need to be taken.

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It was also in this context, following a deepening of the crisis and its spread to the real economy that you arranged for the setting up of a national commission grouping the various relevant parties. In line with your directives, three series of measures have been taken, on the basis of evolving conditions.

The first series of measures was taken in early 2008 to maintain the security of foreign currency reserves by using the safest possible investment instruments, thus protecting the banking and financial systems from the effects of the crisis ; guarantee normal operation on the money market and avoid mobilisation of resources on the international financial market, restricting thus financing to the domestic market, while using in the best possible manner funding already secured via external lines of credit.

As the crisis grew worse and spread to the real economy, a second set of measures was taken toward the end of 2008. Implemented from the start of 2009, these measures were both conjunctural (to support exporting companies suffering from lower demand from abroad) and structural (to boost the competitiveness of Tunisia's economy and to improve the business environment).

As the crisis continued and affected certain export sectors, a third series of measures was taken in the first half of 2009. These measures concerned the extension of deadlines for taking advantage of previous decisions pertaining to support for exporting companies, while introducing more flexibility and launching additional programmes to boost economic activity by increasing public initiatives in the fields of infrastructure and collective facilities and by supporting employment programmes.

In support of conjunctural measures introduced by the State and in order to meet corporate financing needs and thereby help them stand up to difficult international conditions, the Central Bank (thanks to an easing of inflationary pressure at the

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beginning of 2009), reduced its key rate by 75 base points and introduced new facilities for banks, seeking to make the money market more dynamic and to provide the conditions that can help boost economic activity at businesses and for private individuals.

It appears that these measures do indeed complement each other and facilitate interaction between components, acting to attenuate the effects of the crisis and guarantee a minimum level of growth, tapping all potential in the framework of the realistic approach that has always characterised Tunisia's development policy.

Mr. President,

Despite the extent of this crisis, 2008 was marked by economic activity at the national level that continues to grow at a satisfactory pace while maintaining financial balances. These results were made possible by a combination of two essential factors. The first was monitoring of economic and financial trends on the international scene and the ability to counter any adverse effects on Tunisia's economy by taking the right decisions in a timely manner. The second factor involves the process of global, phased-in reforms to develop production sectors, improve the business environment, and boost the competitiveness of the national economy while maintaining financial balance.

Thus Tunisia managed to post a growth rate of 4.6% in 2008, thanks to dynamic market services (especially communications, transport and tourism), while the industrial sector posted somewhat slower growth, mainly in mechanical/electrical and textile/clothing industries and energy/mining.

At the same time, thanks to the ongoing brisk pace of reforms (especially to improve the business environment, encourage private initiative and create new businesses), the volume of investment rose by 14.8%, reaching 24.9% of GDP.

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In this context, regional conferences on investment and financing (which now constitute a major instrument in the strategy to boost investment) continued to be held in 2008, helping 353 initiatives to start activity or to be set up, representing global investment of more than 380 MTD, and potentially providing some 10,000 jobs.

Through these conferences, the banking sector has once again affirmed its commitment to the national priority of boosting investment in regions throughout the country. The extension, at your initiative, of the network of branches for the bank to finance small and medium-sized businesses (BFPME), doubling of its capital and introduction of greater harmony in its interventions and those of SOTUGAR will help give new life to investment in the regions. Similarly, efforts will continue to enhance the capacity of banks to assess initiatives and to tap all available financing mechanisms, notably leasing and venture capital.

Foreign direct investment went up considerably, increasing by some 64% in 2008 to 3400 MTD. Most sectors benefited from FDI, but especially energy, manufacturing industries, and services. Financially, 2008 was marked by ongoing efforts to maintain domestic and external balances, despite pressure from unstable international conditions.

Efforts to boost national savings yielded a volume of 11.7 billion dinars, 23.3% of GNDI, which helped provide adequate financing to the economy. As for external payments, trade enjoyed sustained growth, partially due to a sharp increase in commodity prices and widening of the trade deficit, with the current deficit rising from 2.6% of GDP in 2007 to 4.2% in 2008. But this deficit was covered in a judicious manner by major foreign direct investment flows.

The general balance of payments yielded a high surplus of 2,053 MTD, which helped boost foreign currency reserves to

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11,656 MTD, up from 9,582 MTD at the end of 2007. Indicators of external indebtedness also improved.

On the monetary front, the interbank market showed strong activity in 2008 thanks to abundant liquidity, mainly because of the higher level of foreign currency holdings and notable growth (some 13.5%) in financing of the economy. Money supply (M3) had risen by 14.4% by the end of 2008.

In this context, in order to keep inflationary pressure down, the Central Bank of Tunisia increased the reserve requirement rate on two occasions in 2008, while ensuring closer monitoring of conditions on the money market and making the moves needed to regulate liquidity, which gradually helped to control inflation.

At the same time, efforts continued to develop the instruments of monetary policy and prepare the technical conditions required to move to the stage of targeting inflation.

As for public finance, State core funds went up by 19.8% in 2008 (vs. 6.7% for expenditure), which brought the budget deficit down from 2.9% of GDP in 2007 to 1.2% in 2008, despite a major hike in outlays by the general equalization Fund and fuel subsidies. In effect, reform of the tax system and rationalisation of public expenditure helped to considerably improve public finance indicators and, in particular, reduce the rate of indebtedness from 50% of GDP in 2007 to 47.5% in 2008.

These results provide a margin of manoeuvre that can be used to boost State intervention, strengthen economic recovery programmes, and quicken the pace of public investment in large scale initiatives, especially in inland areas of the country, so as to lessen the impact of the world financial crisis and check higher unemployment.

Mr. President,

Thanks to the attention that you have always given to the banking system, it continued in 2008 to play a leading role in promoting investment and the economy and boosting activity, contributing to better financial indicators and better quality services. In the area of financing, the outstanding balance of financing to the economy came to about 32.6 billion dinars at the end of 2008, an increase of 13.5% over the 2007 figure.

Banks too continued efforts to boost their financial bases. Core funds came to 3.9 billion dinars, an increase of 12.6%, bringing the index for coverage of risk to 11.7%.

In the area of quality of the loan portfolio, banks increased efforts to manage risk, dynamically handle non performing loans, and constitute the required level of provisions, bringing the share of non performing loans to 15.5% (down from 17.6% in 2007) and the ratio of coverage of these claims by provisions to 56.8%. These efforts had a favourable impact on financial results at banks, with net proceeds up by 13.3% in 2008, bringing the profitability of their core funds to 11.2%.

Mr. President,

The world financial crisis has shown just how right Tunisia's choices have been and how appropriate its financial policies, with the banking system able to maintain sound performance and security, protected from fallout from the crisis. In effect, contrary to dysfunctions on the money markets of industrialised countries which led to loss of confidence in financial institutions, Tunisia's money market enjoyed sustained activity and banks continued to finance the economy at a higher pace than the previous decade. Tunisia's financial market continued to benefit from the confidence of operators and investors, thanks to sound bases and concerted efforts, which helped avoid the serious disruption felt on most financial markets and to soundly manage

withdrawal of a few foreign funds seeking liquidity as the crisis grew. Overall, satisfactory results were posted for the year as a whole.

*In the framework of international initiatives to strengthen the bases and supervisory mechanisms of financial institutions and instruments and to set up **structures in charge of coordination and supervision of all components in the financial sector and related fields** such as rating, accounting and audit, it has become indispensable to envisage establishment of a mechanism that can guarantee ongoing financial stability while also giving due importance to the global dimension of oversight and monitoring, so as to determine the best possible transmission channels between the financial economy and the real economy, develop advanced indicators capable of anticipating economic fluctuations, and introduce the right preventive mechanisms. It was in the framework of these orientations (recognised as pertinent worldwide) that a financial and monetary research and studies Centre was set up at your instigation, available to Tunisia's experts specialised in issues relating to financial and monetary stability.*

The pertinent choices made by Tunisia have helped achieve ongoing progress in the reform process in a serene and determined manner, without having to introduce the various protectionist measures behind which many economies have taken refuge, and to persevere along the road to external economic and financial liberalization, providing the Tunisian financial system with the prior conditions that will lead to ranking as a regional hub.

It is in the framework of this orientation that you made the decision to establish offshore financial service mechanism capable of attracting well-known financial institutions, thanks to the platform provided by this mechanism in the area of best

practices for international financial markets, guarantees to investors, and enviable repute for the Tunis stock market.

Mr. President,

Under pressure from the world financial crisis, most industrialised countries have had to adopt costly programmes to save their financial sectors and boost economic activity. This has adversely affected their margin for manoeuvre on the monetary front and that of public finance, potentially contributing to major unbalances that could be detrimental in the future.

*The drop in commodity prices under the influence of lower world demand should not obscure upward trends in these prices over the medium and long terms, and thus the possibility that inflationary pressure could occur once again. **Such perspectives should therefore be taken into consideration, given the risk of backlash they could convey on the world economy and international financial markets in the coming years.***

In this context, it is important to pay attention to the proper implementation of the conjunctural and structural measures that you have identified to help businesses and boost economic activity, supporting them if necessary by means of additional measures, while remaining vigilant and attentive to changes in international economic conditions and by ensuring the optimal use of various sources of growth so as to boost economic resilience in a context of crises and external shocks. To this end, the national dialogue on higher productivity that you have instituted will undoubtedly enrich programmes and action plans so as to prepare for the post-crisis period, strengthen the soundness of the national economy and boost the development process in our country.

The opening of the national economy to the world around it requires ongoing vigilance about the actions to be undertaken to face up to changing economic conditions and the best use of Tunisia's comparative advantages, in order to draw the greatest profit from eventual recovery of the world economy. The challenge is to prepare in an appropriate manner for the post-crisis period, to get back as quickly as possible to the brisker economic activity required if Tunisia is to achieve its goals for growth and employment.

The Governor

Taoufik BACCAR