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IMF Executive Board Concludes 2008 Article IV Consultation with Tunisia

On August 6, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Tunisia.¹

Background

Tunisia's sound economic policies and pragmatic approach to structural reforms continue to bear fruit, as evidenced by strong growth and improved social indicators. Real GDP growth averaged 5 percent a year while the macroeconomic and financial position strengthened substantially during the past decade.

Tunisia has so far weathered relatively well the difficult international environment. Real GDP growth increased from 5.5 percent in 2006 to 6.3 percent in 2007—a record over the last decade—underpinned by strong performance of agriculture, energy, manufacturing and the services sectors. On the demand side, vigorous exports and investment powered the growth acceleration. Inflation has picked up, due mainly to rising international fuel and food prices and, to a lesser extent, growing liquidity in the banking system reflecting increasing foreign direct investment (FDI). Year-on-year inflation reached 6 percent in April 2008 before pulling back to 4.9 percent in June 2008. The Central Bank of Tunisia (BCT) responded by tightening monetary policy starting in the second half of 2007.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

The fiscal deficit was kept within the 2007 budget target of 3 percent of GDP. Revenue exceeded expectations owing mainly to stronger oil revenue—notably from oil companies' higher profits due to surging oil prices and increased domestic production. The additional revenue offset expenditure overruns mainly caused by rising direct food and fuel subsidies. Continued fiscal consolidation and privatization receipts further reduced public debt-to-GDP ratio to about 51 percent at end-2007.

The current account deficit widened due to declining terms of trade, but the significant increase in FDI inflows increased reserves to over \$8½ billion, largely sufficient to cover short-term liabilities.

Bank performance improved significantly in 2007, including banking activity, profitability, and prudential indicators. The ratio of nonperforming loans (NPLs) to total loans declined from 24 percent in 2003 to 17.3 percent in 2007, largely accounted for by the proactive management of such claims, while the provisions-to-NPLs ratio increased from 43.1 percent to 53.8 percent.

The short-term outlook is encouraging despite the challenging international environment. In 2008, real GDP growth is projected to decelerate moderately to 5.5 percent. Inflation would remain around 5 percent if international prices taper off and monetary policy continues to be restrictive. High fuel and food prices are expected to widen the current account deficit to 3.5 percent of GDP. The fiscal deficit is projected to remain at 3 percent of GDP, owing to buoyant revenue, notably from the hydrocarbon sector. The medium-term outlook remains favorable with growth projected at above 6 percent sustained by strong FDI. Risks to the outlook are essentially related to the international environment.

Executive Board Assessment

Directors commended the authorities for the notable resilience and continued strong performance of the Tunisian economy, which has been founded on prudent and forward-looking economic policies and market-oriented structural reforms. The outlook remains favorable, with buoyant FDI supporting growth, although there are downside risks related mostly to the global economic turbulence. Directors considered that the key immediate challenge confronting the authorities will be to address the pressures arising from the global food and fuel price increases while maintaining macroeconomic sustainability. Over the medium term, employment creation and income growth will be key to improving economic welfare in Tunisia.

Directors commended the authorities' commitment to fiscal prudence, which will remain essential for lowering the public debt. They endorsed the authorities' decision to contain the fiscal deficit within the 2008 budget target, which will require tight control over current spending and likely additional adjustments to domestic petroleum prices. They noted that buoyant fiscal revenues, particularly from the hydrocarbon sector, have accommodated the gradual pass-through of international oil and food price increases to domestic prices under the current subsidy system. Directors noted, however, that the current subsidy system is not sustainable, and suggested its replacement with a targeted safety net for the most vulnerable groups that would better support medium-term fiscal sustainability, reduce the country's vulnerability to shocks, and create the fiscal space for additional social and infrastructure expenditures. In this context, they welcomed the authorities' intention in the XIth Plan to phase out subsidies for petroleum products by 2011 and to ensure better control of expenditures for food subsidies.

Directors supported the restrictive monetary stance of the BCT. They recommended that the authorities stand ready to increase the BCT's key policy interest rate if inflationary pressures intensify, given that growth still has significant momentum. They supported the BCT's efforts to manage persistent excess liquidity in the financial system, and to continue to build an inflation-targeting framework for monetary policy.

Directors considered that the exchange rate of the Tunisian dinar is broadly aligned with fundamentals and that the authorities' policies are consistent with external stability. Some Directors saw merit in an accelerated transition toward the authorities' commendable objectives of a floating exchange rate and an inflation-targeting framework.

Directors welcomed the continued strengthening of the banking sector's performance, with greater profitability, a decline in nonperforming loans, and improved loan-loss provisioning. Further strengthening of the banking sector should remain a high priority as the authorities continue to gradually open up the capital account. They welcomed the potential growth and employment benefits of the large FDI-financed projects, but counseled prudence with respect to real estate projects in particular, which may create a credit risk for the banking sector and contingent liabilities for the government. Directors supported the authorities' objective of implementing the Basel II system by end-2009 and achieving full compliance with international AML/CFT standards over the medium term.

Directors welcomed the steps being taken by the authorities to deepen the global and regional integration of the Tunisian economy. They praised the authorities for their pragmatic approach to trade and financial integration, and noted the recent important milestone of achieving bilateral free trade in industrial goods with the European Union. They looked forward to further simplification and reduction of tariffs on a most-favored-nation basis.

Directors welcomed the steps aimed at further improving the business climate. They looked forward to further progress in liberalizing the services sector and reforming the tax and customs administration, in order to promote domestic and foreign investment.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Table 1. Tunisia: Selected Economic Indicators, 2003–08
 (Quota: SDR 286.5 million)
 (Population: 10.2 million; 2007)
 (Per capita GDP: \$3,594; 2007)
 (Poverty rate: 3.8 percent; 2005)
 (Main export: textiles, electronic and mechanical goods, energy, tourism; 2007)

	2003	2004	2005	2006	2007 Prel.	2008 Proj.
Output and Prices	(Annual percentage change)					
Real GDP (market price)	5.6	6.0	4.0	5.5	6.3	5.5
Consumer prices (end of period)	4.5	1.2	3.7	3.3	5.3	4.7
Consumer prices (period average)	2.7	3.6	2.0	4.5	3.1	5.1
Investment and Saving	(In percent of GDP)					
Gross capital formation	25.0	24.5	22.0	24.1	25.1	25.1
<i>Of which: Nongovernment 1/</i>	17.8	17.5	15.6	17.9	19.1	18.8
Gross national savings	22.1	22.5	20.8	22.1	22.4	21.6
<i>Of which: Nongovernment 1/</i>	18.0	18.0	17.5	18.9	19.5	18.1
Public Finances 2/	(In percent of GDP)					
Revenue, excluding grants and privatization	23.7	23.8	23.6	23.8	24.2	24.6
Expenditure and net lending	27.1	26.6	26.9	26.6	27.2	27.6
Budget balance, excluding grants and privatization	-3.4	-2.8	-3.2	-2.9	-3.0	-3.0
Primary balance, excluding grants and privatization	-0.6	0.0	-0.4	-0.1	-0.3	-0.5
Total government debt	60.5	59.4	58.3	53.9	50.9	47.0
Monetary Sector	(Annual percentage change, unless otherwise indicated)					
Credit to the economy	4.6	5.3	6.3	6.6	9.6	8.5
Base money	5.5	12.2	21.9	17.6	15.3	19.7
Broad money	6.3	10.3	11.0	11.4	12.5	10.5
Velocity of broad money	1.7	1.6	1.6	1.6	1.5	1.5
Three-month treasury bill rate (period average, in percent) 3/	5.5	5.1	5.1	5.1	5.1	5.1
External Sector	(In percent of GDP, unless otherwise indicated)					
Exports of goods (in \$, percentage change)	17.1	20.7	8.3	9.7	30.4	29.9
Imports of goods (in \$, percentage change)	14.7	17.6	2.9	12.7	28.0	29.1
Merchandise trade balance	-9.1	-8.6	-6.8	-8.2	-8.4	-9.4
Current account excluding official transfers	-2.9	-1.9	-1.1	-2.0	-2.6	-3.5
Current account including official transfers	-2.7	-1.6	-0.7	-1.5	-2.2	-3.3
Foreign direct investment 4/	2.1	2.1	2.6	3.1	4.2	4.6
Total external debt	66.8	66.5	65.4	58.3	54.9	51.8
Gross reserves (in billions of dollars) 5/	3.0	4.0	4.4	6.8	7.9	8.9
In months of next year imports of goods and services	2.5	3.1	3.3	4.0	3.5	3.6
In percent of short-term external debt (on remaining maturity basis)	61.8	82.2	88.3	137.1	137.7	133.9
Memorandum Items:						
Nominal GDP (in \$ billions)	26.6	29.3	27.6	31.8	36.7	40.2
Unemployment rate (in percent)	14.3	13.9	14.2	14.3	14.1	14.0
Net imports of petroleum products (in millions of dollars)	328.8	399.0	393.4	632.1	-106.3	108.9
Local currency per dollar (period average)	1.3	1.2	1.3	1.3	1.3	...
Real effective exchange rate (annual average, percentage change)	-5.0	-3.5	-4.6	-0.8	-2.9	...
Stock market index 6/	1,250.2	1,331.8	1,615.1	2,331.1	2,614.1	3,075.4

Sources: Tunisian authorities and Fund staff estimates.

1/ Includes public enterprises.

2/ the fiscal year is the calendar year.

3/ In 2008, average for the first four months.

4/ in 2006, excludes receipts from the privatization of Tunisie Télécom, of about \$2.2 billions.

5/ in 2006 includes receipts from the privatization of Tunisie Télécom.

6/ TUNINDEX (1000=4/1/1998). The 2008 data as of August 8, 2008.