TUNISIA

Highlights

- **Growth remained weak in 2016 but has picked up in 2017.** GDP grew by just 1 per cent in 2016 and, coupled with policy slippages, this caused the fiscal deficit to widen to 6.1 per cent of GDP and the debt to increase to 61.9 per cent of GDP.
- **The dinar has depreciated sharply.** The most volatile episodes occurred between July and November 2016 (around 10 per cent depreciation) and in May 2017 (12.8 per cent drop), when the interbank market froze due to political uncertainties and strong demand for foreign exchange for energy importers. The depreciation resulted in rising inflationary pressures, higher debt and a widening in the trade deficit.
- **Structural reform performance has improved.** The authorities have: made important progress in restructuring public banks; adopted a new tax strategy; established the Large Taxpayers Unit; adopted a revised strategy to reform the civil service; published the implementation decrees relating to the laws on competition, public-private partnerships (PPPs) and the investment code; and continued with energy subsidy reforms.

Key priorities for 2018

- **Outstanding legislative reforms should be adopted.** These include the laws on lending rates, bank inspections, and the organic budget law; performance contracts for the five largest state-owned enterprises; the functional reviews of key ministries; the creation of the high anti-corruption authority; and the compilation of the databank on vulnerable households.
- **Removing the discrimination against public banks in managing non-performing loan (NPL) portfolios should be a priority.** The recent restructuring plans of public banks now hinge on these banks improving their ability to resolve their legacy NPLs. And the required legislative changes need to be implemented swiftly, as high NPLs contribute to inadequate access to finance.
- **Sound macroeconomic, fiscal and monetary policies should be implemented to complement progress on structural reforms.** Contractionary monetary policies should be taken to support the depreciating dinar and mitigate rising inflation. The removal of entrepreneurship constraints, a more competitive business environment for exporting firms, and import-substitution should be implemented to create jobs at home, and growth-enhancing and social spending should be prioritised, especially within a limited fiscal space.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	2.3	2.3	1.1	1.0	2.2
Inflation (average)	5.8	4.9	4.9	3.7	4.5
Government balance/GDP	-6.9	-5.0	-4.8	-6.1	-5.9
Current account balance/GDP	-8.4	-9.1	-8.9	-8.8	-8.7
Net FDI/GDP [neg. sign = inflows]	-2.3	-2.2	-2.2	-1.7	-2.5
External debt/GDP	58.8	63.7	68.5	74.7	n.a.
Gross reserves/GDP	16.9	17.6	17.8	15.4	n.a.
Credit to private sector/GDP	68.1	69.3	70.1	72.2	n.a.

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Macroeconomic performance

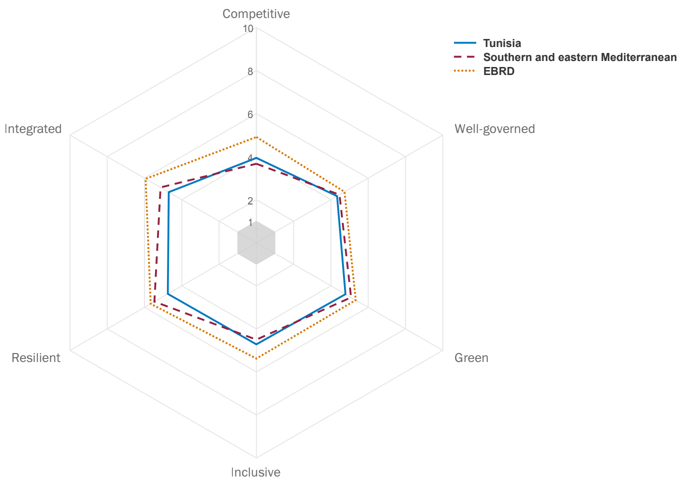
Growth remained weak in 2016. The rate of GDP growth declined slightly to 1.0 per cent from 1.1 per cent in 2015, driven by contractions in mining and agriculture, and slow growth in manufacturing and tourism. However, growth picked up to 1.9 per cent year-on-year in the first half of 2017, supported by a rebound in agriculture, and strong growth in tourism and phosphates production. Unemployment remained elevated at 15.3 per cent in the second quarter of 2017, with youth and female unemployment rates running at double this level.

The fiscal situation worsened in 2016. Lower-than-expected growth and policy slippages caused the fiscal deficit to widen to 6.1 per cent of GDP in 2016 from 4.8 per cent of GDP in 2015. The shortfall in revenues was due also to weaknesses in revenue collection. Meanwhile, the public sector wage bill grew to 14.6 per cent of GDP in 2016 from 13.7 per cent in 2015, among the highest in the world. As a result of the higher deficit, the dinar's depreciation and a reclassification of post office deposits as central government debt, public debt stood at 61.9 per cent of GDP at the end of 2016, up from 55.4 per cent in 2015, with most of it foreign debt.

The external position remained broadly unchanged but reserves are at low levels. The current account deficit was 8.8 per cent of GDP in 2016, almost the same as 2015, as the decrease in exports and current receipts was offset by lower imports of goods. Foreign direct investment declined to 1.7 per cent of GDP in 2016, the lowest since 2011. Meanwhile, a worsening trade deficit eroded gross international reserves, which declined to US$ 5.8 billion at the end of August 2017, covering only 3.3 months of imports.

Growth will recover gradually. Growth is expected to rise in 2017 to 2.2 per cent, but the still-modest rate reflects delays in implementing structural reforms and low private investment. The impact of tax revenue rises and monetary tightening would be mitigated through the recovery of phosphates and tourism, higher public investment and wage increases. Sizeable risks remain; on the domestic side, the fragile socio-political environment, especially in the run-up to the local elections in December 2017, may adversely affect confidence and possibly delay reforms. On the external front, continued conflict in neighbouring Libya and the wider region could affect Tunisia through immigration flows, confidence shocks and weaker social cohesion.

Assessment of transition qualities (1-10)



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Major structural reform developments

The authorities have made important progress in restructuring public banks. Following the recapitalisation in 2015 and management changes in 2016 of the three public banks, performance contracts were completed in early 2017. These developments constitute a major step in strengthening the resilience of the financial sector and improving credit availability in the economy. Meanwhile, the viability of the banks' restructuring plans now hinges on these banks improving their ability to resolve their legacy NPLs, but the required legislative changes are seriously delayed.

The authorities have finalised the first implementation decrees of the banking law. The law, adopted in 2016, fell short of good international practices, mainly on the resolution framework, due to constraints of the guarantee fund to finance transactions, creditor hierarchy in liquidation, and government presence in the resolution committee. Secondary legislation was approved in August 2016 to address some of the weaknesses in the banking law regarding the bank resolution framework. Key measures include the adoption of a government decree to implement the framework of the Bank Deposit Guarantee Fund that includes a least cost-test for resolution (with an exception for systemic cases), and adoption of a bylaw of the Resolution Committee providing a short time-frame to determine resolution measures for systemic cases to achieve financial sector stability.

Major fiscal reforms were completed. The Council of Ministers adopted in early May 2016 a strategy to broaden the VAT base by reducing exemptions; rationalising VAT rates (from three to two); introducing a more progressive personal income tax, including through fewer deductions and a significantly higher tax threshold; reducing further the dichotomy between the offshore and onshore corporate tax rates by 2018; and increasing the tax on dividends. The strategy was presented in May 2017 to the signatories of the Pacte de Carthage, the government's road map for the timely prioritisation of reforms signed by nine parties, the Tunisian Confederation of Industry, Trade, and Handicrafts (UTICA), the Tunisian General Labour Union (UGTT) and the Tunisian Union of Agriculture and Fisheries (UTAP). The authorities have also adopted the decree for the establishment of a modern Large Taxpayers Unit (LTU) that assumes formal responsibility for the major tax and enforcement functions, as well as setting up an implementation timetable that will be guided and monitored by a task force.

The government has adopted a revised strategy to reform the civil service. This strategy, adopted in April 2017, aims to improve the provision of public services and reduce the civil service wage bill to about 12 per cent of GDP in 2020. The strategy mandates no further wage increases unless economic growth substantially exceeds the baseline projections and unless the wage bill reduction path can be maintained as envisaged. It also contains a restrictive recruitment policy that will enforce a limited replacement rate for departing employees, and voluntary departure programmes, which would mainly rely on negotiated departures rather than early retirements.

Business environment reforms are being implemented. In September 2016 the authorities published the implementation decrees relating to the laws on competition, PPPs and the investment code. The new investment law, adopted by the parliament in September 2016, provides more clarity to the investment framework, including equal treatment of domestic and foreign investors and the separation between fiscal and financial incentives in line with international best practices. Parliament also adopted the law on whistleblowers in April 2017, enabling the creation of a legal framework underpinning the civic duty to report wrongdoing.

The authorities continued with energy subsidy reforms. The government increased administered fuel prices in July 2017 to reduce inefficient energy subsidies. It also applied the automatic adjustment mechanism (monthly) for the three main fuels starting in July, and revised electricity tariffs in the 2017 budget to include an increase in the prices of electricity (5 per cent) and gas (7 per cent), while keeping the social tariffs unchanged.

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Important reforms are delayed. Despite the inspections of five banks being completed in May 2017, inspections for two other banks were delayed, essentially due to a lack of staff within banking supervision. The signature of performance contracts for the five public enterprises (Tunisair, the electricity and gas companies STEG and STIR, the Office des Céréales, and the national Régie des Tabacs) is also delayed, with work at an advanced stage for four of them and an interim contract signed for Tunisair. Following the government's request, delayed parliamentary discussions on the Organic Budget Law, the law creating the high anti-corruption authority, and the law on the excessive lending rate will be accelerated, after which they will be published in the official gazette.