TUNISIA

Highlights

- **Growth is slowly picking up.** The economy grew 2.7 per cent in the first half of 2018, up nearly a percentage point on 2017 growth, on the back of agriculture, agribusiness, food production, manufacturing, in addition to tourism and financial services.
- **Inflation has reached its highest level in decades.** In mid-2018, inflation reached 7.8 per cent, the highest level in more than 26 years, because of the depreciation in the dinar, the VAT rate increase in January 2018, and several rounds of subsidy removals.
- **Some reforms have passed amid domestic tensions.** The law to allow public banks to write off non-performing loans (NPLs) was passed and the Tunisia Investment Authority and the Strategic Investment Council were formed, but other key reforms have been delayed.

Key priorities for 2019

- **Increasing the employability of the youth is essential.** There is a need to create a better link between education and vocational training and the skills needed by employers. Moreover, policies are needed to encourage women to increase their participation in the labour market.
- **Further economic reforms should be prioritised.** The authorities should focus on modernising monetary policy, completing energy subsidy reforms, introducing anti-corruption mechanisms, and completing a census on the vulnerable segments of society to improve targeted social safety nets.
- **The business environment for the private sector needs to improve.** Top priorities to encourage private sector activity and job creation include accelerating the opening of the renewable energy sector to the private sector, developing public-private partnerships (PPPs) for infrastructure, and gradually facilitating access to foreign currencies for Tunisian companies for their internationalisation and expansion.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	2.3	1.1	1.0	1.9	2.8
Inflation (average)	4.9	4.9	3.7	5.3	8.1
Government balance/GDP	-5.0	-4.8	-6.1	-6.1	-5.2
Current account balance/GDP	-9.1	-8.9	-8.8	-10.3	-9.6
Net FDI/GDP [neg. sign = inflows]	-2.2	-2.2	-1.5	-2.0	-2.0
External debt/GDP	63.7	68.5	74.7	83.8	82.6
Gross reserves/GDP	17.6	17.8	15.4	14.2	15.3
Credit to private sector/GDP	69.3	70.1	72.2	74.7	n.a.

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Macroeconomic performance

The economy is picking up in 2018. Real GDP growth accelerated to 2.7 per cent year-on-year in the first half of 2018 from 1.8 per cent in the same period of 2017, the fastest growth since 2014. Growth was driven by the rebound in agriculture, notably olive oil and dates, which reached record highs amid favourable weather conditions. The rebound in agriculture in turn supported agribusiness and food production industries, and consequently manufacturing. Services – mainly tourism and banking – continued to support growth, while non-manufacturing industries contracted, due to a decline in oil and gas extraction, construction and mining. Unemployment remained high at 15.4 per cent in the first quarter of 2018, and higher among women. Due to rapid population growth, GDP per capita has been declining since 2009 by 2.4 per cent per year on average, and the country has been reclassified by the World Bank as a lower middle income country since June 2016.

Inflation has been elevated, necessitating central bank policy tightening. The inflation rate peaked at 7.8 per cent in June, the highest level since 1991, before moderating slightly to 7.5 per cent in July and August. The dinar's depreciation, the VAT rate increase in January 2018, and the increase in prices of certain products (for example, fuel, tobacco and telecommunications) have all contributed to rising prices. As a result, real interest rates have been negative for all but two out of the 19 months since December 2016. In March 2018, the central bank raised its benchmark interest rate by 75 basis points for the first time in almost a year, in an attempt to tame the inflationary pressures. Another rate hike, of an unprecedented 100 basis points, followed in June 2018.

The fiscal deficit remained unchanged in 2017 but the current account deficit has widened. Stronger revenues from corporate income tax, VAT and oil, combined with lower public investment, were offset by lower subsidies and income tax revenue, yielding a fiscal deficit of 6.1 per cent of GDP, the same as in 2016. Meanwhile, public spending on wages remained high at 14.6 per cent of GDP, among the highest ratios in the world. Public debt has continued its upward trend since 2010 and reached 69.9 per cent of GDP in 2017. On the external side, the current account deficit widened to 10.3 per cent of GDP in 2017 from 8.8 per cent of GDP in 2016, the first time the economy has recorded a double-digit deficit since 1984. The widening was led by the increase in imports of goods, despite the pick-up in exports of goods (agricultural, food and energy) and in tourism receipts. Meanwhile, the dinar continued to depreciate in relation to the euro, and as of May 2018, it had lost one-quarter of its value compared with 2016. The expanding current account deficit, exacerbated by the rising international prices of oil and the slowly recovering tourism inflows, has been eroding foreign reserves, which continued to decline, covering less than three months of imports in August 2018.

Growth is expected to increase gradually. GDP is forecast to rise by 2.8 per cent in 2018 and gradually pick up to 3.0 per cent in 2019, driven by a continued recovery in tourism and investment, stronger growth in major export markets in Europe, and the implementation of structural reforms. Risks stem from the 2019 election-related uncertainties and the possibility that socioeconomic protests will disrupt production in the phosphate and hydrocarbon sectors. The depreciation of the dinar and the reintroduction of a mechanism that adjusts fuel prices in line with fluctuations both in currencies and in international oil prices may further raise inflationary pressures. Furthermore, a faster-than-anticipated normalisation of monetary policy in the United States of America could lead to a stronger US dollar and amplify debt vulnerabilities, given that two-thirds of public debt is denominated in foreign currency.

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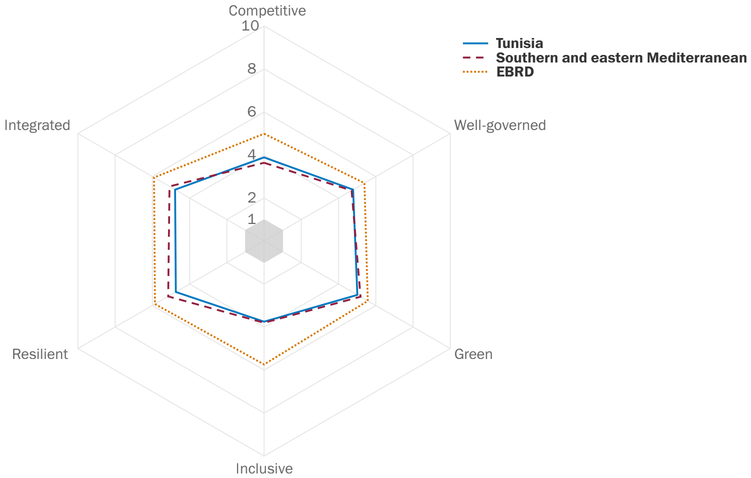
Assessment of transition qualities (1-10)



Major structural reform developments

New fiscal measures are in place. In December 2017, parliament passed the 2018 budget which included a package of fiscal measures to cut the budget deficit. MPs approved new articles, including the enlargement of the 35 per cent corporate tax rate scope to include car dealership activities, shopping centres and franchises. Another article stipulates the simplification of conditions for granting tax benefits in terms of reinvestment of revenues and profits in the subscription of the companies' capital. The 2018 budget also raises customs taxes on some imported products to cut the trade deficit. The parliament approved a rise of 1 percentage point in value-added tax and imposed a new 1 per cent social security tax on employees and firms. Taxes on bank profits will rise from 35 to 40 per cent. The 2018 budget also limited new recruitment into the civil service to graduates of state training schools. Consistent with the civil service reform strategy, hiring will be capped below 3,000 civil servants for 2018.

Foreign investment rules have been liberalised. In June 2018, the government announced that foreign investors would be allowed to acquire property in foreign currency. Tunisia continues to impose restrictions on foreign land and property buying, including a ban on purchasing agricultural land or social housing, but has amended the legislation for foreign investors in order to stimulate investments. The authorities also established a one-stop shop for large investors and adopted a restricted list of eight sectors that remain subject to investment authorisations, while freeing all other sectors from prior approval.

New agencies are being established. During the past year the government established the Tunisian Investment Authority, the Strategic Investment Council and the High Anti-Corruption and Good Governance Authority (HACGGA). The new Investment Law has now entered into force, with the Tunisia Investment Authority close to becoming fully operational. The HACGGA will become functional once its board members are appointed by parliament following consultations among political parties. Moreover, the General Committee on Taxation, Public Accounts and Collections was created in December 2017, tasked with combating tax fraud and smuggling. This committee was set up following the merger between the General Directorate of Taxes and the General Directorate of Public Accounting and Collections.

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Non-performing loans are being tackled. In February 2018 the Council of Ministers passed a new legal framework to facilitate the resolution of non-performing loans (NPLs) in public banks. Parliament voted the new framework into law in May 2018. The law allows public banks to write-off and resolve NPLs in the same way as private banks. Before this amendment, NPLs were disproportionately concentrated in public sector banks, mostly in the tourism industry. As of the end of 2017, NPLs were 13.9 per cent and higher in public banks, which until recently faced legal discrimination in managing NPLs portfolios, thus constraining growth and access to finance.

A new initiative is encouraging entrepreneurship. In April 2018, parliament passed the Start-up Act to incentivise local entrepreneurs to initiate and operate their ventures. As part of the government's 'Digital Tunisia 2020' plan, the new act aims to increase the number of Tunisian start-up companies, primarily in the tech industry, with the aim of boosting innovation and the country's international competitiveness. One of the major advantages of this legislation is the appeal to the youth, thus tackling one of Tunisia's lingering economic problems of youth unemployment.

The government is targeting assistance to vulnerable groups. In January 2018, the government announced a US$ 70 million package for poor and vulnerable families. This support, which became effective in April 2018, includes a 20 per cent increase in the cash transfer amount, as well as an increase in the minimum pensions of retirees.