TUNISIA

Highlights

- **Economic growth significantly weakened.** The tourism sector was severely affected by three deadly attacks in 2015, contributing to a 19 per cent drop in tourist arrivals in May 2016 year-on-year. Ongoing industrial disputes in the mining sector as well as cutbacks in investment by international oil companies, a weak recovery in Europe and increasing social tensions also contributed to the slow-down.
- **The fiscal deficit narrowed slightly but budget composition continued weakening.** The fiscal deficit marginally improved to 4.8 per cent of GDP in 2015 from 5.0 per cent in 2014, helped by lower subsidy spending. However, public debt has been increasing since 2010, and foreign debt is high and increasing.
- **Legislative approval of much-needed structural reforms picked up after a protracted political transition, but implementation has been slow to materialise.** Legislative approval of key reforms accelerated pace, including the new Competition Law, the Law on Public-Private Partnerships (PPPs), the Bankruptcy Law and the Investment Code. However, they have yet to be implemented through decrees. Long-awaited reforms related to public administration, pension and state-owned enterprises, are still pending.

Key priorities for 2017

- **Financial sector vulnerabilities need to be addressed.** A new Central Bank Law and Banking Law were recently passed, and the audit and recapitalisation of the three major state-owned banks were completed; but their restructuring is yet to be performed; toxic assets remain an issue; some dimensions of the Central Bank law fall short of best practices; and non-performing loans (NPLs) are still high.
- **Reforms to address fiscal rigidity and public institution weaknesses are urgently needed.** Public administration needs to be modernised – including the long-awaited reform of the civil service to contain the wages bill – the financial viability of the pension system should be addressed, the restructuring of state-owned enterprises (SOEs) is urgently needed and the adopted tax reform strategy for a more equitable and efficient tax system should be fully implemented.
- **Significant infrastructure and transport sector investments are necessary to support the development of impoverished regions.** A strategy is needed to disentangle operational and regulatory responsibilities in order to attract private capital into these sectors. In this regard, the swift implementation of the adopted law on PPPs to attract private sector participation is key.

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Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	3.9	2.4	2.3	0.8	1.5
Inflation (average)	5.1	5.8	4.9	4.9	3.8
Government balance/GDP	-5.5	-6.9	-5.0	-4.8	-4.5
Current account balance/GDP	-8.3	-8.4	-9.1	-9.0	-8.0
Net FDI/GDP [neg. sign = inflows]	-3.7	-2.6	-2.4	-2.4	-2.3
External debt/GDP	53.3	56.2	56.0	61.5	n.a.
Gross reserves/GDP	19.2	16.6	16.1	17.0	n.a.
Credit to private sector/GDP	76.3	76.9	78.1	79.6	n.a.

Macroeconomic performance

Economic growth fell markedly to just 0.8 per cent in 2015, down from 2.3 per cent in 2014. The tourism sector was severely affected by three deadly attacks – in March, June and November 2015 – resulting in a slump in tourism revenues of 35 per cent over 2015 and a decline in tourist arrivals of 25 per cent. The trend continues as tourist arrivals decreased by 19 per cent in May 2016 year-on-year. Ongoing industrial disputes in the mining sector as well as cutbacks in investment by international oil companies, a weak recovery in Europe and increasing social tensions also contributed to the slow-down. Growth in the first quarter of 2016 only marginally improved to 1 per cent, helped by a pick-up in the phosphate sector and the chemical industry. Agriculture, which helped partially offset the adverse shocks in 2015, saw a decline of 2.5 per cent year-on-year in the first quarter of 2016 owing to low rain levels (an increasing concern for both agriculture and drinkable water). Oil and gas production continued to decline in the first quarter of 2016 by 12.6 per cent – due to industrial action, a decline of older fields and a drop in exploration investment. Unemployment was high at 15.4 per cent as of the end of the first quarter (even higher for women at 22.8 per cent).

The fiscal deficit narrowed slightly in 2015, and Tunisia secured donor support, but the budget composition continued to weaken. The fiscal deficit narrowed somewhat to 4.8 per cent of GDP in 2015, down from 5.0 per cent in 2014 and 6.9 per cent in 2013, helped by lower subsidy spending. Total revenue declined from 25.2 per cent in 2014 to 23.9 per cent of GDP but less than overall expenditure, the latter being driven by a decrease in transfers and subsidies from 7.2 per cent to 5.5 per cent of GDP and also weak implementation of planned capital spending which narrowed to 5.7 per cent of GDP from 5.9 per cent in 2014. Wages and salaries rose further to 13.7 per cent of GDP from 13.0 per cent in 2014. To help finance the 2016 budget, Tunisia has secured donor support from the World Bank (US$ 550 million), the African Development Bank (US$ 500 million), the European Union (US$ 492 million in lending and US$ 96 million in grants), and a bond issue guarantee from the United States (US$ 500 million) to access international markets. In addition, the International Monetary Fund (IMF) approved in May 2016 a four-year US$ 2.9 billion loan under the Extended Fund Facility (EFF) with Tunisia to support the economic and financial reform programme of the country, aimed at promoting more inclusive growth and job creation. Total public debt, at 53.9 per cent of GDP as of the end of 2015, has been increasing since 2010, and foreign debt is high and increasing (65.0 per cent of total public debt as of the end of 2015).

External imbalances remain high. The current account deficit stood at 9.0 per cent of GDP in 2015, compared with 9.1 per cent of GDP in 2014. While Tunisia's balance of payments have benefited from low oil prices as a net oil importer, export performance has been lacklustre due to weak demand in Europe, while tourism receipts have fallen sharply. Exports remain under pressure, while tourist receipts declined sharply in the first quarter of 2016 by 50.6 per cent year-on-year. Gross international reserves remain above the three-months of import cover critical threshold despite external pressures, at US$ 5.9 billion as of the end of July 2016, or about four months of imports. The Tunisian dinar has been depreciating over the past months (10.5 per cent depreciation year to date in 2016 against the euro), adding pressure to an inflation rate of 3.6 per cent (July 2016) and to the servicing of the large share of foreign debt.

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The economic outlook is projected to remain sluggish given the security situation, the recent political impasse and readjustments (parliament's vote of no confidence in the incumbent prime minister in July and formation of a new government in August), and the ongoing vulnerability of the financial system. Growth is expected to pick up only modestly, to 1.5 per cent in 2016 and 2.5 per cent in 2017.

Major structural reform developments

Obstacles to private sector development remain in key dimensions of Tunisia's business regulatory framework. While Tunisia ranks 77th (out of 190 economies) in the World Bank's *Doing Business 2017* report, legal and regulatory constraints remain, especially for starting a business (country ranked 103rd), access to credit (ranked 101st) and investor protection (ranked 118th). To address these issues, the government announced in June 2016 a new economic development plan 2016-2020 (pending parliament approval) with an emphasis on private sector development and reforms spanning good governance, moving the economy up the value chain, fostering social and regional inclusion, and transitioning towards a green economy.

Legislative approval of much-needed structural reforms picked up at the end of 2015 and in 2016, but implementation has been slow. The new Competition Law was approved in September 2015, which should improve the business environment by reducing barriers to entry and reducing discretionary application of regulation. The Law on PPPs was approved in November 2015 with the aim to facilitate private concessions. And the long-awaited Bankruptcy Law was finally adopted by parliament in April 2016. However, these laws have yet to be implemented, pending decrees yet to be issued. In addition, there has been progress in streamlining administrative procedures related to a number of sectors including transport, agriculture, commerce and industry which should help improve the business environment. After repeated delays, the new Investment Code was finally approved by the parliament in September 2016. The revised code focuses on simplifying investment procedures (a single high investment authority will deal with foreign investors) and aims to encourage infrastructure projects in deprived areas particularly (through an investment fund). The law also includes a number of foreign investment incentives including more flexibility to transfer funds abroad and tax exemptions.

Notable progress has been made in the financial sector reform agenda, but vulnerabilities remain. The audit and recapitalisation of the three major state-owned banks – Societe Tunisienne de Banque, Banque de l'Habitat and Banque Nationale Agricole – were completed in 2015 and followed by the appointment of new management. A new Central Bank Law, approved in April 2016, grants the Central Bank of Tunisia more independence and clearly delineates a lender of last resort framework. The banking law passed in May 2016 will help make the financial system more stable, with gradual adoption of prudential and supervision tools in line with international standards such as a banking resolution framework and a deposit guarantee scheme. However, vulnerabilities remain. The operational and financial restructuring of the public banks is yet to be performed, toxic assets remain an issue with the withdrawal of the asset management company, and some dimensions of the central bank law fall short of best practices such as the presence of the government on the central bank board. Despite some progress in resolving NPLs, they are still high at 16 per cent of total loans as of the end of last year.

Energy subsidy reforms progressed with the implementation of a new price adjustment mechanism, but other critical fiscal reforms are still pending. The authorities introduced in July 2016 an automatic and symmetric fuel price adjustment mechanism, which is expected to ensure full cost recovery and help contain energy subsidy spending to 0.2 per cent of GDP in the future (compared with 5.9 per cent in 2013). The adjustment will be initially applied on a quarterly basis before moving to a monthly basis from January 2017. However, long-awaited reforms related to the civil service, pension and state-owned enterprises are still pending. A civil service reform strategy that aims to make public administration more efficient and limit the wages bill is yet to be adopted. The public pension system is not financially viable and needs budget transfers of 0.4 per cent of GDP in 2016. The government adopted a strategy to improve the governance and transparency of state-owned enterprises but the restructuring of their operations and finances is pending.

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A tax reform strategy has been adopted. The new strategy, adopted by the Council of Ministers in May 2016, is aimed at introducing a more equitable and efficient tax system. Measures include the widening of the value-added tax (VAT) base, reducing the number of VAT rates, and narrowing the discrepancy between onshore and offshore tax rates. However, a previously adopted tax administration modernisation plan – aimed at establishing a unified tax administration and strengthening monitoring capabilities – has not yet been implemented.