



TUNISIA

Highlights

- **Tunisia entered a technical recession in the first half of 2015.** Rising domestic security concerns, a tourism sector crisis, ongoing labour strikes and a slow recovery in Europe are hampering growth, despite a successful political transition, a record olive oil harvest and the substantial fall in oil prices.
- **The fiscal deficit is narrowing, but the budget composition is weakening.** The deficit narrowed in 2014 and Tunisia has secured significant international financial support. However, investment spending in 2014 reached a record low of 4.2 per cent of GDP while the public wage bill rose.
- **Progress on the structural reform agenda has been slow.** With the exception of a recent bill approving the recapitalisation of public sector banks, financial sector reforms have been repeatedly delayed and revisions to the investment and tax codes have also been slow to materialise.

Key priorities for 2016

- **Vulnerabilities in the banking sector still need to be addressed.** A long-awaited law approving the recapitalisation of public sector banks has been passed, but measures still need to be taken to increase the sector's liquidity and capital base, improve governance standards, deal with toxic assets, strengthen supervision and ensure appropriate resolution mechanisms are in place.
- **Substantial investments in the infrastructure and transport sectors are required 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, developing transparent public-private partnership (PPP) solutions to attract private sector participation is key.
- **There is a need to reduce fiscal expenditure rigidity and enhance public investment implementation capacity.** The high public wage bill should be addressed through civil service reform, taxes and subsidies should be reformed and capacity constraints holding back public investment should be addressed.

Main macroeconomic indicators %

	2011	2012	2013	2014	2015 proj.
GDP growth	-1.9	3.9	2.4	2.3	1.0
Inflation (average)	3.5	5.1	5.8	4.9	4.8
Government balance/GDP	-2.8	-4.3	-6.0	-4.2	-7.1
Current account balance/GDP	-7.5	-8.2	-8.3	-8.8	-8.5
Net FDI/GDP [neg. sign = inflows]	-0.4	-1.5	-1.1	-2.2	-2.3
External debt/GDP	48.0	53.8	54.1	56.2	n.a.
Gross reserves/GDP	16.4	19.1	16.0	15.1	n.a.
Credit to private sector/GDP	76.3	75.9	75.7	n.a.	n.a.

Macroeconomic performance

Tunisia entered a technical recession in the first half of 2015 amid domestic and external headwinds to growth. After growing by a sluggish 2.3 per cent in 2014, year-on-year growth slowed to just 1.2 per cent in the first half of 2015. Even though annual growth remained positive, Tunisia's performance in the first half of the year represented a technical recession, with output declining for two successive quarters. While a record olive oil harvest led to a 6.5 per cent surge in agricultural production in the first half of this year, tourism and transport activity contracted following the March attack on the Bardo Museum and the June attack in Sousse. In addition, mining, phosphate and energy production has continued to fall as industrial action in these sectors continues, while exports have been hampered by the slow recovery in Europe. Unemployment remains high at 15.2 per cent as of the second quarter of 2015 but is far higher among youth.

The fiscal deficit has narrowed and Tunisia has secured international financial support, but budget composition has weakened. The fiscal deficit narrowed from 6 per cent of GDP in 2013 to 4.2 per cent of GDP in 2014, driven by improved revenue collection and lower subsidy spending, but also weak implementation of planned capital spending. While the public wage bill rose to 14 per cent of GDP, public investment fell to a record low of 4.2 per cent of GDP. Ongoing energy subsidy reforms and low oil prices will ease fiscal pressures this year, but security spending is likely to rise. To help finance its deficit, Tunisia has secured significant international financial support, including from the IMF, World Bank, African Development Bank, the United States, the European Union (EU) and Japan. In August 2015, the IMF concluded its sixth review of its Stand-By Arrangement with Tunisia, bringing cumulative disbursements since June 2013 to US\$ 1.4 billion (out of a total of US\$ 1.6 billion). Moreover, Tunisia is able to access international capital markets. In January 2015, Tunisia's first unassisted sovereign bond issuance (of US\$ 1 billion) since 2011 was four times oversubscribed, allowing the country to borrow at an interest rate of 5.875 per cent. Public debt remains manageable at around 49 per cent of GDP as of the end of 2014.

External balances remain under pressure. The current account deficit widened to 8.8 per cent of GDP in 2014 compared with 8.3 per cent of GDP in 2013. This was driven by a rise in the trade deficit, reflecting weak demand in Europe (which represents 75 per cent of Tunisia's export market) and strikes and technical halts interrupting oil exports. The current account deficit widened to 9.5 per cent of GDP in the first half of 2015, driven primarily by sharply lower tourism receipts in the aftermath of the attack on the Bardo Museum. This outweighed the beneficial effects of the low oil prices on the balance of goods. Moreover, further drops in tourism receipts are expected in the latter half of 2015 following on from the Sousse attack. Despite external pressures, foreign reserves remain adequate, at 116 days of import cover at the end of August 2015.

The outlook has worsened considerably in the wake of recent terror attacks. Although Tunisia's successful political transition, lower oil prices and a gradual eurozone recovery are supportive of growth, the outlook has worsened as a result of the recent deterioration in the domestic security environment. This is expected to adversely affect tourism and investment, and will constrain Tunisia's recovery.

Major structural reform developments

Progress to alleviate the regulatory burden on the private sector continues to be slow, with a large legislative backlog. Tunisia ranks 74th (out of 189 economies) in the World Bank's *Doing Business 2016* report, and performs relatively well in the areas of getting electricity and dealing with construction permits. However, pressing reforms need to be implemented in key areas for a more business-friendly environment. These include simplifying procedures to start a business (where Tunisia is ranked 103rd) and easing access to credit (where it ranks 126th). Improvement is especially needed around regulations that directly affect small and medium-sized enterprises (SMEs), such as enabling the use of moveable assets as collateral.

There has been a significant delay in implementing the structural reform agenda. This is mainly due to the focus on the legislative and presidential elections over the past year. A key issue remains the country's outdated Investment Code. The code is highly complex, incomplete and not transparent, thus creating uncertainty for investors and imposing a heavy regulatory burden on businesses. A revised draft was withdrawn from parliament in May 2014 after being judged to be too complex and allowing too much room for discretion. A modified code was expected to be ready by May 2015, but this has now been delayed to October 2015. Other key pieces of legislation still to be approved by parliament include a law on PPPs that will facilitate private concessions and a new Bankruptcy Law that will improve bankruptcy provisions, improve debt recovery and hence strengthen credit provision. On the positive front, a new Competition Law was adopted in September 2015, which should improve the business environment by reducing barriers to entry and reducing discretionary application of regulation.

A long-awaited bank recapitalisation bill was passed in August 2015, but financial sector vulnerabilities remain. The Tunisian banking system has the highest non-performing loan (NPL) ratio in the SEMED region, at nearly 16 per cent at the end of March 2015. NPLs are particularly high in public banks, which are in need of recapitalisation. In 2014, audits of two out of three major public banks: Société Tunisienne de Banque (STB) and Banque de l'Habitat (BH), were completed. Parliament approved the recapitalisation of both banks in August 2015, and the process is now under way. The financial audit of a third major public bank, Banque Nationale Agricole (BNA) is not yet finalised, but sales of the bank's non-strategic assets are under way. Although the progress on recapitalisation is a positive and much-needed step, financial sector vulnerabilities remain. Strengthening governance in banks and improving adherence to prudential standards remains a key challenge. In addition, plans to create an Asset Management Company to absorb toxic assets have shown little progress and may be withdrawn. Moreover, a draft banking law that strengthens banking supervision and regulation in Tunisia and establishes a crisis and resolution management mechanism in line with international best practice is still pending. As a result, the financial sector in Tunisia remains fragile, thus restricting the flow of credit to business and impeding growth.

The Tunisian government remains committed to comprehensive tax reform. The government has set out a medium-term tax reform strategy aimed at expanding the tax base and modernising tax administration. There are also plans to strengthen the governance of public enterprises, improve public expenditure management and boost the effectiveness of public investment, although implementation has been slow. A tax administration modernisation plan was adopted in June 2014, which aims to establish a unified tax administration and to strengthen monitoring capabilities. So far, measures have been taken to strengthen tax audits and improve collection. In addition, national tax consultations with stakeholders were held in November 2014 and the consolidation of tax laws and codes into a single code was approved in October 2014 in a move to improve transparency.