TUNISIA

Five years after the Revolution, Tunisia's economic performance remains weak, with growth too low to make a significant dent on unemployment, poverty and inequality amid widening fiscal and current account deficits. The Tunisian President's recent call for a unity government has been supported by most political parties and civil society and followed by the formation of a new government in late August 2016. This initiative is intended to ease political bottlenecks and provide impetus to the much needed reforms to strengthen security, improve the business environment and restart growth.

Recent developments

The Tunisian economy slowed markedly in 2015: growth reached a mere 0.8 percent (versus 2.3 percent in both 2013 and 2014), with notable declines in manufacturing, mining (oil, gas, and phosphate industries) and tourism following two terrorists attacks targeting tourists. Data for the first half of 2016 indicate some moderate improvement of economic conditions. The economy expanded in Q1 and Q2 2016 at 1.0 and 1.4 percent (year-on-year, yoy), respectively. This modest uptick in growth reflected improved performance within manufacturing industries and non-tradable sectors, which grew by 2.0 percent and 3.3 percent (yoy) in H1 2016 while agriculture and fisheries, and non-manufacturing industries contracted by 2.8 percent and 0.8 percent, and value-added in tradable services remained flat. Importantly, imports of machinery and equipment, and raw products rose by 10 percent, as an improving security environment supported investment sentiment.

Notwithstanding this improvement, a number of indicators point to a still fragile and modest economic recovery in 2016. Industrial production fell by 0.3 percent in H1 2016, led by production declines in the agro-food, energy, and rubber and plastics industries. Furthermore, tourist arrivals fell by 25 percent in H1-2016. The significant trade deficit, combined with the deterioration of the capital and financial accounts, is eroding the country's foreign reserve buffer and leading to a depreciation of the Tunisian dinar. In June 2016, foreign reserves were estimated at USD 6.5 billion, amounting to a mere 3.5 months of imports.

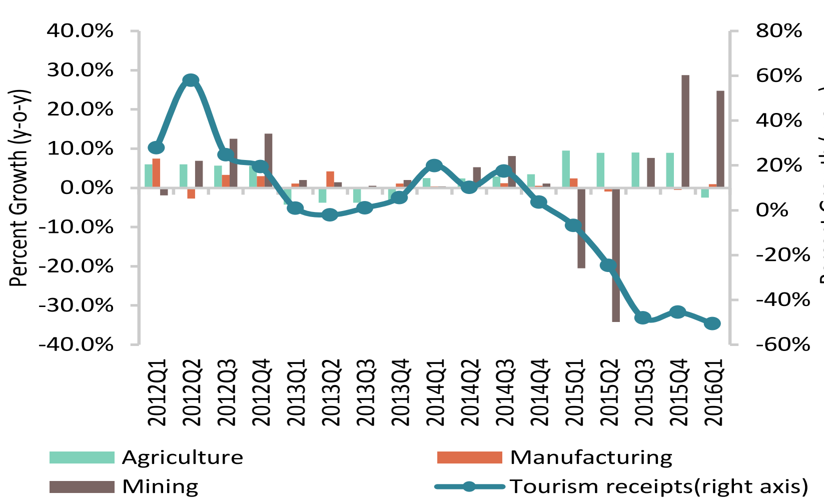
The unemployment rate remains high at 15.4 percent, particularly for women (22.6 percent), university graduates (31. 2 percent) and the youth (31.8 percent), while inflation is subdued (4 percent) as monetary policy remains prudent.

The Tunisian President recently proposed the formation of a national unity government to tackle the security, economic and social challenges facing Tunisia, and called for the participation of all political parties and civil society groups (worker unions, business organizations and other civil society). A short document, "The Carthage Agreement" outlining the priorities of the new government to be formed, was drafted and signed by most stakeholders. A new cabinet was formed and endorsed by Parliament in late August 2016 and is expected to try to unlock the political bottlenecks to reforms and give new impetus to the much needed and urgent measures to strengthen security, improve the business environment and restart growth.

Outlook

The economy is projected to expand modestly by 2.0 percent in 2016 driven by rising public consumption (up 10.1 percent) as negotiated wage increases are enacted, and investment (up 4.5 percent). In the medium term, economic growth is project-

FIGURE 1 Tunisia / Sectoral value added and tourism receipts growth (y-o-y)



Sources: National Institute of Statistics, Central Bank of Tunisia, and Staff calculations.

ed to pick up to 3.0 and 3.7 percent in 2017 and 2018 respectively in a scenario that would combine the acceleration of structural reforms, the improvement of security at the national and regional level (most notably a start of normalization in Libya), greater social stability, and a moderate increase in external demand.

Lower fiscal revenues in H1 2016 were compensated by the sale of 4G licenses and the transfers of excess money held by the Central Bank of Tunisia. But energy subsidies and net transfers to the State oil refining company have increased by 0.1 percentage points of GDP. Moreover about 0.6 percent of GDP were transferred to the State pension fund, which is structurally in deficit, to cover its liquidity needs. Overall the data for the first half of the year indicate that the fiscal deficit could be 1 percentage point of GDP higher than initially budgeted (4.6 percent of GDP) if no compensatory measures are implemented to keep the structural deficit below 4 percent (benchmark of the new IMF Extended Fund Facility). In the medium term, reining in the public wage bill and expanding the tax base are critical for fiscal sustainability and to create the space for more investment spending.

On the external side, the current account deficit is projected to drop to 7.7 percent of GDP in 2016, with the decline in imports partially offset by the fall in exports. In the medium term the current account is likely to benefit from the gradual recovery of remittances and services trade and would decline gradually toward 6.4 percent of GDP in 2017-18.

Risks and challenges

The main risks to the economic outlook remain the high level of youth unemployment and social unrest, as well as the security situation domestically and in the region. While the government is deploying resources to improve the security situation, reforms to stimulate private sector growth and job creation are needed to counter these risks. This would include, most notably: (i) adopting and implementing regulations to provide strong signals to investors that improve conditions for market access, and to move towards a level playing field in all sectors; (ii) developing and implementing a comprehensive strategy on civil service reform and SOE reform; (iii) improving governance, including fighting against corruption and elite capture; and (iv) establishing a dialogue aimed at tackling and resolving sources of social unrests, particularly with trade unions. Slow progress on such reforms is a key risk in the baseline.

TABLE 2 Tunisia / Macro outlook indicators (annual percent change unless indicated otherwise)

	2013	2014	2015	2016 f	2017 f	2018 f
Real GDP growth, at constant market prices	2.3	2.3	0.8	2.0	3.0	3.7
Private Consumption	4.2	1.8	2.3	1.1	2.3	3.1
Government Consumption	6.2	4.2	8.8	10.1	-2.0	3.9
Gross Fixed Capital Investment	-3.8	1.2	-4.5	4.5	5.0	7.0
Exports, Goods and Services	3.5	3.9	-6.8	1.6	5.5	6.1
Imports, Goods and Services	4.9	2.2	-3.2	3.5	2.1	4.7
Real GDP growth, at constant factor prices	2.6	2.3	0.6	1.5	2.5	3.2
Agriculture	-4.0	2.8	9.0	3.2	3.2	3.2
Industry	-0.2	-1.1	-1.6	-6.3	-3.2	-0.8
Services	5.0	3.8	0.5	4.6	4.6	4.6
Inflation (Consumer Price Index)	5.8	4.9	4.9	3.9	3.9	3.8
Current Account Balance (% of GDP)	-8.4	-9.1	-8.9	-7.7	-7.0	-6.2
Fiscal Balance (% of GDP)	-7.5	-4.3	-5.5	-4.6	-3.9	-3.7
Debt (% of GDP)	44.5	49.0	53.2	54.6	54.5	53.1
Primary Balance (% of GDP)	-5.7	-2.5	-3.6	-2.5	-1.8	-1.8

Sources: World Bank, Macroeconomics and Fiscal Management Global Practice, and Poverty Global Practice.
Notes: e = estimate, f = forecast.
(a) Calculations based on 2010-NSHBCSL.
(b) Projection using neutral distribution (2010) with pass-through = 1 based on GDP per capita constant in constant LCU.