البنك المركزي التونسي
BANQUE CENTRALE DE TUNISIE

COPING WITH RISING INTEREST RATES:
THE CASE OF TUNISIA

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Outlines

1. **Introduction**
2. **An overview of the international scene**
3. **The current economic and monetary situation in Tunisia**
4. **How to cope with raising interest rates?**
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1. Introduction

- Since 2011, the Tunisian economy has had to contend with numerous shocks, both domestic and foreign.
- Despite successful elections (legislative and presidential), successive Governments continue to face significant socio-economic and political challenges that often accompany transitions to democracy.
- The tense socio-political climate combined with an unstable geopolitical context have had significant negative effects on the Tunisian economy, resulting in an accentuation of imbalances and a resurgence of inflationary pressures.
- The main challenges for the Tunisian authorities are to restore macroeconomic balances, counter inflationary pressures and reestablish healthy, sustainable and inclusive growth.

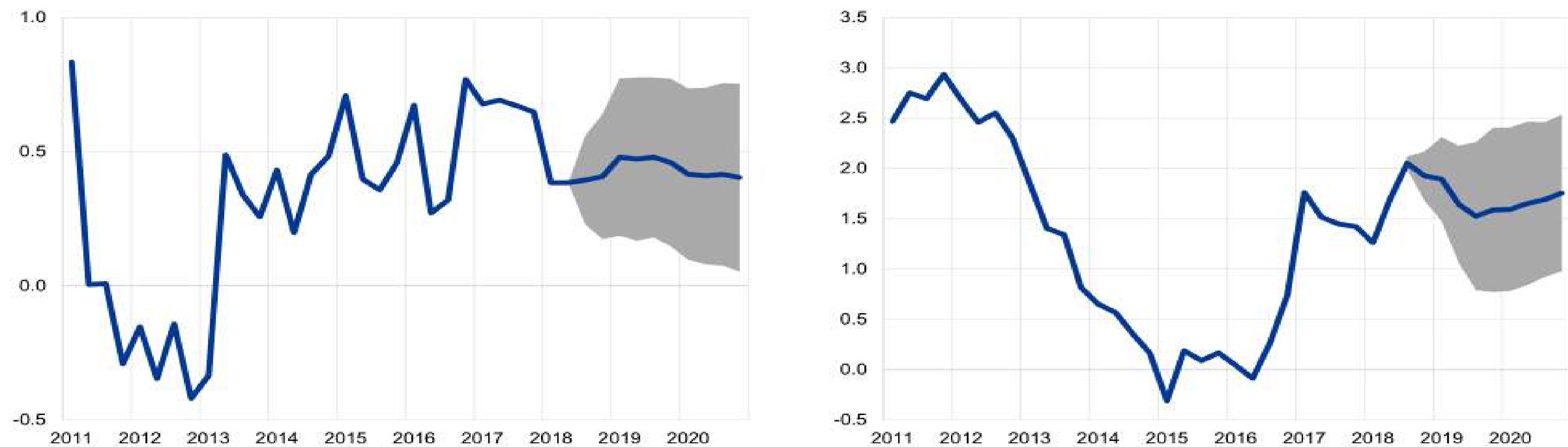
2. An overview of the international scene: The macroeconomic stabilization in the Euro Zone is confirmed and the normalization of monetary policies benefits from the rise in inflation towards its target value

Macroeconomic projections[1)]

(quarterly data)

Euro area real GDP[2)] — (quarter-on-quarter percentage changes)

Euro area HICP — (year-on-year percentage changes)



1) The ranges shown around the central projections are based on the differences between actual outcomes and previous projections carried out over a number of years. The width of the ranges is twice the average absolute value of these differences. The method used for calculating the ranges, involving a correction for exceptional events, is documented in *New procedure for constructing Eurosystem and ECB staff projection ranges*, ECB, December 2009, available on the ECB's website.
http://www.ecb.europa.eu/pub/pdf/other/newprocedureforprojections200912en.pdf?917c588c190f66c694c463d2cee934d4
2) Working day-adjusted data.

Source: *Eurosystem staff macroeconomic projections for the euro area (September 2018)*

2. An overview of the international scene:

- Recent economic developments in the US and the euro area support continuing monetary policy tightening by the Fed and the ECB
- The upward pressure on commodities prices could accelerate the rise of inflation and therefore of the interest rates in the coming years
- Countries with significant weaknesses (macroeconomic imbalances, political uncertainty, and high level of debt), like Tunisia, will continue to face more restrictive conditions on financial markets.
- Vulnerability of indebted emergent economies to the rise of interest rates.

2. An overview of the international scene: The raise of interest rates could affect debt conditions in emerging countries

***Source*: Datastream**

3. The current economic and monetary situation in Tunisia

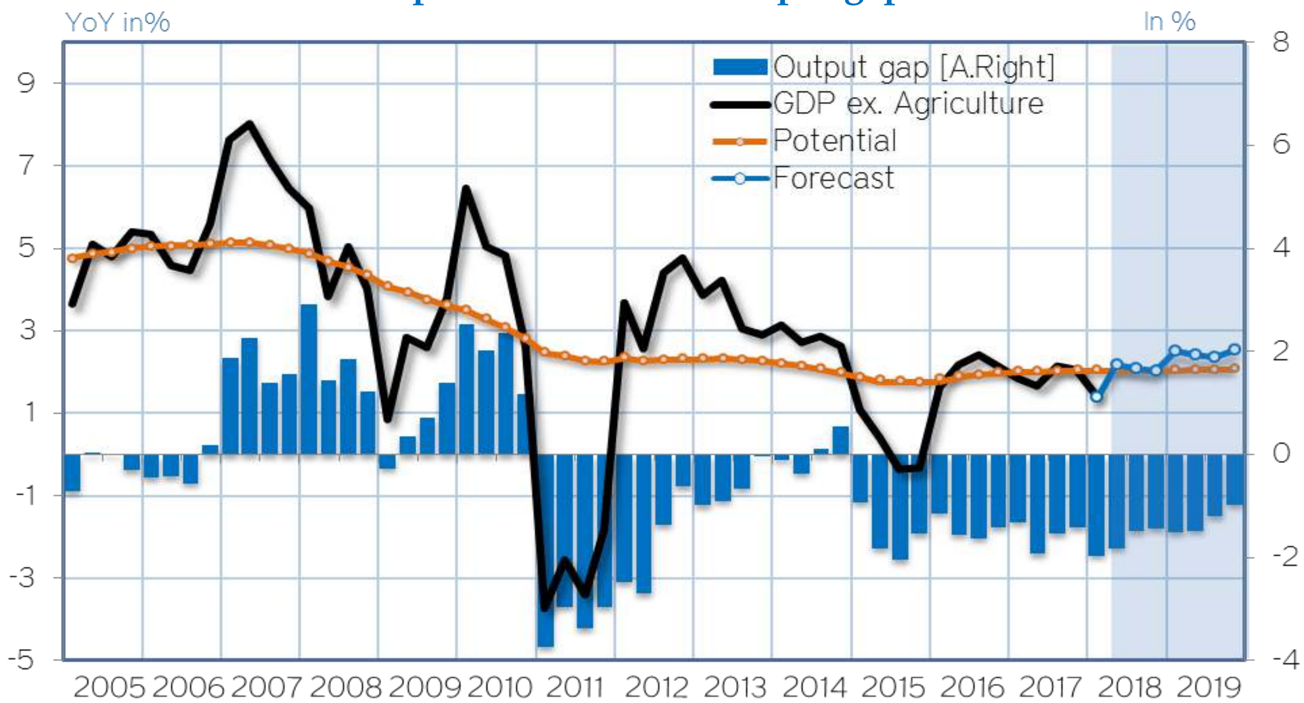
- Low growth rates (1.9% of GDP in 2017 vs 1% in 2016); gradual recovery over H1-2018 with 2.6% yoy well below inflation rates
- High unemployment rate (15.4% in Q2-2018) especially for high-graduated young people (29.2%)
- High inflation rates (7.5% yoy in August 2018 vs 5.7% in August 2017); persisting pressure with core inflation at its highest (7.7% yoy Aug 2018 vs 6% in Aug 2017)
- Deepening current account deficit (10.2% of GDP yoy in 2017 vs 8.8% in 2016) with a huge trade deficit
- High Budget deficit (6.1% of GDP both in 2016 & 2017) heated by countercyclical public spending

3.The current economic and monetary situation in Tunisia

- Debt-to-GDP ratios increasing at a faster pace (70% for public debt)
- Downgrades by all Agencies
- Drop in Net International Reserves (78 days of import as of 20/09/2018) and ongoing depreciation of the domestic currency
- High volatility in international commodity prices and oil
- Spillovers of the crisis in neighboring Libya
- Price-wage spiral keeping up pressure on inflation

3. The current economic and monetary situation in Tunisia

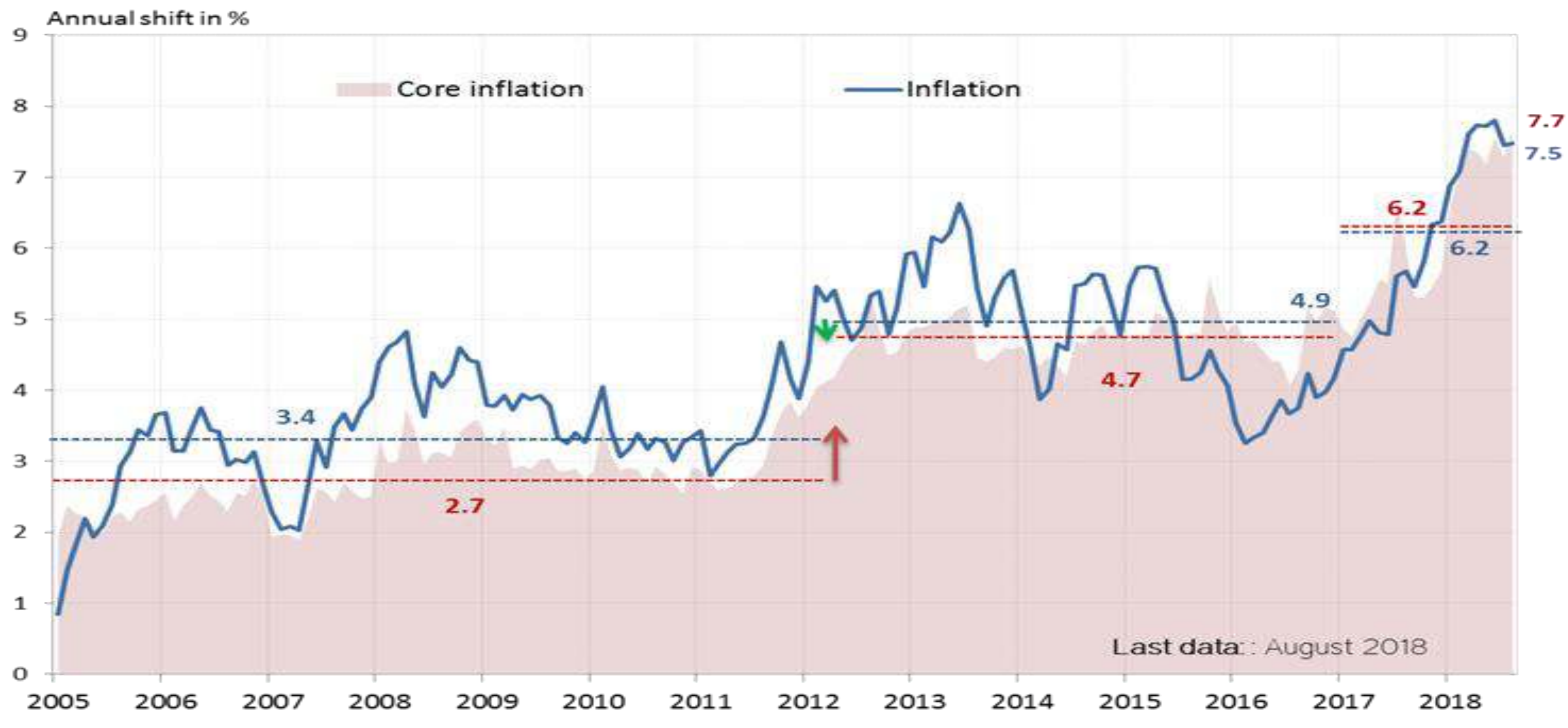
Forecasts of non-agricultural GDP Growth, its potential and the Output gap



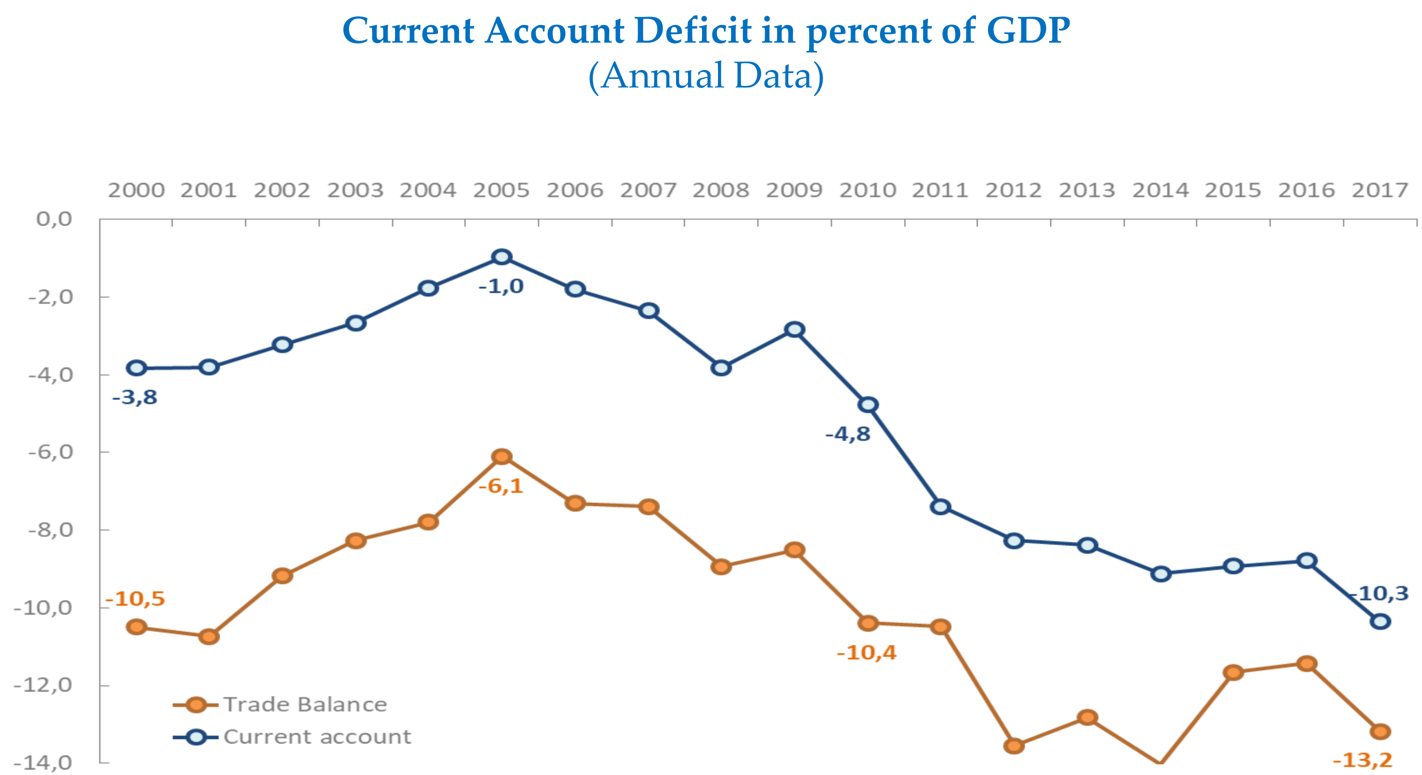
Source: BCT and INS

3. The current economic and monetary situation in Tunisia

Trends in Headline and core inflation (monthly data yoy)



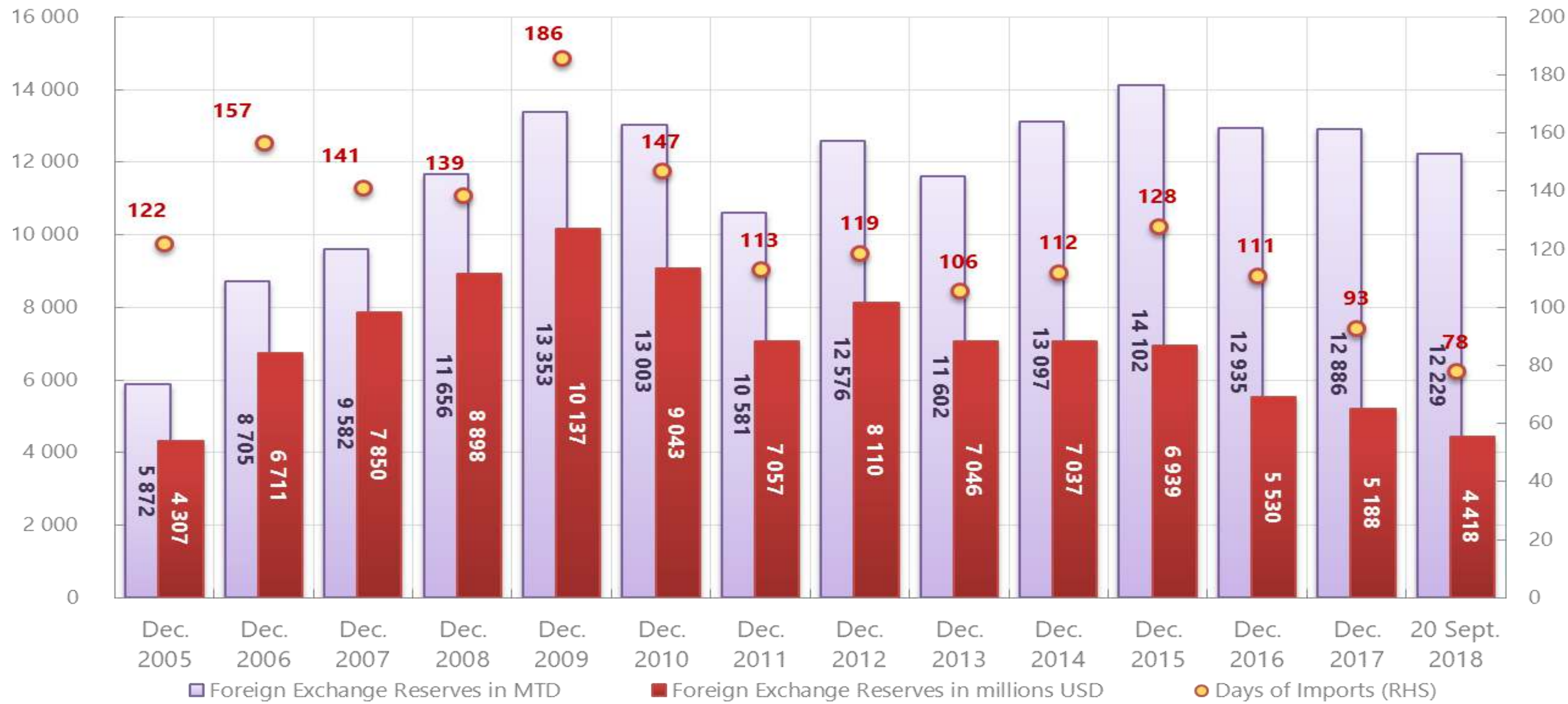
3. The current economic and monetary situation in Tunisia



Source: BCT & INS

3. The current economic and monetary situation in Tunisia

Foreign Exchange Reserves



Source: BCT and INS

3. The current economic and monetary situation in Tunisia

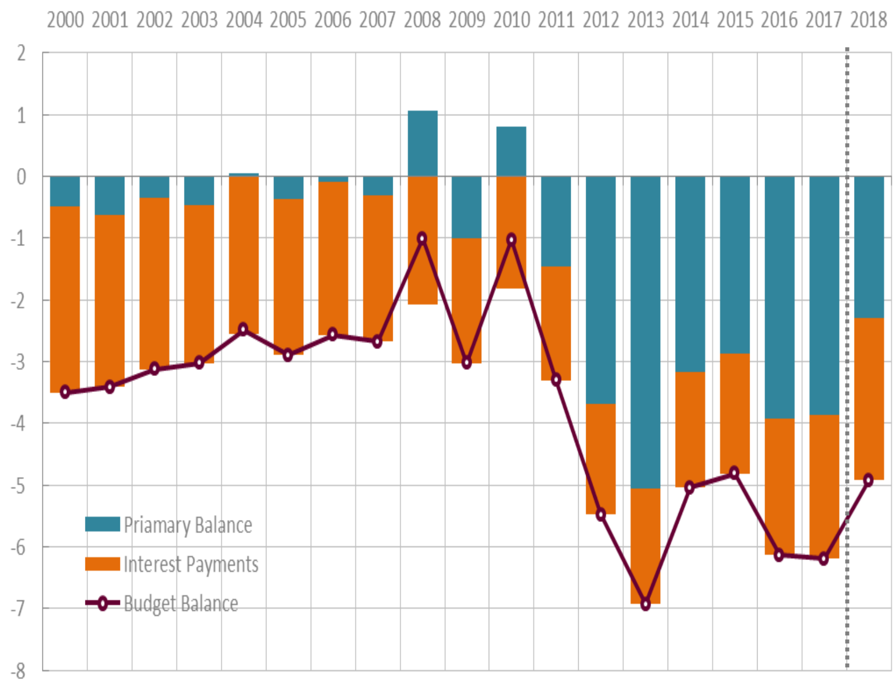
Exchange rates
(Daily data)

	EUR-USD		USD-TND		EUR-TND	
31/12/2010	1,3362		1,43793		1,92208	
31/12/2017	1,1993	**-10,2%**	2,48387	**-42,1%**	2,94779	**-34,8%**
20/09/2018	1,2323	**-1,9%**	2,42609	**-10,3%**	2,99491	**-9,5%**

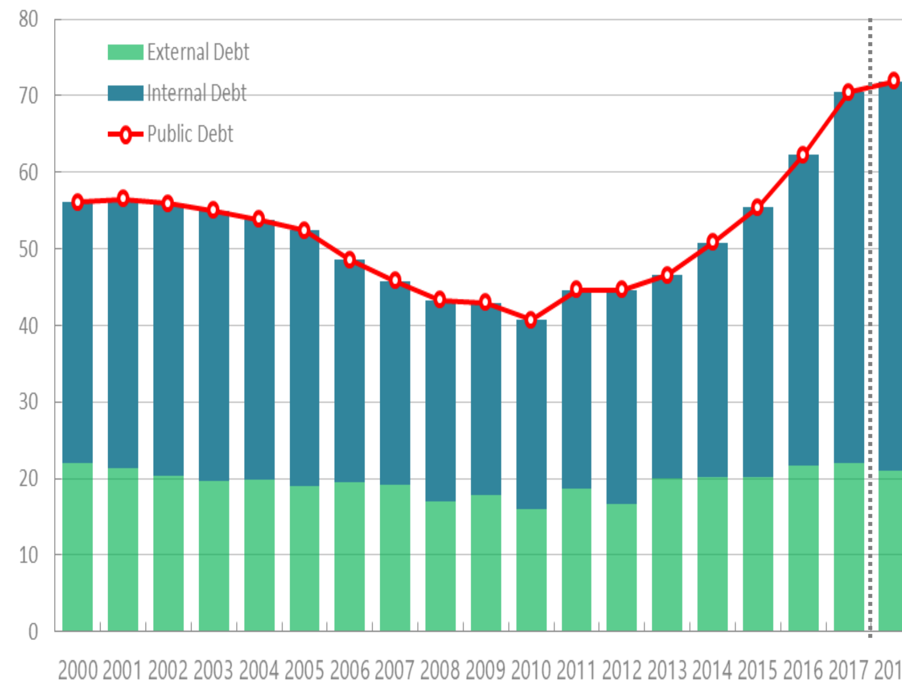
***Source*: BCT and BdF**

3. The current economic and monetary situation in Tunisia

Budget deficit in % of GDP
(Annual Data)



Structure of public Debt in % of GDP
(Annual Data)



Source: MoF and INS

3. The current economic and monetary situation in Tunisia

Trends Twin Deficits in percent of GDP
(Annual Data)

Source: BCT, MoF and INS

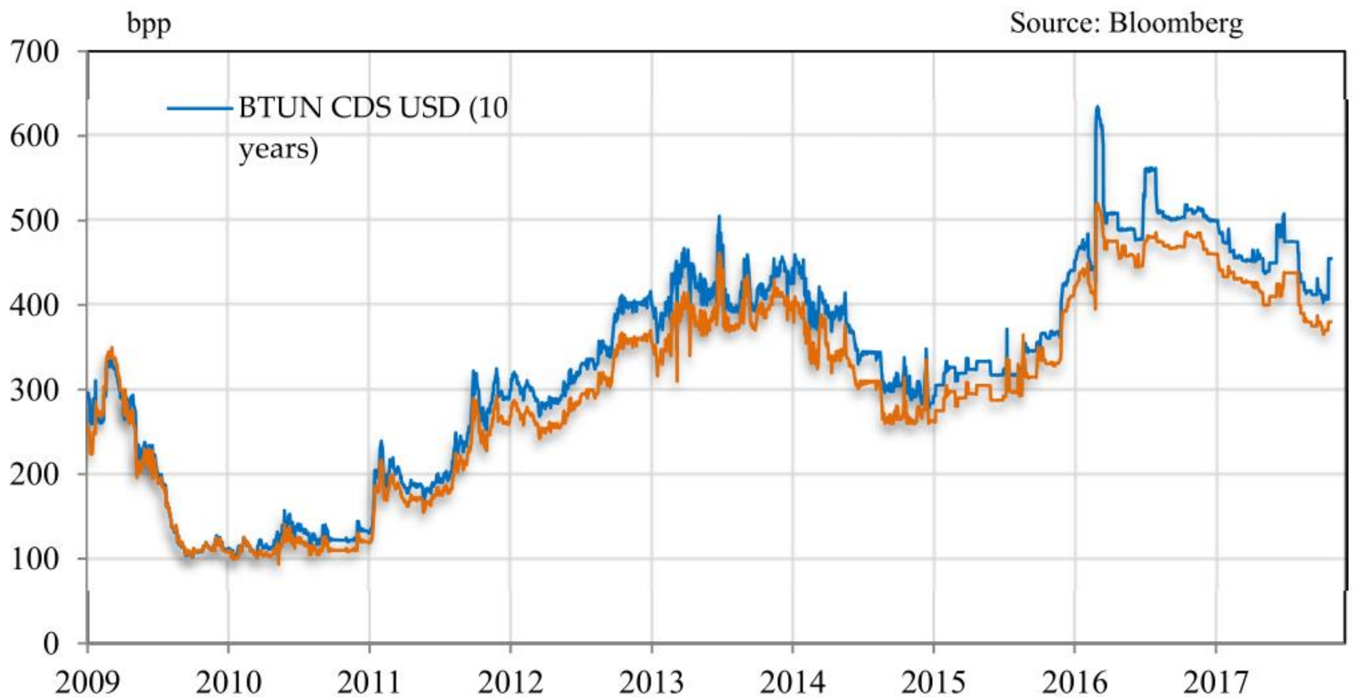
3. The current economic and monetary situation in Tunisia

Rating of Tunisia's long Term Sovereign Risk in Foreign Currency

	AGENCY			
	R & I	*FITCH*	*MOODY'S*	*STANDARD & POOR'S*
2018		**B+** Negative Outlook 27 May 2018	**B2** Stable Outlook 14 March 2018	
2015	**BB+** Negative Outlook 24 December 2015	**BB-** Stable Outlook 25 September 2015 **BB-** Stable Outlook 27 March 2015	**Ba3** Stable Outlook 25 May 2015	
2010	**A-** Stable Outlook	**BBB** Stable Outllok	**Baa2** Stable Outlook	**BBB** Stable Outlook

3. The current economic and monetary situation in Tunisia

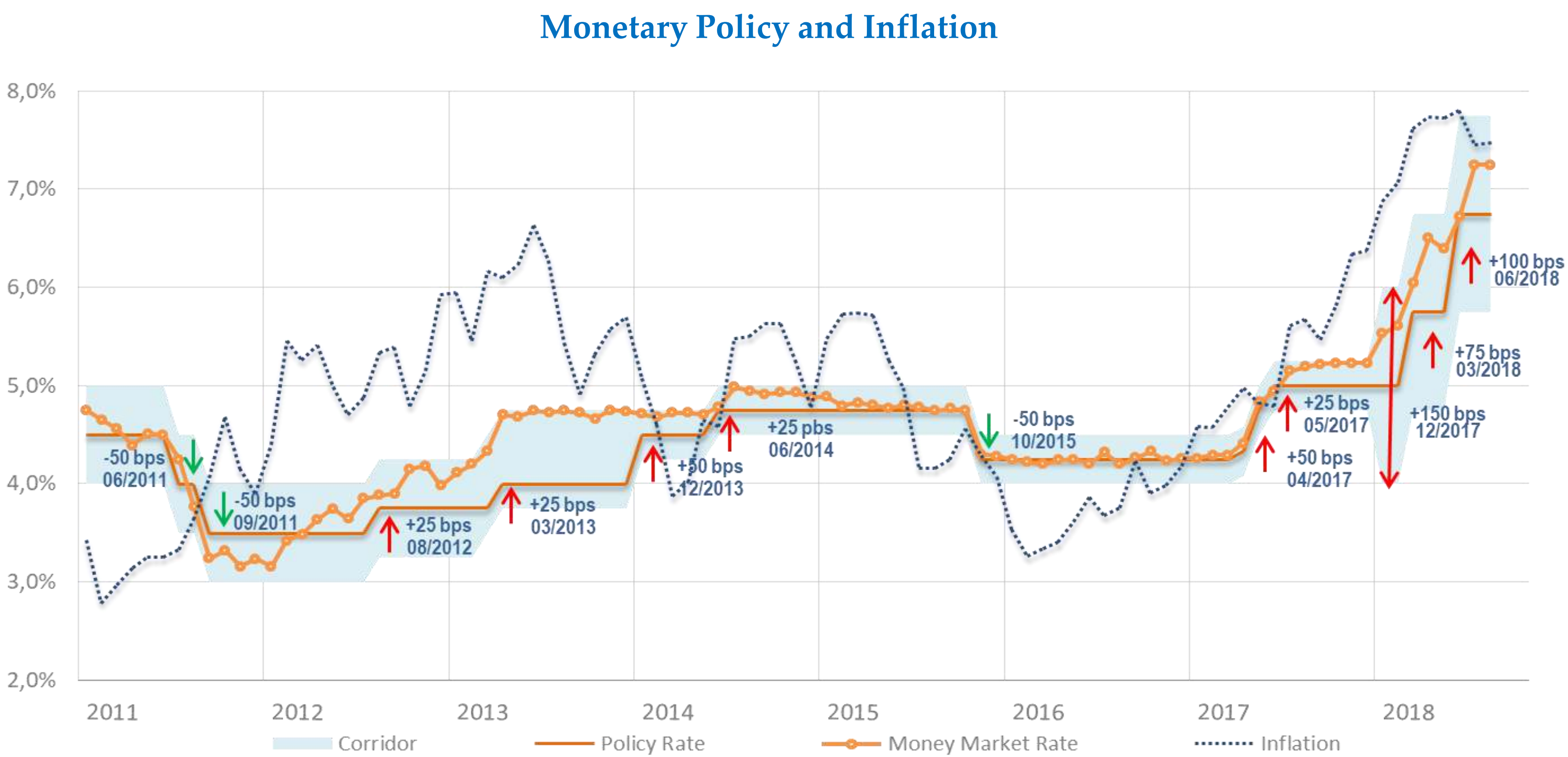
Tunisia Sovereign Risk



4. How to cope with raising interest rates?

- Consolidating Macroeconomic Stability
  - Adopting stronger ***monetary policy framework*** (like inflation targeting): Coping with inflationary pressure and anchoring expectations through the monetary policy tightening using the interest rate as a main instrument (According to the main objective of the Central bank). Also, the c**ommunication** of the central bank on its economic assessment, forecasts and its strategy to fight inflation should help improving its action's effectiveness.
  - Reducing ***external imbalances*** through exchange rate flexibility that preserves international reserves in the face of important exogenous shocks (facilitate external adjustment).
  - Setting up ***macro-prudential measures*** (fixing loan-to-deposit ratio of banks at 110%) to cope with the acceleration of credit, which has resulted in a sharp increase in central bank refinancing to banks.
  - Improve fiscal discipline.

4. How to cope with raising interest rates?



4. How to cope with raising interest rates?

Inflation Forecast
(Quarterly Data)

Source: **INS and BCT forecasts**

4. How to cope with raising interest rates?

- Structural reforms to boost the economy and to reduce economic vulnerabilities and avoid systemic financial crises.
  - Reforming Government Institutions, and especially SOEs and pension funds.
  - Financial Sector Reform for better soundness
  - Improving Business Climate (for a better ranking in Doing Business)

5. Conclusive remarks

- Rising rates in advanced economies combined with the downgrade of sovereign rating of Tunisia boosted the cost of financing to very high levels
- In the absence of external financing from the international capital market, the weight of domestic financing could increase substantially, to meet the Budget needs, with all the spillovers on monetary policy conducting.

5. Conclusive remarks

Despite this challenging environment:

- Tunisia is a « Nascent democraty » and the move to democraty has a cost
- Tunisia succeeded to set democratic institutions: The Assembly of the Representatives of People (Parliament); Constitution; Democratically elected President; successfull legislative elections;
- Even still at low levels (2.6% yoy expected for 2018), growth is of a better quality, boosted mainly by productive sectors

5. Conclusive remarks

Ongoing process of reforms in all fields notably:

- Economic sectors: New Investment Code
- financial sector : Newly adopted Central Bank Statues and banking law endowing a safety net (LOLR+Resolution Mecanism+Mecanism for Depositors'guarantee)
- Social sector: pension funds

THANK YOU FOR YOUR ATTENTION