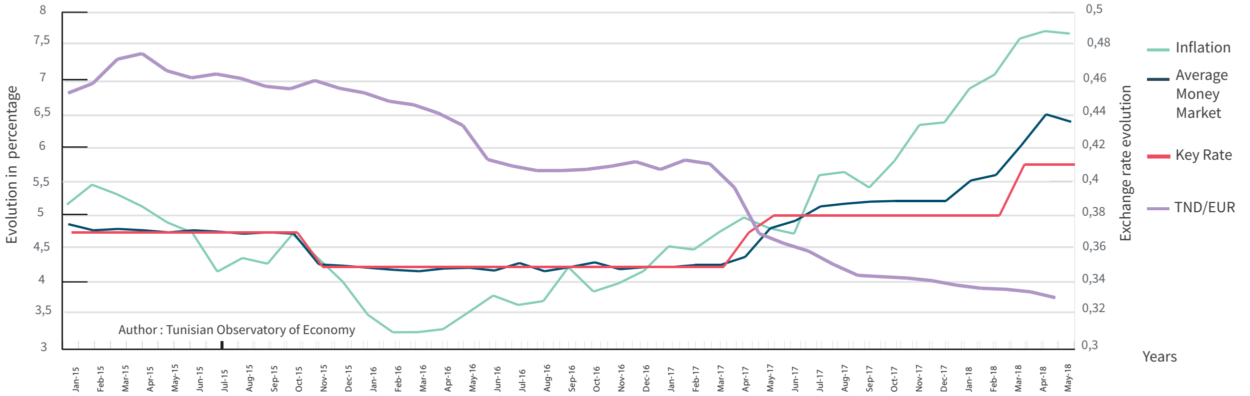
Inflation and Interest Rates: IMF's failure.

Key Highlights :

- Inflation in May 2018 reached 7.7, a level not reached since 1991.
- Inflation is mainly due to the liberalization of the dinar and the fall in its value which increases the prices of imported goods.
- The increase in interest rates will not have a significant impact on current inflation.

|Title : Inflation Vs Exchange rate Vs Interest rate (CBT Key Rate, Average Money Market rate) 2015 - 2018
Author : *Tunisian Observatory of Economy*
Sources : *CBT - NIS*



In its latest press release of 30 May 2018, the IMF stated that «decisive action is necessary this year to fight inflation». Indeed, inflation reached 7.7% in May 2018, a level never reached since 1991, when Tunisia was also under structural adjustment by the IMF under an Extended Fund Facility (1988-1992). As the figure shows, the first turning point in inflation is around April 2016. This month, the IMF had imposed on Tunisia to pass the law on the independence of the CBT (Central Bank of Tunisia) with the main mission of fighting inflation (see our study) while liberalizing the dinar. This structural change materialized on 10 March 2017, the month in which the dinar suffered its biggest dropout, with a CBT circular instituting the new central bank monetary policy inspired by IMF's ideology.

The IMF ideology is that inflation is everywhere and always of monetary origin, i.e. it can only come from an excessive distribution of credit. To combat this monetary inflation, interest rates would have to be raised to reduce inflation. The reality in Tunisia is quite different. Inflation in Tunisia increased mainly with the liberalization of the dinar in April 2016 then accelerated in particular after the drop of the dinar in March 2017. We calculated that between January 2013 and March 2016, the correlation coefficient between inflation and the exchange rate TND/EUR was low (0.25) while it became very strong between April 2016 and May 2018 (-0.91). These figures thus support our interpretation that inflation is due mainly to the liberalization of the dinar and then to the fall in its value which increases the prices of imported goods. As proof, the increase in the key rate of the CBT in April and May 2017 had no impact on inflation. In fact, inflation has never been as high as it has been since the IMF required the CBT to focus only on fighting inflation. The failure of the monetary policy promoted by the IMF is therefore total. Not only is inflation not monetary, but it is the direct result of the policies imposed by the IMF (liberalization of the dinar, increase in VAT and gasoline prices). Moreover, in its second review, the IMF acknowledges that the increase in interest rates has no impact on credit demand (paragraph 15). Meanwhile, inflation and rising interest rates are financially choking households and businesses in Tunisia. It becomes urgent to redefine the mission of the CBT by adapting it to the needs of the Tunisian economy (unemployment, growth, investment) rather than to the ideology of the IMF.

Author: Chafik Ben Rouine | Email: Chafik.benrouine@economie-tunisie.org