TUNISIA

ANOTHER HIGH-RISK YEAR

With real GDP contracting by 8.5% in 2020, Tunisia was one of the region's most severely hit economies. The prospects of a recovery are highly uncertain. The economy is threatened by the resurgence of the pandemic, but the government no longer has the manoeuvring room that it had in 2020. The budget deficit and public debt have soared to alarming levels, which calls for a difficult consolidation of public finances. Although FX reserves have been stable, the country's external vulnerability is growing. The pandemic's shock has aggravated a structural deterioration in fundamentals. This could have lasting consequences.

For a little more than a year, Tunisia has been faced with a triple whammy of overlapping political, health and economic crises. Since the legislative elections of October 2019, the country has already had three prime ministers. The cabinet that took office on 2 September 2020 has just been reshuffled and now needs to receive the approval of the parliament. Its ability to rule the country amid a highly fragmented political landscape remains to be seen. Yet there is an urgent need for action. A three-year financing agreement with the IMF seems highly necessary, although its signing has been pushed back by political paralysis. The IMF agreement could be adopted in Q1, but uncertainty remains high. The previous plan signed in 2017 was interrupted and it had to be replaced by emergency financial assistance following the outbreak of the Covid-19 crisis.

PUBLIC FINANCES: GROWING PRESSURE

The deterioration in public finances is worrisome. Initially forecast at 3% of GDP, the budget deficit excluding grants is estimated to have reached more than 12% of GDP in 2020. About two thirds of the shock is due to the contraction in government revenue (5.5% of GDP). Meanwhile, spending was largely swollen by the payment of government arrears to state-owned companies and a new increase in the total wage bill for public-service employees (+15% compared to 2019), which has already been rising for several years. In 2020, it absorbed 67% of government revenue. The target of holding the increase in the wage bill below 5% in 2021 will be hard to reach in the face of strong social pressures. Other factors will continue to strain budget implementation in 2021, starting with the ongoing impact of the 2020 recession on fiscal receipts. To bring the fiscal deficit down to 6-7% of GDP, the government plans to withdraw several support measures introduced during the pandemic. Yet the situation is far from stable. In any case, covering financing needs will be challenging.

In addition to a high fiscal deficit, the government will also have to deal with significant debt amortization (see chart 1). Its borrowing strategy expects the amount of total loans to reach more than 16% of GDP – of which 70% are due to be external, the equivalent of 11.5% of GDP. This is 4 points higher than the average for the past five years. Tunisia is not currently benefiting from any IMF assistance and, without it, attracting support from international donors (which have provided more than half of its external financing since 2015) or tapping the international financial markets will prove to be difficult. There are also domestic financing constraints. For the first time, the government had to call on the central bank to directly finance part of its fiscal deficit in 2020. Although the amount was modest (2.5% of GDP), this strategy can hardly be replicated without undermining the monetary stabilisation gains that have been achieved over the past two years. This might be another sticking point in its negotiations with the IMF.

FORECASTS

	2019	2020e	2021e	2022e
Real GDP growth (%)	1.0	-8.5	4.0	2.6
Inflation (CPI, year average, %)	6.7	5.7	5.4	5.0
Central Gov. balance / GDP (%)	-3.3	-12.3	-7.5	-5.6
Central Gov. debt / GDP (%)	72.5	88.6	93.0	95.0
Current account balance / GDP (%)	-8.8	-7.2	-8.1	-7.4
External debt / GDP (%)	97.1	106.8	109.6	113.6
Forex reserves (USD bn)	7.4	8.0	8.2	8.0
Forex reserves, in months of imports	3.8	4.8	4.4	3.9
Exchange rate USDTND (year end)	2.80	2.71	2.90	3.05

TABLE 1 e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

GOVERNMENT FINANCING REQUIREMENT

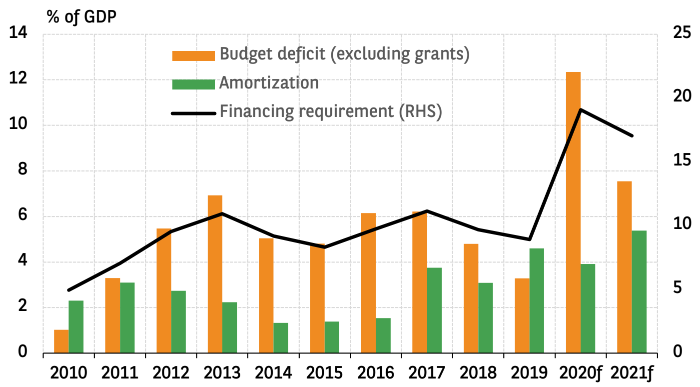

CHART 1 SOURCE: MOF, BNP PARIBAS

Moreover, a higher recourse to market financing would aggravate the increasingly alarming debt dynamics. Government debt is expected at 93% of GDP this year, 20 points higher than in 2019. Despite a debt stock that is still 45% owned by official creditors, the interest burden has risen rapidly. It absorbed 15% of government revenue in 2020, up from 10% in 2019, and it is bound to swell in the years ahead. With two-thirds of the debt denominated in foreign currency, the debt trajectory is also vulnerable to currency risk.

EXTERNAL ACCOUNTS: A PRECARIOUS STABILITY

Tunisia has so far been able to absorb the external shock thanks to a significant fall in imports due to the contraction in economic activity and lower oil prices. Despite the collapse in tourism receipts and a downturn in manufacturing exports, the current account deficit has narrowed, FX reserves have been rebuilt and the dinar has remained stable against the euro, appreciating thus slightly against the US dollar. With FX reserves of USD 8.2 bn and external financing needs estimated at a little over USD 6 bn in 2021 (including the EUR 1 bn Eurobond in 2 tranches with an American guarantee), there is still a low risk of an imminent government default on its international bonds.

Yet the situation is fragile. Even though the current account deficit has narrowed, it remains high at about 7-8% of GDP. Meanwhile the spread of the pandemic continues to strain the main sectors that generate foreign currency. Moreover, as slow as it may be, the expected rebound in the Tunisian economy will fuel greater demand for imports. Foreign direct investment will also come under downward pressure and is unlikely to exceed 2% of GDP this year. This covers less than 25% of the expected current account deficit. Consequently, there is a significant gap to close, which could place new pressure on external liquidity and the dinar if international donors fail to provide sufficient financial assistance. Persistent external imbalances will also continue to drive up the external debt, which could approach 110% of GDP by year-end 2021, an increasingly unsustainable debt level.

ECONOMIC GROWTH: PROBABLY A LASTING IMPACT

The capacity of the economy to rebound is highly uncertain. The year 2020 already got off to a bad start with real GDP declining by 2% year-on-year in Q1. Economic activity abruptly contracted by 21% in Q2 under the combined impact of strict lockdown measures, the collapse of the tourism sector, and the decline in European demand (75% of Tunisian exports). Despite the Q3 recovery, especially in the manufacturing sector, Tunisia reported one of the region's most severe recessions, with GDP contracting 9.6% on average in the first nine months of the year. The resurgence of the pandemic, both locally (with between 1,000 and 1,500 new cases each day since mid-October, compared to fewer than 50 cases during the first wave) and among its main trading partners, is also threatening the economy again. Major efforts have been deployed to secure vaccine supplies, thanks notably to the World Health Organization's Covax initiative. Yet the vaccination campaign will not start up before early Q2.

In the meantime, the government has virtually no fiscal manoeuvring room. Capital expenditure barely exceeds 3% of GDP in the 2021 finance bill, more than 2 points less than in 2019. CAPEX is likely to act as an adjustment variable in case of renewed pressure on Treasury's liquidity. In comparison, the total wage bill for public-sector employees is projected at 16.6% of GDP this year.

Monetary policy is also constrained. The continued decline in the inflation rate, in part due to the strong dinar, has certainly allowed the central bank to lower its key rate by 150 basis points to 6.25% (see chart 2). Yet its approach remains cautious, and real interest rates are still positive. Moreover, monetary easing will only marginally improve the poor health of the banking sector. With a non-performing loan ratio of 14% at year-end 2019 (of which provisions cover only 55%), the quality of bank loan portfolios was already deteriorated before the crisis, especially among state-owned banks (one third of the banking system). The moratorium on loan payments has so far helped limit the impact of the Covid-19 shock. Yet pressures on the banking system are bound to intensify due to its high exposure to the most vulnerable sectors (manufacturing accounted for 23% of loans outstanding at year-end 2019; commerce, 16.7%; and tourism, 4.8%).

MONETARY ENVIRONMENT

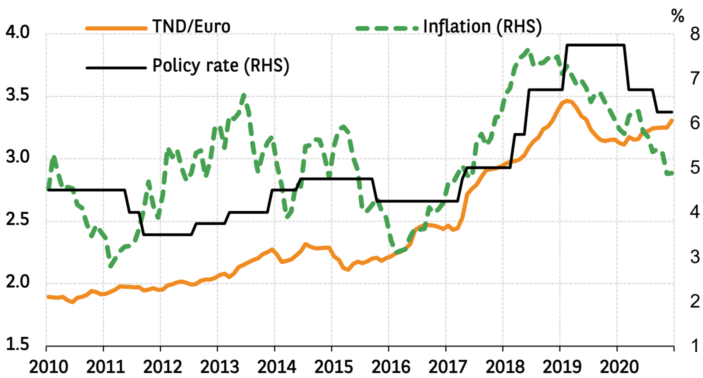

CHART 2

SOURCE: NATIONAL STATISTICAL OFFICE, CENTRAL BANK

The expected rebound in economic growth in 2021 remains hypothetical (forecasted at 4% after a recession estimated at 8.5% in 2020). Even if this is confirmed, real GDP would be still 4.8% below the 2019 level. The epidemic's shock could have a lasting impact because it slams an economy already weakened by a decade of sluggish growth (1.6% on average between 2011 and 2019). This has been the consequence of a declining trend in private-sector investment (from an average of 17.5% of GDP in 2000-2010 to 15.2% in 2011-2019) and the steady deterioration of fundamentals. In particular, the need to consolidate public finances means that new sources of economic growth will have to be found in order to reduce the unemployment rate, which has now reached 16.2%.

Completed on 18 January 2021

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