TUNISIA

GROWING CONCERNS

Two years after the shock of the pandemic, Tunisia is now being hit hard by the consequences of the conflict in Ukraine. The rise in commodity prices is leading to a dangerous deterioration in external accounts and public finances. Inflation is at historically high levels, weighing further on economic activity, which has already been struggling to recover since the 2020 crisis. In the absence of any financial room for manoeuvre, Tunisia is hoping to obtain support from the IMF to ease macroeconomic tensions. There are pressing needs.

Despite some positive steps forward recently, Tunisia's situation remains a cause for concern. Following the adoption of a new constitution in July and the publication of an electoral law in September, prior to the holding of legislative elections set for 17 December, the government has just reached agreement with the powerful trade union, the UGTT, on an annual increase of 3.5% for salaries of civil servants until 2025. This agreement does not address all the problems, but it should help to calm the social climate, at least in the short term. Above all, it could open the way for an IMF aid programme for which a broad consensus is needed on the reforms to be implemented. Unblocking this could be a catalyst for support from the country's other traditional bilateral and multilateral creditors, and may help to restore investor confidence. The authorities are convinced of this and expect it to be signed shortly. They have developed a programme of reforms which has found favour with the IMF. However, caution is called for, and the ability of the authorities to adhere to the roadmap negotiated with the IMF is open to question given the fragility of the Tunisian socio-political context. Nonetheless, given the deep economic crisis, there is no alternative.

FORECASTS

	2019	2020	2021	2022e	2023e
Real GDP growth (%)	1.3	-8.7	3.3	2.5	2.7
Inflation (CPI, year average, %)	6.7	5.7	5.7	8.2	6.5
Central Gov. balance / GDP (%)	-3.1	-9.6	-7.7	-8.8	-6.6
Central Gov. debt / GDP (%)	67.3	77.8	79.7	82.3	85.7
Current account balance / GDP (%)	-8.1	-6.0	-6.2	-9.8	-8.5
External debt / GDP (%)	90.2	97.3	87.0	90.5	94.4
Forex reserves (USD bn)	7.6	9.4	8.4	7.9	8.9
Forex reserves, in months of imports	3.8	5.8	4.2	3.2	3.6

TABLE 1

e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

DANGEROUS WIDENING OF EXTERNAL IMBALANCES…

The surge in oil and cereal prices as a result of the conflict in Ukraine is putting significant pressure on external accounts. Over the first eight months of the year, the trade deficit widened by 46% compared to the same period in 2021, reaching the almost unprecedented level of USD 5.5 billion (chart 1). More than 70% of the widening in the trade deficit comes from the energy and agricultural deficits. The increase in oil and gas imports has been huge (+72%), the result of a powerful price shock as well as of an upward trend in needs due to the 38% decline in national hydrocarbon production over the last ten years. In 2021, the energy deficit was 4,614 tonnes of oil equivalent compared to just 605 in 2010. Regarding cereals, Tunisia was also already exposed to sources of vulnerability when the crisis broke out, as it has both one of the highest levels of per capita consumption in the world (255 kg of wheat per year, or five times more than the African average) and a high dependence on imports (around ¾ of national consumption), almost half of which comes from Ukraine and Russia.

Despite the recent easing in commodity prices, the current account deficit is expected to be around 10% of GDP this year, compared to 6.2% in 2020. The continued increase in financial transfers of the Tunisian diaspora and the recovery in the tourism sector will not be enough to cushion the full impact of the shock on external trade. After quite a satisfactory Q1, the current account deficit stood at a record level of USD 1.7 bn in Q2. It was USD 800 million in Q2 2021. Revenues from tourism rose by 43% year-on-year in Q2, but were still 31% below their 2019 level.

TUNISIA: TRADE DEFICIT, FIRST 8 MONTHS OF THE YEAR

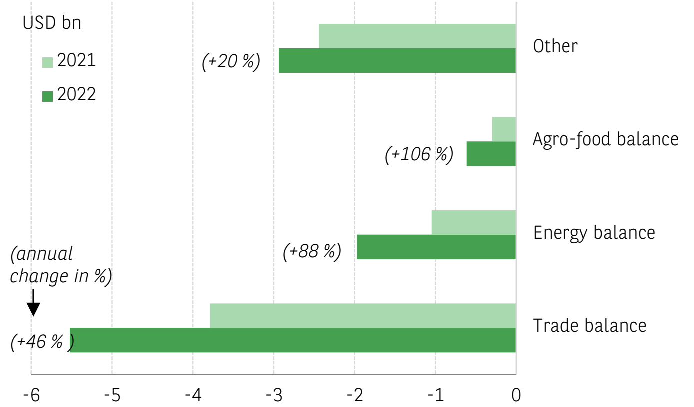

CHART 1

SOURCE: INS, BNP PARIBAS

In this context, the good performance of the dinar might come as a surprise. The TND remained stable against the euro and depreciated by only 8% against the US dollar. Despite foreign direct investment flows continuing to be low (only 13% of the current account deficit in H1) and the impossibility of tapping international financial markets, Tunisia has managed to mobilise sufficient support from its partners to cover its external financing needs. The central bank's foreign exchange reserves have fluctuated around USD 8 bn since the beginning of the year, equivalent to 3.6 months of imports of goods & services at the end of June (compared to 4.6 months in June 2021). Therefore, external liquidity appears to remain adequate. However, the coverage ratio is deteriorating and visibility remains very limited given the multitude of risks which continue to weigh on the dynamics of external accounts (crisis in Europe, volatility in commodity prices). In the absence of a rapid agreement with the IMF, foreign exchange reserves could fall rapidly.

...AND FISCAL DEFICITS

The situation of public finances is even more fragile. After peaking at 9.6% of GDP during the Covid crisis in 2020, the budget deficit had reduced to 7.7% in 2021 thanks to the good performance of fiscal revenues. It will widen again in 2022 because of the effect of a sharp hike in oil and food subsidy costs. Initially budgeted at 5.2% of GDP, they are likely to ultimately reach 8% of GDP this year. In fact, social policy relies to a large extent on a system of keeping prices low and stable for a wide range of products, mainly energy and cereals, and is therefore highly vulnerable to the current shock. The government has limited room for manoeuvre, even though tax revenues have continued to grow robustly since the start of the year. Over 70% of governement revenues are absorbed by the wage bill of public service employees (one of the highest in the world at 15.6% of GDP) and the payment of debt interest. Despite expected cuts in public investment, slippage in spending on subsidies is therefore likely to push the budget deficit to almost 9% of GDP this year. In addition to this there are significant debt repayments. The government's financing needs are now expected to be 17.6% of GDP in 2022 compared to 13.7% anticipated in the initial budget.

However, financing constraints are strong. The local debt market is narrow and has already been called upon to a significant degree in the past two years to compensate for the depletion in financial assistance from traditional donors and the inability to issue Eurobonds. Prior to the outbreak of the conflict in Ukraine, the government was hoping to cover more than 60% of its needs through external resources. Although some donors are continuing to provide funds, a wider mobilisation of external creditors remains conditional on getting an agreement with the IMF.

The increased reliance on domestic financing does not only pose a liquidity problem. It also aggravates an increasingly worrying debt dynamics. Government debt will exceed 80% of GDP in 2022 compared to 67.3% of GDP in 2019. Although 46% was still held by bilateral and multilateral creditors at the end of 2021, local currency debt is rapidly increasing (+11 points of GDP between 2019 and 2021), resulting in a shortening of the average maturity of the debt (from 6.8 years in 2018 to 5.9 years in 2021) and an increase in its cost. 12% of government revenues are therefore expected to be allocated to debt interest payments in 2022 compared to 10% in 2019. With financing requirements exceeding 15% of GDP over the next two years, it will be difficult for the government to continue on this path as it risks undermining the sustainability of its debt. In addition, the debt trajectory is also sensitive to currency shocks and to the deterioration in growth prospects.

ECONOMIC GROWTH: A VERY UNCERTAIN OUTLOOK

The dangerous deterioration in macroeconomic imbalances poses an additional threat to the recovery of an economy already weakened by a decade of sluggish growth and a recession in 2020 that was amongst the most severe in the region. Despite the upturn in tourism activity, growth only reached an average of 2.8% in the first half of 2022.

TUNISIA: MONETARY ENVIRONMENT

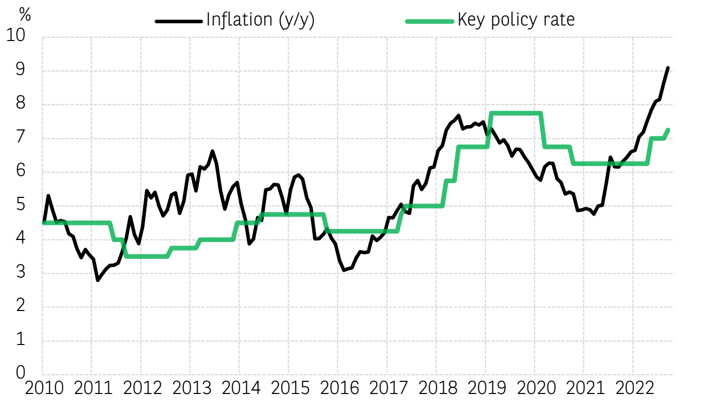

CHART 2

SOURCE: INS, CENTRAL BANK, BNP PARIBAS

At this pace Tunisian economic activity may not return to its pre-pandemic level until the end of 2023/start of 2024. But downside risks are accumulating, starting with a deteriorating economic situation in Europe, which is by far the country's most important economic partner (75% of exports and 85% of FDI in 2020). Moreover, inflationary pressures are high. Inflation has just reached an all-time high of 9.1% in September (chart 2), driven to a large extent by the rise in food prices (+13%) despite the system of subsidies. In addition to the disruptions caused by the international context, there were delays in payments by the State, which destabilised the distribution channel and generated shortages and price increases even for certain subdizided products. Inflationary pressures are likely to remain strong in the short term, which could force the central bank to raise rates following the hike of 75 basis points decided upon in May and the 25 bps hike in October. At 7.25%, however, the key policy rate is still well below inflation, highlighting the central bank's cautious attitude towards an economy which would find it difficult to cope with too sharp a monetary tightening. In the absence of an agreement with the IMF, domestic financing conditions could deteriorate further. The government could therefore be forced to make further cuts in its public investment programme, the level of which has steadily decreased in recent years (3% of GDP in 2022 compared to 5.3% in 2017) and is already insufficient given the country's development needs.

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