



TUNISIA

Highlights

- **The economy is contracting significantly in 2020.** The Covid-19 crisis and related containment measures are leading to higher unemployment and rising fiscal deficits, but inflation is lower, foreign exchange reserves are up and the exchange rate is stable.
- **The authorities have responded to the crisis with a wide range of measures.** The government executed an emergency plan, created a fund for health and social spending, and disbursed cash transfers for the most vulnerable segments of the population. The Central Bank of Tunisia (CBT) reduced the policy interest rate by 150 basis points.
- **There has been some progress in structural reforms.** The CBT raised the limits on overseas borrowing by local firms, the interbank guarantee fund for bank deposits started operating, and a new law regulating crowdfunding was approved.

Key priorities for 2021

- **Digitisation of government services should continue.** During the Covid-19 crisis, several digital applications were developed to meet the needs of the administration with a large number of ministries and several online services, such as tax regulation. Increased literacy of the population alongside upgraded digital infrastructure in southern and interior regions will allow digital technology and electronic payments to be applied more widely.
- **Tunisia could benefit from the relocation of European and Asian industry to the southern Mediterranean post-Covid-19.** Tunisia should develop its international positioning to benefit from a wide range of business opportunities. Essential reforms include improving the competitiveness of economic sectors such as health and education, agricultural and agro-food, automotive and textiles.
- **The authorities should commit to further reforms in the energy sector and public administration.** Key reforms on the agenda include a reduction in energy subsidies and streamlining of the civil service wage structure.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	1.2	1.9	2.7	1.0	-8.0
Inflation (average)	3.6	5.3	7.3	6.8	5.8
Government balance/GDP	-6.2	-5.9	-4.6	-3.9	-8.1
Current account balance/GDP	-9.3	-10.2	-11.2	-8.5	-8.3
Net FDI/GDP [neg. sign = inflows]	-1.7	-2.0	-2.5	-2.1	-0.6
External debt/GDP	66.9	82.0	86.1	99.4	n.a.
Gross reserves/GDP	14.2	14.1	13.1	19.1	n.a.
Credit to private sector/GDP	76.8	80.3	80.4	77.4	n.a.

Covid-19: macroeconomic implications

The economy is undergoing a severe contraction. GDP fell by 11.4 per cent year-on-year during the first half of 2020 because of the Covid-19 crisis and related containment measures. The largest contractions were in the tourism, transport, public administration, manufacturing, construction, textiles and trade sectors. Meanwhile, the agricultural and agro-food sectors posted strong positive growth, thanks to a record-breaking olive oil harvest in 2019-20. Unemployment increased to 18 per cent in the second quarter of 2020, the highest rate reported since 2011. Inflation is also quite elevated by regional standards at 5.4 per cent in September 2020, although it is slowing down. The CBT implemented a rate cut of 100 basis points (to 6.75 per cent) in March 2020 in response to the Covid-19 crisis, and by another 50 basis points in October, reversing a trend of monetary tightening to contain inflation.

The fiscal deficit widened and debt increased. The original budget targeted a deficit of 3.0 per cent of GDP for 2020, but the complementary budget forecasts a much higher deficit because the implications of the Covid-19 crisis emerged. In the first eight months of 2020, revenues shrank while expenditures stagnated, as the drop in capital spending offset the increase in interest payments and administrative spending, mainly the public sector wage bill, although an increase in expenditures is projected for the end of the year. Meanwhile, the government's public debt stock increased to 71.4 per cent of GDP at the end of June 2020, and is likely to be higher by the end of the year, given the contraction in GDP and a larger fiscal deficit.

The external accounts have been supported by record olive oil exports and by a lower imports bill due to declining crude oil prices. The current account deficit narrowed to 4.0 per cent of GDP in the first half of 2020, reflecting a larger contraction in imports than in exports. Exports started to rebound in June and July, as did imports in July. Meanwhile, tourism declined by 61 per cent year-on-year in the first eight months of 2020 because of the Covid-19 crisis, and foreign direct investment flows dropped 14.2 per cent year-on-year during the first half of 2020. However, reserves actually increased to US\$ 7.6 billion in October 2020, covering 4.7 months of imports.

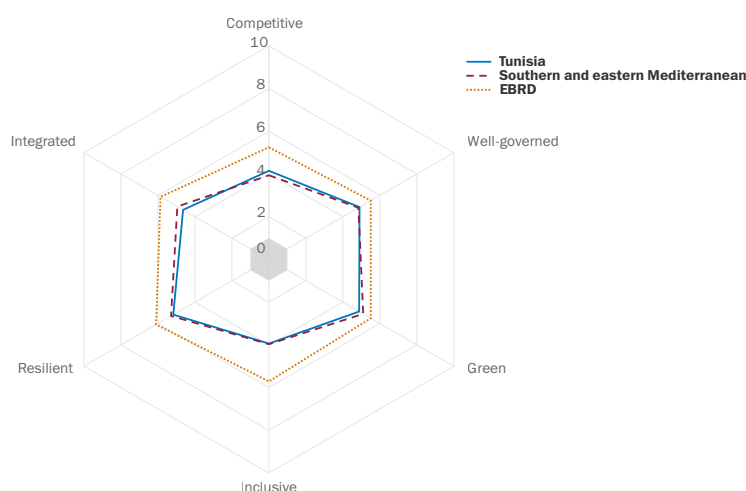
Negative growth in 2020 should be followed by a recovery in 2021. We forecast GDP growth at -8.0 per cent in 2020 before picking up to 4.0 per cent in 2021. Lower global oil prices and reforms anchored within a new IMF-supported programme are expected to support the economy next year, but risks remain with slow policy reforms and a possible resurgence of the pandemic globally.

Policy response to Covid-19

The authorities responded to the Covid-19 crisis with a range of measures. The government implemented an emergency plan, to which it allocated TD 2.5 billion (US\$ 0.9 billion), including value-added tax (VAT) exemptions, VAT refund procedures and reimbursement acceleration, the creation of a TD 100 million (US\$ 36 million) fund for the acquisition of equipment for public hospitals, the purchase of emergency medical equipment and medicine, and increasing the strategic food reserve. On the social side, the government disbursed cash transfers for low income households, disabled and homeless people (TD 150 million, US\$ 55 million) and support for those in temporary unemployment (TD 300 million, US\$ 109 million). It also created investment funds (worth TD 600 million, US\$ 219 million) and a state guarantee for new credits (TD 500 million, US\$ 182 million). The CBT asked banks to suspend fees for electronic payments and withdrawals, and initiated a mechanism to cover the difference between the policy rate and the effective interest rate on investment loans within a 3 per cent cap.

The CBT is also supporting the recovery. In June 2020 the CBT raised the limits on overseas borrowing by local firms to help them tap other sources of finance and support the recovery from the Covid-19 crisis. This is a welcome step towards foreign exchange control relaxation. Allowing firms to borrow more money from abroad will widen the credit pool and reduce the demand for loans from local banks. The CBT's move will likely increase the flow of foreign credit to Tunisian businesses in the short to medium term, which could potentially allow local corporates to seize more cross-border merger and acquisition opportunities.

Assessment of transition qualities (1-10)



Structural reform developments

The interbank guarantee fund for bank deposits started operating. Almost all of the 29 banks operating in Tunisia are taking part in this new public body, which began operating in August 2020 and is managed by the state and the CBT. The fund was mandated by the Banking Law of 2016, which brought a number of sizeable amendments to existing rules and regulations and laid out new frameworks. The bank deposit guarantee fund serves to provide reimbursements in cases provided for by law and up to TD 60,000 (US\$ 22,000) in case of default or forced administrative liquidation of a bank. The mission of the fund is to protect the savings of bank clients, reimburse them if their deposits become unavailable and contribute to the stability of the Tunisian financial system.

A new law regulating crowdfunding was passed in August 2020. It aims to organise a new means to provide financing – based on raising funds from the public via a dedicated online platform – for projects and companies to promote investment, entrepreneurship, creativity and innovation. The Financial Market Council, the CBT and the Microfinance Control Authority will regulate financing through crowdfunding. This law will help to address some of the economic problems that Tunisia is facing, by introducing new means of financing projects, as the private sector has identified lack of access to finance as one of the main obstacles to doing business.

The authorities implemented direct employment measures to target long-term unemployment, but the feasibility of such a strategy is doubtful. In August 2020 parliament approved a bill that allows the public sector to prioritise recruitment of those aged 35 and over who have been unemployed for more than a decade. Serious questions remain about the feasibility of implementing this law. Tunisia already has one of the highest wage bill to GDP ratios in the world, and several attempts to contain spending and freeze wage increases in previous years faced strong opposition from the powerful labour and trade unions.

Fuel subsidies have been reduced. In March 2020 the government introduced an automatic adjustment mechanism to align domestic prices with the global market price and reduce fuel subsidies. The technical price adjustment committee, set up by virtue of a decree by the energy and finance ministries in March 2020, sets fuel prices each month. The decree outlines that the maximum monthly adjustment step is no more than 1.5 per cent in either direction. As international fuel prices have been falling, the government was able to cut fuel prices for five consecutive months in 2020, with a 1.4 per cent cut on average in August 2020. The reduction in global oil prices is expected to have a favourable effect on Tunisia's energy imports and state budget via a reduction in planned fuel subsidy spending.