TUNISIA

Highlights

- **Tunisia's recovery from its deepest recession since 1956 is slow.** The economy continued to contract in the first quarter of 2021, inflation is accelerating, reserves are declining and unemployment is high, notably among the youth.
- **The fiscal situation has deteriorated.** The fiscal deficit widened and debt is climbing, particularly the domestic currency-denominated part, but foreign currency-denominated debt still accounts for two-thirds of total debt. The public sector wage bill is now among the highest of all emerging markets, relative to gross domestic product (GDP).
- **Reform progress and an International Monetary Fund (IMF)-supported programme have been delayed by the ongoing political crisis.** Technical discussions with the IMF on the authorities' draft reform programme started in May 2021, but were put on hold due to political instability and a lack of societal consensus on reforms among various stakeholders.

Key priorities for 2022

- **An agreed economic reform programme and recovery plan is necessary to help the economy rebound more quickly from the impact of the Covid-19 crisis.** To advance reform progress, institutions need to be stabilised and confidence among international donors and institutions restored. Innovative financing mechanisms are essential if companies affected by the pandemic are to be restructured.
- **Fiscal consolidation should be prioritised.** The government needs to cut its public-sector wage bill, reduce transfers to state-owned enterprises (SOEs) and enhance their governance, and replace subsidies with direct support for the needy, to ensure adequate and targeted social protection. Public debt needs to be put on a sustainable, declining path.
- **A deal with the IMF is needed to stabilise the economy and unlock other sources of external financing for Tunisia's needs.** In addition to fiscal consolidation, the government will need to implement labour-market reforms to create high-value skilled jobs, to modernise and liberalise the banking sector, and to advance reforms to the business environment to promote competition and facilitate access to markets.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	2.2	2.5	1.5	-9.3	2.5
Inflation (average)	5.3	7.3	6.7	5.6	5.3
Government balance/GDP	-6.0	-4.5	-3.9	-9.8	-8.3
Current account balance/GDP	-10.3	-11.1	-8.4	-6.8	-7.3
Net FDI/GDP [neg. sign = inflows]	-2.0	-2.5	-2.1	-1.5	-1.4
External debt/GDP	82.4	86.1	97.3	100.3	n.a.
Gross reserves/GDP	14.1	12.9	19.0	23.2	n.a.
Credit to private sector/GDP	80.5	78.9	74.8	82.1	n.a.

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Covid-19: macroeconomic implications

Economic recovery started in the second quarter of 2021. Real GDP increased 15.4 per cent year-on-year in the second quarter, reflecting base effects, after a drop of 2.1 per cent year-on-year in the first quarter, the fifth consecutive quarter of contraction. The tourism and transport sectors continued to be affected by Covid-19 restrictions, and agriculture contracted after a record year in 2020. However, the export-driven manufacturing sector recovered. Inflation remained quite elevated by regional standards, at 5.5 per cent year-on-year in the first nine months of 2021 and a 21-month high of 6.4 per cent in July 2021, driven by a reduction in subsidies and base effects. Meanwhile, the unemployment rate rose to 17.9 per cent in the second quarter of 2021 and was higher than average for women (23.6 per cent) and youth (41.7 per cent).

The fiscal deficit widened and debt increased. In 2020 the fiscal deficit widened to 9.8 per cent of GDP on the back of a decline in revenues, mainly tax and an increase in interest payments, as well as the public-sector wage bill, which, at 17.3 per cent of GDP, is among the highest in emerging markets. Meanwhile, public debt increased to 83.5 per cent of GDP in 2020, of which two-thirds is denominated in foreign currency.

The current account deficit narrowed in 2020, but reserves are diminishing. The change in the current account from 8.4 per cent of GDP in 2019 to 6.8 per cent in 2020 came thanks to the substantial narrowing of the foreign trade deficit, reflecting a sharper drop in imports, notably energy products, than in exports. Meanwhile, tourist arrivals declined by 19.4 per cent year-on-year in the first half of 2021. Moreover, reserves decreased to US$ 8 billion, covering just over four months of imports. Furthermore, in February and October Moody's downgraded Tunisia's credit rating to B3, then to Caa1, maintaining the negative outlook, while in July Fitch downgraded it to 'B-' with a negative outlook. Both agencies cited heightened fiscal and external liquidity risks.

A weak recovery is expected in the short term. GDP is projected to grow by just 2.5 per cent in 2021, before picking up to 3.3 per cent in 2022. The recovery will depend on the pace of vaccination allowing the reopening of the economy, including for the tourism sector, and on the pace of implementing reforms, currently held back by the lack of political consensus and limited ambition to overhaul public administration and SOEs. Fiscal tightening is expected to hold back a stronger recovery, as will lingering effects of the Covid-19 pandemic and the slow recovery in tourism worldwide.

Policy response to Covid-19

The authorities extended some of the policy response measures announced in 2020 into 2021. The 2021 budget law included additional measures to support the most affected enterprises and sectors, especially the tourism sector. These measures included an extension of the state guarantee scheme to the end of 2021, the exemption from corporate income tax payments during 2021 and support for the temporarily unemployed and most vulnerable. Moreover, in January 2021 the Banque Centrale de Tunisie (BCT) revised a methodology to calculate general provisions to address potential financial stability concerns that may arise from the debt repayment moratoria. It also extended the deferral of loan repayments for the tourism sector and for companies to September 2021.

Tunisia's vaccination programme accelerated after a slow start. Tunisia began its vaccination programme in March 2021 but progress in the first four months was slow owing to vaccine shortages, widespread vaccine hesitancy and administrative failings. However, thanks to a surge in international aid, the pace of vaccination accelerated from July and close to two-fifths of the population was fully vaccinated as of early November 2021.

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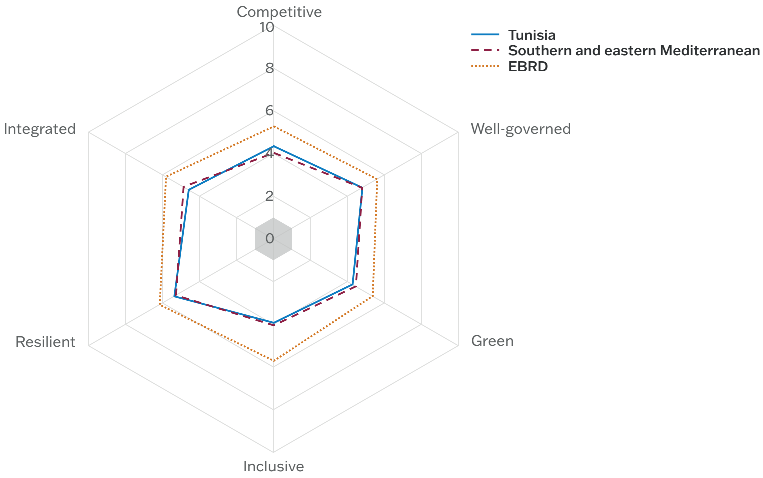
Assessment of transition qualities (1-10)



Structural reform developments

Talks with the IMF for a programme are on hold. The president's decision in late July 2021 to suspend parliament and dismiss the prime minister added further delays to reaching an agreement with the IMF, as did the absence of societal consensus on reforms among various stakeholders. Prospects for reforms were already poor before the president's move. The fragile coalition in parliament, tensions between key political leaders and entrenched social opposition – including from the Tunisian General Labour Union (UGTT) – to budget cuts complicated efforts to advance fiscal consolidation and thus get IMF support. The fiscal situation would require the government to cut its public-sector wage bill, reduce transfers to SOEs and replace subsidies with direct support for the needy, while ensuring adequate and targeted social protection.

The government and unions made some progress on tax and SOE reform. In March 2021 the government and the UGTT signed an agreement to reform the subsidy system, the tax system and seven SOEs. However, the government committed not to privatise these SOEs, some of which are loss-making. Moreover, no agreement was reached on cutting the public-sector wage bill.

Fuel prices increased under the automatic indexation mechanism. Fuel prices, which are adjusted automatically in line with market prices, were raised in February, March and April 2021 after a series of cuts in 2020, when oil prices dropped substantially. The hike in April, by 5 per cent on average, signalled the lifting of the cap on monthly adjustments of 2 per cent. This would have positive effects on the government's fuel subsidy bill, which had already decreased by 70 per cent in the first four months of 2021.

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The economic recovery and regularisation of the law relating to foreign exchange offences has been adopted. The decision by parliament in July 2021 entails about 20 measures, including revaluing company fixed assets for tax purposes, deducting reinvested profits and income from the capital of fully exporting companies, a lower tax burden on housing built by property developers and regularising customs offences. It also allows people, for the first time, to open foreign currency accounts, permits companies and individuals to agree a financial settlement for foreign exchange violations, and enables firms to easily access loans and draw money from the black market. The law has yet to be promulgated by the president to enter into force. However, the BCT has advised the president against doing so, stating that it includes measures that are likely to hamper the sound conduct of monetary policy and affect Tunisia's international commitments and ability to continue to mobilise necessary external funds.

The government's objective to increase the share of renewable energy in the electricity mix to 30 per cent by 2030 is advancing. During 2021 the government launched tenders to develop and build 16 solar power plants with a total capacity of 70 MW. Selected projects will sell electricity to Tunisia's state-owned utility company STEG under a long-term power purchase agreement. Tunisia aims to install 3.8 GW of renewables before 2030. However, private-sector involvement in other sectors traditionally dominated by the public sector has been slow, with only limited progress on the public-private partnership (PPP) agenda.