الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

Republic of Tunisia

September, 2021

TRUST . TRANSPARENCY . INDEPENDENCE

Economic Overview

Table 1: Key Macroeconomic Indicators							
	2017	2018	2019	2020	2021F	2022F	2023F
Real GDP Growth Rate	1.9	2.7	1.0	(8.8)	3.8	2.5	2.0
In ation (year-end)	6.2	7.5	6.1	4.9	6.0	6.4	6.9
Current Account / GDP	(10.3)	(11.1)	(8.4)	(6.8)	(9.5)	(9.4)	(9.3)
Fiscal Balance / GDP	(5.9)	(4.6)	(3.9)	(11.4)	(9.3)	(6.8)	(6.5)
External Debt / GDP	84.6	97.4	92.8	94.7	99.2	101.2	99.3

Following 1% real GDP growth in the year 2019, Tunisian economy shrank by 8.8% in 2020 as Covid-19 induced lockdowns pressured domestic demand and tourism. Agriculture and fisheries segment (11% of GDP) was the main positive driver posting 4.4% growth given record olive oil production, backed by a good harvest. Manufacturing industry (16% of GDP) depicted 9.3% retardation with interruptions to production and economic contraction in Tunisia's EU markets, which reduced external demand. Commercial services segment denoting around 46% of aggregate GDP retreated by 13.3% mainly due to the 64% fall in tourism receipts and a 30% decline in the turnover of the transport sector. Unemployment rate rose sharply in Q4'20 to 17.4%, up from 14.9% at the end of 2019. Employment indicators continued to worsen with unemployment ratio edging up to 17.8% as of Q1'21. Increasing unemployment disproportionally affected low-skilled workers, women, and youth. The Country expects GDP growth of 4% for the year 2021, as per 2021 budget, in line also with IMF estimates. In Q1'21, weakness persisted as GDP declined a further 3% on YoY basis, driven by weak performance of agriculture (largely owing to weaker olive harvest) and services segments, and despite growth in the industrial segment ashydrocarbon production rose and manufacturing export sectors experienced recovery with pickup in demand from the Eurozone.

In January 2021, the Ministry of Health announced a nationwide Covid-19 vaccination campaign. Accordingly, inoculation will be free and targets to cover 50% of Tunisians over 18 years of age (around 6 million people), to cost about USD111mn in 2021 and 2022. In March 2021, Tunisia began its vaccination drive, with front line workers and the elderly. Authorities have received more than 300,000 doses in April2021 and further secured the purchase of more than 10 million doses.

To counteract the repercussions of Covid-19 on the economy, TND2.6bn emergency plan (2.3%of GDP) was announced in March 2020. Revenue measures include solidarity contributions to finance the Covid-related response and measures to provide financial resources to affected sectors. The authorities introduced the Fund 1818 supported by voluntary contributions, withheld one day of salary from all economic agents, increased the tax rate on the interest from bank deposits, and introduced an exceptional 2% profit tax surcharge on financial institutions for 2020–21. On the expenditure front, measures included the additional financing for the health sector; supporting affected businesses and sectors, such as tourism, through interest rate subsidy on investment loans; expanding direct cash transfers to low-income households and supporting the unemployed and self-employed. The budget for 2021 also includes further measures to support the most impacted enterprises and sectors, especially tourism, and including an extension of the state guarantee scheme till the end of 2021. Exemption from corporate income tax payment in 2021 and support for temporarily unemployed due to the COVID-19 shock, are other notable measures.

Inflation had been trending low at 4.9% as of year-end 2020 (2019: 6.1%). On the other hand, core inflation excluding food and energy prices registered at 5.9% at the end of 2020. Downtrend in inflation could be attributed to the contraction in domestic demand and lower international fuel prices. At the end of June 2021, annual headline inflation increased to 5.7% while core inflation eased to 5.4%.

In 2020, CBT reduced its policy rate in two steps by a cumulative 150 bps in March and September 2020. The rate cuts were justified given the downtrend in the pace of inflation and aimed at establishing favorable conditions to boost investment and resume the pace of economic activity while preserving financial stability. Since then, policy rate was kept unchanged at 6.75%.

The current account deficit as a percentage of GDP has retreated to 6.8% in the year 2020 from 8.4% for 2019 as the decline in exports at 11.7% was lower than 18.7% annual drop in imports. On the other hand, 8.7% annual increase in the income of Tunisians living abroad also contributed to consolidation of favorable performance in the external sector, despite the sharp drop of 64.1% in tourism receipts. In the first four months of 2021, CAD has declined to TND2,744mn or 2.3% of GDP, down from 2.7% in the corresponding prior year period as trade deficit narrowed further (down 8.7%) and remittance grew (up 16.8%) which collectively overcame the further decline (55%) in tourism revenues. Hence, net foreign currency assets reached TND20.8bn or 139 days of imports at the end of May 2021, against TND21.5bn or 137 days of import on the same date of the previous year. According to IMF, current account deficit is expected to move up to 9.5% of GDP at the end of year 2021, as imports begin to recover in line with improved domestic demand and as oil prices increase.

Following depreciation of 7% and 9.1% respectively against USD and EUR in the year 2019 as against 2018, TND depicted relatively stable performance in the year 2020 gaining 3.5% against USD while losing 5.6% against EUR and reflecting the EUR/USD parity moves. So far in 2021, TND has depreciated 3.5% against USD and 1.0% against EUR as of July23rd. The currency is likely to remain stable, barring material deterioration in current account balance.

Tunisia's public finances depicted budget deficit of 11.4% of GDP in 2020, the highest in nearly four decades whereas the 2021 budget forecasts 6.6% deficit to GDP. Fiscal deficit increase in 2020 was precipitated by lower tax revenues and expansion of wage bill due partly to additional hiring mainly in health sector, only partly mitigated by lower investment spending and energy subsidies. On a nominal basis, budget deficit surged by 92% to TND7.1bn in the first 11 months of 2020 with 6.4% contraction in tax revenues and 2.9% YoY increase in expenses as salary expenses grew 12.8%. In Q1'21, budget deficit narrowed down by 27% YoY to TND760mn with 1.7% rise in tax revenues and 2.3% decline in expenses.

In October 2020, the parliament amended the CBT's statutes so that it is permitted to provide TND2.8bn direct monetary interest-free financing to government budget with a maturity of up to 5 years with a one-year grace period. The 2021 Finance Law for Tunisia abolished the corporate tax rates of 25%, 20% and 13.5% and replaced with a single rate of 15% applicable to financial year 2021. On the other hand, corporate income tax rate of 10% is applicable for investment in agriculture, fishing, handicrafts, environment protection, and the rate of 35% applicable to the financial sector, oil and gas and telecommunications has remained unchanged.

According to the reform bill within the context of IMF Program, Tunisia aims to cut all general subsidies by 2024 and reduce the wage bill to 15% of GDP by 2022 from 17.4% in 2020, through early retirement and reductions in working hours. The proposal to cut subsidies is said to embody first phasing out food subsidies and then gradually ending subsidies for electricity and oil. The Country is said to seek USD4bn loan from IMF for which discussions had started in May 2021 and are expected to last for two months[1].

The first government Sukuk issue is targeted by July 2021 to raise up to TND300mn from local markets. The 2021 budget provides for a total of USD7.2bn borrowing including USD5bn from external markets. Gross external debt comprises mainly government debt (49.7%) followed by non-FI corporates (26.6%) and financial institutions (14.3%). At the end of December 2020, external debt stock went down by 0.8% reaching TND111.1bn.

Banking Sector

Tunisian Banking Sector comprises 23 banks as of April 2021 among which 3 are Islamic Banks. Following an annual asset growth of 0.9% in 2019, growth accelerated to 6.5% in 2020and total assets reached TND131.7bn by year-end. Islamic Banks share stood at 6.1% in system assets at end 2020 (2019: 5.6%). In addition to AlBaraka Bank Tunisia, two full-fledged Islamic Banks operate in the country being Banque Zitouna (BZ) and Wifack International Bank (WIB). Bank Zitouna dominates with a market share of 58.5% in the Islamic Banking segment as of year-end 2020 whereas WIB's market share stood at 10.3% in terms of assets.

[1] *https://www.reuters.com/world/africa/tunisia-seek-4-bln-imf-loan-pm-says-2021-04-30/*

Table 2: Banking Sector Indicators					
%	**2016**	**2017**	**2018**	**2019**	**Q3 2020**
NPLs to Total Loans	15.6	13.9	13.3	13.4	13.1
Speci c Provisions to NPLs	57.9	57.0	55.7	55.9	58.2
Net NPLs to Total Loans	6.6	6.0	5.9	6.2	6.2
Loans to Deposits Ratio	115.2	116.7	117.4	113.9	112.0
Capital Adequacy Ratio	11.3	11.8	11.7	13.0	13.2
Tier 1 Ratio	8.6	8.8	9.0	10.6	10.8
Average Spread btw. Loans and Deposit	2.9	3.2	3.9	4.4	n/a
Return on Assets	1.0	1.2	1.2	1.1	n/a
Return on Equity	11.4	13.8	13.5	13.3	n/a

Loan growth at 6.9% for the sector in 2020 depicted modest deceleration from 7.1% in 2019. Consumer loan growth of 5.8% was noteworthy, while credit to business expanded by a sharper 7.2%. Within consumer loans, general-purpose financing and particularly housing finance remained dominant drivers of growth, although at 23.4%, the consumer segment remains under financed. FCY lending is limited at 5.1% of aggregate lending book and has remained broadly stable over the course of the last few years.

Even though nonperforming loans have gradually retreated in relation to total loans after peaking at 16.6%, at the end of year 2015, the most recent NPL ratio reading of 13.1% as of September 2020 (2019- year end: 13.4%) remains still high by international standards. Following the lifting of forbearance measures taken to address the pandemic, non-performance is likely to depict modest uptick. Impaired loans are provisioned to the extent of 58.2% as of September 2020 with specific provisions, with net impairment around 5.5% of financings.

In the last several years, capitalization of the sector has been gradually and modestly improving owing to better internal capital generation. By end September 2020, total CAR and tier-1 ratios for the sector stood at 13.2% and 10.8% respectively, denoting 20bps improvement compared to year end 2019 and 150bps and 180bps increase over 2018. As such, the sector has sufficient buffers over 10% and 7% thresholds set by the CBT for CAR and tier 1.

One of the early steps taken by the CBT to moderate the impact of the Covid-19 pandemic was deferral of maturities of loans granted by banks. By year end, the CBT had extended the period for companies hit by the corona virus pandemic to defer loan repayments to September 2021 subject to approval of banks. CBT also let banks grant new loans for a tenor of up to seven years, including a two-year grace period until year end 2021, to assist with business recovery. Such postponement will also ease off asset quality related burden to be absorbed over a period of time. Banks extended deadline for loan payments for almost 20,000 companies[2] (a value of TND5bn) indicating that about 99% of the rescheduling requests submitted were approved[3].

In early 2021, CBT issued a circular regarding general provisioning (or collective provisioning) so as to cover latent risks in standard loans and under close monitoring loans, so as to incorporate risk weights as per economic sectors and cover for high-risk sectors such as tourism and real estate brokerage. Accordingly, the Banks were to set aside these additional provisions against the performing portfolio effective from year-end 2020 to build buffers proactively. These incremental provisions shall address potential financial stability concerns that may arise from the debt repayment moratoria.

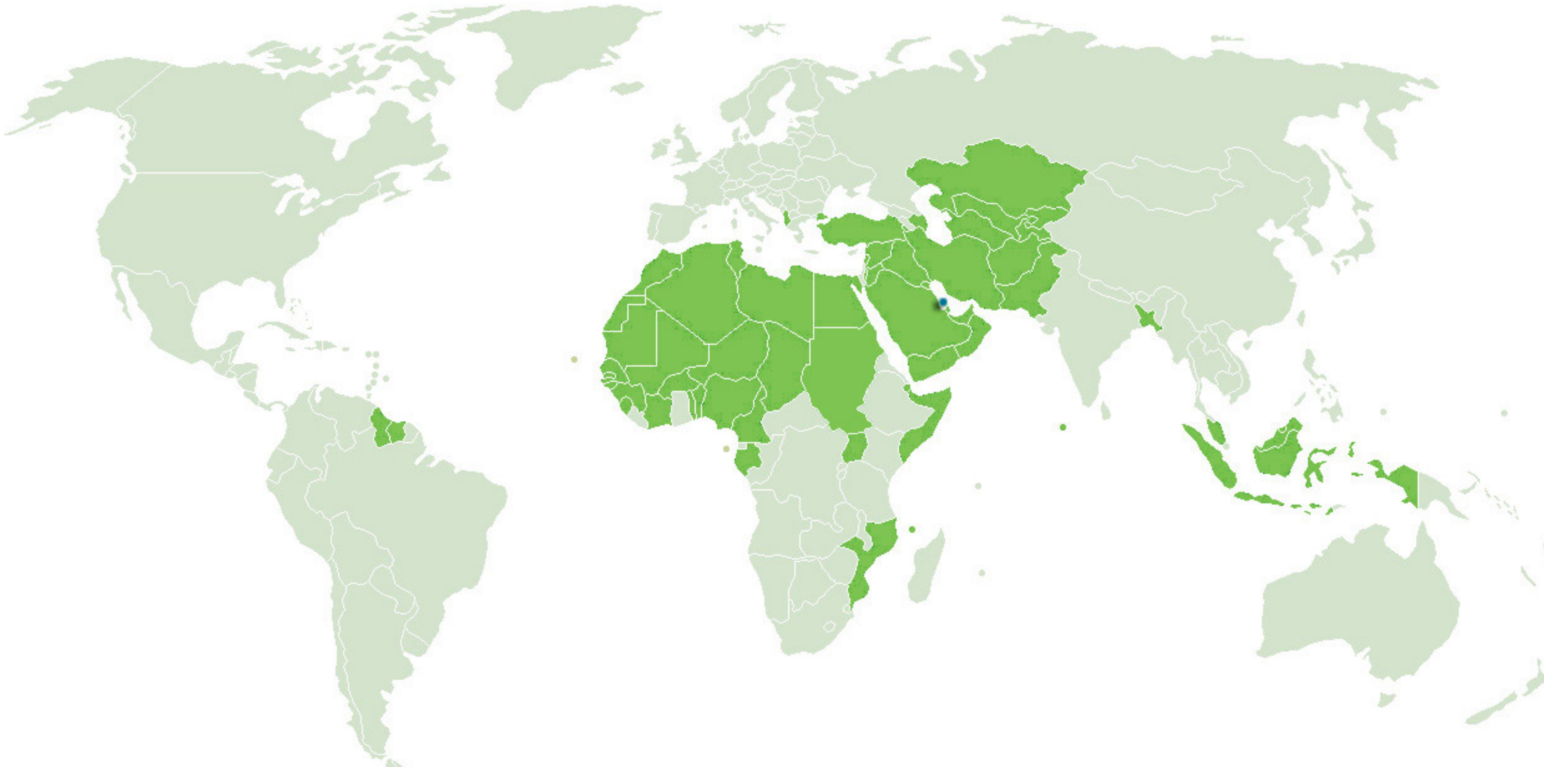
There had been an improvement in profitability indicators of the sector over a timeline until year-end 2019 as spreads widened within a higher rate environment. In 2020, a 150bps rate cut by the Central Bank pressured the margins and net banking revenues increased by only 1.1% for the 12 banks quoted on Bourse de Tunisas against 13.4% increase for 2019 over 2018. By the same token, net banking revenues of 12 banks grew by 5.5% on aggregate in Q1'21 over Q1'20.

Following the spread of Covid-19, CBT directed banks and financial institutions to suspend the distribution of dividends or any planned buyback of shares for the fiscal year 2019 to protect their capital and maintain excess buffers. In addition, the government announced a set of financial measures including the creation of investment funds (TND600mn), a state guarantee for new credits (TND500mn), and the activation of a mechanism for the state to cover the difference between the

[2] *According to comments of His Excellency, Governor of the Central Bank of Tunisia*
[3] *https://www.tap.info.tn/en/Portal-Economy/14086914-banks-covid-19*

policy rate and the effective interest rate on investment loans with a cap of 3%.As part of the 3-year Strategic Plan of the Central Bank, IFRS-9 will be implemented by banks starting from the year-end 2021. Banks and FIs will test the resultant impact on their accounting systems at the end of March 2021, as required by the BCT. Implementation is likely to increase provisioning charges due to forward-looking provisioning brought on by IFRS-9.

Meanwhile, there is a need to adopt an economic recovery plan based on an innovative financing mechanism for the restructuring of companies which suffered most from the pandemic. This economic recovery plan focuses on strengthening the equity of companies and adopting an innovative mechanism to support companies with large production and employment capacity and it will be based on the partnership between the various operators: The State, banks, donors and foreign partners as well as on the orientation of the private sector towards investment in restructuring funds. CBT is expected to commence the elaboration of the technical framework and the implementation plan of the innovative financing mechanism, subject to consultation with the banking sector.



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