



الوكالة الإسلامية الدولية للتصنيف  
Islamic International Rating Agency

# ECONOMIC & BANKING SECTOR OVERVIEW

**Republic of Tunisia**

*October, 2018*

**Economic & Banking Sector Overview– Republic of Tunisia**

The Republic of Tunisia is a strategically located country on the Mediterranean Sea route in the North African belt. With a GDP of USD 40b and a population of 11.6m in 2018, Tunisia is categorized as a lower middle income country. Roughly two-thirds of the economy is driven by the services sector, with one-fourth comprising industry and agriculture constituting a further 10%.

Despite being the only country emerging with a stronger democracy following the Arab Spring, Tunisia's economy has struggled since then. Installments of payments from IMF following the agreement executed in 2016, brought partial relief to the economy. This year, the country will hold parliamentary elections in October and presidential elections in November.

Tunisian economy expanded 2.5% in 2018, following a 2% expansion in 2017 as per the National Institute of Statistics. However, this was below the 2.9% target set by the government. Despite stellar yearly growth in agriculture at 9.8%, stemming from an exceptionally good olive harvest, overall growth in the economy was dampened by the manufacturing and non-manufacturing industry (i.e. mining) segments at 0.3% growth and 1.2% contraction, respectively, vis-à-vis the prior year. Meanwhile, the services sector activity expanded 3.3% y-o-y on the back of tourism segment's improving performance.

For the current year, the government has projected 3.1% GDP growth, however, the pace is so far trailing behind expectations, having decelerated to 1.1% y-o-y in H1'19 despite relatively benign readings on agriculture and services while the manufacturing industry weighed negatively on headline growth due to both drop in fuel production and weak external demand conditions. Meanwhile, IMF forecasts amelioration in economic activity in the medium run with progress in tourism as well as pick up expected in the manufacturing industry.

Annual inflation stood at 7.0% as of May 2019 with food inflation hitting 7.3% and FCY linked components such as transportation, houseware and clothing related inflation having edged up. Presently, inflation level is above historical averages given the sizable depreciation of the currency which shed around 18% of its value vis-à-vis USD in 2018. Central Bank of Tunisia raised the key interest rate by 100bps to 7.75% in February 2019 which brought the cumulative rate hikes since March 2017 to 350bps. The TND has so far remained steady against the USD in 2019, and appreciated slightly given the rate hike by CBT and weaker USD compared to emerging market currencies, due to expectations of a potential rate cut by the Federal Reserve, which is expected to ease pressures on inflation for the rest of the current year.

Despite the improving tourism revenues and higher transfers from Tunisians abroad, the country's current account deficit continued to deteriorate in 2018, reaching 11.2% of GDP on account of worsening trade deficit (2017 CAD: 10.2% of GDP). Net assets in foreign currency posted a decrease that came to TND13,050m or 74 days of imports compared to TND13,974m or 84 days at the end of 2018. This drop is mainly attributable to external debt servicing along with the delay in drawdowns on scheduled external financing.

In line with the fiscal discipline measures parallel to IMF prescriptions, the budget deficit in the Q1'19 dropped by around 4% to TND912m as income tax and corporate tax revenue grew notably by 48% and 45% respectively, while indirect taxes (54% of total tax base for Q1'19) also grew by 7%. For 2019, the government expects to reduce the budget deficit as a percentage of GDP to 3.9% compared to 4.9% in the previous year. Among the measures to increase revenues, corporate tax on banks was raised to 40% from 35%; VAT increased by 1% and an additional 1% new social security tax on employees and companies was imposed. These followed the tax hikes in 2018 on cars, alcohol, telephone calls, the internet, hotel accommodation and other items. Meanwhile, 2019 budget incorporated exemption for startups and aid for SMEs as well as increased financing for the employment fund. Starting from 2020, the government will also introduce 1% revenue tax on banks, insurance companies, telephone operators and companies in oil & hydrocarbon industries and this contribution will be directed towards funding Tunisia's social welfare benefits. The country also expects to reduce the share of public sector wages as % GDP to 12.5% in 2020 from 15.5% in 2020. As of September 2018, gross government debt is around 74% of the country's GDP.

Unemployment rate maintained its high levels at around 15.5% as of year-end 2018, same as prior year and declined slightly to 15.3% as of end of Q1'19. Youth unemployment at 33.4% and unemployment rate for university graduates at 28.8%, present challenges to the society and economic activity.

**Banking Sector**

With a banking asset base of TND 123.4b as of February 2019, Tunisia has a diversified financial market with 12 banks, 7 leasing companies, 4 insurance companies, and 5 investment companies among others. There are 3 Islamic banks, market share of which has been on a steady rise, having reached 3%.

The process of upgrading the Tunisian banking system continued in 2018 with the Central Bank issuing new regulations on bank deposit guarantee, liquidity and credit risk management. First three-year Strategic Plan of the Central Bank of Tunisia (2019-2021), aims mainly to establish a clear and transparent governance framework for monetary policy conduct, implementing a macro-prudential operational framework to prevent risks, reduce the usage of cash in the economy and enhance the effectiveness of data collection systems.

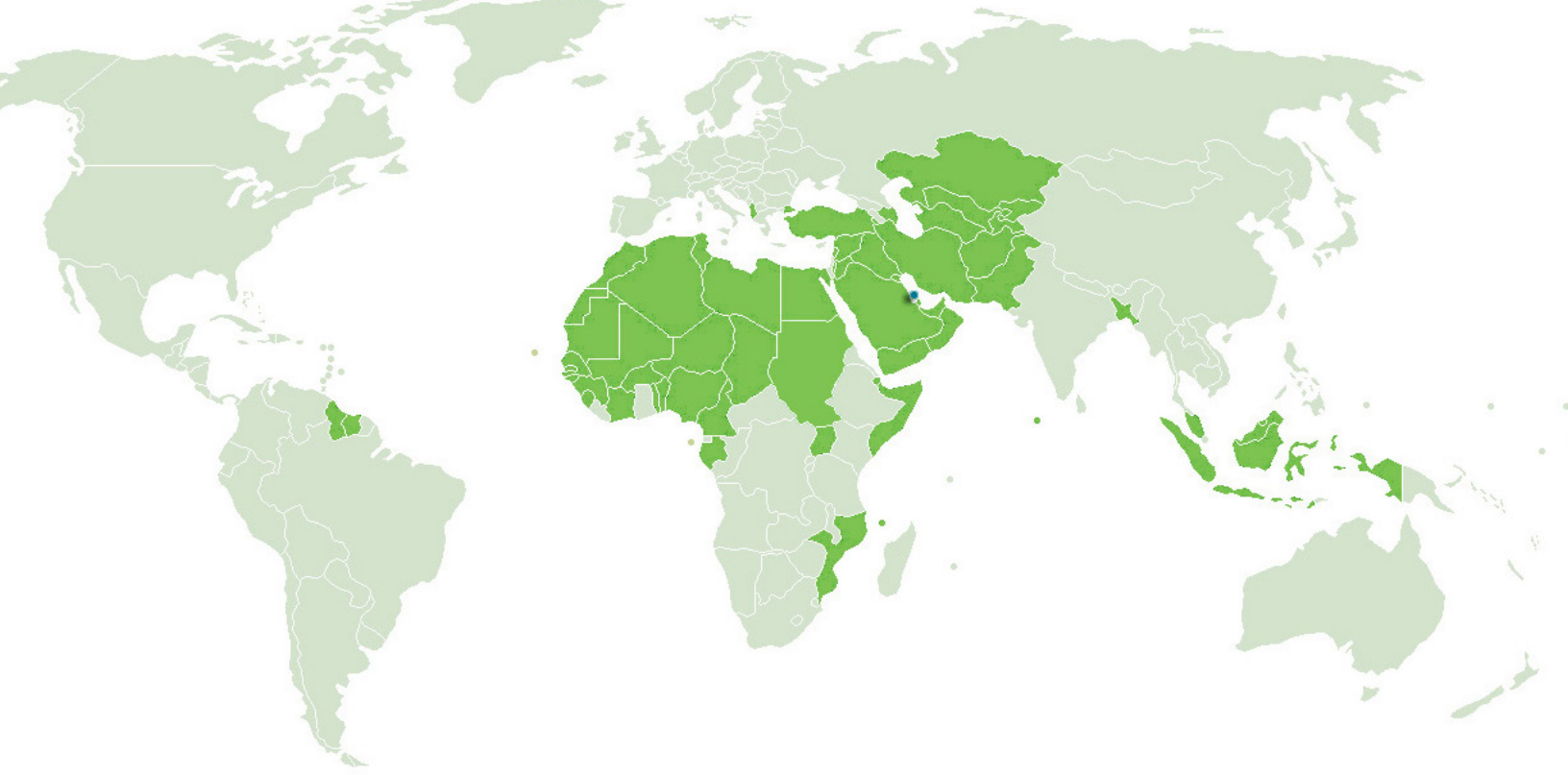
%	2014	2015	2016	2017	Q1'18
NPLs to Total Loans	15.8	16.6	15.6	13.9	13.9
Specific Provisions to NPLs	58.0	56.9	59.0	63.3	63.7
Net NPLs to Total Loans	6.6	7.2	6.4	5.1	5.0
Deposits to Loans	88.8	87.4	86.8	85.4	84.8
Capital Adequacy Ratio	9.4	12.0	11.6	11.9	11.8
Average Spread btw. Loans and Deposits	3.1	3.0	2.9	3.2	3.3
Return on Assets	0.9	0.9	1.0	1.2	n.a

In 2018, the sector's asset base grew by around 10.2% while loans expanded 9.4%. Sector's loan book corresponds to about two-thirds of the asset base as of year-end 2018. Around one-fourth of the lending book of the Tunisian Banking Sector pertains to retail loans meanwhile industry and commerce have around 28% and 16% share in the total lending of the system. Tourism and agriculture, the other two important components of the country's economy have relatively lower shares with 5% and 3% respectively. Foreign currency loans contribute approximately 5% of total lending.

Aggregate NPL ratios have been very high on account of legacy impairment (driven by lending to tourism sector) yet falling slightly in the last few years (Q1'18: 13.9%), as new impairments remain minimal, evidenced by lower cost of risk, despite the increasing provisioning coverage ratio over time. Total average CAR is only slightly above CBT threshold of 10% and new capital and asset impairment accounting related regulations could pressure capital ratios further while liquidity issues in the system persist. Higher interest rates coupled with CBT requirement capping loan-to-deposit ratios at 120% (sector average of around 130%) as of December 2018, is likely to constrain growth of new financings as well as pressuring the debt payment ability of companies and households.

Tunisian Banking Sector's profitability has been on an uptrend supported by improving volumes and spreads, better efficiency and lower cost of risk. Elimination of lending caps could help the sector to price risk better and achieve better risk adjusted returns. Overall, the operating environment will continue to weigh negatively on growth and asset quality of the banks going forward.

<sup>1</sup> Source: IMF



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