الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

ECONOMIC & BANKING SECTOR OVERVIEW

The Republic of Tunisia

February , 2018

TRUST . TRANSPARENCY . INDEPENDENCE

Economy Overview – Republic of Tunisia

The Republic of Tunisia ('Tunisia' or 'the country') is strategically located on the Mediterranean Sea route in the North African belt. The country has an estimated population of 11.375mn in 2016. The unemployment rate has remained high at 15.3% in the first quarter of 2017, value added exports are few, tourism activity has declined, both on account of global decline in tourism and the aftermath of civic and security related disorders in recent years. The formation of a national unity government by way of coalition of the main political parties and civil society groups in September 2016 was a positive political development and is since reflected in a more conducive economic environment.

Agriculture (olive, grain etc.) and mining (mainly phosphate and iron ore) are the key economic activities of the country besides textile. Key trade partners mainly include the Euro zone and China to the East.

Table 3: Key Economic Indicators[1]

	2012	2013	2014	2015	2016f	2017f
GDP at current prices (USD bn)	45.0	46.3	47.6	43.6	44.0	44.4
Real GDP Growth	3.9%	2.4%	2.3%	0.8%	2.0%	3.0%
Consumer price index (CPI), end of period	5.9%	5.7%	4.8%	4.1%	4.0%	3.9%
Current account (in percent of GDP)	-8.3%	-8.4%	-9.1%	-8.9%	-7.7%	-7.0%
Fiscal Balance (excluding grants)	-5.8%	-7.5%	-4.3%	-5.5%	-4.6%	-3.9%
External debt (USD bn)	24.0	26.0	26.7	26.7	29.3	30.7
Central government debt (foreign and domestic)	45.5	44.5	49.0	53.2	54.6	54.5

The economic performance of Tunisia has remained under pressure over the years. The country is running a high fiscal deficit which peaked at 7.5% in 2014 and estimated at 4.6% in 2016. The current account deficit is estimated to remain negative even in 2017 at 3.9%, although rapid narrowing of the same is a favorable trend. The current account component i.e. imports and exports both have been on a declining trend. The following chart depicts the overall economic performance which marks an improving trend in current account, fiscal balance and GDP growth which has picked from a low of 0.8% to an estimated 3% in 2017. However, with continuing (although narrowing) twin deficits, national indebtedness is unavoidably on an increasing trend being estimated to exceed 70% in 2017 and making the country increasingly vulnerable to external shocks. Tunisia's international reserves are also declining since 2012 given that foreign exchange revenues from exports and tourism are declining in the foreground of slower growth in Europe.

Figure 2: Key Economic Indicators Snapshot

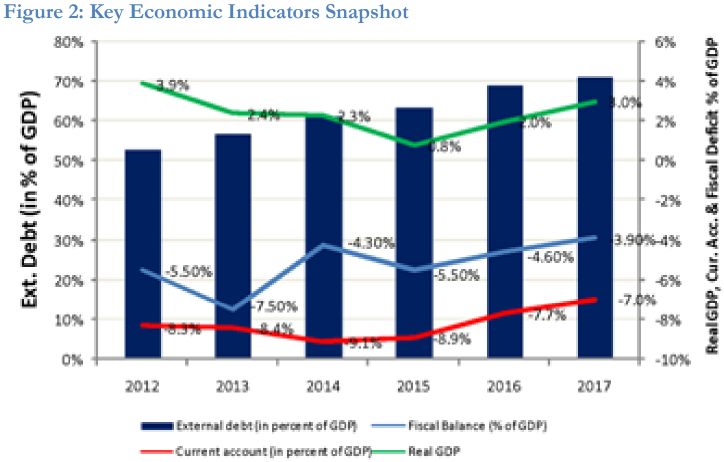
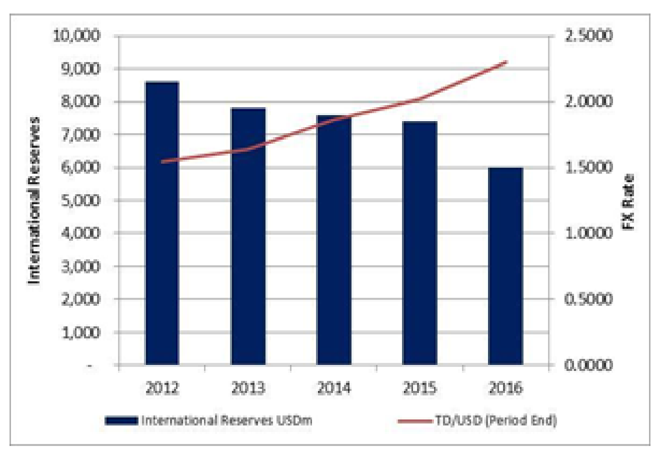


Figure 3: Foreign Exchange Rate and Reserves



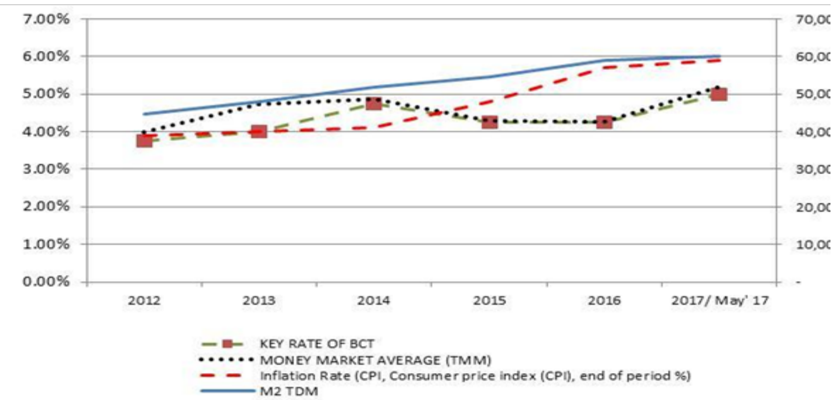
[1] *Source: IMF Data and press releases*

In May 2017, the Tunisian government announced plans of USD 500mn Sukuk to cover its budget deficit. The deteriorating economic conditions and international reserve position of the country has taken its toll on the local currency. The Tunisian Dinar has lost 5.84% of its value in 2017. The current and projected economic performance suggests continued pressure on local currency value and on the country's international reserves position. Figure 3 summarizes this trend over the last five years.

The Tunisian banking sector comprises 18 universal banks, 2 banks specialized in microcredit and small and medium-sized businesses financing, and 3 Islamic banks. The most recent entrant in Islamic banking is Wifak Bank, following its transformation from a leasing company in late 2015. In addition to the 23 onshore banks, the country has a total of seven offshore institutions. The largest players in the sector are Banque Internationale Arabe de Tunisie (BIAT), the majority state-owned Banque Nationale Agricole (BNA) and the locally owned Amen Bank.

The banking sector has been affected by the overall economic climate. Dinar depreciation and a general increase in price levels led the Central Bank of Tunisia (CBT) to increase its policy rate by 75 basis points to 5 percent over first half of 2017 to contain inflation below 5 percent, as shown in the following chart. The money market rates that directly influence the banking sector's credit supply level and cost of funds has also been on the rise. The rising M2 money supply indicated pressures stemming from the budget deficit and reduced access to international funds, available to the country barring international institutions such as IMF etc.

Figure 4: Monetary Variables



The current business environment puts pressure on assets' credit quality, profit spreads and business growth. In a challenging economic scenario, overall assets prices level and liquidity may go down making it difficult for banks to liquidate collateral if needed.

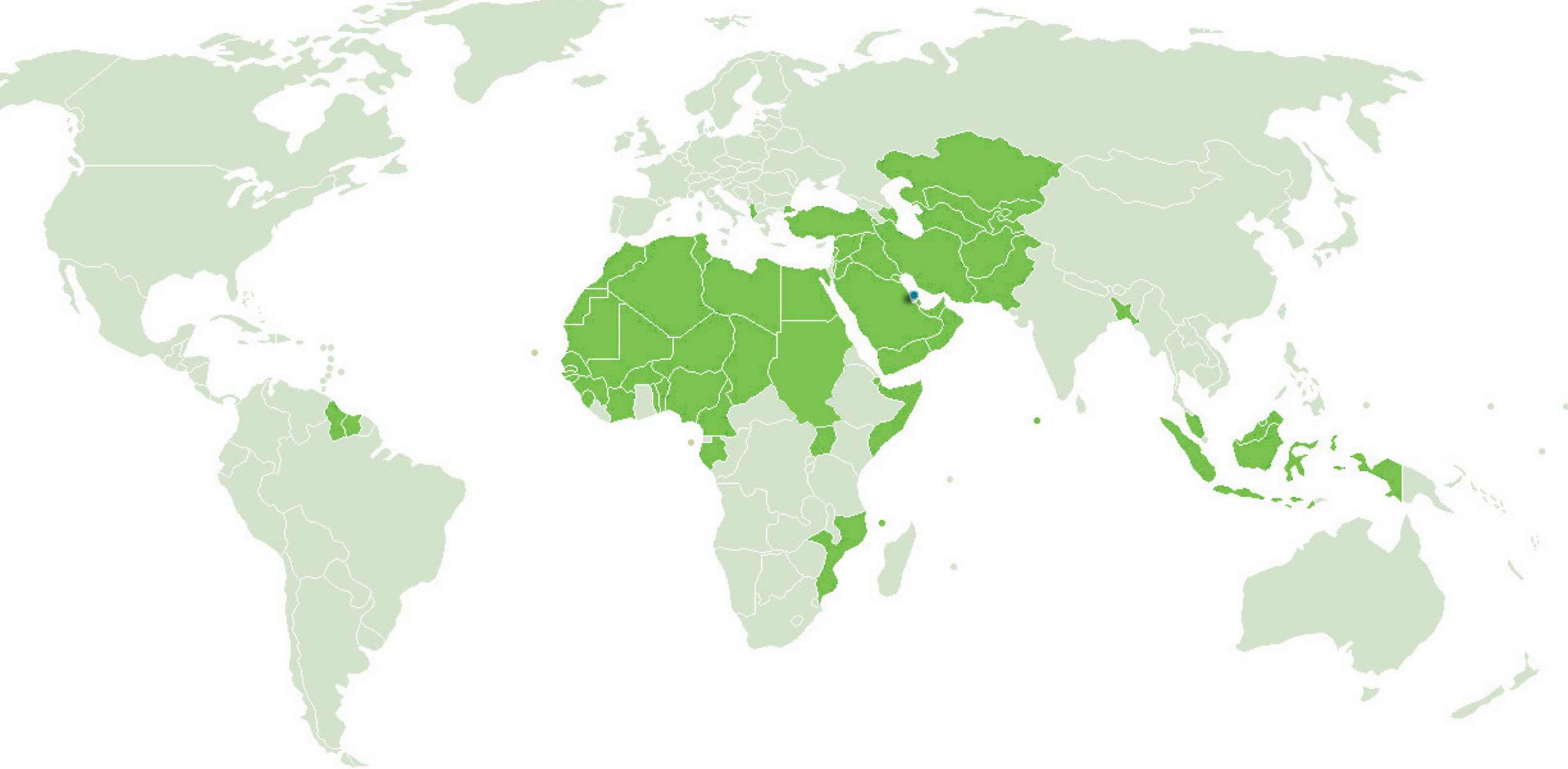
On a positive note, new banking regulations were introduced in 2016. Aside from setting higher new capital requirements (minimum of TND 50mn), the New Banking Law No. 2016-48 establishes a dedicated regulatory framework for Shari'a compliant financial services and allows conventional banks to offer Islamic banking products through Islamic windows.

From a corporate governance perspective, the new law mandates the separation of the roles of director-general of a bank from that of Chairman of the board of directors and the establishment of management appointment and remuneration committees at the board level. It also provides guidelines on the exact roles of the board and other entities within banks and obliges banks to include independent board members. In an attempt to further stabilize the financial system and protect financial consumers, the law establishes a new deposit guarantee fund that will guarantee deposits of up to TND 60,000 in the event of a bank failure. This is expected to provide coverage to approximately 95% of banking customers. The law caps related-parties lending at 75% of the value of a bank's capital in 2017. This is to be reduced to 25% in 2018. Further reforms are in the pipeline as CBT aims for sector-wide compliance with Basel III standards by 2020.

2016 also marked the establishment of the country's first credit and insurance bureau. The private platform will collect data from banks, financial organizations, insurance companies, telcos, utilities and micro-finance institutions, providing lenders with more comprehensive data on potential borrowers and means to better assess credit risk.

These notable developments in Tunisia's Islamic finance industry were reflected in a higher ranking in The Islamic Corporation for the Development of the Private Sector (ICD)-Thomson Reuters Islamic Finance Development Indicator (IFDI[2]) Report 2017.

[2] *IFDI covers the entire Islamic finance ecosystem in terms of Quantitative Development, Knowledge, Governance, Corporate Social Responsibility, and Awareness.*



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Islamic International Rating Agency

P.O. Box 20582, Kingdom of Bahrain
Tel: +973 17211606, Fax: +973 17211605
Website: www.iirating.com | Email: iira@iirating.com