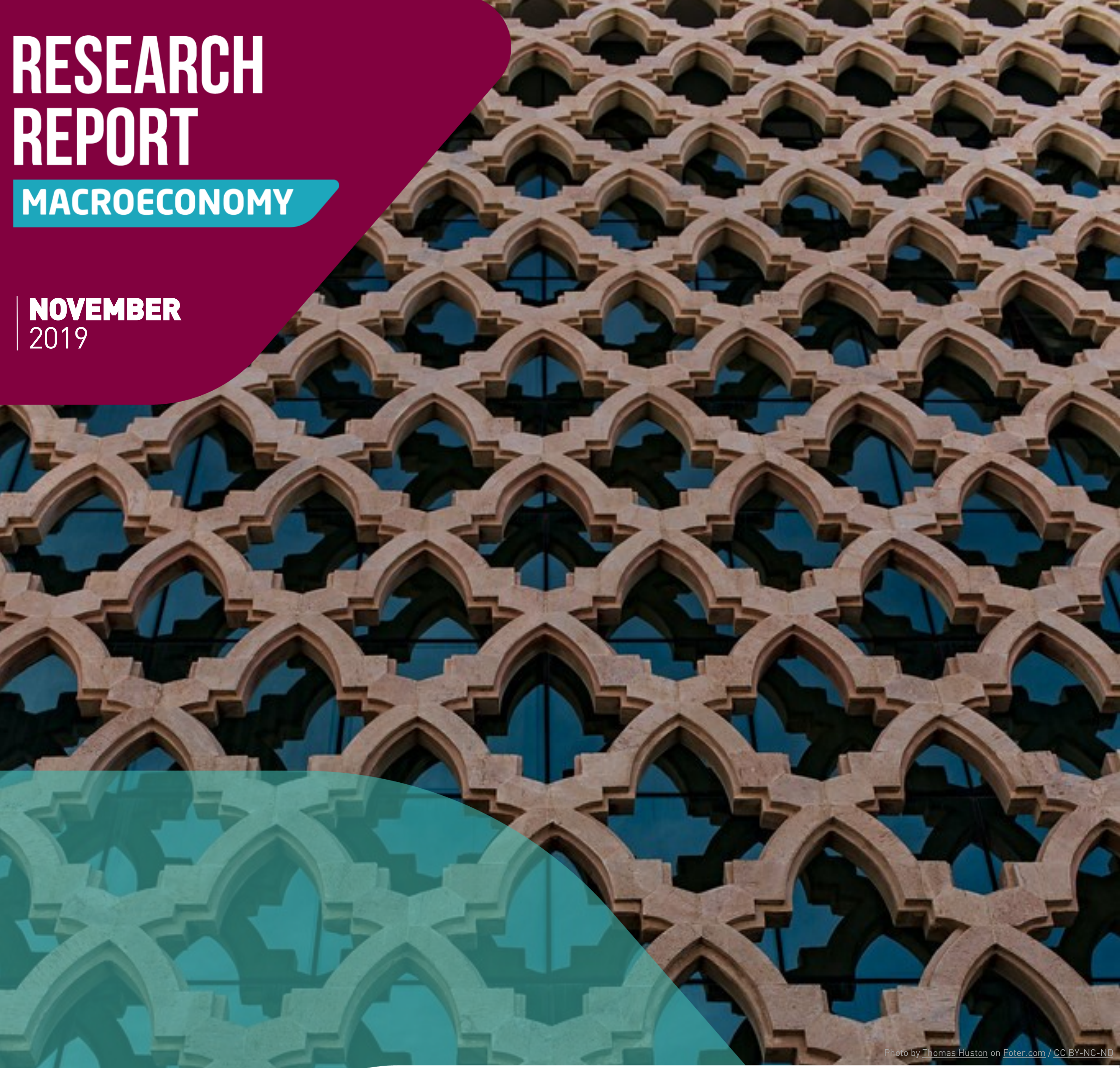
RESEARCH REPORT

MACROECONOMY

NOVEMBER
2019



Tunisia: Finance Act Draft 2020

A text adapted to a transition period

Attijari Global Research

RESEARCH REPORT
MACROECONOMY

26 | NOVEMBER 2019

By Attijari Global Research

GDP GROWTH		FISCAL DEFICIT		GENERAL BUDGET (TD*)		CAP. EXPENSES (TD*)	
↗	+ 1.3 pts	↘	-0.5 pt	↗	+9.5%	↗	+14.7%
FAD 2020	2.7%	FAD 2020	3.0%	FAD 2020	47.2 Bn	FAD 2020	7.2 Bn
2019E	1.4%	CFA 2019	3.5%	2019E	43.1 Bn	CFA 2019	6.3 Bn

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Tunisian Economic indicators call for greater dynamism in monitoring economic policy. Indeed, GDP growth would slow down in 2019E to 1.4% from 2.5% a year earlier. The fiscal deficit, despite its improvement, remains considerable with the 2019 forecast of 3.5% of GDP against 4.8% in 2018. The current account deficit of the balance of payments is expected to be below 10%** in 2019E compared to 11.2% a year ago.

The Finance Act Draft (FAD 2020) is indeed a real opportunity to implement new corrective measures for this downward growth trajectory, and to consolidate the fiscal balance while providing the necessary support measures in order to restore a normative level for the balance of payments.

Thus, the expectations of the economic actors are multiple. The FAD represents a chance for fiscal policy to introduce measures capable to spur not only economic dynamism, but even improve the climate of confidence.

The analysis of the FAD 2020 content suggests that this text is adapted to a transition period. This project contrasts with the FA 2019 which had carried out an accurate diagnosis of the economic situation in Tunisia, targeted some of the country's main economic issues and proposed measures within the available leeway.

The main focus of this Act is the consolidation of fiscal balances with the ambition of achieving a "sustainable" level of fiscal deficit of 3% of GDP and avoiding any new taxes aiming to support public finances.

Enjoy your reading.

* At 11/26/19: 1 TD= 0.32 Euro = 0.35 USD

** TCB Forecasts

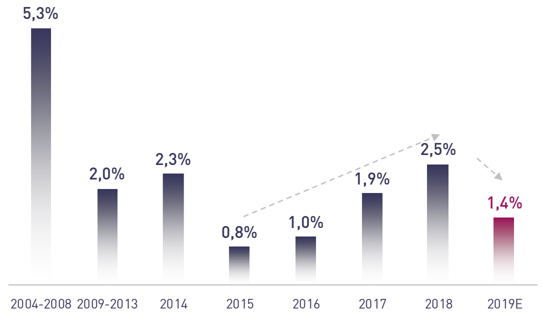
Sources: Ministry of Finance, AGR Calculations

A SPECIAL ECONOMIC CONTEXT...

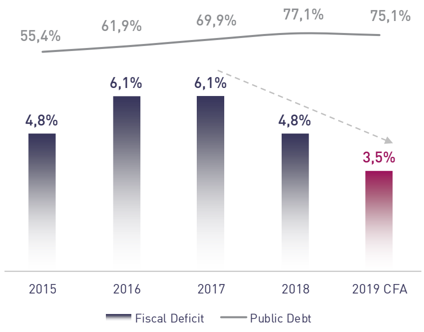
Decline in growth... confirming its fragile nature

Expected at 1.4% in 2019E, Tunisian GDP growth breaks the economic acceleration observed since 2016 by increasing from 0.8% in 2015 to 2.5% in 2018. This confirms the fragile nature of the economic recovery in Tunisia and keeps it far from the 5.3% threshold observed during the five-year period 2004-2008.

ECONOMIC GROWTH (GDP)



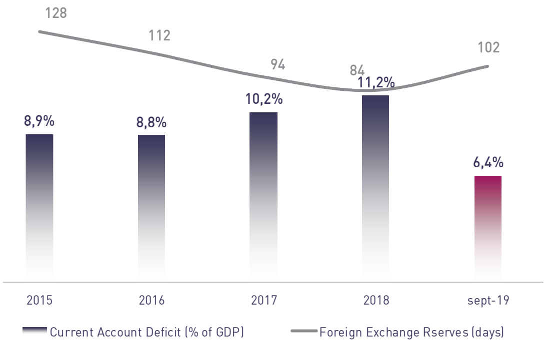
FISCAL DEFICIT VS. TREASURY DEBT (% OF GDP)



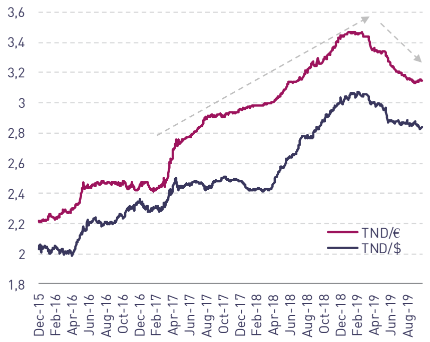
Rebalancing public finances...a real success of fiscal policy

In our opinion, the reduction of the fiscal deficit is the main success of fiscal policy in Tunisia. A 'restrictive' fiscal policy has become a priority due to the large rebound in the Treasury debt stock (75% of GDP), its predominantly foreign structure (74%), and its high cost.

EXTERNAL INDICATORS



EVOLUTION OF TND AGAINST USD AND EURO



Dinar recovery ... a cyclical upturn

While the TND recorded a significant slide against the Euro all over 2018, moving from a TND/EUR parity of 2.95 to 3.41 (-15.6%), it has recovered as of February 2019 from 3.45 to nearly 3.15 in mid-November 2019 (+ 8.7%). A behavior that reflects a consolidation of foreign exchange reserves (102 days of imports [+ 20d]) related to:

⇒ the improved performance of tourist revenues (+38%) ;

⇒ the slight improvement in the coverage rate of imports by exports to 69% (+1.5 pts); and of course

⇒ the inflow of foreign currency related to the Eurobond issuance of 500 M€ in October 2018, followed by 700 M€ in july 2019.

This cyclical upturn can not hide the structural deficit of the current account of the balance of payments which is forecasted at a level lower than 10% in 2019E according to the Central Bank of Tunisia against 11.2% in 2018.

Sources: Ministry of Finance, Central Bank of Tunisia, AGR Calculations

... WHICH RAISED CONCERN

The current economic context calls for a strong mobilization of economic policy to achieve the targets of accelerating growth and restoring economic equilibria. To this end, the Finance Act represents a real opportunity for fiscal policy to introduce measures capable to spur economic dynamism and even improve confidence climate. At the same time, the Central Bank of Tunisia is pursuing a restrictive monetary policy to reduce inflation (currently 6.7%). To this end, we present a collection of the economic actors expectations :

⇒ Efforts to integrate the informal sector

Estimated at 35% of global trade according to the Governor of the Central Bank of Tunisia, the informal sector had prospered since the period after the «Arab Spring». The gradual integration of the grey economy would help to expand the tax base, contributing to reinforce a feel of tax fairness and to reduce liquidity shortage of the banking system.

⇒ Incentives for the private investment

It is well known that the success of a recovery program can not rely on the public sector alone. The involvement of the private sector is primary. Indeed, the increase in the development expenditure budget can not be sufficient to ensure sustainable growth. Beyond tax incentives, we expect forming Public Private Partnerships (PPP), in-kind support such as mobilization of land or measures to protect local production.

⇒ Financing support

The size of the current account deficit of the balance of payments combined with the sharp rise in rates complicates access to loans. In this context, the development of the local financial sector would open up new access for businesses to funding and reduce exposure to foreign sovereign debt.

⇒ Employment support

Despite an estimated unemployment rate of 15.1% of the labor force in Q3-2019, the Government limited recruitment for public service to urgent needs and to graduates of the top-ranking higher education establishments. While this restriction is fiscal in nature, it does not exclude the possibility of introducing more flexibility into labor legislation, and thereby supporting investment in job-creating sectors.

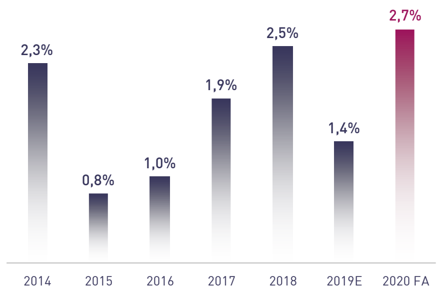
⇒ Support of exporting sectors

The TND devaluation was not able to contain the trade deficit. Exports and imports are moving at a similar pace. This fact could lead us to say that the problem of export development is not only a matter of prices. The processing and manufacturing sectors should be priorities for export volume development.

Source: AGR documentation

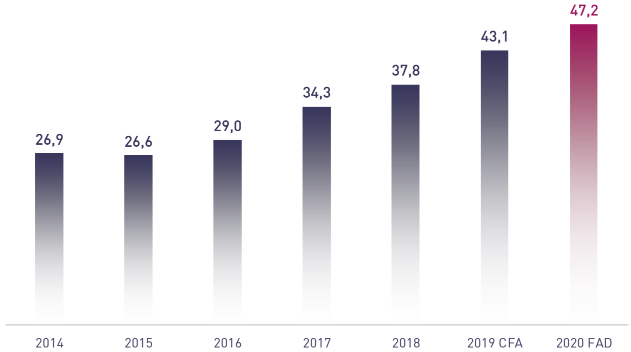
FINANCE ACT DRAFT 2020: MAIN ASSUMPTIONS

GDP GROWTH (%)



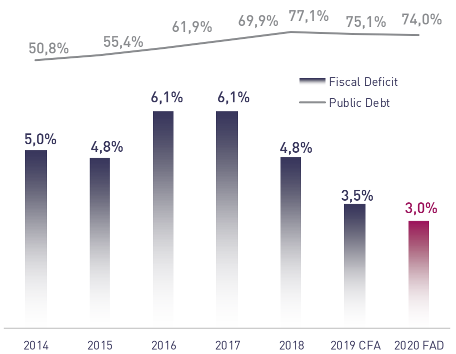
The break in the progress of economic growth would only be short-lived. In 2020E, growth should gain momentum without reaching comfortable levels.

GENERAL BUDGET (BILLION TD)



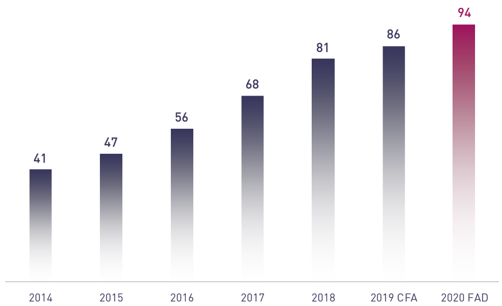
Tunisia has a steady pace of life ... Its spending has increased by 9.8% over the past 6 years fueled in particular by the wage bill increase.

FISCAL DEFICIT AND DEBT (% OF GDP)



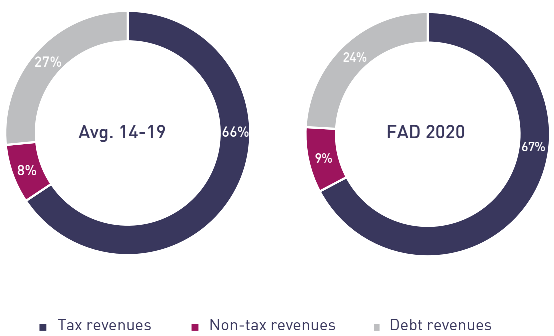
Fiscal deficit contraction is a priority of this Finance Act. Its decline to 3.0% of GDP would allow to reduce the debt level to 74.0% of GDP.

PUBLIC DEBT (BILLION TD)



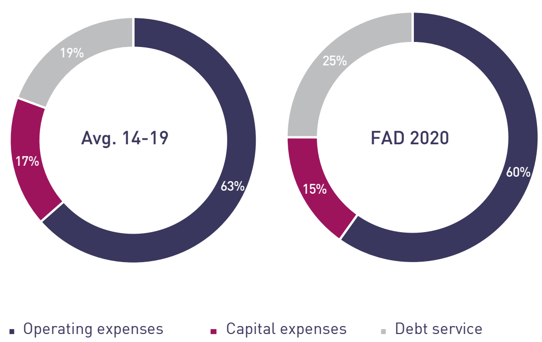
However, the outstanding debt remains in constant progression. The management of its cost and its predominantly foreign structure is a real challenge in the future.

BREAKDOWN OF PUBLIC REVENUES (%)



The gradual acceleration of economic growth and the expansion of the tax base would allow a greater contribution of tax revenues to resources.

BREAKDOWN OF PUBLIC EXPENSES (%)



The debt stock increase should mechanically increase the debt service burden (amortization + financial charges) to 25.0% of the budget.

Sources: Ministry of Finance, AGR Calculations

FINANCE ACT DRAFT 2020: THE ABSOLUTE PRIORITY IS THE FISCAL BALANCE

The spirit of this FAD 2020 reveals the priority given to conserving Tunisia's public finance balance. As a result, the reduction in the fiscal deficit level and consequently the indebtedness level would be the ultimate result of this bill. Indeed, for 2020E, the estimated budget deficit is TD 3.8 Bn representing 3% of GDP compared to a forecasted level of TD 4.1 Bn (3.5% of GDP) in 2019F.

It should be remembered that it is intended to achieve this target without the introduction of new taxes, which is in itself a real feat, given the characteristics and the context of the Tunisian economy :

An insufficient economic growth...

The economic growth forecast for 2020E is only 2.7% compared to 1.4% in 2019F. This level shows that the growth in tax revenues should come as much from recovery efforts as from the improvement of taxpayers' revenues. Thus, tax revenues are expected to reach TD 31.8 Bn in 2020E, up 9.2% compared to the 2019 Complementary Finance Act.

...A sustained lifestyle...

The Tunisian state has a sustained lifestyle. The general 2020E budget is TD 47.2 Bn, up 9.5%, after a 14.2% increase recorded in the 2019 CFA. This rate is a result of a sustained evolution of all the main expenses :

⇒ Hiring freeze...insufficient to curb the evolution of the wage bill

The budget for 2020E is expected to reach TD 47.2 Bn, up 9.5%. This significant increase takes into account in particular the evolution of 10.9% of the wage bill, which represents 15.2% of GDP. Indeed, the hiring freeze in the public service, with the exception of major positions and urgent needs, can not be enough to slow down the evolution of salary expenditures that are subject to the double increase in salaries experienced in 2018 and 2019. Overall, wage bill has been growing at an average rate close to 10% since 2015.

⇒ Debt service ... a concomitant increase to major fundraising

In line with the strong debt stock increase , which represents 75% of GDP in 2019 compared to 51% in 2014, debt service has risen sharply. The latter reached TD 11.7 Bn up 18.3% from the level announced in CFA 2019. It should be noted that the debt structure shows an overweight of the debt labeled in a foreign currency which represents 76% of the total debt. In the same proportion, the 2020E budget provides for an additional borrowing of TD 11.7 Bn, of which TD 6.8 Bn from foreign sources, including a new international fundraising for TD 5 Bn .

⇒ Investments ... a fiscal effort to support growth

In order to support growth, the development expenditure budget has been brought up by 14.7% to TD 7.2 Bn compared to the CFA 2019. However, the subsidies budget was reduced to TD 4.2 Bn, down 12.7%. The oil subsidy is the most affected, suggesting a price revision in 2020E. In general, Tunisia is closely studying a more targeted purchasing power support system, which would allow subsidies to benefit to the most needy.

Sources: Ministry of Finance, Central Bank of Tunisia, AGR Calculations

FINANCE ACT DRAFT 2020: MAIN TAX MEASURES

We present here some of the key tax measures of the FAD 2020. It should be noted that these proposals may be subject to amendments before a vote in the Parliament:

⇒ Extension of the tax incentive for companies wishing to be listed on the Stock Exchange

In order to encourage the main family groups to develop their business, in particular by raising funds on the stock market (either official or alternative market), the 2020 FAD foresees an extension until the end of 2024 of the lowering of the corporate tax for companies opening more than 30% of their capital. Companies operating in telecoms and hydrocarbons sectors are not subject to this extension. Subsidized CT rates are 20% or 15%, depending on the initial CT scale.

⇒ Strengthening tax audits through the implementation of "spot checks"

In order to prevent tax evasion and develop a spirit of fairness, the FAD 2020E provides for an unannounced and less stringent control system covering a period between 1 and 4 years with shortened response deadlines applied to either the taxpayer or the Administration.

⇒ Compliance with international standards

Taking into consideration the EU increasing demand vis-à-vis its counterparties, and with regards to the importance of the partner (70% of total Tunisian trade), Tunisia intends to comply with international standards in order to avoid being listed as a non collaborating country. To this end, Tunisia intends to rationalize eligibility conditions at the preferential corporate tax rate of 13.5%. The main concerned sectors are ICT, Trade and Logistics.

⇒ Electronic exchange of tax data

Initiated at the 2019 FA, the electronic exchange of data proves itself with the taxpayer and especially vis-à-vis the tax administration. This mean allows faster processing, a reallocation of resources to control, and a cross-check of information between different databases.

⇒ Tax neutrality between «Takaful» and conventional regimes

Aware of the importance of the development of Takaful insurance for the development of Islamic financing, it was proposed to standardize the CT rates of the Takaful regime with those of the conventional regime at 35%.

Sources: Ministry of Finance, AGR Calculations

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