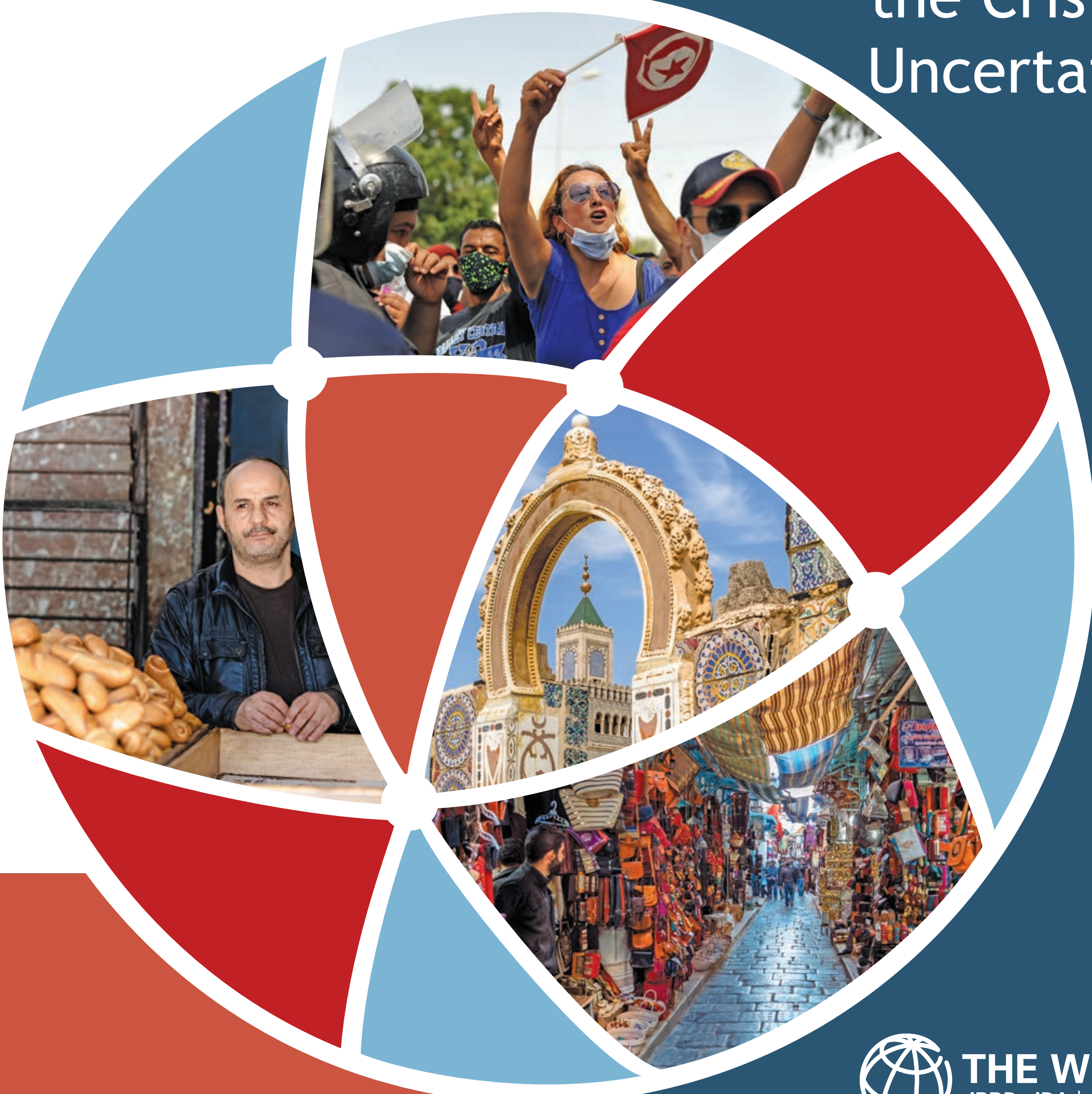
TUNISIA ECONOMIC MONITOR

Navigating the Crisis during Uncertain Times

Summer 2022



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EXECUTIVE SUMMARY

Rising international prices have exacerbated economic vulnerabilities

The war in Ukraine and rising commodity prices have exacerbated the vulnerabilities of the Tunisian economy in the first months of 2022. The impact of the war began to be felt as the trade deficit widened by 56 percent in the first six months of 2022 reaching 8.1 percent of GDP. Lower oil and gas production and increased demand for energy and agricultural products have exacerbated the vulnerability of the trade balance to the vagaries of international markets.

The rapidly rising import bill has caused signs of balance of payments distress despite the resilience of external capital flows. The pressure on the dinar against the dollar increased but the level of foreign exchange reserves has remained stable. The increase in international commodity prices has created additional pressures on public finances, mainly through subsidy spending. Our simulations suggest that energy subsidies and food subsidies in 2022 would increase relative to the 2022 Budget Law by 2.8 and 0.4 percentage points of GDP respectively. The increase in subsidies translates into pressure on public debt, which between 2017 and 2021 had already increased from 66.9 to 82.4 percent of GDP. In view of the continuing difficulties in accessing international financing, the Central Bank continues to refinance treasury bond issuance, which increases liquidity. The increasing use of local funding may lead to crowding out of credit in the economy.

Inflationary pressures increased significantly, mainly from global markets and higher administered prices (the inflation rate rose from 6.7 percent in January 2022 to 8.1 percent in June 2022). Rising inflation pushed the Central Bank to raise its policy rate by 0.75 basis points in May 2022, the first increase since October 2020. On the other hand the adverse terms of trade had only a mild impact on economic activity through the first semester of 2022. The recovery in travel and trade and the strong performance of mining and manufacturing boosted economic growth. The increase in economic growth rate could improve the unemployment rate, which returned close to pre-pandemic levels (15.3 percent in Q2 2022 versus 15.1 percent in Q2 2019). The increased control of the COVID-19 pandemic has also helped support economic growth.

With a challenging global environment, the economic recovery appears weaker than previously forecast

With a projected growth rate of 2.7 percent, the economy appears to be on a slightly lower growth path than previously expected. This is compounded by the worsening budget and trade deficits resulting from higher global commodity prices. The shortage of cereals on international markets could lead to new risks of poor availability on the domestic market. The budget deficit is likely to reach 9.1 per cent in 2022 compared to 7.4 percent in 2021. Tax revenues could increase particularly through measures leveraging additional indirect taxes. Investment expenditures could fall in nominal terms and as a proportion of tax revenues if the reforms of subsidies, the public wage bill and state-owned enterprises are not implemented. The financing of the budget remains problematic given the size of the budget deficit in a context of stable debt at fairly high levels.

Rising commodity prices increase the urgency of decisive reforms, including the food subsidy system

As the war in Ukraine has created further challenges for the economy, the Tunisian government has announced a program that includes several measures to support the economy and social inclusion. One of the more timely proposals of this programme concerns the price adjustments of subsidized basic products while compensating vulnerable populations for the price increase.

Part B of the Bulletin highlights the importance of this type of reform in the context of the cereal subsidy system, which dominates food subsidies. Tunisia has long held a policy of keeping cereal prices artificially low. Part B shows how this subsidy structure has maintained low and stable prices for consumers. But at the same time this has led to large losses for the State, for the entire wheat value chain and for the food security of Tunisians. The low prices paid to wheat farmers have increasingly led them to abandon wheat production. The price control system has reduced investment and competition incentives for cereal processors, which as a result appear to be less dynamic and productive than all other food processors. The structure of subsidies has also encouraged overproduction—at the processor level—and overconsumption—at the household level—of cereals, generating significant leakages and waste.

The cost of the universal subsidy system has become unsustainable for the state in terms of subsidies and imports. The system, as currently designed, is ill-prepared to deal with shocks. Indeed, Tunisia's current difficulties in obtaining sufficient wheat have led to shortages of cereal products and uncertainty about future supplies. Replacing subsidized cereal consumption prices with transfers to households would improve the efficiency of the system, reduce the fiscal and import costs, and strengthen the resilience of the food system. The timing of such politically and socially sensitive reform, including its sequencing, would need to be carefully considered.

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