The Effects of the Global Financial Crisis and Combined Transition Factors Associated with the Post-Revolutionary Period: The Case of Tunisia

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The revolution of dignity and freedom that broke out on 14 January 2011 in Tunisia is a major historical event that has enshrined the irreversibility of democratic values. But the road out of the ensuing political crisis, which leads past some of the same economic challenges that originated the social revolt, seems for the time being even more uncertain since it overlaps with the latent impact of the latest international economic and financial crisis. It is this circularity that the present paper will attempt to support, recalling in the first section the channels through which the crisis reached the Tunisian economy, and in the second, analysing the effects of the superposition of several destabilising factors associated with the transition period.

The Cartography of Economic Repercussions of the Financial Crisis in Tunisia: A Brief Review

The international economic and financial crisis was significant for its global, systemic dimension and in particular for its unprecedented form of propagation (cf. Mouley, 2011). In the absence of decoupling, this crisis, whose origins fall within the chain reaction of financial sector failures in developed countries, gradually reached Tunisia via a number of mechanisms and transmission channels. It is above all on the level of the real economy that this crisis has produced negative spillover effects (cf. Mouley, 2012, 2013) due to close commercial ties with Europe (Tunisia sends an average of over 75% of its exports there). This is why the growth of exports plunged, going from 12% in 2007 to 1% in 2008 and -22% in the first semester of 2009. The growth of the GDP likewise sharply decelerated in late 2008 and dropped by 1.3% during the first quarter of 2009 from its position in the last quarter of 2008. Due to the economic downturn of Western economies, in particular European ones, which had gone into technical recession, Tunisian economic activity, largely oriented to the outside, has evolved under the effect of the decline in foreign demand in the main export sectors since October 2008. The slowdown of exports is focussed primarily in the textile and clothing sectors (-16.6%) and the mechanical and electrical industries (-12.6%). In contrast, the pace of exports has grown for the chemical industries, associated with a significant rise in phosphate derivative prices on the international market, as well as for foodstuffs (14.5% in 2008 vs. 1% in 2007).

In contrast, on the financial level, the low exposure of the stock market to external shocks and its relative disconnection from other financial markets was enabled by foreign exchange controls on capital accounts. Hence, the limited impact on the Tunisian stock exchange can essentially be ascribed to the low share of foreign investments in market capitalisation. On the monetary level, there was a sparse use of securitisation techniques with extremely low risk of payment defaults. Moreover, Tunisian banks are not internationally oriented and their investment of foreign exchange resources on international financial markets is governed by strict controls and regulations. The introduction of prudential measures (restrictions on foreign borrowing by banks and companies, investment ban on foreign capital markets and restrictions on foreign exchange and derivatives) has limited resident banks' exposure to international financial markets, while non-resident banks are subject to the supervision of the Central Bank of Tunisia (BCT). Generally speaking, bank foreign currency assets account for 8% of their total assets and are primarily comprised of bank deposits, with minor exposure to international debt markets through non-resident banks (0.3% of total bank assets). Insofar as liability, liquidity is maintained primarily by resident deposits. Non-resident deposits, likely to be volatile, represent only 12% of the total. On the whole, therefore, the international financial crisis has not had significant effects on the country's banking system.

From One Crisis to Another: Tunisia's New Challenges during the Transition Period

All transition administrations governing during the transition period have faced other factors of vulnerability that have accumulated since the events of 2011. These factors concern a number of dimensions on all levels of the macroeconomic management framework, whether they pertain to unemployment, extreme poverty, regional disparities, the pursuit of monetary and fiscal policies, the need for mobilising foreign finance resources, the quality of institutions, the business climate, etc… Below, we will limit ourselves to discussing certain monetary and financial aspects, with a focus on the banking sector's global liquidity crunch, its weak points, downgrading of sovereign ratings and the resumption of inflationary pressure.

Global Liquidity Crunch in the Banking Sector

The evolution of the banking system's global liquidity has been marked during the post-revolutionary period by a further tightening of autonomous liquidity factors, going from +827 million Tunisian dinars (MTD) on average during the 2006-2010 period to -2,040 MDT in 2011. In contrast with the situation of surplus liquidity during the previous period, the dynamic of which began in 2006, the patent tightening of bank liquidity was accentuated by the sharp growth of banknotes and coins in circulation brought about by the hoarding behaviour of households and trade in cash outside of conventional circuits in response to social unrest, as well as by the decline in net foreign assets associated with the decrease in net foreign currency holdings following the downturn in major export sectors (tourism, chemical industries, mining and energy). This situation led to rising trade deficit and hence the deterioration of the overall balance of payments.

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Weaknesses of the Banking Sector

Despite the efforts made and the programmes implemented to this end, the weaknesses of the banking system have grown. Beyond certain innovative aspects in governance (namely, the establishment of risk management committees as support structures for bank administrative boards), the vulnerabilities of the banking sector remain largely confined to the relative magnitude of non-performing loans, a relatively low level of bank profitability, lack of compliance with certain principles fundamental to both effective banking supervision and financial stability standards and the weakness if not absence of an institutionalised safety mechanism.

Non-Performing Loans

Although the banks are not dependent on foreign financing and their activities are financed in large part by domestic deposits (nearly 80% of bank resources), the share of impaired or non-performing loans remains high with respect to comparators and emerging countries (13% in 2011). Nonetheless, according to the conclusions of the IMF's latest Financial Sector Assessment Program (FSAP) in 2012, the reclassification of loans authorised for rescheduling[1] after the revolution as impaired loans would add at least 5% to the overall ratio of non-performing loans (NPLs), which would put the percentage of unproductive loans at over 18%.[2] It is thus estimated that the level of NPLs in the Tunisian banking sector is currently on the order of 10 billion dinars, in contrast to a preliminary estimate of 7 billion dinars, i.e. 13%.

Bank Profitability

Regarding management quality and bank profitability, there is essentially a low average return on bank assets, stagnating in the last period at 1% (compared to an average of 1.8% in MENA economies). The same is true of the performance of bank capital, though experiencing slight improvement over the last period.

Banking Supervision and Regulation

Assessment of compliance with the Basel Core Principles for Effective Banking Supervision indicates appreciation of material non-compliance with certain principles, in particular insofar as deficiencies in bank credit policy (Principles 7 and 8). It is mainly a question of major shortcomings and distortions with regard to conditions for granting loans, risk assessment, insufficient provisions set aside for NPLs, the cumbersome nature of the current system of mortgage guarantees and above all, their overvaluation. At the same time, the process of migrating to the Basel system is not yet complete. Moreover, although current regulations on internal supervision and credit management by banks has recently been reformed as per the BCT's Circular No. 2011-06 on credit institutions, amending Circular No. 2006-19, the fact remains that the new obligations for internal monitoring and supervision of credit risk seem to be based even more on compliance and not real risk management.
At the same time, the monetary authorities have a clearinghouse based on a credit risk centre set up in 1972, but it is imperative to develop a regulatory framework applicable to other centres capable of offering independent external assessment of corporate borrowers, which would allow improved management of operation risk and improved internal control. Moreover, the supervising authorities are still missing the resource of a central balance sheet data office.

Other Compliance Deficits

These primarily consist of delays in compliance with the latest standards of the Financial Stability Board for a sound financial system, based on the standardised international framework established at the April 2009 G20 Summit in London. The same is true of material non-compliance with key criteria and prerequisites for a formal framework targeting inflation. And finally, insofar as a safety system, Tunisia does not yet have an institutionalised safety net such as the function of lender of last resort (LLR) in case of systemic crisis, or a deposit guarantee and insurance system capable of limiting the effects of moral hazard.[3] In addition, the methods for monitoring portfolio quality are inefficient and the means of debt collection inadequate.

Downgrading of Sovereign Ratings

In 2011, the main ratings agencies proceeded to downgrade Tunisia's sovereign rating or place it on a negative watch list. Hence, Standard & Poor's (S&P), for instance, downgraded the local currency rating from A-/Stable to BBB+, placing it on negative watch, and put the foreign currency rating at BBB, also placing it on negative watch. Moody's Investors downgraded the sovereign rating from Baa2 to Baa3 and placed it on negative watch. R&I also downgraded the foreign currency rating and placed it on negative watch, revising it from A-/Stable to BBB Negative. Fitch Ratings put the foreign currency rating at BBB, also on negative watch.
Nonetheless, Tunisia maintained its investment rank before May 2012, when S&P again lowered

[1] The volume of rescheduled loans is estimated at over 5 billion dinars, that is, 7.7% of the GDP.
[2] This figure would rise even more if one were to consider loans to public companies, which are never classified as non-performing due to the presumed guarantee of the State.
[3] In this regard, there is no mechanism for managing and/or simulating liquidity crises.

the country's rating for long-term debt in local and foreign currency by two notches, from BBB(-) to BB, as well as the issuer credit ranking of the BCT from BBB(-) to BB stable, which means that the country is now under the category of speculative loans. Moody's, on the other hand, in September 2012 (and again in December 2012), maintained a rating of Baa3 with negative watch, whereas Fitch Ratings, in December 2012, downgraded Tunisia's long-term foreign currency debt rating (Issuer Default Rating or IDR) from 'BBB-' to 'BB+' and the long-term foreign currency IDR from 'BBB' to 'BBB-. Finally, in February 2013, S&P again downgraded Tunisia's sovereign rating, this time to BB- with a negative outlook. This was immediately followed, in the same period, by Moody's, which also downgraded the rating, from Baa3 to Ba1 with a negative outlook, relegating the country to the category of speculative, as did Fitch Ratings and R&I, which also downgraded their ratings.

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In its latest report in February 2013, S&P particularly noted that, apart from the exacerbation of socio-political risks, the vulnerability of the Tunisian banking sector had reached such unprecedented levels that the agency lowered the ranking for the BCT to the level of the sovereign rating. Generally speaking, the downgrade in ratings was prompted by a number of factors, both economic and socio-political, in particular the undercapitalisation of banks, failure to apply prudential regulations, namely by public banks, the level of bad debts, the latent climate of economic uncertainty, safety net problems, the sluggish pace of reforms and above all, the uncertainty as to when the next elections will be held as well as their results.

The sovereign rating downgrades have also increased the risk of default as measured by the spread on credit default swaps (CDSs). This consequence was foreseeable via the symmetrical and proportional relationship between sovereign downgrades and the costs of mobilising external resources in the form of foreign currency. Hence, Tunisia's bond spread has risen by 38 basis points, going from 376 BPs before publication of the S&P report to 414 BPs. Note that the spread had already surpassed 121 basis points before the revolution, at 10 January 2011 – when the wave of protests began – and reached 223 basis points by 14 April 2011. Despite the good outcome of the Constituent Assembly elections, the latent climate of economic uncertainty made the spread again begin to climb, first to 257 basis points by 14 November 2011, and then to 376 BPs.

Resumption of Inflationary Pressure

The annual average inflation rate reached 5.6% in 2012, as compared to 3.5% in 2011, primarily in connection with the rise in prices across all product groups, in particular foodstuffs, whose prices had risen by 8.4% by the end of the preceding year. In particular, since June 2012, inflationary pressure has become inertial (permanent or persistent),[4] with regrowth that can be ascribed to:

- Cyclical factors: rise in prices of raw materials and imported energy;
- Factors that have become structural regarding internal demand: increase in food prices due to the excess demand on the Libyan market and the consequent food contraband to Libya, anti-competitive, speculative practices on the

[4] The year-on-year (YoY) change in the general price index had reached 5.6% in July, as compared to 5.4% over the course of June 2012. In YoY growth, the general consumer price index has thereafter experienced a steady evolution, reaching 5.7% in September, 5.3% by the end of October, 5.5% in November and 5.9% in December 2012 (oscillating at around 6% in January 2013, it returned to 5.8% by the end of February 2013, in association with winter sales).

wholesale and retail markets, errors and absence of control over distribution channels and the proliferation of widespread informal segments.

- As a corollary, the risk of inflationary movement due to the progression of internal demand. The output gap (i.e. the gap between production and potential production) was negative in the post-revolutionary period, going from +1.82 in 2010 to -2.31 in 2011 and -1.95 in 2012. Nonetheless, there was an increase of 0.36 points between 2011 and the third quarter of 2012 (year on year), which means an overall upward trend in aggregate demand.
- Pass-through effects associated with inflation imported through effective nominal depreciation of the exchange rate, in particular pertaining to the euro. An inevitable dynamic, given the scale of the aggravation of the trade and current account deficit since the onset of the transition a little less than two years ago due to the limited effect of the exchange rate on export competitiveness in a transition period that has coincided with a situation of recession in the euro zone. Nevertheless, the BCT has made undeniable efforts to support the exchange rate through intervention in the foreign exchange market to adjust the inflation differential relative to partners.
- Exogenous factors (uncertain business, regulations and investment climate).
- The wage/price spiral due to the successive wage raises following labour union demands during the transition period.

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