

FITCH PLACES TUNISIA'S 'BBB' ON RATING WATCH NEGATIVE

Fitch Ratings-London/Paris-14 January 2011: Fitch Ratings has placed Tunisia's Long-term foreign currency Issuer Default Rating (IDR) of 'BBB' and its Long-term local currency IDR of 'A-' on Rating Watch Negative (RWN). The agency has affirmed the Country Ceiling at 'BBB+' and affirmed the Short-term foreign currency IDR at 'F2'.

The RWN reflects the unexpected eruption in political risk and uncertain political and economic outcomes. Social unrest began in mid-December and recently spread to the capital, Tunis. The calling of early elections and a promised opening-up of the political system introduce further uncertainty. Fitch expects to resolve the watch within six months.

Renewed disorder, with negative consequences for the economy, would lead to a downgrade. Any weakening of the macro policy regime would also be a concern. By contrast, if the political climate stabilises quickly, with limited downside for the economy, an affirmation of the ratings is likely.

Prior to December 2010, Fitch expected growth to recover to nearly 5% in 2011 and the budget deficit to meet the government's target of 2.5% of GDP. However, owing to economic disruption, budget performance and growth will now be weaker than previously assumed. Political changes may lead to longer-term public spending concessions and could result in changes to economic policy and governance.

Fitch notes that the government faces external bond repayments of equivalent to USD750m in April and September 2011. A planned new eurobond issue is unlikely for now. However, sovereign foreign currency deposits held at the central bank are USD1.5bn, and provide short-term financing flexibility.

The current account deficit (CAD) widened to 4.8% of GDP last year from 2.8% of GDP in 2009 as import growth outpaced that of exports, but the trend had reversed by Q4, pointing the way to a narrowing in the CAD in 2011. However, with tourism (12% of current account receipts) and FDI flows at risk of disruption, financing pressures will mount if unrest fails to abate. Foreign exchange reserves were already falling last year although at USD9bn as of 12 January 2011 they remain in line with the historical range at 3.7 months of current account payments.

Tunisia has demonstrated macroeconomic stability in the face of previous shocks. Economic growth has outperformed many of its recession-hit peers between 2008 and 2010. Yet per capita income, an indicator of social stability, debt tolerance and financing flexibility, still lags the 'BBB' median.

Political risk has always weighed on Tunisia's ratings. However, the protests have thrown the spotlight on persistently high unemployment among graduates and the country's uneven development. The national rate of unemployment is estimated at 13% and joblessness rose by 1pp between 2005-2009 despite growth averaging 4.7% annually and inflows of foreign direct investment averaging 5% of GDP.

Improved public finances over the last 10 years support the ratings and mean that Tunisia enters this challenging period in a better position than would otherwise have been the case. Tunisia has progressively reduced the government debt ratio in every year since 2001, by a total of 20pp of GDP. While government debt of 42% of GDP remains above the 10-year 'BBB' median, it is closing the gap.

Capital controls and low private sector foreign borrowing reduce Tunisia's vulnerability to external financing difficulties. Overall net external debt was 21% of GDP in 2010, above the 10-year 'BBB'

median of 8%, while sovereign external assets almost match external liabilities, a slightly stronger position than the 10-year median.

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Applicable criteria, 'Sovereign Rating Methodology', dated 16 August 2010, are available at www.fitchratings.com.

Applicable Criteria and Related Research:

Sovereign Rating Methodology

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=547765

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