Responsible Expert:

Mikhail Kaptsov
Rating Analyst

For further information contact:
Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00, 1216
E-mail: kaptsov@raexpert.eu
        www.raexpert.eu

Ratings

Sovereign Government Credit (LC)	**B**
Sovereign Government Credit (FC)	**B-**
Outlook (LC)	**Negative**
Outlook (FC)	**Negative**

* These ratings are unsolicited

Ratings dynamics

◻ SGC (LC) ◻ SGC (FC)

Feb 2020	Aug 2020	Feb 2021

Main Economic Indicators of Tajikistan

Macro indicators	2018	2019	2020*
Gross gov. debt, TJS bn	32,9	33,3	39,0
Nominal GDP, TJS bn	68,8	77,4	81,7
Real GDP growth, %	7,3	7,5	1,0
Gross gov. debt/GDP, %	47,8	43,1	47,8
Deficit (surplus)/GDP, %	-2,8	-2,1	-6,0
Inflation rate, %	5,4	8,0	7,5
Current Account Balance/GDP, %	-	-	-7,7
External debt, USD bn	-	-	5,6

Development indicators	2020*
Inequality adj. HDI	0,57**
GDP per capita, USD th	3,6

Default indicator	05.02.2020
7Y Gov Bond Yield, %	10,3***

Source: RAEX-Europe calculations based on data from the IMF, WB, NBT.
* Forecast **2018 data ***Maturity in 2027.

RAEX-Europe has confirmed Tajikistan's ratings at 'B-' in FC and 'B' in LC. The rating outlook is negative.
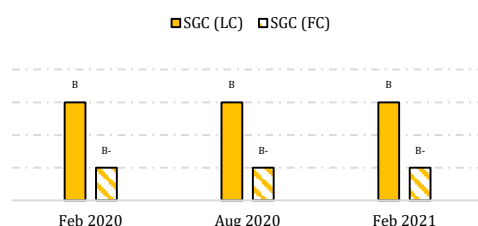
RAEX-Europe confirmed the sovereign government credit rating (SGC) of Tajikistan at 'B' (Moderately low level of creditworthiness of the government) in national currency and at 'B-' (Moderately low level of creditworthiness of the government) in foreign currency. The rating outlook is negative, which means that in the mid-term perspective there is a high probability of downgrading the rating score.

Summary

The Agency has confirmed Tajikistan's ratings at 'B-' in FC and 'B' in LC with a negative outlook. The confirmation of the ratings is based on the projected recovery of the Tajik economy and mitigation of the debt repayment risks due to significant financial support from international financial organizations on concessional terms.

In the long-term perspective, the ratings and the outlook reflect low level of welfare and high unemployment, underdeveloped institutions and financial system. Moreover, the external position of the government remains very fragile with a high share of FX-denominated debt, dependence on imports and remittances, low level of export to GDP, and elevated dollarization of the financial system.

The pandemic strongly affected the growth of the Tajik economy. Real GDP growth in the first nine months of 2020 was 3p.p. lower than for the same period of 2019 (4,2% against 7,2%). Services (especially tourism and hospitality) suffered a major decline, whereas agriculture provided a significant contribution to growth (8,1% y-o-y) due to favorable weather conditions. Another major contributor was the industrial sector with a 10,7% growth (y-o-y) supported by the food processing and metallurgical branches.
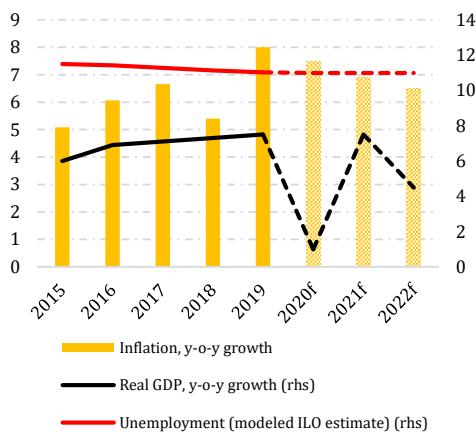
Consumer demand and business activity in Tajikistan declined sharply mainly as a result of pandemic-related disruptions of supply chains and limitations of mobility of migrants. The latter translated into an abrupt drop in remittances (e.g. in August, the share of households receiving remittances was 25p.p. lower than the last year's value of about 42%). This created a significant pressure for one of the most remittance-dependent countries in the world, which is magnified by declining public investment

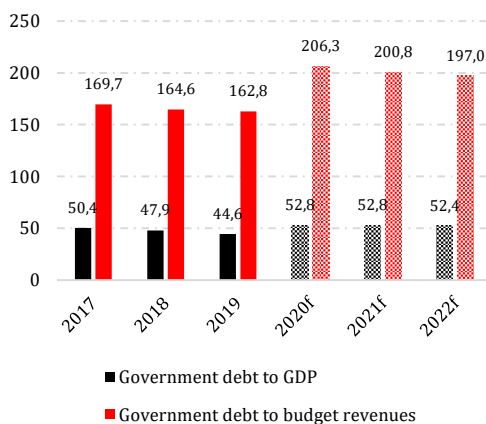**Graph 1:** Macroeconomic indicators, %

Source: RAEX-Europe calculations based on data from the WB, IMF, NBT

Graph 2: Fiscal budget dynamics, % of GDP

Source: RAEX-Europe calculations based on data from the WB, IMF, NBT

Graph 3: Government debt dynamics, %

Source: RAEX-Europe calculations based on data from the WB, IMF, NBT

associated with the government measures to combat the effects of the pandemic.

Taking the abovementioned developments into account, we expect the economic growth of the country to decline to 1,0% in 2020[1]. However, due to the easing of the anti-pandemic measures in Tajikistan and in Russia (the major source of remittances inflows) and vaccine distribution, as well as an expected recovery in household consumption and FDIs, we forecast a gradual reacceleration of economic growth to pre-crisis levels in the medium term (2021-2022) (see graph 1).

In the long term, the economic stance of the country and government creditworthiness will remain limited. The level of institutional development of Tajikistan is low: the updated Corruption Perception Index (2020) for Tajikistan stayed at the same level of 25, which corresponds to the position in the fourth quartile of the global ranking. GDP per capita at around USD 3,6 th (in PPP terms) is one of the lowest readings in the region.

COVID-19 outbreak led to a significant increase in both budget deficit and debt. The government implemented a package of fiscal measures and prioritized healthcare spending (19,6% growth in the first nine months of 2020 y-o-y) while the energy sector and state administration saw significant budget cuts (23,1% and 11,4% y-o-y, respectively). This package included VAT exemptions on essential imports (consumer staples), direct aid to vulnerable households (including subsidized food distribution, direct payments of TJS 400 a year for eligible families and one-time COVID assistance of TJS 500), additional payments for healthcare workers, tax-holidays for several industries and financial support for SMEs, which included restructuring of loans by banks.

As a result, budget expenditures are expected to grow from 29,5% of GDP in 2019 to 33,4% of GDP in 2020. At the same time, due to the slowdown of business activity, budget revenues (as % of GDP) saw a significant decrease of around 2p.p. in 2020, which will lead to a widening of the fiscal deficit above 7,5% of GDP (see graph 2). Consequently, the government debt is forecast to increase to 206,3% of budget revenues and to 52,8% of GDP in 2020 (by more than 40 p.p. and 8 p.p. from the readings of 2019, respectively) (see graph 3).
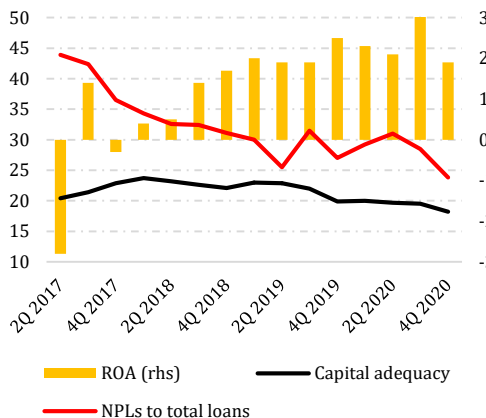
The budget support programs were mostly financed by international organizations. In addition to the approval of USD 189,5 m disbursement under the IMF Rapid Credit Facility in May 2020, other grants and loans were agreed, namely, more than USD 102,5 m from the Asian Development Bank, USD 50 m from the European Fund for Sustainable Development and

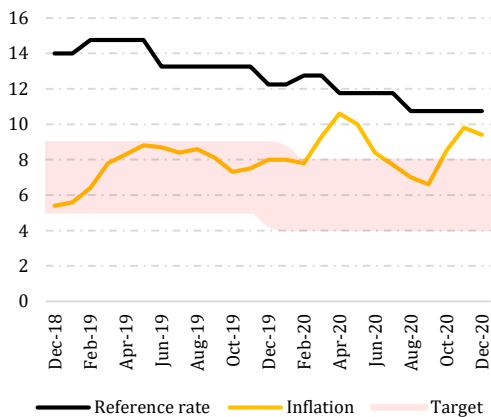[1] Based on own calculations and data from the WB, IMF, EDB and TAJSTAT

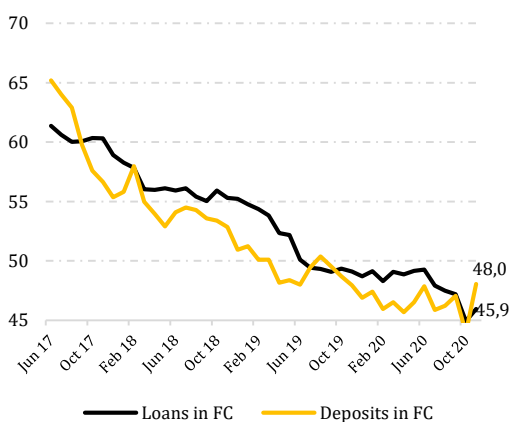**Graph 4:** Financial soundness indicators, %

Source: RAEX-Europe calculations based on data from the NBT

Graph 5: Reference rate vs inflation rate, %

Source: RAEX-Europe calculations based on data from the NBT

Graph 6: Financial dollarization, % of total

Source: RAEX-Europe calculations based on data from the NBT

USD 27,5 m from the World Bank. Additionally, Tajikistan, alongside other 46 countries, applied for the G-20 Debt Service Suspension Initiative (DSSI). This debt moratorium will release around USD 50 m because of the suspension of the external debt payments.

The major problems for the government finances remain the high level of indebtedness of SOEs, lack of internal capacity for revenue growth and investments; nonetheless, financing issues are largely mitigated by the international donors' support on concessional terms. The long-term construction of the Rogun hydroelectric power plant, which commenced in 2016 represents a significant capital expenditure (around 5% of GDP a year), although it is of a strategic importance for the country in terms of its potential role for the energy security.

The coronavirus pandemic had a modest impact on the banking system. Two new banks in Tajikistan got a license in 2020 and the number of branches and banking service centers increased by 10 units and amounted to 1935 units. Total assets of the Tajik financial organizations in 4Q 2020 increased by TJS 4 335 m or by 19,7% y-o-y. The ratio of NPLs (30 days overdue) to total loans, as of end 4Q 2020 decreased down to 23,8% of total loans, a drop of about 7p.p. from the reading of 2Q 2020 and about 3p.p. from the figure recorded in 4Q 2019. The banking sector's profitability slightly declined but remains positive: as of the end of 2020, ROE and ROA amounted to 5,23% and 1,43%, respectively. Capitalization in the system remains adequate as the capital adequacy ratio remained high at 18,2% (see graph 4).
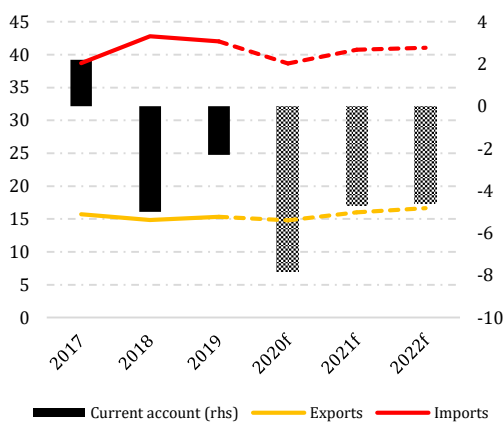
Low level of trust to the banking system from the population and absence of listed shares currently traded on the national Central Asia Stock Exchange (Dushanbe) remain a significant problem for the country's financial system. Additionally, two large systematically important banks (Tojiksodirotbank and Agroinvestbank) are under a risk of possible liquidation. The collapse of these two banks would represent a major risk to the government debt burden because the government would need to step in and bail the banks out.

The effectiveness of the Central Bank policy remains limited. The policy rate was cut by 100b.p. on 1 May 2020, and the National Bank of Tajikistan (NBT) lowered it again by 100b.p. down to 10,75% in August. At the same time, the exchange rate of the TJS, after remaining flat between March and October 2020, experienced another sharp depreciation falling from around 0,097 USD to 0,088 USD for 1 TJS (more than 9%) (see graph 8). These factors created an additional inflationary pressure – the inflation rose from 6,6% in September to 8,5% in October and 9,8% in November, which is above the NBT inflation target of 6% (+/- 2p.p.).
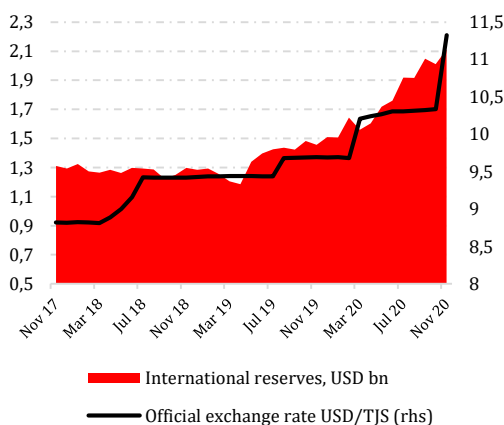
Graph 7: External sector indicators, % of GDP

Source: RAEX-Europe calculations based on data from the WB, IMF

Graph 8: International reserves and exchange rate

Source: RAEX-Europe calculations based on data from the WB, IMF, NBT

We assess the NBT response as adequate and expect the inflation to enter the target interval in the medium term. Nevertheless, the level of dollarization in the country remains high: 48% of deposits and around 46% of loans are nominated in foreign currency. Due to the weak banking system, undeveloped local capital markets, high dollarization and low independency of the NBT the transition mechanisms remain inefficient.

The pandemic strongly affected the external performance. The external position of Tajikistan remains very fragile. Due to the pandemic, the main commodity exports (minerals, cotton, and aluminum) experienced a sharp decline with the only exception of gold. We expect the ratio of exports to GDP to decline by 0,5p.p. to 14,8% in 2020 and to gradually recover in 2021-2022 and get above the pre-pandemic levels. Drop in imports due the slowdown of consumer demand partially lowers the pressure on the current account stance: a decline of import to GDP from 42% to 38,6% is forecast for 2020. Taking into account the significant fall in remittances, we expect the current account deficit to widen to about 7% of GDP in 2020 (see graph 7) and shrink subsequently because of the projected rebound in economic activity and intensifying remittances inflows.

International reserves increased to USD 2,1 bn in November as a consequence of the NBT's gold purchases, which corresponds to around 8 months of imports (see graph 8). At the same time, the exchange rate remains controlled by the NBT: it allowed another sharp depreciation of TJS in November 2020. Thus, the control over the currency has caused the predominance of a black foreign exchange market. Implementation of the plans to remove the currency restrictions could lead to an upgrade of the forecast outlook for Tajikistan.

Stress factors:

- Despite positive dynamics over the last two years, financial dollarization remains high with the share of FX-loans and deposits at 48,0% and 46,9%, respectively by November 2020 (very weak stress-factor)

   The following developments could lead to an upgrade:

   - Faster and stronger than expected recovery of the global economy, as well the as main trade partners, including Russia, which can lead to increase in remittances and improvement of the external position of Tajikistan;

   - Significant development of the financial market and improvement of the banking system: growth of assets and loans to the economy, reduction of NPLs, decrease of financial dollarization and realization of agreements with investors regarding troubled banks;

   - Consistent further improvement of the monetary policy and the transmission efficiency, as well as liberalization of the exchange rate regime.

   The following developments could lead to a downgrade:

- Continued lock-down measures in the country and longer period of turbulence in the global economy, including a second wave of COVID-19 pandemic, which would lead to further deterioration of the external position, as well as a deeper contraction of local economy;

- Significant expansion of budget expenditures in order to smooth the negative effects from the COVID-19 pandemic and to finalize infrastructure projects in the energy sector, which will create risks of government debt growth;

- Further hikes in inflation and dollarization levels due to external shocks.

ESG Disclosure:

Inherent factors

- Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; Level of corruption, CPI; Government Effectiveness Index; quality of the business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Drivers of change factors

- Due to the global climate change the distortions in the usual ice and water accumulation were recorded during the autumn 2019 – winter 2020. This led to the lack of water in the lakes, used as a sources for the Rogun HPP. As a result, in July 2020 the break in the electricity export from Tajikistan to neighboring countries was observed. Due to the fact that Rogun HPP is the strategically important project for Tajikistan in terms of export diversification and improvement of the external position, potential distortions in water accumulating in the future can lead to deterioration of already weak country's external position. Thus, the factor in our sovereign methodology which could be directly affected by this is *Level and dynamics of production* and *current account balance and export to GDP*.

Next scheduled rating publication: 06.08.2021. The full sovereign rating calendar can be found at
Sovereign Rating Calendar 2021

For further information contact:

Responsible expert:
Mikhail Kaptsov,
Rating Analyst of RAEX-Europe
+49 (69) 3085-45-00, 1216
kaptsov@raexpert.eu

Reviewer:
Hector Alvarez,
Associate Director of RAEX-Europe
+49 (69) 3085-45-00, 1213
alvarez@raexpert.eu

Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
07.08.2020	Scheduled revision of both types of ratings for the country	B	B-	Negative	Negative
07.02.2020	Scheduled revision of both types of ratings for the country	B	B-	Negative	Negative
09.08.2019	Scheduled revision of both types of ratings for the country	B	B-	Negative	Negative
10.05.2019	First assignment of both types of ratings	B	B-	Developing	Developing

Minute's summary

The rating committee for Tajikistan was held on 05.02.2021**.** The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings – Full Public Version (from April 2019). Descriptions and definitions of all rating categories can be found under the Rating scale section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

The definition of default can be found on the Agency's website in the section for Internal policies.

These ratings are unsolicited. The rated entity did not participate in the rating process

Main sources of information: IMF, World Bank, National Bank of Tajikistan, Tajstat

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: ESG factors in RAEX-Europe's Credit Ratings

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process**.**

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

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Office responsible for preparing the rating

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Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.