Research Report on Tajikistan

6 August 2021

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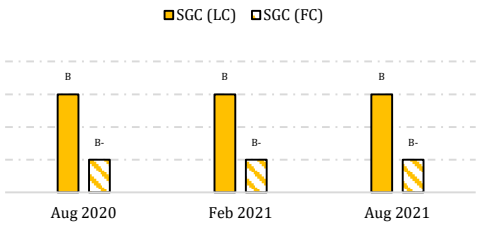
Ratings

Sovereign Government Credit (LC)	B
Sovereign Government Credit (FC)	B-
Outlook (LC)	Stable
Outlook (FC)	Stable

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Tajikistan

Macro indicators	2018	2019	2020
Gross gov. debt, TJS bn	32,9	33,4	39,7
Nominal GDP, TJS bn	68,8	77,4	82,5
Real GDP growth, %	7,3	7,5	4,5
Gross gov. debt/GDP, %	47,8	43,1	48,1
Deficit (surplus)/GDP, %	-2,8	-2,1	-4,4
Inflation rate, %	5,4	8,0	9,4
Current Account Balance/GDP, %	-	-	-2,3

Development indicators	2020*
Inequality adj. HDI	0,57**
GDP per capita, USD th	3,6
Default indicator	**05.08.2021**
10Y Gov Bond Yield, %	8,69***

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 changed from negative to stable.

RAEX-Europe confirmed the sovereign government credit ratings (SGCs) 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 changed from negative to stable, which means that in the mid-term perspective there is a high probability of maintaining the rating score.

Summary

The Agency has confirmed Tajikistan's ratings at 'B-' in FC and 'B' in LC, the rating outlook changed from negative to stable. 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 fragile with a high share of FX-denominated debt, dependence on imports and remittances, low level of exports to GDP, and elevated dollarization of the financial system.

The Tajik economy is showing signs of recovery after the pandemic-related decline in 2020. As of the end of 2020, real GDP of Tajikistan grew by 4,5% what constituted a significant decline of growth rate of 3 p.p. in comparison to 2019. However, the growth exceeded the expected value of 1%. In 1Q 2021 the economic activity in the country increased what led to real GDP rising by 7,5% y-o-y. The main drivers behind this growth are increased internal demand and the effect of a low base linked to the first wave of pandemic in the first half of 2020. The contributors to economic growth were such industries as extractives (+32,4%), food processing (+18,8% y-o-y), textiles (+19,1% y-o-y) and non-metal mineral goods (+50% y-o-y).

The unemployment level remains high at around 11% (see graph 1), whereas real wages demonstrated only a minor drop of 0,1% in February y-o-y. This is a positive dynamic when compared to the decline of real wages by up to 20% in 2020 caused by pandemic. Another important growth factor is the recovery of remittances. According to the National

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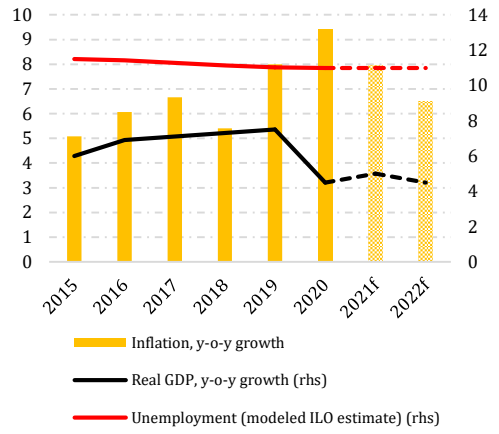
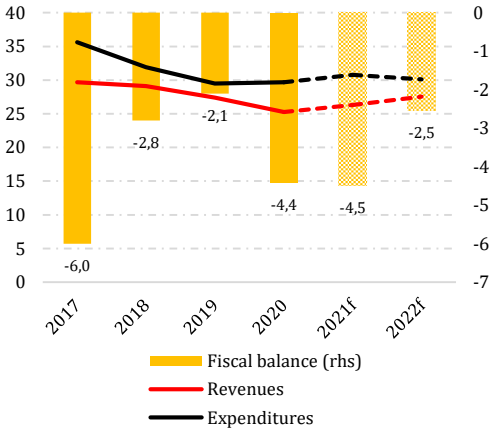
Graph 1: Macroeconomic indicators, %



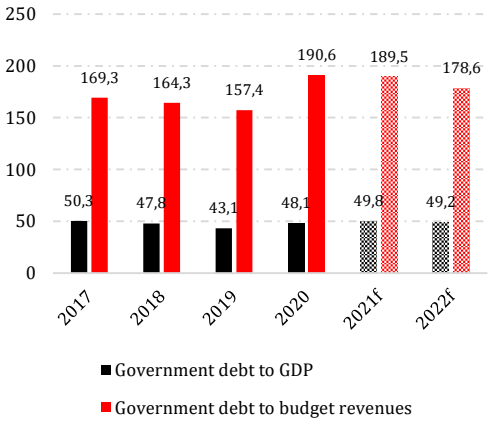
Source: RAEX-Europe calculations based on data from the WB, IMF, NBT

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

Bank of Tajikistan (NBT), they showed a significant growth by 13,8% in 4Q 2020 after three consecutive quarters of decline, which lowered the pressure for one of the most remittance-dependent countries in the world. Remittances are expected to further recover after the president of Tajikistan, Emomali Rahmon, signed a decree on a national vaccination campaign, while air service with Kazakhstan, Russia (major sources of remittances), Uzbekistan and Turkey has been restored in May 2021.

Taking the abovementioned developments into account, we expect the economic growth of the country to climb to 5,0% in 2021[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.

COVID-19 outbreak affected both budget deficit and debt, however, not as significantly as expected. In order to limit the outbreak of the pandemic, the government prioritized healthcare spending and implemented a package of fiscal measures. These measures were mostly financed by such organizations as European Fund for Sustainable Development, World Bank and the G-20 Debt Service Suspension Initiative.

As a result, budget expenditures slightly grew from 29,5% of GDP in 2019 to 29,7% of GDP in 2020. At the same time, due to the slowdown of business activity, budget revenues (as % of GDP) saw a decrease of around 1,8 p.p. in 2020, which lead to a widening of the fiscal deficit up to 4,4% of GDP (see graph 2). As a result, the government debt increased to 190,6% of budget revenues and to 48,1% of GDP in 2020 (by 33 p.p. and 5 p.p. from the readings of 2019, respectively) (see graph 3).

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 banking system indicators are showing a positive dynamic after experiencing a modest impact from the COVID-19 pandemic in 2020. The ratio of NPLs (30 days overdue) to total loans peaked in 2Q 2020 reaching 31% and then declined to 23,8% by the end of the year and to 23,1% as of 1Q 2021.The banking sector's profitability (ROA) reached its

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

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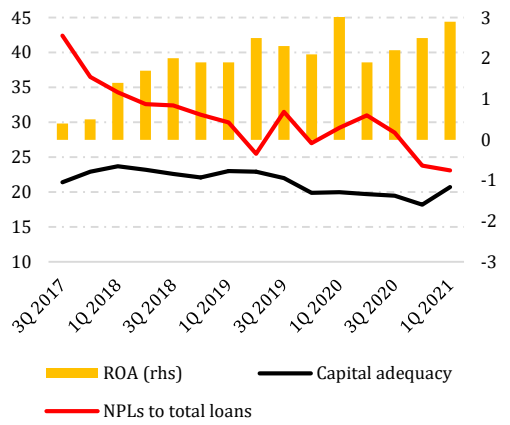
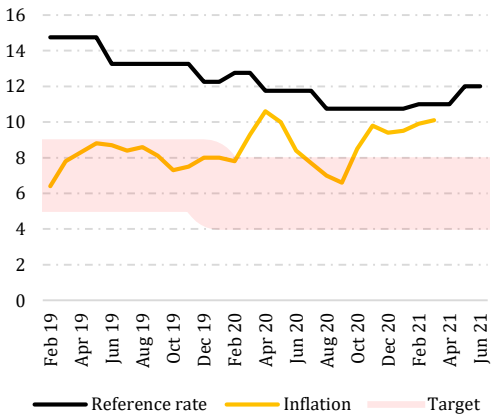
Graph 4: Financial soundness indicators, %



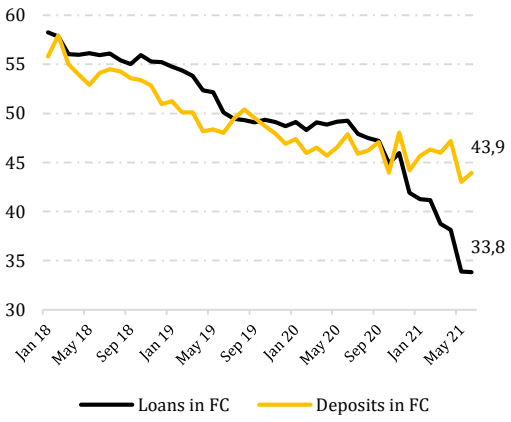
Source: RAEX-Europe calculations based on data from the NBT

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

low by 2Q 2020 (1,9%) and since then has been increasing (2,5% in 4Q 2020 and 2,9% in 1Q 2021). Capitalization in the system remains adequate as the capital adequacy ratio increased from 18,2% in 4Q 2020 to 20,7% in 1Q 2021 (see graph 4).

Low level of trust of 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 development.

The Central Bank raised the reference rate by 25 b.p. to 11% in February 2021 and then by another 100 b.p. to 12% in May 2021. Inflation accelerated from 9,4% by the end of 2020 to 10,1% in March 2021 and remains well above the NBT inflation target of 6% (+/- 2 p.p.) (see graph 5). The USD/TJS exchange rate, after remaining flat between March and October 2020, experienced a sharp depreciation falling from around 0,097 in October 2020 to 0,088 (more than 9%) in July 2021 (see graph 8).

The level of dollarization in the country remains high: around 44% of deposits are nominated in foreign currency. Share of loans in foreign currency demonstrated a significant decrease from about 42% by the end of 2020 to 33,8% in June 2021 (see graph 6). Nevertheless, due to the weak banking system, undeveloped local capital markets, high dollarization and low independency of the NBT the transition mechanisms remain inefficient.

The external position has strengthened. In 1Q 2021 exports increased by 34% y-o-y due to a strong performance of sectors such as textiles, cement and precious metals while imports remained almost stable (+1,6% y-o-y). This is mainly linked to the lower prices for mineral commodities, which are the major import goods for the Tajik economy. International reserves peaked at USD 2,3 bn in December 2020 and remain on a high level of USD 2,2 bn (see graph 7). At the same time, the exchange rate remains controlled by the NBT. Implementation of the plans to remove the currency restrictions could lead to an upgrade of the forecast outlook for Tajikistan.

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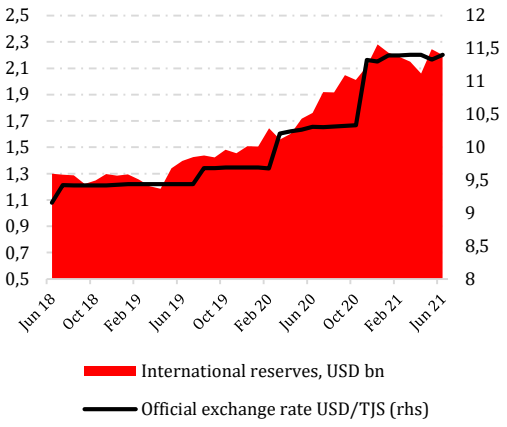
Graph 7: International reserves and exchange rate



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

Stress factors:

- Despite positive dynamics over the last two years, financial dollarization remains high with the share of FX-loans and deposits at 33,8% and 43,9%, respectively by June 2021 (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

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- 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: TBD in December 2021. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2021

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
05.02.2021	Scheduled revision of both types of ratings for the country	B	B-	Negative	Negative
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

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Minute's summary

The rating committee for Tajikistan was held on 5 August 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 of assigning sovereign government credit ratings – Full Public Version (from August 2020). 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**.**

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Office responsible for preparing the rating

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