Research Report on Tajikistan

7 February 2020

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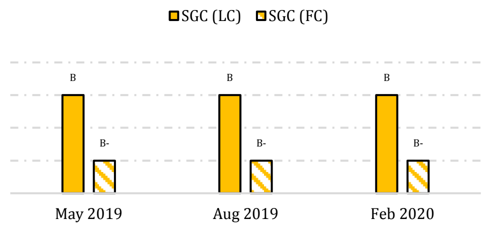
Ratings

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

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Tajikistan

Macro indicators	2017	2018	2019
Gross gov. debt, TJS bn	30,8	33,0	35,0
Nominal GDP, TJS bn	61,1	68,8	77,4
Real GDP growth, %	7,6	7,3	7,5
Gross gov. debt/GDP, %	50,4	47,9	45,2
Deficit (surplus)/GDP, %	-6,0	-4,8	-3,8
Inflation rate, %	6,7	5,4	8,0
Current Account Balance/GDP, %	-	-	-4,5
External debt, USD bn	-	-	6,4*

Development indicators	2018
Inequality adj. HDI	0,57
GDP per capita, USD th	3,42

Default indicator	05.02.2020
7Y Gov Bond Yield, %	9,6**

Source: RAEX-Europe calculations based on data from the IMF, WB, NBT.
*as of September 2019; **Maturity in 2027.

Summary

The Agency has decided to maintain Tajikistan's ratings at 'B-' in FC and 'B' in LC with a negative outlook. The rating remains negatively affected by an ineffective economy with a low level of welfare and high unemployment, subdued and undeveloped financial system, as well as the lingering risk of materialization of contingent liabilities. In addition, the rating is constrained by weak institutional development, imbalanced external position and high financial dollarization. In contrast, the ratings are supported by strong and stable economic growth, the moderate level of the government debt with favorable payment conditions and maturity.

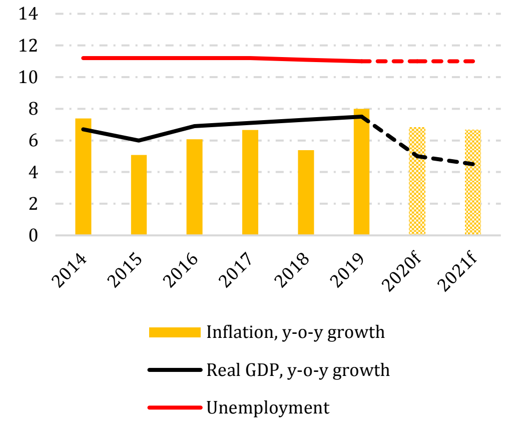
The negative outlook reflects the existing risks and vulnerabilities of the external position, which may lead to deterioration of public finances and destabilize the macroeconomic situation.

The economy keeps growing at an accelerated pace, although national wealth and institutional development remain weak. Tajikistan's economic growth remains one of the most outstanding in the Central Asian region due to favorable prices for major export commodities and household consumption activities supported by remittances. Real GDP growth in 2019 amounted to 7,5%, similar to that of previous years (see graph 1). The main driver of the economy was the increase in industrial production, mainly mining and energy. However, we anticipate that growth in 2020-2021 will be lower at 5%, but will remain stable on the back of weaker prices for major export commodities and an expected slowdown in the economies of its main trade partners.

At the same time, the Tajik economy remains undeveloped as shown by the lowest GDP per capita in PPP terms among non-oil regional peers[1], which is expected to be at USD 3,6 th in 2019. The unemployment rate, according to ILO methodology, is estimated to be quite high at 11% in 2019 and a significant share of the Tajik labor force works abroad and depends on the markets of Russia and Kazakhstan. Low Institutional development and transparency of the government policy also limit economic development[2]. Moreover, the country's high exposure to environmental shocks and disasters have significant economic impacts.

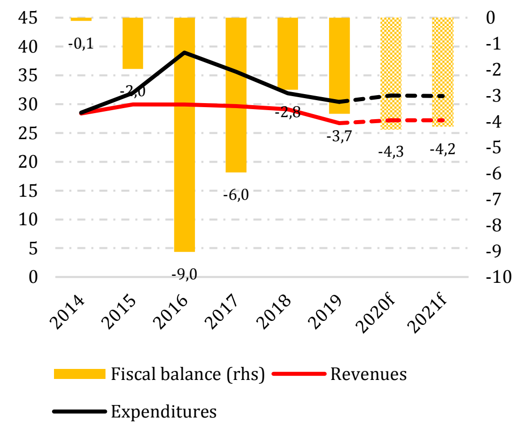
[1] Central Asia and Caucasus non-oil peers: Armenia, Georgia, Kyrgyzstan and Uzbekistan.
[2] In 2019, Tajikistan occupied the 153rd place out of 180 countries in the Corruption Perception Index and the 106th position out of 190 countries in the Doing Business 2019 report published by the World Bank.

Graph 1: Macroeconomic indicators, %



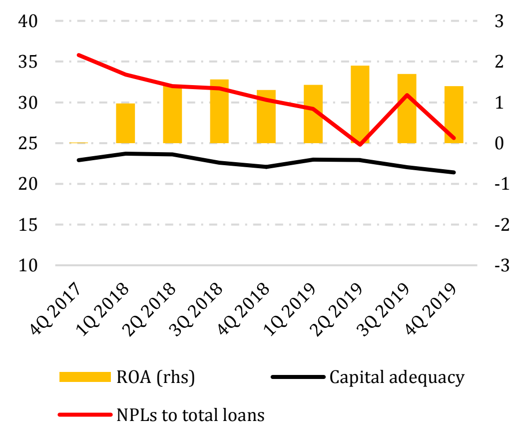
Source: RAEX-Europe calculations based on data from the WB, IMF, NBT

Graph 2: Fiscal budget dynamics, % of GDP



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

Graph 3: Financial soundness indicators, %



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

Moderate level of government debt and conservative fiscal policy. The government continues to pursue a consolidation policy in managing public finances, mainly by cutting costs by restraining investment in infrastructure projects. Consequently, the budget deficit for 9M 2019 narrowed to 2,8% from 4,3% a year earlier, supported by increased non-tax revenues. However, we estimate the overall public deficit, which includes quasi-fiscal operations, to have stood at 3,7% in 2019, driven by further public investments in the energy sector (see graph 2). We still expect the budget balance to be volatile in the following years due to the significant volume of investments in infrastructure projects and the lack of internal capacity for revenue growth.

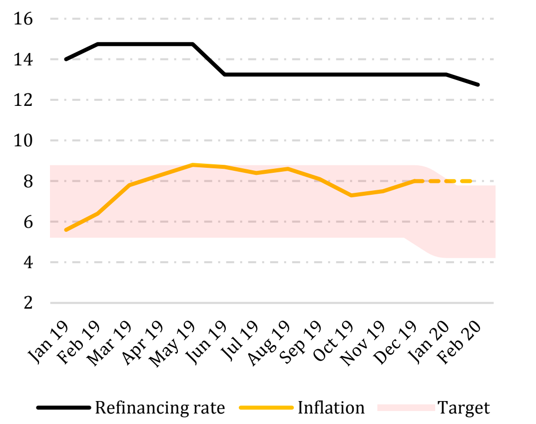
The government indebtedness stands at a moderate level with a ratio of the total direct and guaranteed debt to GDP and budget revenues expected to post figures of 45,2% and 162% in 2019 respectively, according to IMF estimates. Despite the low figures, the risk of these metric deteriorating in the mid-term perspective is high because of SOE's accumulated external debt, and the high share of the government's FX-denominated debt (up to 80% of total public debt). However, the risks are partially mitigated by the high share of long-term concessional loans from international institutions and foreign governments[3], which increases the likelihood of debt prolongation and restructuring. In the medium term (2020-2021), we do not expect a significant increase in the external debt burden, given the government's intention to attract funding in the form of grants.

The banking industry shows signs of recovering. The banking system is fragile as we estimate banks' assets and domestic credit to GDP ratios to have stayed at 28,4% and 15,6% as of end-2019 respectively and the presence of large troubled banks[4] remains a concern. On the positive side, the sector continued to recover by improving the asset quality and positive profitability. As of the end 2019, ROE and ROA amounted to 5% and 1,4%, respectively, while capitalization in the system remains adequate as the ratio of capital to assets remained high at 28,3% as of the same date. Moreover, the ratio of NPLs to total loans, as of end-2019 was up to 25,6% of total loans[5] from 31,1% in 2018 (see graph 3).

The effectiveness of the monetary policy remains limited. Despite the fact that inflation accelerated from 5,4% in 2018 to 8% in 2019 in annual terms, the National Bank of Tajikistan (NBT) has been pursuing an expansionary policy, actively applying other monetary instruments. As a result, the refinancing rate was gradually lowered by 1,25p.p. between

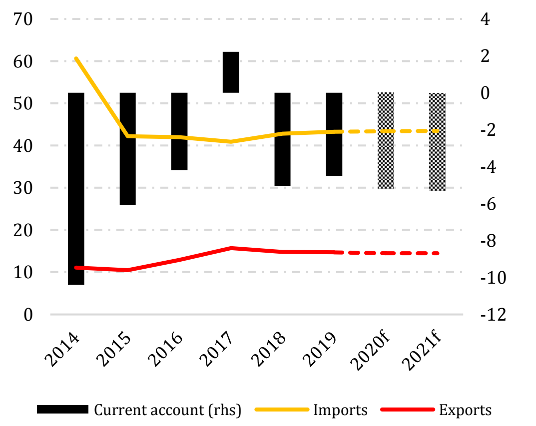
[3] The Export-Import Bank of China is the largest creditor of the government.
[4] Tochiksodirobank and Agroinvestbank.
[5] The figure refers to the local definition of NPLs, which include customer and interbank loans with overdue payments of more than 30.

Graph 4: Reference rate vs inflation rate, %



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

Graph 5: External sector indicators, % of GDP



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

May 2019 and February 2020 (see graph 4). The benchmark for the inflation target corridor was lowered to 6% (+/-2%) in 2020 and we expect the regulator to continue improving the policy effectiveness and transition to a fully flexible exchange rate regime by 2023. However, the transition mechanism is limited by high levels of financial dollarization[6], the shallow financial market and curtailed independence of the NBT.

Imbalances in the external position prevail. The current account deficit is expected to reach 4,5% in 2019, as there is a high dependence on imports with a ratio of imports to GDP of 43,3% in 2019, while at the same time, the low level of exports to GDP stood at around 15% (see graph 5). We see risks for the widening of the trade balance in the medium term as commodity prices are expected to decrease. Nevertheless, international reserves slightly improved at the level of USD 1,5 bn, which covers more than 5 months of imports and more than 50% of external public debt. Besides, support can be provided by foreign direct investments in the mining sector due to new concession agreements.

Important note for sovereign ratings

This Research Report shall be treated as a supplementary part of the published Press Release included in the following link:

https://raexpert.eu/reports/Press_release_Tajikistan_07.02.2020.pdf

Both documents shall be treated as essential parts of each other.

For further information on the factors, their weights, methodologies, risks and limitations of these ratings, and other regulatory disclosures, please refer to the Press Release and the website of the Agency.

[6] The share of FX-loans and deposits at 50,5% and 46,9%, respectively by December 2019.