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Ratings

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

* These ratings are unsolicited

Main Economic Indicators of Tajikistan

Macro indicators	2016	2017	2018
Gross gov. debt, TJS bn	23	31	33
Nominal GDP, TJS bn	54	61	69
Real GDP growth, %	6,9	7,1	7,0
Gross gov. debt/GDP, %	42,0	50,4	47,9
Deficit (surplus)/GDP, %	-9,0	-6,0	-4,8
Inflation rate, %	6,1	6,7	5,4
Current Account Balance/GDP, %	-	-	-5,3
External debt, USD bn	-	-	2,9

Development indicators	2018
Inequality adj. HDI	0,65
GDP per capita, USD th	3,4

Default indicator	10.05.2019
10Y Gov Bond Yield, %	5,4

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

Summary

The assigned 'B-' and 'B' sovereign government credit ratings in foreign and national currency respectively, reflect Tajikistan's extremely low level of economic and institutional development, very fragile banking system stance with a very low level of financial system development, as well as high amount of contingent liabilities of the government. At the same time, ratings are supported by solid economic growth, positive dynamics of FDI inflow, moderate level of fiscal deficit and still acceptable levels of government debt, despite the gradual increase over the last years.

The assignment of the foreign currency credit rating one notch lower than the national currency rating reflects a very fragile external position evidenced by the low level of export to GDP, high dependence on imports, meager international reserves, high share of FX-denominated public debt, as well as presence of an informal FX-currency market.

The developing outlook shows our concerns regarding the amount of funds provided by the IMF and other international financial organizations during 2019, as well as the implementation of the Rogun hydropower plant (HPP) project on time. Both factors weigh on the credit ratings and makes them very sensitive to the event-related factors.

The national wealth and institutional development levels are extremely low, but economy is expanding with a high pace. Tajikistan is the country with the lowest level of GDP per capita in PPP terms in the CIS, among Central Asia and Caucuses non-oil peers[1] and among all countries rated by the Agency. Moreover, the institutional development of Tajikistan as well as business climate in the country are very weak, as shown by the assessment of international organizations. Despite the fact that the government announced different reforms in order to promote local and international business over the last years, Tajikistan still occupied only the 126th position out of 190 countries in the Doing Business 2019 report. In addition, as in many other countries of the region, the Corruption Perception Index published by Transparency International is very low at 25, which puts the country on the 152nd place out of 180 countries.
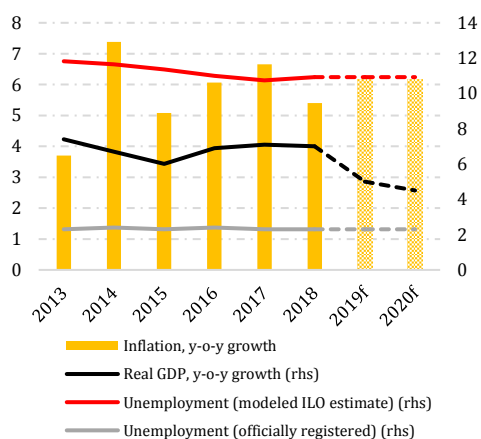
[1] Central Asia and Caucuses non-oil peers: Armenia, Georgia, Republic of Kyrgyzstan and Uzbekistan.

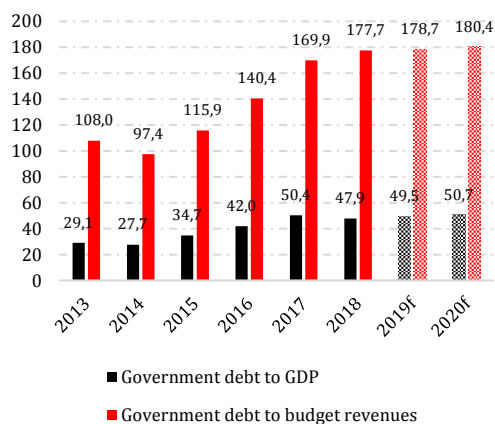**Graph 1:** Macroeconomic indicators, %

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

Graph 2: Fiscal budget dynamics, % of GDP
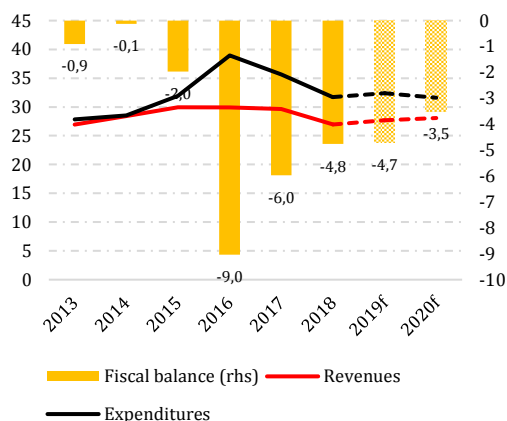
Source: RAEX-Europe calculations based on data from the WB, IMF

Graph 3: Government debt dynamics, %

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

The country's macro stance assessment is supported by very high GDP growth in real terms, which is the highest in the region and stood around 7% y-o-y in the last three years (see graph 1). Such a robust growth was supported by the government investments in infrastructure, including Rogun HPP project, increase of FDI inflow, mostly from Chinese companies investing in local mining projects, as well as increase of remittances inflow from Russia and other CIS countries, supporting internal consumption.

In our view, the GDP growth prospects are heavily exposed to external and environmental[2] shocks, and remain subdued by the above-mentioned institutional weakness. Therefore, we expect the mid-term growth to be close to the range of 5%-6%[3], rather than current 7%. However, the start of operations of the Rogun HPP in full capacity will boost economic growth even further. Nonetheless, since there is no clear evidence of on-time finalization of the project, we stick to our base-line scenario of GDP growth between 5% and 6%.

Fiscal position remains acceptable but very sensitive to external and internal shocks. The fiscal balance of the government remains negative since 2012, with the largest deficit of 9% of GDP recorded in 2016 (see graph 2), when the country was affected by negative spill-over effects from the recession in the region, especially in Russia, as well as non-favorable market conditions for key exported goods (including gold, zinc ore and raw aluminum). These factors, together with the expansionary policy of the authorities, led to the deterioration of the fiscal position.

Since 2017 the government has tried to stick to fiscal consolidation, partly in order to comply with the international financial institutions' conditions, and keeps showing a gradual reduction of the fiscal deficit, which reached 4,8% of GDP in 2018. At the same time, this metric was higher than originally planned due to the pressure to launch the Rogun HPP by November 2018. Despite the fact that the 2019 Budget Law includes a state budget deficit target of 3% of GDP; we do not expect the overall budget balance to improve significantly since the fiscal targets do not take into account all government expenses for infrastructure projects including the Rogun HPP.

The level of government debt load has increased substantially over the last years and was expected to reach 47,9% of GDP and 177,7% of budget revenues in 2018 according to IMF estimates (see graph 3). Such a negative dynamic was mostly due to borrowing related to infrastructure
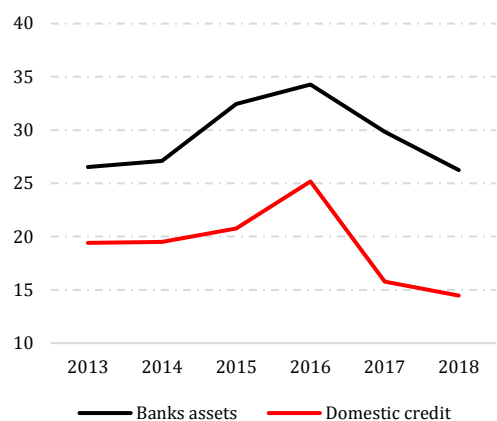
[2] Mostly weather, taking into account high share of agricultural sector in GDP and shortage of water resources.
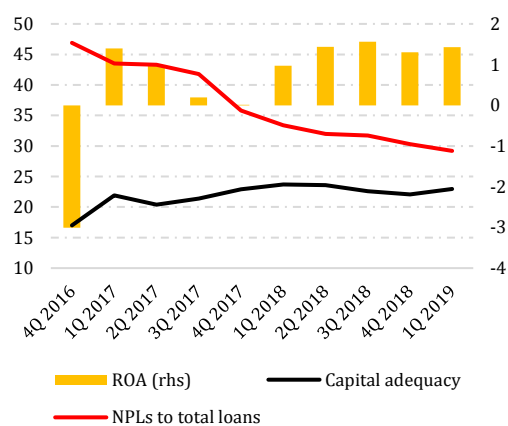[3] This scenario includes an assumption that Rogun HPP project will not be finalized on time.

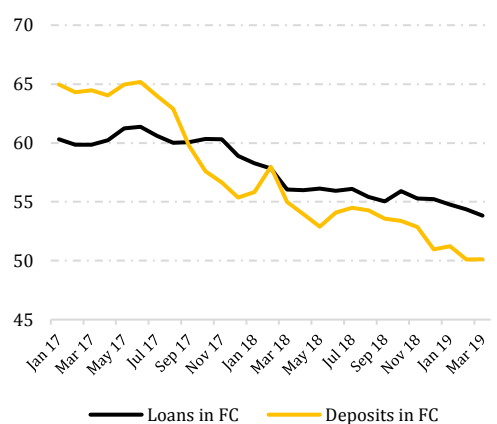**Graph 4:** Credit to the economy dynamics, % of GDP

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

Graph 5: Financial soundness indicators, %

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

projects in the country, as well as adverse effects of the TJS devaluation taking into account that around 85% of public debt is FX-denominated.

These risks are partially mitigated by the high share of concessional debt provided by international financial institutions and foreign governments, which can be prolonged or restructured with a high probability.

At the same time, Tajikistan is characterized by a large amount of contingent liabilities of the government, related to the debt of loss-making SOEs, especially in the energy sector, as well as unsolved problems with two large state-owned banks.

Banking system stance is weak despite slight improvement. The overall level of financial intermediation in the country remains weak, as shown by the banks' assets and domestic credit to GDP ratios at 26% and 14% respectively in 2018 (see graph 4), that are more than 10p.p. lower than the 2016 peaks. In addition, local capital markets remain underdeveloped, with no listed shares currently traded on the Central Asia Stock Exchange (Dushanbe).

Despite significant amount of capital injections to state-owned banks done by the government in 2016, the overall stance of the banking system remains weak. The NPL to total loans ratio, according to the local definition, stood as high as 30% of total gross loans as of March 2019 (see graph 5). However, due to the fact, that nonperforming loans according to the local definition include customer and interbank loans with overdue more than 30 days, instead of generally accepted 90 days, the internationally accepted levels of NPLs could be lower than disclosed. In addition, ROE and ROA stood at 7% and 1,9% respectively by March 2019, which is an improvement as compared to last year.

Monetary policy effectiveness remains subdued despite improvements. As shown by the weak correlation between the refinance rate of the National Bank of Tajikistan (NBT) and average credit rate on the market, the monetary policy transmission mechanism remains weak. The effectiveness of the NBT's policy remains limited in our view due to still high levels of dollarization (graph 6), abovementioned banking system weakness as well as low independency of the NBT.

However, the effectiveness increased due to the introduction of new instruments, such as overnight and intraday lending facilities, overnight deposits and credit, and certificates of deposit auctions. In addition, 2018 inflation of 5,4% stayed within the NBT's target of 7% (+/- 2p.p.).

The FX market in our view remains highly regulated by the NBT, which constrains access to currency for people and SMEs and indirectly limits imports. This leads to the presence of informal FX market. In the context

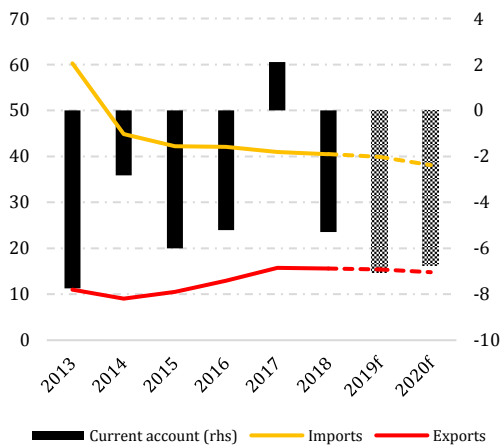**Graph 7:** International reserves and exchange rate
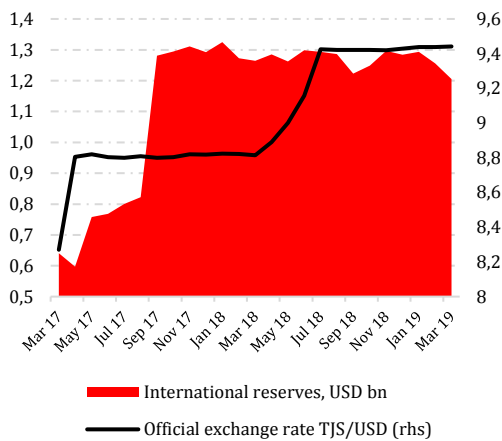
Source: RAEX-Europe calculations based on data from the NBT

Graph 8: External sector indicators, % of GDP

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

of increasing spread between the official and black-market rates, in the summer of 2018 the NBT made a sharp adjustment by devaluing the TJS by 2,6% against USD (see graph 7).

Weak external position and exposure to event-related shocks are key negative factors for the creditworthiness. Tajikistan is the country with the weakest external position in the region. The ratio of import to GDP is expected to be at 40,5% in 2018, while export to GDP was as low as 15%. Therefore, the country is characterized by a persistently high trade deficit, which has varied from 25% to 50% of GDP over the last six years. We expect the situation to remain in place within the following years taking into account limited export opportunities of the national economy.

The international reserves of the NBT despite sharply increasing in 2017, remain extremely low and covered only 2 months of imports and 46% of government external debt by end-2018.

Together with the abovementioned high share of FX-denominated debt, these factors make the country's external balance, fiscal and debt position extremely sensitive to the provision of financial support from international organizations, mainly from the IMF. In addition, substantial delays in the finalization of the Rogun HPP project, together with increase of additional financial needs for this project, can lead to an increase in government debt and deficit levels. Due to the fact that both factors are very exposed to event related risks, we can expect various rating actions within the next three months.

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_10.05.2019.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.