RAEX-Europe confirmed at 'B-' the FC rating and at 'B' the NC rating of Tajikistan. 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 '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.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- After an increase in the level of net FDI inflow in 2018 to 2,9% mostly due to a substantial increase of investments of Chinese companies into the mining industry, as well as other FDI to metallurgy and retail, the metric slightly decline to 2,6% in 2019, while we can expect a sharp decrease by end-2020;

- Major part of public and publically guaranteed debt belongs to multilateral and bilateral creditors, while almost all debt increase during 2020 is related to donors support, including the IMF, and has concessional terms. This partially mitigates the risks of debt increase, since the ratio of debt to GDP and budget revenues, after a gradual decline, are expected to exceed up to 50% and 200% respectively by the end of 2020 and to remain close to these levels in 2021. Moreover, external liabilities of SOEs and the high share of FX-denominated debt (up to 80% of total public debt) create a pressure on the debt position of the government.

Restricting factors:

- After a period of consolidating fiscal policy in 2018-2019, in response to the COVID-19 economic crisis, the Tajik government turned to fiscal expansion in 1H 2020 and is expected to continue this trend by end-2020. The authorities have launched an action plan accompanied by a costing exercise for medical supplies and equipment. In addition, the government is providing VAT exemptions on essential imports, lump-sum assistance equivalent to minimum wage to vulnerable households and other socially disadvantaged groups. Health workers are to receive supplemental pay, while tariff increases on electricity, water, and communal services have been postponed until the end of 2020. Together with other measures, and a sharp drop in public budget revenues, this is expected to lead to a deficit of up to 7-8% of GDP. However, after the disbursement of USD 189,5 m for budget support from IMF, the Tajik government confirmed its commitment to fiscal consolidation after the crisis: authorities agreed on deficit targets of 4,4% of GDP in 2021, and 2,6% of GDP in 2022. We will keep monitoring the final results of 2020, including quasi-fiscal operations, as well as the budget execution in 2021;

- In response to the COVID-19 economic crisis, the National Bank of Tajikistan (NBT) has taken measures to ease monetary and liquidity conditions and adopted an Action Plan to address the effects of the pandemic on the banking sector. It allowed a one-off 5% exchange rate depreciation in March and a greater exchange rate flexibility to align the official rate with the market rate. The policy rate was cut by 100b.p. to 11,75% in April, while reserve requirements were lowered, relaxed enforcement of prudential

requirements and provided foreign exchange liquidity. Although these measures are considered as an adequate response to the economic turbulence, in our view the effectiveness of the monetary policy remains limited by still high levels of financial dollarization, the poor stance of the banking system, undeveloped local capital markets, as well as low independency of NBT;

- Inflation in Tajikistan remains very volatile. After reaching 5,4% in 2018, it jumped again up to 8% by end-2019 and reached 10,6% y-o-y in April 2020 on the back of sharp devaluation of TJS. We expect the metric to be volatile during 2H 2020, but to be close to the upper bound of the NBT's target of 6% (+/- 2p.p.) by end 2020;

- The overall deficit of public finances in the IMF definition (which includes public infrastructure projects) is expected to reach 2,1% of GDP by end-2019 as compared to 2,8% a year ago. However, due to a sharp decrease of budget revenues and the abovementioned fiscal stimulus, we expect the budget deficit to be in the range of 7-8% by end 2020;

- Before the COVID-19 economic crisis, Tajikistan's economic growth was one of the highest in the region with a metric of 7,3% in 2018 and 7,5% in 2019 respectively. However, the global crisis affected the country's economy and we expect an overall contraction up to 2% y-o-y in 2020.

Negative factors:

- The economy remains underdeveloped and inefficient, as evidenced by the WEF competitiveness index in 2019 – 52,4 (104th place out of 141 countries), persistently high trade deficit and subdued level of GDP per capita in PPP, which is expected to have stood at USD 3,6 th as of the end of 2019, the lowest level among the non-oil regional peers[1];

- Contingent liabilities remain substantial arising from the high level of indebtedness of unprofitable SOEs, especially in the energy sector, while problems with two large systemically important banks (Agroinvestbank and Tochiksodirotbank) remain in place. These institutions have debts to the state in the amount of about TJS 4 bn altogether (around 20% of budget revenues or 5% of GDP). Moreover, the COVID-19 economic crisis can lead to further deterioration of the financial stance of local banks and SOEs;

- The development of the financial system remains subdued as we estimate banks' assets and domestic credit to GDP ratios to have stayed at 28,4% and 15,8% as of end-2019 respectively, as well as absence of listed shares currently traded on the national Central Asia Stock Exchange (Dushanbe);

- The banking system remains very weak with a high share of state-owned banks, low level of trust to banking system from population and the presence of large troubled institutions. The ratio of NPLs to total loans, as of end 2Q 2020 was up to 31% of total loans[2]. However, the level of NPLs according to the internationally recognized definition may be lower than the disclosed metrics. On the other hand, the banking sector' profitability remains positive despite the current economic turbulence. As of end 2Q 2020, ROE and ROA amounted to 7,0% and 1,9%, respectively, while capitalization in the system remains adequate as the capital adequacy ratio was as high as 19,7%;

- Institutional development and transparency of the government policy in Tajikistan is quite low, as shown by the assessment of international organizations. The Corruption

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[1] Central Asia and Caucasus non-oil peers: Armenia, Georgia, Republic of Kyrgyzstan and Uzbekistan.
[2] The figure refers to the local definition of NPLs, which include customer and interbank loans with overdue payments of more than 30 days, instead of the generally accepted number of 90 days.

Perception Index stood at 25 (153rd place out of 198 countries) in 2019, while inequality adjusted HDI indexes was 0,57 in 2018. Moreover, the country occupied only the 106th position out of 190 countries in the Doing Business 2019 report published by the World Bank;

- According to ILO methodology, unemployment is estimated at 11% in 2019. This metric is heavily exposed to the conditions of the largest economies in the region, such as Russia and Kazakhstan, where a significant part of the Tajik labor force works. Due to the high level of labor migration to Russia, the employment and income of the population and, accordingly, the volume of remittances, largely depends on the state of the Russian economy;

- The spread for the 10Y USD-denominated Tajikistan government bond with maturity in 2027 (7-year remaining maturity) and 7Y U.S. Treasury bonds is currently around 9p.p., showing the negative investors' perceptions regarding sovereign risks.

Stress factors:
- Despite positive dynamics over the last two years, financial dollarization remains high with the share of FX-loans and deposits at 49,3% and 47,9%, respectively by June 2020 (very weak stress-factor)

Currency risks:
- The FX-currency market remains managed by the NBT, which constrains access to hard currency and indirectly limits imports. This leads to the presence of an informal market of FX-currency, especially taking into account the size of remittances inflow which accounted for almost 30% of GDP according to World Bank data;

- The current account deficit reached 2,3% in 2019 and is expected to widen up to 7,8% by end-2020, high dependence on imports persists with a ratio of imports to GDP of 42,7% in 2019, while exports and remittances were weak. Nevertheless, international reserves stabilized at the level of USD 1,5 bn, which covers around 5 months of imports and 50% of external public debt;

- Very low level of exports to GDP at around 15,6% in 2019;

- Exposure to currency risks of public debt servicing remains high, as about 80% of debt is denominated in foreign currency. However, these risks are partly mitigated by a high share of concessional debt.

SENSITIVITY ASSESSMENT:

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 an 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 recorder 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*.

"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 mitigation of the debt repayment risks in the short- and mid-run perspective due to significant financial support from international financial organizations on concessional terms.

In the long-term perspective, the ratings and the outlook reflect deterioration of the debt and fiscal position of the government on the back of the COVID-19 crisis, 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 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." - Clarified Vladimir Gorchakov, Associate Director of RAEX-Europe.

Research report on Tajikistan is available at:

https://raexpert.eu/reports/Research_report_Tajikistan_07.08.2020.pdf

Next scheduled rating publication: TBD in December 2020. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2020

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
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 7 August 2020. 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, National statistical office of the Republic of Tajikistan, Ministry of finance of the Republic of Tajikistan, Central Asia Stock Exchange, WEF, Transparency international, open sources.

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

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

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The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

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.