Rating-Agentur Expert RA assigned 'B-' rating to Tajikistan. The rating outlook is developing.

Rating-Agentur Expert RA assigned 'B' sovereign government credit rating (SGC) to Tajikistan in national currency (Moderately low level of creditworthiness of the government) and 'B-' in foreign currency (Moderately low level of creditworthiness of the government). The rating outlook is developing which means that in the mid-term perspective there is an equal probability of downgrade, upgrade or maintenance of the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- The economic expansion in Tajikistan is one of the strongest in the region with real GDP growth at 7,1% in 2018 mostly supported by government investments in infrastructure and recovery of internal consumption due to an increase of remittances inflow (mostly from Russia). We do not expect recession in the Tajik economy in the following years due to demographic trends and the current substantially low level of national wealth per capita; however, we can expect a slowdown of the economy based on the country's high exposure to external and environmental shocks and significant internal imbalances of the national economy;

- Moderately high level of net FDI inflow in 2018 at 2,5% as compared to 1,5% in 2017 mostly due to substantial increase of investments of Chinese companies to the mining industry;

- Moderate level of government debt load with ratios of public debt to GDP and budget revenues at 47,9% and 177,7% in 2018 according to IMF estimates, with a high share of concessional debt provided by international financial institutions and foreign governments, as well as moderate level of short-term government debt around 11% of GDP. However, if taking into account external liabilities of SOEs accumulated over the last years, the abovementioned ratios of overall public debt can exceed 50% and 180% respectively;

- Acceptable level of consolidated budget deficit at 4,8% of GDP in 2018 as compared to deficits of 6% and 9% in 2017 and 2016 respectively. Despite the fact that the government confirmed its commitment to fiscal consolidation by introducing a new a budget law for 2019, we can expect the budget balance to be volatile in the next years due to the significant volume of investments in infrastructure projects.

Restricting factors:

- Reduced effectiveness and consistency of fiscal policy of the government. After the period of expansionary fiscal policy, that led to a deficit of 9% of GDP in 2016, the government announced the return to a policy focused on fiscal consolidation, which was already reflected in the budget balance figures from 2017 and 2018 at -6% and -4,8% of GDP respectively. However, the latter deficit was wider than originally planned due to the augmented pressures to launch the Rogun Hydropower Plant (HPP) by November 2018. In addition, the positive dynamic of budget revenues in 2018 was mostly supported by collection of fines and penalties raised through non-planned inspections of enterprises,

instead of usual tax income. The 2019 Budget Law stipulates fiscal consolidation with the state budget deficit not wider than 3% of GDP; however, this metric does not take into account all government expenses for infrastructure projects including the Rogun HPP;

- The effectiveness of the National Bank of Tajikistan's (NBT) monetary policy remains limited despite significant improvement over the last years. The transmission mechanism remains subdued due to high levels of dollarization, poor banking system stance, undeveloped local capital markets, 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 as well as certificates of deposit auctions. In addition, the 2018 inflation of 5,4% stayed within the NBT's target of 7% (+/-2p.p.);

- Tajikistan shows a moderate level of inflation with a reduced volatility as compared to its regional peers[1]. The official CPI index reached 5,4% in December 2018 as compared to 6,7% and 6,1% in 2017 and 2016 respectively. Based on the CPI index growth figures reported by the NBT for the first three months of 2019 and taking into account high expo sure to external shocks, we can expect higher inflation metrics by the end 2019 close to 7%.

Negative factors:

- Extremely low level of economic development as shown by GDP per capita in PPP terms at USD 3,4 th, which is the lowest level among Central Asia and Caucuses non-oil peers; while the economy's effectiveness is subdued as shown by persistent trade deficit and very low competitiveness index from the World Economic Forum (WEF) at 52,1 in 2018 (102nd position out of 140 countries);

- High debt levels at loss-making SOEs', especially in the energy sector, as well as unsolved problems with two large state-owned banks, create significant contingent liabilities for the government and therefore weigh negatively on the sovereign credit profile;

- Very low level of financial system development with the banks' assets and domestic credit to GDP ratios at 26% and 14% respectively, as well as absence of listed shares currently traded on the Central Asia Stock Exchange (Dushanbe);

- The banking system stance remains very fragile despite some improvements. The sector remains dominated by state owned banks (SOBs), with high concentration risks shown by the share of the three largest banks being more than 90% of total assets. The NPL to total loans ratio, according to the local definition[2], stood as high as 30% of total gross loans as of March 2019. However, the internationally accepted levels of NPLs could be lower than that disclosed by the NBT (see note). In addition, the system showed a positive financial result in 2018 for a second year in a row, with ROE and ROA at 7% and 1,9% respectively, while the capital to assets ratio was extremely high at 27%;

- The country is characterized by very low level of institutional development and transparency of the government policy, as shown by the assessment of international organizations. The Corruption Perception Index stood at 25 (152nd place out of 180 countries); transparency of government policymaking and inequality adjusted HDI indexes at 3,7 and 0,65 respectively in 2018. In addition, the country occupied only the 126th position out of 190 countries in the Doing Business 2019 report published by the World Bank;

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[1] Central Asia and Caucuses non-oil peers: Armenia, Georgia, Republic of Kyrgyzstan and Uzbekistan.
[2] Nonperforming loans according to the local definition include customer and interbank loans with overdue more than 30 days, instead of generally accepted 90 days.

- Officially registered unemployment remains low at 2,3% as of end 2018, while the unemployment calculated according to the ILO methodology, shows a rate of 10,9%. In addition, the local labor market is heavily exposed to the economic developments in other countries, especially Russia, which is a key provider of employment for the population of Tajikistan;

- The spread for the 10Y USD-denominated Tajikistan government bond with maturity in 2027 (8-year remaining maturity) and 10Y U.S. Treasury bonds is currently more than 5p.p., showing the negative investors' perceptions regarding the sovereign risks.

Stress factors:

- Despite positive dynamic over the last two years, financial dollarization remains high with the share of FX-loans and deposits slightly exceeding 50% by March 2019 (weak stress-factor).

Currency risks:

- The FX-currency market remains de-facto regulated 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 more than 30% of GDP;

- High dependency on imported goods and services with a ratio of import to GDP expected to be at 40,5% in 2018, combined with meager amount of international reserves, covering only 2 months of import and 46% of government external debt;

- Very low level of exports to GDP at around 15% in 2018;

- Currency structure of public debt is worrisome with around 85% of debt being FX-denominated.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Successful and prescheduled finalization of the Rogun HPP project in a full capacity, which would start to generate FX-revenues for the fiscal budget and propel economic growth in the country;

- Provision of the IMF financial support prior to the end of 2019 in full as compared to the originally planned amount, together with additional financial support from other international organizations and foreign governments during 2019; which would, all together, cover the financial needs of the Tajik government for the year.

The following developments could lead to a downgrade:

- Substantial delays in the finalization of the Rogun HPP project, together with an increase of additional financial needs for this project, which can lead to an increase in the government debt and deficit levels;

- Partial, nil or delayed provision of the originally expected IMF financial support;

- Hikes in inflation and dollarization levels due to external shocks.

"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 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 HPP project on time. Both factors weigh on the credit ratings and makes them very sensitive to the event-related factors." - Clarified Vladimir Gorchakov, Associate Director of Rating-Agentur Expert RA.

Research report on Tajikistan is available at:

https://raexpert.eu/reports/Research_report_Tajikistan_10.05.2019.pdf

Next scheduled rating publication: TBD. The full sovereign rating calendar can be found at
Sovereign Rating Calendar 2019

For further information contact:

Responsible expert:
Vladimir Gorchakov, Associate Director of Rating-Agentur Expert RA
+49 (69) 3085-45-00, ext. 1216
gorchakov@raexpert.eu

Reviewer:
Hector Alvarez, Associate Director of Rating-Agentur Expert RA
+49 (69) 3085-45-00, ext. 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

Minute's summary

The rating committee for Tajikistan was held on 10 May 2019. 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.

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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