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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

☐ SGC (LC)   ☐ SGC (FC)
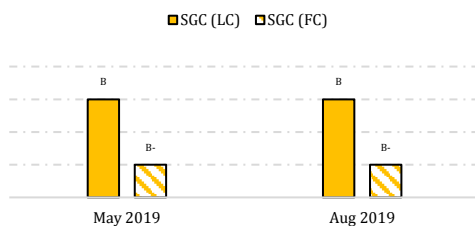
Main Economic Indicators of Tajikistan

Macro indicators	2016	2017	2018
Gross gov. debt, TJS bn	22,9	30,8	33,0
Nominal GDP, TJS bn	54,5	61,1	68,8
Real GDP growth, %	6,9	7,6	7,3
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	0,56
GDP per capita, USD th	3,4

Default indicator	09.08.2019
8Y Gov Bond Yield, %	8,4**

Source: RAEX-Europe calculations based on data from the IMF, WB, NBT.
* Preliminary data. **Maturity in 2027.

Summary

The Agency has decided to maintain Tajikistan's ratings at 'B-' in FC and 'B' in LC while, at the same time, the outlook was changed to negative. This rating reflects the lowest nation's wealth among the peer-countries, poor institutional development and lagged competitiveness position of the economy, fragile position of the banking and financial systems, as well as a high risk of contingent liabilities' materialization for the government. Meanwhile, the ratings are supported by stable economic growth, continued narrowing of the budget deficit, acceptable debt burden and a favorable structure of creditors of the government.

The FC rating is lower by one notch as a result of the weak external position which is highly dependent on imports, the high share of foreign currency government debt and the presence of an informal foreign exchange market.

The negative outlook reflects our concern about the stability of the budget and the current account of the country on the background of growing external uncertainties, hiking inflation, as well as delays in the timely implementation of the Rogun HPP with the absence of direct financial support from international organizations for this project. These factors exert pressure on the ratings and make them very sensitive to the deterioration of public finances and current account as a result of external shocks.

The economy demonstrates high growth rates, although national wealth and institutional development are very weak. Tajikistan's economy showed the highest GDP growth rate in the region at 7,3% in 2018 (see graph 1) owing to public investment in energy, increased external investment in the mining sector and domestic demand driven by growth in remittances, mainly from Russia. We anticipate that growth in 2019-2021 will be stable but lower at around 6-7% on the back of strong private consumption and favorable prices for major export commodities. The reduction of government spending on infrastructure, which is in line with the intention to pursue a fiscal consolidation policy, could be a constraining factor for future growth rates of the economy. Despite operations of the first unit of the Rogun HPP having resumed and having planned the launch of the second unit at the end of 2019, the prospects of

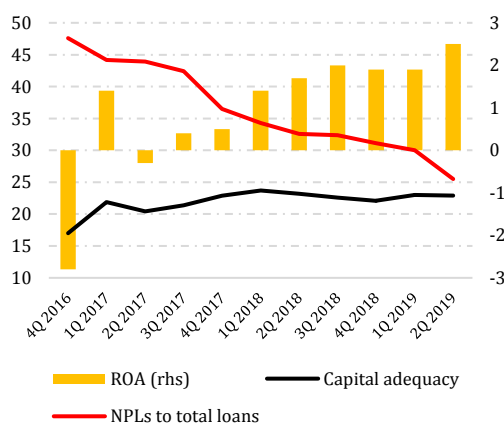**Graph 1:** Macroeconomic indicators, %
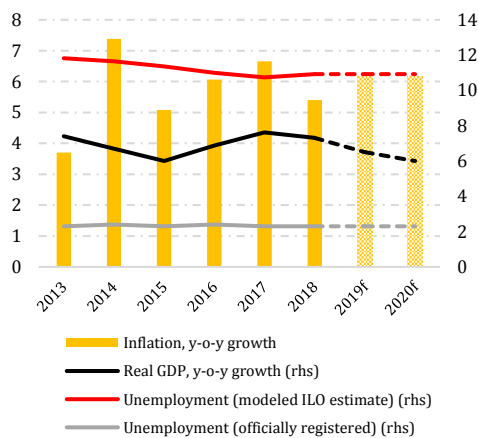
Source: RAEX-Europe calculations based on data from the WB, IMF

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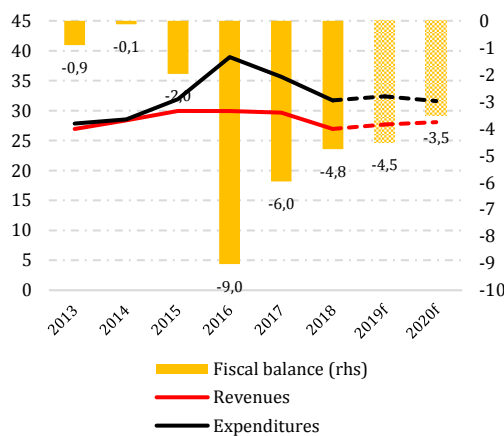
Source: RAEX-Europe calculations based on data from the WB, IMF

Graph 3: Financial soundness indicators, %

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

reaching the designed capacity and the contribution of the HPP to GDP in the mid-term perspective are not yet clear.

Moreover, the lowest level of GDP per capita in PPP terms among all non-oil peers from Central Asia and the Caucasus[1], as well as poor state institutions and a business climate are factors that negatively affect the potential economic growth and the sovereign's rating. Despite the declaration of reforms to boost investment and business, Tajikistan ranks 126th out of 190 countries in the Doing Business Ranking, and has a Corruption Perception Index of 25 (152nd out of 180 countries).

The budget deficit is shrinking, but the budget volatility and debt instability remains. The budget deficit decreased to 4,8% in 2018 compared to 6% in 2017 (see graph 2), mainly due to the outpacing dynamics of non-tax revenues from fines and penalties during unplanned inspections of the business, as well as delays in expenditures on non-priority infrastructure projects, while the expenditures on Rogun HPP exceeded the planned volumes. The 2019 State Budget Law provides for further fiscal consolidation in order to comply with the requirements of international financial institutions. However, our estimates of the overall public deficit including the off-balance operations in 2019 are in the range of 3-4,5%, as the budget is under pressure from the need for further public investments in the energy sector, while there are uncertainties in receiving external financing.

According to IMF estimates, the government's debt burden stood at 48% of GDP and 178% of budget revenues in 2018 with a high share of FX-denominated debt at around 80%. The weak external position combined with the negative budget balance creates the preconditions for increasing public debt at a moderately high level of 50% of GDP going forward. In addition, the debt instability stems from significant contingent liabilities for the government arising from loss-making SOEs, as well as unresolved problems of the two largest banks. However, risks are partly mitigated by the high share of long-term concessional loans from international institutions and foreign governments which increases the probability of debt prolongation and restructuring.

The financial sector remains weak, but banks showing slight improvement. The development of the financial sector remains very weak, as evidenced by the fragile banking system with a ratio of banks' assets to GDP at 26% in 2018, as well as the absence of the local capital market since, currently, shares are not traded on the Central Asian Stock Exchange (Dushanbe). The situation with two problem banks -

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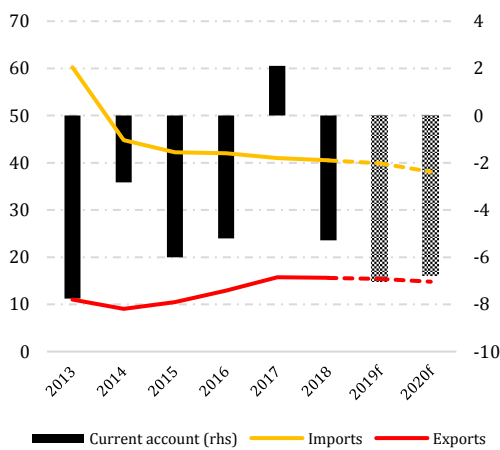[1] Central Asia and Caucasus non-oil peers: Armenia, Georgia, Republic of Kyrgyzstan and Uzbekistan.

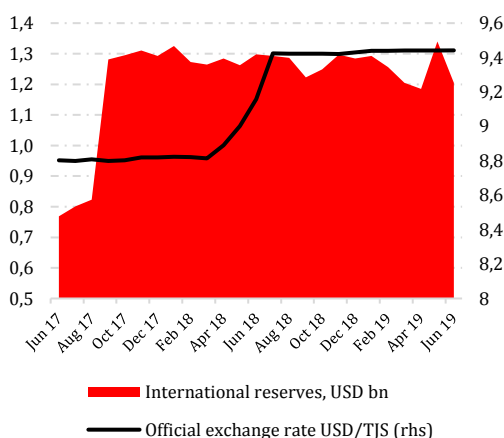**Graph 4:** Base rate vs inflation rate, %
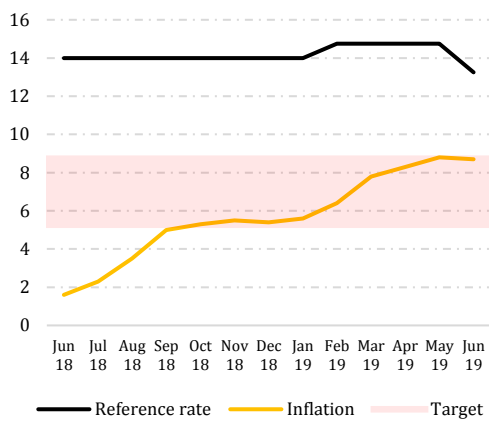
Source: RAEX-Europe calculations based on data from the NBT

Graph 5: External sector indicators, % of GDP

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

Graph 6: International reserves and exchange rate

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

Tochiksodirobank and Agroinvestbank, on which the state intends to find investors for sale, has not been resolved yet. However, in 2018 and 1H 2019, the improvement of the banking system has been noted. The NPLs ratio, according to the local definition[2] improved to 25,5% as of June 2019. Moreover, ROE and ROA as of 2Q 2019 were 9,2% and 2,5% respectively, which is the best performance since 2014. Besides, the capital adequacy ratio reached 22,9% (see graph 3).

Monetary policy quality remains subdued and inconsistent despite improvements. The transmission mechanism of the monetary policy remains inefficient due to the relatively high level of financial dollarization (the share of FX-deposits was 48,4% as of May 2019), the weakness of the banking system, as well as the exposure of the NBT to political influence. The NBT increased the efficiency of the transmission channel by introducing overnight deals, short-term deposits and auctions of deposit certificates; however, the monetary policy overall is inconsistent as shown by the introduction of contradicting actions by the NBT. In the first half of 2019, the refinancing rate changed twice: in January 2019 it was raised by 0,75p.p., while in May the monetary authorities significantly reduced it by 1,5p.p. Such divergent actions are not in line with the inflation targeting with the goal 7% (+/- 2p.p.), especially given that the annual inflation rate in June 2019 was high at 8,7% (see graph 4). In addition, the foreign exchange market remains tightly regulated which limits access to foreign currency, indirectly restricts imports and stimulates the existence of an informal FX market.

Unfavorable external position and exposure to event-related shocks are key negative factors for the creditworthiness. Tajikistan's weak external position with a current account at -5,3% of GDP in 2018 was mainly due to high dependence on imports with a share of 40% of GDP and a poor export economy, which highly depends on remittances and demand for cotton and aluminum as well as their price volatility (see graph 5). We anticipate that in the medium term the current situation will prevail given the significant needs of industrial imports, as well as limited export opportunities. The current account deficit is partially offset by stable net FDI, which increased to 2,9% in 2018 mainly due to Chinese investments in the mining sector. In addition, international reserves have maintained an average of about USD 1,3 bn for the second consecutive year, covering four months of imports and 44% of external public debt by the end of 2018 (see graph 6).

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[2] Non-performing loans according to the local definition include loans to customers and interbank loans with a delay of more than 30 days, instead of the generally accepted 90 days. Thus, internationally accepted NPLs levels may be lower than disclosed.

The external position imbalances together with the high share of public debt denominated in foreign currency makes the fiscal and debt position of the country extremely sensitive to external shocks. Moreover, further delays in the completion of the Rogun hydropower plant and increased additional project financing requirements could lead to growing public debt and widening budget deficits.

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_09.08.2019.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.