TAJIKISTAN

Highlights

- **Tajikistan shows strong growth figures, but significant weaknesses remain.** Growth of more than 7 per cent in the first half of 2018 has been supported by rising public investment related to the construction of the Roghun hydroelectric power plant. Nevertheless, vulnerabilities remain due to difficulties in the banking sector and fiscal risks.
- **Fiscal space is narrowing.** Following a Eurobond issue in 2017, public debt rose from 44.8 per cent of GDP in 2016 to 51.7 per cent at the end of 2017, further breaching the now-removed legal debt ceiling of 40 per cent of GDP.
- **Unbundling in the power sector has advanced.** A decree signed in April 2018 to unbundle the vertically integrated electricity company Barqi Tojik will pave the way for a more efficient operation of the energy sector.

Key priorities for 2019

- **The main short-term priority is to resolve challenges in the financial sector and restore public trust in banks.** Policy actions are required to handle the two troubled banks, Agroinvestbank (AIB) and Tojiksodirotbank (TSB). In addition, improvements are needed to central bank supervisory functions and corporate governance in banks. System-wide measures to reduce non-performing loans (NPLs) should also be implemented.
- **Administrative hurdles discouraging business activities should be removed.** Specifically, the authorities should focus in the next year on reducing the burden of tax administration, further cutting arbitrary inspection practices, and easing currency convertibility restrictions.
- **Further steps should be taken to implement energy sector reform.** This includes ensuring adequate oversight of Barqi Tojik companies and close adherence to the tariff methodology adopted in mid-2017.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	6.7	6.0	6.9	7.1	6.1
Inflation (average)	6.1	5.8	5.9	7.3	6.3
Government balance/GDP	0.3	0.8	-1.7	-0.3	-3.8
Current account balance/GDP	-2.8	-6.0	-5.2	-0.5	-3.2
Net FDI/GDP [neg. sign = inflows]	-3.3	-5.4	-3.5	-2.8	-2.0
External debt/GDP	56.0	60.5	68.8	77.3	n.a.
Gross reserves/GDP	5.5	6.3	9.4	18.0	n.a.
Credit to private sector/GDP	21.5	22.7	19.2	13.7	n.a.

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Macroeconomic performance

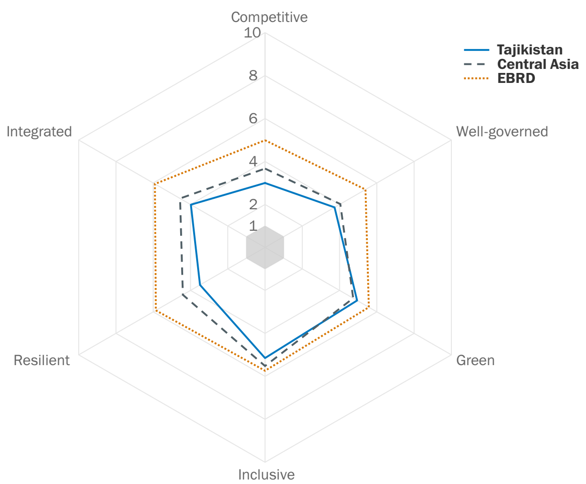
The economy continues to grow strongly but tensions are rising. Real GDP growth was 6.9 per cent in 2016, and accelerated to 7.1 per cent in 2017 and 7.2 per cent year-on-year in the first half of 2018. Growth in 2017 was supported by a recovery in remittances from Russia, which rose by 32 per cent year-on-year in US dollar terms in 2017, following a decline of 13.1 per cent in 2016. In 2018 growth has been enabled by rising fixed investment, which grew by 33 per cent in the first half of 2018, primarily due to higher government spending. Imports rose by 18 per cent year-on-year in the first nine months of 2018 while exports contracted by 10 per cent in the same period, leading to a widening of the trade deficit. Despite strong headline growth, the economy faces significant structural weaknesses in the banking sector and heightened fiscal pressures.

The currency weakened but inflation nevertheless moderated. After depreciating by 10.5 per cent against the US dollar in the first five months of 2017 the somoni was broadly stable until April 2018, when the gap between the official and parallel exchange rates reached 3.4 per cent. The official exchange rate then started weakening and overall depreciation was6.3 per cent in the first 10 months of 2018. Despite the currency depreciation and high growth, inflation decelerated from 6.8 per cent in September 2017 to 5.0 per cent in September 2018, which is well below the central bank's target of 7.0 per cent. This allowed the NBT to cut its policy rate stepwise from 16.0 per cent since March 2017 to 14.0 per cent in March 2018, reversing rate hikes that began in December 2016.

Public debt is rising. It rose from 44.8 per cent of GDP in 2016 to 51.7 per cent in 2017, amounting to US$ 3.67 billion. Under the national foreign borrowing programme for 2018-20, the government intends to borrow an additional US$ 850 million on external markets from bilateral and multilateral partners over the next three years. The proceeds are envisaged to finance projects in agriculture, health care, education, energy and transport. The fiscal deficit narrowed in 2017 but significant fiscal pressures remain, related mainly to financing large infrastructure projects such as the Roghun power station.

Economic growth is projected to reach 6.1 per cent in 2018 and 5.0 per cent in 2019. This growth is expected to be achieved due to continued strong public investment and a further increase in remittances. The first unit of the Roghun hydroelectric power plant is to begin operating in November 2018, which will also support growth. However, downside risks associated with fiscal and banking sector vulnerabilities remain significant.

Assessment of transition qualities (1-10)



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Major structural reform developments

The investment climate and business environment remain challenging despite the government's efforts to encourage entrepreneurship. In his annual address in 2017, the President of Tajikistan acknowledged the burden of frequent intrusive inspections from various agencies on businesses and called for a two-year moratorium on the inspection of businesses, effective from January 2018. However, the moratorium applies only to businesses operating in manufacturing, and inspections continue to hamper the development of small and medium-sized enterprises outside this sector. Although several sector-specific tax benefits were introduced over 2017-18, the tax burden remains high owing to distortive tax collection practices implemented to fulfil revenue targets. Tajikistan ranks 126th out of 190 countries in terms of ease of doing business according to the World Bank *Doing Business 2019* report. The country performs relatively well in protecting minority investors but rather poorly in getting electricity, accessing credit, trading across borders and paying taxes. Within indicators, Tajikistan has progressed most in trading across borders by streamlining customs clearance with Uzbekistan.

The institutional framework for central bank operations has been strengthened. In August 2018, amendments to the Law on the National Bank of Tajikistan and the Law on Banking Activities were adopted. The new amendments provide for an increase in the authorised capital of the National Bank of Tajikistan (NBT) from 20 million somoni (US$ 2.1 million) to 500 million somoni (US$ 53 million) with a view to ensuring an adequate level of capital to effectively implement monetary policy. The NBT has further continued its transition to inflation targeting, as outlined in the Monetary Policy Strategy for 2016-20. In this regard, the NBT has made some progress in strengthening transmission channels and in better communication of the decision-making process.

Banking sector weaknesses persist. Since 2015 significant steps were made by the NBT in strengthening the legal base and regulation practice for the supervision of the financial sector. However, further banking sector reform and improvement of corporate governance practices in the sector are needed. NPLs remained elevated at 24.5 per cent in July 2018, according to official statistics, and credit is contracting. Following the bail-out in 2016, AIB and TSB are now required to buy back their shares from the Ministry of Finance according to a pre-defined timeline and are seeking to attract investment to increase capital. While TSB is on track with payments, AIB failed to repurchase 5 per cent of its shares from the government by the end of 2017.

Regional connectivity prospects are improving. The ties between Tajikistan and Uzbekistan have improved significantly during 2017 and 2018. During the first official presidential visit to Tajikistan in March 2018 in 18 years, the President of Uzbekistan renounced his country's opposition to the construction of the Roghun hydroelectric power plant along the river bordering the two countries. Uzbekistan also expressed its willingness to participate in the project, although it remains unclear in which capacity. In April 2018 Tajikistan started supplying electricity to Uzbekistan through the regional power grid, which was shut down in 2009 when Uzbekistan withdrew from it. The revival of the electricity grid also presents an opportunity for Tajikistan to start exporting electricity to other Central Asian countries which do not border with Tajikistan.

Energy sector reform has advanced. The Power Sector Financial Recovery Action Plan, adopted in June 2017, outlines measures to improve the commercial viability of Barqi Tojik, including through gradually bringing tariffs to cost-recovery levels, reducing losses and increasing revenue collections. In April 2018 the government signed a long-awaited decree which envisages splitting Barqi Tojik into three separate entities responsible for generation, transmission and distribution of electricity and heat. These measures are expected to enhance the business operations of the company. However, delays have occurred in the consistent implementation of the new tariff methodology and in improving oversight of the sector. These delays have built-up losses, which amounted to US$ 2.6 billion in 2017 according to World Bank estimates, resulting from operating inefficiencies, currency depreciation and below cost-recovery tariff levels.