

Rating-Agentur Expert RA confirmed at 'B-' the FC rating and at 'B' the NC rating of Tajikistan. The rating outlook changed from developing to negative.

Rating-Agentur Expert RA 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 changed from developing to 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:

- Tajikistan's economic growth is one of the strongest in the region, with a y-o-y real GDP growth of 7,3% in 2018 and around 7,5% by 1H 2019¹, driven mainly by public investment in infrastructure and the recovery of domestic consumption through increased remittances from Russia. Despite the expected conservative government spending on infrastructure, we anticipate growth to remain at 6-7% in the next three years, supported by demographic trends and additional effects from the Rogun HPP performance. However, economic growth rates may be negatively affected by the country's high exposure to external and environmental shocks and significant internal imbalances of the national economy;
- Moderately high and increased level of net FDI inflow in 2018 at 2,9% as compared to 2,6% in 2017 mostly due to substantial increase of investments of Chinese companies into the mining industry, as well as other FDI to metallurgy and retail;
- Moderate level of debt load with a ratio of public debt to GDP and budget revenues of 48% and 178% in 2018 respectively, according to IMF estimates, with a high share of concessional debt from international financial institutions and foreign governments, as well as moderately low level of short-term public debt. In the short term, the government does not plan to increase borrowing to finance the Rogun HPP. However, taking into account the external liabilities of SOEs accumulated in recent years and high exposure to FX-fluctuations, the above mentioned total public debt ratios may exceed 50% of GDP and 180% of budget revenues;
- Acceptable level of consolidated budget deficit at 4,8% of GDP at 2018 as compared to a deficit of 6% and 9% in 2017 and 2016 respectively. Despite the fact that the government confirmed its commitments to consolidated fiscal policy with 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 towards infrastructure projects and the lack of internal capacity for revenue growth.

Restricting factors:

- Limited efficiency and consistency of the government's fiscal policy. Due to the reduction of budget expenditures for infrastructure projects, the budget deficit gradually decreased from 9% in 2016 to 4,8% in 2018. However, the transition to consolidated budget policy

¹ Preliminary data.

is under pressure from the need for additional injections of funds to complete the construction of the Rogun Hydropower Plant (HPP). In addition, the positive dynamics of budget revenues in 2018 were mainly underpinned by the collection of fines and penalties received from unscheduled inspections of enterprises, instead of regular tax revenues. The 2019 official fiscal plans focus on further fiscal consolidation with an official government budget deficit of 0,5% of GDP, but this figure according to our estimates does not take into account all government spending on infrastructure projects;

- The effectiveness of the monetary policy remains constrained despite significant improvement over the last years. The transmission mechanism is subdued due to high levels of financial dollarization, poor banking system stance, undeveloped local capital markets, as well as low independency of the National Bank of Tajikistan (NBT). However, the effectiveness increased due to introduction of new instruments, such as overnight and intraday lending facilities, overnight deposits, and credit and certificates of deposit auctions. In addition, the NBT declared inflation targeting for 2018 within 7% (+/- 2p.p.) and intends to transit to a flexible exchange rate by 2023;
- After a record low consumer price inflation of 1,6% y-o-y as of June 2018, a gradual increase was noted and, by the end of June 2019, annual inflation reached 8,7% y-o-y mostly due to rising prices for basic consumption food products. We consider this hike to be seasonal and, with a stable exchange rate and steady prices of fuel and foodstuffs imports from Uzbekistan, the annual inflation rate will not likely exceed the NBT target, however, it will be higher than the 2018 metric.

Negative factors:

- Underdeveloped and inefficient economy, as evidenced by the WEF Competitiveness Index in 2018 – 52,2 (102nd place out of 140 countries), persistently high trade deficit and subdued level of GDP per capita in PPP at USD 3,4 th as of the end of 2018, which is the lowest among the non-oil regional peers²;
- The country's creditworthiness is negatively affected by significant contingent liabilities arising from the high level of indebtedness of unprofitable SOEs, especially in the energy sector, as well as unresolved problems with two large systemically important banks (Agroinvestbank and Tochiksodirobank), which have debts to the state in the amount of about TJS 4 bn;
- Low level of financial system development with the banks' assets and domestic credit to GDP ratios at 26,3% and 15,6% as of 1Q 2019 and end-2018 respectively, as well as absence of listed shares currently traded on the national Central Asia Stock Exchange (Dushanbe);
- The banking system is very fragile with a high concentration of assets in state-owned banks and the presence of large problem banks. The ratio of NPLs to total loans, as of June 2019 was up to 25,5% of total loans³. However, the level of NPLs according to the internationally recognized definition may be lower than the disclosed metrics. On the positive side, the banking sector' profitability remains favorable. As of June 2019, ROE and ROA amounted to 9,2% and 2,5%, respectively. Besides, the ratio of capital to assets is high at 27,6%;
- The country is characterized by negligible level of institutional development and transparency of the government policy, as shown by the assessment of international

² Central Asia and Caucasus non-oil peers: Armenia, Georgia, Republic of Kyrgyzstan and Uzbekistan.

³ 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.

organizations. The Corruption Perception Index stood at 25 (152nd place out of 180 countries) and Inequality-adjusted Human Development Index (HDI) at 0,56 in 2018 Report. In addition, the country occupied only the 126th position out of 190 countries in the Doing Business 2019 report published by the World Bank;

- Officially registered unemployment remained low at 2,3% at the end of 2018, although, according to the ILO methodology, unemployment is much higher at 10,9%. 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 (8-year remaining maturity) and 7Y U.S. Treasury bonds is currently almost 6p.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-deposits at 48,4% by May 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 to almost 30% of GDP according to World Bank data;
- The current account deficit stood at 5% in 2018⁴, as there is a high dependence on imports with a ratio of imports to GDP of 43% in 2018. Nevertheless, international reserves stabilized at the level of USD 1,3 bn, which covers four months of imports and is equivalent to 43,9% of external public debt;
- Very low level of export to GDP at around 15% in 2018;
- 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 high share of concessional debt.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Scheduled launch of capacities of the Rogun HPP project, which will allow to start generating foreign currency revenues to the budget and stimulate economic growth;
- Significant improvement of the banking system: growth of assets and loans to the economy, further reduction of NPLs, decreasing of financial dollarization and realization of agreements with investors regarding the problem banks;
- Consistent further improvement of monetary policy and transmission efficiency, as well as the liberalization of the exchange rate regime.

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 commercial debt and deficit levels;

⁴ Preliminary data.

- Not adhering to the consolidation policy and widening the budget deficit due to lack of external financial support for the major infrastructure projects in the country;
- Deterioration of the external position in case of recession in the country's major trade partners and significant external shocks;
- Hikes in inflation and dollarization levels due to external shocks.

“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.” - Clarified Vladimir Gorchakov, Associate Director of Rating-Agentur Expert RA.

Research report on Tajikistan is available at:

https://raexpert.eu/reports/Research_report_Tajikistan_09.08.2019.pdf

Next scheduled rating publication: TBD in December 2019. The full sovereign rating calendar can be found at [Sovereign Rating Calendar 2019](#)

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
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 8 August 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.

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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.