TAJIKISTAN

Highlights

- **Officially reported economic growth remains strong.** Real GDP grew by 7.5 per cent year-on-year in the first half of 2019 as growth in services and industry picked up.
- **The first two turbines of the Rogun hydropower plant (HPP) were put into operation.** The first turbine, launched in November 2018, produced 211.3 million kWh of electricity in the first half of 2019, while the second turbine came online in September 2019.
- **Barqi Tojik, the state-owned energy company, has been unbundled into power generation, transmission and distribution.** Two entities were created which will be responsible for electricity transmission and distribution and will be subordinated to Barqi Tojik, which retains electricity generation.

Key priorities for 2020

- **Banking sector stabilisation is an immediate priority.** While the sector has been recapitalised, the protracted resolution and restructuring of the two troubled banks continues to hinder sector development. Legacy problems of weak governance and directed and related party lending should be tackled vigorously.
- **Efforts to address investment, regulatory and institutional gaps in the energy sector should be stepped up.** The required measures include restructuring Barqi Tojik's debt, implementing the recently adopted tariff methodology and establishing an independent sector regulator. There is a need for greater transparency, higher efficiency, independent oversight, and careful management of public investments.
- **Business environment constraints should be addressed**. Simplifying tax policies and improving tax administration are of paramount importance to incentivise firms operating in the real economy to become more transparent.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	6.0	6.9	7.1	7.3	7.0
Inflation (average)	5.8	5.9	7.3	3.8	7.9
Government balance/GDP	-2.0	-9.0	-6.0	-2.8	-4.5
Current account balance/GDP	-6.1	-4.2	2.2	-5.0	-6.0
Net FDI/GDP [neg. sign = inflows]	-5.8	-3.5	-2.6	-2.9	-2.5
External debt/GDP	51.3	61.2	71.2	69.8	n.a.
Gross reserves/GDP	6.3	9.4	14.4	14.6	n.a
Credit to private sector/GDP	22.7	19.2	13.7	12.3	n.a

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Macroeconomic performance

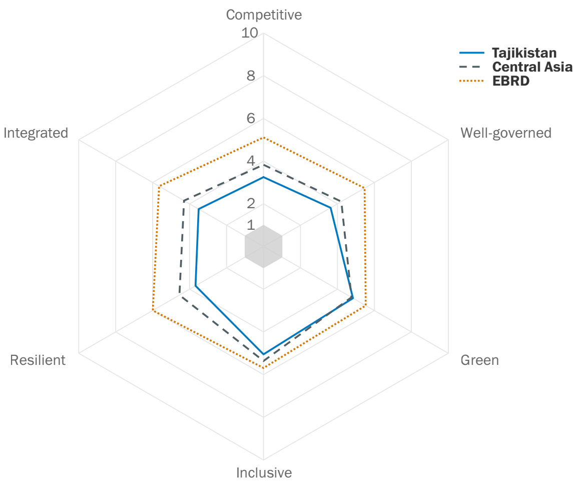
The economy continues to grow by more than 7.0 per cent. In the first half of 2019 officially reported real GDP growth was 7.5 per cent year-on-year, following 7.3 per cent growth in 2018. Growth was driven by gains in services and industry. Exports increased by 8.1 per cent year-on-year in US dollar terms in the first six months of 2019, while imports grew by 2.3 per cent. However, fixed investment contracted by 8.6 per cent in the same period, mainly due to lower public investment in the energy sector, which also contributed to a slowdown in import growth. The economy continues to face structural challenges stemming from the solvency and liquidity issues in the banking sector, as well as a significant debt overhang.

Inflation has accelerated. After decelerating to an average of 3.8 per cent in 2018 from an average of 7.3 per cent in 2017, inflation started rising again in early 2019, mainly due to higher food prices. Inflation reached 8.1 per cent year-on-year in September 2019, nearing the upper bound of the central bank's targeted inflation corridor of 5.0 to 9.0 per cent. Nevertheless, the central bank reduced its refinancing rate to 13.25 per cent in May 2019 from 14.75 per cent set in February 2019, with the expectation that inflationary pressures would subside in the second half of 2019. The somoni has been broadly stable since August 2018, supported by the administrative measures introduced by the authorities in 2015. In August 2019, the central bank devalued the currency by 2.7 per cent to bring the official exchange rate closer to the unofficial rate.

Fiscal accounts have improved but external deficits are rising. The fiscal deficit narrowed in 2017 and 2018, with the authorities undertaking fiscal consolidation aimed at reducing the large amount of public debt. Capital expenditures were reduced, except for infrastructure outlays for the construction of the Rogun dam. Public debt fell to 47.9 per cent of GDP in 2018 from 50.4 per cent in 2017. The current account turned into a deficit of 5.3 per cent of GDP in 2018 from a surplus of 2.1 per cent in 2017 as imports surged rapidly. The significant growth in imports largely reflects the purchase of equipment for the construction of the Rogun HPP. In the first half of 2019, the growth of exports exceeded that of imports and the current account deficit slightly narrowed to 3.1 per cent of GDP.

A moderation in the growth rate is likely in the short term. Real GDP growth is projected at 7.0 per cent in 2019 and 6.3 per cent in 2020. Fiscal challenges, combined with a difficult business environment, are likely to continue to weigh on economic activity. Remittances, electricity exports from the Rogun HPP, and improving bilateral ties with Uzbekistan are expected to be the main growth drivers. An agreement on an International Monetary Fund (IMF) programme, which is currently under negotiation, would support economic stability by enabling banking sector resolution, building fiscal and external buffers and improving the investment climate.

Assessment of transition qualities (1-10)



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Major structural reform developments

The business environment is improving. Tajikistan was among the top 10 improvers in the World Bank's *Doing Business 2020* report, rising from 126th to 106th place (out of 190 countries). Areas of improvement included starting a business, getting credit and trading across borders. Access to credit is helped by the introduction of a collateral registry and establishment of a secured-transactions system. The new registry will allow business owners to use movable assets such as motor vehicles and livestock to secure business loans. This is an important step towards enabling secured lending and expanding access to credit by accepting collateral beyond land and real estate – Tajikistan now ranks 11th on this indicator. Trading across borders was made easier by prioritising customs clearance of perishable goods exports. However, the country continues to experience major bottlenecks in getting electricity, paying taxes and resolving insolvency.

The Rogun dam – the largest HPP in Central Asia – has begun operating. The first unit of the Rogun HPP started operating in November 2018 and produced 211.3 million kWh of electricity in the first half of 2019. The second unit was launched in September 2019. Once all six turbines are operational, the Rogun HPP is expected to generate 13.1 billion kWh of electricity per year. This will be sufficient to close the domestic energy deficit, which is particularly acute in the winter, and export electricity to Afghanistan and Pakistan. In the past, Tajikistan has resorted to regular power rationing during the winter and, while formal limits on power delivery have been lifted as of now, the country still experiences occasional power outages. The Rogun HPP is not only expected to strengthen the energy security of the country but also to become the main driver of economic growth and living standards. However, there are challenges with the full implementation of the project, primarily related to financing. While Tajikistan used proceeds from the sale of Eurobonds to finance the initial stages of the project, further funding options remain unclear given the constrained fiscal space and weak investment climate.

Institutional and regulatory reforms in the energy sector have proceeded. In June 2019, the government established two new joint stock companies (transmission and distribution) subordinated to Barqi Tojik, a state-owned energy company, which retains electricity generation. These companies are later expected to be separated from Barqi Tojik. A draft action plan on improving the financial viability of Barqi Tojik for 2019-25 has been prepared, the implementation of which would require US$ 1.2 billion. Part of the funds will be used to repay debt owed to two HPPs, Sangtuda-1 and Sangtuda-2. In addition, a new electricity tariff methodology was approved in June 2019, which envisages gradual increases in electricity tariffs. A new tariff-setting unit is expected to be established by the end of 2019 with the primary function of setting tariffs for the regulated sectors.

Banking sector restructuring after the crisis in 2016 is still under way, with the resolution of problematic systemic state-owned banks pending. Resolution of the two troubled banks, Agroinvestbank and Tojiksodirotbank, is high on the agenda of financial sector reforms to be targeted by a potential IMF programme, which has been under discussion for the last three years. Further consolidation in the sector is expected, including through a potential increase in capital requirements for banks. Banking sector indicators are moving in the right direction. For example, overdue and non-performing loans, mostly concentrated in the two banks, declined from around 35.8 per cent of total loans at the end of 2017 to 24.8 per cent in June 2019. However, data quality remains an issue. Loan and deposit dollarisation fell to 52 per cent and 48 per cent, respectively, as of the end of June 2018. Apart from contraction in the demand for foreign currency loans, this was in part due to measures to reduce the foreign exchange exposure of banks by prohibiting foreign currency-denominated mortgage loans to unhedged borrowers and increasing the risk weight for foreign currency loans from 100 per cent to 150 per cent.

Businesses continue to face restrictions on currency convertibility. This is flagged as a top concern in the World Economic Forum's Executive Opinion Survey. Banks are unable to meet the foreign currency demands of clients, which necessitates prioritising specific sectors and transactions, as recommended by the central bank (for example, export-oriented transactions, or imports of food and fuel). The shortage of foreign currency liquidity in part reflects the contraction in remittances from Russia, limited inflows of foreign exchange from exports, and low foreign direct investment. Compliance requirements related to remittance operations have been tightened by the regulator, which had the effect of shifting remittances to informal channels to some extent.