



## TAJIKISTAN

### Highlights

- **Growth is declining in 2016.** After increasing by a reported 6.0 per cent in 2015, officially reported growth is expected to decline to 4.5 per cent in 2016, reflecting sharply lower remittances (and returning migrants) since 2014, rising non-performing loans (NPLs) and other challenges in the banking sector and business environment.
- **The banking sector has been under significant pressure.** The Tajik somoni weakened by around 33 per cent (against the US dollar) between January 2015 and mid-2016, which, combined with the declining household income and more challenging economic environment, is contributing to sharply rising NPL levels, affecting the liquidity and solvency of banks.
- **Distortive tax administration practices and currency controls, which have been stepped up in the past two years, are affecting the operations of firms.** Heavy-handed tax administration practices in response to fiscal pressures and currency controls, the latter introduced in March and expanded in December 2015 to limit depreciation of the local currency, are increasingly negatively affecting the ability of firms to carry out their activities, thus limiting profitability and curtailing new investment.

### Key priorities for 2017

- **Steps need to be taken to resolve the banking sector crisis.** The crisis resolution needs to address fundamental problems facing the sector, so that a sustainable banking sector is created. In the largest systemic banks it is essential to make a comprehensive assessment of their financial situation, to recapitalise them and restore their liquidity, and to improve their management. The regulatory framework needs to be enhanced, including through the introduction of an improved bank resolution framework.
- **The vertically integrated electricity company Barki Tojik needs to be restructured, and tariff setting in the sector needs to be enhanced.** Transparency of generation, transmission and distribution parts needs to be improved, and ultimately the three parts need to be unbundled and tariffs adjusted gradually over time, notwithstanding affordability constraints.
- **The business environment needs to be enhanced, with a particular focus on improving tax administration practices.** In the light of current fiscal pressures, the increasingly distortive tax administration practices have become one of the most important constraints to doing business in Tajikistan. Access to finance also remains challenging, with steep interest rates on loans in local currency effectively closing off access to finance for most regional companies.

### Main macroeconomic indicators %

	2012	2013	2014	2015	2016 proj.
GDP growth	7.5	7.4	6.7	6.0	4.5
Inflation (average)	5.8	5.0	6.1	5.8	6.0
Government balance/GDP	0.6	-0.8	0.0	-2.3	-4.0
Current account balance/GDP	-2.5	-2.9	-2.8	-6.0	-5.0
Net FDI/GDP [neg. sign = inflows]	-3.1	-1.2	-3.3	-5.0	-3.4
External debt/GDP	46.3	43.2	41.0	49.8	n.a.
Gross reserves/GDP	8.5	5.6	5.5	6.3	n.a.
Credit to private sector/GDP	15.0	18.6	21.5	23.4	n.a.

## Macroeconomic performance

**Despite negative developments Tajikistan's officially reported economic growth in 2015 remained strong.** GDP growth reached 6.0 per cent in 2015 and was reported at 6.5 per cent in the first half of 2016, helped by financial support and foreign direct investment (FDI) from China, but the headline figure masks the build-up of structural vulnerabilities and pressure on the population (decreasing income in particular) and businesses. The slow-down in Russia and decline of the rouble has significantly affected the Tajik economy. According to data from the Central Bank of Russia, remittances from Russia (constituting around 50 per cent of GDP before the crisis) declined by 42 per cent in US dollar terms and 33 per cent in somoni terms in 2015 year-on-year.

**The somoni has depreciated significantly.** As a result of external pressures, the somoni depreciated by 24 per cent against the US dollar in 2015 and another 10 per cent in the first half of 2016. In addition to introducing currency controls, the National Bank of Tajikistan (NBT) also intervened in the foreign exchange market to support the currency, which has put pressure on the level of international reserves. The central bank has also gradually increased the refinancing rate from 4.8 per cent in the beginning of 2014 to 11.0 per cent in July 2016.

**Currency depreciation and the general economic slow-down have led to a rise in NPLs.** The level of reported NPLs (defined as 60 days overdue) rose from 11.5 per cent in 2014 to 16.1 per cent in 2015 and further to 23.2 per cent in March 2016, although the quality of banks' reporting is poor and the actual level of NPLs could well be higher. Several of the largest banks in the country are facing severe liquidity and solvency problems.

**Tajikistan's fiscal and external positions remain weak.** The fiscal deficit reached 2.3 per cent of GDP in 2015 and is expected to be adversely affected in the short term by the possible costs of bank recapitalisation as well as by external debt service-related budgetary outlays on behalf of two loss-making state-owned enterprises (Barki Tojik and Talco). The current account deficit reached 6.0 per cent of GDP in 2015, with imports down by 21.0 per cent year-on-year due to weak domestic demand, while exports fell by 9.0 per cent in the same period as a result of weaker external demand and the poor performance of the aluminium sector.

**Officially reported growth in 2016 and 2017 is expected to decline to 4.5 per cent and 4.1 per cent,** respectively, with significant downside risks to achieving this level of growth that can arise from possible further deterioration in the banking sector and the challenging fiscal position of the country. Lower growth reflects the legacy of sharply reduced remittances and returning migrants in 2014-15, increasing NPLs and a banking system under stress, all of which are bringing down GDP growth in the short term.

## Major structural reform developments

**The business environment and investment climate are weak.** Tajikistan ranks 128th out of 190 countries in the World Bank's *Doing Business 2017* report. The business environment has been made more difficult by the tax administration. Despite ongoing reforms to improve the efficiency of tax administration, poor budget planning processes and heavy handed tax collection practices, coupled with limited dispute resolution measures for firms are creating constraints to doing business. Access to finance also remains a problem, with steep interest rates on loans in local currency effectively closing off access to finance for most regional companies.

**The National Bank of Tajikistan has taken steps to counter stress in the banking sector.** The NBT temporarily took into administration the second largest bank, Tojiksodirotbank, in May 2016 for an initial period of three months, which was extended for a further three months in August. In June 2016, it resumed money transfer transactions including salary payments and remittance transfers. However, conditions at the bank remain difficult. Some of the other large banks also face significant liquidity and solvency challenges, and action will need to be taken by the NBT and other stakeholders to resolve the situation.

**The central bank's management has developed a strategic plan for 2015–19.** The plan covers such areas as banking system stability, improvement of the system's assets quality through risk monitoring, corporate governance and bank liquidity. The work on implementation of the plan is progressing across such areas as the institutional and regulatory frameworks; the payment system; and automatisisation and modernisation of NBT's structure and its operations. However, direct results have not been reached yet.

**Tax administration practices have become more distortive.** In response to the fiscal pressures, in 2015 and 2016 tax administration practices have become more intrusive and arbitrary, with companies at times being asked to pay excessive amounts of tax based on unrealistic forward-looking profits. This is affecting both domestic and foreign companies operating in the country and limiting their ability to carry out their operations. Tax administration has become one of the key obstacles to doing business for a majority of businesses in the country.

**Currency controls have been introduced.** Currency controls were introduced in March 2015, when the central bank stopped selling foreign currency to the population. In December 2015, operations of all currency exchanges in the country were suspended, allowing only authorised banks and official financial institutions to exchange currency. In its latest measure, introduced in February 2016, the NBT allowed withdrawals of Russian rouble money transfers in somoni only.

**China has increased its investments in Tajikistan.** A metallurgical plant will be built in the two countries' joint industrial zone, at an estimated cost of US\$ 200 million as announced at the beginning of 2016. In September 2015 China signed a US\$ 500 million currency swap agreement with Tajikistan. The prospective Central Asia-China pipeline, which will pass through Uzbekistan, Tajikistan and the Kyrgyz Republic, is another large project with Chinese involvement. The Export-Import Bank of China is Tajikistan's largest creditor with outstanding debt representing 53 per cent of total external public debt.