EFSD Eurasian Fund for Stabilization and Development

Republic of Tajikistan

Social and Economic Development in 2021*

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EXECUTIVE SUMMARY

In 2021, all sectors of the economy of the Republic of Tajikistan experienced a rapid recovery from the growth deceleration due to the COVID-19 pandemic. As a result, the real GDP grew by 9.2% in 2021. In the context of conservative fiscal policy, it was evidenced by declining budget deficit and public debt, down to 1.8% of GDP and 42.8% of GDP, respectively. Growing gold exports, accompanied by a gradual recovery of remittances and foreign investments, generated a current account surplus and contributed to further accumulation of reserves by the National Bank of Tajikistan and enhanced sustainability of the balance of payments in 2021. Monetary policy was aimed at containing inflation, which was greatly impacted by rising world prices for food and commodities and depreciation of the local currency. The liquidation of two distressed commercial banks contributed to rehabilitation and stronger performance of the financial sector.

REPUBLIC OF TAJIKISTAN: SOCIAL AND ECONOMIC DEVELOPMENT IN 2021

Real Sector and Labour Market

In 2021, the economic growth of the Republic of Tajikistan accelerated greatly as a result of a rapid recovery in consumer and investment activity. In January–December, the short-term indicator of the development of main sectors of the economy grew by 9.2%[1] compared to 4.5% a year earlier (Figure 1). There was growth of all GDP components, with domestic demand remaining its key driver. Stronger consumer activity is explained by both a low base of the previous year and an increase in household incomes – an inflow of remittances and an increase in real wages by 1.4%, against their fall by 3.9% in 2020. Capital investments went up by 23.3%. The highest rates of investment growth were recorded in the mining industry (up 2.1 times compared to the same period of the previous year), trade (1.7 times), and transport (33.5%). It was attributable to stronger activity of the private sector and recovered inflows of foreign investments, while the share of government capital investments declined. The export growth rate (53.4%) outpaced that of import (33.7%), boosting the contribution of net exports to the GDP growth (about 2.0 p.p.)[2]. The rapid growth of exports was mainly driven by exports of precious and semi-precious products (despite the suspension of gold sales in foreign markets from April to November 2021) and greater exports of minerals (ores and cement), electricity, cotton fibre, and base metals.

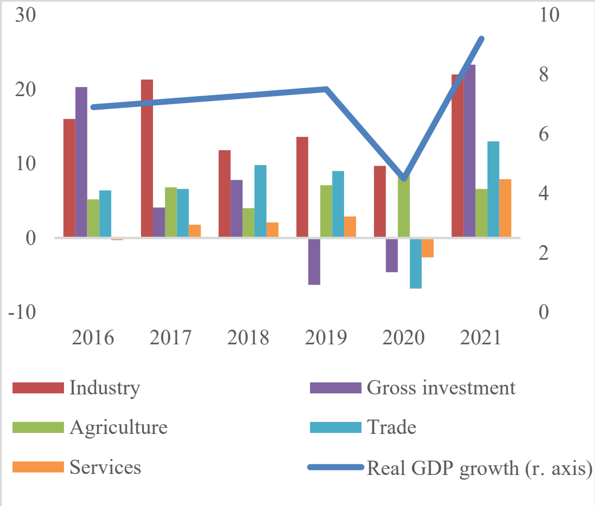
In terms of sectors, there was growth registered in all major sectors of the economy in 2021. The largest contribution to the growth was made by the services sector (3.8 p.p.) and industrial production (2.1 p.p.; Figure 2). The gross output grew much more in the mining industry – up 1.5 times against a 16.3% increase in the manufacturing industry. The significant output growth in the mining industry was attributable to a low base of the previous year in the context of the pandemic and a recovery of the global demand for commodities. The main contributors to the growth of the manufacturing industry were textiles, garments, leather, leather goods and footwear (3.8 p.p.); rubber, plastic and other non-metallic minerals (2.3 p.p.); and metal products (1.5 p.p.). The contribution of agriculture and construction to the GDP growth amounted to 1.1 p.p. and 1.3 p.p., respectively.

The high rate of the economic growth promoted an increase in employment and average real wages in 2021. Despite a slight slowdown from 3.7% to 3.1% compared to 2020, the employment grew in all sectors of the economy. The highest shares of new jobs were recorded in agriculture (32%), construction (18%), wholesale and retail trade (13%), and manufacturing (7%). The official unemployment rate remained unchanged at 2.1%. On average, economy-wide real wages grew by 1.4% (December to December). The greatest growth of real wages in the real sector of the economy was recorded in the manufacturing industry; electricity, gas, steam and air conditioning supply; as well as mining. In the services sector, in general, real wages fell by 0.6% (December 2021 in % to December 2020).

[1] Based on preliminary data for 2021.

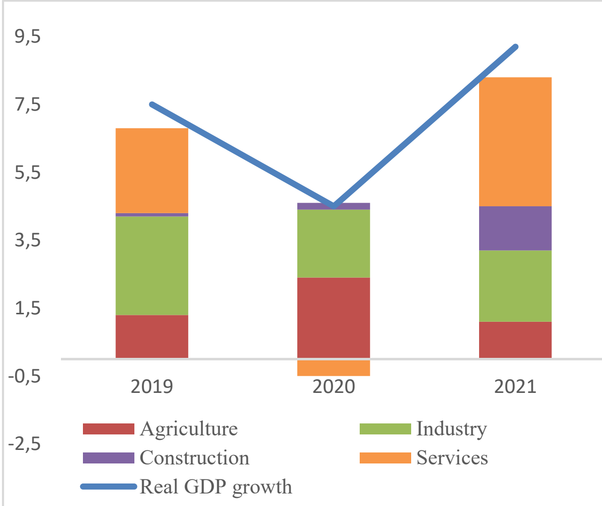
[2] According to the EFSD Project Unit.

Figure 1. *Economic growth (in %, y-o-y)*



Source: Tajstat

Figure 2. *Composition of economic growth (contribution, in %)*

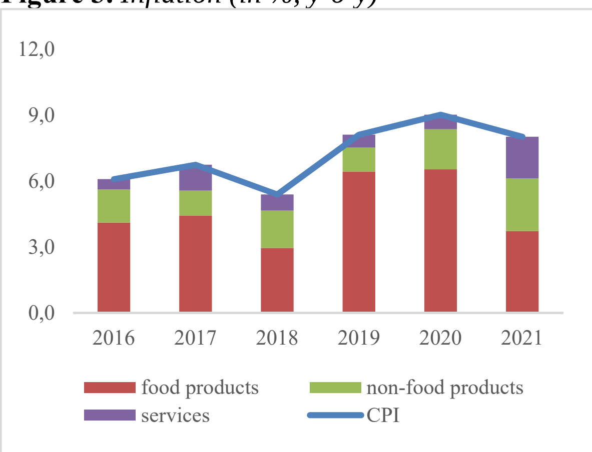


Source: Tajstat

Inflation and Monetary Policy

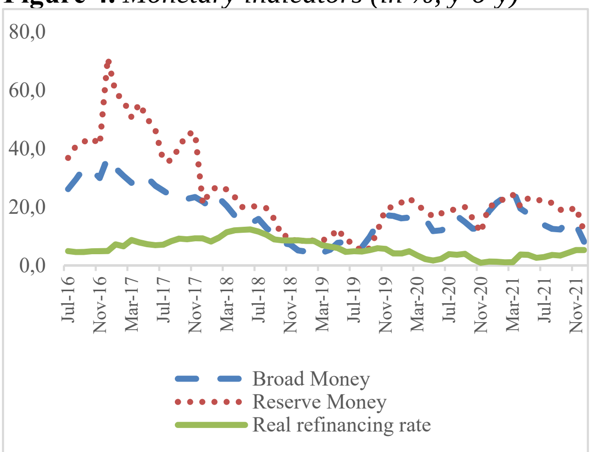
Inflation declined in 2021 but remained at a relatively high level amid heightened inflationary pressures due to the global inflation. In 2021, the 12-month inflation was 8% (Figure 3) compared to 9.4% a year earlier (against the NBT's target of 6±2%). The key factor contributing to the slowdown of inflation was deceleration of the food price growth (from 13% to 7.3%). Nevertheless, the food price growth rate remained high, mainly due to growing prices on world food markets. At the same time, the local currency depreciated by 10%, resulting in a significant acceleration of the growth of non-food prices (from 5.8% to 7.5%). The growth of prices for services also accelerated (from 4% to 11.3%) mainly due to the utility and transport price hikes (as a result of an increase in liquefied gas prices).

Figure 3. *Inflation (in %, y-o-y)*



Source: Tajstat

Figure 4. *Monetary indicators (in %, y-o-y)*



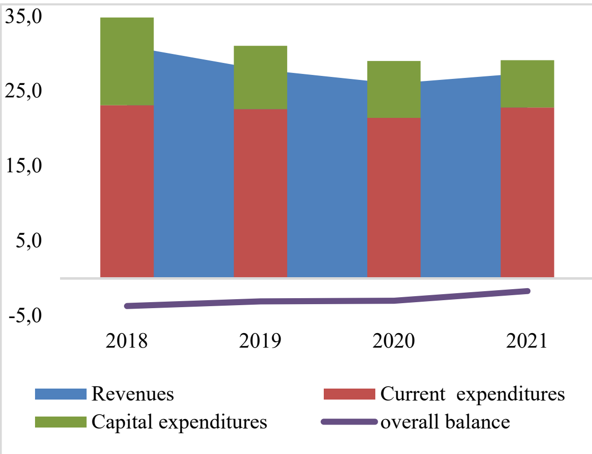
Source: NBT, Tajstat

The behaviour of monetary aggregates indicates a weaker contribution of monetary factors to the growth of inflation. In 2021, the 12-month base money growth was 11.6% compared to 20.3% a year earlier (Figure 4). The main drivers of the base money growth were an increase in net domestic assets (9.1 p.p. contribution to the base money growth) and net demand for liquidity from commercial banks against the background of the accelerated economic growth (2.7 p.p.), while the contributions of the net profits of the National Bank of Tajikistan and the growth of Government deposits to the sterilisation of liquidity and curbing the base money growth were -1.9 p.p. and -3.2 p.p., respectively. The growth of money supply decelerated to 8.2% in 2021 compared to 18.5% a year earlier. The main driver of the money supply growth was the growth of cash in circulation (10.7 p.p. contribution to the money supply growth), *inter alia* due to the purchase of gold by the National Bank of Tajikistan. Deposits made a negative contribution (-2.5 p.p.). The money multiplier was at its historic low of 113%. Against the background of the mounting pressure of non-monetary factors on inflation, the National Bank gradually raised the key interest rate from 10.75% to 13.25% in order to mitigate inflation risks and spillovers.

Budget Sector and Government Debt

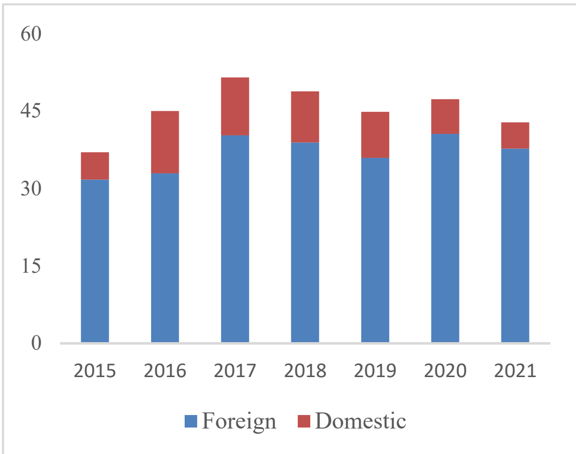
In the context of the accelerated economic growth, the fiscal position of the Republic of Tajikistan improved significantly. In 2021, the state budget deficit narrowed to 1.8% from 3.0% a year earlier, as the budget revenues grew, and the budget spending remained almost at the same level (Figure 5). Budget revenues went up from 26.0% to 27.3% of GDP owing to higher tax revenues, mainly due to changes in their composition and an expanded tax base. The share of special funds also grew (by 0.4 p.p.). However, the share of some types of revenues as a percentage of GDP decreased. It was accompanied by a decline of non-tax revenues by 0.5 p.p. and grants by 0.3 p.p. due to a slight decrease in donor assistance compared to 2020. Budget expenditures remained almost unchanged, amounting to 29.1% of GDP in 2021. Their composition, however, changed significantly: a decrease in capital expenditures from 7.6% of GDP in 2020 to 6.3% of GDP in 2021 (mainly due to lower financing of capital expenditures from domestic sources) was offset by an increase in current expenditures from 21.4% to 22.8% of GDP. Despite an indexation of public sector wages and a raise of pensions and scholarships, the shares of these categories of expenditures as a percentage of GDP did not go up, since the indexation was less than the nominal GDP growth rate. At the same time, the increase in the share of current expenditures was attributable to the growth of purchases of goods and services by 1.1 p.p.

Figure 5. *State budget (in % of GDP)*



Source: MF RT, Tajstat

Figure 6. *Government debt (in % of GDP)*



Source: MF RT, Tajstat

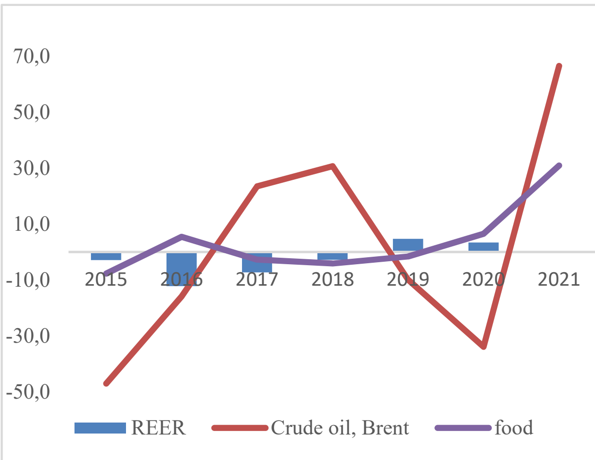
The recovery of the economic activity contributed to a decrease in the overall level of the government debt. In 2021, the government debt of the Republic of Tajikistan declined from 49.9% of GDP to 42.8% of GDP (Figure 6). It was mainly due to the accelerated GDP growth. The external debt went down by 5.6 p.p. of GDP, and the domestic debt – by 1.4 p.p. of GDP. The share of foreign currency-denominated debt in the total government debt increased to 88.1% (37.7% of GDP), reaching a new historic high. The gross financing need fell to 2.4% of GDP in 2021 against 4.5% a year earlier.

External Sector

A rapid recovery of domestic demand led to import growth and a higher trade deficit, despite a significant increase in gold exports. In 2021, the trade deficit went up to 23.5% of GDP (by 2.6 p.p. compared to 2020) despite growth of exports by 52.8%, of which 14.7 p.p. were generated by growth of exports of precious metals, 23.5 p.p. – by that of mineral products, 5.9 p.p. – by exports of textiles and cotton fibre, and 5.6 p.p. – by exports of base metals and products made from them. Imports grew by 33.6%, with the key drivers of the growth being machinery and equipment (9.7 p.p. contribution to growth), base metals and products made from them (2.1 p.p.), and vehicles (5 p.p.). The path of imports was mainly determined by higher imports of investment and durable goods.

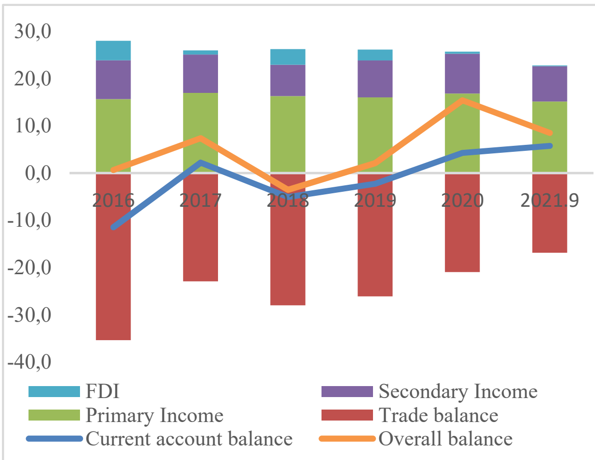
A recovery in remittances led to a significant improvement of the current account despite the growing foreign trade deficit (Figure 8). The current account surplus increased from US $402.8 million a year earlier to US $507.6 million. The key factor contributing to the stronger current account was the growth of primary and secondary incomes, most of which are remittances from Tajik citizens working abroad. Primary incomes amounted to US $1,327.8 million in 2021 against US $956.7 million a year earlier, and secondary incomes were US $652.8 million against US $483 million a year earlier.

Figure 7. *World prices and REER (in %, y-o-y)*



Source: World Bank, national authorities, EFSD estimates

Figure 8. *Balance of payments (in % of GDP)*



Source: NBT, Tajstat

In January–September 2021, there was a slight improvement of investment activity, which was reflected in a higher capital account surplus, up to US $166.8 million. Based on preliminary estimates, foreign investments grew by 43.7% in the first half of 2021 compared to the first half of 2020, reaching US $118 million. Taken together, the above factors contributed to further accumulation of reserves by the National Bank of Tajikistan and enhanced sustainability of the balance of payments in 2021.

Financial Sector

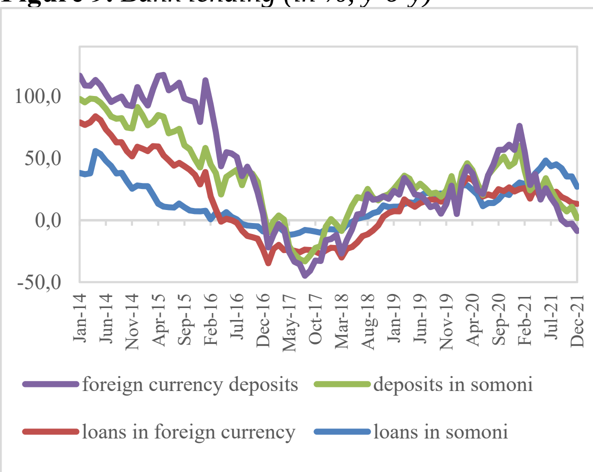
Despite the rapid growth of the economy, lending decelerated as a result of the liquidation of two commercial banks. The annual growth rate of the loan portfolio slowed down in 2021 and amounted to 9.9% against 12.0% a year earlier (Figure 9). At the same time, loans in foreign currency fell sharply (-5.8 p.p. contribution to growth), which was caused by the refinancing of old foreign currency loans with loans in the local currency due to the liquidation of

Tojiksodirotbank and Agroinvestbank. Against the background of the refinancing rate raised in 2021, the average lending interest rate went up from 23.2% to 23.9%.

As a result of the liquidation of two commercial banks, the stock of deposits decreased by 11% in 2021. (Figure 9). That was driven by corporate deposits, which dropped by 21.1%. As to household savings, there was an increase in deposits in the local currency by 20.6% and a fall in foreign currency deposits by 20.5% due to the conversion of foreign currency deposits of households with the liquidated banks into the local currency. The average yield of new 6- to 12-month term deposits in the local currency decreased from 11.44% to 11.27%, and that of foreign currency deposits remained unchanged at 4.79%.

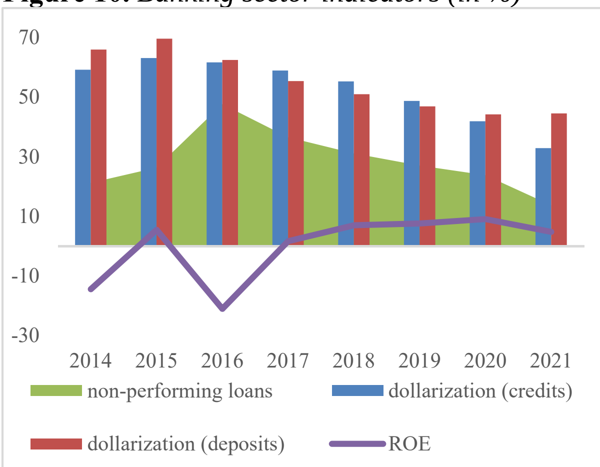
The liquidation of the distressed banks and stronger economic growth contributed positively to the reduction of the share of non-performing loans. The share of non-performing loans fell sharply from 28.3% to 13.7%, with the return on assets down from 2.5% to 1.1% and the return on equity – from 9.1% to 4.8% (Figure 10). The decline occurred due to the implementation of rehabilitation measures in one of the commercial banks[3]. Against the background of lending expansion, the dollarisation of loans decreased from 41.9% to 32.9%. However, the share of foreign currency deposits practically did not change and amounted to 44.5%.

Figure 9. *Bank lending (in %, y-o-y)*



Source: NBT

Figure 10. *Banking sector indicators (in %)*



Source: NBT

It indicates a change in the currency composition of household deposits. In addition, it should be noted that changes in the indicators are also attributable to an adjustment of the balance sheet indicators of the banking sector due to the liquidation of two major banks (TSB and AIB).

[3] https://nbt.tj/en/suboti-moliyavi/submenu/sharhi-ustuvorii-moliyavii-nizomi-bonk.php

ANNEX

Direct and Contingent Liabilities in Fiscal and Debt Sustainability Analysis: the Case of the Republic of Tajikistan

One of the key areas of the EFSD's mission is to promote long-term sustainability and development of the economies of its recipient countries. The achievement of these goals depends both on the quality of the macroeconomic policies followed by the countries and on the identification of potential risks of direct and contingent liabilities materialising, as well as their impact on the countries' fiscal and debt positions. Therefore, when analysing the debt and fiscal sustainability of the countries, the EFSD follows an approach based on taking account of the liabilities that form the government debt in the most complete and comprehensive way, including an assessment of quasi-fiscal risks.

With regard to Tajikistan, which is in an area of relatively high fiscal risks, this approach is justified given the active state intervention in economic activities, which is manifested in support provided to major companies and banks both directly from the budget and through the use of quasi-fiscal operations (guarantees, sub-loans,[4] etc.). In general, state-owned enterprises hold a dominant position in a wide range of industries, primarily in the energy sector, banking, infrastructure, and transport. Moreover, more than 80% of the assets of state-owned enterprises are concentrated in three companies: Open Joint-Stock Holding Company "Barki Tojik", State-Owned Unitary Enterprise "Tajik Aluminium Company" and State-Owned Unitary Enterprise "Rokhi okhani Tojikiston" (railway). However, state-owned enterprises are characterised by weak financial performance, as well as substantial overdue debts, which, in turn, generates high risks to the fiscal sustainability.

In particular, the debt of Barki Tojik OJSHC has remained at the level of over 30% of GDP[5] in recent years. However, over the past 8 years, the energy holding's revenues have on average covered only 82% of its operating costs[6], which indicates that the holding company is unable to continue operating without mobilising funds, even if there were no debt service and repayment costs associated with existing loans and borrowings. In addition, the major liabilities of Barki Tojik (sub-loans, and penalties and fines accrued thereon, payable to the Ministry of Finance of the Republic of Tajikistan, as well as a commercial loan from Orienbank) are denominated in foreign exchange, which enhances the importance of the foreign exchange risk as a factor in the company's debt sustainability.

Given the contingent liabilities, the pressure on the government debt remains high in Tajikistan, which makes the country's fiscal positions more vulnerable. In 2021, the level of the government debt of Tajikistan was estimated at about 42.8% of GDP, with about 30% of payments to repay this debt depending on the performance by state-owned enterprises of their obligations. It should be noted that contingent liability risks were materialising already in 2021. For instance, the liquidation of Agroinvestbank OJSC and Tojiksodirotbank OJSC led to an increase in the Government's obligations to repay the debts of the banks estimated at about TJS 3.9 billion or 4.6% of GDP.

In the paper, prepared by the EFSD Project Unit in 2021 to offer a comprehensive analysis of debt and contingent liabilities[7], a stress scenario was considered to quantify their potential impact on the change of Tajikistan's financing needs. Its key assumption was that, in case of shocks and sharp deterioration of the economic situation, the Government would prevent a default of key state-owned enterprises and extend state support to them in an amount equivalent to the materialised contingent liabilities accumulated by the state-owned sector at the level of 12.1% of

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[4] Loans provided to the Government by international organisations and then on-lent to enterprises.

[5] Estimated by the EFSD Project Unit based on the consolidated financial statements of Barki Tojik OJSHC (http://www.barqitojik.tj/upload/iblock/4f2/FS_Barqi%20Tojik_rus_2020_G.pdf)

[6] Cost of production, costs of sales, general, and administrative costs.

[7] E. Vinokurov, N. Lavrova, D. Taltaev EFSD Working Paper WP/21/2 "Total Debt is So Much More Than Just Sovereign Debt. Contingent Liabilities in Armenia, Belarus, Kyrgyz Republic, and Tajikistan".

GDP. Based on this, the government debt of Tajikistan may increase in 2022 to almost 64.1% of GDP, compared to the level of 52% of GDP projected under the baseline scenario. In the medium term, the government debt will begin to decline.

Despite the fact that Tajikistan will maintain access to borrowing on concessional terms, which will be its main source of financing, its debt sustainability may be greatly impacted by the materialising of risks associated with contingent liabilities. It reinforces the relevance of measures aimed at improving the system of budgetary resource management, enhancing the transparency of fiscal and quasi-fiscal operations, and streamlining the operation of state-owned companies.