

REPUBLIC OF TAJIKISTAN

Social and Economic Development in the first half 2022*

October 2022

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The materials presented may not coincide with the official opinion of the EDB and the EFSD governing bodies.

LIST OF ABBREVIATIONS

CA – current account of the balance of payments

CPI – consumer price index

EFSD Project Unit – Project Unit of the Eurasian Fund for Stabilization and Development

FDI – foreign direct investment

GDP – gross domestic product

MF RT – Ministry of Finance of the Republic of Tajikistan

NBT – National Bank of the Republic of Tajikistan

RT – Republic of Tajikistan

Tajstat – Statistical Agency under the President of the Republic of Tajikistan

US – United States of America

VAT – value added tax

WB – World Bank

In H1 2022, Tajikistan's economy continued to show high growth rates. The main drivers of growth were industrial production and the services sector. The economic activity was supported by high world prices for exported commodities and a relatively high level of remittances from Russia due to appreciation of the Russian ruble. At the same time, the growth rate of capital investment decelerated. As a result of the growth of import outpacing that of export, there was a trade deficit emerging. In the face of inflationary pressure, the National Bank of Tajikistan maintained its relatively tight monetary policy, keeping the refinancing rate at a fairly high level. The fiscal position improved due to a decrease in capital expenditures. The key indicators of the banking sector show that it remains relatively stable.

Real Sector and Labour Market

Despite a slight slowdown in H1 2022, the economic growth remained at a fairly high level, which corresponded to the average annual growth rates prior to the coronavirus pandemic. In H1 2022, the short-term indicator of economic activity in the main industries was 7.4%, against 8.7% in the corresponding period of 2021 (Figure 1). The growth was mainly supported by services – 2.8 p.p. (3.8 p.p. in H1 2021). The contribution of industrial production was 1.9 p.p. (1.8 p.p.), that of agriculture¹ – 1.0 p.p. (0.8 p.p.), construction – 0.8 p.p. (1.3 p.p.), and net taxes – 0.9 p.p. (1.0 p.p.). The main factor contributing to the slowdown in economic growth was lower growth of services and construction, which was partially offset by an increase in industrial production and agriculture.

The increase in industrial production (17.3%) was supported by the manufacturing industry (9.7 p.p.), in particular the production of food products, including beverages and tobacco (4.7 p.p.), and the production of textiles, clothing, leather, leather goods, and footwear products (1.9 p.p.). The contribution of the mining industry amounted to 1.7 p.p. There was a rise in metal ore production by 7.3% (a contribution of 1.4 p.p.) and an increase in electricity, gas, steam, and air conditioning supply by 18% (4.3 p.p.).

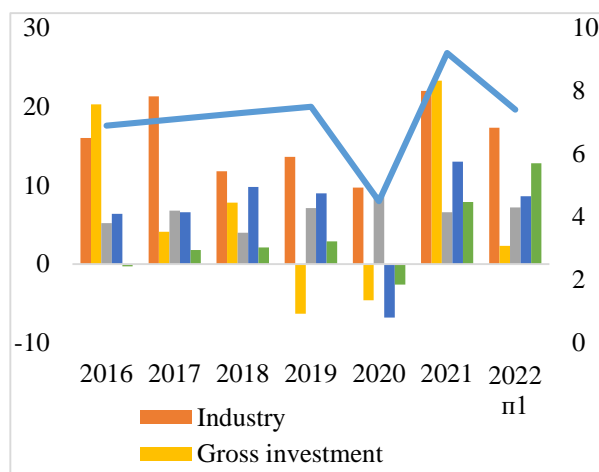
Growth of domestic demand has traditionally been the key driver of GDP growth on the expenditure side. The growth of consumer activity is explained both by a relatively high level of remittances from Russia due to Russian ruble appreciation and by growth of household incomes – real salaries and wages grew by 2.4% in the first half of the year, against 1.9% in the same period last year. The growth rate of capital investment dropped significantly and amounted to 2.5%, against 22.1% a year earlier. At the same time, FDI continued to play an important role in investment financing. There were mixed trends in the area of investment. High investment growth rates were recorded in agriculture (by a factor of 2.3 y-o-y), education (by a factor of 1.9), hotel and restaurant services (by a factor of 1.7), transport and communications (18.2%), production and distribution of electricity, gas, and water (9%). However, there was a substantial drop in investment in production facilities, in particular in mining (-58.4%), manufacturing (-33.5%), and wholesale and retail trade (-47.2%). Investment in non-production facilities also decreased in the area of public administration and defence; social insurance (-34.4%); and other utilities and personal services (-38.2%). Compared to H1 2021, exports remained almost unchanged, with a slight increase of 0.1% to US \$1,215.2 million, while imports grew by 24.2% to US \$2,298.0 million.

In H1 2022 (y-o-y), the average monthly real wages continued to grow amid a slight increase in the unemployment rate. In H1 2022, the average monthly wages grew by 10.2% in nominal terms and by 2.4% in real terms². The officially registered unemployment rate increased slightly to 2.1% in H1 2022 compared to 2.0% in H1 2021. There was also a slowdown in employment growth compared to the same period of 2021 – from 3.6% to 1.2%.

¹ Including forestry and fishing.

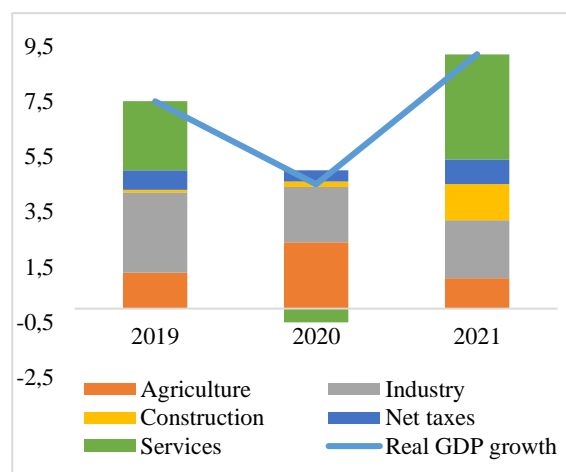
² One of the factors contributing to the growth of real wages in the public sector was Decree of the President of the Republic of Tajikistan No. 312 dated 13 January 2022 “On Measures to Improve Social Protection of the Population and Raise the Current Position Salaries of Civil Servants, Employees of Budgetary Organisations and Institutions, Pensions and Scholarships”, which came into force in January 2022.

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



Source: Tajstat

Figure 2. Economic growth composition (contribution in p.p.)



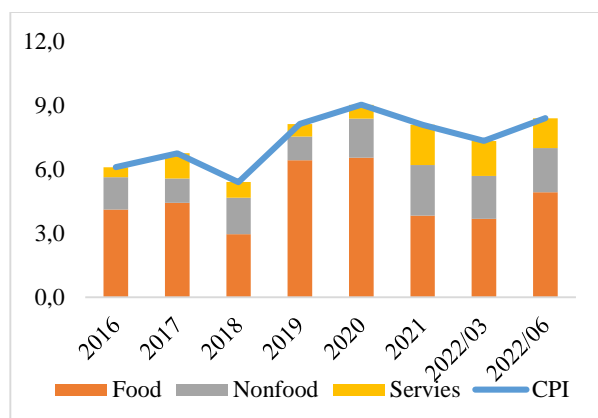
Source: Tajstat

Inflation and Monetary Policy

Inflation accelerated slightly in H1 2022 amid rising food prices. As at end-June 2022, inflation was 8.3% in annual terms, compared to 8.0% as at end-2021. Notably, inflation slowed down to 7.3% in Q1 due to a lower rate of growth of prices for non-food goods and services. However, in Q2, inflation accelerated to 8.3% due to an increase in prices for imported food products (growth of 9.6%), which account for about 51.5% of the CPI basket (a contribution of 4.9 p.p.). It was mainly due to an increase in prices for flour by 38.3% (a contribution of 3.3 p.p.) and sugar by 22% (a contribution of 0.4 p.p.). The price index for non-food products also accelerated to 6.6% (a contribution of 2.1 p.p.) due to rising prices for medicines, detergents, and liquefied gas. High rates of growth of consumer prices also persist in services – 8.4% (a contribution of 1.4 p.p.). The main contribution to the increase in prices for services was made by housing and utilities, and transport services (a contribution of 0.3 p.p. and 0.8 p.p., respectively). Against the background of mounting inflationary pressures and inflation accelerating beyond the level targeted by the NBT (6%±2), the NBT kept the refinancing rate at a relatively high level – 13.25%.

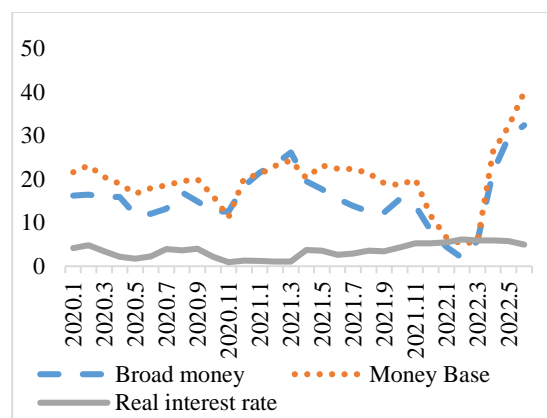
The growth of monetary aggregates accelerated substantially due to an increase in cash in circulation and term deposits. The base money as at end-June 2022 grew by 40% y-o-y (against 22.4% a year earlier). The main driver of the base money growth was cash in circulation (a contribution of 34.9 p.p.). Banks' reserves on accounts with the NBT increased by 38.2% (4.4 p.p.). Broad money grew by 32.4% as at the end of H1 2022 (against 15.5% a year earlier). One of the factors contributing to the higher growth rate of money supply compared to June last year was an increase in net foreign assets in NBT accounts by 33.8%. That liquidity growth was partially offset by an increase in Government deposits on accounts held with the NBT in the reporting period.

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



Source: Tajstat

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



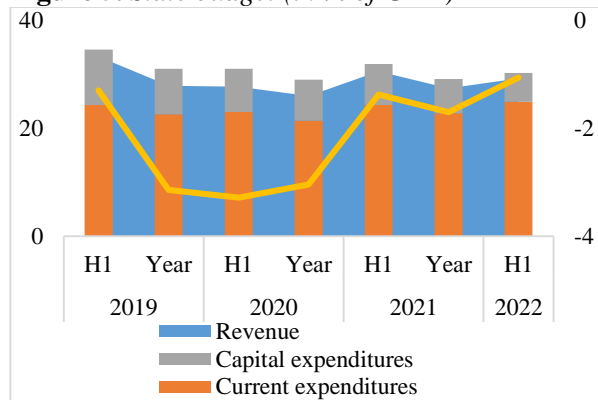
Source: NBT, Tajstat

Budget Sector

In H1 2022, there was an improvement in the fiscal position of the RT due to a reduction of capital expenditures against the background of a slight decrease in budget revenues. The budget deficit declined in H1 2022 to 1.1% compared to 1.4% in the corresponding period of the previous year, mainly due to actual budget expenditures falling short of budgeted amounts. Tax revenues fell by 1.3 p.p. to 29.2% of GDP, which was due to lower tax rates under the new Tax Code. In particular, revenues from the VAT fell by 1.2 p.p., the social tax – by 0.4 p.p., and the natural resource tax – by 0.2 p.p. That was accompanied by an improvement of revenues from the profit tax, property tax, and other external revenues related to trade. Budget expenditures fell by 1.6 p.p. to 30.3% of GDP. However, current expenditures increased by 0.6 p.p. Thus, the reduction of budget expenditures was executed through the decrease of capital expenditures, which decreased by 2.2 p.p. due to lower domestic financing. Current expenditures grew because of an increase in expenditures on goods and services by 1.2 p.p. due to higher prices, as well as an increase in debt-related interest payments by 0.3 p.p., accompanied by a decrease in labour costs by 0.7 p.p. and in expenditures on pensions and social benefits by 0.6 p.p.

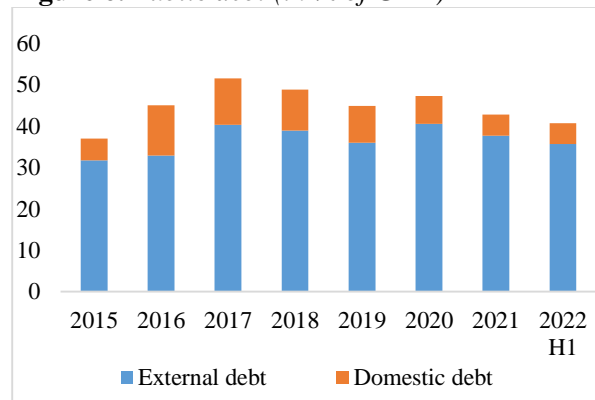
The RT public external debt decreased from US \$3,299.3 million (37.7% of GDP) as at end-2021 to US \$3,254.4 million (35.6% of GDP) as at 1 July 2022. The decline of the level of public external debt was mainly driven by rapid GDP growth and positive exchange rate differences, formed due to depreciation of the world's leading currencies against the US dollar. The domestic debt remained virtually unchanged and amounted to about US \$460 million (5% of GDP) as at 1 July 2022. As a result, the total public debt fell from 42.8% of GDP as at end-2021 to 40.7% in H1 2022, reflecting weakening debt pressure on the economy.

Figure 5. State budget (in % of GDP)



Source: MF RT, Tajstat

Figure 6. Public debt (in % of GDP)



Source: MF RT, Tajstat

External Sector

The balance of payments improved in the first half of the year due to a recovery in remittances and higher international financing, which led to an increase in international reserves and appreciation of the local currency. In Q1 2022, the current account (CA) deteriorated to a deficit of US \$472 million compared to a surplus of US \$545 million a year earlier. The main reason for the weaker CA was deterioration of the trade balance to a deficit of US \$731 million against a surplus of US \$177 million a year earlier. The primary driver of that was a reduction in gold exports, which may be due to restrictions on gold exports in order to replenish Tajikistan's gold and foreign currency reserves. Other important factors included higher import prices and lower remittance inflows from abroad.

The balance of primary income for Q1 2022 amounted to US \$163.1 million (9.5% of GDP), having decreased by 45.2% compared to the same period of 2021. The decrease was due to lower wage incomes and higher obligations to pay returns on direct investment. The secondary income balance in Q1 2022 amounted to US \$204.2 million (11.9% of GDP), an increase of 43.9% compared to the same period of last year. The volume of humanitarian aid received in Q1 2022 increased by a factor of 4.1 compared to the same period of last year and amounted to US \$51.8 million. The inflow of remittances in Q1 2022 amounted to US \$98.3 million, having decreased by 20.1% compared to the same period of last year, due to sharp depreciation of the Russian ruble against other currencies in March 2022.

The CA deficit was financed in Q1 2022 by attracting external financing in the form of grants in the amount of US \$32.8 million, loans in the amount of US \$53.3 million, and FDI growth. As a result, the financial account balance was negative US \$50.2 million compared to negative US \$177 million a year earlier. At the same time, sharp deterioration of the CA in Q1 put pressure on the balance of payments and the exchange rate, and the NBT engaged in currency interventions to smooth out volatility in the foreign exchange market. As a result, the international reserves decreased by US \$49.7 million compared to the beginning of the quarter, making US \$2,449.0 million (6.1 months of imports of goods and services³) as at 31 March 2022.

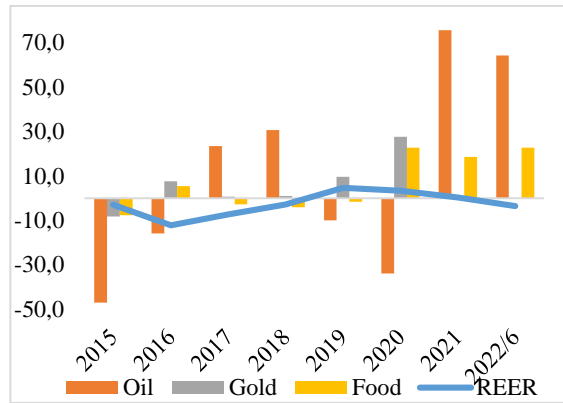
The behaviour of some indicators of the balance of payments in H1 2022 indicates that there is a persistent trade deficit. Compared to H1 2021, exports remained almost unchanged (an increase of 0.1%) and amounted to US \$1,215.2 million, while imports increased by 24.2% to US \$2,298.0 million, resulting in a trade deficit of US \$1,082.8 million. An increase in exports of mineral products – in particular, ores and concentrates by 1.6 times, textile materials and products by 1.6 times, and base metals by 43.6% – was offset by a drop of exports of precious metals by 41.2%. One of the drivers of higher imports was growth of world prices for some food and energy commodities. Imports of animal and vegetable fats and oils increased by 20.5%, finished food products – by 9.4%, mineral products (including petroleum products) – by 38.6%, and chemical products (including mineral fertilizers and pharmaceutical products) – by 41.6%.

Despite a persistent trade deficit, the balance of payments strengthened in Q2 2022 due to a recovery in remittances and external financing from development partners. An important factor for the recovery of remittances was appreciation of the Russian ruble against the US dollar and against the somoni in Q2 2022. In order to prevent excessive appreciation of the local currency in Q2 2022, the NBT engaged in currency interventions to buy foreign exchange. As a result, in Q2 2022, the RT's gold and foreign currency reserves increased by 22.3% to US \$2,995 million (7.4 months of imports of goods and services)⁴. Against the background of the interventions, somoni appreciated by 6.6% against the US dollar in H1 2022 (from TJS 11.3 as at 31 December 2021 to TJS 10.6 as at 30 June 2022).

³ According to the EFSD Project Unit.

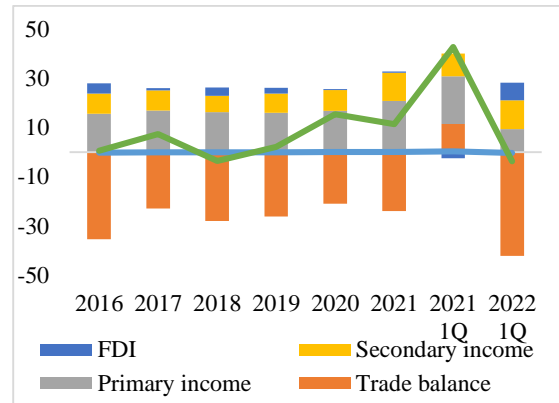
⁴ Estimates of the EFSD Project Unit based on data on net foreign assets as at the end of the period in the table “Monetary Review of the National Bank of Tajikistan”.

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



Source: WB, national authorities, EFSD estimates

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



Source: NBT, Tajstat

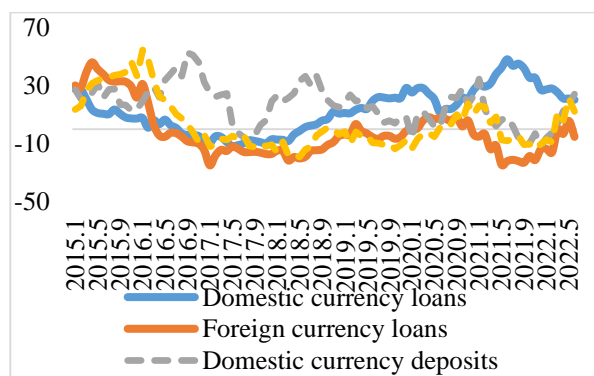
Financial Sector

The economic growth deceleration in H1 2022 was accompanied by a slowdown of the growth rate of lending to the economy. The annual growth rate of the loan portfolio of commercial banks was 11.5% in June 2022 against 13.5% a year earlier (Figure 9). In January–June 2022, the average interest rate on loans in the local currency remained practically unchanged compared to the previous year and amounted to 24.1%. At the same time, the average interest rate on loans issued in foreign currency declined from 13.4% in January–June 2021 to 12.2% in January–June 2022.

The somoni appreciation was accompanied by growth of savings. The total amount of commercial bank deposits increased by 18.8% in the period of the past 12 months. Deposits of households and legal entities increased by 27.9% and 10.2%, respectively. Deposits in the local currency grew by 24%, while deposits in foreign currency went up by 12.1%. The growth of deposits in the local currency was driven by rising interest rates, as well as appreciation of the local currency against the US dollar. The weighted average interest rate on term deposits in the local currency increased from 9.9% in January–June 2021 to 10.3% in January–June 2022 due to depreciation pressure at the beginning of the year. As to term deposits in foreign currency, the weighted average interest rate fell from 4.7 to 3.5% during that period.

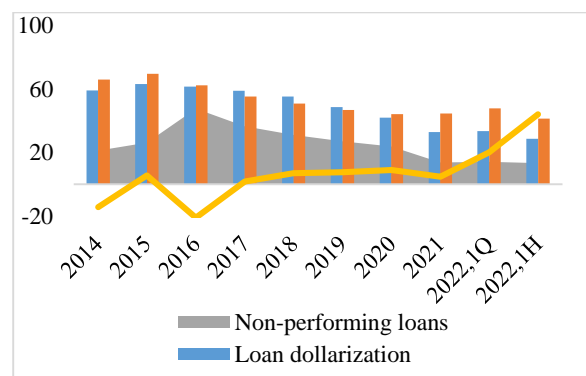
The financial indicators of the banking sector demonstrated continued stability. The capital adequacy ratio increased from 23.4% as at end-2021 to 25.1% at the end of H1 2022. The share of non-performing loans also declined slightly from 13.4% to 13.2%. At the same time, the return on assets during that period increased by a factor of almost 9, from 1.1% to 9.1%, while the return on equity reached a peak since September 2015 at 44.1% (compared to 4.8% a year earlier) due to the local currency depreciation in March and higher fees associated with opening new bank accounts (the number of plastic cards increased by 20% in 5 months).

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



Source: NBT

Figure 10. Banking sector indicators (in %)



Source: NBT

Medium-Term Outlook

In 2022–2024, the macroeconomic conditions in the RT would be mainly determined by external factors. Consumer activity and public investment, funded mainly from external sources, would remain the key drivers of growth. In 2022, the economic activity is supported by high world prices for exported commodities and a relatively high level of remittances from Russia due to the Russian ruble appreciation. According to the EFSD Project Unit, the real GDP would grow by 7.3% in 2022. In 2023, the expected slowdown of the global economic growth and Russian ruble depreciation would have a deterrent effect on Tajikistan's economic growth rate. In 2023 and 2024, the real GDP would grow by 5.2% and 5.7%, respectively, which is comparable to the long-term potential rates.

In the face of the inflationary pressure associated with rising global prices and restrictions on food exports from Russia, as well as taking into account the evolution of inflation during the first 9 months, the 12-month inflation is projected at 6.4% in 2022. At the same time, continued moderately tight monetary policy, a stable exchange rate of the local currency, and a decrease in global inflation would contribute to moderate inflation at the level of 7.0–6.5% in 2023–2024, which corresponds to the NBT's medium-term inflation target (6±2%).

The CA deficit would expand but remain relatively low. Remittances and external financing would help maintain the stability of the balance of payments in 2022–2024. At the same time, the international reserves would remain at a comfortable level of at least 7.2 months of imports of goods and services.

Against the background of a slowdown in economic growth and lower tax rates, state budget revenues are projected to decline from 27.3% of GDP in 2021 to 26.8% in 2022 and 24.9% in 2024. If planned expenditures remain at the level approved in the current State Budget Law, the budget deficit is projected to expand to 2.1% in 2023 and decrease to 1.5% in 2024.

An expansion of the budget deficit in the medium term would lead to the formation of financing gaps. It is projected that the financing gaps may amount to US \$117 million and US \$64 million in 2023 and 2024, respectively, due to a shortfall of tax revenues in response to slower economic growth and due to lower tax rates under the new Tax Code.

Risks to Medium-Term Outlook

The above outlook is mainly subject to downward risks associated with external factors. The main risks include lower global economic growth rates and a deeper economic downturn in Russia due to a potential expansion of sanctions restrictions. It would have a negative impact on the RT economy, primarily due to a slow recovery of migration flows and remittance inflows, which, in turn, would be a deterrent to stronger domestic demand.

Table 1. Tajikistan: Key macroeconomic indicators

	2021 Actual	2022 Forecast	2023 Forecast	2024 Forecast
<u>National accounts and prices</u>				
<u>(in %)</u>				
Real GDP growth	9.2	7.3	5.2	5.7
CPI (December, y-o-y)	8.0	6.4	7.0	6.5
<u>Money and credit (end of period)</u>				
Broad money, percentage change	8.2	17.4	11.6	14.5
Policy interest rate	13.25	13.5	13.5	13.5
<u>Public finance (in % of GDP)</u>				
Budget revenues	27.3	26.8	25.6	24.9
of which tax revenues	19.9	19.8	19.7	19.8
Budget expenditures	29.1	28.0	27.7	26.4
Budget balance (“-” deficit/“+” surplus)	-1.8	-1.2	-2.1	-1.5
<u>External sector (in % of GDP)</u>				
Current account	8.4	0.0	-0.8	-0.6
Export of goods and services	24.7	22.7	21.9	22.9
Import of goods and services	48.6	46.0	44.6	45.7
FDI	0.4	0.6	0.7	0.7
Gross reserves, in months of imports of goods and services of the current year	7.2	7.3	7.2	7.2

Source: National statistics, EFSD Project Unit estimates

ECONOMIC GROWTH OF THE REPUBLIC OF TAJIKISTAN IN THE CONTEXT OF TRADEABLE AND NON-TRADEABLE SECTORS OF THE ECONOMY

Tajikistan's economy is growing at high rates; over the past 10 years, the average real GDP growth has been about 7%. At the same time, the share of the tradeable sector in Tajikistan's GDP increased significantly between 2016 and 2021. In 2011–2015, the share of the tradeable sector averaged 31% of GDP, while in 2016–2021 it increased to an average of 41% of GDP. The entire period under consideration can be divided into two shorter periods. In 2011–2015, the share of the tradeable sector fell sharply from 38% to 13%, and then rose to 42% in 2020. Over the past 7 years (disregarding the crises of 2015 and 2020), the contribution of tradeable sectors to the real GDP growth averaged 4 p.p. (industry – 2.5 p.p.; agriculture – 1.5 p.p.), and that of non-tradeable sectors was on average 3.3 p.p. (services – 2.1 p.p.; construction – 1.2 p.p.) (see Figure 1). It should be noted that within the tradeable sector, the contribution to the GDP growth tended to increase in the part of both industry and agriculture. Within the non-tradeable sector, there were mixed developments. A significant increase in the contribution of services was accompanied by a decrease in that of construction.

Figure 1. Share of tradeable and non-tradeable sectors of the economy in GDP

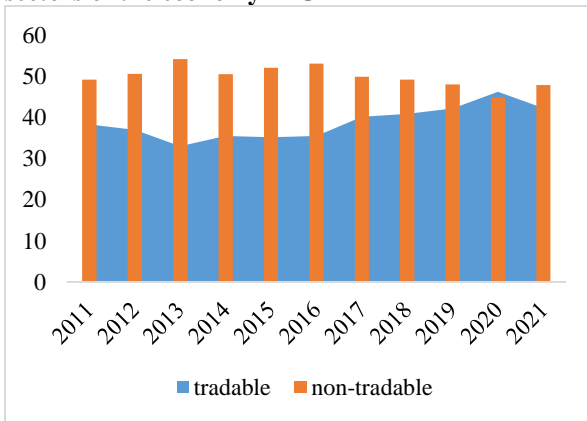
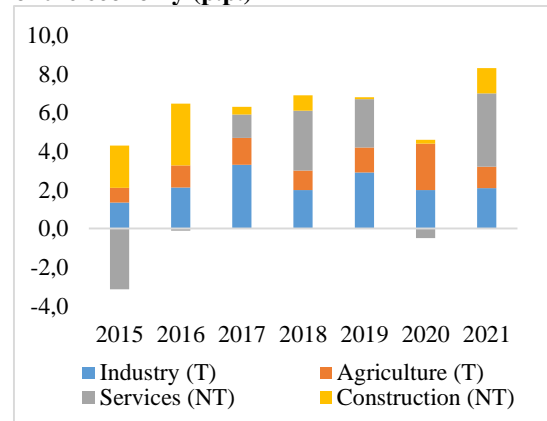


Figure 2. Contribution to real growth, by sectors of the economy (p.p.)



Source: EFSD Project Unit estimates based on data from Tajstat

The share of the tradeable sector in the GDP increased mainly due to high growth rates in the mining industry. In the period under consideration, the share of the manufacturing industry in the total industrial production was 60–70%. During the period, the volume of manufacturing production increased threefold. The growth of the manufacturing industry was generated by the production of food products (including beverages and tobacco), metallurgy production, and the production of finished metal products, textile and clothing, rubber and plastic products, and other non-metallic minerals. At the same time, the main driver of industrial growth was the mining industry, whose share in the GDP has increased by a factor of about 7 since 2013 due to extraction of metal ores (gold, aluminum). As a result, the share of the manufacturing industry in total production fell from 70% in 2013 to 57% in 2021, while the share of the mining industry doubled, going up from 11% to 22%.

Disruptions in supply chains and growing global demand led to hikes of international prices and, thus, Tajikistan's export prices for mining and agricultural goods in dollar terms, which contributed to higher supply by Tajik producers and increased physical volume of exports of products of the tradeable sector (see Figure 3). In particular, aluminium prices increased by 14% during the period of 10 years. Gold prices rose by 46%. At the same time, the increase in the volume of exports of precious or semi-precious stones and precious metals increased approximately fourfold (from 5,700 to 23,100 tons). There was also a substantial increase in exports of electricity (about 4 times) and chemical products (about 10 times). However, some industries saw a decrease in both physical volumes and prices of exports. During the same period, cotton prices fell by 2.3%, and the physical volume of cotton produced dropped by 30% (from 144,400 to 100,600 tons). Thus, the evolution of international prices for products of the tradeable sector is important for RT producers.

It should be noted that with regard to commodity prices, there are also 2 shorter periods with different price trends within the period under consideration. In 2011–2016, the prices for gold, cotton,

and aluminium fell. After 2016, there was an opposite trend. Thus, changes of the tradeable sector within the GDP composition are closely related to the evolution of international commodity prices. Therefore, a sharp decline in commodity prices in the RT may lead to a contraction of net exports and, accordingly, GDP. Lower foreign exchange earnings can put pressure on the exchange rate and, through the exchange rate, on domestic prices.

Nominal depreciation of the local currency after the regional crisis of 2014 also contributed to higher external demand for products of the tradeable sector. Nominal depreciation of the local currency by 9.3% per year contributed to depreciation of the real exchange rate of the local currency against the US dollar, while domestic inflation was higher than in trading partner countries throughout the period under consideration (see Figure 4). The effect of the real effective exchange rate depreciation after 2014 on production growth was mainly positive. Thus, depreciation of the local currency gradually absorbed external shocks and contributed to growth of the tradeable sector.

Figure 3. Evolution of international prices for certain exported goods (2010 = 100%)

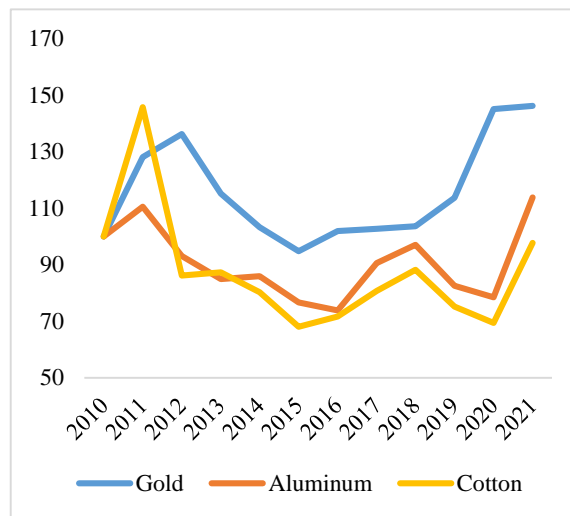
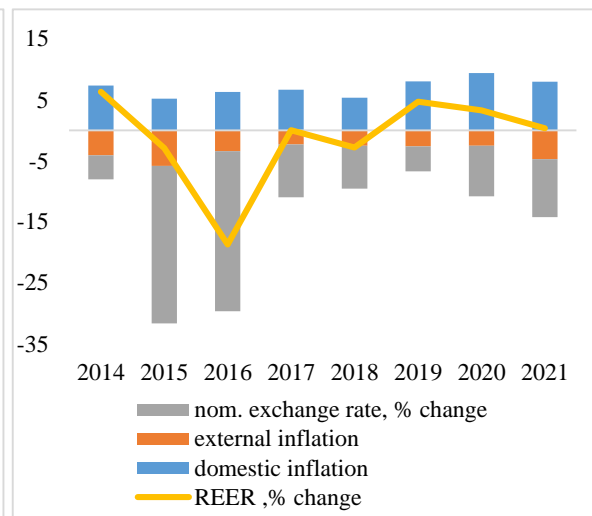


Figure 4. Factors affecting real exchange rate, in % ('+' increase; '-' decrease)



Source: NBT, WB database

Another factor that contributed to the positive trend in the tradeable sector was tax benefits in the framework of the country's fiscal policy. The fiscal policy of the RT was aimed at supporting the tradeable sector by providing tax and customs benefits to priority sectors. In particular, tax benefits were granted in the areas of poultry and fish farming, production of combined feed for poultry and animals, cement production, mining industries, etc. The share of tax benefits accumulated by 2021 amounted to 12.1%⁵ of GDP.

Thus, the share of the tradeable sector in Tajikistan's economy has increased significantly over the recent years, mainly owing to industry, and within industry – largely owing to the mining sector. That model of economic growth carries certain risks. It is associated with the fact that, when the external situation changes (for example, metal prices decline), the high dependence on the mining industry may result in lower exports, deceleration of the GDP growth and employment in that sector.

⁵ Source: MFRT