Tajikistan

Growth accelerated in 2018 on continued public investment and an improved external environment. Inflation slowed, but the current account slipped back into deficit as exports shrank and imports grew. Economic expansion is projected to slow in 2019 and again in 2020 as capital spending moderates. Inflation may accelerate under more exchange rate flexibility, but rising electricity exports should narrow the current account deficit. Diversifying exports could improve incomes and economic resilience.

Economic performance

Growth increased marginally from 7.1% in 2017 to 7.3% as large public investment projects continued, remittances remained high, and relations improved with Uzbekistan, boosting bilateral trade. Improvement came despite weak private investment and persistent problems in banking.

On the supply side, growth in industry fell by almost half from 21.3% in 2017 to 11.8% as aluminum production plunged by 7.1% because of delays in importing ore and ongoing renovation of production facilities—and despite gains of 16.3% in mining, 12.5% in manufacturing, and 7.8% in electricity generation (Figure 3.6.1). Gold production rose by 16.9% to a new record. Growth in agriculture slowed from 6.8% in 2017 to 4.0% as drought cut cotton production by 22.3%. Despite fruit and vegetable production higher by more than 10%, agriculture's share in GDP slipped from 21.1% in 2017 to 18.7% (Figure 3.6.2). Growth in services accelerated from 1.8% to 2.1% as an 11.0% rise in disposable income from higher remittances and government salaries boosted retail trade by 9.8%. Expansion in construction, fueled by infrastructure and private building, rose from 4.1% in 2017 to 7.8%.

On the demand side, growth in investment accelerated from 4.1% in 2017 to 7.8% on higher public outlays. Despite improved trade with Uzbekistan, net exports plunged by 40.2% as continued heavy infrastructure spending drove a 13.5% rise in imports, in particular of capital goods, and weak demand for minerals cut exports by 10.4% even as electricity exports rose.

Inflation decelerated from 6.7% in 2017 to 5.4% (Figure 3.6.3). This reflected prudent monetary policy, the introduction of inexpensive food imports from Uzbekistan and a cut in that country's transit fees, flat global food prices, lower railroad tariffs, and moderate credit growth at 6.5%.

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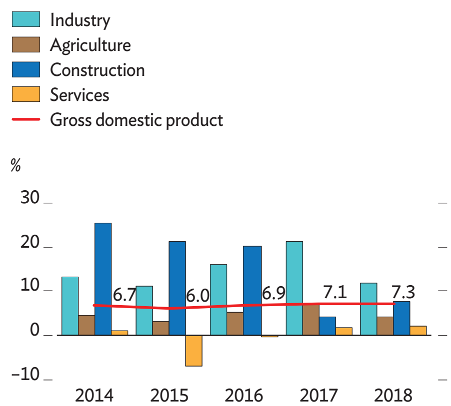
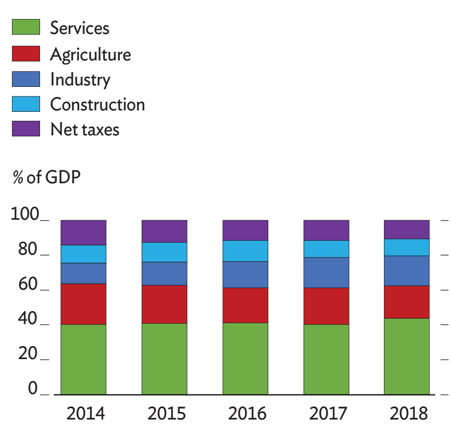
3.6.1 GDP growth by sector



Source: Tajikistan State Statistical Agency.

3.6.2 Production structure



Source: Tajikistan State Statistical Agency.

These factors more than compensated for a 15.0% hike in government salaries and pensions in September, a 10.0% rise in utility prices in October, a further 15.0% rise in electricity tariffs in November, and 6.9% depreciation of the somoni against the US dollar. Prices rose by 4.9% for food, 6.4% for other goods, and 4.9% for services.

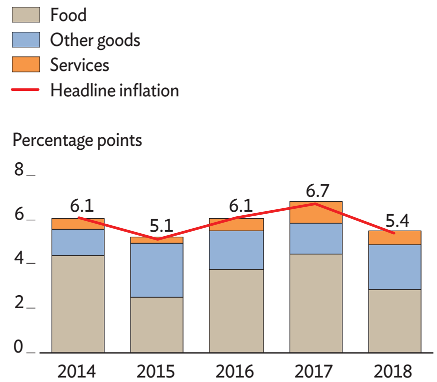
The budget deficit narrowed from the equivalent of 5.1% of GDP in 2017 to 4.8% as revenue slipped from 30.6% of GDP to 30.0% with shortfalls in corporate profits and value-added taxes, though higher imports and improved tax administration boosted excise and customs duties (Figure 3.6.4). Expenditure declined from 35.7% of GDP in 2017 to 34.8% under fiscal consolidation and despite continued large infrastructure outlays for the Rogun hydropower project, the first unit of which came online in November. Repayment of external debt and limited new borrowing reduced public and publicly guaranteed external debt from the equivalent of 44.5% of GDP at the end of 2017 to 38.9%, with total public debt declining from 54.7% of GDP to 48.8% (Figure 3.6.5).

Monetary policy aimed to maintain currency stability and limit inflation. The National Bank of Tajikistan, the central bank, continued moving toward an inflation target of 5%–9% by expanding sales of Treasury bills and central bank securities to slow monetary expansion even as it extended significant credit to the government budget. Growth in broad money tumbled from 21.8% in 2017 to 5.1%, though private credit reversed a 1.3% decline in 2017 to rise by 6.5% (Figure 3.6.6). Reserve money growth slowed sharply from 21.0% to 7.0%. With less inflation, the central bank cut the refinancing rate from 16.00% to 14.75% in January 2018 and further to 14.00% in March, but returned the rate to 14.75% in February 2019 to cool the economy. Tightened foreign exchange controls and other efforts to combat dollarization trimmed the share of foreign currency deposits from 60.3% at the end of 2017 to 53.2% a year later, and of loans in foreign currency from 61.0% to 57.2%.

Higher remittances and more careful screening of new borrowers helped cut the rate of nonperforming loans from 36.5% of all lending at the end of 2017 to 31.1% a year later. The return on bank assets improved from 0.5% in 2017 to 1.9%, and on bank equity from 1.7% to 7.0% (Figure 3.6.7). Two large banks remained troubled, however, with no resolution plan for them yet approved. The government established in June 2018 the National Financial Stability Council, chaired by the minister of economic development and trade, to facilitate information sharing and crisis management and to recommend how to reduce risk in the financial sector.

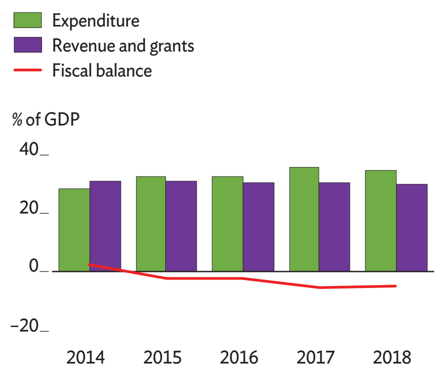
The current account slid back into deficit estimated at the equivalent of 4.4% of GDP, reversing a 2.1% surplus in 2017. The trade deficit widened from $1.6 billion to $2.1 billion

3.6.3 Sources of inflation



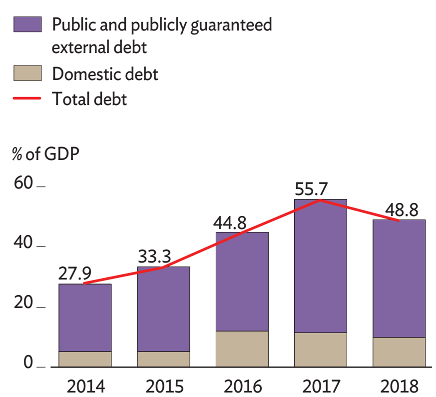
Source: Tajikistan State Statistical Agency.

3.6.4 Fiscal indicators



Source: Ministry of Finance of Tajikistan.

3.6.5 Public debt



Source: Ministry of Finance of Tajikistan.

as weak global demand for minerals cut exports by 10.4% after a 9.4% rise in 2017, and as capital inputs for the Rogun hydropower project boosted imports by 13.5%, reversing 8.5% contraction in 2017 (Figure 3.6.8). With economic recovery in the Russian Federation, remittances in the first 9 months of 2018 rose to $1.9 billion, equal to 36.5% of GDP, from $1.7 billion in the same period of 2017. Gross international reserves at the end of September 2018 slightly exceeded $1.2 billion, providing cover for 4.7 months of imports. The improvement came from purchases of domestically produced gold and a $500 million eurobond issue (Figure 3.6.9).

Economic prospects

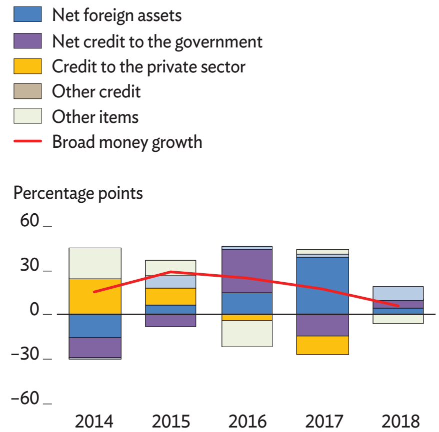
Growth is forecast to slow to 7.0% in 2019 and 6.5% in 2020 as capital spending moderates following the completion of the second phase of the Rogun project in April 2019. Support for expansion will continue from higher remittances under positive growth in the Russian Federation, an expected pickup in private credit, increased production across sectors, and export expansion with additional electricity generation and improving economic relations with neighboring countries (Figure 3.6.10). Downside risks stem from weakness at two large banks and several state-owned enterprises.

On the supply side, industry is forecast to expand this year and next as the completion of the second turbine of the Rogun hydropower plant and accelerated industrialization boost electricity generation, mining, and manufacturing. Ongoing construction of the Tajikistan segment of a gas pipeline from Turkmenistan to the People's Republic of China should boost construction. Agriculture is expected to rise modestly with additional area under cultivation. Higher remittances will expand services and enhance demand for private lending.

On the demand side, public investment will remain the main growth driver as private investment languishes in a weak business climate. Private consumption will rise moderately on higher remittances. Exports are forecast higher as electricity exports expand with Rogun coming online and the construction of a new transmission line reconnecting Tajikistan's electricity system to the Central Asian power grid. Abundant electricity will also facilitate the domestic production of import substitutes.

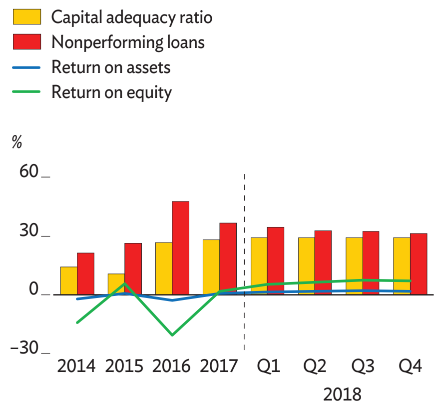
Inflation is projected to accelerate to 7.5% in 2019 with expected exchange rate flexibility, higher consumer demand from increased remittances, and possibly faster monetary expansion from a second round of bank recapitalization (Figure 3.6.11). In 2020, inflation will likely remain within the targeted range of 5%–9%. It could go higher, however, if somoni depreciation exceeds expectations or fiscal spending spurs growth in the money supply.

3.6.6 Contributions to money supply growth



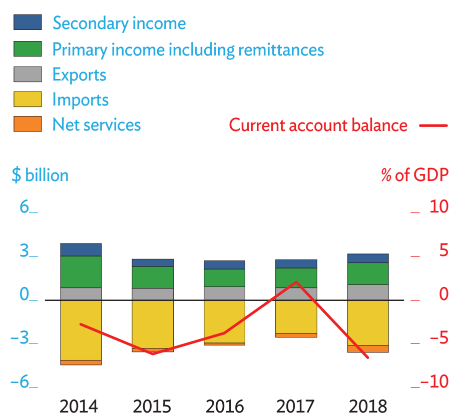
Source: National Bank of Tajikistan.

3.6.7 Banking system soundness indicators



Source: National Bank of Tajikistan.

3.6.8 Current account components



Sources: National Bank of Tajikistan; ADB estimates.

Over the next 2 years, fiscal policy will be less expansionary despite significant financing needs for the Rogun project. The budget deficit is forecast to narrow to the equivalent of 4.0% of GDP in 2019 and 3.3% in 2020—both higher than approved in the fiscal strategy for 2017–2020. Revived business activity and higher imports are projected to boost revenue to 30.5% of GDP in 2019 and 30.8% in 2020. Expenditure is forecast equal to 34.5% of GDP in 2019 and 34.1% in 2020 on stepped-up repayment of external debt, currently equal to 1.5% of GDP, and domestic debt, now 0.3% of GDP. Expenditure could turn out higher with additional recapitalization of troubled banks, a clearing of arrears at state-owned enterprises, or faster currency depreciation. With foreign assistance now entirely through grants because of high debt risk, commercial borrowing is expected to cover gaps in financing for infrastructure, raising external debt to $3.3 billion, or 42.2% of GDP, by the end of 2020.

Monetary policy will likely tighten liquidity to contain inflation, including raising the refinancing rate if necessary, and to limit somoni depreciation. Gradual recovery in the banking system may increase resources available for private lending.

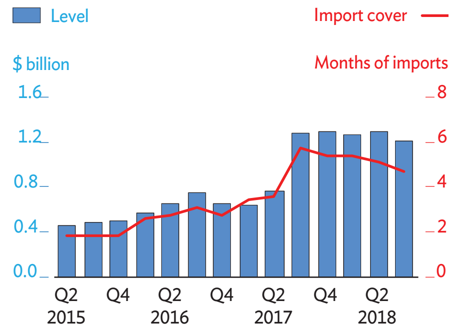
The current account deficit is forecast to narrow to 4.0% of GDP in 2019 and 3.8% in 2020 despite continued heavy imports of capital goods (Figure 3.6.12). Exports are projected to grow by 5.0% in 2019 and 10.0% in 2020 with higher electricity generation, including substantial exports of electricity to Afghanistan and Uzbekistan. With continued, if slow, growth in the Russian Federation, remittances are projected to rise by an additional 10% annually in 2019 and 2020. Despite higher remittances, imports are expected to contract by 5.0% in 2019 and stabilize in 2020 as efforts continue to replace food imports with local alternatives and to manufacture more import substitutes.

Policy challenge—diversifying production and exports

Tajikistan has traditionally had an agrarian-industrial economy that produces few exports, with services, fueled mainly by remittances, comprising more than half of GDP. This has made it vulnerable to external economic shocks that emanate largely from the Russian Federation, the main source of remittances, as occurred in the global financial crisis of 2008–2009 and in 2014–2015, when global oil prices tumbled. To reduce its vulnerability, Tajikistan needs to diversify its economy and in particular its export base.

Work on the Rogun hydropower project, the second generator of which is due to come online in April 2019, has diversified the economy both directly and indirectly.

3.6.9 Gross international reserves



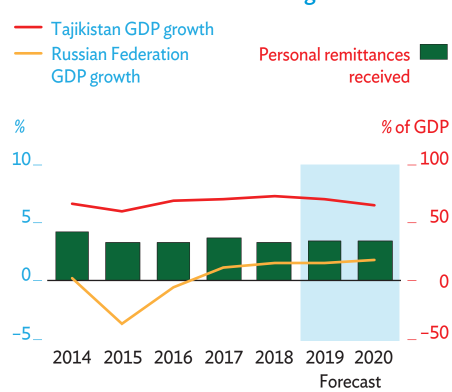
Q = quarter.
Source: National Bank of Tajikistan.

3.6.1 Selected economic indicators (%)

	2019	2020
GDP growth	7.0	6.5
Inflation	7.5	7.0
Current account balance (share of GDP)	–4.0	–3.8

Source: ADB estimates.

3.6.10 Remittances and GDP growth



Sources: World Bank. *World Development Indicators online database*; National Bank of Tajikistan; ADB estimates.

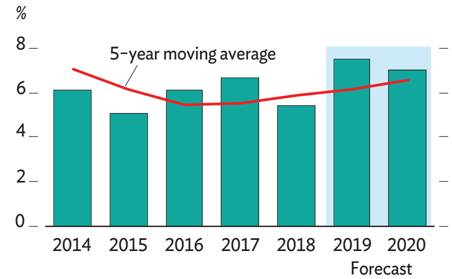
More electricity generation—along with the construction of a new power transmission line and Tajikistan's reconnection to the Central Asian power grid—will boost electricity exports and provide additional power for domestic manufacturing and other activities. However, more could be done to promote diversification.

First, Tajikistan would benefit from strengthening information technology to provide better commercial support services. This would require education and training to enhance computer skills in the population while making internet access cheaper and better. In December 2018, the Speedtest Global Index ranked Tajikistan the worst in the world for mobile internet speed and at 113 of 177 countries for the quality of its fixed broadband. Tajikistan could reap significant economic dividends by strengthening its information technology infrastructure—improving internet connections and encouraging private investment in data and voice services, both domestic and international—and by training a cohort of young developers in programming and technology applications.

Second, Tajikistan should explore opportunities to export products for which it likely enjoys a comparative advantage, such as high-value agricultural products. With appropriate branding and marketing, it could sell in nearby countries and potentially beyond. Yet agriculture remains largely subsistence, according to a 2014 survey by the World Bank, with only one-third of crop producers selling their output and more than half of this group doing so at the farm gate. Giving farmers technical support in marketing, and establishing marketing associations to attain economies of scale and reduce transaction costs, could help boost production, sales, and ultimately exports, which would raise rural incomes.

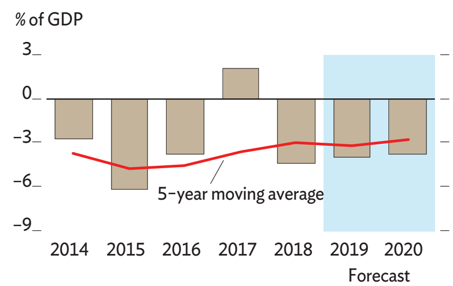
Third, Tajikistan should address other shortcomings in its investment climate. In *Doing Business 2019*, the World Bank ranked Tajikistan at 148 of 189 countries in cross-border trade, a deficiency it could address by improving customs, transport, and logistics procedures and by upgrading its rail and road connections with neighboring countries. Tajikistan similarly ranks at 136 of 189 countries in tax policy and collection. Its effective tax rate on company profit is, at 67.3%, more than double the 32.3% national average in Europe and Central Asia. Lower tax rates could be made feasible by reviewing tax policy to see whether some of the corporate tax burden could be shifted to other sources and by eliminating tax exemptions that fail to promote investment and innovation while distorting markets. Simplifying procedures for starting a business could potentially expand the tax base. Finally, Tajikistan could explore how to improve access to credit, another area where it ranks low, at 124 of 189 countries. Reducing the rate of nonperforming loans would help, as would creating more equitable access to loans for private firms.

3.6.11 Inflation



Sources: Tajikistan State Statistical Agency; ADB estimates.

3.6.12 Current account balance



Sources: National Bank of Tajikistan; ADB estimates.