

Tajikistan

Economic Update
No.2 | Fall 2015



A moderate Slowdown in Economic Growth Coupled with a Sharp Decline in Household Purchasing Power



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**Macroeconomics
& Fiscal Management**
Global Practice



Tajikistan:

A moderate Slowdown in Economic Growth Coupled with a Sharp Decline in Household Purchasing Power

Tajikistan Economic Update No. 2

Fall 2015

Government Fiscal Year:	January 1 – December 31
Currency Equivalents:	Exchange Rate Effective as of November 16, 2015 Currency Unit = Tajikistan Somoni (TJS) US\$1 = 6.6355 TJS
Weights and Measures:	Metric System

Abbreviations and Acronyms

ADB	Asian Development Bank
BT	Barki Tojik
FDI	Foreign direct investment
GBAO	Gorno-Badakhshan Autonomous Oblast
GDP	Gross domestic product
HBS	Household budget survey
LHS	Left-hand scale
LSS	Living standards survey
MoEDT	Ministry of Economic Development and Trade
MoF	Ministry of Finance
NBT	National Bank of Tajikistan
NPL	Nonperforming loan
PFM	Public financial management
PPG	Public and publicly guaranteed
PPP	Purchasing power parity
RHS	Right-hand scale
RMB	Renminbi (abbreviation for "Chinese yuan")
ROA	Return on assets
ROE	Return on equity
RRS	Regions of Republican Subordination
SOE	State-owned enterprise
TajStat	Agency of Statistics under the President of Tajikistan
TALCO	Tajik Aluminum Company
TJS	Tajikistan somoni (unit of currency)
TSA	Targeted social assistance
VAT	Value added tax
Y/Y	Year-on-year

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Foreword

This edition of the Tajikistan Economic Update is part of a biannual series of reports designed to monitor recent economic developments in Tajikistan and examine emerging issues. It presents a broad overview of the country's macroeconomic, policy and structural context, and assesses its macro-fiscal profile and growth outlook over the short and medium term. This edition's authors are Marina Bakanova (Senior Country Economist) and Ravshan Sobirzoda (Economist). Alisher Rajabov (Poverty Economist), Zarina Odinaeva (Operations Officer), Victoria Strokova (Economist), Angela Elzir (Junior Professional Associate), David de Padua (Research Assistant), and Dino Merotto (Lead Economist) provided valuable contributions. The analysis also benefited from the valuable input provided by Naoko C. Kojo (Senior Economist), Christos Kostopoulos (Lead Economist for Central Asia), John Litwack (Lead Economist) and Patricia Veevers-Carter (Country Manager for Tajikistan).

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Overview

Tajikistan's economy exceeded expectations during the first six months of 2015 despite a challenging external environment. According to official data, GDP growth slowed only moderately from 6.7 percent in the first half of 2014 to 6.4 percent year on year (y/y) in the first half of 2015, even as remittances from Russia fell, global demand weakened, and prices for the country's key export commodities such as aluminum and cotton dropped significantly. Domestic factors continued to drive growth, and both the construction and industrial sectors expanded as the economy's focus shifted from consumption to investment. The state budget surplus reached 1 percent of GDP, and the external public debt to GDP ratio dropped to below 20 percent.

The sharp decline in remittances is limiting the growth of household consumption and could threaten the sustainability of recent gains in poverty reduction and shared prosperity. According to the National Bank of Tajikistan (NBT), remittances dropped by 32 percent (y/y), in US dollar terms during the first six months of 2015. Although the decline was less dramatic (about 18 percent) in Tajikistan somoni (TJS) terms, income losses were much larger than implied by GDP statistics. Falling remittances, limited employment creation outside the public sector, and rising prices are slowing the rate of poverty reduction. Moreover, the lack of well-targeted social programs leaves households vulnerable to economic shocks.

The government is shifting its policy stance to reflect the worsening external environment. The government is maintaining its commitment to fiscal discipline by setting clear spending priorities and postponing less urgent expenditures while protecting social outlays. However, the delayed revision of the budget until November has both heightened the risk of arrears and created perverse incentives for tax authorities to exert excessive pressure on businesses in order to meet their revenue targets. Monetary policy has been accommodative during the first six months of 2015, and rising inflation rates have prompted the NBT to defend the *somoni* through a combination of interventions and administrative controls, including ceilings on the exchange rates offered by foreign-exchange offices. This policy has depleted the country's already low stock of foreign reserves, which stood at just one month of imports in early July. The NBT has recently ceased its interventions and is gradually allowing the unification of the official exchange rate with both the cash and market rates. The NBT is also intensifying efforts to rebuild its reserves and improve their management.

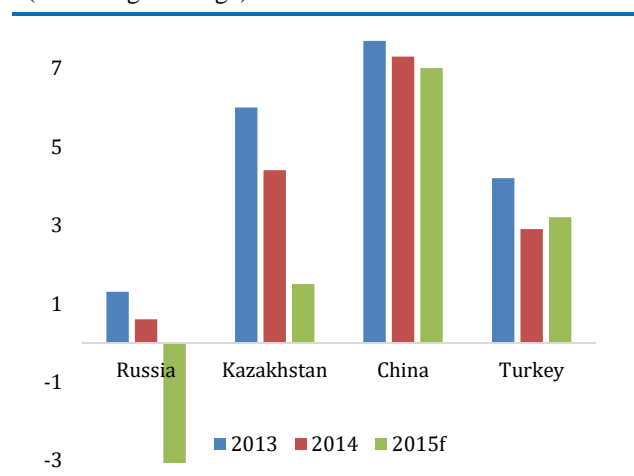
The country's economic outlook is broadly positive, but current forecasts are subject to significant downside risks. The recession in Russia—combined with slowing growth among Tajikistan's other major trading partners, including China, Kazakhstan and Turkey—is negatively impacting its short-term outlook. After slowing to an estimated 4.2 percent for 2015 as a whole, GDP growth is projected to recover gradually over the medium term, though it is expected to remain below its recent historical average. The current-account deficit is expected to improve moderately, narrowing from about 8 percent of GDP in 2014 to 6.3 percent in 2015 and remaining at around 6 percent thereafter. The fiscal accounts (excluding externally financed public investments) are expected to remain broadly balanced over the near term. However, external-account volatility, dwindling foreign-exchange reserves, contingent liabilities generated by state-owned enterprises and systemic vulnerabilities in the banking sector all pose significant downside risks to Tajikistan's macroeconomic outlook. While weakening GDP growth is slowing the pace of poverty reduction, the poverty rate is still projected to fall to 27.3 percent by 2017. As external and domestic pressures continue to mount, addressing fiscal risks and implementing reforms to boost productivity, enhance competitiveness and strengthen social safety nets will be critical to sustain growth and support further progress in poverty reduction.

A. Recent Economic Developments

Economic Growth and Domestic Demand

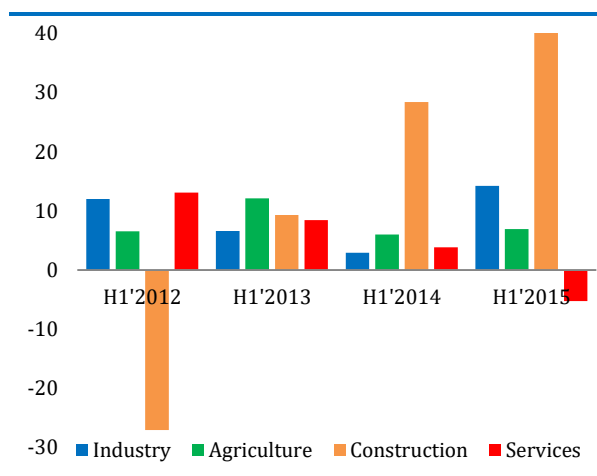
According to official data, economic growth remained strong in the first half of 2015 in the face of a challenging external environment. Tajikistan's GDP grew by 6.4 percent (y/y) between January and June, down slightly from 6.7 percent for the same period a year earlier. The country's main trading partners—China, Russia, Kazakhstan and Turkey—have all recently experienced either slowing growth rates or outright recessions (Figure 1). However, falling exports have been offset by even larger declines in imports, as a steep drop in remittances has reduced household consumption. As a result, net exports have made a positive contribution to economic growth despite worsening external conditions. Moreover, internal dynamics continued to drive growth, and while consumption declined, fixed investment grew by an extraordinary 41.4 percent (y/y), up from an already robust 28.4 percent a year earlier. Thirty-nine percent of total fixed-capital investment was foreign financed, largely by Chinese investors. The public sector accounted for 37 percent of fixed-capital investment, and the rest was comprised of private investment by domestic firms and companies with joint foreign and domestic ownership.¹

Figure 1. Economic Growth among Tajikistan's Major Trading Partners
(Percentage Change)



Source: World Bank, September 23, 2015.

Figure 2. Output Growth by Sector
(Percent)



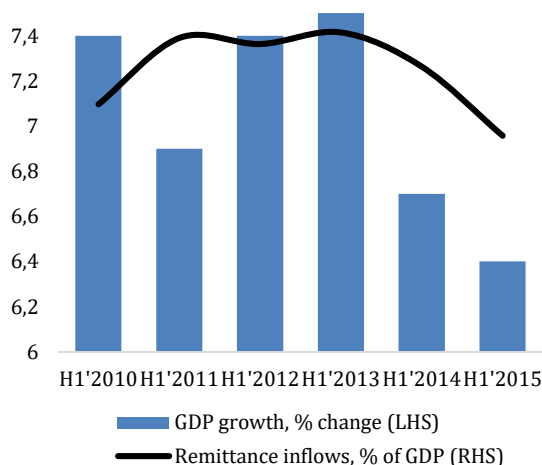
Source: TajStat, World Bank staff calculations.

Construction and industry propelled growth in the first half of 2015 (Figure 2). The construction sector's remarkable performance reflected the completion of TJS 4 billion in investment projects, an increase of 43 percent (y/y). Infrastructure, communications, electricity production and transmission, and residential and commercial projects were all completed during this period. Sixty percent of these projects were investments in productive capacity. The strong growth of industrial production, which rose by 14.2 percent (y/y), was led by the extractive industries, the electricity sector and manufacturing, especially the construction materials. Favorable weather conditions boosted growth in the agricultural sector, which rose from 6 percent in the first half of 2014 to 6.9 percent in the first half of 2015. However, a frost in the early spring damaged orchards in northern

¹ These are preliminary estimates from the national statistics agency (TajStat) and may be subject to further revision.

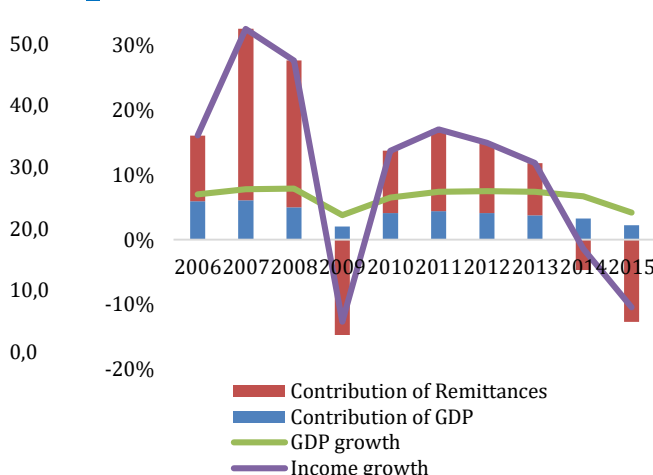
Tajikistan, causing US\$90 million in losses and a 45 percent drop in fruit production according to official estimates. After rising by 3.8 percent in the first half of 2014, services contracted by 5.3 percent in the first half of 2015 as falling remittances undermined domestic demand.²

Figure 3. Economic Growth and Remittances
(% change and % of GDP)



Source: NBT, World Bank staff calculations.

Figure 4. GDP Growth and Income Growth
(Percent)



Source: MoEDT, World Bank staff calculations.

The Russian recession, a weakening ruble, and tighter regulations on labor migration sharply reduced remittance inflows in the first half of 2015. According to the NBT, the value of remittance inflows in US dollars during the first six months of 2015 fell to US\$1.2 billion, a 32 percent decline from the same period in 2014 (Figure 3).³ Falling remittances have negatively impacted domestic demand, causing the service sector to contract. Over 80 percent of Tajikistan's inbound remittances originate in Russia and are denominated in rubles, and the dramatic plunge in remittances is mainly due to the exchange-rate effect of the ruble's depreciation.⁴ In somoni terms remittances fell by a more modest 17.5 percent.⁵ There is also evidence that tighter restrictions on immigration in the Russian Federation since January 2015 may be affecting remittances.⁶ According to Russia's Federal Migration Service, as of June 2015 there were 992,170 Tajikistani migrants in the Russian Federation, down 15 percent from the same period in the previous year. Furthermore, the number of Tajikistani

² According to the 2015 National Human Development Report, "Tajikistan: Access to Resources for Human Development," a full 83 percent of Tajik households depend at least in part on remittance inflows. The survey also revealed that 86.5 percent of remittances are used for immediate consumption and are not deposited in the banking system. See:

www.tj.undp.org/content/dam/tajikistan/docs/projects/democratic_governance/UNDP_TJK_MHDT_2014_Eng.pdf

³ Data provided by the Central Bank of Russia indicate a decline of 46 percent (y/y) during the first half of 2015. The disparity may be due to differences in the periodicity of ruble-dollar conversions, differences in the analytical methodology and/or the definition of primary and secondary income, or differences in the accounting of inflows from other countries.

⁴ According to the Central Bank of Russia the ruble depreciated by 42 percent against the dollar in 2014, then appreciated slightly by about 1.2 percent as of end-June 2015.

⁵ Using the unofficial (or "street") rate would result in an even smaller decline of no more than 10 percent.

⁶ World Bank. 2015. *Special Topic: Labor Migration and Remittances* in "Tajikistan: Slowing Growth, Rising Uncertainties." Economic Update #1, Spring 2015.

labor migrants banned from re-entry reached 324,634 by August 2015, up from 270,000 in November 2014.

The sharp decline in remittances is slowing the growth of household income. In recent years household income growth in Tajikistan has substantially outpaced GDP growth, but recent events appear to have reversed this trend. Because of sharp decline in real remittances the projected drop in purchasing power is over 10 percent in 2015, much more than suggested by the GDP numbers (Figure 4).⁷ As discussed in the following section, micro-level data confirm the diverging trends of GDP and income growth.⁸ Remittances comprise the country's second-largest source of household income, and households are struggling to cope with the decline in remittance values by increasing the labor supply, both domestically and in foreign labor markets other than Russia, such as Kazakhstan. However, this shift in labor dynamics does not appear to have fully compensated for the income lost due to the depreciation of the ruble.

The Labor Market, Poverty and Inequality

There is evidence of mounting pressure in the labor market since end-2014. According to Tajikistan's national statistics agency (TajStat), the unemployment rate was just 2.5 percent in June 2015, unchanged from June 2014. However, the number of unemployed workers grew by about 5 percent during the first half of 2015 despite the creation of 120,404 jobs by the Ministry of Labor, Migration, and Employment of Population.⁹ Furthermore, the number of job seekers rose by 4.1 percent, while the number of vacancies dropped by 22.1 percent (y/y), resulting in the increase in the ratio of applicants per vacancy from 6.9 in June 2014 to 9.2 in June 2015—the highest rate of the post-crisis period. Slow rates of employment creation have pushed many job seekers into the informal sector, which accounted for about 49 percent of total employment in 2009. In February 2015 the government adopted a new strategy to reduce informal employment, which includes measures to strengthen monitoring of the informal sector, reform labor laws, reduce barriers to formalization and strengthen interagency coordination.

Agriculture offers the lowest compensation of any sector, yet it continues to dominate the labor market, accounting for 45 percent of total employment. Employment in agriculture declined by 3.2 percent over the last three years (Figure 5), and a combination of rising prices for agricultural inputs, urbanization and emigration appears to be driving this trend. Repeated droughts in the southern part of the country encouraged rural-urban migration and emigration, and the impact of climate change has emerged as a subject of heated political debate following recent floods and mudslides in Gorno-Badakhshan Autonomous Oblast (GBAO) and the Rasht Valley in July 2015, which caused about US\$100 million in damages.¹⁰

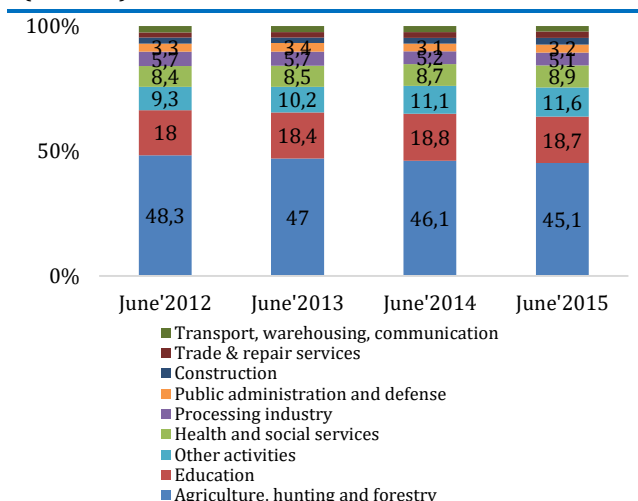
⁷ For the methodology of estimation of income generated by remittances see, World Bank. 2015. "Low Commodity Prices and Weak Currencies". World Bank ECA Economic Update October 2015.

⁸ These data were obtained from the "Listening to Tajikistan" survey, which was conducted through biweekly computer-assisted telephone interviews in May 2015.

⁹ The ministry created 15.4 percent fewer jobs than originally planned during the first half of 2015. Major vacancies were left unfilled in construction, industry, agriculture, transport and communication, trade and other areas. Of all created jobs, 30.3 percent were permanent, 33.8 percent were temporary and 33.2 percent were seasonal.

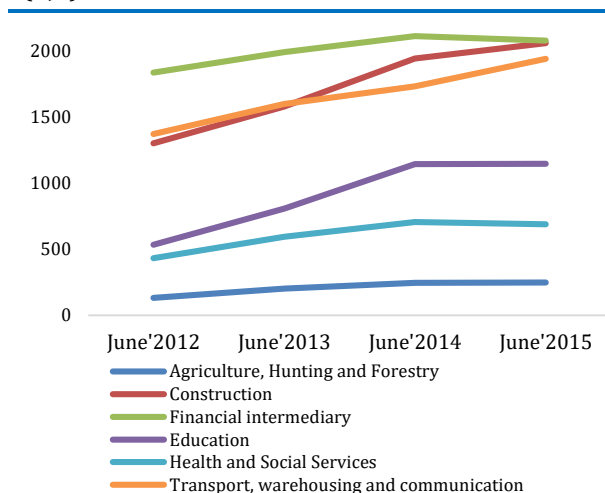
¹⁰ See also World Bank. 2014. "Tajikistan: Autonomous Adaptation to Climate Change: Economic Opportunities and Institutional Constraints for Farming Households." Report #85597-TJ, May 2014.

Figure 5. Wage Employment by Economic Activity (Percent)



Source: TajStat, World Bank staff calculations.

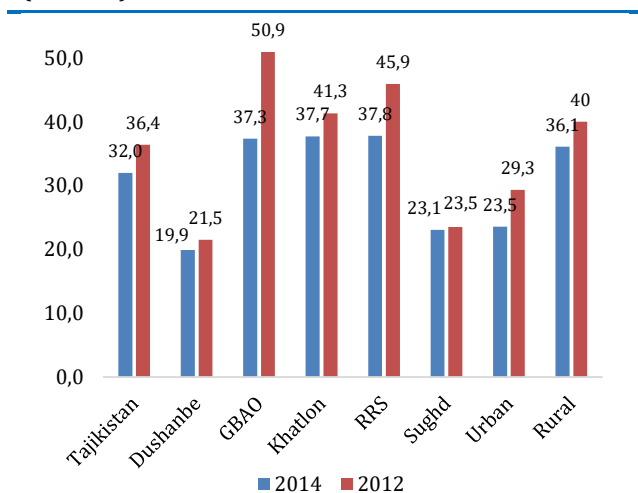
Figure 6. Average Monthly Wage by Sector (TJS)



Source: TajStat, World Bank staff calculations.

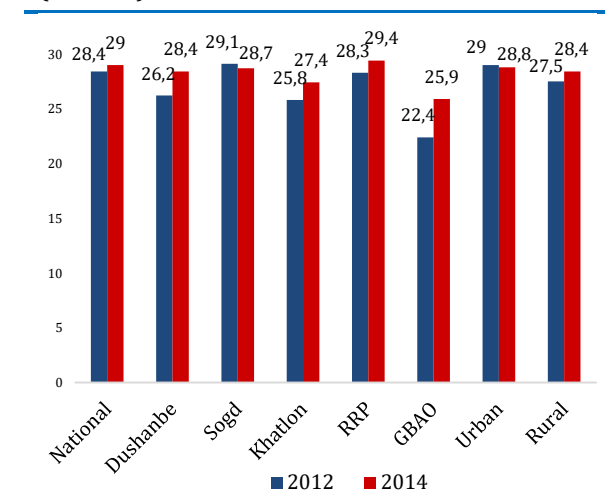
According to official statistics¹¹ Tajikistan's poverty rate fell by 4.4 percentage points over the last two years to 32 percent, but gains varied across regions and between urban and rural areas. The poverty rate fell most sharply in GBAO, from 50.9 to 37.3 percent, and in Regions of Republican Subordination (RRS), from 45.9 to 37.8 percent (Figure 7). Poverty incidence is highest in RRS, Khatlon, and GBAO and lowest in Sughd and Dushanbe. Poverty in Tajikistan is predominantly rural, and almost four out of five poor people live in rural areas.

Figure 7. Poverty Headcount Rate by Region and Rural/Urban Aggregate (Percent)



Source: Poverty Measurement Methodology Note, TajStat, 2015

Figure 8. Gini Coefficients by Region and Rural/Urban Aggregate (Percent)



Source: Poverty Measurement Methodology Note, TajStat, 2015

¹¹ On June 24th, 2015 TajStat launched a new official poverty series and methodological note using a new approach in measuring poverty. The new method is based on the quarterly Household Budget Survey (HBS), which has been consistently implemented and repeatedly improved. The national poverty line was set at TJS 158.71 per capita per month in 2014.

Income inequality is relatively low overall, but urban centers are less equal than rural areas. The Gini coefficient¹² for per capita consumption increased by 0.6 percentage points between 2012 and 2014 to reach 29.0 in 2014 (Figure 8). This is below the conventional “low inequality” threshold of 30. Inequality rose in most regions, except for Sughd, with Dushanbe and GBAO seeing the largest increases of 2.2 and 3.5 percentage points, respectively. Overall urban inequality fell slightly, while rural inequality increased.

RRS is by far the country’s most unequal district. RSS is relatively wealthy, with an average rate of consumption per capita higher than that of Khatlon and GBAO; it also has the highest Gini coefficient in the country (29.4), above even that of Dushanbe. Meanwhile, at 25.9 inequality is substantially lower in GBAO than in all other districts. GBAO is Tajikistan’s poorest district. It is largely agricultural, and has few urban areas, which likely contributes to its relative equality. At the national level inequality in Tajikistan is comparable to that of other countries in the region. Its Gini coefficient is the same as Kazakhstan’s last recorded figure in 2010, and well below that of the Kyrgyz Republic, which was 33 in 2011.¹³

The national poverty rate fell to 31.6 percent in the first quarter of 2015, but the pace of poverty reduction has recently slowed. Moreover, welfare indicators are worsening fastest among poor households. According to the “Listening to Tajikistan” survey, between May and July 2015 the average real income per capita dropped by 23 percent among households in the bottom 40 percent and by 16 percent among households in the top 60 percent. These declines were primarily due to lower remittance income, which was only partially offset by seasonal increases in the number of remittance transfers—though even these were lower in total value—and by rising agricultural income during the summer months. The decline in poverty in recent years has been driven by wage growth, particularly in the public sector, and pensions, as well as remittances. Limited employment creation outside the public sector, falling remittances, and rising prices have slowed the rate of poverty reduction below its 2012-2014 average.

B. Economic and Structural Policies

Fiscal Developments

Despite lower revenues the state budget showed a surplus of 1 percent of GDP in the first half of 2015. Total revenues were 3.3 percent below target due to a sharp drop in import-related revenues such as customs duties and VAT. In response, the government reprioritized its expenditures and deferred certain capital investments. As a result total expenditures were under-executed by 16.8 percent, largely due to the Rogun hydropower plant, which spent 15.3 percent less than originally planned during the first half of 2015.

Revenue performance was uneven during the first half of 2015, raising concerns that revenue authorities may face perverse incentives to increase collections at the expense of the tax base. As import tax and VAT revenues fell, a substantial increase in other tax and nontax revenues helped mitigate the net effect on the budget. However, this appears to have been the result of tax authorities

¹² The Gini coefficient is the most commonly used measure of inequality. In this case 0 represents complete equality of consumption, while 1 indicates complete inequality of consumption.

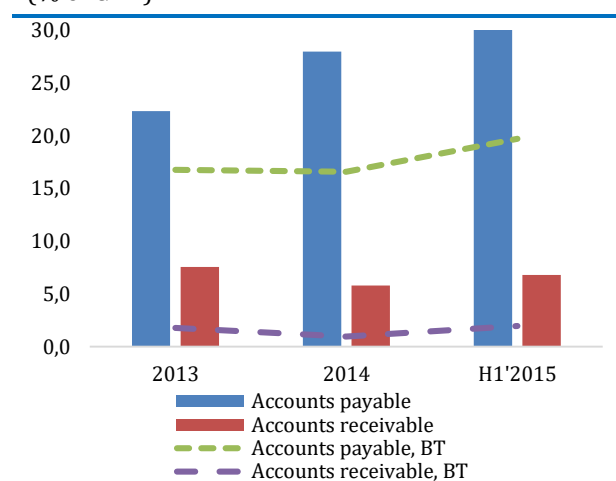
¹³ World Development Indicators, 2015.

increasing pressure on businesses to meet revenue targets. While this tactic may boost revenues in the short run, over time it threatens to erode the tax base by encouraging evasion and informality.

The government has largely protected social programs from the fiscal consolidation, and social spending continued to represent roughly half of total expenditures. Social spending remained at 16 percent of GDP, similar to the first half of 2014. At 2.2 percent of GDP healthcare spending was 0.2 percentage points higher than a year earlier, yet it remains the lowest in the Europe and Central Asia (ECA) region. The amendment of the budget has been delayed until the fall, and its specifics have yet to be defined. Proposed amendments designed to protect social expenditures by cutting spending in other areas, such as procurement, and by delaying capital projects that are far from completion. A promised increase in public sector wages and pensions in September 2015 has been postponed due to worsening economic conditions.¹⁴

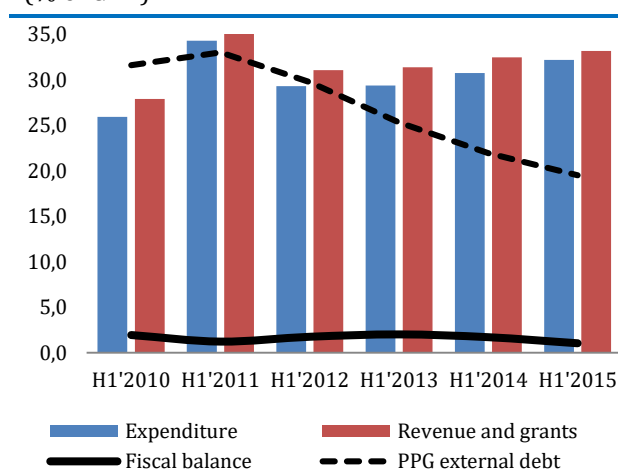
The financial performance of state-owned enterprises (SOEs) has worsened, intensifying fiscal risks. SOEs' net arrears on accounts payable and receivable rose sharply during the first six months of 2015. As of July 1st, the 24 largest SOEs had TJS 3.2 billion (US\$547.8 million) in arrears on accounts receivable and TJS14.4 billion (US\$2.5 billion) on accounts payable, or about 6.8 and 30.8 percent of GDP, respectively (Figure 9). The state energy company Barki Tojik accounts for the lion's share of these arrears, almost 64 percent of payables and 29 percent of receivables. In August 2015 the government dismissed its top management, laid-off 50 percent of its personnel and mandated that the new management maintain strict control over financial and human resources management.

Figure 9. Arrears of SOEs and Barki Tojik
(% of GDP)



Source: Ministry of Finance, World Bank staff calculations.

Figure 10. State Budget and PPG External Debt
(% of GDP)



Source: Ministry of Finance, World Bank staff calculations.

¹⁴ In a January speech to Parliament, President Emomali Rahmon pledged to increase public sector salaries in September 2015. Government, law enforcement and security sector salaries are slated to rise by 15 percent, education sector salaries and pension payments by 20 percent, wages of social protection workers by 25 percent, and stipends by 30 percent. The minimum monthly wage will rise by 60 percent, from TJS 250 to TJS 400. The Ministry of Finance is considering postponing some of these increases due to the underperformance of revenues.

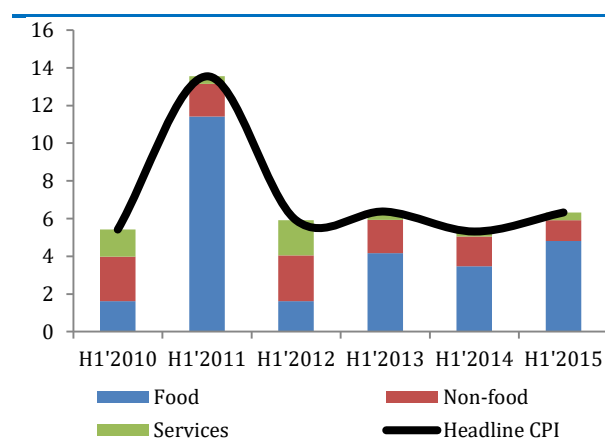
The stock of external public and publicly guaranteed (PPG) debt declined to below 20 percent of GDP. Tajikistan's external PPG debt declined from 21.9 percent of GDP in the middle of 2014 to 19.6 percent in July 2015 (Figure 10) due to exchange-rate effects (US\$58.4 million) and principal repayments (US\$55.1 million). The Chinese Export-Import Bank is Tajikistan's largest creditor, and its loans represented about 46 percent of total external public debt in the reporting period. Other major creditors include the World Bank (15.1 percent) and the Asian Development Bank (12.7 percent). Despite low external debt levels and a declining risk of debt distress,¹⁵ the government is continuing to pursue concessional loans exclusively due to its limited fiscal buffers, rising debt-service obligations and low foreign reserves.

Monetary Policy and Financial Sector Developments

Rising food and service sector prices are causing inflation to accelerate. Average consumer price index (CPI) inflation reached 6.3 percent in the first half of 2015, up from 5.3 percent a year earlier (Figure 11). As food constitutes about two-thirds of the CPI basket, and over 70 percent of all food is imported, the pass-through effect of the depreciation pushed the food prices up 8.3 percent (y/y) in the first half of 2015. However, the potential impact of the somoni's depreciation was attenuated by falling demand and rising domestic food production. During the same period the cost of services rose by 3.4 percent, compared to 2.2 percent a year earlier, due to a 25 percent increase in water tariffs in Dushanbe, as well as higher energy tariffs nationwide.

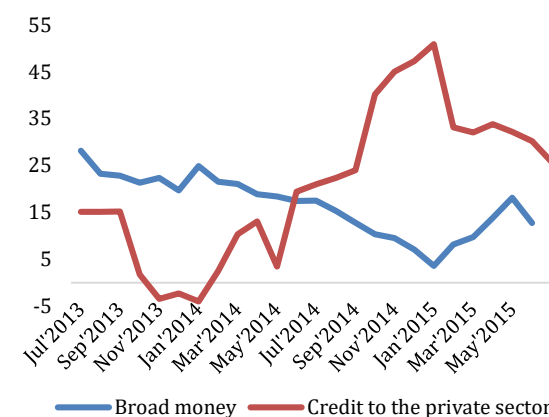
The NBT implemented an accommodative monetary policy during the first six months of 2015. Broad money and credit to the private sector grew by 12.7 percent and 25.7 percent y/y through June 2015 (Figure 12). The refinancing rate was increased in December 2014 and has since remained unchanged (Figure 13). However, because the NBT's share of funding at the refinancing rate in the banking sector is low, monetary policy has only a limited effect on inflation. There is a considerable gap between the refinancing rate and the interbank loan rate, and the latter stood at 20.3 percent in June 2015.

Figure 11. Sources of Inflation
(Percent)



Source: NBT, World Bank staff calculations.

Figure 12. Broad Money And Private Credit Growth
(% change)

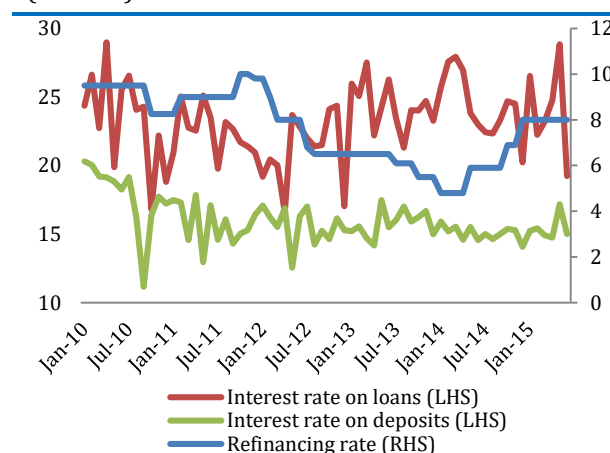


Source: NBT, World Bank staff calculations.

¹⁵ A 2015 Debt Sustainability Analysis (DSA) assessed Tajikistan's risk of debt distress as low, an improvement over the rating of moderate recorded in the 2013 DSA.

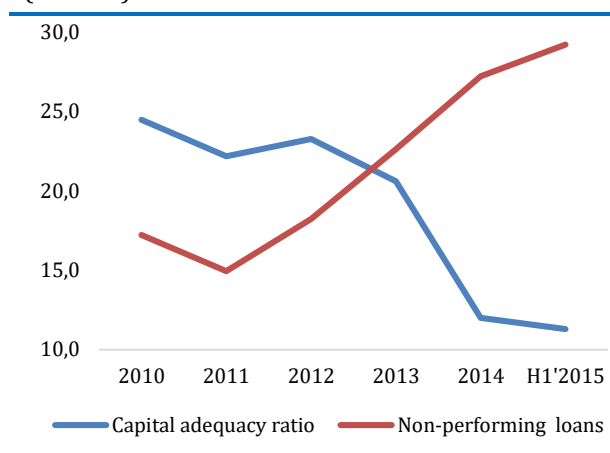
Faced with a deteriorating macroeconomic environment the NBT loosened monetary policy to support output growth in the real sector. Reserve requirements for credit institutions observing prudential norms were reduced by 50 basis points in somoni and by 100 basis points in foreign currency to 1.5 percent and 7 percent, respectively. Meanwhile, interest rates for NBT liquidity-support were reduced by 117 basis points to 17.5 percent. These changes took effect on October 1st, 2015.

Figure 13. Interest Rates
(Percent)



Source: NBT, World Bank staff calculations.

Figure 14. Key Financial Soundness Indicators
(Percent)



Source: NBT, World Bank staff calculations.

Banking sector indicators reveal a continuing deterioration in asset quality. The reported share of nonperforming loans (NPLs) rose from 27.2 percent in December 2014 to 29.2 in June 2015 (Figure 14). However, the real level of NPLs may be significantly higher due to the misclassification of certain loans. The reported aggregate capital adequacy ratio for the banking system fell from 14.8 percent in December 2014 to 14.3 percent in June 2015, and banks are becoming more sensitive to credit risks, including indirect risks from foreign-currency lending and market (exchange) risk. Many banks also face liquidity pressures due to maturity mismatches, and some have become increasingly dependent on the NBT for liquidity support. The financial system remains vulnerable to shocks, and measures to support banks in distress are urgently needed.

Despite recent reforms targeting supervisory mechanisms and the enforcement of prudential regulations, the banking sector continues to suffer from serious structural weaknesses. The deterioration of asset quality reflects inadequate risk-management systems, poor regulatory enforcement, an underdeveloped NBT supervisory framework, and deficiencies in financial infrastructure that persist despite the rapid growth of credit-reporting and secured-transaction systems. However, directed lending has declined significantly in recent years, as banking regulators now closely monitor lenders and penalize misallocations of credit resources. The government has taken steps to mitigate risks in problem banks, including through state purchases of bad loans, the reorganization of senior management and attempts to collect on NPLs.

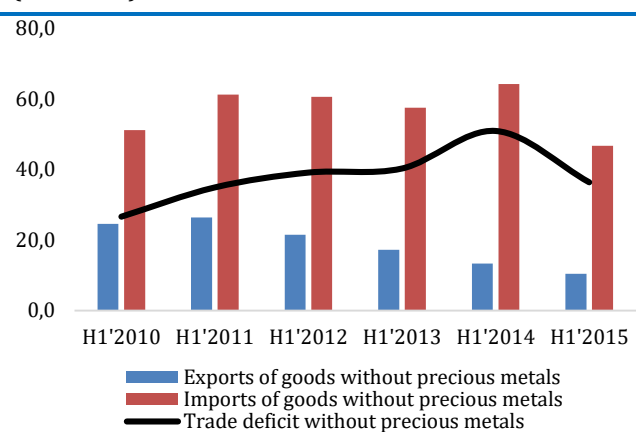
Financial intermediation in Tajikistan remains limited, and it plays only a marginal role in supporting economic growth. Tajikistan's credit and deposit indicators are low by regional standards. Deposits amounted to just 16.5 percent of GDP in June 2015, up from 14.2 percent at end-2014. Credit to the private sector increased from 20.2 percent of GDP in 2014 to 23.2 percent in June 2015, though this reflects a potentially problematic trend of aggressive credit growth (32.6 percent in 2014 and 26.5 percent in June 2015) in a financial sector marked by weak governance and a high

NPL ratio. In the latest *Doing Business in 2016* report Tajikistan ranked 109th out of 189 countries in terms of access to credit.¹⁶ Expanding credit access, particularly for small and medium enterprises, will require the government to enhance enforcement of regulatory norms, strengthen its credit culture, further develop its financial infrastructure and improve risk management.

The Balance of Payments

The trade deficit narrowed during the first half of 2015. Merchandise exports declined by 8 percent (y/y), whereas imports shrank by 25 percent (y/y). Excluding precious and semiprecious metals¹⁷ the trade gap narrowed to 36.3 percent of GDP in the first half of 2015 from 51 percent in the first half of 2014 (Figure 15). Weakening external and domestic demand caused trade turnover to fall by 31 percent, including a particularly sharp contraction in trade with CIS countries. The preliminary balance of payments data suggest that the current account deficit narrowed in the first half of 2015 as the drop in remittance inflows was offset by an improved trade balance.

Figure 15. Exports, Imports and the Trade Deficit
(% of GDP)



Source: TajStat, World Bank staff calculations.

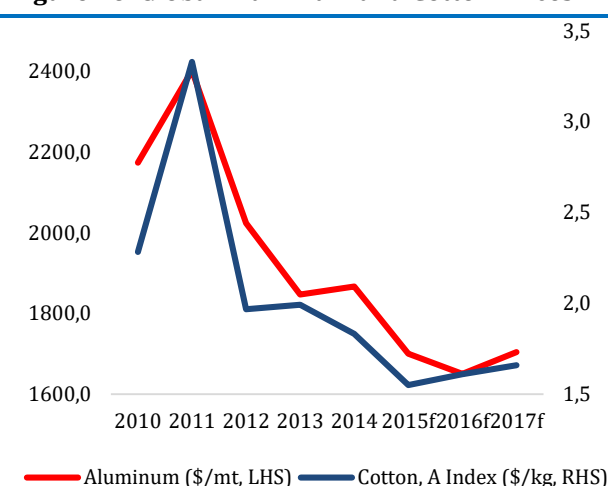
Lower prices for major export commodities caused total exports to decline. In the first half of 2015 merchandise exports amounted to 10.4 percent of GDP, down from 13.3 percent in the first half of 2014. Primary commodities and simple manufactures led the export sector, including precious and semi-precious stones, cotton and textiles, and mineral products. Electricity exports rose by 9.4 percent; Afghanistan received 92 percent of Tajikistan's electricity exports, and the Kyrgyz Republic received 8 percent.

The Tajik Aluminum Company (Talco), the country's largest SOE, met its semiannual output target and plans to double production within the next two years.¹⁸ During the first six months of 2015 Tajikistan exported 61,200 tons of aluminum, up 3.6 percent (y/y). Talco is currently planning to produce 190,000 tons of aluminum in 2015, 52 percent more than in 2014. Over the next two years Talco will attempt to expand its annual production capacity to 270,000 tons in anticipation of a moderate increase in global aluminum prices (Figure 16). However, the recent decline in global commodity prices casts doubt on previous projections.

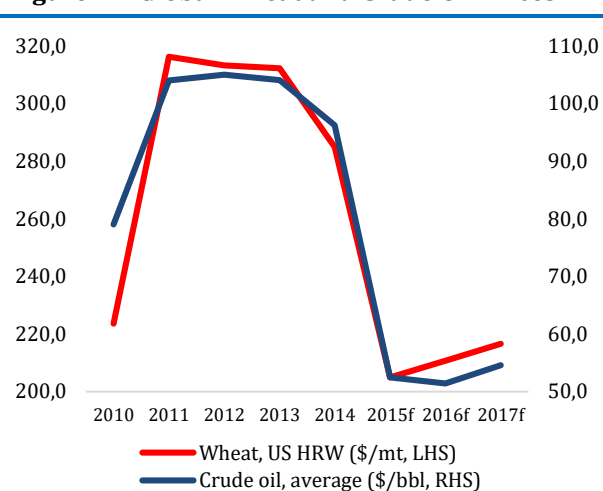
¹⁶ Source: <http://www.doingbusiness.org/rankings>

¹⁷ Most of these exports are part of an NBT program with Switzerland to convert nonmonetary gold into monetary gold, a process known as "affinage." When semiprecious and precious metals are included, the deficit narrows further to 34.7 percent of GDP, down 15.4 percentage points (y/y).

¹⁸ See Talco's official website: <http://talco.com.tj/en>.

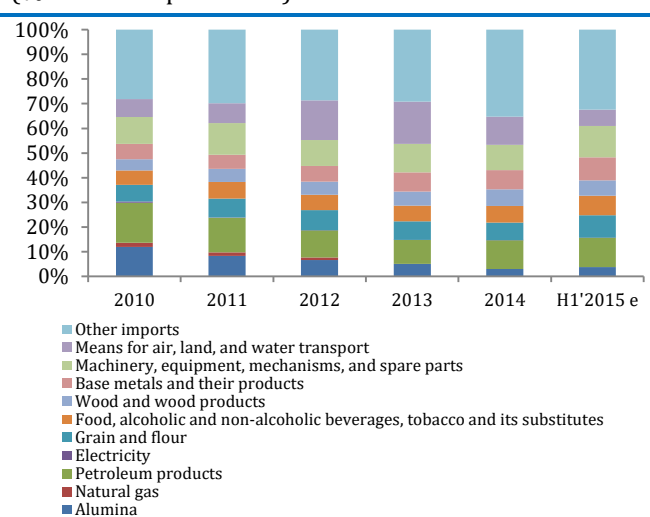
Figure 16. Global Aluminum and Cotton Prices

Source: World Bank Commodity Price Data, October 20, 2015.

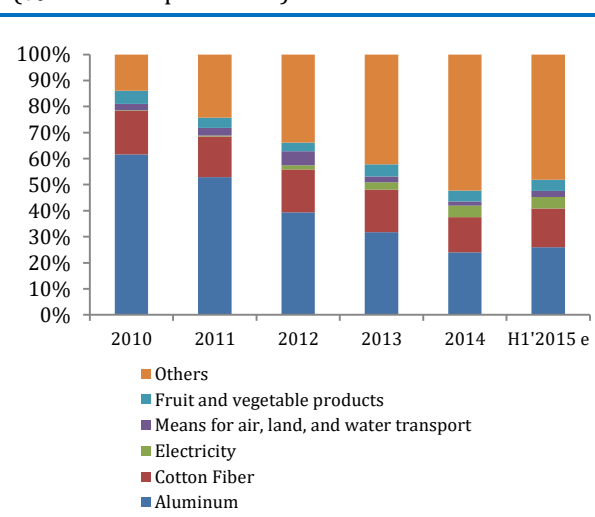
Figure 17. Global Wheat and Crude Oil Prices

Source: World Bank Commodity Price Data, October 20, 2015.

Softening domestic demand caused imports to decline during the first six months of 2015. Merchandise imports contracted from 64.2 percent of GDP to 46.7 percent of GDP (y/y), driven by a drop in fuel and food imports, as low international prices did not pass through to the domestic market. Although both wheat and oil prices fell dramatically in recent years (Figure 17), domestic monopolies prevented any significant price reduction for those commodities. Nevertheless, the depreciation of the exchange rate prompted consumers to shift from imports to domestic substitutes, especially domestic foodstuffs. Falling household consumption also reduced demand for imported cars and other consumer goods. During the first half of 2015 Tajikistan imported only 6,700 vehicles valued at almost US\$48 million. This represents a decline of 15,100 cars, or 60 percent in dollar terms, compared to the first six months of 2014. The overall composition of imports by sectors remains broadly similar to previous years, with the exception of vehicle imports (Figure 18).

Figure 18. Composition of Imports
(% of total import value)

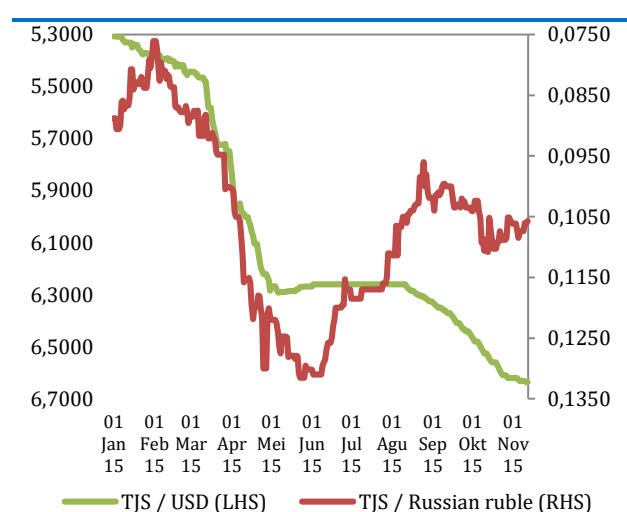
Source: TajStat, World Bank staff calculations.

Figure 19. Composition of Exports
(% of total export value)

Source: TajStat, World Bank staff calculations.

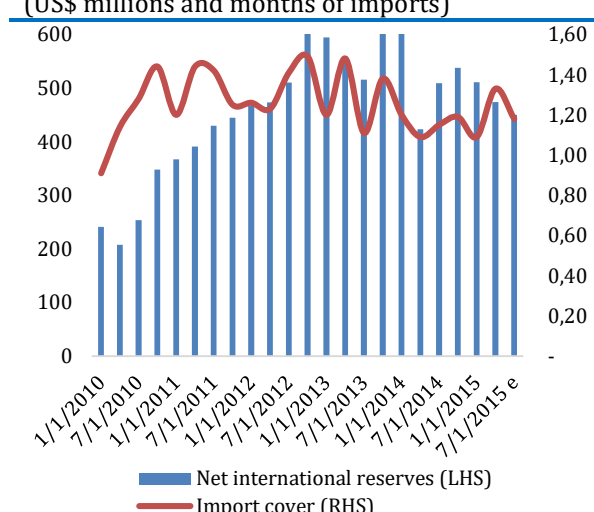
After depreciating by 11.1 percent in 2014 the somoni lost 25 percent of its value against the US dollar during the first ten months of 2015 (Figure 20). Concerned about rising inflation, the NBT initially defended the somoni through a combination of interventions and administrative controls. However, this policy depleted the country's already modest reserves, which stood at about one month of import coverage in early July (Figure 21). After about two and a half months of relative stability, and as the currencies of Tajikistan's major trading partners continued to depreciate against the US dollar, the NBT allowed the somoni to adjust gradually beginning in late August. The NBT recently ceased its interventions, allowing for a gradual unification of exchange rates at different market segments. The NBT has also stepped up efforts to rebuild its reserves and improve their management. In September the NBT signed a currency-swap agreement with the People's Bank of China for the equivalent of US\$500 million in renminbi.

Figure 20. Official Nominal Exchange Rates



Source: NBT, World Bank staff calculations.

Figure 21. Net International Reserves
(US\$ millions and months of imports)



Source: NBT, World Bank staff calculations.

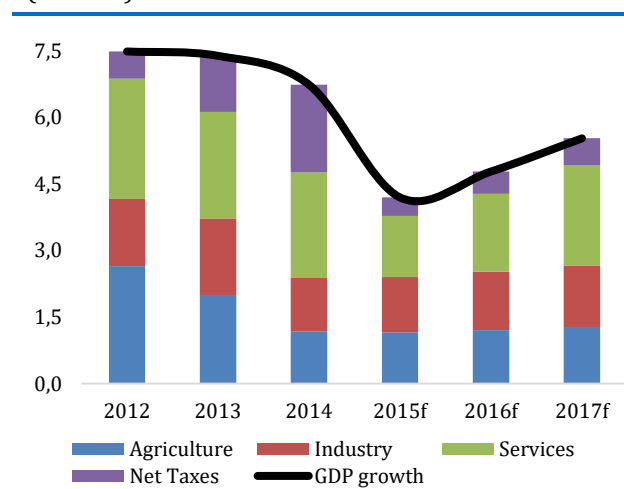
C. Outlook

The recession in Russia, combined with slowing growth among Tajikistan's other major trading partners, is negatively affecting its short-term outlook. The GDP growth rate is projected to fall from 6.7 percent in 2014 to 4.2 percent in 2015 (Figure 22).¹⁹ An estimated 30 percent drop in remittances, in dollar terms, is impacting growth in the services sector, which accounts for over 40 percent of the economy. Meanwhile, slowing growth among Tajikistan's major trading partners, including China, Kazakhstan and Turkey, will continue to depress demand for the country's key export commodities, especially cotton and aluminum. The depreciation of the somoni may mitigate this effect by boosting exports, encouraging the substitution of domestic production for imports and increasing the somoni value of remittances. Yet the current-account deficit is projected to improve only moderately, narrowing from about 8 percent of GDP in 2014 to 6.3 percent in 2015. The depreciation will push up inflation, though low international food and fuel prices may hold the

¹⁹ This growth forecast has improved since the previous update, which projected 3.2 percent growth in 2015, due to changes in some key underlying assumptions, including a less severe contraction forecast for Russia (-2.7 percent compared to -3.8 percent) and more moderate decline in the dollar value of remittances (30 percent compared to 40 percent). It also takes into account the latest statistical data from government agencies.

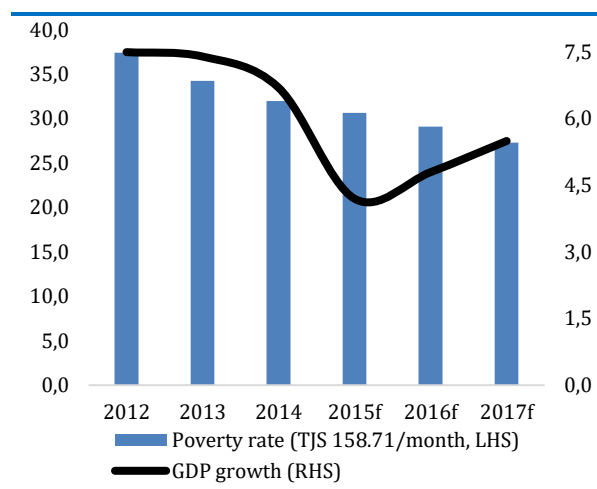
average inflation rate to single digits in 2015. The government is committed to keeping the fiscal deficit below 0.5 percent of GDP over the medium term, which will require restraining and rationalizing expenditures while protecting social programs.

Figure 22. GDP Growth and Contribution to GDP Growth by Sector (Percent)



Source: TajStat, World Bank staff calculations.

Figure 23. GDP Growth and Poverty Rates (Percent)



Source: TajStat, World Bank staff calculations.

GDP growth is projected to recover gradually over the medium term, but this forecast is subject to significant downside risks. Investment will drive growth, and is projected to rise to 16 percent of GDP by 2017. Despite a modest projected recovery in exports and remittances the current-account deficit is expected to remain at about 6 percent of GDP over the medium term, due largely to rising capital-goods imports related to investment projects. The fiscal accounts (excluding externally financed public investment programs) are expected to remain roughly balanced over the near term. However, external-account volatility, dwindling foreign-exchange reserves, contingent liabilities generated by state-owned enterprises and systemic vulnerabilities in the banking sector all pose significant downside risks to the macroeconomic outlook.

Slowing GDP growth is expected to limit progress in poverty reduction. The poverty rate is projected to fall to 30.7 percent in 2015 and reach 27.3 percent in 2017 (Figure 23). However, lower remittances, a weaker labor market, and slower increases in real wages are expected to constrain the growth of household purchasing power. The poor are likely to be negatively affected by both the decline in remittances and higher inflation rates, though low international food and fuel prices will help contain CPI inflation. A lack of effectively targeted social programs leaves households vulnerable to economic shocks, underscoring the urgency of implementing the new Targeted Social Assistance Program nationwide. This program is relatively modest in size and scope, yet it could play a pivotal role in mitigating the impact of a worsening external environment on extremely poor households.

As external conditions continue to deteriorate, it will become increasingly difficult to sustain progress in poverty reduction and shared prosperity. In an environment marked by lower commodity prices and slowing growth among Tajikistan's major trading partners, domestic factors such as productivity and competitiveness, human capital formation, the development of a more robust service sector, and the quality of the investment climate will be critical to Tajikistan's medium- and long-term growth prospects. The challenge of fostering continued growth and development despite worsening external conditions will be compounded by the weakening of key foreign labor

markets, particularly in Russia, which will not only depress remittances, but is likely to increase the domestic labor supply by discouraging emigration. In this context, a focus on creating high-quality jobs should serve as a cornerstone of the country's development strategy.

D. Special Focus Section: Growth and Jobs in Tajikistan²⁰

Tajikistan's economy grew at a robust average of 7.9 percent per year during the 2000-2014 period. Growth was supported by rising export revenues and strong remittance inflows as both the global and regional economies expanded rapidly from 2000 to 2009. However, exports of aluminum and cotton declined rapidly in the wake of the global financial crisis, and Tajikistan's economy became increasingly dependent on remittances, which peaked to over 50 percent of GDP in 2013.

High growth rates produced remarkable achievements in poverty reduction. Over the past 10 years Tajikistan has ranked among the top 10 performers in the world in terms of poverty reduction.²¹ The country's poverty headcount ratio (at the national poverty line) fell from 96 percent in 1999 to an estimated 32 percent in 2014.²² Although Tajikistan became a lower-middle-income country in 2014, with a gross national income per capita²³ of US\$1,080, it remains the poorest country in the ECA region. Moreover, less progress has been observed in nonmonetary poverty indicators, especially access to education, utilities and other service.²⁴

Rapid economic growth has not translated into robust job creation. Years of strong economic and income growth did not produce significant improvements in the availability and quality of jobs in Tajikistan, further incentivizing emigration.²⁵ Due in part to limited employment opportunities in the domestic labor market, about 1 million Tajikistani citizens have left the country in search of better jobs. While the official unemployment rate remains low, a large share of the workforce, including one-third of men aged 20-39, has opted to leave the country, with most bound for the Russian Federation.²⁶ Over the past year, however, a deepening recession in Russia and the imposition of more stringent migration policies by the Russian authorities have encouraged the return of Tajikistani migrants, intensifying pressure on the domestic labor market.

Tajikistan's dependence on remittances and limited economic diversification have left it highly vulnerable to external shocks. Despite important gains in income growth and poverty reduction, the country's current economic model presents several important challenges to its long term-development. This Special Focus Section analyzes the key role of employment creation in sustaining the country's recent progress in poverty reduction and supporting the development of a more resilient growth model capable of thriving in a less favorable external environment.

²⁰ Victoria Strokova is the primary author of this section, with contributions provided by Angela Elzir and David de Padua and guidance from Dino Merotto and Marina Bakanova. The analysis presented here is based on research conducted for the forthcoming World Bank Jobs Diagnostic and Jobs Strategy for Tajikistan.

²¹ Azevedo, Joao Pedro, Aziz Atamanov, and Alisher Rajabov. 2014. "Poverty Reduction and Shared Prosperity in Tajikistan: A Diagnostic," World Bank Working Paper Series. WPS6923.

²² Due to the change in poverty measurement methodology the 2009 and 2014 data are not fully comparable. See, World Bank 2014. "Tajikistan Economic Report" No.6, Fall.

²³ World Bank Atlas Method.

²⁴ *Ibid.*

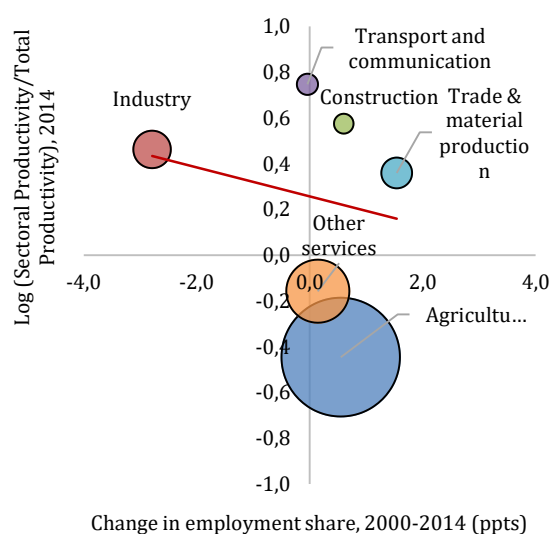
²⁵ While increases in both labor earnings and remittances drove poverty reduction between 2003 and 2009, the creation of new employment opportunities contributed marginally to poverty reduction See Azevedo, Atamanov and Rajabov (2014).

²⁶ See: World Bank 2014. "The Skills Road: Skills for Employability in Tajikistan," and World Bank (2015) "Tajikistan Economic Update" No.1. Spring.

Tajikistan's population is relatively young, with a median age of about 25, and the domestic labor market is ill equipped to absorb the influx of new workers. While the working-age population grew by almost 3.2 percent per year between 2000 and 2014, domestic employment grew by just 2.1 percent. During this period annual real GDP growth averaged 7.5 percent, implying an average employment-to-growth elasticity of around 0.28. This is slightly lower than the average for both developing countries in ECA (0.30) and lower-middle-income countries worldwide (0.32).²⁷ Moreover, this elasticity decreased significantly following the global financial crisis, from 0.33 in 2000-2009 to just 0.13 in 2010-14, further slowing the already inadequate pace of job creation.

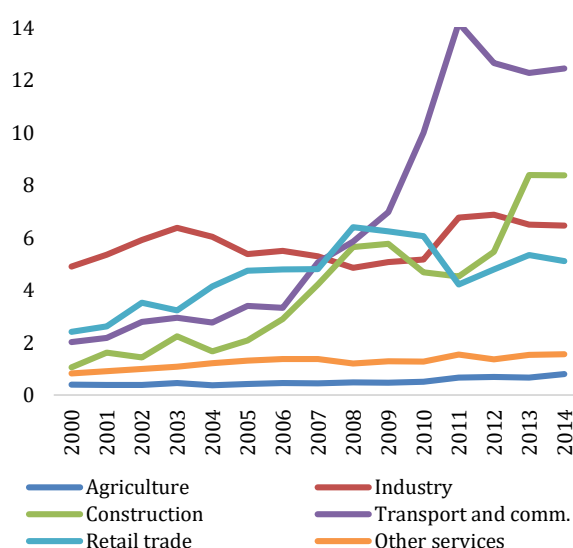
Tajikistan's structural transformation has been gradual and incomplete, and the majority of workers remain employed in agriculture. The agricultural sector employs about two-thirds of the workforce, and this share has remained virtually unchanged since 2000 (Figure 24). Agriculture also continues to exhibit the lowest labor productivity of any sector (Figure 25). During the same period the share of workers employed in the more productive industrial sector decreased from 7 to 4 percent. The only subsectors that saw both increased employment and rising labor productivity were trade, construction, transportation and communications, all of which began at very low levels.

Figure 24. Structural Change, 2000-14



Source: TajStat and World Bank staff calculations.
Note: The size of the bubble represents employment share by sector in 2000.

Figure 25. Labor Productivity by Sector
(Value added per worker, thousands of real TJS)



Source: TajStat and World Bank staff calculations.

Real wage growth in the formal sector outpaced increases in labor productivity, eroding competitiveness and hindering job creation. Labor productivity grew by about 5 percent annually between 2000 and 2014, substantially slower than in many comparable countries.²⁸ Real wages in the formal sector rose by 326 percent between 2005 and 2014, while labor productivity increased by only 61 percent.²⁹ Rising labor earnings play an important role in poverty reduction, but further

²⁷ Authors' calculations using the WDI data. Regional averages are for 2000-2013, as 2014 data are not yet available.

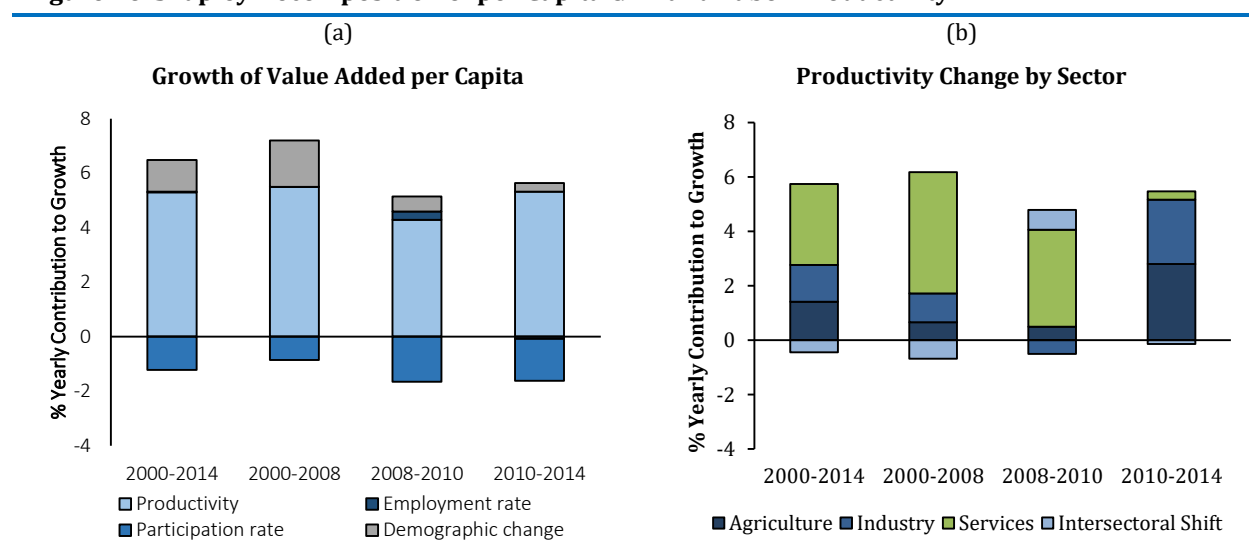
²⁸ World Bank 2014. "The Skills Road: Skills for Employability in Tajikistan." World Bank, Washington, DC.

²⁹ Tajikistan Country Partnership Strategy FY 15-18 p. 7, World Bank.

increases in wages without commensurate improvements in underlying labor productivity could undermine competitiveness and inhibit job creation.

Services drove the growth of labor productivity, supported by more modest recent contributions from agriculture and industry. Increases in labor productivity underpinned the growth of GDP per capita in 2000-14, and rising value added per worker in the service sector represented more than half of aggregate labor productivity growth (Figure 26), with transportation and communications playing the most important role. However, industry and agriculture have increased their share dramatically since 2010, with services contributing less than 10 percent to total labor productivity growth since the crisis. Inter-sectoral labor mobility is low in Tajikistan, and the reallocation of labor has made a slight negative contribution to the growth of value added per worker.³⁰ These trends highlight the extent to which the country's current model of remittances-driven, service-sector-led growth has ceased to provide a sound basis for its continued economic development.

Figure 26. Shapley Decomposition of per Capita GDP and Labor Productivity



Source: TajStat, MoEDT and World Bank staff calculations using the *JobStructure* tool.

Low rates of job creation are the result of multiple interrelated factors, but an analysis of the labor market reveals three overarching causes.³¹ The first is weak macroeconomic management, which undermines the economic stability necessary to attract private investment. The second is an inhospitable business environment marked by weak governance, erratic tax administration and limited access to quality infrastructure, especially energy and information technology, which inhibits diversification and erodes competitiveness. The third is a shortage of workforce skills, low geographic and inter-sectoral labor mobility, and information asymmetries in the labor market. These factors conspire to constrain employment and income growth and inhibit improvements in labor productivity.

In order to sustain progress on poverty reduction and shared prosperity in a worsening external environment Tajikistan's development strategy should prioritize accelerated job

³⁰ The only exception to this trend was during the global financial crisis in 2008-2010.

³¹ World Bank 2010. "Inclusive Growth Analysis for a Remittance-Dependent Country: The Case of Tajikistan". World Bank, Washington, D.C.

creation. While remittances have had a highly positive impact on poverty, excessive dependence on foreign labor markets is unsustainable and leaves Tajikistan vulnerable to external shocks. Enabling private sector development through an improved business environment and the continued implementation of the structural reform agenda will be critical to robust employment growth. While an enabling environment for private investment will be vital to the creation of high-quality jobs, a comprehensive strategy will be necessary to address specific obstacles to private-sector-led growth.

A comprehensive employment-creation strategy should be rooted in three core objectives: (i) supporting job growth in the private sector, (ii) building the workforce skills demanded by employers, and (iii) facilitating accessibility to jobs among vulnerable people and communities. These objectives reflect the unique challenges faced by Tajikistan over both the short and medium term. The first is based on the axiom that sustainable job creation requires an efficient and competitive private sector. Policy actions designed to advance these objectives would include macroeconomic and structural reforms, as well as improvements in the business climate that would enable firms to invest, expand, and hire workers.

Employment growth in Tajikistan is constrained by both demand- and supply-side factors. Therefore the second objective focuses on developing the workforce skills required by an increasingly sophisticated and dynamic labor market. Policy actions in this area range from reforms in primary and secondary education to the provision of specialized vocational training tailored to the needs of employers.

Finally, promoting a healthy and inclusive labor market will require resolving information asymmetries and encouraging labor mobility. Measures to expand the availability of information on labor demand and ease the mobility of workers across regions and sectors would leverage the impact of improvements in human capital. In addition, strengthening social safety nets would help to minimize the risks faced by workers as they attempt to transition to new regions and industries, increasing the flexibility of the labor force and enabling employers to attract workers to emerging economic sectors.

Annex 1: Economic and Social Indicators in Tajikistan, 2010–17

(Percent of GDP unless otherwise is stated)

Selected Indicators	2010	2011	2012	2013	2014	2015 ^a	2016 ^a	2017 ^a
<i>Income and Economic Growth</i>								
GDP growth (percent change)	6.5	7.4	7.5	7.4	6.7	4.2	4.8	5.5
GNI per capita, Atlas method (current USD)	730	790	890	1,000	1,080	...	...	...
Gross fixed investment	11.9	14.3	14.1	13.0	12.8	12.8	14.5	16.0
<i>Money and Prices</i>								
Consumer price inflation	6.4	12.5	5.7	5.0	6.2	8.5	7.5	7.0
Average exchange rate (TJS/USD)	4.38	4.61	4.76	4.77	4.94	...	...	...
Real effective exchange rate	92.1	90.9	92.4	95.1	106.4	...	...	...
<i>Fiscal</i>								
Revenue and grants	23.5	25.3	25.5	26.8	28.4	26.3	26.5	27.5
Expenditure and net lending	26.5	27.5	24.9	27.9	28.9	27.7	28.4	29.4
Fiscal balance	-3.0	-2.2	0.6	-1.0	-0.5	-1.4	-1.9	-1.8
Primary fiscal balance	-2.5	-1.7	1.2	-0.1	0.5	0.1	-0.9	-0.8
Total public debt	36.9	36.1	32.9	29.5	22.8	20.0	18.8	18.7
<i>External Accounts</i>								
Export of goods & services	15.9	18.1	22	13.9	11.3	11	11.3	11.9
Import of goods & services	60.5	66.1	70.6	64.2	58.4	48.4	46.9	48.6
Workers' remittances, net	39.8	46.2	44	47.6	42.7	...	....	...
Current account balance	-6.7	-4.8	-2.6	-2.8	-7.9	-6.3	-6.0	-5.9
Foreign direct investment (USD million)	16	65	146	105	198	...	....	...
<i>Population, Employment, and Poverty</i>								
Population (millions)	7.6	7.8	8	8.2	8.4	8.5	8.7	8.8
Population growth (percent change)	2.4	2.5	2.5	2.5	2.4	1.5	1.5	1.5
Unemployment rate (percent of labor force) ^b	2.1	2.4	2.4	2.4	2.5	...	...	...
Poverty rate (Somoni 158.71/month) ^c	...	...	37.4	34.3	32	30.7	29.1	27.3
Life expectancy (years)	67	67.1	67.3	67.4	...	...	...	...

Notes: An ellipsis (...) indicates that data are not available. a - Projections. b - Registered unemployment. c - Calculations are based on 2014 HBS with projections using neutral distribution method (2014).



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