CONTEXT

1. **Tajikistan is the poorest of the CCA countries (Figure 1)—2012 per capita GDP US$943—and is vulnerable to shocks.** The country relies heavily on imports of food (58 percent share in the CPI) and fuel, and inflation tends to fluctuate with international prices for these commodities. The export base is narrow and commodity driven (aluminum and cotton). Tajikistan exhibits an extraordinary dependence on remittances, earned mainly by workers in Russia and equivalent to 48 percent of GDP and more than five times export earnings. The country's remote and landlocked location makes transport costs to global markets high, and transport links are periodically interrupted by Uzbekistan. The expected drawdown of NATO troops from Afghanistan—with which Tajikistan shares a long and porous border and a sizeable ethnic group—adds to uncertainty in coming years. Periodic outbreaks of domestic violence reflect tensions remaining from the civil war of the 1990s. Presidential elections are scheduled for November 2013.

2. **Tajikistan's vulnerability is exacerbated by a poor business climate and weak policy frameworks.** Growth in recent years has been strong, but not inclusive, with job growth held back by state-directed lending and investment that displace opportunities for private investment and help fuel rent seeking.[1] Though the authorities' medium-term fiscal framework is consistent with maintaining public debt below 35 percent of GDP, contingent liabilities arise from quasi-fiscal spending directed through SOEs and banks. Monetary policy traction is weak due to underdeveloped financial markets, and the NBT's policy framework is effectively based on an exchange rate anchor to the U.S. dollar. While the 2011 central bank law is based on best practice, NBT independence is weak in the face of pressure to support quasi-fiscal activities through uneven application of prudential norms and liquidity loans to banks. Tajikistan's anti-money laundering and combating the financing of terrorism (AML/CFT) framework is gradually being strengthened, including through recent measures on customer due diligence, although certain deficiencies remain. Progress on recommendations from the last Article IV remains uneven, especially on structural reforms, (Box 1). The authorities have expressed interest in a successor ECF arrangement. Discussions on a possible Fund-supported program have started and are likely to continue after the November 2013 presidential elections.

[1] While the business environment remains weak, potential improvements lie in the implementation of the new tax code, fewer steps required to start a business (2012 World Bank Doing Business), and rules for investor protection (Tajikistan acceded to the Convention on Recognition and Enforcement of Foreign Arbitral Awards in May 2012).

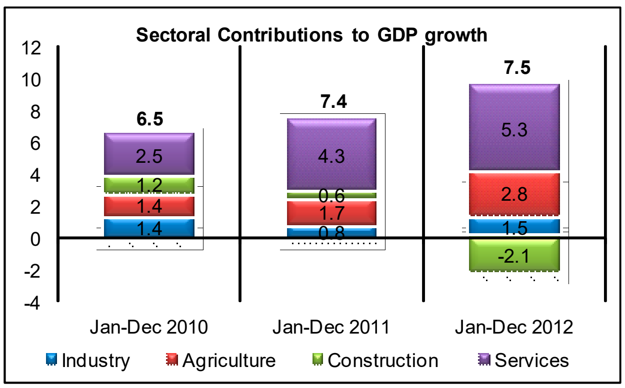
Box 1. Tajikistan: How Much Traction Did Previous IMF Advice Receive?

Staff advice	Policy action
Fiscal Policy	
Pursue fiscal consolidation to ensure medium-term fiscal and debt sustainability while maintaining a careful balance between current and capital expenditures to meet resource constraints and social and developmental objectives.	The fiscal position moved from a deficit of 0.4 percent of GDP (excluding PIP) in 2010 to a surplus of 1.9 percent of GDP in 2012. Social and poverty related expenditure has been increasing, while capital investment remains high.
Facilitate tax revenues by improving tax administration, simplifying the tax regime, expanding the tax base.	A new tax code was introduced on 1/1/13. It simplifies the tax regime and broadens the tax base. IMF TA recommendations on tax administration are largely being implemented.
Continue development of the domestic debt market.	T-bills are auctioned once a month, but yields do not reflect market pricing and there is a single maturity of 91-days.
Operations to procure food and fuel for strategic reserves should be carried out as a fiscal operation rather than through the banking system, and blanket subsidies should be avoided.	The authorities continue to use directed lending for such operations, as evidenced by the large loan AIB was directed to extend to the State Materials Reserve Agency in Q1 2013.
Monetary, exchange rate and financial sector policies	
Monetary policy to focus on containing inflation through a reduction of liquidity lending in line with a path for net domestic assets and reserve money consistent with macroeconomic stability	NBT liquidity lending fell sharply following the government bailout of AIB in April 2012. Monetary policy stance is now consistent with single-digit inflation.
Take a flexible approach to exchange rate management to facilitate external adjustment and protect the limited stock of FX reserves.	Partially met, but further effort is needed to increase flexibility of exchange rate.
Address structural weaknesses in the financial system by ending directed lending, requiring banks to fully provision for the uncollateralized portion of NPLs, and applying a uniform classification of NPLs, together with tighter standards on reclassification.	Directed lending continues. Provisioning requirements have been tightened, and uniform classification now applies. Provisioning for NPLs continues to fall short of NBT regulations.
Structural Reforms	
Create a self-sustaining mechanism for agricultural financing to prevent future recourse to the NBT or directed lending by the banking system to meet agricultural financing needs.	While agricultural reforms have progressed, a sustainable model of agricultural financing has not emerged and directed lending is still targeted at the sector.
Enhance Tajikistan's AML/CFT framework, notably by implementing the recommendations made during the Eurasian group 2008 mutual evaluation	Tajikistan is making timely progress on the action plan agreed with FATF to address these recommendations, although certain deficiencies remain.
Enhance social safety nets through better targeting of social assistance.	Slow progress is being made, including through pilot projects with EU and World Bank assistance in districts outside of Dushanbe.

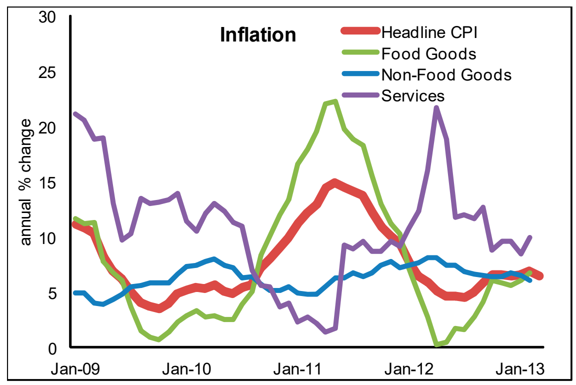
RECENT DEVELOPMENTS AND SHORT-TERM OUTLOOK

3. **GDP growth remains robust and headline inflation has declined.** Supported by strong services (fueled by growing remittance inflows), agriculture, and industry, real GDP grew 7.5 percent in 2012. While holding almost steady at 7.3 percent through the first quarter of 2013, growth is projected to ease to under 7 percent by year-end due to slowing growth in Russia and anticipated declines in aluminum production and exports. Headline inflation moved with international food prices and declined from 9.3 percent at end 2011 to 6.4 percent by end 2012.[2] Annual CPI inflation in the first quarter of 2013 held steady at 6.5 percent. Inflation pressures should remain low in light of projected food and fuel prices and the stances of macro policies.

Growth driven by remittances and services



Inflation driven by international prices



4. **The external current account (CA) deficit shrank from 4.7 percent of GDP in 2011 to 1.3 percent of GDP in 2012.** Slower import growth—partially underpinned by a temporary slowdown in external loan disbursements for the public investment program (PIP)—and rapid growth of gross remittances (26.8 percent) helped to put the CA deficit on a downward path.[3] As a consequence of slower external loan disbursements and large amortization payments to China, total public and publicly guaranteed external debt fell to 28.3 percent of GDP at end 2012 from 32.1 percent of GDP a year earlier. The somoni has been relatively stable vis-à-vis the U.S. dollar and gross international reserves settled at just 1.6 months of imports at end 2012. Despite appreciating somewhat in recent months, the REER remains broadly in line with medium-term fundamentals and historical averages (Annex I).

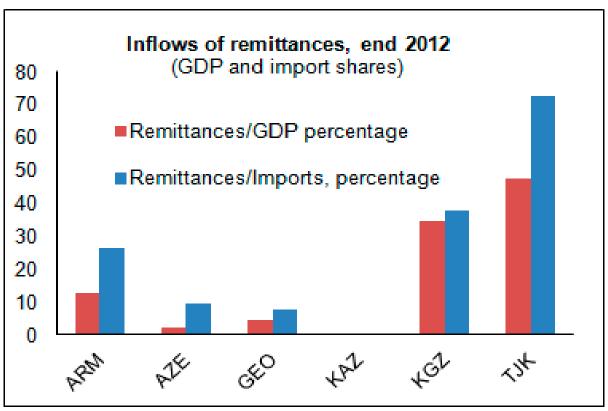
[2] Tariff increases for transportation (rail and air) and communication contributed to core inflation (CPI excluding food and energy) of 7.1 percent through end 2012.

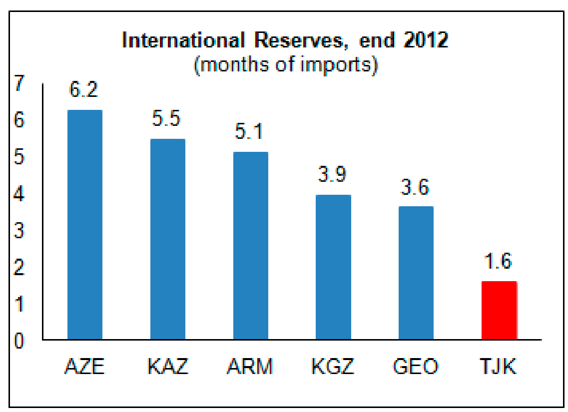
[3] The authorities revised upward import estimates for 2011. More generally, the NBT changed the methodology for compiling various BOP accounts, causing a break in the series. There are measurement issues in the computation of remittances at the NBT, and the current value may be overstating remittance flows to Tajikistan.

5. Fiscal policy over-performed the 2012 budget target. Data for 2012 indicate that the fiscal position moved to a surplus of 1.9 percent of GDP (excluding the PIP; compared to earlier staff estimates of a deficit of 0.2 percent of GDP and a budgeted deficit of 0.5 percent of GDP). Fiscal saving (excluding PIP grants and expenditures) in 2012 was driven both by stronger tax and non-tax revenues and lower domestically financed capital expenditure, the latter in large part due to an agreed and appropriate temporary halt in Roghun construction while feasibility studies for that project are completed. Budgeted social spending (which incorporated double-digit minimum wage and pension increases that took effect in September) was fully implemented. The fiscal outcome was consistent with the anchor of bringing, and maintaining, public debt below 35 percent of GDP. Total public and publicly-guaranteed debt stood at just over 32 percent of GDP at end 2012.

6. The fiscal deficit (excluding externally-financed PIP) is projected to loosen in 2013 relative to the 2012 outcome. The projected loosening of 2 percent of GDP is consistent with the adopted 2013 budget and it accounts for possible challenges in implementing the new tax code (effective from January 1, 2013), the potential for higher election-related expenditures, and the full-year effect of 2012 social sector wage increases. The projected deficit remains consistent with medium-term debt sustainability. In practice, the fiscal outcome in 2013 may be less expansionary than projected due to conservative budgeting practices (e.g. the authorities often slightly inflate the wage bill and are conservative on revenue estimates).[4]

Remittances help with shock absorption | *But reserve cover is lowest in the region*





7. Reserve and broad money growth in 2012 were slower than expected (Table 1). As headline inflation declined, the NBT lowered its refinance rate—which serves as a floor for bank lending rates—and reduced reserve requirements. Reserve money growth was contained in 2012 through over performance of the budget, large end-year sterilization, and the decline in liquidity

[4] Though the 2013 budget and subsequent projections anticipated challenges in implementing the new tax code, preliminary results for Q1 2013 point to tax revenue over-performance of around 2 percent vis-à-vis budget projections.

lending.[5] Broad money growth was suppressed due in part to the transfer of large Roghun HPP deposits from commercial banks to the NBT. After accounting for the write-off of bad loans at Agroinvestbank (AIB) in 2012, credit to the private sector grew by about 9 percent.

8. **The banking system continues to show signs of weakness, and vulnerability of the system is high and escalating**. Profitability of the system in 2012 remained low by regional standards while non-performing loans keep rising (Annex III). Lending-deposit spreads are high, reflecting the poor business environment and elevated credit risk. Though system-wide capital adequacy is high (23.3 percent), stress tests indicate that this masks vulnerabilities in large banks. A vivid recent example was the 2012 government bailout of AIB, the largest bank by assets, through the Ministry of Finance (MOF) purchase of bad loans for SM 500 million at virtually no discount and injection of SM 200 million as capital. This operation came at a total fiscal cost of 2 percent of GDP and gave the government a 52 percent stake in AIB, while leaving existing private shareholders with the remaining equity in the bank and effective control of the bank's management. In early 2013, an unsecured government-directed loan to the State Materials Reserve Agency in the amount of SM 150 million added further strain to AIB by breaching the maximum single borrower exposure limit (74 percent of regulatory capital against an allowed maximum of 20 percent) and by further eroding AIB's liquidity position. Central bank independence, a level playing field for investors, and the credit culture were further compromised by this action.

MEDIUM-TERM OUTLOOK AND RISKS

9. **Tajikistan's medium-term outlook is generally favorable, provided prudent macroeconomic policies continue to be implemented.** The macroeconomic scenario is characterized by robust—yet moderating—growth, single-digit inflation, and a slight deterioration in the current account. Adverse projected global conditions are expected to weigh on growth in the near term, while growth eases further over the medium term due to the assumed slow pace of structural reforms. The outlook incorporates gradual fiscal consolidation consistent with debt sustainability, a moderate pace of construction of the Roghun HPP (to be reassessed following completion of the Roghun feasibility studies by the World Bank), and little improvement in electricity supply. Though fixed capital investment is projected to firm in the outer years—in part due to the pick-up in donor-financing for government investments—growth dividends are also muted by moderating remittance growth and slowing private consumption and investment, again in view of modest expected structural reforms. Expectation of benign global conditions for food and fuel prices, planned fiscal consolidation, and maintenance of an appropriate monetary policy stance should contain inflation. The external current account path is driven by the slower growth in remittances—tied to likely downside spillovers into Russia—and import growth consistent with the assumed pace of Roghun construction.

[5] The volume of emergency liquidity lending by the NBT slowed following the rescue of AIB (which had depended on this facility).

10. Tajikistan's risk of debt distress improves to moderate with remittances included in the updated LIC DSA. However, risks remain to the debt position. Fiscal costs arising from directed lending—such as in the case of AIB in 2012—and unreformed SOEs periodically increase public debt. Moreover, debt sustainability depends critically on a steady flow of remittances, with a standard shock to remittances assessed to lead to the breach of debt thresholds (Debt Sustainability Analysis, Figure 1 and Table I, 1a and 1b).

11. The outlook is subject to many risks (Box 2). Unfavorable shifts in import (food and fuel) and export (cotton and aluminum) prices would adversely affect inflation, the current account and international reserves. Sustained weak growth in Russia would put further pressure on the external position and reduce domestic growth through the remittance channel. Failure to resolve properly weak financial institutions and establish financial accountability—including by stopping directed lending—will limit financial market development, weaken fiscal sustainability, and further dent business confidence, investment, job creation and private-sector led growth. Developments surrounding NATO troop withdrawal from Afghanistan and periodic blockades of regional transport links also increase uncertainty. Upside risks come from a greater growth dividend if the pace of structural reforms picks up, stronger-than-expected remittance growth, and emerging substantial hydrocarbon discoveries.

12. Authorities' views. The authorities (NBT and the MOF) broadly shared the staff's views on the medium-term outlook and risks. They concurred with staff on the adverse impact of unfavorable shifts in commodity prices and of uncertainty generated by NATO troop withdrawal from Afghanistan and transport blockades from Uzbekistan. They remained ambivalent to lower growth prospects in Russia putting downward pressure on reserves and remittance inflows and did not see the urgent need to resolve weak banks or shift to market-based financing and stop directed lending.

Box 2. Tajikistan: Risk Assessment Matrix

		Likelihood	Up/down side	Impact/Policy response
Short-term risks	**Risks to the economic outlook**			
	Financial stress in Euro Area re-emerges (triggered by stalled or incomplete delivery of national and Euro area policy commitments and Emerging Markets capital flow reversal (associated with a strong unwinding of asset price overvaluation in some countries)	M *	↓	**Impact**: High. Direct financial linkages to Europe are small. Contagion is likely to occur from developments in Russia. It is the major source of remittance income for the population, and helps to finance imports and growth. Import compression and limited fiscal space will slow growth. A large financing gap (close to 3 percent of GDP) with little reserve buffer (1/2 month of import cover) is likely to appear (per shock estimated in VE-LIC). **Policy response:** Allow more flexibility in the exchange rate to stabilize foreign reserves; more external financing may be needed to cover financing gap. Increase social spending targeted at vulnerable groups.
	Deeper than expected slowdown in EMs (reflecting lower than anticipated potential growth), leading to severe slowdown of remittance growth	M *	↓	**Impact**: High. Remittances are the major source of income for many in the population. They are also closely correlated to imports (in part an automatic stabilizer), stimulate construction and services, and are an important source of foreign exchange reserves. Channels of transmission are same as above (taken from VE-LIC scenario). **Policy response.** Same as above.
	Escalation of domestic social and political tensions	M	↓	**Impact:** High. Social or regional unrest could severely alter the fragile political consensus on which the regime depends. **Policy response:** Use fiscal policy supportively and re-orient public expenditure to respond to the most pressing social needs.
	Global oil shock triggered by geopolitical events (driving oil prices to $140 per barrel);	L *	↓	**Impact**: Medium. Tajikistan's current account depends to a large extent on world market prices, particularly import bills for food and fuel. **Policy response:** Allow for internal price adjustment and focus on second round effects on inflation. Increase social spending to the vulnerable and use exchange rate flexibility as needed to help protect reserves.
	Risks to the financial sector			
	Insolvency of commercial banks, including because of problems arising from directed lending.	H	↓	**Impact**: High. Would result in much larger bank recapitalization needs and increased public debt, and would undermine the banking sector's contribution to growth. **Policy response:** Halt directed lending. Accelerate bank restructuring while minimizing fiscal costs, thereby helping to address moral hazard and strengthen the repayment culture. Fully enforce prudential norms, and relevant AML measures.
Medium-term risks	Instability in Afghanistan	M	↓	**Impact:** High. Due to ethnic ties to a large part of the population in Afghanistan, this could lead to an increase of refugees, increase the influence of potentially radical political factions, and further lower investors' confidence. **Policy response:** More external financing would be needed to weather adverse effects on Tajikistan.
	Escalation of dispute with Uzbekistan over the construction of Roghun HPP	M	↓	**Impact:** High. Trade disruptions for landlocked Tajikistan could become more severe and inflation could rise from higher transport costs. **Policy response:** Further diversify trading partners; improve other transport links to reduce reliance on roads and railways through Uzbekistan.

Source: IMF staff.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff).

The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The RAM reflects staff views on the source

*/ Taken from GRAM May 2013.

POLICY DISCUSSIONS

13. Against this backdrop, the policy discussions focused on (i) reducing Tajikistan's vulnerabilities to external shocks; (ii) making growth more inclusive and private-sector led, including by bolstering private investment and deepening financial intermediation, and (iii) addressing fiscal vulnerabilities and strengthening public sector governance.

A. Strengthening External Accounts

14. Reducing vulnerability to external shocks and strengthening competitiveness remain overarching policy objectives. Tajikistan's trade is commodity based, making the country vulnerable to external shocks. Food and fuel imports constitute 18 percent of merchandise imports.[6] The export base is very narrow (less than 18 percent of GDP in 2012) and commodity-driven (aluminum tolling fee and cotton at 12 percent and 15 percent, respectively, of goods and services exports). These factors, complemented by Tajikistan's reliance on remittance funding, remain key contributors to external vulnerability, which rests also on inadequate international reserves and increasing debt service. At end 2012, international reserves—at US$ 0.7 billion, or only 1.6 months of import cover—remained substantially below the level of 2.7 months of import cover calculated based on the costs and benefits of holding reserves using the reserve adequacy tool (Annex II). In addition, although trends in Tajikistan's REER compare favorably with other CCA countries, limited transport links, distance to markets, and the poor business climate raise Tajikistan's trading costs and weaken competitiveness.

15. Near- and longer-term measures were proposed to protect against external vulnerability and improve competitiveness. Staff urged the authorities to pursue an ambitious international reserve build-up through greater exchange rate flexibility, as warranted by market conditions, and by converting their stocks of non-monetary gold to monetary gold. Staff also emphasized that the authorities could take steps to improve transparency and the business climate—for instance through the even application of the new tax code, consistent enforcement of prudential regulations on banks, and rapid implementation of WTO commitments—to support competitiveness and diversification of domestic production and the export base over the medium term.

16. Authorities' views. The NBT is committed to allow greater exchange rate flexibility to support international reserves. While the NBT indicated that the conversion of its non-monetary to monetary gold is likely to be completed in the second half of this year, the MOF is still considering whether to convert its non-monetary gold and sell it to the NBT (which would also provide a liquid fiscal buffer). The authorities noted they are taking steps to improve competitiveness, product and market diversification, and the business climate. Following Tajikistan's entry into the WTO on March

[6] Changes in international food prices have major effects on headline inflation and household food security due to the 58 percent share of food in the CPI.

2, 2013, the authorities are assessing the impact of tariff rationalization on production and are taking measures to reduce administrative costs to help producers remain competitive. Discussions have started on transit agreements to facilitate trade through Afghanistan and with countries in South Asia.[7] Legislation to liberalize further the capital account—allowing individuals and businesses to open accounts abroad—is under consideration by parliament. The authorities are partnering with international organizations on projects to enhance private sector competitiveness as well as investments in energy and infrastructure projects. Finally, the business climate is expected to improve further with ongoing reforms in tax administration and implementation of the new tax code, which has reduced the number of taxes.

B. Making Growth Inclusive and Private-Sector Led

17. Staff stressed that while economic growth is strong, it is not inclusive because current policies do not support domestic job creation[8]. Domestic and foreign direct private investments are held back in part because of state-directed lending and investment.[9] These practices displace private sector activity, contribute to rent seeking, and weaken the business environment. They also put the financial sector at risk and limit its growth. Several large banks have weak governance frameworks and are often expected to lend at preferential interest rates and without regard to whether an activity may be profitable (e.g. AIB). The NBT's balance sheet and independence have repeatedly been put at risk by these practices, both through refinancing of directed-lending operations (e.g. for the cotton sector) and providing liquidity to problem banks.

18. Weak financial intermediation also hinders private sector development and inclusive growth. Tajikistan has made some progress in this area, particularly connected to financial market infrastructure. Work is underway to strengthen the payments system and reform the collateral registration system, and a private credit bureau is now operational. However, money and bank credit as a share of GDP remain low even by regional standards. The economy remains largely cash based, as reflected in small individual deposits in banks. Bank loans are predominantly short term and to provide working capital for domestic and international trade. Access to finance by micro, small, and medium enterprises is limited. The shallowness of the financial system and financial markets (the interbank and government securities markets in particular) hampers the shift toward greater market orientation, limits the sector's contribution to economic growth, undermines the effectiveness of monetary policy, and constrains the ability of the government to finance budget deficits from domestic sources. Financial market development would, therefore, play an important role in fiscal sustainability, create traction for monetary policy, and support growth.

[7] Tajikistan is not yet considering membership in the Belarus-Kazakhstan-Russia customs union (CU) as it has no common border with any member state and views its WTO membership as complicating any effort to join the CU.

[8] Staff estimates indicate that real growth of at least 9 percent is needed just to absorb new entrants into the labor force and stabilize unemployment. The official unemployment rate is 2 to 3 percent; alternative sources report unemployment rates in the range of 10 to 40 percent, consistent with the amount of outmigration.

[9] The government often cites food security as a motive for directed lending, both to procure food reserves and to support agro-processing.

19. Staff noted that non-inclusive growth contributes to outmigration and the extraordinary reliance of Tajikistan's economy and many households on remittances. Given strong linkages with Russia (the source of over 90 percent of remittances), an intensified Euro area or emerging market crisis, or a global structural shift (e.g. shale oil) that slows growth in Russia could significantly reduce remittances and negatively affect debt sustainability and growth. This highlights again the need for structural reforms that support more balanced development through private investment and broad-based job-creating growth.

20. Staff proposed measures in three areas to relax key constraints to financial market development and support private investment and inclusive growth. This would also require supporting reforms in fiscal and monetary operations to displace successfully the command-based financing mechanism and move to a fully market-based system. First, it is a matter of urgency to halt the practice of directed lending and to resolve AIB properly to help establish financial accountability, improve governance, and create a level playing field for investors. Given the strength of vested interests, staff recommended that international managers be brought in to run AIB, and improve and protect the value of the bank. Second, complementary measures to develop the interbank and government debt markets—including increasing the range of T-bill maturities to other than 91 days and allowing price discovery (the current 2 percent rate on T-bills does not reflect appropriate market pricing and rates will have to rise)—are needed to provide banks with greater placement opportunities and the government with alternative financing instruments. Development of short-term government securities markets would also help strengthen the quality of collateral available for liquidity support from the NBT and the interbank market, thereby helping to strengthen monetary transmission. Third, exercising central bank independence to strengthen bank supervision and align regulatory standards to international practices (e.g., additional risk weighting for large exposure to government and government entities), stop regulatory forbearance, and apply prudential norms equitably across banks is essential for sustaining financial development.

21. Authorities' views. The authorities agreed that moving to a more market-based financial sector would spur private sector development. They commented that banks alone could not serve various scales of private investments and that microfinance institutions as well as savings institutions (such as pension and insurance funds) with longer horizons are required to support small scale (SME activities) and larger scale (infrastructure) investment projects, respectively. The NBT expressed the urgent need for development of the government securities market as well as other instruments for hedging risk (such as various insurance products), and noted that this would help in the medium term to generate government financing for prioritized spending and help protect against pressure for directed lending. The authorities agreed on the need to better coordinate among various agencies (i.e. the NBT and the MOF) to strengthen supervision and regulatory practices and with the need to align regulatory standards to international practice. While the NBT has expressed publicly its willingness to consider foreign management for AIB as part of a resolution strategy, there is no support for this from the broader economic team.

C. Reducing Fiscal Vulnerability and Strengthening Public Sector Governance

22. Staff noted that the medium-term fiscal framework is constrained and subject to contingent risks despite positive fiscal outcomes in the past two years. Government deposits (a key fiscal buffer) are—at just 15 percent of revenues—less than half the level of the pre-crisis period (Annex IV). Concomitantly, amortization of foreign debt is increasing sharply, which will—in the absence of measures to build other buffers (see below)—lead to the full depletion of this deposit buffer over the next two years. SOEs are not well integrated into the budget (no policy requires them to pay dividends; uneven reporting of financial statements) and many exhibit poor financial discipline (arrears, including on taxes, are high). Given Tajikistan's future resource needs for social and investment spending, and its low reserve and fiscal buffers, staff argued that it is important to gain greater control over potential revenue sources, prioritize expenditure, and limit contingent liabilities.[10]

23. Staff recommended that, given its limited fiscal space, Tajikistan should retain a zero limit on contracting or guaranteeing new external non-concessional debt, at least in the near term. Including remittances in the DSA threshold analysis—consistent with the new LIC DSA guidelines—moves Tajikistan from high to moderate risk of debt distress. Tajikistan is, however, assessed to remain vulnerable to shocks on non-debt creating flows (includes official and private transfers and FDI; Debt Sustainability Analysis, Figure 1).[11]

24. Staff noted a range of measures to reduce fiscal vulnerability and improve public sector governance. Gradually moving to small fiscal surpluses will stabilize overall public debt relative to GDP and keep the fiscal deficit within the limited domestic and external financing envelope, thereby helping to preserve reserves. A one-off sale of MOF non-monetary gold to the NBT would boost liquid fiscal buffers and could help support international reserves. Gradually increasing the borrowing envelope, particularly for domestic debt, would help support cash management and create room to finance needed social and infrastructure spending through the budget. This should also limit pressure for quasi-fiscal operations and new directed lending. Strengthening the large taxpayer inspectorate (LTI) and implementing a dividends policy for all SOEs—including Talco Management (TM)—would support tax collection and implementation of the new tax code.[12] Fiscal risks can be better managed if the government strengthens the SOE

[10] The first audit of Talco Management—the offshore arm of the state aluminum company—was completed in late 2011 and indicates that the company earned substantial profits that were not taxed. These funds form part of Tajikistan's government's offshore assets, and little is known or reported about them.

[11] This is shown by protracted breaching of debt burden indicators (PV of debt-to-GDP and remittances ratio; PV of debt-to exports and remittances ratio; and PV of debt-to-revenue ratio) under most extreme shock scenarios.

[12] Specific measures to strengthen the LTI include the development and application of new criteria for determining which firms should be included in the LTI, strengthening audit procedures and practices, and implementing—over the coming two years—the agreed new organizational structure of the LTI.

monitoring unit, brings more SOEs—again, including TM—under the unit's oversight, and develops a concrete plan to address fiscal risks emerging from SOEs and problem banks.

25. Authorities' views. The authorities acknowledged the need for continued prudent fiscal management, as well as the need to rebuild some fiscal buffers. They recognize that a tight fiscal stance is required to create room to service debt, and that additional risks exist if resources cannot be obtained through grants. They also highlighted pressing social expenditure needs (a point also emphasized by donors), with particular emphasis on the low level of capital spending in the social sector compared with that of other countries in the region. On financing, while acknowledging the importance of developing domestic debt markets, the MOF argued that concessional external borrowing—which it will continue actively to pursue—offers more favorable terms than t-bill issuance at domestic market rates. The authorities indicated they are considering a dividends policy for SOEs. However, they said they do not have the consensus at this time to include TM in the SOE monitoring division at MOF, to apply a possible future dividends policy for SOEs to TM, or to create greater transparency around TM's overall financial flows. The Tax Committee noted that it is developing new criteria for the inclusion of taxpayers in the LTU and an arrears management strategy to support implementation of the new tax code.

STAFF APPRAISAL

26. Tajikistan is weathering global economic stresses relatively well, but faces important development challenges and remains highly vulnerable to shocks. While near-term economic prospects remain reasonably robust, growth is likely to slow in the medium term due to the modest pace of structural reforms. Heavy reliance on remittances from Russia, a slowdown in Russia, and movements in international commodity prices create substantial risks for the population and the economy. Regional factors and Tajikistan's remote location and high transportation costs to global markets also complicate the economic environment. Early reports of substantial hydrocarbon discoveries may mean that the outlook will need to be reassessed in coming years.

27. There is a need to take a fresh look at medium-term fiscal objectives in the post-crisis environment, in particular the need to rebuild fiscal buffers. The authorities' plan to move the fiscal position (excluding PIP) over the medium term from small deficits to balance is welcome, and in practice small surpluses are likely to be achieved due to conservative budgeting. Strong tax administration reforms should be pursued to support revenue and the overall fiscal position, especially in the face of sharply higher external debt service. Fiscal buffers can be strengthened through the adoption of a dividends policy for SOEs, the sale of the MOF's stock of non-monetary gold to the NBT, strong efforts to collect on the bad loans the government purchased from AIB, and the re-privatization over the medium term of the government's share in AIB.

28. The authorities' intention to continue to seek only concessional external financing is welcome. Risks remain to the debt position even though public debt stands at just 32 percent of GDP and the risk of debt distress has improved to moderate with remittances included in the updated LIC DSA. Fiscal costs arising from directed lending—such as in the case of AIB in 2012—and

unreformed SOEs periodically increase debt. A standard shock to non-debt creating flows (mostly remittances)—on which Tajikistan heavily depends—is assessed to lead to the breach of debt thresholds. Debt sustainability also depends critically on the government's decision on whether to build the full-height Roghun dam and the financing terms of the remainder of that project. The authorities' current view on concessional borrowing may be tested when the government tries to secure financing for the Roghun HPP.

29. Protecting the poor is an important priority, and should be done more efficiently and transparently. Blanket subsidies should be avoided. Furthermore, in the absence of adequate social safety nets, operations to procure food and fuel for strategic reserves should be carried out as a fiscal operation rather than as directed lending through the banking system. Going forward, the authorities are encouraged to cooperate closely with the World Bank and other donors to develop a more effective means of providing direct and targeted assistance to the poor. The authorities should also halt directed lending of all types and consider setting aside fiscal contingency funds in the budget—that are consistent with deficits that yield gradual fiscal consolidation—to allow them to manage the costs of potential unanticipated government priorities in a more transparent manner.

30. Monetary policy should continue to focus on containing inflation. The NBT's policy stance, which is supportive of low inflation, is welcome. Reserve money targets are consistent with single-digit inflation, the interest rates on liquidity lending are set to prevailing market levels, and the NBT is mindful of the need to extend liquidity loans only to solvent banks and against good collateral.

31. Exchange rate policy needs to retain flexibility and further structural reforms are needed to support competitiveness. The somoni is at present broadly in line with medium-term fundamentals and the nominal exchange rate has remained stable in the absence of major shocks. However, potential adverse movements in the terms of trade—through shifts in food, energy, or cotton prices—or shocks to remittances from a slowdown in Russia suggest the need for more exchange rate flexibility to strengthen reserves and competitiveness. The NBT's readiness to allow greater exchange rate flexibility—while intervening to smooth excess volatility—is, therefore, welcome, as is its decision to convert its non-monetary gold into monetary gold in 2013 to bolster reserves. Tajikistan's accession to WTO membership should support competitiveness and trade integration, including through the authorities' initiative to diversify markets, products, and market access, and to reduce administrative costs for businesses in line with WTO commitments.

32. A comprehensive and well-sequenced effort is needed to address financial sector vulnerabilities and limit the emergence of new fiscal liabilities. While Tajikistan is strengthening the payments system and reforming the collateral registration system, and a first private credit reporting bureau is now operational, the financial sector remains underdeveloped due to weak governance and the lack of effort to develop government debt markets. In view of this, the authorities should pursue a decisive resolution of AIB by hiring foreign managers to strengthen governance and protect the value of the bank, and this should be complemented by strict NBT enforcement of prudential norms across all banks and a halt to directed lending to protect the financial sector. The lack of aggressive action to date on AIB is protecting the vested interests of

existing private shareholders and forfeiting the opportunity to minimize the fiscal cost of the intervention in the bank. This lost opportunity to strengthen financial accountability also weighs on the development of the interbank market. The MOF's reluctance to develop the government debt market—due to its concern about the potential cost of servicing domestic debt— is preventing the creation of instruments to strengthen the monetary policy framework, limiting Tajikistan's ability to deal with shocks, and creating rollover risks.

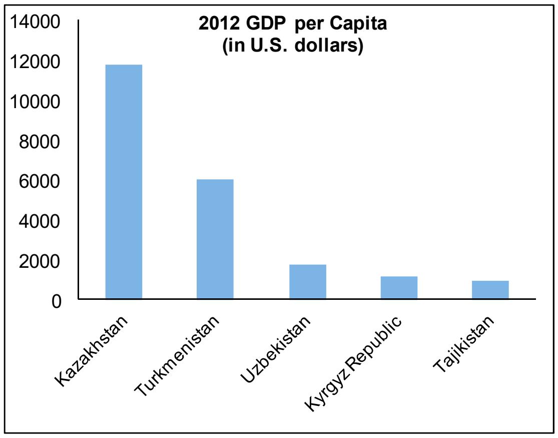
33. Structural reforms should continue to target governance and transparency, and seek to facilitate market orientation. Progress made under the 2009–12 ECF-supported program with respect to transparency of state enterprises and government operations is laudable. The potential benefits of the overhaul of the tax regime—in terms of boosting revenue and creating a more open business environment— are welcome. The establishment of the SOE monitoring unit in the MOF is positive and the authorities are encouraged to move forward quickly with the adoption of a dividends policy for SOEs. Further progress on transparency around SOEs and in public financial management is needed and is likely to be slow. The 2008–10 audits of the Roghun HPP open joint stock company should be published, and this practice should continue. Including Talco Management (TM) in the SOE monitoring unit at the MOF, applying a possible future dividends policy for SOEs to TM, and creating greater transparency around TM's financial flows are needed to strengthen public financial management and bolster revenues and fiscal buffers. Tajikistan should continue to implement in a timely manner the FATF-approved action plan on AML/CFT and to strengthen compliance with FATF standards, notably with respect to the terrorist-financing offense, confiscation, freezing of terrorist assets, and customer due diligence.

34. Data provision to the Fund for surveillance purposes is broadly adequate. Tajikistan participates in the GDDS and, while there are some weaknesses, data provision is broadly adequate for surveillance. Further technical assistance from the IMF would be helpful to improve national accounts, balance of payments, and external debt data.

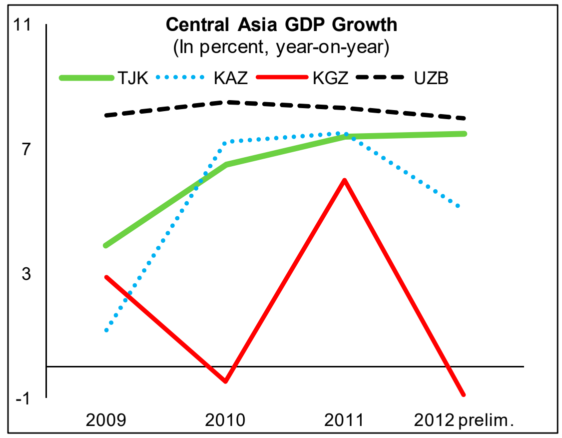
35. Staff recommends that the next Article IV consultation with Tajikistan be held on the regular 12-month cycle.

Figure 1. Tajikistan: Economic Developments Compared To Other Countries in the Region

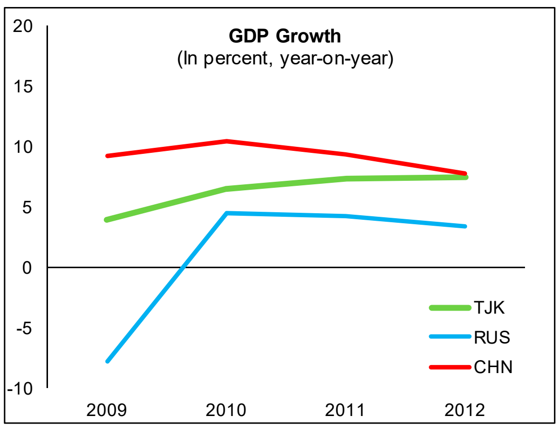
Tajikistan is the poorest CIS country in the region....



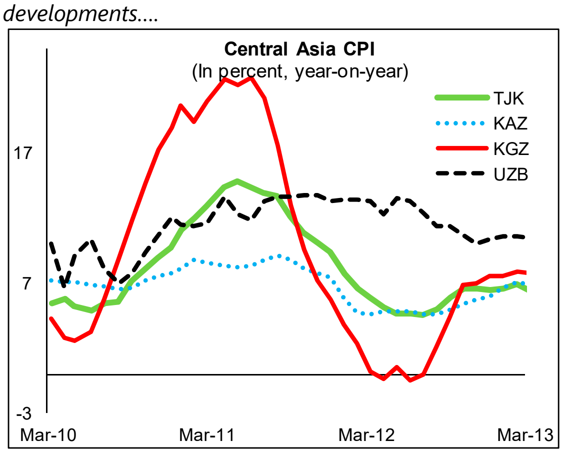
Growth was relatively stable in the past years....



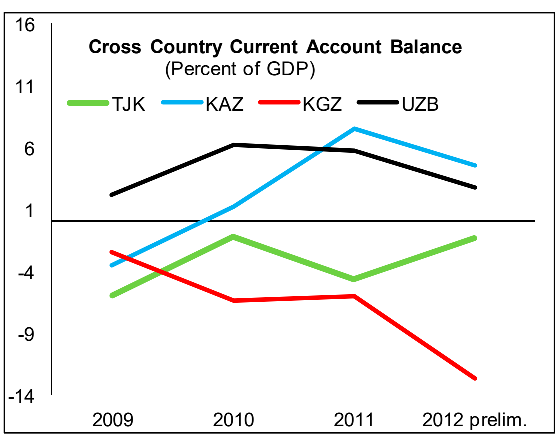
GDP growth crucially depends on developments in Russia....



Headline inflation rates in line with regional developments....



Current account balance relatively stable...



Key policy rates have been lowered in most neighboring countries....

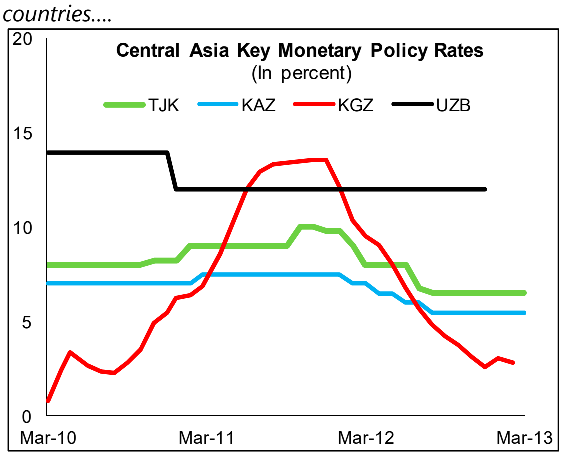
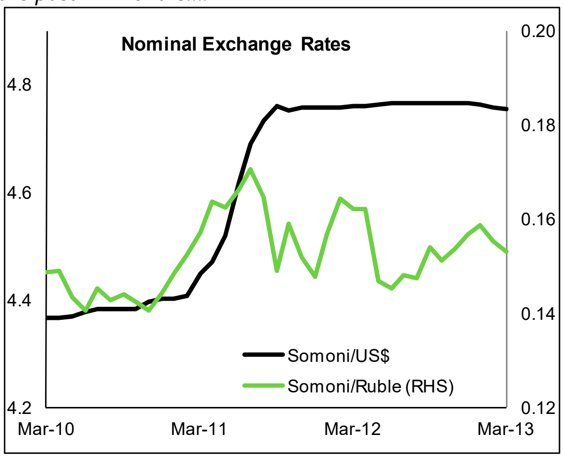
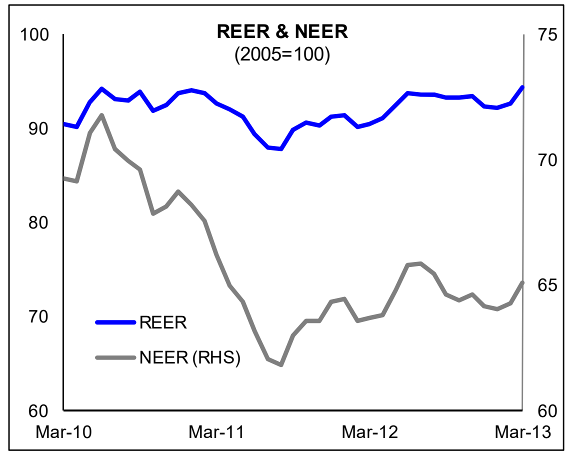


Figure 2. Tajikistan: Monetary Developments

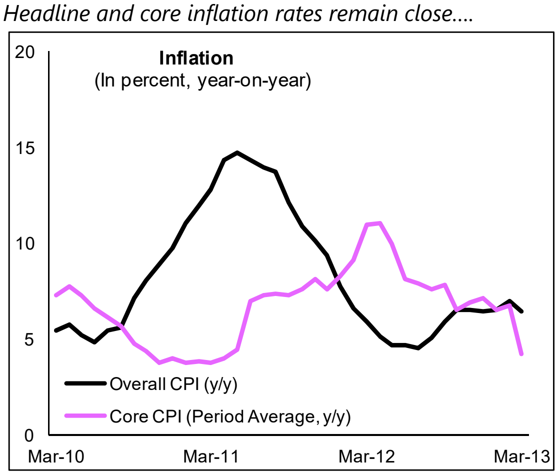
The exchange rate vs. the USD has been relatively stable the past 12 months....



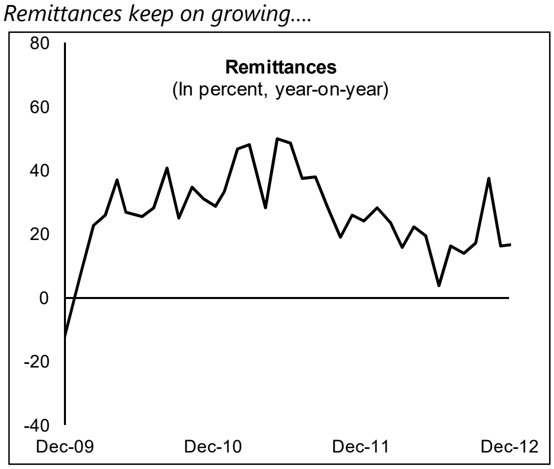
The REER appreciated slightly this year....



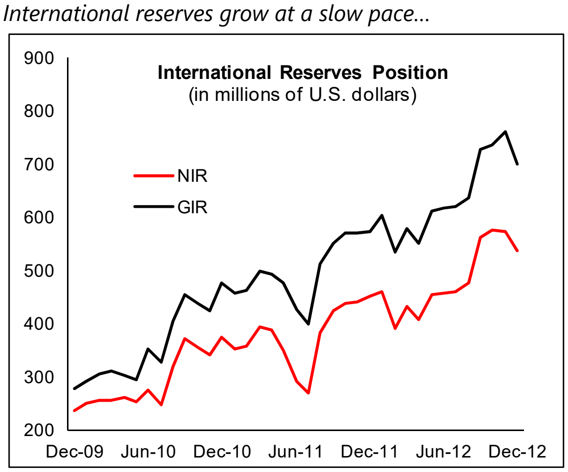
Headline and core inflation rates remain close....



Remittances keep on growing....



International reserves grow at a slow pace...



Private Credit is affected by AIB resolution in 2012....

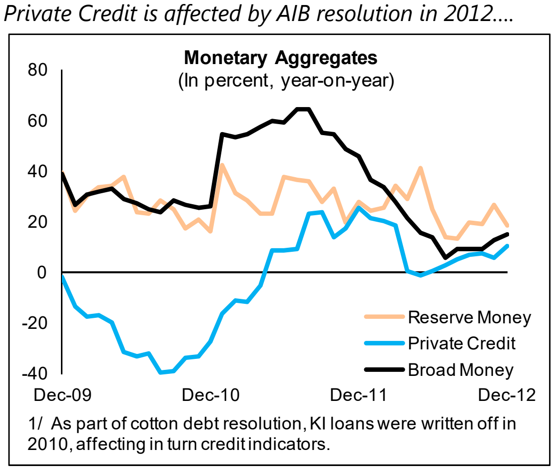
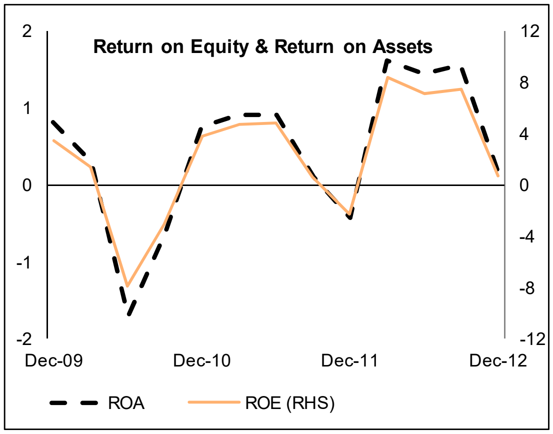
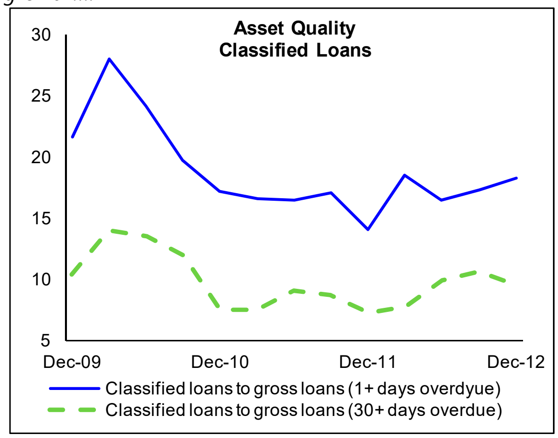


Figure 3. Tajikistan: Financial and Fiscal Developments

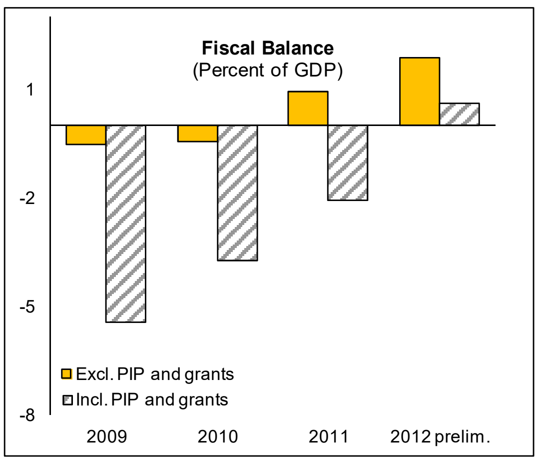
Profitability of financial sector remains problematic….



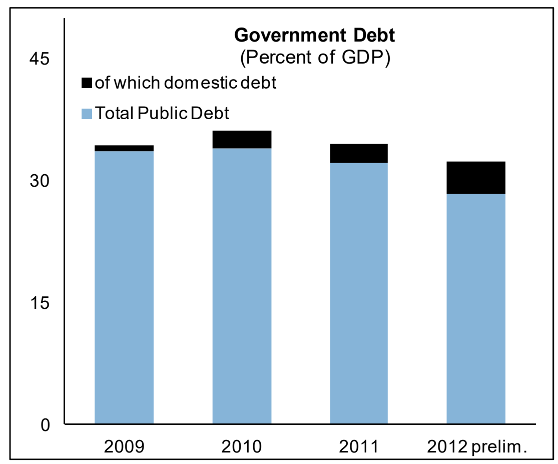
Classified loans increased in 2012 despite strong economic growth….



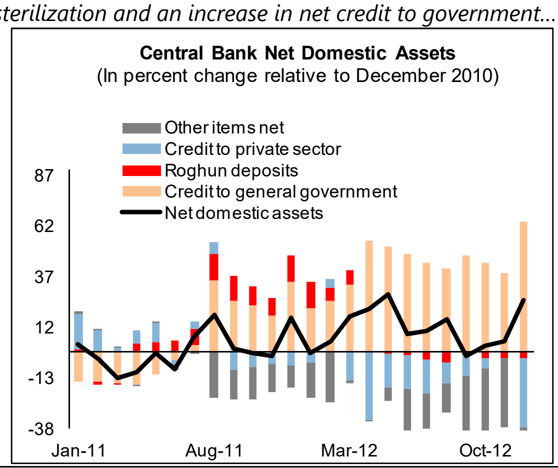
Fiscal position incl. PIP is close to balance….



Domestic debt is only small part of total government debt….



Central Bank's NDA reflected massive end-year sterilization and an increase in net credit to government…



Inward remittances largely explain imports….

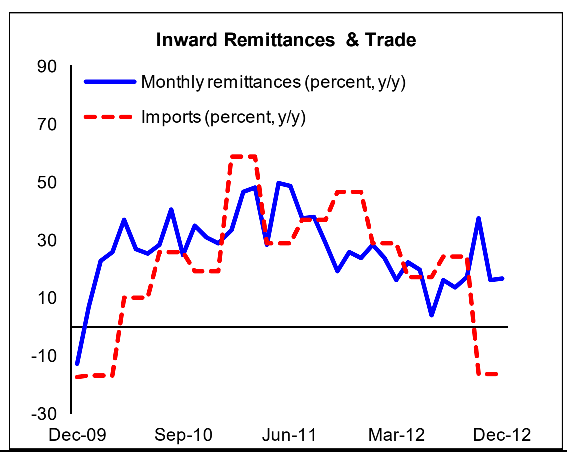


Table 1. Tajikistan: Selected Economic Indicators, 2010–18

	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Act.	Est.	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Annual percent change; unless otherwise indicated)								
National accounts									
Real GDP	6.5	7.4	7.5	6.8	5.8	5.8	5.8	5.8	5.8
GDP deflator (cumulative)	12.5	13.3	11.9	8.0	7.0	7.0	7.0	7.0	6.0
Headline CPI inflation (end-of-period)	9.8	9.3	6.4	7.0	7.0	7.0	7.0	7.0	6.0
Headline CPI inflation (period average)	6.4	12.4	5.8	7.5	7.2	7.0	7.0	7.0	6.0
Core CPI inflation (period average)	5.9	6.0	8.4	5.2	6.9	7.0	6.5	6.2	6.0
	(In percent of GDP; unless otherwise indicated)								
Investment and saving 1/									
Investment	17.9	20.5	17.5	18.5	17.1	17.6	17.4	18.4	20.9
Fixed capital investment	12.9	15.5	13.0	15.5	14.1	14.6	15.9	16.9	18.4
Government	10.9	12.5	9.0	10.3	8.3	7.8	8.5	9.2	10.6
Private	2.0	3.0	4.0	5.2	5.8	6.8	7.4	7.7	7.8
Gross national savings	16.7	15.8	16.2	16.8	14.9	15.2	15.1	16.2	18.8
Public	7.2	10.5	9.6	7.9	7.0	6.8	7.1	7.3	7.0
Private	9.5	5.3	6.5	8.8	7.9	8.4	8.0	8.9	11.8
General government finances									
Revenue and grants	23.2	24.9	25.1	26.1	24.9	24.6	25.0	25.2	25.9
Tax revenue	18.0	19.4	19.8	19.6	19.9	19.9	20.1	20.1	20.5
Expenditure and net lending 2/	26.9	26.9	24.5	28.4	26.2	25.6	26.5	27.1	28.7
Current 2/	15.0	14.7	15.7	18.2	17.9	17.8	17.9	17.9	18.1
Capital	10.9	12.5	9.0	10.3	8.3	7.8	8.5	9.2	10.6
Overall balance (excl. PIP and stat. discrepancy)	-0.4	0.9	1.9	-0.1	0.4	0.4	0.4	0.4	0.4
Overall balance (incl. PIP and stat. discrepancy)	-3.7	-2.0	0.7	-2.3	-1.3	-1.0	-1.4	-1.9	-2.7
Domestic financing	-0.4	-0.5	-0.9	1.2	0.7	0.6	0.6	0.6	0.5
External financing	4.1	2.6	0.3	1.1	0.6	0.4	0.8	1.4	2.2
Total public and publicly-guaranteed debt	36.3	35.4	32.3	30.7	31.4	31.0	31.2	31.8	31.5
Monetary sector									
Broad money (12-month percent change)	25.4	46.8	15.5	18.1	17.4	17.5	16.7	16.5	15.6
Reserve money (12-month percent change)	15.8	27.9	18.5	16.5	16.4	15.7	13.8	14.3	13.4
Credit to private sector (12-month percent change) 4/	-25.7	23.9	8.9	17.2	16.9	16.2	14.8	14.7	14.4
Velocity of broad money (eop)	4.9	4.1	4.2	4.1	4.0	3.8	3.7	3.6	3.5
Refinancing rate (in percent, eop/ latest value)	8.25	9.80	6.50	…	…	…	…	…	…
	(In percent of GDP; unless otherwise indicated)								
External sector 5/									
Exports of goods and services (U.S. dollar, percent change)	14.6	34.5	18.9	4.2	6.7	7.1	6.8	7.6	9.3
Imports of goods and services (U.S. dollar, percent change)	9.4	47.6	11.7	11.3	8.6	6.9	8.4	8.4	8.9
Current account balance	-1.2	-4.7	-1.3	-1.7	-2.2	-2.4	-2.4	-2.2	-2.1
Trade balance (goods)	-37.0	-47.7	-42.4	-44.8	-45.4	-44.6	-44.4	-44.1	-43.9
FDI	0.3	1.0	1.9	1.8	2.0	2.4	2.7	3.0	3.0
Total public and publicly guaranteed external debt	34.1	33.1	28.3	27.0	27.7	27.4	27.4	27.8	27.4
Exports of goods and services, in millions of U.S. dollars	866	1,164	1,384	1,443	1,540	1,650	1,761	1,895	2,072
Imports of goods and services, in millions of U.S. dollars	2,968	4,382	4,894	5,449	5,918	6,326	6,855	7,431	8,093
Current account balance, in millions of U.S. dollars	-69	-307	-99	-145	-207	-236	-257	-266	-273
Total public and publicly guaranteed external debt, in millions of U.S. dollars	1,911	2,094	2,150	2,248	2,501	2,698	2,954	3,281	3,538
Gross official reserves (in millions of U.S. dollars)	476	572	699	935	1,075	1,245	1,415	1,540	1,680
In months of next year's imports 6/	1.3	1.4	1.6	1.9	2.1	2.2	2.3	2.3	2.3
In percent of broad money	21.4	16.8	17.2	19.0	17.8	16.9	15.9	14.3	13.2
Memorandum items:									
Nominal GDP (in millions of somoni)	24,705	30,069	36,161	41,690	47,153	53,331	60,319	68,223	76,474
Nominal GDP (in millions of U.S. dollars)	5,642	6,523	7,592	8,537	9,221	10,028	10,956	11,994	13,079
Social and poverty-related spending (in percent of GDP)	9.0	9.7	10.9	11.1	11.9	12.5	13.1	13.7	14.3
Nominal effective exchange rate (Index 2005=100)	69.5	64.4	64.6	…	…	…	…	…	…
Real effective exchange rate (Index 2005=100)	92.1	90.9	91.8	…	…	…	…	…	…
Average exchange rate (somoni per U.S. dollar)	4.38	4.61	4.76	…	…	…	…	…	…

Sources: Data provided by the Tajikistan authorities, and Fund staff estimates.

1/ Private investment and savings are estimates. Investment includes changes in stocks.

2/ Including statistical discrepancy.

4/ Decline in 2010 is due to resolution of Kredit Invest (KI) carrying large nonperfoming loans to the cotton sector. Slowdown in 2012 is due to bad loans write-off at Agroinvestbank.

5/ Receipts from aluminium exports under the tolling arrangements are booked as services exports.

6/ Excluding electricity, which is on barter basis, and imports related to Roghun and projects financed with loans from China.

Table 2. Tajikistan: General Government Operations, 2010–14

(In millions of somoni, unless otherwise indicated)

	2010 Act.	2011 Act.	2012 Proj.	2013 Proj.	2014 Proj.
Overall revenues and grants	5,722	7,483	9,089	10,884	11,763
Total revenues	5,153	6,792	8,546	9,611	10,993
Tax revenues	4,436	5,833	7,163	8,192	9,387
Income and profit tax	780	987	1,306	1,544	1,760
Payroll taxes	567	741	947	1,156	1,330
Property taxes	152	171	191	141	162
Taxes on goods and services	2,582	3,472	4,152	4,766	5,482
VAT	1,823	2,511	3,056	3,569	4,106
Excises and other internal indirect taxes	759	962	1,096	1,196	1,376
International trade and operations tax	355	461	567	586	654
Nontax revenues	718	960	1,383	1,419	1,605
Of which: Extra-budgetary funds	404	457	705	613	693
Grants	568	690	543	1,273	770
Of which: Public Investment Program (PIP) financing	367	534	448	1,053	639
Total expenditures and net lending	6,457	8,127	8,890	11,852	12,374
Current expenditures	3,698	4,450	5,716	7,569	8,440
Expenditures on goods and services	2,414	2,964	3,742	5,169	5,685
Wages and salaries	1,141	1,465	2,022	2,627	3,056
Others	1,274	1,499	1,720	2,542	2,629
Of which: extra-budgetary funds	362	473	495	613	693
Interest payments	121	156	214	251	277
External	100	127	142	168	163
Domestic	0	29	72	83	115
Transfers and subsidies	1,162	1,330	1,761	2,149	2,477
Transfers to households	1,087	1,238	1,644	1,964	2,245
Subsidies and other current transfers	75	92	117	184	232
Capital expenditures	2,693	3,756	3,240	4,277	3,928
Externally financed PIP	1,178	1,438	903	1,981	1,439
Domestically financed	1,515	2,317	2,337	2,296	2,489
Net lending	67	-79	-66	6	6
Statistical discrepancy ("+" = additional spending)	185	-23	-24	…	…
Overall balance (incl. PIP)	-920	-621	223	-968	-611
Overall balance (excl. PIP and PIP-related grants)	-110	284	678	-40	188
Total financing (incl. PIP)	920	621	-223	968	611
Net external	1,020	769	108	450	302
Disbursements	1,118	905	455	928	799
Program loans	307	0	0	0	0
Project loans	811	905	455	928	799
Amortization	-97	-135	-347	-478	-498
Net domestic	-100	-149	-331	518	309
NBT	-253	388	192	410	143
Commercial banks	-35	24	-395	83	141
Operations with assets 1/	187	-560	-128	25	25
Accumulation of arrears	0	0	0	0	0
Memorandum items:					
Recapitalization bonds–NBT 2/	…	120	160	140	140
Recapitalization bonds–commercial banks 2/	353	… .	…	…	…

Sources: Tajikistan authorities, and Fund staff estimates.

1/ Includes transfer of MDRI deposits to the NBT in 2011 towards NBT recapitalization.
2/ Issuance to compensate the NBT and banks for losses related to cotton lending as part of cotton debt resolution.

Table 3. Tajikistan: General Government Operations, 2010–14
(In percent of GDP, unless otherwise indicated)

	2010 Act.	2011 Act.	2012 Act.	2013 Proj.	2014 Proj.
Overall revenues and grants	23.2	24.9	25.1	26.1	24.9
Total revenues	20.9	22.6	23.6	23.1	23.3
Tax revenues	18.0	19.4	19.8	19.6	19.9
Income and profit tax	3.2	3.3	3.6	3.7	3.7
Payroll taxes	2.3	2.5	2.6	2.8	2.8
Property taxes	0.6	0.6	0.5	0.3	0.3
Taxes on goods and services	10.5	11.5	11.5	11.4	11.6
VAT	7.4	8.4	8.5	8.6	8.7
Excises and other internal indirect taxes	3.1	3.2	3.0	2.9	2.9
International trade and operations tax	1.4	1.5	1.6	1.4	1.4
Nontax revenues	2.9	3.2	3.8	3.4	3.4
Grants	2.3	2.3	1.5	3.1	1.6
Of which: Public Investment Program (PIP) financing	1.5	1.8	1.2	2.5	1.4
Total expenditure and net lending	26.1	27.0	24.6	28.4	26.2
Current expenditures	15.0	14.8	15.8	18.2	17.9
Expenditures on goods and services	9.8	9.9	10.3	12.4	12.1
Wages and salaries	4.6	4.9	5.6	6.3	6.5
Others	5.2	5.0	4.8	6.1	5.6
Interest payments	0.5	0.5	0.6	0.6	0.6
External	0.4	0.4	0.4	0.4	0.3
Domestic	0.0	0.1	0.2	0.2	0.2
Transfers and subsidies	4.7	4.4	4.9	5.2	5.3
Transfers to households	4.4	4.1	4.5	4.7	4.8
Subsidies and other current transfers	0.3	0.3	0.3	0.4	0.5
Capital expenditures	10.9	12.5	9.0	10.3	8.3
Externally financed PIP	4.8	4.8	2.5	4.8	3.1
Domestically financed	6.1	7.7	6.5	5.5	5.3
Net lending	0.3	-0.3	-0.2	0.0	0.0
Statistical discrepancy ("+" = additional spending)	0.7	-0.1	-0.07	…	…
Overall balance (incl. PIP)	-3.7	-2.1	0.6	-2.3	-1.3
Overall balance (excl. PIP and PIP-related grants)	-0.4	0.9	1.9	-0.1	0.4
Total financing (incl. PIP)	3.7	2.1	-0.6	2.3	1.3
Net external	4.1	2.6	0.3	1.1	0.6
Disbursements	4.5	3.0	1.3	2.2	1.7
Program loans	1.2	0.0	0.0	0.0	0.0
Project loans	3.3	3.0	1.3	2.2	1.7
Amortization	-0.4	-0.4	-1.0	-1.1	-1.1
Net domestic	-0.4	-0.5	-0.9	1.2	0.7
NBT	-1.0	1.3	0.5	1.0	0.3
Commercial banks	-0.1	0.1	-1.1	0.2	0.3
Operations with assets 1/	0.8	-1.9	-0.4	0.1	0.1
Accumulation of arrears	0.0	0.0	0.0	0.0	0.0
Memorandum items:					
Public debt (in percent of GDP)	36.3	35.4	32.3	30.7	31.4
Social and poverty-related expenditure (in percent of GDP) 2/	9.0	9.7	10.9	11.1	…

Sources: Tajikistan authorities, and Fund staff estimates.

1/ Includes transfer of MDRI deposits to the NBT in 2010 towards NBT recapitalization.
2/ Includes spending on health, education, and social protection.

Table 4. Tajikistan: Accounts of the National Bank of Tajikistan, 2010–15

(End-of-period stock, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015
	Dec. Act.	Dec. Act.	Dec. Proj.	Dec. Proj.	Dec. Proj.	Dec. Proj.
	(In millions of somoni)					
Net foreign assets	1,251	1,788	2,354	3,222	4,117	5,249
Gross assets	2,340	3,075	3,830	5,177	6,116	7,238
Gross liabilities	446	578	771	810	825	791
Net international reserves 1/	1,134	1,815	2,433	3,569	4,427	5,516
Gross international reserves 1/	1,577	2,387	3,090	4,379	5,252	6,307
Gross reserve liabilities	443	572	657	810	825	791
Net domestic assets	1,739	2,034	2,176	2,057	2,030	1,863
Net credit to general government	-1,462	-856	-343	307	899	1,111
General government	-1,113	-725	66	616	899	1,111
Roghun JSC	-349	-131	-409	-309	0	0
Credit to the private sector 2/	410	286	-175	30	92	256
Claims on banks	262	139	-293	-88	-25	138
Cotton sector	0	0	0	0	0	0
NBT bills	-3	-25	-421	-288	-249	-114
Liquidity loans	186	86	68	140	164	193
Credit to nonbank institutions	148	147	118	118	118	118
Other items net	2,790	2,605	2,695	1,720	1,038	496
Retained profits (-) and provisions (+)	2,850	2,304	…	…	…	…
Reserve money	2,990	3,823	4,530	5,279	6,147	7,113
Currency in circulation	2,421	2,988	3,667	4,273	4,976	5,758
Bank reserves	565	834	862	1,004	1,169	1,353
Required reserves	234	337	297	391	468	560
Somoni	128	181	151	106	134	167
Foreign exchange	106	156	145	285	334	392
Other bank deposits	331	497	565	613	702	794
Other deposits	4	1	2	2	2	2
	(12-month growth in percent of reserve money)					
Reserve money	15.8	27.9	18.5	16.5	16.4	15.7
Net foreign assets	28.9	18.0	14.8	19.2	16.9	18.4
Gross international reserves	15.2	27.1	18.4	28.4	16.5	17.2
Net international reserves	4.9	22.8	16.1	25.1	16.3	17.7
Net domestic assets	-13.1	9.9	3.7	-2.6	-0.5	-2.7
Net credit to general government	-23.1	20.2	13.4	14.3	11.2	3.5
Credit to the private sector	-1.4	-4.2	-12.1	4.5	1.2	2.7
NBT bills	-0.1	-0.7	-10.4	2.9	0.7	2.2
Other items net	11.4	-6.2	2.3	-21.5	-12.9	-8.8
Memorandum items:						
Net international reserves (in millions of U.S.dollars)	258	381	511	713	847	1,019
Net international reserves (percent of broad money)	22.3	24.5	28.5	35.5	37.5	39.7
Official exchange rate (somoni/U.S. dollars)	4.40	4.76	…	…	…	…

Sources: National Bank of Tajikistan, and Fund staff estimates.
1/ Excludes nonmonetary gold and foreign assets denominated in non-convertible currencies.
2/ Decrease in 2010 reflects the write-off of credits to KI.

Table 5. Tajikistan: Monetary Survey, 2010–15

	2010	2011	2012	2013	2014	2015
	Dec.	Dec.	Dec.	Dec.	Dec.	Dec.
	Act.	Act.	Proj.	Proj.	Proj.	Proj.
	(In millions of somoni, end-of-period stock)					
Net foreign assets	1,239	1,463	2,139	3007	3902	5035
National Bank of Tajikistan 1/	1,251	1,788	2,354	3222	4117	5249
Commercial banks	-11	-325	-215	-215	-215	-215
Net domestic assets	3,865	6,019	6,493	7,166	8,017	8,954
Net credit to general government (incl. Roghun OJSC)	-1,282	-642	-523	210	944	1,447
National Bank of Tajikistan	-1,462	-856	-343	307	899	1,111
Commercial banks	179	214	-180	-97	45	336
Credit to the private sector	3,291	4,080	4,443	5,206	6,087	7,070
Other items net	1,856	2,581	2,573	1,749	987	437
Broad money (excl. bills payable) 2/	5,078	7,406	8,524	10,064	11,811	13,880
Somoni broad money	3,179	4,481	5,081	6,000	7,041	8,274
Currency outside banks	2,011	2,723	3,418	3,874	4,365	4,924
Deposits	1,169	1,758	1,663	2,125	2,676	3,350
Foreign currency deposits	1,899	2,925	3,443	4,065	4,770	5,606
Bills payable 3/	26	76	109	109	109	109
	(12-month growth in percent)					
Broad money (excl. bills payable)	25.7	45.8	15.1	18.1	17.4	17.5
Net foreign assets	128.0	18.0	46.2	40.6	29.8	29.0
Net domestic assets (incl. bills payable)	9.4	55.7	7.9	10.4	11.9	11.7
Net credit to general government	60.9	-49.9	-18.5	-140	349.3	53.3
Credit to the private sector	-25.7	23.9	8.9	17.2	16.9	16.2
	(12-month growth in percent of broad money)					
Broad money (excl. bills payable)	25.7	45.8	15.1	18.1	17.4	17.5
Net foreign assets	17.2	4.4	9.1	10.2	8.9	9.6
National Bank of Tajikistan	18.5	10.6	7.6	10.2	8.9	9.6
Commercial banks	-1.2	-6.2	1.5	0.0	0.0	0.0
Net domestic assets (incl. bills payable)	8.2	42.4	6.4	7.9	8.5	7.9
Net credit to general government	-12.0	12.6	1.6	8.6	7.3	4.3
Credit to the private sector	-28.1	15.5	4.9	9.0	8.8	8.3
Other items net	48.4	14.3	-0.1	-9.7	-7.6	-4.7
Bills payable	-0.3	1.0	0.4	0.0	0.0	0.0
Memorandum items:						
Deposit dollarization (in percent)	61.9	62.5	…		…	…
Velocity 4/	4.9	4.1	4.2	4.1	4.0	3.8
Money multiplier	1.7	1.9	1.9	1.9	1.9	2.0

Sources: National Bank of Tajikistan, and Fund staff estimates.

1/ Excludes nonmonetary gold.
2/ 2011 and 2012: preliminary and subject to further verification. Monetary and Financial Statistics TA is in progress.
3/ Liabilities to cotton financiers related to domestic cotton financing.
4/ Structural break in velocity in 2011 due to Kredit Invest write-off.

Table 6. Tajikistan: Balance of Payments, 2010–18

(In millions of U.S. dollars, unless otherwise indicated)

	2010	2011	2011	2012	2013	2014	2015	2016	2017	2018
	Act.	3S/11/64	Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	-69	-253	-307	-99	-145	-207	-236	-257	-266	-273
Balance on goods and services	-2,103	-2,601	-3,217	-3,510	-4,006	-4,378	-4,676	-5,094	-5,535	-6,021
Balance on goods	-2,089	-2,601	-3,111	-3,216	-3,828	-4,188	-4,472	-4,867	-5,284	-5,747
Exports	460	827	593	782	804	858	918	977	1,054	1,137
Imports	-2,549	-3,428	-3,704	-3,998	-4,632	-5,045	-5,390	-5,844	-6,338	-6,884
Balance on services	-14	0	-106	-294	-178	-190	-204	-227	-251	-274
Balance on income	-79	-63	-40	-52	-50	-51	-52	-54	-57	-59
Balance on transfers	2,113	2,410	2,950	3,463	3,910	4,223	4,492	4,890	5,326	5,807
Migrants' remittances, net	2,040	2,293	2,627	3,353	3,804	4,147	4,425	4,829	5,270	5,754
Capital and financial account	178	273	382	186	381	142	240	261	228	444
Capital transfers	84	108	116	94	216	125	110	149	167	245
Public sector (net)	210	272	161	21	89	57	37	87	162	285
Disbursements	255	265	195	95	188	156	138	199	278	408
Projects financed by China	108	119	139	25	79	35	50	50	50	150
Amortization	-45	-32	-34	-75	-99	-99	-100	-113	-116	-123
FDI	16	110	65	146	149	184	241	296	360	392
Portfolio Investment	34		10	29	30	32	35	38	42	46
Commercial bank NFA (- increase)	11	0	66	-23	-2	-4	-2	-3	-3	-3
Other capital flows and errors and omissions	-178	-218	-36	-81	-100	-253	-181	-306	-500	-522
Overall balance	109	19	75	87	236	-64	3	3	-38	171
Financing items	-109	-53	-75	-87	-236	64	-3	-3	38	-171
Use of international reserves (- increase)	-169	-110	-96	-127	-236	-140	-170	-170	-125	-140
IMF net purchases	60	0	21	40	0	-4	-12	-22	-27	-31
Purchases/disbursements	60	0	21	40	0	0	0	0	0	0
Repurchases/repayments	0	0	0	0	0	4	12	22	27	31
Residual financing gap 1/	0	0	0	0	0	208	178	188	190	0
Memorandum items:										
Nominal GDP	5,642	6,830	6,523	7,592	8,537	9,221	10,028	10,956	11,994	13,079
Current account balance (in percent of GDP) 1/	-1.2	-3.7	-4.7	-1.3	-1.7	-2.2	-2.4	-2.4	-2.2	-2.1
Gross reserves	476	557	572	699	935	1075	1245	1415	1540	1680
(in months of next year's imports of goods and services) 2/	1.3	1.6	1.4	1.6	1.9	2.1	2.2	2.3	2.3	2.3
Total Public and Publicly Guaranteed (PPG) external sector debt 3/	1,911	2,260	2,094	2,150	2,248	2,501	2,698	2,954	3,281	3,538
(in percent of GDP)	34.1	33.1	33.1	28.3	27.0	27.7	27.4	27.4	27.8	27.4
Debt service on PPG external debt	73	64	63	111	136	141	149	170	181	195
(in percent of exports of goods and services)	8.4	5.2	5.4	8.0	9.4	9.2	9.1	9.7	9.5	9.4

Sources: Tajik authorities; and Fund staff estimates.

1/ The NBT changed the methodology for compiling various BoP accounts, causing a break in the series in 2011. The residual financing gaps during 2014-17 reflect assumed financing for HPP Roghun. The World Bank feasibility study, instrumental in identifying the financing, is ongoing.

2/ Excluding imports related to projects financed with loans from China.

3/ External debt is defined as debt to nonresidents.

Table 7. Tajikistan: Financial Soundness Indicators, 2010–12
(In percent, unless otherwise indicated)

	2010	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
Capital adequacy									
Tier I capital as percent of risk-weighted assets	24.5	20.3	18.9	19.3	21.3	22.1	24.3	25.4	23.3
Reported total capital to risk -weighted assets (K1-1)	26.3	23.2	22.8	23.7	24.4	24.3	27.3	27.2	25.9
Asset quality 1/									
Nonperforming loans to gross loans	17.2	16.6	16.4	17.0	14.1	18.5	16.4	17.3	18.2
Nonperforming loans to gross loans 2/	7.5	7.5	9.1	8.7	7.2	7.7	9.9	10.6	9.5
Nonperforming loans net of provisions to reg. capital	31.2	31.8	32.2	28.3	20.9	31.0	20.3	24.4	25.4
Provisions to nonperforming loans	35.9	34.8	34.7	40.8	45.0	35.4	45.0	40.2	43.5
Banks exceeding maximum single borrower limit 3/	0 of 14	1 of 14	0 of 14	1 of 15	2 of 15	1 of 16	1 of 16	1 of 16	1 of 16
Earnings and profitability									
Reported return on assets (ROA)	0.8	0.9	0.9	0.1	-0.4	1.6	1.5	1.6	0.2
Reported return on equity (ROE)	3.8	4.7	4.8	0.6	-2.3	8.3	7.1	7.4	0.7
Interest income to gross income	51.4	48.4	39.5	36.6	34.2	37.3	32.9	31.2	29.2
Non-interest expenditures to gross income	63.9	61.2	67.2	73.1	75.7	65.5	70.1	71.9	77.2
Salary expenditures to non-interest expenditures	23.2	22.5	16.9	14.9	14.0	15.1	13.7	13.7	13.5
Liquidity									
Liquid assets to total assets	24.2	22.3	22.7	20.7	20.7	27.3	18.9	30.4	29.0
Liquid assets to demand and savings deposits	133.5	116.3	128.5	117.3	105.3	157.8	99.9	166.1	140.0
Liquid assets to total deposits	49.8	45.2	46.1	42.7	40.9	55.6	37.5	62.1	57.8
Sensitivity to market risk									
Net open position in foreign exchange to capital	0.33 short	6.2 lon	4 long	4.7 long	3.2 short	0.5 long	1.9 long	6.8 long	0.7 short

Sources: National Bank of Tajikistan.

Note: Improvements of certain ratios in June 2012 reflect the transfer of a sizable bad loan portfolio of one bank to the MoF.

1/ Nonperforming loans includes loans more than 1 day overdue.

2/ Nonperforming loans includes loans more than 30 day overdue.

3/ Maximum single borrower limit is defined as 25 percent of capital (K3-1).

Table 8. Tajikistan: Millennium Development Goals

	1990	1995	2000	2005	2011	LIC 2011	ECA 2011
Goal 1: Eradicate extreme poverty and hunger							
Employment to population ratio, 15+, total (%)	58	58	59	58	59	71	54
Employment to population ratio, ages 15-24, total (%)	38	38	38	37	38	54	35
GDP per person employed (constant 1990 PPP $)	8,192	3,311	3,277	4,299	5,048	3,241	18,911
Income share held by lowest 20%	..	..	8	8	8	..	..
Malnutrition prevalence, weight for age (% of children under 5)	..	..	..	15	..	23	1
Poverty gap at $1.25 a day (PPP) (%)	..	..	15	5	1	18	0
Poverty headcount ratio at $1.25 a day (PPP) (% of population)	..	..	49	21	7	48	1
Vulnerable employment, total (% of total employment)	..	..	..	..	..	..	18
Goal 2: Achieve universal primary education							
Literacy rate, youth female (% of females ages 15-24)	100	..	100	..	100	70	99
Literacy rate, youth male (% of males ages 15-24)	100	..	100	..	100	77	99
Persistence to last grade of primary, total (% of cohort)	..	71	96	99	99	56	..
Primary completion rate, total (% of relevant age group)	..	100	93	103	104	68	98
Adjusted net enrollment rate, primary (% of primary school age children)	..	..	96	98	98	81	95
Goal 3: Promote gender equality and empower women							
Proportion of seats held by women in national parliaments (%)	..	3	15	18	19	20	16
Ratio of female to male primary enrollment (%)	98	97	93	96	96	95	99
Ratio of female to male secondary enrollment (%)	..	..	86	83	87	86	96
Ratio of female to male tertiary enrollment (%)	..	..	45	47	52	64	121
Share of women employed in the nonagricultural sector (% of total nonagricultural employment)	36.5	40.2	40.0	39.4	..	..	46.9
Goal 4: Reduce child mortality							
Immunization, measles (% of children ages 12-23 months)	68	70	88	85	98	77	94
Mortality rate, infant (per 1,000 live births)	89	87	76	64	53	63	18
Mortality rate, under-5 (per 1,000 live births)	114	111	95	79	63	95	21
Goal 5: Improve maternal health							
Adolescent fertility rate (births per 1,000 women ages 15-19)	..	36	33	30	26	92	26
Births attended by skilled health staff (% of total)	90	81	71	83	88	47	98
Contraceptive prevalence (% of women ages 15-49)	..	..	34	38	..	37	74
Maternal mortality ratio (modeled estimate, per 100,000 live births)	94	160	120	79	65	410	32
Pregnant women receiving prenatal care (%)	..	..	71	77	..	75	..
Unmet need for contraception (% of married women ages 15-49)	..	..	..	24	..	..	..
Goal 6: Combat HIV/AIDS, malaria, and other diseases							
Children with fever receiving antimalarial drugs (% of children under age 5 with fever)	..	..	69	2	..	..	..
Condom use, population ages 15-24, female (% of females ages 15-24)	..	..	..	..	..	..	..
Condom use, population ages 15-24, male (% of males ages 15-24)	..	..	..	..	..	..	..
Incidence of tuberculosis (per 100,000 people)	70	148	220	200	193	252	80
Prevalence of HIV, female (% ages 15-24)	..	..	..	..	0.1	1.5	..
Prevalence of HIV, male (% ages 15-24)	..	..	..	..	0.2	0.7	..
Prevalence of HIV, total (% of population ages 15-49)	0.1	0.1	0.2	0.2	0.3	2.4	0.6
Tuberculosis case detection rate (%, all forms)	67	24	20	42	47	59	77
Goal 7: Ensure environmental sustainability							
CO2 emissions (kg per PPP $ of GDP)	1	1	0	0	0	0	1
CO2 emissions (metric tons per capita)	1	0	0	0	0	0	7
Forest area (% of land area)	2.9	..	2.9	2.9	2.9	25.7	38.7
Improved sanitation facilities (% of population with access)	..	89	90	93	94	37	84
Improved water source (% of population with access)	..	62	61	63	64	65	96
Marine protected areas (% of territorial waters)	..	..	..	..	..	..	10
Net ODA received per capita (current US$)	2	11	20	39	51	52	18
Goal 8: Develop a global partnership for development							
Debt service (PPG and IMF only, % of exports of goods, services and primary income)	..	..	9	5	4	4	4
Internet users (per 100 people)	0.0	..	0.0	0.3	13.0	6.0	42.1
Mobile cellular subscriptions (per 100 people)	0	0	0	4	91	42	132
Telephone lines (per 100 people)	5	5	4	4	5	1	25
Fertility rate, total (births per woman)	5	5	4	4	3	4	2
Other							
GNI per capita, Atlas method (current US$)	350	200	170	340	870	571	7,734
GNI, Atlas method (current US$) (billions)	1.9	1.2	1.1	2.2	6.1	466.0	3,156.6
Gross capital formation (% of GDP)	24.8	28.7	9.4	14.3	22.1	24.8	24.7
Life expectancy at birth, total (years)	63	62	64	66	68	59	71
Literacy rate, adult total (% of people ages 15 and above)	98	..	99	..	100	63	98
Population, total (billions)	0.0	0.0	0.0	0.0	0.0	0.8	0.4
Trade (% of GDP)	63.0	137.5	199.7	78.8	73.6	69.5	69.6

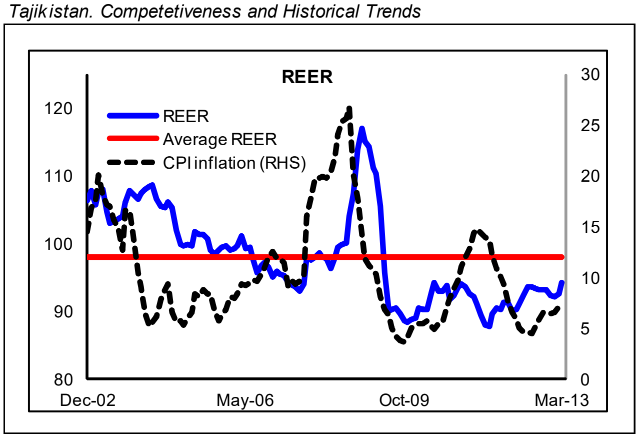
Source: World Development Indicators (World Bank)

Note: Figures in italics refer to periods other than those specified. The last two columns are averages for Low Income Countries (LIC) and Europe & Central Asia (ECA) countries.

Annex I. Tajikistan: External Sustainability, Competitiveness and Structural Reforms

The somoni has appreciated in recent months, and remains around historical averages. In the period before the global financial crisis (GFC), the somoni appreciated by 20 percent in real effective terms, following a spike in domestic inflation (driven in part by the food and fuel crisis). Since the GFC, appreciation of the currencies of Tajikistan's trading partners and a decline in domestic inflation has led to a real depreciation. The real effective exchange rate (REER) appreciated in recent months and remains slightly below the past ten-year average.

Tajikistan. Competetiveness and Historical Trends



Preliminary results applying CGER-type methodologies confirm that the REER is consistent with medium-term fundamentals. It is customary to take a simple average of estimates based on three approaches, which gives an overvaluation of 0.3 percent, within the standard forecast error. Though this average masks a range of estimates from an undervaluation of 5.5 percent to an overvaluation of 3.6 percent using each approach separately, all estimates remain within the standard forecast error indicating neither sizable overvaluation nor undervaluation.

Tajikistan: Methodologies to Assess Real Exchange Rate Misalignment 1/

	Underlying Current Account Balance 2/	Current Account Norm	Estimated over(+)/ under(-) valuation (in percentage)
Macroeconomic Balance Approach 2/	-2.1	-1.8	2.9
External Sustainability Approach 2/	-2.1	-2.6	-5.5
Equilibrium Real Exchange Rate Approach 3/	…	…	3.6

Source: WEO and IMF staff estimates.

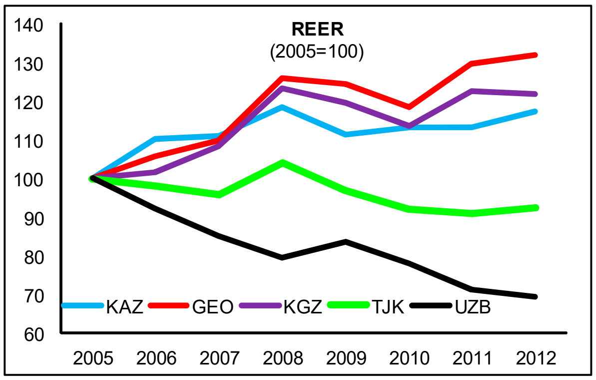
1/ Based on CGER methodologies (SM/06/283).

2/ The macroeconomic balance approach and the external sustainability approach define misalignment as the exchange rate adjustment needed to eliminate the gap between an estimated "current account norm" and the "underlying" current account balance based on 2018 WEO projections.

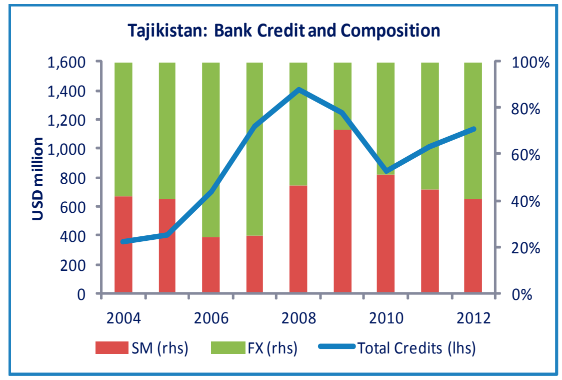
3/ This approach defines misalignment as the change in the real exchange rate required to eliminate the gap between actual REER and the estimated values from the regression of the equilibrium exchange rate based on current fundamentals.

Cross-country data suggest that Tajikistan remains competitive in the region. For the past half decade, the path of Tajikistan's REER has remained below that of its CCA peers, except Uzbekistan. More recently, the REER has trended up towards its peers and away from Uzbekistan.

Tajikistan. Trends in Peer Competetiveness

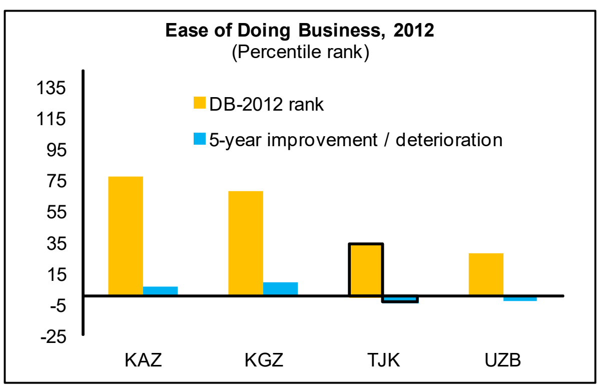


Tajikistan. Credit Dollarization

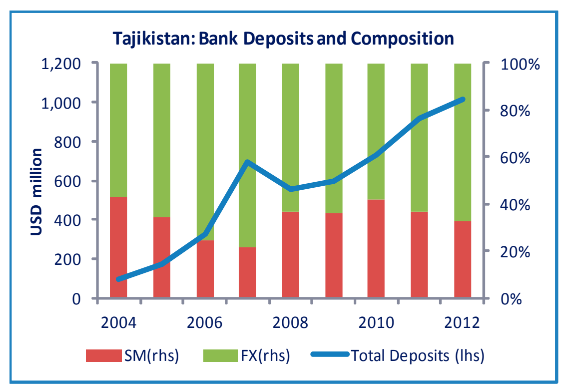


Weak confidence in the economy is hurting long term competitiveness. Tajikistan's ranking in the World Bank's Doing Business index is low and has worsened, declining from 133 in 2007 to 141 in 2012. This, along with high dollarization, suggests limited willingness to do business in somoni, and could be addressed in part by investing in structural reforms to secure business confidence and long term competitiveness. Tajikistan completed its membership negotiations with the WTO in late October 2012, and became the 159th WTO member on March 2, 2013.

Tajikistan: Competetiveness Indicators



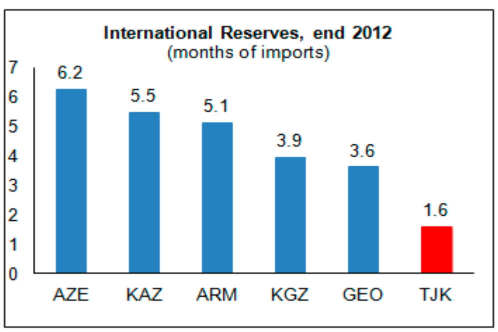
Tajikistan. Deposit Dollarization



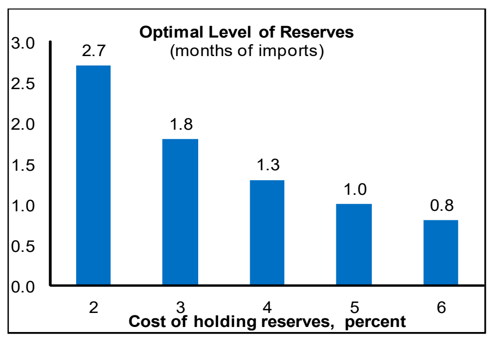
Annex II. Tajikistan: Broader External Sector Vulnerability Assessment

Tajikistan's vulnerability remains elevated with limited reserve buffers. Gross reserves—currently US$ 0.7 billion (covering 1.6 months of imports)—are expected to increase to about US$ 1 billion (covering 1.9 months of imports) by end-2013 due to steady increase in inward remittances, a stable food and fuel price outlook, and the conversion of the NBT's non-monetary gold into monetary gold. Remittances, however, play a buffering role and do not secure the reserve position. Tajikistan scores the lowest in a CCA peer comparison of reserves coverage of imports—months of next year's imports of goods and services. The new reserve metric—based on the costs and benefits of holding reserves—shows that the appropriate level of reserves for Tajikistan is 2.7 months of imports with the cost of holding reserves at 2 percent, significantly higher than the current level of reserves (1.6 months of imports).[13] [14]

Reserves lowest among regional peers



Reserves lower than suggested optimal

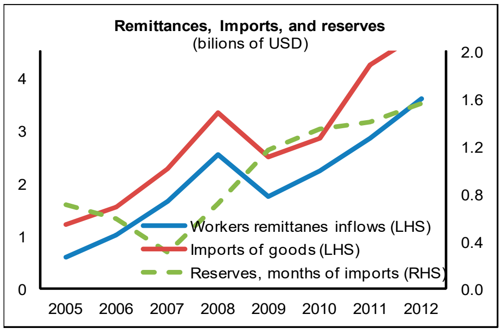


Diversification of the economy and investment in structural reforms will facilitate building buffers. While current market conditions suggest that the somoni is broadly in line with medium-term fundamentals (Annex I), allowing exchange rate flexibility together with adjustment in macroeconomic policies, as warranted, will help to provide necessary near-term buffers. Over the long term, structural reforms—aimed at improving the business environment and transparency—as well as building a broader export base will help to build resilience and enhance competitiveness. In the interim, alternative strategies, such as accumulation of hard currency through converting non-monetary gold to monetary gold can help to build buffers against external shocks.

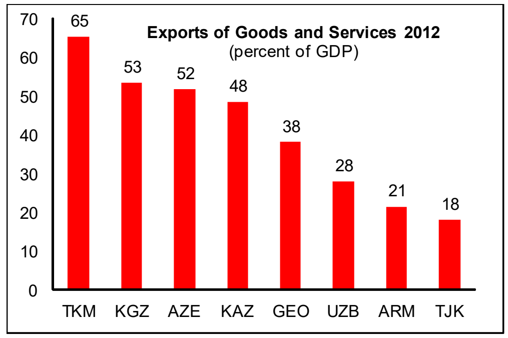
[13] Dabla-Norris, Kim and Shirono (2011) define the optimal level of reserves for LIC countries taking into consideration cost and benefits of holding reserves.

[14] Cost of holding reserves of 2 percent is taken from estimates of the marginal product of capital in LIC countries similar to Tajikistan in terms of economic size, non-oil commodity-based exports, and development as in Caselli and Feyrer (2007).

Remittances provided limited buffering



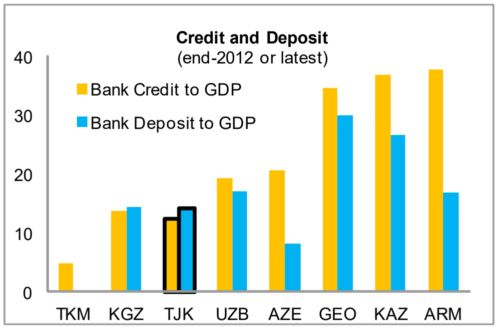
Export base is narrow



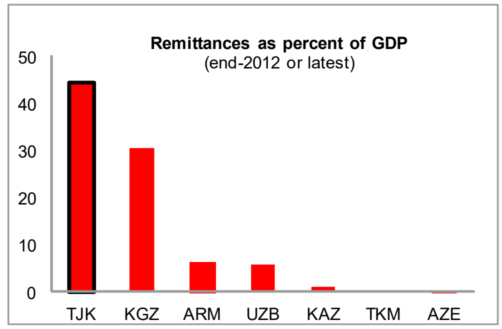
Annex III. Tajikistan: Financial System–Issues and Options

Tajikistan's financial markets are shallow. A central policy issue in Tajikistan is the limited role of financial intermediation and lack of adequate market-based financing for sustaining economic growth.

Depth and access to intermediation are limited,

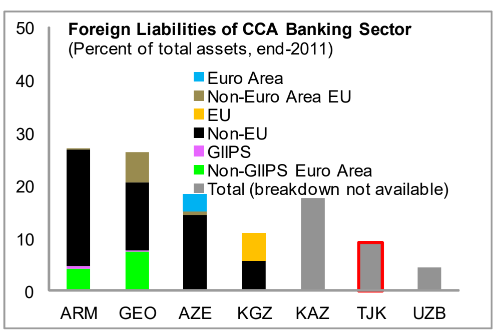


fostering dependence on non-productive remittance financing.

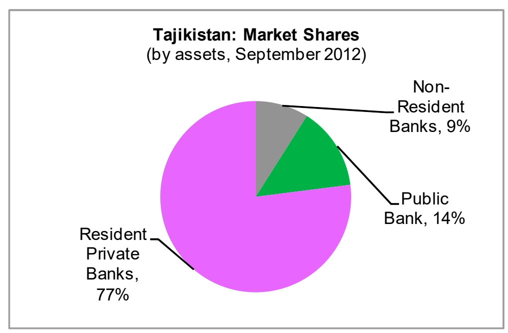


The financial system is largely closed, mostly bank-based, and development of capital markets and access to global financing sources remain limited. Commercial banks cover over 87 percent of total assets, limiting alternate financing sources. The remainder is accounted for largely by microfinance organizations (10 percent), with negligible share of NBFIs, and a virtually non-existent securities market, including for government debt.

Limited debt instruments and foreign financing sources

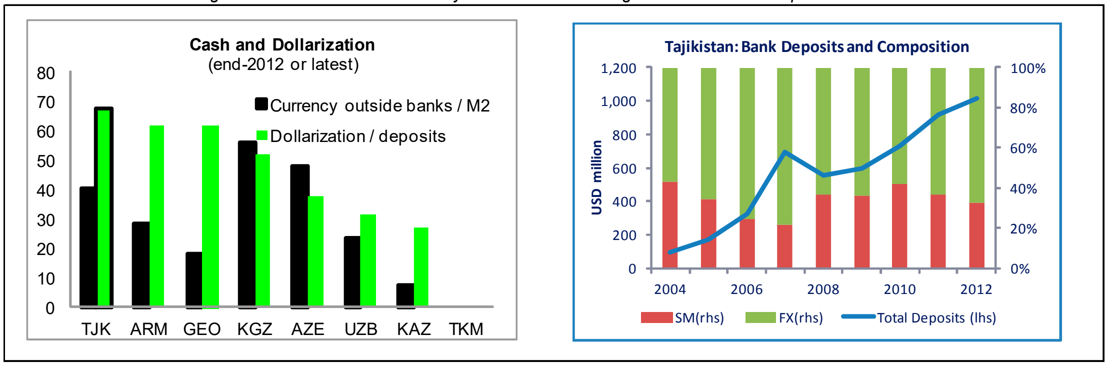


and low penetration of foreign capital

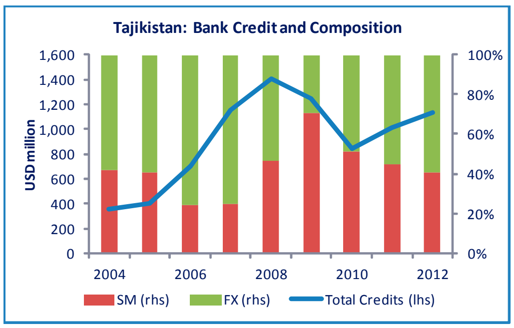


Confidence in the existing financial system is low. As a result, the economy operates largely with cash, suggesting lack of trust in the system and a large informal economy. Formal intermediation heavily relies on foreign currency, indicating limited confidence in the local currency. The interbank market remains underdeveloped and banks rely heavily on NBT's emergency liquidity support at times of strain, though this has recently trended down following the 2012 rescue of AIB.

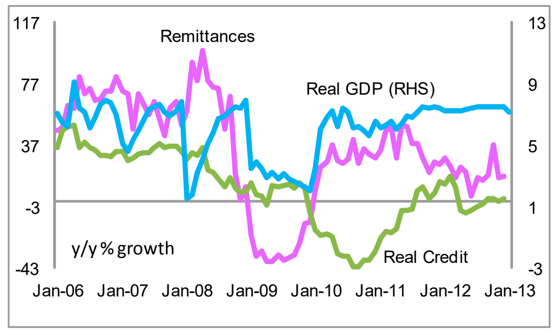
Large cash based informal economy and dollarized funding base for banks and private borrowers



Most deposits are in FX and credit growth is skewed towards FX.

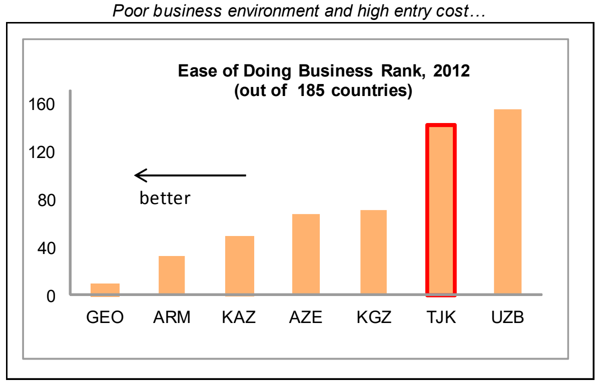


Remittance fund consumption, not channeled well to investments.



Structural problems such as poor governance and accountability in the financial sector reinforce the cycle of low confidence and limited financial market growth. Directed and preferential lending generates an uneven playing field. This, together with a weak loan repayment culture and weak enforcement of prudential regulations, raises barriers to entry. This limits competition, shrinks the scope for intermediation, and increases financial sector vulnerability. A vivid recent example is the failure and government bailout of AIB, the biggest bank by assets.

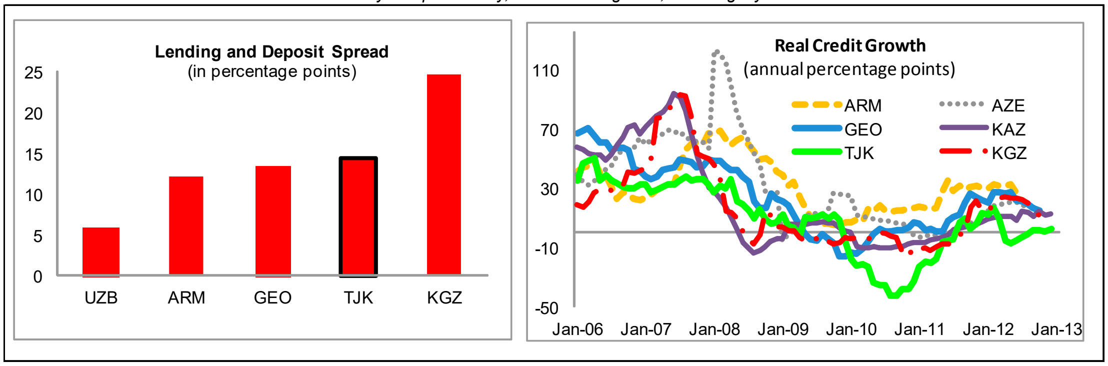
Poor business environment and high entry cost…



Banking sector vulnerability is high. Lending-deposit spreads are high, reflecting the poor business environment and elevated credit risk, and possibly political risk. The profitability of the banking system remains low (2012 ROA is just 0.2 percent; mainly driven by losses at AIB) while NPLs are elevated and keep rising, with one-day plus overdue loans amounting to 18.2 percent of total loans outstanding (Figure 3). While system-wide capital adequacy is high (23.3 percent), stress tests indicate that this masks vulnerability in large banks from direct credit risk and large borrower

exposure, as well as indirect credit risk related to depreciation. Over 50 percent of system-wide deposits are concentrated in some of these large banks, making them potentially vulnerable to shifts in sentiment.

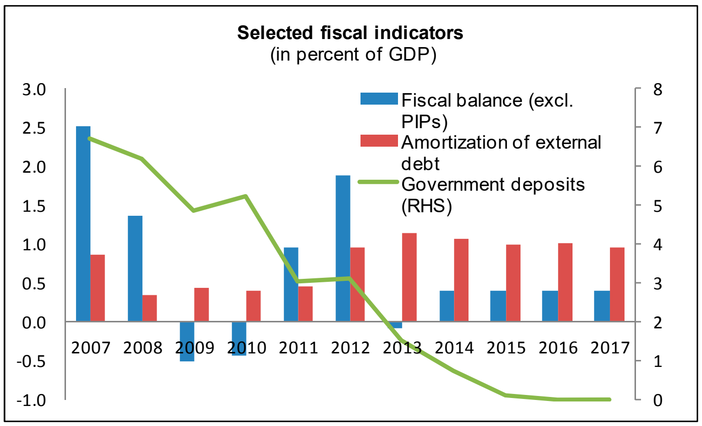
deter entry and profitability, thwart credit growth, and magnify risk.



Options. Halt the practice of directed lending. Focus on resolving AIB to help establish financial accountability, improve governance and create a level playing field for investors. Strengthen bank supervision and stop regulatory forbearance; apply prudential norms equally across banks. Develop the interbank and government debt markets. Together with strengthening supervision, cautious consideration could be given to expanding the financing base beyond banks by leveraging technological leaps in banking to expand financial access of small and medium businesses and across difficult geographic terrain, see chapters I, II, and III, IMF. Enhancing Financial Surveillance in Low Income Countries (LICs)—Case Studies.

Annex IV. Tajikistan: Medium Term Fiscal Framework

The MTFF remains constrained despite positive fiscal outcomes achieved in the past two years. During 2009-2010 the authorities ran fiscal deficits as a countercyclical response to the global crisis. Such policies were partially financed from government deposits accumulated during previous surplus (balance excluding PIP) years. Returning to fiscal surpluses in the past two years has reversed the draw-down of deposits. However, this deposit buffer has been depleted and remains at half of the pre-crisis period, standing at 15 percent of revenues. At the same time, starting in 2012, amortization of foreign debt has sharply increased, creating challenges for debt management.



The projected fiscal stance supports a stable path of debt, but fiscal buffers are drained. To raise sufficient resources to service foreign obligations, the fiscal position is expected to tighten after 2013, while accommodating the needed social and capital expenditure spending. Following this, the budget excluding externally financed PIPs envisages a surplus of at least 0.4 percent of GDP in the medium term. Such an outcome would be achieved by vigilant prioritization of spending and improved tax collection under the new tax code. Still, under the baseline, the accumulated deposit buffer will be fully depleted over the next two years, as debt amortization will outpace the fiscal surplus. Moreover, additional fiscal buffers may be needed to counter expenses from realization of any contingent liabilities.

Under these circumstances, priority should be given to re-build buffers. Currently, prospects remain limited for obtaining debt relief, debt restructuring, financing through additional budget grant support, or concessional borrowing. Sales of the MOF's non-monetary gold to the NBT and implementation of a dividends policy— requiring large SOEs to pay regular dividends to the budget— would help accumulate substantial buffers in the near term. In addition, raising domestic financing through issuance of treasury bills would help to alleviate fiscal pressures. Domestic financial markets are shallow (see Annex III) and efforts should be made to deepen securities

markets. Fiscal dynamics would also benefit from improving tax administration and financial discipline of SOEs (as of end-September 2012, total tax arrears amounted to 12 percent of total tax revenues, of which 40 percent was related to large SOEs).