TRIP NOTE: TAJIKISTAN

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GlobalEvolution

GLOBAL EVOLUTION TRIP NOTES

We visited Tajikistan in October 2017, which recently made their debut in the international financial markets by issuing a USD500m Eurobond to partially fund a huge hydropower project. The mountainous landlocked country in Central Asia represent an early stage frontier market where the main purpose of the trip was to cover the macroeconomic and political development through meetings with government officials, multilateral organization and financial market participants.

Tajikistan

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Introduction

Given that Tajikistan is one of the poorest countries in Asia, one is pleasantly surpised when arriving in Dushanbe by the well-functioning road networks, limited traffic, high standard hotels, and an international presence from a large number of multilateral organisation.

Boarding the flight to Dushanbe

It soon becomes apparent that during the last decade the country has increasingly come under Chinese economic influence at the expense of its traditional ties with Russia. Domestically, the civil war from 1992-1997 seems long forgotten.

The growing Chinese influence has helped foster economic transformation and growth in recent years. That said, the economy's vulnerabilities were shown up by the external shock from lower commodity prices in 2015, which hit both aluminum earnings and remittances from Russia.

As part of the adjustment, the National Bank of Tajikistan's (NBT) allowed sharp TJS depreciation and raised its refinancing rate to 16.0% in an attempt to reverse dollarization. With inflation not going higher than 9.0% y/y, real interest rates are high.

In conjunction with a current account and balance of payment surplus, which has allowed FX reserves to be rebuilt, the TJS now looks well supported making TJS fixed income attractive, however, not really accessable at this point.

The issuance of a debut Eurobond (USD500m) to develop hydropower projects will further assist TJS liquidity. With yields of the Eurobond above 8.0% and the IMF deal in the making valaution seem attractive for a B credit.

Natural resource development

Some 90% of Tajikistan's land is mountainous. It is not great for mechanized agriculture, but does give competitive advantage in hydroelectricity. Besides from electricity, exports include aluminum, cotton, gas transit and dried fruit. The economy is well supported by large remittances. Anecdotally more Tajik´s live outside Tajikistan with a very large migrant population in Russia.

It's central Asia location also give it value as a logistics hub, especially for China as part of its belt and road initiative.

Some two-thirds of FDIs come from China compared to less than 10% for Russia. Most investment goes into mining and manufacturing, but the financial sector is also expected to pick up.

Notable Chinese investment includes the state aluminum company (TALCO), a new oil refinery in Danghara free zone, exploring for gas, building a new gas pipeline, building a railway, power transmission lines and a cryolite and phosphate plant used in aluminum production and cement production.

The GDP numbers look questionable with nominal and real rates not always making sense. But the potential for swift investment fostered growth from a very low base is material.

The focus on huge increases in hydroelectricity will play a large role in the process competitive value added manufacturing in the future.

IMF deal in the making

The country is currently working on an Extended Credit Facility (ECF) with the IMF which is expected to be formalised in Q1:18. Ahead of any deal, we expect an Article 4 review to be released during early November. For the ECF to happen, the authorities need to continue their reform agenda to assure debt sustainability, prudent macroeconomic policies and the required structural reforms. We would expect significant (positive) macroeconomic implications from the large hydropower infrastructure projects and the banking reform which is already well under way. Non-performing loans (NPLs) in the banking sector are around 20-25%, excluding a couple of the troubled banks like TSB where NPLs are as high as 75%.

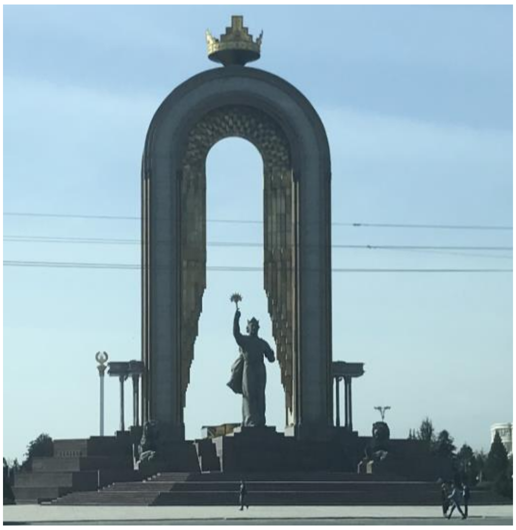
Debt levels remain relatively contained, but the collapse of GDP and currency devaluations makes sustainability less clear cut, especially after the government picked up the bill for restructuring two of the key banks in 2016.

According to authorities government debt/GDP stands at 39%. Following the currency devaluation and the USD500m Eurobond issue, we estimate the total debt to be around 70% of GDP. As the hydropower projects progresses over the coming years the government plans to tap the Eurobond, likely with an additional USD500m.

Reserves are improving

NBT's Gross FX reserves are around USD1.3bn (5 months import cover), including the undisbursed proceeds from the Eurobond (USD320m). This represents a sharp recovery following the collapse from mid-15 to mid-16 during when the NBT sold FX in an attempt to control the currency amid a marked Balance of Payment shock from lower commodity prices and remittances from Russia. Both of these factors are now improving.

Interestingly, 90% of the FX reserves are held in gold and part of the FX reserve growth is from higher prices and the purchase of greater quantity from domestic producers. The NBT plans to sell a large portion of gold converting into FX deposits in the near future.



Somoni Square, Dushanbe

Monetary reforms are gaining pace

During the height of the currency crisis in late 2015-early 2016, dollar deposits increased to over 80% of M2. They are now back below 40.0%.

The process of restoring confidence in the TJS has involved finally allowing the market to find a clearing level (removing the spread between the official and parallel market rates and raising interest rates to high levels in real terms). The process also involved the NBT improving its liquidity draining method.

Interestingly, inflation remained relatively muted during the height of the currency weakness due to low food inflation. The reverse occurred in mid-17 with 12.4% y/y food inflation pushing the headline rate to a high of 8.9% y/y in June 17. Inflation was 7.8% y/y in Oct 17. Inflation looks set to come down to around 6% and monetary rates are likely to follow suit falling from 16% to 10%.

NBT is currently in the process of changing its monetary policy regime from a managed float to an inflation targeting. NBT target single digit inflation.

Interestingly, the REER value of the TJS looks the cheapest it has for many years.

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