

# Tajikistan

Country Economic Update  
Fall 2018

## *Rogun HPP – Potential Resource for Building Human Capital*



**WORLD BANK GROUP**

**Macroeconomics, Trade  
& Investment**  
Global Practice

# **TAJIKISTAN:**

## ***Rogun HPP - Potential Resource for Building Human Capital***

Country Economic Update

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Fall 2018



Government Fiscal Year: January 1–December 31

Currency Unit: Tajikistan Somoni (TJS)

Currency Equivalents: Official Exchange Rate Effective as of November 30, 2018

US\$1 = TJS 9.4191

Weights and Measures: Metric System

## Abbreviations and Acronyms

CAR	Capital Adequacy Ratio
CASA	Central-Asia South Asia Power Project
CEU	Country Economic Update
CPI	Consumer Price Index
DRS	Districts of Republican Subordination
EBF	Extra-Budgetary Funds
EGRA	Early Grades Reading Assessment
EMIS	Education Management Information System
FDI	Foreign Direct Investment
FSAP	Financial Sector Assessment Program
GBAO	Gorno-Badakhshan Autonomous Oblast
GDP	Gross Domestic Product
HCI	Human Capital Index
HPP	Hydropower Plant
IMF	International Monetary Fund
NBT	National Bank of Tajikistan
NPL	Non-Performing Loans
PCF	Per Capita Financing
PIP	Public Investment Program
PPP	Purchasing Power Parity
ROA	Return on Assets
ROE	Return on Equity
SCO	Shanghai Cooperation Organization
SOE	State-Owned Enterprise
TajStat	Tajik Statistical Agency
TIMSS	Trends in International Mathematics and Science Study
TSA	Targeted Social Assistance
UN	United Nations
VAT	Value Added Tax

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## Foreword

*This edition of the Tajikistan Country Economic Update (CEU) is part of a semiannual series designed to monitor socioeconomic developments in Tajikistan. It presents an analysis of political, economic, and social developments, as well as the progress of and challenges with the implementation of structural reforms in 2018. It also includes a special section highlighting human capital development in Tajikistan.*

*This edition's main authors are Bakhrom Ziyaev (Economist for Tajikistan) and Saodat Bazarova (Senior Education Specialist and author of the focus section). The CEU benefited from the valuable guidance by Julio E. Revilla (Lead Economist for Central Asia) and Gohar Gyulumyan (Senior Economist for Tajikistan). Essential inputs were provided by Alisher Rajabov (Poverty Economist), Dilshod Karimova (Procurement Specialist), Faridun Sanginov (Operations Officer), Madina Nurmatova (Senior Private Sector Specialist), Mutriba Latypova (Health Consultant), Nigina Alieva (Communications Officer) and Zarina Odinaeva (Senior Financial Sector Specialist).*

*The authors are grateful for the feedback and comments provided by Jan-Peter Olters (World Bank Country Manager for Tajikistan) and Padamja Khandelwal (IMF Mission Chief to Tajikistan). Tojinisso Khomidova (Executive Assistant) and Nasiba Saidova (Program Assistant) provided administrative support. Nigina Alieva and Navruza Aliqulova helped with the dissemination of the report.*

*Sandeep Mahajan  
Practice Manager  
Macroeconomics, Trade and Investment Global Practice*

## Overview

### **Growth remains strong albeit less inclusive.**

Gross domestic product (GDP) growth slightly accelerated through nine months of 2018, reaching 7 percent compared to 6.8 percent during the same period of 2017. Growth was supported by domestic demand while net exports declined. Large-scale public investments and growing remittances fueled the construction sector and helped prop up domestic consumption. Main drivers from the supply side were industry followed by services and construction sectors. The country's external position deteriorated due to surging import for capital-intensive projects and falling export proceeds as global prices for minerals was on a downtrend.<sup>1</sup> Despite the sustained high rates of economic growth, the future growth prospects remain overshadowed by the protracted resolution of the banking crisis and long-awaited improvements in the business environment. The package of amendments to the financial sector legislation was adopted in June 2018 and is expected to upgrade the regulatory and supervisory framework. However, the resolution of the two problem banks is still pending. Despite some initiatives by the Tajik authorities to foster the overall investment climate and improve the business environment, structural reforms fell behind global trends as evidenced by the recent outcomes of Doing Business Survey.<sup>2</sup> Based on the national definition, the poverty rate fell from 30.3 percent in 2016 to 29.5 percent in 2017. Though the urban poverty has declined at a faster pace, the poverty response to growth in recent years has slowed significantly from a few years ago, challenging the inclusiveness of growth and its distributional effects, especially for the lower-income segments of population.

### **Authorities pursued fiscal consolidation and cautious monetary policy.**

After extensive fiscal expansion of 2016–17, the authorities sought fiscal consolidation path in 2018. However, the magnitude of fiscal consolidation fell short of initially targeted level because of pressure to launch Rogun HPP by November 2018. The latter drove the fiscal deficit up to an estimated 4.9 percent of GDP by the third quarter of 2018. A disproportionately high share of public investments into the energy sector has undermined public expenditures in other sectors, leading to spending cuts and delays. In line with the ring-fencing on core social obligations, the government increased public sector wages, pensions, and other social transfers on September 1 by 15 percent, in line with the approved budget. To meet inflationary target, the central bank continued to issue bills to absorb excess liquidity from the market which was also buttressed by benign prices on imported food and increased agriculture import from Uzbekistan.

### **Outlook remains positive with sizeable risks ahead.**

Tajikistan's growth prospects are weighed down by external and domestic risk factors. Potential escalation of trade tensions and hikes of interest rates by leading central banks impose significant tail risks on foreign exchange inflows through remittances, low mineral prices, and foreign investment channels. Domestic vulnerabilities are emanating from insufficient structural reforms to improve the investment climate, improper governance and

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<sup>1</sup> Based on preliminary information from Tajik Statistical Agency (TajStat) for January–September 2018.

<sup>2</sup> Tajikistan was ranked 126 in Doing Business 2019 sliding three places compared with 2018.

transparency in state-owned-enterprises (SOEs), and unresolved banking sector problems. The country's risk of debt distress remains high in the context of the elevated public debt and further spending pressures to support the construction of the Rogun HPP. To increase the Tajik economy's resilience and ensure macro-stability, the authorities need to accelerate reforms in public finance by improving the efficiency of public spending and quality of tax collections and promoting development of a vibrant private sector for a sustainable economic progress.

## A. Recent Socioeconomic Developments

### Recent Political Events

#### **Tajikistan hosted UN-led Water Conference.**

In June 2018 Dushanbe hosted a *High-Level International Conference on the International Decade for Action "Water for Sustainable Development", 2018–2028* organized by the Government of Tajikistan in cooperation with the United Nations (UN). The goal of the event was to discuss ways the international community, UN, and other partners and international organizations, including the private sector, can contribute to the Water Decade with a view to supporting the implementation of the 2030 Agenda for Sustainable Development.

#### **SCO member states gathered in Dushanbe.**

At the *17th meeting of the Council of Heads of Government of the Shanghai Cooperation Organization (SCO)* that took place in October 2018 in Dushanbe, the President of Tajikistan, Emomali Rahmon, called on the SCO member states to consolidate efforts in tackling global threats of terrorism, extremism, drug trafficking, and other kinds of organized transboundary crime. The President noted that the security and stability in the SCO region directly depends upon the current situation in the Middle East and Afghanistan. As part of his visit to attend the SCO meeting, the Premier of China, Li Keqiang, took part in the ceremony to lay the foundation stone of the new buildings of Parliament and the Government of Tajikistan in Dushanbe, to be built with a grant from China in the amount of 1.5 billion yuans (US\$215 million).

#### **The banking system faced the President's criticism.**

On October 15, 2018, during the *International Entrepreneurship Forum*, President Emomali Rahmon criticized the country's banking system for inaccessibility of low-interest loans for entrepreneurs. It was also noted that over US\$5 billion has been invested by private sector firms into Tajikistan's economy over the past five years, US\$2 billion of which is foreign direct investments (FDIs).

#### **Agreements with Uzbekistan are being firmly implemented.**

Economic relations with Uzbekistan have been expanding after the state visit of the Uzbek president to Tajikistan in March 2018. In September 2018, three new bus routes were launched connecting Tajikistan to the Uzbek towns of Termez, Denau, and Samarkand. Commercial flights between Bukhara, Samarkand, and Dushanbe, which were interrupted in 1992, were resumed in August 2018. In September, the two countries' ministries of defense held their first joint military drill in northern Tajikistan. As of August 1, 2018, Uzbekistan allows Tajik trains to board and land passengers as well as

purchase tickets at the railway stations of Termez, Karshi, and Samarkand. Uzbekistan provided Tajikistan with 30–50 percent discount for the transit fees for railway goods through its territory until end-2018. During the August state visit of President Emomali Rahmon to Uzbekistan, a strategic partnership document was signed between the two countries, along with 27 other bilateral cooperation agreements. The trade turnover between the two countries increased from US\$70 million in 2016 to US\$240 million in 2017. Both countries are planning to increase the volume of bilateral trade to US\$500 million by 2020.

**Rogun HPP was inaugurated on November 16, 2018.**

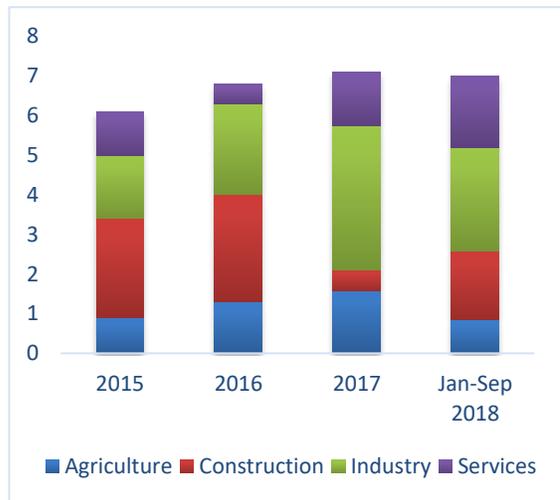
The commissioning of the first unit of the Rogun HPP with an installed capacity of 600 MW will enable early generation of electricity, which will allow Tajikistan to cope with internal demand and raise revenues for the project’s subsequent financing needs. The second turbine is expected to start producing electricity in 2019. The Rogun HPP, when completed, will have an installed capacity of 3,600 MW and will be the most powerful HPP in Central Asia. Speaking at the launch ceremony, the World Bank’s Vice President for Europe and Central Asia, Cyril Muller, said that the Rogun HPP has a great potential to provide a significant development impetus to Tajikistan, if embedded into broader reforms and a sound macro-fiscal framework.

**Economic Growth and Inflation**

**Public investments and private consumption drove growth.**

Real GDP growth accelerated to 7 percent in the first three quarters of 2018 compared to 6.8 percent during the same period a year earlier. Higher economic output was bolstered by growing public investments in infrastructure projects and continued recovery in private consumption supported by migrant transfers.<sup>3</sup> On the other hand, the net export position was afflicted by massive import of capital-intensive goods whereas exports dropped because of the reduced global demand for mineral products, according to preliminary estimates for the first nine months of 2018.

**Figure 1. Sector Contribution to Growth**  
(Annual percentage change)



Source: TajStat and World Bank staff calculations.

<sup>3</sup> According to Central Bank of Russia, money transfers to Tajikistan totaled US\$1.94 billion in January–September 2018 from US\$1.88 billion in January–September 2017.

**Industry drove growth, but other sectors contributed too.**

On the supply side, the largest contribution to growth came from industry which expanded by 13.5 percent and accounted for 2.6 percentage points of overall growth. New capacity buildups in the food processing, metallurgy, and energy sectors were the primary drivers in industrial output. The remaining growth was largely generated by the services and construction sectors which grew by 3.7 percent and 15.8 percent, respectively, and each accounted for one-fourth of total GDP growth. Supported by continued recovery in remittances, annual growth in retail trade jumped to 15.6 percent from 6.2 percent a year ago while expansion of production facilities in energy and textiles stimulated higher growth in the construction sector. Investment into fixed assets continued to be driven by the public sector (60 percent) followed by FDI (30 percent) and the rest by domestic private and joint ventures. Annual growth in agriculture decelerated to 4 percent (from 6.1 percent a year ago) affected by relatively low precipitation observed last winter as well as throughout spring and summer periods.

**Table 1. Contribution to Real GDP Growth, 2015–2018**  
(Percentage points)

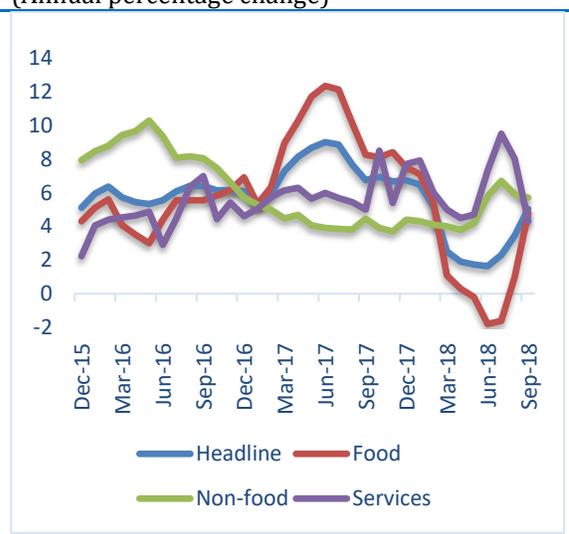
	2015	2016	2017	9 Months-2018
<b>Real GDP growth</b>	<b>6.0</b>	<b>6.9</b>	<b>7.1</b>	<b>7.0</b>
Agriculture	0.9	1.3	1.6	0.8
Construction	2.5	2.7	0.5	1.7
Industry	1.6	2.3	3.6	2.6
Services	1.1	0.5	1.4	1.8

Source: TajStat and World Bank staff estimates.

**Prudent monetary policy contained inflationary pressures.**

Annual consumer inflation dropped to 5 percent in September 2018 compared to 6.7 percent a year earlier (figure 2) but increasing from a record low in June 2018. Prudent monetary policy, relatively stable exchange rates, and a sudden jump in agriculture imports from neighboring Uzbekistan after the reopening of the common border helped contain inflationary pressures. Since March 2018, the National Bank of Tajikistan (NBT) has kept the policy rate at 14 percent, and the inflation target of 7 percent ( $\pm 2$  percentage points) is expected to be achieved in 2018. Food inflation, which comprises over 55 percent of consumer price index (CPI) basket, was contained on the back of declining prices in wheat,

**Figure 2. Consumer Price Inflation**  
(Annual percentage change)



Source: TajStat and World Bank staff estimates.

and the inflation target of 7 percent ( $\pm 2$  percentage points) is expected to be achieved in 2018. Food inflation, which comprises over 55 percent of consumer price index (CPI) basket, was contained on the back of declining prices in wheat,

sugar, and vegetables, among others. Despite administrative adjustment in water tariffs early in the year, overall services inflation went down supported by lower railroad tariffs as Uzbekistan reduced transit fees. On the other hand, inflation in non-food items surged largely because of uptrending global oil prices.

## External Sector

### External imbalance widened.

The current account deficit widened to 4.3 percent of GDP in January–June 2018 from 0.5 percent of GDP a year ago due to intensified import needed for infrastructure projects.<sup>4</sup> Continued growth in exports, rising by 15.3 percent, and remittance inflows growing by 9.2 percent was outweighed by surging imports that rose by 27 percent, during the same period. Intensified construction of infrastructure projects, particularly in the energy sector, has substantially increased imports of machinery equipment, heavy-duty vehicles, and metals. In contrast, exports benefited from growing global demand for cotton and aluminum—Tajikistan’s principal commodities along with gold—the latter, however, suffering from a downward trend in prices. Total electricity exports increased by 20 percent to US\$30 million supported by resumption of sales to Uzbekistan. Since last year, trade turnover with Uzbekistan rose by more than 200 percent and the country is currently in the top five trade partners list while Russia, Kazakhstan, China, and Turkey comprise the top four in descending order.

### FDI inflows yet strengthened.

Financing of the current account deficit was predominantly ensured by growing FDIs and to a lesser extent by the drawdown of international reserves. In the first half of 2018, net FDI rose by almost 4.5 times, though from a low base, and reached 3.7 percent of GDP (US\$267 million) compared to 0.9 percent of GDP (US\$61 million) in the corresponding period of last year. Supported by vast tax exemptions, the mining industry received almost 60 percent of total FDI inflows and was followed by manufacturing at 34 percent. About 78 percent of FDI originated from China whereas the other two largest contributors were Turkey accounting for 8.7 percent and Great Britain at 5.2 percent.

**Table 2. Balance of Payments and Official Reserves, 2015–2017**  
(US\$, millions)

	2015	2016	2017 <sup>a</sup>	6 Months-2018 <sup>e</sup>
<b>Current account balance</b>	<b>-472</b>	<b>-362</b>	<b>151</b>	<b>-313</b>
Merchandise trade	-2,254	-1,886	-1,517	-912
Exports f.o.b.	572	668	873	429
Imports f.o.b.	2,826	2,554	2,390	1,341
Services	-241	-138	-122	-105
Primary income	1,526	1,089	1,207	471
Secondary income	497	572	582	232
<b>Capital and financial account balance</b>	<b>637</b>	<b>423</b>	<b>496</b>	<b>224</b>

<sup>4</sup> Balance of payments statistics for January–September 2018 will be released with a 90 days lag.

	2015	2016	2017 <sup>a</sup>	6 Months-2018 <sup>e</sup>
Capital account	144	144	135	26
FDI, net	426	234	-15	267
Portfolio investment	0	0	500	1
Other capital flows	67	45	-123	-70
<b>Errors and omissions</b>	<b>-146</b>	<b>-296</b>	<b>-115</b>	<b>-49</b>
<b>Overall balance</b>	<b>19</b>	<b>-235</b>	<b>531</b>	<b>-138</b>
<i>Memorandum items:</i>				
NBT official reserves (months of import)	1.7	2.7	5.4	5.1
Nominal GDP (US\$, millions)	7,857	6,922	7,162	5,179

Source: NBT.

Note: a. NBT revised balance of payments statistics for 2017; f.o.b. = free on board.

## Financial Sector

### Financial soundness indicators are on the positive trend.

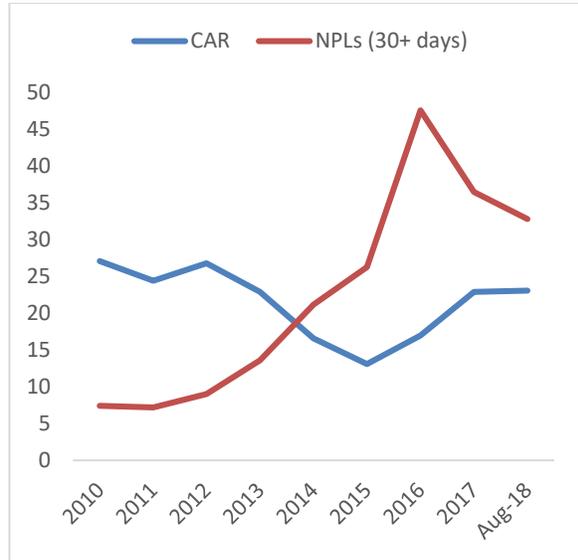
Capital levels are on a marginal rise supported by bottoming out private sector credit, improving loan repayment performance, and growing profits. The system-wide capital adequacy ratio (CAR) slightly increased from 22.9 percent at end-2017 to 23.1 percent by August 2018. Continued growth in remittances and strengthening business activity have helped reduce the level of non-performing loans (NPLs) to 32.8 percent from 36.5 percent earlier, whereas the provisioning rate at 91.1 percent currently stands much higher than good practice prescribed at 75 percent. The quality of assets continues to be weighed down by two troubled banks and the government's resolution is still pending even after three years. On the supervisory front, the NBT instructed all banks to prepare loan recovery plans which are under close watch on execution. Return on assets (ROA) and return on equity (ROE) are slowly picking up after negative figures in 2016. In August 2018, the ROA and ROE reached 1.6 percent and 5.6 percent, respectively, however, still far from pre-crisis levels in 2013 at 2.2 percent and 10.7 percent. Although liquidity indicators have stabilized in the past two years, the picture hides restricted access to withdraw deposits in insolvent banks, which are still pending the government's resolution. While local currency deposits rose by 3.7 percent in January–June 2018, foreign currency deposits fell by almost 7 percent. On the positive side, dollarization levels of both deposits and credits continued to decline, reaching 54.1 percent and 55.9 percent, respectively, by end-June 2018, compared to 69.5 percent and 63.1 percent—peak level in 2015.

### The microfinance sector has consolidated.

In line with the Financial Sector Assessment Program (FSAP) recommendations to harmonize minimum capital requirements for old and new institutions, the microfinance segment of the financial sector experienced substantial consolidation. The number of microfinance organizations decreased from 120 in 2014 to 66 in March 2018, driven primarily by sharp reduction of microcredit organizations from 42 to 7, followed by microdeposit organizations from 42 to 27 and to a lesser extent by microcredit funds from 36 to 32. The consolidation of market participants was in the form of mergers, acquisitions, and closures. The reduction in the

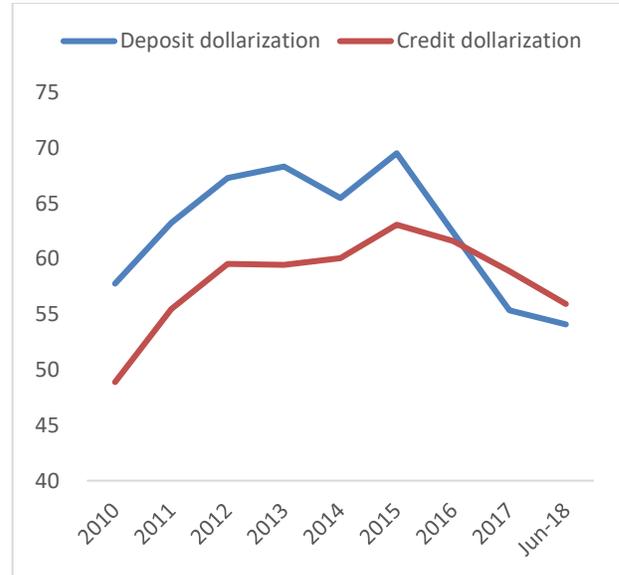
number of microfinance institutions also led to a reduction of branches from 415 in 2014 to 336 in March 2018.

**Figure 3. Financial Indicators 2010–2018**  
(Percentage)



Source: NBT and World Bank staff calculations.

**Figure 4. De-dollarization trends 2010–2018**  
(Percentage)



Source: NBT and World Bank staff calculations.

## Social Sector

### Labor market pressures remain elevated.

Labor market pressures stayed relatively similar in 2017 and 2018. The number of applicants per vacancy declined slightly between June 2017 and June 2018, from 8.7 to 8.5 persons per vacancy. The rate of officially registered unemployment stood at 2.2 percent of the labor force, in the first six months of 2018. The highest official unemployment rate was observed in Gorno-Badakhshan Autonomous Oblast (GBAO) followed by Districts of Republican Subordination (DRS) at 6.8 and 4.5 percent, respectively.

**Table 3: Official Unemployment Rates by Regions, June 2018**  
(Percentage)

<b>Tajikistan</b>	<b>2.3</b>
GBAO	6.8
Sogd	1.3
Khatlon	2.0
Dushanbe	1.6
DRS	4.5

### Average wages have increased modestly.

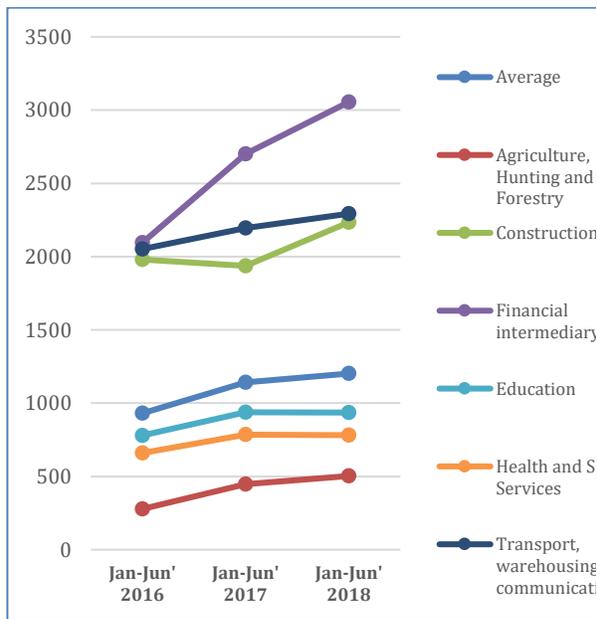
All sectors, except health and education, experienced wage growth in the first half of 2018 with primary increases in the financial intermediation, agriculture, and construction sectors. This dynamic, facilitated by an administrative decision, helped reduce the large sectoral disparities in wage earnings as well as the ratio between the highest-paid financial sector and the

lowest-paid agriculture sector from 8 in 2016 to almost 6 in 2018. Financial services, construction, and transport and communications remain the highest-paid sectors. The difference in paid wages is in line with the divergence in sectoral levels of labor productivity. Agriculture, with the lowest productivity per worker, lags construction by a factor of 10 in productivity. In contrast, agriculture, which employs almost half of the labor force remains the lowest-paid sector with an average monthly wage of TJS 503 (just 25 percent above the minimum wage).

**Agriculture accounts for more than 45 percent of the employment.**

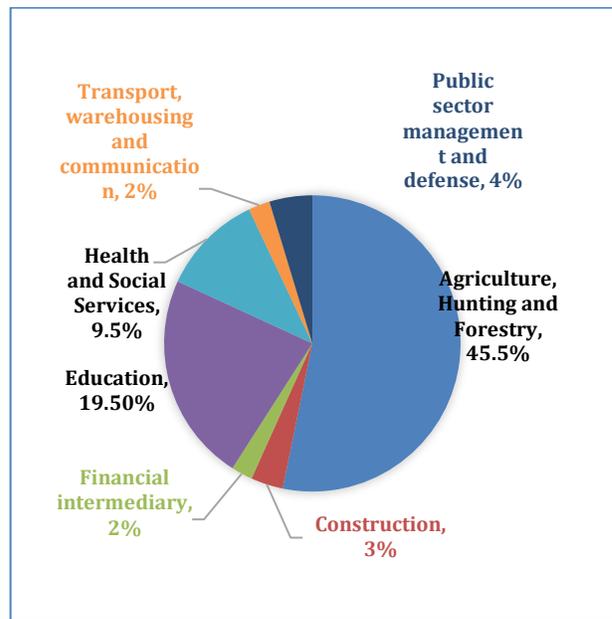
The sectoral profile of wage employment in Tajikistan has not changed dramatically during the last three to four years. About 45.5 percent of total hired employment was in the agriculture sector in the first half of 2018 (up from 42.9 percent in 2016 and 45 percent in 2017), followed by education and health and social services accounting for 19.5 percent and 9.5 percent of employment, respectively.

**Figure 5. Average Monthly Wage by Sector (TJS)**



Source: TajStat and World Bank staff calculations.

**Figure 6. Employment Share by Sector (Percentage of total)**

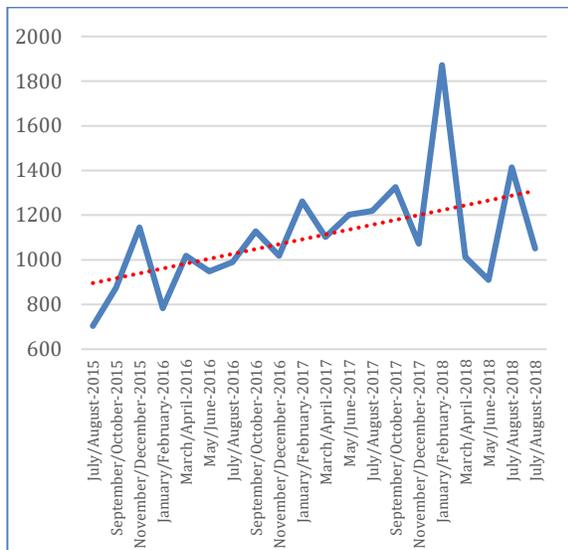


Source: TajStat and World Bank staff calculations.

**The average size of remittances increased though the number of receiving households continues to decline.**

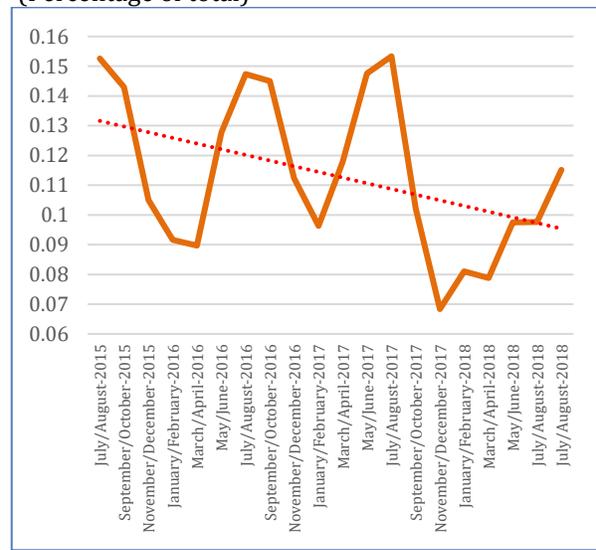
Tajikistan has achieved a significant reduction in its poverty rate since 2012. According to the national poverty line, the poverty rate fell from over 37 percent in 2012 to 29.5 percent in 2017. However, the poverty reduction response to economic growth, which was higher before the 2008–09 financial crisis, has weakened since 2010. Moreover, extreme poverty has remained stagnant at 14.1 percent of the population during the last several years. Income from employment and remittances remains the primary driver of poverty reduction. While recent trends show a decline in the share of households receiving remittances, the average real value of remittances is on a steady rise. The decline in remittance inflows to households slowed the pace of poverty reduction in the period between 2014 and the first half of 2016; poverty reduction resumed in the second half of 2016 and accelerated throughout 2017. Recent progress on poverty reduction has varied for urban and rural areas. Poverty was relatively stagnant in urban areas during 2015–16 at around 24 percent before falling to 22 percent in 2017. By contrast, rural poverty fell significantly from 36.1 percent in 2014 to 33.1 percent in 2017.

**Figure 7. Average Real Remittance Value (TJS)**



Source: TajStat and World Bank staff calculations.

**Figure 8. Share of Households Receiving Remittance (Percentage of total)**

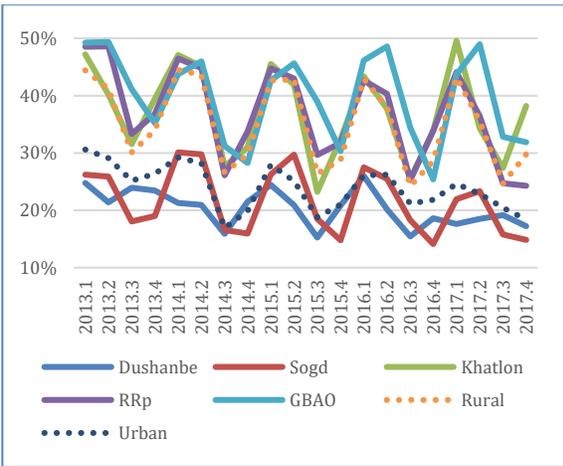


Source: TajStat and World Bank staff calculations.

**Poverty rates are falling in most regions, fluctuations are more pronounced in rural areas.**

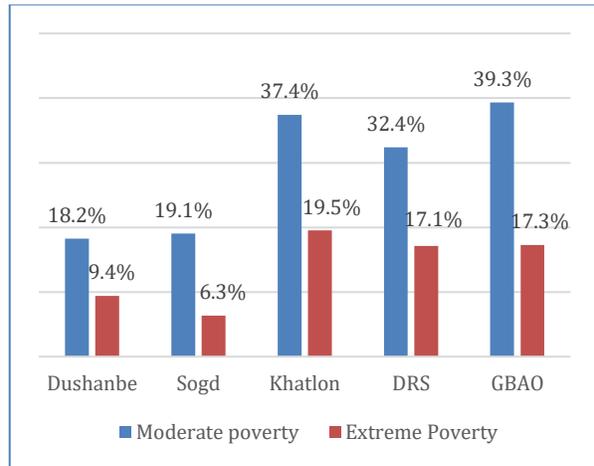
Both national and regional poverty rates are falling, but due to seasonality of income and consumption patterns, poverty rates are fluctuating from one quarter to another and fluctuations are more pronounced in rural areas. The highest poverty rate is in GBAO, but Khatlon has the highest extreme poverty rate.

**Figure 9. Quarterly Poverty Rates (Percentage)**



Source: TajStat and World Bank staff calculations.

**Figure 10. Poverty by Regions, 2017 (Percentage)**

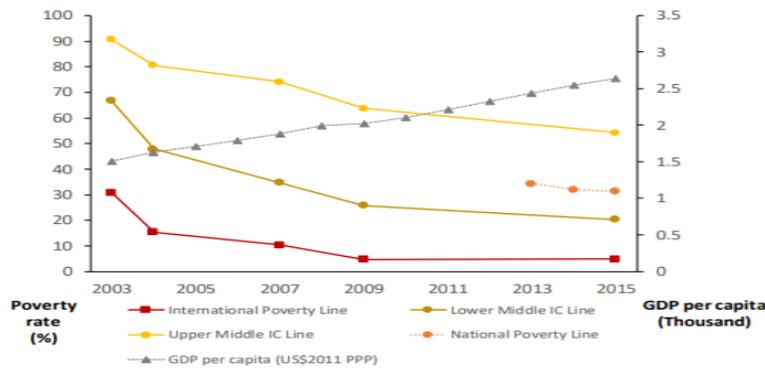


Source: TajStat and World Bank staff calculations.

**Poverty has been falling in Tajikistan at both national and international poverty lines.**

Poverty rates in 2015 were around 5 percent and 20 percent using the US\$1.9 2011 Purchasing Power Parity (PPP) international poverty line and the US\$3.2 2011 PPP lower-middle-income country poverty line, respectively. While using the US\$1.9 and US\$3.2 lines, poverty is moderately low in Tajikistan, whereas at the US\$5.5 2011 PPP line (used mostly for upper-middle-income countries) poverty is alarmingly high at 54 percent. For instance, in Kazakhstan, the poverty rate for 2015 at the US\$5.5 line was 7.7 percent.

**Figure 11. Poverty Rate and GDP Per Capita**



Source: World Bank staff calculations

**B. Macroeconomic Policies and Structural Reforms**

**Assessment of Fiscal and Debt Policies**

**Strategic projects are weighing on the state budget.**

Over the last two years, government expenditure rose sharply due to the continued construction of the Rogun HPP. According to preliminary estimates for September 2018, the fiscal deficit made 4.9 percent compared to

6.7 percent in 2017. High level of capital expenses was largely financed by the remaining balance of Eurobond proceeds issued last year and also by gold sales from government deposits. The authorities met the tax collection targets, while nontax revenues overperformed significantly supported by penalty charges on business inspections, including tax audits. The budget stumbled on its execution in all sectors except for the energy complex—the latter consuming over one-third of total expenditures. Core social obligations were reportedly met, and public-sector wages, pensions, and other social payments were increased by 15 percent as of September 1, 2018. The level of public debt remains elevated at over 55 percent of GDP, suggesting high risk of debt distress and raising the country's sovereign borrowing costs.

**Inspections ensured revenue collection targets.**

The state budget achieved its gross revenue collection target. This was, however, due to outperforming nontax revenues (16.5 percent) above projections. The shortfall in domestic value added tax (VAT) receipts (15.4 percent), customs fees (16.5 percent), and grants for public investment programs (PIP) (4.9 percent) was largely offset by fines and penalties raised through on-site business inspections. As planned earlier, the government is no longer showing tax audit charges in a separate category and corresponding amounts were redistributed to relevant taxes. This methodological shift in presentation of the budget prevents proper assessment of voluntary tax compliance trends in the economy. As of the third quarter of 2018, the budget support grants were not received as was envisaged in the budget law. All development partners have postponed budget support programs until the government reaches an agreement with the International Monetary Fund (IMF).

**The energy sector absorbed most funding.**

The state budget was underexecuted by about 8 percent. Except for the energy and fuel complex, underexecution was spread across all sectors, including education, health, and social protection. Rogun HPP expenditures overran budgeted amounts by a significant margin driven by the acceleration in construction to launch the first turbine in November 2018. Budgetary cuts and delays were primarily associated with non-priority infrastructure facilities and refilling inventories. Reportedly, core social payments were fulfilled in line with the budgeted amounts, yet funds earmarked for the targeted social assistance (TSA) program could not be fully absorbed due to administrative delays. The government continued to accumulate interest payment arrears on domestic bonds held by the NBT.

**Budget Law 2019 envisages fiscal consolidation.**

The Budget Law for 2019 stipulates fiscal consolidation with the state budget deficit reducing to 3 percent of GDP<sup>5</sup>. Total government revenues are expected to remain at the same level (27.1 percent of GDP) while expenditures will be cut by 6 percent of GDP (30.1 percent of GDP). For the upcoming fiscal year, the government scaled up budget allocations for social sectors (education, health, and social protection) while cuts will largely concern the energy sector. Total allocations for energy and fuel complex have been earmarked at 5.2 percent of GDP compared to 7.3 percent of GDP in

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<sup>5</sup> The Budget Law does not indicate full scope of financing of strategic infrastructure projects which may potentially increase the level of fiscal deficit.

January–September 2018. Debt service obligations are estimated at TJS 2.2 billion or 2.8 percent of GDP. The TSA program is expected to be rolled out nationwide with total funding at TJS 86 million. Overall social spending (including on culture and sport) will account for 43.7 percent of total budget expenditures compared to 35.5 percent in nine months of 2018. Policy-wise, the authorities have revised domestic and external excise taxes to converge with regional tax policies which have higher rates. In 2019, the government intends to continue concessional external borrowing by attracting 3.4 percent of GDP from multilateral and bilateral sources, which will comprise a major source of deficit financing. Eurobond issuance has not been envisaged in the budget law.

**Table 4. Consolidated Fiscal Accounts, 2015–2018**

(Percentage of GDP)

	2015	2016	2017e	9 Months- 2018
<b>Revenue and grants</b>	<b>29.9</b>	<b>28.8</b>	<b>29.6</b>	<b>27.1</b>
Tax revenue	22.0	20.6	21.5	21.2
Income and profit taxes	4.8	4.4	5.0	4.9
Payroll taxes	2.8	2.5	2.6	2.5
Property taxes	1.2	1.2	1.3	1.3
Taxes on goods and services	12.0	11.3	11.5	11.4
International trade and operations taxes	1.1	1.2	1.2	1.1
Nontax revenues	5.0	5.2	5.6	4.0
of which extra budgetary funds	2.1	2.5	3.5	2.1
Grants	3.0	3.0	2.4	2.0
of which PIP	2.1	3.0	2.1	2.0
<b>Expenditure and net lending</b>	<b>31.8</b>	<b>38.5</b>	<b>36.3</b>	<b>32.0</b>
Current expenses	18.1	17.6	18.1	16.2
Capital expenses and net lending	13.7	21.0	18.2	15.8
<b>Overall fiscal balance (including externally financed PIP)</b>	<b>-1.9</b>	<b>-9.8</b>	<b>-6.7</b>	<b>-4.9</b>
<b>Overall fiscal balance (excluding externally financed PIP)</b>	<b>1.2</b>	<b>-6.6</b>	<b>-1.8</b>	<b>-2.8</b>
<i>Memorandum items</i>				
Total Public Debt <sup>a</sup>	36.7	49.0	54.7	55.4
Nominal GDP (TJS, millions)	48,402	54,471	61,094	47,518

Source: Ministry of Finance and World Bank staff estimates.

Note: a. Public debt figures include SOE external borrowings.

## Assessment of Monetary and Exchange Rate Policies

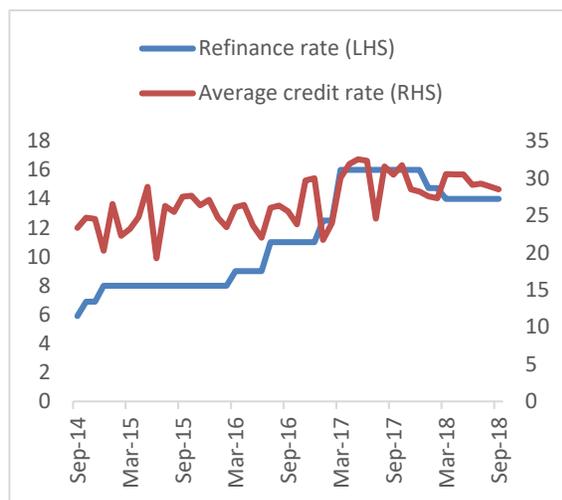
### Prudent monetary policy ensured low inflation.

In the context of the envisaged move to an inflation targeting framework, the NBT became more cautious in regulating money supply and earlier-adopted new instruments have improved the transmission mechanism to credit markets. Through January–September 2018, broad and reserve money grew by 10.6 percent and 15.9 percent, respectively, compared to 21.8 percent and 21 percent in 2017. As inflation remained within the target range of 7 percent ( $\pm 2$  percentage points), the refinance rate has been kept at 14 percent since March 2018 and excess liquidity was mopped up through NBT securities which rose by about 70 percent compared to nine months of 2017. Based on the last press release of the Monetary Policy Committee, inflation is forecast to end the year at the lower band of the target range. Over the last few years, the transmission channel of the policy rate has improved largely on account of revised linking of the refinance rate to NBT securities as well as newly introduced standing facilities. In addition to overnight deposits and credits, in 2018 the NBT enriched its basket of tools by adopting short-term deposits, given the low level of trust among financial institutions to interact in the interbank market.

### The real effective exchange rate appreciated.

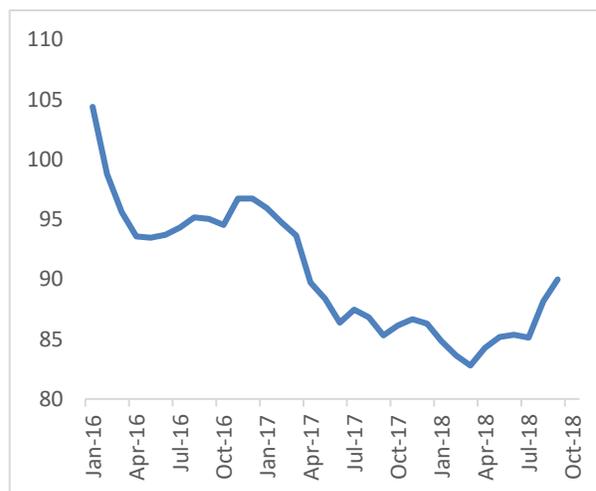
The foreign exchange market remains highly regulated by the central bank, which constrains access to hard currency, indirectly limits imports, and stimulates the informal market. In the context of growing pressures and increasing spread between the official and black-market rates, in mid-July the central bank made a sharp adjustment by devaluing the somoni by 2.6 percent against the U.S. dollar. On the other hand, limited nominal devaluation weakened trade competitiveness of the economy as in real terms the somoni strengthened against its major trade partners. According to NBT estimates, the real effective exchange rate appreciated by 4.8 percent since the end of last year.

**Figure 12. Policy Rate Effectiveness**  
(Percentage)



Source: NBT and World Bank staff calculations.

**Figure 13. Real Effective Exchange Rate Index**  
(December 2009 = 100)



Source: NBT and World Bank staff calculations.

## Ongoing Structural Reforms

### **Regulatory reforms are not translating into ground realities.**

Tajikistan continues with a recently initiated inspections reform including by streamlining planning procedures, applying a risk-based approach, and developing checklists. The government is enhancing the legal framework on investments by amending the Investment Law and defining, among others, the types of state support which could be provided to investors, including financial, property, and natural grants. The Amended Investment Law appoints the State Investment Committee as the government body responsible for providing natural grants and stresses that such grants (amount, size, and use conditions) are subject to investment agreements. Amendments to tax and customs legislation include expansion of the excise product list and introduction of a special payment system for certain types of goods on cross-border trade. Despite ongoing changes in legislation, the overall business environment has not yet improved, and the economy feels the high regulatory burden.<sup>6</sup>

### **The focus on health reforms intensified.**

Several important health-related policies and legislative documents have been enacted in 2017 and 2018. The first Health Code was adopted in May 2017 consolidating 16 national laws related to health. At the same time, the State Insurance Program for 2017–19, National Program on Prevention of HIV for 2017–20, National Program on Rehabilitation of Disability for 2017–20, and other strategic programs and action plans on health and nutrition were enacted. Multiple other strategic documents and policies are currently under development including a strategic plan for reforming health financing for 2019–21, the National Health Strategy 2030, and 30 other health-related legal documents and orders.

### **Disaster Risk Management Strategy has been developed.**

In May 2018, the government adopted the ‘Development Program of Committee of Emergency Situations and Civil Defense under the Government of Tajikistan for 2018–22’. The program identifies goals, principles, priorities, and measures for restructuring and upgrading state bodies responsible for the management of emergency situations; prescribes rules for inter-agency coordination; and outlines strategic development of the sector. At the same time, authorities have finalized preparation of the ‘National Disaster Risk Management Strategy 2017–30’. The strategy has been developed in line with the 2015 Sendai Framework for Disaster Risk Reduction, which outlines seven targets and four priorities for action to prevent new and reduce existing disaster risks. The strategy is expected to be endorsed by the end of 2018.

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<sup>6</sup> See report on Doing Business 2019.

**Procurement system remains inadequate.**

To address current problems, authorities are working toward increasing the coverage and performance of the public procurement law, enhancing application of e-government procurement, and strengthening capacity building. In this regard, a new Public Procurement Law and bylaws have been prepared and will be submitted for approval in July 2019. At the same time, the government is carrying out a full-scale transition to an e-procurement system under a unified portal. By current estimates, upgrade to the e-procurement system will be completed in 2020. The comprehensive e-procurement system will cover procurement planning, bidding process, contract management, framework agreements and catalogues, online complaints handling, procurement data management and measurement of public procurement performance, and development of interfaces between e-procurement, treasury, and other e-government systems. Nonetheless, there is a lack of strategy on adequate resourcing of the procurement function, knowledge transfer, and capacity building of the procuring entities that makes the period of decentralization process uncertain and potentially lengthy thus requiring comprehensiveness and urgency before the new procurement law comes into force.

## **C. Economic Outlook and Risks**

### **Tajikistan's Baseline Scenario**

**Favorable external environment and public investments will support strong growth though downside risks are significant.**

Tajikistan's short- and medium-term outlook is positive, building on a favorable external environment and publicly driven investment policies. Growth in the Russian economy, elevated prices for major export commodities—cotton and aluminum—and growing regional cooperation will support external proceeds. Strong remittance inflows will stimulate private consumption and ensure gradual pickup in private credit as trust in the banking system restores. Along with the high volume of investments into the Rogun HPP, average growth is expected to hover around 6 percent in 2019–2020. Inflation is forecast to remain within the target range of the central bank's smooth transition to the inflation targeting regime by 2020. The poverty rate is expected to benefit from strong economic growth, migrant transfers, and growing wage income earnings. The national rollout of the TSA program will contribute to the reduction of extreme poverty. Using US\$3.2 international line (2011 PPP), Tajikistan's poverty rate is projected to fall to around 11.9 percent by 2020 from 20.3 percent in 2015.

**The external deficit is projected to remain high.**

The country's external position is projected to remain highly imbalanced due to capital-intensive import needs for the construction of the Rogun HPP, an appreciated somoni, and increasing private consumption—the latter propelled by remittance inflows. The current account deficit is estimated to reach 3.8 percent of GDP in 2018 and steadily reduce in the medium term. FDIs will remain low, suffering from the general business climate. Over the medium term, capital outflows are expected to accelerate, assuming Tajikistan's slow reforms in creating a business-friendly environment compared to regional economies,

especially Uzbekistan. International reserves will drop in line with construction of the Rogun HPP.

**Public investments and debt service will impose high fiscal stress.**

Although, the government is expected to pursue fiscal consolidation, in the medium term, Tajikistan will continue facing fiscal stress engendered by Rogun HPP investments and growing debt service obligations. Massive tax exemptions and an uncondusive business climate will continue eroding the tax base. Revenue collections from additional electricity generation will be modest and subject to timely construction of Central Asia-South Asia (CASA)-1000 power transmission lines. Under the baseline scenario, the fiscal deficit will reduce to about 2–3 percent of GDP while overall public debt (including from SOEs) will remain at elevated levels. Despite strong economic growth, the country will be at a high level of debt distress.

**Table 5. Baseline Scenario: Selected Macro-Fiscal Indicators, 2017–2020**

(Percentage, unless otherwise indicated)

	2017e	2018f	2019f	2020f
Real GDP growth	7.1	6.0	6.0	6.0
Private consumption	3.3	6.6	4.0	4.0
Government consumption	2.5	2.2	2.6	2.7
Gross fixed investments	30.6	19.7	10.9	15.4
Export, goods and services	5.0	2.5	2.9	3.2
Import, goods and services	-4.5	10.0	2.8	2.5
Consumer price inflation, period average	7.3	6.0	7.0	7.0
Current account balance (percentage of GDP)	2.1	-3.8	-3.8	-3.6
Overall fiscal balance (percentage of GDP)	-6.7	-5.5	-3.0	-2.3
Public debt (percentage of GDP)	54.7	56.3	55.0	55.0

Source: Tajik authorities, and World Bank staff estimates and projections.

## Risks and Challenges

**Downside risk prevail in the economic outlook.**

The structure of the economy remains highly susceptible to external and domestic risk factors. Further escalation of global trade tensions coupled with interest rate hikes by the Federal Reserve will dampen external earnings through commodity price shocks, lower FDI, and remittance inflows. Domestic vulnerabilities are magnified by long-standing irresolution of toxic banks, contingent liabilities of SOEs, particularly in the energy and transport sectors, and unsatisfying progress in structural reforms to improve the business environment. The transformational change of the country into an industrial-innovative economy—the high case scenario in the National Development Strategy 2030—is not possible without lifting reform efforts to a completely new level. Creating a level playing field for all private sector participants, improving corporate governance in loss-making SOEs, and investing in human capital will be vital going forward.

## D. Focus Section

### Human Capital Index in Tajikistan

#### Overview and background information.

At the World Bank Group's 2017 Annual Meetings, the World Bank presented the Human Capital Project—a new effort to demonstrate the link between investing in people and economic growth and to accelerate more and better investments in people for greater equity and economic growth. A year later, at the 2018 Annual Meetings in Bali, the Human Capital Index (HCI)—one of the Human Capital Project's key pillars—was launched. The index provides an easy-to-understand answer to the question “How much human capital will a child born today acquire by the age of 18, given the risks to health and education that prevail in the country where he/she was born?”

Human capital consists of the knowledge, skills, and health that people accumulate throughout their lives, enabling them to realize their potential as productive members of society. Investing in people through nutrition, health care, quality education, jobs, and skills helps develop human capital, and this is key to ending extreme poverty and creating more inclusive societies.

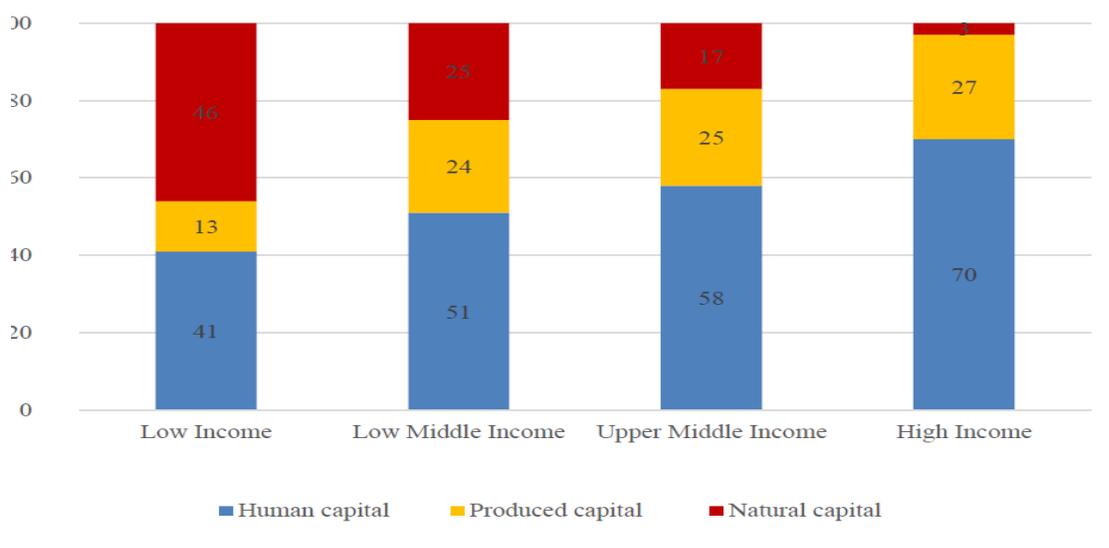
Economic growth and development depend on both human capital and physical capital and on the factors affecting their productivity. Investments in human and physical capital complement and reinforce each other. To be productive, a workforce requires physical capital, such as infrastructure, equipment, and a stable well-governed economy. In turn, a healthy, educated workforce can earn more and invest more in an economy's physical capital.

#### Benefits of investing in human capital.

**Benefits to economic growth (enterprises).** Firms benefit from high skilled employees. Skills are found to explain a substantial part of the difference in growth rates between Organisation for Economic Co-operation and Development (OECD) countries. For example, increased GDP growth in Ireland, Japan, and South Korea has been linked to high investments in human capital; conversely, GDP growth in countries such as New Zealand and Switzerland grew, on average, less than 1.5 percent due to low investment in human capital.

**Benefits to poverty reduction (individuals).** Empirical research shows that building skills (whether cognitive, socioemotional, or technical) can drastically improve employment outcomes, social outcomes, and civic engagement. In almost all countries worldwide, individuals with higher levels of education enjoy higher employment rates, are more often formally employed, and have higher earnings; and changes in earnings are the largest contributor to poverty reduction.

**Figure 14. Human Capital Is the Largest Contributor to Global Wealth (share of total wealth)**



### Box 1. HCI Components Definition

HCI measures the human capital that a child born today can expect to attain by his/her 18th birthday, given the risks of poor health and poor education in the country where he/she lives. Units represent productivity relative to a benchmark of complete education and full health, on a scale of 0 to 1.

#### ***HCI Component 1: Survival***

Probability of survival to age 5, represents the unfortunate reality that not all children born today will survive until the age of 5, when the process of human capital accumulation through formal education begins. It is measured using under-5 mortality rates.

#### ***HCI Component 2: School***

- **Expected years of school:** Number of years of school that a child can expect to attain by 18th birthday if he/she starts preschool at age 4 and given enrollment rates in the country where he/she lives for a maximum of 14 years.
- **Harmonized test scores:** Harmonized test scores combine data from major international student achievement testing programs into common units, where 300 represents minimal attainment, and 625 represents advanced attainment.
- **Learning-adjusted years of school:** This indicator discounts time spent in school by a factor measuring how much children learn. It is calculated by multiplying expected years of school by harmonized test scores as a fraction of the advanced attainment benchmark score of 625.

#### ***HCI Component 3: Health***

- **Fraction of children under 5 not stunted:** The fraction of children under 5 who are not stunted and are experiencing normal healthy growth. Stunting summarizes the adverse health shocks experienced by children in their early years, with important consequences for adult health and well-being.
- **Adult survival rate:** Defined as the fraction of 15-year-olds that survive until age 60. In the context of the HCI, this serves as a summary indicator of the overall health environment.

**HCI in Tajikistan lags peer countries.**

The overall HCI in Tajikistan currently stands at 0.53 which indicates that individuals and the country as a whole are foregoing almost half their future economic potential. The country modestly falls behind regional countries such as Armenia (0.57) and Kyrgyzstan (0.58), while the gap with Kazakhstan (0.75) and the Europe and Central Asia average (0.63) is much more pronounced. The survival and health indices particularly suffer from high rates of infant mortality, stunting, and hypertension among adult women.<sup>7</sup> Every major nutritional index for women in the Republic of Tajikistan has worsened at the national level since 2009, and growing rates of overweight and obesity among women pose a risk of chronic diseases such as cancer, cardiovascular disease, and diabetes. On the other hand, education indices show relatively divergent results. Expected years of schooling in Tajikistan is less than in selected regional countries and below the Europe and Central Asia average. The indicator’s value reflects low preprimary enrollment rate (12.4 percent for 3–6-year-olds in 2016) and 9 years of mandatory education in school with high dropout rate after grade 9, especially for girls. Although, harmonized test scores suggest a relatively good stance with respect to other countries in Europe and Central Asia, the index should be taken with a grain of salt. The scores were harmonized across major international student achievement testing programs measured in TIMSS<sup>8</sup>-equivalent units, where 300 is minimal attainment and 625 is advanced attainment. The only available assessment data for Tajikistan are from EGRA<sup>9</sup> 2016 which was not nationally representative.

**Table 6. HCI Comparison with Other Regional Countries**

HCI Components	Tajikistan	Kyrgyzstan	Armenia	Kazakhstan	Europe and Central Asia average <sup>a</sup>
Total HCI score	0.53	0.58	0.57	0.75	0.63
Probability of survival to age 5	0.97	0.98	0.99	0.99	0.987
Expected years of school	10.8	12.6	11.1	13.3	12.4
Harmonized test scores	444	420	443	537	410
Learning-adjusted years of school	7.7	8.4	7.9	11.5	7.4
Fraction of children under 5 not stunted	0.83	0.87	0.91	0.92	0.762
Adult survival rate	0.87	0.82	0.88	0.80	0.835

*Note:* a. Excluding high-income countries such as France, United Kingdom, and Finland.

<sup>7</sup> According to the Demographic and Health Survey 2017, infant mortality is at 27 per 1,000 live-born, stunting below age 5 at 17 percent, and hypertension among women of ages 15–49 at 10 percent.

<sup>8</sup> TIMSS - Trends in International Mathematics and Science Study.

<sup>9</sup> EGRA - Early Grades Reading Assessment.

**Education system remains underfunded.**

Education is the second largest public sector after energy and comprised 16 percent of the state budget in 2017, with a bulk of the funds spent at the general education level. However, despite steadily growing financing,<sup>10</sup> total funding is still inadequate to meet the needs of the education system caused by, among others, a rapidly growing school population<sup>11</sup> and demolished infrastructure during the civil war. To increase efficiency in the allocation, utilization, equity, and transparency of funds, in 2010 the government introduced national per capita financing (PCF). The new framework was adopted in the general education system with the support from the World Bank, Global Partnership for Education, and other partners. This change in policy augmented with an increased autonomy of schools in the decision making on the allocation of school funds resulted in savings for school development. Building on the successful PCF implementation in general education, the government is now undertaking steps toward expanding the PCF program to preschools. In parallel, in 2010, authorities introduced the Education Management Information System (EMIS) in general education system. The EMIS helped policy makers to identify important gaps such as scarcity of teachers in rural areas, high level of dropouts, and factors influencing sectoral trends.<sup>12</sup> In 2017, the EMIS was expanded to other levels of education, namely preschool, professional, and higher education.

Tajikistan does not have a systematic standardized student assessment for general education; however, proxy assessments indicate poor quality in the education system. The national launch of a new primary grades competency-based curriculum in 2016 is expected to improve educational outcomes. Additionally, Tajikistan started work on strengthening the quality assurance system and curriculum modernization in higher education with support from the World Bank.

**Out-of-pocket expenses remain high in the health sector.**

Health is considered a foundational investment in a country's human capital. Poor health and nutrition hold people back from achieving their fullest potential at any point in life. When investments in health begin in the early years of life and are sustained through the life cycle, they lay a strong foundation for the growth and competitiveness of nations. Poor nutrition in the first 1,000 days of a child's life—from a woman's pregnancy to the child's second birthday—can lock them into a lifetime of health and social challenges that are devastating and irreversible. During this critical period, if children do not get the vital ingredients needed to grow their bodies and develop brains, they are not only more likely to get sick from diseases throughout their whole life, and die, but will also earn less than peers in adulthood.

While the Government of Tajikistan remains the main provider of health care services, most health expenditure is covered through private out-of-pocket payments. Health planning in Tajikistan remains focused on the budgetary process. The process of budget formation in Tajikistan continues to follow

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<sup>10</sup> From 4.4 percent of GDP in 2010 to 6.1 percent of GDP in 2017.

<sup>11</sup> For example, enrollment in general education institutions increased by 5.8 percent between the 2016 and 2017 academic years and reached 1.82 million students.

<sup>12</sup> EMIS data are also used to predict student intake in grade 1 and appropriately plan required resources, including on teacher training needs and investments in physical infrastructure.

mechanisms inherited from the Soviet period, with an emphasis on inputs and staffing rather than on quality and outputs. There are marked inequities in the health system regarding both finance and the distribution of services and resources. Quality of care is another major concern, which is affected by the lack of investment in health facilities and technologies, an insufficient supply of pharmaceuticals, poorly trained health care workers, and a lack of medical protocols and systems for quality improvement.

Tajikistan has undertaken several significant health sector reforms in the past decade. The overall aims of health reforms undertaken in Tajikistan were to improve the efficiency of health spending, redirect the limited budgetary means toward primary care, develop and implement national programs and projects, introduce a basic benefit package that would provide financial protection for vulnerable groups of the population, and create and strengthen the legislative basis of the health system. However, the progress of health reforms in Tajikistan has been relatively slow, compared, for example, to Kazakhstan and Kyrgyzstan.

In 2017, overall health spending was 2.3 percent of GDP. The national health strategy 2010–20 includes plans to raise public expenditure on health to 4.4 percent by 2020. To motivate specialists in the health and social sectors, the government has promised to increase wages by 15–25 percent on an annual basis.

Tajikistan's population is facing a double burden of both noncommunicable and communicable diseases. Although the Ministry of Health and Social Protection of Tajikistan has reported that all demographic and health indicators such as maternal and child mortality, incidence of infectious diseases (tuberculosis, HIV/AIDS, malaria) and noncommunicable diseases (cardiovascular, oncological, endocrinological) are improving, infant and maternal mortality rates are among the highest in the World Health Organization European Region and malnutrition is a major public health concern.

## Annex 1. Selected Macroeconomic and Social Indicators, 2015–2020

	2015	2016	2017	2018	2019	2020
	Actual	Actual	Estimate	Projections		
<b>National Income and Prices</b>	(Percent, unless otherwise indicated)					
Real GDP growth	6.0	6.9	7.1	6.0	6.0	6.0
Private consumption	-15.0	6.4	3.3	6.6	4.0	4.0
Gross investment	24.4	20.3	30.6	19.7	10.9	15.4
Consumer price inflation, period average	5.8	5.9	7.3	6.0	7.0	7.0
Average exchange rate (TJS per US\$)	6.17	7.84	8.5	—	—	—
<b>External Accounts</b>	(Percent of GDP, unless otherwise indicated)					
Exports of goods and services	10.5	13.3	15.6	15.6	15.4	14.8
Imports of goods and services	42.3	42.8	38.8	40.5	39.9	38.1
Current account balance	-6.0	-5.2	2.1	-3.8	-3.8	-3.6
Capital and financial account	8.0	6.1	-3.0	10.0	9.1	7.3
FDI, net	5.3	3.4	0.2	2.5	2.5	2.4
<b>Consolidated Fiscal Accounts</b>	(Percent of GDP, unless otherwise indicated)					
Revenues	29.9	28.8	28.8	25.8	24.3	24.1
Expenditures	31.8	38.5	35.5	31.3	27.4	26.3
Overall fiscal balance	-1.9	-9.8	-6.7	-5.5	-3.0	-2.3
Primary fiscal balance	-1.5	-9.2	-6.2	-4.8	-2.4	-1.8
Total Public Debt <sup>a</sup>	36.7	49.0	54.7	56.3	55.0	55.0
<b>Monetary Accounts</b>	(Percent, unless otherwise indicated)					
Broad money growth	18.7	37.1	21.8	...	...	...
Reserve money growth	16.0	71.1	21.0	...	...	...
Private sector credit growth	12.7	-4.9	-20.2	...	...	...
Refinance rate, end of period	8.0	11.0	16.0	...	...	...
<b>Social Indicators</b>						
Population, total (millions)	8.5	8.6	8.8			
Population growth (percent)	2.4	2.2	2.2			
Unemployment rate (officially registered)	2.5	2.4	2.2	...	...	...
Poverty rate, (national poverty line TJS 175.2 per month)	31.3	30.3	29.5			
Inequality - Gini coefficient	27.5	28.0	...	...	...	...
Life expectancy (years)	69.4	...	...	...	...	...

Source: Tajik authorities, and World Bank staff estimates and projections

Note: a. Including SOE external borrowing.

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