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Republic of Tajikistan: Letter of Intent

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TAJIKISTAN: LETTER OF INTENT

April 23, 2012

Her Excellency
Ms. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, DC 20431

Dear Ms. Lagarde:

I would like to express my gratitude to the International Monetary Fund (IMF) for its continued support of our economic reforms. Tajikistan's economy has performed well in the past year, but nonetheless remains vulnerable to external shocks. Support from international financial institutions (IFIs) and donors continues to be critical.

Economic performance in 2011 was strong. Despite adverse climate conditions and negative shocks to food and fuel prices, real GDP growth registered 7.4 percent, fueled by trade and services, agriculture, and construction. While inflation has been high (reflecting trends in international commodity markets), it subsided by end-year to single digits. Financial sector indicators remain a concern. We recognize the need for more proactive supervision and lasting solutions for banks not meeting established prudential criteria.

Against this background, we have successfully implemented our reform program supported by the IMF's Extended Credit Facility (ECF). I am pleased to inform you that we succeeded in meeting or over-performing on all of the end-December 2011 performance criteria and indicative targets. We have also implemented most of the structural benchmarks for the sixth and final review under the program. A treasury single account (TSA) was established on the Republican level, audited financial statements for the Roghun OJSC were completed by the auditor in draft and are expected to be published on the MOF website in May, a treasury single account (TSA) was established on the Republican level, and a financial risk statement related to state enterprises was completed and published on the MOF website. We have also submitted a revised tax code to the government for consideration. This is a first draft, and work on revising the tax code to strike a balance between IMF recommendations and short-term revenue considerations will continue. Technical support in this area would be welcome.

While non-performing loans have largely stabilized, weaknesses in some financial institutions remain a concern. One bank in particular is facing immediate challenges with respect to meeting established prudential criteria and may require restructuring and/or

recapitalization. In this context, we have already tightened supervision, undertaken a review and revision of the bank's end-year balance sheets, and have received technical assistance missions from the IMF. We are committed to finding a credible, equitable, and lasting solution for the problems facing this bank. We will continue to work closely with IMF staff in are committed to refraining from directed lending, and will undertake a more proactive approach to financial sector supervision. As agreed with the IMF mission, the NBT will require banks to comply with International Financial Reporting Standards (IFRS). Looking forward, for those banks not meeting established prudential criteria, the NBT will require developing a time-bound action plan for restructuring and/or recapitalization. Every effort will be made to ensure the safety of individual deposits and the stability of the banking system, as well as to limit any fiscal cost. We also fully recognize that directed lending has played a key role in creating these problems, and commit to end this practice.

We are committed to achieving the remaining reforms outlined in the Memorandum of Economic and Financial Policies (MEFP) of December 22, 2011. In addition, as noted above, we intend to tackle decisively financial sector issues to promote financial stability. While recent economic performance is encouraging, we are concerned about inflation, the risks of another global downturn or regional instability, and the potential impact on Tajikistan in terms of growth, poverty, and fiscal and external balances. We ask the international community for assistance in these areas. We remain committed to ensuring that Roghun project and its financing are undertaken in a way consistent with macroeconomic stability, and external and fiscal sustainability. The current ECF supported program expires in May 2012, but we will continue to adhere to macroeconomic parameters in line with staff advice, and intend to continue discussions on a new program.

We hereby request completion by the Executive Board of the sixth review under the ECF arrangement, and disbursement of the seventh loan totaling an amount equivalent to SDR 13.045 million. In parallel, we seek continued concessional support from donors for the coming year to achieve the objectives of the 2010–12 Poverty Reduction Strategy.

The Government believes that the policies set forth in this letter and the MEFP are adequate to achieve the objectives of its program, but will take any further measures that may become appropriate for this purpose. We will consult with the Fund on the adoption of these measures and in advance of any revision to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We intend to remain in close consultation with Fund staff and provide timely information necessary for monitoring economic developments and implementation of policies under the ECF arrangement. In addition, the Government stands ready to take any further measures that might be required to ensure that the overall objectives of the program are attained.

Finally, in continuing with our commitment to transparency, we hereby request that all program related documents, including this letter, be published on the IMF website.

Your Excellency, please accept my assurances of my highest consideration,

Emomali Rakhmon/s/
President of the Republic of Tajikistan

Table 1. Tajikistan: Quantitative Performance Criteria and Indicative Targets under the 2011 Extended Credit Facility

(In millions of somoni; unless otherwise indicated)

	2010		2011				2012	
	End-Dec	End-June	End-Sept.	End-Dec.	End-Dec.	End-Mar.	End-Mar.	
	Act.	Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.
<i>Quantitative Performance Criteria (PC):</i>								
1. Ceiling on cumulative flow of net domestic assets of the NBT 1/ 2/	...	120	19	210	213	678	522	-122
2. Floor on cumulative flow of total net international reserves (in millions of U.S. dollars) 1/ 2/	...	25	3	45	21	32	58	12
3. Zero-ceiling on new lending from the NBT to private sector (continuous quantitative performance criterion) 2/	...	0	0	0	0	0	0	0
4. Floor on cumulative overall fiscal balance of the general government excluding foreign-financed Public Investment Program and related grants 2/	...	-134	150	-208	316	-187	164	208
5. Ceiling on general government wage and pension arrears (continuous quantitative performance criterion)	...	0	0	0	4	4	4	0
6. Ceiling on contracting or guaranteeing of any non-concessional external debt (continuous quantitative performance criterion)	...	0	0	0	0	0	0	0
7. Ceiling on disbursements of concessional external financing (in millions of U.S. dollars) 2/	...	154	87	231	142	308	195	71
8. New external payments arrears (continuous quantitative performance criterion)	...	0	0	0	0	0	0	0
<i>Indicative Targets (IT):</i>								
1. Floor on tax collection 2/	...	2,470	2,717	3,837	4,211	5,759	5,833	1,563
2. Floor on social and poverty-related expenditure 2/	...	1,421	1,200	2,131	1,853	2,841	2,920	775
3. Ceiling on gross equity sales and contributions for Roghun (in millions of somoni) 3/	...	880	840	880	841	880	841	880
4. Ceiling on loans to banks for liquidity purposes by the NBT (average per quarter)	...	227	263	244	218	100	90	100
<i>Memorandum items:</i>								
Program exchange rate	4.40							
NDA of the NBT (in millions of somoni) 1/	1,739	1,285	1,758	1,375	1,952	2,417	2,261	2,305
Net international reserves (in millions of U.S. dollars) 1/ 4/	376	400	378	420	397	408	434	419

1/ At program exchange rates of end-December 2010.

2/ Cumulative from January 1 of the year; performance criteria for end-June and end-December 2011, and indicative targets for end-March and end-September.

3/ Cumulative from January 1, 2010.

4/ Adjusted for presumed forward sale of fx on June 30, 2011 in the amount of 10.8 mln USD.

Table 2. Tajikistan: Structural Benchmarks and Prior Actions for 2011 and 2012

	Date	Rationale	Status
Publish the audited financial statements of Talco Management for 2008–09 together with the audit reports.	Prior action for Board meeting	Transparency	Met on Nov. 17, 2011
NBT to set the interest rate on liquidity loans in Somoni and foreign exchange no lower than the average interest rate on commercial bank credits (as published on the NBT website) of the preceding month, plus a margin of not less than 200 basis points, and to publish this rate on the NBT website.	Prior action for Board meeting	Transparency	Met
Appoint a senior member of the ministry of finance to attend monthly monetary policy committee meetings and to report on monthly projected spending on the Roghun hydropower project.	Prior action for Board meeting	Transparency/liquidity management	Met
Banks not meeting established prudential criteria to submit to NBT for approval time-bound actions plans to become fully compliant with these standards, including correct provisioning for nonperforming loans.	End-March	Financial sector stability	Met on March 31, 2011
Expand the number of large taxpayers under the Large Taxpayer Inspectorate (LTI).	End-June	PFM / Revenue	Met
Issue a government resolution specifying a multi-year (2011–18) schedule for injections of capital from the government into the NBT as part of the NBT recapitalization plan and in line with IMF recommendations.	End-June	NBT recapitalization	Met on June 30, 2011
NBT Board to approve an action plan, in line with IMF recommendations, for addressing weaknesses in the financial sector.	End-June	Financial sector stability	Met on June 24, 2011
National Bank of Tajikistan to publish audited 2010 financial statement	End-September	Transparency	Met on Dec. 13, 2011
Submit to cabinet a strategy for reform of the tax regime.	End-September	Revenue	Met
Fiscal risk statement related to condition of SOEs to be introduced as part of the published 2012 budget document.	End-December	SOE governance	Met on April 11, 2012.
Publish the audited financial statements of Roghun OJSC for 2008 and 2009 with the audit reports on the Ministry of Finance's website.	End-March 2012	Transparency	Partially met.
Submit to cabinet a revised tax code consistent with IMF recommendations.	End-March 2012	Revenue/transparency	Partially met
Implement in line with IMF recommendations a Treasury Single Account (TSA) at the Republican level.	April 1, 2012	Public financial management	Met

**ATTACHMENT II. NBT REFORM ACTION PLAN AND FINANCIAL SECTOR STABILITY
ACTION PLAN**

TABLE 1: NBT REFORM ACTION PLAN

Reform	Timing	Status
<i>GOVERNANCE</i>		
Close down the Cotton Debt Department at the NBT.	June 2009	Done
Develop proposals to restructure the NBT' organizational set up	December 2010	Done
Appoint the NBT Board for a fixed term with 3 non-executive members.	June 2010	Done
Establish NBT Board Committees, such as an audit committee, chaired by a non-executive member of the NBT Board.	June 2010	Done
Create and publish on the NBT's website a register of commercial interests of NBT Board members and top management	June 2010	Done
A draft revised central bank law substantially compliant with the recommendations of Fund staff should be approved by the President of the Republic and submitted to Parliament for enactment.	December 2010	Done
<i>AUDITING</i>		
The appointment of the external auditor for the 8 months ended December 31, 2009 should be finalized in time for the external auditor to attend vault counts in headquarters and all branches to confirm the balances in vaults as well as unissued currency at end-December.	Before end-December 2009	Done.
External audit of the April 2009 financial accounts to be completed.	Prior action for 1 st and 2 nd reviews	Done. Audit posted on NBT website in April 2010.
Continue NIR reviews by an international audit firm at test dates under the ECF arrangement. Such reviews should be completed before the IMF Board meeting and the TOR for	End-June 2011 audit prior to fifth	Done

Reform	Timing	Status
the reviews should be adapted as needed to ensure that (i) the auditor attends vault counts on the relevant test date; (ii) emerging issues are addressed; and (iii) previous recommendations are being addressed.	Board meeting.	
Publish on its external website in a dedicated section the financial statements and audit opinion within 1 month from completion of the audit, also including all past audit reports.	Continuous	Completed for fiscal year ending April 2009, December 2009, and 2010.
Develop an internal regulation to define a formal policy for the selection and appointment of its external auditor. The policy should stipulate: (i) the composition of the selection committee, including participation by non-executive Board members; (ii) criteria for making the selection; (iii) a timeline for the tendering, bidding and appointment, ensuring the contracting of the external audit not later than 3 months before the year-end; and (iv) multi-year audit contracts.	By September 2010, in time for the 2010 audit selection	Done
Outsource—through a formal tendering process—to an external consulting firm the internal audit of the activities of (i) the international relations department, including foreign exchange lending and liquidity support; (ii) the domestic lending and liquidity support activities; and (iii) the management of foreign currency vault operations at headquarters. Ensure that external consultant contributes to capacity building in the Internal Audit Department.	April 2010	Done
Plan and organize an external quality assurance review of the NBT's Internal Audit Department by certified experts on its compliance with Institute of Internal Auditors (IIA) standards.	June 2011	Extended for 5 years in line with IMF TA recommendations
<i>ACCOUNTING AND OPERATIONS</i>		
Create a new base of the NBT balance sheets and continuously monitor their conformity with analytical data	June 2009	Done
Keep full records of adjustments made with regard to audited financial reports, and keep full records to confirm the data that the IMF publishes in its reports	Continuously	Completed for 2009 and 2010.
Increase the number of sudden checks of cash available in	Continuously	Done

Reform	Timing	Status
the NBT's head office and regional branches.		
Develop a mechanism to transfer and share information between departments on any reclassification of items in the NBT's accounting balance sheet for the purpose of compiling the monetary analysis.	Continuously	Done
Establish a register of the gold bars held in the NBT vaults, including gold owned by the ministry of finance. This register must include details on the serial number of the gold bars and the ownership. This register must be included in the scope of the NIR review, starting with the end-December 2009 test date.	March 2010	Done
Take measures to create a centralized accounting system of the NBT by transferring all accounting functions to relevant departments and introduce software for centralized recording of transactions done by the NBT's regional branches.	June 2010	All departments excluding International Reserves Department now part of centralized accounting system.
Include the issue of accounting and monitoring of the NBT balance sheet items in daily meetings of the working group. Include representatives of the internal audit and accounting into the working group		Not done. No representation from Audit Department
Strengthen cash management by setting up basic structures which assure the segregation of duties between the front-office, back-office and accounting functions in order to mitigate operational risks.		Done

TABLE 2: FINANCIAL SECTOR STABILITY ACTION PLAN

Reform	Timing	Status
<i>Asset Quality</i>		
NBT to approve regulation on uniform classification and provisioning (Regulation 177).	July 2011	Done
Banks to fully provision for NPLs in accordance with established prudential criteria.	August 2011	Done
All banks to work on an accrual basis and (i) stop accruing interest on NPLs, or (ii) make 100 percent provision for interest earned on NPLs.	August 2011	Done
Banks to provide for treasury bills issued in lieu of cotton sector NPLs, in accordance with international financial reporting standards (IFRS) principles.	September 2011	Done
Banks to implement regulation 177 to ensure uniform classification of NPLs and full provisioning.	September 2011	Done
In accordance with Regulation 177, banks to upgrade NPLs to a category requiring lower provisioning <i>only</i> after all amounts due (including principal and interest) have been repaid and the borrower continues to service the loan without default at least for 6 months.	September 2011	Done
In accordance with Regulation 177, all rescheduled accounts to remain in the	September 2011	Done

same asset classification as at the time of the restructuring (for the first restructuring) and downgrade by at least one level for the second restructuring.		
In accordance with regulation 177, NBT to allow banks to upgrade rescheduled NPLs to <i>standard</i> category only after they demonstrate satisfactory performance under the revised terms for at least 6 months.	September 2011	Done
<i>Liquidity, Funding, and Contingency Planning</i>		
NBT to require banks to reflect all material corrections from the annual external audits in their general ledgers to make retroactive corrections.	July 2011	Done
NBT to prepare, on a rolling basis, contingency plans to meet and overcome vulnerabilities in individual banks that may arise during the following 12 months.	August 2011	Done
To assess liquidity position of banks, NBT to require an independent audit for cash counts in all banks.	September 2011	Completed except for head office of one bank.
Banks most vulnerable to liquidity and funding risks to submit contingency liquidity and funding plans for managing liquidity under stressful situations and rectify structural liquidity and funding imbalances, <i>without</i> any reliance on NBT's liquidity facilities.	October 2011	Done

<i>Provisioning and Capitalization</i>		
In line with regulation 177, banks to provision for re-possessed assets, on par with those of doubtful assets.	November 2011	Done
Banks to maintain higher level of provisions and capital for exposures to customers who have unhedged foreign currency risk exposures; and comply with proposed prudential limits for such exposures.	November 2011	Done.
Increase the minimum capital-to-asset ratio (CAR) for the top 6 banks from 12 to 15 percent.	December 2011	Done
NBT to adjust banks' capital adequacy position for correct provisions and asset valuation until actual implementation by banks, and require those banks that either breach or are close to breaching the regulatory minimum to infuse capital within a prescribed timeframe.	December 2011	Done
NBT to improve its prompt remedial action framework (PRAF) including reviewing and understanding the shortcomings of the current framework, creating a supervisory manual covering off- and on-site aspects, develop internal guidelines, procedures, and sanctions to ensure effective remedies are initiated at the earliest stage of bank problems.	January 2012	In progress. [The supervision department is waiting for an expert from the World Bank for assistance].
NBT to review its supervisory function and undertake an assessment of its	March 2012	

compliance with the gaps identified by the assessment of Basel Core Principles (BCP) for effective banking supervision conducted in February 2011.		
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