Appendix I. Letter of Intent

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431
USA

Dushanbe, April 29, 2020

Dear Ms. Georgieva:

1. The COVID-19 pandemic and sharp decline in oil prices have severely disrupted trade and transport and weakened the macroeconomic outlook and the external and fiscal positions in Tajikistan. The pandemic is slowing economic activity substantially. The closure of the border and travel disruptions with China, Uzbekistan, Iran, Russia, and Kazakhstan have affected migrant worker mobility and remittances and have significant negative bearing on industrial production, construction, and services. Travel restrictions and lower oil prices are already suppressing remittances inflows from Russia, which declined by around USD 80 million (50 percent y-o-y) in March and the first half of April 2020. With the decline in remittances, our external position has deteriorated, and the NBT recently depreciated the exchange rate by 5 percent. Border closures and the slowdown in economic activity have also led to a significant decline of budget revenues over the first three months of 2020. In addition, the budget is experiencing expenditure pressures associated with containment measures, health checks at the border, establishment of quarantine zones, other prophylactic and disinfection actions.

2. The COVID-19 shock has fundamentally changed the macroeconomic outlook for Tajikistan in 2020. The downturn in remittances is likely to last several months leading to a sharp drop in consumption and higher unemployment, as well as FX market pressures. Supply difficulties for food and other essentials and recent currency depreciation are likely to increase inflationary pressures. The fiscal deficit is also expected to widen substantially, as the revenues are declining while the government needs to spend to contain the spread of the virus, treat sick patients, and provide support for the poor.

3. The rapid deterioration in the external accounts and fiscal positions has opened a large balance of payments gap, which preliminary estimates suggest is USD 384 million (4.7 percent of 2019 GDP). In this regard, we request financial support from the IMF for an amount of 80 percent of quota (SDR 139.2 million) under the “exogenous shock” window of the Rapid Credit Facility (RCF).

We also request that the full amount of this disbursement be made to the account of the Ministry of Finance at the National Bank of Tajikistan to provide immediate budget support. We have been actively engaging with donor community to obtain grant funding from the World Bank Group (WBG) (USD 47 million) and Asian Development Bank (ADB) (USD 86 million), and other development partners. Discussions with the Eurasian Fund for Stability and Development (EFSD) for a concessional financing operation (USD 40-60 million) are ongoing. We will continue making every effort to secure the needed financing, and we expect that IMF's emergency financing will catalyze additional support from development partners. While the starting level of reserves appear adequate, external financing in the near term will be essential to prevent a sharp drop in international reserves and an overshooting of the exchange rate, which could lead to an immediate and severe economic disruption. Given the high level of dollarization in the financial sector (above 50 percent), an excessive exchange rate depreciation could aggravate credit risk and raise nonperforming loans, which would weaken the banking sector which is still recovering from the 2015-16 shocks. The financing will also help meet health and social spending needs to mitigate the impact on poor and vulnerable groups and avoid a procyclical fiscal response. We remain committed to policies that help reduce poverty by fostering stability and provide effective protection for the most vulnerable.

4. The Government is committed to enhancing governance, and ensuring transparency and accountability in this process. We will ensure any funds provided for addressing the impacts of COVID-19 will be put to best possible use. We have created a high-level Inter-agency Task Force, chaired by Deputy Prime Minister and comprised of Ministries of Health, Transport, Foreign Affairs, National Security, and other government agencies. The Task Force has launched an action plan to respond to COVID-19, including through border and sanitary control, quarantine, and treatment facilities. The Task Force will guide spending decisions, and the usual budgetary procedures and controls will apply. We will prepare quarterly reports on the spending of emergency funds and publish the results on the external website of the Ministry of Finance. In addition, to ensure quality of this additional spending, we will subject the health spending, including procurement of urgently needed medical supplies, and social spending to ex-post audits by the Chamber of Accounts and ex-post validation of deliveries in a year's time, which will also be published on the external website of the Ministry of Finance. The government will also improve the transparency of its procurement processes in line with international best practices.

5. The Government of Tajikistan is implementing actions to contain the economic and health damage caused by the COVID-19 and to ensure macroeconomic stability. Our policy response is underpinned by our commitment to containing the health effects of the epidemic in a timely way, to fiscal consolidation once the effects of COVID-19 subside, and to exchange rate flexibility to ensure

price competitiveness and faster adjustment to shocks, while avoiding excessive volatility and economic disruption.

6. In 2020, the initial budget allocation includes TJS 1.5 billion for health spending, about 1.9 percent of GDP, excluding PIP expenditures. Total additional COVID-19 related spending is expected to be 2.5 percent of GDP, of which health spending for COVID-19 is expected to increase by 2 percent of GDP above the initial budget allocation. Currently, our targeted social assistance provides benefits in 40 out of 68 districts. We will maintain and expand the coverage of targeted social assistance to people who are vulnerable in the current situation and to all districts in Tajikistan. Through this channel, we will increase social transfers by about 0.5 percent of GDP to mitigate the effects of higher unemployment through a temporary real increase in benefit levels. On the tax side, in order to prevent price increases, we have granted VAT exemptions for imports of essential consumer staples (such as wheat, sugar, and cooking oil). These exemptions are temporary and will be phased out as the supply constraints ease. These VAT exemptions will help support the poor as the consumer staples are a large part of their consumption basket. We are also considering providing tax relief for small and medium-sized businesses in affected sectors (by delaying the 2020 tax filing deadline and ensuring that advance tax payments are based on the current economic situation and not the past economic outcomes). Together with a weakening in economic activity, these measures are expected to result in a decline in tax revenues by 1.4 percent of GDP in 2020 relative to the 2019 outturn but will help protect businesses and the financial sector from an adverse impact. To offset the deteriorating fiscal position, we have identified cuts to capital expenditures of 1 percent of GDP, including to lower-priority domestically financed capital spending of 0.5 percent of GDP, and to current spending of 0.6 percent of GDP relative to the 2020 budget envelope to help generate savings. We have issued a Budget Resolution signed by the Prime Minister on April 24, 2020 to ensure that these reductions are implemented in line with our intentions. In 2020, we need to maintain spending on Roghun in line with the previously contracted engineering schedule. The total envelope for Roghun financing over the period 2020-2022 is expected to be about USD 1.1 billion.

7. Over 2021-22, we will be making strong policy efforts to ensure fiscal and debt sustainability. Albeit significant improvement of the fiscal deficit in 2021 is likely as the shock and unforeseen consequences of the pandemic dissipate, we will also implement additional fiscal consolidation measures. Our main goal will be to achieve an overall fiscal deficit of 4.4 percent of GDP in 2021 and 2.6 percent of GDP in 2022, respectively, which is estimated to require implementation of fiscal consolidation measures worth 2.0 percent of GDP over 2021-22. This consolidation will help stabilize public debt at a sustainable level. To underpin this fiscal adjustment, we will implement a combination of revenue and expenditure measures to ensure that more of our priority capital

spending can be financed domestically and reduce the reliance on external financing. We have already established a working group to review the effectiveness of existing tax exemptions. In the context of the ongoing tax reform which is supported under a WB project and with IMF TA, we will prioritize broadening of the tax base, including by phasing out the existing inefficient tax incentives to yield 0.5 percent of GDP starting in 2021. We will refrain from granting new tax incentives. The high tax rates will be rationalized only after a broadening of the tax base has been secured. As the economy recovers in 2022, we will prioritize our capital spending to reduce it by 1.5 percent of GDP, while improving the efficiency of public investment projects.

8. The detailed policies underpinning the medium-term fiscal consolidation program will be included in the FY2021 and FY2022 budgets. Right now, our immediate focus is on containment and prevention efforts to protect the health and safety of our citizens. However, we will prepare a supplementary FY2020 budget by end-June 2020 and subsequently start work on the formulation of next year's budget and the specification of a medium-term macroeconomic plan within the fiscal parameters mentioned above by end-November 2020. We will engage early with Fund staff on the design of fiscal measures underpinning the consolidation in the budgets.

9. We are also making strong efforts to improve debt profile and management. Prior to the crisis, we were in the advanced stages of securing sukuk financing or issuing other sovereign bonds under favorable capital market conditions. This financing is now uncertain under current global financial market conditions, but if it were to be realized in the future, it will be used to refinance more expensive borrowings and improve our debt profile. Our external debt would not rise as a result of this transaction. We are also actively seeking external grants to minimize recourse to future borrowing and are seeking the Fund's assistance in that regard. We commit to avoid any other non-concessional borrowing until the Roghun power purchase agreements have been finalized and debt is on a sustainable path over the long term.

10. In addition to the recent move to align the official and parallel market exchange rates, we will continue to allow greater exchange rate flexibility to facilitate external adjustment. Given the temporary nature of the shock, the NBT will also use foreign exchange (FX) interventions to smooth excessive exchange rate volatility and avoid economic disruption (owing to high levels of dollarization and external liabilities). Once the shock has eased and conditions permit, we commit to gradually remove the existing Article VIII restriction and allow the exchange rates to reflect FX supply and demand. We will also remove existing multiple currency practices by issuing corrective guidelines. We will also improve data collection regarding FX supply and demand, exchange rates in the official and non-official markets, and associated transaction volumes to help improve the functioning of the FX market.

11. We will remain vigilant to inflationary pressures and will stand ready to step up liquidity provision to viable banks through Emergency Liquidity Assistance, in line with IMF TA recommendations, to help ensure financial sector stability in the face of possible outflows from banks. We have eased bank reserve requirements on domestic currency and FX deposits to support bank liquidity and private sector credit. We will continue to maintain strong oversight and supervision to ensure financial sector stability. As non-performing loans increase, we will ensure that loan classification and provisioning rules are transparently and fully applied. To the extent that bank capital or other metrics fall below minimum prudential requirements, we will require banks to implement credible restoration plans.

12. We want to note that the Covid-19 shock is still unfolding and is subject to considerable uncertainty. If the shock turns out to be more intense than expected, we would boost fiscal spending for treatment and containment costs. If the downturn in remittances is more pronounced, we would allow greater exchange rate flexibility to promote external adjustment. We would also mobilize additional donor support to close financing gaps. We remain committed to take additional fiscal measures to ensure fiscal sustainability and identify additional lower-priority spending that can be cut in case donor financing is unavailable. Non-concessional borrowing to finance Roghun will be considered only as a last resort over the medium term.

13. Tajikistan's capacity to repay the Fund remains adequate and we will continue meeting our financial obligations to the IMF on a timely basis. The NBT and the Ministry of Finance will agree on and sign a Memorandum of Understanding before the approval of RCF by the IMF Executive Board. The MOU will: (i) commit the Government to maintaining funds received from the IMF in a government account at the NBT, pending their use, (ii) require the Government to hold foreign exchange balances only with the NBT, and (iii) clarify the responsibilities for repaying Fund resources.

14. We intend to avoid introducing measures or policies that would exacerbate balance of payments difficulties. We will not impose new or intensify existing restrictions on the making of payments and transfers for current international transactions, trade restrictions for balance of payments purposes, or multiple currency practices, or enter into bilateral payments agreements which are inconsistent with Article VIII of the Fund's Articles of Agreement.

15. In line with IMF safeguards policy, the NBT is committed to undergo an update of the safeguards assessment before the approval of any new subsequent arrangement by the IMF Executive Board. We agree that the safeguards assessment will also review the framework between the NBT and the Government for the servicing of IMF lending. The NBT will continue to provide IMF

staff with access to its most recently completed audit reports and to authorize the NBT's external auditors to hold discussions with IMF staff.

16. We authorize the IMF to publish this Letter of Intent and the staff report for the request for disbursement under the RCF.

Sincerely,

/s/
Emomali Rahmon
President