Research Report on Uzbekistan

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Introduction

Assessment of current situation in the economy of Uzbekistan based on the official figures does not indicate significant risks for the creditworthiness of the country. Government debt position remains stable and the current fiscal stance can be assessed as solid, despite the significant reduction of fiscal surplus in recent years. Key drawbacks for this country are concentrated in the sphere of institutional development, investment climate, as well as in currency policy of the Central Bank of Uzbekistan. Recently, a number of new risk factors such us current decline of remittances from abroad (mostly from Russia) and high probability of political crisis in the mid-term, emerged.

Main Economic Indicators of Uzbekistan

Macro indicators	2012*	2013*	2014*
Gross pub. debt, bill UZS	8 274	9 910	12 256
Nominal GDP, bill UZS	96 723	119 750	144 868
Real GDP growth, %	8,2	8	8,1
Gross gov. debt/GDP,%	8,6	8,3	8,5
Deficit (surplus)/GDP,%	8,5	2,9	1,7
Inflation rate,%	10,4	10,2	9,8
Curr. Account balance/GDP,%	-1,9	-0,6	0,1

Development indicators	2014
Inequality adj. HDI	0,6
GDP per capita (Thou. of USD)	5,6

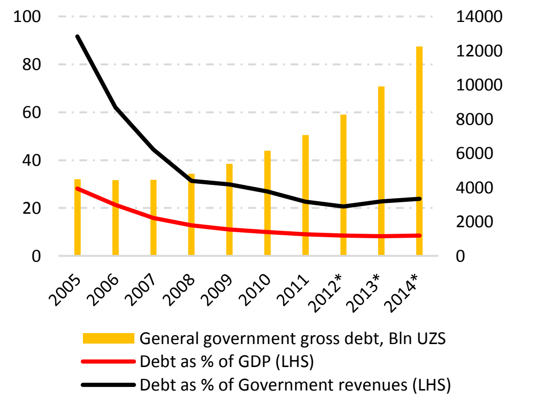
Sources: RAEX (Europe) calculations based on data from IMF. *Estimations

Government debt load and fiscal position are still at acceptable level and do not carry meaningful risk for the creditworthiness of Uzbekistan. Despite the fact that the total volume of gross government debt more than doubled during the last decade, the ratios of debt to GDP and debt to government revenues remained at reasonable levels (see graph 1). Rapid growth of GDP and budget revenues, supported by rise in commodities' prices, allowed the Uzbek government to maintain acceptable levels of debt load and accumulate sufficient FX reserves. At the same time, current stance of fiscal balance shall be kept on watch (see graph 2). According to IMF estimations, the fiscal surplus of Uzbek government budget reduced from 8,8% of GDP in 2011 to 1,7% in 2014. Taking into account the current global economic downturn and the fall in export prices, fiscal balance is expected to suffer even more than experts expected to.

Current policy of the Central Bank of Uzbekistan regarding the foreign currency transactions is still one of the main risks factor for the country. As was mentioned in the previous research report[1], Uzbekistan is characterized by a foreign currency black market with a parallel exchange rate. The official exchange rate provided by the CBU can be used only as benchmark indicator and doesn't reflect the real market conditions. Interbank and stock market exchange rates are closer to the

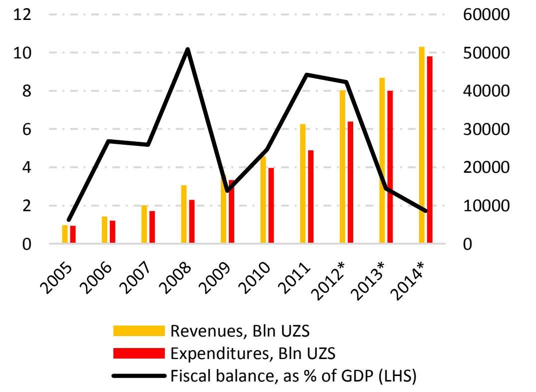
[1] Research report on Uzbekistan from 6th of November, 2014 (http://raexpert.eu/reports/Research_report_Uzbekistan_06.11.2014.pdf)

Graph 1: Uzbek gross government debt



Source: RAEX (Europe) calculations based on data from the IMF
* IMF Estimations

Graph 2: Fiscal performance of Uzbek government



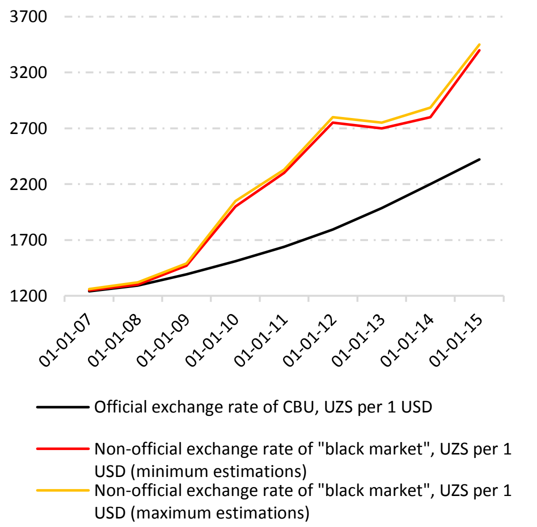
Source: RAEX (Europe) calculations based on data from the IMF
* IMF Estimations

real one, but only a limited number of enterprises (usually favoured by authorities) have access to operations with these rates. Authorities prohibited purchasing foreign exchange in form of cash for residents from 1st of February 2013, but this didn't contribute to fighting the illegal market. There are two regulatory measures in place which contribute negatively to operations of legal entities. The first measure includes the obligations for exporters (especially, in the gold and cotton industries) to surrender a large share of their FX revenues. In addition, restrictions to operate in foreign currency makes the repatriation of profits and dividends problematic. Some foreign companies had to create «additional» export-oriented business in order to have access to foreign currency. Information about current exchange rate on the "black market" is not publicly available. Last estimations by IMF showed that the cost of US dollar on the "black market" was 46% higher than the official rate in 2012; less reliable, but more current information from the local media shows that the difference between the official exchange rate and "black market" rate was around 40% as of 1st of January 2015 (see graph 3). According to experts' assessments, the recent depreciation of SUM (during the last quarter of 2014 and 1st quarter of 2015) at the "black market" was mostly driven by depreciation of Russian ruble and reduction of remittances flow from Russia.

Combination of lack of trust in local statistic, high levels of corruption and authoritarian political system is the main institutional risk of Uzbekistan. The country maintained its position in the ranking of most corrupted countries issued by Transparency International: Uzbekistan is perceived to be the 8th most corrupt country in the world according to the 2014 CPI index. High level of distortions in official statistic, as well as low level of authority's transparency make the overall assessment of the country very difficult. All together, these factors contributed negatively to the institutional climate in the country. In addition, the results of last president elections (March 2015) indicated the potential mid-term political conflict in the country regarding the next head of the country (there are no clear candidates who could compete for the president position in future).

Sluggish business environment and contradictory government policies in relation to foreign investors slow the inflow of investors to the Uzbek economy. Despite the fact that Uzbekistan holds a range of different natural resources (gold, uranium, oil and gas, etc.) and a potentially highly attractive local consumer market (population is over 30 mln. of people), the country demonstrates one of the lowest levels of FDI per capita compared with neighboring countries in Central Asia and

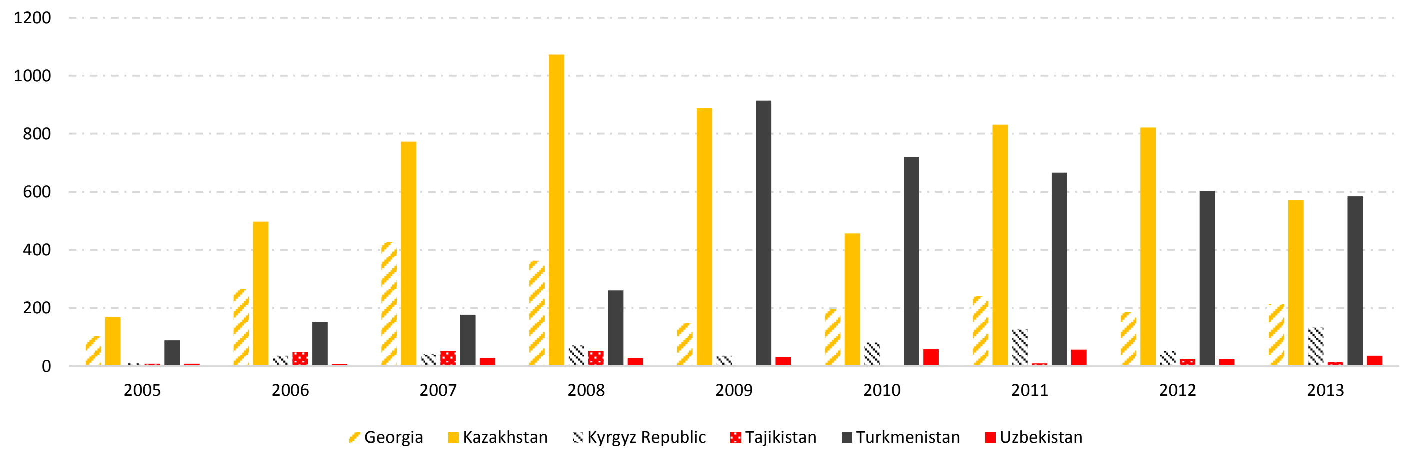
Graph 3: Amount of UZS per 1 dollar in accordance of different exchange rates



Source: RAEX (Europe) calculations based on CBU and Media

Caucasus region (see graph 4). The Uzbek government actively pursued a policy of attracting large foreign investors until 2005. A range of joint ventures was created during this period in different spheres of the Uzbek economy: "Zaravshan-Newmont", "Oxus Gold" (gold industry); "Uz-Texaco" (oil and chemical industry), "Uzkeysagrolizing" (finance), etc. After 2006 most of these enterprises were deprived of privileges (in taxation and other spheres). In addition, the independent media and the experts noticed a significant number of scandals associated with hostile takeovers and even nationalization of assets of some foreign investors in recent years. For instance, Mobile TeleSystems OJSC ("MTS") which is the leading telecommunication group in Russia and the CIS, lost its assets in Uzbekistan in 2012. The general assessment of Uzbek business-climate made by international organizations is also extremely negative: the country occupies 141st place in the ranking of Doing Business out of more than 180 countries and 100th in the ranking of "Protecting investors".

Graph 4: Dynamic of foreign direct investments per capita (current USD per capita)

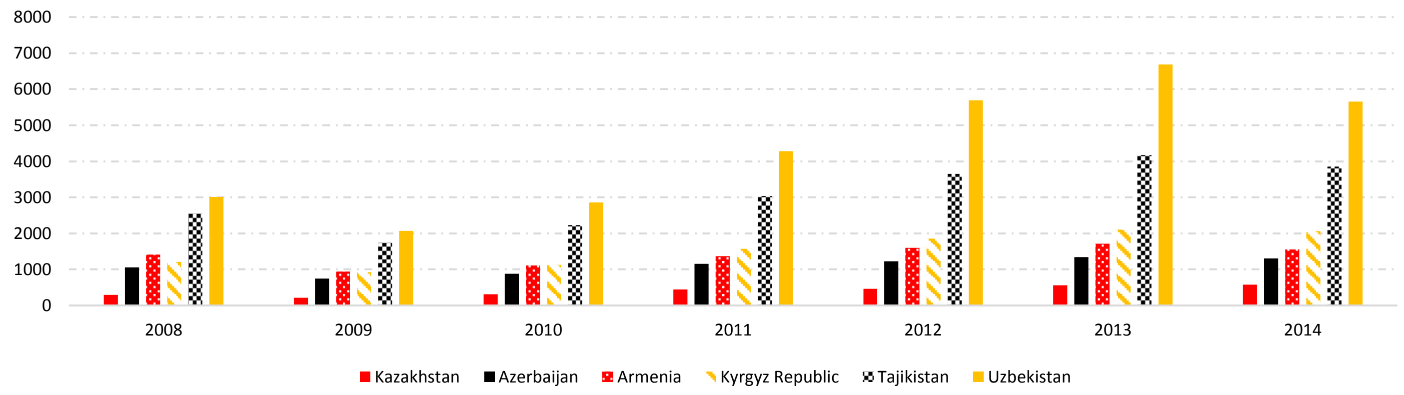


Source: RAEX (Europe) calculations based on data from the World Bank

The reduction in the amount of remittances from Russia can be assessed as additional risk factor for the Uzbek economy, in particular for its currency market. In terms of export-import operations, the current economic slowdown in Russia poses negligible risks to the Uzbek economy. According to IMF estimations, less than 3% of exports and 3-10% of imports depend on Russia. On the other hand, Uzbekistan is the largest acceptor of remittances from Russia among CIS countries (see graph 5). According to the IMF estimations net remittances constituted 6,4% of country's GDP in 2014 (6,5% in 2013). Regarding the fact that the overall current balance of Uzbekistan was equal to 2,3% of

GDP in 2014, the importance of remittances inflow shall be assessed as very high.

Graph 5: Cross-border transactions of Individuals, from Russia to CIS countries (Mln USD)



Source: RAEX (Europe) calculations based on data from the Central Bank of Russia

Conclusion

During 2014 the key official macroeconomic and fiscal indicators of Uzbekistan remained at tolerable levels. The overall assessment of the country's creditworthiness can be characterized as satisfactory. At the same time, taking into account low level of reliability of local statistics and the range of indirect indicators (decline of remittances inflow, volatility of "black market" exchange rate, etc.), the situation in the country shall be kept on watch.