Rating-Agentur Expert RA GmbH confirmed at 'B' the sovereign government rating and at 'CCC' the credit climate rating of Uzbekistan

Rating-Agentur Expert RA GmbH confirmed the sovereign government credit rating (SGC) of Uzbekistan at 'B+' (moderately low level of creditworthiness of the government) in national currency and at 'B' (moderately low level of creditworthiness of the government) in foreign currency.

Rating-Agentur Expert RA GmbH confirmed the country credit environment rating (CCE) of Uzbekistan at 'CCC+' (low quality of credit environment of the country) in national currency and at 'CCC' (low quality of credit environment of the country) in foreign currency.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- According to the IMF, Uzbekistan's gross government debt stood at around 11,5% of GDP and 35,2% of budget revenues in 2016 and still remained the lowest among the country's regional peers;
- Low short-term debt continues to have a very positive impact on the rating and is estimated at 1,04% of GDP in 2016;
- FX reserves at 45% of GDP in 2016 remain solid covering gross government debt by more than 3x and short-term government debt by more than 43x;
- Fiscal deficit has narrowed further to 0,3% of GDP in 2016 due to lower tax collection and higher expenditures. However, the imbalance stays the lowest amongst Uzbekistan's regional peers and does not provoke a significant risk;
- Real GDP growth has slightly declined to 7,8% in 2016 from 8% in 2015 (Uzbekistan remains the fastest growing real GDP rate among its regional peers). However, the continuing regional spillovers (which caused remittances to fall sharply and exports to decline) and low commodities' prices may force Uzbekistan to search for other drivers of economic growth in the future;
- Despite being small scale and undeveloped the banking sector stays solid with NPLs at 0,44% of total loans and capital to assets ratio at 10,7% in 2016 according to data from the World Bank;
- Uzbekistan's long-term growth perspectives remain favorable driven by a significant amount of natural resources (mainly natural gas, gold and cotton) and good investment potential evidenced by significant inflows of foreign direct investments at around 1,6% of GDP in 2015, as well as improving FX market and exports regulatory environment.

Restricting factors:

- The unemployment rate, as reported by the World Bank, showed a slight improvement but remained high at 8,9% in 2016;
- In response to the weak economic performance of the country's largest trading partners and the decreasing world commodity prices, Uzbekistan has adopted a loose fiscal policy focused on social spending in 2016, which has significantly eroded the fiscal balance in 2016. Although, the level of fiscal imbalance and government indebtedness of Uzbekistan relative to GDP stays the lowest amongst the country's regional peers and does not pose a

significant risk, going forward the fiscal stance is likely to remain tight, given the newly introduced exchange rate policy regime;

- Due to the recent expansionary fiscal policy, the gross government debt relative to GDP, according to IMF, is set to increase by 1,3 p.p. y-o-y in 2016;
- With the help of a separate government entity, Uzbekistan runs an open and clear privatization plan. However, the scope of the privatization process remained low with no significant funds being raised in 2016;
- The Central Bank of Uzbekistan has recently tightened its monetary policy by raising the refinancing rate from 9% to 14%. The Agency will monitor if the policy change will be able to sustain the increased inflationary pressures caused by accelerated money and credit growth.

Negative factors:

- Uzbekistan remains one of the most undeveloped countries in the region as shown by the low level of GDP per capita, estimated at USD 6 563 in 2016, and an HDI index of 0,59 in 2016;
- The inflation rate is expected to remain rather high (according to IMF), at 7,9% in 2016, despite a favorable accumulated decrease of 1,4p.p. in the last three years;
- The banking sector remains underdeveloped, as reflected by low bank's asset and private credit volumes relative to GDP at 40,3% and 23,3% in 2016 respectively;
- Institutional development continues to be sluggish with low transparency and quality of official statistics, high levels of corruption and a diminished rule of law in the country. This may harm the country's plan to promote international trade and FDI and as the consequence may affect the realization of the 2017-21 development strategy;
- The share of state-owned banks (SOB's) in the banking sector remains substantially high at around 80% of total bank's assets by the end of 2014. The banking system remains well-buffered, additionally the SOB's have been recapitalized in response to the liquidity and loan quality concerns;
- Immature capital market with a low market capitalization of companies listed on the national stock exchange of just 4,6% of GDP as of 3Q 2016 and high concentration with the ten most active issuers effectively make the market with 99,9% of total trades;
- The economy's competitiveness is limited by high concentration, with 84% of the country's GDP being produced by the top-3 sectors in 2015 and a persistent foreign trade fund outflow estimated at 1,5% of GDP in 2016. However, the picture may change provided a favorable outcome of the ongoing FX market liberalization policy and as a result increased competitiveness of Uzbek export.

Stress factors:

- Stress-factor for the risk of transition from controlled FX market to a liberalized one. The Agency will closely monitor the developing in regard of the country's FX policy (very weak stress-factor).

Currency risks:

- Most of the total gross government debt is of an external nature. Additionally, there is a genuine uncertainty about how effective the recently implemented FX market liberalization policy will be.

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Restricting factors:

- Low protection of investors as evidenced by the ranking of Doing Business (Uzbekistan ranked 87th out of 180 countries in 2016).

Negative factors:

- Limited quality and quantity of instruments in the local financial market;
- Banks' credit policy is influenced by state-directed lending, often below market rates.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Smooth transition process from controlled to liberalized FX;
- Recovery of the external environment along with further development of the financial sector and transparency of national institutions.

The following developments could lead to a downgrade:

- Continued deterioration of the fiscal balance and accumulation of government debt.

"The ratings of Uzbekistan continue to be constrained by highly concentrated and largely underdeveloped banking and financial sectors, low rule of law and government effectiveness as well as continued inability of the Central Bank of Uzbekistan (CBU) to curb inflation.

On the positive ground, short- and long-term debt levels continue to be low and well covered by the FX reserves. Comparatively high GDP growth rates and well-balanced budget continue to support the rating. The recent elimination of FX and export controls, aimed at promoting the country´s exports and FDI, had a positive influence on the rating assessment. However, the long-term impact on the overall economy will only depend on how well the authorities will continue to implement the policy during the transition period and prevent a possible downturn in asset quality, profitability and capitalization of the banking sector. " – Clarified Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH.

Responsible expert: Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH

Reviewer: Gustavo Angel, Rating Associate of Rating-Agentur Expert RA GmbH

Research report on Uzbekistan is available at:

https://raexpert.eu/reports/Research_report_Uzbekistan_22.09.2017.pdf

Next scheduled rating publication: TBD in December 2017.

For further information contact:

Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
24.03.2017	Scheduled revision of both types of ratings for the country	B+	B	CCC+	CCC
23.09.2016	Scheduled revision of both types of ratings for the country	B+	B	CCC+	CCC
15.04.2016	First assignment of both types of ratings for the country	B+	B	CCC+	CCC

Minute's summary

The rating committee for Uzbekistan was held on 21 September 2017. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings and Country Credit Environment Ratings – Short Public Version (from April 2017) can be found under the following link: http://raexpert.eu/files/methodology/Methodology_Short_Sovereign_v2.pdf. Descriptions and definitions of all rating categories can be found under the following link: http://raexpert.eu/sovereign.php under the "Rating scale" section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: International Monetary Fund, World Bank, CIA Fact book, World Economic Forum, Doing Business, United Nations, The State Committee of the Republic of Uzbekistan on Statistics, Central Bank of Uzbekistan (CBU), Ministry of Finance of Uzbekistan, Transparency International.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Regulatory use

Only SGC ratings can be used for regulatory purposes according to the ESMA definition. CCE ratings are not considered as credit ratings within the framework of Regulation (EC) No 1060/2009.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process**.**

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.