Research Report on Uzbekistan

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Introduction

The Republic of Uzbekistan, one of the wealthiest countries in Central Asia, had a real GDP per capita of 5 176 USD in 2013 and one of the highest levels of corruption in the world. Even though Gross government debt has steadily increased over the last decade, these figures accounted for ever smaller percentage of GDP during that period (gross government debt accounted for 8,5% of GDP in 2013). From a budgetary point of view, the government of Uzbekistan succeeded in maintaining positive fiscal balances over the last 6 years as a result of better management of expenses and higher export prices.

Government debt load does not pose any risk for the Republic of Uzbekistan. While Uzbek gross government debt has more than doubled over the last decade, the government of Uzbekistan has shown great commitment in reducing the ratio of Debt to GDP (see graph 1), which declined by more than 40% during that period. Additionally, interest payments in 2011 represented as low as 1,2% of 2012 debt outstanding and this figure was projected to remain at similar levels during the following years. Despite the fact that government external debt represents more than 95% of gross government debt, the Central Bank of Uzbekistan (CBU) holds significant amount of international reserves to face this types of obligations (foreign exchange reserves represented 683% of government FX debt in 2013).

Driven by better targeting of social welfare expenditure and strong commodity revenues, fiscal budget showed positive balance in recent years. Driven by high prices of commodities exported by Uzbekistan (mainly gas, gold and cotton) as well as prudent management of government expenses, the fiscal budget reached 2013 with a positive balance of 2,9% of GDP (see graph 2). In this respect, transfers from the Fund for Reconstruction and Development (FRD), whose main purpose is to accumulate revenue in excess of the established cut-off prices on mineral resources, played a key role in financing the government. Since its creation in 2006, the FRD has accumulated $11 billion in assets, of which $9,5 billion (as of October 2012) were managed abroad by the CBU as part of the international reserves. The remainder was used for domestic

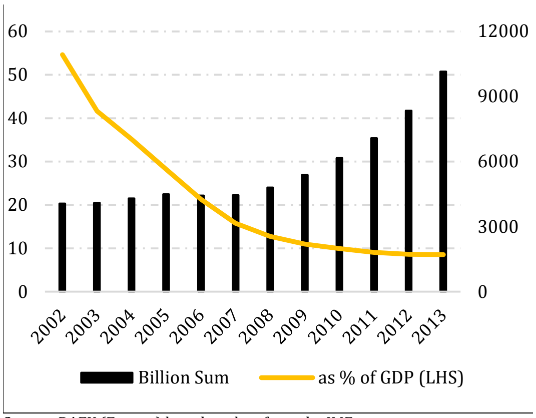
Main Economic Indicators of Uzbekistan

Macro indicators	2011	2012	2013
Gross pub. debt, bill Som	7076	8341	10155
Nominal GDP, bill Som	77866	96723	118987
Nominal GDP growth, %	26,0	24,2	23,0
Gross gov. debt/GDP,%	9,1	8,6	8,5
Deficit (surplus)/GDP,%	8,8	8,5	2,9
Inflation rate,%	13,3	10,4	10,2
Curr. Account balance/GDP,%	5,8	1,2	0,1

Development indicators	2013
Inequality adj. HDI	0,65
GDP per capita (Thou. of USD)	5,18

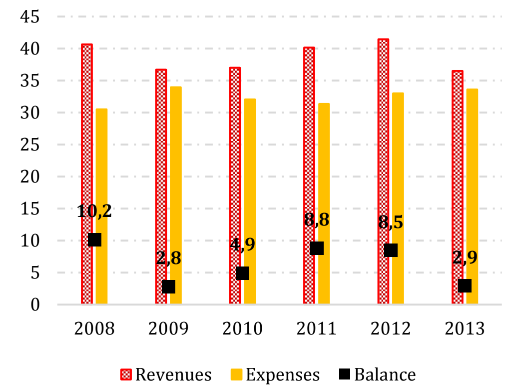
Sources: RAEX (Europe) calculations based on data from World Bank, IMF, Bloomberg

Graph 1: Gross Government Debt of Uzbekistan



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

Graph 2: Fiscal Performance of Central Government (as % of GDP)



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

lending in FX under government projects and is destined for imports, in particular of capital and intermediary goods.

Strong distortions in the FX market continue to hinder foreign trade and financial transactions. The gap that emerged in 2009 between the official exchange rate (de facto crawling peg) and unofficial rate in the FX black market was triggered by the heavy controls that exist in Uzbekistan to operate in foreign currency. According to IMF, this gap has recently widened to 38% after reaching a peak of 55% by early 2012. While Uzbek authorities consider that the parallel exchange rate is neither representative nor significant, the existence of a black market generates volatility in the exchange rate and encourage out-of-the-market operations of foreign currency (for example, remittances are more likely to be exchanged in the black market due to its more attractive exchange rate). In addition, exchange rate regimes like this, fuel speculation in the FX market, providing additional profit advantages to those who have access to official cheaper FX market (for example, companies which operate with export-import transactions).

Despite the fact that international reserves are comfortable by any measure, the CBU is committed to further increase them. Even though current levels of international reserves (18 Billion USD by the end of 2013) represent 424% of gross government debt and import coverage by official FX reserves are around 10 months, authorities prefer to have even higher international reserves going forward. As a result of CBU's strong foreign reserves accumulation, FX surrender requirements[1] stand at 100% for cotton and gold exports and 50% for other exports while the availability of FX for imports is restricted. Due to the CBU's commitment to maintain inflation rate at stable levels, the excess supply of money that results from FX accumulation is sterilized with issuance of Central Bank's securities. So far, Uzbekistan has been able to maintain average annual real GDP growth rates around 8%, but current drop in oil and gas products introduces a risk on its future growth. If Uzbekistan is not able to hold sustainable growth rates in the future, the higher money supply resulting from cancelation of its obligations will fuel price pressure.

Corruption and lack of transparency in official statistics remain the main institutional drawbacks of Uzbekistan. Despite Uzbek legislation (including criminal law) condemns corruption, enforcement is arbitrary and low wages in public service stimulate widespread corruption within government bodies. While three agencies of the government are tasked with fighting corruption (the National Security Service, the Ministry of

[1] Uzbek government forces to exchange foreign currency proceeds from exports in the official market.

Table 1: Top ten most corrupt countries in 2013

Country	CPI Ranking/Score*
Somalia	175/8
North Korea	175/8
Afghanistan	175/8
Sudan	174/11
South Sudan	173/14
Libya	172/15
Iraq	171/16
Uzbekistan	168/17
Turkmenistan	168/17
Syria	168/17

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

Internal Affairs (MVD), and the General Prosecutor's Office) the country ranks in the top 10 most corrupt countries of the world according to CPI index of transparency international (see table 1). Moreover, lack of transparency and inconsistency of statistical data provided by government agencies impede assessment of economic conditions of the country as well as business planning and investment.

Conclusion

While fiscal performance and debt load introduce no risks to the country, low quality of official statistics and high levels of corruption represent negative factors which affect Uzbekistan's creditworthiness. Furthermore, current distortions and restrictions which are in place in the foreign exchange market stand as the main strong stress factors for Uzbekistan. These factors will be kept on watch by Rating-Agentur Expert RA GmbH for further developments.