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Research Report on Uzbekistan

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Ratings

Sovereign Government Credit (LC)	B+
Sovereign Government Credit (FC)	B
Country Credit Environment (LC)	CCC+
Country Credit Environment (FC)	CCC

* These ratings are unsolicited

Main Economic Indicators of Uzbekistan

Macro indicators	2013	2014	2015
Gross gov. debt, UZS bn	9910	12256	20391[f]
Nominal GDP, UZS bn	119750	144868	175877[f]
Real GDP growth, %	8,0	8,1	8,0
Gross gov. debt/GDP, %	8,3	8,5	11,6[f]
Deficit (surplus)/GDP, %	2,4	2,2	0,1[f]
Inflation rate, %	10,2	9,8	9,5*
Current Account Balance/GDP, %	2,9	1,7	0,2[f]
External debt, USD bn	-	-	0,11[f]

Development indicators	2015
Inequality adj. HDI	0,57
GDP per capita, USD th	6,0[f]

Source: RAEX (Europe) calculations based on data from the IMF
* The Central Bank of Uzbekistan (CBU) reported 5,6%

Summary

Uzbekistan's ratings are positively supported by extremely low levels of government debt, favorable fiscal metrics, above average economic growth and satisfactory levels of FX reserves. The resilience of the economy to the regional slowdown and other external shocks also contributed positively to the ratings.

On the other hand, the Agency observed several risks for the country's creditworthiness and credit environment. The main risk factor is the FX black markets which emerged after a series of government controls. These markets cause great imbalances in the economy including inflationary pressures. In addition, lack of institutional development and government transparency, combined with an underdeveloped financial system and low and declining domestic credit also disfavored the rating.

Government debt, albeit set to increase, remains very low. According to IMF projections, gross government debt, as a percentage of GDP and budget revenues, is set to increase by 3p.p. and 9p.p. respectively in 2015. Despite the increase, the new figures for debt to GDP (11%) and budget revenues (32,9%) will stay acceptable and remain the lowest among its CIS peers (see table 1). The increase is due to the new 5-year public investment program to upgrade industry and infrastructure worth about USD 40 bn. Furthermore, almost all of the debt comes from external sources.

Short-term debt has been historically low. During the period from 1997 to 2013 the maximum amount of short-term debt has been USD 626 m in 1999. In addition, we estimate that, based on historical parameters, short-term debt is currently around USD 612 m with a 90% probability of not exceeding USD 880 m[1] (see graph 1). Even taking into account the maximum estimated value (USD 880 m) with 90% probability, the short-term debt would still be covered by current FX reserves by 27x and would be as low as 1,4% of the projected GDP for 2015.

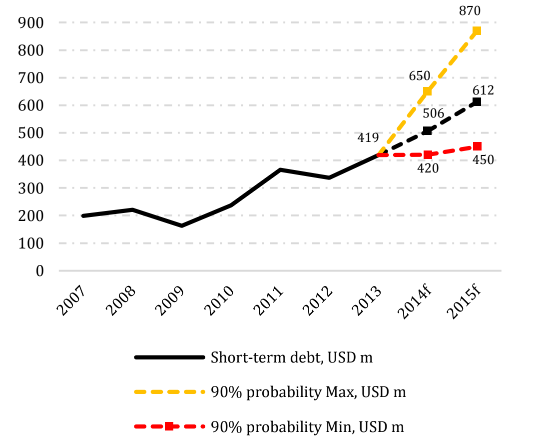
Table 1: Peer comparison of CIS countries for 2014*

	Uzbekistan	Armenia	Azerbaijan	Belarus	Georgia	Kazakhstan	Kyrgyzstan	Russia	Tajikistan
Government debt/GDP	11,6%	44,2%	16,4%	37,9%	35,1%	15,1%	53,0%	17,9%	28,2%
FX reserves/GDP	39,0%	14,5%	21,3%	6,7%	16,3%	13,6%	26,4%	20,8%	5,5%

Source: RAEX (Europe) calculations based on data from the IMF
*Data for Uzbekistan is preliminary for 2015

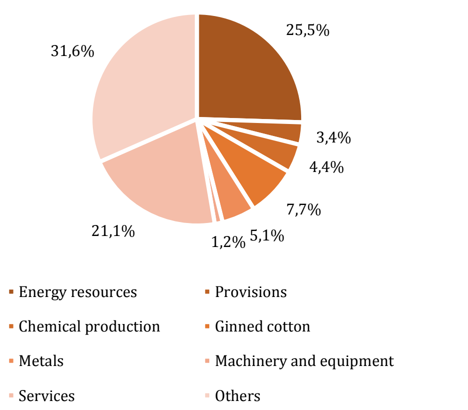
[1] The estimation was performed using strictly historical data from the Asian Development Bank from 1997 to 2013 using a stochastic model. Due to the lack of information on the country, it does not include other assumptions.

Graph 1: Historical and estimated short-term debt



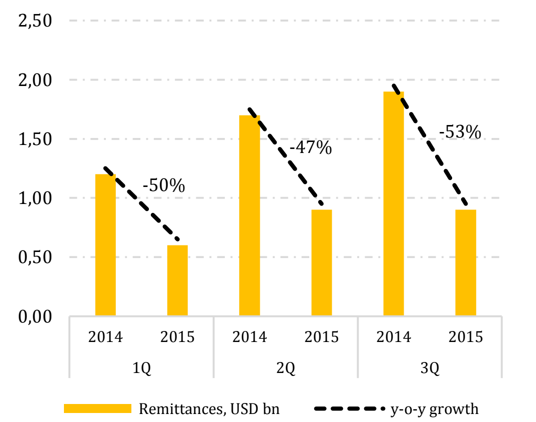
Source: RAEX (Europe) calculations based on data from the Asian Development Bank

Graph 2: Exports structure in 1Q 2015



Source: RAEX (Europe) calculations based on data from the Ministry of Foreign Economic Relations Investment and Trade

Graph 3: Remittances from Russia



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

The economy remains resilient to external developments. Despite the slowdown in remittances and exports as well as lower commodities prices, the economy managed to grow at an 8% rate in 2015 propelled by public investment. Nevertheless, the Asian Development Bank (ADB) expects the real economy to slow down to 6,9% in 2016 driven by adverse external developments.

In 2015, exports were affected by lower prices for world food and the country's main commodities which include gas, gold and cotton, important products in the country's export structure (see graph 2), alongside regional economic slowdown, especially in Russia. On the other hand, imports also declined due to government controls and lower prices of imported goods. The effect on exports and imports resulted in a slight trade surplus of USD 455 m at end-2015 and an estimated current account surplus of 0,2% of GDP.

Due to the aforementioned regional struggles, remittances also took a hit in 2015. Transfers from Russia to Uzbekistan, the largest outflow from Russia in terms of remittances, had a steep fall declining by an average of 50% in the first three quarters of 2015 (see graph 3).

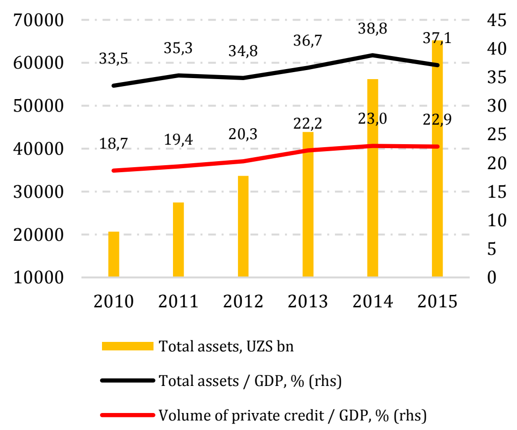
Fiscal and monetary policies are loose. The Central Bank of Uzbekistan (CBU) reported a 5,6% inflation rate for 2015[2] standing within its target. Nonetheless, the IMF estimates an inflation rate of 9,5% at year-end 2015, which is high and outside the CBU's 6%-7% inflation target. Despite this, it has remained stable for the past four years. The stable inflation reflects lower administered price increases, dampened import and commodities prices contrasted by wage increase and UZS depreciation.

The CBU reduced the reference rate from 10% to 9% back in January 2015 confirming its accommodative policy despite having high inflation figures. However, it also controls cash in circulation by promoting transactions with debit cards.

The CBU continues to depreciate the UZS, however, it is still considered overvalued. This is reflected by the steep depreciation of the parallel market rate (estimated to be approximately 6 100 UZS per USD as of January 2016 compared to the official rate of 2 810 UZS per USD in the same period), which emerged as a result of the excessive FX and import controls. The UZS has in fact appreciated in real terms. Other economies in the region had steeper and faster devaluations, making those countries' exports more competitive.

[2] The IMF projects an inflation rate of 9,5% for 2015. The Agency used this figure for the assessment due to the lack of transparency in the reported statistics.

Graph 4: Dynamics of domestic credit



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

FX reserves accumulation of the CBU is the highest among its CIS peers (see table 1). These cover gross government debt by more than 3x and represent 39% of GDP creating a more than sufficient buffer to curve external shocks.

The fiscal policy is loose relying on continuous expansion in public spending to sustain growth. The new USD 40 bn infrastructure program expanded expenditures and caused the surplus to narrow down to 0,2% of GDP in 2015.

Institutional underdevelopment and low transparency remain a concern for business and credit climate. The limited access to national statistics and their reliability remain a big concern for the country. According to the Transparency International index, Uzbekistan is one of the most corrupt countries in the world. It was ranked 153rd out of 167 countries in 2015. Additionally, Uzbekistan is also ranked 87th out of 180 in the Doing Business ranking.

The 2015 elections saw the current president reelected by a landslide. Nonetheless, the process was criticized by western observers due to several irregularities and a lack of competition. The government has a tight grip on the economy. Excessive controls in the financial system such as quotas on exports, directed lending and exchange rate restrictions hamper the access to credit, hindering growth of SME and the inflow of FDI.

Financial markets remain underdeveloped but the banking system is stable. Financial markets in Uzbekistan remain poorly developed with market capitalization of listed companies at 5% of GDP and the ten largest issuers representing about 91% of total trading. Additionally, there are only seven bonds listed in the exchange.

The banking system is well capitalized with low level of NPLs. However, the amount of credit to the economy is low as shown by the 37,1% of banks assets to GDP and 22,9% of private credit to GDP in 2015. These figures also declined by 1,6p.p. and 0,1p.p. respectively from a year back (see graph 4).

Important note for sovereign ratings

This Research Report shall be treated as a supplementary part of the published Press Release included in the following link:

http://www.raexpert.eu/reports/Press_release_Uzbekistan_15.04.2016.pdf

Both documents shall be treated as essential parts of each other.

For further information on the factors, their weights, methodologies, risks and limitations of these ratings, and other regulatory disclosures, please refer to the Press Release and the website of the Agency.