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Research Report on Uzbekistan

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Responsible Expert:

Ilya Makunin
Rating Analyst

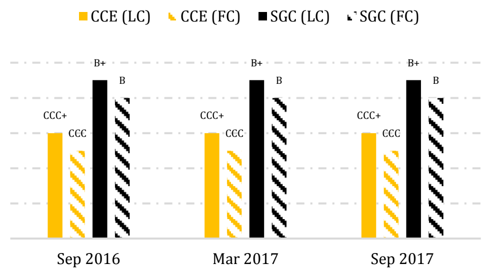
For further information contact:
Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

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

Ratings dynamics



Main Economic Indicators of Uzbekistan

Macro indicators	2014	2015e	2016e
Gross gov. debt, UZS tn	10,4	17,6	22,9
Nominal GDP, UZS tn	145,9	171,1	199,3
Real GDP growth, %	8,1	8,0	7,8
Gross gov. debt/GDP, %	7,1	10,3	11,5
Deficit (surplus)/GDP, %	2,2	-0,5	-0,3
Inflation rate, %	9,2	8,4	7,9
Current Account Balance/GDP, %	-	-	0,01
External debt, USD bn	-	-	9,8

Development indicators	2016
Inequality adj. HDI	0,59
GDP per capita, USD th	6,6*

Source: RAEX (Europe) calculations based on data from the IMF, WB.
*estimate.

Summary

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.

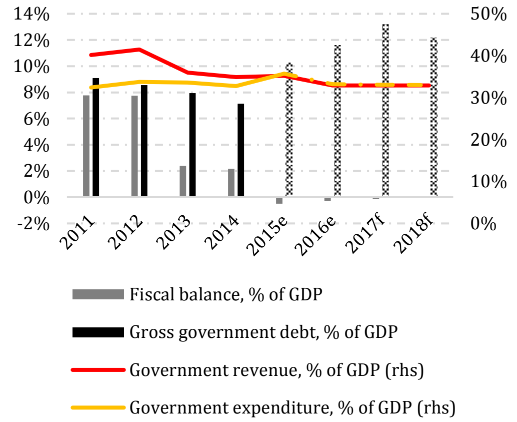
Debt level is increasing but remains low. Gross government debt was estimated at around 11,5% of GDP and 35,2% of budget revenues in 2016, which represented a 4,4p.p. and 14,8p.p. increase in the past three years respectively, caused mainly by a recent expansionary fiscal policy (see graph 1). Due to the external nature of most of Uzbekistan's debt, the abovementioned debt metrics (still the lowest amongst the country's regional peers[1]) may deteriorate following the recent UZS depreciation.

The short-term debt remains historically low at around 1% of GDP and 3% of budget revenues. This, combined with a substantial amount of FX reserves at more than 43x of short-term debt, reflects the reduced short-term credit risks of the country.

Strong growth driven by expansionary fiscal policy. The real GDP growth rate of Uzbekistan slightly drops to 7,8% in 2016, but remains one of the highest in the region. The economy showed resilience to unfavorable external shocks (decreased remittance inflow and low commodity prices), supported mainly by the well-timed expansionary fiscal policy focused on cutting taxes and increasing social expenditure. These measures have supported the economic growth, however have significantly eroded the fiscal balance, which was estimated to be at -0,3% of GDP in 2016 (see graph 2). Given the new FX policy regime and the

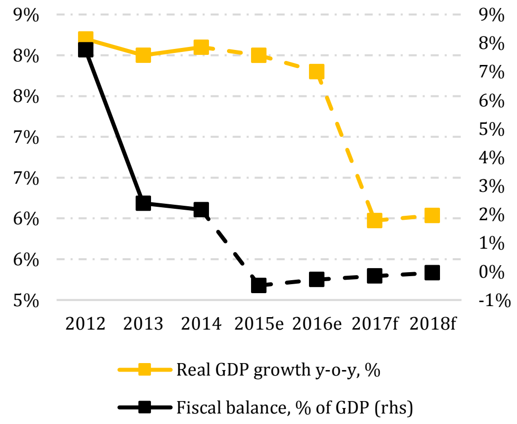
[1] Regional peers of Uzbekistan include Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan and Turkmenistan.

Graph 1: Budget vs debt dynamics, % of GDP



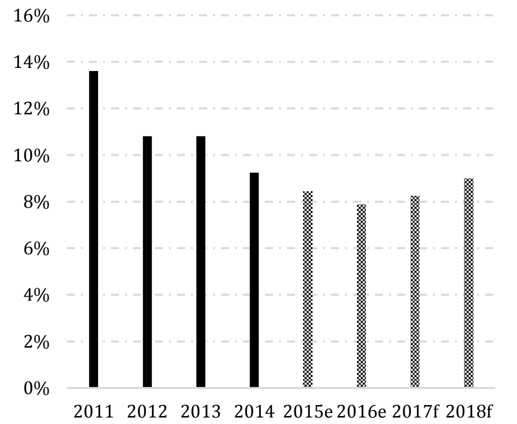
Source: RAEX (Europe) calculations based on data from the IMF

Graph 2: Fiscal balance vs real GDP growth



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

Graph 3: Inflation dynamics, % y-o-y



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

country's unfavorable foreign position (diminished TOTs and remittances), Uzbekistan is expected to consider tightening its fiscal policy in order to sustain low fiscal imbalance figures and search for other sources of economic growth in the future.

Despite stagnating world commodity prices, the country´s exports were expected to increase by around 25% in 2016, reflecting improvements in exports of chemicals, machinery, gold and services which managed to offset decreased exports of the country´s key commodities. Given an estimated 6% increase in imports in 2016, the country´s current account is likely to have turned positive at 1,4% of GDP in 2016.

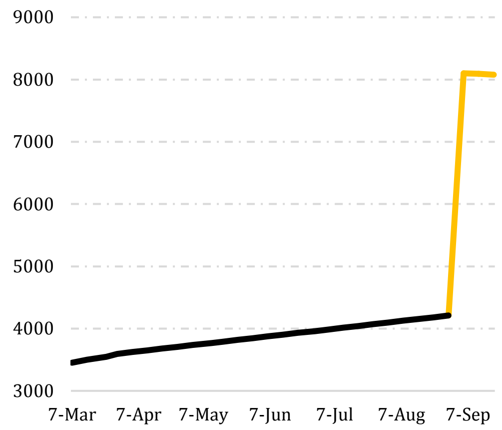
Banking sector risks remains low. The state-owned-banks-dominated banking sector remains low in scale with assets and volume of private credit to GDP at just 40,3% and 23,3% respectively. The banking sector showed diminished risks as NPLs stood at just 0,44% of total loans and capital to asset ratio, despite declining reached 10,7% in 2016. In response to the concerns about the liquidity and loan quality of the banking sector, the authorities have recapitalized state owned banks (SOBs), raised liquidity requirements and reviewed the CBU´s liquidity provision and bank intervention frameworks. Nevertheless, the recent UZS devaluation may have a negative impact on the asset quality, profitability and capitalization level of the key banks.

Monetary policy has been under a significant change. Inflation rate was estimated at 7,9% in 2016 (see graph 3) and well above the CBU target band. However, in order to control for further inflationary pressures, mainly caused by rapid money and credit growth, the CBU has tightened the monetary policy and raised the refinancing rate from 9% to 14% in 2017.

In order to remove the FX parallel market and enhance currency convertibility the CBU´s has announced elimination of the FX controls and the requirement to surrender 25% of export foreign currency revenues at the appointed banks at the official exchange rate. This has led to a 50% steep devaluation of official UZS FX rate and to its convergence with the market FX rate in September 2017 (see graph 4). This reform is meant to increase the country´s exports by improving the terms of trade, help the government to open up the economy and attract FDI and as a result facilitate job creation and an economic growth. Additionally, the reform will help to converge to a stable monetary policy and more efficient control of inflation.

Credit climate remains constrained. Despite some recent efforts towards greater transparency (e.g. the authorities decided to adopt a new

Graph 4: USD/UZS Exchange rate in 2017



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

CPI measurement of inflation starting from 2018), limited access and availability of national statics remains one of the key concerns for the country´s institutional development. Uzbekistan stays one of the most corrupt countries in the world ranking 156th out of 176 countries. The country is characterised by a very low rule of law and government effectiveness. As a result, Uzbekistan occupies rather low position in the Doing Business ranking (87th out of 180 countries) in 2016. Additionally, 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 newly elected president, Shavkat Mirziyoyev, has continued making steps towards opening the country to the outside world. In 2017 policies were made in order to reform FX, legal and tax regulation in order to stimulate FDI inflow and bring the economy from informal to formal. The authorities have adopted 2017-21 strategy for further development of Uzbekistan, successful implementation of which will strengthen the economy further.

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:

https://raexpert.eu/reports/Press_release_Uzbekistan_22.09.2017.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.