INTERNATIONAL GROUP OF RATING AGENCIES
RAEX EXPERT RA EUROPE
Moscow - Ekaterinburg - Almaty - Minsk - Frankfurt - Hong-Kong

Research Report on Uzbekistan

23 September 2016

Responsible Expert:

Hector Alvarez
Rating Analyst

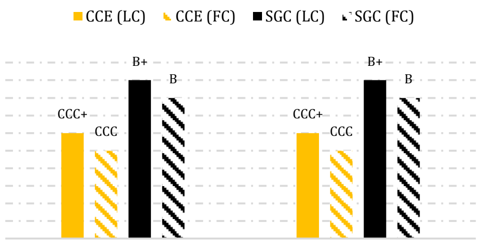
For further information contact:
Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

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	2013	2014	2015
Gross gov. debt, UZS bn	9910	11166	1832[f]
Nominal GDP, UZS bn	119750	145999	171369[f]
Real GDP growth, %	8,0	8,1	8,0
Gross gov. debt/GDP, %	8,3	7,6	10,7[f]
Deficit (surplus)/GDP, %	2,4	2,2	0,9[f]
Inflation rate, %	10,8	9,2	8,4*
Current Account Balance/GDP, %	2,853	0,72	-0,01[f]
External debt, USD bn	-	-	0,1[f]

Development indicators	2015
Inequality adj. HDI	0,57
GDP per capita, USD th	6,1

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

Summary

The ratings of Uzbekistan remain constrained by the continued growth of the FX black markets (caused by restrictions to operate in foreign currency), underdevelopment of the financial markets and institutions, lack of government transparency and a concentrated financial system combined with low credit growth and marginal amount of financial instruments.

Low government debt, narrow fiscal balance and strong GDP growth positively affected the ratings; however, these indicators are set to deteriorate at end-2016 due to higher spending and regional slowdown. Additionally, the high level of international reserves also supported the country's creditworthiness.

Furthermore, the recent decease of Islam Karimov could create a turbulent political transition in the country which may cause instability. So far the transition has been smooth and controlled; nonetheless, there is still ground to cover to complete the process. Moreover, despite the change in leadership, the way the country is governed is not expected to change.

Debt remains low but is expected to increase. Gross government debt is estimated to have been around 11% of GDP and 30% of budget revenues at end-2015. Despite the low figures, both are projected to increase substantially due to the direction of the current fiscal policy. In addition, around 75% of the total debt is external.

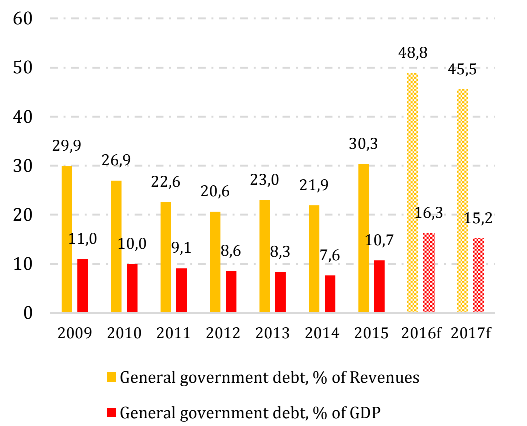
Debt figures are projected to reach 16,3% of GDP and 48,8% of budget revenues according to IMF estimates (see graph 1). Despite the projected increase of more than 5p.p. and 18p.p. respectively, the metrics are still within our internal threshold of acceptable debt levels.

Furthermore, as mentioned in our previous report[1], short-term debt has been historically low and we do not expect this to change in the near future.

Economic growth remains strong but is set to lower its pace. The Uzbek economy showed resilience to external factors, such as lower remittances and lower commodities prices in order to grow by 8% in 2015. However, real GDP growth is set to decelerate in 2016. The flow of

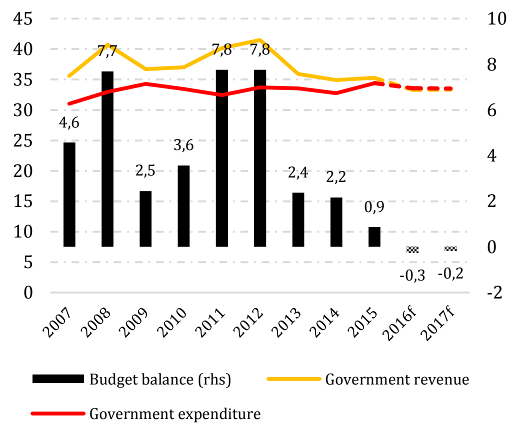
[1] Research report on Uzbekistan from 15 April 2016 (http://raexpert.eu/reports/Research_report_Uzbekistan_15.04.2016.pdf).

Graph 1: Government debt dynamics



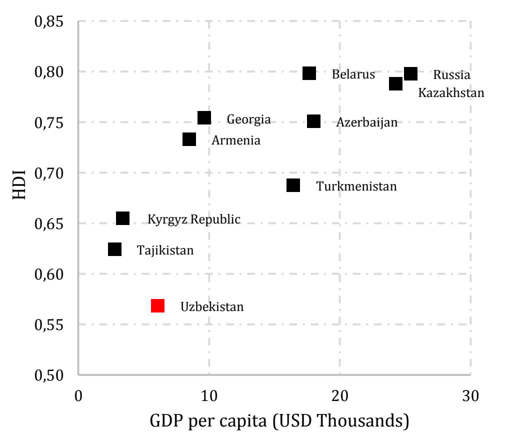
Source: RAEX (Europe) calculations based on data from the IMF

Graph 2: Budget dynamics, % of GDP



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

Graph 3: Development peer comparison



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

remittances continues to decrease and will have an effect on the economy in the current year as real output is set to grow by 5%, the slowest pace in more than ten years.

As mentioned in our previous review, Uzbekistan's main exports were affected by the low commodity prices and adverse regional conditions. However, revised current account figures showed that the impact of imports and exports on this indicator were worse than expected as it is estimated to have registered a deficit of -0,01% in 2015.

Fiscal policy set to produce a deficit in 2016. The fiscal plan set in place by the authorities is focused on spending to sustain growth and, in October 2016, a new increase in wages, allowances and pension benefits will come into effect. Given the expansion in expenditures and a projected decrease in revenues, the fiscal balance is expected to go into negative territory (estimated by the IMF at 0,9% of GDP in 2015 and projected at -0,26% for 2016) for the first time since 2003 (see graph 2).

Credit climate remains constrained by institutional anomalies. One of the major concerns for Uzbekistan is the reliability of its institutions and their transparency. Access to national statistics remains extremely limited and outdated. 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. Furthermore, the country remains one of the most undeveloped countries in the region as shown by the low level of GDP per capita (estimated at USD 6 068 by the IMF in 2015) and HDI index of 0,57 (see graph 3).

After the death of Islam Karimov, we do not expect the country to hold free and fair elections as, in the view of international observers, it has never done it before. Instead, current Prime Minister and acting president Shavkat Mirziyoyev, will most likely win in the December 4 elections. Mirziyoyev is described as being very similar to Karimov with the same management style and oppressing behavior and is expected to follow Karimov's legacy. This shows that it is almost certain that the political and institutional situation in the country will not change any time soon.

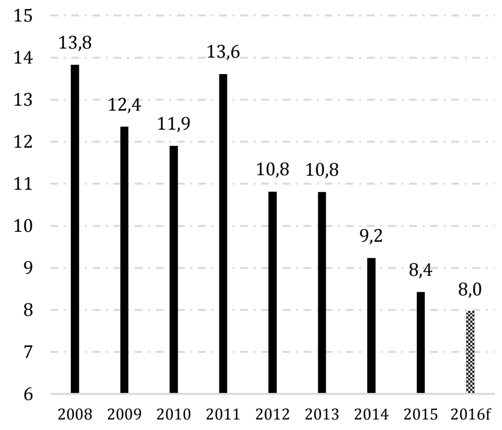
Thus, we expect the new regime to continue having a strong grasp on the economy and the financial system which will continue to affect the access to credit, hindering growth of SMEs and the inflow of FDI.

Banking sector remains strong led by State Owned Banks (SOBs). Even though the amount of SOBs in the banking system remains substantially high (about 80% of total bank assets at end-2014), the major

SOBs remain strong and stable with low NPLs and acceptable levels of liquidity.

However, credit to the economy remains low. Even though the volume of bank assets increased by around 13% in 1H 2016 compared to 16% from 2014 to 2015 in absolute terms reflecting a faster pace in credit growth, it remains substantially low at around 38% of GDP.

Graph 4: Inflation dynamics, % y-o-y



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

Loose monetary policy despite high inflation levels. As mentioned in our previous report, the inflation level reported by the Central Bank of Uzbekistan (CBU) substantially differs from the one reported by the IMF. The projected inflation level by the IMF stands at around 8% for 2016. Despite inflation having reduced in the last years, the figure remains high (see graph 4). However, Karimov's death has caused some recent inflationary pressures due to the created uncertainty.

The CBU has sustained the reference rate at 9% since it trimmed it from 10% in January 2015 still reflecting an accommodative policy.

Furthermore, the parallel FX market is still a growing concern in the country. Since the CBU has a tight control over the currency and maintains an overvalued exchange rate, the parallel rate continues to widen as compared with the official rate.

The amount of international reserves accumulated by the CBU remain a strength for the country. These reserves cover gross government debt by more than 3x and represent around 40% of GDP, which protects the economy from potential liquidity and external shocks.

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://raexpert.eu/reports/Press_release_Uzbekistan_23.09.2016.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.