Research Report on Uzbekistan

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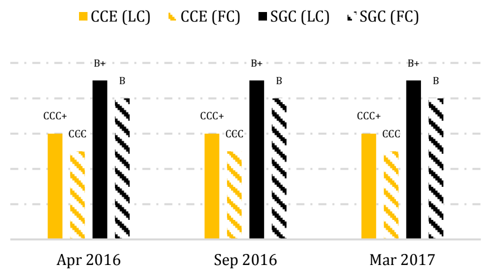
Ratings

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

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Uzbekistan

Macro indicators	2014	2015f	2016f
Gross gov. debt, UZS bn	11157	18433	29509
Nominal GDP, UZS bn	145999	171369	199325
Real GDP growth, %	8,1	8,0	6,0
Gross gov. debt/GDP, %	7,6	10,8	14,8
Deficit (surplus)/GDP, %	2,2	0,9	0,0
Inflation rate, %	9,2	8,4*	8,4
Current Account Balance/GDP, %	-	-	0,1
External debt, USD bn	-	-	9,8

Development indicators	2016
Inequality adj. HDI	0,57**
GDP per capita, USD th	6,5f

Source: RAEX (Europe) calculations based on data from the IMF, WB
*The Central Bank of Uzbekistan (CBU) reported 5,6% in 2015
**inequality adjusted HDI is reported as of 2015

Summary

The ratings of Uzbekistan continue to be supported by the very low levels of short- and long-term debt, which are well covered by the accumulated FX reserves. Noticeably high GDP growth rates and balanced government budget, despite regional instability and increased social expenditure, positively affected the ratings.

On the negative ground, the short-term orientation of the current fiscal policy, as well as the inability of the Central Bank of Uzbekistan (CBU) to curb inflation continue to constrain the ratings. Capital controls and the parallel FX market, combined with underdeveloped financial institutions and rather unfavorable business environment had a negative effect on the ratings. However, a lot will depend on how well the recently elected president, Shavkat Mirziyoyev, will implement the initiatives designed to liberalize political and economic environment of Uzbekistan.

Low but increasing debt load. Gross government debt, as a percentage of GDP and budget revenues are estimated to have grown around 8 p.p. and 24 p.p. respectively in the last three years, due to the recent expansionary fiscal policy. Despite the sharp increase, we expect these metrics to stay fairly low at 14,8% and 45,7% in 2016 respectively (see graph 1), the lowest amongst Uzbekistan's regional peers[1]. It is worth mentioning, that most of the debt is external.

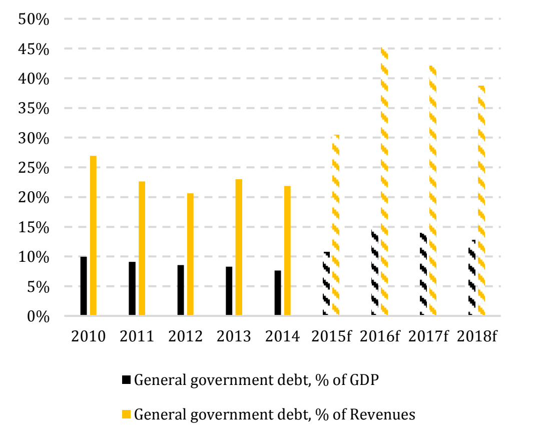
The amount of short-term debt remains quite low, at around 1% of GDP and 3% of budget revenues. This, combined with the substantial FX reserves at 3x of GDP, and 40x of short-term debt, were regarded as credit-positive in the rating assessment.

Production growth is strong despite external shocks. We expect the real GDP of Uzbekistan to continue growing at a slower pace around 6% in 2016, driven by low prices for commodities and spill-over effects from the neighboring countries, which translates into lower remittance inflows (see graph 2). However, the real GDP growth of Uzbekistan still remains one of the highest among the regional peers (see graph 5).

The volume of exports is expected to decrease by around 13% due to the low prices of the country's main export commodities (gas, gold and cotton), as well as the ongoing economic slowdown in the region. At the

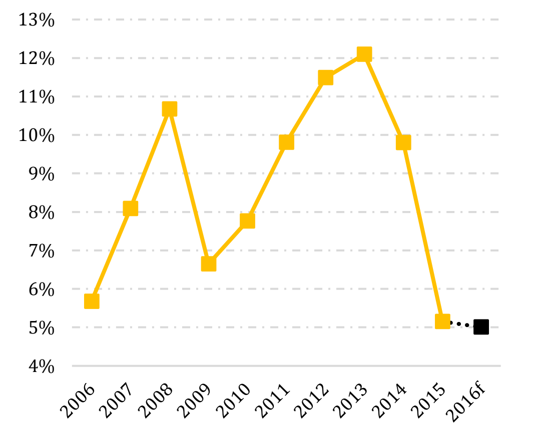
[1] Regional peers of Uzbekistan include Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan and Turkmenistan.

Graph 1: Government debt dynamics



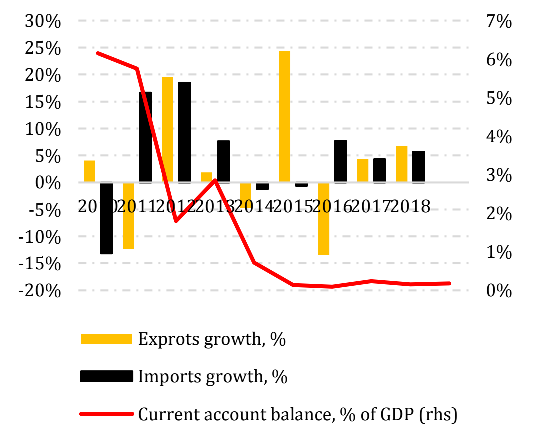
Source: RAEX (Europe) calculations based on data from the IMF

Graph 2: Personal remittances, % of GDP



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

Graph 3: Current account dynamics



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

same time, imports are expected to recover by 7,5% in 2016, contributing to the narrowing of the current account, which is estimated at 0,1% of GDP in 2016 (see graph 3).

Risks in the banking sector are low. Despite banks' asset and private credit volumes are still low at 40% and 22% of GDP in 2016 respectively, the risks of the banking sector remained small as NPLs stood at 0,44% of total loans and capital to assets ratio was at 11,1% in 2016 (see graph 4). The sector is to a large extent dominated by the State Owned Banks (SOBs), which are characterized by low NPL's and acceptable levels of liquidity.

Fiscal policy remains expansionary. The government has successfully adopted an expansionary fiscal policy, which helped to stimulate growth and partially mitigate the current regional economic instability. On the other hand, the fiscal stimulus were dominated by a further 9% increase in social spending (accounts for 59% of government spending in 2016), which is believed to have a rather short-term effect and is likely to fuel further inflationary pressures. Furthermore, coupled with a decrease in custom tax collections, above is expected to further erode the fiscal balance to a level just above zero in 2016. Nevertheless, the level of fiscal balance of Uzbekistan remains the highest within its regional peers and does not pose a significant risk. (see graph 5)

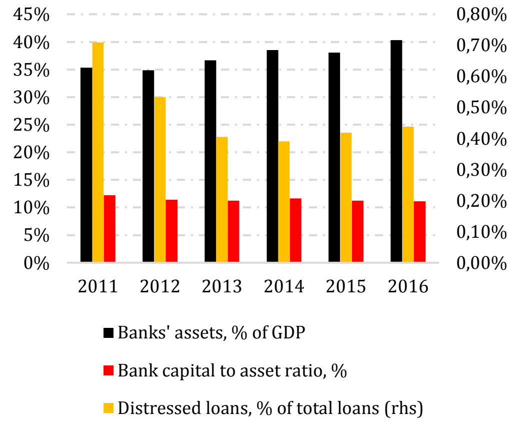
Monetary policy continues to be loose. The projected inflation rate according to IMF remains high at 8,4%[2] in 2016 and above the Central Bank of Uzbekistan (CBU) target rate between 5,5-6,5%. Despite this, the CBU continues to pursue an accommodative monetary policy, keeping the reference rate unchanged at 9% after reducing it from 10% in January 2015.

The parallel FX market, which emerged as a result of the excessive FX and import controls, hinders the rating of the country. Although CBU is gradually depreciating the UZS, the FX parallel exchange rate (estimated at 7 800 UZS per USD and around 2x the official rate as of March 2017) is showing that the UZS is currently highly overvalued.

At the same time, in the end of 2016 the new FX reform consultation document has been published for discussion on the web-site of the government. The proposed reform is designed to develop and liberalize the internal FX market through reduction of capital controls, maintenance of equal rights principle amongst all participants of FX market, as well as establishing the market-driven FX rate. As of December 2016 the

[2] Inflation rate reported by the CBU substantially differs from the one reported by the IMF and stands at 5,6% as of 2015

Graph 4: Banking sector dynamics



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

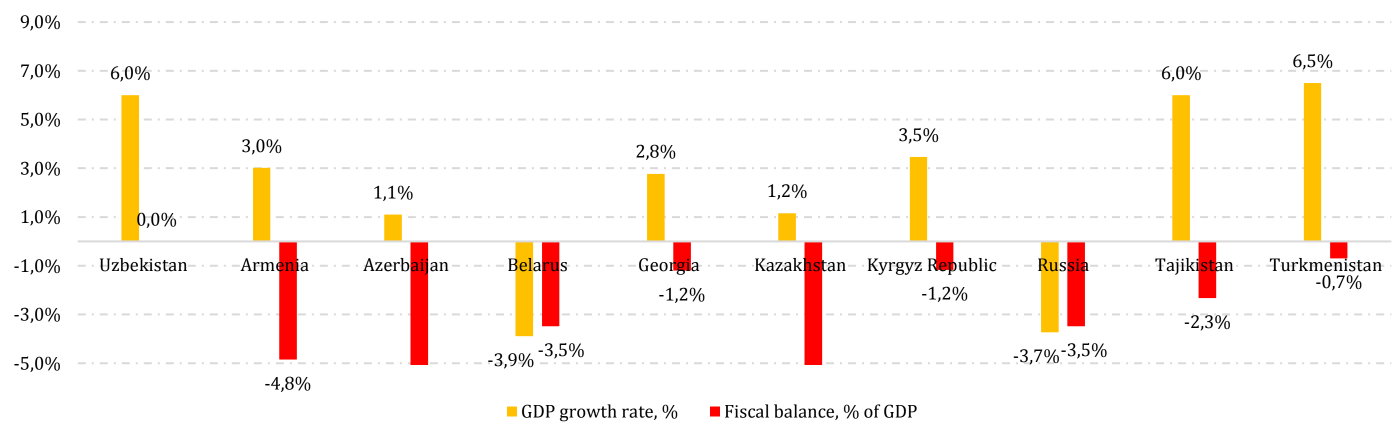
document has been removed from public consultation, hence a lot will depend on the extent to which this initiative is going to be implemented.

Low transparency and institutional development constrain the CCE. The limited access and availability of national statistics remains one of the big concerns to the country's institutional development. Uzbekistan is one of the most corrupt countries in the world ranked 156th out of 176 countries in 2016 according to Transparency International. Additionally, Uzbekistan occupies 87th place out of more than 180 countries in the Doing Business ranking in 2016. Moreover, 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 6 453 by the IMF in 2016) and HDI index of 0,57 in 2015.

The county's credit environment continues to be consistently constrained evidenced by an underdeveloped financial market, state direct lending, which often done below market rates and largely influences banks' credit policy, as well as a moderately low position of Uzbekistan in investors protection ranking at 70th out of 180 countries in 2016.

The recently elected president, Shavkat Mirziyoyev, has already managed to give a rise to hopes about liberalization of political and economic life of Uzbekistan. First several initiatives include extension of the parliament's role, amnesty, FX market liberalization, capital and FX revenue controls reduction, as well as an anti-corruption program. Successful implementation of the above listed initiatives can improve the country's credit environment.

Graph 5: Projected GDP growth dynamics and fiscal balance of Uzbekistan and its peers in 2016



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

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http://raexpert.eu/reports/Press_release_Uzbekistan_24.03.2017.pdf

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

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