UZBEKISTAN

Highlights

- **Officially reported GDP growth slowed to 5.3 per cent in the first nine months of 2017,** from 7.0 per cent in the first half of 2017 and 7.8 per cent in 2016, however this likely reflects more accurate accounting rather than a sharp contraction in the third quarter.
- **A series of market-oriented reforms have been initiated.** In addition to the liberalisation of the foreign exchange regime (see below), there have been measures to improve the business and investment climate, a reduction of the state presence in the economy, and judicial reforms.
- **Major steps were made to liberalise the foreign exchange regime.** Since 5 September 2017 the sum has been allowed to float freely and currency controls have been loosened, representing the most important economic reform for the country to date. A comprehensive plan for monetary policy reforms for 2017-21 has also been approved, which includes the gradual move to an inflation targeting regime.

Key priorities for 2018

- **Further deep structural reforms need to be launched.** Fiscal and tax reforms, customs reform, financial market reform, and others are crucial for successful competition with intensified imports after the opening up of the country. Foreign investments need to be encouraged and remaining legal and administrative obstacles need to be removed.
- **Banking sector reforms need to deepen and state-directed lending should be phased out.** The underdeveloped banking system with high state ownership hinders the development of a resilient and competitive economy. Strengthening of the banking sector is needed through stricter enforcement of prudential banking rules and better risk and credit management, and the reduction of state-directed lending at preferential terms is critical.
- **Efforts to improve the business and investment climate need to continue and deepen.** The authorities should carry on with the ongoing work to address excessive regulations, improve business registration and the licensing regime, and reform the complex and distortive tax system.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	8.0	8.1	8.0	7.8	5.4
Inflation (average)	11.7	9.1	8.5	8.0	13.2
Government balance/GDP	2.4	3.4	0.8	0.4	0.6
Current account balance/GDP	2.9	1.7	0.7	0.7	0.9
Net FDI/GDP [neg. sign = inflows]	-1.1	-1.2	-0.1	-0.2	-0.2
External debt/GDP	13.4	14.5	18.1	20.2	22.2
Gross reserves/GDP	39.4	38.2	38.7	37.8	n.a.
Credit to private sector/GDP	n.a.	n.a.	n.a.	n.a.	n.a.

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Macroeconomic performance

Officially reported GDP growth slowed to 5.3 per cent in the first nine months of 2017 year-on-year, from 7.0 per cent in the first half of the year and 7.8 per cent in 2016. However, the lower reported growth figure is likely to be due to more accurate accounting rather than reflecting a sharp contraction in the third quarter. Growth was driven by an increase in exports of 25.6 per cent year-on-year and a strong performance in the industry, construction and services sectors.

The sum has been allowed to float freely. Since 5 September 2017 the Central Bank of the Republic of Uzbekistan (CBU) stopped administratively setting the exchange rate and devalued the official rate by 48 per cent to Sum 8,100 to 1 US dollar from Sum 4,210 to 1 US dollar set previously. Interventions serve only to prevent large fluctuations.

Inflation has accelerated in 2017. Consumer prices were 5.2 per cent higher in June 2017 than in December 2016 mainly reflecting the increases in food prices. This compares with 2.5 per cent a year earlier and 8.0 per cent for 2016 overall. Some further acceleration in inflation might take place when prices, currently partially frozen, will be adjusted. The liberalisation of exports of some goods previously supplied only to the domestic market also contributes to higher inflation, whereas the pass-through from the devaluation of the official exchange rate has been limited thanks to the wide use of the unofficial exchange rate before the currency reform.

Monetary policy was fairly accommodative until mid-2017, but has been tightened since. The central bank increased its monetary policy rate from 9 per cent to 14 per cent in June 2017 in a move to halt credit expansion during the run-up to exchange rate convertibility. At the same time the central bank opened emergency liquidity lines to banks – up to three months. After significant growth in the first half of 2017, banks have halted credit growth to conserve liquidity and manage capitalisation, as well as reflecting the shift in government policies towards restricting monetary growth during the transition to the new exchange rate regime. Banks had received significant liquidity and capitalisation support from the central bank and a state fund earlier in 2017 as measures to prepare for currency liberalisation.

Fiscal and external positions remain in surplus. The officially reported fiscal balance remained in surplus at 0.4 per cent of GDP in 2016 and in marginal surplus also in early 2017. At the same time the government has kept up significant off-budget investment spending, permitted by the large cash buffer available. The current account balance has been maintained at near balance in recent years, turning out at an estimated 0.7 per cent of GDP deficit in 2016. The inflow of foreign direct investment (FDI) and investment loans totalled Sum 6.6 trillion in the first half of 2017 according to official data, with 68 per cent invested in the oil and gas sector and 10 per cent in telecommunications.

Real GDP growth is projected to reach 5.4 per cent in 2017 and increase moderately to 6.2 per cent in 2018, supported by continued robust domestic investment and the stepwise implementation of economic reforms. Export growth will be supported by the improved economic relations with neighbouring countries. Furthermore, the better economic prospects for Russia and Kazakhstan, the main destinations for Uzbek migrant workers, will support remittance inflows. There is however significant forecast risk with regard to the headline figures, as statistical methods might significantly change during the reform process.

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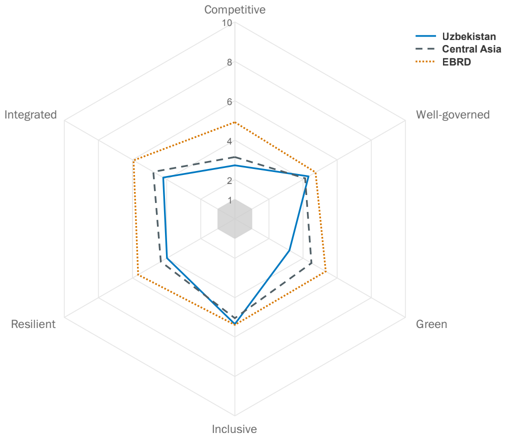
Assessment of transition qualities (1-10)



Major structural reform developments

A series of reforms were announced after the 2016 presidential election. The government's development strategy, approved in February 2017, includes five priority areas: (i) improving public administration and state buildings; (ii) ensuring the supremacy of law and reforming the judicial system; (iii) maintaining solid economic growth and liberalising the economy; (iv) improving the social safety net; and (v) ensuring security. Alongside these reforms the government plans to implement investment projects worth US$ 40 billion over the next five years in energy, infrastructure, chemicals, pharmaceuticals and other sectors. In order to attract the required foreign investment and advanced technologies, the government also plans to open four additional Free Economic Zones in the Samarkand, Bukhara, Fergana and Khorezm regions.

Uzbekistan showed one of the most notable improvements in the World Bank's *Doing Business 2018* report. With five implemented reforms, Uzbekistan has become the regional leader in the total number of reforms in the Europe and Central Asia region and is among the 10 economies improving most in 2016-17. Uzbekistan's rank was 74th out of 190 countries, up from 87th in the previous year's report. Areas reformed were the starting of businesses, access to electricity, paying taxes, dealing with construction permits and protecting minority investors. The largest improvements were made in two areas: paying taxes was made easier and less costly by introducing an electronic system for filing and paying VAT, land tax, unified social payments, CIT, infrastructure development tax, environmental tax, personal pension fund contributions and cumulative pension contributions, while the process of getting an electricity connection was streamlined by introducing a turnkey service at the utility that fulfils all connection-related services, including the design and completion of the external connection.

Steps have been taken to liberalise the currency regime. The reform was launched by the presidential decree issued on 2 September ordering the exchange rate to be decided by market mechanisms. Since 5 September CBU stopped administratively setting the exchange rate and devalued the official rate by 48 per cent. Interbank currency exchange trading sessions are held daily. CBU interventions are intended to prevent large fluctuations. The official central bank rate continues to be published weekly (every Monday), from now on equal to the average value of the rates fixed at the trades of the currency exchange in the previous week. The official rate applies for accounting purposes, statistical and other reporting, as well as for calculating customs and other mandatory payments on the territory of the Republic of Uzbekistan. The decree relaxed some stringent capital controls on foreign currency for businesses and individuals. Legal entities, as well as individual entrepreneurs and farmers with foreign exchange income can now purchase unlimited foreign currency for use in international payment operations. Individuals can receive foreign exchange on payment cards and use it abroad.

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Further steps to improve monetary policy and introduce inflation targeting are being developed. On 13 September the President advised CBU, the Ministry of Finance and the Ministry of Economy to outline a plan for monetary policy reforms for 2017-21 including measures for the coordination of economic, fiscal and monetary policies; the introduction of monetary policy instruments for liquidity management; increasing transparency and improving communication on monetary policy decisions between CBU and the public; and developing the domestic capital markets in the medium term. Monetary policy will be guided by inflation targeting. CBU has been ordered to present a medium-term road map for the implementation of the 2017-21 monetary policy reforms by March 2018. A new law "On foreign exchange regulation" will be introduced by July 2018.

The business environment has significantly improved. Non-scheduled inspections of companies have been limited by law. The state's influence in non-strategic companies has been reduced (whereas previously the state had special rights even if it had a small shareholding, those rights are proportional now). The government is working on the development of e-services to limit face-to-face interactions of the regulator and private sector representatives. The government established the State Committee for Investments in March 2017, responsible for coordinating the formulation and implementation of a unified state investment policy and attracting foreign investments. The government is also working on public-private partnership (PPP) legislation, a renewables framework and a law on state procurement.

The government has adopted a resolution to revise tax legislation. The legislation was adopted in June 2017, and specifying amendments are to follow in the coming months. The structure of the tax system is impeding the creation of specialised businesses (as part of the production value chain) because the taxation of turnover instead of value-added constrains tax deductibility for smaller businesses. The tax system also disincentivises larger businesses and thus discourages companies from growing beyond a certain size. The government is also working to align definitions of micro-, small- and medium-sized enterprises with international practices.

Cross-border integration is being enhanced. Two new border crossings opened between Uzbekistan and Kazakhstan in July 2017 on a section of the Tashkent-Samarkand road passing through Kazakhstan, which had been closed for more than a decade. A new railway link between Samarkand and Astana via Tashkent was launched in June 2017. Uzbekistan is trying to resolve tensions in its relationships with Tajikistan and the Kyrgyz Republic over issues including territorial disputes and access to water resources. In April 2017, a commercial flight between Uzbekistan and Tajikistan was carried out for the first time in 25 years. Efforts are being made to establish bilateral contacts with Turkmenistan.

A new business district and a technopark are planned to be built in Tashkent. In July 2017 Toshkentboshplan, the state-owned company in charge of urban planning and construction in Tashkent, announced that a 70-hectare district, called Tashkent City, will be constructed at a cost of US$ 1 billion in Tashkent in 2018. The project is part of the President's programme aimed at infrastructure development, modernising the economy and positioning the country as investor-friendly.