UZBEKISTAN

Highlights

- **The economy is growing strongly.** Real gross domestic product (GDP) growth reached 5.1 per cent in 2018 and 5.7 per cent year-on-year in the first three quarters of 2019, and the country has moved towards greater exchange rate flexibility.
- **The government has initiated a large-scale restructuring and privatisation programme.** A total of 29 state-owned enterprises (SOEs) in the energy, chemical, financial and consumer sectors have been selected for privatisation, and major SOEs in the energy and transportation sectors are undergoing reorganisation.
- **Uzbekistan has issued its first Eurobond.** Issued in February 2019, it consists of two tranches of US$ 500 million five-year and US$ 500 million 10-year sovereign bonds. Standard & Poor's (S&P) and Fitch assigned first-time sovereign ratings for Uzbekistan at "BB- Stable" in December 2018, and Moody's assigned it "B1 Stable" in February 2019.

Key priorities for 2020

- **Efforts to restructure and privatise SOEs need to step up.** The newly established State Assets Management Agency should facilitate the improvement of corporate governance practices, transparency and accountability of SOEs and take forward privatisation of identified SOEs in a transparent manner.
- **Price liberalisation should continue.** Following the liberalisation of bread prices and increases in utility tariffs combined with social safety net increases in 2018, it is important to continue price adjustments and to bring energy and water prices closer to cost recovery levels.
- **Banking-sector reform is critical.** State-directed lending still remains prevalent with negative implications for credit intermediation in the economy and effective banking supervision. The state's presence in the sector should be reduced and privatisation of the state-owned banks should be taken forward.

Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	7.4	6.1	4.5	5.1	5.5
Inflation (average)	8.5	8.8	13.9	17.5	14.6
Government balance/GDP	1.1	1.6	1.8	2.2	0.5
Current account balance/GDP	0.6	0.4	2.5	-7.1	-6.0
Net FDI/GDP [neg. sign = inflows]	-0.1	-2.0	-3.0	-1.2	-3.5
External debt/GDP	16.1	18.6	34.1	34.5	n.a.
Gross reserves/GDP	36.6	39.4	57.5	65.7	n.a.
Credit to private sector/GDP	n.a.	n.a.	n.a.	n.a.	n.a.

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Macroeconomic performance

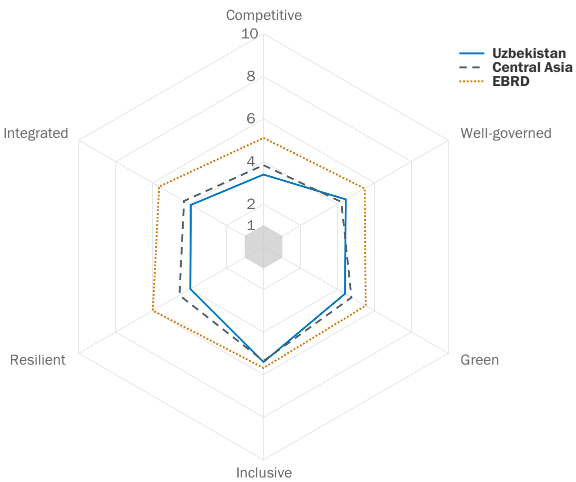
Economic growth remains robust. The economy continued growing steadily in the first three quarters of 2019 at 5.7 per cent year-on-year on the back of strong performance in the industry, construction and services sectors. Exports increased by 45.0 per cent year-on-year in US dollar terms in the first eight months of 2019, and imports by 33.0 per cent, reflecting trade liberalisation policies. Credit expansion remains high at 60.4 per cent year-on-year in August 2019, which has supported the growth of infrastructure investment and surging imports. Average inflation decelerated to 14.1 per cent in the first three quarters of 2019 from 18.9 per cent during the same period in 2018. This mostly stems from the slower growth of food prices, which has compensated for an increase in services inflation. The central bank has kept the policy rate unchanged at 16.0 per cent since September 2018.

The central bank has moved towards greater exchange rate flexibility. As of August 2019, the monetary authorities have removed the 5.0 per cent limit on daily exchange rate fluctuations. In addition, the sale of foreign currency by commercial banks is now allowed for purposes other than business or tourism travel, including in cash form, which was not possible earlier. This is part of a wider set of measures to further liberalise the foreign exchange market. The exchange rate was broadly stable in 2018 and in the first half of 2019, but market pressures intensified in August 2019.

The external position has weakened, but the fiscal deficit is contained. Uzbekistan's current account posted a deficit in 2018 – for the first time since 1999 – of 7.1 per cent GDP in 2018. This was caused by surging capital imports reflecting higher investment in housing and infrastructure to modernise the economy. The overall fiscal deficit, according to the International Monetary Fund's definition which includes policy lending, increased to 2.1 per cent of GDP in 2018 from 1.9 per cent in 2017. Public debt is low at around 20.0 per cent of GDP in 2018.

Real GDP growth is projected to remain stable in the short term. The economy is predicted to grow by 5.5 per cent in 2019 and 5.8 per cent in 2020, driven by further expansion of fixed investment, helped by rapid credit expansion and foreign direct investment (FDI) facilitated by the government's policies. Downside risks include a slowdown in the economies of trading partners and a continued credit surge, which may ignite inflationary pressures.

Assessment of transition qualities (1-10)



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Major structural reform developments

A Reform Roadmap for 2019-21 was adopted in early 2019. The roadmap outlines economic reform goals in five "strategic directions". These include maintaining macroeconomic stability, strengthening social protection and accelerating market transition, including through the creation of an Economic Council, a consulting platform bringing together the government and local and international experts. FDI and greater private-sector participation via privatisations and public-private partnerships (PPPs) are seen as the main priorities of economic development. In this regard, the new PPP Law, adopted in May 2019 and based on the recommendations of international financial institutions, will be an important step towards increasing the overall attractiveness of investment.

A large-scale privatisation programme has been launched and SOE restructuring is moving forward. Since January 2019 the newly established State Assets Management Agency has been responsible for SOE restructuring, corporatisation and optimisation of state ownership of assets. A presidential decree signed in April 2019 sets out steps for the privatisation of 29 state-owned enterprises (SOEs) in the energy, chemical, financial and consumer sectors. In most cases, the SOEs billed for sale were mid-size, and only partial privatisations were proposed. Controlling (51 per cent or above) stakes were offered in the remaining companies, except for minority shares in three banks, an insurance company and a cement plant. In addition, a presidential decree adopted in January 2019 sets out the framework for preparing the Uzbek Metallurgy Plant, Almalyk and Navoi mining and metallurgy plants, which are potentially very valuable assets, for initial and secondary public offerings in 2022-23. SOEs in energy and transportation are undergoing restructuring, along with the separation of managerial, supervisory and regulatory responsibilities.

Institutional and legal reforms in the energy sector are advancing. In February 2019, a new Ministry of Energy was established as a policy-setting and regulatory body in the oil and gas and power sectors. The overall sector reform will be guided by a new strategy, signed in March 2019, for further development and reform of the energy sector. Among other measures, the strategy envisages the splitting of Uzbekenergo, the vertically integrated state-owned electricity utility, into three separate entities (generation, transmission and distribution). In addition, in July 2019 the government announced measures to unbundle Uzbekneftegas, a state-owned oil and gas company, into gas and oil, pipelines and gas distribution companies. A key advance in the sector includes the adoption of a new electricity tariff methodology in April 2019, which outlines measures to bring tariffs to full cost recovery levels and aims to achieve financial sustainability of electricity companies. The government introduced higher utility tariffs in August 2019.

The pace of banking-sector reform has been slow. Distortions in the banking sector, due to state-directed lending at preferential terms, remain unaddressed. A new concept for financial-sector development, currently under progress, envisages lowering state ownership in banks, reforming the government's approach to directed lending and developing capital markets. Three banks have been earmarked for privatisation with a proposed sale of a 25 per cent equity stake in each. Amendments to the banking law and central bank law were approved by the parliament in September 2019. The amendments provide greater independence to the central bank operations and improve its supervisory powers, ensure its transparency and accountability and include provisions to ensure better corporate governance in banks.

Tax reforms have advanced. Measures adopted so far in 2019 include the simplification of tax reporting, reductions in several types of taxation, including corporate income tax, and wider applicability of value added tax. A key change was the introduction of a turnover-based taxation for small businesses to operate under the simplified tax regime, replacing headcount-based taxation. This removes the incentive for small firms to limit firm growth beyond a certain size. At the same time, some elements of the original plan have undergone significant changes since June 2018, when the plan was first published, and uncertainty remains as to how exactly the tax reform will be implemented. A revised tax code will come into force in January 2020, instead of December 2018 as originally planned.

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Steps have been taken to further improve fiscal transparency. A presidential resolution signed in August 2018 envisages measures for bringing budget accounting in line with international standards and inclusion of the budget in the Open Budget Index rankings after 2020. The authorities have published medium-term fiscal projections and an assessment of key fiscal risks in the 2019 budget. Another major advance is the publication of a citizen's guide to the budget, which encourages greater public engagement. By the end of 2019, the government plans to bring off-budget expenditure (primarily, the Uzbekistan Fund for Reconstruction and Development) on budget.

Uzbekistan tapped the international bond market with a debut Eurobond placement. Two tranches of a US$ 500 million five-year sovereign bond, yielding 4.75 per cent and a US$ 500 million 10-year sovereign bond yielding 5.375 per cent were successfully placed in February 2019. Uzbekistan received its first sovereign credit ratings "BB- Stable" from S&P and Fitch in December 2018 and a "B1 Stable" from Moody's in February 2019. According to a presidential decree, US$ 889.2 million will be deposited in banks, US$ 20 million will be loaned to Agrobank and US$ 89.9 million will be loaned to the state-owned enterprise Navoi mining and metallurgical complex, a large gold and uranium producer.