Passport

ECONOMY, FINANCE AND TRADE: UZBEKISTAN

Euromonitor International

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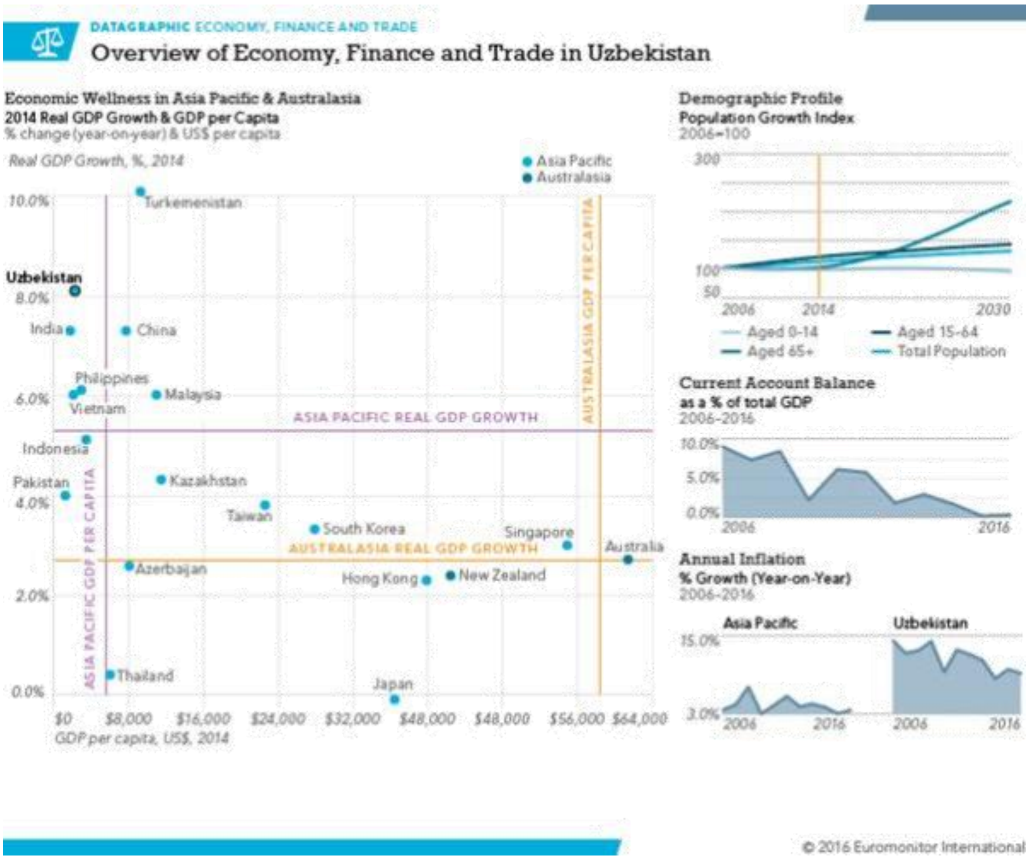
ECONOMY, FINANCE AND TRADE: UZBEKISTAN

Uzbekistan's real GDP growth rate in 2014 was amongst the highest in the world. The economy benefited from sustained investment in infrastructure projects. Its low corporate tax rate of 7.5%, large consumer market and richness in natural resources are major incentives for foreign investors. The fall in commodity prices globally reduced the country's export revenues. Brain drain, lack of availability of mortgage finances, and low foreign investment are key issues that the state needs to address.

Chart 1 SWOT Analysis: Uzbekistan

Source: Euromonitor International

Chart 2 An Overview of Economy, Finance and Trade in Uzbekistan: 2014



Source: Euromonitor International from national statistics/IMF/UN
Note: Data for 2015 to 2030 are forecasts.

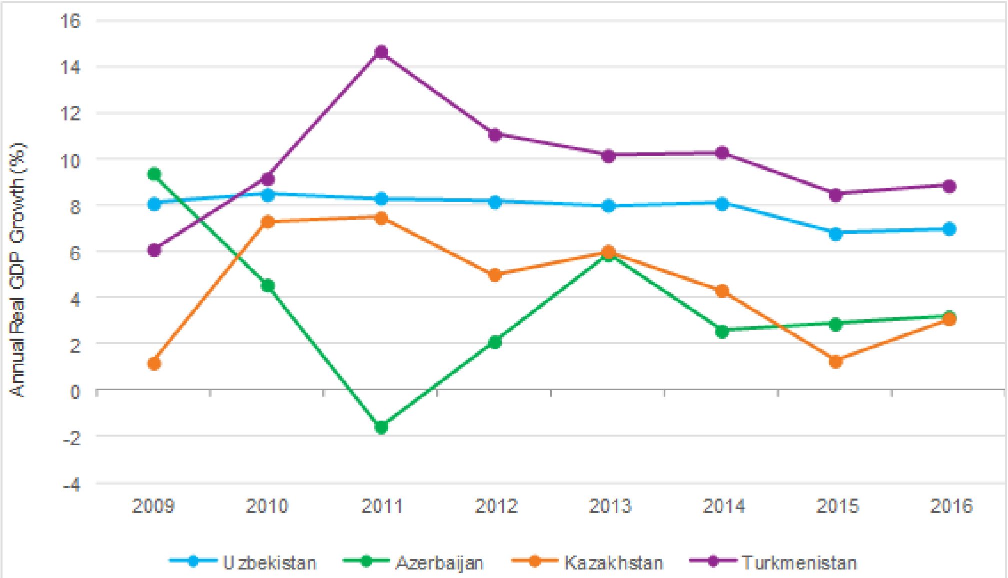
MAJOR COMPONENTS OF THE ECONOMY

the World’s Sixth Highest Annual Real GDP Growth Rate of 8.1% in 2014

Uzbekistan’s total GDP of UZS145 trillion (US$62.6 billion) in 2014 made it the second largest economy in Central Asia after Kazakhstan, in US$ terms. In 2014, it continued to be one of the fastest growing economies in the world with an annual real GDP growth rate of 8.1%. Uzbekistan’s economy has been resilient to the 2008-2009 global financial crisis, owing to the country’s limited involvement in the global financial markets, strong external and fiscal buffers, sustained public investment and the implementation of the government’s Anti-Crisis Action Programme (2009-2012). Despite the fall in commodity prices and economic slowdown in Russia and China (its major trading partners), Uzbekistan’s economy has continued to grow buoyantly at an average annual real GDP growth rate of 8.2% between 2009 and 2014:

- Annual real GDP growth in Uzbekistan further strengthened from 8.0% in 2013 to 8.1% in 2014, as a result of sustained growth in public investment, strong domestic demand and favourable governmental policies;
- The fall in commodity prices globally, economic slowdown in Ukraine, Russia and China and large depreciation of the ruble will reduce Uzbekistan’s export revenues and lower the value (in dollars) of remittance inflows. This will moderate Uzbekistan’s annual real GDP growth rate to 6.8% in 2015 and 7.0% in 2016.

Chart 3 Real GDP Growth in Uzbekistan and Selected Economies: 2009-2016



Source: Euromonitor International from national statistics/OECD/UN/International Monetary Fund (IMF)/World Economic Outlook (WEO)
Note: Data for 2015 and 2016 are forecasts.

- Uzbekistan has a strong consumer segment, large textile industry and is rich in natural resources, such as natural gas, uranium, cotton and gold, and is the world's leading producer of cotton, uranium and gold. According to the World Bank, in 2014, the largest sector of Uzbekistan's economy was services, accounting for about 44.0% of the total GDP, followed by industry and agriculture, accounting for about 24.1% and 17.2% respectively;

Uzbekistan's major exports comprise of cotton, gold, natural gas, copper and fertilisers. The fall in international prices for all of the above commodities in 2015, coupled with the ongoing economic slowdown in its major trading partners, such as Russia, China and Ukraine, will heavily weigh on the country's export revenues. The return of migrant workers from Russia and Ukraine, due to job cuts and the large depreciation of the ruble, will result in lower remittance inflows to Uzbekistan. Apart from these, some of Uzbekistan's long-term challenges that would persist include the lack of jobs and high disparity in the living standards between the people living in urban and rural areas.

SOCIO-POLITICAL RISK

Slow Reduction in Unemployment Amidst High Economic Growth

Rampant corruption has deterred foreign investment:

- Uzbekistan is a presidential republic, with Islam Karimov as the President of the country since March 1990. In the World Bank's 'Voice and Accountability Index', Uzbekistan's ranking was 191st out of 196 countries in 2014, highlighting restrictions on freedom of speech, press and assembly, despite these being guaranteed by the constitution;
- Due to the lack of strict laws and weak implementation of existing one, domestic violence in Uzbekistan has been an issue for decades. In the World Bank's 'Political Stability and

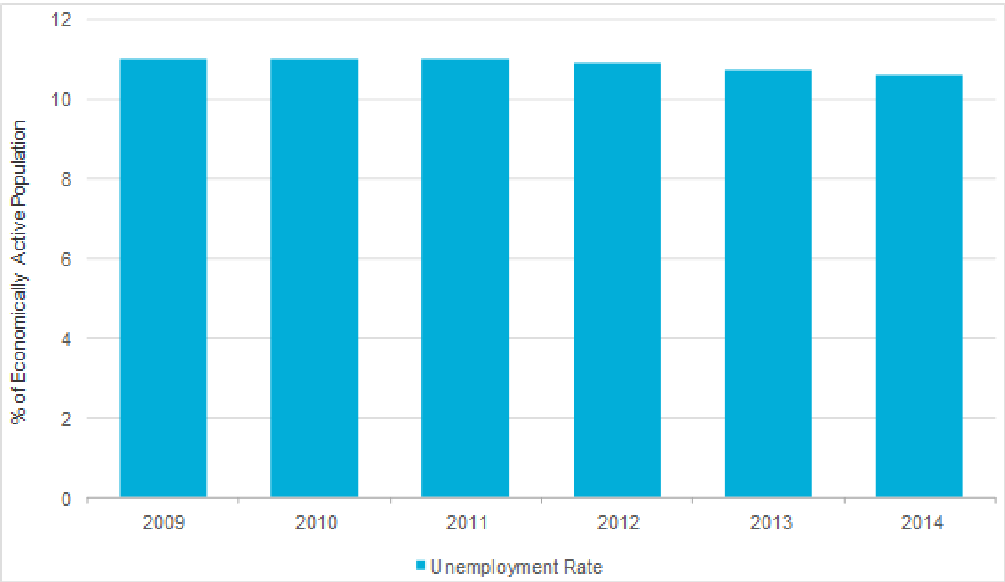
Absence of Violence Index', the country's ranking improved from 166th in 2009 to 128th in 2014 (both out of 202 countries), owing to the lack of genuine opposition in elections that result in a relatively peaceful outcome;

- With rampant corruption, Uzbekistan ranks as one of the most corrupt countries in the world. It ranked 166th out of 175 countries in Transparency International's Corruption Perceptions Index 2014. Bribery is very common among officials and corruption is prevalent in its public procurement and customs sectors. In October 2014, several senior employees from Uzbekistan's customs department were accused of bribery and arrested. Corruption at the higher levels has even manifested into extortion with Gulnara Karimova (Islam Karimov's eldest daughter) demanding percentage shares from telecom operators as a price for admission into the country's lucrative telecom market. Such practices and the prosecution of telecom company officials abroad has deterred foreign investment;
- Social protests are rare in the country, owing to restrictions imposed on freedom of assembly and continued suppression of all political opposition by government authorities. One of the few latest protests in Uzbekistan was held in January 2016 when local historians filed a complaint against the government's plan in demolishing a 700 year old minaret in Andijan and building a fountain in its place.

The Uzbek labour market suffers from a significant brain drain problem and lack of job opportunities:

- Uzbekistan's unemployment rate reduced marginally from 11.0% in 2009 to 10.6% in 2014, despite the country's strong average annual real economic growth rate of 8.2% between 2009 and 2014. This was due to the lack of job opportunities in the country that highlighted the need for more inclusive economic growth. However, the gradual improvement can be attributed to the labour market policies that aim to increase private sector jobs and the country's strong economic growth that has increased job opportunities especially in the services sectors.

Chart 4 Total Unemployment Rate in Uzbekistan: 2009-2014



Source: Euromonitor International from International Labour Organisation (ILO)/national statistics

Note: Youth unemployment rate refers to the unemployed population aged 15-24 as a percentage of economically active population aged 15-24.

Uzbekistan has a young population that will help boost its competitiveness:

- Uzbekistan has a very young population that will gradually age in the long run, due to falling fertility and birth rates and an increase in older people. The proportion of those aged 65+ accounted for 4.3% of the total population in 2014 and their share is expected to increase to only 7.9% by 2030. The old-age dependency ratio will accordingly rise from 6.3% in 2014 to 11.4% by 2030;
- The government's policies to abandon the country's minority communities (Russians and Tajiks), low pay and lack of job opportunities have made brain drain a problem in Uzbekistan. A major proportion of its educated and skilled professionals migrate to neighbouring countries, such as Russia, Kazakhstan and Ukraine, in search of higher pay and better career prospects. Remittance inflows play a major role in reducing poverty and increasing household consumption in Uzbekistan. However, the slowdown in Russia and the ongoing ruble crisis have resulted in job losses for migrants working in Russia and decreased the value of remittances in US dollar terms, respectively;
- The onset of the 2008-2009 global financial crisis, the slowdown in Russia and the ongoing Ukraine crisis, coupled with Uzbekistan's strong economic growth, has led to an improvement in Uzbekistan's net migration from a negative figure of 61,800 in 2009 to a negative figure of 34,700 (the lowest in Central Asia) in 2014. However, with the improvement in its neighbouring countries' economic growth, especially Russia, the country's net migration will increase to a negative figure of 40,400 by 2030.

EXTERNAL SECTOR

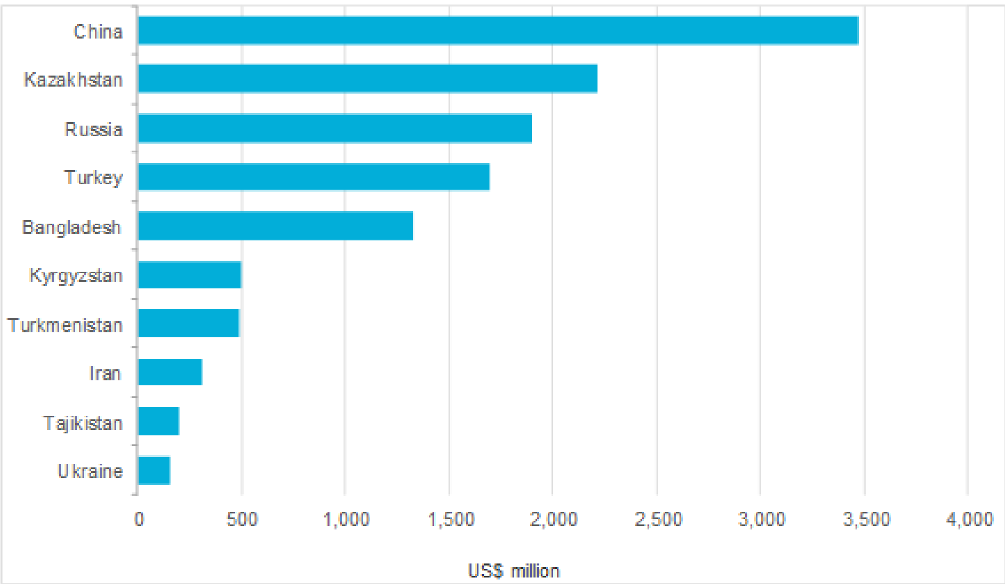
Higher Trade Deficit and Lower Remittance Inflows Narrowed the Current Account Surplus

Uzbekistan is relatively open to trade, with total exports of goods accounting for 21.3% of total GDP in 2014. In US$ terms, its total goods exports posted a year-on-year growth of 12.8% in 2013 and 5.2% in 2014. In April 2014, to protest against Russia's growing presence in Central Asia, Uzbekistan cut off gas supplies to Kyrgyzstan immediately after the ownership of Kyrgyzstan's gas network by Russia's Gazprom. In January 2014, the Russian-led Eurasian Economic Union imposed restrictions on car imports, which reduced Uzbekistan's car exports. All of the above, along with lower demand in Russia and Ukraine, led to the weaker performance in Uzbekistan's exports in 2014. Had there not been increased demand for Uzbekistan's exports from its other major trading partners, such as China, Bangladesh, Turkey and Kazakhstan, the country's exports would have declined further. However, the slowdown in the Chinese economy, coupled with the continued economic crisis in Russia and Ukraine and the fall in commodity prices, will lower export revenues in the future:

- Uzbekistan is very rich in resources and its exports mainly comprises of commodities, highlighting its vulnerability to the fall in global commodity prices. Apart from exporting natural gas, Uzbekistan also exports cars, copper, uranium, cotton and gold. According to trade sources, in 2014, the country ranked as the world's sixth, seventh and eighth largest producer of cotton, uranium and gold, respectively;
- Uzbekistan's export destinations are not well diversified, with 64.3% of its total goods exports going to Asia Pacific in 2014. Strong demand for its commodities (gold, cotton and natural gas) and its geographical proximity made China, Kazakhstan and Russia its biggest export partners in 2014 with 26.1%, 16.7 and 14.3% of its total goods exports destined to these

countries, respectively. Uzbekistan's excessive reliance on China and Russia makes it highly vulnerable to the ongoing Russian ruble crisis and economic slowdown in Russia and China.

Chart 5 Uzbekistan's Top 10 Export Destinations: 2014



Source: Euromonitor International from International Monetary Fund (IMF)/Direction of Trade Statistics

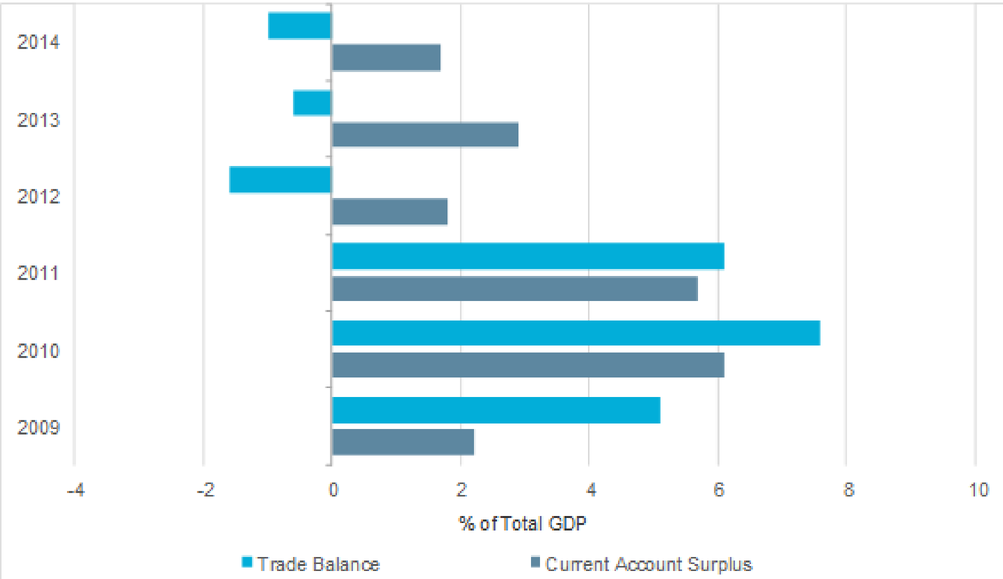
Although the share of total goods imports to total GDP decreased from 26.8% in 2009 to 22.2% in 2014, in US$ terms, Uzbekistan's imports grew by 54.1% between 2009 and 2014. This can be attributed to higher demand for input materials and machinery, owing to the country's robust economic growth that has spurred an increase in its industrial output and domestic demand:

- Uzbekistan does not manufacture heavy capital goods and thus machinery and heavy transport equipment form a major component of its imports. The country also imports raw materials and car parts for its large textile and car manufacturing industries;
- In 2014, Asia Pacific was Uzbekistan's largest import region with 50.3% of total goods imports, followed by Europe with 47.4%. In 2014, Russia and China were Uzbekistan's biggest import partners by country, accounting for 23.4% and 20.0% of total goods imports respectively. A relatively slower depreciation of Uzbekistani som with respect to the US dollar compared to its major trading partners' currencies will result in higher imports and lower exports. However, Uzbekistan's trade relationship with its neighbouring countries remains vulnerable to the growing number of member countries in the Eurasian Economic Union.

A relatively lower export revenue and higher import expenditure widened Uzbekistan's trade-deficit-to-total-GDP ratio from 0.6% in 2013 to 1.0% in 2014. This, coupled with the year-on-year contraction of remittance inflows by 15.8% in US$ terms, deteriorated the country's current account surplus from 2.9% of total GDP in 2013 to 1.7% in 2014:

- According to the World Bank, in 2014, Uzbekistan had high foreign exchange assets that were enough to cover more than 14 months of total goods and services imports. Thus, Uzbekistan's strong external position will be able to withstand abrupt changes in its trade or exchange rate.

Chart 6 Uzbekistan's External Balances: 2009-2014



Source: Euromonitor International from national statistics/OECD/International Monetary Fund (IMF)/International Financial Statistics (IFS)/World Economic Outlook (WEO)

Uzbekistan's unpredictable regulatory environment, its large state intervention in the economy and sluggish progress in its business environment (due to the government's unwillingness to open up the economy) restrict and have lowered foreign direct investment (FDI) inflows into the country:

- Its FDI intensity, therefore, decreased from 4.2% of total GDP in 2010 to 1.2% in 2014, highlighting the country's decreasing reliance on FDI as a source of investment for its economic growth;
- The biggest attraction for investors in Uzbekistan was its low corporate tax rate of 7.5% in 2015, large consumer market and its richness in resources such as natural gas, gold, uranium and copper. Uzbekistan has signed bilateral free trade agreements (FTAs) with eleven Commonwealth of Independent States (CIS) countries, which provide investors with access to those countries. However, the government's selective approach of preventing foreign investment in import-intensive sectors and welcoming those that are in line with its export-orientated and import-substitution industrialisation policy have hurt the country's competitiveness. Also, the lack of transparency in the country's regulatory environment has deterred foreign investments.

Uzbekistan follows a strict regime of currency controls and the existence of a black market for foreign currency creates distortions in the country's foreign currency market:

- To control the flourishing foreign currency black market, Uzbekistan's government exercised strict currency controls by banning the purchase of foreign currency cash in February 2013 and restricting access to foreign currencies, making it difficult for companies to import. This, coupled with lower export revenues, contraction of remittance inflows from Russia and fall in its value in US$ terms, depreciated the Uzbekistani som from 2,093 per US$ in 2013 to 2,315 per US$ in 2014.

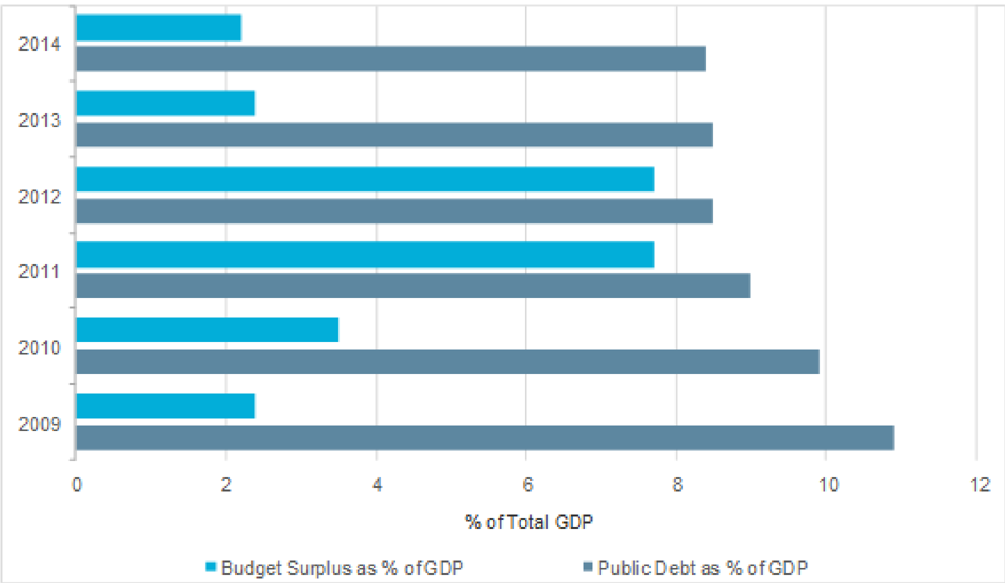
GOVERNMENT FINANCE

Further Reduction of Taxes Will Put Pressure on Government Finances

Uzbekistan's general government net budget surplus reduced from 7.7% of total GDP in 2012 to 2.2% in 2014, as a result of increased investments and expenditure on imports amidst lower exports and tax revenues:

- Total government revenue declined from 41.0% of total GDP in 2012 to 35.5% in 2014, owing to lower exports and tax revenues. According to the World Bank, the taxes-to-total-GDP ratio in Uzbekistan reduced from 21.5% in 2008 to 20.5% in 2014, owing to the gradual reduction of individual income and corporate profit taxes. For instance, the corporate profit tax was lowered from 31.0% in 2000 to 8.0% in 2014 and then further to 7.5% in 2015.The ongoing governmental strategy to widen the country's tax base and reduce the tax burden will further lower tax revenues;
- Between 2009 and 2014, Uzbekistan's total government expenditure grew by 72.4% in real terms to reach UZS48.3 trillion (US$20.9 billion), owing to its high public spending on education and sustained investment in infrastructural projects during the time period;
- Uzbekistan's current account surpluses have helped it pay off all its domestic indebtedness in 2012 and reduced its external debts. Hence, the public-debt-to-total-GDP ratio continuously declined from 10.9% in 2009 to 8.4% (a record low) in 2014, the lowest in Central Asia;
- Standard & Poor's, Moody's and Fitch Ratings do not publish credit ratings for Uzbekistan. Datong Global (based in Beijing, China), assigned Uzbekistan its first rating of 'BBB' in March 2013 with a stable outlook. This action was based on Uzbekistan's rapid economic growth, sufficient fiscal and foreign exchange reserves and low government debt;
- Although Uzbekistan's economy until now has been able to withstand the impact of lower external demand and commodity prices, the country's rising imports and capital spending, coupled with the further fall in commodity prices and tax revenues, might turn the general net government budget surplus into a deficit in the future. However, the Fund for Reconstruction and Development, the country's sovereign wealth fund, had accumulated assets worth US$15.0 billion by 2014 (according to the World Bank), with which the government hopes to finance its future investment programmes.

Chart 7 Public Debt vs. General Government Budget Surplus in Uzbekistan: 2009-2014



Source: Euromonitor International from National Statistics Offices/International Monetary Fund/OECD

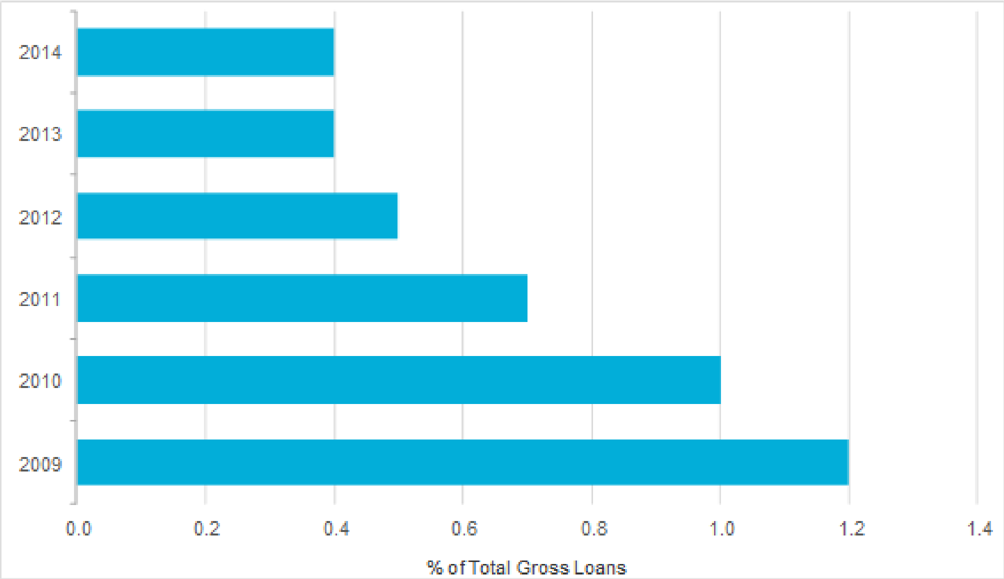
FINANCIAL STABILITY

the Banking Sector Enjoys A Very High Capital Adequacy Ratio

Uzbekistan's financial sector was able to withstand the 2008-2009 global financial crisis, owing to its limited integration within the global financial market. The banking sector remains highly capitalised with a capital adequacy ratio of 24.0% in 2014 (according to the World Bank). The majority of banks are state owned, accounting for about 80.0% of total bank assets, as of September 2013, according to the International Monetary Fund (IMF), thereby limiting competition:

- The proportion of nonperforming loans (NPLs) to total gross loans reduced from 1.2% in 2009 to 0.4% (the lowest in Central Asia) in 2014. Uzbekistan has successfully maintained a low proportion of NPLs, owing to its restrictive lending practices and strong economic growth.

Chart 8 Uzbekistan's Bank Nonperforming Loans to Total Gross Loans: 2009-2014

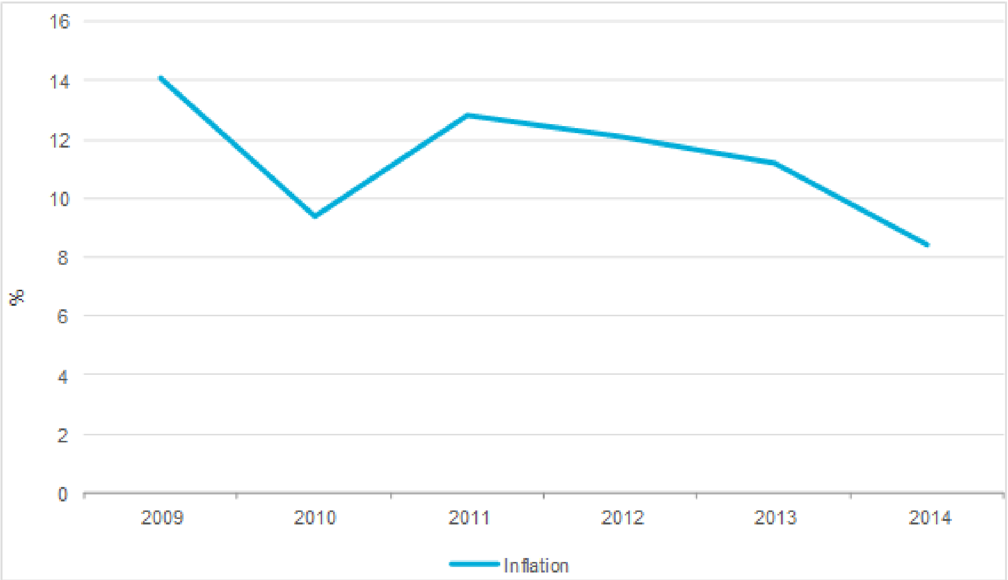


Source: Euromonitor International from World Bank

The Central Bank of Uzbekistan's (CBU's) primary function is to maintain price stability and at the same time help support economic growth:

- The CBU has been using a mixture of both restrictive and easing policies to maintain price stability and at the same time help boost domestic demand. Since January 2014, the CBU has been cutting its key interest rate from 12.0% in 2013 to 10.0% in 2014 and then further to 9.0% in 2015. Meanwhile, it also imposed tight control on cash availability and increased non-cash transactions to control inflation;
- Annual inflation in Uzbekistan decreased from 11.2% in 2013 to 8.4% in 2014, owing to low commodity prices and the CBU's cash control measures. In 2015, the country's inflation is expected to rise to 9.8%.

Chart 9 Inflation Rate in Uzbekistan: 2009-2014



Source: Euromonitor International from national statistics/OECD/UN/IMF

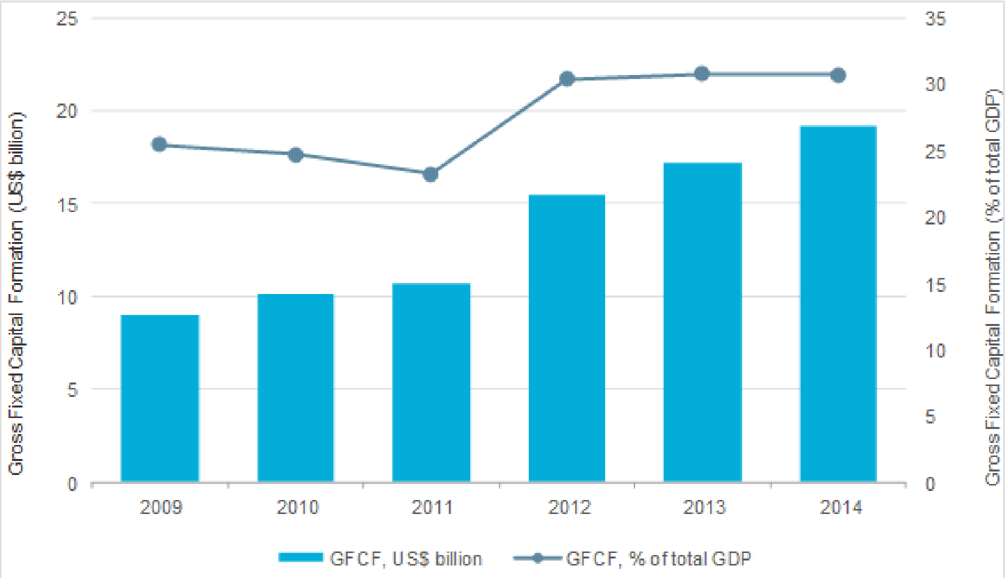
REAL ESTATE

Lack of Foreign Investment and Financing Stagnate the Real Estate Market

Uzbekistan's infrastructure sector will continue to grow on the back of sustained government investment on capital projects:

- High government investment in infrastructure projects increased Uzbekistan's gross fixed capital formation from UZS12.6 trillion (US$8.6 billion) in 2009 to UZS44.4 trillion (US$19.2 billion) in 2014;
- The government investment programme (2011-2015) worth US$47.0 billion has helped to upgrade the country's infrastructure and industry. Between 2015 and 2019, the government plans to invest US$10.0 billion in transport infrastructure and US$38.0 billion in developing export-orientated industries and new high-tech enterprises.

Chart 10 Gross Fixed Capital Formation in Uzbekistan: 2009-2014



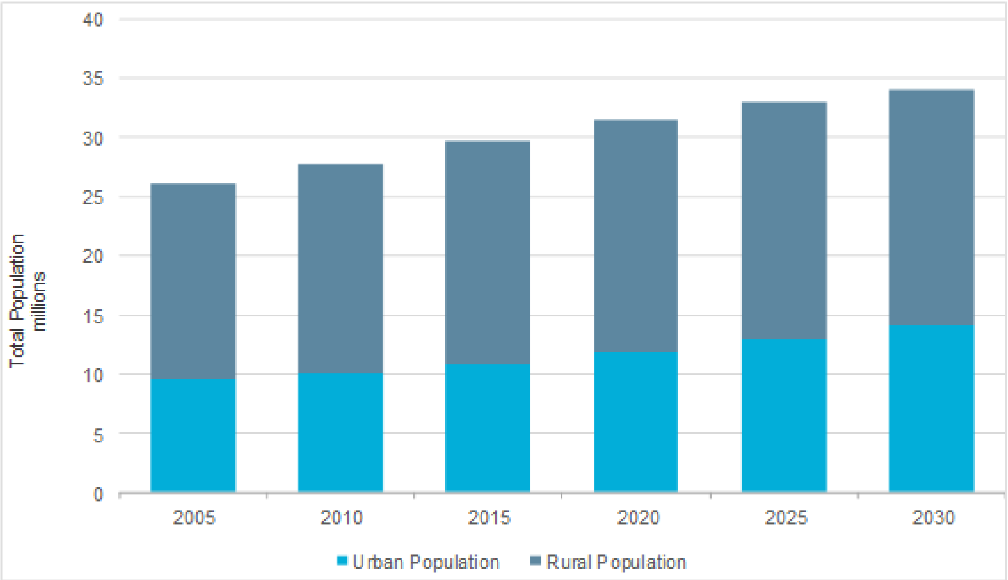
Source: Euromonitor International from national statistics/OECD/UN/International Monetary Fund (IMF)/International Financial Statistics (IFS)

Note: Gross fixed capital formation is measured in constant 2014 prices, fixed exchange rates.

The underdeveloped mortgage market and the adoption of cash control measures by the government have made it difficult for people to access mortgage and finances. This has resulted in people not being able to afford housing in the country. However, the government has been investing in major rural housing programmes to develop the country's overall infrastructure and make housing available and affordable in rural areas:

- Lack of financing and lower foreign investment, owing to the government's restrictive policies and an uncertain regulative environment, have left the country's real estate market stagnant. Vacancy rates for apartments and office spaces remain high in the capital, Tashkent;
- The proportion of people residing in urban areas accounted for 36.3% of the total population in 2014 and their share is expected to increase to 41.4% by 2030, highlighting the increasing demand for urban infrastructure and housing;
- Under the Housing for Comprehensive Rural Development Program (2009-2014), the government invested about US$2.5 billion for the construction of over 1,000 new rural settlements. The Asian Development Bank (ADB) aims to build 40,800 new rural houses between 2012 and 2016. The government further plans to increase investment in new rural housing and aims to build 2,500 new settlements by 2020.

Chart 11 Uzbekistan's Population by Rural/Urban Location: 2005-2030



Source: Euromonitor International from UN/national statistics

ENERGY AND ENVIRONMENT

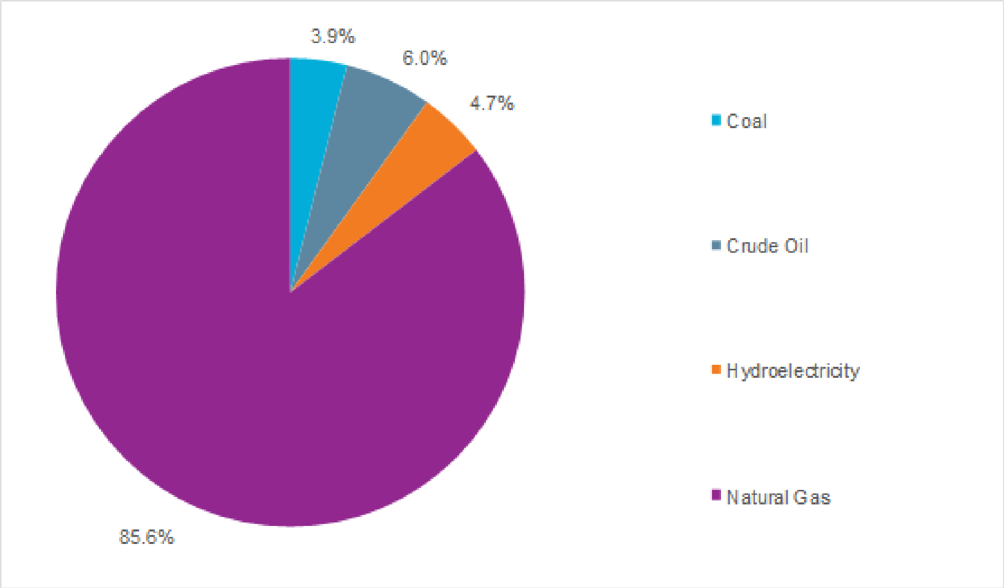
Government Looking To Introduce Energy-efficient Technologies and Systems

Uzbekistan is rich in hydrocarbon resources, from which it generates most of its energy. In 2014, with 51.6 million tonnes of oil equivalent, Uzbekistan stood as the second largest producer of natural gas in Central Asia after Turkmenistan with 62.3 million tonnes of oil equivalent. However, the production and exports of these resources have slowed down in recent years, owing to the country's ageing energy infrastructure and insufficient pipelines to export these in large volumes:

- Uzbekistan's total primary energy consumption increased from 43.4 million tonnes of oil equivalent in 2009 to 51.3 million tonnes of oil equivalent (the second highest in Central Asia) in 2014, owing to the increasing activity in the country's industrial sector;
- Uzbekistan's energy consumption was not well diversified in 2014, with 85.6% of its total primary energy consumption derived from natural gas, 6.0% from crude oil, 4.7% from hydroelectricity, and 3.9% from coal;
- However, the government's core energy policy aims to transform Uzbekistan from an energy-intensive to an energy-efficient country by investing in major energy-saving projects. With continued funding from the World Bank, as of April 2013, Uzbekistan aims to bring down CO2 emissions by 400,000 tonnes by 2018 and ensure energy savings of more than 200,000 MWh by 2020;
- The plunge in hydrocarbon prices since mid-2014 has led to lower export revenues. This has raised concern over the pressure it would put on Uzbekistan's public finances. Energy shortage is not a major issue in Uzbekistan, as it has enough hydrocarbon deposits to meet the country's increasing energy demand.

Chart 12 Uzbekistan's Primary Energy Consumption: 2014

% of Total Primary Energy Consumption

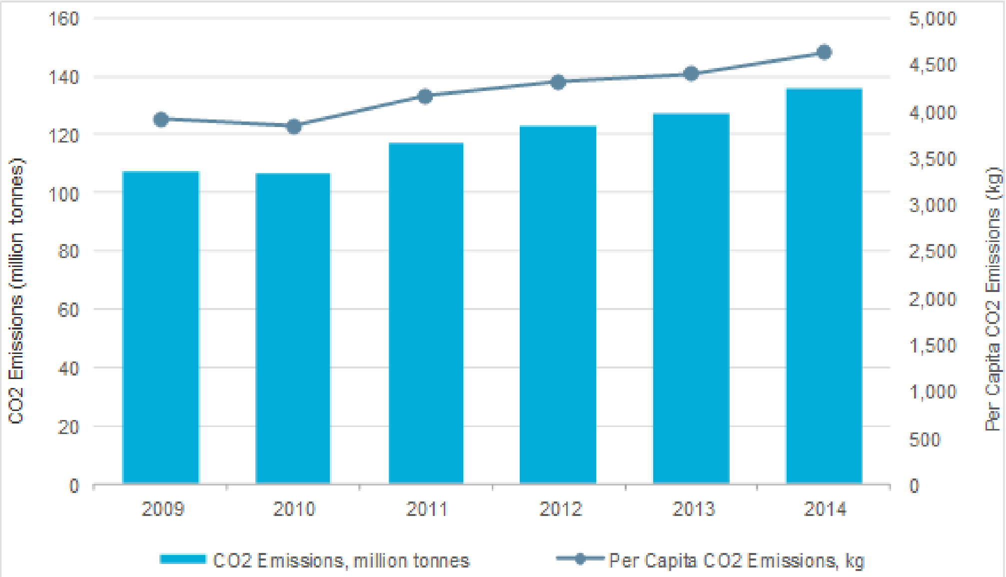


Source: Euromonitor International from BP Statistical Review of World Energy

Uzbekistan's CO2 emissions increased from 107 million tonnes in 2009 to 136 million tonnes (the second highest in Central Asia) in 2014, owing to country's out-dated equipment and technology, energy-intensive industries and high reliance on hydrocarbon resources:

- Despite the continuous decrease in CO2 emissions per unit of output from 3,179 grams per US$ in 2009 to 2,167 grams per US$ in 2014, it still stood as the highest in Central Asia. Similarly, the energy efficiency of the country improved from US$776 per tonne of energy consumed in 2009 to US$1,219 per tonne of energy consumed in 2014, owing to energy-saving technologies introduced by the government in the industrial sector.

Chart 13 Total and Per Capita CO2 Emissions in Uzbekistan: 2009–2014



Source: Energy Information Administration of the US Government, International Energy Annual
Note: CO2 emissions encompass the consumption and flaring of fossil fuels.

Apart from being located in one of the most seismic active zones in Central Asia. Uzbekistan is also affected by weather-related natural disasters, such as seasonal floods, landslides and droughts:

- According to EM-DAT estimates, between 2009 and 2014 an earthquake that occurred in July 2011 killed 12 and affected 86 people in Uzbekistan. Thankfully, the economic damages caused by natural disasters have been negligent in the country during the same time period;
- Being an arid land, Uzbekistan faces increasing water scarcity, due to its huge irrigated areas, a rapid population growth, drought and shrinking of the Aral Sea.

DEFINITIONS

Corruption Perceptions Index relates to perceptions of the degree of corruption as seen by business people and country analysts.

Energy Efficiency indicates the value of gross domestic product produced per tonne of oil equivalent of energy consumed.

Foreign Direct Investment (FDI) is investment made to acquire a lasting interest in or effective control over an enterprise operating outside of the economy of the investor.

FDI Inflows are the net value of inward direct investment made by non-resident investors in the reporting economy, including reinvested earnings and intra-company loans, net of repatriation of capital and repayment of loans.

FDI intensity measures FDI inflows as percentage of total gross domestic product (GDP).

Gross Fixed Capital Formation (GFCF) equals acquisition less disposals of fixed assets, improvement of land, change in inventories and acquisitions less disposals of valuables.

Gross Value Added (GVA) is the value of output less the value of intermediate consumption. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources.

House-Price-Income Ratio is the ratio of the cost of a typical upscale housing unit of 100 square metres compared to the country’s GDP per capita.

Net Migration is the difference between the number of immigrants into and emigrants from the area during the year.

Old-Age Dependency Ratio is the percentage of the population aged 65+ (retired) per population aged 15-64 (of working age).

Openness of the Economy is reflected by exports as a percentage of total GDP. More than 50.0% is very open; 25.0%-49.0% is open; 6.0%-24.0% is relatively open; and 0.0%-5.0% is relatively closed, high barriers to trade.

Political Stability and Absence of Violence Index reflects a better score in a higher position and measures the perceptions of the likelihood that the government will be destabilised or overthrown by unconstitutional or violent means (including domestic violence and terrorism).

Public Debt is total gross debt owed by any level of government (central government, local government, social security funds). Debt is reported at values outstanding at the end of the year and is consolidated between and within the sectors of general government - a loan from one level of government to another represents both an asset and an equal liability for the government as a whole and so it cancels out (is "consolidated”) for the general government sector.

Unemployment Rate represents unemployed population as a percentage of the economically active population, also known as the labour force (the total number of people employed plus unemployed).

Voice and Accountability Index captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media. A high ranking reflects a high score in the index.

Youth Unemployment Rate refers to the unemployed population aged 15-24 as a percentage of economically active population aged 15-24.