Rabobank

Country Report **UZBEKISTAN**

Summary

Uzbekistan is a land-locked country located in Central Asia with a very low level of development. Economic growth is estimated at 7.1% in 2012. The political situation is stable, however only in the sense that it is ruled in an authoritarian fashion by President Karimov. But, as Karimov is 74 years old, succession is a key concern. The social situation is troublesome, since economic, religious and press freedom are strictly limited, the legal system is not independent and corruption continues to be endemic. The current account balance is healthy on the back of substantial gas, cotton and gold exports. As a result, the external position is also healthy.

Things to watch:

- Succession risks in the event of a sudden death of President Karimov
- Troublesome social situation

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Uzbekistan

National facts		
Type of government	Republic	
Capital	Tashkent	
Surface area (thousand sq km)	447	
Population (millions)	27.5	
Main languages	Uzbek (74%)	
	Russian (5.5%)	
Main religions	Muslim (88%)	
	Eastern Orthodox (9%)	
	Other (3%)	
Head of State (president)	Islam Karimov	
Head of Government (prime-minister)	Rustam Azimov	
Monetary unit	som (UZS)	
Economy		**2011**
Economic size	*bn USD*	*% world total*
Nominal GDP	45	0.07
Nominal GDP at PPP	95	0.12
Export value of goods and services	14	0.06
IMF quotum (in mln SDR)	276	0.13
Economic structure	*2011*	*5-year av.*
Real GDP growth	8.3	8.5
Agriculture (% of GDP)	22	24
Industry (% of GDP)	38	34
Services (% of GDP)	40	47
Standards of living	*USD*	*% world av.*
Nominal GDP per head	1581	15
Nominal GDP per head at PPP	3317	27
Real GDP per head	811	10

Social and governance indicators	rank / total
Human Development Index (rank)	115 / 187
Ease of doing business (rank)	166 / 183
Economic freedom index (rank)	164 / 179
Corruption perceptions index (rank)	177 / 183
Press freedom index (rank)	157 / 178
Gini index (income distribution)	36.72
Population below $1.25 per day (PPP)	n.a.

Foreign trade			2011
Main export partners (%)		*Main import partners (%)*	
Russia	21	Russia	21
Turkey	17	South Korea	19
China	15	China	15
Kazakhstan	10	Germany	7
Main export products (%)			
Energy			26
Gold			23
Cotton			18
Openness of the economy			
Export value of G&S (% of GDP)			31
Import value of G&S (% of GDP)			29
Inward FDI (% of GDP)			0.0

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Due to limited data availability, the figures presented in this report should be treated as indicative.

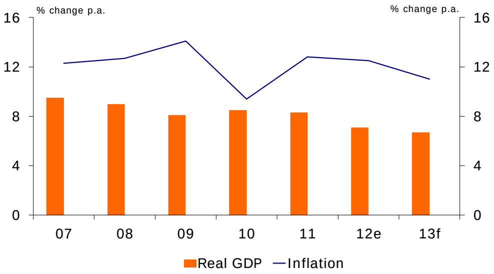
Economic structure and growth

Uzbekistan is a land-locked country located in Central Asia with a very low level of development. With a per capita income of USD 3,317 (PPP), Uzbekistan is among poorest countries in the CIS region. The low per capita income reflects the country's low level of development, with the economy predominantly relying on the export of labor (remittances), gold, gas and cotton. Most ordinary Uzbek's make a living from agriculture or live on remittances. Uzbekistan's population is growing with more than 1% per year. With 40% of the population below the age of 16, creating enough employment will be a key long term challenge for the government, which tightly controls the economy.

The country's growth performance has been very stable with real GDP expanding by an average of 8.7 percent in the past five years, according to the official figures. These figures also show that stable growth continued during and after the 2008/2009 global economic slowdown that strongly and negatively affected the Russian and Ukrainian economies, Uzbekistan's main trade partners, while commodity prices plummeted. However, given Uzbekistan's dependence on the production and export of a few commodities, the high growth rate during the global financial crisis seems highly unrealistic and the official figures should therefore be interpreted with caution. Higher international commodity prices and the recovery of Russia and Ukraine have benefited the Uzbek economy. However, given the weak and uncertain global economic environment, Uzbekistan's economic performance could weaken more strongly than currently estimated. Going forward, economic growth is estimated at around 7% in 2012. We forecast around 6.7% economic growth for 2013, spurred by strong inflows of foreign capital, a push of public infrastructure construction, a new round of privatizations and elevated global commodity prices.

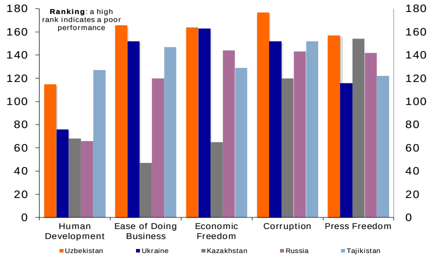
Uzbekistan's banking sector is one of the least developed in the former Soviet Union. The main banks are state-owned and are effectively lending arms of the government. As a result, commercial rationale is replaced by political rationale in making credit decisions. Although state guarantees and a recent government capitalization render the banking sector in a decent shape, underlying balance sheet problems remain unexposed.

Figure 1: Growth and inflation



Source: EIU

Figure 2: Social & economic indicators



Source: See factsheet

Political and social situation

Uzbekistan's president, Islam Karimov, has been ruling the country in an authoritarian fashion since its independence in 1991. Power is highly centralized within the executive, and more specifically in the person of Karimov himself. Elections are held regularly – Karimov was elected for another 7-year term in 2007 - but are a farce, as they are manipulated by the government while any real opposition is absent. Economic, religious and press freedom are strictly limited, as reflected by the country's dismal ranking on social indicators (see figure 2), the legal system is not independent and corruption continues to be endemic. Forced labor is also a problem that has led to Uzbekistan's cotton being banned from the US market in past years, although the US' stance has softened somewhat recently.

As a result of Karimov's dominance of the political scene, the political situation has been very stable. But, as Karimov is 74 years old, succession is a key concern. Some arrangements are being put in place to allow an orderly transfer of power, for example by appointing the leader of the senate as president in case Karimov becomes incapacitated. However, a sudden death of Karimov could result in a destabilizing power struggle amongst the elite. A prolonged period of political and social unrest is not unimaginable in that case. A "palace coup" scenario, where he is ousted while in office, is less likely, as we believe that as long as Karimov keeps Uzbekistan's political and economic elites in check, his rule will not be threatened.

While Uzbekistan has historically strong ties with Russia, it has recently improved its relations with the West. The West has softened its position towards Uzbekistan to encourage positive steps that Karimov took towards improving the political representation in the country. The shift in Western policy was also dictated by fact that NATO needs to use Uzbekistan as a logistical route to the conflict zone in Afghanistan. The US has also allowed the sale of non-lethal military equipment to Uzbekistan as a sign of its changing policies towards Uzbekistan.

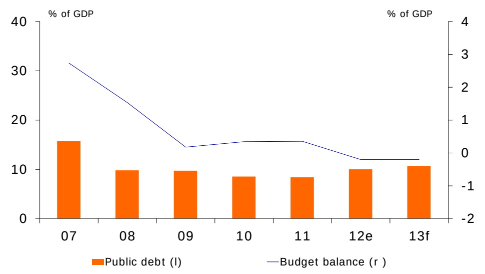
Economic policy

Given that the Uzbek economy continues to be managed in a Soviet manner, the government's presence in the economy is very strong. Economic growth will continue to be supported by expanding public investments in infrastructure and industry. The country's Fund for Reconstruction and Development plays and important financial role in this regard. Downside is, however, that mostly state-owned enterprises benefit from this fund's financing. Increasing public sector wages and social payments are other means of the Uzbek government to support the economy. In spite of the strong public spending, public debt remains low at 10% of GDP. However, the budget balance is anticipated to continue its worsening trend and start to show deficits in the coming years, although these are expected to remain limited to less that 0.5% of GDP.

Although the government budget is officially balanced, huge off-book expenditures and pervasive corruption likely keep the state in perpetual deficit. To fulfill these financing demands, the government depends upon large export earnings. Without these inflows, a financing crunch would develop. Fortunately for the Uzbek government, international commodity prices are projected to remain relatively high, thus providing the much-needed financing for the country. Even with these export earnings, however, the state lacks sufficient capital to fully transform the country's infrastructure and major manufacturers so that growth can be maintained for the long-term. For this, the government wants to continue to attract foreign investors, while maintaining and extending its recent restrictions for foreign capital inflows into the country. However, these restrictions, such as tariffs and limited currency convertibility, will remain at the discretion of the government, and are always vulnerable to sudden changes, with little recourse for the injured parties and is likely to deter foreign investment

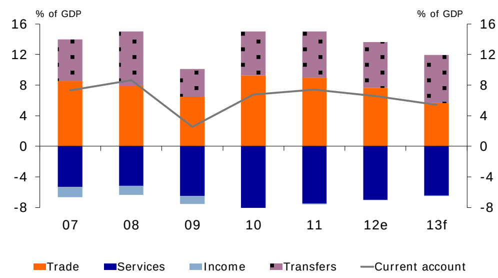
Inflation, usually in the double-digit territory, is rising as a result of expansionary policies and is estimated at around 12% in 2012. In spite of repeated calls by the IMF to liberalize trade and payment systems and to adopt a more flexible exchange rate policy (currently targeted at a slow depreciation in order to support exports), progress on these issues is not expected.

Figure 3: Public finances



Source: EIU

Figure 4: Current account



Source: EIU

Balance of Payments

Uzbekistan is one of the world's top producers of cotton. Additionally, the country exports natural gas and gold. With prices of these and other commodities still elevated, the country's merchandise trade and current-account surpluses are projected to remain substantial for the foreseeable future. Uzbekistan has been consistently running large current account surpluses in the past years and for

2013 a surplus of 5.4% is forecast. This, however, will largely be due to the tight government controls on capital flows, which suppresses foreign currency outflows (imports) while supporting foreign currency inflows (exports) by the means of tariffs and an undervalued currency and more worrisome, by limiting currency convertibility. The structure of the current account is vulnerable, as Uzbekistan depends on the export of a few commodities such as hydrocarbons and cotton, rendering it vulnerable to international commodity market fluctuations.

While we expect large current-account surpluses in the short term, Uzbekistan's increasing import demand will eventually eat away at these surpluses in the longer term. The government will likely maintain strict import controls, though, preventing this surplus from deteriorating too quickly. As long as the current account surplus is maintained, the country will be able to utilize its export earnings to finance needed investment activity, and thus Uzbekistan will be able to avoid international debt markets.

External position

Uzbekistan's external position is sound. External debt is moderate at USD 8.5bn end-2011, which equals 19% of GDP. An increase to USD 12.4bn is anticipated for 2012. However, as GDP growth remains steady and strong (according to official figures), this will still equal only 21% of GDP. Short term foreign debt is very low at below 2% of total foreign debt. Meanwhile, FX-reserves have been increasing and are expected to rise to USD 10.5bn at end-2012. Liquidity ratios are favorable; the import cover offered by FX-reserves stands at over nine months in 2012.

Uzbekistan

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	9.5	9.0	8.1	8.5	8.3	7.1	6.7
Consumer prices (average % change pa)	12.3	12.7	14.1	9.4	12.8	12.5	11.0
Current account balance (% of GDP)	7.3	8.6	2.6	6.8	7.4	6.6	5.4
Total foreign exchange reserves (mln USD)	3955	6659	7750	7858	9560	10540	11980
Economic policy							
Budget balance (% of GDP)	2.7	1.5	0.2	0.3	0.4	-0.2	-0.2
Public debt (% of GDP)	16	10	10	9	8	10	11
Uzbekistan, Money market interest rate (%)	14.0	14.0	14.0	14.0	12.0	12.0	12.0
M2 growth (% change pa)	46	32	31	31	32	30	29
Consumer prices (average % change pa)	12.3	12.7	14.1	9.4	12.8	12.5	11.0
Exchange rate LCU to USD (average)	1264.1	1320.4	1466.7	1587.2	1715.8	1872.3	1999.2
Recorded unemployment (%)	0.8	1.0	1.1	1.1	1.0	1.0	0.9
Balance of payments (mln USD)							
Current account balance	1627	2413	843	2637	3360	3280	3010
Trade balance	1894	2205	2119	3603	4060	3820	3130
Export value of goods	7692	10811	10495	11083	12590	12580	12170
Import value of goods	5798	8606	8376	7480	8530	8760	9040
Services balance	-1193	-1440	-2138	-3200	-3400	-3500	-3600
Income balance	-298	-332	-338	-17	-50	-30	-30
Transfer balance	1224	1980	1200	2250	2750	3000	3500
Net direct investment flows	705	711	700	800	650	950	1000
Net portfolio investment flows	-489	-750	-550	-750	-800	-800	-850
Net debt flows	53	324	1859	787	1022	2050	2110
Other capital flows (negative is flight)	259	1260	-1673	-2724	-1732	-4480	-4270
External position (mln USD)							
Total foreign debt	4211	4686	6550	7404	8540	10460	12460
Short-term debt	198	221	163	238	260	260	270
Total debt service due, incl. short-term debt	1028	1111	1145	923	1475	1490	1300
Total foreign exchange reserves	3955	6659	7750	7858	9560	10540	11980
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	8.5	7.9	6.5	9.2	9.0	7.6	5.6
Current account balance (% of GDP)	7.3	8.6	2.6	6.8	7.4	6.6	5.4
Foreign debt (% of GDP)	19	17	20	19	19	21	22
Foreign debt (% of XGSIT)	44	35	48	51	57	68	83
Debt service ratio (% of XGSIT)	11	8	8	6	10	10	9
Interest service ratio incl. arrears (% of XGSIT)	2	1	1	1	2	1	1
FX-reserves import cover (months)	5.8	7.0	8.0	7.9	8.6	9.3	10.2
FX-reserves debt service cover (%)	385	600	677	852	648	709	921

Source: EIU