

Rating-Agentur Expert RA confirmed at 'B' the sovereign government rating and at 'CCC' the credit climate rating of Uzbekistan

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of Uzbekistan at 'B+' (moderately low level of creditworthiness of the government) in national currency and at 'B' (moderately low level of creditworthiness of the government) in foreign currency.

Rating-Agentur Expert RA confirmed the country credit environment rating (CCE) of Uzbekistan at 'CCC+' (low quality of credit environment of the country) in national currency and at 'CCC' (low quality of credit environment of the country) in foreign currency.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Following IMF recommendations, Uzbekistan is expected to adopt a less expansionary fiscal policy to help contain inflationary pressures, with public spending being mainly directed to support social and public investment programs as well as critical SOEs. If successfully implemented in the course of 2018, the newly announced tax regulation may foster economic growth;
- Historically low short-term debt remains a significant positive factor and is estimated at 1,01% of GDP and 3,2% of budget revenues in 2017;
- FX reserves continue to be solid in 2017 at 92% of GDP, covering gross government debt by more than 3,7x and short-term government debt by more than 90x;
- Due to increased fiscal expenditure associated with the FX liberalization reform, as evidenced by significant additional lending and bank recapitalization, the fiscal deficit is expected to increase by 2,7p.p. y-o-y up to 3,3% of GDP in 2017. However, as the government is planning to restrain fiscal expenditure and collect additional revenue from improved tax administration and increased commodity prices in the course of the year, fiscal deficit is expected to narrow to 1,3% of GDP in 2018;
- The country's real GDP growth is expected to have declined to around 5,3% in 2017 from 7,8% in 2016, however it still remains one of the largest among the CCA peers¹. The future economic growth will be supported by increasing domestic investment, gradual implementation of economic reforms, as well as by a continuous recovery of the main regional trading partners;
- Uzbekistan's small and undeveloped banking sector remains solid and well-buffered with NPLs at 1,2% of total loans and capital-to-assets ratio at 12,4% in 2017 according to the Central Bank of Uzbekistan (CBU). Banks have received liquidity and capitalization support prior to the FX liberalization reform in the mid-2017 and are expected to be supported further if financial distress arises.

Restricting factors:

- The recent sharp increase in bank's assets and private credit volumes relative to GDP by around 24,6p.p. and 17,9p.p. to 66,9% and 44,4% in 2017 respectively was mainly due to the FX liberalization reform and flow of cash funds into the banking system, as the country's financial system is still characterized by high levels of credit and deposit dollarization. Despite this positive dynamic, the highly concentrated SOB- and channeled-

¹ Here Caucasus and Central Asia (CCA) oil exporters: Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan.

loan-dominated financial sector remains underdeveloped, failing to facilitate sufficient intermediation in the economy;

- Despite foreign trade inflow figures picking up by 3p.p. y-o-y to an estimated 3,7% of GDP in 2017, the economy's competitiveness remains limited due to high concentration of the country's production. However, the picture may change once further international trade reforms (as a follow-up to the already implemented FX and trade liberalization reforms) materialize into increased competitiveness of Uzbek export;
- According to the IMF, Uzbekistan has shown a very negative dynamic in terms of debt accumulation, with gross government debt increasing by around 14p.p. and 45p.p. to an estimated 24,5% of GDP and 77,5% of budget revenues in 2017. Nevertheless, the debt load is likely to increase further as the government is planning to issue Eurobonds in 2018;
- The unemployment rate, as reported by the World Bank, showed a slight improvement but remained high at 8,7% in 2017;
- The CBU has increased the refinancing rate from 9% to 14% in June 2017 in order to stem inflationary pressures, which resulted from the ongoing economy liberalization reforms. As further inflationary pressures are expected in 2018, the CBU is likely to hold monetary policy tight, in order to keep inflation under control. Monetary policy effectiveness will ultimately depend on how well the policy reforms 2017-2021 are realized, including the transition to inflation targeting;
- Uzbekistan's long-term growth perspectives remain favorable driven by a significant amount of natural resources (mainly natural gas, gold and cotton). However the effectiveness of attracting new inflow of FDI (stood at 1% of GDP in 2016) will depend on how well the economic reforms are implemented.

Negative factors:

- The country remains one of the least developed amongst its CCA peers as shown by the low level of GDP per capita, estimated at USD 6 910 in 2017, and an HDI index of 0,59 in 2016;
- As a result of UZS depreciation, coupled with an increase in food prices, the inflation rate reached 18,9% in 2017 and is expected to remain around 17% in 2018 due to the ongoing liberalization of economic activity, increasing public sector salaries and pensions and rising energy prices;
- Despite the recent steps to improve the quality and transparency of official statistics, the institutional development remains limited, as indicated by high levels of corruption and a diminished rule of law in the country. This may harm the country's plan to promote international trade and FDI and, as a consequence, may affect the materialization of the 2017-2021 development strategy;
- The financial market of Uzbekistan remains immature characterized by a low market capitalization of companies listed on the national stock exchange of just 20,3% of GDP in 2017 and high concentration of trading, with the five most active issuers amounting to 99,7% of total trades.

Currency risks:

- Most of the total gross government debt is of an external nature. Additionally, there is a genuine uncertainty about how effectively will the FX be managed, given the new economic policy.

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Restricting factors:

- Moderate investor protection as evidenced by the ranking of Doing Business (Uzbekistan improved by 13 positions and was 74th out of 190 countries in 2017).

Negative factors:

- Subdued quality and quantity of instruments in the local financial market;
- State-directed lending, often below market rates, which influences banks' credit policy.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Smooth economic policy transition process leading to stabilization of the economy;
- Recovery of the external environment along with further development of the financial sector and transparency of national institutions.

The following developments could lead to a downgrade:

- Continued deterioration of the fiscal balance and accumulation of government debt.

“The ratings of Uzbekistan remain constrained by the underdeveloped SOB-dominated financial sector, low institutional development and high corruption. The country's fiscal and monetary figures have been negatively affected, as Uzbekistan entered a transition period due to the ongoing liberalization of the economy. However, we expect the economy to stabilize, as the government is engaged in coordinating the fiscal and monetary policy.

On the positive ground, short- and long-term debt levels continue to be rather low and well covered by the FX-reserves. This provides sufficient room for further indebtedness without harming the country's creditworthiness. The future development of the ratings will largely depend on how effectively the government implements the 2017-2021 policy reforms.” – Clarified Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH.

Responsible expert: Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH

Reviewer: Gustavo Angel, Rating Associate of Rating-Agentur Expert RA GmbH

Research report on Uzbekistan is available at:

https://raexpert.eu/reports/Research_report_Uzbekistan_16.03.2018.pdf

Next scheduled rating publication: 14 September 2018. The full sovereign rating calendar can be found at <http://raexpert.eu/sovereign/#conf-tab-5>

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RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
22.09.2017	Scheduled revision of both types of ratings for the country	B+	B	CCC+	CCC
24.03.2017	Scheduled revision of both types of ratings for the country	B+	B	CCC+	CCC
23.09.2016	Scheduled revision of both types of ratings for the country	B+	B	CCC+	CCC
15.04.2016	First assignment of both types of ratings for the country	B+	B	CCC+	CCC

Minute's summary

The rating committee for Uzbekistan was held on 16 March 2018. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings and Country Credit Environment Ratings – Short Public Version (from April 2017) can be found under the following link: http://raexpert.eu/files/methodology/Methodology_Short_Sovereign_v2.pdf. Descriptions and definitions of all rating categories can be found under the following link: <http://raexpert.eu/sovereign.php> under the "Rating scale" section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: International Monetary Fund, World Bank, CIA Fact book, World Economic Forum, Doing Business, United Nations, The State Committee of the Republic of Uzbekistan on Statistics, Central Bank of Uzbekistan (CBU), Ministry of Finance of Uzbekistan, Transparency International.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Regulatory use

Only SGC ratings can be used for regulatory purposes according to the ESMA definition. CCE ratings are not considered as credit ratings within the framework of Regulation (EC) No 1060/2009.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

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Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.