Research Report on Uzbekistan

3 September 2021

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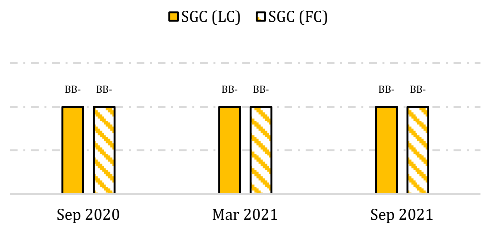
Ratings

Sovereign Government Credit (LC)	BB-
Sovereign Government Credit (FC)	BB-
Outlook (LC)	Stable
Outlook (FC)	Stable

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Uzbekistan

Macro indicators	2018	2019	2020*
Gross gov. debt, LC bn	83087	150050	219946
Nominal GDP, LC bn	406649	510117	580203
Real GDP growth, %	5,4	5,8	1,6
Gross gov. debt/GDP, %	20,4	29,4	37,9
Overall fiscal Deficit (surplus)/GDP, %	-2,1	-3,9	-4,4
Inflation rate, %	14,3	15,2	11,1
Current Account Balance/GDP, %	-	-	-5,4
External debt, USD bn	-	-	23,2

Development indicators	2020
Inequality adj. HDI	0,72**
GDP per capita, USD th	7,3

Default indicator	03.09.2021
9Y Gov Bond Yield***, %	3,8

Source: RAEX-Europe calculations based on data from the IMF, WB, CBU, NSC.
*Estimation **2019 ***USD government bonds with remaining maturity 9 years

RAEX-Europe has confirmed at 'BB-' the ratings of Uzbekistan. The rating outlook is stable.

RAEX-Europe has confirmed the sovereign government credit ratings (SGC) of Uzbekistan at 'BB-' (Sufficient level of creditworthiness of the government) in national currency and at 'BB-' (Sufficient level of creditworthiness of the government) in foreign currency. The rating outlook remains stable, which means that in the mid-term perspective there is a high probability of maintaining the rating score.

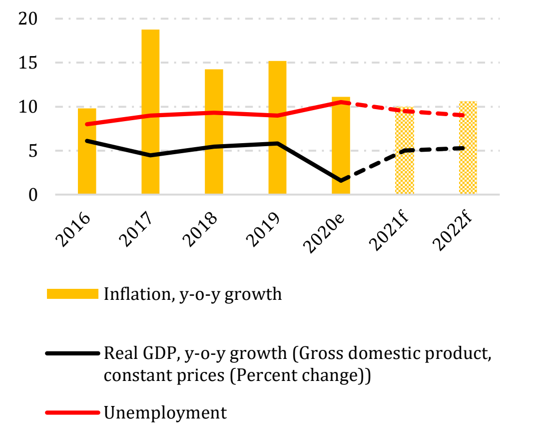
Summary

The confirmation of Uzbekistan's ratings at 'BB-' with stable outlook reflects the acceptable level of public debt and the recovery of economic activity in the second half of 2020 and further in the first half of 2021. The economy of Uzbekistan remains actively developing and the government remains committed to continuing the ongoing structural reforms. However, the explicit effects of the COVID-19 pandemic are still to be observed. Slow vaccination rollout in Uzbekistan and worldwide as well as the spread of the new variants of the virus might halt economic growth worldwide and in Uzbekistan.

The ratings also remain restrained by high inflation, low levels of institutional development and national welfare, and elevated levels of unemployment. Furthermore, despite improved management and transparency, the effectiveness of the monetary policy is undermined by the heavy segmentation of bank lending, high financial dollarization and underdeveloped local capital markets.

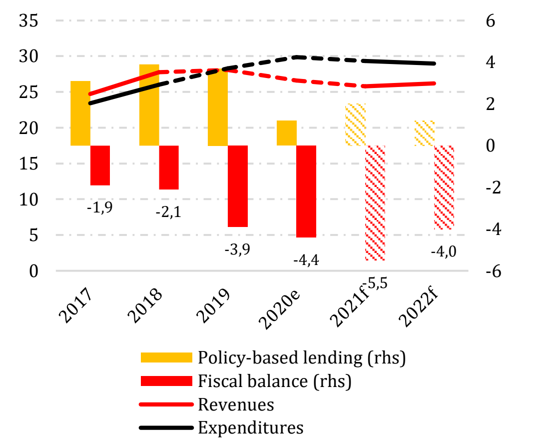
The economic activity is recovering, but the growth might still be halted, should the pandemic persist. In 2020 Uzbekistan has faced lower external demand due to sluggish economic activity globally, as well as lower private consumption and investment, caused by quarantine restrictions and uncertainty. Despite the significant impact of the pandemic, Uzbekistan is one of the few countries able to avoid economic contraction in 2020, showing a year-end GDP growth of 1,6%. After the initial slowdown in the first half of 2020, the economic activity recovered in the second half of 2020 and further in the first half of 2021. We expect the growth rate of the economy to come back to its pre-pandemic levels of around 5% in the medium term (see graph 1). Our base case scenario can

Graph 1: Macroeconomic indicators, %



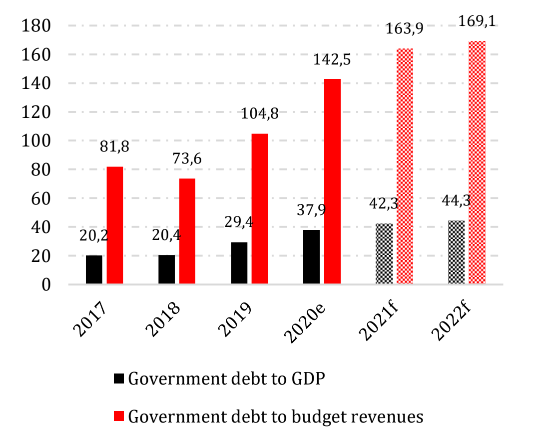
Source: RAEX-Europe calculations based on data from the IMF, WB, State Committee of the Republic of Uzbekistan on Statistics, Ministry of finance of the Republic of Uzbekistan

Graph 2: Fiscal budget dynamics, % of GDP



Source: RAEX-Europe calculations based on data from the IMF and WB *Overall fiscal balance in IMF definition, that includes policy-based lending

Graph 3: Government debt dynamics, %



Source: RAEX-Europe calculations based on data from the Ministry of finance of the Republic of Uzbekistan

however be restricted by the negative developments of the ongoing pandemic.

The rate of unemployment has increased to 10,5% in 2020 (9% in 2019) and remains one of the main restricting factors. At the same time, the rate of unemployment has proven to be lower than the projected 16,5%. We expect the unemployment rate to reach the levels of 9-10% in subsequent periods (see graph 1). Additionally, GDP per capita in PPP terms remains very low among regional peers[1] (USD 7,3 th in 2020).

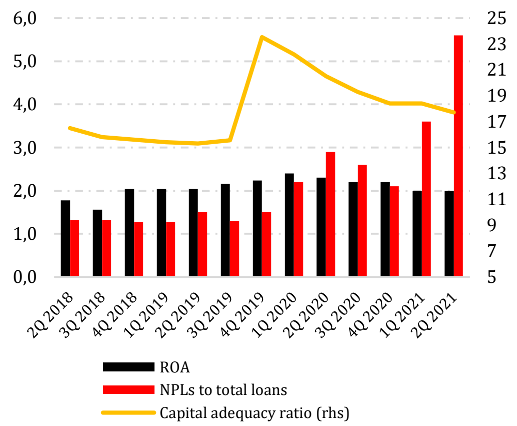
The government of Uzbekistan continues to provide fiscal stimulus to support the economic activity and eliminate the consequences of the coronavirus pandemic. Although the budget revenues remained resilient in 2020, due to the urgent need to cushion the effects of the COVID-19 pandemic the government had to increase spending on social sphere and medical care which has contributed to the widening of the overall fiscal deficit[2] to 4,4% by the end of 2020 (see graph 2). Since the beginning of 2021 the government continues to provide fiscal stimulus to support economic activity, increase household income and eliminate the consequences of the coronavirus pandemic. The overall fiscal deficit is expected to further widen to 5,6% by the end of 2021 and to return to its pre-pandemic levels in mid-term perspective (see graph 2).

Going forward we see two main factors which will define the stability of Uzbekistan's public finances in the mid-term: the development of the situation with COVID-19 and the continuation of the government's reforms regarding improvements in fiscal planning and transparency, reduction of the volume of policy lending, and implementation of announced plans for privatization of the massive public sector.

The level of public debt remains acceptable. Uzbekistan's total public and publicly guaranteed debt (PPG) increased to 37,9% of GDP as of 2020 (see graph 3), compared to 29,4% of GDP in 2019. The growth of public debt in 2020 was associated with the attraction of external borrowings to finance additional budget expenditures to combat the negative consequences of the COVID-19 pandemic and for further financing of state economic development programs. At the expense of concessional loans from the international financial institutions, the Anti-Crisis Fund was created. Despite the growth, Uzbekistan's public debt remains moderate and does not add additional risks to the country's creditworthiness. The majority of the debt is long term and comes in form of concession agreements with foreign governments and state banks, as well as international financial institutions. In terms of currency structure, the

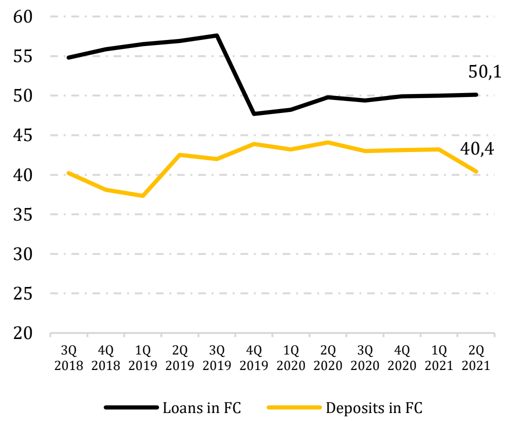
[1] Here Caucasus and Central Asia (CCA) oil and gas exporters: Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan.
[2] Includes policy-lending operations in IMF definition.

Graph 4: Financial soundness indicators, %



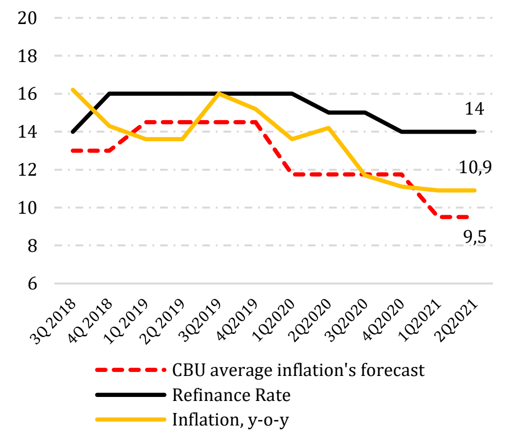
Source: RAEX-Europe calculations based on data from the CBU

Graph 5: Financial dollarization, % of total



Source: RAEX-Europe calculations based on data from the CBU

Graph 6: Refinance rate vs inflation rate, %



Source: RAEX-Europe calculations based on data from the CBU

prevalence of foreign currency-denominated debt (90% of debt) remains a key risk factor, making the debt position vulnerable to currency fluctuations. After a sharp devaluation of UZS in April 2020, the national currency has continued to weaken through the end of 2020 and the first half of 2021, which will increase the debt burden. Although the government seeks to diversify debt structure by issuing domestic bonds, their share remains insignificant, and further issuance of these instruments is limited by the underdeveloped domestic capital market. In addition, we continue to note the high level of contingent liabilities of the government related to SOE and SOB debts, which may be lowered as the implementation of the privatization program continues.

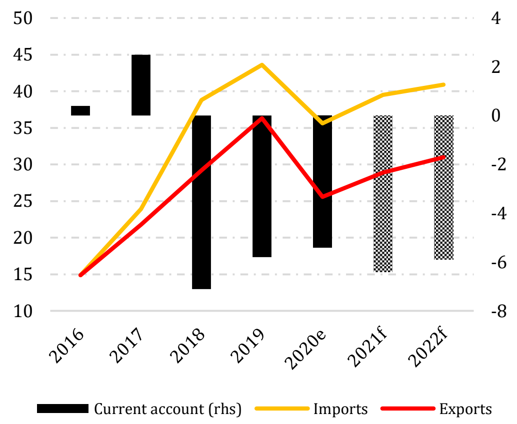
The share of NPLs in the banking sector has increased. The share of NPLs has risen sharply in the first half of 2021 and stood at 5,6% at the end of Q2 2021 (see graph 4). The profitability of the banking sector, however, has remained stable during the first half of 2021 with ROA standing at 2,0% at the end of Q2 2021. Although the capital adequacy ratio has deteriorated from 18,4% as of Q4 2020 to 17,7% as of Q2 2021, it still remains above minimum regulatory requirements.

The role of the financial sector for the economy remains limited due to the high concentration of assets on state-owned banks (83% of sector's assets as of Q2 2021), as well as a still significant share of preferential loans to public sector enterprises. We expect a reduction of systemic risks of the banking sector if the authorities' plans to cancel policy lending to SOEs at below market rates are executed.

Monetary policy has contributed to the provision of macroeconomic stability. The CBU has implemented a set of measures in order to support the economy during the pandemic which included postponement of repayment of loans to the population and businesses, maintaining the liquidity of the banking system and ensuring the stability of the payment system. Given the impact of the pandemic on the macroeconomic situation and the dynamic of the inflation the CBU reduced the key rate to 15% in April 2020, and further to 14% in September 2020 (see graph 6).

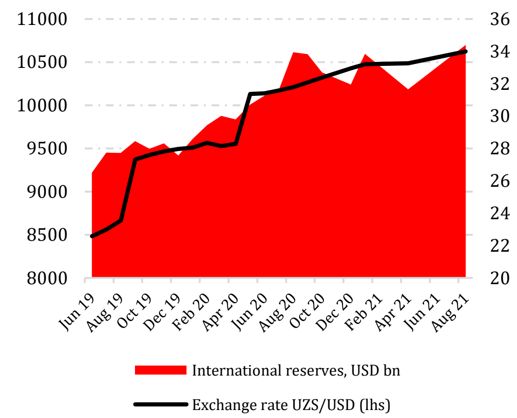
Overall, the CBU continues to improve the quality, predictability and transparency of its monetary policy within the framework of inflation targeting and the transition to a free-floating exchange rate regime. The regulator maintains its course to achieve the inflation target of 10% in 2021 and 5% by 2023. A number of factors however, including an increased level of financial dollarization (see graph 5) and underdeveloped domestic capital markets, limit the effectiveness of the monetary policy transmission mechanism.

Graph 7: External sector indicators, % of GDP



Source: RAEX-Europe calculations based on data from the WB and IMF

Graph 8: International reserves vs exchange rate



Source: RAEX-Europe calculations based on data from the CBU

Stress or Support factors:

- The level of financial dollarization of the economy remains high. At the end of 2Q 2021, the share of FX in total deposits and loans was 40,4% and 50,1% respectively.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Faster than expected recovery of the global economy, which can lead to an improvement of the external position of Uzbekistan and to enhance the state of government finances;
- Smooth continuation of the initiated structural reforms of the public business sector with reduction of the government footprint in the economy and banking industry;
- Further improvement of the exchange-rate flexibility and monetary policy, providing more freedom to monetary authorities, resulting in a long-term and controlled reduction of inflation and levels of financial dollarization.

The following developments could lead to a downgrade:

- Continued lock-down measures in the country and longer period of turbulence in the global economy, which would lead to further deterioration of the external position, as well as a contraction of local economy;
- Deterioration of the stance of the banking system, which would materialize contingent liabilities of the government;
- Higher than expected increase of the government debt and deficit metrics due to the need of additional financing for the government expenditures, and underperforming of tax and external revenues.

ESG Disclosure:

Inherent factors

- Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; level of corruption, CPI; Government Effectiveness Index; quality of the business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Drivers of change factors

- Natural disasters, such as earthquakes and droughts have negative economic impact through affecting agriculture and damaging of infrastructure. Thus, the factor in our sovereign methodology which could be directly affected by this is **Level and dynamics of production**.

Next scheduled rating publication: TBD December 2021**.** The full sovereign rating calendar can be found at Sovereign Rating Calendar 2021

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
05.03.2021	Scheduled revision of both types of ratings for the country	BB-	BB-	Stable	Stable
04.09.2020	Scheduled revision of both types of ratings for the country	BB-	BB-	Stable	Stable
06.03.2020	Scheduled revision of both types of ratings for the country	BB-	BB-	Stable	Stable
06.09.2019	Scheduled revision of both types of ratings for the country	BB-	BB-	Stable	Stable
08.03.2019	Scheduled revision of both types of ratings for the country	BB-	BB-	Stable	Stable
14.09.2018	Scheduled revision of both types of ratings for the country	B+	B+	Positive	Positive
16.03.2018	Scheduled revision of both types of ratings for the country	B+	B	NA	NA
22.09.2017	Scheduled revision of both types of ratings for the country	B+	B	NA	NA
24.03.2017	Scheduled revision of both types of ratings for the country	B+	B	NA	NA
23.09.2016	Scheduled revision of both types of ratings for the country	B+	B	NA	NA
15.04.2016	First assignment of both types of ratings for the country	B+	B	NA	NA

Minute's summary

The rating committee for Uzbekistan was held on 3 September 2021. 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 – Full Public Version (from August 2020). Descriptions and definitions of all rating categories can be found 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.

The definition of default can be found on the Agency's website in the section for Internal policies.

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), Asian development bank, Ministry of Finance of Uzbekistan, Transparency International.

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: ESG factors in RAEX-Europe's Credit Ratings

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

SGC ratings can be used for regulatory purposes according to the ESMA definition.

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.

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Risk warning

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Office responsible for preparing the rating

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