

Rating-Agentur Expert RA confirmed at 'BB-' the ratings of Uzbekistan. The rating outlook is stable.

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of Uzbekistan at 'BB-' (Sufficient level of creditworthiness of the government) and at 'BB-' (Sufficient level of creditworthiness of the government) in foreign currency. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Overall government debt¹ of the Republic of Uzbekistan keeps increasing and estimated to reach 36% of GDP and 142% of budget revenues due to active borrowing on international markets (including an issuance of USD 1 bn Eurobonds in February 2019), as well as issuance of local UZS-denominated bonds and an increase in guarantees for national projects. We expect the debt load to increase by end-2020, but at a slower pace. In our view, the current and forecast debt load remains at acceptable levels. In addition, maturity and repayment conditions remain favorable, with around 32% of overall debt owed to foreign governments and public institutions, and 33% to international financial institutions on concessional terms;
- According to preliminary data from the MFRU the consolidated budget² in 2019 was executed with a deficit of 1,5% to GDP, while the overall budget deficit³ could reach around 1,6% of GDP by the end of 2019 according to the IMF's latest estimates. In order to increase transparency and accountability of public finances, as well as to be in line with international standards, the MFRU introduced the official "overall fiscal balance"⁴ with targets of -2,7% and -2,1% of GDP for 2020 and 2021, respectively. Our assessment of the overall fiscal balance is close to the mentioned indicator, and does not pose substantial risks to the government's creditworthiness;
- Preliminary data for 2019 shows an accelerated growth of the Uzbek economy at 5,6% in real terms, as compared to 5,4% in 2018, supported by significant growth in construction, manufacturing and service industries. Such growth remains one of the highest in the region and we expect the metric to be in the range between 5,5% and 6% in 2020-2021, while the long-term growth rates will depend on the privatization of SOEs as well as the overall effectiveness of structural reforms;
- As a result of the Central Bank of Uzbekistan's (CBU) policy, regarding the capitalization of state-owned banks, the overall regulatory capital increased by 2,2x by the end of 4Q 2019 y-o-y, with capital adequacy and capital to assets ratios reaching 23,5% and 18,7% respectively. Asset quality and profitability metrics also remained at positive levels, with an officially recorded NPLs to total loans ratio at 1,5% and ROA at 2,2% as of the same date. At the same time, we still see potential risks in the system related to the high concentration (around 85% of assets) of state-owned banks, strong government influence and partly controlled distribution of credit resources at preferential rates. There are

¹ According to the Ministry of finance of the Republic of Uzbekistan (MFRU) data, including direct external and internal debt as well as publically guaranteed debt.

² Includes State budget and all "State target funds".

³ Includes estimation of directed lending and off-budget operations.

⁴ Includes the expenses for National development programs financed by the external government debt.

elevated risks of materialization of contingent liabilities, taking into account financial position of some large SOEs and expected decrease of the scale of preferential lending.

Restricting factors:

- Due to the dominance of FX-denominated obligations in the structure of public debt (more than 97% of internal debt and 100% of external debt) and high volatility of the national currency, the debt position remains vulnerable to exchange rate fluctuations. In 2019, the national currency depreciated by 14% against the USD, which led to an increase in the debt burden. The government is diversifying the debt structure by launching from December 2018 the issuance of UZS-denominated domestic bonds, but the share of such obligations remains insignificant, around 1% at the end of 2019;
- According to the preliminary data, the trade deficit in Uzbekistan in 2019 reached 11% of GDP as compared to 10% in 2018, mostly due to the growth of imports of machinery and equipment for the modernization of local enterprises, while exports increased at a slower pace. We expect the current trend in foreign trade to continue in 2020 as export demand weakens and imports are stably high, nevertheless the external position of Uzbekistan is supported by a moderate debt level and its favorable maturity, as well as sound foreign exchange reserves covering 13 months of imports by end-2019;
- After a rapid growth over the last several years the ratio of banking system assets and domestic loans to GDP is expected to stabilize by the end of 2019 at 52,1% and 40,4% respectively (as compared to 52,6% and 41,4% in 2018) mostly due to the restructuring of the banking system balance-sheet⁵. Although these indicators are still at a moderate level, a significant share of loans is still directed lending to SOEs, which limits the effectiveness of the market role of the banking sector;
- The officially reported unemployment rate slightly decreased to 9% in 2019 from 9,3% a year before. This level is considered as elevated according to our internal benchmarks. In addition, the local labor force market is heavily exposed to the economic situation in Russia and Kazakhstan, and therefore the unemployment level can deteriorate in case of significant economic distress of these economies;
- The CBU is pursuing a tight monetary policy, keeping the refinancing rate at 16% after an increase of 2p.p. in 2018. However, from 1 January 2020 the CBU introduced the new policy rate (“key rate”), which is expected to be the main money market benchmark⁶, as well as implemented interest corridor of +/-1 p.p. and introduced new policy instruments, including REPO transactions, currency swaps and overnight deposits. Besides, adhering to the free float exchange rate regime, the CBU conducts neutral interventions mainly to sterilize the purchase of gold in order to contain the monetary base, smoothing out only sharp fluctuations in FX rates. In addition, the official inflation in 2019 remained within the CBU’s forecast corridor of 13,5%-15,5% and reached 15,2%. However, the efficiency of the monetary transmission mechanism is limited by the availability of preferential lending to SOEs at below-market rates (the current spread between the market and preferential rates is around 16p.p.), as well as by the lingering high dollarization, which remained elevated after a slight decrease to 47,7% for loans and 43,9% for deposits as of December 2019;
- The quality of the fiscal policy in Uzbekistan has improved substantially over the last two years, including continuing tax reform, improvement of fiscal planning, accountability to the legislative body, substantial increase of transparency and consistency of all fiscal operations (especially, the implementation of the “overall fiscal balance”), as well as the introduction of borrowing limits for each year and plan for gradual reduction of deficits till 2022. However, we still observe risks of deviations from the policy in the form of

⁵ Around USD 4 bn in loans originally granted by the Uzbekistan Fund for Reconstruction and Development (UFRD) to be lent to SOEs, are to be returned to the UFRD. In addition, USD 1,5 bn in loans, originally lent by the UFRD, was granted to banks to convert into equity in order to improve capitalization in the system.

⁶ As of beginning of March 2020, both refinancing rate (currently used only for the interbank loans from the CBU to commercial banks) and the key rate are at the same level of 16%.

directed lending to SOEs and financing of social programs, despite the fact that these risks are expected to be partly mitigated by the activation of the privatization program and the reduction of the scale of preferential lending within the next years;

- Uzbekistan is one of the leading countries in the world in terms of diversity and availability of natural resources (mainly gold and natural gas), which contributes to sustainable economic growth. At the same time, the country has long been in a water crisis, the severity of which may increase with the reduction of water resources amid the melting of mountain glaciers due to global climate change. Agriculture is the most exposed to water risk, accounting for around 30% of gross value added.

Negative factors:

- GDP per capita in PPP terms over the past five years has expanded by 30% to USD 8,8 th. However, Uzbekistan remains lagging other peers in the Central Asian region. Furthermore, the unadjusted HDI as of 2018 also remained extremely low, at 0,71 (109th place among 189 countries);
- After the period of price and exchange rates liberalization, inflation remains high and volatile in Uzbekistan. Mostly triggered by the food price increase, inflation in 2019 hiked once again to 15,2% after a slowdown in 2018 (14,3% as compared to 18,8% in 2017), but remained within the CBU's forecast corridor. We expect the inflation to decrease gradually by the end of 2020 and to be close to the upper bound of the CBU's corridor of 12-13,5%, if the macroeconomic environment remains stable;
- Institutional development continues to be hampered by high level of corruption perception, moderately weak checks and balances system and rule of law indicators. According to Transparency International, the Corruption Perception Index was 25 out of 100 in 2019, while Government Effectiveness and Rule of Law Indexes stood at -0,55 and -1,1 in 2018. However, Uzbekistan reached significant progress in the World Bank's Ease of Doing Business ranking by occupying the 69th position out 190 countries in the 2020 report and it also showed a substantial increase in governance transparency;
- The national capital markets remain undeveloped in global terms despite the ambitions reforms, which started in 2019. The stock market remains represented by a limited number of participants with a narrow range of financial instruments and a high concentration of trades (ten largest issuers account for about 73% of the annual trading). However, we notice substantial growth of the number of market participants, issuers, traded shares as well as new instruments, including traded UZS government bonds, which were issued in order to create a benchmark for local issuers and add more instruments for the management of liquidity in the banking system. However, despite the fact that national companies capitalization to GDP more than doubled over the last six years, it remains below 10% of GDP.

Stress factors:

- The level of financial dollarization remains elevated at 47,7% for loans and 43,9% for deposits by end-2019, showing still high demand for lending in foreign currency and not enough confidence of the population in the national currency (very weak stress factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Ensuring macroeconomic stability, economic growth and reduction of unemployment through a smooth continuation of the initiated reforms and restructuring of the public business sector;
- Prudent and transparent fiscal policy focused on diversifying revenue sources and significant curtailing of policy lending programs;

- Improving the efficiency of monetary policy, its consistency and 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:

- Strong growth of directed lending with concentration in state banks, which may lead to increased external imbalances, higher inflation and materialization of contingent liabilities;
- Sharp increase of dollarization levels due to adverse conditions in the FX-market;
- Elevation of the government debt load due to devaluation of UZS, taking into account the high share of FX-denominated debt.

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***.

“The confirmation of Uzbekistan's ratings at ‘BB-’ with a stable outlook are supported by accelerated economic growth, bearable level of public debt and deficits, as well as continuing structural reforms in the economy. The ratings are also underpinned by the solid stance of the banking sector, which maintains favorable levels of capitalization and profitability.

Nonetheless, rating levels are constrained by widening debt and public deficits, high inflation and exchange rate volatility, as well as elevated financial dollarization. Despite the significant improvements, the level of per capita wealth, institutional development, large contingent liabilities of the government, as well as the limited effectiveness of monetary and fiscal policies restrain our rating assessment.” – Clarified Vladimir Gorchakov, Associate Director of Rating-Agentur Expert RA.

Research report on Uzbekistan is available at:

https://raexpert.eu/reports/Research_report_Uzbekistan_06.03.2020.pdf

Next scheduled rating publication: 4 September 2020. The full sovereign rating calendar can be found at [Sovereign Rating Calendar 2020](#)

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
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 5 March 2020. 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 April 2019). 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.

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

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

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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.