UZBEKISTAN

Highlights

- **The economy is proving to be relatively resilient to the impact of Covid-19.** Growth slowed but remained positive at 0.4 per cent year-on year in the first three quarters of 2020, led by growth in agriculture and construction. Also, the economy is less dependent on external developments than some of its Central Asian peers.
- **The government's Anti-Crisis Fund is strengthening both the healthcare system and support for affected workers and businesses.** By investing in public infrastructure works and developing private land plots, the fund is also helping to create earning opportunities for low-income families.
- **Ambitious market reforms continue to advance despite the crisis.** Measures have been adopted in the past year to strengthen judicial independence and improve other aspects of the investment climate, privatise and develop the banking sector, promote export-oriented agribusiness clusters, and attract private investment in the electricity sector.

Key priorities for 2021

- **The immediate key priority is to continue providing support to sectors affected by Covid-19 and sustain private sector employment.** To help businesses stay afloat, support measures should seek to smoothen income shocks and boost consumption in the hardest-hit sectors, such as recreation and hospitality.
- **The authorities should step up efforts to promote digital transformation.** Investment in broadband infrastructure, and upgrading digital skills and the IT ecosystem are essential to enable remote working and learning for all groups of the population.
- **The government should adjust reform priorities in light of post-Covid-19 realities.** In the short term, priority should be given to macroeconomic stabilisation, continued improvement of the investment climate, and other measures to build investor confidence. Earlier plans for large-scale privatisation of state-owned banks and enterprises may have to be delayed in case of slower-than-expected economic recovery. Where feasible it would be important to proceed with divesting smaller-sized assets, while proceeding with improving corporate governance at state-owned enterprises and banks.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	6.1	4.5	5.4	5.6	-2.0
Inflation (average)	8.8	13.9	17.5	14.5	13.0
Government balance/GDP	0.8	1.3	1.7	-0.3	-4.5
Current account balance/GDP	0.4	2.5	-7.1	-5.6	-7.0
Net FDI/GDP [neg. sign = inflows]	-2.0	-3.0	-1.2	-4.0	-3.0
External debt/GDP	17.9	26.3	33.9	41.7	n.a.
Gross reserves/GDP	32.3	47.5	53.7	50.3	n.a.
Credit to private sector/GDP	12.4	16.6	23.8	30.0	n.a.

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Covid-19: macroeconomic implications

Uzbekistan's economy is proving relatively resilient to the impact of Covid-19. Compared with other countries in Central Asia, Uzbekistan's economy is more diversified: industrial output (mining, manufacturing and construction) accounted for 36 per cent of its GDP in 2019. Industry, and construction in particular (14 and 19 per cent growth in 2018 and 2019, respectively), also served as the main engines of growth in recent years. The country's export structure is quite diversified as well. Commodity exports constituted about 50 per cent of total exports in 2019, with gold accounting for more than half, providing a natural hedge in turbulent times.

Economic growth is slowing but remains positive. Real GDP increased by 0.4 per cent year-on-year in the first half of 2020, led by growth in agriculture and construction (3.4 and 8.6 per cent year-on-year, respectively). Industry output dropped by 2.7 per cent and gas production fell by 19.6 per cent year-on-year. Services, however, recovered in the third quarter of 2020 and recorded an increase of 1.8 per cent year-on-year in January to September 2020. The government imposed the first round of lockdown restrictions from mid-March until May 2020 and the second round from 10 July until 17 August 2020, gradually easing them since then. As a result, the unemployment rate surged to 13.2 per cent in January to July 2020 from 9.1 per cent a year ago. Real incomes started contracting in April 2020 and posted a decline of 1.7 per cent year-on-year in June 2020.

The country faces rising external pressures. While imports of goods decreased by 15 per cent year-on-year in the first eight months of 2020, growth of exports stalled in the same period, with the trade balance remaining negative. Energy exports declined by around 78 per cent year-on-year, owing to weak demand from China and Russia. Gold exports rose significantly by 47 per cent year-on-year in January to August 2020 thanks to the positive effect of record-high gold prices and higher gold shipments. Exports of services declined by 76 per cent year-on-year (mostly transport and tourism receipts). At the same time, closure of borders and limited economic activity in Russia and Kazakhstan led to a decline in remittances by 5.4 per cent year-on-year in US dollar terms in the first eight months of 2020.

The economy is forecast to contract in the short term but recover in 2021. Real GDP is forecast to drop by 2.0 per cent in 2020. A recovery of 4.5 per cent is expected in 2021, driven by an expected rebound in exports and domestic demand. Thus any failure of this rebound to materialise (because of a prolonged pandemic) is a key risk.

Policy response to Covid-19

An Anti-Crisis Fund has been established. This fund, of around 1.5 per cent of GDP, was established in April 2020 to strengthen the healthcare system and support vulnerable workers and affected businesses. Its revenues come from the state budget as well as loans from the International Monetary Fund, World Bank and Asian Development Bank (totalling more than US$ 1 billion). The fund finances spending on medicine, healthcare and medical workers' bonuses. It also allocates funding to support employment through public infrastructure works and development of private land plots of low-income families. Several sectors, such as aviation (Uzbekistan Airways) and transport (Tashkent Metro), received financial support during lockdown. In addition, the fund covers government expenditures on provision of liquidity, interest subsidies and guarantees to businesses.

The central bank eased monetary policy but maintained prudential requirements. As inflationary pressures eased, the central bank's policy rate was reduced from 16.0 per cent to 15.0 per cent in April 2020, and to 14.0 per cent in September 2020. In January 2020 the central bank introduced an interest rate corridor of plus/minus 1 per cent around the policy rate as part of its transition to an inflation-targeting regime, with the target rate declining from 10 per cent in 2021 to 5 per cent in 2023. In terms of prudential measures, the regulator recommended that banks deferred loan repayment by affected individuals and entrepreneurs until October 2020. Some banks were given access to targeted refinancing operations from the central bank.

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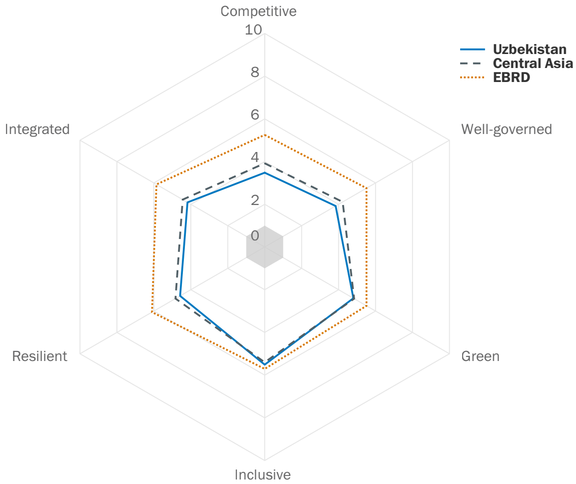
Assessment of transition qualities (1-10)



Structural reform developments

A new banking sector development strategy has been approved. The strategy, approved in May 2020, sets out an ambitious reform plan for the period 2020-25. It seeks to reduce state ownership in the banking sector and state-directed lending to the private sector. The government intends to keep shares in only three banks – the National Bank for Foreign Economic Activity, Agrobank and Microcreditbank. Other measures include improving the legal framework by introducing Basel standards and international financial reporting standards, facilitating digitalisation and improving customer services. Lastly, the reform calls for new preferential loans to be issued at interest rates not lower than the refinancing rate since 1 January 2020 and not lower than market rates as of 1 January 2021.

The authorities outlined post-Covid development plans for the transport sector. In the airline sector the aim is to attract new air carriers in order to increase competition and outsource the management of Uzbekistan Airways to an experienced foreign company. Airports will be modernised by attracting private investments through public-private partnerships. The plan for the railways sector is to restructure the non-core activities of the state-owned integrated monopoly, Uzbekistan Temir Yullari, and improve the tariff-setting mechanisms. The introduction of the “user pays” principle is envisaged for the road sector.

The government is planning to implement energy sector reforms to meet growing demand for electricity. Its efforts will be guided by the Concept for Provision of Electric Energy to Uzbekistan in 2020-30, which was approved in May 2020. The concept envisages transition to the wholesale electricity market by 2023, the establishment of an independent energy regulator in 2020-21, and the introduction of differentiated tariffs for electricity from 2022. In addition, there are plans to create an energy market operator – a state-owned company with online platforms for wholesale market customers to carry out purchases and sales of electricity and natural gas. The government also sets new targets for power generation, including solar, hydro, wind and nuclear power to meet growing demand (annual power consumption is expected to rise by 6-7 per cent a year until 2030).

Development of the agricultural sector is advancing under a new strategy. Approved in October 2019, Uzbekistan’s Agriculture Development Strategy for 2020-30 aims to liberalise the sector, remove export barriers and eliminate mandatory production quotas for cotton and wheat. It provides a plan for diversifying agricultural production, phasing out state control of production, and the sale and processing of cotton and wheat. Agribusiness clusters will be created in the cotton,

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wheat, horticulture and livestock sectors in order to attract private capital, increase value added through deeper processing, and improve access to export markets. The sector's development will be accompanied by measures to ensure environmental protection and efficient use of resources.

Reforms have been introduced to the rule of law. Recent presidential decrees seek to advance the rule of law by introducing plea bargaining arrangements and ensuring greater independence of lower level courts. The plea bargaining mechanism will pave the way for faster trials and shorter prison terms for suspects who cooperate with investigators. In addition, a presidential decree from 24 July 2020 introduced additional measures to further improve judicial procedures. A panel of judges within the Supreme Court will consider investment disputes and competition involving large investors.