

## Overview

- 2017 marks the beginning of a transition from a closed, state-centered economic model to an open market economy
- High foreign exchange reserves and a low level of public and external debt are favourable preconditions for a successful transition
- GDP growth in 2018-2020 is at approx. 5% p.a., with a slight upward trend
- Currency liberalisation in 2017 led to an inevitable devaluation of the Uzbek Sum
- High current account deficits (2018: 7.1% of GDP) are a new reality after years of traditional surpluses and should be monitored. The opening of the market is causing rising imports (especially of capital goods); the increase and diversification of exports remains an important challenge
- In the context of the devaluation, inflation rose sharply (2018: 17.5%). Tight monetary policy (refinance rate: 16% p.a.) is expected to lead to a gradual decline in inflation (2020: 14.1%)
- Moderate budget deficits and very low government debt (2019: 23.2% of GDP)

## Topics

- **Development Strategy 2017-2021.** Implementation of comprehensive reform agenda in 5 key areas
- **Tax reform.** Positive implications for investment and business climate, but also for the state
- **Banking sector.** Reforms in this state-dominated sector are indispensable
- **Export potential of textile products.** Identification of promising products
- **Reform of free economic zones.** Cluster approach offers the chance to increase effectiveness

# Basic indicators

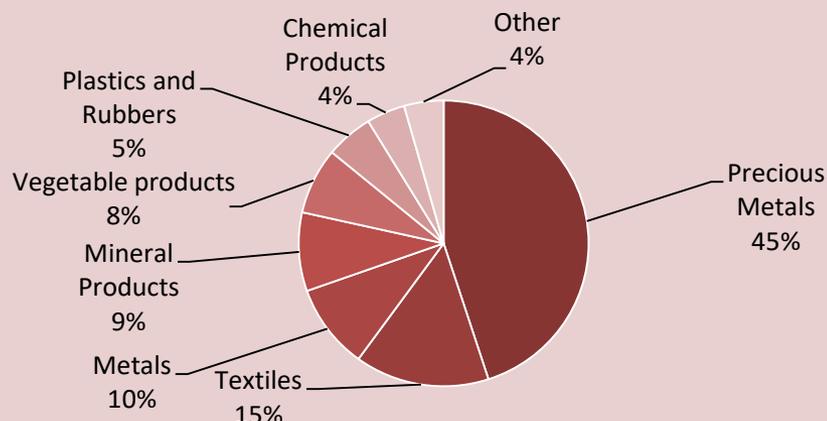
	Uzbekistan	Kazakhstan	Belarus	Ukraine	Russia
GDP, USD bn	49.2	164.2	61.0	134.9	1,610.4
GDP/capita, USD	1,483	8,763	6,477	3,221	11,191
Population, m	33.2	18.7	9.4	41.9	143.9

Source: IMF, forecast for 2019

## Trade structure

### Exports

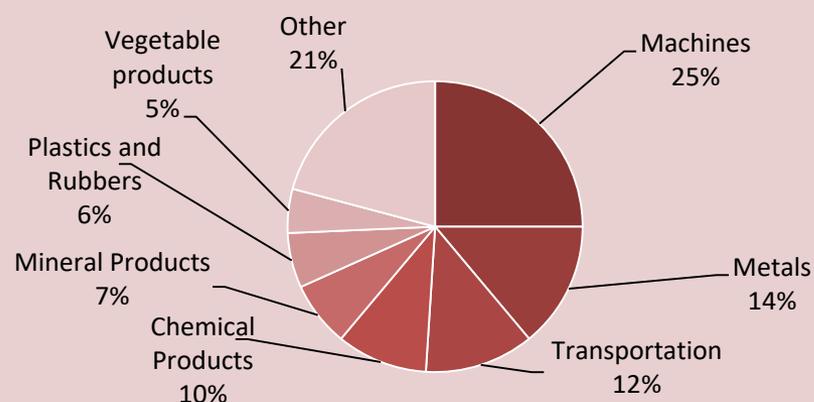
CIS 25% | China 17% | EU 2% | Switzerland 44% | Other 12%



Source: Observatory of Economic Complexity (based on mirror statistics of UN Comtrade), Data for 2017, Note: Trade in goods

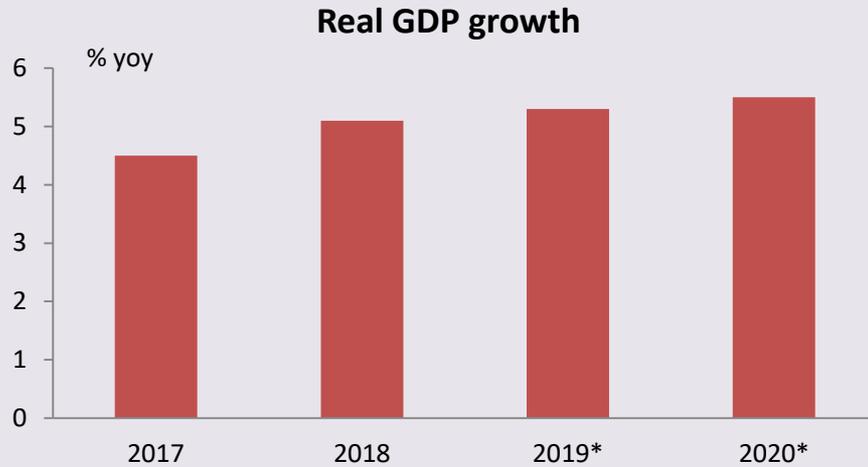
### Imports

CIS 38% | China 24% | EU 15% | Switzerland 1% | Other 22%

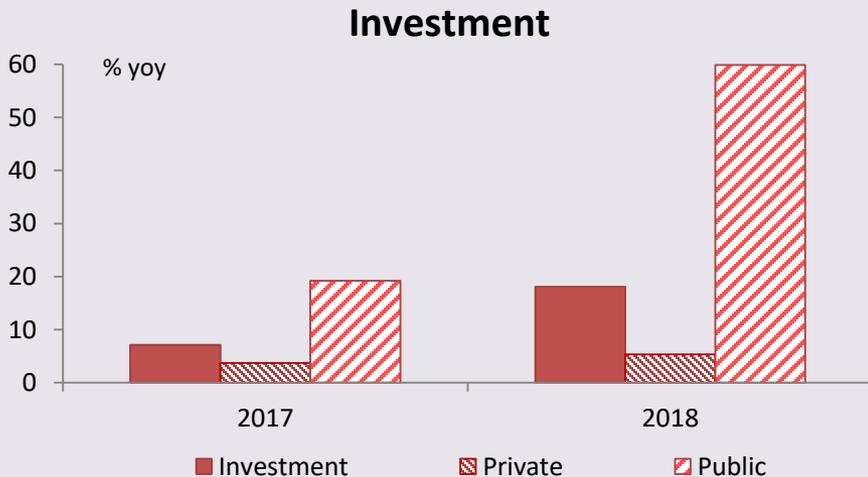


Source: Observatory of Economic Complexity (based on mirror statistics of UN Comtrade), Data for 2017, Note: Trade in goods

# Economic Growth



Source: Worldbank, \*Forecast



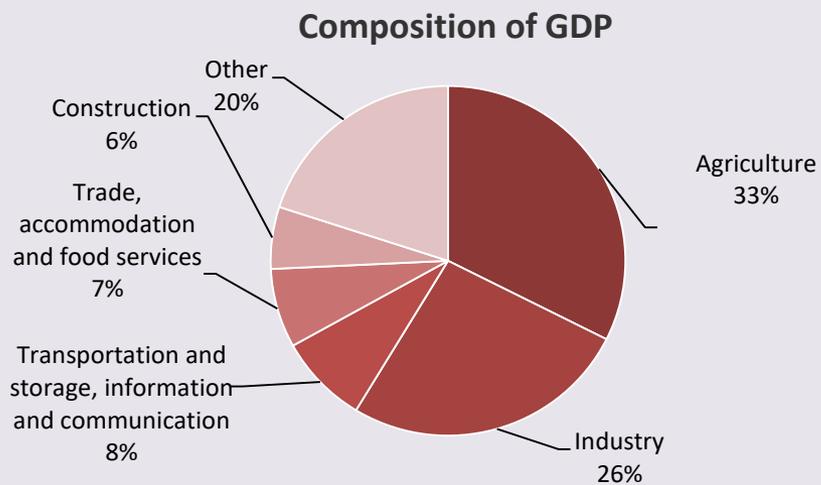
Source: National Statistics Office

- High official GDP growth before 2017 (above 8% p.a.), but questionable data quality
- A recent data revision led to lower growth figures (retroactive until 2010)
- Reliable economic statistics are an important basis for policy decisions
- GDP growth of approx. 5% p.a. in 2018-2020, with a slight upward trend
- However, population growth of about 2% p.a.
  - Increasing the low per-capita-income requires high GDP growth
- Growth drivers (demand side):
  - Public investment (2018: +60%)
  - In the future, this should be complemented by private investment, including FDI

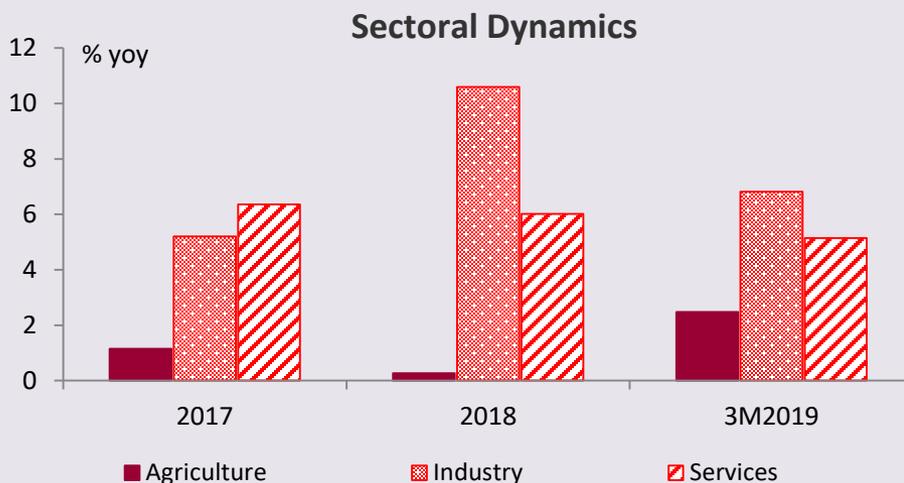
## Conclusions

- Stable growth at around 5% p.a., driven by investment

# Sectoral perspective



Source: National Statistics Office, 2018



Source: National Statistics Office

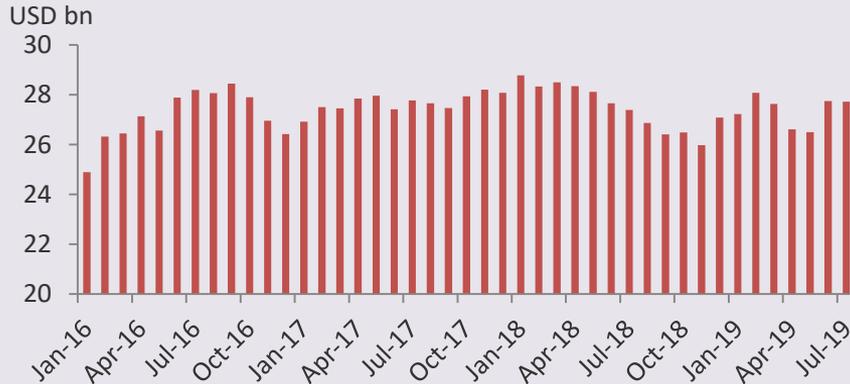
- Main sector: agriculture (33% of GDP)
  - Crop production (incl. cotton): 51%
  - Livestock production: 45%
- Share is significantly higher than in:
  - Ukraine: 12%
  - Russia: 3.5%
  - Kazakhstan: 4.6%
- Industry also plays a very important role (26% of GDP)
  - Manufacturing: 70%
  - Mining and quarrying: 22.7%
- Service sectors have room for improvement
- Growth dynamics: relatively balanced development of individual sectors, with agriculture growing at a slower rate since 2017

## Conclusions

- Significant share of agriculture
- Industry also plays an important role

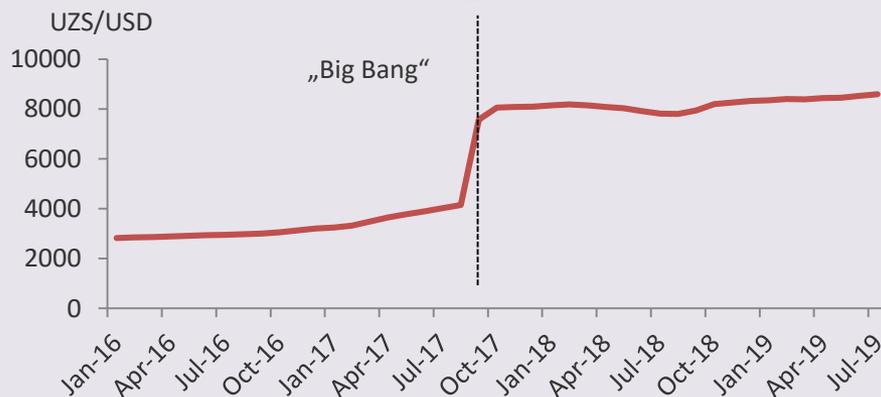
# Exchange rate and international reserves

International reserves



Source: Central Bank of Uzbekistan

Exchange rate



Source: Central Bank of Uzbekistan

- Old UZB model was a closed economy
- Shortage of foreign currency due to previously over-regulated FX market caused massive distortions in trade and investment
- Currency liberalisation according to "big bang" approach was absolutely necessary in 2017:
  - Sharp depreciation of the Sum from 3,250 UZS/USD (01.01.2017) to 8,146 UZS/USD (01.01.2018)
- After devaluation, transition to a more flexible exchange rate regime in which market forces determine the price
- Uzbekistan holds substantial international reserves
  - July 2019: USD 27.7 bn
  - Import coverage at approx. 13 months very high
  - Stable development, no significant interventions on the foreign exchange market

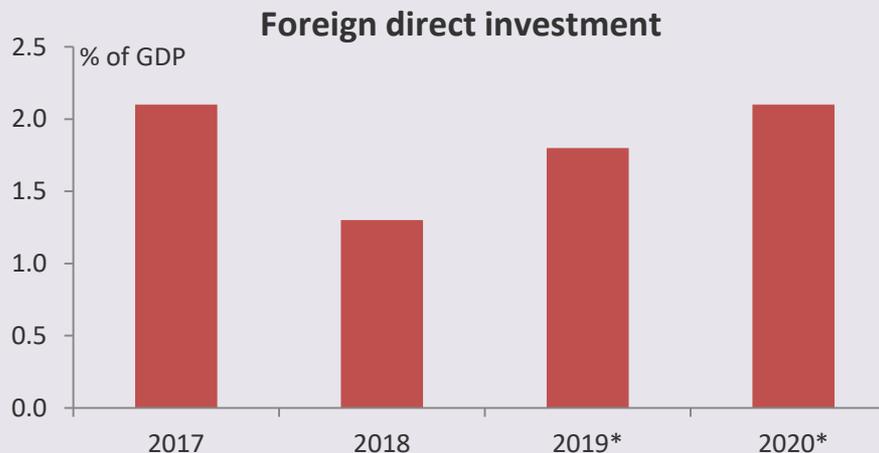
## Conclusions

- Currency liberalisation 2017 an important milestone in the reform process

# Current account and FDI



Source: Worldbank, \*Forecast



Source: Worldbank, \*Forecast

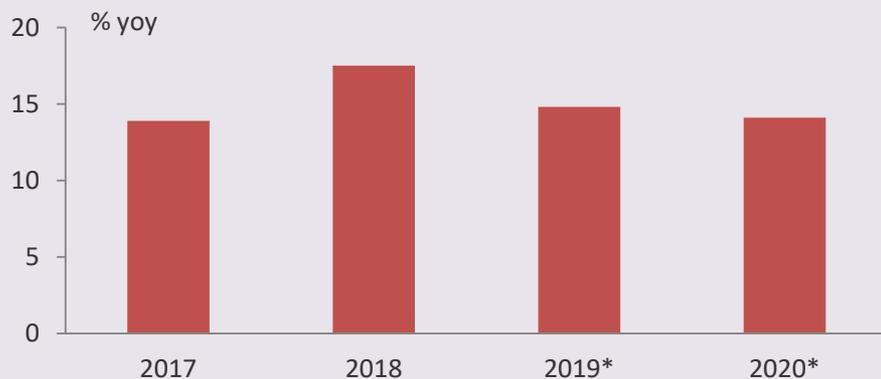
- Current account balance reacts clearly to changes in relative prices due to currency liberalisation
- From traditional surpluses in the former closed economic model to significant deficits:
  - 2017: 2.5% of GDP
  - 2018: -7.1% of GDP
- Especially imports of capital goods are rising significantly
- The situation should be monitored despite a projected reduction of the deficit
- Efforts needed to increase deficit financing through FDI (2018: 1.3% of GDP)

## Conclusions

- Move towards open economy leads to current account deficit
- Development not alarming, but should be monitored

# Inflation and monetary policy

## Inflation rate



Source: Worldbank, \*Forecast; Note: annual average (consumer prices)

## Policy Rate



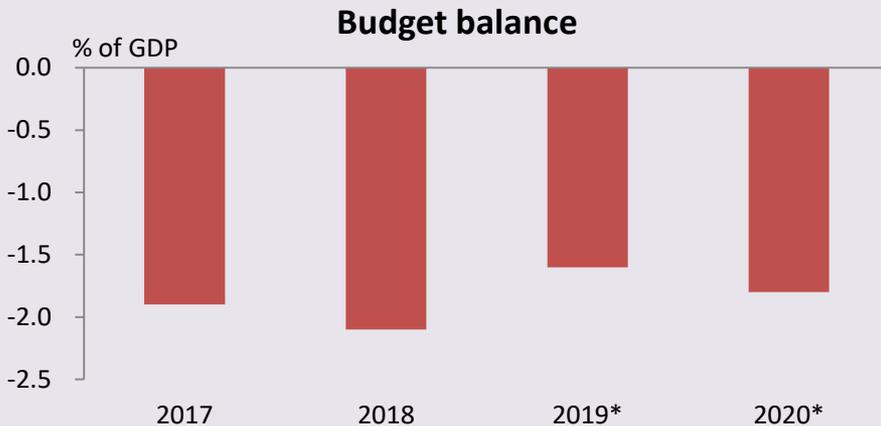
Source: Central Bank Uzbekistan

- Significant increase in inflation after exchange rate liberalisation and accompanying devaluation (“imported inflation”)
- Necessary price liberalisation (e.g. tariff adjustments in energy sector) also drives inflation
- Both factors are inevitable phenomena of a transition process
- Central Bank increases policy rate twice in order to get inflation under control
  - Policy rate from 9% p.a. in 2017 to 16% p.a. in 2018
- Objective: Move towards inflation targeting with single-digit inflation numbers from 2021

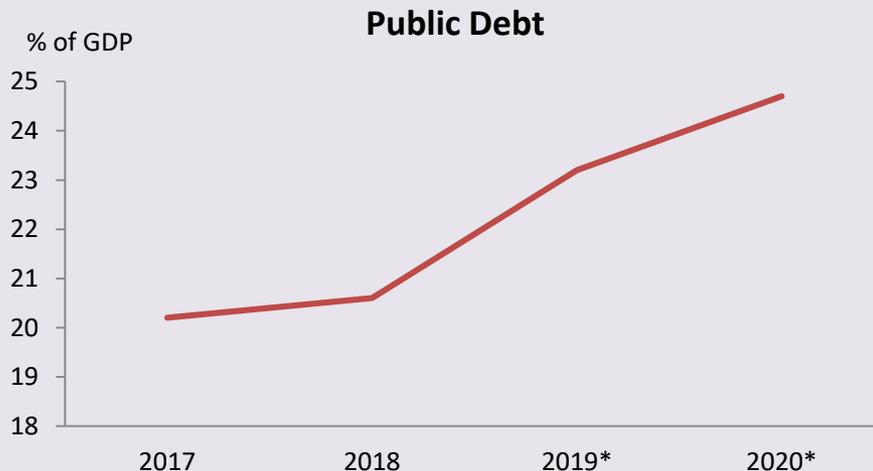
## Conclusion

- Increase in inflation inevitable, correct reaction by the Central Bank

# Public finances



Source: Worldbank, \*Forecast; Note: Broad budget balance definition



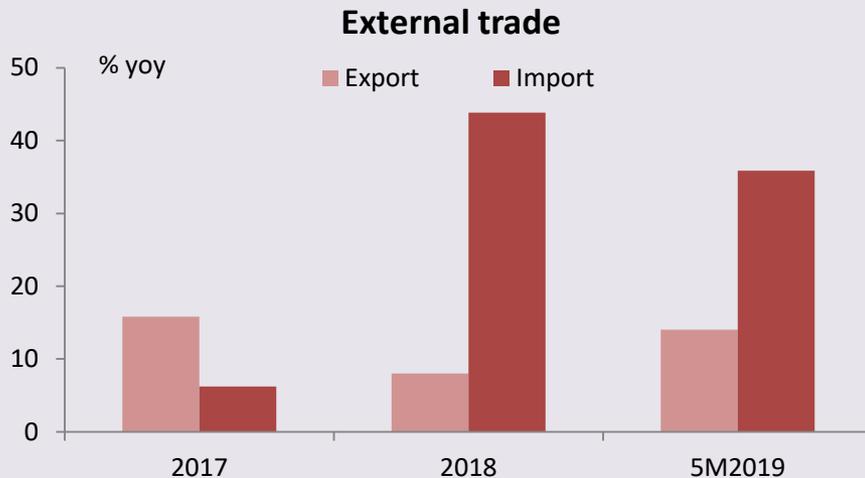
Source: Worldbank, \*Forecast

- Traditional budget surpluses according to national definition (2018: 0.5% of GDP)
- However, moderate deficits when „quasi-fiscal“ activities (e.g. including directed lending) are taken into consideration
  - 2018: -2.1% of GDP
  - 2019: -1.6% of GDP
- Public debt: Very low level in international comparison with 23% of GDP, slight increase
  - Mainly external; internal market not very developed
- Positive: Issuance of a Eurobond in February 2019, sign of confidence by international investors
  - 2 tranches: 5/10 years maturity
  - International rating: BB- (stable)
  - For comparison: Georgia: BB-, Ukraine: B-, Belarus: B
- Opens access to international capital markets for Uzbek companies

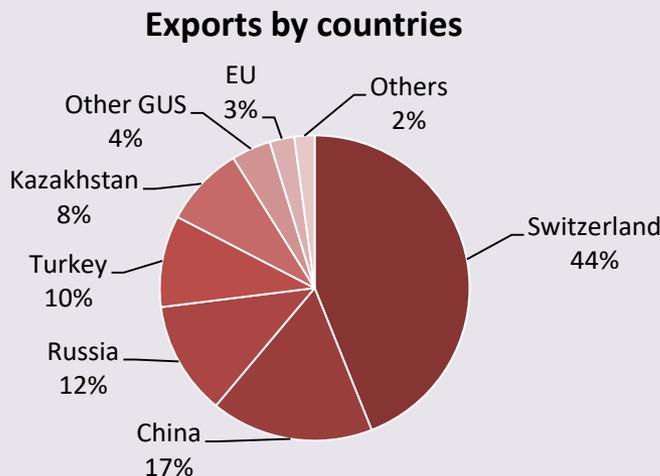
## Conclusion

- Conservative fiscal policy positively assessed

# External trade



Source: National Statistics Office, Note: Trade in goods



Source: Observatory of Economic Complexity (based on mirror statistics of UN Comtrade), Data for 2017, Note: Trade in goods

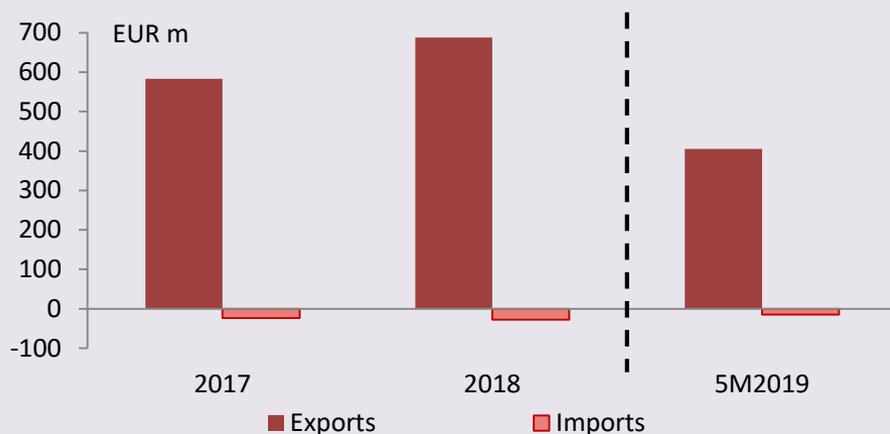
- External trade (especially imports) strongly restricted in old economic model
  - Limited access to foreign exchange
- Dynamic expansion of external trade due to currency liberalisation and opening of the market (e.g. tariff cuts)
  - Strong import increase: +44% in 2018
  - Exports less dynamic: +8% in 2018
- Exports concentrated on commodities (precious metals, metals, energy and cotton account for 73%) and few destination countries (Switzerland, China and Russia: 73%)
- Aim: Diversification of products (esp. with high value added) and countries
- Identification of competitive advantages is key precondition

## Conclusion

- Liberalisation of external trade is positive
- Pursued WTO membership is reasonable
- Improved regional trade is important (“double landlocked country“)

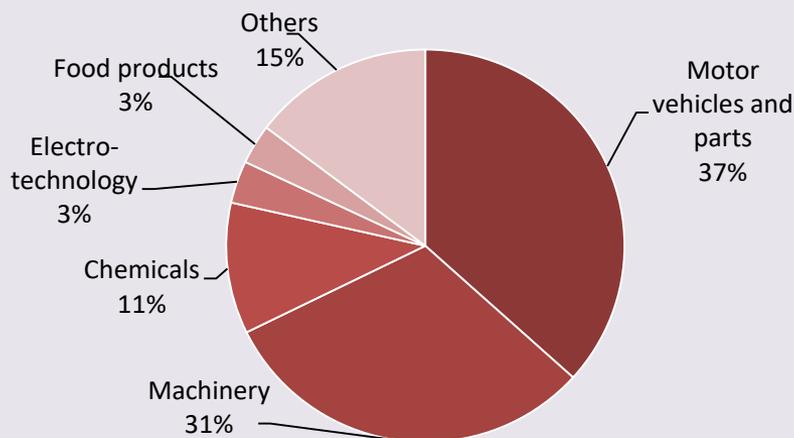
# Bilateral trade between Germany and Uzbekistan

## German trade with Uzbekistan



German Federal Statistics Office, Note: trade in goods

## German exports to Uzbekistan



Source: German Federal Statistics Office, 5M2019; Note: trade in goods

## German exports

- In 2019 very dynamic development of exports:
  - 5M2019: +77%
  - Share of cars, machinery and chemicals in 5M2019: 79%
- Strong connection to new structure of growth, which is now rather based on investments

## German imports

- Until now hardly any imports from UZB
  - 5M2019: EUR 14.9 m
- Large potential for development

## Conclusion

- Positive development of German exports
- German businesses as important partner for modernisation

# Strategy for the development of Uzbekistan 2017 -2021

## Government Reform Priorities

### 1 Economic liberalisation

- Reducing the role of the state and promoting privatisation
- Promoting development of private entrepreneurship
- Improving the investment climate and attracting FDI
- Enhancing efficiency of the banking and agricultural sector

### 2 Development of the social and environmental spheres

- Creating jobs
- Enhancing the role of women
- Improving municipal services and utilities
- Increasing energy efficiency

### 3 Constructive foreign policy

- Improving the legal framework for foreign economic activity
- Improving relations with neighbours
- Resolving border issues

### 4 Rule of law

- Measures to ensure the independence of the judiciary and protection of civil and property rights
- Strengthening the legal system
- New mechanisms for fighting corruption

### 5 Good governance

- Strengthening the role of parliament, political parties and civil society
- Reform of public administration
- Increasing transparency

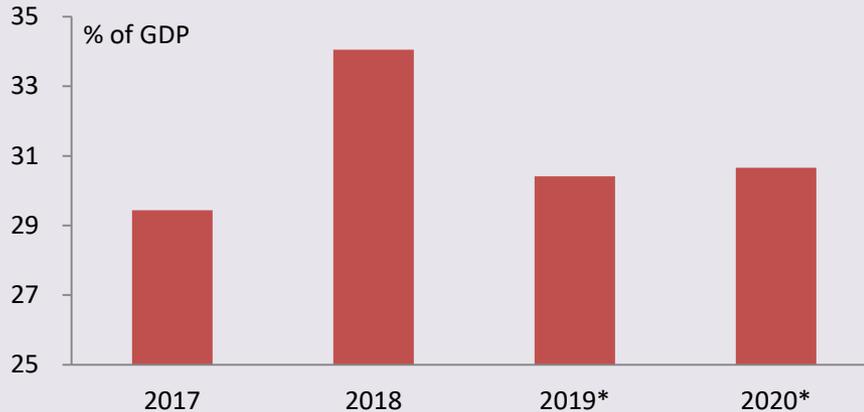
- Ambitious reform programme developed by President Mirziyoyev end 2016
  - Economic transition from a closed, state-centered model towards an open market economy
- Comprehensive reform programme with 5 priorities published by government in February 2017
- In economic sphere, important steps have been taken already:
  - Exchange rate liberalisation
  - Tax reform
  - Liberalisation of external trade
- Quick positive results are important to maintain legitimacy vis-à-vis the population

## Conclusion

- Key factor for success will be the implementation of the strategy, also of its less popular parts (e.g. tariff adjustments)
- International support is important for the implementation of the reform agenda

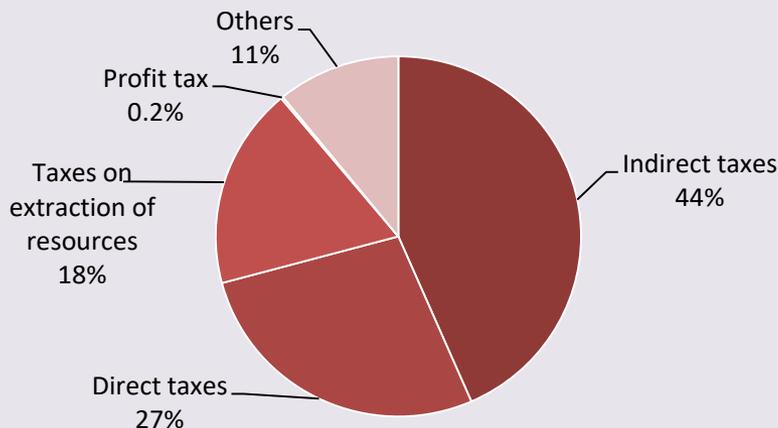
# Tax reform

## Development of state revenues



Source: IMF, \*Forecast

## Structure of state revenues



Source: Ministry of Finance of Uzbekistan, 6M2019

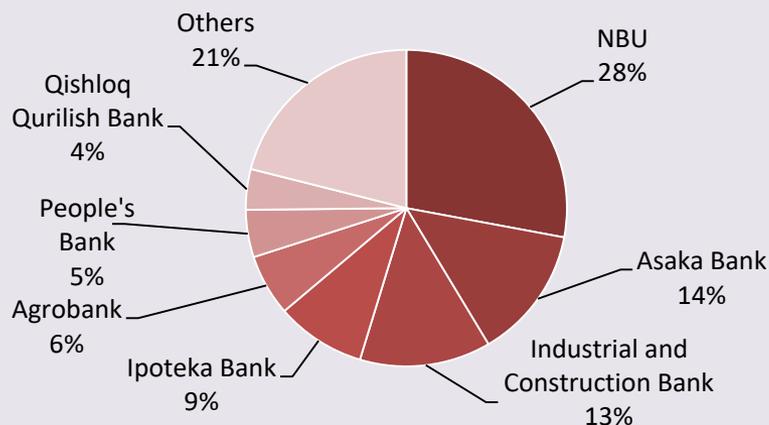
- Fragmented and opaque tax system impedes development and growth of private businesses
- Low share of taxes in government revenues, state used to be financed mainly by profits of state companies
- In 2018, a comprehensive tax reform was announced to eliminate this barrier
- Core idea: reduce tax rates, broaden tax base
  - Introduction of a VAT system instead of tax on turnover
  - Corporate tax: 14%
  - „Flat Tax“ income tax: 12%
  - Reduction of social security contributions
- First results point at significant increase in registered VAT payers

## Conclusion

- Positive assessment of tax reform from the perspective of private businesses, but also from that of the state

# Banking sector

**Banking sector market shares**



Source: Central Bank of Uzbekistan, 6M2019; Note: market shares by assets

**Credit growth**



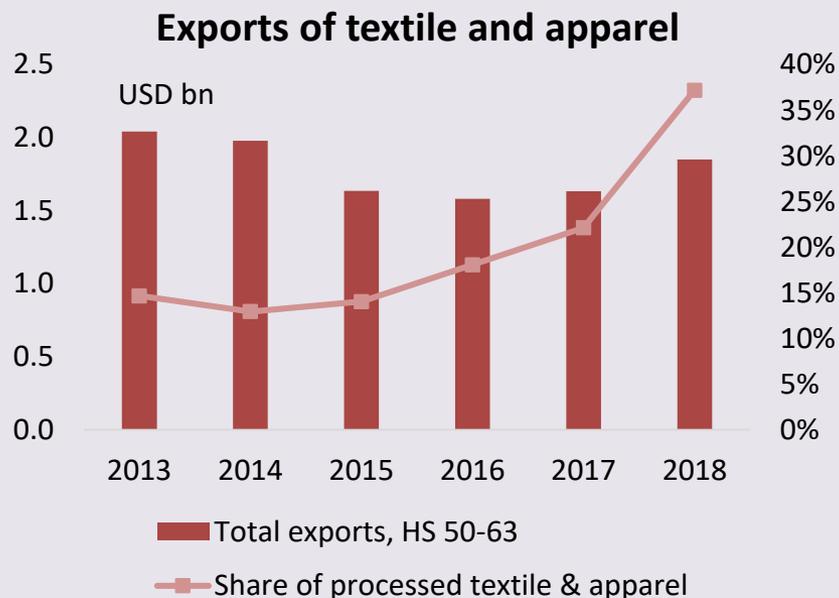
Source: IMF, Note: Nominal credit growth at constant exchange rate

- Until now sector is dominated by the state
  - 86% market share of state-owned banks in 6M2019
  - Hardly any foreign banks active: 2.7%
- Hence, influence on lending
  - Widespread directed lending
- Fundamental changes are a precondition for the transition towards a market economy
  - Increased commercialisation, less direct political influence
  - More private capital through privatisation
- Increased involvement by IFIs (e.g. EBRD/IFC) in the form of pre-privatisation is recommendable
- Current tendency: Very high credit growth, ca 50%
  - Strong growth of investment aimed at modernisation of the capital stock requires vigilance

## Conclusion

- Transformation opens chances for the future

# Export potential of UZB textile and apparel



Source: UZ Statistical Office, MTN classification, authors' estimates

## Trade costs of moving goods across the border

Indicator	Assessment for UZ
WB Doing Business 2019, Trading Across Border	165 out of 190 countries
WB Logistics Performance Index 2018	99 out of 160 countries
OECD Trade Facilitation Indicators 2018	0.63 out of 2.00

Source: World Bank, OECD

## UZB exports of textile and apparel

- Value (2018): USD 1.9 bn, 11% of total exports
- Key partners: Russia (35%), China (22%), Kazakhstan (8%), Kyrgyzstan (8%), Iran (8%)

## Trade costs

- FTAs with CIS (56% of exports), GSP by EU, Turkey, Canada, Japan, Switzerland (10%)
- UZ still performs worse than average in easiness of trading across border → need to further progress with customs reforms

## UZB export potential in textile and apparel

- Top-5 products: bed & table linen; cotton yarn; woven fabrics of cotton; not tufted or flocked carpets, and women's or girls' suits
- Most potent destination under current trade regime: Russia
- Most potent destination if duty-free access is gained: EU → important to proceed with reforms needed for GSP+

# Reform of free trade zones

## Proposed first cluster-development phase



## Background

- The Uzbek government is working on a reform of Free Economic Zones (FEZ) in order to enhance their attractiveness for investors
- To increase efficiency, synergies between the development of zones and clusters shall be used

## Challenges

- The development of clusters requires a „critical mass“ of companies and important actors of related value chains in a region
- The positioning as well as the infrastructure and service supply should meet the demands of the clusters

## Conclusion

- A gradual approach is recommended
- First, the approach should be tested with the combination of a pharmaceutical cluster and zone in the Tashkent region
- Dependent on the outcome, more pharmaceutical zones and other industries can be included

# German Economic Team Uzbekistan



The German Economic Team Uzbekistan (GET Uzbekistan) has been supporting the Uzbek government in macroeconomic stabilization and reform efforts since 2019.

In a continuous dialogue with high ranking decision makers, we receive inquiries on various topics and subsequently develop analyses with concrete policy recommendations.

In addition, GET Uzbekistan supports German institutions in politics, administration and business with its detailed knowledge of the country's economic situation.

GET Uzbekistan is financed by the German Federal Ministry for Economic Affairs and Energy and implemented by Berlin Economics.

## Contact

GET Uzbekistan  
c/o Berlin Economics  
Schillerstraße 59  
10627 Berlin

Tel: +49 30/ 20 61 34 64 0  
info@get-uzbekistan.de  
www.get-uzbekistan.de  
Twitter: @BerlinEconomics  
Facebook: @BE.Berlin.Economics

