

**November 27, 2019**

*Due to the smooth transit of power and the beginning of reforms aimed at moving to a more open economy, starting in 2016, Uzbekistan has attracted an increased attention of investors worldwide. Large-scale changes and the first steps towards liberalization pave the way to the promising development prospects for Uzbekistan, however, the success of this transformation depends on how consistent the authorities will be in implementing the announced reforms and how successfully they will be able to translate the declared plans into reality.*

**The average growth rate of 5% in recent years.** Historically (2000-2015), the economy of Uzbekistan has been characterized by high growth rates of more than 7%, that were the result of industrial production growth due to extraction and export of energy resources and agricultural production<sup>1</sup>. The nominal GDP in 2018 amounted to 407.5trln sum (\$50.5bn). Current economic growth rates are noticeably lower than historical ones and average 5.1%-5.7%, but the data is supported by a large amount of statistical data. The main contribution to real GDP growth in 2018 was made by industrial production (2.7pp), other services (1.0pp) and construction (0.6pp). According to the results of 9 months of the current year, the growth rate of real GDP amounted to 5.7% yoy. Large state-owned enterprises continue to play the dominant role in the structure of the economy and it is planned to achieve a noticeable reduction by 2022. Current plans implies sale of a government stake in at least 20 enterprises through an IPO (SPO), the issuance of bonds of 50 enterprises with state participation, as well as reduction non-core assets of enterprises with state participation by 50% by the end of 2022.

**The increase in investment inflows.** In December 2018, S&P for the first time ever assigned the Republic of Uzbekistan a long-term rating of BB- with a stable outlook. In June of this year, the ratings were affirmed unchanged. In May 2019, the Fitch Ratings rating agency also affirmed Uzbekistan's long-term ratings of BB with a stable outlook, which were assigned in 2018. Obtaining ratings of international rating agencies preceded Uzbekistan's placement of its first sovereign 5-year and 10-year Eurobonds in February this year for a total of \$1bn. In addition, a few days ago the first issue of Eurobonds in the recent history of Uzbekistan was made by a corporate issuer – UzPromStroybank that placed international bonds on MTN in the amount of \$300mn. In addition to capital inflows in the form of sovereign debt and attracting corporate debt there is observed a high rate of foreign direct investment (FDI) in the country, as well as investments from the state development institutions. In 2018, investments in Uzbekistan were carried out mainly through commercial loans within the country, loans and investments against state guarantees that increase the debt burden on the economy, as well as through development funds that expand government support and presence in the economy. In the current year, there are changes in investment areas. If in 2018 a significant part of investments was directed to the development of the country's raw materials sector (22% of all investments), then this year over the past 9 months there has been a significant investment inflow in the manufacturing industry (27.2% of all investments), in housing construction ( 11.6%) and in agriculture (8.4%). In total, over 9M2019, investments in fixed assets amounted to 134.0 trln sum (\$14.3bn), an increase of 46.0% yoy.

**Liberalization of the currency regime.** In September 2017, the liberalization of the exchange rate regime took place in Uzbekistan, as a result of it was possible to unify the exchange rate instead of several exchange rates that previously existed for various reasons (official rate, black market rate and stock exchange clearing rate). Since 2017, the liberalization of monetary policy implies the exclusive use of market mechanisms for the exchange rate of the national currency against foreign currencies (free float). By the end of 2017, the national currency rate decreased by 93% from the pre-devaluation level. In 2018, the national currency of Uzbekistan strengthened from 8 160 at the beginning of the year to 7 794 sum per US dollar at the end of the year (+ 4.5%). This strengthening of the national currency was facilitated by the inflow of foreign currency through foreign economic channels in the form of investments and the growth of remittances from the Russian Federation. The depreciation of the national currency in August of this year was accompanied by further liberalization of the currency regime, under which the population of the republic was allowed to purchase foreign currency from August 20 after 6 years of the ban. Also, the Central Bank of the Republic of Uzbekistan abandoned the target currency corridor of 5%, arguing this decision by a notable depreciation of the currencies of the countries of trading partners. As a result, the national currency of Uzbekistan depreciated by the end of August by 8.1% to 9 369 sum per US dollar, and as of the end of the 3rd quarter it reached the level of 9 435 sum per US dollar, having depreciated by 12.3% since the beginning of the year.

**The Central Bank of the Republic of Uzbekistan expects a slowdown in consumer inflation.** The effect of the devaluation of the national currency translated at the inflation, which spiked 20% yoy in March 2018 and by

<sup>1</sup> Taking into account the criticism of the new leader of the country regarding the quality of the accounting methodology used by the State Committee on Statistics in previous years, it is possible that the data on the growth of the economy of Uzbekistan in previous years at the level of 7% per year are somewhat overstated. With the advent of Sh. M. Mirziyoyev, the country took a course not only on the openness of the economy, but also on a significant improvement in the quality and quantity of published statistical data and bringing their accounting methodology to modern standards.

the end of 2018 amounted to 14.3%. Over 9M2019, inflation accelerated to 16.0% yoy. At the same time, the Central Bank forecast for inflation in the framework of the MCP at the end of 2019 is 13.5-15.5% yoy. In 2020, the regulator predicts a decrease in inflation to 10-12% yoy, and in 2021 expects inflation to slow to less than 10%. In 2018, the Central Bank of the Republic of Uzbekistan tightened monetary conditions by increasing the refinancing rate from 14% to 16% to limit the inflationary "overheating" of the economy from consumption. Despite the slowdown in inflation, lending growth rates remain high, which increase the likelihood of further tightening of the monetary conditions in the country. Inconsistency of fiscal and monetary policies (stimulating fiscal policy), the influx of investments and cash income from abroad, and the expected liberalization of energy prices will support a two-digit inflation rate.

**The expansion of the trade account deficit.** The trade balance of Uzbekistan in 2018 amounted to \$5.3bn (-10.5% of GDP). According to the results of 9M2019, the trade balance was also negative at \$4.3bn. The growth rate of imports for 9M2019 at + 31.5% yoy (\$18.0bn) is determined by the expansion of production due to the transfer of technology and the import of cars and equipment that is not produced in the territory of the republic, as well as a consequence of increasing the volume of production of automotive equipment. Export of goods from Uzbekistan increased by + 45.5% yoy and amounted to \$13.7bn. We believe that the trade deficit at the level of 2018 will remain until 2022 with a subsequent slight reduction. The current account deficit will also remain in the horizon 2019-2023 at an average of 3.0bn.

**Export opportunities are limited.** The main export commodities of Uzbekistan are gold, natural gas and metals. In 2012-2018 Uzbekistan exported 348 tons of gold to Switzerland (according to ITC according to statistics on mutual trade of countries of trade partners), during the same period Kyrgyzstan sold 78 tons of gold to Switzerland. Other countries in the region carry out their own gold mining and processing. Significant competition for the supply of natural gas to China from Uzbekistan is observed by natural gas from Turkmenistan, whose export volume in 2018 amounted to 25mn tons compared to 4.8mn tons. The export of copper from Kazakhstan to China significantly competes with the Uzbek export of copper. So, in 2018, Kazakhstan shipped 220.1 thousand tons of copper to China against 22.6 thousand tons. The export of Uzbek copper to Turkey amounts to 44.7 thousand tons against 113.5 thousand tons of export of this metal from Kazakhstan. Another point of export of the Republic of Uzbekistan can be called the export of labor. According to the official figures, the unemployment rate is 9.3% of the economically active population, or about 1.4mn people. Such a volume of unused workers in the economy will continue to serve as the basis for the export of labor resources to neighboring countries.

**The banking sector is expanding its participation in the economy.** As of October 1, the banking sector of the Republic of Uzbekistan is represented by 30 credit organizations, of which 13 are state-owned banks. Banking assets to GDP as of October 1 of this year, in our estimation, make up about 55.4% of GDP (290.9trln sum or \$30.8bn according to the Central Bank of the Republic of Uzbekistan), while the ratio of loans to GDP is 44.7% (234.7 trln sum or \$24.8bn). The growth dynamics of banking assets in Uzbekistan remains high. So, in 2017, the growth of banking assets amounted to 98.2% yoy, and in 2018 already 28.7%. In 2017, lending to the economy grew 2.1 times (taking into account the effect of devaluation), and in 2018 its growth amounted to 51.4%. As of October 1 of this year, the capital adequacy ratio is 15.6%, and the total capital of 30 banks is 34.0 trln sum (+ 49.4% yoy) or \$3.6bn. The return on bank assets is 2.2% with a combined profit of 3.2trln sum, while the return on equity is 18.2%. The loan portfolio as of October 1 of this year grew by 55.1% yoy and amounted to 234.7trln sum (\$24.8bn).

#### The main macroeconomic indicators of countries in Central Asia (at the end of the report)

Nominal GDP, \$bn.	2010	2011	2012	2013	2014	2015	2016	2017	2018
Kazakhstan	148,1	192,6	208,0	236,6	221,4	184,4	137,3	166,8	179,3
Uzbekistan	39,3	45,9	51,8	57,7	63,1	66,9	67,0	60,5	50,5
Turkmenistan	22,6	29,2	35,2	39,2	43,5	35,8	36,2	37,9	44,1
Kyrgyz Republic	4,8	6,2	6,6	7,3	7,4	6,6	6,9	7,7	8,1
Tajikistan	5,6	6,5	7,6	8,5	9,2	7,9	7,0	7,2	7,5
Real GDP, %	2010	2011	2012	2013	2014	2015	2016	2017	2018
Tajikistan	6,5	7,4	7,5	7,4	6,7	6,0	6,9	7,1	7,3
Turkmenistan	9,2	14,7	11,1	10,2	10,3	6,5	6,2	6,5	6,2
Uzbekistan	7,3	7,8	7,4	7,6	7,2	7,4	6,1	4,5	5,1
Kazakhstan	7,3	7,4	4,8	6,0	4,2	1,2	1,1	4,1	4,1
Kyrgyz Republic	-0,5	6,0	-0,1	10,9	4,0	3,9	4,3	4,7	3,5

## The current state of the economy

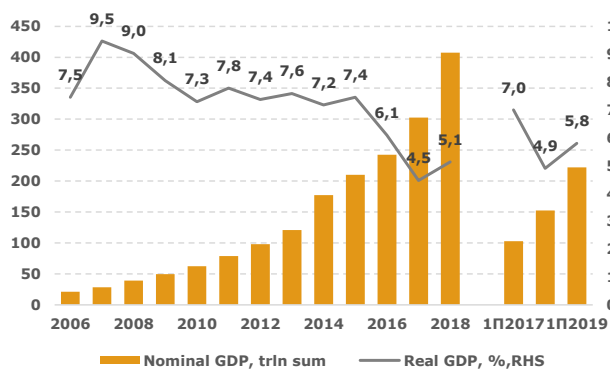
There are two models of economic development that can be distinguished in the history of Uzbekistan: one was formed by the first president of the country, I. A. Karimov, and the second is taking shape today under the leadership of Sh. M. Mirziyoyev. If the first development model was marked by isolationism and was of an investment and savings by nature with a high proportion state presence, the second, according to the statements of the new leadership of the country, provides for the maximum openness, mutually beneficial regional partnership, regional integration, as well as a gradual decrease in state presence in the economy through the privatization of state assets. To mark the beginning of the movement within the framework of the new paradigm, the country's leadership liberalized the exchange rate regime, initiated tax reforms and intensified regional cooperation in the field of energy, transport and trade.

*Economic growth is accompanied by an increased availability of statistical data and a change in accounting methodology.* Historically (2000-2015), the economy of Uzbekistan has been characterized by high growth rates of 6.8% that were the result of the growth of industrial production, especially in the mining and quarrying (extraction and export of energy resources) and agricultural production<sup>2</sup>.

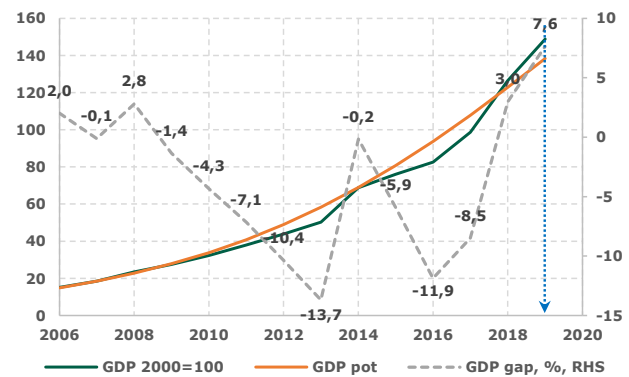
The main factors of the current growth in Uzbekistan are the synergy of the inflow of foreign investment, the expansion of credit to the economy by commercial banks and the implementation of state development programs, on the one hand, and the gradual increase in employment, on the other. The growth of the economy is also facilitated by the expansion of lending and the growth of household income, including income from abroad. The export of labor resources will continue. Despite the new growth factors, the gradual increase in employment and the increase in traditional exports, the export of labor resources will remain one of the drivers of economic growth in Uzbekistan in the mid-term. Along with the new economic policy, elements of the old model of economic growth will accompany the development of the country's economy. At the moment, in the economy there is no way to use all excessive labor resources. In addition, the level of wages in the country are still lower than the wages of labor migrants in the Russian Federation and Kazakhstan, which will also facilitate the export of labor resources.

*The export of labor resources will continue.* Despite the new growth factors, the gradual increase in employment and the increase in traditional exports, the export of labor resources will remain one of the drivers of economic growth in Uzbekistan in the medium term. Along with the new economic policy, elements of the old model of economic growth will accompany the development of the country's economy. At the moment, in the economy there is no way to use all the excess labor resources. In addition, the level of remuneration within the country is still lower than the income level of labor migrants in the Russian Federation and Kazakhstan and that will also favor the export of labor resources.

Fig. 1. The dynamics of economic growth in Uzbekistan Fig. 2. Real GDP, %



Source: SCS RU, Halyk Finance



Source: SCS RU, Halyk Finance

<sup>2</sup> Taking into account the criticism of the new leader of the country regarding the quality of the accounting methodology used by the State Committee on Statistics in previous years, it is possible that the data on the growth of the economy of Uzbekistan in previous years at the level of 7% per year are somewhat overstated. With the advent of Sh. M. Mirziyoyev, the country took a course not only on the openness of the economy, but also on a significant improvement in the quality and quantity of published statistical data and bringing their accounting methodology to modern standards.

Currently, the economy of Uzbekistan has seen a significant expansion of aggregate demand (investment, consumer, government spending and expansion of demand for imports as part of foreign economic operations), accompanied by a lagging dynamics of aggregate supply. A significant contribution to the growth of the economy from the supply side will be made by the growth of industrial production, construction and agriculture. In the services sector, tourism, transportation and financial services will be the growth driver. The inflow of secondary income in the form of remittances from the Russian Federation and Kazakhstan amid rising nominal incomes of the population will expand domestic effective demand, which, accompanied by high lending rates, will maintain relatively high economic growth rates.

*Change in GDP structure through investment.* Investments in the industrial production sector in recent years (2017-2019) have transformed the GDP structure of Uzbekistan. It has changed from the predominance of the agricultural sector and the services sector (73.5% on average in 2000-2016) to a more even contribution of other sectors. Thus, as of 2018, industrial production, including construction, amounted to 32%, agriculture, forestry and fishery - 32.4%, and the service sector - 35.6%. Given the high growth rates of housing construction and construction associated with the renovation of industrial enterprises, as well as the growth of industrial production in the manufacturing (especially chemical industry), in the near future we can expect the industrial production to take a leading role in the GDP structure. However, it should be noted that large state-owned enterprises continue to play the dominant role in the structure of the economy of Uzbekistan and their reductions according to the "Strategy for Owning, Managing and Reforming Enterprises with State Participation for 2019-2021" are planned to be achieved only by 2022. The reform provides for the implementation of the state participation in enterprises through an IPO (SPO) of at least 20 enterprises, the issuance of bonds of 50 state-owned enterprises, as well as reduction non-core assets of state-owned enterprises by 50% by the end of 2022.

*The success of the reforms depends on the improvement of the investment climate and the quality level of officials.* The implementation of the strategy for the privatization of state assets is faced with the need to further improve the country's investment climate. In August last year, a decree of the President of Uzbekistan on measures to drastically improve the investment climate was issued. The decree introduced personal responsibility of government officials for the implementation of those measures and ordered the prosecutor general to exercise strict control over their implementation at the primary administrative level in the regions. An order was also given to the relevant departments to harmonize the regulatory legal acts regarding investments in the Republic of Uzbekistan. To successfully implement those measures it is necessary to reform the tax and customs legislation and its reforms are under way in the country. Thus, the ongoing and planned reforms affect the entire architecture of the state administration of the country's socio-economic development that was formed under the previous leadership. In our opinion, and such a large-scale transformation will require at least two or three years to implement. The success of the reforms themselves will largely depend on the formation of a new cadre of the leadership of the central apparatus of the republic and local leaders.

*Internal and external risks of economic growth and its prospects.* The internal risks associated with the implementation of large-scale reforms are joined by the risks of external macroeconomic instability due to the trade wars of the United States and China, the weak growth of the Russian economy (6M2019, only 0.7% yoy), unstable dynamics of commodity prices. High growth rates of investment, lending, and the involvement of labor in the economy will create pro-inflationary pressure, so that indicates a positive output gap, which will gradually decrease, but will remain above the real one. We believe that the economy of Uzbekistan will grow within the range of 5.4% - 5.9% in the medium term. Higher growth rates will be constrained by the high share of state presence in the economy, the lack of qualified managers both in the field of public administration (currently reform of the public administration system for 2017-2021 is under way) and in private business.

## **The structure of the economy of Uzbekistan**

Investment growth in 2017-2018 led to a change in the structure of economic growth in Uzbekistan. If in the period 2000-2016 the main industry driver was agriculture, the average share of which in the structure of GDP was 27.7% (1.7pp average contribution), then in the last two years there has been a decrease in the share from 34.0% in 2017 to 32.4% in 2018 (contribution to the growth of 0.1-0.4pp). Along with a reduction in the share of agriculture in GDP, there is a gradual increase in the share of industry from 22.2% in 2017 to 26.3% in 2018. The average value of the share of industry from 2000-2016 is 22.2%. At the same time, the contribution is growing from an average of 1.1 pp to 1.2 pp in 2017 and 2.8 pp in 2018. The share of services in GDP was 43.9% on average in the period 2000-2016. Over the past three years, the share of services has decreased from 39.4% in 2016 to 35.6% in 2018.

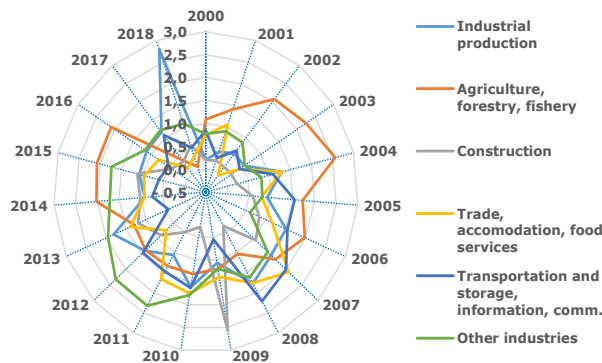
We believe that the structure of the economy of Uzbekistan will gradually change by increasing industrial production, construction industries and other services that were previously poorly developed or non-existent. Thus, according to our estimates, there is a 5.1% growth of the economy of Uzbekistan in 2018, the contribution of industry (2.7pp), construction (0.6pp) and other services (1.0pp) amounted to 4.3pp (84.3% share in the structure

of growth). In 2016, a significant contribution to the growth of the economy was provided by agriculture (2.1pp), accommodation and food services (0.8pp) and other services (1.2pp) or together 4.1pp from 6.1% growth (67.2% share in the structure of growth).

In 2018, industrial production in Uzbekistan increased by 14.4% yoy and amounted to 288.9 trln sum. According to preliminary data, in 9M2019, industrial production increased by 7.0% yoy and amounted to 234.7 trln sum (+6.3% Yoy, 151.2 trln sum in 9M2018). Within industrial production in 9M2018, a noticeable growth dynamics was registered in mining industry (+ 1.9% yoy) and manufacturing (+ 8.9% yoy).

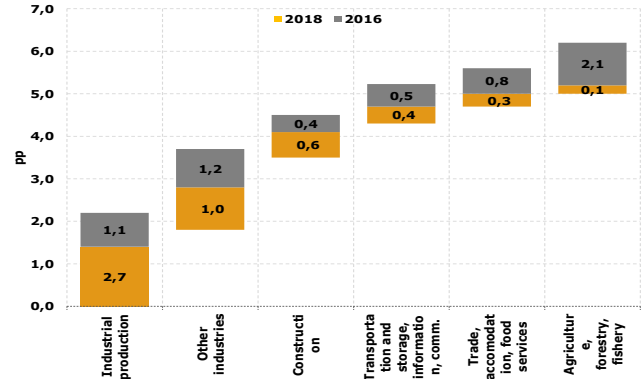
In 2017-2018, there is a gradual reduction of the share of industrial production of deeply processed goods from 80.3% to 76.6% with an increase of commodity sector of industry from 9.6% to 16.1%. Growth drivers of commodity sector in 2018 were the growth in gas condensate (+ 9.9% yoy), gas (+ 6.1% yoy), crushed stone (+ 19.8% yoy) and coal (+ 3.4% yoy). Oil output decreased by 8.2% yoy in 2018. However, during 9M2019, there was a change in the structure of industrial production in Uzbekistan towards increasing of manufacturing to 80.1% (75.9% in 9M2018) with simultaneous reduction of mining industry to 13.1% (16.4% in 9M2018). The decrease in commodity sector was facilitated by the negative dynamics in the growth of coal (-6.8% yoy), oil (-6.5%) and gas condensate (-3.3%), as well as the increase in the share of manufacturing.

Fig. 3. Sectoral structure of economic growth



Source: SCS RU, Halyk Finance

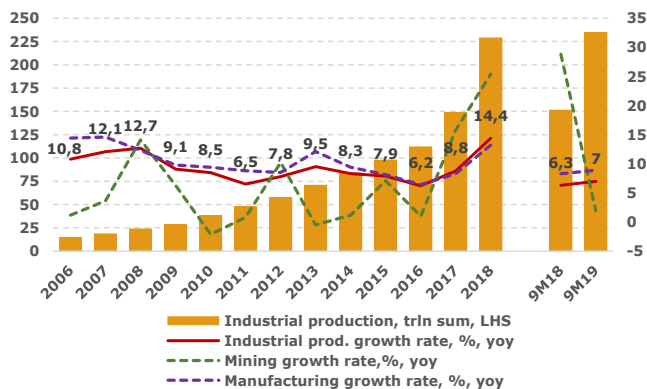
Fig. 4. The contribution of industries to economic growth



Source: SCS RU, Halyk Finance

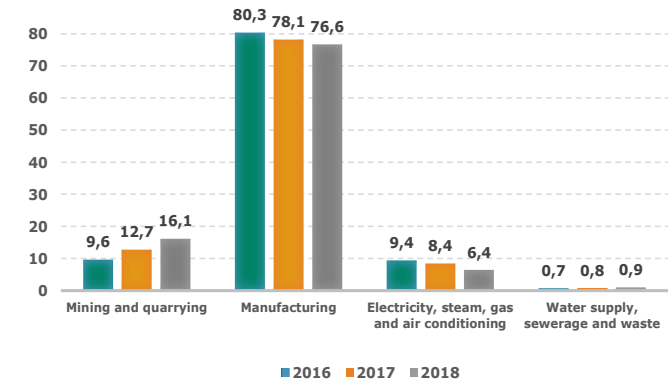
Manufacturing of Uzbekistan is based on machine-building 25.5% (2018), the production of textiles, clothing, leather products (17.8%), food production (17.3%) and the metallurgy (14.6%). The share of production of chemical products, rubber and plastic products is 10.8%. For 9M2019, the main structure of the manufacturing was as follows: metallurgy 22.7% (15.9% for 9M2018), machine-building 21.6% (23.4% for 9M2018), food production 15.5% (17.8% for 9M2018) and the textile industry 16.1% (17.3% for 9M2018). The share of chemical production is 9.9% (10.8% for 9M2018).

Fig. 5. Volumes and growth rates of industry



Source: SCS RU, Halyk Finance

Fig. 6. Structure of industrial production, %



Source: SCS RU, Halyk Finance

The regional concentration of industrial production in 2018 by 61.8% was represented by 4 regions and a city: Tashkent (18.6%), Tashkent region (15.3%), Andijan (11.8%), Navoi (9.9%) and Kashkadaryn region (6.2%). Over 9M2019, the regional concentration slightly decreased to 68.1% (68.3% according to the results of 9M2018),



and the Navoi region increased its share in total industrial production to 13.5% (10.7%), while the share of Tashkent amounted to 16.7% (15.9% on 9M2018).

Uzbekistan implements a program to localize the production of finished products, components and materials for 2017-2019. Within the framework of this program, the volume of localized products increased by 1.5 times, however, there is a decrease in the volume of export of localized products to \$457.8mn against \$512.4mn a year earlier. The program also increases local production of agricultural machinery - plows 64.5 times, tractors 3.4 times, combine harvesters 19.4% yoy. The number of new jobs under the program amounted to 3.0 thousand 2017 and 1.1 thousand in 2018. Over 9M2019, the export of localized products increased from \$359.6mn in 9M last year to \$433.9mn, and the number of new jobs under the program has grown to 8.5 thousand people. As part of the program, in 2018, production amounted to 15 trln sum (9.9 trln sum in 2017). For 9M2019, the volume of production under this program amounted to 15.4 trln UZS (11.0 trln UZS for 9M2018).

Agricultural products and services in 2018 amounted to 199.5 trln sum (0.3% yoy). In the structure of GDP, this industry occupies 32.4%, decreasing from 34% in 2016 and 2017. Livestock products accounted for 46.8%, crop production 53.2%. In the structure of production of the industry by category of households, Dekhan personal subsidiary farms prevail, occupying 70%, the share of farms is 27.3%, and organizations engaged in agricultural activities account for 2.7%.

In 9M2019, the industry products and services increased by 2.4% yoy (+ 2.3% yoy in 9M2018) and amounted to 150.8 trln (79.1 trln 9M2018) sum. In January-September 2019, the growth in crop production amounted to 76.2 trln sum (+ 2.4% yoy), while livestock production increased by 2.5% yoy and amounted to 74.7 trln, or 49.5% of the total agricultural output. For 9M2019, we are seeing an increase in the share of Dekhan farms to 73.7% and a decrease in the share of farms to 23.8%, with a simultaneous reduction in the share of organizations engaged in agricultural activities to 2.5%.

The observed structural changes in the economy suggest that the country is deepening industrialization and Uzbekistan, while maintaining its agricultural orientation (32.4% in 2018), is being transformed through investments and development programs into an economy with a predominance of industrial production (a share of 16.0% in 2001 increased to 26.3% in 2018). We believe that in the next two years, the share of industry will reach the level of 30% -33% in the structure of the entire economy of the country.

## Investments

*Getting the first sovereign ratings and the first placement of sovereign debt.* In December 2018, the S&P rating agency first assigned the Republic of Uzbekistan a long-term credit rating of BB- with a stable outlook. In June of this year, the ratings were confirmed without changing the outlook. In May 2019, the Fitch Ratings rating agency also confirmed long-term issuer default ratings in national and foreign currencies at BB with a stable outlook assigned to Uzbekistan in 2018. Ratings that were received from international agencies allowed Uzbekistan to place its first sovereign 5-and 10-year Eurobonds totaling \$1bn. In addition, a few days ago, the first issue of Eurobonds in the recent history of Uzbekistan was made by a corporate issuer - UzPromStroybank placed Eurobonds in the amount of \$300mn. Uzbek government's gross debt at the end of 2018 amounted to 20.6% of GDP according to the IMF. In addition to the inflow of capital into the country in the form of sovereign debt and the attraction of debt by corporate issuers, the country has a high rate of inflow of foreign direct investment (FDI), as well as investment from state development institutions. Historically, the average annual growth rate of investment in fixed assets in the country in 2010-2016 accounted for about 9.6%. In 2017, there was a decrease in growth rates to 7.1% yoy in real terms. In 2017, the volume of investments in fixed assets amounted to 68,423.9 bn sum (\$13.3bn at the rate of 5,140 sum per US dollar) or 22.6% of GDP. In 2018, there has been a noticeable increase in investment in the economy by 18.1% yoy to 107.333bn sum (\$13.3bn at the rate of 8 073 sum per US dollar) or 26.3% of GDP. Structurally, according to the State Committee on Statistics of the Republic of Uzbekistan (SCS RU), within non-state and non-budgetary sources, there is a slight decrease in investments from own sources from 30.9% a year earlier to 28%, funds from the population from 13.6% to 11,3% due to FDI from 18.7% to 13.7%. At the same time, investments are growing due to loans from commercial banks. Investments from state sources increased significantly due to foreign loans guaranteed by the Republic of Uzbekistan from 6.4% a year earlier to 15.5%. Investment growth due to the Fund for Reconstruction and Development of Uzbekistan (FRDU) decreased from 8.3% to 7.4% in 2018. The republican budget also reduced investment in fixed assets from 5.1% to 3.8%. At the same time, there has been an increase in investment in fixed assets through trust funds from 3.5% to 5.1%.

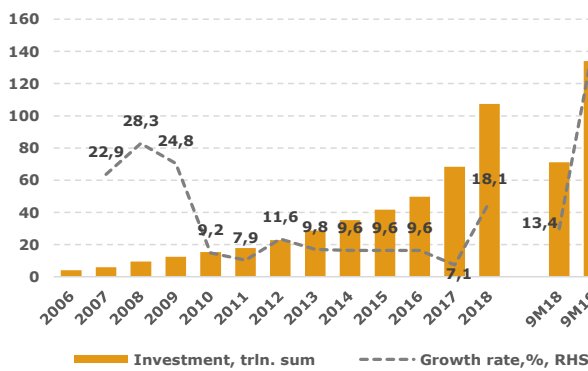
Over 9M2019 fixed investment amounted to 134.0 trln sum (\$15.5bn), an increase of 46.0% yoy. The main sources of investment in the period were funds of enterprises 21.6% (31.1% for 9M2018), funds of the population 9.8% (12.6% for 9M2018), FDI 16.0% (10.3% for 9M2018), loans from commercial banks 15.7% (16.9% for 9M2018). State sources of fixed investment were carried out mainly through foreign loans guaranteed by the government, amounting to 14.6% this year (14.7% for 9M2018), due to FRDU 4.4% (6.5% 9M2018), at the

expense of the republican budget 8.5% (3.5%). The other sources of investments amounted to 9.4% (4.4% for 9M2018). Thus, if in 2017 non-state sources were the source of investments in fixed assets, accounting for 75.3% (of which FDI and loans reached 20.4%), and state-owned 24.7% (FRDU 8.5%) then in 2018 the structure by sources of investments begins to change due to an increase in state sources of financing up to 32.1% (FRDU 7.4% and foreign investments and loans guaranteed by government of Uzbekistan 15.5%).

The share of private investments in the structure decreased to 67.9% (FDI and loans to 13.7%) in 2018. Over 9M2019, the share of public investment amounted to 28.4% (29.1% on 9M2018). Private investments accounted for 71.6% (70.9% on 9M2018). Investments in fixed assets are carried out mainly through commercial loans within the country, loans and investments against guarantees of Uzbekistan (increasing the debt burden on the economy) and through development funds (expanding state support and presence in the economy). The volume of foreign direct investment in Uzbekistan, according to the statistics of the Central Bank of the Republic of Uzbekistan, decreased from \$1.8bn in 2017 (\$1.7bn in 2016) to 624mn in 2018. In the first quarter of this year, the inflow of foreign investment in the country shrank by 48.2% yoy and amounted to \$221.3mn, while in the second quarter the growth was \$922.9mn. In the first half of the year, FDI growth accelerated 2.7 times.

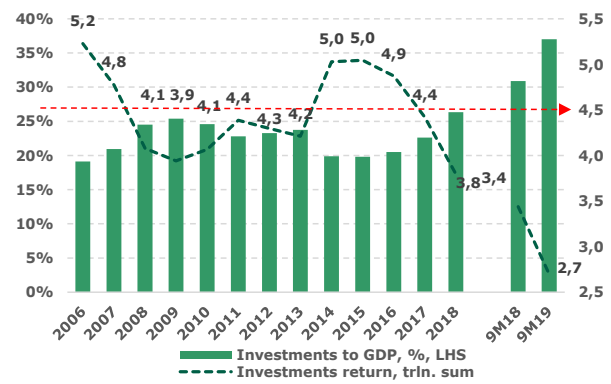
The state has to increase the volume of investment in the economy through borrowed funds, gold sales and development programs in order to maintain the existing growth and transformation of the economy.

Fig. 7. Investment Growth



Source: SCS RU, Halyk Finance

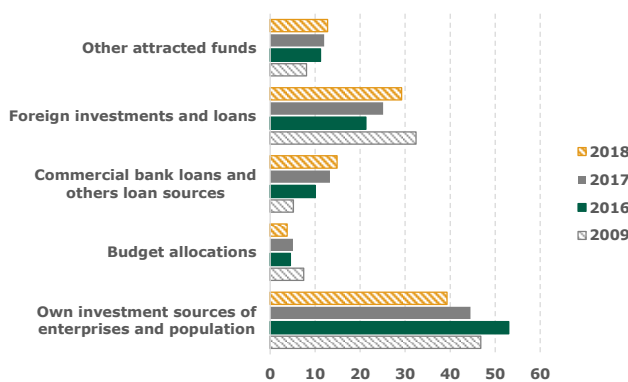
Fig. 8. Capital efficiency



Источник: ГКС РУ, Halyk Finance

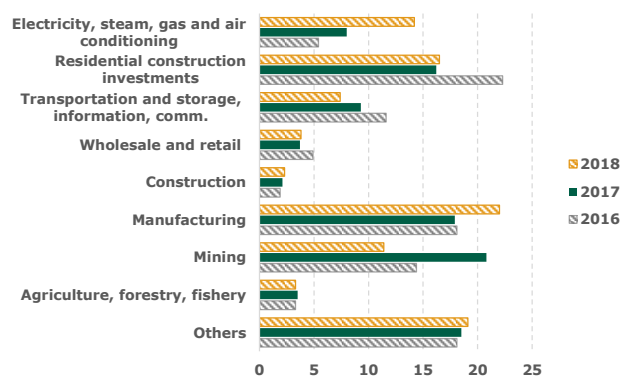
Accelerated rates of investments through external and internal sources accumulate capital in the economy of Uzbekistan, while at the current rate of economic growth, return on investment is decreasing. As of 2018, at current prices, it amounted to 3.7 trln sum per investment sum with an average value of 4.5 trln sum (in the first half of the year this value amounted to 2.6 trln sum). This happens, on the one hand, due to the quicker growth rates of the investments, and, on the other hand, due to the time-delayed gradual output of producing facilities to design capacities.

Fig. 9. Structure of investments by source of funds, %



Source: SCS RU, Halyk Finance

Fig. 10. The structure of investments in the direction, %



Source: SCS RU, Halyk Finance

Investments by types of economic activity. A significant inflow of investment goes to the manufacturing, power supply, steam supply, etc., as well as to residential housing construction. If the major investment flow in 2017

went to mining and quarrying, circa 20.8% of all investments (18.1% in 2016), while manufacturing - 14.4% (14.4% in 2016), electricity supply - 8.0% (5.3% in 2016), and residential construction - 16.2% (20% in 2016), then in 2018 only 11.4% went to mining, while in manufacturing 22.0%. Investments in electricity supply increased noticeably to 14.2%, as well as in housing construction 16.5%. Agriculture received 3.3% of all investments against 3.5% in 2017. Over 9M2019, the growth of investments in mining amounted to 8.1% against 12.9% a year earlier, in manufacturing 27.2% against 21, 9% in January-September last year and 11.7% in electricity supply compared to 11.4% a year earlier. Investments in residential construction amounted to 11.6% versus 18.3% in January-September 2018. The share of investments in agriculture was 8.4% versus 3.5% in 9M2018.

*Foreign investment in the fuel and energy complex.* Over the past three years, a significant inflow of foreign investment was observed in the country's fuel and energy complex (FEC), which has received \$6.5bn since the beginning of 2016. Currently, geological exploration projects for the total amount of \$9.7bn are also being implemented in the republic until 2016–2056. In addition, Uzbekistan is implementing large-scale projects for the development of fields and hydrocarbon production in the Gissar investment block, as well as the Ustyurt region and the Kandym group fields, the Khauzak and Shady fields with a start date of 2004-2007 totaling \$6.3bn. The largest operators for these projects are Lukoil Overseas, Gazprom, CNODC, CNPC International, Korea National Oil Corporation, DAEWOO International, KOGAS. Completion of these major projects is planned in 2035-2046.

*Other investments in the economy.* Over the past three years, \$575mn of FDI has been raised to the textile industry of the republic. In 2018, \$14mn was invested in the pharmaceutical industry of the republic, and in 2019 it is planned to implement projects totaling \$130mn. In agriculture, investors from China are implementing a project to grow various types of agricultural products with a total value of \$50mn. Also Turkish investors are implementing a project at the "junction" of agriculture and the food industry in the amount of \$70mn for the cultivation of corn and the production of glucose and fructose.

Two large projects are being implemented in the field of metallurgy: one, the construction of the Tashkent Metallurgical Plant is being implemented by an investor from the Netherlands in the amount of \$335mn, the other by metal processing and metal production in the amount of \$10.7mn is being implemented by Turkish investors. Project implementation period is 2017-2019. In the engineering industry, a Korean investor's project is being implemented with a total amount of \$200mn for setting up production of Hyundai cars with an implementation period of 2018-2021. A significant inflow of investment is observed in the tourism industry of Uzbekistan: two projects are being implemented with the participation of FDI for a total amount of \$324mn with an implementation period of 2018-2021.

Inflows of foreign investment in the largest fuel and energy projects evidence that currently the mainspring of the development of the economy of Uzbekistan will be the commodity sector and primary processing sectors (metallurgy, gas liquefaction (GTL), polymer production). Projects in the chemical industry and metallurgy can form inter-sectional relationships (clusters) with related industries such as engineering (automotive and agricultural production), thereby increasing the structural integration of industrial production as a whole. The development and deepening of inter-industry links within the cotton-textile cluster (cotton processing, fabric manufacturing and tailoring), along with a significant increase in the competitive export potential of the republic's textile industry, will create the necessary basis for a wider import substitution (the domestic consumer market is quite capacious 33.3mn people). Investments inflow and preferential taxation regime in the tourism and related services, as well as in the construction of tourism infrastructure along with the development of production of building materials (cement, foam blocks, drywall, etc.) create the basis for the spread of the multiplication effect in related sectors of the economy of Uzbekistan. We see the current task of the country's leadership not to proceed in creation of a commodity economy, with a short production cycle, weak inter-sector integration and with the production of low-value products.

## **Labor market**

As of the end of 2018, the number of economically active population in Uzbekistan amounted to 14.635 thousand people (according to the new methodology of the Ministry of Labor 14.642 thousand), which is 44.8% of the total population of the republic (33.3 mn people). The share of the employed population in the economy in 2018 is 41.5%. As of the end of 2018, the number of employed people amounted to 13.786mn people (according to updated data from the Ministry of Labor, 13.273 thousand people). The number of unemployed in 2018, according to updated statistics from the Ministry of Labor, amounted to 1,362 thousand people. A sharp increase in the number of unemployed people, according to the statement of the Ministry of Employment and Labor Relations, from 5.8% in 2017 to 9.3% in 2018 was due to an improved methodology and not due to an increase in the number of unemployed.

An analysis of the historical data shows that an improvement in the accounting methodology of unemployment in Uzbekistan also occurred in 2007, when the number of unemployed increased from 25.5 thousand to 563.8 thousand people (Methodology for calculating the unemployed population requiring employment in 2007). The



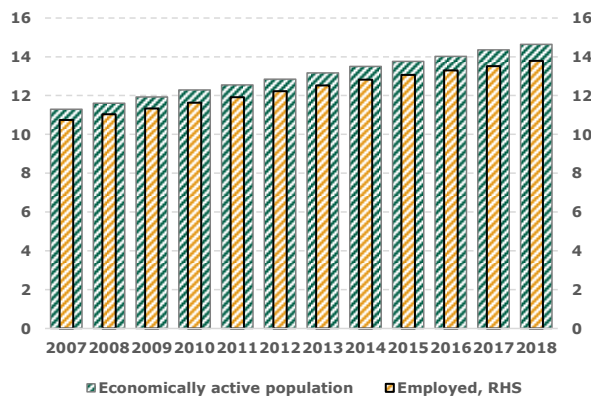
implementation by the statistical authorities of a new accounting methodology for unemployment limited the analysis of labor resources in the republic for the period 2007-2018.

According to the official statistics, about 190 thousand people annually left the republic as part of the investment-savings model of the economy with import substitution that took shape under I. Karimov. The official statistical agencies do not provide data on the type of external migration, but we believe that official and unofficial labor migration in the Russian Federation amounted to about 0.8-1.2mn people annually over the past 7 years (according to various expert estimates, up to 2.5mn people). According to official data, the external migration from Uzbekistan totaled about 176-214 thousand people (Fig. 13).

Thus, based on the fact that labor migrants are excess resources, the employment of which is limited within the country, together with the number of official unemployed, the overall unemployment rate in the country increases from 9.3% in 2018 to 15.7% ( 2.3mn people), and the average unemployment rate in 2007-2018 increases from 5.5% to 11.2% (Fig. 12). And these are only statistics on the Russian Federation. Taking into account statistics for Kazakhstan, the second largest area of labor migration, these indicators could be about 18-19% in 2018.

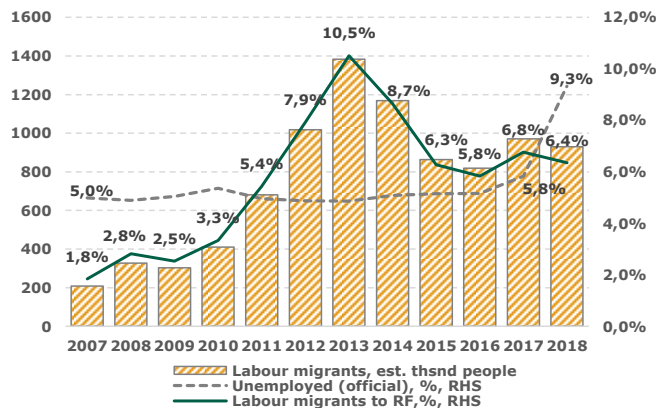
Remittances from labor migrants provide a significant inflow of money to the economy of Uzbekistan, which in different years is comparable to almost 12% of the country's GDP. As of the end of 2018, the remittances to the GDP of Uzbekistan amounted to 8.1%. This volume forms a significant support for domestic consumption of households within the country. So, if the nominal salary in Uzbekistan in 2018 amounted to 1,822.2 thousand sum (+ 25% yoy) or \$226, then the average size of a one-time transfer from Russia (assuming that this is a one-time monthly transfer to Uzbekistan) amounted to 2 953.3 thousand sum or \$366. In January-June 2019, the amount of nominal wages in Uzbekistan increased on average to 2 092.6 thousand sum (2 213.4 thousand sum on 9M2019) or \$248 (+ 30.1% yoy), the average size of a single transfer from the Russian Federation amounted to about \$372 in the 2nd quarter of 2019. We believe that within the export-oriented investment-consumption model of the economy, remittances from labor migrants will provide a significant support to domestic consumer demand, since presently the size of the economy of Uzbekistan does not offer an employment for about 1.4mn of official unemployed (9.3%) and about 930 thousand labor migrants (6.4%).

Fig. 11. Employed population, mln.



Source: SCS RU, Halyk Finance

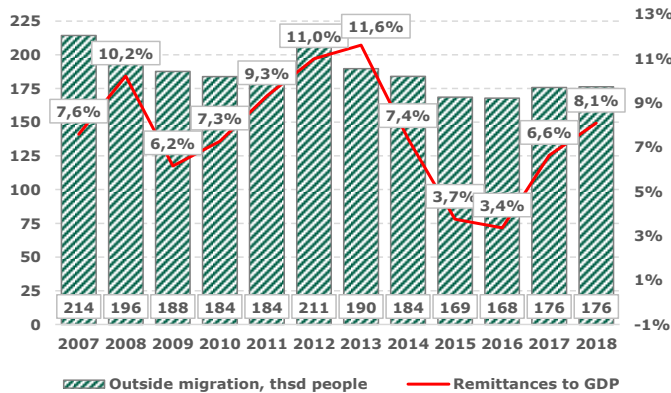
Fig. 12. Unemployment in Uzbekistan



Source: SCS RU, Halyk Finance

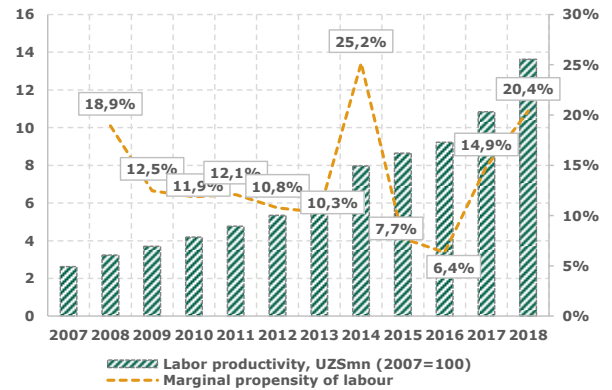
A significant increase in labor productivity in Uzbekistan was observed in 2014, when there was a steady trend towards a gradual decrease in the growth rate of the employed population in the economy from an average of 2.6% (2007-2014) to 2.4% yoy. Subsequently, the dynamics of the growth of the employed population declined even more – up to 1.7% yoy in 2017.

Fig. 13. External migration



Source: SCS RU, Halyk Finance

Fig. 14. Labor productivity



Source: SCS RU, Halyk Finance

The employed population amounted to 222 thousand people per year, is the lowest indicator since 2003. Thus, the Uzbekistan’s investment-savings growth model began to run out of potential in 2014 and gradually “squeezed” out excess labor resources into more dynamically developing regional economies of the Russian Federation and Kazakhstan.

The reduction of “redundancy” of labor resources in 2014, while maintaining the existing structure of production, contributed to an increase in labor productivity by 25.2%, however, in subsequent years there has been a decrease in the share of GDP growth due to labor productivity, indicating a decreasing contribution to the growth of GDP of this factor of production. In 2017-2018 the situation had changed markedly, because gradually the structure of the economy began to change and new opportunities began to appear to provide employment. In 2017, the trends of 2014 were continued by inertia, and in 2018, an increase in the employment of the population made a significant contribution to GDP growth due to labor productivity.

We believe that the export of labor resources will continue over the next 5 years, because, despite the growth of the economy, the number of labor resources not involved in this growth will remain at a fairly high level.

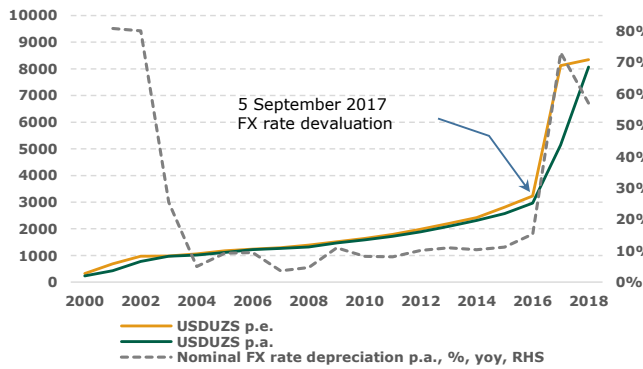
## FX policy

Historically, the Central Bank of the Republic of Uzbekistan pursued a policy of monetary targeting, ensuring the stability of the national currency by determining the target growth rate of the money supply. The exchange rate of the national currency was pegged to the US dollar and was gradually weakening (crawling peg). Historically, the depreciation of the sum occurred with an average annual dynamics of 2.0-3.0% (average value of 2.6% in 2008-2016). In August 2017, the exchange rate regulation regime of the national currency of Uzbekistan changed from crawling peg to free market exchange rate (free float) and the official rate was reduced to the level of the exchange rate adopted for foreign economic operations (earlier several rates were used in the republic: the official rate of the Central Bank, the rate of the black market, exchange and exchange clearing - the latter was used by importers and was the highest).

Currently, the Central Bank of the Republic of Uzbekistan implements a policy of free FX rate, but it is quite active in the FX market, being a net seller of foreign currency in the country. In 2018, the sales by the Central Bank of the Republic of Uzbekistan on the Uzbek Republican Currency Exchange (UZRCE) increased by 10.8% yoy and amounted to \$4.155 mn.

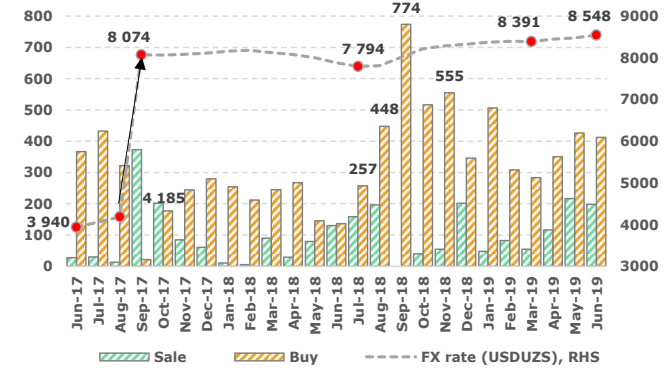
*Growth in FX sales in the domestic market.* In the first quarter of 2019, there was a noticeable increase in sales of foreign currency by 54.5% yoy to \$1.099 mn, however, compared with the first quarter of 2017, there was a decrease in quarterly sales by 2.4%. Over the 9 months of this year, the FX sales increased by 40.4% yoy and amounted to \$3.845mn that is 4.2 times more than the FX buys. The growth in the FX sales on the UZRCE, observed in the second half of 2018, is primarily determined by the growth in FX remittances from labor migrants from abroad, and is also associated with significant volumes of gold purchases from local producers. Thus, in 2018, the Central Bank of the Republic of Uzbekistan increased its gold holdings by 5.7% yoy to 355 tons or 11.4mn troy ounces. The maximum gold holdings formed in November 2018 and amounted to 381 tons, or 12.3mn troy ounces.

Fig. 15. USD / UZS FX rate in Uzbekistan



Source: Central Bank of Uzbekistan, Halyk Finance

Fig. 16. FX transactions by CBU, \$mn.



Source: Central Bank of Uzbekistan, Halyk Finance

Until August of this year, the regulator adhered to a tough policy aimed at ensuring the stability of the national currency, targeting the corridor of fluctuations in the FX rate of 5%. In August 2019, CBU decided to abandon the management of the national currency FX rate within this band. In the medium term, the Central Bank of Uzbekistan plans to maintain a neutral position in conducting interventions in order to reduce its interference in the processes of free exchange rate formation. The current presence of the regulator in the market is not associated with the active management of FX rate (managed float). Nevertheless, the Central Bank of Uzbekistan reserves the right to carry out interventions to smooth out short-term volatility of the FX rate.

*Significant strengthening of the national currency in the summer of 2018.* During free FX rate formation of the national currency the Uzbek sum showed a significant strengthening in June-August 2018, increasing from 8 170 to 7 797 sum in June and weakening to 8 016 sum per dollar in late September. As of the end of 2018, the exchange rate was at the level of 8 404 sum per US dollar. It should be noted that the monthly volume of sales of dollars on UzRCE gradually decreased and in June 2018 reached an annual minimum of 136.1mn US dollars. In the next three months, sales increased significantly (Fig. 16.) and as of September reached a peak value of \$773.6mn, having peaked at an average level of \$472.3mn by the end of 2018. The inflow of currency in the form of money transfers from the Russian Federation in the amount of \$1.254mn (+ 16.4% yoy) contributed to strengthening the Uzbek sum in the 3rd quarter of 2018, according to statistics from the Central Bank of the Russian Federation. According to the National Bank of the Republic of Kazakhstan, the transfers from Kazakhstan increased by 5.2% yoy and amounted to \$49.8mn. This was reflected in the volume of dollars purchased by banks from the population, which grew by 71.5% yoy and amounted to \$2.257mn in June-August 2018. Banks' sales of dollars over the same period increased 7.2 times compared to their buys in 2017 and amounted to \$1.901mn. The balance of domestic demand for the national currency amounted to \$356mn in dollar terms. Receipt of foreign exchange earnings from export operations in March-June 2018 played an important role in strengthening the national currency FX rate.

*Reduction of gold holdings in hard currency.* Currency sales in the country's foreign exchange market did not slow to affect the level of gold holdings in the hard currency of the regulator (Fig. 18.), which fell from \$13.444mn in June to \$10.648mn in November 2018 (-19.5%). At the same time, gold in the reserves of the Central Bank of the Republic of Uzbekistan increased from 345 tons (\$13.842mn) to 381 tons (\$14.967mn), and the most highly liquid assets decreased by \$2.796mn. Thus, the Central Bank of Uzbekistan bought gold at the "bottom" levels of \$1,175 dollars per troy ounce until the beginning of 2019, when an ounce of gold was trading at \$1,281 dollars. In 2019, the reverse process was observed when gold volumes are reduced from 381 tons (\$14.967mn) in November 2018 to 314 tons in June 2019 (\$15.080mn), while the volume of reserves in foreign currency increased from a minimum \$10.648mn to \$12.282mn. The share of hard currency and gold amounted to 41% and 57% of the total gold holdings of the republic at the beginning of June. We believe that the Central Bank of the Republic of Uzbekistan "played" at lowering the value of the reserve asset, buying it at the "lower levels" and selling it at the "top", thereby replenishing the most liquid part of its reserves. As of the end of October 2019, the Central Bank of the Republic of Uzbekistan increased its holdings in gold to 339 tons (10.9 mn ounces). The total amount of gold reserves in Uzbekistan in October of this year increased by 6.9% yoy and amounted to \$28.3bn.

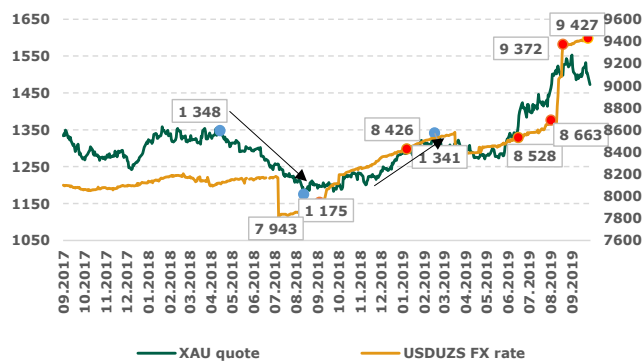
*The correlation between gold prices and the national currency is on an increase.* The correlation between the gold quotes and the national currency FX rate showed the following pattern: if in 2017 the ratio was 61%, then in 2018 during maneuvers with gold and a reduction in its export sales from 90 tons in 2017 to 60 tons in 2018, the correlation ratio decreased to 27.8%. For 9M2019, the ratio recovered to 86.4%. Taking into account the export orientation of the economy of Uzbekistan, the nominal export earnings will substantially depend on the value of gold (about 42% of exports in 2017, 50% in the 1st quarter of 2019) in global markets.

At the end of the first quarter of 2019, the Uzbek sum rate depreciated to 8 389 sum per US dollar (0.2% yoy, 2.7% yoy). As of the end of the second quarter, the FX rate of the national currency against US dollar was at the level of 8 562 sum and weakened by 2.1% since the beginning of the year and by 4.8% yoy. As of the end of August of the current year, the national currency rate was formed at the level of 9 373 sum per US dollar (-12.4% since the beginning of the year), and in September it weakened to 9 501 sum per US dollar.

The depreciation of the national currency in August of this year was accompanied by further liberalization of the currency regime, under which the population of the republic was allowed to purchase foreign currency from August 20 of this year. In addition, the Central Bank of the Republic of Uzbekistan canceled to target currency band of 5%, arguing this decision by depreciating the currencies of the countries of trading partners. As a result of such a decision, the national currency of Uzbekistan depreciated by the end of August by 8.1% to 9 369 sum per US dollar, and as of the end of the 3rd quarter it reached the level of 9 435 sum per US dollar, weakening by 9.1% yoy or by 12.3% since the beginning of the year.

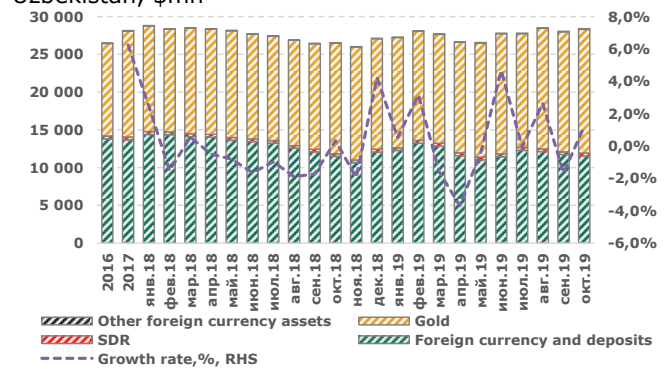
*Depreciation of the national currency amid widening current account negative balance.* The observed depreciation of the national currency is taking place against the backdrop of a sharp increase in the current account deficit from a surplus of \$1.5bn in 2017 to a deficit of \$3.6bn in 2018. Current account deficit resulted from outpacing dynamics of import growth by 47,5% yoy compared with export 12.0% yoy (according to the Central Bank of the Republic of Uzbekistan, according to the State Statistics Committee of the Republic of Uzbekistan 49.8% yoy and 2.3% yoy). Such dynamics affected the expansion of the negative trade balance by 3.1 times to \$6.9bn. Services balance deficit increased by 32.6% yoy and amounted to \$2.4bn. Positive balance on the primary income account, the growth of which amounted to 24.1% yoy or \$1.5bn, as well as a positive balance on the secondary income account, which, although it decreased by 2.7% yoy and amounted to \$4.2bn, could not compensate for the accelerated expansion of the account deficit goods and services.

Fig. 17. USD / UZS exchange rate and gold quotation



Source: Bloomberg, Halyk Finance

Fig. 18. Gold reserves of the Central Bank of Uzbekistan, \$mn



Source: Central Bank of Uzbekistan, Halyk Finance

As of the end of 1H2019, current account deficit persists, although it decreased by 11.9% yoy to \$1.4bn (according to preliminary data for 9M2019, \$1.6bn, -49.6% yoy). Maintaining the current account deficit is facilitated by the expansion of the negative trade balance by 7% to \$3.1bn (according to preliminary data for 9M2019, the deficit is at the level of \$4.5bn, -17.5% yoy) and the reduction in the positive balance of primary income by 4.4% yoy to \$631 mn (\$834.6mn in 9M2019, -20.4% yoy). Reduction of the service account deficit by 5.2% yoy to \$1.1bn. (\$1.7 bn for 9M2019, -8.5% yoy) and a significant increase in the balance of secondary income by 20.2% yoy to \$2.2bn (\$3.8bn for 9M2019, +24.1% yoy according to preliminary data) on the contrary contributed to the improvement of the current account.

Under such conditions, gold sales are increasing, and the outflow of currency from the country through foreign trade channels is offset by an inflow to the financial account, which in 2018 amounted to \$1.4bn (in 1H2019, the inflow amounted to \$4.5bn), as well as an inflow through primary and secondary income account. The current account deficit observed in the first half of 2019 will continue throughout the current year. Such dynamics, according to the republic's external accounts, creates pressure on the FX rate of the Uzbek sum towards its weakening.

## Inflation

The inflationary processes in Uzbekistan after the one-time devaluation of the national currency in 2017 significantly accelerated. The weakening of the national currency by 2.5 times led to an acceleration in the

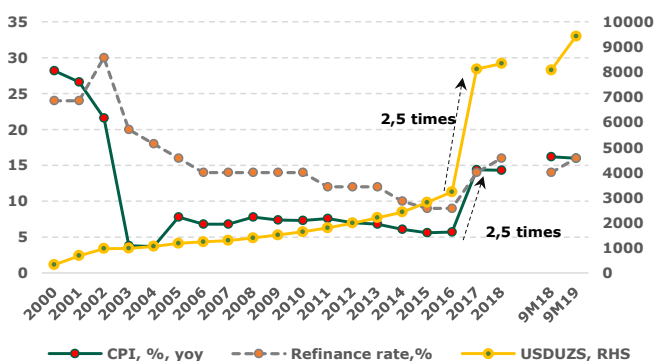


dynamics of consumer price inflation, that also increased by 2.5 times. The consequences of the devaluation shock through the currency channel accelerated consumer price inflation to 20% at the beginning of 2018. Stabilization and subsequent appreciation of the FX rate in the middle of last year led to a gradual decrease in the dynamics of price growth within the country, which at the end of last year was formed at the level of 14.3%. In September of this year, consumer inflation in Uzbekistan accelerated and amounted to 16.0% yoy (16.2% yoy in September 2018).

Inflationary expectations so far remain high. Surveys by the Central Bank of the Republic of Uzbekistan for 2018 showed that respondents from the middle of last year changed their short-term inflation expectations upward. In November, short-term inflation expectations of respondents reached their maximum among the population of 671 p (out of 1 000 possible), and among business entities 654 p. In the first quarter of 2019, short-term expectations decreased to 552 p among the population and 517 points among entrepreneurs. However, the surveys for the second quarter of this year show that the index of short-term inflation expectations among the population begins to grow and amounts to 566 p in June and 523 p for business entities. It is attributed to the expected liberalization of electricity and gas prices in the second half of this year. According to surveys of the Central Bank of Uzbekistan, short-term expectations in 3Q2019 reached 683 p for the population and 682 p for business entities. Over the past two years, these are record values that are second only to the August figures of 775 p and 749 p respectively. Not last contribution to the growth of inflation expectations makes a depreciation of the national currency, which is at the end of September was 12.3% ytd.

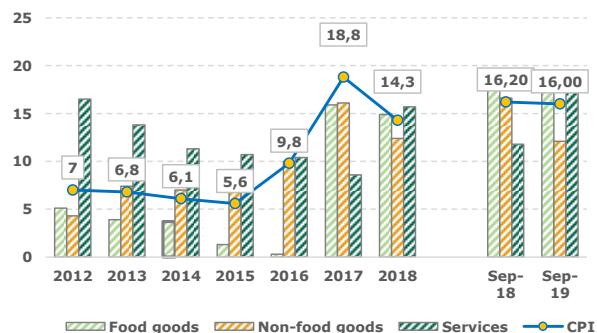
Food price inflation in Uzbekistan in June 2019 amounted to 16.3% compared to 19.3% in June last year. Compared to 2017 (25.7% yoy), food inflation in 2018-2019 is slowing down. The growth of food inflation in the country was promoted by rising prices for bakery products, meat and dairy products, fruit and vegetable products. The increase in prices for those food products in the first half of 2019 was caused by an increase in energy prices, the liberalization of which the country's leadership carried out in November 2018. An important role in the growth of prices in the domestic market is played by the export of food products thereby forming a food shortage in the domestic market. Exemption from import duties of meat and livestock in 2018 for a period up to January 1, 2020 did not solve the problem of the supply of those goods in the domestic market. Food inflation in the third quarter of this year was at the level of 17.5% yoy (17.5% yoy in September 2018). A significant contribution to the increase in prices was made by the rise in price of meat and meat food products (22.7% yoy), dairy products (18.7% yoy) and eggs (28.4% yoy).

Fig. 19. Inflation in Uzbekistan



Source: SCS RU, Halyk Finance

Fig. 20. Inflation components



Source: SCS RU, Central Bank of RU, Halyk Finance

**Minimum increase in prices for non-food products.** The growth in prices for non-food products was minimal compared to other components of inflation in July 2019 and amounted to 10.9% yoy, falling from 17.4% yoy in 2018 (11.1% yoy in 2017). In September of this year, inflation for non-food products accelerated and amounted to 12.1% yoy (16.6% in September last year). A significant contribution to the increase in prices for non-food products was made by changes in prices for clothes 12.2% yoy, shoes 11.3% yoy, as well as the cost of fabrics and yarn 13.6% yoy.

Prices for paid services follow the growth of the minimum wage. The change in prices for paid services in Uzbekistan is largely due to the "adjustment" of this sector of the economy to an increase in the minimum wage of the population by 30.1% to 2 092.6 thousand sum. In November last year, the "adjustment" took place against the backdrop of changes in energy costs and taxes. At the end of June 2019, paid services showed an increase of 12.9% yoy, which is 0.1 bp less than the inflation rate in the corresponding period last year, but significantly higher than the 2017 indicator of 8.5% yoy. In September, price inflation for paid services reached an annual maximum and amounted to 19.5% yoy (11.8% yoy in September last year). The main contributor to inflation is the increase in prices for housing and communal services (+ 29.8% yoy) and education services (+ 22.8% yoy)



*Monetary conditions contribute to double-digit inflation.* An important role in maintaining high inflation in Uzbekistan is also played by a 40.2% increase in the country's money supply in 2017 (16.1% yoy in September this year), and the expansion was facilitated by a credit channel transmission in the framework of lending to the economy commercial banks, FRRU (+ 55.1% yoy on November 1 of the current year), as well as an increase in receipts in the form of foreign credit lines. Not the last contribution to inflation growth in Uzbekistan is made by the growth of population incomes, the growth of remittances of labor migrants, as well as a stimulating fiscal policy (from January 2019, CIT was reduced from 14% to 12%). The budget for 2019-2021, having been surplus for several years in a row in the past, is planned to be deficit at the level of 0.8% -0.9% of GDP. The consolidated budget deficit will be -1.5% in 2019 and -0.7% in 2020.

*The inconsistency of fiscal and monetary policies rises a doubt on the achievement of inflation targets.* Lending to the economy under budget development programs contrasts with the tight monetary policy of the Central Bank of the Republic of Uzbekistan. The inconsistency of the monetary policy of the Central Bank of the Republic of Uzbekistan and fiscal policy creates the risks to macroeconomic stabilization under which the regulator is taking steps to reduce the rate of consumer inflation. The government forecast for inflation at the end of 2019 is 13.5-15.5% yoy. By 2020, the regulator predicts a decrease in inflation to 10-12% yoy, and in 2021 inflation is expected to be less than 10%.

We believe that the inconsistency of fiscal and monetary policies, the inflow of investments and cash income from abroad will support a two-digit inflation rate (monetary component of inflation) in the Republic of Uzbekistan. Therefore, we consider that the regulator may resort to yet another tightening of monetary conditions.

## **Interest rate policy**

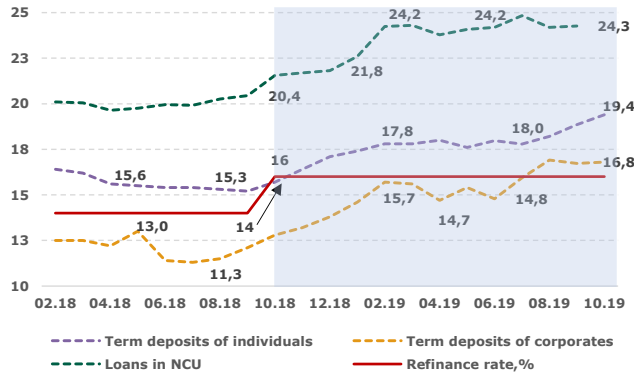
The interest rate policy of the regulator after the transition to a free floating exchange rate of the national currency is characterized by tightening monetary conditions. With the introduction of a floating exchange rate, the regulator tightened its monetary policy, increasing the refinancing rate in 2017 to 14%, and in September 2018 to 16%. At the moment, the refinancing rate has not changed.

An increase in the refinancing rate in September last year led to a rise in the cost of loans in the national currency from 20.4% to 24.1% in May 2019. Tighter monetary conditions also resulted in a decrease in the dynamics of growth in loans in the economy from 5.5% mom in September 2018 to 3.0% mom in March 2019, however, in May this year, lending dynamics reached the level of 5.6% mom, having exhausted the "restrictive" monetary impulse of the Central Bank of the Republic of Uzbekistan. The growth of loans in the economy for 9 months of 2018 amounted to 36.8%, and since the increase in interest rates, the nominal growth of loans amounted to 34.8%, i.e. there is a slight slowdown in lending growth.

Against the background of tightening monetary conditions, the average annual dynamics of the growth of deposits accelerated from 1.5% in January-September 2018 to 3.1% in October 2018 - May 2019, and the volume of deposits from September 2018 to May 2019. increased by 26.5%. At the same time, there has been an increase in rates on deposits of individuals in national currency from 15.2% to 18.0% (in June of the current year), and of legal entities from 12.1% to 14.8% in June 2019. In October, the average weighted rates on deposits of individuals in national currency amounted to 19.4% and legal entities 16.8%.

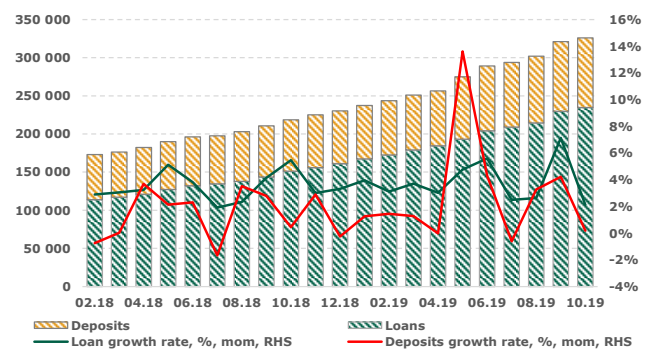
The adjustment of deposit rates in national currency after an increase in the refinancing rate by 2pp led to a decrease in the share of deposits in foreign currency from 42.8% to 41.8%. The appreciation of loans in national currency increased the share of loans in the economy in foreign currency from 53.3% to 54.1%. The growth rate of loans in national currency decreased from 5.5% on average for 9 months of 2018 to 3.9% from October 2018 to October 2019. However, despite the decrease in the monthly rate of lending, the annualized growth in October of the current of the year amounted to 40.2% yoy, while attracted deposits over the same period showed an increase of 30.5% yoy. The Central Bank of Uzbekistan predicts that the growth rate of lending in the country in 2019 will be about 25% yoy and will gradually decrease to 15% yoy in 2020 and up to 14% in 2021. However, we believe that the lending rate will exceed 35% in 2019 due to the accumulated pent-up demand and growth of incomes of the population, and in 2020-2021 will show a moderate decrease. Given that it will take time to build up the country's export potential, domestic demand that is supported by credit expansion will provide major support to the economy.

Fig. 21. Deposit and credit market rates,%



Source: Central Bank of Uzbekistan, Halyk Finance

Fig. 22. Loans and deposits in the economy, bn sum



Source: Central Bank of Uzbekistan, Halyk Finance

In the interbank deposit market, the average interest rate after increasing the refinancing rate increased from 11.3% to 13.7% in October and continued to grow until the end of last year, when it reached 14.8%. As of the end of the first half of 2019, the interest rate on the interbank market amounted to 14.7% (the first quarter of 2019 - 14.6%). For 9 months of the current year, the interbank deposit market rate was at the level of 14.9%.

*Reduction in money supply growth as a result of the tightening of monetary policy.* The tightening of monetary policy affected the growth rate of the money supply of (M2) from 40.2% yoy in 2017 to 14.4% yoy in 2018. As of the end of September 2019, this aggregate is growing 16.1% yoy to 95.3 trln sum. The broad money supply growth over the 9 months of this year was facilitated by the expansion of the volume of money in circulation by 2.9 trln sum from the beginning of the year to 25.1 trln sum (+ 11.9% yoy), deposits in national currency by 5.5 trln sum up to 41.8 trln sum (22.5% yoy) and deposits in foreign currency worth 3.1 trln sum up to 28.4 trln sum (+ 11.1% yoy). Not the least role in expanding the money supply is played by lending to the economy. The sectors of the economy that have the highest lending rates at the beginning of October 2019 include logistics and sales with a growth rate of 47.2% yoy, lending to individuals (+ 78.1% yoy) and trade, the lending rate of which amounted to 38.7% yoy. The growth rate of lending to industry and agriculture is 55.8% yoy and 56.5% yoy, respectively.

The Central Bank of the Republic of Uzbekistan uses reserve requirements for commercial banks in order to manage money supply, as well as for "devaluation" and to reduce the share of foreign currency in the system. Thus, reserve requirements from October 1, 2018 for deposits of legal entities and individuals in national currency, depending on the terms, are 0-2%, for other liabilities 4%, and reserve requirements for deposits of legal entities and individuals in foreign currency are 0-7%, for other liabilities about 14%. The formation of required reserves is carried out in different currencies in proportion to their share in the deposit base. Since July 1, 2018, reserve requirements have been unified and, regardless of the term, deposits of individuals and legal entities in national currency apply reserve requirements of 4%, while for deposits in foreign currency 14%.

Targeting monetary aggregates was a part of the previous monetary policy. At the moment, along with inflation targeting, tracking of monetary aggregates is a transitional benchmark for monetary policy. Hybridization of the monetary system in Uzbekistan is caused by the gradual creation and improvement of the controls of the financial system. So, along with the republic's traditional tools of monetary and currency targeting, the Central Bank of the Republic of Uzbekistan introduced deposit auctions (December 2018 - January 2019), held by an open auction of government securities, and improved mechanisms for the provision and withdrawal of liquidity.

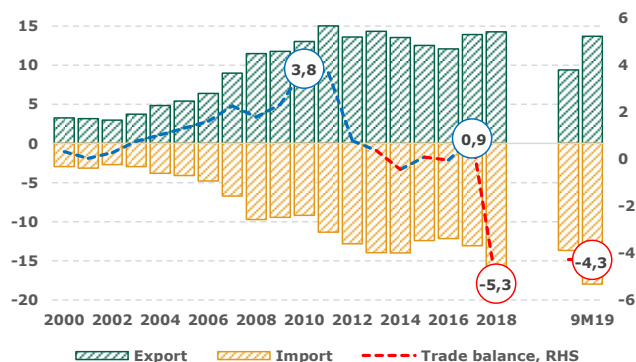
The Central Bank of the Republic of Uzbekistan continues to balance the financial system in the country amid high rates of inflow of foreign currency into the country. The expansion of the instrumental base of monetary policy within the framework of the inflation targeting regime and its successful application gives reason to believe that the regulator will be able to manage the monetary factors that form the high inflation rate in the country. A significant inflow of money into the country and its massive transmission through the banking system to the economy in the form of a loan increases the likelihood of further tightening of monetary conditions in order to avoid overheating of the economy by consumption. However, the key task of the regulator in terms of the formation of monetary conditions in the country, in our opinion, remains the task of finding the optimal balance between economic growth and inflation.

## Foreign trade

In 2018, there was a significant increase in trade turnover by 27.3% yoy to \$33.8bn due to the outpacing dynamics of imports (+ 39.6%) over exports (+ 13.5%). According to the SCS RU, the trade balance of Uzbekistan in 2018

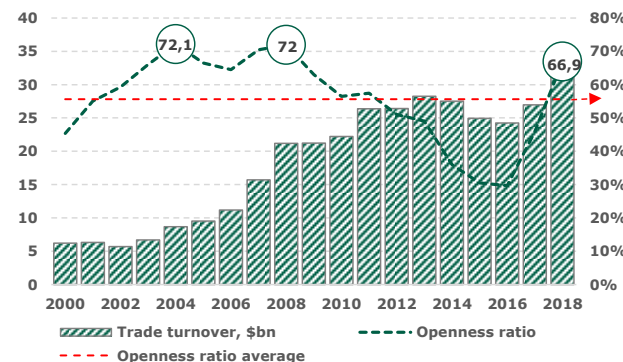
amounted to \$5.3bn (10.5% of GDP). According to statistics for 9M2019, the trade balance was also negative at the level of \$4.3bn. The growth rate of imports + 31.5% yoy (\$18.0bn) is determined by the expansion of production due to the transfer of technology and the import of machinery and equipment that are not produced on the territory of the republic, and is also the result of increasing production of consumer vehicles. The growth rate of exports of goods from Uzbekistan increased by 45.5% yoy and amounted to \$13.7bn.

Fig. 23. Foreign trade of Uzbekistan, \$bn



Source: SCS RU, Halyk Finance

Fig. 24. The indicator of economic openness



Source: SCS RU, Halyk Finance

**Limited potential export growth.** The current potential for expanding Uzbek exports is limited by both by an assortment of exported goods and by the list of importing countries. Thus, in recent years (2012-2018), according to statistics on mutual trade (mirror data) of the International Trade Center, Uzbekistan exported 348 tons of gold to Switzerland (according to statistics on mutual statistics between Switzerland and Uzbekistan), over the same period Kyrgyzstan sold only 78 tons of gold to Switzerland (according to data provided by the Kyrgyz Statistics Committee). Other countries in the region carry out their own gold processing. Significant competition for the supply of natural gas to China from Uzbekistan is faced from Turkmenistan, natural gas of which in 2018 amounted to 25mn tons compared to 4.8mn tons of the Uzbek gas. The export of copper from Kazakhstan is a significant competition to the Uzbek export of copper to China. Thus, in 2018, Kazakhstan supplied 220 thousand tons of copper to China against 22.6 thousand tons from Uzbekistan. The export of Uzbek copper to Turkey amounts to 44.7 thousand tons against 113.5 thousand tons of export of this metal from Kazakhstan.

We see the competitive advantage of Uzbek exports in the production of cotton and cotton products. With the in-depth development and modernization of that industrial cluster in the future, the export of fabrics and finished products from them could become a significant export advantage of the country. However, Uzbekistan will have to compete for the markets for those products with Turkey, Kyrgyzstan and China.

**High concentration of exports by trading partner countries.** The structure of Uzbekistan's exports by trade partners over the past three years comprises 89-90% of five countries. Of these, Switzerland in 2018 ranks the first with a share of 25.6%. A significant increase in the share of Switzerland in exports began to occur from 2012 from 8.2% to 2017, when the share of this country reached 42.1%. According to ITC's mutual trade data for 9M2019, the share of this country was 38.5% or \$2.6bn. Gold is the main export product delivered to Switzerland. The physical volume of gold supplies to Switzerland in 2018 amounted to 60 tons, decreasing from 90 tons a year earlier. In nominal terms, exports to this country decreased from \$3.7bn to \$2.5bn. Gold exports to Switzerland from 2006 to 2011 were minimal and averaged 5.4% of the total.

The second country in terms of share in the export structure of Uzbekistan is China. Its share in 2018 was 23.9% (the maximum since 2001). The change in the share of China in exports from Uzbekistan was irregular in 2003-2009, however, since 2010, the share has grown steadily and averaged 19.7% in 2010-2018. In 9M2019, China's share in the export structure amounted to 24.9% or \$1.7bn. The main exported goods delivered to China in 2018 were natural gas (60.7%), cotton (17.3%) and copper (7.3%). As of the end of 2018, the nominal exports for those three items amounted to \$1.8bn.

The third position in the export structure in 2018 was taken by the Russian Federation with a share of 11.4%. The share of exports to the Russian Federation at the beginning of 2001-2005 was high, and accounted for 25.1%. Subsequently, it decreased until in 2015 it reached its minimum of 8.9%. The main range of exports to the Russian Federation in 2018 consisted of natural gas 35.7%, cotton (15.5%), clothing (11.7%), plastic and articles thereof (9.4%) and edible fruits, nuts, melons, etc. (6.6%). In 2018, in nominal terms, exports of those five items amounted to \$1.3bn.

The fourth position is held by Kazakhstan with a share of 11%. An increase in Kazakhstan's share in the structure of Uzbek exports began in 2011 from 11%. The main exported goods to Kazakhstan were represented by 44.0% of

natural gas, edible fruits, nuts, melons, etc. (23.8%), edible vegetables, roots and tubers (7.5%), as well as plastic and articles thereof (5.8%). The nominal volume of exports to Kazakhstan in 2018 amounted to \$989mn.

Turkey occupied the fifth position in the export structure, the share of exports to which at the end of last year amounted to 8.7%. The maximum value of this share was observed in 2011 (14%). The last three years, the share of Turkey is 9.3-9.4%. The main export goods supplied to Turkey are copper and its products (48.3%), cotton (14.8%), plastic and its products (11.3%), as well as zinc and zinc products (15, 6%). The nominal export volume for these items in 2018 amounted to \$778mn.

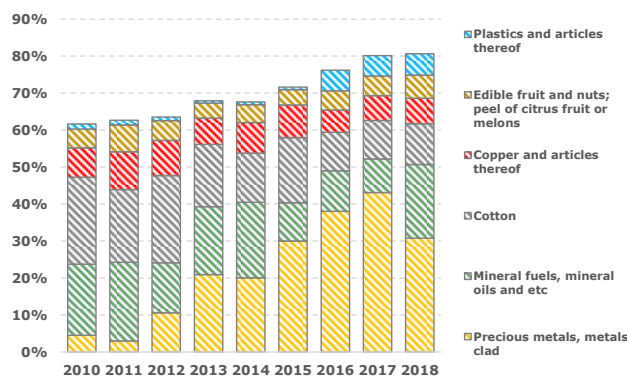
Over 9M2019, the export structure underwent notable changes in the trading partner countries. Thus, Switzerland's share amounted to 38.5% of total exports (29.3% in 1H2018). The share of exports to China decreased from 28.3% in 9M2018 to 24.9% in 9M2019. The share of exports to Russia decreased from 13.5% a year earlier to 8.1% in 9M2019. For 9M2019, the share of Turkey in exports increased from 9.9% in 9M2018 to 11.5% in 9 months of the current year. The share of exports to Kazakhstan significantly decreased from 10.8% a year earlier to 5.4% for 9M2019. Statistics for 9M2019 indicates an increase in the concentration of trade partners by countries from 91.7% (5 countries) to 88.4%.

The main importing countries are China, whose share since 2001 increased from 2.4% to 22.9% in 2018, the Russian Federation whose share was 19.3% in 2018, decreasing from 27.0% in 2004. The Republic of Korea ranks third among the trading partner countries with a share of 12.3% (average value of 13.5% in the period from 2001-2018). The share of Kazakhstan is 9.5% in 2018, with an average value of 9.6% for the period. Import from Turkey is 5.5% of the share of imports with an average value of 4.5%. And if the shares of the Republic of Korea, Turkey and Kazakhstan as a whole are evenly distributed during the observation period, then the share of Germany decreased from 9.6% in 2001 to 4.7% in 2018.

According to the data for 9M2019 of the International Trade Center, 6 trading partner countries, accounted for 82.3% of imports for 9M2019 (77.9% for 9M2018). Imports from Kazakhstan in 9M2019 decreased from 10.5% a year earlier to 8.8%. China accounts for 31.7% of imports (24.7% for 9M2018), for the Russian Federation 15.1% (20.3% for 9M2018), for the Republic of Korea 14.5% (11.7% for 9M2018), 7.5% for Turkey (6.0% for 9M2018) and 4.7% for Germany (4.8% for 9M2018).

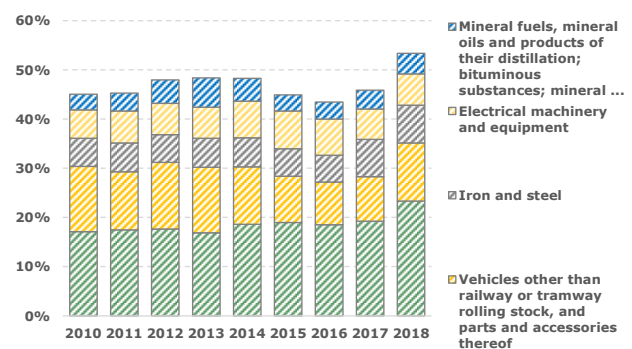
The main setup of imports from China in 2018 was 40.3% represented by machinery and mechanical equipment, and 9.8% by electrical equipment. Imports of iron and steel account for 5.7% of all imports, about the same share of imports of plastic and plastic products (6.0%). The nominal size of imports for those items in the first half of the year amounted to \$2.2bn. Uzbekistan imported iron and steel (17.9%), wood and its products (16.5%), mineral energy (10.7%), machinery and mechanical equipment (10.7%) from the Russian Federation for a total cost of \$1.9bn.

Fig. 25. Export structure by goods



Source: ITC, Halyk Finance

Fig. 26. The structure of imports by goods



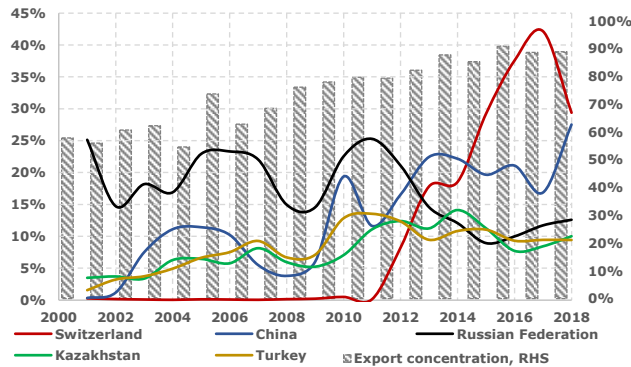
Source: ITC, Halyk Finance

The structure of Uzbekistan's imports from the Republic of Korea in 2018 is represented by the following goods - transportation vehicles, other than railway or tram rolling stock, and their parts, and accessories (52.8%) and machines and mechanical appliances (15.0%), which in nominal terms totaled \$1.3bn. In Korean imports, the predominant part is occupied by individual units, parts and parts of large-knot assembly (SKD - semi knock-down) of Korean cars in Uzbekistan.

Imports from Turkey is represented mainly by machinery and mechanical devices (44.7%), electrical equipment (8.4%), plastic products and plastic (4.8%), iron and steel products (6.8%) totaling \$772mn.

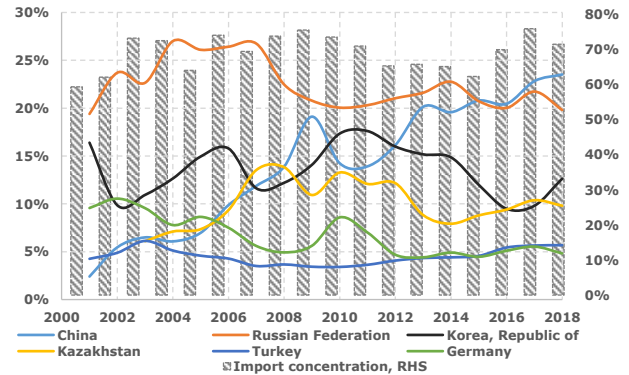


Fig. 27. Structure of exports by partner countries



Source: ITC, Halyk Finance

Fig. 28. Structure of import by partner countries



Source: ITC, Halyk Finance

Imports from Kazakhstan are predominantly represented by iron and steel (25.0%), cereals (19.1%), mineral energy products (13.2%) and flour products (7.4%). In nominal terms imports from Kazakhstan amounted to \$1.1bn.

Imports from Germany are represented by machinery, mechanical devices, nuclear reactors, etc. (49.8%), by 10.6% by means of land transport other than railway or tram rolling stock, their parts and accessories, as well as airplanes and their parts (8.4%). In nominal terms, the volume of imports from Germany amounted to \$481mn.

For 9M2019, according to the SCS RU, the major setup of imports is represented by 44.8% of imports of machinery and equipment (40.8% in 9M2018), by 12.7% in chemical products and products thereof (13.2% in 9M2018), 7.5% of ferrous metals and products from them (8.5% for 9M2018). Food products account for 7.5% of the total import structure for 9M2019 (8.7% for 9M2018). Services in the structure of imports account for 10.0% (12.1% for 9M2018).

We do not expect significant changes in the structure of imports in the near future. We assume an extensive increase in imports from Korea, since with the growth of incomes of the population and the expansion of car loans, domestic demand for the products of the Uzbek automobile industry will only increase. The sale of cars on the Kazakhstan market will also partially contribute to the growth of large-node supplies from the Republic of Korea. Imports of grain and metals will also increase due to the growth of the economy and population (33.3mn people, in 1992 - 21.4mn).

## Banking sector

As of October 1, the banking sector of the Republic of Uzbekistan is represented by 30 credit organizations, 13 of them are banks with state participation. The branch network of commercial banks totals 847 branches. The share of assets of banks with state participation ranged from 0.04% to 27.4%, while the share of banks without state participation ranged from 0.04% to 2.9% of the total assets. As of October 1, the total share of assets of 13 banks with state participation is 86.1% of total banking assets. The growth dynamics of banking assets is declining, but remains high. So, in 2017, the growth of banking assets amounted to 98.2% yoy, and in 2018 already 28.7%. In 2017, lending to the economy grew 2.1 times, and in 2018 its growth amounted to 51.4%. Banking assets to GDP as of October 1 of this year, in our estimation, make up about 55.4% of GDP (290.9 trln sum or \$30.8bn according to the Central Bank of the Republic of Uzbekistan), while the ratio of loans to GDP is 44.7% (234.7 trln sum or \$24.8bn).

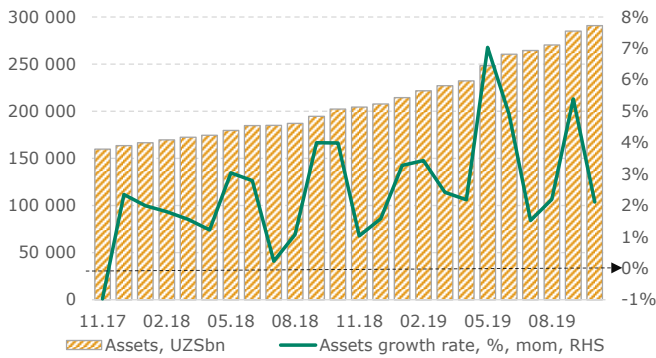
The first group of banks in terms of assets (> 5%) is represented by six banks, whose assets range from 15.2 trln sum up to 79.8 trln sum (\$1.6bn - \$8.4bn). The largest of them are Uznazbank with a share of 27.4% and total assets (79.8 trln sum), Asaka Bank with a share of 14.1% (41.1 trln sum), Uzpromststroybank with a share of 13.4% (39 trln sum), Ipoteka bank with a share of 9.0% (26.1 trln sum), Agrobank with a share of 6.4% (18.7 trln sum) and Narodnyi Bank with a share of 5.2% (15.2 trln sum). The total share of those banks is 75.6% (219.9 trln sum or \$23.3bn) of the total assets of the country's banking sector. All listed banks are the banks with state participation. The share of loans of the first group of banks is 79.0% of the total loans of the republic. The share of deposits in the first bracket of banks is 58.8% of all deposits.

The second group of banks (1% -5%) is represented by 11 banks with a total share of assets of 21.4% (62.1 trln sum or \$6.6bn). Assets of banks of this bracket ranged from 3.3 trln sum up to 11.8 trln sum (\$345.5mn - \$1.3bn). The largest in the group are Qishloq Qurilish Bank with a 4.1% stake and an asset size of 11.8 trln sum,



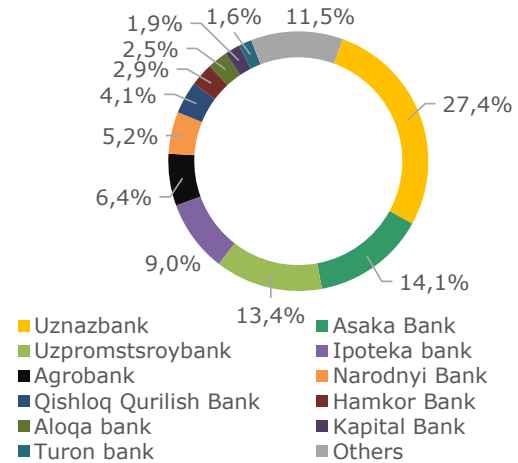
Hamkor Bank with a share of 2.9% and an asset size of 8.4 trln sum, Aloqa bank with a 2.5% stake and an asset size of 7.3 trln sum, Kapital Bank with a share of 1.9% and assets of 5.5 trln sum, UzKDB bank with a share of 1.4% and total assets of 4.1 trln sum, Ipak yuli bank with a 1.6% stake and assets of 4.6 trln sum. The share of second group of bank loans is 18.5% of the total loans of the republic. The share of deposits in the second group of banks is 35.4% of all deposits.

Fig. 29. Assets of the banking sector of Uzbekistan



Source: Central Bank of Uzbekistan, Halyk Finance

Fig. 30. The largest banks in terms of assets

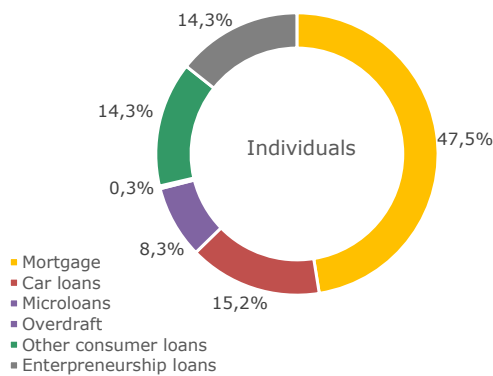


Source: Central Bank of Uzbekistan, Halyk Finance

The third group of banks (<1%) is represented by 13 banks with an aggregate share of assets of 3.1% (8.8bn sum or \$940mn). Assets of banks of this group from 119bn sum to 2.3 trln sum (\$13mn - \$247mn). The largest representatives of this group of banks are Asia Alliance Bank with a share of 0.8% and assets of 2.3 trln sum, Davr Bank 0.5% and assets of 1.3 trln sum, Turkiston Bank with a share of 0.3% and assets of 1.0 trln sum. The share of loans of the third group of banks is 2.5% of the total loans of the republic. The share of deposits in the third group of banks is 5.8% of all deposits. As of October 1 of this year, the capital adequacy ratio is 15.6%, and the total capital of 30 banks is 34.0 trln sum (+ 49.4% yoy) or \$3.6bn. The return on bank assets is 2.2% with a combined profit of 3.2 trln sum, while the return on equity is 18.2%.

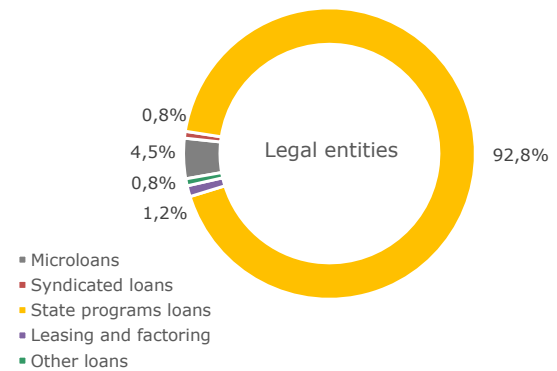
Loans. The balance of the principle amount of the loan portfolio as of October 1 of this year increased by 55.1% yoy and amounted to 234.7 trln sum (\$24.8bn). Loans to individuals by banks amounted to 37.9 trln sum (+ 78.1% yoy) or \$4.0bn. A significant share in the structure of loans provided to individuals is held by mortgage loans in the amount of 18.0 trln sum (+ 46.7% yoy) with a share of 47.5%. The share of car loans to individuals is 15.2% or 5.8 trln sum (130.2% yoy). The share of loans for the development of entrepreneurship amounted to 14.3% or 5.4 trln sum (+ 117.7% yoy). Loans for other consumer purposes make up 14.3% or 5.4 trln sum (+ 58.9% yoy). The share of microloans is 8.3% of the loan portfolio, or 3.1 trln, but has the highest growth dynamics (5.3 times).

Fig. 31. Structure of the loan portfolio as of 01.10.2019



Source: Central Bank of Uzbekistan, Halyk Finance

Fig. 32. Structure of the loan portfolio as of 01.10.2019

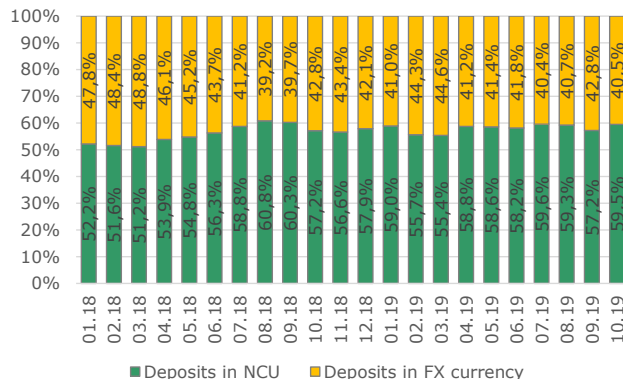


Source: Central Bank of Uzbekistan, Halyk Finance

The share of foreign loans in the structure of the loan portfolio of banks from the maximum value of 60.6% as of the beginning of last year decreased to the minimum value of 53.3% in October 2018. As of October 1, 2019, the share of loans in foreign currency is 55.7%.

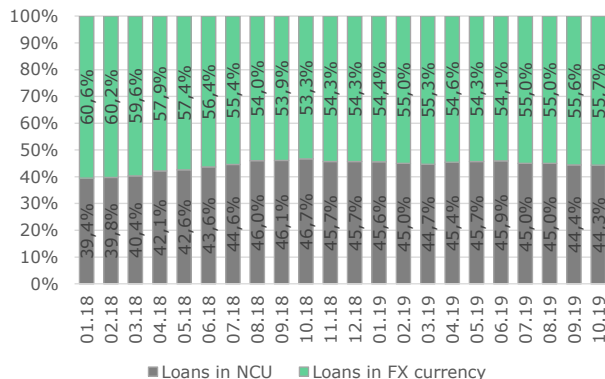
**Loans to legal entities.** The volume of loans provided to legal entities as of September 1 of this year is 196.8 trln sum (+51.5% yoy) or \$20.8bn. The largest share of loans in the structure of the loan portfolio of legal entities is represented by loans issued under the state programs of 92.8% or 183 trln sum (+ 53.5% yoy). Microloans to legal entities make up 4.5% of the total loan amount or about 8.9 trln sum (2.9% yoy). The share of leasing and factoring in the structure of the loan portfolio of legal entities is 1.2% or 2.4 trln sum (+37.9% yoy).

Fig. 33. Currency structure of deposits



Source: Central Bank of Uzbekistan, Halyk Finance

Fig. 34. Loan portfolio structure



Source: Central Bank of Uzbekistan, Halyk Finance

The share of other types of loans is 0.8% or 1.5 trln sum, but at the same time it has the most significant growth dynamics of 13.1 times per year. The share of syndicated loans is 1.5 trln sum (+159.9% yoy) or 0.8% of the total structure of loans to legal entities.

**Deposits** The volume of attracted deposits (for all types of organizations), as of October 1 of this year, increased by 35.5% yoy and amounted to 91.3 trln sum or \$9.4bn. In the structure of deposits (for depository corporations of the banking sector), the share of deposits in FX currency, having reached its maximum value as of March 1 of last year at 48.8%, steadily decreased to 39.2% in August last year. The growth dynamics of deposits in foreign currency at depository corporations in the banking sector is 11.1% yoy or 28.4 trln sum (\$3.0bn). The growth dynamics of deposits in national currency as of October 1, 2019 is 22.5% yoy or 41.8 trln sum (\$4.4bn).

## Prospects for the development of the economy of Uzbekistan

We assume that in the medium term, Uzbekistan will demonstrate economic growth at the level of 5.4-5.9% yoy. One of the main drivers of growth will be investments, a large portion of which will be carried out through budget development programs. The state budget for the next two years is planned to be deficit at the level of 0.8-0.9% of GDP. In the period from 2019-2020, an almost twofold increase in the size of the transfer to the budget is planned and indicates the implementation of the budget impulse.se.

We are still somewhat restrained about the growth prospects of Uzbekistan, as there are still risks of internal macroeconomic instability in the economy, large-scale reforms that are being carried out simultaneously and accompanied by external macroeconomic uncertainty associated with trade disputes between the USA and China, as well as the threat of a large-scale recession of the global economy.

Despite changes in the structure of the economy and the creation of new jobs, in Uzbekistan there are excessive labor resources that, along with traditional export of goods, will be delivered to larger regional economies (Russia and Kazakhstan). We believe that the inflow of secondary income of labor migrants will have a positive impact on domestic demand that will share at least 4.5%-5.0% of GDP.

Over the past two years, we have seen a development of money management mechanisms in the country, the creation of a new regulatory tool base as part of the transition to an inflation targeting policy. However, the monetary authorities still face the task of monetary management of inflation, because, in our opinion, the devaluation effect of 2017 has gradually exhausted its influence, and inflation is maintained at a relatively high level mainly due to monetary reasons (high lending rates). We believe that lending rates in the republic will remain high and will be supported by the inflow of remittances from labor migrants, who, due to the availability of credit, will increase consumption (there is pent-up demand in the republic, especially for durables). Therefore, we see the

need for a gradual tightening of monetary conditions through an increase in the base rate. In addition, it is necessary to coordinate a tight monetary policy and a stimulating fiscal policy to achieve macroeconomic stabilization in the republic. We believe that inflationary processes in the country will remain relatively high and inflation will gradually decrease from 15.4% yoy in 2019 to 11.7% in 2021.

We believe that the interest rate will remain at 16% until the end of the year. The Central Bank of the Republic of Uzbekistan will make a decision on tightening monetary conditions based on the inflation rate for the year. If the inflation rate goes beyond the range of 13.5%-15.5%, we do not exclude the possibility of tightening of monetary conditions in the country. High rates of consumer lending, remittances inflows from labor emigrants, fiscal stimulus policy and investment inflows into the country, as well as the development of the tourism business create pro-inflationary pressure on the demand side of the economy (demand-pull inflation). A positive output gap, high business activity, growth in nominal wages, and liberalization of energy prices also create pro-inflationary pressure on the economy from the supply side (supply cost inflation). Under such circumstances, the tightening of monetary conditions seems quite likely.

Amid the uncertainty surrounding the trade disputes between the US and China, the recession of large European economies will put pressure on the Uzbek FX rate towards its weakening. Despite the growth of gold quotes (as a safe haven asset) and the growth of physical gold exports, as well as the inflow of capital to the country on the financial account, we expect the weakening of the sum of this year at least 13-15%. The weakening of the sum is necessary to support Uzbek exporters of agricultural products and energy. However, we do not expect the regulator to allow a significant weakening of the national currency, as it will provoke acceleration of inflationary processes in the republic through the currency channel. It should be noted that Uzbekistan still has high inflationary and devaluation expectations, and with the current structure of the economy, they exert significant inflationary pressure on the price level in the country.

We adhere to a restrained forecast for the growth of Uzbek exports and its assortment at least in the next 3-5 years. The current increase in export are due to gold exports, along with other goods, is a way to improve the trade balance, which in 2018 developed with a record high deficit for the country. We believe that the trade deficit at the level of 2018 will remain in 2022, followed by a slight decrease. The current account deficit will remain in 2019-2023 at the average level of \$3.0bn.

The banking sector of the Republic of Uzbekistan will show steady growth due to the re-distribution of cash inflows from foreign investors, budget development programs, population deposits due to wage growth and remittances from labor migrants. We predict a continued high lending and deposit base growth dynamics. This growth will also be facilitated by the further improvement of the transmission mechanism for the transformation of monetary savings into credit by the central bank of the republic.

**The main macroeconomic indicators of countries in Central Asia**

	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Nominal GDP, \$bn.</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Kazakhstan	148,1	192,6	208,0	236,6	221,4	184,4	137,3	166,8	179,3
Uzbekistan	39,3	45,9	51,8	57,7	63,1	66,9	67,0	60,5	50,5
Turkmenistan	22,6	29,2	35,2	39,2	43,5	35,8	36,2	37,9	44,1
Kyrgyz Republic	4,8	6,2	6,6	7,3	7,4	6,6	6,9	7,7	8,1
Tajikistan	5,6	6,5	7,6	8,5	9,2	7,9	7,0	7,2	7,5
<b>Real GDP, %</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Kazakhstan	7,3	7,4	4,8	6,0	4,2	1,2	1,1	4,1	4,1
Uzbekistan	7,3	7,8	7,4	7,6	7,2	7,4	6,1	4,5	5,1
Turkmenistan	9,2	14,7	11,1	10,2	10,3	6,5	6,2	6,5	6,2
Kyrgyz Republic	-0,5	6,0	-0,1	10,9	4,0	3,9	4,3	4,7	3,5
Tajikistan	6,5	7,4	7,5	7,4	6,7	6,0	6,9	7,1	7,3
<b>Fixed capital investments, %</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Uzbekistan	8,7	3,8	12,7	12,1	9,9	9,6	7,7	7,1	18,1
Kazakhstan	-3,0	2,9	4,1	6,9	4,2	3,7	2,0	5,8	17,5
Tajikistan	12,6	2,8	-23,3	14,1	24,9	28,3	20,3	1,7	7,8
Kyrgyz Republic	-9,2	-3,1	42,1	7,6	24,9	14,0	5,8	6,6	3,3
Turkmenistan	14,1	23,2	38,0	7,1	6,1	7,8	0,4	-8,8	-22,2
<b>Population, mn</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Uzbekistan	29,1	29,6	30,0	30,5	31,0	31,6	32,1	32,7	33,3
Kazakhstan	16,4	16,7	16,9	17,2	17,4	17,7	17,9	18,2	18,4
Tajikistan	7,6	7,8	8,0	8,2	8,4	8,6	8,7	8,9	9,1
Kyrgyz Republic	5,5	5,6	5,7	5,8	5,9	6,0	6,1	6,3	6,4
Turkmenistan	-	-	-	-	5,3	5,4	-	5,8	-
<b>Unemployment, %</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Uzbekistan	5,4	-	4,9	4,9	5,1	5,2	5,2	5,8	9,3
Kazakhstan	5,8	5,4	5,3	5,2	5,0	5,1	5,0	4,9	4,9
Tajikistan	11,5	-	-	-	-	-	6,9	-	-
Kyrgyz Republic	8,6	8,5	8,4	8,3	8,0	7,6	7,2	6,9	-
Turkmenistan	-	-	-	-	11,0	6,1	-	8,6	-
<b>CPI, %, yoy</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Uzbekistan	7,3	7,6	7,0	6,8	6,1	5,6	5,7	14,4	14,3
Kazakhstan	7,8	7,4	6,0	4,8	7,4	13,6	8,5	7,1	5,3
Tajikistan	9,8	9,3	6,4	3,7	7,4	5,0	6,1	6,7	5,4
Kyrgyz Republic	19,2	5,7	7,5	4,0	10,5	3,4	-0,5	3,7	0,5
Turkmenistan	4,8	5,6	7,8	4,0	4,4	6,0	6,2	10,4	7,2
<b>FX rate, p.a.</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Uzbekistan USD/UZS	1586,9	1715,4	1 889,7	2094,7	2310,9	2567,4	2967,1	4999,0	8063,9
Kazakhstan USD/KZT	147,4	146,6	149,1	152,1	179,2	221,7	342,2	326,0	344,7
Tajikistan USD/TJS	4,4	4,6	4,8	4,8	4,9	6,2	7,8	8,6	9,2
Kyrgyz Republic USD/KGS	46,0	46,1	47,0	48,4	53,7	64,5	69,9	68,8	68,8
Turkmenistan USD/TMT	2,9	2,9	2,9	2,9	2,9	3,5	3,5	3,5	3,5
<b>Export, \$bn.</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Kazakhstan	60,3	84,3	86,4	84,7	79,5	46,0	36,7	48,5	61,1
Uzbekistan	13,0	15,0	13,6	14,3	13,5	12,5	12,1	12,6	14,0
Turkmenistan	9,7	16,8	20,0	18,8	19,8	12,2	7,5	7,8	-
Kyrgyz Republic	1,8	2,2	1,9	2,0	1,9	1,5	1,6	1,8	1,8
Tajikistan	1,2	1,3	1,4	1,2	1,0	0,9	0,9	1,2	0,9
<b>Import, \$bn.</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
Kazakhstan	31,1	36,9	46,4	48,8	41,3	30,6	25,4	29,6	33,7
Uzbekistan	9,2	11,3	12,8	13,9	14,0	12,4	12,1	14,0	19,4
Turkmenistan	8,2	11,4	14,1	16,1	16,6	14,0	13,2	10,2	-
Kyrgyz Republic	3,2	4,3	5,6	6,0	5,7	4,2	4,0	4,5	4,5
Tajikistan	2,7	3,2	3,8	4,1	4,3	3,4	3,0	2,8	2,8

Source: KS RK MNE, GKS RU

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