



Uzbekistan

Economic Assessment

For the first quarter of 2004, the Government announced that GDP grew at 4.8% year on year. Although its official plan investment reportedly shot up during this period, and may, with export increases, have boosted growth, official data are difficult to fully reconcile with the tight monetary and fiscal policies and widespread downbeat reports from the private sector. Moreover, official data show that overall capital investment contracted in the first quarter of 2004 by 0.4% from a year earlier. The IMF estimate of 1.5% GDP growth in 2003 stands in contrast to the 4.4% government estimate for 2003 and exemplifies the difficulties in using available statistics for assessing economic developments.

Agricultural output expanded by 6.7% in the first quarter of 2004 from the previous year, according to official figures. For the whole of 2004, the Government revised down its target for raw cotton production to 3.60 million tons from its original target of 3.75 million tons, reflecting a reduced crop area. Industrial growth was officially put at 8.8% in the first quarter, but again, as these data rely on self-reported figures by SOEs and high, undocumented output growth in small enterprises, they should be viewed with circumspection. The production of cars, machinery, and certain chemicals is reported to have increased, but these have high import content and contribute relatively little to real GDP growth. The Government lowered its 2003 industrial growth estimate to 2.8%; according to IMF estimates, the sector contracted. Various indications point to an expansion of the shadow economy, particularly in the services sector, largely because businesses struggle to keep earnings out of strictly controlled official channels.

The budget deficit in 2003 was 0.4% of GDP, down from 0.8% in 2002. State revenues were 24.2% of GDP and expenditures 24.7%, down

from 25.0% and 25.9%, respectively, in 2002. A combination of rate reductions in profit and individual income taxes, special tax and customs exemptions associated with government efforts to encourage local production, and sluggish economic growth were responsible for the lower revenue share. Modest wage increases, lower energy subsidies, and weaker budgetary investment expenditures were the main reasons for the lower expenditure ratio.

The Government reported a fall in inflation from 21.6% in 2002 to 3.8% in 2003, against an IMF estimate of 7.7%. Over the first quarter of 2004, inflation was officially put at 1.1%, down from 5.2% in the first quarter of 2003. The annualized growth in broad money in the first quarter decelerated to about 23% from around 27% a year earlier. Public access to cash stayed restricted and cash payments on transactions continued to benefit, as in 2003, from a 30–40% discount against noncash payments. The Central Bank of Uzbekistan (CBU) further lowered the monthly refinancing rate from 1.7% to 1.5% (19.6% annualized) from July 2004. At end-July, the exchange rate stood at Som1,020/\$1, representing a depreciation of approximately 5% since the establishment of currency convertibility (by government acceptance of IMF Article VIII obligations) in October 2003.

The balance-of-payments situation reportedly improved in the first half of 2004. Imports and exports both rose, according to official sources. However, details are scarce and the real extent of the prominence of state-owned or state-supported trade activity is unclear. IMF data show that the current account surplus jumped in 2003 to about 9% of GDP, mostly due to a surge in exports on account of stronger export volumes of gold and natural gas and higher world prices for cotton and gold. Gross international reserves at end-2003 were officially put at \$1.6 billion, or equivalent to about 6.5 months of imports.

Table 2.19 Selected Economic Indicators, Uzbekistan, 2004–2005, %

Item	2004		2005	
	<i>ADO 2004 Update</i>	<i>ADO 2004 Update</i>	<i>ADO 2004 Update</i>	<i>ADO 2004 Update</i>
GDP growth	4.5	3.0	4.0	3.0
Inflation (CPI)	20.0	10.0	20.0	10.0
Current account/GDP	6.0	6.0	6.0	6.0

Source: Staff estimates.

Policy Developments

As discussed in *ADO 2004*, in order to stabilize and unify exchange rates in the run-up to convertibility, the authorities tightened monetary and fiscal policies but also adopted intensified trade restrictions, erected procedural barriers to accessing cash at commercial banks, and delayed budgetary payments, which resulted in substantial arrears. Subsequently, the authorities have allowed a gradual depreciation of the som but have yet to unwind the large economic imbalances created in 2003. Government payment arrears have persisted.

The trade regime has continued its bias against imports by small traders—mainly of consumer goods—granting preferential treatment to goods and enterprises considered a state priority. In addition, there have been reports of unofficial restrictions on currency convertibility, particularly for imports of consumer goods and items not considered a priority. Moreover, since March 2004, national currency imports and exports have been restricted in an attempt to clamp down on foreign exchange transactions across the border with Kazakhstan.

In the monetary area, broad money growth maintained its declining trend in the first quarter of 2004 with CBU's increased use, since 2002, of indirect monetary policy instruments (mainly CBU certificates of deposit and special deposits held by commercial banks) to control reserve money growth. The authorities do not appear to have sterilized their buildup of foreign exchange reserves but have continued to use cash controls instead of conventional monetary measures. Cash shortages persisted in the first half of 2004 as commercial banks failed to fully meet customers' demands for withdrawals despite the CBU declaration that, as of February 2004, banks would

have unrestricted access to their correspondent accounts with CBU. State efforts to control commercial activity via the banking system, together with the cash shortages, have prompted businesses to curtail their use of banking channels: the ratio of bank deposits to GDP has fallen from the already relatively low level of 8% in 2001 to only 6% in 2003.

The Government raised salaries for public sector workers, pensions and social benefits, and stipends for students at higher, specialized, and vocational educational establishments by 30% from 1 August 2004. It plans to partly offset these added expenditures by a 20% reduction in the public sector workforce. The same month, it added 20% to the negotiated price of cotton, which applies to purchases over the 25% of production that farmers are required to sell to the state at the procurement price (though almost all cotton is still channeled through the state procurement system as no private traders have been licensed).

Some market-oriented structural changes were put into effect. For example, privatization revenues of close to \$40 million were reported in the first half of 2004 from the sale of over 1,000 enterprises, an 80% increase over the same period in 2003, though information on transactions has not been made public. However, stringent investment requirements attached to privatization offers and strict conditions on postprivatization operations continued to deter private investors, especially for any large enterprises on offer. In addition, the authorities undertook measures to partially replace the centralized distribution of some commodities with transactions on commodity exchanges, which serve as clearinghouses for spot transactions, and combined this with price liberalization for selected commodities.

The Government has also continued its efforts to directly steer the economy. For example, the "localization" program—originally announced in 2000 as a means of supporting domestic industry to encourage local production of priority products—has been revamped. This included a new list of projects for products, inputs, and raw materials eligible for state support; new tax exemptions and preferential access to bank credits for eligible enterprises; and a special committee to oversee project implementation.

To date, FDI in Uzbekistan has been relatively

small with the Russian Federation the major source. However, much larger capital flows are in prospect. Russian companies have recently stated their aim of investing close to \$2 billion in Uzbekistan's oil and gas sector and one company in 2004 acquired a 75% stake in the nation's largest mobile phone operator. In addition, the Government has announced that it expected to secure credits of \$955 million from the PRC in the period 2004–2007 for investment projects.

With backing from the authorities, the governments of the PRC and the Russian Federation separately made public their intention to invest a total of about \$3 billion in the country over the next 5 years. It is envisaged that this will be directed mainly to the oil and gas, fertilizer, energy, telecommunications, irrigation, and financial subsectors. In contrast, the US indicated in July 2004 that it would cut \$18 million of annual aid to Uzbekistan, citing disappointing progress toward democracy and a poor human rights record.

Outlook for 2004–2005

The proposed investments from the PRC and the Russian Federation are expected to bolster economic growth, though after the forecast period. Policy reforms and agricultural restructuring are unlikely to provide any substantial growth effect over the forecast period and the main stimulus to growth remains tied to world prices of cotton and gold, which are expected to stay robust over this period. The Government's targets for low broad money growth could lead to a limited expansion in credit to the economy and pose a further constraint on economic growth. Official projections point to an average annual growth rate of about 6% over 2004–2005, against the *ADO 2004* forecast of 4.0–4.5%. The *Update*

forecast is now put at 3% in light of greater than expected difficulty in adjusting to the economic imbalances.

The increase in public sector salaries will lift the revenues of the pension and employment fund (business units' dues to these funds are assessed on salaries). The cost of increased pensions and social benefits as well as larger student grants will be partly offset by the planned reduction in public sector employment. Tax benefits and preferential import duties associated with the Government's efforts to encourage local production will have a negative impact on its revenues. The net effect is that the budget deficit in 2004 is expected to exceed the official target of 1% of GDP but not differ substantially from the *ADO 2004* forecast of about 2%. The absence of detailed data on the composition of government investment spending makes it difficult to assess the implications of lower public investment for future growth.

The authorities will likely continue their efforts to control inflation. Nevertheless, reflecting the higher social support payments and public sector salaries as well as proposed increases in electricity and gas tariffs, inflation over 2004–2005 is now expected to rise to about 10%, but be substantially below the 20% inflation rate forecast in *ADO 2004*. The trade restrictions make it difficult to assess the appropriateness of the exchange rate.

However, a gradual further depreciation of the som over the rest of 2004 is expected as imports linked to the revamped localization program strengthen, though a sharper depreciation would be likely if trade distortions are substantially corrected. The state is expected to maintain its tight control over the external trade regime, and the balance of payments is unlikely to move much from the current account surplus of 6% of GDP projected in *ADO 2004* for 2004–2005.