

Uzbekistan

A favorable export environment and prudent fiscal and monetary policies have driven strong economic performance in the last few years. But in the second half of 2008, the economy started slowing as international commodity prices retreated. Although the global financial crisis has hardly touched the domestic financial sector directly, the economic downturn has slowed exports, remittances, and investment. Rising unemployment and inflation will hinder government efforts to stimulate demand, and successful implementation of anticrisis policies will require acceleration of structural reforms.

Economic performance

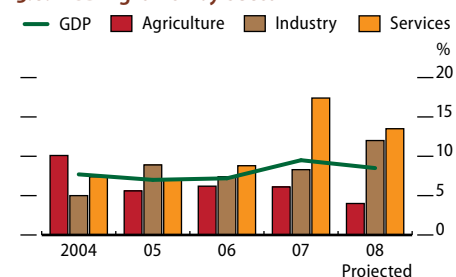
GDP growth in 2008 declined to an estimated 8.5% from 9.5%, largely due to the decline in services growth stemming from the high-base effect of the previous year (Figure 3.8.1). Industry, with 12.0% growth, was led by increased production of fuel, machinery, and metals, which collectively posted a 21.5% expansion (and which accounted for 33.5% of total industrial output). The hydrocarbon and metals-producing subsectors have boomed in recent years as a result of surging global commodity prices, buoyant external demand, and heavy public and private investment. Gold production in 2008 rose by 3%, to 80 tons, and automobile production strengthened.

Services expansion (13.5%) reflected rising receipts from gas transit, burgeoning telecommunications, and a growing financial market. Agriculture lagged behind, growing by only 4.0% in 2008. Drought affected both cereal and cotton production; additionally, degrading soil quality hit cereal output particularly, and a smaller sown area cut cotton production.

Driven by high international prices and strong external demand, exports grew by 25.0% in 2008, with energy, cotton, and metals accounting for half the export revenue. Although toward the end of the year international prices for metals retreated from their historical highs, their average annual levels were still high. Uzbekistan secured a 40% increase for the bulk of its gas exports for 2008, to approximately \$300 per 1,000 cubic meters.

The contribution of current transfers to the current account surplus showed a substantial gain in 2008 due to the sharp increase in remittance inflows, largely from the two main destination countries for migrant workers—Kazakhstan and the Russian Federation. Based on data from the Central Bank of the Russian Federation, remittances from that country through formal channels to Uzbekistan in 2008 are estimated at \$3.3 billion, or 13% of Uzbekistan's GDP, which is twice the prior-year level. Many migrant workers, however, were reportedly returning home because of job losses toward the end of 2008.

3.8.1 GDP growth by sector



Sources: International Monetary Fund, *Regional Economic Outlook, Middle East and Central Asia*, October 2008, available: <http://www.imf.org>; State Statistics Committee of Uzbekistan; staff estimates.

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In a context of numerous import restrictions and importers' reported difficulties in obtaining hard currency for trade purposes, imports grew by only 15.0% to \$7.0 billion. The largest import item was machinery and equipment, mainly in the hydrocarbon and communications subsectors. The current account balance is estimated at \$4.7 billion, or 18.0% of GDP (Figure 3.8.2).

The capital account is expected to have been in deficit by approximately \$1.7 billion in 2008, down from the \$2.1 billion deficit posted in 2007. The narrowing was due to rising foreign investment and lower levels of external debt service. Foreign direct investment rose to approximately \$1.0 billion and the ratio of external debt to GDP declined to 15.4% of GDP.

The greater part of foreign capital inflows came in the first half of the year; the global financial crisis in the second half limited the investment capacity of major investors—Russian and Asian oil and telecoms companies. Large overall surpluses and the Government's conservative external borrowing policy allowed further accumulation of gross official reserves of \$2.7 billion, to an estimated \$10 billion at year-end (Figure 3.8.3).

According to the International Monetary Fund, inflation in 2008 was 13.0%, or slightly above the 2007 rate (Figure 3.8.4). Inflation pressures came from the global rise in food prices in the first 6 months of the year, increases in government-administered wages, hikes in prices of utilities, and depreciation of the local currency against the United States dollar. These pressures, however, were somewhat mitigated by slower money supply growth: M2 decelerated to 32.4% in 2008 as a result of slower growth in net foreign assets, continued accumulation of foreign exchange revenue in the Fund for Reconstruction and Development (FRD), and a greater volume of sterilization operations by the Central Bank of Uzbekistan.

The general government budget is estimated to have posted a surplus of 2.0% of GDP in 2008 (Figure 3.8.5). (Including the surplus of FRD, the government budget surplus amounted to 8.0% of GDP.) Budget revenue increased, because state enterprises benefited from high commodity and utility prices, particularly for hydrocarbons. The revenue gain was sufficient to cover hikes in public sector wages and social spending.

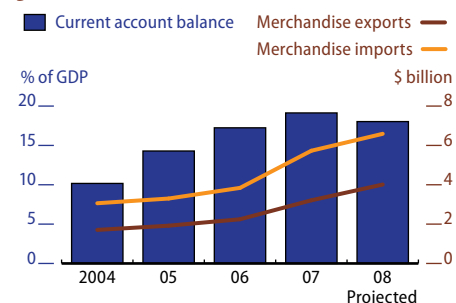
Economic prospects

Due to the isolated and underdeveloped nature of the financial system, Uzbekistan will not be affected by the global financial crisis directly. Instead, the global economic downturn is impacting the economy via exports and remittances.

The contraction in external demand for major export commodities (excluding gas) and the decline in commodity prices in 2008 are expected to continue in 2009–2010. Remittance inflows will shrink as economic difficulties in Kazakhstan and the Russian Federation persist. An increase in gas exports, which are expected to double in dollar terms this year, will partly offset the decline in nonhydrocarbon exports.

The current account balance will remain in surplus, aided by lower import prices for consumer goods and fewer imports of capital goods. Also, the Government is expected to impose tighter import restrictions

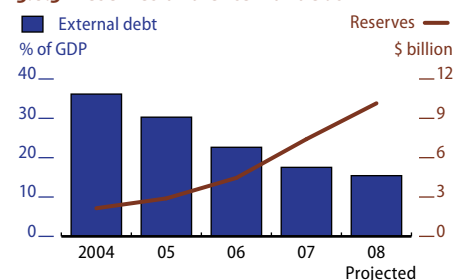
3.8.2 External sector



Sources: International Monetary Fund, Article IV Consultation, July 2008, available: <http://www.imf.org>; staff estimates.

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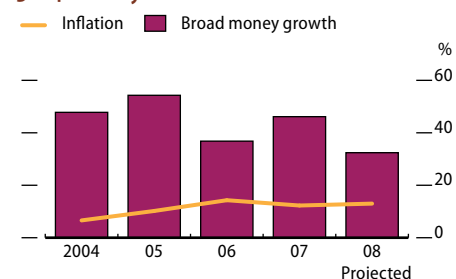
3.8.3 Reserves and external debt



Sources: International Monetary Fund, Article IV Consultation, July 2008, available: <http://www.imf.org>; staff estimates.

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3.8.4 Money and inflation



Sources: International Monetary Fund, *Regional Economic Outlook, Middle East and Central Asia*, October 2008, available: <http://www.imf.org>; State Statistics Committee of Uzbekistan; staff estimates.

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to limit foreign exchange outflows. Moreover, it has announced plans to expand import substitution through public procurement by giving preferential treatment for locally produced goods and services.

Responding to the need to sustain economic growth, employment, and social stability, the Government outlined a large-scale anticrisis package in four presidential decrees at the end of 2008. It is targeted at export promotion, greater demand for domestically produced goods, higher energy efficiency, and more development of small and medium-sized enterprises (SMEs). To help meet these objectives, the Government will increase domestic investment through budget spending and FRD investment. Much of the public investment will be directed toward transport and social services in rural areas. In addition, the Government has pledged to raise all public-sector wages, pensions, and social benefits by 150% during 2008–2010.

The Government wants to boost commercial banks' lending to the economy through central bank loans to the banking sector, recapitalization of several major commercial banks, and increased lending from FRD. The Government will also provide subsidized lending to SMEs. Recognizing the increasing demand for microfinance services, the anticrisis package envisages expansion of credit lines to nonbanking financial institutions by the Microcredit Bank. As well as the additional budget spending, the Government will provide numerous tax reductions, mainly to exporting industries and SMEs.

Overall, the cost of the stimulus package is estimated at 4% of GDP. As a result, the consolidated budget will post a deficit of 0.5–1.0% of GDP in the forecast period. These stimulus measures are expected to help sustain GDP growth at about 7.0% in 2009 and 6.5% in 2010.

Inflation is forecast to stay within its 2007–2008 bands. Inflation pressures will stem from expansionary fiscal and exchange rate policies, but will be offset a little by a government-imposed price cap on energy and utility prices in early 2009, lower prices of imported goods, and the central bank's money market operations. (The central bank has announced plans to increase the volume of its certificates of deposit by 50% this year to sterilize excess liquidity.)

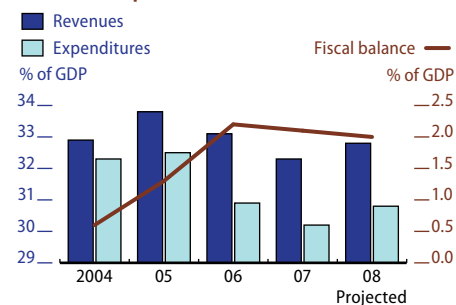
Even with the Government's anticrisis package, the forecasts carry downside risks. The package is only likely to be successful in a context of high-quality public administration, governance, and transparency. Government commitment to these areas is crucial.

Development challenges

To mitigate the adverse impacts of the global economic downturn in the short term, the Government needs to reinvigorate internal demand by generating employment opportunities, increasing access to financial services, and fostering private sector growth.

In the medium term, industrial diversification, long-awaited liberalization of the banking system, trade liberalization, and the strengthening of an enabling environment for private sector development will not only help absorb the impact of the global turmoil with minimal economic and social costs, but will also pave the way for sustained, long-run economic growth.

3.8.5 Fiscal position



Note: The fiscal position excludes the Fund for Reconstruction and Development.

Sources: International Monetary Fund, Article IV Consultation, July 2008, available at <http://www.imf.org>; staff estimates.

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3.8.1 Selected economic indicators (%)

	2009	2010
GDP growth	7.0	6.5
Inflation	12.5	13.0
Current account balance (share of GDP)	11.0	10.5

Source: Staff estimates.