

# Uzbekistan

High commodity prices and buoyant external demand helped generate impressive economic growth and a record current account surplus in 2007. Yet this strong performance, alongside rising capital inflows and the exchange rate policy, created inflation pressure. The outlook for continued rapid growth is favorable, but inflation will likely remain high. Although tax and treasury reforms are under way, the overall reform process needs additional impetus for the country to reach its broader economic development objectives.

## Economic performance

The economy grew by 9.5% in 2007. Industry and services were the major contributors, growing by 12.1% and 26.6%, respectively. Industrial growth was grounded in the increased production and export of metals, gas, and automobiles. Metals are the country's largest single export, and have received significant government investment in recent years. Reconstruction worth \$49.4 million was completed last year at two big mines belonging to Almalyk Mining and Smelting, the country's second-biggest producer of gold and the only producer of copper and zinc.

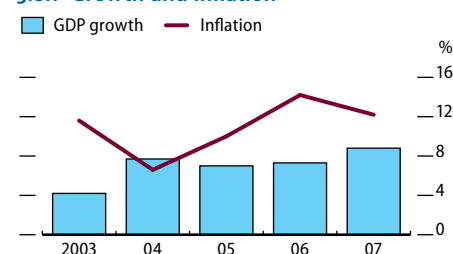
Benefiting from higher gas production, Uzbekistan boosted gas export volumes by about 18% to an estimated 14.5 billion cubic meters in 2007, and secured a 40% gain in the export price. Overall, the fuel and energy subsector grew by 10.1%. Output of the automotive industry, driven by substantial government support in the form of tax exemptions and subsidies, climbed by 27%, with much production going to the Russian Federation and other countries in the Commonwealth of Independent States.

Growth in services stemmed from increased revenues from gas transit, substantial Russian-led investments in the communications sector, and intensified construction activity in housing and infrastructure. Despite deteriorating soil quality, favorable world prices for cotton, rising grain harvests, and greater productivity from privatization of agricultural cooperatives lifted growth in agriculture to 6.1% in 2007.

Although official data put consumer price inflation at around 7% in 2007, estimates by the International Monetary Fund point to 12.3% (Figure 3.8.1). Inflation pressure stemmed from a marked expansion in the money supply, public sector wage rises, and activities related to the general election.

Booming commodity exports and remittances propelled the current account surplus to an estimated \$4.3 billion, or 21.1% of GDP in 2007 (Figure 3.8.2). A heavy export concentration in gold, cotton, and energy (mostly gas), together accounting for 56% of total exports of goods in

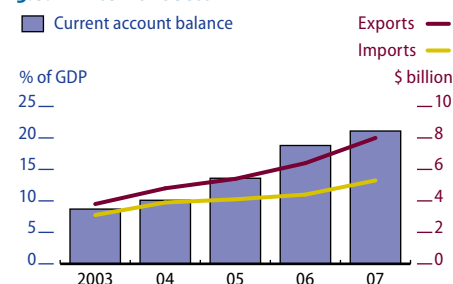
3.8.1 Growth and inflation



Sources: International Monetary Fund, *Regional Economic Outlook: Middle East and Central Asia*, October 2007; staff estimates.

[Click here for figure data](#)

3.8.2 External sector



Sources: International Monetary Fund, *Regional Economic Outlook: Middle East and Central Asia*, October 2007; staff estimates.

[Click here for figure data](#)

2006, as well as strong external demand, allowed the country to reap the benefits of soaring international prices in 2007. As one of the world's largest producers and exporters of gold, Uzbekistan has benefited tremendously from the metal's record prices. Remittances represent another significant foreign currency source, and come primarily from Uzbeks working in Kazakhstan and the Russian Federation.

A conservative external borrowing policy by the Government led to a further reduction in the external debt ratio to a projected 19.5% of GDP by end-2007. The country posted a record level of gross official reserves in 2007, of about \$6.5 billion, equivalent to 15 months of imports of goods and services (Figure 3.8.3). In addition to vibrant export performance, the long-standing restrictive import policy has helped foster the current account surplus and a large accumulation of official foreign reserves.

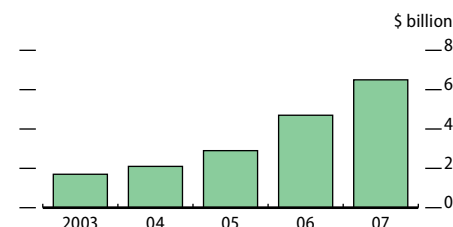
The current account surplus and foreign direct investment inflows put upward pressure on the exchange rate, with the result that the central bank intervened in the foreign exchange market to prevent a nominal appreciation of the local currency, the sum, against the dollar, continuing a policy aimed at boosting exports. Indeed, over the year the sum depreciated by about 4% against the dollar. Intervention, which resulted in an estimated \$1.8 billion net increase in official reserves in 2007, created pressures for growth in bank liquidity and monetary expansion. To mitigate them, the central bank expanded its open-market operations, mainly by selling central bank certificates. The impact of these operations, however, was partly offset by a reduction in reserve requirements for local deposits from 15% to 13%. Money supply grew rapidly, by an estimated 46% over the year, up from 36.8% in 2006 (Figure 3.8.4).

The consolidated general government budget is expected to have recorded a surplus of 2.3% of GDP in 2007, somewhat less than in 2006 as the earlier surge in revenues decelerated (Figure 3.8.5). Wages and pensions were raised twice during the year, by 25% in August and by 20% in November, though these were counterbalanced by moderation in planned capital spending and continued strong government revenues, which are estimated at about one third of GDP for 2007. The strong budget performance of the past 2 years was driven by tax reforms, growing customs receipts, and increases in utility prices. However, still more revenue strengthening will be required as the Government has pledged to raise all public sector wages, pensions, and social benefits by 150% by 2010, relative to 2006.

The Government has initiated important reforms in the public sector (and see Box 3.8.1). In January 2008, Parliament approved a substantially revised tax code. Consistent with the long-standing policy of easing the tax burden, the rate of unified tax for micro- and small enterprises was reduced from 10% to 8%, and the rate of corporate income tax for banks was lowered from 17% to 15%. The new code also introduced an excess profits tax for "subsurface users" extracting or producing cathode copper, cement, polyethylene granules, and gas. The tax rates are 60% for cathode copper and 75% for all other commodities. The taxable base for the excess is defined as the difference between the price set by legislation and the selling price.

Although general confidence in the banking system has been rising, the ratio of broad money (M2) to GDP is low (10.3% in 2006), which

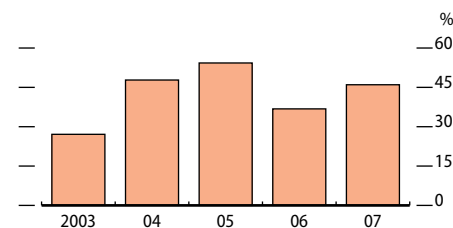
### 3.8.3 Gross international reserves



Sources: International Monetary Fund, *Regional Economic Outlook: Middle East and Central Asia*, October 2007; staff estimates.

[Click here for figure data](#)

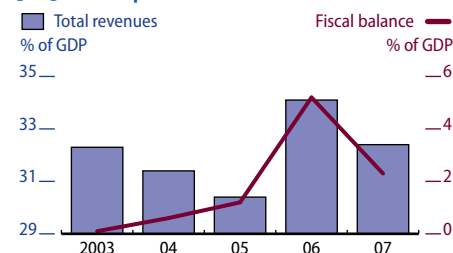
### 3.8.4 Broad money growth



Sources: International Monetary Fund, *Regional Economic Outlook: Middle East and Central Asia*, October 2007; staff estimates.

[Click here for figure data](#)

### 3.8.5 Fiscal position



Sources: International Monetary Fund, *Regional Economic Outlook: Middle East and Central Asia*, October 2007; staff estimates.

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suggests that banking still plays a relatively minor role in the economy. The fact that the tax authorities are allowed to check taxpayers' bank accounts undermines confidence in banking—as does the central bank's anti-inflationary effort of limiting the volume of cash that depositors may withdraw, which induces greater holdings and transactions in cash.

## Economic prospects

World prices of gold, cotton, and gas seem set to stay buoyant over the next couple of years (Figure 3.8.6). The Government plans to continue promoting development of the gold sector and recently adopted an extensive program of modernization and technical renovation at Almalyk Mining and Smelting for 2008–2012. The price of cotton is expected to keep on rising, reflecting a rundown of global stocks and a strengthening of demand. The People's Republic of China, for example, is expected to become a more important buyer of cotton. For 2008, Uzbekistan once again negotiated substantial price rises for gas exports.

Apart from strong price incentives for increased commodity production, industry will remain a major contributor to growth through expanded automobile production, following General Motors' investment in UzDaewooAuto. Greater investment in communications and hydrocarbons, much by Asian and Russian companies, as well as government infrastructure spending, will maintain construction's strong expansion. Moreover, government policy to raise wage levels should ensure that consumer demand remains buoyant. All these factors indicate that the economy should grow by around 7–8% in the forecast period.

Healthy external demand and surging commodity prices, coupled with greater remittances and import controls, are expected to keep the current account surplus at 18.5% in 2008 and 17.5% in 2009. Exports will continue to flow toward the Russian Federation and neighboring countries. With the strong current account surplus, gross official foreign exchange reserves should keep building. This will sustain inflation pressure in the economy, because the monetary authorities are unlikely to be able to fully sterilize the liquidity created by continuing the policy of gradual nominal depreciation of the sum.

The conservative fiscal stance is expected to be kept in place, leading to a positive fiscal balance and so assisting monetary policy efforts. Still, the central bank's commitment to currency depreciation will likely result in persistent rapid monetary expansion. This and planned increases in utility tariffs are expected to mean little relief in inflation.

## Development challenges

The benign outlook may deter the Government from embarking on major structural reforms in the forecast period, even though large foreign exchange reserves, a low level of external debt, and rising fiscal revenues put it in a comfortable position to push through long-awaited reforms aimed at industrial diversification, banking and trade liberalization, and private sector development. The authorities are in a position to exploit the present growth momentum and substantially expand reform initiatives in order to secure sustainable growth for the longer term.

### 3.8.1 Restructuring the budget

The Government has established a treasury, which, under a public finance reform management project, is setting up a treasury single account and is streamlining the budget execution mechanism. In 2007, it implemented treasury operations at the regional level, closed thousands of accounts of spending units, and introduced territorial single treasury accounts. The major medium-term hurdle for these reforms will be the consolidation of all government fiscal accounts into a single account, including those of the Government's extrabudgetary funds.

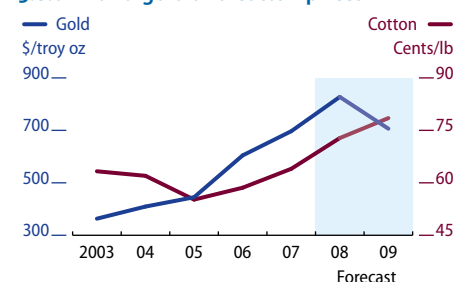
The Reconstruction and Development Fund (RDF) was established in 2006 with capital targeted to reach \$1.0 billion by 2010, though in fact it had already reached \$1.2 billion at end-2007 because of a strong budgetary position. According to the State Investment Program, eight high-priority investment projects were approved for financing from RDF funds in 2008, mainly in the chemical and hydrocarbon sectors. RDF's role in these projects will focus on procuring capital goods.

### 3.8.1 Selected economic indicators

	2008	2009
GDP growth	7.8	7.2
Inflation	10.9	10.5
Current account balance (% of GDP)	18.5	17.5

Source: Staff estimates.

### 3.8.6 World gold and cotton prices



Source: Economist Intelligence Unit, *Global Outlook*, March 2008.

[Click here for figure data](#)