Uzbekistan

Growth remained robust at 8.0% in 2013, led by wage and pension increases, high public investment spending, and large remittances. Recovery in external demand raised the current account surplus to 3.7% of GDP. Continued high public spending, strong private consumption, and an improving external environment are projected to keep growth near 8.0% in 2014 and 2015.

Economic performance

GDP grew by 8.0%, down slightly from 8.2% in 2012 but making 2013 the seventh consecutive year of growth at 8.0% or better. On the supply side, the main contributors to growth were industry including construction, which expanded by 9.0% (up from 8.0% in 2012) and services at 8.8% (down from 10.4%). In industry, the ongoing modernization program, backed by substantial public investment and recovering external demand, boosted the production of machinery, textiles, construction materials, and foodstuffs. Services posted healthy growth as retail trade, telecommunications, finance, and catering all recorded double-digit increases. The continuing housing boom raised construction growth to 16.6% from 11.5% in 2012. Agriculture grew by 6.8% (versus 7.0% in 2012), supported by favorable weather and record harvests of the key cereal and vegetable crops (Figure 3.8.1).

On the demand side, wage and pension increases and substantial remittance inflows boosted private consumption, while net exports also increased. The government raised public sector wages and pensions by 21% in 2013 and maintained large-scale public investment in industry and housing. State investment spending grew by 11.0% to $11.3 billion, enabling gross fixed capital formation to rise by 19.8%, following 11.1% growth in 2012. An increasing share of investment is financed by the Fund for Reconstruction and Development (FRD), a sovereign wealth fund with assets exceeding $15 billion.

The government reported that inflation in 2013 was 6.8% (Figure 3.8.2), below the 7%–9% target range set by the Central Bank of Uzbekistan. (The International Monetary Fund, using the same data but different methods, estimated inflation to be unchanged from 2012 at 12.1%.) Despite public wage and pension increases, tariff hikes, and greater exchange rate depreciation, inflation was held in check by ongoing global food price deflation, lower import costs, and the central bank’s sterilization of excess liquidity. On 1 January 2014, the central bank reduced its main policy rate from 12% to 10%, signaling lower inflation expectations for 2014.
The continuing if slower accumulation of net foreign assets put upward pressure on reserve money. In response, the central bank increased its issuance of certificates of deposits, mainly to commercial banks; the volume of sterilization operations, including sales of certificates of deposits on the open market, rose by 20% in 2013. These activities helped slow broad money growth to around 26% from 27% in 2012.

Uzbekistan’s state-dominated banking sector has promoted industrial development by channeling public investment to strategic industries and increasing total bank lending, while keeping banks sound. At the end of 2013, the sector’s capital adequacy ratio reached 24.3%. Aggregate capital in the banking sector rose by 25%, helping expand total credit by 31%. In August 2013, Moody’s Investors Service issued a stable outlook for the country’s banking sector, citing healthy bank profits, improvements in asset quality, stable liquidity, limited reliance on wholesale funding, and few problem loans, averaging less than 10% of total lending.

The government reported a budget surplus of 0.3% of GDP in 2013, though the surplus in the augmented budget, which includes the FRD, is estimated to have narrowed to 1.8% of GDP from the 4.7% recorded in 2012 (Figure 3.8.3). Budget revenues (including the FRD’s estimated revenues) are estimated to have declined slightly, from 38.6% of GDP in 2012 to 35.8% in 2013, in line with declining international prices for key export commodities. Rising government spending, particularly for health and education, helped slightly raise budget expenditures (including the FRD’s estimated expenditures) from 33.9% of GDP in 2012 to 34.0% in 2013. The government adopted a new budget code in 2013, streamlining legislation on public finance management and strengthening the enforcement framework.

The current account surplus rose to 3.7% of GDP, reflecting a larger trade surplus, as external demand started to recover and destinations for key exports diversified (Figure 3.8.4). Despite lower international prices, export earnings grew by 14.7%, mainly on higher gas exports. Declining prices for natural gas exports to the Russian Federation led Uzbekistan to begin shifting exports to other markets, starting in April 2013 to export gas to the People’s Republic of China (PRC). Data through September 2013 showed a substantial 80% jump year on year in energy exports, likely reflecting natural gas exports to the PRC.

Imports of goods and services rose by 9%, as continued infrastructure development and industrial modernization required more imports of capital goods and services. Remittances and compensation from abroad grew sharply. Remittances and income from the Russian Federation are estimated to have risen by 20.7% in the first 9 months of 2013 to $4.9 billion (Figure 3.8.5).

The government reported foreign investment inflows of $3.0 billion, up from $2.5 billion in 2012, mainly into oil and gas, petrochemicals, and automobile manufacturing. External debt is estimated at 13% of GDP. Gross official reserves are believed to have increased to $19.4 billion from $18.4 billion at the end of 2012.
Economic prospects

Higher government spending and private consumption are projected to support growth at 8.0% in 2014 and 7.8% in 2015 (Figure 3.8.6). Improvement in the external environment should raise demand for exports. On the supply side, investment-led industry and consumption-led services will remain the key drivers of growth. Planned wage and pension increases exceeding the inflation rate should, combined with remittances, boost private consumption and promote services. Agriculture is projected to grow by 6.5% each year, reflecting stable production in cotton and wheat.

The government will continue its large-scale investment program, which is set to conclude by 2015. Its aim is to increase industry’s share of GDP to 28% in 2015 from 24% in 2013. The state investment program for 2014 envisages an investment package of $14.3 billion (equal to 23% of GDP), of which $3.9 billion is to be financed externally. A growing share of investment is coming from the Russian Federation and the PRC, Uzbekistan’s main trading partners. Gross fixed capital formation is forecast to rise by 10% in 2014 and 13% in 2015.

As in 2012 and 2013, the government will stimulate domestic consumption in 2014 and 2015, most likely by raising public sector wages, welfare payments, and pensions. If external risks materialize, the government is expected to implement additional measures, including consumer lending, to sustain household spending. These developments are forecast to raise private consumption by 4.5% in 2014 and 6.0% in 2015.

Inflation is forecast at 11.0% in 2014 and 10.0% in 2015, reflecting higher government spending, greater accumulation of net foreign assets, and the continued depreciation of the local currency (Figure 3.8.7). Anticipated declines in global food prices and lower import costs could partly offset these pressures. Nevertheless, inflation will remain a key challenge, requiring that monetary and fiscal policies be closely coordinated.

The government projects a consolidated budget deficit of 1.0% of GDP in 2014, to support economic expansion. Including expected FRD surpluses, the augmented budget is projected to post surpluses of 2.9% of GDP in 2014 and 2.5% in 2015. Augmented budget expenditures are forecast to dip slightly, to 33.5% of GDP in 2014 and 33.7% of GDP in 2015, as the government offsets wage and pension increases by trimming less critical spending. Despite the announced cuts in the profits tax from 9.0% to 8.0% and the personal income tax from 8.0% to 7.5% for the lowest taxable income bracket, higher revenue collection, reflecting the external environment and continued tax reform, is forecast to yield augmented budget revenues equal to 36.4% of GDP in 2014 and 36.2% in 2015.

The current account surplus is forecast at 4.7% of GDP in 2014 and 3.6% in 2015, as recovering global trade should boost the trade surplus and transfers. Merchandise exports are projected to rise by 11.9% in 2014 and 6.0% in 2015, while imports are forecast to increase by 10.3% in 2014 and 10.9% in 2015, reflecting continued public spending for infrastructure and industrial modernization. Remittances are likely to reflect the economic situation in the Russian Federation. Gross official
reserves are expected to reach $21 billion by the end of 2014, covering about 20 months of imports, and $22 billion by the end of 2015, covering 19 months (Figure 3.8.8).

The key downside risks are continuing economic slowdown in the European Union and uncertainties regarding the Russian Federation; how US tapering of quantitative easing may affect the Russian Federation through lower oil prices, tighter access to international capital markets, and higher capital outflows; and decelerating import demand from the PRC as its economy slows.

Policy challenge—improving financial services

Uzbekistan’s banking sector—which represents 95% of the finance system—is stable but remains at an early stage of development and faces many challenges. Financial intermediation is underdeveloped and unable to meet growing need in the private sector. Independent business surveys identify the lack of access to finance (including credit, cash, and foreign exchange) as a major challenge facing Uzbekistan’s private sector. Underlying this problem are three key factors: At 25% of GDP, financial intermediation is barely half the average in developing countries in Europe and Asia. The banking sector accounts for only 37% of the GDP in terms of assets, while total loans at 21% and total deposits at 24% are among the lowest in the region. A third of private sector demand for external financing remains unmet.

The sector is highly concentrated, with state-controlled banks holding 76% of total assets in 2012. While supporting the government’s industrial modernization policies, banks have not done much to promote private sector development, and credit to the private sector is substantially lower than in other transitional economies (Table 3.8.2). The need to maintain noncore functions, such as monitoring and registering import contracts, hinders banks’ ability to meet private sector demand.

The government recognizes the importance of financial sector reform and supports financial activities through a variety of legal and regulatory frameworks, the most important being Presidential Resolution No. 1438 of November 2010: On Priority Areas for Further Reforms and Sustainability Improvement of Country’s Finance and Banking System in 2011–2015 and Achieving High International Ratings. This resolution elaborates priorities for further reform, including comprehensive programs for banks, nonbank institutions, and microfinance, and covering the extension of nonbank credit networks and their range of services.

The government’s reform agenda is to maintain the sector using state support, credit infrastructure, risk management, and banking supervision. Additional reforms are needed to prioritize private sector access to finance through competition, diversification, and market-driven allocation and distribution of resources. These additional reforms would strengthen the ability of banks to provide efficient intermediation, thereby supporting government targets for growth and improved well-being.