

**FOR
INFORMATION**

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To: Members of the Executive Board

From: The Secretary

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Republic of Uzbekistan—Assessment Letter for the Asian Development Bank and World Bank
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▪ **Background**

1. **Uzbekistan continues to make good progress on reforms and entrenching macroeconomic stability.** Significant improvements have been made to the budget, the monetary policy framework, and operations of state enterprises. In 2019, growth was robust at 5.6 percent, while inflation continued to decline, averaging 14.5 percent. However, the global Covid-19 crisis has changed the near-term outlook and the authorities have announced measures to boost healthcare, protect the vulnerable, and support firms and workers. Growth is expected to slow markedly in 2020 and fiscal and external deficits are expected to widen. But with low public and external debt and adequate external and domestic buffers, Uzbekistan's macroeconomic outlook remains robust. The authorities have reiterated their commitment to sustainable macroeconomic policies and continued economic reforms: maintaining moderate fiscal deficits and public debt once the outbreak abates, improving budget processes, lowering inflation, reforming the financial system, and restructuring state enterprises.

▪ **Recent Developments and Outlook**

2. **Uzbekistan's authorities have acted quickly to contain the impact of the Covid-19 virus.** The first case of Covid-19 was reported in Uzbekistan on March 15, 2020. The government promptly closed schools, cancelled religious and social gatherings, and suspended most border crossings. On March 19, the President announced anti-crisis measures including additional health care spending, support to firms and workers, and additional social support. The government also created a USD1 billion (1.5 percent of GDP) Anti-Crisis Fund to cover these costs and is seeking equivalent financing from multilateral donors.

3. **The Covid-19 crisis is having a strong negative impact on the economy, with the 2020 outlook worsening significantly.** The main economic channels are a fall in trading partner demand and natural gas prices, lower remittances and labor income—particularly from migrants in Russia, and lower activity as measures to contain the Covid virus reduce output, particularly in tourism and transportation. Higher gold prices and fiscal stimulus will help partially offset these effects. Overall, in 2020 real growth is projected to fall from 6 percent pre-crisis to 1.8 percent currently. In 2021, growth is expected to bounce back to 7 percent as economic activity rebounds.

4. **The fiscal deficit is expected to increase on the back of the economic slowdown and measures to contain the crisis.** In 2019, Uzbekistan implemented major tax reforms in 2019, which lowered rates on private firms, SMEs, and labor income and broadened the tax base. Adjusted revenues¹ performed better than expected, reaching 28.2 percent of GDP. Expenditures, particularly central government investment, increased in line with revenues generating a broadly balanced fiscal position. However, policy lending by the Fund for Reconstruction and Development (FRD) was significantly higher than planned and the overall fiscal deficit, including policy lending, amounted to 4 percent of GDP. Higher borrowing by the government and state enterprises from official creditors caused public and publicly guaranteed debt to rise to 29 percent of GDP at end-2019. For 2020, staff currently projects a fiscal deficit of 3.3 percent of GDP (before policy lending) and an overall deficit of 5.0 percent of GDP, including policy lending. Additional external borrowing to finance an increase in the fiscal deficit due to the Covid crisis will raise PPG debt from 29 percent of GDP at end-2019 to about 33 percent of GDP. But the fiscal deficit

¹ The government of Uzbekistan has carried out significant reforms to its fiscal reporting and is expected to bring them in line with Government Financial Statistics standards in 2020. In the meantime, IMF staff adjusts revenues and expenditures for international comparison.

and debt ratios are still be moderate by international standards and the most recent debt sustainability analysis indicates that Uzbekistan remains at low risk of debt distress.

5. **After improving in 2019, Uzbekistan's external position is projected to worsen in 2020.** At the time of the 2019 Article IV consultation, Uzbekistan's external position was assessed as moderately weaker than implied by economic fundamentals and desirable policies. Nonetheless, benefitting from strong external demand, the current account deficit narrowed to 5.5 percent of GDP, as growth of exports outpaced imports, external debt was 43.5 percent of GDP and FX reserves stood at a strong \$29 billion. In 2020, the Covid-19 crisis is expected to weaken trading partner demand and remittances and staff projects the current account deficit will increase to 9.5 percent of GDP. On the financial account, foreign direct investment and issuance of external bonds by the government and state enterprises are projected to decline. Without additional financing, reserves would decline by USD3 billion bringing reserve cover down to about 11 months of imports of goods and services.

6. **With the Covid-19 crisis, the outlook is subject to a higher degree of uncertainty and downside risk.** External risks could arise from further deterioration in trading partner demand, a fall in commodity prices—particularly gold or natural gas, or a sharper than projected fall in remittances or labor income. Domestically, measures to contain and mitigate the virus could result in a larger or more prolonged fall in GDP. Lower trade and GDP or higher expenditures for health, social protection, or support to individuals and firms could cause the fiscal deficit to increase further. The crisis also increases the potential for longer term problems, such as disrupted supply chains and lower tourism and remittances.

■ Economic Policies

7. **The government has made good progress on fiscal reforms, and its response to the Covid crisis is broadly appropriate.** Recent reforms include bringing major fiscal operations on budget, implementing significant tax reforms, and parliament's approval of the budget for the first time. In 2020, an increase in expenditures on health, social production, and support to firms and workers is appropriate to deal with the Covid crisis. The government has fiscal space to accommodate an increase in the fiscal deficit. Going forward, the government should continue to improve tax administration and public financial management. Adhering to its annual cap of USD 4 billion in new PPG debt would stabilize the debt to GDP ratio around 35 percent.

8. **Prior to the crisis, the CBU appropriately tightened monetary policy but could loosen if warranted to support the economy.** The CBU has kept the refinancing rate at 16 percent since 2018, but interest rates effectively increased in January 2020 when the rate on new policy loans was raised to the refinancing rate. Monetary tightening was appropriate in early 2020 to reduce excessive policy lending and reduce inflation, which has been driven by nominal exchange rate depreciation, gradual liberalization of administered prices, and lagged public wage adjustments. To deal with the Covid-19 crisis, the CBU can loosen monetary policy if warranted by developments but the government should avoid a return to subsidized policy lending. As the Covid-crisis abates, the CBU aims to reduce consumer inflation to 10 by 2021 and 5 percent by 2023. The CBU continues its neutral intervention policy, whereby purchases of domestically produced gold are offset by sales of foreign exchange. Nonetheless, the exchange rate depreciated 14 percent in 2019. Since the beginning of 2020, the exchange rate against the dollar has remained broadly stable due to strong FX sales by households, while CBU intervention to prevent excessive volatility appears to have played a minor role. However, greater exchange rate flexibility may be required as the external environment deteriorates.

9. **Financial sector reform is progressing and the CBU is encouraging banks to support firms affected by the Covid crisis.** In 2019, the authorities approved a new banking law and took steps to

reform state banks, including: (i) limiting FRD funding, ii) improving balance sheets, iii) centralizing management oversight at the Ministry of Finance, and iv) set corporate governance objectives. To deal with the Covid crisis, the CBU has encouraged banks to consider grace periods on principal repayments by firms in affected sectors on a case-by-case basis. Moreover, the government has announced subsidies for interest payments to support households and SMEs. The worsening economic situation could lower banks' income and raise nonperforming loans, but strong financial indicators and recapitalization at end-2019 should help banks deal with these risks. Once the crisis abates, a challenge is to further orient state banks towards commercial lending and to attract strategic investors to support the modernization of the banking system.

10. **The authorities have made good progress on structural reforms and emphasized their continued commitment despite the crisis.** Major structural reforms have included trade and current account liberalization, freeing up price controls and raising energy prices, implementing tax reforms favorable to private sector businesses and workers, and improving the operations of state enterprises. The business environment is improving, and several international corporations have announced investment in Uzbekistan. The authorities have emphasized their ongoing commitment to reforms, including on public governance and corruption, despite the current crisis. Additional reforms should prioritize additional trade and price liberalization, restructuring state enterprises, and steps to promote competition and the private sector.

■ IMF Relations

11. **Surveillance.** The IMF Executive Board concluded the 2019 Article IV Consultation on May 9, 2019 (see [IMF Country Report No. 19/129](#)). Uzbekistan is on a standard 12-month cycle. The next Article IV mission is expected to occur in fall 2020.

12. **Capacity Development.** In recent years, the IMF has significantly increased its technical assistance to Uzbekistan. Areas of focus include tax policy, tax administration, public financial management, medium-term debt management, monetary and FX operations, bank stress testing, and economic statistics (i.e., on the external sector, government finance, monetary and financial surveys, and national accounts).