Uzbekistan

The government responded to the recent global financial and economic crisis with a well structured and timed anticrisis program. The program substantially increased domestic investment to create employment opportunities that offset the impact of the crisis on exports. The government has strengthened its efforts to diversify the economy through the private sector. Further acceleration of sector modernization will help greater private sector mobilization. The recovery of the global economy will improve external demand, providing an opportunity to accelerate reforms.

Economic performance

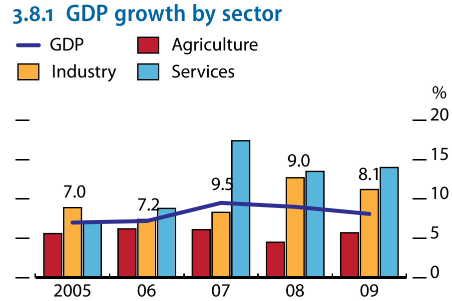
Despite the global recession and economic contraction among its major trading partners, Uzbekistan continued its strong economic performance in 2009 with GDP growth of 8.1% (Figure 3.8.1). The economy was affected by the recession through weaker external demand and lower remittance inflows.

The government responded to the recession early with a large-scale anticrisis program for 2009–2012, which was adopted at end-2008. Measures included substantial public infrastructure investment, tax preferences to exporting industries and small and medium-sized enterprises, increases in public sector wages, and recapitalization of commercial banks. The program was financed through the government budget, state-owned enterprises (SOEs), and the Fund for Reconstruction and Development (FRD), a sovereign wealth management fund established in 2006. Healthy budget revenues and good export performance of gold and natural gas supported the program's implementation. As a result, GDP growth was sustained by output gains in industry, including construction (11.2%) and services (14.0%).

Nonconstruction industrial growth is attributable to increased production of hydrocarbons, machinery, and chemicals, which together accounted for 42% of total industrial production. These three subsectors combined posted growth of 13.1%. The performance of other industrial subsectors was more modest, with the output of nonferrous metallurgy (mainly gold, silver, and copper) growing by 2.6%.

Within industry, construction shot up by 33.1%. This gain was driven primarily by an increase in fixed capital investment. According to official data, such investment rose by 24.8% in 2009. Construction output was lifted by public infrastructure development projects in rural areas. Notable sources of construction demand were large SOEs under government-led sector modernization and renovation programs (primarily manufacturing and mining). The share of fixed capital investment in GDP increased from 23.0% in 2008 to an estimated 26.1% in 2009.

3.8.1 GDP growth by sector



Sources: International Monetary Fund. 2008. *Article IV Consultation*. July. http://www.imf.org; State Statistics Committee of Uzbekistan; ADB estimates.

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This chapter was written by Iskandar Gulamov and Kiyoshi Taniguchi of the Uzbekistan Resident Mission, ADB, Tashkent.

Rapidly growing telecommunications and financial markets were one of the major contributors to growth in services: mobile subscriber numbers have increased 10-fold in less than 4 years. The financial services market is growing fast in areas of microfinancing and bank debit card processing. In response to rising demand for credit from microenterprises, especially in rural areas, the volume of microfinance lending reached $200 million in 2009.

Agriculture posted growth of 5.7%. Although difficult climatic conditions impacted the cotton harvests, increased production of cereal crops and vegetables supported sector growth.

The government reported that foreign direct investment in 2009 increased by 80% from 2008. The bulk of the increase came from expansion of activities in the hydrocarbons and communications sectors. In December 2008, the government established the first free industrial-economic zone in the Navoi region (FIEZ Navoi), which provides tax and customs preferential facilities for foreign investors. By end-2009, the government had signed 37 investment agreements with various foreign investors for FIEZ Navoi amounting to more than $500 million. The first investment outlays are expected this year.

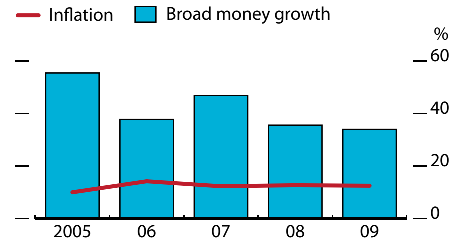
Inflation has been falling since 2008 despite inflation pressures stemming from a nominal depreciation of the exchange rate against the US dollar (of around 10% in 2009) and public sector wage increases. Such pressures were balanced by lower global commodity prices, coupled with administrative price caps on energy and utilities. The government reported end-period consumer price inflation of 7.4% for 2009. The latest estimate of the year-average consumer price index by the International Monetary Fund is 12.5%. Broad money growth is estimated at 34.0% in 2009 (Figure 3.8.2).

The depreciation of the local currency supported exports. Sharp falls in the Kazakhstan tenge and Russian ruble against their respective major trade partners added downward pressure on the nominal exchange rate.

The main elements of the anticrisis program implemented through fiscal policy were recapitalization of commercial banks to support lending; increased public infrastructure development to support job creation; and tax exemptions to support exporting industries and small and medium-sized enterprises. The government also increased public sector wages by 40% on average in 2009. These expenditures were offset by strong revenue receipts stemming from high export prices (especially for gold and gas) and tax reforms. The general government budget is estimated to have posted a surplus of 0.2% of GDP in 2009. Including the FRD, the consolidated budget surplus is estimated at 4.4% of GDP (Figure 3.8.3).

The crisis had impacts on exports and remittances. Exports to Uzbekistan's main markets, namely Kazakhstan, the Russian Federation, and Ukraine, and remittances from Kazakhstan and the Russian Federation, were heavily affected. Nonhydrocarbon exports contracted by 11% in 2009. Machinery (with a 61% decrease to $341 million) and cotton (a 6% drop to $1.0 billion) were among the worst hit, but their lower export revenues were offset by strong global demand for gold and income from natural gas sales to the Russian Federation (the largest customer). Hydrocarbon exports increased by 41% to $4.0 billion. With the gold and gas prices hitting records, export revenue increased by about 2.0% relative to 2008.

3.8.2 Inflation and money



Sources: International Monetary Fund. 2009. *Regional Economic Outlook, Middle East and Central Asia*. October. http://www.imf.org; ADB estimates.

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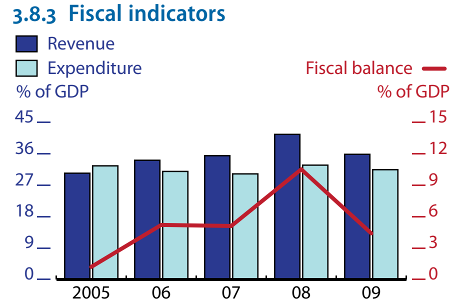
3.8.3 Fiscal indicators



Sources: International Monetary Fund. 2009. *Regional Economic Outlook, Middle East and Central Asia*. October. http://www.imf.org; ADB estimates.

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The growth of imports is estimated at 25.8% in 2009. As in past years, machinery and equipment were the largest import items, reflecting infrastructure development. The sharp fall in export growth, increased imports, and lower remittances cut the current account surplus to an estimated 12.0% of GDP at end-2009, down from 16.7% in 2008 (Figure 3.8.4).

In the framework of its anticrisis program for 2009–2012, the government will continue its infrastructure development initiatives as well as sector modernization programs. This implies significant investment commitments, most of which will be financed by domestic banks, the FRD, and SOEs. Domestic investments by SOEs will be geared toward the hydrocarbon, energy, chemical, and transport sectors. Foreign direct investment will also provide important financing for investment. The government's investment program envisages a $2.4 billion inflow of foreign direct investment in 2010, out of which $2.0 billion will be directed to hydrocarbons. In April 2009, the national oil and gas company, Uzbekneftegaz, established a $2.5 billion international joint venture to produce gas-to-liquid synthetic fuel.

Due to the active industrial policy, foreign investments are expected to increase steadily in the near future. At FIEZ Navoi, 16 investment projects for a total amount of $200 million are forecast to start in 2010. A major part of the foreign investment is expected to be from Asia and the Middle East. The government plans to attract about $1.0 billion of investment into FIEZ Navoi in the medium term. It has supported the private sector through reductions in rates of unified and fixed taxes, as well as value-added tax refunds and soft loans through commercial banks for exporters.

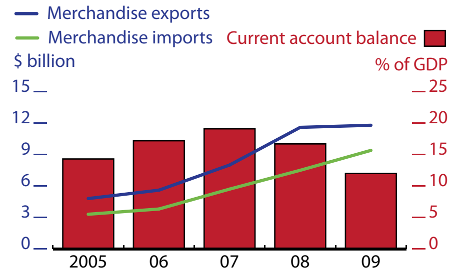
Economic prospects

Due to the economic recovery of the major trading partners as well as the government's active industrial policies, improved export performance and higher investment inflows are expected to be major drivers of growth in the forecast period (at 8.5% and 9.0%). International prices for Uzbekistan's major export commodities look favorable in 2010 and 2011 (Figure 3.8.5).

The downside risks to these forecasts lie in external factors related to the situations in the main trading partners, as well as persistent fundamental imbalances in industrial countries. On the domestic side, timely implementation of the investment program and continued efforts on sector modernization would ensure intended outcomes of the government's anticrisis program. Well-designed public and private investment, including commercial bank lending, will benefit a broader population through improved access to credit and increased employment opportunities.

The government will continue increasing its social and infrastructure expenditures while broadening the tax base and reducing tax rates. The 2010 budget, approved by Parliament at end-December 2009, envisages increasing these expenditures to 13.5% of GDP in 2010, up from an estimated 11.5% in 2009. The rates of both corporate and personal income taxes will be decreased to stimulate business investment and private

3.8.4 Current account indicators



Sources: International Monetary Fund. 2008. *Article IV Consultation*. July. http://www.imf.org; ADB estimates.

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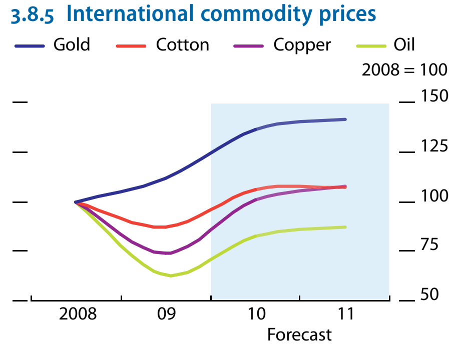
3.8.1 Selected economic indicators (%)

	2010	2011
GDP growth	8.5	9.0
Inflation	9.3	9.0
Current account balance (share of GDP)	13.0	14.0

Source: ADB estimates.

3.8.5 International commodity prices



Note: Prices of commodities are based on US$ prices.

Sources: World Bank. 2010. *Global Commodity Markets*. www.worldbank.org/globaloutlook; Bloomberg (accessed 8 March 2010); Economic Intelligence Unit. 2010. *Global Outlook*. March; ADB estimates.

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consumption. The corporate and personal income tax rates will fall by 1 percentage point to bring rates to 9% for corporations, 8% for small businesses, and 11% for individuals. The revenue will be sustained by the recovery in international commodity prices for certain exports that weakened in 2009, counterbalancing the increasing expenditures. The consolidated budget, including the FRD, is seen posting a surplus of 5.5% of GDP in 2010 and 6.5% of GDP in 2011.

Investment will also be boosted by increased bank lending and FRD resources. The banking sector increased its lending to small businesses by 50% in 2009, and this trend is expected to continue in 2010 and 2011 in light of significant demand for small and micro-lending. A new direction in the investment activities will be residential construction. The rural residential housing construction program for 2010 plans to allocate up to SUM588.7 billion ($390 million) for this purpose. A large portion of funding will come from the new Rural Construction Bank, established in 2009, in which the government is the majority shareholder.

Strong external demand and rising exports will stimulate growth in net foreign assets and the money supply, creating inflation pressures that will be boosted by the large increases in public sector wages. It is expected that nominal depreciation of the sum will be gradual. Thus, fully sterilizing the excess liquidity from the large foreign exchange inflows may be a challenge. As a result of these factors, the government forecasts inflation at about 9% in 2010–2011.

The gradual recovery of the global economy and expected growth of world trade will underpin the current account surplus. The country will benefit from the international prices of its main export commodities, which will stay high on rebound.

Export gains will be partly offset by rising imports. Import growth will be determined mainly by demand for inputs into modernization of manufacturing and public infrastructure development, and by higher global commodity prices. The current account surplus is forecast at 13.0% in 2010 and 14.0% in 2011.

Development challenges

The immediate challenge is to mitigate emerging inflation pressures from rising exports and continued fiscal expansion. A close coordination of monetary, fiscal, and industrial policies will be useful in ensuring price relative stability and continued economic development. For the longer term, the major challenge is to diversify the economy. Currently, it is resource-based, making it susceptible to global commodity price fluctuations. The sources of export income need to be more widely spread.

In order to achieve broad-based inclusive growth, private sector development, industrial diversification and trade liberalization are essential. Accelerating ongoing reforms in these areas, along with the continued efforts to streamline public administration, would help sustain economic growth and broaden improvements in living standards. The recent economic achievements of the country provide a sound opportunity for speeding up the transition to a sustainable and competitive economy.