

Uzbekistan



COUNTRY RISK CATEGORY

6/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.



EKN'S OUTSTANDING GUARANTEES TO THE COUNTRY

SHORT-TERM TRANSACTIONS: SEK 0 MILLION

MEDIUM AND LONG-TERM TRANSACTIONS: SEK 1,217 MILLION

DATE

17/3/2015

Future transfer of power the greatest risk factor

President Karimov has been in power since the country's independence in 1991. The forms of a future transfer of power are unclear, which poses a risk of leading to a power vacuum when Karimov's era is over. Economically, the past decade has been characterised by high economic growth, increasing diversification and a steady accumulation of international reserves. However, the country's growth has been much slower structurally, politically and institutionally. The country is relatively closed to the outside world, state intervention into the economy is extensive and the regulatory environment is very complicated. The economy's commodity dependence and its strong ties with Russia are other risk factors. The country is expected to stick with its protectionist economic direction in the future, while the country seems to be heading toward greater instability due to political factors of uncertainty.

EKN categorises Uzbekistan in country risk category 6 of 7. The country risk policy is restrictive on account of the political turbulence and the difficult business environment. EKN has limited experience of covering payment risks in Uzbekistan.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Strong public finances and a solid external balance.
- Considerable supplies of raw materials.
- Rapid growth rate and increasing economic diversification.

Weaknesses

- Risk of conflicts related to a future transfer of power or regional turbulence
- Extensive government intervention into the economy and strict currency controls put a check on entrepreneurship, trade and investment.
- A very weak regulatory environment with widespread corruption and a politicised judiciary.

EKN'S POLICY

Uzbekistan was upgraded to country risk category 6 of 7 in 2008 – a categorisation made in coordination with the OECD. EKN can cover sovereign risks, but a letter of credit, or a bank or government guarantee is required for other public buyers. For bank risks, there is particular emphasis on the availability of complete and audited IFRS financial statements. A letter of credit, or a bank or government guarantee is preferred for companies. The risk assessment policy is restrictive for direct risks associated with companies. Special consideration is given to financial transparency and the ability of companies to manage the complicated operating environment. The waiting period for claims adjustment in the event of non-payment has been extended due to the currency controls.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- A clear improvement in the business environment, including the politicised judiciary, high corruption levels and strict currency controls.
- Orderly transfer of power and improved relations with neighbouring countries.

The policy may be made more restrictive in the event of

- Increased political instability related to a future transfer of power and regional turbulence.
- A deterioration of the external balance caused by prolonged low commodity prices.

EKN'S EXPOSURE AND EXPERIENCE

Little and negative experience

EKN's experience providing guarantees to buyers in Uzbekistan is limited, and partially negative. In several cases, companies have lost necessary licences or had their business operations expropriated by the government. In addition, employees of these companies have been imprisoned, and the possibility of repossession of equipment has proven weak. EKN's exposure is currently dominated by one guarantee in the gas sector.

COUNTRY ANALYST



EKN's country analyst for Uzbekistan:

Johan Dahl

Telephone: +46 8 788 00 45

email: johan.dahl@ekn.se

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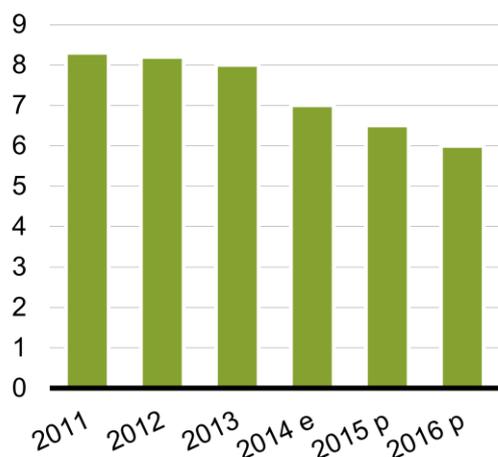
Political concentration of power and centralised economic control

Uzbekistan's political situation has been shaped by Islam Karimov's rule since the country gained independence in 1991. The country has never experienced a transfer of power during the time of its independence. As a result of Karimov's control of the security forces, the government has largely been able to quell social unrest. The authoritarian form of government and the widespread corruption pose a risk of spurring popular uprisings and instability similar to what the neighbouring countries of Tajikistan and Kyrgyzstan have gone through. The concentration of power in the 76-year old president is significant and there is no clear successor. There is a great risk of greater instability in the post-Karimov era, at least until the next leader is able to consolidate his/her power. This process could take several years. A power vacuum increases the risk of conflicts between the country's clans, opposition groups and militant Islamists and thus an economic redistribution favouring those who are in power.

Uzbekistan has been a NATO ally during the war in the neighbouring country of Afghanistan. There is a risk of increased instability in the region as NATO withdraws its troops. The troop withdrawal also decreases Uzbekistan's strategic significance, which may open the door for increased international criticism and actions taken against the country's human rights violations. The country's relations with Russia are important, but are periodically strained. Uzbekistan has chosen to stay out of Russia's customs union. Closer relations with Russia are likely in the future, given Uzbekistan's decrease in significance to the West and Putin's aim to increase integration between the former Soviet republics. However, Russia's ability to realise this will be limited by Uzbekistan's unwillingness to allow itself to be influenced by foreign powers.

The surpluses of the public and external finances, low debt and limited economic and financial integration with the outside world protected the Uzbek economy from the global

GDP GROWTH (% PER YEAR)



Growth is on a falling trend. Data: IMF.

financial crisis in 2009. Growth has been very strong over the past decade, averaging over 8%. Uzbekistan will be impacted in the coming years by negative economic conditions in Russia, Uzbekistan's second-largest export market after China. A decline in economic activity in Russia will decrease exports of goods such as cars, Uzbekistan's most important export product aside from commodities. Nevertheless, the negative effect on remittances from Uzbek guest workers in Russia will have the greatest impact. A gradual decline in the growth rate is to be expected in the long term. Uzbekistan's closed and centrally planned economic model will put a check on productivity, whereas productivity is needed to maintain high growth and reduce commodity dependence. The

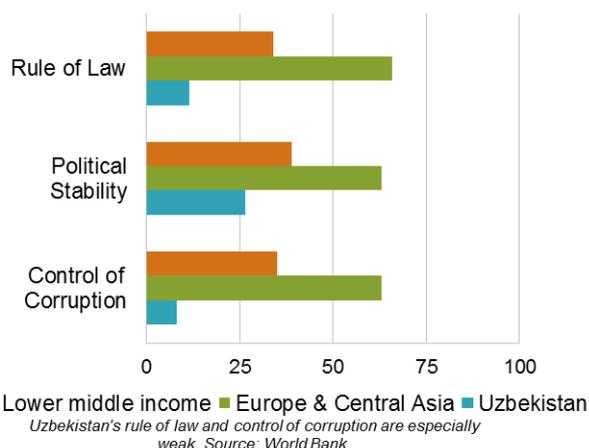
government controls a large portion of the economy and the planned economy structures from the Soviet period leave their mark.

Uzbekistan has had a current account surplus since the early 2000s thanks to substantial commodity exports. Cotton, natural gas and gold together account for half of the country's exports. Large oil and gas reserves serve as potential for increased exports and investments in the future. Nevertheless, the weak regulatory environment and legal system serve as an obstacle and foreign direct investment is relatively low. The country's external debt has gone down steadily over the past decade and is equal to nearly 15% of GDP. The country's international reserves have increased substantially during the same period and are equal to nearly 20 months of import coverage. The central bank's policy of increasing domestic competitiveness and bolstering the international reserves has led to a falling exchange rate. However, the policy creates excess liquidity and increases import prices, which has contributed to high inflation of 11%. A change in the monetary policy direction is not probable in the short term, which is why increasing buffers, depreciation and high inflation are to be expected.

BUSINESS ENVIRONMENT

Government dominance and problematic currency controls

The business environment in Uzbekistan is one of the weakest in the world. The government intervenes into the economy to a great extent. The business opportunities of foreign companies are dependent on their relations with the government or state-owned companies. Regulations can change quickly, licences can be revoked and operations can be expropriated,



which has occurred in the mining, commercial and telecom sectors in the past years. Corruption is widespread and Uzbekistan is ranked 166 out of 175 countries in Transparency International's corruption index. The country comes in 141st place out of 189 in the World Bank's Doing Business rankings. The legal system is ineffective, politicised and suffers from lacking predictability. Improvements in related areas, such as starting businesses and managing bankruptcies, have been made, but the overall

regulatory environment is still very weak. The banking sector is small, weak and dominated by the government. Companies do their accounting mainly using local standards, while banks largely meet the requirements of IFRS accounting.

A lack of access to financing and foreign currency serves as obstacles for companies. Protectionist policies are pursued, where investments and export sectors are stimulated, but imports are kept down. The strict capital controls aim to minimise capital outflows, control imports and stimulate local production. It can take from three months to over one year to convert local currency to foreign currency. This makes it very time-consuming and expensive to import input goods and raw materials. In addition, companies are required to convert 50-100% of currency revenues into local currency. The private sector's access to foreign currency is generally very limited, which poses a risk of leading to payment delays from Uzbek importers.