

## Positive economic outlook thanks to reform dynamics

For two years now, Uzbekistan is in the focus of many international observers. President Mirziyoyev has initiated a comprehensive reform and modernisation process, which aims to transform the country from a closed, state-centred economy into an open market economy.

The economic preconditions for such an extensive transformation are positive. The country's external situation is strong, with a high stock of international reserves and low external debt. In addition, public debt and the budget deficit are at moderate levels, which is the result of conservative macroeconomic politics.

### Start of the transition process

The "old" economic model, existing until 2017, was relatively closed towards other countries (low imports and foreign investment) and dominated by the state. However, time has shown that this model was not an adequate response to Uzbekistan's demographic development. The relatively young population grows at around 2% annually. The labour market can only partially absorb the additional workforce, resulting in an annual deficit of ca 300,000 jobs. Widespread migration, a large informal sector and low per capita income (2017: USD 1,828) were the consequences.

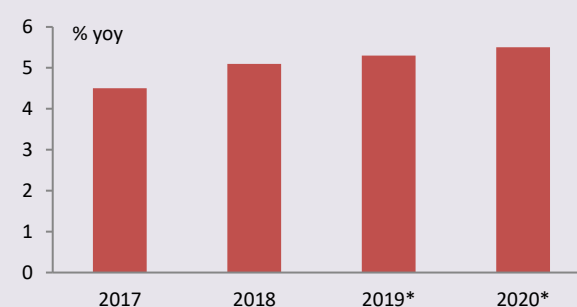
The "new" economic model that the current reform policies want to achieve is, contrary to the old model, characterised by an opening towards other economies as well as the transition towards a market economy. The liberalisation of economic activity, less state control and more transparency are the key principles. Thus, Uzbekistan has embarked upon a comprehensive economic transition process, similar to that in Eastern Europe in the beginning of the 1990ies. How does the economy develop under these fundamentally changed conditions?

### Current economic development

Economic growth rates of around 5% annually, with a slight upward trend, are very positive. However, the above-mentioned population growth rate is to be taken into consideration, which requires high GDP growth rates in order to increase the low per capita income. On the demand side, the key driver for growth is state investment, aimed at the modernisation of the capital stock. In the structure of the supply side, the large share of agriculture (33% of GDP) stands out, but also that of industry (26% of GDP). Together the two sectors account for almost 60% of the economy. While the indus-

trial sector records high growth rates, agriculture performs weaker. Here it needs to be mentioned that economic statistics have been fundamentally revised (also in retrospective), such that they now show a more realistic picture of the current situation.

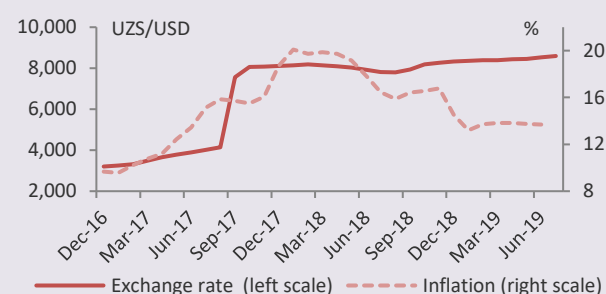
### Real GDP growth



Source: World Bank, \*forecast

A central element of economic reforms was the currency liberalisation in 2017. This reform brought about a necessary depreciation of the Uzbek Sum, the rate of which is now determined predominantly by market forces. The high level of international reserves (currently at ca USD 28 bn, equal to 13 months of import coverage) is an important factor for the stability of the currency.

### Exchange rate and inflation



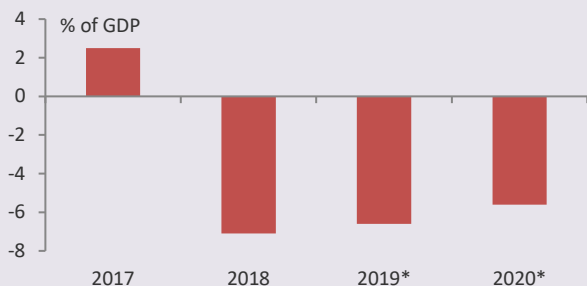
Source: Central Bank of Uzbekistan, National Statistical Office

The currency depreciation brought about a significantly higher level of inflation. Necessary price liberalisation (e.g. the adjustment of energy tariffs) is pushing into the same direction. These developments, however, are necessary side effects of a reform that terminates distortions of relative prices and thus strengthens market forces. The Central Bank has reacted correctly to these developments with a contractive monetary policy in the form of repeated policy rate hikes. In the midterm, the Central Bank expects inflation to return to single-digit values until 2021.

A strong increase of imports (especially investment goods) in the course of economic opening have turned

the traditional current account surpluses into significant deficits (2018: -7.1% of GDP). Thus, the increase and diversification of exports remains an important challenge. In addition, the financing of these deficits (which will gradually decrease in the future) by foreign direct investment (currently at 1-2% of GDP) should be strived for.

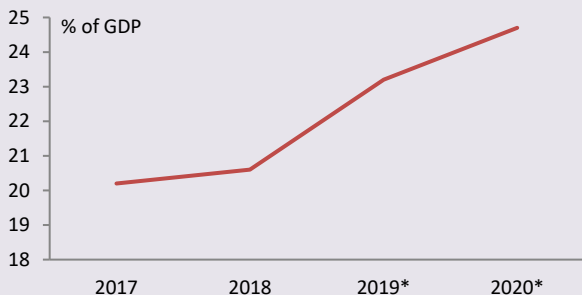
**Current account**



Source: World Bank, \*forecast

Public finances are a further important reform sector, in which the tax reform, including the introduction of a modern VAT system, which was introduced in 2019, is a key element. Uzbekistan's budget deficit has been at moderate levels of between -1.5% and -2% of GDP (according to a broad definition which includes certain quasi-fiscal activities) over the last years. The level of public debt is low, but will slightly increase in future.

**Public debt**



Source: World Bank, \*forecast

In order to raise funds on international capital markets, a sovereign Eurobond was issued in 2019 for the first time ever (USD 1 bn in two tranches with maturities of 5 and 10 years). Thanks to a comparatively good country rating (BB-), which can be compared to Georgia (and is better than that of Ukraine or Belarus), the issuance was very successful. It can be expected that in the future Uzbek companies will follow the sovereign and become increasingly active on international capital markets.

**Conclusion**

Uzbekistan is only at the beginning of a fundamental economic transition process. The country is striving towards an open economy based on market principles,

which can address the challenges of population growth and the necessary increase of the population's living standards in a sustainable manner. In this context, profound reforms like exchange rate liberalisation, the opening of external trade and the tax reform have been conducted.

A strong balance sheet with high level of international reserves and low public and external debt are very good preconditions for Uzbekistan to successfully master this process.

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