POLICY BRIEFING 04 | 2022

German Economic Team

UZBEKISTAN

# Economic implications for Uzbekistan of the war in Ukraine and the sanctions against Russia

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# Summary

- **UZB economy strongly affected** by war in UKR and sanctions against RUS
- **Exports** to RUS likely to **drop** by USD 555 m or 0.8% of GDP in 2022, through reorientation total export decrease smaller: **USD 272 m or 0.4% of GDP**
- Strongest impact on textiles & apparel (USD 91 m or 1/3 of total decline)
- **Remittances** from RUS to **drop by USD 2.5 bn or 3.5% of GDP**; strong shock, measures to support vulnerable households necessary
- **Effects on energy prices in UZB likely small** due to own resources and buying discounted RUS oil products
- **Higher global energy and food prices** further fuel **inflation** in UZB; need for tight monetary policy to anchor inflation and exchange rate expectations
- **Budget deficit likely to increase** to around **4% of GDP** in 2022 due to increased spending to support households; deficit still moderate

➢ **Strong economic shock on UZB, mainly due to lower remittances from RUS and exports to RUS**

# Outline

1. Introduction
2. Economic outlook in Russia in 2022
3. Implications for exports to Russia
4. Implications for energy prices
5. Implications for food prices
6. Implications for remittances from Russia
7. Macroeconomic implications

# 1. Introduction

**The war in UKR and sanctions against RUS affect UZB economy in many ways:**

- The RUS economy is severely weakened; as a result, UZB exports to RUS, but also remittances from RUS will suffer
- Furthermore, global energy and food prices have increased significantly, which might increase import prices and inflation in UZB

**Aim of the briefing:**

- Analysis of key economic implications of war in UKR & sanctions against RUS
- Recommendations on policy reaction to this shock

***Disclaimer**: we do not analyse the impact on foreign trade of disrupted logistics (e.g. exports to Europe) and of lower economic growth in trading partners*

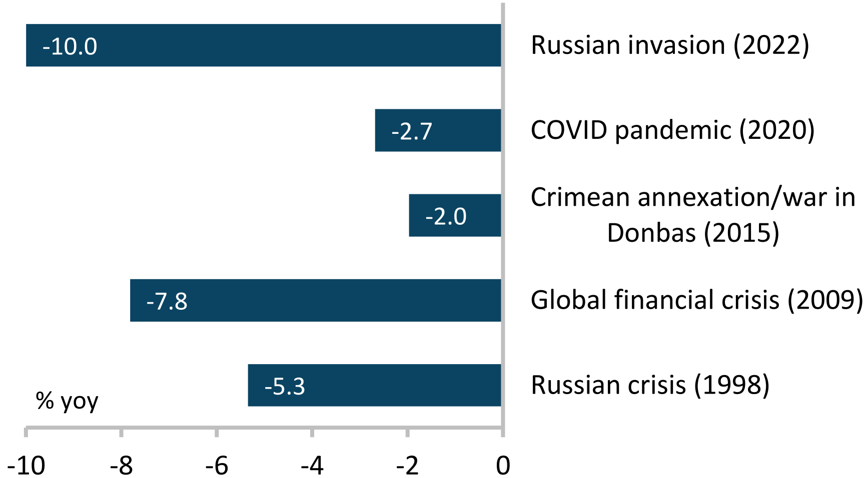
# 2. Economic outlook in Russia in 2022

Selected economic indicators

| Indicators | 2022 |
|---|---|
| Real GDP growth, % | -10% |
| Nominal USD GDP growth, % | -34% |
| Inflation, % eop | 20% |
| Exchange rate, RUB/USD | 120 |

*Sources: Goldman Sachs, CBR, own assumptions/calculations*

Historic GDP declines




*Sources: Rosstat, own calculations*

**Severe economic and financial damage**

- The war has led to a wave of sanctions on Russia by Western countries
  - Significant impediments to trade (including logistics) as well as to foreign investments
  - Russia reacted by tightening financial conditions, e.g. emergency CBR rate hike to 20% p.a.
  - Material risk that RUS defaults, ratings only slightly above „Default" status

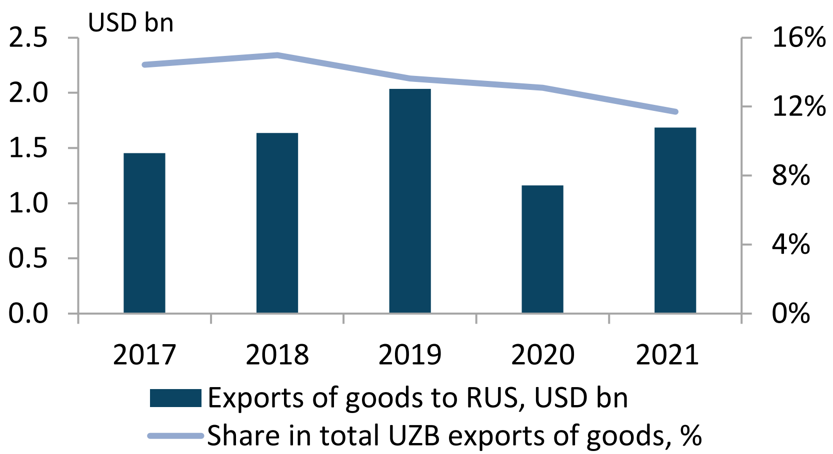
**Still high uncertainty**

- As war continues, new sanctions may follow & target the crucial energy sector

➢ **Russia's real GDP likely to decline by 10% in 2022, which is unprecedented in modern history**

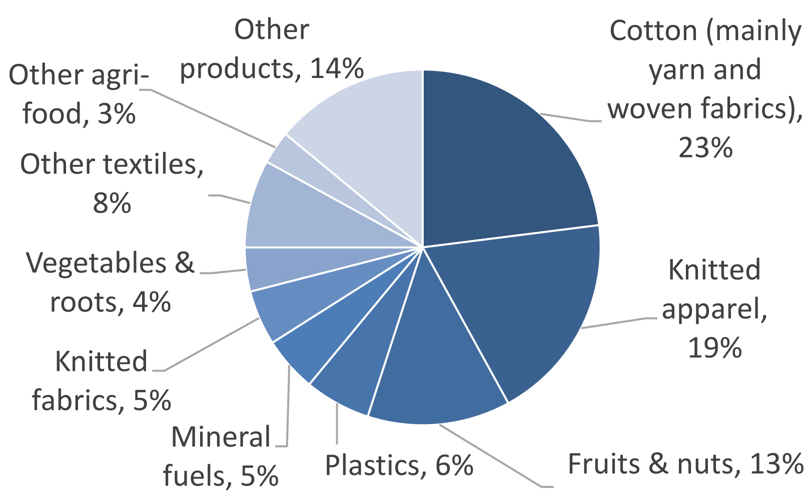
# 3. Implications for exports to Russia

UZB exports  of goods to RUS




*Source: ITC Trade map, WITS*

Structure of UZB exports to RUS, 2021




*Source: ITC Trade map, WITS*

## UZB exports of goods to RUS, 2021:

- Value: USD 1.7 bn, 12% of total exports
- Share in GDP: 2.5%
- ➢ **Significant role of RUS market**

## Export structure by sectors, 2021:

- Textile & apparel: 55%
- Agriculture & food: 20%
- ➢ **Exports of textile & apparel is most exposed**

## Outlook for 2022

- Decline in exports but no full disruption

# Estimation of impact on exports

| | HS code | Product Description | Impact on UZB exports to RUS, USD m | Impact on UZB total exports, USD m |
|---|---|---|---|---|
| 1 | 5205 | Cotton yarn containing 85% or more by weight of cotton, not for retail | -57 | 0 |
| 2 | 6109 | T-shirts, knitted or crocheted | -32 | -32 |
| 3 | 0806 | Grapes; fresh or dried | -27 | -16 |
| 4 | 3901 | Polymers of ethylene, in primary forms | -9 | 0 |
| 5 | 0809 | Apricots, cherries, peaches | -55 | 0 |
| 6 | 6006 | Knitted or crocheted fabrics | -10 | 0 |
| 7 | 5208 | Woven fabrics of cotton, < than 200 g/m2 | -7 | 0 |
| 8 | 6302 | Bed linen, table linen | -2 | 0 |
| 9 | 7901 | Unwrought zinc | -14 | 0 |
| 10 | 6104 | Women's or girls' suits, knitted or crocheted | -9 | -9 |
| | | Other textile & apparel | -99 | -59 |
| | | Other agriculture & food | -39 | -10 |
| | | Other products | -195 | -146 |
| | | **Total** | **-555** | **-272** |

*Source: WITS; own estimates (see Policy Briefing PB/03/2022 for details)*

- **UZB drop in exports to RUS estimated at USD 555 m or 0.8% of GDP in 2022**
- **Due to reorientation, total losses of exports are smaller: USD 272 m or 0.4% of GDP**

# Policy recommendations on exports

**All products**

- Potential bottlenecks of transport corridors should be analysed and addressed

**Textiles & apparel**

- For less processed products like cotton yarn and fabrics reorientation should be possible in the short-term as demand is high
- For processed products like t-shirts reorientation will be difficult
- Efforts to diversify exports should be continued e.g. towards the EU through
  - Information campaigns on fulfilment of ILO standards
  - Introduce state support scheme for international certification (see PB/07/2021)

**Agriculture & food**

- Reorientation should be possible in the short term, most exports to neighbouring countries
- Diversification of exports could be supported by expanding use of precooling facilities (perishable goods) and systematic support for food safety certification (see PB/07/2021)

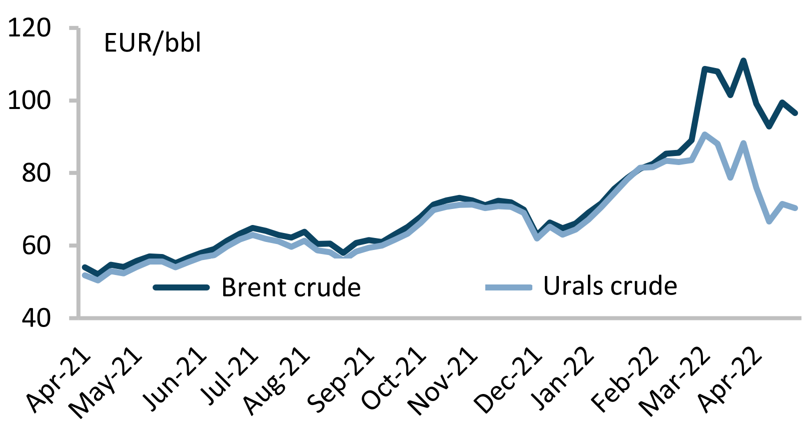
# 4. Implications for energy prices

UZB energy supply and Russian imports (2019)

| | Share in TES* | Gross import share | RUS share in imports | RUS share in TES* |
|---|---|---|---|---|
| **Solid fossil fuels** | 4% | 27% | 1% | 0% |
| **Oil and oil products** | 8% | 23% | 36-48% ** | ~1% |
| **Natural gas** | 86% | 0% | - | - |
| **Renewables** | 1% | - | - | - |

**Total Energy Supply **large uncertainties due to differences in reported data*
*Sources: IEA, UNComtrade, Observatory for Economic Complexity, own calculations*

Global oil prices (2021/22)



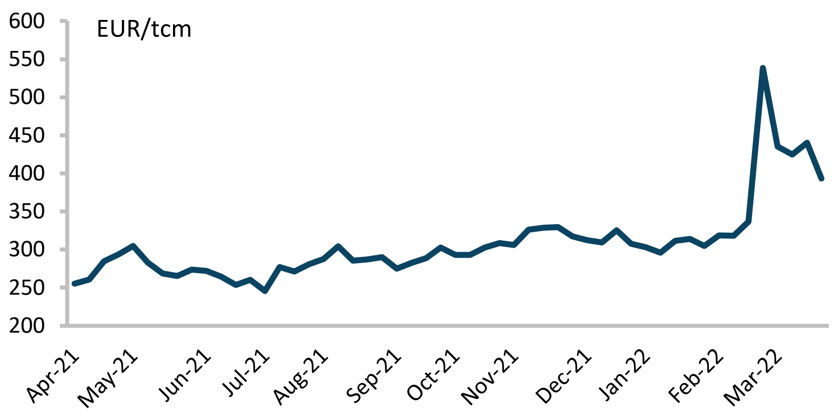

*Source: IEA, World Bank, Marketwatch*

- Natural gas demand as main energy source is covered by own resources
- Little crude oil but significant proportion of oil products are imported from Russia
- Increase of global oil prices due to war in UKR & sanctions against RUS
- But RUS Urals crude with increasing discount due to lack of buyers
- UZB will continue to buy RUS oil products
- So far no effects on fuel prices in UZB

➢ **No significant effects on UZB energy prices expected**

# 5. Implications for food import prices

Global wheat prices (2021/22)




Wheat price shock

| | Wheat |
|---|---|
| Net quantity imported p.a. | 2.2 m t |
| Import price before war* | 255 EUR/t |
| Expected import price** | 368 EUR/t |
| Price differential | 113 EUR/t |
| Additional cost p.a. | EUR 249 m |
| **Additional cost p.a., % GDP** | **0.4 %** |

*Source: World Bank, Marketwatch, own calc.; *avg. 2021; **avg. 2022 future prices for wheat*

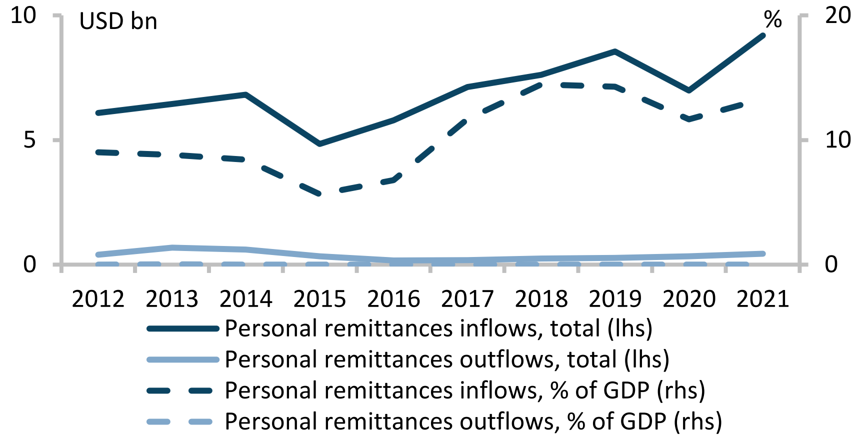
## Wheat

- UZB is a net importer wheat, which is mainly imported from KAZ
- Wheat prices increased strongly due to expected loss of shipments from UKR & RUS export ban
- Assuming a price increase of 44% to last year, UZB would face additional expenditures of EUR 249 m or 0.4 % of GDP in 2022

➢ **Balance of payments shock of 0.4 % of GDP due to higher wheat prices**

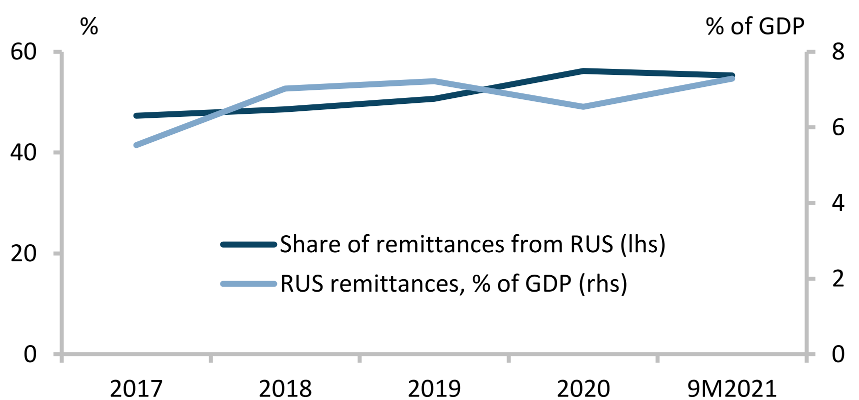
# 6. Implications for remittances from Russia

Personal remittances inflows to Uzbekistan (gross)




*Sources: Central Bank Uzbekistan, IMF, own calculations; Note: personal remittances = (personal transfers + compensation of employees)*

Personal remittances inflows from Russia




*Sources: Central Bank Uzbekistan, Central Bank Russia*

- Remittances play a key role for the economy of UZB
  - USD 9.2 bn (13.3% of GDP) in 2021
  - Up from USD 6.1 bn (9.0% of GDP) in 2012
  - No component of GDP but strongly support demand, esp. consumption
- Share of RUS has slowly increased over time
  - 2017: 47.3% of inflows
  - 2021: 55.3% of inflows
  - Other relevant source countries: Kazakhstan, Turkey and Korea

➢ **RUS main source of remittance inflows to UZB**

# Expected shock and economic effects

| | Reduction in remittances from Russia | | Effect on GDP | | Effect on consumption | | Effect on investment | |
|---|---|---|---|---|---|---|---|---|
| | USD bn | *% of GDP* | USD bn | *% of GDP* | USD bn | *% of GDP* | USD bn | *% of GDP* |
| **Expected shock** | **-2.5** | ***-3.5%*** | **-1.0** | ***-1.4%*** | **-1.7** | ***-2.4%*** | **-0.3** | ***-0.4%*** |
| Maximum exposure | -4.7 | *-6.4%* | -2.0 | *-2.8%* | -3.5 | *-4.8%* | -0.5 | *-0.7%* |

*Source: Own calculations; note: economic effects calculated as a short-term demand shock caused by declining remittances, methodology analogous to GET MDA, PP/03/2014*

- Economic sanctions will decrease remittances from RUS by ca. 50%
- Effects on GDP is moderated somewhat by import share of UZB economy
- Effects are likely most severe for individual households

➢ **Strong economic effects: -3.5% of GDP in remittance income, -1.4% of GDP effect on growth**

➢ **Possible policy responses: targeted social assistance, efforts to diversify labour migrants target countries**

# 7. Macroeconomic implications

RUS invasion of UKR has various macroeconomic implications beyond the transmission channels discussed above, to which policy makers have to react:

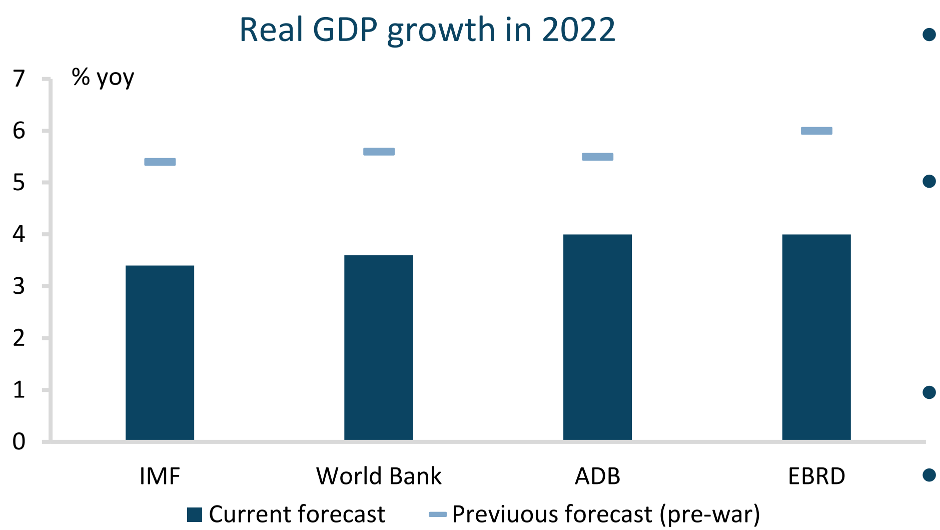
**Monetary policy must address inflationary pressures**

- Inflation might accelerate due to higher commodity prices
- Depreciation pressures could increase as currency inflows from remittances are affected

**Fiscal policy will be negatively affected**

- Lower revenues due to lower growth
- Measures to support economy and households
- Tighter external financing conditions

# Economic growth




*Source: respective institutions*

Regional comparison of real GDP forecasts for 2022

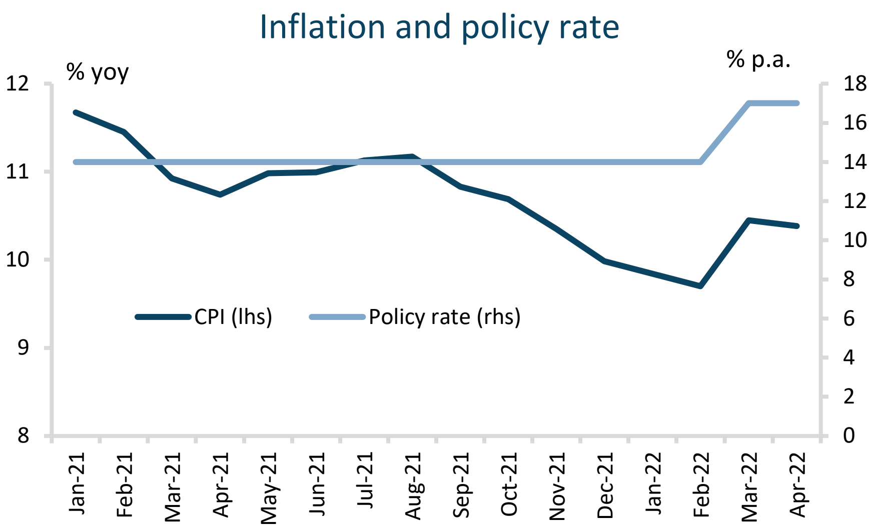
| | Current forecast (% yoy) | Change in forecast (pp) |
|---|---|---|
| **Uzbekistan** | 3.4 | -2.0 |
| Kazakhstan | 2.3 | -1.5 |
| Tajikistan | 2.5 | -2.0 |
| Russia | -10.0 | -12.0 |
| Germany | 2.1 | -1.9 |
| EU-27 | 2.8 | -0.7 |

*Sources: IMF, Goldman Sachs, IfW Kiel*

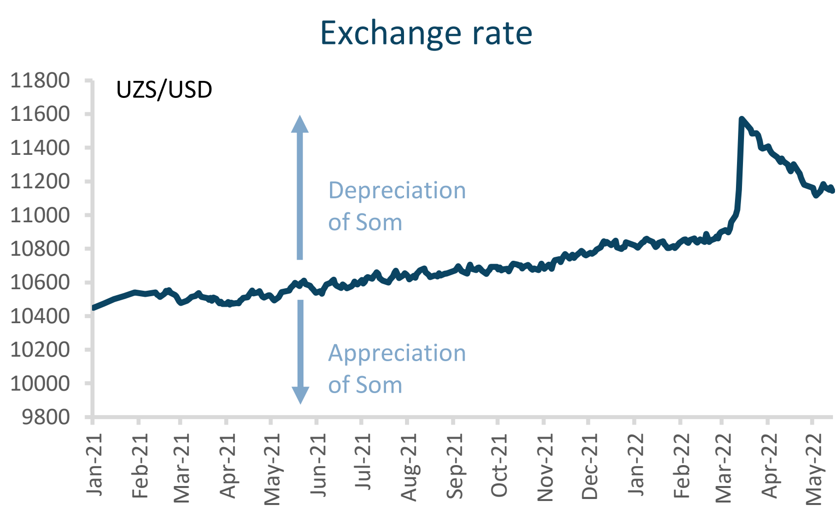
- GDP forecast 2022 by IMF before the war: 5.4% yoy
- Due to expected decline of exports and remittances, forecast has been reviewed
- New forecast by IMF: 3.4%
- Thus: war-induced reduction in GDP forecast amounts to 2.0 pp
- Potential upsides through high-skilled migration and relocation of firms from RUS
- Potential downsides from escalation of war and sanctions towards RUS

➢ **Strong effect of war in UKR on GDP**

# Monetary and exchange rate policy




*Source: Central Bank Uzbekistan, own calculations*




*Source: Central Bank Uzbekistan*

## Inflation

- 2021: high but continuously decreasing
- 2022: war leads to higher commodity prices, esp. for food
- Central bank increased policy rate by 300bp to 17% to anchor inflation expectations

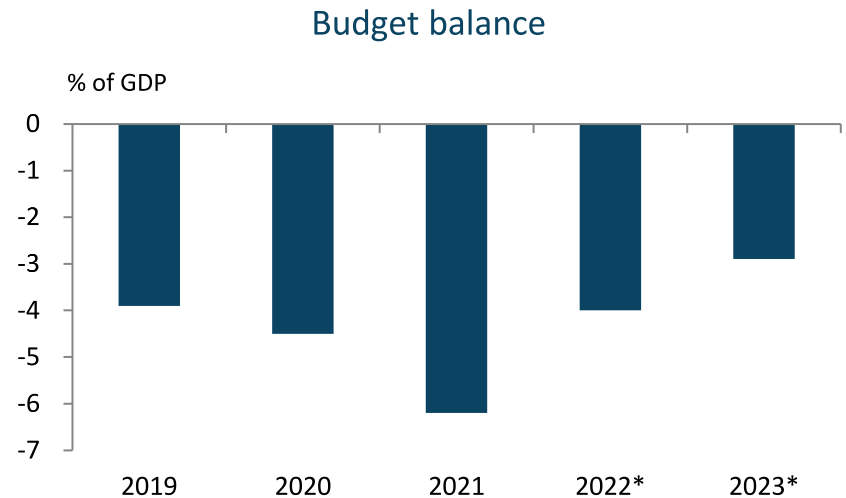
## Exchange rate

- Som depreciated by over 6% vs US dollar between start of war and Mid-March 2022
- Since increase of policy rate continuous appreciation

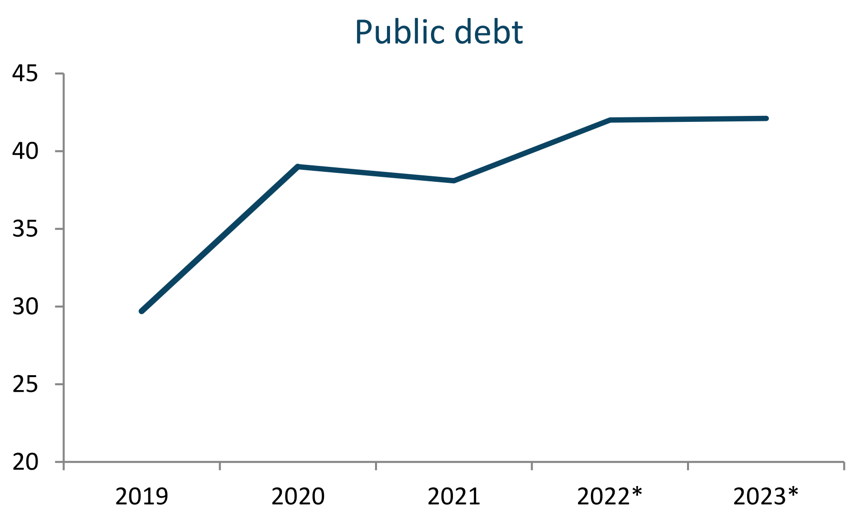
➢ **Tight monetary policy stance need to continue to anchor expectations**

➢ **Inflation target of 5% by end-2023 too ambitious in current environment**

# Fiscal policy




*Source: Word Bank, *forecast*




*Source: World Bank, *forecast*

**Budget deficit**

- Original plan: bring deficit back to 3% of GDP
- But unrealistic due to
  - Lower revenues form weaker economic activity even if cushioned by higher gold sales
  - Higher expenditure for support of households that face falling remittances
- Deficit at 4% of GDP forecast

**Public debt**

- 2022: likely to reach 42% of GDP, still moderate
- Key role of donors to finance the deficit
- ➢ **Deficit and debt moderate, no major concern also due to comprehensive international support**

# About the German Economic Team

Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

**Advisory activities in Belarus are currently suspended.*

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