

Credit risks in the Republic of Uzbekistan

Tashkent, 6 November 2019

Agenda

- About RAEX
- Sovereign government credit risks of Uzbekistan
- Banking system credit risks of Uzbekistan



About RAEX

Rating-Agentur Expert RA (RAEX-Europe)

- The Agency works since 2013 in **Frankfurt am Main**
- **The CRA, registered by the European Securities and Markets Authority (ESMA)**
- **Official status** of External Credit Assessment Institution (ECAI)
- International **rating service team** with diverse academic and professional experience
- More than **20 years of experience** in the analytical researches and risks analysis

ECAI mapping RAEX- Europe

Mapping, approved by the European Commission in April 2018:

Credit quality step	RAEX- Europe	Fitch	Moody's	S&P
1	AAA, AA	AAA, AA	Aaa, Aa	AAA, AA
2	A	A	A	A
3	BBB	BBB	Baa	BBB
4	BB	BB	Ba	BB
5	B	B	B	B
6	CCC, CC, C, D, E	CCC, CC, C, RD, D	Caa, Ca, C	CCC, CC, R, SD/D

RAEX- Europe activities

- Assigning **credit ratings** to:
 - ✓ Sovereign issuers
 - ✓ Sub-sovereign issuers (regions)
 - ✓ Banks
 - ✓ Insurance companies
 - ✓ Companies from non-financial sectors
- Assigning **non-credit ratings: ESG ratings** (environmental, social and governance)
- Additional **services for stock-exchanges: Green Bond Second Opinion**
- **Business-conferences** and presentations in Frankfurt-am-Main

Sovereign government credit risks of Uzbekistan

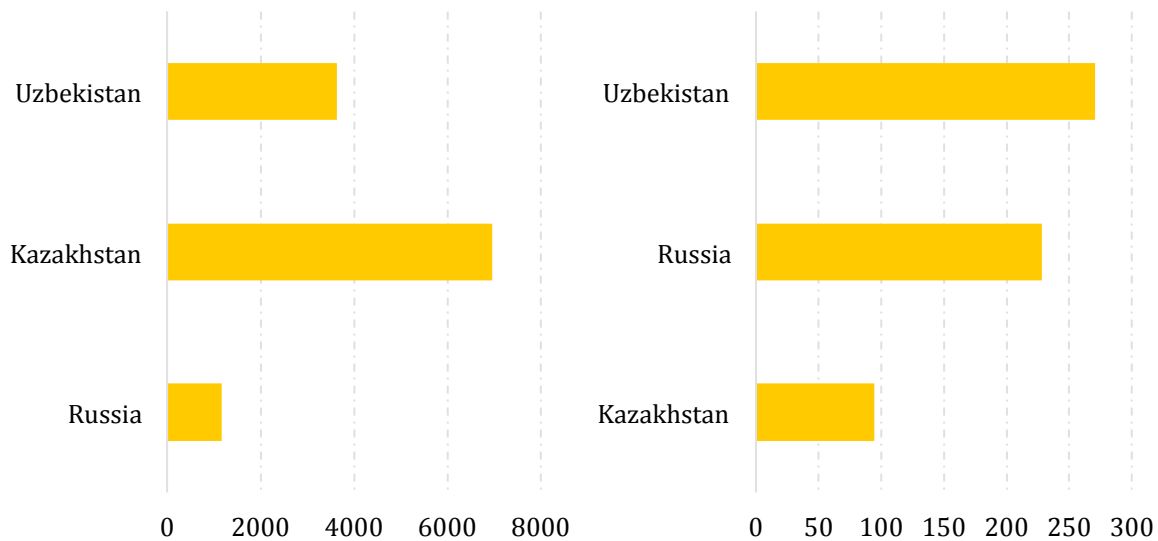
Sovereign rating list of RAEX-Europe:

Country	Sovereign government rating		Dynamics		Outlook		Date
	National currency	Foreign currency	National currency	Foreign currency	National currency	Foreign currency	
Armenia	BB-	BB-	Confirmed	Confirmed	Positive	Positive	12.07.2019
Azerbaijan	BB+	BB+	Initial assignment	Initial assignment	Stable	Stable	10.05.2019
Belarus	B	B	Confirmed	Upgraded	Positive	Positive	12.07.2019
Georgia	BB	BB	Confirmed	Confirmed	Stable	Stable	04.10.2019
Germany	AAA	AAA	Confirmed	Confirmed	Stable	Stable	30.08.2019
Kazakhstan	BBB-	BBB-	Confirmed	Confirmed	Stable	Stable	14.06.2019
Kyrgyzstan	B	B	Confirmed	Confirmed	Stable	Stable	28.06.2019
Russia	BBB-	BBB-	Confirmed	Confirmed	Stable	Stable	14.06.2019
Tajikistan	B	B-	Confirmed	Confirmed	Negative	Negative	09.08.2019
Uzbekistan	BB-	BB-	Confirmed	Confirmed	Stable	Stable	06.09.2019

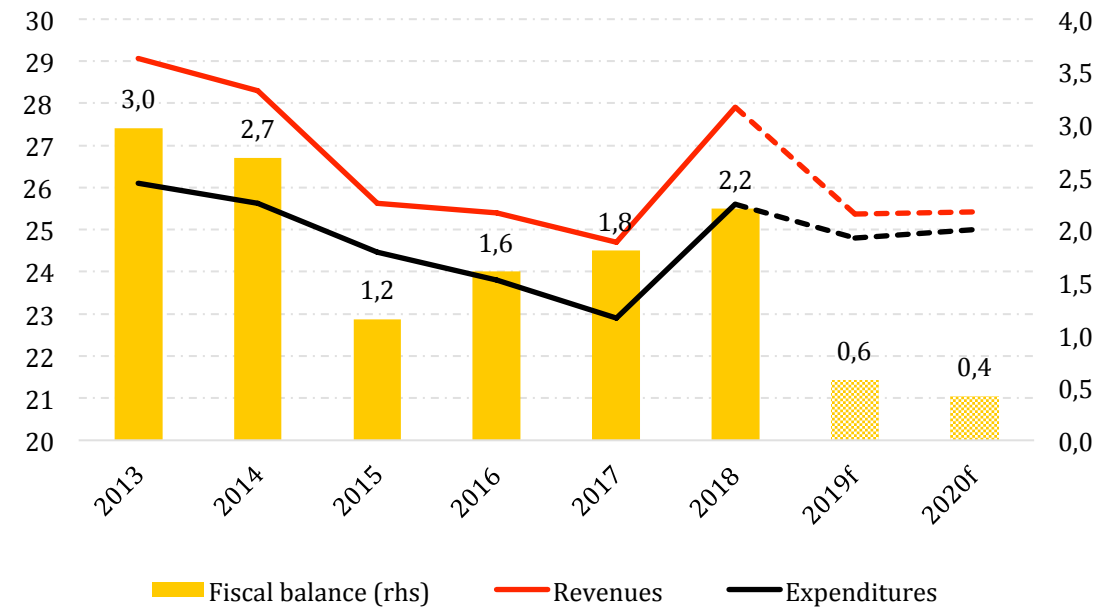
Positive factors

- Even though the active borrowings, **the gross government debt is low with favorable maturity and terms, solidly covered by FX reserves**
- The consolidated budget surplus at 2,2% in 2018 was driven by **increased revenues** and **tight fiscal policy**

Foreign exchange reserves /
 Short-term debt (l) and Gross government debt (r), %



Consolidated fiscal budget dynamics*, % of GDP

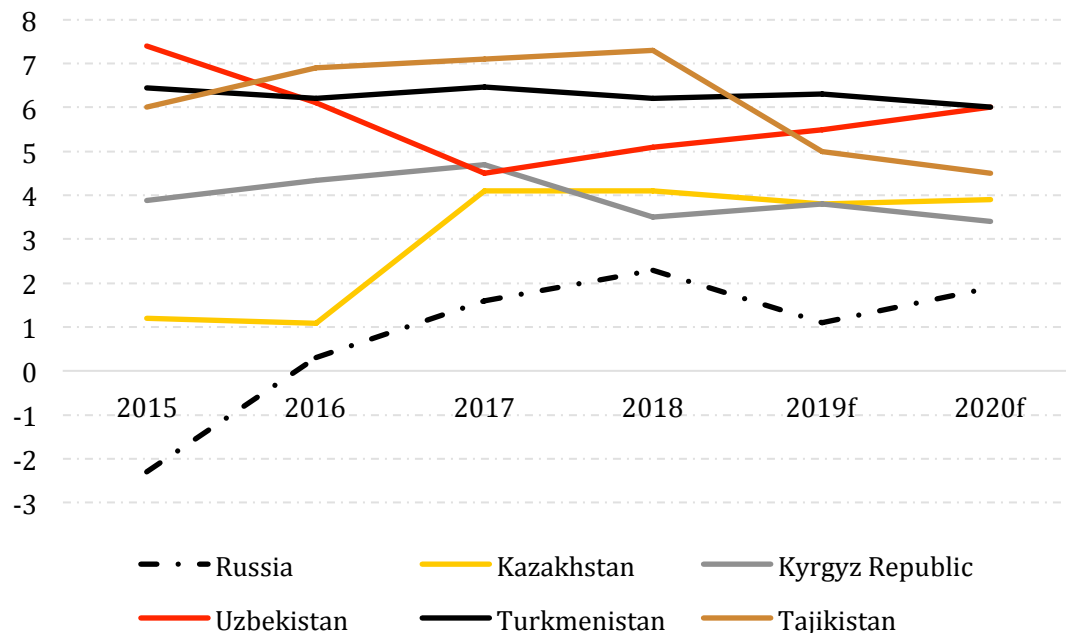


*Policy-based lending and off-budget operations are not included

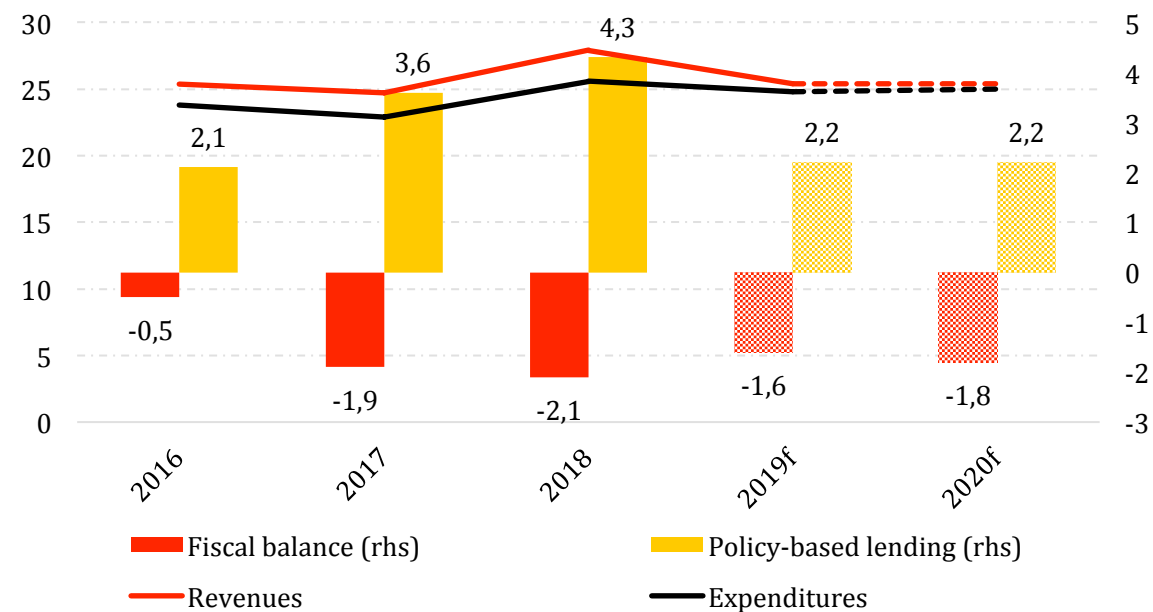
Positive factors

- **The country's real GDP growth** accelerated to 5,1% in 2018. An upward trend to continue in the next years, in contrast to the slowdown in other Central Asia countries and Russia
- **The overall fiscal deficit** widened to 2,1% of GDP in 2018, however, representing a low credit risk according to our internal benchmarks

Real GDP growth, % y-o-y



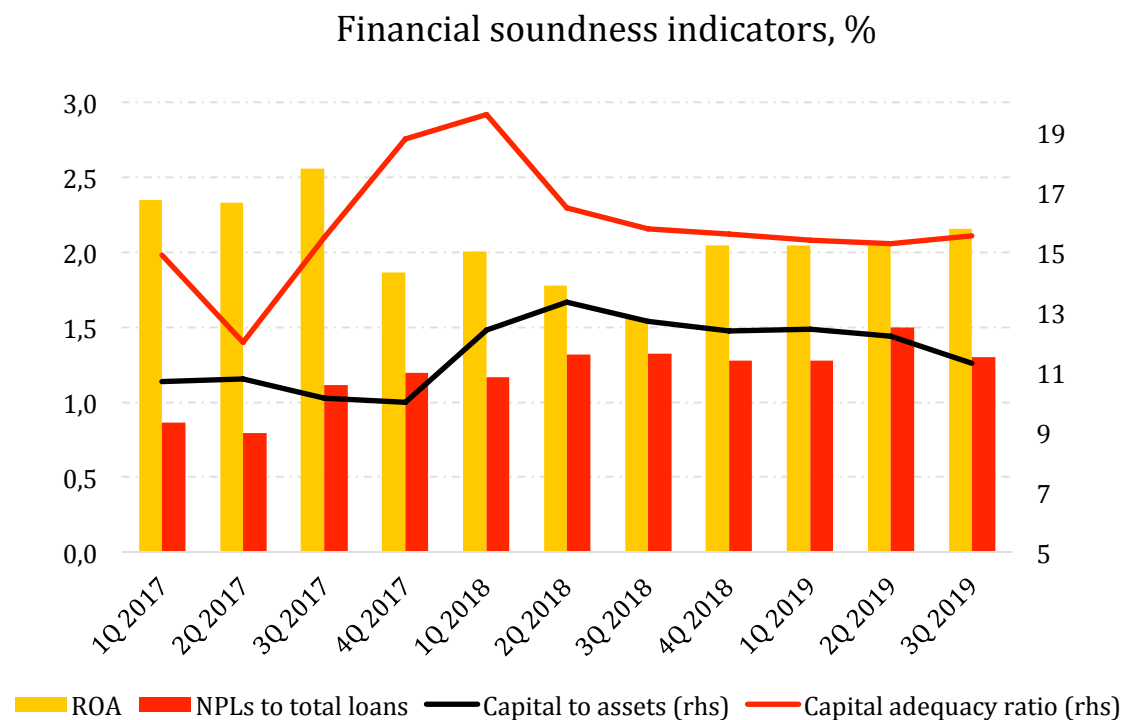
Augmented fiscal budget dynamics*, % of GDP



*Policy-based lending and off-budget operations are included

Positive factors

- Uzbekistan's banking sector remains profitable and sound with ROA at 2%, NPLs at 1,3% of total loans* and capital-to-assets ratio at 12,4% in 2018



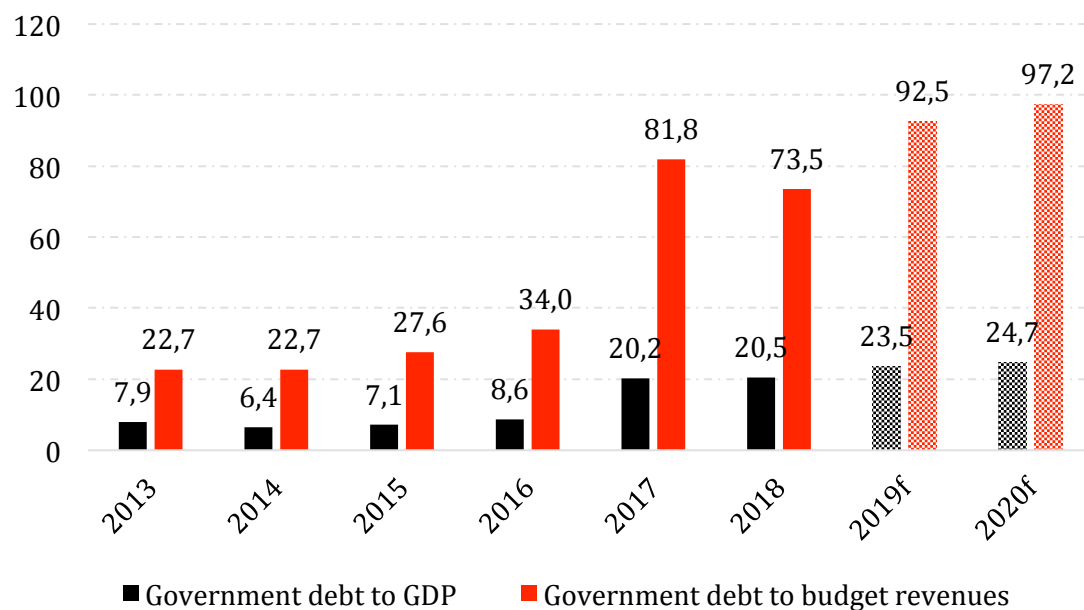
- However, we see **potential risks** in the banking system related to the **high concentration** (about 85%) of state-owned banks, **strong government influence and controlled distribution of credit resources**

*Officially recorded NPL level according to the CBU data

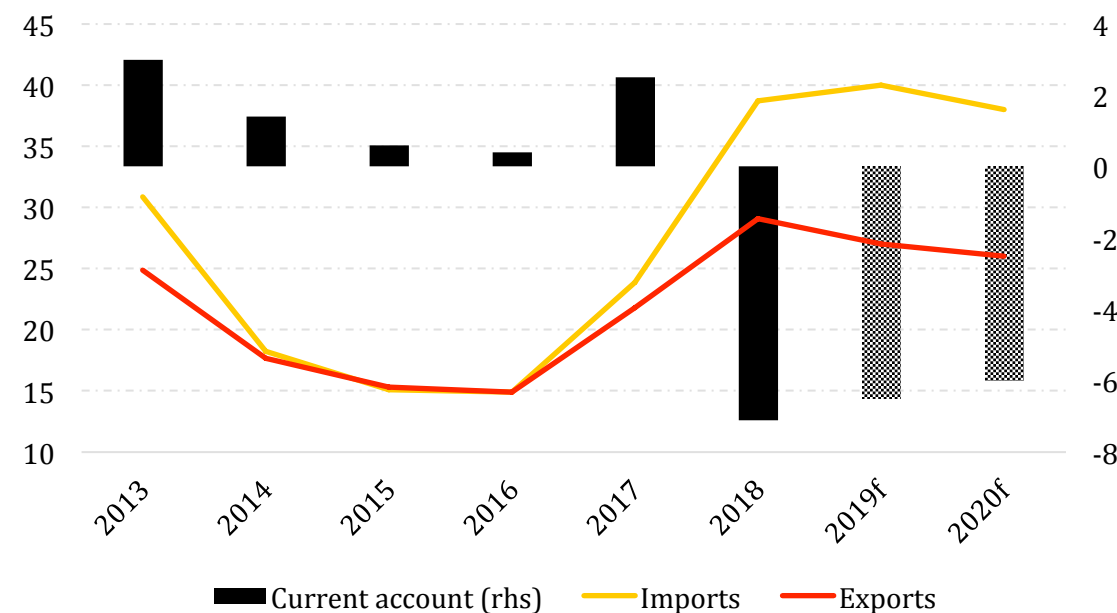
Restricting factors

- As FX debt comprise on 98% of government obligations, **the debt position is vulnerable to exchange rate fluctuations**
- The **economy's competitiveness** remains limited, as export demand weakening and high share of import weigh on external position

Government debt dynamics, %



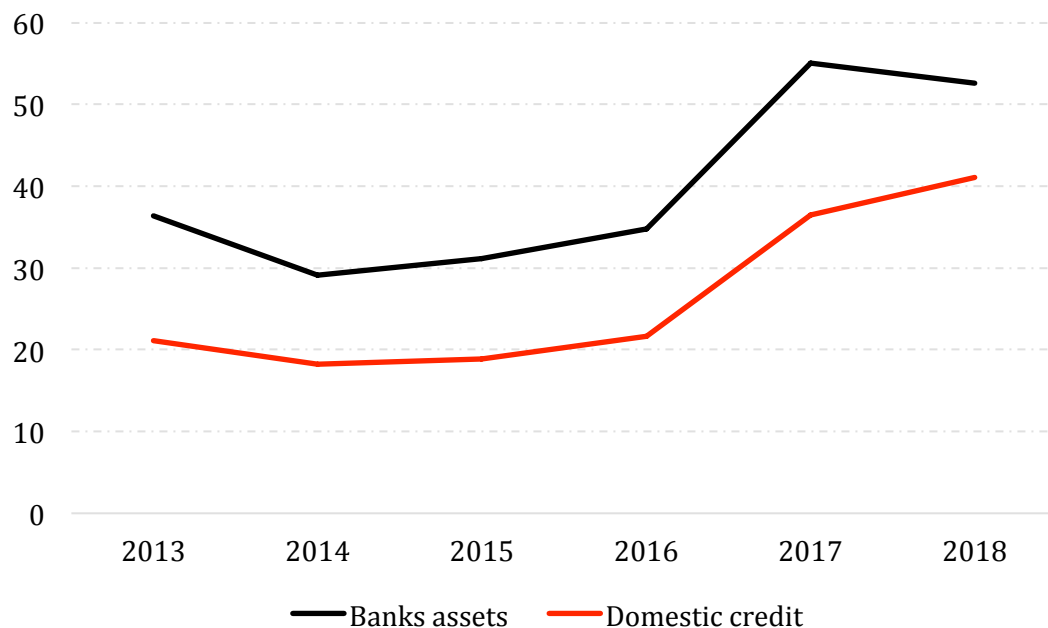
External sector indicators, % of GDP



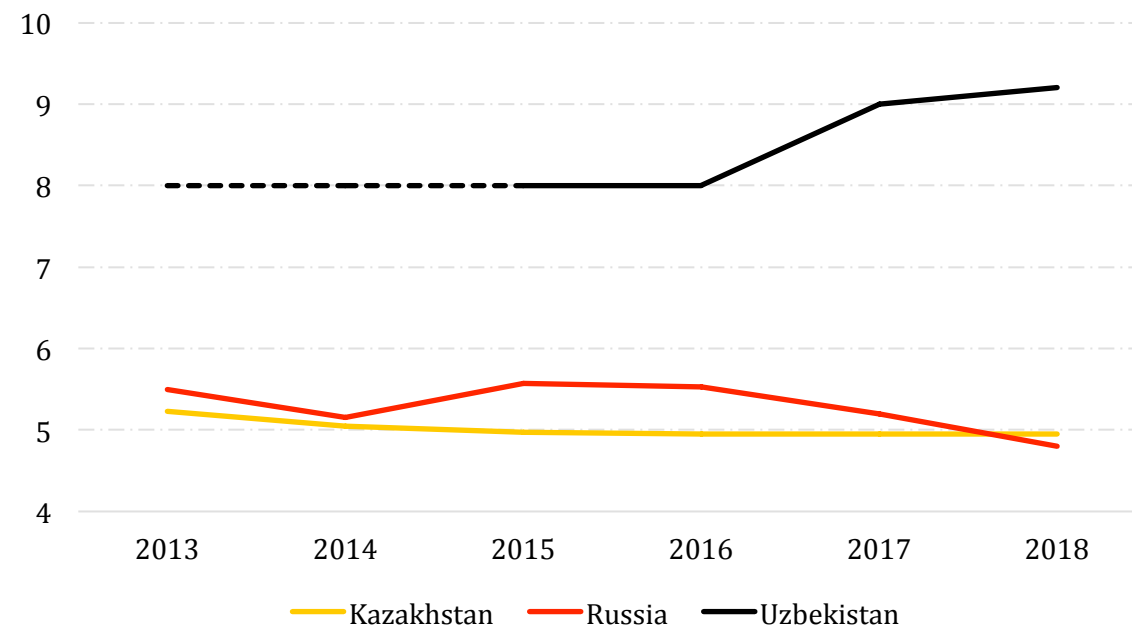
Restricting factors

- **The accelerated growth of lending** in 2018 carries potential risks of overheating the economy; moreover, a significant portion of **direct loans to SOEs** limits the market effectiveness of the banking sector
- The **unemployment rate** remained elevated at 9,3% in 2018*

Credit to the economy dynamics, % of GDP



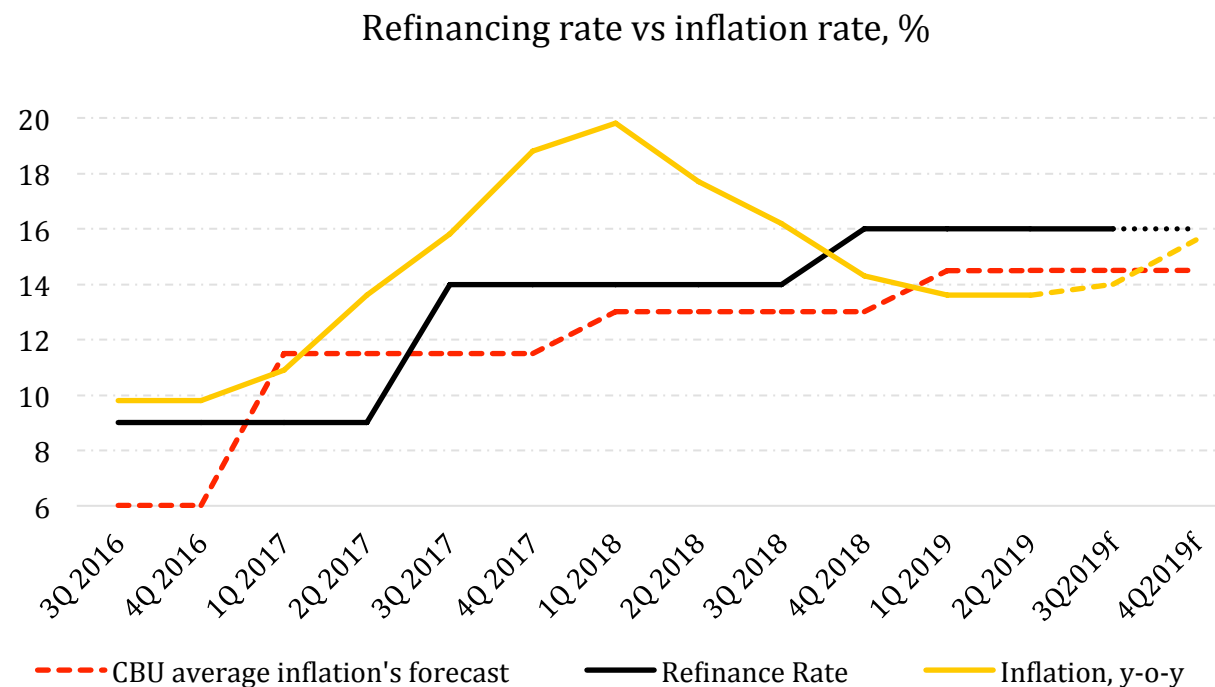
Unemployment rate, %



*Enhanced methodology for unemployment calculation

Restricting factors

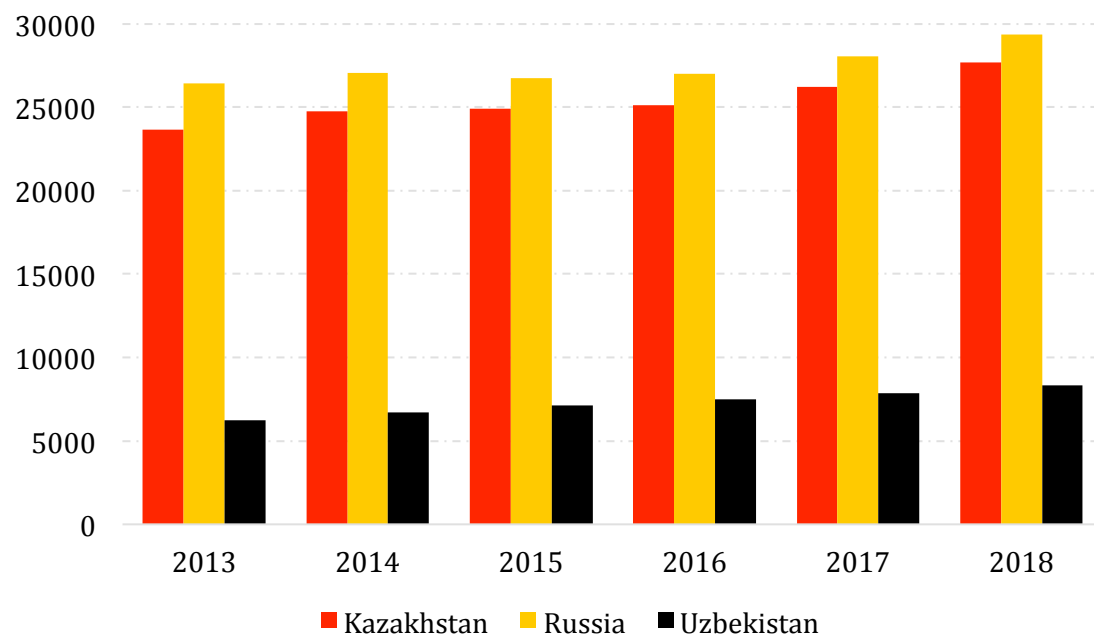
- The CBU is pursuing the **tight monetary policy** in order to reduce inflation pressure
- Continuation of the **significant off-budget financing** may weigh on government finance
- Uzbekistan's long-term growth perspectives supported by **diverse and abundant natural resources**, however, the country's has **exposure to water risk**



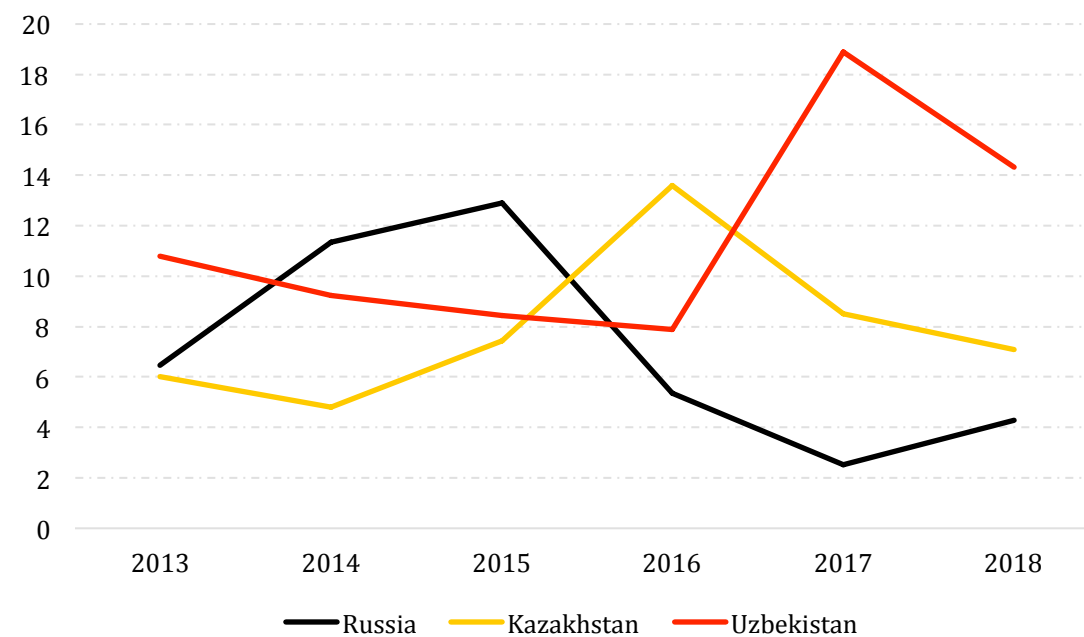
Negative factors

- The country remains one of the least developed amongst its peers as shown by the low level of **GDP per capita**
- The high volatility of **inflation persists**, after a peak in 2017, it remained elevated at 14,3% in 2018 and expected to be close to 15,5% be end 2019

GDP per capita at PPP, USD

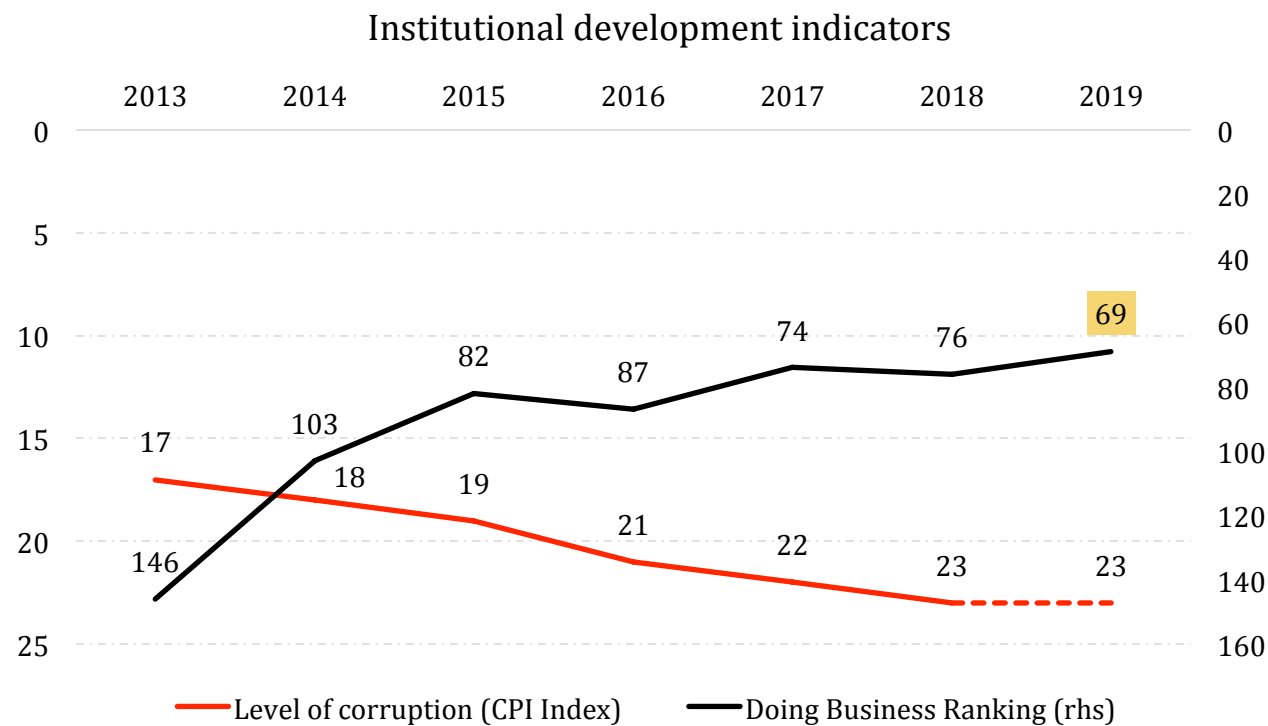


Annual inflation rate, % y-o-y



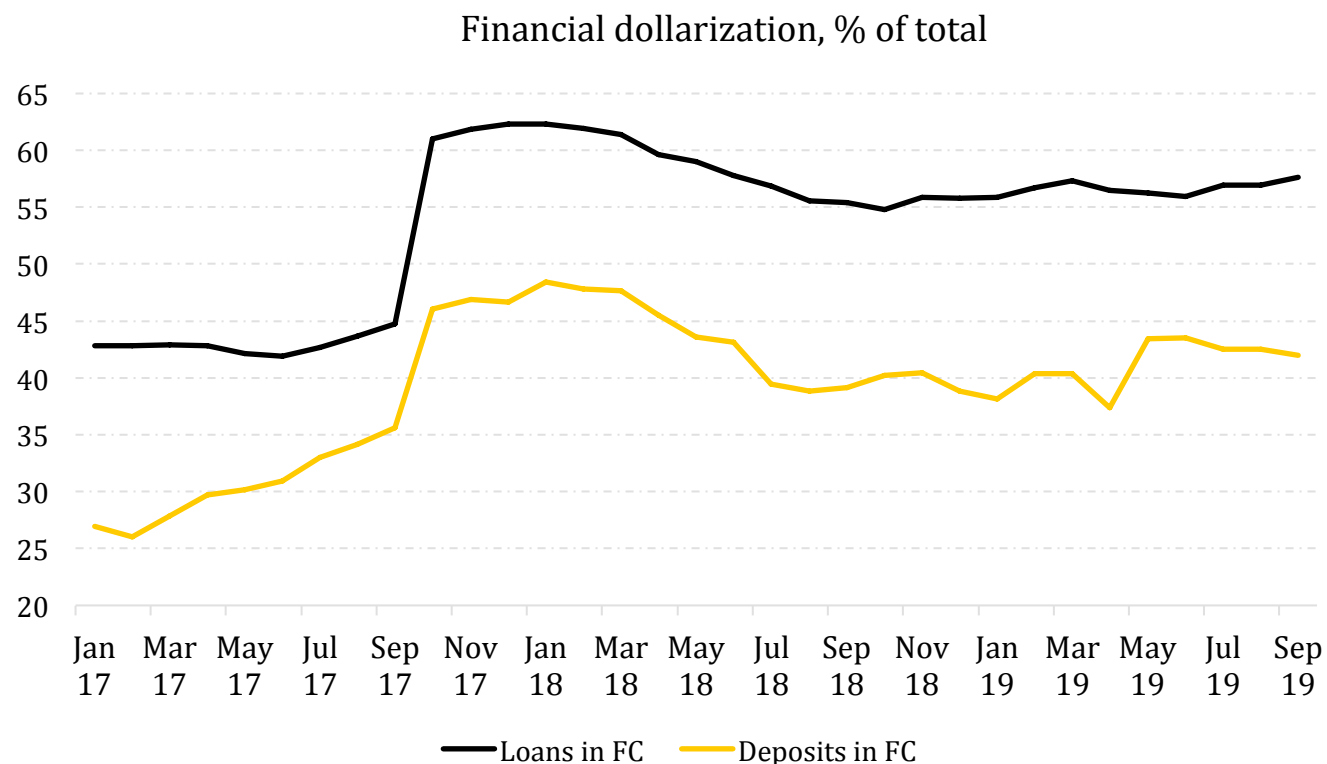
Negative factors

- Despite the recent reforms and improvements, **the institutional development is subdued** and hampered by the high level of corruption and the various legislative barriers
- The country's **capital market remains underdeveloped**, evidenced by a low market capitalization of companies listed on the national stock exchange of 5,3% of GDP in 2018



Stress-factor

- Despite positive dynamics, **financial dollarization** remains a problem for the economy representing 42% of total deposits and 57,6% of total loans in September 2019



Stable outlook

The **stable outlook** on ratings reflects our expectations about the **balance of negative and positive factors**, that might affect the rating in the future:

Could lead to an upgrade:	Could lead to a downgrade:
<p>Ensuring macroeconomic stability, economic growth and reduction of unemployment</p>	<p>Strong growth of directed lending with concentration in state banks, which may lead to increased external imbalances, higher inflation and materialization of contingent liabilities</p>
<p>Prudent and transparent fiscal policy focused on diversifying revenue sources and significant curtailing of policy lending programs</p>	<p>Sharp increase of dollarization levels due to adverse conditions on the FX-market</p>
<p>Improving the efficiency of monetary policy</p>	<p>Elevation of the government debt load due to devaluation of UZS</p>

Banking system credit risks of Uzbekistan

Banking Sector Risk (BSR)

- Assessment of BSR is an integral part of the process of assigning a credit rating according to the **international scale**. The Banking Sector Risk is assessed for the country where a bank's operations are concentrated (if the bank has a diversified structure of operations - in proportion to the distribution of assets)
- Group of **quantitative** and **qualitative factors** is assessed for each country:

Quantitative Factors	Qualitative factors
Credit Conditions	Bank regulatory capital to risk-weighted assets
Market Conditions	Level of government involvement in the banking sector
Funding Conditions	Presence of an active capital market in the economy
Institutional Framework	Political risk assessment
Economic Factors	State of the real estate market in the economy
Additional stress-factor:	Banking sector stability
<i>presence of a major crisis in the economy</i>	Systematic risks

- The risk assessment of the banking system is based on the final BSR score: from **15 (minimum risk level)** to **0 (maximum risk level)**

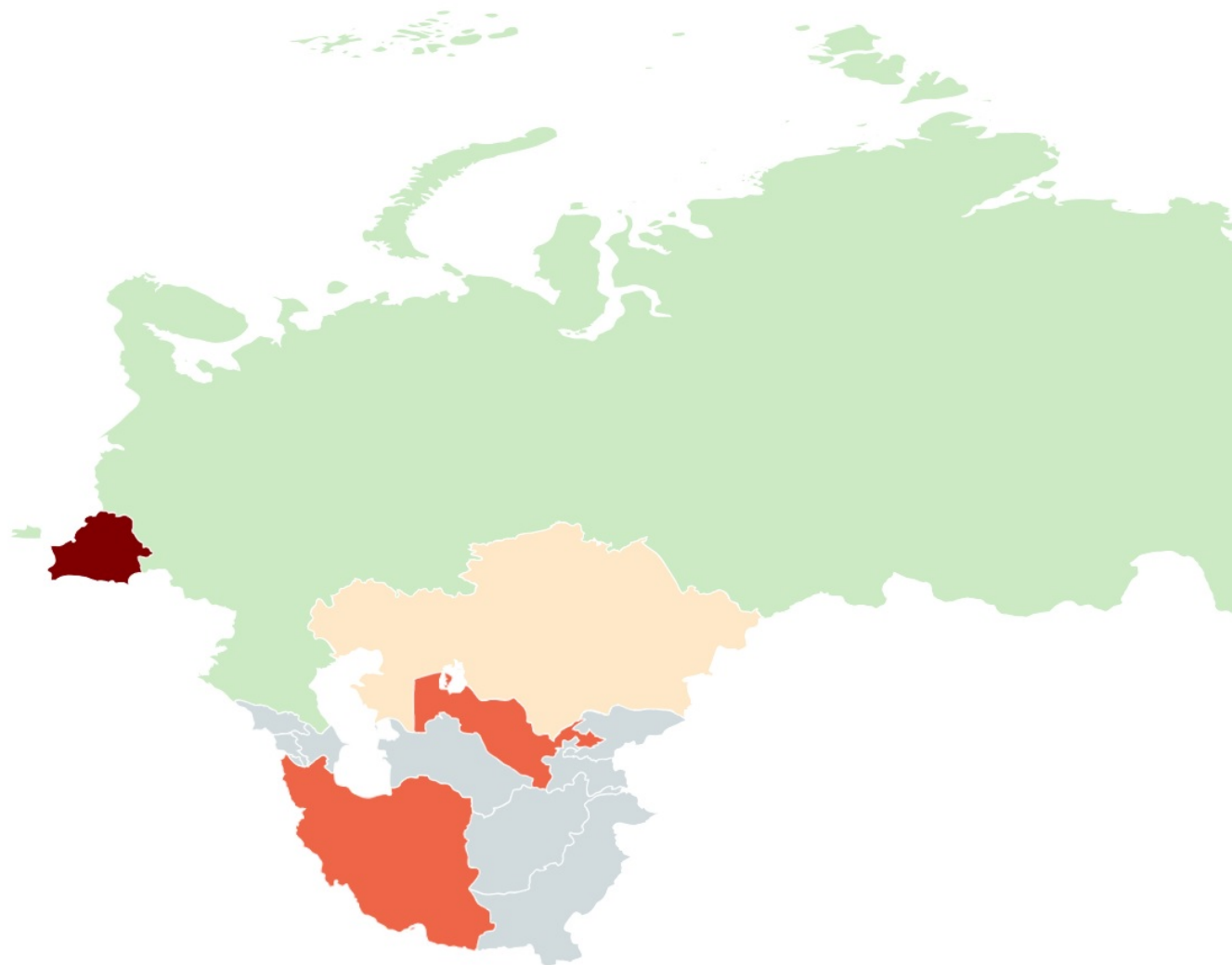
Banking Sector Risk (BSR)

- The final credit rating of a bank according to the **international scale** is assigned based on preliminary credit rating of the bank and an assessment of the Banking Sector Risk:

		BSR														
		15	14	13	12	11	10	9	8	7	6	5	4	3	2	1
Preliminary credit rating	1	AAA / AA+	AAA / AA	AA+ / AA-	AA / AA-	AA- / A+	AA- / A	A+ / A	A / A-	A- / BBB+	BBB+ / BBB-	BBB / BB+	BBB- / BB	BB+ / BB-	BB- / B+	B+ / B
	2	AA+ / AA	AA / AA-	AA- / A+	AA- / A	A+ / A	A / A-	A- / BBB+	A- / BBB	BBB+ / BBB-	BBB- / BB+	BB+ / BB	BB / B+	BB- / B+	B+ / B	B / B-
	3	AA / A+	AA- / A+	A+ / A	A / A-	A / BBB+	A- / BBB+	BBB+ / BBB	BBB / BBB-	BBB- / BB+	BB+ / BB	BB / BB-	B+ / B	B+ / B	B / B-	B- / B-
	4	A+ / A	A+ / A-	A / BBB+	A- / BBB+	BBB+ / BBB	BBB+ / BBB-	BBB / BBB-	BBB- / BB+	BB+ / BB	BB / BB-	BB- / B+	B / B	B / B-	B- / B-	B- / CCC+
	5	A / BBB+	A- / BBB+	BBB+ / BBB	BBB+ / BBB-	BBB / BBB-	BBB- / BB+	BBB- / BB	BB+ / BB-	BB / BB-	BB- / B+	B+ / B	B / B-	B- / B-	B- / CCC+	CCC+ / CCC+
	6	BBB+ / BBB-	BBB+ / BBB-	BBB / BB+	BBB- / BB+	BBB- / BB	BB+ / BB	BB / BB-	BB- / B+	BB- / B+	B+ / B	B / B-	B- / CCC+	B- / CCC+	CCC+ / CCC+	CCC+ / CCC+
	7	BBB- / BB+	BBB- / BB	BB+ / BB	BB+ / BB-	BB / BB-	BB / B+	BB- / B+	B+ / B	B+ / B	B / B-	B- / B-	CCC+ / CCC+	CCC+ / CCC+	CCC+ / CCC	CCC+ / CCC
	8	BB / BB-	BB / BB-	BB / B+	BB- / B+	BB- / B	B+ / B	B+ / B	B / B-	B / B-	B- / CCC+	B- / CCC+	CCC+ / CCC	CCC+ / CCC	CCC / CCC	CCC / CCC
	9	BB- / B	BB- / B	B+ / B	B+ / B-	B / B-	B / B-	B / CCC+	B- / CCC+	B- / CCC+	CCC+ / CCC	CCC+ / CCC	CCC / CCC	CCC / CCC	CCC / CCC	CCC / CCC
	10	B / CCC+	B / CCC+	B- / CCC+	B- / CCC	B- / CCC	B- / CCC	CCC+ / CCC	CCC+ / CCC	CCC+ / CCC	CCC / CCC	CCC / CCC	CCC / CCC	CCC / CCC	CCC / CCC	CCC / CCC
	11	CCC+/D	CCC+ / D	CCC / D	CCC / D	CCC / D	CCC / D	CCC / D	CCC / D	CCC / D	CCC / D	CCC / D	CCC / D	CCC / D	CCC / D	CCC / D

* Schematic representation

Banking Sector Risk (BSR) of the Republic of Uzbekistan



Country	BSR score	Risk level
Russia	6	Moderate
Kazakhstan	4	High
Uzbekistan	2	Very high
Iran	2	Very high
Belarus	1	Very high

BSR score reflects the state of banking sector macro environment in each country rated and is scaled from 1 to 15, ranging from very high risk to very low risk levels of the banking sector respectively.

Key negative factors

- Moderately **small economy** (the second largest economy of Central Asia, but more than three times smaller as compared to Kazakhstan)
- Very low **level GDP per capita**
- Double-digit **inflation** in one of the highest in region
- **Institutional environment** for the credit institutions remains subdued

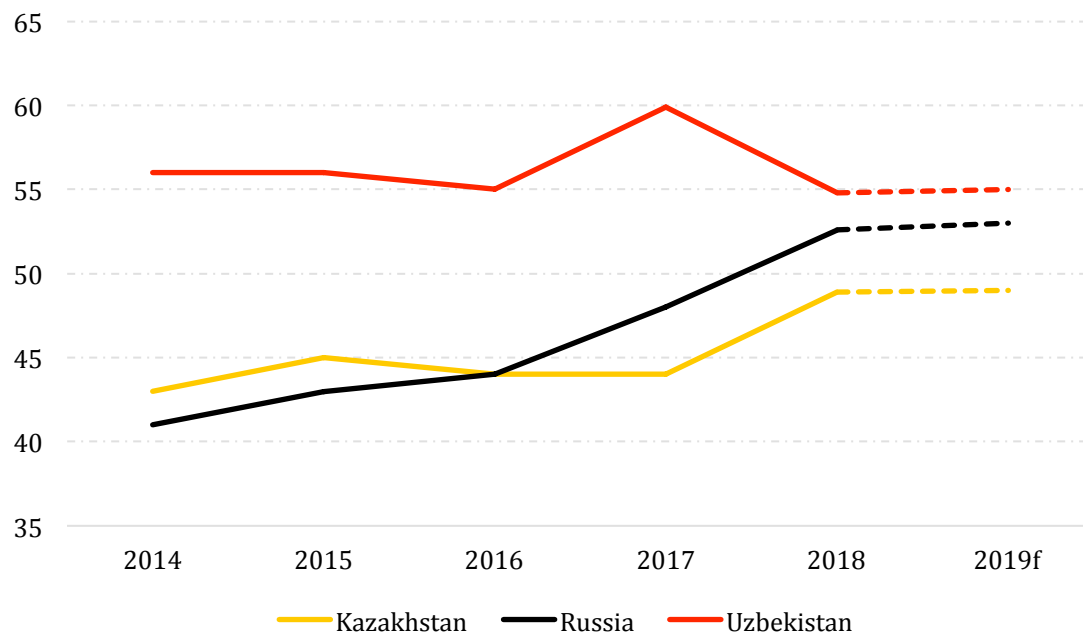
	Kazakhstan	Russia	Uzbekistan
Nominal GDP, USD bn	153	1 495,3	48,9
Real GDP growth, %	4,1	2,3	5,1
GDP per capita at PPP, USD	27 660	29 380	8 320
Inflation rate, %	5,3	4,3	14,3
Total assets of the banking system, USD bn	65,7	1 354,3	25,7
The ratio of bank assets to GDP, %	42,9	90,6	66,9

*as of end 2018

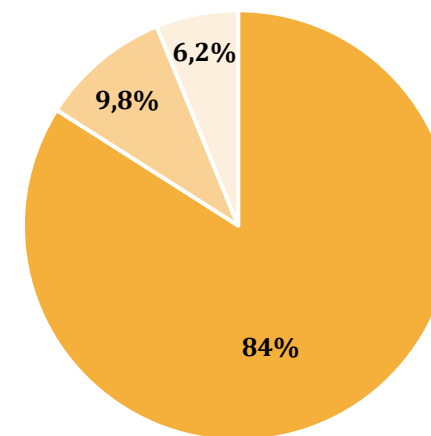
Key negative factors

- Among the three largest economies in the CIS the Republic of Uzbekistan at the end of 2018 had **the most concentrated banking system**
- **State ownership** dominates the banking system

Dynamics of the banking system concentration (share of three largest banks assets in total banking assets), %



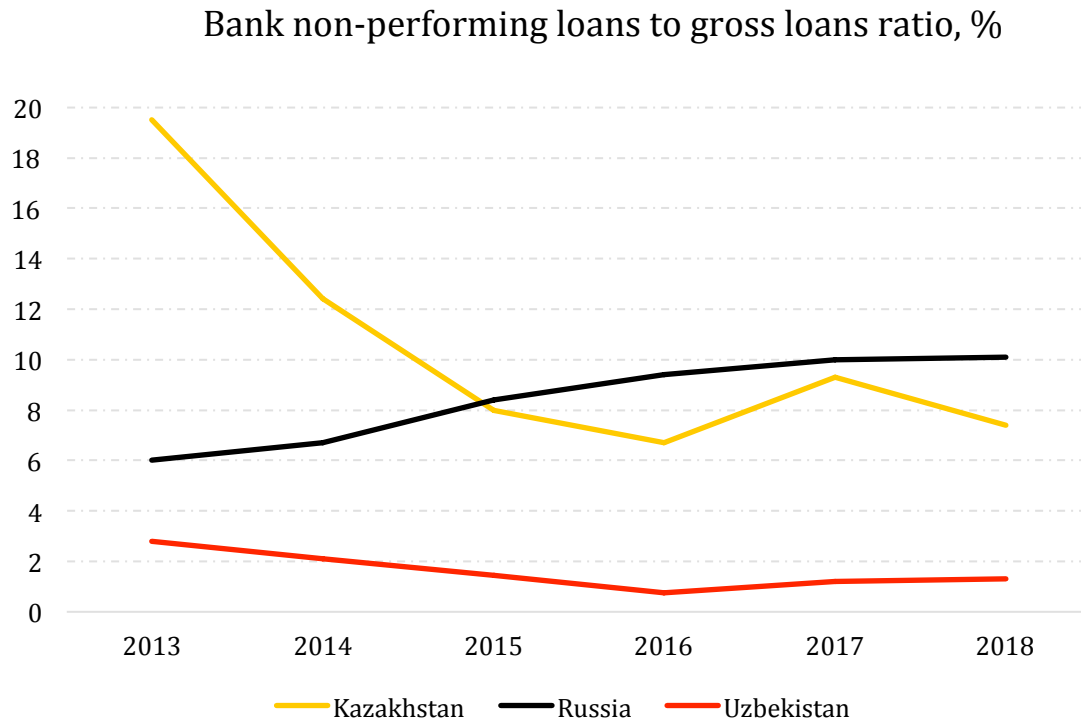
Structure of the banking system assets by type of banks, %



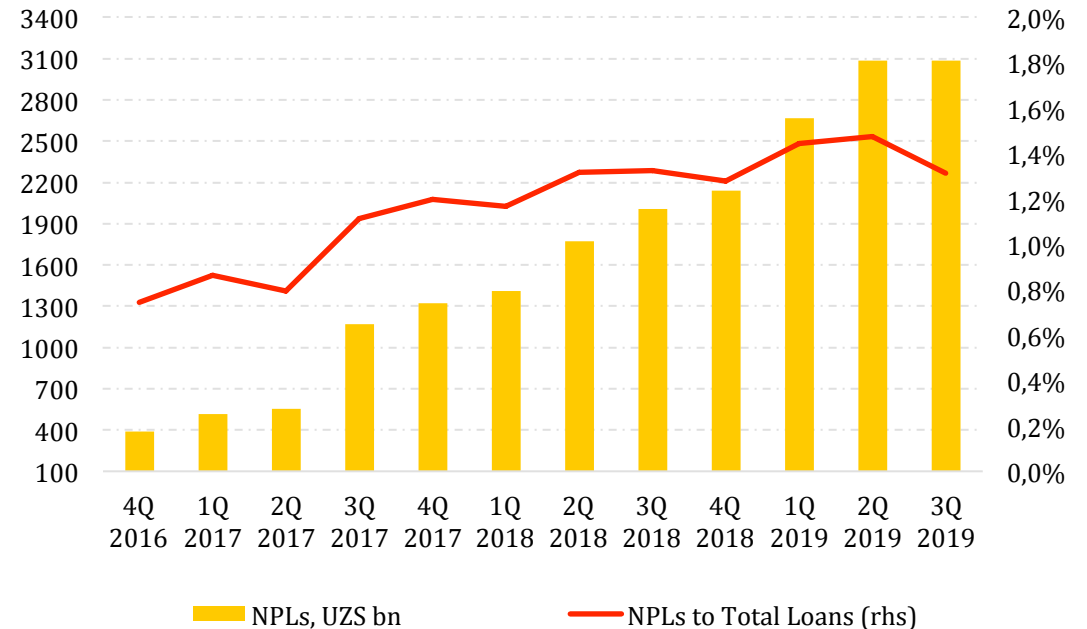
Government owned Private domestic Private with foreign capital

Key positive factors

- The ratio of **officially reported bank nonperforming loans to gross loans** in Uzbekistan is at a minimum level among the countries of the region



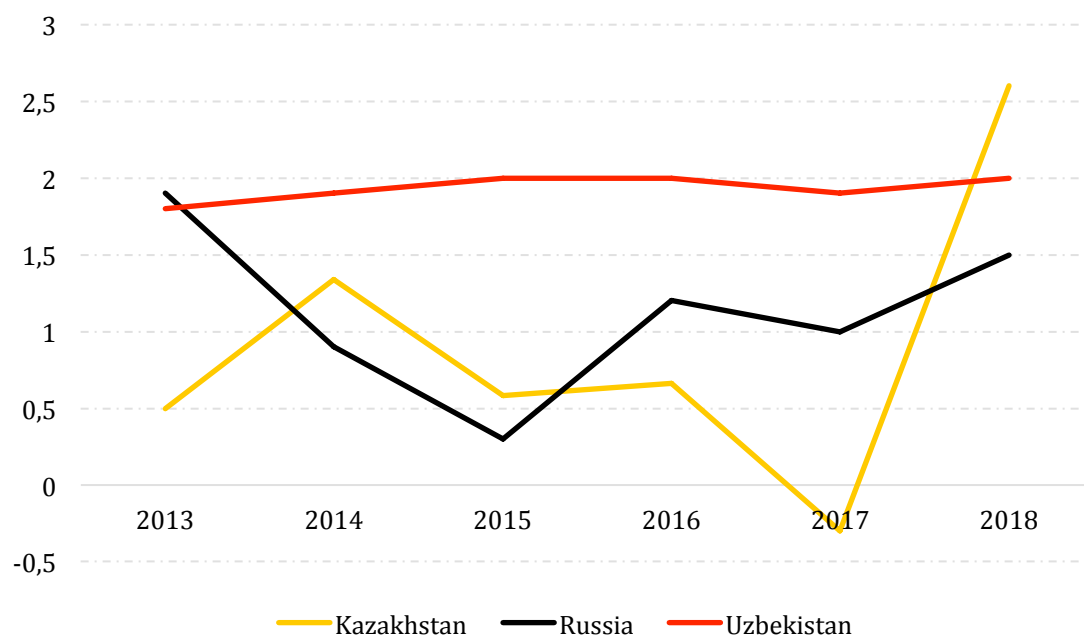
Non-performing loans of the banking system of Uzbekistan according to the national standards



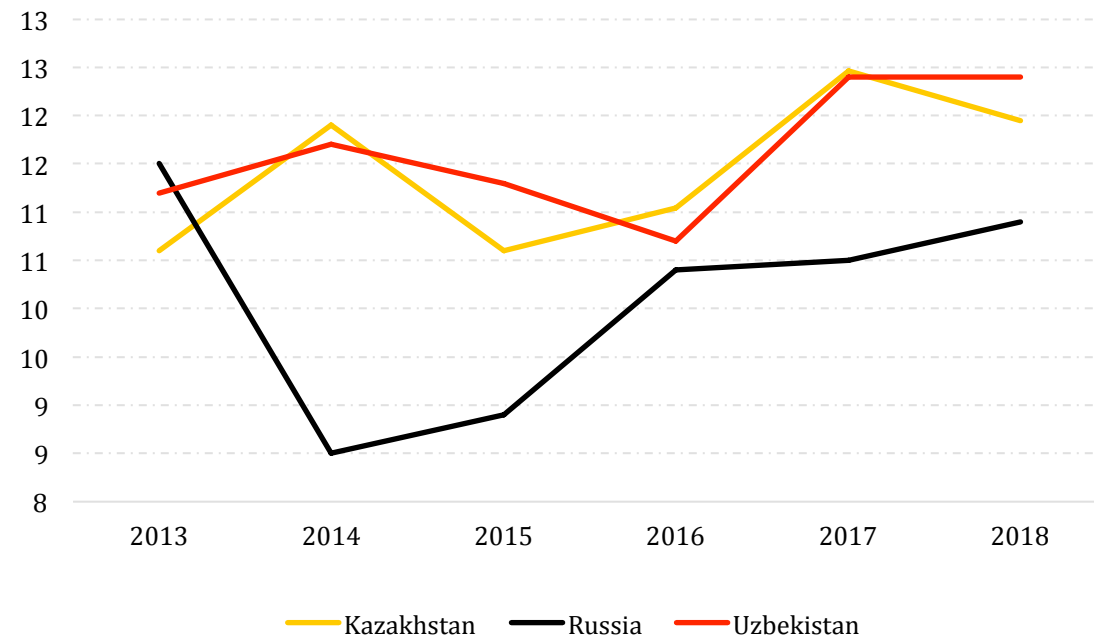
Additional positive factors

- The banking system of Uzbekistan demonstrated a **positive financial result** over the past 5 years, and remained profitable even during the devaluation of UZS
- In Uzbekistan the ratio of **bank capital to assets** remains high according to global standards but close to the levels typical for emerging markets

Return on assets ratio (ROA), %



Capital to assets ratio, %



Outlook

- The key risks of the banking system is growing **concentration on government-owned banks** and **elevated financial dollarization**
- Booming lending may lead to a **possible deterioration of the asset quality** in the medium term
- Probability of **financial support of the banking system by the government** in case of a crisis is assessed as high
- In the long run, the main constrain factor of the banking system risk assessment score is the **level of economic development**



Thank you for your attention!

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