

## Risks to the Economy of Uzbekistan in 2021

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**ABSTRACT:** It is expected that in 2021 the main risks and challenges in the world will be associated with uncertainty about the further spread of the pandemic and the possibility of transition to economic recovery processes after the shocks of 2020.

Against this background, it is advisable to analyze what awaits the economy of Uzbekistan in 2021 and what challenges the Uzbek economy will have to overcome.

**KEYWORDS:** payment balances, stability, budgetary, restrictions, lockdown, recovering, export, import, currency exchange.

### Introduction

According to the financial institution, while the pandemic hit the economy hard in the first half of 2020, the downturn was cushioned by strong restrictive measures and support. A set of measures was taken in the budgetary, monetary and financial spheres - they were made possible thanks to the significant buffer stocks accumulated by the implementation of balanced macroeconomic policies in previous years and significant international support. Therefore, the economy began to vigorously recover in the second half of the year.

**Risks to Macroeconomic Resilience.** The coronavirus pandemic and the associated challenges, possible negative manifestations in the form of continued large-scale restrictions in international passenger traffic, lockdowns in individual countries are expected to retain their negative impact on the economy of Uzbekistan, in particular, in the following areas.

1. It is visible to everybody that, recently, in connection with the liberalization of the economy, inflation has been observed. The central bank has set an inflation target for 2021 at 10%. Meanwhile, the greatest risks for inflation may arise from a possible rise in import prices. A possible widening trade deficit, as well as a significant reduction in foreign investment flows and remittances, could put pressure on the exchange rate.
2. The stability of the national economy may also be under pressure from a potential decrease in the volume of remittances from labor migrants. According to the World Bank, due to the continuation of COVID-19 at the end of 2021, the volume of remittances in the world may decrease by 14% compared to the level of 2019. Globally, cuts in production, wages and jobs are expected to reduce demand for labor from Uzbekistan. Also, foreign countries may introduce new restrictions on the entry of citizens of Uzbekistan due to precautions related to COVID-19. All this will undoubtedly affect the volume of remittances of labor migrants to the country. In turn, the reduction in remittances will negatively affect the balance of payments, to some extent putting additional pressure on the exchange rate of the soum.
3. High dependence on commodity exports such as gold, copper and gas, as well as remittances from Russia, which is also prone to commodity price shocks, could leave Uzbekistan vulnerable to adverse changes in global market conditions, as has been the case in the past. year. So, it was the increase in the share of gold exports in the total export volume up to 40.9% following the results of 9 months, which made it possible to compensate for the significant reduction in the export of other goods due to the pandemic crisis. If the Federal Reserve prioritizes further quantitative easing with the arrival of President-elect Joe Biden's administration, the dollar will fall further in value and gold prices will rise.
4. In the banking sector, uncertainty about the spread of the virus could lead to an increase in the cost of credit. The possible continuation of the economic crisis due to COVID-19 is likely to lead to an increase in reserves for possible loan losses, which, in turn, could lead to lower profits. Consolidation requirements and lower risk appetite may induce banks not to finance higher risk projects. In addition, the government support measures that have strengthened banks and helped borrowers survive in difficult times cannot last forever. The expected phase-out of such support in 2021 will negatively affect the quality of banks' underlying assets.
5. Public debt is subject to exchange rate and interest rate risks. Loans to the general government are denominated in foreign currencies, mainly in US dollars, which makes them sensitive to changes in the exchange rate. In addition, floating rate loans account for about half of the external debt portfolio, which makes debt servicing sensitive to changes in interest rates. It should be borne in mind that there is uncertainty about the expected dynamics of the dollar. To stimulate the national economy, the Democrats are planning to resort to large-scale budgetary injections

into the economy. Specialist from National Australia Bank Ltd. Rodrigo Catril said: "Yellen's position shows that the US government is unlikely to prevent the dollar from falling." But how the situation will develop in this direction is still not clear.

6. Naturally, the unwinding of negative scenarios creates risks of an increase in the consolidated budget deficit from the forecast indicator for 2021, set at 5.4% of the WFP. This, in turn, will lead to additional serious pressure on the stability of the economy. For example, according to calculations by CEIR, an increase in the deficit by 1 percentage point to GDP may lead to an increase in inflation by 0.6 percentage points. From the target inflation rate (10%), as well as the current account (trade balance) by 0.4 pp, will put pressure on the exchange rate of the soum against the dollar.

A potential deterioration in working conditions, especially in key sectors such as hospitality and retail, lower real estate rates, and increased corporate insolvency could lead to deterioration in creditworthiness and profitability, undermining confidence in banks.

### **Sectoral challenges.**

In addition to general risks and challenges that can have a negative impact on the successful development of the entire economy, it is also necessary to say about possible challenges and the persistence of negative trends, one way or another affecting the development of certain sectors and industries of the economy of Uzbekistan.

1. The continuation of the pandemic in 2021 also poses a number of threats to the country's agricultural sector and food security. As 2020 has shown, in the face of sharp shocks, countries impose restrictions on the export of food products. Considering that Uzbekistan is a net importer for certain types of food products, possible repeated restrictions on exports from Kazakhstan, Russia and other countries may create certain difficulties in the domestic market. For example, a possible ban on the export of soybeans, sunflower seeds, flour, sunflower oil and other food products from the EAEU countries in connection with the new wave of the COVID-19 pandemic may lead to a significant decrease in the production of domestic enterprises due to a lack of imported raw materials and rising prices in the domestic market.

A long-term risk for domestic producers and exporters of fruits and vegetables is the import substitution policy pursued by Russia. In Russia, under the conditions of sanctions and the depreciation of the ruble, there is an acceleration of the import substitution process for such agricultural products as dairy products, fruits (apples), tomatoes, etc. that Russians are switching to more affordable products.

2. In the industrial sector, risks are associated both with the situation in foreign markets and with the changing conditions of the activities of economic entities. From the perspective of this article, one cannot but mention the existing short-term shocks and risks for manufacturers as a result of the cancellation of benefits and preferences, thanks to which they managed to maintain financial and economic stability last year. These risks exist for a number of manufacturers in the building materials industry, electrical engineering, and ferrous metallurgy.

Changes in the external environment also carry additional risks and challenges for industries. For example, ferrous metallurgy enterprises depend on the import of raw materials. Therefore, any changes in the regulation of the sale of ferrous metallurgy raw materials to foreign markets in the Russian Federation may create additional difficulties for domestic enterprises. On December 28, 2020, the Federal Antimonopoly Service of Russia (FAS) proposed introducing a regressive system of export duties on all steel products from raw materials to final products. For domestic enterprises, this carries the risks of an increase in prices for imported raw materials and, as a result, an increase in prices for manufactured products.

3. For the light industry, which is export-oriented and supplies a significant part of its output to foreign markets, the pandemic has become a period of both serious shocks and new opportunities. On the one hand, this is a decline in demand for clothing, on the other, an explosive growth in demand for textile products for medical purposes - protective masks, overalls, materials used in their production. In 2021, if the situation with the coronavirus improves, in the countries - the main trading partners, we should expect a decline in demand for protective masks and overalls. At the same time, the demand for clothing around the world will remain below the pre-crisis level. According to The State of Fashion 2021 McKinsey & Company and The Business Fashion report, global apparel sales by the end of 2020 will decline by 15-30% and it will take at least 2 years for the industry to recover revenues. This could hold back a potential increase in Uzbekistan's apparel exports.

4. The tourism industry has become one of the hardest hit by the coronavirus pandemic. In 2021, tourist flow is expected to remain lower compared to the period before the coronavirus pandemic, due to continued restrictions on passenger traffic in interstate traffic and the risks of a new round of the spread of coronavirus. However, in Uzbekistan, the government is taking steps to keep tourism businesses afloat during this challenging time. Meanwhile, the persistence of the problems of previous years will minimize the opportunities for an increase in tourist flow and slow down the development of the industry in subsequent years, when the pandemic is over. For example, the continued low

level of development of the basic tourism infrastructure will continue to negatively affect the tourist attractiveness of Uzbekistan. The low degree of diversity of existing entertainment establishments will restrain the development of the country's tourism potential and limit the possibilities for additional monetization of tourism services. The lack of diversification of air travel destinations increases the likelihood that tourists and citizens of Uzbekistan can use the airports of neighboring countries. In the long term, the lack of accommodation can lead to an increase in prices for accommodation and catering services, given that in 2019 the occupancy rate of tourist accommodation facilities was more than 80%.

5. Energy security risks. Not related to the pandemic, the threat of a shortage of fuel and energy resources for a dynamically developing economy clearly manifested itself last year in the form of rolling blackouts, restrictions on the operation of gas stations, and a decrease in gas pressure among consumers. Thus, without taking timely proactive and anticipatory measures, there is a high probability of a repetition of local blackouts, a shortage of fuel and energy resources, especially in the autumn-winter period, which naturally can lead to an increase in social discontent.

Interruptions in the supply of energy resources, especially natural gas, have an extremely negative impact on producers. For example, in October-November 2020, 173.5 thousand tons of cement were not produced in the country due to a shortage of 18.3 million cubic meters of natural gas. The lack of natural gas forces consumers to use other sources of energy, mainly coal, which creates risks of increased imports of coal products from neighboring countries, since their own coal is of low quality. Agriculture is another prime example of the risks posed by a shortage of natural gas to the economy. Greenhouse farms in Uzbekistan experience limited access to natural gas.

Meanwhile, in neighboring countries, where the greenhouse business is also actively developing, gas for greenhouses is supplied uninterruptedly and at the same time is cheaper. Thus, gas in Kazakhstan is 30-40% cheaper than in Uzbekistan. In Turkmenistan, gas is supplied to local greenhouses about 2-3 times cheaper than in Uzbekistan. As a result, Kazakhstan and Turkmenistan are increasing their exports of greenhouse vegetables much faster than Uzbekistan. This situation leads to an increase in production costs, a decrease in the competitiveness of domestic producers of fruit and vegetable products and carries with it the risk of losing a share in foreign markets for Uzbek fruit and vegetable products.

In this perspective, it should be noted that in 2021, as noted in the President's Address, the formation of a wholesale electricity market will begin and market mechanisms will be introduced in the supply of natural gas, which is expected to optimize and increase the efficiency of energy use in the country. Another solution to mitigate the situation in the fuel and energy complex is the further diversification of energy sources, in particular, an increase in the share of renewable energy sources, which now account for only 11.2% of the total electricity generation. A massive increase in renewables will also help slow the depletion of hydrocarbon resources and air pollution.

As you know, Uzbekistan is a large exporter of natural gas, the sale of which provides a significant inflow of foreign currency earnings of the country. Despite the long-term plans to reduce the export of raw materials and increase gas processing within the republic, there is no need to talk about the immediate cessation of gas exports, as this will lead to a sharp increase in the current account deficit and a reduction in gas production due to a lack of processing capacities. From this perspective, Uzbekistan over the next few years will be interested in the supply of blue fuel to foreign markets.

In this regard, the sharp decline in demand in 2020 due to the pandemic in the main sales markets - Russia and China - seriously affected the volume of exports. Accordingly, given that there is still uncertainty about the pandemic in 2021, risks remain associated with low volumes of natural gas exports. In addition to this, it must be said that the low level of diversification of exports of oil and gas products (98.8% of Uzbekistan's products are in 6 countries) creates risks of dictating prices and terms of supply by importers.

Digitization and Cybersecurity. Cybersecurity threats in the context of the forced digitalization of the economy are extremely dangerous and the inability to effectively resist such threats makes the economy of Uzbekistan extremely vulnerable. For example, according to the IT threat evolution Q3 2020 Kaspersky report, the risk of infection in Uzbekistan by banking Trojans and malware for ATMs and POS terminals is 4.6%, and Uzbekistan ranks 4th in the world in terms of exposure to the risk of possible infection. The rapid transition to online banking is increasing the risk of cyberattacks.

Despite the accelerated digitalization of economic activity in recent years, the lag behind not only the leading countries, but also the neighboring countries in many areas, still persists, which reduces the competitiveness of the economy. This, in turn, creates risks, for example, in the transport sector, where a low level of integration into international information logistics systems and a lag in the digitalization of transport services relative to other countries will negatively affect the country's transit competitiveness.

On the other hand, the pandemic has given a powerful impetus to the development of online sales. For example, according to The State of Fashion 2021 McKinsey & Company and The Business Fashion report, fashion executives

expect their online sales to grow by an average of 20% in 2020. This means that if domestic enterprises lag behind the trend of digitalization of sales, they will begin to lose their competitiveness.

Naturally, the pandemic has already adjusted the usual format of life. New forms and tools of doing business, distance learning and work were tested in the world and in Uzbekistan. The pandemic has given a powerful impetus to digitalization in all areas. This leads to increased global competition in the IT market, in the field of high technologies and innovations. And the risk of Uzbekistan lagging behind the global mainstream in the future can be costly and significantly reduce the competitiveness of the domestic economy.

### Conclusion

Thus, 2021 presents many challenges for the national economy of Uzbekistan. The continued uncertainty regarding the further development of the pandemic in the world, geopolitical risks, short-term negative effects caused by structural reforms will accompany a gradual recovery in business and investment activity. Due to the continuing risks, achieving the declared forecast parameters for GDP growth by 5.1% in 2021 may become a rather difficult task.

However, as 2020 showed, the country's economy remains resilient to shocks, which was manifested in the preservation of positive GDP growth. In this regard, in the absence of large-scale lockdowns and a gradual recovery of the world economy, the achievement of the declared indicators will be quite feasible.

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