

A stylized illustration of a phoenix, a mythical bird that is reborn from its own ashes. The phoenix is depicted in vibrant orange and red, with its wings spread wide, rising from the bottom of the frame. The background is a deep green, featuring a faint, light green star and crescent symbol at the top center. The Uzbek flag is visible at the bottom, with its characteristic blue, white, and green horizontal stripes and a white crescent and star on the blue stripe. The overall composition suggests a theme of rebirth and resurgence.

SPECIAL REPORT

# UZBEKISTAN RISING





# Uzbekistan rising

Ben Aris in Tashkent

Uzbekistan's economy is taking off. President Shavkat Mirziyoyev, who was just re-elected for another five years, took over five years ago and launched a radical reform programme. He re-opened the country to the rest of the world. The government started frenetically working to modernise and put the country on a market footing. At the same time, the president launched a diplomatic effort to better integrate Uzbekistan in the region and further afield, as well as try to create something like a common market with his neighbours in the region. Now all that work is starting to bear fruit.

A tour of the country in October revealed extraordinary progress. In an unsung success the entire cotton sector – long the backbone of the country's economy to the extent that cotton plants are part of the nation's symbol – has been completely privatised and the entire sector put into privately owned commercial hands. The wheat sector, also strategically important and also

part of the national emblem, is currently undergoing the same transformation, which will be completed next year.

A string of banks are being prepared for privatisation and the first big bank, the mortgage specialist Ipoteka Bank, has already been sold to Hungarian investors, with another nine banks from the total of 12 to be put under the gavel soon.

But more impressive is that every factory and kombinat visited on the tour is in the midst of, or has already completed, investment projects to expand and modernise their production to meet burgeoning demand and rapidly growing exports.

The lifting of currency controls in 2017 that transformed the foreign trade regime means Uzbekistan's biggest and best enterprises have seized the opportunity to start exports, which have ballooned. Initially only involving the country's immediate neighbours in the first round, foreign trade has since

expanded and exports are now going to the whole of the Commonwealth of Independent States (CIS), China, Turkey and even the African market, which has recently been opened to made-in-Uzbekistan goods. The country was awarded the sought-after general preferential trade status for textile exports to the EU in April; this allows it to sell cotton fabric and fibre without duties or quota restrictions. Textile exports have already more than doubled this year, and privately owned white goods manufacture Artel has become the biggest maker of consumer gizmos in the whole CIS. Its factory, located in the wastes of the Kyzyl-Kum desert, is becoming a truly international business.

The sense of optimism is palpable. The lives of the ordinary people have improved materially. Mirziyoyev's re-election on October 24 was criticised for the total lack of any real opposition candidates, but according to voters polled by this publication he would have won a landslide victory even if there had been competition. The

population are extremely happy with the way things are going and are happy to let Mirziyoyev keep going.

The Central Bank of Uzbekistan told *bne IntelliNews* in an interview: "We face no major risks or difficulties at the moment. Our task now is to manage the growth and put the republic on a solid footing and modernise the economy."

## Long road

When I first arrived in the country as a young correspondent in 1995, tasked with reporting on its first attempt to open up to the rest of the world, the country was in almost total collapse. Industry was not functioning. The currency had been deeply devalued to the point where it was almost worthless. Inflation was in triple digits. The power was out and the shops were empty. If it hadn't been for the open-air markets and Uzbekistan's legendary agricultural output the situation for its citizens would have been impossible.

The lifeline that kept the country afloat was cotton. A major producer in Soviet times, cotton exports remained the newly independent Uzbekistan's main source of hard currency earnings, of about \$3bn a year.

Nevertheless, investors were flooding in because it is the largest and most populous of the five so-called Stans (Tajikistan, Turkmenistan, Kyrgyzstan, Kazakhstan and Uzbekistan) and had so much to offer. A large and largely young population of 35mn makes it by far the biggest retail market in Central Asia. As the only country to share a border with all the other Stans – Uzbekistan is also one of only two double-landlocked countries in the world – makes it the natural production and distribution centre for the rest of the region. And its lack of massive hydrocarbon resources means that it already had a relatively diversified economy based on textiles, manufacturing, gold mining, food processing and other industries.

It should have taken off. But when the country's former president Islam Karimov got the bill for the opening of trade in the form of a \$1bn trade

deficit he lost his cool. "We are not going to spend our hard-earned foreign currency on importing chewing gum," he said in a famous speech. He clamped down and introduced strict exchange controls that killed business off dead.

The next 20 years are a story of stagnation and autarky, where Karimov tried to make the hobbled republic work by reaching for the tools most familiar to him: a state-dominated centrally planned command economy. To give him credit, the economy did make progress. Industry was rescued and a sophisticated automotive sector built up that exported its UzDaewoo cars all over the CIS, now rebranded UzAvto after Daewoo collapsed several years ago. Rising gold prices added another source of revenue and Karimov introduced some market reforms such as special economic zones, but they were not enough. Uzbekistan fell far behind its local rival Kazakhstan, even if it didn't turn into a complete basket case like Tajikistan and Turkmenistan.

Many people interviewed for this article were appreciative of the stability and improved living conditions they enjoyed under Karimov and he is not

"We face no major risks or difficulties at the moment. Our task now is to manage the growth and put the republic on a solid footing and modernise the economy"

widely seen as the dictator that he is viewed as in the West. Certainly the new administration has in no way demonised or heavily criticised Karimov, but then Mirziyoyev served as his prime minister for several years, so the current administration prefers to emphasise the continuity.

## Change of guard

The first stop of the tour was the far western town of Nukus, a lost settlement in the midst of the Qizilqum (aka Kyzyl-Kum) desert and the capital of Karakalpakstan, the birthplace of the Turkic people.

When I first visited Nukus over 20 years ago I went with a Turkish friend who was running a UN programme that gave chickens to women so they could support themselves by selling eggs and at the same time add some protein to their diet. The city was an ecological disaster, as over-irrigation had seen the water table rise to the surface and the fields were caked with salt that lay like snow on the ground. The local firms had no money and were paying their workers with sacks of pasta so that at least they had something to eat.

The white goods manufacturer Artel set up a Hoover assembly plant in Nukus in 2011 during Karimov's time under licence from Korean consumer electronics giant Samsung, but since then has expanded production to include several of its own branded items that are now best sellers not only in Uzbekistan but throughout Central Asia and in the CIS.

After a stop-off in the ancient Silk Road way station of Khiva where the legendary 1,001 Nights stories are set, we travelled on to the industrial mining town of Navoi that is home to Muruntau, the largest open-cast

gold mine in the world, as well as NavoiAzot, a large petrochemicals plant, and Qizilqumsement, the biggest cement plant in the country.

When I visited the gold mine 20 years ago the city was a grimy run-down place with few shops and little life on the streets, populated by mainly Russians and Ukrainians that knew the mining business well from their homelands. The US company Newmont had opened a gold processing plant that was working the thousands of tonnes of tailings from decades of Soviet gold mining that were still rich with the yellow ore in a simple



process to turn the rocks into gold. A fortified shed next to the plant was stacked from floor to ceiling with bars of gold.

Today the mine is flourishing. Newmont is long gone following a dispute with Karimov over tax payments, but the mine is still working the tailings, but is expanding its open-cast operations and is on track to increase output by 30% in the next five years. However, the main event will be its 100% privatisation,

We want to be transparent and have everything to international standard!"

Currently international consultants McKinsey are auditing the assets and valuing the works, but the corporate restructuring has already been completed and the sale of the company is awaiting a government decision.

NavoiAzot has been investing in several new product lines and has just launched the production of PVC

The plant is of Soviet vintage, set up in 1977, and is the biggest cement maker in Central Asia. If construction is one of the main drivers of economy growth, then the frenetic activity at the cement plant is perhaps a good indicator of the changes in the Uzbek economy. The beaten huge silos of the original production stand at the back of the territory and continue to churn out some 3mn tonnes of cement a year entirely for the domestic market, as domestic demand is currently outstripping domestic supply by 6mn tonnes, forcing Uzbekistan to import cement.

Qizilqumsement is investing \$112mn to add a fourth production line, the first significant investment made since 1986. The grounds of Qizilqumsement are littered with material and equipment as a new silo soars overhead and is already more than half completed. The company is funding 81% of the investment from its retained earnings and the rest has been taken as commercial loans from Uzbek banks.

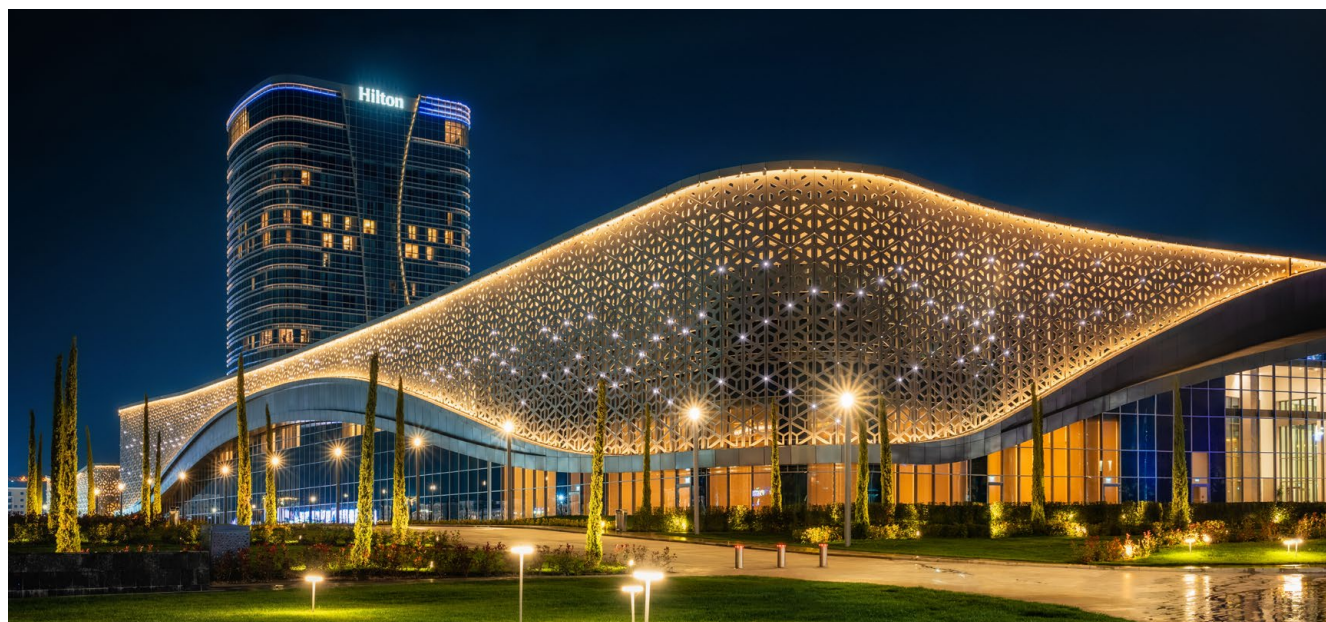
"In 1994 we had to close down one of the three lines, as there was no demand," says Abduqahhor Salomov, the general director of Qizilqumsement. "Today we can't produce enough and even after the new line goes into action we will be working at full capacity. You can feel the difference in the country." ●

"Many are appreciative of the stability and improved living conditions they enjoyed under Karimov and he is not widely seen as the dictator that he is viewed as in the West"

where shares will be sold on the open market. The gold mine will be ready to be privatised from January 1, its ebullient director told *bne IntelliNews*.

"We are 90% ready!" chief engineer Nikolai Snitka told *bne IntelliNews* in an interview. "It could happen from January 1. The company has been restructured and transformed into a joint stock company [JSC]. International consultants like McKinsey are currently auditing the assets.

plastics that have never been produced in Uzbekistan before. The demand has been so great that the company has already launched a second project to more than double the production together with some Chinese investors. Previously the company borrowed money for its expansion, but business has been growing so fast that now the company is investing its own funds, borrowing using commercial credits or inviting investors to participate.



Uzbek President Shavkat Mirziyoyev was criticised for running unopposed for re-election, but he hasn't abandoned democracy. He has turned instead to a system of social organisation that has been around since the Bronze Age in Central Asia – the Mahalla.

## Uzbekistan's Mahalla democracy

Ben Aris in Navoi

Uzbek President Shavkat Mirziyoyev was roundly criticised in September after he won re-election with a landslide, standing unopposed apart from a few straw men put up to make the elections seem legitimate.

As *bne IntelliNews* reported from Tashkent, there were a total of five candidates, including the incumbent, but the other four were from pro-government parties. The real opposition candidates from the traditional opposition parties were barred from the election, reportedly under pressure from the authorities.

However, this was no Lukashenko-like election and the landslide victory was genuine; voters vox-popped by *bne IntelliNews* in Tashkent on the day overwhelming supported Mirziyoyev and wanted him to stay on in office.

And election observers from the OSCE interviewed by *bne IntelliNews* on the day reported that the voting was free and fair, as far as the actual voting was concerned; there was no Russian-style mass stuffing of ballot

boxes, as no falsification was needed. Moreover, observers interviewed by *bne IntelliNews* said that the government was co-operating closely with the OSCE, as "they seem keen to understand how to run a free election."

Is Uzbekistan reverting to the Central Asia norm of centralised dictatorship where the president remains in office for life and elections are a sham, designed only to bolster the beloved leader's legitimacy. After all, that is

"Uzbekistan has adopted a political system that has been in use in Central Asia since the bronze age – the Mahalla"

the system the country had under its previous, and only, president since independence, Islam Karimov.

The truth is more complicated. The government is genuinely interested in giving its citizens a voice and it is working hard to deal with their problems. But what it has done is to

ignore Western style parliamentary politics where the policies are debated on the house floor and instead adopted a political system that has been in use in Central Asia since the bronze age – the Mahalla.

### The Mahalla

"The problem is not the lack of qualified people. We have managers enough. The main issue is to work more closely and more efficiently with the Mahalla. They connect social groups of 500-1,000 people. They tell us their problems and what they expect. Our work is to solve these problems from the bottom up," Tursunor Kabul, the Khakim, or mayor, of the city of Navoi told *bne IntelliNews* in an interview.

The Mahalla is a local organisation based on a community. This can be a few blocks on a street, a section of a city, a suburb or even just a village. The territory is ill defined but the Mahalla is a community living together with shared interests and needs and they form an elected representation that can then talk to the local authorities to meet these needs.

The issues the Mahalla deals with are manifold. If a couple wants to divorce the Mahalla will come and try to iron out the conflicts. If the breadwinner in a family dies or is incapacitated the Mahalla will club together to support them. And more significantly for the Mirziyoyev government, if the roads in the street

are broken, they lack a kindergarten or need gas to heat their homes in the winter, then the Mahalla will go to the administration and request them.

Kabul says that it is his local administration's main work: to listen to the Mahallas in Navoi and meet all their needs. He says his goal is to cut down



on the number of bureaucrats between the local government and the Mahalla in order to deal with the issues they bring up as quickly and efficiently as possible.

This is a form of direct action democracy. Tashkent's lack of interest in Western style parliamentary politics is the lack of things to debate and the distance there is between a political party and the man in the street. Uzbekistan is at an early stage of transition, so there is little to debate on what needs to be done. The reforms needed are large, basic and obvious. Moreover, party politics directly connects the parties to the people only once every four years during

been increased, so whereas a Mahalla used to employ two or three full time persons, many Mahallas have a full time staff of up to 10 people, says Kabul.

The Mirziyoyev government has expanded the legal state of the Mahalla in order to better integrate it and formally include it as part of Uzbekistan's political system. In the most significant changes the Mahalla's powers as a self-governing body were defined and guaranteed by changes to Article 105 of the Constitution.

On top of that, there have been 49 new laws on the status, role and responsibilities of the Mahalla

**“Elections for the “Khakim”, or “elder”, and the local representatives follow a traditional, not formal, schedule”**

elections. It is possible to lobby your MP in the meantime, but the Uzbek version of this has put the lobbying of MPs at the centre and moreover, it has created a much more formal system of community representation than the West has, which just relies largely on individuals to start awareness campaigns on specific issues. In the Uzbek system the contact between the Mahalla and the administration is routine and constant. Problems are fixed more or less immediately.

Building Mahallas into the system The Communist Party tolerated the Mahalla, but Mirziyoyev has gone out his way to make use of and extend the system as well as formally integrating it into the constitution as a basic political unit.

Elections for the “Khakim”, or “elder”, and the local representatives follow a traditional, not formal, schedule and each Mahalla has its own timing and rules. But those elected receive a salary from the state and hold no other job. Moreover, under Mirziyoyev the budget dedicated for these salaries has

enacted over the last four years as well as 40 changes to regional laws and five presidential decrees, one of which singled out improving the rights of women and children, as families and their needs remains at the very core of the Mahalla's raison d'être. Indeed, the formal name for the ministry that deals with social issues is the Ministry for Mahalla and Family Support of the Republic of Uzbekistan, which has divisions in all the regions of the country.

With expansion of the Mahalla's official staff new positions have been created that deal specifically with law enforcement, family, women's and socio-spiritual issues, urban beautification, farmland and entrepreneurship.

The Mahalla is not a political system that is recognisable to westerners that have been brought up on a diet of parliamentary debate and individual freedoms. The Mahalla may well serve the Uzbek community better than the western system, but one key element missing from the Mahalla system is the checks and balances the western

political system puts on those in power, something that has been sorely lacking in most countries in Central Asia.

The Mahalla puts more weight on the community and shared responsibility. But for the Mirziyoyev government it is a structure that connects the government as directly to the communities in the country as it can and is being used by the government to push through change in a relationship that is a two-way street.

The Mahalla system is especially effective in the more remote settlements in Uzbekistan, which are much more dependent on the government's help as conditions in the desert towns are harsh. In 2020 the government gave grants and loans to more than 200,000 people via the Mahallas to support small-scale agriculture and craft workshops, amongst other things, the ministry says. The Mahallas also helped resolve conflicts in 21,000 potential divorces, intervened in 16,000 cases of domestic violence and organised assistance to 164,000 low-income families.

The Social Affairs ministry described the relation on its website like this: “The main criterion was the effective implementation of a new system for solving social problems of the population on the basis of the principle “The chairman of the Mahalla is a reformer”.

Navoi is flourishing and for Mayor Kabul the Mahalla is the key institution to make sure the prosperity is felt at street level.

“We have opened our gates to investors and the number of foreign investors and experts coming here has increased. The exports by local companies have increased four-fold from just Navoi and the amount of in-bond investment in 2021 will reach \$170mn plus credits,” Kabul said. “That creates new jobs for the youth. The increase in the local budget also allows us to solve the local problems, as before there was too little money to spend on things like infrastructure. Now the per capita income in Navoi is in the top two next to Tashkent and also in the regional economic production.” ●

## Tashkent conference aims to lure new investors

### Muzaffar Ismailov in Tashkent

Uzbekistan's opening up has been a hot story for the international press in the last few years. The country has been doing its best to demonstrate the effectiveness of reforms initiated by incumbent leader Shavkat Mirziyoyev. With less than a month left before the next presidential elections, Mirziyoyev's government organised a massive international Economic Forum 2021 held in Tashkent on September 29 to showcase progress made so far and the privatisation of SOEs and banks already achieved.

The event, held with the support and high-level participation of the World Bank and the Asian Development Bank (ADB), brought together in an in-person setting around 300 participants -including top members of the Uzbek government, international business and financial communities, international and regional multilateral development institutions, policymakers and NGOs.

According to Anna Bjerde Vice President, Europe and Central Asia World Bank (WB), no country in the world has achieved so much in such a short space of time as Uzbekistan has.

### Next generation of reforms

Bjerde shared her view on what the government should focus on next. The first step is the continuation of diversification, as the country is still dependent on agriculture.

Even though there has been job creation from the economic growth of recent years the unemployment level

remains high at about 10.5% and more needs to be done to boost economic expansion. The most important step within the next generation of reforms, according to her, is to expand the role of the private sector. Another direction that the government should focus on is natural resources.

“A lot of opportunities have already launched in renewable energy. The government aims to reach 25% renewable energy in the near future. But natural resource management needs more attention when it comes to pollution and water management,” Bjerde said.

**“A lot of opportunities have already launched in renewable energy. The government aims to reach 25% renewable energy in the near future”**





### Public debt is huge but sustainable

The IMF Mission head for Uzbekistan Ron van Rooden said that the Fund has observed a rapid increase of public guaranteed debt over the past few years, adding that the organisation was projecting it at close to 40% of GDP. Debt is mainly used in the power sector and poverty reduction.

“The increase in public debt was quite rapid. SOEs and state-owned banks were issuing more external debt”, he said.

According to Uzbekistan’s Deputy Prime Minister Jamshid Kuchkarov, who is also the Minister of Economic Development and Poverty Reduction, over the past five years, the debt to GDP ratio increased significantly, But since the beginning of 2021, the borrowing rate has been reduced. The government has also approved a limit on total state debt of 60% of GDP.

“Now we are going to rely on private investment”, added Kuchkarov.

Bjerde, meanwhile, noted that even though the overall debt was high, it still remained sustainable. It was still generating benefits for the country. Uzbekistan was one of the very few countries in the world to put in positive economic growth amid the pandemic. Bjerde also urged the government to keep the debt management transparent.

### Privatisation, IPOs and SPOs

Deputy PM Kuchkarov outlined two large privatisation deals that have happened in the country since the sell-off programme was announced.

Uzbekistan’s State Assets Management Agency (SAMA) reached an agreement to sell a 57.118% stake in Coca-Cola Bottlers Uzbekistan (CCBU) to Turkey-based Coca-Cola Icecek (CCI) through its wholly-owned subsidiary CCI International Holland B.V. for a cash consideration of \$252.28mn. The acquisition process was completed on September 29.

Another huge asset that went under the hammer was Ipoteka Bank (Mortgage Bank), the activity of which is mainly focused on mortgage financing. The new owner of a 75% stake is Hungary’s OTP Bank.

One of the biggest deals in the coming years may be the sale of a 10-15% stake in uranium and gold miner Navoi Mining and Metallurgical Combine. Kuchkarov said that the transaction could be completed in 2024.

“There is no concrete plan yet, but we may come to it in 2024,” he said, adding that the company first needs to be restructured and reform its accounts in line with international standards.

Kuchkarov added that the government was not in a hurry to sell off its assets. “The first thing we do is restructuring, followed by preparation for privatisation. And only after that do we consider a sale,” he said.

“The government this year will hold two IPOs and SPOs,” Kuchkarov noted without disclosing the details. “By 2022, 10 large companies will hold IPOs and by 2025 there will be 20 big names”.

Asked whether the government was considering the sale of assets through foreign exchanges Kuchkarov answered: “We are considering listing both on Tashkent exchange and on international exchanges. We will hire nearly 100 top-level managers who will deal with privatisation issues. We are not in a hurry to conduct privatisation. But we are in a hurry for transformation and preparation.”

According to Timur Ishmetov, Finance Minister, privatisation is the best tool to minimise the potential fiscal risk of SOEs. “We have a lot of SOEs in many sectors of the economy. The risks include getting less than projected tax payments and the extended burden on the budget, and we may have expenses on loans,” he said. ●

In the most radical of all reforms made since Uzbek President Shavkat Mirziyoyev took over in 2016, the entire cotton sector has been privatised and production of this vital crop is now entirely owned by private companies.

Cotton has been intimately associated with cotton since Soviet days to the extent that the country’s national emblem features cotton buds on one side and wheat on the other – and wheat production is in the midst of privatisation on the same lines, which is due to be completed next year.

“There used to be a state company Uzpaxtasanoat that owned everything. Today that company has been closed down. It doesn’t exist anymore! It’s an extremely radical reform. In my personal opinion [it] may be too radical,” Alisher Sukurov, Deputy Minister for Agriculture, bluntly told *bne IntelliNews* in an exclusive interview. “But we decided there was no other way and now it’s finished.”

Uzbekistan doesn’t boast the hydro-carbon resources that its neighbours Kazakhstan and Turkmenistan enjoy, and after independence in 1991 the country’s main hard currency earner was cotton exports. The sector was tightly controlled by former president Islam Karimov, earning the country some \$3bn a year.

Farms were state-controlled and the Karimov administration was constantly tinkering with the forms of financing and production targets, but Mirziyoyev has abandoned the old system entirely and simply sold everything off.

### Cotton clusters

Mirziyoyev kicked the process off in 2019 with a decree that launched the sale of the cotton assets, which took less than two years to complete. The sector was broken up into “clusters” that united the farmers and the cotton processing facilities, and two forms of privatisation were adopted.

In the first, private investors – almost entirely domestic companies, many of which were moving into agriculture for



## Uzbekistan privatises its entire cotton sector in its most radical reform yet

Ben Aris in Tashkent





the first time – bought the cotton mills and the farmers in their catchment area were forced to sell to the local mill in order to preserve jobs and output levels.

“We were concerned not to disrupt the cotton production,” said Sukurov. “Cotton remains an important strategic sector and a priority. We don’t want to de-emphasise the sector. But the approach as to how it should be managed has completely changed. The government doesn’t want to be involved in regulation, quotas or setting prices. All of that has been transferred to the private sector.”

The government has been adopting a suck-it-and-see approach, as Sukurov explained that the first challenge was how to value the assets.

**“The government is still providing funding to the clusters at low rates. But next year that will also start to be put on commercial terms”**

“I would not have bought some of the mills, as the equipment was very old and worn out,” Sukurov said in his characteristically direct way, but sold they were. “It was done on a ‘first come, first served’ basis.”

The ministry reports there was no lack of investors. The sector was broken up into around 100 clusters, all owned by different companies. Uzbekistan seems to have avoided the trap that Ukraine fell into, where a few very large agricultural companies snapped up the lion’s share of access to the land leases and built up a few oligarch-controlled agro-industrial concerns that concentrated the business in a few hands.

During the transformation process about 10% of the privatisations have already failed because the inexperienced new owners could make the business work. But the government does not seem unduly concerned, as a bit of “creative destruction” was to be expected.

“In the old days everyone in the Ministry would follow the cotton-picking campaign closely. There was a newsletter that reported exactly how much had been brought in in each region and even the security guards at the front door knew the numbers of each region,” Sukurov said excitedly. “But this year we honestly had very little idea. It just is not relevant any more. We have other things to do now.”

The second method of privatisation was introduced more recently. Once the groundwork was laid, the government decided to adopt an even more radical method with a new presidential decree that has put the sector entire on a market basis: since February this year farmers have been free to sell to anyone they liked based purely on

price. This has introduced competition between the clusters and created a domestic market price for raw cotton.

“There was some resentment amongst farms who were tied to a certain mill,” said Sukurov. “We didn’t want to go down the road where the sector was regulated and prices controlled by the government, or the farmers forced to work at fixed prices. So they were given the freedom to sell to anyone.”

#### **Land sales eventually**

The government has retained the ownership of the land and Sukurov says the discussion of selling the land is “on the agenda to be on the agenda” but not for the foreseeable future, as there are still many other reforms to be done. But farmers have been given long-term leases, and amendments to the law are in the works to protect their rights better so as to encourage investments.

The government has also helped with the financing of agricultural production, as farming is a seasonal business

and needs sophisticated funding by the largely state-owned banks.

“The government is still providing funding to the clusters at low rates. But next year that will also start to be put on commercial terms,” said Sukurov.

The ministry is now turning to developing the rest of the sector. With the success of the cotton privatisation, next up is wheat production, which will be finished next year and will use the cotton sector’s privatisation as a template. Here there is also a state holding that owns everything, Uzdonsmahsulot, but it should cease to exist sometime next year.

Connected to these reforms are also some restrictions on buying equipment – Uzbekistan is a big producer of tractors, among other things, and farms were forced to buy the made-in-Uzbekistan equipment to support the local industry, but those restrictions are also in the process of being removed.

Sukurov says that the Agriculture Ministry is working hand in glove with the Finance and Economics Ministries to reform the agriculture sector, which remains the backbone of the economy. Sukurov says the Ministry’s focus is shifting to improving nutrition and it is working closely with the Ministry of Health, with special attention being paid to women’s and youth health issues connected to diet, using the EU’s Agricultural Knowledge and Innovation Systems (AKIS) as a blueprint.

“For us, what is important is the transparency of the system, to create an enabling environment. Not everything is perfect. There are still a lot of problems to work out. It’s still a highly subsidised sector. This is a new initiative to respect the value chain,” said Sukurov. “The whole thing will be complete by 2022. The entire Uzbek agro sector will be entirely in private hands. There is no other way.” ●



## **Uzbekistan’s multi-coloured textile revolution**

**Ben Aris in Tashkent**

**U**zbekistan has a very long history of making luxury textiles and today the country is trying to revive them. The khalat, the vibrantly coloured long-sleeved silk robe worn by Uzbeks, has been a hallmark of the country for thousands of years and is still worn today by many.

Uzbek craftsmen in Khiva, and the country’s other ancient Silk Road way stations, still practise the delicate embroidery and weave the multi-coloured patterned cloth as their ancestors did, but following a revolution in the textile business in the last few years they are now turning their attention to T-shirts, jeans and shoes.

Uzbekistan is famous for its high quality cotton production that used to be the country’s main source of foreign exchange earnings. However, in 2017 Uzbek President Shavkat

Mirziyoyev simply banned the export of raw cotton entirely, forcing the whole industry to invest into textile production almost overnight.

It may have been a rather heavy-handed reform to the sector, but it worked. Within only a few years textile

production has soared and the export revenue earned has already overtaken the money Uzbekistan used to make from selling its raw cotton abroad. The idea of going up the value chain is at the core of all of Mirziyoyev’s reform ideas, but it has probably been most successful with the changes made to the cotton-textile complex.

“There is a blooming of Uzbek textiles. We have a new openness to the rest of the world and there have been many changes in the last five years,” Jasur Rustambekov, deputy head of the textile association of Uzbekistan, told *bne IntelliNews* in an interview in Tashkent. “Textile exports have been exploding. In 2016 Uzbekistan exported to 43 countries; today it exports to 72.”

The production of textiles has been supported by advances made in cotton production. In 1991 Uzbekistan was growing 50mn tonnes of raw cotton, which produced 1.7mn tonnes of cotton fibre but only 7% of the raw cotton was processed into textiles, says Rustambekov.

“In those days Uzbekistan was in the top five biggest producers of cotton in the world. But it was an unfair situation with people working in the fields,” said Rustambekov. “The transformation of cotton production was very hard. Why? Because no one wanted Uzbek textiles, only the raw cotton.”

And cotton production is only like to improve from here, as in 2018 the state launched a privatisation programme and in under two years has sold the entire sector off to over a 100 separately privately owned firms. Coupled with the concurrent ban on raw cotton exports, the whole sector has been transformed. This stands in stark contrast to the regime of former president Islam Karimov,

**“It may have been a rather heavy-handed reform to the sector, but it worked”**

who ran a more or less unreformed centralised economy, where the state owned all the key assets.

“As a result of the changes today we are in the first place in terms of cotton fibre production. Before we earned about \$1.5bn from raw cotton exports, but now we will get about \$500mn



from cotton fibre and another \$3bn from the export of textiles in 2021. That means new jobs for people and more tax for the government,” says Rustambekov. “There are no state companies in the sector any more. It is all in private hands. The sector was privatised in 2018 and the cluster system [was] introduced to turn raw cotton into textiles more efficiently.”

### Cotton Campaign

The state has also abandoned the old system of forcing students, doctors, teachers and any one else the state could order or cajole to work in the cotton fields when the harvest was ready. That brought down accusations of forced and child labour and the Cotton Campaign was set up to raise public awareness and organised a very effective boycott of Uzbek cotton products.

A boycott of Uzbek cotton was launched in 2007 and was joined by some 300 companies that under public pressure refused to buy Uzbek cotton products.

Since then, the ban on Uzbek cotton products has been gradually lifted as the Mirziyoyev wound down the use of forced and child labour, which has been completely halted since the privatisation of the sector, the government claims.

In August last year the activists along with the International Financial Corporation (IFC) and other donors met with Uzbekistan's Ministry of Investment and Foreign Trade, Agriculture, Labour and other state bodies, and publically welcomed the government's pledge to seek responsible investment and completely end the use of forced labour in the cotton fields.

“The Cotton Campaign welcomes the commitment of Uzbekistan's Ministry of Investment and Foreign Trade to seek responsible investment in Uzbekistan's cotton sector and to support reforms to end forced labour,” Allison Gill, senior Cotton Campaign co-ordinator at GLJ-IRLF adds. “As brands are looking to get out of the Uyghur region, Uzbekistan

provides an opportunity – to develop new sourcing and to come in under a co-governed structure where workers, producers and brands all have a seat at the table,” the Cotton Campaign said in a statement at the time.

Unwinding the boycott is taking time, and few of the big multinational textile retailers have set up production in Uzbekistan yet, that stage is coming soon, says Rustambekov.

“Most companies joined [the boycott] on a voluntary basis and were free to leave again, and many have,” Rustambekov told *bne IntelliNews*. “The US Department of Labour declared us free of child labour and since 2018 this has no longer been a problem. The international organisations, including the IMF, have recognised the new child labour-free status too.”

Since then the Uzbek government has invited delegations from the NGOs and international financial institutions (IFIs) to come and inspect the cotton harvest each year and check the labour practices, including representatives from the International Labour Organisation and the EU.

### New markets

The exports of textiles are flourishing as the newly established privately owned companies develop their markets, made easier since the currency and exchange controls were lifted in 2017 allowing them to deal directly with customers in dollars.

The main markets so far are places like Turkey, China and the other members of the Commonwealth of Independent States (CIS). But more recently the EU has emerged as a major new market, which is only 14 days away by truck, says Rustambekov. In April this year the EU granted Uzbek textiles a special preferential status that allows exports to the EU with no quotas and no duties. Uzbekistan also has a preferential trade deal with the US where there are also no quotas, but there are export duties to be paid. Exports of textiles to the EU

have already jumped fourfold y/y since the new special status was granted.

The next phase will be with the multinationals move in and start to produce their shoes, jeans and T-shirts in Uzbekistan. While preliminary deals have already been signed with international shoemakers Nike and Adidas last September the big deals are yet to be done.

“We are in talks with more than 100 major brands, and we have invited everyone to come and see. But it will demand lots of investment – more than \$2.5bn is needed. Still we are already attracting about \$500mn a year into setting up manufacturing plants,” says Rustambekov.

The first investment began in 2017 with the liberalisation of the sector, as “that allowed the first foreign investment to happen and the first international manufacturing business could start,” says Rustambekov, who adds there are about 200 international companies already working in Uzbekistan, although none of them are big ones.

“There are British, Swiss, Dutch, Austrian, Latvians, companies from China, the UEA and Kingdom of Saudi Arabia, as well as lots of Poles,” says Rustambekov.

In 2020 Uzbekistan produced \$2bn worth of textiles for export and expects to sell \$2.2bn this year before rising to \$3bn the year after. But those are only the exports. As the most populous country in Central Asia and the third most populous in the CIS, Uzbekistan also has a large domestic market: including the domestic market the textile business is currently worth \$4.7bn, says Rustambekov.

“We don't just work for the export market. The internal market is growing every year too. But broadly speaking you can divide the market into four: the internal market, the CIS, Turkey and China,” says Rustambekov. ●



Surrounded by deserts, the Artel Hoover factory in Nukus is making white goods that dominate the local market and are now being exported all over the CIS and increasingly further afield.

## The hoovers of Nukus

### Ben Aris in Nukus

Flying into Nukus in the far west of Uzbekistan, the ground surrounding the city was white. The Soviets flooded the land with water to grow cotton for decades, and that ended with the disappearance of the nearby Aral Sea. The resulting ecological disaster poisoned the soil, leaving a crust of salt that lay on the ground like snow. Dust storms hit the city a dozen times a year.

The city seems like an unlikely location to set up a production line to produce Samsung vacuum cleaners to supply the domestic market and increasingly for export. Shipments are going first of all to the Commonwealth of Independent States (CIS), but, more and more, further afield to the rest of the world.

The unlikely arrival of the production line is what happened when Artel, Uzbekistan's biggest consumer electronic firm and now the largest manufacturer of white goods in the Former Soviet Union (FSU), opened its plant in Nukus 20 years ago.

the country. The company was founded in 2011 and amongst its early businesses was producing Samsung white goods under licence. Since then Artel has introduced a range of its own brands, which dominate the markets of Central Asia and are best sellers in the burgeoning export market of the CIS.

Ferus Kholmorodov, the deputy director of the factory, meets us as the gates of the modern building on the edge of the city of 300,000 inhabitants. Originally housed in a renovated factory building, the facility was completely renovated in 2017 and today is a modern building that houses the company's equipment and production lines.

The Nukus factory makes hoovers, which are assembled on a line of 230 workers before they are packed and stored, ready for delivery at the end of the hall. The factory also serves as a distribution hub and a variety of other products are waiting on the industrial shelves ready for delivery elsewhere in the country. The factory is churning out 1,300 hoovers a day and some 364,000 were made last year alone.

Since setting out the company has broadened its range of goods and while Samsung hoovers are still prominent in the production at Nukus, the factory also makes its own Shivaki hovers, which are based on Japanese technology that the company bought the rights to several years ago.







“We are the biggest private employer in the city,” says Kholmorodov. “We used to assemble TVs here too but three months ago that was moved to another factory in Akhangaran in the Tashkent region, which also makes TVs, to consolidate the production in one place.”

And the factory doesn't only assemble the vacuum cleaners, but presses its own components in a series of Chinese-made giant plastic machines.

“In the beginning we made only 10 components here but now it's over 150,” says Kholmorodov. “About 65% of the component production has been localised, with the rest imported

Nukus to support the beleaguered local economy and the company has kept it there as part of its developing ESG (environment, social and corporate governance) policies to support society with its work. It is part of the reason that Artel has built facilities around the country in several of the larger cities to provide jobs for the locals.

The presence of the government in business has retreated but the state is still a major driver for business in the country. A portrait of Mirziyoyev hangs on the wall in the main meeting room, as is common across the whole CIS, and a giant banner hangs across the main wall in the production hall,

“In the beginning we made only 10 components here but now it's over 150”

from China, Vietnam and Korea, where Samsung also has factories.”

Nukus may seem a little out of the way, as it is in the far west of the country. Artel has its biggest flagship production facilities in Tashkent, the nation's capital, but when the company was founded then-president Islam Karimov insisted a facility was built in

a quote from the president: “Innovation is the future for our country's development.” Old habits die hard.

Nukus' local economy is now back on its feet. The plastic granules for the Chinese presses come from the local state-owned plant that employs 7,000 people and mostly exports its output all over the world.

The domestic market for white goods has been growing steadily in the last decade as the economy has stabilised and since President Shavkat Mirziyoyev took over in 2016 business has been good. Stability and the opening of the economy have allowed companies like Artel to flourish. One of the biggest changes was the lifting of exchange rate controls in 2017 that killed international trade. A large share of the Nukus output now is exported.

“Ukraine and Kazakhstan are the most important markets, but we export to all the countries of the CIS,” says Kholmorodov. “And this year we are just about to start exports to Nigeria, Tanzania and Syria.”

Exports have helped bolster the company's bottom line during the pandemic. Kholmorodov says that domestic sales were hurt somewhat during the lockdowns in 2020, but the expanding exports have more than compensated.

The factory is an important component in bringing Nukus back to life and Artel is also planning to open a second factory in the city in the coming month that makes doors and flooring for the construction industry. It has also signed a co-operation deal with the local university, has invested in its engineering and IT departments, and will hire some of its students on graduation.

The UN has identified Nukus as one that needs special attention to prevent its depopulation. The UN has launched a special fund, in addition to assistance to the federal government, in order to support and develop the local economy.

The government is also working to improve the city's situation and is about to make the region a free economic zone to promote more business and investment.

“We are not sure exactly what this will mean,” says Kholmorodov, “but I'm sure it will bring benefits and we will take advantage of them.” ●

## Uzbekistan's economy bouncing back strongly, World Bank ups 2021 GDP forecast to 6.2%

Ben Aris in Berlin

As one of the only two major economies in the world to avoid recession last year, the Uzbek economy is bouncing back from last year's coronacrisis crisis strongly. The World Bank has upped its GDP forecast to 6.2% this year from 4.1% previously, and to 5.8% in 2022.

The country was hurt like everyone else as so much of the global economy shut down for months during the worst of the coronavirus (COVID-19) pandemic. With a young population and a diversifying economy, Uzbekistan has been flourishing in recent years since Uzbek President Shavkat Mirziyoyev started to open up to the rest of the world and lift restrictions on private business imposed by his predecessor Islam Karimov, who died in 2016.

Most of the main macroeconomic indicators are doing well. After slowing to 1.7% last year, Uzbekistan's GDP rose to 6.2% in the first half of this year. Economic growth was fuelled by increased household incomes and domestic investment, anti-crisis measures and tax breaks, the World Bank says.

Inflation, a problem for all countries this year, has also been taken in hand and fell from 14.7% in June last year to 11% in June this year. The indicator remained double-digit due to the outstripping growth in food prices, the World Bank said in its report.

In a country with a large and very young population unemployment is a major concern for the government, but its decisive action and government subsidies have kept it in check. The unemployment rate fell from 13.2% in the first half of 2020 and 10.5% at the end of 2020 to 10.2% in the first half of 2021. However, unemployment remains at elevated levels and has not yet reached the level of the period before the start of the pandemic (about 9%).

### Retail sector booming

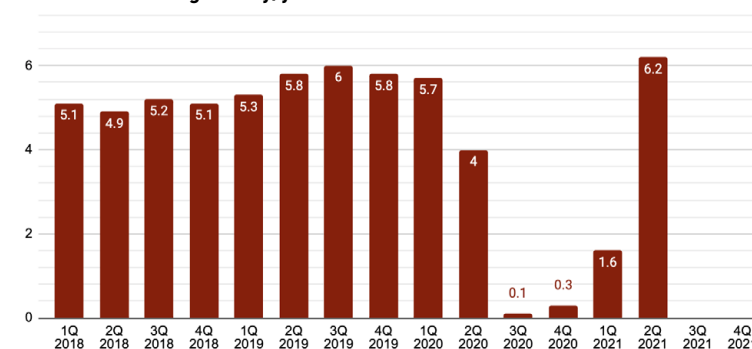
The Uzbek retail market is becoming increasingly attractive and the supermarket sector in particular has been singled out as “ready to boom” following its peers, where the introduction of organised retail has led to a rapid development of the sector.

The sector has attracted tens of millions of dollars in foreign investment, according to the Financial Times. The European Bank of Reconstruction and Development (EBRD) has also invested some \$40mn to take a stake in Korzinka, one of the biggest supermarket chains, while big French grocer Carrefour became the first international retailer to enter the Uzbek market last year, intending to invest \$100m.

Korzinka, which accounts for half of all supermarket turnover in the country, anticipates expanding its chain from 68 to 150 stores by 2025. Carrefour has opened three stores, and a further four to six are planned for this year alone. The biggest expansion is expected from Makro, Uzbekistan's current leader by the number of stores, with 109 mainly supermarkets and express shops. Makro plans to have between 800 and 1,000 stores in the next five years, according to its chief executive, Roman Sayfulin.

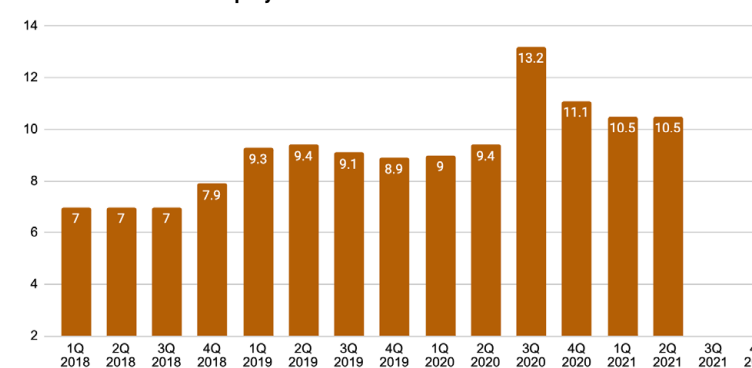
The latest addition to the increasingly hot Uzbek retail sector, Ukraine and Moldova's largest online retailer Rozetka, has arrived on the Uzbek market, launching the website rozetka.uz in September. The site offers household

Uzbekistan GDP growth y/y



Source: Uzbekistan state statistics agency

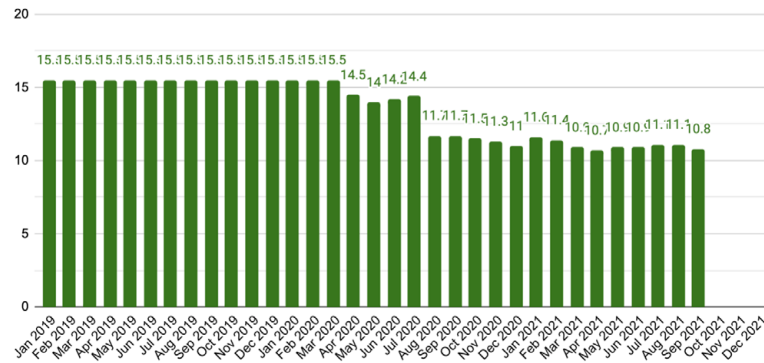
Uzbekistan ILO unemployment



Source: Rosstat



Uzbekistan inflation y/y



Source: Central bank of Uzbekistan

appliances, electronics, sports equipment, books, children's toys, and more.

Other international retailers to tap the Uzbek market last year included Russian discounter Fix Price, and Belarus' Baraka Market, which plans to have 400 small supermarkets in the country by the year-end.

#### Reforms driving growth

To maintain the country's fast "catch up" growth the government needs to stick to its frenetic reform agenda. Uzbekistan's GDP growth is forecast to reach 6.2% in 2021, facilitated by a recovery in domestic investment, international trade and remittances – all of which remain vulnerable to the risks of the coronavirus pandemic resurging.

The World Bank experts remain optimistic and expect the country's GDP growth rate to remain strong in 2022, reaching 5.6%, as the pace of vaccination of the population

accelerates and the disruptions in the global economy decrease.

But the biggest difference can be made by the ongoing reforms and investments they attract. Despite being in office for five years, the country has barely left square one in the president's effort to transform it into a modern market economy. The World Bank says that it expects foreign direct investment (FDI) to stay at a low level this year, but it will partially recover next year.

In the meantime, the state is pushing ahead with its privatisation programme and restructuring of the state-owned enterprises (SOEs) to bring in more investment.

The banking and energy sector reforms are the most advanced and in a sign of things to come, both have already attracted significant foreign investment. Two banks have already been sold, the most recent being mortgage specialist

Ipoteka bank to the Hungarian OTP. And Georgia's TBC Bank has also entered the market, which is three times the size of its own domestic market back home.

The organisation of the energy market has already been transformed and with the help of the European Bank for Reconstruction and Development (EBRD) and other international financial institutions (IFIs) foreign investment has been attracted into modernising the existing facilities as well as building new renewable energy production capacity. In October the Uzbek government announced it is set to take its first corporate loan from the EBRD to invest into two wind farms.

All this costs money and the expansion of social support for the population, state investment in the development of rural infrastructure, as well as the costs of the vaccination campaign for the population and on the agenda and will further increase public spending by the end of the year. The World Bank has said these costs will be partially offset by higher tax revenues to the budget and revenues from mining as well as revenues earned from the ongoing privatisation of SOEs.

Sustained economic recovery, gradual elimination of anti-crisis measures and tax administration reforms aimed at expanding the tax base are expected to help reduce the budget deficit and stabilise public debt at about 42% of GDP by the end of 2023, the World Bank says. ●



The company is investing large sums in downstream gas processing facilities with an eye on petrochemical and other markets.

## Market weighing up Uzbekneftegaz's scheduled eurobond

### Muzaffar Ismailov in Tashkent

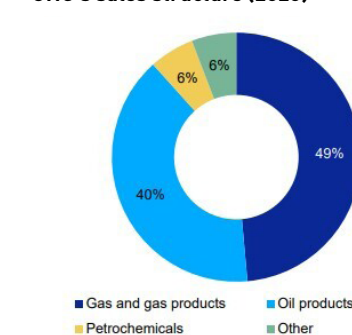
State-owned Uzbekneftegaz (UNG), an oil and gas producer, is marketing its debut USD-denominated eurobond with a tenor of five and/or 10 years, according to preliminary deal terms unveiled by VTB Capital.

UNG to date controls around 50% of hydrocarbon deposits in Uzbekistan. In 2020, UNG accounted for 67% of Uzbekistan's gas extraction and generated 85% of the country's electric power, contributing 3.5% of Uzbekistan's GDP. The company's production (33.1bn cubic metres (bcm) of natural gas and 1.6mn tonnes of liquid hydrocarbons in 2020) has been on a downtrend in recent years, reflecting a lack of investment in exploration in the past.

Fitch and S&P rated UNG on par with Uzbekistan's sovereign rating (i.e. at BB- with a 'Stable' outlook), thanks

to the issuer's strong ties with the state. Among other things, the state support for the company is reflected in state-debt guarantees, covering some 80% of the issuer's total debt at YE20, and the practice of debt to equity swaps, which reduced UNG's total debt by \$1.7bn in 2020 to \$3.3bn. Fixed gas tariffs constrain the company's financial performance.

UNG's sales structure (2020)



Source: Company data, VTB Capital Research; \* in terms of revenue

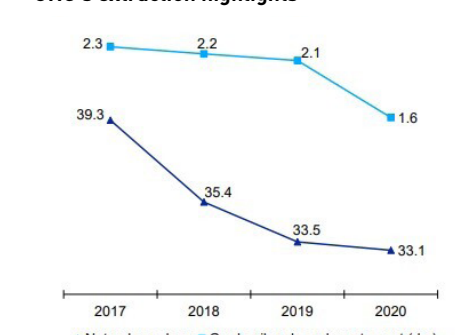
Based on the 1H21 results, UNG generated LTM Ebitda of almost \$1bn on revenues of \$2.2bn. About 85-95% of the issuer's Ebitda comes from natural gas sales, which are realised domestically (UNG does not export gas) at a low fixed tariff (USD 23/kcm), since the company fulfills a social function for the local economy. The issuer's margin support comes from low upstream costs, sizeable production and integration into chemicals and refining.

UNG was 3.3x leveraged at the end of 1H21, while its net leverage ratio has not dropped below 3x in the past four years. Apart from heavy exploration capex, since 2019, UNG has been involved in several large-scale investment projects (for a total cost of ~\$5.5bn), namely the construction of a gas-to-liquids (GTL) plant and the expansion of the Shurtan gas chemical complex (GCC), which the company is financing via new debt. These sizeable investments have led to UNG's FCF generation being negative in recent years.

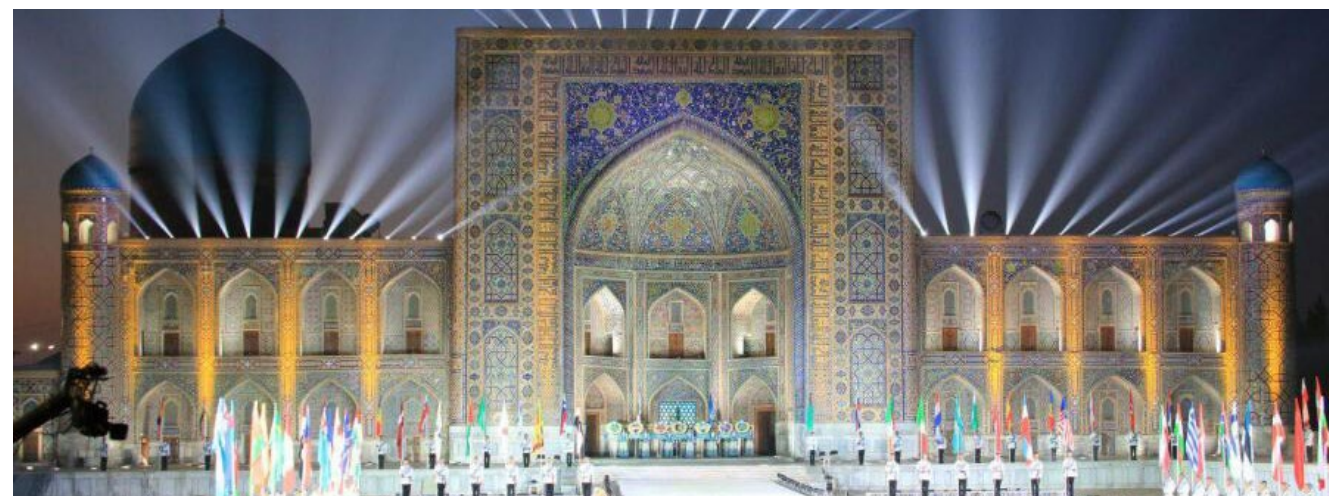
The rating agencies estimate that once completed (GTL by YE21 and GCC in 2023-24), the projects might increase the company's Ebitda by more than 50% and contribute to the issuer's deleveraging. During an investor call, UNG's management indicated the company's net leverage ratio target of 2.5x, which it plans to achieve with new assets coming on stream.

UNG's total debt portfolio stood at \$3.6bn as of the end of 1H21, comprising of banking debt with the bulk of it denominated in USD (79%)

UNG's extraction highlights

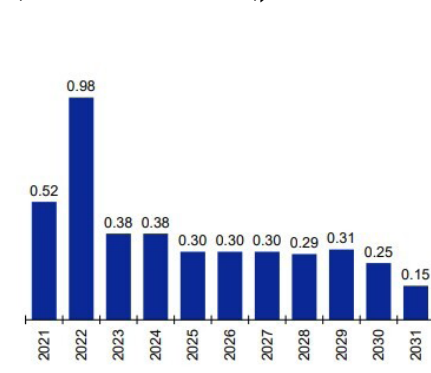


Source: Company data, VTB Capital Research





**Debt maturity schedule**  
(as of the end of October), USD bn

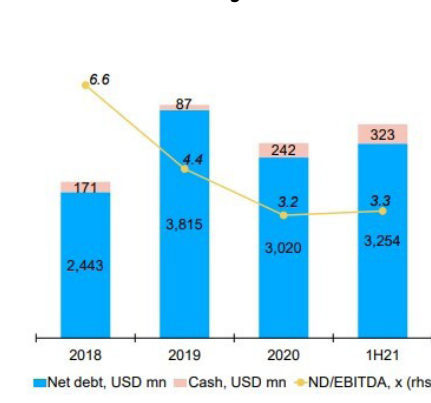


Source: Company data, VTB Capital Research

and EUR (13%). The issuer's average cost of debt was 3.61% as of YE20 (3.40% for the USD-denominated debt). UNG's local debt maturity peaks in 2022 (~\$1bn). According to the deal prospectus, the company intends to devote almost \$0.6bn of the proceeds raised from the eurobond placement towards refinancing its current indebtedness, while the remainder is to be used for general corporate purposes (including capex financing).

In late 2020, the Uzbek government included UNG in its privatisation programme, meaning that the company's IPO could be on the table during the next few years. The state is considering selling up to 25% of UNG.

**UNG's debt and leverage**



Source: Company data, VTB Capital Research

VTB said that it was not considering a partial privatisation (with the state retaining control) as a negative credit development for UNG. The potentially lower government support for the company post-IPO could weaken the issuer's credit profile and, to a certain extent, threaten its credit ratings.

UNG's debut eurobonds are to be issued under English Law in the RegS and 144A formats, and rank as a senior unsecured obligation of the company. Based on the preliminary deal terms, there is the possibility of a double-tranche transaction (five and 10 years), while the total size of the offering is likely to exceed \$0.6bn (VTB estimates it at up to \$1bn),

considering the company's declared refinancing plans for raised proceeds.

The pricing of the debut UNG eurobonds, according to VTB, is likely to go through the prism of yield levels currently formed by Uzbekistan's sovereign curve, which appear to be the most suitable benchmark, and additionally, the so far sole outstanding corporate bond out of Uzbekistan: UZAMTS 26 (YTM 5.2%) of UzAuto Motors (another of the country's quasi-sovereign borrowers, rated a notch lower than UNG).

"With the current yield curve positioning of Uzbekistan and the country's QSIssues, we see UNG's 5Y tenor bond pricing within the range of 3.9 – 4.4% (mid swaps + ~275 – 325bp), which suggests a ~50-100bp yield premium relative to Uzbekistan's sovereign curve. That is mostly in line with the spread levels to sovereign at which other CIS O&G majors are currently trading," the investment bank concluded.

For UNG's 10Y tranche bond, the estimate is 4.7-5.2% (mid swaps + ~320-370bp).

According to a resolution of the government, the eurobond listing is set to take place by the end of this month. ●



Uzbekistan boasts largely solid macro fundamentals, but high inflation and even higher expectations for more increases amongst the population remain the main headache.

## Uzbekistan central bank focuses on inflation targeting, but rising prices remain a problem

Ben Aris in Tashkent

"We have no serious problems. The macroeconomic fundamentals are solid. Really all we have to do now is manage the economy to improve stability and promote growth," Mirsaid Nosirov, an analyst at the Central Bank of Uzbekistan (CBU), told *bne IntelliNews* during a trip to Tashkent.

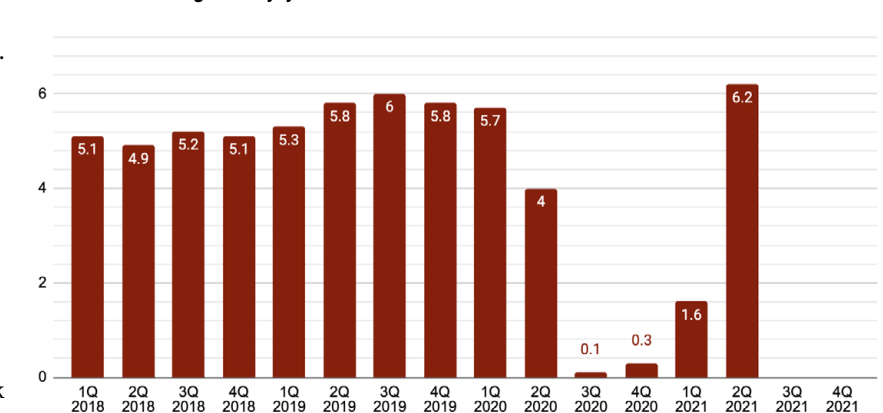
The Uzbek economy was one of only two major economies in the world that didn't go into recession in 2020. It was hurt like everyone else in the pandemic. No one escaped the shock of a global pandemic. But thanks to the new market-oriented prudent management and the robust growth Uzbekistan has been enjoying since Uzbek President Shavkat Mirziyoyev took over in 2016, the economy had enough momentum to plough through the storm.

Uzbekistan has a lot going for it. The economy has been booming on the back of simply liberalising the rules over the last five years. Locked up by the

former, and only other, president Islam Karimov, just opening the gates again has allowed companies to do business. All of the easy catch-up growth most countries of the Former Soviet Union (FSU) have enjoyed in the last three decades remains ahead for Uzbekistan.

Before the pandemic hit, GDP was rising by more than 6% a year. But in

**Uzbekistan GDP growth y/y**



Source: Uzbekistan state statistics agency

2020 that fell to a mere 1.7% before bouncing back this year, returning to 6.9% in the first nine months of this year compared to the same period a year earlier, according to the Central Bank of Uzbekistan (CBU).

The main drivers of growth include: increases in information and communications (21.6%), manufacturing (14.2%), hospitality and dining (17%), transportation and storage (16%) and wholesale and retail trade (10.9%). The only sector that contracted was banks and finance (-0.9%) according to the official figures.

### Retail and incomes

However, the population remains poor. GDP per capita for the first nine months of this year was UZ\$14.9mn (\$1,402), up 4.9% year on year and up by a third from 2019, but still less than a sixth of Kazakhstan's GDP per capita of \$9,055.

Things are getting better as the catch-up unfolds. That is driving growing consumption and that in turn is a powerful stimulus for economic growth. Retail turnover reached UZ\$167,026bn (\$15.6bn) in the first nine months of this year, reports investment bank Bluestone, up 9.8% on the same period a year earlier.

Small and medium-sized enterprises (SMEs) make up three quarters of all the retail business and saw volumes increase by 6.9%, while large enterprises expanded by a little more, up 13.1% in the same





period, but the biggest gains were in the informal sector (32.8%).

As of October 1 there were 472,273 SMEs (excluding farms) operating in Uzbekistan, up by a fifth from a year earlier, and more than 2.3 times the number in 2016, when Mirziyoyev took over the helm. The new president's liberalisations have created a much more fertile business climate for small entrepreneurs, which were generating about \$2.3bn worth of goods and services in 2020, according to official statistics.

Although much of business remains small-scale, the make-up of the economy is already fairly well balanced, with services accounting for 38.7% of GDP, agriculture 26.9%, industry 27.6% and construction 6.8%, according to the official statistics.

As the economy returns to health the international financial institutions (IFIs) have upped their forecasts for this year. The International Monetary Fund (IMF) revised its outlook for 2021 to 6.1% and for 2022 to 5.4%. The World Bank is predicting 6.2% for 2021 and 5.6% for 2022. And the Asian Development Bank (ADB) is a little more cautious, with a prediction of 5% growth this year and 5.5% for next year.

In addition to retail, a construction boom is adding to the growth impetus, posting a 4.5% y/y growth in the first nine months of this year after expanding only 0.1% in the first half of this year. Cement production, a proxy for construction growth, increased by 18.2% y/y to 8mn tonnes in the first eight months of this year and is knocking on to the leading cement producers like Qizilqumsement (QZSM), which is investing heavily into expanding its production.

Tashkent remains the epicentre of the construction boom, but construction is mushrooming in several other regional cities, including Khorezm (32.4%), Syrdaryo (23.6%) and Kashkadaryo (20.2%). The total value of construction projects in the entire country reached UZS76,891bn

(\$7.2bn) in the first nine months of this year, according to the Uzbek State Statistics Committee.

**Inflation**

The bugbear is, as for most of the countries in the Commonwealth of Independent States (CIS), inflation that has been driven up by the faster than expected post-coronavirus (COVID-19) bounce-back and soaring food prices. The introduction of inflation targeting is now the main focus of the CBU, which is trying to anchor the population's expectations for price rises.

After the centralised controls on the economy were eased in the first quarter of 2020 inflation has been falling from a steady 15.5% to reach a low of 10.7% in April 2021 that allowed the CBU to make a series of rate cuts.

Since the pandemic broke out inflation has been remarkably contained and after rising to 11.1% during the worst of the crisis it has fallen back to 10.8% as of September. However, the CBU has refrained from more rate cuts, although it hasn't had to hike rates either, choosing to leave them on hold at 14% at its last policy meeting in October.

“The inflation rate [in September] was slightly higher than the CBU baseline forecast and was driven primarily by the increases in the prices of food products, although the rate of food inflation slowed in September. Core inflation was recorded at 9.2%, down 3% since the beginning of 2021,” says the Tashkent-based Bluestone investment bank.

Long-term, massaging inflation down is one of the biggest challenges for the CBU, which has only recently introduced its inflation targeting policy. The regulator forecasts inflation falling to 9% in 2022 then to 7%, 6.5% and 6% each year in the next three years. The CBU intends to cut rates each year to 12% in 2022 then to 10%, 9% and 9% in each of the following three years.

But the challenges for the CBU remain manifold. The basic problem the central bank faces is that having lived

through decades of economic chaos the population has little confidence in the central bank and the inflation expectations of the population and businesses have never been anchored. The expectations for price rises remain significantly higher than those of the CBU forecasts, which is itself inflationary.

“We introduced inflation targeting in 2020 and we are now creating the tools,” says the CBU's Nosirov. “Inflation has fallen to 10.8% in December from 11.1% in 2020 and 15.2% in 2019. The pandemic helped reduce inflation as it depressed agricultural demand, but the fast recovery since then has reacted new inflationary pressures. Now we are focused on getting inflation under 11% again and have a medium-term target of 10% with a long-term forecast of 9%... Overall we regard inflation to be stable.”

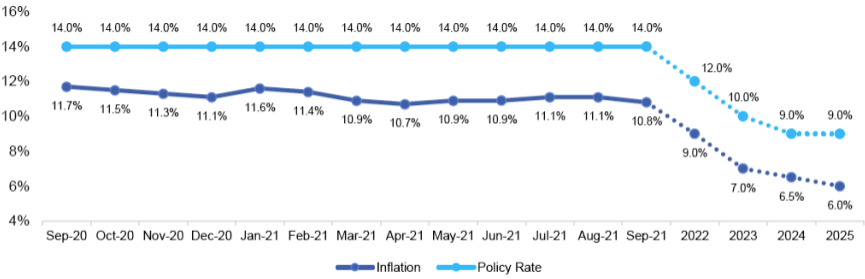
In addition to the high expectations, more immediately global food prices have been soaring and this year a poor harvest in Russia will keep prices high. And Uzbekistan has the highest rate of inflation in the region.

On the flip side the global boom in commodity prices has been a boon, particularly as gold prices – something else Uzbekistan produces – have risen strongly in recent years.

Inflation is being exported from surrounding countries as several of Uzbekistan's neighbours have started to limit or tax exports of commodities like fertiliser, grain and vegetable oil, which have also driven prices up on the domestic market as supplies become restricted.

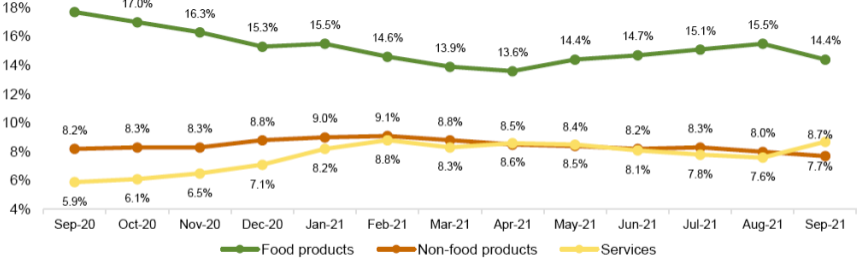
Uzbek food prices in September were up 14.4% y/y, although that was down slightly from the 15.5% in August as supply chains are repaired and the autumn harvest starts to come in, but fruit and veg didn't experience its typical seasonal declines this year. Happily the prices for non-food products have been less affected and were already

**Inflation and interest rates**



Source: Central Bank of Uzbekistan, Bluestone Research

**Inflation by product type (yoy % change)**



Source: State Statistics Committee of Uzbekistan

falling more noticeably, from 9.1% in February to 7.7% in September.

**Rates mismatch**

High inflation causes another problem that will fade as price rises are brought under control. High inflation means the CBU has to keep its monetary policy rate relatively high; however, banks with access to dollar funding can afford to offer significantly low rates on dollar loans. The spread between the cost of borrowing in soum and dollars is so wide that most borrowing is done in foreign exchange that exposes Uzbek companies to significant FX risks.

“The dollar share of loans is currently 48%, but there is a gradual decline,” says Nosirov. “There is still a big interest rate differential.”

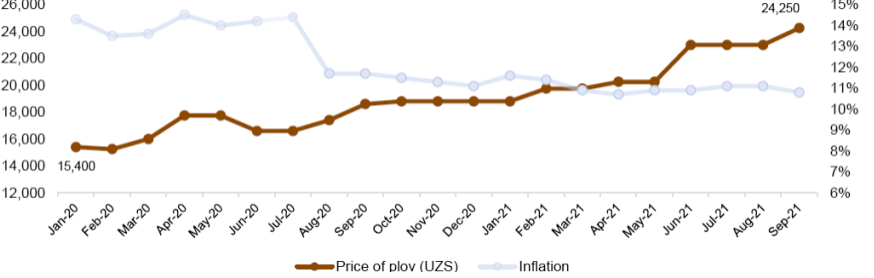
With retail deposits paying 17.5% and loans costing 21% in soum there is a 3-4% spread that remains a disincentive for business to borrow for investment capital in the local currency. However, Nosirov points out that the soum has been very stable and only devalued against the dollar by 2% in the first nine months of this year.

“But it will take time for this differential to fade,” says Nosirov. “We have only just started the inflation targeting policies. It's a new mentality but we already see that it's having an effect.”

The central bank has to be worried by the dollarisation of credits as other countries, like Ukraine and Poland, have come a cropper in the past by exposing themselves too big FX risks. The share of dollar loans has already started to fall from 70% previously to 50%:50% local vs foreign exchange now.

“It's changing now thanks to the stable currency and the falling inflation,” says Nosirov. “But it will take several years to normalise.”

**Plov Index (Cost of 1 portion of plov in Tashkent city)**



**Plov index**

In order to get a better handle of how prices rises hurt the most vulnerable sections of society the Uzbek State Committee has set up the “plov index”, an equivalent of the Economist magazine's famous Big Mac index to track prices, that also has a Russian equivalent, the borscht index.

All these indices do is track the prices of the most basic food – a burger, or in Russia's and Uzbekistan's cases, the cost of the ingredients needed to make the most popular staples. Plov is the national dish and made of lamb, rice, yellow carrots, onion, garlic and vegetable oil. Changes in the cost of a portion of plov have the most direct impact on a household's income.

The statistics committee publishes the monthly cost of a kilo of plov in all the regions as an alternative to measuring inflation and the cost of one portion of plov in Tashkent in September has gone up by 30.4% y/y compared to an increase of 10.7% for headline inflation in the same period.

The plov index shows that those at the lower end of the income bracket are disproportionately hurt by rising food prices, which is another reason why inflation expectations have become unanchored and are significantly higher than the CBU forecast for the headline inflation rate.

**External trade**

The final piece in the macroeconomic puzzle is Uzbekistan's improving foreign trade balance. Since the foreign exchange currency liberation in 2017, dismantling the harsh systems of controls imposed by



Karimov, companies have leapt at the chance to do their own export deals and trade is flourishing.

Without the hydrocarbons that bless the economies of Kazakhstan and Turkmenistan, Uzbekistan continues to run a trade deficit that reached \$7.6bn in the first nine months of this year on exports of \$10.3bn and imports of \$17.9bn. The total trade turnover was \$28.2bn, a 2.5% increase y/y in the period, after the turnover bounced back by over a half (54%) in the first half of the year as coronavirus restrictions were lifted.

“About 40% of our imports is equipment but a lot of that comes from China, where inflation remains stable so the import of inflation effect has been muted,” says Nosirov.

China remains Uzbekistan’s most important trade partner, but turnover with its ancient partner has still not regained pre-pandemic levels, whereas trade with the other Central Asian republics and Turkey has surpassed 2019 levels, the last year of strong growth.

Uzbekistan’s trade with the other CIS countries in the first nine months of this year was up 28.7% y/y, while its trade with non-CIS countries further afield is down by 9.1% in the same period, and trade with these other countries make up almost two thirds (61.6%) of the republic’s trade, according to the state statistics service.

To improve the balance of payments equation the government is fully focused on investing into adding

value to production. Uzbekistan’s biggest export item is now textiles, which is a reflection of the state’s new policy of aggressively targeting value added exports following the complete ban on raw cotton exports, which has forced cotton growers to invest into textile production.

Textile exports were worth \$2.1bn in the first nine months of this year. The ban on raw cotton exports has worked, with textile exports soaring by 58.3% y/y in the first three quarters. Moreover, new trade deals are opening up new markets: in April Uzbekistan won the coveted preferential trade status with the EU that allows it to export textiles to Europe with no duties and no quotas, allowing volumes to more than double in less than a year. ●

The banks are being prepared for sale, but Fitch warns there is still a lot of work to do.

“Uzbek banks have a significant proportion of unseasoned exposures as a result of lending growth as well as loan [moratoria] granted in 2020 to alleviate pressure on borrowers caused by the pandemic. The sector’s longer-term performance will depend on asset quality trends, operating environment stability and how successfully the state-owned banks targeted for privatisation can shift from directed lending to a more commercial focus,” Fitch said.

Long neglected under the rule of the former president Islam Karimov, who ran a tightly controlled de facto centralised economy with strict currency and cash controls, the banking sector has flourished since Uzbek President Shavkat Mirziyoyev took over 2016.

However, that has also introduced new problems as loan growth – particularly retail loan growth – has since boomed.

“The sector’s asset quality risks mainly stem from rapid loan growth at most state-owned banks in recent years and a high share of foreign currency

loans, particularly at larger banks. In addition, material amounts of loans are still being issued under government development programmes that require banks to target issuance volumes, in some cases resulting in relaxation of underwriting standards,” Fitch said.

Uzbek banks often provide long grace periods of up to three years on loans, especially in cases where financing was used to set up businesses or expand production, Fitch reports.

“Asset quality metrics weakened in 2020 and we expect further deterioration in 2021-2022 now that moratoria have expired and as more grace periods come to an end. The banks’ pre-impairment profit provides only a limited buffer against a potential increase in loan impairment charges, given thin net interest margins,” Fitch said.

Impaired loans (Stage 3 loans under IFRS) increased at most banks in 2020, except for Asaka, which reclassified a large amount of its Stage 3 loans, Fitch reports.

“Although Fitch-rated banks’ impaired loans ratios were below 10% at end-2020, we do not believe this fully captures the asset quality picture. The ratios are distorted by rapid loan growth and [moratoria] and we expect Stage 3 loans to increase further as more Stage 2 and restructured loans become impaired. However, according to our discussions with rated banks, most of the exposures that underwent pandemic-related restructuring had returned to their payment schedules by end-1H21, which suggests that the pandemic has had a limited impact on asset-quality metrics,” Fitch said.

“Coverage of Stage 3 loans by total loan loss allowances was 0.5x-1.0x at large Uzbek banks at end-2020. We consider this to be adequate given the collateral and state guarantees available on some impaired exposures. However, we consider most banks’ capitalisation as only moderate in view of increasing asset quality risks, limited pre-impairment profit and a high appetite for loan growth,” Fitch added.

The Uzbek government is flush with money, thanks to the country’s gold production. And the banking sector has been able to tap international financial institution (IFI) loans, which it has used to fund lending. But this has also lead to a dollarisation of credits where interest rates are much lower. The rates on local currency loans are in double digits and unpopular as a result. One of the government’s main tasks is to bring down rates to encourages local currency credits and so reduce FX risk in the banking system.

“State-owned Uzbek banks have financed recent loan expansion mainly with state funding or external funding from international financial institutions and development banks. This reflects the moderate level of customer deposits in the local banking system. Refinancing needs are modest in the medium term as maturities of external facilities are mostly linked to funded loans, and most banks have sufficient liquidity to service external liabilities in 4Q21-2022. However, long-term repayments will depend on the performance of loan books and

state-owned banks could face foreign currency liquidity gaps if there is asset quality deterioration,” Fitch said.

Six state-owned banks have been targeted for privatisation by end-2025. IFIs may initially acquire minority stakes in the banks to kick-start the process.

The government is moving cautiously with privatising the banks, wary of allowing big banking groups from countries like Russia buying into the sector, which they would dominate thanks to their sheer size. So far one bank from Georgia, TBC Bank, and another from Turkey have been allowed to do deals in Uzbekistan.

After the IFIs have taken stakes in the banks on offer and participate in completing their preparation for sale, the government intends to sell controlling stakes to strategic investors.

All banks targeted for privatisation are shifting business models from directed lending to becoming more commercially based, with a focus on improving margins and profitability metrics, Fitch reports. ●



Uzbekistan's banks used to be a tool of the centralised economy but since the government removed its controls the sector has flourished. But that has brought a new set of problems.

## Uzbek banking sector faces increasing asset quality risks

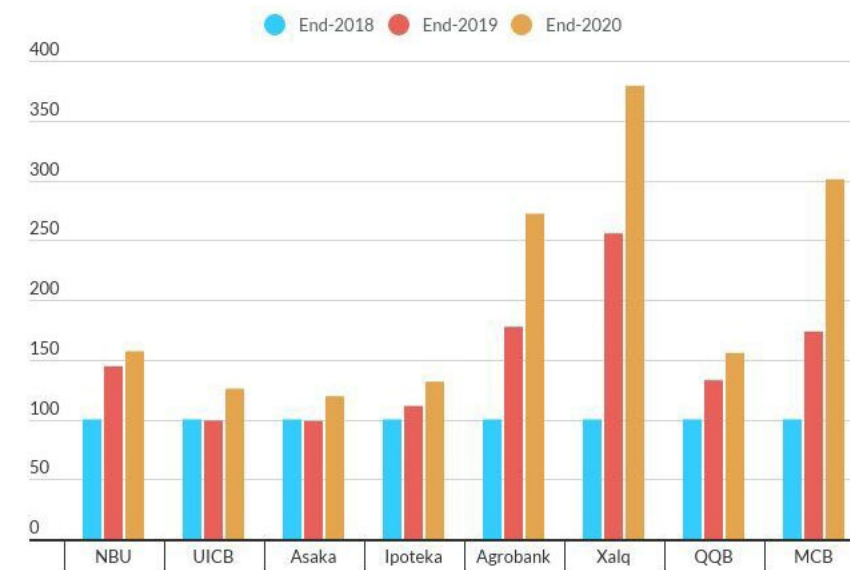
Ben Aris in Berlin

The Uzbek banking sector faces increasing asset-quality risks due to rapid lending growth, high balance-sheet dollarisation and an increased reliance on external funding, Fitch Ratings said in a report released on October 8.

Uzbek banks are in the limelight as the sector that is most advanced in the government’s reform and privatisation drive. One bank, mortgage specialist Ipoteka Bank, has already been sold to Hungary’s OTP bank, and several more are to be put on the block soon.

Uzbek Banks' Loan Growth

Foreign currency adjusted loan stock; end 2018=100



Source: Fitch Ratings, local GAAP accounts





# Uzbek banking privatisation gathering steam

Ben Aris in Tashkent

Uzbekistan's most profitable bank, UzPromStroyBank (known locally by the Uzbek language abbreviation SQB), is going to be the first big bank to be sold off as the country's banking sector privatisation gets under way. Two smaller banks have already been sold this autumn, but the sale of the big banks is just starting and SQB will probably have new shareholders sometime next year.

The Uzbekistan state is committed to getting out of the economy. The cotton sector has already been sold and a raft of hotels and real estate assets as well. Most of the largest industrial family jewels will be sold in the coming years, but banks have been the focus of an intense restructuring programme and most are now ready to go.

As *bne IntelliNews* reported, the effort moved to a practical level in March this year as the State Assets Management Agency (SAMA) began to implement a presidential decree that mandates the privatisation of banks with a new zeal.

The decree included lists of banks

to be sold but work on getting the banks ready started earlier with the acceptance of a roadmap for reform prepared by the IFC and EBRD.

In all, six banks are being prepared for privatisation and SQB is the biggest and most profitable. The banks that have been prepared for privatisation are: SQB, Asakabank, Aloqa Bank, QQB, Ipoteka Bank and Turonbank.

The international financial institutions (IFIs) have been actively involved in the process and as part of the changes all Uzbek banks must have switched to IFRS reporting by the end of 2022 and the government hopes to have the whole programme completed by 2025.

Uzbek media outlet Spot compiled a list of Uzbekistan's domestic banks in terms of their profitability following the release of 3Q results, and SQB tops the list. Its analysis showed that almost all of the financial institutions ended the reporting period in profit. The profit posted by the top ten banks is fivefold that of the other 17 banks in the sector, according to Spot.

## The banking business

As part of the preparations the bank has been refocusing its business. Under the previous Karimov administration the country's banks were split up by activity and used to provide directed credits to finance the various aspects of the economy. SQB was primarily focused on industry and infrastructure, a focus it retains, but now all its business decisions are made on a commercial basis, not state orders from on high.

“Our funding is from the local market deposits and the Ministry of Finance funds. The bank's focus is investment and development of Uzbekistan infrastructure and industrial development. We can fund these projects on a commercial basis, drawing on our deposits as well as synthetic loans from international financial institutions,” Ilkhom Khudayberganov, SQB chief funding officer, told *bne IntelliNews* in an exclusive interview.

SQB's loan portfolio is largely made up by corporate clients (60%), with SMEs comprising another third (30%), and the rest is retail customers (10%),

according to Khudayberganov. The bulk of the corporate clients remain state-owned enterprises (SOEs), but that share should fall as the privatisation in the rest of the economy gets under way.

“We are aiming to reduce the number of SOEs in our mix and increase the number of private sector customers,” says Khudayberganov. “But the pandemic has not helped, as the private sector clients have fallen in the last year after the borders closed and raw materials trade fell. In the meantime, we have been concentrating on improving the quality of our service.”

The bank has abandoned the directed credits and now makes loan decisions on the basis of market conditions and how they will affect the bank's risk profile and return on assets, says Khudayberganov.

## Two step privatisation

SQB's privatisation will be conducted in two steps. In the first it will take a convertible loan from the IFC and EBRD to fund its work, but that loan will be eventually converted into an equity stake as the two development banks join the bank's board of directors. With this help the bank will continue its transformation but then either a strategic investor can be found or the bank can be listed on an exchange. The presence of the development banks in the bank's shareholder structure will give investors extra confidence in the bank's reliability and should make it easier to sell. The same model has been used by the IFIs to help in the privatisations of many banks in other countries such as Russia, Georgia and Moldova. It is a path worn smooth by use.

SQB's co-operation with the IFC began in 2018 when the development bank conducted its first due diligence on the bank, after which it gave the management a “to do” list that was implemented over the next two years, says Khudayberganov.

Now the co-operation is coming to a cusp where the IFC is preparing to take a stake in SQB. The bank is in the

middle of organising the convertible loan worth \$75mn that will be invested into giving credits to small and medium-sized enterprises (SMEs) to help grow that sector, of which half are also green projects such as improving energy efficiency in small firms.

The EBRD is also involved in this project and will also offer another credit worth \$50mn in local currency which is almost all dedicated to funding energy efficiency investments. And the Asian Development Bank (ADB) is also participating in a convertible loan to the tune of \$50mn too.

Khudayberganov says that the current IFI lending has a strong green focus and SQB has set up Uzbekistan's first green loan department specifically to promote this type of lending.

“We have the first green headquarters in the country and the building is built with energy-efficient materials, which we are about to move into,” says Khudayberganov.

The IFC loan is denominated in dollars, but paid out in Uzbek soum. The loan has to be repaid in foreign exchange

at the market rate of the time of repayment, which means that the FX risk from a devaluation all falls on the IFC, not SQB. “If there is a devaluation then the IFC will simply get less dollars bank,” says Khudayberganov. “But we are hedging the risk too.”

The IFIs have been very active in offering credit lines to Uzbek banks and have become a major source of funding for the banks, with the EBRD having granted over \$200mn of credits alone.

The current convertible loan deal is subject to the IFIs' due diligence process at the moment but it is expected to get the all clear in the first half of next year.

“Once the deal is closed then we will issue new shares and the loan will be converted to equity. The IFC will get up to 20% in the bank depending on the exchange rate then, but it could be a bigger stake,” says Khudayberganov.

In the next stage the IFIs and the Ministry of Finance will start the hunt for a strategic investor and intend to sell at least 51% of the bank, says Khudayberganov. Then the IFIs can exit the bank's shareholding at any time.

Profits of the top ten most profitable banks in Uzbekistan in 3Q21

Uzpromstroybank	UZS 787.3bn	\$73.3mn
NBU	UZS 676.8bn	\$63mn
Ipoteka-bank	UZS 587.7bn	\$54.7mn
Trastbank	UZS 323.9bn	\$30.7mn
Hamkorbank	UZS 303.6bn	\$28.3mn
Ipak Yo'li	UZS 299.9bn	\$28mn
Qishloq qurilish bank	UZS 272bn	\$25.3mn
Kapitalbank	UZS 267.8bn	\$24.9mn
Asakabank	UZS 258bn	\$24mn
Orient Finance Bank	UZS 213.7bn	\$19.9mn

Source: Spot



**Bank deals**

Two banking deals have already been done, but both were smaller and had more specialist goals.

In October the IFC and the EBRD announced their intention to buy equity stakes of up to 20% in TBC Bank Uzbekistan, a subsidiary of Georgia's TBC Bank, also using a convertible loan. The two banks will pay \$9.4bn each this year and may increase their share in the coming three years. As *bne IntelliNews* reported, TBC was the first foreign bank to enter the Uzbek market in April 2019 that offered digital banking and fintech services. Since then it has already built up a 630,000-strong customer base.

"This is the first equity investment in the banking sector of Uzbekistan since the resumption of EBRD co-operation with the country in 2017. We welcome competition and expect that it will benefit everyone," Alkis Drakinos, head of the EBRD representative office in Uzbekistan, told *bne IntelliNews*.

TBC is now the biggest bank in Georgia and knows the EBRD well, as it went through similar reforms when the EBRD bought a stake in it several years ago and helped it with its reforms before it was eventually listed on the London Stock Exchange (LSE). Since then, EBRD has exited the bank's shareholder structure, but now is proposing to get involved again, this time with TBC's Uzbek daughter bank.

"We are going to offer our digital offering. We are the largest financial institution in the Caucasus and differentiate ourselves through our digital offering," Giorgi Shagidze, TBC Bank's CFO and deputy CEO, told *bne IntelliNews* in an exclusive interview at the time.

The Uzbek government has also sold off the mortgage specialist Ipoteka Bank in September to Hungarian banking powerhouse OTP. The deal was announced in September at an economic forum organised by the Ministry of Finance to showcase the progress the privatisation drive was making. The sale of Ipoteka was significant, as it is the third most profitable bank in the country, according to Spot. The acquisition marks

the first foreign takeover by Hungarian banking powerhouse OTP outside Europe.

Like the other deals, the IFC played an important role brokering the deal. Ipoteka Bank is the fifth-largest bank in Uzbekistan, with a market share of 8.5% based on total assets at the end of July 2021, with more than 1.2mn retail customers and a large corporate clientele. The bank had a balance sheet total of UZ\$32.6 trillion (€2.64bn) and equity of UZ\$4 trillion last year.

"The underdeveloped banking market in the highly populated Uzbekistan may provide an excellent growth opportunity for OTP Group, where economic reforms have already begun and the banking sector is before privatisation," OTP said in a statement at the time the deal was announced.

**Reforms still not over**

But the Uzbek banking sector is not without its problems. The coronacrisis hurt the banking sector and slowed its growth. Bank services were the only part of the Uzbek economy to see a contraction in 2020, although economic growth slowed dramatically that year.

The Uzbek banking sector faces increasing asset-quality risks due to rapid lending growth, high balance-sheet dollarisation and an increased reliance on external funding, Fitch Ratings warned in a report released on October 8.

One of the problems is the large spread in interest rates for dollar vs local currency loans. As foreign exchange loans are so much cheaper, lending is heavily skewed towards borrowing in dollars, which exposes industry to the risk of a devaluation. This is partly because inflation expectations in Uzbekistan have never been anchored by the regulator, but as the Central Bank of Uzbekistan (CBU) told *bne IntelliNews* in an interview, it has now introduced a policy of inflation targeting and hopes to close the gap in the coming years.

Last year the non-performing loan (NPLs) ratio tripled to 6.2%, which is uncomfortable but not dangerously

high, after which the ratio began to fall again as the economic growth gathered some momentum in the third quarter of this year. The NPL ratio was down to 5.8% as of October and is expected to continue to shrink up until the end of the year as the banking sector clean-up and privatisation continues.

"The decline in problem loans is primarily driven by state-owned banks," Bluestone investment bank said in a note, whose NPL ratio fell from 6.4% in August to 5.9% in October. Major state-owned banks such as National Bank of Uzbekistan, [saving bank] Xalq Bank and Qishloq Quriish Bank improved their asset qualities. Privately owned banks saw their NPL ratios rise slightly in October, with Turkiston Bank (69.2%) and Ravnak Bank (31.9%) registering the highest levels amongst the large private banks."

Nevertheless, the sharp rise in NPLs this year has focused attention on the banking sector's health. The liquidity coverage ratio of banks also declined in the three quarters of this year, falling from 224.5% in January to 152.4% in September, with the highly liquid assets shrinking 10% in the same period.

Pressure on the balance sheets will ease as profits grow. The banking business was picking up in October when the volumes of loans extended were up by 33% over the first nine months of 2021 and microloans in particular increased 2.3-fold. Auto-loans is another category that is growing, up 1.3-times as consumption takes off on the back of rising incomes.

Funding remains an issue, as banks had to dig into their capital to fund these loans. Banks' tier one capital adequacy fell slightly from 15.2% in January to a still comfortable 14.8% in October and well above the 10% considered to be a safe minimum.

It's still early days in reforming Uzbekistan's banks, but several years of work that has already been put in are starting to bear fruit. As more banks go under the gavel in the next two years these will play an increasingly important role in driving economic growth and should flourish in the process. ●



**Odilbek Isakov,**  
the deputy Finance Minister of Uzbekistan

to 0.8% in 2018 but jumped again to 2.6% in 2019, 2.9% in 2020 and it was over 3% for the first nine months of this year," Odilbek Isakov, the deputy Finance Minister of Uzbekistan, told *bne IntelliNews* in an exclusive interview. "And that is not including some of the money spent on reconstruction and additional social support spending. That has driven the debt up."

"Lower policy-based lending and higher tax revenues from a rebounding economy offset higher budget spending on social support, health and public infrastructure."

"We have run a budget deficit for the last few years and it has grown more and more as expenditure was needed to support society: social spending, schools, hospitals, salaries, etc. Spending has gone up many times in the last few years," he said.

"Though the deficit was financed through an increase in public debt, robust nominal GDP growth contributed to a slightly lower ratio of public debt to GDP of 38.5% of GDP in the first half of the, compared with 38.9% at end-2020," the World Bank said in its last assessment.

Much of the new spending next year will be financed by debt as well. The country's public debt in the first half of this year

**INTERVIEW:**

## Bootstrapping Uzbekistan's finances

**Ben Aris in Tashkent**

**U**zbekistan was one of only two major economies in the world to avoid recession last year and as the pandemic recedes the economy is bouncing back. Since Uzbek President Shavkat Mirziyoyev took over in 2016 growth has soared to over 6% a year, but during 2020 it fell to 1.7% as the lockdowns disrupted supply chains and hurt commerce. But in 2021 the economy staged a comeback and growth has returned to 6.2% in the first half of the year. The World Bank upped its GDP forecast for the full year to 6.2% in October from 4.1% previously, and to 5.8% in 2022.

Growth is already strong but the country has meagre domestic resources and has reached out to the international financial institutions (IFIs) and international investors to help it bootstrap its economy. The government is pouring money into investment

projects and spending heavily on social programmes, but the focus is not simply to make its people feel a bit richer; the focus is to invest into human capital and infrastructure so that its growth becomes self-sustaining and sustainable.

**Deficit and debt**

The budget deficit has also been growing fast, as the government had to cope with the economic shock of the coronacrisis and the financial demands of transformation.

"There has been a budget deficit since 2017, when it was 1.9% of GDP. It fell

"We have run a budget deficit for the last few years and it has grown more and more as expenditure was needed to support society"



expanded by \$1bn to \$24.2bn, but had surged again by the end of September to a record high of \$36bn, or 57% of GDP. Of the external debt, the public debt amounted to \$22bn, up 3% YTD. Private debt was \$13.9bn, up 11% YTD.

The plan is to expand debt again modestly next year to continue the investments into the economy. During the deliberations on the new 2022 budget the Accounting Chamber

**“In five years we have invested into power stations using public money but now they are all PPP, with no public money at all”**

decided to increase the debt up to 60% of GDP next year with limits on new agreements of \$4.5bn.

From these funds, \$2bn will be allocated to support the state budget and finance non-project activities, and another \$2.5bn will go to finance investment projects.

Most of this debt – Isakov estimates about 90% of it – has been raised from the IFIs, but he says it is still very moderate and Uzbekistan maintains a BB- with stable outlook from Fitch and S&P.

However, after the coronacrisis-related spending recedes the Finance Ministry says it wants to bring debt down again to the pre-corona level of 27% of GDP. The government also plans to keep the level of public debt and the budget deficit within 50% and 2% of GDP in coming years respectively.

Another option is to issue bonds on the international exchanges. Uzbekistan's debut \$1bn Eurobond issued on the London Stock Exchange (LSE) in February 2019 proved a smash hit, with demand of over \$8.5bn, or eight-times oversubscribed.

The launch was made with yields of 4.75% on the 5-year note and 5.375%

on the 10-year note and was greeted with an air of optimism among investors who attended Uzbekistan's New York, Boston and London roadshows. The issuance is set to pave the way for regular debt sales.

Now Uzbekistan's leading corporates are getting into the game, with the state-owned oil and gas company Uzbekneftegaz launching plans for a Eurobond issue in November. The

company is marketing its debut USD-denominated Eurobond with a tenor of five and/or 10 years and estimated a yield of 4.7-5.2%, according to preliminary deal terms unveiled by VTB Capital (VTBC) at the start of November. That bond will join UzAuto Motors, the country's leading carmaker and the only other Uzbek corporate bond on the market.

#### Investments

The epidemic has been an economic shock to the economy, but underlying that has been a large state investment programme to rapidly modernise the economy.

The previous government under-invested, leaving the country with poor infrastructure, education and health services among other problems. We need to spend the money now. We have a brain drain because of the low salaries. The government needs to invest into our human capital.

As the government gets more into its investment programme it is starting to look at diversifying its funding options. In the energy sector, for example, it has conducted the first private-public partnership (PPP) investments to build power stations. Likewise, money for the expansion of the NavoiAzot chemical plant was

initially financed with loans that carried a state guarantee, but new projects at the plant are now being funded with private and commercial investments.

“We are starting to use more private investment via PPP,” says Isakov. “In five years we have invested into power stations using public money but now they are all PPP, with no public money at all.”

Those power projects include a solar power plant at Navoi and plans for more that were co-funded by the Asian Development Bank (ADB) and European Bank for Reconstruction and Development (EBRD), who continue to play an important role in Uzbekistan funding plans, especially for green energy, which is supposed to make up 25% of the generating capacity by 2030, according to the government's plans.

The overarching theme of all these investments is to comply with the UN's Sustainable Investment Goals, 16 goals in total, that cover things like the green economy, social issues such as education and health, clean water and the like, says Isakov.

“We are the first sovereign in the region to have a SDG framework,” says Isakov. “We are spending on 11 out of the 16 goals at the moment and we will have to issue more bonds to cover a \$5bn-\$6bn funding gap. In all we will spend around \$15bn on the SDG if you also include the private investment.”

The Ministry of Finance is not just looking at London but is also in talks with the ADB, looking at green sukuk bonds and the Islamic Development Bank and the Gulf Cooperation Council from the Middle East as possible sources of funds.

#### Banking sector privatisation

The Ministry of Finance is also playing a central role in Uzbekistan's bank privatisation drive, as it is the owner of the big state-owned banks. Here too, the IFIs play a central role, as they are helping to restructure the banks and have been invited to become stakeholders in the first

phase of the sell-off. The EBRD, International Financial Corporation (IFC) and ADB are all playing an active role in the privatisation.

“Once the IFC is in a bank's shareholder structure it gives the investors a reassurance of the quality of the bank and then they are easier to sell,” says Isakov. “We can bring stronger investors who know how to improve a bank's performance and governance.”

Isakov is very upbeat on the potential of the banking sector, which was under-utilised in the Karimov-era and so the privatisation of the sector should be a fillip for the economy's development.

“The market is far from saturated. There is lots of demand,” says Isakov. “A large percentage of the population does not have a bank account. There is a huge potential.”

But while the first deals were done in September, the process is still only

“The government has for many years overcrowded the banking sector and the SOEs have crowded out the loan market,” says Isakov.

Under the new administration the emphasis has shifted to growing the loans to the small and medium-sized enterprises (SMEs) that will also support more job creation in a country where over half the population is under 30 years old.

“We have to make sure the SMEs have access to funding that is cheap,” says Isakov. “But so far there is only a fraction available of what is needed. By 2030 the population of Uzbekistan will be 40mn people – more than in both Ukraine and Poland.”

By then the per capita incomes will have risen from just under \$2,000 today to \$4,500 and the size of the economy should have trebled from today's \$60bn to \$180bn, according to the government's forecasts.

**“A large percentage of the population does not have a bank account. There is a huge potential”**

stepping off square one: 80% of the banking sector assets are still in the state's hands, says Isakov, and three quarters of the loans they make are to state-owned enterprises (SOEs).

The banks are being transformed early on as once the 15 really big state-owned industrial companies are sold off they will need regular banking services and a functioning capital market. Selling

off the banks will only be the first step in creating that capital market: once the last bank is sold the financial sector will only have finished the first stage of a much larger and more ambitious programme to create a domestic capital market to support industry.

“Over the last five years the government has been offering state guarantees but today we want the private sector to take up this task, as it is a profitable business,” says Isakov. “The government will exit these businesses by selling to strategic investors or via IPOs and the companies will be better managed as a result. This is the direction we are travelling in.”

Comprehensive bank sector reforms were launched in May 2020, including a concrete lists of banks to be sold, and the seeds of the change were planted, says Isakov.

“It won't be swift and we are not selling for selling's sake,” says Isakov. “So each exit has to be tailored, as it has an impact on the economy. We need to think about the consequences as a chain reaction and how it will affect society. Eventually we have to give everything to the market and the government's role will become more about targeted subsidies to help the poorest sections of society. That is why it's more important to make growth in GDP per capita the goal, not just earnings. We need to improve quality via developing human capital and infrastructure that was left over from the Soviet-era.” ●







Founded in 1964, the NavoiAzot chemical works has been in a comprehensive rejuvenation programme since 2016 that is starting to bear fruit.

## The rejuvenation of Uzbekistan's NavoiAzot chemical works

Ben Aris in Navoi

**O**dil Temirov, the deputy chairman of the chemical plant NavoiAzot in the industrial city in the Qizilqum (aka Kyzyl-Kum) desert is a busy man. He was late to pick us up and show us around the Soviet era plant that is in the midst of a large-scale modernization drive.

"I'm sorry. I was on the phone to our new Polish partners Alliance Capital who we are setting up a joint venture with," he explained.

The plant is one of the biggest in Uzbekistan and was founded in 1964. Much of the original plant is a fairly typical post-Soviet installation; run down and rusty. But in between the original production lines are gleaming new buildings and chemical-making equipment.

The plant's renovation was kicked off

in 2016 with some state guaranteed credits, but since then it seems the investment drive has reached a critical mass and NavoiAzot has attracted several partners, each that have invested into separate projects and business is booming.

In total the company is planning to invest \$1.7bn in new production facilities that includes ammonium, urea and nitric acid production amongst other things with a variety of partners from different countries.

There is still plenty of untapped potential in just meeting domestic demand, but NavoiAzot has also seen exports soar by 170% in the last year to over \$200mn expected by the end of 2021. Now a second stage of investments has started that will only increase in the next few years, Temirov explains.

### PVC

Our first stop was the new PVC facility that was co-built with Chinese partners to produce PVC (polyvinyl chloride), the basic input for plastics, for the first time in Uzbekistan.

Previously all the PVC in Uzbekistan was imported but now the plant's entire 100,000 tonnes a year production has been snapped up by domestic customers. Demand remains so high NavoiAzot is already breaking ground on a second even bigger 120,000 tonnes per year facility on its own territory to expand production further.

Once the new facility comes online next year, it hopes to cover domestic demand and probably will be able to start exports to its neighbours in Central Asia.

The first plant was built in cooperation with a Chinese consortium including CAMC Engineering and HQC Shanghai using a \$439mn state guaranteed debt that primed the pump, but the new facility was funded commercially with the Chinese partners contributing to the investment of \$397mn.

### Partners

NavoiAzot has commissioned a new \$1bn ammonia and urea (carbamide) production facility that is used to make fertilizers amongst other things. The facility is being constructed with its Austrian partners Continaz, and a second \$216mn facility to make 500,000 tonnes capacity nitric acid is being built with the Swiss company Casale.

A consortium of Japanese companies Mitsubishi Heavy Industries and Mitsubishi Corporation built the complex. The Danish Haldor Topsoe supplied technologies for the production of ammonia, the Italian Saipem - for the production of urea, and the German Uhde for the granulation of urea.

Japanese banks and financial institutions provided \$ 577mn in loans for the \$985.7mn project, and the Uzbekistan Fund for Reconstruction and Development contributed a \$320mn loan, while the company allocated \$88mn from its own resources.

In operation since last December, together the plant produces 577,000 tonnes of urea a year and 660,000 tonnes of ammonia after \$780mn of investment as well as 500,000 tonnes of nitric acid following another \$200mn of investment.

After the commissioning of the new facility the previous 50 year-old outdated production capacities are being dismantled. The company officials emphasized that the launch of these facilities will give impetus to the comprehensive renewal of a number of nitrogen fertilizer production units, which in turn, will boost the agricultural industry.

"One of the sources of funding is export credit agencies that provide loans to build the facilities and they have participated in all the projects now in operation," says Temirov. "The urea production line is under contraction and should start operations in March."

Half of the ammonia production will be used to produce urea and the rest will be used to make ammonia nitrate and other chemicals that will be sold on the domestic market although about 15%

of the production is due to be exported and 60% of the urea will be exported. "Now we are starting to pay the credits from the first year. The plant went into business in 1964 and the units we have been using were old, but those have been decommissioned now as we are modernizing the whole production since 2016," says Temirov.

In the plant's control room a team of operators sit at screens watching the plant at work. Chinese characters adorn some of the hardware and

**"In total the company is planning to invest \$1.7bn in new production facilities that includes ammonium, urea and nitric acid production amongst other things"**

on the screen displays as well, testifying to the active investments the Chinese partners have played.

Temirov takes us to a board that shows the plant's grounds that are covered with plans for new units. Some have

been built and are already in operation. Some are under construction, like the second PVC unit. But most of the units are still dotted lines of the plan as they have yet to be started.

The first round of investments have been completed and the plant is now working on a commercial basis. In the next phase the company can already raise commercial loans to fund the second phase of investment and is looking to build a new "chemical cluster" – another buzz word for the Mirziyoyev administration.







## Uzbekistan's cement giant Qizilqumsement on a roll

Ben Aris in Navoi

**Q**izilqumsement (QZSM) is of Soviet vintage, set up in 1977, and is the biggest cement maker in Central Asia. If construction is one of the main drivers of economy growth, then the frenetic activity at the cement plant is perhaps the best indicator of the boom that is sweeping the country.

Located outside of the city limits of the industrial town of Navoi and surrounded by flat rocky desert entering the plant's grounds is a step back in time for anyone that has spent time in the Former Soviet Union (FSU).

At the gate is a wall with the photos of the previous directors, all of them with sour po-faced poses that are the hallmark of Soviet-era official portraits. Another section has pictures of the best employees of the month with equally serious faces.

Driving into the plant there are three huge beaten silos of the original

production standing at the back of the territory that continue to churn out 3.2mn tonnes per year (tpy) of cement entirely for the domestic market. Domestic demand is currently outstripping domestic supply by 6mn tonnes, forcing Uzbekistan to import cement, and the Qizilqumsement plant is working flat out to get cement out to its customers.

In the first eight months of this year Uzbek companies bought a total of 8mn tonnes of cement, up 18.2% year on year and driving the prices up by 2.4% as a construction boom gathered momentum in the same period. But thanks to the production deficit the country had to import 550,000 tonnes of cement from its neighbours in that period.

Qizilqumsement is hoping to do something about that. Earlier this year the company launched a \$112mn investment to add a fourth production

line – the first significant investment in the plant since 1989 – that is slated to come online in December. The new line will add 2.2mn tpy of cement to its output, bringing the total output to 5.8mn tpy – a bit less than a third of Uzbekistan's entire cement production.

“The contractors are Russian, Turkish and Chinese, although most of the equipment is German,” says Abduqahhor Salomov, the general director of Qizilqumsement sitting in his modest office drinking tea. “We have mostly financed it from our own funds and the return on investment should take about seven years. There is huge domestic demand. We can't even meet that. Even with the new capacity there won't be enough of a surplus to do any exports. Maybe next year.”

The centre of the grounds where the new silo and processing plant is going up is a hive of activity. The ground is littered with metal components, material and equipment and the new silo tower soars overhead, cloaked in scaffolding and cranes and busy with men working on the structure. It is already more than three-quarters completed and looks oddly out of place with its slick coat of paint and obvious shinny newness compared to the surrounding buildings that have been battered by desert weather for decades.

The ebullient director proudly tells *bne IntelliNews* that the company is funding 81% of the investment from its retained earnings and the rest has been taken as commercial loans from Uzbek banks.

“In 1994 we had to close down one of the three lines, as there was no demand,” says Salomov. “Today we can't produce enough and even after the new line goes into action we will be working at full capacity. You can feel the difference in the country.”

Qizilqumsement business has been freed and transformed. Once a key part of the command economy, its status was little changed during the administration of Islam Karimov, Uzbekistan's first president, who maintained a more or less centrally controlled economy.

What has changed since Uzbek President Shavkat Mirziyoyev took over in 2016 is not any specific sweeping reform other than the plant is allowed to run its own affairs and manage its own funds, despite the fact that it remains largely state-owned.

Nevertheless, Uzbekistan's cement deficit is a strategic and balance of payments problem for the country and Qizilqumsement's investment project to boost production is one of a dozen going on at smaller plants in the country. Uzbekistan's total cement output is around 19mn tpy, but the demand is currently some 24mn tpy. The new projects are expected to close the gap next year and make the country self-sufficient in cement.

### Reorganisation and privatisation

Freeing up companies to be in charge of their own business has been the most effective reform, but Qizilqumsement has also been through a more formal restructuring too that started in the Karimov era when it was transformed into a joint stock company. But now the company is working up towards its eventual privatisation.

“We were changed into a joint stock company already in 1996 that is 86% owned by the government,” says Salomov. “Now we are getting ready for privatisation. The plan is to sell the

Navoi is in the heartland of Uzbekistan's industry, as many elements of the country's heavy industry are located in the desert city. But even Salomov says the changes in the country are obvious here too.

“Today there is a huge difference. We can feel the development in the different spheres of the country. Things are noticeably accelerating in the last two years,” says Salomov. “Everyone has their own ideas. Me? I'm in cement production, but I can feel the development from the production and sale of cement.”

The government has been giving the industry a helping hand as it tries to reach self-sufficiency. The taxes on cement production were cut last year from UZS40,000 (\$3.72) per tonne to UZS25,000. At the same time, the profit tax on cement makers was cut from 20% to 15%.

“I hope the taxes fall again,” says Salomov. “The government cut the taxes so Uzbek cement is more competitive against the imported cement. If our cement costs too much then construction companies will just buy cement made elsewhere, but now ours is cheaper and that lays the basis for our investment into new production, as we know we will have buyers for it.”

“Today there is a huge difference. We can feel the development in the different spheres of the country. Things are noticeably accelerating in the last two years”

entire 86% stake. We are preparing, but no one is sure when it will happen.”

Asked if he thinks it is a good idea to privatise the company Salomov says simply: “Privatisation is a good idea, as the company will be more profitable than when it is owned by the state.” This is the director who has been working at the plant for 36 years speaking in a deadpan voice of someone stating the obvious.

One possible cause for concern is the company borrowed part of its investment funds as commercial debt from the local banks and chose to borrow the money in dollars, which were converted to soum for the project.

“We borrowed in currency as it was cheaper. But the foreign exchange risk is not really a problem: the devaluation of the soum to the dollar this year has so far only been 1%,” says

Salomov. “Besides, we have a natural hedge, because in addition to cement we produce lime which we export to Kazakhstan which is paid in dollars, so we have dollars too which we can use to pay off the debt if we have to.”

### Stock pickers darling

Majority-owned by the government, another 14% of the company is listed on the Tashkent Stock Exchange (TSE) and owned by portfolio investors as well as a share that has been given to the workers. Asked who the minority shareholders are, Salomov says he doesn't know.

Qizilqumsement has already emerged as one of the most popular stocks on the Tashkent Stock Exchange (TSE) and most of the shares in the free float are owned by the nascent funds. The business is basic and the company is a cash cow, say analysts.

It mines limestone in a massive deposit in the Qizilqum (aka Kyzyl-Kum) desert less than a kilometre away from the production facilities that turn the stone into cement that is shipped all over the country.

In October the company reported its nine month results under Uzbek accounting standards that saw revenues fall by 11.5% y/y despite the construction boom in Uzbekistan, but a 4.4% decline in the cost of goods.

At the moment the company is ploughing much of the cash it is earning into the construction of the fourth line. Construction work increased by 4.5% in the period, the Bluestone investment bank reported, although the pace of increase in the construction had slowed somewhat.

Net income also fell by 46% in the period due to the fall in revenues, increased operating expenses, shrinking interest income as funds were spent on construction and some FX losses. However, the total assets rose in value by 19.6% thanks to the significant increase in capex on the fourth line. The company's finances highlight that even in a boom management still has



a lot of work to do, as the company also reported an 11.9% rise in receivables that “contributed to QZSM’s cash crunch and [indicate] that the country’s rapid economic recovery is not evenly distributed among the construction companies,” says Bluestone. Demand is high and sales are strong but companies still need to collect the payments on time, and that is not always easy.

The one bone of contention is the company’s failure to pay dividends, due to the cash crunch. After using its cash to retire some of its long-term debt obligations in 2019 the company took out a fresh UZ\$240bn of long-term debt, denominated in dollars, this year, ostensibly to pay out dividends of UZ\$660 per share but to the chagrin of shareholders it failed to pay. The company has borrowed a total of \$112mn but its overall level of debt

to equity ratio remains an extremely modest 0.10, according to Bluestone.

“Despite Qizilqumsement’s large-scale investment in a fourth production line, on May 22 the company announced it would allocate 75% of 2020 net profits to dividends at UZ\$989 per share. However, the company failed to pay the dividends within the 60 days stipulated by the regulations due to cash needs for construction,” Bluestone reports.

The management called an EGM at the end of August and voted to reduce the dividend payments to UZ\$660 per share to free up more cash to pay for its capital investment, but it wasn’t enough. In September the management announced that it was suspending the dividend payment altogether.

Despite these growing pains portfolio investors remain keen on the company. The Tashkent-based, but foreign managed, AFC Capital says that Qizilqumsement accounts for a third of its portfolio on its own and Bluestone also has a Buy recommendation on the stock, estimating the shares still have a 14% upside. When the fourth production line comes online the capex should drop to nothing and the revenues will increase; the company’s financials could improve dramatically in the New Year.

“Our price target is a conservative forecast that could be revised significantly upwards if the fourth cement production line opens in December 2021, as the company indicated in 2020, and the company resolves its dividend and cash flow issues,” Bluestone said in a note. ●

#### Ben aris in Tashkent

**U**zbekistan under its new president, Shavkat Mirziyoyev, is a country gearing up for a bright future – in that the president wants to make sure there is enough power to keep all the lights on as both the economy and the population are growing fast.

“Now the situation is very dynamic. There is rapid economic growth and the energy sector will not be able to meet all the needs. Today we have 15 GW of capacity and the plan is to increase this to 30 GW by 2030 of which 25% will be renewables,” Azim Akhmedkhadjaev, the newly appointed First Deputy Energy Minister told *bne IntelliNews* in an exclusive interview.

The president launched a comprehensive five-year energy reform plan in 2019 that is, after the bank sector reforms, probably the most advanced of all the country’s reforms.

Investments into power and electricity infrastructure have accelerated in the last four years, during which time investments into electricity

infrastructure amounted to 75% of the total investment during the independent period, or 2.5 times more than in the previous 26 years, according to the ministry.

Uzbekistan has enough power for the meantime, but it is already clear that if the pace of growth goes as predicted it will need to double its generating capacity by the middle of the decade.

There are several other elements going into the transformation. One of those is the greenification of the power sector. Another is to repurpose gas from using it as a fuel and repurpose it as the feedstock of a burgeoning petrochemical industry.

In August the energy ministry announced plans to increase its 2030 renewables targets and the EBRD reports that there has been a lot of interest in the proposed projects by international investors.

The original concept note on ensuring electricity supply in Uzbekistan for 2020-2030, published in last year, set out plans to develop power capacity by rebuilding existing power plants, inviting private power developers to take part in power sector development and deepening reforms in the energy sector. It also said that PV and wind power will account for a significant share of generation capacity.

Among the deals signed so far, in 2019, Uzbekistan picked Masdar Clean Energy of the United Arab Emirates as the winner of its first ever competitively tendered solar power public-private partnership (PPP) to develop a utility-scale solar plant located in Navoi Region.

But the main drive of the programme for the moment is making more use of what Uzbekistan already has.

“The green trend is very fashionable at the moment but it is a chicken and egg situation: we want to invest in renewables but people question the time and the expense of it, as it is complicated. Let’s invest in what

we have, they say. There is enough gas,” says Akhmedkhadjaev.

“The president’s policy is to invest in green energy and develop more capacity. Uzbekistan is committed to a net-zero carbon future. Now we are working out the best way to get there,” says Akhmedkhadjaev.

The main fuel in Uzbekistan is coal, which is still used, but Akhmedkhadjaev says the state

**“The president’s policy is to invest in green energy and develop more capacity. Uzbekistan is committed to a net-zero carbon future”**

has invested heavily into scrubbing and other technologies to reduce emissions while the green generation is built up that will eventually replace much of the coal.

That also frees up the country’s limited domestic gas production for other value-added uses. The country’s first petrochemical plant was built in 2001 under former president Islam Karimov but the new administration is investing heavily in expanding this profitable business.

“We are self-sufficient in gas and there is some import and re-export of gas. Plus we have a lot of undiscovered gas and the exploration is ongoing in Sukhand and Karakalpakstan,” says Akhmedkhadjaev. “Mirziyoyev has emphasised that we should focus on adding value and creating more jobs so the gas is used in [the] petrochemical industry.”

Money has been poured into the gas separation plant built upon the crest of a cliff of the long-forgotten Aral Sea, which now produces polypropylene, polyethylene and hessian bags for export around the region and further afield.

“Added value” is the buzzword in Uzbekistan and in each sector part of

each reform programme is hunting for chances to move up the value chain. The most obvious example is with cotton production, where the president simply banned the export of raw cotton and forced the local producers to invest in textile production. The same logic is being applied to energy where it is applicable.

Uzbekistan is currently in talks with Russian petrochemical giant Sibur on a deal to form a joint venture, as

the country’s own plant can’t keep up with the demand from just the domestic market. A second plant was launched in 2015 and the third is due to go online in the first quarter of 2022, says Akhmedkhadjaev.

Exports of petrochemical products is also starting to grow with Uzbekistan neighbours. Exports to Afghanistan grew from nothing to \$100mn, until the recent regime change there put business on hold. And exports to Kazakhstan have ballooned from \$50mn to over \$1bn turnover. Trade with the other ‘Stans is also growing fast, says Akhmedkhadjaev.

At the same time, to keep up with demand the country has been mulling its first nuclear power station since 2018 that will be built in co-operation with Russia, which supplies the technology and funding. Russia’s nuclear exports are booming and it has brought several new nuclear power stations (NPPs) online in other countries of emerging Europe such as Belarus and Turkey.

The government’s forecast, as set out in its power sector development concept for 2020 to 2030, is for the current demand of around 68bn kWh to increase to between 110bn kWh and 115bn kWh by the end of the decade. “This increase is because of two factors:



## Uzbek energy reforms focus on energy saving, high efficiency in the first phase



the population is growing and will increase from 34mn today to close to 38mn by 2030, and consumption per capita, which is currently below the global average, is also expected to increase,” Bakhrom Umarbekov, project manager on renewables at the energy ministry, told *bne IntelliNews* in a separate interview.

#### **Efficient power**

The entire structure of the electricity market is being overhauled and put on a market basis. Uzbekistan is planning to introduce a wholesale electricity market by 2025 that can improve the management of the electricity industry and reduce state ownership.

In June the energy ministry outlined its plans to create a wholesale electricity market by 2025, which again is

“The entire structure of the electricity market is being overhauled and put on a market basis.”

intended to improve management and reduce state ownership. Such a market, if competitive, would improve the management of the electricity industry and reduce state ownership, the Uzbek Energy Ministry said on June 15.

The transition will take place in three stages. In the first, state electricity companies will be liberalised and private companies will be allowed to obtain licences to sell electricity. In the second stage, an operator of the electricity distribution system will be created, after which the functions of selling power to consumers will gradually be transferred to suppliers with licences. And in the final stage, the government will launch an intraday electricity trading platform. It will allow surplus or deficit volumes of hourly production and consumption of electricity to be traded online.

While this is going on in the background the ministry has been investing into new high-efficiency power plants. There are already several joint ventures with German

engineering company Siemens and Turkish contractors that have already produced successful results.

“They bringing energy-efficiency equipment. If it works well then we will either modernise our existing power facilities or rebuild them using newer more efficient equipment,” says Akhmedkhadjaev.

One project to construct a high-efficiency power plant in Tashkent has already been completed with Turkish partners and was built on a PPP basis.

“The installed capacity was the same as the plant it replaced but the energy efficiency is twice [as good] and the plant covers a territory a third of the size,” says Akhmedkhadjaev. “It was an extremely successful project.”

The plan is to extend this model and find investors to continue building more modern and high-efficiency power stations so that the old inefficient ones can be eventually closed. The first phase is going to continue for the next eight years but the whole programme to modernise all the power stations is set to run until 2050.

The improving energy-efficiency policy runs through the entire energy reforms programme right down to the individual households, as simply using power more efficiently will be as good as generating more power.

The state-owned enterprises (SOEs) consume 60% of all Uzbekistan’s energy, which Akhmedkhadjaev says “is not normal.” But he also tells a story of visiting a house in a remote village where they used an open flame from a gas pipeline to heat the house. “She was heating the street, not the house, but they had no money to buy a better system,” recounts Akhmedkhadjaev.

The government intends to tackle this problem too with investments into improving energy use in communal housing and new developments. A fund has been set up and a TV, Facebook and YouTube campaign run to raise awareness for the programme, which is being supported by the World Bank.

#### **Privatisation**

In the short term the government is investing into upgrading the power network to ensure there is enough power capacity, but in the longer term the goal is privatise the sector and put it on a market basis.

“Now we are working on the privatisation concept for the energy sector,” says Akhmedkhadjaev. “The last-mile business will be sold off to private owners and in the first phase 25% of the gencos will be sold to private investors. Then any new power generating capacity will be 100% private. It will become a market where private investors meet the demands for supply and demand. It will be a fully market regulated system. It’s not easy, but there is no other way.”

Akhmedkhadjaev says that as Uzbekistan is late to the game it has the advantage of learning from the mistakes of other countries and has been watching their progress carefully.

“We watch the failures but we are not in a rush,” says Akhmedkhadjaev. “We will proceed step by step and we will have to make people pay for the power they consume, as it is a closed circle.” ●



## Uzbekistan privatisation: “There is no other way”

#### **Ben Aris in Tashkent**

The offices of Uzbekistan State Capital Investment Agency are an unassuming government building in Tashkent and a new addition to the government following the moribund days of the previous Karimov administration.

The old system had changed little from Soviet days, where the state owned almost everything of value. Run by “red directors” and managed using state orders, quotas systems and decrees, little real business was done. But all that has changed now. The job of the Uzbekistan State Assets Management Agency (SAMA) is to sell pretty much everything the state owns to private investors – domestic and international – and to do it quickly.

Uzbekistan’s privatisation programme has been in development for several years, and now the first wave of candidate companies has been prepared the number of auctions is snowballing. This year has already seen more sales completed than all the sales made in the last four years taken together.

During an economic forum organised by the Ministry of Finance in September, more than \$250mn worth of privatisation deals were closed, including the Coca-Cola bottling plant and the first two banks that kicked off the privatisation of Uzbekistan’s financial sector that will see many of the biggest banks flogged to the highest bidder in the next few years.

As *bne IntelliNews* reported, the entire cotton sector – the backbone of the economy since Soviet times

“There is no other way,” is a mantra repeated by one state official and head of a large industrial concern after another

– has already been completely sold off, and the same privatisation of wheat production, also a strategically important sector, is anticipated to be complete by the end of 2022.

“The sale of the Coca-Cola plant was also completed during the economic forum in September at a price of \$250mn, which was twice the valuation going into the deal and x16 EBITDA. It was a highly successful deal,” Akram Mukhamatkulov and Shokhrukh Okhunov, who run Uzbekistan’s department for the transformation and privatisation of SOEs at SAMA in Tashkent, told *bne IntelliNews*.

The Uzbek Coca-Cola plant was purchased by the Turkish Coca-Cola çecek (CCI) Group, one of the biggest structures in the Coca-Cola empire, which bought the government’s 57.1% stake in the company after a successful bid in a privatisation auction run by SAMA. The deal was launched as an open tender in line with the presidential decree dated October 27, 2020. Investment bank Rothschild & Co. acted as financial advisor to the government and Denton’s as legal advisor.

“CCI was one of seven bidders, but the first to apply when the auction process was launched in January 2021,” Mukhamatkulov and Okhunov said, “but all the bidders were all very keen. There were also bidders from the US, Turkey, Israel and elsewhere, which drove the price up to double the starting price.”

Governments are usually cautious about selling off their biggest and best SOEs, concerned to get the best price possible for their industrial family jewels, but during a course of the interview by *bne IntelliNews* representatives of the state said over and over again: the state

companies needs to be sold off and given to the private sector. “There is no other way,” has been a mantra repeated by one state official and head of a large industrial concern after another



in a series of interviews conducted by *bne IntelliNews* in Tashkent.

In the first nine months of this year the government has already raised \$370mn from privatisations and is expecting to clear a total of \$600mn by the close of the year; a total of \$160m worth of privatisations were sold in all of the preceding four years.

The Coca-Cola deal also highlights the role of international consultants which the administration of Uzbek President Shavkat Mirziyoyev have been relying on heavily to get its transformation and privatisations right. Mukhamatkulov and Okhunov say that no big deal is contemplated without the participation of a major international consultant that helps in the restructuring and valuation of the assets being put up for sale.

“We are keen to create sustainable businesses and want to the process to be transparent,” say Mukhamatkulov and Okhunov. “It’s important to build

The government has already privatised Poytakhat Bank (Capital bank), a smaller state-owned bank that has signed a MoU with Russia’s Expobank that has plans to create a digital bank in Uzbekistan.

“That is another important part of the privatisation process: its not just about valuations; the investor should also bring some sort of added value to the deal. The bank sector reform must develop much faster, and deals like this help,” say Mukhamatkulov and Okhunov.

However, the privatisation programme is not a fire sale and each auction is tailored to the needs of each company. Another major asset up for sale is the Fergana Oil Refinery, which is going to be sold piecemeal starting in the first quarter of 2022 and in the second quarter part of its equity might be listed on exchanges.

Real estate was an early entry into the sell-off. As *bne IntelliNews* reported,

“Mirziyoyev is betting on privatisation. He wants to reduce the government share in the economy by 75% by 2025. That’s the goal”

trust during the sales process. Coca-Cola was sold to an international buyer but most of the smaller companies [are] being sold to local buyers, but the same rules apply to them.”

Mukhamatkulov and Okhunov say the government is agnostic to sales to local or international investors; there is no preference. “The best bid wins. That is all there is to it,” says Mukhamatkulov and Okhunov.

The entire cotton sector has already been sold off, mostly to domestic investors, and the wheat production sector is currently in the middle of being privatised, which should be finished by the end of 2022. Next up is the banking sector.

the first to go was the iconic Hotel Uzbekistan in the heart of the capital that has been there since Soviet times and was bought by Malaysian investors in May of 2020, who paid \$23.2mn in another competitive auction. Next up is the Hyatt Regency and the Hotel Tashkent, which are due to be sold soon.

“The government is also going to sell its resorts, its government-owned tourist assets. It’s going to sell other real estate assets,” says Mukhamatkulov and Okhunov. “Mirziyoyev is betting on privatisation. He wants to reduce the government share in the economy by 75% by 2025. That’s the goal.”

To make all this work smoothly, and to avoid the danger of creating an oligarch

class or of the process being overtaken by insiders, SAMA has tried to set high standards of transparency and fairness in the sell-off. Mukhamatkulov and Okhunov emphasised throughout the conversation that transparency and trust are the key elements of the auctions. International consultants provide a measure of objectivity to valuations and as part of the restructuring the accounts of the target companies are transformed into the IFRS standards. The international financial institutions (IFIs) have also been invited to take stakes in the first round as an added safeguard to transparency and a hands-off approach to the sales. For example, the EBRD and IFC have bought a 20% in the TBC Uzbekistan, after Georgia’s TBC bank bought a local bank in one of the first sales of an Uzbek bank to a foreign player.

The legislation supporting privatisation has been on the books for several years already but work to fine-tune it is ongoing. New laws are on the way in the New Year that the government hope will improve the situation further by introducing a new mechanism to bring the valuations closer into line with the bids being offered by potential buyers, for example.

All this is leading up to the sale of the largest 15 state-owned companies, including the biggest, Navoi Mining and Metallurgical Kombinat, one of the biggest gold miners in the world.

“The big 15 will probably sold via an IPO; maybe on the Tashkent Stock Exchange (TSE); maybe a dual listing on an international exchange as well,” say Mukhamatkulov and Okhunov. “Now we are working on preparing them, but its very likely that some of the shares will be sold on TSE as part of the government’s efforts to develop the domestic capital market as well.” ●



## Savitsky museum, the Louvre of the Steppe

Ben Aris in Nukus

The small town of Nukus in the wastes of Uzbekistan’s Qizilqum (aka Kzyl-Kum) desert is the “Louvre of the Steppe.” The new building, put up in 2017, houses an Aladdin’s cave of lost Russian impressionist art, an entire generation’s worth that was rescued by art enthusiast Igor Savitsky. It is probably the second-biggest collection of avant-garde art in the world collected in the 30s after Stalin had most of an entire generation of impressionist artists repressed or executed.

Savitsky was born in the Ukraine in 1915 to a well-to-do family but eventually ended up running an archaeological project in Nukus. Stalin didn’t like the new impressionist style that was being developed in France and leaked into Russia where a whole school of painters embraced it, turning out their own interpretations. In 1932 the Kremlin officially ruled that only the social realism style was acceptable and most of the Russian artists simply stopped displaying their work, while many were arrested for anti-Soviet propaganda.

Savitsky began travelling to Moscow and St Petersburg and bought up entire collections, or was sometimes gifted them by relatives hoping to save the paintings from destruction. In all Savitsky assembled a collection of over 80,000 canvases, many of them masterpieces, and opened the Savitsky Museum in a few rooms of Nukus’ natural history museum in 1966, where they hung as many of the best pieces from ceiling to floor. At the same time, Savitsky collected the work of local artists and is credited with being the father of a whole school of Central Asian painting, which is also on display in the Nukus museum.

### Old building

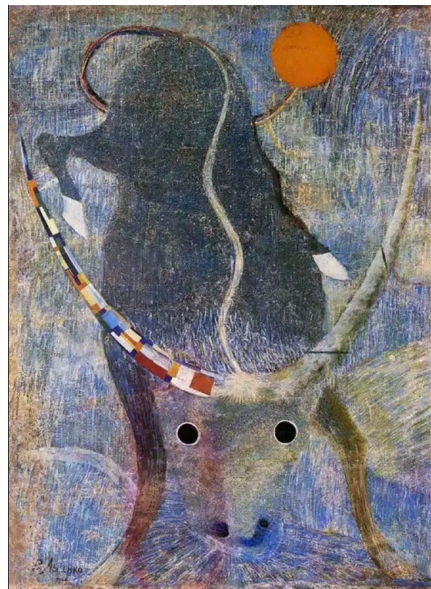
The Uzbek authorities took a long time to realise the treasure trove that was sitting in a run-down old building in the remote western town that is the capital of the Karakalpakstan region.

I first visited the museum when I was correspondent to Uzbekistan and met the curator Marinika Babanazarova, the daughter of Savitsky’s friend who helped

him open the museum. Even the new building only has room to exhibit about 3% of the entire collection, so the paintings are rotated regularly, but rarely leave Nukus. However, in 1999 they were stacked in wooden racks along the walls and on the floors. You could flick through the canvases. For closer inspection you could pick out picture and hang it on a large nail in the wall in front of a bare light bulb.

At the time Nukus was an ecological disaster and the local economy had completely collapsed. The region’s firms had no money and were paying workers with sacks of pasta so they at least had something to eat. Decades of over-irrigation of the surrounding cotton fields meant the water table had risen to the surface and the foundations of all the buildings in the small city were rotting in the stagnant water. Babanazarova was doing what she could to preserve the paintings and protect them from damage. But in the last five years the museum has become increasingly famous and more and more travellers are going out of their way to visit the collection.





The most famous painting in the Nukus collection is "The Bull" by the Belarusian artist Vladimir Lysenko, originally called "Fascists Approach." Soviet censors deemed it anti-Soviet and interned the artist in a mental asylum for 15 years, from which he eventually emerged paralysed and very ill.

Just before he died in 1984 he told Babanazarova: "I created the museum too soon. But one day people from Paris will come to Nukus."

Babanazarova said: "Savitsky always said people would come from Paris to see it, and now the French are our number one visitors." In 2008 President Chirac was one of those admirers of part of the collection at a rare foreign show in Paris.

### Savitsky's career

Growing up in Ukraine in the twilight days of the Russian empire, Savitsky's grandfather was a well-known member of the Russian Academy of Sciences. As a child, Savitsky received an excellent education, travelled abroad and spoke fluent French. Having decided to become an artist, Savitsky entered the Surikov Institute in Moscow but couldn't find work after graduating.

When World War II erupted, Savitsky was evacuated to Uzbekistan (he was unfit to serve due to an illness). During this period he befriended prominent Russian artists Robert Falk and Konstantin Istomin, who had also been evacuated to the region.

Savitsky trained and worked as an archaeologist in Central Asia, but was

also a painter and passionate art lover. He began to collect the art of locals and encouraged them by giving lessons to young artists, including some of the more prominent Uzbek artists of the period.

When a chance to work as an artist at the Khorezm Archaeological and Ethnographic Expedition in the Kyzyl-Kum desert came up, he took it. The expedition made significant discoveries in local history, while Savitsky developed a deep attachment for the Karakalpakstan region, which featured heavily in his own art.

Savitsky started collecting ethnographic objects from local villages: carpets, costumes, folk art. Soon local authorities noticed his efforts and made him the head of the museum in Nukus in 1966.

After the museum was established Savitsky paid more attention to the paintings being produced by local artists, many of which are on exhibition in Nukus today. This led to Savitsky's discovery of Alexander Volkov, Ural Tansykbaev, Viktor Ufimtsev and others, whose style is now dubbed "Turkestan avant-garde" and amongst the most famous of the local artists.

Tansykbaev – the most famous of all – was initially attracted to Fauvism and Expressionism, but later turned to Socialist Realism as the political climate changed, and he became a member of the Soviet Academy of Arts.

The Nukus art museum was the first dedicated to Central Asian art where he displayed his collection in a few rooms in the old history museum in Nukus, the same building that Babanazarova occupied when I met her.

### Russian impressionism

The artistic movement which emerged in Russia around 1890 unfolded through the extensive flow of art and artists between Paris and Moscow, which were culturally joined at the hip in Tsarist Russia. However, following the October Revolution in 1917 the ties with France were broken and art became the preserve of the state.

Stalin cracked down on the new school and constrained art to populist, realist

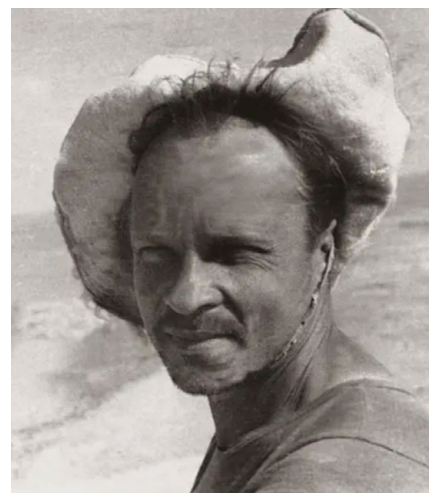
and easily understandable iterations via Socialist Realism. Art took on a propaganda role that impinged on its style and narrowed the interpretations an artist could make. The State fought an escalating campaign to completely eradicate the genre of true art until Stalin's death in 1953. Savitsky played a major role in preserving that entire generation of Soviet art.

Russia was rocked by Stalin's terror in the early 30s. In 1932 the Soviet government decreed that artists had to follow the social realism school, but this was the heyday of impressionism and a Russian school had embraced the new ideas.

The painters soon got into trouble. Some were arrested. Others didn't show their work for fear of retribution. And many simply ran out of money.

Savitsky started to travel up to Moscow and St Petersburg to rescue the works of these artists and take them back to the relative safety of his museum in Nukus. Under the noses of the Soviet censors Savitsky amassed a collection that encompassed the works of almost an entire generation of artists.

He disguised thousands of priceless paintings as simple luggage and packed them off to Uzbekistan. He loaded them onto trains and trucks assigned to a non-existent archaeological expedition, which whisked them off to safety in the far flung desert town that was his home.



Art collector Igor Savitsky.

Savitsky bought a lot of the art using the museum's money but most of it came from his own pocket, or he simply wrote IOUs to the artist's family. When he was in Moscow close to the end of his life he would joke: "I can't die yet as I owe too much money!"

Among the Russia impressionist works on display today in Nukus are some from the group of Russian artists painting in the impressionist style called the "Jack of Diamonds" group in the 20s centred around Sergei Nikritin, who had lived in Paris and was friends with Picasso.

There are also works on the wall in Nukus by Lyubov Popova, probably the best-known female artist of the Russian avant-garde, as well as more obscure painters such as Alisa Poret and Boris Rybchenkov.

In one of the most brazen collection stories, after discovering a series of sketches by Nadezhda Borovaya, an artist who smuggled depictions of her daily life out of the Temnikov Gulag, Savitsky persuaded party officials that her art actually illustrated Nazi, not Russian, concentration camps and persuaded the local Party chief to give him money to purchase her surviving work, which is now also in the Nukus collection.

Predictably the Jack of Diamonds group fell foul of the authorities, but Savitsky managed to scoop up much of their work, including that of Nikritin, before it could be confiscated and destroyed.



### Old and new building

The old building remained largely untouched since Savitsky set the museum up. When I visited first in 1999 most of the paintings were housed on racks inside concrete blocks that Savitsky had built himself at the back of the museum proper. But conditions were not good.

"We can't afford anything. Despite having these treasures we are in a critical position. We are financed by the local budget, but they give us nothing other than salaries," Babanazarova told me, who is the daughter of the co-founder of the museum, Marat Nurmukhamedov.

However, as the secret of the treasure in Nukus began to leak out Babanazarova start to get offers of money and help. Experts from Russia's legendary Hermitage museum in St Petersburg flew down to see her and tried to recover the collection, but she resisted.

The Nukus Museum became better known after several exhibits were organised abroad in the 1990s. Then in 2011 an American-made documentary, "The Desert of Forbidden Art", about Savitsky was shown and promoted a group of 85 American artists to charter a plane to fly to Nukus specifically to visit the museum, where they offered Babanazarova large sums of money to buy a few pieces. She refused that offer too, afraid that if she sold even one painting it would suddenly become clear to the authorities in Tashkent how incredibly valuable the

entire collection was and trigger a massive auction of the collection by the cash-strapped Karimov regime.

Nevertheless, following the success of the international exhibits the authorities were slowly waking up to the value of the collection and the need to preserve it. In 2003 a new building was put up and then expanded into the modern three-story complex that is there today.

In November 2010, while Babanazarova was out of town on business, officials suddenly declared the original museum building condemned. Granted just forty-eight hours to evacuate its contents, employees haphazardly piled fragile canvases on the new building's exposed basement floor in a rush to transfer them to a new building.

Babanazarova had by this time become a more influential woman and thanks to a degree in English had built up contacts with the international art community and was actively promoting dissident art. Uzbekistan was still under the control of the authoritarian president Islam Karimov and the authorities became increasingly suspicious of Babanazarova's relationship with foreigners as well as threatened by her growing international stature.

During the summer of 2015, they struck. A scandal erupted where the authorities accused Babanazarova of pilfering from the museum and selling art on the black market. She was fired from her position. Her supporters claim that Uzbek authorities fabricated the story in order to take control of the collection into the hands of the state.

### Collection

Today the museum displays a mixture of the famous Central Asian artists but only a fraction of the Russian impressionist collection. Despite the large new building, the wall space is too limited and the role of the museum is more about celebrating the domestic artistic achievement than those of the lost generation of Russian impressionist painters.

Karimov took a selection of the paintings with him to Paris during his state trip



and current Uzbek President Shavkat Mirziyoyev did the same in April 2017 shortly after his appointment on his first state visit to Russia. The decision to bring the famous collection was a soft power move by the newly installed president designed to show the deep cultural ties and long-standing friendship between the two countries, and it went down very well.

The paintings were shown at the renowned Pushkin Museum in Moscow: 200 canvases of the collection's most iconic items. The Pushkin was the perfect venue, as it boasts Moscow's largest collection of European art. Ironically, its most distinguished pieces are works of impressionist and post-impressionist painters, including Van Gogh, Picasso, Derain and Matisse – the same artists that inspired the Russian impressionists that were castigated by Stalin. The exhibition was a huge success with round-the-block queues that prompted the administrators to extend it by three weeks as Russians lapped up their missing avant-garde artistic legacy for the first time.

The centrepiece of the Nukus collection is “*The Bull*” by the Belarusian artist Vladimir Lysenko, originally called “Fascists Advances,” and is the picture most intimately associated with the museum.

The Soviet censors deemed it anti-Soviet and Lisenko was interned in a metal asylum for 15 years from which he eventually emerged paralyzed and extremely ill.

Lysenko was born in Bryansk, now in Russia on the Ukrainian border, to Belarusian parents and studied under the famous artist Kazimir Malevich at the Institute of Artistic Culture in Russia, one of two art academies established by Lenin.

As the movement's most influential patron, Lenin's institutes offered artists such as Malevich and the international renowned abstract artist Vasili Kandinsky, who also studied at

the institute, space to debate freely the ideologies that shaped avant-garde. The abstract images they produced, which involved precise geometry and which emphasised proportion and space, challenged commonplace notions of art and reality in the golden period of Russian impressionism. During this time, both the movement and art revolution were seen as in step with the new revolutionary society, but after Lenin's stroke in 1922 the tolerant attitude to experimental art evaporated.

Unlike Lenin, Stalin considered the avant-garde bourgeois, instead preferring the more straight-forward and more easily understood realism. Stalin's preferences were eventually institutionalised in what became known as socialist realism, characterised by the glorified, realistic portrayal of communist values by larger-than-life heroic figures. By 1930, about the time Lysenko returned to Tashkent, Stalin dissolved both of Lenin's institutes and forced the movement underground. Two years later, the Party took control of artists' unions and officially imposed socialist realism one year after that. Stalin insisted that art should portray the easily understood iterations of the New Soviet Man and the accomplishments of the first and second Five-Year Plans.

During Stalin's reign, “formalism” came to be used as the catch-all term to denigrate any form of art that deviated from the Soviet norm and was often used in political struggles between artists to denounce rivals.

Lysenko painted *The Bull* but hid it for years, fearing it would not conform to the officially approved form of art.

And the painting is very political. Lysenko dropped the original name “Fascist approaching” as he considered it to be too provocative, but the symbolism is obvious to even an untrained eye. The flags on the horn of the bull are of those countries that supported the Nazis in WWII and the hollow back eyes of the

bull are clearly the barrels of a cannon.

When the painting was put on display, the censors saw it as a parody of the mighty USSR advancing as a raging bull; its eyes symbolic of Stalin's methods of repression and blindness of state; and the rising sun symbolic of the Soviet Union.

Few details of Lysenko life are known. He first visited Uzbekistan's capital, Tashkent, in either 1918 or 1919. Between 1925-9, he studied at the Lenin institute under Malevich, when it is believed that Lysenko painted *The Bull*. He exhibited several times in various Russian cities but in 1935 he was declared a formalist and sent to a mental institute for seven years. He spent the next decade in and out of institutes until he was finally rehabilitated in 1950, but by that time he was seriously ill and paralysed, living with his sister.

Savitsky visited the artist at his home and bought the painting from his sister, although by that point Lysenko could no longer talk. He eventually died sometime in the late 1950s after Stalin's death.

Back in Nukus Savitsky put *The Bull* on display in his museum, but in a typically brazen episode the museum was subjected a surprise inspection by Soviet art inspectors, who immediately focused on the painting. The inspectors quickly assessed *The Bull* as “anti-Soviet” and Savitsky immediately agreed and removed it from display... until the inspectors left. Then he immediately returned it to its place in the exhibition. Nukus is a very long way from Tashkent and the inspectors come to check the exhibition very rarely.

Over the last two decades Nukus has recovered. The salt that caked the soil is gone. Local agriculture has been re-engineered to produce crops that are less damaging to the soil. A new museum building dominates the dusty main square and its clean and cool interior welcomes a steady trickle of art lovers from around the world. ●

# NEWSBASE

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