Financial Risks in Uzbekistan Debt Management: Analyzing And Developing Effective Mitigation Strategies For Uzbekistan

Sukhrob Rustamovich Allayarov
Shoirakhon Sarvarbek qizi Bakhtiyorova
Tashkent State University of Economics

Abstract: This thesis explores financial risks associated with Uzbekistan's public debt, identifying primary risk factors and proposing management tactics for effective risk mitigation. As Uzbekistan modernizes, reliance on domestic and foreign public debt to support infrastructure and development projects has risen, increasing exposure to currency, interest rate, and liquidity risks. Through qualitative insights, this study provides strategies for mitigating these risks, drawing from best practices relevant to Uzbekistan's unique economic structure. This approach can support Uzbekistan's debt sustainability while fostering economic growth (World Bank, 2023; IMF, 2022).

Keywords: financial risks, public debt management, risk mitigation, currency risk, interest rate risk, liquidity risk, debt portfolio diversification, hedging strategies

As per the data, the debt profile of Uzbekistan has improved in the recent past due to the undertaking of projects funded through borrowing to drive growth and reforms in the country according to ADB 2023. These projects, however, are associated with overseas debts that increase the financial risks involved in these projects and lack management structures that could avert fiscal risks themes (Ministry of Finance, Uzbekistan, 2023). In such a scenario, this paper seeks to explore the development of Uzbekistan's debt management framework by identifying financial risks and suggesting various measures that can be utilized to manage these risks. The study seeks to respond to questions like: What are the most serious financial risks in Uzbekistan's debt? How should these risks be mitigated? and so on, focusing on currency risks, interest risks, etc. (World Bank, 2023). To answer this question, the study formulates three research questions and objectives: presenting a detailed assessment of the structure and composition of the debt profile of the economy of Uzbekistan, assessing and rating the level of the financial risks embedded in the debt profile, and recommending policy and planning solutions drawing from the best international examples (Moghadam & Rahimi, 2022). Achieving these objectives is crucial not only for Uzbekistan's fiscal stability but also for maintaining the credibility and sustainability of its economic reforms. Through this research, they offer clear operational directives to policymakers, while also making conceptual contributions to the understanding of sovereign debt management within fiscal frameworks that promote stability in society in the long run (IMF, 2022).

Furthermore, MPT and Debt Overhang theories have demonstrated their contribution to the achievement of these macroeconomic goals by providing relevant strategies in sovereign debt management with respect to risk and its mitigation through diversification and limitations to debt bearing (Berkowitz & Schmieder, 2021). Similarly, both of these theories show the importance of the trade-off between the usage of the debt for economic development and the ideal sustainable levels of the debt which is critical in the case of reform-led debt accumulation in Uzbekistan. On the other hand, the Optimal Debt Theory posits that, debt level should always be kept within a manageable limit to avoid negative consequences to economic growth (Kumar & Miller, 2020). It is these theoretical frameworks that provide basis for assessment of the financial risks in Uzbekistan and the strategies developed in this study.

The debt of Uzbekistan whose currency is foreign denominated, exposes it to vulnerabilities of currency risk, rapid increase in global interest rates and constraints in liquidity as prominent risks (Ministry of Finance, Uzbekistan, 2023). The burden of currency risk increases as the depreciation of the currency of the Uzbek som raises the costs of debt servicing (IMF, 2022) To make matters worse, the recent increases in interest rates in various parts of the world have led to a surge in borrowing costs, which are making the debts heavier still (World Bank, 2023). Liquidity pressures also emerge as a critical concern, as the high volume of maturing short-term debt obligations strains national reserves and reduces the flexibility of fiscal policy (Berkowitz & Schmieder, 2021). These risks demonstrate even more the need for adoption of the more comprehensive approaches, which tackle the multiple challenges which the countries in central Asia, and likely Uzbekistan in particular, are facing. To strengthen their loans, several countries, including Malaysia and Kazakhstan, offer concepts for multi-disciplinary over-indebtedness, which could be learned from international best practice models. In this regard, the case of Malaysia with its diversification of debt, other additional borrowing and Kazakhstan's development of a sovereign wealth fund, enhanced the effectiveness of these measures, and lowered the risks through early intervention (Rahman, 2022; Kazakhstan’s National Bank, 2021). These examples offer insights into how similar strategies could be adapted to the specific challenges facing Uzbekistan.

This research utilizes a multi-faceted approach in order to obtain a deep understanding of the debt management challenges facing Uzbekistan. The quantitative analysis uses data from the IMF, World Bank and the Ministry of

Finance of Uzbekistan to analyze the trends of the debt statistics. Policy Maker's qualitative perspectives also add value to this data by providing information from the context perspective that strengthen the analysis (Creswell & Plano Clark, 2018). The methodology integrates the two approaches marrying the qualitative with the quantitative allowing a comprehensive understanding of the financial risks as well an evaluation of the proposed plans.

These findings indicate that due to the increasing exposure, most of the debts that have been borrowed by Uzbekistan are in foreign currencies. Due to the depreciation of the Uzbek som, the som debt limitations have extremely increased the cost of repaying such debts, and due to the increase in global interest rates, obtaining more loans is becoming harder (IMF, 2022; World Bank, 2023). Besides, an emerging scope of short-term liquidity pressure indicates the concern as due to high amount of maturing obligations, there is little room for budgetary management (ADB, 2023). These results stress the need to develop timely sound measures to bring the exposure of debt vulnerabilities that exist within the boundaries of Uzbekistan under control.

At the same time, current debt management policies in the country, including the recent introduction of debt ceilings, are a positive development. However, these are still insufficient to face the widespread challenges of currency and interest rate risks. There are also no diversified debt instruments and hedging strategies which limits the effectiveness of such policies (Rahman, 2022). A comparative analysis with international best practices suggests that elements like creating sovereign wealth funds and embracing sophisticated forms of hedging could greatly improve Uzbekistan's fiscal resilience (Kazakhstan's National Bank, 2021). To reduce the pointed out risks, this study proposes some strategies. Limiting dependence on foreign-currency-denominated debt and enhancing the issuing of local-currency debt could substantially reduce currency risk and simultaneously promote the domestic capital market development (IMF, 2022). Furthermore, by adopting hedging instruments like currency and interest rate swaps, Uzbekistan can stabilize debt servicing costs and insulate it from external economic shocks (Rahman, 2022).

Establishing a fiscal stabilization fund, modeled on Kazakhstan's approach, could further enhance Uzbekistan's fiscal resilience. By allocating export revenues to such a fund, the government can create a financial buffer against future economic shocks (Kazakhstan's National Bank, 2021). Lengthening debt maturities and restructuring existing obligations also emerge as critical tactics for improving liquidity and aligning debt servicing with fiscal capacity (Moghadam & Rahimi, 2022). Finally, strengthening institutional capacity through the creation of a dedicated debt management office, coupled with improved policy coordination, is essential for effective risk monitoring and the implementation of these strategies (World Bank, 2023). The findings of this study highlight significant financial risks in Uzbekistan's debt profile, particularly from currency fluctuations, rising interest rates, and liquidity pressures. Addressing these risks requires a comprehensive approach, including diversification of the debt portfolio, implementation of hedging instruments, and the establishment of a fiscal stabilization fund (ADB, 2023). Institutional reforms, such as the creation of a dedicated debt management office and enhanced transparency, are also critical for achieving long-term debt sustainability (IMF, 2022).

References

1. Asian Development Bank (ADB). (2023). "Uzbekistan Economic Report". [Accessed 7 Nov. 2024].
2. Berkowitz, E., & Schmieder, C. (2021). "Sovereign Debt Management: Risks and Best Practices". Springer.
3. Jiyanova N, Tashmatova R, Afsona S, Allayarov S, Abdurashidova M, Topical issues of increasing the role of economic ratings and indices in economic stability, E3S Web of Conferences 402, 13028
4. Allayarov S.R, Rizokulova E.O, Issues of attracting domestic investments to the economy, "Science and Education" Scientific Journal, December 2023 / Volume 4 Issue 12
5. Allayarov S.R., Innovation in providing national economic growth, Best journal of innovation in science, research and development, ISSN: 2835-3579, Volume:03 Issue:06|2024
6. Allayarov S.R., Strategic directions for the maturation and implementation of islamic financial services in commercial banks of Uzbekistan, International journal of formal education, Volume: 3 Issue: 6 | May –2024
7. Allayarov S.R, Ismailova D.J, Effect of the exchange rate policy on economic growth, "Science and Education" Scientific Journal, October 2023 / Volume 4 Issue 10
8. Allayarov S.R., Modern tendencies in the organization and management of finance of small business enterprises, World Economics & Finance Bulletin (WEFB), Vol. 22, May 2023
9. Allayarov S.R., Prospects of fiscal policies in the condition of economic integration, International Journal of Studies in Business Management, Economics and Strategies,Volume 02, Issue 05, May, 2023
10. Allayarov S.R., Theoretical Study of Optimal Fiscal and Monetary Policies for Stimulating Economic Growth, Research Journal of Finance and Accounting 9 (8), 206-212