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Capital Adequacy and Risk Management in Uzbekistan's Banking Sector: Trends and Perspectives

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Abstract

The adequacy of bank capital remains a cornerstone of financial stability, particularly in emerging economies facing macroeconomic transformation. This paper examines the capital adequacy and risk management practices of Uzbekistan's commercial banks during 2016–2024, using official statistical data published by the Central Bank of Uzbekistan. The study evaluates trends in capital adequacy, profitability (ROA and ROE), refinancing rate dynamics, and recent regulatory reforms aligned with Basel standards. Findings demonstrate that Uzbekistan's banking sector has consistently maintained capital adequacy ratios between 14–20%, significantly above the Basel III minimum of 8%. Profitability indicators, however, fluctuated more widely, with ROE dropping to 8.84% in 2016 before recovering. Despite strong capitalization, challenges persist in liquidity management, credit concentration, and risk diversification. The paper concludes with policy recommendations aimed at sustaining resilience while improving efficiency and profitability.

Keywords: Capital adequacy; Banking stability; Risk management; Profitability indicators; ROA; ROE; Monetary policy; Basel III standards; Liquidity management; Uzbekistan banking sector.

Introduction

A sound banking system is fundamental for macroeconomic stability, efficient intermediation, and sustainable growth. Capital adequacy serves as a primary safeguard against financial shocks, ensuring that banks can absorb unexpected losses without systemic disruption. International standards, particularly the Basel III framework, require banks to maintain a minimum capital adequacy ratio (CAR) of 8% alongside buffers for risk protection.

Uzbekistan's banking sector has undergone substantial transformation in recent years. Exchange rate liberalization in 2017, modernization of monetary policy, and the introduction of new regulatory frameworks have reshaped risk management practices. These reforms were accompanied by the Central Bank of Uzbekistan's (CBU) emphasis on stability indicators such as capital adequacy, liquidity, and profitability.

The objective of this paper is to analyze capital adequacy and risk management in Uzbekistan's banking system, with particular attention to the period 2016–2024. Using official CBU data, the study highlights the sector's strengths, vulnerabilities, and alignment with international standards.

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Capital Adequacy Dynamics in Uzbekistan

Capital adequacy is measured as the ratio of bank capital to risk-weighted assets. Between 2016 and 2024, Uzbekistan's commercial banks consistently maintained CAR levels far above the Basel minimum (Figure 1):

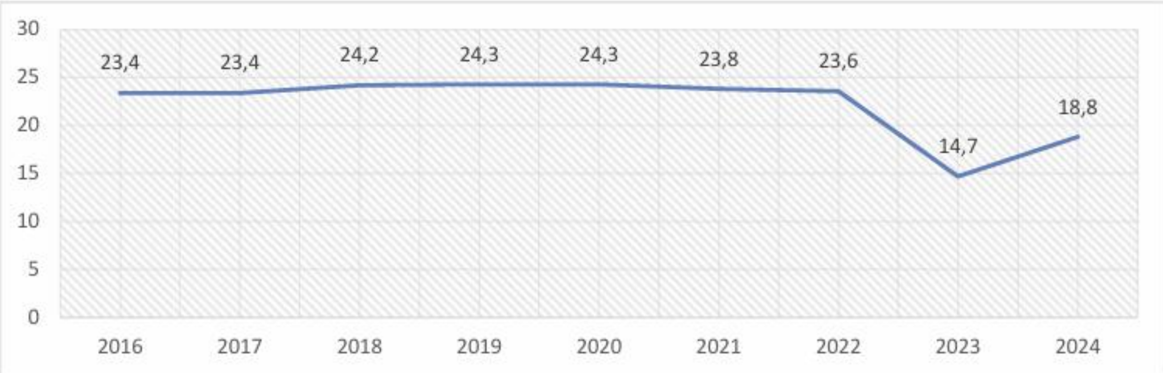

Figure 2.3. The capital adequacy ratio of commercial banks in the Republic of Uzbekistan, in percent

This consistent overperformance demonstrates the resilience of Uzbekistan's banking system. Compared with Basel's 8% requirement, domestic banks often operated with two to three times the minimum buffer. This margin reflects both regulatory conservatism and the role of government-led recapitalization programs.

Profitability Indicators and Risk Implications

Profitability dynamics in Uzbekistan's banking sector during 2014–2024 are illustrated in Figure 2 (ROA) and Figure 3 (ROE). These indicators demonstrate that, while the system remained adequately capitalized, banks faced significant challenges in sustaining stable returns.

Return on Assets (ROA). As shown in Figure 2, ROA decreased from 1.71 percent in 2015 to 1.14 percent in 2018, reflecting the immediate impact of structural reforms and exchange rate liberalization on banks' asset utilization efficiency. Between 2017 and 2020, ROA hovered around 1.2–1.3 percent, indicating limited profitability from asset portfolios. A gradual improvement followed from 2021, with ROA reaching 2.0 percent in 2023, before slightly easing to 1.9 percent in 2024. These results suggest that banks increasingly struggled to transform their asset base into earnings during the early reform period, but showed moderate recovery in recent years.

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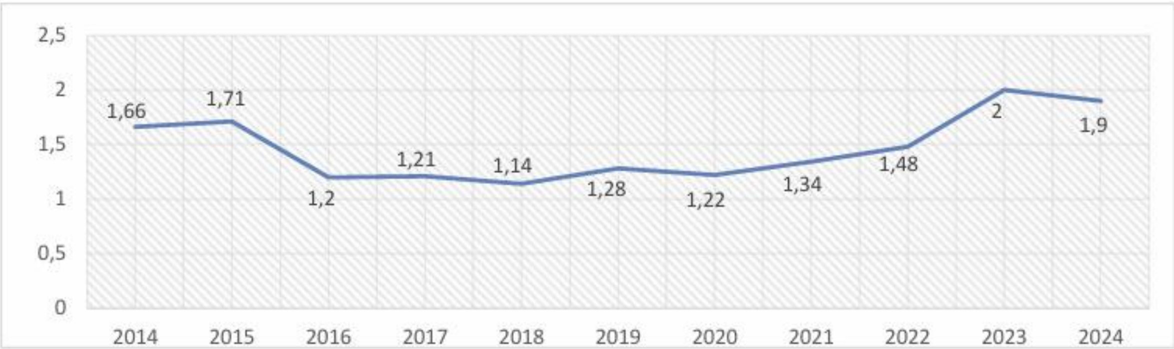

Figure 2. Return on Assets (ROA) of banks in the Republic of Uzbekistan, percent

Return on Equity (ROE). As presented in Figure 2.2, ROE showed even more pronounced fluctuations. After standing at 13.92 percent in 2014 and 13.35 percent in 2015, it plunged to 8.84 percent in 2016, the lowest point of the period. This sharp decline reflected the pressure of macroeconomic shocks, including devaluation and tightening refinancing rates, which reduced net interest margins. A recovery phase followed: ROE rose to 11.24 percent in 2017, surpassed 13 percent by 2019, and peaked at 17.9 percent in 2023 before declining slightly to 17.1 percent in 2024.

Taken together, these figures reveal that the profitability of Uzbekistan's banking sector remained vulnerable despite strong capitalization. From a risk management perspective, the decoupling of high capital adequacy from relatively weak and volatile profitability indicates structural inefficiencies. The concentration of lending in state-prioritized sectors with lower yields, combined with high operating expenses and limited non-interest income sources, constrained overall profitability. Moreover, the sharp fall in ROE in 2016 demonstrates the difficulty of aligning capital strength with efficient equity utilization during periods of macroeconomic transition.

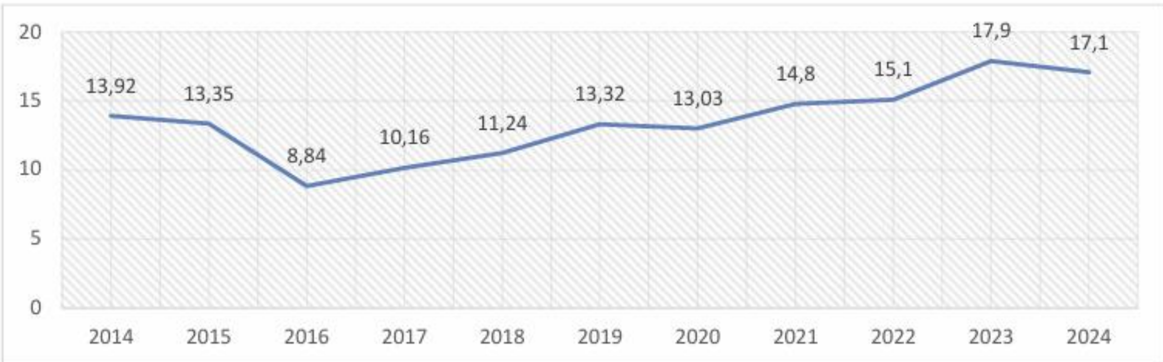

Figure 3. Return on Equity (ROE) of banks in the Republic of Uzbekistan, percent

In summary, Figures 2 and 3 confirm that Uzbekistan's banks were able to recover profitability after the initial shock of reforms, but continued to face challenges in ensuring sustainable and diversified returns. This underlines the importance of complementing capital adequacy policies with measures aimed at efficiency, cost reduction, and lending diversification.

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Monetary Policy and Regulatory Reforms

The Central Bank plays a key role in maintaining stability in the banking system through both monetary policy and regulation. One of its main tools is the refinancing rate. When this rate is high, it helps reduce inflation and support financial stability, but it also makes borrowing more expensive, which limits credit growth and lowers bank profits. When the rate is reduced, banks and businesses can borrow more easily, which supports economic activity, but this creates the risk of higher inflation. This shows that monetary policy must carefully balance stability with growth.

At the same time, the Central Bank has carried out important reforms to align Uzbekistan's banking system with international standards. It has expanded the measurement of risks beyond credit risk to include operational and market risks, and introduced a capital conservation buffer to protect banks from unexpected losses. These steps are consistent with the Basel III framework and make the system safer and more resilient. While banks in Uzbekistan already had high levels of capital, the combination of monetary policy tools and stronger regulation ensures a more reliable balance between safety, profitability, and sustainable development.

Challenges in Risk Management

Despite progress, several challenges remain:

1. Some commercial banks barely met the regulatory liquidity requirement of 30% in recent years. Reliance on Central Bank interventions, rather than a developed interbank market, increases systemic vulnerability.
2. Lending remains concentrated in government-prioritized sectors, creating potential systemic risks if these industries face shocks.
3. Strong capitalization does not automatically translate into efficiency. Volatility in ROE indicates inefficiencies in resource allocation.
4. Exchange rate liberalization introduced exposure to foreign currency volatility, which requires more advanced hedging mechanisms.

Recommendations

To strengthen capital adequacy and risk management, the following measures are recommended:

1. Develop an interbank money market to reduce reliance on Central Bank liquidity provision.
2. Diversify credit portfolios by encouraging private sector and SME lending, thereby reducing concentration risks.
3. Introduce hedging instruments (forwards, swaps) to mitigate currency risks.
4. Enhance digital banking to reduce operating costs and improve ROE.
5. Balance capital strength with profitability by promoting efficient use of capital, avoiding excess idle reserves.

Conclusion

The analysis of Uzbekistan's banking system for 2016–2024 demonstrates strong capitalization, with CAR levels consistently ranging between 14–20%, significantly above Basel requirements. This resilience highlights the sector's ability to absorb shocks and maintain solvency. However, stability built on high capitalization alone is insufficient. Weak liquidity management, profitability volatility, and credit concentration remain pressing challenges.

Aligning with Basel standards, introducing market-based instruments, and diversifying risks will be essential for the sector's sustainable development. With ongoing reforms, Uzbekistan's

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banking system has the potential to evolve into a modern, resilient, and efficient financial sector capable of supporting long-term economic growth.

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