CIS-4 face higher CPI risks despite stronger exchange rates

As global volatility has eased somewhat, markets in the CIS region are turning their focus back to issues closer to home. Most of the region's currencies are strengthening against the dollar, although country-specific constraints are weighing on performance. Meanwhile, inflationary pressures are mounting, complicating matters for central banks

The Armenian dram is stronger than expected. Pictured: shoppers in Yerevan

CIS-4 currencies edge higher, but domestic constraints temper gains

Over the past four weeks, the currencies of the CIS-4 – excluding the pegged Azerbaijani manat – have appreciated by 1.5-2.0% against the US dollar. This movement largely reflects the continued weakness of the greenback relative to core global currencies. However, this performance appears modest when viewed alongside a 6-7% rebound in Brent crude prices, an ongoing 1% gain in gold, and a further 3% strengthening of the Russian ruble – a key trade partner currency for most CIS-4 economies.

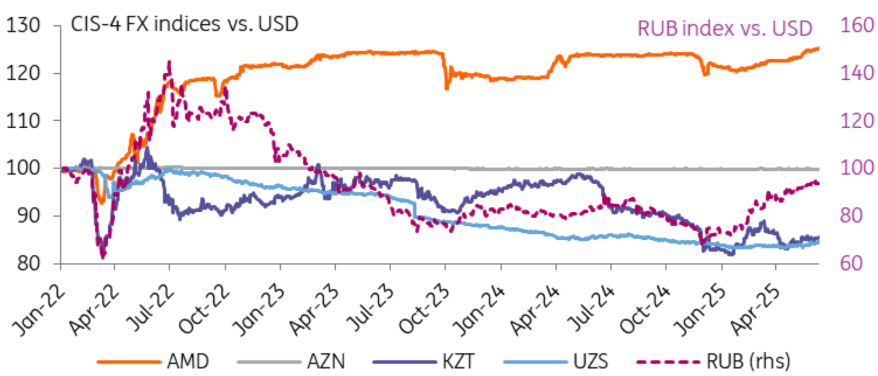
We believe this restrained appreciation is primarily due to domestic factors. Chief among them is a deterioration in trade balances driven by rising imports, with Uzbekistan being the notable exception. In Armenia's case, country-specific foreign policy challenges have added to the pressure. Kazakhstan's ongoing tensions with OPEC+ regarding oil production quotas are also drawing attention.

Despite these headwinds, the Armenian dram remains significantly stronger than our expectations, and the Uzbek soum's pause in its multi-month depreciation trend should be seen as a positive development. Conversely, Azerbaijan's continued currency peg, despite a shrinking trade surplus and growing uncertainty around energy prices, may eventually bring its FX market into sharper focus.

Overall, we remain constructive on CIS-4 currencies in the near term, supported by relative macroeconomic resilience. However, we see limited support for sustained appreciation over the longer horizon, as country-specific challenges are likely to weigh on performance.

CIS-4 FX lifted by weaker dollar amid mixed domestic factors

Index of CIS currencies vs. US Dollar, Year-end 2021 = 100



Source: Refinitiv, CEIC, national sources, ING

Inflation pressures are up, putting central banks in the spotlight

The appreciation of floating exchange rates across the CIS-4 region since the start of the year should, in theory, exert a disinflationary effect. However, this has been outweighed by mounting pro-inflationary pressures. Consumer price inflation has been trending upward across most of the region since mid-2024.

Uzbekistan stands out as an exception, showing some moderation in inflation recently, although this is largely a base effect following last year's spike driven by domestic utility tariff hikes. Even with the recent decline, inflation remains elevated at around 10% year-on-year.

The drivers of inflation in the CIS region over the past 12 months are both supply and demand-side in nature. On the supply side, key contributors include rising global food prices, a front-loaded increase in freight costs amid global trade woes, persistent inflation in Russia (a major trade partner), and domestic utility tariff increases in Kazakhstan and Uzbekistan. In Kazakhstan, expectations of a VAT hike in 2026 are also adding to the current price pressures.

On the demand side, expansionary fiscal policies in Armenia, Kazakhstan, and Uzbekistan, along with credit growth in Armenia and Kazakhstan, are fuelling domestic demand and adding to inflationary momentum.

The recent rise in inflation across the CIS region is placing national central banks in a difficult position. On one hand, they cannot ignore mounting price pressures and the growing divergence from their official CPI forecasts. This has already prompted several rounds of key rate hikes in Kazakhstan and Uzbekistan over recent quarters.

On the other hand, the inflation spike is largely driven by cost-side factors, such as utility tariffs and imported inflation, while uncertainty around both global and domestic demand complicates the policy response. For instance, in its meeting last week, the National Bank of Kazakhstan (NBK) acknowledged rising inflation risks, including demand-side pressures, but chose to keep the policy rate unchanged, instead opting to curb retail lending through macroprudential tools.

The Central Bank of Azerbaijan (CBRA) held the key rate steady this week despite accelerating inflation and even signalled the possibility of a rate cut, likely reflecting concerns over subdued domestic demand. The Central Bank of Uzbekistan (CBRU) decided today to keep its policy rate unchanged at 14.00%, with the commentary focused on persisting proinflationary risks, likely limiting the room for rate cuts in future. The Central Bank of Armenia (CBA) is also likely to hold its policy rate steady at 6.75% despite rising inflation due to ongoing uncertainty surrounding the composition of inflation drivers.

Overall, we reiterate our view that the current environment limits the scope for rate cuts in the CIS region – especially when compared to developed markets. However, the reluctance to tighten monetary policy further, particularly in light of the recent decision by Russia’s central bank, underscores the delicate balance regional policymakers are trying to strike between inflation control and supporting domestic demand. Further fiscal and FX performance will remain important watch factors for all the CIS-4 countries, in our view.

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