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CREDIT ARMENIA AZERBAIJAN

CLS macro and credit: Fiscal side back in the spotlight

In line with our initial view at the start of last year, the CIS-4 countries continue to show signs of fiscal easing, which is leading to upward revisions in projected CPI and key rate trajectories and, in some cases, to a deterioration in the FX rate views. In the sovereign credit space, we expect new Eurobond issuance will be met with strong investor demand



Country views

Economic activity in **Armenia** is moderating as the momentum related to high-skilled immigration in 2022 and higher participation in external trade is wearing off. The role of domestic drivers of financing activity, including local household savings, lending, and state spending is increasing. Re-integration of refugees from Nagorno-Karabakh and continued tensions with Azerbaijan are likely to keep the fiscal deficit elevated, in line with our initial view at the start of last year. The resulting elevated CPI risks should limit the scope for monetary policy easing from current levels. The Armenian dram, which has so far avoided depreciation, may come under pressure on the normalisation of the balance of payments.

Still sluggish on the core oil activity, **Azerbaijan's** economic activity is posting a recovery on the non-oil side, financed heavily by domestic credit and public expenditure. The resulting price pressures mean that the monetary policy easing cycle is most likely over. The country's fiscal

and external reserves are ample, but the gradually eroding trade surplus and growing current account breakeven, if not addressed, could create some pressure on the manat's dollar peg in the coming years.

Economic momentum in **Kazakhstan** has slowed owing to the commodity sector and other cyclical factors, but the rest of the economy, especially consumer-focused, appears robust and well supported by lending and public spending. Budget policy is becoming more generous, and at some point, the issue of US\$100+/bbl fiscal breakeven oil price will need to be addressed. For now, it has added to pro-inflationary risks and caused the central bank to signal that the end of the rate easing cycle is near. In the meantime, KZT depreciation risks seem to have materialised, but the challenges of the budget and balance of payments are likely to keep the tenge under pressure in the medium term.

Uzbekistan continues to show a fast and well-diversified economic growth rate. Another positive is that the tariff-related spike in CPI was somewhat lower than expected, allowing key rate easing expectations to improve for the coming quarters. Also, the soum depreciation rate slowed in the first half of the year, in line with our view, also helped by the strong gold market, but the pressure may increase in the second half. Our concern for the medium term is the continued widening in the consolidated budget deficit which reached 7% of GDP for the four quarters ending March 2024. Like its CIS-4 peers, consolidation might be on the agenda at some point.

Sovereign credit views

Valuations look reasonable for a region that has seen fundamentals improving over the past few years, while geopolitical risks also appear to be easing. At the same time, with fiscal policy generally loosening, the focus will be on expectations for more Eurobond issuance to come over the next year. Our preference in the region would be Armenia, while expectations for near-term issuance could push spreads in Kazakhstan wider from fairly rich levels.

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